Banks’ glib waffling on baffling products

BY ELEANOR WONG
For The Straits Times

DON’T get me wrong. I’m a firm believer in individual responsibility and the prudence of free lunches.

My attitude, when others beg for shares of product enticements, is to place the onus firmly on the buyer to beware.

But looking at some of the downright indescribable financial products that are being marketed by our banks, I’ve had no option but to question whether simple wariness is enough to protect the average buyer.

You know the products I’m talking about. The brochures trumpeting them are displayed prominently in bank halls and at ATM machines. They purport to protect your principal investment while allowing you to participate in the region’s heady growth.

Marketeteers, disguised as senior bank staff, lurk behind the tellers waiting to talk you into investing a slug of your life savings when all you want to do is deposit your modest monthly pay cheque.

I wouldn’t be so uncomfortable if the products actually lived up to their taglines. Or if the senior bank staff could explain the potential risks of the products in simple, clear terms. Or if the brochures themselves were crystal clear about the possible downsides.

Or, indeed, if the products were marketed only to obviously high-net-worth individuals who could afford the occasional wipe-out.

Instead, the products I’ve seen usually have a “hook” in the form of some immediate “high” payout. The hook is coupled with an arcane formula for future payouts that doesn’t always tell you what you would really be getting.

When I ask the marketeer how the formula works, I am usually met with a repeat of what’s in the brochure and no explanation of hidden costs or risks. And this often takes place in a consumer banking hall in an HDB estate.

Let me illustrate with a recent example. I will not name the bank.

The promotional material for this particular product tells you that it will help you participate in the “Asia-Pacific Region that is poised for growth”. Here is how the product works.

You are given an “immediate” guaranteed payout of 6.3 per cent six months after you invest. This is the upfront hook. Then, you will have to wait till the end of years two, three and four to discover whether you will get any additional payouts.

The formula used to calculate your payout on those dates is linked to the lowest performing market index out of a list of seven regional indices.

The formula for the individual year-end payouts is as follows: (10 per cent + lowest performing index)/5. The total annual payout is subject to a cap of 2 per cent. If the cumulative cap of 2 per cent is achieved at the end of year two or three or four, the deposit terminates and a bonus of 3 per cent is paid to the investor at that time.

If you’re still with me, you might have noticed the first reduction in the house.

Because the formula is tied to the lowest performing market index in the list, it may not matter if the entire region is generally performing well.

If even one of the market indices regresses year-on-year because of, oh, a natural disaster like a tsunami or an unexpected political change, then the payout is affected.

In such circumstances, the “growth” in the lowest-performing index might be a negative number which, when plugged into the formula, can reduce payout to below 2 per cent (and possibly to zero).

But, you might argue, what about that bonus at the end? It would seem that, as long as all the markets in the region stay steady or grow, the 2 per cent annual payout will easily be achieved at the end of the second year.

After all, the formula states that even if there is zero growth, the payout will be 2 per cent — that is (10 per cent + 0)/5. In that case, the investor would receive the 2 per cent annual payout, plus the 3 per cent bonus, for a total return of 11.3 per cent within two years — or 5.6 per cent annually, a meaningful (if not exactly dizzying) return.

Perhaps, for hidden away under the innocuous heading of “Fund Facts” is a management fee of 3.7 per cent that is deducted upfront.

This means that the maximum potential payout over the life of the instrument is really 7.6 per cent (not 11.3 per cent) after deduction of the management fee.

Add in the fact that this product is being offered at a time when the Singapore dollar fixed deposit rate being offered by the same bank is 3 per cent (and rising), and the product starts to look a lot less attractive for the risk.

The bottom line is this: Assuming that all goes well and there is no idiosyncratic downnick in any single index that stops you from achieving the cap and the bonus within two years, the product pays slightly more than a fixed deposit — 3.8 per cent against 3 per cent.

However, if any market index goes south and the instrument is dragged out longer than two years, the scale tips very quickly in favour of the plain vanilla — much less risky and complicated — fixed deposit.

And if every year just one index does poorly so that the 2 per cent cumulative cap is not reached even at the end of four years, your annual return over four years might be in the region of a paltry 1.15 per cent.

Of course, none of this is pointed out to you at the bank counter. Instead, you’re directed to the cheerful blurb telling you that this product will “put your goals within your grasp”. Eventually, I suppose.

In fairness to the bank, the brochure does contain an example of how the payouts would be calculated in the event of a negative lowest-performing index. All the necessary information is contained somewhere in the brochure so that a sceptical buyer could work out the implications for himself or herself. Eventually, I suppose.

And it’s true. No one is being forced to purchase any of these instruments.

Still, I can’t quite get rid of that faint smell of fish in the air.

The writer is a lawyer and director of the legal skills programme at the National University of Singapore.