Structured Notes: Draw the Repayment Map Before Chasing the Coupon

Description

A 9 per cent coupon is not a 9 per cent return unless the structured noteâ??s conditions, timing and principal repayment all behave as expected. Before buying, draw every route from the initial investment to the final cash received. Include early redemption, missed coupon conditions, reference-asset loss, issuer default and an early sale.

MoneySenseâ??s structured-notes guide explains that a note combines debt with derivatives. The payoff may be linked to shares, indices, rates, currencies or other references. The investor is not simply placing a fixed deposit at a higher rate.

The repayment map for a hypothetical S$10,000 note

Path	Illustrative cash outcome	Question to answer from the terms
Conditions met to maturity	Principal plus stated coupon, subject to issuer payment	What exact observations determine each coupon and repayment?
Early redemption by product design	Principal and specified coupon up to the call date	Can the issuer or formula end the note when the outcome favours it?
Reference asset breaches a barrier	Repayment may be reduced or delivered in another form	Is loss based on the worst performer, final level or another formula?
Investor sells early	Market price may be below S$10,000 and fees may apply	Is there a firm secondary market, and who quotes it?
Issuer defaults	Coupon and principal may not be paid as promised	Who is the legal issuer and what ranks ahead of the note?

The amounts are not forecasts. They force the adviser and investor to name the condition that changes the outcome. Replace the generic paths with the exact formula in the pricing statement and product documents.

Separate five promises that marketing often blends

1. **Coupon:** Is it guaranteed by the issuer, conditional or memory-based?
2. **Principal:** Is full repayment conditional on a barrier or reference level?
3. **Currency:** Can repayment or the reference exposure create foreign-exchange loss?
4. **Liquidity:** Can the investor exit, at what spread, and with whose quote?
5. **Credit:** Can the issuer meet its promise at maturity?

A product can pay every coupon and still produce a poor total result if principal is reduced. It can also preserve principal at contractual maturity but cause a loss to an investor forced to sell early.

â??Principal protectedâ?• needs a sentence after it

If the note uses that phrase, ask: protected by whom, at what date, subject to what events, and in which currency? Protection may apply only at maturity and only if the issuer remains able to pay. A guarantee from an affiliate is not the same as Singapore deposit insurance.

The Singapore Deposit Insurance Corporation consumer guide distinguishes insured deposits from investment products. Structured notes are investment products, not insured deposits. Do not infer coverage because the seller is a bank or because the product uses the word â??depositâ?• informally.

Run the worst-performer test

For a note linked to several shares, the weakest reference may determine the result. Write each initial level, observation date, barrier and final level in a table. Then calculate the payoff if only one share falls 10, 30 or 50 per cent while the others rise. If the formula converts the investment into shares or cash linked to that fall, show the units and value explicitly.

This calculation should be labelled an illustration. Market gaps, corporate actions and valuation rules may produce outcomes not captured by a neat percentage step.

The document set before acceptance

- Final terms and pricing statement
- Product highlight sheet and prospectus where applicable
- Issuer and guarantor identity
- All observation, call and maturity dates
- Barrier, strike, conversion and settlement rules
- Fees, bid-offer spread and early-exit mechanics
- Needs analysis, recommendation and risk explanation

For background on why bond prices, rates and credit move separately, read our bond risk checklist. If the product is treated as a Specified Investment Product, the SGX qualification route explains the investor assessment context.

A decision rule that survives the coupon

Do not invest unless you can explain the worst plausible repayment path in plain language, tolerate the principal and liquidity loss, and accept the issuer credit exposure. Compare that path with simpler alternatives, not only their headline yield. The repayment tree is complete when every branch ends in a number, an asset or an identified uncertainty.

Convert the formula into three numbers

For every observation date, calculate the reference level that triggers a coupon, early call or principal loss. Then convert percentages into dollars on the proposed investment. A 30 per cent principal loss on S$10,000 is S$3,000 before fees; seeing the dollar amount tests risk tolerance more honestly than reading â??70 per cent barrierâ?•.

Ask who can end the investment

Some notes redeem early when stated conditions are met. That can cap the time an investor receives the attractive coupon, especially when reference assets perform well. By contrast, the investor may have no equivalent right to exit at par when conditions deteriorate.

Question	Document answer
Who may call the note?	Issuer, automatic formula or neither
At what observation?	Dates and price source
What is paid?	Coupon, principal, shares or cash formula
What if markets close?	Disruption and postponement clauses

Check concentration

Look through the note to the underlying shares, sectors and currencies, then combine that exposure with existing holdings and employment income. A diversified-looking basket can still be governed by one weakest performer or concentrated in a sector the investor already owns.

Independent exit comparison

Request an indicative early-exit quote and ask how it is formed. Compare the note with a simpler bond, diversified fund or insured deposit that serves the same goal. The simpler option may have a lower headline return but clearer liquidity and fewer conditional branches.

If the repayment map cannot be reproduced from the documents, the product is not understood well enough to buy.

Date Created
03/09/2026
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