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# HNIs turn to capital protected schemes to tide over volatility

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High net worth individuals, or HNIs, are increasingly turning to capital protected equity-linked structures to navigate the volatile market. Although termed as equity-linked, these structured products are essentially non-convertible debentures that combine investing through debt with Nifty-linked derivative instruments. In fact, some wealth management companies are also distributing capital protected commodity-linked structures, which are modelled on similar lines.

Taking a cue from these products, in the last few months, some of the mutual fund houses such as Canara Robeco MF, Birla Sun Life MF and Sundaram MF have also launched capital protection schemes. BNP Paribas MF was among the recent ones to have filed an offer document with market regulator to launch capital protection scheme.

“It’s a prudent way of investing as capital is protected and there’s enough potential for upside,” said Hrishikesh Parandekar, CEO of Karvy Private Wealth. “The net worth of many HNIs runs into crores. For these individuals, protecting their capital is as important as getting high returns,” said Maneesh Kumar, managing director of Burgeon Wealth Managers. Indian equity markets as measured by Sensex has corrected 11% in the year on the back of higher inflation and concerns over corporate earnings.

With one-year term money rates ruling at around 10%, these products have gained popularity with issuers as well. High interest rates translate into better returns on the debt portion and gives issuers greater flexibility to invest a higher portion of the capital into equities to maximise returns.

Here’s how these products typically work. If Rs 100 is invested in the Nifty-linked structure, Rs 70 could be deployed into fixed income products. The remaining amount could be utilised to buy call options on the Nifty. Under this structure, even if the Nifty were to fall, the issuer will be able to protect the capital because of the fixed returns from the debt portion. If the Nifty rises, the gains can be substantial.

The amount allocated in debt and equity varies with issuers and depends on market conditions.

However, these products do have their downsides. Since the lock-in period for these products is one to three years, these products are less liquid compared with direct investment in equities or open-ended mutual fund products. And being debentures, these products are often tax inefficient.

What’s more, the products are not completely risk-free. “Investors need to be aware of the credit rating of the issuer. Often, these issuers are small unlisted subsidiaries of bigger entities and there is an underlying credit risk involved,” said Rajeev Thakkar, CEO, PPFAS, an investment advisory firm.

He cites the loss suffered in 2008 by investors who had invested in structured products issued by Lehman Brothers as a case in point.