

Catering to Investors Through Security Design: Headline Rate and Complexity

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Abstract

This study investigates how banks design financial products to cater to yield-seeking investors. We focus on a large market of investment products targeted exclusively at households: retail structured products. These products typically offer a high return under their best-case scenario—the headline rate—that is nested in a complex payoff formula. Using a text analysis of the payoff formulas of the 55,000 products issued in Europe from 2002 to 2010, we measure product headline rates, complexity, and risk. Over this period, product headline rates depart from the prevailing interest rates as the latter decrease, complexity increases, and risky products become more common. In the cross section, the headline rate of a product is positively correlated with its level of complexity and risk. Higher headline rate, more complex, and riskier products appear more profitable to the banks distributing them. Our results suggest that financial complexity is a by-product of banks catering to yield-seeking investors.

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