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Investment certificates under German taxation: Benefit or burden for structured products' performance?

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**Investment Certificates under German Taxation
Benefit or Burden for Structured Products' Performance?**

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June 2010

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Investment Certificates under German Taxation — Benefit or Burden for Structured Products' Performance?

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Abstract

Despite their impressive market success, investment certificates' benefits are puzzling from both a theoretical and an empirical viewpoint. Previous research analyzed portfolio-theoretical issues, mispricing patterns, and counterparty risk. This work highlights the impact of taxation, which has not been previously addressed for these instruments. In order to capture tax effects, we simulate the entire return distributions of several structured products under the two most recent German taxation systems. Evaluation is done based on the concepts of stochastic dominance as well as expected utility. For the latter, we use both a risk neutral and a loss averse value function. Individual preferences prove relevant especially for those instruments that have been tailored to loss averse investors.

We find significant tax effects, but they depend on the particular tax regime and the structure of the instrument. Interestingly, the introduction of the final withholding tax system substantially diminishes previously existing tax advantages.

Keywords: Abgeltungsteuer, Bootstrapping, Capital Gain Tax, Expected Return, Expected Utility, Financial Instruments, Flat Tax, Halbeinkünfteverfahren, Historical Simulation, Investment Certificates, Return Shaping, Risk-Return Profiles, Stochastic Dominance, Structured Products, Taxation

JEL Classification: G11

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“...but in this world nothing can be said to be certain, except death and taxes.”

Benjamin Franklin (November 13th, 1789)

I Introduction

The first German investment certificate was an index tracker issued by Dresdner Bank in 1990, which simply replicated the German DAX index. Since then, the market for certificates has grown significantly in size as well as in the complexity of the products' payoff profiles and structures. This went hand in hand with intransparency, which has evoked serious criticism from the media and investor advocates.¹ Nevertheless, investment certificates have gained a significant market share of privately invested money and compete very successfully with the traditional mutual funds industry. During the summer of 2007, open interest in certificates peaked at €140bn and the monthly trading volume of the very active secondary market approximated €18bn.² This boom ended abruptly with the onset of the subprime crisis and the subsequent market correction. The insolvency of Lehman Brothers, a well known issuer of investment certificates, entailed a sustained loss of confidence in the product group. However, new product constructions that overcome counterparty risk are already being marketed such that the product class itself, to all appearances, should have a future. The 2009 statistics indicate a recovery: in the course of the year the monthly open interest rose from €80bn to more than €100bn.

Investment certificates are legally defined as debt instruments with the investor bearing the counterparty risk of the issuer.³ Coupon payments and principal repayments are typically linked to the development of a predetermined reference asset. Often used underlyings are indices, stocks or commodities. However, any well specified, observable financial asset or variable could serve as a potential underlying. To date, market standards regarding the product details (e.g. exchange ratio, maturity, or barrier levels etc.) have not been established. The issuers assign product terms individually, before they offer a certificate on the primary market.

The term *structured product* usually denotes a subset of investment certificates. Following Grünbichler & Wohlwend (2005), a structured product combines at least two different financial

¹The sales of investment certificates to investors in the U.S. is more restrictive than in Germany. See Bethel & Ferrel (2006) for a discussion regarding regulations to protect investors. Nonetheless, the U.S. market is growing as well (Hernández, Lee & Liu 2007).

²Cf. DDV statistics: www.deutscher-derivate-verband.de

³In contrast to mutual funds, an investment certificate is usually not collateralized by separate assets. Nevertheless, an adapted legal construction is able to exclude counterparty risk by two amendments: firstly, the engineering is achieved via government bonds instead of the issuer's own securities to reduce default risk. Secondly, the certificates' assets are separated from the issuer's balance sheet. The DWS already launched its GO SAFE product line according to this construction.

products, at least one of them being a derivative. Due to this component, a structured product offers some non-linear payoff function to the investor (Burth, Kraus & Wohlwend 2001). This is an additional feature compared to the linear payable index trackers (or more generally so-called Δ -1 certificates), which replicate the return of the underlying with minimal tracking error. By contrast, structured products alter or “reshape” the underlying’s return distribution in order to get a better match with the investor’s risk/return preferences (Stoimenov & Wilkens 2005). We call this process *return shaping*.

Apart from a few studies like Bernard, Boyle & Tian (2007), who try to find the optimal design of a structured product from an issuer’s perspective, previous research on investment certificates has mainly focused on the matter whether this asset class provides economic benefits to investors or not. In a theoretical context, Meincke & Nippel (2004) pointed out that investment certificates cannot provide any advantage in a complete and information efficient market, as they are redundant and hence do not improve the efficient frontier.⁴ Taking upfront costs into account, an investment certificate typically has a negative impact on the investor’s portfolio choice (Hens & Rieger 2009). Starting with Baubonis, Gastineau & Purcell (1993) on U.S. guarantee certificates,⁵ a series of empirical studies analyzed the market prices of structured products by comparisons to expected hedging costs. The general result is that certificates do not trade at fair hedging costs but at a systematically higher price. According to Wallmeier & Diethelm (2008) the more complex the structure and the more illiquid the underlying, the more pronounced the overpricing. Wilkens, Erner & Röder (2003) found that certificates tend to be most overpriced at the initial issuance. When maturity approaches and more and more clients sell the securities back to the issuers, the products tend to be underpriced. As a result, issuers earn a favorable bid/offer spread. This finding is referred to as *life-cycle hypothesis* or *order-flow hypothesis*. The issuers’ profit can be interpreted as a monopolistic rent enforcable due to the lack of market transparency caused by the variety and diversity of the products. Since trading mostly takes place between investors and the market-maker — very often the issuer itself — there is a virtual absence of competition. Furthermore, short-selling of certificates is not possible so that arbitrage opportunities cannot be exploited by other market participants (Entrop, Scholz & Wilkens 2009).

Given the substantial shortcomings of investment certificates, the instruments’ market success may seem puzzling. Several authors including Shefrin & Statman (1993), Henderson & Pearson (2008) as well as Breuer & Perst (2007) suggested that investors’ cognitive or behavioral biases could be responsible. Others have argued that investment certificates also offer true benefits to investors. They provide access to OTC dealings and to markets which are otherwise

⁴The study focuses on so-called *discount certificates*.

⁵They denoted the securities as equity-linked certificates of deposit.

difficult for small investors to enter, such as commodities or emerging markets (Baule, Rühling & Scholz 2004). Furthermore, margins that may be required for dealing options and forward transactions are not incurred. In a situation with no other access to derivatives, Branger & Breuer (2008) show that structured products may improve the annualized risk-adjusted excess return of an investor's (static) portfolio by up to 35 basis points.⁶ Accordingly, the additional costs may be interpreted as a compensation for the service provided by the issuers, which charge for their specialized knowledge, cost advantages and creation of a specific payoff profile (Wilkins et al. 2003). Under the assumption of restricted market access to derivatives for private clients,⁷ certificates also provide a means of exploiting heterogeneous expectations between the investor and the issuers, first and foremost with respect to implied volatility (Meinke & Nippel 2004).

While Benet, Giannetti & Pissaris (2006) mention that some real-world factors like tax treatments may attenuate the observed pricing biases, the influence of tax effects on structured products' performance has not been analyzed systematically. Our research thus contributes twofold to the existing literature. First, we show that as a result of tax effects, structured products may offer a benefit to private investors. This holds, when comparing the certificate with the underlying as well as the hedging strategy. The advantage arises from the fact that the taxation of a certificate can significantly differ from the taxation of a direct investment in the underlying or in the hedging instruments. Secondly, we disclose the impact of the recent revision of the German tax law on the potential tax benefits. This is achieved by distinguishing three taxation schemes: a world without taxes as a reference, the capital gain tax system as previously in force in Germany and the current German flat-tax system. As these three variants widely cover the taxation systems presently enacted in Europe, our results also may give some indication for tax effects in other European countries.

In order to capture the tax effects, we use historical simulations to estimate the entire return distributions.⁸ We quantify the tax benefit from buying a return shaped product by comparing the resulting return profiles under different tax regimes. As hedging instruments also introduce tax effects, we compare a product both to its hedging strategy and its underlying. Comparison is done based on the concept of stochastic dominance as well as expected utility. For the latter, we consider not only risk neutral but also loss averse investors by applying a Kahneman-Tversky value function. Throughout this paper, we assume that all analyzed products are fairly priced

⁶Discount certificates show the best results. The more sophisticated the structure, the smaller the potential excess return.

⁷For example, in Germany private investors have to be approved for derivatives trading according to § 53 II 1,2 BörsG, and this approval requires the written acceptance of accompanying the higher risk of those dealings.

⁸For example, similar methods were used to assess protection strategies (Annaert, Osselaer & Verstraete 2009).

(using standard derivative pricing methods). In this way, we preclude both systematic mispricing effects as mentioned above and counterparty risk.⁹

The paper is organized as follows. In the next section we introduce the three products used in the study: discount certificates, bonus certificates and guarantee certificates. Then, we describe our methodology for estimating and assessing return profiles. In Section 4, we collect the basic rules of the three taxation schemes used in the simulations. Section 5 presents our results on taxation effects. Finally, we conclude and suggest further research.

II Description of Selected Structured Products

For our analysis, we choose three different structured products: discount-, bonus- and guarantee certificates. According to DDV statistics, these types belong to the products most favoured by investors.¹⁰ However, they show very different characteristics: whereas discount certificates belong to the rare group of “short derivative” products, bonus certificates provide an exotic derivative-long component. Finally, guarantee certificates were formerly subject to a substantially different tax treatment as they were classified as so-called *financial innovations*.

II.1 Discount Certificates

The first discount certificate on the German market was issued in 1995 by HSBC Trinkaus & Burkhardt (Szczesny 2005). The basic idea of these vehicles is to enable investors to buy an asset “at a discount”, i.e. below the underlying’s current market price. In return, the investors have to accept a cap. If the underlying’s price at maturity S_T is higher than a predefined strike level X , then the payoff Y is limited to this strike level. Otherwise, the investor receives an amount equal to the underlying’s price. Formally:

$$Y = \min[S_T, X]. \quad (1)$$

Fig.1 shows the return profile at expiry. Compared to a direct investment, the investor benefits if the underlying’s price evolves trendless or decreases. As long as the final underlying’s price does not fall below the certificate’s purchasing price, $S_T \geq DC_0$, an investor does not experience a loss (if opportunity costs are not considered). Therefore, due to the initial discount, the certificate provides a partial loss protection. The product may be replicated by several strategies. The

⁹Even though the Lehman Brothers insolvency clearly showed that the latter may be very relevant, at present most of the issuers still have an investment grade ranking. Furthermore, Baule et al. (2004) could not find any impact of ratings on certificate’s prices. They confirmed those results in a later work (Baule, Entrop & Wilkens 2008) and showed that the credit risk of the issuer is a main driver for the product’s total margin.

¹⁰Only the so-called express certificates exhibit a comparable market share. But due to their complex hedging strategy we do not consider them in this study.

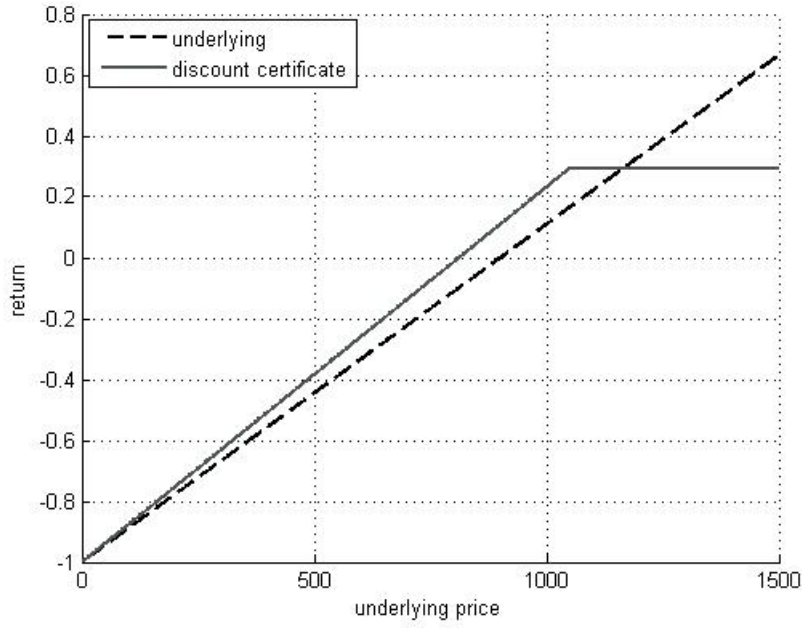


Figure 1: Return profile of discount certificate at maturity

variant often presented to customers combines the underlying asset long with a short European call resulting in a covered call. Accordingly, the price of a plain-vanilla discount certificate at the day of purchase, $t = 0$, can be written as

$$DC_0 = S_0 - c_0 \quad (2)$$

with the call price c_0 denoting the discount.¹¹ In fact, issuers normally use the hedging strategy of a zero bond long with a short European put. This strategy is equivalent when taxes are ignored, but may cause differing tax effects. Therefore, we analyse both variants in our study.

The discount certificate used in our simulations is based on the DJ Euro Stoxx 50, a price index, which does not participate in dividend payments. Hence, to avoid discrimination of the investor, instead of the underlying itself a zero-strike-call (zsc) is used, which incorporates the discounted estimated dividend payoffs in the call price.¹²

¹¹Using standard Black-Scholes option pricing (as proposed by Black & Scholes (1973) and Merton (1973)), the price of a discount certificate evolves as $DC_t = S_t - c_t = S_t \cdot N(-d_1) + X \cdot e^{-r \cdot (T-t)} \cdot N(d_2)$ with d_1 and d_2 appropriately defined as usual.

¹²In our simulations we applied the standard Black-Scholes formula with $X \rightarrow 0$.

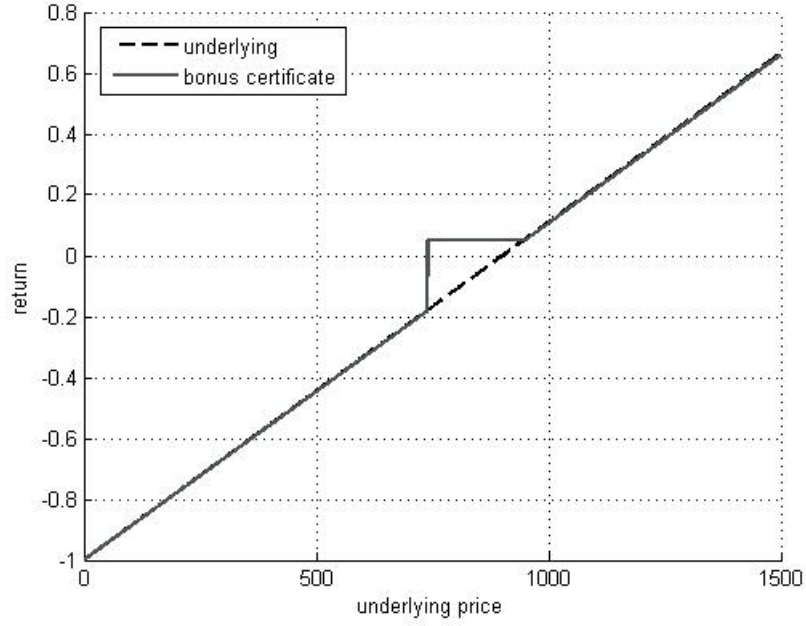


Figure 2: Return profile of bonus certificate at maturity

II.2 Bonus Certificates

The originator of bonus certificates is considered to be Sal. Oppenheim,¹³ which introduced this product around 2003. A bonus certificate pays off a fixed amount called *bonus*, as long as two events do not happen: neither is the underlying's price allowed to trigger a lower barrier H called the *protection level* during the certificate's lifetime, nor may the upper strike level or *bonus level* X be exceeded at maturity. If one of both events happens, then the holder gets the underlying's final price at maturity. When t denotes any point of time between issuance and expiry, this payoff can be expressed as

$$Y = \begin{cases} \max[S_T, X] & \text{if } S_t > H \\ S_T & \text{if } S_t \leq H \end{cases} \quad (3)$$

It is usual practice to issue these certificate with a bonus level above the current underlying's price (i.e. in-the-money). Then, these terms grant a partial loss protection up to the barrier level and an extra return compared to the underlying as long the underlying's price evolves trendless. If it rises above the bonus level, the investor participates fully. Underlying's prices below the barrier level cause the unmitigated loss [see the return diagram in fig.2]. Bonus certificates can be replicated as an underlying long (or a zero-strike call respectively, if the underlying pays a

¹³Handelsblatt: *Bonusmeilen fürs Depot* (November 11th, 2006).

dividend) combined with a down-and-out put option (*dop*) long that provides the bonus. The brief pricing formula can be displayed as:¹⁴

$$BC_0 = zsc + dop_0. \quad (4)$$

An alternative replication of a bonus certificate consists of a long zero bond combined with a long call (strike equals bonus level) and a short down-and-in put (strike equals bonus level and barrier equals protection level). The holder of a certificate typically does not participate in any dividend payments. This allows the issuers to finance the option price for the bonus component by the present value of the expected underlying's dividend payments. Accordingly, the certificate can be offered at a price close to the underlying's current market price.

II.3 Guarantee Certificates

The first German guarantee certificates were being issued during the mid 1990s but the product class only gained popularity after 11 September 2001.¹⁵ Basically, a plain-vanilla guarantee certificate, which provides full protection against potential losses, is an ordinary warrant-linked (zero) bond.¹⁶ Guarantee certificates can thus be constructed as a zero bond long (the protection component which provides the floor level) combined with a call option long (the so-called performance component which generates the upside potential). If the constant am denotes the participation rate we have:¹⁷

$$GC_0 = X \cdot e^{-r \cdot T} + am \cdot c_0. \quad (5)$$

The payoff of this strategy comes as [cf. also the payoff diagram in fig.3]

$$Y = \max[X + am \cdot (S_T - X), X]. \quad (6)$$

Since a plain-vanilla at-the-money European call may be expensive, issuers reduce protection costs by lowering am below 1. Hence, they can offer guarantee certificates that have “the same price” as the underlying in the primary market. However, with $am < 1$ there is a shortfall

¹⁴For the valuation within a Black-Scholes-context we used the down-and-out formula as shown in Wilmott (2000).

¹⁵However, the product idea is older: in the U.S. the first guarantee certificates were issued in 1987 by Chase Manhattan Bank (Abken 1989). In Europe, the Swiss Bank Corporation started to issue securitized portfolio insurances in January 1991 (Wasserfallen & Schenk 1996).

¹⁶This follows from put-call parity: neglecting interest and dividend payments a guarantee certificate combines an underlying S and a long put option p as insurance. A warrant-linked bond evolves as a (zero) bond X and a call option c . According to put-call parity $S + p = X + c$.

¹⁷ X hereby denotes the strike, discounting is done by the interest rate r , T denotes maturity. A Black-Scholes based pricing formula of a European style plain-vanilla guarantee certificate thus evolves as $GC_t = X \cdot e^{-r \cdot (T-t)} + am \cdot c_t = am \cdot S_t \cdot e^{-q \cdot (T-t)} \cdot N(d_1) + (1 - am \cdot N(d_2)) \cdot X \cdot e^{-r \cdot (T-t)}$, with d_1 and d_2 appropriately defined as usual.

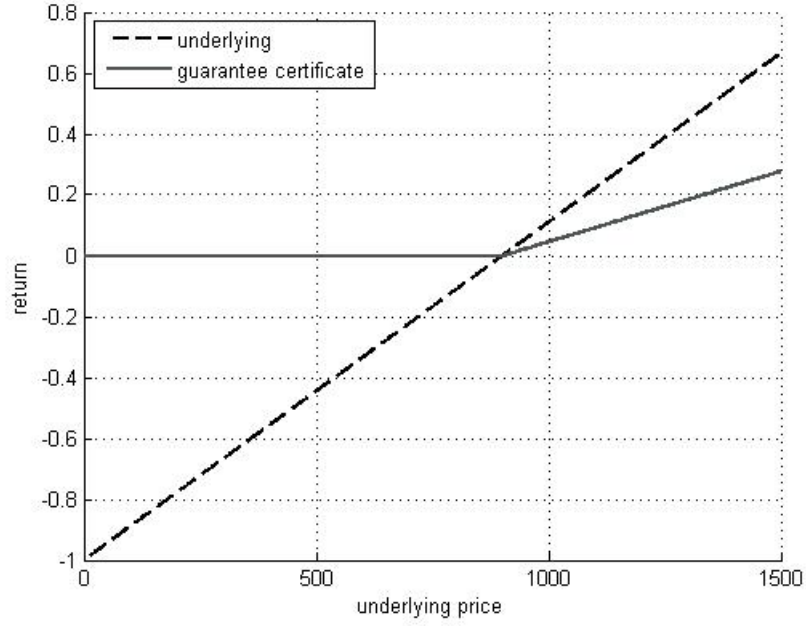


Figure 3: Return profile of guarantee certificate at maturity

in return compared to the underlying if the underlying rises above the floor level at maturity. Expected payoffs (dividends) of the underlying lower the price c of the performance component. Such payments accordingly also allow for a higher participation level am while keeping the certificate's issuing price. The total opportunity cost the investor has to bear for the protection consists of a lower return compared to the underlying in case of bullish markets and the option price usually paid by giving up interest income. When $S_T < X$, a total of T years of interest income is waived.¹⁸

III Assessment Methodology

To capture tax effects, we follow the approach of Edwards & Swidler (2005) and compare structured products with their underlying and their hedging strategy respectively. The comparison with the underlying as a benchmark does not allow to separate the return shaping effects from the tax effects but shows the cumulated benefit or burden for the investor. Checking the certificate against its hedging strategy excludes any return shaping effect. However, since a duplicating

¹⁸In order to offer more attractive participation factors, the issuers created alternatives, for example by using Asian options instead of European ones to lower the price of the performance component. However, this has to go hand in hand with other shortfalls. In our analysis we just consider the basic construction without further variations.

strategy consists of more instruments than the underlying alone, compound tax effects may arise. We therefore consider both variants.

Our assessment is based on a historical simulation approach, which generates price paths to estimate the entire return distribution. Due to the return shaping idea behind many certificates, the resulting return distributions are typically significantly skewed or truncated. Standard performance measures like Sharpe ratio or its modifications thus do not adequately capture the relevant characteristics (Kaiser 2007). Furthermore, the tax burden of a strategy often depends on the concrete realized profit or loss and cannot be calculated on an aggregated level. In order to evaluate the resulting return distributions, we do not rely on parameters (like in Edwards & Swidler 2005) but apply the concepts of stochastic dominance and expected utility.

For our analyses, we used the DJ Euro Stoxx 50 as underlying.¹⁹ The simulations are based on daily prices from 31 December 1986 to 31 October 2008, taken from Thomson Reuters.

III.1 Non-Parametric Historical Bootstrap Technique

The historical simulation technique introduced by Tompkins & D'Ecclesia (2006) simulates alternative price paths for a given asset.²⁰ Following this approach, we initially calculated the daily log-returns r_d from the original price series. A conditional volatility model is then used to capture the inter-temporal volatility dynamics. We used a standard GARCH(1,1) model (based on Bollerslev 1986):

$$\sigma_n^2 = \gamma \cdot V_L + \alpha \cdot u_{n-1}^2 + \beta \cdot \sigma_{n-1}^2. \quad (7)$$

The resulting state dependent volatilities $\widehat{\sigma}_d$ are used to standardize the daily returns which results in the daily unconditional devolatilized disturbances udd_d

$$udd_d = \frac{r_d - \overline{r_d}}{\widehat{\sigma}_d} \quad (8)$$

where $\overline{r_d}$ is the mean of the raw returns. These standardized returns are assumed to be independent, allowing a random remixing to generate new paths. Accordingly, a new path is created by reshuffling the udd_d variables such that each return is taken exactly once (i.e. sampling without replacement) and revolatizing it with the previously estimated GARCH(1,1) volatility.²¹ The prices of the new paths are thus generated as

$$S_t = S_{t-1} \cdot e^{\overline{r_d} + udd_d \cdot \widehat{\sigma}_d}. \quad (9)$$

¹⁹Following DDV statistics, indices are the most frequently chosen underlying of certificates. The DJ Euro Stoxx 50 as a reference index for European investors provides the highest level of transparency and liquidity.

²⁰A similar approach can be found in Annaert et al. (2009), who use a block bootstrapping technique.

²¹One also could revolatize by a newly generated series of GARCH(1,1)-volatilities using the estimated parameters γ , α and β . This would increase variation but at the cost of losing independence from parameters.

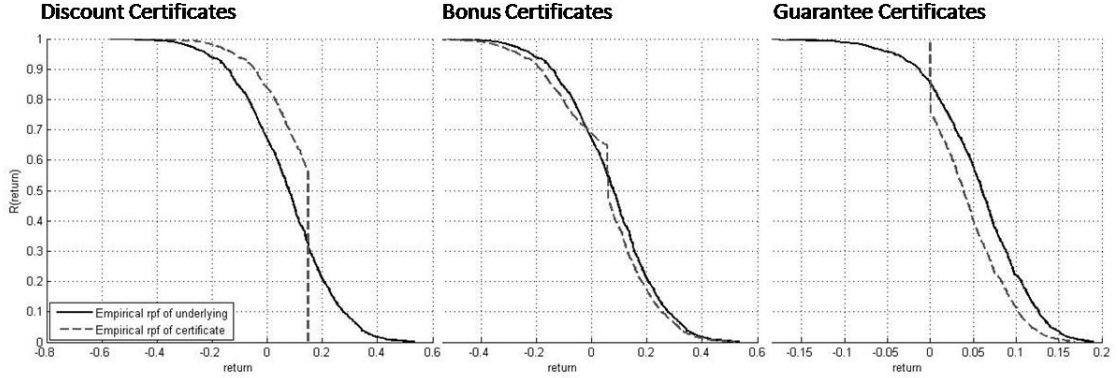


Figure 4: Typical shape of risk profile of discount-, bonus- and guarantee certificate

This simulation technique delivers alternative price paths with the same statistical properties as the original one. No assumptions about the underlying distribution or parameter estimates are necessary. Moreover, the method needs less computing time than e.g. a standard Monte-Carlo simulation. In our case $n = 1,000$ paths were enough to get stable results.

III.2 Comparison of Return Distributions using Risk Profiles and Stochastic Dominance

We use the concept of risk profiles as described by Eisenführ & Weber (2003) to visualize return distributions. A risk profile is derived from a distribution function $F(x)$ by the transformation $R(x) = 1 - F(x)$ so that it contains the exact same information. Nevertheless, risk profiles facilitate the interpretation of graphs. A point $(x, R(x))$ indicates that with a probability of $R(x)$ the investor makes at least a return of x . Typical risk profiles for a discount-, bonus- and guarantee certificate are shown in fig.4. The profile of the discount certificate, for example, lies above its underlying for low returns (up to the cap level). This means the probability of reaching some minimum return level is higher for the certificate, which shows its partial protection. Naturally, the probability to get a return above the cap level is zero. The attractiveness of a return distribution from an investor's point of view generally depends on the individual preferences. However, a comparison of alternatives only requires weak assumptions on the preferences if one strategy stochastically dominates the other one. If we denote the risk profiles of two alternatives A and B by $R_A(x)$ and $R_B(x)$, then first-order stochastic dominance of A over B holds if

$$R_A(x) \geq R_B(x) \quad \text{for all } x. \quad (10)$$

Graphically this means that the risk profile $R_A(x)$ lies completely above the profile of $R_B(x)$, no intersection occurs. In such a case any investor with a monotonically increasing utility function

will prefer alternative A (Levy 2006). In our analyses, we found first-order stochastic dominance only if we compared the structured product with its hedging strategy. When comparing the certificate and its underlying, one intersection (for discount and guarantee certificates) or even two (for bonus certificates) are very likely. The weaker concept of second-order stochastic dominance may still hold in such cases. Alternative A dominates B at second order if

$$\int_{-\infty}^y R_A(x)dx - \int_{-\infty}^y R_B(x)dx > 0 \quad \text{for all } y. \quad (11)$$

Any investor with a monotonically increasing and concave utility function will then prefer A (Levy 2006). Testing for stochastic dominance in general is difficult.²² In our analyses, pre-knowledge about the number of intersections facilitates the test. We perform an approximate numerical integration by measuring the areas between the simulated distributions applying trapezoid techniques, which were implemented in MATLAB.

III.3 Comparison of Risk Profiles based on Value Functions

In cases where no stochastic dominance holds, a preference-free comparison of investment alternatives is no longer possible. In order to compare the tax burden of two investment alternatives, we apply two kinds of preferences. In a first step we assume risk neutrality and use the identity as utility function. According to the relationship (Shreve 2008)

$$\mathbb{E}x = \int_0^{\infty} (1 - F(x))dx, \quad (12)$$

the area under a risk profile is the expected return. The aggregated size of the areas between two risk profiles therefore measures the difference in expected return. For a risk neutral investor, this coincides with the gain or loss in expected utility. Accordingly, our performance measure is the annualized expected excess return of the certificate compared to its underlying or its hedging strategy.

In a further step, we incorporate risk averse preferences. For this purpose, we introduce a value function as proposed by Tversky & Kahneman (1992), which reflects loss aversion with respect to a given reference value. This approach is based on the prospect theory (Kahneman & Tversky 1979) and assumes that investors try to maximize an S-shaped value function, given as

$$V(x) = \begin{cases} -A \cdot (\theta - x)^{\gamma_L} & \text{for } x \leq \theta \\ +B \cdot (x - \theta)^{\gamma_G} & \text{for } x > \theta. \end{cases} \quad (13)$$

²²Fast routines for simulated distributions have been found only recently, cf. Annaert et al. (2009) for an example and further references.

The parameters A and B control the loss aversion, the exponents γ_L and γ_G describe the sensitivity of the value function. The parameter θ determines the reference point, while the restrictions $A > 0$ and $B > 0$ ensure that $V(x)$ is an increasing function. The condition $A > B$ reflects loss aversion by a steeper slope for losses than for gains. Since $0 < \gamma_L \leq 1$ and $0 < \gamma_G < 1$, the curve is concave for gains and convex for losses. Empirically, Tversky & Kahneman (1992) found the following values for the parameters: $A = 2.25$, $B = 1.0$ and $\gamma_L = \gamma_G = 0.88$, which we use in our simulations. As we examine the certificates' performance independent from any further assets of the investor,²³ we set $\theta = 0$.

Applying the value function on the returns, i.e. $R(V(x)) = 1 - F(V(x))$, we obtain “weighted” risk profiles and analyze the areas between these curves as described above. Relationship (12) now reads as

$$\mathbb{E}(V(x)) = \int_0^{\infty} (1 - F(V(x))) dx. \quad (14)$$

The area under the risk profile can therefore be interpreted as the expected utility according to the utility function applied, the area between two profiles as the difference in expected utilities. In a loss averse setup, we use this annualized expected excess utility as our performance measure.

IV Taxation of Investments

To analyze the impact of two quite different taxation schemes, we consider a world without taxes as a reference and the two most recent German systems: the lately replaced capital gain tax system including the so-called half income system (*Halbeinkünfteverfahren*) and the new final withholding tax system (*Abgeltungsteuer*). Indeed, these variants serve as a rule for most of the systems that are presently in effect in Europe.²⁴ Since we do not intend an in-depth analysis of the tax systems themselves, we concentrate on the most important taxation rules that have the strongest impact on the average tax payer.²⁵

²³We implicitly assume that the investment in the certificate only accounts for a small part of the overall wealth of the investor.

²⁴For example, some countries either do not charge taxes on profits or offer very high allowances for private investors, which means there is virtually no taxation of profits from buying and selling assets, like in Belgium, Luxemburg, Austria or Switzerland. Norway and Denmark show a system similar to the previous German one, where the profits are taxed at the individual tax rate. Finland, Italy and Sweden are further examples of a flat tax system comparable to the new German one, with different tax rates though (Mennel & Förster 2009).

²⁵We do, for example, not take any tax allowances or exemption levels into account because this would require a very individual perspective. In the following, the term tax rate or tax level is understood as the marginal rate.

IV.1 Capital Gain Tax System

Until 31 December 2008, a capital gain tax system was in effect in Germany. This tax law distinguished between capital gains (resulting from price differences between the purchase and the sale of an asset) and earnings like dividends and interest payments. Apart from some exceptions,²⁶ current income from capital investments had to be taxed at the individual tax rate. Capital gains, however, were tax free, unless earned on an asset held less than twelve months, the so-called *speculation period*.²⁷ For equity investments an additional rule — the half income system — applied. According to this, merely 50% of the cash dividends and price gains were subject to income tax. Moreover, the taxable part of the dividends was possibly reduced by the saver's tax-free amount. An important exception to these general rules was the treatment of so-called *financial innovations*. If an investment was classified as such by the tax authorities, any capital gain had to be taxed at the individual tax rate. No tax exemptions due to the speculation period or the half income system applied for financial innovations.

IV.2 Final Withholding Tax System

In the course of the corporate tax reform in 2008, new tax rules came into effect on 1 January 2009.²⁸ The new system is a final withholding tax and hence breaks with the previous imposition technique. First and foremost, the discrimination between price gains and earnings has been abolished. Additionally, the speculation period and the half income system have been abrogated. An important further innovation is the introduction of a standardized tax level, which will be evenly applied to all earnings from capital assets.²⁹ This tax rate is set to 25% plus surcharges, resulting in an overall tax rate of about 28%, which we use in our analyses.³⁰ The gross profits generally form the tax base, reduced however by the saver's tax-free amount.³¹ Furthermore, the offsetting of losses from stock transactions against other capital transactions has been restricted.³²

²⁶Interest income was for example reduced by a saver's tax-free amount of € 801 for singles and € 1,602 for married couples, including a flat sum for tax allowable expenses.

²⁷Capital gains within the speculation period had only to be taxed if they exceeded the exemption level of € 512 (until 2007) or € 600 (since 2008).

²⁸There are some transition periods. As these are not part of our analysis they are not discussed here.

²⁹These earnings include interests, dividends, distributions of funds as well as profits from private sales transactions of securities.

³⁰A solidary surcharge has to be paid in Germany. Furthermore, most investors have to pay a church tax. Hence, we apply the most common rate of 28%. If an investor's individual marginal tax rate is below 25% this lower rate would apply.

³¹€ 801 for singles and € 1,602 for married couples, including a flat sum for tax allowable expenses. Additional offsetting against expenses is no longer possible.

³²At the same time, investors benefit from a reduced taxation of dividends on the corporate level since the corporate tax rate has been lowered from 25% to 15%. This should result in rising cash dividends.

V Simulation Results

Our estimations of the return distributions after taxes use simulated price paths for the underlying of the selected certificates as described above. For each path, we determine the product’s payoff at maturity after taxes. A reasonable issuing price for each of the three certificates — one discount-, one bonus- and one guarantee certificate — was determined by the pricing formulas given in Section II, using initial parameters that create a “favorable” environment for the product. For example, we choose a higher volatility level for the discount certificate than for a guarantee certificate. This is reasonable since an investor knows the present market condition when considering the purchase of a product and would only buy in a promising environment.³³ With respect to maturities, strikes, and barriers (if applicable), we choose specifications that correspond to typically issued products. Table 1 summarizes the parameter specifications used in the simulations. Finally, we assume that the investor always buys at the initial issuing date and holds the product until maturity.

Parameter		Discount	Bonus	Guarantee
Initial Price	S_0	900.82	900.82	900.82
Strike	X	1050	950	900
Barrier	H	n/a	739	n/a
Volatility	σ	0.3	0.15	0.25
Interest Rate	r	0.04	0.04	0.04
Time to Maturity	T	1.5	1.5	5

Table 1: Input parameters used for the initial pricing of the certificates. The parameters are set such that they create a beneficial environment for the products

We investigate the certificates’ performances in the three tax environments described in Section IV: no taxes, capital gain tax system (following the basic rules of the *Halbeinkünfteverfahren*) and final withholding tax (following the basic rules of *Abgeltungsteuer*). The comparison is done from three different perspectives:

³³Nevertheless, choosing the initial parameters independently from the simulated price paths results in a slight inconsistency. A parameter jump may occur at the beginning of the simulation, especially with respect to volatility levels. The effects on our results are fairly small, however, due to the long simulation time horizon of 18 to 60 months. As we use the same historically defined volatility structure in any simulated path, a possible impact of varying volatility levels on the relative advantage measure is not detected. This should not affect the qualitative tax effects we focus on in this study. For other aspects of the products’ price behaviour this could be relevant, though.

1. *Risk neutral return shaping.* The purchase of the certificate is compared to a direct investment in the underlying asset. Thus, return shaping effects as well as tax effects are captured. In this perspective, no first-order stochastic dominance can be found. The evaluation is thus based on the annualized expected excess return of the certificate as introduced in Section III.3 assuming a risk neutral investor.
2. *Loss averse return shaping.* As before, but evaluation is done from the perspective of a loss averse investor as described by the value function introduced in Section III.3.
3. *Tax effects without return shaping.* The purchase of the certificate is compared to an investment in a replication strategy that generates exactly the same risk-return-profile.³⁴ This excludes the evaluation of any return shaping effects. However, since a duplicating strategy consists of more instruments than the underlying alone, compound tax effects may arise. Certificates can moreover be replicated either by using the underlying plus derivative or a zero bond plus derivative. Since this may lead to different tax effects, we investigate both variants. The evaluation is generally done from a risk neutral investor's perspective (i.e. without applying a value function). This is justified since the analyzed structured products virtually always first order dominate or are dominated by their hedging strategy.

In all three perspectives, we analyze dividend levels from $q = 0.00$ up to 0.07 , easily covering the underlying's dividend yields observed during the last 25 years. Regarding marginal tax levels, we use 0% , 20% , 30% , 40% and 50% ,³⁵ which also covers the relevant interval. To represent the current system, a flat tax of 28% is applied.

V.1 Major Effects Driving the Results

The performance effects measured and presented in the following mainly arise from few sources. When comparing structured products with their underlying, three major components can be identified: the interaction between implied and historical volatility, individual preferences, and taxation. The selling of implied volatility by holding short option positions is largely beneficial, since in most empirical analyses the historical or realized volatility is smaller than the implied one (e.g. see Christensen & Prabhala (1998) or Bollerslev, Gibson & Zhou (2007)).³⁶ Hence, discount certificates tend to profit, whereas bonus and guarantee certificates show a disadvantage. The impact of preferences naturally only shows up in the loss averse setting. Since structured products are designed to fit individual preferences, it is not surprising that especially guarantee certificates but also discount certificates do well for loss averse investors. Bonus certificates alter the underlying return distribution only slightly. Accordingly, one needs well-specified expectations to benefit from those products or their impact is negative. Regarding taxation, certificates

³⁴Private investors, in particular, are not always able to reproduce the strategy behind the certificate.

³⁵The German tax law does not have a 10% marginal tax level.

³⁶This also is true in our data sample, where the annualized historical volatility was approx. 23% .

had a clear benefit in the capital gain tax system when taxable dividends could be converted into tax free price differences. The only exceptions were financial innovations. With the introduction of the flat-tax system, this advantage was abolished. However, due to the possibility of “cross-loss-offsetting”, structured products now provide another benefit: within the structured product, all kinds of profits and losses can be offset against each other. Without the cover of the certificate this would not be possible.

If the structured products are compared to the corresponding hedging strategies (perspective 3), individual preferences as well as differences between historical and implied volatility become irrelevant. The tax effects, however, clearly affect the performance. In the capital gain taxation system, a conversion of dividends into price differences offered a tax advantage. Most of the certificates (except financial innovations) provided such a tax shield. Further effects depend on the precise replication strategy. Due to put-call parity, most of the standard certificates³⁷ can be replicated either using the underlying (here equity) or zero bonds, each with derivative components. In the capital gain tax systems, zero bonds were classified as financial innovation. The duplication using zero bonds was thus always unfavorable for retail investors. In the final withholding tax system, the replication using bonds now allows the very same “cross-loss-offsetting” as the certificate since there are no stocks involved. The advantage from converting dividends into price differences is gone as well. Hence, as long as no equity is used in the hedging strategy, the certificate is deprived of any taxation benefit.

V.2 Discount Certificates

Simulation Setup The initial price for the discount certificate is calculated using the following input parameters: price of the underlying $S_0 = 900.82$ as given by the dataset (DJ Euro Stoxx 50 as of 31 December 1986), strike $X = 1050$ (out-of-the money as customary in practice), time to maturity $T = 1.5$ (customary lifetime at issuance), volatility $\sigma = 0.3$ (rather high, benefiting the short option component), and a risk free rate $r = 0.04$. Under the former taxation system, discount certificates and investments in the DJ Euro Stoxx 50 were tax-free if held longer than twelve months. However, the dividend had to be taxed if distributed so that the tax effect is sensitive to the dividend level.

Results

1. *Risk neutral return shaping.* When we compare the performance of the certificate with the underlying’s one in a risk neutral setup (see fig.5), we observe that it offers a benefit

³⁷This largely holds for the most popular structured products like discount-, bonus-, guarantee-, outperformance- etc. certificates.

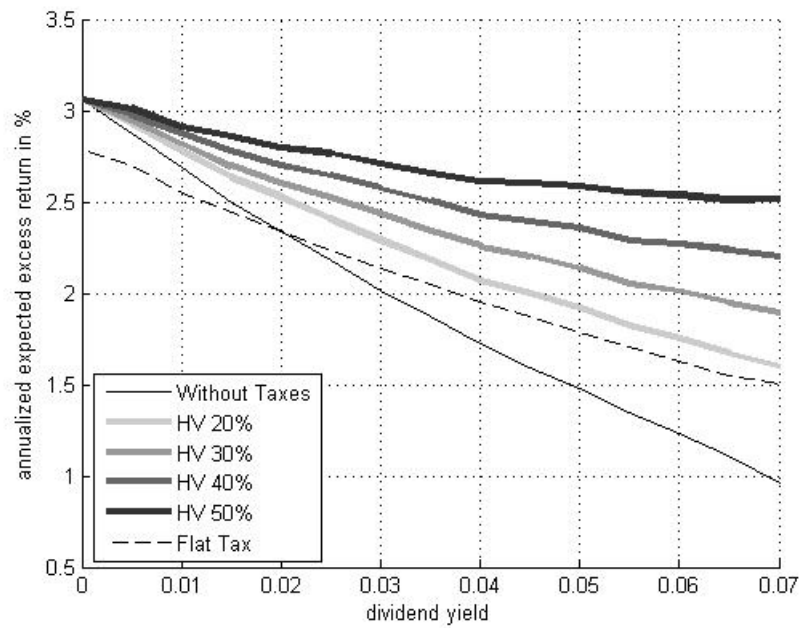


Figure 5: Annualized expected excess return of the discount certificate compared to underlying for a risk neutral investor

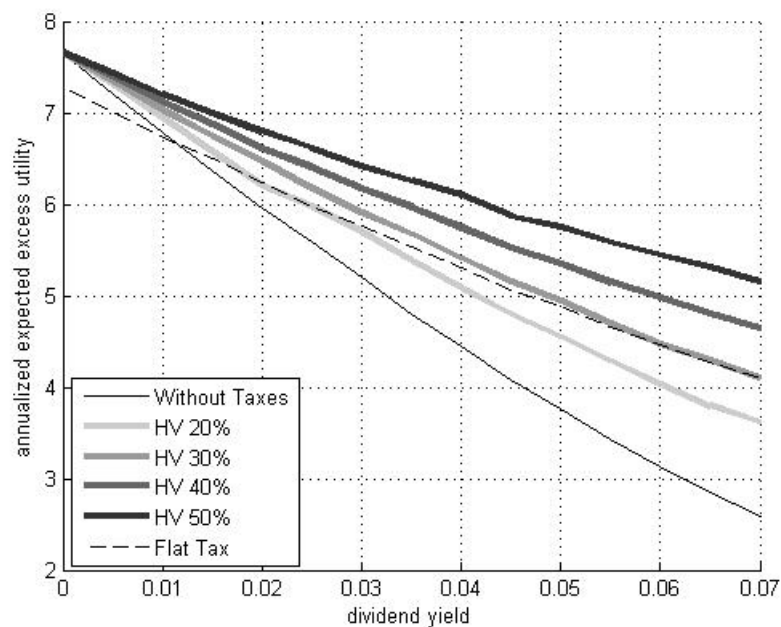


Figure 6: Annualized expected excess utility of the discount certificate compared to underlying for a loss averse investor

to the investor for all dividend levels and tax environments, indicating that the certificate dominates its underlying at second order. The main reason behind this, is the selling of implied volatility by holding a short option position. Furthermore, the discount certificate is not handicapped by using dividend payments for buying a derivative component.³⁸ The expected excess return of the certificate generally shrinks with rising dividend levels. This is due to the call component, which provides the discount: the higher the dividend, the lower the call price, indicating that less implied volatility can be sold.

Taxation effects depend on the specific taxation scheme. Under the capital gain tax system, the certificate clearly benefits from the dividend conversion effect: the higher the marginal tax level and the higher the dividend, the higher the expected excess return. Under the new tax system, investors have a smaller, but still positive overall tax effect. Although the dividend conversion effect is gone and the initial premium from selling the call option is taxed, within the certificate, “cross-loss-offsetting” is possible, i.e. dividend payments are offset against potential losses in the underlying, which also provides a tax-shield effect. In fig.5, the flat-tax line hence runs flatter than the tax-free line. Moreover, for small dividend levels, there is a relative disadvantage compared to the tax-free setting, since the tax-shield from offsetting is not big enough to compensate the taxation of the premium.

2. *Loss averse return shaping.* If we additionally apply the value function,³⁹ the resulting expected excess utility rises significantly. This reflects the loss averse investor’s appreciation of the partial loss protection offered by a discount certificate [see fig.6]. Low (or even negative) returns now gain in weight. Yet, the overall picture remains similar in nature. The slope of the dashed line merely becomes flatter indicating a relatively better assessment of the flat-tax system. The reason for that is that the impact of cross-loss-offsetting becomes stronger because the offsetting is only effective for negative returns, which are more pronounced in this setup.

3. *Tax effects without return shaping.*

When we compare the product with its equity replicating strategy (fig.7), the alternatives cannot differ in a tax-free setting, i.e. the resulting graph coincides with the horizontal axis. Taking taxes into account, the positive expected excess returns again indicate the tax benefit from dividend conversion. The higher the dividend yield and the higher the tax level, the higher the advantage as shown by the rising lines. Looking at the flat-

³⁸We used deterministic dividends for our simulations. In practice, however, future dividends are uncertain. The zero-strike call estimates the future dividend payments.

³⁹Since discount certificates stochastically dominate their underlying at second order, the overall positive assessment cannot change.

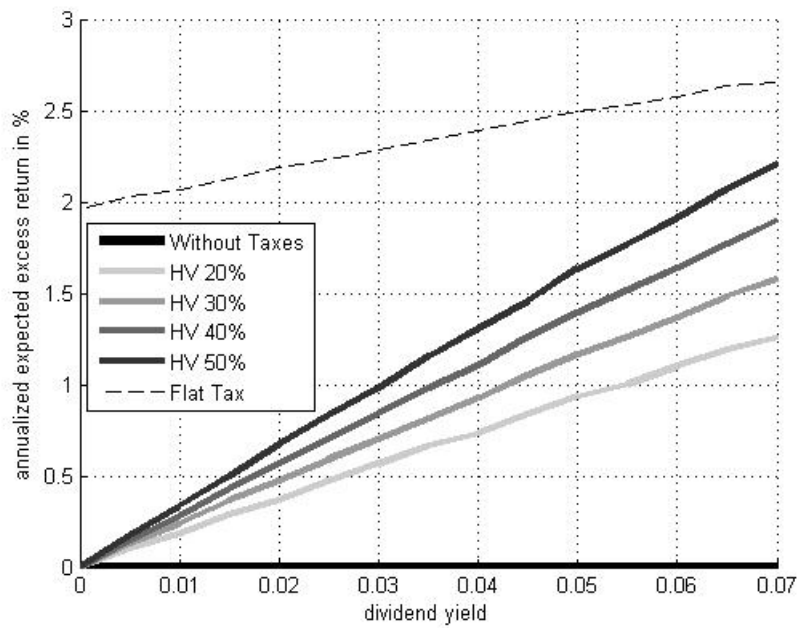


Figure 7: Annualized expected excess return of the discount certificate compared to equity replicating strategy for any investor

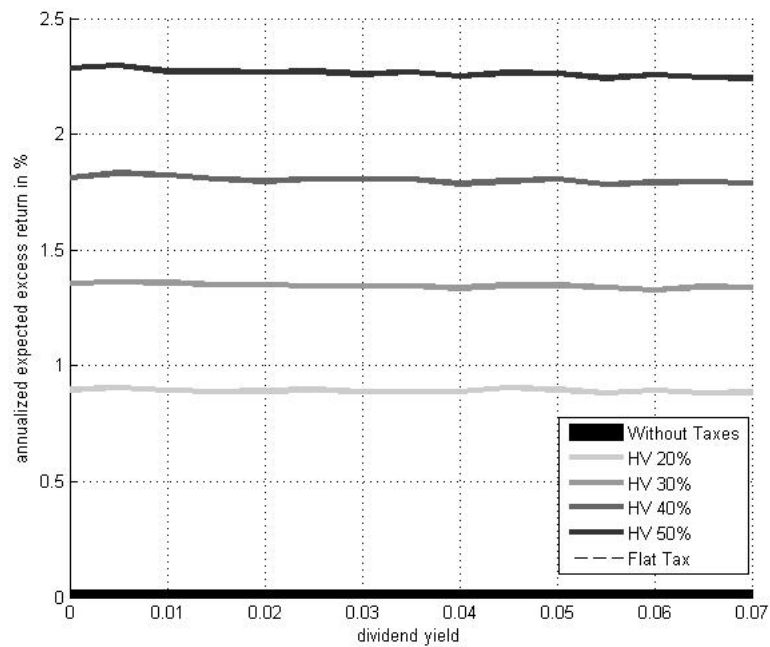


Figure 8: Annualized expected excess return of the discount certificate compared to zero bond replicating strategy for any investor

tax system, there is a positive tax effect even if no dividends are distributed as it is potentially possible to offset the negative price differences and the initial option premium. Since dividends can only be offset against potential losses in the underlying, the slope of the dashed graph is fairly flat. The certificate produces a smaller tax shield compared to the situation under the previous taxation system.

Using a zero bond for replication purposes changes the whole picture. In the capital gain taxation system, the certificate provided an added value due to the fact that returns from the zero bond were subject to full taxation (financial innovation rule). In the new system however, returns from bonds, dividends and option payments can be offset. No more benefit from taxation can thus be gained (see fig.8).

4. *Conclusions.* As a result, discount certificates tend to provide a benefit to investors. This is mainly based on the fact that implied volatility can be sold. By comparison, these products also benefit greatly from the effect that dividends are converted into price differences, especially under the former taxation system. The application of a loss averse value function improves the benefit due to the partial loss protection provided by these vehicles. The introduction of the new flat-tax system disadvantages the product group, however. There is still a relative advantage, though smaller. Comparing the product with the equity replication strategy, the product is always the better choice. If the zero-bond replication is considered, the certificate is deprived of any taxation benefit.

V.3 Bonus Certificates

Simulation Setup To calculate the initial price of the bonus certificate, we used the following input parameters: the underlying's price is again $S_0 = 900.82$ as given by the dataset, strike $X = 950$ (a typical bonus level at issuance, slightly in-the-money), knock-out level $H = 739$ (assures an initial price of the product equal to the underlying's price, which is preferred practice in retail banking.), time to maturity $T = 1.5$ (customary in practice), volatility $\sigma = 0.15$ (low volatility in the market),⁴⁰ and $r = 0.04$. The risk profiles of bonus certificate and underlying are generally at close range and usually have more than one intersection. Hence, the determination of stochastic dominance is hard and maybe inaccurate.

Results

1. *Risk neutral return shaping.* Using the risk neutral setup (fig.9), we observe that there is no expected excess return in a tax free environment (thin black line). This mainly derives

⁴⁰Bonus Certificates are recommended for markets that do not show strong trends (Szczytny 2005).

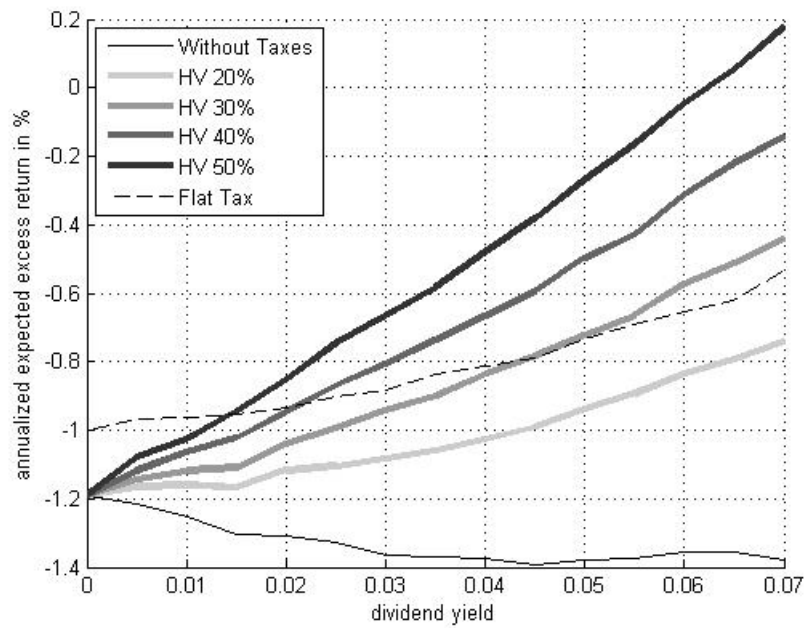


Figure 9: Annualized expected excess return of the bonus certificate compared to underlying for a risk neutral investor

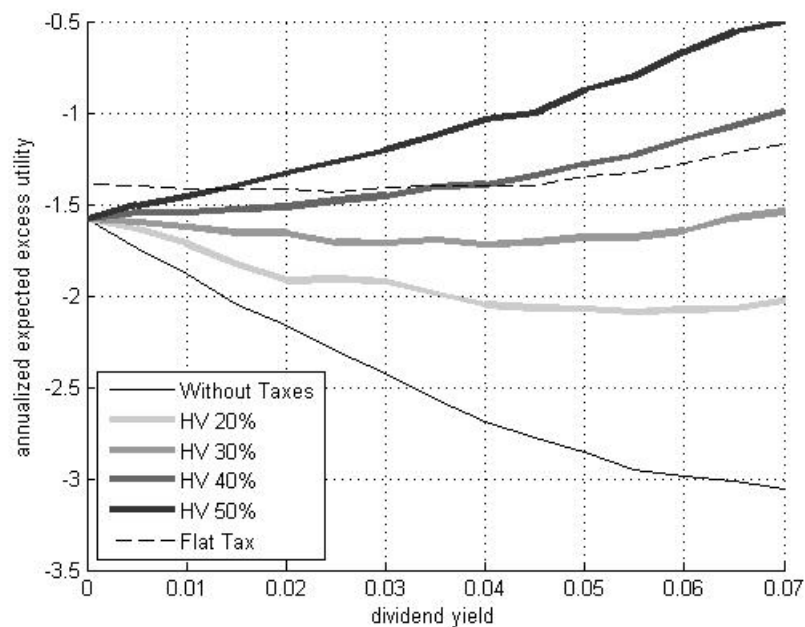


Figure 10: Annualized expected excess utility of the bonus certificate compared to underlying for a loss averse investor

from two different sources: first, the investor has to buy an option within the certificate, which means he has to pay implied volatility and receives a historical one. Second, he dispenses with dividend payments to get a derivative component that contributes only a small benefit, as can be seen in the risk/return profile [see fig.4]. As a result, the higher the dividend yield, the worse the product is assessed. Even if we include taxation, an overall benefit is achieved only for very high dividend yields and high taxation levels in the former taxation system. The reduced disadvantage shows up in the now rising lines of the graph. The reason behind this is that the investor only gives up after-tax dividends within the certificate but receives an option component equivalent to the pretax value of the dividends. The introduction of the flat-tax system leads to a smaller disadvantage even if there are no dividend payments, because the initial premium paid for the derivative component always reduces taxable profits in comparison to the zero-strike call. We again see that the higher the dividend payments, the higher the potential for loss-offsetting against possible negative price differences in the zero-strike call. The line representing the flat-tax system is upwards sloping, which means a reduced disadvantage.

2. *Loss averse return shaping.* As shown in fig.10, the introduction of our value function aggravates the impact of the characteristics of the bonus certificate. The relative disadvantage grows. Even the positive impact from taxation is never strong enough to over-compensate the underlying's dominance. Therefore, all the lines are twisted, resulting in a flatter or even negative slope. This is because bonus certificates only provide an advantage to the investor within a very small interval of the underlying's final price. For high negative returns (which are pronounced by the value function) as well as for high positive ones, the certificate underperforms. The performance of the bonus certificate in the flat-tax system is better when compared to the pre 2009 system, since the loss-offsetting is weighted higher by applying the value function.
3. *Tax effects without return shaping.* In comparison to its equity replication strategy, there is a tax benefit of bonus certificates [see fig.11]. Again, without any taxes, both strategies coincide. Under the previous tax system, the bonus certificate benefits from the dividend converting effect. Under the current system, the certificate additionally benefits from the initial premium payment, which reduces the tax base and brings an advantage even if no dividends are paid.

Comparing the certificate against its zero bond replication strategy, there is the same effect as with discount certificates: a benefit from taxation under the old system which vanishes under the new system.

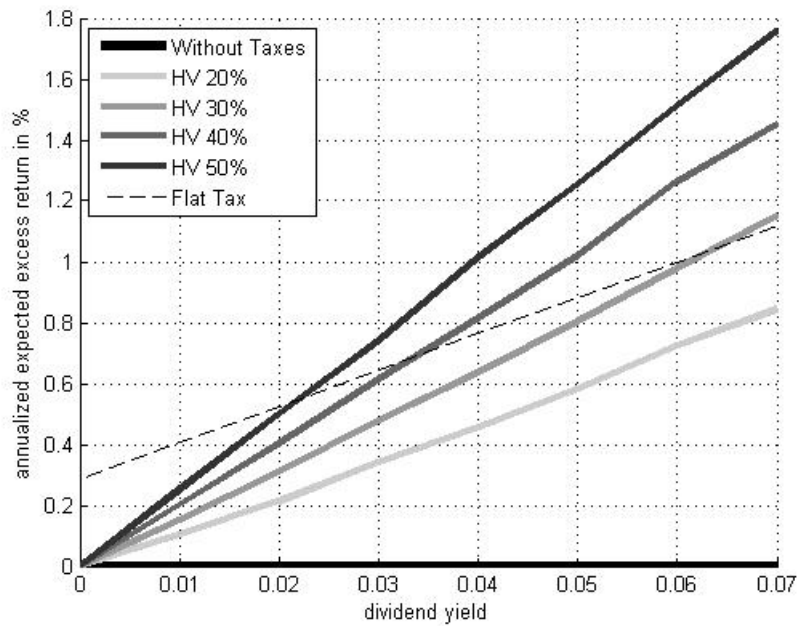


Figure 11: Annualized expected excess return of the bonus certificate compared to equity replicating strategy for any investor

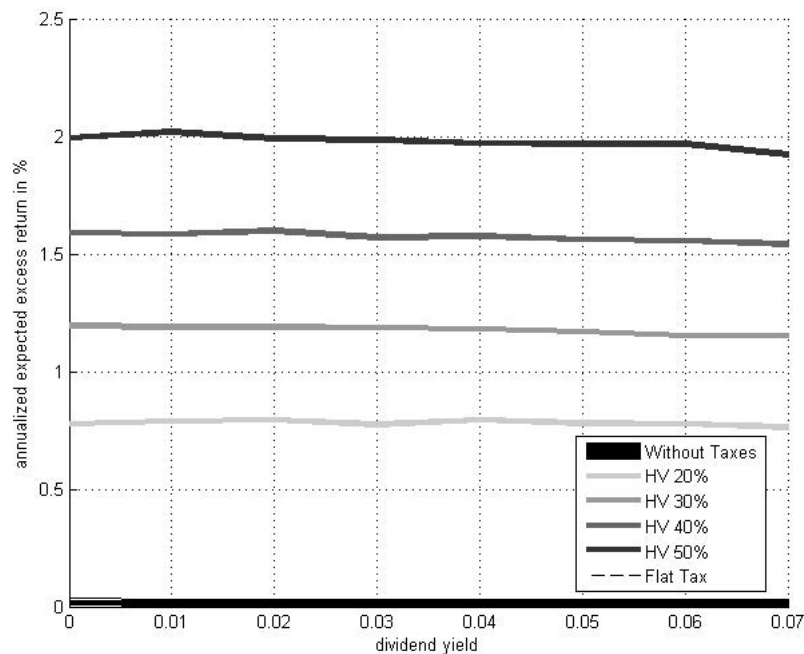


Figure 12: Annualized expected excess return of the bonus certificate compared to zero bond replicating strategy for any investor

4. *Conclusions.* Bonus certificates are only suitable for investors with a very precise expectation. They only provide an advantage in the close corridor where the bonus is paid. However, dividend payments are “lost”, i.e. converted into a derivative. If the underlying provides a high dividend yield and the investor bears a very high tax burden, this could be enough to produce a relative advantage under the old tax system — under the new one, this is not longer possible. Even for loss averse investors, the overall picture is unchanged. Only when comparing the product with the replication strategy in the previous tax system, the product is the better choice due to taxation.

V.4 Guarantee Certificates

Simulation Setup The guarantee certificate is initially priced using the following input parameters: underlying’s price $S_0 = 900.82$ as before, strike $X = 900$ (at-the-money, ensuring a 100% guarantee level at issuance), time to maturity $T = 5$ (those certificates have typically a longer time to maturity), $\sigma = 0.25$ (average volatility in the market),⁴¹ and $r = 0.04$. Taxation of guarantee certificates was fundamentally different under the former tax system: due to their guarantee component they were treated as financial innovations. Therefore, all profits were subject to full taxation. No half income system or speculation period were applicable.

Results

1. *Risk neutral return shaping.* Looking at the risk-neutral setup (fig.13), we can see that there is always a negative expected excess return, i.e. the risk-neutral investor would prefer the underlying. Moreover, the higher the dividend level, the more expensive the derivative component, so guarantee certificates benefit from lower dividend distributions. With respect to taxation, we see that guarantee certificates are at a disadvantage by the previous taxation system. The impact of taxation is always negative here, becoming even stronger with a higher marginal tax level. The reason for that is that all income from financial innovation was subject to income tax, whereas the profits from price differences in the underlying were tax free. We thus observe a parallel shift between the different tax levels. With the introduction of the flat-tax system, the discrimination of financial innovations was abolished. Guarantee certificates now benefit from the loss-offsetting effect in the same manner as the other certificates. However, there is still an overall disadvantage of the certificate, since a derivative component must be bought again. Accordingly, the

⁴¹Of course it is cheaper to buy this certificate at lower volatility levels. But that is not realistic: if the investor is thinking about using this product group, there is typically some nervousness and thus a higher volatility level in the market.

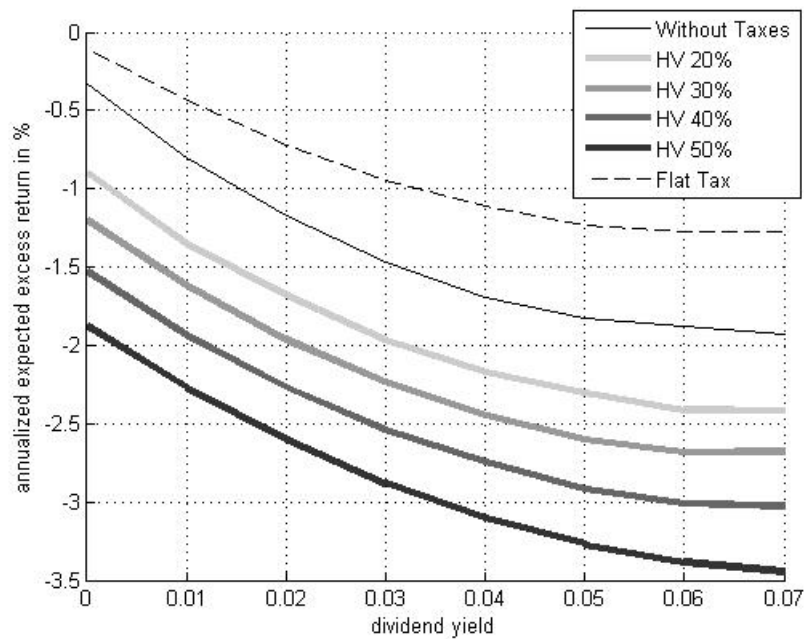


Figure 13: Annualized expected excess return of the guarantee certificate compared to underlying for a risk neutral investor

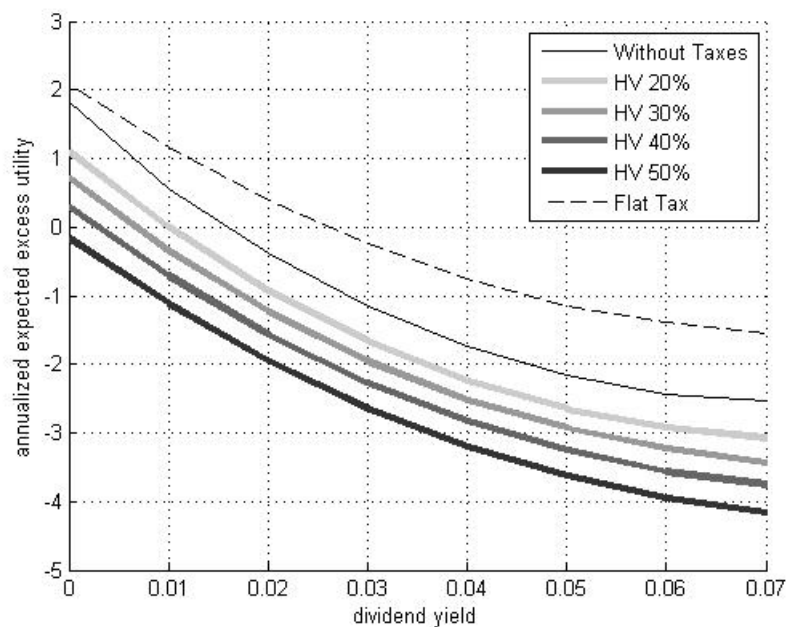


Figure 14: Annualized expected excess utility of the guarantee certificate compared to underlying for a loss averse investor

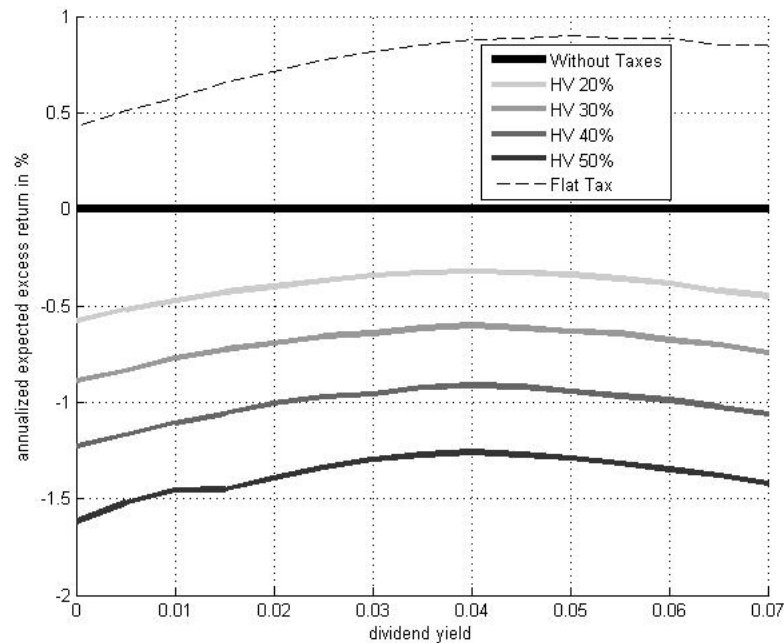


Figure 15: Annualized expected excess return of the guarantee certificate compared to equity replicating strategy for any investor

product group also faces the problem of buying (expensive) implied volatility. Nevertheless, guarantee certificates are not dominated, so the introduction of a value function is expedient.

2. *Loss averse return shaping.* If we look at the value function weighted curves shown in fig.14, the absolute numbers change: compared to the risk neutral case, there is an upwards parallel shift of all curves, which indicates an improved evaluation. Since guarantee certificates protect the investor against high losses, their risk profiles clearly benefit from the loss averse value function. A loss averse investor would hence prefer the certificate when low dividends are distributed. The structured product is then the better choice for the investor.
3. *Tax effects without return shaping.* Comparing the equity replicating strategy and the product itself under the previous tax system (fig.15), it always would have been better for an investor to create the strategy by himself (if possible), since then the profits from price differences would not have been subject to income tax (after an investment period of at least twelve months). Hence, the graphs of the previous tax system always show a relative disadvantage. Under the new tax system, the product benefits from taxation since it is

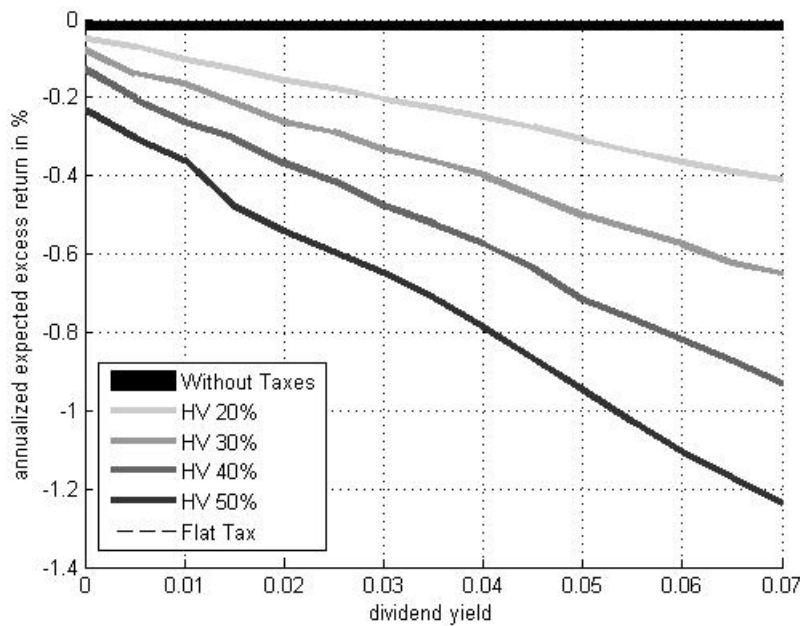


Figure 16: Annualized expected excess return of the guarantee certificate compared to zero bond replicating strategy for any investor

possible to offset price losses and option premium against price and dividend gains. Of course, in case of no taxes at all, both alternatives are equivalent.

Again, using zero bonds for replication, there is no advantage left in the new taxation system. In the previous system, however, the certificate was even worse, since all returns had to be taxed (including dividends). By contrast, within the duplication strategy only the profit from the zero bond was subject to taxation.

4. *Conclusions.* Since guarantee certificates were handicapped under the previous German tax systems by being classified as financial innovations, they could not provide a benefit to risk neutral investors. However, a risk averse investor would have preferred the certificate if low dividends were distributed and for low tax levels. Under the new tax system, this effect is greater so that even larger dividend payments may still result in an overall benefit. Whereas under the old system the replication was always the better choice, under the new system the replication using zero bonds is equal to the certificate.

VI Conclusions

This research investigates the benefit of return shaping investment certificates primarily from a tax perspective. We measure tax effects for three types of structured products — discount-,

bonus- and guarantee certificates — under three different taxation schemes. As real existing taxation schemes discriminatively allow for the offsetting of dividend income against capital losses, the tax burden of an instrument depends on the full return distribution. Any assessment of the tax effect therefore interacts with the return shaping created by the certificate. These effects cannot be completely disentangled. We address this issue by presenting two types of comparison. When comparing the certificate with an investment in the underlying, the return shaping effect is incorporated. We use both a risk neutral and a loss averse preference function for the assessment. The comparison between the underlying and its hedge eliminates the return shaping but introduces taxes on the hedging instruments. We estimate the return distributions after taxes using a non-parametric historical simulation approach. To compare strategies, we apply concepts of stochastic dominance as well as expected utility.

Our results show that, when comparing structured products with their underlying, taxation as well as the interaction between implied and historical volatility are the main drivers of a total benefit or burden from return shaping. Tax effects are significant but depend on the type of instrument and the tax regime. In most of the cases, taxation improves the certificate's position since either dividends could be converted into tax-free price differences (in the capital gain system) or "cross-loss-offsetting" is possible (in the flat tax system). The only exception was the guarantee certificate under the previous German capital gain tax system. In general, the direct comparison between the capital gain tax system and the flat-tax system shows an advantage of the latter for private investors. Overall, risk neutral investors would prefer discount certificates but dislike the other two types of certificates. The introduction of a loss averse value function changes this picture. Due to their partial protection, discount- and guarantee certificates are, as expected, more positively evaluated than under risk neutrality. Bonus certificates suffer in contrast and almost never provide an excess return or excess utility, respectively.

When comparing the certificates to their corresponding replication strategies, the taxation effects remain the only source of performance differences. If equity based duplication is considered, then the certificate largely provides a tax benefit due to the dividend conversion effect in the capital gain tax system or "cross-loss-offsetting" in the final withholding tax system. Using zero bonds for replication has never been favorable for private investors in the previous capital gain tax systems, since these instruments were classified as financial innovations. In the new flat-tax system, however, the tax advantage of the structured product vanishes due to the possibility to offset all relevant kinds of gains and losses as within the certificate. Hence, replication using zero bonds is a dominant strategy for retail investors. Thus, we can confirm the suspicion raised in Germany that investment certificates might be disadvantaged by the change in the taxation scheme for replicable products.

Our results indicate that the introduction of the new tax system in Germany alters the relative attractiveness of different types of certificates. In principle, this should cause a shift in the transaction volumes which establishes a testable hypothesis. However, many other factors besides taxes are responsible for investment decisions so that the effect could be hard to measure. We leave this hypothesis for further research. Another question not addressed in this study is the interesting topic of fair pricing. If there is a tax benefit, how much of this would finally be distributed to the investor and how much would be retained by the issuer? Existing research indicates some scepticism. By and large, the more exotic the structure and the more illiquid the underlying, the more advantage remains with the issuer, leaving the investor with little or no benefit.

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