THE STRUCTURED PRODUCTS LAW REVIEW

THIRD EDITION

Editors
Christopher S Schell, Yan Zhang and Derek Walters

THE LAWREVIEWS

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PREFACE

It is our pleasure to continue to act as the editors for this third edition of *The Structured Products Law Review*. Despite the significant growth of the global structured products market in recent years and the continuing evolution of the global regulatory framework, very few books on legal and regulatory issues related to structured products are available. Our first edition two years ago was meant to cover that gap, and we hope that this third edition will continue to further the knowledge base of legal practitioners and other structured products market participants.

For this year, we are pleased to report that this third edition adds one new jurisdiction and updates each existing geographical overview to cover its developments over the past year. One of the major developments, of course, has been the global covid-19 pandemic and the societal and governmental responses to that health risk. One of the more interesting effects of the pandemic for the structured products market was the intense volatility of the global stock markets in March and April 2020 as the world grappled with the new virus and its economic consequences. The volatility index of Chicago Board Options Exchange, known as the VIX index, reached a peak of 82.7 on 16 March 2020, which was higher than during the 2008 financial crisis and significantly higher than its long-run volatility average of approximately 20. This volatility resulted in substantial pricing movements in the structured products market. Combined with high levels of investor demand and longer marketing periods for typical structured products, and thus longer periods between the indicative pricing at launch and the final pricing at the close of the marketing, this unprecedented volatility required significant issuer and distributor efforts to appropriately price and sell structured products to those who understood the risks. Many transactions needed restructuring or repricing. At the same time, the investors saw the value of capital protection, including features such as buffers and triggers. The ultimate effects of this market dislocation, including any regulatory response, will take a long time to unravel. The near term results, however, are unambiguous: investors clearly noticed that structured products provided them with a set of investment options to capitalise on, or mitigate against, those unparalleled market conditions.

For our purposes, the term structured product refers to a pre-packaged investment that combines derivatives with other financial instruments to provide a return based on the performance of one or more underlying assets, including equity securities, indices, commodities, interest rates, currencies and, in some jurisdictions, credit risks. Typical structured products are issued as debt securities, certificates of deposit or investment certificates or units, and include embedded derivatives to provide a customised risk-return trade-off. Common issuers of structured products are financial institutions, other corporate issuers, special purpose vehicles and trusts. Structured products should not be confused with other structured finance products, which include asset-backed securities such as collateralised debt obligations and mortgage-backed securities, synthetic loans and credit derivatives such as credit default swaps.

Structured products have been in the spotlight since the global financial crisis in 2008. In the years following the financial crisis, there was an increase in regulatory investigations into the issuance and distribution of structured products and the promulgation of new rules and regulations to govern the conduct of structured product issuers and distributors. Regulators are particularly concerned about certain risk characteristics of structured products, including credit risk, investor suitability, pricing transparency, secondary market liquidity and conflicts of interest. Global regulators have taken a range of approaches to address these issues. To enhance investor protection, the International Organization of Securities Commissions published a report on the regulation of structured products in December 2013, which provides a toolkit outlining possible regulatory options that regulators in different jurisdictions may find useful to address their concerns about structured products. The process that led to the publication of this report has helped increase regulatory consistency across different jurisdictions and is an excellent example of international collaboration. The growing popularity of complex structured products among retail investors has also caught regulators' attention. Pursuant to the EU Markets in Financial Instruments Directive legislation that came into effect in January 2018, an issuer is required to supplement offering materials with a key information document when offering structured products to retail investors in EU Member States in order to strengthen investor protection and improve their investment decision and selection process. Other jurisdictions have also implemented rules aimed at protecting retail investors.

Given its unique ability to tailor investments to investor preferences, the structured product industry continues to grow at an impressive pace, and it is estimated that the size of outstanding structured products around the world has increased to over US$3 trillion in 2021. Technology plays an increasingly important role as the structured product market continues to grow in terms of issuance volume, innovation and broadening distribution channels. Recent examples include the growing popularity of online distribution platforms that provide an open marketplace for structured product issuers and distributors with a focus on streamlining the offering process to increase efficiency and transparency, the development of blockchain technology to facilitate securities clearing and settlement, and the use of large volumes of data from non-traditional sources, such as social media, to assess investors' financial needs and to design investment strategies. In recent years, not only have market participants embraced the rise of fintech by integrating new technology into offerings and issuances of structured products, securities regulators are also exploring the possibility of adopting new technology in structured product regulation. In Japan, online-based procedures have been permitted since November 2018 as a new know-your-customer (KYC) process to complement traditional face-to-face or mail-based KYC procedures. The US Securities and Exchange Commission (SEC) also has explored the use of big data in enforcement actions. In one recent example, the SEC used for the first time a coding technique against a broker-dealer that allows regulators to analyse data across an entire trading platform to identify potential unsuitable sales to a particular class of investors. The financial industry has historically been an early adopter of new technologies. With the onset of the remote working environment in many jurisdictions due to covid-19, the industry saw a continued investor demand for structured products throughout 2020 and 2021 and the technology was available to deliver structured products to those investors notwithstanding the dramatic decrease in in-person interactions. There is no doubt that technological development will continue to have a profound impact on structured products markets across all jurisdictions.

The Structured Products Law Review is designed to provide an overview of recent changes and developments in legal and regulatory issues regarding structured products markets. It would not have come together without the participation of a group of top lawyers and law firms from eight jurisdictions around the world. We hope that you find this book a useful tool in navigating the ever-changing legal and regulatory landscape in a fast-growing industry.

Finally, we would like to thank our counsel, Vidal Vanhoof, and other colleagues for their contributions in editing this book and the team at Law Business Research for their patience and efforts in compiling this third edition.

Christopher S Schell, Yan Zhang and Derek Walters
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Appendix 1

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