The Structured Products Law Review

Fifth Edition

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PREFACE

It is our pleasure to continue to act as the editors for this fifth 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. Four years ago, our inaugural edition was meant to cover that gap, and we hope that this fifth 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 fifth edition adds one new jurisdiction (Spain) and updates each of Argentina, Brazil, Luxembourg and the United States to cover its developments over the past year. Three years on from the onset of the covid-19 pandemic and the subsequent hyper-volatile markets around the globe, the current market climate continues to be highly influenced by the ongoing war in Ukraine, high inflation and rising interest rates, as well as the recent banking crisis in the early months of 2023. To varying extents, these events have resulted in increased market disruption events and related valuation issues for products linked to the affected assets. For example, the sanctions imposed by other nations following Russia's invasion of Ukraine produced market disruptions for indices and exchange-traded funds (ETFs) that track Russian equity securities. While commodity prices underwent extreme price fluctuations in response to supply fears over the war in Ukraine and associated sanctions, leading to a rare market shutdown for nickel in 2022, the war's continued effects on global market assets remain in flux and its long-term effects unclear. Similarly, global geopolitics as they relate to China, including her ambitions in the South China Sea, Sino-American relations and the increasingly beleaguered Belt & Road Initiative, have resulted in a fair amount of market anxiety. On the other hand, this year's banking crisis that saw the absorption of Credit Suisse by UBS – among other major shake-ups in the banking sector – has had little discernible effect on the wider structured products market, and the financial sector in general. Yet, the continued market uncertainty has meant that, perhaps unsurprisingly, investors have continued to turn to structured products as a means to provide themselves with a set of valuable investment options, including capital protection, to manage risk and capitalise on, or mitigate against, these 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 (IOSCO) 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. In the United States, the transition from the London Interbank Offered Rate (LIBOR) to the Secured Overnight Financing Rate (SOFR) where after 30 June 2023 all remaining US dollar LIBOR rates were discontinued and affected instruments linked to that rate would in large part be transitioned to a SOFR rate in accordance with the provisions in the Adjustable Interest Rate (LIBOR) Act of 2021, was recently completed. Yet, in all of these cases, unique and case-specific wrinkles in the regulatory and legislative spaces persist.

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 increased to over US$3 trillion in 2022. 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. When work-from-home arrangements began to pervade the industry after the beginning of the covid-19 pandemic, there was 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. Although there was a slight slowdown in overall market activity in 2022 from historic highs, this trend of remote investing has continued into 2023 even as much of the industry's biggest participants have returned to a majority in-office work environment. As such, the technological development has continued 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 five 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 fifth edition.

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