The Structured Products Law Review

Fifth Edition

Editors
Christopher S Schell, Yan Zhang and Derek Walters

The Law Reviews

Published in the United Kingdom
by Law Business Research Ltd
Holborn Gate, 330 High Holborn, London, WC1V 7QT, UK
© 2023 Law Business Research Ltd
www.thelawreviews.co.uk

No photocopying: copyright licences do not apply.

The information provided in this publication is general and may not apply in a specific situation, nor does it necessarily represent the views of authors' firms or their clients. Legal advice should always be sought before taking any legal action based on the information provided. The publishers accept no responsibility for any acts or omissions contained herein. Although the information provided was accurate as at September 2023, be advised that this is a developing area.

Enquiries concerning reproduction should be sent to info@thelawreviews.co.uk.
Enquiries concerning editorial content should be directed to the Content Director, Clare Bolton – clare.bolton@lbresearch.com.

ISBN 978-1-80449-209-3

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

ALLEN & OVERY

BOMCHIL

DAVIS POLK & WARDWELL LLP

PINHEIRO NETO ADVOGADOS

URÍA MENÉNDEZ ABOGADOS, SLP

Chapter 5

UNITED STATES

Christopher S Schell, Yan Zhang and Derek Walters[1]

I OVERVIEW

The structured products market in the United States has undergone tremendous change in the past dozen or so years since the ending of the global financial crisis. Last year, the industry continued its strong overall trend with over 31,000 deals, representing an aggregate total of US$93.7 billion.[2] Although this amount was a decline from the historic high in 2021, with just over US$101 billion, investors continued to seek out structured products in significant volumes throughout 2022.[3] The product mix has changed, and a wider variety of equity-linked products are available today, with many products being routinely issued today that were entirely unavailable 10–12 years ago. In addition, the increase in interest rates and market volatility has further changed the product mix so that it now includes more principal-protected structures together with increased commodity and currency linked offerings. Tremendous variation in the manner of issuing structured products now exists in the United States, including large institutional or high net worth private offerings, SEC-registered retail offerings and offerings of structured certificates of deposits issued by regulated banks. Moreover, the distribution model for selling structured products in the United States has undergone arguably the most change. Many existing large wealth management or financial advisory firms have embraced the concept of 'open architecture'. Whereas in the past, these firms would typically restrict their sales to products issued by their affiliates, they now actively encourage non-affiliated structured product issuers to use their distribution platforms. Supplementing, and at times competing with, the sale of structured products by these large broker-dealers is an increase in sales of structured products by independent wholesale or intermediate distribution firms, as well as increasingly independent financial advisers, often acting in a fiduciary capacity for their investor clients. New issuers, primarily financial institutions based in Canada and Europe, have entered the marketplace. Finally, dedicated structured product electronic platforms have been created to allow brokers to access product information, as well as educational materials, and to purchase products,

---

1 Christopher S Schell, Yan Zhang and Derek Walters are partners at Davis Polk & Wardwell LLP. The authors would like to thank their colleagues Vidal Vanhoof, Michael J Russo, Marc Swenson, Lisa Giglio Connor, Zachary Dooley and Nicollette Farkas and summer associate Paul M Sessa for their assistance with this chapter. They would also like to thank their colleagues Lucy W Farr and David S Fisher for their assistance with the tax section of this chapter and colleagues Randall D Guynn, Gabriel D Rosenberg and Dana Seesel Bayersdorfer for their assistance with the bank regulatory section of this chapter.

2 Structured Retail Products, https://www.structuredretailproducts.com/news/details/78754 (last accessed 14 July, 2023).

3 *Id.*

through website portals created for these purposes. While those multi-dealer electronic platforms and individual dealer's separate electronic platforms played a significant role in this market's ability to thrive despite in-person restrictions due to covid-19, their influence has not noticeably diminished even while many of the major players in the industry have returned to a majority in-office work situation. The role and rules of the various regulators in the United States tasked with supervising this market has evolved with the market. This chapter addresses the regulatory framework that has been built to address this expanding and changing marketplace.

One of the central tensions for the US regulators grappling with this changing landscape has been between the perspective that the market is benefiting from democratisation versus the view that it is subject to inappropriate 'retail-isation'. The principal US market regulator, the Securities and Exchange Commission (SEC), has made clear that it will not determine the merits of any given structured product or otherwise proscribe products in light of the view that the continued depth of the US capital markets benefits from new product introductions. This view stems from the bedrock belief that investors should be able to make their own investment decisions, even with complex products, so long as they have full and accurate disclosure with which to make their investment decision. This approach stems from the belief that individual investors can benefit from products that were only available to large institutional investors in the past and thereby democratises the investment landscape. On the other side, regulators are clearly concerned that not all retail investors will benefit from these products, whether they do not have the financial experience necessary to understand the products or whether unscrupulous distributors recommend unsuitable investments to them. From this perspective, the SEC and perhaps even more so the Financial Industry Regulatory Authority, Inc (FINRA), a self-regulatory organisation regulating broker-dealers, have created new rules and regulatory frameworks to police the market for complex products covering a range of issues. While these new rules have not always exclusively targeted structured products, they evince concerns that retail investors need careful protection when facing investment decisions relating to the retail-isation of complex financial instruments. These intertwined regulatory initiatives have addressed a wide variety of issues, including conflicts of interests, fees and commissions, sales to retirees, distribution governance procedures, and supervision and complex product creation and marketing more generally. Even geopolitics have intruded into this part of the market as US presidential executive orders aimed at Chinese military companies have impacted structured products that link to broad market indices that include the Chinese market.

The regulatory environment in the United States is made more complex by the fact that structured products are primarily issued by heavily regulated bank holding companies (BHCs). These banks are subject to a myriad of bank capital, resolution planning and similar regimes that directly affect capital markets transactions, including structured products. For example, the Board of Governors of the Federal Reserve System (the Federal Reserve) has formalised rules regarding eligible long-term debt that have had a major impact on structured products, and which types of entities can issue them, as described in this chapter.

Two primary themes underlie the current regulatory regime for structured products. The first is the direct message from the regulators that providing clear, accurate product disclosure to investors is not always sufficient. The rules promulgated by the principal regulators focus on appropriate governance of the product creation process and sufficient oversight of the sales process, even to the extent where the product issuer must, in some circumstances, take certain actions to monitor and assess the sales process by independent

third-party distributors of the issuer's products. This focus evinces the regulators' concerns that certain sales efforts can, in some circumstances, amount to a concerning level of pressure on less financially sophisticated retail investors of products. As such, these regulators have taken the view that the creators and issuers of these products are well placed to understand the benefits and risks of their products and so should act as one of the gatekeepers to ensure they are sold only to suitable investors. The second is that the US regulators have retained the post-financial crisis activism in enforcement. This trend has meant that while a number of landmark enforcement actions occurred in the aftermath of the crisis as the regulators took a more activist approach to enforcement, the enforcement task forces remain active to this day. Given that this focus has now spanned four different presidential administrations, including the Trump administration and now the Biden administration, it is fair to say that it likely reflects a bipartisan approach to the enforcement of the laws and regulations governing complex products sold to individual investors, including structured products. While the enforcement of existing laws and regulations has bipartisan support, further regulation of the industry is a more complex issue. The elevation of Gary Gensler as chair of the SEC, with his known interest in regulatory change from his days as chair of the Commodity Futures Trading Commission in the early 2010s, has already impacted a number of areas of the capital markets, especially around climate change. How a more active SEC could alter the structured products landscape remains less than clear.

This chapter explores how these trends manifest themselves in the overall regulatory landscape. It discusses the roles and legal regimes of the various US regulators of structured products from the SEC and FINRA to state law regulators, and specific issues such as the sales and marketing rules, Regulation Best Interest, exchange listing issues, the rules governing the use of distributors, such as know-your-distributor (KYD) requirements, and cash tender offers for structured products. It also addresses the evolving situation at the Department of Labor (DOL) over its protean DOL Fiduciary Rule that the new presidential administration has telegraphed may again be amended in the upcoming year. While the United States and the world have finally emerged from the covid-19 pandemic, the markets now have to face not only heightened geopolitical uncertainty with respect to China and the war in Ukraine but also a period characterised by inflation, rising interest rates and poor economic growth. As such, this chapter discusses the impact of this new adverse economic reality on the disclosure, marketing, pricing and trading of structured products. In general, the chapter is organised thematically to address these principal regulatory rules and related concerns raised by regulators. We also cover generally the typical US tax treatment of structured products and other issues that touch upon structured products, such as the recently completed transition from the London Interbank Offered Rate (LIBOR) to the Secured Overnight Financing Rate (SOFR).

II LEGAL AND REGULATORY FRAMEWORK

i US securities laws and the role of the SEC

Most structured products issued in the US market are issued as securities or certificates of deposit (CDs).

The Securities Act of 1933, as amended (the Securities Act), regulates offers and sales of securities in the United States. All offers and sales of securities must be made pursuant to a registration statement, except for certain exempt securities and exempt transactions. Every offering needs to be registered or rely on an exemption from registration: it is the specific

offering that is registered, not a series or class of securities. If no exemption is applicable, under the central provision of the Securities Act, Section 5, it is unlawful to offer a security unless a registration statement has been filed as to the security, and it is unlawful to sell a security unless a registration statement is in effect as to the security.

A registration statement is a filing with the SEC that includes a base prospectus, which contains general information about the issuer and the securities being registered. Disclosure about the issuer in its annual, quarterly and other periodic reports is typically incorporated by reference into the base prospectus. The SEC is a government agency that is the primary overseer and regulator of the US securities markets. Its mission is 'protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation'.[4]

Registration statements are subject to review by SEC staff, although the SEC states that it 'does not evaluate the merits of securities offerings, or determine whether the securities offered are 'good' investments or appropriate for a particular type of investor'.[5] Registration statements become effective upon SEC declaration or, in certain cases, automatically. Filing fees are payable to register securities with the SEC (currently US$110.20 per US$1 million of securities (with effect from 1 October 2022)).

Exemptions from registration include:

a Rule 144A: a safe harbour exemption for resales of securities to qualified institutional buyers (essentially, large institutional investors);

b Regulation D: exemptions for sales of securities to accredited investors (which include certain institutional investors, as well as high-income or high net worth individuals);

c Regulation S: safe harbours for offers and sales that occur outside the United States; and

d Section 3(a)(2): an exemption for securities issued or guaranteed by a bank or a regulated US branch or agency of a non-US bank.

CDs are issued by banks and insured by the Federal Deposit Insurance Corporation (FDIC) up to applicable limits. Structured CDs always provide for the repayment of the deposit amount at maturity. CDs are generally not securities for the purposes of the Securities Act and, therefore, are not required to be registered thereunder. However, similar risk and disclosure considerations apply. As a result, typical market practice is for the disclosure package about a structured CD to be relatively equivalent to the disclosure package about an SEC-registered security.[6]

US securities laws generally impose liability for material misstatements and omissions in the offering documents. The applicable standard, persons subject to liability and potential defences depend in part on whether the securities are SEC-registered.

The typical disclosures provided to investors in SEC-registered structured product offerings can be divided into three broad categories:

a Disclosure about the issuer: typically, structured products are issued or guaranteed by an entity that is subject to extensive ongoing reporting requirements. Those disclosures,

4 US Securities and Exchange Commission, 'What We Do': https://www.sec.gov/Article/whatwedo.html (accessed 14 June 2023).

5 US Securities and Exchange Commission, 'Small Business and the SEC': https://www.sec.gov/reportspubs/investor-publications/infosmallbusqasbsec (accessed 14 June 2023).

6 Typical plain vanilla CDs have very abbreviated disclosure, often limited to the term and interest rate.

which are made in public filings, are typically incorporated by reference into the base prospectus or similar base offering document (such as the offering memorandum or offering circular).

b Disclosure about the structure and related adjustment mechanics: these disclosures are typically contained in one or more of the offering documents that supplement the base offering document (such as a prospectus supplement or product supplement or the preliminary and final pricing supplements).

c Disclosure about the underlying reference asset or assets. These disclosures are typically contained in one of the offering documents that supplements the base offering documents (such as an underlying supplement or the preliminary and final pricing supplements). However, under a 1996 no-action letter, the SEC staff has granted relief to issuers of securities linked to equity securities issued by another (unaffiliated) issuer (underlying company) if the issuer does not have any material non-public information about the underlying company and where there is sufficient market interest in and publicly available information regarding the underlying company. In this case, the issuer may refer investors to disclosures made by the underlying company without having to take liability for such disclosures. The SEC staff has extended this analysis to exchange-traded funds (ETFs). Starting in December 2020, issuers began to launch SEC-registered structured notes linked to actively managed ETFs. Since then, issuers have launched hundreds of offerings linked to one or more actively managed ETFs. Most issuers have included cover page and risk factor disclosure relating to active management.

ii Broker-dealer regulation and the role of FINRA

FINRA is a non-governmental self-regulatory organisation that regulates member broker-dealer firms. Most issuers of structured products are affiliated with one or more broker-dealers that are members of FINRA and need to comply with its rules. FINRA has long been focused on structured and complex products and other issues relevant to structured products, such as communications with the public, conflicts of interest, suitability and KYD policies and procedures. Some of FINRA's key relevant guidance in these areas is summarised in Section III.

iii State securities laws

Each state has its own securities laws (often referred to as 'blue sky laws'). These state laws frequently prescribe registration or qualification requirements that apply to securities, including SEC-registered securities, unless such requirements are pre-empted pursuant to Section 18 of the Securities Act. Because issuers of structured products typically list at least one class of their equity (or debt) securities on a national securities exchange, these state law requirements will be pre-empted for all of its securities (including structured products) that rank equal or senior to that listed security so long as that listed security remains outstanding and listed.

However, even if the registration and qualification requirements are so pre-empted, state securities laws may still require notice filings or payment of fees. In addition, state securities regulators retain the ability to bring actions under state laws that, for example, prohibit fraud.

iv Select bank regulatory issues applicable to structured products

The Federal Reserve's final rule on total loss-absorbing capacity (TLAC) and eligible long-term debt (LTD) securities (the TLAC Rule), which was adopted in December 2016,[7] requires the top-tier holding company of each US global systemically important banking organisation (G-SIB) (each a covered BHC) to maintain certain minimum amounts of external eligible TLAC (consisting, essentially, of regulatory capital and eligible LTD securities) and external eligible LTD securities.

In addition, according to the clean holding company requirements in the Final Rule, a covered BHC is prohibited from directly incurring certain liabilities, including short-term debt and parent guarantees of subsidiary liabilities with certain impermissible cross-defaults. The clean holding company requirements also impose a cap on unrelated liabilities of a covered BHC at 5 per cent of its external TLAC. Unrelated liabilities generally include, among other non-contingent liabilities, any LTD securities issued by a covered BHC to third parties that are excluded from eligible LTD securities. Importantly, structured notes are excluded from eligible LTD securities. As a result, they do not count towards a covered BHC's minimum external TLAC or LTD requirements and instead are treated as unrelated liabilities that are subject to the 5 per cent cap.

The TLAC Rule defines structured note as a debt instrument that:

(1) Has a principal amount, redemption amount, or stated maturity that is subject to reduction based on the performance of any asset, entity, index, or embedded derivative or similar embedded feature;
(2) Has an embedded derivative or similar embedded feature that is linked to one or more equity securities, commodities, assets, or entities;
(3) Does not specify a minimum principal amount that becomes due upon acceleration or early termination; or
(4) Is not classified as debt under GAAP, provided that an instrument is not a structured note solely because it is one or both of the following:
(i) An instrument that is not denominated in U.S. dollars; or
(ii) An instrument where interest payments are based on an interest rate index.

This definition clearly includes, for example, structured notes where the payment at maturity is based on the performance of one or more equities, commodities or other assets. In other cases, the analysis may be more complex and will depend heavily on the specific structure.

Certain US intermediate holding companies that are controlled by foreign G-SIBs are also subject to minimum TLAC and LTD requirements and clean holding company requirements under the TLAC Rule, including a cap on unrelated liabilities at 5 per cent of external or internal TLAC (as applicable depending on the G-SIB's resolution strategy).

On 7 October 2022, the Federal Reserve and FDIC jointly issued an advance notice of proposed rule-making that solicited public comment on the potential application of LTD and clean holding company requirements to certain large, non-G-SIB US banking

7 Federal Reserve, Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important US Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations, 82 Fed. Reg. 8266 (15 December 2016).

organisations.[8] The Federal Reserve and FDIC are expected to issue a notice of proposed rule-making on the same topic in the second half of 2023. That proposal would be expected to provide more detail on the potential impact of the rule-making on structured notes of such banking organisations.

Another area of bank regulation that has affected structured products has been the QFC Stay Rules. These Rules were designed to improve the resolvability and resilience of US G-SIBs, including their subsidiaries and branches worldwide, and the US subsidiaries, US branches and US agencies of foreign G-SIBs (covered entities), by mitigating the risk of destabilising closeouts of qualified financial contracts (QFCs) in the event of a covered entity's entry into insolvency or resolution proceedings. QFCs include derivatives, repos, securities lending agreements and contracts for the purchase and sale of a security, among other contracts. The definition of QFC can pick up structured products in certain instances.

The QFC Stay Rules only apply to 'in-scope' QFCs: that is, QFCs that expressly include a default right[9] against a covered entity or expressly restrict the transfer of the QFC (or any interest in or under or any property securing the QFC) from a covered entity. The QFC Stay Rules include two substantive requirements:

a a requirement that an in-scope QFC expressly recognises the FDIC's power to stay the exercise of certain default rights and transfer the QFC under the Federal Deposit Insurance Act and Title II of the Dodd-Frank Act (Express Recognition Requirement); and

b a requirement to expressly override certain cross-default rights against a covered entity and provisions restricting the transfer of an affiliate credit enhancement upon an affiliate of the covered entity party entering any insolvency or resolution proceedings (Override Requirement).

While structured products were not the focus of these rules, the rules were drafted such that structured products were captured in certain cases. Issuers were required to review carefully their structured product portfolio to determine whether they included QFCs and, if so, whether any of the QFCs included provisions bringing them in scope for the rules.

The QFC Stay Rules also include a number of exemptions: for example, certain in-scope QFCs governed by US law, and where all non-covered entity parties are US entities are exempted from the Express Recognition Requirement. In-scope QFCs that do not include cross-default rights against a covered entity and that do not restrict the transfer of an affiliate credit enhancement are exempted from the Override Requirement. Even if a structured product is an in-scope QFC, it has to be further analysed to determine whether an exemption is available, depending upon the specific terms of and parties to each agreement.

These rules are another example of the complex interplay between bank regulatory regimes and the sophisticated capital markets transactions that financial institutions perform.

8 Federal Reserve and FDIC, Resolution-Related Resource Requirements for Large Banking Organizations, 87 Fed. Reg. 64,170 (24 October 2022).

9 The QFC Stay Rules define default right extremely broadly to include, among other things, a right of a party under an agreement to liquidate, terminate, cancel, rescind or accelerate an agreement or transactions thereunder, set off or net amounts owed, exercise remedies in respect of collateral or other credit support, demand payment or delivery, or suspend, delay or defer payment or performance thereunder.

v The enforcement environment

Structured products, especially those offered and sold to retail investors, have faced and will continue to face a very high level of regulatory and media scrutiny in the United States. This includes scrutiny in the form of enforcement actions by the SEC and FINRA.

The SEC is committed to policing all parts of the US capital markets and periodically reviews filings related to offerings of structured products. In recent years, it has brought a number of enforcement actions related to structured products with a focus on both sales practice and disclosure issues. The SEC's Enforcement Division has a special Complex Financial Instruments Unit, which includes former industry participants.

One example of an enforcement action involving the Complex Financial Instruments Unit concerned information about potential offerings (essentially, the embedded options from the investor's perspective) being shared between a structuring desk and potential issuers, but not included in internal education materials for financial advisers. The SEC found that the relevant supervisory policies and procedures were not reasonably designed and implemented to provide effective oversight of the training, education and recommendations of the registered representatives to prevent and detect violations of the Securities Act. This action has led market participants to focus even more heavily on whether, where information about structuring an offering (such as how the underlying reference asset is selected) is shared internally between business units or with issuers, that same information should be included in training materials prepared for financial advisers (and, potentially, shared with investors through the disclosure).

Other cases have concerned failures to adequately disclose hedging and embedded index fees that could negatively impact the value of an underlying index. These cases have further highlighted the importance of clear disclosure regarding trading strategies that underlie indices, as well as the importance of clear disclosure that sets out all of the costs and fees included in indices, including the effect of such costs and fees.

FINRA has also focused much of its recent attention on sales practice risks. For example, its 2023 Report on FINRA's Examination and Risk Monitoring Program, which provides member firms with insight into findings from the recent oversight activities of FINRA's regulatory operations programmes, noted that FINRA will continue to review member firms' communications and disclosures made to customers in relation to complex products, and will also review customer account activity to assess whether member firms' recommendations regarding these products are in the best interest of the retail customer given their investment profile and the potential risks, rewards and costs associated with the recommendation.

The US regulators' focus on enforcement spans changes in administrations, and so is likely bipartisan.

vi The impact of international law and regulation

Outside of laws and regulations governing securities offerings generally, the main area where international developments have affected offerings of structured products in the United States has been in the sphere of benchmarks regulation. In 2013, the International Organization of Securities Commissions published its Principles for Financial Benchmarks: Final Report (the Principles), which seek 'to create an overarching framework of Principles for Benchmarks

used in financial markets'[10] covering governance and accountability, as well as the quality and transparency of benchmark design and methodologies. Under the Principles, the term benchmark is defined very broadly and includes, among other things, the types of indices often used as underlying reference assets for structured products. While the Principles are not binding, they have been highly influential. As a governance matter and in light of market expectations, many administrators of these types of indices (including proprietary indices) have undertaken audits and published public attestations or compliance statements disclosing the extent of their compliance with the Principles.

In relation to this, the EU Benchmarks Regulation (BMR) has established an EU regulatory framework for benchmarks, including requirements related to benchmark integrity and reliability, transparency and consumer protection, and the authorisation, registration and supervision of administrators. As is the case under the Principles, the term benchmark under the BMR is defined very broadly. In addition to imposing requirements on EU benchmark administrators, the BMR imposes requirements on third-country (i.e., non-EU) administrators by providing that, from January 2024, EU financial institutions will only be able to use a benchmark produced by a third-country administrator (such as a US administrator) in the EU if:

a the European Commission has adopted an equivalence decision recognising the regulatory framework in the applicable third country as equivalent to the requirements of the BMR;

b the third-country administrator is recognised under the BMR; or

c the benchmark has been endorsed by an EU financial institution.

As a result, US entities that create indices that will be used on a global basis (e.g., as an underlying reference asset for structured products sold to investors in the EU) have had to consider the requirements of the BMR in creating these indices, in addition to having to engage with regulators in the EU (e.g., in seeking recognition) so that these indices may be used beyond 2023.[11]

vii Recent developments affecting underlying reference assets

Two recent regulatory developments have affected underlying reference assets, including the disclosure about such assets that issuers have provided for new issuances.

Holding Foreign Companies Accountable Act

In December 2020, the Holding Foreign Companies Accountable Act (HFCAA) was signed into law and requires the SEC to prohibit the trading of securities of a non-US company on US stock exchanges or the over-the-counter market if the Public Company Accounting Oversight Board (PCAOB) has determined that it has been unable to inspect the company's

10 International Organization of Securities Commissions, 'Principles for Financial Benchmarks: Final Report': https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf (accessed 14 June 2023).

11 The European Commission has adopted a delegated regulation, which is currently in the scrutiny phase, to further extend the transition period applicable to third-country benchmarks to the end of 2025.

accounting firm for two[12] consecutive years because of a position taken by an authority in the company's jurisdiction. In December 2021, the SEC adopted rules to implement the requirements of the HFCAA, which established procedures to identify companies (the commission-identified issuers) that have retained an accounting firm that: (1) is located in a foreign jurisdiction; and (2) the PCAOB is unable to inspect or investigate as a result of a position taken by an authority in the foreign jurisdiction (as determined by the PCAOB). Under the rules, the SEC will issue an order to prohibit the trading of the securities of a commission-identified issuer 'as soon as practicable' after such company has been conclusively identified as a commission-identified issuer for two consecutive years. Once the a trading ban comes into effect for a commission-identified issuer, it is expected that US exchanges will commence a delisting process for the Commission Identified Issuer. To end a trading prohibition, a commission-identified issuer must certify to the SEC that it has retained or will retain an accounting firm that the PCAOB has determined it is able to inspect or investigate. In addition to the trading ban that kicks in after two years, once identified as a commission-identified issuer, the company will have to comply with the HFCAA's enhanced submission and disclosure requirements in their subsequent annual reports to establish that the company is not owned or controlled by a governmental entity in the relevant foreign jurisdiction as well as other enhanced disclosure requirements.

In December 2021, the PCAOB made a determination that it was unable to inspect or investigate completely all registered accounting firms headquartered in mainland China and Hong Kong. Following this determination, the SEC identified more than 170 China-based companies as commission-identified issuers. Based on this determination, some issuers began including disclosure in structured products linked to US-listed American depositary shares of China-based companies about potential delisting under the HFCAA. However, in August 2022, the PCAOB signed a statement of protocol agreement (the Cooperation Agreement) with the China Securities Regulatory Commission and the Ministry of Finance of China, establishing a framework to allow the PCAOB to conduct on-site inspections of PCAOB-registered accounting firms in mainland China and Hong Kong. In December 2022, the PCAOB announced that its inspections were successful, and it vacated its December 2021 designations of China and Hong Kong as jurisdictions where the PCAOB is not allowed to conduct full and complete audit inspections under the HFCAA. Significantly, this means that China-based companies avoid, at least for now, involuntary delisting from US exchanges under the HFCAA. However, the previously identified commission-identified issuers must comply with the HFCAA's enhanced submission and disclosure requirements for the year in which they were identified.

While the PCAOB's December 2022 determination resets the two-year clock for compliance and temporarily removes the risk of delisting for China-based companies, it does not permanently end the delisting risk for such companies. As stated by the chair of the PCAOB, 'this is the beginning of our work to inspect and investigate firms in China, not the end'. Each year, the PCAOB will determine whether it can completely inspect and investigate audit firms in China and Hong Kong, among other jurisdictions.

12 In December 2022, the President signed the Consolidated Appropriations Act, 2023 which, among other things, amended the HFCAA to reduce the number of consecutive years an issuer can be identified as a commission-identified issuer before the Commission must impose an initial trading prohibition on the issuer's securities from three years to two years.

Executive Order 14032

On 3 June 2021, President Biden signed Executive Order 14032, which refined and replaced President Trump's executive order concerning companies with ties to the Chinese military, with a delayed effective date of 2 August 2021 and a delayed divestment date of 3 June 2022. Executive Order 14032 prohibits US persons from engaging in the purchase or sale of any publicly traded securities (and derivatives) of certain companies with ties to the Chinese military. It does not prohibit US persons from possessing securities covered by the order following the conclusion of the 365-day divestment period, though any sale of these securities after that date would require authorisation from the Office of Foreign Assets Control. The definition of 'publicly traded securities' is broad and encompasses securities that trade 'over-the-counter', as well as on a securities exchange. Some issuers have begun including disclosure in structured products linked to Chinese underlying reference assets about these recent executive orders, as well as more generic disclosure about the potential impact of governmental regulatory actions, such as sanctions, in structured products linked to other non-US underlying reference assets.

III OFFERING PROCESS AND POST-SALE REQUIREMENTS

i Offerings and distribution

The key players in the structured product markets include issuers who design and issue the structured products and distributors who market and sell the structured products to end investors. Issuers may distribute structured products through their affiliated broker-dealers or financial advisers or through third-party distribution channels, including private banks, retail distributors and independent asset managers.

A number of web-based multi-issuer distribution platforms, such as SIMON, Luma and Halo, have been launched in recent years to provide an open marketplace for broker-dealers and financial advisers to analyse, trade and monitor structured products for their clients. Some platforms use risk analysis tools and models developed by structured product issuers or other technology providers. These online distribution platforms provide broker-dealers and financial advisers easy access to a broad range of structured products and tools to more easily identify, compare and select the right product. By automating many of the processes involved with structured product offerings, these platforms are expected to simplify how structured products are created, distributed and managed over the entire life cycle and lower the notional amounts required for structured product issuances. These online distribution platforms may help issuers further expand the structured products market in the United States.

The SIMON platform is operated by Institutional Capital Network (iCapital), a fintech company headquartered in New York City. The SIMON platform is designed to provide educational content, analytics and life cycle management tools to financial advisers to help them learn, transact and manage client portfolios. Originally developed by Goldman Sachs,

the SIMON platform became an independent online platform in December 2018 through equity investments by a group of structured product issuers including Barclays, Credit Suisse, HSBC, JP Morgan and Wells Fargo[13] before being acquired by iCapital in August 2022.[14]

The Luma platform, created by Luma Financial Technologies and headquartered in Cincinnati, Ohio, is a joint venture formed by Navian Capital, Bank of America Merrill Lynch and Morgan Stanley,[15] with subsequent investments by TD Bank and CIBC.[16] Luma is focused on workflow automation, post-trade position monitoring and comprehensive education, training and compliance management. Luma allows distributors to design and price custom structures across all issuers and track all bids in one place.

The Halo platform was developed by Halo Investing, a fintech company headquartered in Chicago. The Halo platform provides tools to financial advisers to assist with structured note offerings, including educational resources, options to customise structured notes by payoff, theme or risk profile, access to bids and pricing from an array of issuers and pre- and post-trade administration.[17]

Communications with broker-dealers and financial advisers over these online distribution platforms, including dissemination of marketing pieces relating to offerings of structured products as well as more generic educational videos and interactive tools, will pose questions for issuers, distributors and platform operators as to whether any of these communications should be deemed to constitute an 'offer' as that term is defined under the Securities Act, whether the communications should be attributed to the issuer or the platform operator, and whether the communications will be subject to FINRA filing, review and approval as described below.

ii Sales and marketing

As noted above, FINRA is a self-regulatory organisation dedicated to investor protection and market integrity through regulation of registered broker-dealers. Because most structured products are sold by registered broker-dealers, offerings and sales of these structured notes

13 See SIMON Markets LLC, 'SIMON Expands Structured Investment Platform with Six New Investors' (press release dated 10 December 2018): https://www.prnewswire.com/news-releases/simon-expands-structured-investment-platform-with-six-new-investors-300762379.html.

14 See iCapital, 'iCapital® Completes Acquisition of SIMON Markets' (press release dated 2 August 2022): https://www.businesswire.com/news/home/20220802005408/en/iCapital%C2%AE-Completes-Acquisition-of-SIMON-Markets.

15 See Luma Financial Technologies, 'Navian Capital, Bank of America Merrill Lynch and Morgan Stanley Launch Open Architecture Online Platform for Structured Products and Annuities' (press release dated 31 July 2018): https://www.businesswire.com/news/home/20180731005692/en/Navian-Capital-Bank-of-America-Merrill-Lynch-and-Morgan-Stanley-Launch-Open-Architecture-Online-Platform-for-Structured-Products-and-Annuities.

16 See Luma Financial Technologies, 'Luma Financial Technologies Confirms Funding from TD Bank Group and CIBC to Streamline Access to Structured Product Marketplace' (press release dated 11 May 2022): https://www.bloomberg.com/press-releases/2022-05-11/luma-financial-technologies-confirms-funding-from-td-bank-group-and-cibc-to-streamline-access-to-structured-product-marketplace.

17 See Halo Investing, 'Key Private Bank Selects Halo Investing for Access to Structured Notes Program' (press release dated 13 March 2023): https://www.globenewswire.com/en/news-release/2022/11/30/2565177/0/en/Halo-Investing-Selected-by-BMO-Wealth-Management-U-S-to-Provide-Access-to-Structured-Notes-Program.html.

need to comply with FINRA regulations. In recent years, FINRA and the SEC have been heavily focused on structured products, including sales practice, investor communications and conflicts of interest.

Know your customer and suitability

A key concern raised by the SEC and FINRA was the mis-selling of structured products by distributors. The purpose of the know your customer and suitability obligations under FINRA Rules 2090 and 2111 is to ensure robust investor protection and promote fair dealing and ethical sales practices.

FINRA Rule 2090 (Know Your Customer) requires firms to use reasonable diligence, in regard to the opening and maintenance of every account, and to know the essential facts concerning every customer.[18] The know-your-customer obligation arises at the beginning of the customer–broker relationship and does not depend on whether the broker-dealer has made a recommendation.

FINRA describes suitability obligations as 'critical to ensuring investor protection and promoting fair dealings with customers and ethical sales practices'.[19] FINRA Rule 2111 (Suitability) requires that a member have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member to ascertain the customer's investment profile.[20] The rule provides that a customer's investment profile 'includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs [and] risk tolerance', along with other information. FINRA Rule 2111 contemplates three main suitability obligations:

a reasonable basis suitability: a broker-dealer must perform reasonable diligence to understand the nature of the recommended security or investment strategy involving a security or securities, as well as the potential risks and rewards, and determine whether the recommendation is suitable for at least some investors based on that understanding;

b customer-specific suitability: a broker-dealer must have a reasonable basis to believe that a recommendation of a security or investment strategy involving a security or securities is suitable for the particular customer based on the customer's investment profile; and

c quantitative suitability: a broker-dealer who has control over a customer account must have a reasonable basis to believe that a series of recommended securities transactions, taken together, are not excessive. Quantitative suitability was FINRA's attempt to codify its position against excessive trading.

On 5 June 2019, the SEC adopted Regulation Best Interest under the Securities Exchange Act of 1934 (the Exchange Act). Regulation Best Interest establishes a 'best interest' standard of conduct for broker-dealers and associated persons, when they make a recommendation to

18 See FINRA Regulatory Notice 11-02.

19 Financial Industry Regulatory Authority, Inc, 'Suitability': https://www.finra.org/industry/suitability (accessed 31 July 2019).

20 See FINRA Regulatory Notices 12-55, 12-25 and 11-25.

a retail customer of any securities transaction or investment strategy involving securities.[21] Among other things, Regulation Best Interest incorporates and enhances principles that are also found in FINRA Rule 2111 (Suitability). To provide clarity over which standard applies, FINRA has amended its suitability rule on 30 June 2020 to clarify that Rule 2111 does not apply to recommendations that are subject to Regulation Best Interest.[22]

Investor communications

FINRA Rule 2210 governs investor communications by registered broker-dealers and associated persons. The Rule sets forth requirements for content, approval, review, recordkeeping and filing of communications with FINRA.

FINRA Rule 2210 defines three categories of communications:

a retail communication: any written (including electronic) communication that is distributed or made available to more than 25 retail investors within any 30 calendar-day period. A retail investor is any person other than an institutional investor, regardless of whether the person has an account with the firm;

b correspondence: any written (including electronic) communication distributed or made available to 25 or fewer retail investors within any 30 calendar-day period; and

c institutional communication: any written (including electronic) communication that is distributed or made available only to institutional investors but does not include a firm's internal communications. Institutional investors include various financial institutions, government entities, FINRA members, registered investment advisers, and a person or entity with assets of at least US$50 million.[23]

Unless an exclusion applies, retail communications concerning any registered structured products must be filed with FINRA's Advertising Regulation Department within 10 business days of first use or publication. Prospectuses, preliminary prospectuses, offering circulars, free writing prospectuses and similar documents that have been filed with the SEC or any state and similar offering documents concerning securities offerings that are exempt from SEC and state registration requirements are exempted from the filing requirements.

An appropriately qualified registered principal must approve each retail communication before the earlier of use or filing with FINRA. A broker-dealer must establish appropriate written procedures for the review of institutional communications by an appropriately qualified registered principal.

In addition, pursuant to FINRA Rule 2210 and related FINRA guidance:

a communications must be based on principles of fair dealing and good faith, be fair and balanced and provide a sound basis for evaluating the facts;

21 See US Securities and Exchange Commission, 'SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Financial Professionals' (press release dated 5 June 2019) and SEC release No. 34-86031 dated 5 June 2019.

22 See FINRA Regulatory Notice 20-18.

23 Financial Industry Regulatory Authority, Inc, 'What and When to File with Advertising Regulation': https://www.finra.org/rules-guidance/key-topics/advertising-regulation/chart (accessed 10 September 2019).

b no member may make any false or misleading statement or claim in any communication or publish, circulate or distribute any communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading;

c members must ensure that statements are clear and not misleading within the context in which they are made and that they provide balanced treatment of risks and potential benefits; and

d backtested data (e.g., hypothetical retrospective simulation data for an index) is generally prohibited.

Regulation Best Interest

As noted above, the SEC adopted Regulation Best Interest on 5 June 2019, which imposes a new standard of conduct for registered broker-dealers that will enhance the standard of conduct beyond the existing suitability obligations imposed by FINRA regulations. Regulation Best Interest became effective on 30 June 2020.

Specifically, Regulation Best Interest requires that a broker-dealer and its associated persons who are natural persons when making a recommendation, including a recommendation of structured products, must act in the retail customer's best interest and not place its own interests ahead of the customer's interests. To satisfy this best interest obligation, a broker-dealer must satisfy each and every one of the following four component obligations:

a disclosure obligation: a broker-dealer, before or at the time of the recommendation, must provide the retail customer, in writing, full and fair disclosure of all material facts as to the scope and terms of its relationship with the retail customer and all material facts relating to conflicts of interest that are associated with a recommendation;

b care obligation: a broker-dealer must exercise reasonable diligence, care and skill in making the recommendation. The care obligation is modelled after the concepts of reasonable-basis suitability, customer-specific suitability and quantitative suitability, but under a higher best interest conduct standard than the existing requirements under FINRA regulations;

c conflict of interest obligation: a broker-dealer must establish, maintain and enforce policies and procedures reasonably designed to identify, monitor and mitigate (or eliminate, if possible) conflicts of interest; and

d compliance obligation: a broker-dealer must establish, maintain and enforce policies and procedures reasonably designed to achieve compliance with Regulation Best Interest.

The SEC does not define best interest. Instead, whether a broker-dealer has acted in a retail customer's best interest is based on an objective assessment of the facts and circumstances of how the broker-dealer has satisfied the four component obligations of Regulation Best Interest at the time the recommendation is made. The best interest standard does not necessarily obligate a broker-dealer to recommend the least expensive security or investment strategy, so long as the broker-dealer can show that it satisfies the four component obligations of Regulation Best Interest.

Regulation Best Interest only applies when a broker-dealer makes a recommendation to a retail customer, which is defined as a natural person, or the legal representative of such person, who receives a recommendation for any securities transaction or investment strategy and uses the recommendation primarily for personal, family or household purposes. Unlike the FINRA definition of retail investor, the term retail customer includes only natural persons

acting for personal, family or household purposes, regardless of wealth or sophistication. In addition, Regulation Best Interest will not apply when the natural person is represented by professional representatives such as broker-dealers, registered investment advisers or other similar fiduciaries. Therefore, distributors who sell structured products directly to broker-dealers or registered investment advisers, rather than retail customers, will not be subject to Regulation Best Interest.

The SEC explicitly stated that it does not intend for Regulation Best Interest to create a new private right of action. Under certain circumstances, Regulation Best Interest may provide, however, a new basis for investors to bring claims of fraud against broker-dealers. To protect investors, broker-dealers are not permitted to contract out of Regulation Best Interest.

Shortly after Regulation Best Interest was adopted, the attorneys general of seven states and the District of Columbia and an organisation of investment advisers initiated litigation against the SEC seeking to strike down Regulation Best Interest on the grounds that the SEC exceeded its statutory authority under the Dodd-Frank Act. The 2nd US Circuit Court of Appeals upheld Regulation Best Interest in a unanimous decision in June 2020 by finding that the Dodd-Frank Act grants the SEC broad rule-making authority, and Regulation Best Interest falls within the discretion granted to the SEC by Congress.

At the state level, legislators and regulators in several states are working towards imposing fiduciary duties and more stringent broker-dealer conduct standard. The SEC does not affirm in the final release that the Regulation Best Interest would pre-empt any standards under state law that are inconsistent with SEC regulation. Instead, the SEC states that the pre-emptive effect of Regulation Best Interest on any state law governing the relationship between broker-dealers or investment advisers and their customers would be determined in future judicial proceedings based on the specific language and effect of that state's law.

DOL Fiduciary Rule

Beyond the suitability obligations imposed by FINRA regulations and the best interest obligation imposed by Regulation Best Interest, structured products sales practices where parties provide investment advice with respect to assets of employee plans or individual retirement accounts (IRAs) may also be subject to the fiduciary obligation imposed by the US Department of Labor Fiduciary Rule under the Employee Retirement Income Security Act of 1974.

From its original form dating back to 1975, the DOL Fiduciary Rule has changed over time amidst an evolving regulatory landscape and interest in investor protection. In 1975, the DOL first promulgated a definition of 'investment advice' for the purposes of determining when financial institutions and their investment professionals would be viewed as providing fiduciary investment advice with respect to assets of employee plans or IRAs (the Original Fiduciary Rule). Pursuant to the Original Fiduciary Rule, a party would be viewed as providing fiduciary investment advice only upon the satisfaction of all five elements of the following test, which required that the advice:

a pertain to the purchase, sale or value of securities or other property;

b be provided on a regular basis;

c be provided pursuant to a mutual agreement, arrangement or understanding between the provider of the advice and the plan, plan fiduciary or IRA owner;

d would, pursuant to the mutual understanding, serve as a primary basis for investment decisions with respect to assets of the plan or IRA; and
e would be individualised to the particular needs of the plan or IRA.

In 1996, the DOL issued an Interpretive Bulletin that clarified that the provision of various forms of investment education materials and tools to assist individuals in the investment and management of their retirement assets would not constitute the provision of fiduciary investment advice (Investment Education Bulletin). The Investment Education Bulletin acted as a carve-out to the Original Fiduciary Rule.

Decades later, in 2016, the DOL adopted revised rules that significantly broadened the circumstances in which parties would be viewed as providing fiduciary investment advice and also repealed the Investment Education Bulletin (the 2016 Fiduciary Rule). The 2016 Fiduciary Rule was accompanied by two new prohibited transaction class exemptions, the best interest contract exemption and the principal transactions exemption, which were intended to assist financial institutions and their investment professionals navigate the broadened definition of 'investment advice'. However, the 2016 Fiduciary Rule was challenged by various financial industry groups, including broker-dealers who were concerned that the 2016 Fiduciary Rule could discourage the sale of commission-based structured products through retirement channels. In March 2018, the Fifth Circuit vacated the 2016 Fiduciary Rule and its related exemptions, concluding that the DOL had overreached its authority and acted in an arbitrary and capricious manner in violation of the Administrative Procedure Act. Subsequently, in June 2018, the Fifth Circuit issued a mandate, making its opinion effective and returning the entire regime to the status quo of the Original Fiduciary Rule. In the interim, the two related exemptions were preserved by the DOL in May 2018 through a Field Assistance Bulletin meant to accommodate financial institutions that had already devoted significant resources to complying with such exemptions and that might prefer to continue relying on them.

Then, in June 2020, the DOL proposed formally reinstating the Original Fiduciary Rule and also proposed a new prohibited transaction class exemption. Accordingly, on 18 December 2020, the DOL issued a final rule (the 2020 Fiduciary Rule) that went effective on 16 February 2021. The 2020 Fiduciary Rule not only reinstated the Original Fiduciary Rule, but did so in a way that modestly reinterpreted the Original Fiduciary Rule's five-part test. The 2020 Fiduciary Rule provides new guidance on rollover advice and other matters. In addition, the new prohibited transaction class exemption (PTE 2020-02) permits financial services companies to: (1) receive compensation while acting as investment advice fiduciaries, including in connection with offering advice on individual retirement account rollovers; and (2) execute 'riskless' and certain other principal trades for retirement assets to which they act as investment advisers, if the fiduciaries comply with 'impartial conduct' standards and satisfy certain other requirements. Although the current administration allowed the 2020 Fiduciary Rule to go effective, the DOL may propose yet another iteration. According to its Spring 2021 Regulatory Agenda, the DOL plans to rewrite the definition of 'fiduciary', with the notice of rule-making expected to be issued by December 2021.

iii New product approval and post-sale review

Published in October 2013, the stated objective of FINRA's Report on Conflicts of Interest (Conflicts Report) was to focus on firms' approaches to identifying and managing conflicts in three critical areas: firms' enterprise-level frameworks to identify and manage conflicts of interest; approaches to handling conflicts of interest in manufacturing and distributing new financial products; and approaches to compensating their associated persons, particularly those acting as brokers for private clients.

The Conflicts Report specifically addresses broker-dealers' obligations in identifying and managing conflicts in manufacturing and distributing new structured products. The key practical takeaway from the Conflicts Report for structured products is the need for firms to be on the lookout for situations in which they or one of their affiliates plays a role in connection with an offering that may give rise to potential conflicts, for example, acting as an index sponsor or calculation agent, and consider how to minimise and appropriately disclose any such potential conflict. The Conflicts Report noted a number of effective practices issuers and broker-dealers can adopt to address the conflicts of interest that a new product may present, including using new product review committees to identify and mitigate conflicts and performing post-launch reviews of new products to identify potential problems with a product that may not have been readily apparent during the initial review.

Historically, most issuers of structured products in the United States relied on one or more of their affiliated broker-dealers to distribute their products. More recently, the open architecture model has become more prevalent. Under this model, broker-dealers that are not affiliated with the issuer may distribute the issuer's products. Among other things, this model allows broker-dealers to offer their clients structured products issued by a number of different issuers, thereby avoiding giving their clients concentrated exposure to the credit risk of one issuer or a small number of issuers. The open architecture model is also particularly important for foreign issuers that may not have a sales force in the United States to assist in distributing their products.

The Conflicts Report encouraged issuers, as product manufacturers, to take responsibility for how products, particularly complex products, are distributed to investors by implementing effective KYD policies to assess potential distributors' sales practices, marketing strategies, registered representative training, investor education, compliance culture and customer base. Market participants use KYD policies and procedures to assess potential distributors of structured and complex products, which FINRA says helps 'mitigate the incentive to increase revenue from product sales by using distribution channels that may not have adequate controls to protect customers' interests'.[24] According to FINRA in the Conflicts Report, effective KYD practices include:

a conducting background checks on the distributor and relevant employees;

b reviewing the financial soundness of the distributor;

c requiring distributors to complete a detailed questionnaire to help the manufacturer assess a distributor's sales practices, marketing strategy, registered representative training, investor education, compliance culture, product classification, trade review and sign-off process and distribution strength;

24 Financial Industry Regulatory Authority, Inc, 'Report on Conflicts of Interest': https://www.finra.org/sites/default/files/Industry/p359971.pdf (accessed 31 July 2019).

d interviewing a distributor to develop an understanding of the firm's:
- compliance culture;
- experience, particularly with more complex products; and
- capability and willingness effectively to discharge its suitability obligations;

e obtaining information about a distributor's customer base;

f reviewing a distributor's relevant compliance manuals, written supervisory procedures and other relevant materials;

g reviewing and approving the distributor through a cross-functional committee;

h reviewing sub-distributors and sub-dealers annually; and

i requiring distributors and sub-distributors to sign an agreement committing to ensure adherence to the relevant rules and regulations (such as suitability and due diligence).

FINRA's guidance with respect to complex products is discussed in Section VI.i.

IV EXCHANGE LISTING AND TRADING

i Exchange-traded notes generally

Exchange-traded notes (ETNs) raise special legal and regulatory considerations in the United States. The term ETNs is commonly used to refer to exchange-listed notes that are linked to an underlying index or asset, offered on a continuous basis and subject to daily or weekly redemption at the investor's option. These features distinguish notes referred to as ETNs from ordinary debt securities that are listed on an exchange; the latter two features also distinguish ETNs from ordinary structured notes that are listed on an exchange.

ETNs are typically offered on a continuous basis, which means that the issuer or its broker-dealer affiliate continuously stands ready to issue and sell the ETNs to meet market demand. The price at which the issuer or its broker-dealer affiliate would be willing to sell the ETNs is typically based on their indicative value. The indicative value of a series of ETNs is determined in a formulaic manner based on the value of the ETNs' underlying index or asset at the time of determination, and is the amount the issuer would be required to pay on the ETNs if the payment at maturity or upon early redemption were determined at that time. The willingness of the issuer or its broker-dealer affiliate to issue and sell ETNs at their indicative value, combined with the right of an investor to cause the issuer to redeem the ETNs at their indicative value, is expected to ensure (through the creation of arbitrage opportunities) that the trading price of the ETNs on the exchange tracks their indicative value, which the issuer publishes on a real-time basis throughout the trading day. However, the trading price of a series of ETNs on the exchange is determined by supply and demand, and there is no guarantee that their trading price will closely track their indicative value.

ii Disclosure

The unique features of ETNs raise special disclosure considerations. Issuers typically include prominent disclosure about the fact that the indicative value of an ETN is not the same as its trading price on the exchange and that there is no guarantee that an investor will be able to buy or sell the ETNs at their indicative value in the secondary market. Although an investor has the right to cause the issuer to redeem the ETNs at their indicative value, the investor must typically submit at least a specified minimum number of ETNs to exercise that right; an investor owning less than the minimum number must therefore look only to the secondary

market for liquidity. ETN prospectuses also typically caution that the issuer may suspend sales of the ETNs at any time, which may cause a premium to develop, and then restart sales, which may cause the premium to collapse.

Market participants sometimes use terminology from the ETF context with respect to ETNs, referring to a new issuance of an ETN as a 'creation' and to the indicative value of an ETN as its 'NAV'. Like ETFs, ETNs offer exposure to an underlying index or asset, with continuous creations and redemptions and the liquidity of an exchange-traded product. Unlike ETFs, however, ETNs do not represent an ownership interest in any underlying assets, but rather are unsecured debt obligations of the issuer. The SEC has advised ETN issuers that their disclosures should avoid using terminology (such as referring to a unit of an ETN as a share) that would suggest that the investor is purchasing an equity interest in an ETF, rather than an unsecured debt security.

iii Leveraged ETNs

Some ETNs offer leveraged exposure to their underlying index or asset. That leverage may be reset daily, monthly or at some other interval. Leveraged ETNs present heightened risks as compared to otherwise similar unleveraged ETNs. Some leveraged ETNs, especially those for which the leverage is reset daily, are not meant to be held for more than one day and may be expected to lose value over time regardless of the directional performance of the underlying index or asset. FINRA has issued a special regulatory notice reminding broker-dealers of their sales practice obligations in connection with leveraged ETNs, including the obligations to ensure that recommendations to customers are suitable and based on a full understanding of the terms and features of the product recommended; that sales materials are fair and accurate; and that adequate supervisory procedures are in place to ensure that these obligations are met. In 2018, the SEC brought an enforcement action against a broker-dealer for unsuitable recommendations of leveraged ETNs that were intended only for short-term trading, but that were sold to investors who incurred significant losses after holding them for an extended period of time.

iv Regulation M

Common terms and practices with respect to ETNs require relief from certain US regulatory requirements, most saliently Regulation M under the Exchange Act. Regulation M is an anti-manipulation regulation that, subject to certain exemptions, prohibits an issuer, distribution participant and their respective affiliated purchasers from bidding for or purchasing any security that is the subject of a distribution until after the completion of the distribution. ETNs are in continuous distribution and, at the same time, are continuously purchased by the issuer or its broker-dealer affiliate. Absent relief or an available exemption, the purchase of the ETNs at a time when they are in distribution would violate Regulation M.

In 2006 and 2007, the staff of the SEC issued a series of no-action letters advising that it would not recommend enforcement action under Regulation M in connection with the ETNs described in those letters. The principal bases for the staff's no-action position were the representations of the issuers that the ETNs were redeemable at the option of the holder on a daily or weekly basis and that the secondary market price of the ETNs should not vary substantially from the value of the relevant underlying indices. At the time of listing a new

series of ETNs, the issuer is typically required to affirm to the relevant exchange that the new ETNs comply with these no-action letters, which requires the issuer to determine that the ETNs are substantially similar in relevant respects to the ETNs described in the letters.

v Exchange listing rules

To be listed on a US national securities exchange, an ETN must meet the requirements for listing set forth in the rules of the exchange. Many US national securities exchanges have generic listing standards that permit the listing of an ETN so long as those standards are met. The NYSE Arca, for example, has generic listing standards that permit the listing of notes linked to an equity index, commodity or commodity futures, currency, bond index, certain futures or a combination of those underlyings, subject to the satisfaction of certain criteria generally applicable to the issuer of the ETNs and the ETNs themselves, as well as criteria specific to the ETNs' underlying index or asset.

The NYSE Arca's generally applicable criteria include requirements that:

a the issuer of the ETNs meet certain minimum asset and tangible net worth tests and be in compliance with certain corporate governance requirements;

b the ETNs be redeemable at the option of the holders on at least a weekly basis, or else have a minimum number of publicly held units, and either have a minimum number of holders or be traded in US$1,000 denominations;

c the ETNs have a minimum principal amount or market value outstanding of US$4 million;

d the ETNs be non-convertible debt securities with a minimum term of one year and a maximum term of 30 years; and

e the ETNs may not provide for a loss or negative payment at maturity that is accelerated by a multiple that exceeds three times the performance of the underlying index or asset.

The NYSE Arca's underlying-specific criteria vary depending on the type of underlying index or asset. The criteria for an underlying equity index, for example, relate to the concentration of the index in any single issuer, the market capitalisation and trading liquidity of the component stocks and whether the component issuers are domestic or foreign.

If an ETN does not fall within the generic listing standards of an exchange, the exchange may submit a Rule 19b-4 filing to the SEC, requesting that the SEC approve a new exchange listing rule permitting the listing of the particular ETNs in question.

vi Day 20 formula pricing in cash tender offer for ETNs

A tender offer is an offer, typically made by an issuer, to purchase all or a portion of its outstanding debt or equity securities for consideration that may be cash, securities or a combination of both.[25] Rule 14e-1 under the Exchange Act lays out certain requirements to prevent unlawful tender offer practices. These requirements include, but are not limited to, keeping a tender offer open for at least 20 business days after notice of its commencement and keeping a tender offer open for at least 10 business days after notice of an increase or decrease in the consideration offered. In addition, Section 14(e) of the Exchange Act prohibits any

25 The term 'tender offer' has not been defined in any SEC Rule or other statutory provision. The staff of the SEC and the courts consider various factors to make such determination. The definition provided above is a general one for purposes of the subsequent discussion.

person from omitting to state any material fact necessary to make the statements made in connection with a tender offer, in light of the circumstances under which they were made, not misleading.

However, tender offers of structured products (including ETNs) raise unique pricing issues. For instance, using a fixed purchase price announced at the commencement of the tender offer or revised at least 10 business days before the expiry of such tender offer (Day 10 pricing) would not be consistent with the valuation method for structured products, whose values may fluctuate wildly based on the performance of the underlying assets on the relevant trading day. Accordingly, Day 10 pricing would not capture any increase or decrease in the levels of the underlying assets in the last 10 business days of the tender offer, and the issuer would need to increase the purchase price to induce holders to tender or decrease the purchase price to avoid overpaying. Such adjustments to the purchase price would require multiple extensions of the tender offer, making it extremely difficult to complete the tender offer in a short period of time.

The SEC considered a similar pricing issue for cash tender offers of convertible debt securities and has granted no-action relief since 2009 to allow issuers of convertible debt securities to determine the purchase price on the expiry date of the tender offer (Day 20 pricing).[26] Such no-action relief with respect to Day 20 pricing was recently expanded to apply to ETNs. On 28 May 2020, the staff of the SEC granted no-action relief to Barclays Bank PLC (Barclays) with respect to a proposed cash tender offer to purchase its outstanding iPath® MSCI India Index ETNs (India ETNs) for a purchase price to be determined on the expiry date of the tender offer, calculated in a formulaic manner based on the closing level of the underlying index on such expiry date.[27] The incoming letter to the SEC argued that because Barclays would announce the actual pricing formula upon the commencement of the tender offer and describe the precise manner in which the purchase price would be calculated in the offering memorandum, the proposed tender offer would not violate Rule 14e-1(b) or Section 14(e) under the Exchange Act. In addition, the letter reasoned that holders of the India ETNs would expect to receive a purchase price determined using the same valuation method for the India ETNs at maturity or upon early redemption by referencing the closing level of the underlying index on the relevant trading day, and therefore, it would be appropriate to calculate the purchase price in a manner consistent with the single-trading-day valuation method at maturity or upon early redemption of the India ETNs.

In light of the SEC's grant of no-action relief to Barclays with respect to the India ETNs, those contemplating tender offers of ETNs or other structured products need not be bound by the impracticality of Day 10 pricing. Instead, with such precedent in place, greater pricing flexibility for structured products may be possible in cash tender offers within the confines of the overall regulatory scheme.

vii Recent enforcement action

In May 2021, the SEC announced a settled enforcement action against an index provider in connection with an index it had licensed for use as an underlier for certain ETNs. The SEC alleged that the index provider failed to disclose that the index in question contained an 'auto

26 See, for example, the letters for Thermo Fisher Scientific Inc (13 November 2009), Textron, Inc (7 October 2011), CNO Financial Group, Inc (11 February 2013), Group 1 Automotive, Inc (16 May 2014) and GenCorp Inc (19 December 2014).

27 See the letter for Barclays Bank PLC (28 May 2020).

hold' feature, a quality control feature pursuant to which its real-time calculation would be suspended during times of extreme volatility. In February 2018, the index in question experienced a high degree of volatility, triggering the 'auto hold' and resulting in a temporary freezing of the index level at a level that did not represent the real-time value that would have been calculated absent the 'auto hold'. According to the SEC, because the 'auto hold' was not disclosed, investors buying and selling the linked ETNs were not aware that the published index level was not accurate. In announcing this action, the SEC stated that an index provider that licenses an index for use in the issuance of securities has an obligation to ensure that disclosures about the important features of the index are materially accurate.

viii Recent market events and considerations for oil ETNs

The volatility caused by the covid-19 pandemic had a significant impact on structured products that provide exposure to oil markets. The decline in demand for oil as a result of the lockdowns related to covid-19, together with rising global oil supply and diminished storage capacity, resulted in record low crude oil prices. The West Texas Intermediate (WTI) crude oil futures contracts for May 2020 delivery fell into negative territory for the first time ever, settling at negative US$37.63 per barrel shortly before expiry – meaning sellers were willing to pay buyers to take barrels off their hands. The next day, the WTI crude oil futures contracts for June 2020 delivery fell 43 per cent to close at US$11.57 per barrel. Due to these extraordinary events in the crude oil market, structured products that provide exposure to oil experienced significant volatility, problems with valuation and issues with commodity index calculations. For example, with respect to ETNs, this volatility caused dislocation between the trading price of the ETNs and their indicative value – often resulting in the ETN trading at a premium above its indicative value. In addition, some issuers had to redeem the ETNs affected by negative underlying values or find alternative ways to hedge such ETNs. Such redemption or hedging adjustment required careful planning by the issuers ahead of time to avoid any legal or regulatory issues down the road.

In response to the decline in oil demand and oil prices, FINRA released a notice on 15 May 2020 to its members regarding exchange-traded products (ETPs) (which includes ETNs) that provide exposure to oil markets. The FINRA notice warned that some investors may not understand oil-linked ETPs' investment objectives, including the difference between the futures price and the spot price and the impact of rolling. The FINRA notice 'reminds firms of their sales practice obligations in connection with oil-linked ETPs, including that recommendations to customers must be based on a full understanding of the terms, features, and risks of the product recommended; communications with the public must be fair and accurate; firms must have reasonably designed supervisory procedures in place to ensure that these obligations are met; and firms that offer oil-linked ETPs must train registered representatives who sell these products about the terms, features and risks of these products'.[28]

More recently, oil prices have continued to be very volatile and have increased significantly, in part as a result of disruptions in the supply of oil resulting from Russia's further invasion of Ukraine and inflation. These developments are discussed in more detail in Section VI.v.

28 See FINRA Regulatory Notice 20-14.

V TAX CONSIDERATIONS

i General overview

The US taxation of structured products is a grey area built on a skeletal framework of statutes and case law, fleshed out only in part by regulations and other regulatory guidance. Although the framework and regulatory authorities establish certain basic principles regarding the treatment of structured products generally and address the treatment of certain products with a higher level of detail, the Internal Revenue Service (IRS) has not issued tailored guidance on the tax treatment of many of the structured products most commonly offered. Because of the lack of certainty concerning the proper treatment of many popular products, tax practice in the area is frequently characterised by careful analysis of the economics of a particular structure and rigorous analogy to the most similar financial instruments for which there is clear treatment under the law. In ambiguous cases, practitioners commonly tend towards more conservative treatments that are less likely to be challenged by the IRS, especially in light of the fact that many issuances require an opinion of tax counsel as to their treatment.

For US investors, the fact that there will be a recognition event at some point during the term of the investment, at which time income, gain or loss will be recognised, is a foregone conclusion with respect to most investments. Thus, the critical tax issues for US investors are the timing and character of income, gain, loss or deduction. US investors generally will prefer not to recognise gain until maturity (or until disposition, if they dispose of the instrument prior to maturity) and will prefer to recognise long-term capital gain rather than ordinary income. The benefits of capital versus ordinary treatment are twofold. First, capital losses can only be used to offset income other than capital gain in limited circumstances. Therefore, taxpayers with capital losses generally prefer that their gains be capital to allow them to utilise the capital losses. Second, for individual taxpayers, long-term capital gains are taxed on the federal level at a lower rate (currently, at a maximum rate of 20 per cent) than ordinary income (currently, at a maximum rate of 37 per cent). Thus, the tax impact to a US investor can differ significantly depending on whether the structure allows for deferral of income recognition and whether tax items in respect of the investment are ordinary or capital.

For a non-US investor, the primary focus from a US tax standpoint is whether the investor will be subject to US withholding on payments received pursuant to the investment (assuming the income or gain from the investment is not effectively connected with a US trade or business conducted by the investor) or whether it can benefit from an exemption as a result of the characterisation of the particular type of payment in question. This will be a gating question for many non-US investors who will not consider investing in an instrument that will result in US tax. Hence, the tax characterisation of a particular structured product, if the issuer is a US entity or is engaged in a US trade or business, is of critical importance for a non-US investor as well.

ii Distinction between debt and non-debt

Debt

The tax analysis of any structured product begins with the question of whether the product is treated as debt for tax purposes. Surprisingly, there is no general statutory or regulatory definition of what constitutes debt; the governing framework is rather a nebulous body of case law and IRS guidance. Under this framework, the most prominent feature of a debt instrument is an investor's right to receive (at a minimum) a fixed amount of money roughly equal to the investor's initial investment at some definite point in the foreseeable future,

commonly referred to as principal protection. Regular coupon payments, limited upside participation in the issuer, creditor enforcement rights and a lack of voting rights are other significant identifying features of debt. For many structured products, however, the deciding, and often sole, debt-like feature is the existence of principal protection with concomitant creditor rights. However, the threshold percentage of the principal amount that needs to be protected in order for an instrument to be considered debt is unclear. Market practice is generally to treat anything that is at least 90 per cent principal protected as debt. Notes with less than 80 per cent protection descend into an ambiguous netherworld in which practitioners often conclude that they cannot provide much comfort that an instrument will be respected as debt.

If an instrument is treated as debt, then a US investor is required to recognise ordinary interest income throughout the term of the instrument, and the issuer will generally be able to take interest deductions (subject to certain exceptions beyond the scope of this publication). Any stated interest on an instrument treated as debt that is payable at least annually at a single fixed rate (qualified stated interest) generally is taxable to a US investor at the time it accrues or is received, in accordance with the US investor's method of accounting for US tax purposes. If a debt instrument provides for any stated interest that does not meet the requirements described above or the debt instrument is issued at a discount, the excess of the total payments on the instrument that are not qualified stated interest over the issue price of the instrument is treated as accruing over the term of the instrument for tax purposes (subject to a *de minimis* exception). This excess is included in income by a US investor as original issue discount (OID) as it accrues, in accordance with a constant-yield method based on a compounding of interest. When a note is publicly traded and is subject to OID accrual, the issuer will file an IRS Form 8281 to inform the IRS that the note is subject to accrual of OID. The IRS periodically publishes a list of notes with OID and their required accruals online.

Subject to the discussion below concerning contingent payment debt instruments (CPDIs), gain or loss recognised by a US investor on the sale or other taxable disposition of an instrument treated as debt generally is treated as capital gain or loss and generally is long-term capital gain or loss if at the time of the sale or other taxable disposition the instrument has been held by the US investor for more than one year.

Debt instruments that provide for a variable rate of interest are subject to special rules. If the instrument provides for payment of interest at least annually at one or more floating rates that can be reasonably expected to measure variations in the cost of borrowing in the currency of the instrument's denomination (a qualified floating rate), an objective rate that uses a single, fixed formula based on objective economic information (an objective rate), or a combination of a single fixed rate and one or more qualified floating rates, it will generally be treated as a variable rate debt instrument (VRDI). VRDIs are generally subject to the same rules governing OID described above, but OID accruals will also be required when a VRDI provides for payment at two or more rates over its term with sufficient discrepancy between them to result in non-*de minimis* OID.

If an instrument that provides for a variable rate does not qualify as a VRDI, or if an instrument otherwise provides for a contingent payment that is not remote or incidental and is not subject to certain enumerated exceptions in the relevant Treasury regulations, then it generally will be subject to the regulations governing CPDIs. These regulations require accrual of interest income based upon a projected payment schedule, which must produce a yield equal to the issuer's comparable yield (the yield at which the issuer would issue a fixed rate debt instrument with terms and conditions similar to those of the CPDI) and is

determined at the time of issuance of the instrument. The rules provide for positive or negative adjustments to the amount of income or deductions attributable to the debt instrument in a taxable year for any differences between projected and actual contingent payments. In addition, any income on the sale, exchange, retirement or other taxable disposition of the instrument is treated as ordinary interest income rather than as capital gain. Accordingly, the qualification of a note as a VRDI and not as a CPDI can be particularly important.

Open transactions (non-debt)

Even if it is relatively clear that a structured product is not debt, there remains a question as to how the product is to be treated for tax purposes. Although perhaps the most familiar contrast to debt is equity, structured products generally do not contain features emblematic of an equity investment. Structured products generally do not provide the investor with any upside or downside economic exposure to the issuer (other than to the issuer's credit risk) or give the investor any governance rights with respect to the issuer. Moreover, structured products have a limited term rather than an indefinite one. Thus, instruments that are not debt most commonly fall into the broader category of what are known as open transactions. Open transactions are transactions where the amount of gain or loss is calculated when the investment is closed out. The purchase of a cash-settled option is the quintessential example of an open transaction. Because whether the taxpayer recognises an economic gain or loss on the contract depends on whether, and the extent to which, the amount to be received upon disposition, lapse or settlement is in excess of the premium paid for the option, the taxpayer does not recognise a loss at the time it makes a premium payment. Rather, the recognition event is deferred until the time that the gain or loss on the investment can be more fully ascertained.

While the Internal Revenue Code (the Code) and the regulations promulgated thereunder provide rules explicitly addressing the treatment of certain kinds of open transactions (e.g., certain options and swaps), when an instrument cannot be squeezed into one of these rubrics, the character of the gain or loss at maturity or upon a taxable disposition, and the treatment of any coupons paid under the instrument, is often less clear. However, the Code provides a general framework for the treatment of gain or loss on the termination of a right or obligation that is 'with respect to property which is . . . a capital asset in the hands of the taxpayer'. Under this framework, gain or loss attributable to the cancellation, lapse, expiry or other termination of such a right or obligation is treated as capital gain or loss, and generally will be long-term capital gain or loss if the instrument was held for more than a year.

Component analysis

To further complicate the topography, there are times at which the most compelling tax treatment of an instrument is to bifurcate the instrument into its component parts and treat each component separately for tax purposes. Structured products are generally constructed from a combination of one or more derivatives and a loan. Although as a general matter, case law and other authorities suggest that components of a derivative that are not economically separable (i.e., cannot trade separately) generally should not be treated as separate instruments for tax purposes, for certain structured products where the view is that bifurcation results in an approach that best mirrors economics, market practice is to separate out these components and treat them as separately taxable.

iii Non-US investors

Certain types of US-source income of non-US investors (that is not effectively connected with the conduct of a trade or business in the United States, which generally results in the non-US investor being subject to US taxation in the same manner as a US investor) are subject to a withholding tax of 30 per cent of the gross amount paid unless a statutory or treaty-based exception applies. This withholding tax applies to interest, dividends and many other types of income, although it notably does not apply to gains from the sale or exchange of property. In the structured products context, this withholding tax commonly will not apply because:

a the income is not US-sourced;

b the income qualifies for the portfolio interest exemption (an exception applicable to many interest payments received by non-US investors who are not banks and who do not own a significant interest in the equity of the issuer); or

c the income is exempt under a treaty between the non-US investor's home country and the United States.

Non-US investors are required to verify their identity as non-US persons and their eligibility for any applicable treaty benefits to qualify for any reductions or exemptions from withholding, and generally do so by providing the relevant IRS Form W-8 to the appropriate payor.

Section 871(m) and dividend equivalents

Prior to the addition of Section 871(m) to the Code, if a non-US investor entered into a derivative transaction with another non-US person that was linked to a US equity, there generally was no US withholding required on any payments on the transaction. Thus, a non-US investor was able to enter into a derivative that replicated the economics of an investment in a US equity and was able to receive the economic equivalent of a dividend from a US company without being subject to withholding. In 2010, Section 871(m) was enacted, and along with the implementing regulations, it restricts such workarounds by assessing a 30 per cent withholding tax (or lower treaty rate) on dividend equivalent amounts paid with respect to transactions that provide non-US investors with economic exposure substantially equivalent to a direct investment in US equities. Special regulatory tests apply for determining whether instruments give rise to dividend equivalents (including a delta test for instruments with simpler payouts under which instruments with a delta of 80 per cent or more are subject to Section 871(m) withholding tax). However, the IRS has clarified that for securities issued before 1 January 2025, this withholding will not apply with respect to most instruments unless the instrument has a delta of one. (Delta is the ratio of the change in the fair market value of the instrument to a small change in the fair market value of the number of shares of the underlying security referenced by the instrument.) Most equity-linked structured products do not have a delta of one and therefore are not currently subject to Section 871(m). In addition, an exception to Section 871(m) applies for instruments linked to certain 'qualified' indices.

iv Application to common structured products

This section illustrates the principles described above by demonstrating their application to a number of common structured products.

Prepaid forwards

Prepaid forwards refer to a broad group of instruments that contemplate an upfront payment by an investor in exchange for a single payment at maturity linked to the performance of a particular reference asset (the underlier), whether physically settled or cash settled. They are commonly linked to an equity index, such as the S&P 500 or Russell 2000, or to one or more stocks. Common variants provide for downside protection in the form of a buffer[29] or a trigger,[30] a levered return with a maximum upside, or both. As long as any buffer or trigger feature is not so large as to raise the possibility of the instrument being characterised as debt, these instruments are treated as open transactions generally resulting in capital gain or loss on maturity to US investors and no interim recognition of income. However, for structured products linked to exchange-traded funds and certain other underlying equities, there may be a risk that a special rule (Section 1260) applies to deny capital gain treatment. For non-US investors, any amounts received on these instruments generally will not be subject to US withholding tax.

Non-principal protected instruments with contingent coupons

Contingent coupon instruments are instruments linked to an underlier that pay a periodic coupon to the investor if the underlier is above a minimum threshold on the relevant testing date for the coupon. An investor typically does not participate in any upside at maturity, but bears the downside risk beyond a buffer or trigger. To compensate for this risk, the coupons are usually far in excess of prevailing interest rates. While the instrument itself generally is regarded as an open transaction, generating capital gain or loss to US investors at maturity, the proper treatment of the coupons is a matter of substantial uncertainty. As an economic matter, portions of the coupons may be characterised in various ways, such as option premium, interest on a loan, or a return of principal. Out of an abundance of caution, the market has adopted the view that these coupons are treated as unspecified ordinary income when received. This treatment, in conjunction with the fact that any losses at maturity are treated as capital losses, may produce adverse tax consequences to US taxpaying investors. For non-US investors, any capital gains generally will not be subject to withholding tax. However, as a result of the uncertain nature of the coupons, withholding agents may treat any coupon as subject to withholding (unless the investor qualifies for a treaty exemption).

Fixed-coupon instruments

Instruments that provide for fixed-rate coupons and are principal protected are treated as debt, as described above under 'Debt'. Assuming that any OID is *de minimis*, the coupons are treated as interest (ordinary income), and gain or loss on disposition not attributable to interest is capital gain or loss. Non-US investors will generally be exempt from withholding on interest payments under the portfolio interest exemption.

Fixed-coupon instruments also come in non-principal-protected variations, which are linked to the performance of one or more underliers. An investor in such instruments generally

29 A buffer is a minimum percentage decline in the underlier before which the investor is not subject to loss, and thereafter, loss is incurred on a 1:1 basis on amounts below the threshold such that, for example, a buffer of 30 per cent with a decline in the underlier of 31 per cent will yield a 1 per cent loss.

30 A trigger is a minimum percentage decline before which the investor is not subject to loss, and thereafter, the entirety of the loss is 'triggered' such that, for example, a trigger of 30 per cent with a decline in the underlier of 31 per cent, will yield a 31 per cent loss.

bears the downside risk of the underlier or underliers (generally beyond a buffer or upon the tripping of a trigger) and may have no participation in the upside (reverse convertibles or reverse exchangeables) or may have limited participation in the upside (mandatory exchangeables). It is common practice to apply a component analysis to fixed-coupon instruments with no upside and to treat these instruments as a combination of a deposit by the investor with the issuer and a put option written by the investor to the issuer. A portion of each coupon payment is thus treated as interest on the deposit (determined by using the comparable interest rate the issuer would pay on similar loans) and includible in income by a US investor when accrued or received (in accordance with the US investor's method of accounting for US tax purposes), while the remaining portion is treated as premium on the put option. Under the tax rules governing options, a put premium is not taxable when received because it is unclear at that point whether the writer will ultimately have an economic gain or loss. Rather, if at maturity the underlier has not declined below any buffer or trigger and the initial investment (plus any final coupon) is returned to the investor (i.e., the put effectively expired unexercised), the total amount of premium is then taxable to a US investor as short-term capital gain. If, on the other hand, the US investor receives less than the entire initial investment, the investor recognises at maturity short-term capital gain or loss equal to the difference between the amount received at maturity (excluding any final coupon paid at maturity) plus the total put premium paid, and the initial investment amount (the deposit). The issuer generally publishes the portion of the coupon includible as interest and the portion attributable to put premium in the final disclosure accompanying the product documents.

For non-US investors, the portion of a coupon that is interest will generally qualify for the portfolio interest exemption, while any amounts that result in capital gain will generally not be subject to withholding.

When non-principal-protected fixed coupon instruments provide for some upside exposure at maturity, market practice is generally to treat the coupons as ordinary income under the same conservative approach used for contingent coupon notes described above. At maturity, if they are cash settled, a US investor recognises capital gain or loss generally equal to the difference between the initial investment and the amount received. If they are physically settled for stock, no gain or loss generally is recognised, and the investor takes the same tax basis in the stock as it had in the note. Upon disposition of the stock, the investor will then recognise capital gain or loss, as appropriate. As with non-principal-protected contingent coupon instruments, non-US investors may be subject to withholding on the coupons (unless a treaty exemption applies).

Equity-linked notes

Certain equity-linked notes are principal-protected instruments where the payment at maturity is linked to the performance of an index, a particular equity or a basket of equities. In one very common form, they are 100 per cent principal-protected and provide for no payment other than a payment at maturity reflecting the appreciation of the underlier (on a 1:1 or on a leveraged basis). Because they are principal-protected, they clearly are debt. However, as they do not provide for interest payments, but rather a contingent payment at maturity, they generally are treated as CPDIs. Accordingly, a US investor is subject to the rules governing CPDIs described above. Non-US investors generally will be exempt from withholding under the portfolio interest exemption.

v Afterword

The taxation of structured products is a nuanced field and commonly subject to some degree of uncertainty. Moreover, the relevant tax considerations may vary significantly based on an investor's particular status and circumstances. Investors for whom tax considerations are important are best advised to carefully read the tax disclosure that accompanies an investment product and to seek expert guidance on the tax consequences applicable to their particular situation.

VI OTHER ISSUES

i Issues to consider with complex products

Regulators in the United States have long had, and continue to have, a focus on product complexity. This encompasses both complex structures and complex underlying reference assets.

In the case of the SEC, on 28 October 2020, then-Chairman Clayton issued a joint statement with three division directors regarding complex financial products and retail investors. The authors noted that they believed that complex products may present investor protection issues, particularly for retail investors who may not fully appreciate the particular characteristics or risks of these investments, including the risks that holding these products may pose to their investment goals.

In the case of FINRA, Notice to Members 05-26 (New Products), published by its predecessor, the National Association of Securities Dealers (NASD), began by noting that NASD was concerned about the number of increasingly complex products being introduced to the market, some of which were described as having unique features that may not be well understood by investors and others of which were described as raising concerns about suitability and potential conflicts of interest. In describing procedures for vetting new products, NASD indicated that every firm should ask and answer, before a new product is offered for sale, whether complexity of the product in terms of structure, function or description impairs the understanding and transparency of the product and suitability considerations, or the training requirements associated with the product, or both.

In its Regulatory Notice 12-03 (Heightened Supervision of Complex Products), FINRA discussed the risks that it considered were raised by a number of different types of products, including the possibility that the product will not perform as many investors anticipate or that it might be inappropriately sold on the basis of enhanced yield, principal protection or the tracking of an index or a reference asset. According to FINRA, '[a]ny product with multiple features that affect its investment returns differently under various scenarios is potentially complex', citing as examples '[p]roducts that include an embedded derivative component that may be difficult to understand', such as 'steepener' notes and reverse convertible notes, and structured products with 'worst-of' features. FINRA says:

a the decision to recommend complex products to retail investors is one that a firm should make only after the firm has implemented heightened supervisory and compliance procedures;

b firms should rigorously monitor the extent to which these procedures address the various investor protection concerns raised by the recommendation of complex products to retail investors; and

c firms should monitor the sale of these products in a manner that is reasonably designed to ensure that each product is recommended only to a customer who understands the essential features of the product and for whom the product is suitable.

On 8 March 2022, FINRA published Regulatory Notice 22-08: FINRA Reminds Members of Their Sales Practice Obligations for Complex Products and Options and Solicits Comment on Effective Practices and Rule Enhancements. Noting that the availability of complex products and options can potentially expand the investment opportunities for retail investors, the notice highlights that important regulatory concerns arise when investors trade complex products without understanding their unique characteristics and risks. As a result, also taking into account the fact that the number of accounts trading in complex products has increased significantly in recent years, FINRA again reminded members of their current regulatory obligations, including the application of Regulation Best Interest, when broker-dealers and their associated persons make securities recommendations, and recommendations of investment strategies involving securities, to retail customers.

In addition, FINRA highlighted in its 2021 Report on FINRA's Examination and Risk Monitoring Program that, '[a]s always', it remains focused on reviewing member firms' communications relating to complex products. In its 2019 Risk Monitoring and Examination Priorities Letter, FINRA indicated that firms should expect that FINRA will review for compliance regarding its ongoing areas of focus, specifically referencing obligations related to suitability determinations, including with respect to recommendations relating to complex products. This echoes themes raised in its December 2018 Report of FINRA Examination Findings, in which FINRA noted that it had observed unsuitable recommendations involving complex products and identified, as an example of one of the sound supervisory practices for suitability that it had observed, a requirement that registered representatives receive training on specific complex or high-risk products before recommending them so that the representatives understood the products' risks and performance characteristics, as well as the types of investors for whom a product might be suitable.

An area of recent interest has been the potential issuance of structured products linked to cryptocurrencies. While there have been SEC-registered offerings of structured products linked to companies with exposure to cryptocurrency, including to Coinbase Global, Inc, which operates a trading platform for cryptocurrencies, there have not as yet been any offerings linked to any cryptocurrency.

Market participants have understood that regulators are likely to view any products linked to cryptocurrencies as warranting particular attention and focus. In a 2015 speech, Amy M Starr, Chief, Office of Capital Market Trends, encouraged market participants to speak to the SEC staff before introducing certain new or novel products.[31]

In Regulatory Notice 22-08, FINRA indicated that mutual funds and ETFs that offer strategies employing cryptocurrency futures may be considered complex, requiring careful scrutiny and supervision by FINRA members.

Recent events in the cryptocurrency arena have introduced additional uncertainty to the potential issuance of structured products linked to cryptocurrencies or cryptocurrency-related instruments. In mid-2022, a steep sell-off occurred in cryptocurrencies, including certain

31 Amy S Starr, 'Structured Products – Complexity and Disclosure – Do Retail Investors Really Understand What They Are Buying and What the Risks Are?': https://www.sec.gov/news/speech/speech-amy-starr-structured-products-.html (accessed 14 June 2023).

'stablecoins', as well as in cryptocurrency-related companies such as Coinbase, Inc. The sell-off was followed by failures of several cryptocurrency tokens, trading and lending platforms and hedge funds, including the collapse of the Bahamas-based FTX cryptocurrency exchange, its bankruptcy and the arrest of its founder on criminal and civil fraud charges in late 2022. Through various enforcement actions, the SEC has indicated that it considers many cryptocurrencies to be securities, and in 2023, the SEC brought charges against several companies operating cryptocurrency trading platforms, including Coinbase, Inc and Binance Holdings Ltd, for operating unregistered securities exchanges and other securities law violations. In a different vein, a judge in the Southern District of New York ruled in July 2023 against the SEC, in a closely watched case against Ripple Labs, that dealt a potentially significant blow to the SEC's digital asset regulatory and enforcement programme. Although the court ruled that Ripple's sales of XRP directly to sophisticated buyers amounted to investment contracts under the *Howey* test – and therefore were securities transactions under federal law – the court found that the XRP token itself is not a security. If such a ruling stands and is adopted by other US jurisdictions, the ability of the SEC to bring cryptocurrency cases will be severely undermined. Given this judicial uncertainty and the current regulatory environment and volatility in the cryptocurrency arena, market participants may be less focused on introducing SEC-registered structured products linked to cryptocurrencies or cryptocurrency-related instruments than in the past.

ii The impact of the covid-19 pandemic

The covid-19 pandemic presented unprecedented challenges to business around the globe and the structured products market was not immune to its impacts. The economic impact of the covid-19 pandemic resulted in additional risk disclosures in structured product offering documents and the resulting market volatility also caused marketing, pricing and trading issues.

In March 2020, the SEC issued guidance, which was supplemented in June 2020, regarding disclosure that companies should consider with respect to covid-19 and related business and market disruptions. As a general matter, the guidance 'encourage[s] companies to provide disclosures that allow investors to evaluate the current and expected impact of covid-19 through the eyes of management and to proactively revise and update disclosures as facts and circumstances change'.[32] Additionally, the guidance makes clear that the effects that covid-19 has had on a company, including what management believes the impact might be, how the company is planning for covid-19-related uncertainties and how management is responding, could be material information for investors. In response, many structured product issuers began to include risk disclosure in their offering documents (or in the Exchange Act filings that are incorporated by reference into the offering documents) addressing the pandemic's effect as it relates to the operations, liquidity and capital resources of the issuer. In addition, some structured product issuers have added risk disclosures to their offering documents regarding the covid-19 pandemic's impact on the underlying reference asset and the stock market in general. This type of disclosure, unlike the disclosure regarding the covid-19 pandemic's impact on the issuer's business operations, has not been universally adopted.

32 See US Securities and Exchange Commission, 'Coronavirus (COVID-19) – Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources' CF Disclosure Guidance: Topic No. 9A (dated 23 June 2020): https://www.sec.gov/corpfin/covid-19-disclosure-considerations.

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. The market volatility caused by the covid-19 pandemic caused structured product issuers to reassess the appropriate way to offer these securities, and required significant issuer and distributor efforts to appropriately price and sell structured products. For example, structured products in the United States have traditionally been offered on a monthly calendar cycle where products are launched at the beginning of the month and priced at the end of the month. During the periods of increased market volatility, it can be difficult for issuers to hold static the same pricing terms of an issuance for the entire monthly marketing period. Large market swings would typically mean that the pricing offered at the beginning of the month would be out of sync with market levels at the end of the month. As a result, many issuers moved to a weekly calendar or even shorter marketing periods in the second quarter of 2020. While volatility has declined in the US significantly from its peak in March 2020, volatility has not stabilised to pre-pandemic levels and continues to experience spikes. For example, the VIX index posted its biggest jump in two years on 27 January 2021 when it saw an increase of approximately 62 per cent, from below 25 to above 37. Again, on 26 November 2021, the VIX index spiked approximately 54 per cent. Most recently, on 25 August 2022, the VIX spiked approximately 17 per cent. While the covid-19 pandemic is much more under control as of the date of this publication, the current market climate, including the war in Ukraine, high inflation and rising interest rates have resulted in volatility continuing to experience significant fluctuations. These changes to the marketing calendar and increased effort to appropriately price these products have largely remained thus far, and time will tell whether the industry reverts to its earlier timetables or makes further changes to the way it markets these products.

iii Environmental, social and governance products

Another area of growing interest is environmental, social and governance (ESG) products. In some cases, these have taken the form of 'social' or 'green' bonds, where the proceeds are allocated to new or existing projects, or both, with social or environmental benefits (often linked to the United Nations' Sustainable Development Goals). While such instruments are often issued with a 'plain vanilla' structure, there have been SEC-registered offerings of green bonds with a structured payout. 'Social' or 'green' bonds involve the careful preparation of use of proceeds disclosure that accurately describes how the proceeds will be allocated. In addition, investors have focused on what ongoing reporting, if any, will be provided about the allocation of funds after the instrument has been issued. There is also significant market focus on 'greenwashing', which includes making misleading claims about environmental credentials or products, such as overstating the environmental benefits of a project to which funds are allocated. Allegations of greenwashing present a significant reputation risk for market participants involved in offerings of ESG products.

The SEC has continued to focus on ESG-related disclosures. For example, in May 2022, the SEC charged BNY Mellon Investment Adviser, Inc. (BNYMIA) for misstatements and omissions about ESG considerations in making investment decisions for certain mutual

funds that it managed.[33] The order found that, over a number of years, BNYMIA represented or implied that all investments in the funds had undergone an ESG quality review, even though that was not always the case, and that numerous investments held by certain funds did not have an ESG quality review score as of the time of investment. In the SEC's press release, Adam S Aderton, Co-Chief of the SEC Enforcement Division's Asset Management Unit, said that '[i]nvestors are increasingly focused on ESG considerations when making investment decisions . . . the Commission will hold investment advisers accountable when they do not accurately describe their incorporation of ESG factors into their investment selection process'.

The SEC has also focused on assessing whether investments are appropriately labelled as ESG products. For example, in November 2022, the SEC charged Goldman Sachs Asset Management, LP for failures to establish policies and procedures involving the ESG research its investment teams used to select and monitor securities for two mutual funds and one separately managed account strategy marketed as ESG.[34] In the SEC's press release, Sanjay Wadhwa, Deputy Director of the SEC's Division of Enforcement and head of its Climate and ESG Task Force, said that 'advisers . . . are increasingly branding and marketing their funds and strategies as "ESG"' and '[w]hen they do, they must establish reasonable policies and procedures governing how the ESG factors will be evaluated as part of the investment process, and then follow those policies and procedures, to avoid providing investors with information about these products that differs from their practices'. In a 2023 speech, Mark Uyeda, SEC Commissioner, noted that it can be difficult to determine what assets are truly ESG products, as asset managers are incentivised to label products as being ESG, sometimes inappropriately, in order to extract the higher management fees that ESG products typically charge compared to non-ESG products.[35] Commissioner Uyeda further explained that because ESG can mean different things, complying with the federal securities laws requires asset managers to clearly explain the nature of their ESG fund or product, with a focus on financial materiality.

There have also been offerings of structured products linked to ESG-related underlying assets, such as ESG funds and indices that have the goal of tracking the performance of companies that exhibit a commitment to certain ESG-related goals. As with any index-linked structured product, a key focus for products linked to ESG indices is the preparation of an accurate description of the index, as well as related risk factors, for inclusion in the offering documents. As these indices can involve some amount of discretion in the selection of their components, the risk factors often highlight the fact that the component selection in accordance with the index's methodology may differ significantly from alternative approaches and investor expectations.

33 See US Securities and Exchange Commission, 'SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations': https://www.sec.gov/news/press-release/2022-86 (accessed 11 August 2022).

34 See US Securities and Exchange Commission, 'SEC Charges Goldman Sachs Asset Management for Failing to Follow its Policies and Procedures Involving ESG Investments': https://www.sec.gov/news/press-release/2022-209 (accessed 12 June 2023).

35 Mark T. Uyeda, 'Remarks at the California '40 Acts Group': https://www.sec.gov/news/speech/uyeda-remarks-california-40-acts-group (accessed 12 June 2023).

iv Recent developments in benchmark reform

The impact of the LIBOR transition

The transition from LIBOR to alternative reference rates has been having a significant impact on the US structured product market as many structured products referenced LIBOR. In addition to structured products that paid an interest rate based on LIBOR, LIBOR had also effectively been used as an underlying reference asset for structured products (e.g., the payment at maturity depended on the percentage change in LIBOR over the term). Furthermore, many proprietary indices that are used as underlying reference assets for structured products had returns based on LIBOR or contained embedded costs or fees calculated by reference to LIBOR.

For legacy structured products, the contractual fallback language was typically intended to address a temporary unavailability of LIBOR, not its permanent discontinuation. For example, for interest-bearing products, the fallback language typically provided that if LIBOR was not available, the rate would be determined by reference to quotations by reference banks and, if the reference banks were not quoting, LIBOR for the relevant interest determination date would remain LIBOR for the immediately preceding interest reset period. Without a change to the terms (whether effected via holder consent or legislation), the effect of this fallback language would be that such products, which were intended to be floating rate instruments, would become fixed rate instruments, with the interest rate being fixed at LIBOR prior to its discontinuation, and no longer fluctuating based on changes in interest rates. As a result, in many cases, fallback language in legacy products might have produced unintended economic outcomes of turning an instrument that uses a floating rate to one that is effectively tied to a fixed rate. Unlike many English law-governed products, New York law-governed products typically require the consent of each holder to amend the interest rate. However, in March 2022, Congress passed legislation that included the Adjustable Interest Rate (LIBOR) Act, which expressly supersedes any provision of any state or local law, statute, rule, regulation or standard. At a high level, the legislation applies to certain contracts, securities, instruments, obligations and assets that used any of the overnight or 1-, 3-, 6- or 12-month tenors of US dollar LIBOR as a benchmark and effectively buckets contracts into three categories (after giving any effect to provisions in the legislation that generally disregard references in fallback provisions to a benchmark replacement that is based in any way on any LIBOR value or requires a poll). These categories are as follows:

a Contracts that contained no fallback provisions or contained fallback provisions that identified neither a specific benchmark replacement nor a 'determining person' (i.e., any person with the authority, right or obligation to determine a benchmark replacement). These contracts were effectively automatically changed on the LIBOR replacement date (the first London banking day after 30 June 2023) to use the 'Board-selected benchmark replacement'. This rate is a benchmark replacement identified by the Federal Reserve that is based on the Secured Overnight Financing Rate (SOFR) (in the case of structured products, CME Term SOFR), including any tenor spread adjustment.

b Contracts that contained fallback provisions that identified a benchmark replacement that is not based in any way on any LIBOR value (including the prime rate or the effective Federal funds rate). The legislation does not alter these contracts.

c The category of contracts that identified a determining person. The determining person had the authority to select the Board-selected benchmark replacement as the benchmark replacement. Importantly, the selection or use of a Board-selected benchmark replacement as a benchmark replacement (and any 'benchmark

replacement conforming changes' (as defined in the legislation)) enlivened safe harbour provisions that, among other things, generally provide that such selection or use would not discharge or excuse performance under, give any person the right to unilaterally terminate or suspend performance under, constitute a breach of, or void or nullify, the contract. The legislation does not alter any contract as to which a determining person did not elect to use a Board-selected benchmark replacement.

In addition, the legislation does not alter or impair any written agreement specifying that a contract shall not be subject to the legislation.

Structured products linked to SOFR and other alternative rates to LIBOR

SOFR has been identified by the Alternative Reference Rates Committee (ARRC) as its recommended alternative to US dollar LIBOR for certain financial contracts. SOFR is intended to be a broad measure of the cost of borrowing cash overnight collateralised by US Treasury securities. The volume of new issuances of securities, including structured products, linked to SOFR in the US market continues to grow. In addition, there has been an increase in the volume of new issuances linked to other alternative rates to LIBOR, including AMERIBOR, which is based on certain overnight unsecured loan transactions, and the Bloomberg Short Term Bank Yield Index (BSBY), which is based on certain bank funding transactions. The SEC has cautioned the market that these alternative rates may have the same flaws as LIBOR as they also may not be based upon a sufficiently robust market of underlying transactions. Accordingly, the open question in the US market is whether it will embrace a range of LIBOR replacements or consolidate around SOFR.

Constant maturity swap-linked structured products

Because most ICE Swap Rates (ISRs) were historically calculated by reference to LIBOR, the market has been focusing on the impact of the LIBOR transition on contracts that reference these ISRs. In November 2021, ICE Benchmark Administration Limited (IBA) launched its US dollar SOFR ISR for use as a benchmark in financial contracts and financial instruments. Issuers have since begun to reference this rate for new products and, for legacy products, the ARRC has developed a suggested fallback formula based on the US dollar SOFR ISR that has been used for US dollar LIBOR ISR fixings after the discontinuation of 3-month US dollar LIBOR. In addition, IBA publishes the USD SOFR Spread-Adjusted ICE Swap Rate, which is determined in line with this suggested fallback formula.

v Recent market disruption events

The current market climate, including the war in Ukraine and high global inflation, has resulted in increased market disruption events and related valuation issues for products linked to certain assets.

For example, Russia's further invasion of Ukraine, the subsequent sanctions imposed by other nations and the resulting collapse of the country's economy resulted in market disruptions for indices and ETFs that track Russian equity securities. The Moscow Stock Exchange was shut down for over a month from the end of February 2022 to late March 2022, and the prices of Russian equity securities and indices that track such securities tumbled. In early March 2022, securities exchanges halted trading of Russian ETFs. Because trading was halted, such funds no longer had a daily closing price and their NAVs were trading near zero. Since then, most major ETF providers have terminated their Russian ETFs. For structured

products linked to such indices or ETFs, issuers and calculation agents had to decide whether and when to call a market disruption event, as well as the appropriate valuation methodology to use upon the occurrence of such market disruption event.

In addition, in March 2022, commodity prices experienced extreme price jumps as a result of supply fears related to the war in Ukraine and related sanctions, which resulted in a rare market shutdown. The London Metal Exchange (LME) suspended trading of nickel after prices more than doubled on 8 March 2022. In response, the LME retrospectively cancelled the trades executed on or after 00:00 UK time on 8 March 2022 and implemented daily upper and lower price limits for nickel trading. Such retrospective cancellation was unprecedented in nickel trading. When the LME resumed nickel trading on 16 March 2022, a technical glitch allowed trades below the newly imposed daily price limit and such trades were again cancelled. The recent jumps in commodity prices as a result of the ongoing war in Ukraine and subsequent sanctions has increased the risk of commodity market disruptions. This development will require issuers to review their market disruption adjustments carefully in advance of any offerings to ensure they contemplate these risks and to avoid any unexpected losses as a result of such market disruption occurring in the future.

vi Recent developments in the regulation of index providers

Under the Investment Advisers Act of 1940 (Advisers Act), an 'investment adviser' generally includes anyone who, for compensation, engages in the business of advising others as to the value of securities or the advisability of investing in, purchasing or selling securities. Investment advisers have fiduciary duties to their clients, are subject to the anti-fraud provisions of the Advisers Act and are generally required to register with the SEC or with a state regulator. SEC-registered advisers are required to comply with numerous SEC requirements.

On 15 June 2022, the SEC issued a request for public comments (RFC)[36] regarding whether 'information providers', including index providers, fall under the definition of an investment adviser. Coinciding with the issuance of the RFC, SEC Chair Gary Gensler stated, 'An index provider's decision to include a particular security in an index often influences users of the index to purchase or sell securities. This raises questions about whether the index provider is providing investment advice'.[37]

Market participants have raised concerns about a potential extension of the definition of investment adviser to include index providers.[38] For example, market participates have noted that, under the legislative history of the Advisers Act, Congress was primarily concerned with regulating those businesses that have a fiduciary relationship with their clients through providing personalised investment advice. However, index providers do not interact on a personalised basis with those who uses their indices for investment purposes. Instead, index providers generally license their indices to financial intermediaries for the creation of financial products, reporting or other internal uses. In addition, market participants have

36 See US Securities and Exchange Commission, 'Request for Comment on Certain Information Providers Acting as Investment Advisers' CF Disclosure Guidance: Topic No. 9A (15 June 2022): https://www.sec.gov/rules/other/2022/ia-6050.pdf.

37 See Gary Gensler, 'Statement on Request for Comment on Certain Information Providers' (15 June 2022): https://www.sec.gov/news/statement/gensler-statement-comment-certain-information-providers.

38 See US Securities and Exchange Commission, 'Comments on Request for Comment on Certain Information Providers Acting as Investment Advisers' (19 August 2022): https://www.sec.gov/comments/s7-18-22/s71822.htm.

also noted that index providers should be excluded from the definition of investment adviser under Advisers Act exclusion for publisher. Under a 1985 US Supreme Court decision, a person may rely on the publisher's exclusion for publications that include investment advice if the publications: (1) provide only impersonal advice; (2) are 'bona fide', meaning that they provide genuine and disinterested commentary; and (3) are of general and regular circulation rather than issued from time to time in response to episodic market activity.

VII OUTLOOK AND CONCLUSIONS

The legal and regulatory environment in the United States as it relates to structured products is dynamic and continues to evolve. At the same time, the structured products marketplace continues to grow and change. Manufacturers of structured products continually seek to innovate and design new products to help their customers meet their investment objectives. Developments such as open architecture and new technology platforms continue to change the ways in which structured products are distributed.

Despite this continual change, the central focus of regulators in the United States has remained constant: ensuring that structured products are sold only to investors who fully understand their features and risks and for whom they are appropriate. Disclosure is the cornerstone of the regulatory regime for securities in the United States, and ensuring that disclosures are full and fair and provide investors with an adequate basis on which to make an informed investment decision has long been a key focus of the SEC in the structured products area. The staff of the SEC regularly reviews disclosure documents filed by issuers with the SEC and has from time to time identified ways to improve disclosures. Many of the now-standard features of structured product disclosure in the United States, including disclosure of the estimated value of securities, product titles and certain ETN disclosures, can be traced to SEC disclosure reviews. SEC guidance is likely to continue to shape disclosure practices in the future. That is particularly likely to be the case with respect to new products, as the SEC staff actively encourages issuers to consult with it on disclosure issues that arise in connection with developing new products.

Although good disclosure is necessary, it is not by itself sufficient, and both the SEC and FINRA remain focused on ensuring that broker-dealers meet their sales practice obligations in connection with sales of structured products. Those obligations include understanding the terms of the securities the broker-dealer is recommending (good disclosure is essential in this regard) and ensuring that recommendations are in the best interest of their customers. We expect these areas to remain a continued focus of regulators in the United States in the years to come.