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STRUCTURED PRODUCTS: INVESTMENT COMPANY ACT AND INVESTMENT ADVISERS ACT CONSIDERATIONS

Growing in popularity, these debt securities with cash flows linked to reference assets may raise issues under the federal securities laws if the reference assets are viewed by the SEC as an unregistered investment company or if a broker-dealer structuring such products is not exempt from registration as an investment adviser. The authors describe the characteristics of these products, the case law and no-action letters relating to the Investment Company Act, issues under Investment Advisers Act, and other related compliance considerations.

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When Mark Twain famously observed that "The reports of my death are greatly exaggerated …," he did not have structured products in mind, but his quote is apposite when one considers the U.S. structured products market. Despite challenging economic conditions and even more challenging regulatory developments, the U.S. market for structured products has continued to grow, with sales exceeding $60 billion in 2012.[1] Investors that seek higher yields and portfolio diversification are drawn to structured products.

The growth in popularity of structured products has fueled product innovation. In turn, this innovation increasingly raises issues under the Investment Company Act of 1940 (the "1940 Act") and the Investment Advisers Act of 1940 (the "Advisers Act"). This article analyzes the 1940 Act and Advisers Act issues that may arise in connection with structured products that reference baskets of securities, indices, or research-driven strategies.

CHARACTERISTICS OF STRUCTURED PRODUCTS

Structured products or market-linked investments are debt securities with cash flow characteristics that depend on the performance of one or more reference assets. Generally, these products are structured as senior debt securities offered by an issuer (usually a financial institution that is a well-known seasoned issuer) pursuant to its shelf registration statement, or they may be structured as market-linked certificates of deposit offered by a bank. They are designed to meet the risk/reward needs of investors and offer distinct benefits that cannot be obtained from other investments. For some retail investors, structured products provide access to reference assets that may not otherwise be readily available, such as commodities. Structured products

[1] Source: structuredretailproducts.com.

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also provide retail investors with the opportunity to invest in an underlying reference asset without necessarily being fully exposed to the risks associated with that asset. A retail investor may not have ready access to a bond of a particular tenor or the derivatives that might be needed to replicate the particular pay-off of a security. Investors also appreciate that structured products have distinct tax attributes, and tax considerations may contribute to investor interest.

A structured note may be linked to a variety of reference assets. The most common structured notes include equity-linked notes, index-linked notes, ETF-linked notes, and commodity-linked notes. For an equity-linked note, the return will depend on the fluctuation in the value of a listed equity security over the term of the note or, frequently, on the fluctuation in the value of a basket of listed securities. The return on an index-linked note is tied to the fluctuation in the performance of a well-known market index, or a customized or proprietary index developed by an investment bank.

The return on a structured product is specific to each individual instrument. There is no "typical" return profile. For example, payments may be calculated using the percentage increase of the reference asset based on the starting level (determined on the pricing date) and the ending level (determined before the maturity date), or may be calculated using the average of the levels of the reference asset, based on a series of observation dates throughout the term of the security.

Payments may be subject to a cap, or ceiling, representing a maximum appreciation in the level of the reference asset. Depending on the terms, the particular security may also have a participation rate, which represents the exposure of the security to movements in the underlying reference asset. For example, an investor in a security with a 90 percent participation rate will only receive 90 percent of the gain in the performance of the reference asset; if the participation rate is 80 percent, an investor will receive 80 percent of the increase in the value of the underlying reference asset.

Generally, structured products marketed to individual investors have some measure of principal protection. Thus, structured products involve trading away a portion of the full potential upside associated with a direct investment in the reference asset, as described above, in exchange for a return of principal at maturity (subject to the issuer's credit risk), or in exchange for assuming some lesser risk to the reference asset. Products marketed to a more sophisticated institutional client base (or to a high net worth retail client base) may not be principal-protected.

Many investment advisers or other investment professionals compare structured products with mutual funds or ETFs, which serve similar portfolio objectives. Financial advisers may, for example, consider exchange-traded funds, exchange-traded notes, structured notes, market-linked investments, and structured certificates of deposit as close substitutes that may meet their clients' needs. In fact, as the market for structured products and exchange traded products continues to grow and develop in the United States, many more new products are being introduced that provide for similar investment returns, although these returns may come in different packages. For example, a structured product may reference the performance of an index, while an ETF may also track the same index.

Of course, each of these products is subject to a distinct regulatory framework, but the investment thesis or investment opportunity they present may be similar. New product development is likely to lead to greater convergence among product types, and to present regulatory considerations for those structuring products, including considerations arising under the 1940 Act and the Advisers Act.

1940 ACT CONSIDERATIONS

As discussed above, the returns on a structured product will be specific to each note. Special considerations may arise in connection with notes that provide for a one-for-one return on the level of an underlying reference index or a basket of securities. A note that provides for a one-for-one return on the underlying reference asset, with no floors, caps, or other adjustment features, is often referred to as a "Delta-One Instrument." A Delta-One Instrument differs from other structured products because the one-for-one correlation may cause the product to resemble a direct investment by the holder in the reference assets. As a result, this may raise concerns that the structured product may be recharacterized by the Securities and Exchange Commission, with the reference assets viewed as a pool of securities that may be an unregistered investment company.

This issue would arise only in the context of a structured note (that is a security), and not, for example, in the context of a certificate of deposit (which is a bank deposit, and not a security). Also, the issue surfaces only where the structured product references the performance of a security, a basket of securities, or a security-based index, and an investor's principal is at risk, as we discuss further below.

An entity that would otherwise be an investment company, as defined in Section 3(a)(1) of the 1940 Act, may be exempt from registration.[2] Typically, a Delta-One Instrument would be exempt from the definition of an investment company by reason of Section 3(c)(3) of the 1940 Act.[3] However, as we note above, the pool of reference assets might itself be viewed as a separate issuer. If the pool is viewed as a separate issuer, the pool might be considered an "investment company" subject to registration requirements, unless an applicable exemption is available. There is significant guidance regarding the circumstances under which a pool of assets would be viewed as a separate issuer.

Case Law and "No Action" Letters

Prudential Insurance – Separate Accounts. The leading case on the issue of whether a pool of assets within an operating company can be deemed a separate issuer is *Prudential Insurance Company v. SEC*.[4] Prudential Insurance Company offered variable annuity contracts funded by separate accounts that supported liabilities under the contracts. As an insurance company, Prudential was itself exempt from registration under the 1940 Act. The SEC acknowledged that Prudential was excluded from the 1940 Act, but held that the fund created by the sale of the contracts, which were to be used for investment purposes, gave rise to a separate investment company within the coverage of the 1940 Act. The SEC concluded that while Prudential itself was not an investment company, it was the "creator of one," and proposed to be its investment adviser and principal underwriter.

The court agreed, holding that the separate account was a "fund" as contemplated in the 1940 Act, and that the fund, not Prudential, was the issuer of the securities for purposes of the act. The court cited these factors to support its conclusion:

- The fund was a completely segregated account, devoted to investing in securities.
- The cash for these investments was derived from payments made by the purchaser of the variable annuity contract.
- Though the proceeds of the fund were held for the sole benefit of the annuitant, it was the fund, and no other entity, in which the annuitant had the interest.

This case is central to an analysis of whether an issuer is an investment company, because it looks beyond the exemptions available to an issuer and focuses on the nature of the investment vehicle and the context in which it is offered to the public. Prudential marketed the separate accounts as investments and structured products are marketed as investments. That is a point of similarity, but in our view, insurance company separate accounts are quite different from a typical structured product and raise different concerns. For example, investors in separate accounts only have recourse to the assets in the separate accounts (not to the issuer) for payments owed under the insurance contracts. In addition, the value of the contracts is based solely on the value of the assets in the separate accounts. In contrast, holders of structured notes look solely to the credit of the issuer; their recourse is not limited to any particular assets of the issuer. That these are crucial differences is evident when one considers how the SEC has applied a *Prudential* analysis to other structures and products. We consider three other cases – tracking stocks, trust units, and deferred compensation plans.

Comdisco – Tracking Stocks. In a letter to Comdisco, Inc., the Staff of the SEC said it would not recommend an enforcement action if the company issued stocks that tracked the performance of certain of its operating business segments.[5] The company planned to issue two series of stock, Comdisco Ventures Stock and Comdisco Group Stock. Although the Comdisco Ventures Stock

[2] Section 3(a)(1) of the 1940 Act generally defines an investment company as a company that:

(A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

(B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or

(C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 percent of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

[3] Section 3(c)(3) excludes banks, insurance companies, savings and loan associations, and other similar institutions from the definition of "investment company." Rule 3a-6 of the 1940 Act excludes foreign banks and foreign insurance companies from the definition of "investment company."

[4] 326 F.2d 383 (3d Cir.), cert. denied, 377 U.S. 953 (1964), upholding *In re Prudential Ins. Co*., 41 S.E.C. 335 (1963), Release No. IC - 3620, 1963 WL 62725.

[5] Comdisco, Inc., SEC No-Action Letter, 2000 SEC No-Act. LEXIS 917 (Oct. 25, 2000), *available at* http://www.sec.gov/divisions/investment/noaction/2000/comdisco102500.pdf.

would track the economic performance of the Comdisco Ventures business unit and the Comdisco Group Stock would track the economic performance of the remaining Comdisco business units, shareholders of both series of stock would be investors in Comdisco as a whole, have undivided interests in all of Comdisco's assets, and be subject to the same risks and liabilities arising from all of Comdisco's businesses. The business units would be separate for accounting purposes, but they would continue to be part of a single operating company with one board of directors. In addition, the board would have the right to reconstitute the two series of stocks into a single series of common stock at any time.

Relying on the *Prudential* analysis, the SEC reasoned that a separate issuer may exist within an operating company if:

- the operating company causes interests to be issued in a pool of assets that is legally segregated from the company's other assets;

- the assets in the pool are held primarily for the benefit of the interest-holders as the sole measure of their investment participation; and

- the interests in the pool do not confer significant rights in other assets of the operating company.

The Staff concluded that separate issuers had not been created in this instance. In addition to the above-mentioned factors, the Staff also considered 11 aspects of the tracking group structure, including whether:

- the tracked group was a separate corporation legally distinct from the operating company;

- the tracked group had a separate board of directors from the operating company;

- the operating company was restricted from eliminating the tracking stock or disposing of the assets of the tracked group;

- the tracked group and the operating company were restricted from encumbering each other's assets;

- general creditors of the operating company were able to seek repayment from the assets of the tracked group;

- the tracking stock exposed tracking stock investors to the risks and rewards of the businesses and assets of the operating company as a whole;

- the proceeds of a tracking stock offering were required to be used exclusively for the tracked group and the proceeds of an offering of any other series of common stock of the operating company may not be used for the tracked group;

- the source of any dividends paid to tracking stock investors was required to be limited to the assets allocated to the tracked group, or the ratio between any dividends paid to tracking stock investors and any dividends paid to other investors must have corresponded to the ratio between the profitability of the tracked assets and the profitability of the other assets of the operating company;

- the relative rights of tracking stock investors and other investors with respect to voting, asset dispositions, and liquidations fluctuated with the actual values of the assets allocated to the tracked group and the other assets of the operating company;

- the offering or marketing documents encouraged tracking stock investors to look primarily to the assets of the tracked group for a return of their investment; or

- the market performance of the tracking stock differed greatly from the market performance of other series of common stock issued by the operating company.[6]

The Staff determined that, on balance, although some of these 11 factors might be present to some degree in the Comdisco structure, it could not conclude that issuance of the tracking stock created separate issuers for 1940 Act purposes.

Although many of these factors are not relevant to Delta-One Instruments, it is worth noting that, just as in the case of the Comdisco stock, an investor in a structured product invests in the issuing entity as a whole. The structured product investor, as a holder of a senior debt obligation of the issuer, has recourse to all of the issuer's assets, and does not have any particular rights to the reference assets.

Tuition Plan Consortium – Tuition Certificates. In a letter to Tuition Plan Consortium, LLC ("TPC"), the Staff said it would not recommend an enforcement action if the company issued tuition certificates in

[6] *Id.* at *18-20.

connection with its tuition prepayment plan.[7] TPC established a prepaid tuition plan through which prospective college students and their families could purchase "annual tuition benefits" at any of a number of private educational institutions – enabling students to lock in discounted tuition rates by prepaying tuition. Each participating educational institution must be a member of TPC and, as such, would be issued membership units of TPC. Proceeds received from the sale of the certificates would be held in a "qualified trust," in accordance with Internal Revenue Service regulations, for the exclusive benefit of the designated beneficiary. TIAA-CREF Tuition Financing, Inc. would be the overall plan manager and one of its affiliates that is a federally chartered savings bank and registered investment adviser would be the trustee and investment adviser to the plan.

The issues presented in the no-action letter included whether TPC and the program trust should be treated as one entity or as two separate entities, and if either or both of these entities should be considered an "investment company" under the 1940 Act. Unlike the case of Comdisco, the assets in the program trust established by TPC would be segregated from TPC's general assets and would be available to beneficial owners of the tuition certificates only. In addition, TPC would be restricted from eliminating the tuition certificates and disposing of the program trust's assets. Both TPC and the program trust would also be prohibited from encumbering each other's assets. The Staff concluded that TPC and the program trust were separate legal entities and that an analysis should be undertaken to determine if either was an "investment company."

Ultimately, the Staff concluded that TPC was not an investment company because, among other things, it was in the business of tuition administration, not primarily engaged in the business of investing in securities. It also concluded that the program trust was not an investment company. It reasoned that the program trust it was not an "issuer" as defined in the federal securities laws, as the tuition certificates were not "securities."

Goldman Sachs – Deferred Compensation Accounts. In a letter to Goldman Sachs Group, Inc., the Staff said it would not recommend an enforcement action if the company established notational deferred compensation accounts for each participant in its deferred compensation plan.[8]

Under the deferred compensation program, eligible employees could defer a specified percentage of their bonuses or commissions. The deferred amounts would become general assets of Goldman Sachs, although, for recordkeeping purposes, a notional deferred compensation account would be established for each participant. Under the plan, a committee of four senior employees would administer the plan and designate various performance benchmarks against which Goldman Sachs measured its obligations to pay each participant. Plan participants would have the right to initially designate and periodically update the performance benchmark. The notional accounts would not be the sole means of payment for plan participants. Each plan participant would be a general unsecured creditor of Goldman Sachs in respect of any amounts owed to that participant.

Goldman Sachs also sought to establish a "rabbi trust" to hold any investments made by it to hedge against amounts owed under the plan and to provide comfort to plan participants that Goldman Sachs would meet its contractual obligations under the plan. Goldman Sachs would have the sole discretion to establish the rabbi trust, which would not affect its contractual obligations under the plan. Although the funds in the rabbi trust would not be available for general corporate purposes, they would be part of the general bankruptcy estate in the event of a Goldman Sachs bankruptcy.

To determine which entity (Goldman Sachs, the plan, or the rabbi trust) was the issuer of the plan interests for purposes of the 1940 Act, the staff considered whether:

(i) Goldman Sachs caused interests to be issued in a pool of assets that was legally segregated from its other assets;

(ii) the pool assets were held primarily for the benefit of interest-holders as the sole measure of their investment participation; and

[7] Tuition Plan Consortium, LLC, SEC No-Action Letter, 2003 SEC No-Act. LEXIS 117 (Feb. 4, 2003), *available at* http://www.sec.gov/divisions/investment/noaction/tuitionplan020403.htm.

[8] The Goldman Sachs Group, Inc., SEC No-Action Letter, 2005 SEC No-Act. LEXIS 366 (March 8, 2005), *available at* http://www.sec.gov/divisions/investment/noaction/goldman030805.htm.

(iii) the interests in the pool conferred significant rights in other assets of Goldman Sachs.[9]

With respect to the plan, the Staff noted that the plan had no assets of its own so there was no legal segregation of assets, and that plan participants would have no greater protections or rights with respect to the assets than any other general unsecured creditor of Goldman Sachs. With respect to the rabbi trust, the Staff noted that although the assets might be deemed a pool, they would not be legally segregated from Goldman Sachs' assets and assets in the rabbi trust would be available to satisfy obligations to all general unsecured creditors of Goldman Sachs. Finally, the Staff also noted that Goldman Sachs had no obligation to create a rabbi trust; whether Goldman Sachs established such a trust would not impact the rights or protections of plan participants. After concluding that neither the plan nor the rabbi trust would be deemed a separate issuer, the Staff noted that Goldman Sachs did not request a determination of whether it would be deemed an investment company under the 1940 Act.[10]

Analysis

Relying on this guidance, issuers would be well-advised to apply a 1940 Act analysis in connection with offering certain types of structured products. In structuring a Delta-One Instrument that references a pool of securities (or assets that may be deemed securities), a *Prudential* analysis may be appropriate. Apart from applying the *Prudential* analysis, issuers might reasonably conclude that an investment in the structured product easily may be distinguished from an investment in the reference assets.

Under the *Prudential* test, issuers must consider whether they manage account assets to ensure that cash flow correlates with the satisfaction of contract liabilities. In the case of Delta-One Instruments, issuers are not required to hold the reference assets, and the issuers do not "control" the assets. In fact, an issuer of a Delta-One Instrument usually will not own any of the reference assets. The return on the structured product does not depend upon the issuer's ability to manage the investment, and the investor is not depending upon any such management by the issuer. Any investment made by the issuer or its affiliates in the reference assets in order to hedge the issuer's exposure under the Delta-One Instruments would be held as part of the issuer's general assets and would be not be segregated.

Moreover, unlike the separate accounts marketed in *Prudential*, Delta-One Instruments are marketed as unsecured debt obligations of the issuer rather than an investment in an identifiable pool of securities. Payment at maturity and interest payments (if any) are made by the issuer from its general funds. If the issuer were to become insolvent, holders of the Delta-One Instruments would be general unsecured creditors of the issuer with no rights or recourse to specific assets of the issuer. With Delta-One Instruments, investors rely for payment on the general credit of the issuer of the security and not on a separate pool of assets.

An issuer may seek to ensure that a Delta-One Instrument is not an investment company by linking the product to a basket of stocks or to an index that is not a "narrow-based security index" under Section 3(a)(55)(B) of the Securities Exchange Act. While this extra precaution may be helpful, it is not required by any statute or regulation. Just as a product linked to a narrow-based securities index can be subject to registration under the 1940 Act if the product does not satisfy the standards of *Prudential* and its progeny, a product linked to a broad-based index can be subject to the 1940 Act. Many registered mutual funds are in fact linked to broad-based indices. The core issue in determining the applicability of the 1940 Act relates to the substance of the instrument and its terms, as opposed to the number of securities that comprise the applicable index or basket.

Advisers Act Considerations – Broker-Dealers

As we noted above, more and more structured products are being offered that reference "custom" baskets or proprietary or novel indices. Often, the broker-dealer that is developing a new structured product would like to offer investors the opportunity to benefit from an investment in a particular industry sector, or to benefit from an investment strategy that is reflected in an index. Oftentimes, an index may not be a broad-based or well-known benchmark-type index, and may instead be a more tailored or "proprietary" index developed by an affiliate of the broker-dealer or by a third-party index provider. The stocks comprising a referenced basket or the proprietary index may reflect particular research-driven views or investment recommendations, which may cause the resulting structured product to resemble a 1940 Act-type product or a product that embodies "investment advice." In

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[9] *Id.* at *33-34, citing ComDisco, Inc. (setting forth elements for assessing the existence of a separate issuer within an operating company based upon elements articulated in *Prudential*).

[10] Presumably, Goldman Sachs would be exempt from the definition of "investment company" pursuant to Section 3(c)(3) because it is a registered broker-dealer, among other reasons.

addition, indices that involve investment discretion (and that are not reliant on a rules-based formula or algorithm) may require the index sponsor to make judgments. These judgments may be akin to "investment management" or "investment advice." As a result, a broker-dealer developing a new product, or an issuer offering a new product, should consider whether the structure raises Advisers Act issues.

Section 202(a)(11)(C) of the Advisers Act excludes from the definition of investment adviser any broker or dealer whose performance of investment advisory services is *solely incidental* to the conduct of its business as a broker or dealer and who receives *no special compensation* for such services. So the questions raised are: (1) whether a broker-dealer offering for sale a structured product is providing investment advisory services, and (2) if so, whether such services are solely incidental to its business as a broker or dealer and there is no special compensation.

When a sponsor creates a financial product that references the performance of a basket of securities or a proprietary index, the principal role of the broker-dealer is to assist the issuer in designing the security, which includes identifying the reference asset, devising the payoff structure, and distributing the securities to investors.

It seems clear that a broker-dealer, in offering for sale a particular structured note, is not advising on the merits of an investment in the underlying reference asset in the manner that one would associate with "advisory" activities. Rather, the broker-dealer is providing investment advice on whether the structured note (a security) is a "suitable" investment for its customer. Its focus is not on providing investment advice on the underlying benchmark. Assuming that a broker-dealer offers a structured product that references an index that is developed by a third party, it would still be unlikely that the mere structuring of a security referencing a third-party index would constitute a recommendation of that third-party's investment advice, because the underlying third-party index, by itself, is not a security.

When a broker-dealer assists a financial institution in designing a structured product, is this activity "incidental" to its business as a broker-dealer? In the context of participating in the issuance and distribution of a structured product, the broker-dealer generally would not be holding itself out as an investment adviser. The broker-dealer would identify its role as the underwriter, dealer, agent, or distributor of the particular product and its compensation would be consistent with its sales role. The broker-dealer typically would not receive any special compensation for "advisory" services. Of course, the broker-dealer should consider whether any arrangements with a third-party index provider or third-party research provider engaged to create new indices or investments that will serve as reference assets for structured products would raise an issue as to whether the broker-dealer is an "investment adviser."

When a broker-dealer creates a reference index for a structured product there is an issue of whether it falls within the definition of an investment adviser and whether the broker-dealer exemption applies. For example, the broker-dealer may not be able to rely on the broker-dealer exemption from the definition of an "investment adviser" if it is considered to receive special compensation for advisory services that are not incidental to its role as a broker-dealer.

OTHER RELATED COMPLIANCE CONSIDERATIONS

Although broker-dealers that develop a structured product referencing a securities basket or an index are not necessarily engaging in "investment advisory" activities, nonetheless they should implement compliance safeguards.

To the extent that the broker-dealer is developing products based on the firm's own investment views and its own research, the broker-dealer should ensure that it has addressed, through the implementation of robust information walls, any actual or potential conflicts of interest and handling of material non-public information. Also, the information walls should separate and "wall off" product marketers from those responsible for research or index creation. This will ensure that product marketers are not able to improperly influence research or index features, or selection of index components. A separate or designated group within the firm should be responsible for any index development.

Some proprietary indices with an equity component may from time to time represent a concentrated position in one or more equity securities. In these instances, it may be appropriate for the issuer of the product and the broker-dealer to perform "window cleaning" procedures that are comparable to those that it uses when issuing a structured product linked to a small number of stocks, or to a non-proprietary index that has a high concentration in a particularly security. These procedures should be effective in ensuring that the broker-dealer is not offering a product that references a security to which the broker-dealer possesses material non-public information, or to which the broker-dealer's research arm has a negative rating or recommendation.

In developing structured products, a broker-dealer also will want to consider carefully whether a referenced index is discretionary or rules-based. As discussed above, an index that is discretionary rather than rules-based may raise Advisers Act concerns. In addition, an index that entails discretion also may present other compliance challenges.

For example, decisions made by an index sponsor or by the calculation agent that are deemed discretionary may be questioned in hindsight – did the index sponsor or the calculation agent have any conflicts of interest in making their determinations or judgments, or did they possess material non-public information that affected their judgments. Stating the rules or criteria also will help avoid any claims that an index involved "cherry-picking," or was engineered or constructed to benefit from a very particular market movement and may not be an accurate reflection or characterization of an investment strategy or phenomenon.

An index that relies solely on a rules-based formula will shield the parties from many of these concerns. Issuers and broker-dealers should describe index rules in detail, particularly in the context of a registered offering. This disclosure is essential to provide investors with complete information about the index, including any risks that arise from these rules. A detailed description of the index will also be relevant if the index sponsor must transfer the index to another sponsor. Similarly, if the structured product is listed on a securities exchange, the exchange will want a detailed description of the index as part of its listing eligibility review. An index based on a "recommended list" created by a broker-dealer's research analysts presents additional issues. In this structure, the reference asset will change over time when the broker-dealer's analysts add or remove issues from the list. To the extent that the list resembles a managed portfolio, the broker-dealer may be considered to be providing investment advice, or the list itself may raise issues under the 1940 Act. Moreover, this structure creates the potential for, or the appearance of, conflicts of interest, and thus creates additional compliance challenges for the broker-dealer.

CONCLUSION

The Investment Company Act and the Investment Advisers Act may present opportunities and challenges for issuers and broker-dealers who design structured products. When designing these products:

- consider the advantages and disadvantages of an investment company structure versus a non-registered structured product;

- when choosing a registered fund structure, ensure that you have the compliance and operational infrastructure to ensure compliance with the myriad of requirements and restrictions;

- when choosing a non-registered structure, consider whether the design raises any implications under the Investment Company Act; and

- in either structure, consider any implications under the Investment Advisers Act on the sponsor and the creator of the index.

In conclusion, although there is little direct guidance, structured products are less likely to be viewed as investment companies if the investor is relying exclusively on the credit of the issuer, the issuer has no equity interest in the underlying or reference securities, and the maintenance of the underlying index involves a minimum of "human intervention." A rules-based index that leaves little or no room for any investment discretion on the part of the index creator or sponsor, is less likely to raise 1940 Act or Advisers Act concerns. ■