

MIND THE GAP

THE EQUITY GAP

STRUCTURED PRODUCTS can be used to provide investors with access to the risks and benefits attached to a variety of underlying assets. Fund linked securities have proved particularly attractive in this regard. This is partly because many funds contain high minimum investment or other eligibility requirements which may preclude a direct investment. A special purpose vehicle funded by a number of investors may however allow indirect access to the performance of the fund. In addition, many investors, such as pension funds could be prohibited from making a direct investment for regulatory reasons but may be permitted to invest in a structure exposed to a fund performance but with built-in principal protection.

Our lawyers have been actively involved in advising in relation to dynamic leveraged structures such as CPPI products which provide investors with the prospect of for enhanced returns whilst retaining full or partial principal protection. Typically, a special purpose vehicle issues notes to investors using the proceeds to invest in a portfolio divided into a mix of fund investments and lower risk securities which is dynamically managed and rebalanced through the life of the transaction.

An essential feature of such products is the “equity gap” representing the difference between the current portfolio value and the “base value” (the amount that would need to be invested in a notional zero coupon investment for the investor to receive back its original investment). If the gap falls below specified levels, the portfolio is rebalanced in favour of less risky assets.

To cover off the risk of the gap disappearing completely and the portfolio value falling below the base value due to a rapid deterioration of asset value, a principal protection provider will usually make up such difference, usually by selling a cash-settled put option over the portfolio.

We have worked with clients to develop these structures in many jurisdictions. Issues vary from case to case including making sure that all regulatory and tax considerations are addressed. With our breadth of experience, we have the right team to meet these challenges.