

# RESEARCHING AN ANSWER

## RESEARCH-BASED STRUCTURED NOTES

MORE AND MORE FREQUENTLY, clients ask us to work with them to develop proprietary indices that will be the reference asset for a swap or a structured note. The proprietary index often reflects an investment strategy or thesis, and may be based on equity research.

Most equity indices underlying structured products tend to have a fixed set of components. Baskets of equities underlying structured products also tend to be static. Using a fixed set of components or a static basket raises fewer legal questions. Similarly, many issuers strive to structure an index that is highly rules-based, so that a third party could step in and perform all necessary index related calculations or even take over the index. The index components may be selected by application of a methodology rather than based on particular “research picks.” These design features may have certain limitations in the sense that an investor will not necessarily benefit fully from a strategy that is research-driven and that changes based on market developments.

Working with our client, we have formulated an approach to index construction that incorporates discretionary research-based index components. In order to address the separation or independence of research from the economics of the note itself, an unaffiliated issuer offers the security. Taking this a bit farther, we worked with our client to formulate a dynamic index comprised essentially of equity research-based selections. Components are varied based on the independent research selections, with index adjustments made to account for liquidity and other factors. Careful structuring was required in order to ensure that activity in the index or in components comprising the index would not have a disruptive effect on the securities, and in order to address disclosure questions relating to the index component and investment company and investment advisory questions.