1. **How is a structured note defined?**

Invested Assets (E) Working Group discussed this in their May 12, 2014 open call. Below are examples of bonds which may or may not be categorized as Structured Notes, as defined in the SVO Purposes and Procedures Manual. The definition of *Structured Note* with *some annotations for additional clarification* is:

A *Structured Note* is a direct debt issuance by a corporation, municipality, or government entity, ranking pari-passu with the issuer’s other debt issuance of equal seniority where either:

- The coupon and/or principal payments are linked, in whole or in part, to prices or payment streams from index or indices, or assets deriving their value from other than the issuer’s credit quality *[These are Structured Notes]*, or

- The coupon and/or principal payments are leveraged by a formula *[which means they are Structured Notes]* that is different from either a fixed coupon, or a non-leveraged floating rate coupon linked to an interest rate index, including but not limited to LIBOR or the prime rate *[These would not be Structured Notes]*

Analytically, a Structured Note can be divided into the issuer’s debt issue and an embedded derivative.

Securities with certain embedded derivatives are not considered Structured Notes, including but not limited to bonds with standard call or put options.

*When the issuer is a trust, the source of payments on the security is the assets in the trust, and investors’ recourse is limited to the assets in that trust, the security is not a Structured Note.*

**Examples:**

**Principal-Protected Note (PPN):** These are bonds where the return of at least the minimum amount of principal invested is reasonably certain. However, since the interest payment is linked to an interest rate index that is not typical (such as LIBOR) or is leveraged based on a formula, then the PPN **IS** a Structured Note. **However, most PPNs are issued via a trust** structure, in which case they would **NOT** be classified as a Structured Note.

**Index-Linked Bond /Principal-Indexed Note:** These are bonds/notes where payment of principal is tied to a specific price index - often the Consumer Price Index. Cash flows are adjusted to ensure that the investor receives a known real rate of return, not a nominal fixed rate or typical floating/adjustable rate. As a result, they **ARE** Structured Notes.

**Floating Rate Note (FRNs):** These are notes which have variable interest rates. If the interest rate is tied to a benchmark that is not a typical interest rate index (such as LIBOR), or the spread is not fixed, or is leveraged based on a formula, then it **IS** a Structured Note. However, if the interest rate is tied to a typical interest rate benchmark, such as the U.S. Treasury Bill rate, LIBOR, fed funds rate, prime rate, etc., **plus a spread**, then it is **NOT** a Structured Note.

**Inverse Floater:** Similarly structured to FRNs, inverse floaters are bonds whose interest rates have an inverse relationship to short-term interest rates, meaning that as interest rates rise, their coupon falls. If the note is an issuer obligation whose interest rate is tied to a benchmark that is not a typical interest rate index (such as LIBOR), or the spread is not fixed, or is leveraged based on a formula - such as, for example, the note coupon decreases when LIBOR increases - then the note **IS** a Structured Note. However, if the interest rate is fixed or tied to a typical interest rate benchmark, such as the U.S. Treasury Bill rate, LIBOR, fed funds rate, prime rate, etc., plus a spread, then it is **NOT** a Structured Note. **Most inverse floaters are issued as agency RMBS, so they are structured with a trust, and; therefore, would NOT be a Structured Note.**

**Equity-Linked Note:** Return is determined by the performance of a single equity security, a basket of equity securities, or an equity index. As such, interest is linked to a non-basic interest rate index and so they **ARE** Structured Notes.
**Index-Amortizing Note (IAN):** Note whose maturity period extends when interest rates increase, and as interest rates decline, the maturity period shortens. They are structured to increase/reduce noteholders' interest rate risk and have a specified maximum maturity date by which time any remaining principal is paid. Similar to FRNs, if the interest rate is tied to a benchmark that is not a typical interest rate index (such as LIBOR), or the spread is not fixed, or is leveraged based on a formula, then the IAN IS a Structured Note. However, if the interest rate is fixed or tied to a typical interest rate benchmark, such as the U.S. Treasury Bill rate, LIBOR, fed funds rate, prime rate, etc., plus a spread, then it is NOT a Structured Note. In addition, as with most IANs, principal repayment is based upon an amortization schedule connected to a particular index such as LIBOR, the Constant Maturity Treasury, or mortgage interest rate. If the effect of the indexing is only to change the timing of the principal payments, they would not qualify as a Structured Note.

**Treasury-Indexed Protected Securities (TIPS):** TIPS are backed by the U.S. government and, therefore; low-risk. They provide protection against inflation; principal increases with inflation and decreases with deflation, as measured by the Consumer Price Index. At maturity, the investor is paid the adjusted principal or original principal, whichever is greater. TIPS have a fixed interest rate that is applied to the adjusted principal, so it also rises with inflation and decreases with deflation. TIPS ARE Structured Notes.

**Step-Up Coupons:** While relatively straight forward, bonds with step-up coupons ARE Structured Notes. The interest rate is not fixed for the life of the bond; it increases at regular intervals over the life of the bond.

**Steepeners:** These are structured securities that pay more interest if the difference between long- and short-term rates increases. That is, they pay a fixed rate for a period of time and then switch to a coupon tied to the differential between two rates (such as the 2-year and 30-year U.S. Treasury rates); the spread (differential) between rates can also be leveraged. Steepeners ARE Structured Notes.