Structured Products: Reverse Convertible Notes Disclosure

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Reverse convertible notes are designed to pay a relatively high fixed periodic income ("**coupon**"). The notes return par value to the investor at maturity, as long as the underlying equity remains above a downside protection level.

Reverse convertible note features

Income generation

A key feature of reverse convertible notes is income generation. Investors who are mildly bullish on a stock, or who already own the underlying stock, can earn a relatively high coupon along with contingent downside price protection on that stock. Coupons are typically structured as monthly or quarterly payments.

Contingent downside protection

Most reverse convertible notes include contingent downside protection (or a "**barrier**"), which can vary from as little as 10% to as much as 50% of the initial price of the underlying asset. As long as the price of the underlying security does not close below the barrier during the term of the note, the investor will receive 100% of their principal (original investment) at maturity.

Breaching the protection point

If the underlying stock does break the downside barrier during the term of the note, the investor will likely receive shares of the underlying equity at maturity if the stock closes below its initial price on the final determination date. The number of shares received would be par divided by the initial share price: $1,000 par/$10 initial price = 100 shares received in this example. If shares are delivered at maturity, they will be valued at less than the initial investment because the cost basis is set at the time of initial pricing. In the event that the underlying security does breach the downside limit and then rebounds to a level equal to or greater than the initial fixing price, with most structures, the investor would receive 100% of principal at maturity.

Periodic coupons

Whether the protection point is breached or not, the investor usually will receive periodic coupons through the term of the note.

Fixing price

The initial fixing price is established just prior to settlement, based on the reference stock's market closing price on the initial pricing date.

Upside participation

Upside participation is typically limited to the coupon amount. Some reverse convertible note structures may allow the investor to participate in some portion of the positive performance of the underlying equity. This type of structure would typically result in a reduction of the coupon.

First touch

A reverse convertible note structure may include a first touch feature. Rather than linking the reverse convertible note to a single equity, a note can be structured so that a basket of underlying equities is created and, if any of them breaches the protection point, it would become a single stock reverse convertible.

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Key facts

- **Settlement** — Notes generally settle T + 1 and clear the regular way.
- **Maturity** — Notes will typically have maturities ranging from 3 months to 1 year.
- **Coupon payments** — Notes will typically pay monthly coupons. However, certain structures may have alternate periodic payment schedules.
- **Ratings** — Each note will carry the credit rating and represent an unsecured debt obligation of the issuer. When purchasing structured products, an investor has a legitimate and compelling need to look at the creditworthiness of the company issuing the notes. The issuer rating relates only to the periodic coupon payments and performance of the reverse convertible's specific terms at maturity; it does not refer to the safety or suitability of the investment.
- **Minimum** — Individual broker-dealers may set their own minimum amounts for purchase of reverse convertible notes in the primary market, subject to applicable restrictions.
- **Taxes** — There are a number of tax implications with reverse convertible notes. Consult your tax advisor for specifics. Neither RBC CM, nor its affiliates provide legal, accounting or tax advice. All legal, accounting or tax decisions regarding your accounts and any transactions or investments entered into in relation to such accounts, should be made in consultation with your independent advisors. No information, including but not limited to written materials, provided by RBC CM should be construed as legal, accounting or tax advice.

Risks and suitability

Market conditions

Since reverse convertible notes are hybrid securities, they carry the risks associated with both fixed income and equity investments. Any examples or scenarios regarding these securities in this fact sheet are for illustrative purposes only and are intended to demonstrate how reverse convertible notes will operate under different market conditions. They are not intended to predict future market conditions, the performance of an underlying equity, or the returns of reverse convertible notes linked to a security.

Liquidity

While broker-dealer affiliates of issuers and other market makers often maintain a secondary market for reverse convertible notes, there is no guarantee that such a secondary market will be maintained for any particular note. When the investor sells (or buys) in the secondary market, the amount of accrued coupon received (paid) is included in the quoted price. Early liquidation may result in a price above or below par. Factors that may influence the secondary pricing of a reverse convertible include but are not limited to: a change in the credit rating of the issuer or underlying security, the issuer's cost of hedging, a change in the volatility of the underlying security and the inability to access a liquid market in the underlying, overall market volatility.

Underlying equity risk

In general, the market value of a specific issue of reverse convertible notes will fluctuate in price with changes in the market value of the underlying security. However, that change may not be fully reflected in the market value of the notes. Also, if the underlying security falls below the downside protection price, the investor is subject to ownership of the underlying security and from that point on will be fully exposed to the downside performance of that security. Investors looking into reverse convertible notes should be fully aware of the risk associated with the underlying security and be comfortable owning that security.

Suitability

Reverse convertible notes may not be appropriate for all investors. Structured products such as reverse convertible notes are most appropriate for investors looking to hold the note until maturity.

Investors selling reverse convertible notes prior to maturity may receive a market price which is at a premium or a discount to par and which does not necessarily reflect any increase or decrease in the market price of the underlying equity to the date of such sale.

Reverse convertible notes are most appropriate for an investor comfortable with owning the reference stock but who believes it will be range-bound over the note's term, meaning the share price will trade in a range above the downside barrier, but below the coupon percentage on the upside.