

INSIDE STRUCTURED PRODUCTS

A comprehensive guide on how to invest
in Structured Retail Investment Products.

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Part 2

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1 Introduction

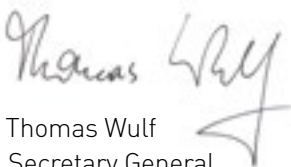
Within the past three decades, Structured Products have become an integral part of the passive investment product landscape throughout all established financial markets world-wide. Structured Products represent a flexible and helpful tool for asset managers, independent financial advisers and retail investors in diversifying the risk structure of their portfolios and get access to certain asset classes.

While the most advantages of these products – fast time-to-market manufacturing, nearly unlimited variety of underlyings and high liquidity – are well-known, their technical features sometimes are not. This book, which supplements the product categorisation set out on the EUSIPA Map®, seeks to change this: It offers an insight into features and functioning of the most common pay-offs of Structured Products including investment and leverage products. With this book, we would like to address financial professionals who deal with Structured Products at any part of the value chain. This includes the structuring process, portfolio risk analysis and management and as well as the distribution of Structured Products to investors.

The markets in Structured Products in and beyond Europe still feature a number of national specifics. Most of those are rooted in different regulatory and tax rules, but many also extend to diverging investor preferences and distribution structures. EUSIPA, the Pan-European association of Structured Products issuers, promotes as one of its statutory goals the proliferation of technical insight and understanding among market participants. This book strives to be seen as a major contribution to this headline goal.

Expressing my thanks to everyone who was involved in the drafting process or delivered feedback, I am convinced that the information set out on the following pages will be of huge benefit to the daily work of our readers.

Brussels, October 2016



Thomas Wulf

Secretary General

European Structured Investment Products Association (EUSIPA)

1.2 ACKNOWLEDGEMENT

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1.3 EUSIPA AT A GLANCE

EUSIPA pursues, as an umbrella association for issuers, the aim to coordinate transparency initiatives at the European level and to support uniform market standards. Through us, many issuers engage in direct discussions with the decision-makers at European level. The association is headquartered in Brussels/Belgium and organized as a non-profit association under Belgian law. EUSIPA was founded in 2009.

To make national markets grow together to a cross-border level playing-field, our members see the necessity of retaining attractive conditions and a fair framework conditions in Europe. Our members contribute for their part by adhering to a set of principles drawn up as self-regulatory framework for issuers, by promoting initiatives for uniform product classification such as the EUSIPA map and by enhancing product and market transparency on an overall basis. More information and research material you can find on www.eusipa.org.

1140 Capital Protection with Coupon

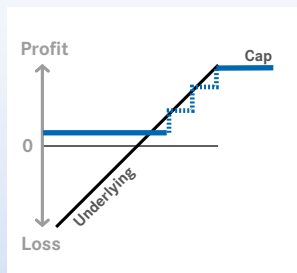
SUMMARY

CAPITAL PROTECTION WITH COUPON (1140)

Market expectation

- Rising underlying
- Sharply falling underlying possible

Payoff Profile



Characteristics

- Minimum redemption at expiry equivalent to the capital protection
- Capital protection is defined as a percentage of the nominal (e.g. 100%)
- Capital protection refers to the nominal only, and not to the purchase price
- Value of the product may fall below its capital protection during the lifetime
- The coupon amount is dependent on the development of the underlying
- Periodic coupon payment is expected
- Limited profit opportunity

1. FUNCTIONALITY

1.1 Fundamental Concept and Characteristics

Capital Protection Certificates with Coupon are very similar to fixed-income investments (bonds). Most products have a minimum coupon, which is paid out annually. The issuer guarantees redemption equal to the floor at expiry. In addition to minimum coupon and capital protection, the investor participates in the performance of one or more underlyings.

Capital Protection Certificates with Coupon can have a number of different underlyings. Apart from money market interest rates (e.g. the three-month Libor or the three-month Euribor), shares or share indices, such as the EURO STOXX 50, can also be used as underlyings. Below, two forms of Capital Protection Certificates with Coupon, which differ from the structure of Capital Protection Certificates with Participation, are discussed in detail.

1.2 First Example of a Capital Protection Certificate with Coupon

Many Capital Protection Certificates with Coupon have more than one share, a share basket or an index as underlying. In addition to the guaranteed minimum coupon, there is the opportunity for an additional coupon, which is derived from the performance of the underlyings. The coupon is paid out in regular intervals (e.g. annually). The level of payment is dependent on the performance of the underlying. The following example shows a possible product on a basket comprising three shares.

Maturity:	2 Years
Issue Price:	EUR 1,000 (100%)
Underlying 1:	Oliver Co. share
Underlying 2:	Williams Co. share
Underlying 3:	James Co. share
Reference Price Underlying 1:	EUR 100
Reference Price Underlying 2:	EUR 200
Reference Price Underlying 3:	EUR 300
Minimum Coupon:	1%
Cap-Level (Performance):	25%
Capital Protection Level:	100%
Dividend:	0% (applies to all underlyings)

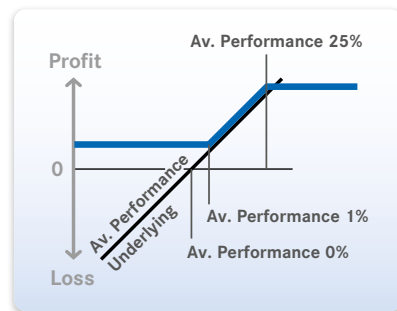


Figure 107

The level of the effective coupon is calculated by the arithmetic mean of all performance factors, which are included in the basket. Every positive performance of an underlying is limited by a cap of 25%; whereas, the full effect of the negative performance is included in the calculation. For example, if an underlying increases by 50%, only 25% of the performance is factored in. If, however, the price falls by 50%, this figure is fully included in the calculation. However, a minimum coupon of 1% is always guaranteed.

The formula for this example is as follows:

$$\text{Coupon} = \max \left[\frac{1}{3} \sum_{i=1}^3 \min[\text{Performance}_i, 25\%]; 1\% \right]$$

Let us consider the following scenarios for the second year:

Scenario 1 - on average, strong rise in price of underlying

The performance factors for the last stage of maturity (second year) are 35%, 50% and 43%. Due to the cap, the maximum price gain of the underlyings which is included in the calculation is 25%. The arithmetic mean is $(25\% + 25\% + 25\%) / 3 = 25\%$. Thus, redemption at expiry is EUR 1,250, i.e. the nominal of 1,000 EUR plus a coupon of 250 EUR.