What are Structured Notes?

Structured notes are securities issued by financial institutions whose returns are based on, among other things, equity indexes, a single equity security, a basket of equity securities, interest rates, commodities, and/or foreign currencies. Thus, your return is "linked" to the performance of a reference asset or index. Structured notes have a fixed maturity and include two components – a bond component and an embedded derivative. Financial institutions typically design and issue structured notes, and broker-dealers sell them to individual investors. Some common types of structured notes sold to individual investors include: principal protected notes, reverse convertible notes, enhanced participation or leveraged notes, and hybrid notes that combine multiple characteristics.

Risks and Other Considerations with Structured Notes

Complexity. You and your broker should take time to fully understand the manner in which your return on a structured note is calculated. You should understand the reference asset(s) or index(es) and determine how the note's payoff structure incorporates such reference asset(s) or index(es) in calculating the note's performance. This payoff calculation may include leverage multiplied on the performance of the reference asset or index, protection from losses should the reference asset or index produce negative returns, and fees.

Market risk. Some structured notes provide for the repayment of principal at maturity, which is often referred to as "principal protection." This principal protection is subject to the credit risk of the issuing financial institution. Many structured notes do not offer this feature. *For structured notes that do not offer principal protection, the performance of the linked asset or index may cause you to lose some, or all, of your principal.* Depending on the nature of the linked asset or index, the market risk of the structured note may include changes in equity or commodity prices, changes in interest rates or foreign exchange rates, or market volatility.

Issuance price and note value. The price you will pay for a structured note at issuance will likely be higher than the fair value of the structured note on the date of issuance. Issuers now disclose an estimated value of the structured note on the cover page of the offering prospectus, allowing investors to gauge the difference between the issuer's estimated value of the note and the issuance price. The estimated value of the notes is likely lower than the issuance price of the note to investors because issuers include the costs for selling, structuring or hedging the exposure on the note in the initial price of their notes. After issuance, structured notes may not be re-sold on a daily basis and thus may be difficult to value given their complexity.

Liquidity. Your ability to trade or sell structured notes in a secondary market is often very limited as structured notes (other than exchange-traded notes known as ETNs) are not listed for trading on security exchanges. As a result, the only potential buyer for your structured note may be the issuing financial institution's broker-dealer affiliate or the broker-dealer distributor of the structured note. In addition, issuers often specifically disclaim their intention to repurchase or make markets in the notes they issue. You should, therefore, be prepared to hold a structured note to its maturity date, or risk selling the note at a discount to its value at the time of sale.

Payoff structure. Structured notes may have complicated payoff structures that can make it difficult for you to accurately assess their value, risk and potential for growth through the term of the structured note. Determining the performance of each note can be complex and this calculation can vary significantly from note to note depending on the structure. Notes can be structured in a wide variety of ways. Payoff structures can be leveraged, inverse, or inverse-leveraged, which may result in larger returns or losses for you. You should carefully read the prospectus for a structured note to fully understand how the payoff on a note will be calculated and discuss these issues with your broker. For example, the payoff on structured notes can depend on:

Participation rates. Some structured notes provide a minimum payoff of the principal invested plus an additional payoff to you based on multiplying any increase in the reference asset or index by a fixed percentage. This percentage is often called the participation rate. A participation rate determines how much of the increase in the reference asset or index will be paid to investors of the structured note. For example, if the participation rate is 50 percent, and the reference asset or index increased 20 percent, then the return paid to you would be 10 percent (which is 50 percent of 20 percent).

Capped maximum returns. Some structured notes may provide payments linked to a reference asset or index with a leveraged or enhanced participation rate, but only up to a capped, maximum amount. Once the maximum payoff level is reached, you do not participate in any additional increases in the reference asset or index. For example, a note may provide the investor 100% of all funds invested at the end of two years, plus an enhancement of any rise in the performance of the S&P 500 up to 20%. If the performance of the S&P 500 increases 25% in those two years, you only receive a return of 20%.

Knock-in feature. If the reference asset or index falls below a pre-specified level during the term of the note, you may lose some or all of your principal investment at maturity and also could lose coupon payments scheduled throughout the term of the note. This pre-specified level may be called a barrier, trigger, or knock-in. When this level is breached, the payout return changes on the note. For example, if the reference asset or index falls below the knock-in level and its value is lower than on the date of issuance, instead of receiving a return of your principal, you may instead receive an amount that reflects the decline in value of the reference asset or index. For certain types of structured notes, you may actually receive the reference asset that has declined in value during the term of the note.

Credit risk. Structured notes are unsecured debt obligations of the issuer, meaning that the issuer is obligated to make payments on the notes as promised. These promises, including any principal protection, are only as good as the financial health of the structured note issuer. If the structured note issuer defaults on these obligations, investors may lose some, or all, of the principal amount they invested in the structured notes as well as any other payments that may be due on the structured notes.

Call risk. Some structured notes have “call provisions” that allow the issuer, at its sole discretion, to redeem the note before it matures at a price that may be above, below or equal to the face value of the structured note. If the issuer “calls” the structured note, investors may not be able to reinvest their money at the same rate of return provided by the structured note that the issuer redeemed.

Tax considerations. The tax treatment of structured notes is complicated and in some cases uncertain. Before purchasing any structured note, you may wish to consult with a tax advisor. You also should read the applicable tax risk disclosures in the prospectuses and other offering documents of any structured note you are considering purchasing.