

Reverse Convertibles

Reverse convertible notes are 'hybrid' securities, and possess characteristics of both fixed income and equity investments. While the structures and features vary, reverse convertible notes usually mature in one year or less. They are typically linked to the performance of a single equity, but can also be linked to an index, commodity or a basket of underlying equities.

Reverse convertible notes are designed to pay a relatively high fixed periodic coupon. The notes return par value to the investor at maturity, as long as the underlying equity remains above a downside protection level. Institutional and global investors have been active in purchasing reverse convertible notes for several years, but widespread participation by individual investors is relatively new.

FEATURES OF REVERSE CONVERTIBLE NOTES

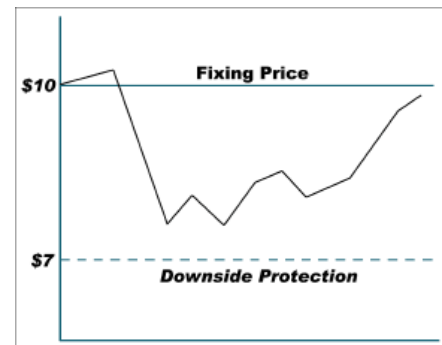
Income Generation: A key feature of reverse convertible notes is income generation. Investors who are mildly bullish on a stock, or who already own the underlying stock, can earn a relatively high coupon while locking in some downside price protection on that stock. Coupons are typically structured as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

ADDITIONAL FEATURES OF REVERSE CONVERTIBLE NOTES

The following features may be included in specific structures of reverse convertible notes:

Downside Protection: Most reverse convertible notes include downside protection (also known

as a “cushion”), which can vary from as little as 10% to as much as 50% for the most volatile reference stocks. As long as the price of the underlying security does not close below the cushion the investor will receive 100% of their principal (original investment) at maturity. The graph below further explains this downside protection.



Breaching the 'Protection Point': If the underlying stock does break the downside limit (30% in the example above), the investor will likely receive shares of the underlying equity. The number of shares would be par divided by the price; $\$1000 / \$10 = 100$ shares 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 30% downside limit and then rebounds to a level equal to or higher than the initial fixing price, with most structures the investor would receive 100% of principal at maturity.



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Periodic Coupons: Whether or not the protection point is breached, 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.

KEY FACTS

Settlement: Notes generally settle T + 3 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.

RISKS & 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.



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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. Market participants expect the bid-ask spread to be no greater than 1% of the par value. 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, 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 best suited to 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 suited to 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 limit “cushion,” but below the coupon percentage on the upside.

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