CAPITAL PROTECTION BARRIERS – STYLES AND THEIR IMPACT

INVESTMENT DESIGN AND DISTRIBUTION

A key issue for investors is capital preservation and this aspect of their wealth strategy tends to increase in importance as retirement nears. There are a number of ways that a structured product can provide this protection.

“Hard protection” – this term is used when the product seeks to deliver a pre-determined level of capital protection irrespective of the performance of the underlying asset(s) to which any growth or income may be linked.

“Soft protection” – this term is used when the return of capital is conditional upon predefined criteria being met. Generally this means defining how the underlying must perform in order to avoid risk to the capital. This performance is a set percentage movement of the underlying across the fixed term, in relation to its initial level. This is known as the Barrier Level.

There are **two main styles of Soft Protection** which can be incorporated within a structured product with the options defined by differing criteria and characteristics.

Final Level Barrier (often referred to as a European-style barrier) – the return of initial capital is determined by comparing only two value points of the underlying asset – the opening level and final level. Any movement by the underlying asset between these points does not have a bearing on the return of initial capital. For example - a product with a 50% Final Level Barrier provides protection to the capital invested as long as the final level of the Underlying asset has not fallen by more than 50% from its opening level. If the 50% barrier is breached then the loss of capital will be proportionate to the decrease in the Underlying asset’s value between those two observation dates.

Example below:

	Initial level of Underlying	Final level of Underlying	% Movement	Capital return
Final Level Barrier (European-style) set at 50%	10,000	12,500	25%	100%
	10,000	8,000	-20%	100%
	10,000	4,000	-60%	40%

(*) Any capital protection offered, irrespective of the style and level, is subject to the counterparty meeting their financial obligations.

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Daily Close Barrier (often referred to as an American-style barrier) – the return of capital uses the daily closing levels of the underlying asset to determine whether the capital returned will be reduced. Here, the value of the underlying asset is noted at the close of business every business day during the product's term. For example - a product with a 50% Daily Close Barrier provides protection to the capital invested, as long as the daily close of business level of the underlying does not fall by more than 50% from its opening level on any day throughout the investment term. Should the 50% barrier be breached, and not recover to at least its initial level by the end of the fixed term, the loss of capital will be proportionate to the decrease in the value of the underlying between the opening and final levels (not the lowest daily closing level during the term).

	Initial level	Lowest Daily close level (%)	Final level	Barrier breached?	Initial to Final Level Movement (%)	Capital return
Daily Close Barrier (American-style) set at 50%	10,000	75%	12,500	No	25%	100%
	10,000	60%	8,000	No	-20%	100%
	10,000	40%	11,000	Yes	10%	100%
	10,000	35%	8,000	Yes	-20%	80%
	10,000	25%	4,000	Yes	-60%	40%

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