INTRODUCTION TO:

Reverse Convertibles

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Siebert
Muriel Siebert & Co., Inc.

Reverse Convertible Securities

DEFINITION

Short-term investors seeking a high coupon rate. Risk that may be rewarded with a dependable income stream and high interest rates.

A Reverse Convertible Security is a short-term investment tied to one or more underlying stocks. It provides an income stream with return of principal based on the performance of the underlying stock. Reverse convertible securities can provide a short-term steady income stream, however overall returns may be lower based on call features and other factors. Your income stream may be less than stated if the security is called and you may not be able to reinvest the funds at similar rates. Risks associated with these investments make them unsuitable for many investors.

IS IT RIGHT FOR YOU?

- Are you looking for a dependable stream of income generated by a high interest rate?
- Are you seeking to diversify your investment portfolio?
- Are you knowledgeable concerning how options work and comfortable with investing in securities incorporating option features?
- Are you willing to accept the risk of possibly owning at maturity an underlying stock with significantly less value than your initial investment?

CHECKLIST OF FEATURES

Low minimum investment.
$10,000 minimum initial purchase; $5,000 increments thereafter.

High coupon.
Typically in the range of 8% - 12% per year.

Steady income.
Regardless of the performance of the underlying stock, the stated amount of interest is paid, usually on a monthly basis.

Short-term maturity.
3 month, 6 month or one year.

High Issuer credit quality.
Issuers of these securities are typically large banks rated investment grade or better.

Not principal-protected.
Principal may be reduced depending on performance of the underlying stock(s).

Contingent downside protection.
A “knock-in” feature provides a set amount of downside protection.

THE KNOCK-IN FEATURE

The Knock-In feature provides the investor with a certain amount of downside protection. The Knock-In level, also called the downside barrier, is set at a predetermined percentage of the initial share price. The Knock-In level will be less than the amount of the initial share price.

THREE TYPES OF REVERSE CONVERTIBLE SECURITIES

1. Single-Stock Reverse Convertible Securities
2. Single Observation Reverse Convertible Securities
3. Multi-Stock “Worst of Basket” Reverse Convertible Securities

Single-Stock Reverse Convertible Securities

As long as the single, underlying stock never closes at or below the Knock-In price level for the life of the investment, then even if on the final determination date, the stock price is lower than the initial price, the investor receives 100% of the initial investment in cash at maturity. The coupon payments are unaffected. However if, on the final determination date, the closing price of the underlying stock is lower than the initial stock price, and the stock closed on any single day lower than the Knock-In price level, then the investor receives the predetermined quantity of shares instead of 100% of the initial investment in cash. The amount received will be less than the initial principal invested. The coupon payments are unaffected. Final determination date is usually a few days prior to maturity.

THREE TYPES OF KNOCK-IN SCENARIOS

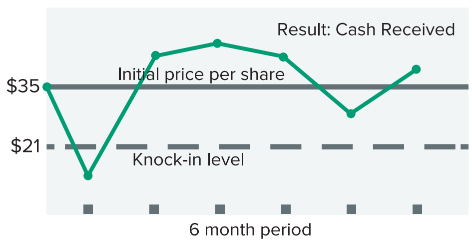
In all three of the following scenarios, the total amount of coupon earned is paid into the account.

ASSUMPTIONS

Initial investment of $1,000* (the principal) - Maturity at 6 months - Initial price per share of underlying stock is $35 - A coupon 15% - Knock-In level is $21*

Single-Stock Reverse Convertible Securities

**These examples use $1,000 initial investment for simplicity purposes. The required minimum initial investment is $10,000.*

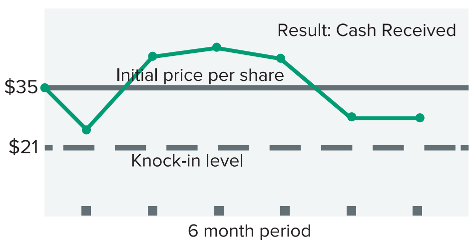


SCENARIO 1

Knock-In Factor: The underlying stock dropped below the $21 Knock-In Price level during the term of the investment.

Closing Price On Determination Date: Eventually the underlying stock rose beyond the Knock-In level equal to or greater than the initial price, closing at $37 at the final determination date.

Final Result: Regardless of the drop below the Knock-In level, 100% of the initial investment principal is returned in cash because the final price on the determination date of the underlying stock was at or higher than the initial price.

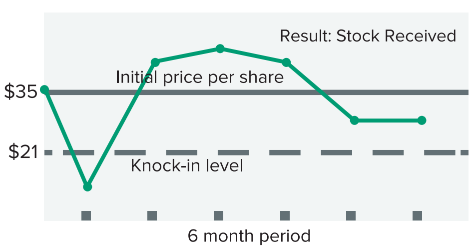


SCENARIO 2

Knock-In Factor: The underlying stock dropped for a period to a level below the initial price, but never (on any single day) reached or breached the $21 Knock-In level.

Closing Price On Determination Date: The final closing price of the underlying stock on the determination date was $25, which is below the initial price.

Final Result: Regardless of the final closing price, 100% of the initial investment is returned in cash because the underlying stock price never reached or breached the $21 Knock-In level.

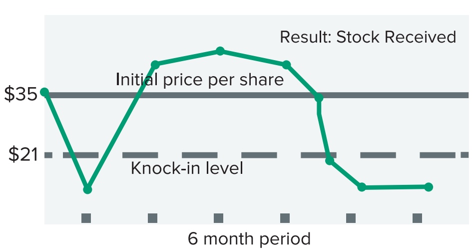


SCENARIO 3

Knock-In Factor: For a period of time, the underlying stock price fell below the $21 Knock-In level.

Closing Price On Determination Date: The final closing price of the underlying stock on the determination date was $25, which is below the initial $35 price.

Final Result: The Knock-In level was breached and the underlying stock did not return to or above initial share price by the observation date. Therefore, instead of 100% cash return of the initial investment, the investor receives the predetermined number of underlying shares of stock- **the total value of which is less than the initial investment.**



SCENARIO 4

Knock-In Factor: The underlying stock dropped below the $21 Knock-In Price level during the term of the investment.

Closing Price On Determination Date: The final closing price of the underlying stock on the determination date was $18, which is below the $21 Knock-In Price level price.

Final Result: The Knock-In level was breached, **and** the underlying stock did not return to or above the knock-in level price by the observation date. Therefore, instead of 100% cash return of the initial investment, the investor receives the predetermined number of underlying shares of stock—**the total value of which is less than the initial investment.**

In Scenario 3, the holder would receive a predetermined number of shares of the underlying equity instead of the original $1000 invested. The number of shares received is calculated by dividing the amount of the original investment by the strike price set at the initial time of the investment.

$$\frac{\text{Amount invested in Reverse Convertible (par value) \$1,000}}{\text{Strike Price of underlying stock \$35}} = \begin{array}{c}\text{Quantity of shares that would be delivered:} \\ \text{28.57 shares with a final market value of} \\ \text{\$714.25 @ \$25 per share}\end{array}$$

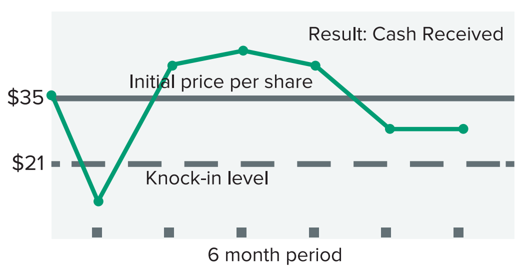
28 shares worth $25 per share would be delivered instead of the original investment principal. The principal loss would be equal to $1,000 initial principal - final result share value $700 = -$300. Fractional shares are paid in cash (.57 shares in the above example) and is based upon the closing price of the shares on the final determination date.

Single-Observation Reverse Convertible Securities

DEFINITION

The primary difference between Single Observation Reverse Convertibles and Classic Reverse Convertible Securities exists in what happens at maturity if an underlying stock has breached the Knock-In level.

If the Knock-In level has been breached, single observation type Reverse Convertible issues do not require the underlying stock to increase in price up to the initial share price (or strike price) on the observation date in order to receive cash at maturity. Instead, they require only that the share price of the underlying stock be above the Knock-In level on the observation date to receive cash at maturity.



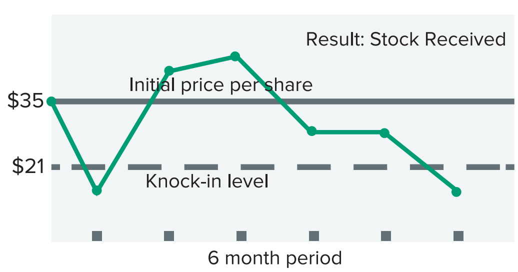
SCENARIO 1

Knock-In Factor: For a period of time, the underlying stock price fell below the $21 Knock-In level.

Final Closing Price: The underlying stock's final closing price at the observation date was $25, which is below the initial $35 price.

Final Result: The Knock-In level was breached and the underlying stock did not return to the initial price or above on the determination date.

However, since it was a **Single Observation Reverse Convertible** and the underlying stock's final closing price was above the $21 Knock-In level on the observation date, 100% of the initial investment is returned in cash. Although the underlying stock price breached the $21 Knock-In level, the maturity result was determined by the underlying stock price, which was above the $21 Knock-In level on observation date.



SCENARIO 2

Knock-In Factor: The underlying stock fell below the $21 Knock-In level on observation date.

Final Closing Price: The underlying stock's final closing price at the observation date was $20, which is below the $21 Knock-In level price.

Final Result: The Knock-In level was breached *and* the underlying stock was not above the Knock-In level price on the observation date.

Therefore, instead of 100% cash return of the initial investment, the investor receives the predetermined number of shares of the underlying stock - **the total value of which is less than the initial investment.**

Multi-Stock "Worst of Basket" Reverse Convertible Securities

DEFINITION

This type of security is similar to the Single-Stock Knock-In Reverse Convertible Security. However, instead of there being one underlying stock, there is a "basket" of multiple stocks.

The securities in the basket are commonly from the same or similar market sector, such as airline issues or pharmaceuticals. Baskets of stocks usually include two, three or four separate issues.

Unlike the Single-Stock Knock-In, Multi-Stock "Worst of Basket" Knock-In feature permits the issuer to deliver at maturity the shares of the ***worst performing-stock*** in the basket if the closing price of at least one of the stocks falls to or below the predetermined Knock-In level. The worst-performing stock is determined on the basis of percentage of price decline.

As is the case with Single-Stock Knock-Ins, the maximum return at maturity or call with Multi-Stock issues is the principal plus the coupon payment. The investor does not participate in any appreciation of the underlying stocks.

As with Single-Stock Knock-Ins, an investor might lose some or all of the initial principal investment, but the stated coupon payment is never affected by price changes of the underlying stock or basket of securities.

Because the potential risk is higher for a Multi-Stock Reverse Convertible to reach or go below the Knock-In level than with a Single-Stock Reverse Convertible, the issuer normally offers a higher coupon and/or more downside protection than with a comparable Single-Stock issues.

Stock Redemption Calculation

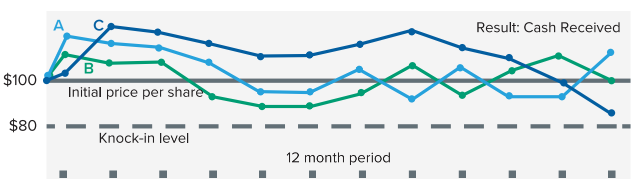
Cash payment or number of shares of stock to be delivered

The prospectus provisions that guide whether at maturity 100% of principal will be returned in cash, or whether a predetermined number of shares of stock are delivered instead, are similar for Multi-Stock Reverse Convertibles as they are for Single-Stock Reverse Convertibles. The difference is that if, during the observation period, any one stock within the basket falls to or below the Knock-In level, the investor will then be at risk to receive the worst performing stock in the basket as determined by percentage loss in price below the initial strike price. The stock the investor receives may even be a stock from the basket that never reached its Knock-In level. Investors should read and understand the prospectus prior to investing as the determination of worst-performing stock may vary by issue.

Multi-Stock "Worst Of Basket" Reverse Convertible Knock-In Scenarios

ASSUMPTIONS

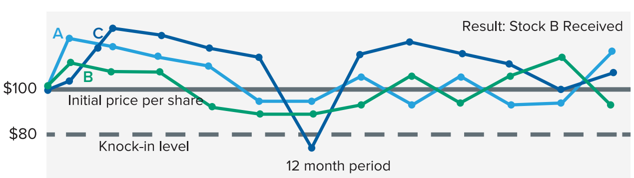
- Initial investment of $1,000 (the principal)
- A coupon of 15%--paid into the account regardless of underlying share performance.
- Maturity at 1 year
- A basket of three stocks - A, B and C - each priced at $100 per share for simplicity of example (normally the price per share would vary)
- The Knock-In level is $80, which is 80% of the original stock price
- Delivery of shares will occur if any one or more of the three underlying stocks ever trades at or below the Knock-In level at the close of any trading day between the date the stocks were originally priced through the observation date, which is a date typically set at three days or less before the maturity date. If no breach of the Knock-In level occurs, original invested principal will be repaid in cash.



SCENARIO 1

Knock-In Factor: By the determination date, Stock A rose to $160; Stock B finished even at $100; and Stock C fell to $85. None of the three stocks in the basket fell equal to or below the $80 Knock-In price level on any day up to and including the observation date of the investment.

Final Result: In addition to the 15% coupon of $150, 100% of the initial investment of $1,000 is returned in cash because the Knock-In level was never reached or breached. The total return equals 15%.

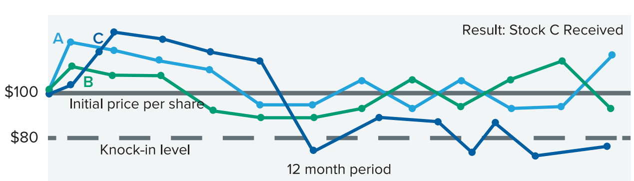


SCENARIO 2

Knock-In Factor: By the observation date, Stock A rose to $160; Stock B finished at $90; Stock C fell at one point to $75, breaching the $80 Knock-In level, then rose again, to end at $110.

Final Closing Price: On the observation date, Stock C's final closing price was $110, but Stock B had fallen by then to $90, $10 below the initial $100 per-share price.

Final Result: Because one of the stocks breached the Knock-In level on observation date, the investor receives 10 shares of the ***worst performing stock*** (Stock B--currently trading at $90 per share). The result is a return of $150 in interest payments from the 15% coupon and a delivery of 10 shares of Stock B, currently worth $900. The total net return equals 5%--consisting of 10% loss in principal, plus 15% coupon paid.



SCENARIO 3

Knock-In Factor: By the observation date, Stock A rose to $160; Stock B finished at $90; Stock C fell at one point to $75, breaching the $80 Knock-In level, then fails to rise again, to end at $70.

Final Closing Price: On the observation date, the final closing price of Stock C was $70, which is $30 below its initial $100 per-share price.

Final Result: Because one of the stocks breached and remained below the Knock-In level on observation date, the investor receives 10 shares of the worst performing stock (Stock C—currently trading at $70 per share). The result is a return of $150 in interest payments from the 15% coupon and a delivery of 10 shares of Stock C, currently worth $700. The total net return equals negative 15%--consisting of 30% loss in principal, plus 15% coupon paid.

Single Observation Multi-Stock "Worst Of Basket" Reverse Convertible Securities

DEFINITION

This type of security is similar to the Single-Observation Reverse Convertible Security. However, instead of there being one underlying stock, there is a "basket" of stocks.

Single-Observation Multi- Stock "Worst of Basket" Reverse Convertibles require that the share price of each stock closes above the Knock-In level only on the observation date in order to receive cash at maturity.

The securities in the basket are commonly from the same or similar market sector, such as airline issues or pharmaceuticals. Baskets of stocks usually include two, three or four separate issues.

Unlike the Single-Stock Knock-In, the Multi-Stock "Worst of Basket" Knock-In feature permits the issuer to deliver at maturity the shares of the worst performing-stock in the basket if the closing price of at least one of the stocks falls to or below the predetermined Knock-In level on the observation date.

As with Single-Stock Knock-Ins, the maximum return on Multi-Stocks is the initial principal plus the coupon payment. The investor does not participate in any appreciation of the underlying stocks.

As with Single-Stock Knock-Ins, an investor might lose some or all of the initial principal investment, but the stated coupon payment is never affected by price changes of the underlying stock or basket of securities.

Because the potential risk is higher for a Multi-Stock Reverse Convertible to reach or go below the Knock-In level than with a Single-Stock Reverse Convertible, the issuer normally offers a higher coupon and/or more downside protection than with a comparable Single-Stock Knock-In security.

Stock Redemption Calculation

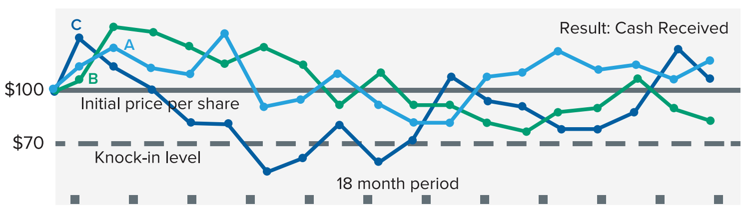
Cash payment or number of shares of stock to be delivered

The prospectus provisions that guide whether at maturity 100% of principal will be returned in cash, or whether a predetermined number of shares of stock are delivered instead, are similar for Multi-Stock Reverse Convertibles as they are for Single-Stock Reverse Convertibles. The difference is that if, on the observation date, any one stock within the basket falls to or below the Knock-In level, the investor will then be at risk to receive the worst performing stock in the basket as determined by percentage loss in price below the initial strike price. The stock the investor receives may even be a stock from the basket that never reached its Knock-In level. Investors should read and understand the prospectus prior to investing as the determination of worst-performing stock may vary by issue.

Single Observation Multi-Stock "Worst Of Basket" Reverse Convertible Knock-In Scenarios

ASSUMPTIONS

- Initial investment of $1,000 (the principal)
- A coupon of 10%
- Maturity at 1 year
- A basket of three stocks - A, B and C - each priced at $100 per share for simplicity of example (normally the price per share would vary)
- The Knock-In level is $70, which is 70% of the original stock price
- Delivery of shares will occur if any one or more of the three underlying stocks trades at or below the Knock-In level on the observation date.

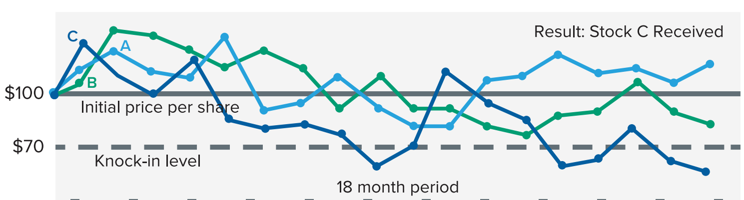


SCENARIO 1

Knock-In Factor: By the observation date, Stock A rose to $120; Stock B fell to $85; and Stock C finished at $110. For a period of time Stock C fell below the $70 Knock-In price level.

Final Closing Price: All three final closing prices of the stocks were above the Knock-In level on the observation date. Stock C breached the Knock-In level for a period of time, but since it was a Single Observation "Worst of Basket" the final closing price was reviewed only on the observation date.

Final Result: In addition to the 10% coupon of $100, 100% of the initial investment of $1,000 is returned in cash because the Knock-In level was not reached or breached on the observation date. The total return equals 10%.



SCENARIO 2

Knock-In Factor: By the observation date, Stock A rose to $120; Stock B finished at $85; and Stock C fell to $60, breaching the $70 Knock-In level.

Final Closing Price: On the observation date, Stock A and Stock B were above the Knock-In level, but Stock C's final closing price was $60, below the Knock-In level price.

Final Result: Because one of the stocks breached the Knock-In level on the observation date, the investor receives 10 shares of the worst performing stock (Stock C). The result is a return of $100 in interest payments from the 10% coupon and a delivery of 10 shares of Stock C currently worth $600. The net investment loss is $500.

Upside-Down Reverse Convertible Securities

Occasionally, the market provides an opportunity to profit from falling stock prices for a single stock or multiple stocks within a specific industry.

TO CAPITALIZE ON THIS OPPORTUNITY, THERE ARE UPSIDE-DOWN REVERSE CONVERTIBLE SECURITIES WHICH FEATURE:

- **Short-term maturity.** Typically 3 months
- **High coupon.** Typically in the range of 8% - 12% annually.
- **Contingent upside protection.** The Knock-In feature provides the investor with a certain amount of upside protection. The Knock-In level (also called the upside barrier) is set at a predetermined percentage of the initial share price.

An investor who purchases an Upside-Down Reverse Convertible Security is anticipating the underlying stock (or basket of stocks) will not breach the upside Knock-In level. If the Knock-In level is breached, and the stock price does not return to or below the initial price by the final determination date, the investor will receive a cash settlement in the amount of the original principal **minus the increase in the value of the stock(s) as determined by closing prices on that date**. Since potential stock increase is unlimited, 100% of the invested principal could be lost if the underlying stock(s) experience significant increase.

Regardless of whether or not the Knock-In level is breached, the coupon interest is paid.

ASSUMPTIONS

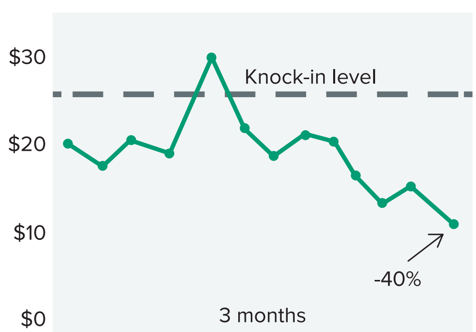
- 3-month term
- 125% Knock-In level = $25
- 20% coupon (5% per quarter)
- Strike price of underlying shares = $20

SCENARIO 1

Result: Investor receives coupon and 100% return of principal in cash.

Total Return = Principal + 5% coupon

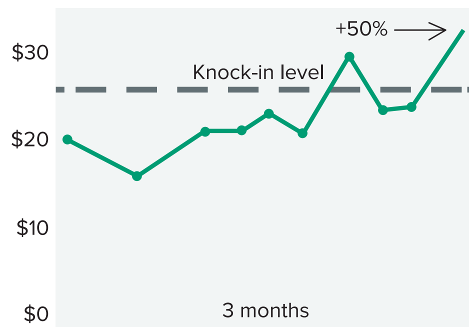
SCENARIO 2



Result: Investor receives coupon and 100% return of principal in cash.

Total Return = Principal + 5% coupon

SCENARIO 3



Result: The Knock-In level was breached & the final price of the underlying shares rose. Cash settlement, principal minus share price gain.

Total Return = 50% of Principal + 5% coupon

The risk to invested principal is in the potential increase in the price of the underlying share(s). If the closing price on the final observation date is significantly higher, most or all of the initial investment would be lost.

Summary Of Investor Risks & Suitability

PRINCIPAL AT RISK

Purchase of a Reverse Convertible Security carries with it the risk of loss of some or all of the initial invested principal. By purchasing the Reverse Convertible Security, the investor also indirectly sells the issuer a put option, except in the case of an Upside-Down Reverse Convertible. The option is the right for the issuer to deliver the underlying stock to the investor at maturity, when that stock has lost some or all of its value since the original strike price was established. The purchaser of a Reverse Convertible Security should be financially capable of withstanding a complete loss of principal, should understand how the option works and should be willing to receive stock that is worth less than the original investment instead of cash at maturity.

LIQUIDITY

Reverse Convertible Securities are designed to be held to maturity, although investors are not required to do so. Most issuers intend to provide a secondary market, but they are under no obligation to do so. Some issuers post secondary pricing on their websites during market hours, where pricing fluctuates intraday.

When considering selling in the secondary market, the investors should contact their broker. *While a secondary market of a Reverse Convertible Security is usually available, there is no guarantee that a secondary market for the security will exist or that an investment can be sold without loss. In addition, market variables make secondary pricing unpredictable.*

ISSUER CALL

There are some Reverse Convertible Securities that are issued with a call feature. This allows the issuer **(not the investor)** to redeem the notes before the maturity date. If the security is called, the investor may be faced with investing within a lower interest rate environment and the stated annualized coupon or percentage return may be lower.

CREDITWORTHINESS OF THE ISSUER

In addition to evaluating the underlying securities, the investor should investigate the creditworthiness of the issuer to evaluate its ability to make principal and interest payments.

TAXES

For full information regarding the tax consequences of Reverse Convertible Securities, investors should review the prospectus or offering circular and consult with their tax advisor.

PROSPECTUS

A prospectus will be provided to you upon request. It contains important information regarding the risks and unique structure of reverse convertibles that make them different from other debt instruments. The special risks associated with reverse convertible notes should be fully understood and carefully evaluated before making any investment. These securities are not suitable for all investors.

Fees & Commissions

- Fees and commissions may lower your overall return. Please review the prospectus or contact your investment representative for further information.
- * Noted here for informational purposes only; refer to issuer-specific materials for complete details.

Reverse Convertible Securities

- Reverse Convertible Securities may prove to be a smart investment if you seek above-average income within a well-diversified portfolio.
- Your Financial Representative can help you determine if a Reverse Convertible Security could fit into your Investment Strategy.

DISCLAIMER

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