

c. Bonds

Definition

Bonds (= debentures, notes) are securities that obligate the issuer (= debtor) to pay the bondholder (= creditor, purchaser) interest on the capital invested and to repay the principal amount according to the bond terms. Besides such bonds in the strict sense of the term, there are also debentures that differ significantly from the aforementioned characteristics and the description given below. We refer, in particular, to the debentures described in the "structured products" section.

In this area in particular, not the designation as bond or debenture is decisive for the product-specific risks, but the specific structure of the product.

Income

The income of a bond consists of the interest paid on the invested capital and any difference between the purchase price and the achievable price upon sale/repayment.

Consequently, the income can only be determined in advance if the bond is held until maturity. If the bond bears variable interest, the income cannot be determined in advance. The return (upon maturity) is used as comparative figure/measure for the income, which is calculated according to customary international standards. Bond yields which are significantly above the levels of bonds with a similar term should always be questioned, with an increased credit risk being a possible reason. If the bond is sold before the regular repayment date, the achievable sell price is uncertain and the effective return may differ from the originally calculated return. When calculating the income, accrued expenses must also be taken into account.

Credit risk

There is the risk that the debtor is not able to meet its obligations in whole or in part, e.g. if it is insolvent. Therefore, you need to take the debtor's credit rating into account in your investment decision.

The so-called rating (= credit assessment of the debtor) by an independent rating agency may be an indication for the assessment of the debtor's creditworthiness. The rating "AAA" and/or "Aaa" is the best credit rating; the worse the rating (e.g. B or C rating), the higher the credit risk and the higher will probably be the interest (risk premium) of the security at the expense of an increased default risk (credit risk) of the debtor. Investments with a comparable rating BBB or better are called "investment grade".

Price risk

If the bond is held until maturity, you will receive the redemption proceeds set out in the bond conditions upon redemption. Please note in this connection the risk of early termination by the issuer (where stipulated in the terms of issue). If you sell the bond before maturity, you receive the market price. It is based on supply and demand, which depend, amongst others, on the current interest rate level. For example, the price of fixed-interest bonds will decline if the interest rates increase for similar terms; conversely, the bond will increase in value if the interest rates for similar terms decline. A change in the debtor's creditworthiness may also affect the market price of a bond. With variable-interest bonds whose yield curve is flattening and/or flat, the price risk is considerably higher with bonds the interest rate of which is adjusted to the capital market interest rates than with bonds whose interest rate depends on the amount of the money market interest rates.

The degree of change in the price of a bond in response to a change in the interest level is described by the indicator "duration". The duration depends on the residual term of the bond. The greater the duration, the stronger the effects of changes to the general interest rate level on the price, both positive and negative.

Liquidity risk

The tradability of bonds depends on several factors, e.g. issuing volume, residual term to maturity, stock market rules and market situation. A bond may also be difficult to sell or not sellable at all and would have to be held until redemption in such case.

Bond trading

Bonds are traded at a stock exchange or off-market. Upon request, your investment company can usually provide you with the buy and sell prices of specific bonds. However, there is no claim for tradability.

If bonds are also traded at the stock exchange, the prices formed at the exchange may differ considerably from the OTC prices. The risk of weak trading can be limited by a limit supplement.

Right to terminate and repurchase limit

Subordinated bonds must not be terminated at the bondholders' option. Any rights of the issuer for termination or repurchase of the subordinated bonds depend on the prior consent of the responsible authority.

Some special bonds

Subordinated bonds ("tier 2")

These are instruments of the supplementary capital (tier 2) according to Art. 63 CRR. The bonds establish immediate, unconditional, unsecured and subordinated liabilities of the issuer with a minimum term of 5 years. The creditors are not entitled to terminate. In case of liquidation or the issuer's insolvency, the creditors' claims of tier 2 bonds are subordinate to the claims of creditors of non-subordinated bonds.

High-yield bonds

High-yield bonds are securities where an issuer with a low credit rating (= debtor, issuer) undertakes to pay fixed or variable interest on the capital received from the holder (= creditor, purchaser) and to repay such capital according to the bond conditions.

Residential convertible bonds

Residential convertible bonds are issued by housing banks and serve to finance housing (new construction and refurbishment). They securitise, in addition to the right to claim payment of capital and interest, a conversion right. They may be converted (= exchanged) to participation rights of a housing bank according to the bond conditions. After the conversion, the rank of the participation rights corresponds to the rank of ordinary shares. Payments on the participation rights are profit-based; a supplementary payment of remunerations cancelled in individual years is not made. There are currently tax benefits for residential convertible bonds. Prior to acquisition, it should be checked whether such benefits still apply.

Further special bonds

Please contact your customer adviser if you have any queries about further special forms of bonds, such as option bonds, convertible bonds or zero-coupon bonds.