

# Bonds

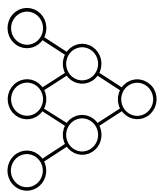
## General information

Bonds are debt instruments with which an investor loans money to an entity for a defined period at a floating or fixed interest rate. Bonds are used by companies, municipalities, states and sovereign governments to raise money and finance a variety of projects and activities.

When issuing bonds, it has to be determined, will they have fixed or floating interest rate or they are issued at a discounted value.

Fixed interest rate bonds	Floating interest rate bonds	Discounted bonds
The total amount repaid is larger than the nominal of bond.	The total amount repaid is larger than the nominal of bond.	The amount repaid is equal to the nominal of bond.
Coupon payments are fixed and paid with predetermined regularity.	Coupon payments are floating and paid with predetermined regularity.	No coupon payments.
If an investor holds a bond until the maturity, its return is known.	Amount of coupon payment depends on an index or other rate for each relevant period, therefore the exact amount is not known in advance.	Bonds purchase price is lower than its nominal value. By holding the bond until the end of the redemption period, the income arises from the difference between the nominal value of the bond and its purchase price.

The issuer has an obligation to repay back the money to the investors at the maturity of the bond. During the term of the bond, the investor may sell the bond on the secondary market, if one exists. When determining the market price of bond, the relevant factor is current interest rates in the market. The other factors that have a significant impact on bond prices are the issuer's credit rating and ability to repay the investment.



## Complexity and classification

Bonds can be classified into simple and complex financial instruments. Bonds are classified as complex financial instruments in case they embed a derivative or if the structure of the bonds is such that it may be difficult for the customer to understand the risk associated with the bond. Some examples of complex bonds:

- **Subordinated bond** is an unsecured debt instrument that in the case of borrower default, will be repaid only after all other corporate debts and loans are fully repaid (however, before the shareholders' requirements are met);
- **Callable bond** (also known as redeemable bond) allows to its issuer to redeem bond before maturity day and in this case investor will not receive remaining coupon payments, as well as face reinvestment risk, as reinvestment might be available only at lower interest rate. Terms under which the bond may be redeemed before maturity are defined in the bond's documentation;
- **Convertible bond** is a bond with a feature under certain circumstances to be converted to equities. In this case, conversion will be performed by certain conversion rate specified in bond's documentation;
- **Bond with embedded derivative.** For example bond with embedded option gives rights to its issuer or holder to take specified action in the future, according to what is specified in the bond's documentation (for example, redeem or sell bond before its maturity date).

Investing in complex bonds will generally be riskier than investing in simple bonds, as the additional risks associated with a complex bond must be taken into account. As well as these additional risks may vary depending on the specific bond and its complex attribute, so the client should read the bond's documentation very carefully before making an investment. To compensate for the investor's risk, complex bonds are usually issued at a higher interest rate than equivalent simple bonds, however higher yields are not guaranteed.



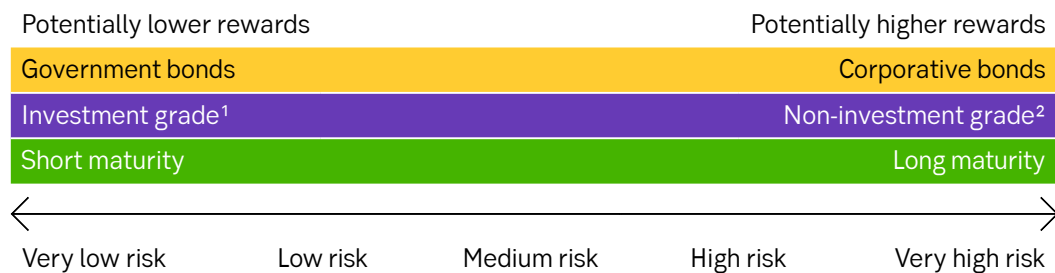
## Value

One of the reasons to invest in bonds is predictable income as coupon payments or in case of discounted bonds – as difference between nominal and purchase price. If the bonds are held until maturity, investors get back the entire principal, therefore investing in bonds might be used also to preserve capital.

If the bond is traded on secondary market, then also price changes matter – investor can earn or lose due to differences between sales and purchase prices.

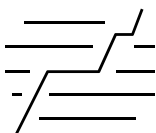
The value of bond depends on:

- **Current interest rates.** Market interest rates and the prices of bonds in the secondary market generally move in opposite directions. The longer the term of the bond, the bigger the impact;
- The **issuer's credit rating** and its ability to repay the investment;
- **The terms of the indenture.** A bond with a longer maturity usually will provide higher interest rate than a shorter-term bond. The longer the maturity of your bond investments, the greater the price volatility.



<sup>1</sup> Investment grade bonds are bonds rated as investment grade by Standard & Poor's (rated BBB- or higher), Moody's (rated Baa3 or higher) and Fitch (rated BBB or higher).

<sup>2</sup> Non-investment grade bonds are bonds rated as non-investment grade by Standard & Poor's (rated BB+ or lower), Moody's (rated Ba1 or lower) and Fitch (rated BB+ or lower).



## Risks

The main risks associated with debt instruments consist of the potential changes to the market value of the instrument due to changing market interest rates before the instrument reaches maturity, and of the risk of default by the issuer.

**Liquidity risk** is associated with the market risk and lies primarily in the fact that the client may suffer losses due to absence of liquidity in the respective regulated market, which impedes the sale of securities at the time desired by the client or the securities cannot be sold at a price close to the market price or at a price desired by the client. In case bond is delisted, it can become illiquid. Liquidity risk is usually significantly higher for bonds, which are not listed in regulated markets.

**Currency risk** may emerge when investor invests in a bond denominated in other than investor's main currency. For investors it is less risky to invest in their main currency, unless they have sufficient knowledge of currency risks.

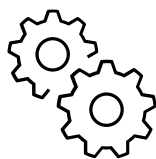
**Default risk** occurs when the issuer will not be able to make the required interest payments or redeem the nominal at the redemption date. In case of a default of an issuer, investor can lose everything he had invested. For government bonds, the issuer is less likely to become insolvent than for corporate bonds. For investment grade bonds, the issuer is less likely to become insolvent than for high yield bonds. When company is facing bankruptcy, it might decide also to restructure the debts. The bond restructuring process typically involves reducing the interest rates and/or nominal value, extending maturity and other unfavorable conditions.

**Market risk** is a risk that the client suffers losses due to overall adverse price movements in the securities market or in a certain area thereof. Adverse price movements may be caused, for instance, by poor economic indicators of the relevant state or branch of the economy, unstable economic environment, unstable securities market, etc.

**Interest rate risk** – Interest rate may change the price of a bond. The interest risk is related to the market risk and lies in the fact that the client may suffer losses from adverse developments on the market, which may be manifested in changes in interest rates, interest rate volatility, interest rate gap between investment objects of different risk levels, early repayment of debts, etc.

**Reinvestment risk** appears for a callable bond, since the issuer may call back the bond before maturity date and the investor may be forced to reinvest the received funds in securities with a lower yield.

**Credit risk** – the client may suffer losses due to the fact that the value of financial instruments acquired by it falls, since the issuer of the securities may exhibit poor financial performance, economic difficulties or other similar indicators. The issuer's poor economic performance may cause, among other things, the inability of the relevant issuer to perform obligations arising from the securities before the investors.



## Taxation and fees applied

Taxes can be applied for activity of investing. An investment account allows Latvian tax residents to postpone the taxation of return on investments. The tax treatment depends on the individual circumstances of each client and may be subject to change in the future. Clients should independently evaluate all circumstances related to taxes on investments or their return.

### Fees applied:

- Bond trading fee
- Safekeeping fee

More detailed information about the fees is provided in SEB's price list.