BNP PARIBAS FORTIS

Bonds

A loan granted to a company or to a public authority

Entrepreneurs need money to start a business and to develop that business. They can raise this money in various ways – they can either invest themselves or apply to a bank for a loan. But they can also call directly on savers by issuing bonds. The party issuing a bond is called "the issuer".

Public authorities also issue bonds. In everyday language, we talk about "**Government bonds**": this is the method used by the state to raise money from the general public.

Do you think it is a good idea for banks to use your money to finance projects involving social responsibility, such as building hospitals or schools or small businesses? Then you might consider investing your money in a **citizen's loan**.

When you buy a bond from a business or from a public authority, you are lending it money, which the issuer has to pay back to you after an agreed period. In exchange for making your money available, the issuer pays you interest.

Features

→ **Term**
Most bonds have a fixed term. The business or the public authority to which you lend money tells you the day on which it intends to pay back your money. This day is called "due date".
"Perpetual bonds" also exist. This is borrowing with an unspecified term, which you cannot ask to be repaid by a certain due date, as there is no maturity.

→ **Interest**
Most bonds have a fixed interest rate; you know in advance exactly how much interest you will earn. Usually, this interest is paid annually. This is called "the coupon". This name dates back to the era of "paper" bonds. At that time, every year, investors had to detach a coupon from their paper bond in exchange for which they would then receive their interest. Today, bonds are "paperless"; they no longer exist on paper, only in electronic form, in a custody account. Interest on your bonds is paid automatically into your bank account.
Variable rate bonds also exist. The interest you earn usually fluctuates in relation to changes in the market interest rate. Ask your banker or financial intermediary for information before investing in variable rate bonds.
For some bonds, all interest is paid in a single lump sum on the due date. These are "zero-coupon bonds". As the interest on these bonds is not paid annually, the rate or value increases every year. On the due date, you therefore recover a sum which is greater than the price you paid for their purchase.

→ **Risks**
A bond is an investment product and there are risks associated with it. These risks differ from one bond to another. Many bond issuers have a rating, which indicates the probability of the bond issuer being able to repay the capital and the interest on that capital. This is called its "solvency".

Primary or secondary market?

Bonds are nearly always purchased and sold via a banker or a financial intermediary. Make sure you get enough information from these parties to find out exactly what you are buying and how the product works.

You can buy bonds from when a business or a public authority decides to issue them. You can then buy them on the **primary market**. You can also buy bonds that have already been issued: in this case, you do not buy them from the business or from the public authority issuing them, but from someone wanting to sell their bonds. In this case, you buy them on the **secondary market**.

When a bond is issued for the first time, it is allocated a value. This is the "nominal value". The nominal value is not always the sum that you actually have to pay to buy the bond. You may have to pay a little more or a little less than the nominal value. The price that you have to pay for the bond is called the issue price. For example, the nominal value of the bond is €1,000, but the issue price is €1,010. The difference of €10 is an "issue premium" of 1%.

You will recover your money on the due date. The amount repaid is usually the nominal value. In some cases, you receive a small supplement at the time of repayment: the "redemption premium".

Below and above par

You can also buy bonds from someone on the stock market. In this case, you buy on the secondary market. The price that you pay on the secondary market for a bond depends on the law governing supply and demand.

The stock market price of a bond is always expressed as a percentage of the nominal value. When a bond with a nominal value of €2,000 is quoted at 104%, this means that you have to spend €2,080 to buy it. A bond quoted above 100 is quoted "above par" and a bond quoted below 100 is quoted "below par".

Charges and taxes

The charges and taxes that you pay when you invest in bonds also determine the return on your investment. Five types of charges are associated with an investment in bonds; in particular, you pay tax on the return on your investment.

1. **Stock market tax**
   When you buy existing bonds on the secondary market, you have to pay stock market tax of 0.09%. If you buy stock market bonds for €1,000, you have to pay €0.90 in stock market tax. If you buy new bonds, so on the primary market, this tax is not due.
2. **Brokerage fees**
   Banks and stock market companies bill fees for carrying out your orders on the secondary market. These are brokerage fees or commission. When you buy bonds listed on a foreign stock market, you also need to take into account the charges and taxes in force in the country concerned.
3. **Custody fees**
   In the past, you could physically receive the bonds that you bought. Today, they are paperless. They no longer exist physically, on paper, but are registered in a custody account with a bank or with a stock market company. Most institutions bill fees for keeping your bonds in a custody account. Here too, charges vary from one institution to another.
4. **Withholding tax on interest**
   Since January 2013, tax of 25% has been due on the interest from bonds of Belgian companies or Belgian government bonds. As a result, €100 in gross interest produces €75 net. Interest on bonds from non-Belgian companies or foreign governments is firstly taxed in the country of origin and then in Belgium. In countries with which Belgium has signed a tax treaty, it may be possible to recover the foreign tax. Where applicable, ask your banker or financial intermediary for more details, to find out the situation for you in tax terms.
5. **Capital gains tax**
   If you sell your bonds before the due date at a price higher than the price that you paid to buy them, you make a capital gain. You do not have to pay tax on this capital gain.
   Note, however, that you do have to pay 25% in withholding tax on the difference between the purchase price and the redemption price of a zero-coupon bond.

Test your knowledge of bonds

Did you know...?

- By buying a bond, you are granting a loan to the issuer (a public authority, a business, a bank, etc.) for a predetermined term.
- In return, you are entitled to repayment of the capital on the final due date. During the investment period, there is no protection of the capital (you can still sell it before redemption date).
- The value of a bond may fluctuate during the investment period, on account, for example, of changes in interest rates and the reliability of the issuer.
- In addition to coupons (which are liable to withholding tax and depend on the issuer's solvency and the term), bonds can also bring in additional income, in the form of a capital gain when market rates fall below the rate of the bond held.
- Investing in bonds is not without risk. There are several types of bonds, each carrying their own level of risk. The main risks are liquidity risk, currency risk, rate fluctuation risk, interest rate risk which might mean a drop in the share price, risk of absence of income, risk of insolvency, capital risk or redemption risk.
- The liquidity of a bond can influence its price on the secondary market.
- The purchase or sale of a bond gives rise to the levying of charges.

Like to know more about bonds?

Go to www.wikifin.be or consult our Financial Instruments Information Brochure on our website www.bnpparibasfortis.be/saveandinvest > MiFID > Like to know more about MiFID?

Some sections of this document were taken from www.wikifin.be

BNP Paribas Fortis sa/nv – Montagne du Parc/Warandeberg 3 – 1000 Brussels – RPM/RPR Brussels – VAT BE0403.199.702.

F04159N / 01.04.2014