WHAT ARE BONDS?

Entrepreneurs need money to start a company and enable it grow. They can obtain this money in various ways. They can invest their own money or obtain a loan from a bank. They can also appeal directly to savers and investors by issuing bonds.

The government also issues bonds. A bond issued by the Belgian government is commonly referred to as a **treasury bill**. The government issues these bonds to obtain money from the public at large. The company or government issuing the bonds is referred to as the **issuer**.

If you purchase a bond from a company or a government, you are lending money to the issuer. The company or government must pay back your loan after a term agreed upon beforehand. In exchange for making your money available, you receive interest from the issuer during the term. This is called the **coupon**.

At the end of the term, on the **maturity date**, you normally get your original deposit back. However, you should take into account that, if the issuer becomes bankrupt, your original deposit may be paid back only in part or not at all. So if you wish to minimise this risk, you should choose an issuer with an excellent creditworthiness rating.

Do not become blinded by a very high coupon or returns that look too attractive. After all, a high coupon or a very low quoted price for a bond can be an indication that the issuer is in financial difficulties, which means that you may very well be paid back only part or none of your original deposit on the maturity date.

You can buy bonds when a company or a government decides to issue bonds. You then buy them on the **primary market**. When a bond is issued for the first time, it is given a value: **the par value**. The par value is not always the amount you actually have to pay to buy the bond. It is quite possible that you will have to pay a bit more or a bit less than the par value. The price that you have to pay for the bond is called the **issue price**. For instance: the par value of the bond is €1000, but the issue price is €1,010. The difference of €10 is an **issue premium** of 1%.

You can also buy bonds that were issued a while back. You then do not buy them from the company or government itself but from someone who wishes to sell his bonds before the maturity date. In that case, you buy them on the **secondary market**.

The price you pay for a bond on the secondary market can be lower or higher than the original issue price. This is determined, among other things, by the changes in the market rate of interest and the creditworthiness of the issuer (refer to risks). Accordingly, if someone wishes to sell his bonds on the secondary market before the maturity date, he will book a gain or a loss compared to his original deposit, depending on the market conditions. He can therefore realise a profit or sustain a loss.

Features

Issuer: The company, the government, or the organisation that issues the bond.

Interest: Most bonds have a fixed interest. Usually, the interest is paid out annually. This annual interest is called the **coupon**. The interest on your bonds is automatically paid into your bank account.

There are also bonds with a variable interest rate. The interest that you receive then usually fluctuates in line with the fluctuations in the market rate of interest. Make sure you receive sufficient information from your bank or financial intermediary before you invest in bonds with a variable interest rate.

For some bonds, all the interest amounts are paid out at one go on the maturity date. These are **zero-coupon bonds**. As the interest on these bonds is not paid out each year, the price or value of these bonds increases annually. On the maturity date, the amount you are paid back is then higher than the price you paid when you bought the bond.

Term: most bonds have a fixed term. The company or the government to which you are lending money will tell you on which day they will repay your loan.

Currency: a bond can be issued in euros or in a foreign currency.

Risks

Currency risk: a bond issued in a foreign currency constitutes a currency risk against the euro. In other words, due to fluctuations in exchange rates, the amount in euros that you receive if you sell it before the maturity date or wait until the maturity date may end up being less or more than the amount you originally invested.

Liquidity risk: the liquidity of a bond is an indication of how easy or difficult it is to sell it on the market. Liquid bonds are easy to buy or sell. Non-liquid bonds are difficult or impossible to buy or sell.

Market risk: the value of a bond is strongly dependent upon the market interest rate. If the interest rate rises, the value of your bond decreases. The interest rate paid on your bond is then less than the current market interest rate. As a result, your bond will be less sought after on the secondary market. In contrast, if the market rate of interest decreases, the value of your bond will rise.

Credit risk: if the issuer of your bond has financial problems, it is possible that you will get back only part or none of your original deposit. The creditworthiness of an issuer is expressed in the form of a rating. You should check this before buying a bond.

Costs and taxes

If you buy bonds, you should also take into account the costs and taxes that you need to pay. After all, these will influence the return on your bond.

COSTS

Brokerage costs: Banks charge costs to carry out your orders on the secondary market.

Custody fee: Most banks charge costs to hold your bonds in a custody account.

Sale and placement commission: If you buy a bond on the primary market, you pay a placement commission. Together with the par value, this is the issue price.

TAXES

Tax on stock exchange transactions (TOB): If you buy existing bonds on the secondary market, you must pay a tax on stock exchange transactions. If you buy new bonds on the primary market, you do not have to pay this tax.

Withholding tax on the interest amounts: You must pay withholding tax on the interest from bonds issued by companies or governments. The interest paid on bonds from non-Belgian companies or governments is first taxed in the country of origin, after which it is subject to withholding tax in Belgium.

Capital gains tax: If you sell your bonds before the maturity date for an amount that is higher than the price you paid upon purchase, then you realise a capital gain. You do not have to pay any tax on this capital gain.

Please note: you do have to pay withholding tax on the difference between the purchase price and the repayment price for a zero-coupon bond.

Would you like to know more about bonds?

Read our *Information brochure on financial instruments* on our website www.bnpparibasfortis.be. Some sections of this document were taken from www.wikifin.be.

Responsible editor: A Moenaert - BNP Paribas Fortis SA/NV, Montagne du Parc/Warandeberg 3, 1000 Brussels, RPM/RPR Brussels, VAT BE0403.199.702 – june 2016.

032809800668

BNP PARIBAS FORTIS

The bank
for a changing
world