WHAT ARE PERPETUAL BONDS OR PERPETUALS?

Perpetuals are bonds with no maturity date. So they can last forever.

These bonds usually have a callable feature. This means that the issuer is entitled to terminate the loan and pay back the bondholder at a predetermined price on certain dates or in certain periods defined when the loan was issued.

Features

Perpetuals have the same basic features as ordinary bonds.

- The **issuer** is the entity issuing the bond. This entity borrows money from investors and will pay interest (**coupon**) to those investors in return. Interest is usually paid annually.
- Perpetual bonds can also be **rated**. This rating gives an indication of the creditworthiness of the issuer when it is awarded. It is awarded by specialised, independent firms (mainly Moody's and Standard & Poor's).

A perpetual bond differs from an ordinary bond in the following ways:

- As the name suggests, perpetual bonds have no **maturity date**.
- Perpetual bonds usually have a **callable feature**. This entitles the issuer to pay back the bond early under certain conditions.
- If the issuer gets into financial difficulties, it may be decided to reduce the **coupons** or not to pay them at all. The coupon is therefore not guaranteed.
- The **issuer** of these bonds is usually a financial institution. There are often extra conditions (see clauses in the prospectus) which you as the investor should take into account. If the financial institution breaches the conditions, especially those related to the institution's creditworthiness, the bond can be converted into shares or written off in part or in full.
- A perpetual bond also has a number of **features of an equity investment**. The risk inherent in such an investment is therefore considerably greater than that in a classic bond.

Please note: always read the prospectus carefully before buying a perpetual bond.

Risks

Currency risk: if you invest in perpetual bonds in foreign currency, there is a currency risk against the euro. The amount in euro that you receive in the event of sale or on the expiry date can be more or less than the amount that you originally invested owing to the exchange rate.

Liquidity risk: a bond's liquidity reflects whether it is easy or difficult to sell the bond on the market. Liquid bonds are easy to buy and sell. Illiquid bonds are more difficult to buy and sell. Perpetuals are very often less liquid than conventional bonds.

Interest rate risk: the value of a bond is considerably dependent on the evolution of the market interest rate: if the interest rate rises, a bond's value falls; and if the interest rate falls, the bond's value rises. The longer the term of the bond, the more the value will rise or fall if there is a change in the market interest rate. The interest rate risk inherent in perpetuals is therefore greater than in classic bonds.

Credit risk: perpetuals are highly subordinated bonds. This means that, in the event of bankruptcy, you will only be paid back after all creditors and after the holders of classic subordinated bonds. It is therefore highly unlikely that you will recoup any of your outlay.

Market risk: as perpetual bonds can be converted into shares, the price is also very sensitive to developments on the equity markets.

The existence of a callable feature is also a risk for investors: this is because the issuer will exercise the call if it sees an opportunity to obtain finance at a better price. This is often the case with a low market interest rate. Bondholders are then obliged to reinvest at less favourable terms.

Fluctuations: as you will almost certainly receive nothing in the event of bankruptcy, and as even the coupon is not always guaranteed in difficult periods, the price of a perpetual bond will behave considerably like a share. Price fluctuations can therefore be very significant. This is why, in terms of risk profiles, perpetual bonds are compared to shares, in that their future value is also not guaranteed and the return is uncertain in difficult financial periods.

Costs and taxes

When you buy bonds, it is in your best interest to take the costs and taxes that you will have to pay into account. This is because they will affect the return on your bonds.

COSTS

Brokerage: banks charge fees to execute your orders on the secondary market.

Custody fee: most banks charge fees for keeping your bonds in a custody account.

Sale and placing commission: when buying bonds on the primary market, you pay placing commission. Together with the par value, this forms the issue price.

TAXES

Stamp tax on share deals: if you buy or sell existing bonds on the secondary market, you have to pay stock exchange tax. If you buy new bonds on the primary market, you don't have to pay this tax.

Withholding tax on interest: you have to pay withholding tax on the interest earned on Belgian corporate and government bonds. The interest earned on non-Belgian corporate and government bonds is taxed first in the country of origin and then it is subject to withholding tax in Belgium.

Capital gains tax: if you sell bonds for more than the price you paid at the time of purchase, you make a capital gain. You don't have to pay any tax on this capital gain.

Do you want to find out more about perpetual bonds?

Read our *Financial instruments information sheet* on our website at www.bnpparibasfortis.be.

032809800668

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