Bonds

Convertible and warrant bonds
A convertible bond is a fixed-income security that normally bears interest at an agreed nominal rate with no adjustment for inflation. It gives the holder the right to convert it within a predefined period and at a predefined ratio into an equity instrument from the same issuer, e.g. a share. If this conversion right is not exercised, the bond falls due for repayment at the end of its term. Convertible bonds are sometimes used as a means of exchanging shares between the shareholders of two companies that are merging, in which case they are known as exchangeable bonds. Instead of a conversion right, warrant bonds comprise an option, subject to certain conditions, to buy equity instruments in addition to the bond. Convertible bonds that must be converted into equity instruments at a specific time or under specific conditions are called mandatory convertible bonds. Mandatory convertible bonds issued by a bank are called contingent convertible bonds (CoCos).

Special risks
When buying convertible bonds, investors should always consider whether conversion is mandatory and, if so, what conditions are attached. The right to convert a bond or exercise an option may also be restricted.

Hybrid bonds
Hybrid bonds are debt instruments with certain equity-like elements, such as no fixed term, the possibility of postponing or cancelling periodic interest payments or – like equity securities – lower priority if the issuer is liquidated. Banks and insurers tend to qualify hybrid bonds as regulatory capital, while rating agencies can sometimes attribute them to the issuer's equity, depending on their structure. This makes them attractive for industrial companies as well.

Special risks
The overview below is limited to the characteristic features and risks of the most commonly issued types of hybrid bond. Investors are advised to consult the term sheet or key information document before making a decision.

Asset-backed securities (ABSs)
With asset-backed securities (ABSs), risks, for instance those attached to a group of debt claims, are transferred to a special-purpose vehicle (SPV). The SPV finances this transaction by issuing bonds backed by a portfolio or a pool of assets, hence the term "asset-backed". If the assets backing a bond are mortgages, it is called a mortgage-backed security (MBS). Many other types of ABS exist, and there is no standard structure or terminology. Two examples are collateralised debt obligations (CDOs) and collateralised loan obligations (CLOs). The individual portfolio components would be unattractive or even unobtainable in this form for individual investors. Creating a portfolio makes it possible to combine and sell a range of assets and risks.

Special Risks
The risk level of ABSs always depends on the issuer – the SPV – as well as the quality of the portfolio and the specific structure of the security. For example, if additional assets (e.g. blocked credit balances on reserve accounts) are created outside the portfolio to account for certain scenarios, these ensure the agreed payment flows as well as those that are important for the overall transaction. This reduces the risk of default on the payment flows considerably and also reduces the overall risk of default on the periodic interest payments or the repayment of the ABS at the end of its term. The SPV routinely issues several classes of ABS shares with different ranks, credit ratings and risk premiums. If it does not have sufficient funds to meet all its obligations when they fall due, the available funds are paid out by rank. The lower ranks bear any losses, while the higher ranks might be covered in full. In addition, ABS holders may be granted a security interest in the SPV's assets, which could reduce their loss risk. Anche laddove venga costituito un pool o un portafoglio, la mancanza di diversificazione può dare luogo a un rischio di accumulazione. Even if a pool or portfolio is created, a lack of diversification can lead to a cluster risk.
If the SPV is domiciled outside Switzerland, attention should be paid in particular to the issuer risk and the quality of state supervision of SPVs in the domicile country. Classes with higher risk premiums (and thus higher yields) typically also have a higher risk of default than those with lower risk premiums**.**

Issuer risk
Risk of the issuer of the financial instrument becoming insolvent.

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DISCLAIMER

This information sheet contains an extract from the brochure "Risks Involved in Trading Financial Instruments" published by the Swiss Bankers Association (SBA), the complete version of which can be consulted at www.swissbanking.org or on the Bank's website (www.corner.ch).

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Before making any investment decision, we invite you to consult a financial advisor and to examine carefully all documents and information available for each financial instrument (prospectus, basic information sheet, term sheet, etc.).

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