Bonds/Debentures

The issue of bonds in the Czech Republic shall be subject to the Bonds Act No. 190/2004 Coll., as amended. The issue of foreign bonds is ruled by similar legal regulations adopted abroad. Bonds bind the issuer (=debtor, issuer) to pay the bond holder (=creditor, buyer) the interest on the invested capital and to repay the principal in accord with conditions of the bond.

Return:

The bond yield is composed of the interest on the capital and any difference between the purchase price and the price achieved upon the sale/redemption of the bond.

The return can be determined in advance only if the bond is held until maturity. In case of variable interest rates, the return cannot be determined in advance. For the sake of comparison, the annual yield (based on the assumption of the bullet repayment of the loan due) is calculated in line with international standards for calculation of the annual yield. Bond yields that are significantly above the generally customary level should always be questioned, because an increased credit risk can be a possible reason.

The price achieved when selling a bond prior to its redemption (market price) is not known in advance. Consequently, the return may be higher or lower than the yield calculated initially. In addition, transaction costs, if any, must be deducted from the overall return.

Credit risk:

There is always the risk that the debtor is unable to pay all or part of his obligations, e.g. in the case of the debtor's insolvency. The credit standing of the debtor must be therefore considered in an investment decision.

Credit ratings (assessment of the creditworthiness of the issuer) issued by independent rating agencies provide some guidance in this respect. The highest creditworthiness is "AAA“ or "Aaa“ (e.g. for German or American government bonds). In the case of low ratings (e.g. "B“ or "C“) the risk of default (credit risk(is higher but by way of compensation the instruments generally pay a hither interest rate (risk premium). Investments with a rating comparable to BBB or higher are generally referred to as "investment grade". For comparison, the investment grade of the Czech government bonds is A+.

Price risk

If a bond is held until maturity, the investor will receive the redemption price as stated in the bond terms. Please note the risk of early calling-in by the issuer, to the extent permitted by the terms and conditions of the issue, so-called call option, i.e. the right of the issuer to repay or redeem the bonds prematurely.

If a bond is sold prior to maturity, the investor will receive the current market price. The price is regulated by supply and demand, which is also subject to the current interest rate level. For instance, the price of fixed rate securities will fall if the interest on bonds with comparable maturities rises. Conversely, bonds will gain in value if the interest on bonds with comparable maturities falls.

The value of the change in the price of a bond as a reaction to the change in the interest level is called "duration". The duration depends on the remaining time until maturity of a bond. The higher the duration is – time until maturity, the higher is the impact of changes in the general interest rate on the price, whether negative or positive.

In case of variable interest bonds whose interest rate is indexed to the money market rates (PRIBOR, LIBOR, EURIBOR) the market price movement is considerably lower.

A change in the issuer's creditworthiness may also affect the market price of a bond.

Liquidity risk

The liquidity, or the negotiability of bonds, depends on several factors, e.g. a volume of the issue, remaining time to maturity, s market rules and market conditions. Bonds which are difficult to sell or which cannot be sold at all must be held until maturity.

The next information about types of risk are described in a document "Investment Services in UniCredit Bank Czech Republic and Slovakia, a.s.

SOME SPECIAL BONDS

Zero Bonds

Zero Bonds are bonds that do not pay any coupon. The yield on such bonds is realized by buying the bond for a lower purchase price and selling it for a higher price, or at the maturity.

Asset Backed bonds

Asset Backed bonds are a special type of bonds where the repayment of debts is covered not only by a legal obligation of the issuer, but also by other assets. A typical example is mortgage bonds where debts are fully covered by claims from mortgage loans. Such bonds mean for an investor an additional decrease of risk of default on bonds.

Subordinated bonds

In case of the debtor's liquidation or insolvency the investor will receive the money only after all other non-subordinated debts of the debtor have been settled. It is impossible to set-off claims for the repayment arising out of a subordinated bond against the claims of the bond issuer.

Structured bonds

Structured bonds mean the investment in bonds and simultaneously in other more risky asset. A bond item is to secure a certain degree of return on the invested amount, because, in accord with the Bonds Act (with foreign bonds in accord with terms of the bond) the issuer is obliged to repay at least the nominal value of a bond. This amount is the minimal value of the bond at the maturity. The risk part of the structured bond is linked to a coupon. The coupon rate is usually derived from the price development or from the value of other underlying asset (share, index, exchange rate, etc.).

The information about other special types of bonds, such as guaranteed bonds, convertible bonds, etc. can be provided to you on request.