Facts about Over-the-Counter Bond/Certificate of Deposit

Bonds are debt instruments, or agreements to repay capital and interest on pre-determined dates. They are issued by companies or governments (Issuers) to raise capital. As an investor, it is effectively equivalent to lending money to the Issuers. **A certificate of deposit (CD)** is a product offered by banks that offers a coupon rate, which is in general higher than interest on an ordinary savings account, in exchange for the customer agreeing to leave a lump-sum deposit untouched for a predetermined period of time.

Bonds/CDs are typically traded Over-the-Counter (OTC). OTC Bonds/CDs can be traded in the primary market or secondary market via banks and brokers. HSBC Broking Securities (Asia) Limited ("HSBC Broking Securities") have lined up with multiple liquidity providers to support OTC Bonds/CDs trading with investors.

Investors may buy Bonds/CDs in search of steady interest or potential capital gain. Different types of risks are also associated with Bonds/CDs, such as credit risk, interest risk, inflation risk and liquidity risk.

How does it Work?

Before understanding more about the trading mechanics and complexity for bonds/CDs, there are some key terms you should know in relation to this instruments:

Issuer	The party that borrows the money.
Guarantor	Some Bonds are guaranteed by a third party called a Guarantor. If the Issuer defaults, the Guarantor agrees to repay the Principal and/or Accrued Interest to the investors.
Principal	This is also called the par value or face value. It is the amount repaid to the investors when the Bond/CD matures.
Coupon/Interest	The interest that an Issuer pays to the investors.
Coupon Rate	This is the rate at which the Issuer pays Coupon on the Principal to the investors each year. The Coupon Rate can be fixed, floating or even zero.
Coupon Frequency	The regular intervals that Coupon payments are normally made, eg annually, semi-annually or quarterly.
Coupon Date	It is the date that the Issuer makes Coupon payment. Investors may receive the Coupon payment later than the Coupon Date due to processing time taken by payment agent and custodian.
Fixed Rate Coupon	Coupon Rate of a Bond/CD is a fixed rate over the Term of the Bond/CD.
Floating Rate Coupon	Coupon Rate of a Bond/CD is adjusted periodically according to a predetermined benchmark.
Zero-coupon	There is no periodic Coupon payment, but the Bond/CD is usually issued at a discount to its par value. On maturity, investors receive the full par value.
Accrued Interest	It is the unpaid Coupon on a Bond/CD that has accumulated since the issuance date of the Bond/CD, or since the last Coupon Date.
Day-count Convention	It is a system used to calculate the amount of Accrued Interest. Different Bonds/CDs may have adopted their own Day-count Convention. Among the most common conventions are 30/360 or 365, actual/360 or actual/365, and actual/actual.
Maturity Date	It is the date that the Issuer repays the Principal. Investors may receive the Principal payment later than the Maturity Date due to processing time taken by payment agent and custodian.
Term	This is the life of the Bond/CD, ie the period (usually a number of years) over which the Issuer has promised to meet its obligations under the Bond/CD. Some Bonds/CDs may have an indefinite life, ie no Maturity Date, eg Perpetual.
Yield-to-maturity (YTM)	YTM is the rate of return anticipated on a bond if it is held until maturity. YTM is usually expressed as an annual rate of return.
Credit Rating	Investors can refer to the Credit Rating of the Bonds, assigned by credit rating agencies. The credit rating agencies will assign higher rating to the Bonds which, in their opinion, the investors may have a better chance of receiving a payment for the Principal and Coupon. Some Bonds may not be rated by credit rating agencies and are classified as unrated.
Security and Seniority	Some Bonds are secured by specific assets or revenue stream of the Issuer as collateral. If the Issuer defaults, investors can take possession of the collateral and sell it to regain some or all of the amount originally loaned to the Issuer. Seniority refers to the order of repayment in the event of a sale or bankruptcy of the Issuer. Upon the occurrence of winding-up of the Issuer, Senior Bond must be repaid before Subordinated (or Junior) bond is repaid. Payment claim of a subordinated investor will rank behind the claims of, amongst others, the holders of unsubordinated debt.

Call Option	Issuer has the right to call (or retire) the Bond and return the par value/face value together with the Accrued Interest to the investors at some pre-specified date before maturity. A Bond with a Call Option is a Callable Bond, which limits the upside potential of the bond price since it is likely that the Issuer will call back the Bond if the bond price goes up beyond the call price.
Call Date	It is the date pre-specified on which a Callable Bond can be redeemed before maturity.
Yield-to-call (YTC)	Yield-to-call is applicable to a callable bond and if it is called prior to maturity. It assumes that investors hold the bond until the call date.
Keepwell Deed Provider	A Keepwell Deed Provider is usually the ultimate parent company of the Issuer. A Keepwell Deed is an agreement to maintain the Issuer's solvency and financial backing throughout the term. However, its obligation is not the same as Guarantor. Investors should not rely on the Keepwell Deed Provider to make Principal and Coupon payment in case the Issuer failed to make payment.
Bond Placement	It is a funding round of Bonds which are sold through a private offering. Investors are sometimes offered the opportunity for participation by brokers.
Complex Bonds	Bonds with one or more special features (including, but not limited to, Perpetual or subordinated bonds, or those with variable (eg step-up or step-down) or deferred interest payment terms, extendable maturity dates, or those which are convertible or exchangeable or have contingent write down or loss absorption features, or those with multiple credit support providers and structures).
Put Option	Investor has the right to sell the Bond back to the Issuer and gets back the par value/face value together with the Accrued Interest from the Issuer prior to the Maturity Date. A Bond with a Put Option is a Puttable Bond.
Coupon Re-fix	A Bond has a scheduled feature which the coupon rate can be reset on dates specified by the Issuer. Examples are Bonds with step-up or step-down feature.
Convertible	A Bond can be converted into shares of the Issuer at some pre-determined ratio upon maturity. The convertibility follows certain conditions. Investors have the right to convert their Bond into some amount of equity. Instead of receiving the Principal and Accrued Interest, the investor receives shares of the Issuer. Bond investor's seniority is generally higher than shareholders.
Exchangeable	An Exchangeable Bond has the same features as a Convertible Bond except that investors have the right to convert it into shares of a company other than the Issuer. The company involved is usually a subsidiary or a company in which the Issuer owns a stake.
Perpetual	A Perpetual Bond has no Maturity Date. It is not redeemable and the return of capital is not automatic. Investors can only dispose the Bond in the secondary market or when the Bond is called, but the Call Option is at the sole discretion of the Issuer.
Coupon Payment Deferrable and Non-Cumulative	Coupon on the Bond is at the sole discretion of the Issuer. It may be paid out of the profits of the Issuer or Guarantor available for distribution and permitted by law to be distributed. The Coupon missed will not be accumulated. There are limited remedies for non-payment under the Bonds. Any scheduled Coupon will not be due if the Issuer elects to defer that Coupon. Deferred Coupon does not constitute as payment default.
Coupon Payment Deferrable and Cumulative	Issuer has the option to defer Coupon. Any Coupon not paid on a Coupon Date constitutes arrears of Coupon but additional interest on the Coupon may or may not accrue. Although distribution of Coupons are cumulative, the Issuer may defer payment for an indefinite period of time. There are limited remedies for non-payment under the Bonds. Any scheduled Coupon will not be due if the Issuer elects to defer that Coupon. Deferred Coupon does not constitute as payment default.
Extendable	It is a Bond with an embedded option for an investor or an Issuer to extend its maturity date by a number of years. If the investor has an option to extend, then such Bond may be considered as a portfolio of a straight, shorter-term Bond and a Call Option to buy a longer-term Bond. This relatively rare type of Bond works to the advantage of investors during periods of declining interest rates. Pricing of this type of Extendable Bond will be similar to that of a Puttable Bond. If the Bond is structured to give the Issuer an option to extend, then the pricing will be similar to that of a Callable Bond.
Credit Support Provider	It covers structures where a Bond has a Guarantor or/and Keepwell Deed Provider. In the event of default by the Issuer, a Credit Support Provider agrees to assure a portion of the repayment dues. Some of the Credit Support Providers may not have significant operations and financial strength to fulfill their obligations as Credit Support Providers.
Bonds with Bail-in Features	All or part of the Bond may be cancelled or converted into shares (or other instruments), or their Terms may be changed, by the relevant authorities if the Issuer starts to face difficulties in its operations or performance of its functions. The risk factors in the offering document of the Bonds with Bail-in Features should be read carefully.

Return on investment in Bonds/CDs

In addition to receiving the Principal on maturity, investors, in general, can receive a Coupon payment at a rate higher than a general deposit rate.

Scenario Analysis – Bond/CD	
Assuming a client would like to invest in Bond A on 1st July 2019 with bond features as below: *(No other charge or fee, such as custody fee, is included in this analysis)*	
Basic specification of Bond A	
Client Buying Price	102% of par value/face value
Face Value	USD100,000
Coupon Rate/Coupon Frequency/Coupon Date/Day-count Convention	5% p.a. / Annually / 31 December / 30/360
Term/Maturity Date	4.5 Years / 31 December 2023
Purchase of Bond	
Client Buying Bond at Bond Price of 102%	USD100,000 x 102% = USD102,000
6-month Accrued Interest paid to Seller	USD100,000 x 5%p.a. x 180 / 360 = USD2,500
Total investment amount required	USD102,000 + USD2,500 = USD104,500
Scenario 1: Holding the Bond until maturity	
Client receives Coupon payment every year until maturity (ie 5 coupon payments in total during 2019 – 2023) and the Bond face value on the Maturity Date.	
Coupon payment received	USD100,000 x 5%p.a. x 5 (ie 5 coupon payments) = USD25,000
Bond face value upon maturity	USD100,000
Total receivable	USD25,000 + USD100,000 = USD125,000
Total return (loss)	USD125,000 – USD104,500 = USD20,500
Scenario 2: Selling the Bond before maturity at 101% after 2 years	
Client sells the Bond at 101% after 2 years on 30th June 2021. Client receives Coupon payment every year and Accrued Interest until the sale (ie 2 coupon payments plus accrued interest until the sell date in total) and the Bond selling value.	
Coupon payment received	USD100,000 x 5%p.a. x 2 (ie 2 coupon payments) = USD10,000
Bond value at Bond price 101%	USD100,000 x 101% = USD101,000
6-month Accrued Interest received	USD100,000 x 5%p.a. x 180 / 360 = USD2,500
Total receivable	USD10,000 + USD101,000 + USD2,500 = USD113,500
Total return (loss)	USD113,500 – USD104,500 = USD9,000

Scenario 3: Selling the Bond before maturity at 85% after 2 years	
Client sells the Bond at 85% after 2 years on 30th June 2021. Client receives Coupon payment every year and Accrued Interest until the sale (ie 2 coupon payments plus accrued interest until the sell date in total) and the Bond selling value.	
Coupon payment received	USD100,000 x 5%p.a. x 2 (ie 2 coupon payments) = USD10,000
Bond value at Bond price 85%	USD100,000 x 85% = USD85,000
6-month Accrued Interest received	USD100,000 x 5%p.a. x 180 / 360 = USD2,500
Total receivable	USD10,000 + USD85,000 + USD2,500 = USD97,500
Total return (loss)	USD97,500 – USD104,500 = (USD7,000)

What you need to consider when trading Bonds/CDs?

Investors might consider Bonds/CDs trading if

- You are looking for an investment mainly for medium to long term.
- You are prepared to take the risk of liquidity constraints. Since bond trading is typically OTC, there may not be buyers or sellers when you are seeking to buy or sell certain bonds.

If you are in doubt, you should obtain independent professional advice.

Trading with HSBC Broking Securities

HSBC Broking Securities offer access to a comprehensive range of Bonds/CDs to meet the needs of regular income, combination of regular income and capital growth, capital growth or aggressive wealth growth. Our team has expertise and experience in helping investors trading Bonds/CDs to achieve their investment objective.

Comprehensive Coverage of Bonds/CDs
You can choose from a comprehensive range of Bonds/CDs with different choices in the following categories:

- Issuer: Government (including quasi-government or government agencies) or Corporate
- Currency: HKD, USD, EUR, GBP, JPY, CNY, AUD, NZD, CAD and SGD
- Coupon Rate: Fixed rate, Floating rate or Zero-coupon
- Term: Maximum 30 years or Perpetual
- Credit Rating: Investment Grade to High Yield

Multiple Liquidity Providers
We have lined up multiple liquidity providers in the OTC Bonds/CDs market to provide competitive pricing and support your bond trading.

Margin Financing
We offer margin financing services for Bonds/CDs trading.

Please feel free to contact our Relationship Managers for more details.

General Risk Disclosures

You should carefully consider whether Bonds/CDs trading is suitable for you in light of your financial condition, experience and investment objectives. The following is a summary of some of the risks involving bonds trading and it is NOT an exhaustive list and you are recommended to obtain independent professional advice before entering into any trade.

1. Bond/CD is an investment product but NOT equivalent to a time deposit. CD is not a protected deposit and is NOT protected under the Hong Kong Deposit Protection Scheme.

2. Bond is mainly medium to long term product, not for short term speculation. You should be prepared to hold your funds in Bond for the full Term; you could lose part or all of your Principal if you choose to sell Bond prior to maturity.

3. CD is generally shorter term product than Bond. It is not protected by the Protection Deposit Scheme in Hong Kong. You could still lose part or all of your Principal if you choose to sell CD prior to maturity.

4. Receipt of Principal and Coupon is subject to credit risk and default risk of the Issuer and/or Guarantor. In the worst scenario, investors could loss 100% of investment amount and Accrued Interest.

5. You should make your own investment decision to buy a Bond/CD after your broker who sells it to you has explained to you that the product is suitable for you having regard to your financial situation, investment experience and investment objectives.

6. A corporate event such as a merger or takeover may lower the Credit Rating of the Issuer. In case the corporate restructurings are financed by the issuance of a large amount of new debt-burden, the Issuer's ability to pay off existing bonds will be weakened.

7. Bond/CD is subject to both the actual and perceived measures of credit worthiness of the Issuer. There is no assurance of protection against a default by the Issuer in respect of the repayment obligations. In the worst case scenario, you might not be able to recover the Principal and any Coupon if the Issuer defaults on the Bond/CD.

8. Credit Ratings of the Issuers or/and Bonds themselves factor the credit ability, collateral and security. However, they are not recommendation to buy, sell or hold securities and may be subject to revision at any time.

9. Bond's/CD's price may fluctuate. Factors affecting the market price of Bond/CD include, and are not limited to, fluctuations in interest rates, credit spreads, and liquidity premiums. The fluctuation in yield generally has a greater effect on prices of longer term Bonds. There is an inherent risk that losses may be incurred rather than profit made as a result of buying and selling Bond/CD.

10. Any transaction involving foreign currencies, involves additional risks not common to transactions denominated entirely in your domestic currency. Forex rates can be highly volatile and can be affected by factors such as changes in political and economic policies (both domestic and overseas), political instability, wars, natural disasters and global market movements.

11. You should consider the possible risk inherent in giving instructions by facsimile. Non-original signatures on facsimiles may be forged and instructions given by facsimile may be transmitted to wrong numbers, may never reach HSBC Broking Securities and may thereby become known to third parties thus losing the confidential nature. HSBC Broking Securities accepts no responsibility for the occurrence of any such circumstances or for any action, claim, loss, damage, or cost incurred by you in connection with instructions given via facsimile. HSBC Broking Securities shall not be held liable for acting in good faith on faxed instructions which emanate from unauthorized individuals or in any circumstances whatsoever.

Important Notes

Before you trade, please read the Terms of Business which had been provided to you by HSBC Broking Securities. In case of any discrepancy between the Terms of Business and this document, the Terms of Business shall prevail.

In the event of conflict or inconsistency between the English and Chinese versions of this document, the English language version of this document shall prevail for all purposes.

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