Complex Fixed Income Instruments
Information sheet

Financial instruments are all types of instruments that are intended to be traded on the securities market. They can be divided into complex and non-complex instruments. Before you trade in a financial instrument, we are required to ascertain whether you have sufficient knowledge and experience to understand the properties and risks involved in trading in financial instruments. Below is some information about the most important qualities and risks associated with a type of instrument in which you have shown an interest. If you do not have sufficient knowledge and experience, we recommend that you do not trade in this instrument.

Introduction

Certain fixed income instruments are regarded as complex financial instruments. This could be because they have a more complicated structure, are difficult to understand or contain some kind of derivative element.

When you buy a fixed income instruments, you lend money to the entity that issued the fixed income instrument. This means you run the risk of the issuer being unable to repay the money you lent them. The return on investments in fixed income bonds is generally expressed as interest. The return is usually known in advance, provided that you retain the instrument until the due date.

A fixed income instruments can usually be sold during the investment term, but the return may then be lower than expected.

How fixed income instruments work

Fixed income instruments are a claim on the issuer. You are therefore exposed in regard to the issuer's credit rating, or credit risk. If the issuer's ability to pay declines, so does their credit rating.

There are various types of fixed income instruments. They vary depending on who the issuer is, any security pledged by the issuer for the loan, the issuer's credit rating, the time left until the repayment date, the form in which interest is paid out, and so on.

The value of a fixed income instruments is affected by the market interest rate and the issuer's credit rating, among other things.

- If the issuer's credit rating increases, the value of the fixed income bond increases as well.
- If the issuer's credit rating decreases, the value of the fixed income bond decreases as well.
- If the market interest rates go down, the value of a previously issued fixed income bond increases.
- If the market interest rates go up, the value of a previously issued fixed income bond decreases.

Complex fixed income instruments

A complex fixed income instruments may have one or more of the following properties:

- The instrument may be structured in such a way that it is difficult to understand the risk and the expected return.
- The actual return may differ from the expected return due to lower or unpaid interest payments (coupon payments).
- The term of the instrument may be uncertain; the instrument may be redeemed early or extended.
- Public prices are not always available.
- It can be difficult to buy or sell the investment during the term of the investment.
- Rates may vary substantially depending on the specific terms of the instrument.

Types of fixed income instruments

Money market instruments

Money market instruments have an investment term of up to one year. They are issued at a discount, e.g. 98 per cent, and repaid on the due date at 100 per cent of the nominal amount. The difference between the issue price and the nominal amount repaid on the due date comprises the interest/return.

Issuer	Name
Governments	Treasury bills
Companies, banks, local authorities and county councils	Commercial papers

Bonds

At the time of issue, bonds have an investment term of more than one year. There are a number of different structures for paying a return to the holder.

Bonds with a fixed interest rate

The return is usually paid out on a yearly basis. Provided that you retain the bond until the final due date and the issuer doesn't default, you know what return you will get.

Floating Rate Note (FRN)

The coupon payments usually track a three-month reference rate, such as STIBOR (Stockholm Inter Bank Offered Rate). The coupon interest rate is usually set one quarter at a time at the start of each quarter.

Zero coupon bonds

These have a similar structure to money market instruments, i.e. they are sold at a discount, e.g. 92 per cent of the nominal amount. On the due date, the holder receives the nominal amount. The difference between the purchase price and the nominal amount repaid on the due date comprises the interest/return.

Indexed bonds

These hedges against inflation, i.e. the capital retains its purchasing power. Most commonly both the nominal amount and the coupon interest rate are calculated using the Consumer Price Index (CPI).

Issuer	Name
Governments	Government bonds
Mortgage institution	Mortgage bonds
Institutions that are authorised by the Swedish Financial Supervisory Authority to issue secured bonds, e.g. mortgage institutions	Secured bonds
Companies, banks, local authorities and county councils	Corporate bonds
Mortgage institutions and companies	Retail bonds
The Swedish State	Premium bonds
Supranational organisations, such as the IMF or the World Bank	SSA

For whom are fixed income instruments suitable?

The risk in various types of fixed income instruments may vary, depending among other things on the issuer's credit rating and the investment term. In general, however, fixed income instruments are regarded as lower risk than equities. A fixed income instrument issued by an issuer with a high credit rating can be a good option if you want to minimise the risk of your savings capital declining in value. Fixed income instruments are generally a suitable investment if you are looking for short-term savings.

However, when trading in complex fixed income instruments, you should be aware of the special properties that may apply to these instruments, which may involve, for example, uncertain coupon payments, uncertain investment terms and a risk of substantial rate fluctuations.

Trading in fixed income instruments

Trading in fixed income instruments differs in many ways from trading in equities. The market is dominated by financial institution investors such as pension funds, insurance companies and banks. Alongside institutional trading, some trading also takes place on a smaller scale via SOX (part of the Stockholm Stock Exchange), which is primarily aimed at private individuals and other smaller investors. Private individuals usually buy money market instruments and bonds via money market and bond funds.

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On the money and bond market, the rates for fixed income instruments are set continuously. The market interest rates are influenced by analyses and assessments produced by the Riksbanken and other major institutional market operators regarding factors such as inflation, the economic situation and interest rate changes both in Sweden and in other countries.

When trading in complex fixed income instruments, you should be aware that public prices are not always available, and that it can be difficult to buy and sell these instruments during the investment term.

In order to trade in fixed income instruments, you must have a securities account (VP account), a service account or a deposit account. You can also trade in certain fixed income securities via an Investeringssparkonto (ISK).

Risk

In the context of investment, the term "risk" denotes the probability that the invested capital will decline in value. A higher risk often means a greater opportunity for a high return, but at the same time the risk of losing money increases. There is always a risk that you will lose all of your invested capital, or that you will be unable to sell a financial instrument that you own.

- The greater the risk, the greater the rate fluctuation you can expect.
- The lower the risk, the steadier the rate movement you can expect.

In a fixed income instruments, the risk is made up partly of the change in interest that may occur during the investment term, depending on interest rate changes, and partly on the issuer's credit risk. During the investment term, fixed income instruments are affected by various factors, such as changes in the issuer's credit rating, economic conditions and the actions of the national banks.

The credit risk reflects the issuer's ability to repay the loaned amount and accrued interest. It may change depending on market conditions and the issuer's repayment capacity.

Swedish fixed income instruments issued by the government, local authorities and mortgage financing companies are generally regarded as being relatively low risk. The risk for fixed income instruments issued by other companies and foreign issuers can vary substantially: for example, the risk may differ for different governments and companies.

If you invest in fixed income instruments that are listed in a foreign currency, you are also taking a currency risk. The investment may increase or decrease in value due to exchange rate fluctuations.

Costs

When you trade in fixed income instruments, you usually pay a commission fee, which is calculated as a percentage of the transaction size. Some operators charge a minimum commission fee. If you trade in foreign fixed income instrument, the commission is higher than when trading in Swedish fixed income instruments. A currency exchange fee is also payable for fixed income bonds that are traded in a currency other than Swedish kronor.

Things to remember:

- The historical return of a financial instrument is not a guarantee of future return. The value of financial instruments can rise or fall, and it is not certain that you will get back all the capital you have invested.
- In order to trade in these instruments, you must familiarise yourself with the terms and conditions that apply to trading in financial instruments. The contracts that apply depend on the instrument you are trading in.
- Certain instruments require you to be liable to make payments in future. It is important that you are prepared to comply with your undertaking.
- Check the information on the statement and other reporting relating to your holdings, and inform us immediately of any errors.
- Regularly monitor changes in the value of your holdings and positions.
- You are responsible for taking any action necessary to reduce the risk of losses.
- Always ask for supplementary marketing material or further information with more details about the financial instrument you are interested in.

Check your experience

How long have you invested in this type of instrument?	What is the average amount of money you have invested in this type of instrument?	How many times per year have you traded in this type of instrument?
☐ No experience	☐ Up to 50 000	☐ Up to 2
☐ Less than one year	☐ Up to 100 000	☐ Up to 5
☐ 1 to 5 years	☐ Up to 250 000	☐ Up to 10
☐ More than 5 years	☐ Up to 500 000	☐ More than 10
	☐ More than 500 000	

Check your knowledge

1. When you buy a fixed income instrument...

A) ☐ The issuer lends you money
B) ☐ You lend money to the entity that issued the instrument
C) ☐ You are entitled to a share of the issuer's company

2. If the issuer's credit rating increases...

A) ☐ ... the value of the fixed income instruments usually increases
B) ☐ ... the value of the fixed income instruments usually decreases
C) ☐ ... the value of the fixed income instruments is not usually affected

3. If the market interest rates go up...

A) ☐ ... the value of a previously issued fixed income instruments usually increases
B) ☐ ... the value of a previously issued fixed income instruments usually decreases
C) ☐ ... the value of a previously issued fixed income instruments is not usually affected

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4. In the case of a bond with a fixed interest rate...

A) ☐ ... the entire return is paid out on the due date
B) ☐ ... no return is paid
C) ☐ ... the return is usually paid out on a yearly basis

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5. A zero coupon bond with two years to go until it falls due, which was bought for 98 per cent of a nominal amount...

A) ☐ ... has an annual return of 49 per cent
B) ☐ ... has an annual return of around 1 per cent
C) ☐ ... has an annual return of around 10 per cent

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6. How does a normal bond differ from an FRN (Floating Rate Note)?

A) ☐ The FRN has a fixed interest rate
B) ☐ There is no difference
C) ☐ The coupon interest rate for an FRN is usually set one quarter at a time

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7. Which of the following applies to pricing of complex fixed income instruments?

A) ☐ There are always official prices, just as there are for equities listed on a stock exchange
B) ☐ Prices are published at least once a day
C) ☐ Official prices cannot always be guaranteed

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8. Which of the following is true regarding the term of a complex fixed income instruments?

A) ☐ The term may be changed
B) ☐ The term is always less than one year
C) ☐ The term is always known in advance

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