Regarding bond purchases and redemptions: what exactly does “par” mean?

# While it is true that I am most often contacted about equity issues, I sometimes handle requests relating to bonds. This month, in the case below, I have the opportunity to remind you of their specific characteristics.

# The Facts

On 21 September 2005, Mr R. indicated that he had subscribed to 14,039 bonds with his bank at an annual interest rate of 3.5%, issued by a financial institution, for a total of €14,299.42. The maturity date was set for 12 years later.

However, on the maturity date in September 2017, Mr R. was surprised to find that:

* firstly, when the bonds were purchased on issue, they were admitted to the market at the price of €1, corresponding to the nominal value of the bond, i.e. an overall valuation of €14,039, which in his view represented an immediate loss of €260.42;
* secondly, at the time of redemption, the same amount of €14,039 was repaid to him upon maturity, whereas the day before, on 20 September 2017, the bonds were valued in the portfolio at a total of €14,739, i.e. a difference of nearly €700 in one day.

Seeking explanations and given his bank’s failure to respond, Mr R. to asked me to contact the bank on his behalf.

# Investigation

After examining the conditions of this issue provided for in the prospectus[[1]](#footnote-1) approved by the AMF, and especially the nominal value of the bond, its issue price and the redemption price, I informed Mr R. that both the issue and the redemption of the bonds had been carried out in accordance with these conditions.

Remember that the **nominal value of a bond** corresponds to the amount borrowed by the issuer divided by the number of securities issued. This is also referred to as face value or “par”.

On this point, it should be stressed that the **issue price** of a bond – i.e. the price actually paid by the subscriber – is not necessarily equal to its nominal value and may, depending on the transactions and changing market circumstances, be lower, equal or higher than par. The difference between the two is referred to as the **share premium**.

In all cases, the issue may be below or above par so that, in due course, the issue price initially envisaged can be adjusted to the actual market conditions on the day on which the transaction is launched.

In this case, it was a so-called “above par” issue, with the issue price of the bonds being higher than their nominal value. The prospectus stated that the nominal value of the bond was €1 (or expressed as a percentage, 100%), but that its issue price – i.e. the actual purchase price – was set at €1.01855 (101.855%).

It is therefore entirely normal and in accordance with the prospectus that Mr R had acquired 14,039 bonds for the price of €14,299.42, which were then listed at their nominal value of €1, i.e. a total valuation of €14,039 on the day they were admitted to trading.

Similarly, at maturity 12 years later, the 14,039 bonds held by this client were redeemed “at par”, i.e. on the basis of their nominal value of €1, in accordance with the prospectus terms, which explains why the same amount of €14,039 was repaid.

In response to Mr R’s question about the valuation of the bonds on the day before redemption, I informed him that, since they are listed, they are subject to market fluctuations. Their valuation may therefore, throughout the issue, fluctuate upwards or downwards in relation to their issue price, regardless of their redemption value, which is permanently fixed at the time of issue.

I also reminded Mr R that the amount of interest accrued, i.e. the annual interest due but not yet paid, was included in the valuation of the bond on the day before maturity. In this case, this amounted to €491.17 gross, which was paid to him on 21 September 2017 at the same time as the repayment of the bonds he held.

**Mr R’s Situation**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Nominal value (also called “par”) | Issue price (above par) | Repayment (at par) |
| 1 bond | €1 (or 100%) | €1.01855 (or 101.855%) | €1 |
| 14,039 bonds | €14,039 | €14,299.42 | €14,039 |

# Recommendation

In light of this information, I informed Mr R. in a very detailed letter that I had no means of accusing his bank of a regulatory breach. I could therefore not give a favourable opinion regarding his request, but I hoped that the response provided would allow him to better understand the rules for the issue and redemption of debt securities.

# L**esson to be learned**

While it is understandable that Mr R. might have felt that he was being wronged, at least initially, it is worth remembering that he had received an annual coupon for 12 years. To avoid any surprises regarding the subscription and/or redemption amount, the potential subscriber must therefore, in addition to the interest rate and the quality of the issuer, carefully examine the conditions of purchase and redemption of a bond.

The guarantee to be repaid “at par” is only valid on the maturity date. The subscriber remains free to sell his/her bonds on the stock exchange, but in such cases is exposed to market risks.

1. The prospectus is a document that every company must ask the AMF to approve before carrying out a public offering or an admission of securities to a regulated market relating to:

- shares and other securities that give or may give, direct or indirect access to capital or voting rights;

- debt securities;

- any equivalent instruments issued on the basis of foreign laws. [↑](#footnote-ref-1)