

Creation and Structure: Synthetic bonds are created by combining traditional debt securities, like bonds, with derivatives such as options, swaps, or futures. The goal is to replicate the cash flows and risk profiles of a particular asset or set of assets. For example, an investor might combine a zero-coupon bond (a bond that pays no interest until maturity) with a derivative that provides income based on the performance of a stock index.

Purpose: These bonds are typically used to gain exposure to a certain asset class or market without actually owning the physical assets. This can be beneficial for managing risk, diversifying portfolios, or accessing markets that might be otherwise out of reach due to cost, regulatory, or other constraints.

Risk Management: Synthetic bonds allow investors to tailor the risk and return profiles of their investments more finely than traditional bonds. By adjusting the mix of the underlying debt and derivative components, investors can control factors such as credit risk, interest rate risk, and market volatility.

Use in Portfolios: Investors, particularly institutional ones like pension funds or insurance companies, might use synthetic bonds to hedge against certain risks or to improve the yield of their portfolios under specific financial conditions.

In essence, synthetic bonds provide a versatile tool in modern finance, allowing for complex strategies that can be customized to suit specific investment goals and risk management requirements.



Based on the provided content from the FINM Circular 2016/5 document, here is how each answer aligns with the document's guidelines on synthetic bonds and their usage:



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