**What Is a Hybrid Security?**

A hybrid security is a single financial security that combines two or more different financial instruments. Hybrid securities, often referred to as "hybrids," generally combine both debt and equity characteristics. The most common type of hybrid security is a [convertible bond](https://www.investopedia.com/terms/c/convertiblebond.asp) that has features of an ordinary bond but is heavily influenced by the price movements of the stock into which it is convertible.

**Understanding Hybrid Securities**

Hybrid securities are bought and sold on an exchange or through a brokerage. Hybrids may give investors a fixed or floating rate of return and may pay returns as interest or as dividends. Some hybrids return their face value to the holder when they mature and some have tax advantages. Hybrid securities can be viewed as a form of [esoteric debt](https://www.investopedia.com/terms/e/esoteric-debt.asp) and may be difficult to sell due to their complexity.

**Types of Hybrid Securities**

In addition to convertible bonds, another popular type of hybrid security is convertible [preference shares](https://www.investopedia.com/terms/p/preference-shares.asp), which pay dividends at a fixed or floating rate before common stock dividends are paid, and can be exchanged for shares of the underlying company's stock.

Pay-in-kind toggle notes are another type of hybrid security where the issuing company can toggle the payment from interest rates to the additional debt owing to the investor, meaning the company owes the investor more debt but doesn't actually pay interest on it immediately. This interest deferral allows the company to keep cash flowing, but the larger principal payment may never come if the cash flow situation isn't resolved.

Each type of hybrid security has a unique risk and reward characteristics. [Convertible bonds](https://www.investopedia.com/terms/c/convertiblebond.asp) offer greater potential for appreciation than regular bonds, but pay less interest than conventional bonds, while still facing the risk that [the underlying company could perform poorly](https://www.investopedia.com/ask/answers/042715/how-convertible-bond-valuation-different-traditional-bond-valuation.asp). They can also fail to make coupon payments and not be able to repay the bond's face value at maturity. Convertible securities offer greater income potential than regular securities but can still lose value if the underlying company underperforms. Other risks of hybrid securities include deferred interest payments, insolvency, market price volatility, early repayment, and illiquidity.

**Special Considerations**

Other new types of hybrid securities are being introduced all the time in an attempt to meet the needs of [sophisticated investors](https://www.investopedia.com/articles/investing/042613/how-become-sophisticated-investor.asp). Some of these securities are so complicated that it is difficult to define them as either debt or equity.In addition to being difficult to understand, another criticism of some hybrid securities is that they require the investor to take more risk than the potential return warrants. Hybrid securities are not marketed toward retail investors, but even institutional investors sometimes fail to fully understand the terms of the deal they are entering when buying a hybrid security.

**Derivative Warrants Explained: Types and Example**

**What Is a Warrant?**

Warrants are a derivative that give the right, but not the obligation, to buy or sell a security—most commonly an equity—at a certain price before expiration. The price at which the underlying security can be bought or sold is referred to as the exercise price or strike price. An American [warrant](https://www.investopedia.com/trading/warrants-risky-but-high-return-investment-tool/) can be exercised at any time on or before the expiration date, while European warrants can only be exercised on the expiration date. Warrants that give the right to buy a security are known as call warrants; those that give the right to sell a security are known as put warrants.

KEY TAKEAWAYS

* [Naked warrants](https://www.investopedia.com/terms/n/naked-warrant.asp) are issued on their own, without accompanying bonds or preferred stock.
* There are a variety of warrants such as traditional, naked, wedded, and covered.
* Investors may find trading warrants to be a complex endeavor.

**How a Warrant Works**

Warrants are in many ways similar to options, but a [few key differences distinguish them](https://www.investopedia.com/ask/answers/08/stock-option-warrant.asp). Warrants are generally issued by the company itself, not a third party, and they are traded over-the-counter more often than on an exchange. Investors cannot write warrants like they can options.

Unlike options, warrants are dilutive. When an investor exercises their warrant, they receive newly issued stock, rather than already-outstanding stock. Warrants tend to have much longer periods between issue and expiration than options, of years rather than months.

Warrants do not pay dividends or come with voting rights. Investors are attracted to warrants as a means of leveraging their positions in a security, hedging against downside risk (for example, by combining a put warrant with a long position in the underlying stock), or exploiting arbitrage opportunities.

Warrants are no longer common in the United States but are heavily traded in Hong Kong, Germany, and other countries.

**Types Of Warrants**

Traditional warrants are issued in conjunction with bonds, which in turn are called warrant-linked bonds, as a sweetener that allows the issuer to offer a lower [coupon rate](https://www.investopedia.com/terms/c/coupon-rate.asp). These warrants are often detachable, meaning that they can be separated from the bond and sold on the secondary markets before expiration. A detachable warrant can also be issued in conjunction with preferred stock.

Wedded or wedding warrants are not detachable, and the investor must surrender the bond or preferred stock the warrant is "wedded" to in order to exercise it.

Covered warrants are issued by financial institutions rather than companies, so no new stock is issued when covered warrants are exercised. Rather, the warrants are "covered" in that the issuing institution already owns the underlying shares or can somehow acquire them. The underlying securities are not limited to equity, as with other types of warrants, but may be currencies, commodities, or any number of other financial instruments.

**How to Find Derivative Warrants**

Trading and finding information on warrants can be difficult and time-consuming as most warrants are not listed on [major exchanges](https://www.investopedia.com/ask/answers/08/security-market-usa.asp), and data on warrant issues is not readily available for free.

When a warrant is listed on an exchange, its ticker symbol will often be the symbol of the company's common stock with a W added to the end. For example, Abeona Therapeutics Inc's ([ABEO](https://www.investopedia.com/markets/quote?tvwidgetsymbol=abeo)) warrants were listed on Nasdaq under the symbol ABEOW.1 In other cases, a Z will be added, or a letter denoting the specific issue (A, B, C…).

Warrants generally trade at a premium, which is subject to [time decay](https://www.investopedia.com/search?q=time+decay) as the expiration date nears. As with options, warrants can be priced using the [Black Scholes model](https://www.investopedia.com/terms/b/blackscholes.asp).

How do derivative warrants differ from options?

Both derivative warrants and options give the holder the right to buy or sell shares at a set price before a specified date. However, options are listed on an exchange and traded from investor to investor while derivative warrants are issued by the company itself.

What does it mean for a derivative warrant to be dilutive?

A derivative warrant is dilutive because it dilutes or reduces each other shareholder's ownership in the issuing company. If you hold a warrant allowing you to buy 1 share in a company that currently has 10 shares outstanding and you exercise it, the number of shares outstanding will increase to 11. You'll gain ownership while each other shareholder will lose a percentage of their stake in the company.

What happens if a derivative warrant expires?

If a warrant expires without being exercised, it becomes worthless. The holder of that warrant can no longer use it to buy shares in the issuing company.

Why buy derivative warrants over options?

Derivative warrants have some advantages over options. For example, they have much longer expiration timelines and are often attached to otherwise already valuable securities, such as bonds.

**The Bottom Line**

Derivative warrants are a complex type of security that isn't widely traded. They give investors the opportunity to buy shares in a company, but can be difficult to research and costs for trading can be high.

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