Bond Definitions

Because of the special nature of bonds, here are some definitions that should be useful to the beginning investor.

- Principal or face amount — the amount on which the issuer pays interest, and which, most commonly, has to be repaid at the end of the term.
- Issue price — the price at which investors buy the bonds when they are first issued, which will typically be approximately equal to the face amount. The net proceeds that the issuer receives are thus the issue price, less issuance fees.
- Maturity date — the date on which the issuer has to repay the nominal amount. The maturity can be any length of time, although debt securities with a term of less than one year are generally designated money market instruments rather than bonds.
- Coupon — the interest rate that the issuer pays to the bond holders. Usually this rate is fixed throughout the life of the bond. It can also vary with a money market index.
- Coupon dates — the dates on which the issuer pays the coupon to the bond holders.
- Yield - the actual rate of return, which is a function of the coupon interest and the actual price paid.
- Yield curve - a measure of the term structure of bonds. It is the relationship between yield and maturity for comparison of bonds.
- Indentures and Covenants — an indenture is a formal debt agreement that establishes the terms of a bond issue, while covenants are the clauses of such an agreement.
- Call date — some bonds give the issuer the right to repay the bond before the maturity date on the call dates. There may or not be a penalty to the issuer to call a bond.
- Put date — some bonds give the holder the right to force the issuer to repay the bond before the maturity date on the put date.
- Sinking fund – the setting aside funds by the issuer so that a certain portion of the issue can be retired periodically.
- Convertible bond - lets a bondholder exchange a bond to a number of shares of the issuer's common stock.
- Basis points – the term is used in bond trading and valuation instead of percentages. 1 percent equals 100 basis points.

Types of Bonds

1. Fixed rate bonds have a coupon that remains constant throughout the life of the bond
2. Floating rate notes (FRN's) have a variable coupon that is linked to a reference rate of interest,
3. Zero-coupon bonds pay no regular interest. They are issued at a substantial discount to par value, so that the interest is effectively rolled up to maturity (and usually taxed even though the bondholder has not received it). The bondholder receives the full principal amount on the redemption date.
4. Inflation linked bonds, in which the principal amount and the interest payments are indexed to inflation. Treasury Inflation-Protected Securities (TIPS) and I-bonds are examples of inflation linked bonds issued by the U.S. government.
5. Asset-backed securities are bonds whose interest and principal payments are backed by underlying cash flows from other assets. Examples of asset-backed securities are mortgage-backed securities (MBS's), collateralized mortgage obligations (CMO's) and collateralized debt obligations (CDO's).
6. Subordinated bonds are those that have a lower priority than other bonds of the issuer in case of liquidation.
7. Perpetual bonds are also often called perpetuities or 'Perps'. They have no maturity date.
8. Bearer bond is an official certificate issued without a named holder. In other words, the person who has the paper certificate can claim the value of the bond.
9. Registered bond is a bond whose ownership (and any subsequent purchaser) is recorded by the issuer, or by a transfer agent. It is the alternative to a Bearer bond. Interest payments, and the principal upon maturity, are sent to the registered owner.
10. Book-entry bond is a bond that does not have a paper certificate. As physically processing paper bonds and interest coupons became more expensive, issuers (and banks that used to collect coupon interest for depositors) have tried to discourage their use. Some book-entry bond issues do not offer the option of a paper certificate, even to investors who prefer them.
11. Treasury bond, also called government bond or treasury, is issued by the Federal government and is not exposed to default risk. It is characterized as the safest bond, with the lowest interest rate.
12. Agency bonds are issued by various government agencies. The best known of these are mortgage backed bonds such as GNMA's or FNMA's.
13. Municipal bond or "muni" is a bond issued by a state, U.S. Territory, city, local government, or their agencies. Interest income received by holders of municipal bonds is often exempt from the federal income tax and from the income tax of the state in which they are issued, although municipal bonds issued for certain purposes may not be tax exempt.
14. Build America Bonds (BAB's) is a new form of municipal bond authorized by the American Recovery and Reinvestment Act of 2009. Unlike traditional municipal bonds, which are usually tax exempt, interest received on BAB's is subject to federal taxation.
15. Revenue bond is a special type of municipal bond distinguished by its guarantee of repayment solely from revenues generated by a specified revenue-generating entity

associated with the purpose of the bonds. Revenue bonds are typically "non-recourse," meaning that in the event of default, the bond holder has no recourse to other governmental assets or revenues.

16. Corporate bonds are sold by publically held companies to raise money for a range of activities, such as capital expansion. They generally have a higher rate of interest than government bonds.
17. Junk bonds or High Yield bonds are bonds sold by corporations, which are evaluated in the markets as being extremely high risk and therefore have a very high rate of interest.
18. Serial bond is a bond that matures in installments over a period of time. In effect, a $100,000, 5-year serial bond would mature in a $20,000 annuity over a 5-year interval.