



Glossary of Bond Terms

accreted value

The current value of your zero-coupon municipal bond, taking into account interest that has been accumulating and automatically reinvested in the bond.

accretion bond

Often the last tranche in a CMO, the accretion bond, or Z-tranche, receives no cash payments for an extended period of time until the previous tranches are retired. While the other tranches are outstanding, the Z-tranche receives credit for periodic interest payments that increase its face value but are not paid out. When the other tranches are retired, the Z-tranche begins to receive cash payments that include both principal and continuing interest.

accrual bond

Often the last tranche in a CMO, the accrual bond or Z-tranche receives no cash payments for an extended period of time until the previous tranches are retired. While the other tranches are outstanding, the Z-tranche receives credit for periodic interest payments that increase its face value but are not paid out. When the other tranches are retired, the Z-tranche begins to receive cash payments that include both principal and continuing interest.

accrued interest

(1) The dollar amount of interest accrued on an issue, based on the stated interest rate on that issue, from its date to the date of delivery to the original purchaser. This is usually paid by the original purchaser to the issuer as part of the purchase price of the issue; (2) Interest deemed to be earned on a security but not yet paid to the investor.

active tranche

A CMO tranche that is currently paying principal payments to investors.

ad valorem tax

[Latin: to the value added] A tax based on the value (or assessed value) of real property.

adjustable-rate mortgage (ARM)

A mortgage loan on which interest rates are adjusted at regular intervals according to predetermined criteria. An ARM's interest rate is tied to an objective, published interest rate index.

advance refunding

A financing structure under which new bonds are issued to repay an outstanding bond issue prior to its first call date. Generally, the proceeds of the new issue are invested in government securities, which are placed in escrow. The interest and principal repayments on these securities are then used to repay the old issue, usually on the first call date.

agency transaction

A sale and purchase of bonds in which the dealer places bonds with the buyer on a commission basis rather than selling bonds that the dealer owns.

Agreement Among Underwriters (AAU)

Legal document used principally in negotiated sales by underwriters. The document consists of the instructions, terms and acceptances, and the standard terms and conditions.

allotment

Distribution of bonds to syndicate members by the book running manager.

all or none (AON)

Where the offeror of a block of bonds will only sell all of the available bonds and not only a portion of them.

Alternative Minimum Tax (AMT)

An alternative way of calculating income under the Internal Revenue Code. Interest on private-activity bonds [other than 501(c)(3) obligations] issued after August 7, 1986, is used for such a calculation.

amortization

Liquidation of a debt through installment payments.

arbitrage

In the municipal market, the difference in interest earned on funds borrowed at a lower tax-exempt rate and interest on funds that are invested at a higher-yielding taxable rate. Under the 1986 Tax Act, with very few exceptions, arbitrage earnings must be rebated back to the federal government.

arbitrage certificate

Transcript certificate evidencing compliance with the limitations on arbitrage imposed by the Internal Revenue Code and the applicable regulations.

ascending, or positive, yield curve

The interest rate structure which exists when long-term interest rates exceed short-term interest rates.

ask price

Price being sought for the security by the seller. Also called the offer.

ask yield

The return an investor would receive on a Treasury security if he or she paid the ask price.

assessed valuation

The value of property against which an ad valorem tax is levied, usually a percentage of "true" or "market" value.

auction

Sealed-bid public sale of Treasury securities; method of determining the rate or yield.

auction rate bonds

Floating-rate tax-exempt bonds where the rate is periodically reset by a dutch auction.

authority

A separate state or local governmental issuer expressly created to issue bonds or run an enterprise, or to do both. Certain authorities issue bonds on their own behalf, such as transportation or power authorities. Authorities that issue bonds on the behalf of qualified nongovernmental issuers include health facilities and industrial development authorities.

authorizing resolution

Issuer document which states the legal basis for debt issuance, and states the general terms of the financing.

average life

On a mortgage security, the average time to receipt of each dollar of principal, weighted by the amount of each principal prepayment, based on prepayment assumptions.

basis point

Smallest measure used in quoting yields on bonds and notes. One basis point is 0.01% of yield. For example, a bond's yield that changed from 6.52% to 7.19% would be said to have moved 67 basis points.

basis price

The price of a security expressed in yield, or percentage of return on the investment. Price differentials in municipal bonds are usually expressed in multiples of 5/100 of 1%, or "05."

bearer security

A security that has no identification as to owner. It is presumed to be owned by the bearer or the person who holds it. Bearer securities are freely and easily negotiable since ownership can quickly be transferred from seller to buyer. Tax-exempt municipal bonds are no longer being issued in bearer form.

benchmark

A bond whose terms are used for comparison with other bonds of similar maturity. The global financial market typically looks to U.S Treasury securities as benchmarks.

beneficial owner

One who benefits from owning a security, even if the security's title of ownership is in the name of a broker or bank ("street name").

bid

Price at which a buyer is willing to purchase a security.

bid list

Schedule of bonds distributed by holder or broker to dealer in order to get a bid, or current price, on the bonds.

bill

A short-term direct obligation of the U.S. Treasury that has a maturity of not more than one year (for example, 13-, 26- or 52-week maturity).

blended yield to maturity

The combination and average of two points on the yield curve to find a yield at the midpoint.

blue-sky memorandum

A memorandum for use by the account specifying the way a specific issue will be treated under state securities laws, frequently of all 50 states, Puerto Rico, and the District of Columbia. This memorandum is prepared first in preliminary form, which may note that certain steps need to be taken in various jurisdictions in order to qualify the issue for sale within these jurisdictions. The memorandum is then issued in supplemental form and generally the supplemental form reports that the required actions in the various jurisdictions have been taken.

bond

(1) The written evidence of debt, bearing a stated rate or stated rates of interest, or stating a formula for determining that rate, and maturing on a date certain, on which date and upon presentation a fixed sum of money plus interest (usually represented by interest coupons attached to the bond) is payable to the holder or owner. A municipal bond issue is usually comprised of many bonds that mature over a period of years; (2) For purposes of computations tied in to "per bond," a \$1,000 increment of an issue (no matter what the actual denominations are); (3) Bonds are long-term securities with a maturity of greater than one year.

bond anticipation note (BAN)

A note issued in anticipation of later issuance of bonds, usually payable from the proceeds of the sale of the bonds or of renewal notes. BANs can also be general obligations of the issuer.

bond bank

Agencies created by a few states to buy entire issues of bonds of municipalities. The purchases are financed by the issuance of bonds by the bond bank. The purpose is to provide better market access for small, lesser-known issuers.

The Bond Buyer™

The daily newspaper of the municipal bond market. *The Bond Buyer* publishes news stories, new-issuer calendars, results of bond sales, notices of redemptions and other items of interest to the market. *The Bond Buyer* also publishes weekly indexes of bond yields that are widely followed by the market.

bond counsel

A lawyer or law firm that delivers a legal opinion which deals with the issuer's authorization to issue bonds and the tax-exempt nature of the bond. Bond counsel is retained by the issuer.

bond equivalent yield

An adjustment to a CMO yield which reflects its greater present value, created because CMOs pay monthly or quarterly interest, as opposed to semiannual interest payments on most other types of bonds.



bond funds

Registered investment companies whose assets are invested in diversified portfolios of bonds.

bond insurance

Legal commitment by insurance company to make scheduled payment of interest and principal of a bond issue in the event that the issuer is unable to make those payments on time. The cost of insurance is usually paid by the issuer in case of a new issue of bonds, and the insurance is not purchased unless the cost is far more than offset by the lower interest rate that can be incurred by the use of the insurance.

bond purchase agreement (BPA)

The contract between the issuer and the underwriter setting forth the terms of the sale, including the price of the bonds, the interest rate or rates which the bonds are to bear and the conditions to closing. It is also called the purchase contract.

bond resolution

Issuer legal document which details the mechanics of the bond issuer, security features, covenants, events of default and other key features of the issue's legal structure. Indentures and trust agreements are functionally similar types of documents, and the use of each depends on the individual issue and issuer.

bond swap

The sale of a bond and the purchase of another bond of similar market value. Swaps may be made to establish a tax loss, upgrade credit quality, extend or shorten maturity, etc.

bond year

An element in calculating average life of an issue and in calculating net interest cost and net interest rate on an issue. A bond year is the number of 12-month intervals between the dated date of the bond and its maturity date, measured in \$1,000 increments. For example, the "bond years" allocable to a \$5,000 bond dated April 1, 1980, and maturing June 1, 1981, is 5.830 [1.166 (14 months divided by 12 months) \times 5 (number of \$1,000 increments in \$5,000 bond)]. Usual computations include "bond years" per maturity or per an interest rate, and total "bond years" for the issue.

book entry

A method of registering and transferring ownership of securities electronically which eliminates the need for physical certificates.

bought deals

GSE-issued securities sold through negotiated direct placements or competitive bids, with terms and size determined by the immediate needs of the GSE.

broker

A firm or person who acts as an intermediary by buying and selling securities to dealers on an agency basis rather than for its own account.

bullet

A security with a fixed maturity and no call feature.

call

Actions taken to pay the principal amount prior to the stated maturity date, in accordance with the provisions for "call" stated in the proceedings and the securities. Another term for call provisions is redemption provisions.

callable

Subject to payment of the principal amount (and accrued interest) prior to the stated maturity date, with or without payment of a call premium. Bonds can be callable under a number of different circumstances, including at the option of the issuer, or on a mandatory or extraordinary basis.

call date

The date at which some bonds are redeemable by the issuer prior to the maturity date. In the event of a refunded security, a prerefunded date will appear in place of any call date and will be indicated by an R = prerefunded; or an E = escrowed to maturity.

call premium



A dollar amount, usually stated as a percentage of the principal amount called, paid as a “penalty” or a “premium” for the exercise of a call provision.

call price

The specified price at which a bond will be redeemed or called prior to maturity, typically either at a premium (above par value) or at par.

call protection

Bonds that are not callable for a certain number of years before their call date.

call risk

The risk that declining interest rates may accelerate the redemption of a callable security, causing an investor’s principal to be returned sooner than expected. As a consequence, investors may have to reinvest their principal at a lower rate of interest.

cap

The top interest rate that can be paid on a floating-rate security.

carry

The cost of borrowing funds to finance an underwriting or trading position. A positive carry happens when the rate on the securities being financed is greater than the rate on the funds borrowed. A negative carry is when the rate on the funds borrowed is greater than the rate on the securities that are being financed.

certificate of ownership

Proof of ownership; a document issued to shareholders by a trustee of a unit investment trust.

certificates of participation (COPs)

COPs are a structure where investors buy certificates that entitle them to receive a participation, or share, in the lease payments from a particular project. The lease payments are passed through the lessor to the certificate holders with the tax advantages intact. The lessor typically assigns the lease and lease payments to a trustee, which then distributes the lease payments to the certificate holders.

clean CMO

Also known as "sequential-pay CMO," the most basic type of CMO, in which all tranches receive regular interest payments, but principal payments are directed initially only to the first tranche until it is completely retired. Once the first tranche is retired, the principal payments are applied to the second tranche until it is fully retired, and so on.

closed-end investment company

An investment company created with a fixed number of shares, which are then traded as listed securities on a stock exchange. After the initial offering, existing shares can only be bought from existing shareholders.

closing date

This is similar to a settlement date, but occurs for a new issuance of bonds. The closing may be as long as 30 days in case of a competitively sold issue.

collar

Upper and lower limits (cap and floor, respectively) on the interest rate of a floating-rate security.

collateralized mortgage obligation (CMO)

A multiclass bond backed by a pool of mortgage pass-through securities or mortgage loans.

commission

The fee paid to a dealer when the dealer acts as agent in a transaction, as opposed to when the dealer acts as a principal in a transaction (see “net price”).

common stock

A share representing participation in the ownership of an enterprise, generally with the right to participate in dividends and in most cases to vote on major matters affecting stockholder interests.

companion tranche

A CMO tranche that absorbs a higher level of the impact of collateral prepayment variability in order to stabilize the principal payment schedule for a PAC or TAC tranche in the same offering.

competitive underwriting or sale

A sale of municipal securities by an issuer in which underwriters or syndicates of underwriters submit sealed bids (or oral auction bids) to purchase the securities. The securities are won and purchased by the underwriter or syndicate of underwriters which submits the best bid according to guidelines in the notice of sale. This is contrasted with a negotiated underwriting.

compound accreted value

The value of a zero-coupon bond at any given time, based on the principal, with interest compounded at a stated rate of return over time.

concession

Fractional discount from the public offering of new securities at which the underwriter sells the bonds to dealers not in the syndicate.

confirmation

A written document confirming an oral transaction in municipal securities that provides pertinent information to the buyer and seller concerning the securities and the terms of the transaction.

constant maturity treasury (CMT)

A series of indexes of various maturities (one, three, five, seven or 10 years) published by the Federal Reserve Board and based on the average yield of a range of Treasury securities adjusted to a constant maturity corresponding to that of the index.

confirmation

A document used by securities dealers and banks to state in writing the terms and execution of a verbal arrangement to buy or sell a security.

constant prepayment rate (CPR)

The percentage of outstanding mortgage loan principal that prepays in one year, based on the annualization of the Single Monthly Mortality (SMM), which reflects the outstanding mortgage loan principal that prepays in one month.

continuing disclosure

Under amendments to Rule 15c2-12, the obligation on the issuer's part to provide annual updating of financial information and operating data of the type included in the official statement for the primary bond offering. The issuer must also provide notice of material events.

conventional mortgage loan

A mortgage loan granted by a bank or thrift institution that is based solely on real estate as security and is not insured or guaranteed by a government agency.

convertible

Convertible bonds may be converted into shares of another security under stated terms, often into the issuing company's common stock.

convexity

A measure of the change in a security's duration with respect to changes in interest rates. The more convex a security is, the more its duration will change with interest rate changes.

Cost of Funds Index (COFI)

A bank index reflecting the weighted average interest rate paid by savings institutions on their sources of funds. There are national and regional COFI indexes.

counterparty

One of two entities in a traditional interest rate swap. In the municipal market a counterparty and a party can be a state or local government, a broker-dealer or a corporation.

coupon

The rate of interest payable annually. Where the coupon is blank, it can indicate that the bond can be a "zero-coupon," a new issue, or that it is a variable-rate bond.

covenant

The issuer's pledge, in the financing documents, to do or to avoid from doing certain practices and actions.

cover bid

The second-highest bidder in a competitive sale.

CP Index

Usually the Federal Reserve Commercial Paper Composite, calculated each day by the Federal Reserve Bank of New York by averaging the rate at which the five major commercial paper dealers offer "AA" industrial commercial paper for various maturities. Most CP-based floating-rate notes are reset according to the 30- and 90-day CP composites.

CPI-U

The index for measuring the inflation rate is the non-seasonally adjusted U.S. City Average All Items Consumer Price Index for All Urban Consumers (CPI-U), published monthly by the Bureau of Labor Statistics (BLS). The CPI-U was selected by the Treasury because it is the best known and most widely accepted measure of inflation.

credit enhancement

The use of the credit of a stronger entity to strengthen the credit of a weaker entity in bond or note financing. This term is used in the context of bond insurance, bank facilities and government programs.

credit ratings

Designations used by ratings services to give relative indications of credit quality.

credit spread

A yield difference, typically in relation to a comparable U.S. Treasury security, that reflects the issuer's credit quality. Credit spread also refers to the difference between the value of two securities with similar interest rates and maturities when one is sold at a higher price than the other is purchased.

current face

The current remaining monthly principal on a mortgage security. Current face is computed by multiplying the original face value of the security by the current principal balance factor.

current refunding

A financing structure under which the old bonds are called or mature within 90 days of the issuance of the new refunding bonds.

current yield

The ratio of interest to the actual market price of the bond, stated as a percentage. For example, a bond with a current market price of \$1,000 that pays \$60 per year in interest would have a current yield of 6%.

CUSIP

The Committee on Uniform Security Identification Procedures, which was established under the auspices of the American Bankers Association to develop a uniform method of identifying municipal, U.S. government, and corporate securities. CUSIP numbers are unique nine-digit numbers assigned to each series of securities.

dated date (or issue date)

The date of a bond issue from which the bondholder is entitled to receive interest, even though the bonds may actually be sold or delivered at some other date.

daycount

The convention used to calculate the number of days in an interest payment period. A 30/360 convention assumes 30 days in a month and 360 days in a year. An actual/360 convention assumes the actual number of days in the given month and 360 days in the year. An actual/ actual convention uses the actual number of days in the given interest period and year.

dealer

A securities firm or department of a commercial bank that engages in the underwriting, trading and sale of municipal (or other) securities.

dealer bank

Department of commercial bank that engages in the underwriting, trading and sale of municipal (or other) securities.

debenture

Unsecured debt obligation, issued against the general credit of a corporation, rather than against a specific asset.

debt limit

Statutory or constitutional limit on the principal amount of debt that an issuer may incur (or that it may have outstanding at any one time).

debt service

Principal and interest.

debt service coverage

The ratio of net revenues to the debt service requirements.

debt service requirements

Amounts required to pay debt service, often expressed in the context of a time frame (such as “annual debt service requirements”).

debt service reserve fund

The fund into which are paid monies which are required by the trust agreement or indenture as a reserve against a temporary interruption in the receipt of the revenues or other amounts which are pledged for the payment of the bonds. A common deposit requirement for a “debt service reserve fund” is six months or one-year’s debt service on the bonds. The “debt service reserve fund” may be initially funded out of bond proceeds, over a period of time from revenues, or by a combination of the above.

deep discount

A discount greater than traditional market discounts of 3%.

default

Failure to pay principal or interest when due. Defaults can also occur for failure to meet nonpayment obligations, such as reporting requirements, or when a material problem occurs for the issuer, such as a bankruptcy.

default risk

Possibility that a bond issuer will fail to pay principal or interest when due.

defeasance

Termination of the rights and interests of the trustee and bondholders under a trust agreement or indenture upon final payment or provision for payment of all debt service and premiums, and other costs, as specifically provided for in the trust instrument.

denomination

The face amount, or par value, of a bond or note that the issuer promises to pay on the maturity date. Most municipal bonds are issued in a minimum denomination of \$5,000.

derivative

A financial product that derives its value from an underlying security. In the tax-exempt market, there are primary and secondary derivative products.

discount

(1) Amount (stated in dollars or a percent) by which the selling or purchase price of a security is less than its face amount; (2) Amount by which the amount bid for an issue is less than the aggregate principal amount of that issue.

discount bond

A bond sold at less than par.

discount margin

The effective spread to maturity of a floating-rate security after discounting the yield value of a price other than par over the life of the security.

discount note

Short-term obligations issued at discount from face value, with maturities ranging from overnight to 360 days. They have no periodic interest payments; the investor receives the note’s face value at maturity.

discount rate



The rate the Federal Reserve charges on loans to member banks.

distribution of principal

Return of principal to unit trust shareholders, usually when a bond in the portfolio reaches maturity, is called or, if necessary, is sold prior to maturity.

divided account

Account structure that is divided as to liability, and not as to sales. Also called “Western” account.

dollar bond

A bond that is quoted and traded in dollar prices rather than in terms of yield.

double and triple tax-exemption

Securities that are exempt from state and local as well as federal income taxes are said to have double or triple tax-exemption.

double-barreled bond

A bond is said to be “double-barreled” when it is secured by the pledge of two (or more) sources of payment. In some states a bond secured in the first instance by a user charge, e.g., water or sewer, may be additionally secured by ad valorem taxes if the user charges don't bring enough revenue.

double exemption

Securities that are exempt from state as well as federal income taxes are said to have “double exemption.” In states where this exemption occurs, the exemption is usually only for bonds issued by the state or its local governments. An exception to this rule is the bond debt of U.S. territories such as Guam. Debt of Puerto Rico is also double exempt.

downgrade risk

Possibility that a bond's rating will be lowered because the issuer's financial condition, or the financial condition of a party to the financial transaction, deteriorates.

duration

The weighted maturity of a fixed-income investment's cash flows, used in the estimation of the price sensitivity of fixed-income securities for a given change in interest rates.

embedded option

A provision within a bond giving either the issuer or the bondholder an option to take some action against the other party. The most common embedded option is a call option, giving the issuer the right to call, or retire, the debt before the scheduled maturity date.

evaluator

An independent service responsible for appraising the value of securities in a trust's portfolio.

excess spread

The net amount of interest payments from the underlying assets after bondholders and expenses are paid and after all losses are covered. Excess spread may be paid into a reserve account and used as a partial credit enhancement or it may be released to the seller or the originator of the assets.

exempt facilities bond

Refers to those types of privately owned or privately used facilities which are authorized to be issued on a tax-exempt basis under the Internal Revenue Code. The Tax Reform Act of 1986 amended prior law to exclude the following types of facilities from those which can be financed on a tax-exempt basis: sports facilities; convention and trade show facilities; air and water pollution control facilities; privately owned airport, dock, wharf and mass-commuting facilities; and most parking facilities, among others.

expected maturity date

The date on which principal is projected to be paid to investors. It is based on assumptions about collateral performance.

extension risk

The risk that rising interest rates will slow the anticipated rate at which mortgages or other loans in a pool will be repaid, causing investors to find their principal committed longer than expected. As a result, they may miss the opportunity to earn a higher rate of interest on their money.

extraordinary redemption

This is different from optional redemption, or mandatory redemption, in that it occurs under an unusual circumstance, such as destruction of the facility financed.

face amount

The par value (i.e., principal, or maturity, value) of a security appearing on the face of the instrument.

face value

The par value of a security, as distinct from its market value.

factor

A decimal value reflecting the proportion of the outstanding principal balance of a mortgage security, which changes over time, in relation to its original principal value. publishes the "Monthly Factor Report," which contains a list of factors for Ginnie Mae, Fannie Mae, and Freddie Mac securities. Fannie Mae, Freddie Mac and trustees of private-label CMOs also publish CMO tranche factors.

federal funds rate

The interest rate charged by banks on overnight loans of their excess reserve funds to other banks.

Federal Reserve commercial paper composite

Calculated each day by the Federal Reserve Bank of New York by averaging the rate at which the five major commercial paper dealers offer "AA" industrial Commercial Paper for various maturities. Most CP-based floating-rate notes are reset according to the 30- and 90-day CP composites.

final maturity date

The date on which the principal must be paid to investors, which is later than the expected maturity date. Also called legal maturity date.

financial advisor

A consultant to an issuer of municipal securities who provides the issuer with advice with respect to the structure, timing, terms or other similar matters concerning a new issue of securities.

financial and operations principal

A municipal securities employee who is required to meet qualifications standards established by the MSRB. The individual is the person designated to be in charge of the preparation and filing of financial reports to the SEC and other regulatory bodies.

FINRA

Created in July 2007 through the consolidation of NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange, FINRA is the largest non-governmental regulator for all securities firms doing business in the United States.

firm

Free option to buy securities for a stated time at a stated price.

fixed-rate bond

A long-term bond with an interest rate fixed to maturity.

fixed-rate mortgage

A mortgage featuring level monthly payments, determined at the outset, which remain constant over the life of the mortgage.

floating-rate bond

A bond for which the interest rate is adjusted periodically according to a predetermined formula, usually linked to an index.

floor

The lower limit for the interest rate on a floating-rate bond.

flow of funds



Refers to the structure which is established in the bond resolution or the trust documents which sets forth the order in which funds generated by the enterprise will be allocated to various purposes.

forward cap

An agreement to enter into a cap at some date in the future.

forward floor

An agreement to enter into a floor at some date in the future.

forward swap

An agreement to enter into a swap at some date in the future.

fully registered

A security that is registered as to principal and interest, payment of which is made only to or on the order of the registered owner.

futures contract

In the municipal market, an agreement to purchase or sell the municipal bond index (The Bond Buyer 40-Bond Index) for delivery in the future.

general obligation bond (GO)

A municipal bond secured by the pledge of the issuer's full faith, credit and taxing power.

Ginnie Mae I

Pass-through mortgage securities on which registered holders receive separate principal and interest payments on each of their certificates. Ginnie Mae I securities are single-issuer pools.

Ginnie Mae II

Pass-through mortgage securities on which registered holders receive an aggregate principal and interest payment from a central paying agent on all of their Ginnie Mae II certificates. Ginnie Mae II securities are collateralized by multiple-issuer pools or custom pools, which contain loans from one issuer, but interest rates that may vary within one percentage point.

global debt facility

The issuance platform used by most GSEs when issuing "global" debt into the international marketplace or a particular foreign market. Has same credit characteristics as nonglobal debt but is more easily "cleared" through international clearing facilities.

good-faith funds

Security deposit on new securities, ranging from 1% to 5% of the par amount, provided to the issuer at the time of a competitive bid by each underwriting syndicate. Also called good-faith check, if delivered as a check, or good-faith deposit.

government-sponsored enterprise (GSE)

Financing entities created by Congress to fund loans to certain groups of borrowers, such as homeowners, farmers and students.

grantor trust

A special-purpose vehicle set up to issue fixed-rate capital securities and use the proceeds to purchase debt of the parent company. Investors who hold interests in the trust are taxed as if they owned pro rata undivided interests in the trust's assets.

hedge

An investment made with the intention of minimizing the impact of adverse movements in interest rates or securities prices.

high-yield bond

Bonds issued by lower-rated corporations, sovereign countries and other entities rated Ba or BB or below and offering a higher yield than more creditworthy securities; sometimes known as junk bonds.

I Bonds

A type of inflation-adjusted security issued by the Treasury. Series I savings bonds pay interest according to an earning rate that is partly a fixed rate of return and partly adjusted for inflation.

indenture

Issuer legal document which details the mechanics of the bond issuer, security features, covenants, events of default and other key features of the issue's legal structure. Bond resolutions and trust agreements are functionally similarly types of documents, and the use of each depends on the individual issue and issuer.

index ratio

For any particular date and any particular inflation-indexed security, the Reference CPI-U applicable to such date divided by the Reference CPI-U applicable to the original issue date (or dated date, when the dated date is different from the original issue date).

indexed rate bonds

Tax-exempt bonds where the rate is periodically reset on a formula that incorporates an index, such as The Bond Market Association Swap Index.

industrial revenue bond

A security issued by a state, political subdivision or certain agencies or authorities, for certain specific purposes, but backed by the credit of a private enterprise.

inflation-adjusted principal

For an inflation-indexed security, the principal amount of the security, derived by multiplying the par amount by the applicable index ratio.

inflation-indexed securities

1. Securities designed to protect investors and the future value of their fixed-income investments from the adverse effects of inflation. Using the Consumer Price Index as a guide, the value of the securities' principal is adjusted to reflect the effects of inflation. Also known as Treasury Inflation Protected Securities (TIPS) or Treasury Inflation-Indexed Securities (TIIS). 2. Notes periodically issued by the GSEs whose return is adjusted with changes in the PPI or CPI.

initial delivery

The delivery of a new issue by the issuer to the original purchaser, upon payment of the purchase price. Also called "original delivery."

initial offering price

The price (based upon yield to maturity) stated as a percentage of par at which the account determines to market the issue during a set period of time, called the initial offering period. Members of the account may not offer any part of the issue at any other price during that period.

insurance

Municipal bond insurance companies guarantee timely payment of principal and/or interest on municipal and certain other types of bonds in the event of a default. The major insurers are identified by these symbols:

- ACA = American Capital Access;
- AMBAC = AMBAC Indemnity Corp.;
- CapMAC = Capital Markets Assurance Corp.;
- CL = Connie Lee;
- FGIC = Financial Guaranty Insurance Co.;
- FSA = Financial Security Assurance Inc.;
- MBIA = MBIA Insurance Corp.

interest

the compensation paid or to be paid for the use of money, usually expressed as an annual percentage rate. Interest rates change in response to a number of things including revised expectations about inflation, and such changes in the prevailing level of interest rates affects the value of all outstanding bonds.

interest rate cap

An agreement where a party pays a premium up front or in installments to the counterparty. If the floating interest rate exceeds a stated fixed rate during the time of the cap agreement, the counterparty will pay the difference, based on the notional amount. The cap rate is also called the strike rate. An interest rate cap can protect the purchaser against rising interest rates.

inverse floater

A CMO tranche that pays an adjustable rate of interest that moves in the opposite direction from movements in a representative interest rate index such as the London Interbank Offered Rate (LIBOR), the Constant Maturity Treasury (CMT) or the Cost of Funds Index (COFI).

inverse floater bonds

A primary derivative tax-exempt bond. The interest payable is based on a formula that has a ceiling rate less a specified floating rate index or bond.

inverted, or negative, yield curve

The interest rate structure which exists when short-term interest rates exceed long-term interest rates. See "ascending, or positive, yield curve."

investment grade

Bonds considered suitable for preservation of invested capital; ordinarily, those rated Baa3 or better by Moody's Investors Service, or BBB- or better by Standard & Poor's Corporation (see "ratings").

IO (interest-only) security

In the case of a CMO, an IO tranche is created deliberately to pay investors only interest and not principal. IO securities are priced at a deep discount to the "notional" amount of principal used to calculate the amount of interest due.

issue

The issue description includes the name of the issuer of the bonds. If a municipal bond, the issuer is typically a state, political subdivision, agency or authority which borrows money through the sale of bonds or notes. Corporate bonds are issued by private corporations.

issue date

The date on which a security is deemed to be issued or originated.

issuer

A state, political subdivision, agency, authority or corporation that borrows through the sale of bonds or notes. The public entity is the "issuer" even in those cases where the actual source of the money to pay debt service is to be an entity other than the issuer.

joint managers

Underwriting accounts are headed by a manager. When an account is made up of several groups of underwriting firms that normally function as separate accounts, the larger account is often managed by several underwriters, usually one from each of the several groups, and these managers are referred to as "joint managers."

jumbo pools

Ginnie Mae II pass-through mortgage securities collateralized by pools which are generally larger and contain mortgages that are often more geographically diverse than single-issuer pools. Mortgage loans in jumbo pools may vary in terms of the interest rate within one percentage point.

jump Z-tranche

A Z-tranche that may start receiving principal payments before prior tranches are retired if market forces create a "triggering" event, such as a drop in Treasury yields to a defined level, or a prepayment experience that differs from assumptions by a specific margin. "Sticky" jump Z-tranches maintain their changed payment priority until they are retired. "Non sticky" jump Z-tranches maintain their priority only temporarily, for as long as the triggering event is present. Although jump Z-tranches are no longer issued, some still trade in the secondary market.

junior security

A security with a claim on a corporation's assets and income that is subordinate to that of a senior security. For example, common stock is junior to preferred stock, which is junior to unsecured debt such as debentures, which is junior to secured debt.

junk bond

A debt obligation with a rating of Ba or BB or lower, generally paying interest above the return on more highly rated bonds, sometimes known as high-yield bonds.

legal opinion

An opinion concerning the validity of a securities issue with respect to statutory authority, constitutionality, procedural conformity and usually the exemption of interest from federal income taxes. The legal opinion is usually rendered by a law firm recognized as specializing in public borrowings, often referred to as bond counsel.

letter of credit (LOC)

A commitment, usually issued by a bank, used to guarantee the payment of principal and interest on debt issues. The LOC is drawn if the issuer is unable to make the principal and/or interest payments on a timely basis.

level debt service

A debt service schedule where total annual principal plus interest is approximately the same throughout the life of the bond. This entails a maturity schedule with increasing principal amounts each year.

level principal

A debt service schedule where total annual principal plus interest declines throughout the life of the bond. This entails a maturity schedule with the same amount of principal maturing each year, with a resulting smaller interest component each year. This is also called declining debt service.

leverage

The use of borrowed money to increase investing power.

LIBOR (London Interbank Offered Rate)

The rate banks charge each other for short-term Eurodollar loans. LIBOR is frequently used as the base for resetting rates on floating-rate securities.

limited-liability company

A special-purpose company incorporated under special limited-liability company legislation enacted in many states and foreign countries. This type of entity is structured as a "pass-through" and treated like a partnership for tax purposes.

limited partnership

An entity formed under state legislation that enables large numbers of investors to become limited partners of a partnership, owning an economic interest in the entity's assets, but sharing in its liabilities only to the extent of their initial investment.

limited tax bond

A bond secured by a pledge of a tax or category of taxes limited as to rate or amount.

line of credit

A commitment by a bank to provide funds to a borrower, if certain conditions have been met, or if certain conditions do not exist.

liquidation value

The amount a securities holder may receive in case of a liquidation of the issuer.

liquidity

The ability to trade bonds efficiently without causing any major changes in their prices.

lockout

The period of time before an investor will begin receiving principal payments.

long

Securities that are owned by a dealer or investor.

long-term debt

Debt which matures in more than one year.

manager (or senior manager)

The underwriter that serves as the lead underwriter for an account. The "manager" generally negotiates the interest rate and purchase price in a negotiated transaction or serves as the generator of the consensus for the interest rate and purchase price to be bid in a competitive bidding situation. The "manager" signs the contracts on behalf of the account and generally receives either a fee or a slightly larger spread for its services in this capacity. See also "joint managers."

mandatory sinking-fund redemption

A requirement to redeem a fixed portion of term bonds, which may comprise the entire issue, in accordance with a fixed schedule. Although the principal amount of the bonds to be redeemed is fixed, the specific bonds which will be called to satisfy the requirement as to amount are selected by the trustee on a lot basis.

marketability

A measure of the ease with which a security can be sold in the primary and secondary market without an undue price concession.

market price or market value

For securities traded through an exchange, the last reported price at which a security was sold; for securities traded "over-the-counter," the current price of the security in the market.

material events

In the municipal market, with regard to Rule 15c2-12, one of 11 specified events that must be disclosed to investors if they occur.

maturity date

The date when the principal amount of a security becomes due and payable, if not subject to prior call or redemption.

maturity schedule

The listing, by dates and amounts, of principal maturities of an issue.

medium-term note

A debt security issued under a program that allows an issuer to offer notes continuously to investors through an agent. The size and terms of medium-term notes may be customized to meet investors' needs. Maturities can range from one to 30 years.

modified duration

Duration adjusted to price and yield levels to represent percent change relationship of price and yield.

monetary default

Failure to pay principal or interest promptly when due.

monoline bond insurer

A Triple-A-rated company that guarantees that all interest and principal payments on a bond will be paid as scheduled and that participates in no other line of insurance business.

moral obligation bond

A municipal bond which, in addition to its primary source of security, possesses a structure whereby a state pledges to make up shortfalls in a debt service reserve fund, subject to legislative appropriation. There is no legal obligation for the state to make such a payment, but market participants recognize that failure to honor the "moral" pledge would have negative consequences for the state's own creditworthiness.

mortgage

A legal instrument that creates a lien upon real estate securing the payment of a specific debt.

mortgage banker

An entity that originates mortgage loans, sells them to investors and services the loans.

mortgage loan

A loan secured by a mortgage.

mortgage pass-through security

A security representing a direct interest in a pool of mortgage loans. The pass-through issuer or servicer collects the payments on the loans in the pool and "passes through" the principal and interest to the security holders on a pro rata basis. Mortgage pass-through securities are also known as mortgage-backed securities (MBS) and participation certificates (PC).

mortgage revenue bond

A security issued by a state, certain agencies or authorities, or a local government to make or purchase loans (including mortgages or other owner-financing) with respect to single-family or multifamily residences.

municipal bond

A bond issued by a state or local governmental unit.

municipal over bond (MOB)

Spread measures the relative difference between the municipal bond index future price and the U.S. Treasury bond futures price.

municipal securities principal

A municipal securities employee under MSRB rules who has supervisory responsibility for the municipal securities operations of the firm.

municipal securities representatives

The broadest class of municipal securities professionals who are required to pass a qualifications examination under the rules of the MSRB. This group includes individuals who underwrite, trade or sell municipal securities, do research or offer investment advice, provide financial advisory services or communicate with investors in municipal securities.

Municipal Securities Rulemaking Board (MSRB)

An independent self-regulatory organization established by the Securities Acts Amendments of 1975, which is charged with primary rulemaking authority over dealers, dealer banks and brokers in municipal securities. Its 15 members are divided into three categories — securities firms representatives, bank dealer representatives and public members — each category having equal representation on the Board.

mutual fund

Also known as an open-end investment company, to differentiate it from a closed-end investment company. Mutual funds invest pooled cash of many investors to meet the fund's stated investment objective. Mutual funds stand ready to sell and redeem their shares at any time at the fund's current net asset value: total fund assets divided by shares outstanding.

negative convexity

A characteristic of callable or prepayable securities that causes investors to have their principal returned sooner than expected in a declining interest rate environment or later than expected in a rising interest rate environment. In the former scenario, investors may have to reinvest their funds at lower rates ("call risk"); in the latter, they may miss an opportunity to earn higher rates ("extension risk").

negotiated underwriting

In a negotiated underwriting, the sale of bonds is by negotiation and agreement with an underwriter or underwriting syndicate selected by the issuer prior to the moment of sale. This is in contrast to a competitive or an advertised sale,

net direct debt

Total direct debt of a municipality less all self-supporting debt, any sinking funds, and short-term debt such as tax anticipation notes and revenue anticipation notes.

net interest cost

The traditional method of calculating bids for new issues of municipal securities. The total dollar amount of interest over the life of the bonds is adjusted by the amount of premium or discount bid, and then reduced to an average annual rate. The other method is known as the true interest cost (see also "true interest").

net order

Bond sold to investors at the price or yield shown in the reoffering scale. This is the price with no concessions.

net price

Price paid to a dealer for bonds when the dealer acts as principal in a transaction, i.e., the dealer sells bonds that he owns, as opposed to an agency transaction (see [agency transaction](#)).

new-issue market

Market for new issues of bonds and notes.

noncallable bond

A bond that cannot be called for redemption at the option of the issuer before its specified maturity date.

non-investment grade

Bonds not considered suitable for preservation of invested capital; ordinarily, those rated Baa3 or below by Moody's Investors Service, or BBB- or below by Standard & Poor's Corporation. Bonds that are non-investment grade are also called high-yield bonds.

notes

Short-term promises to pay specified amounts of money, secured usually by specific sources of future revenues, such as taxes, federal and state aid payments, and bond proceeds.

notice of sale

An official document disseminated by an issuer of municipal securities that gives pertinent information regarding an upcoming bond issue and invites bids from prospective underwriters.

notional amount

A stated principal amount in an interest rate swap on which the swap is based.

NRMSIRS

Nationally Recognized Municipal Securities Information Repositories

odd lot

Block of bonds of \$100,000 or less.

offer

The price at which a seller will sell a security.

offering price

The price at which members of an underwriting syndicate for a new issue will offer securities to investors.

official statement (OS)

The offering document for municipal securities that is prepared by the issuer. The "OS" discloses security features, and economic, financial and legal information about the issue. The final OS contains the pricing information on the issue that is not contained in the preliminary official statement.

off-the-run Treasuries

Those sold in the secondary market rather than "on-the-run" Treasury Securities, which are those most recently issued by the Government.

option-adjusted duration (effective duration)

A measure of the bond's movement for a shift in the yield curve. For noncallable bonds modified duration and effective duration are the same.

option-adjusted spread

The average spread over the AAA spot curve, based on potential paths that can be realized in the future for interest rates. The potential paths of the cash flows are adjusted to reflect the options (puts/calls) embedded in the bond.

optional principal redemption bond

Term used to describe callable securities issued by the FHLB with either fixed- or floating-rate structures.

optional redemption

A right to retire an issue or a portion thereof prior to the stated maturity thereof during a specified period of years. The right can be exercised at the option of the issuer or, in pass-through issues, of the primary obligor. "Optional redemption" usually requires the payment of a premium for its exercise, with the amount of the premium decreasing the nearer the option exercise date is to the final maturity date of the issue.

order period

Specific length of time when orders for new issues are placed by investors.

original delivery

The delivery of a new issue by the issuer to the original purchaser, upon payment of the purchase price. Also called "initial delivery."

original face

The face value or original principal amount of a security on its issue date.

original-issue discount

The amount by which a security's price at issuance is lower than its par value. In the case of fixed-rate capital securities, original-issue discount is also generally considered to exist if the issuer is entitled to elect to defer distributions.

original-issue discount bond (OID)

A bond initially issued at a dollar price less than par which qualifies for special treatment under federal tax law. Under federal tax law for tax-exempt bonds, the difference between the issue price and par value is treated as tax-exempt interest rather than capital gain.

overcollateralization

A type of credit enhancement in which the principal amount of collateral used to secure a given transaction exceeds the principal of the securities issued.

overlapping debt

On a municipal issuer's financial statement, "overlapping debt" is the debt of other issuers which is payable in whole or in part by taxpayers of the subject issuer. As an example, a county usually includes several smaller governmental units and its debt is apportioned to them for payment based on the ratio of the assessed value of each smaller unit to the assessed value of the county. Another example is when a school district includes two or more municipalities within its bounds. In each example, "overlapping debt" is the proportionate share of the county and/or of the school district borne by the included subject issuer.

over-the-counter market (OTC)

A securities market that is conducted by dealers throughout the country through negotiation of price rather than through the use of an auction system as represented by a stock exchange.

owner trust

An amortizing structure that permits significant cash-flow engineering, which is generally prohibited with grantor trusts. Owner trusts are often used with auto loans, equipment leases and student loans.

P&I (principal and interest)

The term used to refer to regularly scheduled payments or prepayments of principal and of interest on mortgage securities.

PAC (planned amortization class) tranche

A CMO tranche that uses a mechanism similar to a sinking fund to determine a fixed principal payment schedule that will apply over a range of prepayment assumptions. The effect of the prepayment variability that is removed from a PAC bond is transferred to a companion tranche.

par

Price equal to the face amount of a security; 100%.

par amount

The principal amount of a bond or note due at maturity. Also known as par value.

parity debt

Securities issued or to be issued with equal and ratable claim on the same underlying security and source of payment for debt service.

participation

Principal amount of bonds to be underwritten by each syndicate member.

party

One of two entities, in a traditional interest rate swap. In the municipal market a counterparty and a party can be a state or local government, a broker dealer, or a corporation.

paying agent

Place where principal and interest are payable. Usually a designated bank or the office of the treasurer of the issuer.

payment date

The date that actual principal and interest payments are paid to the registered owner of a security.

performance

An investment's return (usually total return), compared to a benchmark that is comparable to the risk level or investment objectives of the investment.

perpetual floating-rate note

A floating-rate note with no stated maturity date.

plain-vanilla CMO

Or "sequential-pay CMO." The most basic type of CMO, in which all tranches receive regular interest payments, but principal payments are directed initially only to the first tranche until it is completely retired. Once the first tranche is retired, the principal payments are applied to the second tranche until it is fully retired, and so on.

PO (principal-only) security

In the case of a CMO, a PO tranche is created deliberately to pay investors principal only and not interest. PO securities are priced at a deep discount from their face value.

point

Shorthand reference to 1%. In the context of a "bond," a "point" means \$10, since a "bond" with this reference means \$1,000 (no matter what the actual denominations of the bonds of the issue). An issue or a security that is "discounted two points" is quoted at 98% of its par value.

pollution control bond

A debt security issued by a state, certain agencies or authorities, a local government, or development corporation to finance the construction of air- or water-pollution control facilities or sewage or solid waste disposal facilities pursuant to federal law. The bonds are backed by the credit of the beneficiary of the financing rather than the credit of the issuer. New issues of these bonds are prohibited under the 1986 Tax Law.

pool

A collection of mortgage loans assembled by an originator or master servicer as the basis for a security. In the case of Ginnie Mae, Fannie Mae, or Freddie Mac mortgage pass-through securities, pools are identified by a number assigned by the issuing agency.

preferred stock

An equity security that is junior to the issuing entity's debt obligations but senior to common stock in the payment of dividends and the liquidation of assets. The dividend can be fixed or floating and is usually stated as a percentage of par value. Preferred stock usually has no voting rights and frequently has a mandatory or optional redemption provision.

preliminary official statement

The offering document for municipal securities, in preliminary form, which does not contain pricing information. It is also called a POS, or a red herring.

premium

The amount by which the price of a security exceeds its principal amount.

premium bond

Bonds priced greater than par.

premium or discount price

When the dollar price of a bond is above its face value, it is said to be selling at a premium. When the dollar price is below face value, it is said to be selling at a discount.

prepayment

The unscheduled partial or complete payment of the principal amount outstanding on a mortgage loan or other debt before it is due.

prepayment provision

Provision specifying that, and at what time and on what terms, repayment of the principal amount may be made by the issuer prior to the stated maturity. Includes "call," but "prepayment" usually connotes less formal procedures than a call.

prepayment risk

The risk that falling interest rates will lead to heavy prepayments of mortgage or other loans, forcing the investor to reinvest at lower prevailing rates.

price

The dollar amount to be paid for a security, stated as a percentage of its face value, or par. Bond prices are best reflected in their yields, which vary inversely with the dollar price. The price you pay for a bond is based on a host of variables, including interest rates, supply and demand, credit quality, maturity and call features, tax status, state of issuance, market events and the size of the transaction.

primary market (new-issue market)

Market for new issues of municipal bonds and notes.

primary tax-exempt derivative products

These are based on bonds issued by state and local governments. Examples include inverse floater bonds; bonds with embedded swaps and caps; and bonds based on interest rate tax-exempt derivative products that are based on a custodial receipt, a trust certificate, or another security that is not directly issued by a state or local government. Examples include tender option bonds, trust certificates with interest rate swaps, and stripped interest rate bonds.

prime rate

A commercial bank's stated reference rate for lending.

principal

The face amount of a bond, exclusive of accrued interest and payable at maturity.

principal transaction

A sale and purchase of bonds in which the dealer commits its own capital in effecting the transaction.

private activity bond

Under the 1986 Code, PABs are defined as any municipal obligation, irrespective of the purpose for which it is issued or the source of payment, if more than 10% of the proceeds of the issue will finance property that will be used by a nongovernmental person in a trade or business, and the payment of debt service on more than 10% of the proceeds of the issue will be secured by property used in a private trade or business or payments in respect of such property, or derived from payments in respect of property used in a private trade or business. These two tests — the "private business use test" and the "private payment or security test" — must be examined in connection with the issuance of any municipal security.

private label

The term used to describe a mortgage security whose issuer is an entity other than a U.S. government agency or U.S. government-sponsored enterprise. Such issuers may be subsidiaries of investment banks, financial institutions or home builders.

private placement

The negotiated offering of new securities directly to investors, without a public underwriting.

public offering price

The aggregate value of securities in a unit investment trust fund, divided by the number of units, plus the applicable sales charge. This is the price at which units are offered for sale to the public.

put bond

A bond that gives the holder the right to require the issuer or the issuer's agent to purchase the bonds at a price, usually at par, at some date or dates prior to the final stated maturity.

put option

A put option allows the holder of a bond to "put," or present, the bond to an issuer (or trustee) and demand payment at a stated time before the final stated maturity of the bond.

ramp



A concept often used with HELs and manufactured-housing transactions to describe a series of increasing monthly prepayment speeds, prior to a plateau, on which the expected average life of a security is based.

rate covenant

A covenant in the financing proceedings requiring the charging of rates or fees for the use of specified facilities or operations at least sufficient to achieve a stated minimum coverage.

rate reset

The adjustment of the interest rate on a floating-rate security according to a prescribed formula.

ratings

Alpha and/or numeric symbols used to give indications of relative credit quality. In the municipal market, these designations are published by the rating services. Internal ratings are also used by other market participants to indicate relative credit quality.

real yield

For an inflation-indexed security, the yield based on the payment stream in constant dollars, i.e., before adjustment by the index ratio.

recession

A downturn in economic activity on a large scale, such as in the U.S. economy. The Commerce Department defines a recession as two or more quarters of decline in output, as measured by Gross National Product (GNP) or Gross Domestic Product (GDP).

reciprocal immunity doctrine

The doctrine that many believe provides the constitutional basis for the exemption from federal taxation of the interest earned on municipal securities. The doctrine holds that the states are immune from taxation by the federal government and vice versa. The advocates of tax-exemption for bonds believe that a tax on the interest income a taxpayer receives constitutes a tax on the issuer of the bonds.

record date

The date for determining the owner entitled to the next scheduled payment of principal or interest on a mortgage security.

redemption

The paying off or buying back of a bond by the issuer; also, repurchase of investment trust units by the trustee, at the bid price.

red herring

A preliminary official statement.

redemption premium

The amount by which the "call" price of a security exceeds its principal, or par value.

redemption provisions

Another term for call provisions. Actions taken to pay the principal amount prior to the stated maturity date, in accordance with the provisions for "call" stated in the proceedings and the securities.

refunding

Sale of a new issue, the proceeds of which are to be used, immediately or in the future, to retire an outstanding issue by, essentially, replacing the outstanding issue with the new issue. Refundings are done to save interest cost, extend the maturity of the debt, or to relax existing restrictive covenants.

registered bond

A bond whose owner is registered with the issuer or its agent. Transfer of ownership can only be accomplished when the securities are properly endorsed by the registered owner.

registered owner

The name in which a security is registered, as stated on the certificate or on the books of the paying agent. P&I payments are made to the registered owner on the record date.

reinvestment risk



The risk that interest income or principal repayments will have to be reinvested at lower rates in a declining rate environment.

remarketing

A formal re-underwriting of a bond for which the form or structure is being changed. Most commonly used in connection with changing variable rate to fixed-rate financings — typically because “the construction phase is over”; or rates are at a level the issuer feels comfortable with for the long term; or because of indenture requirements (probably relating to arbitrage).

remarketing agent

A dealer or dealer bank responsible for the pricing of variable-rate demand bonds. The remarketing agent periodically sets and resets the interest rate of a VRDN. If bonds are tendered, the remarketing agent will use his/her best efforts to sell tendered bonds to another purchaser.

REMIC (Real Estate Mortgage Investment Conduit)

Because of changes in the 1986 Tax Reform Act, most CMOs are now issued in REMIC form to create certain tax advantages for the issuer. The terms REMIC and CMO are now used interchangeably.

request for proposals

Widely referred to as an “RFP.” A series of questions sent by a potential issuer to evaluate the qualification of potential underwriters of their negotiated issues. Written and sometimes oral (the “orals”) responses to questions may include a marketing plan for the bonds, the plan of finance, and estimated costs. Also referred to as “Request for Qualifications,” or “RFQs.”

residual

In a CMO, the residual is that tranche which collects any cash flow from the collateral that remains after obligations to the other tranches have been met.

revenue anticipation note (RAN)

RANs are issued in anticipation of sources of future revenue other than taxes. This may include intergovernmental aid.

revenue bond

A bond on which the debt service is payable solely from the revenue generated from the operation of the project being financed or a category of facilities, or from other non-tax sources.

revolving trust

A securitization structure frequently used for assets with high turnover rates, such as credit card, trade and dealer floor-plan receivables. It is characterized by having a revolving period and an accumulation (or controlled-amortization) period.

risk

A measure of the degree of uncertainty and/or of financial loss inherent in an investment or decision. There are many different risks, including:

call risk—The risk that declining interest rates may accelerate the redemption of a callable security, causing an investor’s principal to be returned sooner than expected. As a consequence, investors may have to reinvest their principal at a lower rate of interest.

credit risk—The risk that the obligor on the bonds will be unable to make debt service payments due to a weakening of their credit.

event risk—The risk that an issuer’s ability to make debt service payments will change because of unanticipated changes, such as a corporate restructuring, a regulatory change or an accident, in their environment.

market risk—Potential price fluctuations in a bond due to changes in the general level of interest rates.

underwriting risk—The risk of pricing and underwriting securities and then ultimately not being able to sell them to the investor.

round lot

Block of bonds \$100,000 or higher.



safekeeping

The storage and protection of customers' securities, typically held in a vault, provided as a service by a bank or institution acting as agent for the customer.

scale

Listing by maturity of the price or yields at which a new issue will be offered.

consensus scale—In a negotiated issue, the very early price indications.

preliminary scale—Initial prices and yields, before a bid is submitted.

final scale—Scale that is submitted to the issuer at the time of the sale.

reoffering scale—Scale offered to the investor by the underwriter who has purchased bonds. Also called the winning scale.

scenario analysis

Examining the likely performance of an investment under a wide range of possible interest rate environments.

seasoning

The age of accounts. In the ABS market, this term refers to the fact that various asset types have different seasoning patterns, which are characterized by periods of rising and then declining losses.

secondary market

Ongoing market for bonds previously offered or sold in the primary market.

Section 501(c)(3)

The section of the Internal Revenue Code under which not-for-profit organizations receive their tax-exempt status.

sector

The grouping of securities into a category, based upon similarities that they share. Typically, securities found in a distinct industry are grouped together.

secured debt

Debt backed by specific assets or revenues of the borrower. In the event of default, secured lenders can force the sale of such assets to meet their claims.

security

Specific revenue sources or assets pledged by an issuer to the bondholder to secure repayment of the bond.

selling group

A selling group includes dealers or brokers who have been asked to join in the offering of a new issue of securities, but are neither liable for any unsold syndicate balance, nor share in the profits of the overall syndicate. They obtain securities for sale less the take-down.

senior manager

The underwriter who coordinates the sale of a bond or note issue and manages a syndicate or selling group. A senior manager is usually used only with regard to a negotiated financing. The senior manager will “run the books.” If other securities firms share in the management responsibilities, they may be called co-senior managers, or, to a lesser extent, co-managers.

senior securities

Bonds and other debt obligations, fixed-rate capital securities and preferred stock that are considered senior to common stock within an entity's capitalization structure.

sequential-pay CMO

The most basic type of CMO, in which all tranches receive regular interest payments, but principal payments are directed initially only to the first tranche until it is completely retired. Once the first tranche is retired, the principal payments are applied to the second tranche until it is fully retired, and so on.

serial bonds

All or a portion of an issue with stated maturities in consecutive years (as opposed to mandatory sinking fund redemption amounts).

servicing

Collection and pooling of principal, interest and escrow payments on mortgage loans and mortgage pools, as well as certain operational procedures such as accounting, bookkeeping, insurance, tax records, loan payment follow-up, delinquency loan follow-up and loan analysis. The party providing the servicing receives a servicing fee.

servicing fee

The amount retained by the mortgage servicer from monthly interest payments made on a mortgage loan.

settlement date

The date for the delivery of securities and payment of funds.

short

Borrowing and then selling securities that one does not own, in anticipation of a price decline. When prices fall, the short is "covered" by buying the securities back and returning them to the lender.

short-term debt

Generally, debt which matures in one year or less. However, certain securities that mature in up to three years may be considered short-term debt.

single monthly mortality (SMM)

The percentage of outstanding mortgage loan principal that prepays in one month.

sinker

A bond with a sinking fund.

sinking fund

Separate accumulation of cash or investments (including earnings on investments) in a fund in accordance with the terms of a trust agreement or indenture, funded by periodic deposits by the issuer (or other entity responsible for debt service), for the purpose of assuring timely availability of moneys for payment of debt service. Usually used in connection with term bonds.

SMMEA

Secondary Mortgage Market Enhancement Act of 1984.

SMMEA securities

Securities that are both ultimately secured by a first-lien mortgage loan and rated in one of the top two rating categories by at least one nationally recognized statistical rating organization. The complete definition may be found in Section 3(a)(41) of the Securities Exchange Act of 1934, as amended. Institutional investors should check state laws regarding investments in SMMEA securities.

special-purpose vehicle (SPV)

A bankruptcy-remote entity set up to insulate the issuer of ABS (the trust) from the sponsor, or originator, of the assets. Also called special-purpose corporation (SPC).

special tax bond

A bond secured by a special tax, such as a gasoline tax or a sales tax.

sponsor

An investment firm that organizes a unit investment trust and offers the units for sale.

spread

(1) The difference between the price at which an issue is purchased from an issuer and that at which it is reoffered by the underwriters to the first holders. (2) The difference in price or yield between two securities. The securities can be in different markets, or within the same securities market between different credits, sectors or other relevant factors.

spread to Treasury

The difference between between the yield on a fixed-income security and the yield on a Treasury security of comparable maturity. For example, the spread between a 10-year Treasury yielding 4.75% and a 10-year corporate yielding 5.25% is 50 basis points.

Standard Prepayment Model of The Bond Market Association

A model based on historical mortgage prepayment rates that is used to estimate prepayment rates on mortgage securities. The Association's model is based on the Constant Prepayment Rate (CPR), which annualizes the Single Monthly Mortality (SMM),

or the amount of outstanding principal that is prepaid in a month. Projected and historical prepayment rates are often expressed as "percentage of PSA" (Prepayment Speed Assumptions). A prepayment rate of 100% PSA implies annualized prepayment rates of 0.2% CPR in the first month, 0.4% CPR in the second month, 0.6% CPR in the third month and 0.2% increases in every month thereafter until the 30th month, when the rate reaches 6%. From the 30th month until the mortgage loan reaches maturity, 100% PSA equals 6% CPR.

stated maturity

The last possible date on which the last payment of the longest loan may be paid.

STRIPS

Separate Trading of Registered Interest and Principal of Securities. The Treasury Department's program under which eligible securities are authorized to be separated into principal and interest components, and transferred separately. These components are maintained in book-entry accounts and transferred in TRADES (Treasury/Reserve Automated Debt Entry System).

subordinated debt

A type of debt that places the investor in a lien position behind or subordinated to a company's primary creditors. Securities issued as subordinated debt will pay interest and principal but only after all interest that is due and payable has been paid on any and all senior debt.

super PO

A principal-only security structured as a companion bond.

superfloater

A floating-rate CMO tranche whose rate is based on a formulaic relationship to a representative interest rate index.

support tranche

A CMO tranche that absorbs a higher level of the impact of collateral prepayment variability in order to stabilize the principal payment schedule for a PAC or TAC tranche in the same offering. Also known as a "companion tranche."

surety bond

A bond that backs the performance of another. In the ABS market, a surety bond is an insurance policy typically provided by a rated and regulated monoline insurance company to guarantee securities holders against default.

swap

A transaction in which an investor sells one security and simultaneously buys another with the proceeds, usually for about the same price and frequently for tax purposes.

syndicate

A group of underwriters formed for the purpose of participating jointly in the initial public offering of a new issue of municipal securities. The terms under which a "syndicate" is formed and operates are typically set forth in an "agreement among underwriters." One or more underwriters will act as manager of the "syndicate" and one of the managers will act as lead manager and "run the books." A "syndicate" is also often referred to as an "account" or "underwriting account."

TAC (targeted amortization class) tranche

A TAC tranche uses a mechanism similar to that of a sinking fund to determine a fixed principal payment schedule based on an assumed prepayment rate. The effect of prepayment variability that is removed from the TAC tranche is transferred to a companion tranche.

take-down

The discount from the list price allowed to a member of an underwriting account on any bonds purchased from the account.

Tax Anticipation Note (TAN)

TANs are issued by states or local governmental units to finance current operations in anticipation of future tax receipts. TRANS are notes that are issued in anticipation of both taxes and revenues.

taxable municipal bond

A municipal bond whose interest is not excluded from the gross income of its owners for federal income tax purposes. Certain municipal bonds are taxable because they are issued for purposes which the federal government deems not to provide a significant benefit to the public at large.

tax-backed bond

A broad category of bonds that are secured by taxes levied by the obligor. The taxes are not necessarily unlimited as to rate or amount, so while all general obligation bonds are tax backed, not all tax-backed bonds are general obligations. Examples of tax-backed bonds include moral obligations and appropriation-backed bonds. This category is also known as tax-supported.

tax base

The total property and resources subject to taxation. (See "assessed valuation.")

tax-exempt bond

A common term for municipal bonds. The interest on the bond is excluded from the gross income of its owners for federal income tax purposes under Section 103 of the Internal Revenue Code of 1954, as amended. Municipal bonds that are also exempt from state and local as well as federal income taxes are said to have double or triple tax exemption.

tax-exempt commercial paper

A short-term promissory note issued for periods up to 270 days, often used in lieu of fixed-rate BANs, TANs and RANs because of the greater flexibility offered in setting both maturities and determining rates. The purpose for issuing TECP or TXCP can be the same as that for BANs, TANs and RANs.

tax-exempt/taxable yield equivalent formula

A formula which converts the lower yield of a tax-exempt security into the higher yield of a taxable security. The tax-exempt yield is divided by 100% less the investor's marginal tax rate, and the resulting quotient is expressed as a percentage. This allows investors to compare equivalent yields on the two securities.

T-bill rate

The weekly average auction rate of the three-month Treasury bill stated as the bond equivalent yield.

technical default

A default under the bond indenture terms, other than nonpayment of interest or principal. Examples of technical default are failure to maintain required reserves, or to maintain adequate fees and charges for service.

term bonds

Bonds of an issue that have a single stated maturity date. Mandatory redemption provisions require the issuer to call or purchase a certain amount of the term bonds using money set aside in a sinking fund at regular intervals before the stated maturity date.

term funding

A financing done to meet specific cash-flow needs for a specific period of time.

toggle tranche

A Z-tranche that may start receiving principal payments before prior tranches are retired if market forces create a "triggering" event, such as a drop in Treasury yields to a defined level, or a prepayment experience that differs from assumptions by a specific margin. "Sticky" jump Z-tranches maintain their changed payment priority until they are retired. "Non sticky" jump Z-tranches maintain their priority only temporarily, for as long as the triggering event is present. Although jump Z-tranches are no longer issued, some still trade in the secondary market.

total bonded debt

Total general obligation bond debt outstanding of a municipality, regardless of the purpose.

total direct debt



The sum of the total bond debt and any unfunded debt (typically, short-term notes) of a municipality.

total return

Investment performance measure over a stated time period which includes coupon interest, interest on interest, and any realized and unrealized gains or losses.

trade date

The date that a trade, or sale and purchase, is consummated, with settlement to be made later (see "settlement date").

tranche

A class of bonds in a CMO offering which shares the same characteristics. "Tranche" is the French word for "slice."

transcript of proceedings

Final documents relating to a municipal bond issue.

transfer agent

A party appointed by an issuer to maintain records of securities owners, to cancel and issue certificates and to address issues arising from lost, destroyed or stolen certificates.

transparency

The concept of disseminating price, volume and other information to the public about transactions in the municipal market.

Treasury Inflation-Indexed Securities (TIIS)

Securities designed to protect investors and the future value of their fixed-income investments from the adverse effects of inflation. Using the Consumer Price Index as a guide, the value of the securities' principal is adjusted to reflect the effects of inflation. Also known as Treasury Inflation Protected Securities (TIPS).

trigger

The market interest rate at which the terms of a security might change. Triggers are common on index amortization notes and range securities.

triple-A claims-paying rating

Designation for insurers offering superior security on both an absolute and a relative basis. Such insurers have been judged to possess the highest safety and have the capacity to meet policyholder obligations.

true interest cost

A method of calculating bids for new issues of municipal securities that takes into consideration the time value of money (see "net interest cost").

true sale

An actual sale, as distinct from a secured borrowing, which means that assets transferred to an SPV are not expected to be consolidated with those of the sponsor in the event of the sponsor's bankruptcy. Rating agencies usually require what is called a true-sale opinion from a law firm before the securities can receive a rating higher than that of the sponsor.

true yield

The rate of return to the investor taking into account the payment of capital gains at maturity on a bond bought at a discount.

trust agreement

Agreement between the issuer and the trustee (1) authorizing and securing the bonds; (2) containing the issuer's covenants and obligations with respect to the project and payment of debt service; (3) specifying the events of default; and (4) outlining the trustee's fiduciary responsibilities and bondholders' rights. Generally does not include an assignment to the trustee of collateral to secure the payment of debt service.

trustee

A bank designated by the issuer as the custodian of funds and official representative of bondholders. Trustees are appointed to ensure compliance with the bond documents and to represent bondholders in enforcing their contract with the issuer.

undated issue



A floating-rate note with no stated maturity date (see also "perpetual floating-rate note").

underwrite

The purchase of a bond or note issue from an issuer to resell it to investors.

underwriter

The securities dealer who purchases a bond or note issue from an issuer and resells it to investors. If a syndicate or selling group is formed, the underwriter who coordinates the financing and runs the group is called the senior or lead manager. The difference between the offering price to the public by the underwriter and the purchase price the underwriter pays to the issuer. The underwriter's expenses and selling costs are usually paid from this amount.

undivided account

Syndicate account structure that is undivided as to sales and liability. Also called "Eastern" account.

unit

A fractional, undivided interest in a unit investment trust.

unit investment trust

Investment funds created with a fixed portfolio of investments that never changes over the life of the trust. They are created by brokerage houses, and are liquidated as investments within the trust are paid off. They provide a steady, periodic flow of income to investors.

unlimited tax bond

A bond secured by the pledge of taxes that are not limited as to rate or amount.

variable-rate demand obligation (VRDO)

A bond which bears interest at a variable, or floating, rate established at specified intervals (e.g., flexible, daily, weekly, monthly or annually). It contains a put option permitting the bondholder to tender the bond for purchase when a new interest rate is established. VRDOs are also referred to as VRDNs (N=Notes), VRDBs (B=Bonds) or low floaters.

volatility

A statistical measure of the variance of price or yield over time. Volatility is low if the price does not change very much over a short period of time, and high if there is a greater change.

volume cap

Dollar limitation of private-activity bonds that are allowed to be issued, by state, each year. Legislation enacted by Congress sets the volume cap.

weighted average coupon (WAC)

The weighted average interest rate of the underlying mortgage loans or pools that serve as collateral for a security, weighted by the size of the principal loan balances.

weighted average loan age (WALA)

The weighted average number of months since the date of the loan origination of the mortgages in a mortgage pass-through security pool issued by Freddie Mac, weighted by the size of the principal loan balances.

weighted average maturity (WAM)

The weighted average number of months to the final payment of each loan backing a mortgage security, weighted by the size of the principal loan balances. Also known as weighted average remaining maturity (WARM) and weighted average remaining term (WART).

window

In a CMO bond, the period of time between the expected first payment of principal and the expected last payment of principal.

yield

The annual percentage rate of return earned on a security. Yield is a function of a security's purchase price and coupon interest rate.

yield burning



In a refunding, the practice of a dealer marking up the price of the securities to be put in an escrow, in order to "burn the yield down" to levels that do not violate federal arbitrage regulations. Yield burning has a negative connotation.

yield curve

The graphical relationship between yield and maturity among bonds of different maturities and the same credit quality. This line shows the term structure of interest rates.

yield spread

The difference in yield between two bonds or bond indexes.

yield to call

A yield on a security calculated by assuming that interest payments will be paid until the call date, when the security will be redeemed at the call price.

yield to maturity

A yield on a security calculated by assuming that interest payments will be made until the final maturity date, at which point the principal will be repaid by the issuer. Yield to maturity is essentially the discount rate at which the present value of future payments (investment income and return of principal) equals the price of the security.

yield to worst

This is the lowest yield generated, given the potential stated calls prior to maturity.

zero-coupon bond

A bond for which no periodic interest payments are made. The investor receives one payment at maturity equal to the principal invested plus interest earned compounded semiannually at the original interest rate to maturity.

Z-tranche

Often the last tranche in a CMO, the Z-tranche receives no cash payments for an extended period of time until the previous tranches are retired. While the other tranches are outstanding, the Z-tranche receives credit for periodic interest payments that increase its face value but are not paid out. When the other tranches are retired, the Z-tranche begins to receive cash payments that include both principal and continuing interest.

* This glossary of bond terms was created and is owned by *The Securities Industry and Financial Markets Association*.

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