

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.

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.

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.

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.

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."

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.

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.

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 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 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 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) x 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.

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 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.

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.

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.

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.

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.

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.

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 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.

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.

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

Debt service- Principal and interest.

Debt service coverage- The ratio of net revenues to the debt service requirements.

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.

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

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.

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.

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.

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.

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.

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.

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

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.

Government-sponsored enterprise (GSE)- Financing entities created by Congress to fund loans to certain groups of borrowers, such as homeowners, farmers and students.

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.

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.

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.

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."

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.

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.

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.

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.

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-term debt- Debt which matures in more than one year.

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.

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.

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

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).

Municipal bond- A bond issued by a state or local governmental unit.

NASD- National Association of Securities Dealers. Largest securities industry self-regulatory organization in the United States .

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").

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 .

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.

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.

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.

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.

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.

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.

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.

Positive, yield curve- The interest rate structure which exists when long-term interest rates exceed short-term interest rates.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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 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).

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 .

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.

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."

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."

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

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.

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

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."

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.

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.

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.

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).

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 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.

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.

Source: The Securities Industry and Financial Markets Association