Fixed Income

Fixed-Income Instrument Features

Exam Focus

Detail

- Features of fixed-income securities
- Yield measures
- Yield curves

Background content

- Bond indentures

Features of Fixed-Income Securities

- Maturity
- Principal
- Coupon
- Issuer
- Seniority
- Contingency provisions

Bond: Example

3.2% BRWA Corporation Five-Year Notes (The "Notes") Prospectus Summary	
Issuer:	Bright Wheels Automotive Corporation
Settlement date:	[T + three business days]
Maturity date:	[Five years from settlement date]
Principal amount:	US $300 million
Interest:	3.2% fixed coupon
Interest payment:	Commencing six months from SD to be paid semiannually with final payment on MD
Seniority:	The notes are unsecured and unsubordinated obligations of BRWA Corporation and will rank *pari passu* with all other unsecured and unsubordinated indebtedness
Business days:	New York

Source: CFA Institute. Used with permission.

Bond: Example

3.2% BRWA Corporation Five-Year Notes Cash Flows	
T0	$300m
T0.5	($4.8m)
T1	($4.8m)
T1.5–T4.5	($4.8m)
T5	($304.8m)

Source: CFA Institute. Used with permission.

Yield Measures: Example

Five-year BRWA bond trading at $101 per $100 face value immediately after issuance.

Current yield = annual coupon / bond price

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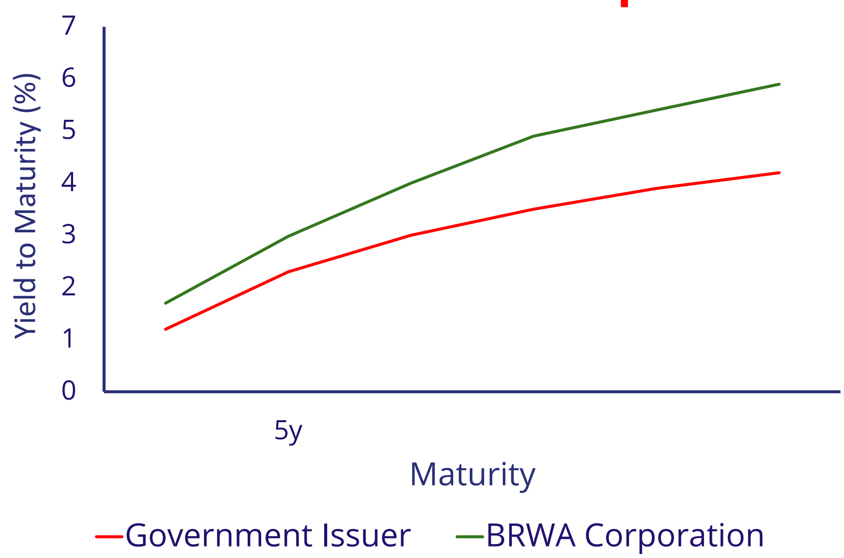
Yield Measures: Example

Five-year BRWA bond trading at $101 per $100 face value immediately after issuance.

Yield to maturity (YTM) = IRR using all coupons, principal, and current price:

N =
PMT =
PV =
FV =

Yield Curves: Example



Bond Terminology

- Bond indenture
- Trustee
- Secured vs. unsecured bond
- Collateral/lien/pledge
- Covenants

Trustees: Example

The individual or entity that *most likely* assumes the role of trustee for a bond issue is:

A. a financial institution appointed by the issuer.

B. the treasurer or chief financial officer of the issuer.

C. a financial institution appointed by a regulatory authority.

-1

Source: CFA Institute. Used with permission.

Covenants: Example

An example of an affirmative covenant is the requirement:

A. that dividends will not exceed 60% of earnings.

B. to insure and perform periodic maintenance on financed assets.

C. that the debt-to-equity ratio will not exceed 0.4 and times interest earned will not fall below 8.0.

-1

Source: CFA Institute. Used with permission.

Solutions

Yield Measures: Example

Five-year BRWA bond trading at \$101 per \$100 face value immediately after issuance.

Current yield = annual coupon / bond price

$$= \frac{\$3.20}{\$101} = 0.03168 \text{ or } 3.168\%$$

Yield Measures: Example

Five-year BRWA bond trading at $101 per $100 face value immediately after issuance.

Yield to maturity (YTM) = IRR using all coupons, principal, and current price:

N = 10
PMT = 1.6
PV = –101
FV = 100

CPT I/Y = 1.49%
× 2 to annualize = 2.98%

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Trustees: Example

The individual or entity that *most likely* assumes the role of trustee for a bond issue is:

A. a financial institution appointed by the issuer.

B. the treasurer or chief financial officer of the issuer.

C. a financial institution appointed by a regulatory authority.

The issuer chooses a financial institution with trust powers, such as the trust department of a bank or a trust company, to act as a trustee for the bond issue.

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Source: CFA Institute. Used with permission.

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Affirmative covenants indicate what the issuer "must do" and are administrative in nature. A covenant requiring the issuer to insure and perform periodic maintenance on financed assets is an example of an affirmative covenant. A and C are incorrect because they are negative covenants; they indicate what the issuer cannot do.

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