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Key Characteristics of Bonds

by Sophia

WHAT'S COVERED

In this lesson, you will learn about key terms associated with bonds. Specifically, this lesson will cover:

1. Par Value

One term that we hear regarding bonds is the **par value**, which is the face value. This is the amount of money that a bondholder will be paid at the date of maturity.

HINT

This is usually $1000, but it can be higher.

TERM TO KNOW

Par Value

The amount of money a holder will get back once a bond matures.

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2. Coupon Rate

The **coupon rate** is the amount of interest the bondholder will receive per payment. It is expressed as a percentage of the par value. Most often, it is fixed for the life of the bond; it never changes. Coupon payments can be paid at any period, but the most common payment is semi-annually.

DID YOU KNOW

The coupon got its name from the fact that in the past, paper certificates were issued that had coupons attached to them that the bondholder had to actually cut and deposit in order to receive that interest payment. Today, coupon payments are made in an automated manner without paper.

TERM TO KNOW

Coupon Rate

Amount of interest that the bondholder will receive per payment, expressed as a percentage of the par value.

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3. Maturity Date

The **maturity date** is the date on which the bond will be redeemed; it is the payment date for the loan. It is the date when the principal and any remaining interest is repaid to the bondholder. Most often, the maturity date is fixed, and the term is 30 years. Some bonds can have a longer maturity.

Treasury securities of the federal government have their own terms.

- Short-term bills have maturities between one and five years.
- Medium-term maturities, called notes, have maturities between six and 12 years.
- Long-term bonds have maturities that are greater than 12 years.

TERM TO KNOW

Maturity Date
The final payment date of a loan or other financial instrument.

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4. Call Provision

An indenture for a bond issuance can also have provisions for callability. A call provision allows the issuer to redeem the bond at some point in time before the maturity date. This date is called the call date. The call date is the date on which **callable bonds** can be redeemed early.

TERM TO KNOW

Callable Bond
A bond that allows the issuer of the bond to retain the privilege of redeeming the bond at some point before the bond reaches its date of maturity.

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5. Sinking Fund

There can also be provisions in an indenture for a payment to a sinking fund. A**sinking fund** is a way for an issuer to set aside money over time to retire the bond. It requires funds to be set aside periodically. For bondholders, this reduces the risk that the issuer will default when paying the face value at maturity.

TERM TO KNOW

Sinking Fund
A method by which an organization sets aside money to retire debts.

SUMMARY

In this lesson, we learned that the **par value** is the face value of a bond and is the amount the bondholder will receive at maturity, which is usually $1000. The **coupon rate** is the amount of interest that a bondholder will receive, expressed as a percentage of the face value. These interest payments are most often made semi-annually. The **maturity date** is the date on which the bond will be redeemed. This is the date that the principal is paid to the bondholder. Maturity is usually 30 years, and it is a fixed date that is not changed.

There are two provisions that may be found in a bond indenture. One is a **call provision** that allows an issuer to redeem their bond prior to maturity. The other is a **sinking fund** which is a provision that calls for the issuer to set aside payments periodically that will be used to retire the principal at maturity.

Best of luck in your learning!

TERMS TO KNOW

Callable Bond
A bond that allows the issuer of the bond to retain the privilege of redeeming the bond at some point before the bond reaches its date of maturity.

Coupon Rate
Amount of interest that the bondholder will receive per payment, expressed as a percentage of the par value.

Maturity Date
The final payment date of a loan or other financial instrument.

Par Value
The amount of money a holder will get back once a bond matures.

Sinking Fund
A method by which an organization sets aside money to retire debts.