

# INTERACTIVE BROKERS DISCLOSURE STATEMENT FOR BOND TRADING

This Disclosure Statement discusses the characteristics and risks of trading bonds through Interactive Brokers (IB). Before trading bonds you should consider consulting a financial advisor, who can provide advice on whether particular investments suit your financial goals.

IB merely provides execution and clearing services and does not provide specific trading or investment advice. IB will not monitor your trades and investments to determine if they are appropriate for your financial needs.

Before trading any particular bond, you should understand the exact terms and conditions of the bond, including its credit rating, its maturity, its rate and yield, whether it is callable, and other relevant information.

More information on bond trading can be found on the following website sponsored by the Securities Industry and Financial Markets Association: [www.investinginbonds.com](http://www.investinginbonds.com).

## Section 1 – Characteristics of Bonds

---

### 1.1 – What is a bond?

A bond is a type of interest-bearing or discounted security usually issued by a government or corporation that obligates the issuer to pay the holder an amount (usually at set intervals) and to repay the entire amount of the loan at maturity. It is another way for the issuer to generate money as opposed to issuing stock.

### 1.2 – What are the types of bonds?

#### A. U.S. Government Bonds

Bonds issued by the U.S. government are called Treasuries. These are grouped into three categories: (1) Treasury bills; (2) Treasury notes; and (3) Treasury bonds. They each have a different length of time until maturity. Income earned on Treasuries is exempt from state and local taxes, but taxable by the federal government. Treasuries are considered to be the safest bond investments since the U.S. government backs them and it is highly unlikely that a situation of default will occur. However, Treasuries with long maturities have more potential for inflation and credit risk.

#### B. Municipal Bonds

Municipal bonds are debt obligations of state or local governments. The funds may be used to support general governmental needs or special projects. Municipal bonds are considered riskier investments than Treasuries, but they are exempt from taxing by the federal government and local governments often exempt their own citizens from taxes on its bonds. However, municipal bonds often have a lower coupon rate because of the tax break.

#### C. Corporate Bonds

Corporate bonds are debt instruments issued by private corporations. They usually have four distinguishing characteristics: (1) they are taxable; (2) they usually have a par value of \$1,000; (3) they have a term maturity (they become

due all at once) and are paid for out of a sinking fund for that purpose; and (4) they are traded on major exchanges with prices published in newspapers. Corporate bonds come in various maturities. They are considered the riskiest of the bonds because there is much more of a credit risk with corporate bonds, but this usually means that the bondholder will be paid a higher interest rate. Corporations with low credit ratings issue bonds too, and these are speculative products called junk bonds.

Par value, or face amount, is usually \$1,000, but bond prices are quoted on \$100. For example, a quote of 80 is a bond selling for \$800. Amounts less than \$10 are quoted in eighths (\$1.25). Therefore, a quote of 80 1/8 is equal to \$801.25.

Convertible Bonds are bonds that may be converted into another form of corporate security, usually shares of common stock. Conversion only occurs at specific times at specific prices under specific conditions and this will all be detailed at the time the bond is issued.

#### D. Zero-Coupon Bonds

These are bonds that do not pay interest periodically, but instead pay a lump sum of the principal and interest at maturity. Investors, however, must pay taxes on the interest as it accrues, not when they receive it.

### 1.3 – Bond Ratings

Standard & Poor’s and Moody’s Investors Service assign credit ratings to governments and corporations which help determine the amount of interest paid. The ratings for bonds are in the chart below. The ratings represent greater default risk as you read down the chart (see Section 2 for credit and other risks associated with bonds).

Quality	Moody’s	Standard & Poor’s
Best Quality	Aaa	AAA
High Quality	Aa	AA
Upper-medium grade	A	A
Medium grade	Baa	BBB
Junk Bonds/Speculative/High Yield	Ba, B, Caa, Ca	BB, B, CCC, CC
Default	-	D

Bond ratings are subject to change by factors that affect the company’s credit.

The ratings that appear for the bonds IB offers are from sources IB believes to be reliable; however, IB cannot guarantee their accuracy.

## Section 2 – General Risks of Bond Trading

---

Trading bonds may not be suitable for all investors. Although bonds are often thought to be conservative investments, there are numerous risks involved in bond trading. If you are uncomfortable with any of the risks involved, you should not trade bonds.

*There is a credit risk involved with trading bonds.* When you purchase a corporate bond, you are lending money to a company. There is always the risk that the issuer will go bankrupt. If this happens, you will not receive your investment back. This is a risk of which you must be aware.

Credit risk is figured into the pricing of bonds.

*There is a prepayment risk involved.* Prepayment risk involves the scenario where an issuer “calls” a bond. If this happens, your investment will be paid back early. Certain bonds are callable and others are not, and this information is

detailed in the prospectus. If a bond is callable, the prospectus will detail a "yield-to-call" figure. Corporations may call their bonds when interest rates fall below current bond rates.

A "put" provision allows a bondholder to redeem a bond at par value before it matures. Investors may do this when interest rates are rising and they can get higher rates elsewhere. The issuer will assign specific dates to take advantage of a put provision. Prepayment risk is figured into the pricing of bonds.

*There is a significant inflation risk when trading bonds.* Inflation risk is the risk that the rate of the yield to call or maturity of the bond will not provide a positive return over the rate of inflation for the period of the investment. In other words, if the rate of inflation for the period of an investment is six percent and the yield to maturity of a bond is four percent, you will receive more money in interest and principal than you invested, but the value of that money returned is actually less than what was originally invested in the bond. As the inflation rate rises, so do interest rates. Although the yield on the bond increases, the price of the actual bond decreases. This is a risk of which you must be aware.

*There is an interest rate risk associated with bonds.* Changes in interest rates during the term of any bond may affect the market value of the bond prior to call or the maturity date.

### Section 3 – Risks of Trading Bonds Electronically

---

IB is an online, direct access brokerage firm that executes virtually all trades on electronic market centers. IB will post bids and offers for bonds from various information sources and markets and will allow you to execute trades against those electronically-displayed bond quotes.

Unlike the practice of many other brokers, IB will not make telephone calls to various bond dealers in seeking to execute your bond orders. Rather, IB will provide you with direct access to electronic bond trading platforms.

Electronic trading has a number of inherent advantages (such as speed, low cost, and a clear audit trail) but it also has certain inherent disadvantages. *You should be aware that electronic bond trading platforms may have less liquidity or less advantageous prices than could be offered telephonically by a bond dealer. In addition, electronic trading platforms are inherently vulnerable to technical errors and outages.*

Please note that many bond dealers place quotes to buy or sell the same bond position on multiple bond trading venues (e.g., 10 bonds on Market A and 10 bonds on Market B). If an IB customer order executes against both of the quotes (e.g., an order to buy 20 is filled 10 at Market A and 10 at Market B), the dealer may request that one of the trades be busted (reversed). IB reserves the right to grant such requests without consent of customer if IB, in its discretion, believes that the dealer is acting in good faith.

### Section 4 – Margin

---

When a broker-dealer lends a customer part of the funds needed to purchase a security such as a bond, the term "margin" refers to the amount of cash, or down payment, the customer is required to deposit. Bonds, like equity securities, may be traded on margin. Trading on margin is inherently more risky than trading in fully-paid-for securities. For risks associated with margin trading, please see Interactive Brokers LLC's "DISCLOSURE OF RISKS OF MARGIN TRADING."

## Section 5 – Commissions and Mark-Ups

---

You will be charged a commission for bond trades executed through IB. IB may execute your bond trade through or against an affiliate of IB (such as Timber Hill LLC or another affiliate), which may charge a markup on trades such affiliate executes as principal against your bond order.

### **INTERACTIVE BROKERS DISCLOSURE REGARDING DISTRESSED BONDS**

On the Settlement Date, the buyer must pay to seller only the agreed upon price, without any payment in respect of interest. The person holding the bond on the Record Date receives any and all interest payments whenever made. If a Record Date occurs before the Settlement Date, seller will get any interest paid on a bond that is trading Flat. If there is a change in the Record Date, the party that was a bondholder with respect to the prior Record Date loses any rights they may have had to receive any related payment of principal or interest.

If a bond that was sold with accrued interest begins trading Flat after the trade date but before Settlement date, the buyer remains responsible for paying the accrued interest to the seller, even though the buyer may not receive interest from the bond issuer. If the accrued interest payment is not made on the actual Payment Date, but is made during the Grace Period, any interest payments will accrue to the seller. If accrued interest is paid after the Grace Period, it will belong to the buyer when paid.

Bankruptcy courts can issue broad orders at the request of a bankruptcy debtor that halt or seriously restrict trading in all of the debt and equity of the debtor corporation for the protection of the bankruptcy debtor's net operating loss ("NOL") carryovers and other tax attributes of the debtor.

"Minimum denomination transfer requirements" are generally found in the Indenture and the offering documents and provide that a transfer of a bond whether in physical or book-entry form be made in certain minimum denominations.