

Proposed Rule Change by National Association of Securities Dealers
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

<input type="checkbox"/> Initial	<input checked="" type="checkbox"/> Amendment	<input type="checkbox"/> Withdrawal	<input checked="" type="checkbox"/> Section 19(b)(2)	<input type="checkbox"/> Section 19(b)(3)(A)	<input type="checkbox"/> Section 19(b)(3)(B)
			Rule		
<input type="checkbox"/> Pilot	<input type="checkbox"/> Extension of Time Period for Commission Action	<input type="text" value=""/> Date Expires	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

<input type="checkbox"/> Exhibit 2 Sent As Paper Document	<input type="checkbox"/> Exhibit 3 Sent As Paper Document
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Description
Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name	<input type="text" value="James"/>	Last Name	<input type="text" value="Eastman"/>
Title	<input type="text" value="Assistant General Counsel"/>		
E-mail	<input type="text" value="james.eastman@nasd.com"/>		
Telephone	<input type="text" value="(202) 728-6961"/>	Fax	<input type="text" value="(202) 728-8264"/>

Signature
Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date	<input type="text" value="07/16/2007"/>
By	<input type="text" value="Marc Menchel"/>
	(Name)
	<input type="text" value="Executive Vice President and General Counsel"/>
	(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

On August 19, 2005, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“Commission”) SR-NASD-2005-100, which proposed NASD Rule 2231. On December 21, 2005, NASD filed Amendment No. 1, and on January 26, 2007, NASD filed Amendment No. 2, which modified proposed Rule 2231 and proposed amendments to NASD Rule 2340. This partial Amendment No. 3 reflects comments of the Commission staff on Amendment No. 2 as well as certain technical changes. Attached Exhibit 5 shows the proposed rule change in its entirety with proposed new language underlined and proposed deletions in brackets. Attached Exhibit 4 shows modifications to the proposed rule change made by Amendment No. 3 marked against the proposed rule change in Amendment No. 2 and is shown as if the proposed rule change in Amendment No. 2 had been adopted. Additionally, Exhibit 1 filed with Amendment No. 2 would be modified by adding the following two sentences to the final paragraph of Item II.A.1’s section entitled “Proposed Disclosures” (immediately prior to the heading entitled “Proposed Disclosure Document”):¹

¹ See page 25 of 67 of Amendment No. 2. For purposes of reference, the sentence immediately prior to the two new sentences states that:

Finally, when a member sells to a customer a debt security that is callable and, at issue, is not structured to include scheduled interest payments (e.g., “zero coupon bonds”), the member would be required to provide to the customer the dollar equivalent of the debt security’s imputed interest until the next occurring call date (assuming that the price at which the debt security may be called is paid to the holder). [Footnote 25 omitted.]

Additionally, customers would have the right to make a written request for certain additional cash flow information as well as the disclosure document (see discussion below of proposed disclosure document).² Firms would have three business days to provide a written response to such requests, unless the request were made more than six months after the settlement of a transaction, in which case a firm would have ten business days to respond.³

² See subparagraphs (A), (B), and (C) of proposed Rule 2231(b)(5) and proposed Rule 2340(e)(3).

³ Id.

Exhibit 4
Amendment No. 3 to
SR-NASD-2005-100

Exhibit 4 shows changes to the proposed rule change made by Amendment No. 3 marked against the proposed rule change in Amendment No. 2. The changes are shown as if the proposed rule change in Amendment No. 2 had been adopted. Proposed new language is underlined; proposed deletions are in brackets.⁴

2231. Confirmation of Transactions in Debt Securities

(a) Confirmation of Transactions in Debt Securities

(1) Except as otherwise provided herein, any member that is required to disclose to a customer information pursuant to Rule 10b-10 under the Act in connection with any transaction in a debt security also shall, with respect to any TRACE-eligible security, disclose to the customer, other than an institutional account, the information set forth in paragraph (b). Except as otherwise provided herein, this information shall be disclosed in the same manner and at the same time in which the member discloses to the customer information in connection with the transaction pursuant to Rule 10b-10 under the Act. A member need not

⁴ Additionally, NASD is making three technical amendments to the disclosure document “Important Information You Need to Know about Investing in Corporate Bonds” proposed in Amendment No. 2. First, the word “base” will be replaced by the word “face” in the sentence on page 19 of 29 of Exhibit 5 of this Amendment No. 3: “(A bond’s coupon rate is the rate of interest paid periodically on the face[base] amount of the obligation.)” Second, the comma appearing after the word “because” will be removed from the sentence on page 22 of 29: “This risk will be reflected in a lower market value for the bond because[,] any appreciation” Third, parentheses will be added around the term “or Aaa” and a comma will be added after the word “example” in the sentence on page 24 of 29: “In issuing a credit rating, a credit rating agency reviews...and assigns a rating (for example, AAA (or Aaa) to D).” The full text of the disclosure document is contained in attached Exhibit 5.

disclose to customers information required to be disclosed under this Rule if the member discloses such information pursuant to Rule 10b-10 under the Act.

(2) For purposes of this Rule:

(A) “institutional account” shall have the same meaning it has [when used]in Rule 3110 and means an account that, within the past twelve months, the member has determined is an institutional account;

(B) “debt security” shall have the same meaning it has in Rule 10b-10 under the Act, except that any exempted security or asset-backed security is excluded from this definition;

(C) “exempted security” shall have the same meaning it has in Section 3(a)(12) of the Act;

(D) “asset-backed security” shall have the same meaning it has in Rule 10b-10 under the Act;

(E) “nationally recognized statistical rating organization” (“NRSRO”) shall have the same meaning it has [when used]in Rule 15[(c)][(3)]-1 under the Act;

(F) “clearing member” shall have the same meaning it has [when used]in Rule 3230;

(G) “service bureau” shall have the same meaning it has [when used]in IM-4632-1 under Rule 4632; and

(H) “TRACE-eligible security” shall have the same meaning it has [when used]in Rule 6210(a).

(b) Information Required to be Disclosed

(1) *Debt security information.* A member must disclose the debt security's CUSIP number and the TRACE symbol of the debt security if one has been designated by NASD.

(2) *Broker-dealer charges.* A member must disclose, if acting as principal, the following: "The broker-dealer's remuneration on this transaction has been added to the price in the case of a purchase or deducted from the price in the case of a sale."

(3) *Credit rating.* A member must disclose the lowest credit rating(s) it has received at the time the transaction confirmation is generated, the date of such credit rating(s), and the NRSRO(s) assigning the credit rating(s) of the debt security the member purchased for or from or sold to or for a customer, if:

(A) the member has entered into a written agreement with the NRSRO to receive such credit rating(s);

(B) a service bureau that provides confirmation services to the member for the transaction has entered into a written agreement with the NRSRO to receive such credit rating(s) and provides them to the member as part of the confirmation services at no additional cost; or

(C) a member that acts as a clearing member for, and provides confirmation services to, the member for the transaction has entered into a written agreement with the NRSRO to receive such credit rating(s) and provides them to the member as part of the confirmation services at no additional cost.

(4) *Indicators of marketability and liquidity.* A member must disclose that transaction price information for the securities subject to this Rule is publicly available on the Internet at www.nasdbondinfo.com for the customer's non-commercial use at no charge, or at other sources that provide such information.

(5) *Cash flow information.* For purchases only, a member must disclose on a per debt security basis the following:

(A) The frequency of interest and/or principal payments as applicable, if either are paid on a periodic, fixed schedule. If the debt security does not pay interest or principal on a regular schedule, [the] a member must disclose the following: "This security does not pay interest or principal on a regular schedule. Information regarding the frequency of interest or principal payments for this security will be furnished to you upon written request." A member shall provide such additional information in writing within three business days of receiving a customer's written request, or within ten business days if such a request is received more than six months after the transaction's settlement date.

(B) Yield to maturity, and, if the debt security is subject to call prior to maturity through any means, a notation of "callable" shall be included. The date and price of the next pricing call shall be included and so designated. If the debt security is continuously callable (i.e., callable on any date after the first call date), a member must disclose the following: "This security is continuously callable." If there are any call features in addition to the next pricing call, [disclosure must be made

that]a member must disclose the following: “Additional call features exist that may affect yield; additional information will be [provided]furnished to you upon written request.” A member shall provide such additional information in writing within three business days of receiving a customer’s written request, or within ten business days if such a request is received more than six months after the transaction's settlement date.

(C) For debt securities carrying a variable coupon rate, a member must disclose the following: [a statement indicating that] “T[t]he coupon rate may vary, [and that the member will provide in writing] [a]Additional information that describes the way in which the debt security’s interest and principal payments are calculated will be furnished to you upon[a] written request.”[from the customer that is sent not later than six months from the date of settlement.] A[M]member[s] shall provide such additional information [to any customer to whom disclosure is provided under this Rule]in writing within three business days of receiving [the]a customer’s written request, or within ten business days if such a request is received more than six months after the transaction's settlement date. Any such additional information shall contain:

- (i) the amount of the next interest payment based on the current coupon rate,
- (ii) a statement that this amount will change if the coupon rate changes,
- (iii) how often the coupon rate may be recalculated,

(iv) an explanation of the event(s) that may trigger the recalculation, and

(v) the formula for recalculating such coupon rate.

(D) For debt securities that are callable and, at [issue]issuance, are not structured to include scheduled interest payments (e.g., “zero coupon bonds”), the dollar equivalent of the debt security’s imputed interest until the next occurring call date (assuming that the price at which the debt security may be called is paid to the holder).

2340. Customer Account Statements

(a)-(d) No change.

(e) Notice of Availability of NASD Disclosure on Debt Securities

(1) Except as otherwise provided in subparagraph (2) below, a member that has provided a customer disclosure under Rule 2231 during the period since the last account statement was sent to the customer also must disclose the following[statement]: “A disclosure document discussing your rights as a bondholder and some of the risks related to buying and holding bonds, titled ‘Important Information You Need to Know About Investing in Corporate Bonds,’ has been prepared by NASD and is available online at www.nasd.com. A paper version of this document is available from your broker upon your written request[made not later than six months from the date of settlement of your transaction].”

(2) In lieu of disclosing the internet Web site address “www.nasdaq.com” in the statement set forth in subparagraph (1), a member may disclose the member’s internet Web site address, provided that the document, “Important Information You Need to Know About Investing in Corporate Bonds,” or an internet hyperlink directly thereto, is easily accessible from the internet address that is disclosed.

(3) A [M]ember[s] [must]shall provide the document, “Important Information You Need to Know About Investing in Corporate Bonds,” to any customer to whom a statement is provided pursuant to subparagraph (1) within three business days of receiving a[the] customer’s written request, or within ten business days if such a request is received more than six months after the transaction’s settlement date. This document provides information that an investor should know immediately prior to buying or selling a bond such as the basics of bond pricing, yield, and the difference between yield to maturity and yield to call. It also describes certain risks that bond investors assume in such transactions (e.g., interest rate risk and liquidity risk). This document also contains a short description of basic types of bonds (e.g., floating rate bonds, zero coupon bonds and convertible bonds) as well as debt structure (e.g., junior or subordinated debt). Finally it informs investors that even if they are not charged a commission they are nevertheless paying a fee to their broker-dealer when they buy or sell bonds.

(f) Exemptions

Pursuant to the Rule 9600 Series, the Association may exempt any member from the provisions of this Rule for good cause shown.

Exhibit 5
Amendment No. 3 to
SR-NASD-2005-100

Exhibit 5 shows the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

2231. Confirmation of Transactions in Debt Securities

(a) Confirmation of Transactions in Debt Securities

(1) Except as otherwise provided herein, any member that is required to disclose to a customer information pursuant to Rule 10b-10 under the Act in connection with any transaction in a debt security also shall, with respect to any TRACE-eligible security, disclose to the customer, other than an institutional account, the information set forth in paragraph (b). Except as otherwise provided herein, this information shall be disclosed in the same manner and at the same time in which the member discloses to the customer information in connection with the transaction pursuant to Rule 10b-10 under the Act. A member need not disclose to customers information required to be disclosed under this Rule if the member discloses such information pursuant to Rule 10b-10 under the Act.

(2) For purposes of this Rule:

(A) “institutional account” shall have the same meaning it has in Rule 3110 and means an account that, within the past twelve months, the member has determined is an institutional account;

(B) “debt security” shall have the same meaning it has in Rule 10b-10 under the Act, except that any exempted security or asset-backed security is excluded from this definition;

(C) “exempted security” shall have the same meaning it has in Section 3(a)(12) of the Act;

(D) “asset-backed security” shall have the same meaning it has in Rule 10b-10 under the Act;

(E) “nationally recognized statistical rating organization” (“NRSRO”) shall have the same meaning it has in Rule 15c3-1 under the Act;

(F) “clearing member” shall have the same meaning it has in Rule 3230;

(G) “service bureau” shall have the same meaning it has in IM-4632-1 under Rule 4632; and

(H) “TRACE-eligible security” shall have the same meaning it has in Rule 6210(a).

(b) Information Required to be Disclosed

(1) Debt security information. A member must disclose the debt security’s CUSIP number and the TRACE symbol of the debt security if one has been designated by NASD.

(2) Broker-dealer charges. A member must disclose, if acting as principal, the following: “The broker-dealer’s remuneration on this transaction has been added to the price in the case of a purchase or deducted from the price in the case of a sale.”

(3) Credit rating. A member must disclose the lowest credit rating(s) it has received at the time the transaction confirmation is generated, the date of such

credit rating(s), and the NRSRO(s) assigning the credit rating(s) of the debt security the member purchased for or from or sold to or for a customer, if:

(A) the member has entered into a written agreement with the NRSRO to receive such credit rating(s);

(B) a service bureau that provides confirmation services to the member for the transaction has entered into a written agreement with the NRSRO to receive such credit rating(s) and provides them to the member as part of the confirmation services at no additional cost; or

(C) a member that acts as a clearing member for, and provides confirmation services to, the member for the transaction has entered into a written agreement with the NRSRO to receive such credit rating(s) and provides them to the member as part of the confirmation services at no additional cost.

(4) *Indicators of marketability and liquidity.* A member must disclose that transaction price information for the securities subject to this Rule is publicly available on the Internet at www.nasdbondinfo.com for the customer's non-commercial use at no charge, or at other sources that provide such information.

(5) *Cash flow information.* For purchases only, a member must disclose on a per debt security basis the following:

(A) The frequency of interest and/or principal payments as applicable, if either are paid on a periodic, fixed schedule. If the debt security does not pay interest or principal on a regular schedule, a member must disclose the following: "This security does not pay interest or

principal on a regular schedule. Information regarding the frequency of interest or principal payments for this security will be furnished to you upon written request.” A member shall provide such additional information in writing within three business days of receiving a customer’s written request, or within ten business days if such a request is received more than six months after the transaction's settlement date.

(B) Yield to maturity, and, if the debt security is subject to call prior to maturity through any means, a notation of “callable” shall be included. The date and price of the next pricing call shall be included and so designated. If the debt security is continuously callable (i.e., callable on any date after the first call date), a member must disclose the following: “This security is continuously callable.” If there are any call features in addition to the next pricing call, a member must disclose the following: “Additional call features exist that may affect yield; additional information will be furnished to you upon written request.” A member shall provide such additional information in writing within three business days of receiving a customer’s written request, or within ten business days if such a request is received more than six months after the transaction's settlement date.

(C) For debt securities carrying a variable coupon rate, a member must disclose the following: “The coupon rate may vary. Additional information that describes the way in which the debt security’s interest and principal payments are calculated will be furnished to you upon

written request.” A member shall provide such additional information in writing within three business days of receiving a customer’s written request, or within ten business days if such a request is received more than six months after the transaction’s settlement date. Any such additional information shall contain:

(i) the amount of the next interest payment based on the current coupon rate,

(ii) a statement that this amount will change if the coupon rate changes,

(iii) how often the coupon rate may be recalculated,

(iv) an explanation of the event(s) that may trigger the recalculation, and

(v) the formula for recalculating such coupon rate.

(D) For debt securities that are callable and, at issuance, are not structured to include scheduled interest payments (e.g., “zero coupon bonds”), the dollar equivalent of the debt security’s imputed interest until the next occurring call date (assuming that the price at which the debt security may be called is paid to the holder).

2340. Customer Account Statements

(a)-(d) No change.

(e) Notice of Availability of NASD Disclosure on Debt Securities

(1) Except as otherwise provided in subparagraph (2) below, a member that has provided a customer disclosure under Rule 2231 during the period since the last account statement was sent to the customer also must disclose the following: “A disclosure document discussing your rights as a bondholder and some of the risks related to buying and holding bonds, titled ‘Important Information You Need to Know About Investing in Corporate Bonds,’ has been prepared by NASD and is available online at www.nasd.com. A paper version of this document is available from your broker upon your written request.”

(2) In lieu of disclosing the internet Web site address “www.nasd.com” in the statement set forth in subparagraph (1), a member may disclose the member’s internet Web site address, provided that the document, “Important Information You Need to Know About Investing in Corporate Bonds,” or an internet hyperlink directly thereto, is easily accessible from the internet address that is disclosed.

(3) A member shall provide the document, “Important Information You Need to Know About Investing in Corporate Bonds,” to any customer to whom a statement is provided pursuant to subparagraph (1) within three business days of receiving a customer’s written request, or within ten business days if such a request is received more than six months after the transaction’s settlement date. This document provides information that an investor should know immediately prior to buying or selling a bond such as the basics of bond pricing, yield, and the difference between yield to maturity and yield to call. It also describes certain risks that bond investors assume in such transactions (e.g., interest rate risk and

liquidity risk). This document also contains a short description of basic types of bonds (e.g., floating rate bonds, zero coupon bonds and convertible bonds) as well as debt structure (e.g., junior or subordinated debt). Finally it informs investors that even if they are not charged a commission they are nevertheless paying a fee to their broker-dealer when they buy or sell bonds.

[(e)](f) Exemptions

Pursuant to the [Rule 9600](#) Series, the Association may exempt any member from the provisions of this Rule for good cause shown.

Important Information You Need to Know about Investing in Corporate Bonds

This document is intended to provide you with some basic facts about the most common features of corporate bonds, and to alert you to some of the risks associated with buying, selling, and holding corporate bonds.

As with any investment, before buying a corporate bond, you should analyze the bond on its own merits, weighing its risks, costs, and rewards. Consult with your firm about any questions you may have about investing in a particular bond.

Corporate Bond Basics

What is a Corporate Bond?

Corporate bonds are, at their simplest, loans that investors make to public and private corporations. Consequently, bonds are referred to as debt securities. Corporations

generally issue corporate bonds to raise money for capital expenditures, operations, and acquisitions.

Typically, bondholders receive interest payments during the term of a bond (or, for as long as a bondholder owns a bond), at the stated interest rate—also called the coupon rate. In addition, if bondholders hold bonds until maturity, they also are repaid the principal amount, called par value or face amount.

Bond Price and Yield

Price

If you sell a bond before it matures, you may not receive the full principal amount of the bond. This is because a bond's price is not based on the par value of the bond. Rather, it is set in the secondary market and is established by the current market values of such bonds, which may be more or less than the amount of principal the issuer would be required to pay the bondholder at maturity. Therefore, it is impossible to predict in advance the price that a bondholder will receive if the bondholder purchases a bond and later sells the bond before maturity.

The price of a bond is often above or below its par value because the price is adjusted according to current interest rates in the whole market for the same debt security and comparable debt securities. For example, if the bond you desire to purchase has a coupon rate of 8 percent, and similar quality new bonds available for sale have a coupon rate of 5 percent, you will have to pay more than the par amount of the bond that you intend to purchase, because you will receive more interest income than the current coupon rate (5

percent) being attached to similar bonds. (A bond's coupon rate is the rate of interest paid periodically on the face amount of the obligation.)

Yield

Yield is the overall return on the capital you invest in the bond. Yield is similar to, but different from, a bond's coupon rate. This distinction is important, because as is explained above, while a bond's face amount or par value is fixed, its market value almost always changes over time. Because bond prices fluctuate continually in the market, the yield your bond investment will provide if it is sold prior to maturity also changes constantly. A bond's price is inversely related to its yield. As a bond's price increases, its associated yield decreases; as the price of a bond decreases, the associated yield increases.

For example, a bond that sells today for \$1,000 and has a coupon rate of 8 percent has a current yield of 8 percent. Because the "price" equals the face amount of the bond, the current yield of 8 percent equals the 8 percent coupon rate. However, usually after the first sale of a bond, the price of a bond differs from the face amount. For example, if the same bond sells tomorrow for \$990, the current yield would be slightly higher than 8 percent.

Yield to Maturity and Yield to Call: What's the Difference?

Yield to maturity is calculated by taking into account the total amount of interest you will receive over time, your purchase price (the amount of capital you invested), the face

amount (or other amount you will be paid when the issuer “redeems” the bond), the time between interest payments, and the time remaining until the bond matures.

If you hold a callable bond, another type of yield calculation, yield to call, also is important for you to understand. This calculation takes into account the impact on a bond’s yield if it is called prior to maturity and is often done using the first date on which the issuer could call the bond. (Other call dates may be used in specified circumstances.)

A bond’s yield to call may be lower than its yield to maturity.

To get a more accurate picture of what a bond will cost you or what you received for it, you should also ask your broker to calculate the yield adjusting the purchase price up (when you purchase) or down (when you sell) by the amount of the mark-up or commission (when you purchase) or mark-down or commission (when you sell) and other fees or charges that you are charged by your broker for its services. This is called yield reflecting broker compensation.

Corporate Bond Risks

Like virtually all investments, corporate bonds carry risk. It is important that you fully understand the risks of investing in corporate bonds. These risks include:

Interest Rate Risk

When interest rates rise, bond prices fall, and when interest rates fall, bond prices rise.

Interest rate risk is the risk that changes in interest rates generally in the U.S. or the world economy may reduce (or increase) the market value of a bond you hold. Interest rate risk increases the longer that you hold a bond. For example, if interest rates rise throughout

the economy, bond issuers, along with other borrowers, will need to offer potential bondholders higher rates to compete with the higher interest rates available elsewhere.

Any bonds issued in a period of rising interest rates generally will carry higher coupon rates, which will be more attractive to potential bondholders than the coupon rate paid by bonds issued before the rise in interest rates. This decreased appetite for older bonds that pay lower interest depresses their price in the secondary market, which would translate into your receiving a lower price for your bonds if you chose to resell them in a period of rising interest rates. The opposite holds true as well, and the market value of older bonds that pay higher than current interest rates tends to rise in periods where interest rates are generally declining.

Call and Reinvestment Risk

Bonds with a call provision can be redeemed or “called” by the bond issuers, requiring bondholders to redeem their bonds at the call price well before their maturity dates.

Bonds often are called when market interest rates are falling, because bond issuers want to refinance their debt at lower interest rates (similar to when a home owner seeks to refinance a mortgage at a lower rate when mortgage interest rates decrease). This is known as call risk.

With a callable bond, a bondholder might not receive the bond’s coupon rate for the entire term of the bond, and it might be difficult or impossible to find an equivalent investment paying rates as high as the called bond. This is known as reinvestment risk.

Additionally, at any given point in time, the period that a callable bond will generate cash

flow is uncertain. This risk will be reflected in a lower market value for the bond, because any appreciation in the value of the bond's periodic interest payments may not be fully realized if it is "called away" by its issuer.

Refunding Risk and Sinking Funds Provisions

A sinking fund provision, which often is a term included in bonds issued by industrial and utility companies, requires a bond's issuer to retire a certain number of bonds periodically. This can be accomplished in a variety of ways, including through purchases in the secondary market or forced purchases directly from bondholders at a pre-determined price.

Holder of bonds subject to sinking fund redemptions should understand that they risk having their bonds called (or redeemed) prior to maturity. Unlike other bonds subject to call, depending on the sinking fund provision, there may be a relatively high likelihood that the issuer will redeem some or many of the bonds prior to maturity, even if market-wide interest rates do not change.

It is important to understand that there is no guarantee that an issuer of these bonds will be able to comply strictly with any redemption requirements. In certain cases, an issuer may need to borrow funds or issue additional debt to refinance an outstanding bond issue subject to a sinking fund provision when it matures. If the issuer is unable to raise adequate funds to refinance the outstanding issue, the issuer could default and the bondholder could lose all or most of his/her investment.

Default and Credit Risk

If you ever loaned money to someone, chances are you gave some thought to the likelihood of being repaid. Some loans are riskier than others. The same is true when you invest in bonds. You are taking a risk that the issuer's promise to repay both principal and interest will not be upheld. In the case of Treasuries and other government-issued bonds backed by the "full faith and credit of the U.S. government," that risk is almost zero. However, there is some risk of default with corporate bonds. This means the corporations issuing them may either be late paying bondholders or -- in worst-case scenarios -- be unable to pay at all.

Bond ratings are a way of measuring default and credit risk. Bond ratings are issued by private companies called credit rating agencies. In issuing a credit rating, a credit rating agency reviews relevant information supplied to it by the issuer or its agents, and from sources the credit rating agency considers reliable, including financial information such as the issuer's financial statements, and assigns a rating (for example, AAA (or Aaa) to D).

Generally, bonds are categorized in two broad categories—investment grade and non-investment grade. Bonds that are rated BBB (or Baa) or higher are considered investment grade. Bonds that are rated BB (or Ba) or lower are non-investment grade. Non-investment grade bonds are also referred to as high-yield or junk bonds, and in some cases, distressed bonds. These bonds are considered riskier investments because the issuer's general financial condition is less sound, and the issuer may default -- (may not be able to pay the interest and principal to bondholders when they are due).

Many bondholders heavily weigh the rating of a particular corporate bond in determining if the corporate bond is an appropriate and suitable investment for them. Although credit ratings are an important indicator of creditworthiness, you should also consider that the value of the bond might change depending on changes in the company's business and profitability. The credit rating could be revised downward. In the worst scenario, if you own a bond and the company that issues it defaults you could lose all of your investment. Finally, some bonds are not rated. In such cases, an individual bondholder may find it difficult to assess the overall creditworthiness of the issuer of the bond.

Liquidity Risk

You should determine whether the bond in which you are interested has traded frequently, infrequently, or not at all in recent months, and if your broker regularly buys and sells the bond. While certain bonds are very actively traded and are relatively "liquid," other bonds, including many high-yield bonds, are traded much less frequently or not at all and may not be easy to sell. If you think you might need to sell the bonds you are purchasing prior to their maturity, you should carefully consider the likelihood of your being able to do so, and whether your broker will be able and willing to assist you in liquidating your investment at a fair price reasonably related to then current market prices. It is possible that you may be able to re-sell a bond *only* at a heavy discount to the price you paid (loss of some principal) or not at all. Additionally, bonds that are less frequently traded may be subject to wider "spreads" in the secondary market, which means that you would receive less for your bond if selling, or pay more if buying, than otherwise would be the case.

Corporate Bonds with Special Features

It also is important to understand any special features a bond may have before you buy, since these features may affect risk.

Floating Rate Bonds

Floating-rate bonds have a floating or variable interest rate that is adjusted periodically, or floats, using an external value or measure (for example, the prime rate or a stock index). Such bonds offer protection against interest rate risk, but their coupon rate is usually lower than those of fixed-rate bonds.

Zero-Coupon Bonds

Zero-coupon bonds, unlike other bonds, don't make regular interest payments. Instead, the bondholder buys the bond at a discount from the face value of the bond, and, when the bond matures, the issuer repays the bondholder the face amount. The difference between the discounted amount the bondholder pays upon purchase and the face amount later received is the imputed interest. Because zero-coupon bonds don't pay any interest until maturity, their prices may be more volatile than other bonds with similar maturities that pay interest periodically.

Secured Bonds

Secured bonds are backed by collateral that the bond's issuer has agreed to sell if it otherwise is unable to meet its obligation when the bond matures. For example, a bond might be backed by a specific factory or industrial equipment. However, any

such backing is only as good as the value of the asset being used as collateral, the value of which can decrease during the term of the bond.

Bonds that are not backed by any collateral are unsecured and are sometimes called debentures. Debentures are backed solely by an issuer's promise to repay you. Most corporate bonds are debentures.

Guaranteed and Insured Bonds

Certain bonds may be referred to as guaranteed or insured. This means that a third party has agreed to make the bond's interest and principal payments if the issuer is unable to make these payments. You should keep in mind that such guarantees only are as valuable as the creditworthiness of the third party making the guarantee or providing the insurance.

Convertible Bonds

Convertible bonds may be converted into the stock of the bond's issuer. A bondholder should be careful to understand the conditions under which the bonds may be converted, as this right often is contingent upon the issuer's stock reaching a certain price level, among other things. Bond investors also should ask their broker or financial adviser whether there is any charge or fee associated with making a conversion.

Junior or Subordinated Bonds

The more junior bonds issued by a company typically are referred to as subordinated debt, because a junior bondholder's claim for repayment of the principal of such bonds

has a lower priority than the claims of a bondholder holding an issuer's more senior debt. Therefore, in the event of a bankruptcy, junior bondholders receive payment only after senior debt claims are paid in full. Additionally, other types of claims also may have priority on the issuer's remaining assets over the claims of *all* bondholders (e.g., certain supplier or customer claims). Therefore, although bondholders generally are paid prior to stockholders in a bankruptcy proceeding, this doesn't mean the bondholder will get any money back because the issuer's assets could be reduced to zero by other creditors that have the right to be paid before bondholders.

Broker Compensation for Selling Bonds

No Commission does not Mean No Charge.

You should understand that your broker is being compensated for performing services for you, even if you are not charged a commission when you buy or sell a bond. In most bond transactions, brokers are compensated, even though a commission charge is not disclosed, because the transaction is structured as a principal transaction (i.e., your broker sells you a bond it already owns). This is because when a dealer sells you a bond in a principal capacity, the dealer increases or marks up the price you pay over the price the dealer paid to acquire the bond. The mark-up is the dealer's compensation and is similar to a commission. Similarly, if you sell a bond, a dealer will offer you a price that includes a mark-down from the price that the dealer believes he can sell the bond to another dealer or another buyer. You should understand that the firm has charged you a fee for its services.

Would a Similar Bond Cost Less?

Finally, it is important to consider the potential conflicts that your broker might have when it sells you a bond. Bonds issued by different issuers often have very similar risk profiles and carry similar coupon rates. Before you buy a bond, you should shop around and consider if there are other bonds that you could buy at a cheaper price than the one recommended by your broker. You should consider whether there are other bonds available with similar risk/return profiles that might be available at lower cost. You also should try and understand how your broker is being compensated for any bond transaction, particularly those that are recommended to you where similar bonds may be available.