Regulation Best Interest Disclosures: Fixed Income Sales and Trading

TD Ameritrade

Contact Information:

Log in and go to Client Services > Message Center to contact us

Mailing Address:
PO Box 2209, Omaha, NE 68103-2209

These Regulation Best Interest (Reg BI) disclosures are designed to give you a better understanding of how TD Ameritrade, Inc. (referred to in this document as "TD Ameritrade," "we," "us" or "our"), a broker-dealer, works with fixed income retail clients like you. This includes:

- The types of products and services we might recommend to you.
- The fees or expenses that might be associated with those recommendations.
- Material facts as to our client relationships and conflicts we may have.

Understanding Fixed Income Securities

Fixed income securities are securities that typically provide income payments at a specified rate over a specified term. The principal types of fixed income securities are debt obligations and preferred stocks. For debt obligations, the interest rate and/or maturity date vary. For example, some obligations may have a call date prior to the maturity date and/or a varying interest rate for specified periods after the issue date and prior to the maturity date. For preferred stocks, there generally are fixed dividends paid at specified intervals. Sometimes, the preferred shares are subject to redemption prior to maturity.

Fixed income securities come in a wide variety of forms, along with many individual specifications and credit ratings. The vast majority of fixed income securities are traded "over the counter" through dealers like TD Ameritrade rather than through centralized exchanges. Some of the securities may not trade for days or even weeks. A relatively small portion of fixed income trading is done online.

Fixed Income Sales and Trading at TD Ameritrade

We have two Fixed Income groups, Fixed Income Sales (FIS) and Fixed Income Trading (FIT). The FIT group maintains an inventory of new issue and secondary market fixed income securities that may be offered to retail investors. The securities are provided to TD Ameritrade retail clients through FIS teams located throughout the country. The types of these securities are described in the **Fixed Income Types, Definitions and Risk Considerations** section of this document.

In addition, secondary bonds and certificates of deposit (CDs) are available to our retail clients online. We also provide access to other securities in the fixed income markets through FIS. FIS team members deal directly with TD Ameritrade retail investors, who are often referred to them by TD Ameritrade Financial Consultants (FCs) in TD Ameritrade branch offices. Our FCs do not work directly with fixed income securities for our retail clients.

Brokered deposits (certificates of deposit issued by financial institutions) and U.S. Treasury obligation auctions make up over 90% of TD Ameritrade's fixed income new issue activity. The balance of the new issue activity includes government agency securities, corporate bonds, and structured products. Over 90% of TD Ameritrade's fixed income secondary sales activity is made up of U.S. Treasury obligations and corporate bonds. The balance includes municipals, brokered deposits and government agencies.

How the FIS Team Makes Recommendations

TD Ameritrade's FIS team members work to find the right fixed income security for the right TD Ameritrade client at the right time. Before we make a recommendation on a fixed income security, we gather information from you – about you. Questions about your current financial position, investing history, risk tolerance, investment objectives, goals, time horizons and more provide us with insight. Your answers help us find an investment security or strategy aligned with your objectives. When an FIS team member recommends a fixed income security, they determine its suitability for a client at the time of the recommendation. Generally, neither TD Ameritrade nor FIS has discretionary authority in client accounts, or an ongoing duty to monitor accounts to ensure past recommendations continue to be suitable.

FIS team members can recommend specific fixed income securities or investment vehicles to you. They also can suggest fixed income investment strategies, such as bond ladders. For retail trades done through our FIS team members, TD Ameritrade acts as principal. This means we buy a security from a third party and sell it to you, or we buy a security from you and sell it to a third party.

Material Facts About Fixed Income Securities Pricing

There is a difference between the purchase price and the sale price of a fixed income security, known as the spread. The spread at TD Ameritrade is usually less than 1% of the principal amount of an existing fixed income security. If the FIS team sells a new issue of a fixed income security to you, the spread can be more than 1% and varies based on maturity and product type. As a result, FIS team members have a financial incentive to highlight new issues to you over existing issues. Please note that secondary bond or CD trades made through TD Ameritrade's online platform are done on a riskless principal basis, with a fixed fee of $1 per bond or CD (subject to a minimum of $10 and a maximum of $500).

TD Ameritrade acts as principal on all FIT fixed income transactions. That means we will add a markup to any purchase, in addition to the spread, and subtract a markdown from every sale. This markup or markdown will be included in the price quoted to you. Pricing of fixed income products is subject to both regulatory Best Execution standards and Prevailing Market Price rules. TD Ameritrade provides access to thousands of fixed income securities from hundreds of dealers. In addition, we act as agent for U.S. Treasury securities offered at auction. For more details, see the sections **Compensation to the Firm** and **Compensation to the FIS Associate** at the end of this document.

Material Limitations

We will only provide recommendations on investment grade fixed income securities to our retail clients, from the vast universe of fixed income products. We seek to identify issues likely to meet client needs across product types, maturities, tax advantages, quality and many other factors. We partner with other firms to offer new issue securities with these same considerations. There may be securities offered at other firms (primarily new issues) that we are not able to access. Additionally, FIS representatives are limited to recommendations within certain product sets. Should needs be identified outside their area of scope and expertise, such as in regard to a bond mutual fund, you may be referred to another TD Ameritrade representative.

Fixed Income Types, Definitions and Risk Considerations

Fixed Income Type	Definition	Risk Consideration
Agency Bonds	Issued by U.S. government agencies with higher returns and higher risks than Treasuries.	Subject to credit and market risk factors.
Certificates of Deposit	Principal and accrued interest are covered by FDIC insurance up to applicable limits. Wide variety of issuers and types.	Fixed maturity but limited secondary market, if any.
Collateralized Mortgage Obligations	Obligations are backed by a pool of mortgages on residential home loans that are backed by the full faith and credit of the U.S. government. Principal is returned over the life of the bond.	Subject to contraction, pre-payment and extension risks.
Corporate Notes, Bonds and Preferred Stocks	Issued by a corporation to raise capital.	Higher returns and higher risk, depending on the company's financial health.
Money Market Mutual Funds	An open-ended mutual fund that invests in short-term debt securities. Designed to provide income, stability of capital and access to funds invested.	Possible pricing risk as to the $1 per share price in a severely distressed market environment.
Municipal Bonds	Issued by state and local governments; most issues are exempt from federal and often state and local taxes.	Subject to market, inflation, interest rate, call and material event risk. Interest may be subject to the Alternative Minimum Tax.
Structured Products	Equity-linked CDs: An FDIC-insured CD that ties its rate of return to the performance of a stock index. Principal Protected Notes: A senior unsecured obligation of an issuer linked to an underlying investment and designed to return at maturity the principal invested, even if the underlying investment has declined in value. Principal at Risk Notes: Linked to underlying investments and the value of the security at maturity is linked to the performance of those underlying investments.	Subject to the credit rating of the issuer, a limited secondary market and the possibility of no return on investment at maturity (or even total loss of principal). Not suitable for all investors. Investment objectives, risks, charges and expenses should be carefully considered.
Treasury Bills, Notes, and Bonds	Backed by the full faith and credit of the U.S. Government; federally taxable; state and local tax-exempt.	Subject to market risk and interest rate risk.
Unit Investment Trusts	An investment company offering a fixed, unmanaged portfolio, generally of stocks and bonds, as redeemable "units" to investors for a specific period. They are designed to provide capital appreciation and/or dividend income.	Subject to interest rate, credit, market and material events risk and can have a wide fluctuation in price. Before investing in a UIT, carefully consider its investment objectives, risks, charges and expenses.

In addition to the above, FIS can assist TD Ameritrade retail clients in investing in fixed income portfolios managed by TD Ameritrade Investment Management, LLC, an affiliated registered investment advisor.

Fixed Income Product Risks

Fixed Income products are subject to a number of general types of risk:

- **Financial (or Credit) risk:** The financial health of the issuer is an important influence on the value of its fixed income securities. The credit ratings assigned by the major rating agencies, such as Moody's Investors Service and Standard & Poor's Corp., are widely accepted measures of the credit risk of a particular security. Accordingly, a change in the credit rating of an issuer (or the expectation of a change) would generally affect the price of its bonds. A credit downgrade would be viewed as a negative and would tend to decrease the price of the issuer's fixed income security; similarly, a credit upgrade would tend to raise the price of the security.

  Determining the appropriate level of credit risk for a portfolio depends largely on the situation of the particular investor. Generally, for an investor who is concerned with preservation of capital, high credit quality should be a priority.

- **Liquidity risk:** Liquidity risk refers to the risk that an investor may not be able to sell a security quickly at its fair value. Investors should be aware of the liquidity risk of the market as a whole, in addition to the liquidity risk of particular securities. Even though the liquidity of a particular issue may be high, at times the market itself may be less liquid.

- **Interest rate risk and price sensitivity:** For most fixed-income securities, price moves in the opposite direction of interest rates. For example, when interest rates rise, the price of the security will fall. When interest rates decline, the price of the security will rise. This risk is commonly referred to as market, or interest rate risk.

  The price sensitivity for a particular fixed income security to a change in interest rates depends largely on characteristics such as the coupon or dividend rate, the maturity date, and the call features. The most common measure of price sensitivity is duration. Duration equals the weighted-average term to maturity of all cash flows. The weight assigned to a particular cash flow is determined by computing its present value in relation to the present value of all the security's cash flows. Essentially, the greater duration of the security, the greater its price sensitivity.

  The price sensitivity of a fixed-income security to changes in interest rates is greater for securities with lower coupons or dividends. That's because the duration of a lower-coupon or dividend security is greater than for a high coupon or dividend security**.**

- **Re-investment risk:** Re-investment risk refers to the risk that interest payments and re-payment of principal would need to be re-invested in a low interest-rate environment and, therefore, give the investor a lower total rate of return than might have been expected when the security was originally purchased.

  The income received from the re-investment of coupon or dividend payments can be an important element in the total return from a security, particularly long-term issues.

- **Call risk:** Fixed income securities are often issued with a call provision. From the investor's perspective, there are three major disadvantages associated with a call provision. First, the cash flow stream is not known with certainty. From the investment strategy standpoint, this creates a problem with identifying the proper time horizon. Since a security is callable before maturity, its actual duration is less than its duration to maturity, but more than its duration to call.

  Second, the issuer will generally call bonds or preferred stocks when interest rates have declined, leaving the investor to reinvest the proceeds at an inopportune time. (See Re-investment risk above.)

  Finally, the price appreciation of "callables" is limited since the price of a callable issue does not rise much above its call price. The same is not true for the downside price risk. The price of a callable issue can fall far below its call price if there is a substantial rise in interest rates.

- **Inflation (or purchasing power) risk:** Most fixed income securities are designed to provide a stream of interest or dividend payments over time, plus the return of your principal at maturity. The drawback, however, is that you do not know what the purchasing power of those payments will be in the future. This risk is commonly referred to as inflation risk. Inflation risk is the likelihood that inflation will erode the value of those payments over time. A rise in inflation would generally push up yields and reduce the price of the security.

  Inflation risk is higher the longer the maturity of the fixed income security. One way to counteract inflation risk is to stagger maturities or build a portfolio ladder. With a ladder, maturing funds can be re-invested as they mature. If inflation rises, yields are likely to rise as well, so the maturing funds can be re-invested at higher yields.

Compensation to the Firm

Our FIT desk can profit from taking securities positions. In doing so, it accepts the risks associated with assuming those positions and selling securities to our clients from those positions. The firm profits from adding a markup to those transactions with our clients. These markups (or markdowns) are disclosed on all trade confirmations and are available prior to the transaction from the FIS representative. For new issue securities, TD Ameritrade receives a sales concession from the underwriter of those issues which varies by product type, issue size, issuer credit quality and complexity. This is identified in the prospectus or offering document that accompanies the transaction confirmation.

Compensation to the FIS Associate

Our FIS associates receive a base salary plus incentive compensation driven by individual performance. The incentive compensation is based, in part, on sales volumes generated. Incentive compensation is not specific to a particular fixed income product so our FIS Associate can select an appropriate fixed income product for you without a product conflict. To mitigate the potential sales conflict of interest, TD Ameritrade policies, procedures and supervision help ensure the focus is on the most appropriate solutions for our retail clients.