Perpetual knowledge bank series: Coupon Rate

By Perpetual Asset Management
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All types of bonds pay interest to bondholders and the amount of interest paid out is known as the coupon rate. The issuer of the bond agrees to make annual or semi-annual interest payments equal to the coupon rate to investors. These payments are made until the bond's maturity. Bonds that have higher coupon rates offer investors higher yields on their investment and this remains fixed for the life of the bond. For example, an Australian Treasury Bond with a 5% coupon interest rate will pay investors $5 a year per $100 amount in instalments of $2.50 every six months. These instalments are called coupon interest payments. Because the coupon interest rate is set when the bond is first issued and remains fixed for the life of the bond, it is usually different from the yield-to-maturity figure.

The name “coupon” comes from the time when bonds were issued in the form of bearer certificates and the physical possession of the certificate was sufficient proof of ownership. They became known as “bearer bonds” because anyone with the appropriate coupon could present it to the issuer’s agent and receive an interest payment. The coupons were printed on the bond, from which they could be detached and presented for payment. These days most bonds are created electronically and do not come with physical certificates, but the term coupon is still used to describe the bond’s nominal yield.