WELLS FARGO ADVISORS

A Guide to Investing in Floating-rate Securities

What to know before you buy

Are floating rate bonds suitable for you?

The features, risks, and characteristics of floating rate bonds are different from traditional fixed income products and should be evaluated by you and your Financial Advisor before making an investment decision. Investors should note that changes in interest payments can significantly affect an investor's yield and, consequently, the price of the security may vary.

What are floating-rate securities?

Also known as "floaters," these fixed income investments provide interest income based on widely used interest rate benchmarks. The interest rate on floaters will adjust periodically (float) depending on movement in the benchmark rates to which they are tied. Floaters can be linked to almost any benchmark and pay interest based on a variety of formulas, some very complex. Basic floaters, though, pay a coupon equal to the benchmark plus a spread that does not change. This type of floater, along with others, will be discussed later in this guide.

Floating-rate securities versus traditional bonds

Floating-rate securities are not traditional bonds and they will have fluctuating interest rates and values. Traditional bonds are generally issued with a fixed interest rate that is set when the security is issued. This fixed interest rate, or coupon, will not change for the entire life of the bond. On the other hand, floating-rate securities are issued with variable interest rates, meaning the interest rate can go up or down over the life of the bond, reflecting changes in the underlying reference rate. The features, risks, and characteristics of floating rate bonds are different from traditional fixed income products and should be evaluated by you and your Financial Advisor before making an investment decision.

Reference rates for floating rate securities

The most important factor to understand with floating-rate securities is their underlying benchmark, or reference rate. While there are many rates that can be used as the reference rate for floating-rate securities, below are some of the most common. Typical reference rates include:

- **U.S. Treasury Bill (T-Bill) rate.** The prevailing rate at which short-term Treasury Bills issued and backed by the U.S. government are trading.
- **London Interbank Offered Rate (LIBOR).** The rate used in the short term, international interbank market.
- **U.S. prime rate.** The interest rate that U.S. banks charge their largest commercial investors.
- **Constant maturity swap (CMS) rate.** The rate used in the interest rate swaps market to represent a specific maturity on the yield curve. For example, the 10-Year CMS rate is the fixed rate of interest payable on an interest rate swap with

a 10-year maturity, and is one of the market-accepted indicators of longer term interest rates.

- **Consumer Price Index (CPI).** CPI measures changes in the price level of consumer goods and services purchased by households. The CPI is defined by the United States Bureau of Labor Statistics as "a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services."
- **Federal Funds rate.** The Federal Funds rate is the interest rate on overnight loans between banks.

Investors typically receive an additional amount, called a spread, above the reference rate on the floater.

Types of floating-rate securities

Floating rate notes (FRNs)—Floating rate notes are bonds that typically have a variable coupon equal to a benchmark rate plus an additional amount. Once the reference rate is chosen (such as T-Bill, LIBOR, CPI, or prime rate), the issuer will add an additional amount, or spread, that it is willing to pay beyond the reference rate. This spread is usually described in basis points (one one-hundredth of one percent, or 0.01%) and is added to the reference rate to determine the overall coupon. For example, a floating rate note may be issued with a spread of 40 basis points above the three-month T-Bill rate. If the T-Bill rate is 2% when the floating rate note is issued, its initial coupon will be 2.40%.

Spreads on floating rate notes are based on a variety of factors, including the issuer's credit quality and when the bond will mature. Please be aware that floating rate notes may pay less interest than fixed-rate notes that mature at the same time.

Collared floater

A collared floater is a floating-rate note whose coupon payments are subject to an embedded collar, meaning the coupon is capped at a predetermined level, so the buyer gives up some upside, but also has a floor, offering protection from a downturn in the reference interest rate. Collared floaters are also sometimes known as a mini-max floater.

Reverse floater

A reverse floater is a floating rate note which has a coupon that rises when the underlying reference rate falls. The coupon is calculated as a fixed rate minus the floating reference rate. Often a non-negative clause is added to the structure; this prevents the coupon from being negative.

Fixed-to-float bonds—Fixed-to-float bonds are issued with a coupon that is fixed for a specific period of time, typically one to two years. At some point prior to maturity, the bonds change from a fixed coupon (the income stream from the bond does not change) to a floating coupon (the income stream changes, resulting in larger or smaller payments). Many of the fixed-to-float bonds in the market are issued by financial institutions. Investors should note that changes in interest payments can significantly affect an investor's yield and consequently the price of the security may vary.

Auction rate securities—Auction rate securities (ARS) refer to long-term investments that have short-term features: the interest rates or dividends they pay are reset at frequent intervals through dutch auctions, which typically occur every seven, 14, 28, or 35 days or longer depending on the issue. The dutch auction attempts to match sellers of ARS with potential buyers. The process is designed to set the interest rate for the next auction period.

There are two varieties of ARS: long-term bonds that earn variable, short-term coupon payments, and perpetual preferred stock that pays variable, short term dividends. ARS rates are determined through a periodic auction process or in the event of a failed auction derived by a formula which is detailed in the securities' prospectus. Auction rate bonds are issued by municipalities, student-loan authorities, museums, and many others. Some auction rate bonds, such as those issued by municipalities, may offer certain tax advantages. Auction rate preferred shares are issued by closed-end funds. It is important to note that auctions can fail, resulting in liquidity issues for investors. Auction rate securities are not money market equivalents; you can lose money investing in auction rate securities.

For more information on the risks, features, and characteristics of ARS, reference the Wells Fargo Advisors brochure, *Auction Rate Securities Overview, Features and Risks.* For questions regarding a specific ARS, contact your Financial Advisor.

Variable rate demand notes (VRDNs)—A VRDN is a debt instrument that represents borrowed funds that are payable on demand and accrue interest based on a prevailing money market rate. The interest rate applicable to the borrowed funds is specified from the outset of the debt, and is typically equal to the specified money market rate plus an extra margin. The interest rate for VRDNs is reset periodically, usually on a daily or weekly basis by a designated remarketing agent. The remarketing agent resets rates based on its judgment of current market conditions, which may include assessments of market indices, current inventory levels and investor demand. VRDNs are generally issued by municipalities in the form of tax-exempt bonds. They are usually issued with intermediate to long-term maturities but—because of the investor's "put" option—generally priced and traded at par as short-term instruments.

VRDNs are typically issued as long-term securities, but are structured to provide investors short-term access to their investments because investors can "demand" that the remarketing agent find a purchaser (or call on liquidity support provisions). In practical terms, the demand works like a put. Barring a credit event that would jeopardize the issuer's ability to meet the demand, VRDNs allow investors to liquidate their bonds at par plus accrued interest, subject to notification and settlement requirements of the issue. Most VRDNs have some form of liquidity support to improve an issuer's ability to honor this demand feature. This is often achieved through a liquidity facility/standby purchase agreement or, in some cases, through a letter of credit (LOC). VRDNs with a daily reset period can be liquidated and settled on the trade date provided the execution occurs before the same-day settlement guidelines.

In addition to the risks associated with other floating rate securities (discussed later in this guide), VRDNs carry other risks. For example, VRDNs may be exempt from SEC municipal security disclosure requirements. In addition, issuers generally reserve the right to convert their outstanding VRDNs into long-term bonds with a fixed coupon rate. This would require investors to tender their VRDNs at par plus accrued interest, subjecting investors to reinvestment risk. VRDNs are not money market equivalents; you can lose money investing in VRDNs.

For more information on the risks, features and characteristics of VRDNs, ask your Financial Advisor for a copy of the Wells Fargo Advisors fact sheet, *Variable-Rate Demand Notes* (VRDNs). For questions regarding a specific VRDN, contact your Financial Advisor.

Market linked investments—Fixed income market linked investments encompass a number of income-oriented investment strategies that may provide higher current yields than could be achieved by investing directly in a traditional debt instrument of similar credit quality and maturity. Fixed income market linked investments are economically similar to owning a bond, and buying and selling a combination of options (typically cap and/or floor options) on a related asset. In many of these structures, investors put their coupon at risk in return for the potential for above-market yields. With many fixed income market linked investments, investors will generally place their coupon at risk based on the performance of some market measure, such as an interest rate. Coupon-bearing market linked investments may accrue interest at 0% based on the performance of the respective yield curve. For instance, some notes accrue interest at 0% for any day that LIBOR is above a specified level.

For more information on market linked investments, in general, reference *A Guide to Investing in Market Linked Investments* (wellsfargoadvisors.com/guides). For questions regarding a specific market linked investment, contact your Financial Advisor.

Floating rate packaged investment products (mutual funds, exchange traded products, closed-end funds, and unit investment trusts)—Floating rate packaged investment products are considered complex, speculative investments and can be structured as open or closed-end funds, exchanged-traded products, or unit investment trusts. They generally invest a majority of their holdings in floating-rate loans with a smaller portion allocated to cash, investment grade or junk bonds, and derivatives. The floating rate nature of the packaged investment product is derived from the underlying floating rate loans. These loans are often made by financial institutions to companies that are generally considered to have low credit quality. After the financial institutions issue these loans, they are then sold to hedge funds, collateralized loan obligations, and packaged investment products. Like other floaters, interest on the loans is generally comprised of two components: a benchmark interest rate plus a predetermined credit spread. This spread will depend on things like the credit quality of the borrower, the value of any collateral, and any covenants associated with the loans. Floating rate loans are considered senior debt and are usually collateralized by real assets like inventory or property.

Packaged investment products that invest in floating rate loans may appeal to investors as they generally carry greater returns than traditional bond funds, however, higher rates are generally offered to compensate for increased risk. The market for the floating rate loans used in these packaged investment products is largely unregulated and such loans do not trade on any organized exchange. This can make valuation of the loans difficult and they can be relatively illiquid. Though they may be marketed as less vulnerable to interest rate fluctuations, they will generally be subject to increased and significant credit, valuation, and liquidity risk.

Moreover, floating rate packaged investment products are not the same as money market funds, cash alternatives, or traditional CDs. Keep in mind CDs are FDIC insured up to $250,000 per depositor per insured depository institution for each account ownership category, whereas floating rate packaged investment products are not.

Further, CDs may be issued by out of state institutions and generally may not be withdrawn prior to maturity. In addition, unlike money market funds, packaged investment products do not seek to maintain a stable net asset value (NAV). Further, when investing in floating rate packaged investment products, you should avoid concentrated positions within your overall portfolio.

For more information on packaged investment products in general, reference *A Guide to Investing in Mutual Funds, A Guide to Investing in Exchange Traded Products, A Guide to Investing on Unit Investment Trusts,* and *A Guide to Investing in Closed-end Funds* available at wellsfargoadvisors.com/guides. For questions regarding a specific packaged investment product, contact your Financial Advisor.

Features and characteristics

Issuers—Municipalities, banks, states, government-sponsored enterprises (GSEs), such as the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Bank system, and corporations, issue floaters as part of their overall funding strategies.

Resetting coupons—Something else to keep in mind with floaters is how often the interest rate is adjusted to reflect the current reference rate, which is called the "reset frequency." The reset frequency is set when the securities are issued and could reset daily, monthly, quarterly, or even annually. Typically, coupons reset each time the issuer makes an interest payment and then remain constant until the next payment reset.

If the floater resets between coupon payments, the issuer pays interest based on the average coupon resets since the previous interest payment. For example, a floater that resets each month and pays quarterly coupons would most likely reflect the average of the three monthly resets that occurred in the previous quarter. A floater may be either non-callable or callable. If a floater is callable, the issuer can only call it before maturity. Floaters have a variety of maturities, although most are issued with maturities of 10 years or less.

Potential protection from rising interest rates—Investors who believe rates will soon rise may hesitate to "lock in" a long-term fixed rate. On the other hand, rates offered by short-term investments may be less attractive. Floaters offer an alternative because they pay a spread above current short-term rates and let investors take advantage of future rate increases.

Valuation versus interest rate fluctuations—When interest rates rise, the value of fixed-rate bonds tends to fall; likewise, when interest rates fall, the value of fixed-rate bonds tends to rise. As a result, a bond's value changes to make up for the difference between the fixed coupon rate and varying interest rates. The coupon rate on a floater resets when market rates change, so its price will generally fluctuate less than comparable fixed-rate bonds.

Capped return—Some floaters may have a cap, a maximum interest rate the issuer will pay, regardless of how high the reference rate may go. A cap protects the issuer from rising interest rates.

Floored return—Some floaters may set a floor, or a minimum rate that will be paid, even if the coupon's reference rate is lower. A floor protects investors from declining income.

The following table illustrates the difference between two floaters that pay a spread of 40 basis points above the reference rate. As you can see, one has a 4% cap and 2% floor and the other does not have a cap or floor:

Reference Rate	4% cap and 2% floor	No cap or floor
1.00%	2.00%	1.40%
2.00%	2.40%	2.40%
3.00%	3.40%	3.40%
4.00%	4.00%	4.40%

This information is hypothetical and is provided for informational purposes only. It is not intended to represent any specific return, yield or investment, nor is it indicative of future results.

Risks

Interest rate risk—A floater's market value is relatively insensitive to interest rates changes, but the income received is highly dependent on the level of the reference rate over the investment's life. Total return may be significantly less than anticipated if interest rate expectations are not met.

Credit risk—Credit risk is the potential risk and loss of principal resulting from an actual or perceived deterioration in the financial health of the issuing entity. While many floating rate securities may be rated by an independent rating agency, some issuers may choose not to be rated as the cost to do so may outweigh the benefit. Two subcategories of credit risk are default risk and downgrade risk.

> **Default risk** is the risk that an issuer will be unable to pay interest or principal when due. Many factors can contribute to a default—downturns in the economy or a particular industry, downturns in a local economy, etc. Securities in default are highly illiquid. If a security defaults you may lose most, if not all, of your principal value.
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> **Downgrade risk** is the risk that the independent rating agencies will lower their ratings on a particular security. An issuer's credit rating, for example, could be downgraded from A to BBB if the rating agency believes the issuer has become less able to meet its debt obligations. A downgrade is normally accompanied by a decline in the prices of the security. When the marketplace anticipates a downgrade, the price often declines before the actual downgrade. Often, the rating agencies will place an issue on "credit watch" status before a downgrade; this also normally brings a price decline.

Call/Reinvestment risk—If the issuer calls a callable floater before maturity, the investor may be unable to reinvest funds in another floater with comparable terms. The investor should be prepared to hold it until maturity in case the floater is not called.

Inconsistent income stream—Due to the variable interest rates associated with floaters, interest rate payments may fluctuate significantly. Investors needing a predictable income stream should consider traditional fixed income securities instead of floaters.

Spreads influence market prices—It is a common misconception that floaters will usually trade at or around par value. Investors should be aware that as new issues are introduced to the marketplace, the spread paid on the benchmark can widen or narrow. If those spreads widen, the market value of outstanding floaters would likely fall below par. If you needed to sell your floater prior to maturity, you could lose a significant portion of your principal value.

Liquidity risk—Floaters are investments intended to be held until maturity and may only offer limited liquidity. If sold prior to maturity, you may receive significantly less than your invested principal. Investors may sell floaters at prevailing market prices, which may be more or less than the original amount invested.

Market prices may fluctuate based on unpredictable factors—The market value of floating rate securities will be affected by unpredictable factors that interrelate in complex ways. These factors may include, but are not limited to, the price or level of the benchmark, the volatility of the benchmark, interest rates, dividend rates, the issuer's creditworthiness, time remaining to maturity, and geopolitical conditions. Apart from these, there are many other factors that may affect the market value of floating rate securities. The past performance of any of these factors is not indicative of future results.

Statement pricing of floating rate securities—There may be limited pricing information available for certain floating rate securities. While firms will seek to obtain pricing on floating rate securities, it's important that you understand how your interest rate is calculated as such information may not be readily available.

Taxation

Any tax comments contained within this document are indicative only and are based on understanding of current law and practice. These comments are not intended to be, nor should they be regarded as, legal or tax advice. The precise tax treatment of a holder of the floating rate security will depend on the holder's individual circumstances and on the applicable terms of the security under the law and practice at the relevant time. The tax treatment of these securities can be complex and the amount of tax paid may change during the life of the security. In addition, interest income received from municipal floating rate securities is often exempt from federal income tax and income tax of the state in which they are issued if the purchaser is a resident of that state.

Wells Fargo Advisors is not a tax or legal advisor and prospective investors in the product should consult their own tax advisers to obtain advice about their particular tax treatment in relation to their holding such floating rate securities.

Cost of investing in floating-rate securities

Floating rate securities are generally bought and sold between dealers and investors, much like other fixed-income instruments. Dealers trade the securities at a net cost, which includes their own spread, or profit, on the transaction. Upon purchase and sale of a floating-rate security, you will generally incur a commission or mark-up in processing the transaction. Floating rate securities purchased during the initial public offering (IPO) period have a sales concession built into the purchase price, a portion of which is paid to your Financial Advisor.

Investor characteristics

Suitability—Investors who believe that interest rates may rise and are dissatisfied with low short-term rates may consider a floating-rate investment. You should understand the features and characteristics of the security, including reset dates and underlying benchmarks. You can lose money investing in floating rate securities. Some types of floating rate securities are considered speculative and highly volatile. Floating rate securities can be offered in a variety of structures with unique risks, so you should only purchase floaters after consulting with your Financial Advisor to ensure you understand the risks associated with the type of floater you are considering.

Diversification—Wells Fargo Advisors believes that investors should diversify their investments. It is recommended that investors observe an asset-allocation strategy and not overweight their overall portfolio in any one class of securities. Although asset allocation can be an effective investment strategy, it cannot eliminate the risk of fluctuating prices and uncertain returns.

How are your Financial Advisor and Wells Fargo Advisors paid on floating rate securities?

For helping you invest in floating rate securities, Wells Fargo Advisors and your Financial Advisor are compensated in ways that vary depending on the selected investment. If the purchase is made during the IPO period, a Financial Advisor may be paid a sales concession. This sales concession is built into the offering price and is passed along to the Financial Advisor. Your Financial Advisor will receive compensation in the form of a commission or mark-up from most transactions. For most purchases, a Financial Advisor's compensation is based on the dollar amount purchased or sold. In certain fee-based accounts a Financial Advisor's compensation is based on a percentage of assets in the account rather than on the concession, as mentioned above. The compensation formula that determines the amount of payment can vary depending on the type of floating rate security purchased.

Within the division that operates in Wells Fargo branches, a Licensed Banker (LB) may refer you to a Financial Advisor, as they generally work as a team. In this case, the LB will be compensated through a referral arrangement with the Financial Advisor. Wells Fargo Advisors may receive compensation for making a market in or underwriting new issues of floating rate securities. Additionally, Wells Fargo Securities, LLC may have investment banking relationships with entities issuing floating rate securities. Consult your Financial Advisor or the offering documents for more information regarding potential conflicts of interest. Wells Fargo Securities, LLC is a separate broker-dealer non-bank affiliate of Wells Fargo & Company.

Additional information

Floating rate securities can be a valuable part of your portfolio. Before making an investment decision, it is important to review your financial situation, investment objectives, risk tolerance, time horizon, diversification needs, and liquidity objectives with your Financial Advisor. To learn more about floating rate securities, ask your Financial Advisor or visit the following websites:

Wells Fargo Advisors
wellsfargoadvisors.com

Financial Industry Regulatory Authority (FINRA)
finra.org

U.S. Securities and Exchange Commission
sec.gov

Securities Industry and Financial Markets Association (SIFMA)
sifma.org

Summary

Floating-rate securities can be a valuable addition to your fixed-income portfolio. They may provide more income than short-term investments and may provide minimum payment amounts (floors) that protect against declining interest rates and liquidity. Your Financial Advisor from Wells Fargo Advisors can help you determine whether floaters fit your investment objectives and risk tolerance and if so, which types may best suit your investment needs. For more information about floaters and your portfolio, consult your Financial Advisor today.

Investing in fixed income securities involves certain risks such as market risk if sold prior to maturity and credit risk especially in investing in high yield bonds, which have lower ratings and are subject to greater volatility. All fixed income investments may be worth less than original cost upon redemption or maturity.