Forward-Rate Agreements (FRAs) for borrowers

The situation

Your firm will need to borrow $500,000 USD in 3 months' time for a 6-month period. You think interest rates will rise. You want to protect yourself against a rise in your borrowing cost and you are looking at ways of doing this.

The product

A Forward-Rate Agreement (FRA) can offer you a solution in these circumstances. It is an agreement between you and us, which is based on the amount that you will borrow. It fixes an interest rate now for the loan you are going to take out in the future.

The solution

Your firm buys a Forward-Rate Agreement to cover the interest you will be charged for this 6- month period beginning in 3 months. In Forward-Rate Agreement terms this is known as a '3v9' FRA. You buy this FRA for $500,000 in USD and we will agree to give you a fixed rate of 5%. This guarantees your firm an interest-rate cost of 5% for the 6 months of the loan. If in 3 months' time the 6 month LIBOR rate is greater than 5%, we pay you compensation for the extra cost. If it is less than 5% you must pay us compensation. We will sort out the difference in the interest rate at the beginning of the Forward-Rate Agreement period. Let us see how the product works in practice:

1 January: Your firm buys a 3v9 FRA for $500,000 at an agreed 5% interest rate

1 April: 6-month Libor sets at 5.5%. We pay you compensation for the 0.5% difference in the interest rate over the 6-month period. Rather than pay you this at the end of the 6-month period we will settle with you immediately

Advantages

- Forward-Rate Agreements give you the chance to protect yourself against rising interest rates.
- Forward-Rate Agreements allow you to plan your cashflow.
- You can get a Forward-Rate Agreement whenever you need one and we can tailor it to suit your needs. We provide Forward-Rate Agreements for all major currencies and for a wide range of maturities.
- You can get a Forward-Rate Agreement from banks other than the bank that provides your loan. You can use the Forward-Rate Agreement for any loans you have or expect to have.
- If you take out a Forward-Rate Agreement it will come into force even if you do not take out a loan. You must make sure you have worked out your cashflow for the future correctly.
- The price of your Forward-Rate Agreement will be determined by market conditions at the time you lock in.
- We will settle the agreement against the relevant Libor at the start of the Forward-Rate Agreement period.
- You can sell us back the Forward-Rate Agreement at any time up to the settlement date if you no longer need it.

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