

## Interest-Rate Caps

### The situation

Your firm owes \$500,000 in USD, which you have borrowed on a 6-month floating-rate basis. You do not think that short-term interest rates will rise. In fact some analysts think they may fall. You want to take advantage of any opportunities to borrow more cheaply, but you also want to be protected against any rises in interest rates.

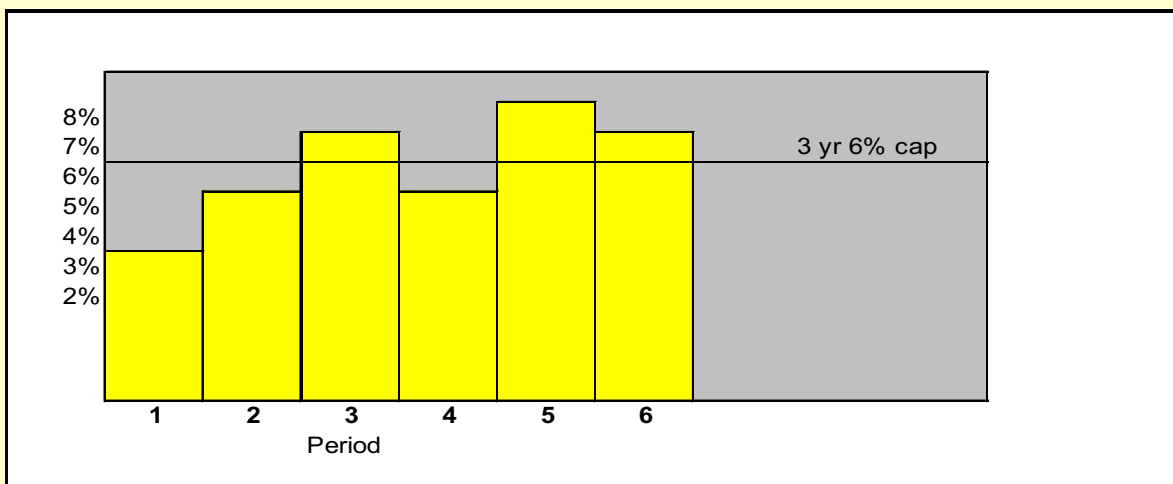
Traditionally you have protected yourself against rising rates by using an Interest-Rate Swap. On those occasions you thought that interest rates were increasing and it seemed the sensible way to secure your funding costs. On this occasion the Interest-Rate Swap would mean that you have to give up the possibility of lower borrowing costs.

### The product

An Interest-Rate Cap is a product, which can be useful in these circumstances. It protects you against interest rates rising while still allowing you to take advantage of the benefit of falling interest rates. It does this by setting an upper limit (or cap) on the floating interest rate, which you have to pay. It actually insures you against a borrowing cost greater than this 'capped' level. If the interest rate goes over this, we will pay you compensation. With this protection, you are then free to benefit from lower interest rates if they come about.

### The solution

The chart on this page shows the effect of a 6% 3-year Interest-Rate Cap. At each reset date, if interest rates are below the cap rate, you simply pay those market rates, because they are lower. On the other hand, if the interest rates on any reset date are higher than the Interest-Rate Cap, you will not pay more than the capped rate. In the following example you would receive compensation in period 3, period 5 and period 6. The cap level we have used refers to the cost of funds for your loan before a lending margin is added.



If, on the other hand, you had used an Interest-Rate Swap, you would have a constant rate throughout and would not benefit in any period when the market rate fell below the fixed Interest- Rate Swap rate.

### The benefits

- The cap gives full protection against rising interest rates beyond the cap level.
- The cap gives you freedom to benefit from future falls in interest rates.
- If you pay off the loan, you can sell us back the Interest-Rate Cap and **may** receive some value.

### Features

- You can get an Interest-Rate Cap from a bank other than the one who gave you the original loan.
- The Interest-Rate Cap does not need to be based on a particular loan. You can use the cap for any loans you already have or expect to have.
- We provide Interest-Rate Caps in US Dollars and the other major currencies.
- We can arrange Interest-Rate Caps on Libor and also the BMA index
- We can arrange Interest-Rate Caps for different maturities.
- We usually pay compensation under an Interest-Rate Cap agreement at the end of each relevant floating period.
- You pay the premium for the Interest-Rate Cap up front.