

Interest-Rate Collars for borrowers (Zero Cost/Zero Cash)

The situation

Your firm wants to buy an Interest-Rate Cap to protect you against higher interest rates. You are not sure about the price of the cap and you want to look into ways of reducing the cost of this protection.

The product

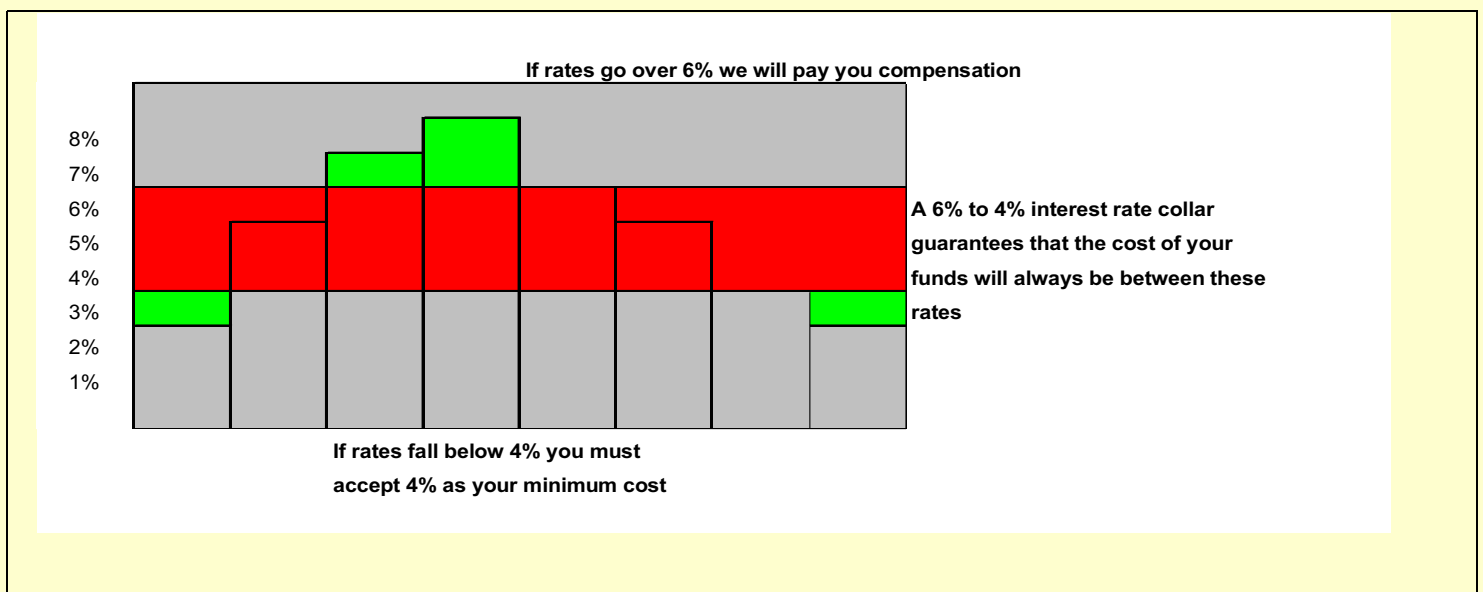
If you buy a cap and sell a 'floor', this is known as an Interest-Rate Collar. Interest-Rate Collars will reduce the cost of protecting yourself against higher interest rates. By buying an Interest-Rate Cap you will protect yourself against higher interest rates but you can also take advantage of lower rates without any limit. By selling a floor you give up some of the possible benefit of lower interest rates. How much of this benefit you give up will depend on the interest rate level at which you sell the floor. If the value of the floor you sell is the same as the cost of the cap you buy, this is known as a 'Zero-Cost Collar'.

The term collar comes from the fact that your interest-rate cost will never be lower than the floor level and will never be greater than the cap level. Interest-Rate Collars are a popular way of managing the risk of higher interest rates. We can tailor a collar to suit you.

The solution

The chart on this page shows the effect of a 3-year 6% Interest-Rate Cap combined with the sale of a 4% floor. When interest rates go over the cap level we will pay you compensation. On the other hand, when interest rates fall below the level of the agreed floor, you need to pay us an amount, which will bring the cost of your funds back to the level of the floor at 4%. When interest rates settle within the range of the Interest-Rate Collar, neither of us has to pay anything.

An Interest-Rate Collar allows your firm to set a range for its interest costs. In this example the cost is no greater than 6% and no less than 4%.



The benefits

- The collar reduces the cost of interest-rate protection.
- The collar provides protection against higher interest rates.
- You can sell the collar back to us at any time.

The main disadvantage of a collar is that you have to pay a certain minimum rate of interest and you lose some of the possible benefit of lower interest rates.

Features

- You can use a Collar for a loan you already have or a loan you are planning to take out in the near future.
- We provide Interest-Rate Collars in major currencies.
- We can arrange different maturities normally up to five years.
- Interest-Rate Collars are generally set against Libor but we can set them against any other index (for example BMA).
- We usually pay, or ask you to pay, compensation at the end of each relevant Libor period.
- The premium you pay for an Interest-Rate Collar may be 'tax allowable' - check with your tax advisers.
- If you have a zero-cost interest-rate collar, you do not have to pay any premiums at inception.