

Interest-Rate Guarantees (FRA Options) for cash managers

The situation

Your firm will have \$1,000,000 in 3 months' time, for a 6-month period. Nobody is sure what interest rates will do in the future. Some analyst's think rates will increase, others feel they will fall. You want to protect your firm against the risk of a reduced return on your funds. In the past you have used Forward-Rate Agreements to protect yourself, but you know that if you use Forward-Rate Agreements now you will give up the possibility of benefiting from higher interest rates.

The product

An Interest-Rate Guarantee is a product, which can be very useful in these circumstances. Basically, it is an option on a Forward-Rate Agreement. It allows you a period of time during which you have the right to buy a Forward-Rate Agreement at a set price. The guarantee protects you against a fall in interest rates while giving you the freedom to enjoy a better return if rates increase. If you want this guarantee you will need to pay us a premium.

The solution

You will have a deposit of \$1,000,000 for a 6-month period beginning in 3 months' time. You want to protect your firm against lower interest rates and guarantee a minimum return of 5%. You buy an Interest-Rate Guarantee from us at this rate of 5% Let us see how the option would work.

Two examples

- In 3 months' time the 6-month Libor sets at 4.5% You use your Interest-Rate Guarantee and ask us to pay compensation for the 0.5% difference in interest rates. We do this so your 5% return is protected.
- In 3 months' time the 6-month Libor sets at 5.5%. You choose not to use your guarantee and instead you will deposit your funds at the higher rate. In these circumstances the Interest-Rate
- Guarantee protected you against lower interest rates and also allowed you to take advantage of the rise in interest rates.

The benefits

- The guarantee will give you full protection against falling interest rates.
- The guarantee will give you freedom to benefit if rates increase.
- If you decide that you do not need the guarantee, you can sell it back

Features

- You can get an Interest-Rate Guarantee whenever you need one and we can tailor it to suit you. We provide Interest-Rate Guarantees for all major currencies and for a wide range of maturities.
- You can get Interest-Rate Guarantees from a bank other than the one who holds your cash. You can use the Interest-Rate Guarantee for any cash you have or expect to have.
- The price of your Interest-Rate Guarantee will depend on:
 - the guaranteed rate;
 - how long you want the Option for; and
 - how often interest rates are changing.
- We will settle the agreement against the relevant Libor at the start of the Interest- Rate Guarantee period.
- You can sell us back the Interest-Rate Guarantee at any time if you no longer need it.