Interest Rate Swap

What is an Interest Rate Swap?

The Interest Rate Swap is an agreement to exchange interest rate payments based on a pre-agreed amount (notional amount) on future dates that are defined upon trade conclusion. The interest payments are usually defined as one party paying a fixed interest rate pre-agreed upon conclusion while the other party is paying a floating interest rate.

Who is the Interest Rate Swap intended for?

The Bank offers the Interest Rate Swap in order to be used for hedging of credit exposures based on floating interest rate (e.g. Euribor) with medium and long repayment period. The Interest Rate Swap is used for hedging of fixed income asset exposures.

How to the Interest Rate Swap works?

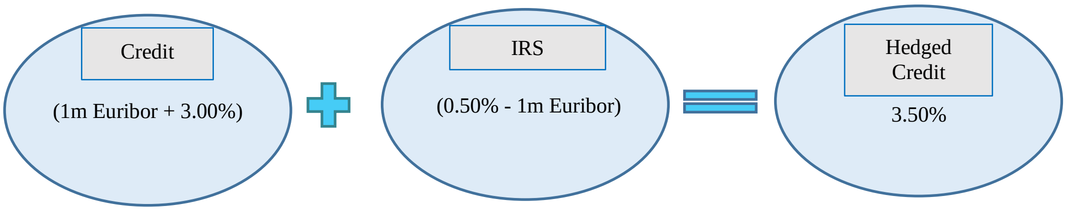
In case that a client has a credit with interest defined as credit spread + floating interest rate, he may fix his interest rate by using an Interest Rate Swap. This is done by a deal where the client pays fixed interest rate and receives floating. Thus, the combined interest of the credit and the swap equals the credit spread + the fixed rate of the swap.

Example:

Under the terms of a credit a company pays 1m Euribor + credit spread of 3.00%

To hedge its credit exposure the company may conclude an Interest Rate Swap deal, where it pays fixed rate of 0.50% and receives 1m Euribor.

The combined interest of the hedged credit is fixed at 3.50%.



Main advantages:

- **Protection** – The clients, which use the Interest Rate Swap for hedging purposes receive protection against increasing or decreasing interest rates.
- **Cash flow management** – With the Interest Rate Swap the interest cash flows become known in advance.
- **Flexibility** - The Interest Rate Swap is an OTC instrument and its parameters are negotiated between the counterparties of the deal.
- **No premium** – The counterparties of the deal do not pay premium in advance for the interest rate swap.

Main risks and requirements:

- **Early Termination** – Depending on the value of the instrument, the clients receive or pay a certain amount upon early termination.
- **Opportunity costs** – Clients who pay fixed interest rate under the swap terms may realize opportunity costs if the interest rates are falling.
- **Market risk** – The value of the instrument is affected by the market conditions, mainly by changes in the interest rate levels.
- **Currency risk** – If the swap payments are denominated in a foreign currency, there is a currency risk.
- **Limit for concluding deals** – The clients, who enter into a flexible forward transaction must provide cash collateral or have a pre-approved limit.

What happens with the Interest Rate Swap, when the hedged credit is terminated before maturity?

The Interest Rate Swap is a separate deal and in case of the early termination of the credit, it continues to exist.

Can the client terminate an Interest Rate Swap before its maturity?

Yes, the client can terminate his Interest Rate Swap before its maturity. The swap has its own intrinsic value anytime during its term. Its value can be positive or negative depending on the current interest rate levels. For this reason the client receives or pay a certain amount depending on the intrinsic value of the swap. In addition, clients should also take into account the early termination costs.

Collateral/ limit for Interest Rate Swap deal:
To conclude an Interest Rate Swap deal the client has to provide cash collateral or to have an approved sublimit for investment services. The sublimits for investment services are prepared and approved by the respective responsible unit – the Corporate Banking Directorate or the Department "Small and Medium Enterprises and Agribusiness".

Collateral/ limit management:
Definitions:
- **The Principal collateral/Investment services sublimit** for the deal is the initially approved limit/ collateral for this type of deals.
- **The Initial margin** for the deal is the minimum required limit for this type of deals.
- **Variable margin** – means the negative market revaluation (from client's point of view) of the deal.
- **Coverage ratio** – the ratio of the sub-limit for investment services/ principal collateral, reduced by the variable margin and increased by the additional collateral provided by the Client, divided by the initial margin multiplied by the notional value of the concluded and unmatured transaction/s.

Collateral/ limit management process:
The Bank runs a **daily valuation of the financial instrument**. As a result of the valuation if the coverage ratio is:

1.1.1. 90% or less than 90% at the date of the revaluation, the Bank shall inform the Client by telephone and/or e-mail and shall send a written request to the Client to provide additional collateral, so that the coverage reaches 100%. If the Client is unable to provide the necessary collateral, the Bank has the right to close the Client's open position by applying the current market price on the day of termination.

1.1.2. 70% or less than 70% at the date of the revaluation, the Bank shall inform the Client of the decline and shall send a written request to the Client to provide additional collateral up to 100% within 24 hours of sending the written request. If Client is unable to provide the necessary collateral, the Bank has the right to close the Client's open position by applying the current market price on the day of termination.

1.1.3. 50% or below 50%, the Bank closes the Client's open position by applying the current market price on the day of termination.

Documents:
- Interest Rate Swap Trading Agreement
- General terms & conditions applicable to agreements for the provision of investment services and activities to the clients of DSK Bank AD
- Additional Agreement to settle their relationship in relation to the fulfilment of their obligations under Regulation (EU) No 648/2012 (EMIR)
- Notification-questionnaire for client categorization under the Markets in Financial Instruments Act (MFIA)
- Product's Target Market Compatibility Test
- Information on the nature and risks of financial instruments
- Information on costs
- Order for concluding an Interest Rate Swap deal
- Confirmation for concluding an Interest Rate Swap deal

Key Information Document:
A key information document has been prepared for the financial instrument Interest Rate Swap, which every client should become acquainted with before entering into such a transaction. The KID can be obtained at the following address: 5 Georgi Benkovski str., Sofia or can be downloaded from the following web address: https://dskbank.bg/бизнес-клиенти/корпоративно-банкиране/финансови-пазари-и-инвестиции on the DSK Bank website.

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