Interest Rate Cap

What is an Interest Rate Cap?

The Interest Rate Cap is an agreement where the buyer of the instrument receives a payment at the end of an interest period for which a floating interest rate is higher than the predetermined interest rate level. Payments are made on a pre-agreed schedule, including notional, payment period and a floating rate value date. The buyer pays a premium in advance for the Interest Rate Cap, which is due on the settlement date of the transaction.

Who is the Interest Rate Cap intended for?

The Bank offers the Interest Rate Cap in order to be used for hedging of mid and long - term credit exposures.

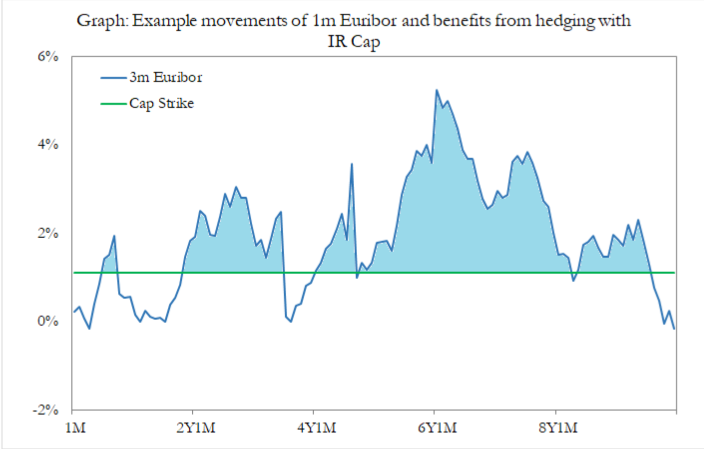
How the Interest Rate Cap works?

The Interest Rate Cap protects its buyer from increasing interest rates above a certain level (interest rate cap level, strike). In case the floating interest increases above the strike, the client receives payment equal to the difference between the floating rate and the strike of the interest rate cap.

Example:

A company pays a floating interest of 1m Euribor + 3% spread under the terms of its loan agreement

To hedge its credit exposure the company may buy an interest rate cap with strike of 0.50%. In case that the 1m Euribor reaches 1%, the client shall receive the difference between the 1m Euribor and 0.50%. The combined maximum interest on the hedged credit is not more than 3.50%.



Main advantages:

- **Protection** – The clients, which use the Interest Rate Cap for hedging purposes receive protection against increasing interest rates.
- **Cash flow management** – With the Interest Rate Cap the cash flows become easily predictable.
- **Flexibility** - The Interest Rate Cap is an OTC instrument and its parameters are negotiated between the counterparties of the deal.
- **No opportunity costs –** With the interest rate cap deals, there is no possibility that the client miss the opportunity costs from decreasing interest rates.
- **Fixed expenses** – The client's expenses are limited to the amount of premium.

Main risks and requirements:

- **Early termination** - The Interest Rate Cap does not involve any obligations for the client and its value can only be positive. Upon an early termination, the Bank pays to the client an amount, depending on the value of the instrument.
- **Maturity date –** Interest Rate Cap has a maturity date and it is possible that the client does not realize any benefits from it.
- **Market risk –** The value of the instrument is affected by the market conditions, mainly by changes in the interest rate level.
- **Currency risk** – In case the payments of the Interest Rate Cap are denominated in a foreign currency, there is currency risk.
- The client has to pay the **total premium upfront**.

What happens with the Interest Rate Cap, when the credit is paid off before maturity?

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

Can the client terminate an Interest Rate Cap before its maturity?
Yes, the client can terminate the Interest Rate Cap before its maturity. The product has its own intrinsic value during its term. Its value can be only positive, because the Interest Rate Cap does not involve any obligations to the client. Upon an early termination, the client receives an up to date quote from the dealers in Department Treasury Sales, which is in line with the current market levels of the instrument. In addition, the client should also consider the early termination costs.

Collateral to Interest Rate Option (Cap):
Clients pay a premium for the purchase of an interest rate cap and the placement of cash collateral or approval of a limit is not required.

Documents:

- Interest Rate Option (Cap) 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 Option (cap) deal
- Confirmation for concluding an Interest Rate Options (cap) 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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