Interest Rate Collar

What is an Interest Rate Collar?

The Interest Rate Collar is a financial instrument for protection against rising floating interest rates. The Interest Rate Collar has two key fixed levels – the interest rate cap level and the interest rate floor level. In case the floating interest rate is above the level of the interest rate cap, the client receives the difference between the two, and in case it is below the level of the interest rate floor – the client pays the difference between the floor and the current level. When the floating interest rate is between the two levels, the two parties to the transaction do not owe anything to each other.

Who is the Interest Rate Collar intended for?

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

How the Interest Rate Collar works?

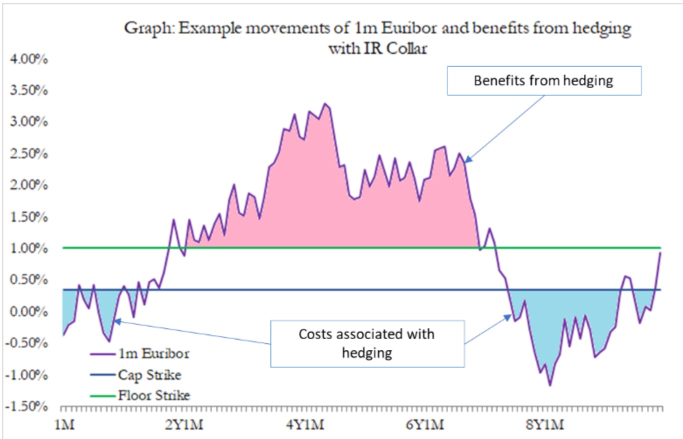
In case a client has a credit with an interest rate defined as a spread + floating interest rate, it can buy an interest rate collar and receive protection from rising interest rates. Thus, the interest rate on its credit will be no higher than the spread + interest rate cap and no lower than the spread + interest rate floor.

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 enter into an interest rate collar transaction with an interest rate cap of 0.80% and an interest rate floor level of 0.20%. When the floating interest rate is above 0.80%, the client will receive the difference between the floating interest rate and 0.80%, and when it is below 0.20% - it will pay the difference between 0.20% and the floating interest rate.

The combined interest rate on the hedged credit is not higher than 3.80% and not lower than 3.20%.



Main advantages:	Main risks and requirements:

Main advantages:

- **Protection** – The clients, who use the Interest Rate Collar for hedging purposes receive protection against increasing interest rates**.**
- **Cash flow management** – With the Interest Rate Collar, the cash flows become easily predictable.
- **Flexibility** – The Interest Rate Collar is an OTC instrument and its parameters are negotiated between the counterparties of the deal.
- **No premium** – For the Interest Rate Collar, the parties to the transaction do not pay a premium in advance.

Main risks and requirements:

- **Early termination** – Depending on the value of the instrument, it is possible that the client receives or pays a certain amount when the transaction is early terminated.
- **Opportunity costs** – In case the floating interest rate falls below the level of the interest floor the clients have opportunity costs.
- **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 Collar are denominated in a foreign currency, there is currency risk.
- **Collateral/ limit requirement** – Clients concluding transactions with an Interest Rate Collar must provide cash collateral or have a pre-approved limit.

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

The Interest Rate Collar 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 Collar before its maturity?

Yes, the client can terminate its Interest Rate Collar before its maturity. At every moment of its life, the transaction has its intrinsic value. It can be positive or negative for the client, depending on the current market interest rates. For this reason, the client receives or pays a certain amount depending on its intrinsic value. In addition, the client must take into account the cost of early termination.

Collateral/ limit to Interest Rate Collar:

In order to conclude a transaction with an Interest Rate Collar, the client must provide cash collateral or be granted an investment services sub-limit. The limits for investment services are prepared and approved by the respective client service unit – Corporate Banking Directorate or the Small and Medium Enterprises and Agribusiness Department.

Collateral/ limit management:

Definitions:

- **The Principal collateral/Investment services sublimit** for the deals 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 all concluded and unmatured deals.
- **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:

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

Documents:

- Framework agreement for interest rate collar trading
- 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

Key Information Document:

A key information document has been prepared for the financial instrument FX Option Collar, 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.

Contacts:

For more information you may contact Treasury Sales at:

- **phone numbers**: +359 2 80 10862 / +359 2 93 91126/ +359 2 93 91133 / +359 293 91365 /
- **e-mail:** Treasury.Sales@dskbank.bg

Disclaimer:

This document is an advertising material intended for retail clients, it has information purpose and does not claim comprehensiveness and completeness with respect to the information contained therein for the product. The material does not constitute an investment research, consultation, advice or recommendation to conclude a transaction or to undertake an investment strategy. DSK Bank warns potential and current clients of the Bank that the financial product presented poses a potential risk to the client from loss or not realizing profits as a result of unfavorable market conditions. The stated interest rates, terms and premiums are indicative and do not bind the Bank.