**Interest Rate Swap example**

**Terms:**
- **Fixed rate payer:** Alfa Corp
- **Fixed rate:** 5 percent, semiannual
- **Floating rate payer:** Strong Financial Corp
- **Floating rate:** 3-month USD Libor
- **Notional amount:** US$ 100 million
- **Maturity:** 5 years

A fixed-for-floating interest rate swap is often referred to as a “plain vanilla” swap because it is the most commonly encountered structure.

- **Alfa Corp** agrees to pay 5.0% of $100 million on a semiannual basis to Strong Financial for the next five years
  - That is, Alfa will pay 2.5% of $100 million, or $2.5 million, twice a year
- **Strong Financial** agrees to pay 3-month Libor (as a percent of the notional amount) on a quarterly basis to Alfa Corp for the next five years
  - That is, Strong will pay the 3-month Libor rate, divided by four and multiplied by the notional amount, four times per year
    - Example: If 3-month Libor is 2.4% on a reset date, Strong will be obligated to pay 2.4%/4 = 0.6% of the notional amount, or $600,000.
  - Typically, the first floating rate payment is determined on the trade date
- **In practice,** the above fractions used to determine payment obligations could differ according to the actual number of days in a period
  - Example: If there are 91 days in the relevant quarter and market convention is to use a 360-day year, the floating rate payment obligation in the above example will be \((91/360) \times 2.4\% \times 100,000,000 = \$606,666.67\).