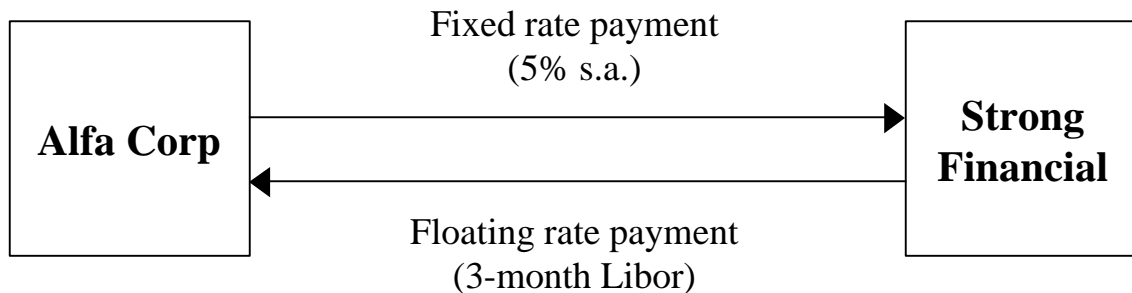


Interest Rate Swap example

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 $(91/360) \times 2.4\% \times \$100,000,000 = \$606,666.67$.