UniCredit Bank

## INTEREST RATE SWAPS (IRS)

### Definition

An interest rate swap is an agreement between two parties to exchange interest obligations (payments) at different rates related to the same notional principal amount. As a rule, fixed interest rates payments are exchanged for the variable ones. This means that only interest payments are swapped, not the principal is exchanged (i.e. no the capital flow occurs)

### Return

The buyer of an interest rate swap (payer of fixed interest rates) benefits from the rise in interest rates. The seller of an interest-rate swap (acquirer, recipient of fixed interest rates) benefits from a fall in interest rates. The return on an interest-rate swap cannot be determined in advance.

### Interest risk

The interest-rate risk results from the uncertainty over future changes in market interest rates. The buyer or seller of an IRS is exposed to the risk of loss if interest rates fall or rise.

### Credit risk

The credit risk with IRS is derived from the possibility of the counterparty default, causing the loss of the IRS positive cash values as compared to the market and the necessity of covering transactions on the market for a worse price.

### Special conditions of IRS

Interest-rate swaps do not have standardised terms. The details of the deal realization must be contractually agreed upon in advance. It is therefore very important to obtain full information on the exact terms and conditions of interest-rate swaps, in particular:

– principal amount

– term

– interest rates agreed

## FORWARD RATE AGREEMENTS - FRA

### Definition

Forward Rate Agreements are used to fix interest rates to be paid at a specified time in the future. Since FRAs are dealt in on the interbank market and not on a stock exchange, they do not have standardized terms. Unlike interest rate futures, FRAs are customised investment products in terms of the principal amount, currency and interest period.

### Return

Through buying or selling an FRA, the investor fixes the interest rate for the period in question. If the reference rate is higher than the agreed interest rate (FRA price) at the maturity date, the buyer of the FRA will be compensated for the movement in interest rates. If the reference rate is lower than the agreed interest rate at the maturity date, the seller of the FRA will receive a compensation payment.

**Interest risk**

The interest-rate risk results from the uncertainty over future changes in interest rates. Generally, this risk is all the higher, the more pronounced the increase or decrease in interest rates is.

**Credit risk**

The credit risk with FRAs derives from the possibility of the counterparty default, causing the loss of the FRA's positive cash values and the necessity of covering transactions at a less favourable price in the market necessary.

**Special conditions of FRA**

FRAs do not have standardised terms, but are customised investment products. It is therefore very important to obtain full information on the exact terms and conditions of the contract, in particular:

– principal amount

– term

– interest rates agreed