Swaption

Product Overview

Bank of Ireland

Global Markets

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The Governor and Company of the Bank of Ireland acting through its business unit Global Markets (hereafter “Bank of Ireland”) provides Swaptions as a tool for managing interest rate exposure which provides protection against adverse interest rate movements.

In exchange for an upfront premium, the buyer of a Swaption gains the right, but not the obligation, to enter into a pre-defined interest rate swap at a future exercise date, i.e. the buyer can ‘exercise’ their option. Swaptions can be European - exercisable only on one date, American- exercisable at any date over an exercise period, or Bermudan - exercisable on a number of pre-agreed dates over the exercise period. Physical settlement is where the buyer and seller enter into the underlying swap on exercise. Cash settlement means that a cash payment is made by the Swaption seller on expiry to compensate the Swaption buyer for any adverse movements in the underlying swap rate i.e. the value of the underlying swap is paid to the Swaption purchaser.

An interest rate swap is an agreement between a Bank and a customer to swap Floating Interest Rate Payments, linked typically to a Reference Rate, (e.g. Euribor/Libor), for Fixed Interest Rate Payments over a specified Term for an agreed Notional Amount. The Notional amounts are not exchanged and, on each interest Payment Date, the cash flows are netted. For more information on interest rate swaps please see our Guide to Interest Rate Management.

Please note this booklet has been prepared by Bank of Ireland as an information/marketing communication. Terminology used in this document is defined within the glossary, in our Guide to Interest Rate Management and Guide to Foreign Exchange Management which can be found at **https://corporate.bankofireland.com/library/**.

Bank of Ireland doesn’t provide products for speculative purposes. Products are provided by Bank of Ireland in order to manage a known exposure e.g. where you have a loan in one currency that you wish to service with cashflows you are in receipt of in another currency and you require protection from this risk.

Other mechanisms / products are available to manage interest rate risk including, but not exclusively, IR options and Interest Rate Swaps. Please contact your Bank of Ireland Relationship Manager for further details. We may be in a position to provide a solution tailored to your particular requirements dependent on your experience.

PLEASE NOTE:

Bank of Ireland Global Markets does not provide investment advice and provides risk management solutions on a strictly non-advised basis only.

You should consider seeking your own independent advice on the financial and legal aspects before entering into any derivative transaction

The product outlined is intended for both retail and professional clients taking account of the identified target market in accordance with Appendix 1 of our Guide to Interest Rate Management **https://corporate.bankofireland.com/library/**.

Key Benefits

Certainty

A Swaption enables you to align your future known or expected cash flows and your view of the market, by considering the following parameters:

- Notional Amount (this Notional Amount can remain constant over the Term or can vary)
- Currency of your Notional Amount
- Exercise Date
- Effective Date / Start Date
- Term / Maturity Date
- Interest Payment frequency (monthly, quarterly or semi-annually)
- Floating Reference Rate
- Interest Payment Dates
- Reset Dates
- Strike Rate

Your Swaption can provide certainty by securing a maximum interest rate for the life of the underlying swap. This can allow for more accurate cash flow management and budgeting.

Portability

It may be possible to novate i.e. transfer a Swaption to another entity or another bank, subject to credit approval.

Early Termination

It may be possible to terminate the product during the life of the swap, at prevailing market rates. This may incur costs. Please refer to Early Termination section for further information.

Key Risks

Interest Rate Risk

Interest rate markets can be unpredictable and can move in either direction. As a result, the value of this Swaption will change and the strike rate on the underlying swap may be higher or lower than the prevailing rates in the market on exercise.

Early Termination / Changes to the terms of the Swaption

It is sometimes possible to terminate your Swaption early or alter other pre-agreed terms during the life of the Swaption. However, depending on prevailing interest rates at the time, there may be a cost to you or you may realise a gain. Given these risks it is important that you consider carefully the terms and duration of your Swaption at the time of trading. Please refer to the Early Termination section for further information.

Counterparty Risk

By entering into a derivative contract with Bank of Ireland you have an exposure to Bank of Ireland in the event of insolvency or related events such as bail in.

How does an Interest Rate Swaption Work?

There are two types of Swaption available:

- A Payer Swaption is where the buyer has the right to pay a fixed rate and receive a floating rate
- A Receiver Swaption is where the buyer has the right to receive a fixed rate and pay a floating rate.

At expiry of the Swaption, the following outcomes may occur:

1. If the market swap rate on the exercise date is greater than the strike rate on a Swaption, then payer's Swaption will have a positive market value while a receiver's Swaption will expire worthless.
2. If the market swap rate on the exercise date is less than the strike rate on the Swaption, the payer's Swaption will expire worthless and the receiver's Swaption will expire with a positive market value.

If the Swaption has a positive market value it can be either cash settled or physically settled. If the swaption is physically settled, you will enter into the Interest Rate Swap on expiry of the option.

Please see our guide to **Interest Rate management** for further details on Interest Rate Swaps.

Example

The examples below are indicative only. In order to assess the merits of any particular Swaption, you would need to use the actual rates and figures quoted to you at the time.

A Company expects to draw down €10m of 3 year debt in 6 months time, however, there is uncertainty around whether the underlying project requiring the debt will proceed. In order to hedge this potential interest rate exposure the customer purchases a European Payer Swaption which expires in 6 months time with physical settlement. The cost of this Swaption is 1.25% of the principal amount or €125,000, and is paid by the Company upfront.

The underlying swap is for a 3 year term and matches the debt profile of the loan in question. The strike rate on the swap is the prevailing market rate for a 3 year swap starting in 6 months time, in this example, 3%. The below tables outlines the possible scenarios at expiry.

Scenario	Prevailing 3 year market swap rate on expiry	Has the loan drawn down?	Does the Swaption have value i.e. is the 3 year swap rate >3%?	Will the Swaption be exercised, i.e. should the Company enter into the underlying swap?
A	2.75%	Yes	No	No
B	3.50%	Yes	Yes	Yes
C	3.50%	No	Yes	Yes

Warning: These figures are estimates only. They are not a reliable guide to the future performance of your investment

Scenario A The Company can enter into an interest rate swap in the market at 2.75%.

Scenario B The Company will exercise and enter into a swap to hedge the loan, at a 0.5% discount to the current available rate.

Scenario C The Company does not need the swap but rates have risen and so the swap has value. After exercising the treasury manager can then cancel this swap, locking in a profit as they do so.

Generic Example of an Early Termination

If you wish to terminate early or partially terminate a transaction before its Maturity Date, we will consider such request as soon as reasonably practicable. Should we agree to such a request, the termination may result in a breakage cost payable by either you (to the Bank) or the Bank (to you) (the “Breakage Cost”). This cost will be dependent on the time remaining on the transaction and the relevant market rate available to the Bank on the day on which such Early Termination takes effect. The market rate available is not controlled by the Bank and is impacted by external factors such as volatility, liquidity or lack of thereof and economic or political turbulence. All of these factors will impact the breakage cost. You are strongly advised to discuss potential Early Termination cost with us in advance of requesting an Early Termination of a transaction.

Example of Early Termination cost calculation for a Swaption

If you purchase a payer Swaption, the Early Termination cost would be determined by:

- The value of the underlying swap, which will be higher if rates are higher
- The time remaining until exercise; the value of the Swaption is correlated with the time to expiry
- The volatility of rates in the market; an increase in volatility increases the value of the Swaption

Should you wish to transact an Interest Rate Swaption

Please follow the steps below to enter into a Swaption:

- talk to your Bank of Ireland Relationship Manager who will refer you to the relevant interest rate derivative contact in our Global Markets unit.
- ensure you have read and understood this document.
- you will be required to sign an ISDA Master Agreement.
- talk to your Bank of Ireland Global Markets contact about the particular parameters of the Interest Rate Swaption you require.

In accordance with the rules and requirements set out by the European Union (Markets in Financial Instruments) Regulations 2017 and the Financial Conduct Authority the Bank of Ireland is required to categorise each client either as eligible counterparty, professional client or retail client. Bank of Ireland also has to assess the appropriateness of the product for each customer. Therefore, you may be required to supply supporting documents in order to establish the client category and the appropriateness of the transaction. Before your first transaction, you should receive a categorisation letter and associated Terms of Business. If you do not receive these before the proposed transaction, please contact your Bank of Ireland Global Markets contact.

Your Bank of Ireland Global Markets contact will give you an indicative quote based on the details of your Swaption. Once you have decided you would like to enter into a Swaption, you will be required to provide the necessary documentation, such as:

- Mandate and other account opening requirements
- Credit approval will be required before entering into a physically settled Swaption
- Confirmation of capacity as detailed in your Memorandum and Articles of Association
- Execution of an ISDA Master Agreement
- Any other relevant documents

All conversations such as telephone conversations and electronic communications will be recorded (even where they do not lead to the conclusion of an agreement). Transactions are also executed on recorded lines.

As the prevailing market rates are constantly changing, the rate quoted is only valid for immediate acceptance. This rate may differ from the indicative quote given previously.

Any person authorised in your mandate to trade the relevant product may engage and conclude transactions with Bank of Ireland.

Confirmations

Post transaction Bank of Ireland will send you a Confirmation outlining the relevant commercial terms of the transaction.

It is important you check the Confirmation to make sure that it matches your understanding of the Trade. If so, please sign and return the Confirmation as directed. In the case of a discrepancy, you will need to raise the matter with your Bank of Ireland Global Markets contact as a matter of urgency

What are the Fees and Charges?

Typically there are no upfront fees. However, the Fixed Rate agreed will incorporate Bank of Ireland's risk, execution, administration costs and revenue margin.

A disclosure of expected Aggregated Costs and Charges and expected Total Consideration will be provided as an indication via a pre trade term sheet in advance of any transaction. This pre trade term sheet will use actually incurred costs as a proxy for the indication term sheet. We will also provide this information on a post trade term sheet confirming actual Aggregated Costs and Charges and actual Total Consideration following execution of any Derivative trade. An itemised break down of costs will be provided on request.

Glossary

Aggregated Costs and Charges is the total of all execution, administration ,credit margin	
Bank of England Official Base Rate is the interest rate that the Bank of England charges Banks for secured overnight lending.	
Bank of Ireland means The Governor and Company of The Bank of Ireland.	
Cap An Interest Cap is a derivative under which the buyer receives payments at the end of each period in which the interest rate exceeds the agreed Strike Price.	
Cap Rate The agreed Strike Rate on a Cap.	
Collar A Collar is the simultaneous purchase of a Cap and the sale of a Floor on the same Reference Rate for the same Maturity Date and Notional Amount. (Cap and Floor can also be transacted on a stand alone basis)	
Commencement Date or Start Date means the date on which your Interest Rate Product commences. This will be referred to as the 'Effective Date' in your Confirmation.	
Confirmation means the document issued to you by Bank of Ireland following the agreement of the Trade.	
Derivative a financial contract which derives its value from the performance of an underlying asset or value such as an interest rate.	
Early Termination refers to bringing a transaction either partially or wholly to an end before the agreed Maturity Date.	
Effective Date is the Start Date of your product. This is not necessarily the same as the Trade Date.	
EURIBOR The Euro Interbank Offered Rate is the benchmark rate of the large euro money market. A detailed explanation of EURIBOR and how it is calculated may be found at: http://www.euribor-ebf.eu/euribor-org/about-euribor.html	
Fixed Interest Rate means the fixed interest rate applying to your Notional Amount during the Term of a Swap.	
Fixed Rate Lending refers to a fixed rate loan where the interest rate does not fluctuate during the period of the loan.	
Floating Interest Rate means the floating or variable interest rate applying to your Notional Amount during the Term of your Interest Rate Product, expressed as a percentage and based on the Reference Rate.	
Floor An interest rate floor is a derivative contract under which the buyer receives payments at the end of each period in which the interest rate is below the agreed Strike Price.	
Floor Rate The agreed Strike Rate on a Floor.	
Interest Rate Exposure means that a move in variable interest rate will impact you or your business.	
Interest Rate Product means a Cap, a Collar,a Floor or a Swap	
ISDA stands for International Swaps and Derivatives Association and is also a shorthand reference to the ISDA Master Agreement, 1992 version and 2002 version, which are standard master dealing agreements issued by the Association and used to document your Interest Rate Product(s) with Bank of Ireland.	
LIBOR [London Interbank Offered Rate] is the rate of interest at which banks borrow funds, in marketable size, from other banks in the London interbank market. LIBOR, the most widely used benchmark or reference rate for short term interest rates, is an international rate. A detailed explanation of LIBOR and how it is calculated may be found at https://www.theice.com	
Maturity Date means the date on which your Interest Rate Product expires. This will be referred to as the 'Termination Date' in your Confirmation.	
MiFID Markets in Financial Instruments Directive as amended from time to time	
Negative Interest Rates – means where Reference Rates set below Zero	
Net Interest Payment means the net payment made on an Interest Rate Swap at each Payment Date in respect of the Notional Amount.	
Notional Amount is the nominal amount that is used to calculate payments made on an Interest Rate Product. The Notional Amount can be a fixed amount for the full Term or vary over the Term. If the Notional Amount varies, the balance at the beginning of the period is used for calculation purposes.	
Option a derivative which gives the buyer of the Option the right, but not the obligation, to buy or sell an underlying asset at a specified price on or before a specified date. Each contract will specify whether the buyer of the Option has the right to buy or to sell the underlying asset.	
Payment is a movement of money either from Bank of Ireland to you, or from you to Bank of Ireland. The economics of the underlying deal and market conditions will decide the direction of the movement.	
Payment Date refers to each date on which a payment will be made in respect of your Notional Amount on your Interest Rate Product. The specific Payment Dates applying to your Interest Rate Product will be specified in your Confirmation. If a Payment Date does not fall on a business day, the payment will be processed on the following business day.	
Premium The premium is the upfront cost/price the customer pays to the Bank when they purchase a Cap or Collar.	

Glossary

Reference Rate The type of Floating Interest Rate you chose at the start of your transaction. Typical Reference rates are 1 month Euribor or Libor, 3 month Euribor or Libor, Bank of England base rate but other terms and currencies are available. The period/term of the Reference Rate will be the same as the interest payment frequency you have chosen and should match the roll over frequency of your loan with a view to hedging your interest rate exposure. For example, if your variable rate loan has a quarterly rollover against 3 month Euribor it will be appropriate to choose 3 month Euribor as your Reference Rate.
Reset Date refers to each date on which the Floating Interest Rate is set. The specific Reset Dates applying to your Interest Rate Product will be specified in your Confirmation. If a Reset Date does not fall on a business day, the Floating Rate will be set on the following business day.
Start Date means the date on which your Interest Rate Product commences. This will be referred to as the 'Effective Date' in your Confirmation
Strike Rate The price at which an option can be exercised. This is the agreed maximum rate applicable in a Cap, or the agreed minimum rate applicable to a Floor.
Swap is a derivative under which two parties (counterparties) swap Floating Interest Rate payments, linked typically to a Reference Rate (eg Euribor/Libor), and Fixed Interest Rate payments over a specified Term for an agreed Notional Amount.
Swaption an agreement between you and a Bank to enter into an interest rate Swap at some agreed future point in time. The buyer of the option has the right but not the obligation, to enter into the Swap at a pre-defined Fixed Rate at the agreed expiry of the option.
Term means the period between the Start Date and the Maturity Date.
Term Sheet A document which sets out the details of an Interest Rate Product. A draft of the Term Sheet will be compiled prior to trading specifying the details such as; Term, Notional Amount, Fixed rate if applicable, Premium if payable, Aggregated Costs and charges,Total Consideration Reference Rate and Start Date.
Total Consideration is the Final agreed rate or premium including aggregated costs and charges
Trade the purchase of an Interest Rate Product
Trade Date is the date on which the trade details are agreed and binding on both parties.
Volatility The relative rate at which the underlying interest rates move up and down over the term of a product.