Is your company’s interest rate risk consistent with your risk appetite and tolerance? Identifying and managing interest rate exposure is essential in managing your assets and liabilities. Interest rate derivatives are flexible and can be structured to meet your financing needs.

PNC DELIVERS

PNC’s dedicated team of senior derivatives specialists can help you identify exposures and determine the appropriate risk management tools to effectively hedge interest rate risk. We can customize solutions tailored to manage interest rate risk and lower funding costs.

PRIMARY DERIVATIVE PRODUCTS

**Interest rate swap**
An interest rate swap (or “swap”) is a contractual agreement in which two counterparties agree to exchange interest payments at different rates through a stated maturity date. A fixed-for-floating swap is used to synthetically convert a floating-rate obligation to a fixed-rate obligation. In the diagram below, the swap provider (PNC) pays the customer a floating rate. Conversely, a floating-for-fixed swap converts a fixed-rate obligation to a floating-rate obligation. Swaps can also be floating-to-floating (a “basis swap”), which converts the floating-rate index on an obligation to an alternate index (usually to match the payment stream on a related asset that floats on the new index).

**Interest rate cap**
An interest rate cap is an agreement between the seller of the cap (PNC) and a customer to limit the customer’s floating interest rate exposure to a specified level for a specified period of time.

The customer pays an upfront fee for an interest rate cap. Should the floating rate ever rise above the cap strike, the customer receives a payment from the cap seller that effectively reduces the interest rate to the specified cap-strike rate. The customer can manage the upfront cost of the cap by selecting a higher cap-strike rate (i.e., lower level of protection).

**Interest rate collar**
Customers who prefer a floating rate but find the upfront cost of a cap to be prohibitive might opt for a collar instead. With a collar, the customer finances the purchase of the cap by selling an interest rate floor. That floor works as a lower limit on the customer’s floating rate.

Collars are typically structured as a “zero-cost” structure, which means that the floor value offsets the cap cost exactly, so no upfront payment is required by either the customer or PNC.
PRIMARY DERIVATIVE PRODUCTS (Cont.)

This offers the customer the full benefit of falling floating rates, until the floating rate hits the floor-strike rate.

**Cancelable interest rate swap**
The cancelable interest rate swap is similar to the traditional interest rate swap described previously, with one added feature. One of the parties purchases the right to terminate the swap early, with no early termination fees due.

Customers who want to unwind their swap early, usually due to the expectation of early loan repayment, can purchase the option to terminate early and ensure no early termination costs. The cost of that cancelable option is typically paid by the customer through an increase to the fixed swap rate rather than an upfront payment.

Conversely, if customers are looking to achieve a fixed rate that is below that of a traditional swap, they can sell PNC the option to terminate the swap early. PNC pays customers for that option via a reduction to the fixed swap rate. Therefore, customers give up the certainty of the maturity of the swap agreement in exchange for a reduced fixed rate.

**Interest rate step-up swap**
An interest rate step-up swap is similar to a traditional interest swap, with an added feature. The step-up swap offers a lower initial rate that “steps up” to a higher rate at a predetermined time. The initial rate and the step-up rate, as well as the date of the step up, are known at the outset of the agreement.

The step-up swap is useful to customers who may need to preserve cash in the short run, but expect to be able to pay a higher fixed rate in subsequent years. There are no limits to the number of step-ups that can be included in a swap. The number of step-ups are dependent upon the customer’s cash flow projections.

**Customized solutions**
The solutions described above are just a small sample of the full suite of products offered by PNC’s Derivative Products group. Other common solutions include:

- Forward starting interest rate swaps
- Treasury locks
- Cross currency swaps
- Interest rate swaptions

In addition, PNC’s experienced team of derivatives specialists can work with you to structure a customized solution that meets your organization’s unique needs.

PNC’S DERIVATIVE PRODUCTS SALES AND TRADING DESKS

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