



AMERICAN FINANCIAL EXCHANGE

AMERIBOR[®] Swaps Overview

Funding Challenges in Today's Low Interest Rate Environment

Given funding markets current low interest rate environment, many banks, financial institutions, and corporations are restructuring their balance sheets to reduce overnight demand. New strategies are being implemented to advantageously lock in low-cost funding by borrowing for term in various funding products.

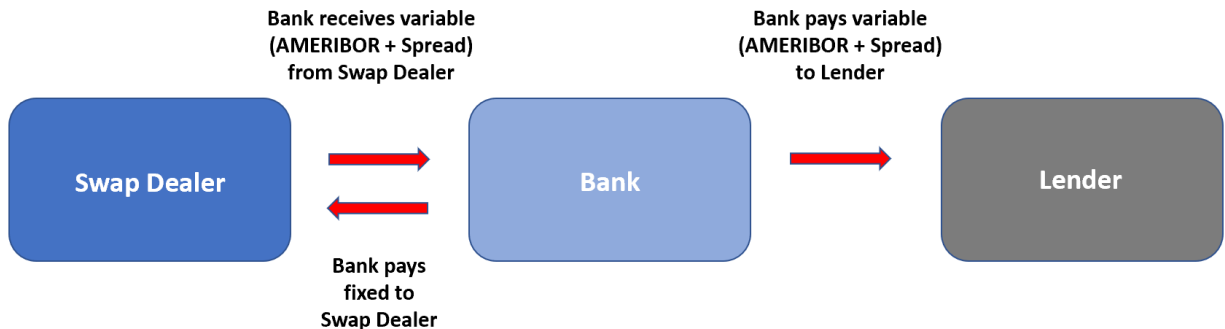
In search of additional yield, lenders have opted for shorter maturities that match this new term demand using a benchmark interest rate, such as AMERIBOR[®] (American Interbank Offered Rate) plus a credit spread. These variable rate AMERIBOR[®] loans are typically structured with a one (1) year maturity and monthly resets on the variable AMERIBOR[®] rate that is charged to the borrower.

To protect themselves against a sudden rise in rates, banks may swap the variable rate payment for a fixed rate by transacting in a variable AMERIBOR[®] rate to fixed rate swap.

The benefit of executing the variable to fixed interest rate swap are:

1. Converts the bank's uncertain monthly variable rate AMERIBOR[®] interest payments into a known stream of monthly fixed interest rate payments
2. Extends the duration of the bank's liability

The swap transaction is done by a Swap Dealer. Since the Swap Dealer pays monthly variable AMERIBOR[®] interest and receives monthly fixed interest, the Swap Dealer is exposed to a sudden rise in rates. The Swap Dealer hedges this exposure by selling a strip of one month AMERIBOR[®] futures contracts (ticker symbol "AMB1") on the Cboe Futures Exchange (CFE). This eliminates maintenance for the bank's interest rate risk management, while still locking in term borrowing.



AMERIBOR[®] Variable – Fixed Interest Rate Swap Cash Flow Diagram

**AMERIBOR Interest Rate Swap Example
Indicative Term Sheet**

Participants	Dealer: Counterparty:
Transaction type	AMERIBOR interest rate swap Dealer: <ul style="list-style-type: none"> • Receives 0.10% fixed monthly • Pays variable AMERIBOR + 10 bps monthly Counterparty: <ul style="list-style-type: none"> • Pays 0.10% fixed monthly • Receives variable AMERIBOR + 10 bps monthly
Start date	11.01.2020
End date	11.01.2021
Notional	\$100MM
Variable AMERIBOR rate fixing	Fixings will be made monthly in arrears with one (1) business day lag based on the arithmetic average of that month's daily closing overnight unsecured AMERIBOR interest rate (ticker symbol "AMBOR30" which is available on Bloomberg and www.ameribor.net)
Payments	Fixed payment is determined as: <ul style="list-style-type: none"> • $(0.10\%) \times (\# \text{ of days in the ending month}) / 360 \times \text{Notional}$ Variable payment is determined as: <ul style="list-style-type: none"> • $(\text{AMBOR30} + 10 \text{ bps}) \times (\# \text{ of days in the ending month}) / 360 \times \text{Notional}$
Netting	Payments will be netted and made monthly
Interest rate basis	Fixed leg: Actual/360, following business day convention Variable AMERIBOR leg: Actual/360, following business day convention

Illustration of the AMERIBOR[®] interest rate swap payments at the end of the first month.

	Notional	Swap Leg	Time Period	# of Days	Type of Rate	Rate	Spread	Rate + Spread	Payment**
Swap Dealer	\$100MM	#1	11.01.2020-11.30.2020	30	Fixed	0.10%	0%	0.10%	\$8,333.33
Counterparty	\$100MM	#1	11.01.2020-11.30.2020	30	AMBOR30*	0.07761%	0.10%	0.17761%	\$14,800.83
Net Payment made by Counterparty to Swap Dealer									\$6,467.50

*Note: AMBOR30 is fixed on 12.01.2020 (1 business day lag after 11.30.2020)

**Note: Payments are calculated as: Notional x (Rate + Spread) X (# of Days) / 360

The **AMERIBOR[®] Swaps Tutorial** on the next page provides an overview of the swap documentation and procedures typically required by the swap dealer and counterparty.

AMERIBOR[®] Swaps Tutorial

Swap Dealer Requirements

Swap dealers typically require the following documentation from the counterparty prior to being able to transact in AMERIBOR[®] swaps with new counterparties:

1. Name of legal entity that will be the swap counterparty
2. Two years audited financial statements
3. Copy of the Certificate of Incorporation
4. Copy of the Articles of Incorporation
5. Copy of the Register of Directors
6. Legal Entity Identifier (“LEI”) number
7. Organization chart
8. ISDA Master Agreement / Swap Trading Agreement
9. Copy of Incumbency Certificate
10. List of authorized swap traders
11. Swap Trading Application
12. Credit Support Annex (“CSA”) For Variation Margin

Counterparty Internal Requirements

Counterparties typically require the following documentation and internal reviews and approvals prior to being able to transact AMERIBOR[®] swaps:

1. ISDA Master Agreement between counterparty and swap dealer
2. Draft or updated Asset-Liability Committee (“ALCO”) Policy for AMERIBOR[®] swaps and review / approval by ALCO committee
3. Board of Directors and/or Risk Committee approval of AMERIBOR[®] swaps
4. Hedge Designation Memo for AMERIBOR[®] swap and asset or liability being swapped
5. Pre-trade Draft Acknowledgment Sheet
6. Potential Future Exposure on the trade to 2 standard deviations
7. Review and approval by all relevant departments including Operations, Legal and Accounting

Accounting for AMERIBOR Swaps

Below is some general guidance concerning hedge accounting for AMERIBOR[®] interest rate swaps. This guidance is provided for general informational purposes only. Users should consult with their accounting department for further information.

Cash Flow Hedge Accounting

AMERIBOR[®] qualifies for cash flow hedge accounting. Please see AFX Exchange Notification 2019 – 010 dated December 9, 2019.

Fair Value Flow Hedge Accounting

While AMERIBOR[®] is not yet on FASB’s list of approved benchmark interest rates for fair value hedge accounting, counterparties can still qualify for fair value hedge accounting by using one of FASB’s approved interest rate benchmarks if the benchmark interest rate chosen has high correlation with AMERIBOR[®].

There are third party service providers such as Chatham Financial www.chathamfinancial.com and DerivativePATH www.derivativepath.com that provide AMERIBOR[®] derivatives consulting and outsourced hedge accounting services.

For more information please contact Frank Kalble, Vice President at fkalble@theafx.com or visit www.ameribor.net