

# Interest Rate Risk Management

## Product Features Booklet

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# Welcome

This Product Features Booklet provides an overview of the products offered by Suncorp to assist a customer\* manage interest rate risk. This booklet includes product feature information for the following products:

- Interest Rate Cap
- Interest Rate Collar
- Interest Rate Swap
- Interest Rate Swaption

**\*Whilst investors and other parties can also use these products, in this booklet we only discuss how these products can be used by customers who are borrowers to manage their interest rate risk.**

## Important to know

- This booklet should be read in conjunction with the Terms and Conditions for Suncorp Treasury.
- This booklet is not a Product Disclosure Statement. If a Product Disclosure Statement is required for a product, product features and terms and conditions for that product are contained within the relevant Product Disclosure Statement.
- When a customer acquires any of these products the customer is entering into a contract with Suncorp-Metway Limited (“Suncorp”). This means that the customer can only transact with Suncorp in relation to this acquired product.
- **In all of the examples outlined in this booklet, the interest rates used do not include credit margins or funding costs. The products included in this booklet are all benchmarked against an interbank market rate (eg. BBSW and SWAPREF). Interbank rates are those rates at which banks will deal directly with other banks, not with customers.**
- Any interest rates used in the examples are for illustrative purposes only and may not reflect current market rates.

## About Interest Rate Risk Management

Interest rate risk management aims to limit a customer’s potential exposure to fluctuating interest rates. A range of products is available to help manage interest rate risk and the products offered by Suncorp are outlined in this Product Features Booklet. All of these products can be tailored to suit a customer’s specific risk management objectives.

The information set out in this booklet is of a general nature and has been prepared without taking into account a particular customer’s objectives, financial situation or needs. Before acting on this information a customer should consider its appropriateness relative to the customer’s objectives, financial situation and needs.



# Interest Rate Cap

# Product description

An Interest Rate Cap (“Cap”) is an agreement that compensates the customer if the benchmark interest rate applicable to the customer’s Cap rises above a certain pre-agreed level.

The customer pays a premium for this right to compensation.

A customer would use a Cap to set a worst case rate (strike rate) for an agreed notional amount and term.

During the term of the Cap there are exercise dates – tailored to fall in line with the interest payment dates of the customer’s underlying variable rate loan facility. Intervals are usually every month, 3 months or 6 months (as nominated by the customer and agreed by Suncorp).

On these exercise dates the Cap strike rate is compared to a benchmark interest rate. Suncorp uses the Bank Bill Swap Reference Rate (“BBSW”) published by Reuters on every business day, as the benchmark interest rate.

BBSW rates are published for terms out to 12 months e.g. 1 month (“BBSW1Mth”) and monthly to 6 months (“BBSW6Mth”), then 9 months (“BBSW9Mth”) and 12 months (“BBSW1Year”).

The BBSW rate used as a benchmark interest rate for the customer’s Cap depends on the frequency of the customer’s exercise dates (e.g. we use BBSW1Mth for Caps with monthly exercise dates and BBSW6Mth for Caps with six-monthly exercise dates).

For example, if a customer has a Cap with monthly exercise dates on the 15th of each month, the customer’s Cap strike rate will be compared to the BBSW1Mth rate published on the 15th of each month – or the next business day if the 15th is not a business day.

If the benchmark interest rate is higher than the Cap strike rate on any exercise date, Suncorp pays to the customer’s nominated account (as per the customer’s standard settlement instructions) a settlement amount for the interest rate differential for the period, which is calculated as follows:

$$\text{Settlement amount} = \left( \frac{\text{Benchmark Rate} - \text{Strike Rate}}{100} \right) \times \text{Notional Amount} \times \frac{\text{Number of days}}{365}$$

where

*Number of days* = days from this exercise date to the next exercise date

The settlement amount can be paid either at the beginning or end of each interest period in line with the customer’s underlying loan facility. For example, if the customer’s loan is on a bill facility, the interest on the loan is paid at the start of each interest period. The customer may tailor the Cap to receive settlement amounts at the beginning of the interest period to coincide with the interest payments on the loan.

## Example

Cap strike rate	3.00%	Benchmark rate	3.50%
Notional Amount	\$1,000,000	Number of days	90

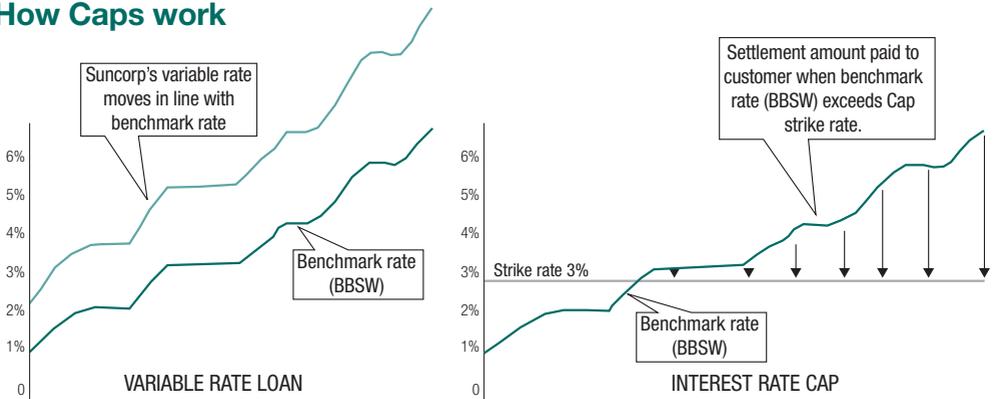
$$\text{Settlement amount} = \left( \frac{3.50 - 3.00}{100} \right) \times 1,000,000 \times \frac{90}{365}$$

Settlement amount = \$1,232.88

Suncorp pays \$1,232.88 to the customer's nominated account.

If the benchmark interest rate is lower than the strike rate, there is no settlement amount because a Cap only compensates the customer if the benchmark rate rises above the customer's strike rate.

## How Caps work



## Premium

The premium is a once-off upfront cost that will vary depending on:

- the strike rate of the Cap
- the prevailing interest rate (to maturity date of the Cap)
- term of the Cap
- the notional amount
- market volatility
- the margin
- frequency of exercise dates.

The customer nominates the Cap parameters including strike rate, term, notional amount and frequency of exercise dates. A Suncorp Treasury Representative can provide guidance on the parameters when required.

- If a credit facility is in place, the premium is due two business days after the deal date.
- If a credit facility is not in place, the premium is due on the deal date.

## Risks

If a customer decides to terminate his/her contract before expiry date there is a risk that the Cap could be worth less (possibly zero) than the premium paid by the customer. Factors affecting the value of the Cap are the same as those when calculating the premium at the time of buying the Cap (Refer to Premium above).

### Example

Mr Petersen is a borrower with a \$1,000,000 loan on a variable interest rate. He is worried that interest rates will rise to a level that will hurt the profitability of his business. Mr Petersen doesn't want to fix an interest rate on his loan because he thinks he might sell his business in the next two years and doesn't want to incur potential early termination costs for breaking a fixed interest loan contract.

Mr Petersen could buy a Cap at his nominated strike rate. This would:

- let him take advantage of any fall in interest rates on his variable rate loan
- protect him against rate increases above his strike rate
- give him the flexibility to repay all or some of his borrowings if he does sell his business
- involve a once-off premium paid up front.

# Interest Rate Collar

# Product description

Before reading about Interest Rate Collars, please refer to 'Interest Rate Cap' in the preceding section.

A customer would use an Interest Rate Collar ("Collar") to set a **minimum** and **maximum** interest rate the customer will pay on his/her variable rate loan.

The customer creates a Collar by **buying an Interest Rate Cap (Cap) from Suncorp** and simultaneously **selling an Interest Rate Floor (Floor) to Suncorp**.

A Collar:

- puts in place best and worst case interest rates and
- allows the customer to benefit from a fall in interest rates limited to the level of the Floor strike rate.

By introducing a minimum rate, the premium cost usually associated with a Cap is reduced and in some cases can be structured to zero. This is the main reason a customer may choose to enter into a Collar rather than buy a Cap in isolation.

An **Interest Rate Cap (Cap)** is an agreement, which compensates the buyer (in this case the customer) if interest rates rise above a certain pre-agreed level. The customer pays a premium to Suncorp for this right. (Refer to 'Interest Rate Cap')

An **Interest Rate Floor (Floor)** is an agreement, which compensates the buyer (in this case Suncorp) if interest rates fall below a certain pre-agreed level. When the customer sells a Floor to Suncorp to create a Collar, the customer must compensate Suncorp if interest rates fall below the Floor strike rate during the term of the Floor. The customer receives a premium from Suncorp when he/she sells Suncorp a Floor.

## How Caps & Floors work

During the term of the Collar there are exercise dates tailored to fall in line with the interest payment dates of the underlying variable rate loan facility. Intervals are usually every month, 3 months or 6 months (as nominated by the customer and agreed by Suncorp). On these exercise dates the Cap and Floor strike rates are compared to a benchmark interest rate ("BBSW").

The BBSW rate used as a benchmark for a customer's Collar depends on the frequency of the customer's exercise dates (e.g. we use BBSW1Mth for Collars with monthly exercise dates and BBSW6Mth for Collars with six-monthly exercise dates). For example, if a customer has a Collar with monthly exercise dates on the 22nd of each month, the Cap and Floor strike rates will be compared to the BBSW1Mth rate published on the 22nd of each month - or the next business day if the 22nd is not a business day.

If the benchmark interest rate is higher than the Cap strike rate on any of the exercise dates, **Suncorp pays the customer a settlement amount** for the interest rate differential. Refer to 'Interest Rate Caps' for calculations.

If the benchmark interest rate is lower than the Floor strike rate on any of the exercise dates, the customer pays Suncorp a settlement amount for the interest rate differential. The calculation is the same as for Caps, the only difference being that the customer pays Suncorp.

If the benchmark interest rate is lower than the Cap strike rate and higher than the Floor strike rate on any of the exercise dates there will be no settlement amount.

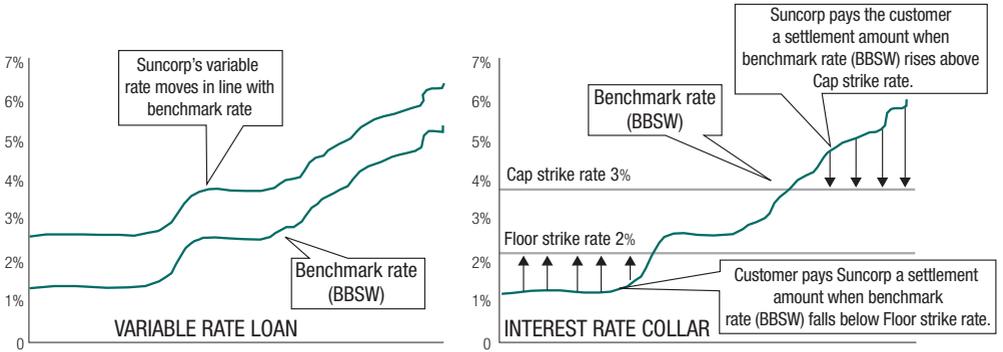
**Example**

Cap strike rate	3.00%	Floor strike rate	2.00%
Notional Amount	\$1,000,000	Number of days	90

(Note that a premium is payable upfront. A Suncorp Treasury Representative can provide a quote.)

Benchmark rate	Outcome
BBSW30 = 3.50%	<p>Cap is 'in the money' so Suncorp pays the customer a settlement amount.</p> $\text{Cap settlement amount} = \left( \frac{3.50 - 3.00}{100} \right) \times 1,000,000 \times \frac{90}{365}$ $\text{Cap settlement amount} = \$1,232.88$ <p><b>Suncorp pays the customer \$1,232.88.</b></p>
BBSW30 = 2.50%	<p>No settlement amount because Cap and Floor are both 'out of the money'.</p>
BBSW30 = 1.50%	<p>Floor is 'in the money' so the customer pays Suncorp a settlement amount.</p> $\text{Floor settlement amount} = \left( \frac{1.50 - 2.00}{100} \right) \times 1,000,000 \times \frac{90}{365}$ $\text{Floor settlement amount} = -\$1,232.88$ <p><b>The Customer pays Suncorp \$1,232.88.</b></p>

## The workings of the Collar are illustrated in the diagram below;



## Premium

The premium is a once-off upfront cost that will vary depending on:

- the strike rates of the Cap and Floor
- the prevailing interest rates (to maturity date of the Collar)
- term of the Collar
- the notional amount
- market volatility
- the margin
- frequency of rate resets

A customer may nominate the Collar parameters including strike rates, term, notional amount and frequency of exercise dates. A Suncorp Treasury Representative can provide guidance on the parameters when required.

When a customer buys a Cap the customer pays a premium and conversely when the customer sells a Floor the customer receives a premium. In the case of a Collar, the premium will be the premium paid for the Cap, minus the premium received for the Floor, and in some cases the Collar can be structured to achieve a zero premium. The premium is due two business days after the deal date.

# Risks

- **Interest rate falls below the Floor strike rate.** If the benchmark rate falls below the Floor strike rate on any of the exercise dates, the customer must compensate Suncorp for the difference in interest between the lower benchmark rate and the Floor strike rate.
- **Termination of contract by customer before expiry date might result in an early termination amount, which could be a cost to the customer.** When a customer terminates a Collar before the expiry date, the customer actually **buys back the Floor** from Suncorp and **sells the Cap** back to Suncorp. At the time of termination, if the Floor is worth more than the Cap, the customer will have to pay Suncorp a termination amount, being the difference between the value of the Floor and the value of the Cap. This termination amount is not known until the customer advises Suncorp that he/she wants to terminate the Collar. Factors affecting the termination amount are the same as those when calculating the premium at the time of entering into the Collar (Refer to 'Premium' above).

## Example

ABC Pty Ltd has a \$2M loan on a variable interest rate.

ABC has been on a variable interest rate while interest rates have been low, but the directors think the economic outlook has changed and ABC should fix or cap its debt. ABC has quotes for a fixed rate and Cap from Suncorp.

ABC doesn't want a fixed rate because it prefers the flexibility of a variable rate loan. ABC is forecasting a very good year, and any surplus cashflow would be used to reduce debt levels. If ABC opted for a fixed rate loan, any unexpected principal reductions could incur an early repayment cost.

A Cap would suit ABC but it thinks the premium looks expensive. ABC could reduce the cost of the Cap by selling a Floor to create a Collar.

If ABC buys a 5-year Cap with a worst case interest rate of 3.00% and sells a 5-year Floor with a best case interest rate of 2.00%, ABC would pay no more than 3.00% and no less than 2.00% for the next 5 years. By entering into a Collar rather than a Cap, ABC is exposed to some degree of risk, which it would not have been exposed to with a Cap:

- if interest rates fall below 2.00% on any of the exercise dates, ABC must compensate Suncorp for the interest rate differential (refer to 'Risks' above), and
- if ABC make an early repayment on all or some of its debt and therefore wants to cancel part or all of the Collar, ABC may incur an early termination cost (refer to 'Risks' above).

# Credit facility

A customer must have a credit facility with Suncorp before being able to enter into a Collar with Suncorp. This way, if a customer has insufficient funds to settle any amounts owing to Suncorp pursuant to an interest rate risk management product, Suncorp may draw on the customer's credit facility to settle/cover it.



# Interest Rate Swap

# Product description

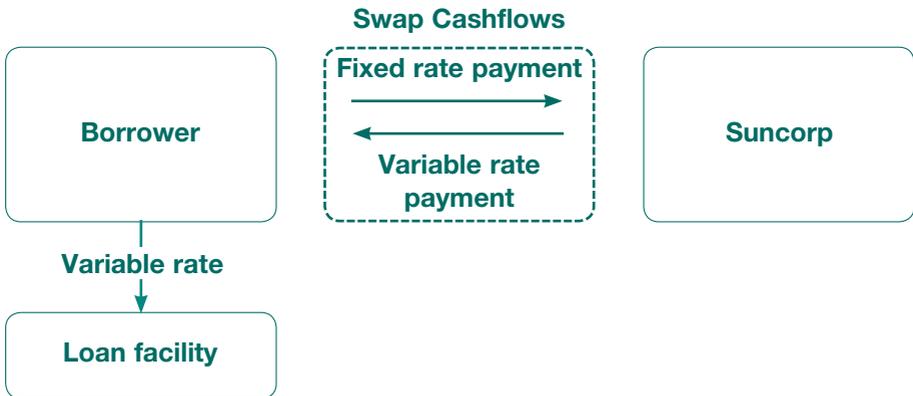
An Interest Rate Swap (“Swap”) is an agreement between two parties to exchange interest payment obligations for an agreed period of time. One party makes fixed rate interest payments while the other makes variable rate interest payments. Only the interest payments are exchanged, not principal. Swap parameters are tailored to meet a customer’s specific risk management objectives. The parameters include:

- start and end dates,
- frequency of interest payments and
- notional amount on which interest payments are based.

A customer typically uses a Swap to hedge against rising interest rates and to minimise borrowing costs. For example, a customer with a variable rate loan, wanting to protect against interest rate rises, can ‘swap’ his/her variable rate interest payments to fixed rate interest payments.

## How Swaps work

The following diagram illustrates the flow of a Swap where the customer is swapping a variable rate interest obligation to a fixed rate of interest:



In the above illustration the customer:

- **Pays variable** interest on the underlying loan facility
- **Receives variable** interest on the Swap
- **Pays fixed** interest on the Swap

The net effect is that the customer pays fixed interest for the term of the Swap with the underlying loan contract remaining unchanged.

The **fixed interest rate** is agreed at the time the Swap is entered into and will be based on the prevailing interest rate for the term of the Swap. A Suncorp Treasury Representative can provide a quote for a fixed or floating rate Swap.

The **variable interest rate** will be reset at regular intervals during the term of the Swap – in line with the interest payment dates of the underlying variable rate loan facility. Intervals are usually every month, 3 months or 6 months. On these rate-reset dates the variable rate is reset to a benchmark interest rate (“BBSW”).

The BBSW rate used as a benchmark interest rate for a Swap depends on the frequency of the rate reset dates (e.g. Suncorp uses BBSW1Mth for Swaps with monthly rate resets and BBSW6Mth for Swaps with six-monthly rate resets). For example, if a customer has a Swap with monthly rate resets which fall on the 15th of each month, the variable rate will be reset to the BBSW1Mth rate published on the 15th of each month - or the next business day if the 15th is not a business day.

Only one interest payment is exchanged at each rate-reset date. The fixed and variable rate interest payments are netted off at each rate reset date with a single settlement amount being made by the customer to Suncorp or vice versa. In the above illustration, if at any of the rate reset dates, the fixed interest rate is higher than the variable interest rate, the customer will pay a settlement amount to Suncorp. If the fixed rate is lower than the variable rate Suncorp will pay a settlement amount to the customer.

### Example

ABC Pty Ltd has a 10 year variable interest rate loan. ABC wants to ‘swap’ to fixed rate interest payments for a 3-year term and then see what happens after that.

#### Details of swap:

Start date	31 October 2012	Term	3 years
Rate reset	Monthly (BBSW 30)	Fixed rate	4.00%
Notional amount	\$5,000,000		

ABC enters into the above swap to pay fixed at 4.00% for 3 years and receive variable, reset monthly to BBSW30.

#### At rate reset date of 31 October 2012:

BBSW30	3.5000%
Number of days	30 (to next rate reset date of 30 November 2012)

$$\text{Net settlement amount} = \left( \frac{\text{Fixed Rate} - \text{BBSW}}{100} \right) \times \text{Notional Amount} \times \frac{\text{Number of days}}{3.50}$$

$$\text{Net settlement amount} = \left( \frac{4.00 - 3.50}{100} \right) \times \$5,000,000 \times \frac{30}{365}$$

$$\text{Net settlement amount} = \$2,054.79$$

Net settlement amount at the first rate reset date is calculated as follows:

**ABC Pty Ltd pays \$2,054.79** to Suncorp for the period 31 October 2012 to 30 November 2012 because the fixed interest rate is higher than the variable interest rate.

If interest rates rise above the fixed swap rate on any of the rate-reset dates, ABC will receive a settlement amount from Suncorp. Looking twelve months ahead, let's assume interest rates have risen above ABC's fixed rate.

**At rate reset date of 31 October 2013:**

BBSW30 4.50%

Number of days 29 (to next reset date of 29 November 2013)

Net settlement amount at the first rate reset date is calculated as follows:

$$\text{Net settlement amount} = \left( \frac{\text{Fixed Rate} - \text{BBSW}}{100} \right) \times \text{Notional Amount} \times \frac{\text{Number of days}}{365}$$

$$\text{Net settlement amount} = \left( \frac{4.00 - 4.5}{100} \right) \times \$5,000,000 \times \frac{29}{365}$$

Net settlement amount =  $-\$1,986.30$

**Suncorp pays \$1,986.30 to ABC Pty Ltd** for the period 31 October 2013 to 29 November 2013 because the fixed interest rate is lower than the variable interest rate.

## Risks

**Termination of contract by customer before expiry date might result in an early termination amount, which could be a cost to the customer.** The termination amount cannot be determined until the customer terminates the Swap. A Suncorp Treasury Representative can provide a quote in this regard. Factors effecting the early termination amount include but are not limited to:

- time remaining to expiry date of the Swap, and
- prevailing interest rates (applicable for the remaining term of the Swap) at the time of termination, as compared to the fixed rate of the customer's Swap.

## Credit facility

A customer must have a credit facility with Suncorp before being able to enter into a Swap with Suncorp. This way, if a customer has insufficient funds to settle any amounts owing to Suncorp pursuant to an interest rate risk management product, Suncorp may draw on the customer's credit facility to settle/cover it.

# Interest Rate Swaption

# Product description

Before reading about Swaptions, refer to 'Interest Rate Swap' in the preceding section.

An Interest Rate Swaption ("Swaption") is used by a customer to set a fixed interest rate now, for a future date, without actually committing to an Interest Rate Swap ("Swap") transaction.

By definition, a Swaption gives a customer the right (but not the obligation) to enter into a specified Swap agreement:

- at an agreed fixed interest rate (also referred to as the Swaption "strike rate"),
- for an agreed fixed term, and
- on a specified future date (Swaption "exercise date").

The customer pays a premium for this right and is protected against interest rate rises above the strike rate up to the exercise date of the Swaption.

Examples of where a customer may apply a Swaption:

- there is existing debt and the customer is unsure which direction interest rates will take but wants to retain the flexibility of a variable rate loan, and
- there is a potential requirement for debt in the future and the customer wants to protect against interest rate rises between now and a future date. For example, a customer who has submitted a tender to buy an investment property. The customer may not know the results of the tender for 2 months and therefore does not know if he/she has a requirement for debt or not. To protect against interest rate rises in the next 2 months, the customer could buy a Swaption, with an exercise date in 2 months time.

## How Swaptions work

When a customer buys a Swaption the customer nominates the parameters of the underlying Swap:

- notional amount,
- term,
- interest frequency,
- strike rate, and
- exercise date.

# Possible outcomes at exercise date

**At exercise date, the strike rate is compared to a benchmark rate.** Suncorp uses the SWAPREF rate published by Reuters on every business day, as the benchmark rate. The benchmark rate used for a Swaption depends on the term of the specified Swap. For example if a customer buys a 3-year Swaption, the strike rate will be compared to the SWAPREF 3YR rate published on the exercise date.

If the benchmark rate is higher than the strike rate at exercise date, the Swaption is 'in the money' to the customer, ie it has value. If the benchmark rate is lower than the strike rate at exercise date, the Swaption is 'out of the money' to the customer, and has no value.

**If the Swaption is 'in the money'** a customer can 'exercise' his/her right under the Swaption agreement and either:

- enter into the specified Swap (to pay fixed interest) or
- 'cash settle' the Swaption which means Suncorp pays to the customer's nominated account (as per the customer's standard settlement instructions) a settlement amount for the difference between the strike rate and the benchmark rate.

Before buying a Swaption a customer must nominate how he/she intends to 'exercise' the Swaption, ie enter into the specified Swap agreement or 'cash settle'.

## **If a customer has chosen to receive a settlement amount**

At exercise date, the strike rate is compared to a benchmark rate, SWAPREF. If the benchmark rate is higher than the strike rate at exercise date, Suncorp will pay the customer a settlement amount. The settlement amount is calculated as the difference between the strike rate and the benchmark rate, for the term of the specified Swap. This amount is 'present valued', to take into account that the customer is being paid now for an interest difference which relates to a future period (the term of the specified Swap).

# Swaption Example

Notional amount	5,000,000
Strike rate	3.00%
Benchmark rate	3.25%

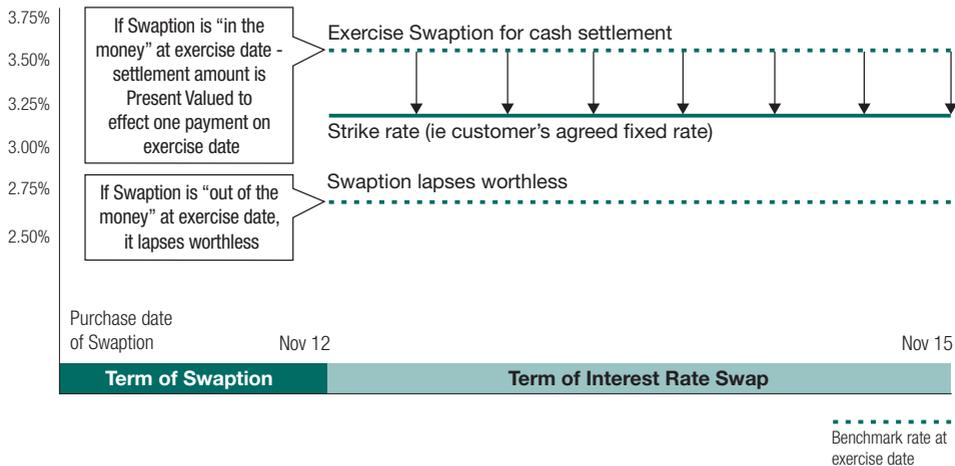
Swaption exercise date	30/11/12
Swap maturity date	30/11/15
Frequency	Quarterly

Settlement amount calculated as follows:

Period start date	Period end date	Cashflow difference	Discount factor	PV
30-Nov-12	28-Feb-13	3,082.19	0.99166	3,056.49
28-Feb-13	30-May-13	3,116.44	0.98389	3,066.23
31-May-13	30-Aug-13	3,116.44	0.97647	3,043.10
30-Aug-13	30-Nov-13	3,150.68	0.96919	3,053.62
29-Nov-13	28-Feb-14	3,116.44	0.96195	2,997.85
28-Feb-14	30-May-14	3,116.44	0.95463	2,975.03
30-May-14	30-Aug-14	3,150.68	0.94720	2,984.33
29-Aug-14	30-Nov-14	3,184.93	0.93967	2,992.78
28-Nov-14	28-Feb-15	3,150.68	0.93202	2,936.51
27-Feb-15	30-May-15	3,150.68	0.92412	2,911.60
29-May-15	30-Aug-15	3,184.93	0.91585	2,916.91
31-Aug-15	30-Nov-15	3,116.44	0.90783	2,829.20
		<b>37,636.99</b>		<b>35,763.65</b>

(Note that a premium is payable upfront. A Suncorp Treasury Representative can provide a quote.)

In the above example Suncorp pays the customer a settlement amount of \$35,763.65 at exercise date, because the Swaption has expired 'in the money' by 0.25%. The actual calculations are more complex than shown in the example. The supplied example is merely to provide a broad illustration of how the settlement amount is calculated. In summary, Suncorp calculates the difference between the cashflows of the underlying swap using (1) the strike rate and (2) the benchmark rate. These cashflow differences are then present valued using discount factors (Refer to 'Some terms explained').



### If a customer chooses to enter into an Interest Rate Swap Agreement

When a customer buys a Swaption, the customer is buying a 'right' and there is no obligation to enter into a Swap at the exercise date.

There are two possible outcomes at expiry date:

- the benchmark rate is lower than the strike rate ('out of the money'). The customer would let the Swaption lapse, and if the customer so chose, enter into a Swap Agreement at the prevailing Swap rate.
- the benchmark rate is higher than the strike rate ('in the money'). The customer can enter into the specified Swap Agreement.

If the customer does not require the Swap the customer can then close out the Swap by entering into an equal and opposite Swap. Suncorp will calculate the present value of the two Swaps and pay to the customer's nominated account (as per the customer's standard settlement instructions) a settlement amount for the net difference in their values.

## Premium

The premium is a once-off upfront cost that will vary depending on:

- strike rate of the Swaption
- term of the Swaption, to exercise date
- parameters of the specified Swap – notional amount, term and interest payment frequency
- market volatility
- the margin

The customer nominates the Swaption parameters as well as the parameters of the specified Swap. A Suncorp Treasury Representative can provide guidance on the parameters when required.

If a credit facility is in place, the premium is due two business days after the deal date. If a credit facility is not in place the premium is due on the deal date.

# Risks

If a customer decides to terminate his/her contract before the exercise date there is the risk that the Swaption could be worth less than the premium the customer paid and possibly zero. Factors affecting the value of the Swaption are the same as those when calculating the premium at the time of buying the Swaption (Refer to 'Premium' above).

## Example

ABC Pty Ltd is tendering for a shopping centre and if successful will be looking to borrow \$5,000,000. ABC will know the tender results in 3 months time. ABC prefers to pay a fixed interest rate and if successful, will be wanting to enter into a 3-year Swap. To protect against interest rate rises in the next 3 months, ABC could buy a 3-year Swaption with an exercise date in 3 months and a strike rate equivalent to the prevailing 3-year Swap rate (forward start in 3 months time).

Details of the Swaption are as follows:

Notional amount	\$5,000,000	Strike rate	3.25%
Swap term	3 years	Exercise date	3 months time

- Prevailing 3-year swap rate to start in 3 months time is 3.25%.

(Note that a premium is payable upfront. A Suncorp Treasury Representative can provide a quote.)

At exercise date, the strike rate is compared to the benchmark rate, SWAPREF 3YR. ABC has elected to exercise its Swaption with 'cash settlement'.

## Possible outcomes on exercise date:

SWAPREF 3YR rate	Result
Below 3.25%	The current 3-year Swap rate is better than the strike rate of 3.25%. ABC can let the Swaption lapse and enter into a Swap at the current Swap rate.
3.25%	The current 3-year Swap rate is the same as the strike rate of 3.25%. ABC can let the Swaption lapse.
Above 3.25%	The strike rate is better than the current Swap rate so ABC can exercise the Swaption and receive a settlement amount for the interest differential.

# Receiver Swaption

The information above outlines 'fixed paying' Swaptions – the customer is buying the right to pay an agreed fixed interest rate.

A Receiver Swaption has the same features as a 'fixed paying' Swaption except that the customer is buying the right (but not the obligation) to receive a fixed rate (and pay floating) for an agreed term and on a specified future date (Swaption exercise date). This product is typically used in combination with a Swap, where the customer is paying a fixed interest rate on the Swap. The Swap and Swaption can be entered into at the same time, but not necessarily. The customer may enter into a Swap and sometime during the term of the Swap, buy a Receiver Swaption.

The objective of this strategy is to give the customer a known fixed rate for an agreed term plus the flexibility to take advantage of a potential fall in interest rates, at an agreed point in time during the term of the Swap.

## Example

ABC Pty Ltd enters into a 5-year Swap to pay fixed (and receive floating) at a rate of 3.50%. At the same time ABC buys a 3-year Receiver Swaption with a strike rate of 3.50% and an exercise date in 2 years time. If economic conditions deteriorate and interest rates fall over the next 2 years, ABC will have the flexibility to take advantage of this fall in interest rates and enter into a Swap to receive a fixed interest rate of 3.50% for 3 years from the exercise date. Details of the example will help to explain how the strategy works:

### Interest Rate Swap:

Notional amount	\$5,000,000	Term	5 years
Start date	30 November 2012	Fixed rate	3.50%

### Receiver Swaption:

Notional amount	\$5,000,000	Swap term	3 years
Exercise date	30 November 2014	Strike rate	3.50%

- Prevailing 3-year Swap rate to start in 2 years time is 3.50%.

(Note that a premium is payable upfront. A Suncorp Treasury Representative can provide a quote.)

## Possible outcomes on exercise date of 30 November 2014:

SWAPREF 3YR rate	Result
Below 3.50%	The prevailing 3-year Swap rate is lower than the strike rate of 3.50% (and ABC's Swap rate). ABC can exercise the Swaption and enter into a Swap to receive a fixed interest rate of 3.50% and pay variable. The net effect when combined with ABC's Swap, is that ABC has switched from paying fixed to now paying variable. ABC may also consider entering into a new Swap.
3.50%	The current 3-year Swap rate is the same as the strike rate of 3.50%. ABC may decide to exercise the Swaption and enter into a Swap to receive a fixed interest rate of 3.50% and pay variable. The net effect when combined with ABC's Swap, is that ABC has switched from paying a fixed rate of interest to now paying a variable rate of interest.
Above 3.50%	The prevailing 3-year Swap rate is higher than the strike rate of 3.50% (and ABC's Swap rate). ABC would let the Swaption lapse.

## Credit facility

A customer must have a credit facility with Suncorp before he/she can buy a Swaption with the right to enter into a Swap. A customer does not need a credit facility with Suncorp for Swaptions which are 'cash settled'.

# General features of Interest Rate Risk Management Products

## Acceptable currencies

Australian Dollars

## Minimum notional amount

Interest Rate Caps	\$500,000
Interest Rate Collars	\$1,000,000
Interest Rate Swaps	\$1,000,000
Interest Rate Swaptions	\$1,000,000

## Term

Terms are usually from 1 month to 5 years. Terms can be longer than 5 years by negotiation.

## Fees and charges

In line with market practice Suncorp applies a buy-sell spread (often called a margin) to its Interest Rate Risk Management products. This margin is the difference between the rate at which Suncorp lends or sells and the rate at which Suncorp borrows or buys. The margin will depend on a number of factors including for example:

- size of transaction
- term of product
- Suncorp's business relationship with the customer
- prevailing market rates.

The margin is not an additional cost but is incorporated in the price or rate a customer is quoted by Suncorp.

## Product is no longer needed

If a customer no longer needs the Cap, Collar, Swap or Swaption, the customer can:

- contact a Suncorp Treasury Representative to arrange the termination of the customer's contract for the remaining term or
- use the product for new or other debt in the customer's name. The debt can be with Suncorp or any other institution.

Terminating a customer's contract before the expiry date may result in an early termination amount, which could be either a cost or benefit to the customer. (See 'Risks' in each product section)

Suncorp is not obliged to terminate a customer's contract before the expiry date and the product can not be traded on a market with any party other than Suncorp.

In the case of a Cap or Swaption, a customer also has the option to hold on to the product even if the underlying loan has been repaid. If the Cap is 'in the money' on any of the exercise dates a customer will continue to receive settlement amounts from Suncorp. Similarly if the Swaption expires 'in the money' the customer will receive a settlement amount.

## How to transact

Contact your Treasury Representative. Please note that instructions by phone, fax, email, post or any other agreed electronic form can only be accepted from an individual properly authorised to give them. An authorised signatory of the product must sign the instructions.

If you are a new customer, we will send you forms that you need to complete, sign and then return the originals to us before you can transact.

## Documents

If a customer is considering entering into a Collar, Swap or Swaption (other than 'cash settled Swaptions):

- Suncorp will send the customer a Derivatives Master Agreement ("DMA") issued by Suncorp Metway Limited, or an ISDA Master Agreement, unless the customer already has one in place.
- **The customer needs to sign the document and return it to Treasury Operations before he/she can enter into any of these products with Suncorp.**
- **The customer may also need to satisfy other requirements that Suncorp may have before he/she can enter into any of these products with Suncorp.**

After a customer buys a Cap, Collar, Swap or Swaption, Suncorp will send the customer:

- an Agreement, which is confirmation of the customer's transaction, no later than the following business day. A customer must sign the original copy within seven (7) business days and return it to Suncorp Treasury Operations at:

Suncorp Treasury Operations 4FI015  
GPO Box 1453  
Brisbane QLD 4001

- a confirmation on each exercise or rate reset date advising the customer of the benchmark interest rate and the settlement amount Suncorp must pay the customer or the customer must pay Suncorp.

If Suncorp does not receive back from the customer a signed Agreement prior to the second exercise or rate reset date in the case of a Cap, Collar and Swap, or by the exercise date of the Swaption, settlement may not be effected or Suncorp may choose to unwind the transaction. In such circumstances Suncorp reserves its rights to seek compensation from the customer where the contract has been cancelled and a loss incurred by Suncorp.

## Taxation

Any settlement amounts paid to the customer, or paid by the customer, may be assessable as taxable income or claimable as a loss in the customer's hands depending on the customer's individual circumstances.

A customer should contact an accountant to discuss the taxation implications of these products.

# How to contact Suncorp Treasury Representatives

For questions about this booklet please contact a Suncorp Treasury Representative:

City	Phone
Brisbane	07 3362 4026

**Postal Address:**

Treasury Operations 4FI015  
Suncorp-Metway Ltd  
GPO Box 1453  
Brisbane 4000

# Some terms explained

The following table defines and explains the meaning of some terms used in this booklet.

Term	Means
AFMA	The Australian Financial Markets Association.
AFSL	Australian Financial Services Licence.
Authorised dealer	The person/s who is/are authorised by a customer to operate the customer's product.
Authorised signatory	The person/s who is/are authorised by a customer to sign for the product and are authorised to change the customer's operating details.
Bank Bill Swap Reference rate (BBSW)	A rate published daily by Reuters and used by banks as a benchmark rate for interest rate risk management products. BBSW rates are published for terms out to 12 months e.g. 1 month ("BBSW1Mth") and monthly to 6 months ("BBSW6Mth"), then 9 months ("BBSW9Mth") and 12 months ("BBSW1Year"). BBSW rates are published daily in the Financial Review for the previous day.
Benchmark interest rate	A rate used as a point of reference for interest rate risk management products.
Business day	A day when banks are open for business in Sydney.
Confirmation	The written advice provided by Suncorp to a customer that is proof of a customer's transaction. It shows details such as the date, name, address, term, notional amount, benchmark rate, strike rate, interest rate, start and end dates.
Contract	The Interest Rate Cap Agreement, or The Interest Rate Collar Agreement, or The Interest Rate Swap Agreement, or The Interest Rate Swaption Agreement.
Credit facility	The facility under which Suncorp has agreed to provide an agreed amount of credit for the customer's use for a set period.
Deal date	The date when the terms of the transaction are agreed.
Derivatives Master Agreement	The Master Agreement for Foreign Currency and Derivative Transactions issued by Suncorp Metway Limited.
Discount factor	A number that is multiplied by a monetary value to reduce an expected future cashflow to its present value.

Term	Means
Exercise dates	A date when the strike rate of a transaction is compared to a benchmark rate.
Expiry date	The date when the terms of a Contract end.
In the money	When the strike rate is better than the current market rate.
ISDA Master	The Master Agreement approved by the International Swaps and Derivatives Association.
Market volatility	A measure of market fluctuations of the underlying instrument of an interest rate risk management product.
Notional amount	A contracted amount used for the purpose of settlement calculations but not physically exchanged.
Out of the money	When the strike rate is worse than the current market rate.
Present valued	Determining what a sum of money to be received in the future is worth today, based on a mathematical formula.
Reuters	Financial information provider.
Strike rate	The agreed rate of a transaction.
Suncorp	Suncorp-Metway Ltd ABN 66 010 831 722, its successors and assigns.
SWAPREF	A rate published daily by Reuters and used by banks as a benchmark rate for interest rate risk management products.
Term	The period of time from start date to Expiry date of a Contract.
Transaction	Any fees, charges, deposits, withdrawals, credit or debit instructions or advice made from or added to a product in any way.

Contact us for more information  
or to change your details:

 **Call 1300 137 359**

**www [suncorpbank.com.au](http://suncorpbank.com.au)**

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