LPA Geistesblitz.
January 2018

Bonus-Deposit with contingent interest reduction

1. Preliminary remarks

In the current EUR interest environment the money market desk is of very different significance depending on the individual situation of the bank. Some banks support the money market sale to a great extent, to strenghten their funding base. They offer attractive interest rates to their clients and recompense their sales departmens generously. A diverse range of products supports their funding efforts.

Alternatives to classic money market Products are relevant…

But even banks with a funding surplus should take a closer look at their product range. Alternatives to the classic products "fixed" and "float" offer the opportunity to earn additional sales commission. This sales commission can partially offset the negative effects of a funding surplus that may not be reducable due to strategic considerations of the bank. The loss of a negative interest margin, due to the deposit of client funds at negative rates way below the client interest can at least be partially recuperated. Thus, the diverse product range is not used to increase the funding position but to improve its rentability.

…for banks with funding need to support their funding efforts …

…for banks with funding surplus, because the sales commissions earned ease its negative effects.

A possible approach is adding optionality to the interest the client receives. The strategy presented in the current "Geistesblitz" offers an attractive Bonus Interest Rate for a 12-month investment horizon in case of stable or rising money market rates.

However, the interest received is reduced disproportionally high, if the 3-month Euribor is fixed at or below the current levels at maturity. This strategy is implemented using floors on a money market rate, in this case the 3-month Euribor. It has been chosen, because corporate clients are most likely familiar with it due to the protection they can offer as guarantor of a minimum rate in plain vanilla swaps.[1] The following Figure 1 shows the evolution of the 3-month Euribor and its floor premiums at a basis price of -0.3000% p.a. over the last zwo years

[1] *The Floor on the receiver side of the swap guarantees a fixed rate in the swap under all circumstances.*

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3-month Euribor stable and floor premiums declining over the last months.

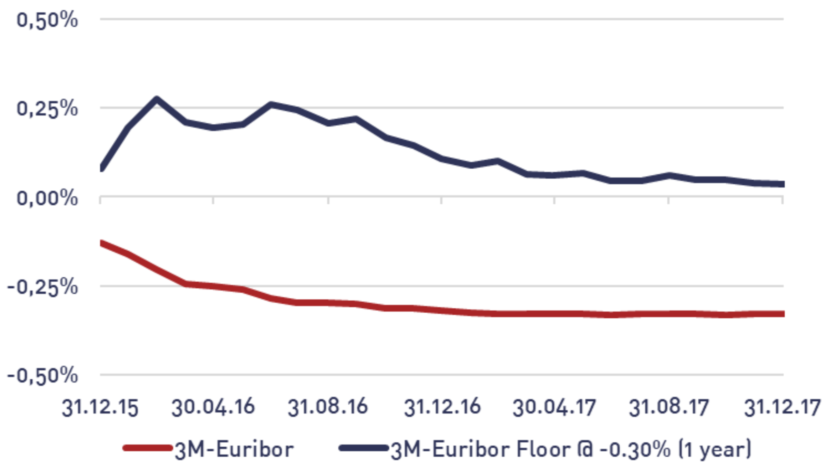

Figure 1: 3-month Euribor and floor premiums[2]

Market data (2nd January 2018):

3-Month Euribor rate:	-0.3290% p.a.
12-Month Euribor rate:	-0.1860% p.a.
Client Interest Rate (exemplary)	0.2140% p.a.

2. Bonus-Deposit with contingent interest reduction

Product description:

Bonus interest rate offers double interest spread on the 12-month Euribor:

The client has an investment need of 12 months. He seeks a deposit with a high return in an environment of stable or rising interest rates. If the 3-month Euribor is considerably lower at maturity, the client is willing to accept a reduced interest rate. However, a minimum interest rate not lower than the 12-month Euribor at closing (-0.1860% p.a.) is mandatory.

Interest rate of 0.6140% p.a. instead of 0.2140% p.a., if 3-month Euribor is at or above -0.3000% p.a. at maturity.

In this example, the client would receive a bank-specific interest spread on 12-month Euribor of appr. 0.4000% p.a. Therefore, the alternative fixed deposit rate for one year is 0.2140% p.a.

In the „Bonus-Deposit with contingent interest reduction" your client receives approximately the double interest spread of 0.8000% p.a. The fixing of the 3-month Euribor occurs once at maturity. Is the 3-month Euribor below -0.3000% p.a., the bonus interest rate is reduced by 5 basis points for every basis point under -0.3000% p.a. However, your client receives a minimum interest rate of -0.1860% p.a. This is the case, if the 3-month Euribor is fixed at or below -0.5000% p.a. at maturity.

[2] *Floor on the 3-month Euribor with basis price -0.30% p.a. and a one year maturity.*

Indicative terms and conditions:

Minimum rate -0.1860% p.a., if the 3-month Euribor is fixed below -0.5000% p.a. at maturity.

Notional:	1,000,000 EUR
Maturity:	08.01.2018 – 08.01.2019
Payments:	In arrears at maturity, act/360
Client receives:	Bonus rate minus contingent interest reduction
Bonus rate:	0.6140% p.a.
Contingent interest reduction:	4 times (-0.3000% p.a. minus 3-month Euribor), max. 0.8000% p.a.
Interest Fixing:	The 3-month Euribor is fixed once at maturity (11.12.2018)

Benefits and Risks from a client perspective:

Bonus rate 0.6140% p.a. is approximately thrice the regular interest rate for one year.

Benefits:

- The bonus rate 0.6140% p.a. exceeds the regular fixed deposit rate considerably by 0.4000% p.a.
- Should the money market rates not develop as the client expects, he achieves at least the minimum rate equal to the 12-month Euribor at closing.

Minimum rate -0.1860% p.a. equals the 12-month Euribor without bank-specific spread.

Risks:

- A fixing of the 3-month Euribor below -0.3000% p.a. at maturity reduces the client interest rate disproportionally high by a factor of 4.
- If the 3-month Euribor is fixed at or below -0.5000% p.a. after one year, the bank-specific interest spread is eliminated completely.
- The sole interest fixing of the 3-month Euribor occurs at maturity. A disadvantage in times of falling money market rates.

Overview of alternative interest rates:

Attractive bonus rates for different interest spreads between 0.2000% p.a. and 0.4000% p.a. as well as beyond.

Interest Spread:	Fixed Rate:	Bonus Rate:
0.4000% p.a.	0.2140% p.a.	0.6140% p.a.
0.3000% p.a.	0.1140% p.a.	0.4500% p.a.
0.2000% p.a.	0.0140% p.a.	0.2500% p.a.

The calculations of the bonus rate are based on a minimum rate of -0.1860% p.a., an interest barrier of -0.3000% p.a. and a factor of 4.

3. In a nutshell

The current Geistesblitz „Bonus-Deposit with contingent interest reduction" is an example of alternatives that clients have besides the regular fixed or floating deposits. The client receives an attractive bonus interest rate, if money market rates develop according to his expectations. Despite the chance for an interest rate "almost thrice"[3] that of a fixed rate, the strategy does not include additional "unnatural" risk categories such as foreign exchange risks. Using floors on 3-month Euribor, the strategy utilizes instruments the client is most likely already familiar with through the minimum rates on the receiver side in plain vanilla swaps.

For questions, feedback or suggestions please contact:

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[3] *The wording „almost thrice" is based on the interest rates 0.2140% p.a. and 0.6140% p.a. Considering the interest spreads 0.4000% p.a. and 0.8000% p.a. it is double the interest rate.*