

Classic Plus Cap Primer

The Classic Plus Cap combines a fixed-rate bullet advance with an embedded LIBOR-indexed interest -rate cap. By embedding an interest-rate cap in the advance, the interest rate paid on the advance will fall if the LIBOR index resets above the strike rate on the periodic reset date. The notional amount of the embedded interest-rate cap can be between one and three times the dollar amount of the advance. The embedded interest-rate cap is in effect over the term of the advance and its premium is included in the advance rate.

With the Classic Plus Cap, a member is able to select the term and a strike rate that will provide additional protection over a regular fixed-rate Classic advance. The selection will depend upon a member's interest-rate outlook and interest-rate risk profile. The rate on the Classic Plus Cap will never be higher than the initial rate, but the interest rate will decrease with any increase in the cap index above the strike rate. This feature can provide members with additional margin relief from sharp increases in short-term interest rates.

Members who would like to have the long-term protection against rising rates that a fixed-rate Classic advance provides, coupled with the potential to decrease interest expense should rates rise, will find the Classic Plus Cap advance a viable funding option to consider.

On each rate adjustment date, the current index rate is compared to the cap strike rate. If the index is above the cap strike rate, the payment on the cap is based on the difference between the two rates multiplied by the notional factor, i.e., the notional amount of the cap as a multiple of the advance amount. The payment on the cap is applied as an adjustment to the initial interest rate for the advance and will be in effect until the next rate adjustment date. In a rising-rate environment, the option will typically gain value and the advance rate will decrease. Whenever the index is below the strike rate, the cap will have no impact on the initial advance rate. The net adjusted advance rate cannot be less than zero percent.

For example, assume a \$10 million 5-year Classic Plus Cap advance with a 2.50% strike rate on an embedded cap with *double* (\$20 million) the notional amount of the advance. Assume three-month LIBOR is 0.37% at the start of the advance and the initial advance rate is 1.28%. The advance rate includes the cost of the cap for double the notional amount of the advance. If three-month LIBOR increases to 3.00% at a rate adjustment date, the member's adjusted advance rate would be reset to 0.28% for the next three-month period, computed as follows:

$$\begin{aligned} & \text{Initial advance rate} = 1.28\% \\ & \text{'Payment' on cap component (if LIBOR exceeds 2.50\%)} = \\ & (\$ \text{ notional amount of cap} / \$ \text{ amount of advance}) \times (\text{current LIBOR} - \text{cap strike rate}) = \\ & (\$20\text{M} / \$10\text{M}) \times (3.00\% - 2.50\%) = 1.00\% \\ & \text{Net adjusted advance rate} = \text{initial advance rate} - \text{'payment' on cap component} = \\ & 1.28\% - 1.00\% = 0.28\% \end{aligned}$$

The Bank has financial strategists who can help members best decide what type of funding meets their specific needs. Please contact a strategist to put together an analysis for your institution. The strategists may be reached at 800-357-3452 or via email at strategies@fhlbboston.com.

A member should review the [Products and Solutions Guide](#) prior to taking an advance so as to understand the terms of the contract and the prepayment provisions. This statement does not purport to disclose all of the risks and other material considerations associated with Classic Plus Cap advances. Members should not construe this disclosure statement as business, legal, tax, or accounting advice from the Bank. Members should consult with their own business, legal, tax, and accounting advisers with respect to Classic Plus Cap advances and should refrain from entering into Classic Plus Cap advances unless they have fully understood the terms and risks of Classic Plus Cap advances.