

Reading 74**PRICING AND VALUATION OF
INTEREST RATES & OTHER SWAPS****1. (A) Its value****Explanation**

As with other derivatives, the price of an interest rate swap (the fixed rate specified in the contract) is typically set such that the value of the swap is zero at initiation.

(Module 74.1, LOS 74.b)

2. (B) borrowing at a floating rate and buying a fixed-rate bond**Explanation**

The investor in the swap will pay the reference rate and receive fixed-rate payments (on a notional principal amount). The net payments can be replicated by borrowing at a floating rate and investing the proceeds in a fixed-rate bond. The payments could also be replicated by taking a floating-rate loan (or issuing a floating-rate bond) and entering a series of FRAs, but these would not necessarily (or likely) be zero-value FRAs; zero-value FRAs would typically not all have the same fixed rate as swap payments do.

(Module 74.1, LOS 74.a)

3. (B) is established at contract initiation.**Explanation**

The price of a swap contract is set such that the contract has a value of zero at initiation. The value of a fixed-for-floating interest rate swap contract may vary over its life as the floating rate changes.

(Module 74.1, LOS 74.b)

4. (A) values at swap initiation that sum to zero.**Explanation**

When replicating a swap with a series of forward contracts, each forward contract is likely to have a non-zero value at initiation, but they can replicate a swap with a value of zero at initiation if the values of the forward contracts sum to zero at swap initiation.

(Module 74.1, LOS 74.a)

