

Collar Advance Primer

I. Product Information

Background

The Federal Home Loan Bank of Boston (the “Bank”) offers the Collar advance, enabling members to create an interest-rate band within which the advance rate will vary. It is usually a cost-effective solution for members seeking protection against higher interest rates.

Characteristics

The Collar advance is a floating-rate, nonamortizing advance containing a combination of an interest-rate cap and an interest-rate floor. Embedded in the advance are a purchased, or “long,” interest-rate cap and a sold, or “short,” interest-rate floor (the “collar”). The interest-rate floor reduces the cost of the interest-rate cap and establishes a minimum rate on the advance. The key feature of the Collar advance is the interest-rate band created, establishing a minimum and maximum advance rate within which the advance rate will fluctuate for the term of the advance. (See below, “How it Works”).

The Collar advance adjusts to either the one- or three-month London Interbank Offered Rate (LIBOR). Collar advances are available in terms of one to 10 years. Interest on a Collar advance is calculated on an actual/360-day basis and is payable on rate-reset dates. The principal on the Collar advance is due at maturity. Typically, Collar advances can be requested until 1:00 p.m. on a Boston and London business day for a second-day (spot) disbursement. Collar advances have a \$10 million minimum but smaller requests may be accommodated in special offerings, which the Bank may offer from time to time. The floating-rate funding is prepayable, in whole or in part, on any rate-reset date without fee with two business-days notice. However, a member may be charged a fee to make the Bank financially indifferent to the member’s decision to unwind the embedded collar feature.

How it Works

For example, a member might take down a Collar advance with a three-year term indexed to three-month LIBOR. In this example, the member establishes a 2.25 percent strike on the interest-rate cap and a 0.50 percent strike on the interest-rate floor. The advance rate in this transaction might be three-month LIBOR plus 86 basis points, for example. Since the strike rate on the cap is 2.25 percent, the maximum advance rate will be 3.11 percent (2.25 percent LIBOR cap strike plus 86 basis points). At the same time, since the strike rate on the floor is 0.50 percent, the minimum advance rate will be 1.36 percent (0.50 percent LIBOR floor strike plus 86 basis points). If LIBOR resets between 0.50 percent and 2.25 percent, neither the cap nor the floor will be “in-the-money,” so the advance rate would adjust to the current LIBOR index plus the spread (86 basis points). The chart below illustrates how an advance with these terms reacts at different LIBOR levels. In this example, the member’s advance rate will never reset higher than 3.11 percent or fall below 1.36 percent.

quarterly, equal to the term of the LIBOR), if it is a Boston business day. If the date is not a business day, the advance will reset on the next business day. The interest rate for each reset date will be based off a two-day look back period, i.e. the Bank will use LIBOR two days prior to each reset date plus or minus the fixed spread. If you would like to find out more about the Collar advance or have additional questions, please call the Money Desk at 800-357-3452.

Members may have to purchase additional activity stock in some cases. The activity stock capitalization requirement on a Collar advance is 4.5 percent.

Uses

Members use Collars advances for different reasons. Liability sensitive (exposed to rising rates) members use Collar advances to manage/mitigate their interest-rate risk as rates rise. They get protection from rising rates typically at a lower cost than by using a Capped Floater advance. Members who are asset sensitive (exposed to falling rates) may choose a Collar advance so that they can take limited advantage of falling rates but still benefit from protection from rising rates. In general, the Collar is a good tool for members to manage balance-sheet interest rate sensitivity within a certain “interest rate band”.

The Bank has financial strategists who can help members decide what type of funding meets their specific needs. If you would like a strategist to put together an analysis, please call the strategists at 800-357-3452 or via email at strategies@fhlbboston.com.

A member should review the [Products Policy](#) and the [Collar advance application](#) 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 Collars 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 Collar advances and should refrain from using a Collar advance unless they have fully understood the terms and risks of the Collar advance.