O B X™

Collar

Situation

XYZ Corporation ("XYZ") operates on a tight budget and wants to fix its $100,000,000 September commercial paper issuance at yields less than 3.50%. It also does not believe that rates will be lower than 2.50% and would be prepared to issue at this rate.

Objective

To fix the rate of a future borrowing within acceptable levels.

Strategy

MARKET CONDITIONS:

September BAX:	97.20

STRIKE PRICE	CALLS			PUTS		
	March	June	September	March	June	September
96.50	1.35	1.13	0.83	-	0.01	0.11
97.00	0.85	0.67	0.45	-	0.05	0.23
97.50	0.37	0.28	0.18	0.02	0.16	0.46

Method:

XYZ will purchase 100 Sept. 96.50 puts and finance it with the sale of 100 Sept. 97.50 calls.

COST :

- Long 100 Sept. 96.50 Puts
  (100 x 0.11 x 100 basis points per contract x $25 per basis point) = ($27,500)
- Short 100 Sept. 97.50 Calls
  100 x 0.18 x 100 basis points per contract x $25 per basis point = $45,000

	Credit	**$17,500**

Results

By replicating an OTC collar, XYZ Corporation will effectively hedge the risk of rising rates above (100 − 96.50) 3.50% while still participating in a potential fall in the rates down to (100 − 97.50) 2.50%, which is the rate at which XYZ is prepared to finance. XYZ accomplished this strategy at a credit of $17,500.00. In fact, the all in cost of financing is reduced by the $17,500.00 credit.