Question #1 of 4

Question ID: 1574483

Which of the following is typically equal to zero at the initiation of an interest rate swap contract?

A) Its value. ✓

B) Its price. ✗

C) Neither its value nor its price. ✗

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)

Question #2 of 4

Question ID: 1574482

An investor could best replicate the position of the floating rate payer in a swap by:

A) borrowing at a floating rate and entering a series of zero-value FRAs. ✗

B) borrowing at a floating rate and buying a fixed-rate bond. ✓

C) borrowing at a fixed rate and entering a series of zero-value FRAs. ✗

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)

Question #3 of 4

Question ID: 1574484

The price of a fixed-for-floating interest rate swap contract:

A) may vary over the life of the contract. ✗

B) is established at contract initiation. ✓

C) is directly related to changes in the floating rate. ✗

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)

Question #4 of 4

Question ID: 1574481

For a series of forward contracts to replicate a swap contract, the forward contracts must have:

A) values at swap initiation that sum to zero. ✓

B) values at swap expiration that sum to zero. ✗

C) values at swap initiation that are equal 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)