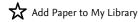
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Isolating the Effect of Day-Count Conventions on the Market Value of **Interest Rate Swaps** 

12 Pages

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## Abstract

Day-count conventions are a ubiquitous but often overlooked aspect of interest-bearing investments. While many market traded securities have adopted fixed or standard conventions, over-the-counter agreements such as interest rate swaps can and do use a wide variety of conventions, and many investors may not be aware of the effects of this choice on their future cash flows. Here, we show that the choice of day-count convention can have a surprisingly large effect on the market value of swap agreements. We highlight the importance of matching day-count conventions on obligations and accompanying swap agreements, and demonstrate various factors which influence the magnitude of day-count convention effects. As interest rate swaps are very common amongst municipal and other institutional investors, we urge investors to thoroughly understand these and other `fine print' terms in any potential agreements. In particular, we highlight the ability of financial intermediaries to effectively increase their fees substantially through their choice of day-count conventions.

Keywords: Day-Count Convention, Interest Rate Swaps

JEL Classification: E4, P43

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