Risks Related to the Use of Benchmarks in Loans

This section shall be read in conjunction with the section entitled “General Risks Related to the use of Benchmarks”.

Loan documentation generally includes provisions intended to address the short-term unavailability of Benchmarks such as LIBOR. If a Benchmark is not available for the required currency and interest period, a waterfall of fallback methods to determine an alternative rate will apply, with the final fallback typically referencing the lender(s) cost of funding.

However, loans may (and often are) specifically negotiated. You should note that your financing may or may not include such a mechanism.

An ultimate cost of funding fallback is intended for situations where there is temporary unavailability of rate, rather than in circumstances where a Benchmark permanently ceases or is otherwise disrupted.

There are public consultations by different industry groups, including the (i) Alternative Reference Rates Committee (ARRC) constituted by the Federal Reserve and (ii) Bank of England to develop new recommended contractual fallbacks that will apply in the event of an IBOR discontinuation. It is expected that new contractual fallbacks will define the events that will trigger the methodology that will determine the fallback rate.

As and when the new recommended fallbacks are finalised, we expect that market participants will (1) adopt them in new transactions, and (2) incorporate them into existing transaction documentation, by way of amendment.

If an alternative Benchmark is used, it is possible that the alternative Benchmark may result in a change to the amounts that would otherwise have been payable under the terms of a transaction as well as its value.

If the alternative Benchmark is an RFR, it may be that the methodology of the interest rate calculation is that the interest is determined at the end of an interest period rather than at the start of an interest period as is the case today.

RFRs in different currencies are being developed at different times. Therefore, the consequences of such developments on affected financial contracts may differ.