

Negative interest rate benchmark implications under syndicated lending documentation

Whilst this has not yet occurred with benchmark rates in Australia, negative interest rate benchmarks are not unknown. The European loan market first grappled with the issue in 2011 when Swiss Franc LIBOR was reported as negative in some circumstances.

Recent activity by European central banks has resulted in a preponderance of negative LIBORs for Swiss Francs and negative LIBORs and EURIBORs for Euro, sparking fresh concern about the potential effect on lending arrangements.

This briefing considers some of the key questions arising for lenders and borrowers in the syndicated loan market, and the implications of a negative interest rate benchmark under syndicated lending documentation.

This briefing assumes that the facility agreement in question follows the recommended form of the Australian branch of the Asia Pacific Loan Market Association and is governed by the laws of a State or Territory of Australia

What is the effect of a negative interest rate benchmark on the interest rate calculation?

The effect of a negative interest rate benchmark will differ depending on whether the facility agreement in question contains a Zero Floor (see box "*Interest rate calculation under syndicated loans*" overleaf).

■ Does contain a Zero Floor

The overall interest rate will be determined by adding the Zero Floor to the margin. The result will be that the interest rate will be the margin. The negative

interest rate benchmark will not have the effect of eroding the margin.

■ Does not contain a Zero Floor

The overall interest rate will be determined by adding the negative interest rate benchmark to the margin. The result will be that the interest rate will be less than the margin. The negative interest rate benchmark will have the effect of eroding the margin.

In the absence of a Zero Floor, is there an implied term to the effect

that the overall interest rate will never fall below the margin?

Unlikely. In Australia, courts have implied terms into contracts to give business efficacy to a contract or where custom or law requires this in particular classes of contracts. Agreements of this nature are not of a class where custom or law requires an implied term of this nature, nor is it necessary for businesses efficacy. The contract is effective without it and the wording clear. Accordingly it is unlikely that a court would imply such a term.

In the absence of a Zero Floor could the overall interest rate be negative?

Yes. Adding the negative interest rate benchmark to the margin could, depending on the figures involved, result in a negative interest rate under the facility.

Does an overall negative interest rate require the lenders to make a payment to the borrower?

In general terms, no. If the overall interest rate itself is negative there will be no requirement in the ordinary course for the lenders to pay the borrower.

APLMA style facility agreements provide only for the payment of interest by the borrower to the lenders and it is unlikely that a court would interpret the relevant provisions (or otherwise imply a term) to mean the lenders pay the absolute value of a negative interest rate to the borrower.

However, it is important to note that transaction specific terms or circumstances might lead to a different conclusion, and the parties would need to take into account all relevant circumstances and connected transactions, including hedging.

Should I include a Zero Floor in future transactions?

The inclusion of a Zero Floor will be a function of the commercial dynamics of the transaction. If a lender's imperative is to prevent potential erosion of its margin as a result of a negative interest rate benchmark, then inclusion of a Zero Floor is likely to be a high priority.

However, other factors may militate against the inclusion of a Zero Floor

(for example, if the transaction involves a corresponding hedging product the inclusion of a Zero Floor could result in mismatches with rates payable under the derivative).

Such factors may outweigh the benefits of margin protection in some cases. Of course the borrower's perspective in any negotiation will also be critical.

Does a negative interest rate benchmark mean that the market disruption provisions will be triggered?

A negative interest rate benchmark will not in itself trigger the market disruption mechanic. The mechanic applies only if a specified proportion of lenders notify the facility agent that their cost of funding the loan exceeds the applicable interest rate benchmark.

Although as a matter of fact a number of lenders might find that their cost of funding the loan exceeds a negative interest rate benchmark (or any Zero Floor), the market disruption provisions will apply only if the required proportion of lenders choose to invoke those provisions by notifying the facility agent that this is the case.

Interest rate calculation under syndicated loans

The interest rate under syndicated loans is typically expressed as the sum of:

- The selected interest rate benchmark (determined in the first instance by reference to an official screen rate); and
- the specified margin.

The calculation may incorporate wording which provides that the applicable interest rate benchmark shall never be less than zero. We refer to this as a "Zero Floor".

Contacts

Sydney

Caroline Jury

Partner

T: +61 2 8922 8035

E: caroline.jury@cliffordchance.com

Scott Bache

Partner

T: +61 2 8922 8077

E: scott.bache@cliffordchance.com

Chad Bochan

Counsel

T: +61 2 8922 8501

E: chad.bochan@cliffordchance.com

Daniel Collins

Senior Associate

T: +61 2 8922 8043

E: daniel.collins@cliffordchance.com

Vicky West

Registered Foreign Lawyer

T: +61 2 8922 8030

E: vicky.west@cliffordchance.com

Nelda Turnbull

Senior Associate

T: +61 2 8922 8031

E: nelda.turnbull@cliffordchance.com

Kate Stevens

Senior Associate

T: +61 2 8922 8063

E: kate.stevens@cliffordchance.com

Perth

Philip Sealey

Partner

T: +61 8 9262 5542

E: philip.sealey@cliffordchance.com

Mark Gillgren

Senior Associate

T: +61 8 9262 5543

E: mark.gillgren@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

HKG#1063351

www.cliffordchance.com

Clifford Chance, Level 16, No. 1 O'Connell Street, Sydney, NSW 2000, Australia; Level 7, 190 St Georges Terrace, Perth, WA 6000, Australia.

© Clifford Chance 2015

Clifford Chance is a law firm with liability limited by a scheme approved under Professional Standards legislation

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta* ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Linda Widyati & Partners in association with Clifford Chance.