Loan agreements: Inclusion of Zero Interbank Offered Rates (“IBOR”) Floors

Summary and key considerations

• The interest rate in our floating rate loan agreements is expressed as the sum of IBOR (determined by reference to an official screen rate, for example LIBOR or EURIBOR) and the margin specified in the loan agreement (the “Margin”).
• Your loan agreement with Barclays will include a zero IBOR floor (“Zero IBOR Floor”). This means that for the purposes of calculating the interest rate, the IBOR rate of your loan agreement will be deemed never to be less than zero.
• Therefore if the IBOR rate is zero or below zero, the overall interest rate under the loan agreement will be equal to the Margin. As such, a negative IBOR rate will not have the effect of reducing the Margin.
• If you are contemplating interest rate hedging for a loan which has a Zero IBOR Floor, consideration should be given to the potential impact on both cash flows and hedge accounting when considering a hedging strategy.

Background

• A period of unprecedented low interest rates and instances of negative rates across global and European markets (JPY, EUR, CHF) has seen increased focus on Zero IBOR Floors.
• The Loan Market Association (LMA) added a Zero IBOR Floor as an option in its standard documentation as a response to these market developments in 2012.
• Since this time, Zero IBOR Floors (and in some instances positive IBOR floors) have been typical in many segments of the loan market (for example in leveraged finance transactions and some EUR denominated loans).
• Following the UK’s EU referendum in June 2016, GBP 3 months LIBOR fell to historic lows and 3 months EURIBOR first dropped below zero percent as early as April 2015.

General interest rate hedging considerations

• Careful consideration needs to be given to a hedging strategy for a loan where the loan agreement contains a Zero IBOR Floor. Entering into an interest rate hedging arrangement (a “Hedging Agreement”) which does not also contain a Zero IBOR Floor matching the relevant loan agreement (an “Unmatched Hedging Agreement”) would lead to higher overall payments being made under the Hedging Agreement if the IBOR rate fell below zero. An example is set out on the next page by way of illustration.
• Having a Hedging Agreement which contains a Zero IBOR Floor matching the Zero IBOR Floor in the loan agreement (a “Matched Hedging Agreement”) may protect against the higher overall payments of an Unmatched Hedging Agreement. However, the Matched Hedging Agreement may be more expensive since you will need to purchase a Zero IBOR Floor.
Additional interest rate hedging considerations

- Your client categorisation for the purposes of the Markets in Financial Instruments Directive ("MiFID") regulation will determine the type of Hedging Agreement that can be offered to you.

- As such, if Barclays categorises you as Retail in accordance with MiFID, we will only offer a Matched Hedging Agreement which, as previously mentioned, may be more expensive.

- You should consult with your advisors ahead of entering into your loan and any Hedging Agreement.

- You may wish to consult with your auditors ahead of entering into any Hedging Agreement as your auditor will determine whether hedge accounting applies.

Next steps

Should you wish to discuss interest rate hedging in more detail, please ask your Relationship Director or another Barclays representative to arrange a call or meeting with a representative from Barclays’ Risk Solutions Group or speak to your hedge provider or hedge advisor.

It is important you fully understand all the terms and details of any loan agreement you may look to enter into and obtain any advice you deem necessary before you sign.
Interest cost scenario analysis

The calculations opposite provide examples of interest costs borrowers would pay if a zero LIBOR floor is included in a GBP loan agreement at various theoretical GBP LIBOR levels.

Numbers quoted assume a 2.00% loan margin, are shown for an individual 3 month interest period (91 days), and are based on a loan amount of £10,000,000.

1. GBP LIBOR above zero – no impact
   Scenario 1: (3M GBP LIBOR at 0.30%)
   Interest Cost without IBOR Floor = £57,342.47
   Interest Cost with IBOR Floor = £57,342.47

2. GBP LIBOR at zero – no impact
   Scenario 2: (3M GBP LIBOR = 0.00%)
   Interest Cost without IBOR floor = £49,863.01
   Interest Cost with IBOR floor = £49,863.01

3. GBP LIBOR at -0.30% – impact £7,479.45
   Scenario 3: (3M GBP LIBOR at -0.30%)
   Interest Cost without IBOR floor = £42,383.47
   Interest Cost with IBOR floor = £49,863.01

4. GBP LIBOR at -1.00% – impact £24,931.51
   Scenario 3: (3M GBP LIBOR at -1.0%)
   Interest Cost without IBOR floor = £24,931.51
   Interest Cost with IBOR floor = £49,863.01

Potential cash flow mismatch example

Where a borrower has an Unmatched Hedging Agreement, a mismatch could occur between the loan and hedge cash flows if the IBOR rate falls below zero.