Risk Disclosure for RFR Loans

The following is provided for general information only. You should conduct your own independent research and analysis regarding the risks involved in conjunction with your legal, tax, accountancy and other advisers. The statements below are not exhaustive. Whilst HSBC monitors the market and updates from regulators as to their expectations, there are events relevant to benchmark rates which are not yet known. Accordingly, HSBC cannot give any statement about the likelihood of any specific outcome or its potential impact on any transaction or client position nor is HSBC providing any advice or recommendation.

What is LIBOR?
The London Interbank Offered Rate ("**LIBOR**") is an interest rate benchmark which has often been used directly or indirectly to determine the interest payable under a loan and/or trade facilities.

What is changing?
LIBOR is the subject of national and international regulatory guidance and reform. Examples of recent regulatory and industry led guidance and proposals include:

- On March 5, 2021, the Financial Conduct Authority ("**FCA**"), the UK financial regulatory authority which regulates the calculation of LIBOR, announced[1]:
    - Publication of the following LIBOR settings will cease immediately following the publication of that LIBOR setting on the dates set forth in the table below.

LIBOR Currency	LIBOR Tenors	Final Publication Date
EUR, CHF	All tenors	December 31, 2021
JPY	Spot Next, 1-week, 2-month and 12-month	December 31, 2021
GBP	Overnight, 1-week, 2-month and 12-month	December 31, 2021
USD	1-week and 2-month	December 31, 2021
USD	Overnight and 12-month	June 30, 2023

    - The following LIBOR settings will no longer be representative and representativeness will not be restored following the Final Date of Representativeness set forth in the table below.

LIBOR Currency	LIBOR Tenors	Final Date of Representativeness
JPY	1-month, 3-month and 6-month	December 31, 2021
GBP	1-month, 3-month and 6-month	December 31, 2021
USD	1-month, 3-month and 6-month	June 30, 2023

[1] https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf

- On March 5, 2021, ISDA confirmed that the announcement by the FCA constitutes an index cessation event for all 35 LIBOR settings. As a result, the fallback spread adjustment is fixed as of the date of the FCA announcement for all euro, sterling, Swiss franc, US dollar and yen LIBOR settings.[2]
- UK regulators have made it clear that all new issuance of GBP LIBOR referencing loan products that expire after the end of 2021 should cease by the end of March 2021.
- US regulators released supervisory guidance encouraging banks to cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable and in any event by December 31, 2021.[3]
- "Risk-Free Rates", also known as "Near Risk-Free Rates" ("**RFRs**"), have been developed as alternative interest rate benchmarks. RFRs are typically backward looking overnight rates based on actual transactions and reflect the average of the interest rates that certain financial institutions pay to borrow overnight on an unsecured basis from wholesale market participants (for unsecured RFRs, such as SONIA) or the average rate paid on secured overnight repurchase or "repo" transactions (for secured RFRs, such as SOFR). RFRs do not include or imply any credit or term premium of the type seen in LIBOR or EURIBOR. However, RFRs are not truly free of risk. RFRs can rise or fall as a result of changing economic conditions and central bank policy decision.

What has HSBC been doing?
In line with the expectations of our regulators and following discussions with a number of our clients we have been developing a range of lending and trade finance products based on RFRs.

Why are we sending this to you?
You have expressed an interest in being provided with one or more lending and/or trade finance product(s) referencing a RFR. As the market and industry conventions for RFRs are continuing to evolve and are new in the context of many lending and trade finance products, we want to outline some of the key differences to loans and/or trade facilities that have previously referred to LIBOR.

<u>The below is not an exhaustive list of changes that may impact you in this regard. You should seek guidance from your own professional advisors in deciding whether a product that references a RFR is right for you.</u>

What are the key differences between LIBOR and RFRs and the associated risks?
The RFR interest rate benchmark for loans and /or trade facilities available in sterling and US dollars is SONIA and SOFR, respectively. For JPY, EUR and CHF the RFR interest rate benchmarks for loans and/or trade facilities are TONAR, €STR and SARON, respectively.

- RFRs are overnight rates based on actual historic transactions. RFRs are published at the end of the overnight borrowing period.
- LIBOR is a 'term rate' which means it is published for different periods of time (*e.g*. 3 or 6 months) and is a 'forward looking' rate which means it is published at the beginning of the borrowing period and remains the same for that period.

Therefore, where your loan and/or trade facility references a RFR it is important to note:

- if using daily RFRs calculated in arrears, the exact amount of interest will only be capable of being determined at the end of an interest period based on a series of overnight rates over that interest

[2] https://www.isda.org/2021/03/05/isda-statement-on-uk-fca-libor-announcement/
[3] https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201130a1.pdf

period. It may be difficult for you to estimate the exact amount of interest payable for an interest period;

- to allow time to calculate and pay interest on products using daily RFRs in arrears, interest will be calculated by reference to the rate that is published a specified number of days prior to each day in the interest period (this is often referred to as a ‘lookback’ or ‘lag’);

- term RFRs are based on forward-looking derivatives (typically Swaps or Futures) on overnight RFRs and therefore include future rate expectations but not interbank credit risk. The quality and stability of a term RFR is a function of derivative market liquidity;

- trade facilities using daily RFRs in arrears do not generally use a lookback or lag with the result that the exact amount of interest due may only be known on the due date which would be debited from the relevant account;

- the overnight rates will fluctuate over the relevant interest period and may behave materially differently from traditional forward-looking interest rate benchmarks such as LIBOR;

- the manner of adoption, calculation and application of RFRs in loan facilities and/or trade facilities may differ compared with the application, calculation and adoption of RFRs in other markets, such as the bond and derivatives markets;

- if you have a multi-currency facility with us you may find that different currencies will use different interest rate benchmarks for calculating interest and the methodologies and conventions for each may differ (*e.g*. a facility with euros and US dollars may utilize EURIBOR for euros and SOFR for US dollars). You should consider the impact this may have on you from an operational perspective;

- if you have a combination of products with us you may find that different products will use different methodologies and conventions for calculating interest (*e.g*. a loan facility may use a simple in arrears methodology while a trade facility may use a forward looking term rate or a simple overnight rate). You should consider the impact this may have on you from an operational perspective;

- using a RFR could mean that amounts payable are lower or higher than using LIBOR. If a loan or trade finance facility references a RFR instead of LIBOR, there may be differences to the economics over the duration of the loan or trade facility and you should ensure you speak to your advisers to understand this;

- for LIBOR loans transitioning to a RFR, a spread adjustment may be added to the RFR and the level of this may vary depending on several factors, including, but not limited to, the calculation methodology and the interest period selected;

- RFR conventions will likely require your internal treasury, accounting and/or payment systems to be enhanced in order for you to manage these products in an accurate, efficient and timely manner; and

- future changes to market practice or conventions relating to the use of daily RFRs or term RFRs in loan and/or trade finance facilities could potentially be adverse to your interests, and/or require changes to the documentation or to other administrative and operational changes which could result in you incurring additional costs.

What are the key differences between Term SOFR and daily SOFR in arrears (for US dollar facilities)?

- Forward-looking SOFR term rates are based on market expectations implied from derivatives markets, not the financing transactions that back overnight SOFR rates. [4] SOFR term rates can be produced in all market conditions including periods of heightened market volatility or negative interest rates;[5]

- SOFR term rates are known in advance of the interest period, similar to LIBOR-based loans, therefore most of the loan conventions can be similar to LIBOR loan conventions[6] and they will be calculated and published daily in 1-month, 3-months and 6-months tenors;

- the CME Term SOFR Reference Rates were endorsed by the Alternative Reference Rates Committee ("**ARRC**") as the recommended Term SOFR Rate. The ARRC recommended best practices for the use of Term SOFR supports the use of Term SOFR in business loans and trade finance and for certain securitizations that hold underlying business loans or other assets that reference Term SOFR; however, the ARRC recommends that any use of Term SOFR derivatives be limited to end-user facing derivatives;[7] and

- the adoption, calculation and application of Term SOFR in a facility could result in differences to the economics over the duration of that facility and mean that amounts payable are lower or higher than using daily SOFR (simple or compounded in arrears) or another interest rate benchmark which was previously or is currently available or may be available in the future. You should ensure you speak to your advisers to understand the potential impact.

What happens if the RFR becomes unavailable?

The facility may include fallback provisions intended to address the unavailability of a RFR as an interest rate benchmark. The fallback will vary by jurisdiction and might result in changes to the amounts payable under the facility. Such amounts might be lower or higher than would have been payable if the RFR had applied and might operate in a different way to the RFR.

What should I do in relation to hedging?

If the methodology to calculate the RFR in the facility does not align with the methodology used in the hedging product, or if any fallbacks that might apply to the facility if a RFR is no longer available might not be the same as the fallbacks in any hedging product that you might be using, then this could result in the facility ceasing to be hedged appropriately by that product. Furthermore, in the event of a restructuring or termination of any associated hedging product(s) you have with HSBC or another hedging provider, a payment may be due from you to HSBC or that hedging provider. Such payment may be significant.

What should you do if you have any questions?

HSBC is unable to provide you with any specific advice or recommendations on this issue. We strongly recommend you seek guidance from your usual professional advisers if you have any questions.

If you have questions or would like to receive further information, please contact your relationship manager.

[4] https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/20210420-term-rate-key-principles
[5] https://www.cmegroup.com/market-data/files/cme-term-sofr-reference-rates-faq.pdf
[6] https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/Term_SOFR_Avgs_Conventions.pdf
[7] https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/ARRC_Scope_of_Use.pdf