

## **Risk Disclosure for Interest Rate Swap (IRS)**

## **PRODUCT DESCRIPTION**

Interest Rate Swap (IRS) is an agreement between two parties to exchange interest payments, based on the notional principal amount, over an agreed period of time. All cash flows and payments are denominated in the same currency as the notional principal amount.

Customers may use IRS to hedge their interest rate risk, which typically arises from having an underlying outstanding loan, such that the interest payments may be swapped from one rate to another rate such as a fixed rate to a floating rate or vice versa.

For example, borrowers may use IRS to hedge their interest risk exposure, i.e., to convert floating rate into fixed rate, in a market where interest rate is expected to rise. Also, fixed rate borrowers would use IRS to convert fixed rate into floating rate to take advantage of lower interest rates where interest rate is expected to fall.

## **Potential Client**

- The client who has floating rate loan can convert the floating interest rate into a fixed rate to minimize interest rate risk to protect business against interest rate volatility.
- The client who has fixed rate loan can convert fixed rate loan into floating loan to potentially reduce the interest rate cost. However, the client will face the risk as it will need to pay higher interest rate if floating interest rate moves higher.

## **Transaction process**

If the client would like to enter into Interest Rate Swap (IRS) with the bank, the client is required to follow the steps below:

1. The client contacts the Relationship Manager (RM) for credit line set-up, and signs the product risk disclosure.
2. The bank sends the indicative IRS rate to the client.
3. After the client agrees with the IRS rate, the client will receive initial confirmation via email and the client will need to sign such confirmation or reply the email to confirm the transaction.
4. The client will then receive a formal long-form confirmation or short-form confirmation, and will need to sign and return the confirmation back to the bank with authorized signatures.

## **Required documents for transaction**

- Know your customer form (KYC) and Client Suitability form
- Product risk disclosure with authorized signature from the clients
- Underlying documents (if required by related regulations)
- Initial confirmation
- Long form/ Short form confirmation with authorized signature from the clients

## **Termination Process, Cost and associated Risk(s)**

In case the client informs the bank of its intention to terminate the contract, the bank will thoroughly consider the justification provided by the client and related regulations. In the event such termination is agreed upon by the bank, the client will bear the risk that there may be gain or loss based on the market value on the termination date and associated costs. The changes in market conditions may adversely impact the termination cost paid by the client.

## **RISK DISCLOSURE STATEMENT**

### **IMPORTANT NOTICE**

**THIS NOTICE DOES NOT PURPORT TO DISCLOSE OR DISCUSS ALL OF THE RISKS AND OTHER SIGNIFICANT ASPECTS OF ANY TRANSACTION. IT IS THE CLIENT'S SOLE RESPONSIBILITY TO DETERMINE WHETHER ANY TRANSACTION IS SUITABLE FOR ITSELF AND TO SEEK RECOMMENDATION FROM THE CLIENT'S OWN INDEPENDENT ADVISORS TO REACH SUCH CONCLUSION IF NECESSARY.**

#### **1. CONTRACTUAL TERMS**

The client has the responsibility to fully understand the terms and conditions of the Transactions to be undertaken including, without limitation, (a) the terms as to Rate, Term, Settlement Dates, Business Days, and other terms material to the Transaction; (b) the circumstances under which the client may become obliged to make or take delivery of the underlying interest of the Transaction; and (c) the legal risks surrounding the Transaction including, but not limited to, the circumstances under which the Transaction may be illegal, resulting in it being void and unenforceable.

#### **2. SEVERAL INSTRUMENT TRANSACTIONS**

Where a Transaction is made up of several instruments, the client should be aware that there is a risk associated with each instrument evaluated separately and a risk of the Transaction evaluated as a whole. As such Transaction is usually executed over-the-counter, the client should be aware that it may be difficult to liquidate an existing position of, determine a fair price for, or assess the client's exposure to risks under, such Transaction. This uncertainty should be factored in by the client in the overall consideration of the potential impact on the client's investment in the Transaction.

#### **3. MARKET RISKS**

The client's payments or receipts under a Transaction will be linked to changes in the particular financial market or markets to which the Transaction is linked, and the client will be exposed to price, currency exchange, interest rate or other volatility in that market or markets. The client may sustain substantial losses on the contract, trade, product or financial investment if the market conditions move against the client's positions.

It is in the client's interest to fully understand the profit/loss impact of market movements and the extent of loss if the client has to liquidate a position if market conditions move against the client. The lack of market transparency, liquidity and efficiency may subject the Transaction and the parties involved to high volatility and large price differences.

#### **4. LIQUIDITY RISKS**

Under certain market conditions the client may find it difficult or impossible to liquidate a position, assess a fair price or assess risk exposure. This can happen, for example, where the market for a Transaction is illiquid or where there is a failure in electronic or telecommunications systems, or where there is the occurrence of an event commonly known as "force majeure" (which shall include, without limitation, any form of restriction, moratorium or suspension on trading imposed by an exchange, market or other authority regulating trading of the Transaction).

#### **5. TAX RISKS**

Before entering into any Transaction, the client should understand the tax implications of doing so, e.g., income tax. Different derivatives transactions may have different tax implications. The tax implications of Transaction are dependent upon the nature of the client's business activities and the Transaction in question. The client should, therefore, consult a tax adviser to understand the relevant tax considerations.

#### **6. COUNTERPARTY RISKS AND CONFLICT OF INTEREST**

The client must note that the bank deals with the client at arms-length as a counterparty. The bank is not the client's fiduciary. Any dealing, trading or engagement or Transaction with the bank by the client could result in a loss to the client and a gain to the bank.

## 7. NON-TRANSFERABILITY AND NON-MARKETABILITY

Generally, a Transaction is not assignable or transferrable without a prior consent of the other party. The bank is not obliged to repurchase a Transaction from the client because the Transactions are customised and not fungible. The client acknowledges that engaging in a Transaction with another dealer to offset a Transaction that the client has entered into with the bank will not automatically close out those positions (as would be true in the case of equivalent exchange-traded futures and options) and will not necessarily function as a perfect hedge.

## 8. RISKS NOT COVERED IN THIS DOCUMENT

The following risks which are not strictly related to the Transactions are not covered in this document:

**Country risks.** A country risk can arise if a country hinders currency trading by imposing economic sanctions or currency restrictions; and

**Economic risk.** In particular, the impact of the global economy and the bigger nations on the world economic market which impact on interest and inflation rates.

*This document also does not deal with the issues of taxation or any other legal consequences pertaining to the Transactions (e.g. duties of disclosure) as these issues are very often dependent on the client's individual situation. The bank recommends that the clients contact their tax specialist or lawyer.*