Copenhagen, September 2019

Dear Customer of Danish Ship Finance

Changes to interest rate benchmarks and discontinuance of LIBOR

As you may already be aware the world of interest rate benchmarks is going to change. Certain existing dominant and long-used inter-bank offered rates (IBORS) such as EURIBOR and LIBOR are likely to be restructured (hybrid EURIBOR) or may disappear altogether (LIBOR) as a result of i.a. the new European Benchmark Regulation (EU)2016/1011) and market forces originating from the LIBOR review in 2012. Loans charging interest based on LIBOR need a replacement reference rate **and loan agreements must provide for a way to make such replacement.** The reason being that while existing loan agreements already contain a market disruption clause or a cost of funds fallback to LIBOR's unavailability, these protections are intended as short-term fixes and not permanent solutions.

Current documentary solutions and how this may affect your loan documentation

The purpose of this note is thus to let you know that such interest rate benchmark reform/discontinuation may affect your existing as well as new loan documentation being entered into prior to 2022 to the effect that such loan-, and security documentation may need to be amended to provide for the inclusion of a new replacement benchmark rate plus credit adjustment spread (cf. explanation below) once agreement is reached in the different financial markets (loans, derivatives and bonds) as to the use of a specific benchmark rate, credit adjustment spread calculation methodology, fallbacks, market disruption clauses and timetable provisions etc. for the relevant financial product.

In the interim while we await the replacement reference rate we may ask that existing loan agreements (by way of an amendment) as well as new loan agreements (by way of first time inclusions) shall include the Loan Market Association's (LMA) *replacement of screen rate clause* which operates as a *placeholder* in that it contemplates the incorporation of a new interest rate benchmark once known. Conceptually it provides a framework for the replacement of LIBOR and enables the parties to transition the loan documentation to the new world of interest rate benchmarks to include the *actual* replacement interest rate benchmark as well as the relevant supporting infrastructure which amendment may take the form of the LMA's reference rate selection agreement which is currently being prepared. Additionally - depending on the governing law of the ship mortgage - the relevant supporting ship mortgage may also need to be amended.

Why and what

A catalyst for this development was the speech by Andrew Bailey, Chief Executive of the UK Financial Conduct Authority on 27 July 2017 in which he announced that the FCA will no longer encourage or compel panel banks to submit to LIBOR post-2021 to the effect that market participants cannot rely on LIBOR being available after 2021 – at least not in its current form.

The reason for this development is in essence that the thinness of the interbank lending market has caused the panel banks submitting to LIBOR to rely on their own "expert judgements" in order to be able to make their submissions to the effect that LIBOR has become the exact opposite of what it was originally intended to be – transactions based - as the interbank market now relate to a very thin market as banks have turned to alternative funding sources.

The FCA has therefore called on the market to work towards finding an alternative rate and/or alternative calculation methodologies and to transition away from LIBOR by the end of 2021. This period is intended to enable an orderly transition across the different financial markets.

Alternatives to (L)IBORS

So, what will the replacement rate for LIBOR be? The starting point for the answer is alternative risk-free rates (RFRs) which are stated to be risk-free (as they do not contain either a term liquidity premium or a bank credit risk element) robust, overnight rates published daily based on transactions in a liquid market. In order to be suitable in the loan market, term versions of these overnight rates are required. The two main methods of achieving such term rate are:

(a) forward-looking term rates based on overnight index swaps (“OIS”) or future markets referencing the RFRs; or

(b) compounding or averaging the overnight rates over a period to provide backward-looking term rates.

Work related to creating (a) is ongoing, however, a forward-looking term rate will be long in coming and may not be available in time end-2021 or available at all.

With respect to (b) several challenges need to be worked out in order to adapt RFRs to the loan (cash) markets including without limitation the determination of an appropriate credit adjustment spread to enable the RFRs use as a replacement for LIBOR.

If you have any questions on the above referenced matter please do not hesitate to contact your Senior Relationship Manager as well as dive into the numerous articles, briefings, reports etc. made available on the internet by market participants and trade associations.

Yours sincerely

Danish Ship Finance