STRATEGIES FOR MANAGING INTEREST RATE RISK

Managing interest rate risk is important, as it allows you to manage the potential upside and downside resulting from interest rate movements in a way that works with your cash flow and other financial obligations. With the Prime interest rate touching levels last seen in August 1979, RMB Private Bank has received a number of client queries on the feasibility of fixing the rate on their facilities.

Read more

At RMB Private Bank, we have two products that allow you to effectively manage this risk – a Fixed Rate or a Capped Rate loan.

Deciding to fix
The Fixed Rate Loan (FRL) allows you to fix a portion of your facility at a particular rate for a specified period, regardless of any movements in the Prime interest rate. This protects you from an increase in the Prime rate, but conversely does not allow you to participate in the benefit of a decrease in the Prime rate.

For example, it is possible to fix 90% of your facility for a period of two years. This means that you can contract a rate, with specific repayments that have to be made every month, regardless of the overall utilisation of your facility, or changes in the Prime interest rate. There are a number of advantages and disadvantages to fixing your loan:

Pros
1. You want regular repayments with no surprises.
2. You have a regular or fixed income with which to service the debt (e.g. rental income is fixed regardless of interest rate movements).
3. You want protection from rising interest rates.

Cons
1. Any extra payments will not go towards the fixed portion of the loan, but rather towards the variable portion.
2. If interest rates decrease, you will not receive the benefit of the downward movement.
3. You cannot settle the loan earlier than the agreed term, for example, if you sell the property taken as security on the fixed.
4. You have no transactional access to the amounts that are fixed, (i.e. no additional deposits or withdrawals are possible on the fixed portion).

Opting to cap
The RMB Private Bank Capped Rate Loan is a suitable for managing short to medium-term interest rate risk by offering protection if interest rates should rise above a pre-determined ceiling. So long as interest rates remain below that ceiling, you pay only the going market rate. The Capped Rate Loan (CRL) enables an individual or entity with borrowing requirements to protect against increasing interest rates while retaining the right to benefit from decreasing interest rates. This product is offered as an alternative to the Fixed Rate Loan. A CRL is always based on a Single Facility (SF) or Single Credit Facility (SCF). It allows you to set a cap on the interest rate charged on a portion or on the whole of the SF or SCF. The client will pay the lower of the facility rate or the capped rate.

When the FNB prime rate increases above the capped rate, you will pay the capped rate. When the FNB prime rate decreases to below the capped rate, you will pay the rate applicable to your facility.

Why would you use a Capped Rate Loan?

- You may anticipate that due to certain market conditions the RMB Private Bank facility rate will increase significantly and negatively impact your cash flow.
- You want the ability to control the maximum payment amount required on your loan and effectively manage your cash flow.
- You want the flexibility of transacting against the capped portion of your facility.

An upfront fee is payable to secure a capped rate on either a portion of the loan or on the full loan.

For more information, or to obtain a quote on either of these products, please contact the RMB Private Bank Service Centre on 0860 67 4446, or your banker.