IFC and Local Currency Financing
The Case for Local Currency Financing

Private sector lending in developing countries has often been in the form of loans denominated in foreign currency like dollars or euros. The general lack of long-term local currency financing meant that some entities, such as infrastructure projects and small businesses, were either unable to obtain financing, or they received foreign currency loans at their own risk.

Frequently, currency risk has been passed on to other borrowers. For example, a domestic bank that obtained funding in euros would, in turn, offer euro loans to its end borrowers whose revenues were in local currency. Or, a sanitation project financed in dollars might have charged local consumers dollar-indexed fees for water and sewage services.

Currency mismatches were sometimes considered acceptable because of the perceived stability of the local exchange rate. However, a decade of financial crises in emerging markets has demonstrated that currency markets can be unexpectedly volatile. Firms that borrow in currencies different from those of their revenues are ultimately gambling. Prudent firms prefer to concentrate on their core businesses and avoid currency bets.

IFC views local currency financing as part of sustainable private sector investment. Moreover, the availability of local currency financing is crucial for sectors that underpin development: infrastructure, housing and smaller businesses.

While local currency financing is in itself an important development objective, the mechanisms through which the local currency is provided are equally important. Market-based approaches to enabling local currency financing include use of local swap markets and structured product solutions to help clients gain access to local bank and capital market funding.

Market-based mechanisms are important because they promote development of local capital markets. In the long run, these markets enable developing economies to finance their own investment.

IFC’s innovative financial solutions leverage IFC’s expertise in core Treasury functions. In particular, IFC’s funding activities have positioned it as a pioneer in developing emerging capital markets. To date, IFC has borrowed in 38 currencies and has been the first nonresident to issue debt denominated in Chinese renminbi, Brazilian reais, West African CFAs, Peruvian soles, Singapore dollars, Moroccan dirham, and Malaysian ringitt in the domestic markets.

FIGURE 1: Emerging Markets Can Be Very Volatile...

FIGURE 2: IFC’s Strategic Focus—Customized Products

CLIENT/PRODUCT MATRIX

- Infrastructure, Large Corporates, Financial Institutions, and Municipalities (e.g. Local Currency Loans and Guarantees)
- Large Exporters, some Large Corporates, and Financial Institutions (e.g. Dollar Financing)
- Mortgages, SMEs and Consumer Loans (e.g. Local Currency Securitization)
- SME Exporters (e.g. Cross-Border Securitization)

Asset Size

FX Earnings
How IFC Provides Local Currency

As an internationally rated AAA institution, IFC leverages its powerful credit to provide customized local currency products to private sector clients. The local currency can come directly from IFC in the form of a local currency loan or swap. IFC also mobilizes other sources of local currency, like local banks and capital markets, through credit enhancement. Whether the client prefers senior debt, quasi-equity, funding from IFC or from some other source, IFC stands ready to provide flexible, market-based instruments.

From 2000 to 2008 (YTD), IFC has committed over US$5.7 billion equivalent in local currency financing for 221 projects in 31 currencies. Of this, IFC has used derivatives to provide local currency financing for 152 projects in 21 countries for over US$4.8 billion. Through structured and securitized products, IFC has completed 69 local currency transactions in 23 countries, and mobilized a total of US$4.2 billion with IFC credit exposure of US$900 million.

TAMWEEL, THE WORLD’S FIRST SHARIAH-COMPLIANT RESIDENTIAL MORTGAGE BACKED SECURITIZATION (RMBS) TRANSACTION

To remain competitive as one of the largest originators of housing finance in the United Arab Emirates (UAE), Tamweel needed additional funding at a reasonable cost. At the same time, there was a strong demand from Gulf Cooperation Council (GCC) investors looking for products compliant with Islamic strictures. A securitization transaction was an attractive solution, as it bridged Tamweel’s funding needs with Islamic investors’ demand for Shariah-compliant investment products.

Through provision of a US$20 million mezzanine-level investment and active participation as a structuring investor, IFC’s assistance enabled Tamweel to obtain the highest rating to date from an international rating agency on any debt issuance from the UAE. It also helped GCC-based investors through the provision of a Shariah-compliant, fixed-income investment product. The merging of traditional Shariah structures with modern conventional finance represents a significant step forward in the evolution of Islamic finance and the Tamweel transaction serves as a useful benchmark for future Islamic-finance compliant securitizations. The transaction was the first mortgage-backed securitization from the UAE and the first true, Shariah-compliant securitization with mezzanine tranches. In recognition of this issue’s innovations, Tamweel received the Deal of the Year Award 2008 from Euromoney Islamic Finance Awards.
Local currency financing through loans or swaps is made possible through the existence of a derivatives or swap market. Existence of a long-term swap market between the local currency and dollars permits IFC to hedge the loans it makes in local currency, and to provide risk management products tied to the loan currency. IFC works closely with market counterparts and government regulators to expand the availability and liquidity of these markets.

IFC’s local currency loans may carry a fixed rate or a variable rate, based on the preference of the client. Variable-rate loans depend on the availability of a liquid, local reference interest rate, usually a short-term interbank lending rate or government securities rate. The repayment terms for local currency loans are customized to meet the needs of the client. IFC can currently provide long-term local currency loans in over 30 emerging market currencies.

An overlay currency swap allows IFC clients to transform existing or new foreign currency liabilities into local currency. The foreign currency liability could be from any third-party source such as a bank loan or bond issue. The currency swap can be tailored so that currency payments from IFC to the client exactly offset currency payments owed by the client under the original foreign currency loan. IFC provides clients with hedging instruments, via synthetic local currency financing, that otherwise would not be available for companies with their credit profile.

In fiscal year 2008, IFC committed its first local currency loans in Argentina, Ghana, and Zambia, and has been particularly active in providing financing in Brazilian reais, Russian rubles, and South African rand. IFC not only uses existing derivatives markets to provide local currency products, but also works with swap dealers to extend the maturities of derivatives markets, and uses offshore investor interest to structure swap-based local currency loans in new markets.

**Derivatives-Based Products**

In Nigeria 74 percent of health expenditures are private, mostly taking the form of out-of-pocket payments. The inefficiency of out-of-pocket spending for health care and the potentially impoverishing effects of such spending on individuals without health insurance are well known.

Hygeia Nigeria Limited, a private provider of hospitals and Health Maintenance Organization (HMO) services in Nigeria, was founded in 1984 as a multi-specialty hospital in Lagos. Over time, the company has evolved into an integrated health care services group with an HMO, three hospitals in Lagos, 25 worksite clinics and a network of over 200 clinics across the country.

In 2006, Hygeia was interested in borrowing money to finance an expansion and renovation of its hospitals and to improve its HMO business. Historically, Hygeia has borrowed in dollars and was exposed to significant currency risk. From 2000 to 2003, the Nigerian naira depreciated by over 40 percent relative to the U.S. dollar. Since 2003, it has appreciated over 15 percent relative to the U.S. dollar. As currency markets can be extremely volatile, it is important to link a company’s revenues and liabilities to the same currency. Hygeia was seeking long-term local currency debt, which was scarce in a market where sources of any kind of long-term debt financing are limited.

Using derivatives, IFC provided Hygeia with a loan of 390 million Nigerian naira (US$3 million). The swap used to fund this loan was the longest maturity currency swap in the Nigerian naira market to date, and is expected to pave the way for more long-term naira/dollar swaps, leading to more local currency investments.

**LOCAL CURRENCY FINANCING FOR HEALTH CARE IN NIGERIA**

In Nigeria 74 percent of health expenditures are private, mostly taking the form of out-of-pocket payments. The inefficiency of out-of-pocket spending for health care and the potentially impoverishing effects of such spending on individuals without health insurance are well known.

Hygeia Nigeria Limited, a private provider of hospitals and Health Maintenance Organization (HMO) services in Nigeria, was founded in 1984 as a multi-specialty hospital in Lagos. Over time, the company has evolved into an integrated health care services group with an HMO, three hospitals in Lagos, 25 worksite clinics and a network of over 200 clinics across the country.

In 2006, Hygeia was interested in borrowing money to finance an expansion and renovation of its hospitals and to improve its HMO business. Historically, Hygeia has borrowed in dollars and was exposed to significant currency risk. From 2000 to 2003, the Nigerian naira depreciated by over 40 percent relative to the U.S. dollar. Since 2003, it has appreciated over 15 percent relative to the U.S. dollar. As currency markets can be extremely volatile, it is important to link a company’s revenues and liabilities to the same currency. Hygeia was seeking long-term local currency debt, which was scarce in a market where sources of any kind of long-term debt financing are limited.

Using derivatives, IFC provided Hygeia with a loan of 390 million Nigerian naira (US$3 million). The swap used to fund this loan was the longest maturity currency swap in the Nigerian naira market to date, and is expected to pave the way for more long-term naira/dollar swaps, leading to more local currency investments.
Gaining access to reliable energy is crucial for the economic development of a rural population as it improves education, health, and productivity. The provision of electricity to low-income households permits increased opportunities for studying in the evenings, and also improves the efficiency of agricultural and micro-enterprise activities. In addition, the social benefits from electrification – the ability to power light bulbs, radios, small appliances and televisions – make a significant contribution to enhancing quality of life.

Maranhão is one of the poorest states in Brazil with nearly 60 percent of its 6.2 million inhabitants living below the poverty line. The residents of Maranhão are in need of access to reliable electricity; their current electricity access rates are approximately 80-85 percent compared to over 97 percent for all of Brazil. Companhia Energética do Maranhão (CEMAR) is the electricity distribution company operating in Maranhão and is focused on expanding access to electricity throughout the rural areas of the state. Since 2004, CEMAR has been the implementing agency for Brazil’s government sponsored Light for All Program in Maranhão. CEMAR has already connected over 125,000 customers and is working to connect an additional 145,000 customers by the end of 2009.

CEMAR was seeking long-term financing in Brazilian reais to rehabilitate, expand and modernize its electricity distribution system and its access to long-term local currency financing was limited. The bond market in Brazil and local banks were offering shorter financing than CEMAR required. Through the use of derivatives, IFC was able to provide a long-term loan with the flexibility, size, and interest rate that CEMAR needed. In the beginning of 2008, IFC disbursed an US$80 million equivalent loan for 8 years to CEMAR to help fund its investment in Maranhão’s electricity infrastructure.

### FIGURE 4:
**IFC’s Derivatives-Based Products 2000-2007: Selected Transactions**

<table>
<thead>
<tr>
<th>CURRENCY</th>
<th>COMPANY</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazilian Reais</td>
<td>Banco Daycoval S.A.</td>
<td>A US$30 million Reais-linked loan to a bank focused on small and medium enterprises in the less developed regions of Brazil</td>
</tr>
<tr>
<td>Colombian pesos</td>
<td>Corporación Mundial de la Mujer Medellín</td>
<td>Fixed-rate financing that will enable a microfinance institution to provide an additional 5,000 loans</td>
</tr>
<tr>
<td>Indian rupees</td>
<td>Allain Duhangan</td>
<td>A 13-year rupee loan to expand hydro-electric generation capacity in the northern region of India</td>
</tr>
<tr>
<td>Mexican pesos</td>
<td>Compania Tratadora de Aguas Negras de Puerto Vallarta</td>
<td>Currency swaps for a wastewater treatment plant to hedge variable rate dollar loans into fixed rate pesos</td>
</tr>
<tr>
<td>Philippine pesos</td>
<td>Asian Hospital Inc.</td>
<td>A 10-year fixed-rate peso loan that will enable a privately owned hospital to upgrade and expand its facilities</td>
</tr>
<tr>
<td>Russian rubles</td>
<td>Chuvashavtodor</td>
<td>A US$50 million equivalent loan to finance the development of rural access roads and the rehabilitation of major regional roads</td>
</tr>
<tr>
<td>Romanian lei</td>
<td>Procredit Romania</td>
<td>Financing to a microcredit institution that will provide local currency funding to micro, small and medium enterprises</td>
</tr>
<tr>
<td>South African rand</td>
<td>Blue Financial Services Limited</td>
<td>Long-term rand loan to provide consumer-finance products to low-income segments of Botswana, South Africa and Zambia</td>
</tr>
<tr>
<td>Turkish lira</td>
<td>YUCE Private Education and Cultural Services Inc.</td>
<td>Fixed-rate lira financing to help expand and modernize a high school and vocational institute</td>
</tr>
<tr>
<td>Vietnamese dong</td>
<td>Saigon Thuong Tin Commercial Joint Stock Bank</td>
<td>Longest-to-date swap in the Vietnamese dong market to provide funding for a mortgage finance business</td>
</tr>
</tbody>
</table>
Structured and Securitized Products

IFC has developed four primary structured and securitized products to assist clients in obtaining local currency funding: partial credit guarantees, securitization credit enhancements, risk sharing facilities, and local currency loan provision through the recently implemented Matching Assets Through Currency Hedging (MATCH) facility. Mobilizing local currency through local banks or bond markets allows domestic borrowers to reduce or eliminate the exchange-rate risk associated with borrowing in foreign currency.

PARTIAL CREDIT GUARANTEES
IFC can provide local currency-denominated credit enhancement in most countries through partial credit guarantees. The partial credit guarantee product covers all interest and principal payment shortfalls up to an amount defined as a percentage of the principal balance of a debt instrument. In most markets, the partial credit guarantee can be used to enhance the creditworthiness of both bonds and loans.

SEcurITIZATION
IFC participates in domestic securitizations by providing credit enhancement, generally at the mezzanine level, for the benefit of senior investors. This credit enhancement typically takes the form of either a partial guarantee on the senior note tranche or a partial guarantee on the investment vehicle asset pool. In either case, these are denominated in local currency. In certain circumstances, IFC can also purchase subordinated securities denominated in local currency.

RISK-SHARING FACILITIES
A risk-sharing facility is similar to a securitization in that a portion of the risk associated with a pool of assets is transferred to IFC. Risk transfer in this type of facility is achieved through the use of a local currency portfolio guarantee provided by IFC. This portfolio guarantee allows the loan assets to remain on the originator’s balance sheet, rather than being sold as would be the case in a securitization. IFC clients generally find risk-sharing attractive when they have adequate funding, but wish to: (i) address economic or regulatory capital constraints, (ii) improve the overall risk-adjusted return on their portfolio, or (iii) expand their lending to economic sectors in which they face exposure constraints.

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>CLIENT</th>
<th>IFC ENHANCEMENT</th>
<th>HIGHLIGHTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>Maghreb Leasing Algerie</td>
<td>US $8.1mln equivalent guarantee on a local currency loan</td>
<td>First IFC local currency credit-linked guarantee in Algeria and the Middle East/ North Africa region</td>
</tr>
<tr>
<td>Ghana</td>
<td>Trust Bank</td>
<td>US $1mln equivalent risk-sharing facility covering loans to local schools</td>
<td>First local currency risk-sharing facility in Africa for the education sector</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Sampoerna Foundation</td>
<td>US$2.5mln equivalent local currency risk-sharing facility</td>
<td>First private student loan risk-sharing in Indonesia</td>
</tr>
<tr>
<td>Morocco</td>
<td>Al Amana</td>
<td>US$0.8mln equivalent local currency loan</td>
<td>First MATCH local currency loan for a microfinance institution</td>
</tr>
<tr>
<td>Russia</td>
<td>Chuvash Republic</td>
<td>US$7.9mln equivalent local currency partial credit guarantee on a bond</td>
<td>First sub-national bond in Russia issued with a guarantee from a third party</td>
</tr>
</tbody>
</table>
Local currency financing through structured and securitized products provides multiple benefits, including:

- **Market access**: By providing credit enhancement, IFC helps first-time issuers access the capital markets and establish attractive pricing benchmarks for future debt offerings.

- **Capital market development**: By enhancing credit quality, IFC helps establish benchmarks in the domestic capital markets for new asset classes or novel structures that help both IFC clients and other market participants secure long-term local currency funding.

- **Long-term funding**: IFC can help clients secure long-term funding by structuring its credit enhancement so that investors and lenders are comfortable lengthening maturities.

- **New investor base**: By improving the credit quality of enhanced debt instruments, IFC’s structured and securitized products often allow clients to attract new investors. These new investors receive, in turn, the benefit of a more diversified portfolio.

- **IFC involvement**: Investors also receive the benefits of IFC’s direct participation in the transaction. These benefits include a thorough initial due diligence process and ongoing monitoring of the borrower throughout the life of the credit-enhanced instrument.

China today is facing a severe shortage of energy resources amid rapidly growing energy demand. While the country’s government has identified energy efficiency as a priority, investments in this area face critical market barriers. Many small and medium enterprises can significantly reduce their energy consumption by investing in cleaner technologies but have limited access to credit. At the same time, commercial banks in China lack experience in evaluating the potential risks and savings associated with energy efficiency financing.

For these reasons, the Chinese government has sought IFC’s assistance in developing a market-based solution to raising energy efficiency. IFC responded by creating the China Energy Efficiency and Emission Reduction Finance Program, drawing on its experience in other markets as well as its local knowledge of China. This program uses vendors of energy efficient equipment, utilities and energy service companies as agents for the marketing and delivery of energy efficiency projects. The program is expected to achieve several key outcomes that support sustainable development including: (i) increasing the volume of energy efficiency funding available to finance environmentally friendly technology improvements; (ii) helping commercial banks improve their lending and risk management practices; and (iii) mobilizing local currency funds that eliminate the foreign exchange risks associated with foreign currency financing.

IFC shares the risk of these local currency loans with the lending banks through the provision of portfolio guarantees. Funding for a portion of these guarantees comes partially from the Global Environment Fund. Under this program, three key players in China’s economy—utilities, suppliers of energy efficiency equipment, and commercial banks—came together for the first time to create a new financing model for promoting energy efficiency. The program is expected to generate US$500 million of investment in energy efficiency projects over the next six years while reducing greenhouse gas emissions by 50 million tons. The first phase of the program began in 2006. Since the completion of the initial projects in the program, IFC has reduced the relative amount of funds allocated from the Global Environment Fund from 7.5 percent to 2.5 percent of total portfolio volume, achieving a much higher leveraging of donor funds.
Nearly 1,200 nongovernmental organizations provide microcredit services in more than 40,000 Bangladeshi villages, where half of the population lives below the poverty line. The country’s microfinance sector, particularly the smaller microfinance institutions, historically has been financed through contributions from donors and subsidized government funds. As this funding diminishes, the sector is drawing finance increasingly from the voluntary savings of its members and borrowing from commercial banks.

BRAC is one of the largest microfinance institutions in the world, and it continues to expand its portfolio. Its microfinance and development programs cover all 64 districts in Bangladesh. It also offers microloans to women through its group-lending methodology. IFC, recognizing BRAC’s successful business model and its need to expand its reach, partnered with Citibank to overcome its funding constraints. IFC partially guaranteed a local currency loan from Citibank to support BRAC’s microlending in Bangladesh. The loan and guarantee were made available in the local currency, Bangladesh taka, and each has a 5-year amortizing tenor.

This innovative long-term structured financing will help BRAC better manage its balance sheet and diversify its sources of financing. The loan is part of a wider Citibank-led financing initiative for BRAC developed last year. Of the US$55 million worth of Bangladeshi taka financing, Citibank is providing US$42 million. This partnership with IFC enables Citibank in Bangladesh to extend more long-term local currency funds to BRAC. The deal is also part of a larger effort made by IFC to provide local currency solutions to its microfinance clients, which has resulted in successful local currency transactions in Mexico, Peru, Morocco, Jordan, Tunisia and Madagascar.

**The Road Ahead**

The financing needs of emerging and frontier markets are enormous. Sectors such as infrastructure, health and education, housing, and small businesses are instrumental to sustainable development of emerging markets. Since these sectors primarily generate domestic revenues, IFC is meeting the challenge by delivering market-based local currency products.

Working with the market and national regulators, IFC is extending maturities and developing new swap and structured and securitized product solutions. A key objective is to help deepen and broaden local capital markets. This will enable countries to harness domestic savings for domestic private investment. The rapid growth of pension funds in many developing countries is a powerful push for local capital markets. IFC’s structured and securitized product solutions help deploy this liquidity into new asset classes.

IFC leverages its core strengths—financial expertise, an international triple-A rating, and sustainability—to provide local currency financing, thus contributing to sustainable private sector development.