Partial Credit Guarantees

HIGHLIGHTS
- Credit enhancement mechanism for bonds and loans
- Allows IFC to use its triple-A credit rating to bring borrowers to market and/or extend debt maturity
- Guarantee can be in local or foreign currency, depending on client needs
- For summaries of prior deals, please visit www.ifc.org/structuredfinance

PRODUCT DESCRIPTION
A Partial Credit Guarantee (PCG) is a credit enhancement mechanism for debt instruments (bonds and loans). It is an irrevocable promise by IFC to pay principal and/or interest up to a pre-determined amount. Typically, the guarantee is structured to cover 100% of each debt service payment, subject to a maximum cumulative payout equal to the guarantee amount. The guarantee amount is usually expressed as a percentage of principal and amortizes in proportion to the bond or loan. In certain circumstances, this percentage can increase or decrease in the later years of the debt obligation, depending upon the needs of the borrower or creditors.

HOW IT WORKS
The PCG product allows IFC to use its triple-A (AAA/Aaa) credit rating to help borrowers diversify their sources of funding, extend maturities, and obtain financing in their currency of choice, including local currency. The guarantees are tailored to meet the needs of both borrower and creditors. They increase recoveries upon a default of the borrower and can be structured to reduce the probability of a default occurring. Reductions in the probability of default are accomplished through a reinstatement provision that allows the guarantee to be drawn to meet debt service payments during periods of illiquidity. As long as the amounts drawn under the guarantee are repaid within a prespecified period, they are reinstated. In essence, the reinstatement provision acts like a liquidity facility for the guaranteed debt instrument. In terms of increasing recovery given default, IFC’s objective is to offer the minimum amount of guarantee necessary in order to facilitate a successful transaction. This generally allows the borrower to achieve the lowest possible funding cost; permits investors to maximize their return given their risk tolerance; and mobilizes the maximum amount of borrower financing for a given level of IFC credit exposure.

WHEN IS IT APPLICABLE?
Partial guarantees can be denominated either in local currency (typically for domestic transactions) or foreign currency (typically for cross-border transactions). Local currency guarantees are most appropriate for a borrower that has local currency revenues, but lacks access to local currency financing of the desired tenor. By helping to mobilize this longer-term local currency funding, the IFC local currency guarantee permits borrowers to match more effectively their assets and liabilities and to reduce foreign exchange risk.

Foreign currency guarantees work best for a borrower that cannot access international markets on its own because of the high-risk premium associated with the country in which it is domiciled. Although all IFC guarantees are structured to provide credit enhancement, for cross-border issues IFC is able to offer a structure that mitigates transfer and convertibility (T&C) risk as
well. By providing a guarantee sized to cover only the debt service due during the estimated duration of a T&C event, the IFC PCG allows a borrower to obtain in a cost effective manner the rating elevation possible through mitigation of T&C risk, thus negating the need for political risk insurance. It is particularly useful for borrowers possessing a non-investment grade international foreign currency rating, but an investment grade international local currency rating. In this situation, the IFC PCG may allow borrowers to achieve an investment grade rating for their cross-border debt issue with relatively low levels of credit enhancement.

**BENEFITS**

**Market access:** IFC’s role in credit enhancing debt instruments allows investors to benefit from IFC’s relationship with, and ongoing monitoring of, the underlying borrower. This oversight role often allows viable first-time borrowers to tap markets that they otherwise would not normally be able to access.

**Long-term funding:** By structuring the PCG so that investors and lenders are comfortable extending credit for a longer tenor, IFC can help borrowers to secure long-term funding that may have been previously unavailable.

**New investor base:** By using an IFC PCG to improve the credit quality of a debt instrument, borrowers may be able to gain access to creditor groups (such as dedicated investment grade investors) that would otherwise not be able or willing to extend credit to the borrower.

**Liquidity backstop feature:** If a borrower faces temporary liquidity problems, IFC’s guarantee may be drawn upon to prevent a default. If the borrower repays IFC in a timely manner, the guarantee amount may then be reinstated.

**Capital market development:** By creating high-quality assets with long tenors, IFC assists in the establishment of benchmarks in the domestic capital markets that will help other borrowers secure long-term funding.

**Transfer and convertibility risk mitigation:** By structuring the PCG to cover only the amount of debt service due during the estimated duration of a T&C event, IFC provides a cost-effective enhancement that allows borrowers to achieve potentially significant credit rating elevation for their cross-border debt instruments.

![Structure for a Peso 100mn 8 Year Amortizing Bond with 10% Coupon and 40% Guarantee](image-url)