

Local Currency Financing

EBRD Treasury

Tbilisi
7 March 2014



Local Currency Financing

Integral to the Bank's Mission

“To stimulate and encourage the development of capital markets”

Agreement Establishing the European Bank for Reconstruction and Development (Chapter 1, Article 2. Functions)



EBRD's Rationale for Lending and Borrowing in Local Currency



Rationale for Lending in Local Currency

By lending in local currency, the Bank is able to:

- Improve the creditworthiness of projects which solely generate local currency income by avoiding FX risk
- Direct short-term, speculative liquidity back into the real economy
- Extend the maturity of local currency loans available in the market
- Reinforce existing market indices, or create new, transparent ones
- Stem unhedged currency mismatches on the balance sheets of both corporate and household sectors



Rationale for Borrowing in Local Currency

By borrowing in local currency, the Bank is able to:

- Offer an alternative triple-A benchmark to the government curve, which will increase the transparency of corporate pricing in the domestic market
- Create an opportunity for credit diversification in domestic investors' portfolios
- For international investors local currency Eurobonds can provide a AAA conduit allowing the dissociation of currency and currency allocation risks. This is often a precursor to them participating in the local government and corporate / bank market.
- Introduce innovative techniques that help to foster the overall development of the market
- Reinforce existing market indices, or create new, transparent ones



EBRD's Local Currency Portfolio



EBRD's Local Currency Asset Portfolio

- First local currency loan: Hungarian Forint (HUF) loan in 1994
- Since 1994, the Bank has committed loan financing in:

Albanian Lek (ALL)
Armenian Dram (AMD)
Azerbaijani Manat (AZN)
Belarusian Rouble (BYR)
Bulgarian Lev (BGN)
Czech Koruna (CZK)
Egyptian Pound (EGP)
Georgian Lari (GEL)
Hungarian Forint (HUF)
Jordanian Dinar (JOD)
Kazakh Tenge (KZT)

Kyrgyz Som (KGS)
Macedonian Denar (MKD)
Moldovan Leu (MDL)
Mongolian Tugrik (MNT)
Polish Zloty (PLN)
Romanian Leu (RON)
Russian Rouble (RUB)
Slovak Koruna (SKK)
Tajikistani Somoni (TJS)
Turkish Lira (TRY)
Ukrainian Hryvnia (UAH)

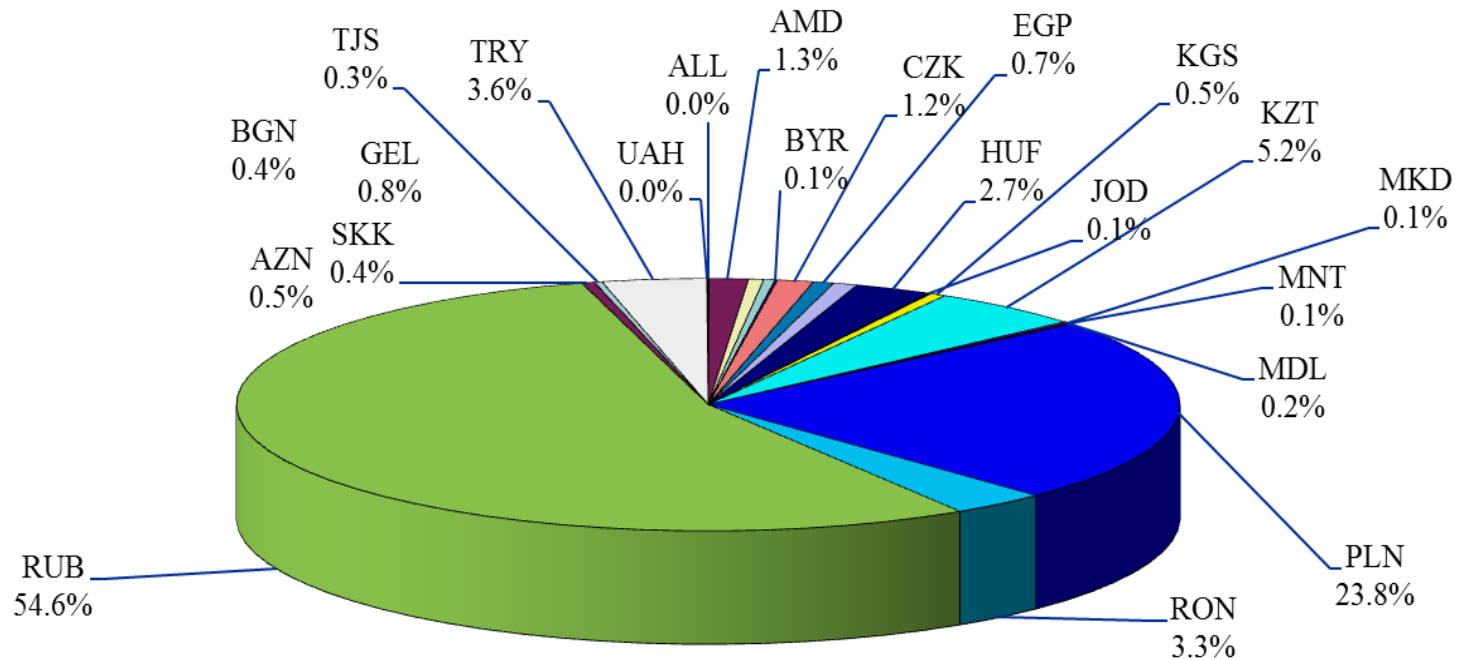
- The Bank has signed 410 loans denominated in 22 local currencies for a total project value of EUR 9.3 billion
- The Bank has provided senior and subordinated loan financing in a number of local currencies, as well as one investment in a RUB-denominated residential mortgage-backed security.



Local Currency Loans arranged by EBRD

EUR 9.3 billion

Portfolio by Currency Share

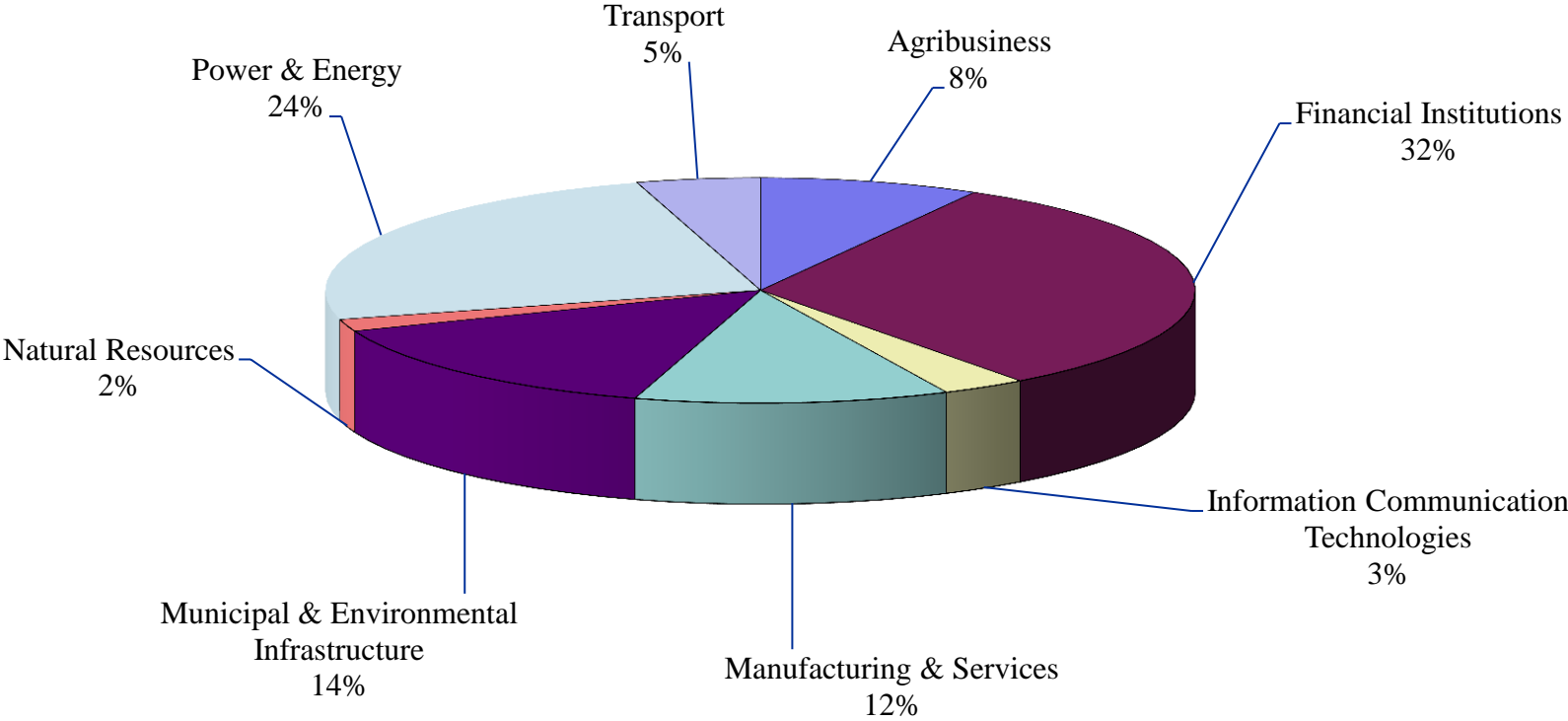


**EBRD's current portfolio in Georgia is EUR 544 mn (73 projects), of which GEL portfolio is EUR 67 mn (12 projects)*



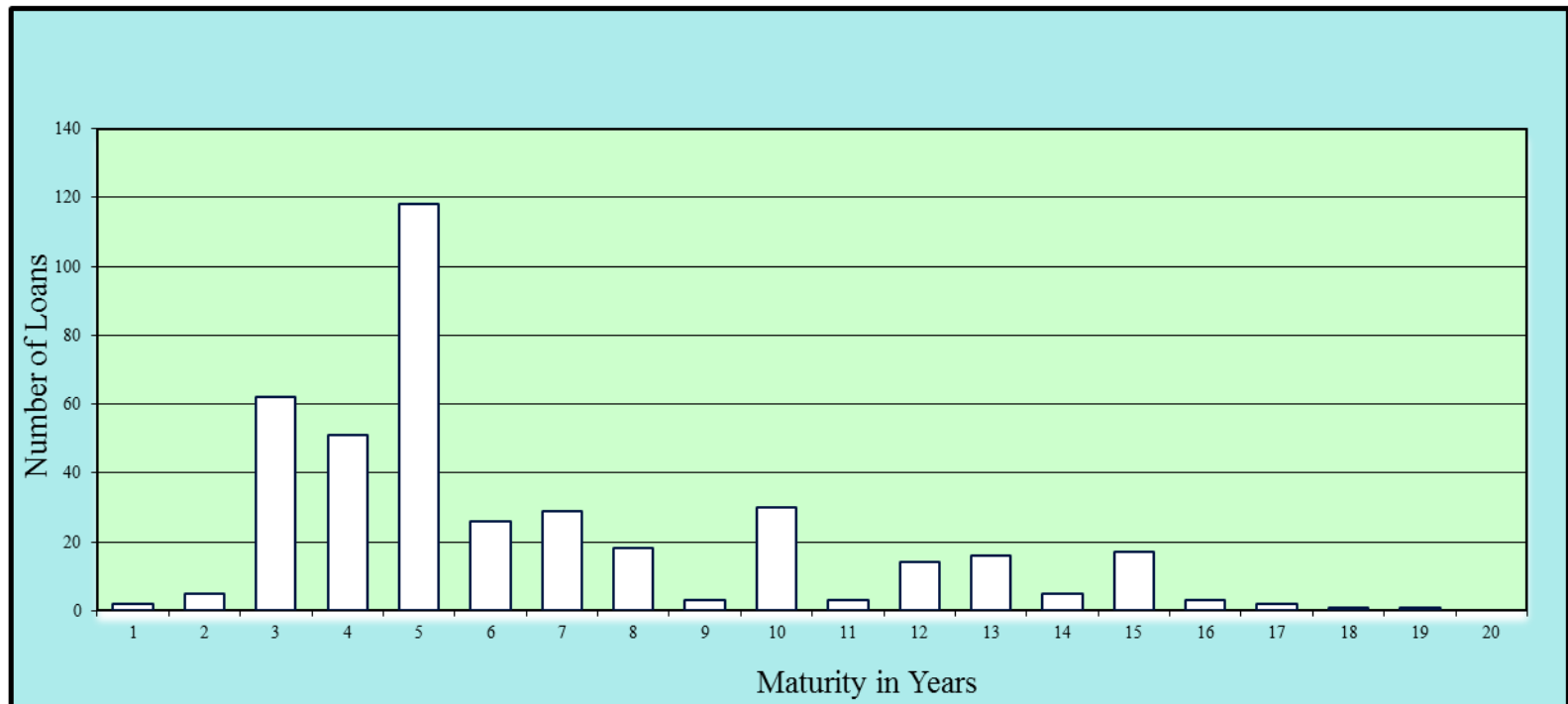
EBRD's Local Currency Loan Portfolio

Portfolio by Sector Business Groups



EBRD's Local Currency Loan Portfolio

Local Currency Loans: Maturity Profile



EBRD's Local Currency Financing Platform



EBRD's Local Currency Financing Platform

- Single currency revolving facilities
- Cross currency interest rate swaps
- Domestic bonds
- Eurobonds
- Promissory notes
- TCX

*Under **Loan Agreements** denominated in local currencies that are not fully convertible and where hedging instruments are circumscribed, the typical 3 month interest rate period may be shortened to a compounded overnight rate or may be indexed to the USD or EUR during periods of **market disruption**.*



Single Currency Revolving Facilities

- Committed floating rate financing through 1 year extendible back up lines
- First facilities negotiated in RUB in 2001
- Have signed facilities in BGN, KZT, RON and UAH

Advantages	Cost efficient source of financing, especially with low disbursement levels of project financing
	Straightforward to negotiate
	Does not create excess cash, as drawdowns only occur upon project disbursements
	Endorses existing money market index or creates a new one
Drawback	Refinancing risk owing to short tenor of the facilities



Cross Currency Interest Rate Swaps

- Optimal means of matching loan features (size, tenor, amortisation) when the FX regime and legal enforceability of derivatives contracts permit
- The EBRD has established pools of liquidity through swaps in CZK, HUF, KZT, PLN and TRY

Advantages	Timing, size and tenor requirements can be matched more closely
	Allows flexibility to offer fixed or floating loans
Drawbacks	Poor pricing transparency where markets lack liquidity and depth
	May limit activity with local banks/subsidiaries when requirement to use local counterparty



Domestic Bonds

- Issued under local laws and regulations
- The EBRD issued domestic HUF bonds in 1994 and 1996, and has launched domestic RUB bond issues from 2005

Advantages	Contributes to capital markets' development
	Can lengthen maturity of liabilities
Drawbacks	Onerous and sometimes inchoate legal and regulatory requirements
	Loan disbursement patterns may give rise to cash management needs, utilising bank credit lines and potentially increasing costs
	Triple-A rating not valued appropriately
	Exposure to payment and clearing systems



Eurobonds

- Means to fund local currency loan where a currency is fully convertible
- EBRD has issued Eurobonds in CZK, EEK, HUF, KZT, PLN, RON, RUB, SKK and TRY. RUB was accepted as a full settlement currency in ICSDs (Euroclear and Clearstream) in 2007

Advantages	Can contribute to capital markets development
	Possible access to longer term funding
	Easy to document in MTN format
Drawbacks	Loan disbursement patterns may give rise to cash management needs, utilising credit lines and potentially increasing costs
	Sporadic international investor interest



Local Currency Eurobonds:

Which Bond Markets has EBRD Accessed?



- **Czech Republic**
 - First Eurobond issue in 1996
- **Estonia**
 - First Eurobond issue in 1999
- **Hungary**
 - First domestic issue in 1994
 - First Eurobond in 2004
- **Poland**
 - First Eurobond issue in 1998
- **Romania**
 - Issued first domestic/international bond in 2009
- **Russia**
 - Promissory note programme launched in 2001
 - Have issued first domestic RUB bonds in 2005.
 - From 2007 the Bank has been issuing Eurobonds settling in RUB through ICSDs
 - First structured domestic transaction in 2009
- **Slovak Republic**
 - First Eurobond issue in 1999
- **Turkey**
 - First Eurobond issue in 2001.

Promissory Notes

- These are typically short-term instruments issued in countries which were signatories to the Geneva Convention on Bills of Exchange and Promissory Notes of 1930
- Generally, there are no prospectus and registration requirements
- EBRD issued promissory notes in RUB in 2001-2003

Advantages	Can contribute to capital markets' development
	Simplicity of documentation
Drawback	Short-term liquidity management tool creates refinancing risk
	Surrogate cash instruments can create reputational risk



The Currency Exchange Fund (TCX)

- Designed to hedge currency and interest rate risks associated with long-term borrowing in local currencies
- TCX's pricing policy is based on market prices and the application of state-of-the-art valuation methods, optimally applied to circumstances in thin markets
- EBRD has hedged, via TCX, loans in **Albanian Lek, Armenian Dram, Azerbaijani Manat, Belarusian Rouble, Georgian Lari, Kyrgyz Som, Macedonian Denar, Moldovan Leu, Mongolian Tugrik and Tajikistani Somoni**
- No minimum formal/maximum loan size in line with its support of micro-finance institutions. EBRD's loans using TCX have maturities between 2014 – 2018.

Advantages	Mitigates FX and interest rate exposure for borrowers whose revenues are denominated in local currency
	Risks are transferred to TCX by using non-deliverable forward transactions
	Offers long term maturity of loans not provided by financial markets
Drawback	There must be a short-term benchmark rate available for pricing



EBRD's Role in Capital Markets Development



Barriers to Local Currency Lending

- Exchange rate policy
 - focus by central bank on exchange rate targeting, rather than monetary policy
 - macroeconomic instability and the lack of a transparent and credible policy framework
 - political rhetoric and/or commitment (incl. ERM II) to replace domestic currency
 - adoption of currency board (Bulgaria, Bosnia and Herzegovina, Estonia and Lithuania)
- Poorly regulated and/or capitalised banking system
 - lack of a lender of last resort (with guaranteed access to central bank repo facility)
 - term deposits that can be withdrawn with little (or no) notice
- Lack of credible market indices, liquid money-markets and mechanisms for secured instruments (Repo)
- High domestic interest rates
- Inadequate market infrastructure
 - conflicting or unclear legal and regulatory environment, bureaucratic processes
 - imposition of new taxes, currency restrictions and other controls
 - poor payment and settlement systems
 - high domestic costs including listing fees and taxes
 - lack of institutional investor base and credit culture



Capital Markets Development:

EBRD's Role in Widening Access to Local Currency Resources

EBRD has been successful in enhancing local currency usage:

- Improving existing and/or helping to develop new money-market indices (KazPrime, KievPrime, MosPrime, ROBOR, RUONIA) has stimulated activity in local currency;
- Leading syndications of RUB 49.8 bn of loans that are up to 10 years in maturity
- Extending local currency loan syndications to AMD, KGS, MDL, PLN and RON
- Acting as an anchor investor in local currency bonds, including securitisations;
- Working on clearing and settlement to establish bridge between systems:
 - EBRD worked to establish a bridge between international clearing and depository systems* (“ICSDs”) and the Latvian Central Depository and the Romanian Central Depository and to get currencies accepted by ICSDs including Latvian Lat, Hungarian Forint and Russian Rouble;
- Directing donor funding for technical assistance to stock exchanges, and to the pension and insurance sectors;
- Supporting local investors.

** Euroclear and Clearstream*



Credible Money-Market Indices

Key to Successful Local Currency Lending

- EBRD has worked with local banks and authorities in Kazakhstan, Romania, Russia and Ukraine to help to create local money market indices and improve their transparency and credibility.
- The development of a credible money-market index allows:
 - greater pricing transparency and consistency in the pricing of all index-linked loans.
 - the pricing of derivatives (including futures and interest rate swaps).
 - the interbank money-market to develop greater liquidity, increasing efficiency, and lengthening the maturity of interbank activity.



Capital Markets Development:

EBRD's Role in Reforming Legal/Regulatory Environment

- Helping to improve capital market legislation and regulation (Armenia, Czech Republic, Hungary, Romania, Russian Federation, Serbia and Ukraine)
 - Securities market laws
 - Disclosure requirements
 - Listing regulations
 - Secondary trading
 - Broadening eligible instruments for institutional investors
 - Facilitating the development of secondary mortgage markets
- Working to clarify derivatives' environment with ISDA (Czech Republic, Hungary, Kazakhstan, Poland, Russia, Slovakia and Ukraine)
 - Recognition of swaps
 - Netting opinions
- Improving investor friendly practices (CIS Regional, Kyrgyz Republic and Russian Federation)
 - Regional CIS Model Investor Protection Law
 - Russia Corporate Governance Code
 - Working on Kyrgyz Corporate Governance rules
- Upgrading joint stock companies laws (Russian Federation)
- Assisting in development of leasing laws (Moldova and Uzbekistan)



Capital Markets Development:

EBRD Supports the Development of a Local Investor Base

EBRD has focused on the development of a local investor base through:

- Making equity investments in local banks, pension funds and insurance companies;
- Improving the regulatory environment for investors, including through pension reform;
- Channelling donor funding for technical assistance to the pension and insurance sector;
- Providing guidance towards standardising mortgage loans to facilitate the development of secondary mortgage markets;
- Facilitating the restructuring of bank balance sheets through co-investing in facilities to purchase non-performing loans;
- Supporting local brokerage houses' market-making activities in mid-tier corporate bonds.



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