THE WORLD BANK
Treasury

IBRD Local Currency Financing

The IBRD Flexible Loan is denominated in one of the four following currencies: USD, EUR, JPY and GBP. Given that the principal revenue streams of most IBRD borrowers are in local currency, borrowing in foreign currency exposes them to foreign exchange (Fx) risk.

Fx risk also presents a dilemma for central governments borrowing from IBRD who on-lend loan proceeds to sub-borrowers such as state governments, government agencies, state-owned enterprises, or private sector borrowers (e.g., public utility companies). Some governments take the Fx risk and charge a fee to sub-borrowers for on-lending in local currency. Others do not want to be exposed to Fx risk and therefore on-lend in foreign currency-denominated loans to sub-borrowers. Many of these sub-borrowers have earnings or revenues denominated in local currency and have neither market access nor the institutional capacity to execute swap transactions to manage Fx risks. On-lending IBRD loans to sub-borrowers with currency risk can result in additional credit risk for the government. These governments can convert the disbursed and outstanding balance of IBRD loans into local currency and on-lend to sub-borrowers in local currency. IBRD local currency financing can thus reduce the Fx risk for both the government and the sub-borrower.

At a Glance

- Repaying IBRD loans in local currency can help reduce currency risk for sovereign and sub-sovereign borrowers
- IBRD can convert disbursed and outstanding balances of IBRD loans into local currency, subject to market availability. In some currencies, IBRD can convert loans at the time of disbursement.
- Benefits of IBRD local currency financing:
  - ✓ Competitive pricing
  - ✓ No counterparty credit risk
  - ✓ No need to post collateral or use credit lines
  - ✓ No credit charges
  - ✓ Administratively simple
  - ✓ Capacity building

IBRD offers local currency financing through (i) loan conversion options, and (ii) free-standing local currency swaps.

i) Local currency conversion option: The conversion option is included in the loan agreement to enable borrowers to convert current disbursements (Automatic Conversion of Loan Currencies or ACLC) and disbursed and outstanding loan balances (DOB) into local currency, all subject to market availability. IBRD may provide the conversion by a) hedging through swap market transactions, or b) funding through local currency bond issuance (back-to-back financing)**.**

a) **Conversions hedged with swap transactions.** IBRD does not take currency risk. Local currency conversions are hedged with offsetting swaps with market counterparties. IBRD can execute partial maturity and partial amount conversions for currencies with limited swap market liquidity or if it meets the borrrower's needs. The price is the actual cost achieved in IBRD's swap with market counterparties plus the applicable transaction fee available on the World Bank Treasury website.

b) **Conversions through bond issuance (back-to-back financing).** IBRD's ability to fund itself at attractive levels in selected bond markets allows it to offer local currency conversions at attractive rates. IBRD issues a local currency bond in the market (generally with a bullet structure) and passes on the proceeds in local currency to the project. The bond and loan have the same structure. The timing of the transaction is critical to match investor appetite and country needs. The price comprises the all-in issuance cost of the IBRD bond plus IBRD's contractual spread and maturity premium in local currency and transaction fees.

Request for local currency financing through loan conversion. The borrower may submit a request for 1) ACLC by selecting the relevant option in the Loan Choice Worksheet at negotiation and signing the ACLC letter accompanying the loan agreement or with a loan amendment after negociation; 2) conversion of disbursed and outstanding loan balances by submitting the request through the Conversion Request Form available on the World Bank Treasury website.

ii) Free-standing local currency swaps: The free-standing currency swap enables borrowers to convert disbursed and outstanding balances of existing IBRD loans into local currency without changing the terms of the underlying loan. It is subject to market availability and borrowers wishing to transact free-standing swaps with the Bank need to enter into a Master Derivatives Agreement (governed by the International Swaps and Derivatives Association ISDA) with the Bank. Free-standing swaps for local currencies are also available on liabilities contracted with Third Parties (non-IBRD) and assets. (see product note on Hedging Products and ask your Banker for more information). The price is the actual cost achieved in an offsetting swap with market counterparties plus the applicable transaction fees available on the Treasury website.

Request for local currency financing through Free-standing swaps. The borrower may submit a request to IBRD through the Hedge Request Form on the the World Bank Treasury website.

All forms and Conversion and Hedging Guidelines are available on the Treasury website here: http://treasury.worldbank.org/bdm/htm/Forms_and_Guidelines.html

IBRD local currency financing through currency swaps executed with market counterparts

Loan principal and interest payments **Swap principal and interest payments**

Back-to-back local currency financing through bond issuance

At disbursement

During the life of the loan and at maturity

For more information:

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