Local Currency Financing

EBRD Treasury

January 2009

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)

Rationale for Lending in Local Currency

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

- Fund projects that are legally required to be denominated in local currency
- 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
- Impose stringent conditionality and transparency requirements to uphold “best practice” in the international capital markets
- Stem unhedged currency mismatches on the balance sheets of both corporate and household sectors
- Offer technical assistance and, where appropriate, improvement grants to promote transition

Rationale for Borrowing in Local Currency

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

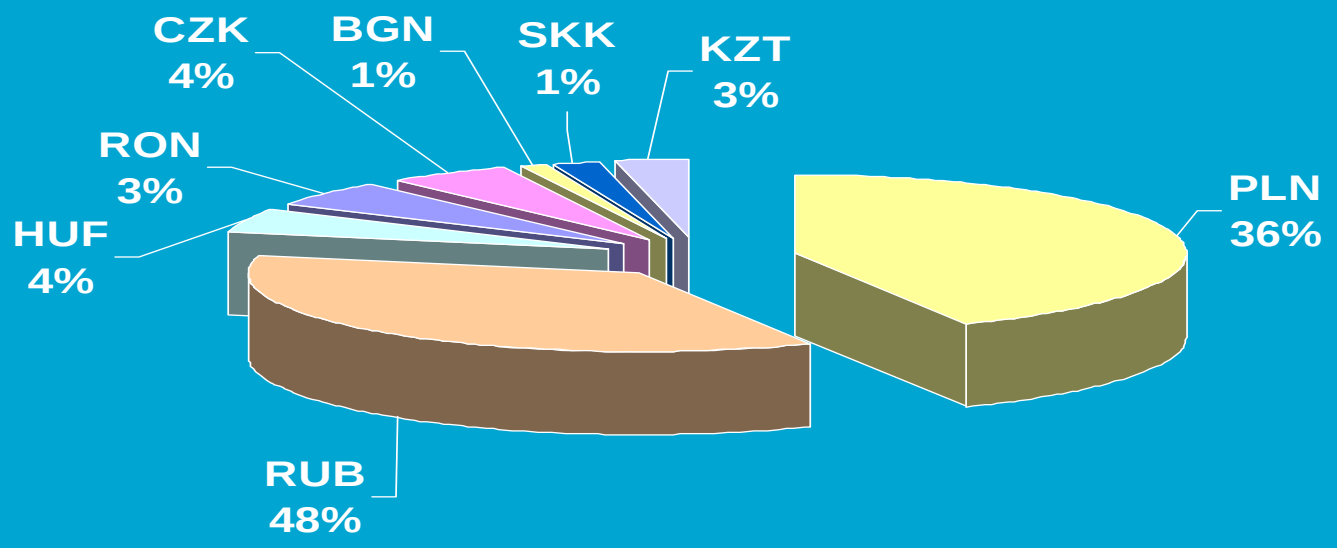
- Offer an alternative triple-A benchmark to the government curve, which will increase the transparency of corporate pricing
- Introduce innovative techniques that help to foster the overall development of the market
- Reinforce existing market indices, or create new, transparent ones
- Provide a triple-A conduit through which new investors may gain exposure to the local market, allowing the dissociation of credit and currency allocation risks. This is often a precursor to these (often foreign) investors participating in the local government and corporate/bank debt market
- Create an opportunity for credit diversification in domestic investors' portfolios

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 Bulgarian Lev (BGN), Czech Koruna (CZK), Hungarian Forint (HUF), Kazakh Tenge (KZT), Polish Zloty (PLN), Romanian Leu (RON), Russian Rouble (RUB) and Slovak Koruna (SKK)
- The Bank has signed 134 loans denominated in eight local currencies for a total project value of EUR 2.6 billion as at the end of last month
- 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 for AHML.

EBRD's Local Currency Loan Portfolio by Currency - EUR 2.6 billion to date

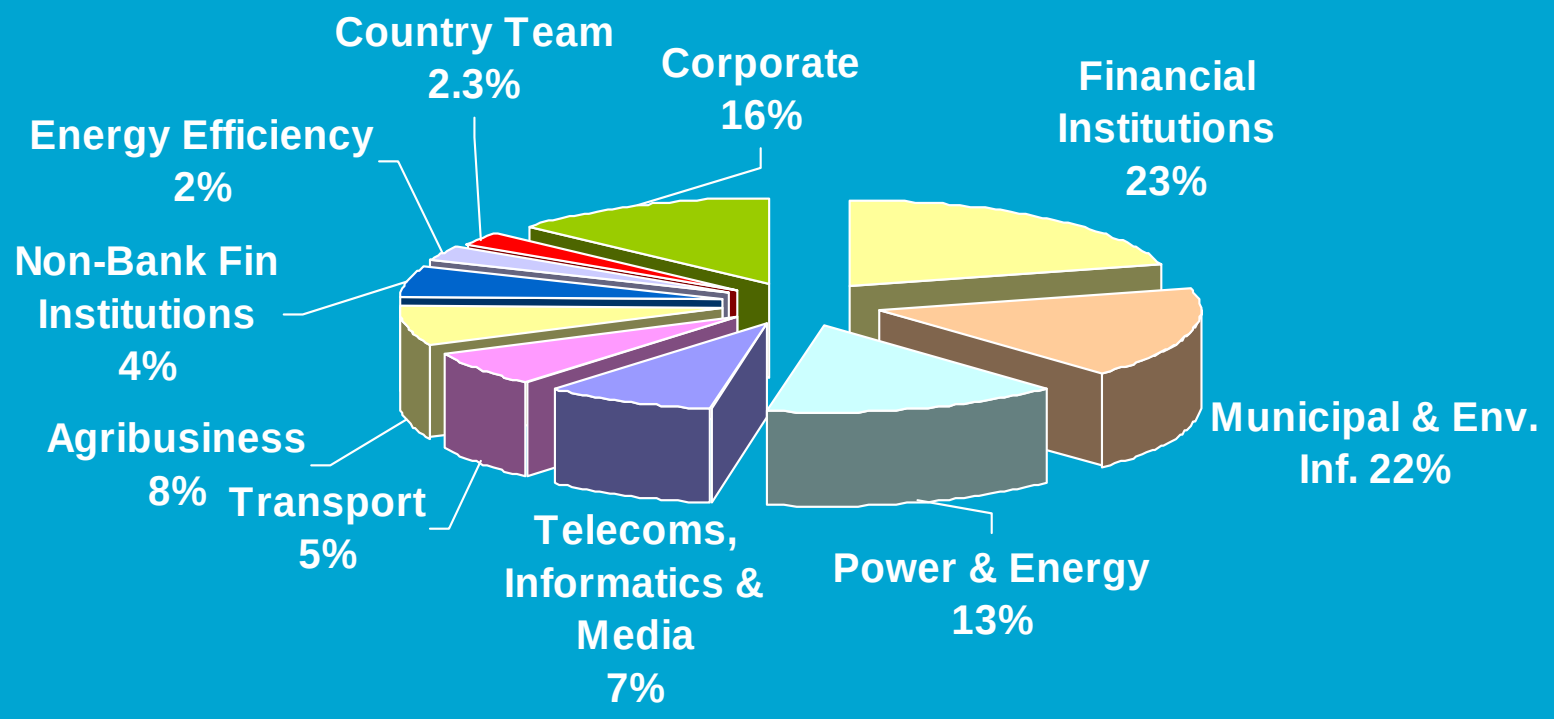
Portfolio by Currency Share



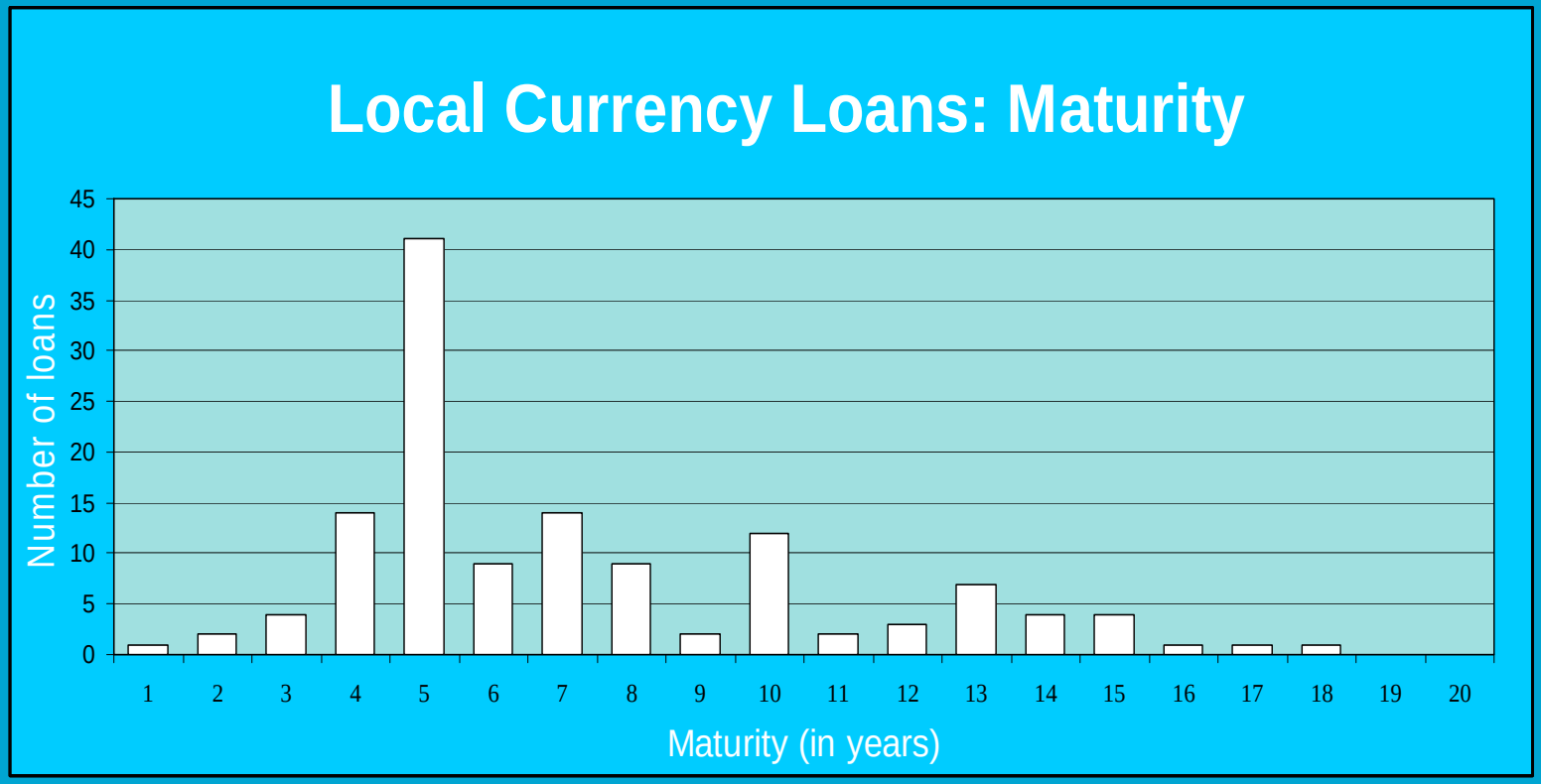
- Total value of EBRD's Local Currency loans (incl. "B" loans): EUR 3.6 bn

EBRD's Local Currency Loan Portfolio since 1994

Portfolio by Sector Business Groups



EBRD's Local Currency Loan Portfolio since 1994



EBRD's Local Currency Financing Platform

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

*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 and 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 and PLN

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 in 2005 and 2006

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

Domestic Bonds:
EBRD's RUB Bonds

EBRD's Objectives

- Strengthen funding base in the Russian market
- Establish transparent benchmarks for the Russian debt market
- Contribute to the further development of the market
- Allow the development of longer term financing for the real economy

Summary Description of the Issues

- *Format:* 5-year Floating Rate Note
- *Size:* RUB 5 billion & RUB 7.5 billion
- *Coupon rate:* Linked to new Russian money-market index – "MosPrime"
- *Exchange:* MICEX
- *Custody:* NDC
- *Repo Eligibility:* Eligible for repo at the Central Bank

Eurobonds

- Means to fund local currency loan where a currency is fully convertible
- EBRD has issued Eurobonds in CZK, EEK, HUF, PLN, RUB and SKK. RUB was accepted as a full settlement currency in 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

Eurobonds:
Which Bond Markets has EBRD Accessed?

Czech Republic

- Most recent Eurobond issue in 2001

Estonia

- Eurobond issue in 1999

Hungary

- Issued two HUF bonds in 2007. Launched first Global bond in 2001 and first domestic issue in 1994

Poland

- Most recent issue in 2000. First Global bond and first non-synthetic issue

Russia

- Promissory note programme launched in 2001 and several synthetic Euro-Rouble issues. Have issued domestic RUB bonds in 2005 and 2006. From 2007 the Bank has been issuing Eurobonds settling in RUB through Euroclear and Clearstream.

Slovak Republic

- Most recent Eurobond issue in 2002

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

Barriers to Local Currency Lending

- Exchange rate policy
  - irrevocable surrender of independent national monetary & exchange rate policy (Slovenia)
  - adoption of currency board (Bulgaria, Bosnia and Herzegovina, Estonia and Lithuania)
  - political rhetoric and/or commitment (incl. ERM II) to replace domestic currency
  - macroeconomic instability and the lack of a transparent and credible policy framework
- Poorly regulated and/or capitalised banking system
- Lack of credible market indices and liquid money-markets
- 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

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 improve the transparency and credibility of local money market indices.
- To date, EBRD has arranged over RUB 85 billion of MosPrime-linked loans to financial, corporate and municipal institutions.
- 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 on MICEX and Interest Rate Swaps in Kazakhstan and Russia).
  - the interbank money-market to develop greater liquidity, increasing efficiency, and lengthening the maturity of interbank activity.

MosPrime: Description

- MosPrime is the yield for money-market time deposits offered by first-tier banks in the Russian market to financial institutions of comparable credit standing.
- MosPrime is calculated daily for O/N, 1W, 2W,1M, 2M, 3M, and 6M tenors provided by ten contributor banks.
- The MosPrime calculation procedure is based on international standards: the arithmetic average of quoted rates after rejecting the highest and the lowest offers.
- Currently the list of contributing banks consists of:

ABN Amro Bank
Bank of Moscow
Gazprombank
International Moscow Bank
Sberbank
Bank for Foreign Trade (VTB)
Citibank
HSBC
Raiffeisenbank Austria
WestLB Vostok

Capital Markets' Development:

EBRD's Role in Widening Access to Local Currency Resources

EBRD has been successful in enhancing investor access to local products:

- Syndicating local currency loans
- 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 the Latvian Central Depository and international clearing systems) and to get currencies accepted by Euroclear and Clearstream (including Latvian Lat, Hungarian Forint and Russian Rouble)
- Development of a transparent money-market index (KazPrime, KievPrime, MosPrime and ROBOR) has stimulated activity in local currency.

Capital Markets' Development:

EBRD's Role in Reforming Legal/Regulatory Environment

- Helping to improve capital market legislation and regulation (Czech Republic, Hungary and Russian Federation)
  - securities market laws
  - disclosure requirements
  - listing regulations
- Working to clarify derivatives' environment with ISDA (Czech Republic, Hungary, Kazakhstan, Poland, Russia and Slovakia)
  - 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)

Disclaimer

This information is provided for discussion purposes only, may not be reproduced or redistributed and does not constitute an invitation or offer to subscribe for or purchase any securities, products or services. No responsibility is accepted in respect of this presentation by its author, the European Bank for Reconstruction and Development (the "Bank") or any of its directors or employees (together with the author and the Bank, the "EBRD") for its contents. The information herein is presented in summary form and does not attempt to give a complete picture of any market, financial, legal and/or other issues summarised or discussed. The EBRD is not acting as your advisor or agent and shall have no liability, contingent or otherwise, for the quality, accuracy, timeliness, continued availability or completeness of the information, data, calculations nor for any special, indirect, incidental or consequential damages which may be experienced because of the use of the material made available herein. This material is provided on the understanding that (a) you have sufficient knowledge and experience to understand the contents thereof; and (b) you are not relying on us for advice or recommendations of any kind (including without limitation advice relating to economic, legal, tax, regulatory and/or accounting risks and consequences) and that any decision to adopt a strategy, deal in any financial product or enter into any transaction is based upon your own analysis or that of your professional advisors, whom you shall consult as you deem necessary.