



# Local Currency Financing for MFIs

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# Shortage of Local Currency Financing

## *A Serious Impediment to MFIs' Growth*

- Global microfinance has been growing at more than 25% annually, during the past decade.
- Shortage of local currency financing remains a serious impediment to MFIs' sustainable growth.
- Domestic capital markets are often too shallow or non-existent altogether.
- Commercial banks have generally been reluctant to lend to MFIs, though this is changing, but very slowly.

# Hard Currency Borrowings by MFIs

## *Significant Risks*

- 70% of the private capital invested in microfinance is in hard currency.
- Hard currency loans add several layers of risks on MFIs:
  - Asset/Liability mismatch risk;
  - FOREX risk; and
  - Increased probability of credit defaults and potential bankruptcy, following sudden adverse exchange rate movements.

# Local Currency Supply

## *The IFC Approach*

- IFC has provided local currency financing through credit enhancements, derivatives, guarantees, and credit investment vehicles.
- IFC's local currency financing through derivatives is limited to countries where derivatives markets exist to hedge back the exposure to US Dollar.
- IFC's local currency financing through guarantees has been limited to cases where it is commercially viable as a result of the cost of structuring such guarantees.

# IFC's "EM Local Currency Debt Fund" *An Early Approach to LC Financing*

- Established in 1997 – managed by Lazard Freres Asset Management.
- US\$153 million by 1999 - IFC investment US\$10 million.
- Fund actively managed a portfolio of uncorrelated local currency loans, and offered a competitive risk adjusted return to hard currency debt investors.
- Despite several adverse exchange rate movements and sovereign defaults, the Fund achieved competitive positive dollar denominated IRR.

# Global Microfinance Facility

## *IFC's First Microfinance Structured Vehicle*

- Established in 2004 with a US\$30 million facility.
- GMF invests in credit and credit enhancement instruments dedicated to the provision of local currency debt financing to MFIs.
- Building on its success, GMF is boosting the size of its facility to US\$150 million. GMF plans to partner with private banks to expand its senior tranche instruments to institutional and retail investors.

# Local Currency Debt Facility

## *IFC's Approach to Unhedged LC Funding*

- IFC is launching a US\$100 million pilot program for local currency financing targeting countries where IFC has no other cost-effective alternatives to providing local currency loans.
- The pilot program strives to build a portfolio of uncorrelated currencies that will serve as a natural hedge.
- The pilot program will allow IFC's clients to strengthen their balance sheets and build credible credit histories, and through strong demonstration effects, encourage other investors to supply local currency debt funding.