



Grameen Foundation USA



Reducing Global Poverty with Microfinance

SEEP AGM

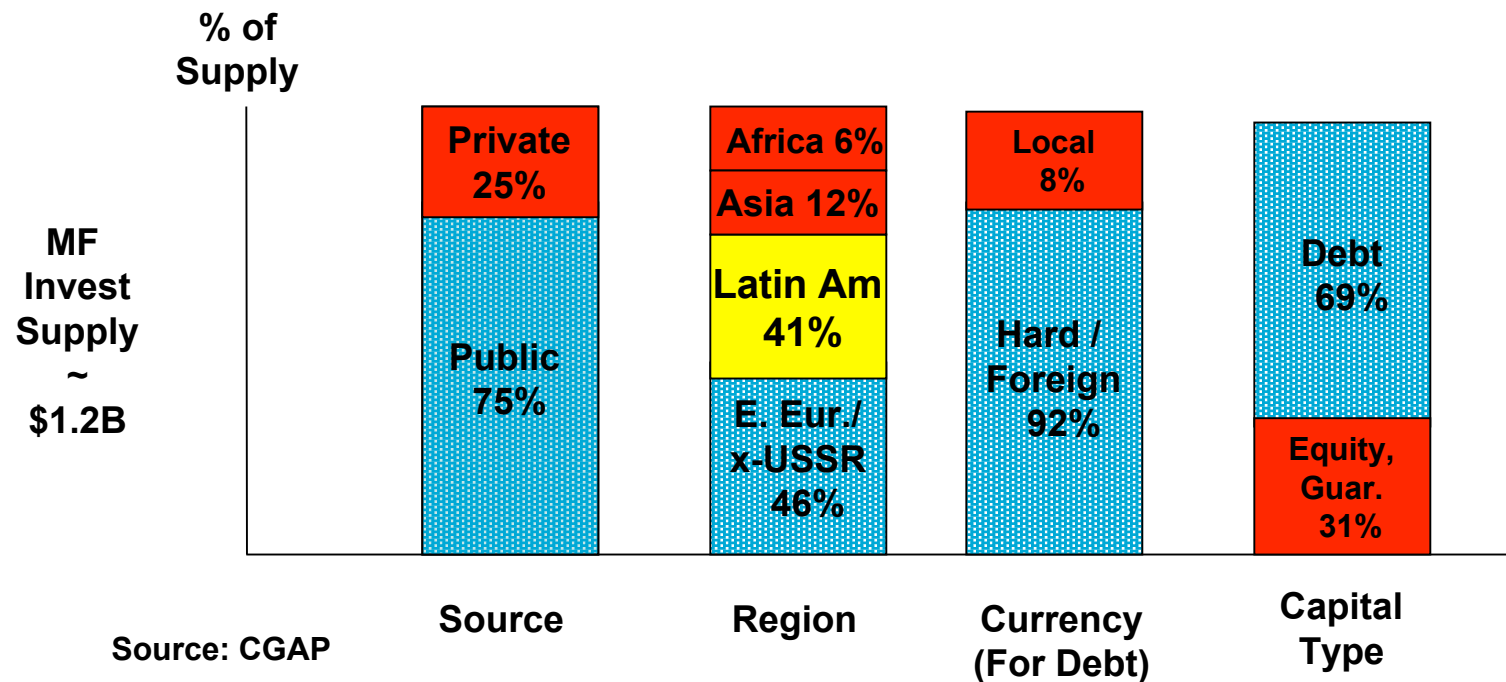
Managing Foreign Currency Risk
For Microfinance Institutions

October, 2005

Celebrating the United Nations International Year of Microcredit 2005

\$\$\$: Capital in Microfinance

The Issue: \$1.2 Bn, but mostly the “wrong” type of capital & and lots more new private investment coming up



Opportunity: Foster private, local currency esp. to Asia & Africa

Foreign Currency Issues for MFIs

Risk is acute: 23 countries, avg. 8.8% compounded ann. decline of local currency against US\$. In 22, currency down 3+ years. (WWB White Paper)

- **Hard currency financing: who should carry the risk?**
 - MFIs are arguably in the worst position to bear foreign currency risk
 - Hard currency issuances reduce risk to investors. Since many investors are socially motivated, they might be willing to take on more FX risk through local currency transactions
- **There has been little industry engagement on this issue w/ donors, who at least in terms of mission, are strong stakeholder to address**

Oversimplified Example: Cost of Debt

MFIs think they get cheaper money, but not always the case

Which is cheaper: hard currency @ 8% or local currency @ 12%?

If devaluation or relative inflation $< 4\%$, hard currency.

If devaluation or relative inflation $> 4\%$, local currency.

Ex. If devaluation = 12%, total loan cost ~ 20%. Ouch!!

5 Strategies to Address F/X Risk

1. Pursue Local Currency Options First
2. Establish Internal Policies on FX Management & Exposure
3. Convert Hard Currency Loans to Local Currency
4. Explore FX Hedging Instruments
5. Others (less ideal)
 - Match lending to borrowing
 - Pass through cost to client

These 5 strategies, including case studies, are detailed in new SEEP Progress Note No. 13 (co-authored by WWB/GFUSA)

GFUSA Capital Markets Strategy

Goal: Harness vast resources from the capital markets to support rapid expansion of leading, poverty-focused MFIs

- 1. Develop and manage GFUSA branded financial products**
 - Simple, flexible, with varied risk-return profiles
- 2. Establish “Microfinance as an Asset Class”**
 - Identify, negotiate & execute local currency capital markets opportunities
 - Present microfinance risk-return in terms that investors understand
- 3. Demonstrate leadership linking poverty-focused microfinance and the capital markets**
 - Facilitate domestic capital market as the primary source of long-term financing for MFIs while incorporating interested international investors
 - Spread GFUSA capital markets knowledge to countries with high numbers of poor people

GFUSA Approach to FX - Avoid It

First Product: GFUSA Growth Guarantees

- Up to \$50 million facility, 100% private capital in the form of back-to-back stand by letters of credit (SBLCs). Citibank issues US\$ to In-Country Bank.
- MFI receives leveraged local currency loans. **Local bank carries F/X risk.**
- GFUSA is actively involved in assisting the MFI with bank negotiations and structuring.

Benefits

- ***Increasing access to investment for world-wide poverty-focused MFIs***
 - Get beyond favorite 114 MFIs receiving 70% of investment capital
 - Flexible regarding MFI legal structure (includes NGOs)
- ***Emphasizes local capital markets***
 - Many local markets have extensive excess liquidity
 - Local banking relationships ultimately healthier and more sustainable
 - Support variety of financings: loans, bonds, securitizations, agency model, etc.
- ***MFIs get cheaper pricing & better capital access***
 - Reduce hesitation for local investors and banks to participate in the sector
 - Seek interest rates closer to prime rate; lengthen tenors

Key Take-Aways



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- 1. Important for MFIs to consider F/X issues in advance, rather than in crisis. For example, have a policy**
- 2. Hard currency is tempting, but can you afford it?**
 - May be more expensive at first, but better/cheaper in long run
 - How much will you really be saving?
- 3. F/X must be managed actively**
 - It cannot be removed, but it can be minimized
- 4. Potential for declining/flat dollar in the near future reduces attention to this issue**
 - BUT remember currency meltdowns i.e. Mexico, Indonesia, Russia & ripple effects elsewhere ALL within the last decade

For Discussion

- **Add your examples on addressing F/X issues**
- **What can we (SEEP community) do?**
 - Develop a message to donors
 - Develop a message to private investors
 - T.A. to MFIs to overcome challenges and to take action
 - Increase industry's market-rate investment transactions

- **Innovations and new ideas**

Consider market-oriented industry initiatives to address the problem

- Create a fund to hedge currencies
- Develop an insurance type of product that covers F/X Risk
- Work with donors & socially motivated investors in new ways

Thank you!



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