

Partial Maturity Currency Conversions: How a Client Was Protected Against Fourfold Currency Depreciation

The World Bank helped a Turkish state-owned bank save USD 3.48 million on a USD 5 million loan by using the Partial Maturity Currency Conversion feature of IBRD Flexible Loans.

Background

Small and Medium Enterprises (SMEs) are one of the growth engines of the Turkish economy. In the aftermath of the global economic crises of 2008-2009, the government leaned on SMEs to retrigger economic growth. This included World Bank's "Access to finance for Small and Medium Enterprises" projects in 2008 and 2010. The project financing was in the form of credit lines intermediated by state-owned banks (Turkish Investment Bank, Vakıfbank, and Ziraat Bankası) to on-lend to SMEs. The banks were selected based on their extensive network and diversified lending practices, including underserved regions.

Ziraat Bankası's loan allocation of USD 100 million designated at least 25 percent of the loan proceeds to be on-lent in priority regions where SME's revenue was mainly in Turkish lira (TRY). As a result, five percent of the loan carried FX risk: Ziraat Bankası was obligated to pay back the IBRD loan in USD, but some of its customers in the priority regions were paying back in TRY. The mismatch exposed both Ziraat Bankası and the government (as the guarantor of the loans) to FX risk due to TRY volatility.

Risk Management Objectives

Manage Ziraat Bankası's exposure to FX risk from debt obligations to IBRD in USD, and the on-lending operations to SMEs in TRY.



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IBRD Financial Solution

IBRD provides clients the ability to convert their outstanding loans into local currency for risk management purposes, provided IBRD can hedge the FX risk in the market. As in the case of TRY at that time, when the maximum swap tenor available in the market is shorter than that of the loan, clients can avail of the option of **Partial Maturity Conversion** of their loan.

In 2014, at the request of Ziraat Bankası, the World Bank executed a partial maturity conversion on an outstanding USD five million, 21-year loan at LIBOR + 73bps to TRY 10.6 million at 11.1 percent for seven years (which reflects the maximum swap tenor available in the market at the time when it was requested). The World Bank does not take FX risk with this redenomination, as it offloads this risk to the market with a currency swap.

On April 1, 2021, the conversion period end date, using the FX rates on that date, the remaining loan amount (denominated in TRY) was redenominated back to USD at a new lower amount.

Transaction Structure

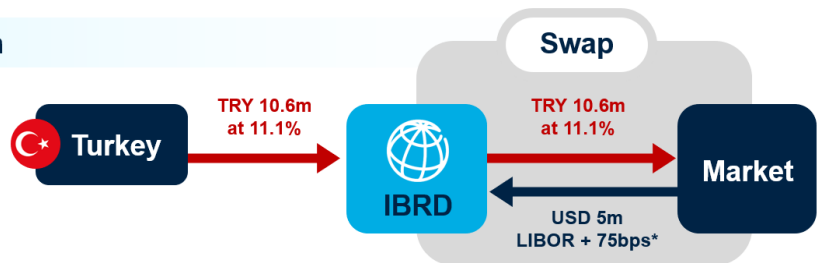
Original Loan Terms:

From 15-Apr-2014 to 1-Apr-2035
USD 5m amortizing loan at LIBOR + 73bps



Loan Terms with Partial Maturity Conversion

From 15-Apr-2014 to 1-Apr-2021
TRY 10.6m amortizing loan at 11.1%



* 2bps transaction fee for currency conversion added to original term

From 1-Apr-2021 to 1-Apr-2035
USD 1.19m amortizing loan at LIBOR + 73bps



World Bank Treasury's Role

- The IBRD leveraged its triple-A credit rating to provide Turkey's Ziraat Bankası with improved market access and competitive financial terms.
- On the loan closing date, September 30, 2014, IBRD converted the outstanding loan amount from USD to TRY, using the ad hoc request for [the conversion feature of the IBRD Flexible Loan \(IFL\)](#).
- The applicable interest rate following the conversion was determined on market terms by converting the Variable Rate — 6-month USD LIBOR +73 bps into a Fixed Rate in TRY as well as a transaction fee for the conversion.

The partial maturity loan conversion allowed the total loan amount to be protected against FX risk up to the first seven years. Ziraat Bankası had the option to conduct another redenomination at the end of the conversion period.

Outcome

Over the term of the partial maturity conversion from April 1, 2014, to April 1, 2021, the client's exposure on the IBRD loan was matched with their on-lending activity in TRY.

On April 1, 2021, Ziraat Bankası chose not to conduct another redenomination and kept the loan in USD at the new, much lower notional.

The remaining loan amount of TRY 9.92 million was redenominated to USD 1.19 million (which otherwise would have been USD 4.67 million).

The client was thus immunized against any FX movement in the 7-year period (in this case TRY depreciated almost fourfold, from 2.13 TRY/USD to 8.35 TRY/USD). Mitigating the FX risk for Ziraat Bankası facilitated financially sound on-lending to SMEs, particularly in the priority regions.

Managing financial risk through conversions to local currency is one of the many ways the World Bank Group helps member countries become more resilient to economic shocks. IBRD's triple-A credit rating, market presence and convening power allow the World Bank Treasury team to develop innovative new products to help clients maximize financing and mitigate risk.

How can a partial maturity loan conversion help protect Borrowers from FX risk?

Partial maturity conversions are offered to clients when the maximum swap tenor available in the market is shorter than that of the loan.

Partial maturity loan currency conversions redenominate loans to local currency, allowing the total loan amount to be protected against any FX risk up to the end of the partial period.

At the end of the period, the client has the choice to further hedge this amount in local currency by requesting to do another partial (or full if the FX market allows) maturity redenomination.