
653.25

RESILIENT

EBRD operations build resilience by fostering the emergence of a stable banking system, promoting the development of local capital markets and supporting local currencies. These measures and others support growth, prevent excessive volatility and protect against shocks.

DELIVERING INNOVATION AND IMPACT

Maximising the impact of EBRD bond investments

The EBRD is developing its practice of investing in bonds to expand the range of financing instruments it offers, deepen their impact and promote the growth of capital markets in the Bank's regions. Strong capital markets help to make economies more resilient by offering alternative sources of funding. They also generate attractive investment opportunities, contributing to the growth and competitiveness of companies in these economies.

OGC lawyers support these transactions and provide expertise that serves to maximise the impact of EBRD bond investments on both capital-market development and the wider economy.

The EBRD invests in four categories of bond. From most to least liquid, these are hard-currency bonds publicly listed on a stock exchange in a well-developed capital market; local-currency bonds listed on local stock exchanges; local-currency bonds (which may or may not be listed) in jurisdictions with less developed capital markets; and illiquid bonds, where the EBRD is often one of a few or, occasionally, the sole investor and where the driver is the specific use of proceeds. In each of these categories, the impact of the EBRD investment can be on the individual bond issuer or on the development of the market as a whole (hopefully, both).

In addition to simply financing the activities of an issuer, a bond investment by the Bank can have a ripple effect on capital-market development. By participating in a bond issuance, the EBRD gives confidence to other potential investors, which can increase demand and lead to more favourable conditions for the issuer.

In addition, the investment shows that the debt capital market in question meets the standards required by the Bank in terms of laws, regulations and internationally accepted practices, which in turn provides comfort to investors who may be considering other issuers in the market. This includes new regulations under consideration in many EBRD economies that are similar to the EU's updated Markets in Financial Instruments Directive (MiFID II).

Corentine Delobel
Counsel, EBRD

Joshua Van der Ploeg
Principal Counsel, EBRD

> OGC lawyers work on every EBRD bond transaction, but make an especially valuable contribution to capital-market development in cases of less liquid issuance in emerging bond markets

Lastly, a bond investment can energise a local primary market or exchange when the EBRD requires an issue to be listed, either exclusively or in conjunction with another exchange.

OGC lawyers provide significant input to issuance in emerging bond markets that are less liquid. In such markets, we have substantial involvement in drafting and negotiating the terms and conditions of the issue and advising the issuer on the intricacies of international best practices. Through such transactions, the Bank makes significant contributions to the development of local capital markets.

In addition, the Bank increasingly invests in bonds that have a leverage effect. These are bonds where the issuer undertakes to reinvest a multiplier (up to 200 per cent) of the EBRD funds into projects of a particular kind. Typically, these are projects with a strong transition impact, such as those that benefit the environment (as in the case of Green Economy Transition bonds) or facilitate lending to MSMEs.

For these bonds, the EBRD sets specific reinvestment criteria for the issuer through policy statements, taking into account the issuer's particular practices, often strengthening their existing portfolio. OGC lawyers advise on how these conditions are to be clearly reflected in the legal documentation.

For example, in the case of Bank Millennium, a large commercial bank in Poland, the issuer committed to reinvest 150 per cent of the amount invested by the EBRD in eligible green investments. This leverages the impact of EBRD financing and helps to deliver a stronger transition impact. ■

DELIVERING INNOVATION AND IMPACT

Building resilience through local capital-market development

The EBRD is strongly committed to the development of domestic capital markets in the economies where it invests and, in many markets, the Bank has become the leader in this field among international financial institutions (IFIs). The OGC works closely with the Treasury department to deliver on this commitment.

The importance of EBRD local-currency lending for reducing foreign-exchange risk in the countries where it operates is indisputable. However, it is by borrowing in local currency that the Bank fosters the development of local capital markets, thereby boosting the resilience of economies.

Bonds issued by an AAA-rated institution, such as the Bank, serve as an alternative pricing benchmark to government bond markets. For domestic investors, EBRD bonds serve as an additional investment asset of the highest credit quality, a class of asset of which there may be few in the local market.

These bonds also attract new investors wishing to gain exposure to local currency without being exposed to local credit risk. In addition, the Bank is able to introduce innovative techniques to local-currency financing activities that help foster the overall development of the market.[1]

The EBRD has issued local-currency bonds in a number of countries, including Armenia, Georgia, Hungary, Kazakhstan, Russia and Serbia, as well as Eurobonds in the currencies of many countries in the region. In many markets, the Bank was the first IFI to raise funds on the local market in local currency and the first to offer innovative products that had not been available previously.

Issuing an inaugural local-currency bond in one of the economies in which we invest is usually the culmination of months, years, or even decades of work by the Treasury and OGC lawyers on amending local legislation to create a regulatory framework suited to IFI bond issuance.

Elena Sulima
Senior Counsel, EBRD

> Pursuing the task of changing local legislation requires not only the technical expertise for which OGC lawyers have long been praised

In addition to establishing favourable issuance rules, these changes seek to build a market infrastructure capable of mitigating legal, settlement, regulatory and other risks. Other goals of legislative reform in this area include creating a credible money-market index, a working settlement system, a properly functioning depositary, an appropriate base of investors, clear rules for the admission of bonds to public trading and a multitude of other issues.

Pursuing the task of changing local legislation requires not only the technical expertise for which OGC lawyers have long been praised, but also calls for diplomatic skills to build relationships with local authorities (sometimes from scratch, when governments change), to persuade them to follow international best practices and to promote collaboration between various government bodies in order to achieve a functioning overall market.

The result is always rewarding. Once the regulatory framework is in place, the Bank starts by issuing a simple floating-rate note and moves on to more complex, innovative structures, such as index-linked, equity-linked or commodity-linked notes.

These complex structured bonds may seem relatively usual in developed capital markets, but they are significant milestone events for local markets, where the choice of financial instruments available to investors is not that broad and where the regulatory environment is constantly evolving. This is why a debut issue in a local market is usually a landmark issue with a considerable demonstration effect, attracting new long-term investors to the local market.

The Bank's involvement in local capital markets – on the regulatory side and by issuing bonds and entering into other financial transactions – is widely recognised as contributing significantly to their development. OGC lawyers are proud to be part of the process of helping the financial markets of the Bank's regions in their transition to becoming fully operational and more resilient. ■

[1] There are many colleagues I would like to thank for their valuable contribution to this work, but I would like to pay tribute, in particular, to the late Alexander Semernin.

Local-currency hedging benefits Kazakh clients

Since the global financial crisis, the EBRD has significantly increased its levels of local-currency financing to help clients service their hard currency-denominated debt following a devaluation of their currency of revenue.

Providing financing in local currencies, however, presents clients with another risk: that of a mismatch between the debt currency and the currency in which project costs are denominated.

Many EBRD investments involve construction periods of up to 24 months, during which the Bank disburses its financing in stages in order to limit its exposure to any losses arising from a failed project. During this time, there is a risk that the undisbursed portion of local-currency financing may be devalued. If this occurs, a client may find it impossible to cover its hard currency-denominated costs, such as the acquisition of new technologies. The problem is compounded by the shortage of local-currency hedging products available in many local financial markets.

The EBRD has devised an innovative arrangement to overcome this difficulty. On several recent projects in Kazakhstan, the Bank agreed to disburse local-currency loans in hard currency by means of a pre-funding mechanism. This involved converting the major portion of the Kazakh tenge-denominated loans into hard currency and, subject to a range of conditions, disbursing them into an offshore escrow account belonging to the borrower, but controlled by the EBRD.

The conditions for the pre-funding included a guarantee from the project sponsor covering risks related to the hedging arrangement, an assignment by way of security in respect of the escrow account and the establishment of a trust arrangement in relation to the escrow account and the pre-funded disbursement.

As the funds were made available shortly after signing, before a standard set of preconditions was satisfied, it was essential for the EBRD to have sufficient security and other creditor support arrangements in place. Structuring the disbursement mechanism around both a trust and a security assignment creates an additional layer of lender protection. In particular, the trust

Gani Nassimoldin
Senior Counsel, EBRD

Anna Melnychuk
Associate, EBRD

> OGC lawyers helped to find innovative solutions to the problems faced by clients in the economies where the Bank invests and demonstrated once again that the EBRD is a reliable partner in all circumstances.

arrangement ring-fences the offshore escrow account and pre-funded disbursement from the other assets of the borrower, mitigating the risk of these funds being claimed by creditors in the event of the client facing bankruptcy.

In the case of the aforementioned Kazakh projects, the borrower held in trust the offshore escrow account – all amounts credited to the offshore escrow account and the debt thereby represented – for the beneficiary offshore engineering, procurement and construction (EPC) contractor. If the borrower were to use the trust property for any other purpose, it would then be held in trust for the EBRD. Thus, the loan proceeds disbursed to the escrow account would essentially be deemed to belong to the EBRD if used for any other purpose than payments to the EPC contractor.

This solution addresses the foreign-exchange risks faced by clients, while also providing a certain level of comfort to lenders. It is, nevertheless, rather novel and not devoid of risks, given the differences between common- and civil-law security instruments and property-law concepts, the variation in bankruptcy regimes from one jurisdiction to another and the potential difficulties with regard to the recognition and enforceability of court judgments.

OGC lawyers were instrumental in devising this hedging arrangement. In response to a client's request for a hedging product, we facilitated discussions with colleagues from the EBRD's banking teams and the Treasury Department to determine what options were available. Overcoming various hurdles along the way, we managed to design a legal structure for the pre-funding mechanism and conducted a thorough assessment of its legal and commercial risks before reaching an agreement with the client.

Through this work, OGC lawyers helped to find innovative solutions to the problems faced by clients in the economies where we invest and demonstrated once again that the EBRD is a reliable partner in all circumstances. ■