Diversified Payment Rights (DPR)-secured Financing

Global Remittances Working Group
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Fedecredito: Remittance-backed Future Flow Financing

How does an emerging market savings and credit union cooperative system in El Salvador that serves exclusively “base of the pyramid” individuals tap its US Dollar remittance flows to obtain attractive, long-term financing from IFC and eventually other investors?
Transaction Elements

Several Firsts

- First remittance-secured transaction for IFC

- First transaction with a credit cooperative union for IFC with ‘base of the pyramid’ focus. Mobilizes savings from lower income individuals to channel to target market of individuals and MSMEs

- Debut borrower is introduced to the international markets through securitization of its remittance flows

- Transaction structure is designed to allow FDC to attract other investors in to the transaction
How Can Banks Sell/Pledge Payments Belonging To A Third Party?

- Terms of the international payment system (SWIFT) provide that financial intermediaries are the owners of cross-border electronic payment orders and receive the right to these payments in return for the obligation to reimburse the designated recipient.

- This “right to receive” can be legally separated from the “obligation to pay” the third party.

- If local law is supportive (many jurisdictions, but not all—e.g. US), local onshore FI’s may be able to sell or pledge their “right to receive” DPR payments in return for financing.
Why Do A DPR-secured Financing?

**Benefits for Issuers:**

- Allows clients to monetize an identifiable and predictable offshore hard currency stream to obtain longer-term hard currency funding at lower cost.
- Provides a “funding platform” for multiple issuances—Turkish banks have been using existing DPR platforms for over 10 years.
- Can be done in loan or bond form; pledge or true-sale structure.
- Introduces first-time issuers to the international capital markets and allows them to build a credit history.
- Can provide access to funding when other sources are closed.

**Benefits for Investors/Lenders:**

- Security for a DPR structure is offshore in legally robust jurisdictions. For other financing formats, security is generally located in the domestic jurisdiction and subject to local law/regulatory intervention.
- High overcollateralization = reduction in risk of diversion or volume of DPR flows.
- Mitigation of transfer & convertibility risk—without use of preferred creditor capacity (benefit for DFI investors).
- Can enable exposure to non-investment grade issuers.
- Performance Triggers = mechanism for early exit. DPR deals offer more options—investors can choose to accelerate the amortization of the DPR transaction or, in more serious situations, demand immediate full repayment.
FEDECREEDITO

Description & Highlights

- Fedecredito is a collective of 55 microfinance institutions and workers’ banks serving predominantly the rural poor in El Salvador.
- Goal was to provide Fedecredito with a financing platform for both this IFC investment and future fundraising with international investors based on its flow of remittance receivables.
- IFC was able to bring the structuring and legal expertise required to assemble a securitization based on market standards. Fedecredito can use this in the future to tap international investors with or without IFC.
- This financing will allow Fedecredito to expand its lending by about 25% to member institutions that make financial products and services available exclusively to “base of the pyramid” individuals and MSMEs in El Salvador.

Terms

- Closing Date: July 2, 2010
- Total Size: Up to $30 million
- Final Maturity Date: July 1, 2017
- Interest Payment: Floating rate based on 6-month Libor + 3.25%, payable quarterly
- Principal Payment: Interest-only period for first 2 years, then amortizing quarterly
- Subordination: None. One class of notes only.
- Additional Credit Enhancement: Debt service reserve account equal to the highest quarterly payment due over the life of the transaction.
How DPR Transactions Work: Fedecredito

United States

- El Salvadoran Worker (Payor)
  - Remittance Service Provider
    - Citibank (New York)

El Salvador

- FEDECREDITO
  - FEDECREDITO Member Institution
    - El Salvador Retail Payee

Cayman Islands

- Citibank (New York) Account - Controlled by Trustee on behalf of SPV -
- Special Purpose Vehicle (SPV) - Controlled by Investors

- US$ Purchase Price
- Bond/Loan

- Sale of Rights to All Remittance Flows
- US$ Purchase Price for Future Remittance Flows

Debt Service

Excess Flows
Cashflow Comparison between DPR and “A” Loan

$30 MM DPR Structure

- El Salvadoran Workers (Payors)
  - Remittance Service Provider ($500K in Commissions)
    - Citibank (New York) - Off-shore Bank
      - $9 mm to Pay IFC debt Service
      - $9 mm to FEDECREDITO
      - $9 mm to Recipients

$30 MM “A” Loan

- El Salvadoran Workers (Payors)
  - Remittance Service Provider ($500K in Commissions)
    - Citibank (New York) - Off-shore Bank
      - $9.5 mm to Pay IFC debt Service
      - $9.5 mm to FEDECREDITO
      - $9.5 mm to Recipients

USA

El Salvador

- $500K To Pay IFC debt Service
- $500K To Pay IFC debt Service
- $500K To Pay IFC debt Service

Recipient's Liquidity

FEDECREDITO

Recipients
Key Points To Keep In Mind:

- DPR financing provides significant structural protection beyond that provided by unsecured loans and generally includes recourse to the originator—"best of both worlds".

- Debt Is Debt—DPR financings must be repaid out of a client’s balance sheet resources, because DPR debt service withheld offshore must be backfilled in order to provide the intended onshore payment recipients with their funds.

- A client cannot borrow any more with a DPR financing than it could via any other debt structure. However, it should be able to borrow more cheaply and for longer-term than with other structures.

- Setting up a DPR “Platform” is not inexpensive, so the client should have a need for a sizeable issuance or plan to use it for more than one issuance over time.

- Local law provisions matter. Ability to sell/pledge will vary from country to country, so the strength of the legal structure will likewise vary.
Profile of a DPR Financing Candidate:

- **Has the Required DPR Flows:**
  - Rule-of-thumb: need 6x issuance amount in annual flows to support a given issuance amount. $300mm in annual flows = @$50mm issuance possible.
  - Source of flows matters: Flows from higher risk countries or sourced through certain entities (Western Union) can pose credit risk or involve legal issues and may not be included in the structure.
  - Trend growth rate in flows: Good to see a steady increase or good reasons for fluctuations.
  - Currency Match: Most favorable if most or all flows are in the same currency as the funding provided by the structure.

- **Systemically Important.** Likelihood of official support in a stress scenario improves credit risk profile of the transaction.

- **Possesses a strong market position & franchise within the country**—helps protect against risk that insufficient flows will be generated in the future.

- **Domiciled in a country with favorable laws.** Ability to assign or sell the rights to future-generated cashflow is critical.

- **Non-investment grade country.** Near investment-grade clients/countries are optimal for market investor mobilization. For DFI investor, lower quality is okay.
Key Credit Issues

• Systemic importance of the DPR originator = helps to determine likelihood of gov’t support during a financial crisis or insolvency.
• Strength of local law and regulatory environment.
• Long-term trend of the country’s and originator’s DPR flows & assessment of their sustainability.
• Geographic origin and dispersion of DPR flows.
• Possibility of sovereign interference.
• Percentage of DPR flows that can be gathered through banks willing to sign an acknowledgement.
• Debt service coverage ratios and other performance-related triggers.