

IBRD Hedging Products

IBRD offers a range of hedging products to help clients manage their financial risks. Using standard risk management techniques, these products can transform the risk characteristics of a borrower's IBRD obligations without changing the terms negotiated in the loan agreements.

IBRD borrowers can enter into interest rate swaps or buy caps and collars to reduce interest rate risk. Currency swaps can be used to manage currency risk. Commodity hedges can help borrowers reduce exposure to changes in commodity prices. Such a hedge would have two components:

- An existing IBRD loan with a corresponding interest rate and pre-determined repayment schedule.
- An overlying hedge transaction to mitigate the risk of the particular exposure.

IBRD also offers interest rate and currency swaps in relation to borrowers' non-IBRD debt. Clients eligible to use these products are sovereigns that have an existing portfolio of IBRD loans, are in good standing with respect to debt service obligations to the Bank, and are eligible for new IBRD loans.

In providing IBRD Hedging Products to its clients, IBRD acts as a financial market intermediary, i.e., IBRD stands between market institutions and the borrower, having separate financial contracts with each. The box shows how clients benefit from IBRD's intermediation.

Interest Rate Swaps

Interest rate swaps are individually negotiated transactions that may be used to manage the interest rate risk of a borrower's underlying loan obligation. As counterparties, IBRD and the borrower agree to exchange, at certain future dates, two sets of cash flows denominated in the same currency. The cash flows paid by one counterparty reflect a fixed rate of interest, while those of the other counterparty reflect a floating rate of interest. There is no exchange of principal amounts.

Interest Rate Caps and Collars

Interest rate caps and collars provide protection against rising interest rates. Interest rate caps are individually negotiated transactions which set an upper limit on the interest a borrower would pay on a floating rate loan in exchange for an up-front premium. Interest rate collars are individually

At a Glance

- IBRD Hedging Products help borrowers manage currency, interest rate and commodity price risk.
- Borrowers benefit from IBRD's transaction execution experience, knowledge of derivative pricing methods, as well as relationships with major financial institutions.
- IBRD's AAA credit rating allows countries to access these instruments in larger volumes, longer maturities, and lower costs than they could secure on their own.
- Using IBRD as an intermediary may save borrowers valuable credit lines with private sector institutions.
- IBRD Hedging Products also help borrowers build their knowledge and institutional capacity for using derivative instruments.

negotiated transactions which set an upper and a lower limit on the interest a borrower would pay on a floating rate loan.

Currency Swaps

Currency swaps are individually negotiated transactions that can be used to manage the currency risk of a borrower's net loan obligation. As counterparties to a currency swap, IBRD and the borrower agree to exchange two sets of cash flows, denominated in different currencies, at certain dates in the future. The cash flows reflect payments of interest on these currencies which may be fixed or floating, as well as exchanges of principal amounts.

Commodity Hedges

IBRD commodity hedges give clients an opportunity to manage exposure to commodity prices by linking repayment obligations on IBRD loans to the commodity price. For example, an oil-importing country exposed to the risk of commodity price increases can structure a commodity swap so that repayment of the principal and/or interest rate on the IBRD loan will decrease if commodity prices increase. Conversely, for an oil-producing country exposed to the risk of commodity price declines, the commodity swap can be structured so that repayment of the principal and/or interest rate would decrease if commodity prices decrease.

IBRD Hedging Products are available:

- for purposes of managing risks. Borrowers are required to provide a rationale for the intended use of IBRD Hedging Products when initiating a hedge request. IBRD reserves the right to decline a request that does not meet the conditions for IBRD Hedging Products, or in IBRD’s opinion, does not seem to be suitable for project or debt management needs.
- for use with disbursed and outstanding balances of specific IBRD loans, or with a group of such loans.
- in major currencies, and potentially other emerging market currencies supported by liquid derivatives markets.
- in maturities no longer than the remaining maturity on the loan or portion which is being hedged.
- at any time during the life of a loan. A borrower may choose to use IBRD Hedging Products to effectively transform its loan obligation, on one or more occasions, whether to fix, unfix, or re-fix the interest rate, to establish caps or collars on the variable rate, or to change the currency of obligation.

Borrowers that wish to use IBRD Hedging Products enter into a master derivatives agreement with IBRD. This agreement provides the contractual framework between the borrower and IBRD and allows each hedge transaction between the borrower and IBRD to be documented by a confirmation.

The Table below lists the schedule of fees in effect for IBRD Hedging Products.

Transaction Type	Fee	
IBRD Hedges		
Interest Rate Swaps	0.010%	
Interest Rate Caps and Collars	0.125% (1)	
Currency Swaps	0.020%	
Non-IBRD Hedges		
	Major Currencies	Local Currencies
Currency Swaps	0.100%	0.020%
Interest Rate Swaps	0.030%	0.010%
Notes		
1. Expressed as a percentage of the principal amount involved, and payable as a lump sum.		

See information on guidelines, pricing, and forms at <http://treasury.worldbank.org/en/about/unit/treasury/ibrd-financial-products>

IBRD borrowers can also make use of embedded conversion options in the IBRD Flexible Loan to manage currency and/or interest rate risks over the life of the loan. The main difference between conversions and swaps is that in the case of a conversion the loan currency or interest rate basis of the loan is changed, while the original loan terms remain unchanged when a swap is used.

For Information:

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