THE WORLD BANK
Treasury

Webinar

Using cross currency swaps in public debt management

Wednesday, January 20, 2016, 9:00 – 10:30 a.m.
Washington, D.C., time (EST)

Description of the topic

Introduction

By exchanging debt servicing flows in a given currency for another, cross currency swaps (CCS) increase the number of funding and risk management operations at a debt manager's disposal. A number of debt management offices (DMOs) already use CCS regularly to facilitate the transformation of the composition of the debt portfolio, in many cases reducing financial risks, or to execute funding operations in a more cost effective manner.

CCS are a vehicle for reducing the FX exposure by swapping payout flows in foreign currency for payments in local currency. At the right price, these instruments permit debt managers to de-dollarize/euroize their portfolios rapidly, moving closer to the desired currency composition. Several countries in Latin America, like Uruguay and Colombia, have explored this route.

CCS also offer debt managers the possibility to delink funding from foreign currency exposure, encouraging them to access funding sources that were normally out of their reach and thus helping to diversify their funding sources, which is a key vehicle for reducing refinancing risk. This has been a key motivation for DMOs in Eastern and Central Europe.

In some cases, CCS could also be used to reduce funding costs by exploiting arbitrage opportunities. These operations should always abide by the debt management strategy and should never be used for speculative purposes.

As with any financial instrument, the usefulness of CCS depends on the application being made. The user needs to understand how the instrument works and how it is valued. More importantly, to be able to execute a CCS in the market, a complete infrastructure needs to be in place including legal agreements, credit risk policies, collateral and liquidity management, and systems for valuation, accounting and settlement.

Objective of the Webinar:

To provide a high level overview of the use of cross currency swaps by debt management offices. The overview covers the practical application of these instruments in the management of the government debt and the infrastructure DMOs need for the use of these instruments.

Structure of the Webinar

To meet the above-mentioned objective, the webinar offers 3 presentations. The first one explains the use of CCS, dividing its application in three stages: pre-trade legal and counterparty requirements, execution, and post-trade processes. At the end of the presentation, the audience should have an idea of the complexity of these operations and

understand that closing a CCS transaction requires much more than just knowing the mechanics of the instrument and its valuation. The second and third presentations are country cases of DMOs that have been using cross currency swaps for some time. These countries show the motivation for these transactions, the difficulties they faced and the overall results obtained in terms of the broad debt management objectives.

First presentation: an overview of CCS

This presentation covers the 3 parts of the swap transaction: pre-trade, execution, and post-trade processes.

Pre-trade: CCS transactions cannot be undertaken without proper legal agreements and credit lines with the market maker. The legal infrastructure consists of an ISDA Master Agreement including the Credit Support Annex and the internal authorizations required; with ISDA documentation duly completed, credit lines are needed since after completing a transaction market movements generate claims from one counterparty to the other.

Execution: Once requirements are in place, the trade has to be structured, valued, negotiated and executed. These functions are typically performed by the Front Office after a decision on performing a CCS has been made as a means to achieve a given objective.

Post-trade: Completing the trade requires its settlement, booking and margining. As part of the management of credit risk and in compliance with the international regulations, the DMO needs to manage collateral. In addition, the exchange of debt servicing flows requires managing the incoming and outgoing cash flows.

Second and third presentations: country cases

The country cases of Hungary and Belgium illustrate the use of CCS by DMOs as part of the arsenal of instruments utilized to perform their debt management functions. Both countries have extensive experience both with interest-rate and cross-currency swaps. Mr. Bangó and Ms. Leclerq will share their experiences emphasizing the motivation for the DMOs to use swaps. They will talk about the relative importance of these transactions in the context of the overall debt management operations and the growth of the use of CCS over time. One of the presenters will provide a brief overview of the evolution of the international swap market and will pay particular attention to the impact of the changes in the regulations and the challenges these changes pose in terms of finding acceptable swap counterparties. They will finally discuss the pros and cons of CCS as used in their countries, an overall assessment of the contribution of CCS to the debt management objectives, and some considerations on the use of CCS in the future.