Benefit in borrowing

KAREN BOXALL INTRODUCES A SERIES OF ARTICLES WITH A LATIN AMERICAN FLAVOUR, STARTING WITH FUNDING IN LATIN AMERICA VIA THE NON-DELIVERABLE FORWARDS MARKET.

Too good to be true! That's the usual initial reaction to hearing that it is possible to borrow money from a bank and at maturity pay back less than you borrowed. But negative interest rates are available in Latin America via the non-deliverable forwards (NDF) market due to a continuing excessive demand for US dollars. As you would expect, it is not exactly the same as drawing down on your syndicated facility as there are other factors to take into consideration but it is relatively straightforward and, depending on the reason for a hedge, hedge accounting can also be achieved. At the end of each "loan" period, rolling over is simply a case of agreeing a new rate and settling the dollar flow.

COLOMBIA Currently it is possible to borrow funds at negative interest rates in Colombia. An effective onshore loan can be created with physical delivery to a local entity account in Colombia. For example, using dollars at Libor flat, the effective loan rate in Columbian pesos over one month is -3.6%, while the three-month and six-month rates come out at -4% for both. The benefit dwindles around the one-year tenor.

One factor to take into consideration is counterparty credit risk. There is a 14% withholding tax unless the "loan" is via a Spanish bank (such as BBVA) or Chilean bank due to the tax treaty between these countries, in which case there is zero withholding tax.

There is also a GMF tax, which is levied whenever funds are moved from an account in Colombia. The GMF rate is currently 4 pesos per 1,000 (so, 0.40%) and would apply to an onshore Columbian peso loan too. An IVA tax (VAT) may also be levied on the last step/maturity, when a Colombian entity sells Columbian pesos and buys dollars for spot onshore delivery. This is computed on any gain with regard to the Colombian banks' daily average transactions and is likely to be immaterial. The GMF and the IVA do not outweigh the benefit of negative interest rates.

PERU In the case of Peru, borrowing via the NDF market is presently cheaper than local onshore borrowing via bank debt.

Let's take SABMiller, the world's second largest brewer, as an example. The brewer has taken advantage of the disconnect in Peru between bank facilities and funding through the NDF market for the last three years.

Historically SABMiller borrowed up to $250m in local currency (Peruvian nuevo sol) through local relationship banks. During the credit crisis of 2008 the decision was taken to diversify this bank debt and investigate other funding opportunities.

Initially $100m of bank debt was converted into financing via the NDF market. The dollars were borrowed from the transacting bank to preserve the group's commercial paper (CP) facility, and then "swapped" into local currency via a spot transaction, settling the original Peruvian nuevo sol bank facility and entering an NDF. From a group point of view a Peruvian nuevo sol liability is maintained with this structure.

This achieved cheaper funding than the equivalent local bank facility, although with less flexibility to close out the transaction within the hedged period. However, SABMiller achieved net investment hedge accounting under IAS 39 in its consolidated financial statements. The local currency debt/NDF was designated as a hedge of the group's net investments in Peru. As an effective hedge the mark-to-market movements on the NDF have been recognised in equity, offsetting FX translation gains/losses on the group's Peruvian net assets.

Once the CP market became more accessible, the group financed the dollar leg through the CP market, reducing the funding cost further.

Each transaction is in excess of 63 days to mitigate any local taxes, and at the maturity the dollar leg is settled and then the transaction is rolled forward for between 64 days and six months depending on the implied interest rate and the local currency debt portfolio.

SABMiller is liable to pay the ITF tax, which is currently 0.05% of the notional on the initial spot delivery and on the spot delivery at maturity.

If the "loan" is required for a further period, then this can be rolled over with no movement of funds and no ITF liable at rollover dates, only on the physical payments at the start and at maturity. At each rollover, the new current market pricing is applied.

For more, see Workshop 1, Funding in LatAm via the FX Market – The Corporate View, at ACTAC.

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