Achieving Investment-grade Bonds with MIGA’s Credit Enhancement

Overview

Since the global financial crisis began in 2008, lending to Hungarian businesses has declined sharply, mainly as a result of deleveraging and strict credit allocation decisions of foreign banks operating in the country. In fact, funding reductions by foreign banks have accelerated in Hungary beyond the pace seen in peer countries.

At the same time credit demand has remained robust, especially in the export sector, which has remained buoyant despite the weak overall outlook in the Hungarian economy. It is estimated that 85-90 percent of the country’s GDP has its home in the export sector and the sector is dominated by small and medium enterprises.

In this context, Hungary’s export-import bank, Magyar Export-Import Bank plays a strategic role within the government’s economic plan, as it focuses on Hungary’s export trade—following the sharp drop in domestic consumption and investment—while compensating for the severe decline in credit supply. When the Hungarian government mandated Exim to provide more, affordable financing to Hungarian exporters, Exim was hard-pressed to deliver on a tough mandate in difficult market condition.

MIGA’s Credit Enhancement Solution Boosts Bond Rating

The solution was to issue bonds to raise additional resources, but the challenge was to make the bonds attractive to the market. In an effort to increase the marketability of Exim’s bond issuance, the issuing banks (Jefferies, HSBC, and Deutsche Bank) sought MIGA’s non-honoring of financial obligations cover to enhance the credit quality of the issue. As Hungary’s official export credit agency—wholly-owned by the Hungarian state through the Ministry for National Economy—Exim’s liabilities would be secured by a government guarantee based on Hungarian law, making the transaction eligible for MIGA’s cover.

On October 1, 2013, MIGA issued guarantees totaling €424.4 million ($574.9 million) covering a €400-million financing by a special purpose entity, Magyar Eximbank Secured Funding Limited (MESF) of Ireland, by Magyar Export-Import Bank (Exim) of Hungary. MIGA’s coverage is for a period of up to five and a half years against the risk of non-honoring of sovereign financial obligations for 95 percent of the principal and interest on the notes issued by Exim. This represented the first time MIGA used its non-honoring of financial obligations cover for a capital markets transaction.

MIGA’s guarantee enhanced the credit quality of the issue—boosting the bond ratings from non-investment to investment grade. This lowered the longer-dated borrowing costs of Exim, thereby enabling these savings to be passed on to the Hungarian export sector. This will ultimately strengthen the sector’s competitive position in foreign markets.

An additional, indirect development effect of enhancing Exim’s lending ability deserves note. As it does not possess its own branch network, Exim closely cooperates with Hungarian commercial banks in order to reach small and medium enterprises through their distribution networks. This cooperation supports the stability of the Hungarian banking sector in general, as Exim provides long-term refinancing facilities, strengthening liquidity.
Key features of transformational transaction

- First non-honoring coverage in capital markets
- First purely “public market” (144-A/Reg S) bond issue supported by MIGA PRI coverage
- First time bonds backed by MIGA were rated ‘AAA’
- First time a “price point” established for MIGA risk, reflective of MIGA’s stand-alone credit quality (90 bps over swaps)
- MIGA’s debut transaction comfortably oversubscribed
- Eximbank’s all-in fixed funding cost significantly lower than that of Hungarian sovereign, saving 6 billion – 7 billion Hungarian forint ($27 million – $31 million) over the next 5.5 years

Transaction Structure