Currency Exchange Fund (TCX), TCX Investment Management Company BV

Development Assistance Committee member: Multiple, submitted by the Netherlands

Duration: Ongoing since 2007

Budget: Available capacity of more than USD 1 billion

Geographic focus: Global

Sectoral focus: Finance

Offered: Hedging products

Description: The Currency Exchange Fund (TCX) is a fund managed by TCX Investment Management Company BV, a private company that was established in 2007 by a group of development finance institutions following an initiative by the Netherlands Development Finance Company (FMO). The Dutch government is among investors and, together with the German government, it provided risk capital to facilitate the participation of other investors. The fund provides over-the-counter derivatives to hedge the currency and interest rate mismatches that are created when international investors lend to financial institutions in developing countries in their local currencies.

Objectives: The TCX is mandated to develop markets for long-term exchange rate risk and interest rate risk hedging products, primarily cross-currency swaps, in developing countries and emerging economies where such markets do not yet exist. By contributing to the reduction of market risks associated with currency mismatches, the fund gives borrowers in these countries access to long-term financing in their own currencies and risk management products that help manage exchange rate risks. With such access, borrowers are protected from growing debt burdens, financial losses, reduced abilities to repay debt and possibilities of default linked to high currency volatility, all of which can undermine their businesses and the economic development of their countries.

Partners: The TCX has 22 investors including: development finance institutions from the Netherlands, Germany (the KfW, German Investment and Development Corporation [DEG] and European Fund for Southeast Europe), France (Proparco and the French Development Agency [AFD]), Belgium, Austria, Japan and Spain; international finance institutions, namely the European Bank for Reconstruction and Development, International Finance Corporation, Inter-American Development Bank, African Development Bank and Development Bank of Southern Africa; and specialised microfinance investment vehicles, including Okocredit, Oxfam Novib, Triple Jump, ASN Bank, BlueOrchard and Grameen Crédit Agricole Microcredit Foundation. Investors in the fund must be professional investors from outside the United States, subject to prior approval of the fund manager and existing shareholders in the TCX and subject to a minimum initial investment of USD 5 million.

How it works: Access to TCX hedging products is granted to TCX investors, their clients, parties introduced by TCX investors, and trading counterparties such as broker-dealers. Counterparties that have not invested in the TCX can hedge their currency risks with equity or debt instruments received from TCX investors directly with the fund after a counterparty onboarding process has been concluded and commercial and International Swaps and Derivatives Association agreements have been signed. The onboarding process is based on confirmation of the financial relationship between the prospective counterparty and one or more TCX investors, an anti-money laundering and environmental and social standards certificate, disclosure of the director and ultimate beneficiary owners, disclosure of the non-speculative nature of the currency exposure that the TCX is requested to hedge, financial and corporate information to determine the counterparty's risk rating, and a legal opinion for counterparties domiciled in countries where the TCX has not already secured an opinion.

Procedures and trading capacity with the TCX are different according to the type of counterparty involved. For clients of TCX investors, the trading capacity with the TCX is up to USD 30 million. For partners of TCX investors, the amount can go up to a maximum of their equity investment per annum. For TCX investors, the amount is limited to six times their equity investment during the first 18 months. The limitation is waived after that period and investors are guaranteed to trade up to a maximum of their equity investment per annum. Above that level, investors can access the available fund capacity when their own trading capacities are reached. The current available capacity of the TCX is more than USD 1 billion.

Monitoring and evaluation: A joint evaluation of the TCX has not yet been carried out. Each investor appears to be responsible for evaluating its respective share of investment in the fund.

Results: Since its launch in 2007, the TCX has hedged USD 1.5 billion in loans to borrowers in developing and emerging countries, covering around 70 currencies and particularly benefiting microfinance institutions and small and medium-sized enterprises. The fund has absorbed approximately USD 890 million in currency risks for microfinance institutions and USD 300 million in currency risks for small and medium-sized enterprises. Moreover, by providing hedging products where previously no markets existed, the TCX has operated as a market maker, encouraging other participants to enter markets.

Insights: The TCX is particularly innovative in terms of the diversity and nature of investors involved – government institutions, development finance institutions, and specialised microfinance investment vehicles. The fund is unique in terms of the problem that it seeks to address, namely the availability of local currency lending in developing and emerging countries where there are no liquid, sustainable financial markets, and ensuring additionality. The use of hedging products and the diversity of partners that enables the fund to hold a diversified portfolio of currencies and thus mitigate risks are also innovative.

SOURCE:

TCX (n.d.), Currency Exchange Fund website, www.tcxfund.com (accessed 1 July 2016).