



Local Currency Risk Management, Financing and Hedging Solutions

AADFI annual workshop
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Ruurd Brouwer, Isabelle Lessedjina, Demba TANDIA

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TÇX

Agenda

Part I

- About TCX

Part II

- LCY and FX risk survey & findings

Part III

- Local currency financing and FX hedging
- TCX pricing
- Challenges and advantages of LCY financing
- Benefits and development of a LCY strategy and FX-risk management

Annex

- Trading with TCX pricing
- Special program



About TCX

*Ambassade de France
aux Etats Unis*

Washington, le 31 mai 1946

714

Monsieur le Président,

J'ai l'honneur, au nom du Gouvernement Provisoire de la République Française, de présenter à la Banque Internationale pour la Reconstruction et le Développement la demande d'un emprunt à long terme d'un montant de 500 millions de dollars.

Je me tiens à votre disposition pour vous faire fournir, dès que vous le jugerez utile, les renseignements qui pourraient être nécessaires à la Banque./.

Veuillez agréer, Monsieur le Président, les assurances de ma haute considération.

H. Boue

Ambassadeur de France

The Honorable Emilio G. Collado,
Temporary Chairman,
International Bank for Reconstruction
and Development,
1818 H Street, N.W.
Washington, D.C.

First World Bank loan

Borrower was Republic of France

TCX investors

A group of DFIs and private investors active in emerging and frontier markets and backed by 5 governmental entities

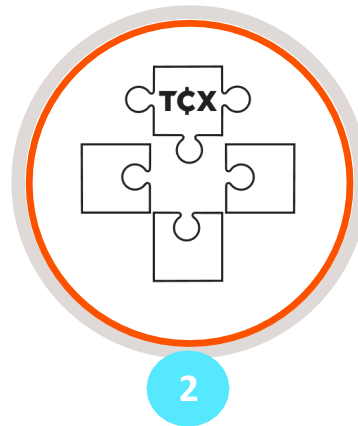


TCX principles

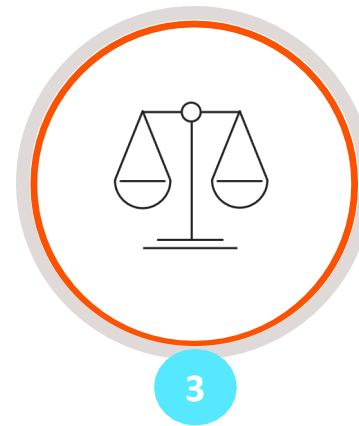
TCX has four key principles that guide the business operations



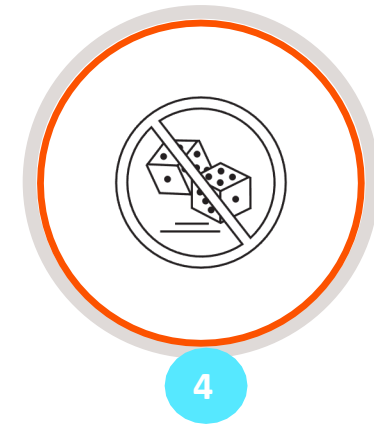
Reliability



Additionality

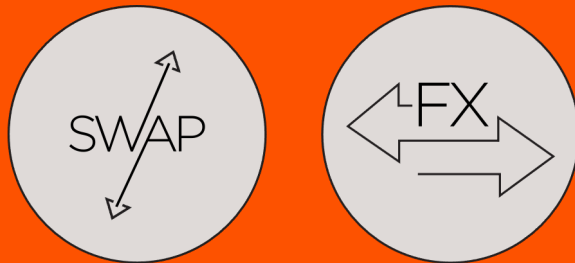


Market-based pricing



No speculation

TCX products & features



TCX offers to its clients FX Forwards and Cross-Currency Swaps (CCS)

These products are non-deliverable with settlements in USD or EUR

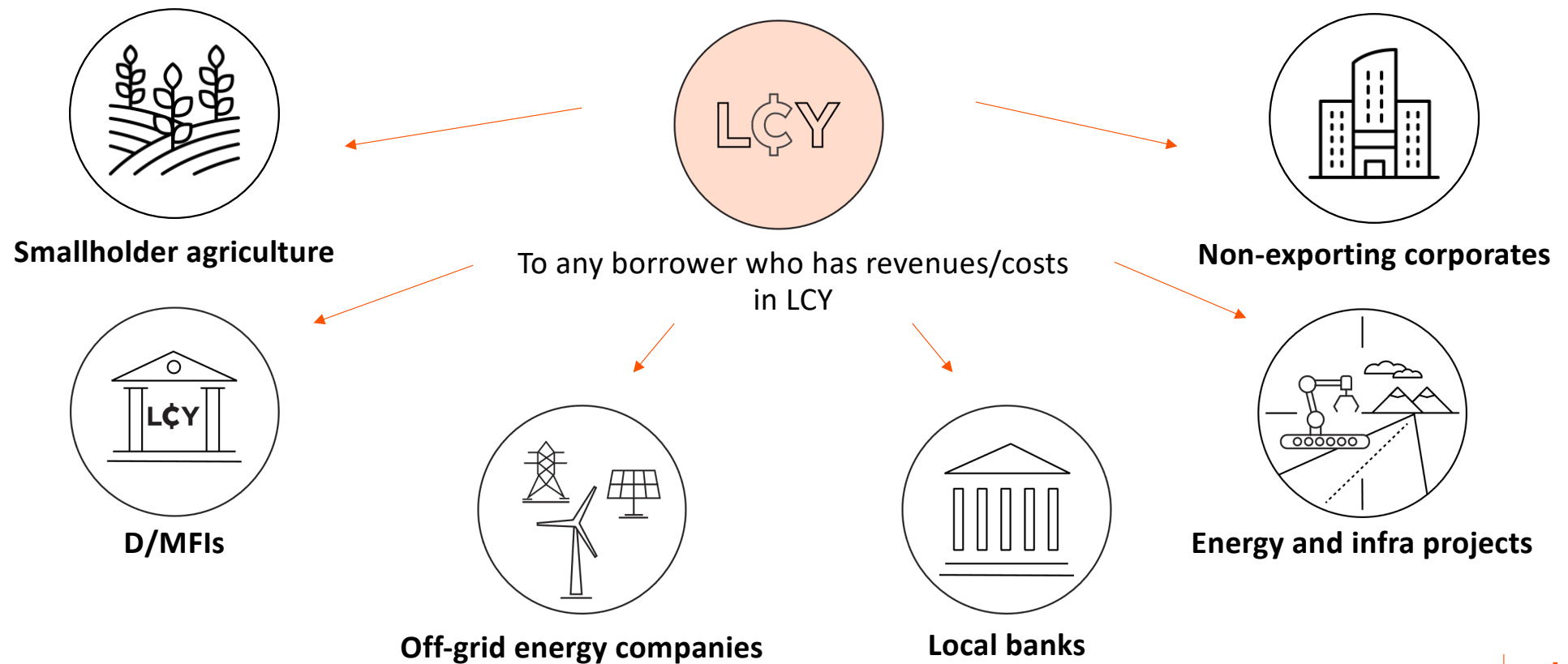
TCX can offer quotes usually from 2Y onwards with no tenor limitation

For CCS, TCX can offer floating rate based on an interest or inflation benchmark

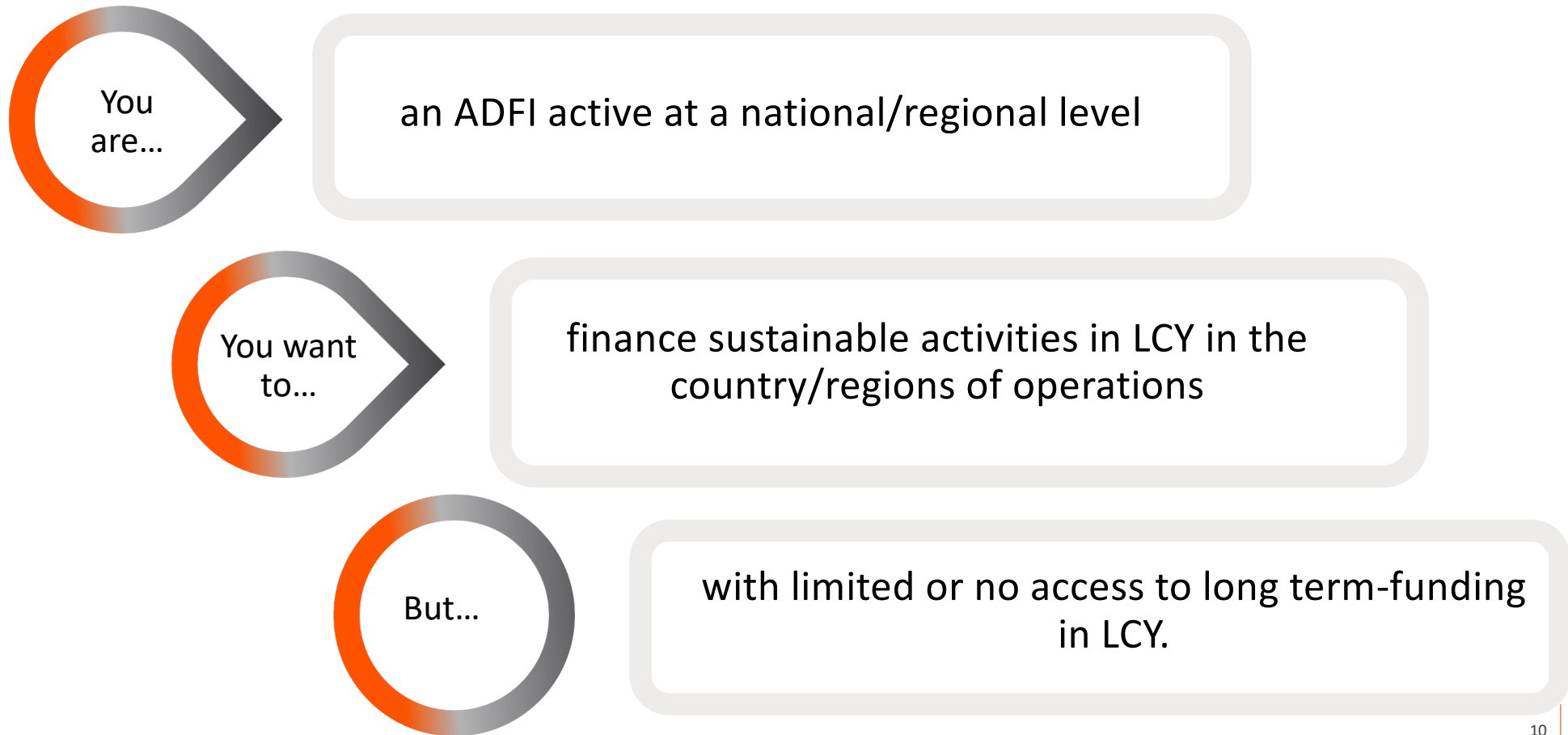


LCY financing and hedging

Sectors that need LCY



What could be the situation of an ADFI ?



Sources of LCY

LCY from onshore sources

LCY from local sources

- Retail deposits
- loans from a local bank
- Debt capital markets (bonds issuance)
- Central Banks refinancing

(Offshore DFI) guarantees

- To encourage local banks/investors to lend (e.g. GuarantCo)

LCY from offshore sources

Unhedged LCY loans

- The investor or the borrower takes the FX risk

Hedged LCY loans

- LCY loans hedged with a derivative product

2 offshore solutions

LCY-denominated facility

Request LCY-denominated long-term funding when negotiating with international lenders (official, bilateral, private)

**Simple
way**

Combine USD funding + hedging instrument

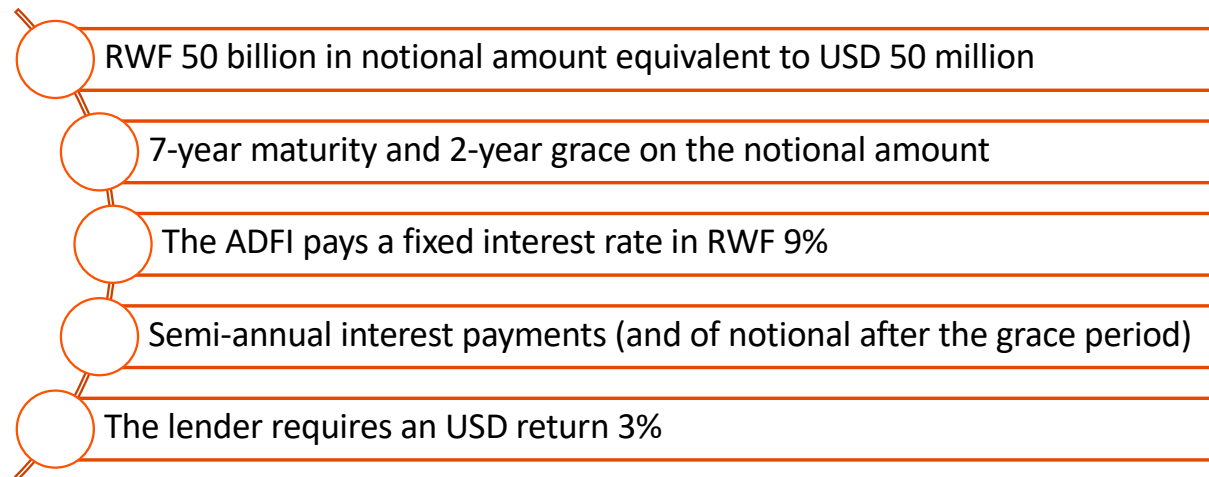
Recycle your USD liability and liquidity by entering into derivatives with FX-hedge providers

**Tailored
made**

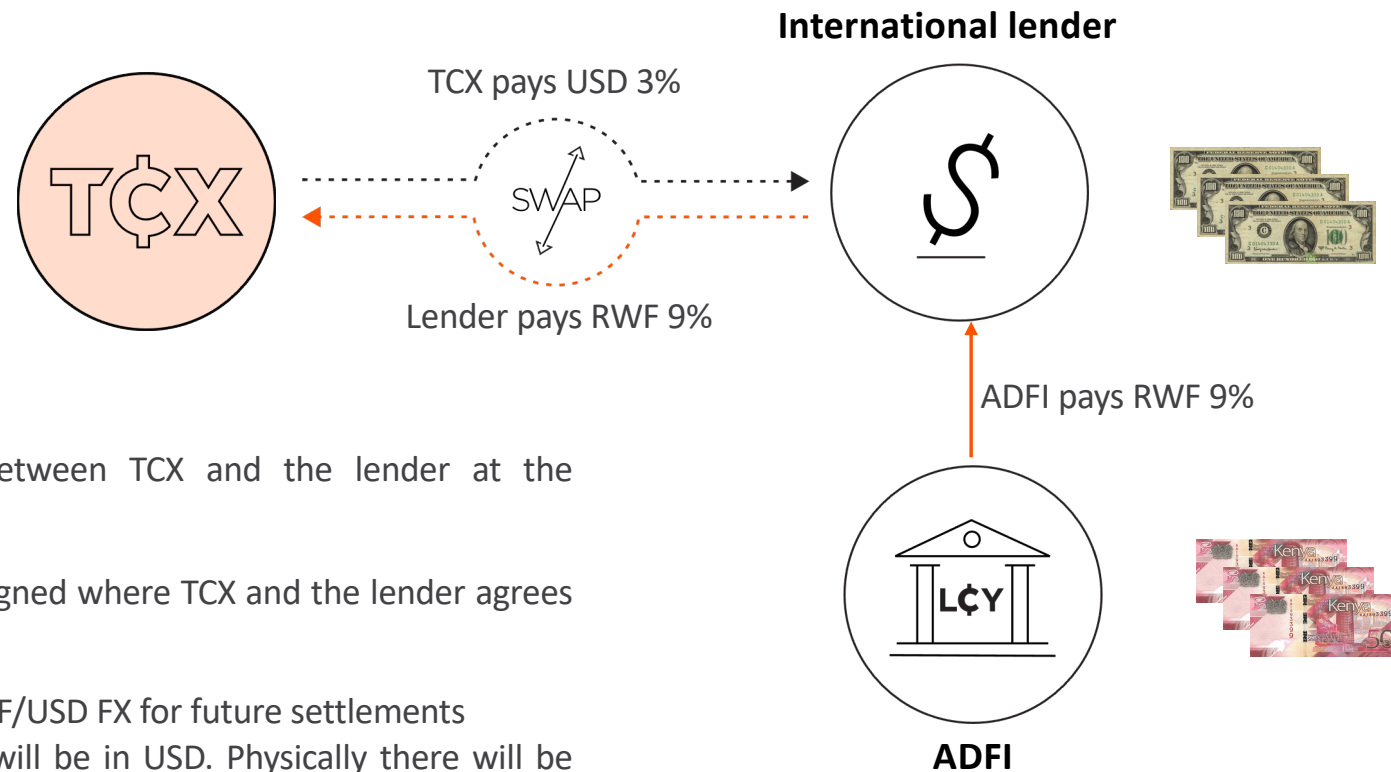
Solution #1 : synthetic LCY from offshore lenders

Rwandan Franc example

- An ADFI is looking for a long-term funding and enters into negotiations with an international lender/investor.
- After negotiations, the 2 parties agreed the following.
- The operation was structured as a **synthetic local currency loan** with the following terms.



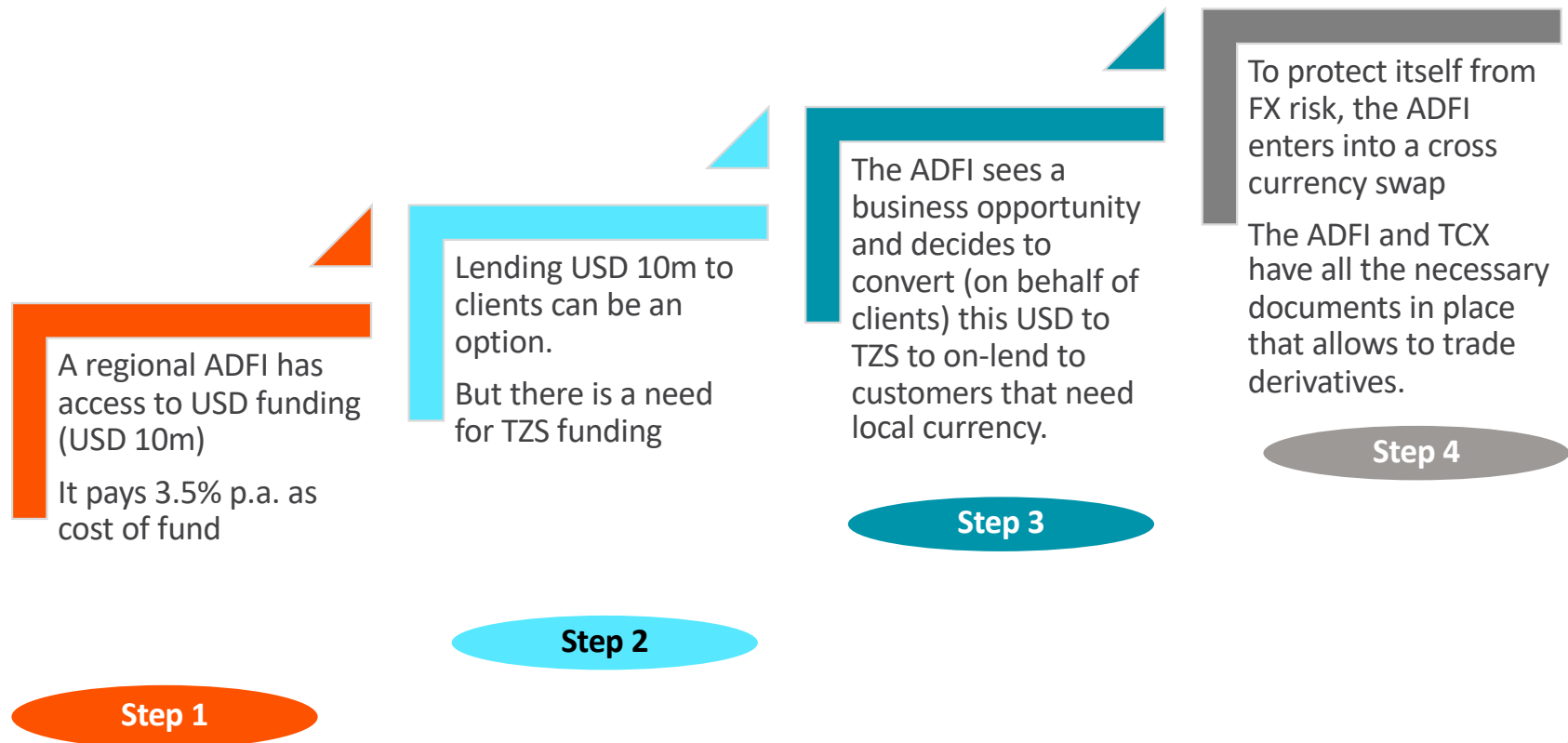
Mechanism



- No exchange of amounts between TCX and the lender at the disbursement of the loan.
- Simply a swap agreement is signed where TCX and the lender agrees on:
 - the definition of the RWF/USD FX for future settlements
 - that future settlement will be in USD. Physically there will be no flows in RWF.

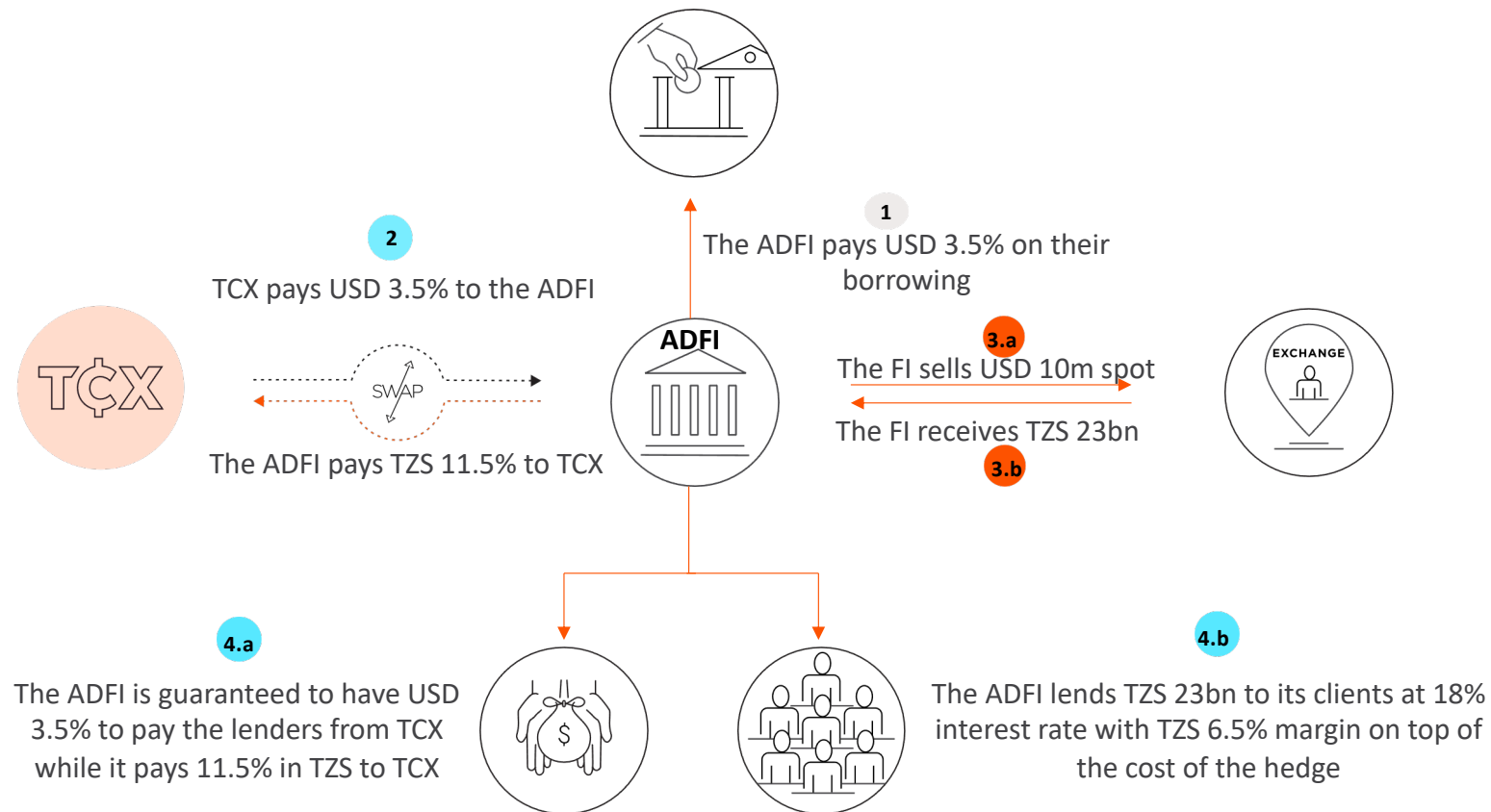
Solution #2 : recycling USD funding & hedging

Tanzanian Shilling example



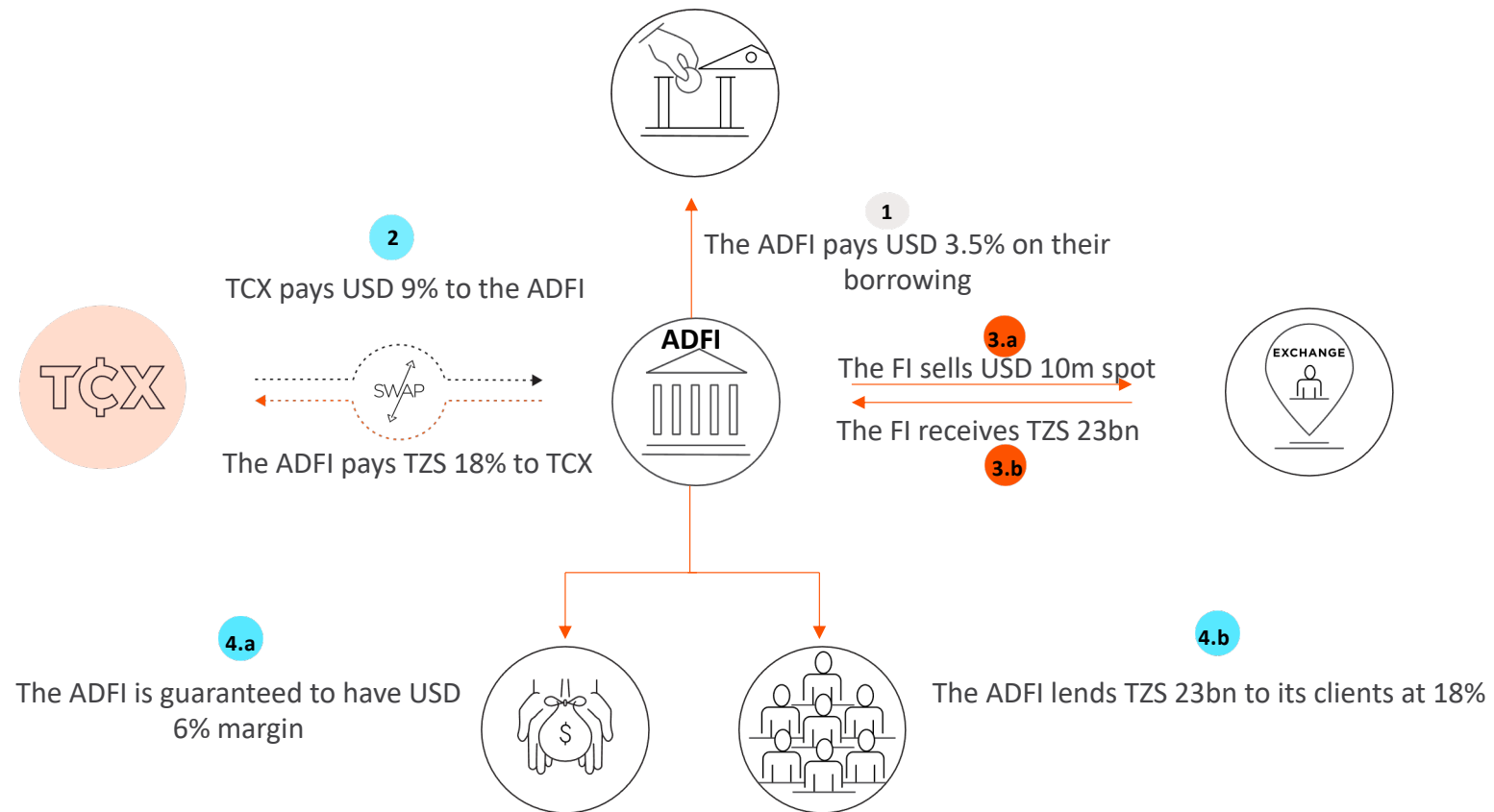
Mechanism

With unhedged margin



Mechanism

With hedged margin

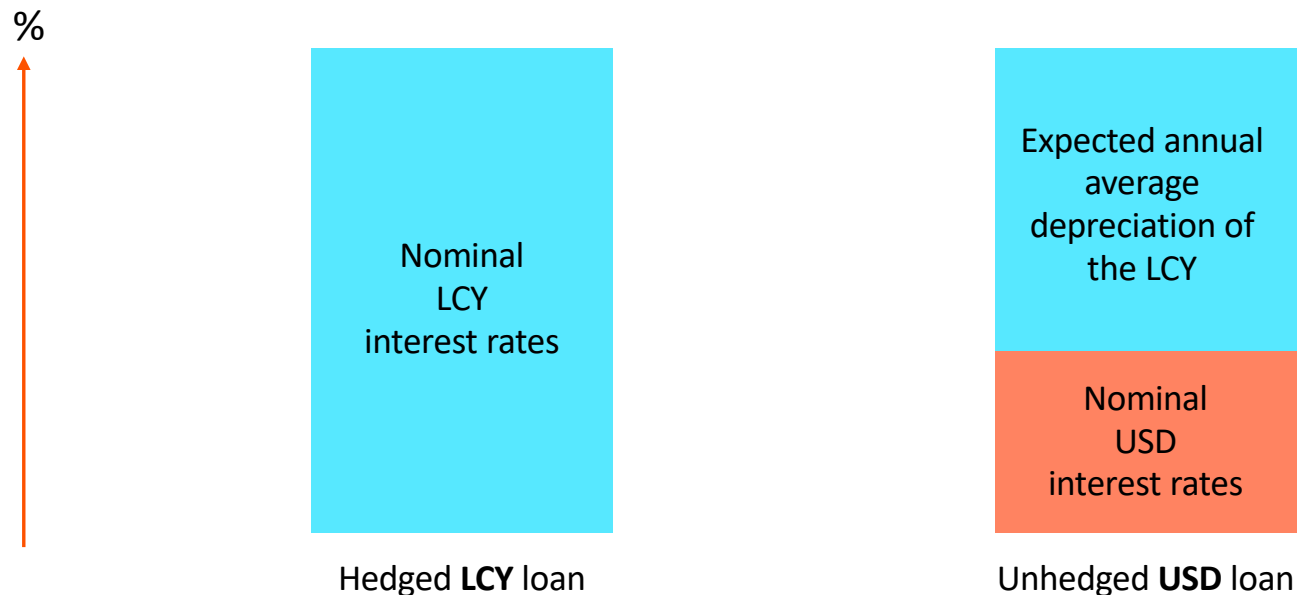




TCX pricing

Cost of LCY compared to that of USD

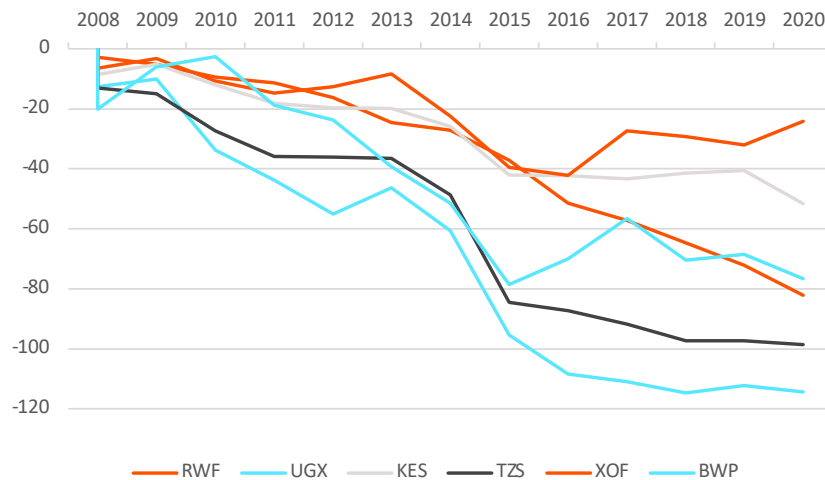
- LCY financing on average costs the same as USD financing (TCX is the empirical evidence!)



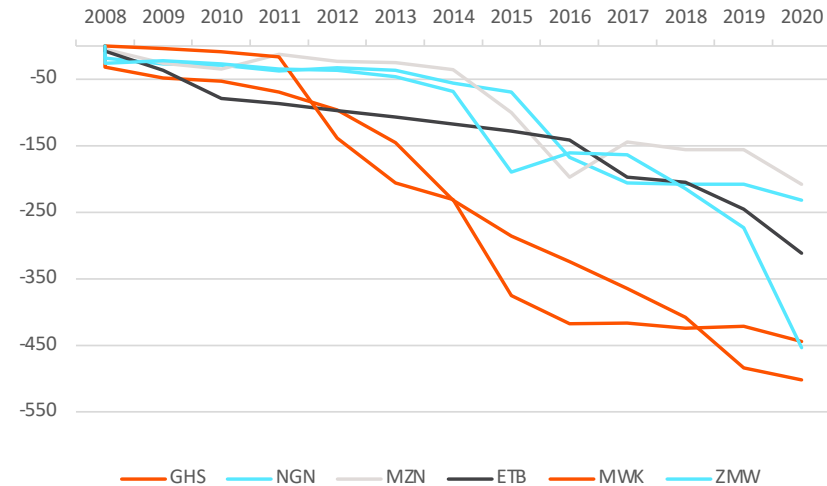
Historical volatility of SSA currencies

	RWF	UGX	KES	TZS	XOF	BWP	GHS	NGN	MZN	ETB	MWK	ZMW
FX rate vs USD at YE07	543	1726	72	1165	443	6.3	1	118	24	9	140	4
FX rate vs USD at YE20	989	3701	109	2314	550	11.1	6	391	74	38	764	21
Gross depreciation YE07-YE20	82%	114%	52%	99%	24%	77%	502%	232%	208%	312%	444%	454%
Avg. annual depreciation	4.7%	6.4%	3.4%	5.6%	1.9%	4.9%	15.2%	10.5%	10.6%	11.9%	16.5%	15.9%

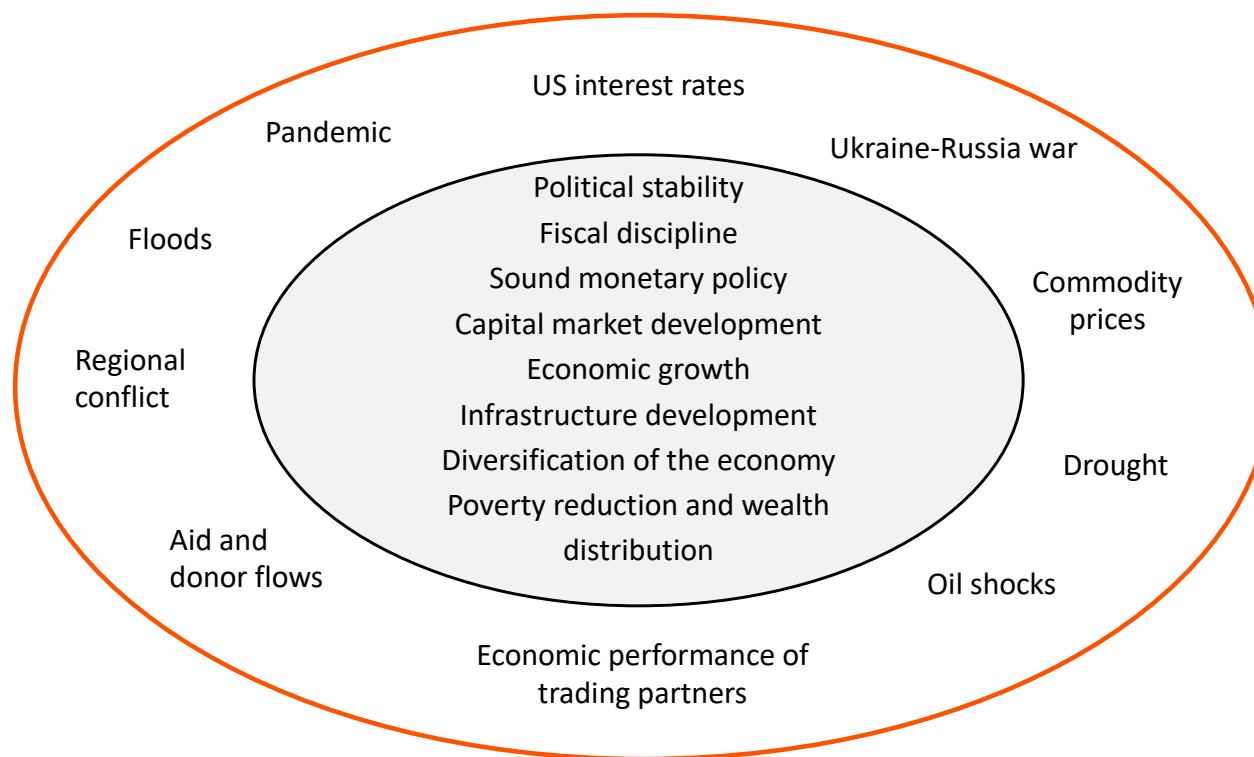
Cumulative depreciation in % from 2008 to 2020



Cumulative depreciation in % from 2008 to 2020



What influences/can influence exchange rates?



TCX pricing in practice

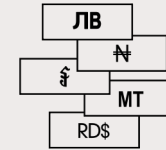
TCX provides reliable and market-based pricing



Non-market distortion &
Non-speculation



Pricing based on economic
theory



Pricing methodology
based on currency
classification

Pricing methodologies

1. Market-based Currencies

South Africa **ZAR** 

2. Partially Market-based

Ghana **GHS** 
 Kenya **KES** 
 Nigeria **NGN** 
 Uganda **UGX** 
 Zambia **ZMW** 
 Tanzania **TZS** 

3. Pegged Currencies

Botswana **BWP** 
 West African CFA **XOF**
 Central African CFA **XAF**

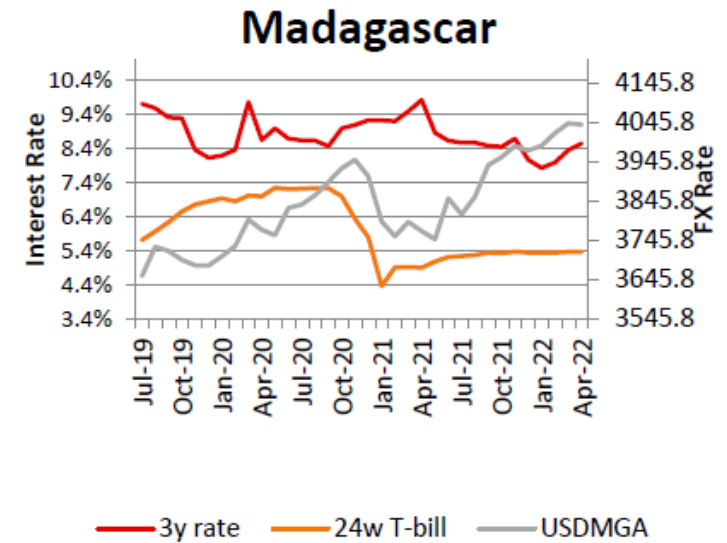
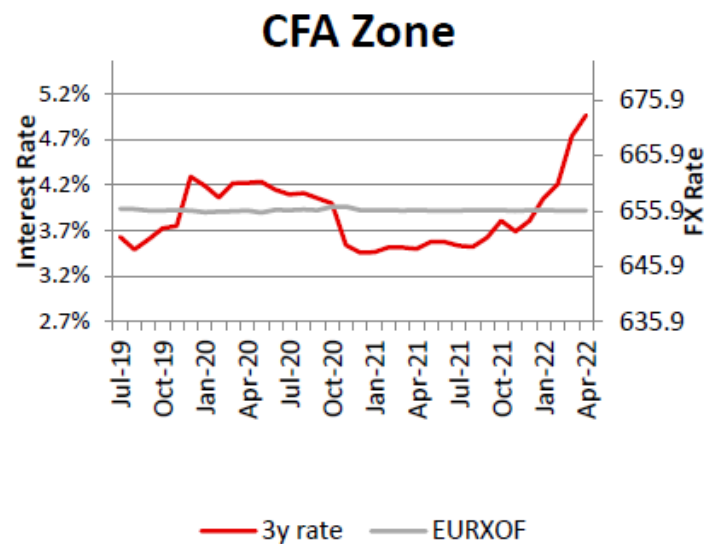
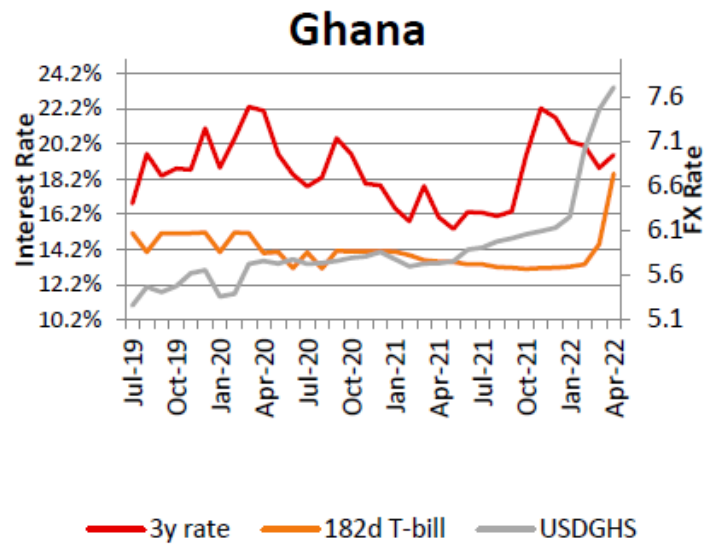
4. Currencies with no market

Ethiopia **ETB** 
 Guinea **GNF** 
 Madagascar **MGA** 
 Mauritania **MRU** 
 Malawi **MWK** 
 Mozambique **MZN** 
 Rwanda **RWF** 
 Sierra Leone **SLL** 

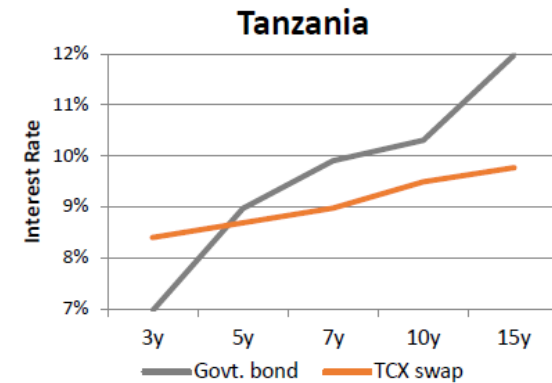
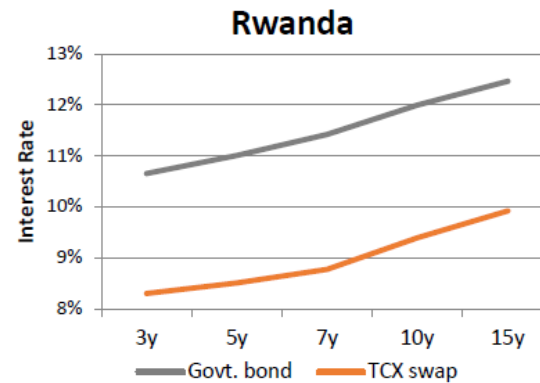
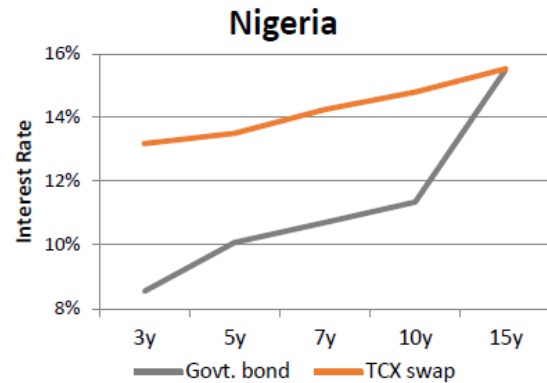
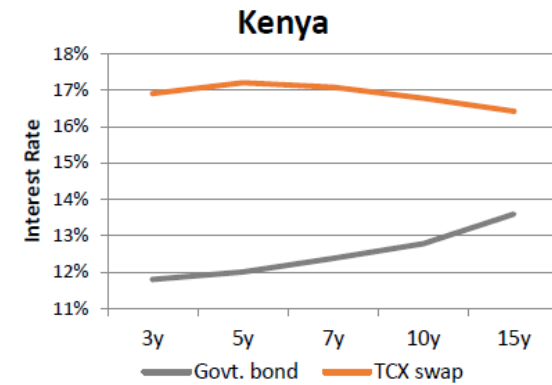
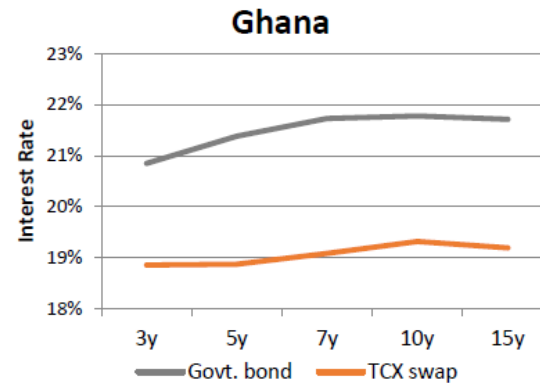
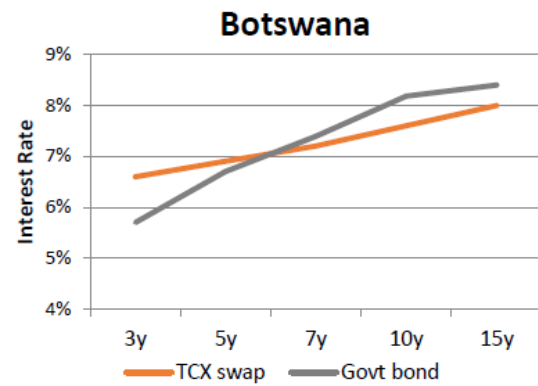
More developed

Less developed

Pricings across the time

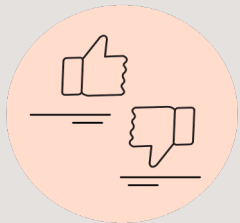


Pricings across the curve





Challenges and advantages of hedging



Challenges vs TCX solutions

Challenges

- **No benchmarking:** international banks do not quote frontier market currencies
- **Pricing volatility:** pricing is in principle adjusted prior to disbursement
- **Non-deliverability:** TCX has no onshore presence and cannot solve USD liquidity scarcity and convertibility risk
- **USD funded sectors:** sectors like energy and infra are often dollar financed, despite LCY revenue
- **Misperception of the cost of LCY:** nominal interest rates in LCY are higher, therefore it is more expensive ???
- **Technical complexity:** structuring of LCY deals and trading derivatives are considered operationally complex

Solutions

- Transparent pricing methodology and an external pricing committee
- Price freezing for 3 months for fixed rate trades and 6 months freezing for the margin on a benchmark
- On demand development of deliverable products
- LCY financing advocacy and product developments -> no tenor limits, no volume limits, inflation linked swaps etc.
- Build risk awareness, cost analysis only at maturity
- Continuous client support for structuring LCY loans and operational assistance

What are the risks of the synthetic loan?

Fixing risk

- To convert LCY amounts in USD for settlements, TCX uses the official rate as reference.
- However, a local client sells LCY for USD using its bank's spot rate.
- There is always a difference between the official rate and a bank's spot rate that inevitably leads to a fixing risk for the local client.
- This is the so-called "fixing" or "slippage" risk, and it is generally borne by the local client.

Convertibility risk

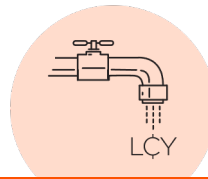
- Despite the cash flows being denominated in LCY, settlements occur in USD.
- The responsibility to sell/buy USD falls on the local client that needs to find liquidity in the local banking market.
- Should hard currency liquidity dry up, the local client might find difficult to convert LCY in USD.
- This is the so-called "convertibility" risk, and it is borne by the local client.

Advantages of LCY



Improves a lender's reach and impact

- Serve more clients that require LCY financing
- Development impact is greatest in LCY sectors (microfinance, SMEs, offgrid etc.)
- Contribute to capital market development
- Be competitive and relevant



Right product for the borrower

- No currency mismatches between debt and revenue, no exposure, no risk
- Predictable cash flows
- Better credit risk for lenders and risk/return for investors

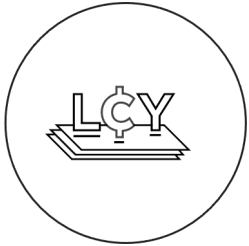


Reduce systemic risk!

- Improving resilience to external shocks by decreasing the dollarization of local markets
- Break the destructive cycle of currency risk fueling high LCY interest rates and with that, a propensity to borrow even more in USD



Benefits and implementation of a LCY strategy and hedging



Benefits of a local currency strategy for ADFI

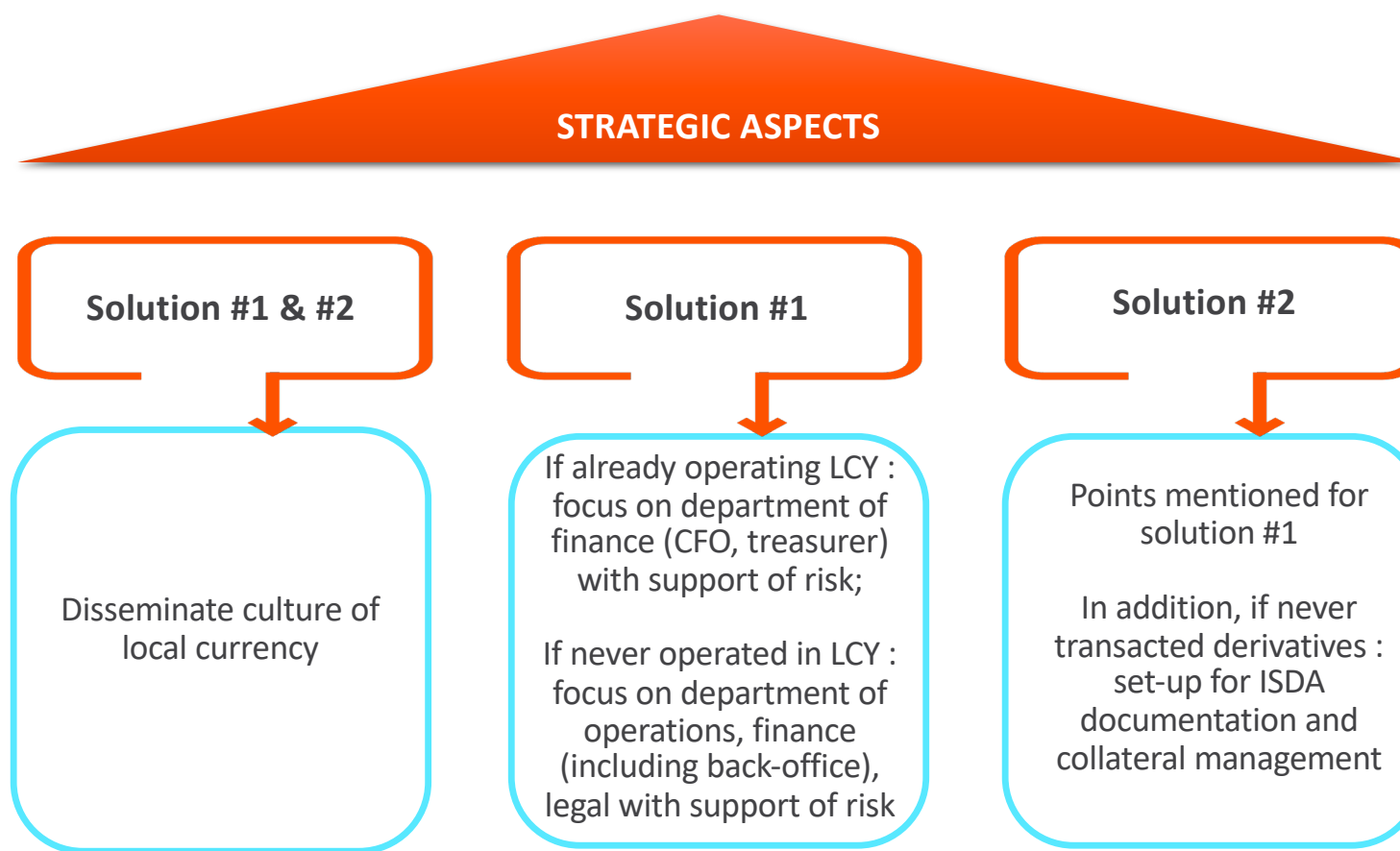
Expand lending activities beyond USD/EUR denominated facilities with potential new clients

Promote sustainable finance by offering suitable financial solutions to borrowers

Diversify funding source and strengthen risk management that could be recognized by external parties (investors, rating agencies...)

Promote the development of local capital markets as an issuer or investor through thematic bonds (e.g. ESG)

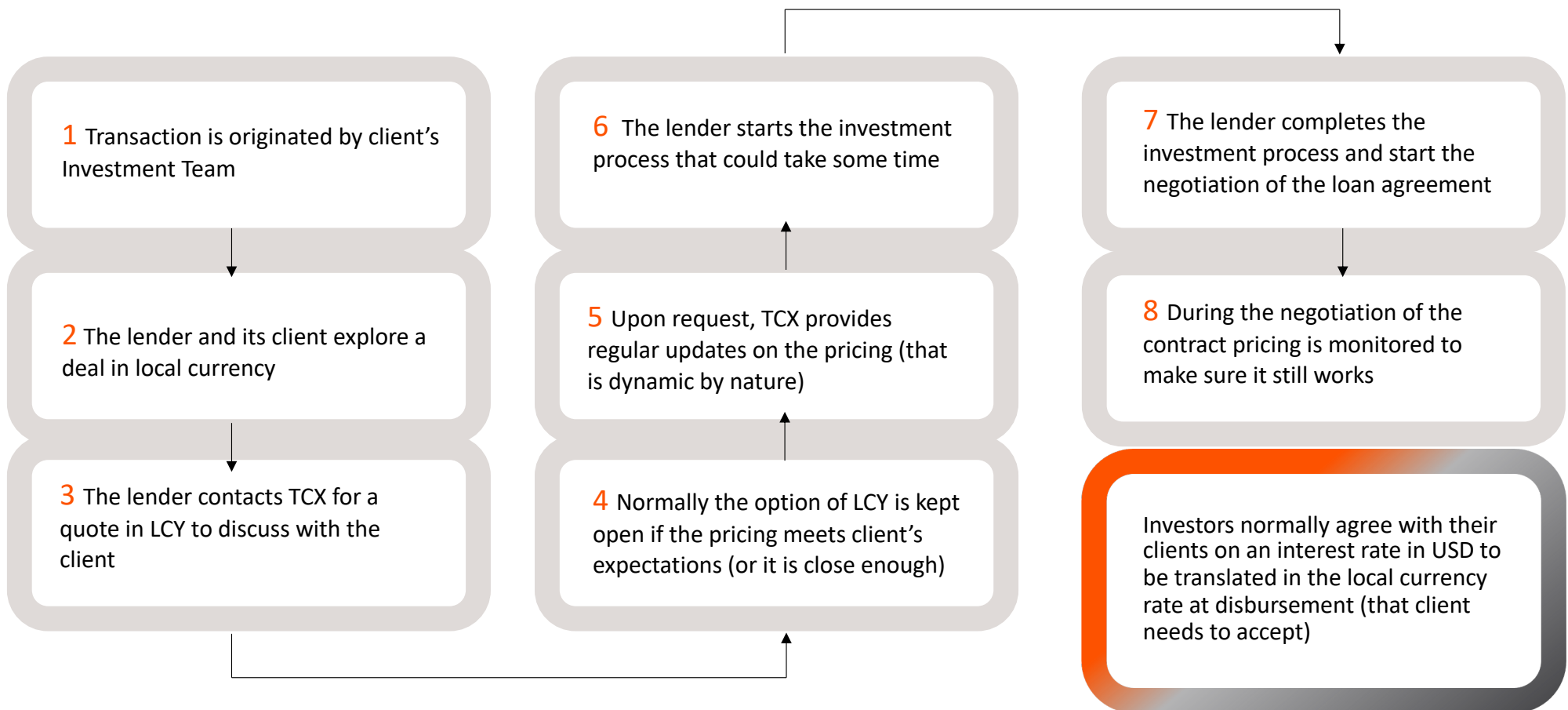
How to develop local currency strategy





Trading with TCX

Negotiation timeline



Type of quotes

Indicative quotes

- Pricing provided by TCX Trader routinely to clients that are negotiating/discussing with potential clients. These quotes can be requested to TCX Trading Desk
- Good approximation but non-tradable pricing
- TCX can provide quotes to all staff of the client upon request

Binding quotes

- Pricing immediately tradable however this type of quote is provided mostly for reserving capacity (see next point)
- Upon request, for shareholders, TCX can reserve capacity (notional amount) for a specific trade in its system for 6-month period basically granting TCX will be in the position to close the trade at a later date
- Pricing is not held and will be refreshed at the trade date

Live quotes

- Pricing immediately tradeable
- Validated by TCX external Risk Manager
- TCX prefers to being informed who has the authority to close trades (normally Finance or Treasury Team)

Requesting quotes

Contact TCX with
following
informations

Information required

- **Product:** Swap or FX Forward with indicated the currency pair requested
- **Notional amount:** in USD/EUR or Local Currency
- **Structure:** maturity, grace period, notional amortizations and interest
- **Day count:** (ex. Act/360, Actual/365, 30/360)
- **Desired rate in USD/EUR or Local Currency:** TCX provides the equivalent in the other currency

1 TRADE DATE (T-2)

Trades are normally closed two days before the trade itself is effective (T-2)

3 The trade is booked within 24h (normally immediately) in TCX's system in line with regulation requirement

5 On the following day (T-1) TCX Back Office provides automatically to the client a full trade confirmation for electronic signatures

Trading Timeline

2 On the trade date TCX provides a live price to the client, then TCX agrees with the client on all terms via email (pre-confirmation & disclosure form)

4 Client transfers the funds to the client and provides the final repayment schedule with amounts denominated in local currency

6 EFFECTIVE DATE (T)

2 days after trading, the trade is effective, interest starts accruing. By then the lender has already sent the funds to its clients

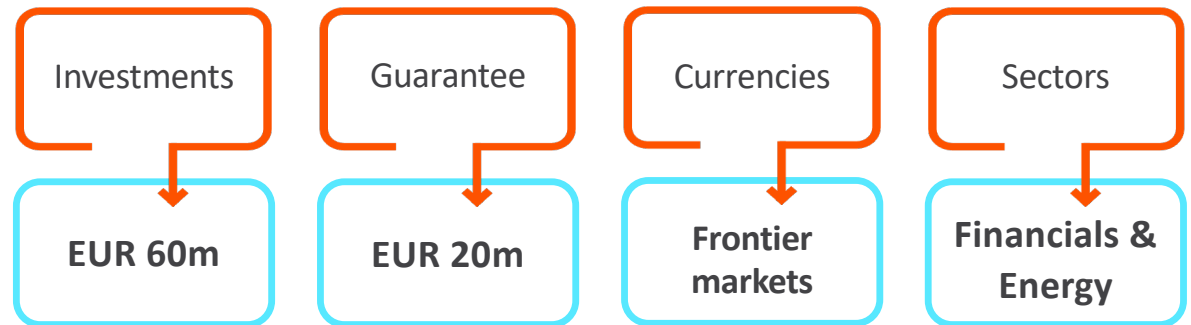


Special Program



European Commission Pricing Facility

- Increase access to synthetic local-currency borrowing for institutions based in Sub-Saharan Africa and the European Neighborhood countries
- TCX is be able to offer discounted pricing in several target currencies to (development finance) investors thanks to a dedicated EC guarantee (risk-sharing mechanism)





Questions?



Thank you

For more informations please contact
Demba Tandia | d.tandia@tcxfund.com



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