MOODY'S INVESTORS SERVICE

CREDIT OPINION

25 July 2023

Update

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RATINGS

TCX

	Rating	Outlook
Long-term Issuer	A1	STA
Short-term Issuer	--	--

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The Currency Exchange Fund NV (TCX) – A1 positive

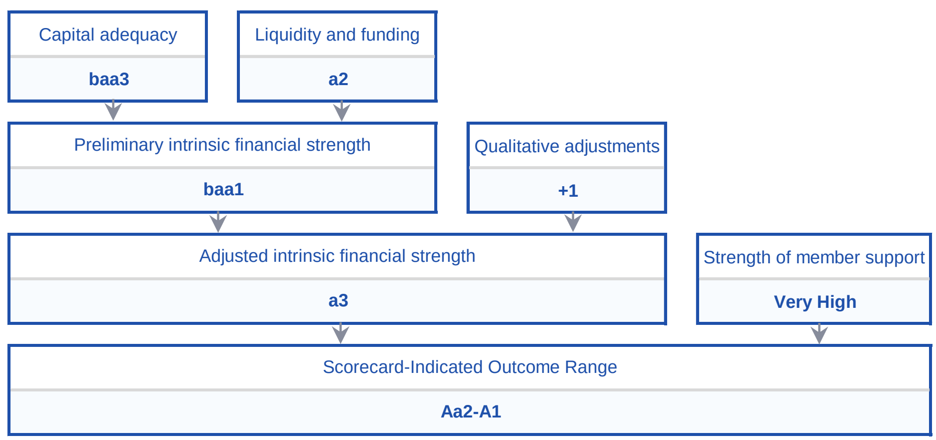
Update following rating affirmation, outlook changed to positive

Summary

The credit quality of The Currency Exchange Fund NV (TCX) reflects the strong liquidity and solid support it receives from mostly highly rated shareholders, which are also the main users of TCX's currency-hedging services, and its strong risk management policies and practices. These strengths are counterbalanced by TCX's volatile asset performance and weak asset quality because of its focus on emerging- and frontier-market currencies.

Exhibit 1

TCX's credit profile is determined by three factors



Source: Moody's Investors Service

Credit strengths

» Very large liquidity buffers invested in highly rated and liquid instruments

» Very strong support from a diverse group of mostly highly rated shareholders

» Sophisticated and prudent risk management

Credit challenges

» Unusually risky and inherently volatile business profile

» Redemption feature of capital instruments, which weakens capital adequacy

Rating outlook

The positive outlook reflects the very strong member support, as illustrated by TCX's continuous ability to attract substantial funding from highly rated new and existing shareholders that will fund TCX's growth plans. This indicates that additional capital may be provided which would strengthen TCX's credit profile. Similarly, the positive outlook also reflect the prospects of TCX delivering on its targeted portfolio growth without compromising its solid capital and liquidity positions over the coming years.

Factors that could lead to an upgrade

The rating could be upgraded if the prospect for additional capital materialized. This could be in the form of further callable or paid-in capital or if the existing paid-in equity was made permanent. While TCX's capitalisation is solid, we do not give full equity credit to its capital instruments because of shareholders' redemption rights.

Factors that could lead to a downgrade

The outlook would likely return to stable if our expectation of further capital injections did not materialize. The rating could be downgraded in a scenario of much higher leverage, which could be the result of TCX's inability to hedge its exposures or of severe losses and sharply deteriorating asset performance, coupled with evidence that shareholders were unwilling to provide additional capital. In a remote scenario, TCX's capital levels would approach the trigger levels at which shareholders would have to decide on the voluntary winding-down of the fund.

Key indicators

Exhibit 2

TCX	2017	2018	2019	2020	2021	2022
Net Asset Value (US$ million)	558.4	508.6	751.3	795.5	829.2	838.2
Development-related Assets (DRA) / Usable Equity [1][2]	272.6	309.0	256.5	246.1	248.0	258.5
Non-Performing Assets / DRA	4.7	4.4	4.9	4.2	4.8	4.8
Return on Average Assets	11.9	-4.3	12.2	2.1	9.6	0.8
Liquid Assets / ST Debt + CMLTD	--	--	--	21,508.4	--	--
Liquid Assets / Development-related Assets [1]	57.2	53.3	57.3	63.0	59.8	57.8
Callable Capital / Gross Debt	0.0	0.0	0.0	20.5	52.1	88.7

[1] We define development assets as the notional value of the primary and hedging portfolios
[2] Usable equity includes 75% of the Class A shares and Convertible Subordinated Loans maturing in 2045

Sources: TCX and Moody's Investors Service

Profile

The Currency Exchange Fund NV (TCX), based in Amsterdam, is a specialized finance vehicle that provides hedging mainly in the form of non-deliverable cross-currency swaps on illiquid emerging market currencies. It was set up in 2007 by a group of development finance institutions to support their development mandate, by enabling them to lend in local currency while removing the currency risk from their balance sheet. It is currently owned by 19 multilateral and bilateral development finance institutions and microfinance investment vehicles that are also its primary clients. The main shareholders are highly rated and include Kreditanstalt für Wiederaufbau (KfW, Aaa stable); the European Bank for Reconstruction & Development (EBRD, Aaa stable); FMO, the development agency of the government of the Netherlands (Aaa stable); the International Finance Corporation (IFC, Aaa stable); and the European Investment Bank (EIB, Aaa stable). TCX also receives funding from several highly rated governments in the form of convertible subordinated loans.

TCX only offers hedging solutions where no market exists or only at longer maturities than the market offers (additionality principle). TCX prices its products in accordance with prevailing market pricing principles to provide its counterparties with competitive prices while avoiding distorting existing markets or hindering potential market developments (market-based pricing principle). TCX only transacts to offset open currency exposures (non-speculation principle). As of year-end 2022, TCX had active swaps in 55 currencies.

Detailed credit considerations

Our determination of a supranational's rating is based on three rating factors: capital adequacy, liquidity and funding, and strength of member support. For Multilateral Development Banks (MDBs), the first two factors combine to form the assessment of intrinsic financial strength, as shown on the cover page graphic. Additional factors can affect the intrinsic financial strength, such as risks stemming from the operating environment or the quality of management. The strength of member support is then incorporated to yield a rating range. For more information, please see our Multilateral Development Banks and Other Supranational Entities Methodology, published in October 2020.

FACTOR 1: Capital adequacy score: baa3

Our "baa3" score for TCX's capital adequacy balances solid levels of paid-in capital and other funding support against a high exposure to market risk, in particular foreign-currency risk, and its inherently volatile operating performance. The score is in line with that of peers such as West African Development Bank (BOAD, Baa1 stable) and the African Export-Import Bank (Afrexim, Baa1 stable).

Moderate leverage as increasing hedging activity and equity injections mitigate portfolio growth

We calculate leverage as development-related assets/usable equity. In TCX's case, we consider as development assets the notional net value of its primary and hedging portfolio, which was $2.0 billion as of year-end 2022. The size of the outstanding portfolio has grown only moderately since the pandemic despite continued growth in transaction volumes, reflecting the relatively short maturity of swaps and a slowdown in lending in the CIS region following Russia's invasion of Ukraine (Ca stable).

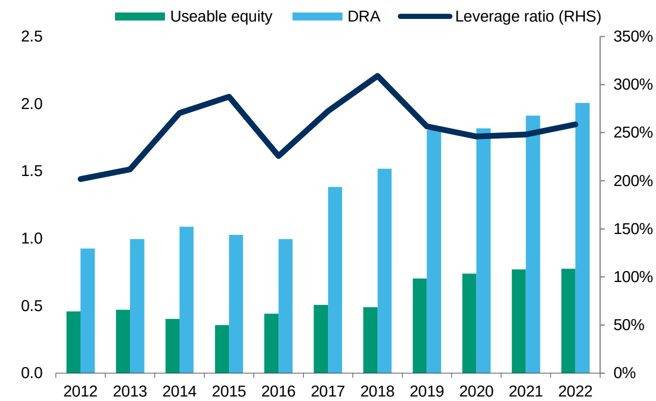
Over the past several years, the primary swap portfolio has remained broadly stable at around $3.2 billion, but TCX's ability to hedge an increasing share of its swaps — either with shareholders or investment banks — has helped it reduce its leverage from a peak of 309% in 2018 to 258% in 2022. The hedge portfolio has increased from around $430 million in 2018 to close to $1.2 billion last year; we consider these hedges to be effective in reducing the overall risk on TCX's balance sheet. They also contribute to the fund's objective of developing local currency debt markets.

Hedges are done with both commercial counterparties and some shareholders via local-currency bonds. In those transactions, a shareholder issues a synthetic local-currency bond on offshore markets. The issuer then swaps back its cash flow into dollars with TCX, effectively reducing the fund's net exposure to the local currency.

TCX has substantial capital buffers at its disposal. According to its definition and including Class A shares, retained earnings and convertible subordinated loans (CSLs), its total capital stands at $1.265 billion or 27.6% of risk-weighted assets as of end-2022 and 27% in June 2023. We only include 75% of the total in our calculation of useable equity because shareholders have the right to redeem their shares under specified conditions. As of June 2023, the fund had a substantial buffer of $483 million available for future portfolio growth without the need for additional capital.

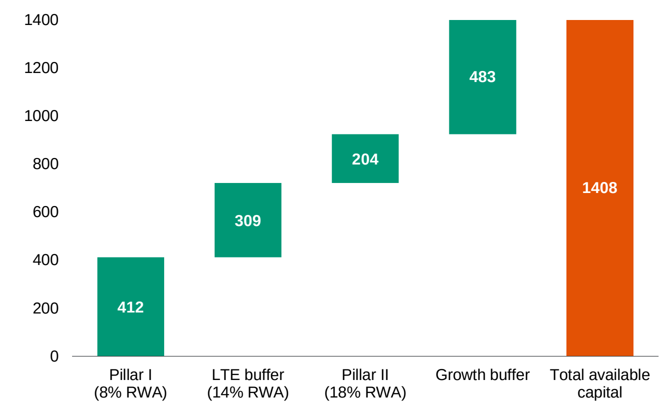
TCX's shareholders have introduced an effective minimum capital ratio of 14% of RWA, at which they would need to consider whether to inject additional capital or liquidate the fund. To avoid reaching this situation, a substantial additional Pillar II capital buffer of 4% of RWA is added; in reality, TCX targets a minimum capital ratio of 20%. The 18% capital ratio serves as a redemption gate — if TCX is at risk of falling below this capital level it can reject requests by shareholders to redeem their shares, a simple and effective method to preserve capital.

Exhibit 3
Portfolio has grown rapidly in recent years
($ billions)



Sources: TCX and Moody's Investors Service

Exhibit 4
TCX has sufficient capital buffers to grow further
(In $ millions, June 2023)



Shareholders established a so-called Liquidation Trigger Event (LTE) at a capital ratio of 14%, at which they would need to decide whether to wind down TCX.
Sources: TCX and Moody's Investors Service

Apart from Class A shares, TCX has obtained convertible subordinated loans (CSLs) worth $197.1 million maturing on 31 December 2045 from the governments of Germany (Aaa stable), Switzerland (Aaa stable), the United Kingdom (UK, Aa3 negative) and since last year also from Proparco, one of the government of France's (Aa2 stable) development agencies. The CSLs automatically convert into Class B shares upon a voluntary wind-down scenario, in which they rank junior to Class A shares and can only be redeemed after all shareholders have redeemed their initial investment plus a return equal to three-month compounded SOFR+26 basis points. Therefore, they provide a first-loss protection to trading counterparties and Class A shareholders, and enhance the risk-return of their investment to attract new shareholders. Given the similarities and the junior treatment to Class A shares in a wind-down scenario, we also assign 75% equity content to the CSLs. We do not include a convertible subordinated loan of $70.6 million nor a first-loss loan of $10.9 million that writes down to zero in a wind-down scenario, both provided by the government of the Netherlands (Aaa stable) because the facilities mature much earlier, in 2025. In our baseline scenario, we expect those loans to be repaid in full without a significant impact on TCX's capital base.

Focus on emerging market currencies results in weak asset quality...
Our assessment of Development Asset Credit Quality (DACQ) starts with an anchor point of “caa” because of TCX's focus on illiquid emerging market currencies. The fund is widely diversified across currencies, which leads to a higher DACQ score of “b”. The score is in line with that of peers such as GuarantCo (A1 stable) and International Islamic Trade Finance Corporation (ITFC, A1 stable).

The top 10 currencies accounted for 51% of the net portfolio in 2022 (2021: 48%). As of year-end 2022, the top three currencies were the Vietnamese dong (7.5%), the Serbian dinar (7.3%) and the Georgian lari (7.1%). The currency composition changes frequently, but limits are strictly enforced and the number of actively traded currencies has remained consistently high at around 40-55 over the past several years. Since its inception, TCX has offered swaps in more than 100 currencies.

Exposure to a single currency cannot exceed the lower of (i) 25% of the capital base and (ii) 10% of the maximum potential portfolio size.[1] On a regional basis, the fund has set limits at 30%-50% of its notional exposure. As of year-end 2022, the fund was well below its limits and the increased use of hedging instruments has helped TCX reduce its exposure to single currencies.

...and drives volatile asset performance

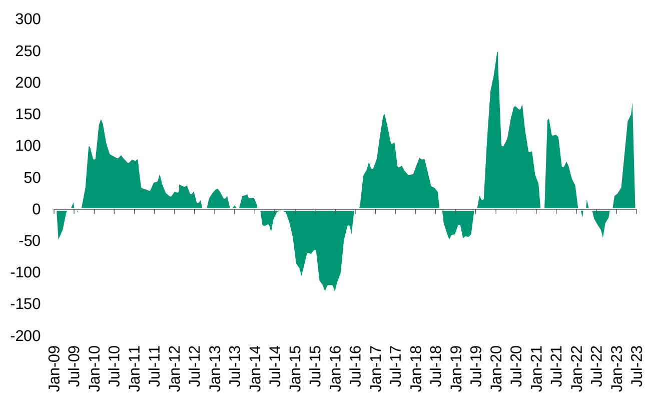
TCX has no nonperforming assets (NPA) as such. All losses — including unrealised mark-to-market losses — on its portfolio directly flow into its financial results and directly affect the net asset value (NAV) of the fund and its usable equity. We use the worst historical change in the NAV as a proxy for NPA, because market risk is the fund's dominant risk exposure, which translates into a score of "baa2" for asset performance.

TCX's solid diversification provides some protection against economic and financial shocks. On average, TCX has made a small positive return in its 16 years of existence and its monthly performance is skewed towards marginally positive returns. The fund generates positive financial results from three sources: the net interest spread (carry) originating from the difference in local versus hard currency and from the bid-ask spread locked in when positions are hedged; the appreciation of local currencies against the US dollar; and interest income on its large liquidity portfolio, although this tends to be small because of the high credit quality of the assets.

However, TCX has been founded to absorb losses that would otherwise have to be absorbed by the clients of its investors. Longer-lasting regional crises tend to leave the biggest impact on TCX. Its largest-ever loss over a 12-month period was $130.5 million between October 2014 and September 2015, as a result of the slump in oil prices at the time. Losses on just three currencies (the Kyrgyz som, the Tajik somoni and the Armenian dram) accounted for 60% of the losses in 2014 and 2015 because of their high interconnectedness with Russia and Kazakhstan (Baa2 stable) through remittances and trade.

Exhibit 5

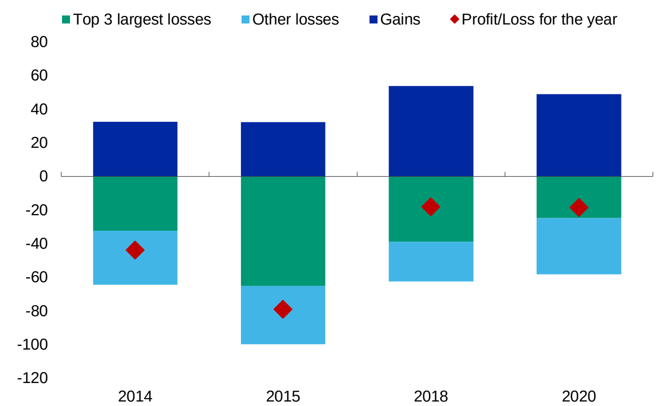
TCX tends to post profit in most months except during 2014-15
(12-month rolling sum of monthly change in net asset value in $ million)



Sources: TCX and Moody's Investors Service

Exhibit 6

Losses tend to be driven by a small number of currencies
(In $ millions)



Excludes USD:EUR hedges.
Sources: TCX and Moody's Investors Service

FACTOR 2: Liquidity and funding score: a2

TCX's liquidity and funding score is set at "a2" and reflects very strong liquidity, with large liquidity buffers and prudent policies. The score also incorporates a funding profile in line with that of peers such as GuarantCo, which, similar to TCX, does not raise funds in capital markets.

Very strong liquidity buffers mitigate liquidity risks stemming from margin calls

TCX has very solid liquidity, which is essential because of its high-risk business profile. Its available liquidity was $1.16 billion as of year-end 2022, and is invested in assets of very high credit quality, so as to not add to the fund's already high exposure to market risk. Per the fund's guidelines, investments are limited to bonds with a minimum rating of Aa3, and cash deposits, money market funds and commercial paper, which can quickly be converted into cash. Deposits can only be held in large systemic banks rated A2 or above. Around 51% of assets are invested in Aaa-rated securities or cash deposits, and roughly 90% of assets have a remaining term shorter than one year.

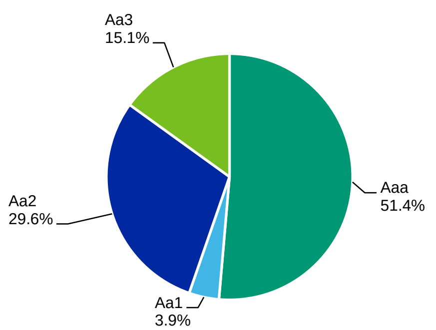
Liquidity risk primarily arises from margin calls on the swap portfolio. TCX only offers non-deliverable swaps, which eliminates convertibility risk because all transactions are settled in US dollars or euro and do not involve any local currency. As a result of fluctuations in the underlying rates of derivative instruments (foreign exchange rates, local interest rates and dollar interest rates), the fund regularly posts and receives collateral, with TCX typically posting more collateral than it receives.

In addition to conservative asset allocation guidelines, liquidity policies are very prudent and rely on frequent and sophisticated stress testing. Under its internal guidelines, TCX uses a liquidity coverage ratio inspired by Basel III to define its liquidity requirements under a stress scenario, defined as liquid assets of high credit quality/net stressed cash outflows over the next 12 months. The stress case assumes the worst historical portfolio performance over one month, rising margin calls and shareholder redemption of 20% of their capital. The fund targets a liquidity coverage ratio of more than 150% and has consistently stayed well in excess of this requirement. As of year-end 2022, the ratio was 186%.

Our measure of liquidity coverage differs somewhat from the fund's own metrics. We use its calculations of stressed cash outflows and only consider highly liquid assets such as cash and short-term bank deposits, and securities rated A2 or higher. TCX's ratio of available liquid resources was 210% as of year-end 2022, higher than that of most peers.

Exhibit 7

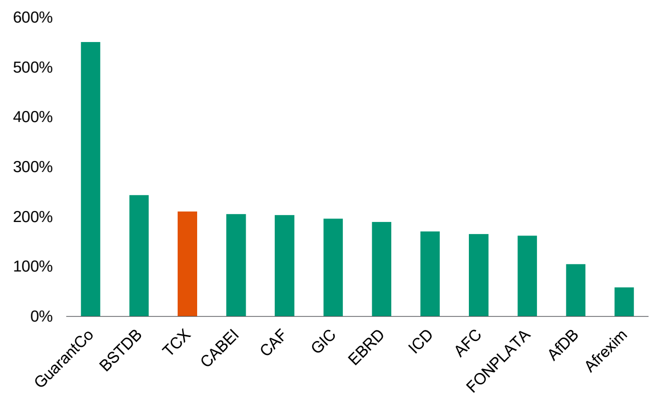
Liquidity is held in highly rated instruments
(Liquid assets, as of year-end 2022)



Sources: TCX and Moody's Investors Service

Exhibit 8

Availability of liquid resources is stronger than that of most peers
(Liquid assets/net cash outflows, latest)



Sources: MDBs and Moody's Investors Service

In the absence of debt, we assess quality of funding as moderate

Our assessment of the quality of funding is typically based on considerations such as the track record of bond issuance, the cost of funding compared with peers, the availability of credit lines, and the diversity of funding sources and the investor base. We score TCX's quality of funding at “baa”, in line with that of GuarantCo, the Fondo Latinoamericano de Reservas (FLAR, Aa2 stable) and the Emerging Africa Infrastructure Fund (EAIF, A2 stable). Similar to those entities, TCX has never issued any bonded debt but receives all its funding from development finance institutions and governments. We assume that TCX would have reasonably good market access should it want or need to do so based on solid support from a group of highly rated shareholders and very strong liquidity metrics, while paying a moderate risk premium.

Qualitative adjustments to intrinsic financial strength

Quality of management

We apply a one-notch upward adjustment to TCX's intrinsic financial strength on account of the high quality of management and particularly risk management. TCX's policies and standards follow a very prudent approach, even compared with many higher-rated

MDBs. Its framework closely follows Basel rules for commercial banks, and is adapted to reflect its specificities and predominant exposure to market risk. We positively note the existence of the independent valuation committee, but also the tailored stress testing of the portfolio, long-term capital planning and very prudent liquidity management. Reporting and transparency are of very high quality and frequent. The fund performs an annual internal capital adequacy assessment process (ICAAP) to ensure that all risks are fully captured, and it has sufficient capital at hand to implement its strategy and ensure its continued existence. At the same time, the inherent riskiness of TCX's activities requires a correspondingly higher degree of sophistication.

Operating environment

We do not apply any such adjustment for TCX. Although TCX's operating environment is highly risky because of its exposure to emerging and frontier market currencies, the diversification of its derivative portfolio limits those risks.

FACTOR 3: Strength of member support score: Very High

Our assessment of strength of member support is "Very High", reflecting the strong ability and willingness of its main shareholders to provide additional support if needed, as well as the availability of callable capital in the form of a first-demand guarantee from the European Union (Aaa stable). Other MDBs with a "Very High" strength of member support include Aaa-rated peers such as the EBRD or the Nordic Investment Bank (Aaa stable). The score has recently been improved from "High" and is set higher than the initial score of "High" to reflect the expected increase in size of the guarantee from the EU and the strong and clear trigger to call on the guarantee.

A diverse group of highly rated shareholders and supporters has strong ability to provide support

With a weighted shareholder rating of A1, TCX's group of shareholders is among the strongest of rated MDBs.[2] As of year-end 2022, 74% of Class A shares were held by Aaa-rated institutions, while 80% of the CSLs are provided by Aaa-rated governments (excluding the Netherlands). The average shareholder rating is skewed lower by the presence of small and unrated microfinance investment vehicles and impact investors, which account for around 8% of total capital and to which we assign an implicit Caa2 rating in line with our methodology. We do not expect those entities to provide additional support for TCX in case of need given their small size and other limitations.

Callable capital in the form of EU guarantee provides an additional buffer

Our key metric to assess the contractual willingness to provide support is the ratio of callable capital to the stock of debt. In the case of TCX, we define as debt any portion of the CSLs that does not receive equity credit. We include into our calculation of callable capital the unfunded commitment from the EU in the form of a guarantee extended through the European Fund for Sustainable Development (EFSD) for €145 million. The guarantee is structured in the same way as the CSLs. In case of a decision to wind down the fund, the activated EC guarantee amount will be disbursed and turned into Class B shares, which will rank junior to Class A shares. Although the maturity is 2035 and thus shorter than the CSLs, we nevertheless also assign 75% equity credit to the guarantee facility, given the similarities to the CSLs. We also incorporate in our assessment the additional €105 million that the EFSD has authorized and which will in all likelihood be activated by TCX later this year. Once the guarantee is fully activated, callable capital will cover around 173% of TCX's debt, which corresponds to a "aaa" score for contractual support. We also incorporate a one-notch upward adjustment to reflect the strength of the guarantee, which is a timely and unconditional guarantee with a clear trigger.

The loans provided by the Dutch government and maturing in 2025 will have to be repaid, but TCX has sufficient capital available to cover the principal amount of $81.5 million.

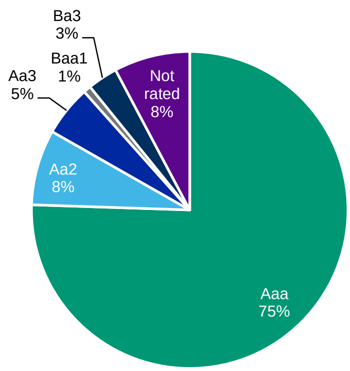
Unique relationship with shareholders supports high non-contractual willingness to support

We assess shareholders' non-contractual willingness to support as "High" to reflect the fact that support from highly rated shareholders through capital injections has been long-standing and increasing over time. TCX was explicitly set up to assume specific risks that shareholders would otherwise have to assume themselves at higher cost and risk. Some would not be able to extend local-currency loans to their borrowers at all without TCX, which would reduce their own development impact. Hence, their interest in the continued existence and solidity of TCX is very strong.

Shareholders have the option to redeem their shares, although under very strict conditions. So far, eight shareholders, mostly small microfinance investment vehicles, have redeemed all or parts of their shares (see Exhibit 9). Japan Bank for International Cooperation

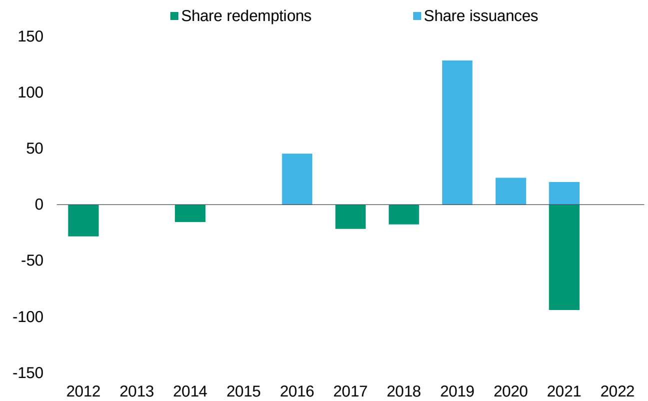
(JBIC, A1 stable) and the African Development Bank (AfDB, Aaa stable) were the largest shareholders to depart from the fund in 2021, but neither was an active user of TCX's services and the redemption did not affect our assessment of shareholder support.

Exhibit 9
Shareholder base comprises mostly highly rated entities
(Paid-in equity capital by rating, year-end 2022)



As per our definition, 75% of the Class A shares and CSL are included.
Sources: TCX and Moody's Investors Service

Exhibit 10
Redemptions are infrequent and typically smaller than capital subscriptions
(In $ millions)



Sources: TCX and Moody's Investors Service

None of the large shareholders that actively use TCX has ever redeemed any shares. Over the years, TCX's shareholder base has expanded significantly and paid-in equity under our definition increased to $776 million in 2022 from $459 million in 2012, indicating the relevance of the institution and its mandate. Several shareholders have repeatedly raised their stakes, while new shareholders join on a regular basis. TCX's government supporters have repeatedly shown their support, in particular the German government, which extended the maturity of its CSLs by 20 years to 2045 in 2019.

ESG considerations

The Currency Exchange Fund NV (TCX)'s ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 11
ESG Credit Impact Score

CIS-2
Neutral-to-Low

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

The credit impact score is neutral-to-low (**CIS-2**) for TCX, reflecting a combination of neutral to low environmental and social risks and very strong governance, supported by strong shareholder support.

Exhibit 12
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	**S-2**	**G-1**
Neutral-to-Low	Neutral-to-Low	Positive

Source: Moody's Investors Service

Environmental

TCX exhibits neutral-to-low exposure to environmental risks across all five categories, resulting in an overall environmental issuer profile score of neutral-to-low (**E-2**). While active in emerging markets and frontier economies with often high exposures to environmental risks, TCX's exposure is further removed from these risks than most other MDBs due to its business focus on providing hedging solutions to other MDBs and DFIs.

Social

TCX has neutral-to-low exposure to most social risks, resulting in a neutral-to-low social issuer profile score (**S-2**). We consider TCX's 'responsible production' to be a positive feature of its issuer profile, given the high developmental impact of TCX's hedging operations, which allow its shareholders and investors to lend in local currencies, avoiding to burden borrowers with foreign-currency risk.

Governance

We consider governance to be a positive feature of TCX's issuer profile, resulting in a positive governance issuer profile score (**G-1**). This mostly reflects TCX's very strong financial strategy and risk management practices, as well as very solid management credibility and a strong track record of profitability despite its high market risk exposures.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

All of these considerations are further discussed in the “Detailed credit considerations” section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks Methodology. Additional information about our rating approach is provided in our Multilateral Development Banks and Other Supranational Entities Methodology.

Recent developments

After a series of shocks, portfolio expansion will resume in 2023

As of year-end 2022, TCX had a portfolio of swaps totaling $3.2 billion, slightly lower than in 2021. Since the start of the pandemic, the size of the portfolio has remained broadly stable because of the repeated shocks leading to a temporary moderation in demand for swaps. In terms of new transactions, the fund reached a record high of $1.4 billion last year, which was, however, slightly lower than its target of $1.5 billion. The lower-than-targeted business volume was mainly because of a combination of sizeable redemptions and unwinding of trades in the aftermath of the pandemic. Also, a relatively large share of TCX's portfolio is in the CIS region where lending activity dipped at the onset of the Russian invasion of Ukraine.

After the two large shocks of the pandemic and the war, we expect TCX's portfolio to return to growth as transactions that were postponed last year are executed and the increase in dollar interest rates makes local currency funding more attractive. In the first six months of 2023, primary production exceeded targets by a large margin (targets are only indicative and used for capital management purposes). TCX targets new transactions of $1.5 billion for the whole year.

At the same time, the fund continues to grow its hedging portfolio. The hedging portfolio grew to $1.2 billion or around 40% of the outstanding primary portfolio last year. In 2022 alone, the fund offset 60% of its portfolio production. The hedging activities allow TCX to offset risks in the primary portfolio, reducing concentrations and freeing up capacity for new transactions. Demand for the local currency notes often exceeds what TCX can offer and it has remained strong despite the higher interest rate environment. We view hedges as an effective tool in reducing TCX's market risk exposure while also supporting its mandate to develop local-currency bond markets and therefore net them out of the primary portfolio in our assessment of development assets.

According to its latest ICAAP exercise, TCX plans to grow its swap portfolio to up to $8.3 billion by 2027, which would be equivalent to an annual portfolio growth of 18%. In particular, the fund sees potential of expanding into climate, sovereign and infrastructure finance; all of these areas would require longer-tenor financing and higher transaction volumes. Although its targets are purely indicative and used only for risk management purposes, we expect TCX to be able to manage such growth without significant impact on its credit profile because of continued support from shareholders and continued hedging activity. TCX plans to continue selling its local-currency exposure in the form of notes, with a target of offsetting 45% of the swap portfolio. The fund estimates that implementing its growth plan would require additional capital from shareholders of around $648 million. Capital would only be needed in 2026-27 under this scenario, given the current capital buffers and assuming continuing profit over the coming years.

TCX posted a small profit in 2022 despite the shock of the war

TCX posted a small profit of $8.9 million in 2022 (2021: $107.4 million) despite the shock of the war in Ukraine. During the first three months of the Russian invasion, the fund posted cumulative losses of more than $61 million. While TCX's direct exposure to Ukraine is small (3% of swap portfolio as of year-end 2022) and it has no exposure to Russia, it incurred losses from re-pricing of swaps in some CIS countries that have large economic and financial links with Russia. The losses were quickly recovered in the later months of the year as those currencies recovered on the back of large capital inflows from Russia. In the first six months of 2023, TCX posted a cumulative profit of $124.6 million.

Capital base will continue to expand with the provision of additional callable capital

In June 2023, the IFC raised its shareholding by $14.8 million. Last year, TCX received an additional capital injection of $2.6 million by the French development agency PROPARCO in the form of a CSL. The fund's capital ratio under its own definition was at 27% of RWA as of June 2023, substantially above the levels at which the fund would start to take remedial action (20%), can restrict shareholders' redemption requests (18%) or would face a voluntary winding down (liquidity trigger event LTE at 14%). According to its calculations, TCX could withstand a loss of more than $687 million, or 13% of RWA, before causing an LTE.

Also in 2022, TCX activated the remaining amount of $65 million under the unfunded guarantee provided under the European Fund for Sustainable Development (EFSD) of the European Commission (EC). Given the unfunded nature of the facility, we consider the guarantee similar to callable capital and, therefore, include it in our assessment of contractual willingness to support. In January 2023, the EC allocated an additional €105 million in unfunded financial guarantees and is in discussions with TCX to provide up to €300 million in further financial support, to be divided between a pricing subsidy for frontier market hedges and additional capital in a funded format. Although commitment letters or agreements are yet to be signed, these commitments would significantly increase TCX's callable and paid-in capital buffers, a key driver for the outlook change to positive. The EC's substantial increase in funding clearly demonstrates its support for TCX's business.

Rating methodology and scorecard factors

Factor / Subfactor	Metric	Initial score	Adjusted score	Assigned score
Factor 1: Capital adequacy (50%)			baa3	baa3
Capital position (20%)			baa1	
	Leverage ratio	baa1		
	Trend	0		
	Impact of profit and loss on leverage			
Development asset credit quality (10%)			b	
	DACQ assessment	b		
	Trend	0		
Asset performance (20%)			baa2	
	Non-performing assets	baa2		
	Trend	0		
	Excessive development asset growth	0		
Factor 2: Liquidity and funding (50%)			a2	a2
Liquid resources (20%)			aaa	
	Availability of liquid resources	aaa		
	Trend in coverage outflow	0		
	Access to extraordinary liquidity	0		
Quality of funding (30%)			baa	
Preliminary intrinsic financial strength				baa1
Other adjustments				+1
Operating environment		0		
Quality of management		+1		
Adjusted intrinsic financial strength				a3
Factor 3: Strength of member support (+3,+2,+1,0)			High	Very High
Ability to support (50%)			a1	
	Weighted average shareholder rating	a1		
Willingness to support (50%)				
	Contractual support (25%)	aa2	aa1	
	Strong enforcement mechanism	+1		
	Payment enhancements	0		
	Non-contractual support (25%)		High	
Scorecard-Indicated Outcome Range				Aa2-A1
Rating Assigned				A1

Note: Our ratings are forward-looking and reflect our expectations for future financial and operating performance. However, historical results are helpful in understanding patterns and trends of an issuer's performance as well as for peer comparisons. Additional considerations that may not be captured when historical metrics are used in the scorecard may be reflected in differences between the adjusted and assigned factor scores. Furthermore, in our ratings we often incorporate directional views of risks and mitigants in a qualitative way. For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

Related websites and information sources

» Moody's Supranational webpage

» Moody's Sovereign and supranational rating list

Endnotes

1 The potential portfolio is estimated assuming the portfolio grows to the point the capital ratio reaches 18% and there are no resulting changes in the portfolio composition.

2 In line with our treatment of TCX's capital instruments, we use both the Class A shares and the CSLs to calculate the weighted average shareholder rating.

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