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Management Response MASSIF Local Currency Report

In 2012, FMO embarked on a multi-year Evaluation Program of different Government Funds. The goal is to draw lessons and gain more insight in the impact of the funds that are managed by FMO. Output of the program is shared with the Ministry of Foreign Affairs, the principal of these funds. The Evaluation Program includes effectiveness studies (looking back 5 years) and impact studies (following clients over a 5-year period), which analyze and track results at beneficiary and end-client level. All studies are outsourced to specialized parties and meet the quality requirements as set by FMO's external evaluation panel.

This particular study is focused on local currency financing in Central America which was provided from the MASSIF fund to different clients in Latin America. The integral study as drafted by Dalberg consultants will be published on the FMO website. This FMO Management Response is mainly about the conclusions and recommendations as worded in the study.

The study is broken down into two sections:

i) An analysis of the pricing of MASSIF local currency deals and the management of the MASSIF local currency portfolio; and
ii) Through several case studies, an assessment of the benefits of local currency financing to MASSIF clients (Financial Institutions) and end-clients (MSMEs).

According to the study, MASSIF's yearly returns (on the local currency risk financing) are in line with the objective to sustainably provide local currency financing over a long-term period. MASSIF local currency pricing has proven to be sustainable and serves as an important demonstration to the rest of the market. Dalberg suggests that FMO could conduct further correlation analyses of currencies and introduce portfolio limits on identified currency groups. FMO appreciates this suggestion and will explore this. At this moment MASSIF has provided local currency to over 20 different currencies in all continents with a good spread across the currencies. The main outlier is the Indian Rupee which is relatively large in the portfolio.

As the report shows, the higher volatility of MASSIF (compared to the USD-denominated LocFund) is mainly caused by the USD-EUR exchange rate swings as many currencies follow the USD more closely than the EUR. The report shows that the pricing of MASSIF is adequate. The report also suggests to set-up a working group with DFIs and TCX to monitor benchmark rates, and share lessons learned. FMO does not intend to set up new working groups. We are in regular touch with TCX, Locfund and other DFIs providing local currency loans where many lessons are shared. It is TCX that monitors benchmark rates, one of the reasons why FMO keeps close contact with them.

In the second section, Dalberg analyses nine case studies to assess the effectiveness and additionality of MASSIF funding in improving the risk profile of receiving institutions and their outreach to the intended end-clients. MASSIF local currency financing has contributed to improvement of the Asset and Liability Management and capitalization of MASSIFs Financial Institutions clients. Hence, Massif clearly contributed to strengthening of these local financial institutions. The financing provided has been additional to the market, an important criteria for MASSIF-funding. In particular in Nicaragua (via client FAMA) MASSIF has played a pioneering role by offering the first local currency financing which generated demonstration effects. MASSIF financing and capacity development supported some of the clients in improving their product offering to their (end) clients. A relevant recommendation of the study is for MASSIF to more systematically assess the end-client product range and help support new product development. The goals of MASSIF at start in 2006 were clearly around the development and strengthening of the financial sector. The last few years, MASSIF already paid more attention to the end-clients (via increased attention to Environmental &Social issues and client protection principles). FMO will certainly explore how to incorporate the end-clients' needs even more in our MASSIF product offering.

We welcome the overall valuable observations that local currency financing is highly beneficial to our clients, reduces the risk profiles of clients, and leads to increased SME lending. The report stresses the pioneering role of FMO in this niche market, and hence underlines an important reason of existence of MASSIF.

FMO, The Hague, 30 June 2015