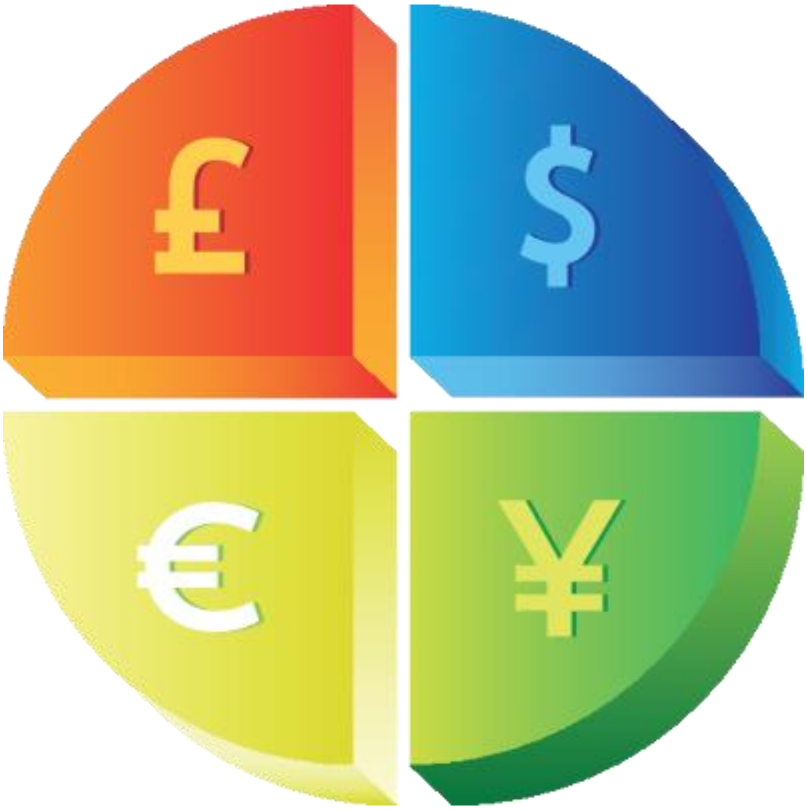

Survey for Public Development Banks (PDBs) on "How currency depreciations/risk impact PDB's ability to reach SDG (Sustainable Development Goals) and to be sustainably resilient"

FINAL REPORT

Survey

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Glossary

PDB	*Public Development Banks*
SDGs	*Sustainable Development Goals*
FiCS	*Finance in Common*
TCX	*The Currency exchange Fund*
LCY	*Local Currency*
DFIs	*Development finance Institutions*
FX	*Forex*
MDBs	*Multilateral Development banks*
TA	*Technical Assistance*
LATAM	*Latin America*
IFIs	*International Financial Institutions*
ADB	*Asian Development Bank*
MIGA	*Multilateral Investment Guarantee Agency*
AADFI	*Association of African Development Finance Institutions*
ALIDE	*Latin American Association of Development Financing Institution*
ADFIAP	*Association of Development Financing Institutions in Asia and the Pacific*
IDFC	*International Development Finance Club*
D20LTIC	*D20 Long-Term Investors Club*

Acknowledgments

This report stands as a testament to the fruitful collaboration between four esteemed entities, primarily led by Finance in Common (FiCS), under the auspices of Agence Française de Développement (AFD), in invaluable partnership with The Currency Exchange Fund (TCX), International Development Finance Club (IDFC) and Deloitte.

Throughout this comprehensive study, we have had the privilege of leveraging the extensive experience and guidance provided by AFD and FiCS. We extend our deepest gratitude to Adama Mariko, Secretary General of FiCS, Jimena Iraheta, Program Officer, and their esteemed colleagues at AFD for their dedicated support and substantial contributions in strengthening the PDBs ecosystem against risk mismanagement. Their expertise has been crucial in successfully navigating this project to its completion.

TCX has been an indispensable source of thought leadership and expertise in guiding our study. Moreover, their pivotal role, as an advocate to the PDBs most vulnerable to currency depreciation, has been instrumental. We express our profound appreciation to Isabelle Lessedjina, Senior Vice President of TCX Fund and her colleagues, for their exceptional insights and invaluable contributions throughout the entirety of this process.

Our heartfelt appreciation extends to Making Finance Work for Africa (MFW4A) and IDFC, whose insightful contributions have greatly influenced the outcomes of this study. Their unwavering dedication to a resilient financial sector development and the wealth of insights garnered have significantly enhanced the quality of our study.

This analysis would not have been achievable without the essential contributions from the regional networks of PDBs under FiCS. Their enduring commitment and invaluable inputs from the Association of African Development Finance Institutions (AADFI), the Latin American Association of Development Financing Institutions (ALIDE), the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP), the International Development Finance Club (IDFC), and the D20 Long-Term Investors Club (D20LTIC) have been critical to the success of this endeavor. Furthermore, this analysis would not have been possible without the support of the European Fund for Sustainable Development (EUMCF Technical Assistance).

We extend a very special thanks to the individuals who kindly dedicated their time to facilitate this endeavor or for interviews, including Cyril Okoye for his steadfast commitment to promote the sustainability of African DFIs by providing resilient solutions against current risk, the Deloitte team in Francophone Africa, Aristide Ouattara, Adnane El Jazouli, Ayoub Naass and Hind Bennani-El Azizi. Their willingness to share their time, network and experience has played a significant role in shaping the depth and breadth of this study.

We express our deepest gratitude for the collaboration, support, and resolute dedication demonstrated by all individuals and entities involved. This report is a steadfast commitment to advancing knowledge, understanding and solutions in the field.

Foreword

Currency risk can significantly impact public development banks, posing challenges in their quest to foster economic growth and stability. As financial institutions supporting vital development projects, currency fluctuations can affect their funding costs and overall financial performance. Unfavorable currency movements may lead to higher borrowing expenses and potential losses on foreign investments. The currency risk can impact PDBs' ability to reach the SDG (Sustainable Development Goals) and to be sustainably resilient.

As recognized by the G20, the world's 500 plus Public Development Banks (PDBs) take critical roles to achieve the SDGs and the Paris Agreement goals. PDBs play a pivotal role in advancing economic growth, poverty reduction, and environmental preservation. However, it is important to acknowledge that PDBs are exposed to currency risk exposure and should be helped to manage it in order to focus on financing sustainable projects.

In this context, FiCS is a global community of PDBs working with regional associations of DFIs. As a network for PDBs, it aims for strengthening their alliance and encouraging their commitments to support common actions for addressing pressing development challenges over climate change and ecological evolution. Hence, FiCS allows institutions to share their expertise and experiences through the organization of different events, such as annual summits, where institutions are given the opportunity to meet different players from the financial system and learn more about undergoing plans and recommendations for further investments. This enhances their internal capacities in terms of technical and human resources while staying up to date.

TCX Fund is an internationally recognized institution specialized in hedging currency risk faced by financial institutions in emerging and frontier markets. Thus, it provides currency risk solutions consisting into the employment of financial instruments that help mitigate currency risk for institutions operating in these economies, such as swaps and forward contracts. TCX encourages institutions to promote local currency projects while de-risking their financial transactions and allowing them to attract more investors.

Together, TCX and FiCS have recognized that currency risk significantly threatens PDBs' capacity to achieve their objectives, including SDGs, while seeking to provide guidance to policy decisions and advocate for measures that enhance PDBs' resilience to sustainable development efforts.

For this reason, we cooperated in this study to explore the multifaceted impact of currency risk on PDBs, focusing particularly on those in emerging countries. Based on data collected and analysis elaborated, we identified the impact on institutions operating in economies characterized by volatile currencies and limited hedging mechanisms, these institutions are particularly susceptible to the adverse effects of currency fluctuations on their resilience and capacity to achieve the SDGs.

Based on this paper, results' analysis brings particular attention to the challenges faced by these banks in fulfilling their obligations outlined in the Paris Agreement. It aims to provide practical recommendations, serving as a compelling call to action to inspire stakeholders in uniting and providing substantial support to PDBs to overcome their challenges. By harnessing our collective expertise, resources, and commitment, we can make significant strides towards building resilient financial systems and realizing the transformative potential of PDBs in emerging economies.

Leveraging the diverse expertise and extensive networks of both organizations (TCX and FiCS), the study engaged with a wide range of stakeholders, including PDBs, multilateral organizations, and DFIs. This inclusive and collaborative approach has enriched the analysis and recommendations presented in this study, fostering a holistic understanding of the challenges faced by PDBs in emerging countries regarding currency risk.

Addressing the pressing issues highlighted in this study requires the active participation and cooperation of stakeholders across the global development community. Furthermore, collaboration among PDBs, international financial institutions, governments, civil society, and private sector entities is essential to fortify the resilience of PDBs and support their endeavors in achieving the SDGs.

We extend our sincerest gratitude to the readers for their valuable attention and engagement with this study. May its insightful findings inspire us all to intensify our efforts in assisting PDBs and forging a sustainable, inclusive, and prosperous future.

1.Executive Summary

The Finance in Common initiative, in collaboration with TCX Fund, has conducted a comprehensive study on the impact of currency risk on PDBs and their ability to maintain sustainable resilience. This paper uses results of this survey among FiCS Coalition of PDBs in Africa, Asia and LATAM region.

PDBs play a pivotal role in financing sustainable development projects, particularly in developing countries. With the Paris Agreement in mind, these banks have become crucial actors in accomplishing the agreement's ambitious objectives.

Achieving the goals of the Paris Agreement will require significant investments from PDBs. As we approach the 2023 United Nations Climate Change Conference, the progress towards these goals will be reviewed. PDBs may encounter various challenges, such as currency risk, along this journey, potentially impeding their ability to achieve the SDGs.

Indeed, currency risk affects the ability of PDBs to attract foreign investors. Fluctuations in currency values discourage investors from funding major development projects, and limit funding for SDG initiatives. For various reasons such as the lack of local financing opportunities, high inflation and interest rates, PDBs tend to rely heavily on foreign currency funding for operations and projects. If the domestic currency depreciates against the borrowed currency, the foreign currency-denominated debt will increase, putting pressure on PDBs that usually have their stream of revenues in local currency.

Furthermore, inadequate access to hedging solutions exposes a significant portion of PDBs' foreign currency liabilities to currency fluctuations, increasing repayment burdens and highlighting vulnerability to currency risk and financial sustainability challenges. A substantial percentage of surveyed PDBs do not hedge their open FX positions (created by asset and liability mismatch), primarily due to financial resource constraints, limited risk management expertise, or questionable cost considerations.

68% of the surveyed PDBs are exposed to currency risk (typically the risk that their local currency depreciates against the US dollar), impacting profitability for some, with sizeable FX losses that cause financial strain. Additionally, foreign exchange volatility and uncertainty disrupt the pace of financing development projects, leading to postponed or canceled funding agreements for 25% of PDBs.

In this study, a comprehensive analysis of the practices adopted by PDBs in different regions and sectors will be conducted. The objective is to provide recommendations on how to enhance currency risk management strategies and resilience. Special attention will be given to emerging and frontier countries, as they are particularly vulnerable to heightened currency risk.

We have developed a set of five recommendations organized under three fundamental pillars to address the challenges posed by currency risk and enhance the capacity of PDBs to contribute sustainably to the SDGs.

- **Scaling up local context and regulatory frameworks**

  Recommendation 1: ***Strengthen domestic capital markets and ensure effective regulations and supervision.*** To promote the growth of robust domestic capital markets, stakeholders should actively foster stakeholder engagement and establish a sustainable ecosystem. Concurrently, effective enforcement of regulations and banking supervision is vital to ensure transparency, attract investment, and maintain financial stability. These measures are essential to inspire investor confidence, encourage broad participation, and facilitate sustainable economic growth.

- **Highlighting PDBs' potential solutions to monitor currency risk exposure**

Recommendation 2: ***Promote LCY financing and lending from MDBs to PDBs.*** MDBs should promote responsible lending practices and support financial stability by offering a choice to PDBs between (synthetic) LCY currency and foreign currency funding. Additionally, MDBs should be transparent about the risks of local and foreign currency funding whilst also being transparent about their practices.

Besides, to make local currency lending more conducive to the business of investees, MDBs are encouraged to insert a local currency conversion clause in the loan agreement when they end up financing their client in hard currency. A local currency clause is a provision that allows the investees to return to the MDB throughout the life of the transaction and request a conversion to local currency if specific conditions are fulfilled. Those conditions are usually that the return of the MDBs and intrinsic loan characteristics unchanged.

Recommendation 3: Enhance the use of solutions offered by FX Hedging Providers. We support and urge for the strengthening of initiatives, including the collaboration between International Financial Institutions (IFIs) and FX Hedging providers. This collaboration aims to provide substantial hedging solutions to safeguard PDBs from the adverse effects of foreign exchange volatility in developing countries.

Recommendation 4: Leverage blended finance to increase attractiveness and flexibility thus attracting investors while promoting responsible and sustainable lending. Implementing a blended program can effectively mitigate risks and overcome significant barriers associated with utilizing LCY solutions for hedging purposes with MDBs or PDBs.

- **Improving PDBs' capacities to mitigate currency risk and scale up the SDGs achievement**

Recommendation 5: Support PDBs in reinforcing their internal capacities. To ensure effective resource utilization, resilience and the achievement of SDGs, Public Development Banks (PDBs) must enhance their internal capacities to mitigate currency risk and other market risks, through measures, such as capacity building initiatives, training programs, internal systems improvement.

By implementing these recommendations, PDBs can effectively and proactively address currency risk challenges while building risk management capacity and processes thus strengthening their long-term impact and contributing significantly to the attainment of the SDGs.

2. Study approach

The primary aim of this study is to examine the influence of currency risk on the ability of PDBs to effectively attain the SDGs while maintaining sustainability and resilience. In order to achieve this objective, a survey consisting of 30 questions was developed and distributed to more than a hundred members of the FiCS Coalition. Respondents are mainly PDBs operating in Africa, Asia, and LATAM regions. The questionnaire is divided into five sections that encompass various facets of the impact of currency risk on PDBs' balance sheets, sustainable project financing, SDG achievement, and measures implemented to mitigate currency risk.

The graphs below provide indications on the total gross loan portfolio the respondents PDBs and their scope of operations:

Figure 1: What's your total gross loan portfolio at the end of 2022?

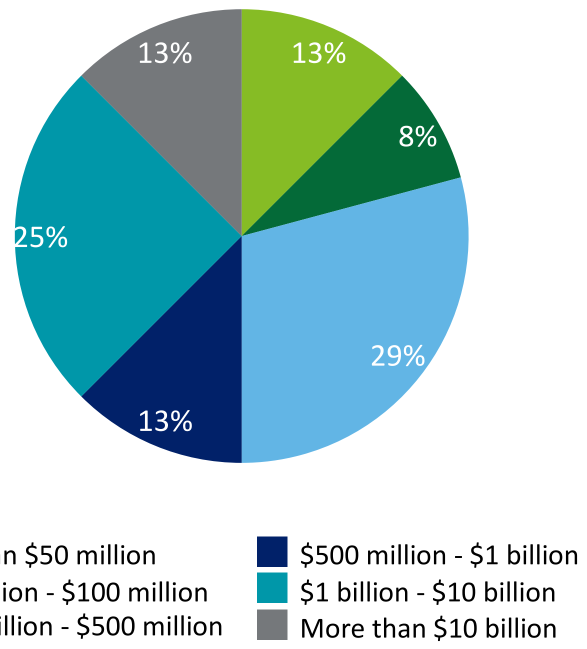
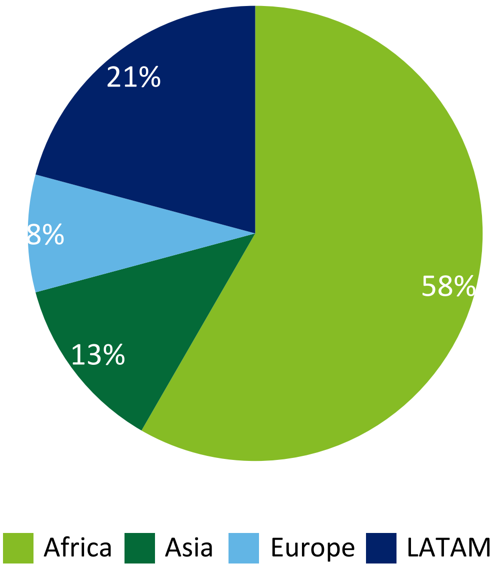


Figure 2: *What is your geographic scope of operations?*



21% of the respondents PDBs are characterized by a gross loan portfolio of less than $100 million USD. Moreover, the PDBs that were included in the survey are mainly located in emerging countries across Africa and the Latin American regions.

The analysis presented in this study primarily focuses on the feedback received from the surveyed PDBs. However, it is essential to acknowledge that PDBs are at different stages in their currency risk-mitigation journey, which can influence the breadth of their responses. Therefore, rather than providing an exact benchmarking, this report identifies the main challenges faced by PDBs and offers recommendations for mitigating currency risk.

The study strives to contribute to the growing body of knowledge on the role of PDBs in financing SDGs within developing countries, providing valuable insights to policymakers and stakeholders concerning the challenges and opportunities associated with currency depreciation and risk. The report sheds light on the obstacles encountered by PDBs and proposes measures to mitigate currency risk, underscoring the significance of expanding local markets to reduce currency risk and achieve SDGs.

2. Currency Risk and its Impact on Development Banks' Ability to Achieve the SDGs

Macroeconomic factors can have a profound impact on PDBs. Among these factors, the risk of foreign exchange fluctuations stands out as a critical concern. Currency risk refers to the potential volatility and uncertainty in the value of a country's currency relative to other currencies. Currency risk poses significant challenges to PDBs in attracting foreign investors and impacts both the asset and liability sides of their balance sheets.

A barrier to attract foreign investors:

When a country's currency experiences frequent and significant fluctuations (appreciations & depreciations), it often signals instability and, consequently, increased risk to investors. Consequently, such foreign exchange volatility can have a detrimental impact on the availability of financing for development projects. These projects, which encompass initiatives towards reaching SDGs, rely on investors for the necessary capital. However, if potential investors perceive significant currency volatility and uncertainty, they may be reluctant to commit funds, affecting the ability of PDBs to attract foreign direct investment (FDI) necessary for SDG-related projects.

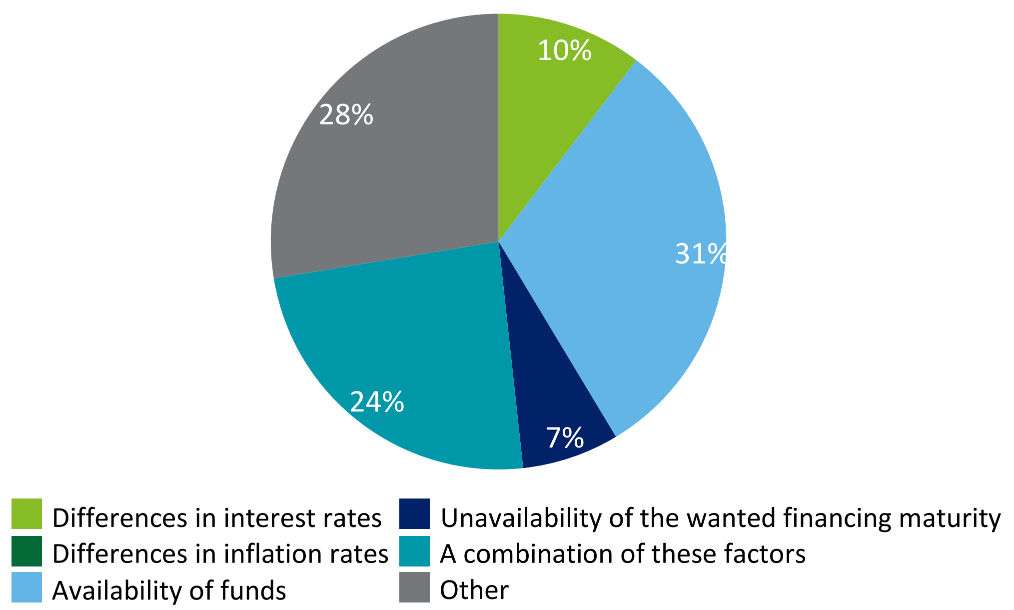
Impact of currency risk on the liability side:

Foreign currency fundings are crucial to PDBs to support their operations and development projects. These institutions often rely on such fundings. However, when the domestic currency experiences depreciation relative to the currency in which they borrowed, **it amplifies the value of their liabilities denominated in foreign currency**. This currency devaluation can result in **elevated repayment obligations and increased interest costs for PDBs**.

This dependency on foreign currency funding arises from various factors. PDBs are often engaged in large-scale infrastructure projects and developmental initiatives that require substantial financial resources beyond what can be sourced from the domestic market. **The limited availability of local currency financing options, such as bonds or loans, may not adequately cover the extensive funding requirements of these projects**.

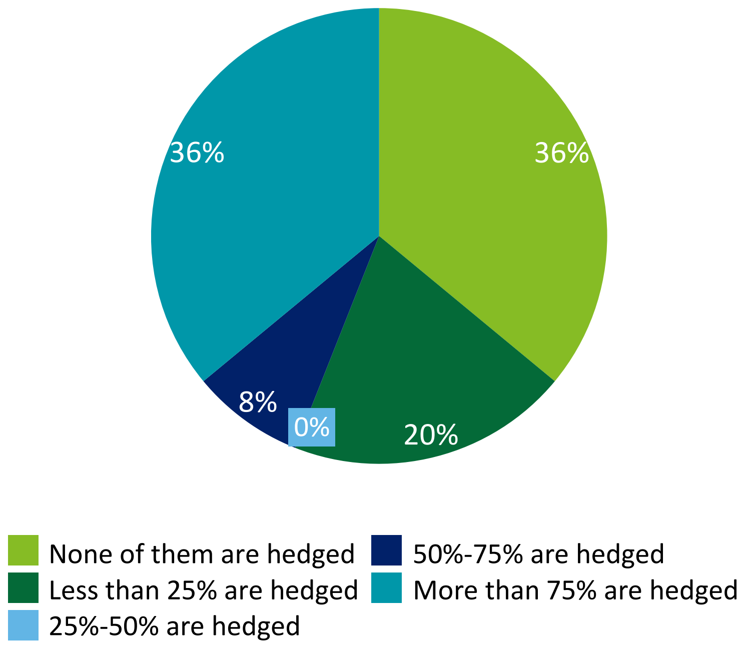
The survey conducted reveals that 31% of the surveyed PDBs attribute their use of foreign currency to funding availability. Additionally, 24% of the surveyed PDBs associate their reliance on foreign currency financing with various factors. These factors include the unavailability of the desired financing maturity in the local market, differences in inflation rates, and disparities in interest rates between domestic and foreign markets. These challenges further contribute to the selection of foreign currency funding options among PDBs. Addressing the factors that "force" PDBs' funding decision is essential and developing more robust local financing options is among the possible solution.

Figure 3: *What is the motivation behind using foreign currency to finance your funding agreements?*



Moreover, according to the questionnaire, 36% of the surveyed PDBs do not hedge their foreign currency-denominated liabilities and another 20% hedges only a portion of its exposures (<25%).

Figure 4: *How much of your foreign currency denominated liabilities are hedged?*



Given the importance to PDBs of foreign fundings and the lack of hedging, their financial position may become strained as it grapples with the burden of meeting **higher repayment commitments should their local currency depreciate over time**. Such circumstances highlight the vulnerability of PDBs to Foreign exchange fluctuations and the potential impact on their financial sustainability.

<u>Impact of currency risk on the asset side:</u>

Foreign exchange fluctuations can have significant consequences for PDBs, affecting not only their liabilities but also their assets. Indeed, currency risk can impact the **credit quality** of assets held by PDBs. If a counterparty has borrowed money from a PDB in a foreign currency (while having local currency revenues/balance sheet) and the domestic currency depreciates, its ability to repay loans may be altered. A (sudden and/or continued) currency depreciation can increase the burden of debt servicing for borrowers, leading to higher default risks. As a result, the credit quality of loans and other assets on the bank's balance sheet may deteriorate.

According to the conducted study, 60% of the surveyed PDBs employ both the local currency and foreign currencies as lending currencies and 32% have at least 50% of their loan portfolio denominated in foreign currencies. The total amount of loan portfolio denominated in foreign currency for all the respondents PDBs amounts to a total of around $140 billion USD.

Figure 5: *What is your lending currency?*

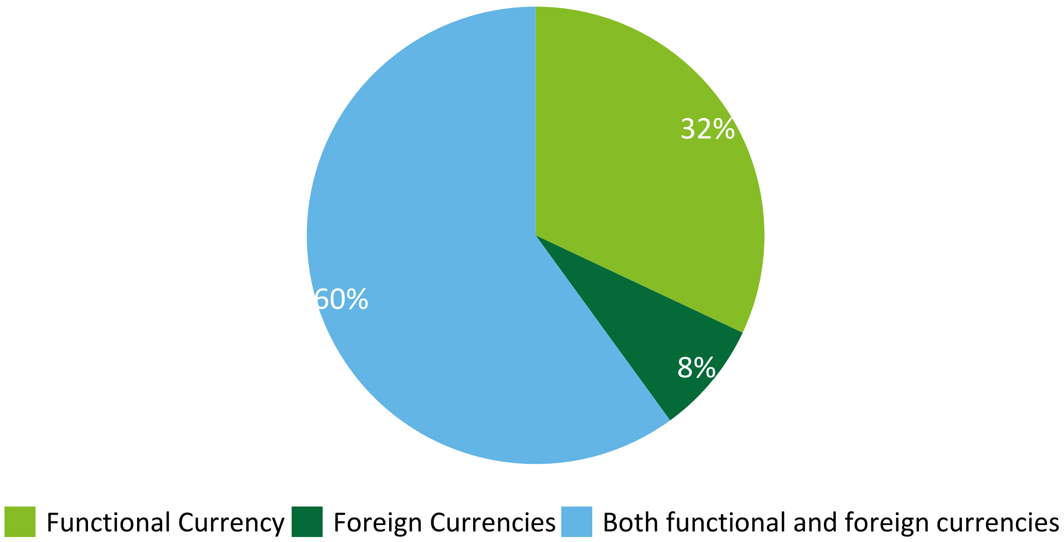
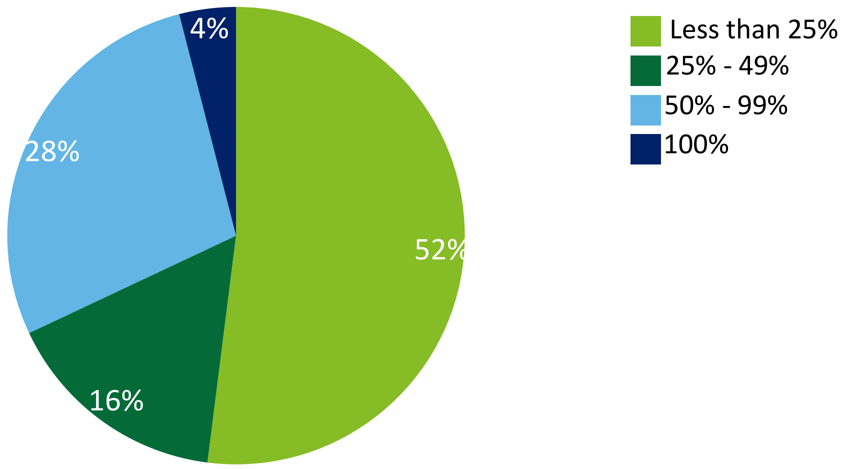


Figure 6: *What percentage of your loan portfolio is denominated in foreign currencies?*



Furthermore, when PBDs hold assets denominated in different currencies due to internationals operations, currency risk arises when the value of these assets fluctuates due to foreign exchange movements. Changes in Foreign exchanges can lead to gains or losses in the valuation of assets denominated in foreign currencies when they are translated back into the reporting currency of the bank.

The findings of the study indicate that a significant proportion, precisely 40% of the surveyed PDBs do not engage in asset hedging[1]. The decision not to hedge assets may be influenced by factors, such as financial resource constraints, a lack of risk management expertise, or the perception that the benefits of hedging may not outweigh the associated costs. For example, the study highlights that 38% of the surveyed PDBs attribute their lack of motivation to hedge to the unavailability of financial resources

[1] Hedging against currency risk involves using financial instruments or strategies to protect against potential losses resulting from fluctuations in foreign Foreign exchanges. This risk arises when individuals, companies, or investors have exposure to foreign currencies due to international trade, investments, or business operations.

to mitigate currency risk. These PDBs face constraints in accessing the necessary funds or suitable financial instruments to implement hedging strategies effectively.

Figure 7: *How much of your foreign currency denominated assets are hedged?*

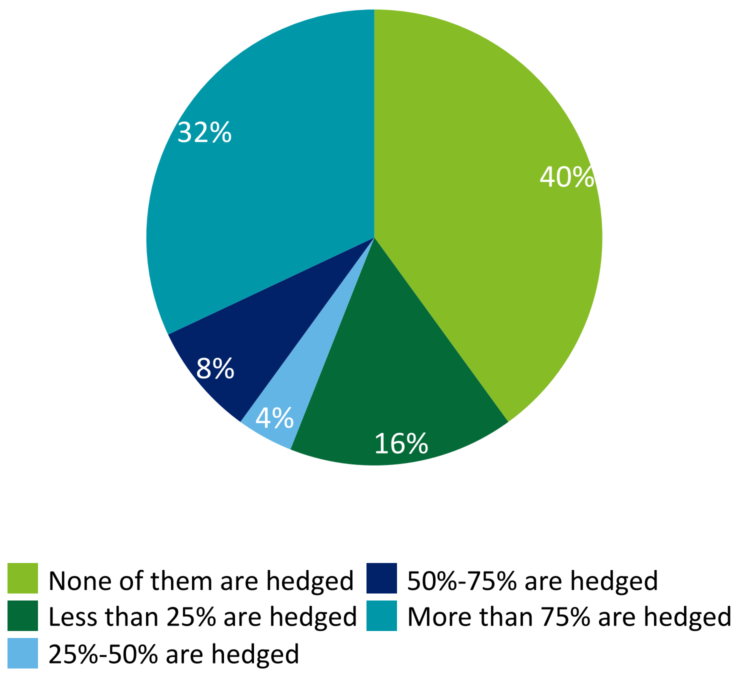
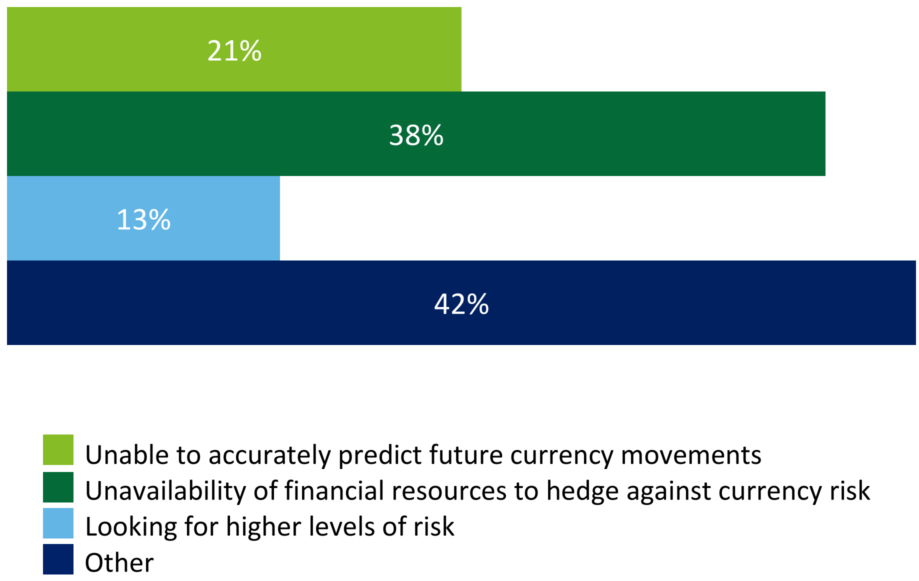


Figure 8: *Which of the following are reasons why you might choose not to hedge against currency risk?*



Perception of the impact of currency risk by PDBs based on the survey

The survey findings reveal that 68% of PDBs are exposed to currency risk, underscoring the pervasive nature of this risk and its pertinence to the majority of PDBs. Moreover, within the subset of PDBs exposed to currency risk, 28% of PDBs consider that this risk has a significant or highly significant impact on their profitability. This distinction highlights the importance of carefully managing currency risk and adopting suitable hedging strategies to optimize financial stability and protect profitability. As a result, these PDBs may face challenges in financing development projects to reach the SDGs.

Figure 9: *Are you exposed to currency risk?*

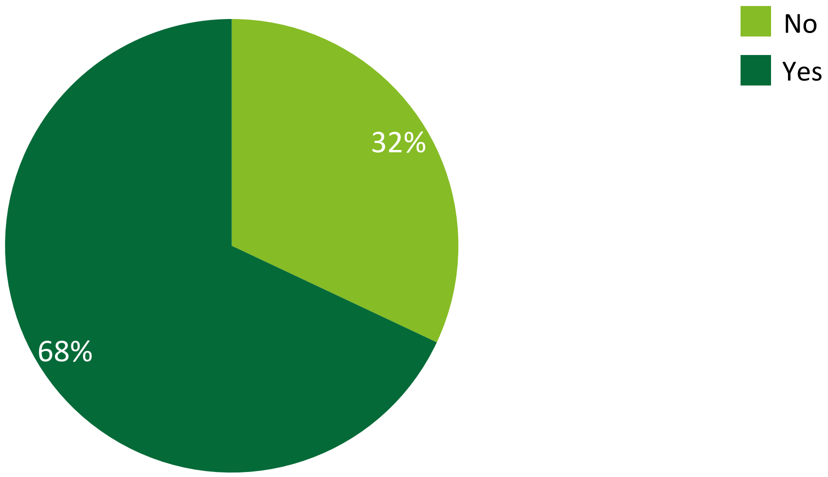
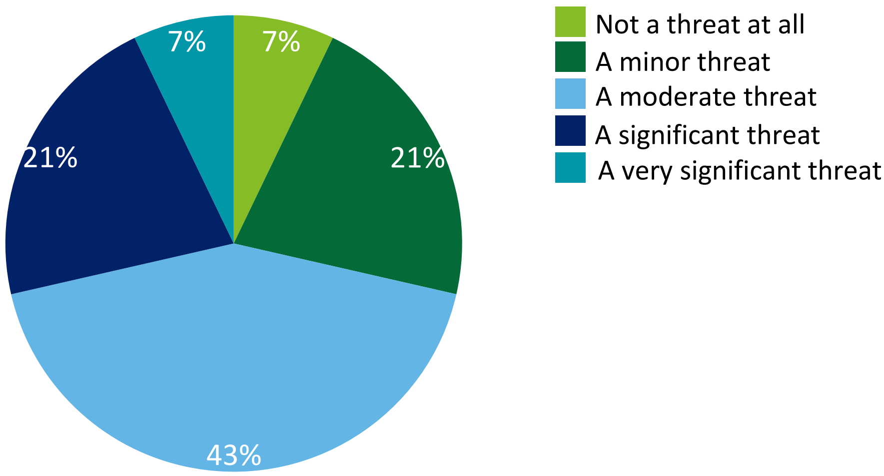


Figure 10: *How much of a threat do you think currency risk poses to your company's profitability?*



The PDBs perceiving a minor threat from currency risk have predominantly embraced risk mitigation strategies, such as hedging operations, leading to the hedging of more than 50% of their liabilities. We note that the PDBs exposed to moderate or significant risk are primarily concentrated within the African continent, characterized by a relatively underdeveloped foreign exchange market.

The findings of the survey also indicate that 13% of the surveyed PDBs encounter losses surpassing 25% of their total equity because of currency risk, resulting in an estimated cumulative impact of more than **$2 billion USD.**

53% of PDBs indicate that currency risk impact them by generating financial losses resulting from the depreciation of the lending currency in comparison to the borrowing currency. 42% of PDBs state that this risk complicates the repayment of debts denominated in foreign currencies with a depreciated local currency.

Figure 11: *Could you quantify the impact of FX losses/profit as a percentage of total equity?*

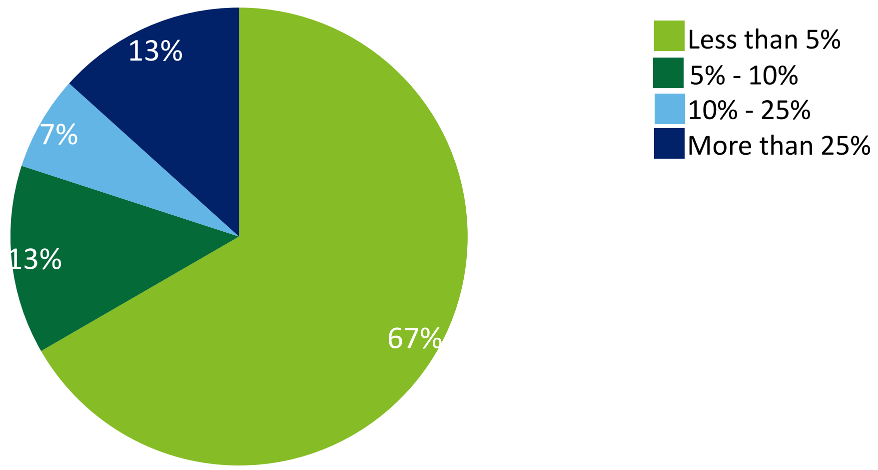
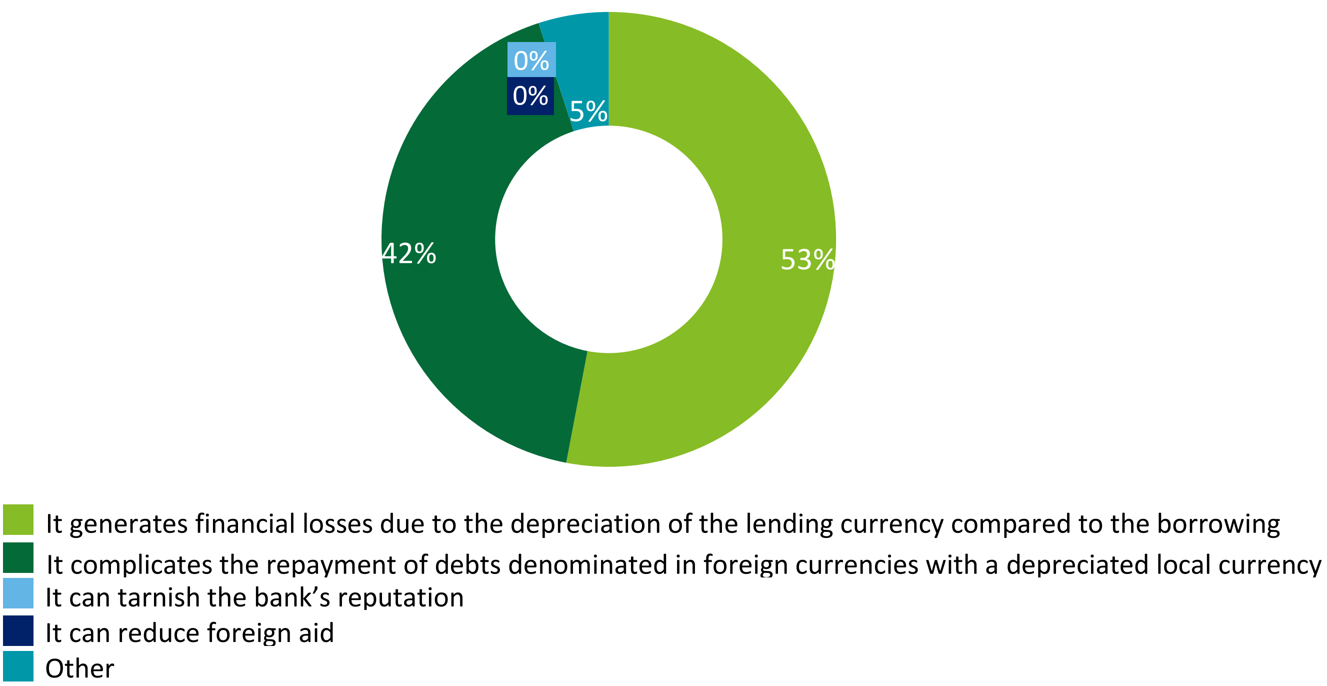


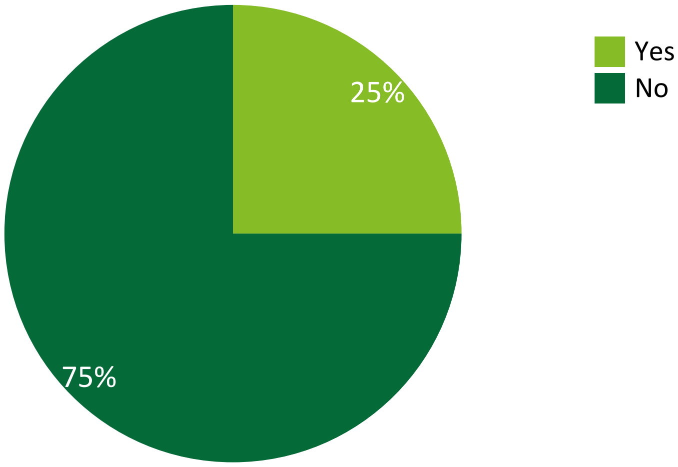
Figure 12: *How currency risk impacts your organization?*



We note that 67% of PDBs experiencing losses exceeding 10% do not have their liabilities adequately hedged. This indicates a lack of risk mitigation measures in place to safeguard against the adverse impact of foreign exchange fluctuations on their liabilities.

The survey conducted reveals that 25% of the surveyed PDBs have had to either postpone or cancel funding agreements due to foreign exchange risk. This shows that volatility and uncertainty associated with foreign exchanges can limit the ability of PDBs to finance development projects at the desired pace.

Figure 13: *Have you had to scale back, postpone, or cancel any funding agreement due to FX risk?*



3. Recommendations

1. Scaling up local context and regulatory frameworks

Recommendation N°1: *Strengthen domestic capital markets and ensure effective regulations and supervision*

Stakeholders, comprising of **governments and DFIs should take the lead in partnership with the private sector** to **foster** an environment that **enables the growth of domestic capital markets** by implementing measures, such as issuing securities, working with local entities to promote higher usage of domestic capital markets, mobilizing partial guarantees, and promoting risk-sharing and collaborative solutions. They can enhance market liquidity, incentivize private sector engagement in developmental projects, and attract additional capital, including foreign investment. A good domestic capital market infrastructure enables the mobilization of local funds and untapped resources and makes it easier for PDBs to reach the scale required to finance their projects' pipeline.

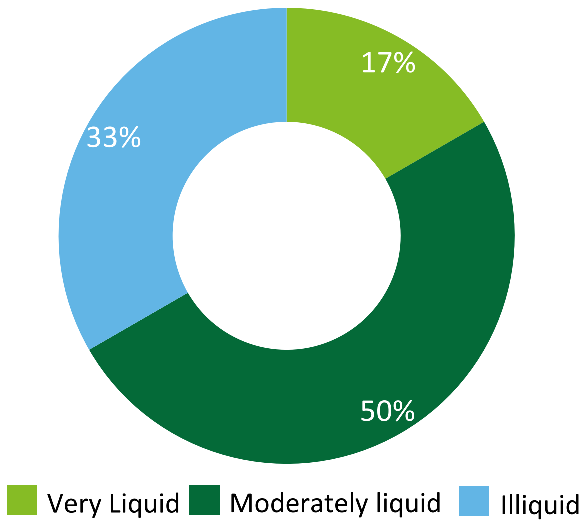
To promote the growth of robust domestic capital markets and further mitigate currency risk on PDBs, governments can take specific measures, such as developing a well-functioning foreign exchange market within the country.

Having a transparent and efficient foreign exchange market **can also help increase the availability of derivatives for PDBs; these products would be used as risk management tools**. These instruments allow PDBs to manage their foreign exchange exposures, thereby reducing the impact of currency fluctuations on their operations. By being able to manage currency risk more effectively, PDBs can focus on their core developmental objectives with greater stability and confidence.

An efficient foreign exchange market also benefits institutional investors and other market participants. It provides them with a transparent and liquid marketplace for foreign exchange transactions, facilitating the conversion of funds into local currency and vice versa. This ease of currency conversion enhances investor confidence and reduces the transaction costs associated with currency exchanges, making it more attractive for institutional investors to participate in the local capital markets and invest in PDBs' local currency-denominated instruments.

Stakeholders should additionally encourage institutional investor participation, which can significantly mitigate the impact of currency risk on PDBs by fostering stability and reducing reliance on foreign currency funding. To achieve this, it is crucial to **educate domestic institutional investors**, including pension funds and insurance companies, about the advantages and risks associated with investing in projects alongside with PDBs. Through comprehensive awareness campaigns, these investors can gain a deeper understanding of PDBs' role in promoting economic development, their financial strength, and their potential impact on the local economy.

Figure 14: *Please rank your FX derivatives market*



To take full advantage of the potential benefits of the solutions above, **it is essential to promote market liquidity through various measures**. With a liquid market, PDBs can access a broader investor base and attract more capital at competitive rates, reducing their dependence on foreign currency funding. Enhancing market liquidity reduces transaction costs for PDBs, making it more cost-effective to issue and trade local currency securities. 33% of surveyed PDBs have an illiquid FX derivative market.

To effectively regulate the transactions of PDBs and capitalize on the efforts made in local market infrastructure development, governments and DFIs can create an enabling environment for domestic capital market development by implementing policies and regulations that promote transparency, enforceability, stability and investor protection. Regulatory and operational oversight play a key role in enabling PDBs to achieve sustainable development goals and raise diverse funding while mitigating currency risks.

To mitigate the potential negative impacts of currency risk on PDBs and enhance their financial stability and resilience, it is imperative to establish prudential regulations. These regulations should focus on maintaining adequate capital buffers, liquidity ratios, and robust risk management frameworks for PDBs. By enforcing prudential regulations, governments and regulatory authorities can ensure that PDBs have sufficient capital to absorb potential losses arising from currency fluctuations, reducing their vulnerability to currency risk. Adequate liquidity ratios help PDBs meet their financial obligations in local currency, safeguarding their operations and mitigating liquidity risks. Additionally, robust risk management frameworks enable PDBs to identify, assess, and manage currency risk effectively, incorporating hedging strategies and appropriate risk mitigation techniques.

To reinforce the stability and soundness of PDBs, it is crucial to strengthen the supervisory oversight of regulatory bodies tasked with overseeing their operations and **improve bank supervision** by enhancing banks' ability to manage risk, **encouraging the adoption of best practices** *(including in areas such as governance, risk management, and sustainability*), and **supporting the development of a stable financial system**. Strengthening supervisory oversight enables regulatory bodies to effectively monitor and evaluate the compliance of PDBs with regulatory frameworks, risk management practices, and reporting requirements. Regular assessments and stress tests play a vital role in identifying potential vulnerabilities and assessing the resilience of PDBs to various risks, including currency risk.

By conducting these assessments, regulatory bodies can gain insights into emerging issues and proactively intervene to mitigate risks before they escalate. This proactive approach helps ensure the stability and integrity of PDBs, promoting a safe and sustainable financial environment that fosters confidence among stakeholders and supports the successful implementation of developmental initiatives.

Ultimately, these efforts will **reduce public development banks' reliance on foreign currency funding**, stimulate private sector investment, facilitate economic growth, and **enhance** their **access to long-term financing** for sustainable investment.

2. Highlighting PDBs' possible financing solutions to monitor currency risk exposure

Recommendation N°2: ***Promote LCY financing and lending from MDBs to PDBs***

The adoption of (synthetic) local currency (LCY) financing facilitated by MDBs serves as an effective solution in tackling crucial concerns such as currency risk mitigation, financial stability, and sustainable development. MDBs offer PDBs the flexibility of obtaining financing through either normal LCY or synthetic LCY arrangements, tailored to meet the unique requirements and preferences of the borrowers. Furthermore, to make local currency lending more conducive to the business of investees, MDBs are encouraged to insert a local currency conversion clause in the loan agreement when they end up financing their client in hard currency. A local currency clause is a provision that allows the investees to return to the MDB throughout the life of the transaction and request a conversion to local currency should a series of conditions be met.

17% of PDBs currently receive financing in local currency by the MDBs, knowing that for the same surveyed sample, 43% wish to have more access to this type of financing. By providing funding in the local currency, LCY financing enables PDBs to be protected against currency fluctuations altogether, therefore choosing stability and predictability. It strengthens the financial stability of PDBs by reducing vulnerabilities associated with currency mismatches, enhancing their capacity to allocate resources and sustainably manage operations.

Figure 15: *What are your current hedging solutions?*

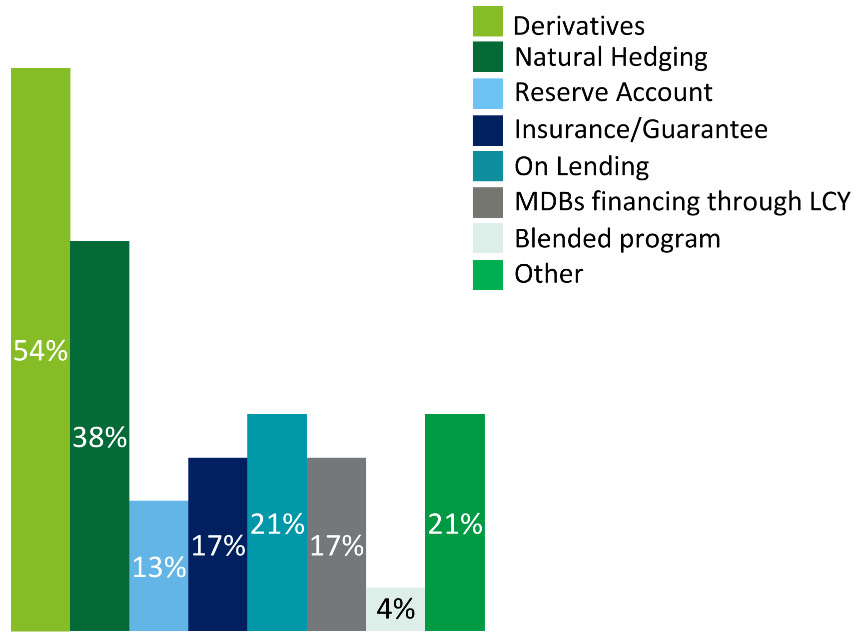
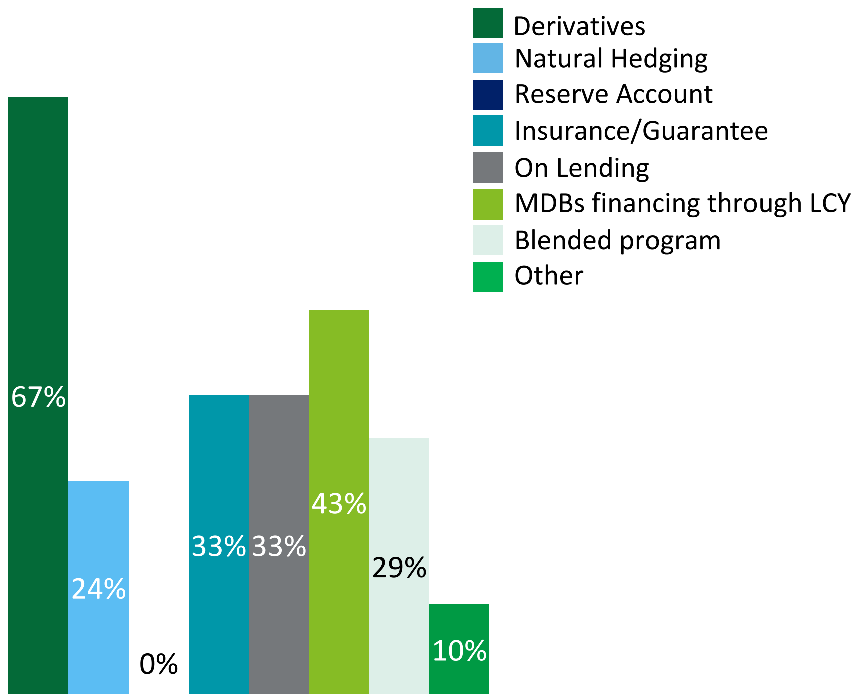


Figure 16: *What are the solutions you would like to have access to?*



Indeed, LCY financing promotes project viability by aligning funding with local economic conditions, attracting investor confidence and sustainable investments. It further contributes to the development of robust local financial markets, driving financial inclusion and stimulating overall economic growth. Additionally, LCY financing facilitates policy alignment between MDBs and recipient countries, reinforcing the importance of coordination and coherence in achieving shared development objectives.

Embracing LCY financing also supports regional integration efforts, promoting currency harmonization and cross-border transactions for increased regional resilience and shared prosperity. Policymakers can leverage this approach to reinforce financial stability, drive sustainable development, and foster inclusive growth in their economies.

MDBs can ensure that PDBs have access to appropriate and sustainable financing solutions. Furthermore, it is important to encourage MDBs to offer flexible terms (grace periods, extended repayment period, longer periods etc.) and conditions that accommodate the specific circumstances of PDBs. This flexibility can be reflected in longer tenors, allowing for extended repayment periods including grace periods or options for conversions (currencies, rates). These measures enable PDBs to better manage their financial resources and align repayment schedules with their income streams, thus reducing the strain on their financial capacities while also being able to adjust to potential economic fluctuations and uncertainties.

MDBs can also provide financing through synthetic LCY despite the hurdles they perceive compared to the normal LCY financing. A Synthetic Local Currency Loan is a loan denominated in the country's currency; the loan is disbursed in that local currency, and repayments (interest and principal) are based on a local interest rate. Finally, payments will be made in hard currency but based on defined (unchanged) local currency amounts then converted in hard currency (USD or EUR) based on a pre-agreed FX source (normally the Central Bank FX rate).

Regulatory policies and frameworks play a crucial role in determining the legal status, enforceability, and treatment of synthetic local currency funding. MDBs must operate within established legal frameworks and comply with international financial regulations. If the regulatory policies surrounding synthetic local currencies are uncertain or restrictive, MDBs may be hesitant to engage in financing PDBs using these currencies due to concerns about compliance and legal risks.

The promotion of LCY financing can be significantly enhanced through regional cooperation and coordination among MDBs, PDBs, and regional development organizations. By fostering collaboration among these entities, a collective effort can be formed to promote and strengthen local currency financing initiatives within a specific region. This can be achieved through the establishment of a formalized network or platform that serves as a collaborative space for sharing knowledge, expertise, and best practices. Through regular meetings, workshops, conferences, and online platforms, member institutions within the regional network can actively engage in the exchange of experiences, lessons learned, and policy frameworks. This exchange of information enables countries in the same region to benefit from each other's successes, challenges, and strategies, ultimately contributing to the development and refinement of effective local currency financing policies and practices. By leveraging the power of regional cooperation, the promotion of local currency financing can be approached holistically, with shared goals and collective efforts aimed at fostering economic growth and stability within the region.

By joining forces, MDBs, PDBs and DFIs can effectively address the challenges associated with local currency lending initiatives. One key approach to collaboration involves **establishing co-financing arrangements, where multiple institutions contribute funds to a specific project or initiative**. This not only helps to diversify the sources of financing but also provides a larger pool of resources to support local currency financing. Moreover, joint risk-sharing mechanisms can be implemented, enabling institutions to collectively manage and mitigate the risks involved in local currency lending. By sharing the risks, MDBs, PDBs, and financial institutions can enhance their ability to support projects in local currencies, thus reducing the exposure and potential vulnerabilities of individual institutions. Additionally, the establishment of syndicated loan structures allows for the pooling of resources and expertise from multiple institutions, which can provide borrowers with access to a larger amount of funds. Through collaboration and partnerships, MDBs, PDBs, and other financial institutions can leverage their combined resources and expertise to foster sustainable local currency financing initiatives, ultimately contributing to the economic development and stability of the regions they serve.

Recommendation N°3: *Enhance the use of solutions offered by FX Hedging Providers*

Strengthening various initiatives aiming at fortifying foreign exchange hedging mechanisms, particularly through enhanced collaboration between International Financial Institutions (IFIs) and FX Hedging providers can help safeguard PDBs from the adverse effects of Foreign exchange volatility in developing countries.

24% of the surveyed PDBs state that there are no currency hedging products available locally and 56% of them believe that currency hedging products are available in their local regions, but that the selection of product is limited.

Figure 17: *Are any currency hedging products available in your local financial market?*

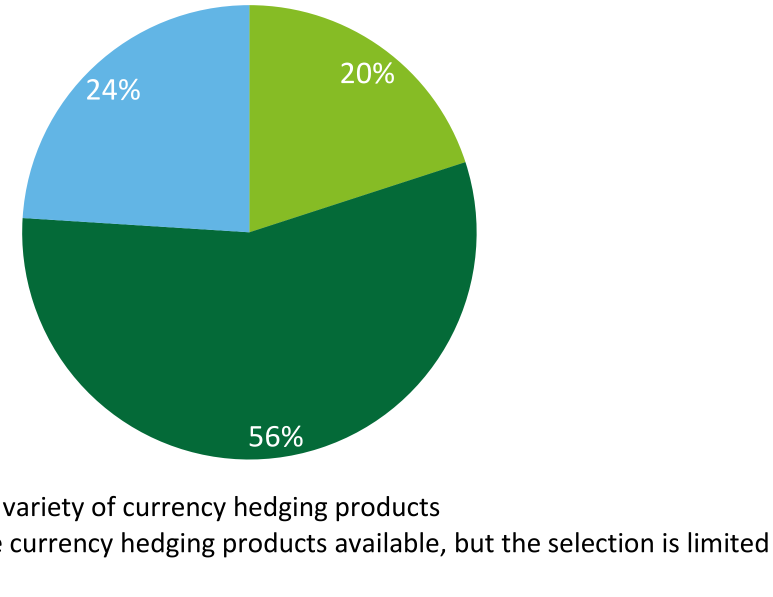
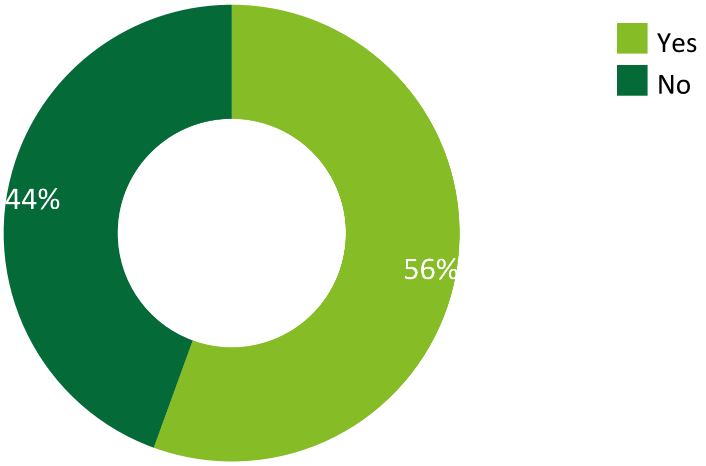


Figure 18: *Is the offer in terms of tenors furnished enough to hedge adequately your currency risk?*



As an illustration of limited choices, the availability of adequate tenors to meet the needs of PDBs depending on their risk profile at a given moment. In fact, 44% of PDBs cannot find the desired tenors in their local market to hedge currency risk.

67% of surveyed PDBs have expressed their desire to have access to these types of solutions. While derivatives solutions provided by FX hedging counterparts offer a viable avenue for PDBs to mitigate currency risks, there are often implementation challenges that impede their utilization.

These challenges may include limited understanding and awareness of derivative instruments among PDBs, regulatory constraints that restrict their use, operational complexities in integrating these solutions into existing systems, and the need for skilled human resources with expertise in managing derivative transactions.

One of the obstacles faced by FX hedging providers when dealing with PDBs is their reluctance to offer the required collateral for the transactions. This reluctance arises from PDB's apprehensions regarding the potential risks and limitations linked to pledging collateral for hedging purposes. Therefore, it becomes imperative to address these concerns and establish mechanisms that enable PDBs to enter these transactions without providing collateral, ensuring a more conducive environment for successful hedging operations. A fruitful perspective to achieve this goal is the introduction of guarantee schemes that mitigate the credit or collateral risks associated with hedging solutions. Implementing such a system reduces the complexity and uncertainty associated with credit and collateral risks, resulting in a simplified, low-cost hedging solution for PDBs. In addition to these collateral schemes, some schemes on pricing might accelerate adoption in sensitive sector, such as climate.

To address the challenge mentioned above, a significant role is played by institutions, such as the Multilateral Investment Guarantee Agency (MIGA). MIGA, as part of the World Bank Group, specializes in providing political risk insurance and credit enhancements, including guarantee schemes. MIGA's expertise and experience in risk mitigation can be instrumental in designing and implementing effective guarantee schemes that address the concerns of both FX hedging providers and PDBs.

With a thorough understanding of the complexities involved and the range of available solutions offered by FX hedging providers, PDBs can more confidently use these solutions to mitigate currency risk. To achieve this, PDBs can maintain strategic partnerships with FX hedging providers, MDBs and DFIs. These collaborations create avenues for capacity building, sharing expertise and resources and facilitating a comprehensive approach to understanding the role of FX hedging providers. By leveraging the strengths and capabilities of various stakeholders, joint initiatives can be developed to deliver end-to-end solutions for PDBs. These efforts cover all aspects of foreign exchange risk management and ensure seamless integration with PDB's overall financial strategy.

Recommendation N°4: ***Leverage blended finance to increase investors attractiveness and flexibility***

Blended finance can be a powerful tool to increase the attractiveness and flexibility of financing options and to mobilize additional private sector capital while promoting responsible and sustainable lending.

By using blended finance, PDBs can effectively de-risk investments, making them more attractive to private sector investors. This practice not only enhances the lending capacity of PDBs but also facilitates the provision of comprehensive support to expand the scope of sustainable development projects.

To reach this goal, developing innovative **financial structures** that effectively combine public and private capital can contribute to closing the funding gap and reducing investment risks. **These structures** play an important role in attracting investors and ensuring the financial viability of investments. Here are some examples:

- One approach is to introduce **first-loss schemes**, in which public funds partially insure or absorb initial losses on investments. Public funds taking part of the risk reduces the overall risk for private investors, makes investments more attractive, and encourages private investor participation. The provision acts as a safety net, building trust and encouraging private investors to participate in projects deemed too risky.
- Another approach is to provide **concessional financing.** Providing loans and grants at below-market rates or on favorable terms can reduce project borrowing costs. It is particularly beneficial in areas of social or environmental impact. By making investments financially viable, concessional financing is attractive to both private investors and project developers, allowing them to pursue projects that are consistent with their sustainability goals.
- Another possibility is to put in place **risk-sharing mechanisms**. They consist in sharing investment risks between public funds and private investors. Risk-sharing agreements and insurance products can be considered as means of doing this. These mechanisms reduce the financial burden on individual investors by distributing the burden of risk, giving them a greater sense of security.

There are some successful blended programs such as the **"EU Market Creation Facility – Pricing Component"**[2] by the European commission that could be replicated or extended to specific sector, customer group or region to increase the access and adoption of LCY.

[2] The primary objective of this program is to facilitate an upsurge in debt investments within Sub-Saharan Africa and the European Neighborhood, allowing for the refinancing of current debts. An additional benefit is that borrowers will not be subjected to currency risk. Through these efforts, the program seeks to promote institutional stability and establish local-currency lending capabilities precisely when and where they are most required.

According to our survey, only 4% of PDBs use blended finance, indicating a significant untapped potential. The fact that 29% of PDBs express their desire to access this solution further emphasizes the need to leverage blended finance to de-risk investments.

By enhancing the access and management of blended finance programs for PDBs, donors can leverage on blended finance to its full potential thus providing affordable local currency financing thus accelerating SDG achievements and the resilience of the entire PDBs ecosystem.

3. Improving PDBs' capacities to mitigate currency risk and scale up the SDGs achievement

Recommendation N°5: ***Support PDBs in reinforcing their internal capacities***

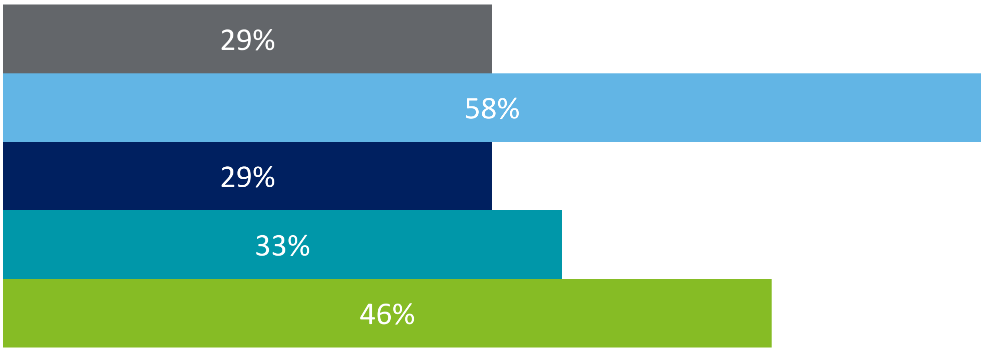
To ensure efficient resource allocation and achievement of the SDGs, PDBs need to strengthen their internal capacities to effectively manage currency risk. This requires a comprehensive and multifaceted approach that includes several key strategies.

First, it is important to prioritize **training and knowledge sharing** among all stakeholders. Depending on their maturity and progress, PDBs should invest in dedicated training programs focused on foreign exchange risk management to ensure that their staff, especially those in finance, risk, legal and treasury departments, have the necessary skills and expertise. This training covers topics such as hedging strategies, risk management, ISDA financial derivatives and foreign exchange stress test analysis. By equipping its staff with in-depth knowledge, PDBs will be able **to better understand** the impact currency risks on their customer and financials as well as **make informed decisions to effectively mitigate them**.

In order to fully leverage the training provided by PDBs and promote widespread knowledge, it is imperative to **foster knowledge sharing and collaboration among PDBs**. Establishing a platform for peer-to-peer exchanges and creating a network in which PDBs can share their experiences, lessons learned and best practices in dealing with currency risk can greatly improve their internal capabilities. This joint effort will also facilitate the development of a common risk management framework and the sharing of risk assessment methodologies, facilitating a collective learning approach across all PDBs. To facilitate this, the global network of Finance in Common, which encompasses a wide range of DFIs, can serve as a vital platform for these knowledge-sharing and collaborative efforts.

Not only should PDBs possess knowledge to mitigate currency risk, but they should also have tools and data to help them monitor this risk. PDBs should consider **enhancing their data systems and reporting mechanisms**. Implementing advanced risk management information systems will provide real-time currency risk data, allowing PDBs to monitor and assess risks more effectively. With using advanced analytical tools, PDBs can gain insight into market trends, identify potential vulnerabilities, and adjust risk management strategies in a timely manner. PDBs can also run periodic reports to ensure transaction transparency and store a history of data useful for multiple follow-up studies and various stress tests.

Figure 19: *Do you monitor and manage currency risk on an ongoing basis, and what procedures do you have in place to mitigate currency risk?*



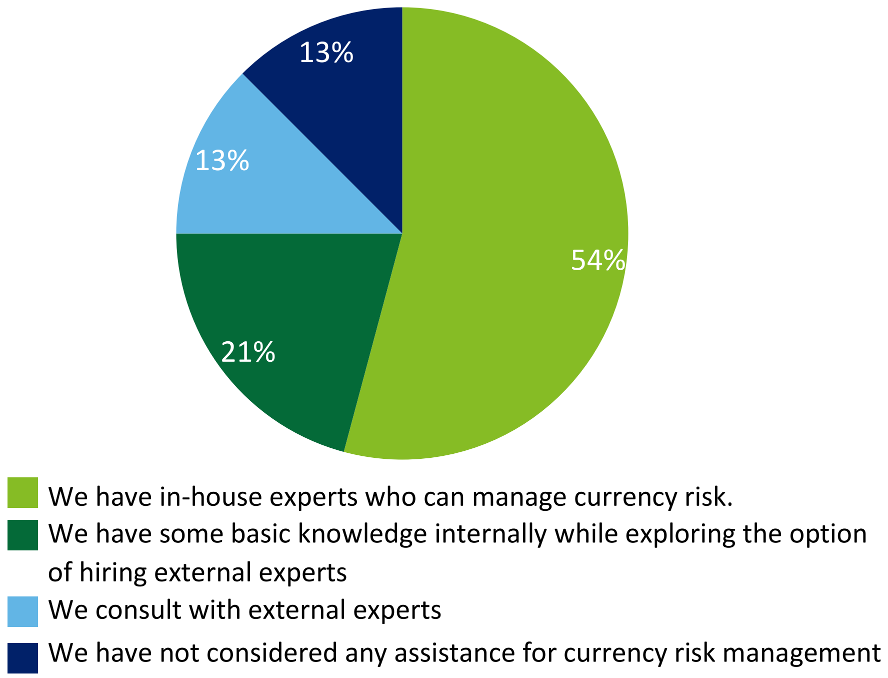
- We use a combination of internal and external tools to monitor and analyze currency risk, including exposure tracking systems and market analysis software.
- We regularly review and update our currency risk management policies and procedures to ensure they are up-to-date and effective.
- We use a range of hedging strategies, such as forward contracts and options, to manage currency risk.
- We maintain a diversified portfolio of currency exposures to help reduce overall currency risk.
- We regularly assess and stress-test our currency risk exposure to identify potential vulnerabilities and proactively implement measures to mitigate risk.

According to the answers collected from the survey, PDBs use several ways to monitor and manage currency risk on an ongoing basis. In fact, 29% of the surveyed PDBs confirmed that they used a combination of internal and external tools to monitor and analyze currency risk, including exposure tracking systems and market analysis software.

On the other side, 46% approved the implementation of measures to mitigate risk, such as the application of regular stress tests, while 58% stated that they regularly reviewed and updated their currency risk management policies and procedures to ensure they are up-to-date and effective. This raises a point on how important it is for PDBs to manage the currency risks they are facing through the implementation of a series of procedures and solutions involving systems bearing and strategies engagement. Moreover, PDBs' focus interest toward currency risk management policies proves the importance of regular reporting and accountability.

In order to have an external view and/or to strengthen the systems already in place, PDBs can rely on **experts specializing in currency risk management**. Collaborating with risk management consultants can provide valuable insights and guidance on best practices in managing currency risks. External partners can offer technical assistance (TA) in developing risk management policies, implementing robust internal control frameworks, and conducting comprehensive risk assessments tailored to the specific needs of PDBs. According to the results of the survey, 21% stated they have basic knowledge for currency risk management although they remain open to hiring external experts and only 13% institutions responded that they were only consulting external experts.

Figure 20: *In terms of human resources, how do you manage currency risk in your organization?*



6. Conclusion

According to the results collected from the survey and the analysis built upon it, this study treats the topic of currency risk and its impacts on PDBs and their development strategies. Based on the survey's data, appropriate recommendations are given to accommodate the most pressing challenges raised by PDBs through their answers and through the interviews conducted with a selection of PDBs. In this regard, the suggested recommendations can be dispatched over the following main points: Strengthening domestic markets via adequate regulations' implementation, fostering LCY financing, enhancing FX hedging providers' solutions, leveraging on blended finance solutions, and reinforcing internal capacities of PDBs.

- **Strengthening domestic markets:** The engagement in the domestic market development leads to fruitful outcomes as PDBs can have access to additional liquidity by relying on local economies and reducing foreign investments dependance. Therefore, stakeholders must provide the necessary support in terms of strengthening domestic markets. To enhance the financial stability and resilience of PDBs and mitigate currency risk, establishing prudential regulations is crucial.
- **Fostering LCY financing:** The utilization of (synthetic) LCY financing provided by MDBs helps address critical issues, such as currency risk mitigation, financial stability, and sustainable development. By providing funding in the local currency, LCY financing enables PDBs to be naturally hedged against currency fluctuations. The promotion of LCY financing can be significantly enhanced through regional cooperation and coordination among MDBs, PDBs, and regional development organizations.
- **Enhancing FX hedging providers solutions:** The survey findings indicate a strong desire among PDBs to gain increased access to FX hedging solutions. Strengthening collaboration between IFIs and FX hedging providers is pivotal in bolstering foreign exchange hedging mechanisms. This collaboration serves a dual purpose: first, to shield PDBs from the adverse effects of currency volatility, and second, to promote the utilization of FX hedging solutions offered by these entities.
- **Leveraging on blended finance solutions:** blended finance helps attract additional investors by developing innovative financial structures that effectively combine public and private capital can contribute to closing the funding gap and reducing risks. According to our survey, only 4% of PDBs use blended finance, indicating a significant untapped potential. The fact that 29% of PDBs express their desire to access this solution further emphasizes the need to leverage blended finance to de-risk investments.
- **Reinforcing internal capacities:** To effectively manage foreign exchange risk and achieve the SDGs, PDBs will prioritize training and knowledge sharing, promote cooperation among PDBs, improve data systems and reporting mechanisms, and work with risk management consultants.

The objective behind each point consists into enhancing emerging nations' inclusion as part of the global economy while promoting their financial resources into valuable development projects and investments. The Paris agreement hereby plays a primitive role in strengthening this belief as a legally binding international treaty on climate change to which almost every country in the world committed to engage in further initiatives for global warming reduction. Thereafter, the agreement urged developed economies to assist and support emerging nations by undertaking ambitious efforts to monitor the movement.

These recommendations, although seemingly difficult to engage in, represent the suitable path for PDBs toward the SDGs' achievement. Indeed, PDBs need guidance and support from external and internal parties to reach the aimed objectives in the most efficient development strategy. It is exactly what the report suggests in its call for action urging governments, DFIs, and MDBs to help secure not only the future of PDBs, but also emerging economies' future relying on their development investments and financial growth initiatives.

Therefore, TCX and FiCS are engaged in joining their resources while looking for further partners to mobilize resources in order to reduce currency risk impact on PDBs and overcome its consequences. With the help of recommendations announced, these institutions should be able to expand their knowledge furthermore and raise awareness about currency risk exposure by spreading the word in informative conferences they shall organize, joint ventures they may engage in and more of the initiatives previously cited in this report.

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Appendices

Annex A: Survey Questions

I. Respondent Profiling

1 - Please select your total gross loan portfolio at the end of 2022:

☐A. Less than $50 millions

☐B. $50 millions - $100 millions

☐C. $100 millions - $500 millions

☐D. $500 millions - $1 billion

☐E. $1 billion - $10 billions

☐F. More than $10 billions

2 - Please select your institution's ownership structure at the end of 2021:

☐A. Publicly traded company

☐B. Privately held company

☐C. Government-owned or controlled

☐D. Other (please specify): _______

3 - Please select the geographic scope of your operations:

☐A. Africa

☐B. Asia

☐C. Europe

☐D. LATAM region

☐E. Other (please specify): _______

II. Asset composition & Funding

4 - What is your lending currency?

☐ A. Functional currency

☐ B. Foreign currency / currencies

☐ C. Both functional currency and foreign currency(ies)

Please specify the lending currency(ies) used (i.e.: USD, EUR, GBP, JPY, CNY): _________________

5 - What percentage of your loan portfolio is denominated in foreign currencies?

☐ A. Less than 25%

☐ B. 25% to 49%

☐ C. 50% to 99%

☐ D. 100%

6 - How has this percentage changed over the last 3 years?

☐ A. decreased

☐ B. Unchanged

☐ C. increased

7- How much of your foreign currency denominated **assets** are hedged?

☐ A. None of them are hedged

☐ B. Less than 25% are hedged

☐ C. 25% to 50% are hedged

☐ D. 50% to 75% are hedged

☐ E. More than 75% are hedged

8- How much of your foreign currency denominated **liabilities** are hedged?

☐ A. None of them are hedged

☐ B. Less than 25% are hedged

☐ C. 25% to 50% are hedged

☐ D. 50% to 75% are hedged

☐ E. More than 75% are hedged

III. Financial Capacity, resources, and resilience

9- Are you exposed to currency risk?

☐ A. No, we are not exposed to currency risk

☐ B. Yes, we are exposed to currency risk

9.1- **If you selected option 9.B**, how much of a threat do you think currency risk poses to your company's profitability? with 1 being "not a threat at all" and 5 being "a very significant threat"?

1. ☐ Not a threat at all
2. ☐ A minor threat
3. ☐ A moderate threat
4. ☐ A significant threat
5. ☐ A very significant threat

9.2- **If you selected option 9.B**, is a provision for foreign exchange risk included in the income statement?

☐ A. Yes

☐ B. No

9.3- **If you selected option 9.B**, could you quantify the impact of FX losses/profit as a percentage of total equity? (Simple average over the last 3 years)

☐ A. Less than 5% impact

☐ B. 5% to 10% impact

☐ C. 10% to 25% impact

☐ D. More than 25% impact

9.4- **If you selected option 9.B**, how currency risk impacts your organization?

☐ A. It generates financial losses due to the depreciation of the lending currency compared to the borrowing currency

☐ B. It complicates the repayment of debts denominated in foreign currencies with a depreciated local currency

☐ C. It can tarnish the bank's reputation

☐ D. It can reduce foreign aid

☐ E. Other: Please specify: _______

IV. SDG-compatible investments and FX risk

10- How many funding agreements have you signed over the past 3 years? Please enter the number: : _______

11- What are your needed maturities in terms of financing to achieve SDG?

☐ A. Under 5 years

☐ B. Between 5 years and 10 years

☐ C. Above 10 years

12-What is the motivation behind using foreign currency to finance your funding agreements?

☐ A. Differences in interest rates

☐ B. Differences in inflation rates

☐ C. Availability of funds

☐ D. Unavailability of the wanted financing maturity

☐ E. A combination of these factors

☐ F. Other. Please specify: _______

13- Have you had to scale back, postpone, or cancel any funding agreement due to FX risk?

☐ A. Yes
☐ B. No

V. Currency Risk: Local Context & Regulation

14- Do your institution have any legal or regulatory barriers that prevent it from engaging in FX-hedging activities (swap, forward, option…)?

☐ A. Yes

☐ B. No

15- In your local market/regulation, do you have the possibility to create bank accounts in foreign currencies and using these currencies in your transactions?

☐ A. Yes

☐ B. No

16- Are any currency hedging products available in your local financial market?

☐ A. Yes, there are a wide variety of currency hedging products available in our local financial market.

☐ B. Yes, there are some currency hedging products available in our local financial market, but the selection is limited.

☐ C. No, there are no currency hedging products available in our local financial market.

16.1- **If you selected options 16.A or 16.B**, please rank your FX derivatives market liquidity using the following scale:

☐ A. Very liquid tight bid-ask spreads (<1%).

☐ B. Moderately liquid reasonable bid-ask spreads. (Between 1% and 5%)

☐ C. Illiquid wide bid-ask spreads. (>5%)

16.2- **If you selected options 16.A or 16.B**, is the offer in terms of tenors furnished enough to hedge adequately your currency risk?

☐ A. Yes

☐ B. No

17- Is the ISDA (International Swap and Derivatives Association) Agreement enforceable in your local market?

☐ A. Yes

☐ B. No

VI. Currency Risk: FX Risk management

18- Do you monitor and manage currency risk on an ongoing basis, and what procedures do you have in place to mitigate currency risk?

☐ A. We use a combination of internal and external tools to monitor and analyze currency risk, including exposure tracking systems and market analysis software.

☐ B. We regularly review and update our currency risk management policies and procedures to ensure they are up-to-date and effective.

☐ C. We use a range of hedging strategies, such as forward contracts and options, to manage currency risk.

☐ D. We maintain a diversified portfolio of currency exposures to help reduce overall currency risk.

☐ E. We regularly assess and stress-test our currency risk exposure to identify potential vulnerabilities and proactively implement measures to mitigate risk.

19- What are your current hedging solutions?

☐ A. Derivatives (Options/Forward/Futures/ Swaps Contracts)

☐ B. Natural Hedging

☐ C. Reserve account

☐ D. Insurance / guarantee

☐ E. On-Lending

☐ F. MDBs financing through LCY (local currencies)

☐ G. Blended program

☐ H. Other Please specify: _______

20- What are the solutions you would like to have access to?

☐ A. Derivatives (Options/Forward/Futures/ Swaps Contracts/ Collars/Caps & Floors/Barrier options/…)

☐ B. Natural Hedging

☐ C. Reserve account

☐ D. Insurance / guarantee

☐ E. On-Lending

☐ F. MDBs financing through LCY (local currencies)

☐ G. Blended program

☐ H. Other Please specify: _______

21- Which of the following are reasons why you might choose not to hedge against currency risk?

☐ A. You are unable to accurately predict future currency movements.

☐ B. You do not have the financial resources to hedge against currency risk.

☐ C. You prefer to take on higher levels of risk to potentially earn higher returns.

☐ D. Other. Please specify: _______

22- Do you have any suggestions for the donor community on how to cover their foreign exchange risk when providing funding for development projects, and what steps can be taken to mitigate this risk? Please specify: _______

23-In terms of human resources, how do you manage currency risk in your organization?

☐ A. We have in-house experts who can manage currency risk.

☐ B. We have some basic knowledge internally while exploring the option of hiring external experts

☐C. We consult with external experts

☐ D. We have not considered any assistance for currency risk management

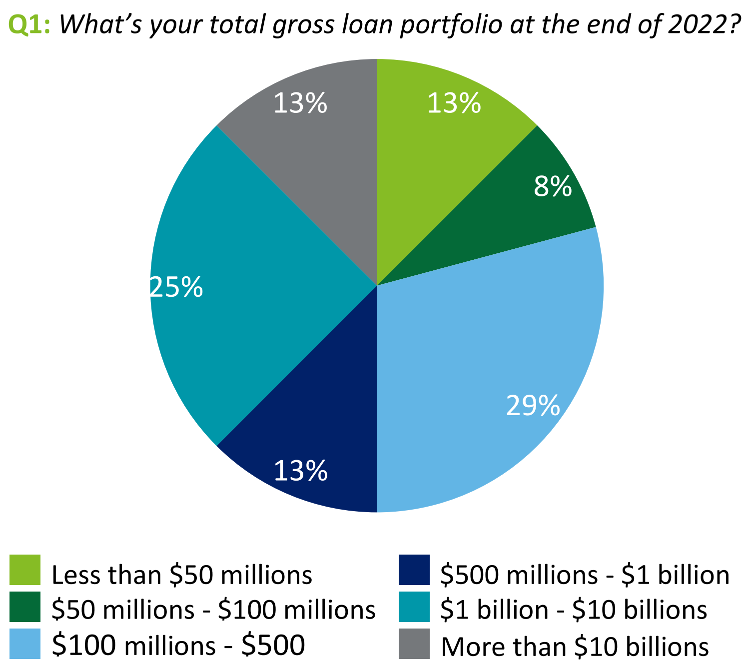
24- **If the ISDA is enforceable in your local market**, do you have the legal experts, operational and commercial Resources to maintain the best use of ISDA standards?

☐ Yes

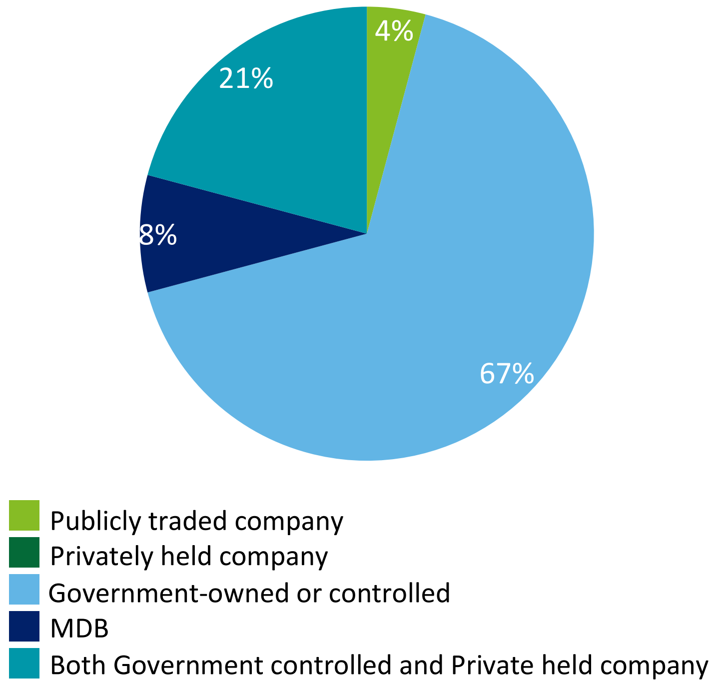
☐ Partially, please specify what do you lack _______

☒ No

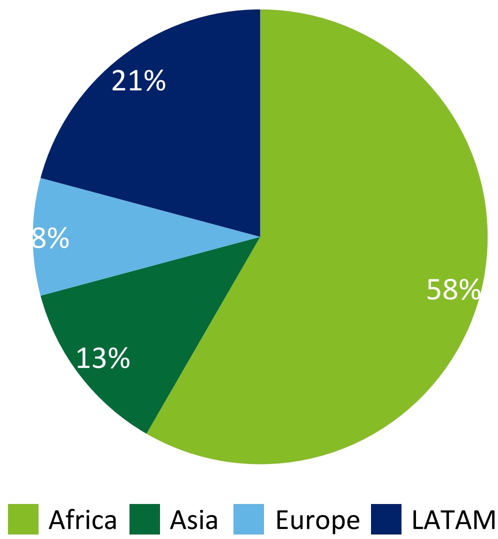
Annex B: Graphs from the survey analysis



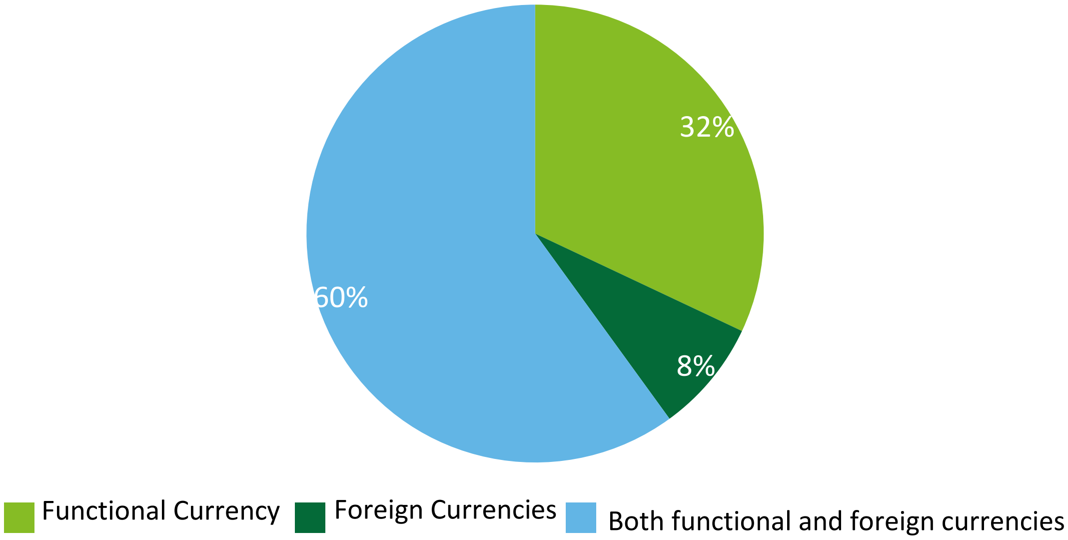
Q2: *What was your institution's ownership structure at the end of 2021?*



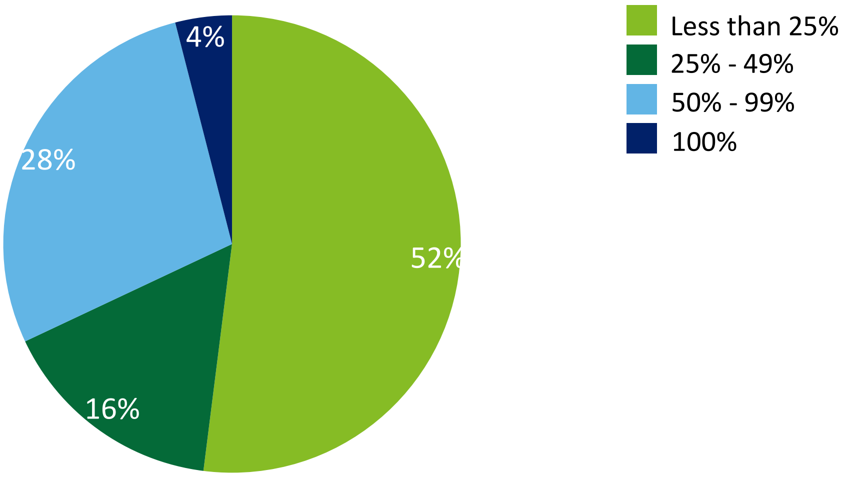
Q3: *What are your geographic scope operations?*



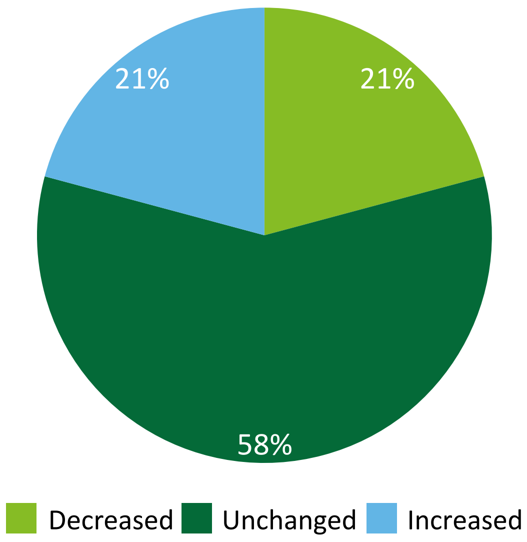
Q4: *What is your lending currency?*



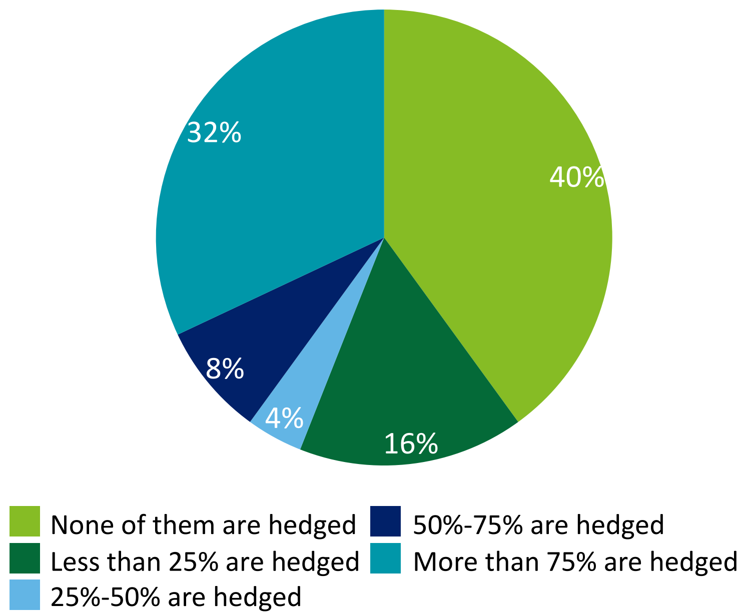
Q5: *What percentage of your loan portfolio is denominated in foreign currencies?*



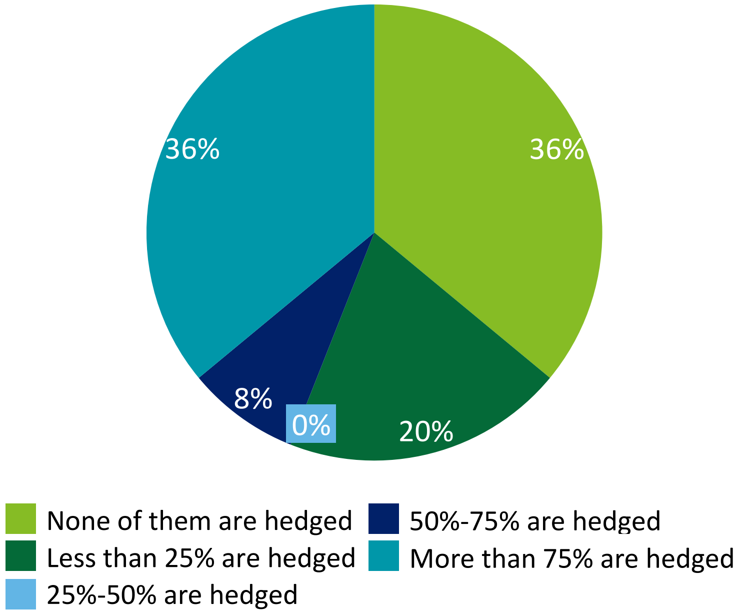
Q6: *How has this percentage changed over the last 3 years?*



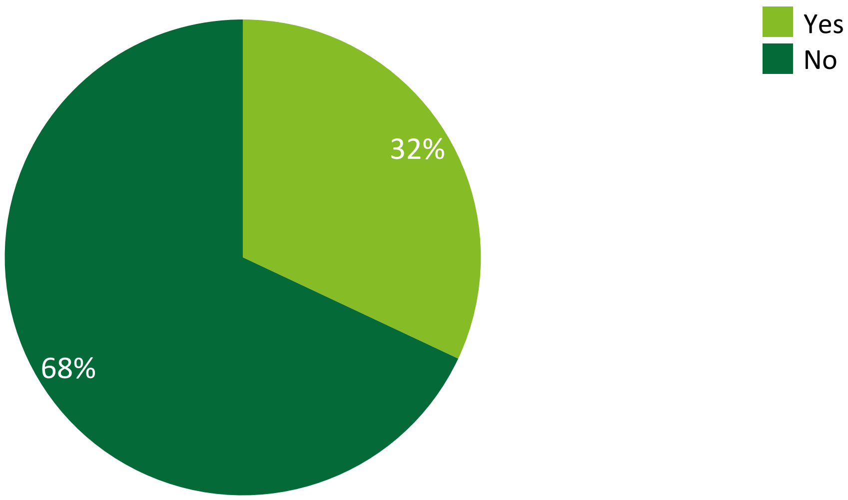
Q7: *How much of your foreign currency denominated assets are hedged?*



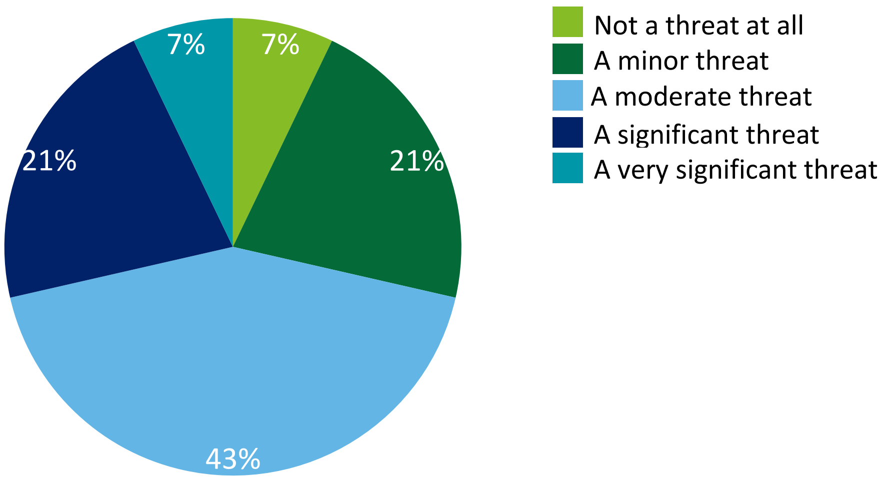
Q8: *How much of your foreign currency denominated liabilities are hedged?*



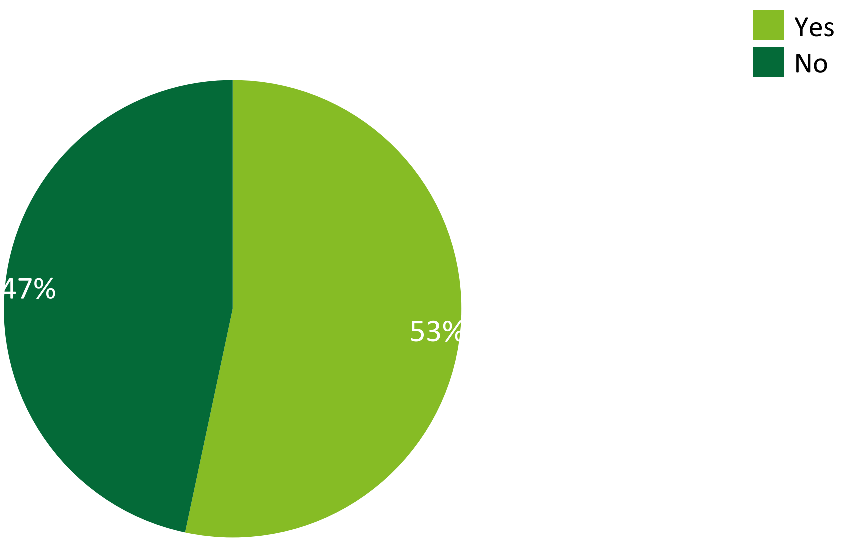
Q9: *Are you exposed to currency risk?*



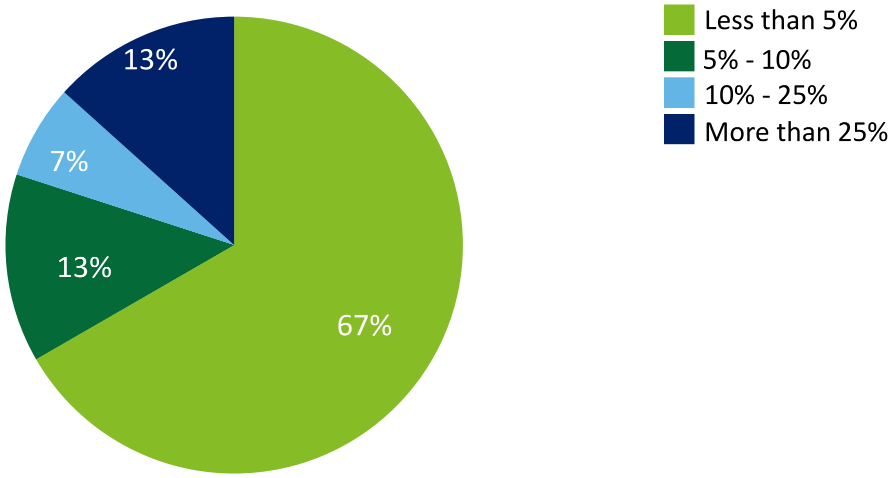
Q9.1: *How much of a threat do you think currency risk poses to your company's profitability?*



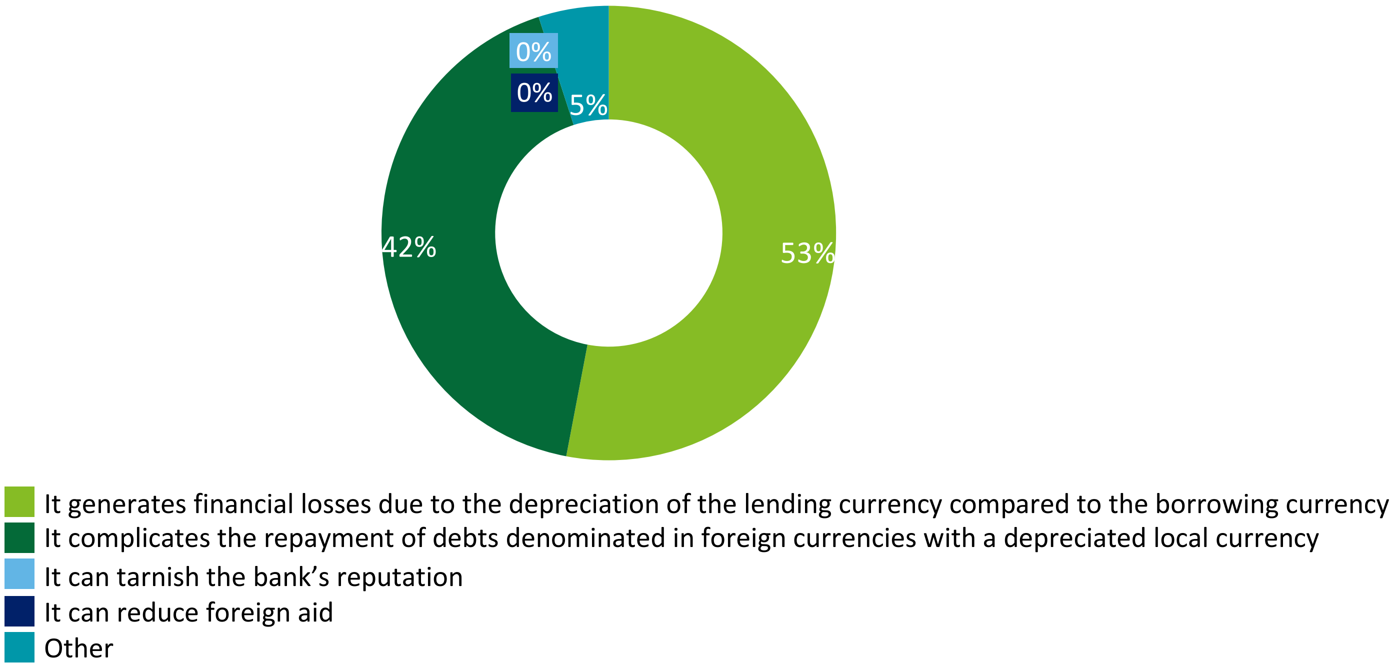
Q9.2: *Is a provision for foreign exchange risk included in the income statement?*



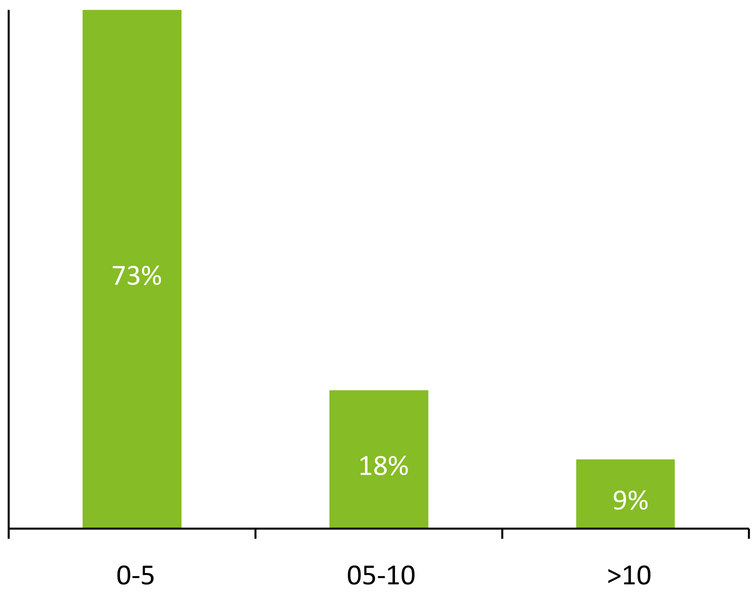
Q9.3: *Could you quantify the impact of FX losses/profit as a percentage of total equity?*



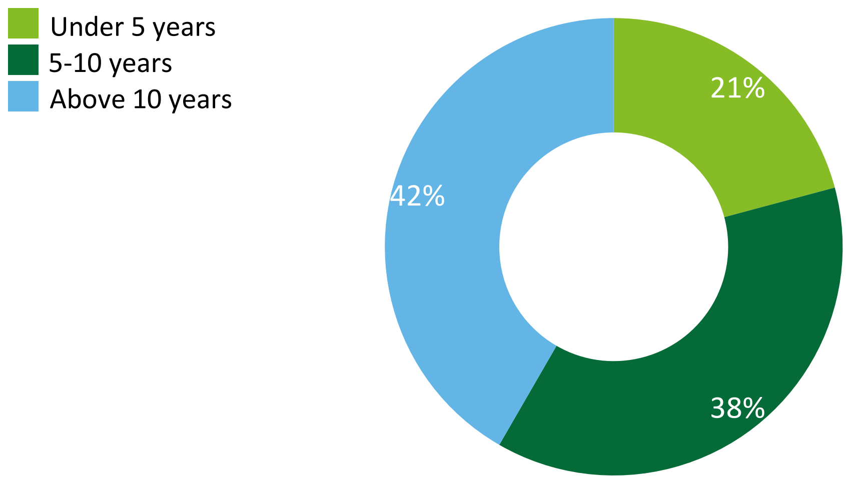
Q9.4: *How currency risk impacts your organization?*



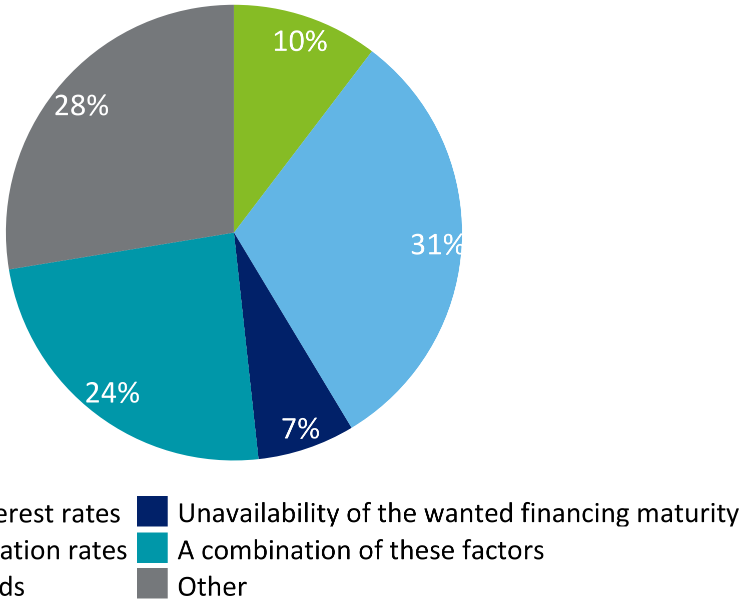
Q10: *How many funding agreements have you signed over the past 3 years?*



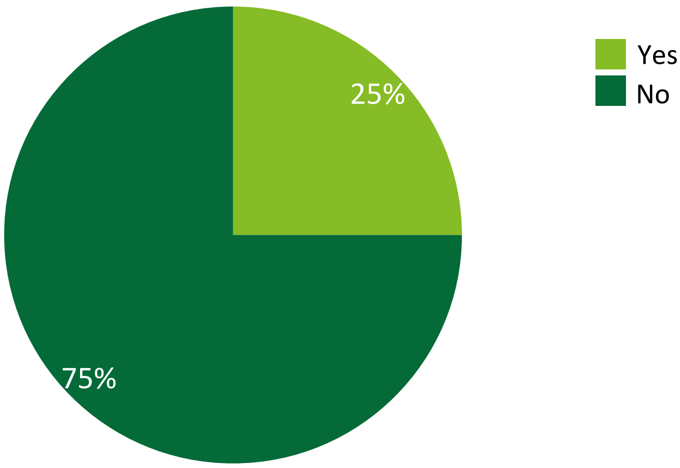
Q11: *What are your needed maturities in terms of financing to achieve SDG?*



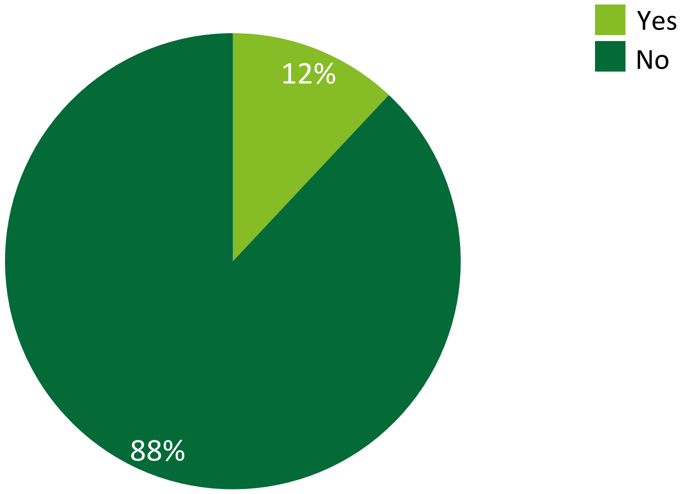
Q12: *What is the motivation behind using foreign currency to finance your funding agreements?*



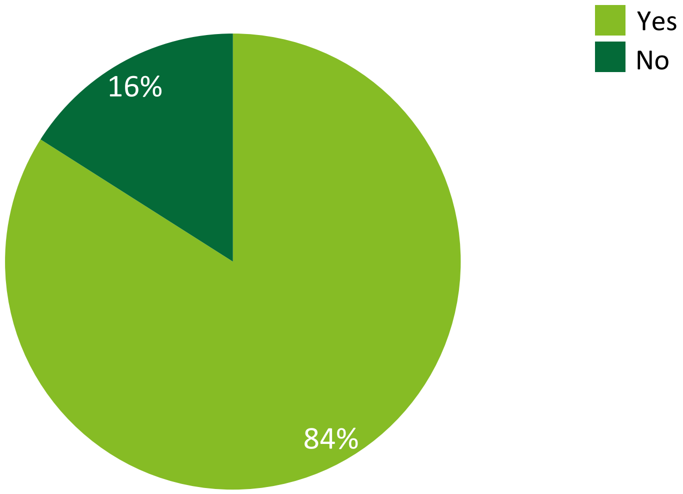
Q13: *Have you had to scale back, postpone, or cancel any funding agreement due to FX risk?*



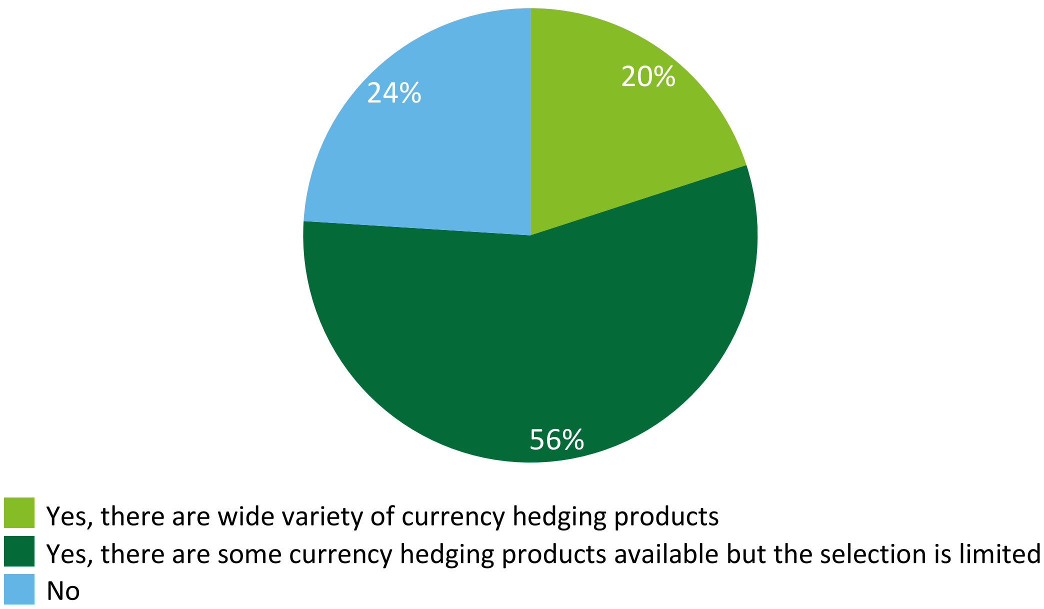
Q14: *Do your institutions have any legal or regulatory barriers that prevent them from engaging in FX-hedging activities?*



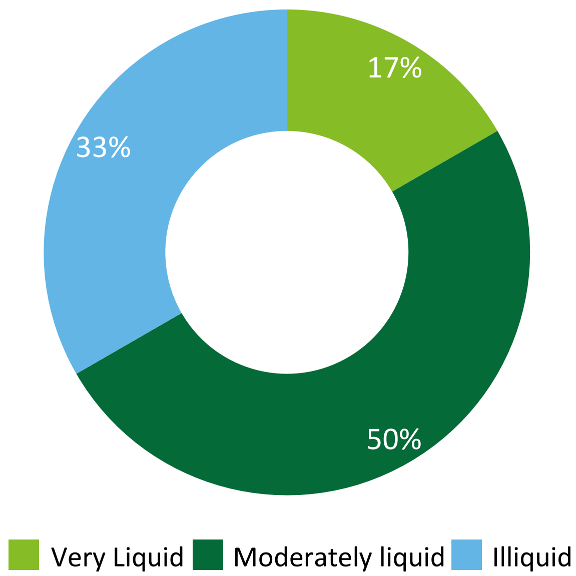
Q15: *In your local market/regulation, do you have the possibility to create bank accounts in foreign currencies and using these currencies in your transactions?*



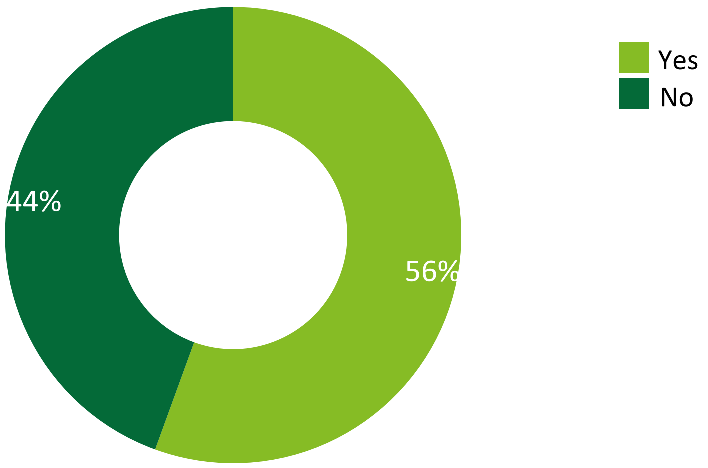
Q16: *Are any currency hedging products available in your local financial market?*



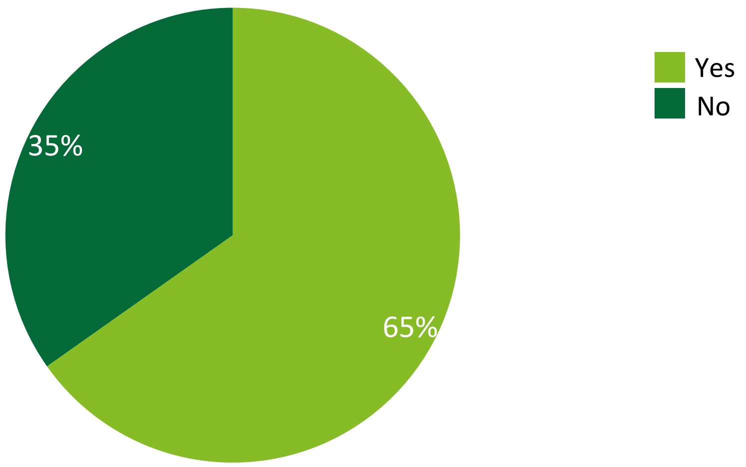
Q16.1: *Please rank your FX derivatives market liquidity*



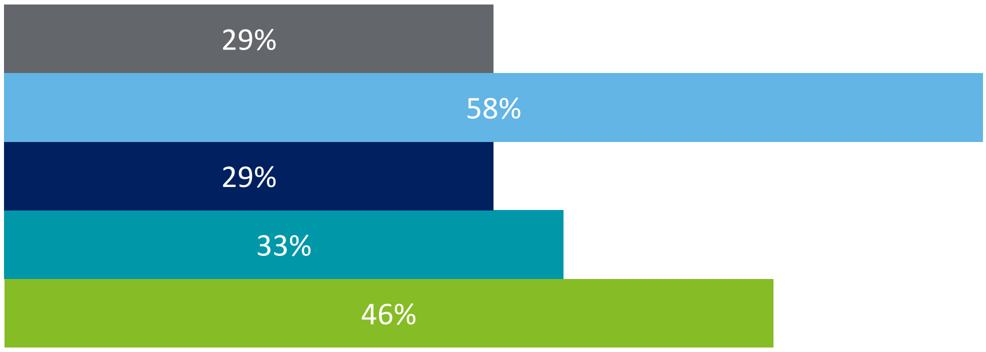
Q16.2: *Is the offer in terms of tenors furnished enough to hedge adequately your currency risk?*



Q17: *Is the ISDA (International Swap and Derivatives Association) Agreement enforceable in your local market?*

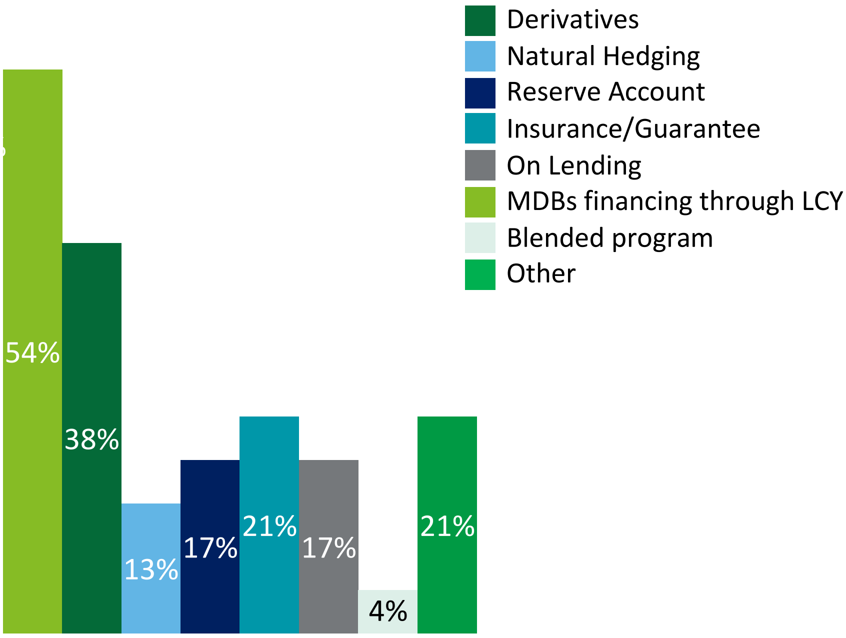


Q18: *Do you monitor and manage currency risk on an ongoing basis, and what procedures do you have in place to mitigate currency risk?*

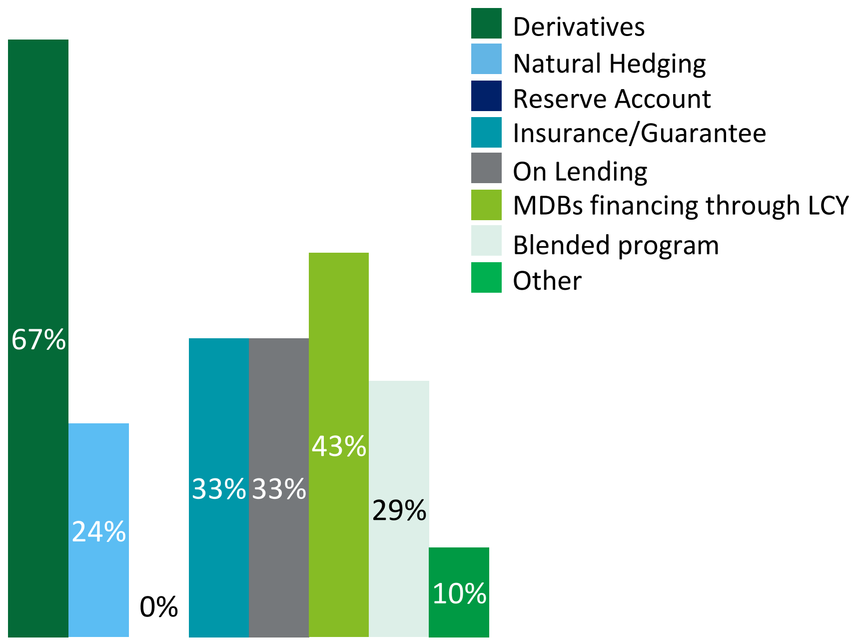


- We use a combination of internal and external tools to monitor and analyze currency risk, including exposure tracking systems and market analysis software.
- We regularly review and update our currency risk management policies and procedures to ensure they are up-to-date and effective.
- We use a range of hedging strategies, such as forward contracts and options, to manage currency risk.
- We maintain a diversified portfolio of currency exposures to help reduce overall currency risk.
- We regularly assess and stress-test our currency risk exposure to identify potential vulnerabilities and proactively implement measures to mitigate risk.

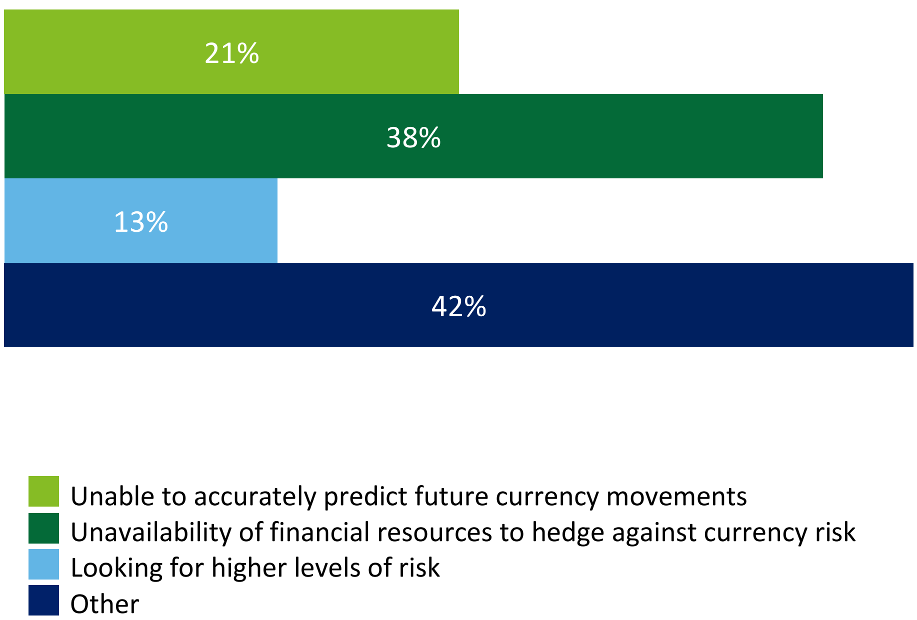
Q19: *What are your current hedging solutions?*



Q20: *What are the solutions you would like to have access to?*



Q21: *Which of the following are reasons why you might choose not to hedge against currency risk?*



Q22: *Do you have any suggestions for the donor community on how to cover their foreign exchange risk when providing funding for development projects, and what steps can be taken to mitigate this risk?*

40% of PDBs expressed their opinion on the steps and actions that can mitigate the currency risk

LCY financing and lending (selection of answers)**:**

- *'By having positions on local currency in both asset and liabilities, hence the exposure is fully offset by each other (natural hedge).'*
- *'Synthetic local currency lending solutions to hedge against currency risk.'*
- *'Support projects that provide an opportunity for a natural hedge. Provide the funds for on-lending through state owned development finance institutions'*
- *'The donor community needs to make arrangements with central bank in order to place the funds in local currency and fixe the foreign exchange for the reimbursements, while the central banks place the local currency funds to the development banks'*
- *'They (MDBs) should use their bigger balance sheets and technical skills to put in place the underlying hedge on their side and provide funding to african DFIs in their local currencies.'*

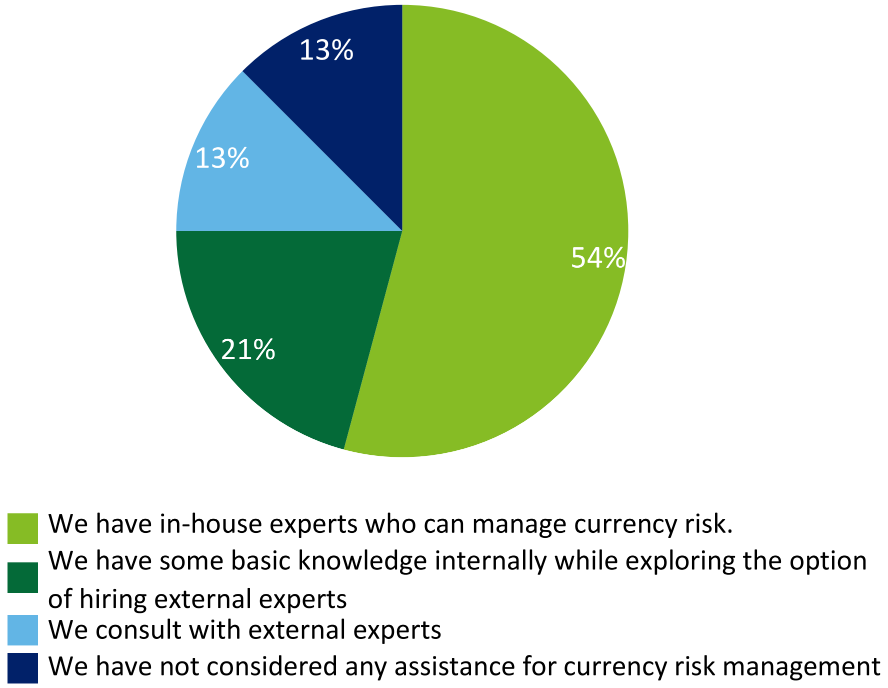
Hedging solutions (selection of answers)**:**

- *'Combination of lending in functional currencies, fund raising in the local markets and use of derivatives.'*
- *'Currency hedging products available in our local financial market are too limited so funding provided with affordable integrated hedging is the only way to mitigate the risk.'*
- *'The project should be denominated in foreign currencies to avoid FX volatility. Immediate conversion and placement into USD escrow for draw down.'*
- *'Provide concessional funding in local currency partner with firms like TCX to provide hedging solutions to their borrowers.'*

Regulation and market infrastructure (selection of answers)**:**

- *'It is wise to implement regulations regarding exchange rate risk.*
- *'It is desirable to have a trading room dedicated to financial operations.'*

Q23: *In terms of human resources, how do you manage currency risk in your organization?*



Q24: *If the ISDA is enforceable in your local market, do you have the legal experts, operational and commercial Resources to maintain the best use of ISDA standards?*