FICS LAB INCUBATOR

Currency Risk-Sharing Facility to Scale Up Local Currency Climate Finance in Uganda

Background

Uganda faces significant climate finance needs, requiring over USD 28 billion for adaptation and mitigation actions by 2030. The Uganda Development Bank (UDB) plays a central role in expanding access to affordable climate finance through local-currency lending. Through its Currency Risk-Sharing Facility, UDB committed UGX 50 billion to capitalize the facility and offers a mix of local-currency and foreign currency loans relying on foreign-currency funding from development finance partners such as EIB, KfW, and, AFD to keep rates affordable. While this structure protects borrowers, it exposes UDB to significant exchange rate risk as the bulk of the Bank's portfolio is in local currency.

Traditional hedging instruments are costly for a development bank like UDB because of the significant interest rate differentials between Uganda's high domestic rates (often in double digits) and the lower rates of hard currencies such as the USD or EUR in which the Bank borrows. Moreover, most available instruments are short-term and need frequent roll-overs, whereas development projects typically require tenors of 7–15 years. This mismatch limits access to affordable and effective FX risk mitigation options, thereby threatening both the affordability and long-term sustainability of climate investments.

The Solution: A Currency Risk-Sharing Facility

To address this risk, UDB is partnering with the FiCS Lab to develop an innovative Currency Risk-Sharing facility by distributing foreign exchange risk across multiple actors. The tool offers protection to UDB against large, unexpected depreciations of the Ugandan Shilling (UGX) versus the relevant funding foreign currency (such as the Euro or the US dollar). By limiting the impact of severe exchange rate shocks, the facility aims to stabilize UDB's capital position and safeguard its ability to lend in local currency at affordable rates for borrowers.

Project Stakeholders and Roles

- **Uganda Development Bank:** Public development bank leading the initiative
- **University of Leeds and the City St George's University of London:** instrument development, modelling, and legal assessment
- **CPI:** Strategic and analytical support

This facility manages currency risk to UDBs portfolio by distributing it between:

Stakeholders	Role	Incentives
UDB	Absorbs moderate FX risk for the first portion of the loan/credit line on its balance sheet	Sustain affordable lower-cost local-currency lending with minimized FX risk
Hedge Providers	Will hedge a portion of the FX exposure with a conventional hedge instrument such as a currency swap, freeing up capital and reducing risk for UDB.	Opportunity to engage in a de-risked environment with structured support
Donors	Will protect UDB against high currency depreciations beyond a predefined threshold	High-leverage use of limited concessional capital to catalyze private finance for climate resilience.

Key considerations of the facility:

- Borrowers are simply the end recipients of UDB's local-currency loan and are fully protected from FX risk and can focus on implementing climate projects
- The guarantee will have a fee, which represents the "premium" UDB would pay to the guarantor for being insured against high currency depreciation
- Any upside (e.g., currency appreciations beyond the threshold) will be retained by the facility—accruing to guarantee providers and donors—to offset costs or enhance the facility's long-term sustainability.

Opportunity for UDB

- UDB is helping unlock greater private and concessional investment into climate-resilient infrastructure and businesses in Uganda
- This is an opportunity for UDB to work with international Multilateral & DFIs that are most suitable for long-dated, concessional hedges. For example, TCX (The Currency Exchange Fund) – specializes in providing long-term currency and interest rate hedging for frontier markets where commercial markets don't offer affordable solutions.
- The Bank will also engage local market actors to gauge their appetite for providing competitive and transparent hedging solutions.

Additionality/impact of the instrument

- **Balancing risk and affordability:** The facility is less risky than a fully unhedged position and more affordable than a fully hedged or local-currency-funded loan
- **Targeted Climate Impact:** The FX risk-sharing scheme applies exclusively to loans with clear environmental and developmental impact under UDB's Climate Finance Facility, helping local borrowers access affordable finance.