Donor Cash Forum - Briefing Note from panel discussion with partners on exchange rates/depreciation and the implications for cash assistance

This briefing note summarises the key points from a discussion held between the Donor Cash Forum (DCF) and partners on 4th April 2022.

The rationale for this session is the increasing number of humanitarian contexts experiencing inflation and/or depreciation, with significant impacts on humanitarian budgets overall, and on cash assistance specifically. This situation is complexified where there is a gap between the official exchange rate and the market rate - in such cases humanitarian agencies may not have access to the market rate and exchange rate gains benefit financial institutions rather than end beneficiaries.

This has been an area of focus of the DCF since early 2021, as exemplified by the group's work spearheading the Good Practice Review on cash assistance in contexts of inflation/depreciation. The DCF invited the following panellists to discuss these issues.

- *Jamal Fares, Regional Cash and Voucher Assistance Adviser – MENA, Save the Children*
- *Liz Hendry, Interim Global Lead – Cash & Markets, NRC*
- *Carmen Hett, Treasurer, UNHCR*
- *Arif Husain, Chief Economist, WFP*
- *Edson Mbewe, Chief - Treasury Unit, UNICEF*
- *Patrick Nyoni, Head of Finance and Administration – Turkey, IFRC*
- *Facilitation: Isabelle Pelly, Global thematic expert on cash & basic needs, DG ECHO*

*The points below have been amalgamated across panellists except in some cases where naming the specific agency is relevant. Specific considerations/recommendations for donors have been indicated **in bold**. The 4 panel questions are followed by background information provided in advance on how agencies set and adapt exchange rates.*

1. What are the experiences and good practices in dealing with exchange rates where there is a significant difference between the official and the parallel market? What learning can you share on engaging with Central Banks?

- The Central Bank (CB) is in charge of fiscal policy including exchange rates. In some cases (e.g. Lebanon, South Sudan), UN agencies (through the UN resident coordinator) have been successful in negotiating of a preferential exchange rate. When negotiating a rate, maybe more pragmatic to go with a % of the market rate rather than a fixed rate, given current global market volatility.
- INGOs & local NGOs usually don't have direct engagement with the CB. Therefore, they are reliant on the UN for negotiating on behalf of the wider community. UN negotiations with the CB should therefore aim to set a rate applicable to all parties. The Cash Working Group (CWG) can play a coordinating role in this regard.
- In other cases, agencies can also rely on Financial Service Providers (FSPs) who have secured preferential rates. Note that there can be some competition between Central Banks and FSPs (which can be beneficial for humanitarian agencies).
- In negotiating with the CB, it is important to understand the macroeconomic context and what can make the difference to fiscal policy - e.g. the amount of hard currency coming into the country and whether agencies are delivering in hard currency, as this in turn will influence the conversion rate (e.g. current situation in Lebanon). The question of whether to implement in hard currency therefore also has implications in terms of the impact on the currency – which is one of many considerations in making such a decision.

- Note that in some parts of Fragile and Conflict Affected States (FCAS), the de facto authority may be different from the CB, and in such cases (e.g. Tigray), different means have been found to transfer funds (UNHCR).
- In such contexts of currency volatility, budgets have to be spent at the UN (or other agency) exchange rate and not at the market rate. There can sometimes be 3 rates to contend with: the UN rate, the official rate and the market rate, further complicated by intra-country differences (e.g. the North vs South rates in Yemen). This challenge is becoming more and more prevalent, post Covid and post Ukraine. This means that **agencies need to constantly re-evaluate and update their budgets, but donors need to be aware that we cannot produce miracles. Flexibility is key.**
- To mitigate these effects, IFRC keeps a hard currency account in Switzerland to monitor large cash programmes with a high financial risk. The advantage of real-time monitoring of the movement of funds between EUR and the local currency provides an opportunity to recognize the FX gains or losses on time and facilitates timely decision making on the use of the FX gains.

2. <u>For cash programmes, how are decisions made (at agency level or jointly) on how deal with exchange rate gains (or losses), with the aim of maintaining beneficiary purchasing power?</u>
   - The basis of decision-making should be how to reduce human suffering and maintain purchasing power, based on an evidence-based approach. This means monitoring of purchasing power in the local currency, relative to the Minimum Expenditure Basket (MEB) as well as monitoring parallel exchange rates and how these differ from the official rate. The MEB analysis should disaggregate the impact on the goods and services within as these may be differently affected by inflation and depreciation.
   - On this basis, analysis of inflation, depreciation and the effects of purchasing power should enable agencies to reprogramme funds on a timely basis, noting that timeliness is key to reduce suffering.
   - Options can include changing transfer values, providing top-ups or increasing coverage – each with their own operational and ethical implications (e.g. those we are helping may be the least disadvantaged as a result of that assistance). **Donors should play a key role in supporting decision-making on adequacy vs. coverage.**
   - A number of factors will affect decision-making: market conditions (and the potential impact of different modalities on currency stability), equity, preferences etc. **Triggers should be set and consistently monitored, ideally under the leadership of the CWG** (as per guidance in the Good Practice Review).
   - These decisions should also consider what government is doing (e.g. for its own social protection systems), ensuring alignment as much as possible.
   - There is a lot of uncertainty involved in dealing with cash transfers, given that programmatic decisions (for the small proportion of people assisted) will have impacts on the wider community (e.g. if humanitarian aid recipients start receiving assistance in hard currency), with implications for equity/social cohesion.
   - Another way of mitigating the impact of volatility on purchasing power is currently being piloted by UNHCR in Ukraine. Assistance is provided through Stable Coin USD, which is held in a digital wallet, and can then be cashed out based on the actual exchange rate.

3. <u>How do these issues affect overall decision-making on modality choice? To what extent is the increasing prevalence of inflation/depreciation across contexts challenging policy/strategy on the use of cash within your organisations?</u>
   - Market volatility and the impact on budgets and purchasing power makes cash more difficult and raises additional dilemmas. There is no perfect algorithm for modality selection and considerations may point in different directions (e.g. in Lebanon beneficiaries consistently prefer cash despite inflation/depreciation and its consequent reduction in value).

- It is generally very hard to shift modalities within an existing programme. Such decisions also highlight the inter-relatedness between agencies, and the **importance of CWGs in informing modality choice and associated triggers**. Agencies should be delivering as one, whilst being in line with their rules and regulations (UNICEF).
- Decisions need to be respectful of what is allowed locally, and not undermine what the government is trying to achieve, and the IMF and World Bank positions on fiscal policy.
- In terms of organisational policies, many organisations have a policy position which favours cash, with beneficiary preferences at the core of decision-making, and are committed to being driven by that (NRC, IFRC).
- However, scale of operations is a major consideration (WFP), and the appropriateness of different modalities needs to be constantly re-assessed. Previously, this was done on a case-by-case basis because high volatility affected only very few countries. Now we see that it is a bigger problem, requiring a re-assessment of in-kind versus cash, and for what goods.

4. <u>How can this learning be better integrated into programme design and adaptation? What are the associated recommendations for donors?</u>
   - The value of cash is absolutely undeniable where markets are functioning, because of its fungibility (WFP). Since 2010, the volume of in-kind food aid for WFP has stayed stable, whilst cash-based transfers has increased X 10.
   - However, decisions have to make decisions based on preferences/purchasing power, but also the value of assistance. From the programmatic side, this is not a "one fits all" approach. **Cash assistance can both stabilise and destabilise markets, and in this respect scale matters.**
   - **Humanitarian donors need to look at this from the macro-side, collaborating with development donors (i.e. IMF) in discussions with the CB.** The IMF don't understand why it is important to negotiate a better rate for partners. For them and other multilateral donors, exchange rates would be a positive externality of their fiscal support. **Humanitarian donors can therefore play a key role in engaging multilaterals on this issue.**
   - More broadly, **consistent donor engagement is also required with authorities to facilitate changes to assistance (e.g. transfer value size)** and encourage alignment with government-led programmes.
   - A collective point of learning is the **need for risk analysis and contingency planning to consider economic deterioration** and its impact on budgets and purchasing power, as well as knock-on effects (e.g. on social cohesion).
   - **Donors should consistently fund market monitoring** to inform programme adaptation
   - Analysis on the points above should be shared as much as possible, including to local and small NGOs, through the CWG.
   - **Finally, agencies and donors should build currency and price fluctuations into the design of grants.** If they do not explicitly state from the outset how we will deal with fluctuations, this comes as an afterthought, and is further complicated when the grant is paid in arrears.

Background information provided prior to the panel

How do agencies set exchange rates? How often do these change, and on what basis?

- The **UN** operational rate of exchange (UNORE) is set by the UN Secretariat for all UN agencies to use in line with Financial regulations and rules.[1] For major currencies (G10), the rates are obtained from Bloomberg 2 days before the effective date. For most if not all other currencies, the main lead agency in each country office would provide the rates currently applicable in that country. Effective Jan 2022, these rates get changes twice in a month (at the beginning and middle of the month to be as close as possible to the market rates. In prior years, the rate used to be changed once a month and at times,

[1] Live UN Operational Rates of Exchange: https://treasury.un.org/operationalrates/OperationalRates.php

twice depending on whether some thresholds were met. E.G. a move either way of 4% or above in major currencies would trigger a rate change.

- The **IFRC** budgeting currency is the Swiss franc (CHF). The IFRC has adopted a conservative strategy in setting the FX budget rates. The IFRC uses a conservative or off-market rate based on the current FX rate (spot rate) with a plus or minus a predetermined safety cushion as a mitigation measure on the impact of adverse currency outcomes.
- For **Save the Children,** donor funds are held in donor currency by the Save the Children Member up to point of transfer to the Country Office (via SCI Treasury in London). Country Offices receive funding on a two-week basis. Save the Children International Treasury Team in London sells donor currencies for local currencies at the most competitive rates bid by banks (via 360T FX trading platform).
- **NRC**'s global reporting currency is Norwegian Krone (NOK). USD is set up in all country offices, and is for most countries the official reporting currency, applied in the country office's annual audited accounts. The main principle for setting the USD/local currency rate is the actual rate obtained from the exchanges of funds. This is set weekly and reflects the actual weighted average cost rate for the funds kept in NRC's USD-bank account in Oslo. The exchange rate between NOK and the local currency is automatically calculated from the NOK/USD and the local currency/USD rates.
- **IRC** calculates exchange rates on a monthly basis using a weighted average method. The rate is calculated by first adding the opening cash balance (Base$) and all the U.S. dollars exchanged to get total US transactions, and then adding up the opening cash (non-USD currency) plus all the non-USD currency amounts received from those exchanges to get total non-USD currency transactions. The average rate is total non-USD currency divided by the total USD. overseas offices are required to convert non-USD currency transactions using a monthly transaction rate for each currency.