The World Bank partnered with Uruguay’s Administración Nacional de Combustibles, Alcoholes y Portland (ANCAP) to develop a Hedging Program for protecting Uruguay against commodity price volatility.

Through June 2019 to January 2020, World Bank intermediated a series of derivative transactions with market counterparties in behalf of ANCAP to hedge against large price increases.

By successfully managing its exposure, Uruguay will benefit from increased fiscal capacity to further expedite its low-carbon transition.

Background
In less than 15 years, Uruguay has dramatically reduced its carbon footprint with an ambitious renewable energy program. By the end of 2019, the country not only provided 98 percent\(^1\) of its total electricity consumption from clean energy sources, but it became a net exporter of energy to neighbors such as Argentina and Brazil.

However, ANCAP, which also operates Uruguay’s single refinery, has been importing commodities to process petroleum derivatives such as kerosene, asphalt, gasoline, jet fuel, etc.

ANCAP, as a net commodity importer, is vulnerable to price increases. Any materialization of a significant deficit in ANCAPs balance sheet leaves the government of Uruguay open to fiscal risk due to the implicit contingent liability of having to pay for the shortfall. A measure, which can divert fiscal resources away from priority areas and may cause roadblocks to equitable growth.

Risk Management Objectives
- Reduce fiscal exposure to commodity price shocks to, among other things, support their low-carbon transition.
- Insulate the budget from abrupt and significant commodity price increases or decreases
- Underpin macro-financial resiliency in line with the government’s risk management strategy

IBRD Financial Solution
ANCAP, under the International Swaps and Derivatives Association (ISDA) agreement with the World Bank, used a "call option" to protect its budget. A call option is a financial instrument that gives the buyer the right, but not the obligation, to buy a specific quantity of the commodity at a pre-set (strike) price on a pre-

determined date in the future. Should the commodity prices increase beyond the threshold, ANCAP would receive a payment from the World Bank, compensating for the difference between the strike price and the market price. Simultaneously, the World Bank, as the intermediary, executed derivatives agreements with the market counterparties, mirroring the agreement conditions between ANCAP and itself, hence protecting its own balance sheet.

**World Bank Treasury’s role**

- Identified ANCAP’s need for capacity-building support to cover a comprehensive set of topics, including legal, accounting, operational, pricing and market considerations, quantitative analysis, financial instruments, strategy development, and implementation.
- Organized a series of capacity building events and excercises to enable ANCAP officials to implement the risk management strategy and execute transactions.
- Devised a clear plan of action, including the implementation plan.
- Intermediated the purchase of call options with the market counterparties.
- Structured and executed market based risk management transactions to protect ANCAPs, and by proxy Uruguay’s, budget against commodity price increases beyond a targeted threshold.

**Outcome**

Working closely with ANCAP officials, World Bank Treasury intermediated three transactions on June 5, 2019, August 2, 2019, and January 15, 2020 to purchase commodity options from market counterparties. The client specified their maximum budget for the options premium in their trade order. The Treasury team executed the transaction in record time using a competitive bidding process to find the best price in the market. Through this transaction, ANCAP was able to mitigate its exposure to price volatility.

The ANCAP program is part of a broader engagement between Uruguay and the World Bank to manage fiscal risks, which includes the innovative [weather and commodity derivative transaction in 2013](#) with the government, and the [commodity price risk management transaction in 2016](#) executed with Ministry of Finance in behalf of ANCAP.

Financial risk management programs, such as protection against commodity price volatility, shield fiscal resources for much needed infrastructure investments, such as, in Uruguay’s case, clean energy generation. For example, since the 2016 transaction, Uruguay has simultaneously further increased its clean electricity consumption from 95 percent to 98.

As a transaction intermediary, the World Bank leverages its triple-A credit rating to provide clients with improved market access and financial terms, while building client’s capacity in the implementation of market based risk management solutions.

**Transaction Structure**

**Transaction Details**

<table>
<thead>
<tr>
<th>Date</th>
<th>Entity</th>
<th>Financial Instrument</th>
<th>Coverage period</th>
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<td>Asian Call Option</td>
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<td>Aug-19</td>
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<td>Asian Call Option</td>
<td>Oct-Dec 2019</td>
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<td>January 20</td>
<td>ANCAP</td>
<td>Asian Call Option</td>
<td>Jan 17 to Mar 31, 2020</td>
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For information:
Miguel Navarro-Martin, Manager of Financial Products,
mnavarromartin@worldbank.org, +1 (202) 458 4722