Climate Investment Funds

August 12, 2013

USE OF LOCAL CURRENCY FOR PRIVATE SECTOR PROJECTS UNDER THE CTF TRUST FUND: PROPOSED TOOLS AND INSTRUMENTS TO SUPPORT LOCAL CURRENCY OPERATIONS (DRAFT)

I. INTRODUCTION

1. At its meeting in April 2013, the CTF Trust Fund Committee reviewed the paper entitled "Interim Proposal related to the Use of Local Currency Loans for Private Sector Projects under the CTF Trust Fund", (CTF-SCF/TFC.10/6) ("Interim Proposal Paper"). The objective of the Interim Proposal Paper was to provide the Committee with relevant information to make a decision regarding an interim proposal on (a) the amount of local currency lending that could be made available under CTF; and (b) whether to implement a cash reserve to generate additional investment income to cover potential losses from foreign exchange movements on such lending.

2. The Interim Proposal Paper presented three scenarios and corresponding analysis of proposed amounts for local currency lending under the CTF Trust Fund. It also provided illustrative examples of how potential FX losses related to local currency lending would be shared among CTF contributors. Six currencies, namely, Colombian Peso, Mexican Peso, Philippine Peso, South African Rand, Thailand Baht and Vietnamese Dong were identified in the proposal for potentially being utilized for local currency operations under CTF programs.

3. In the scenarios, no financial instruments, such as hedges, would be entered into by the Trustee or MDBs to help mitigate potential FX losses. This means that the CTF Trust Fund would be exposed to foreign exchange rate risks over the life of the local currency operations unless a cash reserve were put into place. If the proposed local currencies depreciate against the USD during this time period, losses would be incurred. Conversely, if the local currencies appreciate, the CTF Trust Fund, and correspondingly its capital and grant contributors, would benefit from gains.

4. After reviewing the Interim Proposal Paper, the CTF Trust Fund Committee requested the CIF Administrative Unit, working with the MDBs and the Trustee, to prepare a paper for review and approval by the CTF Trust Fund Committee on the approach for using local currency in private sector projects. This paper was prepared in response to the request by the Committee. Section II summarizes the menu of such tools and instruments and proposes a menu of five tools and instruments that could be used to support local currency lending under the CTF and the countries in which the tools and instruments are expected to be deployed in the next 24 months Section III discusses the expected costs, fees and expenses associated with the implementation of such tools and instruments to be borne by the CTF Trust Fund and how such costs, fees and expenses would be borne among the CTF Contributors. Section IV sets out the amendments that would be necessary to the CTF legal documents to allow for the use of such tools and instruments.

II. SUMMARY OF TOOLS AND INSTRUMENTS TO SUPPORT LOCAL CURRENCY OPERATIONS

5. Local currency lending can enhance the ability of projects/borrowers to repay loans, providing greater assurance to local banks and increasing the potential to mobilize further private

sector funding. All of these factors can improve the risk profile of the CTF investment. Table 1 below presents a summary of five tools that could be used to facilitate the use of local currencies in CTF lending.

Table 1: Summary of Tools and Instruments to Support Local Currency Operations

Tool	Description of Proposed Tool	Expected Costs, Fees and Expenses to be Borne by the CTF Trust Fund	Countries where the Tool could be deployed in the next 24 months	Comments
1	The borrower executes the hedge on the CTF resources lent by the MDBs and the costs of executing hedge are borne by CTF	3-5% per annum of the hedged amount CTF to bear costs of executing the hedge Borrower to bear any additional costs associated with a potential prepayment, redeployment or unwinding/breakage	Chile, Colombia, India, Indonesia, Mexico, Philippines Thailand, and Turkey	
2	MDB executes the hedge on the CTF resources lent by the MDBs and the costs of executing the hedge are borne by the CTF	3-5% per annum of the hedged amount CTF to bear costs of executing the hedge. In addition, CTF to bear any costs associated with a potential prepayment, redeployment or unwinding/breakage, after the MDBs exhausts their standard procedures to recover these costs from the borrower.	Chile, Colombia, India, Indonesia, Mexico, Philippines, South Africa, Thailand, Turkey	Tool 2 cannot be executed by all MDBs. Tool 2 could be relatively less expensive than Tool 1.
3	MDBs use CIF funds to provide a credit Guarantee in USD supporting a local currency loan	No additional costs will be charged to the CTF Trust Fund 1-3% per annum of the guaranteed amount (fee) to be charged to the client	Chile, Colombia, India, Indonesia, Mexico, Philippines, South Africa, Thailand, Turkey	Exposure to be capped in USD. Tool 3 is available only in certain markets.

Tool	Description of Proposed Tool	Expected Costs, Fees and Expenses to be Borne by the CTF Trust Fund	Countries where the Tool could be deployed in the next 24 months	Comments
4	Risk sharing facility in local currency to allow a client to sell a portion of the risk associated with a portfolio of climate related assets.	No additional costs will be charged to the CTF Trust Fund 1-3% per annum of risk covered amount to be charged to the client	All CTF countries	
5	Establish an envelope for the MDBs to use for local currency lending and allow the CTF Trust Fund to absorb losses	No additional cost for the CTF Trust Fund beyond the envelop amount	CTF countries where the swap market is insufficiently developed or mature to meet the project's needs (e.g., insufficient liquidity, a limited number of swap counterparties, or the inability of the swap arrangements to match the tenor of the CIF loan)	The envelope amount will be set to the level where the following formula holds: Projected CTF Net Income* minus projected potential loan losses due to defaults **>=** Potential losses due to exchange rate fluctuations from local currency lending * *CTF Net Income constitutes cumulative investment income on the CTF less cumulative administrative budget, plus interest received on outgoing CTF loans in excess of 0.75%, guarantee fees in excess of 0.75% and reflows from other financial products in excess of 0.75% after deducting the original principal amount.*

Tool Analysis

6. **Tool 1: Hedge executed by the borrower.** Under this risk mitigation tool, the borrower executes a hedge with a commercial bank. The costs of executing the hedge are borne by the CTF Trust Fund.

7. *Process:*

a) The Trustee commits and transfers USDs to the MDB;

b) The MDB signs a loan agreement with the borrower in USD for the project amount with the stipulation that the funds must be repaid in USDs;

c) The borrower subsequently enters into a cross currency swap with a swap counterparty; and

d) The CTF covers the cost of executing the hedge by way of a grant using CTF Grant Contributions.

8. *Costs*: The CTF Trust Fund would cover the costs of executing the hedge by providing a grant to the borrower. CTF Grant Contributions would be used to provide the grant. The borrower would bear any costs associated with a potential prepayment, redeployment, or unwinding/breakage. The availability of this instrument will depend on the acceptability by the swap counterparty of the credit risk of the borrower. CTF is not a direct party to this transaction.

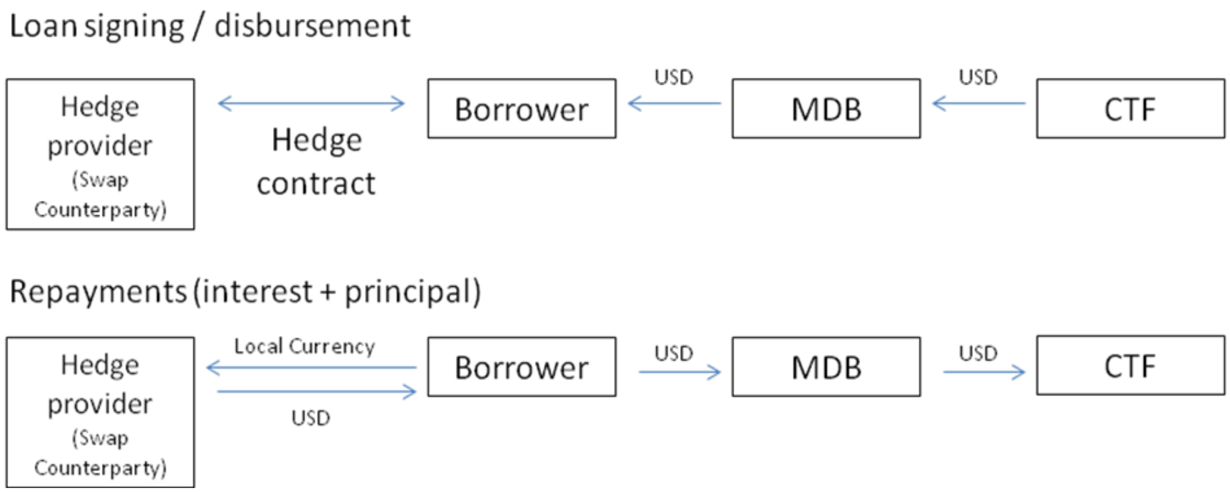
9. *Advantages*: Tool 1 (a) enables project recipients to match local currency revenues with liabilities through the hedge, and (b) mitigates CTF Trust Fund's exposure to currency and interest rate risk related to CTF local currency operations. Further, Tool 1 supports the development of long term swap markets as well as of local financial institutions.

10. *Disadvantages:* If the borrower arranges the hedge, the costs of the swap will be higher than if the MDB arranges the swap (based on differential in credit ratings). In order to mitigate the counterparty risk, the MDBs would include certain requirements in the project proposals, for example, fully hedged (no tail) and counterparty credit and/or rating requirements. As the currency swap locks-in the USD value of local currency loans and the corresponding reflows, the CTF Trust Fund would forego potential gains from foreign exchange rate fluctuations, if any, that could incur if the currency swap were not done.

11. *Residual Foreign Exchange losses:* Any residual foreign exchange losses not covered by the hedge would be borne by the CTF Trust Fund.

12. *Example:* Figure 1 depicts the generic funds flow in a project where the borrower would execute the hedge. The MDB would provide a USD loan, utilizing CTF resources. The borrower would then enter into a hedge contract (cross currency swap) with a hedge provider (e.g. commercial bank), under which both parties would exchange interest and principal payments in different currencies. The borrower would receive periodic payments in USD from the swap counterparty (and with this repay its debt in such currency to CTF through the MDB); the swap counterparty would receive in exchange payments in local currency from the borrower (from local currency revenue generated from the borrower's business/investment).

Figure 1. Proposed Structure of Flow of Funds with Cross Currency Swap Executed by the Borrower



13. **Tool 2: Hedge executed by the MDB.** Under this risk mitigation tool, the MDB executes the hedge using its ISDA[1] agreements with commercial banks. The costs of executing the hedge are borne by the CTF Trust Fund. Due to existing MDB policies (for which amendments would require board approvals), not all MDBs can execute transactions using this tool.

14. *Process:*

a) The Trustee commits and transfers USDs to the MDB for the project amount;

b) The MDB would convert the funds into local currency and sign a loan agreement with the borrower for the local currency amount;

c) The MDB would retain a local currency obligation with a swap counterparty;

d) The borrower repays the loan to the MDB in the same local currency;

e) The MDB repays the funds to the CTF Trust Fund in USD; and

f) The CTF covers the cost of executing the hedge by way of a fee using Grant Contributions.

15. *Costs*: The CTF Trust Fund would cover the costs of executing the hedge. In addition, the CTF Trust Fund would cover any costs associated with a potential prepayment, redeployment or unwinding/breakage, after the MDBs exhaust their standard procedures to recover those costs from the borrower.

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[1] International Swaps and Derivatives Association (ISDA)

16. *Advantages*: Tool 2, like Tool 1, also enables project recipients to match local currency revenues with liabilities and mitigates CTF Trust Fund's exposure to currency and interest rate risk related to CTF local currency operations. In addition, Tool 2 could be relatively less expensive than Tool 1 because the MDBs have AAA rating which results in lower costs and no posting of collateral with the counterparty.

17. *Disadvantages*: As the currency swap locks-in the USD value of local currency loans and the corresponding reflows, the CTF Trust Fund would forego potential gains from foreign exchange rate fluctuations, if any, that could incur if the currency swap were not done.

18. *Residual Foreign Exchange losses:* Any residual foreign exchange losses not covered by the hedge would be borne by the CTF Trust Fund.

19. *Example (Provided by AfDB):* In order to provide practical context to the description of the structure of this hedging mechanism, for illustrative purposes only, Figure 2 depicts a project in South Africa where the AfDB would provide to the borrower CTF funding in ZAR. The project and its tentative loan amount is used to showcase (a) how the proposed hedging structure can mitigate foreign exchange and interest rate risk, and (b) the costs, fees and expenses associated with this hedging tool.

20. Under this structure, the CTF Trust Fund would provide USD 41.5 million to AfDB as CTF's portion of the project financing. AfDB would then enter into a cross currency swap with a market counterparty, whereby it would exchange the USD 41.5 million received from the CTF Trust Fund to a ZAR equivalent amount (approximately ZAR 373 million). The ZAR received from the market counterparty would then be deposited into a separate account established by AfDB to hold CTF proceeds received from the Trustee. Disbursements to the project recipient on the CTF loan would be made from this dedicated account.

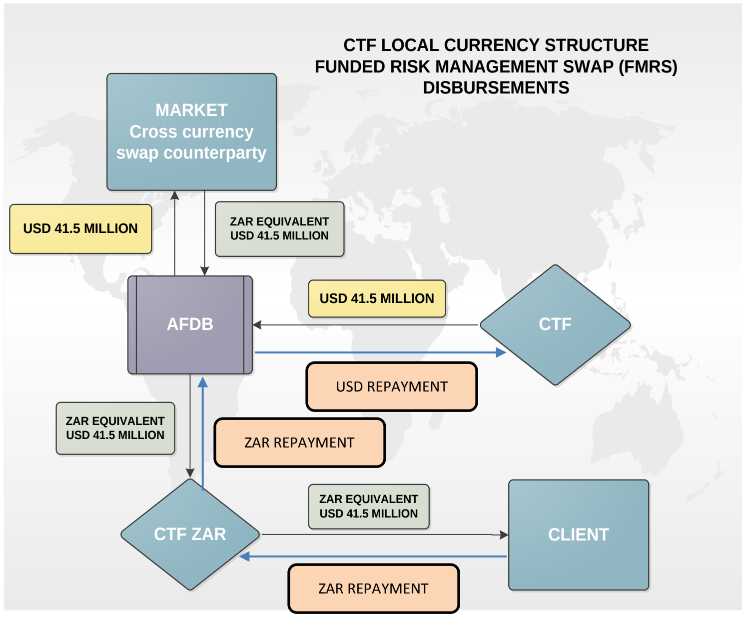
21. Under the cross currency swap, AfDB will pay ZAR and receive USD interest and principal from the market counterparty. The CTF loan to the Project Recipient and the cross currency swap will have the same amortization schedule. This facilitates the AfDB's ability to honor its obligations under the swap agreement as the interest and principal received from the ZAR loan repayments by the project recipient are passed through to pay the ZAR interest and principal repayments of the cross currency swap.

22. The USD principal repayments and interest payments received from the market counterparty will be passed through to the CTF Trust Fund. In structuring the cross currency swap the AfDB will try to ensure that the interest and the credit margin of the ZAR loan to the project recipient is completely hedged with the market counterparty leaving no residual foreign exchange and interest rate risk to the CTF Trust Fund.

23. AfDB will charge an estimated US$200,000 to US$250,000 a year through the USD leg of the swap for the initiation, administration and management of the cross currency swap which requires the use of the AfDB's internal resources on behalf of the CTF. Depending on the complexity of the transactions, this fee may be revisited.

24. The figure below depicts the structure and the flow of the hedging mechanism.

Figure 2: AfDB Proposed Structure for CTF Local Currency Operations



25. **Tool 3: Guarantee in USD**. Under this risk mitigation tool, the MDB would use CTF funds to provide a credit guarantee in USD to support a local currency operation. This credit guarantee could be extended either to a local bank to support its lending operations in local currency for one or more projects or directly to a single project.

26. *Process:*

a) The Trustee commits and transfers USDs to the MDB;

b) The MDB would use the CTF funds to provide a credit guarantee to a local bank for a portion of the exposure of a local currency operations.; or

c) The MDB would issue a credit guarantee using CTF Trust Fund resources to help a potential borrower obtain a local currency loan from a domestic bank.

27. Such a guarantee could be partial or full and guarantee fees would be charged in accordance with the CTF Financing Products, Terms and Review Procedures for Private Sector Operations. The guarantee represents a promise of full and timely debt service payment up to a predetermined amount USD. The MBDs' exposure will be capped in USD terms if the guarantee is called at the time of default. Thus client gets local currency financing and MDBs' exposure is always capped in US dollars.

28. *Costs*: No fees would be charged to the CTF Trust Fund. One to three percent per annum of the guaranteed amount (fee) would be charged to the client in accordance with the CTF Financing Products, Terms and Review Procedures for Private Sector Operations.

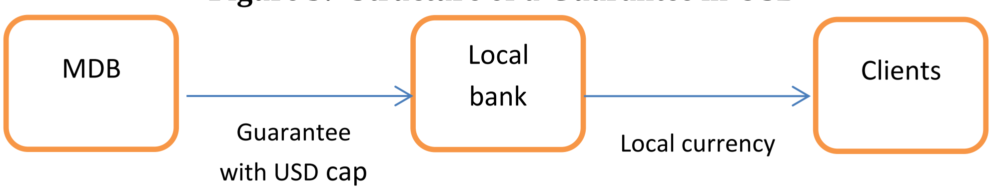
29. *Advantages:* Tool 3 enables project recipients to receive local currency funding from other sources other than the CTF Trust Fund. The MDB's role in credit enhancing debt instruments may allow creditors to benefit from the MDB's relationship with, and ongoing monitoring of, the underlying borrower. This oversight role may allow viable first-time borrowers to tap markets that they otherwise would not normally be able to access. The guarantee can also help borrowers to secure long-term funding from local financial institutions that may have been previously unavailable.

30. *Disadvantages*: This tool supports local currency operations but is not specifically targeted to facilitate direct lending of local currency from the CTF Trust Fund.

31. *No Residual Foreign Exchange Risk under this tool.*

32. *Example provided by IFC***:** If a loan pricing is LIBOR + 300 bps then a guarantee will be priced at 300 bps collected in local currency over time. The MDB's exposure will be capped in USD terms if the guarantee is called at the time of default. Thus the client gets local currency financing and the MDB's exposure is always capped in US dollars.

Figure 3: Structure of a Guarantee in USD



33. **Tool 4: Risk sharing facility in Local Currency.** For local currency financing of a portfolio of climate related assets, a risk sharing facility allows a client to sell a portion of the risk associated with a pool of assets.

34. *Process*:

a) The Trustee commits and transfers funds to the MDB in USDs; and

b) The MDB then enters into a risk sharing agreement with its client. The assets typically remain on the client's balance sheet and the risk transfer comes from a partial guarantee provided by the MDB.

35. In general, the guarantee is available for new assets to be originated by the client using an agreed upon underwriting criteria, but in certain situations may also be used for assets that have been already originated. The risk transfer happens through a partial credit guarantee provided by

an MDB so it is priced similarly as explained under Tool 3, but in the context of a portfolio as opposed to a single loan or project. The MDB's exposure is capped in USD terms.

36. *Costs:* No fees would be charged to the CTF Trust Fund. One to three percent per annum of the guaranteed amount (fee) would be charged to the client in accordance with the CTF Financing Products, Terms and Review Procedures for Private Sector Operations.

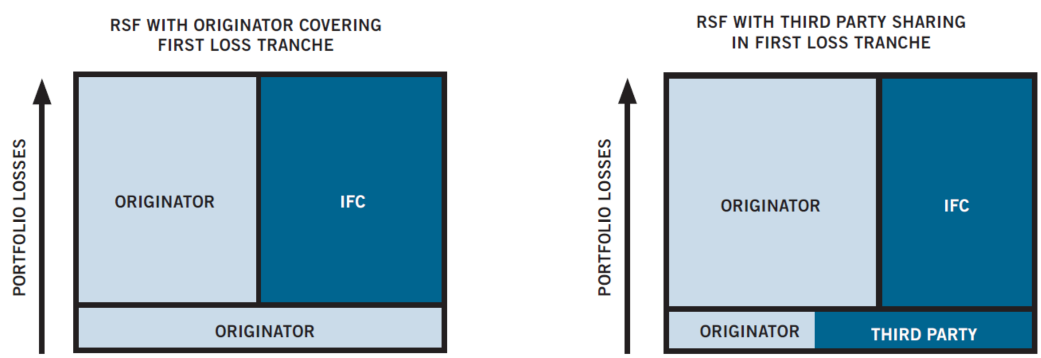
37. *Advantages:* Tool 4 enables project recipients to receive local currency funding from other sources different from the CTF Trust Fund. In addition, by shifting a portion of the risk associated with an asset portfolio to an MDB, a risk sharing facility allows an originator to introduce or expand a new or existing product (e.g. clean technology projects). This may allow the originator—typically a local financial institution—to attract new clients, generate additional fee income, and spread the fixed costs of the covered product line over a large portfolio of assets. This aspect will lessen the risk for the CTF as a pool of assets will be guaranteed and not an individual project as under Tool 3.

38. *Disadvantages*: This tool supports local currency operations but is not specifically targeted to facilitate direct lending of local currency from the CTF Trust Fund.

39. *No Residual Foreign Exchange Risk under this tool.*

40. *Example (provided by IFC):* Several options exist for structuring risk sharing facilities transactions. Depending upon the needs of the originator and possible third-party participants, the availability of historical performance data, and the nature of the assets to be covered by the facility, one or more of the structural options illustrated in the diagrams below may be appropriate for a client originator to consider. In the case where a third party guarantee would be available this would potentially decrease the exposure of the CTF.

Figure 4: Options for Structuring a Risk Sharing Facility



41. **Tool 5: Establish an envelope for the MDBs to use for local currency lending and the CTF Trust Fund absorbs losses.** Under this option, the CTF Trust Fund Committee agrees to a maximum amount for the MDBs to collectively use for local currency lending and agrees that the CTF Trust Fund to absorb aggregate losses and gains due to exchange rate fluctuations, if any. This envelope amount will be set to the point where the balance of the projected CTF Net

Income[2] less projected potential loan losses due to defaults[3] would be sufficient to cover projected potential losses due to exchange rate fluctuations from local currency lending[4] as shown below.

Projected CTF Net Income minus projected potential loan losses due to defaults	>=	Potential losses due to exchange rate fluctuations from local currency lending

42. Based on the most current quantitative analysis conducted by the Trustee, the envelope amount that could be used for local currency lending without putting in place foreign exchange risk mitigation measures is USD 50 million.

43. *Process*:

a) The Trustee commits and transfers funds to the MDBs in USDs;

b) The MDBs either (i) convert the USDs received from the CTF into local currency and subsequently enter into a local currency loan with borrowers in the amount of the proceeds of the conversion, or (ii) the MDBs enter into a USD loan agreement with borrowers and borrowers convert the USDs received from the MDBs into local currency;

c) Following b) above, borrowers repay the loan and interest in (i) local currency or (ii) USDs; and

d) If borrower repays in local currency, the MDBs convert such local currency back into USD using spot rates and subsequently transfer the proceeds in USDs back to the Trustee.

44. *Costs*: Tool 5 does not increase the administrative or project costs of the CTF Trust Fund.

45. *Advantages*: This arrangement will enable local currency operations in countries where there is limited hedge market or limited appetite for guarantees and risk-sharing mechanisms available. The CTF Trust Fund may in some cases receive gains from foreign exchange rate fluctuations.

46. *Disadvantages*: The demand for local currency operations in the CTF will likely exceed the amount of available resources. If this option is approved, the CIF Administrative Unit and the

[2] CTF Net Income constitutes cumulative investment income on the CTF less cumulative administrative budget, plus interest received on outgoing CTF loans in excess of 0.75%, guarantee fees in excess of 0.75% and reflows from other financial products in excess of 0.75% after deducting the original principal amount.

[3] The assumptions for the loan loss rates on public sector loans (5%) and private sector loans (11%) are based on the data obtained from the Global Emerging Markets (GEMs) risk database.

[4] The assumption on the foreign exchange loss rate is based on historical average worst case losses on local currency in the reference portfolio (66%).

MDB Committee would need to determine which private sector projects and programs would avail itself of Tool 5. In addition, if the assumptions used to determine the maximum amount to be used under Tool 5 significantly deviates from actuals, there could be a risk of potential losses that would have to be shared among contributors.

47. *Residual Foreign Exchange Risk:* If the assumptions used to determine the envelope amount under Tool 5 significantly deviate from actuals, there could be potential foreign exchange losses that would have to be shared among contributors.

III. Projected Costs, Fees, and Expenses that May be Incurred from the Proposed Tools and Instruments and How Such Costs, Fees, and Expenses Would be Borne Among the CTF Contributors

Projected costs, fees, and expenses

48. Table 2 below shows the projected cost ranges for each tool and further projects which countries may use each tool.

Table 2: Projected Costs Ranges for Each Tool

Tool	MDB	Project/Program Title/Sector	Country	Financial Instrument	Amount (in USDm)	Costs Range per annum (in USDm)*		
Tool 1	IDB	Renewable Energy Program	Mexico	CTF Loan (USD)	20.00	0.60	-	1.00
	IDB	Energy Efficiency Program – Part 1	Mexico	CTF Loan (USD)	20.00	0.60	-	1.00
	IDB	Sustainable Energy Finance Program	Colombia	CTF Loan (USD)	5.00	0.15	-	0.25
	IDB	Supporting the ESCO ecosystem for Private Sector Clients	Colombia	CTF Loan (USD)	3.00	0.09	-	0.15
	ADB	TBD	Thailand	CTF Loan (USD)	36.00	1.08	-	1.80
Tool 2	AfDB	South Africa Concentrated Solar Project	South Africa	CTF Loan (LC)	41.50	0.2	-	0.25
	AfDB	South Africa Concentrated Solar Project-2 (TBD)	South Africa	CTF Loan (LC)	50.00	0.2	-	0.25
Tool 3	IFC	TBD	Philippines	CTF Guarantee (USD)	25.00	0.00	-	0.00

	IFC	TBD	Indonesia	CTF Guarantee (USD)	50.00	0.00	-	0.00
	ADB	Private Sector Renewable Energy Program	Thailand	CTF Guarantee (USD)	40.00	0.00		0.00
Tool 4	IFC	TBD	Thailand	Risk Sharing Facility	30.00	0.00	-	0.00
Tool 5	All	TBD	TBD			0.00	-	0.00
					320.50	**5.27**		**8.78**

Sharing of projected costs, fees, and expenses among the CTF Contributors

49. Table 3 below presents the sharing of projected costs, fees and expenses among the CTF Contributors.

Table 3: Sharing of Projected Costs, Fees and Expenses among the CTF Contributors

Tool	Expected Costs, Fees and Expenses to be Borne by the CTF Trust Fund	Classification	Types of contributions to cover the Cost
Tool 1	Costs of executing the hedge	Grant funding to borrower	Grant Contributions
Tool 2	Costs of executing the hedge. Costs associated with a potential prepayment, redeployment or unwinding/breakage, after the MDBs exhausts their standard procedures to recover these costs from the borrower.	MDB costs for project implementation support	Grant Contributions
Tool 3	None	No costs, fees and expenses	N/A
Tool 4	None	No costs, fees and expenses	N/A
Tool 5	None	No costs, fees and expenses	N/A

IV. PROPOSED AMENDMENTS TO LEGAL AGREEMENTS

50. Net gains from foreign exchange rate fluctuation will form part of the reflows returned from the MDBs to the Trust Fund and constitute part of the CTF net income. On the other hand, net losses from foreign exchange rate fluctuation exceeding the amount covered by the CTF net income will be shared by all contributors to the CTF, on a pro-rata basis proportional to their overall contributions to the CTF (excluding any portion used for grant funding), in the same manner in which losses on defaults on outgoing loans from the CTF are shared by all

contributors pursuant to the Standard Provisions Applicable to the Clean Technology Fund (the "CTF Standard Provisions") and the Principles regarding Contributions to the Clean Technology Fund (the "Principles"), attached to the Contribution and Loan Agreements/Arrangements between the Trustee and the CTF contributors.

51. Net losses from foreign exchange rate fluctuation will be taken into account at the Recalculation Date for any adjustment on loan contribution repayments. When the CTF Trust Fund is liquidated, the balance of funds remaining in the Trust Fund will be returned to the Grant and Capital Contributors as provided in the CTF Standard Provisions.

52. If the CTF Trust Fund Committee approves the use of tools 1, 2 and 5 proposed in this paper, and thereby agrees that the CTF Trust Fund will absorb potential losses and gains, if any, associated with foreign exchange rate fluctuations related to local currency operations, the following documents will need to be amended:

a) *Contribution and Loan Agreements/Arrangements*. Provisions regarding the sharing of net gains and losses from foreign exchange rate fluctuation will need to be reflected in the Principles. Proposed texts for the amendments to the Principles are attached in Annex I to this paper[5]; and

b) *CTF Financing Products, Terms and Review Procedures for Private Sector Operations*. Proposed texts for the amendments are attached in Annex II to this paper.

V. NEXT STEPS

53. If the CTF Trust Fund Committee agrees that the tools described in this document may be employed in CTF-funded programs and projects with the private sector, the Trustee will work with the contributors to prepare the necessary amendments to the Contribution/Loan Agreements/Arrangements.

54. In addition, the CIF Administrative Unit will revised the *CTF Financing Products, Terms and Review Procedures for Private Sector Operations* in accordance with revisions proposed in Annex II to this paper.

55. When an MDB employs one of the tools in a particular program or project, the use of the tool and the costs will be specified in the program or project proposal submitted for approval of CTF funding. If the cost of the tool cannot be specified at the time that CTF funding for the proposal is approved, the proposal should include an estimate of the cost. When an estimate of the cost is specified at the time of the Committee's approval of CTF funding, the MDB will inform the Committee as soon as the actual cost is known. If the actual cost exceeds by 25% or

[5] Note that with respect to Loan Contributors, the Schedule to the Loan Agreement/Arrangement on "Principal Repayment Adjustment" will also have to be amended accordingly. The Trustee will coordinate with the Loan Contributors to process such amendments.

more the estimated cost approved by the Committee, the Committee will be requested to reconfirm its approval of the costs before the Trustee commits the additional funds.

56. The CIF Administrative Unit will work with the MDBs to include in the second semi-annual operational report of a calendar year a report on the use of the tools proposed in this document and associated costs. It is further recommended that the CTF Trust Fund Committee review the use of the tools and their effectiveness in facilitating the engagement of the private sector in CTF operations by the end of 2015. The CIF Administrative Unit will work with the MDB Committee to prepare an assessment of the use of the tools to serve as a basis for the Committee's review.

ANNEX I

Proposed amendments to the Principles regarding Contributions to the Clean Technology Fund, attached to the Contribution and Loan Agreements/Arrangements between the Trustee and the CTF contributors:

Appendix A to Annex 1

Principles regarding Contributions to the Clean Technology Fund

1. General Principles

1.1. Contributors can provide funding to the Trust Fund as grants, capital contribution and concessional loans with IDA-like terms.

1.2. There will be no cross subsidies among the contributors.

1.3. Outgoing financing from the CTF can be no more concessional than incoming financing.

(a) Grant contributions may be used to finance grants, concessional loans and other financial products, such as guarantees.

(b) Capital contributions may be used to finance concessional loans and other financial products, such as guarantees;

(c) Loan contributions may be used to finance loans and other financial products, such as guarantees, on terms no more concessional than the terms of the contributions.

1.4. The CTF cannot blend financing from grant and capital contributions with financing from loan contributions unless it is on terms no more concessional than the terms of the loan contributions or supports separate parts of a project (for example, grants for technical assistance and concessional loans for investment financing).

1.5. The CTF Trust Fund Committee is responsible for determining the terms of outgoing financing (bearing in mind principle 1.3 above and other financial management issues as determined by the Trustee), including financing and terms for the private sector.

1.6. All sources of funds will be co-mingled for administrative and investment purposes. Sources of funds comprise:

(a) Funding from contributors, as described in principle 1.1 above,

(b) Investment income earned on the undisbursed balance of the CTF,

(c) Investment income returned from MDBs,

(d) Interest (service charge) payments on outgoing loans and guarantee fees,

(e) Principal repayments on outgoing loans, and

(f) Reflows from MDBs related to ~~unused~~ guarantee funds, grant and loan funds and administrative budget.

The Trustee will keep records and report on the amount received for each source of funds on an aggregate basis.

1.7. Loan contributors will provide loans to the CTF at 0.75% interest, 20 years maturity and 10 years grace on principal repayments. The CTF will make interest and principal payments to loan contributors in accordance with the terms of the loan agreement. Such loan agreements will provide for a reduction in the principal payments in case of ~~defaults~~losses on outgoing CTF loans[1], as described in section 2 below.

1.8. Losses ~~on defaults~~ on outgoing loans from the CTF will be shared by all contributors on the same basis, in proportion to their overall contributions to the CTF (excluding the portion, if any, used for outgoing grants) and covered from the CTF net income as described in section 2 below.

1.9. Following repayment of the loan contributors loans, the remaining contributors will then bear the ~~default~~ risk on losses on all outstanding CTF loans (and guarantees and other financial products which may result in ~~defaults~~losses) and upon termination of the Trust Fund will share on a pro-rata basis the outstanding unallocated balance, including any reflow of funds received; provided, however, to the extent contributors provide funds to the CTF that are used to fund grants rather than CTF loans, such donors will not share in CTF reflows, ~~defaults~~losses, CTF net income or any unused balance of funding to the extent of such grant funding.

2. Agreement on ~~Defaults~~Losses on Outgoing Loans from the Clean Technology Fund

2.1. ~~Defaults~~Losses on outgoing loans from the CTF will be shared by all contributors on a pro-rata basis proportional to their overall contributions to the CTF (excluding the portion, if any, used for grants). Such ~~defaults~~losses will be covered, to the extent available, by (i) net investment income on the CTF, (ii) interest received on outgoing CTF loans in excess of 0.75 per cent, ~~and~~ (iii) guarantee fees in excess of 0.75 percent , and (iv) net gains from foreign exchange rate fluctuation[2] on outgoing CTF loans, guarantees and other financial products (collectively "CTF net income")[~~2~~3]. Based on the models prepared by the Trustee, it is projected that the CTF net income would be adequate to cover defaults on CTF loans up to 5 percent, which is the projected loan loss rate used for IDA credits based on historical performance.

2.2. The CTF will make interest and principal payments to loan contributors in accordance with the terms of the loan agreements.

2.3. Twenty five months prior to the maturity date of the loans, the Trustee will calculate (i) each loan contributor's pro rata share of the cumulative amount of ~~default interest/principal payments~~losses on outgoing loans up to such calculation date (i.e., the difference between the scheduled interest and principal payments due to the CTF on

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1 ~~Defaults~~Losses on outgoing CTF loans would include defaults and losses ~~resulting~~ from foreign exchange rate fluctuation on outgoing CTF loans, guarantees and other financial products. Losses from foreign exchange rate fluctuation would be borne by the Trust Fund if the CTF Trust Fund Committee agrees for the Trust Fund to bear foreign exchange rate risks.

2 Net gains from foreign exchange rate fluctuation would constitute reflows to the Trust Fund if the CTF Trust Fund Committee agrees for the Trust Fund to bear foreign exchange rate risks.

~~2~~3 In case any other financial products than loans and guarantees, which generate reflows other than net gains from foreign exchange rate fluctuation, are provided from the CTF, ~~any~~such reflows received in excess of 0.75 percent, after deducting the original principal amount, will be included in the CTF net income.

all CTF loans up to that date and the actual payments received by the CTF up to that date) and (ii) each loan contributor's pro rata share of cumulative CTF net income up to such calculation date. In the event (i) exceeds (ii), the Trustee will adjust either the last or the last two years repayments by deducting the difference between (i) and (ii).

2.4. To ensure that the last two years of principal repayments to loan contributors will fully cover the cumulative ~~default~~loss amount attributed to their contribution, the Trustee will periodically review accumulated ~~default~~loss amounts. If the Trustee determines at any time that loan contributor's pro-rata share of the ~~default~~loss amount is likely to exceed loan contributor's pro rata share of CTF net income at the point that is two years prior to the maturity date of the loan contributors loans, it shall convene a meeting of the Trust Fund Committee to review the situation and to agree on steps to be taken. The Trustee will propose to the Trust Fund Committee all possible actions that may be taken so that there will be sufficient funds available to repay the loan contributors loans in accordance with their terms.

2.5. In the event that the loan contributor's pro rata share of cumulative CTF net income as of the calculation date exceeds their pro rata share of the cumulative ~~default~~loss amount as of such date, loan contributors will not receive the excess amount of CTF net income. Instead, loan contributors will have received 100% of the scheduled interest and principal payments on their loans to the CTF.

Annex II

Proposed amendments to the document entitled "CTF Financing Products, Terms and Review Procedures for Private Sector Operations" (CTF/TFC.5/9):

Current Paragraph 22: Unless otherwise approved by the Trust Fund Committee in the CTF proposal, CTF funds will be allocated by the Trustee to the MDB, and be repayable to the Trustee, in United States Dollars or Euros. However, MDBs may denominate individual financing provided by them to the beneficiaries according to their own policies and procedures, subject to the MDB assuming any exchange rate risk.

Proposed Amended Paragraph 22: Unless otherwise approved by the Trust Fund Committee in the CTF proposal, CTF funds will be allocated by the Trustee to the MDB, and be repayable to the Trustee, in United States Dollars or Euros. However, MDBs may denominate individual financing provided by them to the beneficiaries in local currency according to their own policies and procedures for projects that require such funding. If such a need for local currency financing is anticipated within a program or a project, the MDB will indicate the need for local currency financing at the time it presents the CTF project or program proposal for review and approval by the CTF Trust Fund Committee.

Footnote 7 should be deleted. The footnote currently reads: It should be noted that not allowing CTF funds to be on-lent in local currencies reduces the flexibility of the funds and increases the costs and complexity of the project, as currency risk must be hedged. It should further be noted that most of the MDBs are prevented by their guidelines to incur such exchange rate risk.