CLIMATE INVESTMENT FUNDS

CTF/TFC.15/5
April 16, 2015

Meeting of the CTF Trust Fund Committee
Washington D.C.
Tuesday, May 12, 2015

Agenda Item 5

PROPOSAL FOR PRICING POLICIES FOR THE CTF TRUST FUND

(SUMMARY)

PROPOSED DECISION

The CTF Trust Fund Committee reviewed documents CTF/TFC.15/5, *Proposal for Pricing Policies for the CTF Trust Fund*, and agrees that:

i. the CTF should not change its lending terms at this time; and

ii. the CIF Administrative Unit and Trustee should continue to monitor the CTF's lending terms and review these terms again in the future if there is a significant replenishment of CTF funds, and rise in interest rates.

I. INTRODUCTION

1. At the inception of the CTF, it adopted lending terms similar to the IDA for its public sector loan operations as the IDA's terms were regarded as offering the appropriate balance in the concessionality of funding.

2. At the November 17, 2014 meeting, the CTF Trust Fund Committee reviewed the *Proposal for a Specific Target for the Margin between Projected CTF Net Income and Projected Loan Losses*. A key issue arising from the discussions was the flexibility of the CTF's current lending terms, and the potential impact of changes in these terms on the CTF's projected net income/loan losses and margin. The Committee requested that the CIF Administrative Unit, working with the MDBs and the Trustee, prepare a paper on pricing policies for the CTF.

3. Because guarantees and equity-like instruments represent small fraction of the concessional financing which the CTF offers, this paper focuses on the CTF's lending terms. Additionally, because private sector loans generally involve more limited concessionality, it is unlikely that the CTF could reduce the concessionality of these loans without impeding the CTF's ability to achieve its strategic objectives. For these reasons, limiting consideration for modifying lending terms to only public sector loans would be most prudent.

4. The purpose of this paper is to examine whether the CTF's current public sector lending terms remain appropriate, whether opportunities exist to increase the CTF's net income by modifying the current lending terms, and the impacts of any further alignment of these terms with the IDA's lending terms.

II. ENTERPRISE RISK MANAGEMENT AND TIGHTENING THE CTF'S LENDING TERMS

5. Enterprise risk management (ERM) refers to a structured, consistent and continuous process across the whole organization for identifying, assessing, monitoring and responding to opportunities and threats *which affect the achievement of its objectives*.

6. It is essential for ERM to begin with a clear understanding of the enterprise's objectives. Because no two organizations are identical, individual enterprises have unique strategies and objectives, therefore face different types of risk, and have different options available to them for responding to risk. An organization's objectives provide the necessary context and direction for ERM to be successful. Risk management efforts which fail to incorporate an organization's objectives can cause more harm than good, and undermine the ability of an organization to achieve, or even pursue, its objectives.

7. From a risk management perspective, the CTF is an unusual organization because its objectives are so fundamentally different from those of most private sector enterprises. The CTF was established as a trust fund, and, as such, functions differently than an investment fund. The CTF is funded by contributors rather than investors, andthe CTF was created to provide concessional financing to middle income countries focusing on projects in renewable energy, energy efficiency and transport, rather than to maximize returns for investors.

8. Failing to keep the CTF's strategic objectives at the forefront of ERM efforts, and instead focusing on goals which conflict with the CTF's objectives, can lead to the pursuit of opportunities which may prevent the CTF from achieving its objectives.

9. While tightening the CTF's lending terms represents a potential opportunity to increase the CTF's net income to cover potential losses, the strategic objectives of the CTF necessitate that it extend concessional financing to middle income countries. If the lending terms can not be tightened without remaining sufficiently concessional for the CTF to achieve its objectives, then revising the lending terms would not be prudent.

III. FLEXIBILITY OF CURRENT CTF PUBLIC SECTOR LENDING TERMS

10. A key feature of the CTF is its ability to provide the MDBs with the instruments to blend CTF resources with other sources of financing to tailor terms to a target level of concessionality, which will vary depending on project-specific factors. This increases the overall financing for a project while diluting the concessionality of the CTF's contributions.

11. CTF funds are expected to leverage other resources, specifically from the MDBs, and other financial institutions. Indeed, the *Revised CTF Results Framework* (January 2013) lists, "Volume of direct finance leveraged through CTF funding" as a core performance indicator of the fund. Reducing the concessionality of the CTF's lending terms would further reduce the already diminished ability of the CTF's contributions to leverage financing from other non-concessional sources.

12. Between 2008, when the CTF was established, and 2015, interest rates have dramatically declined. U.S. 6-month LIBOR reached 3.87% in October 2008, and has since fallen to 0.40% in March 2015. Because many potential recipient countries borrow in the commercial markets for their infrastructure financing needs without exhausting their credit lines with IBRD and other multilateral financiers, and because lending terms offered by MDBs and other financiers are usually indexed to LIBOR, the ability of the CTF's lending terms to provide concessionality (or to provide significant subsidy value) has decreased dramatically. This has left the CTF with substantially diminished flexibility to tighten its lending terms without threatening the CTF's ability to achieve its strategic objectives.

13. The modest level of funds which have not yet received project-level approval, limits the impact that a change in lending terms could have on the CTF's net income relative to potential losses. Also, the dramatic decline in interest rates since the CTF was established has already significantly eroded the concessionality of the CTF's public sector loans under its current lending terms, thereby substantially limiting any flexibility to tighten these terms. Tightening the CTF's lending terms would jeopardize the CTF's ability to leverage financing from other non-concessional sources and achieve its strategic objectives. Therefore, although the IDA's lending terms have hardened since the CTF was established, maintaining alignment with the IDA's terms would not be prudent at this time.