CLIMATE INVESTMENT FUNDS

CTF-SCF/TFC.10/5
April 15, 2013

Joint Meeting of the CTF and SCF Trust Fund Committees
Washington D.C.
April 29-30, 2013

Agenda Item 6

ELABORATION OF AN ENTERPRISE RISK MANAGEMENT PROGRAM FOR THE CLIMATE INVESTMENT FUNDS

(SUMMARY)

PROPOSED DECISION

The joint meeting of the CTF and SCF Trust Fund Committees welcomes the work that has been undertaken to elaborate an Enterprise Risk Management Program, taking into account the Enterprise Risk Management Framework approved by the joint meeting in November 2012, and approves the document CTF-SCF/TFC.10/5, *Elaboration of an Enterprise Risk Management Program for the Climate Investment Funds,* and the proposals presented therein related to managing priority risks and implementing the CIF ERM program.

More specifically, the joint meeting agrees to implement the integrated plan of recommended risk actions as elaborated in Annex D of the document and requests the CIF Administrative Unit and the MDBs to prepare an annual assessment of the ERM Program as a basis for review by the CIF committees of the effectiveness of the ERM Program, beginning in May 2014.

The joint meeting requests the CIF Administrative Unit to recruit a senior risk management officer to lead and coordinate the implementation of the ERM program, including the preparation of annual assessments, and to facilitate effective collaboration and oversight of the risks identified in the ERM program.

The joint meeting approves USD 250,000 in additional budgetary resources to be included in the administrative budget of the CIF Administrative Unit to cover the FY14 costs for the senior risk management officer.

The joint meeting requests the working group that prepared the ERM Program to continue its work to develop Tier 2 risks and other risks identified by the joint meeting for review in conjunction with the first assessment of the ERM Program in May 2014 with a view to including action on additional risks in the ERM Program. The senior risk management officer is requested to coordinate the work of the working group.

I. Introduction

1. This Climate Investment Funds (CIF) Enterprise Risk Management (ERM) paper is based on the work of the CIF ERM working group ("Working Group") as requested at the November 2012 joint meeting of the Clean Technology Fund (CTF) and Strategic Climate Fund Trust Fund (SCF) Committees. Booz Allen was recruited by the CIF to lead the preparation of the paper and serve as an advisor to the Working Group. This report is for review and approval by the April 2013 joint meeting of the CTF and SCF Committees. The report is composed of six sections. Following this Introduction, Section II provides the relevant background of the CIF ERM Framework. Section III describes the methodology and approach used by the ERM Working Group. Sections IV and V provide a summary and detailed analysis of the seven risks identified by the Working Group. Section VI addresses the way forward for implementing a CIF ERM Program.

II. Background

2. The CIF, comprised of two funds, the CTF and the SCF, was approved by the Board of Directors of the World Bank on July 1, 2008. To date, donors have pledged over US $7 billion to the funds. The CIF is an important new source of funding through which five Multi-lateral Development Banks (MDBs) provide additional grants and concessional financing to developing countries to address urgent climate change challenges. These five MDBs are the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, and the World Bank Group.

3. The CTF provides scaled-up financing to contribute to the demonstration, deployment, and transfer of low-carbon technologies with a significant potential for long-term greenhouse gas emissions (GHG) savings. The SCF funds the piloting of new development approaches. These include the scale-up of activities aimed at a specific climate change challenge, a sectorial response in the areas of climate resilience (the Pilot Program for Climate Resilience, or PPCR), sustainable management of forests to reduce deforestation and forest degradation management (the Forest Investment Program, or FIP), and scaling up renewable energy in low income countries (the Program for Scaling up Renewable Energy in Low Income Countries, or SREP).

4. CIF financial support, which is provided through diverse financing tools such as grants, credits, loans, and guarantees, are backed by voluntary contributions from countries in the form of grants, capital, and loan contributions.[1]

5. As noted above, the CIF funds are disbursed through MDBs to support effective and flexible implementation of country-led programs and investments. One of the underlying principles of this structure is that each MDB uses its own policies and procedures (including procurement of goods and services and reporting arrangements) in carrying out its responsibility for the use of funds transferred to it. The World Bank serves as the Trustee of the CIF Trust Funds and also as the host of the CIF Administrative Unit.

[1] Loan contributions are only allowed under the CTF.

6. In May 2012 the Committees requested the CIF Administrative Unit and the Trustee, in collaboration with the MDB Committee, to prepare a proposal for a financial risk monitoring and management framework for the CTF and the SCF programs. In response to this request, the Trustee engaged Booz Allen Hamilton (Booz Allen), to develop an ERM framework.[2]

7. At its meeting in November 2012, the Committees agreed to establish a CIF ERM Framework and called for a Working Group comprised of representatives from the CIF Administrative Unit, risk management specialists from the MDBs, the Trustee and an independent risk management specialist to:

i. Identify priority risks to be addressed under the risk management framework;
ii. Clarify what information is currently being gathered to manage those risks;
iii. Undertake consultations with all interested members of the CTF and SCF TFCs to ascertain their risk sensitivities;
iv. Recommend at which level of the CIF such risks should best be monitored and managed; and
v. Prepare recommendations, for review and approval by the joint meeting, as to which risks should be a priority focus and the way forward for implementing a risk management framework.

8. The Working Group, as instructed by the joint meeting of the CTF and SCF Trust Fund Committees ("Joint Meeting "), developed a draft set of risks to be considered as priority (Tier 1) and subsequently conducted consultations with interested members of the Joint Meeting. The Working Group then analyzed the risks and developed a way forward for implementing the Tier 1[3] ERM Program.

III. Methodology

9. Underpinning the work of the ERM Working Group is the approved CIF ERM Framework ("the Framework") presented at the November 2012 Joint Meeting and included in Annex A.[4] This Framework was based on best practices from the Committee of Sponsoring

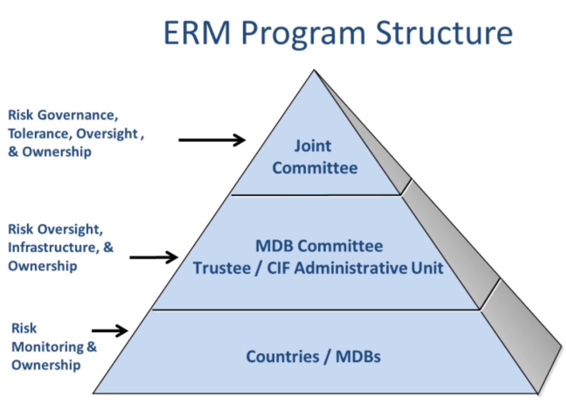

Figure 1

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[2] Summary of the Co-Chairs Joint Meeting of the CTF and SCF Trust Fund Committees, November 2, 2012.
[3] Tier 2 risks will be addresses after Tier 1 risks.
[4] CTF-SCF/TFC.9/9 Enterprise Risk Management Framework for the Climate Investment Funds.

Organizations of the Treadway Commission (COSO), the International Standards Organization (ISO) and the World Bank Group. The Framework includes steps to identify events or circumstances that could impact the CIF's ability to meet its strategic objectives, assess these situations in terms of likelihood and magnitude of impact, determine a response strategy, and develop a proposed reporting and communication process.[5]

10. The Working Group recommended a holistic CIF ERM Program, consisting of three levels, as depicted in Figure 1. Risk governance, oversight, and ownership are at the top of the structure and driven by the CIF Governance Committees ("Committees"). Based on this framework and methodology, the Committees identify the top risks and specific tolerances for each risk on an annual basis.[6] Best practices for ERM reveal that entities that achieve their objectives do so under an umbrella of strong governance. Governance and risk management are high-priority issues that are woven into the fabric of the entity. It is also their responsibility to report on the effectiveness of risk management activities. Additionally, it is necessary to clearly define and delineate risk management roles, responsibilities, and authority.[7]

11. In the middle tier of the pyramid (Figure 1), the MDB Committee, CIF Administrative Unit and the Trustee also have specific responsibilities. The MDB Committee serves as a forum to ensure effective operational coordination and MDB harmonization. Chaired by the CIF Administrative Unit, it provides pipeline oversight, makes recommendations on the activity cycle for approval by the CTF / SCF Committees, and monitors progress in the implementation of CIF programs. The CIF Administrative Unit and the Trustee provide the infrastructure of the CIF ERM program. Their primary responsibilities are designing, implementing, and maintaining capabilities, and providing related guidance to countries and MDBs as needed. This shared risk management infrastructure supports the CIF governance structure by enabling a systematic process and ownership of day-to day risks associated with implementing the CIF programs/projects.

12. The MDBs and countries, the lower tier of the pyramid, are responsible for evaluation and management of program/project level risk at the country level, including providing the Committees with adequate information to ensure that the CIF portfolio is managed efficiently.

13. In preparation for this report, the Working Group convened in Washington, DC to review a preliminary list of risks to (i) identify the priority risks, (ii) discuss the risk context, (iii) discuss the events that could trigger these risks, and iv determine the probability of occurrence and impact of the risks.[8] Following consultations with the Joint Meeting, the Working Group met a second time to incorporate their comments and finalize the Tier 1 risks. During this second

[5] Refer to Annex E for the standard risk definitions and the laymen's terms used by the Working Group.
[6] Tolerance is defined as the level of exposure to the occurrence of a risk event than an entity is willing to accept when pursuing its objectives.
[7] This may require amendments to the existing governance document.
[8] Reflecting the Working Group composition (a mixture of risk, financial, and strategic experts), the Working Group decided to translate the technical risk terms into explanatory terms to facilitate the understanding of the process with all Working Group members and the Committees (see Annex F for a detailed list of ERM and risk terms and definitions).

session, the Working Group also identified current management approaches that address the Tier 1 risks, recommended risk actions to effectively manage these risks, and determined how best to operationalize enhancements to the existing reporting and communication processes.

IV. Risk Analysis Summary

14. The Working Group, in consultation with the Joint Meeting, identified seven Tier 1 risks faced by the CIF. These risks, along with seven secondary risks, emerged from the initial analysis performed by Booz Allen. It is recommended that the Tier 1 risks be addressed by the Committees as a first priority. The secondary risks were seen as important, but not an immediate priority for the CIF. In developing a sustainable risk framework for the CIF, the Working Group took into account the challenges of coordinating CIF risk actions with the existing risk frameworks of five MDBs, which have their own processes, procedures and risk frameworks in place. The Working Group recommended risk actions for the Tier 1 risks that could be implemented within 6 and 12 months.

15. In order to move forward on the CIF ERM Program, the Joint Meeting must agree on i a final list of Tier 1 risks, ii tolerances and thresholds for each risk, and iii the action plan for each risk as presented in this paper. The Tier 1 risks are summarized below in Table 1. Two critical components in implementing a CIF ERM Program that will enhance the CIF's ability to analyze and communicate the health of the Funds (strategic, financial and operational); include:

- An annual assessment of the ERM Program;
- An integrated plan to implement the Recommended Risk Actions, which will enhance the CIF Administrative Unit and Trustee's ability to communicate the health of the Funds (strategic, financial and operational) to the Committees to facilitate risk informed decisions. Section VI summarizes the tasks needed to operationalize the recommended Tier 1 Risk Actions and the proposed reporting and communication process. Most of the recommended actions can be implemented in six months assuming appropriate resourcing and participation.

Table 1: CIF ERM Tier 1 Risks

CIF Tier 1 risks: *Implementing the Tier 1 ERM Program leveraging existing risk mitigation processes in the MDBs; the current assessment shows that the program can be operationalized in 6 to 12 months.*

Risk 1: Committees may not make risk informed decisions

- If quality and complete information is not provided to support oversight of the CIF in a timely manner, the Committees risk making poorly informed decisions. As a consequence, the CIF could fail to achieve its objectives.
- Lack of an integrated portfolio overview was identified as a risk in the context of the Committees not having a portfolio view of the strategic, financial and operational status, which would enhance its ability to make effective decisions and provide integated portfolio information.

Risk 2: Inability to deliver the expected transformational impact (GHG savings for CTF, other goals for SCF)

- This risk may arise if there is no continued oversight of an investment plan (IP) after it is approved and there are no requirements to monitor and measure the programmatic achievements of the IP. As a consequence, an IP could fail to achieve its programmatic objective.

Risk 3: Suboptimal use of CIF funds

- This risk relates to projects in the pipeline for which resources have been allocated that are not advancing in accordance with agreed milestones. As a result, resources are reserved for projects that are delayed which could be used for implementation ready projects.

Risk 4: Portfolio losses exceed tolerances

- This risk may arise due to a lack of systematic monitoring and reporting of threshold breaches. This risk has three key attributes: i losses to the CIF related to project lending—loan non-repayment and calls on guarantees); ii losses related to the investment portfolio managed by the Trustee; and iii losses associated with local currency lending.

Risk 5: Asset - Liability Mismanagement

- This risk occurs when the level of liquidity and or reserves are inadequate or fall below the minimum requirements. This results in the Trustee's inability to meet loan contributor contractual obligations (interest and principal payments), or obligations to MDBs .

Risk 6: Misuse of funds or other problems with project implementation

- This risk arises due to a lack of a systematic process for reporting incidences of misuse of funds. This results in the Committee's inability to effectively respond to such an event.

Risk 7: Misalignment between sources and uses of funding

- This risk relates to the MDB providing the CIF Administrative Unit and the Trustee with the expected category of finanical product (soft vs. hard credit / grant) at the upstream portfolio planning phase. This may result in a breach of the funding limit rule or cause a later stage project renegotiation.

16. An emerging trend across the Tier 1 risks is that information is variously: (i) suboptimal in terms of reporting standards, (ii) missing, and (iii) scattered across multiple channels and not transparent. This situation hinders efficient decision-making about how funds could best be utilized (for instance, the use of local currency lending in CIF funded projects). An improved process for reporting and increased access to information would enable the Committees to move toward 'risk-informed' decisions.

17. To facilitate the Working Group analysis and consultations with the Committees, as discussed in the CIF Enterprise Risk Management Assessment Paper, the Working Group categorized the CIF risks into three conventional areas - Strategic, Financial and Operational (see Figure 2). Strategic risks focus on how to meet the CIF programmatic objectives. Strategic risk management provides a systematic approach to manage risks, communicate to the Committees, and provides an approach to take advantage of opportunities related to the achievement of the CIF mission and strategic objectives. Financial risks focus on quantitative risks such as portfolio losses related to loans and Asset - Liability Management (ALM). Operational risks focus on the risk of loss resulting from inadequate or failed processes, personnel, and systems. Operational risk management ensures alignment of the Fund's operational policies with its strategic framework and provides guidelines for its activities.

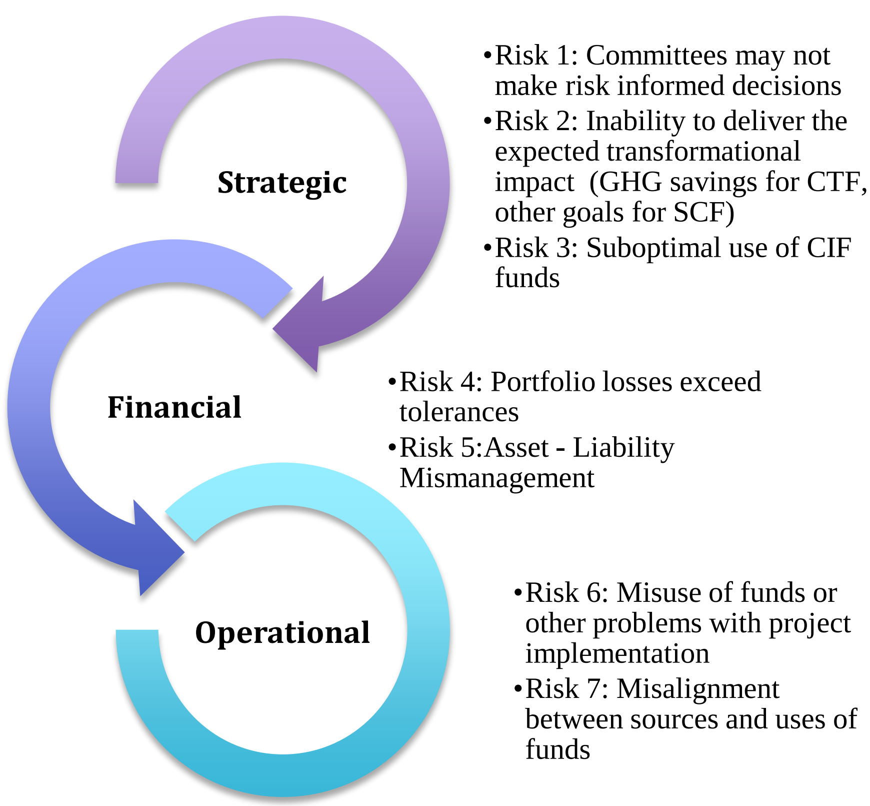

Figure 2

V. Tier 1 Detailed Risk Analysis

18. The Working Group, in consultation with the Committees, identified Tier 1 risks using the CIF Enterprise Risk Management Framework assessment process of identifying the probability and impact of each risk. This section presents the evaluation of the Tier 1 risks. The risks were ranked based on the probability and impact identified by the Working Group.

19. The following sections present each risk from four perspectives, including a description of the risk, risk context and tolerances, and recommended risk management actions. The fourth perspective is a proposed reporting and communication process for each risk.

Strategic Risks

20. This section focuses on how to meet the CIF programmatic objectives. Strategic risk management provides a systematic approach to manage risks, communicate to the Committees, and provides an approach to take advantage of opportunities related to the achievement of the CIF mission and strategic objectives. The key is to identify the strategically relevant information versus a summary of project details. The three strategic risks discussed below are deemed to be a priority for action within the next twelve months:

- *Committees may not make risk informed decisions:* If quality and complete information is not provided to support oversight of the CIF, the Committees risk making poorly informed decisions. As a consequence, the CIF could fail to achieve its objectives. Lack of an integrated portfolio overview was identified in the context of the Committees not having a portfolio view of the Funds' financial status, status of the program in terms of meeting the Funds strategic goals and an understanding of key operational areas, which would enhance its ability to make more effective decisions and provide Fund health information to governments. As stated above the key is providing the relevant portfolio information (programmatic, financial and operational) that is needed by the Committees to make risk informed strategic fund decisions.
- *Inability to deliver the expected transformational impact (GHG savings for CTF, other goals for SCF)*: This risk may arise if there is no continued oversight of the IP after it is approved and further there are no requirements to monitor and measure the programmatic achievements of the IP.
- *Suboptimal use of funds*: This risk relates to projects in the pipeline for which resources have been allocated that are not advancing in accordance with agreed milestones. As a result, resources are reserved for a project that is delayed which could be used for implementation ready projects.

21. To address the three strategic risks described in this section, the ERM Working Group recommends the following:

- Develop and communicate semiannually to the Committees an integrated portfolio summary including financial, pipeline, and risk information.
- Ensure sufficient transparency is in place at the project level so that the CIF Administrative Unit has information to provide timely analysis and solutions to address barriers and challenges across the overall CIF portfolio. By ensuring the

enhanced quality of information is provided by MDBs ***and establishing an integrated (pipeline and financial) portfolio risk analysis, the Committees can enhance the CIF oversight and make risk informed decisions concerning the achievement of the Fund's strategic objectives***.

- Facilitate improved communication from countries and MDBs about programmatic information related to achievement of objectives addressed in the IP. Annex B presents a conceptual design of the recommended CIF Portfolio Dashboard which will enhance the communication of CIF portfolio health to the Committees.
- Ensure that quality information is communicated to the CIF Administrative Unit and Trustee throughout the lifecycle of the CIF. In addition, the ERM Working Group stressed the importance of setting realistic expectations during country program planning and revising the existing programming model for engaging the private sector to better align with market opportunities.