

# CLIMATE INVESTMENT FUNDS

CTF-SCF/12/5  
June 17, 2014

---

Meeting of the Joint CTF and SCF Trust Fund Committee  
Montego Bay, Jamaica  
June 25, 2014

Agenda Item 5

## **RISK REPORT OF THE CTF AND SCF TRUST FUNDS**

### **EXECUTIVE SUMMARY**

## **PROPOSED DECISION:**

The joint meeting of the CTF and SCF Trust Fund Committees, having reviewed the document entitled, *Risk report on CTF and SCF Trust Funds*, dated June 17, 2014,

- a) takes note of the progress made in implementing the ERM Framework and the update on Tier 1 risks,
- b) agrees, with regard to the CTF, on the following steps proposed in the report to mitigate the highlighted risks:

*Risk Management Issue 1: Declining margin between projected CTF Net Income and loan losses*

The meeting requests the Trustee working with the MDBs to refine loss rates and private sector returns assumptions in the CTF cash flow model. The meeting further requests the MDBs to provide expected returns on equity investments and pricing floors for other financial instruments when they submit program or project proposals for funding approval.

*Risk Management Issue 2: Potential Funding Shortage for CTF*

The meeting requests the CIF Administrative Unit, the MDBs and the Trustee to continue their active management of the pipeline, portfolio and contribution schedule so as to eliminate or minimize any negative impact on the availability of the CTF funding for projects.

- c) Agrees, with regard to the SCF, on the following steps proposed in the report to mitigate the highlighted risk:

*Risk Management Issue 3: Potential Funding Shortage for PPCR*

The meeting requests the CIF Administrative Unit, the MDBs and the Trustee to continue their active management of the pipeline, portfolio and contribution schedule so as to eliminate or minimize any negative impact on the availability of the PPCR funding for projects.

## **PREFIX**

- i. This report consists of two parts. Part I presents the risk report for the CTF Trust Fund and Part II presents the risk report for the SCF Trust Fund.
- ii. There are 11 Tier 1 risks in the approved CTF ERM Framework and 9 Tier 1 risks in the SCF ERM Framework.

The following 9 risks are common to the CTF and the SCF:

Risk 1: Financial management portfolio risk

Risk 3: Credit risk

Risk 4: Market interest rate and foreign exchange risk

Risk 6: Pledge risk

Risk 7: Misuse of funds risk

Risk 8: Impact risk

Risk 9: Operational portfolio risk

Risk 10: Pipeline management risk

Risk 11: Financing terms risk

The CTF has the following 2 additional risks that are unique to the CTF:

Risk 2: Financial model risk

Risk 5: Asset liability management risk

- iii. We propose that the joint meeting of the CTF and SCF Trust Fund Committees discuss the 9 risks that are common to the two funds, while the CTF Trust Fund Committee meeting is invited to focus on the 2 risks that are unique to the CTF.
- iv. The proposed decision covers both the CTF and the SCF.

**PART I**  
**CLEAN TECHNOLOGY FUND**

## **I. INTRODUCTION**

1. This report aims to provide the CTF Trust Fund Committee with an update on the progress of implementing the Enterprise Risk Management (ERM) framework, risk management related issues and suggested action plans.

## **II. PROGRESS MADE ON ERM FRAMEWORK IMPLEMENTATION**

### **CIF Enterprise Risk Management (ERM) Dashboard**

2. The first release of the CIF Enterprise Risk Management (ERM) Dashboard was launched on April 1, 2014. The ERM Dashboard portrays data for the agreed Tier 1 Risks for both the CTF and the SCF. The operationalization of the ERM Dashboard has effectively implemented a number of risk mitigation actions.

### **Senior Risk Management Officer**

3. The CIF Administrative Unit undertook a process to recruit the Senior Risk Management Officer position. A highly qualified candidate was identified and offered the position; however, the candidate did not accept the position.

4. Concurrently, the World Bank instituted a number of restrictions to its recruitment process pending the conclusion of the restructuring the World Bank Group. The CIF Administrative Unit is currently consulting with senior management of the World Bank Group to resolve how we may move forward with the recruitment of a Risk Management Officer. Pending this, the Senior Operations Officer, Portfolio Management has agreed to fulfill the responsibilities of the Senior Risk Management Officer as an interim arrangement.

### **Lead MDB identification**

5. A lead MDB has been identified for each CTF investment plan.

6. In anticipation of substantial work in this regard, resources have been incorporated into the proposed country programming budget in fiscal year 2015.

### **Enhanced operational reporting and pipeline management**

7. The operational reporting process and reporting protocol have been further enhanced by formalizing three practices to strengthen the portfolio management framework:

Practice 1: monthly updating and posting schedule of project approvals

Practice 2: full portfolio update on a semiannual basis

Practice 3: portfolio review on a quarterly basis

## **Tier 2 Risks**

8. Due to delays in recruiting the Senior Risk Management Officer, the Tier 2 risk assessment will be conducted in fiscal year 2015 and an update will be reported to the CTF and SCF Trust Fund Committees in November 2014.

## **III. UPDATE ON TIER 1 RISKS**

### **Financial Risks**

#### *Risk 1– Financial management portfolio risk:*

9. Risk 1 is measured by surveying stakeholders to determine whether the current ERM Dashboard sufficiently addresses their major risk areas. A sample questionnaire has been posted on the ERM Dashboard. It is currently envisaged that an actual survey will be conducted six months after the first release of the ERM Dashboard (October 2014) and every six to twelve months thereafter.

#### *Risk 2 – Financial model risk:*

10. The CTF cash flow model has been reviewed by internal model reviewers at the World Bank and is being revised to incorporate three recommended improvements.

11. To date, there has been no reported case of default or project loans in arrears on the CTF portfolio.

#### *Risk 3 – Credit risk:*

#### ***Risk Management Issue: Declining margin between projected CTF Net Income and loan losses***

12. The 2014 projection shows that projected CTF Net Income would be sufficient to cover potential loan losses at Recalculation Date. However, the margin by which the projected CTF Net Income exceeds the estimated potential loan losses in 2014 (US\$ 16 million) is much smaller than was projected in 2011 (US\$ 80 million).

13. As presented in Risk 4 – *Market interest rate and foreign exchange risk*, the CTF liquidity balances are projected to exceed the prudential minimum liquidity level established by the Trustee.<sup>1</sup>

#### ***Proposed Actions to Mitigate Risk:***

14. Proposed Action 1: Refine loss rates and private sector returns assumptions in the CTF cash flow model

---

<sup>1</sup> Prudential minimum liquidity level is determined as projected debt service payments to loan contributors in the next 12 months and projected transfers to MDBs in the next 6 months.

15. Proposed Action 2: In order to ensure sufficient CTF Net Income to cover potential losses, expected returns on equity investments and pricing floors for other financial instruments should be provided by MDBs when program or project proposals are submitted for funding approval.

*Risk 4 – Market interest rate and foreign exchange risk:*

16. Market interest rate risk: The Trustee, in collaboration with the CIF Administrative Unit and the MDBs, has initiated a discussion on the methodology for determining the appropriate level of concessionality.

17. Foreign exchange risk: In order to provide a buffer in the event that the Trust Fund may not have sufficient funds to disburse against commitments already made by the Trustee, as a result of unfavorable foreign exchange movements, a portion of the unencashed promissory note balances (15%, or US\$ 150 million as of March 31, 2014) is restricted from being used for funding decisions by the CTF Trust Fund Committee and the subsequent commitments to be made by the Trustee.

18. As of March 31, 2014, CTF commitments to the MDBs have not exceeded the cash balance of the CTF Trust Fund. Therefore, the risk exposure in this regard is limited.

*Risk 5 – Asset liability management risk:*

19. The ERM Dashboard presents a projection of the CTF cash balance and the prudential minimal liquidity requirement from end of 2014 to end of 2034, which has demonstrated the CTF's solid financial condition in terms of cash liquidity.

**Operational/Strategic Risks**

*Risk 6 – Pledge risk:*

20. As of March 31, 2014, out of US\$ 5.24 billion total CTF pledges<sup>2</sup>, US\$ 4.6 billion has been finalized and paid and the outstanding amount is US\$ 644 million. In May, an additional payment of US\$ 206 million was received which has reduced the outstanding balance of pledge and payment to US\$ 438 million, 8% of the total CTF pledges.

***Risk Management Issue: Potential Funding Shortage for CTF***

21. The CTF may not have sufficient funds to approve project proposals starting in early 2015, assuming the projects are submitted as planned and no additional funding will be made available aside from projected payments. This calculation includes the additional resources made available in December 2014 but does not include projects under the second phase of the DPSP. If the second phase of the DPSP is approved, a shortage of commitment authority may arise much sooner.

---

<sup>2</sup> Represents realized amounts plus unrealized amounts valued on the basis of exchange rates as of March 31, 2014.

22. The potential funding shortage is primarily due to the over-programming pipeline management measure. The accelerated project submissions for funding approvals have pulled forward the timing.

23. As described in Risk 4 – *Foreign exchange risk*, the financial reserve that has been set aside by the Trustee in the amount of 15% of the unencashed promissory note balance plays a role in the perceived funding shortage. There is a tradeoff between mitigating the two risks: foreign exchange risk and the risk of funding shortage.

24. Furthermore, realizing the outstanding pledges in a timely manner would alleviate the pressure to a certain extent and postpone the timing when funds will run short.

***Proposed Actions to Mitigate Risk:***

25. Proposed Action 1: Active Pipeline and Portfolio Management: The potential funding shortage requires active monitoring and tracking of the CTF pipeline and portfolio so that the issue can be timely anticipated, proposals can be identified and solution can be sought in consultation with the MDB committee (and the Trust Fund Committee if need be).

26. Proposed Action 2: Active Contribution Management: The potential funding shortage also calls for active contribution management. For instance, the Trustee has been in contact with relevant contributors to explore ways to accelerate payments or encashment of promissory notes. Also, it may be worth exploring additional approaches to mitigate foreign exchange risks.

***Risk 7 – Misuse of funds risk:***

27. To date, there are no incidents of misuse of funds reported by the MDBs.

28. In an effort to reflect the timeliness of reporting such incidents, more granular details will be added into the ERM Dashboard to specify the time elapsed from when the case of misuse of fund was confirmed to when the incident was reported to the CTF Trust Fund Committee.

***Risk 8 – Impact risk:***

29. A lead MDB has been identified for each CTF investment plan. This is the first step towards the desired situation where the lead MDB works in close collaboration with the country and other MDBs to carry out monitoring and reporting activities at the program level and to ensure that the expected programmatic impact is achieved.

30. Most of the CTF investment plans have gone through revisions or updates. Significant stakeholder consultation, country coordination, and MDB collaboration has been conducted to through the process.



31. However, further effort is needed to strengthen the process and ensure stakeholder engagement, monitoring and reporting and other relevant activities take place at the country level in a systematic manner.

32. A dedicated guideline document has been developed by the CIF Administrative Unit to provide clarity and guidance in this regard.

33. Resource needs have been incorporated into the proposed country programming budget in fiscal year 2015.

## **Operational**

### *Risk 9 – Operational portfolio risk:*

34. Similar to Risk 1, the surveying approach is used to measure Risk 9. A sample questionnaire has been posted on the ERM Dashboard. It is proposed that the actual survey including questionnaire for both Risk 1 and Risk 9 will be conducted six months after the first release of the ERM Dashboard and every six to twelve months thereafter.

35. Overall, the MDB operational portfolio reporting and CIF Administrative Unit's issuance of semi-annual operational reports has been performed in a timely manner.

### *Risk 10 – Pipeline management risk:*

36. For FY14, 27 projects and programs totaling US\$ 1,497.2 million were expected to be submitted to the Trust Fund Committee for funding approval.

37. As of March 31, 2014, actual approvals in CTF funding for FY14 were 11 projects/programs totaling US\$ 778.2 million (including two project preparation grants). Subsequent to the cut-off date (March 31, 2014), US\$ 620.5 million in project proposals have been submitted to the Trust Fund Committee for funding approval. Total approvals during FY14 will amount to almost US\$ 1.4 billion and the delivery ratio will reach 93.3%. Development of CTF projects and programs has considerably accelerated during FY14, resulting in a record level of funding approvals.

### *Risk 11 – Financing terms risk:*

38. Harder terms limit: As of December 31, 2013, the total funding of US\$ 2,527 million is expected to be used by MDBs on term no less concessional than loan contributions. The loan contribution amounts to US\$ 1,094 million. Therefore, the requirement that 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 is expected to be fully satisfied.

39. Non-grant instruments limit: As of December 31, 2013, the non-grant funding to date (approved projects and projects in the pipeline) amounts to US\$ 5,005 million in total and

exceeds by a large margin the requirement of US\$ 2,517 be used to finance concessional loans and other financial products, such as guarantees.

**PART II**  
**STRATEGIC CLIMATE FUND**

## **I. INTRODUCTION**

40. This report aims to provide the SCF Trust Fund Committee with an update on the progress of implementing the Enterprise Risk Management (ERM) framework, risk management related issues and suggested action plans.

## **II. PROGRESS ON ERM FRAMEWORK IMPLEMENTATION**

### **CIF Enterprise Risk Management (ERM) Dashboard**

41. The first release of the CIF Enterprise Risk Management (ERM) Dashboard was launched on April 1, 2014. The ERM Dashboard portrays data for the agreed Tier 1 Risks for both the CTF and the SCF. The operationalization of the ERM Dashboard has effectively implemented a number of risk mitigation actions.

### **Senior Risk Management Officer**

42. The CIF Administrative Unit undertook a process to recruit the Senior Risk Management Officer position. A highly qualified candidate was identified and offered the position; however, the candidate did not accept the position.

43. Concurrently, the World Bank instituted a number of restrictions to its recruitment process pending the conclusion of the restructuring the World Bank Group. The CIF Administrative Unit is currently consulting with senior management of the World Bank Group to resolve how we may move forward with the recruitment of a Risk Management Officer. Pending this, the Senior Operations Officer, Portfolio Management has agreed to fulfill the responsibilities of the Senior Risk Management Officer as an interim arrangement.

### **Lead MDB identification**

44. A lead MDB has been identified for each SCF investment plan. Several pilot countries<sup>3</sup> have organized stakeholder meetings reviewing the progress with the wider stakeholder community in the country.

45. The resource needs have been incorporated into the proposed country programming budget in fiscal year 2015.

### **Enhanced operational reporting and pipeline management**

46. The operational reporting process and reporting protocol have been further enhanced by formalizing three practices to strengthen the portfolio management framework:

Practice 1: monthly updating and posting schedule of project approvals

Practice 2: full portfolio update on a semiannual basis

---

<sup>3</sup> FIP pilot countries include Mexico and Indonesia. PPCR country includes Samoa.

Practice 3: portfolio review on a quarterly basis

## **Tier 2 Risks**

47. Due to delays in recruiting the Senior Risk Management Officer, the Tier 2 risk assessment will be conducted in fiscal year 2015 and an update will be reported to the CTF and SCF Trust Fund Committees in November 2014.

## **III. UPDATE ON TIER 1 RISKS**

### **Financial Risks**

#### *Risk 1 – Financial management portfolio risk:*

48. Risk 1 is measured by surveying stakeholders to determine whether the current ERM Dashboard sufficiently addresses their major risk areas. A sample questionnaire has been posted on the ERM Dashboard. It is currently envisaged that the actual survey will be conducted six months after the first release of the ERM Dashboard (October 2014) and every six to twelve months thereafter.

#### *Risk 2 – Credit risk:*

49. Under the SCF Trust Fund, the financial impact of potential losses due to defaults or non-payments is limited to the final shares of the SCF contributors at the close of the SCF Trust Fund (in approximately 40 years).

50. To date, there have been no reported losses or project loans in arrears in the SCF portfolio. The Trustee will work with the MDBs and the CIF Senior Risk Management Officer to establish the benchmarks for the portfolio losses and the associated methodology to monitor these losses.

#### *Risk 3 – Market interest rate and foreign exchange risk:*

51. Market interest rate risk: The Trustee, in collaboration with the CIF Administrative Unit and the MDBs, has initiated a discussion on the methodology for determining the appropriate level of concessionality.

52. Foreign exchange risk: In order to provide a buffer in the event that the Trust Fund may not have sufficient funds to disburse against commitments already made by the Trustee, as a result of unfavorable foreign exchange movements, a portion of the unencashed promissory note balances (15%, or US\$ 101 million as of March 31, 2014) is restricted from being used for funding decisions by the SCF Trust Fund Committee or Sub-committees and the subsequent commitments to be made by the Trustee.

53. To date, there have been no SCF commitments to the MDBs made against promissory notes. The risk exposure is limited.

## **Operational/Strategic Risks**

### *Risk 4 – Pledge risk:*

54. As of March 31, 2014, out of US\$ 2.29 billion total SCF pledges<sup>4</sup>, US\$ 2.02 billion has been finalized and paid. The outstanding amount is US\$ 266 million. In May, an additional payment of US\$ 113 million was received, which has reduced the outstanding balance of pledge and payment to US\$ 153 million, about 6.6% of the total SCF pledges.

### ***Risk Management Issue: Potential Funding Shortage***

55. It is noted that at the SCF program level, the PPCR may not have sufficient funds to approve project proposals starting in the second quarter of fiscal 2015 or late calendar year 2014.

56. The potential funding shortage may arise from the following two factors: The financial reserve that has been set aside by the Trustee in the amount of 15% of unencashed promissory note balance plays a role in the perceived funding shortage. For the PPCR, the amount is US\$ 57.1 million as of March 31, 2014. There is a tradeoff between mitigating the two risks: foreign exchange risk and the risk of funding shortage.

57. The extended realization of the outstanding pledges also plays a role in accelerating the timing when funds will run short. As of March 31, 2014, out of US\$ 1,159 million total PPCR pledges, US\$ 972 million has been finalized and paid. The outstanding amount is US\$ 187 million. In May, an additional payment of US\$ 113 million was received, which has reduced the outstanding balance of pledge and payment to US\$ 74 million, 6% of the total PPCR pledges.

### ***Proposed Actions to Mitigate Risk:***

58. Proposed Action 1: Active Pipeline Management: The potential funding shortage requires active monitoring and tracking of the PPCR pipeline so that the issue can be timely anticipated, proposals can be identified and solution can be sought in consultation with the MDB committee (and with the Trust Fund Committee and Sub-committees if need be).

59. Proposed Action 2: Active Contribution Management: The potential funding shortage also calls for active contribution management. To protect SCF trust fund commitments from impact of foreign exchange rate fluctuations, a portion of the promissory note balances in currencies other than US\$ (15%) is restricted from being used for funding decisions. Therefore, the early encashment of promissory notes is vital so that restricted funds pertaining to promissory note balances can be released for funding decisions. The Trustee has been in discussion with the concerned contributors regarding encashment schedules with an aim to determine a schedule that minimizes disruption to the projected funding proposals.

### *Risk 5 – Misuse of funds risk:*

60. To date, there are no incidents of misuse of funds reported by the MDBs.

---

<sup>4</sup> Represents realized amounts plus unrealized amounts valued on the basis of exchange rates as of March 31, 2014.

61. In an effort to reflect the timeliness of reporting such incidents, more granular details will be added into the ERM Dashboard to specify the time elapsed from when the case of misuse of fund was confirmed to the time when the incident was reported to the SCF Trust Fund Committee.

*Risk 6 – Impact risk:*

62. A lead MDB has been identified for each investment plan or SPCR. This is the first step towards the desired situation where the lead MDB works in close collaboration with the country and other MDBs to carry out monitoring and reporting activities at the program level and to ensure that the expected programmatic impact is achieved.

63. Stakeholder consultation, country coordination, and MDB collaboration have been conducted to some extent through the revision or update of some SCF investment plans.

64. However, further effort is needed to strengthen the process and ensure stakeholder engagement, monitoring and reporting and other relevant activities take place at the country level in a systematic manner.

65. A dedicated guideline document has been developed by the CIF Administrative Unit to provide clarity and guidance in this regard.

66. Resource needs have been incorporated into the proposed country programming budget in fiscal year 2015.

**Operational**

*Risk 7 – Operational portfolio risk:*

67. Similar to Risk 1, the surveying approach is used to measure Risk 7. A sample questionnaire has been posted on the ERM Dashboard. It is proposed that the actual survey, including questionnaire for both Risk 1 and Risk 7, be conducted six months after the first release of the ERM Dashboard and every six to twelve months thereafter.

68. Overall, the MDB operational portfolio reporting and CIF Administrative Unit's issuance of semi-annual operational reports has been performed in a timely manner.

*Risk 8 – Pipeline management risk:*

69. For FY14, projects at the funding amount of US\$ 733.2 million in total were expected to be submitted to the Sub-committee for funding approval.

70. As of March 31, 2014, actual approvals for FY14 were US\$ 408.4 million or 56%. The delivery ratio has increased from previous years and reached historically high. Subsequent to the cut-off date (March 31, 2014), US\$ 144.9 million in project proposals have been submitted to the

Sub-committee for funding approval or are expected for funding approval. The delivery ratio is expected to reach 76% by end of the fiscal year.

71. At the SCF program level, the acceleration in submission of funding approvals compared to the previous fiscal year has been consistently the case.

*Risk 9 – Financing terms risk:*

72. As of December 31, 2013, the grant contribution (including pledges) to the SCF Trust Fund (US\$ 1,526 million million) exceeds the funding amount for the approved projects and projects in the pipeline that have used or plan to use grants (estimated to be US\$ 1,284 million). The funding limit requirement is expected to be met in terms of grant contributions. Moreover, the funding amount for the approved projects and the identified projects in the pipeline that have used or plan to use non-grant instruments is estimated to be US\$ 520 million. Compared to the total capital contribution of US\$ 761 million, there is significant room available to develop SCF projects or programs using non-grant instruments.

73. The funding allocation at the investment plan level was made earlier based on contribution type (grant and capital). Assuming it is ensured that the project funding proposals are in line with the earlier allocation in terms of the categories of contributions through pipeline management and portfolio monitoring, the funding limit requirements will continue to be satisfied.