

CLIMATE INVESTMENT FUNDS

CTF/TFC/12/9
October 12, 2013

Meeting of the CTF Committee
Washington D.C.
October 28, 2013

Agenda Item 10

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

EXECUTIVE SUMMARY

PROPOSED DECISION

The CTF Trust Fund Committee, having reviewed the document (CTF/TFC/12/9), *Use of Local Currency for Private Sector Projects under the CTF Trust Fund: Proposed Tools and Instruments to Support Local Currency Operations*,:

- a) Agrees that the CIF MDBs may employ Tools 1 to 4 proposed in the document as a way to facilitate local currency operations for private sector projects under the CTF. These include hedging tools (tools 1 and 2) and guarantee tools for domestic clients (tools 3 and 4).
- b) In this regard, the Committee agrees that:
 - i. the CTF Trust Fund will bear any residual losses from foreign exchange rate fluctuation not covered under Tools 1, and 2 as proposed in the document; and
 - ii. the CTF Trust Fund will bear the additional costs associated with the use of Tools 1 and 2, as proposed in the document provided that, when an MDB expects to employ any such tool in a particular program or project, the use of the tool and the costs should 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. For Tools 1 and 2, this cost will be within the 2% per annum cap. 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 immediately prior to the execution of the hedge the expected hedge costs exceeds the estimate provided to the Committee, the MDBs should inform the CIF Administrative Unit and the Trustee of the revised hedging cost before executing the hedge. Approval from the CTF Trust Fund committee will be provided on a no objection basis with 48 hours of receipt of the information from the MDB as long as the revised hedging costs is still within the 2% per annum cap.
- c) Requests the MDBs to report annually, in the CTF semi-annual operational report, on the use of the tools and their costs;
- d) Further requests the CIF Administrative Unit and the MDB Committee to prepare an assessment of the use of the tools, their cost and effectiveness in facilitating the engagement of the private sector in CIF-funded activities for review by the Committee in October/November 2015; and
- e) Requests the CIF Administrative Unit to revise the *CTF Financing Products, Terms and Review Procedures for Private Sector Operations* and the Trustee to work with the CTF Contributors to process the necessary amendments to the legal documents, as described in the document.

EXECUTIVE SUMMARY

1. At its meeting in May 2013, 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.
2. On August 16, 2013, received document entitled “Use of Local Currency for Private Sector Projects under the CTF Trust Fund: Proposed Tools and Instruments to Support Local Currency Operations”, was circulated for approval. Committee members submitted comments and requested clarifications on the tools and instruments that could be used to support local currency operations, and requested that the document be revised taking into account their comments. This revised document addresses comments and questions received from Committee members.
3. The objective of this paper is to outline the principles for each tool and the situations in which they would add most value. However, full details on the terms and conditions of the transactions are difficult to present in the abstract, and cannot be generalized across the pilot countries with heterogeneous financial markets. Once the TFC has agreed on the proposed “toolkit”, the MDBs would present transactions project by project with additional details on structure and cost estimates. The CTF Committee would approve the use of each tool, and the cost estimates of individual operations as they are presented to the Trust Fund Committee.
4. The tools and instruments have been grouped into three categories:
 - A. Hedging Tools (e.g. cross currency swaps)
 - B. Guarantee Tools for domestic clients
 - C. Other tools designated for the purpose of supporting local currency lending.
5. The tools in **category A** are known instruments to the MDBs, but would be new for the CTF. The tools in **category B**, however, are currently available under the existing procedures and guidelines for private sector operations (but any foreign exchange risk had to be borne by the MDBs). The purpose of being presented here is to clarify the conditions under which they can be used and address the cost/risk issue.
6. The implementation of tools described in **category C** depends on financial limits being set. It is understood that it would be premature to reach a decision on the exact limits for these tools in the absence of the ERM system currently being developed for the CIFs. Therefore, they are included here only to illustrate the full range of possibilities for local currency financing. A full discussion and decision on category C will come at a later date.
7. Section II presents a revised menu of CTF tools and instruments. Section III illustrates how the costs, fees and expenses that are to be borne by the CTF Trust Fund would be shared 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, and Section V outlines next steps.