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

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. In September 2013, the CTF and SCF Trust Fund Committees approved the documents entitled "Updates to the Elaboration of an Enterprise Risk Management Program for the Climate Investment Funds" including revised Tier 1 risks and "Duties and Responsibilities of a Senior Risk Management Officer".

2. The document "Duties and Responsibilities of a Senior Risk Management Officer" stipulates that the Senior Risk Management Officer will "prepare and present annual reports and mid-term updates focused on risk management related issues and progress in addressing such issues. The annual reports should document and present observations on the implementation of the Enterprise Risk Management (ERM) framework, should track remediation progress, and may include recommendations and suggested action plans."

3. This report is written in response to the above requirement, with an aim to providing the CTF Trust Fund Committee with an update on the progress of implementing the ERM, risk management related issues and suggested action plans.

II. PROGRESS MADE ON ERM FRAMEWORK IMPLEMENTATION

CIF Enterprise Risk Management (ERM) Dashboard

4. On November 13, 2013, the joint meeting of the CTF and SCF Trust Fund Committees requested that the Trustee and the CIF Administrative Unit ensure that the IT work necessary to support the dashboard commence as early as possible with a view to running a testing phase of the full dashboard in the first quarter of 2014.

5. With great efforts and excellent collaboration among the Trustee, the CIF Administrative Unit and the MDBs, 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.

6. The operationalization of the ERM Dashboard has effectively implemented the following risk mitigation actions identified in the paper "Update to the elaboration of an enterprise risk management program for the Climate Investment Funds" dated August 22, 2013:

   a) Develop a Portfolio Risk Dashboard to enable an integrated view of financial statistics and indicators with outputs from the CTF Cash Flow model (Risk 1: Financial management portfolio risk)

   b) The Trustee will provide in the CTF Portfolio Risk Dashboard the (i) actual default rates by sector and region and the impact on cash flows, if any; and (ii) allocation of actual losses to each contributor. (Risk 2: Financial model risk and Risk 3: Credit risk)

c) The Trustee will develop a system to monitor and test compliance of the projected liquidity levels with the minimum liquidity requirement. The Trustee will report on the results through the CTF Portfolio Risk Dashboard. (Risk 5: Asset liability management risk)

d) Reporting on the status of pledges will be included in the CTF Portfolio Risk Dashboard. (Risk 6: Pledge risk)

7. Further enhancements will be made to the ERM Dashboard in fiscal year 2015 in discussion with the CTF and SCF Trust Fund Committee members.

Senior Risk Management Officer

8. After the approval of a CIF Enterprise Risk Management Framework in October 2013, the CIF Trust Fund Committees approved, through a decision by mail, the terms of reference and funding for a Senior Risk Management Officer.

9. The CIF Administrative Unit undertook a process to recruit the position in accordance with the World Bank recruitment procedures. Through this process, a highly qualified candidate was identified and offered the position. Unfortunately, at the end of March 2014, after lengthy deliberations, the candidate did not accept the position.

10. 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

11. Risk 8: Impact risk requires that "For each investment plan, a lead MDB should be agreed on by the country and the MDBs. The lead MDB will consult with the country and other MDBs on an annual basis to monitor and report on progress at the program level based on the revised results framework."

12. Over the past few months, some progress has been made on this front. Through consultations among the MDBs, a lead MDB has been identified for each CTF investment plan. In anticipation of substantial work in this regard, resources have been planned and incorporated into the country programming budget in fiscal year 2015.

Enhanced operational reporting and pipeline management

13. Some operational processes were tailored to serve the ERM requirements in terms of substace and timing. For instance, the timeliness of the MDB operational portfolio reporting and

the CIF Administrative Unit's issuance of semi-annual operational reports are now being recorded, monitored and reported through the ERM dashboard.

14. The operational reporting process and reporting protocol have been further enhanced. The following three practices have been formalized 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

15. Tier 2 risk assessment was planned to be completed for review by the joint meeting of the CTF and SCF Trust Fund Committees in May 2014. Due to delays in recruiting the Senior Risk Management Officer, the 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

16. Lack of integrated financial portfolio and consolidated cash flow management may increase the likelihood of losses and disruption, and diminish effectiveness of decisions and the overall efficiency of the use of funds.

17. Through consultations held in the form of workshops in November and December 2013, it was concluded that Risk 1 is essentially an overall assessment of the stakeholders on whether the financial portfolio management and cash flow management practices allow the governing body to effectively assess and monitor financial status and make informed decisions.

18. As a result, 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

19. Actual credit default (sovereign/private) as well as other financial indicators may exceed CTF cash flow model projections.

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

21. Default rate is one of the key variables in the CTF cash flow model. To assess the expected loss on CTF public and private sector loans, in the absence of CTF portfolio-specific data, the GEMs[1] Credit Data Consortium database was used to determine baseline assumptions on potential losses to be used in the model: 11% for private sector financing and 5% for public sector financing. This is currently being further refined by gathering more detailed information from the MDBs.

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

23. The Trustee is working together with MDBs and the CIF Administrative Unit to refine assumptions on potential losses from specific private sector financing products. As a result, the model would provide better information on the overall CTF projected portfolio to allow the CTF Trust Fund Committee to make more informed decisions on additional phases of the DPSP and other private sector projects and programs.

Risk 3: Credit risk

24. Portfolio loan losses due to defaults or non-payments may exceed the CTF's ability to absorb such losses.

25. Standard Provisions and Principles regarding contributions to the CTF (the "Principles")[2] agreed by all CTF contributors provide for equitable sharing of losses on defaults on outgoing loans by all contributors. It was agreed that losses on defaults on all outgoing loans from the CTF will be shared by all contributors 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[3] first. If, at the Recalculation Date[4] (a) the cumulative amount of defaults exceeds (b) the cumulative CTF Net Income, the last two years of repayments to loan contributors will be adjusted for their share of the difference between (a) and (b). Specific formula on how the losses and the CTF Net Income are to be calculated was negotiated by CTF contributors and included in the Principles (paragraph 2.1).

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

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[1] Global Emerging Markets Risk Database (GEMs)
[2] CTF Contributions Agreement, Schedule 2 Standard Provisions Applicable to the CTF and Appendix A to Schedule 2 Principles regarding CTF Contributions
[3] CTF Net Income refers to net investment income, interests received on outgoing loans and guarantee fees in excess of 0.75% and any reflows from any other financial products (other than grants) received in excess of 0.75% after deducting the principal amount of funding.
[4] Recalculation Date means the date falling two years and one month prior to the final maturity date of each loan contribution.

26. The CTF ERM Dashboard presents a snapshot of potential loan losses and CTF Net Income at the Recalculation Date as it was projected from the CTF cash flow model in 2011, 2012, 2013, and 2014 (Figure 1). The 2014 projection shows that projected CTF Net Income would be sufficient to cover potential loan losses at the 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).

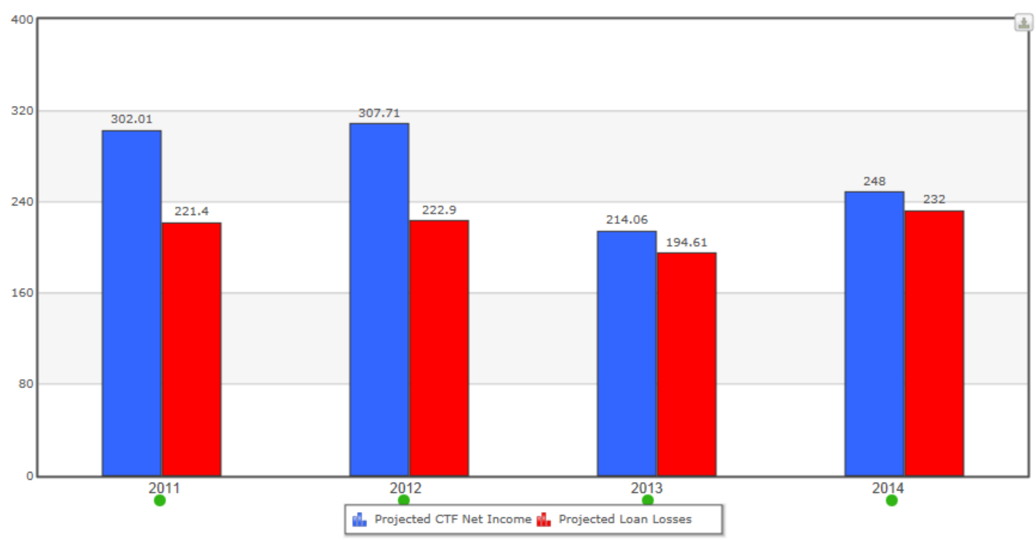
27. The main drivers of the decrease in the margin are the following:

a) Changes in the projected and actual CTF investment income: the rate of investment income was projected to be 1.25% in 2011, higher than the actual annual investment income to date of 0.86% [this rate is now used to update the projected investment income];

b) Changes in market conditions for returns on private sector lending: the projected average interest rate decreased from 2% in 2011 to 1.26% in 2014, which reflects the average rate of actual outgoing private sector loans to date; and

c) Changes in the projected potential loan loss rate for the private sector portfolio: the loss rate has increased from 10% to 11%, based on data extracted from the GEMs database.

Figure 1: Projected CTF Net Income and Loan Loss



28. As noted above under Risk 2: Credit risk, there has been no reported case of default to date. In addition, as presented in Risk 4 the CTF liquidity balances are projected to exceed the prudential minimum liquidity level established by the Trustee.[5]

[5] 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.

Proposed Actions to Mitigate Risk:

29. Proposed Action 1: Refine loss rates and private sector returns assumptions in the CTF cash flow model: The Trustee is working together with MDBs and CIF Administrative Unit to refine the assumptions in the CTF cash flow model regarding potential losses and returns from specific private sector financing products. In order to make these adjustments, MDBs, subject to confidentiality requirements, would provide the Trustee with information on financial products and financing terms (expected interest/return rates, tenor and grace period, as applicable, and projected disbursement profiles) and potential loss rates of private sector projects/programs in the pipeline. MDBs' inputs will then be used to produce aggregate weighted average parameters for each financing instrument in the CTF private sector portfolio. The CTF cash flow model would then be updated with these new assumptions, and as a result, would be more closely aligned with the actual investments.

30. 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

31. CTF interest rates available to borrowers may not have the appropriate level of concessionality; adverse exchange rate movements may create a significant negative impact on CTF's ability to fund project/program portfolio.

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

33. Foreign exchange risk: Commitments made by the Trustee to the MDBs are based on cash and promissory note balances. The portion of commitments made on the basis of promissory notes is subject to foreign exchange risk until the promissory note is encashed and the proceeds are converted into US$. In order to provide a buffer in the event that the Trust Fund may not have sufficient funds to disburse against commitments already made by the Trustee, as a result of unfavorable foreign exchange movements, a portion of the unencashed promissory note balances (15%, or US$ 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.

34. 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.

35. While the financial reserve helps mitigate the foreign exchange risk, it limits the extent of funding commitment authority and may accelerate the timeframe for when the CTF will run into funding shortages. A detailed elaboration is provided in Risk 6: Pledge risk.

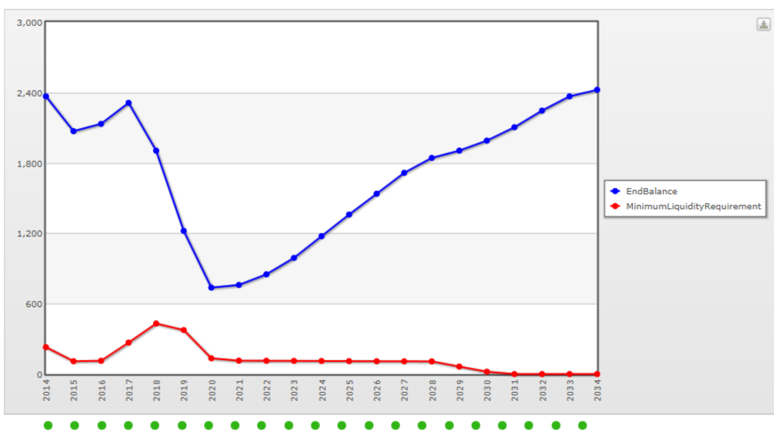
Risk 5: Asset liability management risk

36. Liquidity may not be sufficient to meet the CTF's obligations to repay loan contributors and/or obligations to MDBs; excessive cash reserves may result in disruptions to pipeline management.

37. Maintaining an adequate level of liquidity is critical for the CTF Trust Fund. It allows CTF Trust Fund to meet the CTF's obligations to repay loan contributors and/or obligations to MDBs.

38. As of December 31, 2013, the CTF cash balance was US$ 2.8 billion, four times the minimum liquidity level required to service the interest payments to loan contributors for the following twelve months and projected disbursements in the following six months (US$ 0.7 billion). 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 (Figure 2), which has demonstrated the CTF's solid financial condition in terms of cash liquidity. The fund's minimum cash balance of $308m is reached in 2020, as shown in Figure 2, and is much higher through the life of the fund.

Figure 2: Projection of CTF Cash Balance and Prudential Minimal Liquidity Requirement



Operational/Strategic Risks

Risk 6: Pledge risk

39. Funding pledged by contributors may not materialize in a timely manner.

40. As of March 31, 2014, out of US$ 5.24 billion total CTF pledges[6], 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 reduced the outstanding balance of pledge and payment to US$ 438 million, 8% of the total CTF pledges.

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[6] Represents realized amounts plus unrealized amounts valued on the basis of exchange rates as of March 31, 2014.

41. The recent withdrawal of Australian Government from the CIF has no financial implications as Australia did not seek any return of its fully paid contribution to the CIF.

Risk Management Issue: Potential Funding Shortage for CTF

42. Table 1 presents projected funding availability taking into account projected inflows from donors and estimated funding approvals according to the projects pipeline as updated by MDBs.

Table 1: Clean Technology Fund Resources - Allocations

CLEAN TECHNOLOGY FUND RESOURCES - ALLOCATIONS					
CTF - FY2014/FY2015		**Projected Contributions**	**Indicative Allocations**	**Resources Balance**	**Status**
Projected Mar 2014 Resources Balance				1,153.5	
FY2014	4th quarter	206.0	744.8	614.7	
FY2015	1st quarter	-	218.6	396.1	
	2nd quarter	91.3	410.1	77.3	
	3rd quarter	-	220.5	(143.2)	
	4th quarter	201.0	73.1	(15.3)	
	TOTAL	**498.3**	**1,667.1**	**(15.3)**	

Key:

Available funding is more than $300 million	
Funding is critical and is less than $300 million	
No available funding	

43. Table 1 shows that based on current estimates, the CTF may not have sufficient funds to approve project proposals starting in early 2015, assuming projects are submitted as planned and no additional funding will be made available aside from projected payments shown in the table above. This calculation includes additional resources made available in December 2013 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.

44. 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.

45. 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 mitigation of the two risks: Foreign exchange risk and the risk of funding shortage.

46. 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:

47. 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).

48. It is important to note that a significant amount of resources have been committed to sub-projects within the approved CTF private sector programs that remain pending approval by the MDB Board for a substantial amount of time. The CTF Administrative Unit and the MDB Committee hold detailed review meetings on a quarterly basis to closely monitor the pipeline development. The latest one took place in April 2014.

49. Proposed Action 2: Active Contribution Management: The potential funding shortage also calls for proactive 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 mitigating foreign exchange risks.

Risk 7: Misuse of funds risk

50. Recognizing that each MDB has robust procedures in place to mitigate the misuse of funds, MDB reporting on actual misuse of funds to the Committee may not be timely. This may result in the Committee's inability to effectively respond to such an event.

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

52. In an effort to reflect the timeliness of reporting such incidents, the CIF Administrative Unit has been in consultation with MDBs to better understand MDBs' processes in this regard, and to determine the appropriate timing for 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 CTF Trust Fund Committee.

Risk 8: Impact risk

53. Inability to deliver the expected programmatic impact as defined by CTF objectives, investment criteria, and the results framework.

54. As stated in document CTF-SCF/TFC.8/5, enhancing country coordination mechanisms, MDB collaboration, and stakeholder engagement at the country level is essential to not only delivering high quality investments, but also to maintaining the programmatic approach at the country level. Country-ownership for the CIF programming process and its results is fundamental to the CIF's success.

55. Through consultations with MDBs, a lead MDB has been identified for each of the CTF investment plans. 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.

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

57. 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.

58. A dedicated guideline document, entitled "Note on activities of 'lead MDBs' in Support of the Development and Implementation of CIF Investment Plans" has been developed by the CIF Administrative Unit and intends to provide clarity and guidance in this regard.

59. Recognizing there is a substantial amount of work to be conducted in this regard, resources have been incorporated into the proposed country programming budget in fiscal year 2015.

60. As the work program progresses, more information related to the country coordination mechanism, lead government agency, stakeholder forum and ultimately the results framework will be collected and reflected on the ERM dashboard.

Operational

Risk 9: Operational portfolio risk

61. Insufficient or untimely information hinders the Committee's ability to make risk informed decisions.

62. Recognizing Risk 9 is by nature an overall view and perception of the stakeholders on whether the information on the operational portfolio is sufficient and timely to allow the Committee to make risk informed decisions. Similar to Risk 1, the surveying approach is used to measure Risk 9. A draft survey questionnaire has been posted on the ERM Dashboard. It is proposed that the survey, including questionnaire for both Risk 1 and Risk 9, be conducted six months after the first release of the ERM Dashboard (October 2014) and every six to twelve months thereafter.

63. In addition, to reflect the timeliness of the MDB operational portfolio reporting and CIF Administrative Unit's issuance of semi-annual operational reports, the ERM Dashboard has captured this information to monitor the status.

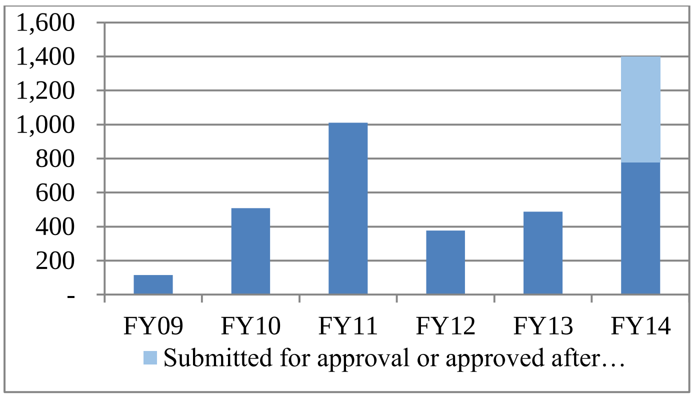
Risk 10: Pipeline management risk

64. Optimistic forecasts and uncertainties of project forecasting may lead to suboptimal use of CTF funds.

65. 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.

66. 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%. See Figure 3 for funding approval by the Trust Fund Committee over time. Development of CTF projects and programs has considerably accelerated during FY14, resulting in a record level of funding approvals.

Figure 3: Trust Fund Committee Funding Approval by Fiscal Year (US$ Million)



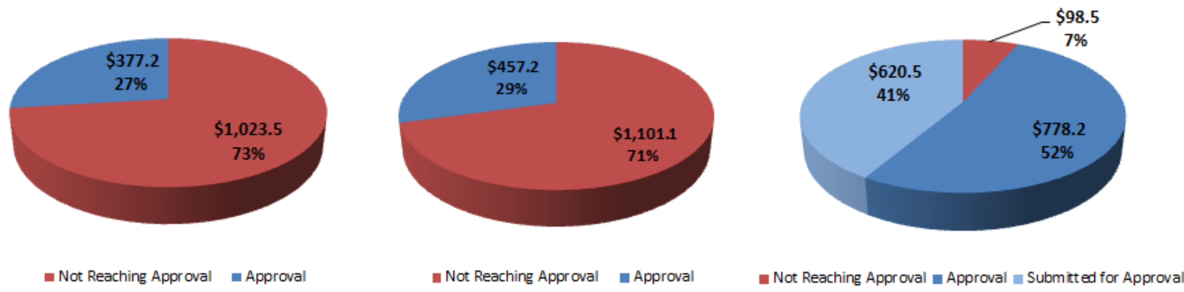
67. Table 2 and Figure 4 show the projected and actual project submission for committee funding approval.

Table 2: Project Funding Approval (Projection vs. Actual) (US$ Million)

FY12			FY13			FY14 *			
Projected Approvals	Actual Approvals	%	Projected Approvals	Actual Approvals	%	Projected Approvals	Actual Approvals (as of 3/31)	Submitted for Approval (as of 5/31)	%
1,400.7	377.2	27%	1,558.3	457.2	29%	1,497.2	778.2	620.5	93%

*For FY14, the projected and actual approvals are from July 1, 2013 to Mar. 31, 2014.

Figure 4: Project Funding Approval (Projection vs. Actual) (US$ Million)



Risk 11: Financing terms risk

68. Lack of active management and tracking of the financing terms for projects may result in a situation where the level of concessionality is inappropriate and/or the distribution of terms within the portfolio does not comply with the Principles Regarding Contributions to the CTF.

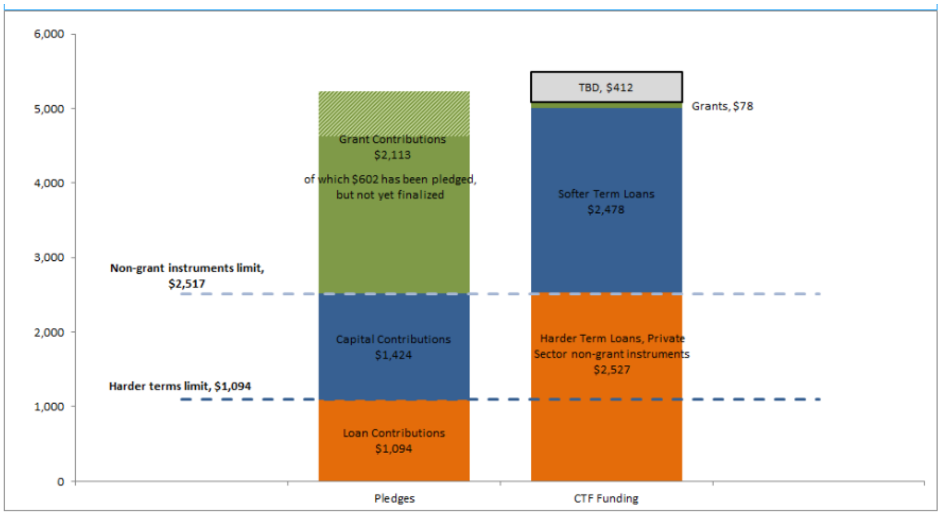
69. *Harder terms limit* (to ensure that loan contributions be used to finance loans and other financial products, such as guarantees, on terms no more concessional than the terms of the contributions)

70. Under the CTF Trust Fund, loan contributions (US$ 1,094 million) may be used to finance loans and other financial products, such as guarantees, on terms no more concessional than the terms of the loan contributions. The target in this case is to reach or exceed this level. As of December 31, 2013, US$ 554.5 million was approved for public sector harder terms concessional loans. In addition, US$ 209.1 million was approved (and deals signed) for private sector projects using terms no less concessional than the loan contributions. The CTF pipeline includes harder concessional loans and private sector loans amounting to US$ 1,763 million, bringing the total expected funding in terms no more concessional than the loan contributions to US$ 2,527 million. Therefore, the risk of not complying with the stated terms is low.

71. *Non-grant instruments limit* (to ensure that capital contributions be used to finance concessional loans and other financial products, such as guarantees, and that loan contributions be used to finance loans and other financial products, such as guarantees, on terms no more concessional than the terms of the loan contributions)

72. The terms of the CTF Trust Fund requires that US$ 2,517 million be used to finance concessional loans and other financial products, such as guarantees. As of December 31, 2013, US$ 1,483.7 million was approved for public sector softer terms concessional loans. In addition, projects in the pipeline at amount of US$ 994.3 million are indicated as softer concessional loans. Adding other public and private sector non-grant instruments as mentioned in paragraph 53, the non-grant funding to date (approved projects and projects in the pipeline) amounts to US$ 5,005 million. This amount exceeds by a large margin the target.

Figure 5: CTF Funding Limit



CTF Funding Limits:
Harder Terms Limit ●
Non-Grant Instrument Limits ●

● *CTF funding for non-grant instruments exceeds limit by 100% or more* ● *CTF funding for non-grant instruments exceeds limit by less than 100%* ● *CTF funding for non-grant instruments is equal or less than the limit*

PART II

STRATEGIC CLIMATE FUND

I. INTRODUCTION

73. In September 2013, the CTF and SCF Trust Fund Committees approved the documents entitled "Updates to the Elaboration of an Enterprise Risk Management Program for the Climate Investment Funds" including revised Tier 1 risks and "Duties and Responsibilities of a Senior Risk Management Officer".

74. The document "Duties and Responsibilities of a Senior Risk Management Officer" stipulates that the Senior Risk Management Officer will "prepare and present annual reports and mid-term updates focused on critical risk management related issues and progress in addressing such issues. The annual reports should document and present observations on the implementation of the Enterprise Risk Management (ERM) framework, should track remediation progress, and may include recommendations and suggested action plans."

75. This report is written in response to the above requirement, with an aim to providing the SCF Trust Fund Committee with an update on the progress of implementing the ERM, risk management related issues and suggested action plans.

II. PROGRESS ON ERM FRAMEWORK IMPLEMENTATION

CIF Enterprise Risk Management (ERM) Dashboard

76. On November 13, 2013, the joint meeting of the CTF and SCF Trust Fund Committees requested that the Trustee and the CIF Administrative Unit ensure that the IT work necessary to support the dashboard commence as early as possible with a view to running a testing phase of the full dashboard in the first quarter of 2014.

77. With great efforts and excellent collaboration among the Trustee, the CIF Administrative Unit and the MDBs, 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.

78. The operationalization of the ERM Dashboard has effectively implemented the following risk mitigation actions identified in the paper "Update to the elaboration of an enterprise risk management program for the Climate Investment Funds" dated August 22, 2013:

a) Develop a Portfolio Risk Dashboard to enable an integrated view of financial statistics and indicators with outputs from the Cash Flow model (Risk 1: Financial management portfolio risk)

b) Trustee will provide in the Portfolio Risk Dashboard the (i) actual default rates and the impact on cash flows, if any; and (ii) allocation of actual losses to each contributor. (Risk 3: Credit risk)

c) Reporting on the status of pledges will be included in the Portfolio Risk Dashboard. (Risk 6: Pledge risk)

79. Further enhancements will be made to the ERM Dashboard in fiscal year 2015 in discussion with the CTF and SCF Trust Fund Committee members.

Senior Risk Management Officer

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81. The CIF Administrative Unit undertook a process to recruit the position in accordance with the World Bank recruitment procedures. Through this process, a highly qualified candidate was identified and offered the position. Unfortunately, at the end of March 2014, after lengthy deliberations, the candidate did not accept the position.

82. 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

83. Risk 8: Impact risk requires that "For each investment plan, a lead MDB should be agreed on by the country and the MDBs. The lead MDB will consult with the country and other MDBs on an annual basis to monitor and report on progress at the program level based on the revised results framework."

84. Over the past few months, some progress has been made on this front. Through consultations among the MDBs, a lead MDB has been identified for each SCF investment plan. Several pilot countries[7] have organized stakeholder meetings reviewing the progress with the wider stakeholder community in the country.

85. In anticipation of substantial work in this regard, resource needs have been planned and incorporated into the country programming budget in fiscal year 2015.

Enhanced operational reporting and pipeline management

86. Some operational processes were tailored to serve the ERM requirements in terms of substance and timing. For instance, the timeliness of the MDB operational portfolio reporting and the CIF Administrative Unit's issuance of semi-annual operational reports are now being recorded, monitored and reported through the ERM dashboard.

[7] FIP pilot countries include Mexico and Indonesia. PPCR country includes Samoa.

87. The operational reporting process and reporting protocol have been further enhanced. The following three practices have been formalized 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

88. Tier 2 risk assessment was planned to be completed for review by the joint meeting of the CTF and SCF Trust Fund Committees in May 2014. Due to delays in recruiting the Senior Risk Management Officer, the 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

89. Lack of integrated financial portfolio and consolidated cash flow management may increase the likelihood of losses and disruption, and diminish effectiveness of decisions and the overall efficiency of the use of funds.

90. Through consultations held in the form of workshops in November and December 2013, it was concluded that Risk 1 is essentially an overall assessment of the stakeholders on whether the financial portfolio management and cash flow management practices allow the governing body to effectively assess and monitor financial status and make informed decisions.

91. As a result, Risk 1 is measured by surveying stakeholders to determine whether the current ERM Dashboard sufficiently addresses their major risk areas. A draft survey questionnaire has been posted on the ERM Dashboard. It is currently envisaged that the survey will be conducted six months after the first release of the ERM Dashboard and every six to twelve months thereafter.

Risk 2: Credit risk

92. Portfolio loan losses due to defaults or non-payments may exceed the SCF's ability to absorb such losses.

93. 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).

94. 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

95. SCF interest rates available to borrowers may not have the appropriate level of concessionality; adverse exchange rate movements may create a significant negative impact on SCF's ability to fund project/program portfolio.

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

97. Foreign exchange risk: Commitments made by the Trustee to the MDBs are based on cash and promissory note balances. The portion of commitments made on the basis of promissory notes is subject to foreign exchange risk until the promissory note is encashed and the proceeds are converted into US$. In order to provide a buffer in the event that the Trust Fund may not have sufficient funds to disburse against commitments already made by the Trustee, as a result of unfavorable foreign exchange movements, a portion of the unencashed promissory note balances (15%, or US$ 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.

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

99. While the financial reserve helps mitigate the foreign exchange risk, it limits the extent of funding commitment authority and may accelerate the timeframe for when the SCF will run into funding shortages. A detailed elaboration is provided in Risk 4: Pledge risk.

Operational/Strategic Risks

Risk 4: Pledge risk

100. Funding pledged by contributors may not materialize in a timely manner.

101. As of March 31, 2014, out of US$ 2.29 billion total SCF pledges[8], 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 reduced the outstanding balance of pledge and payment to US$ 153 million, about 6.6% of the total SCF pledges.

102. The recent withdrawal of Australian Government from the CIF has no financial implications as Australia did not seek any return of its fully paid contribution to the CIF.

[8] Represents realized amounts plus unrealized amounts valued on the basis of exchange rates as of March 31, 2014.

103. Table 1 presents the projected funding availability of the SCF taking into account projected contributions and estimated funding approvals according to the pipeline updates by the MDBs. The overall funding situation is positive though it may enter into the yellow light zone (lower than US$ 300 million) in the 2nd quarter of FY2015.

Table 1: SCF Resources and Allocation (in US$ million)

STRATEGIC CLIMATE FUND RESOURCES - ALLOCATIONS					
FY2014/FY2015		Projected Contributions	Indicative Allocations	Resources Balance	Status
Projected Mar 2014 Resources Balance				763.7	
FY2014	4th quarter	112.8	162.2	714.2	
FY2015	1st quarter	6.6	262.7	458.1	
	2nd quarter	4.2	239.2	223.1	
	3rd quarter	-	73.1	150.0	
	4th quarter	70.0	55.0	165.1	
	TOTAL	**193.6**	**792.2**	**165.1**	

Key:

Available funding is more than $300 million	
Funding is critical and is less than $300 million	
No available funding	

Risk Management Issue: Potential Funding Shortage

104. 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 year 2015 or late calendar year 2014 in case the project submissions takes place as expected and there is no additional funding asides from the projected payments shown in Table 2.

Table 2: PPCR Resources and Allocation (in US$ million)

PILOT PROGRAM FOR CLIMATE RESILIENCE RESOURCES - ALLOCATIONS					
FY2014/FY2015		Projected Contributions	Indicative Allocations	Resources Balance	Status
Projected Mar 2014 Resources Balance				119.4	
FY2014	4th quarter	112.8	42.2	190.0	
FY2015	1st quarter	-	115.2	74.8	
	2nd quarter	4.2	95.2	(16.3)	
	3rd quarter	-	5.6	(21.8)	
	4th quarter	70.0	19.0	29.2	
	TOTAL	**187.0**	**277.2**	**29.2**	

Key:

Available funding is more than $100 million	
Funding is critical and is less than $100 million	
No available funding	

105. The potential funding shortage may arise from the following two factors:

a) As described in Risk 4: Foreign exchange risk, the financial reserve that has been set aside by the Trustee (15% of the 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 mitigation of the two risks: Foreign exchange risk and the risk of funding shortage.

b) 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:

106. 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 anticipated, proposals can be identified and solutions can be sought in consultation with the MDB committee (and with the Trust Fund Committee and Sub-committees if need be).

107. Proposed Action 2: Active Contribution Management: The potential funding shortage also calls for active contribution management. As mentioned in paragraph 22 (Foreign exchange risk) funding decisions are made on the basis of available cash and promissory note balances. To protect SCF trust fund commitments from the 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 to ensure 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

108. Recognizing that each MDB has robust procedures in place to mitigate the misuse of funds, MDB reporting on actual misuse of funds to the Committee may not be timely. This may result in the Committee's inability to effectively respond to such an event.

109. To date, there have been no incidents of the misuse of funds reported by the MDBs.

110. In an effort to reflect the timeliness of reporting of such incidents, the CIF Administrative Unit has been in consultation with MDBs to better understand MDBs' processes in this regard, and to determine the appropriate timing for 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

111. Inability to deliver the expected programmatic impact as defined by SCF objectives, investment criteria, and the results framework.

112. As stated in document CTF-SCF/TFC.8/5, enhancing country coordination mechanisms, MDB collaboration, and stakeholder engagement at the country level is essential to not only delivering high quality investments but also to maintaining the programmatic approach at the country level. Country-ownership for the CIF programming process and its results is fundamental to the CIF's success.

113. Through consultations with MDBs, a lead MDB has been identified for most of the SCF investment plans or SPCRs. 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.

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

115. 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 and programmatic manner.

116. A dedicated guideline document, entitled "Note on activities of 'lead MDBs' in Support of the Development and Implementation of CIF Investment Plans" has been developed by the CIF Administrative Unit and intends to provide clarity and guidance in this regard.

117. Recognizing there is a substantial amount of work to be conducted in this regard, resources have been incorporated into the proposed country programming budget in fiscal year 2015.

118. As the work program progresses, more information related to the country coordination mechanism, lead government agency, stakeholder forum and ultimately the progress made against the results framework will be collected and reflected on the ERM dashboard.

Operational

Risk 7: Operational portfolio risk

119. Insufficient or untimely information hinders the Committee's ability to make risk informed decisions.

120. Recognizing Risk 7 is by nature an overall view and perception of the stakeholders on whether the information on the operational portfolio is sufficient and timely to allow the Committee to make risk informed decisions. Similar to Risk 1, the surveying approach is used to measure Risk 7. A draft survey questionnaire has been posted on the ERM Dashboard. It is

proposed that the 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.

121. In addition, to reflect the timeliness of the MDB operational portfolio reporting and CIF Administrative Unit's issuance of semi-annual operational reports, the ERM Dashboard has captured this information to monitor the status.

Risk 8: Pipeline management risk

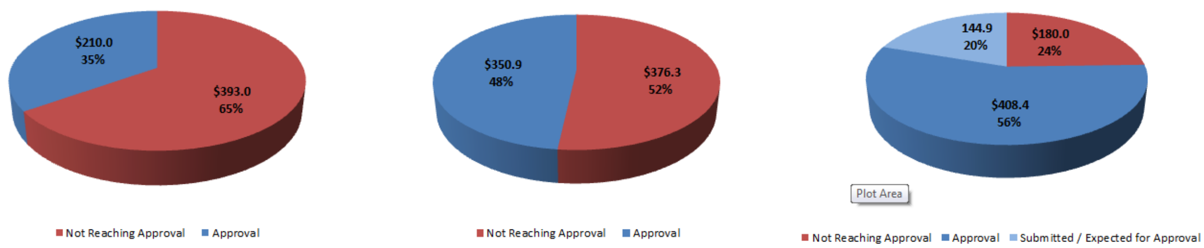
122. Optimistic forecasts and uncertainties of project forecasting may lead to suboptimal use of SCF funds.

Table 3: Strategic Climate Fund

FY12			FY13			FY14 YTD*			
Projected Approval	Actual Approvals	%	Projected Approval	Actual Approvals	%	Projected Approval	Actual Approvals (as of 3/31)	Submitted / Expected for Approval (as of 5/31)	%
603.0	210.0	35%	727.2	350.9	48%	733.2	408.4	144.9	75%

*For FY14, the projected and actual approvals are from July 1, 2013 to Mar. 31, 2014.

Figure 1: Strategic Climate Fund



123. 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.

124. 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.

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

Table 4: Pilot Program for Climate Resilience (PPCR)

FY12			FY13			FY14 YTD*			
Projected Approval	Actual Approvals	%	Projected Approval	Actual Approvals	%	Projected Approval	Actual Approvals (as of 3/31)	Expected for Approval (as of 5/31)	%
445.0	130.8	29%	442.4	289.0	65%	340.4	261.2	28.6	85%

*For FY14, the projected and actual approvals are from July 1, 2013 to Mar. 31, 2014.

Figure 2: Pilot Program for Climate Resilience (PPCR)

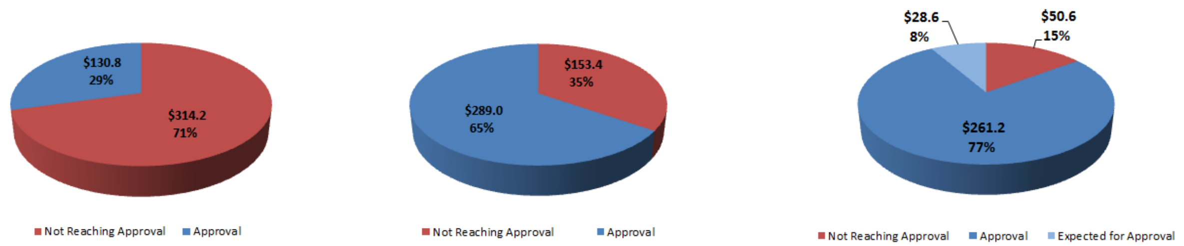


Table 5: Forest Investment Program (FIP)

FY12			FY13			FY14 YTD*			
Projected Approval	Actual Approvals	%	Projected Approval	Actual Approvals	%	Projected Approval	Actual Approvals (as of 3/31)	Expected for Approval (as of 5/31)	%
118.0	45.3	38%	170.8	38.0	22%	265.1	114.3	56.9	65%

*For FY14, the projected and actual approvals are from July 1, 2013 to Mar. 31, 2014.

Figure 3: Forest Investment Program (FIP)

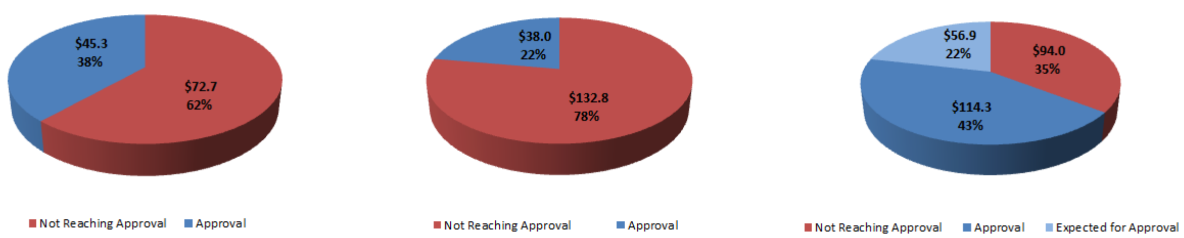
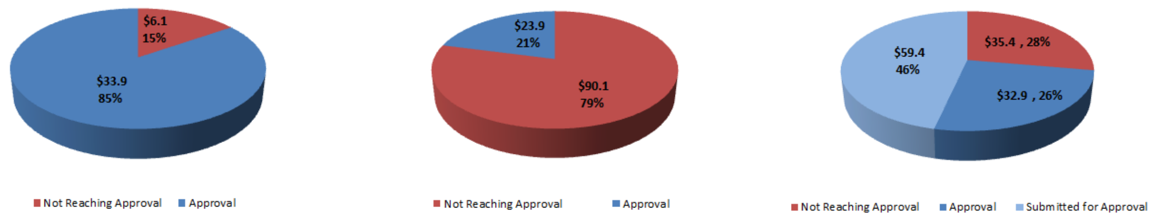


Table 6: Scaling Up Renewable Energy Program (SREP)

FY12			FY13			FY14 YTD*			
Projected Approval	Actual Approvals	%	Projected Approval	Actual Approvals	%	Projected Approval	Actual Approvals (as of 3/31)	Submitted for Approval (as of 5/31)	%
40.0	33.9	85%	114.0	23.9	21%	127.7	32.9	59.4	72%

*For FY14, the projected and actual approvals are from July 1, 2013 to Mar. 31, 2014.

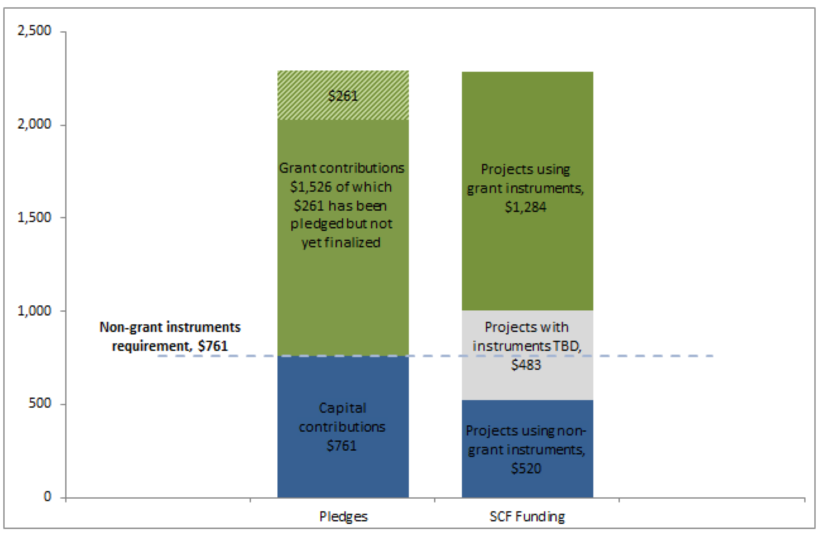
Figure 4: Scaling Up Renewable Energy Program (SREP)



Risk 9: Financing terms risk

126. Lack of active management and tracking of the financing terms for projects may result in a situation where the level of concessionality is inappropriate and/or the distribution of terms within the portfolio does not comply with the Principles Regarding Contributions to the SCF.

Figure 5: Financing Terms risk



127. 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.

128. 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.