

# CLIMATE INVESTMENT FUNDS

FIP/SC.22/4  
May 10, 2019

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Meeting of the FIP Sub-Committee  
Washington DC  
Wednesday, June 5, 2019

Agenda Item 4

## **RISK REPORT OF THE FIP**

## **PROPOSED DECISION**

The FIP Sub-Committee reviewed the document, FIP/SC.22/4, *Risk Report of the FIP*, and welcomes the progress that has been made in advancing the work of the FIP.

The Sub-Committee requests the CIF Administrative Unit to continue to identify, assess, monitor and report the key risk exposures to the program, and to endeavor to enhance the CIF's Enterprise Risk Management (ERM) Framework, including through the following actions and initiatives:

- Assessing, monitoring, and reporting credit risk exposures for each Strategic Climate Fund (SCF); and
- Assessing, monitoring, and reporting interest rate risk exposures for all CIF programs.

## 1 Introduction

1. This report provides an update on assessments of the more significant risk exposures facing the Forest Investment Program (FIP). Data as of December 31, 2018 was used to flag projects for implementation risk and compare them with projects flagged in the previous Risk Report (as of June 30, 2018), with certain projects using more updated information, as indicated in the report. Information as of March 31, 2019 was used to assess the other risks and compare them with risks highlighted in the previous Risk Report (as of September 30, 2018).
2. The following matrix summarizes FIP's key risk exposures.

Summary Risk Matrix as of March 31, 2019 - FIP			
<u>Risk</u>	<u>Likelihood</u>	<u>Severity</u>	<u>Risk Score</u>
Implementation Risk	Possible	Moderate	Medium
Currency Risk	Very Likely	Severe	High
Resource Availability Risk	Very Likely	Severe	High

3. Implementation risk for FIP remained **Medium** as three projects representing USD 66 million of approved funding have been flagged for this risk. The program's implementation risk score has been Medium for the last 4 semiannual reporting cycles
4. Currency risk for FIP remained **High** and the unrealized decline in the value of FIP's uncashed promissory notes remained USD 43 million as reported in the previous reporting cycle. The program's currency risk score has been High for the last 4 semiannual reporting cycles
5. Resource availability risk for FIP is **High**. The shortfall in available grant resources remained USD 29 million, and the shortfall in available capital resources remained USD 21 million. The program's resource availability risk score has been High for the last 4 semiannual reporting cycles.

## 2 Assessment of key risk exposures<sup>1</sup>

6. For FIP, the definition of risk is any threat to the achievement of FIP's objectives. This definition, along with the definition of FIP's objectives, establishes the context for appraising the FIP's risk exposures.

### 2.1 Implementation risk

7. Implementation risk is the risk that a project, once effective, is not implemented in a timely manner. The CIF Administrative Unit flags a project for implementation risk if the project meets at least one of the following two criteria:
  - The project has been effective for 36 months but has disbursed less than 20 percent of approved funds.
  - The project is within 15 months of the date by which all FIP funds are to be disbursed but has disbursed less than 50 percent of approved funds.
8. The MDBs provide this information semi-annually, and the most recent information available is as of December 31, 2018. No private sector projects were flagged.
9. At the program-level, FIP's risk score for implementation risk remained **Medium** as three projects representing USD 66 million of approved funding have been flagged for this risk. At the project-level, each of these three projects has exceeded the program's tolerance for this risk.
10. Table 1 illustrates that one project representing USD 16.5 million of MDB-approved funding has been flagged under the first criterion (vs. two projects totaling USD 38 million as of June 30, 2018). While one of the two projects flagged in June has increased disbursements to above 20 percent of MDB-approved funding (*Integrated REDD+ Project in the Mbuji-Mayi/Kananga and Kisangani Basins – DRC (AfDB)*), the other project (*Decentralized Forest and Woodland Management – Burkina Faso*) remains on the list and is highlighted in orange.

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<sup>1</sup> Severity, in the risk scoring process, is determined (where possible) based on the estimated impact of a risk as a percentage of the program's total pledges and contributions.

- Severe represents an estimated potential impact > 5% of the program's total pledges and contributions.
- Moderate represents an estimated potential impact 1% - 5% of total pledges and contributions.
- Minimal represents an estimated potential impact < 1% of total pledges and contributions.

However, because the impact on funds exposed to implementation risk may simply be delays in the implementation of projects which are ultimately successful (vs. a complete loss of funding for projects as is the case with currency), the following ranges are used to classify implementation risk severity.

- Severe represents an estimated potential impact > 10% of the program's total pledges and contributions.
- Moderate represents an estimated potential impact 5% - 10% of total pledges and contributions.
- Minimal represents an estimated potential impact < 5% of total pledges and contributions.

**Table 1. FIP public sector projects effective for 36 months with less than 20 percent of approved funds disbursed**

COUNTRY	PROJECT TITLE	MDB	FIP Funding (USD million)	Cumulative Disb. FY19-S1	Disbursement Ratio	Effectiveness Date	Months Since Effectiveness Date
Burkina Faso	Decentralized Forest and Woodland Management	IBRD	16.5	2.6	16%	9/1/2014	53

#### 11. Decentralized Forest and Woodland Management – Burkina Faso (World Bank)

- a. Reason(s) for delay: The project is financed by two grants: FIP (USD 16.5 million) and European Union (USD 7 million). The EU grant was prioritized over the FIP grant due to its earlier closing date, set for August 31, 2018. The EU grant was entirely disbursed as of September 1, 2018.

The foreseen increase in FIP-level disbursements to 25 percent before the end of 2018 did not materialize; however, the World Bank team assured that project-level disbursement is now close to 50 percent with 20 percent of the FIP grant disbursed. During the FIP Investment Plan phase, the World Bank team identified that land use planning, land tenure, and land governance are the main indirect causes of deforestation. Therefore, it was important for the Decentralized Forest and Woodland Management project to focus on these issues through a stakeholder participatory approach. This approach includes multiple consultations with decentralized authorities (“communes”), and it is crucial to ensure the appropriate level of ownership by the communes during consultations. Given the onerous processes, these consultations have taken more time than expected. The innovative nature of the participatory approach (phase 1), as well as the political situation in 2015-2016, have delayed the implementation by 12 to 18 months.

- b. Measures underway to accelerate implementation: A mission to evaluate the progress of the communes is expected in mid-2019. If the mission confirms that implementation by the communes is moving forward adequately, an extension of 12 to 18 months may be granted to allow the communes to execute their local investment plans. Otherwise the World Bank team will determine appropriate risk mitigants based on the outcomes of the mission.
- c. Estimated timeframe within which the project will have disbursed 20% of FIP funds: April 30, 2020.

12. Table 2 illustrates that three projects representing USD 66 million of approved funding have been flagged under the second criterion (vs. one representing USD 16 million as of June 30, 2018). *Forest Information to Support Public and Private Sectors in Management Initiatives – Brazil* was also flagged in June and is highlighted in orange.

**Table 2. FIP public sector projects within 15 months of closing with less than 50 percent of approved funds disbursed**

COUNTRY	PROJECT TITLE	MDB	FIP Funding (USD million)	Cumulative Disb. FY19-S1	Disbursement Ratio	Anticipated Dated of Final Disbursement	Months Before Anticipated Last Date of Disbursement	MDB Co-Financing
Brazil	Forest Information to Support Public and Private Sectors in Management Initiatives	IDB	16.5	4.6	28%	12/18/2018	0	0.0
Brazil	Environmental Regularization of Rural Lands in the Cerrado of Brazil	IBRD	32.5	1.3	4%	12/31/2019	12	0.0
Burkina Faso	Decentralized Forest and Woodland Management	IBRD	16.5	2.6	16%	2/28/2020	14	0.0

### **13. Forest Information to Support Public and Private Sectors in Management Initiatives – Brazil (IDB)**

- a. Reason(s) for delay: Approved in December 2013, the project was signed in June 2014 but only began executing in January 2016. This gap was due to the Ministry of Environment's decision to internalize FIP resources. The ratification took over a year to complete and sign (in September 2015). FIP projects executed by external agencies typically do not experience this delay as their resources are not internalized or accounted for in government accounts. Internalizing FIP resources also means the project is subject to different rules and legislation, such as hiring/procurement rules and provisional measures. In December 2016, in light of the economic crisis in Brazil at that time, the President of Brazil ratified a constitutional amendment (Amendment No. 95) that established a ceiling for public spending by all public entities, including international donations internalized by the government. For the Ministry of Environment, spending is capped at BRL 6 million (approximately USD 1.5 million) per year, which made the project infeasible.
- b. Measures underway to accelerate implementation: IDB and the Ministry of Environment of Brazil are working to overcome the challenges represented by the national ceiling for public spending. The project was re-programmed due to the government's annual budget limit, and because there were available resources in the project to be executed. At the request of the Government of Brazil, the project was extended by 24 months with a partial cancellation that reflects government budget ceiling. The amount partially canceled will be redirected to a second phase with the same objective. IDB is already negotiating with a potential executing agency at the request of Government of Brazil to execute Phase 2 to the avoid implementation challenges faced in Phase 1 caused by government internalization of resources.
- c. Estimated timeframe within which project will have disbursed 50% of FIP funds: No updates provided

### **14. Environmental Regularization of Rural Lands in the Cerrado of Brazil (World Bank)**

- a. Reason(s) for delay: The project is facing some budget restrictions due to the internal government processes. In part, the reasons of disbursement delay include the restructuring of the project management unit with a transition of responsibilities from the Ministry of Environment (MMA) to the Ministry of Agriculture (MAPA). Additionally, the BRL/USD exchange rate is a key consideration not only for procurement activities,

but also for the overall disbursement rate. The exchange rate adopted at appraisal was BRL 2.9 per USD, whereas the actual exchange rates used for disbursement were in the range of BRL 3.85 per USD, suggesting that greater implementation is being achieved than indicated by the level of disbursed funds.

- b. Measures underway to accelerate implementation: The Government of Brazil and the World Bank are currently preparing a project restructuring request and an action plan, which will include a partial cancellation. An official request for project restructuring is expected by mid-June 2019.
- c. Estimated timeframe within which project will have disbursed 50% of FIP funds: An estimated timeframe will be reported during the next reporting cycle.

15. **Decentralized Forest and Woodland Management – Burkina Faso (World Bank):** This project was also flagged under the first criterion. See Paragraph 11 for details.

### **2.1.1 MDB cancellation guidelines and criteria**

16. During the December 2017 CIF Trust Fund Committees and Sub-Committees meetings, committee members expressed interest in receiving information pertaining to MDBs' potential decisions to cancel projects. Some MDBs have provided links to their guidelines.

- [ADB – Project Administration Instructions: Suspension and Cancellation of Loans](#)
- [ADB – Externally Financed Grant Regulations Applicable to Grants Financed from a Trust Fund or Other External Sources and Administered by ADB](#)
- [AfDB – Revised Guidelines on Cancellation of Approved Loans, Grants and Guarantees](#)
- [IBRD - Trust Fund Handbook \(see Section 5.9\)](#)

### **2.2 Currency risk via promissory notes**

17. Currency risk via promissory notes is the risk that fluctuations in currency exchange rates will cause the value of the foreign currency in which a promissory note is denominated to decline. FIP's exposure to currency risk remains **High**.

18. There have been no further encashments since September 30, 2018, and GBP 180 million of promissory notes remained outstanding as of March 31, 2019.

19. Table 3 illustrates that it is very likely that FIP will realize a severe (relative to the size of the program) decline in available resources due to the currency risk exposures via GBP-denominated promissory notes. The unrealized decline in the value of the outstanding promissory notes remains USD 43 million.

**Table 3: FIP Currency Risk Exposure Summary**

Program/ Subprogram	Original Amount Pledged/ Received (GBP)	Pledged Amount Outstanding/ Unencashed (GBP)	Realized Currency Gain/ (Loss) (USD)	Unrealized Currency Gain/ (Loss) (USD)	Risk Likelihood	Risk Severity	Risk Score
FIP	223.0	179.6	1.5	(42.8)	Very Likely	Severe	High

## 2.3 Resource availability risk<sup>2</sup>

20. Resource availability risk is the risk that the Trustee will not have sufficient resources, under a respective CIF program, to commit to funding all projects in the program's pipeline. As of March 31, 2019, FIP was experiencing a deficit in available resources of USD 50 million. Table 4 illustrates FIP's available resources (see also Annex A). The shortfall in available grant resources was USD 29 million, and the shortfall in available capital resources was USD 21 million.

**Table 4: FIP resource availability risk summary**

Available Resources as of March 31, 2019				
Program	Available Resources for Projects/Programs (\$Million)*	Risk Likelihood	Risk Severity	Risk Score
FIP Grant	(\$29.0)	Likely	Severe	High
FIP Capital	(\$21.1)			

\*Available Resources for Projects/Programs represent Unrestricted Fund Balance for Project/Program Commitments less Total Anticipated Commitments, as reflected in Annex A.

21. To mitigate this risk, the FIP Sub-Committee, MDBs, and CIF Administrative Unit have all consistently conveyed the message that resource allocations in FIP are not guaranteed during the initial project preparatory stages. The FIP Sub-Committee must approve project/program funding.
22. As of March 31, 2019, USD 43 million of the current capital and grant shortfalls in available resources can be attributed to unrealized declines in the value of FIP's GBP-denominated promissory notes. An additional USD 35 million must be set aside to mitigate over-commitment risk that could result from further declines in the GBP. In the absence of these currency-related factors, FIP would face a moderate shortfall (USD 19 million) in grant resources and a modest surplus (USD 4 million) in capital resources.

<sup>2</sup> Available Resources excludes Currency Reserves as these reserves are not available for the Trustee to commit for programming. Additionally, if, before the remaining promissory notes are cashed, the GBP declines against the USD, some or all of the current amount of the Currency Reserves may never become Available Resources to commit for programming.



## 2.4 External events

23. The project management unit for Indonesia's project, *Promoting Sustainable Community Based Natural Resource Management and Institutional Development – World Bank*, noted in its February 2019 semi-annual report that earthquakes have hampered implementation. Earthquakes and tsunami affected two Forest Management Units (KPH) of the project, namely KPH Rinjani Barat and KPH Dampelas Tinombo.

## 2.5 Fraud and Sexual exploitation and abuse

24. At the February 2019 meeting, the FIP Sub-Committee requested that the MDBs provide to the CIF Administrative Unit information regarding fraud and sexual exploitation and abuse associated with FIP projects implemented by them to the extent that such information is provided to their own MDB boards, and subject to any necessary legal/confidentiality arrangements prior to disclosure.
25. One MDB reported allegations of fraud at the February meeting associated with the *Integrated REDD+ Project in the Mbuji-Mayi/Kananga and Kisangani Basins – DRC*. The project implementation suffered delays related to two allegations of fraud and/or corruption.
- a. AfDB's Integrity and Anti-Corruption Department received a complaint in November 2014 related to the procurement of a consulting firm that would provide services in line with the project's design. The investigation of this complaint lasted until February 2017 when it was determined that the Project Implementation Unit (PIU) should restart the procurement process.
  - b. In January 2018 following the restart of procurement process and submission of all bids to the PIU, AfDB's Integrity and Anti-Corruption Department received a second complaint by one of the bidders that resulted in AfDB allowing for the evaluation to continue but freezing the recruitment of the selected bidder. In November 2018, AfDB recommended closing the complaint as it was determined the allegations were unfounded.
26. Additionally, MDBs issue annual reports on fraud and corruption highlighting statistics related to their anti-corruption efforts. They include the following:
- [ADB – Office of Anti-Corruption and Integrity Annual Report](#)
  - [AfDB – Office of Integrity and Anti-Corruption Annual Report](#)
  - [EBRD – Integrity and Anti-Corruption Annual Report](#)
  - [IDB – Office of Institutional Integrity Annual Report](#)
  - [World Bank Group – Integrity Vice Presidency Annual Report](#)

27. At the CIF Trust Fund Committees and Sub-Committees meetings in January-February 2019, an observer from the Movement for the Survival of the Ogoni People referenced an allegation of sexual exploitation and abuse associated with a FIP project in Kenya. The CIF Administrative Unit has been working diligently to obtain further information related to this allegation, but these efforts have not been successful yet.

### **3 Next steps**

28. In its continuing work to implement the CIF's Enterprise Risk Management (ERM) Framework, the CIF Administrative Unit will endeavor to undertake the following actions and initiatives.

1. Assess, monitor, and report credit risk exposures for each Strategic Climate Fund (SCF) program, now that SCF programs are relying on reflows to cover administrative costs, by end of FY2019.
2. Assess, monitor, and report interest rate risk exposures for all CIF programs.

## Annex A: FIP resource availability

FIP TRUST FUND - RESOURCES AVAILABLE for COMMITMENTS				Total	Capital	Grant
Inception through March 31, 2019 (USD millions)						
Cumulative Funding Received						
Contributions Received						
Cash Contributions			502.1	80.7	421.5	
Unencashed promissory notes	b/		234.9	170.8	64.1	
Total Contributions Received			737.0	251.5	485.5	
Other Resources						
Investment Income earned -up to Feb 1, 2016	c/		14.5	-	14.5	
Total Other Resources			14.5	-	14.5	
Total Cumulative Funding Received (A)				751.5	251.5	500.1
Cumulative Funding Commitments						
Projects/Programs			558.0	151.82	406.1	
MDB Project Implementation and Supervision services (MPIS) Costs			30.0	-	30.0	
Administrative Expenses-Cumulative to 1st Feb 2016	c/		25.6	-	25.6	
Country Programming Budget from 1st Jan 2018	c/		0.3		0.3	
Total Cumulative Funding Commitments			613.9	151.8	462.0	
Project/Program,MPIS and Admin Budget Cancellations	d/		(16.5)	(15.0)	(1.5)	
Net Cumulative Funding Commitments (B)			597.4	136.8	460.6	
Fund Balance (A - B)				154.2	114.7	39.5
Currency Risk Reserves	e/		(35.2)	(25.6)	(9.6)	
Unrestricted Fund Balance ( C )			118.9	89.0	29.9	
Future Programming Reserves:						
Admin Expenses-Reserve (includes Country Programing budget/Learning and Knowledge exchange reserve) and for FY 19-28 (net of estimated investment income and reflows). Breakup of various components are provided below. (Model Updated as of December 31,2017)	f/		(11.6)		(11.6)	
subtract						
Administration Expense reserve for CIFAU, MDB & Trustee		USD 20.9 Million				
Country Programming Budget Reserve		USD 1.6 Million				
Learning and Knowledge Exchange Reserve		USD 1.1 Million				
add						
Estimated Investment Income Share for FIP		USD 5.4 Million				
Projected Reflows		USD 6.6 Million				
Technical Assistance Facility Reserve			(1.1)		(1.1)	
Unrestricted Fund Balance ( C ) after reserves			106.3	89.0	17.2	
Anticipated Commitments (FY19-FY21)						
Program/Project Funding and MPIS Costs			156.4	110.1	46.3	
Total Anticipated Commitments (D)			156.4	110.1	46.3	
Available Resources (C - D)				(50.1)	(21.1)	(29.0)
Potential Future Resources (FY19-FY21)						
Pledges	a/		0.3		0.3	
Contributions Receivable	h/		2.1		2.1	
Potential Technical Assistance Facility Payble	i/		(2.1)		(2.1)	
Release of Currency Risk Reserves	e/		35.2	25.6	9.6	
Total Potential Future Resources (E)			35.6	25.6	10.0	
Potential Available Resources (C - D + E)				(14.5)	4.6	(19.1)
Reflows from MDBs				0.4		0.4

a/ The balance of the pledge amount from the U.S

b/ This amount represents USD equivalent of GBP 179.6 million.

c/ From Feb 1, 2016, Investment income across all SCF programs has been posted to a notional Admin "account", from which approved Administrative Budget expenses for the Trustee, Secretariat and MDBs are committed. The Country Programming budgets are recorded under individual programs.

d/ This refers to cancellation of program and project commitments approved by the SCF TFC

e/ Amounts withheld to mitigate over-commitment risk resulting from the effects of currency exchange rate fluctuations on the value of outstanding non-USD denominated promissory notes.

f/ The amount of this reserve is estimated by the CIFAU and Trustee using the 10-year forecast of the Admin Budget less the 10-year estimate of Investment Income and reflows. Pro-rata estimates across three SCF programs are based on the 22% fixed pro rata share of the FIP's cash balance as at December 31, 2017 approved by the SCF TFC on March 8, 2018. The decision reads as "allocate USD 11.6 million from the available grant resources in the FIP Program Sub-Account to finance estimated Administrative Costs from FY19 to FY28, such that the projected, indicative amount of approximately USD 81.8 million in FIP grant resources remains available for allocation to FIP projects".

g/ The usage of reflow from MDBs are approved by the SCF TFC on March 8, 2018 to cover the shortfall in administrative expenses net of the SCF

h/ Contribution Receivable from Denmark for DKK 14.3 million (USD 2.1M)

i/ The CTF and SCF Trust Fund Committees agreed on July 20, 2018 to establish the Technical Assistance Facility for Clean Energy Investment Mobilization under the terms of the SCF.