Climate Investment Funds

FIP/SC.20/4
May 17, 2018

Meeting of the FIP Subcommittee
Washington D.C.
Thursday, June 7, 2018

Agenda 4

Risk Report of the FIP

I. Highlights

1. At the March 8, 2018, intersessional meeting the Strategic Climate Fund Trust Fund Committee (SCF TFC) agreed that the pause in approval of SCF funding be lifted. Additionally, the SCF TFC agreed that reflows from SCF loans may be used to finance the potential shortfall of grant resources to cover administrative costs after they become available in each program.

Implementation Risk

2. Implementation Risk for the FIP remained **Medium**. Although three projects representing USD 44 million of approved funding had been flagged for this risk as of December 31, 2017, based on subsequent information, this has decreased to two projects representing USD 28 million of approved funding.

Currency Risk

3. Currency Risk for the FIP remained **High**. The GBP appreciated against the USD by 4.6%, causing the unrealized decline in the value of FIP's unencashed promissory notes to decrease to USD 25 million from USD 37 million.

Resource Availability Risk

4. Resource Availability Risk for the FIP remained **High**. The shortfall in available grant resources declined to USD 30 million as of March 31, 2018 from 66 million as of September 30, 2017, and the shortfall in available capital resources declined to USD 10 million from USD 21 million during the period.

Other Updates

5. Since the last TFC Meeting in December, the Risk Analyst joined the CIFAU.

6. The CIFAU has been working to establish information sharing protocols with the MDBs for receiving information pertaining to fraud and corruption related to CIF projects, and has now established such an arrangement with one of the MDBs.

7. This paper provides an update on assessments of the more significant risk exposures facing the FIP. Data as of December 31, 2017, was used to flag projects for Implementation Risk (however in some cases more updated information is available and it is noted in the report when this info is used). Information pertaining to the other risks is as of March 31, 2018.

8. The matrix below summarizes the FIP's key risk exposures as of March 31, 2018.

Summary Risk Matrix as at March 31, 2018			
Risk	**Risk Likelihood**	**Risk Severity**	**Aggregate Risk Score**
Implementation Risk	Possible	Moderate	Medium
Currency Risk	Very Likely	Moderate	High
Resource Availability Risk	Likely	Severe	High

Definition of Risk: Any threat to the achievement of the FIP's objectives.

9. This definition, along with the definition of the FIP's objectives, establish the context for the ERM Framework.

10. Presently, the following represent the three most material risks to which the FIP is exposed.

    i. Implementation Risk
    ii. Currency Risk via Promissory Notes
    iii. Resource Availability

11. The following section provides an update on these risk exposures.[1]

II. ASSESSMENT OF KEY RISK EXPOSURES – FIP

i. Implementation Risk – the risk that, after a project becomes effective, it is not implemented in a timely manner

12. The CIFAU flags a project for implementation risk if the project meets at least one of the following two criteria.

    I. The project has been effective for 36 months, but has disbursed < 20% of approved funds.
    II. The project is within 15 months of closing (i.e. the date by which all CTF funds are to be disbursed), but has disbursed < 50% of approved funds.

13. The MDBs provide this information semi-annually, and the most recent information available is as of December 31, 2017.

[1] 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.

14. The FIP's risk score for implementation risk remains **Medium**.

15. Table 1 illustrates that, two projects (vs. one as of June 30, 2017) representing USD 33 million (vs. USD 16 million as of June 30, 2017) of approved funding have been flagged under the first criterion. Forest Information to Support Public and Private Sectors in Management Initiatives had been previously flagged as of June 30, 2017.

Table 1. FIP Public Sector Projects which have been Effective for 36 months, but have Disbursed < 20% of Approved Funds (USD millions)

Project title	Country	MDB	MDB Approved Funding	Cumulative Disbursement	% Disbursed	Effectiveness Date	Months since Effective
Forest Information to Support Public and Private Sectors in Management Initiatives	Brazil	IDB	16.5	1.8	11%	6/10/2014	43.3
Decentralized Forest and Woodland Management	Burkina Faso	IBRD	16.5	2.0	12%	9/1/2014	40.6

16. <u>Forest Information to Support Public and Private Sectors in Management Initiatives – Brazil</u>: The project, approved in December 2013, was signed in June 2014 but began executing effectively only in January 2016. The delay took place, because Ministry of Environment decided it would internalize the FIP resources and execute the project themselves, differently than other projects that are executed by external agencies and whose resources are not internalized, or accounted for, in government accounts. The ratification took over a year to complete and sign (September 2015). Meanwhile, the project was already considered under implementation. Finally, first disbursement took place December 2015, two years after project approval.

17. Also, because resources were internalized by the government, the project is subject to different rules and legislation, such as hiring rules and provisional measures. Between January and June 2016, disbursements accelerated from 0.7% to 11%, however, in December 2016, in light of the economic crisis in Brazil at that time, the President ratified constitutional amendment No. 95 that established a ceiling for public spending by all public entities including international donations internalized by the government. The new Fiscal Regime has affected a number of projects financed by international donors that are executed by government as it sets a ceiling for how much each Ministry (therefore, each project) can spend per year. For the Ministry of Environment, that amount is 6 million BRL (about USD 1.7 million[2]) per year and impacts 3 other projects.

18. IDB`s procurement specialist has been working very close to the project leader and execution agency to implement an 'acceleration plan' for execution. The Forestry Service has been negotiating with the government for the exclusion of donations from the interpretation of the amendment, and to look for a viable solution to the situation. They have spoken to other organizations which expressed interest in serving as the executing agency but it is still uncertain if this would be feasible.

[2] BRL/USD rate as at 05/07/2018 was 0.28.

19. A disbursement of USD 1.7 million was made in April 2018 increasing the current disbursed percentage to 21 %. The project Forest Information to Support Public and Private Sectors in Management Initiatives – Brazil will no longer be flagged under this criterion.
20. Decentralized Forest and Woodland Management-Burkina Faso: In 2018 Q2, actual disbursements increased to nearly USD 6 million and this project will no longer be flagged under this criterion.

21. Table 2 illustrates that two projects (vs. one as of June 30, 2017) representing USD 28 million (vs. USD 16 million as of June 30, 2017) of approved funding has been flagged under the second criterion. Forest Information to Support Public and Private Sectors in Management Initiatives had been previously flagged as of June 30, 2017.

Table 2. FIP Public Sector Projects within 15 months of Closing, but which have disbursed < 50% of approved funds (USD millions)

Project Title	Country	MDB	MDB Approved Funding	Cumulative Disbursement	% Disbursed	Final Disbursement Date	Months until Final Disbursement Date
Gazetted Forests Participatory Management Project for REDD+ (PGFC/REDD+)	Burkina Faso	AFDB	11.5	4.3	37%	6/30/2018	6.0
Forest Information to Support Public and Private Sectors in Management Initiatives	Brazil	IDB	16.5	1.8	11%	12/18/2018	11.7

22. Gazetted Forests Participatory Management Project for REDD+ (PGFC/REDD+) – Burkina Faso: AfDB in cooperation with the beneficiary are working to address the lack of capacity in terms of procurement, and financial and project management. AfDB will extend the project closure date before the end of June 2018. At that time, the dates for final disbursements will be updated accordingly.

ii. Currency Risk via Promissory Notes – 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.

23. There have been no further encashments since September 30, 2017, and GBP 180 million of promissory notes remained outstanding as of March 31, 2018.

24. Since September 30, 2017, the value of the GBP has increased in value by 4.6%.

25. Table 3 illustrates that it is very likely that the FIP will realize a moderate (relative to the size of the program) decline in available resources due to the currency risk exposures via GBP-denominated promissory notes. However, this unrealized decline in the value of the outstanding promissory notes has decreased to USD 25 million from USD 37 million as reported at September 30, 2017 due to the appreciation of the GBP.

Table 3: FIP Currency Risk Exposure Summary

Currency Risk Exposure (Millions) as of March 31, 2018							
Program/ Subprogram	Original Amount Pledged/ Received	Pledged Amount Outstanding/ Unencashed	Realized Currency Gain/ (Loss)	Unrealized Currency Gain/ (Loss)	Risk Likelihood	Risk Severity	Risk Score
FIP	£223.0	£179.6	$1.5	($25.2)	Very Likely	Moderate	**High**

Resource Availability Risk – the risk that the Trustee will not have sufficient resources, under a respective CIF program, to commit to fund all projects in the program's pipeline.

26. At the December 11, 2017 meeting, the SCF TFC, reviewed the Report of the Trustee on the Financial Status of the SCF and noted that the investment income of the SCF Trust Fund was not currently expected to be sufficient to cover the costs of the projected level of administrative services by the CIFAU, MDBs, and the Trustee up to 2028. The Committee requested the CIFAU, working in collaboration with the MDBs and Trustee, to undertake a full analysis which would explore practical options for financing administrative expenses, costs reductions and attribution of administrative expenses amongst the SCF programs. The Committee also decided to pause the approval of any funding within the SCF other than that of project preparation grants, until such time that the Committee had reviewed the analysis and decided on a way forward.

27. At the intersessional meeting held on March 8, 2018, the SCF Trust Fund Committee considered the proposals for addressing the shortfall in the SCF Trust Fund set out in the document entitled Long-term SCF Administrative Costs and Funding Options developed by the CIF Administrative Unit, the MDBs, and the Trustee. The Committee decided on a means to apportion administrative costs between SCF programs and agreed that reflows from SCF loans may be used to finance the potential shortfall of grant resources to cover administrative costs after they become available in each program. The Committee further agreed that the pause in approval of SCF funding be lifted.

28. More specifically, the SCF Trust Fund Committee agreed to allocate USD 11.6 million of FIP's available grant resources to finance estimated administrative costs for the period of FY19 to FY28.

29. From a risk management perspective, currency risk reserves and pledges which have not yet been received are treated as being unavailable for committing to fund projects because these two sources of funds may not be available if the corresponding currency declines substantially or the pledge is never received. Resource availability risk, if not addressed, may result in unmet recipient expectations, and damage to the CIF's reputation.

30. During the period of September 30, 2017 – March 31, 2018, the shortfall in available grant resources declined to USD 30 million as of March 31, 2018 from USD 66 million as of September 30, 2017, and the shortfall in available capital resources declined to USD 10 million from USD 21 million during the period.

Table 4: FIP Resource Availability Risk Summary

Available Resources as of March 31, 2018				
Program/ Subprogram	**Available Resources for Projects/Programs ($Million)***	**Risk Likelihood**	**Risk Severity**	**Risk Score**
FIP (Grant)	($29.7)	Likely	Severe	**High**
FIP (Capital)	($10.2)			

31. The increase in available resources is primarily attributable to the following.

    I. The change in the approach for allocating administrative costs amongst the SCF programs increased grant resources by USD 29 million.
    II. Appreciation of the GBP increased the value of the unencashed promissory notes by USD 12 million capital resources.

32. To mitigate this risk, the TFC, MDBs, and CIFAU have all consistently conveyed the message that resource allocations in FIP are not guaranteed during the initial project preparatory stages, until the project/program is approved by the FIP Subcommittee.

III. Next Steps

33. As the CIFAU continues to implement the CIF's ERM Framework, the CIFAU will endeavor to undertake the following actions and initiatives.

    I. Implement a fraud risk reporting framework with the remaining MDBs by Q2 FY 2019.

    II. Circulate a paper for SC approval, proposing risk tolerance levels for each risk which is identified, assessed, monitored and reported via the risk dashboards by the end of June 2018.

    III. Work with the MDBs to clarify terminology for the private sector equivalent of Effective Date and Financial Closing Date, and explore whether the CIFAU may gather these data points and aggregate private sector projects' exposure to implementation risk by the end of FY 2019.

    IV. Assess, monitor and report credit risk exposures for each SCF program, now that the SCF programs are relying on reflows to cover administrative by Q2 FY 2019.

ANNEX A – RESOURCE AVAILABILITY

FIP TRUST FUND - RESOURCES AVAILABLE for COMMITMENTS ***Inception through March 31, 2018*** ***(USD millions)***		**Total**	**Capital**	**Grant**
Cumulative Funding Received				
Contributions Received				
Cash Contributions		501.1	80.7	420.4
Unencashed promissory notes	b/	252.5	183.6	68.9
Total Contributions Received		753.6	264.3	489.3
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)		**768.1**	**264.3**	**503.9**
Cumulative Funding Commitments				
Projects/Programs		490.5	132.1	358.5
MDB Project Implementation and Supervision services (MPIS) Costs		25.5	-	25.5
Administrative Expenses-Cumulative to 1st Feb 2016	c/	25.6	-	25.6
Total Cumulative Funding Commitments		541.6	132.1	409.5
Project/Program,MPIS and Admin Budget Cancellations	d/	(16.3)	(15.0)	(1.3)
Net Cumulative Funding Commitments (B)		**525.3**	**117.1**	**408.3**
Fund Balance (A - B)		**242.8**	**147.2**	**95.6**
Currency Risk Reserves	e/	**(37.9)**	**(27.5)**	**(10.3)**
Unrestricted Fund Balance (C)		**204.9**	**119.7**	**85.3**
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 as of SCF Committee Decision March 8, 2018)	f/	(11.6)		(11.6)
Unrestricted Fund Balance (C) after reserves		**193.3**	**119.7**	**73.7**
Anticipated Commitments (FY18-FY21)				
Program/Project Funding and MPIS Costs		233.2	129.9	103.3
Total Anticipated Commitments (D)		**233.2**	**129.9**	**103.3**
Available Resources (C - D)		**(39.9)**	**(10.2)**	**(29.7)**
Potential Future Resources (FY18-FY21)				
Pledges	a/	0.3		0.3
Release of Currency Risk Reserves	e/	37.9	27.5	10.3
Total Potential Future Resources (E)		**38.2**	**27.5**	**10.7**
Potential Available Resources (C - D + E)		**(1.6)**	**17.4**	**(19.0)**

Reflows from MBDs	g/	0.3		0.3

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. In accordance with the terms of the Contribution Agreements, if amounts in the notional Admin account are not sufficient to cover Administrative Budgets, the shortfall is pro-rated across programs, based on cash balances. The Country

d/ This refers to cancellation of program and project commitments approved by the committee.

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 committe 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 committee on March 8, 2018 to cover the shortfall in administrative expenses net of the SCF