CLIMATE INVESTMENT FUNDS

FIP/SC.21/4
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FIP RISK REPORT

1 Introduction

1. This report provides an update on assessments of the more significant risk exposures facing FIP. Data as of June 30, 2018 was used to flag projects for implementation risk, with certain projects using more updated information, as indicated in the report. Also, the severity thresholds for assessing implementation risk were broadened in this report to reflect more accurately the nature of this risk. Information as of September 30, 2018 was used to assess the other risks.

2. The following matrix summarizes FIP's key risk exposures.

Summary Risk Matrix as of September 30, 2018			
Risk	**Likelihood**	**Severity**	**Risk Score**
Implementation Risk	Possible	Moderate	Medium
Currency Risk	Very Likely	Severe	High
Resource Availability Risk	Very Likely	Severe	High

3. Implementation risk for FIP is **Medium**, with three projects representing USD 54 million of approved funding flagged for this risk.

4. Currency risk for FIP is **High.** The GBP depreciated against the USD by 7 percent during the period March 31 to September 30, 2018, causing the unrealized decline in the value of FIP's uncashed promissory notes to increase to USD 43 million from USD 25 million.

5. Resource availability risk for FIP is **High**. The shortfall in available grant resources remained at USD 30 million, but the shortfall in available capital resources increased to USD 21 million as of September 30, 2018, from USD 10 million as of March 31, 2018.

6. In July 2018, an initial draft Risk Appetite Statement for FIP was circulated to the FIP Sub-Committee. The final draft incorporating Sub-Committee comments will be circulated for approval in December 2018.

2 Assessment of key risk exposures[1]

7. 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

8. 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.

9. The MDBs provide this information semi-annually, and the most recent information available is as of June 30, 2018.

10. At the *program-level*, the FIP's risk score for implementation risk remains **Medium** as three projects representing USD 54 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.

11. Table 1 illustrates that two projects representing USD 38 million of MDB-approved funding have been flagged under the first criterion (vs. two projects totaling USD 33 million as of December 31, 2017). While one of the two projects flagged in 2017 has increased disbursement to above 20 percent of MDB-approved funding (*Forest Information to Support Public and Private Sectors in Management Initiatives – Brazil*), the other project (*Decentralized Forest and Woodland Management – Burkina Faso*) remains on the 2018 list and is highlighted in orange. Moreover, the Brazil project is flagged under the second criterion (see Table 2).

[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.

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 (USD millions)

Project Title	Country	MDB	Funding Approved by MDB	Cumulative Disbursement (as of June 30, 2018)	Disbursement ratio (as of June 30, 2018)	Effectiveness Date	Months Since effectiveness date	MDB Co-financing (USD millions)
Decentralized Forest and Woodland Management	Burkina Faso	IBRD	16.5	2.3	14%	9/1/2014	47	-
Integrated REDD+ Project in the Mbuji-Mayi/Kananga and Kisangani Basins	DRC	AfDB	21.5	4.0	19%	2/20/2015	41	-

12. **Decentralized Forest and Woodland Management – Burkina Faso (World Bank):** From the total FIP grant of USD 16.5 million, USD 2.3 million has been disbursed, leaving approximately USD 14 million left to be disbursed.

13. 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 has been entirely disbursed as of September 1, 2018. A significant increase in FIP disbursement is foreseen in the coming weeks: 10 percent of the grant (USD 1.6 million) before December 2018 and 25 percent before the end of 2018.

14. The project faced slow disbursement due to unexpected delays in establishing local REDD+ investment plans for each of the 32 communes (valued at approximately USD 0.3 million each). Municipal investment plans are to be completed in 15 months (August 2018 to December 2019), and an upcoming supervision mission is tasked to ensure delivery. Depending on the outcome of the mission, the task team will consider the possibility of extending the project to allow communes sufficient time to execute their plans, pending satisfactory launch of the work.

15. **Integrated REDD+ Project in the Mbuji-Mayi/Kananga and Kisangani Basins – DRC (AfDB):** Most of the project's core activities in the field have not begun due to a lengthy procurement process for acquiring the services of local implementing agencies. The death of the project's task manager in August 2017 also has impacted the project, as well as proceedings from a formal complaint lodged by one of the bidders in January 2018. A closing memo on the complaint is anticipated by December 2018, which will allow the awarding of contracts. A request for a 24-month extension was also submitted to AfDB in August 2018.

16. Disbursements related to other aspects of the project have continued, with the total disbursement rate reaching approximately 24 percent by November 2018. Therefore, **this project will no longer be flagged under this criterion in the next risk report**.

17. Table 2 illustrates that one project representing USD 16 million of approved funding has been flagged under the second criterion (vs. two representing USD 28 million as of December 31, 2017). *Forest Information to Support Public and Private Sectors in Management Initiatives – Brazil* was flagged in 2017 and again in 2018. *Gazetted Forests Participatory Management Project for REDD+ (PGFC/REDD+) – Burkina Faso* is no longer flagged because its closure date was extended to December 2019.

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

Project Title	Country	MDB	Funding Approved by MDB	Cumulative Disbursement (as of June 30, 2018)	Disbursement ratio (as of June 30, 2018)	Financial Closure	Months Until Financial Closure	MDB Co-financing (USD
Forest Information to Support Public and Private Sectors in Management Initiatives	Brazil	IDB	16.5	3.5	21%	12/18/2018	5.7	-

18. **Forest Information to Support Public and Private Sectors in Management Initiatives – Brazil (IDB):** 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 the 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.

19. Internalizing FIP resources also means the project is subject to different rules and legislation, such as hiring/procurement rules and provisional measures. Between January and June 2016, disbursements accelerated from 0.7 to 11 percent; however, 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. The new Fiscal Regime affected a number of projects financed by international donors that are executed by the government as it capped annual spending for each Ministry (therefore, each project). For the Ministry of Environment, spending is capped at BRL 6 million (about USD 1.7 million) per year, which has impacted three other projects. IDB and the Ministry of Environment of Brazil are working to overcome the challenges represented by the national ceiling for public spending.

2.2 Currency risk via promissory notes

20. 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 is now **High**.

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

22. Since March 31, 2018, the value of the GBP has decreased by approximately 7 percent.

23. 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 has increased to USD 43 million from USD 25 million as reported at March 31, 2018.

Table 3: FIP Currency Risk Exposure Summary

Currency Risk Exposure (Millions) as of September 30, 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	£223.00	£179.60	$1.47	($43.36)	Very Likely	Severe	**High**

2.3 Resource availability risk

24. 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. During the period from March 31, 2018 to September 30, 2018, FIP's deficit in available resources increased from USD 40 million to USD 51 million. Table 4 illustrates FIP's available resources (see also Annex A).

25. During the period of March 31, 2018 to September 30, 2018, the shortfall in available grant resources remained at USD 30 million, while the shortfall in available capital resources increased to USD 21 million from USD 10 million during the period.

Table 4: FIP resource availability risk summary

Available Resources as of September 30, 2018				
Program	Available Resources for Projects/Programs ($Million)*	Risk Likelihood	Risk Severity	Risk Score
FIP Grant	($29.7)	Very Likely	Severe	**High**
FIP Capital	($21.4)			

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

26. The decrease in available resources is primarily attributable to the depreciation of the GBP which decreased the value of the uncashed promissory notes by USD 18 million capital resources. This was somewhat offset by modest declines in the reserves which the Trustee is required to set aside to mitigate over-commitment risk which could result from further currency-related losses currency risk reserves, as well as by a modest decline in anticipated commitments.

27. 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.

28. As of September 30, 2018, USD 43 million of the current shortfall 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 20 million) in grant resources and a modest surplus (USD 4 million) in capital resources.

3 Next steps

29. In its continuing work to implement the CIF's ERM Framework, the CIF Administrative Unit will endeavor to undertake the following actions and initiatives.

- Continue to work with the MDBs to implement a fraud risk reporting framework by end of FY2019.
- Investigate the potential to implement a sexual exploitation and abuse risk management framework.
- Assess, monitor, and report credit risk exposures for each Strategic Climate Fund (SCF) program, now that the SCF programs are relying on reflows to cover administrative costs, by end of FY2019.

Annex A – Resource Availability

FIP TRUST FUND - RESOURCES AVAILABLE for COMMITMENTS *Inception through September 30, 2018* *(USD millions)*		Total	Capital	Grant
Cumulative Funding Received				
Contributions Received				
Cash Contributions		501.1	80.7	420.4
Unencashed promissory notes	b/	234.3	170.4	63.9
Total Contributions Received		735.4	251.0	484.4
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)		**749.9**	**251.0**	**498.9**
Cumulative Funding Commitments				
Projects/Programs		553.0	151.8	401.2
MDB Project Implementation and Supervision services (MPIS) Costs		28.9	-	28.9
Administrative Expenses-Cumulative to 1st Feb 2016	c/	25.6	-	25.6
Country Programming Budget from 1st Jan 2018	c/	0.2		0.2
Total Cumulative Funding Commitments		607.7	151.8	455.9
Project/Program,MPIS and Admin Budget Cancellations	d/	(16.3)	(15.0)	(1.3)
Net Cumulative Funding Commitments (B)		**591.4**	**136.8**	**454.6**
Fund Balance (A - B)		**158.5**	**114.2**	**44.3**
Currency Risk Reserves	e/	**(35.1)**	**(25.6)**	**(9.6)**
Unrestricted Fund Balance (C)		**123.4**	**88.7**	**34.7**
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				
Unrestricted Fund Balance (C) after reserves		**111.8**	**88.7**	**23.1**
Anticipated Commitments (FY19-FY21)				
Program/Project Funding and MPIS Costs		162.9	110.1	52.8
Total Anticipated Commitments (D)		**162.9**	**110.1**	**52.8**
Available Resources (C - D)		**(51.1)**	**(21.4)**	**(29.7)**
Potential Future Resources (FY19-FY21)				
Pledges	a/	0.3		0.3
Release of Currency Risk Reserves	e/	35.1	25.6	9.6
Total Potential Future Resources (E)		**35.5**	**25.6**	**9.9**
Potential Available Resources (C - D + E)		**(15.6)**	**4.1**	**(19.7)**
Reflows from MBDs	g/	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 investment income.