

CLIMATE INVESTMENT FUNDS

SREP/SC.19/6
May 16, 2018

Meeting of the SREP Subcommittee
Washington D.C.
June 6, 2018

Agenda 6

RISK REPORT OF THE SREP

I. HIGHLIGHTS

1. At the March 8, 2018, intersessional meeting the 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 SREP increased from **Medium** to **High** as four projects representing USD 59 million of approved funding have been flagged for this risk.

Currency Risk

3. The GBP appreciated against the USD by 4.6%, causing the unrealized decline in the value of SREP's unencashed promissory notes to decrease to USD 28 million from USD 40 million.

Resource Availability Risk

4. The shortfall in available resources declined to USD 66 million as of March 31, 2018 from 81 million as of September 30, 2017.

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 SREP. 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 SREP's key risk exposures as of March 31, 2018.

Summary Risk Matrix as at March 31, 2018			
<u>Risk</u>	<u>Risk Likelihood</u>	<u>Risk Severity</u>	<u>Aggregate Risk Score</u>
Implementation Risk	Possible	Severe	High
Currency Risk	Very Likely	Moderate	High
Resource Availability Risk	Possible	Severe	High

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

9. This definition, along with the definition of the SREP's objectives, establish the context for the ERM Framework.
10. Presently, the following represent the three most material risks to which the SREP 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

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. Table 1 illustrates that four projects (vs. one as of June 30, 2017) representing USD 59 million (vs USD 15 million as of June 30, 2017) of approved funding has been flagged under the first criterion.
15. The SREP's risk score for implementation risk is now **High**.

Table 1. SREP 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 as of Dec 2017	% Disbursed	Effective date	Months since Effective date
Rural Electrification Hybrid Systems	Mali	IBRD	14.9	1.8	12%	6/18/2014	43
Geothermal Sector Development Project (GSDP)	Ethiopia	IBRD	24.5	4.7	19%	8/5/2014	41
Biogas Extended Program	Nepal	IBRD	7.9	0.6	7%	9/15/2014	40
Accelerating Sustainable Private Investments in Renewable Energy (ASPIRE) Program	Maldives	IBRD	11.7	0.7	6%	10/1/2014	40

16. Rural Electrification Hybrid Systems-Mali: Following the completion of the feasibility studies and procurement of the supply, installation and commissioning services for the mini-grids, the project has significantly advanced. Six contracts were signed for 23 sites and the World Bank has given its no objection for the EPC contracts covering 22 additional sites. The implementation of the resettlement action plans for the selected localities is being completed. **The total disbursement level as of April 30, 2018 represented 22 percent of the approved funding.** Disbursements are expected to further accelerate after June 2018, as construction activities will be well underway.
17. The SREP funding is linked to the financing of equipment and infrastructure for the mini-grids, whose construction phase is subject to the completion of preliminary activities, which have experienced significant delays: (i) it took over a year to complete the feasibility and the detailed engineering studies of the sub-projects, (ii) the implementation unit on the government side did not have adequate capacity to manage such complex bidding processes and thus, there were a number of issues related to project management and adherence to procurement policies which had to be addressed. For all these reasons the tendering process took significantly longer than expected.
18. Geothermal Sector Development Project (GSDP) – Ethiopia: Ethiopian Electric Power (EEP), the implementing agency, has chosen to pursue a single contract that covers drilling rigs supply, operation and maintenance to reduce the EEP's risk of managing multiple contractors. Consequently, the bids for drilling rigs supply have been cancelled and a new bidding document has been prepared. The EEP and the World Bank agreed on a revised action plan in November 2017.

19. Project implementation is picking up speed. Major procurement activities are substantially progressing and **disbursement level has increased to 24 percent in April 2018**. The analysis of the results of the outcomes of the procurement packages is expected to be carried out in the coming months and will inform the decision whether it is necessary to restructure the project to reallocate funding across components.
20. Biogas Extended Program – Nepal: A mid-term review of the project conducted in January 2018 showed the project implementation was affected by the limited capacity and knowledge of key stakeholders (developers, technical service providers, investors etc.) in assessing and developing projects, the lack of necessary design and cost benchmarks to guide the decision-making process, as well as a redundant administrative process for verification and disbursement approval. The World Bank and the implementing agency have agreed on specific actions to strengthen project management and streamline approval and administrative processes.
21. Despite these challenges, total number of applications already received (demand generated) for the development of sub-project by the end of January 2018 was 402, which is more than was anticipated to be received for the entire project duration. Additionally, 93 sub-projects were commissioned over the same period. The two largest bio-gas plants in Nepal (each with more than 3500m³ per day of gas generation capacity), as well as several other smaller (more than 90 plants with maximum of 100 m³ generation capacity) projects are operational. Many others are in the pipeline and under-construction. These two projects, being the largest and first of their kind in Nepal, have recently made to the national news. These projects are a good showcase of a successful public private partnership model in Nepal in the otherwise challenging waste/biomass to energy sector. Overall, the SREP bio-gas project has generated interest among the private entities and financing institutions.
22. Accelerating Sustainable Private Investments in Renewable Energy (ASPIRE) Program – Maldives: All contracts for first sub-project are effective, but delays occurred with government processing. A final legal opinion is needed for guarantee effectiveness. The government has committed to expedite its delivery. However, current political turmoil in the country may cause further delays. The World Bank team is following up closely on the legal opinion and is also engaging the government on future plans for new bids. Due to political developments, country missions were suspended. The World Bank team and government are assessing the opportune time to conduct a project mid-term review mission.
23. SREP does not have any projects with material funding which have been flagged under the second criterion.

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.

24. There have been no further encashments since September 30, 2017, and GBP 177 million of promissory notes remained outstanding as of March 31, 2018.
25. Since September 30, 2017, the value of the GBP has increased by 4.6%.
26. Table 2 illustrates that it is very likely that the SREP 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 28 million from USD 40 million as reported at September 30, 2017 due to the appreciation of the GBP.

Table 2: SREP 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
SREP	£268.00	£177.30	(\$15.3)	(\$28.5)	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.

27. At the December 11, 2017 meeting, the Strategic Climate Fund (SCF) Trust Fund Committee, reviewed the Report of the Trustee on the Financial Status of the SCF and noted that the investment income of the SCF Trust Fund is 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 CIF Administrative Unit, working in collaboration with the MDBs and the 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.
28. At the intersessional meeting held on March 8, 2018, the SCF TFC 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 CIFAU, 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.

29. More specifically, the SCF TFC agreed to allocate USD 31.6 million of SREP’s available grant resources to finance estimated administrative costs for the period of FY19 to FY28.
30. During the period of September 30, 2017 – March 31, 2018, SREP’s available resources increased from a deficit of USD 84 million to a deficit of USD 66 million. Table 3 illustrates the SREP’s available resources (see also Annex A).

Table 3: SREP 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
SREP (Grant)	(\$14.8)	Possible	Moderate	High
SREP (Capital)	(\$51.3)	Possible	Severe	

31. The increase in available resources is primarily attributable to the following.
 - I. Appreciation of the GBP increased the value of the unencashed promissory notes by USD 12 million.
 - II. The Kenya Menengai Geothermal (USD 15 million)² and Uganda (USD 32 million) projects were removed from the active (sealed and reserve) pipeline.
 - III. These two factors offset the impact of the addition of the recently endorsed Lesotho IP, with projects equivalent to USD 17 million now added to the sealed pipeline, as well as the inclusion of a reserve for covering net administrative expenses up until 2028.
32. To mitigate this risk, the TFC, MDBs, and CIFAU have all consistently conveyed the message that resource allocations in SREP are not guaranteed during the initial project preparatory stages, until the project/program is approved by the SREP Subcommittee. In addition, active pipeline management by the MDB committee helped mitigate the expanding of the active pipeline beyond available resources.
33. As of March 31, 2018, USD 44 million of the current shortfall in available resources can be attributed to realized and unrealized declines in the value of the SREP’s GBP-denominated promissory notes. An additional USD 37 million must be set aside to mitigate over-commitment risk which could result from further declines in the GBP. In the absence of these currency-related factors, the SREP would not be facing a resource shortfall.

² This is not in reference to the *Kenya Menengai Geothermal Development Project (USD 25 million)* which is already in advanced stages of implementation.

III. NEXT STEPS

34. 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 TFC 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 in 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 costs by Q2 2019.

ANNEX A – RESOURCE AVAILABILITY

SREP TRUST FUND - RESOURCES AVAILABLE for COMMITMENTS				
<i>Inception through March 31, 2018</i>				
<i>(USD millions)</i>				
		Total	Capital	Grant
Cumulative Funding Received				
Contributions Received				
Cash Contributions		513.2	41.9	471.3
Unencashed Promissory Notes	b/	249.2	249.2	-
Allocation of Capital to Grants from Unencashed Promissory Notes	a/		(27.9)	27.9
Total Contributions Received		<u>762.4</u>	<u>263.2</u>	<u>499.2</u>
Other Resources				
Investment Income earned -up to Feb 1, 2016	c/	9.9		9.9
Other Income		-		
Total Other Resources		<u>9.9</u>		<u>9.9</u>
Total Cumulative Funding Received (A)		<u>772.3</u>	<u>263.2</u>	<u>509.1</u>
Cumulative Funding Commitments				
Projects/Programs		553.0	148.9	404.1
MDB Project Implementation and Supervision services (MPIS) Costs		19.4	-	19.4
Administrative Expenses-Cumulative to 1st Feb 2016	c/	14.3	-	14.3
Total Cumulative Funding Commitments		<u>586.7</u>	<u>148.9</u>	<u>437.8</u>
Project/Program, MPIS and Admin Budget Cancellations	d/	<u>(43.2)</u>	<u>(30.5)</u>	<u>(12.7)</u>
Net Cumulative Funding Commitments (B)		<u>543.5</u>	<u>118.4</u>	<u>425.1</u>
Fund Balance (A - B)		<u>228.9</u>	<u>144.8</u>	<u>84.1</u>
Currency Risk Reserves	e/	<u>(37.4)</u>	<u>(33.2)</u>	<u>(4.2)</u>
Unrestricted Fund Balance		<u>191.5</u>	<u>111.6</u>	<u>79.9</u>
Future Programming Reserves:				
Admin Expenses-Reserve (includes Country programming 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/	(31.6)		(31.6)
Unrestricted Fund Balance (C) after reserves		<u>159.9</u>	<u>111.6</u>	<u>48.3</u>
Anticipated Commitments (FY18-FY21)				
Program/Project Funding and MPIS Costs	g/	226.0	126.4	99.6
Total Anticipated Commitments (D)		<u>226.0</u>	<u>126.4</u>	<u>99.6</u>
Available Resources (C - D)		<u>(66.1)</u>	<u>(14.8)</u>	<u>(51.3)</u>
Potential Future Resources (FY18-FY21)				
Release of Currency Risk Reserves	e/	37.4	33.2	4.2
Total Potential Future Resources (D)		<u>37.4</u>	<u>33.2</u>	<u>4.2</u>
Potential Available Resources (C - D + E)		<u>(28.7)</u>	<u>18.4</u>	<u>(47.1)</u>

a/ Promissory Notes amounting to GBP 19.84 million received as capital contributions are available to finance grants (including administrative costs) according to the terms of the contribution agreements/arrangements. The Promissory Notes are valued as of February 28, 2018 exchange rate.

b/ This amount includes USD equivalent of GBP 177.3 million from the UK.

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 Programming budgets are recorded under individual programs.

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 SREP's cash balance as at December 31, 2017 approved by the committee on March 8, 2018. The decision reads as "allocate USD 31.6 million from the available grant resources in the SREP Program Sub-Account to finance estimated Administrative Costs from FY19 to FY28, such that the projected, indicative amount of approximately USD 59.6 million in SREP grant resources remains available for allocation to SREP projects".

g/ Includes both sealed and Reserve pipeline