

CLIMATE INVESTMENT FUNDS

SREP/SC.20/4
December 21, 2018

Meeting of the SREP Sub-Committee
Ouarzazate, Morocco
Friday, February 1, 2019

SREP RISK REPORT

1 Introduction

1. This report provides an update on assessments of the more significant risk exposures facing the Scaling up of Renewable Energy Program in Low Income Countries (SREP). 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 SREP's key risk exposures.

Summary Risk Matrix as of September 30, 2018			
<u>Risk</u>	<u>Likelihood</u>	<u>Severity</u>	<u>Risk Score</u>
Implementation Risk	Possible	Minimal	Low
Currency Risk	Very Likely	Severe	High
Resource Availability Risk	Possible	Severe	High

3. Implementation risk for SREP is **Low**, with one project representing USD 8 million of approved funding flagged for this risk.
4. Currency risk for SREP is **High**. The GBP depreciated against the USD by 7 percent during the period (March 31 – September 30, 2018), causing the unrealized decline in the value of SREP's uncashed promissory notes to increase to USD 41 million from USD 28 million.
5. Resource availability risk for SREP is **High** as the shortfall in available resources increased to USD 98 million as of September 30, 2018 from USD 66 million as of September 30, 2017.
6. In August 2018, an initial draft Risk Appetite Statement for was circulated to the SREP Sub-Committee. The final draft incorporating Sub-Committee comments will be circulated for approval in December 2018.

2 Assessment of key risk exposures¹

7. For SREP, the definition of risk is any threat to the achievement of SREP's objectives. This definition, along with the definition of SREP's objectives, establishes the context for appraising the SREP'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 SREP 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*, SREP's risk score for implementation risk is **Low** as on project representing USD 8 million of approved funding has been flagged for this risk. However, at the *project level*, this project has exceeded SREP's tolerance for this risk.
11. Table 1 illustrates that one project representing USD 8 million of MDB-approved funding has been flagged under the first criterion (vs. four projects totaling USD 59 million as of December 31, 2017). While three of the four projects flagged in 2017 are no longer at risk, having increased disbursement to above 20 percent of MDB-approved funding (*Geothermal Sector Development Project – Ethiopia*, *Aspire – Maldives*, and *Rural Electrification Hybrid Systems – Mali*), the other project remains on the 2018 list and is highlighted in orange.

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. SREP 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)
Biogas Extended Program	Nepal	IBRD	7.9	1.1	14%	9/15/2014	46	0.0

12. **Biogas Extended Program – Nepal (World Bank):** The Project Development Objective (PDO) is “to promote large off-grid biogas generation in Nepal”. The achievement of PDO has been measured by two result indicators: 1) off-grid bio gas generated for thermal application from the large-scale projects (>12m²), and 2) off-grid bio-gas based electricity generated. Due to reduced load shedding in Nepal, subproject developers’ interest in investing in bio-gas based electricity generation system has diminished. They are now more focused on generating bio-gas for thermal application.

13. The bulk of SREP funds (USD 6.9 million out of USD 7.9 million) is used to reimburse partially the Government of Nepal for funds paid as subsidies (capital cost buydown) for completed and commissioned subprojects. The funds are only drawn once the projects are commissioned and operational, however the cumbersome project approval and verification processes have led to delays. On the commercial side, despite the healthy subproject pipeline (392 projects have already been approved out of 429 applications received), only 124 sub-projects have been commissioned (out of 138 completed). The World Bank and the implementing agency are putting in place specific actions to increase the number of projects reaching the construction and commissioning stage, including 1) technical assistance for design and cost benchmarks to guide the decision-making process and enhance the capacity of the stakeholders to assess and develop projects, and 2) project restructuring to streamline the sub-project approval and verification processes.

14. SREP has no projects flagged under the second criterion.

2.2 Currency risk via promissory notes

15. 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. SREP’s exposure to currency risk is now **High**.

16. There has been a further encashment of GBP 20 million since March 31, 2018, and GBP 157 million of promissory notes remained outstanding as of September 30, 2018. This encashment caused *realized* currency-related losses to increase to USD 20 million from USD 15 million.

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

18. Table 2 illustrates that it is very likely that SREP 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 41 million from USD 28 million as reported at March 31, 2018.

Table 2: SREP 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
SREP	£268.0	£157.5	(20.4)	(41.3)	Very Likely	Severe	High

2.3 Resource availability risk

19. Resource availability risk is 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. During the period from March 31, 2018 to September 30, 2018, SREP’s deficit in available resources increased from USD 66 million to USD 98 million. Table 3 illustrates SREP’s available resources (see also Annex A).

Table 3: SREP resource availability risk summary

Available Resources as of September 30, 2018				
Program	Available Resources for Projects/Programs (\$Million)*	Risk Likelihood	Risk Severity	Risk Score
SREP** Grant	(\$40.4)	Possible	Severe	High
SREP** Capital	(\$57.9)			

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

**SREP's resource availability is based on both the sealed and reserve pipelines.

20. The decrease in available resources is primarily attributable to the following.

- Depreciation of the GBP decreased the value of the uncashed promissory notes by USD 18 million (somewhat offset by a USD 7 million decline in the reserves which the Trustee is required to set aside to mitigate over-commitment risk which could result from further currency-related losses).
- Two new projects in Madagascar representing USD 21 million (*Funding scheme for rural electrification by renewable energy plants and mini-grids and Funding scheme for hybridization of the JIRAMA priority isolated centers*) were added to the reserve pipeline, following the endorsement of the Madagascar SREP Investment Plan in June 2018.

21. To mitigate this risk, the SREP Sub-Committee, MDBs, and CIF Administrative Unit have all consistently conveyed the message that resource allocations in SREP are not guaranteed during the initial project preparatory stages. The SREP Sub-Committee must approve project/program funding.
22. As of September 30, 2018, USD 62 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 31 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, SREP's resource shortfall would be minimal.

3 Next steps

23. 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

SREP TRUST FUND - RESOURCES AVAILABLE for COMMITMENTS				
<i>Inception through September 30, 2018</i>				
<i>(USD millions)</i>				
		Total	Capital	Grant
Cumulative Funding Received				
Contributions Received				
Cash Contributions		539.2	67.9	471.3
Unencashed Promissory Notes	b/	205.4	205.4	-
Allocation of Capital to Grants from Unencashed Promissory Notes	a/	(25.9)	(25.9)	25.9
Total Contributions Received		744.5	247.3	497.2
Other Resources				
Investment Income earned -up to Feb 1, 2016	c/	9.9		9.9
Other Income		-		
Total Other Resources		9.9		9.9
Total Cumulative Funding Received (A)		754.5	247.3	507.1
Cumulative Funding Commitments				
Projects/Programs		622.7	190.9	431.8
MDB Project Implementation and Supervision services (MPIS) Costs		20.6	-	20.6
Administrative Expenses-Cumulative to 1st Feb 2016	c/	14.2	-	14.2
Country Programming Budget expense from 1st Jan 2018	c/	0.2		0.2
Total Cumulative Funding Commitments		657.7	190.9	466.8
Project/Program, MPIS and Admin Budget Cancellations	d/	(43.2)	(30.5)	(12.7)
Net Cumulative Funding Commitments (B)		614.5	160.4	454.1
Fund Balance (A - B)		140.0	87.0	53.0
Currency Risk Reserves	e/	(30.8)	(26.9)	(3.9)
Unrestricted Fund Balance		109.2	60.0	49.2
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). Breakup of various components are provided below. (Model Updated as of December 31, 2017)	f/	(31.6)		(31.6)
Subtract				
Administration Expense reserve for CIFAU, MDB & Trustee		USD 37.9 Million		
Country Programming Budget Reserve		USD 2.2 Million		
Learning and Knowledge Exchange Reserve		USD 1.1 Million		
Add				
Estimated Investment Income Share for SREP		USD 9.0 Million		
Projected Reflows		USD 0.6 Million		
Unrestricted Fund Balance (C) after reserves		77.6	60.0	17.6
Anticipated Commitments (FY19-FY21)				
Program/Project Funding and MPIS Costs	g/	175.9	100.4	75.5
Total Anticipated Commitments (D)		175.9	100.4	75.5
Available Resources (C - D)		(98.3)	(40.4)	(57.9)
Potential Future Resources (FY19-FY21)				
Release of Currency Risk Reserves	e/	30.8	26.9	3.9
Total Potential Future Resources (D)		30.8	26.9	3.9
Potential Available Resources (C - D + E)		(67.5)	(13.4)	(54.0)

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 September 30, 2018 exchange rate.

b/ This amount includes USD equivalent of GBP 157.5 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. 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 SREP's cash balance as at December 31, 2017 approved by the SCF TFC 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