GREEN CLIMATE FUND

Meeting of the Board
30 September – 2 October 2017
Cairo, Arab Republic of Egypt
Provisional agenda item 12

GCF/B.18/05

11 September 2017

GCF risk management framework

Proposal by the Risk Management Committee

Summary

In decision B.17/11, the Board adopted the first set of components of the risk management framework (RMF) and requested the Secretariat to continue with the development of the RMF and its remaining components in consultation with the Risk Management Committee and to present these for consideration of the Board at its eighteenth meeting.

Through the same decision at its seventeenth meeting, the Board also requested the Secretariat to further develop the risk dashboard and the underlying methodologies for consideration by the Board at its eighteenth meeting and to publish the risk dashboard every quarter thereafter.

This document presents the Risk Management Committee's proposal on the second set of components of the risk management framework and the update to the risk dashboard.

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I. Introduction

1. Through decision B.17/11, the Board adopted the first set of components of the risk management framework (RMF) and requested the Secretariat to continue with the development of the RMF and its remaining components in consultation with the Risk Management Committee (RMC) and to present these for consideration of the Board at its eighteenth meeting.

2. The Board, in decision B.17/11, also requested the Secretariat to further develop the risk dashboard and the underlying methodologies for consideration by the Board at its eighteenth meeting and to publish the risk dashboard every quarter thereafter.

3. In addition, through the same decision at its seventeenth meeting, the Board requested the Secretariat to continue with the development of appropriate risk rating models with support from an external professional service provider and in consultation with the RMC and to present the risk rating models for consideration by the Board at its nineteenth meeting.

II. Actions taken

4. To fulfil the risk-related mandate given by the Board, the Secretariat continued with the development of the remaining components of the RMF with the support of Oliver Wyman, an internationally reputable consulting firm.

5. In the process of developing the risk-related policies within the RMF, the Office of Risk Management and Compliance (ORMC), together with Oliver Wyman, gathered feedback on the risk-related policies from relevant divisions within the Secretariat. The risk policies and the revised approach to reporting on country concentration within the risk dashboard were developed under the guidance of the RMC.

6. The RMC reviewed the following documents:

(a) The risk dashboard, with a revised approach to reporting on country concentration;

(b) The non-financial risk policy;

(c) The funding risk policy; and the

(d) The investment risk policy.

7. Following the review of the above components of the RMF, the RMC decided to submit them to the Board for its consideration.

8. In addition, the initial investment framework approved through decision B.07/06 paragraph (a) and contained in document GCF/B.07/11, annex XIV, states that funding received and extended by the GCF will be accounted for in grant-equivalent terms based on a standard methodology, to be developed by the GCF based on best international practices, to provide an accurate comparison of funding amounts between financial instruments. The Secretariat thus developed a grant equivalent calculator with the support of Oliver Wyman and provided informational sessions on the grant equivalent calculator to divisions within the Secretariat, the senior management team and the RMC.

9. The RMC reviewed the proposed grant equivalent calculator and agreed that it is a useful tool for the Secretariat's internal review of funding proposals and for portfolio analysis. The RMC therefore decided to present the grant equivalent calculator to the Board for informational purposes.

III. Objective

10. The purpose and use of the RMF is to provide:

(a) Greater clarity on the risks inherent in individual decisions and the day-to-day functioning of the GCF, enabling the Board to make appropriate trade-offs;

(b) Greater consistency in decisions across the organization, tied together by the Board's views on what are the key risks, how much risk is acceptable and how the risks should be managed;

(c) A more assured path towards achieving the mandate of the GCF (with well understood likelihood and impact of risks); and

(d) Faster decision-making enabled by clarity and consistency (e.g. the RMF provides clarity to accredited entities and the Secretariat on what funding proposals should include from a risk perspective, resulting in more comprehensive and higher quality funding proposals developed with less back and forth).

IV. Recommended action by the Board

11. It is proposed that the Board adopts the draft decision as set out in annex I.

Annex I: Draft decision of the Board

The Board, having reviewed document GCF/B.18/05 titled “GCF risk management framework”:

(a) *Decides* to update component III of the risk management framework “Risk dashboard with revised approach to reporting on country concentration” as set out in annex II to this document;

(b) *Requests* the Secretariat to publish the updated risk dashboard every quarter hereafter;

(c) *Adopts* the second set of components of the risk management framework as contained in annexes III to V to this document as follows:

(i) Risk management framework component V – non-financial risk policy, as set out in annex III;

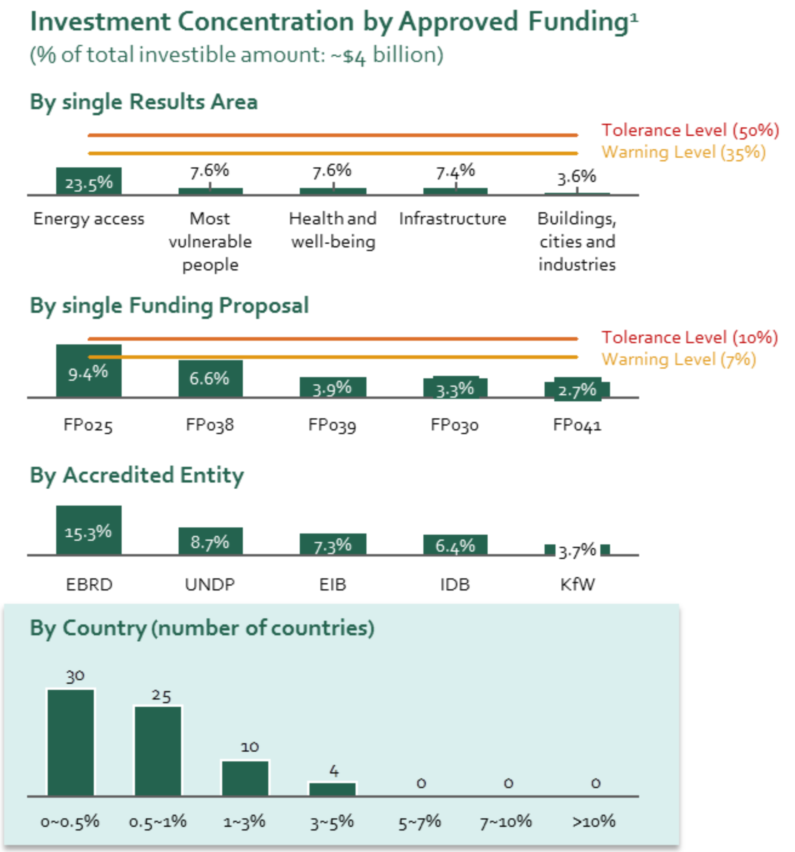
(ii) Risk management framework component VI – funding risk policy, as set out in annex IV; and

(iii) Risk management framework component VII – investment risk policy, as set out in annex V;

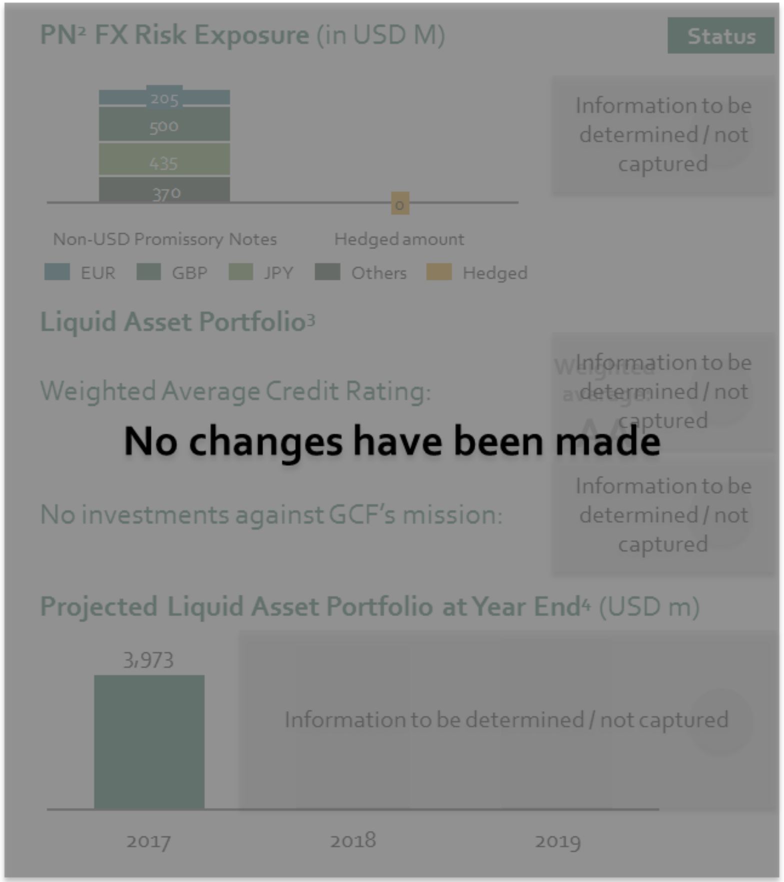
(d) *Takes note* of the grant equivalent calculator developed by the Secretariat and presented to the Board at its eighteenth meeting in response to the request by the Board contained in the initial investment framework adopted pursuant to decision B.07/06, paragraph (a); and

(e) *Recognizes* that the risk management framework will evolve over time and shall be subject to periodic updates and may be supplemented by additional policies which shall be adopted by the Board.

Annex II: Risk dashboard with revised approach to reporting on country concentration



Updated country concentration section of the Risk Dashboard



Source: iPMS, GCFTF Financial Report (as of 31 Mar 2017), GCF Division of Support Services (DSS) – Finance, Status of Initial Resource Mobilization process (B.16/Inf.10), GCF Report on Audits of Financial Statements for year ended Dec 31, 2016
1. Ratios measured as (Notional amounts approved / total investible amount). **As of Mar 2017, the denominator is USD 4 billion. Numerators are collected from iPMS, as of 25 May 2017**. Projects/programmes spanning across multiple countries, results areas, etc. are split equally among them, as specific allocation proportion is not available; 2. Promissory Notes deposited to the GCF as of Mar2017, based on Financial Report by the Interim Trustee. Other non-USD promissory notes includes Swedish Krona; 3. If the Interim Trustee is unable to implement these requirements, they will become applicable after the selection of the Permanent Trustee. Until that time, the GCF should monitor the Fund's adherence to these requirements to the extent possible under the current agreement; 4. Calculated as cash + Promissory Notes to be encashed in 2017.

Annex III: Non-financial risk policy

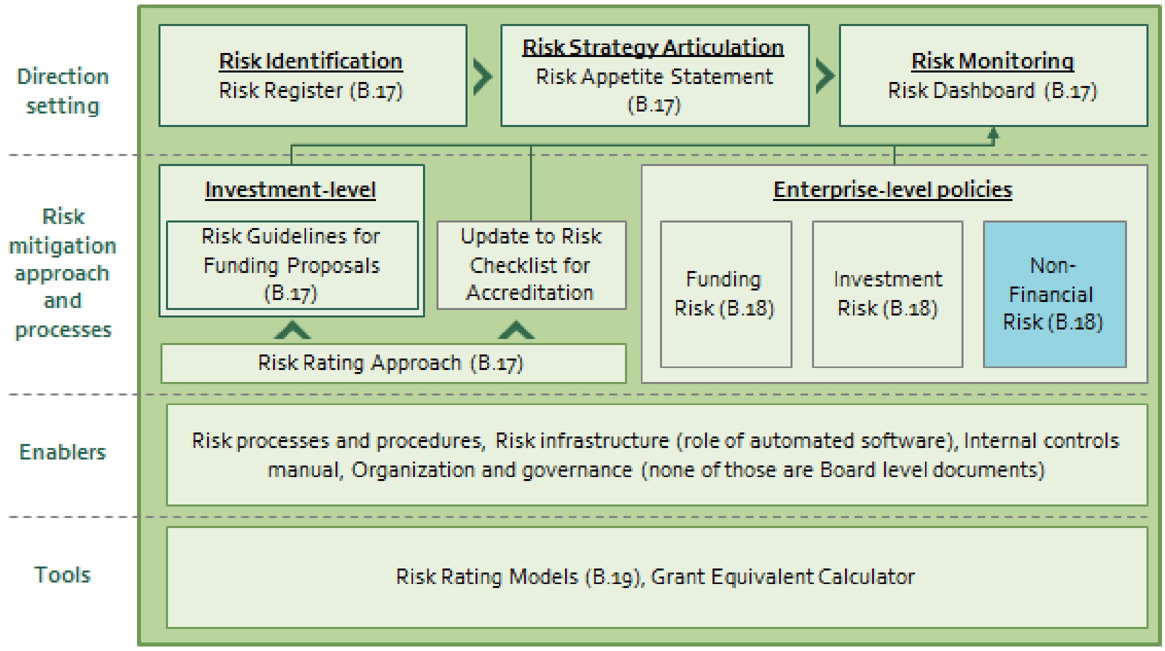
I. Introduction

1. This document presents a critical element of the Risk Management Framework ("RMF"), the policy governing non-financial risk management for the GCF.

II. Objectives and scope

2. This document, the Non-financial Risk Policy ("policy"), is a part of the comprehensive RMF – the components of the framework are presented below in Figure 1.

Figure 1: RMF components



3. Non-financial Risk is defined as the potential for financial and non-financial losses arising from the failure of people, process, or technology or the impact of external events. It covers the following risk types defined in the Risk Register:

(a) **GCF Operational Error Risk:** Failure to meet the GCF's internal operations standards or non-compliance with external requirements such as country laws or international agreements that are applicable to operations activities;

(b) **Staffing Risk**: Operational failures, losses and other disruptions arising from the staffing model of the GCF, including staff headcount level and external consultants as well as from problems with recruitment, retention, succession planning, integrity and morale among the GCF staff;

(c) **Disasters and Other Events Risk**: Disruption of business due to natural or man-made catastrophic disasters;

(d) **IT Systems Failure Risk:** Disruption of business due to unavailability / inaccessibility of IT infrastructure and applications;

(e) **Cyber Attack Risk**: Misappropriation of internal data and/or information by a third party through IT means, such as system security breach, hacking, phishing attacks, cybercrime, and malware / virus attacks; and

(f) **Reputation Risk**: Adverse perception which has a material effect on the credibility of the GCF (beyond the reputational damage which may be incurred due to one of the other risks in the Risk Register).

4. IT Systems Failure Risk and Cyber Attack Risk are hereinafter collectively referred to as "IT Risk".

5. The management approach to Disasters and Other Events Risk is described under Business Continuity Management ("BCM") in Section V of this policy. BCM is a broader programme aimed at ensuring business continuity through the prevention and mitigation of Operational Error Risk events and IT Risk events.

6. This policy design is guided by the following principles:

(a) Ensuring sustainable financial viability for the Fund and enabling the Fund to meet its mission of promoting paradigm shift towards low-emission and climate-resilient development pathways;

(b) Adhering to the Fund's Risk Appetite Statement (part of the RMF) for Operational and IT Risk;

(c) Establishing fit for purpose controls and ensuring efficiency in risk management; and

(d) Allocating roles and responsibilities in line with the Three Lines of Defense framework:

(i) **First Line of Defense ("First Line")**: The first responsibility of risk management and control is with the accountable units who are the primary owners and managers of risk;

(ii) **Second Line of Defense ("Second Line")**: For each risk, there is a Second Line of Defense, or a control function independent of the First Line to ensure risks are managed given asymmetric incentives, short-termism, and optimism of risk takers; and

(iii) **Third Line of Defense ("Third Line")**: The Third Line of Defense focuses on review of the action and interactions of the risk taker and risk controller, and assurance that the RMF is operating as intended.

7. The detailed roles and responsibilities of the First and Second Lines are set out in sections IV, V, VI, and VII below. The Third Line will develop and perform scheduled and ad-hoc audits, reviews, and assurance engagements, in order to gain assurance that the design and implementation of policies and procedures by the First and Second Lines are managing the Fund's risks appropriately.

III. Policy governance

8. The Office of Risk Management and Compliance ("ORMC") is the author and owner of the Non-financial Risk Policy. The Board is the approver of the policy. The ORMC must submit any updates or changes to this policy for review by the Senior Management Team ("SMT") and RMC and approval by the Board. This policy must be reviewed every two years, but earlier reviews and updates may be conducted based on the ORMC's discretion, and based on direction from the RMC or the Board.

IV. Roles and Responsibilities: GCF Operational Error Risks and IT Risks

9. As Operational Error Risk arises from all GCF's activities, an Operational Risk Owner for each operational process should be identified.

10. The following are the GCF's key activities and functions responsible (which the Secretariat deems most appropriate).[1] The heads of each function are responsible for nominating the Operational Risk Owners for all operational processes:

(a) Accreditation process: Country Programming Division ("CPD");

(b) Funding Proposal ("FP", "proposal") review process: Private Sector Facility ("PSF") and Division of Mitigation and Adaptation ("DMA"), for private and public proposals, respectively;

(c) Interim processes between Funding Proposal approval and signing a Funded Activity Agreement ("FAA"): Office of General Counsel ("OGC");

(d) Disbursement process: Chief Finance Officer (CFO); and

(e) Monitoring and evaluation: Portfolio Monitoring Unit ("PMU").

11. Other processes requiring an Operational Risk Owner include: Review process for other proposal types (PPFs, Readiness),[2] Human Resources ("HR") processes, Procurement processes, and other Finance processes (such as cash flow management and FX hedging).

12. Operational Risk Owners are the First Line of Defense for Operational Risks. They are responsible for the following:

(a) Providing information to the Second Line required to populate the Operational Risk section of the Risk Dashboard, which the Second Line will share with the SMT, RMC, and the Board on a quarterly basis;

(b) Ensuring all material risks are identified, assessed, mitigated, and monitored (i.e. conducting a Risk Control Self-Assessment ("RCSA"));[3]

(c) Proposing and implementing control enhancements, in line with the GCF Risk Appetite;

(d) Setting the right tone for the risk management culture in internal communications and performance objectives;

(e) Reporting on monitoring metrics (identified in the RCSAs) to the Second Line;

(f) Reporting each risk event to the Second Line together with a proposed assessment of impact level[4] and a proposal for changes in controls (if required);

(g) Conducting a deeper investigation into risk events, if requested by the SMT or the Office of the Executive Director ("OED"), and preparing a plan for strengthening controls; and

(h) Implementing any plan for strengthening controls.

13. IT Risks arise from all IT systems used by the GCF. The Secretariat will nominate an IT Risk Owner.[5]

[1] The Secretariat may choose other divisions for these processes over time.
[2] Readiness includes National Adaptation Plans; PPF: Project Preparation Facility.
[3] Appendix I specifies further steps applicable to each RCSA.
[4] The impact levels "Low", "Somewhat non-disruptive", "Somewhat disruptive" and "High" have been defined in GCF's Risk Register.
[5] The IT Risk Owner will likely belong to Information and Communications Technology ("ICT") within Division of Support Services ("DSS"), and will likely be nominated by the Head of ICT.

14. IT Risk Owners are the First Line of Defense for IT risks. The IT Risk Owner is responsible for the following:

(a) Providing information to the Second Line required to populate the IT Risk section of the Risk Dashboard, which the Second Line will share with the SMT, RMC and the Board on a quarterly basis;

(b) Conducting an IT systems review (using the RCSA steps described in Appendix I) every three years to identify material risks;

(c) Proposing and implementing control enhancements, in line with the GCF Risk Appetite;

(d) Setting the right tone for the risk management culture in internal communications and performance objectives;

(e) Reporting on monitoring metrics (identified in the RCSAs) to the Second Line;

(f) Reporting each risk event to the Second Line together with a proposed assessment of impact level and a proposal for changes in controls (if required);

(g) Conducting a deeper investigation into risk events, if requested by the RMC or the Board, and preparing a plan for strengthening controls; and

(h) Implementing any plan for strengthening controls.

15. An RCSA must be conducted annually for high priority processes[6] and at least once in three years for lower priority processes.

16. The Second Line of Defense for Operational and IT Risk is the ORMC, which has the following responsibilities:

(a) Reviewing the Risk Dashboard results for Operational and IT Risk;

(b) Prioritizing processes (annually) on which RCSAs are conducted, and selecting the risk events posing the highest risk levels for further mitigation;

(c) Reviewing and confirming RCSA outputs, and the proposed control enhancements;

(d) Finalizing the impact level of risk events and reporting "High" and "Somewhat disruptive" impact events to the RMC and the OED immediately together with recommendations for further action. When considered necessary, the RMC may recommend (to the OED) that the Operational Risk Owner or the IT Risk Owner for the risk event conduct a deeper investigation and prepare and implement a plan for strengthening controls;

(e) Challenging the plan for strengthening controls and sharing the plan and the progress against the plan with the RMC. The RMC may recommend (to the OED) that the Operational Risk Owner or the IT Risk Owner modify the plan and report the plan and progress against it to the Board at the RMC's discretion;

(f) Advising governance bodies on key risks, the effectiveness of mitigants and controls, and alignment of residual risks with the risk appetite; and

(g) The Second Line will build its view, independent of the First Line, on any action required for improving the Fund's Operational and IT Risk management and strengthening its adherence to the Risk Appetite Statement. This view will be discussed with the First Line, reviewed and finalized with the OED and then shared with the RMC on a quarterly basis. This view will be shared with the Board at the RMC's discretion.

17. The Third Line of Defense for Operational and IT Risk is the Office of the Internal Auditor ("OIA").

[6] Defined in Appendix I: Risk Control Self-Assessment.

V. Business Continuity Management

18. The Heads of all GCF divisions are responsible for reporting to the ORMC without undue delay, after they become aware of it, any risk event covered by this policy that threatens the safety and security of the GCF's operations.

19. The OED serves as the Crisis Director with the authority to confirm that the risk event occurring should be classified as a business disruption event and decide on the necessary measures and response plan upon the occurrence of that event. The Crisis Director is supported by the Security Task Force ("STF")[7] in this role.

20. The Crisis Director will notify all units of the Fund immediately upon occurrence and confirmation of a business disruption event. The ORMC will immediately report the business disruption event to the RMC.

21. The STF is responsible for developing business continuity plans to be executed upon occurrence of a business disruption event, and establishing a remote work model for the GCF operations during disruptions events. The business continuity plans should be reviewed by the RMC.

22. The ORMC works with HR to conduct trainings for the GCF staff for business continuity management.

VI. Reputation Risk Management

23. Reputation Risk refers to the risk of adverse public perception which has a material effect on the credibility of the GCF.

24. Reputation Risk arises from not only GCF's activities, but also the public perception that may follow breaches in tolerance levels for all other risk types specified in the GCF Risk Register.

25. The Secretariat will nominate a Reputation Risk Owner. The Reputation Risk Owner is responsible for the following:

(a) Providing information to the Second Line required to populate the Reputation Risk section of the Risk Dashboard, which the Second Line will share with the SMT, RMC and the Board on a quarterly basis;

(b) Maintaining and implementing a Communications Plan that actively tries to mitigate reputation risk;

(c) Monitoring various sources of information relevant to Reputation Risk including:

  (i) Print and electronic media;

  (ii) Quarterly review of the Risk Dashboard for monitoring the GCF's performance against tolerance levels for other risk types that could result in Reputation Risk for the GCF; and

  (iii) The Operational and IT Risk database.[8]

(d) Developing and implementing a Response Plan for any "High" or "Somewhat disruptive" impact Reputation Risk threats (a Response Plan will definitely be required for any

[7] As of May 2017, consists of the CFO, Head of DSS, and Facility Safety Manager. The Risk Manager will also be a part of the STF.
[8] When the database becomes available.

reputation risk events stemming from underlying risks for which the GCF has zero risk tolerance, per the GCF Risk Appetite Statement);

(e) Maintaining a list of approved individuals who are authorized to engage with the media on behalf of the GCF. Those individuals must be authorized by the heads of their respective GCF divisions; and

(f) Collaborating with the Second Line to ensure that when developing controls for managing risks for which the GCF has zero risk tolerance per its Risk Appetite Statement, approaches to manage reputation risk arising from such risk events are also built in.

26. The heads of all GCF divisions are responsible for reporting to the Reputation Risk Owner any threats they foresee to the GCF's reputation. This threat will be taken into account by the Reputation Risk Owner in developing the Communications Plan and any Response Plan.

27. The ORMC plays the Second Line of Defence role, and is responsible for the following in mitigating reputation risk:

(a) Finalizing the impact level of risk threats, and reporting "High" and "Somewhat disruptive" events immediately to the RMC and OED with recommendations for further action;

(b) Reviewing the Risk Dashboard results for Reputation Risk; and

(c) Reviewing and challenging the Communication Plan or Response Plan prepared by the Reputation Risk Owner from a risk perspective, and tracking the GCF's progress against the plan.

VII. Staffing Risk Management[9]

28. Maintaining a Secretariat staff with appropriate skills and qualifications in line with the principles and guidelines set out in the Administrative Guidelines on Human Resources or any successor guidelines or policy is one of the main tenets of effective risk management at the GCF.

29. The Secretariat will nominate a Staffing Risk Owner. The Staffing Risk Owner is responsible for the following:

(a) Providing information to the Second Line required to populate the staffing risk section of the Risk Dashboard, which the Second Line will share with the SMT, RMC, and the Board on a quarterly basis;

(b) Providing the Second Line with a timely update on any key staffing risks, such as those that may be identified through regular processes including staff evaluations and engagement evaluations;

(c) Reviewing staff complaints to identify any systematic themes;

(d) Developing succession plans; and

(e) Taking into account the Administrative Guidelines on Human Resources and other relevant guidelines or policies in force when dealing with matters related to staffing risk.

30. The ORMC plays the Second Line of Defence role, and will be responsible for:

(a) Reviewing the GCF Risk Dashboard results, results of staff engagement evaluations and recommended action plan and succession plan; and

[9] This section will be reviewed when the updated Administrative Guidelines on Human Resources is approved by the Board.

(b) Building its view, independent of the First Line, on any action required for improving the Fund's Staffing risk management and strengthening its adherence to the Risk Appetite Statement. This view will be discussed with the First Line, reviewed and finalized with the OED and then shared with the RMC on a quarterly basis. This view will be shared with the Board at the RMC's discretion.

VIII. Effective date

31. The Policy takes effect on 1st January 2018.

Appendix I: Risk Control Self-Assessment

1. The goal of the RCSA is to ensure all significant Operational and IT Risk exposures are contained within acceptable boundaries. Operational Risk Owners / IT Risk Owners are responsible for conducting an RCSA for the processes and risks within their remit.

2. Each RCSA includes the following four steps:[10]

(a) Risk identification: The aim of risk identification is to prepare a comprehensive list of all risk events relevant to the process / IT risk;

(b) Risk assessment and analysis: The aim of risk analysis is to form a preliminary view of the risk likelihood and impact for each type of risk event identified;

(c) Risk control and mitigation: Operational Risk Owners / IT Risk Owners are responsible for developing mitigation plans. These plans must detail out the controls, outline the execution steps, the resource requirements and the estimated costs. The plans will also include an assessment of the residual risk likelihood and impact; and

(d) Risk monitoring: Operational Risk Owners / IT Risk Owners are responsible for identifying the key risk indicators and warning signals for the process / IT risk.

3. Each RCSA output includes the following:

(a) Risk Events relevant for the process / IT risk events;

(b) Impact and residual impact;[11]

(c) Likelihood and residual likelihood[12] of occurrence;

(d) Priority and residual priority: The relative importance to the organization of each risk based on the combination of probability of occurrence and impact;

(e) Mitigation actions: Mechanisms that should be in place to reduce the probability of occurrence, or to reduce the impact of, each type of risk if it were to occur; and

(f) Key Risk Indicators: Measures used to indicate how risky an activity is.

4. Each RCSA output must be reviewed and challenged by the ORMC. Each final RCSA output must be shared with the RMC which may share it with the Board or the remaining members of the Secretariat at its discretion.

[10] RCSA steps will be detailed further in the Internal Controls Manual (part of the RMF).
[11] The impact levels "Low", "Somewhat non-disruptive", "Somewhat disruptive" and "High" have been defined in GCF's Risk Register.
[12] The likelihood levels "High", "Somewhat likely", "Somewhat unlikely" and "Low" have been defined in GCF's Risk Register.

Annex IV: Funding risk policy

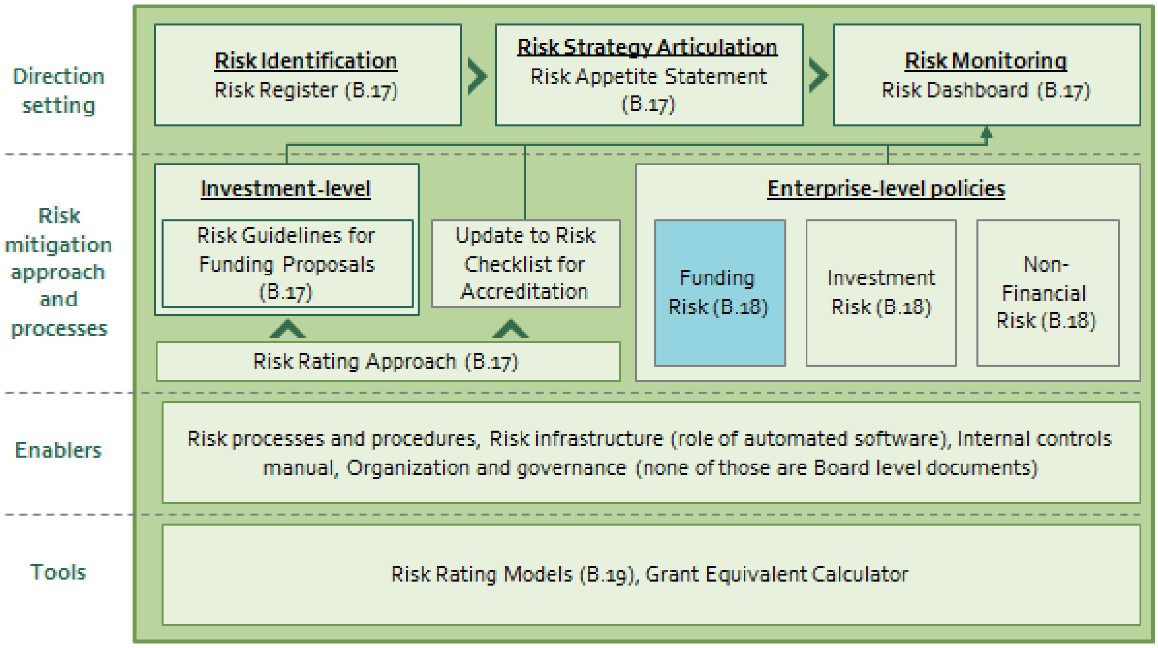
I. Introduction

1. This document presents a critical element of the Risk Management Framework ("RMF"), the policy which governs Funding Risk Management for the Fund.

II. Objective and Scope

2. This document, the Funding Risk Policy ("policy") is a part of the comprehensive RMF – the components of the framework are presented below in Figure 2.

Figure 2: RMF components



3. This document presents the policy governing Funding Risk management for the Green Climate Fund ("the GCF", "the Fund"). It covers the following risk types defined in the GCF's Risk Register:

(a) **Liquidity risk**: The risk of incurring a timing mismatch between cash inflows and cash outflows leading to shortages in the ability of the GCF to face its payment obligations.

(b) **Contribution uncertainty risk**: The risk of failing to convert all pledges into contributions in total, or within the promised time frame.

(c) **Foreign exchange ("FX") risk on the liabilities side:**[13] The risk of incurring losses in the value of contributions due to FX rate fluctuations.

(d) **Funds held in Trust**: The risk of incurring losses in the value of investments of the GCF's funds held with the Trustee due to market movements in the price of the securities, and failing to comply with the GCF's policies on Funds Held in Trust.

4. The policy design is guided by the following principles:

[13] The FX risk on the assets side (the risk of incurring losses in the value of reflows due to FX fluctuations) is covered by the Investment Risk policy.

(a) Adherence to the Fund's Risk Appetite Statement for Funding Risk.

(b) Establishing fit for purpose controls and ensuring efficiency in Risk Management.

(c) Roles and responsibilities are allocated in line with the Three Lines of Defense framework.

(i) **First Line of Defense ("First Line")**: The first responsibility of risk management and control is with the accountable units who are the primary owners and managers of risk;

(ii) **Second Line of Defense ("Second Line")**: For each risk, there is a Second Line of Defense, or a control function independent of the First Line to ensure risks are managed given asymmetric incentives, short-termism, and optimism of risk takers; and

(iii) **Third Line of Defense ("Third Line")**: The Third Line of Defense focuses on review of the action and interactions of the risk taker and risk controller, and assurance that the RMF is operating as intended.

5. The detailed roles and responsibilities of the First and Second Lines are set out in Section V and VI below. The Third Line will develop and perform scheduled and ad-hoc audits, reviews, and assurance engagements, in order to gain assurance that the design and implementation of policies and procedures by the First and Second Lines are managing the Fund's risks appropriately.

6. The Secretariat deems most appropriate that First Line responsibilities should lie with Chief Financial Officer ("CFO") and Second Line responsibilities should lie with the Office of Risk Management and Compliance ("ORMC"). Third Line responsibilities should lie with the Office of the Internal Auditor ("OIA"). The Senior Management Team ("SMT") may choose other divisions for these responsibilities over time.

III. Definitions

The following are the definitions of the key terms applicable for this policy.

Term	Definition
Liquid asset portfolio	The liquid asset portfolio is defined as securities, cash or cash equivalents held in Trust or in the GCF's bank accounts.
Liquidity reserve	The liquidity reserve, as specified in the Risk Appetite Statement, is the amount of funds the GCF needs to hold in cash, cash equivalents, or in securities with duration of less than one year, in order to meet its liquidity risk appetite.
Net funding requirement	Net funding requirements over a period of time are defined as the planned outflows over the period of time (including disbursements and Board and Secretariat (including independent units) expenses) net of the planned contribution encashments over the same period of time. It should be noted that at present, the GCF does not plan to use planned project reflows to reduce net funding requirements. This decision should be reviewed in the future once reflows become more than 20% of the GCF's planned inflows over a one year period.

IV. Policy Governance

7. The ORMC is the author and owner of the Funding Risk Policy. The Board is the approver of the policy. The ORMC must submit any updates or changes to this policy for review by the SMT and RMC, and approval by the Board. This policy must be reviewed every two years, but earlier reviews and updates may be conducted based on the ORMC's discretion, and based on direction from the RMC or the Board.

V. Policy Requirements and Roles & Responsibilities

5.1 Liquidity Risk

8. The Fund's liquidity risk appetite in the Risk Appetite Statement requires the GCF's liquidity reserve (on any day) to be sufficient to sustain the GCF's net funding requirements for at least 1 year.

9. The First Line will be responsible for ensuring that the liquidity reserve of the GCF is monitored and managed within the level specified in the Risk Appetite Statement. The First Line's responsibilities will include:

(a) Ensuring that the Fund's liquidity risk profile is maintained within tolerance levels defined in the GCF's Risk Appetite Statement and all requirements defined in this policy.

(b) Monitoring the Fund's liquid asset portfolio (including necessary financial/cash flow analyses) on a monthly basis and informing the Second Line and the SMT about any significant changes. The liquidity reserve calculation must take into account the following assumptions:

  (i) Project reflows are not included in inflows calculations. This assumption will be reviewed two years after this policy is first approved by the Board; and

  (ii) Use conservative assumptions where there is uncertainty in cash flows (e.g., date of disbursement to a project is unknown).

(c) Setting constraints on the liquidity of the Funds Held in Trust consistent with this policy, specifically the requirement specified in Paragraph 0, and with the Risk Appetite Statement, monitoring adherence to those constraints, and driving corrective action as required; and

(d) Providing information on the Fund's liquid asset portfolio to the Second Line. This information is also needed by the Second Line to populate the Liquidity Risk section in the Risk Dashboard, which the Second Line will share with the SMT, RMC, and the Board on a quarterly basis.

10. The Second Line will review the liquidity reserve forecasts provided by the First Line for the alignment with the GCF's Risk Appetite Statement and this policy, and will review the liquidity risk information provided by the First Line. The Second Line will build its view, independent of the First Line, on any action required for improving the Fund's liquidity risk management and strengthening its adherence to the Risk Appetite Statement. This view will be discussed with the First Line, reviewed and finalized with the Office of the Executive Director ("OED") and then shared with the RMC on a quarterly basis. This view will be shared with the Board at the RMC's discretion.

11. In the event of a breach of the Liquidity Risk Appetite, the First Line will inform the Second Line, SMT, and the RMC immediately. The First Line will initiate the process of taking corrective action for the breach (such as increasing the Funds held as Liquidity Reserve, reducing or delaying planned expenses, expediting contributions and their encashment) within

one week of the awareness of the breach. The corrective action will be finalized collaboratively, taking inputs from the Second Line. The First Line will inform the SMT and the RMC of the corrective action within one week of the action. The breach and the corrective action will also be reported to the Board at the first Board meeting subsequent to the breach, or sooner as advised by the OED, SMT, or the RMC.

12. The First Line and the Second Line will also collaboratively agree if there is a continued risk of breaching the appetite despite the corrective action, and if a longer term remedial plan is required. Such a plan can also be requested by the OED, SMT, RMC, or the Board. If a longer term remedial plan is required, the First Line will develop the plan collaboratively, taking inputs from the Second Line. The longer term remedial plan will need to consider recommendations from the RMC and will need to be agreed with the SMT and, where appropriate, the Board.

5.2 Contribution Uncertainty Risk

13. Predictable funding is essential for the GCF to achieve its objectives. The GCF will take necessary actions to protect the predictability of its financial resources, including: diversifying sources of contributions across a range of contributors; managing cancellation or postponement of contribution commitments and other changes in cash payment and promissory deposit and encashment schedules; ensuring to convert the pledges or encashment of promissory notes in a timely manner; and preventing over-concentration of payments, deposited promissory notes, and contributions to be encashed.[14]

14. The First Line will be responsible for ensuring that contribution uncertainty risk is monitored and managed as required in the Risk Appetite Statement. The First Line's responsibilities will include:

(a) Monitoring and providing information on the Fund's contribution uncertainty to the Second Line, SMT, RMC and the Board. This information is also needed by the Second Line to populate the Contribution Uncertainty Risk section in the Risk Dashboard, which the Second Line will share with the SMT, RMC and the Board on a quarterly basis. The monitored metrics include:

   (i) Total contributions received and their concentration levels by contributing country, and the type of contribution;

   (ii) Total unpaid and unencashed contributions and their concentration levels by contributing country, and the instrument of contribution;

   (iii) Any deviations from the contribution agreements/arrangements and the agreed encashment schedules; and

   (iv) Any pledges not yet signed by the contributor.

(b) In case of significant contribution uncertainty risk, developing a resource mobilization plan (consistent with this policy) and executing the plan. The plan will be developed collaboratively taking inputs from the Second Line. The plan may include, but is not limited to:

   (i) Monitoring upcoming payments, promissory note deposits and encashments, and the conditions attached to future deposits, encashment, and preparing an action plan for the Secretariat to meet those conditions;

   (ii) Communicating in advance with contributors about upcoming payments, promissory notes deposits and encashments; and

[14] As per the Risk Appetite Statement.

(iii) Monitoring any triggers for replenishment.

15. The resource mobilization plan will be shared with the SMT and the RMC. The plan will be shared with the Board at the Board meeting subsequent to the development of the plan, or sooner, at the discretion of the SMT, OED or the RMC.

16. The Second Line will build its view, independent of the First Line, on any action required for improving the contribution uncertainty risk management and strengthening its adherence to the Risk Appetite Statement. This view will be discussed with the First Line, reviewed and finalized with the OED and then shared with the RMC on a quarterly basis. This view will be shared with the Board at the RMC's discretion.

5.3 Foreign Exchange ("FX") Risk

17. The First Line will be responsible for ensuring the Fund adheres to the following requirements from the Risk Appetite Statement:

(a) Contributions already received and encashed will be held in holding currencies. Contributions in non-holding currencies will be converted into holding currencies on receipt of funds, at a proportion determined by the First Line based on their expectation of future cash outflows; and

(b) Future expected encashments of promissory notes, cash payments not yet received and promissory notes not yet deposited and unencashed in non-holding currencies are not required to be hedged; however, the First Line may decide to implement a hedging strategy for additional conservatism. Any such strategy will be developed collaboratively taking inputs from the Second Line, will need to consider recommendations from the RMC and will need to be agreed with the SMT and the Board.

18. The First Line will be responsible for ensuring that FX risk of the GCF is monitored and managed within the level specified in the Risk Appetite Statement. The First Line's responsibilities will include:

(a) Giving direction to the Trustee consistent with this policy, specifically the requirements specified in Paragraphs 17(a) and 17(b), and the Risk Appetite Statement, monitoring adherence to those parameters, and driving corrective action (e.g., conversion of contributions to holding currencies) as required;

(b) Providing information on the Fund's FX risk to the Second Line, SMT, RMC, and the Board. This information is also needed by the Second Line to populate the FX Risk section in the Risk Dashboard, which the Second Line will share with the SMT, RMC and the Board on a quarterly basis; and

(c) Providing the estimated FX conversion profit/loss on promissory notes to the Second Line and the SMT on a monthly basis or as frequently as available.

19. The Second Line will build its view, independent of the First Line, on any action required for improving the Fund's FX risk management and strengthening its adherence to the Risk Appetite Statement. This view will be discussed with the First Line, reviewed and finalized with the OED and then shared with the RMC on a quarterly basis. This view will be shared with the Board at the RMC's discretion.

5.4 Funds Held in Trust Risk

20. Investment of the Fund's liquid asset portfolio will meet the following requirements as defined in the Risk Appetite Statement:

(a) Liquid asset portfolio will only be invested in investment grade securities;

(b) The Fund will target average credit rating of [AA] equivalent by international rating agencies, or an equivalent risk metric approved by the Board, for its liquid asset portfolio;

(c) The funds earmarked for the Fund's liquidity reserve will only be invested in securities with duration no longer than one year. All other funds in the liquid asset portfolio (representing the Fund's excess liquidity) will only be invested in securities with duration no longer than five years and average duration no longer than two years; and

(d) The GCF will refrain from making investments that go against the Fund's mission to promote paradigm shift towards low-emission and climate-resilient development pathways.

21. The First Line will be responsible for ensuring that Funds Held in Trust risk of the GCF is monitored and managed within the level specified in the Risk Appetite Statement. The First Line's responsibilities will include:

(a) Developing and executing an investment plan that ensures that the Funds Held in Trust risk profile is maintained within tolerance levels defined in GCF's Risk Appetite Statement and all requirements defined in this policy. The First Line will develop this plan collaboratively, taking inputs from the Second Line;

(b) Setting investment parameters for the Trustee consistent with this policy, specifically the requirements specified in Paragraph 20, and the Risk Appetite Statement, monitoring adherence to those parameters, and driving corrective action (e.g., re-allocation of the assets in the liquid asset portfolio) as required.;

(c) Providing information on the GCF's Funds Held in Trust risk to the Second Line, SMT, RMC and the Board. This information is also needed by the Second Line to populate the Fund Held in Trust Risk section in the Risk Dashboard, which the Second Line will share with the SMT, RMC and the Board on a quarterly basis; and

(d) Providing information on the investment income to the Second Line and the SMT on a quarterly basis.

22. The Second Line will build an independent view on any action required for improving the GCF's Funds held in Trust risk management and strengthening its adherence to the Risk Appetite Statement. This view will be discussed with the First Line, reviewed and finalized with the OED and then shared with the RMC on a quarterly basis. This view will be shared with the Board at the RMC's discretion.

23. In the event of a breach of the Funds Held in Trust Risk Appetite, the First Line will inform the Second Line, SMT, and the RMC immediately. The First Line will initiate the process of taking corrective action for the breach (such as rebalancing the liquid asset portfolio) within one week of the awareness of the breach. The corrective action will be finalized collaboratively, taking inputs from the Second Line. The First Line will inform the SMT and the RMC of the corrective action within one week of the action. The breach and the corrective action will also be reported to the Board at the first Board meeting subsequent to the breach, or sooner as advised by the OED, SMT or the RMC.

24. The First Line and the Second Line will also collaboratively agree if there is a continued risk of breaching the appetite despite the corrective action, and if a longer term remedial plan is required. Such a plan can also be requested by the OED, SMT, RMC or the Board. If a longer term remedial plan is required, the First Line will develop the plan collaboratively, taking inputs from the Second Line. The longer term remedial plan will need to consider recommendations from the RMC and will need to be agreed with the SMT and where appropriate, the Board.

VI. Solvency concerns

25. Solvency risk refers to the Fund's inability to meet its financial commitments due to a shortfall in its available funds relative to its commitments. The Fund will take all necessary measures to avoid any solvency events during its operations.

26. The Fund only makes investment commitments when a matching source of funding is available (in the form of unmatched cash, cash equivalents, securities or promissory notes). Such matching of source of funds for each investment commitment helps reduce the Fund's exposure to solvency risk.

27. Investment commitments made where the matched funding sources are not in the same currencies as the investment commitment expose the Fund to solvency risk in case the investment currency appreciates against the currencies of the matched funding sources.[15]

28. Such solvency risk exposure arises in two kinds of situations – when the investment commitment is made in a holding currency but the matched funding sources are in different currencies (partially, or wholly);[16] or when the investment commitment is made in a non-holding currency.[17]

29. In order to mitigate this solvency risk arising from currency differences between investment commitments and the matched funding sources, for investment commitments due in the immediate 12 months, the Fund will ensure that the matched source of funds is exactly in the same currency as the investment commitments (through actions such as currency exchanges etc.).[18] This approach will help manage the fund's exposure to solvency risk in the near term (the immediate 12 months).[19]

30. Beyond the immediate 12 months, where the matched source of funds is not in the investment currency but are available in cash or cash equivalents in another currency, the Fund will immediately convert the matched source of funds to the investment currency.[20]

31. For the remaining matched source of funds that are not available in cash or cash equivalents and which are not in the investment currency (e.g., matched source of funds in the form of promissory notes in another currency), the Fund will set aside an FX commitment risk buffer at an initial target amount of 20% of the Fund's nominal investment commitment amount for which the matched source of funds is not in the investment currency. To be clear, this buffer is not intended to support individual projects from FX fluctuation losses that they may suffer, but to protect the GCF from solvency risk. Further, holding this buffer will result in a reduction in the Fund's commitment authority (which will then adjust as the size of the buffer is recalculated over time).

[15] FX depreciation of GCF investment commitments would not create solvency issues as defined in this Policy.
[16] Either in other holding currencies, or in promissory notes in non-holding currencies from a contributor country.
[17] It should be noted that extent of solvency risk exposure arising from investment commitments in non-holding currencies is limited by the diverse set of currencies the Fund may invest in, which provides a natural hedge to the Fund against investment currency appreciation. An equally-weighted currency basket from low-income and lower-middle income countries (as defined by the World Bank) has depreciated by 49% against the SDR basket from 1995 to 2016.
[18] Conversion of funds to non-holding currencies may not be feasible within the Trustee account given the Interim Trustee Agreement. Hence either the Fund will hold non-holding currency assets in an alternative account, and if that is not feasible, then the strategy of immediate conversion will not be applicable for non-holding currency investment commitments till the Permanent Trustee is in place.
[19] 12 months has been chosen consistent with the Fund's liquidity reserve definition. As a result this full currency matching will be relevant for sources of funds which are a part of the Fund's Liquid Asset Portfolio.
[20] Conversion of funds to non-holding currencies may not be feasible within the Trustee account given the Interim Trustee Agreement. Hence either the Fund will hold non-holding currency assets in an alternative account, and if that is not feasible, then the strategy of immediate conversion will not be applicable for non-holding currency investment commitments till the Permanent Trustee is in place.

32. The Secretariat can review and modify the FX buffer amount over time as necessary. Furthermore, the Secretariat will report the status of the FX positions together with the FX buffer and amount of currency mismatch to the RMC and the Board on a quarterly basis.

33. The GCF will monitor the sufficiency of the buffer versus the target level on a quarterly basis. If the buffer falls below the designated target level due to appreciation in some investment currencies, the Secretariat First Line will develop a plan to replenish the buffer back above the target level no later than one month from the day the breach of the target level was first identified.

34. The Secretariat First Line will be responsible for maintaining the proposed FX commitment risk buffer and reporting on size of the buffers versus the target levels, and recommending any actions required (to replenish the buffer). The action will be finalized collaboratively, taking inputs from the Second Line. The actions will need to consider recommendations from the RMC and will need to be agreed with the SMT and the Board.

35. The Second Line will build its view, independent of the First Line, on any action required for improving the Fund's solvency management. This view will be discussed with the First Line, reviewed and finalized with the OED and then shared with the RMC on a quarterly basis. This view will be shared with the Board at the RMC's discretion.

VII. Effective Date

36. The provisions of this policy will take effect on 1st January 2018. If the Interim Trustee is unable to implement the requirements in the policy, they will become applicable after the selection of the Permanent Trustee. Until that time, the GCF should monitor the Fund's adherence to these requirements to the extent possible under the current agreement.

Annex V: Investment risk policy

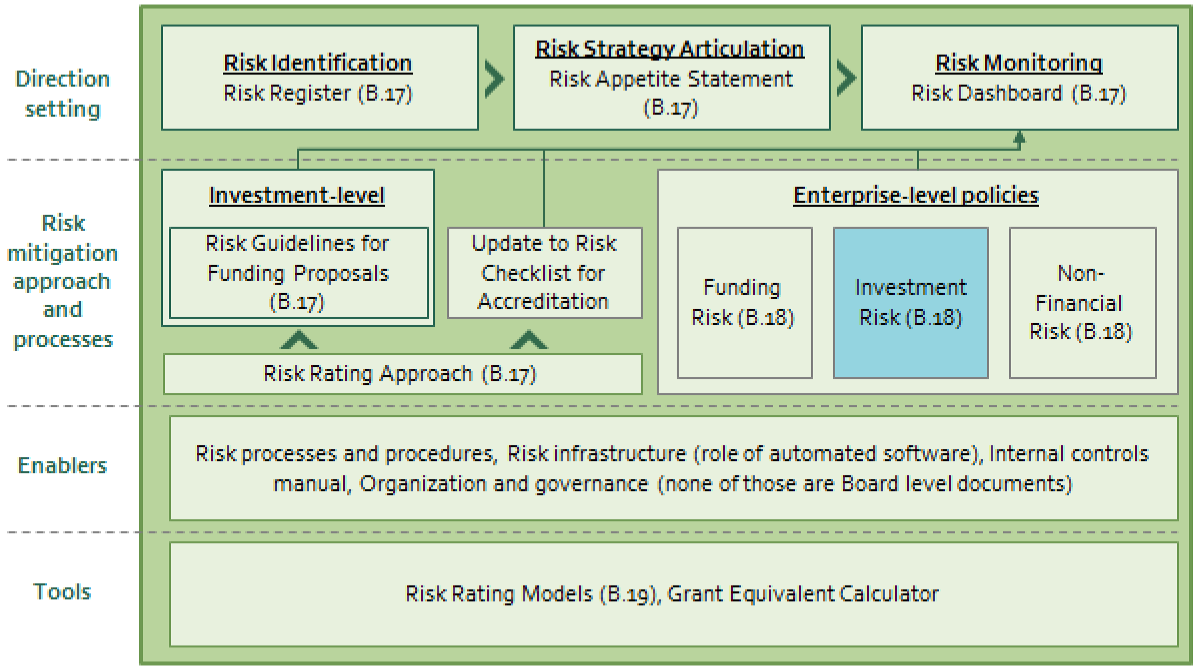
I. Introduction

1. This document presents a critical element of the Risk Management Framework ("RMF"), the policy governing investment risk management for the GCF.

II. Objectives and scope

2. This document is a part of the comprehensive RMF – the components of the framework are presented below in Figure 3.

Figure 3: RMF components



3. The Investment Risk Policy ("Policy") defines investment risk management requirements related to the risk of failure of a Funded Activity[21] or Readiness / Project Preparation Facility ("PPF") Proposal to deliver the expected impact, or the risk of delay or shortfall of reflows[22] from these activities.

4. This Policy is based on the following core principles:

(a) Ensuring sustainable financial viability for the Fund and enabling the Fund to meet its mission of promoting paradigm shift towards low-emission and climate-resilient development pathways;

(b) Adherence to the Fund's Risk Appetite Statement (part of the RMF) for investment risk;

(c) Establishing fit for purpose controls and ensuring efficiency in risk management; and

(d) Roles and responsibilities allocated in line with the Three Lines of Defense framework:

[21] A Funded Activity is defined as a GCF-funded investment or payment for a climate project/programme.
[22] The risk of delay or shortfalls in reflows may originate from various sources – including loss in the counterparty's willingness or ability to repay, convertibility and transfer risk, and foreign exchange losses from non-holding currency investments.

(i) **First Line of Defense ("First Line")**: The first responsibility of risk management and control is with the accountable units who are the primary owners and managers of risk;

(ii) **Second Line of Defense ("Second Line")**: For each risk, there is a Second Line of Defense, or a control function independent of the First Line to ensure risks are managed given asymmetric incentives, short-termism, and optimism of risk takers; and

(iii) **Third Line of Defense ("Third Line")**: The Third Line of Defense focuses on review of the action and interactions of the risk taker and risk controller, and assurance that the RMF is operating as intended.

(e) Recognizing the role of the Accredited Entity ("AE") in risk management given GCF's business model of investing through AEs. The presence of the AE has the following key implications:

(i) The AEs form a key part of the First Line of Defense;

(ii) The role of the First Line within the Secretariat ("Secretariat First Line") is lighter, as part of the First Line responsibilities are with the AEs; and

(iii) An AE's lack of ability or willingness to meet GCF's expectations is a key source of investment risk. However, the management approach for this risk inherent to the AE is not described by this policy. This management approach is addressed in the Risk Checklist for Accreditation, Guiding Framework and Procedures for Accrediting National, Regional, and International Implementing Entities and Intermediaries, individual Accreditation Master Agreements ("AMAs") and Funded Activity Agreements ("FAAs").

5. The detailed roles and responsibilities of the First and Second Lines are set out in Sections IV and V below. The Third Line will develop and perform scheduled and ad-hoc audits, reviews, and assurance engagements, in order to gain assurance that the design and implementation of policies and procedures by the First and Second Lines are managing the Fund's risks appropriately.

6. For roles and responsibilities defined in Sections IV and V of this policy, the Secretariat deems most appropriate that:

(a) Secretariat First Line responsibilities should lie with Private Sector Facility ("PSF"), Division of Mitigation and Adaptation ("DMA"), or the Country Programming Division ("CPD") depending on which division originates the funding outlay. Some of these responsibilities may be given to the Portfolio Management Unit ("PMU"). The specific roles and responsibilities will be outlined in procedural documents developed by the Secretariat;

(b) Second Line responsibilities should lie with the Office of Risk Management and Compliance ("ORMC") and the Office of General Counsel ("OGC"). Some of these responsibilities may be given to PMU where they play a review or control role over First Line activities performed by the AE or Delivery Partner ("DP");

(c) Third Line responsibilities should lie with the Office of the Internal Auditor ("OIA"); and

(d) In order to ensure independence of the First and the Second Lines, the PMU may either be given some Secretariat First Line responsibilities or some Second Line responsibilities, but not both.

7. The Senior Management Team ("SMT") may re-allocate responsibilities to other divisions over time.

III. Policy governance

8. The ORMC is the Author and Owner of the Investment Risk Policy. The Board is the Approver of the Policy. The ORMC must submit any updates or changes to this Policy for review by the SMT and RMC and approval by the Board. This policy must be reviewed every two years, but earlier reviews and updates may be conducted based on the ORMC's discretion, and based on direction from the RMC or the Board.

IV. Investment risk management – Funded Activity

4.1 Initial approval of Funding Proposal

4.1.1 Risk assessment

9. The AE is responsible for conducting due diligence on the Funding Proposal ("FP", "proposal") prior to submitting it to the Secretariat. The AE must meet the standard of care, as defined in its AMA, when conducting its due diligence, and later through the life of the project.

10. The Secretariat First Line is responsible for co-drafting a risk assessment of the Funded Activity in the Secretariat Review with the Second Line as well as other relevant units/divisions, based on the Risk Guidelines for Funding Proposals (GCF/B.17/21) for investment risk. After reaching consensus, this assessment is shared with the SMT and the Board. In addition, the Secretariat First Line is responsible for liaising with the AE/Executing Entity ("EE") for necessary documents and information (including those requested by the Second Line, SMT, RMC, and the Board) required to complete the risk assessment[23] of an FP.

11. Consensus must be achieved between the Secretariat First Line and the Second Line before a Funding Proposal can proceed to the SMT review.

12. The risk assessment gives consideration to the terms and conditions of the proposed funding outlay, as defined in the term sheet.

13. The SMT recommends a decision on an FP to the Board.

14. The Board takes the final decision on an FP.

4.1.2 Generating the risk ratings[24] (including rating refresh)

15. The Second Line is responsible for generating a rating as defined in the Risk Rating Approach (part of the RMF)[25] to be included in the Secretariat Review to the SMT and the Board. The rating is to be refreshed every year.

16. The Secretariat First Line is responsible for collecting the required information from the AE, and providing inputs for non-financial assessment required for generating the rating. Different First Line teams may be responsible for this activity before and after the first disbursement.

17. The Second Line is also responsible for tracking any delays in rating refreshes and reporting to the SMT. The SMT may approve a delay in rating generation of up to 6 months past its due date; any longer delays should be reported by the ORMC to the RMC.

[23] Including term sheets.
[24] Refer to Risk Rating Approach.
[25] Pending deliberation and approval at B.19.

18. The rating may be considered by the SMT in its recommendation to the Board, and may be considered by the Board in taking a decision on an FP.

4.2 FAA administration

4.2.1 Activities leading up to FAA signing

19. The Second Line is responsible for reviewing and approving the FAA and the set of documents received for completeness from a risk perspective and ensuring that all risk conditions have been met. Furthermore, the Second Line is responsible for ensuring the adequacy of all documents from a legal perspective, reviewing the FAA for completeness from a legal perspective, and taking safe custody of all legal documents.

(a) The AE is responsible for promptly collecting necessary documents for Funded Activities from the EE in a timely fashion and ensuring adequate maintenance of all documents related to individual Funded Activities.

(b) The Secretariat First Line is responsible for collecting required documents and other information from the AE regarding the FAA.

4.2.2 Disbursements to the AE

20. The Second Line clears any special conditions required to be met for disbursements to the AE. The Second Line is also responsible for providing legal advice on disbursements as requested by the Secretariat and taking safe custody of all legal documents.

21. The First Line initiates the checks for conditions tied to the disbursement of Funds.

22. The CFO is responsible for providing the necessary disbursement instructions to the Trustee (after receiving the necessary clearances from the Second Line) and ensuring appropriate execution of those instructions.

4.3 Funded Activity monitoring

4.3.1 Individual Funded Activity monitoring

23. The AE is responsible for monitoring each Funded Activity in line with the AE's own internal rules, policies and procedures, and responsibilities set forth in the relevant FP and AMA/FAA with the standard of care as defined in the AMA. It also provides interim and final evaluation reports and other ad hoc reports for each Funded Activity to the Secretariat First Line as specified in applicable legal agreements. When necessary (or whenever requested by the Secretariat), the AE conducts collaborative monitoring missions with the Secretariat First Line and sometimes including the Secretariat Second Line for Funded Activities focusing on concerns areas and communicates with the EE for any information requested by the Secretariat.

24. The Secretariat First Line is responsible for the following activities:

(a) Providing necessary inputs to the Second Line to populate the GCF Risk Dashboard, which the Second Line will share with the SMT, RMC and the Board on a quarterly basis.

(b) Reviewing interim and final evaluation reports and other ad hoc reports provided by the AE on the Funded Activity and monitoring compliance with the FP, AMA/FAA, and the GCF's own internal policies and guidelines;

(c) Conducting collaborative monitoring missions with the AE for Funded Activities; and

(d) Communicating with the AE on any information requests or issues raised during the monitoring process.

25. The Second Line is responsible for the following activities:

(a) Building its view, independent of the First Line, on any action required for improving the GCF's investment risk management for the project/programme and strengthening its adherence to the Risk Appetite Statement. This view will be discussed with the First Line, reviewed and finalized with the Office of the Executive Director ("OED") and then shared with the RMC on a quarterly basis. This view will be shared with the Board at the RMC's discretion; and

(b) Verifying compliance with the FP, AMA/FAA, and the GCF's internal policies and procedures (e.g. through sample checks) and highlighting differences from the Secretariat First Line's assessment to the RMC.

4.3.2 **Portfolio monitoring**

26. The Second Line is responsible for building its view, independent of the First Line, on any action required for improving the Fund's investment risk management at a portfolio level and strengthening its adherence to the GCF Risk Appetite Statement (GCF/B.17/21). This view will be discussed with the First Line, reviewed and finalized with the OED and then shared with the RMC on a quarterly basis. This view will be shared with the Board at the RMC's discretion.

27. The Secretariat First Line is responsible for monitoring delinquent, non-performing loans and losses of Funded Activities, and providing necessary inputs to the Second Line to populate the Risk Dashboard (the Second Line will share the Risk Dashboard with the SMT, RMC and the Board on a quarterly basis). The Secretariat First Line also monitors concentration levels against applicable targets of the GCF Risk Appetite. Any breaches in the Risk Appetite are to be reported to the Second Line, SMT, RMC, and the Board.

4.4 Annual review of Funded Activity

28. The AE is responsible for providing the Annual Performance Report for each Funded Activity to the Secretariat First Line, as specified in the AMA/FAA. It is also responsible for liaising with the EE for any information requests or issues raised during the review process.

29. The Secretariat First Line is responsible for reviewing the Annual Performance Report and other annual reports of Funded Activities provided by the AE, and raising identified issues in its annual Portfolio Performance Review ("PPR"). It is also responsible for liaising with the AE for any information requests or issues raised during the review process and working collaboratively with the Second Line in reviewing the PPR. These reports, together with the Secretariat First Line, and the Second Line's views are shared with the SMT. The SMT reports important issues to the RMC and the Board.

30. At its discretion, the Second Line may share and finalize any differences in its views from the First Line with the OED, and then share them with the RMC and the Board.

4.5 Funded Activity default situation

31. A Funded Activity is considered to be in a default situation if the "event of default" or equivalent as defined in the AMA/FAA has occurred.

4.5.1 Project/Programme default or non-compliance situation[26]

32. The Second Line works collaboratively with the Secretariat First line in reviewing the default situation, the remedial action plan, the step-in decision, the step-in plan and the implementation of the plans. At its discretion, the Second Line may share and finalize any differences in its views from the First Line with the OED, and then share them with the RMC and the Board.

33. Where there is a separate EE, the AE is responsible for developing and executing a remedial action plan[27] under the relevant Subsidiary Agreement for any event of default by the EE for its Funded Activities.

34. The Secretariat First Line, in conjunction with the Second Line, is responsible for the following activities:

(a) Reviewing remedial action plans of the AE and providing inputs if necessary;

(b) Proposing whether GCF step-in is required as specified in the relevant AMA/FAA. This decision must be reviewed quarterly;

(c) Developing and implementing a GCF step-in plan if applicable;

(d) Working collaboratively with the Second Line in reviewing the default situation, the remedial action plan, the step-in plan (where applicable) and the implementation of the plan;

(e) Providing regular reporting to the Board on the GCF's defaulted assets;

(f) Monitoring the execution of conditions applicable to defaulted assets; and

(g) Providing quarterly reports on the progress of remedial actions and step-in actions (where applicable, to the Second Line, RMC, and the Board).

V. Investment risk management – Readiness/PPF Project

5.1 Readiness/PPF Proposal Review

35. The GCF is taking a programmatic approach to Readiness/PPF Proposals. Given this programmatic approach, the Second Line need not approve every single proposal. However, the Second Line must approve all key parameters of the programme including maximum size of a funding outlay and the Endorsement and Approval Authority and Thresholds. The Second Line is also responsible for developing and maintaining the Risk Guidelines for Readiness/PPF.

36. The Secretariat First Line is responsible for reviewing the Readiness/PPF Proposals based on Risk guidelines prepared by the Second Line. The proposals will be approved by the delegated authority levels for the Readiness/PPF projects (currently the Readiness Working Group ("RWG") or the OED).

[26] This section should be reviewed after the development of the Restructuring/Cancellation Policies by the Secretariat.

[27] The remedial action plan differs based on the classification and level of default. For delinquent/default accounts, the remedial action plan focuses on restructuring; for non-performing accounts, the remedial action plan focuses on recovery; and for loss accounts, the remedial action plan commences the write-off process. Further details on their definitions can be found in Annex I.

5.2 New Grant Agreement and Readiness Framework Agreement[28] administration

37. The Second Line is responsible for ensuring the adequacy of all documents from a legal perspective. It also takes safe custody of all legal documents.

38. The Secretariat First Line is responsible for collecting required documents and other information from the National Designated Authority ("NDA")/ DP / AE regarding Grant Agreement or Readiness Framework Agreement administration.

5.3 Readiness/PPF Portfolio Monitoring

39. The Second Line is responsible for conducting a check of monitoring results at a portfolio level and reviewing any issues or recommended actions by the Secretariat First Line, in consensus with the authority which originally approved the project based on the Endorsement and Approval Authority and Thresholds.

40. The Secretariat First Line is responsible for conducting monitoring activities (including collection of necessary information from the NDA/DP/AE). Based on its monitoring, the Secretariat First Line may recommend additional action to be taken for any project (as an example, the Secretariat First Line may recommend legal action, if allowable under the Readiness Grant Agreement, in the case of a prohibited practice violation).

5.4 Readiness/PPF Disbursement

41. The Second Line is responsible for providing legal advice on disbursements as requested and takes safe custody of all legal documents.

42. The Secretariat First Line is responsible for initiating each disbursement, taking into account the latest monitoring results and holding back disbursements where required. The Secretariat First Line works collaboratively with the Second Line to clear the disbursements before the instructions are sent to Finance.

43. The CFO is responsible for providing the necessary disbursement instructions to Finance (after receiving the necessary clearances from the First Line) and ensuring appropriate execution of those instructions.

VI. Foreign Exchange ("FX") Risk in reflows

44. Non-holding currency reflows expose the Fund to FX risk. Recalling its ability to take on risks that other funds/institutions are not able or willing to take, the Fund will on occasions take such FX risks to meet its mandate. Otherwise, it will either pass on this risk to the counterparties through the FAA, or account for such FX risks in structuring the deal terms within the relevant FPs.

VII. Effective date

45. The Policy will take effect on 1st January 2018.

[28] Refers to any legal agreement pertaining to the funding of Readiness and PPF projects, including Readiness Framework Agreements and Readiness Grant Agreements.

Appendix I: Definitions of financial performance for Funded Activities

1. The categories for monitoring of financial performance of Funded Activities are as follows:

(a) Delinquent: Obligor does not meet financial obligations for reflows/payments per contractual schedule and is 1-89 days past due of the grace period;

(b) Non-performing: Obligor meets one or more of the following conditions:

(i) Failure to meet financial obligations for reflows/payments per contractual schedule and is 90-209 days past due of the grace period;

(ii) Breach of any clause specified in the AMA or FAA that triggers a default;

(iii) Default under a guarantee or collateral or other support agreements;

(iv) Failure to pay a final judgment or court order; or

(v) Bankruptcy, liquidation, or the appointment of a receiver or any similar official.

(c) Loss: Obligor does not meet financial obligations for reflows/payments per contractual schedule and is over 210 days past due of the grace period.