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## Annex XI: Initial financial risk management framework

1. The Fund's initial financial risk management framework consists of the following components:

- (a) Financial risk policies;
- (b) Risk monitoring and reporting; and
- (c) Risk governance.

### I. Financial risk policies

2. The Fund's initial financial risk policies are:

- (a) The Fund will in aggregate seek to maximize grant contributions, taking into account its theme-based allocation. It is foreseen that grant contributions must significantly exceed loan amounts;
- (b) The Fund will initially provide grants and loans through implementing entities (IEs) and intermediaries as per the financial terms and conditions to be approved. Intermediaries will be permitted to blend grants and loans received from the Fund with their own sources of financing or with third-party financing;
- (c) There will be no cross-subsidization between providers of grants and providers of loans. To this end, the Fund, with support from the Trustee, will monitor incoming and outgoing flows and incorporate a conservative hypothesis with respect to possible financial losses in order to ensure that actual reflows from outgoing loans will always exceed repayments due to contributors. The modalities of loan contributions will be defined, both at the collective and at the individual contributor level, in terms of concessionality and other modalities (including the possibility of associated grant or capital provision and appropriate arrangements with contributors regarding the possible write-down of loan contributions), to ensure that loan contributions do not entail any risk in this respect. Overall, these provisions will ensure that the average concessionality level of outgoing loans will be less than the average concessionality level of incoming contributions with a sufficient margin to cover credit risk;
- (d) To further avoid cross-subsidization between providers of grants and providers of loans, future financial losses will be borne by all contributors, which will require that one of the following arrangements (preferably the same) be taken with each loan contributor:
  - (i) Appropriate arrangements with contributors regarding the possible write-down of loan contributions; or
  - (ii) The associated provision of a grant or capital contribution by the contributor to the Fund;
- (e) The grant or capital contribution to be made by loan contributors to cushion against credit risk should be calculated on the basis of a realistic assessment of the risks the Fund is expected to take. If, despite all reasonable efforts to maintain the risk profile of the portfolio of the Fund in line with this realistic assessment, the capital cushion proves inadequate, loan contributors will then be expected to contribute additional grant or capital contributions;
- (f) While maximizing effectiveness, the Fund will seek diversity in its asset portfolio on the basis of the Board-determined allocation criteria, geography, results areas, and accredited entities, keeping in mind prudent risk limits from a portfolio diversification perspective where relevant for loans and instruments that entail possible losses;

- (g) The Fund shall take a zero tolerance approach to fraud and shall seek to minimize the risk of moral hazard with respect to intermediaries, consistent with the initial fiduciary principles and standards set out in Annex II.

## II. Financial risk monitoring and reporting management system

3. Table 1 provides an overview of the Fund's risk monitoring and reporting management system.

**Table 1: Fund's risk monitoring and reporting management system**

<b>RISK MONITORING AND REPORTING TOOL</b>	<b>FREQUENCY OF USE</b>	<b>PURPOSE</b>
<b>Financial risk management summary</b>	Quarterly	Track key financial risk indicators in real time.
<b>Financial risk register</b>	Annually	Perform an annual in-depth review of key risk events, management response and residual risk.
<b>Financial statements</b>	Semi-annually	Gain an overview of the institution's financial situation and its trend over time.
<b>Portfolio review</b>	In real time, with an annual portfolio report	Identify leading indicators of financial risk within the portfolio based on the submission of information from intermediaries and implementing entities; perform stochastic portfolio analyses and sensitivity analyses.
<b>External audit report</b>	Annually	Confirm the accuracy of financial statements as well as obtain a third-party view of the financial health of an institution
<b>Self-evaluation by the Committee of Sponsoring Organizations of the Treadway Commission</b>	Every two years	Scan possible risk gaps not covered by the above-mentioned monitoring instruments.

## III. Financial risk governance: roles and responsibilities

4. Table 2 provides an overview of the roles and responsibilities related to the Fund's financial risk governance.

**Table 2: Fund's financial risk governance: roles and responsibilities**

	<b>Chief Financial Officer (and Risk Manager*)</b>	<b>Secretariat's Risk Working Group**</b>	<b>Board's Risk Management Committee</b>
<b>Role and responsibility</b>	<ul style="list-style-type: none"> <li>• Preparation of financial statements</li> <li>• Preparation of annual portfolio reviews</li> <li>• Management of internal and external audit processes</li> <li>• Review of the financial reporting from the Trustee (and implementing entities and intermediaries)</li> <li>• Preparation of periodic financial risk management summaries</li> <li>• Development of an asset-liability management process</li> </ul>	<ul style="list-style-type: none"> <li>• Review of financial statements, portfolio review and risk summary</li> <li>• Integration of portfolio-level risk data into Secretariat's due diligence as part of the approval process for project and programme funding</li> <li>• Management of the annual Committee of Sponsoring Organizations of the Treadway Commission (COSO) risk self-assessment for the Secretariat</li> </ul>	<ul style="list-style-type: none"> <li>• Overall oversight of the Fund's risk management</li> <li>• Review of financial statements, portfolio review and risk summary</li> <li>• Recommendation of risk ceilings (the Fund's risk appetite or risk limit) for the Board's approval</li> <li>• Assessment of compliance of the Fund's financial risk levels with the ceilings</li> <li>• Provision of guidance to the Secretariat on portfolio risk</li> <li>• Reporting on financial risk to the Board</li> <li>• Management of the annual COSO risk self-assessment for the Board</li> </ul>

\* The Risk Manager and General Counsel report to the Executive Director and advise both Executive Director and the Board on risk and on legal matters respectively.

\*\* With support from the Trustee as appropriate.