

## **Annex XXIV: Risk appetite methodology**

1. The proposed risk appetite methodology (RAM) for the Green Climate Fund (the Fund) consists of the following five steps:

### **I. Agreement on risk categories and subcategories**

2. The RAM begins with agreement by the Board on the risk categories and subcategories that will be tracked and modelled. These are provided in Annex XXIII to this document.

### **II. Agreement on a risk dashboard**

3. The risk dashboard consists of regular snapshots of the Board-agreed risk categories and subcategories that will be tracked by the Secretariat, the Risk Management Committee and the Board. The structure of the risk dashboard is provided in Annex XXIII to this document, and consists of the level of priority of each risk subcategory, the key performance metric(s), the triggers (target and limit), the flag and the corrective action plan – if any.

### **III. Development of scenarios**

4. A series of scenarios that pertain to these risk categories will be analysed in consultation with the Risk Management Committee in order to identify the risk targets, tolerances and limits. These scenarios should take into account all the key risks faced by the Fund. Based on the scenarios, the Secretariat, in consultation with the Risk Management Committee, is thereafter to propose to the Board the relevant key performance metric(s) by which to measure tolerance and limit as well as the related target.

5. The Secretariat, in running the risk scenarios, will also assign a priority level (high/medium/low) to risk subcategories, which will be derived from their probability of occurrence and predicted impact on the Fund should they occur.

6. A risk subcategory's probability of occurrence can be categorized as follows:

- (a) High – Highly likely to occur within the next 12 months;
- (b) Somewhat likely – Would not be surprising if it occurred within the next 24 months;
- (c) Somewhat unlikely – Would be surprising if it occurred within the next 24 months; and
- (d) Low – Highly unlikely to occur within the next 24 months.

7. A risk subcategory's impact in the event that it occurs can be categorized as follows:

- (a) High – A material adverse impact that could impede the franchise's ongoing viability and/or its ability to meet its strategic objectives;
- (b) Somewhat disruptive – An adverse impact that would be disruptive to the Fund's viability and/or its ability to meet its strategic objectives;
- (c) Somewhat non-disruptive – A relatively contained adverse impact that could impact the Fund's financials and/or its ability to meet its strategic objectives by up to 10 per cent; and
- (d) Low – Minimal and contained impact.

8. Table 1 below illustrates how different combinations of probability of occurrence and impact in the event of different occurrence yield priorities.

9. For example, a risk subcategory with a high priority of occurrence that would have a high impact in the event of occurrence would be deemed a high priority.

**Table 1: Priority grid**

Impact Occurrence probability	(1) Low	(2) Somewhat non- disruptive	(3) Somewhat disruptive	(4) High
Low (1)	Low priority	Low priority	Low priority	Medium priority
Somewhat unlikely (2)	Low priority	Low priority	Medium priority	Medium priority
Somewhat likely (3)	Low priority	Medium priority	High priority	High priority
High (4)	Medium priority	Medium priority	High priority	Very high priority

10. Risk subcategories that are deemed to have medium or high priorities and for which the key performance metric has breached the target shall be tagged with a red flag on the dashboard so as to solicit a management action plan and attention by the Board.

#### **IV. Agreement on risk targets, tolerances, and limits and development of a risk appetite statement**

11. Based on the risk scenarios already developed, the Secretariat will present a proposed set of risk targets as well as their respective tolerances and limits to the Board for consideration and adoption. Subsequently, the Secretariat will work with the Risk Management Committee on preparing a risk appetite (RA) statement for consideration by the Board. Upon approval of the RA statement – as well the targets, tolerances and limits – credit and investment manuals and software can be developed in order to embed the risk framework into the day-to-day management of the Fund.

#### **V. Risk reporting**

12. As a last step, the Secretariat will integrate targets, tolerances and limits into the risk dashboard and risk register based on the risk monitoring and reporting management system adopted by the Board under the initial financial risk management framework (decision B.07/05). This reporting will be the basis for continuous review and updating of the Fund's RA and risk management practices. The Fund would need to conduct risk control and self-assessment, a process of identification, assessment, effective internal control and action plans related to high-risk events, in a timely manner, in order to ensure the robustness of the risk framework. Such periodic reporting from the Secretariat will enable the Board to review the evolution of the risk borne by the Fund and to make any necessary adjustments.