

## Annex VI: Funding risk policy

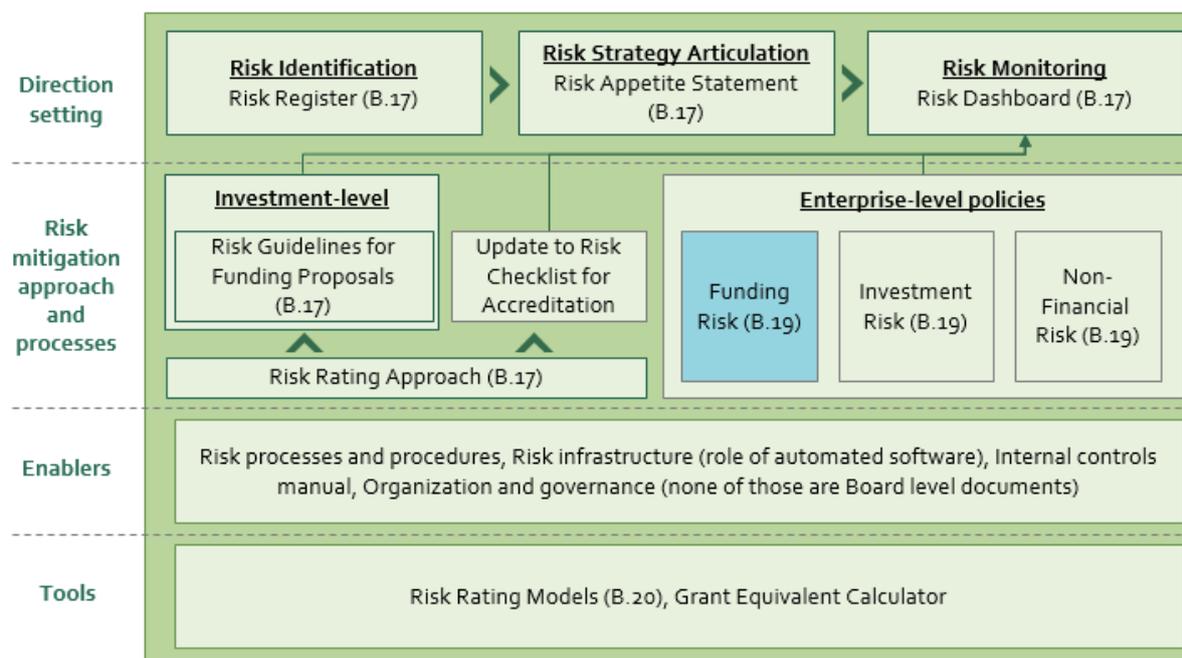
### I. Introduction

1. This document presents a critical element of the Risk Management Framework (“RMF”), the policy which governs funding risk management for the Green Climate Fund (“GCF”).

### 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 3.

**Figure 3: RMF components**



3. This document presents the policy governing funding risk management for the GCF. 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:**<sup>1</sup> 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.

<sup>1</sup> 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.

4. The policy design is guided by the following principles:
- (a) Adherence to the GCF’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:
    - (i) **First Level of Responsibility (“First Level”)**: The first responsibility of risk management and control is with the accountable units who are the primary owners and managers of risk; there may be multiple units within the Secretariat that form the First Level of Responsibility;
    - (ii) **Second Level of Responsibility (“Second Level”)**: For each risk, there is a Second Level of Responsibility, or a control function independent of the First Level, to ensure risks are managed given asymmetric incentives, short-termism, and optimism of risk takers; there may be multiple units within the Secretariat that form the Second Level of Responsibility; and
    - (iii) **Third Level of Responsibility (“Third Level”)**: The Third Level of Responsibility focuses on review of the actions 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 Levels are set out in Sections IV and V below. The Third Level 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 Levels are managing the GCF’s risks appropriately.
6. The Secretariat deems most appropriate that First Level responsibilities should lie with the Chief Financial Officer (“CFO”) and Second Level responsibilities should lie with the Office of Risk Management and Compliance (“ORMC”). Third Level responsibilities should lie with the Office of the Internal Auditor (“OIA”). The Secretariat may choose other divisions for these responsibilities over time.

### III. Definitions

7. 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 funding 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 requirements and roles and responsibilities

### 4.1 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 Level 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 Level'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 regular basis and informing the Second Level and the SMT about any significant changes;
  - (c) Monitoring adherence for the Funds held in Trust to the requirements in this policy, specifically the requirements specified in Section 4.4, and to the Risk Appetite Statement, and driving corrective action as required; and
  - (d) Providing information on the Fund's liquid asset portfolio to the Second Level and the SMT. This information is needed by the Second Level to populate the Liquidity Risk section in the Risk Dashboard, which the Second Level will share with the SMT, RMC, and the Board on a quarterly basis.
10. The Second Level will review the liquidity reserve forecasts provided by the First Level for alignment with the GCF's Risk Appetite Statement and this policy, and will review the liquidity risk information provided by the First Level. The Second Level will develop a recommendation, independent of the First Level, on any action required for improving the Fund's liquidity risk management and strengthening its adherence to the Risk Appetite Statement. This recommendation will be discussed with the First Level, reviewed and finalized with the Office of the Executive Director ("OED").
11. In the event of a breach of the Liquidity Risk Appetite, the First Level will inform the Second Level, SMT, and the RMC immediately. The First Level 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). The corrective action will be finalized collaboratively, taking inputs from the Second Level. The First Level will inform the SMT and the RMC of the corrective action.

### 4.2 Contribution uncertainty risk

12. 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.<sup>2</sup>

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

- (a) Monitoring and providing information on the Fund's contribution uncertainty to the Second Level and the SMT. This information is needed by the Second Level to populate the Contribution Uncertainty Risk section in the Risk Dashboard, which the Second Level 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;
  - (ii) Total unpaid and unencashed contributions and their concentration levels by contributing country; and
  - (iii) Any changes from the original contribution agreements/arrangements and the agreed encashment schedules.
- (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 Level. 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
  - (iii) Monitoring the triggers for replenishment.

14. The resource mobilization plan, if needed, will be shared with the SMT and the RMC.

15. The Second Level will develop a recommendation, independent of the First Level, on any action required for improving the contribution uncertainty risk management and strengthening its adherence to the Risk Appetite Statement. This recommendation will be discussed with the First Level, reviewed and finalized with the OED.

### 4.3 Foreign exchange ("FX") risk

16. The First Level 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

---

<sup>2</sup> As per the Risk Appetite Statement.

receipt of funds, at a proportion determined by the First Level 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 Level may decide to implement a hedging strategy for additional conservatism. Any such strategy will be developed collaboratively taking inputs from the Second Level, should consider recommendations from the RMC and will need to be agreed with the SMT and, where appropriate, the Board.
17. The First Level 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 Level's responsibilities will include:
- (a) Giving direction to the Trustee consistent with this policy, specifically the requirements specified in Paragraphs 16(a) and 16(b), and the Risk Appetite Statement, monitoring adherence to those parameters, and taking corrective action (e.g., conversion of contributions to holding currencies) as required; and
  - (b) Providing information on the Fund's FX risk to the Second Level and the SMT. This information is needed by the Second Level to populate the FX Risk section in the Risk Dashboard, which the Second Level will share with the SMT, RMC and the Board on a quarterly basis.
18. The Second Level will build its view, independent of the First Level, 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 Level, reviewed and finalized with the OED.

#### 4.4 Funds Held in Trust risk

19. 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 GCF'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.
20. The First Level 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 Level'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 Level will develop this plan collaboratively, taking inputs from the Second Level;
- (b) Setting investment parameters for the Trustee consistent with this policy, specifically the requirements specified in Paragraph 19, and the Risk Appetite Statement, monitoring adherence to those parameters, and taking 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 Level and the SMT. This information is needed by the Second Level to populate the Funds Held in Trust Risk section in the Risk Dashboard, which the Second Level will share with the SMT, RMC and the Board on a quarterly basis.
21. The Second Level will develop a recommendation, independent of the First Level, 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 Level, reviewed and finalized with the OED.
22. In the event of a breach of the Funds Held in Trust Risk Appetite, the First Level will inform the Second Level, SMT, and the RMC immediately. The First Level will initiate the process of taking corrective action for the breach (such as rebalancing the liquid asset portfolio). The corrective action will be finalized collaboratively, taking inputs from the Second Level. The First Level will inform the SMT and the RMC of the corrective action.

## V. Solvency concerns

23. 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.
24. 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.
25. 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.<sup>3</sup>
26. 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);<sup>4</sup> or when the investment commitment is made in a non-holding currency.<sup>5</sup>
27. 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 GCF will match the source of funds in the same currency as the investment commitments (through actions such as currency exchanges etc.).<sup>6</sup> This approach

---

<sup>3</sup> FX depreciation of GCF investment commitments would not create solvency issues as defined in this Policy.

<sup>4</sup> Either in other holding currencies, or in promissory notes in non-holding currencies from a contributor country.

<sup>5</sup> 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 GCF may invest in, which provides a natural hedge to the GCF against investment currency appreciation.

<sup>6</sup> Conversion of funds to non-holding currencies may not be feasible within the Trustee account given the Interim Trustee Agreement. Hence either the GCF will hold non-holding currency assets in an alternative account, and if that

will help manage the fund's exposure to solvency risk in the near term (the immediate 12 months).<sup>7</sup>

28. 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 convert the matched source of funds to the investment currency.<sup>8</sup>

29. 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. 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 GCF's commitment authority (which will then adjust as the size of the buffer is recalculated over time).

30. 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 Second Level, the RMC, and the Board on a quarterly basis.

31. 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 Level 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.

32. The First Level 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 Level. The actions should consider recommendations from the RMC and will need to be agreed with the SMT and, where appropriate, the Board.

33. The Second Level will develop a recommendation, independent of the First Level, on any action required for improving the Fund's solvency management. This recommendation will be discussed with the First Level, reviewed and finalized with the OED.

## VI. Administrative provisions

34. The provisions of this policy will take effect on 2 April 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.

35. This policy shall be reviewed every two years, but earlier reviews and consequential revisions may occur upon recommendation by the Secretariat or following a request from the

---

is not feasible, then the strategy of immediate conversion will not be applicable for non-holding currency investment commitments until the Secretariat establishes appropriate currency-holding arrangements.

<sup>7</sup> 12 months has been chosen consistent with the GCF's liquidity reserve definition. As a result, this full currency matching will be relevant for sources of funds which are a part of the GCF's Liquid Asset Portfolio.

<sup>8</sup> Conversion of funds to non-holding currencies may not be feasible within the Trustee account given the Interim Trustee Agreement. Hence either the GCF 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 until the Secretariat establishes appropriate currency-holding arrangements.



RMC or the Board. Any resulting revisions to this policy which are of a material and/or substantive nature shall be presented to the Board for its consideration and approval.