



**GREEN
CLIMATE
FUND**

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GCF risk management framework

Risk Management Committee proposal

Summary

In decision B.13/36, the Board requested the Secretariat to develop the necessary methodologies and internal procedures as well as to enhance the Secretariat's risk management capacity. The Board through decision B.BM-2017/02, decided "that the interim risk and investment guidelines adopted pursuant to decision B.13/36, paragraph (a), will expire the earlier of: (i) the eighteenth meeting of the Board; or (ii) the adoption of an updated set of risk and investment guidelines".

In accordance with the work plan of the Board 2017 adopted in the decision taken between meetings, the first set of components of the updated Risk Management Framework (RMF) including the risk appetite statement is to be considered at the seventeenth meeting of the Board (B.17), and the remaining components of the RMF are to be considered at the eighteenth meeting of the Board (B.18).

This document presents the Risk Management Committee's proposal on the first set of components of the updated GCF RMF for consideration by the Board.

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I. Introduction

1. Through decision B.13/36, the Board requested the Secretariat to develop the necessary methodologies and internal procedures as well as to enhance the Secretariat's risk management capacity.
2. The Board through decision B.BM-2017/02 decided that the interim risk and investment guidelines adopted pursuant to decision B.13/36, paragraph (a), will expire the earlier of: (i) the eighteenth meeting of the Board; or (ii) the adoption of an updated set of risk and investment guidelines.
3. In accordance with the work plan of the Board 2017 adopted in the decision taken between meetings, the first set of components of the updated risk management framework (RMF) including the risk appetite statement is to be considered at the seventeenth meeting of the Board (B.17), and the remaining components of the RMF are to be considered at the eighteenth meeting of the Board (B.18).

II. Actions taken

4. To fulfil the risk-related mandate given by the Board, the Secretariat selected Oliver Wyman, an internationally reputable consulting firm, to support the Secretariat in the development of the RMF.
5. In the process of developing the related documents within the RMF, the relevant divisions within the Secretariat conducted a number of bilateral meetings with Oliver Wyman to help them understand the workings within the organization.
6. The Office of Risk Management and Compliance within the Secretariat worked closely with Oliver Wyman under the guidance of the Risk Management Committee. The Risk Management Committee reviewed the first set of components of the RMF namely:
 - (a) The revised risk register;
 - (b) The risk appetite statement;
 - (c) The risk dashboard;
 - (d) The risk guidelines for funding proposals; and
 - (e) The risk rating approach.
7. Following the review of the first set of components of the RMF, the Risk Management Committee decided to submit them to the Board for its consideration.

III. Objective

8. 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 Board-expressed consistent 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 lesser back and forth).

IV. Recommended action by the Board

9. In the draft decision as contained in annex I, it is proposed that the Board adopt the first set of components of the RMF as contained in annexes II to V to this document.
10. The adoption of the first set of components of the RMF will entail the following elements:
 - (a) Complementing the financial risk management framework adopted through decision B.07/05;
 - (b) Adopting the revised risk register as contained in annex II to this document and replacing the risk register adopted through decision B.12/34;
 - (c) Adopting the risk appetite statement as contained in annex III to this document and replacing the risk appetite methodology adopted pursuant to decision B.10/08 and contained in annex XXIV to document GCF/B.10/17;
 - (d) Adopting the risk dashboard as contained in annex IV to this document and replacing the risk dashboard adopted pursuant to decision B.10/08 and contained in annex XXIII to document GCF/B.10/17. The risk dashboard will be used in the reporting of the risk profile including financial and non-financial risks of the GCF at every Board meeting, in place of quarterly financial risk reporting as requested by the Board through decisions B.07/05, annex XI, table 1 and B.12/34, paragraph (j). The first reporting using the risk dashboard will be submitted to the Board for its consideration at the nineteenth meeting of the Board. This is recommended considering the following factors:
 - (i) In order to prepare the reporting of the risk profile of the GCF using the risk dashboard, it is necessary to set up data capture processes and systems to accumulate more data following the start of further disbursements of the approved funding proposals;
 - (ii) In addition, the Secretariat is currently focusing its efforts in the development of the risk-related policies, guidelines and tool to be considered by the Board at B.18;
 - (iii) As each Board meeting may not be held at every quarter of the calendar year, the Risk Management Committee recommends that the risk profile of the GCF is reported to the Board at every Board meeting; and
 - (iv) As the updated RMF considers both financial and non-financial risks of the GCF, it is recommended that the reporting of the risk profile of the GCF includes both risk types.;
 - (e) Adopting the “Risk guidelines for funding proposals” as contained in annex V to this document, and replacing the “Interim risk and investment guidelines for the public sector” and “Interim risk and investment guidelines for the private sector” adopted pursuant to decision B.13/36 and contained in annexes VIII and IX, respectively, to document GCF/B.13/32/Rev.01. The “Risk guidelines for funding proposals” will work together with investment guidelines to provide a comprehensive set of standards for evaluating funding proposals;
 - (a) Noting the risk rating approach, as contained in annex VI to this document; and
 - (b) Requesting the Secretariat to continue with the development of appropriate risk rating models with the support from an external professional service provider and in consultation with the Risk Management Committee and present the risk rating models

for consideration by the Board at its nineteenth meeting in place of the eighteenth meeting of the Board. This is recommended by the Risk Management Committee considering the following factors:

- (i) The Secretariat selected Moody's Analytics to assist in the development of a risk rating methodology and the firm suggested its off-the-shelf template. Following careful assessment of the suggested template, the risk management function within the Secretariat decided that the template is tailored to project finance within private sector financial institutions and requires adapting to GCF's purposes; and
- (ii) The risk management function within the Secretariat sought an opinion from Oliver Wyman regarding a suitable risk rating approach as contained in annex VI to this document. It was recommended that the GCF incorporate the "project success rating" and "credit risk rating" as contained in annex VI and seek to work with an external professional consulting service provider to build the Fund's risk rating models.

Annex I: Draft decision of the Board

The Board, having reviewed document GCF/B.17/12 titled “GCF risk management framework”:

- (a) Adopts the first set of components of the risk management framework as contained in annexes II to V to this document as follows:
 - (i) Risk management framework component I – revised risk register, as set out in annex II;
 - (ii) Risk management framework component II – risk appetite statement, as set out in annex III;
 - (iii) Risk management framework component III – risk dashboard, as set out in annex IV;
 - (iv) Risk management framework component IV – “Risk guidelines for funding proposals”, as set out in annex V;
- (b) Agrees that the:
 - (i) Risk management framework component I – revised risk register referred to in paragraph (a) (i) replaces the risk register adopted through decision B.12/34;
 - (ii) Risk management framework component II – risk appetite statement referred to in paragraph (a) (ii) replaces the risk appetite methodology adopted pursuant to decision B.10/08 and contained in annex XXIV to document GCF/B.10/17;
 - (iii) Risk management framework component III – risk dashboard referred to in paragraph (a) (iii) replaces the risk dashboard adopted pursuant to decision B.10/08 and contained in annex XXIII to document GCF/B.10/17;
 - (iv) Risk management framework component IV – “Risk guidelines for funding proposals” referred to in paragraph (a) (iv) replaces the “Interim risk and investment guidelines for the public sector” and “Interim risk and investment guidelines for the private sector” adopted pursuant to decision B.13/36 and contained in annexes VIII and IX, respectively, to document GCF/B.13/32/Rev.01;
- (c) Notes that the first set of components of the risk management framework as contained in annexes II to V complements the financial risk management framework adopted pursuant to decision B.07/05;
- (d) Requests the Secretariat to use the risk dashboard in annex IV in the reporting of the risk profile including financial and non-financial risks of the GCF at every Board meeting starting at the nineteenth meeting of the Board;
- (e) Takes note of the risk rating approach as set out in annex VI;
- (f) Requests the Secretariat to continue with the development of appropriate risk rating models with the support from an external professional service provider and in consultation with the Risk Management Committee and present the risk rating models for consideration by the Board at its nineteenth meeting; and
- (g) Requests the Secretariat to continue with the development of the risk management framework and its remaining components in consultation with the Risk Management Committee and present these for consideration of the Board at its eighteenth meeting.

Annex II: Risk management framework component I – revised risk register

I. Introduction

1. Through decision B.12/34, the Board adopted the risk register as contained in annex XXVIII and requested the Risk Management Committee (RMC) to review the probability, impact and resulting priorities of risks prior to the thirteenth meeting of the Board. A technical note was compiled to provide an approach and rationale that estimates the probabilities, impacts and resulting priorities in the risk register. Moreover, the Board indicated that the risk register will be updated at least once a year. In addition, the Board requested the Secretariat to monitor and report to the Board at each Board meeting any changes in the priorities of the risk register.

2. The Board, through decision B.13/35, adopted the proposed revision of the risk register and concluded that the proposal was reasonable. The RMC also recommended that the Board change the risk register update interval from “at least once a year” to “as frequently as the RMC deems necessary, but no less frequent than once every three years”, due to the fact that the risk environment in which the Green Climate Fund (“GCF”, “the Fund”) operates evolves as a result of external events, changes in the mix of instruments deployed by the GCF and other strategic priorities.

3. Through decision B.13/36, the Board requested the Secretariat, in consultation with the RMC, to develop the necessary methodologies to enhance the Secretariat’s risk management capacity.

4. This document is a component of the Risk Management Framework (“RMF”), and it contains an updated version of the GCF’s previous risk register (GCF/B.13/29). The updated technical note from the RMC regarding the risk register is contained in Appendix I. The risk register provides a comprehensive list of non-overlapping risk types that concern the GCF and a clear definition for each risk type in that list. The risk register brings the following benefits:

- (a) It provides a consistent terminology for the GCF to communicate about risk.
- (b) It helps define the mandate of the Office of Risk Management and Compliance by clarifying what should be a risk concern versus what should be a strategy concern.
- (c) It defines the structure around which the rest of the RMF can be defined, thus bringing consistency across the RMF.

5. Specifically, this new version ensures that the set of risks listed in the register are comprehensive and non-overlapping, and that it clarifies the philosophy of what should be a risk concern vs. strategic concern. Beyond the risk types and definitions, GCF’s previous risk register also included some other parameters on each risk type – most importantly the likelihood, impact, and mitigating actions. These other parameters too have been updated in this version of the risk register. The main focus of these updates was to ensure greater consistency in these parameters across various risk types and with the new proposed risk appetite statement. However, the parameters have a strong dependence on the rest of the RMF (including detailed processes and procedures which are a part of the RMF) which is currently being revised. Hence, these parameters should be reviewed again after the rest of the RMF has been detailed.

II. Linkages with previous decisions and other documents

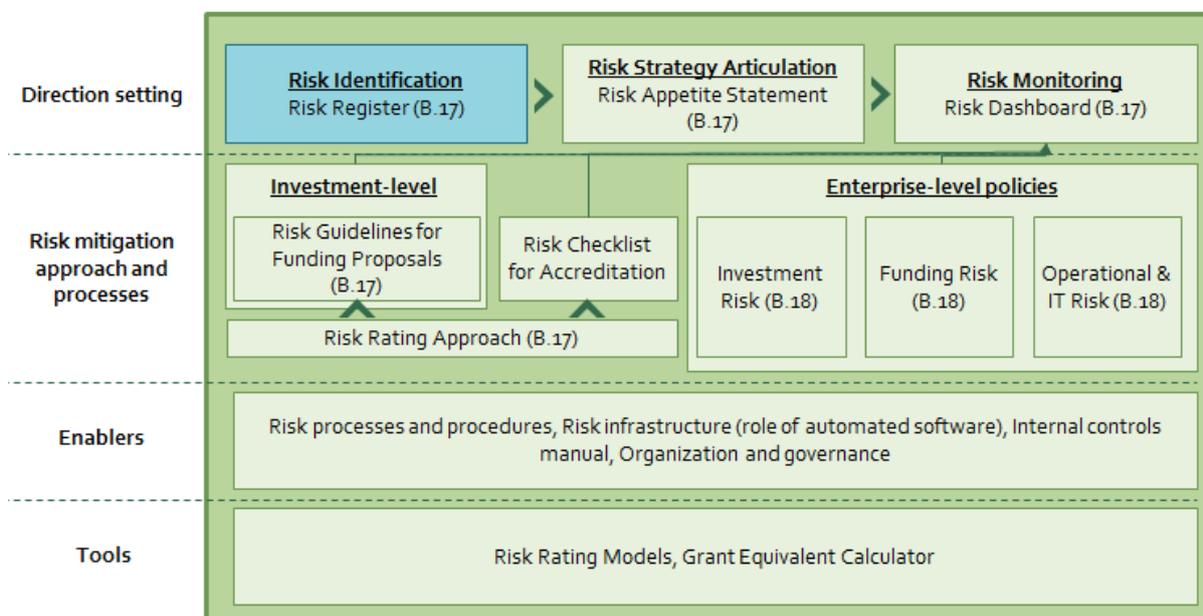
6. This document also has linkages with the following documents:

- (a) Document GCF/B.12/17 titled “Initial risk management framework: risk register, risk appetite update and Initial risk guidelines for credit and investment”
- (b) Document GCF/B.13/29 titled “Report on the proposed revision of the risk register”

III. Objective

7. This document is a component of the Risk Management Framework (RMF), and it contains an updated risk register. The risk register provides a comprehensive list of non-overlapping risk types that concern the GCF, and a clear definition for each risk type in that list.

Figure 1. Risk Management Framework (RMF) components



8. The risk register brings the following benefits:
- (a) Provides a consistent language and terminology for the GCF to communicate about risk, outlining a comprehensive set of non-overlapping risks that GCF faces with clear definitions;
 - (b) It helps define the mandate for the Office of Risk Management and Compliance by clarifying what should be a risk concern versus what should be a strategy concern; and
 - (c) It defines the structure around which the rest of the RMF can be defined, thus bringing consistency across the RMF.
9. The risk register also summarizes mechanisms in place to identify, analyse and evaluate the risks. It can be used to assess the relative priority of the risks and to take control actions to mitigate them.

IV. Effective date

10. The revised risk register set forth in appendix I will take effect on September 1st 2017. If the Interim Trustee is unable to implement the requirements in the revised risk register, 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. It should be noted that beyond the list of risk types and their definitions, other parameters described in this risk register have a strong dependence on the rest of the



RMF (including the RMF's detailed elements like processes and procedures) which is currently being revised. Hence these parameters of the risk register should be reviewed again after the rest of the RMF has been detailed.

Appendix I: Updated technical note from the Risk Management Committee and the revised risk register

I. Introduction

1. In decision B.12/34, the Board adopted the risk register and requested the Risk Management Committee (RMC) to review the probabilities, impacts and resulting priorities of risks prior to the thirteenth meeting of the Board. This technical note was compiled to provide an approach and rationale that estimates the probabilities, impacts and resulting priorities in the risk register.
2. This technical note has been updated as part of the revisions proposed to the risk register in this document.

II. Definition

3. General definitions: Risk is a potential event that can threaten the achievement of an organization's objectives. Organizations take various actions to control risk within their risk appetite and risk tolerances. Risk that exists before organizations take mitigating actions is termed inherent risk, whereas risk that remains after control measures are taken is termed residual risk. A risk register is a documented collection of the risks impacting an activity or the organization, as well as the mechanisms in place to identify, analyze and evaluate the risks. It can be used to assess the relative priority of the risks and to take control actions to mitigate them. For each risk, the following parameters are identified:
 - (a) Probability and impact: The assessment of the likelihood of the risk events occurring and, if the risk event occurs, the overall impact on the organization;
 - (b) Risk tolerance: The level of appetite or tolerance that the organization has to the particular type of risk;
 - (c) Mitigation: Mechanisms that should ideally be in place to reduce the probability of occurrence, or to reduce the impact of, each type of risk if it were to occur. Potential mitigation measures include policies, procedures, internal controls, and analytical tools;
 - (d) Priority: The relative importance to the organization of each risk based on the combination of probability of occurrence and impact; and
 - (e) Key risk indicator: The parameter(s) used to measure the level of risk that materialized.
4. Two other parameters from the previous risk register (GCF/B.13/29) - Triggers and Owners - have been removed in this revision. The Triggers parameter was removed as it had strong overlaps with the Mitigation parameter. The previous risk register (GCF/B.13/29) also assigned multiple owners to each risk. It is recommended that the Owner parameter is considered for inclusion again once the rest of the RMF has been detailed and there is further clarity on ownership (i.e. a single owner) of each risk-related activity.

III. Proposed risk assessment approach

5. There are two types of risk: inherent risk and residual risk. Risk that exists before an organization takes mitigation actions is inherent risk, and risk that remains after control measures are taken is residual risk. The objective of risk management is to maintain the residual risk level within risk appetite and tolerance set by the board of an organization.

6. Ideally, the probability and impact of risk (and the resulting priority also) need to be based on the actual risk/loss events of the GCF. In such cases, the GCF can observe the risk probability and impact from its historical risk data, thereby directly arriving at risk priority. However, many of the estimates of risks will always be based on "expert judgment" since some of the risk types will occur very rarely so as to allow the development of a meaningful historical database with any level of statistical significance.

7. As a start-up organization, the GCF does not have its own historical data, making it inevitable that it will rely on experts' professional judgment as a starting point. Therefore, it is useful to follow the flow of logic from inherent risk to residual risk considering mitigation measure.

IV. Initial assessment

8. The Probability of occurrence and Impact are defined as follows:

(a) Probability of occurrence

- (i) High – highly likely to occur within the next 12 months;
- (ii) Somewhat likely – would not be surprising if it occurred within the next 36 months;
- (iii) Somewhat unlikely – would be surprising if it occurred within the next 36 months; and
- (iv) Low – highly unlikely to occur within the next 36 months.

(b) Impact

- (i) High – a material adverse impact that could impede the organization's ongoing viability and/or its ability to meet its strategic objectives;
- (ii) Somewhat disruptive – an adverse impact that would be disruptive to the viability of the GCF and/or its ability to meet its strategic objectives;
- (iii) Somewhat non-disruptive – a relatively contained adverse impact that could impact the financials of the GCF and/or its ability to meet its strategic objectives by up to 10 per cent; and
- (iv) Low – minimal and contained impact.

9. The priorities for inherent and residual risks are assigned using the priority grid (Table 1) approved by the Board as part of the risk dashboard, and it is effectively the result of combining the probability and impact of occurrence as an estimation of the importance of such risks.

Table 1. Priority table

Probability of occurrence \ Impact	Low (L)	Somewhat non-disruptive (SND)	Somewhat disruptive (SD)	High (H)
Low (L)	Low priority	Low priority	Low priority	Medium priority
Somewhat unlikely (SU)	Low priority	Low priority	Medium priority	Medium priority
Somewhat likely (SL)	Low priority	Medium priority	High priority	High priority
High (H)	Medium priority	Medium priority	High priority	Very high priority

Source: Document GCF/B.10/07 titled "Initial risk management framework: methodology to determine and define the Fund's risk appetite"

Revised risk register

Risk code		1.1	1.2
Risk category		Compliance	Compliance
Subcategory		Internal compliance breach	Regulation and sanction/embargo breach and engagement in prohibited practices
Description		Failure of staff or Board members to comply with the standards and codes of conduct, set by the GCF itself through its policies and procedures, including: Travel Policy, Administrative Policies of the Fund, Policies on Ethics and Conflicts of Interest, Policies on ethics and conflicts of interest for other Board appointed officials and active observers, Information Disclosure Policy, cross-subsidization between providers of grants and loans (Financial Risk Management Framework), Gender Policy and Action Plan, Fiduciary Principles and Standards, Environmental and Social Safeguards	Failure of the GCF, AE/EEs, or other related parties to adhere to the laws and regulations, including sanctions and embargoes, in jurisdictions relevant to the operations or engagements of the GCF as well as to the GCF's Anti-Money Laundering and Countering the Financing of Terrorism Policy and Interim Policy on Prohibited Practices
Inherent risk	Prob.	Somewhat unlikely	Somewhat likely
	Impact	High	High
	Priority	Medium	High
Risk tolerance		GCF will completely avoid this risk (zero tolerance)	GCF will completely avoid this risk (zero tolerance)
Mitigation		The risk will be identified and mitigated as follows: 1) All HR decisions will be screened for this risk. 2) GCF will continuously evaluate internal processes and policies (including the GCF payments process) for this risk and take corrective action as required. It will also take necessary action to improve the Compliance/Ethics Culture across GCF through adequate communication efforts and staff and Board training. 3) GCF will continuously evaluate all internal processes and policies, Funding Proposals, and GCF's overall investments in projects / programmes for potential policy breaches, and take corrective action as required.	The risk will be identified and mitigated as follows: 1) Accreditation process: Potential AEs will be screened for this risk, and accreditation decisions will be taken accordingly. GCF will continue to evaluate AEs for this risk through the ongoing AE monitoring and evaluation and take corrective action as required. 2) Projects / programmes: Concept Notes and Funding Proposals will be screened for this risk, and such evaluations will influence the final decisions taken on them. GCF will continue to evaluate projects / programmes for this risk through the ongoing project / programme monitoring and review process and take corrective action as required. 3) All HR and procurement decisions will be screened for this risk. 4) The GCF will continuously evaluate internal processes and policies (including the GCF payments process) for this risk. and take corrective action as required. It will also take necessary action to drive a Compliance/Ethics Culture across GCF. 5) The GCF will continue to monitor for changes in laws and regulations, including sanctions and embargoes, applicable to GCF and take corrective action as required. GCF will also secure necessary privileges and immunities that are not yet in place and conduct periodic exchanges with home country authorities.
Residual risk	Prob.	Low	Somewhat unlikely
	Impact	High	High
	Priority	Medium	Medium
Key risk indicator		List of compliance breaches	List of compliance breaches; List of countries and exposures where GCF invests in without privileges and immunities

Risk code		2.1	2.2
Risk category		Legal risk	Legal risk
Subcategory		Contractual breach	Non-contractual breach
Description		Financial loss, sanction, and/or reputational damage resulting from the use of defective contracts or contractual relationships	Financial loss, sanction, and/or reputational damage resulting from Non-Contractual Rights Risk (the risk that GCF's assets are not properly owned or are infringed by others, or the infringement by GCF entity of another party's rights)
Inherent risk	Prob.	Somewhat likely	Low
	Impact	Somewhat disruptive	Somewhat non-disruptive
	Priority	High	Low
Risk tolerance		GCF will take this risk in a limited, controlled amount	GCF will take this risk in a limited, controlled amount
Mitigation		The risk will be identified and mitigated as follows: 1) GCF will screen its legal contacts (AMAs, FAAs, procurement contracts, etc.) for this risk. 2) GCF will continuously evaluate internal processes and policies for this risk and take corrective action as required. It will also take necessary action to improve the compliance culture across GCF. 3) GCF will continue to monitor for changes in law applicable to GCF and take corrective action as required. GCF will secure necessary privileges and immunities that are not yet in place and conduct periodic exchanges with home country authorities. 4) The General Counsel will review all contracts, when applicable, and take corrective action as required.	The risk will be identified and mitigated as follows: 1) GCF will continuously evaluate internal processes and policies for this risk and take corrective action as required. It will also take necessary action to improve the Compliance/Ethics Culture across GCF. 2) GCF will continue to monitor for changes in law applicable to GCF and take corrective action as required. 3) The General Counsel will oversee legal documents and internal practices and take corrective action as required. GCF may use external counsel, if necessary. 4) GCF will continue to monitor AMA and FAA commitments and take corrective action as required.
Residual risk	Prob.	Somewhat unlikely	Low
	Impact	Somewhat disruptive	Somewhat non-disruptive
	Priority	Medium	Low
Key risk indicator		List of legal disputes; List of countries and exposures where GCF invests in without privileges and immunities	List of legal disputes

Risk code	3		4.1	4.2
Risk category	Reputation risk		Operational and IT risk	Operational and IT risk
Subcategory	N/A		GCF operational process errors	Disasters and other events
Description	Adverse perception which has a material effect on the credibility of GCF (beyond the Reputational damage which may be incurred due to one of the other risks in this register)		Failure to meet GCF's internal operations standards or non-compliance with external requirements that affect operations activities	Disruption of business due to natural or man-made catastrophic disasters
Inherent risk	Prob.	High	Somewhat likely	Somewhat unlikely
	Impact	Somewhat disruptive	Somewhat non-disruptive	Somewhat disruptive
	Priority	High	Medium	Medium
Risk tolerance	GCF will take this risk in a limited, controlled amount		GCF will take this risk in a limited, controlled amount	GCF will take this risk in a limited, controlled amount
Mitigation	Reputational risk can persist despite the broader risk mitigation measures in place. GCF's strategy will include a clear plan to mitigate and manage this risk ¹ . GCF will be informed by reputational risk monitoring, which will be identified and measured in media monitoring and engagement with AEs, NDAs, CSOs, and other stakeholders. GCF will also set a stakeholder engagement plan that has to be executed in cases where reputation risk is deemed high (e.g. frequent negative international coverage on a GCF-supported project). For reputational risks resulting from the complexity of applying for GCF funds or slow, inefficient decision-making processes, GCF will provide guidance and readiness programmes for relatively inexperienced AE/EE/NDAs, and distribute materials to facilitate awareness and understanding of the process.		GCF will implement controls in its operational processes to mitigate this risk. The effectiveness of these controls will be continuously evaluated through GCF's Risk Control Self-Assessment, and corrective action will be taken to modify controls where required.	GCF will set up a business continuity plan to prepare for such events, and socialize and train the organization on it. This plan will include a cloud-centric way of holding and securing information assets, combined with mobile computing to allow staff to work remotely and a business continuity management system consistent with ISO 22301:2012.
Residual risk	Prob.	Somewhat likely	Somewhat unlikely	Low
	Impact	Somewhat disruptive	Somewhat non-disruptive	Somewhat non-disruptive
	Priority	High	Low	Low
Key risk indicator	List of adverse publicity reports; List of grievances		Funding Proposal approval time; AE accreditation approval time	List of natural catastrophes, geopolitical events, wars, and terrorism affecting GCF's operations

¹ This will include a Communication strategy, which includes an approach to disseminating results. In addition, this risk will be mitigated through internal processes manuals, readiness programme, accreditation process, Country Programming outreach, financial management processes of the GCF, media monitoring, and participation of observers in Board meetings.

Risk code		4.3	4.4	4.5
Risk category		Operational and IT risk	Operational and IT risk	Operational and IT risk
Subcategory		IT systems failure	Cyber attack	Staffing risk
Description		Disruption of business due to unavailability / inaccessibility of IT infrastructure and applications.	Misappropriation of internal data and/or information by a third party through IT means, such as system security breach, hacking, phishing attacks, and cybercrime. Also includes hacking damage and malware / virus attacks.	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 GCF staff.
Inherent risk	Prob.	Somewhat likely	Somewhat likely	High
	Impact	Somewhat disruptive	Somewhat disruptive	Somewhat disruptive
	Priority	High	High	High
Risk tolerance		GCF will take this risk in a limited, controlled amount	GCF will take this risk in a limited, controlled amount	Limited, controlled amount
Mitigation		GCF will set up an IT system evaluation, monitoring, and back-up strategy (in the event of a failure).	GCF will set up appropriate systems to assess, monitor, and prevent breaches, and establish protocols in the case of system breaches or data theft to minimize damages.	GCF will maintain a competitive compensation package, effective performance management system, and continuous learning opportunities. GCF will also take necessary actions to reduce vacancies and turnovers, increase staff morale, and address employee concerns or complaints.
Residual risk	Prob.	Somewhat unlikely	Somewhat unlikely	Somewhat likely
	Impact	Somewhat non-disruptive	Somewhat non-disruptive	Somewhat non-disruptive
	Priority	Low	Low	Medium
Key risk indicator		List of IT system failures	List of information security breaches	List of complaints on employee behavior; Employee turnover rate; Vacancy rate

Risk code		5.1	5.2	6.1
Risk category		Project/programme failure risk	Project/programme failure risk	Funding risk
Subcategory		Project/programme failure: Risk of non-compliance against internal requirements	Project/programme failure: Impact risk	Funds held in Trust: Foreign exchange (FX) risk
Description		Failure of the AE/EE or other related parties to comply with GCF's internal policies, guidelines, applicable regulations, and respective agreements (e.g. AMA, FAA) with involved parties to a project/programme.	Failure of the project/programme to deliver the expected transformative mitigation and adaptation climate impact	Loss in the value of contributions due to foreign exchange rate fluctuations
Inherent risk	Prob.	Somewhat likely	High	Somewhat likely
	Impact	Somewhat disruptive	Somewhat disruptive	Somewhat disruptive
	Priority	High	High	High
Risk tolerance		GCF will take this risk in a limited, controlled amount	GCF will actively take this risk to achieve its mandate	GCF will take this risk in a limited, controlled amount
Mitigation		Concept Notes and Funding Proposals will be screened for this risk, and the evaluation will influence the decisions taken on them. In addition, the risk will also be identified and measured in the accreditation process and AE monitoring process ² . GCF will also continue to evaluate projects / programmes for this risk through the ongoing project / programme monitoring and review process and take corrective action as required.	Concept Notes and Funding Proposals will be screened for this risk, and the evaluation will influence the decisions taken on them. In addition, the risk will be identified and measured in country programming outreach efforts and readiness programme. GCF will also continue to evaluate projects / programmes for this risk through the ongoing project / programme monitoring and review process ³ and take corrective action as required.	The risk will be monitored by the Secretariat through a contribution management system and mitigated through conversion of cash received to one of GCF's holding currencies, FX hedging, and continuous monitoring of the resulting FX position (enabling corrective action if required).
Residual risk	Prob.	Somewhat unlikely	High	Somewhat unlikely
	Impact	Somewhat disruptive	Somewhat disruptive	Somewhat non-disruptive
	Priority	Medium	High	Low
Key risk indicator		List of countries where GCF invests in without privileges and immunities; Customer Due Diligence Assessment Reports	Portfolio distribution by Project Success Risk Rating; Ongoing project delays; Impact achievements (Measurement of core adaptation and mitigation indicators)	Proportion hedged as percentage of total FX exposure

² The AE monitoring process will include monitoring of media and other public sources, and periodic interaction with NDAs.

³ The project / programme monitoring and review process will include assessment based on the GCF results management framework.

Risk code		6.2	6.3	6.4
Risk category		Funding risk	Funding risk	Funding risk
Subcategory		Funds held in Trust: Policy compliance risk	Funds held in Trust: Investment risk	Funding: Liquidity risk
Description		Failure to comply with GCF's policies on funds held in Trust	Losses in the value of investments of GCF's funds held in Trust due to market movements in the price of the securities	Timing mismatch between the cash inflows and cash outflows leading to shortages in the ability of the GCF to face its payment obligations
Inherent risk	Prob.	Somewhat likely	Somewhat likely	Somewhat likely
	Impact	High	Somewhat disruptive	Somewhat disruptive
	Priority	High	High	High
Risk tolerance		GCF will take this risk in a limited, controlled amount	GCF will take this risk in a limited, controlled amount	GCF will take this risk in a limited, controlled amount
Mitigation		GCF will set investment boundaries for its Trustee. The investment portfolio will continuously be monitored against those boundaries and the boundaries will be enforced using the arrangement with the Trustee ⁴ .	GCF will set risk targets for its Trustee. The investment portfolio will continuously be monitored against those targets and the targets will be enforced using the arrangement with the Trustee. GCF will also set concentration targets for its Trustee and monitor concentration levels ⁵ .	GCF's liquidity reserve will be analyzed in each Funding Proposal, and it will guide the decision taken on the Funding Proposal. GCF will continuously monitor its liquidity position vis-a-vis its Risk Appetite through various tools, such as cash flow models and contribution management system, and take corrective action as required.
Residual risk	Prob.	Low	Somewhat unlikely	Somewhat unlikely
	Impact	High	Somewhat disruptive	Somewhat non-disruptive
	Priority	Medium	Medium	Low
Key risk indicator		Confirmation that liquid asset portfolio ⁶ is not invested against the mission of the GCF.	Average credit rating of liquid asset portfolio. Confirmation that the Fund invests only in investment grade securities. Confirmation of the average and maximum duration for liquidity reserve ⁷ and other funds (see risk appetite statement).	Cash flow projection; Liquidity reserve size vs. target; Credit defaults

⁴ 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.

⁵ 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.

⁶ The liquid asset portfolio is defined as cash or cash equivalents held in Trust or in GCF's bank accounts (see risk appetite statement).

⁷ The GCF will set an appetite level on the size of the GCF's liquidity reserve that will be equivalent to sufficient levels to sustain net funding requirements for 1 year (see risk appetite statement).

Risk code	6.5	7.1	7.2
Risk category	Funding risk	Financial investment risk	Financial investment risk
Subcategory	Funding: Contribution uncertainty risk	Equity investments: Valuation shock risk	Equity investments: Exit strategy risk
Description	Failure to convert all pledges into contributions in total, or within the promised time frame	Severe negative shocks to valuations of GCF's equity investments	Failure of GCF to exit its equity investments
Inherent risk	Prob.	Somewhat likely	High
	Impact	High	Somewhat disruptive
	Priority	High	High
Risk tolerance	GCF will take this risk in a limited, controlled amount	GCF will actively take this risk to achieve its mandate	GCF will actively take this risk to achieve its mandate
Mitigation	GCF will continuously evaluate its commitment authority and encashment schedule, and risk of payment roll backs and delays through the contribution management system, periodic engagements with contributors, and media and other public sources monitoring. The Board will be kept abreast with the funding position using the resource mobilization reports.	Concept Notes and Funding Proposals will be screened for this risk, and such evaluations will influence the decisions taken on them. GCF will continue to evaluate projects / programmes for this risk through the ongoing project / programme monitoring and review process and take corrective action as required.	Concept Notes and Funding Proposals will be screened for this risk, and such evaluations will influence the decisions taken on them. GCF will continue to evaluate projects / programmes for this risk through the ongoing project / programme monitoring and review process and take corrective action as required.
Residual risk	Prob.	Somewhat unlikely	High
	Impact	High	Somewhat disruptive
	Priority	Medium	High
Key risk indicator	Deviation from expected payment, deposit or encashment schedules; Percentage of pledges remaining unsigned; Percentage exposure to contributors (by contributor, financial instrument)	Changes in equity valuations relative to the initial equity investment per Funding Proposal; Changes in overall valuation of GCF's equity investment portfolio	List of equity investments without a clear exit strategy

Risk code		7.3	7.4
Risk category		Financial investment risk	Financial investment risk
Subcategory		Credit: Counterparty risk	Credit: Convertibility and Transfer Risk
Description		The risk that a GCF loan financing recipient will become unwilling or unable to satisfy the terms of a loan obligation to the GCF, or that the value of a loan asset declines due to a deterioration in the creditworthiness of the issuer	The risk that a government will impose a moratorium on, or otherwise prohibit private sector obligators from servicing their foreign currency debts in a timely manner by restricting the ability of the obligor to convert a local currency balance to a foreign currency balance and/or transfer a foreign currency balance to its foreign currency creditors.
Inherent risk	Prob.	High	Somewhat unlikely
	Impact	Somewhat non-disruptive	Somewhat non-disruptive
	Priority	Medium	Low
Risk tolerance		GCF will actively take this risk to achieve its mandate	GCF will actively take this risk to achieve its mandate
Mitigation		Concept Notes and Funding Proposals will be screened for this risk, and such evaluations will influence the decisions taken on them. Accreditation decisions will also be dependent on credit risk assessment. GCF will also continue to evaluate projects / programmes / AEs for this risk through the ongoing project / programme and AE monitoring (including credit risk monitoring) and review process and take corrective action as required.	Concept Notes and Funding Proposals will be screened for this risk, and such evaluations will influence the decisions taken on them. GCF will continue to evaluate projects / programmes for this risk through the ongoing project / programme monitoring and review process and take corrective action as required. NDAs will be involved to further mitigate this risk.
Residual risk	Prob.	High	Low
	Impact	Somewhat non-disruptive	Somewhat non-disruptive
	Priority	Medium	Low
Key risk indicator		Deviation of reflows from loan disbursements (split by deviations driven by counterparty risk vs. convertibility and transfer risk); List of delinquent loans with degree of delinquency and delinquent amount (split by delinquencies driven by counterparty risk vs. convertibility and transfer risk); Portfolio distribution by Credit Risk Rating	Deviation of reflows from loan disbursements (split by deviations driven by counterparty risk vs. convertibility and transfer risk); List of delinquent loans with degree of delinquency and delinquent amount (split by delinquencies driven by counterparty risk vs. convertibility and transfer risk)

Annex III: Risk management framework component II – risk appetite statement

I. Introduction

1. Through decision B.13/36, the Board requested the Secretariat, in consultation with the RMC, to develop the necessary methodologies to enhance the Secretariat’s risk management capacity. This document presents the initial risk appetite statement to guide the level of risk taking by the Green Climate Fund (“GCF”, “the Fund”) and, where required, steer mitigation of such risks. This document is part of the broader Risk Management Framework (“RMF”).
2. In order to achieve its mission to promote paradigm shift towards low-emission and climate-resilient development pathways, the GCF will be required to take various forms of risks. The definition of these risks is included in the risk register (part of the RMF).
3. This document⁸ provides a statement of the levels of risk that the GCF is willing to take (the Fund’s “appetite” for risk). The risks are differentiated across the types defined in the risk register (part of the RMF), and are further differentiated between risks inherent with running a large fund, and risks specific to the considered funding proposals.
4. The risk appetite statement is the desired risk profile for the GCF as a whole across the full spectrum of risk-types defined in the risk register (another component of the RMF).
5. The purpose of the risk appetite statement is to provide guidance on:
 - (a) Overall level of risk that GCF is willing to take to achieve its objectives.
 - (b) Types of risks to be monitored.
 - (c) Qualitative appetite statements and quantitative metrics that can be cascaded to specific business units to guide their day-to-day operations.
6. The risks faced by the GCF range from those for which the GCF has no appetite (e.g. compliance risks) to those that the GCF has a relatively high risk appetite, e.g. certain Funding Proposal (“FPs”, “proposals”) risks. Overall, the GCF has zero-tolerance for illegal practices and integrity or policy breaches, relatively moderate risk tolerance for activities that arise as a result of operating a global investment fund, and considerable risk tolerance for activities necessary to realize GCF’s mandate.

II. Linkages with previous decisions and other documents

7. At its seventh meeting, the Board requested the Secretariat, in consultation with the RMC, to prepare an analysis of the Fund’s potential risk appetite under different key assumptions as part of its financial risk management framework (decision B.07/05).
8. Furthermore, the Board took note of document, B.09/13 “Initial Risk Management Framework: Survey of methodologies to define and determine risk appetite” (decision B.09/06).
9. The Board requested the Secretariat, in consultation with the RMC, to present an initial risk appetite statement for the GCF as per decision B.10/08.
10. This document is part of a staged evolution of the RMF at the GCF, as the Fund seeks to refine its vision around risk taking and risk culture. This document builds on previous decisions undertaken by the Board:

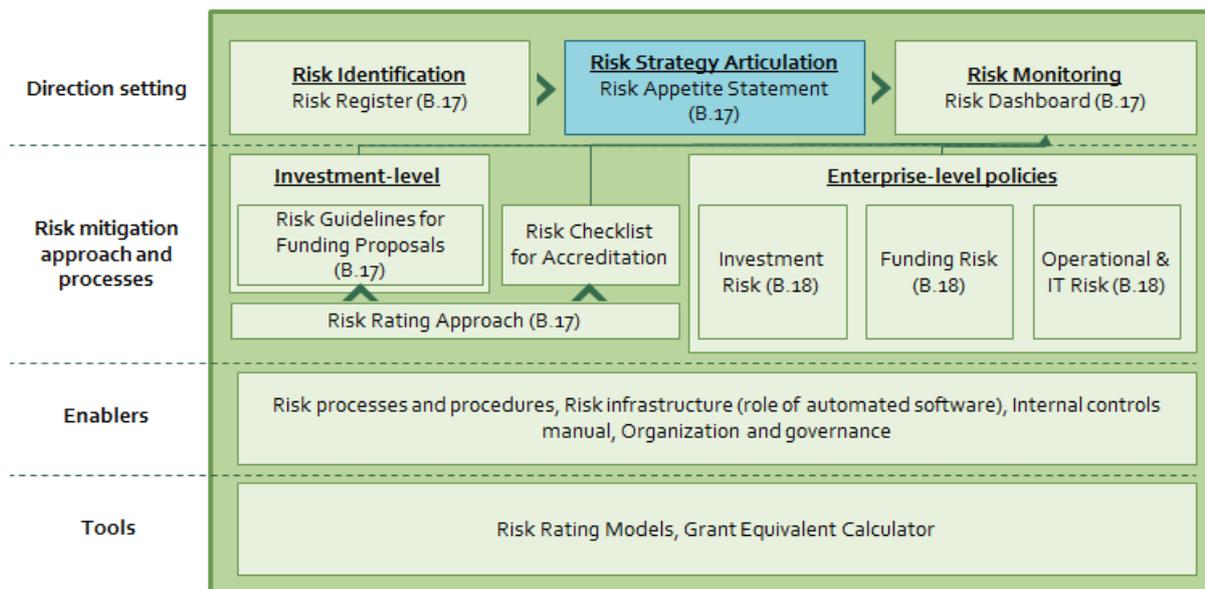
⁸ This document does not specify the process of risk assessment, the investment criteria for the GCF, or methods of mitigating breaches. Such specific details are discussed in other policy documents.

- (a) Paragraph 2 of the Governing Instrument established GCF's mission to "promote the paradigm shift towards low-emission and climate-resilient development pathways by providing support to developing countries to limit or reduce their greenhouse gas emissions and to adapt to the impacts of climate change," taking into consideration the needs of developing countries particularly vulnerable to the adverse effects of climate change.
 - (b) Decision B.06/06 requested the GCF to strive to balance the portfolio based on a 50:50 theme-based allocation between mitigation and adaptation, and within adaptation, at least 50% allocation for particularly vulnerable countries (including Least Developed Countries ("LDCs"), Small Island Developing States ("SIDS"), and African States).
 - (c) Decision B.07/05 established the initial financial risk management framework of the GCF, consisting of financial risk policies, a financial risk monitoring and reporting management system and financial risk governance arrangements. The financial risk policies were further elaborated through decision B.08/13 as part of the policies for contributions. Elements of the financial risk monitoring and reporting management system were defined through decision B.08/18 (financial reporting and the external auditing process) and decision B.BM-2015/06 (internal control framework).
 - (d) Decision B.07/05 also requested the Secretariat to start the process of analysis to determine the risk appetite of the GCF. Through decision B.09/06, the Board took note of a survey of methodologies to define and determine the risk appetite and through decision B.10/08 it adopted the risk dashboard, its related risk categories and subcategories, and the methodology to be followed by the GCF to set its risk appetite.
11. This document also has linkages with the following documents:
- (a) Financial Risk Management Framework (GCF/B.07/05);
 - (b) Investment Framework (GCF/B.07/06);
 - (c) Further development of the Initial Results Management Framework (GCF/B.08/07);
 - (d) Policies for Contributions to the Green Climate Fund (GCF/B.08/16);
 - (e) Initial Risk Management Framework: Survey of methodologies to determine and define risk appetite (GCF/B.09/13);
 - (f) Further development of the Initial Investment Framework: Sub-criteria and Methodology (GCF/B.09/07);
 - (g) Initial Risk Management Framework: risk register, risk appetite update and initial risk guidelines for credit and investment (GCF/B.12/17); and
 - (h) Initial Strategic Plan for the GCF: the need for improved and coherent guidance on the Fund's investment criteria and risk appetite (GCF B.12/32 Annex I).

III. Objective

12. This document is a part of the comprehensive GCF RMF with the objective of setting the appropriate level of risk taken by the GCF. The components of the framework are presented below in Figure 1.

Figure 1. RMF components (in brackets for each component: the Board meeting when it is planned to be discussed).



13. The objective of this document is to propose an initial risk appetite statement for the Fund. The risk appetite describes the overall level of risk that the GCF is willing to take in order to achieve its objectives. This statement will encompass:

- (a) A set of top-down, Board level directions to steer level of risk taking.
- (b) An interpretation of the Governing Instrument into practical risks faced in day-to-day operations.
- (c) An emphasis on key risks that could compromise the ability to achieve GCF’s strategic mandate.
- (d) Quantitative metrics and qualitative statements describing acceptable risk levels.

IV. Structure of the risk appetite statement

14. The GCF defines three levels of appetite for risk taking, from zero tolerance to considerable tolerance, that differ across risk types:

- (a) Prohibited risk taking (“zero risk tolerance”): Activities that the GCF will not engage in and for which the GCF will have zero risk tolerance.
- (b) Risks to be carefully managed and where practicable minimized (“moderate risk tolerance”): Risk taking based on activities that are a by-product of operating a materially significant fund.
- (c) Risks taken to achieve strategic impact (“considerable risk tolerance”): Risks required to be taken to fulfil the GCF mandate, to be compensated through climate change impact.

V. Risk appetite statement

5.1 Overall statement of risk appetite

15. The GCF is required to take risks in order to fulfil its mandate, however such risks will be carefully managed:

- (a) The Fund will uphold the highest level of integrity in conducting its operations and hence has zero-tolerance towards partaking in prohibited practices, breaches of international sanctions / embargoes, by staff, Board members, counterparties and partners (especially Accredited and Executing Entities (“AEs” and “EEs”). The Fund will also have zero tolerance for violations of applicable internal policies by staff or Board members.
- (b) The GCF seeks a stable and moderate enterprise risk profile which will enable the Fund to ensure adequacy and predictability of financial resources, maintain a well-balanced portfolio of projects/programmes consistent with the principles of country ownership and the Conference of the Parties’ guidance, and operate in a transparent, accountable, and efficient manner.
- (c) In order to realize significant impact and promote paradigm shift to meet the Fund’s strategic objectives, the Fund is willing to accept considerable uncertainties around investment risks in return for impact potential, to be evaluated on a case-by-case basis recognizing specifics of each proposal. The Fund will strive to mitigate programme risks to provide reasonable assurance that investments can fulfil their stated objectives.

5.2 Tolerance level 1: zero risk tolerance

5.2.1 Compliance risk

Regulation and sanction/embargo breach and engagement in prohibited practices

16. The GCF will have zero tolerance towards its staff, Board members, counterparties and partners (especially AEs and EEs) breaching the Fund’s prohibited practices requirements, e.g. Anti-Money Laundering, Countering the Financing of Terrorism, etc.

17. The GCF will also have zero tolerance for working with parties subject to sanctions, embargoes, or similar measures issued by reputable international organizations such as the United Nations (“UN”).

5.2.2 Internal compliance breach

18. The GCF will have zero tolerance towards its staff and Board members breaching the following policies:

- (a) Policies on Ethics and Conflicts of Interest (for the Executive Director and external members of the GCF panels and groups) (B.10/13/Rev.01).
 - (b) Information Disclosure Policy (B.12/35).
 - (c) Administrative Policies of the Fund (BM-2014/01).
 - (d) Financial Risk Management Framework (B.07/05): cross-subsidization between providers of grants and providers of loans.
 - (e) Gender Policy and Action Plan (B.09/10).
 - (f) Guiding Framework and Procedures for Accrediting National, Regional and International Implementing Entities and Intermediaries, Including the Fund’s Fiduciary Principles and Standards and Environmental and Social Safeguards (B.07/02).
19. The above lists of policies should be updated on a quarterly basis.

5.3 Tolerance level 2: moderate risk tolerance

5.3.1 Concentration risk

20. To ensure that the GCF maintains a diverse portfolio to optimize deployment of its financial resources, the Fund will maintain prudential risk appetite levels on the amount of funding allocated to result areas, countries, and projects. The GCF will monitor its exposure levels (in nominal amount of cumulative GCF cash transfers and funding approvals for ongoing projects at a Fund level, i.e. for PSF and DMA combined) for the following:

- (a) The GCF will target no more than [50%] of total investible amount into a single results area⁹.
- (b) The GCF will target no more than [10%] of total investible amount into a single country.
- (c) The GCF will target no more than [10%] of total investible amount into a single proposal.¹⁰

21. The total investible amount is defined as the sum of the GCF's liquid asset portfolio size, the nominal amount of GCF's unencashed promissory notes with fixed encashment dates deposited with the Trustee, and the total nominal amount disbursed to live projects / programmes. The liquid asset portfolio is defined as cash or cash equivalents held in Trust or in GCF's bank accounts.

22. In addition, the GCF will monitor its exposure to a single AE and EE¹¹ and the impact of this exposure on other risk dimensions (e.g. credit risk, equity risk, impact risk). The Fund will also balance its deployment of funding instruments (i.e. grant, equity, loan, and guarantees) in accordance with its investment policies and guidelines.

5.3.2 Foreign Exchange ("FX") risk

23. The GCF faces two major sources of FX Risk:

- (a) FX risk on the Asset side. The GCF operates with financial instruments in holding currencies that could be repaid in currencies other than holding currencies to meet the Fund's mandate.
- (b) FX risk on the Liability side. Receiving contributions from countries in currencies that do not match the currency in which future funding proposals will be denominated. This can further be distinguished between:
 - (i) Contributions through cash received and promissory notes encashed, held in the Trustee account;
 - (ii) Contributions through promissory notes received but not yet encashed;
 - (iii) Contributions through cash not yet received and promissory notes not yet deposited or encashed.

24. While the overall FX risk appetite for FX risk is moderate, the fund has markedly different appetite across the above categories.

25. Investments of the GCF that implement funding proposals with local currencies are subject to a risk of repayment in holding currencies. The asset side FX risk can be of considerable risk tolerance providing the Board a broader set of investment options, in line with the Fund's mission to promote paradigm shift towards low-emission and climate-resilient development pathways. However, it should be noted that the Fund's exposure to FX risk on the

⁹ Results area is defined as one of: Energy access and power generation; Low emission transport; Building, cities, and industries and appliances; Forestry and land use; Most vulnerable people and communities; Health and well-being, and food and water security; Infrastructure and built environment; Ecosystem and ecosystem services.

¹⁰ Refer to risk dashboard for examples.

¹¹ The GCF will review annually whether to include an appetite level for concentration by a single AE and EE.

asset side will be limited by the country concentration limit, which would naturally limit the exposure the Fund can have to a single non-holding currency.

26. Contributions already received and encashed will be held in holding currencies, converted on receipt of funds, at a proportion determined by the Secretariat based on their expectation of future cash outflows (referred to in paragraph 23 (b) (i)).

27. Contributions through promissory notes received but not yet encashed (referred to in paragraph 23 (b) (ii)), and contributions through cash not yet received and promissory notes not yet deposited and unencashed (referred to in paragraph 23 (b) (iii)) are not required to be hedged, however the Secretariat may decide to implement a hedging strategy for additional conservatism. Any such hedging must be guided by a clear policy to be approved by the Board. Further, the Secretariat must ensure that the GCF has all necessary arrangements (models, agreements etc.) in place before it engages in any hedging.

5.3.3 Funds held in trust risk

28. The GCF will also actively manage its liquid asset portfolio through the Trustee in accordance with the Fund's investment policy or, should the Fund not have an investment policy, by the Trustee's default investment strategy. The eligibility criteria for the liquid asset portfolio securities will also be guided in the same manner. The GCF will be prudent in establishing liquid asset portfolio investment policies and guidelines to maintain a conservative risk profile with the following appetites:

- (a) The Fund will only invest in investment grade securities;
- (b) The Fund will target average credit rating of [AA] equivalent by international rating agencies 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) In its liquid asset portfolio, 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. The Trustee will monitor the asset allocation of the liquid asset portfolio in this regard and report to the GCF on it.
- (e) 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.

5.3.4 Reputational risk

29. Given that the GCF will operate in new, transformational areas that may be untested, continued support from global stakeholders will be essential to the GCF's success, and the GCF will seek to actively engage stakeholders and plan and respond to reputational issues which may arise. That being said, the GCF will manage the reputational risk through stringent monitoring and oversight policies applied across all GCF operations.

30. The GCF will monitor and manage the following:

- (a) Adverse publicity;
- (b) Grievances from projects.

5.3.5 Project/programme: risk of non-compliance against internal requirements

31. The GCF is heavily reliant on the intermediary entity, the AE, for all stages of operation, from project sourcing and due diligence to project execution, governance, and monitoring. The GCF has policies and documents in place, which set the standards for actions by AEs, EEs and other partners, and there is limited risk appetite to breaches of those standards:

- (a) Gender Policy and Action Plan (B.09/10).
- (b) Guiding Framework and Procedures for Accrediting National, Regional and International Implementing Entities and Intermediaries, Including the Fund's Fiduciary Principles and Standards and Environmental and Social Safeguards (B.07/02).
- (c) Accreditation Master Agreement.
- (d) Funded Activity Agreement.
- (e) Local regulations that are not explicitly covered in the Interim Policy on Prohibited Practices.

32. In order to further mitigate this risk, the GCF will monitor the list of countries (and corresponding approved funding) in which the Fund is investing but has not secured privileges and immunities.

5.3.6 Legal risk

33. Legal risk for the GCF is the risk of loss caused by defective transactions, penalties or sanctions originating from lawsuits filed against the Fund, sanctions pronounced by a regulatory or government body, and changes to legal frameworks. The GCF will manage its legal risk by closely monitoring the number of any legal disputes that arise across the operations of the GCF.

5.3.7 Funding contribution uncertainty risk and liquidity risk

34. 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 contributor countries, managing cancellation, postponement, and other changes in encashment schedules, ensuring to convert the pledges or encashment of promissory notes in a timely manner, and preventing over-concentration of contributions to be encashed. This will effectively help the GCF manage any risks associated with cash flow mismatches, that is, mismatch that may arise between the effective duration of the contributions and commitments with regards to pledge conversions, disbursements, or reflow. Failure to manage cash flow could have an impact on the Fund's ability to undertake and fund projects/programmes.

35. The GCF will ensure sufficient liquidity at all times. The GCF will set an appetite level on the size of the GCF's liquidity reserve that will be equivalent to sufficient levels to sustain net funding requirements for 1 year. This threshold should be reviewed in the future, when GCF's cash management practices are better established. 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 expenses) net of the planned contribution encashments over the same period of time. It should be noted that at present, 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 a significant part of GCF's planned inflows.

36. Currently the GCF approves FPs only if there is a known source of funds from contributions rather than reflows. Further at present the GCF does not plan to depend on project reflows for its liquidity needs. In the future, if the GCF starts depending on project reflows to meet liquidity needs, the Board may consider maintaining an alternate source of funding for the GCF to cover for unexpected shortfalls or delays in reflows.

37. The GCF will also monitor the following areas:
- (a) Projection of expected net inflows and outflows and deviations from expected commitment schedules;
 - (b) Concentration of funding contributors.

5.3.8 Operational and IT risk

38. The Fund will actively manage any operational and IT risks that may arise across all stages of Fund operations, including process and execution, human resources (“HR”), systems and information, and catastrophic events, and business continuity risks that may jeopardize the Fund's day-to-day operations.
39. To do so, the GCF will closely monitor the following risk areas:
- (a) Timelines for FP approval and target timelines for AE approval.
 - (b) Vacancy rate, employee turnover rate and internal or external complaints on employee behaviour.
 - (c) Number of information security breach attempts, and number of system failures.
 - (d) Natural catastrophe occurrences, geopolitical events, wars, and terrorism.

5.4 Tolerance level 3: considerable risk tolerance

5.4.1 Financial investments: equity investments risk

40. The GCF will utilize equity investments, accepting the fact that such investments may pose considerable financial risk. The Fund will seek to understand and manage the associated risks, such as possibility of decline in equity valuation (resulting in decline in return on equity investment below target) or illiquid equity markets that may affect the GCF's exit. The GCF will regularly monitor changes in equity valuations relative to the initial equity investment through the AE during the project lifecycle, depending on accounting requirements of the target country.

5.4.2 Financial investments: credit risk

41. The GCF will actively take credit risk to meet its strategic mandate of promoting paradigm shift towards low-emission and climate-resilient development pathways. The GCF is willing to take on risks that other investors will not take.

42. The GCF will aim to utilize its investments to crowd-in other debt, and to enhance the credit worthiness of a project. The GCF will also enter relatively high risk transactions, such as junior positions in credit structures or being the sole investor, in order to meet its strategic mandate.

43. The GCF will set an initial required cushion for loss reserves being equal to 20%¹² (in grants) of the face value of the loan contribution provided to the Fund by the loan contributors for non-performing loans, and the adequacy of the cushion will be reviewed at the end of the Initial Resource Mobilization (IRM) period. Loan cushions will not count toward grant equivalency or individual debt limit calculations. The GCF will actively monitor the credit performance of its funded portfolio.

44. If the loan contributions provided to the Fund grow in the future and become a significant portion of its investible amount, the GCF might consider updating this appetite

¹² Policies for Contributions (GCF/B.08/16)

statement to further mitigate the risks of excessive credit losses, in order to ensure that the GCF is able to repay the loan contributions.

5.4.3 Project/programme programme failure: impact risk

45. The GCF will manage its project and programme risks, which include project governance, execution, impact, and monitoring, as well as country risks that may impede successful execution, to maximize the possibility of successful execution and delivery of the desired impact. This will involve ensuring sufficient technical and institutional capabilities of the AE/EEs and community readiness (awareness, preparation, commitment); monitoring of country risks, including natural disasters, climate shocks, poor infrastructure, and economic and political risks, as well as country ownership status. The GCF will closely monitor the following areas:

- (a) Projects delays or slippages
- (b) Impact achievements based on the GCF results framework
- (c) Distribution of cumulative cash transfers and funding commitments for ongoing projects by Project Success Rating and Credit Risk Rating¹³

VI. Effective date

46. The provisions of this risk appetite statement will take effect on September 1st 2017. If the Interim Trustee is unable to implement the requirements in the risk appetite statement, 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.

VII. Revisions to the risk appetite statement

47. The overall risk appetite will be revised and submitted to the Board for approval; (i) whenever a new or revised Fund Strategy is formulated; or (ii) the Board or the RMC finds it relevant to review the statement due to major changes in related policies.

VIII. Reporting of risk appetite

48. The Secretariat will integrate the GCF's risk appetite tolerance levels into the risk dashboard (part of the RMF) and risk register (part of the RMF) based on the risk monitoring and reporting management system under the RMF. The risk appetite will be reported to the Board through the risk dashboard. 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. This reporting will be the basis for continuous review and updating of the Fund's risk appetite 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.

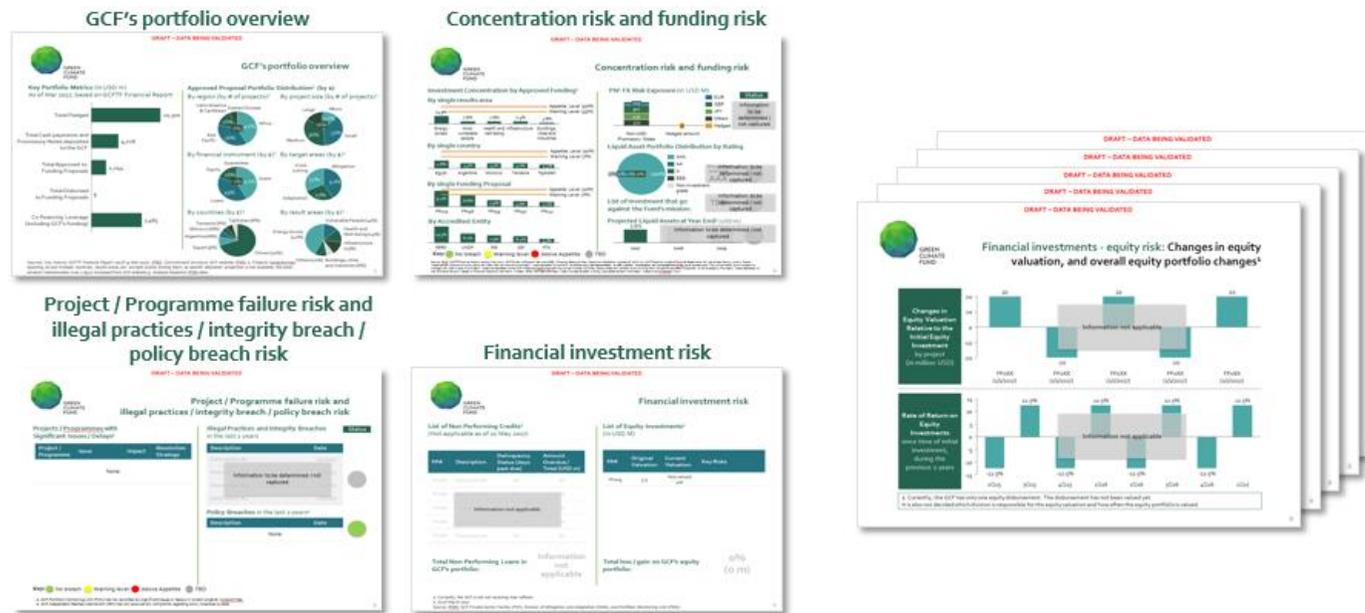
¹³ Risk ratings are discussed in the risk rating approach document (part of the RMF).

Annex IV: Risk management framework component III – risk dashboard

I. Introduction

1. The risk dashboard consists of regular snapshots of the Board-agreed risk categories and subcategories that will be tracked by the Secretariat, the RMC and the Board. This reporting will be the basis for continuous review and updating of the Fund’s risk appetite and risk management practices.

Figure 1. Risk dashboard – Introduction



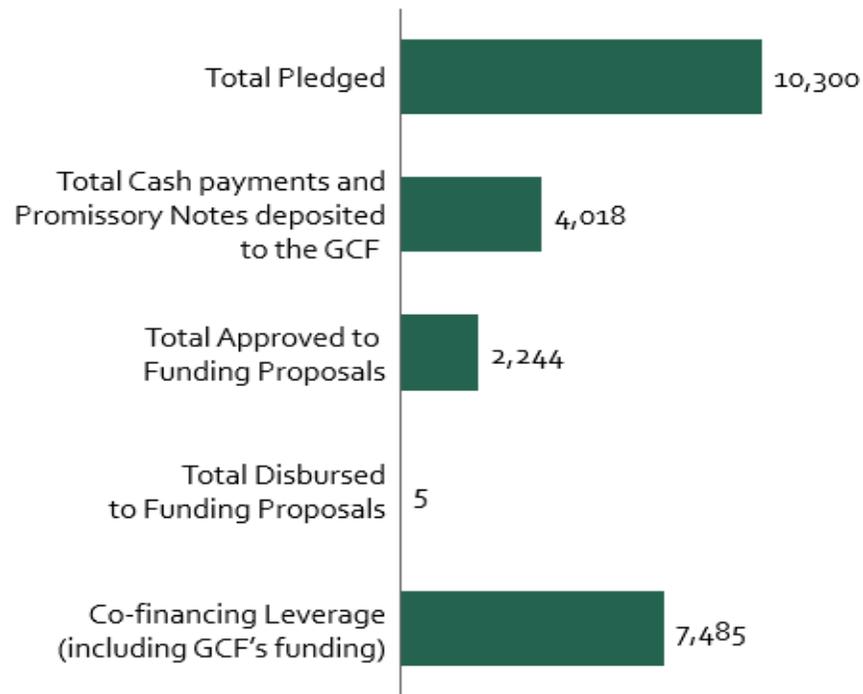
A 4-page summary to be presented to the Board

A more detailed Risk Dashboard for the Secretariat

II. Overview of the portfolio of the GCF

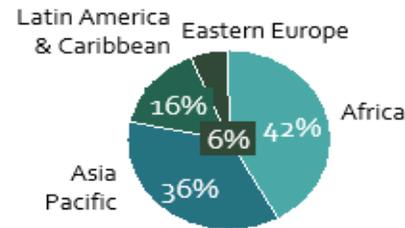
Key Portfolio Metrics (in USD m)

As of Mar 2017, based on GCFTF Financial Report

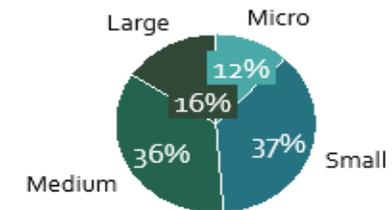


Approved Proposal Portfolio Distribution¹ (by \$)

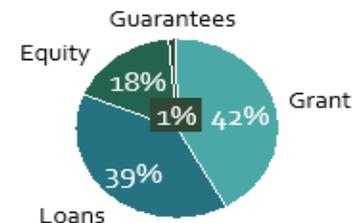
By region (by # of projects)²



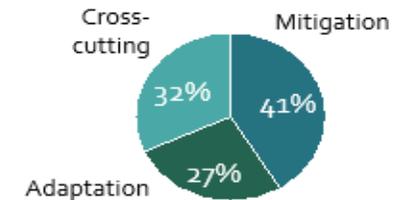
By project size (by # of projects)²



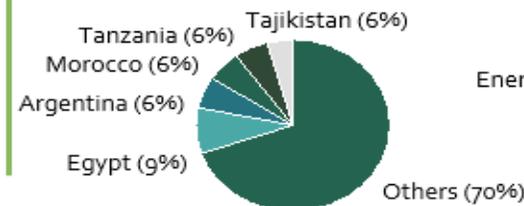
By financial instrument (by \$)²



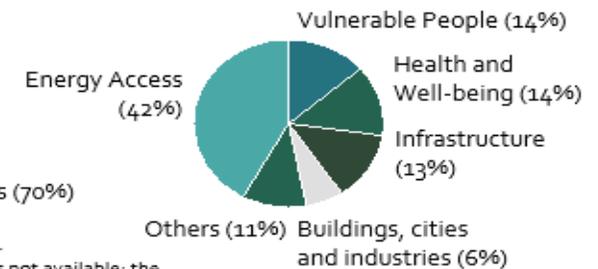
By target areas (by \$)²



By countries (by \$)³



By result areas (by \$)³



Sources: Key portfolio metrics: GCFTF Financial Report (as of 31 Mar 2017), [iPMS](#). Approved Proposal Portfolio Distribution: GCF website, [iPMS](#).

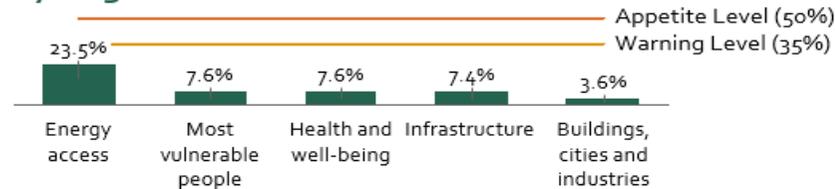
1. Projects / programmes spanning across multiple countries, results areas, etc. are split equally among them, as specific allocation proportion is not available; the total amount (in the denominator) is the Total Approved to Funding Proposals (\$2.244 m) 2. Accessed from GCF website 3. Analysis based on [iPMS](#) data.

III. Concentration risk and funding risk

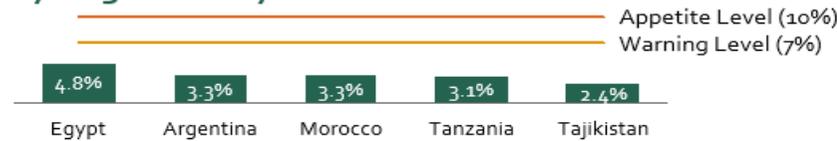
Investment Concentration by Approved Funding¹

(Denominator is the investible amount: ~\$4 billion)

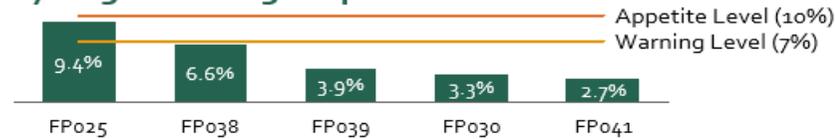
By single results area



By single country



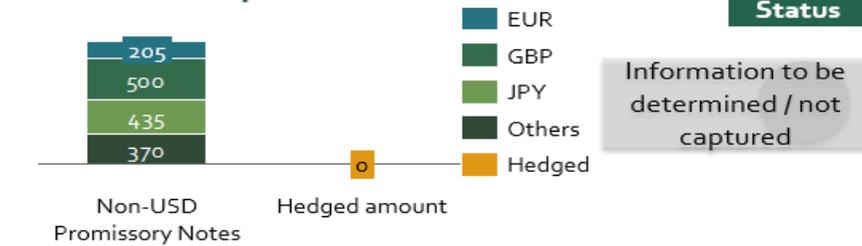
By single Funding Proposal



By Accredited Entity



PN² FX Risk Exposure (in USD M)



Liquid Asset Portfolio³

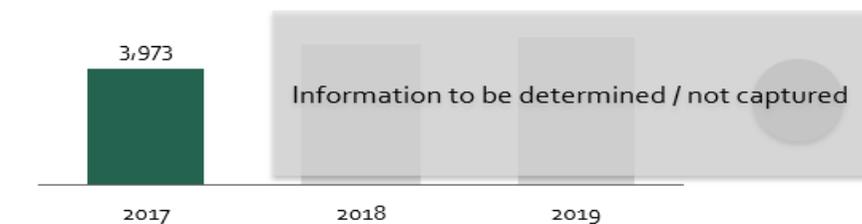
Weighted Average Credit Rating:

Information to be determined / not captured
Average: AA

No investments against GCF's mission:

Information to be determined / not captured

Projected Liquid Asset Portfolio at Year End⁴ (USD m)



Source: iPMS, GCF 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 Mar 2017, 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. 4. Calculated as cash + Promissory Notes to be encashed in 2017.

IV. Project/programme failure risk and illegal practices / integrity breach /policy breach risk

Projects / Programmes with Significant Issues / Delays¹

Project / Programme	Issue	Impact	Resolution Strategy
		None	

Illegal Practices and Integrity Breaches in the last 2 years

Status

Description	Date
Description #1	1/1/2017
Description #2	1/1/2017
Description #3	1/1/2017
Description #4	1/1/2017

Information to be determined / not captured

Policy Breaches in the last 2 years²

Description	Date
None	

Key:  No breach  Warning level  Above Appetite  TBD

1. GCF Portfolio Monitoring Unit (PMU) has not recorded any significant issues or delays in current projects / programmes.
2. GCF Independent Redress Mechanism (IRM) has not received any complaints regarding policy breaches to date.

V. Financial investment risk

List of Non Performing Credits¹ (Not applicable as of 22 May 2017)

FPoXX	Description	Delinquency Status (days past due)	Amount Overdue / Total (USD m)
FPoXX	Description #1	XX	XX
FPoXX	Description #2	XX	XX
FPoXX	Description #3	XX	XX
FPoXX	Description #4	XX	XX
FPoXX	Description #5	XX	XX

Total Non-Performing Loans in GCF's portfolio:

Information not applicable

List of Equity Investments² (in USD M)

FP#	Original Valuation	Current Valuation	Key Risks
FPo05	5.5	Not valued yet	

Total loss / gain on GCF's equity portfolio:

0%
(0 m)

1. No project reflows had been due to the GCF as of 22 May 2017.

2. As of March 2017

Source: iPMS, GCF Private Sector Facility (PSF), Division of Mitigation and Adaptation (DMA), and Portfolio Monitoring Unit (PMU)

Annex V: Risk management framework component IV – “Risk guidelines for funding proposals”

I. Introduction

1. Through decision B.13/36, the Board requested the Secretariat, in consultation with the Risk Management Committee (“RMC”), to develop the necessary methodologies to enhance the Secretariat’s risk management capacity. This document presents the “Risk guidelines for funding proposals” – one of the developed methodologies.
2. Paragraph 2 of the Governing Instrument for the Green Climate Fund (“GCF, “the Fund”) defines the purpose of the Fund as follows: “In the context of sustainable development, the Fund will promote the paradigm shift towards low-emission and climate-resilient development pathways by providing support to developing countries to limit or reduce their greenhouse gas emissions and to adapt to the impacts of climate change”.
3. The GCF will have to take on certain risks to meet this purpose. When deploying its financial resources towards projects with positive climate change impact potential, the Fund will assess the investment risks and enforce appropriate controls. “Risk guidelines for funding proposals” describe the approach to such risk assessment.
4. This document¹⁴ provides guidelines for the risk assessment of Funding Proposals (“FPs”, “proposals”) and Concept Notes (“CNs”) by the GCF. The goal of these guidelines is to ensure that the risks relevant to the GCF are appropriately understood and addressed in a standardized manner. This document divides guidelines into four types:
 - (a) Guidelines for assessing the risk of the project / programme failing to deliver its target impact.
 - (b) Risk guidelines for setting funding terms and conditions.
 - (c) Guidelines for assessing alignment with GCF’s portfolio level risk limits.
 - (d) Guidelines for assessing compliance with GCF’s policies and legal requirements.
5. All proposals under review should be assessed using these guidelines. This assessment will be included as a part of the Secretariat Review to be reviewed by the Board when considering the proposal for approval.

II. Linkages with previous decisions and other documents

6. The “Risk guidelines for funding proposals” are a part of a broader Risk Management Framework (“RMF”) (discussed in more detail in Section III). The Funding Risk, Investment Risk, and Operational and IT Risk Policies documents formalize measurement and mitigation of the risks. The risk rating approach document describes the methodology of applying ratings to assess particular risks. Previous decisions and documents relevant to “Risk guidelines for funding proposals” are listed in Table 1.

¹⁴ The guidelines contained in this document do not specify appropriate risk levels or investment criteria for the GCF. The opinion on whether the risks are acceptable is delivered as an expert assessment in the Secretariat Review - these guidelines define the required assessment dimensions and process.

Table 1. Linkages to previous decisions and documents.

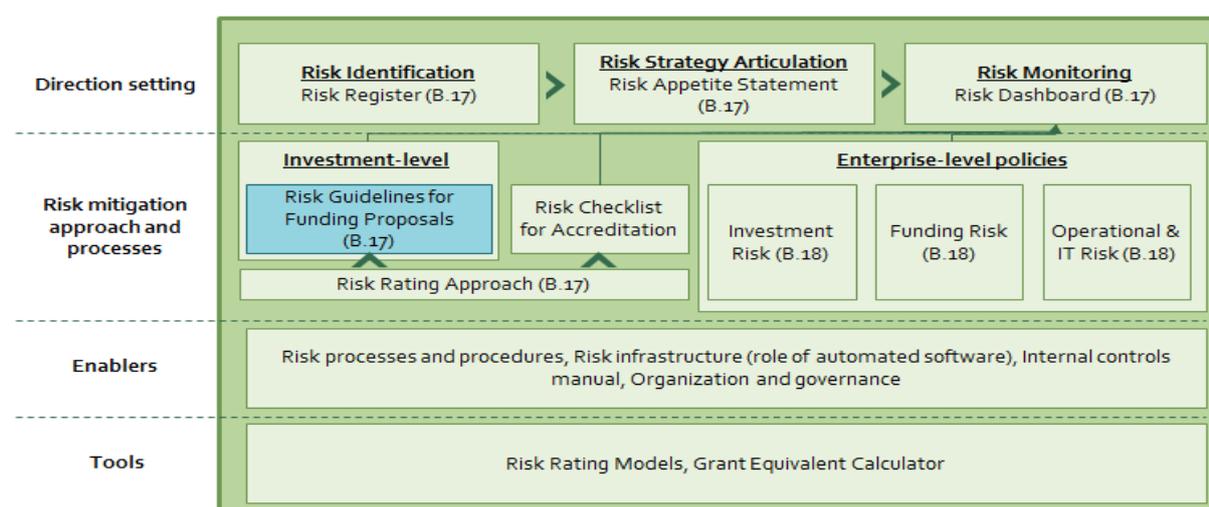
Document	Relevance
GCF/B.13/27/Rev.02 “Interim Risk and Investment Guidelines”	Previous document including proposal level guidelines for risk assessment (superseded by this document).
Governing instrument for the GCF	Access modality and accreditation (para. 45): “Access to Fund resources will be through national, regional and international Implementing Entities accredited by the Board” Financial instruments (para. 54): “The Fund will provide financing in the form of grants and concessional lending, and through other modalities, instruments or facilities as may be approved by the Board. Financing will be tailored to cover the identifiable additional costs of the investment necessary to make the project viable. The Fund will seek to catalyse additional public and private finance through its activities at the national and international levels.”
GCF/B.05/07 “Business model framework: terms and criteria for grants and concessional loans”	Guiding principles (annex II, para. (b)): Guiding principles applicable to public sector operations: <ol style="list-style-type: none"> 1. “Grant elements should be tailored to incremental cost or the risk premium required to make the investment viable; 2. Concessional terms should not displace investments that would otherwise have occurred, including for private sector investment; 3. Overall levels of public debt in the recipient country should be taken into account so as not to encourage excessive indebtedness.” Guiding principles applicable to private sector operations: <ol style="list-style-type: none"> 1. “Structure terms on a case-by-case basis to address specific barriers; 2. Minimize concessional terms by assessing needs, market conditions and other factors; 3. Avoid distortion and crowding out commercial financing; 4. Maximize leveraging of other financing, including public and private financing; 5. Promote long-term financial sustainability; and 6. Apply due diligence to assess the risk to the investment“
GCF/B.07/05 “Financial Risk Management Framework”	Definition of the initial financial risk principles, e.g. para. 6: “By their nature, these activities and technologies would at times assume a higher level of risk than conventional investments undertaken on the market.”
GCF/B.10/inf. 10 “Brief guideline on the application of the case-by-case provisions in the financial terms and conditions of the Fund’s instruments”	Level and structuring of concessionality (para. 26): “(…) the Fund will structure terms on a case-by-case basis to address specific barriers, where the grant element of concessional finance is tailored to provide the appropriate incentive to facilitate the implementation of mitigation and adaptation activities.”
GCF/B.12/32 Annex I: Initial Strategic Plan for the GCF	Enhancing Accessibility and Predictability: “Signal more clearly what kinds of projects and programmes it is looking to finance. This requires providing improved and coherent guidance on the Fund’s investment criteria, risk

	<p>appetite, standards and processes to be published on the website and communicated through the Fund’s communication channels and the Readiness Programme.”</p> <p>Regarding Funding Proposals credit and project / programme risk approach, the GCF has the ability to:</p> <ul style="list-style-type: none"> • Programme and manage financing at scale; • Engage in partnerships with both public and private actors at various levels; • Take on risks that other funds/institutions are not able or willing to take including risks associated with deploying innovative climate technologies; • Pilot and potentially scale-up and replicate innovative approaches; • Deploy the full range of financial instruments at its disposal; • Leverage additional financing inputs from innovative and alternative sources; and • Leverage its status as an operating entity of the financial mechanism of the UNFCCC to set new standards with regard to country ownership, direct access and level of ambition impacting the global practice of climate finance beyond its immediate engagement.
<p>GCF/B.12/17 “Initial Risk Management Framework”</p>	<p>Defined the initial Risk Register, Risk Appetite, and Risk Guidelines for Credit and Investment</p>

III. Objective

7. This document is a part of the comprehensive GCF RMF, which has the objective of setting the appropriate level of risk taken by the GCF, and establishing the risk management and mitigation approach and processes. The guidelines support the notion that the GCF will actively take credit risk to meet its strategic mandate of promoting paradigm shift towards low-emission and climate-resilient development pathways, and that the GCF is willing to take on risks that other investors will not take. The components of the framework are presented in Figure 1.

Figure 1. RMF components (in brackets for each component: the Board meeting when it is planned to be discussed).



8. The objective of this document is to serve as a guideline for the risk analysis required as a part of the review of FPs. The Secretariat can leverage this document as a guide for risk factors to be included in the proposal assessment process, ensuring a consistent view on risk assessment to support Board decisions.
9. These guidelines are applicable at an individual FP level. Assessment of a particular proposal should also be performed in conjunction with a broader portfolio and enterprise-level risk management, e.g. managing concentration risks, foreign exchange risks, etc., which are outlined separately in Funding Risk, Investments Risk, and Operational and IT Risk Policies. While part of the assessment may be operationally done by the Accredited Entity (“AE”), internal responsibility for the application of these guidelines lies with:
 - (a) Private Sector Facility (“PSF”) – for private proposals;
 - (b) Division of Mitigation and Adaptation (“DMA”) – for public proposals
10. Office of Risk Management and Compliance (“ORMC”) should examine and independently review the PSF and DMA’s assessment.
11. The GCF can seek external independent support in the assessment process. The GCF may especially consider such support in specific scenarios (e.g., a large funding request where GCF has been requested to take a junior position relative to other co-investors).
12. Where material information is lacking against the guidelines and a risk assessment cannot be conclusive, further due diligence and examination may be required.
13. The output of the analysis should be included in the Secretariat Review on the proposal presented to the Board.
14. This document is maintained by the ORMC who should review it once every two years or upon a Board request.
15. “Risk guidelines for funding proposals” are submitted to the Board for approval upon prior review and approval by the RMC.

IV. Guidelines

16. The guidelines are divided into four types:
 - (a) Guidelines for assessing the risk of a project / programme failing to deliver its target impact: While the GCF is only indirectly involved in project / programme execution, it must consider risk of their failure. Consequences of failed projects / programmes may not be limited to the disbursed funding, but might also mean additional costs to cover the liabilities, or damage to GCF’s reputation.
 - (b) Risk guidelines for setting funding terms and conditions: The GCF may accept a range of deal structures varying in level of complexity, participation of co-investors, blending of funding instruments and modalities, control and ownership structures, and financial terms and conditions. The guidelines in this section seek to establish a comparable standard in understanding and considering risks across diverse funding structures.
 - (c) Guidelines for assessing alignment with GCF’s portfolio level risk limits: The GCF must assess the risk of a proposal in the context of its current portfolio. A new proposal is not a standalone risk, as it also influences GCF’s risks at the portfolio level.

- (d) Guidelines for assessing compliance with GCF's policies and legal requirements¹⁵: As per the risk appetite (part of the RMF), there is zero risk tolerance for illegal practices and policy / integrity breaches.
17. All the above four types of guidelines should be applied at the FP stage.
18. At the CN stage, guidelines of the types c) and d) should be applied. Additionally, the Fund should apply guidelines of the types a) and b) at the CN stage to the extent possible.

4.1 Guidelines for assessing the risk of a project / programme failing to deliver its target impact

19. Overall assessment
- (a) The proposal should clearly demonstrate that each funding request is directly connected with mitigation and/or adaptation objectives. The GCF should assess whether funding requested is a critical catalyst for the mitigation and / or adaptation objectives and is aligned with the parameters defined in GCF's Investment Framework.
- (b) A broader programme proposal should either provide a clear description of each project to be undertaken, or provide clear parameters for making delegated funding decisions.
- (c) The proposal should have adequate policy and regulatory support from the relevant country. The GCF should assess the actual level of country support beyond the no-objection letter (e.g. stabilization clauses or governmental assurances).
20. AE / EE¹⁶ capability
- (a) The proposal's size, focus, Environmental and Social Safeguards ("ESS") standard, fiduciary standard and gender approach must be within the parameters of the Accreditation Master Agreement ("AMA"). The AE must have a project monitoring process and must deliver updates to the Fund at least as frequently as stated in the AMA. The AE should also monitor and report to the GCF the impact of the project upon successful execution.
- (b) The AEs and EEs should have adequate technical and institutional capabilities to execute the project. They should especially provide adequate assurances about the ability to ramp up the necessary staff and ability to manage third parties involved in the execution (if the AE has specific limitations in the AMA, the proposal must not breach them). They should also provide a clear description of their track record in delivering similar projects. The AE and EEs should present their history of cooperation; the GCF should review the performance of the AE and the EE on previous projects / programmes. The GCF should consider the impact of the proposal on other projects managed by the AE in GCF's portfolio.
- (c) The EEs should have a stable internal management. The proposal should include an assessment of the qualifications of the key management personnel.
- (d) The EEs should provide information about their business and strategic objectives in the proposal. The EEs' objectives should be tied to the successful execution of the project.
- (e) The AE and EEs should allow the GCF to request and audit documents and data related to funded activities execution upon request to the extent as defined in the AMA. Should certain risks related to funded activities arise and the GCF considers it is necessary to do

¹⁵ This category covers GCF's policies not included under other types of guidelines, i.e. specific to project execution, funding structure or portfolio level risk limits.

¹⁶ Where EE has been finalized at the time of CN / FP preparation.

further due diligence, then the GCF should be allowed to verify the details at a later stage.

21. Project specific execution risks
 - (a) The GCF should take execution risks into account. These risks include: staff movement restrictions; construction risk (including permitting and siting); operating risk; and supply risk.
 - (b) The GCF should take country-specific execution risks into account. These risks include: political risks; trade embargoes; stability of legal and regulatory environment; and natural catastrophes.
 - (c) The proposal should include a plan to mitigate risks of environmental and community impact, and demonstrate adequate community engagement. The issues especially covered are: limited awareness, preparation, and/or commitment of affected communities, and tackling lack of motivation by the beneficiaries to adopt new technologies.
22. Financial viability
 - (a) The proposal should be assessed against the Fund's investment policies and guidelines.
 - (b) The proposal should include financial and cash flow analyses, including stress analyses. The specific areas that should be covered include (depending on the characteristics of a particular proposal): market conditions analysis; sensitivity of the asset value and liquidity to economic cycles; debt service financial ratios; repayment schedule; off-take risk; and GCF's control over reflows (including expropriation risk).

4.2 Risk guidelines for setting funding terms and conditions

23. Funding terms
 - (a) Any form of funding should be granted only to acceptable and identified EEs¹⁷. The GCF should assess the EEs' capabilities and intent. The proposal should include a review of:
 - (i) Public reports if the EE is a publicly listed company;
 - (ii) Disclosed relevant documents otherwise.For existing EEs, the previous dealings with the GCF and the AE should be taken into account.
 - (b) Where possible, the GCF should be a co-investor, rather than a sole investor. The participation of co-investors can provide higher confidence in the diligence process, and reveal information about the market's pricing and perception of the risks. Co-investment from the AE is encouraged where possible.
 - (c) The requirements and proposed terms for co-investor participation should be clearly articulated in the terms of the funding agreement.
 - (d) The proposal should include an outline of GCF's rights and responsibilities in case of project failure. The AE should provide clarity around subordination, workout rules and roles of each party, and the GCF should have reasonable assurance that it has the technical and institutional capacity to fulfill its role (or otherwise engage a third party).
 - (e) The execution liabilities should be borne by the AE and the EE (or particular subcontractors) rather than the GCF. While the GCF receives updates about the project

¹⁷ Where EE has been finalized at the time of CN / FP preparation.

progress, it does not actively manage the project operations, and thus shouldn't be responsible for dealing with grievances related to execution; however, the grievances should be monitored by the GCF as well.

24. Additional analysis specific to loan / equity / reimbursable grant investments / guarantees:
- (a) Credit proposals should clearly prescribe the disbursement and repayment schedule, and terms and conditions must comply with GCF's Investment Risk Policy (a component of RMF). The GCF needs to make future cash flow projections for Asset-Liability Management. Credit should not be extended if there is strong doubt about the borrower's willingness or ability to repay from a clear, identifiable set of cash flows. The GCF should also estimate the grant equivalent value of the credit.
 - (b) When the structural subordination of a lending arrangement results in the GCF taking a different level of credit risk compared to the level of credit risk taken by all other co-investors, the GCF may consider an external independent risk evaluation, especially for large funding requests.
 - (c) When taking on an equity/mezzanine stake on different terms than the terms of all other co-investors (including a situation when the GCF is the only equity / mezzanine investor), the GCF may consider an external independent risk evaluation, especially for large funding requests.
 - (d) The GCF should consider reflows Foreign Exchange risk and hedging approach.

4.3 Guidelines for assessing alignment with GCF's portfolio level risk limits

- (a) GCF's portfolio concentration should remain within the risk appetite after inclusion of the proposal. The concentration across a number of metrics is defined in the risk appetite statement document (part of the RMF). The GCF should calculate the incremental impact of every proposal on those metrics during the approval process (and a combined calculation for all the proposals discussed in a particular Board meeting). Note: The Board retains the authority to approve FPs which may be exceptions to the risk appetite statement. Hence if collected at the CN stage, breach of concentration limits should not result in automatic rejection of the proposal.
- (b) Committing to the disbursement of funds as per the proposal should not breach GCF's liquidity tolerance. Otherwise, the Fund must take mitigating actions to ensure sufficient liquidity in accordance with the risk appetite statement document (part of the RMF). The timing of the investment must be clearly defined and there should be a prudent gap in timing between disbursement of GCF's investment and encashment of the relevant contributions.
- (c) Equity proposals should provide financial projections, articulate any terms on exit (e.g. lock-in period) and exit strategies (e.g. in illiquid markets), and discuss shareholder roles and rights (e.g. potential future dilution). Similarly to the credit structures, the GCF needs to make future cash flow projections for ALM purposes and estimate the level of concessionality in equity structures. The GCF also requires that the AE update the valuation periodically and deliver it to the GCF.

4.4 Guidelines assessing compliance with GCF's policies and legal requirements

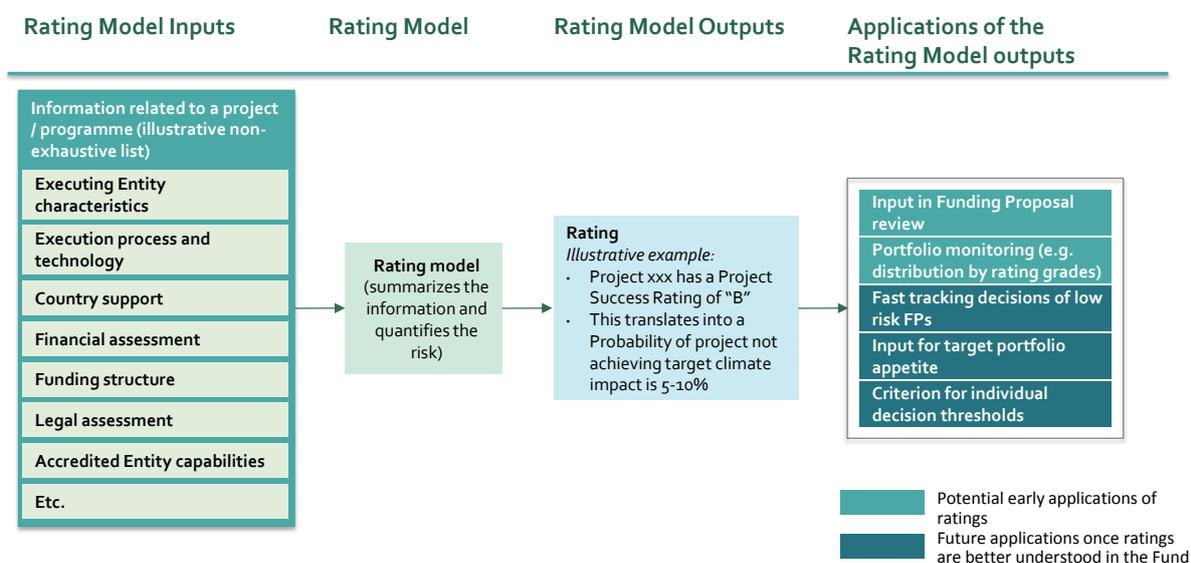
- (a) The AE should demonstrate in the context of the particular proposal, that it can enforce provisions agreed to in the AMA among the project participants (especially the Prohibited Practices policy) as GCF's delegate. Specifically, the AE needs to submit its 'Procedures for controlling procurement by third parties or Executing Agencies undertaking projects financed by the entity'. The AMA and Funded Activity Agreement ("FAA") must be effective before disbursement of the funds.
- (b) The AE should verify the laws/policies in relevant countries and inform the GCF of any discrepancies (especially if they are different than the AMA provisions), and propose a resolution.
- (c) (Guideline applicable to loan funding, guarantees or reimbursable grants) Where there is collateral held in escrow, it must not be invested in assets that go against the GCF's climate change mandate.

Annex VI: Risk management framework component V – risk rating approach

I. Introduction

1. The Board, through decision B.13/36, requested the Secretariat, in consultation with the Risk Management Committee (“RMC”), to develop the necessary methodologies to enhance the Secretariat’s risk management capacity.
2. This document is a component of the Risk Management Framework (“RMF”), and it describes the set of ratings recommended for the Green Climate Fund (“GCF”, “the Fund”) to maintain for prudent risk management purposes.
3. There are two risk ratings recommended for the GCF:
 - (i) Project / Programme Success Rating (“PSR”): a project / programme level rating that enables quantification of the likelihood of project / programme achieving the target climate impact.
 - (ii) Credit Risk Rating (“CRR”): a project / programme level rating that enables quantification of the likelihood of project / programme defaulting.
4. Once developed, these ratings can immediately be applied by the GCF in a range of applications including – supporting Funding Proposal (“FP”, “proposal”) decisions and managing GCF’s portfolio mix.
5. Risk ratings form a critical component of the overall RMF proposed for the GCF. Risk ratings are forward looking estimates of the risk associated with a specific entity / funding contract, mapped to a scale for easy and consistent communication across the organization. Underlying a risk rating is usually a rating model, which defines the quantitative relationship between the risk of a specific entity / funding contract and its various risk drivers. Figure 1 below illustrates a rating model aimed at estimating the risk of project’s failure to achieve its target impact, some example inputs to the rating models and some example applications where the output of the rating model can be used.

Figure 1. Illustrative Risk Ratings (Project Success Rating Example)



6. Risk Ratings are commonly used by most financial institutions (including most Multilateral Development Banks) in order to quantify risks associated with their clients or

funding contracts. These risk ratings are key inputs to several portfolio and individual client / funding contract level decisions at the institution. However, depending on the institution’s mandate and operating model, there is a variety of practices with regards to the specific risk type the ratings aim to quantify (credit risk vs. equity risk etc.) and the entity for which the risk is being assessed (client vs. affiliate vs. project etc.).

7. This risk rating approach document recommends a set of risk ratings appropriate for the GCF, given its mandate and operating model (including describing which risks should be quantified at the individual entity / project / programme level in the form of ratings, and what should be the target of those ratings).

8. Upon the Board taking note of this document, it is expected that the GCF will develop the set of rating models required to generate the risk ratings described in this document, and commence applying the risk ratings in day-to-day decision making.

II. Linkages with previous decisions and other documents

9. The risk rating approach is part of the broader Risk Management Framework (“RMF”) (discussed in more detail in Section III). Relevant components of the RMF are submitted to the Board in parallel to this document. Those components and previous decisions, and other documents relevant to this document are listed in Table 1.

Table 1. Linkages to previous decisions and other documents.

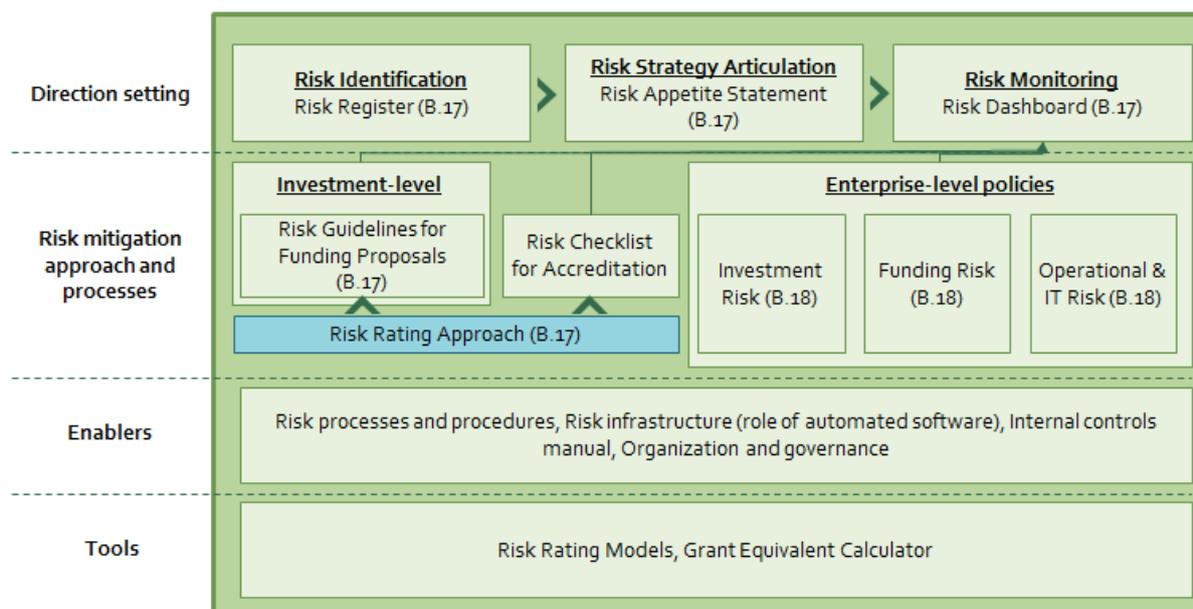
Document	Relevance
Risk Appetite Statement (part of the RMF, to be considered at B.17)	This document provides guidance on: <ul style="list-style-type: none"> • Overall level of risk that GCF is willing to take to achieve its objectives. • Types of risks to be monitored. • Qualitative appetite statements and quantitative metrics that can be cascaded to specific business units to guide their day-to-day operations.
Risk Guidelines for Funding Proposals (part of the RMF, to be considered at B.17)	This document provides guidelines to ensure that the risks relevant to the GCF are appropriately understood and addressed in a standardized manner.
Risk Checklist for Accreditation (part of the RMF, to be considered at B.18)	This document provides guidelines to ensure a consistent assessment of Accredited Entity (“AE”) in the accreditation process.
GCF/B.07/02 “Guiding Framework and Procedures for Accrediting National, Regional and International Implementing Entities and Intermediaries, Including the Fund’s Fiduciary Principles and Standards and Environmental and Social Safeguards”	This document provides an initial guiding framework for the Fund’s accreditation process.
GCF/B.12/17 “Initial Risk Management Framework”	Defined the initial Risk Register, Risk Appetite, and Risk Guidelines for Credit and Investment.

Decision B.13/36	The Board's request to develop the necessary risk management methodologies.
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III. Objective

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

Figure 2. RMF components



11. The objective of this document is to recommend a set of risk ratings appropriate for the GCF, given its mandate and operating model.

12. This document also provides an overview of how the proposed set of ratings can be incorporated in various applications across the Fund. Finally, the document describes the roles and responsibilities of various parties in the Fund in developing the underlying rating models, and in the ongoing risk rating process.

IV. Proposed set of ratings for the GCF

13. The Governing Instrument defines GCF's mandate as to "promote the paradigm shift towards low-emission and climate-resilient development pathways by providing support to developing countries to limit or reduce their greenhouse gas emissions and to adapt to the impacts of climate change (...). The Fund will strive to maximize the impact of its funding for adaptation and mitigation, and seek a balance between the two, while promoting environmental, social, economic and development co-benefits and taking a gender-sensitive approach." Further, the Governing Instrument states that GCF's strategy is to achieve these goals through investments made in projects / programmes, which are supervised by AEs: "Access to Fund resources will be through national, regional and international implementing entities accredited by the Board."

14. Given the above mandate and strategy, GCF's success or failure is most closely linked to the success or failure of its projects, and financial sustainability of the Fund. Thus, an assessment of the likelihood of success of a project / programme and an assessment of the credit risk for credit funded projects / programmes can be extremely useful for the GCF. These

assessments can support various critical decisions at the Fund, including decisions on FPs as well as overall portfolio management.

15. As a result, the following two risk ratings are proposed for the GCF:
 - (a) Project / programme Success Rating (“PSR”): This will be a project / programme level rating, quantifying the likelihood of project / programme achieving success defined as the target climate change impact¹⁸. Example risk drivers expected to be seen in the underlying risk model include – level of local government and community support for the project, construction risk, financial viability (including stress analysis), etc.
 - (b) Credit Risk Rating (“CRR”): This will be a project / programme level rating, quantifying the likelihood of a project / programme entering a Default Event¹⁹, resulting in reflow delays or losses. Example risk drivers expected to be seen in the underlying risk model include – financial guarantees, reliability of control of the project / programme assets by the GCF in case of a default, probability of project success etc.
16. The lists of risk drivers in the rating models for PSR and CRR are expected to have fair amount of overlap, and some correlation is expected between the PSR and CRR. However, it is recommended that the Fund develops both risk ratings as:
 - (a) The PSR is most directly linked to the Fund’s mandate and is required to assess risk for projects / programmes.
 - (b) The CRR is closely tied to the Fund’s financial viability and because funding via credit instruments is expected to grow significantly at the Fund, especially within Private Sector Facility (“PSF”).
17. Upon the Board taking note of this document, it is expected that the GCF will develop the set of rating models required to generate the risk ratings described above. Rating model development would require analysis of a much longer list of potential risk drivers, of which a few examples have been cited above.
18. Additionally, an AE Capabilities Rating was considered for the GCF. An AE Capabilities Rating is an AE level rating, reflecting its capability in ensuring success of the projects / programmes executed through it. The current recommendation for the GCF is to deprioritize the AE Capabilities Rating as:
 - (a) There is already an implicit categorization of the AEs as a result of the accreditation process.
 - (b) This rating can be developed in the future once the recommended two risk ratings are well understood and embedded.
19. The proposed set of ratings is expected to bring the following benefits to the GCF:
 - (a) The ratings will bring a common language within the Fund to communicate about and to compare the risk of various projects / programmes. The ratings will bring further structure and consistency to the evaluation process for FPs.
 - (b) The ratings will enable gradation of risk and improved financial analysis.
 - (c) The ratings will support improving several decisions taken by the Fund (See further elaboration in Section V).

V. Application of the ratings

¹⁸ Covering both mitigation and adaptation targets.

¹⁹ Precise definition of a Default Event is set for each Funding Proposal individually in its FAA.

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20. Once developed, the ratings can immediately be used by the GCF in the following applications:
- (a) Supporting FP Review: The risk rating of a project / programme can be one of the key inputs that the Board can consider while taking a decision on an FP. It should be noted that based on the Risk Appetite Statement (part of the RMF), the Fund is willing to accept considerable uncertainties around investment risks in return for impact potential, to be evaluated on a case-by-case basis recognizing specifics of each FP. The risk ratings are one of several factors that can influence this evaluation.
 - (b) Portfolio monitoring: The distribution of GCF's portfolio by PSR and CRR can be monitored over time, to assess the Fund level risk profile.
21. As the Fund's understanding of the ratings and their implications deepens with time, their application can be expanded into other areas including – fast tracking decisions on low risk proposals; setting target portfolio appetite level based on the ratings; setting individual decision thresholds linked to the ratings; project reflows classification by ratings.

VI. Roles and responsibilities

22. Office of Risk Management and Compliance (“ORMC”) will be responsible for developing and maintaining the rating models. The Secretariat may seek the help of external expertise to develop these models, or to customize off-the-shelf models available in the market.
23. The Secretariat will be responsible for generating the PSR and CRR for each proposal, with strong support from the AEs in gathering the relevant data. Both Ratings will be generated at first during the proposal review process, and then refreshed at least annually, usually together with the project / programme review process.
24. In order to optimize the use of resources engaged in the rating process, rating refresh is expected to follow a simpler process, focusing on updating key rating model inputs.
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