



**GREEN  
CLIMATE  
FUND**

**Meeting of the Board**  
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Provisional agenda item 6

**GCF/B.24/Inf.07**

29 October 2019

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# Reports from committees, panels and groups of the Board of the Green Climate Fund

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## **Summary**

This document contains the reports on activities that have already been conducted or are planned to be undertaken by the following committees and panels of the Board of the GCF during the reporting period from 1 June to 30 September 2019:

- (a) Accreditation Committee;
- (b) Accreditation Panel;
- (c) Budget Committee;
- (d) Ethics and Audit Committee;
- (e) Investment Committee;
- (f) Performance Oversight Committee; and
- (g) Risk Management Committee.

## I. Introduction

1. This report covers the reporting period of 1 June 2019 to 30 September 2019, and also indicates activities planned to be carried out by the committees and panels of the Board of the GCF in advance of its twenty-fourth meeting (B.24).

## II. Report on the activities of the Accreditation Committee

2. The report addresses the mandate given to the Accreditation Committee (AC), in annex IV to decision B.07/02, to provide policy guidance to the Board on accreditation-related matters.

### 2.1 Activities during the reporting period

3. During the reporting period, the AC members held one formal in-person meeting at the twenty-third meeting of the Board (B.23) and one formal virtual meeting. The AC also held one formal in-person meeting jointly with the members of the Accreditation Panel (AP) during the reporting period.

4. Ms. Xia Lyu, Director of International Financial Institutions Division I of the Department of International Economic and Financial Cooperation of Ministry of Finance (China), has replaced Mr. Wenxing Pan as a member of the AC. This replacement is effective as of 11 September 2019.

5. In decision B.23/11, paragraph (c), the Board agreed the principle of the project-specific assessment approach (as contained in document GCF/B.23/05, annex II, section VII) that combines assessments undertaken during the existing accreditation and proposal approval processes in a fit-for-purpose manner; and, in paragraph (d) of the same decision, decided to defer its consideration of the updated accreditation framework and the implementation arrangements and budget for the project-specific assessment approach until the twenty-fourth meeting of the Board (B.24).

6. In response to decision B.23/11, the AC, with the support of the Secretariat, has continued to develop the “Matters related to the accreditation framework” (document GCF/B.24/06) and is presenting it for Board consideration at B.24. The document focuses on the re-accreditation process for accredited entities (AEs) and the project-specific assessment approach.

7. In decisions B.23/15 and B.23/16, the Board requested the AC, in consultation with the Head of the Independent Integrity Unit (IIU), to consider the best way to: (a) integrate the Anti-Money Laundering and Countering the Financing of Terrorism Policy into the interim fiduciary standards of GCF; and (b) integrate the Policy on the Protection from Sexual Exploitation, Sexual Abuse and Sexual Harassment into the relevant standards, safeguards and policies of GCF. The AC was also mandated to bring a proposal for integration of these policies to the Board for consideration. The AC and IIU will discuss the next steps on these issues as mandated.

## III. Report on the activities of the Accreditation Panel

8. This report addresses the mandate given to the AP in decision B.07/02, paragraph (g), to serve as an independent technical panel to advise the Board on matters related to the accreditation of entities to GCF. The AP is responsible for conducting the accreditation process in accordance with its terms of reference, as adopted by the Board through decision B.07/02, paragraph (h).

## 3.1 Activities during the reporting period

### 3.1.1. Review of accreditation applications

9. During the reporting period, the AP held numerous conference calls with applicant entities during the Stage II (Step 1) accreditation review to gain better knowledge of each applicant and to clarify and discuss Stage II questions raised by the AP. In the case of four applicants (three direct access entities and one international access entity), the AP also undertook a site visit to the respective applicants' headquarters to fully understand the applicants' operations and controls.

10. The AP continued to work on its in-depth assessment of applications for accreditation that have successfully completed Stage I, as conducted by the Secretariat. The AP completed the review of seven new applications to recommend for accreditation at B.24. Further details are contained in document GCF/B.24/07 titled "Consideration of accreditation proposals".

### 3.1.2. Review of accreditation conditions for accredited entities

11. The AP has also reviewed evidence provided by AEs pertaining to conditions adopted by the Board at the time of their respective accreditation. For 13 AEs, the AP found the evidence sufficient to close all or some of the accreditation conditions. Further information on accreditation conditions that the AP has found to be closed and fulfilled, and those that are in progress, are contained in annex III of the "Consideration of accreditation proposals" (document GCF/B.24/07).

### 3.1.3. Technical inputs to policies related to accreditation matters

12. In line with decision B.12/30, paragraph (d), the AP members, with the support of the Secretariat, continued to work towards establishing a baseline methodology on the overall portfolio of AEs. The request for proposals to procure a consulting firm for the consultancy assignment to support the pilot phase of the baseline indicator tool was published 13 June 2019 and closed 22 July 2019 (see reference number RFP 2019/C/012). The proposals received are under review by a selected evaluation panel.

13. The AP also advanced the following documents and tools related to improvement of the accreditation process, taking the lead role on some and providing inputs on others:

- (a) Streamlining the Stage I and Stage II checklists applied in the accreditation review process;
- (b) The re-accreditation process;
- (c) The templates for periodic institutional-level monitoring, including those for annual self-assessments and midterm review;
- (d) The online accreditation system upgrade; and
- (e) Complementary accreditation assessment guidance for reviewing the accreditation applications of potential private equity firms and fund management entities, partially piloted for an applicant for consideration by the Board at B.24.

## 3.2 Next steps

14. The accreditation process is ongoing, and AP members are continuing the review of accreditation applications that have completed Stage I, with the aim of providing recommendations on accreditation at subsequent meetings of the Board. AP members are also continuing to develop documents and tools related to improvement of the accreditation process. Following decision GCF B.23/11, which states that accreditation is considered complete upon the effectiveness of the accreditation master agreement (AMA) and subject to the Board's consideration of the re-accreditation process, the AP, alongside the Secretariat, will prepare to undertake implementation of a re-accreditation process, including reviewing re-accreditation applications, beginning in 2020.

15. As a factor of re-accreditation as per the GCF monitoring and accountability framework adopted in decision B.11/10, the AP expects to begin implementation of the pilot phase of the baseline indicator tool in the fourth quarter of 2019.

16. AP members will continue to work on reviewing evidence provided by AEs pertaining to conditions adopted by the Board at the time of their respective accreditation, with the aim of providing recommendations on accreditation conditions at subsequent meetings of the Board.

17. Regarding implementation of the GCF monitoring and accountability framework, AP members, as needed, will continue reviewing self-assessment reports from AEs for the reporting period of calendar year 2019 after B.24. In addition, AP members, starting in late 2019, will conduct midterm accreditation reviews based on the midterm reports, as well as information previously submitted by AEs in their self-assessment reports.

## IV. Report on the activities of the Budget Committee

18. This report addresses the mandate given to the Budget Committee (BC) in annex XXX to decision B.12/37 to provide budgetary guidance to the Board on the preparation and implementation of the administrative budget and annual work programme of the Secretariat.

### 4.1 Activities during the reporting period

19. The BC conducted one virtual meeting on 6 June 2019 and one in-person meeting on 4 July 2019. The BC also engaged in subsequent discussions and shared comments via email.

20. During the reporting period, the BC reviewed the budget execution reports related to the "Forward-Looking Performance Review of the GCF" (document GCF/B.23/20) prepared by the Independent Evaluation Unit and the reports on the activities and expenditure with regard to the "Arrangement for the first replenishment of the Green Climate Fund" (document GCF/B.21/30/Rev.01) prepared by the Secretariat. The BC also provided necessary guidance to the Independent Evaluation Unit and Secretariat on the execution of these budgets.

21. The BC reviewed the Secretariat's proposal on establishing GCF environmental and social safeguards, which had been revised based on BC suggestions provided in a previous meeting held on 23 May 2019. The BC endorsed the proposed budget for developing the GCF environmental and social safeguards in its meeting held on 6 June 2019.

22. The BC reviewed the budgetary implications for implementation of the "Interim Policy on the Prevention and Protection from Sexual Exploitation, Sexual Abuse, and Sexual Harassment" (annex XIII to document GCF/B.22/24), which had been revised based on BC suggestions in a previous meeting held on 23 May 2019. The BC then endorsed the proposed budget, as presented to the Board in limited distribution document GCF/B.23/15 titled "Cost

implications of the implementation of the Interim Policy on the Protection from Sexual Exploitation, Sexual Abuse, and Sexual Harassment”, in its meeting held on 6 June 2019.

23. The Secretariat presented three options for an output-based budget, along with the advantages and disadvantages of each of the three options, and the BC reviewed them during its meeting held on 4 July 2019. The BC subsequently agreed that for the year 2020, the administrative budget should include additional information showing the output-based budgets at the Secretariat goal levels. The BC further agreed that, similarly, the independent units should also provide output-based budget information in their 2020 administrative budgets and work programmes.

24. The BC also reviewed the preparatory work for the administrative budget for 2020 with the Secretariat and the three independent units.

25. Additionally, following internal consideration, the BC agreed to the budget request from the Performance Oversight Committee for hiring a professional firm to assist with developing new contracts for the Heads of the Independent Units and establishing a regular performance evaluation process for them.

26. As per decision B.22/21, the BC was requested to review the risk buffer requirement and update the Board on the adequacy of the risk buffer at its twenty-fourth meeting (B.24). In this regard, the BC has reviewed the risk buffer requirement and proposes to set aside an additional risk buffer in the amount of USD 70 million, thus bringing the total risk buffer to USD 170 million. The document with further details on this risk buffer and a corresponding calculation are provided as annexes I and II to this document, respectively. The BC recommends that this administrative item be decided under agenda item 12, “Work programme of the Secretariat and administrative budget for 2020”.

27. Annex III contains the message from the BC Chairperson to the Co-Chairs, endorsing the contents of this BC report.

## **V. Report on the activities of the Ethics and Audit Committee**

28. The Ethics and Audit Committee (EAC), a standing Committee of the Board, continues its task in accordance with its terms of reference (decision B.05/13, annex XVIII), to provide guidance on issues of conflicts of interest, confidentiality, ethics, financial management, procurement and other audit functions as they relate to the Board. The EAC also provided guidance to the Independent Redress Mechanism (IRM), in accordance with decision B.15/12 and the updated terms of reference of the IRM (decision B.BM-2017/10), and to the Independent Integrity Unit (IIU), pursuant to decision B.14/01, paragraph (e), its workplan and terms of reference adopted in decision B.06/09, annex IV.

29. This report covers the period from 1 June to 30 September 2019, and indicates activities planned to be carried out by the EAC. During the reporting period, the EAC held two in-person meetings at the twenty-third meeting of the Board (B.23). Additionally, the EAC held two virtual meetings during the reporting period to discuss and provide guidance to the Secretariat, the IIU and the IRM on the key mandates given by the Board.

### **5.1 Activities during the reporting period**

30. The following items were the main issues considered by the EAC during the reporting period:

- (a) Review of the Standards for the implementation of the Anti-Money Laundering and Countering the Financing of Terrorism Policy (AML/CFT Standards);

- (b) Policy on the Protection and Prevention from Sexual Exploitation, Sexual Abuse and Sexual Harassment (SEAH Policy);
  - (c) Potential conflicts of interest relating to the persons engaged with the Green Climate Fund (GCF);
  - (d) Quarterly reports on the activities of the IRM;
  - (e) Financial Disclosure for the GCF;
  - (f) Workplan and Budget of the IRM for 2020; and
  - (g) Scoping paper on the development of a policy on sanctions and exclusions.
31. The meetings were attended by EAC members, advisors, the staff and the Heads of the IRM and IIU, and the Secretariat.

## 5.2 Activities addressing mandates from the Board

### 5.2.1 Matters concerning the Independent Integrity Unit

32. Prior to B.23, the EAC received a scoping paper developed by the IIU seeking its guidance on the development of a policy on sanctions and exclusions (i.e., administrative remedies). Under the Policy on Prohibited Practices, the GCF may impose administrative sanctions on Counterparties who violate the Policy on Prohibited Practices. Through decision B.22/19 paragraph (b), the Board requested the IIU, in consultation with the Secretariat, to develop policies on administrative sanctions and exclusions (i.e., administrative remedies) for consideration by the Board in 2019. The EAC discussed and provided feedback to the IIU on the key elements of such policy.

33. During the reporting period, the EAC considered the revised draft AML/CFT Standards, which incorporated changes that were suggested by the Board at B.22. The EAC approved the AML/CFT Standards for presentation to the Board at B.23.

34. During the reporting period, the EAC considered an updated SEAH Policy which establishes guiding principles on preventing, mitigating, investigating and remedying SEAH related to Counterparties in Fund-related Activities (as defined in the SEAH Policy). The EAC provided guidance and feedback to the IIU on the updated SEAH Policy and approved the updated SEAH Policy for presentation to the Board at B.23.

### 5.2.2 Matters addressing conflicts of interest

35. The EAC continued its discussions on the potential conflicts of interest relating to persons engaged with the GCF, as requested by the Board at its sixteenth meeting.<sup>1</sup> The EAC had discussed the issue of the potential conflicts of interest that arise of individuals who have served as members of the Board and who have subsequently joined institutions that do business with the GCF. The EAC noted that there is a gap in the Policy on Ethics and Conflicts of Interest for the Board. Certain revisions to the Policy on Ethics and Conflicts of Interest for the Board to deal effectively with potential conflicts of interest of former members of the Board were discussed by the Committee. The EAC will present its recommendations to the Board with the view that the matter will receive the final endorsement of the Board at a later date.

36. Since it submitted its last report at B.23, the EAC considered and approved a financial interest disclosure form and Declaration of Interest Statement, as required under the Policy on Ethics and Conflicts of Interest for the Executive Director of the Green Climate Fund Secretariat<sup>2</sup>

<sup>1</sup> Document GCF/B.16/Inf.04/Add.02, paragraph 8.

<sup>2</sup> Decision B.10/13, annex XXVII, paragraph (c).

and for Board appointed officials of the Green Climate Fund.<sup>3</sup> The two policies require Covered Individuals to file annually until separation from the GCF a financial interest disclosure in a form and manner to be proposed by the Chief Financial Officer and approved by the Ethics and Audit Committee. In addition, the EAC provided guidance to the Secretariat on the framework to manage the annual financial interest disclosures by Board appointed officials.

### 5.2.3. Matters concerning the Independent Redress Mechanism

37. The EAC received the quarterly reports on the activities of the IRM, which covered the periods from January to March 2019 and April to June 2019. The IRM consulted with the EAC, as mandated by the Board pursuant to decision B.15/12 and Clause 6 of the updated terms of reference of the IRM (decision B.BM-2017/10), reporting to the EAC on a quarterly basis. The reports provided updates on the progress made by the IRM based on its work plan and budget.

38. In accordance with the terms of reference of the IRM, adopted pursuant to decision B.BM-2017/10, the Head of the IRM is mandated to submit its annual workplan and budget to the Board through the EAC. The EAC reviewed the work plan and budget of the IRM for 2020. Following discussions, the EAC approved the annual work plan and budget of the IRM for 2020 for submission to the Board at B.24.

## 5.3 Next steps

39. The EAC will continue to address the items still outstanding from the meetings during the reporting period and will update this report to the Board accordingly.

## VI. Report on the activities of the Investment Committee

### 6.1 Activities during the reporting period

40. The Investment Committee (IC) held one informal virtual briefing on 14 August 2019. The briefing was given by a team of consultants from Nodalys Conseil discussing their findings on the Study on the implementability of conditions on approved projects.

41. Work is progressing on a number of IC mandates. However, as there are no decisions on these mandates coming to B.24, there was no formal IC meeting during the reporting period. These mandates include:

- (a) Revision of the structure and operations of the independent Technical Advisory Panel;
- (b) Second review of the financial terms and conditions of the GCF financial instruments; and
- (c) The updated results management framework.

### 6.2 Next steps

42. The IC will hold an in-person meeting before B.24 begins to discuss the updates and the progress of relevant mandates.

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<sup>3</sup> Decision B.13/27, annex V, paragraph (a).

## VII. Report on the activities of the Performance Oversight Committee

43. The Performance Oversight Committee (POC) was formed at the twenty-first meeting of the Board to provide performance oversight for the Executive Director and Heads of Independent Units, collectively referred to as “Board-Appointed Officials” (decision B.21/13).

44. At its twenty third second meeting the Board, by decision B.23/05, has decided to: (a) reappoint the Head of the Independent Integrity Unit, the Head of the Independent Evaluation Unit and the Head of the Independent Redress Mechanism Unit; and (b) engage an independent external human resources firm to assist the POC. The decision to reappoint the Heads of Independent Units was based on the review of the report submitted by the POC and the external HR firm on the performance evaluations of the Heads, including a 360-degree evaluation.

### 7.1 Activities during the reporting period

45. The POC assisted by the Secretariat carried out a procurement according to GCF established procedures to hire a human resources firm to support the POC in the negotiations of the contract and development of a policy on performance evaluation of the Board-Appointed Officials. With the approval of the Chair and the POC, the selected HR firm, Oxford HR, were contracted on 1 October 2019.

46. The terms of reference of the HR firm include: (a) prepare and negotiate the contracts of the three Heads; (b) develop and carry out the annual regular performance evaluation system of the Board-Appointed Officials; and (c) develop policy related to the introduction of performance-based pay increase. The firm will work in close consultation with the POC and based on the GCF policies and procedures.

47. The Committee and the HR firm had its initial technical-level meeting to discuss the scope of the project on 2 October 2019; and weekly meetings are planned to happen to monitor the progress of the work.

### 7.2 Next steps

48. The POC will present the draft policy on performance-based pay increase and the draft annual performance evaluation system of the Executive Director of the Secretariat and the three Heads of Independent Units, and its respective recommendations to the Board at the twenty fifth meeting of the Board in March 2020.

## VIII. Report on the activities of the Risk Management Committee

49. Through decision B.17/11, the Board adopted the first set of components of the risk management framework (RMF), which included the revised risk register, risk appetite statement, risk dashboard and risk guidelines for funding proposals. The Board also requested the Secretariat to further develop the risk dashboard and the underlying methodologies for consideration by the Board at its eighteenth meeting. In addition, the Board requested the Secretariat to continue with the development of appropriate risk rating models with support from an external professional service provider and in consultation with the Risk Management Committee (RMC) and present the risk rating models for consideration by the Board at its nineteenth meeting.

50. At its eighteenth meeting, the Board took note of document GCF/B.18/05 titled “GCF risk management framework – Proposal by the Risk Management Committee”; however, no

decision was taken under this item. Through decision B.18/01, the Board approved the work plan of the Board for 2018 and decided to postpone the presentation of the risk rating methodologies for consideration by the Board to its twentieth meeting.

51. The Board, through decision B.19/04, adopted the second set of components of the RMF, which included three risk policies governing investment, non-financial and funding risks, respectively. Through the same decision, the Board also decided to update the risk dashboard with the revised approach to reporting on concentration and requested the Secretariat to publish the updated risk dashboard every quarter thereafter.

52. At its twentieth meeting, the agenda item on “Risk management framework: compliance risk policy” was not opened by the Board, and, therefore, no decision was taken under this item. At the same meeting, through decision B.20/03, the Board took note of the updated workplan of the Board for 2018 and decided to defer the consideration of the risk rating models, inter alia, and requested the Secretariat, in consultation with the Co-Chairs and relevant committees, panels and groups of the Board, to progress its work on the matter and present it for consideration by the Board at the earliest possible opportunity.

53. At the twenty-first meeting of the Board, the agenda item on “Risk management framework: compliance risk policy” was not opened, and, therefore, no decision was taken under this item. At the same meeting, through decision B.21/04, the Board approved the workplan of the Board for 2019 and decided to defer the consideration of the remaining components of the RMF, inter alia, and requested the Secretariat, in consultation with the Co-Chairs and relevant committees, panels and groups of the Board, to progress its work on the matter and present it for consideration by the Board at the earliest possible opportunity.

54. At the twenty-second meeting of the Board, no decision was taken by the Board on agenda item “Risk management framework: compliance risk policy” and the item was deferred to B.23.

55. At B.23, the Board adopted the RMF component VIII – compliance risk policy, through decision B.23/14. At the same meeting through decision B.23/02, the Board took note of the updated workplan of the Board for 2019 and decided to consider the review of the initial financial RMF and the risk rating models in 2020.

56. In decision B.12/31, paragraph (d), the Board requested the Executive Director to regard the template AMA as the basis for negotiations with AEs. The Executive Director will determine, in consultation with the risk and legal teams and the RMC whether a change is considered substantive on a case-by-case basis and would require Board approval.

## 8.1 Activities during the reporting period

57. During the reporting period from 1 June to 30 September 2019, the RMC welcomed Mr. Yoshitomo Kondo and Ms. Xia Lyu to the RMC. Mr. Kondo replaced Mr. Munenari Nomura as alternate member and Ms. Xia Lyu replaced Mr. Wenxing Pan as Board member. The RMC thanks Mr. Nomura and Mr. Pan for their contribution to the RMC and looks forward to working closely with the new RMC members.

58. The RMC held two formal meetings and conducted activities via email. The RMC discussed and provided guidance to the Secretariat on the mandates related to risk and compliance given by the Board, including: (i) development of the RMF, and its underlying policies, guidelines and tools; and (ii) AMA consultation.

59. Subsequent to the adoption of the second set of components of the RMF through decision B.19/04, the RMC reviewed the compliance risk policy which is an integral element within the framework. At its twenty-third meeting in Songdo, pursuant to decision B.23/14, the Board adopted the RMF component VIII – compliance risk policy.

60. During the reporting period, the Secretariat provided the RMC with an update on the legal risk policy, risk rating models, risk control self-assessment, and minimizing foreign exchange volatility on contributions. In addition, the Secretariat consulted with the RMC on the risk dashboard for Q2 2019 prior to its publication on the GCF website on 20 August 2019. Due to the heavy agenda for B.24, both the legal risk policy and risk rating models were deferred to 2020.

61. The RMC was also consulted on the following AMAs during the reporting period:

- (a) AMA with National Rural Support Programme (NRSP);
- (b) AMA with Fondo Mexicano para la Conservación de la Naturaleza A.C. (FMCN);
- (c) AMA with Fondo para la Acción Ambiental y la Niñez (Fondo Acción);
- (d) AMA with Landbank of the Philippines (LandBank); and
- (e) AMA with Luxembourg Agency For Development Cooperation (LuxDev).

62. During the RMC review of the NRSP AMA in June 2019, no objections were received from the RMC by the deadline and the Secretariat proceeded to issue the execution version of the AMA to NRSP for signature.

63. During the RMC review of the AMAs with FMCN, Fondo Acción and LandBank in July 2019, proposed changes to the AMA text were submitted to the RMC for consultation on a no-objection basis. There were no objections received from the RMC by the revised deadline and the Secretariat informed the respective AEs accordingly.

64. At B.23 in July 2019, pursuant to decision B.23/15, the Board requested the Secretariat to amend the AMA template, as considered by the Board in decision B.12/31, to ensure consistency with the scope of the Anti-Money Laundering and Countering the Financing of Terrorism Policy such that clause 9.03(a) reads as follows:

apply its own fiduciary principles and standards relating to any 'know your customer' checks, AML/CFT, and financial sanctions imposed by the United Nations Security Council, which should enable it to comply with the Policy on Prohibited Practices and the principles of the AML/CFT Policy.

and that clause 9.03(b) reads as follows:

unless prohibited by law applicable to the Accredited Entity, not use GCF Proceeds or Other GCF Funds for the purposes of any payment to individuals or entities, or for the import of goods, if such payment or import is prohibited by a Decision as may be adopted from time to time by the Board or by a financial sanction of the United Nations Security Council.

65. Following the RMC review of the LuxDev AMA in September 2019, no objections were received from the RMC by the deadline and the Secretariat informed the AE of the RMC no-objection accordingly and proceeded to issue the execution version of the AMA to LuxDev for signature.

## 8.2 Next steps

66. The RMC plans to meet virtually in October 2019 and may decide to hold additional meetings in Songdo during B.24.

## **Annex I: Review of the amounts to be set-aside for the foreign exchange commitment risk buffer for solvency risks**

### **I. Introduction**

1. By its decision B.21/14, paragraph (b), the Board noted that the timing of the first replenishment process of the GCF was still to be decided and that it would be prudent for the Board to make provisions for the operations of the GCF through 2019 and into early 2020 out of the remaining commitment authority of the GCF for the initial resource mobilization period. This was meant to provide assurance to GCF stakeholders that critical functions, such as the ongoing work of the Board, Secretariat, independent units and Trustee; the delivery of the Readiness and Preparatory Support Programme; and the implementation of the Project Preparation Facility, will continue uninterrupted.
2. By its decision B.21/14, paragraph (f), the Board requested the Budget Committee to present to the Board for its consideration at its twenty-second meeting a draft decision covering a set-aside for the operating costs of GCF (including for the administration of the Board, Secretariat, Trustee, and independent units) and a foreign exchange commitment risk buffer for solvency risks for 2019 and 2020 as required.
3. By its decision B.22/21, the Board decided to set aside the amount of USD 45 million towards the operating expenses of GCF for 2020 and to set aside an initial amount of USD 100 million towards the risk buffer. In the same decision, the Board requested the Budget Committee to review the risk buffer requirement and update the Board on the adequacy of the amount at its twenty-fourth meeting (B.24).
4. The commitment authority refers to the level of resources available for funding decisions, which is typically the total amount of actual cash in the GCF Trust Fund plus the promissory notes deposited in a designated custody account, minus net funding commitments (cumulative funding approvals minus cash disbursed) at any given point in time.
5. Solvency risk refers to the inability of the GCF to meet its financial commitments due to a shortfall in its available funds relative to its commitments. GCF will take all necessary measures to avoid any solvency events during its operations.
6. GCF receives financial contributions in a variety of currencies from contributors. Until the twenty-third meeting of the Board (B.23), the GCF made its financial commitments in USD and EUR. Due to changes in foreign exchange rates, the value of contributions fluctuates compared to the currencies in which the GCF financial commitments are made. These variations may be substantial, especially in periods of high foreign exchange rate volatility. In order to ensure that GCF is able to meet its financial commitments, the Board required that GCF maintain a risk buffer (see decision B.19/04). The foreign exchange commitment risk buffer will mitigate the solvency risks related to fluctuations in exchange rates.

### **II. Linkages with other documents**

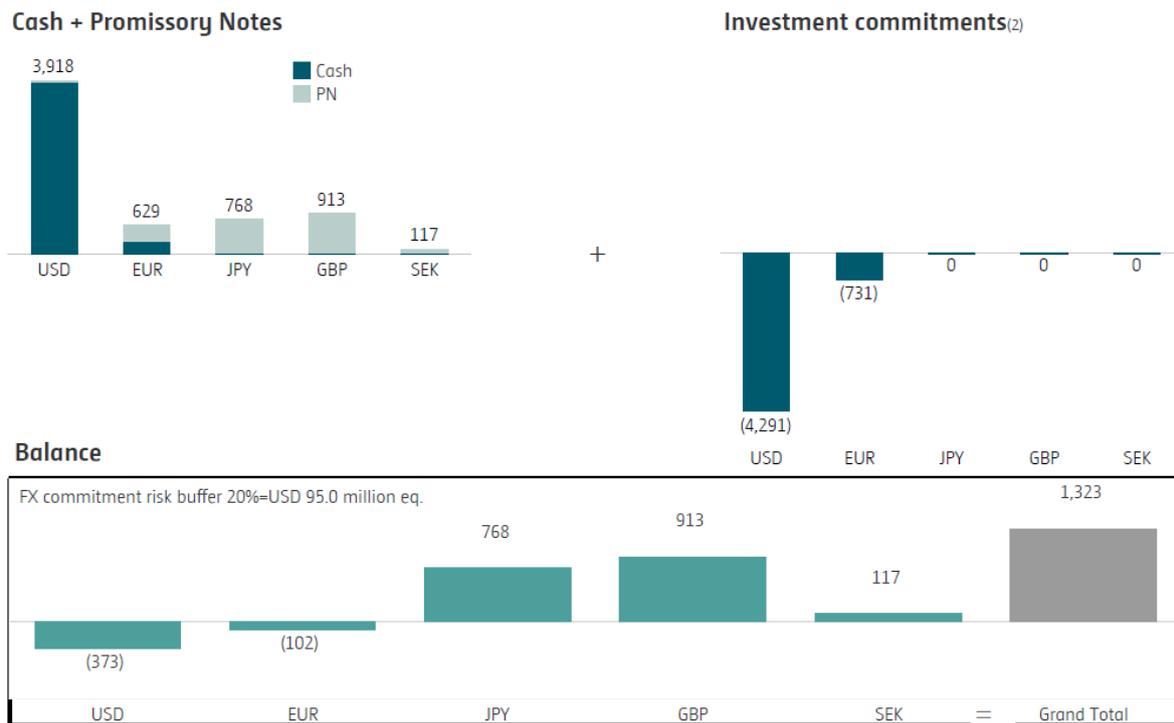
7. This document has actual or potential linkages with the following:
  - (a) “Initial risk management framework and adoption of a risk register” (decision B.12/34);
  - (b) “GCF risk management framework” (decision B.17/11);
  - (c) “GCF risk management framework” (decision B.19/04);

- (d) “Analysis of options for the financial planning of the commitment authority of the Green Climate Fund for the remainder of the initial resource mobilization period, 2019, and 2020” (document GCF/B.21/33/Rev.01); and
- (e) “Review of the amounts to be set aside for the operating costs of the Green Climate Fund and the foreign exchange commitment risk buffer for solvency risks” (decision B.22/21).

### **III. Analysis of the foreign exchange commitment risk buffer for solvency risks**

#### **3.1 Foreign exchange commitment risk buffer for solvency risks**

8. The need for the foreign exchange commitment risk buffer for solvency risks was recognized in decision B.19/04, wherein the Board adopted the risk management framework component VII (the funding risk policy), which was set out in annex VI to that decision. The relevant portion of the funding risk policy, as approved by the Board, is provided in annex II to this document.
9. As per the above decision, in order to meet its financial commitments, GCF will take all necessary measures to avoid any solvency events during its operations.
10. The foreign exchange commitment risk buffer arises because the GCF makes its investment commitments in certain currencies (e.g. USD and EUR), whereas it receives the contributions in multiple currencies. The foreign exchange fluctuation risk remains until the time these contributions, in currencies other than those in which the investment commitments were made, are received in cash, or until promissory notes are encashed and converted into the required currencies.
11. As per the policies of the contributions, cash can be deposited by the contributors until 2020, and the promissory note encashment schedule can run until 2023.
12. Given a large number of unknowns, most importantly future foreign exchange rates and the currencies in which the funding commitments will be made, it is difficult to come up with a precise estimate of the amount for the foreign exchange risk buffer that would be required in the future.
13. The figures calculated here are based on a number of assumptions, and these assumptions may need to be revisited and adjusted over time. As GCF receives cash contributions, encashes promissory notes and converts them into the required currencies, it will then actually realize the foreign exchange gains and losses, and the amount required for the foreign exchange risk buffer will gradually be reduced.



**Figure 1**

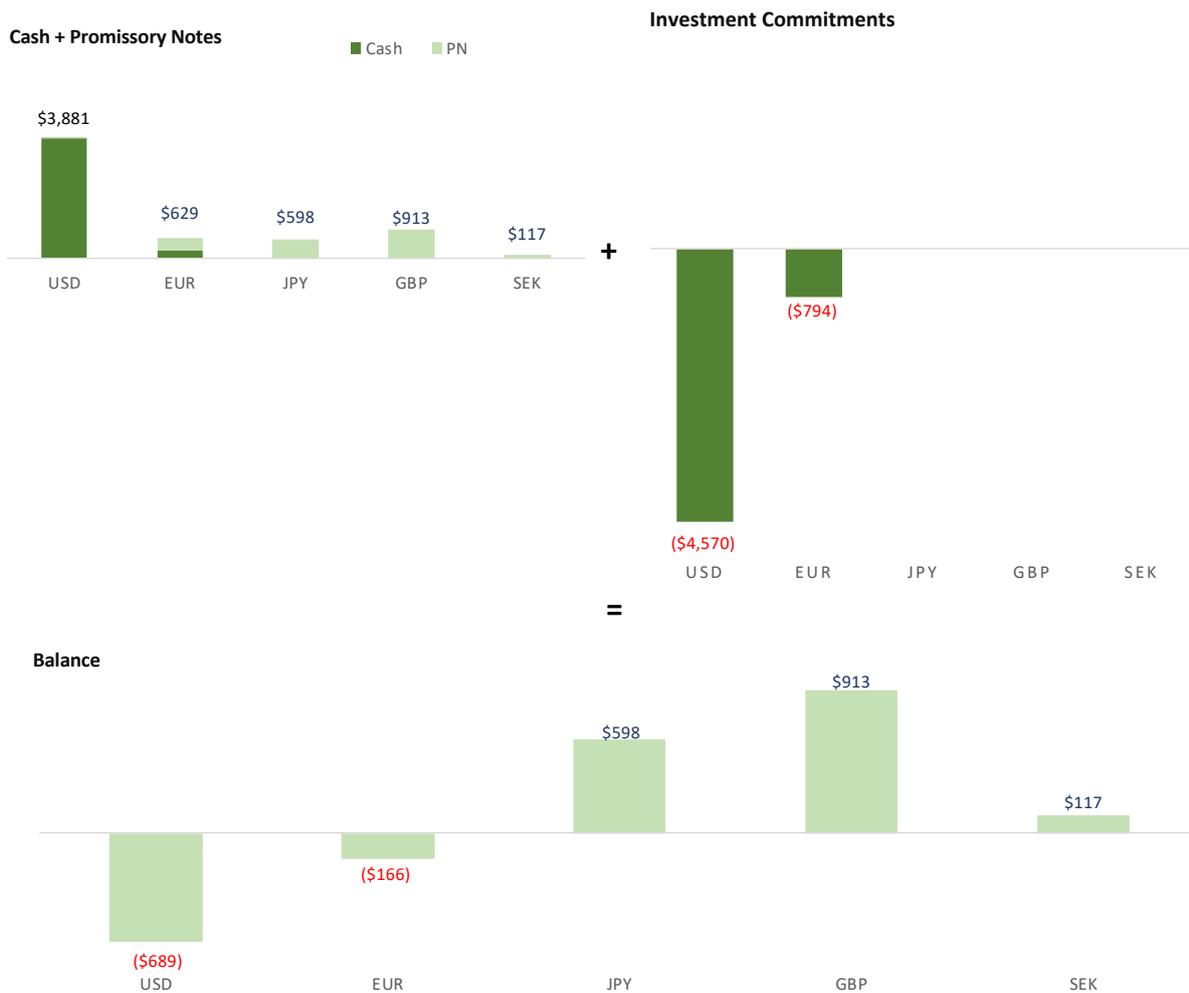
14. Figure 1 shows the cash and promissory notes available in the GCF Trust Fund in different currencies as of June 2019; it includes the funding commitments made by GCF up until B.23. The funding commitments include those for funding proposals, the Readiness and Preparatory Support Programme and the Project Preparation Facility. This chart is also reported quarterly in the risk dashboard;<sup>1</sup> however the risk dashboard, as of June 2019, does not include the funding commitments made at B.23. The risk management framework specifies that GCF will monitor the sufficiency of the foreign exchange commitment risk buffer on a quarterly basis. As per figure 1, the foreign exchange risk buffer, if kept at 20 per cent of the currency mismatch, would be USD 95 million after considering the funding commitments made up until B.23, which is within the set-aside amount of USD 100 million as per decision B.22/21.

15. In order to facilitate planning, figure 2 shows the projected cash and promissory notes available in the GCF Trust Fund in different currencies as of 30 June 2019, plus the estimated amount of the encashment to be carried out until end 2019 and the new commitment authority to be received until end 2019. The estimated funding commitments include the funding commitments made up until B.23 and the estimated new commitments to be made in 2019. For the purpose of this exercise it is assumed that:

- (a) The Board will make new funding commitments of USD 0.52 billion<sup>2</sup> at B.24. It is further assumed that, out of the USD 0.52 billion of the funding commitments, USD 0.43 billion of commitments will be made in USD, whereas the remaining USD 0.09 billion of commitments will be made in EUR;
- (b) In the remaining part of 2019, USD 0.26 billion will be disbursed for the projects; and
- (c) Additional investment income of USD 0.04 billion will be generated in 2019.

<sup>1</sup> See <<https://www.greenclimate.fund/library/-/docs/list/1141191>>.

<sup>2</sup> Estimated for this exercise without pre-judging the outcome of B.24.



**Figure 2**

16. The following considerations should be noted in determining the amounts to be set aside for the foreign exchange commitment risk buffer:
- The risk management framework states that GCF will set aside a foreign exchange commitment risk buffer at an initial target amount of 20 per cent of the nominal investment commitment amount of the GCF, for which the matched source of funds is not in the respective investment currency;
  - Figure 2 shows the projected availability of the cash and promissory notes in the GCF Trust Fund in different currencies and the funding commitments made until end of 2019;
  - As GCF encashes the remaining promissory notes and converts them into the required currencies, it will then actually realize the foreign exchange gains and losses, and the amounts required for the foreign exchange risk buffer will be reduced;
  - The GCF Trust Fund resources generated a cumulative investment income of USD 0.18 billion by end June 2019. An investment income of USD 0.04 billion is projected for the rest of 2019 in the estimates above, thus bringing the total projected investment income to USD 0.22 billion by the end of 2019;
  - Of note, the estimated foreign exchange hedging cost (currency swap) for hedging the future promissory notes to USD would be minimal (i.e. in the range of USD 1–3 million). Currency hedging would likely reduce the need to reserve a foreign currency

commitment risk buffer. Though it should be noted that once a currency swap is done, there can be no gain in the event that there is a favourable currency movement; and

(f) The contributions from the replenishment process, in cash and promissory notes, is likely to reduce the currency gap.

17. As shown in figure 2, the foreign exchange risk buffer, if kept at 20 per cent of the currency mismatch (i.e. USD 689 million + USD 166 million), is estimated to be about USD 170 million. Given that the Board has a set-aside amount of USD 100 million (see decision B.22/21), it is proposed to set aside an additional risk buffer in the amount of USD 70 million, thus bringing the total risk buffer to USD 170 million.

## Annex II: Solvency concerns in funding risk policy (excerpt from funding risk policy adopted through decision B.19/04)

### V. Solvency concerns

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

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

25. Investment commitments made where the matched funding sources are not in the same currencies as the investment commitment expose the Fund to solvency risk in case the investment currency appreciates against the currencies of the matched funding sources.<sup>1</sup>

26. Such solvency risk exposure arises in two kinds of situations – when the investment commitment is made in a holding currency, but the matched funding sources are in different currencies (partially, or wholly);<sup>2</sup> or when the investment commitment is made in a non-holding currency.<sup>3</sup>

27. To mitigate this solvency risk arising from currency differences between investment commitments and the matched funding sources, for investment commitments due in the immediate 12 months, the GCF will match the source of funds in the same currency as the investment commitments (through actions such as currency exchanges etc.).<sup>4</sup> This approach will help manage the fund's exposure to solvency risk in the near term (the immediate 12 months).<sup>5</sup>

28. Beyond the immediate 12 months, where the matched source of funds is not in the investment currency but are available in cash or cash equivalents in another currency, the GCF will convert the matched source of funds to the investment currency.<sup>6</sup>

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

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<sup>1</sup> FX depreciation of GCF investment commitments would not create solvency issues as defined in this Policy.

<sup>2</sup> Either in other holding currencies, or in promissory notes in non-holding currencies from a contributor country.

<sup>3</sup> It should be noted that extent of solvency risk exposure arising from investment commitments in non-holding currencies is limited by the diverse set of currencies the GCF may invest in, which provides a natural hedge to the GCF against investment currency appreciation.

<sup>4</sup> Conversion of funds to non-holding currencies may not be feasible within the Trustee account given the Interim Trustee Agreement.

Hence either the GCF will hold non-holding currency assets in an alternative account, and if that is not feasible, then the strategy of immediate conversion will not be applicable for non-holding currency investment commitments until the Secretariat establishes appropriate currency-holding arrangements.

<sup>5</sup> 12 months has been chosen consistent with the GCF's liquidity reserve definition. As a result, this full currency matching will be relevant for sources of funds which are a part of the GCF's Liquid Asset Portfolio.

<sup>6</sup> Conversion of funds to non-holding currencies may not be feasible within the Trustee account given the Interim Trustee Agreement. Hence either the GCF will hold non-holding currency assets in an alternative account, and if that is not feasible, then the strategy of immediate conversion will not be applicable for non-holding currency investment commitments until the Secretariat establishes appropriate currency-holding arrangements.

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

30. The Secretariat can review and modify the FX buffer amount over time as necessary. Furthermore, the Secretariat will report the status of the FX positions together with the FX buffer and amount of currency mismatch to the Second Level, the RMC, and the Board on a quarterly basis.
31. The GCF will monitor the sufficiency of the buffer versus the target level on a quarterly basis. If the buffer falls below the designated target level due to appreciation in some investment currencies, the Secretariat First Level will develop a plan to replenish the buffer back above the target level no later than one month from the day the breach of the target level was first identified.
32. The First Level will be responsible for maintaining the proposed FX commitment risk buffer and reporting on size of the buffers versus the target levels, and recommending any actions required (to replenish the buffer). The action will be finalized collaboratively, taking inputs from the Second Level. The actions should consider recommendations from the RMC and will need to be agreed with the SMT and, where appropriate, the Board.
33. The Second Level will develop a recommendation, independent of the First Level, on any action required for improving the Fund's solvency management. This recommendation will be discussed with the First Level, reviewed and finalized with the OED.

