September 10, 2013

Comments from Germany on Approval by mail: Documents entitled: Updates to the Elaboration of an Enterprise Risk Management Program for the Climate Investment Funds and Proposed Duties and Responsibilities of a Senior Risk Management Officer

Section 1 - GER Comments on the documents entitled: Updates to the Elaboration of an Enterprise Risk Management Program

General comments/conclusions:

- Current definitions of tier 1 risks still appear neither exhaustive/mutually exclusive, nor do they reflect basic causal relationships;
- GER feels there has hardly been any progress on the definition of measurable triggers and practicable risk mitigation measures of the tier 1 risks;
- The TOR of the Risk Management expert seem to be lacking a number of important responsibilities and provisions (see section 2).

Despite these serious concerns, we would very much like to move the agenda forward and therefore have tried to identify a constructive solution:

(a) GER approves the revised Tier 1 Risks and associated risk mitigation measures to be incorporated in the Enterprise Risk Management Framework *as a basis for the preliminary Risk Register, subject to further revision and refinement as necessary for the completion of the ERM Risk Baseline and the establishment of a coherent final Baseline Risk Register.*

(b) GER requests the CIF Administrative Unit, the Trustee and the MDBs to undertake the next steps identified in the document to ensure the continued implementation of the ERM;

(c) GER approves the duties and responsibilities of a senior risk management officer *subject to revisions and additions proposed under section 2 of this document*, and requests the CIF Administrative Unit to recruit a senior risk management officer to be responsible for the duties outlined in the proposal ASAP!

(d) GER approves the inclusion of additional funds necessary to cover the costs of a Grade G specialist, as proposed in the document, in the FY 14 administrative budget of the CIF Administrative Unit.

⇒ GER reiterates its suggestion to strengthen the working group and speed up the lengthy feedback and coordination processes through the participation of a TFC member. Obviously, we would gladly volunteer.

⇒ Given the delays in the establishment of the ERM, GER requests the Trustee to perform a gap analysis of the information that would have to be provided by the MDBs and the additional requirements and features the current cash flow model would have to perform in order to serve as a sufficiently robust interim tool for CTF portfolio risk analysis and monitoring. The gap analysis should be completed

with a view to enable TFC members to make informed decisions on important pending issues such as the funding envelope for LC lending or the dimensioning of cash reserves for the provision of credits/risk guarantees.

General questions ERM:

- Pls specify the authors of this paper.
- Before finalizing the Baseline Risk Register, pls rework definition and hierarchies of risks according to our May 2013 comments (see below, e.g. Risk 8 is the "final outcome" of all other risks, while Risk #10 is merely a component of Risk #8 and Risk #9 not a risk at all...).
- As already requested in May 2013, pls provide a visual risk mapping (i.e. flow chart/tree diagram) to capture and sort out remaining inconsistencies and allow the TFC to fully comprehend the causalities, interrelations, hierarchies, and priorities b/w the different risks specified in the paper.
- Pls differentiate b/w risks at portfolio level and risks at project level. While these boundaries are important, they are not always clear in the paper.
- Pls specify (i) the frequency with which the Portfolio Risk Dashboard will be updated; and (ii) how it will be made available to TFC members (s. France' comments).
- Pls define threshold levels for proposed triggers and provide more detailed proposed risk responses and processes (e.g. assuming that due to political problems, rating of country X falls under a certain threshold/trigger level - what happens next? (e.g. (i) immediate communication to TFC members, (ii) review of disbursement schedules, (iii) withdrawal/freeze of project approvals...)
- In section VI it still does not become clear how the Committee's risk tolerance should be determined practically. What are the further steps and who is going to undertake them?
- Pls provide an updated timeline for the implementation of the ERM Framework.

Specific comments ERM:

- Risk 2: The assessment of model risk should focus on the hazard of working with a potentially not well-suited model. Hence the objective should not be to the measure overall risk of indicators differing from projections (i.e. random deviation from forecasted mean), but to assess the potential consequences of having picked the wrong model. Consequently, this exercise is not about updating the information and assumptions used for the cash flow model, but assessing the cash flow model itself. Example: In 2011, GER commissioned a rapid assessment of the initial version of the CF model, and among a number of inconsistencies, came across a interest rate calculation error which added up to USD 2 bn. over the total lifetime of the CTF (approx. 25% of total interest rate returns). Given the growing importance of the CF model as a decision making tool (e.g. to determine size of LC lending envelope), we feel it is critical to increase the TFCs comfort level with the model itself and undertake another, more in-depth assessment. This assessment should also find means to provide a more fine grained picture of CTF portfolio risk including country/sector, risks resulting from lower seniority level of CTF loans, counterparty risk, interdependencies b/w sectors/countries (e.g. cluster risk), and risks resulting from the increasing diversity of financial instruments (LC loans, guarantees, risk sharing facilities, capital contributions, etc.).

- Risk 4: Neither interest rate risk nor forex risk have anything to do with the risks of overly concessional lending, market distortions or crowding out. Meanwhile, the risk resulting from LC lending has apparently been omitted.

For ease of reference pls find our comments from May 2013 below:

- To help finalize the definition of Tier 1 risks, and avoid further inconsistencies, overlap and incorrect representation of causalities, we feel it is necessary to prepare a risk mapping along the lines of the below example. This would help the TCF members visualize and better understand the ERM context and interdependencies between the selected risks and hence significantly speed up the definition of risk tolerances.
- Pls provide quantifiable/measurable definitions of indicators and triggers;
- Pls provide a more detailed and exhaustive identification of practicable mitigation responses on tier 1 risks;
- Pls provide a more detailed elaboration on risk mgmt. processes including what happens when threshold levels are exceeded and mitigation response become necessary.
- To avoid redundancies and overlap, risks should be broken down into separate, mutually exclusive parts and clearly differentiate b/w cause and effect. Unfortunately, Risk 1 ***[now Risk 9]*** is a potential cause for all other risks, while Risk 2 ***[now Risk 8]*** is a potential consequence of all other risks;
- As strategic risks, Risks 1&2 ***[now Risks 8&9]*** should more explicitly refer to the key strategic goals and objectives of the CTF. This should include clear references to CTF results framework, logframe, co-benefits and indicators, and most importantly to the key risks clearly addressed in the Investment Criteria (e.g. crowding out, market distortions, technological, policy, environmental, public health, all of which should be monitored in some way, but none of which are explicitly addressed in the current version of the ERM framework);
- Risk 1 ***[now Risk 9]***: misinformed decisions are neither a strategic risk (since informed decision making is not a strategic CTF goal), nor a risk per se (since committees not making risk informed decisions is rather a cause for not reaching strategic objectives and not a risk). Hence Risk 1 *[now Risk 9]* should be redefined accordingly;
- Risk 3 ***[now Risk 8]*** should also include the suboptimal use of funds through ineffective risk management practices (i.e. over-dimensioned “cash cushions”);
- Risk 4 ***[now Risk 1]***: Better to name this risk: “Portfolio losses reaching exceeding critical levels” since this risk should also include the possibility of tolerance levels themselves having been dimensioned wrongly based on faulty risk/cash flow modelling information;
- Assessment frequency: Due to the time sensitive nature of the issue and the urgent need for progress, GER would prefer if assessments of the ERM program could be completed in a semi-annual rather than annual fashion;
- Event/Risk triggers: If portfolio GHG savings are an indicator for transformational impact, then these should be used as trigger as well (e.g. GHG savings estimated - real GHG savings measured > trigger threshold);

- Section on portfolio risk: This section is very weak on the identification of relevant data, indicators, priorities, tolerances, triggers, residual risks, and mitigation responses. It should at least provide indicators and triggers for each of the key sub-categories of financial risk identified (credit/default, political, market, new instruments);
- Event/triggers for ALM Risk: Triggers insufficiently defined (which market rates should serves as benchmarks? how should mismatches with encashment schedules be measured? what are acceptable delays and frequencies in providing cash projections? what “decision is not taken due to lack of info”?)
- Risk responses for ALM Risk: Analysis of risk responses far from exhaustive. We feel it is important to identify all different means for the Trustee and MDBs to manage liquidity and react to shortfalls.

Section 2 - GER Comments on the documents entitled: Proposed Duties and Responsibilities of a Senior Risk Management Officer

Proposed additions to the TOR

Reporting lines:

- We assume that the Senior Risk Mgmt Officer will be reporting to the head of admin unit.
- Nevertheless, a clearly described direct link/communication channel with TFC will be crucial.

Additional selection criteria:

- Given that financial risk mgmt experience is presented as an optional component, the current version of TOR would allow hiring someone with no competence in this crucial area. Therefore section III c) shall be amended into: “Experience in enterprise risk and in financial risk management and experience in at least one of the following: operational risk or strategic risk management“
- 8+ yrs experience management of private equity funds or commercial banking preferably in an emerging markets context (of which > 3 years of relevant experience in risk management).
- Familiarity with banking guidelines and risk provisions (i.e. Basel accords, capital requirements, etc.).

Additional responsibilities:

- Ensure the development and implementation of a simple and pragmatic process while avoiding dissipation of efforts and resources through a strong focus on critical/high risks;
- Ensure the adoption of a well planned and structured approach with clear goals identified at the outset;
- Act as an effective internal facilitator to control the process;
- Periodic review and update of the risk management policy and framework in particular including a critical reassessment of the baseline risk register on a periodic basis, challenging the risk evaluations and action/response plans and identifying new/emerging risks for consideration by the TFC.
- Present updated risk register to the TFC each quarter and discussion of the most significant risks.
- Identify critical risk management-related issues to be presented to the semi-annual TFC meetings.