

Annex XIV: Policy to minimize the effect of currency fluctuations on the commitment authority of GCF

I. Objective

1. The objective of this Policy to minimize the effect of currency fluctuations on the commitment authority of GCF (hereinafter “Policy”) is to set out the approaches by which GCF will seek to manage its foreign exchange (FX) risk exposure to minimize the effect of currency fluctuations on the commitment authority of GCF.

II. Scope

2. This Policy shall apply to non-United States dollar denominated contributions of the commitment authority of GCF as directly deposited cash and deposited promissory notes which are not yet encashed.

III. Definitions

3. For the purposes of this Policy, the following definitions of terms shall apply:

- (a) **FX** means foreign exchange;
- (b) **ISDA Master Agreement** means International Swaps and Derivatives Association (ISDA) Master Agreement;
- (c) **MtM** means mark-to-market;
- (d) **NPV** means net present value.

IV. Hedging principles and application

4. Exposures to be hedged

- (a) Currency hedges may be used to protect the United States dollar (USD) value of both non-USD denominated contributions paid in cash and those deposited as promissory notes not yet encashed.
- (b) Natural hedges resulting from the existence of inflows and outflows in the same currency that reduces net exposure shall be considered before using FX hedging instruments.
- (c) The resultant net exposure due under contribution agreements shall be hedged as follows:
 - (i) Cash contributions received: up to 100 per cent of the exposure arising upon receipt using FX spot contracts; and
 - (ii) Deposited promissory notes: up to 75 per cent of the exposure arising in the next three years, having considered track record and expectations in the realization of contribution agreements, using FX forward and swap contracts.
- (d) The Secretariat shall evaluate at least once per month the GCF commitment authority exposure to FX fluctuations. Hedges shall be executed as soon as is practicable and within one month of the evaluation, having regard to short-term FX market conditions.

- (e) GCF expressly prohibits the use of derivative instruments for speculative purposes and hedging contracts shall only be executed to hedge the foreign exchange risk of an underlying foreign currency transaction.

5. **Foreign exchange hedging instruments**

- (a) The Secretariat is authorized to use to the following FX hedging instruments only:
- (i) FX spot contract – the purchase or sale of a foreign currency for immediate delivery. This instrument is often used by the Secretariat to immediately convert one currency into another at the prevailing daily rate;
 - (ii) FX forward contract – a commitment to purchase or deliver a specified quantity of currency on a designated date in the future for a price determined when the contract is transacted. This instrument will be used when the Secretariat knows that it will need to convert one currency into another at a future date; and
 - (iii) FX swap contract – an agreement to simultaneously borrow one currency and lend another at an initial date, then exchanging the amounts at maturity. This instrument may be used by the Secretariat for liquidity and bridging the gap when GCF has received funds earlier or later than the date of maturity of the FX forward contract.

6. **Counterparties**

- (a) Counterparties suitable for selection by GCF shall have:
- (i) For longer-term hedge exposures, a long-term unsecured credit rating of BBB- or above from at least two credit rating agencies (Standard & Poor's or equivalent Fitch or Moody's rating); and
 - (ii) For short-term (less than one year), hedge exposures, a short-term unsecured credit rating of A3 or above from at least two credit rating agencies (Standard & Poor's or equivalent Fitch or Moody's rating).
 - (iii) Counterparty limits to mitigate the credit risk shall be developed in collaboration between the First Level (Chief Financial Officer) and the Second level (Office of Risk Management and Compliance)¹ and approved by the Risk Management Committee (RMC).
- (b) All hedges shall be transacted under a mutually acceptable ISDA Master Agreement or other market standard FX hedging agreement which shall provide for disputes to be resolved through arbitration only.
- (c) Should GCF be required to post collateral, it shall try to establish a pledge of collateral² instead of collateral delivered as an outright transfer of title.

7. **Collateral posting and early termination**

- (a) A collateral reserve shall be set aside to provide for posting collateral as and when needed.
- (b) The collateral reserve amount shall be USD 50 million.
- (c) The collateral reserve shall be funded out of GCF's commitment authority.
- (d) The collateral reserve shall not be replenished each time funds from the reserve are used for the purposes of posting collateral.

¹ Funding Risk Policy (decision B.19/04, paragraph (a) (iii) and annex VI)

² A pledge of collateral ensures that the pledgor does not lose ownership or possession of the pledged collateral.

- (e) Any increase of the level of the collateral reserve shall be submitted to the Board for approval.
- (f) Funds held within the reserve shall be transferred to the receiving party, as and when required under the collateral agreement.
- (g) Funds returned to the GCF account shall be kept within the collateral reserve.
- (h) The funds allocated to the collateral reserve may be withdrawn:
 - (i) Once the transactions have terminated; or
 - (ii) When the total reserve amount is considered no longer appropriate by the Secretariat First Level (Chief Financial Officer) in agreement with the Second Level (Office of Risk Management and Compliance); or
 - (iii) If GCF no longer holds any contracts with collateral calls.
- (i) The Secretariat shall monitor regularly and report quarterly the level of the collateral reserve to the RMC, the Board and other relevant entities.
- (j) If supplementary funds must be paid into the collateral reserve, the Secretariat shall replenish it after approval from the the Board.
- (k) The investment income earned on the GCF undisbursed cash balance held with the Trustee shall cover potential breakage loss/gain associated with early termination of contracts. In case of shortfall, the liquid asset portfolio³ shall be used.

8. **Roles and responsibilities**

- (a) In accordance with the GCF risk management framework (decision B.19/04), the Chief Financial Officer is the primary owner and manager of FX risk.

9. **Hedging reporting**

- (a) The Secretariat shall implement the appropriate internal controls and reporting for ensuring the safe and sound conduct of currency hedging activities. A quarterly Treasury Dashboard shall be implemented, which shall include portfolio information such as exposures, FX rates, counterparty exposures, pledges and contributions for monitoring purposes. The Board will receive a Hedge Report to be included in the current Risk Dashboard.

V. **Implementation arrangements**

- 10. The Secretariat shall review FX exposures monthly and shall be authorized to carry out currency conversions and hedges in accordance with the provisions of the Policy. The Executive Director or his/her designee shall be authorized to negotiate and enter into legal agreements on behalf of GCF to give effect to this Policy.
- 11. The Secretariat shall prepare a quarterly FX report for the RMC and Board review.
- 12. This Policy shall be effective from the date of the Board decision adopting the Policy.
- 13. The Secretariat shall be authorized to implement this Policy and decide upon the best execution model for entering into FX hedging transactions, which may include outsourcing certain functions relating to trade execution and administration.

³ The liquid asset portfolio is defined as securities, cash or cash equivalents held in trust or in GCF's bank accounts.

VI. Monitoring and review

14. The Secretariat shall perform ongoing monitoring of the implementation of this Policy and shall inform the RMC of any emerging challenges.
15. The RMC, or the Secretariat, may make recommendations on this Policy and report to the Board if it is deemed that a review is needed based on operating experience.
16. In addition to the annual monitoring and reporting, the policy may also be assessed as part of the overall policy review to be conducted by the Board in the Board workplan under each replenishment cycle.