Policies for contribution to the Green Climate Fund for the Initial Resource Mobilization

This document is as adopted by the Board and contained in annexes XIX to XXIII to decision B.08/13, paragraph (a).

GREEN CLIMATE FUND

I. Resource mobilization approach

1. Large, global, multilateral funds usually begin with ad hoc contributions from initial contributors, followed by outreach to a broader universe of contributors and, over time, adopt a more systematic process to replenish resources. Contributions may be roughly based on past contributions, or derived solely from contributors' interests and capacities, and the value proposition of the fund. A summary of the principal approaches and processes used by some global funds is presented in Annex XXII, and the approaches are not mutually exclusive. For example, the adoption of a formal resource mobilization mechanism does not preclude the acceptance of contributions, voluntary or otherwise, outside the formal funding cycle. It is recommended that the Fund follow a voluntary, ad hoc approach for the IRM process, further elaborated below. This process will apply only to the IRM, without any prejudice to future replenishments:

(a) ***Pledging process and end-date for IRM pledging***: Contributors will be invited to pledge contributions at a formal IRM pledging session.[1] Based on Board decision B.05/04, the Fund will nevertheless maintain flexibility to receive additional contributions on an ongoing basis throughout the IRM period;

(b) ***IRM period***: The IRM exercise would secure financing for the 2015-2018 programming period;

(c) ***Effectiveness***: The Fund's commitment authority will become effective when 50 per cent of contributions, confirmed by fully executed contribution agreements/ arrangements, pledged by the November 2014 pledging session are reflected in fully executed contribution agreement/arrangements received by the Secretariat no later than April 30, 2015;

(d) ***Trigger for formal replenishment process***: Once the Fund's cumulative funding approvals exceed 60 per cent of the total contributions, confirmed by fully executed contribution agreements/ arrangements, received during the IRM, the Fund will initiate a formal replenishment process. The IRM participants envisage that this is likely to occur by end-June 2017;

II. Sources of funds

2. The Governing Instrument of the Fund states that the Fund will receive financial inputs from developed country Parties to the Convention, and may also receive financial inputs from other sources, public and private, including alternative sources.[2]

3. Policies for contributions to the Fund will apply to all contributors, including the other sources contemplated in the Instrument, to include:

(a) Non-Parties to the Convention;

(b) Public and private entities; and

(c) Philanthropic foundations, among others.

4. Contributions from Parties and other sovereign entities will be accepted on the basis of pledges received by the Secretariat.

[1] Tentatively scheduled for November 2014.
[2] Governing Instrument, paragraphs 29 and 30.

5. Contributions from philanthropic foundations may be accepted on the basis of pledges received by the Secretariat, following a due-diligence review prior to execution in accordance with policies and procedures approved by the Board.

6. Contributions from other non-public and alternative sources will be accepted on the basis of pledges received by the Secretariat, following a due-diligence review undertaken in accordance with policies and procedures approved by the Board. The purpose of the review will be to prevent reputational or other damage to the Fund.

7. The policies and procedures for contributions from philanthropic foundations, and other non-public and alternative sources should be developed by the Secretariat for consideration by the Board as part of its work program in early 2015.

8. Additionally, sources of funds may include, but are not limited to:

(a) Investment income earned on the balance of the Green Climate Fund Trust Fund;[3] and

(b) Reflows from outgoing loans and other financial products, including interest and principal repayments, net of repayments to loan contributors.

III. Types of contributions

9. As agreed by the Board at its fifth meeting, the following types of contributions to the Fund will be possible:

(a) Grants from public and private sources;

(b) Paid-in capital[4] contributions from public sources;[5] and

(c) Concessional loans from public sources.

Table 1: Contribution Types and Uses

Contribution Type	Definition	Illustrative Uses by the Fund
Grant	• Funds provided in cash or by promissory note • No repayment obligation • Cash and promissory notes are assets of the Green Climate Fund Trust Fund	• Any financial instruments approved by the Board of the Fund, (e.g. grants, concessional loans, equity, guarantees) • Administrative budgets, International Entities(IE) /intermediary fees
Loan	• Funds provided in cash • Obligation of the Fund to repay the contributor, with or without interest • Cash drawdowns are assets of the Green Climate Fund Trust Fund, creating a corresponding liability of the Fund	• Loans on terms less concessional than the loan contributions

[3] This includes investment income earned on balances transferred by the Fund to implementing entities and intermediaries (if applicable).

[4] The term "paid-in capital" used in previous Board decisions and Fund documentation does not denote capital (or equity of the Fund) that may be used as collateral or otherwise to leverage borrowing by the Fund (e.g. as in the case of a financial institution or multilateral development bank) but rather refers to "capital" as defined in Table 1.

[5] As per Board decision referenced above.

Contribution Type	Definition	Illustrative Uses by the Fund
Capital[6]	• Funds provided in cash or by promissory note • Capital contributor may receive a potential return of its contribution, in whole or in part, upon wind-up of the Fund, depending on the availability of such funds at the time	• Financial instruments which generate reflows regardless of the concessionality level (e.g. concessional loans, guarantees generating fee income). Thus, capital contributions may not be used to finance grants unless the specific terms of the capital contribution so allow.

10. **Maximizing the grant element:** The Board has decided that: The Fund will, in aggregate, seek to maximize grant contributions, taking into account its theme-based allocation. It is foreseen that grant contributions must significantly exceed loan amounts.[7] In consideration of the decision of the Board, the requirements during the Fund's IRM phase, and the limitations on the Fund's use of capital contributions, grant contributions must significantly exceed the amounts contributed in the form of loans and capital during the Fund's IRM phase.

11. Loan contributions would be unavailable for non-reimbursable uses such as to finance the administrative budgets of the Fund, and fees charged by the implementing entities and intermediaries using such contributed resources. Therefore, loan contributors would also be required to provide a grant contribution. In the case of capital contributors, a grant contribution may be required in addition, if specific terms of the capital contribution do not allow for grant financing or administrative budget financing.

12. **Critical role of the Financial Risk Management Framework:** Tracking of the different incoming contribution types and their uses by the Fund in accordance with the Fund's contribution policies will be performed by the Secretariat under the Financial Risk Management Framework to avoid cross-subsidisation between contribution types.

IV. Financial terms of contributions

13. The following terms apply to all types of contributions:

(a) **Size of contributions:** The Fund may accept contributions of any size from Parties to the Convention.[8] There will be no maximum limit on the contributions that the Fund will accept, within the prudential debt limit to be established for the Fund;

(b) **Currency and applicable exchange rates:** It is recommended that loan contributions may be made in major freely convertible currencies. Foreign exchange risk relating to loan contributions would be managed by matching currencies of commitments to IEs and intermediaries in aggregate to currencies of loan contributions. In accordance with Board decisions on the Fund's Financial Risk Management Framework, the Secretariat will ensure that it puts in place appropriate measures to manage currency risk related to the receipt, use and any repayment obligations related to contributions to the Fund. Further details on the management of foreign exchange risk are provided in Section X below.

[6] As referred to as "paid-in capital" in previous Board decisions and Fund documentation.
[7] Decision B.07/05 (Annex XI, paragraph 2(a)).
[8] Conditions, including minimum size, related to contributions from non-Parties and other sources, will be considered by the Board independently of the IRM process.

(c) **Requirement to provide grants**: All contributors would be required to provide a grant contribution. Contributions in the form of loans or capital will be accompanied by a minimum grant contribution to the Fund in respect of the administrative costs and expenses of the Fund,[9] and IE/intermediary fees associated with the implementation and use of the loan or capital contribution. It is important to note that this amount is set aside for administrative costs, and reflects the requirement for additional grant resources because loan and capital contributions may not be used for such non-reimbursable uses. The amount of the additional grant contribution required should be at least ten per cent of the amount of the pledged loan or capital contribution, but may be adjusted after the IRM period based on actual Fund administrative costs, IE/intermediary fees agreed by the Board, and other factors.[10] The grant contribution required in respect of administrative costs and expenses would be counted as part of the contributors' overall contribution to the Fund.

V. Policies for grant and capital[11] contributions

14. **Grants:** The Fund can currently receive grant contributions into the Green Climate Fund Trust Fund based on the provisions of the agreement between the Fund and the Interim Trustee (the "Green Climate Fund Trust Fund Agreement"), as approved by the Board.[12] Grant contributions are made to the Fund by way of a Contribution Agreement or Arrangement signed by the contributor, the Fund, and the Interim Trustee. To facilitate loan and capital contributions, new arrangements are required, and the Fund and Interim Trustee will need to amend the Trust Fund Agreement between the two parties.

15. **Capital:** A contribution made to the Green Climate Fund Trust Fund in the form of capital may be used for financial instruments which generate reflows regardless of the concessionality level (e.g. concessional loans, guarantees generating fee income). Thus, capital contributions may not be used to finance grants[13] unless the specific terms of the capital contributions so allow. Both capital and grant contributors may receive the return of their pro rata share of the Green Climate Fund Trust Fund balance in the event the Fund were to wind up operations. The distinction between grant and capital contributions is that the pro-rata share of the remaining funds at the time of the closing of the Fund that would be attributable to the grant contributors would be reduced by the amount of outgoing grants made by the Fund (including administrative budgets and fees); the pro-rata shares of the capital contributors would not be so reduced. Contributors providing capital would also be required to make a grant contribution to cover administrative expenses and fees, as further described below, unless the specific terms of the capital contribution allows for grant financing or administrative budget financing. Capital contributions would be tracked and reported separately under the Fund's Risk Management Framework.

16. It is recommended that aggregate capital contributions not exceed 20 per cent of the total funding provided. This limit may be reviewed within the context of the Fund Financial Risk Management framework upon further analysis on the risk appetite of the Fund.

17. **Legal arrangements for Contributions:** Prior to the establishment of an agreed replenishment process, the signing of Contribution Agreements or Arrangements among the contributors, the Fund and the Interim Trustee, is the most practical and appropriate means of

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[9] Including Interim Trustee and other functions.
[10] The figure of 10 per cent is an estimate of total costs and fees and in no way presupposes a Board decision on IE/intermediary or other fees or costs of the Fund.
[11] Also referred to as "paid-in capital" in Fund documents.
[12] Agreement on the Terms and Conditions for the Administration of the Green Climate Fund Trust Fund dated 15 October 2013.
[13] Capital contributions may also not be used for administrative budgets, IE or intermediary fees.

accepting contributions, and represents the established practice for many global multilateral funds. From the perspective of legal commitment, Instruments of Commitment (IOCs) and Contribution Agreements or Arrangements are equivalent. The features of both instruments, and in particular, the limitations presented by IOCs in the context of the Fund, are described below:

(a) **Contribution Agreements/Arrangements:** Contributions to the Fund would be facilitated through Contribution Agreements or Arrangements signed by the contributor, the Fund, and the Interim Trustee (as the entity holding the contributed funds in trust), which is the existing mechanism for receiving contributions to the Green Climate Fund Trust Fund. The material provisions of the Contribution Agreement or Arrangement will need to be revised to accommodate contributions in the form of loans and capital. The signature of Contribution Agreements or Arrangements is similar to the deposit of an IOC used in other funds such as the Global Environment Facility (GEF) and International Development Association (IDA), and creates a commitment on the part of the contributors to make a contribution to the Fund. Contribution Agreements/ Arrangements could also be used to accept contributions from entities that might not be involved in the IRM discussions or approval/endorsement of an associated formal resolution.

(b) **Instruments of Commitment (IOC):** The use of IOCs depends largely on the underlying replenishment process and particular structure and arrangements of a fund or programme. For the GEF and IDA, the contributors and governing body of the respective funds and the Board of Directors of the World Bank (acting as Trustee) will, in each replenishment period, agree on the contents of a replenishment resolution that is ultimately approved by the trustee's Board of Directors. The resolution summarizes the overall terms and agreements reached during the resource mobilization exercise, including the terms of contributions, payment arrangements, list of contributors, amounts to be contributed and the form of the IOC. Approval of the resolution by the trustee's governing body authorizes the trustee to accept contributions from the listed contributors through the deposit of an IOC consistent with the terms of the resolution. For the Fund, the formalities for the deposit of IOCs could be established as necessary when the Board agrees on the process for replenishment for the Fund in the future. In such cases, the Board could approve a replenishment resolution that would authorize the Fund to receive IOCs from contributors directly. As a separate legal entity from the Fund responsible for the Green Climate Fund Trust Fund, the Interim Trustee would, however, also need to enter into an agreement to agree to the terms of the IOCs deposited by the contributors with the Fund, to the extent such terms are relevant to the functions of the Interim Trustee. Finally, loan contributions would, in any event, require execution by way of a separate agreement or arrangement.

18. Payment of contributions:

(a) **Timing**: The Fund will accept contribution payments within the IRM period. There will be no fixed instalment schedule during the IRM period, and contributors are encouraged to fulfil their pledges, as early as possible, to build up sufficient funding levels available for funding decision/commitments by the Board;

(b) **Method of payment**: Payments may be made in cash or, at the option of the contributor, and with the agreement of the Fund and the Interim Trustee, by depositing, in a designated custody account, non-negotiable, non-interest-bearing promissory notes, to be drawn down in cash on demand;[14] and

(c) **Encashment of Promissory Notes**: For those contributors who elect to make contributions in the form of promissory notes, the encashment of promissory notes will be based on an encashment schedule agreed between the Contributor and the Secretariat, taking into account the expected programming of the Fund and resulting cash requirements. The encashment period will be based on need but it is envisaged not to exceed nine years. The projected cash transfers by the Fund for projects and programmes may remain uncertain until after the IRM pledging session, therefore a flexible approach is recommended that would provide necessary liquidity to the Fund in its early operational phase.

(d) **Comparison of contributions:** For purposes of comparison of donor contributions in real terms, the following encashment schedule will apply:

Table 2: Indicative encashment schedule for IRM period

Calendar Year	% of Contribution
2015	6.7%
2016	11.7%
2017	15.6%
2018	12.3%
2019	11.9%
2020	11.9%
2021	11.3%
2022	10.4%
2023	8.2%
Total	**100.0%**

19. For those contributors that choose to accelerate their cash payment or encashment schedule, a credit will be provided which will be added to the nominal pledge amount. This credit will be calculated as the difference between the present value of the standard encashment schedule and the contributor's encashment schedule. The discount rate for calculating the present value will be based on the estimated investment return on the Fund's liquidity over the term of the standard encashment schedule. For the purposes of the IRM period the discount rate would be 1.5 per cent. The encashment schedule will in no way prejudice the operation of the Fund in terms of programmatic decisions and disbursement profile. In the future, the encashment schedule will reflect the Fund's projected disbursement needs.

20. The Secretariat may also agree with the contributor to encash promissory notes on a basis other than that of the standard schedule as long as the revised encashment schedule is no less favourable to the Fund than the standard encashment schedule, in present value terms.

VI. Policies for loan contributions

21. The introduction of the possibility of loan contributions necessitates a set of additional financial management policies and procedures to ensure the financial sustainability of the Fund,

[14] It is important to note that in the case of promissory notes deposited with the Interim Trustee, there would need to be a provision for transfer to a permanent trustee, otherwise they would need to be drawn down in full before the assets of the Green Climate Fund Trust Fund would be transferred to the permanent trustee. If not, the Fund may have liabilities (funding decisions) booked against promissory notes that the Trustee may be unable to encash.

transparency, equal treatment of contributors, and that *there will be no cross-subsidization between providers of grants and providers of loans.*[15] The Board adopted an initial Financial Risk Management Framework at its seventh meeting,[16] confirming that loan contributions would be used as part of Fund's overall pool of funding.

22. As part of the implementation of the Fund's Risk Management Framework by the Secretariat, a system for tracking loan contributions will be required to reflect that:

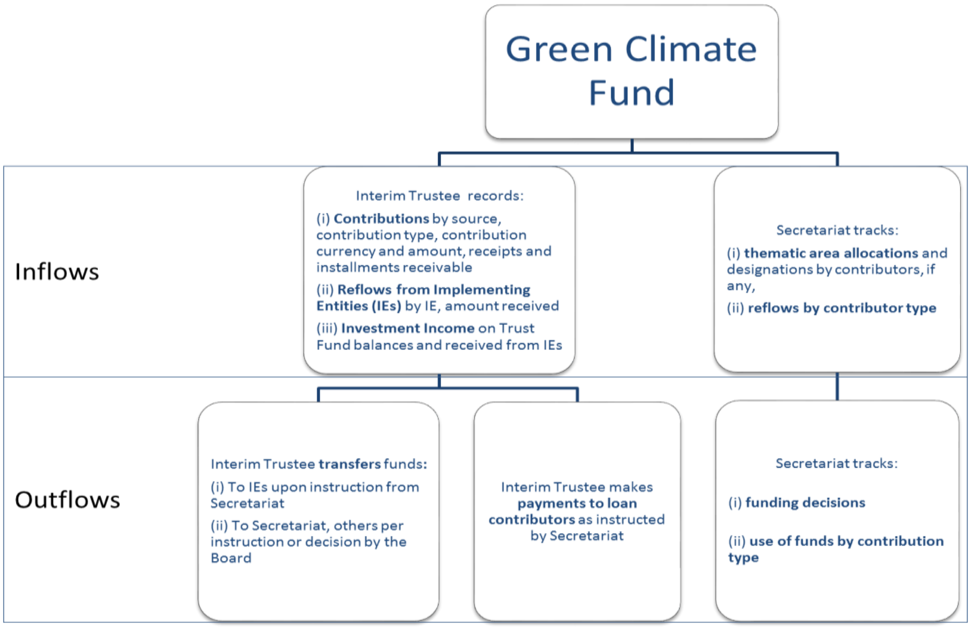
(a) Loan contributions will be tracked separately from grants and capital contributions; and

(b) All loan contributions will be co-mingled and grant amounts in respect of the cushion provided by the loan contributors will be used/shared on a pro rata basis among all loan contributors (see below).

23. The provision of this loan cushion allows the Fund to assume a certain level of risk to meet the needs of developing countries.

24. The tracking of cash flows is summarized in Table 3.

Table 3: Cash Flow Tracks



25. Other criteria to apply to loan contributions are:

(a) **Prudential debt limit**: The Board has already decided that the Fund will, in aggregate, seek to maximize grant contributions, and that grant contributions must significantly exceed the amounts provided in the form of loans.[17] An aggregate prudential debt limit will be established, defined as the total amount of contributions pledged in the form of loans as a percentage of the total pledged contributions. This limit depends critically on the risk appetite of the Fund and further elaboration of the Financial Risk Management Framework.

For the Initial Resource Mobilization phase, it is recommended that a conservative approach be followed and grant contributions are maximized. Many of the Fund's financial variables remain unknown, including the number and profiles of the Fund's IEs and intermediaries, disbursement and other characteristics of project and programmes funded, country and sector allocations, etc., therefore the debt limit will be subject to

[15] Decision B.07/05, Annex XI, paragraph 2(c).
[16] Decision B.07/05.
[17] Decision B.07/07 (Annex XI, paragraph 2(a)).

review under the Fund's Financial Risk Management Framework.[18] Examples of the prudential debt limits possible under various assumptions are presented in Annex XXIII. Interested contributors recommend that for the IRM a conservative prudential debt limit of 20 per cent be established. This limit may be reviewed within the context of the Fund's Financial Risk Management framework upon further analysis of the risk appetite of the Fund:

(i) **Implementation of the prudential debt limit:** The limit will be managed on an aggregate basis. During the initial pledging session, individual contributors would be encouraged to limit the individual loan component of their total contribution amount. The loan contribution should be no higher than 40 per cent of their total contribution. If the total amount of loan contributions is greater than the prudential debt limit, contributors would reduce their loan contribution pledges on a pro-rata basis, or as otherwise mutually agreed among the contributors. A review of the implementation of the prudential debt limit will be undertaken by the Secretariat based on actual loan, grant and capital contributions paid.

(b) **Legal arrangements for loan contributions:** A loan contribution agreement/ arrangement would be signed by the contributor, the Fund as borrower, and the Interim Trustee as the entity holding the contributed funds in trust;

(c) **Reporting of the grant equivalence of a loan contribution:** Funding received and extended by the Fund will be accounted for in grant-equivalent terms based on a standard methodology, to be developed by the Fund based on best international practices, to provide an accurate comparison of funding amounts between financial instruments.[19] It is recommended to utilize a discount rate of 2.65 per cent to calculate grant equivalency of loan contributions. Indicative calculations using 2.65 per cent discount rate are presented in Annex XXI. The full face value amount of the loan contribution would be used in the calculation of the commitment authority for the Fund (see Section VII), and for the purpose of the prudential debt limit calculation;

(d) **Loan drawdowns:** The proceeds of the loan contributions, payable in cash, will be held in the Green Climate Fund Trust Fund and transferred to IEs or intermediaries at the instruction of the Fund. The IEs or intermediaries will use such cash transfers in accordance with the policies and procedures established by the Fund, and submit any associated reflows to the Interim Trustee, in accordance with the legal agreements between the IEs or intermediaries and the Fund. Loan contributions will be drawn down on a schedule agreed by the Fund and contributor;

(e) **Provisions for non-performing loans:** Losses from non-performing loans will be borne by contributors whose contributions were allocated to loans. Should any loan extended by an IE or intermediary for a project or programme it implements be overdue, the Green Climate Fund Trust Fund may not have sufficient cash to fulfil payment obligations to the loan contributors. Based on the Board decisions on the Fund's Financial Risk Management Framework,[20] to further avoid cross-subsidization between providers of grants and providers of loans:

(i) The Secretariat will track loan performance and resource flows; and

(ii) Any financial losses will be borne on a pro-rata basis by contributors whose loan, grant or capital contributions were used by the Fund to extend loans over the

[18] Decision B.07/05.
[19] Decision B.07/06, Annex XIV paragraph 2(b).
[20] Decision B.07/05.

IRM period, in line with the principle of no cross-subsidization between loans, grants and capital contributions.

(f) The provisions for non-performing loans with respect to the loan contributors are as follows:

(i) **Cash-flow monitoring and modelling by the Secretariat:** As noted above, the role of the Financial Risk Management Framework and the function of the Fund's Chief Financial Officer will be crucial to the management of contributions, and particularly the tracking of loan contribution cash flows. The Board has already decided that, *as part of the implementation of the Financial Risk Management Framework, the Fund will incorporate a conservative hypothesis with respect to possible financial losses in order to ensure that actual reflows from outgoing loans will always exceed repayments due to contributors;* and

(ii) **Cushion and write-down of loans:**[21] In addition to the grant contribution amount required to cover administrative costs (described in Section V above), loan contributors will provide an additional grant contribution in respect of the cushion for non-performing loans. In accordance with the prudential debt limit considerations and principle of no cross-subsidization, a portion of the total grant contributions provided by loan contributors would be in respect of a cushion for non-performing loans, to be held as part of the assets of the Green Climate Fund Trust Fund, and available for use to make payments to loan contributors in the event reflows from outgoing loans are not sufficient to cover repayments due to contributors.[22] The amount of the cushion would be calculated as part of the implementation of the Fund's Risk Management Framework, on the basis of a realistic (quantitative) assessment of the risks the Fund is prepared to take on (the Fund's risk appetite) and the analysis of the Fund's expected cash flows, based on default rates and other assumptions. If, despite all reasonable efforts to maintain the risk profile of the portfolio of the Fund in line with the agreed risk appetite, the cushion proves to be inadequate, the loan contribution agreements will require that the loan contributors make additional grant contributions (and/or write-down against the payment of interest and principal repayment of loan contributions). Calculation of the optimal size of the cushion for the IRM period is difficult without making assumptions regarding programming, allocations across countries and sectors, and other factors. The initial required cushion will be 20 per cent of the face value of the loan contribution, and the adequacy of the cushion will be reviewed at the end of the IRM period. In the event there is an excess amount of cushion, as determined by the Secretariat and the loan contributors, the excess amount may be released and may be used as a grant contribution. Loan cushions will not count toward grant equivalency or individual debt limit calculations.

26. **Terms of loan contributions:** The terms of loan contributions will ensure that the average level of concessionality of outgoing loans will be less than the average concessionality level of incoming contributions, with a sufficient margin to cover credit risk.[23] Proposed loan contribution terms are contained in Annex XX.

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[21] Previous references to "Capital Cushion" have been replaced with "Cushion" to reflect the fact that contributions to the Cushion will need to be made in the form of grants.

[22] Reflows are expected to be insufficient until such time as interest payments are received on financing extended by the Fund.

[23] Decision B.07/05. The form and process for acceptance of promissory notes will be subject to agreement by the Fund and the Interim Trustee.

VII. Commitment authority

27. The Fund will develop a pipeline against the total amount of pledges. Funding decisions will be made against the total amount of available resources in the form of cash and promissory notes in the Green Climate Fund Trust Fund. Based on funding approvals, the Secretariat will record financial commitments against the deposit of cash contributions and promissory notes. Based on funding approvals by the Fund and cash transfer requests from the Secretariat, the Interim Trustee will transfer cash to IEs/intermediaries or Secretariat based on cash available in the Green Climate Fund Trust Fund.

28. Based on the tracking by the Secretariat, as part of the implementation of the Financial Risk Management Framework, it is expected that there will always be sufficient commitment authority available in the Green Climate Fund Trust Fund to meet the Fund's obligations and support funding decisions. In the unlikely event there is insufficient commitment authority, funds will be committed and transferred in the following order of priority:

(a) Payment of administrative budget and IE/intermediary fees, to be made from resources available in the Green Climate Fund Trust Fund except for capital and loan contributions;

(b) Transfers to IEs/intermediaries for projects and programmes, to be made based on resources available in the Green Climate Fund Trust Fund and subject to the uses of each contribution types; and

(c) Payment of interest and repayment of loans to the loan contributors, to be made from:

   (i) Reflows received by the Fund from loans extended; and

   (ii) The cushion described above, in line with the principle of avoiding cross-subsidization between grants and loans.

VIII. Liquidity risk management

29. Liquidity risk in relation to contributions represents the possibility of not having sufficient available cash in the Green Climate Fund Trust Fund to meet payment obligations of the Fund, including cash transfers for projects and programmes and debt service payments to loan contributors. Liquidity concerns would arise if the Fund's cash position was lower than its scheduled or unscheduled payment obligations at any point in time.

30. In accordance with the Board decision on the Fund's Financial Risk Management Framework, mechanisms will be put into place to ensure that liquidity risk in relation to contributions is closely managed and monitored by the Secretariat.[24] Among mechanisms to manage this liquidity risk, the Fund will:

(a) Commit only against cash payments and promissory note deposits;

(b) Closely monitor the risk of non-payment;

(c) Closely monitor and report to the Board on non-receipt of contributions on schedule; and

(d) Set aside a financial reserve from the funding available for the minimum liquidity requirements as determined by the Fund's Financial Risk Management Framework.

IX. Managing risk of non-payment of contributions

[24] Decision B.07/05.

31. Related to liquidity management is the risk that:

(a) Pledges are not converted into signed agreements/arrangements to provide contributions and/or loans; and

(b) Instalment payments under signed agreements/arrangements are not paid on time.

32. Non conversion of pledges into signed agreements will impact programming by the Fund based on pledges; non receipt of payments in cash or promissory notes will affect commitment authority of the Fund to approve programmes and projects.[25]

33. Incentive and/or enforcement regimes in other funds rely on a credible link to impacts of non-payment. Some options used in other funds include:

(a) **Voting shares reduced by amounts in arrears**: This requires the adoption of a decision-making structure based on contribution amounts;

(b) **Voice and/or representation in fund governing body linked to actual contributions**: This is difficult to implement in practice, as representation is often constituency-based or determined by other non-financial considerations;

(c) **Deferral provisions**: Contributors may agree to restrict the use of all or a portion of their contribution to the Fund in the event other contributors are not current on instalment payments. This provision which relies, however, on the adoption of a burden-shared approach, has not proven particularly effective in other funds, and adds an additional restriction on the use of funds that negatively impacts beneficiaries;

(d) **Reporting**: Regular financial reporting on contributions received and amounts in arrears is important, in order to provide information that may be used by the Secretariat, other contributors and stakeholders to apply moral suasion; and

(e) **Active follow-up and lobbying efforts**: Under a voluntary contribution scheme, in many cases ongoing lobbying of contributors may be the only effective solution to ensure timely contribution payments.

[25] The risk of inability to encash promissory notes is not considered here; it is deemed to be low based on the prevalence of the requirement for budget and legislative authority by the contributor prior to the deposit of promissory notes.

X. Foreign exchange risk management

34. Foreign exchange risk will be managed under the Fund's Financial Risk Management Framework.[26] In practice, foreign exchange risk relates to a large extent to loan contributions as grant and capital contributions do not involve repayment obligations before the wind-up of the Fund. Foreign exchange risk relating to loan contributions will be managed by matching currencies of loan contributions in aggregate to the currencies of the Fund's commitments to IEs and intermediaries. In practical terms this approach means that the Fund will have multiple holding currencies.

35. This would form part of the Fund's Financial Risk Management Framework and manage foreign exchange risk to acceptable levels (as set by the Board on recommendations by the Risk Management Committee).

36. The ability to extend multiple currencies would enable the Fund to better adapt to country requirements for those countries not wishing to borrow in US dollars.

[26] Decision B.07/05.

Annex XX: Loan contribution terms

1. It is recommended that the terms of loan contributions be standardized for all contributors. Two options for loan terms may be chosen:

(a) A more concessional option (Option 1); and

(b) A less concessional option (Option 2).

2. Standardized loan terms applicable during the initial phase of the Fund's operation would facilitate risk and cash flow management by the Fund.

3. These terms will only apply for the IRM phase, and may be reviewed in the future, during subsequent replenishment processes. They may also need to be reviewed based on the terms chosen by the Board for concessional lending by the Fund, to ensure that such terms are no more concessional than loan contribution terms.

(a) **Loan contribution size**: The maximum size of the loan contribution acceptable to the Fund would depend on the prudential debt limit to be established for the Fund;

(b) **Maturity:** The maturity of loan contributions will be 40 years (Option 1) and 25 years (Option 2);

(c) **Grace period**: The grace period of loan contributions will be 10 years (Option 1) and 5 years (Option 2) and will apply to interest and principal repayments;

(d) **Principal repayments**: Straight-line amortizing repayment schedule after the grace period; payments every six months;

(e) **Interest rate:** Loan contributions will attract a fixed coupon rate of up to 1 per cent per annum; payments every six months (applicable to Option 1 and Option 2) after the grace period;

(f) **Currency:** During the IRM phase, loan contributions may be made in major freely convertible currencies; and

(g) **Drawdown of loan proceeds**: The Fund will draw down loan funds from contributors as agreed between the Fund and contributor.

Annex XXI: Calculation of grant element

Indicative grant equivalence of the Fund loan contributions

Grant equivalence under different assumptions with respect to loan terms are presented below (assuming four-year fixed drawdown period):

Maturity	Grace Period	Interest Rate	Discount Rate	Grant Equivalence
40	10	1.00% p.a.	2.65% p.a.	33.86%
40	10	0.00% p.a.	2.65% p.a.	43.44%
25	5	1.00% p.a.	2.65% p.a.	19.70%
25	5	0.00% p.a.	2.65% p.a.	27.57%

Annex XXII: Resource mobilization approaches used by other multilateral funds

		Resource Mobilization Process	
		Ad-hoc	**Replenishment Cycles**
Funding Approaches	**Voluntary**	• Contributors' pledge amounts are based on individual interest/capacity • Contributions accepted at any time • Contributors can make single- or multi-year commitments • Contribution payment schedules are based on contributor preferences • Potential programming uncertainty <u>Examples</u>: Global Agriculture and Food Security Program, Consultative Group on International Agricultural Research Fund, Climate Investment Funds, Least Developed Countries Fund, Special Climate Change Fund. The Adaptation Fund - originally intended to be financed primarily through the monetization of CERs – uses this approach for additional contributions.	• Greater certainty and predictability for programming • Multi-year pledges that can be formalized through single- or multi-year contribution agreements • Contributions can be accepted outside of the replenishment 'cycle' • Contributor pledge amounts are based on individual interest/capacity • Can be customized to budgetary cycles of contributors <u>Examples:</u> Global Fund for Aids Tuberculosis and Malaria, Global Alliance for Vaccines and Immunization Alliance, Global Partnership for Education
	Burden-shared	n/a	• Greater certainty and predictability for programming • Contributions based on some measure (e.g. past contributions), but with flexibility to contribute other amounts • Can result in a 'structural funding gap' if contributors' shares do not add up to 100 per cent[1] • Multi-year commitments with coordinated, "pro-rata"-based payment arrangements and schedules • Contributions can be accepted outside of the replenishment 'cycle' • Can provide greater planning certainty for contributors <u>Examples</u>: Global Environment Facility, International Development Association, African Development Fund, Asian Development Fund, International Fund for Agricultural Development, and other multilateral development banks and funds.

[1] A 'structural gap' occurs under a burden-shared approach if, for instance, not every country in the benchmark index contributes to the fund. Other contributors may be constrained to go beyond their 'share' to fill the gap.

	Alternative	• Contributors support alternative financing structures through legal obligations containing cross-default or other provisions to front-load or otherwise provide financing that would not be available (International Financing Facility for Immunization,) • Agreements establish international or other levies (Adaptation Fund Share of Proceeds from Clean Development Mechanism)	• Similar to ad-hoc approach but with agreement to replenish on a regular basis (Advance Market Commitment for Pneumococcal vaccines)

Annex XXIII: Green Climate Fund prudential debt limit examples

1. The debt limit is a function of the terms of incoming funds, the terms of outgoing financing, and the relative use of loans and grants. Many of the Fund's variables remain unknown; therefore examples of debt ratios under different assumptions are presented here.

2. The general assumptions used in both examples are:

(a) Two sets of loan contribution terms:

(i) Loan Contribution Terms 1: 40 year maturity, 10-year grace period (for both principal and interest payments) and 0 per cent interest;

(ii) Loan Contribution Terms 2: 25 year maturity, 5-year grace period (for both principal and interest payments) and 1 per cent interest; and

(iii) Contributors will, on an aggregate basis, provide an equal amount of loan contributions on terms in (i) and (ii).

(b) One quarter of the Fund's entire envelope during the IRM, on a nominal basis, will be disbursed to recipients as grants, the balance will be used as non-grant lending products with the approximate distribution as follows:

(i) 20 per cent for public sector highly concessional loans (Product 1);

(ii) 30 per cent for public sector less concessional loans (Product 2); and

(iii) 25 per cent for private sector (Product 3);

(c) For all non-grant lending products a NPL level of 20 per cent is assumed on average;

(d) All reflows from outgoing concessional loans are co-mingled and are used for servicing loan contribution interest payments and principal repayments; and

(e) The disbursement profile for public sector loans is similar to the IDA projected disbursement profile. The disbursement profile for private sector loans is shorter (about three years).

Example 1 uses the following assumptions on the financing terms for outgoing lending and results in a prudential debt limit of 10 per cent

Assumptions on outgoing lending terms	Maturity (years)	Grace Period (years)	Interest (%)
Product 1	40	10	0.00%
Product 2	20	10	1.75%
Product 3	15	5	1.75%

Example 2 uses the following assumptions on the financing terms for outgoing lending and results in a prudential debt limit of 30 per cent.

Assumptions on outgoing lending terms	Maturity (years)	Grace Period (years)	Interest (%)
Product 1	40	10	0.75%
Product 2	25	5	1.75%
Product 3	8	2	1.75%

The two examples show resulting debt limits under scenarios where neither the cumulative net cash flows nor annual net cash flows are negative

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