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Seventh Replenishment of the GEF Trust Fund
Second Meeting: October 3-5, 2017

Prepared by the GEF Trustee



GEF-7 Replenishment: Overview of Financial Structure



- 1. Key Components of GEF-7 Financial Structure**
 - Minimum Contribution and Burden Sharing Principle
 - New Donor Contributions
 - Pro-rata Provision
- 2. Options to manage Foreign Exchange (FX) Risk**
- 3. Road Ahead for GEF-7**



1. Key Components of GEF-7 Financial Structure

Minimum Contribution and Burden Sharing



In GEF-7, the inflation-adjusted minimum contribution is SDR 4.0 million

From GEF-7 onwards, the minimum contribution amount will be adjusted for inflation using the SDR deflator for the four calendar years prior to the start of the replenishment discussions.

Burden-sharing: equitable distribution of financial responsibilities

Burden sharing framework varies across institutions and donors:

- For some, it is important to correlate contribution levels to objective criteria (GNI, previous replenishment shares etc.)
- For others, it is driven by donor preferences to align with their domestic budgetary priorities.

New Donor Contributions



Donor Instrument of Commitment

- Pledge is formalized by the deposit of an instrument of commitment (IoC)

Timing

- Four annual installments by November 30th each year.

Form of payment

- Cash, promissory notes or similar obligations payable on demand.

Encashments

- Indicative encashment schedule is currently 10 years, with options to accelerate.

Pro-rata Provision



Remove Pro-rata Provision

What is the Pro-rata Provision?

- In the event that a “lead donor” (a Contributing Participant and whose contribution is in the form of Qualified IoCs and represents more than 5% of the total replenishment) defers a payment, other donors who have paid their contribution have the right to hold it from programming.
- The pro-rata provision was established in GEF-1 to:
 - Facilitate fair burden sharing between a “lead donor” and other donors;
 - Protect the interests of smaller donors in the event of delayed or reduced contributions by the lead donor; and
 - Incentivize the lead donor to expedite necessary internal approvals of its GEF contribution.

Rationale:

- The pro-rata provision has had limited effect on the timely clearance of arrears, and has not been widely used.



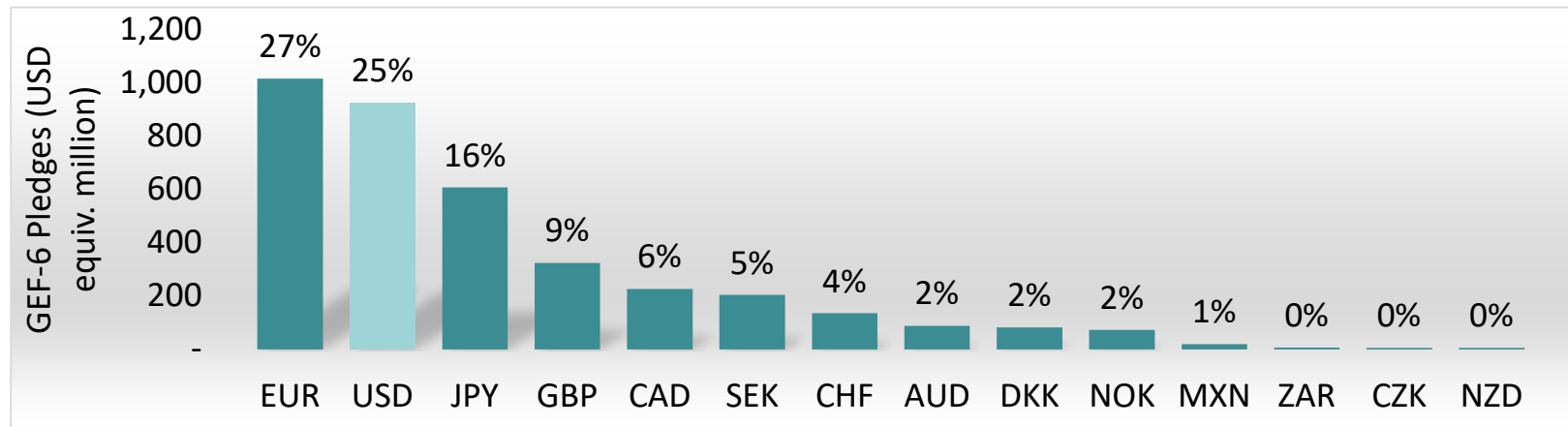
2. Options to Manage Foreign Exchange (FX) Risk

Source of FX Risk in GEF



FX Exposure in the GEF TF arises from:

- The operating currency being the USD while pledges are primarily in national currencies.
 - In GEF-6, 76% of pledges were non-USD **exposing over USD equiv. 2.7 billion to FX risk.**



- The GEF Replenishment Funding Envelope being determined based on the Reference Exchange Rates while the inflow of donor funds happens over time.

The “Shortfall” as of end-August 2017 was **USD 535 million.**

Current Practice: **USD 150 million reserve** to protect against adverse FX rate movements on committed resources.



Overview of an FX Hedging Program



Two options have been identified as most viable for further pursuit:

Option 1: GEF Accesses the Capital Markets as part of IBRD's TF Pool

Option 2: IDA Intermediation on behalf of the GEF TF

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1. FX risk would be **mitigated**.
 2. **Predictability of funds** available for programming.

1. Miss the potential currency gains if the holding currency (USD) depreciates.
2. **Risk of large collateral calls**, which may reduce funds available for disbursement and pose challenges for liquidity management.
3. Adequate **ringfencing** will need to be put in place to limit the risks posed to other participants in the trust fund Pool or IDA.

Simulation of GEF-6 Hedged Envelope



What would GEF-6 look like if it were hedged?

Assuming the contributions from GEF-6 had been fully hedged on July 1 2014, the total value of the hedged replenishment would have been 2.5% higher than the value implied by the GEF-6 Reference Exchange Rates, a **locked in “gain” of USD\$89.3 million assuming all donors paid according to their schedule.**

	Replenishment Rate Value (in US\$)	Hedged Rate Value (in US\$)	Difference
GEF6 Envelope			
- USD Receivables	\$ 872,933,120.00	\$ 872,933,120.00	\$ -
- Non-USD Receivables	\$ 2,711,535,807.46	\$ 2,800,832,635.48	\$ 89,296,828.02
Total	\$ 3,584,468,927.46	\$ 3,673,765,755.48	2.5%

The variation in value primarily came from the higher valuations of the CHF, EUR, GBP and JPY flows, which together accounted for 77.5% of the non-USD flows in GEF-6.

Immediate Next Steps in Implementation



By the Trustee

- Establish a **FX Risk Management Framework**
- Determine the **cost** of hedging
- Determine a **Collateral Arrangement**
- Develop a robust **ringfencing mechanism**
- Agree on **timing of hedging**
- Obtain **World Bank Board and GEF Council approval**
- Systems development

By GEF Contributing Participants

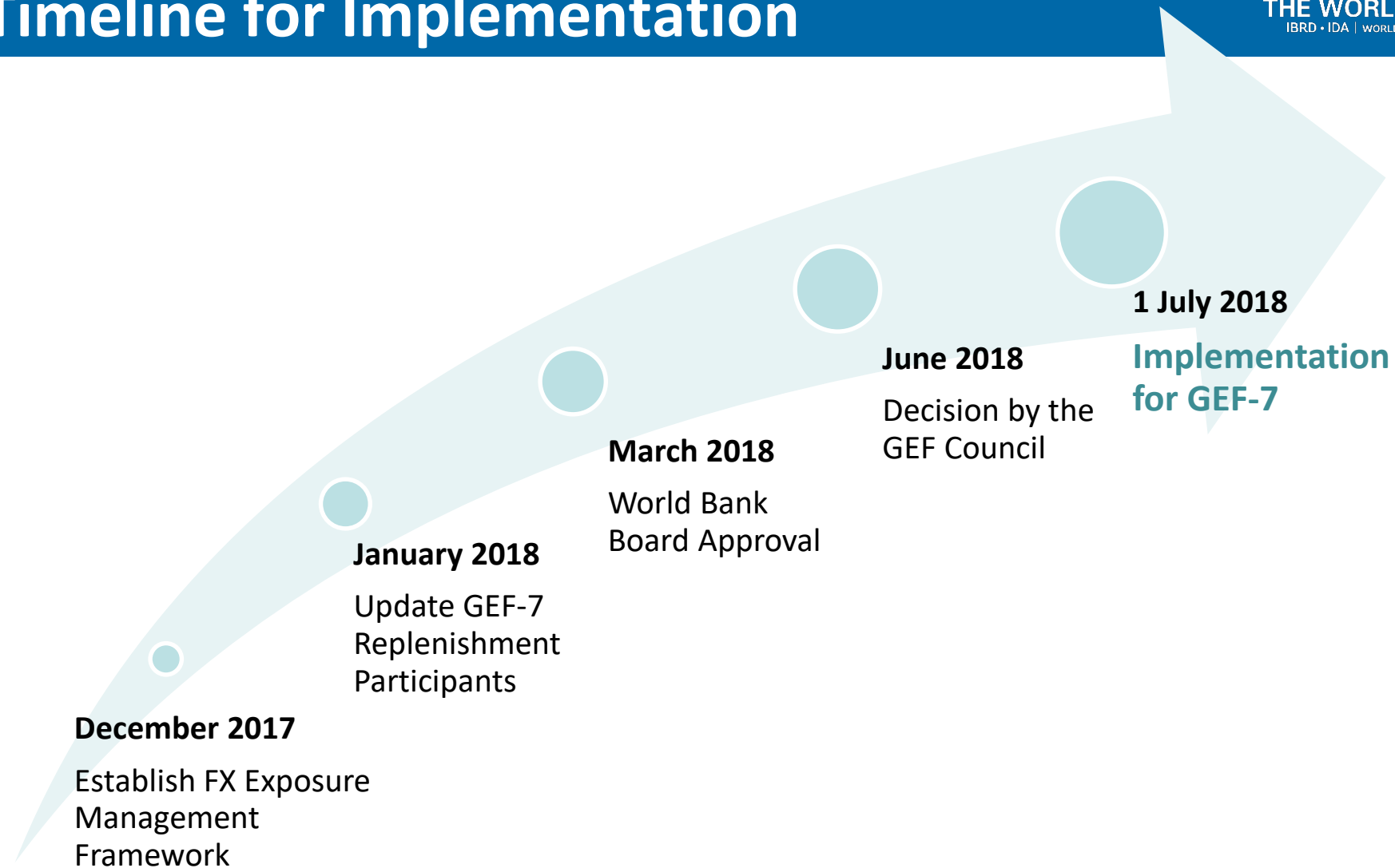
- Consider the provision of **unqualified IoCs** to maximize proportion of GEF TF being hedged
- Commit to **timely payment** to avoid unwinding of hedging transactions
- Consider a **shortened encashment schedule** to reduce the cost of hedging

2. Options to Manage Foreign Exchange (FX) Risk

Timeline for Implementation



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Other Options for Management of FX risk



Second Operating Currency

In GEF-6, a larger proportion of contributions are denominated in EUR (27%) than in USD (25%).

Factors to be considered:

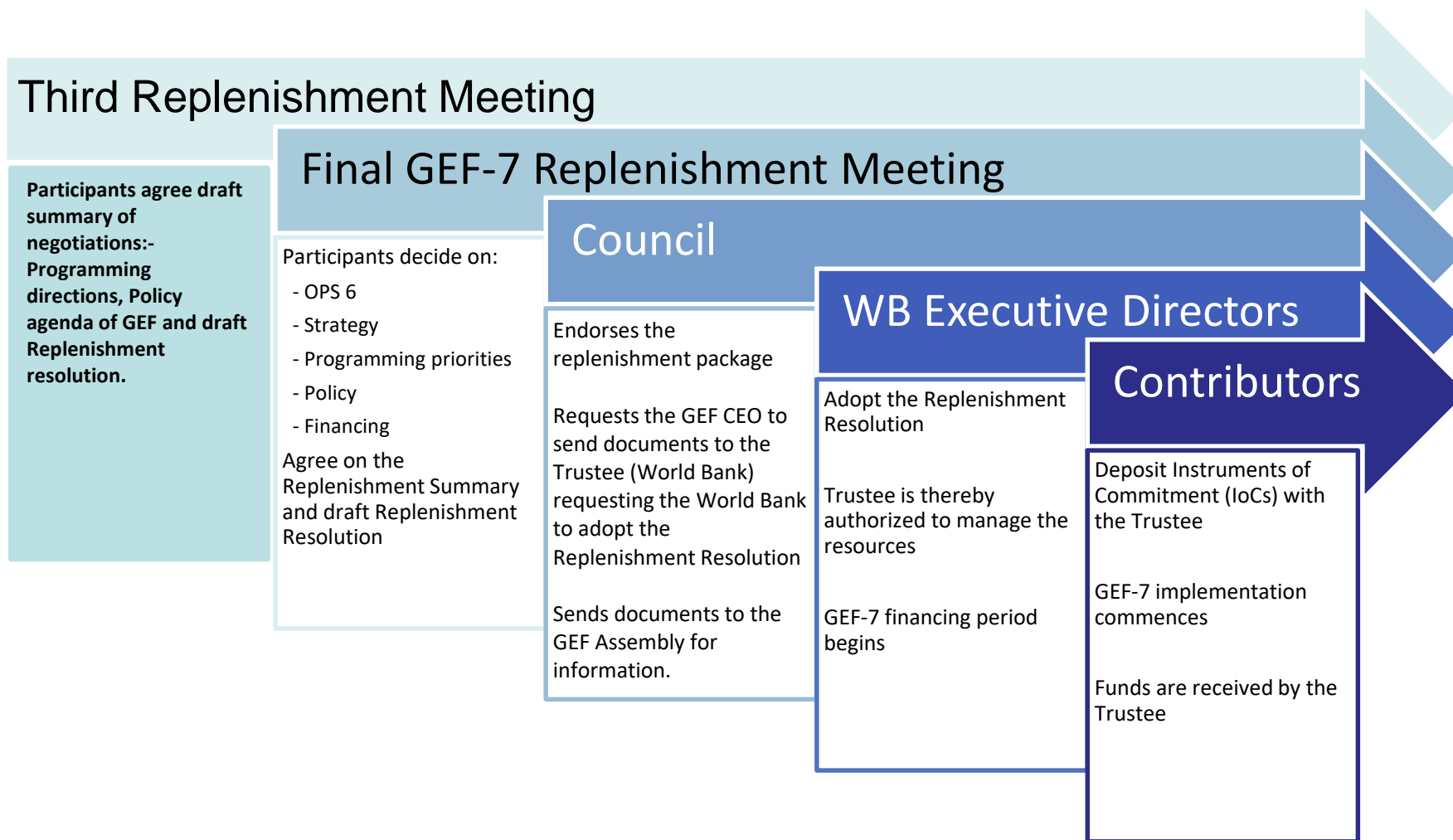
- Dependent on demand for EUR
- Requires meticulous financial management, tracking and reporting by Agencies, Secretariat and Trustee
- Potential increase in operating expenses
- Requires additional investment management efforts involving splitting the GEFs resources into two portfolios

Encourage donors to contribute in US Dollars



3. Road Ahead for GEF-7

Roadmap of the GEF-7 Replenishment





Thank you.