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

Prepared by the GEF Trustee
Overview

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
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.

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

**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.
1. Key Components of GEF-7 Financial Structure

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.
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
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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.
2. Options to Manage Foreign Exchange (FX) Risk

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

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.
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.

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.
2. Options to Manage Foreign Exchange (FX) Risk

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

- **December 2017**: Establish FX Exposure Management Framework
- **January 2018**: Update GEF-7 Replenishment Participants
- **March 2018**: World Bank Board Approval
- **June 2018**: Decision by the GEF Council
- **1 July 2018**: Implementation for GEF-7
2. Options to Manage Foreign Exchange (FX) Risk

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
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Roadmap of the GEF-7 Replenishment

Third Replenishment Meeting

Participants agree draft summary of negotiations:
- Programming directions, Policy agenda of GEF and draft Replenishment resolution.

Final GEF-7 Replenishment Meeting

Participants decide on:
- OPS 6
- Strategy
- Programming priorities
- Policy
- Financing
Agree on the Replenishment Summary and draft Replenishment Resolution

Council

Endorses the replenishment package
Requests the GEF CEO to send documents to the Trustee (World Bank) requesting the World Bank to adopt the Replenishment Resolution
Sends documents to the GEF Assembly for information.

WB Executive Directors

Adopt the Replenishment Resolution
Trustee is thereby authorized to manage the resources
GEF-7 financing period begins

Contributors

Deposit Instruments of Commitment (IoCs) with the Trustee
GEF-7 implementation commences
Funds are received by the Trustee
Thank you.