Overview

1. Key Components of GEF-7 Financial Structure
   - Replenishment Resources
   - New Donor Contributions
   - Encashment Schedule
   - Pro-rata Provision

2. Options to manage Foreign Exchange (FX) Risk

3. GEF Investment Strategy and ESG approach
1. Key Components of GEF-7 Financial Structure
GEF Replenishment Resources

- Unpaid Resources
- Paid-in Deferred Contributions
- Paid-in Unallocated Resources
## New Donor Contributions

<table>
<thead>
<tr>
<th><strong>Donor Instrument of Commitment</strong></th>
<th><strong>Payment Timing</strong></th>
<th><strong>Form of Payment</strong></th>
<th><strong>Encashments</strong></th>
</tr>
</thead>
</table>
| • Pledge is formalized by the deposit of an instrument of commitment (IoC) | • Four annual installments by November 30th each year  
  • That is:  
  - Nov 30, 2018  
  - Nov 30, 2019  
  - Nov 30, 2020  
  - Nov 30, 2021 | • Cash, promissory notes or similar obligations payable on demand | • Indicative encashment schedule is 10 years, with options to accelerate  
  • From FY19 to FY28 |
• The indicative encashment schedule for GEF-7 is as follows:

<table>
<thead>
<tr>
<th>Fiscal Year (July 1 to June 30)</th>
<th>GEF-7 Indicative Encashment Schedule (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2019</td>
<td>3.0%</td>
</tr>
<tr>
<td>FY 2020</td>
<td>8.0%</td>
</tr>
<tr>
<td>FY 2021</td>
<td>11.0%</td>
</tr>
<tr>
<td>FY 2022</td>
<td>15.0%</td>
</tr>
<tr>
<td>FY 2023</td>
<td>16.0%</td>
</tr>
<tr>
<td>FY 2024</td>
<td>16.0%</td>
</tr>
<tr>
<td>FY 2025</td>
<td>13.0%</td>
</tr>
<tr>
<td>FY 2026</td>
<td>9.0%</td>
</tr>
<tr>
<td>FY 2027</td>
<td>5.0%</td>
</tr>
<tr>
<td>FY 2028</td>
<td>4.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>
The pro-rata provision has had limited effect on the timely clearance of arrears, and has not been widely used.

Participants broadly agree that it should be dropped from GEF-7.

Due to some country constraints, the change may not be able to take place before the start of GEF-7.

- If it does, changes to the Replenishment Resolution will be presented at the April 2018 meeting.
2. An FX Exposure Management Framework for the GEF TF
Key conclusions after the Addis Ababa meeting

Hedging is the most efficient way of managing GEF currency risk

- Introducing a second operating currency not suitable from a recipient perspective
- Donors continue to have the option to contribute in US Dollars

Hedging should be done using the existing Trust Fund investment infrastructure

- Fastest and the most cost effective way for the GEF TF to access the capital markets
- Leverages the Bank’s relationships and experience
GEF currency risk by numbers

![Pie chart showing currency distribution]

<table>
<thead>
<tr>
<th>Currency</th>
<th>Amount (USD mln)</th>
<th>Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>985</td>
<td>36%</td>
</tr>
<tr>
<td>JPY</td>
<td>607</td>
<td>22%</td>
</tr>
<tr>
<td>GBP</td>
<td>324</td>
<td>12%</td>
</tr>
<tr>
<td>CAD</td>
<td>210</td>
<td>8%</td>
</tr>
<tr>
<td>SEK</td>
<td>191</td>
<td>7%</td>
</tr>
<tr>
<td>CHF</td>
<td>124</td>
<td>5%</td>
</tr>
<tr>
<td>AUD</td>
<td>84</td>
<td>3%</td>
</tr>
<tr>
<td>DKK</td>
<td>77</td>
<td>3%</td>
</tr>
<tr>
<td>NOK</td>
<td>73</td>
<td>3%</td>
</tr>
<tr>
<td>MXN</td>
<td>18</td>
<td>1%</td>
</tr>
<tr>
<td>ZAR</td>
<td>7</td>
<td>0%</td>
</tr>
<tr>
<td>CZK</td>
<td>6</td>
<td>0%</td>
</tr>
<tr>
<td>NZD</td>
<td>6</td>
<td>0%</td>
</tr>
</tbody>
</table>

Total 2,712 100%
### Reference Rate

**When?**
- Throughout the latter part of the replenishment process and at pledging date

**Why?**
- Determines each donor’s USD contribution to replenishment

### Spot Rate

#### Cash Instalments

**When?**
- At instalment date

**Why?**
- Determines instalment USD value and what resources are available

#### Promissory Notes

**When?**
- After note deposit date

**Why?**
- Determines the USD value of the liability created by making commitments

**When?**
- At encashment date

**Why?**
- Determines whether the GEF TF records a balance sheet gain or loss
Objective & Impact of the FX hedging

**OBJECTIVE of hedging**
Hedging offers **predictability** and **stability** in terms of resources available for programming.

**IMPACT on the value of resources**
Hedging preserves the economic value of pledges, by “locking-in” at the time of hedging the USD equivalent value of contributions. It may result in a higher or lower resource envelope than the target envelope.

**IMPACT on the availability of resources**
Once the hedges are in place, programming level can be determined based on the “locked-in” USD value.
Overview of Proposed Hedging Framework

**WHAT do we hedge?**
- Unqualified non-USD IoCs, in currencies with liquid FX forward markets

**HOW do we hedge?**
- Buying USD by entering FX forwards, with maturity dates equal or close to installment/encashment dates

**WHEN do we hedge?**
- On IoC receipt, or at a later time, if “bunching” together several IoCs schedules leads to increased efficiency

**HOW are hedges managed?**
- GEF’s exposure to changes in FX rates (for the hedged IoCs) will be reflected daily in the MtM of the forwards. The MTM determines the collateral and can only become a real gain or loss if contracts are prematurely closed
Hedging simulation for GEF-6 Replenishment

WHAT do we hedge?
• According to the Framework, we choose for the simulation the unqualified IoCs denominated in EUR, JPY, GBP, SEK, CHF, AUD. This accounts for 77% of non-USD contributions, amounting to USD 2.1 billion at FX forward rates.

HOW do we hedge?
• We simulate closing 298 FX Forward transactions, with an average size of USD 7 million and an average maturity of 4.4 years.

WHEN do we hedge?
• The transactions were simulated to take place between 1 July 2014 and end-August 2015, when the last IoC was received.

HOW are hedges managed?
• Mostly because of the USD strengthening since 2015, the MtM would have been positive, with a maximum of USD 230 million.
• GEF exposure to FX risk before hedging – expressed as the average loss in 2.5% of worst loss cases in the USD value of the GEF-6 contributions, was USD 691 million. After the hedging, GEF’s exposure would have been USD 93 million.
Risks associated with hedging

- Delays or cancellations by donors may trigger financial costs
  - Premature closing out of hedges may need to be done at a loss

- Collateral associated with GEF hedges may become very large
  - This may result in temporary rebalancing of portfolios or closing out of hedges

- Market counterparties to GEF hedges may default
  - May result in the need to put on new hedges
  - Pool collateral netting might result in complex settlement arrangements in case of counterparty default
How can donors help hedging efficiency?

- Maintain timely payments: This reduces the risk of real losses due to hedge unwinds.
- Where possible, provide unqualified IoCs: This will increase risk coverage of the replenishment.
- Provide IoCs as early as possible: This will give earlier risk coverage and certainty of envelope.
- Accelerated encashment schedules: This will reduce mark to market of hedges and any associated collateral.
Next steps in implementation

- Trustee to obtain internal World Bank Approvals for hedging (by April 2018)
- GEF Council to approve FX Hedging Framework (June 2018)
- Hedging to begin (July 2018)
3. GEF Investment Strategy and ESG approach
• Integration of ESG factors into the Trustee’s investment process will follow a dual approach

**ESG Awareness**

“What does my current investment process mean for the investment portfolio with respect to ESG profile?”

**ESG Consideration**

What ESG outcome do I want or am I seeking and how do I best achieve that outcome?”
A timeline for ESG Integration

**In progress** - World Bank investment staff receiving formal ESG Training

April 2018 – Presentation of joint GPIF/World Bank research

**July 2018** – Adoption of ESG policy into Bank investment process

**Future** – World Bank possibly signing up to UN PRI
Thank you
Historical Changes in GEF Funding Envelope

Changes in GEF Funding Envelope (USD eq) over each Replenishment Period (as of Dec 31, 2017)