



**GREEN  
CLIMATE  
FUND**

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# Risk appetite statement

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## **Summary**

This document presents a proposed update to the GCF risk appetite statement to make it fit-for-purpose for an experienced and maturing GCF and to respond to the Board's strategic directions contained in the updated Strategic Plan for the GCF 2024–2027 (USP-2).

The updated risk appetite statement aims to ensure that the risk appetite reflects the evolution of the GCF and its policies, the climate change and climate finance landscape, and the strategic priorities outlined in USP-2 while remaining aligned with the Governing Instrument for the GCF. It also establishes a foundation for revising the other components of the GCF risk management framework to ensure a cohesive and aligned approach to risk management.

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## I. Introduction

1. As the world's largest dedicated climate fund operating in over 125 developing countries, the GCF mandate is to promote a paradigm shift towards low-emission, climate-resilient development pathways in developing countries. This requires GCF to seek opportunities for impact potential where other investors will not take or are unable to take the risks. GCF considers risks through a distinctive lens to unlock opportunities for climate impact and to fulfil its mandate and strategic objectives.
2. By seeking opportunities for climate impact, GCF inherently encounters diverse risks. These risks – and linked opportunities – stem from both internal and external factors, including the continually evolving climate change landscape, the increasing sophistication of climate finance, the challenges faced by developing countries and the evolution of the GCF portfolio and operations. Recognizing this dynamic risk and opportunity environment, GCF has cultivated a nuanced risk profile and requires a robust, proactive and strategic approach to risk management, enabling it to achieve ambitious climate impacts while safeguarding the resources and reputation of GCF.
3. The risk appetite statement articulates the overall level and types of risk (financial and non-financial) GCF is willing to assume to achieve its strategic objectives. The risk appetite statement defines the institution's risk tolerance (the level of risk that GCF can accept per risk category), establishes a robust, proactive and strategic risk management culture, and guides both institutional and programming decision-making.
4. The development of a risk appetite statement began when, through decision B.10/08, the Board adopted a risk appetite methodology. This was a proactive step taken after approving only seven accreditation applications and before approving any funding proposals or finalizing a strategic plan. This was followed by an initial risk appetite statement adopted by the Board in 2017 (decision B.17/11 (a) (ii)) as one of the components of the risk management framework (RMF).<sup>1</sup> The initial Risk appetite statement benefited from experience with initial accreditation and funding approvals (approximately USD 2.2 billion in GCF funding) and Board approval of an initial strategic plan.
5. In 2019, recognizing the evolution and growth of the institution and its portfolio, the Board requested the Risk Management Committee (RMC) to review the RMF and propose any necessary actions for Board approval (decision B.24/04 (h)). To fulfil this mandate, the RMC, following its reconstitution in 2023, agreed to take a phased approach, starting with a well-defined risk appetite statement to inform all other RMF components.
6. This document reviews the current risk appetite statement and recommends changes designed to make it fit-for-purpose for an experienced and maturing GCF and to respond to the Board's strategic directions contained in the updated Strategic Plan for the GCF 2024–2027 (USP-2) and the recommendations of the Second Performance Review of the Green Climate Fund (see document GCF/B.35/07) to ensure that “the current review of GCF's risk appetite results in an updated risk appetite that is robust enough to encompass the diversity and character of GCF investments.”

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<sup>1</sup> The other components of the RMF are the Revised initial financial risk management framework in 2021, the Revised risk register (component I) (annex V to decision B.17/11, paragraph (a)), the Risk dashboard (component III) (annex VII to decision B.17/11, paragraph (a), as updated by annex VII to decision B.19/04, paragraph (b)), the Risk guidelines for funding proposals (component IV) (annex VIII to decision B.17/11, paragraph (a)), the Investment Risk Policy (component V) (annex IV to decision B.19/04, paragraph (a)), the Non-financial Risk Policy (component VI) (annex V to decision B.19/04, paragraph (a)), the Funding Risk Policy (component VII) (annex VI to decision B.19/04, paragraph (a)), and the Compliance Risk Policy (component VIII) (annex VIII to decision B.23/14).

## II. Policy rationale

7. The current risk appetite statement has been in use since 2017. While the time elapsed suggests the need for a review, more critical reasons lie in the evolution of GCF and its understanding of the progress of the climate change and climate finance landscape, underscoring the need for a proactive risk management approach. Since 2017, GCF has evolved in scale and maturity through the Board approval of an additional USD 12.7 billion in GCF funding for projects and programmes and the accreditation of over 80 additional accredited entities (AEs). This growth and valuable experience monitoring and facilitating implementation in a changing environment have exposed GCF to a wider range of risks. In addition, the urgency of climate change is underscored by the Intergovernmental Panel on Climate Change Sixth Assessment Report, which emphasizes the narrowing window for both mitigation and adaptation, highlighting the imperative need to shift from incremental to systemic responses. Externally, GCF and its partners experienced a global pandemic and have been navigating an increasingly volatile economic and political environment, including surging public debt burden, soaring inflation, significant currency fluctuation, and ongoing and emerging conflicts. All these inevitably increase the overall risk exposure of GCF.

8. The 2017 risk appetite statement also predates several key developments shaping GCF. The Board has guided GCF through two strategic plan updates and adopted various new strategies and policies, including other RMF components. Most recently, through USP-2, the Board has directed GCF to enhance access to climate finance for developing countries, expand programming for direct access entities (DAEs), streamline policies and processes, and increase engagement with the private sector. USP-2 emphasizes the unique ability of GCF to assume higher risks for transformative climate action. These strategic shifts position GCF at the forefront of the climate finance architecture, fulfilling its intended role as the main global fund for climate finance in accordance with paragraph 32 of the Governing Instrument for the GCF.

9. The updated risk appetite statement contained in this document is therefore proposed to ensure the GCF risk appetite reflects the evolution of GCF and its policies, the climate change and climate finance landscape, and strategic priorities as outlined in USP-2 while remaining aligned with the Governing Instrument. The updated risk appetite statement will also establish a foundation for further evolving the GCF operating modalities and policies, particularly as GCF fosters its robust risk culture.

## III. Analysis of policy proposal

### 3.1 Policy proposal

10. Building on the policy rationale outlined above, the Secretariat, under the direction and guidance of the RMC, conducted a thorough review of the 2017 risk appetite statement. This review informed the proposed revisions, categorized as framing changes and substantive changes.

#### 3.1.1. Framing changes

11. The updated risk appetite statement strengthens its foundation by expanding the objectives section. It clarifies the GCF risk management focus on institutional and programming risks, ensuring the ability to achieve the strategic mandate of the GCF. To further emphasize this approach, the risk appetite statement has been restructured to categorize risks by type (i.e., institutional, programmatic) rather than solely by tolerance levels.

12. The new “context” section acknowledges the dynamic risk landscape GCF faces, including a broader range of risks at the institutional level and within its supported projects, programmes and partners, which requires a proactive and fit-for-purpose approach to risk management. It also highlights that the GCF mandate includes taking risks that other investors will not take to support high-impact climate projects and programmes, collaborating with new partners, crowding in other investors, and working with partners to reach the most vulnerable, including in fragile and conflict-affected areas.

13. The updated risk appetite statement integrates reputational risk throughout the document, recognizing it as a consequence of all GCF activities. This approach acknowledges that reputation is not a separate risk category but stems from various aspects of the work of the GCF, including speed, efficiency, compliance and results delivery. This approach also recognizes the difficulty of isolating and measuring reputational risk while emphasizing its significance across all GCF operations.

### 3.1.2. Substantive changes

14. Several substantive changes have been made regarding specific risks, as follows:

- (a) Learning from past experience and recognizing that it is neither possible nor practicable to have zero residual risk,<sup>2</sup> particularly when managing a climate fund with a diverse portfolio, the zero risk tolerance for compliance risk and internal compliance breaches has been replaced by zero tolerance for prohibited behaviours and activities as well as low risk tolerance for internal compliance breaches (under operational risk) and policy breaches by partners. This approach seeks to more effectively identify and address potential risks and apply appropriate mitigations to minimize the likelihood and/or impact of policy and compliance breaches. This approach also shifts from solely focusing on ensuring policy compliance to defining a list of non-tolerated behaviours and activities and emphasizing building the capacity of partners to meet the GCF standards;
- (b) Adjusting the risk tolerance levels from “zero, moderate and considerable risk tolerance” to “zero tolerance for prohibited behaviours and activities, and low, moderate and considerable risk tolerance”. The descriptions of low, moderate and considerable risk tolerance have been updated to provide more granular differentiation regarding risk levels, with the aim of making the implementation of the risk appetite statement more effective. As a result, risks with moderate risk tolerance in the 2017 risk appetite statement have been reclassified to align with the new descriptions;
- (c) Adjusting the concentration risk approach as follows: (i) change from limits to monitoring thresholds and clarify that the thresholds are not caps, do not serve as allocations, and will be monitored by the Secretariat and reported to the RMC; (ii) the focus has been changed from investible amount to total committed amount; and (iii) monitoring thresholds for results areas and single proposals have been lowered while a monitoring threshold for AE<sup>3</sup> concentration has been defined. These changes reflect the evolving and growing GCF portfolio and provide a more accurate picture of actual exposure;

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<sup>2</sup> The amount of risk that remains after taking into consideration the controls that have been established for its mitigation.

<sup>3</sup> AE concentration has been monitored and reported through the risk dashboard (updated by decision B.19/04, paragraph (b) and as set out in annex VII of that decision). The monitoring threshold for a single AE is set at 10 per cent of the total committed amount.

- (d) Updating the foreign exchange (FX) risk by categorizing it into programming-side and funding-side FX risks<sup>4</sup> with differentiated risk tolerance levels and reflecting that the Board has approved the hedging strategy on the funding side through the “Policy to minimize the effect of currency fluctuations on the commitment authority of GCF” (decision B.34/22(b)). To support the broader programme investment options that are aligned with the mission of GCF, the programming-side risk maintains a higher tolerance than the funding side. However, it is crucial to carefully understand and manage these risks by adhering to the GCF risk management policies and procedures;
  - (e) Balancing the importance of adhering to the GCF policy requirements with the need to support partners, particularly in developing countries, GCF is committed to expanding its partner network and acknowledging the challenges that partners face. GCF will support AEs, particularly DAEs, through capacity-building and adaptive risk management during project implementation;
  - (f) Combining credit and equity investment risk into a single category, reflecting a more holistic approach, emphasizing active risk management, balancing risk with potential impacts and opportunities, and closely monitoring the portfolio’s performance; and
  - (g) Acknowledging the contextual risk environment in which GCF partners operate under project and programme implementation risk and highlighting the support provided by GCF to partners, particularly DAEs, in building capacity and adapting to evolving challenges.
15. For the remaining risks, amendments have been made to clarify and streamline their descriptions and provide high-level direction on how they will be monitored, addressed and reported (e.g. funds held in trust risk, legal risk, funding contribution uncertainty risk, liquidity risk and operational risk). In addition, risks with moderate risk tolerance levels have been adjusted to align with the new risk tolerance descriptions.

## 3.2 Policy impact

16. The overarching aim of the updated risk appetite statement is to provide direction to guide and steer the overall level of risk-taking and risk management across GCF operations, aligning it with the objectives outlined in USP-2. Specifically, the risk appetite statement:
- (a) Highlights key risks across various aspects of GCF operations that could compromise the ability of the GCF to achieve its strategic mandate;
  - (b) Describes acceptable risk levels and, where required, steers mitigation of such risks; and
  - (c) Fosters a cohesive and shared understanding of risk tolerance and risk-taking within GCF and among stakeholders, facilitating informed decision-making.

## IV. Implementation arrangements

17. Once the updated risk appetite statement is adopted, several actions will be crucial for the statement’s successful implementation and achieving its intended outcomes. These actions will ensure broad communication and awareness of the updated risk appetite statement, integrate the risk appetite statement within existing processes, and strengthen the overall GCF risk culture.

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<sup>4</sup> Programming-side FX risk: GCF investments that implement funding proposals with local currencies are subject to a risk of repayment in holding currencies. Funding-side FX risk: GCF receives contributions from countries in currencies that may not match the currency of future funding proposals, creating potential currency mismatch challenges.

18. A comprehensive dissemination plan will be delivered to reach all stakeholders, including the Board, the Secretariat, the independent units and partners. This plan will explain the updated risk appetite statement, its key principles and its implications at both the programmatic and institutional levels.
19. The Secretariat and independent units will review and, if necessary, update the relevant processes and guidance to ensure the updated risk appetite statement is effectively integrated and to inform the relevant targeted audiences of these changes.
20. GCF will actively foster a proactive risk culture internally and will make efforts to promote risk management best practices across entities funded by GCF. This includes setting a strong example through the Board leadership, ensuring solid linkages between decision-making and risk management, investing in enhancing risk management capabilities through adequate resourcing, training and development, and promoting open and transparent communication about risks at all levels. GCF will address potential risks through regular risk assessments and proactive stakeholder engagement.
21. The updated risk appetite statement will inform the revision of the other components of the RMF, ensuring a cohesive and aligned approach to risk management. Starting in 2025, the Secretariat, in consultation with the RMC, will work on the sequence of the review and revision.
22. In addition to the RMF, the updated risk appetite statement will be used as a reference point when updating or revising other relevant policies to ensure consistency in risk management practices. Any necessary policy changes will be brought to the Board for approval.

## V. Budgetary implications

23. The updated risk appetite statement will be implemented in the context of the Secretariat and independent units' ongoing risk management efforts, and overall budget implications will be proposed as part of the multi-year work programming and budget exercise. Specific budget considerations will be integrated into the review of the other RMF components and updated policy proposals.

## VI. Research and consultation

24. In conducting the review and updating the risk appetite statement, the Secretariat conducted a comprehensive review that assessed the experience gained through the application of the risk appetite statement adopted at the seventeenth meeting of the Board (B.17/11), identifying valuable lessons learned and areas for improvement.
25. The Secretariat worked under the direction and guidance of the RMC throughout the update process. This collaboration involved:
  - (a) Sharing the review findings to assess the effectiveness of the risk appetite statement in the light of the evolving risk landscape of the GCF;
  - (b) Working to develop options for refining the risk tolerance levels and risk management practices outlined in the risk appetite statement; and
  - (c) Presenting these options for feedback and incorporating insights from the RMC to ensure the updated risk appetite statement aligns with the Governing Instrument and the strategic direction and the risk management objectives of the GCF.
26. Beyond the RMC, the Secretariat also consulted the independent units to ensure that these units have a comprehensive understanding of the risks and can effectively apply the updated risk appetite statement.

27. The Secretariat also reflected the intentions and directions from crucial policies under development to ensure robust coherence across policy documents.

## **VII. Monitoring and review**

28. The Secretariat will update the risk dashboard and use it to monitor aggregate risk levels. This dashboard will also facilitate the identification of deviations from the established risk tolerance. Regular reports summarizing these findings will be submitted to the RMC.

29. The Secretariat will monitor the implementation of the risk appetite statement against the outcomes and expected benefits and report to the RMC and the Board. Monitoring will include, but is not limited to, the following metrics:

- (a) Concentration and funding risk metrics;
- (b) Operational risk events; and
- (c) Project/programme financial and implementation performance.

30. Although the Secretariat acknowledges the existence of data gaps that may initially limit the comprehensiveness of these monitoring efforts, it will undertake a review to identify areas for improvement and deliver targeted actions to ensure robust and effective monitoring and reporting to the RMC and Board.

31. For policies relevant to the risk appetite statement, the RMC will be consulted during policy reviews to ensure continued alignment with both the risk appetite and evolving operational environment of the GCF. The Secretariat will provide recommendations to the RMC on any necessary updates.

## **VIII. Recommended action by the Board**

32. The RMC recommends that the Board adopt the decision contained in annex I.



## Annex I: Draft decision of the Board

The Board, having considered document GCF/B.40/09 titled “Risk appetite statement”:

- (a) Adopts the risk appetite statement, as contained in annex II;
- (b) Agrees that the risk appetite statement referred to in paragraph (a) above replaces the risk appetite statement adopted through decision B.17/11 effective on the date of this decision; and
- (c) Requests, notwithstanding decision B.24/04, paragraph (h), the Secretariat, in consultation with the Risk Management Committee, to review the other components of the risk management framework, ensuring alignment with the risk appetite statement referred to in paragraph (a).

## Annex II: Risk appetite statement

### I. Objective

1. The objective of the risk appetite statement is to provide direction to guide and steer the overall level of risk-taking and proactive risk management across GCF operations, while aligning with the objectives outlined in the updated Strategic Plan for the GCF 2024–2027. The risk appetite statement is part of the robust and comprehensive GCF risk management framework (RMF). Specifically, the risk appetite statement:
  - (a) Highlights key risks across various aspects of GCF operations that could compromise the ability of the GCF to achieve its strategic mandate;
  - (b) Describes acceptable risk levels and, where required, steers mitigation of such risks; and
  - (c) Fosters a cohesive and shared understanding of risk tolerance and risk-taking within GCF and among stakeholders, facilitating informed decision-making.
2. The risk appetite statement sets the foundation for further review, revision and development of other policies, guidance and parameters within the RMF, and future policies or reviews of additional policies and frameworks in the GCF policy suite.

### II. Description of risk tolerance levels

3. In addition to zero tolerance for defined behaviours and activities, GCF has three levels of risk tolerance, from low risk tolerance to considerable risk tolerance:
  - (a) “low risk tolerance”: risks accepted when unavoidable for which appropriate mitigants to minimize the likelihood and/or impact will be applied;
  - (b) “moderate risk tolerance”: risks to be carefully managed and mitigated to reduce the likelihood and/or impact; and
  - (c) “considerable risk tolerance”: risks required to be taken to deliver the GCF mandate, that will be managed, monitored and, where practicable, mitigated, and only accepted if compensated through impact.

### III. Risk appetite statement

#### 3.1 Context

4. As the world’s largest dedicated climate fund serving developing countries, GCF faces a dynamic risk landscape, including financial and non-financial risks at the institutional level and within its supported projects, programmes and partners. These risks continue to evolve as the Fund expands in size, sophistication, portfolio and partners, and adopts innovative financial instruments and structures to achieve the objectives of its strategic plans. On the programming side, in order to achieve its strategic mandate of promoting a paradigm shift towards low-emission and climate-resilient development pathways, GCF is prepared to take risks that other investors do not take to support projects and programmes with significant climate impact potential, crowd in other investors, improve project financial viability, and work with partners to reach the most vulnerable, including in fragile and conflict-affected areas.
5. Externally, GCF and its partners navigate an increasingly volatile economic and political risk environment. These realities, coupled with the need to improve access and increase speed and programming levels to address urgent climate challenges, require a commensurate risk

appetite, including for potential reputational impacts. The GCF will adopt a proactive approach to managing and monitoring these risks to maximize climate impacts at the portfolio level.

### 3.2 Overall statement of risk appetite

6. GCF will uphold the highest level of integrity in conducting its operations. It has zero tolerance for a range of behaviours and practices and will promptly respond to allegations or incidences of related violations.

7. GCF seeks to maintain a stable and manageable institutional risk profile enhancing its ability to help ensure the adequacy and predictability of financial resources; maintain a well-balanced portfolio of projects and programmes consistent with a country-driven approach and in response to guidance from the Conference of the Parties to the United Nations Framework Convention on Climate Change and the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement; and operate in a transparent, accountable and efficient manner by implementing Committee of Sponsoring Organizations of the Treadway Commission (COSO) internal control framework.<sup>1</sup>

8. To realize significant impact and promote a paradigm shift to meet its strategic objectives, GCF is willing to accept considerable risks in its programmes and projects in return for impact potential, to be evaluated on a case-by-case basis, recognizing the specifics of each funding proposal. GCF will strive to understand, monitor and manage project, programme, partner and external risks, providing essential support and reasonable assurance to fulfil its mandate and strategic objectives.

9. A cornerstone of the GCF risk management approach is proactive risk management, including risk identification, assessment, appropriate mitigation, monitoring, reporting and appropriate actions to minimize, reduce and respond to risks, both directly and through partners that are implementing GCF projects and programmes.

### 3.3 Zero tolerance behaviours and activities

10. GCF has zero tolerance for Prohibited Practices in Fund-related Activities.<sup>2</sup>

11. GCF has zero tolerance for sexual exploitation, sexual abuse or sexual harassment in Fund-related Activities.<sup>3</sup>

12. GCF has zero tolerance for working with parties and engaging in activities subject to sanctions imposed by the United Nations Security Council.<sup>4</sup>

13. GCF will seek to minimize the risk of occurrence of such behaviours and activities. GCF will promptly respond to allegations or incidences of behaviours and activities for which it has zero tolerance and will take appropriate action.

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<sup>1</sup> The COSO framework was approved by the Board in decision B.BM-2015/06 as the internal control framework for GCF, to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance.

<sup>2</sup> As further set out in the GCF Policy on Prohibited Practices adopted in decision B.22/19, as may be amended by the GCF Board from time to time.

<sup>3</sup> As further set out in the GCF Revised Policy on the Prevention and Protection from Sexual Exploitation, Sexual Abuse, and Sexual Harassment in decision B.BM-2021/08, and as set out in Principle IV (k) (“Zero-tolerance of SEAH”) of the GCF Revised Environmental and Social Policy in B.BM-2021/18, as may be amended by the GCF Board from time to time.

<sup>4</sup> As further set out in the GCF Anti-Money Laundering and Countering the Financing of Terrorism Policy and Standards adopted in decisions B.18/10 and B.23/15, as may be amended by the GCF Board from time to time.

## 3.4 Institutional risk

### 3.4.1. Funding contribution uncertainty risk and liquidity risk

14. Predictable funding and sufficient liquidity are essential for GCF to achieve its objectives. GCF has low risk tolerance for funding contribution risk and liquidity risk.

15. GCF will take necessary actions to protect the predictability of its financial resources, including diversifying sources of contributions across a range of contributors and managing cancellations, postponements and other changes in contribution payment schedules to minimize risks associated with asset–liability cash flow mismatches.

16. GCF seeks to maintain sufficient liquidity to preserve its commitment capacity and meet its cash flow obligations. GCF will maintain a liquidity reserve equivalent to its anticipated net funding requirements for the upcoming one (1) year period. Currently, GCF does not use planned project reflows to reduce net funding requirements. The Secretariat will review the net funding requirements and the use of project reflows in consultation with the Risk Management Committee (RMC) in the future once reflows become a more relevant and predictable part of planned inflows.

### 3.4.2. Funds held in trust risk

17. GCF has low risk tolerance for risks related to funds held in trust. GCF will manage its liquid asset portfolio through the Trustee and the applicable investment strategy in accordance with evolving investment policy of GCF. The eligibility criteria for the liquid asset portfolio securities will also be guided in the same manner. GCF will maintain a prudential risk profile, limiting the investment universe of its liquid asset portfolio to investment grade securities with appropriate duration, as specified in the relevant policies, and will refrain from making investments that go against its mandate.

### 3.4.3. Foreign exchange risk

18. GCF faces two (2) primary sources of foreign exchange (FX) risk:

- (a) Programming-side FX risk: Investments of GCF that implement funding proposals with local currencies are subject to a risk of repayment in holding currencies. GCF maintains a moderate risk tolerance for such risk, providing the Board with a broader set of investment options in line with its mandate and its mission to promote a paradigm shift towards low-emission and climate-resilient development pathways. GCF shall seek to understand, manage and monitor this risk through relevant risk management policies, procedures and systems; and
- (b) Funding-side FX risk: GCF receives contributions from countries in currencies that may not match the currency of future funding proposals, creating potential currency mismatch challenges. It maintains a low risk tolerance for the funding-side of FX risk. To manage FX risk, contributions received may be converted to holding currencies to minimize mismatch. Any hedging will be in accordance with applicable Board-approved policies and risk management arrangements.

### 3.4.4. Operational risk

19. GCF has low to moderate risk tolerance for operational risks. GCF recognizes that daily operations carried out by its personnel through information systems and operational processes are susceptible to various internal and external risks that may jeopardize day-to-day operations, lead to financial losses, negatively impact the speed of programming delivery and damage its

reputation. Such operational risks include the failure of information systems, human errors, fraud and other internal compliance breaches, and cybersecurity threats.

20. GCF has low risk tolerance for fraud risk, the risk of non-compliance with internal policies and threats against the safety and security of GCF members and alternate members of the Board, Board advisers and GCF personnel in performing their functions for GCF. GCF has moderate risk tolerance for operational risks such as failure of information systems, human errors, information security or digital attacks.

21. GCF implements a proactive risk-based approach to prevent, mitigate and manage these risks through its internal control framework and by maintaining and updating the institutional risk register.

#### 3.4.5. Concentration risk

22. GCF has a moderate risk tolerance for concentration risk. To ensure that GCF optimizes the deployment of its financial resources to achieve its strategic priorities and climate impacts, GCF will maintain a diversified portfolio with respect to the amount of funding allocated to result areas,<sup>5</sup> countries, projects/programmes and accredited entities (AEs). The Secretariat will adopt a proactive approach by monitoring and assessing the Fund's exposure levels (in a nominal amount of cumulative funding approved for ongoing projects/programmes at a Fund level).<sup>6</sup> In addition, GCF will balance its deployment of funding instruments (e.g. grants, equity, loans and guarantees) and monitor the portfolio in accordance with the GCF investment and risk policies and procedures.

#### 3.4.6. Legal risk

23. GCF has moderate risk tolerance for legal risk, which, for the purposes of this section, is the risk of loss, including but not limited to financial loss, penalties, prosecutions, regulatory actions, loss of legal or contractual rights or reputational harm caused by or arising from:

- (a) Legally defective transactions or unenforceable legal agreements;
- (b) Programming in countries in which GCF has not secured privileges and immunities;<sup>7</sup>
- (c) Non-compliance with legal obligations under applicable laws or contracts; or
- (d) Litigation brought against or affecting GCF.

24. GCF will carry out appropriate diligence and monitoring to identify, carefully manage and mitigate legal risks to reduce the likelihood and impact thereof, including, where appropriate, by entering into legal agreements (including, for the avoidance of doubt, agreements to secure privileges and immunities) and incorporating risk mitigants in its legal agreements proportionate to the inherent legal risks. In addition, GCF will exercise its rights under its legal agreements appropriately to achieve its objectives. Notwithstanding paragraph 23(b) above, GCF will not establish a presence in countries that have not recognized its privileges and immunities.

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<sup>5</sup> The results areas are: energy access and power generation; low-emission transport; building, cities, and industries and appliances; forestry and land use; most vulnerable people and communities; health and well-being, and food and water security; infrastructure and built environment; ecosystem and ecosystem services.

<sup>6</sup> The Secretariat will monitor and report to the Risk Management Committee (RMC) against the following thresholds: 25 per cent of the total committed amount into a single results area, 2.5 per cent of the total committed amount into a single proposal, and 10 per cent of the total committed amount into a single AE. The RMC will review annually whether to include a monitoring threshold for country concentration.

<sup>7</sup> Further information on the consequences of the absence of privileges and immunities is contained in "Thirteenth report of the Green Climate Fund to the Conference of the Parties to the United Nations Framework Convention on Climate Change" (document GCF/B.39/14, pp. 131-133)

## 3.5 Programme risk

### 3.5.1 Policy breaches by partners

25. GCF has low risk tolerance for non-compliance by partners of GCF policies (e.g. prohibited practices, anti-money laundering, environmental and social safeguards, Indigenous Peoples, gender, and monitoring and accountability). GCF will proactively manage and apply appropriate mitigants to minimize such risks. GCF relies extensively on a network of partners, including AEs, for all stages of its operations (i.e. project identification, due diligence, execution, governance and monitoring). GCF has established policies and will enter into legal agreements that set the standards and define the expected actions and responsibilities of AEs, executing entities and other partners. GCF partners are expected to fulfil such obligations.

26. GCF is committed to growing the network of national and regional entities it works with to deliver climate finance in diverse country circumstances, including in fragile or conflict-affected situations. GCF will recognize the contextual risk environment in which its partners operate, and will support AEs, particularly direct access entities (DAEs), through capacity-building to meet best practice standards over time. In addition, GCF will take active adaptive measures during project implementation to manage such risk. GCF will assess and address cases of non-compliance and take appropriate actions, which may include remedial measures and capacity-building support to address capacity constraints, so that the risk of subsequent non-compliance is minimized.

### 3.5.2 Credit and equity investment risk

27. GCF has considerable risk tolerance for credit and equity investment risk in projects and programmes in order to meet its strategic mandate of promoting a paradigm shift towards low-emission and climate-resilient development pathways. GCF will support innovations, utilize a wide range of financial instruments to crowd in additional investors and enhance the financial viability of projects and programmes to meet its strategic mandate. GCF will seek to understand and, where practicable, mitigate the risk, and will balance such risk against the potential climate impacts and opportunities and assess concessionality for informed risk-taking and appropriate risk-sharing with partners. In addition, GCF will proactively manage the associated risk and closely monitor the credit and investment performance of its portfolio in accordance with its investment and credit risk management policies and procedures.

28. GCF has established a required cushion for loan loss reserves equivalent to 20 per cent (in grants) of the face value of the loan contribution provided to GCF by the loan contributors for non-performing loans. The adequacy of the cushion will be reviewed and updated periodically by the Secretariat in consultation with the RMC to ensure the ability of GCF to repay the loan contributions during the programming period.

### 3.5.3 Project and programme implementation risk

29. GCF has considerable risk tolerance for project and programme implementation risk, in order to achieve climate impacts and a paradigm shift. GCF will actively assess and manage this risk across various domains to maximize the likelihood of successful project execution and impact delivery. These domains include project governance, execution, political and macro-economic risks; partners' technical and institutional capabilities and track record in implementing GCF programmes; and community readiness (i.e. awareness, preparation, commitment).

30. GCF will recognize the contextual risk environment in which GCF partners operate and will support AEs, particularly DAEs, to build technical and institutional capabilities over time. GCF will actively monitor partner performance in project and programme implementation and

will take active adaptive measures during project implementation to respond to evolving risks and challenges to maximize the likelihood of successful project execution and impact delivery.

#### **IV. Implementation arrangements**

31. GCF will apply a multi-pronged approach to ensuring the successful implementation of the risk appetite statement, including a strong emphasis on proactive risk identification, assessment and mitigation, which may include:
- (a) A comprehensive communication plan to increase understanding of the risk appetite statement, its key principles and implications for programming and the operation of the institution;
  - (b) Integration of the risk appetite statement into existing processes, updating relevant guidance as needed; and
  - (c) Medium-term efforts to foster a proactive risk culture within GCF and make efforts to promote risk management practices across entities receiving GCF financing, including strengthening the linkages between decision-making and risk management; enhancing staff capabilities through adequate resourcing and training; and promoting open and transparent communication about risks at all levels.
32. The risk appetite statement will also inform revisions to the other components of the GCF RMF and its wider policy suite, ensuring a cohesive and aligned approach to managing risk across the institution.

#### **V. Monitoring and review**

33. GCF will use the updated risk dashboard to monitor aggregate risk levels across GCF. This dashboard will also facilitate identifying deviations from the established risk tolerance levels. Regular reports summarizing these findings will be submitted to the RMC by the Secretariat.
34. GCF will proactively monitor the implementation of the risk appetite statement by tracking its effectiveness in achieving the desired outcomes and delivering the anticipated benefits. If any updates are necessary to ensure continued alignment with the strategy, risk tolerance and evolving operational environment of GCF, the Secretariat will provide recommendations to the RMC.

### Annex III: Summary of risk tolerance

Section	Risk category	Risk tolerance
Institutional risk	Funding contribution uncertainty risk and liquidity risk	Low
	Funds held in trust risk	Low
	Foreign exchange risk	Funding-side: Low Programming-side: Moderate
	Operational risk	Low to moderate
	Concentration risk	Moderate
	Legal risk	Moderate
Programme risk	Policy breaches by partners	Low
	Credit and equity investment risk	Considerable
	Project and programme implementation risk	Considerable

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