



GEF/C.67/09
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Agenda Item 09

**MANAGEMENT RESPONSE TO:
ASSESSING PORTFOLIO-LEVEL RISK AT THE GEF**

Recommended Council Decision

The Council, having considered documents GEF/E/C.67/03, *Assessing portfolio-level risk at the GEF*, and GEF/C.67/09, the *Management Response*, takes note of the related evaluation recommendations and endorses the management response to address them.

INTRODUCTION

1. The GEF Secretariat welcomes the IEO report, *Assessing portfolio-level risk at the GEF* (GEF/E/C.67/03). The Secretariat welcomes IEO's efforts to assess portfolio-level risk of the GEF financing and to provide lessons that can improve risk management and risk taking in achieving global environmental benefits.
2. The Secretariat shares the IEO's view expressed in the report that paying due attention to risk management in the GEF portfolio is needed. The GEF Secretariat recognizes the importance of ensuring risk-informed project design and implementation, and over the past few years has initiated several measures to strengthen risk management, in response to evaluations from IEO and also to technical and scientific advice from STAP. These initiatives take place against the backdrop of the agenda of transformative change and continuous emphasis on blended finance in GEF-8, which provide opportunity for more risk taking and acceptance.
3. This evaluation was conducted during the preparation and eventual endorsement of the *GEF Risk Appetite* (GEF/C.66/13).¹ It addresses the introduction of this new framework, presenting it as "ambitious" and noting that the "*GEF risk appetite document develops guidance that agencies can use for deliberate risk-taking*". While this evaluation takes place too early to assess the implementation of this new risk framework, the GEF Secretariat welcomes that the report confirms the appropriateness of the risk appetite levels identified for its three dimensions: Substantial for Context, High for Innovation and Moderate for Execution.
4. The Secretariat agrees broadly with the assessment that Agencies monitor risks closely, grounded on their own overarching risk management system. It also recognizes that internal work culture and practices in Agencies may yield to rating risk differently at the project level. To mitigate this challenge and promote consistency in rating approaches, the *GEF Risk Appetite* invites Agencies to provide ratings grounded on the residual risk - that is the ultimate risk remaining after accounting for the implementation of mitigation measures.
5. The Secretariat is also encouraged by the fact that the evaluation identified rewards to high risk-taking in the context of innovative endeavors, while recognizing the challenges specific to fragile countries. Examples from investments from earlier GEF phases in renewable energy and in support of protected areas point to significant achievements in the face of high risks. Notably, the Secretariat agrees with the evaluation's assessment that higher risk may, in some instances, lead to lower outcomes in countries facing situations of fragility and with lower state capacity.

¹ *GEF Risk Appetite*, 2024 (GEF/C.66/13), https://www.thegef.org/sites/default/files/documents/2024-01/EN_GEF.C.66.13_GEF_Risk_Appetite.pdf

Recommendation 1. Refine the 2024 risk appetite statement to clarify risk ownership and establish a risk tolerance band.

6. The GEF Secretariat partially agrees with this recommendation.

7. The GEF Secretariat would like to highlight that the *GEF Risk Appetite* approved by Council in 2024, based on the deliberations of a working group, did not establish a risk tolerance band. Nevertheless, it includes a commitment to review the Risk Appetite and Framework based on observed experience at the beginning of GEF-9. It is within this context that the GEF Secretariat will proceed on this recommendation.

Clarifying risk ownership

8. The revision planned for GEF-9 will allow the clarification of risk ownership across the GEF partnership, building on foundational elements expressed in the *GEF Risk Appetite*: *“Responsibility for risk management is distributed across the partnership - among countries executing entities, Agencies, the GEF Secretariat and Council. Executing entities are responsible for managing risk in the day-to-day implementation of a project. They are overseen and supported by Agencies who adhere to their own operating frameworks in accordance with GEF minimum standards. This includes deploying experts and practices to address fiduciary risks (procurement and financial management) and risks related to environmental and social safeguards. In Agencies, project teams are primarily responsible for managing risk. Finally, the Secretariat supports Council’s oversight of risk in the GEF portfolio, informed by data, including through reporting in the Monitoring Report.”*

9. Under its indirect operating model, the GEF Secretariat relies on Agencies’ risk management practices in addressing risk in projects and programs. The GEF Secretariat concurs with findings from the evaluation indicating that Agencies have already established active risk management and escalation structures. It should be noted that the GEF Minimum Fiduciary Standards for Agencies approved by Council include that *“a project-at-risk system is in place to flag when a project has developed problems that may interfere with the achievement of its objectives, and to respond accordingly to redress the problems”* (GEF/C.57/04/Rev.02).² GEF internal analyses and evaluation findings indicate many Agencies have in fact developed sophisticated enterprise risk management systems.

10. During GEF-8, the GEF Secretariat anticipates the description of risk ownership to stay within these overall Council-approved parameters, as they reflect its indirect operating model whereby Agencies bear the direct risk. The GEF Secretariat recognizes that its risk management and governance structure differ from other climate funds, which operate under different

² GEF/C.57/04/Rev.02, *Updated Policy on Minimum Fiduciary Standards*, https://www.thegef.org/sites/default/files/council-meeting-documents/EN_GEF.C.57.04.Rev_.02_Update_GEF_Minimum_Fiduciary_Standards.pdf

business models and possess legal, oversight, and other essential capacities, assuming overall responsibility for fund utilization. While playing an important approval and oversight role, neither the GEF Secretariat nor Trustee directly supervises the use of GEF financing. This is the role of its 18 Agencies that receive funding and are responsible for project or program implementation.

Establishing a risk tolerance band

11. The GEF Secretariat will explore the merits and applicability of introducing a risk tolerance band for the overall portfolio as it refines the GEF risk appetite at the beginning of GEF-9, as agreed to by Council in the *GEF Risk Appetite*. In doing so, it will consider whether setting such risk tolerance band is practical, helpful and appropriate in the GEF context. In principle, a risk tolerance level is helpful in that it helps to communicate the share of projects that can exceed an established risk appetite level. This could allow clarification that Council would accept that a given share of the GEF portfolio faces higher risk than what is expressed as per appetite levels, without resorting to extraordinary measures.

12. In practice, setting a tolerance band would depart from the recently adopted GEF risk appetite and framework, in two main ways. First, appetite levels under the *GEF Risk Appetite* are set for three risk dimensions—Context, Innovation, Execution— whereas the IEO recommendation suggests that a tolerance level should be set for the overall risk where the overall risk is defined as the risk to achieving overall project outcomes. Second, appetite levels are set across the project lifecycle, whereas it is likely that the effectiveness of this tolerance band would be best assessed during implementation, when the risk is revealed, and when Agencies can indicate facing higher risk than anticipated.

Recommendation 2. Establish a risk management structure to proactively manage risks.

13. The GEF Secretariat agrees with this recommendation.

14. The GEF Secretariat will strengthen risk management and related support structures, within the confines of its operating model. This may include clarifying guidance in assessing and rating risk, and in identifying effective mitigation measures, as a way to enhance communication with Agencies on the risk appetite set by Council. The GEF Secretariat will also clarify further how it will report on the GEF risk appetite at the beginning of GEF-9, drawing from two years of implementation. Accountability on the risk appetite implementation currently takes place in the *Work Program Cover Note* and in the *Monitoring Report*.

15. At the level of the GEF, regular internal monitoring and planned public reporting on portfolio risk along the *GEF Risk Appetite* allow the alerting of any observed deviation. This acts as a transparent and accountable risk management structure, with communications to Council structured around regular monitoring exercises. Here again, the GEF Secretariat recognizes its indirect operating model differs from the governance structure of other funds which enter into direct agreements with accredited entities governing use and return of funds, outcomes and other elements and as such, are directly exposed to risk.

16. A key element of this aspect is ensuring that systematic monitoring takes place along the main milestones of the project lifecycle. Relevant GEF templates and related GEF Portal modules at PIF/PFD, CEO endorsement and MTR stages now include a dedicated section on Key Risks, aligned to the *GEF Risk Appetite* framework. This comes in addition to guidance from IEO to assess risk at completion with a view to supporting the sustainability of outcomes. The implementation of this framework involves ensuring quality risk assessments are provided during preparation and implementation.

Conclusion

17. The implementation of actions taken in response to IEO's recommendations will occur under the provision in the *GEF Risk Appetite* to review and revise the statement and framework in each GEF Replenishment cycle, as a way to reflect the level of ambition agreed in each Replenishment.

18. This exercise for GEF-9 will benefit from two years of implementation of the *GEF Risk Appetite* allowing the identification of evidence-based actions to strengthen the implementation of the risk framework. This will also help ensure Agencies and countries take on the expected level of additional risks and contribute to top-level risk communication, in alignment and supported by the level of ambition expressed in GEF-9 Programming Directions.

19. The forthcoming measures and monitoring mechanisms will strengthen risk management and risk taking. Implementation of these recommendations will be informed by evaluation findings, the implementation of the *GEF Risk Appetite* and GEF-9 replenishment discussions.