Note on Development of Risk Appetite Framework at the GEF

A STAP Note

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STAP SCIENTIFIC AND TECHNICAL ADVISORY PANEL
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Background

During the 62nd GEF Council meeting (June 2022), the GEF Council requested "…the GEF Secretariat, in consultation with the STAP and interested Council Members and Alternates, to prepare a paper on GEF-8 programming risk framework for consideration by Council at its 64th session."[1] This followed discussion in Council on the theme of a STAP Advisory Document circulated prior to the GEF Council meeting entitled Risk Appetite and the GEF.

To assist with follow-through on the Council decision, STAP reached out to several GEF Agencies and other organizations to better understand the process undertaken (or, in some cases, currently underway) to develop a risk appetite statement, or framework, focusing on experiences particularly relevant to the topic of programmatic risk.[2] Intended to be read in conjunction with the STAP Advisory Document, this Note provides a summary of key messages that may help inform the process envisioned for the GEF.

1. Consistent **leadership** is needed to reinforce the importance of risk appetite, build a culture of effective risk management, and strengthen **incentives** for innovation.

It is critical that **leadership** "**set the tone**" for the purpose and intent of investing in a risk appetite framework. Without strong leadership and buy-in from management at multiple levels (and across functional units), the entire exercise can turn into a tick-the-box activity. Or, worse, it can lead to disagreement, undue risk aversion, and unintentional hampering of operational teams. As the STAP Advisory Document details, a primary focus should be on the connection between prudent programmatic risk and innovation to achieve transformational change at scale.

Sending the right signals for appropriate risk-taking to pursue programmatic innovation in pursuit of systems transformation also requires attention to how the **results framework** is communicated and implemented. If teams at country and portfolio levels are well-focused on ambitious and meaningful targets that track progress towards transformational change, this will underscore the importance of appropriate risk taking. Risk appetite and results should go hand in hand.

Agreeing upon a risk appetite statement is unlikely to add value in isolation without concurrent investment in developing the supporting **procedures, practices, and culture**. This is essential to be able to effectively measure the degree to which decisions align with the intended risk appetite. In developing a risk appetite framework, therefore, it is important to set practical objectives tailored to GEF capacities so they can be monitored and measured.

Critically, this process **requires time, resources, and willingness to adapt**. A useful exercise is to map people across the partnership who can champion and facilitate the process. Ultimately, as one agency representative put it, developing the statement is easy compared to winning over the "hearts and minds" of those needed to reflect expectations meaningfully

[1] See Joint Summary of the GEF Council Co-Chairs (June 2022), para 50.
[2] STAP undertook separate consultations with specialists at seven GEF agencies (IFAD, UNDP, UNEP, World Bank, IUCN, WWF, and UNIDO) plus two non-GEF agencies with relevant recent experience (USAID and GCF).

in program design and implementation. Risk management should be understood as a dynamic process and its effectiveness in helping achieve overall organizational goals periodically re-evaluated. Similarly, it should encourage a practice of regular stocktaking during the course of project and program implementation to assess emerging risks and opportunities and adapt plans accordingly.

2. An effective development process includes **structured deliberation**, followed by planned roll-out and **capacity support** to embed the risk appetite framework in practice.

As multiple agencies pointed out, the key factor in gauging the starting point of the process is to assess an institution's current **risk maturity**. This refers to the degree to which risk assessment and management tools are currently in place and reflected in the decision-making culture within the institution. In the case of the GEF, assessments of risk maturity must consider practices not only within the Secretariat but also the 18 Implementing Agencies, many of which already have their own risk management frameworks in place. Existing safeguard policies and procedures constitute important elements of risk management as well.

Recognizing this diversity, **extensive consultation** is needed to agree on overall scope, objectives, and approach, and to avert unintended consequences. This can help affirm and validate important strategic thrusts, such as the focus on innovation and transformational change. The UNDP Risk Appetite Statement, for example, includes among its objectives "better understanding and planning for the risks associated with its plans to promote innovation and learning, find creative solutions and open itself up to new and stronger partnerships, especially with non-state actors and the private sector."[3]

Mixed experiences have resulted from working with professional audit/accounting firms as **outside facilitators** or advisors. Some organizations found that doing so brings in a "professional perspective"; however, many noted that the firms are not well equipped to advise nongovernmental or intergovernmental organizations. Sometimes it is possible to identify people within these firms who have that specific expertise, which can be helpful to consult with stakeholders and gather information. Nevertheless, it is essential that the team guiding the process be closely **familiar with the operational context**.

The cross-cutting nature of risk necessitates **collaboration across organizational units**. This may begin with a "horizon scanning" exercise to identify micro and macro trends that could inform the risk appetite framework. In stakeholder meetings, it is best to avoid technical "risk jargon." One approach is an open conversation about what is "keeping people up at night" to identify concerns and opportunities in an individual's portfolio, understanding that people have different thresholds for risk (i.e., some may be more risk averse whereas others might undervalue risk).

Ensuring **full engagement of stakeholders** and a diversity of ideas and perspectives takes time. USAID, for example, undertook 4 to 6 months of focus groups to develop its risk appetite statement. IFAD conducted meetings with division heads, offices, and focal points to clarify which risks are relevant, how to define and measure them, and to determine where data is available to assess them.

[3] UNDP Risk Appetite Statement (October 2021). For comparison, see IFAD Risk Appetite Statement (December 2021) and USAID Risk Appetite Statement (revised August 2022).

Ultimately, the risk appetite statement is a communication vehicle, so it is important to develop talking points and have a **roll-out strategy**, including **training and capacity building**. UNDP engaged an outside organization to develop training materials, including "train the trainer" activities, and manages a help site with responses summarized on an FAQ page for broader reference. IUCN is organizing interactive webinars for dispersed colleagues to ask questions. It is important to offer a space where information can be shared on a day-to-day basis when people have risk-related questions.

Operationalizing a fuller risk management framework requires **additional investments**, including a dedicated **focal point person or team**, to support effective risk management. UNEP, for example, established an enterprise risk management group in recent years. UNIDO developed a "risk and results focal point network" to ensure risk assessment and results measurement activities are well integrated in operations. Embedding risk management in senior management position descriptions is another way to influence the culture of the organization. The GCF has implemented a dashboard to summarize key areas of operational performance and risk, which it reports quarterly to the Council and makes available to the public.

3. Key **strategic choices** will help ease the process.

Given the complex institutional structure of the GEF partnership, it is important to anticipate a series of choices that will need to be deliberated and decided:

- *What **categories** of risk will be the focus for risk appetite?* Foundational to establishing risk appetite is a basic **risk taxonomy**, which defines the various categories of risk and, possibly, their components. The World Bank, for example, has defined four categories of risk (strategic, operational, financial, and development outcome), with operational guidance on assessing each. Development outcome risk is the focus of its recent efforts to clarify risk appetite, and is further divided into nine sub-categories at the project level to aid planning and measurement. While it will not be possible for the GEF to expect standardization in approach across implementing agencies, it will be important to design a taxonomy compatible with those currently in use. Some categories may already be well covered by existing GEF safeguards and policies. Others–particularly those addressing innovation in program design and implementation–will require more deliberation to provide clear guidance.
- *What level of **consistency** in approach is expected?* It will be important to balance **"core" expectations** regarding risk appetite and results that apply across GEF-financed operations with particularities of approach that may differ by agency. One option may be to develop a "yardstick" that would help GEF agencies determine how they compare based on a set of pre-defined parameters or questions, such as "Does the agency have its own risk appetite statement?" or "Has the agency engaged in training on risk assessment?" Doing so could enhance overall **transparency** and help agencies learn from each other, while maintaining flexibility suited to each.
- *How much **precision** in measurement is planned?* It is necessary to decide whether the risk management framework will be **qualitative or quantitative** in nature. In some cases, an organization may begin with a qualitative framework as an intermediate step, with the intent of establishing expectations in advance of rigorous or consistent tools for risk measurement. Regardless, it is necessary to have a clear message of the different levels of tolerance and to have a structure in place to give practical

meaning to the qualitative targets. Several specialists advised, however, that without quantitative targets, a risk appetite framework can be difficult to operationalize.

- *At what **programmatic level** will risk be assessed?* As multiple agency representatives noted, risk assessments should be undertaken based on residual risk, which is risk that remains after planned mitigations are put in place. At a **program level**, within a particular Integrated Program or Focal Area, for example, it could be possible to systematically review each of the program targets and evaluate the uncertainties, risks, and potential for impact to determine the level of inherent risk. This is followed by asking what is being done to mitigate the risk and ultimately deciding whether the residual risk aligns with the intended level established in the risk appetite. A complementary approach could be to assess risk at the **country level.** For example, if several GEF projects in one country are managed by different agencies, it might be useful to assess risks across the portfolio of projects within that country.
- *How will **responsibility** be distributed?* Understanding **who is bearing the brunt of the different categories of risk** is critical, particularly for the GEF partnership, which is comprised of many different stakeholders. Some categories of risk, for example, are borne primarily by country agencies or by affected communities; other categories, such as reputational risk, may apply to the implementing agency or to the GEF as a whole. Distinguishing between "risk owners," responsible for managing a particular risk, and "risk enablers," responsible for establishing guidance and ensuring implementation of policies and procedures, can help clarify expectations.