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Investing in rural people

## IFAD's Investment Policy Statement

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For: Approval

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## Preamble

1. The present Investment Policy Statement is designed to establish fundamental directives for the placement or investment of IFAD cash funds not needed immediately for operations or administrative expenditures. Such directives also aim at ensuring that financial counterparts abide, as far as possible and within the objective and functions set forth in the Agreement Establishing IFAD, by the Ten Principles of the United Nations Global Compact.
2. The responsibility to set the Investment Policy Statement rests with the Executive Board, within the parameters established by the Governing Council, whereas the President remains responsible for adopting guidelines for staff and external fund managers concerning investment of the Fund's resources.

## Recommendation for approval

The Executive Board is invited to approve IFAD's Investment Policy Statement, as contained in this document.

## IFAD's Investment Policy Statement

### I. Scope and purpose

1. This Investment Policy Statement (IPS) has been drafted in accordance with the components suggested by the Chartered Financial Analyst Institute's Elements of an Investment Policy Statement for Institutional Investors. Minimum IPS components include the governance of investments, objectives for return and risk, and criteria for performance and risk management.
2. This IPS provides a framework for management of the investments of the Fund.<sup>1</sup> The purpose of this IPS is to document the Fund's investment policy by:
  - (a) Identifying key roles and responsibilities relating to the governance of IFAD's investment portfolio (section II);
  - (b) Setting forth IFAD's investment objectives for risk and return, including eligible asset classes (section III); and
  - (c) Establishing a risk management framework (section IV).

### A. Definition of investor and assets

3. IFAD is a specialized agency of the United Nations. It came into existence on 30 November 1977, when the Agreement Establishing IFAD entered into force. Membership in the Fund is open to any State member of the United Nations – or any of its specialized agencies – or the International Atomic Energy Agency.
4. This IPS governs the investments of the Fund's resources that are derived from regular replenishments and/or are used for commitments of loans and grants under IFAD's regular programme. It will also serve as a framework for investments of other cash funds entrusted to and managed by the Fund and will complement any gaps left uncovered by separate policies and guidelines established to govern such other assets.

### B. Actors and their roles

#### Governing Council

The Governing Council is IFAD's highest decision-making authority. Each Member State is represented in the Governing Council and all the powers of the Fund are vested in the Governing Council. Subject to the limitations stated in the Agreement Establishing IFAD, the Governing Council may delegate powers to the Executive Board.<sup>2</sup>

#### Executive Board

The Executive Board is responsible for the conduct of the general operations of the Fund and exercises the powers given to it by the Agreement or delegated to it by the Governing Council.

- Audit Committee. The Executive Board has established a subsidiary body, the Audit Committee, to which it refers, among other matters,

<sup>1</sup> The application and paramount considerations on investment of funds are described in regulation VIII of the Financial Regulations of IFAD.

<sup>2</sup> Article VI of the Agreement Establishing IFAD defines the powers that may be delegated by the Governing Council.

questions concerning the investment of IFAD's resources in preparation for decisions by the Executive Board.

#### The President

Under the control and direction of the Governing Council and the Executive Board, the President heads, organizes and appoints and manages the Fund's staff, and is responsible for conducting the business of the Fund. Based on his/her authority to organize staff, the President may reconfigure IFAD's organizational structure. The President may place or invest cash funds not needed immediately for the Fund's operations or administrative expenditures.

- Advice. In order to discharge functions related to financial management and investments, the President has established a management committee to provide investment and financial advice – the Finance and Investment Advisory Committee (FISCO).

The Chief Financial Officer. The President may delegate the responsibilities outlined in the IPS to the Chief Financial Officer.

## II. Governance

### A. Responsibilities for determining, executing and monitoring the investment policy

5. The President will ensure implementation and monitoring of all aspects of the investment policy.

### B. Process for reviewing and updating the investment policy

6. The appropriateness of the investment policy will be reviewed annually by the Executive Board at the last session of each calendar year on the basis of a report submitted to it by the President. Having considered the report, the Executive Board may amend and update the IPS accordingly.

### C. Responsibilities for approving investment guidelines and changes thereto

7. Acting under regulation XIV of the Financial Regulations of IFAD and in implementation of regulation VIII thereof, the President shall approve and adopt investment guidelines for managing each investment portfolio with due regard to the IPS.

### D. Responsibilities for engaging and discharging external investment managers, the custodian bank(s) and other financial advisers

8. The President is responsible for the appointment and dismissal of external investment managers, the custodian bank(s) and other financial advisers required to execute the Fund's investments.
9. External investment managers must fulfil the following initial requirements in order to be considered for the selection process:
  - (a) Investment managers must clearly articulate the investment strategy that they will follow and document that such strategy has been adhered to over time;
  - (b) Investment managers must, in all countries in which they operate, adhere to the governing legislation and regulations concerning financial services, including the authority of the competent regulatory bodies;
  - (c) Investment managers should endeavour to comply with the Global Investment Performance Standards and to provide at least historical quarterly performance data calculated on a time-weighted basis, based on a

composite of fully discretionary accounts or similar investment style, and reported net and gross of fees; and

- (d) Investment managers must provide detailed information on the history of the firm, key personnel, key clients, fee schedule and support personnel.
- 10. External investment managers are formally appointed through the signing of an investment management agreement by the President. The agreements outline in detail the responsibilities of the managers.
- 11. A copy of this IPS is provided to each external investment manager retained to provide investment services to IFAD. Each manager will acknowledge receipt of the document and acceptance of its content in writing as part of the agreement.

#### E. Responsibilities for monitoring external investment managers, the custodian bank and financial advisers

- 12. The President will ensure that properly equipped organizational units are made responsible for developing and maintaining relationships with external investment managers, the custodian bank(s) and financial advisers.
- 13. These units will ensure that appointed investment managers fulfil their mandates within the contractual obligations outlined in the relevant investment management agreement, including the investment guidelines incorporated in each agreement.

#### F. Responsibilities for internally managed investments

- 14. The President will ensure that internal investment portfolios are managed appropriately by the relevant organizational unit in line with this IPS and the specific investment guidelines.

### III. Investments, return and risk objectives

#### A. Overall investment objective

- 15. The Financial Regulations of IFAD provide, in regulation VIII(1), that “the President may place or invest cash funds, not needed immediately for the Fund’s operations or administrative expenditures”. Regulation VIII(2) establishes the principles that guide the investment of funds: “In investing the resources of the Fund, the President shall be guided by the paramount considerations of security and liquidity. Within these constraints, and subject to the policy statement laid down by the Executive Board, the President shall seek the highest possible return in a non-speculative<sup>3</sup> manner.” Regulation VIII(2) forms the basis of IFAD’s investment objectives, which for the purpose of this IPS are:
  - (a) Security, meaning preservation of the value of invested assets.
  - (b) Liquidity, meaning liquidity of assets as defined through the minimum liquidity requirement (MLR), i.e. that resources must be readily available if and as required by operations; and
  - (c) Return, meaning the highest possible return within the above conditions in a non-speculative manner.

#### B. Risk tolerance

- 16. The level of risk taken should be consistent with the investment objective of the Fund. Consequently, IFAD will only accept non-speculative risk in order to achieve its investment objectives. Risk tolerance levels are quantified in portfolio investment guidelines.

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<sup>3</sup> In the context of this IPS, non-speculative is defined as: managing investments within the established risk tolerance and return objectives and based on thorough analysis of options and consideration of market and economic conditions.

### C. Return on investment requirements

17. While IFAD has no explicit return on investment requirement, it seeks to generate the highest possible non-speculative return within the constraints of security, liquidity and low volatility.

### D. Eligible asset classes

18. The following asset classes are eligible within IFAD's asset allocation (see table 1 below for asset class rating floors):

#### Money market instruments

- (a) Time deposits, certificates of deposit, commercial paper, treasury bills and money funds

#### Fixed-income securities<sup>4</sup>

- (b) Government and government agencies, at national or subnational level  
(c) Supranationals  
(d) Asset-backed securities (only agency-issued or guaranteed)  
(e) Corporates  
(f) Callable bonds  
(g) Covered bonds

#### Equity

- (h) Developed market equities

#### Derivatives are allowed only for hedging purposes:<sup>5</sup>

- (i) Currency forwards  
(j) Exchange-traded futures and options  
(k) Interest rate swaps  
(l) Cross currency swaps  
(m) Credit default swaps  
(n) Asset swaps

19. IFAD can enter into securities lending agreements.  
20. IFAD does not use any form of leverage and does not use derivatives contracts to leverage positions in the investment portfolio.

### E. Environmental, social and governance principles

21. Responsible investing is, in addition to more traditional financial factors, the consideration of environmental, social and governance factors in the choice of financial investments.  
22. IFAD aims to be a responsible investor, and therefore adheres to the Ten Principles of the United Nations Global Compact (UNGC). Only investments that comply with the UNGC are considered by IFAD as eligible for investment.

### F. Time horizon

23. The time horizon for IFAD's investment portfolio is driven by preservation of portfolio value, by IFAD's approach to long-term financial sustainability through the sustainable cash flow approach and by the MLR. As the investments are fully committed, management of investments and their time horizon need to be linked

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<sup>4</sup> Including nominal and inflation-linked bonds; developed and emerging markets.

<sup>5</sup> This restriction does not apply to call options embedded in fixed income instruments, e.g. callable bonds.

to, and guided by, IFAD's short-term liquidity needs (MLR) and the IFAD business cycle of lending commitments, which covers a replenishment period (medium term) as well as the sustainable cash flow approach (long term).

#### G. Foreign currency management

24. IFAD aims to ensure that its assets are held in the same currency composition as its future commitments.

#### H. Tax considerations and other privileges and immunities

25. Pursuant to article 10 of the Agreement Establishing IFAD, the Fund "shall enjoy in the territory of each of its Members such privileges and immunities as are necessary for the exercise of its functions and for the fulfilment of its objective".
26. As a general rule, IFAD may freely transfer funds, gold or currency from one country to another, or within any country, and convert any currency held into any other currency. The Fund is exempt from all direct taxes on its assets, income and property.

### IV. Risk management framework

27. The President will ensure that risk tolerance levels are constantly monitored and reviewed on a quarterly basis by the relevant organizational unit. Through the report on IFAD's investment portfolio, the Executive Board will receive updates on overall portfolio and individual investment portfolio risk levels and will be informed of any adjustments to be made to align these with agreed risk levels.
28. Any risk-mitigating measure(s) taken will be reported to the Executive Board as part of the report on IFAD's investment portfolio.

#### A. Risk reporting

29. The President will ensure that analyses are performed and reports prepared on the following financial risks by the relevant organizational unit.

##### Market risk

30. Market risk is monitored for the overall portfolio and for single mandates based on measures provided on a monthly basis by the global custodian or by another external risk management company. Examples of these measures include the portfolio's standard deviation, the value at risk, the conditional value at risk and the active risk compared with benchmarks.

##### Credit risk

31. Credit risk is managed through the establishment of a minimum rating floor in the investment guidelines. The eligibility of individual securities and issuers is determined on the basis of ratings by major credit rating agencies. For investment management purposes, credit analyses by security and by issuer will be performed – for all internally managed investments and, on a selective basis, for externally managed assets, and for commercial and central banks – using financial information systems, credit analysis provider(s) and other sources. All other credit analysis will be performed and reported as an integral part of risk management.

32. The following table shows the rating floors for each eligible asset class.

Table 1

**Asset class rating floors**

	<i>Credit rating floors (Standard &amp; Poor's [S&amp;P], Moody's or Fitch)</i>
<b>Money market</b>	Investment grade <sup>a</sup>
<b>Fixed-income securities:</b> both nominal and inflation linked	
<ul style="list-style-type: none"> <li>Government and government agencies fixed-income securities at national or subnational level</li> </ul>	Investment grade
<ul style="list-style-type: none"> <li>Supranationals</li> </ul>	Investment grade
<ul style="list-style-type: none"> <li>Asset-backed securities (only agency-issued or guaranteed)</li> </ul>	AAA
<ul style="list-style-type: none"> <li>Covered bonds</li> </ul>	Investment grade
<ul style="list-style-type: none"> <li>Corporate bonds</li> </ul>	Investment grade
<ul style="list-style-type: none"> <li>Callable bones</li> </ul>	Investment grade
<b>Equity</b>	
<ul style="list-style-type: none"> <li>Developed market equity</li> </ul>	Investment grade <sup>b</sup>
<b>Derivatives:</b> for hedging purposes only	
<ul style="list-style-type: none"> <li>Currency forwards</li> <li>Exchange-traded futures and options</li> <li>Interest rate swaps</li> <li>Cross currency swaps</li> <li>Credit default swaps</li> <li>Asset swaps</li> </ul>	Counterparty must have a minimum short-term rating of A-1 (S&P), or F1 (Fitch), or P-1 (Moody's) <sup>c</sup>

<sup>a</sup> Any additional eligibility criteria, as approved by the President, also apply.

<sup>b</sup> The credit quality requirement refers to the issuer and is introduced to ensure consistency with IFAD's overall investment management strategy.

<sup>c</sup> At least one rating must comply with the minimum short-term rating; other available ratings must be within investment grade.

Counterparty risk

33. Counterparty risk is managed for all investments through establishment of a minimum rating for eligible counterparties, including banks for operational cash and for short-term investments. Counterparty risk will also be managed by capping exposure to each issuer/bank. Counterparty risk analyses are performed for the purpose of investment management using financial information systems, credit analysis providers and other sources. All other counterparty risk analysis will be performed and reported as an integral part of risk management.

Country risk

34. Country risk is a collection of risks associated with investing in a particular country. These risks include political risk and sovereign risk.
35. Country risk is managed for all investments through the establishment of maximum country exposure concentrations within the guidelines of every individual investment portfolio. Country exposures are monitored on a daily basis.

Currency risk

36. IFAD manages the currency risk that results from any mismatch between the currency composition of its assets and the currency composition of its commitments – i.e. the approved but still undisbursed portion of its committed loans and grants.
37. The risk is managed by monitoring any mismatches and implementing a realignment strategy if any deviations become significant.

#### Liquidity risk

38. Liquidity risk is addressed through the MLR supported by long- and short-term financial projections. Sufficient liquidity, as stipulated in the MLR, must be available at any point in time to ensure IFAD's ability to meet its disbursement obligations and long-term sustainability. IFAD's Liquidity Policy sets forth liquidity needs and definitions in further detail.

#### Operational risk

39. Operational risk includes all risk sources other than those stated above, including business continuity and legal risk. The President will ensure that operational risk is addressed by establishing a clearly defined framework of responsibility and accountability within IFAD's financial structure.
40. The President will ensure that any legal risk is assessed by the Office of the General Counsel.

#### B. Performance reporting

41. The overall portfolio and benchmark performance in local currency terms will be reported to the Executive Board at each session in the report on IFAD's investment portfolio. The report will include comparative performance figures for the previous quarters and previous year.

#### C. Monitoring of compliance

42. The President will ensure that the relevant organizational unit monitors the external and internal investment managers' compliance with IFAD's investment guidelines on a daily basis. Should a compliance breach arise, it will be analysed and any necessary action taken.

## A tranche-based approach to risk budgeting and asset allocation

1. In order to ensure that the IFAD investment portfolio is structured appropriately to meet its objectives of security and liquidity, IFAD follows a "tranching" approach to risk budgeting and asset allocation.
2. The IFAD investment portfolio is therefore split into four tranches, as follows:
  - Liquidity tranche: Used for immediate cash disbursements;
  - Buffer tranche: Should the liquidity tranche be temporarily depleted due to an unforeseen spike in disbursements, funds in the buffer tranche will be used to fund these outflows. The size of the tranche is determined by the parameters of IFAD's minimum liquidity requirement (MLR);
  - Surplus tranche: These are funds in addition to what is required by the MLR and are used to provide return enhancement; and
  - Funding tranche: Borrowed funds, managed according to an asset-liability management framework.
3. Each tranche has a risk budget and list of eligible instruments assigned to it, that corresponds to the objectives of the tranche. In addition, risk tolerance for the overall investment portfolio is set at a conditional-value-at-risk level of 3 per cent.