

Document: EB 2010/100/R.34
Agenda: 20(c)
Date: 4 August 2010
Distribution: Public
Original: English

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Enabling poor rural people
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Report on IFAD's investment portfolio for the second quarter of 2010

Note to Executive Board representatives

Focal points:

Technical questions:

Munehiko Joya
Treasurer
Tel.: +39 06 5459 2251
e-mail: m.joya@ifad.org

Tiziana Galloni
Treasury Officer
Tel.: +39 06 5459 2232
e-mail: t.galloni@ifad.org

Dispatch of documentation:

Deirdre McGrenra
Governing Bodies Officer
Tel.: +39 06 5459 2374
e-mail: gb_office@ifad.org

Executive Board — 100th Session
Rome, 15-17 September 2010

For: **Information**

Report on IFAD's investment portfolio for the second quarter of 2010

I. Executive summary

1. During the second quarter of 2010, IFAD's prudent investment policy and high-quality instruments contributed to protecting the investment portfolio from the turmoil in global financial markets.
2. The value of the investment portfolio in United States dollar terms decreased by US\$23,687,000 equivalent, from US\$2,505,649,000 equivalent at 31 March 2010 to US\$2,481,962,000 equivalent at 30 June 2010. The main factor in this decrease was foreign exchange movements, which were partially offset by the net investment income and disbursement inflows.
3. The year-to-date rate of return on the investment portfolio is 2.50 per cent, which translates into a year-to-date investment income amount of US\$59,167,000 equivalent, net of all fees and securities lending cash collateral activities.

II. Introduction

4. This report on IFAD's investment portfolio¹ presents final data as at the end of the second quarter of 2010. It consists of the following sections: market conditions; asset allocation; investment income; rate of return; composition of the investment portfolio by currency; securities lending cash collateral; liquidity level in IFAD's investment portfolio; and risk measurement.

III. Market conditions

5. Throughout the second quarter of the year, fixed-income markets were generally positive, with all of IFAD's asset classes generating positive returns. IFAD's global government bonds asset class benefited from the portfolio's concentration in safe, high-quality issuers, whose performance was supported by the flight-to-quality caused by the sovereign debt crisis in European peripherals. A slowdown in the pace of the economic recovery was also beneficial, as most central banks have postponed interest rate increases. The diversified fixed-interest asset class performed very strongly, partly due to assets benefiting from the continued recovery, and partly due to investors' renewed appetite for high-quality credit products. The inflation-indexed bonds asset class also benefited from demand for safe, high-quality government debt.
6. During the period, in order to combat rising financial market tensions triggered by worldwide concerns over public finances, the European Union made significant support schemes available to its member countries. Because of its prudent investment policy, IFAD's portfolio has little or no exposure to the countries that were most affected by the recent market volatility, particularly in Europe.
7. In the currency market, the United States dollar appreciated against the euro (10.47 per cent) and the British pound sterling (1.39 per cent), while depreciating against the Japanese yen (5.30 per cent).

IV. Asset allocation

8. Table 1 shows the movements affecting the investment portfolio's major asset classes during the second quarter of 2010 and compares the portfolio's asset allocation at the end of the quarter with the investment policy allocation.

¹ This quarterly report presents IFAD-only investment information, while financial information involving non-IFAD entities – including Supplementary Funds, the Belgian Fund for Food Security (BFFS), Heavily Indebted Poor Countries (HIPC) and the After-Service Medical Coverage Scheme (ASMCS) – is presented to the Executive Board in the annual consolidated financial statements. The Annual Report for the Credit Union of IFAD Employees is published separately.

9. During the period, there was a net cash inflow of US\$5,123,000 equivalent into the internally managed operational cash portfolio, representing cash receipts and encashment of Member States' contributions net of disbursements for loans, grants and administrative expenses.
10. The appreciation of the United States dollar against the euro and the pound sterling was slightly offset by its depreciation against the Japanese yen, resulting in a decrease in the portfolio balance in United States dollar terms of US\$62,082,000 equivalent during the second quarter of 2010.
11. The above movements, combined with an investment income of US\$33,272,000² equivalent, decreased the overall investment portfolio value by US\$23,687,000 equivalent for the period.

Table 1

Movements affecting asset allocation within the portfolio, second quarter 2010

(Thousands of United States dollars equivalent)

	<i>Operational cash^a</i>	<i>Held-to-maturity</i>	<i>Government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Total</i>
Opening balance (1 April 2010)	186 577	401 185	1 048 207	440 187	429 493	2 505 649
Investment income ^b	217	3 621	6 610	16 088	6 736	33 272
Transfers due to allocation	4 140	(4 140)	-	-	-	-
Transfers due to expenses/income	(1 225)	33	503	421	268	-
Net disbursement ^c	5 123	-	-	-	-	5 123
Movements on exchange	(10 091)	(16 884)	(43 867)	2	8 758	(62 082)
Closing balance by portfolio (30 June 2010)	184 741	383 815	1 011 453	456 698	445 255	2 481 962
Actual asset allocation (percentage)	7.4	15.5	40.8	18.4	17.9	100.0
Investment policy asset allocation ^d (percentage)	5.5	15.5	43.6	15.4	20.0	100.0
Difference in asset allocation (percentage)	1.9	-	(2.8)	3.0	(2.1)	-

^a Cash and time deposits held with banks, readily available for disbursing loans, grants and administrative expenses.

^b Investment income is further detailed in table 2.

^c Disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.

^d The investment policy allocation for the held-to-maturity portfolio is set to match the current 15.5 per cent asset allocation in the investment portfolio.

12. Table 1 reflects IFAD's actual asset allocation as well as investment policy asset allocation. IFAD is currently reviewing its investment policy and closely related liquidity policy within an overall asset liability management framework. The ongoing review is supported by external technical expertise and is performed with due regard to future return and risk assumptions and possibilities of enhancing the portfolio's risk diversification. The Executive Board will be kept abreast of the outcome of the review.

V. Investment income

13. In the first half of 2010, net investment income amounted to US\$59,167,000 equivalent. All realized and unrealized gains and losses are included in investment income. Table 2 presents a summary of second quarter 2010 investment income broken down by asset class.

² This figure does not include the impact of the unrealized gain/loss of the securities lending cash collateral reinvestment shown in table 2. The reason is that the security lending cash collateral is not directly related to any asset classes within the investment portfolio and therefore its market value change shall not affect the portfolio's asset allocation.

Table 2
Breakdown of investment income by asset class and impact of the reinvested securities lending cash collateral, second quarter and year-to-date 2010

(Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Held-to-maturity</i>	<i>Government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Subtotal second quarter 2010</i>	<i>Subtotal year-to-date 2010</i>	<i>Year-to-date securities lending cash collateral impact</i>	<i>Total year-to-date 2010</i>
Interest from fixed-interest investments and bank accounts	78	3 848	6 771	3 410	4 202	18 309	35 464		35 464
Realized capital gains	141	-	950	1 301	1 663	4 055	9 255		9 255
Unrealized capital gains/(losses)	-	-	(608)	11 657	1 139	12 188	16 474	701	17 175
Amortization/accretion ^a	-	(194)	-	-	-	(194)	(425)	-	(425)
Income from securities lending	-	9	25	11	11	56	121	-	121
Investment income before fees and taxes	219	3 663	7 138	16 379	7 015	34 414	60 889	701	61 590
Investment manager fees	-	-	(403)	(234)	(224)	(861)	(1 744)	-	(1 744)
Custody fees/bank charges	(2)	(4)	(25)	(12)	(11)	(54)	(221)	-	(221)
Financial advisory and other investment management fees	-	(38)	(100)	(45)	(44)	(227)	(464)	-	(464)
Taxes recoverable	-	-	-	-	-	-	6	-	6
Investment income after fees and taxes	217	3 621	6 610	16 088	6 736	33 272	58 466	701	59 167

^a A period's amortization amount represents a portion of the difference between the purchase price and the final redemption value of the held-to-maturity investments as per International Financial Reporting Standards.

VI. Rate of return

14. The rate of return of IFAD's investment portfolio is calculated in local currency terms without reflecting the impact of foreign exchange movements, which is neutralized through the currency alignment.
15. The investment portfolio returned a positive 2.50 per cent in the first half of 2010, net of all fees and securities lending cash collateral activities.

Table 3
Quarterly rates of return on IFAD's investments for 2009 and first and second quarter 2010
 (Percentages in local currency terms)

	<i>Quarterly rates of return in local currency</i>					
	<i>1st quarter 2009</i>	<i>2nd quarter 2009</i>	<i>3rd quarter 2009</i>	<i>4th quarter 2009</i>	<i>1st quarter 2010</i>	<i>2nd quarter 2010</i>
Operational cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Held-to-maturity	0.99	1.12	1.11	1.07	0.97	0.91
Government bonds	1.14	(0.28)	0.96	0.34	0.99	0.80
Diversified fixed-interest bonds	0.54	0.81	3.54	0.28	1.75	3.75
Inflation-indexed bonds	2.26	1.06	2.57	1.63	1.05	1.72
Net rate of return^a	1.38	0.61	1.73	0.66	1.07	1.41

^a Net of all securities lending cash collateral activities.
 Note: n.a. = not applicable.

16. Differences among the rates of return of the mandates are due to the diverse characteristics of asset classes and demonstrate the positive impact of portfolio diversification.

VII. Composition of the investment portfolio by currency

17. The majority of IFAD's commitments are expressed in special drawing rights. Consequently, the Fund's overall assets are maintained in such a way as to ensure that commitments for undisbursed loans and grants denominated in SDRs are matched, to the extent possible, by assets denominated in the currencies and ratios of the SDR valuation basket. Similarly, the General Reserve and commitments for grants denominated in United States dollars are matched by assets denominated in the same currency.
18. The Executive Board of the International Monetary Fund reviews the SDR valuation basket every five years to determine which currencies should be part of the basket and what their percentage weight should be at the date of reweighting of the basket.
19. The current units for each of the four currencies making up the SDR valuation basket were determined on 30 December 2005 in such a way that the value of the SDR was precisely US\$1.42927, in terms of both the old units and the new units, which became effective on 1 January 2006. The applicable units, together with their weights as at 1 January 2006 and 30 June 2010, are shown in table 4.

Table 4
Units and weights applicable to SDR valuation basket

<i>Currency</i>	<i>1 January 2006</i>		<i>30 June 2010</i>	
	<i>Units</i>	<i>Percentage weight</i>	<i>Units</i>	<i>Percentage weight</i>
United States dollar	0.6320	43.7	0.6320	42.8
Euro	0.4100	34.3	0.4100	34.0
Yen	18.4000	10.9	18.4000	14.1
Pound sterling	0.0903	11.1	0.0903	9.1
Total		100.0		100.0

20. At 30 June 2010, assets in the form of cash, investments, promissory notes and contribution receivables from Member States under the Fifth, Sixth, Seventh and Eighth Replenishments, net of provisions, amounted to US\$2,998,309,000 equivalent, as summarized in table 5 (compared with US\$3,105,054,000 equivalent at 31 March 2010).

Table 5

Currency composition of assets in the form of cash, investments and other receivables

(Thousands of United States dollars equivalent)

<i>Currency</i>	<i>Cash and investments^a</i>	<i>Promissory notes^a</i>	<i>Contribution receivables from Member States</i>	<i>Total</i>
United States dollar group ^b	1 092 516	152 617	76 106	1 321 239
Euro group ^c	787 845	97 596	95 774	981 215
Yen	361 716	46 294	36 023	444 033
Pound sterling	239 378	-	12 444	251 822
Total	2 481 455	296 507	220 347	2 998 309

^a Includes only assets in freely convertible currencies, and excludes assets in non-convertible currencies of US\$508,000 equivalent for cash and investments, and US\$1,399,000 equivalent for promissory notes.

^b Includes assets in Australian, Canadian and New Zealand dollars.

^c Includes assets in Swiss francs, Swedish kronor, Danish and Norwegian kroner.

21. The alignment of assets by currency group against the SDR valuation basket as at 30 June 2010 is shown in table 6. The balance of commitments denominated in United States dollars at 30 June 2010 amounted to US\$159,113,000 equivalent, composed of the General Reserve (US\$95,000,000) and commitments for grants denominated in United States dollars (US\$64,113,000).

Table 6

Alignment of assets per currency group with the SDR valuation composition as at 30 June 2010

(Thousands of United States dollars equivalent)

<i>Currency</i>	<i>Asset amount</i>	<i>Less: commitments denominated in US dollars</i>	<i>Net asset amount</i>	<i>Net asset amount (percentage)</i>	<i>SDR weights (percentage)</i>	<i>Difference (percentage)</i>
US dollar group	1 321 239	(159 113)	1 162 126	40.9	42.8	(1.9)
Euro group	981 215	-	981 215	34.6	34.0	0.6
Yen	444 033	-	444 033	15.6	14.1	1.5
Pound sterling	251 822	-	251 822	8.9	9.1	(0.2)
Total	2 998 309	(159 113)	2 839 196	100.0	100.0	0.0

22. As at 30 June 2010, there was a shortfall in the pound sterling (-0.2 per cent) and in the United States dollar currency group (-1.9 per cent), which was offset by an excess allocation in the euro currency group (+0.6 per cent) and in the Japanese yen (+1.5 per cent).
23. IFAD takes active measures to bring the currency allocation more in line with the SDR basket. Despite currency conversions to align the investment portfolio with the SDR basket weights, volatility in the foreign exchange market partially offset the proactive corrections.

VIII. Securities lending cash collateral

24. The market value of cash collateral reinvested against securities lent as at 30 June 2010 was US\$193,309,000³ equivalent, with a corresponding net liability to the borrowers for US\$193,836,000 equivalent. The asset class and credit quality compositions of the cash collateral reinvested against securities lent are shown in table 7. The difference in the collateral reinvested and the corresponding liability as at 30 June 2010 shrank to US\$527,000 equivalent from US\$1,228,000 equivalent as at 31 December 2009, thus bringing an unrealized gain of US\$701,000 for the first half of 2010, as shown in table 2.

Table 7

Composition and credit ratings of the cash collateral reinvested against securities lent as at 30 June 2010

(Thousands of United States dollars equivalent)

	AAA	AA	A	BBB	Total	Percentage
Cash	112 281	-	-	-	112 281	58.1
Corporate bonds	-	14 130	-	-	14 130	7.3
Banking industry	-	-	2 827	-	2 827	1.5
Mortgage-backed securities	6 613	-	-	523	7 136	3.7
Asset-backed securities	52 547	2 186	-	2 202	56 935	29.5
Total	171 441	16 316	2 827	2 725	193 309	100.0
Composition weight	88.7	8.4	1.5	1.4	100.0	-

25. The maturity structure of the cash collateral reinvested against securities lent is shown in table 8.

Table 8

Maturity structure of the cash collateral reinvested against securities lent as at 30 June 2010^a

(Thousands of United States dollars equivalent)

Period due	30 June 2010		31 December 2009	
	Amount	Percentage	Amount	Percentage
Due in one year or less	170 855	88.4	333 700	80.4
Due after one year through two years	18 018	9.3	57 424	13.8
Due after two years through three years	2 135	1.1	21 271	5.1
Due after three years through four years	2 301	1.2	2 737	0.7
Total	193 309	100.0	415 132	100.0

^a The maturity structure represents the financial maturities of the reinvested cash collateral, not the legal maturities.

26. As evident from tables 7 and 8, the reinvested cash collateral maintains a high level of quality with over 88 per cent in triple A, while being fairly liquid – reflecting 58 per cent in cash and over 88 per cent to be redeemed through maturity within one year. This implies that the cash collateral reinvestment will not make any meaningful impact on IFAD's liquidity level, which is reported in the following section IX.
27. It should also be noted that IFAD had reduced the cap of the securities lending cash collateral portfolio to US\$350,000,000 in August 2009, as reported to the Audit Committee in January 2010 and to the Executive Board in April 2010. In addition, IFAD continues to monitor securities lending cash collateral activities while an appropriate exit strategy from the securities lending programme is being

³ This figure does not include an income distribution payable/liability of US\$53,661 equivalent.

developed, in conjunction with the review of IFAD's overall investment and liquidity policies, as mentioned in paragraph 12.

IX. Liquidity level in IFAD's investment portfolio

28. Highly liquid assets in IFAD's investment portfolio as at 30 June 2010 amounted to US\$1,196,200,000 equivalent (table 9).

Table 9

Liquidity level in IFAD's investment portfolio as at 30 June 2010

(Thousands of United States dollars equivalent)

	<i>Actuals</i>	<i>Percentage</i>
Highly liquid assets	1 196.2	48.2
Short-term instruments	184.7	7.4
Government securities	1 011.5	40.8
Fairly liquid assets	902.0	36.3
Non-government securities	902.0	36.3
Partially liquid assets	383.8	15.5
Held-to-maturity	383.8	15.5
Total portfolio	2 482.0	100.0

X. Risk measurement

29. With the exception of operational cash and held-to-maturity investments, investment portfolio performance is subject to market movements. Historically, different asset classes have shown different levels of volatility, often referred to as 'risk'. Volatility is measured in terms of standard deviation of returns from their mean. At 30 June 2010, the standard deviation of IFAD's investment portfolio was 1.40 per cent, compared with 1.51 per cent for the investment policy.⁴
30. Value-at-risk (VaR) is the measure of risk that IFAD uses to estimate the maximum amount that the portfolio could lose in value over a three-month forward time horizon, with a 95-per-cent confidence level.⁵ Table 10 shows the VaR of IFAD's investment portfolio and that of the investment policy as at 30 June 2010 and for previous periods.

Table 10

Value-at-risk (VaR)

(Forecast horizon of three months, confidence level at 95 per cent)

<i>Date</i>	<i>Investment portfolio</i>		<i>Investment policy</i>	
	<i>VaR (percentage)</i>	<i>Amount (thousands of US dollars)</i>	<i>VaR (percentage)</i>	<i>Amount (thousands of US dollars)</i>
30 June 2010	1.17	29 090	1.26	31 256
31 March 2010	1.18	29 611	1.28	32 162
31 December 2009	1.23	32 080	1.31	33 987
30 September 2009	1.27	33 245	1.31	34 272
30 June 2009	1.44	36 232	1.58	39 564

⁴ The security lending cash collateral programme is not factored into this volatility measurement.

⁵ The security lending cash collateral programme is not factored into this VaR measurement.

31. At 30 June 2010, the investment portfolio's VaR was 1.17 per cent, a slight decrease from the end of the previous quarter, and below the investment policy VaR of 1.26 per cent. It should be noted that the investment policy VaR is based on the policy allocation (see table 1).