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Enabling poor rural people  
to overcome poverty

## Report on IFAD's investment portfolio for 2010

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For: **Information**

# Report on IFAD's investment portfolio for 2010

## I. Executive summary

1. During 2010, IFAD's prudent investment policy and high-quality instruments contributed to protecting the investment portfolio from any turmoil in the global financial markets.
2. The value of the investment portfolio in United States dollar terms decreased by US\$75,934,000 equivalent, from US\$2,598,687,000 equivalent at 31 December 2009 to US\$2,522,753,000 equivalent at 31 December 2010. The main factors for this decrease were the net disbursement outflows and foreign exchange movements, which were partially offset by the net investment income.
3. The investment portfolio's net rate of return for 2010 is 3.26 per cent and this translates into an annual investment income of US\$79,485,000 equivalent inclusive of all fees and securities lending cash collateral activities.

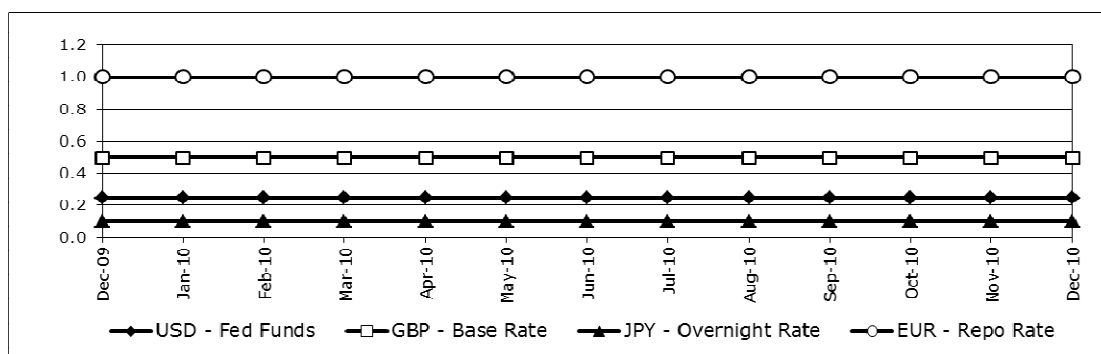
## II. Introduction

4. This report on IFAD's investment portfolio covers the year ended 31 December 2010 and includes comparative figures, where applicable, for the year ended 31 December 2009.
5. The report consists of the following sections: market conditions; asset allocation; investment income; rate of return; composition of the portfolio; securities lending cash collateral; liquidity level in IFAD's investment portfolio; and risk measurement.

## III. Market conditions

6. The following charts show trends for the countries whose currencies make up the valuation basket for special drawing rights (SDRs): Eurozone countries, Japan, the United Kingdom and the United States.
7. Chart 1 shows the evolution of central bank interest rates for SDR countries for 2010. All four central banks maintained their central bank target rates unchanged for the duration of 2010, to continue supporting the economy in its recovery phase. Specifically, the Federal Reserve Bank of the United States maintained its discount rate at 0.25 per cent; the Bank of England bank rate was kept unchanged at 0.50 per cent; the European Central Bank continued its monetary policy with the refinancing rate at 1.00 per cent; and the Bank of Japan kept the overnight rate at 0.10 per cent.

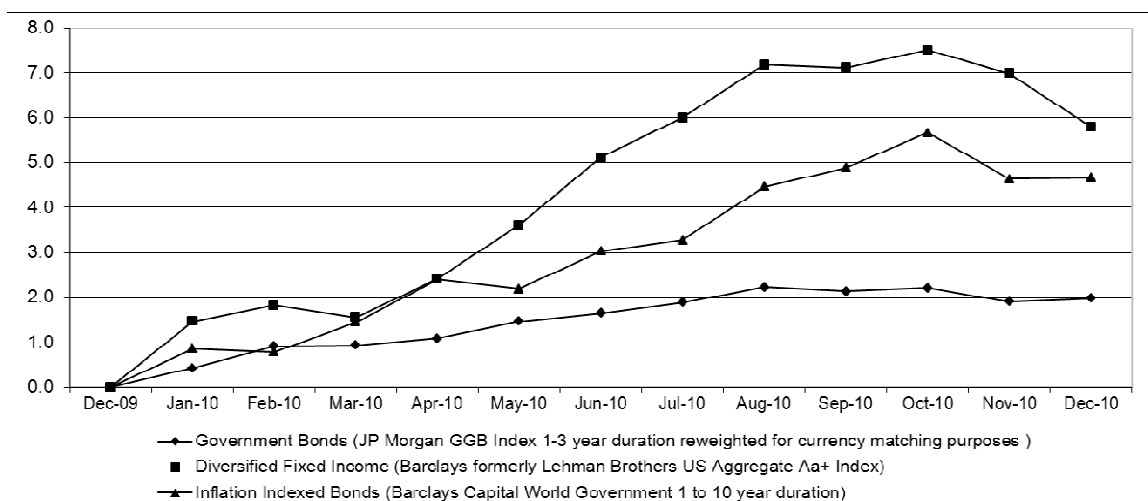
Chart 1  
Central Bank interest rates



Source: Bloomberg

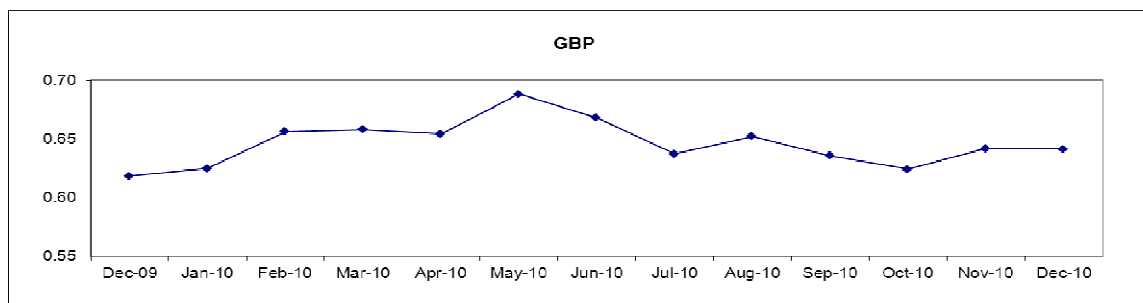
8. Chart 2 shows the cumulative performance in 2010 of the fixed-income markets where IFAD’s investment portfolio was invested and managed. The lines represent the benchmark indexes used by IFAD for the global government bonds, diversified fixed-interest bonds and inflation-indexed bonds portfolios. Fixed-income markets showed a positive performance until the third quarter of 2010. In particular, the diversified fixed-income benchmark showed a very positive trend thanks to the strong recovery of the securitized and corporate sectors. The inflation-indexed bond market showed a good performance, as inflation expectations persisted during the recovery. Government bonds showed a flat to positive trend throughout the year despite the European Union peripherals’ crisis in the second and third quarter. During the last two months of the year, very positive economic data influenced the performance of fixed-income markets.

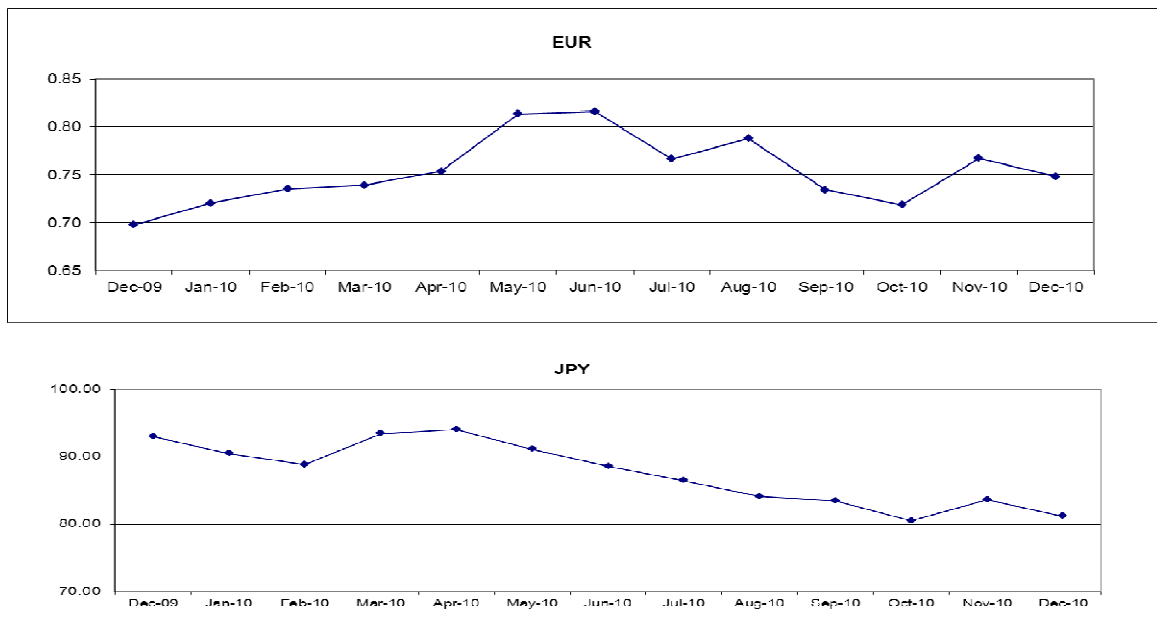
Chart 2  
**Fixed-interest market developments in 2010**  
 (Percentage in local currency terms)



9. Chart 3 illustrates month-end exchange rates for the United States dollar against the three other SDR composite currencies, specifically the British pound sterling (GBP), euro (EUR) and Japanese yen (JPY). In 2010, the volatile foreign exchange markets saw an overall depreciation of the United States dollar against the Japanese yen (-12.88 per cent) and an overall appreciation of the United States dollar against the euro (6.95 per cent) and the British pound sterling (3.14 per cent).

Chart 3  
**Value of US\$ versus other SDR currencies at month-end exchange rates**





Source: Bloomberg

## IV. Asset allocation

10. Table 1 shows the movements affecting the value of investments within the portfolio by asset class in 2010 and compares the portfolio's year-end asset allocation with the policy allocation.

Table 1  
**Movements affecting the asset allocation within the portfolio in 2010**

(Thousands of United States dollars equivalent)

|  | <i>Operational cash<sup>a</sup></i> | <i>Held-to-maturity</i> | <i>Government bonds</i> | <i>Diversified fixed-interest bonds</i> | <i>Inflation-indexed bonds</i> | <i>Total</i>     |
|--|-------------------------------------|-------------------------|-------------------------|---|--------------------------------|------------------|
| <b>Opening balance (1 January 2010)</b>                        | <b>184 243</b>                      | <b>402 809</b>          | <b>1 110 757</b>        | <b>466 993</b>                          | <b>433 885</b>                 | <b>2 598 687</b> |
| Investment income <sup>b</sup>                                 | 777                                 | 15 680                  | 19 977                  | 25 845                                  | 16 337                         | 78 616           |
| Transfers due to allocation                                    | 157 559                             | (7 474)                 | (96 203)                | (50 000)                                | (3 882)                        | -                |
| Transfers due to expenses and securities lending income        | (4 619)                             | 77                      | 2 035                   | 1 421                                   | 1 086                          | -                |
| Net disbursement <sup>c</sup>                                  | (149 742)                           | -                       | -                       | -                                       | -                              | (149 742)        |
| Movements on exchange  | (5 635)                             | (13 430)                | (22 892)                | (25)                                    | 37 174                         | (4 808)          |
| <b>Closing balance by portfolio (31 December 2010)</b>         | <b>182 583</b>                      | <b>397 662</b>          | <b>1 013 674</b>        | <b>444 234</b>                          | <b>484 600</b>                 | <b>2 522 753</b> |
| Actual asset allocation (percentage)                           | 7.2                                 | 15.8                    | 40.2                    | 17.6                                    | 19.2                           | 100.0            |
| Investment policy asset allocation <sup>d</sup> (percentage)   | 5.5                                 | 15.8                    | 43.5                    | 15.2                                    | 20.0                           | 100.0            |
| <b>Difference in asset allocation (percentage)<sup>e</sup></b> | <b>1.7</b>                          | <b>-</b>                | <b>(3.3)</b>            | <b>2.4</b>                              | <b>(0.8)</b>                   | <b>-</b>         |

<sup>a</sup> Cash and time deposits held with banks, readily available for disbursing loans, grants and administrative expenses.

<sup>b</sup> Investment income is further detailed in table 2.

<sup>c</sup> Disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.

<sup>d</sup> The investment policy allocation for the held-to-maturity portfolio is set to match the current 15.8 per cent asset allocation in the investment portfolio.

<sup>e</sup> The differences between policy and actual asset allocations are impacted by fluctuations in market prices and currencies. The asset allocation is reviewed and realigned from time to time.

11. During 2010, transfers of US\$96,203,000 equivalent from the global government bonds portfolio and US\$50,000,000 equivalent from the diversified fixed-interest bonds portfolio, were made to the operational cash portfolio to cover disbursement needs.
12. The balance of transfers due to allocation primarily consists of coupon income from the held-to-maturity portfolio and the inflation-indexed portfolio, all of which was progressively transferred to the operational cash portfolio during 2010.
13. There was a net outflow of US\$149,742,000 equivalent, representing disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.
14. The above movements, combined with an investment income of US\$78,616,000<sup>1</sup> equivalent and negative foreign exchange movements of US\$4,808,000 equivalent, decreased the overall investment portfolio value in United States dollar terms by US\$75,934,000 equivalent during 2010.

## **V. Investment income**

15. In 2010, the net investment income amounted to US\$79,485,000 equivalent, inclusive of all realized and unrealized gains and losses. Table 2 presents a summary of the 2010 investment income broken down by asset class. The diversified fixed-interest bonds portfolio contributed most to generating the 2010 investment income, and was complemented by a solid contribution from the government and inflation-indexed bonds portfolios.
16. As reported to the 101<sup>st</sup> session of the Executive Board, IFAD made a complete exit from the securities lending programme in December 2010. For the year 2010, an amount of US\$869,000 equivalent contributed to the investment income streaming from the custom collateral account, while an additional amount of US\$220,000 equivalent was generated by the securities lending income.

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<sup>1</sup> This figure does not include the interest income or the realized and unrealized gains/losses from the securities lending cash collateral column shown in table 2. The reason is that the securities lending cash collateral is not directly related to any asset class within the investment portfolio and therefore its market value change does not affect the portfolio's asset allocation.

Table 2

**Breakdown of investment income by asset class and the impact of the reinvested securities lending cash collateral in 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</i> | <i>Securities lending cash collateral</i> | <i>Total</i>  |
|--|-------------------------|-------------------------|-------------------------|---|--------------------------------|-----------------|---|---------------|
| Interest from fixed-interest investments and bank accounts | 487                     | 16 497                  | 30 448                  | 13 132                                  | 10 678                         | 71 242          | (43)                                      | 71 199        |
| Realized capital gains                                     | 443                     | -                       | 1 228                   | 7 368                                   | 16 972                         | 26 011          | (361)                                     | 25 650        |
| Unrealized capital gains/(losses)                          | -                       | -                       | (9 664)                 | 6 467                                   | (10 227)                       | (13 424)        | 1 273                                     | (12 151)      |
| Amortization/accretion <sup>a</sup>                        | -                       | (740)                   | -                       | -                                       | -                              | (740)           | -   | (740)         |
| Income from securities lending                             | -                       | 36                      | 99                      | 42                                      | 43                             | 220             | -   | 220           |
| <b>Investment income before fees and taxes</b>             | <b>930</b>              | <b>15 793</b>           | <b>22 111</b>           | <b>27 009</b>                           | <b>17 466</b>                  | <b>83 309</b>   | <b>869</b>                                | <b>84 178</b> |
| Investment manager fees                                    | -                       | -                       | (1 694)                 | (975)                                   | (950)                          | (3 619)         | -   | (3 619)       |
| Custody fees/bank charges                                  | (159)                   | (29)                    | (215)                   | (91)                                    | (86)                           | (580)           | -   | (580)         |
| Financial advisory and other investment management fees    | -                       | (84)                    | (225)                   | (98)                                    | (93)                           | (500)           | -   | (500)         |
| Taxes recoverable  | 6                       | -                       | -                       | -                                       | -                              | 6               | -   | 6             |
| <b>Investment income after fees and taxes</b>              | <b>777</b>              | <b>15 680</b>           | <b>19 977</b>           | <b>25 845</b>                           | <b>16 337</b>                  | <b>78 616</b>   | <b>869</b>                                | <b>79 485</b> |

<sup>a</sup> 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 the International Financial Reporting Standards.

**VI. Rate of return**

17. 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.
18. The portfolio returned a positive 3.26 per cent in 2010, including the impact of investment expenses and securities lending cash collateral activities.

Table 3

**Annual rates of return on IFAD's investments for 2008, 2009 and 2010**

(Percentages in local currency terms)

|                                  | <i>Annual rates of return in local currency</i> |             |             |
|----------------------------------|---|-------------|-------------|
|                                  | <i>2008</i>                                     | <i>2009</i> | <i>2010</i> |
| Operational cash                 | n.a.  | n.a.        | n.a.        |
| Held-to-maturity                 | 4.30  | 4.36        | 4.00        |
| Government bonds                 | 8.70  | 2.17        | 2.19        |
| Diversified fixed-interest bonds | 4.70  | 5.23        | 6.10        |
| Inflation-indexed bonds          | 3.62  | 7.73        | 4.07        |
| <b>Net rate of return</b>        | <b>5.41</b>                                     | <b>4.45</b> | <b>3.26</b> |

19. The differences between annual returns among mandates for the above years are due to the different characteristics of asset classes and demonstrate the positive impact of portfolio diversification on the stability and safety of the overall portfolio return performance.

## VII. Composition of the portfolio

### A. Composition of the investment portfolio by instrument

20. Table 4 shows the composition of the investment portfolio by instrument as at 31 December 2010 in comparison with 31 December 2009.

Table 4  
**Composition of investment portfolio by instrument**  
 (Thousands of United States dollars equivalent)

|   | 31 December 2010 | 31 December 2009 |
|---|------------------|------------------|
| Cash <sup>a</sup>   | 238 671          | 285 778          |
| Time deposits and other obligations of banks <sup>b</sup> | 66 078           | 59 862           |
| Global government bonds/government agencies               | 1 927 580        | 1 772 571        |
| Mortgage-backed securities (MBS) <sup>c</sup>             | 16 032           | 187 338          |
| Asset-backed securities (ABS) <sup>c</sup>                | 11 301           | 4 438            |
| Corporate bonds   | 215 056          | 357 659          |
| Unrealized market value gain/(loss) on forward contracts  | 13 207           | (8 753)          |
| Futures   | 102 914          | 2 615            |
| Options   | -                | (43)             |
| <b>Subtotal: cash and investments</b>                     | <b>2 590 839</b> | <b>2 661 465</b> |
| Receivables for investments sold                          | 70 781           | 37 686           |
| Payables for investments purchased                        | (138 867)        | (100 464)        |
| <b>Total</b>  | <b>2 522 753</b> | <b>2 598 687</b> |

<sup>a</sup> Includes cash in non-convertible currencies amounting to US\$56,000 equivalent (US\$57,000 in 2009).

<sup>b</sup> Includes time deposits in non-convertible currencies amounting to US\$452,000 equivalent (US\$458,000 in 2009).

<sup>c</sup> MBS and ABS in IFAD's investment portfolio require a AAA rating by at least two credit rating agencies (CRAs) and corporate bonds need to be AA- or above. Some securities have been downgraded below these rating requirements due to CRAs' aggressive rating reviews accelerated by the weakening economic conditions. IFAD acted immediately to contain the credit exposure by excluding non-agency mortgages from eligible instruments, by a combination of aggressive monitoring of all security holdings other than government bonds and by selling any downgraded securities wherever the market remains reasonably liquid.

### B. Composition of the investment portfolio by currency

21. 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.
22. 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 the basket.
23. The 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 31 December 2010, are shown in table 5.

Table 5  
Units and weights applicable to SDR valuation basket

| Currency             | 1 January 2006 |                   | 31 December 2010 |                   |
|----------------------|----------------|-------------------|------------------|-------------------|
|                      | Units          | Percentage weight | Units            | Percentage weight |
| United States dollar | 0.6320         | 43.7              | 0.6320           | 40.8              |
| Euro                 | 0.4100         | 34.3              | 0.4100           | 35.5              |
| Yen                  | 18.4000        | 10.9              | 18.4000          | 14.6              |
| Pound sterling       | 0.0903         | 11.1              | 0.0903           | 9.1               |
| <b>Total</b>         |                | <b>100.0</b>      |                  | <b>100.0</b>      |

24. At 31 December 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\$3,116,479,000 equivalent, as summarized in table 6 (compared with US\$3,209,460,000 equivalent at 31 December 2009).

Table 6  
Currency composition of assets in the form of cash, investments and other receivables

(Thousands of United States dollars equivalent)

| Currency                                | Cash and investments | Promissory notes | Contribution receivables from Member States | Total            |
|---|----------------------|------------------|---|------------------|
| United States dollar group <sup>a</sup> | 1 073 711            | 174 280          | 112 801                                     | 1 360 792        |
| Euro group <sup>b</sup>                 | 818 288              | 112 957          | 135 242                                     | 1 066 487        |
| Yen                                     | 392 977              | 58 954           | -   | 451 931          |
| Pound sterling                          | 237 269              | -                | -   | 237 269          |
| <b>Total</b>                            | <b>2 522 245</b>     | <b>346 191</b>   | <b>248 043</b>                              | <b>3 116 479</b> |

<sup>a</sup> Includes assets in Australian, Canadian and New Zealand dollars.

<sup>b</sup> Includes assets in Swiss francs, Swedish kronor, Danish kroner and Norwegian kroner.

25. The alignment of assets by currency group against the SDR valuation basket as at 31 December 2010 is shown in table 7. The balance of commitments denominated in United States dollars at 31 December 2010 amounted to US\$179,087,000 equivalent, composed of the General Reserve (US\$95,000,000) and commitments for grants denominated in United States dollars (US\$84,087,000).

Table 7  
Alignment of assets per currency group with the SDR valuation composition as at 31 December 2010

(Thousands of United States dollars equivalent)

| Currency        | Asset amount     | Less: commitments denominated in US dollars | Net asset amount | Net asset amount (percentage) | SDR weights (percentage) | Difference (percentage) |
|-----------------|------------------|---|------------------|-------------------------------|--------------------------|-------------------------|
| US dollar group | 1 360 792        | (179 087)                                   | 1 181 705        | 40.2                          | 40.8                     | (0.6)                   |
| Euro group      | 1 066 487        | -   | 1 066 487        | 36.3                          | 35.5                     | 0.8                     |
| Yen             | 451 931          | -   | 451 931          | 15.4                          | 14.6                     | 0.8                     |
| Pound sterling  | 237 269          | -   | 237 269          | 8.1                           | 9.1                      | (1.0)                   |
| <b>Total</b>    | <b>3 116 479</b> | <b>(179 087)</b>                            | <b>2 937 392</b> | <b>100.0</b>                  | <b>100.0</b>             | <b>0.0</b>              |



26. As at 31 December 2010, there was a shortfall in the pound sterling of 1.0 per cent and in the United States dollar currency group holding of 0.6 per cent. This was offset by an excess allocation in the euro currency group holding and Japanese yen, both of which are 0.8 per cent.

### C. Composition of the investment portfolio by maturity and duration

27. Table 8 provides details on the composition of the overall investment portfolio by maturity as at 31 December 2010 and compares this with the maturity composition at 31 December 2009.
28. The average duration, which takes into consideration the weighted average of the maturity of all income streams of the overall investment portfolio, was 2.5 years as at 31 December 2010, slightly lower than the previous year-end (2.6 years at 31 December 2009).

Table 8  
**Composition of the investment portfolio by maturity**  
 (Thousands of United States dollars equivalent)

| Period                                | 31 December 2010 |                  | 31 December 2009 |                  |
|---------------------------------------|------------------|------------------|------------------|------------------|
|                                       | Amount           | Percentage       | Amount           | Percentage       |
| Due in one year or less               | 479 142          | 19.0             | 412 334          | 15.9             |
| Due after one year through five years | 1 628 385        | 64.6             | 1 715 361        | 66.0             |
| Due from five to ten years            | 205 454          | 8.1              | 203 320          | 7.8              |
| Due after ten years                   | 209 264          | 8.3              | 267 672          | 10.3             |
| <b>Total</b>                          | <b>2 522 245</b> | <b>100.0</b>     | <b>2 598 687</b> | <b>100.0</b>     |
| <b>Weighted average duration</b>      |                  | <b>2.5 years</b> |                  | <b>2.6 years</b> |

## VIII. Securities lending cash collateral

29. In November 2010, IFAD had completely divested from the securities lending cash collateral programme. The table below summarizes the activities from 1 January 2008 through to 31 December 2010.

Table 9  
**Securities lending cash collateral activities and income from 2008 to 2010**  
 (Thousands of United States dollars equivalent)

| Year         | Unrealized gain/loss | Realized gain/loss | Other income | Securities lending cash collateral account | Securities lending income | Total        |
|--------------|----------------------|--------------------|--------------|--|---------------------------|--------------|
| 2008         | (18 280)             | -                  | -            | (18 280)                                   | 5 285                     | (12 995)     |
| 2009         | 17 007               | (2 391)            | 1 570        | 16 186                                     | 1 300                     | 17 486       |
| 2010         | 1 273                | (361)              | (43)         | 869  | 220                       | 1 089        |
| <b>Total</b> | <b>-</b>             | <b>(2 752)</b>     | <b>1 527</b> | <b>(1 225)</b>                             | <b>6 805</b>              | <b>5 580</b> |

30. Despite a reported unrealized loss of US\$18,280,000 equivalent as at 31 December 2008 in the securities lending cash collateral programme, IFAD managed to reduce the loss to a total of US\$1,225,000 equivalent upon closure of the programme. While the programme was being downsized and subsequently closed, positive securities lending income over the same period of US\$6,805,000 equivalent contributed to a net income position for the programme of US\$5,580,000 equivalent for the three-year period.

## IX. Liquidity level in IFAD's investment portfolio

31. Highly liquid assets in IFAD's investment portfolio as at 31 December 2010 amounted to US\$1,196,300,000, equivalent to more than 47 per cent of the total investment portfolio (table 10).

Table 10

### Liquidity level in IFAD's investment portfolio as at 31 December 2010

(Thousands of United States dollars equivalent)

|                                | <i>Actuals</i> | <i>Percentage</i> |
|--------------------------------|----------------|-------------------|
| <b>Highly liquid assets</b>    | <b>1 196.3</b> | <b>47.4</b>       |
| Short-term                     | 182.6          | 7.2               |
| Government securities          | 1 013.7        | 40.2              |
| <b>Fairly liquid assets</b>    | <b>928.8</b>   | <b>36.8</b>       |
| Non-government securities      | 928.8          | 36.8              |
| <b>Partially liquid assets</b> | <b>397.7</b>   | <b>15.8</b>       |
| Held-to-maturity               | 397.7          | 15.8              |
| <b>Total portfolio</b>         | <b>2 522.8</b> | <b>100.0</b>      |

## X. Risk measurement<sup>2</sup>

32. With the exception of operational cash and held-to-maturity investments, the 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 31 December 2010, the standard deviation of IFAD's investment portfolio was 1.33 per cent, compared with 1.42 per cent for the investment policy.
33. 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. Table 11 shows the VaR of IFAD's investment portfolio and that of the investment policy as at 31 December 2010 and for previous periods.

Table 11

### 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<sup>a</sup></i> |   |
|-------------------|-----------------------------|---|--------------------------------------|---|
|                   | <i>VaR<br/>(Percentage)</i> | <i>Amount<br/>(Thousands of<br/>US dollars)</i> | <i>VaR<br/>(Percentage)</i>          | <i>Amount<br/>(Thousands of<br/>US dollars)</i> |
| 31 December 2010  | 1.11                        | 27 986  | 1.19                                 | 29 946  |
| 30 September 2010 | 1.15                        | 29 716  | 1.15                                 | 29 628  |
| 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  |

<sup>a</sup> The investment policy VaR is based on policy allocation (see table 1).

34. At 31 December 2010, the investment portfolio's VaR was 1.11 per cent, a slight decrease from the end of the previous quarter, and below the investment policy VaR of 1.19 per cent. The gradual reduction of the VaR reflected the effects of the proactive tactical strategies implemented by IFAD to tighten the risk control of the investment portfolio management as a whole.

<sup>2</sup> More comprehensive information pertaining to the Fund's risk management is provided in the 2010 consolidated financial statements in note 4 (document EB 2011/102/R.42).