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Enabling poor rural people
to overcome poverty

Proposed changes to IFAD's Investment Policy Statement

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For: **Information**

Proposed changes to IFAD's Investment Policy Statement

1. In accordance with paragraph II.B of IFAD's Investment Policy Statement (IPS),¹ the President wishes to submit to the Executive Board some updates and revisions to the statement. The first two sentences of paragraph II of the preamble are deleted to reflect the revision to the Financial Regulations that was approved by the 2012 Governing Council. The responsibility to approve the Investment Policy now rests with the Executive Board. An explanatory footnote has been introduced to make reference to the detailed organizational structure within IFAD.
2. Annex I, previously entitled "Proposed benchmarks" is removed as these benchmarks were indicative; the final benchmarks shall be set in the Investment Guidelines for each asset class. Annex II entitled "Proposed risk budgeting" will become annex I and a new annex II will be added. The new annex II is provided for information purposes only, to outline the current policy allocation (with ranges) to complement the conditional value at risk (CVaR) budget.
3. Some necessary editorial improvements have been made to the IPS, while other amendments reflect internal changes that were already communicated to the Executive Board in the document Internal Control Framework for IFAD Investments presented at the December 2011 session.²
4. For ease of reference, the changes to the text of the IPS are shown below in boldface.
5. Section I, paragraph 3 is amended to read: "Accordingly, the present document is divided into four sections. **Annex I is to be considered an integral part of the document, while annex II is provided for information only.**"
6. In section I(B), the final subparagraph, entitled "Organizational units" shall read: "Based on his/her authority to organize staff, from time to time the President configures IFAD's organizational structure." All other text is deleted.
7. In section II(A), paragraph 7, the first sentence is deleted.
8. Section II(F), paragraph 17 is amended to read: "The President will ensure that **properly equipped organizational units are** made responsible for developing and maintaining relationships with external investment managers and the custodian bank."
9. Section II(F), paragraph 18 is amended to read: "The President 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. This may comprise:
 - (a) Follow-up with external investment managers on compliance **issues following the preparation of compliance reports and/or alerts resulting from these. All compliance issues are summarized in a monthly compliance audit report;**
[...]"
10. Section II(F), paragraph 19 is amended to read: "With regard to the custodian bank, the President will ensure **the following:** [...]."

¹ Changes relate to document EB 2011/104/R.43.

² EB 2011/104/R.45.

11. In section II(G), the first sentence of paragraph 20 is amended to read: **"The President will ensure that internal investment portfolios are managed appropriately in line with IFAD's IPS and specific investment guidelines."**
12. Under section II(G), paragraph 21 is deleted, as compliance is now carried out by the Financial Planning and Risk Analysis Unit (FRA) for the internally managed portfolio as reflected in section IV(D), paragraph 75(a) (new paragraph 74(a)). The paragraphs are renumbered accordingly.
13. In section II(H), the first sentence of paragraph 22 (new paragraph 21) is amended to read: **"The President will ensure that operational cash is managed appropriately and in accordance with the IPS."**
14. In section II(I), paragraph 23 (new paragraph 22), the first sentence is amended to read: **"IFAD applies a risk-budgeting framework as the basis for asset allocation."**
15. Under section II(J), paragraph 24 (new paragraph 23) is amended to read: **"The President will ensure the monitoring of and adherence to the risk budget, for investment risk monitoring and for compliance monitoring on internally and externally managed portfolios. This may comprise:**
 - (a) **Follow-up with external investment managers on compliance issues. All activities are summarized in a monthly compliance audit report;**
 - (b) **Follow-up with external managers when their risk levels reach the maximum allowable limit as stated in the risk budget;**
 - (c) **Review of levels of risk budget measures and of other relevant risk measures on a monthly basis; and**
 - (d) **Review of the status of the alignment of IFAD's assets with the special drawing rights (SDR) currency weights for currency risk hedging purposes and recommend corrective actions when needed."**
16. Section III(A), paragraph 25 (new paragraph 24) is amended to read: "The Governing Council adopted the Financial Regulations of IFAD, where it ruled, in regulation VIII(1), that "the President may place or invest cash funds, not needed immediately for the Fund's operations or administrative expenditures." The Governing Council further stipulated, in regulation VIII(2), 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 manner". Regulation VIII(2) forms the basis of IFAD's investment objectives, which for the purpose of this IPS are: [...]"
17. Section III(C), paragraph 27 (new paragraph 26) is amended to read: "IFAD is not a market-based financial institution and its financial commitments are limited to the funds that become available from Member States, complemented by credit reflows and other internal resources such as returns on the investment portfolio. These returns are an important contribution to the funding of IFAD. Additionally, returns should help **increase the internal resources available to approve loans and grants."**
18. In section III(D), paragraph 32 (new paragraph 31), the reference to annex I is deleted.
19. Section IV(A), paragraph 43 (new paragraph 42) is amended to read: **"The President will ensure that appropriate organizational units are made responsible for managing, monitoring, analysing and assessing risks and reporting risk levels."** All other text is deleted.

20. Section IV(A), paragraph 44 (new paragraph 43) is amended to read: "**The President will also ensure monitoring and reporting on exposure to commercial banks and on compliance with minimum established credit ratings for short-term investments.**"
21. Section IV(A), paragraph 45 (new paragraph 44) is amended to read: "**For selected risks, risk-budget ranges are established by the President with due regard to IPS objectives. The President will ensure that the adequacy of risk-budgeting measures and their tolerance levels are constantly monitored and reviewed on a quarterly basis.** The risk levels of the overall investment portfolio and single externally and internally managed portfolios will not exceed the risk appetite of the Fund as defined by the risk-budget level."
22. Section IV(A), paragraph 48 (new paragraph 47) is amended to read: "IFAD's external asset managers will engage in active management, consistent with the risk-budgeting framework and tracking error limits **provided to them**. "Active management" is limited to a discretionary authority to address the tracking errors and any other constraints deriving from the risk-budgeting framework. Deviations from the benchmark are addressed under this discretionary authority and are intended to optimize the external (or internal if any) asset managers' skills and the derived return in the risk-budgeting context."
23. Section IV(A), paragraph 49 (new paragraph 48) is amended to read: "**Should one or more of the risk measures exceed the budgeted level, the President shall ensure that an analysis to highlight the source of increased risk is carried out.**"
24. Section IV(A), paragraph 50 (new paragraph 49) is amended to read: "Should the excess overall portfolio risk level stem from a single manager's position, the President will ensure that **a strategy is elaborated** to reduce the risk in that portfolio and to formulate recommendations for the manager on actions to be taken within that mandate."
25. Section IV(A), paragraph 51 (new paragraph 50) is amended to read: "Should the excess overall portfolio risk stem from joint factors in overall asset allocation, the President will ensure that **various options are analysed in order** to formulate actions to bring back the overall risk profile of the portfolio to the budgeted level."
26. Section IV(B), paragraph 53 (new paragraph 52) is amended to read: "**The President will ensure that analyses are performed and reports prepared on the following risks.**"
27. Section IV(B), paragraph 56 (new paragraph 55) is amended to read: "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 the purpose of the management of investments, the President will ensure that credit analyses by security and by issuer **are 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."
28. Section IV(B), paragraph 57 (new paragraph 56) is amended to read: "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 – including trading, derivatives, banks eligible for investments and commercial and central banks – 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.”

29. Section IV(B), paragraph 61 (new paragraph 60) is amended to read: **“In the case of misalignments that are considered persistent and significant, the President will ensure that an analysis is performed of new currency weights needed to rebalance the assets to the SDR weight. Where necessary, a realignment procedure may be implemented by changing the investment portfolio currency weights and/or instructing external investment managers or an external currency overlay manager to implement currency alignment changes.”**
30. Section IV(C), paragraph 72 (new paragraph 71) is amended to read: **“The President will ensure that a monthly overall analysis is carried out on portfolio performance in United States dollars, together with performance attribution and that the performance in local currency equivalents is also reported.”**
31. Section IV(C), paragraph 74 (new paragraph 73) is amended to read: “Should one or more managers show a significantly poor performance for a period of three or more months, or should a sudden change in a manager’s performance trend be observed in a specific month, **the manager will be contacted and a written explanation of the performance trend will be required.** If the underperformance persists, the President will take the necessary measures to ensure that a strategy and corrective action for the underperforming manager are put in place.”
32. Section IV(D), paragraph 75 (new paragraph 74) is amended to read: **“The President will ensure performance of the following activities:**
 - (a) Monitoring of external and internal investment managers’ compliance with IFAD’s investment guidelines on a daily basis through an online application provided by the custodian and through internal analyses. **Should the compliance system trigger an alert message, this will be analysed and action with respect to the manager will be taken as deemed necessary;** and
 - (b) Monitoring of compliance for internal operational cash on a six-monthly basis **to ensure appropriate liquidity management.”**