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Enabling poor rural people  
to overcome poverty

## Report on IFAD's investment portfolio for 2012

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For: **Information**

# Report on IFAD's investment portfolio for 2012

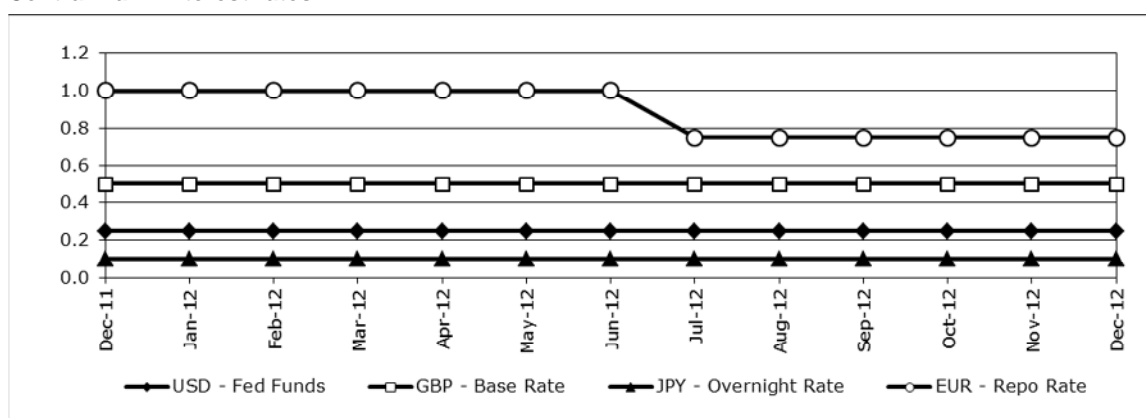
## I. Executive summary

1. The value of the investment portfolio in United States dollar terms decreased by US\$185.9 million, from US\$2,455.5 million at 31 December 2011 to US\$2,269.6 million at 31 December 2012. The main factors for this decrease were the net outflows, which were partially offset by the net investment income and foreign exchange movements.
2. The investment portfolio's net rate of return for 2012 was 3.11 per cent and this translates into a net annual investment income of US\$71.9 million net of all investment-related fees.
3. During 2012, IFAD completed the implementation of the revised investment policy in accordance with the Investment Policy Statement (IPS) approved by the Executive Board in December 2011.<sup>1</sup>

## II. Market conditions

4. Chart 1 shows the evolution of central bank interest rates for special drawing rights (SDR) countries for 2012.

Chart 1  
Central Bank interest rates

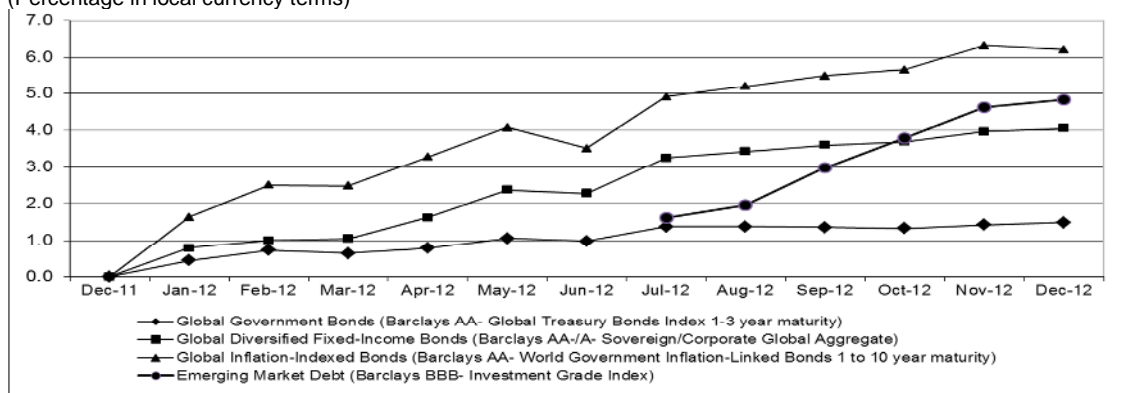


Source: Bloomberg

Chart 2 shows the cumulative performance for 2012 of the benchmark indices applied to IFAD's externally managed asset classes.

Chart 2  
Fixed-interest market developments in 2012

(Percentage in local currency terms)



<sup>1</sup>EB 2011/104/R.43

5. The **global government bonds asset class** performed positively, supported by the flight to quality to United States, United Kingdom and core European government bond markets, owing largely to concerns relative to the debt of several peripheral eurozone countries.
6. The **global diversified fixed-income asset class** also performed positively, with the government bonds sector being the chief contributor together with United States agency mortgage pass-through securities. The asset class also benefited from a very strong performance in the corporate sector, especially in the second part of the year, as investors sought instruments to increase investment returns. However, corporate performance contributed less to the overall asset class, due to the small corporate weight in the asset class.
7. The **global inflation-indexed asset class** registered a very good performance, as it benefited from investors' demand for safety from issuers such as the United States, United Kingdom and core European issuers. The asset class's performance also benefited from renewed investors' interest in the inflation protection element offered by these instruments in response to the easing measures implemented by all major central banks.
8. The **emerging market bond asset class** registered the strongest performance among the asset classes, on the back of continued improvements in the markets' economic fundamentals, and due to investors seeking benefits from diversification versus high quality developed issuers and from higher yields offered by emerging markets issuers.
9. In 2012, the volatile foreign exchange markets saw an overall depreciation of the United States dollar against the British pound sterling (-4.39 per cent) and the euro (-1.54 per cent), which was partially offset by the appreciation of the United States dollar against the Japanese yen (+12.38 per cent). This resulted in a positive foreign exchange movement (see table 1). The currency fluctuations affecting IFAD's assets are offset by similar fluctuations for IFAD's liabilities and are therefore neutralized on an asset liability level. For this reason, the income and performance of IFAD's portfolio are reported in local currency terms.

### III. Implementation of the investment policy

10. During July 2012, all new external portfolio managers for the global government bond, global diversified fixed-income and emerging market debt asset classes<sup>2</sup> were funded. Applicable benchmarks were constructed and implemented for the new global diversified fixed-income and emerging market debt asset classes, while the global government and global inflation-indexed bond benchmarks were also modified to capture the changes made to the investment guidelines and new IPS (see table 3).
11. The first review of the IPS was submitted to the 107<sup>th</sup> session of the Executive Board, in accordance with the IPS, section II, paragraph 8.

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<sup>2</sup> IPS, section III, D

## IV. Asset allocation

12. Part of the IPS implementation included a new asset allocation of US\$150.0 million for the emerging market debt asset class that began on 1 July 2012.
13. In July 2012, the United States currency denominated diversified fixed-income portfolio was updated to become a global diversified fixed-income portfolio. Therefore all references to this portfolio for the first half of 2012 are related to the United States currency denominated portfolio while in the second half of the year, they are related to the global diversified fixed-income portfolio.
14. As a consequence of the updated investment guidelines, the held-to-maturity portfolio in December 2012 was renamed the global strategic portfolio.

Table 1

### Movements affecting the asset allocation within the portfolio in 2012

(Thousands of United States dollars equivalent)

	<i>Operational cash<sup>a</sup></i>	<i>Global strategic portfolio</i>	<i>Global government bonds</i>	<i>Global diversified fixed-income bonds</i>	<i>Global inflation-indexed bonds</i>	<i>Emerging market debt bonds</i>	<i>Total</i>
<b>Opening balance (1 January 2012)</b>	<b>199 944</b>	<b>383 889</b>	<b>950 480</b>	<b>413 885</b>	<b>507 318</b>	<b>-</b>	<b>2 455 516</b>
Investment income <sup>b</sup>	2 571	12 511	14 343	11 499	21 674	9 348	71 946
Transfers due to allocation	263 582	(26 782)	(213 753)	(106 146)	(66 901)	150 000	-
Transfers due to expense allocation	(3 901)	150	1 559	856	1 081	255	-
Net outflows <sup>c</sup>	(259 067)	-	-	-	-	-	(259 067)
Movements on exchange	(8 323)	3 787	10 168	(1 413)	(3 742)	752	1 229
<b>Closing balance (31 December 2012)</b>	<b>194 806</b>	<b>373 555</b>	<b>762 797</b>	<b>318 681</b>	<b>459 430</b>	<b>160 355</b>	<b>2 269 624</b>
Actual asset allocation (percentage)	8.6	16.5	33.6	14.0	20.2	7.1	100.0
Investment policy asset allocation (percentage)	7.0	17.0	36.0	13.0	20.0	7.0	100.0
<b>Difference in allocation (percentage)</b>	<b>1.6</b>	<b>(0.5)</b>	<b>(2.4)</b>	<b>1.0</b>	<b>0.2</b>	<b>0.1</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> Net outflows consist of disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.

15. During 2012, the overall investment portfolio value in United States dollar terms decreased by US\$185.9 million. This decrease was the net result of net outflows of US\$259.1 million partially offset by investment income of US\$71.9 million and positive foreign exchange movements of US\$1.2 million.

## V. Investment income

16. In 2012, the net investment income amounted to US\$71.9 million, inclusive of all investment-related fees. Table 2 presents a summary of the 2012 investment income broken down by asset class.

Table 2  
**Breakdown of investment income by asset class in 2012**

(Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Global strategic portfolio<sup>b</sup></i>	<i>Global government bonds</i>	<i>Global diversified fixed-income bonds</i>	<i>Global inflation-indexed bonds</i>	<i>Emerging market debt bonds</i>	<i>Total</i>
Interest from fixed-income investments and bank accounts	1 780	11 625	20 015	9 195	8 277	3 526	54 418
Realized market gains/(losses)	901	1 785	(1 318)	9 246	11 564	804	22 982
Unrealized market gains/(losses)	(22)	-	(2 794)	(6 086)	2 914	5 273	(715)
Amortization <sup>a</sup>	-	(749)	-	-	-	-	(749)
<b>Investment income before fees</b>	<b>2 659</b>	<b>12 661</b>	<b>15 903</b>	<b>12 355</b>	<b>22 755</b>	<b>9 603</b>	<b>75 936</b>
Investment manager fees	-	-	(1 173)	(690)	(874)	(211)	(2 948)
Custody fees/bank charges	(88)	(9)	(80)	(31)	(27)	(10)	(245)
Financial advisory & other investment related fees	-	(141)	(307)	(135)	(180)	(34)	(797)
<b>Investment income after fees</b>	<b>2 571</b>	<b>12 511</b>	<b>14 343</b>	<b>11 499</b>	<b>21 674</b>	<b>9 348</b>	<b>71 946</b>

<sup>a</sup> A period's amortization amount represents a portion of the difference between the purchase price and the final redemption value for the global strategic portfolio which is reported at amortized cost.

<sup>b</sup> In line with the current IPS, some securities were sold during 2012 that triggered a realized market gain.

## 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 of IFAD's assets and IFAD's liabilities to the SDR currency ratios (see section VIII.E.).

Table 3  
**Quarterly performances for 2012 together with annual performance versus benchmark**  
 (Percentages in local currency terms)

	2012 quarterly and year-to-date performances and benchmark						
	Fourth quarter	Third quarter	Second quarter	First quarter	Annual 2012	Benchmark 2012	Difference
Operational cash	0.01	0.04	0.04	0.03	<b>0.12</b>	<b>0.12</b>	-
Global strategic portfolio	1.00	0.64	0.51	1.22	<b>3.41</b>	<b>2.94</b>	<b>0.47</b>
Global government bonds	0.21	0.50	0.44	0.48	<b>1.63</b>	<b>1.51</b>	<b>0.12</b>
Global diversified fixed-income bonds	0.47	1.88	2.00	(0.09)	<b>4.31</b>	<b>3.46</b>	<b>0.85</b>
Global inflation-indexed bonds	0.79	1.82	0.98	1.06	<b>4.73</b>	<b>6.13</b>	<b>(1.40)</b>
Emerging market debt bonds	2.19	3.74	n/a	n/a	<b>6.01</b>	<b>4.83</b>	<b>1.18</b>
<b>Net rate of return</b>	<b>0.58</b>	<b>1.19</b>	<b>0.77</b>	<b>0.54</b>	<b>3.11</b>	<b>2.99</b>	<b>0.12</b>

Note: n/a : not applicable.

18. The investment portfolio returned a positive 3.11 per cent in 2012, net of all investment-related expenses.
19. The only underperforming asset class, the global inflation-indexed bond portfolio, was the result of a poorly performing external portfolio manager that was subsequently terminated and replaced through IFAD's tendering processes.

## VII. Composition of the portfolio by instrument

20. Table 4 shows the composition of the investment portfolio by instrument as at 31 December 2012 in comparison with 31 December 2011.

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

	31 December 2011	31 December 2012
Cash <sup>a</sup>	233 704	246 892
Time deposits and other obligations of banks <sup>b</sup>	122 179	110 610
Global government bonds/government agencies	1 737 474	1 657 952
Mortgage-backed securities (MBS) <sup>c</sup>	181 813	93 290
Government-guaranteed asset-backed securities (ABS) <sup>c</sup>	20 366	-
Corporate bonds	201 787	186 196
Unrealized market gain/(loss) on forward contracts	(503)	(8 785)
Unrealized gain/(loss) on futures	(3 955)	6 575
Options	2	-
<b>Subtotal: cash and investments</b>	<b>2 492 867</b>	<b>2 292 730</b>
Receivables for investments sold	120 479	1 385
Payables for investments purchased	(157 830)	(24 491)
<b>Total</b>	<b>2 455 516</b>	<b>2 269 624</b>

<sup>a</sup> Includes cash in non-convertible currencies amounting to US\$50,000 equivalent (US\$54,000 in 2011).

<sup>b</sup> Includes time deposits in non-convertible currencies amounting to US\$397,000 equivalent (US\$430,000 in 2011).

<sup>c</sup> MBS and ABS in IFAD's investment portfolio require an AAA rating by at least two credit rating agencies. Over 98 per cent of the MBS allocation is related to government MBS.

## VIII. Risk measurements

21. In accordance with the IPS, the risk measures used for risk budgeting purposes are conditional value-at-risk (CVaR) and the ex-ante tracking error which are reported in subsections B and C below. In addition, other risk indicators are reported in sections A, D, E and F.

### A. Market risk: Duration

22. Duration<sup>3</sup> is defined as the weighted average maturity of cash flows including coupon and principal payments of a bond. As a result, the longer the duration, the more the bond's price is sensitive to movements of market interest rates. Thus a longer duration is normally associated with higher risk. IFAD assesses the optimal asset class duration in line with risk budget levels, and IFAD's investment guidelines set duration limits versus benchmarks.

Table 5

**IFAD's investment portfolio and benchmark effective duration as at 31 December 2012**

(Duration in number of years)

	<i>Portfolio</i>	<i>Benchmark</i>
Global government bonds	1.71	1.86
Global diversified fixed-income bonds	4.10	4.16
Global inflation-indexed bonds	6.25	5.38
Emerging market debt bonds	7.61	6.77
<b>Total portfolio (including global strategic portfolio and operational cash)</b>	<b>2.95</b>	<b>2.76</b>

Note: The total portfolio duration is lowered by the operational cash and global strategic portfolios, which are not subject to fluctuations in prices.

23. The overall portfolio duration was 2.95 years, which is an overall conservative positioning (table 5).

### B. Market risk: Conditional value-at-risk

24. The one-year CVaR at 95 per cent is a measure of the potential average expected loss of a portfolio under extreme conditions (the so-called "left tail"). It gives an indication of how much value a portfolio could lose, on average, over a forward-looking one-year horizon with a 95 per cent confidence level. To derive this measure, the portfolio is revalued (stressed) assuming a large number of market condition scenarios affecting its value. For example, a CVaR of 4.0 per cent on a portfolio of US\$1,000,000 means there is a 95 per cent chance that the average loss of the portfolio will not exceed US\$40,000 in one year.

<sup>3</sup> The measure of the price sensitivity of a fixed-income security to an interest rate change of 100 basis points. Calculation is based on the weighted average of the present values for all cash flows. Duration is measured in years.

Table 6

**CVaR) of current asset classes**

(Confidence level at 95 per cent, percentages, based on historical simulations over five-year history)

	<i>Actual investment portfolio</i>	<i>IPS budget level</i>
	<i>one-year CVaR</i>	<i>one-year CVaR</i>
Global government bonds	1.50	4.00
Global diversified fixed-income bonds	6.56	15.00
Global inflation-indexed bonds	6.85	9.00
Emerging market debt bonds	12.70	27.00
<b>Total portfolio (including global strategic portfolio and operational cash)</b>	<b>2.72</b>	<b>6.00</b>

25. The CVaR of single asset classes and of the overall portfolio were all below the risk budget levels.

**C. Market risk: Ex ante tracking error**

26. The ex ante tracking error is calculated based on the expected portfolio and benchmark returns over a forward-looking one-year horizon. It gives an indication of how different an active strategy is from its benchmark. The more a portfolio differs from the benchmark upon which it is based, the more likely it is to under- or outperform that same benchmark. For example, a one-year forward-looking ex ante tracking error of 0.2 per cent means that, over the coming year, the portfolio excess return over the benchmark is expected to be in the range of +/- 0.2 per cent of its mean value.

Table 7

**IFAD's investment portfolio ex ante tracking error as at 31 December 2012**

(Percentages)

	<i>Actual investment portfolio</i>	<i>IPS budget level</i>
Global government bonds	0.34	1.50
Global diversified fixed-income bonds	0.57	3.00
Global inflation-indexed bonds	0.43	2.50
Emerging market debt bonds	1.01	4.00

27. The current levels of ex ante tracking error are below the budget levels. This indicates a close resemblance of the portfolio strategy to the benchmark indices.

**D. Credit risk: Credit rating analysis**

28. IFAD's IPS establishes credit rating floors for all eligible asset classes. Credit risk is managed through the monitoring of securities in accordance with the investment guidelines. Should a security be downgraded below IFAD's minimum credit rating, procedures are in place to limit market losses through divestment.



Table 8  
**Composition of the investment portfolio by credit ratings<sup>a</sup> as at 31 December 2012**  
 (Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Global strategic portfolio</i>	<i>Global government bonds</i>	<i>Global diversified fixed-income bonds</i>	<i>Global inflation-indexed bonds</i>	<i>Emerging market debt</i>	<i>Total</i>	<i>Percentage</i>
AAA	-	157 728	683 842	220 744	428 153	-	1 490 467	76.1
AA+/-	-	112 933	47 369	65 929	18 839	37 578	282 648	14.4
A+/-	-	8 796	-	53 700	-	14 955	77 451	4.0
BBB+/-	-	-	-	-	-	106 739	106 739	5.5
Cash <sup>b</sup>	194 806	3 752	34 728	4 095	14 728	1 756	253 865	n/a
Time deposits	-	90 346	-	-	-	-	90 346	n/a
Pending sales and purchases <sup>c</sup>	-	-	(3 142)	(25 787)	(2 290)	(673)	(31 892)	n/a
<b>Total</b>	<b>194 806</b>	<b>373 555</b>	<b>762 797</b>	<b>318 681</b>	<b>459 430</b>	<b>160 355</b>	<b>2 269 624</b>	<b>100.0</b>

<sup>a</sup> In accordance with IFAD's current investment guidelines, the credit ratings used in this report are based on the best credit ratings available from either Standard and Poor's (S&P), Moody's or Fitch Ratings. The global strategic portfolio is more conservative and reports the lowest credit rating of the three above-mentioned agencies.

<sup>b</sup> Consists of cash equivalents and cash with central banks, corporate banks and cash held by external portfolio managers. These amounts are not rated by credit rating agencies.

<sup>c</sup> Pending foreign exchange purchases and sales used for hedging purposes and trades pending settlement. These amounts do not have an applicable credit rating.

Note: n/a = not applicable.

## **E. Currency risk: Currency composition analysis**

29. The majority of IFAD's commitments pertain to undisbursed loans and grants and are expressed in SDRs. In order to immunize IFAD's balance sheet against currency fluctuations, the Fund's assets are maintained, to the extent possible, in the same currencies and ratios of the Fund's commitments, i.e. in SDR.
30. At 31 December 2012, the net asset amount consisting of cash, investments, promissory notes and contribution receivables from Member States (net of provisions) less commitments denominated in United States dollars amounted to US\$2,804.2 million.

Table 9  
**Currency composition of net assets in the form of cash, investments and other receivables**  
 (Thousands of United States dollars equivalent)

<i>Currency</i>	<i>United States dollar group<sup>b</sup></i>	<i>Euro group<sup>c</sup></i>	<i>Yen</i>	<i>Pound sterling</i>	<i>Total</i>
Cash and investments <sup>a</sup>	1 004 089	774 173	191 320	299 595	2 269 177
Promissory notes	182 164	-	71 158	-	253 322
Contribution receivables from Member States	115 930	319 808	34 291	-	470 029
Less: commitments denominated in US dollars	(188 354)	-	-	-	(188 354)
<b>Net asset amount</b>	<b>1 113 829</b>	<b>1 093 981</b>	<b>296 769</b>	<b>299 595</b>	<b>2 804 174</b>
Net asset amount (percentage)	39.7	39.0	10.6	10.7	100.0
SDR weights (percentage)	43.0	36.3	9.1	11.6	100.0
<b>Difference (percentage)</b>	<b>(3.3)</b>	<b>2.7</b>	<b>1.5</b>	<b>(0.9)</b>	<b>0.0</b>

<sup>a</sup> The difference in the cash and investments balance compared to other tables derives from the exclusion of assets in non-convertible currencies of US\$447,000 equivalent (cash and investments).

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

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

31. As at 31 December 2012, there was a shortfall in the United States dollar currency group of 3.3 per cent and in the British pound sterling of 0.9 per cent. This was offset by an excess allocation in the euro currency group of 2.7 per cent and Japanese yen of 1.5 per cent.
32. The unusual variances in the euro and United States dollar currency groups were due to Ninth Replenishment contributions starting to materialize and their inclusion as contribution receivables from Member States in table 9. IFAD takes proactive measurements to minimize any variances against the SDR weights.

#### **F. Liquidity risk: Minimum liquidity requirement**

33. IFAD's liquidity risk is addressed through the minimum liquidity requirement (MLR). IFAD's liquidity policy<sup>4</sup> states that the amount of highly liquid assets in IFAD's investment portfolio should remain above 60 per cent of the projected annual gross disbursement level and potential additional requirements due to liquidity shocks. This translates into a MLR of US\$518.0 million over the Eighth Replenishment period (2010-2012).
34. Highly liquid assets in IFAD's investment portfolio as at 31 December 2012 amounted to US\$957.6 million, which comfortably clears the minimum liquidity requirement (table 10).

<sup>4</sup> EB 2006/89/R.40

Table 10

**Liquidity level in IFAD's investment portfolio as at 31 December 2012**

(Thousands of United States dollars equivalent)

	<i>Actual</i>	<i>Percentage</i>
<b>Highly liquid assets</b>	<b>957 603</b>	<b>42.2</b>
Short-term	194 806	8.6
Government securities	762 797	33.6
<b>Fairly liquid assets</b>	<b>938 466</b>	<b>41.3</b>
Non-government securities	778 111	34.2
Emerging market debt securities	160 355	7.1
<b>Partially liquid assets</b>	<b>373 555</b>	<b>16.5</b>
Global strategic portfolio	373 555	16.5
<b>Total portfolio</b>	<b>2 269 624</b>	<b>100.0</b>

35. In line with previous liquidity policies within their specific Replenishment period, a new MLR will be implemented for the Ninth Replenishment period (2013–2015); this will become effective from 1 January 2013 and reported accordingly.