

Document: EB 2013/110/R.30/Rev.1
Agenda: 11(b)
Date: 12 December 2013
Distribution: Public
Original: English

E



Enabling poor rural people
to overcome poverty

IFAD's Investment Policy Statement

Note to Executive Board representatives

Focal points:

Technical questions:

Iain Kellet

Assistant Vice-President
Financial Operations Department
Tel.: +39 06 5459 2403
e-mail: i.kellet@ifad.org

Chieko Okuda

Director and Treasurer
Treasury Services Division
Tel.: +39 06 5459 2251
e-mail: c.okuda@ifad.org

Dispatch of documentation:

Deirdre McGrenra

Head, Governing Bodies Office
Tel.: +39 06 5459 2374
e-mail: gb_office@ifad.org

Contents

Acronyms and abbreviations	i
Preamble	ii
Recommendation for approval	1
I. Scope and purpose	1
A. Definition of investor and assets	1
B. Actors and their roles	2
II. Governance	2
A. Responsibilities for determining, executing and monitoring the investment policy	2
B. Process for reviewing and updating the investment policy	2
C. Responsibilities for approving investment guidelines and changes thereto	3
D. Responsibilities for engaging and discharging external investment managers, the custodian bank and other financial advisors	3
E. Responsibilities for engaging and discharging commercial and central banks for the management of operational cash	4
F. Responsibilities for monitoring external investment managers, the custodian bank and other financial advisors	4
G. Responsibilities for internally managed investments	4
H. Responsibilities for operational cash management	5
I. Responsibilities for the determination of asset allocation	5
J. Responsibilities for risk management, monitoring and reporting	5
III. Investments, return and risk objectives	6
A. Overall investment objective	6
B. Risk tolerance	6
C. Return and risk requirements	6
D. Eligible asset classes	7
E. Unique circumstances	9
F. Foreign currency management	9
G. Tax considerations and other privileges and immunities	10
IV. Risk management framework and performance measurement	10
A. Risk management framework, risk budgeting, decision-making process	10
B. Risk types and metrics	11
C. Performance measurement and reporting	13
D. Monitoring of compliance	13
Annexes	
I. Risk budget – overall portfolio	15
II. Risk budget – investment portfolios	16
III. Policy Asset Allocation	17
Acronyms and abbreviations	
FALCO	Investment, Finance and ALM Advisory Committee of IFAD
FISCO	Investment and Finance Advisory Committee of IFAD
IPS	Investment Policy Statement
MLR	Minimum Liquidity Requirement

Preamble

- I. The present Investment Policy Statement is adopted to address the need to establish the basic directives for the investments of IFAD's resources and with the aim of abiding, as far as possible and within the objective and functions set forth in the Agreement Establishing IFAD, by the Principles of the United Nations Global Compact.
- II. 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.¹

¹Detailed organizational structure and roles and responsibilities are outlined in the document Internal Control Framework for IFAD Investments (EB 2013/110/R.30/Add.1).

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 statement has been drafted in accordance with the Chartered Financial Analyst (CFA) Institute's² Elements of an Investment Policy Statement for Institutional Investors,² which suggests desirable components of an investment policy statement (IPS) 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. The purpose of this statement is to document IFAD'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);
 - (c) Defining key components of investment guidelines (section III); and
 - (d) Establishing formalized criteria to measure, monitor and evaluate performance and risk (section IV).
3. Accordingly, the present document is divided into four sections. Annex I is to be considered an integral part of the document, while annexes II and III are provided for information only.

A. Definition of investor and assets

4. IFAD is a specialized agency of the United Nations. It formally came into existence on 30 November 1977, on which date the agreement for its establishment entered into force. Membership in the Fund is open to any state member of the United Nations or any of its specialized agencies, or of the International Atomic Energy Agency.
5. The Fund mobilizes resources and makes these available on concessional terms, primarily to finance projects designed to improve food production systems, the nutritional level of the poorest populations in developing countries and the conditions in which they live. IFAD mobilizes resources and knowledge through a dynamic coalition of the rural poor, governments, financial and development institutions, non-governmental organizations and the private sector, including cofinancing. Financing from non-replenishment sources in the form of

² The CFA Institute is a global, not-for-profit organization comprising the world's largest association of investment professionals. The institute develops and promotes the highest educational, ethical and professional standards in the investment industry (www.cfainstitute.org).

² CFA Institute, Elements of an Investment Policy Statement for Institutional Investors, ISBN 987-0-938367-32-1 (May 2010), www.cfapubs.org/doi/abs/10.2469/ccb.v2010.n13.1.

supplementary funds and human resources forms an integral part of IFAD's operational activities.

6. This IPS governs the investment portfolio that forms part of IFAD's regular resources and is used for commitments of loans and grants under IFAD's regular programme. It will serve as a broad framework for investments of other assets entrusted to and managed by IFAD and/or 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 the supreme plenary organ of the Fund. It is composed of representatives of the Member States. All powers of the Fund are vested in the Governing Council. Subject to the limitations stated in the Fund's charter, it may delegate powers to the Executive Board.

Executive Board

The Executive Board is the non-plenary executive organ of the Fund and is composed of 36 Member States. In addition to providing oversight on the functions attributed to the President, it is responsible for the conduct of the general operations of the Fund and exercises the powers given to it by the charter or delegated by the Governing Council.

***Audit Committee:** The Executive Board has established a subsidiary body, the Audit Committee, to which it has referred, inter alia, 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.

***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 – Investment and Finance Advisory Committee (FISCO).*

***Discussion forum:** In order to facilitate discussion, review and analysis of technical and operational issues in a broad investment and financial context, the President has established a staff forum that provides recommendations to the above – Investment, Finance and Asset Liability Management (ALM) Advisory Committee (FALCO).*

***Organizational units:** Based on his/her authority to organize staff, from time to time the President configures IFAD's organizational structure.*

II. Governance

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

7. The President will ensure implementation and monitoring of all aspects of the IPS. The implementation status of the IPS will be reported to the Executive Board at its regular meetings.

B. Process for reviewing and updating the investment policy

8. The appropriateness of the IPS will be reviewed annually by the Executive Board at its 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

9. Acting under regulation XIII of the Financial Regulations, 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 and other financial advisors

10. The President is responsible for the appointment and dismissal of external investment managers, the custodian bank and other financial advisors required to execute the Fund's investments.
11. For the selection of external investment managers, the custodian bank and other financial advisors, the President will follow a selection process governed by IFAD's Procurement Guidelines for Headquarters.
12. External investment managers must fulfil the following initial requirements in order to be considered for the selection process:
 - (a) Manager must adhere to the governing legislation and regulation in the relevant country concerning financial services, including the authority of the competent regulatory body;
 - (b) Manager should endeavour to comply with the Global Investment Performance Standards (GIPS)³ 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;
 - (c) Manager must provide detailed information on the history of the firm, key personnel, key clients, fee schedule and support personnel; and
 - (d) Manager must clearly articulate the investment strategy that will be followed and document that the strategy has been adhered to over time.
13. Selected external investment managers are formally appointed on the signing of their investment management agreements by the President. The agreements outline in detail the responsibilities of the managers.⁴
14. A copy of this IPS is provided to each external investment management firm retained to provide investment services to IFAD. Each firm will acknowledge receipt of the document and acceptance of its content in writing as part of the agreement. Sharing of the IPS is intended to make each manager aware of the overarching principles as a common basis and as applicable to the investment guidelines of individual investment portfolios.

³ The CFA Institute created and administered the GIPS standards. These are a set of standardized, industry-wide ethical principles that provide investment firms with guidance on how to calculate and report their investment results to prospective clients.

⁴ Responsibilities include: investment authority, liability of manager, representations and warranties, performance benchmark, fees, reporting and other administrative requirements. The IPS and relevant investment guidelines are incorporated in each agreement.

E. Responsibilities for engaging and discharging commercial and central banks for the management of operational cash

15. In selecting external commercial banks for the purpose of managing IFAD's cash flows, the Fund follows a competitive selection process governed by IFAD's Procurement Guidelines for Headquarters.
16. Accounts with central banks of Member States and intergovernmental organizations are opened and administered following standard procedures in line with the authority vested in the President.

F. Responsibilities for monitoring external investment managers, the custodian bank and other financial advisors

17. 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.
18. 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;
 - (b) Monitoring of criteria that would result in placing an investment manager on "watch" for consideration of possible replacement;
 - (c) Monthly monitoring of the performance of external investment managers relative to benchmarks and other key performance indicators (a quarterly reporting cycle is submitted to the Executive Board);
 - (d) Monthly review of investment strategies;
 - (e) Monthly and quarterly review of performance and risk statistics provided by the custodian bank;
 - (f) Month-end review of trade executions; and
 - (g) Regular review meetings with external investment managers and other service providers.
19. With regard to the custodian bank, the President will ensure the following:
 - (a) Monitoring adherence to the master custody agreement;
 - (b) Monitoring the service-level agreement and key performance indicators that form part of the master custody agreement; and
 - (c) Scheduling quarterly service review meetings.

G. Responsibilities for internally managed investments

20. The President will ensure that internal investment portfolios are managed appropriately in line with IFAD's IPS and specific investment guidelines. Responsibilities for the purpose of managing internal investments include, but are not limited to:
 - (a) Recommendation of investment guidelines and applicable strategy;
 - (b) Construction and funding of a portfolio according to the applicable guidelines and strategy;
 - (c) Trading with established investment counterparties based on eligible instruments;

- (d) Evaluation and maintenance of relationships with trading counterparties, including coordinating the legal documentation;
- (e) Credit risk analysis of securities and issuers;
- (f) Credit risk analysis of counterparties for all investment activities, including trading, derivatives and banks eligible for investments;
- (g) Sovereign risk analysis; and
- (h) Monitoring of financial markets.

H. Responsibilities for operational cash management

21. The President will ensure that operational cash is managed appropriately and in accordance with the IPS. Responsibilities for the purpose of managing operational cash include, but are not limited to:
- (a) Management of all cash flow operations and short-term liquidity, including forecasting and reporting;
 - (b) Transaction processing for IFAD payments (loans, grants, travel, administrative) in compliance with payment industry regulations;
 - (c) Daily reconciliation of all cash balances;
 - (d) Monitoring of compliance with IFAD instructions;
 - (e) Settlement and back office activities of internal investments;
 - (f) Development, management and maintenance of relationships with central and commercial banks;
 - (g) Monitoring of commercial and central bank credit ratings and financial soundness; and
 - (h) Establishment and monitoring of the maximum ceiling per bank.⁵

I. Responsibilities for the determination of asset allocation

22. IFAD applies risk-budgeting as the basis for asset allocation. Risk budgeting is a process in which an investor establishes acceptable risk levels as a "budget" for the overall portfolio and for each investment portfolio (degree of deviation from benchmark returns) through key risk factors and indicators (see section IV.A). Under this approach, as markets evolve, necessary adjustments are made to the investment portfolio composition to stay within the established risk budget, rather than predefining an investment portfolio's asset allocation and holding it constant over time.⁶ The risk budget for the overall portfolio is approved by the Executive Board. Within this limit, the President approves the risk budgets for investment portfolios.

J. Responsibilities for risk management, monitoring and reporting

23. The President will ensure 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:

⁵ The maximum ceiling per bank will be reviewed and determined through FALCO/FISCO in the context of credit and counterparty risk management (see paragraphs 57 and 58).

⁶ Please refer to the table following paragraph 15 in document EB 2011/103/R.32, Background note to IFAD's Investment Policy Statement.

- (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.

III. Investments, return and risk objectives

A. Overall investment objective

24. 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:

- (a) **Security**, meaning conservation of asset value;⁷ and implying that no negative return on the overall portfolio in aggregate should be strived for within the parameters in the risk budget approved by the Executive Board;
- (b) **Liquidity**, meaning liquidity of assets as defined through the minimum liquidity requirement (MLR), i.e. that resources must be readily available if the operations so require; and
- (c) **Return**, meaning the highest possible return within the above conditions. The IPS aims to achieve a return above the inflation rate wherever appropriate and possible.

B. Risk tolerance

25. The level of risk taken should be consistent with the investment objective of the Fund. Consequently, IFAD will only accept non-speculative risk, subject to the security and liquidity conditions, in order to achieve its investment objectives. It is however recognized and acknowledged that some risk must be assumed in order to achieve the investment objectives. The importance of meeting the Fund's operational goals dominates risk considerations. Quantified risk tolerance levels are determined and approved within the risk-budgeting framework. The Fund and its actors are responsible for understanding the risks and for measuring and monitoring them continually.

C. Return and risk requirements

26. 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

⁷ Reference is made to the risk budget for the overall portfolio (see annex I).

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.

D. Eligible asset classes

27. The following asset classes are eligible within IFAD's asset allocation:

Short-term instruments

- (a) Operational cash
- (b) Cash equivalent and short-term

Fixed-income securities

- (c) Government and government agencies
- (d) Government and government agencies inflation-linked
- (e) Supranationals
- (f) Asset-backed securities (only agency-issued or guaranteed)
- (g) Corporates

28. Descriptions of eligible asset classes and their minimum credit quality requirements are outlined in the following table. Annex II lists current investment portfolios for information.

Eligible asset and credit rating floors

<i>ELIGIBLE ASSET CLASSES</i>		
	<i>Description</i>	<i>Credit rating floors (S&P, Moody's and Fitch)</i>
Operational cash	Eligible in the operational cash portfolio	Counterparty must have a minimum short-term rating of A-1 (S&P or Fitch) or P-1 (Moody's)
Cash equivalent and short-term	Eligible in all portfolios except operational cash	Counterparty must have a minimum short-term rating of A-1 (S&P or Fitch) or P-1 (Moody's)
Government and government agencies fixed-income securities	Eligible in all portfolios except operational cash and diversified fixed income.	Developed markets: AA ^a Emerging markets: BBB ^b
Government and government agencies inflation-linked fixed-income securities	Eligible in the inflation-linked bonds portfolio	Developed markets: AA ^a
Supranationals	Eligible in all portfolios except operational cash and diversified fixed income	AA ^c
Asset-backed securities (only agency issued or guaranteed)	Eligible in the diversified fixed-income portfolio	AAA ^{d,e}
Corporate bonds	Eligible in the diversified fixed-income and the global strategic portfolios	Diversified fixed income: A ^f Global strategic: AAA ^g
<i>DERIVATIVES (for hedging purposes only)</i>		
	<i>Description</i>	<i>Credit rating floors (S&P, Moody's and Fitch)</i>
Currency forwards	Eligible in all portfolios except operational cash	Counterparty must have a minimum short-term rating of A-1 (S&P or Fitch) or P-1 (Moody's)
Exchange-traded futures and options	Eligible in all portfolios except operational cash	Counterparty must have a minimum short-term rating of A-1 (S&P or Fitch) or P-1 (Moody's)
Interest rate swaps	Eligible in all portfolios except operational cash	Counterparty must have a minimum short-term rating of A-1 (S&P or Fitch) or P-1 (Moody's)
Credit default swaps	Eligible in all portfolios except operational cash	Counterparty must have a minimum short-term rating of A-1 (S&P or Fitch) or P-1 (Moody's)

^a By S&P or Fitch, or Moody's equivalent.

^b By S&P or Fitch, or Moody's equivalent.

^c By S&P or Fitch, or Moody's equivalent.

^d By S&P or Fitch, or Moody's equivalent.

^e Or equivalent of United States Treasuries or German Bunds ratings, within investment grade.

^f By S&P or Fitch, or Moody's equivalent.

^g By S&P or Fitch, or Moody's equivalent.

29. Eligible instruments and all other components of the investment guidelines are approved and updated by the President. Investment guidelines are incorporated into each investment management agreement and will include at least the following components:

- (a) Investment objectives: defining expected return and risk;
- (b) Risk budget (tracking error, etc.);
- (c) Base currency: typically United States dollar;

- (d) Performance benchmark;
 - (e) Eligible currencies;
 - (f) Eligible instruments;
 - (g) Minimum and maximum portfolio duration;
 - (h) Credit quality;
 - (i) Diversification requirements; and
 - (j) Clearing for futures and options.
30. The benchmarks identified in the investment guidelines must meet the following criteria: (i) unambiguous, transparent and simple; (ii) investable and replicable; (iii) measurable and stable; (iv) appropriate to the investment purpose; (v) reflective of current investment opinions; and (vi) specified in advance.
31. Each investment portfolio will have a performance benchmark.

E. Unique circumstances

32. IFAD does not use any form of leverage⁸ and does not use derivatives contracts to leverage positions in the investment portfolio.
33. IFAD's investment portfolio is unique in that its operational cash is integral as one distinct portfolio, rather than managed separately as working capital.
34. The time horizon for IFAD's investment portfolio is driven by conservation of portfolio value, the MLR (see paragraph 63) and the sustainable cash flow framework.⁹ The overall portfolio will consist of individual investment portfolios that have a short-term, a medium-term and a longer-term investment horizon. As the investments are fully committed, management of investments and their time horizon need to be linked to and guided by IFAD's short-term liquidity needs (MLR), the IFAD business cycle of lending commitments, which covers a replenishment period (medium term) as well as the sustainable cash flow framework (long term).

F. Foreign currency management

Special drawing right (SDR) alignment

35. The majority of IFAD's commitments are expressed in special drawing rights (SDRs). Consequently, the Fund's overall assets are maintained so as to ensure that commitments for undisbursed loans and grants denominated in SDR 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 that currency.
36. 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.

Currency overlay

37. IFAD may externally hire a currency overlay manager to facilitate currency alignment and to separate currency management from the responsibilities of

⁸ Leverage is defined as a level in excess of capital invested in that asset or exposure to any asset in excess of the market value appreciation of the asset.

⁹ **EB 2013/108/R.20**

individual external and internal investment managers, provided that it is more cost-effective to centralize currency alignment by appointing a focal point manager than to decentralize the alignment across individual portfolio managers.

G. Tax considerations and other privileges and immunities

38. Pursuant to article 10 of the Agreement Establishing IFAD (AEI), 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.
39. The privileges and immunities referred to in article 10, section 2(a) of the AEI are set forth in the Convention on Privileges and Immunities of the Specialized Agencies of the United Nations and in annex XVI thereof. Accordingly, article 10, section 2(b) (i) and (ii) of the AEI provide that, in the case of Member States that have ratified the said convention, the privileges and immunities referred to in article 10, section 2(a) shall be defined in the standard clauses of that convention as modified by an annex thereto, approved by IFAD's Governing Council.
40. In particular, the Convention provides that the property and assets of the Fund, wherever located and by whomsoever held, shall be immune from search, requisition, confiscation, expropriation and any other form of interference, whether by executive, administrative, judicial or legislative action. Moreover, the Fund 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. Furthermore, the Fund is exempt from all direct taxes on its assets, income and property.¹⁰

IV. Risk management framework and performance measurement

A. Risk management framework, risk budgeting, decision-making process

Risk management framework

41. IFAD's investments are subject to a number of risk types: interest rate, currency, credit, liquidity and operational risks (see section IV.B.). These risks are measured on a monthly basis with appropriate risk metrics either provided by the custodian or derived from internal analyses.
42. The President will ensure that appropriate organizational units are made responsible for managing, monitoring, analysing and assessing risks and reporting risk levels.

Risk budgeting

43. Risk budgeting is the procedure of allocating risk within funds. It entails setting predetermined risk limits for the investment portfolio – on an overall level as well as at the level of individual investment portfolios. These measures are monitored and the portfolio adjusted whenever they exceed the tolerance level. In more detail, risk budgeting is the process of:
 - (a) Measuring and decomposing the aggregate risk of a portfolio into its constituents on a quantitative basis;
 - (b) Setting risk limits (risk budgets) for the overall investment portfolio and each individual investment portfolio ex ante through the definition of ranges of selected risk metrics in line with the investor's risk appetite and tolerance level;

¹⁰ Article III, Convention on Privileges and Immunities of the Specialized Agencies of the United Nations.

- (c) Allocating risks across the assets in compliance with risk budgets;
 - (d) Monitoring the use or abuse of risk budgets on an ongoing basis;
 - (e) Analysing the results (ex post); and
 - (f) Changing investments when necessary to align the portfolio with the desired risk level.
44. The risk budget for the overall portfolio (see annex I) is approved and adopted by the Executive Board. The risk budget for individual investment portfolios, which also represents the maximum risk budget for individual portfolio managers (see annex II),¹¹ is approved by the President. For selected risk types, risk budgets are also established by the President with due regard to IPS objectives.
45. The President will ensure that the adequacy of risk-budgeting measures and their tolerance levels are constantly monitored and reviewed on a quarterly basis. As part of the report on IFAD's investment portfolio, the Executive Board will receive updates on overall portfolio and individual investment portfolio risk levels versus established risk budgets, and will be informed of any adjustments to be made to align with agreed risk levels.
46. IFAD's external asset managers will engage in active management, consistent with the risk budget 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 management 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.

Decision-making process for establishing and rebalancing the portfolio allocation in line with risk tolerance limits

47. 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.
48. 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.
49. 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.
50. Any risk-mitigating measure(s) taken will be reported to the Executive Board as part of the report on IFAD's investment portfolio.

B. Risk types and metrics

51. The President will ensure that analyses are performed and reports prepared on the following risks.

Interest rate risk

52. Interest rate risk, including volatility risk, is monitored for the overall portfolio and for single managers based on measures provided on a monthly basis by the

¹¹ The investment guidelines for an individual investment manager can authorize a smaller but not a higher risk budget than the applicable investment portfolio.

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.

53. The data provided by the custodian might be complemented by internal analyses on single securities performed through the use of sources such as Bloomberg.

Credit risk

54. 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.

Counterparty risk

55. 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.

Currency risk

56. Currency risk is managed on an asset/liability management basis and monitored through the SDR currency alignment procedure. The majority of IFAD's commitments, i.e. undisbursed loans and grants, are denominated in SDR. Thus, to the extent possible, IFAD maintains a portion of its assets (the investment portfolio, promissory notes and contribution receivables) in the currencies and ratios of the SDR. Similarly, the General Reserve and commitments for grants denominated in United States dollars are matched by assets denominated in that currency.
57. Monitoring of the status of alignment to the SDR valuation basket is performed on a monthly basis.
58. The currency risk measure is the percentage of misalignment of the assets for each of the SDR currencies.
59. 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.

Liquidity risk

60. Liquidity risk is addressed through the minimum liquidity requirement. The MLR must be available at any point in time to ensure IFAD's ability to meet its disbursement obligations.

Operational risk

61. Operational risk includes all risk sources other than those stated above, including business continuity and legal risk.
62. The President will ensure that any legal risk is assessed by the Office of the General Counsel.

63. The President will ensure that procedural risk is addressed by establishing a clearly defined framework of responsibility and accountability within IFAD's financial structure.

C. Performance measurement and reporting

Performance measurement

64. The custodian calculates performance of the overall investment portfolio and of single internally and externally managed portfolios and provides these on a monthly basis.
65. Performance of the overall investment portfolio and single externally managed portfolios is calculated both in United States dollars and in local currency equivalents, i.e. by stripping out the effect of fluctuations of the currencies in which the portfolio is invested. Performance accounts for coupon and price return and includes realized and – if not a held-to-maturity portfolio – unrealized gains/losses.
66. Performance is compared with the relative benchmark indices for all mandates, and out- and underperformances are highlighted in the reports.
67. The performance of single managers is calculated on a "gross of fees" basis. Fees are deducted from the overall portfolio performance, which is shown on gross and net bases, net of management custody and transaction costs.
68. The custodian also provides risk-adjusted return measures on the overall portfolio and by manager, including the Sharpe Ratio, Tracking Error and Information Ratio, and Beta, Alpha and R Squared.
69. On a quarterly basis, the custodian provides performance attribution analysis for externally managed portfolios.

Performance reporting

70. 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.
71. The overall portfolio and benchmark performance in local currency terms will be reported to the Executive Board in the report on IFAD's investment portfolio. The report will include comparative performance figures for the previous quarters and previous year.
72. 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.

D. Monitoring of compliance

73. 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.¹²

¹² Internal operational cash is held in central banks and in two competitively contracted corporate banks. Compliance relates to the commercial banks' ratings and to maximum exposure to a single bank.

This annex is an integral part of IFAD's Investment Policy Statement.

Risk budget – overall investment portfolio

I. Key risk measures

- Conditional value-at-risk (CVaR) at 95 per cent confidence level over a one-year horizon (1-year CVaR): CVaR is the average investment (nominal) loss in the 5 per cent of worst case scenarios of the overall portfolio over a one-year horizon. This measure quantifies the distribution of losses in the 5 per cent left tail and is an indicator of so-called "tail risk".

II. Risk tolerance levels

- 1-year CVaR at 95 per cent confidence level. Budget level: Maximum 6.0 per cent of total portfolio market value.
If the CVaR level hits 6.0 per cent of total portfolio market value, steps will be taken to reduce the risk level, including but not limited to steps to rebalance the individual investment portfolios' allocations.

This annex is for information only.

Risk budget – individual investment portfolios

The risk budget for individual investment portfolios also represents the maximum risk budget for individual portfolio managers per mandate.

I. Key risk measures

- Ex ante tracking error (one-year forward-looking): A measure of how closely a portfolio is expected to track its benchmark. A higher tracking error indicates larger expected deviations.
- Conditional value-at-risk (CVaR) at 95 per cent confidence level over a one-year horizon: CVaR is the average investment (nominal) loss in the 5 per cent of worst case scenarios of the investment portfolio over a one-year horizon. This measure quantifies the distribution of losses in the 5 per cent left tail and is an indicator of tail risk.

II. Risk tolerance level

- Ex ante tracking error (one-year forward-looking)
 - Global government bond portfolio: maximum 1.5 per cent
 - Inflation-indexed bond portfolio: maximum 2.5 per cent
 - Diversified fixed-income portfolio: maximum 3.0 per cent
 - Emerging market bond portfolio: maximum 4.0 per cent
- 1-year CVaR at 95 per cent confidence level
 - Global government bond portfolio: 4.0 per cent
 - Inflation-indexed bond portfolio: 9.0 per cent
 - Diversified fixed-income portfolio: 15.0 per cent
 - Emerging market bond portfolio: 27.0 per cent

This annex is for information only.

Policy asset allocation

Current policy asset allocation within IFAD’s risk budget, as shown below, is subject to change should the risk profile of the overall portfolio so require:

	Allocation	Range within risk budget
Operational cash	7 per cent	+/- 5 per cent
Global Strategic	17 per cent	+/- 5 per cent
Global government bonds	36 per cent	+/- 5 per cent
Global diversified fixed income	10 per cent	+/- 5 per cent
Global inflation indexed fixed income	20 per cent	+/- 5 per cent
Emerging market debt	10 per cent	+/- 5 per cent