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Investing in rural people

Report on IFAD's investment portfolio for 2015

Note to Executive Board representatives

Focal points:

Technical questions:

Shahin Lauritzen
Associate Vice-President,
Chief Financial Officer and Chief Controller
Financial Operations Department
Tel.: +39 06 5459 2403
e-mail: s.lauritzen@ifad.org

Domenico Nardelli
Director and Treasurer
Treasury Services Division
Tel.: +39 06 5459 2251
e-mail: d.nardelli@ifad.org

Dispatch of documentation:

Alessandra Zusi Bergés
Officer-in-Charge
Governing Bodies Office
Tel.: +39 06 5459 2092
e-mail: gb_office@ifad.org

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For: Information

Report on IFAD's investment portfolio for 2015

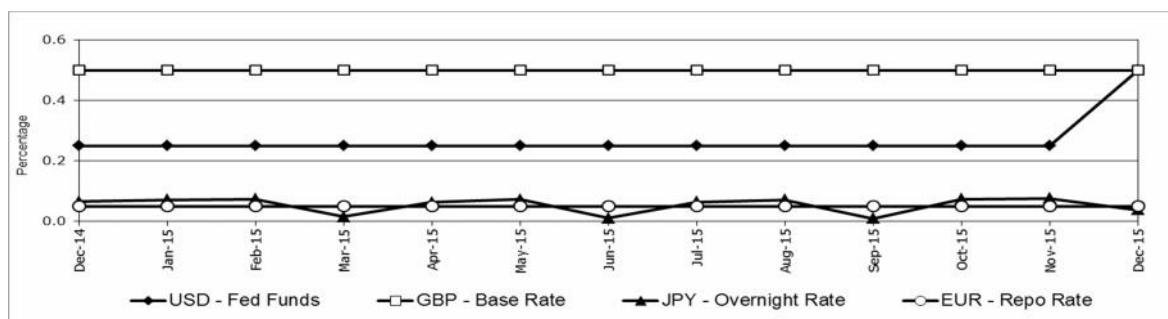
I. Executive summary

1. The value of IFAD's investment portfolio in United States dollar terms decreased by US\$171.6 million, from US\$1,685.3 million at 31 December 2014 to US\$1,513.7 million at 31 December 2015. The main factors for this decrease were net outflows, negative foreign exchange movements and a relatively flat return resulting in a small investment loss.
2. In 2015, IFAD's investment portfolio generated a negative net rate of return of 0.06 per cent translating into an investment loss of US\$2.3 million.

II. Market conditions

3. Chart 1 shows the evolution of central bank interest rates for special drawing rights (SDR) countries in 2015.

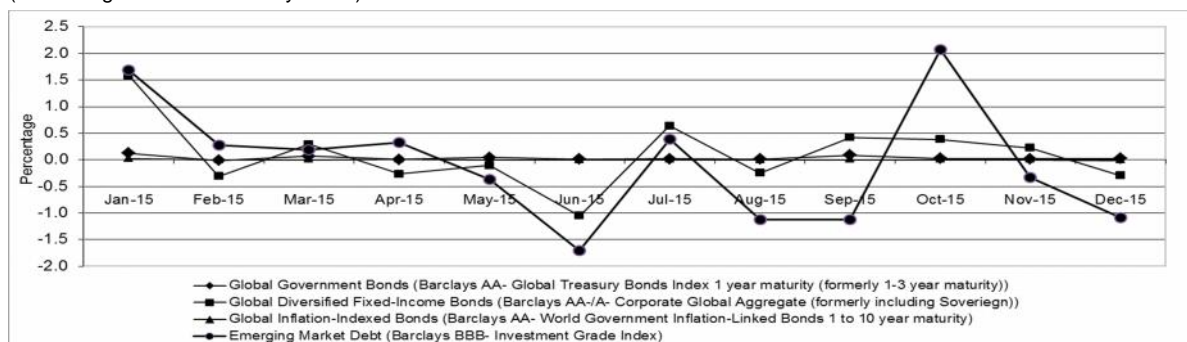
Chart 1
Central bank interest rates in 2015



Source: Bloomberg.

4. Chart 2 shows the monthly performance of benchmark indices applied to IFAD's externally managed portfolios in 2015.

Chart 2
Fixed-interest market developments in 2015
(Percentages in local currency terms)



Source: Barclays.

5. The global government bond asset class registered a slightly positive performance of 0.05 per cent in 2015. Government bond yields stayed at historically low levels while market volatility increased significantly. Divergent monetary policies remained a dominant theme in the global financial environment.
6. The global corporate fixed-income asset class generated a positive return of 1.17 per cent, benefiting from investors' demand for higher yielding investments, continued central bank support and improving economic data in the United States.

7. The global inflation-indexed asset class performed negatively as global inflation remained weak despite recovery in the US economy and mainly due to falling crude oil and other commodity prices.
8. Following a strong return in 2014, the emerging market debt asset class registered the lowest performance among IFAD's asset classes. The sector was negatively affected by expectations of rate increases in the United States, declining oil prices and uncertainty regarding China's economy.
9. The new Asset Liability Portfolio (ALP), was created in early 2015 to receive funds from the loan extended to IFAD by KfW Development Bank. The benchmark for this portfolio was set at the rate payable on the loan. The portfolio was funded in the first quarter and was invested in subsequent months. Thus the performance of the portfolio does not reflect a full year cycle at the end of 2015.
10. In 2015, the United States dollar appreciated against the euro (+11.98 per cent), the British pound sterling (+5.57 per cent) and the Japanese yen (+0.77 per cent). This resulted in large foreign exchange movements in IFAD's investment portfolio (see table 1).

III. Investment policy statement review

11. The yearly review of IFAD's Investment Policy Statement (IPS) was presented at the 116th session of the Executive Board in December 2015.
12. The main changes recommended related to diversifying the investment portfolio from a fixed-income universe by allowing for the introduction of developed market equities, creating an additional source of income through securities lending and defining allowed derivative instruments for hedging, among other currency swaps to enhance IFAD's ability to hedge against risk exposure associated with exchange rate fluctuations.

IV. Asset allocation

13. During 2015, the value of the investment portfolio in United States dollar terms decreased by US\$171.6 million. This was the result of net outflows of US\$97.6 million, negative foreign exchange movements of US\$71.7 million and net investment income of negative US\$2.3 million.
14. Outflows of US\$255.8 million from the operational cash portfolio were offset by funds deposited into the asset liability portfolio of US\$158.2 million (inflows) generating a net outflow amount of US\$97.6 million on an overall level.
15. Internal transfers in 2015 included the liquidation of US\$125.0 million from the global government bond portfolio, US\$75.0 million from the global inflation-indexed bond portfolio and US\$61.6 million from the global strategic portfolio, to cover disbursement needs in the operational cash portfolio.

Table 1

Movements affecting IFAD's asset allocation within the portfolio in 2015

(Thousands of United States dollars equivalent)

	<i>Operational cash^a</i>	<i>Global strategic portfolio</i>	<i>Asset liability portfolio</i>	<i>Global government bonds</i>	<i>Global credit bonds</i>	<i>Global inflation-indexed bonds</i>	<i>Emerging market debt bonds</i>	Total
Opening balance (31 December 2014)	55 847	280 749	-	515 232	254 158	355 301	223 997	1 685 284
Net investment income ^b	(23)	4 222	(1 136)	(964)	1 755	(2 756)	(3 428)	(2 330)
Internal transfers	261 640	(61 640)	-	(125 000)	-	(75 000)	-	-
Transfers due to expense allocation	(3 029)	159	35	825	581	705	724	-
Net flows ^c	(255 791)	-	158 171	-	-	-	-	(97 620)
Foreign exchange movements	(2 645)	(10 914)	(5 231)	(25 694)	(9 622)	(15 028)	(2 535)	(71 669)
Closing balance (31 December 2015)	55 999	212 576	151 839	364 399	246 872	263 222	218 758	1 513 665
Actual asset allocation (percentage)	3.7	14.0	10.0	24.1	16.3	17.4	14.5	100.0
Investment asset allocation ^d (percentage)	6.3	15.3	10.0	32.4	9.0	18.0	9.0	100.0
Difference in allocation (percentage)	(2.6)	(1.3)	-	(8.3)	7.3	(0.6)	5.5	-

^a Cash held with banks, readily available for disbursing loans, grants and administrative expenses.^b Investment income is detailed further in table 2.^c Net flows consist of outflows for disbursements for loans, grants and administrative expenses and inflows from loan reflows and encashment of Member State contributions.^d The investment asset allocation is adjusted towards the asset liability portfolio actual allocation which is denominated in Euro (and reported in United States dollars) and not part of the prescribed investment asset allocation.

V. Investment income

16. Gross investment income in 2015 amounted to US\$0.8 million, whilst net investment income inclusive of all investment-related fees (US\$3.1 million) amounted to negative US\$2.3 million. Table 2 presents a summary of the 2015 investment income broken down by asset class.

Table 2

Breakdown of IFAD's investment income by asset class in 2015

(Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Global strategic portfolio</i>	<i>Asset liability portfolio</i>	<i>Global government bonds</i>	<i>Global credit bonds</i>	<i>Global inflation-indexed bonds</i>	<i>Emerging market debt bonds</i>	Total
Interest from fixed-income investments and bank accounts	79	4 926	410	5 574	8 200	2 346	10 227	31 762
Realized market losses	-	-	(72)	(4 288)	1 435	(490)	(4 647)	(8 062)
Unrealized market gains	-	-	(1 439)	(1 425)	(7 298)	(3 907)	(8 284)	(22 353)
Amortization [*]	-	(546)	-	-	-	-	-	(546)
Investment income before fees	79	4 380	(1 101)	(139)	2 337	(2 051)	(2 704)	801
Investment manager fees	-	-	-	(492)	(421)	(520)	(580)	(2 013)
Custody and bank charges	(102)	(33)	(11)	(119)	(43)	(42)	(37)	(387)
Financial advisory and other investment-related fees	-	(125)	(24)	(214)	(118)	(143)	(107)	(731)
Investment income after fees	(23)	4 222	(1 136)	(964)	1 755	(2 756)	(3 428)	(2 330)

^{*} 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.

VI. Rate of return

17. The rate of return on 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).
18. The investment portfolio returned negative 0.06 per cent in 2015, net of all investment-related expenses, underperforming the benchmark by 22 basis points.

Table 3

Quarterly gross performances together with annual performances versus benchmarks in 2015

(Percentages in local currency terms)

	2015 quarterly and annual performances and benchmarks						Difference
	First quarter	Second quarter	Third quarter	Fourth quarter	Annual 2015	Benchmark* 2015	
Operational cash	0.04	0.04	0.03	0.02	0.13	0.13	0.00
Global strategic portfolio	0.41	0.42	0.44	0.46	1.75	1.12	0.63
Asset liability portfolio	0.01	(1.91)	1.02	0.10	(0.78)	0.31	(1.09)
Global government bonds	0.21	(0.39)	0.11	0.12	0.05	0.43	(0.38)
Global credit bonds	1.44	(1.25)	0.34	0.65	1.17	1.25	(0.08)
Global inflation-indexed bonds	1.38	(0.53)	(0.79)	(0.90)	(0.85)	(0.51)	(0.34)
Emerging market debt bonds	2.35	(1.93)	(2.15)	0.62	(1.17)	(0.86)	(0.31)
Gross rate of return (excluding fees)	0.96	(0.72)	(0.25)	0.13	0.13	0.35	(0.22)
Net rate of return (including fees)	0.91	(0.76)	(0.30)	0.09	(0.06)	0.16	(0.22)

* For the Asset liability portfolio the benchmark represents the cost of funding and does not reflect the investment universe allowed by the guidelines.

Note: The Asset liability portfolio was funded on 19 February 2015 and performances are reported from this date. Performances for individual portfolios are gross of investment fees.

19. Table 4 presents IFAD's historical portfolio performances, which have consistently outperformed the assigned benchmarks.

Table 4

IFAD's historical portfolio and benchmark performances

(Percentages in local currency terms)

	One year	Three years	Five years
Portfolio net performance	(0.06)	0.46	1.65
Benchmark performance	0.16	0.41	1.62
Excess return	(0.22)	0.05	0.03

20. For comparative purposes, table 5 presents the annual performance results generated by the investment portfolio during the previous four years.

Table 5

Annual performance versus benchmark from 2011 to 2014 for comparative purposes

(Percentages in local currency terms)

	2014		2013		2012		2011	
	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark
Operational cash	0.11	0.11	0.07	0.07	0.12	0.12	0.56	0.56
Global strategic portfolio	1.80	1.44	2.13	1.94	3.41	2.94	2.91	3.56
Global government bonds	0.77	0.42	0.34	0.16	1.63	1.51	2.42	2.36
Global credit portfolio	6.13	5.37	(0.04)	(0.32)	4.31	3.46	7.28	7.67
Global inflation-indexed bonds	2.35	2.05	(4.23)	(3.99)	4.73	6.13	6.97	6.84
Emerging market debt bonds	9.44	9.10	(7.49)	(6.54)	6.01	4.83	n.a.	n.a.
Gross rate of return (excluding fees)	2.74	2.24	(0.95)	(0.83)	3.28	3.16	4.01	4.13
Net rate of return (including all fees)	2.58	2.08	(1.11)	(0.99)	3.11	2.99	3.82	3.94

VII. Composition of the portfolio by instrument

21. Table 6 shows the composition of the investment portfolio by instrument at 31 December 2015 and 2014.

Table 6

Composition of investment portfolio by instrument at 31 December 2015 and 2014

(Thousands of United States dollars equivalent)

	31 December 2015	31 December 2014
Cash ^a	131 255	82 217
Time deposits ^b	369	142 097
Global government bonds and agencies	971 644	1 199 733
Government mortgage-backed securities (MBSs) ^c	12 252	18 082
Corporate bonds	397 318	245 893
Unrealized market gains/(losses) on forward contracts	3 797	(2 594)
Unrealized gains on futures	8482	941
Subtotal: cash and investments	1 525 117	1 686 369
Payables for investments purchased	(11 452)	(1 085)
Total	1 513 665	1 685 284

^a Includes cash in non-convertible currencies amounting to US\$46,000 equivalent (US\$48,000 in 2014).^b Includes time deposits in non-convertible currencies amounting to US\$369,000 equivalent (US\$384,000 in 2014).^c Government MBSs in IFAD's investment portfolio require an AAA rating by at least two credit rating agencies.

VIII. Risk measurements

22. The risk-budgeting measures used are the conditional value-at-risk (CVaR) and the ex ante tracking error, which are reported in subsections B and C. Other risk indicators are reported in subsections A, D, E and F.

A. Market risk: Duration

23. Duration is a measure of the sensitivity of the market price of a fixed-income investment to a change in interest rates. IFAD assesses the optimal duration for each asset class in line with risk budget levels and the benchmark duration limits set in IFAD's investment guidelines.

Table 7

Effective durations of IFAD's investment portfolio and benchmarks at 31 December 2015 and 2014
(Duration in number of years)

	31 December 2015		31 December 2014	
	Portfolio	Benchmark	Portfolio	Benchmark
Asset liability portfolio	2.75	n.a.	n.a.	n.a.
Global government bonds	0.83	0.95	0.74	0.97
Global credit bonds	4.19	4.60	4.04	4.57
Global inflation-indexed bonds	6.25	5.31	5.40	5.19
Emerging market debt bonds	6.62	6.48	7.17	6.98
Total portfolio (including global strategic portfolio and operational cash)	3.49	2.85	2.93	2.54

Note: The total portfolio duration is lowered by the global strategic portfolio which is reported at amortized cost and not subject to fluctuations in market prices and the operational cash portfolio which is also not subject to fluctuations in price. The asset liability portfolio is managed internally and has a zero duration benchmark.

24. The overall portfolio duration was 3.49 years (2.93 years in 2014) which is an overall conservative positioning.

B. Market risk: Conditional value at risk

25. The one-year CVaR at 95 per cent is a measure of the potential average probable loss of a portfolio under extreme conditions and gives an indication of how much value a portfolio could lose over a forward-looking one-year horizon with a 95 per cent confidence level. To derive this measure the portfolio is revalued (stressed) by assuming a large number of concurrent market condition scenarios.
26. The IFAD portfolio risk budget level maximum is defined in the IPS as a CVaR of 6.0 per cent. The CVaR for the current IFAD portfolio is 3.34 per cent which means that the average loss of the overall portfolio under extreme market conditions could be US\$51 million.

Table 8

CVaRs of IFAD's current asset classes at 31 December 2015 and 2014

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

	Actual investment portfolio one-year CVaR		One-year CVaR IPS budget level
	31 December 2015	31 December 2014	
Asset liability portfolio (excluding cash)	6.68	n.a.	8.00
Global government bonds	0.75	0.87	4.00
Global credit bonds	4.93	4.46	15.00
Global inflation-indexed bonds	7.15	5.74	9.00
Emerging market debt bonds	7.89	9.99	27.00
Total portfolio (including global strategic portfolio and cash)	3.34	2.56	6.00

27. The CVaRs of all single asset classes and that of the overall portfolio were well below the prescribed risk budget levels but slightly higher than in 2014.

C. Market risk: Ex ante tracking error

28. The ex ante tracking error gives an indication of how different an active strategy is from its benchmark.

Table 9

IFAD's investment portfolio ex ante tracking error at 31 December 2015 and 2014 (Percentages)

	<i>Actual investment portfolio</i>		<i>IPS budget level</i>
	<i>31 December 2015</i>	<i>31 December 2014</i>	
Global government bonds	0.38	0.40	1.50
Global credit bonds	0.73	0.52	3.00
Global inflation-indexed bonds	0.66	0.35	2.50
Emerging market debt bonds	0.70	0.73	4.00

Note: The asset liability portfolio does not have a benchmark as performance is tracked against the cost of funding. The portfolio tracking error is therefore not defined for this portfolio as it would not be representative of the actual portfolio universe allowed by the guidelines.

29. Current levels of ex ante tracking errors of individual portfolios are below the prescribed budget levels indicating a close resemblance between the portfolio strategy and the benchmark indices.

D. Credit risk: Credit rating analysis

30. IFAD's IPS establishes a policy credit rating floor. Credit risk is managed through the monitoring of securities in accordance with investment guidelines, which may foresee stricter credit quality requirements than those contained in the IPS.

Table 10

Investment portfolio compositions by credit ratings^a at 31 December 2015 (Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Global strategic portfolio</i>	<i>Asset liability portfolio</i>	<i>Global government bonds</i>	<i>Global credit bonds</i>	<i>Global inflation-indexed bonds</i>	<i>Emerging market debt</i>	<i>Total</i>	<i>Percentage</i>
AAA	-	102 206	15 193	256 626	15 221	203 741	4 410	597 397	39.4
AA+/-	-	61 884	40 091	95 196	33 607	52 626	46 919	330 323	21.8
A+/-	-	47 120	31 312	-	172 784	-	36 244	287 460	19.0
BBB+/-	-	500	10 996	-	23 843	-	130 696	166 035	11.0
Cash ^b	56 000	865	54 247	14 837	2 392	5 657	6 108	140 106	9.3
Pending trades ^c	-	-	-	(2 260)	(974)	1 197	(5 619)	(7 656)	(0.5)
Total 2015	56 000	212 575	151 839	364 399	246 873	263 221	218 758	1 513 665	100.0
Total 2014	55 847	280 749	n.a.	515 232	254 158	355 301	223 997	1 685 284	100.0

^a In accordance with IFAD's current investment guidelines, the credit ratings used in this report are based on the best credit ratings available from the Standard and Poor's (S&P), Moody's or Fitch rating agencies.

^b Consists of cash and cash equivalents with central banks and approved commercial banks and cash held by external portfolio managers. These amounts are not rated by credit rating agencies.

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

E. Currency risk: Currency composition analysis

31. 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 as the Fund's commitments, i.e. in SDR.

32. At 31 December 2015, the net asset value amounted to US\$1,821.0 million.

Table 11

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^b</i>	<i>Euro group^c</i>	<i>Yen</i>	<i>Pound sterling</i>	<i>Total</i>
Cash and investments ^a	763 626	363 751	76 139	157 895	1 361 411
Promissory notes	82 868	-	49 106	-	131 974
Contribution receivables from Member States	239 576	189 255	24 458	84 126	537 415
Less: commitments not denominated in SDR	(207 105)	(2 699)	-	-	(209 804)
Net asset amount	878 965	550 307	149 703	242 021	1 820 996
Net asset amount (percentage)	48.3	30.2	8.2	13.3	100.0
SDR weights (percentage)	47.7	33.2	7.3	11.8	100.0
Difference (percentage)	0.6	(3.0)	0.9	1.5	0.0

^a The difference in the cash and investments balance compared with other tables derives from the exclusion of assets in non-convertible currencies (US\$415,000 equivalent) and the asset liability portfolio (US\$151.8 million equivalent) as the latter is not subject to the SDR currency alignment as it is maintained in euros in line with its commitments for loans.

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

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

F. Liquidity risk: Minimum liquidity requirement

33. IFAD's liquidity risk is addressed through the minimum liquidity requirement (MLR). IFAD's liquidity policy¹ states that IFAD's investment portfolio should remain above 60 per cent of the projected annual gross disbursement level including additional requirements due to liquidity shocks.
34. IFAD's latest financial model assumptions, incorporating 2015 resources available for commitment under the sustainable cash flow approach, calculate an MLR of US\$680.0 million (60% of gross annual outflows),² which is comfortably cleared by IFAD's investment portfolio balance of US\$1,513.7 million (see table 1).

¹ EB 2006/89/R.40

² EB 2015/116/R.13