Document:	EB 2016/119/R.36/Add.2
Agenda:	19(c)
Date:	2 November 2016
Distribution:	Public
Original:	English

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Summary of amendments and updates to the 2017 IFAD Investment Policy Statement and the Internal Control Framework for IFAD Investments

Note to Executive Board representatives

Focal points:

Technical questions:

Michel Mordasini
Vice-President
Tel.: +39 06 5459 2518
e-mail: m.mordasini@ifad.org

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

Dispatch of documentation:

William Skinner
Chief
Governing Bodies Office
Tel.: +39 06 5459 2974
e-mail: gb_office@ifad.org

Executive Board — 119th Session
Rome, 14-15 December 2016

For: Information

Summary of amendments and updates to the 2017 IFAD Investment Policy Statement and the Internal Control Framework for IFAD Investments

1. The IFAD Investment Policy Statement (IPS) and the Internal Control Framework (ICF) for IFAD Investments are reviewed yearly by Management and findings are presented to the Executive Board at its December session.

2. This addendum provides a summary overview of proposed amendments for approval and updates presented for information, in response to a suggestion from the governing bodies to facilitate the review of the IPS and ICF.

I. IPS review

3. The proposed 2017 IPS incorporates the following amendments and updates in addition to minor edits:

   - New eligible instrument within the fixed-income asset class (paragraph 28(f) for approval);
   - Update of the risk budget for individual investment portfolios with parameters for two new portfolios (annex II - for information); and
   - Restatement of the policy asset allocation (annex III - for information).

New eligible instrument

4. In order to increase diversification, covered bonds have been included as an eligible instrument in the fixed-income asset class (paragraph 28[f]). They are considered an appropriate addition to the IFAD fixed-income universe given their low risk profile which stems from a double layer of default protection. In addition to being backed by the issuer, these bonds are also secured by a pool of assets.

Update of the risk budget for individual portfolios

5. In order to manage liquidity more efficiently, a global liquidity portfolio was created in 2016. Given the introduction of the Chinese renminbi (RMB) to the special drawing rights (SDR) basket of currencies in October 2016, an RMB portfolio is expected to be implemented as soon as feasible.

6. Annex II has been updated with the relevant new portfolio risk tolerance levels (ex ante tracking error and conditional value at risk [CVaR]). The risk parameters of all other portfolios remain unchanged.

Restatement of the policy asset allocation

7. In order to more clearly represent IFAD's risk exposures, risks associated with an asset class have been consolidated under the related asset class name instead of individual portfolio names. Consequently, the allocation for the global strategic portfolio has been assigned to the global government and global credit bonds asset classes reflecting the composition of the portfolio.

8. As it is deemed unlikely that market conditions will favour an entry point in 2017 to the global developed market equities asset class, the related allocation has been reassigned to global government bonds.

9. Operational cash is no longer considered a policy asset class and the allocation to cash has been assigned to global government bonds. Operational liquidity is actively managed in the new global liquidity portfolio invested in government bonds and cash is kept at a minimum.

10. The range around the asset allocation is widened to 10 per cent (from 5 per cent) to provide more tactical flexibility in the management of portfolios given the continuing uncertain market conditions.

11. The restatement of the asset allocation described above has resulted in a shift of weights of asset classes but continues to reflect the same investment strategy and has not materially changed the underlying risk.

12. It is important to note that the 2017 asset allocation has been tested using the new 10 per cent range, including a number of risk scenarios. The proposed asset allocation has a slightly lower CVaR than the current actual portfolio, and stress scenarios in all cases result in overall portfolio risk comfortably below the IFAD risk budget of 6 per cent CVaR.

II. ICF review

13. In addition to the annual review of the document, the proposed 2017 ICF has been amended to reflect the following organizational changes:

- The new organizational structure of the Financial Operations Department and the redistribution of the responsibilities and duties of the Controller’s and Financial Services Division (CFS) into two divisions: the Financial Management Services Division (FMD) and the Accounting and Controller’s Division (ACD);
- The incorporation of the Financial Planning and Analysis Unit (FPA) into the Portfolio Planning Team (PPL) within the Treasury Services Division (TRE); and
- The delineation of duties for the segregated risk and compliance function.

14. The allowed flexibility in the alignment of assets to the SDR currency ratios has been increased from the current 2.5 per cent to 10 per cent. This will facilitate the management of currency risks by reducing the need for frequent foreign exchange transactions triggered only by market volatility and related short-term currency movements. Transaction costs and operational risks associated with such transactions will also be reduced and positively impact the overall efficiency of currency management.