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## IFAD's Investment Policy Statement

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For: Approval

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## Acronyms and abbreviations

ALM	Asset Liability Management
FISCO	Investment and Finance Advisory Committee of IFAD
IPS	Investment Policy Statement
MLR	minimum liquidity requirement

## Preamble

1. The present Investment Policy Statement is adopted to establish fundamental directives for the placement or investment of IFAD cash funds not needed immediately for operations or administrative expenditures. Such directives also aim at ensuring that financial counterparts abide, as far as possible and within the objective and functions set forth in the Agreement Establishing IFAD (the Fund), by the Principles of the United Nations Global Compact.
2. 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.<sup>1</sup>

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<sup>1</sup> Detailed organizational structure and roles and responsibilities are outlined in the document Internal Control Framework for IFAD Investments.

## 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 Investment Policy Statement (IPS) has been drafted in accordance with the Chartered Financial Analyst (CFA) Institute's<sup>2</sup> Elements of an Investment Policy Statement for Institutional Investors,<sup>3</sup> which suggest desirable components of an investment policy statement 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.<sup>4</sup> The purpose of this IPS is to document the Fund'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. The present document is accordingly 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 came into existence on 30 November 1977, when the Agreement Establishing IFAD 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. This IPS governs the investments of the Fund's resources that are derived from regular replenishments and/or are used for commitments of loans and grants under IFAD's regular programme. It will also serve as a framework for investments of other cash funds entrusted to and managed by the Fund and will complement any gaps left uncovered by separate policies and guidelines established to govern such other assets.

<sup>2</sup> 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](http://www.cfainstitute.org)).

<sup>3</sup> CFA Institute, Elements of an Investment Policy Statement for Institutional Investors (May 2010), [www.cfapubs.org/doi/abs/10.2469/ccb.v2010.n13.1](http://www.cfapubs.org/doi/abs/10.2469/ccb.v2010.n13.1).

<sup>4</sup> The application and paramount considerations on investment of funds are described in regulation VIII of the Financial Regulations of IFAD.

## B. Actors and their roles

### Governing Council

The Governing Council is IFAD's highest decision-making authority. Each Member State is represented in the Governing Council and all the powers of the Fund are vested in the Governing Council. Subject to the limitations stated in the Agreement Establishing IFAD, the Governing Council may delegate powers to the Executive Board.<sup>5</sup>

### Executive Board

The Executive Board 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, among other matters, 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. Based on his/her authority to organize staff, from time to time the President configures IFAD's organizational structure. The President may place or invest cash funds, not needed immediately for the Fund's operations or administrative expenditures.

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 – the Investment and Finance Advisory Committee (FISCO).

Discussion forum. Discussion, review and analysis of technical and operational issues in a broad investment and financial context, is included in the mandate of the Financial Operations Department Management Group.

## II. Governance

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

6. The President will ensure implementation and monitoring of all aspects of the IPS.

### B. Process for reviewing and updating the investment policy

7. 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

8. Acting under regulation XIV of the Financial Regulations and in implementation of regulation VIII thereof, the President shall approve and adopt investment guidelines for managing each investment portfolio with due regard to the IPS.

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<sup>5</sup> Article 6 of the Agreement Establishing IFAD defines the powers that may be delegated by the Governing Council.

- D. Responsibilities for engaging and discharging external investment managers, the custodian bank(s) and other financial advisers
9. The President is responsible for the appointment and dismissal of external investment managers, the custodian bank(s) and other financial advisers required to execute the Fund's investments.
  10. For the selection of external investment managers, the custodian bank and other financial advisers, the President will follow a selection process governed by IFAD's corporate procurement guidelines.
  11. External investment managers must fulfil the following initial requirements in order to be considered for the selection process:
    - (a) Investment managers must clearly articulate the investment strategy that they will follow and document that such strategy has been adhered to over time.
    - (b) Investment managers must, in all countries in which they operate, adhere to the governing legislation and regulation concerning financial services, including the authority of the competent regulatory bodies;
    - (c) Investment managers should endeavour to comply with the Global Investment Performance Standards (GIPS)<sup>6</sup> 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; and
    - (d) Investment managers must provide detailed information on the history of the firm, key personnel, key clients, fee schedule and support personnel.
  12. External investment managers selected through the procurement process are formally appointed through the signing of an investment management agreement by the President. The agreements outline in detail the responsibilities of the managers.<sup>7</sup>
  13. A copy of this IPS is provided to each external investment manager retained to provide investment services to IFAD. Each manager will acknowledge receipt of the document and acceptance of its content in writing as part of the agreement.
- E. Responsibilities for engaging and discharging commercial and central banks for the management of operational cash
14. In selecting commercial banks for the purpose of managing IFAD's cash flows, the Fund follows a competitive selection process governed by IFAD's corporate procurement guidelines.
  15. Accounts with central banks of Member States and intergovernmental organizations are opened and administered following procedures<sup>8</sup> approved by the President in line with the authority vested in the President.

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<sup>6</sup> 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.

<sup>7</sup> 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.

<sup>8</sup> Procedures are documented in the IFAD Treasury Manual and executed in line with delegated authorities contained in the IFAD authorized signature list.

## F. Responsibilities for monitoring external investment managers, the custodian bank and financial advisers

16. The President will ensure that properly-equipped organizational units are made responsible for developing and maintaining relationships with external investment managers, the custodian bank(s) and financial advisers.
17. These units 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 includes:
  - (a) Follow-up with external investment managers on compliance issues following the preparation of compliance reports and/or alerts resulting from these. Compliance issues will be summarized in a monthly compliance report;
  - (b) Monitoring of criteria that might 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) Quarterly 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.
18. With regard to the custodian bank, the designated organizational unit 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;
  - (c) Quarterly service review meetings; and
  - (d) Month-end reconciliation of assets and review of trade executions.

## G. Responsibilities for internally managed investments

19. The President will ensure that internal investment portfolios are managed appropriately by the relevant organizational unit in line with this IPS and the specific investment guidelines promulgated by him/her from time to time. Responsibilities for 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) Monthly monitoring of the performance of internally managed portfolios relative to benchmarks and other key performance indicators;
  - (e) Liquidity risk management with due respect to the portfolio mandate and cash flow forecasts;

- (f) Mitigation of post-trade operational risk; credit risk analysis of securities, issuers and counterparties for all investment activities;
- (g) Sovereign risk analysis; and
- (h) Monitoring of financial markets; and oversight and management of relationships with trading counterparties.

#### H. Responsibilities for operational cash management pertaining to IFAD investments

20. The President will ensure that operational cash is managed appropriately by the appropriate organizational unit. Responsibilities for the managing operational cash when related to investment activities include, but are not limited to:
- (a) Management of all cash flow operations and short-term liquidity, including forecasting and reporting;
  - (b) Monitoring of banks' compliance with IFAD instructions;
  - (c) Daily reconciliation of all cash balances;
  - (d) Settlement and back office activities of internal investments; Monitoring of commercial and central bank credit ratings and financial soundness;
  - (e) Establishment and monitoring of the maximum ceiling per bank; and
  - (f) Oversight and management of relationships with central and commercial banks.

#### I. Responsibilities for the determination of asset allocation

21. The Fund 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 through key risk factors and indicators (see section IV.A).
22. Under this approach, as markets evolve, necessary adjustments are made to the investment portfolio asset allocation to stay within the established risk budget.<sup>9</sup>
23. 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 for external and internal portfolios

24. The President will ensure monitoring of and adherence to the risk budget, investment risk monitoring and compliance monitoring of internally and externally managed portfolios by the relevant organizational unit(s). This includes:
- (a) Follow-up with investment managers on compliance issues;
  - (b) Follow-up with investment managers when their risk levels reach the maximum allowable limit as stated in the risk budget;
  - (c) Reviewing levels of risk budget measures and of other relevant risk measures on a monthly basis; and
  - (d) Reviewing of the status of the alignment of IFAD's assets with the special drawing right currency weights for currency risk hedging purposes and recommending corrective actions when needed.

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<sup>9</sup> Please refer to the table following paragraph 15 in document EB 2011/103/R.32, Background note to IFAD's Investment Policy Statement.



### III. Investments, return and risk objectives

#### A. Overall investment objective

25. The Financial Regulations of IFAD provide, in regulation VIII(1), that “the President may place or invest cash funds, not needed immediately for the Fund’s operations or administrative expenditures.” Regulation VIII(2) establishes 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<sup>10</sup> manner”. Regulation VIII(2) forms the basis of IFAD’s investment objectives, which for the purpose of this IPS are:
- (a) Security, meaning preservation of the value of invested assets,<sup>11</sup> within the parameters of the risk budget as approved by the Executive Board;
  - (b) Liquidity, meaning liquidity of assets as defined through the minimum liquidity requirement, i.e. that resources must be readily available if and as required by operations; and
  - (c) Return, meaning the highest possible return within the above conditions in a non-speculative manner.

#### B. Risk tolerance

26. The level of risk taken should be consistent with the investment objective of the Fund. Consequently, IFAD will only accept non-speculative risk in order to achieve its investment objectives. It is 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 external advisers are responsible for understanding the risks and for measuring and monitoring them continually within the defined risk management framework.

#### C. Return requirements

27. IFAD is a United Nations agency and an international financial institution. Its financial commitments are limited to the funds that become available from Member States, borrowed resources, credit reflows and other internal resources such as returns on the investment portfolio. These returns are an important contribution to the funding of IFAD.

#### D. Eligible asset classes

28. The following asset classes are eligible within IFAD’s asset allocation:

##### Money market instruments

- (a) Investments with a maturity of maximum 12 months. Instruments include, but are not limited to: time deposits, certificates of deposit, commercial papers, treasury bills and money funds.

##### Fixed-income securities<sup>12</sup>

- (b) Government and government agencies, at national or subnational level
- (c) Supranationals

<sup>10</sup> In the context of this IPS, non-speculative is defined as: managing investments in support of cash flow sustainability and overall corporate goals within the established risk tolerance and return objectives and based on thorough analysis of options and consideration of market and economic conditions.

<sup>11</sup> Reference is made to the risk budget for the overall portfolio (see annex I).

<sup>12</sup> Including nominal and inflation-linked bonds; developed and emerging markets.

- (d) Asset-backed securities (only agency-issued or guaranteed)
- (e) Corporates
- (f) Callable bonds
- (g) Covered bonds

#### Equity

- (h) Developed market equities included in the Morgan Stanley Developed Markets Index

Derivatives are allowed only for hedging purposes<sup>13</sup>:

- (i) Currency forwards
  - (j) Exchange-traded futures and options
  - (k) Interest rate swaps
  - (l) Cross currency swaps
  - (m) Credit default swaps
  - (n) Asset swaps
29. IFAD can enter into securities lending agreements.
  30. IFAD does not use any form of leverage<sup>14</sup> and does not use derivatives contracts to leverage positions in the investment portfolio.
  31. The list of 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;
    - (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.
  32. Each investment portfolio will have a performance benchmark.
  33. The benchmarks identified in the investment guidelines must be: (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.

#### E. Time horizon

34. The time horizon for IFAD's investment portfolio is driven by conservation of portfolio value, by IFAD's approach to long-term financial sustainability through the

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<sup>13</sup> This restriction does not apply to call options imbedded in fixed income instruments i.e, callable bonds.

<sup>14</sup> 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.

sustainable cash flow framework and by the minimum liquidity requirement (MLR) (see paragraph 62). 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 alignment

35. The majority of IFAD's commitments are expressed in special drawing rights (SDR). 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. Liabilities and commitments not denominated in SDR are matched by assets in the same currencies.

##### Currency overlay

36. IFAD may hire an external currency overlay manager to facilitate currency alignment and to separate currency management from the responsibilities of 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

37. Pursuant to article 10 of the Agreement Establishing IFAD, 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".
38. As a general rule, IFAD 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. The Fund is exempt from all direct taxes on its assets, income and property.

### IV. Risk management framework and performance measurement

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

##### Risk management framework

39. 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.
40. The President will ensure that appropriate organizational units are made responsible for managing, monitoring, analysing and assessing risks and reporting risk levels.

##### Risk budgeting

41. Risk budgeting is the process of allocating risk within funds. It entails setting predetermined risk limits for the overall investment portfolio and for individual investment portfolios. These measures are monitored and the portfolio adjusted if the tolerance level is exceeded. The risk budgeting process includes:
- (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 for each individual investment portfolio in advance through the definition of

ranges of selected risk metrics in line with the investor's risk appetite and tolerance level;

- (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.
42. 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), is approved by the President.
43. The President will ensure that the adequacy of risk-budgeting measures and their tolerance levels are constantly monitored and reviewed on a quarterly basis by the relevant organizational unit. 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 these with agreed risk levels.
44. IFAD's external investment 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 asset managers' skills and the derived return in the risk-budgeting context.
45. Internally managed portfolios that are valued at market cost have a risk budget defined in the related investment guidelines. Active management of such portfolios is defined as discretionary authority aimed at maintaining risk budget parameters within established limits and performing any rebalancing needed to address changes in projected cash flows.
- Decision-making process for establishing and rebalancing the portfolio allocation in line with risk budgeting
46. Should one or more of the risk measures exceed the budgeted level, an analysis to highlight the source of increased risk will be carried out.
47. Should the excess overall portfolio risk level stem from a single internally or externally managed portfolio's position, a strategy will be elaborated to reduce the risk in that portfolio and to formulate recommendations for the manager on actions to be taken within that mandate.
48. Should the excess overall portfolio risk stem from joint factors in overall asset allocation, various options will be analysed in order to formulate actions to bring back the overall risk profile of the portfolio to the budgeted level.
49. 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

50. The President will ensure that analyses are performed and reports prepared on the following financial risks by the relevant organizational unit.
- Interest rate risk
51. Interest rate risk, including volatility risk, is monitored for the overall portfolio and for single mandates based on measures provided on a monthly basis by the 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.

52. 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

53. 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, credit analyses by security and by issuer will be 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.
54. The following table shows the rating floors for each eligible asset class. Available ratings for both issuer and issue cannot be below investment grade.

Asset class	Credit rating floors
	Standard & Poor's (S&P), Moody's or Fitch
<b>Money market</b>	Investment grade <sup>a</sup>
<b>Fixed income</b> – both nominal and inflation linked	
• Government and government agencies fixed-income securities at national or subnational level	Investment grade
• Supranationals	Investment grade
• Asset-backed securities (only agency-issued or guaranteed)	AAA
• Covered bonds	Investment grade
• Corporate bonds	Investment grade
• Callable bonds	Investment grade
<b>Developed market equity</b>	Investment grade <sup>b</sup>
<b>Derivatives</b> – for hedging purposes only	
• Currency forwards	
• Exchange-traded futures and options	
• Interest rate swaps	Counterparty must have a minimum short-term rating of A-1 (S&P), or F1 (Fitch), or P-1 (Moody's) <sup>c</sup>
• Cross currency swaps	
• Credit default swaps	
• Asset swaps	

<sup>a</sup> Any additional eligibility criteria, as approved by the President, also apply.

<sup>b</sup> The credit quality requirement refers to the issuer and is introduced to ensure consistency with IFAD's overall investment management strategy.

<sup>c</sup> At least one rating must comply with the minimum short-term rating; other available ratings must be within investment grade.

#### 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 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.

#### Country risk

56. Country risk is a collection of risks associated with investing in a foreign country. These risks include political risk, exchange rate risk, economic risk, sovereign risk

and transfer risk, which is the risk of capital being locked up or frozen by government action.

57. Country risk is managed for all investments through the establishment of maximum country exposure concentrations within the guidelines of every individual portfolio. Country exposures are monitored on a daily basis through the compliance system.

Industry (or sector) risk (for equities portfolio)

58. This is the risk involved in investing in a specific industry or sector. This risk is addressed in the context of the definition of the equities mandate strategy by ensuring industry and sector diversification and by setting concentration limits in the investment guidelines.

Currency risk

59. 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 United States dollars.
60. Monitoring of the status of alignment to the SDR valuation basket is performed on a monthly basis.
61. The currency risk measure is the percentage of misalignment of the assets for each of the SDR currencies. In the case of misalignments that are considered persistent and significant, an analysis will be performed of new currency weights needed to rebalance the assets and a realignment procedure implemented as appropriate.

Liquidity risk

62. Liquidity risk is addressed through the MLR supported by long- and short-term financial projections. The MLR must be available at any point in time to ensure IFAD's ability to meet its disbursement obligations and the long-term sustainability of the Fund.

Operational risk

63. Operational risk includes all risk sources other than those stated above, including business continuity and legal risk. The President will ensure that operational risk is addressed by establishing a clearly defined framework of responsibility and accountability within IFAD's financial structure.
64. The President will ensure that any legal risk is assessed by the Office of the General Counsel.

## C. Performance measurement and reporting

Performance measurement

65. The custodian calculates performance of the overall investment portfolio and of single internally and externally managed portfolios and provides these on a monthly basis.
66. Performance of the overall investment portfolio and that of single externally and internally 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.

67. Performance is compared with the relative benchmark indices for all mandates, and out and underperformance is highlighted in the reports.
68. The performance of single portfolios 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.
69. The custodian also provides risk-adjusted return measures on the overall and individual portfolios including the Sharpe Ratio, Tracking Error and Information Ratio, and Beta, Alpha and R Squared.
70. On a quarterly basis, the custodian provides performance attribution analysis for externally and internally managed portfolios.

#### Performance reporting

71. 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.
72. 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.
73. Should one or more portfolios show a significantly poor performance for a period of three or more months, or should a sudden change in a portfolio's performance trend be observed in a specific month, the internal or external manager will provide a written explanation of the performance trend. If the underperformance persists, necessary measures will be taken to ensure that a strategy and corrective action for the underperforming portfolio are put in place by the manager.

#### D. Monitoring of compliance

74. The President will ensure performance of the following activities by the relevant organizational unit:
  - (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) Daily monitoring of compliance for internal operational cash to ensure appropriate liquidity management.<sup>15</sup>

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<sup>15</sup> Internal operational cash is held in central banks and in competitively contracted corporate banks. Compliance relates to the commercial banks' ratings and to maximum exposure to a single bank.

## 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 for portfolio. This will apply even in case of introduction of equity exposure.

If the CVaR level hits the risk budget levels, steps will be taken to reduce the risk level, including but not limited to, steps to rebalance the individual investment portfolios' allocations.

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



## 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 liquidity portfolio: maximum 1.5 per cent
- Global government bond portfolio: maximum 1.5 per cent
- Inflation-indexed bond portfolio: maximum 2.5 per cent
- Global credit portfolio: maximum 3.0 per cent
- Emerging market bond portfolio: maximum 4.0 per cent
- Global developed market equities portfolio: will be determined upon implementation and selection of benchmark
- Renminbi portfolio: maximum 1.5 per cent

1-year CVaR at 95 per cent confidence level

- Global liquidity portfolio: 2 per cent
- Global government bond portfolio: 2.0 per cent
- Inflation-indexed bond portfolio: 9.0 per cent
- Global credit portfolio: 7.0 per cent
- Emerging market bond portfolio: 15.0 per cent
- Global developed market equities portfolio: 27 per cent
- Renminbi portfolio: 2 per cent
- Asset liability portfolio: 8.0 per cent

Note: This annex is for information only.

## IFAD policy asset allocation

1. IFAD's strategic asset allocation is presented here below. Ranges around the asset allocation are permitted for strategic and tactical portfolio rebalancing.

<i>Sector</i>	<i>Maximum allocation (Percentage)</i>
Global government bonds	100.0
Global credit	25.0
Global inflation-indexed fixed income	10.0
Emerging market debt	15.0
Global developed market equities	10.0

2. It is important to note that the allocation levels shown in the table can occasionally be subject to deviations outside the range within risk budget due to a variety of reasons: market movements, portfolio performance, change in risk profile of the portfolio, asset reimbursement, or if loan disbursements are not in line with projections and require unforeseen divestments.

Note: This annex is for information only.