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Investing in rural people

## Report on IFAD's Investment Portfolio for 2018

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For: Information

## Executive summary

1. The value of the investment portfolio in United States dollar terms decreased from US\$1,348.0 million at 31 December 2017 to US\$1,036.7 million at 31 December 2018 – a drop of US\$311.3 million. This was principally the result of: net outflows of US\$274.5 million and negative foreign exchange movements of US\$37.3 million; though the portfolio returns of US\$0.5 million offset a portion of this decrease.
2. Returns, although positive, were lower than in 2017 due to challenging market conditions. Risk appetite was low and credit spreads widened, thereby pushing returns on the global credit and emerging market debt portfolios into negative territory.
3. Portfolio risk levels were decreased during the year:
  - The conditional value at risk (CVaR) of the overall portfolio decreased from 1.77 per cent to 0.73 per cent.
  - Portfolio duration levels decreased from 2.23 years to 1.21 years.
  - BBB-rated debt made up only 2.5 per cent of the portfolio at the end of 2018 compared to 17.3 per cent at the end of 2017.
4. The currency composition of the investment portfolio shows a mismatch between assets and commitments due to rapidly increasing demand for loans denominated in United States dollars. The overall size of the portfolio does, however, comfortably exceed the minimum liquidity requirement. The methodologies for calculating both the currency composition and minimum liquidity requirement are currently under review in order to bring them into line with those of other international financial institutions.

### **Key portfolio changes during 2018**

	2017	2018
Portfolio size (thousands of US\$)	1 348 044	1 036 729
Net investment income (thousands of US\$)	31 184	506
Rate of return (percentage)	2.21	0.09
Duration (years)	2.23	1.21
CVaR (percentage)	1.77	0.73

## Report on IFAD's Investment Portfolio for 2018

### I. Market conditions

1. The United States Federal Reserve raised interest rates four times in 2018, thereby exerting upward pressure on United States Treasury yields. However, fears of an economic slowdown kept such yields range-bound. In Europe, government bonds continued to trade at low or negative yields in 2018, as the European Central Bank held interest rates steady and concerns over economic growth in the region persisted.
2. While government bond yields remained steady, corporate bond yields and emerging market yields rose significantly. Interest rate hikes in the United States and trade conflicts caused emerging markets to underperform while concerns over high debt levels among United States and European companies and financial institutions weighed on the corporate bond sector. Consequently, the portfolios with greater allocations of corporate and emerging market bonds underperformed.
3. Divestments were made throughout the year from portfolios with higher risk levels in order to lower the overall investment portfolio risk. The emerging market debt, global inflation-indexed and global government bond portfolios were closed and allocations to the global liquidity portfolio increased.

Table 1  
**Movements affecting IFAD's asset allocation within the portfolio in 2018**  
(Thousands of United States dollars equivalent)

	Operational cash <sup>a</sup>	Global strategic portfolio	Global liquidity portfolio	Chinese renminbi portfolio	Global government bonds	Global credit bonds	Global inflation-indexed bonds	Emerging market debt bonds	RAMP portfolio <sup>c</sup>	Asset liability portfolio	Hedge portfolio	Total
<b>Opening balance (31 Dec 2017)</b>	<b>65 162</b>	<b>173 891</b>	<b>107 589</b>	<b>56 271</b>	<b>101 879</b>	<b>153 974</b>	<b>103 704</b>	<b>108 200</b>	<b>45 132</b>	<b>434 951</b>	<b>(2 708)</b>	<b>1 348 044</b>
Net investment income	480	3 573	3 781	761	732	(379)	(6)	(3 467)	35	(5 002)	(1)	506
Net flows <sup>b</sup>	(18 768)	(32 107)	108 207	(57 792)	(98 823)	312	(101 823)	(104 248)	(45 157)	71 535	4 125	(274 539)
Foreign exchange movements	(1 723)	(1 368)	(2)	1 365	(3 743)	(3 235)	(1 876)	(485)	-	(24 803)	(1 412)	(37 282)
<b>Closing balance (31 Dec 2018)</b>	<b>45 150</b>	<b>143 990</b>	<b>219 575</b>	<b>604</b>	<b>45</b>	<b>150 671</b>	<b>-</b>	<b>-</b>	<b>10</b>	<b>476 680</b>	<b>4</b>	<b>1 036 729</b>

<sup>a</sup> Cash held with banks, readily available for disbursing loans, grants and administrative expenses.

<sup>b</sup> Net flows consist of outflows in respect of loan and grant disbursements and administrative expenses, and inflows from loan reflows and encashment of Member State contributions.

<sup>c</sup> The World Bank's Reserves Advisory Management Programme (RAMP).

## II. Investment income

4. Gross investment income in 2018 amounted to US\$2.0 million, while net investment income inclusive of all investment-related fees (totalling US\$1.5 million) amounted to US\$0.5 million. Table 2 presents a summary of 2018 investment income broken down by portfolio.

Table 2  
**Breakdown of IFAD's investment income by asset class in 2018**  
(Thousands of United States dollars equivalent)

Investment income	Operational cash	Global strategic portfolio	Global liquidity portfolio	Chinese renminbi portfolio	Global government bonds	Global credit bonds	Global inflation-indexed bonds	Emerging market debt bonds	RAMP portfolio	Asset liability portfolio	Hedging portfolio	Total
Interest and coupon income	610	3 695	2 743	808	1 375	3 885	443	2 345	43	1 706	-	17 651
Realized market gains/(losses)	-	-	895	-	(1 363)	(1 496)	1 981	(4 059)	2	80	-	(3 960)
Unrealized market gains/(losses)	-	-	262	-	888	(2 413)	(2 309)	(1 601)	(2)	(6 555)	-	(11 730)
Amortization <sup>*</sup>	-	(7)	-	-	-	-	-	-	-	-	-	(7)
<b>Investment income before fees</b>	<b>610</b>	<b>3 688</b>	<b>3 901</b>	<b>808</b>	<b>905</b>	<b>(9)</b>	<b>116</b>	<b>(3 315)</b>	<b>42</b>	<b>(4 707)</b>	<b>-</b>	<b>2 038</b>
Derivatives expenses	-	-	-	-	(6)	(16)	(1)	-	-	(62)	-	(84)
Investment manager fees	-	-	-	-	(96)	(250)	(70)	(107)	(3)	-	-	(527)
Custody fees	(3)	(35)	(40)	(5)	(36)	(42)	(25)	(26)	(1)	(48)	(1)	(264)
Bank charges	(128)	-	-	-	-	-	-	-	-	(1)	-	(128)
Advisory and other investment-related fees	-	(79)	(80)	(42)	(34)	(61)	(25)	(19)	(3)	(184)	-	(528)
<b>Investment income after fees</b>	<b>480</b>	<b>3 573</b>	<b>3 781</b>	<b>761</b>	<b>732</b>	<b>(379)</b>	<b>(6)</b>	<b>(3 467)</b>	<b>35</b>	<b>(5 002)</b>	<b>(1)</b>	<b>506</b>

\* Amortization represents a portion of the difference between purchase price and final redemption value for the global strategic portfolio, reported at amortized cost.

## III. Rate of return

5. The rate of return on IFAD's investment portfolio is calculated in local currency terms without reflecting the impact of foreign exchange movements. Excluding the asset liability portfolio (ALP), IFAD's investment portfolio generated a net return of 0.85 per cent for 2018, outperforming the benchmark of 0.29 per cent. The ALP generated a negative gross return of 0.91 per cent, primarily due to unrealized losses on the portfolio. However, the interest income on the portfolio of 0.36 per cent for the year exceeds the portfolio's cost of funding of 0.21 per cent.

Table 3  
**Quarterly gross performance together with annual performance versus benchmarks in 2018**  
(Percentages in local currency terms)

	2018 quarterly and annual performance and benchmarks						
	First quarter	Second quarter	Third quarter	Fourth quarter	Annual 2018	Benchmark 2018	Difference
Operational cash	0.19	0.16	0.29	0.24	0.88	0.88	0.00
Global strategic portfolio	0.53	0.55	0.56	0.57	2.22	1.02	1.10
Global liquidity portfolio	0.41	0.50	0.60	0.64	2.16	0.00	2.16
Chinese renminbi portfolio	0.84	0.61	-	0.00	1.46	0.00	1.46
Global government bonds	0.18	0.36	0.33	0.13	0.89	1.88	(0.99)
Global credit bonds	(1.03)	(0.02)	0.22	0.85	0.00	0.90	(0.90)
Global inflation-indexed bonds	(0.47)	0.64	-	-	0.16	0.39	(0.23)
RAMP portfolio	0.12	-	0.01	-	0.14	0.14	-
Emerging market debt bonds	(1.93)	(1.16)	-	-	(3.07)	(2.55)	(0.52)
Hedge portfolio	-	-	-	-	-	-	-
<b>Gross rate of return excluding ALP</b>	<b>(0.21)</b>	<b>0.21</b>	<b>0.43</b>	<b>0.59</b>	<b>1.01</b>	<b>0.46</b>	<b>0.55</b>
<b>Net rate of return excluding ALP</b>	<b>(0.26)</b>	<b>0.16</b>	<b>0.39</b>	<b>0.55</b>	<b>0.85</b>	<b>0.29</b>	<b>0.56</b>
Asset liability portfolio*	(0.03)	(0.16)	0.04	(0.76)	(0.91)	0.21	(1.12)
<b>Gross rate of return including ALP</b>	<b>(0.15)</b>	<b>0.08</b>	<b>0.28</b>	<b>0.01</b>	<b>0.21</b>	<b>n.a.</b>	<b>n.a.</b>
<b>Net rate of return including ALP</b>	<b>(0.19)</b>	<b>0.05</b>	<b>0.26</b>	<b>(0.02)</b>	<b>0.09</b>	<b>n.a.</b>	<b>n.a.</b>

\* The ALP benchmark is a target rate of return representing the cost of funding and does not reflect the investment universe allowed by the guidelines.

Table 4  
**IFAD portfolio performance rolling average as at 31 December 2018**  
(Percentages in local currency terms)

	One year	Three years	Five years
Portfolio performance	0.09	1.73	1.54

6. For comparative purposes, table 5 presents annual portfolio performance over the previous four years.

Table 5  
**Historical annual performance versus benchmarks**  
(Percentages in local currency terms)

	2017		2016		2015		2014	
	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark
Operational cash	0.79	0.79	0.30	0.30	0.13	0.13	0.11	0.11
Global strategic portfolio	1.92	0.80	1.83	0.95	1.75	1.12	1.80	1.44
Asset liability portfolio	0.96	0.22	0.62	0.00	(0.78)	0.31	-	-
Chinese renminbi portfolio	3.72	0.00	0.48	0.00	-	-	-	-
Global government bonds	0.27	0.99	0.64	1.03	0.05	0.43	0.77	0.42
Global credit bonds	3.43	3.31	3.23	3.52	1.17	1.25	6.13	5.37
Global inflation-indexed bonds	1.86	1.53	4.41	4.37	(0.85)	(0.51)	2.35	2.05
Emerging market debt bonds	8.45	7.64	6.83	6.40	(1.17)	(0.86)	9.44	9.10
<b>Gross rate of return (excluding fees)</b>	<b>2.35</b>	<b>n.a.</b>	<b>3.09</b>	<b>n.a.</b>	<b>0.13</b>	<b>0.35</b>	<b>2.74</b>	<b>2.24</b>
<b>Net rate of return (including all fees)</b>	<b>2.21</b>	<b>n.a.</b>	<b>2.91</b>	<b>n.a.</b>	<b>(0.06)</b>	<b>0.16</b>	<b>2.58</b>	<b>2.08</b>

## IV. Composition of the portfolio by instrument

7. Table 6a shows the composition of the investment portfolio by instrument as at 31 December 2018.

Table 6a  
**Investment portfolio by instrument as at 31 December 2018**

<i>Instrument</i>	<i>Actual portfolio allocation</i>	
	<i>Millions of United States dollars</i>	<i>Percentage</i>
Cash	57.1	5.5
Swaps	(0.5)	0
Time deposit	-	-
Global government bonds	452.3	43.6
Global credit bonds	527.8	50.9
Global inflation-linked	-	-
Emerging market debt bonds	-	-
<b>Total</b>	<b>1 036.7</b>	<b>100</b>

8. In December 2018, to align the Fund with other international financial institutions (IFIs), IFAD moved from a strategic asset allocation to a tranching approach for risk budgeting and asset allocation. This means that the portfolio is invested in different layers based on the liquidity needs of the institution rather than setting specific limits for each asset class. Consequently, the IFAD investment portfolio was split into four tranches, as follows:

- Liquidity tranche: Used for immediate cash disbursements;
- Buffer tranche: Should the liquidity tranche be temporarily depleted due to an unforeseen spike in disbursements, funds in the buffer tranche will be used to fund outflows. The size of the tranche is determined by the parameters of IFAD's minimum liquidity requirement (MLR);
- Surplus tranche: These are funds in addition to what is required by the MLR and are used to provide enhanced returns; and
- Funding tranche: Borrowed funds, managed according to an asset-liability management framework.

9. Table 6b shows the net asset value of the portfolio based on the new tranching approach.

Table 6b  
**2018 portfolio by tranche**

<i>Tranche</i>	<i>%</i>	<i>US\$ millions</i>
Liquidity	4.4	45.1
Buffer	49.7	514.9
Surplus	-	-
Funding	46.0	476.7
Hedge *	0.0	0.0
<b>Total</b>	<b>100.0</b>	<b>1 036.7</b>

\* The hedge portfolio is shown separately as its derivative positions are established to immunize the entire portfolio for interest rate risk and foreign exchange rate risk.

## V. Risk measurements

10. The risk-budgeting measures outlined in IFAD's Investment Policy Statement (IPS) – conditional value-at-risk (CVaR) and the ex ante tracking error – are reported on in subsections B and C below. Other risk indicators are reported in subsections A, D, E and F.

## A. Market risk: Duration

11. Duration is a measure of the sensitivity of the market price of a fixed-income investment to a change in interest rates (expressed as a number of years). In general, a portfolio of securities with a lower duration can be expected to be less sensitive to interest-rate changes than a portfolio with a higher duration.

Table 7

### Effective duration of IFAD's investment portfolio and benchmarks

(Duration in number of years)

	31 December 2018		31 December 2017	
	Portfolio	Benchmark	Portfolio	Benchmark
Asset liability portfolio	0.65	0.00	1.27	0.00
Global liquidity portfolio	0.30	0.00	0.22	0.00
Chinese renminbi portfolio	0.00	0.00	0.06	0.00
Global government bonds	0.00	0.87	0.30	1.08
Global credit bonds	4.17	4.62	4.28	4.83
Global inflation-indexed bonds	n.a.	n.a.	5.62	5.32
RAMP portfolio	0.00	0.00	0.51	0.51
Emerging market debt bonds	n.a.	n.a.	7.07	6.92
Hedge portfolio	n.a.	n.a.	n.a.	n.a.
<b>Total portfolio</b> (including global strategic portfolio and operational cash)	<b>1.21</b>	<b>1.22</b>	<b>2.23</b>	<b>2.30</b>

**Note:** The total portfolio duration is lowered because neither the global strategic portfolio – reported at amortized cost – nor the operational cash portfolio are subject to interest rate fluctuations. The asset liability, global liquidity and Chinese renminbi portfolios are managed internally and have a zero-year duration benchmark. The global inflation-linked and the emerging market debt portfolios were closed down on 30 June 2018.

12. The overall portfolio duration was 1.21 years (2.23 years in 2017), which is indicative of the investment portfolio risk reduction.

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

13. The CVaR is a measure of the possible percentage losses to a portfolio under extreme market conditions. The investment portfolio CVaR is stated with a 95 per cent confidence level over a forward-looking one-year horizon.
14. The maximum risk level for the IFAD portfolio is stated in the IPS as a CVaR of 6.0 per cent. In 2018 the CVaR for the overall portfolio was 0.73 per cent, which is well below the approved IPS risk level and lower than in 2017 – the result of a management strategy of divesting entirely from high-risk portfolios (the global inflation-indexed and emerging market debt portfolios). The current CVaR risk level of 1.03 per cent means that the loss to the overall portfolio under extreme market conditions could be US\$7.6 million.

Table 8

### CVaR of IFAD's asset classes at 31 December 2018 and 2017

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

	Actual investment portfolio one-year CVaR	
	31 December 2018	31 December 2017
Asset liability portfolio	1.34	1.38
Global liquidity portfolio	0.64	1.46
Chinese renminbi portfolio	0.00	1.43
Global government bonds	0.00	0.60
Global credit bonds	3.51	4.13
Global inflation-indexed bonds	n.a.	5.14
RAMP portfolio	0.00	0.39
Emerging market debt bonds	n.a.	8.04
Hedge portfolio	n.a.	n.a.
<b>Total portfolio</b> (including global strategic portfolio and cash)	<b>1.03</b>	<b>1.77</b>

### C. Credit risk: Credit rating analysis

15. IFAD's IPS establishes a credit rating floor. Credit risk is also managed by monitoring securities in accordance with investment guidelines, which may provide for stricter credit quality requirements than those contained in the IPS.

Table 9

#### Investment portfolio compositions by credit ratings<sup>a</sup> at 31 December 2018

(Thousands of United States dollars equivalent)

	Opera- tional cash	Global strategic portfolio	Global liquidity portfolio	Chinese renminbi portfolio	Global govern- ment bonds	Global credit bonds	Global inflation- indexed bonds	Emerging market debt	RAMP portfolio	Asset liability portfolio	Hedge portfolio	Total	Percent -age
AAA	-	42 590	144 204	-	-	14 268	-	-	-	-	-	201 061	19.4
AA+/-	-	49 573	75 272	-	-	44 309	-	-	-	155 898	-	325 053	31.4
A+/-	-	51 026	-	-	-	90 667	-	-	-	286 672	-	428 365	41.3
BBB+/-	-	-	-	-	-	643	-	-	-	25 014	-	25 657	2.5
Cash <sup>b</sup>	45 150	800	99	604	45	3 297	-	-	10	9 595	4	59 605	5.8
Time deposit	-	-	-	-	-	-	-	-	-	-	-	-	-
Pending trades <sup>c</sup>	-	-	-	-	-	(2 513)	-	-	-	-	-	(2 513)	(0.2)
Swaps	-	-	-	-	-	-	-	-	-	(499)	-	(499)	(0.0)
<b>Total 2018</b>	<b>45 150</b>	<b>143 990</b>	<b>219 575</b>	<b>604</b>	<b>45</b>	<b>150 671</b>	<b>-</b>	<b>-</b>	<b>10</b>	<b>476 680</b>	<b>4</b>	<b>1 036 729</b>	<b>100.0</b>
<b>Total 2017</b>	<b>65 162</b>	<b>173 891</b>	<b>107 589</b>	<b>56 271</b>	<b>101 879</b>	<b>153 974</b>	<b>103 704</b>	<b>108 200</b>	<b>45 132</b>	<b>434 951</b>	<b>(2 708)</b>	<b>1 348 044</b>	<b>100.0</b>

<sup>a</sup> In accordance with IFAD's current investment guidelines, the credit ratings used in this report are based on the best credit ratings available from the Standard and Poor's, Moody's or Fitch rating agencies.

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

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

### D. Currency risk: Currency composition analysis

16. In order to immunize IFAD's balance sheet against currency fluctuations the Fund's assets have been maintained, to the extent possible, in the same currencies as its commitments, i.e. in special drawing rights (SDR).
17. However, rapidly increasing demand for loans denominated in United States dollars has dramatically changed the composition of the Fund's commitments, so that alignment with the SDR is no longer relevant.
18. The methodology for calculating currency composition is currently under review in order to bring it into line with those of other international financial institutions.



Table 10  
**Currency composition of net assets in the form of cash, investments and other receivables**  
(Thousands of United States dollars equivalent)

<i>Category</i>	<i>Chinese renminbi group</i>	<i>Euro group</i>	<i>Pound sterling group</i>	<i>Japanese yen group</i>	<i>United states dollar group</i>	<i>Total</i>
<b>Assets</b>						
Cash*	-	5 060	1 916	53	37 728	44 758
Contributions receivable	79 594	312 247	83 824	29 066	249 704	754 434
Investments	604	47 819	8 943	2 507	455 101	514 974
Non-SDR loans outstanding	-	1 483	-	-	70 989	72 472
Promissory notes	-	-	-	55 968	42 500	98 468
SDR loans outstanding	761 261	2 271 246	559 496	550 573	2 988 968	7 131 543
<b>Assets subtotal</b>	<b>841 459</b>	<b>2 637 855</b>	<b>654 179</b>	<b>638 166</b>	<b>3 844 991</b>	<b>8 616 650</b>
<b>Commitments</b>						
SDR loans undisbursed	(180 199)	(537 630)	(132 439)	(130 327)	(707 524)	(1 688 119)
SDR grants undisbursed	(2 273)	(6 783)	(1 671)	(1 644)	(8 926)	(21 298)
Non-SDR grants undisbursed	-	(7 724)	-	-	(152 156)	(159 880)
Non-SDR loans undisbursed	-	(125 735)	-	-	(1 576 804)	(1 702 539)
SDR Debt Sustainability Framework (DSF) undisbursed	(68 874)	(205 487)	(50 619)	(49 812)	(270 422)	(645 215)
Non-SDR DSF undisbursed	-	(78 637)	-	-	(177 879)	(256 516)
<b>Commitments subtotal</b>	<b>(251 347)</b>	<b>(961 997)</b>	<b>(184 730)</b>	<b>(181 783)</b>	<b>(2 893 711)</b>	<b>(4 473 568)</b>
<b>Hedging</b>						
Currency forwards	-	-	-	-	-	-
<b>Hedging subtotal</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net</b>	<b>590 112</b>	<b>1 675 858</b>	<b>469 449</b>	<b>456 383</b>	<b>951 280</b>	<b>4 143 083</b>
Net (percentage)	14.24	40.45	11.33	11.02	22.96	100.00
SDR weights (percentage)	10.67	31.85	7.85	7.72	41.91	100.00
<b>Difference (percentage)</b>	<b>3.57</b>	<b>8.60</b>	<b>3.49</b>	<b>3.30</b>	<b>(18.95)</b>	<b>0.00</b>

\* The difference in the cash and investments balance compared with other tables is derived mostly from the exclusion of the ALP (US\$477 million equivalent). The ALP is not subject to the SDR currency alignment since, in line with commitments, it is maintained in euros.

## E. Liquidity risk: Minimum liquidity requirement

19. IFAD's latest financial model assumptions – incorporating the resources available for commitment in 2018 under the sustainable cash flow approach – calculate an MLR of US\$514.0 million (60 per cent of gross annual outflows),<sup>1</sup> which is comfortably cleared by IFAD's investment portfolio balance of US\$1,036.7 million (see table 1). In line with the tranching approach, the value of the buffer tranche of the investment portfolio exceeds the MLR.

<sup>1</sup> See EB 2018/125/R.42/Rev.1 – Resources Available for Commitment.