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Enterprise Risk Management Update

Addendum

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For: **Information**

I. Comments from the United Kingdom

(i) Enterprise Risk Management

1. **It is good to see IFAD's ERM process improving. The current situation underlines the importance. We welcome IFAD using the ERM to consider COVID-19 and encourage continued engagement with country teams and other partners to take action to mitigate, readjusting programmes as proposed in IFAD's COVID-19 response, in a timely way.**

(ii) Risk Appetite policy

2. **We found the draft risk policy good but it needs to be made more user friendly to support country office staff. Including some live examples on how to calculate and use risk appetite would be useful, also for the Board.**

(iii) Risk management policy

3. **The policy is a little high level and seems to expect the reader to have a good understanding of risk management, whereas across IFAD Risk Management awareness is still developing. What is the process for risk escalation from the first line, how should the first line capture risk and escalate them up? Has a standard risk register template been developed, how often should risks be reviewed, how often should they be flagged? These seem to be missing from the policy.**

4. **We look forward to continued focus on strengthening IFAD's ERM and accelerating progress, including through resources provided through the Targeted Capacity Initiative (TCI).**

Response

5. **(i)** Management appreciates the comments and the continuous support from Member States throughout this journey.

6. Given the escalating spread and impact of COVID-19, Management has been continuously assessing existing capabilities across all risk domains to handle a more severe scenario and to continuously and rapidly respond to clients/borrowers, partners and Member States regarding actions and impacts.

7. Specifically with regard to programme delivery, the task force on COVID-19 is operating 24/7 and working in close coordination with country teams and partners to ensure a timely, consistent and effective response, including the roll-out of the stimulus package. Several scenarios have been considered and specific mitigation measures have already been put in place in support of operations in countries affected by the COVID-19 pandemic. Management may adopt a number of additional temporary crisis/emergency measures to support continuity and efficiency of key IFAD business processes while ensuring control effectiveness. These measures provide IFAD additional flexibility and agility for accelerated responses to countries' urgent needs for assistance due to COVID-19. Management will closely monitor the implementation of these measures and adjust or terminate them as appropriate.

8. **(ii) and (iii)** Management takes note of these comments. Many factors were considered in developing the draft Risk Appetite Framework (RAF) and the new Enterprise Risk Management (ERM) Policy discussed at the Audit Committee meeting, including benchmarks with other international financial institutions and United Nations entities, industry best practices and IFAD's size, nature and complexity. Accordingly, both are intentionally high-level and intended to reflect IFAD's current risk maturity and profile, while also allowing for the changes that will occur as IFAD's business model evolves and ERM is further embedded into decision-making.

9. Management is using the draft RAF and the new ERM Policy to implement corporate risk policies that are principles-based and high-level and that will rarely require

significant change (although they will be subject to annual minor updates). Management, with the support of managers and relevant technical teams, will develop detailed standards and guidance tailored to specific areas. Management believes this will allow for more flexibility in updating detailed risk-related practice and guidance, while maintaining more stable, principles-based policies.

10. With regard to specific issues identified by the United Kingdom:

- **Bringing the RAF to life.** Management is investing in dedicated risk management trainings at each step of the ERM Framework implementation. As part of the risk appetite exercise, Ernst & Young conducted risk appetite overview sessions for all managers and selected workforce. An awareness-raising session on risk appetite and risk taxonomy was organized with Ernst & Young at the global operations retreat held in Rome, a gathering attended by all senior operational staff, including about 100 staff from IFAD Country Offices. The Financial Operations Department organized training through the Chartered Institute of Public Finance and Accountancy on risk management and internal control, operational risk and controls, and financial crime risk management. This training started in January 2020, when several three-day sessions were held and 30 staff were trained. Due to disruptions related to COVID-19, the remaining sessions have been postponed to the second half of 2020, when an estimated 100 staff are expected to participate in additional three-day training sessions.

- Management has begun to roll out the new edition of the Operations Academy, together with more focused risk trainings for regional division and Country Office staff, including specific segments on the overall ERM Framework and on programme delivery risks. Financial risk trainings have also been conducted. Management is currently developing dedicated ERM trainings for the different risk owners/groups to ensure that staff will be ready to translate the policies and procedures into effective risk management. Management has previously discussed with the Audit Committee the feasibility of offering informal seminars to Member States. Once the RAF is adopted, an informal seminar might be held to provide practical examples of the calculation of risk appetite.

- These trainings are expected to incorporate real-life examples of the kinds of risks that IFAD experiences and explore how we can identify, measure, monitor, mitigate and report on these risks as they change. Trainings will also focus on educating staff on inherent versus residual risk and the importance of identifying, assessing and documenting the degree to which planned mitigating controls can and do reduce IFAD's exposure to specific risks.

- **First-line risk ownership.** A central tenet of the new ERM Policy and associated ERM governance structure is first-line accountability for managing risks. As Management further matures the ERM programme, we intend to refresh our top-down corporate risk assessment and update the corporate risk register regularly. Management will develop and roll out these and related tools, which are currently being assessed, in a timely manner.

- **Strong risk culture.** An important aspect of the policy is its enabling function and the RAF for IFAD's risk culture. IFAD's risk culture encompasses the values and behaviours exhibited by the workforce as they identify, take and manage risk in the course of IFAD's operations. Enhancing IFAD's risk management culture requires a focus on establishing and driving desired behaviours and embedding those behaviours within strategic planning and day-to-day business processes. The ERM Policy and RAF will articulate the minimum requirements for risk management at IFAD and outline desired risk behaviours. This is one component of the cultural transformation that will help to mainstream risk management and embed the desired behaviours in all operations.

- **Effective and timely risk escalation.** In line with IFAD's accountability framework, delegation of authority framework and Internal Control Framework, the ERM Policy places emphasis on embedding risk management in daily operations by outlining the requirements, roles and responsibilities of key managerial functions in the creation of IFAD's risk culture. Departments will have the flexibility to further detail the risk management roles and responsibilities for staff below the managerial levels. Throughout, there will be a focus on ensuring that everyone within IFAD has a responsibility to proactively assess and manage risks and to escalate those that they believe require additional attention to be properly managed. Again, our trainings incorporate aspects of these responsibilities and real-life examples.

- **Effective risk reporting.** As Management finalizes the selection of key risk indicators (KRIs), in addition to updating the Corporate Risk Dashboard (CRD) it will update its comprehensive corporate risk register and Programme Management Department portfolio reviews. The intent is for risk reporting to be routine and serve as a tool for managing risks proactively.

II. Comment from Sweden

11. **Update on Enterprise Risk Management & IFAD's Corporate Risk Dashboard Sweden would initially like to thank management for updating the board on the developments of IFAD's risk dashboard and enhanced enterprise risk management, on a continuous basis.**

12. **The updates not only facilitate our strategic discussions and dialogue, but also provides us with a transparent flow of information for a better understanding on all forms of corporate risks at stake, which is crucial in a transformation that proceeds fast. In order to secure strategic and sustainable long-term investments now and in the future - managing, monitoring, mitigating and above all foreseeing and preventing risks are central elements of upholding and enhancing accountability towards the board and IFAD's beneficiaries.**

13. **Setting clear targets and baselines for strategic aims in connection to risk tolerance and responsibilities of corporate risks are vital to be able to measure performance and to identify setbacks and lessons learned. Sensitivity analysis, illustrative graphs and concrete examples explaining how and why are welcome in this regard. This particularly applies to the increased engagement with the private sector and the proposals of additional trust funds (e.g. Private Sector Trust Fund and ASAP+), and Sweden expects an inclusive process and continuous updates in the development of IFAD's risk appetite and Key Risk Indicators (KRI).**

14. **With a reference to the replenishment process of IFAD12 and the high ambitions stated in IFAD 2.0 - Sweden would furthermore appreciate an update on the current status in relation to the main corporate risks as well as how IFAD intends to communicate updates on risk status, trends and prognosis to the board going forward.**

15. **This is particularly important considering a world that is going into an economic and social recession due to COVID-19, hitting hard on local food supply chains, food security and economies, especially in fragile and vulnerable countries. It is our belief that the immense challenges and risks in connection to the COVID-19 needs to be incorporated in the overall and complete picture of IFAD's Enterprise risk management, both in regard to beneficiaries and to IFAD's long-term financial sustainability.**

   Response

16. Management thanks Sweden for these remarks and is in full agreement with them. Management fully intends to update the CRD in the second half of 2020.

Management is currently working with cross-departmental teams to identify relevant KRIs for each of IFAD's four major risk domains: strategic, financial, operational and programme delivery. This will allow the alignment of IFAD's KRIs with the recently developed IFAD enterprise risk taxonomy. As Management finalizes the selection of these KRIs, it will prioritize the risk domains that should be routinely included in the updated CRD. As Management redesigns the CRD, it expects to add in trend data and, where and when relevant, align it with level-2 risk appetite thresholds.

17. A major area of focus is on strategic risks, many of which relate to the issues identified by Sweden. Strategic risks are a particularly complex area, in which there are very few comparators from which to draw. In addition, as Sweden notes, this is an area where the nature and magnitude of risks are changing as we move towards the Twelfth Replenishment of IFAD's Resources.

18. Management has established five cross-departmental strategic risk working groups at the managerial level, encompassing more than half of directors and managers across IFAD, including the Director of the Global Engagement, Partnership and Resource Mobilization Division and the Treasurer, who are supporting the identification of KRIs deemed suitable to measure the main risk drivers identified with regard to resource mobilization, borrowing and financial sustainability. As Management finalizes the selection of these KRIs, it will prioritize those that should be routinely included in the updated CRD.

19. Within the strategic and financial risk KRIs, Management will seek to identify additional or enhanced risks associated with IFAD's revised strategy, including those associated with the new financial architecture, private sector engagement and cofinancing. Should Management determine that we would need to adopt a so-called differentiated risk appetite to reflect enhanced risks associated with working with the private sector, it will bring the matter to the attention of the Executive Board (Management has not concluded any such differentiated risk appetites are required at this time). The main risk drivers related to private sector engagement will be identified across various level-2 risk domains. IFAD's private sector team has been actively engaged in setting risk appetite and developing KRIs, thresholds and tolerances to measure the identified risks.

20. More broadly, once the risk appetite is set by the Executive Board, Management will:

(i)   Provide clear communication on the appetite and define specific indicators for key business activities on a regular basis;

(ii) Revamp the corporate risk register, as noted above, to better support risk managers in collecting the information necessary to properly implement the risk appetite and monitor risk tolerance at both an enterprise level and for individual business processes and to ensure the timely escalation of top risks (adjustment in decision-making may be needed to align business and risk appetite);

(iii) Monitor compliance and IFAD's actual risk profile against defined risk appetite levels and limits through the new ERM governance structure and in an enhanced CRD, at both the business and risk-type level, as well as on an aggregate basis, in order to inform and discuss top risks with the Executive Board.

(iv) Regularly review adherence to the approved risk appetite levels, in line with IFAD's evolving strategy and risk capacity. The reviews will also ensure linkage between risk appetite and strategic planning, so that timely guidance can be provided with respect to approved limits.

21. The impact of COVID-19 has been continuously discussed by Management, with input from the ERM working group and dedicated task forces responsible for

identifying the COVID-19 impact across all risk domains and implementing and monitoring mitigation measures. Regular discussions have also been held with the Office of Audit and Oversight. Management has provided a high-level presentation to the Audit Committee in that regard. Management will continue to assess, mitigate, monitor and report COVID-related risks to Member States going forward.

III. Comment from Italy

22. **Italy thanks the Management for this update and we take note of the proposed timeline for the presentation and discussion of the important documents mentioned. We agree on the relevance of continuous involvement at this stage of the Executive Board, which is called to ground strategic decisions for the finalization of policies, instruments and documents such as the Risk Appetite Statement and the Risk Dashboard. The following step will be crucial as well, as IFAD will have to ensure a swift and effective transition to the implementation phase of the revised and improved ERM framework.**

23. **The planned improvement program is, without a doubt, a challenging feat, not only because it will imply a transition to a more structured risk management model, but also because it will need to be supported by enhanced collaboration within the many parts of the IFAD operational structure. An improvement in the quality of the information flows to the Audit Committee and the Executive Board will be required, and important initiatives in this direction are already underway, with the constant updating of the Risk Dashboard.**

24. **It is because of the complex implications of the transition and of the need to step up in terms of ERM maturity - hence credibility of the institution - that we are supporting the much needed changes in the risk governance structure as envisaged, particularly the creation of a dedicated second line of defence. This choice is aligned with best practices and standards in the industry, with the recent reviews produced by several reputable risk consultants, with the typical features of rated institutions, and with the need to correct the identified capacity and capability gaps as recently highlighted by HR studies.**

    Response

25. Management thanks Italy for its continuous support and fully agrees with these remarks.

26. Management expects to continue the open and transparent dialogue with Member States throughout IFAD's risk management journey, as such dialogue is fundamental to effectively implementing IFAD's strategy. As Management encounters challenges in implementing its ERM programme, it will bring these to the attention of the Executive Board and propose revised approaches to maintain progress.

27. Over the last few months, Management has been planning the transition to the new ERM governance. Management expects to operationalize the risk technical committees and the new risk management division over the next months to further strengthen IFAD's second line of defence and IFAD's integrated risk management approach. A Chief Risk Officer (CRO) will be recruited and will work under the overall supervision of the Vice-President and the leadership of the President. The CRO recruitment process is currently under way. Among other responsibilities, the CRO will be tasked with further building out the second-line risk function, working closely with the Office of the President and Vice-President and all departments.