# JLIFAD

Investing in rural people

# Enterprise Risk Management Update

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# Contents

# Definitions and acronyms

CRD      Corporate Risk Dashboard

CRO      Chief Risk Officer

ERM      enterprise risk management

ERMF     Enterprise Risk Management Framework

IFAD12   Twelfth Replenishment of IFAD's Resources

KRI      key risk indicator

RAF      Risk Appetite Framework

RAS      risk appetite statement

# Enterprise Risk Management Update

# I. Context

1. IFAD's internal reform agenda has successfully introduced important organizational and structural changes over the last two years. Changes include decentralization, greater delegation of authority, a modified organizational chart and recalibration of the project design process. Further changes in IFAD's business model, with a new financial architecture, increased private sector engagement and the strategic directions of the Twelfth Replenishment of IFAD's Resources (IFAD12), represent a significant departure from the Fund's prior strategy and directly impact IFAD's risk profile. IFAD's changes are bold, aspirational and focused squarely on maximizing IFAD's contribution to development in the poorest countries. Its success is especially important in the context of the 2030 Agenda for Sustainable Development.

2. Support to these changes, and achievement of the expected strategic goals, requires a strong, enterprise-wide risk management framework. As the risk landscape becomes increasingly complex, donors, Member States, recipients and strategic partners — including credit rating agencies — will expect that risks are properly identified, measured, monitored and mitigated. Having an established, integrated risk framework that is underpinned by a shared understanding of the risks, and the appetite IFAD has for different kinds of risks, will help the Executive Board, Management and staff to manage and mitigate those risks.

3. Based on IFAD's revised business model and need for informed risk-taking across various dimensions, Management assured the Executive Board in April 2018 that it would enhance the Enterprise Risk Management Framework (ERMF), considering not only financial risks, but also non-financial ones (programme delivery, strategic, and operational) as well as cross-cutting legal and reputational risks. IFAD's enterprise risk management (ERM) function and risk identification, monitoring and reporting processes would also be examined.

4. In July 2018, IFAD selected Alvarez & Marsal and Marsh Risk Consulting to support this initiative and evaluate the existing risk frameworks in place across the institution. As part of this exercise, IFAD's ERMF positioning against the industry best practice ERM maturity model was analysed, as shown below.

Figure 1
**ERM maturity model**
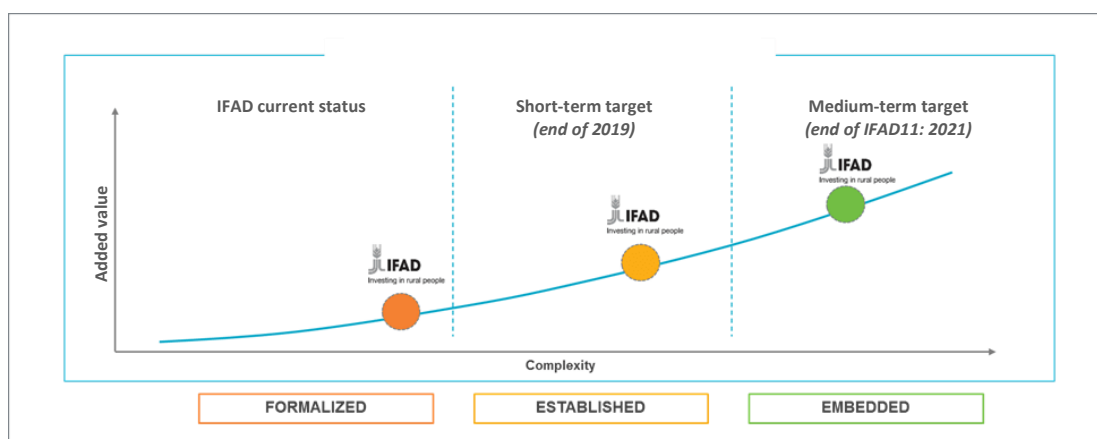
5.  Based on the assessment, IFAD was considered to be in a formalized[1] state, and key interventions were identified for immediate action by the Fund to enhance its ERMF.

6.  In October 2019, Ernst & Young was engaged to support Management in some of these key interventions, including the development of an enterprise risk taxonomy, the new ERM Policy and a draft Risk Appetite Framework (RAF). These documents are being presented to the Audit Committee jointly with this paper and the Corporate Risk Dashboard (CRD), forming the set of ERM communications.

7.  Management is also finalizing a new ERM governance structure that will strengthen its second line of defence with an ERM team under the leadership of a Chief Risk Officer (CRO). The structure will be fundamental in fostering a strong risk culture and ensuring that risk management is embedded in decision-making and processes. It will also play a leading role in the proper implementation of the enhanced ERMF and the coordination of the risk technical committees. The CRO function is already broadly described in the new ERM Policy. Management will present further details at the upcoming Audit Committee meeting and expects to discuss the new ERM Policy with the Audit Committee in June to provide further clarifications on the role of the CRO.

8.  The Fund has taken positive steps to enhance risk management over the past 18 months, especially in its financial architecture, by adopting an integrated approach to all risk domains. But it needs to accelerate progress according to the maturity model (figure 1). IFAD is aiming to fully embed the new ERMF across the organization to drive the expected results.

9.  Accordingly, ERM is part of IFAD's targeted capacity investment initiative, which proposes a two-year implementation plan to introduce structural changes related to risk and fill identified gaps that compromise or have an impact on the effectiveness of IFAD's risks management.

10. The purpose of this paper is to provide information on progress to date and to explain and set in context IFAD's vision for ERM, thus informing the review of the ERM documents by the Audit Committee. Based on the feedback provided, Management will further develop the documents and present the new ERM Policy and the draft RAF to the Audit Committee for discussion in June, and subsequently for approval in September 2020.

## II. Road map deliverables

11. The ERM Policy (including the enterprise risk taxonomy) and the RAF are specifically indicated in the ERMF road map presented to the Executive Board last December. They are the result of IFAD's most recent efforts to develop a strong foundation for effective risk management in the Fund. They establish the framework and the minimum requirements for risk management at the Fund, and form the basis for strengthening IFAD's developing risk culture. Their preparation was informed by assessments of IFAD's current risk management practices and capabilities, as well as a broad range of views from individuals across all risk areas of the Fund.

12. **IFAD's new ERM Policy** is based on industry best practices as applied by other international financial/United Nations institutions and has been adapted to IFAD's

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[1] **Formalized.** Some policies and/or procedures/guidelines are defined, roles and responsibilities are addressed, and periodic risk assessment exercises are performed. An overall scattered approach to risk management is observed and no definition of risk appetite is present.
**Established.** Structured/comprehensive risk assessment processes and governance systems are put in place and promoted through a clear definition of roles and responsibilities and the presence of a risk accountability culture. A first definition of risk appetite is made and communicated to stakeholders, while risk-reporting mechanisms across various layers of the organization are defined.
**Embedded.** A proactive approach to risk management and a common understanding of risks is observed across all the levels of the organization. Risk is embedded in decision-making through consistent definition, comprehension and application of risk appetite and tolerance levels.

specific needs. The policy provides a concise outline of the components of IFAD's enhanced ERMF in response to the numerous changes — both internal and external — that have taken place since the development of the original ERM Policy in 2008. Table 1 below identifies key ERM Policy updates and the associated rationale for such decisions.

Table 1
**Notable updates to IFAD's new ERM Policy**

| *Update* | *Rationale* |
|---|---|
| Document structure | The structure of the policy was refreshed to provide a clear outline of the components of IFAD's ERMF and the methodology behind it. The document is structured so as to clearly identify the separate components of IFAD's ERMF. |
| Principles of the policy | IFAD's strategy has evolved to adapt with the changing development environment. As such, the principles governing the Fund's ERM have been refined to complement the principles of IFAD's accountability framework and provide a clear, concise, and actionable model of leading risk management practices as IFAD implements new initiatives. |
| Roles and responsibilities | IFAD's recent ERM initiatives and the shift to IFAD12 strategic directions require an updated methodology and structure of risk management, including roles and responsibilities. The key roles and responsibilities of IFAD Management and relevant staff have been revised to incorporate leading practices and the needs of the Fund. |
| Risk appetite | An overview of IFAD's RAF, which is a subcomponent of the ERMF, was included to provide additional context on how IFAD's ERM initiatives are being implemented in practice. The new ERM Policy makes reference to the detailed information included in the RAF. |
| Risk escalation | Procedures for escalating key risk issues and themes to the appropriate decision makers have been updated to reflect IFAD's updated model of risk oversight and governance. |

13. **IFAD's enterprise risk taxonomy**, presented as an appendix to the new ERM Policy, provides a structure for the consistent identification, assessment, management, and reporting of risks within IFAD's ERM landscape and establishes a common understanding of the Fund's key risks. The taxonomy consists of four risk domains (level 1) that represent the primary categories of risk to which the Fund is exposed. Each risk domain consists of a set of risk subdomains (level 2) that constitute the main components of each of the four risks. Each risk subdomain is further defined by a set of major risk drivers (level 3). These drivers are monitored and reported using established metric and key risk indicators (KRIs). In addition, reputational and legal risks have been identified as cross-cutting and will be further developed in 2020 to complement the existing four risk domains.

14. **IFAD's draft RAF** takes a closer look at one component of the ERMF: risk appetite. Based on the independent risk assessment report of Marsh Risk Consulting, and the evolving complexities of IFAD's business model, the RAF is proposed as a separate document. The RAF supplements IFAD's ERM Policy and defines the minimum requirements and expectations for the development and implementation of IFAD's risk appetite. It provides guidance on the systematic assessment, management and reporting of risks; and establishes key components of the Fund's common risk language. Within the RAF, IFAD can articulate the type and level of risk the Fund is willing to take in a series of risk appetite statements (RASs) reviewed annually. IFAD's preliminary RASs are currently in development and will be presented to the Audit Committee in September. IFAD's RAF will continue to evolve through 2020 and 2021, undergoing revisions, including to the RASs, probably after year one of implementation. The framework was developed with flexibility in mind, particularly important as IFAD moves to develop a policy hierarchy.

## III. Progress to date

15. In addition to the specific deliverables presented for a first review, building on the last ERM update, table 2 summarizes the progress to date on the enhancement of IFAD's ERMF. Management has developed a detailed two-year ERM implementation

plan for 2020–2021 that is part of the targeted capacity investment, which will be discussed at this Audit Committee meeting as a separate agenda item.

Table 2
**Update and status of action areas**

| Legend: | 🟢 *On target* | 🟡 *Areas to watch* | 🔴 *Areas to address* |
|---|---|---|---|

| *Action* | *Update* | *Next step* | *Status* |
|---|---|---|---|
| *By the end of Q2 2020, IFAD Management expects to propose a RAS for each of the four key risk domains.*[2] | Preliminary, qualitative RASs have been developed and will be finalized on completion of the quantitative RASs. Development of the latter is starting in February 2020. Updates will be provided in June while preliminary RASs are expected to be submitted to the Audit Committee in September 2020. | To allow for a comprehensive discussion of risk appetite, Management proposes to jointly submit the preliminary qualitative and quantitative RASs in Q3 2020. | 🟢 |
| *By mid-year, Management expects to have a revised ERM Policy as well as a governance structure, giving effect to the core elements of a strengthened ERMF for IFAD.* | A new ERM Policy and a draft RAF are herewith submitted for discussion<br><br>Governance structure is in the final stages of development. | Management proposes to re-submit the drafts for discussion in June and for final Audit Committee review and endorsement, as well as for Executive Board review/approval in Q3 2020<br><br>Governance structure is expected to be implemented by Q2 2020. | 🟢 |
| *By the end Q3 2020, Management expects to have the necessary data to identify the appropriate KRIs for IFAD's top risks.* | The kick-off meetings were held in early February. Management expects to have the preliminary data by Q2 2020. | To allow for a comprehensive discussion of risk appetite, Management proposes to jointly submit the preliminary qualitative and quantitative RASs in Q3 2020. | 🟡 |
| *By the end of 2020, the CRD will be revised and presented with KRIs aligned with the new risk taxonomy and with each of IFAD's RASs.* | An improved CRD aligned to the risk taxonomy is submitted to the Audit Committee with this update. | By the end of 2020, the CRD will be revised and presented with KRIs aligned with the new risk taxonomy and with each of IFAD's RASs. | 🟡 |
| **New:** *By Q3 2020, Management expects to roll out and complete dedicated risk appetite training sessions.* | Integrated ERM training workplan and materials are in development. | N/A | 🟡 |

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[2] Actions in italic were communicated to the Audit Committee at its 155th meeting in November 2019.