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Investing in rural people

Report on IFAD's Investment Portfolio for the First Semester of 2020

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For: **Information**

Executive summary

1. During the first semester (S1) of 2020, IFAD's investment portfolio generated a negative net rate of return of 0.17 per cent with a negative net investment income of US\$2.6 million.¹
2. The value of the investment portfolio in United States dollar terms decreased by US\$26.5 million from US\$1,003.9 million at 31 December 2019 to US\$977.4 million at 30 June 2020. The main factors underlying this increase were net outflows of US\$23.0 million, a negative net investment income of US\$2.6 million and negative foreign exchange movements of US\$1.0 million.

Key portfolio changes between the first semesters of 2019 and 2020

	<i>S1 2019</i>	<i>S1 2020</i>
Portfolio size (US\$ '000)	1 123 793	977 360
Net investment income (US\$ '000)	15 928	(2 570)
Rate of return (%)	1.52	(0.17)
Duration	0.52	0.68
Conditional value at risk	0.80	1.78

¹ Note: Numbers in this report have been rounded up or down. There may therefore be discrepancies between the actual totals of the individual amounts in the tables and the totals shown, as well as between the numbers in the tables and the numbers given in the corresponding analyses in the text of the annual report. All roundings, totals, percentage changes and key figures were calculated using the complete (unrounded) underlying data.

Report on IFAD's Investment Portfolio for the First Semester of 2020

I. Market conditions

1. After the extreme volatility of the first quarter of the year, markets retraced somewhat in the second quarter. The retracement, although still volatile, caused for some spread tightening and consequently a rebound in the performance of the portfolio. Specifically, the asset liability portfolio performed well as the yield spread between corporate and government bonds tightened. The recovery, however, remains fragile and consequently the portfolio was repositioned aggressively in the second quarter to protect against any further losses.

II. Portfolio allocation

2. During the first semester of 2020, the value of the investment portfolio in United States dollar terms decreased by US\$26.5 million.

Table 1

Movements affecting IFAD's investment portfolio in the first semester of 2020

(Thousands of United States dollars)

	Operational cash ^a	Global liquidity portfolio	Asset liability portfolio	Other ^b	Grand total
Opening balance (31 December 2019)	135 300	324 314	544 109	138	1 003 862
Net investment income	211	2 835	(5 619)	4	(2 570)
Net flows ^c	(75 372)	83 055	(30 903)	193	(23 026)
Foreign exchange movements	(789)	-	(625)	508	(906)
Closing balance (30 June 2020)	59 351	410 204	506 962	843	977 360

^a Cash held with banks, readily available for disbursing loans, grants and administrative expenses.

^b Residual cash positions of portfolios closed in 2019 as well as cash held in Chinese renminbi.

^c Net flows consist of outflows in respect of disbursements of loans, grants and administrative expenses and inflows from loan refloes and encashment of Member State contributions.

III. Investment income

3. Gross investment income for the first semester of 2020 amounted to negative US\$2.1 million, with net investment income inclusive of all investment-related fees totalling negative US\$2.6 million. Table 2 presents a summary of the first semester 2020 investment income broken down by portfolio.

Table 2

Breakdown of IFAD's investment income by portfolio for the first semester of 2020

(Thousands of United States dollars equivalent)

Investment income	Operational cash	Global liquidity portfolio	Asset liability portfolio	Other	Total
Interest and coupon ^a income	287	2 903	621	-	3 811
Realized market gains/(losses)	-	(76)	(676)	-	(753)
Unrealized market gains/(losses)	-	209	(5 318)	-	(5 109)
Investment income before fees	287	3 035	(5 373)	-	(2 051)
Investment manager fees	-	-	-	8	8
Custody fees	(1)	(16)	(19)	(3)	(39)
Bank charges	(75)	-	(1)	-	(76)
Advisory and other fees	-	(184)	(226)	(1)	(412)
Investment income after fees	211	2 835	(5 619)	4	(2 570)

^a Including net payments on interest rate swap positions.

IV. Rate of return

4. The rate of return on IFAD's investment portfolio is calculated in local currency terms without reflecting the impact of foreign exchange movements.
5. Excluding the asset liability portfolio (ALP), IFAD's investment portfolio generated a positive net return of 0.65 per cent for the first semester of 2020, 24 basis points below the benchmark's return for the same period. The ALP generated a negative net return of 0.87 which was primarily due to unrealized losses on the portfolio. However, the interest income of the portfolio of 0.12 per cent for the semester exceeds the portfolio's cost of funding of 0.08 per cent. The net rate of return for the entire investment portfolio, including the ALP, was negative 0.17 per cent.

Table 3
Performances for 2019, first semester of 2020
 (Percentages in local currency terms)

	<i>Performances in 2019 by semester</i>		<i>Performance in 2020</i>		
	<i>First semester</i>	<i>Second semester</i>	<i>First semester</i>	<i>First semester benchmark return</i>	<i>Difference</i>
Operational cash	0.61	0.70	0.32	0.32	-
Global strategic portfolio	1.20	n.a.	n.a.	n.a.	n.a.
Global liquidity portfolio	1.44	1.29	0.80	1.03	(0.24)
Global credit bonds	3.51	n.a.	n.a.	n.a.	n.a.
Gross rate of return excluding ALP	1.97	1.16	0.72	0.89	(0.17)
Net rate of return excluding ALP	1.90	1.13	0.65	0.89	(0.24)
ALP*	1.10	0.12	(0.87)	0.08	(0.95)
Gross rate of return including ALP	1.58	0.64	(0.11)	n.a.	n.a.
Net rate of return including ALP	1.52	0.61	(0.17)	n.a.	n.a.

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

Table 4
IFAD portfolio performance rolling average as at 30 June 2020
 (Percentages in local currency terms)

	<i>One year</i>	<i>Three years</i>	<i>Five years</i>
Portfolio performance	0.44	1.00	1.38

6. For comparative purposes, table 5 presents annual performances during the previous four years.

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

	<i>2019</i>		<i>2018</i>		<i>2017</i>		<i>2016</i>	
	<i>Actual</i>	<i>Benchmark</i>	<i>Actual</i>	<i>Benchmark</i>	<i>Actual</i>	<i>Benchmark</i>	<i>Actual</i>	<i>Benchmark</i>
Operational cash	0.88	0.88	0.79	0.79	0.30	0.30	0.13	0.13
Global strategic portfolio	2.22	1.02	1.92	0.80	1.83	0.95	1.75	1.12
Asset liability portfolio	(0.91)	0.21	1.39	-	0.62	-	(0.78)	0.31
Chinese renminbi portfolio	1.46	0.00	3.72	-	0.48	-	-	-
Global government bonds	0.89	1.88	0.27	0.99	0.64	1.03	0.05	0.43
Global credit bonds	0.00	0.90	3.43	3.31	3.23	3.52	1.17	1.25
Global inflation indexed bonds	0.16	0.39	1.86	1.53	4.41	4.37	(0.85)	(0.51)
RAMP* portfolio	0.14	0.14	0.31	0.30	n.a.	n.a.	n.a.	n.a.
Emerging market debt bonds	(3.07)	(2.55)	8.45	7.64	6.83	6.40	(1.17)	(0.86)
Gross rate of return (excluding fees)	0.21	n.a.	2.35	n.a.	3.09	n.a.	0.13	0.35
Net rate of return (including all fees)	0.09	n.a.	2.21	n.a.	2.91	n.a.	(0.06)	0.16

* World Bank's Reserves Advisory Management Programme (RAMP).

V. Composition of the portfolio by instrument

7. Table 6 shows the composition of the investment portfolio by instrument as at 30 June 2020.

Table 6

Investment portfolio by instrument as at 30 June 2020

(Millions of United States dollars equivalent)

	30 June 2020	
	Actual portfolio allocation (US\$)	Actual portfolio allocation (%)
Cash	66.4	6.8
Swaps	(5.7)	(0.6)
Commercial paper	10.0	1.0
Global government bonds/agencies	510.9	52.3
Global credit bonds	395.7	40.5
Total	977.4	100.0

8. In November 2019, 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 three 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 for the MLR and are used to provide enhanced returns.

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

Table 6b

Portfolio by Tranche as of 30/06/2020

Tranche	%	US\$ millions
Liquidity	58.0	567.2
Buffer	42.0	410.2
Surplus	-	-
Total	100.0	977.4

VI. Risk measurements

10. The Investment Policy Statement (IPS) risk-budgeting measure of the conditional value at risk (CVaR) is reported in subsection B. Other risk indicators are reported in subsections A, C, D and E.

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. Duration is 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 durations of IFAD's investment portfolio and benchmarks

(Duration in number of years)

	31 June 2020		31 December 2019	
	Portfolio	Benchmark	Portfolio	Benchmark
Asset liability portfolio	1.04	0.49	0.80	0.50
Global liquidity portfolio	0.33	0.45	0.30	0.50
Total portfolio (including global strategic portfolio and operational cash)	0.68	0.44	0.50	0.42

12. The overall portfolio duration was 0.68 years (0.50 years in December 2019).

B. Market risk: conditional value at risk

13. The one-year CVaR at 95 per cent is a measure of the potential average probable loss of a portfolio under extreme conditions and gives an indication of how much value a portfolio could lose over a forward-looking one-year horizon with a confidence level of 95 per cent.
14. The maximum risk tolerance of the IFAD portfolio is defined in the IPS as a CVaR of 3.0 per cent. CVaR for the overall IFAD portfolio was 1.78 per cent, which is below the approved risk budget level. The current CVaR risk level of 1.78 per cent implies an average loss of US\$17.4 million under extreme market conditions.

Table 8

CVaRs of IFAD's asset classes

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

	Actual investment portfolio one-year CVaR	
	30 June 2020	31 December 2020
Asset liability portfolio	2.40	1.15
Global liquidity portfolio	1.83	1.17
Total portfolio (including global strategic portfolio and cash)	1.78	0.81

Note: Total portfolio CVaR is lowered by the global strategic portfolio, reported at amortized cost, and the operational cash portfolio, as neither is subject to market fluctuations.

C. Credit risk: credit rating analysis

15. IFAD's IPS establishes a policy credit rating floor, with credit risk managed by monitoring securities in accordance with investment guidelines. This may foresee stricter credit quality requirements than those contained in the IPS.

Table 9

Investment portfolio composition by credit rating^a at 30 June 2020

(Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Global liquidity portfolio</i>	<i>Asset liability portfolio</i>	<i>Other</i>	<i>Total</i>	<i>Percentage</i>
AAA	-	313 052	11 220	-	324 272	33.2
AA+/-	-	89 457	263 555	-	353 012	36.1
A+/-	-	-	225 502	-	225 502	23.1
BBB+/-	-	-	3 874	-	3 874	0.4
Commercial paper	-	9 996	-	-	9 996	1.0
Cash ^b	59 351	582	5 614	23	65 571	6.7
Pending trades ^c	-	-	-	819	819	0.1
Swaps	-	-2 883	-2 804	-	-5 687	(0.6)
Total	59 351	410 204	506 962	843	977 360	100.0

^a 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 credit rating agencies.

^b 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.

^c 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 short-term liquidity profile from foreign currency risk fluctuations, the Fund ensures that the currency composition of its projected inflows are aligned to its outflows over a 24-month horizon.
17. Projections show that the Fund's currency composition is adequate to cover the projected 24-month currency outflows.

Table 10

Currency composition of assets and commitments as at 30 June 2020

(Thousands of United States dollars equivalent)

<i>Category</i>	<i>Chinese yuan group</i>	<i>Euro group</i>	<i>British pound sterling group</i>	<i>Japanese yen group</i>	<i>United States dollar group</i>	<i>Grand total</i>
Current liquidity						
Cash	110	3 762	3 045	116	52 065	59 098
Investments	0	53	3	0	410 158	410 229
Projected inflows						
Contributions	30 300	233 928	42 372	47 530	259 074	613 205
Projected reflows	77 621	235 088	56 870	59 572	334 562	763 713
Debt drawdowns	0	36 851	0	0	66 589	103 440
Projected liquidity	108 031	509 682	102 290	107 219	1 122 448	1 949 685
Projected outflows						
Projected disbursements	(68 601)	(340 281)	(50 261)	(52 649)	(863 415)	(1 375 206)
Projected operating expenses	0	(216 583)	0	0	(143 165)	(359 749)
Debt repayments & interests	0	(112)	0	0	(691)	(803)
Subtotal outflows	(68 601)	(556 977)	(50 261)	(52 649)	(1 007 271)	(1 735 759)
Hedging						
Currency forwards	0	25 819	0	0	(25 000)	819
Subtotal hedging	0	25 819	0	0	(25 000)	819
Projected liquidity (deficit)/excess	39 431	(21 475)	52 029	54 570	90 177	214 746
(Deficit)/excess as % of commitments	2.27%	(1.24%)	3.00%	3.14%	5.20%	12.37%

* The main difference in the cash and investments balance compared with other tables derives from the exclusion of assets in non-convertible currencies (US\$278,000 equivalent) and the ALP (US\$507 million equivalent). The latter is not subject to the special drawing right currency alignment as it is maintained in euros in line with its commitments. The residual marginal difference is due to the composition report being based on the unaudited figures available at the moment the report is run.

E. Liquidity risk: minimum liquidity requirement

18. IFAD's latest financial model assumptions – incorporating 2019 resources available for commitment under the sustainable cash flow approach – calculate a MLR of US\$672.0 million (60 per cent of gross annual outflows),² which is below IFAD's investment portfolio balance of US\$977.4 million (see table in the executive summary).

² See EB 2019/128/R.37.