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Investing in rural people

Report on IFAD's Investment Portfolio for the Third Quarter of 2020

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For: **Information**

Executive summary

1. The value of IFAD's investment portfolio in United States dollar terms decreased by US\$20.9 million from US\$977 million as of 30 June 2020 to US\$956 million as of 30 September 2020.¹ The main underlying factors were net outflows of US\$49.6 million, net investment income of US\$5.1 million and positive foreign exchange movements of US\$23.5 million.
2. Risk levels in the investment portfolio were stable. The conditional value at risk (CVaR) of the overall portfolio decreased from 1.78 to 1.53. Portfolio duration levels increased from 0.68 to 0.69.
3. The size of the portfolio, US\$956 million, comfortably exceeds the minimum liquidity requirement (MLR), US\$654 million.

Table 1

Key portfolio changes during the third quarter

	Q2 2020	Q3 2020
Portfolio size (thousands of US\$)	977 360	956 374
Net investment income (thousands of US\$)	8 319	5 128
Rate of return (%)	0.88	0.54
Duration	0.68	0.69
CVaR	1.78	1.53
MLR	653 886	653 886
Portfolio size as a % of minimum liquidity requirement	149%	146%

¹ Figures 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 included 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 Third Quarter of 2020

I. Market conditions

1. The global recovery continued to gather momentum in third quarter of 2020 (Q3 2020), with most asset classes having recovered from the intense volatility that occurred in financial markets due to the COVID-19 pandemic. Government bond yields edged higher as market sentiment improved. However, COVID-19 remains a significant risk to investors.
2. The asset liability portfolio generated a positive return as a result of credit spread tightening. The global liquidity portfolio also produced moderate gains. Volatility may increase due to political developments that the market may perceive as risks.

II. Portfolio size

3. During the third quarter of 2020, the value of IFAD's investment portfolio in United States dollar terms decreased by US\$20.9 million.

Table 1

Movements affecting IFAD's investment portfolio during the third quarter of 2020

(Thousands of United States dollars equivalent)

	Operational cash ^a	Global liquidity portfolio	Asset liability portfolio	Other ^b	Grand total
Opening balance (30 Jun 2020)	59 351	410 204	506 962	843	977 360
Net investment income	(23)	1 274	3 878	(1)	5 128
Net flows ^c	5 958	(47 070)	(7 296)	(1 275)	(49 683)
Foreign exchange movements	627	2	22 484	456	23 570
Closing balance (30 Sep 2020)	65 912	364 411	526 028	23	956 374

^a Cash held with banks that is readily available for disbursing loans, grants and administrative expenses.^b Residual cash positions of portfolios closed in 2020 and cash held in Chinese renminbi.^c Net flows consist of outflows for portfolio transfers, disbursements for loans, grants, investment and administrative expenses, inter-fund portfolio transfers and inflows from loan reflows and encashment of Member States' contributions.

III. Investment income

4. Gross investment income for the third quarter of 2020 amounted to US\$5.2 million, with net investment income inclusive of all investment-related fees totalling US\$5.1 million. Table 2 presents a summary of the third quarter 2020 investment income broken down by portfolio.

Table 2

Breakdown of IFAD's investment income by portfolio during the third quarter of 2020
(Thousands of United States dollars equivalent)

<i>Investment income</i>	<i>Operational cash</i>	<i>Global liquidity portfolio</i>	<i>Asset liability portfolio</i>	<i>Other</i>	<i>Total</i>
Interest and coupon income	9	867	286	-	1 162
Realized market gains/(losses)	-	124	(202)	-	(78)
Unrealized market gains/(losses)	-	343	3 870	-	4 213
Investment income before fees	9	1 333	3 954	-	5 296
Investment manager fees	-	-	-	-	-
Custody fees	()	(6)	(6)	(1)	(13)
Bank charges	(31)	-	-	-	(31)
Advisory and other investment-related fees	-	(53)	(71)	-	(123)
Investment income after fees	(23)	1 274	3 878	(1)	5 128

IV. Rate of return

- 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 positive net return of 0.28 per cent during the third quarter of 2020, 21 basis points above the benchmark return for the same period. The ALP generated a positive gross return of 0.77 per cent versus a target rate of return of 0.04 per cent for the same period. The net rate of return for the entire investment portfolio, including the ALP, was 0.53 per cent.

Table 3

Quarterly performances for 2019, and the first, second and third quarters of 2020
(Percentages in local currency terms)

	<i>Quarterly performances in 2019</i>				<i>Quarterly performance in 2020</i>				
	<i>First quarter</i>	<i>Second quarter</i>	<i>Third quarter</i>	<i>Fourth quarter</i>	<i>First quarter</i>	<i>Second quarter</i>	<i>Third quarter</i>	<i>Third quarter benchmark</i>	<i>Difference</i>
Operational cash	0.40	0.44	0.12	0.34	0.27	0.05	0.02	0.02	0.00
Global strategic portfolio	0.59	0.61	0.72	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Global liquidity portfolio	0.71	0.77	0.99	0.37	0.31	0.49	0.34	0.07	0.27
Global credit bonds	0.59	0.61	0.72	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gross rate of return excluding ALP	1.28	0.68	0.77	0.36	0.29	0.42	0.30	0.07	0.24
Net rate of return excluding ALP	1.24	0.65	0.75	0.35	0.26	0.39	0.28	0.07	0.21
ALP*	0.77	0.36	0.11	0.02	(2.22)	1.37	0.77	0.04	0.74
Gross rate of return including ALP	1.05	0.52	0.45	0.18	(1.01)	0.91	0.56	n.a.	n.a.
Net rate of return including ALP	1.02	0.50	0.44	0.17	(1.04)	0.88	0.53	n.a.	n.a.

* 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 of 30 September 2020
(Percentages in local currency terms)

	One year	Three years	Five years
Net portfolio performance (including ALP)	0.53	0.98	1.55

7. For comparative purposes, table 5 presents annual performance during the previous four years.

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

	2019		2018		2017		2016	
	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark	Actual	Benchmark
Operational cash	1.31	1.31	0.88	0.88	0.79	0.79	0.30	0.30
Global strategic portfolio	1.93	0.62	2.22	1.02	1.92	0.80	1.83	0.95
Global liquidity portfolio	2.73	1.11	2.16	0.00	n.a.	n.a.	n.a.	n.a.
Asset liability portfolio	1.22	0.17	(0.91)	0.21	0.96	0.22	0.62	0.00
Chinese renminbi portfolio	n.a.	n.a.	1.46	0.0	3.72	0.00	0.48	0.00
Global government bonds	n.a.	n.a.	0.89	1.88	0.27	0.99	0.64	1.03
Global credit portfolio	3.65	4.72	0.00	0.90	3.43	3.31	3.23	3.52
Global inflation-indexed bonds	n.a.	n.a.	0.16	0.39	1.86	1.53	4.41	4.37
Emerging market debt bonds	n.a.	n.a.	(3.07)	(2.55)	8.45	7.64	6.83	6.40
Gross rate of return (excluding all fees)	2.22	n.a.	0.21	n.a.	2.35	n.a.	3.09	n.a.
Net rate of return (including all fees)	2.13	n.a.	0.09	n.a.	2.21	n.a.	2.91	n.a.

V. Composition of the portfolio by instrument

8. Table 6 shows the composition of the investment portfolio by instrument as of 30 September 2020.

Table 6
Investment portfolio by instrument as of 30 September 2020
(Thousands of United States dollars equivalent)

	30 September 2020	
	Actual portfolio allocation (US\$)	Actual portfolio allocation (%)
Cash*	105.3	11.0
Swaps	-5.7	(0.6)
Commercial paper	10.0	1.0
Global government bonds/agencies	443.0	46.3
Global credit bonds	403.7	42.2
Total	956.37	100.0

* Includes pending trades.

9. Since November 2019, in alignment with other international financial institutions, the portfolio is monitored at different layers based on the liquidity needs of the institution rather than on specific limits set for each asset class. Consequently, the investment portfolio has been split into three tranches, as follows:
- (i) **Liquidity tranche.** Used for immediate cash disbursements.
 - (ii) **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).

- (iii) **Surplus tranche.** These are funds in addition to what is required for the MLR and are used to provide enhanced returns.

10. Table 7 shows the net asset value of the portfolio based on the new tranching approach.

Table 7
Portfolio by tranche as of 30/09/2020

<i>Tranche</i>	<i>%</i>	<i>US\$ millions</i>
Liquidity	61.9	591.9
Buffer	38.1	364.4
Surplus	0.0	0.0
Total	100.0	956.37

VI. Risk measurements

11. The risk budgeting measure used in line with the Investment Policy Statement (IPS) is CVaR, which is reported in subsections B and C. Other risk indicators are reported in subsections A, D, and E.

A. Market risk: duration

12. 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.

Table 8
Effective duration of IFAD's investment portfolio and benchmarks
(Duration in numbers of years)

	<i>30 June 2020</i>		<i>30 September 2020</i>	
	<i>Portfolio</i>	<i>Benchmark</i>	<i>Portfolio</i>	<i>Benchmark</i>
Asset liability portfolio	1.04	0.49	1.04	0.79
Global liquidity portfolio	0.33	0.45	0.31	0.45
Total portfolio (including operational cash)	0.68	0.44	0.69	0.57

13. The overall portfolio duration is 0.69 years.

B. Market risk: conditional value at risk

14. The one-year CVaR at 95 per cent is a measure of the potential average probable loss of a portfolio under extreme conditions and provides 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.
15. The maximum risk budget for the overall investment portfolio is set in the IPS at a CVaR of 3.0 per cent. CVaR for the overall IFAD portfolio was 1.53 per cent. The current CVaR risk level of 1.53 per cent implies an average loss of US\$26.0 million under extreme market conditions.

Table 9

CVaRs of IFAD's asset classes

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

	<i>Actual investment portfolio one-year CVaR</i>	
	<i>30 June 2020</i>	<i>30 September 2020</i>
Asset liability portfolio	2.42	2.11
Global liquidity portfolio	1.83	1.53
Total portfolio (including operational cash)	1.78	1.53

Note: Total portfolio CVaR is lowered by the operational cash portfolio, as cash is not subject to market fluctuations.

C. Credit risk: credit rating analysis

16. The IPS establishes a credit rating floor, in addition to investment guidelines setting out credit quality requirements. Credit risk is managed by monitoring the compliance of securities with these requirements.

Table 10

Investment portfolio composition by credit rating at 30 September 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		276 104	11 750		287 855	30.1
AA+/-		79 516	271 842		351 359	36.7
A+/-			207 545		207 545	21.7
Cash ^a	65 912	1 481	37 854	1	105 271	11.0
Commercial Paper		9 999			9 999	1.0
Pending trades ^b						(0.0)
Swaps		-2 690	-2 963		-5 654	(0.6)
Total 30/09/2020	65 912	364 411	526 028	1	956 374	100.0

^a 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.^b 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**

17. In order to protect the short-term liquidity profile from foreign currency risk fluctuations, the Fund ensures that the currency composition of projected inflows matches that of outflows over a 24-month horizon.

Table 11
Currency composition of assets and commitments as of 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	114	14 403	3 839	119	47 343	65 818
Investments	13	56	4	0	364 363	364 436
Projected inflows						
Contributions	28 360	267 453	42 593	52 102	274 669	665 178
Projected reflows	82 921	253 227	61 203	62 422	346 636	806 408
Debt drawdowns	0	57 672	0	0	8 333	66 005
Projected liquidity	111 409	592 811	107 638	114 642	1 041 345	1 967 845
Projected outflows						
Projected disbursements	(69 372)	(362 687)	(51 202)	(52 222)	(914 927)	(1 450 410)
Projected operating expenses	0	(217 634)	0	0	(143 860)	(361 494)
Debt repayments and interest	0	(117)	0	0	(795)	(912)
Subtotal outflows	(69 372)	(580 439)	(51 202)	(52 222)	(1 059 582)	(1 812 817)
Hedging						
Currency forwards	0	0	0	0	0	0
Subtotal hedging	0	0	0	0	0	0
Projected liquidity (deficit)/excess	42 037	12 372	56 436	62 421	(18 237)	155 028
(Deficit)/excess as % of commitments	2.32%	2.13%	110.22%	119.53%	-1.72%	8.55%

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 minimum liquidity requirement of US\$654 million (60 per cent of gross annual outflows),² which is comfortably cleared by the investment portfolio balance of US\$956 million (see table 1).

² See EB 2018/125/R.42.