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Update on Asset and Liability Management

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For: **Review**

I. Introduction

1. At the 131st session of the Executive Board, Management presented the Update on the Operationalization of the IFAD Asset and Liability Management (ALM) Framework.¹ In the document, prepared by the Office of Enterprise Risk Management (RMO), several areas for development were identified in order to achieve the full implementation of a comprehensive ALM function at IFAD in 2021:
 - (i) First, IFAD must ensure that clear, complete, timely and accurate data are readily available for use in ALM analysis. Robust data are needed to perform the required analysis and produce periodic reporting for both internal and external stakeholders;
 - (ii) Second, specific metrics must be reported in addition to the analysis to assess overall exposures to liquidity, currency and interest rate risks and to support strategic decisions on mitigating strategies; and
 - (iii) Finally, enhancement of the internal ALM governance is required to achieve a clear attribution of tasks and related responsibility between the three lines of defence.
2. At the same session in December 2020, the Executive Board, responding to the overarching changes to the Fund's financial architecture, completed the implementation of a new financial policy set-up encompassing a new Liquidity Policy,² the Integrated Borrowing Framework³ and the 2020 Update to the Methodology for Determination of IFAD's Resources Available for Commitment.⁴ In addition to the Capital Adequacy Policy and the ALM Framework, the new policies constitute important pillars for the development of a comprehensive ALM methodology.
3. This document illustrates the progress made since the presentation of the operationalization of ALM framework by RMO and the approval of new policies, and the next steps in 2021 required to achieve full implementation of the ALM function within the Treasury Services Division (TRE), spanning both first and second line functions.

II. Progress

4. As highlighted in the operationalization of ALM framework document presented in December 2020, TRE has started a number of initiatives aimed at implementing the ALM function. Activities have included engaging with specialized consultancy firms, defining the ALM metrics to be monitored, integrating calculation tools into existing and new systems, and hiring ALM and investment management senior consultants.
5. With the establishment of RMO as an independent division, RMO and TRE have started the implementation of a revised ALM governance arrangement. In this context, it is common practice that TRE, as first line of defence, is responsible for the operational management of financial risks, while RMO, in line with its independent second line of defence role, is responsible for ALM risk control.
6. In accordance with the requirements above, in February 2021, TRE and RMO signed a service-level agreement (SLA), laying the foundations for the governance structure and information flows for all areas of work between the two lines of defence with a focus on deliverables, timing and responsibilities. The SLA's main objective is to normalize the relationship between the separate lines of defence, re-defining roles and responsibilities and agreeing on the format and content of the

¹ EB 2020/131(R)/R.23.

² EB 2020/131(R)/R.20.

³ EB 2020/130/R.31.

⁴ EB 2020/130/R.35.

planned reporting. Based on this SLA, TRE will start reporting regularly to RMO during the first quarter of 2021.

7. At the core of any ALM process, the availability of clear, complete, timely and accurate data, accessible from a centralized source, is pivotal to conduct sound and timely analyses. Data gaps could obstruct a more complete analysis of the financial and risk metrics that are reported in ALM. Automated capabilities for importing model-related data for balance sheet and off-balance sheet items, market data (such as external interest rate scenario data), and timing of cash inflows and outflows are also very important.
8. A comprehensive review of IFAD's financial data environment has started, highlighting specific gaps in data availability and completeness, access and timeliness and to identify the required process to increase efficiencies when needing to reconcile data, once obtained from the corporate systems. Meetings have taken place across the divisions of the Financial Operations Department, RMO and the Information and Communications Technology Division (ICT) to address data requirements, resolve gaps and enhance data access and quality.
9. Management is planning to upgrade the Treasury systems into an integrated platform that can function as a common interface for Treasury's front office, middle office and back office. Management is assessing the specific capabilities of the Bloomberg Enterprise platform to support supplementary ALM calculations and analyses. The development of an integrated ALM tool is expected by Q3 2021, while an in-house tool will support analysis to bridge the need for reporting ad interim on ALM.
10. The ALM model should be based on the same data as the Fund's liquidity model for two reasons: (i) the liquidity model's information incorporates all cash flows; and (ii) using the same data as the liquidity model will ensure consistency of reporting. TRE has finalized the upgrade of IFAD's financial model, which is planned to go live in Q2 2021. The IFAD financial model will function as a data feed into the ALM model sharing all asset and liability cash-flow projections required for ALM analyses.
11. The implementation of ALM requires people with technical skills and specific professional experience to support both the set-up phase and the ongoing management of the function. In November 2020, TRE hired a senior ALM consultant who brings to the financial planning and middle office team strong working knowledge of risk management and ALM practices developed over 20 years at a leading multilateral development bank. In addition, a senior investment management consultant was hired and two vacant positions – Modelling Officer and System and Analytics Officer – were filled in the Financial Planning and Middle Office unit in TRE, which is responsible for ALM oversight.

III. Next steps

12. The operationalization of IFAD's ALM framework is under way and will be gradually implemented during 2021. TRE will continue to focus on the preliminary steps necessary to build a sound centralized and complete data environment and a new ALM model, while continuing to progress on the implementation of recently adopted policies, the development of calculation tools, and upgrade of TRE systems.
13. Once the technical and functional upgrade is fully operative in the short term, the next phase for the evolution of ALM at IFAD will centre on the definition of balance sheet hedging strategies aimed at finding the right balance between the operational, or natural hedging, and derivatives strategies.

14. From the long-term financial planning and balance sheet risk management perspective, ALM takes into consideration business development and allows for alignment of the growth and structure of assets and liabilities with the planned growth of business operations.
15. Given IFAD's operational context, ALM strategies will work hand-in-hand with operations to translate specific gaps of a financial and risk nature into natural hedging solutions. Gaps between assets and liabilities can be offset not only through the customization of the terms of new debt-raising initiatives but also through rebalancing of the existing loan portfolio, the launch of new loan products or other ad hoc measures such as accelerated repayment and voluntary prepayment.
16. However, this approach will be possible only within IFAD's mission constraints on the assets side and funding capacity constraints on the liability side. Derivatives hedging strategies will be used to minimize currency and interest rate risk mismatch.

Next Steps in ALM implementation

Development	Description	Expected completion
<i>Service-level agreement</i>	<i>SLA governing the exchange of information between TRE and RMO, including ALM metrics and reporting</i>	<i>Completed</i>
Data gap solutions	FOD/RMO/ICT effort to map, address and resolve data gaps	Q2 2021
Upgraded IFAD financial model	Upgraded IFAD financial model	Q2 2021
ALM model	Dedicated data, calculation and reporting engine	Q3 2021