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Investing in rural people

Report on IFAD's Investment Portfolio for 2020

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Executive summary

1. The value of the investment portfolio in United States dollar terms increased by US\$161.4 million, from US\$1,003.9 million at 31 December 2019 to US\$1,165.3 million at 31 December 2020.¹ The main factors for the increase were net inflows of US\$108.3 million, positive foreign exchange movements of US\$48.5 million, and income of US\$4.6 million.
2. Returns were stable throughout the year, nonetheless falling behind those of 2019, reflecting the more conservative asset allocation to higher-rated investments and market uncertainties.
3. Portfolio risk levels changed during the year:
 - Portfolio duration levels increased from 0.50 years to 0.60 years.
 - The conditional value at risk (CVaR) of the overall portfolio increased from 0.81 per cent to 1.06 per cent.
 - Exposure to BBB+/-rated debt was 0 per cent of the portfolio at the end of 2020.
4. The overall size of the portfolio exceeds the minimum liquidity requirement (MLR) (see section V, E).

Table 1
Key portfolio changes during 2020

	<i>2019</i>	<i>2020</i>
Portfolio size (thousands of US\$)	1 003 862	1 165 284
Net investment income (thousands of US\$)	23 243	4 614
Rate of return (percentage)	2.13	0.55
Duration (years)	0.50	0.60
CVaR (percentage)	0.81	1.06

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 2020

I. Market conditions

1. The year 2020 proved to be one of the most turbulent in recent times, marked by a number of unexpected developments. However, the year also demonstrated the resilience of people, institutions and financial markets.
2. Governments and central banks worked to provide the necessary financial stimulus, providing support to households, businesses and markets by reducing interest rates and through other mechanisms such as an extension of quantitative easing.
3. Fixed income markets showed unprecedented volatility and dispersion in returns during the first half of 2020. Global yield curves finished the year generally lower than at the start. The United States Treasury and Euro Benchmark curves ended relatively flat in the short end of the curve, but upward sloping from the medium- to long-term maturities.
4. Despite market uncertainty, both the asset and liability portfolio (ALP) and the global liquidity portfolio (GLP) outperformed their relevant benchmarks for the year with positive returns. This was mainly driven by credit spreads tightening and a larger proportion of the portfolio invested in higher-rated investments.

Table 1

Movements affecting IFAD's asset allocation within the portfolio in 2020

(Thousands of United States dollars equivalent)

	<i>Operational cash^a</i>	<i>GLP</i>	<i>ALP</i>	<i>Other</i>	<i>Total</i>
Opening balance (1 Jan 2020)	135 300	324 314	544 109	138	1 003 862
Net investment income	151	4 361	111	(10)	4 614
Net flows ^b	125 690	4 992	(21 346)	(1 054)	108 282
Foreign exchange movements	2 862	5	44 695	965	48 526
Closing balance (31 Dec 2020)	264 003	333 673	567 569	39	1 165 284

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

^b Net flows consist of outflows in respect of loan and grant disbursements and administrative expenses, and inflows from loan reflows and encashment of Member State contributions.

II. Investment income

5. Gross investment income in 2020 amounted to US\$5.6 million, while net investment income inclusive of all investment-related fees (totalling US\$1.0 million) amounted to US\$4.6 million. Table 2 presents a summary of 2020 investment income broken down by portfolio.

Table 2

Breakdown of IFAD's investment income by asset class in 2020

(Thousands of United States dollars equivalent)

<i>Investment income</i>	<i>Operational cash</i>	<i>GLP</i>	<i>ALP</i>	<i>Other</i>	<i>Total</i>
Interest and coupon income	356	4 653	1 412	-	6 422
Realized market gains/(losses)	-	159	(864)	-	(705)
Unrealized market gains/(losses)	-	(97)	11	-	(86)
Amortization ^a	-	-	-	-	-
Investment income before fees	356	4 715	559	-	5 631
Investment manager fees	-	-	-	-	-
Custody fees	(3)	(59)	(65)	(9)	(136)
Bank charges	(202)	-	(1)	-	(204)
Advisory and other investment-related fees	-	(295)	(381)	(1)	(678)
Investment income after fees	151	4 361	111	(10)	4 614

^a Amortization represents a portion of the difference between purchase price and final redemption value for the global strategic portfolio, reported at amortized cost.

III. Rate of return

6. The rate of return on IFAD's investment portfolio is calculated in local currency terms without reflecting the impact of foreign exchange movements.
7. Excluding the ALP, IFAD's investment portfolio generated a net return of 0.98 per cent for 2020, matching the benchmark. The ALP generated a positive gross return of 0.22 per cent, exceeding the portfolio's cost of funding (0.16 per cent).

Table 3

Quarterly gross performance together with annual performance versus benchmarks in 2020
(Percentages in local currency terms)

	<i>First quarter</i>	<i>Second quarter</i>	<i>Third quarter</i>	<i>Fourth quarter</i>	<i>Annual 2020</i>	<i>Benchmark 2020</i>	<i>Difference</i>
Operational cash	0.27	0.05	0.02	0.04	0.37	0.37	0.00
Global liquidity portfolio	0.31	0.49	0.34	0.10	1.24	1.12	0.12
Gross rate of return excluding ALP	0.29	0.42	0.30	0.09	1.11	0.98	0.13
Net rate of return excluding ALP	0.26	0.39	0.28	0.02	0.98	0.98	0.00
Asset liability portfolio ^a	(2.22)	1.37	0.77	0.33	0.22	0.16	0.06
Gross rate of return including ALP	(1.01)	0.92	0.56	0.22	0.67	n.a.	n.a.
Net rate of return including ALP	(1.04)	0.88	0.53	0.19	0.55	n.a.	n.a.

^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 31 December 2020
(Percentages in local currency terms)

	<i>One year</i>	<i>Three years</i>	<i>Five years</i>
Portfolio performance	0.55	0.91	1.57

8. For comparative purposes, table 5 presents annual portfolio performance over the previous four years.

Table 5

Historical annual performance 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	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 and 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 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.

IV. Composition of the portfolio by instrument

9. Table 6a shows the composition of the investment portfolio by instrument as at 31 December 2020.

Table 6a
Investment portfolio by instrument as at 31 December 2020

Instrument	Actual portfolio allocation	
	US\$ millions	Percentage
Cash	326.2	28.0
Swaps	(6.1)	(0.5)
Time deposit	0.0	0.0
Global government bonds	439.9	37.8
Global credit bonds	405.2	34.8
Total	1 165.3	100.0

10. In December 2018, to align itself with other international financial institutions, 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 four 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 MLR;
- **Surplus tranche:** these are funds in addition to what is required for the MLR and are used to provide enhanced returns; and
- **Funding tranche:** borrowed funds, managed according to the Asset and Liability Management Framework.

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

Table 6b
2020 portfolio by tranche ^a

Tranche	Percentage	US\$ millions
Liquidity	22.7	264.0
Buffer	28.6	333.7
Surplus	-	-
Funding	48.7	567.6
Hedge ^b	-	-
Total	100.0	1 165.3

^a The tranching approach will be revisited in accordance with the new Investment Policy Statement for 2021.

^b The hedge portfolio is shown separately as its derivative positions are established to immunize the entire portfolio against interest rate risk and foreign exchange rate risk.

V. Risk measurements

12. The risk budgeting measures outlined in IFAD's Investment Policy Statement (IPS) – duration and CVaR – are reported on in subsections A and B below. Other risk indicators are reported in subsections C and D.

A. Market risk: duration

13. Duration is a measure of the sensitivity of the market price of a fixed income

investment to a change in interest rates (expressed in 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 duration of IFAD's investment portfolio and benchmarks

(Duration in number of years)

	31 December 2020		31 December 2019	
	Portfolio	Benchmark	Portfolio	Benchmark
Asset and liability portfolio	1.0	0.5	0.8	0.5
Global liquidity portfolio	0.4	0.4	0.3	0.5
Total portfolio (including operational cash)	0.6	0.5	0.5	0.4

B. Market risk: conditional value at risk

14. The CVaR is a measure of the possible percentage losses to a portfolio under extreme market conditions. The investment portfolio CVaR is stated with a 95 per cent confidence level over a forward-looking one-year horizon.
15. The maximum risk level for the IFAD portfolio is stated in the IPS as a CVaR of 3.0 per cent. In 2020, the CVaR for the overall portfolio was 1.06 per cent, which is well below the approved IPS risk level. The current CVaR risk level of 1.06 per cent means that the loss to the overall portfolio under extreme market conditions could be US\$12.4 million.

Table 8

CVaR of IFAD's asset classes at 31 December 2020 and 2019

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

	Actual investment portfolio one-year CVaR	
	31 December 2020	31 December 2019
Asset and liability portfolio	1.66	1.15
Global liquidity portfolio	1.31	1.17
Total portfolio (including cash) ^a	1.06	0.81

^a Portfolio CVaR is lowered by the operational cash component of the portfolio, which has a CVaR equal to zero.

C. Credit risk: credit rating analysis

16. IFAD's IPS establishes a credit rating floor. Credit risk is also managed by monitoring securities in accordance with investment guidelines, which may provide for stricter credit quality requirements than those contained in the IPS.

Table 9

Investment portfolio compositions by credit ratings at 31 December 2020

(Thousands of United States dollars equivalent)

	Operational cash	GLP	ALP	Other	Total	Percentage
AAA		219 010	12 306		231 316	19.9
AA+/-		117 207	265 682		382 888	32.9
A+/-			230 944		230 944	19.8
Cash ^a	264 003	290	61 870	39	326 202	28.0
Time deposit						0.0
Pending trades ^b						0.0
Swaps		(2 834)	(3 233)		(6 067)	(0.5)
Total 2020	264 003	333 673	567 569	39	1 165 284	100.0
Total 2019	135 300	324 314	544 109	138	1 003 862	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, IFAD ensures that the currency composition of projected inflows matches that of outflows over a 24-month horizon. Negative mismatches (deficits of liquidity) of any currency above 10 per cent of total outflows require the establishment of hedging positions that will reduce foreign exchange exposure below the 10 per cent threshold.

Table 10

Currency composition of assets and commitments as at 31 December 2020 for the following 24 months

(Thousands of United States dollars equivalent)

Category	CNY Group	EUR Group	GBP Group	JPY Group	USD Group	Grand total
Current liquidity^a						
Cash	98	230 169	5 053	36	28 364	263 720
Investments	31	58	4	0	333 629	333 723
Projected inflows						
Contributions	26 215	304 981	43 423	56 704	290 712	722 034
Projected reflows	88 834	270 855	65 812	65 522	359 564	850 587
Debt drawdowns	0	202 303	0	0	155 874	358 177
Projected liquidity	115 178	1 008 366	114 292	122 261	1 168 142	2 528 240
Projected outflows						
Projected disbursements	(70 356)	(384 055)	(52 123)	(51 893)	(967 124)	(1 525 551)
Projected operating expenses		(218 685)			(144 555)	(363 240)
Debt repayments and interest	0	(122)	0	0	(899)	(1 021)
Projected outflows total	(70 356)	(602 862)	(52 123)	(51 893)	(1 112 578)	(1 889 812)
Hedging						
Currency forwards	0	0	0	0	0	0
Hedging total	0	0	0	0	0	0
Projected liquidity (deficit)/excess	44 822	405 504	62 169	70 368	55 564	638 428
(Deficit)/Excess as percentage of commitments	2.37%	21.46%	3.29%	3.72%	2.94%	33.78%

^a The difference in the cash and investments balance compared with other tables is derived mostly from the exclusion of the ALP (US\$567.5 million equivalent). The ALP is not subject to the currency alignment since, in line with commitments, it is maintained in euros.

E. Liquidity risk: minimum liquidity requirement

18. IFAD's latest financial model results – incorporating the resources available for commitment in 2020 under the sustainable cash flow approach – calculate an MLR of US\$672.0 million (60 per cent of gross annual outflows),² which is comfortably cleared by IFAD's investment portfolio balance of US\$1,165.3 million (see table 1).

² Corporate Risk Dashboard, fourth quarter 2020.