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Investing in rural people

Report on IFAD's Investment Portfolio for the First Semester of 2021

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Executive summary

1. During the first semester of 2021, the net rate of return for IFAD's investment portfolio was 0.07 per cent with a positive net investment income of US\$1.47 million.¹
2. The value of the investment portfolio in United States dollar terms increased by US\$310.1 million from US\$1.165 billion as at 31 December 2020 to US\$1.475 billion as at 30 June 2021. The main contributors to this increase were net inflows to the investment tranches in euro and in United States dollars tranches.
3. On risk metrics, the portfolio's conditional value at risk (CVaR) decreased from 1.06 per cent at the end of 2020 to 0.40 per cent in the first semester of 2021.² The indicator remained within the risk tolerance level defined by the Investment Policy Statement (IPS) and set at 3 per cent.³ Other relevant portfolio risk levels during the first semester of 2021 are shown below:
 - The portfolio duration levels decreased from 0.60 years to 0.35 years.
 - The fixed-income investments were fully allocated in high investment-grade instruments rated at A- and above.
4. Overall, the risk management of the investment portfolio showed no breaches of risk tolerance levels.

Table 1

Key portfolio changes year to date in 2021 and in the second half (H2) of 2020

| | 30/06/2021 | 31/12/2020 |
|---|------------|------------|
| Portfolio size (thousands of US\$) | 1 475 457 | 1 165 284 |
| Net investment income (thousands of US\$) | 1 467 | 5 826 |
| Net rate of return (%) | 0.07 | 0.50 |
| Duration | 0.35 | 0.60 |
| CVaR historical 1-year (%) | 0.40 | 1.06 |

5. IFAD's investment report for H1 2021 reflects the full implementation of the new investment framework defined by the updated IPS. In the new framework, the portfolios are grouped and classified by tranches that follow different purposes (further clarification and allocation under section V).

¹ Numbers in this report were 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 text of the annual report. All rounded numbers, totals, percentage changes and figures were calculated using the complete (unrounded) data.

² In Q2 2021, as part of due diligence by IFAD/Treasury Services Division, the Custodian computations for CVaR and risk metrics have been reviewed. As a major finding, the investigation concluded that the methodology and assumptions applied by the Custodian did not fully reflect the real risk for IFAD's investment portfolio. Hence, from Q2 2021, the risk figures reported in this report will be taken from Bloomberg PORT solution, a well-known and widely used tool for measuring risk metrics.

³ The new tranches of the investment portfolio were established by the Investment Statement Policy (AC 2020/159/R.7, 3 November 2020). It replaces the previous named portfolios (operational cash, global liquidity portfolio and asset liability portfolio).

I. Market conditions

1. Inflation has returned to the global economy. As growth accelerates, concerns over inflation in the United States have moved to the forefront. However, the recent higher inflation levels are not expected to last, being largely driven by supply/demand imbalances and stimulative policies. Inflation on average can be expected to be marginally above the Federal Reserve's 2 per cent target for the next two to three years, but is not projected to rise further or last longer. With the United States economy still in recession, job growth and employment data will be a gauge of the likely trajectory of its growth beyond the current rebound. In terms of economic impact, the COVID-19 pandemic has been similar to a natural disaster, driving increased volatility in inflation, other economic data, and slowing the path to economic recovery. High household savings and supportive fiscal and monetary policies bode well for the economy. After many credit rating downgrades in the past year or so, emphasis on quality investment grade fixed-income investments remains important.
2. The European equity market currently seems comfortable — as if it were in full recovery; however over the rest of the year the picture may become dramatically more mixed and nuanced. Inflation remains the greatest debate between the market's expectations for inflation and employment data, which combined with the United States Federal Reserve's market intervention and forward guidance, has led to elevated uncertainty in markets. In Europe, the expectation is that the recent rise in inflation will be a temporary phenomenon and that inflation will remain under control. Inflation and rising yields will nevertheless continue to worry bond investors in the coming quarters, requiring tactical flexibility given potential drawbacks in fixed-income holdings. Hence, maintaining the short duration in IFAD's investment portfolios is deemed appropriate.

II. Portfolio allocation

3. During the first semester of 2021, the value of the investment portfolio in United States dollar terms increased by US\$310.1 million with inflows to the investment tranches in Euro and in United States dollars tranches being the main contributors to the increase in IFAD's investment portfolio.

Table 1

Movements affecting IFAD's investment portfolio in H1 2021

(Thousands of United States dollars equivalent)

| | <i>Transaction and liquidity tranches^a</i> | <i>Investment tranche in US\$^b</i> | <i>Investment tranche in EUR^c</i> | <i>Other^d</i> | <i>Total</i> |
|---|---|---|--|--------------------------|------------------|
| Opening balance (31 December 2020) | 264 003 | 333 673 | 567 569 | 33 | 1 165 284 |
| Net investment income | (354) | 1 270 | 556 | (4) | 1 467 |
| Net flows ^e | (18 919) | 145 552 | 201 854 | (1 006) | 327 481 |
| Foreign exchange movements | (391) | (2) | (19 399) | 1 018 | (18 774) |
| Closing balance (30 June 2021) | 244 340 | 480 492 | 750 579 | 46 | 1 475 457 |

^a Transaction tranche is cash held by IFAD in commercial banks. Liquidity tranche is cash held in central banks and the Bank for International Settlement. It was the former operational cash portfolio.

^b Investment tranche in US\$ refers to the former global liquidity portfolio.

^c Investment tranche in EUR refers to the former asset liability portfolio.

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

^e Net flows consisting of outflows in respect of disbursements of loans, grants and administrative expenses, and inflows from loan reflows and encashment of Member State contributions.

III. Investment income

4. Gross investment income for the first semester of 2021 amounted to positive US\$2.26 million, with net investment income including all investment-related fees totalling positive US\$1.47 million. Table 2 presents a summary of H1 2021 investment income broken down by portfolio.

Table 2

Breakdown of IFAD's investment income by portfolio for the first semester of 2021

(Thousands of United States dollars equivalent)

| | <i>Transaction and liquidity tranches^a</i> | <i>Investment tranche in US\$^b</i> | <i>Investment tranche in EUR^c</i> | <i>Other^d</i> | Total |
|--|---|---|--|--------------------------|----------------|
| Interest and coupon income | (274.9) | 1 899.5 | 835.1 | - | 2 459.7 |
| Realized market gains/(losses) | - | 188.8 | (144.2) | - | 44.6 |
| Unrealized market gains/(losses) | - | (522.4) | 280.5 | - | (241.9) |
| Investment income before fees | (274.9) | 1 565.9 | 971.4 | - | 2 262.4 |
| Investment manager fees | - | - | - | - | - |
| Custody fees | (1.5) | (30.5) | (34.9) | (3.9) | (71.4) |
| Bank charges | (75.9) | - | (.7) | - | (77.1) |
| Advisory and other investment-related fees | - | (266.7) | (381.2) | - | (647.9) |
| Investment income after fees | (352.3) | 1 268.7 | 555.2 | (3.9) | 1 467 |

See table 1 for notes a to d.

IV. Rate of return

5. IFAD's investment portfolio generated a gross positive return of 0.16 per cent for the first semester of 2021 with the investment tranche in United States dollars generating a gross positive return of 0.37 per cent, which outperformed the benchmark by 0.30 per cent. The total gross rate of return was partially offset by the negative 0.02 per cent performance from the investment tranche in euro that still outperformed its benchmark by 0.29 per cent in the first semester of the year. The net rate of return for the entire investment portfolio was 0.07 per cent in the first semester of 2021. Table 3 shows the historical quarterly performance for the tranches since 2020.⁴

Table 3

Quarterly performance for 2020 and first two quarters of 2021

(Percentages in local currency terms)

| | <i>Quarterly performance in 2020</i> | | | | <i>Quarterly performance in 2021</i> | | | |
|------------------------------------|--------------------------------------|-----------------------|----------------------|-----------------------|--------------------------------------|---------------------------|--|-----------------------------|
| | <i>First quarter</i> | <i>Second quarter</i> | <i>Third quarter</i> | <i>Fourth quarter</i> | <i>First quarter</i> | <i>Second quarter (a)</i> | <i>Second quarter benchmark return (b)</i> | <i>Difference (a) – (b)</i> |
| Gross returns | | | | | | | | |
| Transaction and liquidity tranches | 0.27 | 0.05 | 0.02 | 0.04 | 0.01 | (0.01) | n.a. | n.a. |
| Investment tranche in US\$ | 0.31 | 0.49 | 0.34 | 0.10 | 0.50 | (0.03) | 0.01 | (0.04) |
| Investment tranche in EUR | (2.22) | 1.37 | 0.77 | 0.33 | (0.10) | 0.16 | (0.13) | 0.29 |
| Gross rate of return | (1.01) | 0.92 | 0.56 | 0.22 | 0.08 | 0.08 | n.a. | n.a. |
| Net returns | | | | | | | | |
| Net rate of return | (1.04) | 0.88 | 0.53 | 0.19 | 0.00 | 0.06 | n.a. | n.a. |

⁴ The benchmark for United States dollar-denominated investments has been the ICE Bank of America 0-1 Year United States Treasury Index, which tracks the performance of United States dollar-denominated sovereign debt publicly issued by the United States Government in its domestic market with maturities of less than a year. With the update of the IPS, it was introduced as a benchmark for investments denominated in euro: the ICE Bank of America 0-1 Year AAA-AA Euro Government Index which tracks the performance of euro-denominated sovereign debt publicly issued by Euro-area governments with a rating above AA and with maturities of less than a year.

Table 4
IFAD portfolio net performance rolling average as at 30 June 2021
 (Percentages in local currency terms)

| | YTD | One year | Three years | Five years |
|-----------------------|------|----------|-------------|------------|
| Portfolio performance | 0.07 | 0.79 | 0.98 | 0.99 |

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

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

| | 2020 | | 2019 | | 2018 | | 2017 | |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | Actual | Benchmark | Actual | Benchmark | Actual | Benchmark | Actual | Benchmark |
| Transaction and liquidity tranches | 0.1 | 0.1 | 1.31 | 1.31 | 0.88 | 0.88 | 0.79 | 0.79 |
| Investment tranche in US\$ | 1.14 | 1.12 | 2.73 | 1.11 | 2.16 | 0 | n.a. | n.a. |
| Investment tranche in EUR | 0.13 | 0.16 | 1.22 | 0.17 | (0.91) | 0.21 | 0.96 | 0.22 |
| Global strategic portfolio | n.a. | n.a. | 1.93 | 0.62 | 2.22 | 1.02 | 1.92 | 0.8 |
| Global government bonds | n.a. | n.a. | n.a. | n.a. | 0.89 | 1.88 | 0.27 | 0.99 |
| Global credit portfolio | n.a. | n.a. | 3.65 | 4.72 | 0 | 0.9 | 3.43 | 3.31 |
| Global inflation-indexed bonds | n.a. | n.a. | n.a. | n.a. | 0.16 | 0.39 | 1.86 | 1.53 |
| Emerging market debt bonds | n.a. | n.a. | n.a. | n.a. | (3.07) | (2.55) | 8.45 | 7.64 |
| Gross rate of return (excluding fees) | 0.67 | n.a. | 2.22 | n.a. | 0.21 | n.a. | 2.35 | n.a. |
| Net rate of return (including all fees) | 0.55 | n.a. | 2.13 | n.a. | 0.09 | n.a. | 2.21 | n.a. |

V. Composition of the portfolio by instrument

7. Table 6a shows the composition of the investment portfolio by instrument as at 30 June 2021. As shown in the table below, almost 85 per cent of the portfolio was allocated in global credit bonds and global government bonds/agencies.

Table 6a
Investment portfolio by instrument as at 30 June 2021

| | Actual portfolio allocation | |
|----------------------------------|-----------------------------|---------------------------------|
| | Millions of US\$ | Actual portfolio allocation (%) |
| Global credit bonds | 612.0 | 41.5 |
| Global government bonds/agencies | 618.3 | 41.9 |
| Cash | 244.4 | 16.6 |
| Time deposit | - | - |
| Swaps and others | 0.7 | - |
| Total | 1 475.5 | 100.0 |

8. As indicated in the updated IPS, IFAD's investment portfolio is split into tranches, as follows:⁵
- **Transaction tranche.** To facilitate near-term payments for IFAD's operations or administrative expenditures, to guarantee that enough cash and cash equivalents are available to meet immediate payment obligations.
 - **Liquidity tranche.** The liquidity tranche will replenish the transaction tranche as and when necessary and receives excess cash from the transaction tranche. It guarantees that enough instruments are available that

⁵ AC 2020/159/R.7 from November 2020.

can easily be translated into cash. Together with the transaction tranche, it ensures that expected and unforeseen short-term liquidity requirements are met.

- **Investment tranche.** Funds not needed in the short term and assumed to be disbursed over the medium term. This tranche allows IFAD to optimize prudently the total expected returns on its investments.
9. Table 6b shows IFAD's asset allocation and the net asset value of the portfolio according to the new tranches that have been set up.

Table 6b
Liquidity portfolio's tranches as at 30 June 2021 (updated IPS)

| <i>Tranche</i> | <i>%</i> | <i>US\$ millions</i> |
|----------------|--------------|----------------------|
| Transaction | 5.0 | 73.7 |
| Liquidity | 11.5 | 170.4 |
| Investment | 83.5 | 1 231.3 |
| <i>in EUR</i> | <i>50.8</i> | <i>749.1</i> |
| <i>in US\$</i> | <i>32.7</i> | <i>482.2</i> |
| Total | 100.0 | 1 475.5 |

VI. Risk measurements

10. The risk budgeting measures outlined in IFAD's IPS, duration and CVaR are reported on in subsections A and B below. The credit risk and currency risk analysis are reported in subsections C and D, respectively.

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 (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. As at 30 June 2021, the overall portfolio duration was 0.35 years, 0.25 years lower than the 0.60 years reported as at 31 December 2020.

Table 7
Effective durations of IFAD's investment portfolio and benchmarks
(Duration in number of years)

| | <i>30 June 2021</i> | | <i>31 December 2020</i> | |
|--|---------------------|------------------|-------------------------|------------------|
| | <i>Portfolio</i> | <i>Benchmark</i> | <i>Portfolio</i> | <i>Benchmark</i> |
| Investment tranche in EUR | 0.52 | 0.50 | 1.00 | 0.50 |
| Investment tranche in US\$ | 0.28 | 0.44 | 0.40 | 0.44 |
| Total portfolio (including global strategic portfolio and operational cash) | 0.35 | n.a. | 0.60 | n.a. |

Note: The total portfolio duration is lowered by the operational cash portfolio, which is not subject to interest rate fluctuations.

B. Market risk: Conditional value at risk

12. 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 over a forward-looking one-year horizon.
13. The maximum risk level for the IFAD portfolio is stated in the IPS as a CVaR of 3.0 per cent. In June 2021, the CVaR for the overall portfolio was at 0.40 per cent, below the approved IPS risk level and lower than the 1.06 per cent shown at December 2020.

Table 8

CVaR of IFAD's asset classes

(95 per cent confidence level; percentages based on historical simulations)

| | <i>Actual investment portfolio one-year CVaR</i> | |
|---|--|-------------------------|
| | <i>30 June 2021</i> | <i>31 December 2020</i> |
| Investment tranche in EUR | 0.47 | 1.66 |
| Investment tranche in US\$ | 0.80 | 1.33 |
| Total portfolio (including cash) * | 0.40 | 1.06 |

* 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

14. IFAD's IPS establishes specific requirements for the placement of IFAD funds and provides guidelines for investment selection to be made in compliance with those requirements. As part of the credit risk guidelines, the IPS defines the minimum rating floor for the invested assets, which is applied through the "second-best rating" approach. By doing so, the rating that is compared to the rating floor is the second-best rating assigned by Standard & Poor's, Moody's and Fitch.
15. As shown in table 9, and to comply with the IPS guidelines, the fixed-income investments were allocated in high investment-grade instruments i.e. AAA, AA+/- and A+/- securities at the end of the first semester of 2021.
16. In addition, the updated IPS established that the rating floor for fixed-income security should be at least A- (except for asset-backed securities, which should be AAA).⁶ The IPS requires also that the share of fixed-income investments (excluding cash) in rating category AA- and above should be at least 60 per cent of the total portfolio. As at June 2021, this share was 71.5 per cent.⁷

Table 9

Investment portfolio composition by credit rating as at 30 June 2021

(In percentages)

| | <i>Investment tranche in US\$</i> | <i>Investment tranche in EUR</i> | <i>Total</i> |
|--------------|-----------------------------------|----------------------------------|--------------|
| AAA | 10.4 | 1.0 | 11.4 |
| AA+ | 6.6 | 0.0 | 6.6 |
| AA | 11.2 | 8.0 | 19.2 |
| AA- | 10.9 | 23.4 | 34.3 |
| A+ | 0.0 | 14.0 | 14.0 |
| A | 0.0 | 4.4 | 4.4 |
| A- | 0.0 | 10.1 | 10.1 |
| Total | 32.7 | 50.7 | 100.0 |

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 would require ad hoc hedging positions to reduce foreign exchange exposure below the 10 per cent limit.
18. Projections as at the end of the first semester of 2021 show that the Fund's currency composition is adequate to cover the 24-month projected currency outflows.

⁶ The rating that is compared to the rating floor is the second-best rating of the three agencies, Standard & Poor's, Moody's and Fitch.

⁷ The ratio accounts only for fixed-income investment, i.e. it excludes cash and swaps positions.

Table 10

Currency composition of next 24-month projected cash flows as at 30 June 2021

(Thousands of United States dollars equivalent)

| <i>Category</i> | <i>CNY group</i> | <i>EUR group</i> | <i>GBP group</i> | <i>JPY group</i> | <i>US\$ group</i> | <i>Grand total</i> |
|-------------------------------|------------------|------------------|------------------|------------------|--------------------|--------------------|
| INFLOWS | | | | | | |
| Cash | 128 | 72 161 | 4 034 | 33 | 164 508 | 240 863 |
| Investments | 29 | 747 333 | 4 | 0 | 480 449 | 1 227 815 |
| Contributions | 58 550 | 171 294 | 35 137 | 35 725 | 293 163 | 593 868 |
| Projected reflows | 77 088 | 277 829 | 58 309 | 52 703 | 302 652 | 768 582 |
| Debt drawdowns | 0 | 561 936 | 0 | 0 | 216 667 | 778 603 |
| Assets total | 135 794 | 1 830 554 | 97 483 | 88 461 | 1 457 438 | 3 609 730 |
| OUTFLOWS | | | | | | |
| Projected disbursements | (67 822) | (695 092) | (51 300) | (46 368) | (1 038 547) | (1 899 129) |
| Projected operating expenses | | (202 047) | | | (122 696) | (324 743) |
| Debt repayments and interests | 0 | (77 664) | 0 | 0 | (2 583) | (80 247) |
| Commitments total | (67 822) | (974 803) | (51 300) | (46 368) | (1 163 826) | (2 304 119) |
| CURRENT HEDGING | | | | | | |
| Currency forwards | 0 | 0 | 0 | 0 | 0 | 0 |
| Hedging total | 0 | 0 | 0 | 0 | 0 | 0 |
| Deficit | 0 | 0 | 0 | 0 | 0 | 0 |
| Deficit as % of commitments | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |

E. Liquidity risk: Minimum liquidity requirement

19. The minimum liquidity requirement (MLR) was US\$639 million as at 30 June 2021.
20. The updated Liquidity Policy will form the basis of the computation of resources available for commitment for the Twelfth Replenishment of IFAD's Resources (IFAD12).⁸ The new MLR is a key policy anchor that indicates the level of liquidity IFAD must hold at any time to serve the next 12 months' disbursements of loans and grants, and scheduled repayments of debt, in order to ensure continuity of development operations. In addition to the revamped MLR, the new Liquidity Policy includes the target liquidity level, defined as a variable metric within a range of 80-100 per cent of stressed cash flows over 24 months.
21. Although the new Liquidity Policy will be implemented in IFAD12, the Treasury Services Division has already started monitoring the new metrics to ensure a smooth liquidity policy transition in 2022. As at 30 June 2021, the new MLR was US\$888 million, IFAD's liquidity portfolio net asset value was US\$1.475 billion and the stressed net asset value was US\$1.174 billion.

⁸ AC 2020/159/R.5.