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Investing in rural people

## Enterprise Risk Management Policy

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For: **Approval**

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## **Abbreviations and acronyms**

AUO	Office of Audit and Oversight
AVP	Associate Vice-President
CRO	Director and Chief Risk Officer
ERM	enterprise risk management
ERMC	Enterprise Risk Management Committee
ERMF	Enterprise Risk Management Framework
IOE	Independent Office of Evaluation of IFAD
RMO	Office of Enterprise Risk Management

## **Recommendation for approval**

The Executive Board is invited to approve the Enterprise Risk Management Policy as reviewed by the Audit Committee at its 161<sup>st</sup> meeting.

### **I. Purpose**

1. IFAD's reform agenda and its associated changes – including greater decentralization, reorganization and recalibration of business processes – over the past four years have focused on ensuring IFAD has the operational capacity to maximize its contribution to the 2030 Agenda for Sustainable Development; and that it positions itself as a recognizable, solid, rated institution. Substantive changes in IFAD's business model have been implemented and additional ones are envisaged in the years to come as part of the Twelfth Replenishment of IFAD's Resources (IFAD12), including an improved new financial architecture and increased private sector engagement. These changes represent a significant shift in IFAD's prior strategy and impact directly on IFAD's risk profile. Recognizing the more complex financial and development environment in which IFAD operates, Management is committed to embedding a stronger and more effective Enterprise Risk Management Framework (ERMF) into the organization through a far-reaching revision and improvement of the overall approach to risk management.
2. Enterprise risk management (ERM) plays an integral role in strategy development, budgeting and resource allocation, and the development of a sound risk culture in IFAD. Effective ERM supports risk-informed decision-making and helps determine the appropriate balance between risk-taking and achieving IFAD's strategic and development objectives. An effective ERMF<sup>1</sup> also serves to preserve and maintain the Fund's credit rating. Furthermore, having comprehensive and accurate risk data and reporting allows IFAD to assess overall resource needs and effectively mobilize and allocate resources for the Fund's priorities.
3. The responsible management of risk and the implementation of a systematic process for its identification, assessment, monitoring and mitigation helps an organization determine opportunities and objectives efficiently and sustainably. IFAD recognizes that risk-informed decisions and the presence of a sound risk culture are paramount in maximizing the Fund's development effectiveness.
4. This new ERM Policy is an essential component in the development and maintenance of sound ERM practices. It establishes the Fund's risk management structure and sets out the minimum requirements and expectations for the active management of risk in IFAD's operations. This ERM Policy establishes a formal, systematic and integrated, principles-based approach to identifying, managing and monitoring risks in IFAD. It defines the key roles and responsibilities of ERM stakeholders, and is based on a comprehensive enterprise risk taxonomy.
5. This ERM Policy is intended to consolidate IFAD's risk management structure and underpin the subsequent development of procedures and guidelines by Management. These are expected to operationalize the ERM Policy and guide the systematic application of its principles.
6. IFAD's Office of Enterprise Risk Management (RMO), led by the Director and Chief Risk Officer (CRO), is responsible for overseeing the design and implementation of the ERMF. This includes operationalizing the ERM Policy through development of frameworks, operational guidelines, and/or training to embed the ERM Policy and

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<sup>1</sup> ERMF encompasses the processes and tools, including frameworks, policies and guidelines, used to identify potential threats to IFAD; to define the appropriate strategies for eliminating or minimizing the impact of these risks; and to deploy the mechanisms to effectively monitor and evaluate the effectiveness of the risk management strategy.

its principles throughout IFAD, as well as oversight of business line implementation of risk management measures.

7. This ERM Policy supersedes and replaces IFAD's existing 2008 Policy on Enterprise Risk Management. It serves as an umbrella for all other frameworks, codes and operational guidelines related to ERM.

## A. Principles

8. The principles and enablers of IFAD's Accountability Framework<sup>2</sup> fully apply to IFAD's ERM. Specifically, the following risk-specific overarching principles will guide the management of risk and the development of ERM instruments, processes and procedures at IFAD:
  - (i) **Maintain a sound risk culture.** Promote a culture that systematically integrates risk management into the Fund's business operations, encourages a common understanding of risk, and supports risk-informed decision-making.
  - (ii) **Focus on key risks.** Proactively identify and manage IFAD's risks, including strategic, operational, financial, programme delivery and cross-cutting legal and reputational risks, in accordance with the core components of IFAD's risk management life cycle.
  - (iii) **Maintain sound governance.** Establish a strong ERM governance structure that applies the "three lines of defence" risk management model, built on well-defined roles and responsibilities and clear lines of accountability.
  - (iv) **Robust monitoring and reporting.** Adopt a comprehensive set of key risk indicators to assess and monitor the Fund's risk profile against Board-approved risk appetite statements.
  - (v) **Be flexible.** Regularly review IFAD's risk profile and risk appetite, as well as ERM processes and procedures, and make adjustments as needed to best serve the Fund and its stakeholders.

## B. ERM components

9. In accordance with the United Nations specialized agencies' maturity standards,<sup>3</sup> this ERM Policy is the main instrument supporting the ERM's key components, namely:
  - (i) **Governance and organization** identify the internal risk governance structure, the appropriate delegated authority, the roles and responsibilities, and the organizational entities to assure the effective management and oversight of risk.
  - (ii) **Process and integration** ensure that risks and opportunities that may affect the delivery of organizational results are effectively identified, assessed, responded to, communicated and monitored in accordance with the ERMF. Integration ensures that the interactions/interlinkages with related risk subprocesses or other organizational processes are clearly established.
  - (iii) **Systems and tools** are the IT components used to record, analyse, integrate and communicate/report on risk information.
  - (iv) **Risk capabilities** are the skills, knowledge and capacity that IFAD possesses to effectively manage risks.
  - (v) **Risk culture** refers to the behaviour, shared values and beliefs of IFAD's workforce and Management, together with IFAD's demonstrated attitude to risk.

<sup>2</sup> PB/2019/05, sections II and III of the IFAD Accountability Framework.

<sup>3</sup> The standards were defined and approved by the United Nations High-Level Committee on Management in October 2019.

10. This ERM Policy is the cornerstone of the ERM programme, which requires establishing and implementing a clear organizational risk appetite, supported by processes and procedures for risk appetite development and risk management and reporting, with a clear assessment of the organization's risk capacity. The latter is determined by IFAD's development mandate and its fiduciary duties, and represents the maximum level of risk the Fund can sustain. Within the bounds of its risk capacity, IFAD sets risk appetite levels for each of its level 1 risk domains<sup>4</sup>, which articulate the types and levels of aggregate residual risk the Fund is prepared to accept in pursuit of its strategic and development objectives.

## II. Enterprise risk taxonomy

Figure 1  
Enterprise risks at IFAD



11. IFAD will maintain an enterprise risk taxonomy that classifies the Fund's main risk exposures. The taxonomy provides a structure for the consistent identification, assessment, management, and reporting of risks within a clearly defined ERM landscape and establishes a common understanding of the Fund's key risks.
12. IFAD's taxonomy was developed using three core principles ensuring that it is:
- Mutually exclusive.** Each node should be unique to all others at the same level and not overlap with other risks.
  - Collectively exhaustive.** Based on the scope of the taxonomy, all concepts must be included.<sup>5</sup>
  - Hierarchical.** Each progressive level is more granular and further details the concepts expressed in the previous level.
13. IFAD's taxonomy consists of four risk domains, which represent the primary categories of risk to which the Fund is exposed (level 1). IFAD's four risk domains are defined as follows:
- Strategic risk.** Risks having impact on the Fund's ability to achieve its mission, execute its strategies and meet its objectives.
  - Financial risk.** The risk of financial loss resulting from the Fund's inability to efficiently and economically manage financial resources and satisfy financial commitments.

<sup>4</sup> Level 1 risk domains and level 2 risk subdomains are illustrated in appendix I.

<sup>5</sup> The risk taxonomy is evolving according to the risk landscape. Risk oversight ensures IFAD's effectiveness in detecting changes and a rigorous risk management process improves the Fund's capacity to mitigate evolving and/or emerging risks.

- (iii) **Operational risk.** The risk resulting from inadequate or failed internal processes, people and systems, or from external events that may result in financial loss or damage to the Fund's reputation.
  - (iv) **Programme delivery risk.** Risks to the ability to achieve the expected results in Fund-supported projects, programmes, or strategies, and the risk of unintended consequences.
14. Legal and reputational risks are cross-cutting risks embedded across the four risk domains. While there are clear roles and responsibilities associated with the management of these risks, their overarching nature requires them to be actively considered by IFAD's workforce across each of the established risk domains. Legal and reputational risks are defined as follows:
- (i) **Legal risk.** Any risk arising from IFAD's operations and activities that the Office of the General Counsel (LEG) considers to fall under its expertise and jurisdiction.
  - (ii) **Reputational risk** can call into question the Fund's character or credibility, creating a gap between the Fund's performance or behaviour and the expectations/perceptions of stakeholders.
15. Each risk domain consists of a set of risk subdomains that constitute the main components of each of the four risks (level 2). Each subdomain is further defined by a set of major risk drivers (level 3). These drivers are monitored as part of the risk management process and reported on using established metrics and key risk indicators. IFAD's current level 1 and level 2 taxonomy is presented as appendix I to this ERM Policy.

### **III. Roles and responsibilities**

#### **A. Three lines of defence model**

16. IFAD's ERM operating structure follows a three lines of defence model that establishes oversight, roles and responsibilities to enable the efficient management of risk across the Fund, as established in the Internal Control Framework for IFAD Investments. This model relies on the effective organization of risk, control, and oversight responsibilities, and the appropriate coverage of risks across the three lines of defence.

Figure 2  
IFAD's three lines of defence model<sup>6</sup>



17. **The first line of defence** (risk owner) comprises front-line business and support departments/divisions/units, which take on risks and are expected to manage and mitigate them. The first line of defence is expected to design and apply controls consistent with the principles outlined in this ERM Policy, in the risk appetite framework and the Internal Control Framework, and maintain the effectiveness of those controls.<sup>7</sup>
18. **The second line of defence** (independent risk oversight) includes risk management functions performed by the ERM team led by a CRO, in coordination with other financial and non-financial risk management functions. Together these management units assess the risks being assumed by the Fund, challenge the effectiveness of controls being implemented by first-line functions, enable the monitoring of such controls, and report independently to Management on aggregate levels of risk across IFAD. Integrity risk management includes anti-money laundering and combating the financing of terrorism.
19. **The third line of defence** comprises independent functions such as AUO and IOE. AUO provides ex-post audit assessments of compliance, examines the adequacy of controls to mitigate risks, and identifies cases of non-compliance through ex-post reviews. IOE is responsible for conducting independent and credible evaluations of IFAD's work, including corporate-level assessments, country strategy and programme evaluations, project completion report validations, and impact evaluations.
- B. Key risk roles**
20. The Executive Board is responsible for risk oversight as well as for approving risk-related policies and risk appetite statements. Top risks and key thematic areas will be regularly reported to the Executive Board, which will also be kept updated regularly on the implementation of IFAD's ERMF. Responsibilities also include (i) overseeing Management's progress towards objectives contained in the Fund's Board-approved risk appetite and tolerance levels; (ii) reviewing how risk appetite is embedded throughout the Fund and adequately supported by available

<sup>6</sup> Graphic adapted from The Institute of Internal Auditors' position paper, "The Three Lines of Defence in Effective Risk Management and Control" published in 2013, adapted from European Confederation of Institutes of Internal Auditing/Federation of European Risk Management Associations guidance on the 8<sup>th</sup> EU Company Law Directive, article 41.

<sup>7</sup> Broad organizational *levels* cannot be easily tied to a specific line of defence. Rather, the *activities* or *roles* performed by IFAD's workforce will determine their alignment to one of the three lines of defence and one function can include roles aligned to different lines. This is particularly relevant as the dedicated second line risk management team takes shape and IFAD's ERM practices evolve.



resources; and (iii) obtaining, if so requested, independent assessments of IFAD business operations in the context of risk appetite. The Executive Board establishes the “tone at the top” and supports effective and forward-thinking oversight from the top down.

21. **The Audit Committee** is responsible for the annual review of the risks faced by the Fund, for assessing the risk management practices and procedures in place and for providing its opinions and comments to the Executive Board.
22. **The President’s** key risk responsibilities include implementing strong risk management practices commensurate with IFAD’s strategic and development objectives, and including them in strategic planning. The President ensures that risk exposures remain within the boundaries of appetite and tolerance, and communicate IFAD’s risk appetite. The Executive Board and the President are ultimately accountable to Member States for the strategic planning and monitoring of the Fund’s work and for reporting on the delivery of agreed results.
23. **The Vice-President** is responsible for working with Associate Vice-Presidents (AVPs), the Office of the General Counsel and the CRO to establish and maintain effective risk management in their areas of responsibility; he or she holds the role of Chairperson of the Enterprise Risk Management Committee (ERMC).<sup>8</sup> The Vice-President is not a risk owner but is a risk champion<sup>9</sup>, responsible for supporting risk management initiatives across the organization.
24. **The Director and Chief Risk Officer** is responsible for leading the second-line risk function and ensuring oversight and coordination of risk matters across all risk domains. The CRO provides credible testing of first-line risk management processes and enables clear reporting of IFAD’s aggregate risk profile against Executive Board-approved appetites in the context of strategic objectives. A key role of the CRO is to support the establishment of a collective risk culture and foster risk accountability across the organization. This means the CRO is responsible for regular ERM training and for ERM communications. The CRO, who reports functionally to the Vice-President under the overall leadership of the President, is a member of each risk committee, thus providing continuity across the levels of governance and lines of defence. The CRO is responsible for developing and maintaining the Fund’s ERM Policy and overseeing the implementation of the ERMF across IFAD.
25. **The Associate Vice-Presidents** are each responsible for conducting and managing business operations within their respective departments. AVPs are responsible for risk management at the departmental level, associated reporting, escalation and cross-organizational risk dialogue. Further competencies include the modelling of IFAD’s Code of Conduct and core values, the maintenance of a sound risk culture, and contributing to the effectiveness of IFAD’s ERM approach. AVPs are appointed to oversee the departments responsible for financial operations, programme management, strategy and knowledge, corporate services, external relations and governance. They are also tasked with supporting the development of risk appetite statements and tolerance levels, conducting periodic reviews of their department’s performance against Executive Board-approved risk appetite levels and tolerances, and taking necessary action when those levels are breached.
26. **The Office of the General Counsel** provides legal advice to Management, divisions and units and IFAD’s governing bodies on all legal aspects and risks arising from IFAD’s operations and administration, including its programme of work, corporate and institutional matters, and financial and investment management matters. LEG provides legal advice on a broad range of corporate, institutional and operational issues, including the interpretation, implementation and periodic revision of IFAD’s basic documents and the functioning of its

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<sup>8</sup> See para. 35.

<sup>9</sup> See document EB 2019/126/R.7.

governing bodies; it gives legal advice and support to internal clients on the mobilization, investment and management of the Fund's resources, corporate and administrative matters, and policies and regulations supporting the Fund's new decentralized business model, including all instruments contained in its Human Resources Policy. LEG also provides legal advice on all matters related to IFAD's and IFAD staff's privileges and immunities, granted in different international treaties and headquarters, and host country agreements.

27. **The Office of Audit and Oversight** constitutes the third line of defence, and its main role in the context of ERM is to provide assurance that the first two lines are operating effectively, as well as to advise on how they could be improved. Reporting directly to the President and also supplying functional reporting to the Audit Committee, AUO provides independent and objective assurance and advisory services to the organization's governing body and management through a systematic, disciplined, risk-based approach.
28. **The Director** of Ethics reports administratively to the Vice President and is responsible for overseeing the assessment of organizational risk for misconduct and non-compliance with IFAD's Code of Conduct and Core Values. The Director of Ethics promotes and works to ensure that the highest standards of ethical behaviour, integrity, transparency and respect are maintained at every level of the Fund. The Ethics Office's role is to protect IFAD's image and reputation and promote the consistent application of ethical principles.
29. **Division directors** lead the implementation of risk management activities and make associated risk decisions in their areas of expertise, including identifying risks and applying mitigation measures where needed to reduce risk levels in line with Executive Board-approved risk appetite levels and tolerances. They report on key risk exposures within the division and escalate specific issues to the AVPs as appropriate. Division directors are responsible for oversight and technical support activities for IFAD offices. Division directors who are heads of IFAD offices are also responsible for coordinating the management of strategic, operational, reputational and legal risks in countries in their regions.
30. **Country directors and project team leaders.** Country directors work alongside project team and are responsible for the design and implementation of country strategic opportunity programmes and country strategies in collaboration with relevant government and national stakeholders. Key risk responsibilities include support for, and management of, the design and implementation of loan and grant portfolios, as well as of risks within approved programmes and projects. Country directors who are heads of IFAD offices are also responsible for managing strategic, operational, reputational and legal risks in the field.
31. Authority to further detail, change and review IFAD's managerial risk roles and/or workforce risk functions across the organization resides with the President, based on the recommendations of the CRO, who provides updates to the Executive Board.

### **C. Risk ownership and escalation**

32. Each risk domain is overseen by a risk owner, usually an AVP, who is accountable for managing and reporting on such risk exposures. Each risk owner is responsible for identifying, assessing, managing and reporting risks in accordance with this policy and the ERMF and escalating matters to technical committees when necessary.
33. Risk owners and their teams are responsible for escalating risks when the risk response or action being considered by someone lies outside the type and/or level of authority they hold. RMO, as second line, oversees and monitors the risk owners when they escalate<sup>10</sup> such risks. During escalation, the individual or group with the

<sup>10</sup> While general criteria for escalation of risks are indicated in this policy, detailed guidelines for escalation are developed at the operational level. The terms of reference of the risk committees are also complemented by operational guidelines on the escalation process.

necessary type or level of authority for that risk domain is notified and becomes responsible for considering available alternatives and pursuing an appropriate response. Risks must be escalated in any one or more of the following cases:

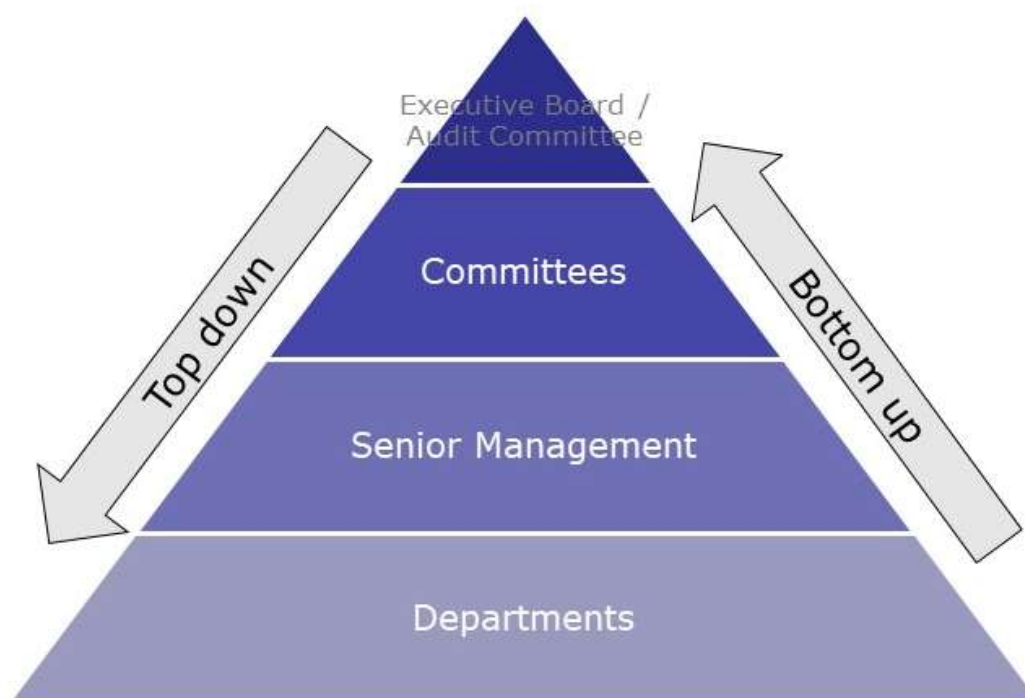
- (i) The risk response being considered lies outside of the type and/or level of authority held by the individual faced with such a risk decision.
  - (ii) The risk/incident being considered is cross-cutting.
  - (iii) A serious incident impacts IFAD's workforce, facilities or programmes.
  - (iv) The risk level/significance is high (as determined by IFAD's risk-rating scale and guidelines).
  - (v) New risks or cases fall outside of the taxonomy and ERM Policy and have to be handled as exceptions.
34. While the Executive Board holds Management accountable for the overall implementation of ERM, each IFAD employee is responsible for day-to-day risk management and for proper risk escalation. Management is accountable for engaging the workforce and fostering a culture conducive to open discussion and clear organizational channels for the reporting and escalation of risks. Managers and the workforce are expected to manage risks appropriately in accordance with established policies and procedures, and the principles outlined in this ERM Policy and the ERMF. The effective compliance with IFAD's risk culture is critical in order to achieve intended development outcomes.

## **IV. ERM governance structure**

### **A. Overview**

35. Effective ERM governance requires a forward-looking, risk-based and responsive oversight process. IFAD's ERM governance structure is lean, focused on risk oversight and designed to support a disciplined approach to risk management. It fosters a risk-aware culture of trust and transparency that empowers IFAD's workforce to take risk-informed decisions. It allocates accountability and enables, risk-taking, incorporating an organization-wide, portfolio-level perspective of risk functions to set the "tone at the top" by modelling and upholding IFAD's Code of Conduct and core values.
36. IFAD's governance structure, as it relates to ERM oversight and associated escalation procedures, comprises the key risk actors described above and is explored in further detail below.

Figure 3  
IFAD's ERM governance structure



## B. Risk oversight

37. The ERMC, chaired by the Vice-President and composed of members of Management is IFAD's highest corporate-level risk committee. Primary responsibilities include reviewing and monitoring IFAD's strategic risks and cross-cutting risks, as well as material emerging risks as escalated by the technical committees. The ERMC performs risk appetite monitoring and escalates material risks to the Executive Management Committee, Audit Committee, and Executive Board, as needed.
38. Technical committees operate along IFAD's level 1 risk domains and cross-cutting risks as outlined in section II above. These committees are also responsible for the oversight of the cross-cutting risks.

## V. Risk management lifecycle

### A. Risk communication and consultation

39. IFAD's risk management process is designed to systematically identify, assess, prioritize, monitor and manage risks across the Fund and to identify business opportunities. It supports a common language and consistent policies, processes, and practices that provide Management and the workforce with a shared understanding of organizational risk appetite and of risk management expectations. The consistent discussion of risk within forums such as technical committees and between first and second line of defence contributes to enhancing risk culture and maintaining an accurate understanding of the Fund's aggregate risk profile. It helps track the resources utilized to maintain such a profile, and to empower the monitoring of how the Fund is performing given the risk appetite levels approved by the Executive Board. IFAD's ERM governance structure allows for effective risk communication in line with IFAD's core values and the risk management lifecycle described below.

## B. Risk management lifecycle

40. IFAD's risk management process is an ongoing cycle that is defined by the following key steps:

Figure 4  
IFAD's risk management lifecycle



41. **Risk identification.** IFAD is establishing processes to identify the risks most relevant to the Fund and its business operations. The Fund will regularly identify and consider new developments or emerging risks that may impact its risk profile. The purpose of the risk identification process is not to collect an exhaustive list of all risk factors within the Fund's operating environment, but rather to identify the risks that are most relevant to the Fund and its operations. The proper identification of these risks guides ERM efforts and associated resource allocation. IFAD's top risks and related mitigation measures are maintained in the corporate risk register and escalated through the ERM governance structure.
42. **Risk assessment.** A standard process for the assessment and rating of identified risks is important to the consistent management of IFAD's risk profile. The Fund must consider both quantitative and qualitative factors in its risk assessments and seek to identify and evaluate the likelihood and impact associated with the materialization of key risks. IFAD must use a standard risk-rating scale, an enterprise-wide risk glossary and supplementary guidance documents to support informed risk-taking and consistent risk assessments across all funded initiatives. The accurate and consistent assessment by IFAD's workforce of the potential impact and likelihood of risks makes for the efficient allocation of resources and appropriate responses to risk factors in line with Fund objectives. Risk assessments identify the inherent risk levels, mitigating controls, or other such mechanisms, and after-control residual risk levels. Risk is managed at residual risk levels.
43. **Risk monitoring, review and treatment.** Risks are monitored constantly across the Fund. IFAD's workforce is responsible for monitoring risks within Fund operations and escalating issues to managers when problems arise. The Fund takes a proactive approach to risk management involving the early identification and systematic escalation of issues that could affect the attainment of objectives. The Fund monitors risks for alignment with established appetites and takes appropriate action to treat risk when necessary. Risk treatment includes:
- (i) The acceptance of risk exposures;
  - (ii) The application of mitigation measures that bring residual exposures in line with the Fund's appetite; and
  - (iii) The escalation of key issues for attention and appropriate action. Mitigation measures are designed to reduce the overall likelihood of risks materializing and include a wide range of strategies and approaches, including but not

limited to: the design and application of preventative controls,<sup>11</sup> risk-sharing, risk transfer, risk avoidance, and risk mitigation (e.g. insurance, hedging).

44. **Risk reporting.** IFAD must establish escalation and reporting structures that allow the Executive Board and Management to take a portfolio-level perspective of the Fund's risk profile. Risk owners in the first line of defence – the front-line workforce responsible for taking risks – are tasked with the maintenance and timely reporting of risk exposures to Management. Stakeholders in the second line of defence are recipients of reporting from the first line. They are also responsible for monitoring aggregate exposures and trends over time, and reporting on such exposures to the Executive Board and Management through the Corporate Risk Dashboard. These aggregate exposures are used to support effective oversight and inform management decisions regarding strategic planning, budgeting, and resource allocation.

## **VI. Risk culture**

45. The Executive Board and all levels of Management support an effective risk culture by establishing and exercising accountability, promoting risk awareness and encouraging proactive risk discussions following the principles, governance, and risk management lifecycle described here. A strong risk culture reinforces the importance of IFAD's risk management framework and promotes collaboration and transparency among the three lines of defence.

## **VII. Policy ownership and additional documentation**

46. The CRO is responsible for the annual review and maintenance of this ERM Policy. Any proposed changes to this ERM Policy will be presented to the Executive Board for approval.
47. The following is a list of additional, interrelated, and/or supplemental documentation relevant to the ERMF. As the ERM Policy establishes the foundation for the subsequent development of procedures and guidelines by Management, the list below is not intended to be exhaustive:
- (i) Risk appetite framework;
  - (ii) IFAD Code of Conduct;
  - (iii) IFAD core values;
  - (iv) Agreement Establishing IFAD;
  - (v) IFAD Strategic Framework;
  - (vi) Internal Control Framework;
  - (vii) Corporate risk register;
  - (viii) IFAD Accountability Framework;
  - (ix) IFAD Framework for Delegation of Authority.

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<sup>11</sup> Comprehensive classification of control types is included in the IFAD Internal Control Framework.

# Enterprise Risk Taxonomy

## 1. Legal and Reputational Risks

**Legal and Reputational risks** are cross-cutting risks. Prevalent throughout Fund business operations, they are embedded across the four risk domains. While there are clear roles and responsibilities associated with the management of these risks, their overarching nature requires them to be actively considered by IFAD's workforce across each of the established risk domains. As such, Legal and Reputational risks are embedded across IFAD's four level 1 risk domains below.

## 2. Financial Risk Taxonomy

**Financial risk (Level 1)** is defined as the risk of financial loss resulting from the Fund's inability to efficiently and economically manage financial resources and satisfy financial commitments.

<b>Financial Level 2 Risk Sub-Domain</b>
<p><b>Credit</b>  <i>The risk of loss of the loan principal or loss of a financial reward stemming from a borrower or counterparty's failure to repay a loan or otherwise meet a financial contractual obligation.</i></p>
<p><b>Market</b>  <i>The risk of losses arising from exposure to changes in financial market variables (prices and rates).</i></p>
<p><b>Liquidity and Funding</b>  <i>The risk of losses resulting from the inability to meet cash flow needs in a timely manner.</i></p>
<p><b>Leverage and capitalization</b>  <i>The risk that the Fund's capitalization or capital position is not adequate to safeguard its ability to continue as a going concern.</i></p>

### 3. Operational Risk Taxonomy

**Operational risk (Level 1)** is defined as the risk resulting from inadequate or failed internal processes, people and systems, or from external events that may result in financial loss or damage to the Fund's reputation.

<b>Operational Level 2 Risk Sub-Domain</b>
<p><b>External Prohibited Practices &amp; Financial Integrity</b>  <i>The risk of unexpected financial, material loss, or legal or reputational damage due to acts committed by an external party that misappropriate assets, or circumvent laws or regulations, or attempt to do so, which include corruption, fraud, collusion, coercion, obstruction and money laundering/terrorist financing. An external party is anyone outside of IFAD's Staff definition, including individuals hired by IFAD under the provisions of the Handbook on consultants and other persons under a non-staff contract, vendors, recipients, and third parties.</i></p>
<p><b>Unsatisfactory conduct &amp; misconduct</b>  <i>The risk of potential unsatisfactory conduct and misconduct arising as a consequence of any act or omission, whether deliberate or resulting from negligence, committed by an IFAD staff member or an individual hired by IFAD under the provisions of the Handbook on consultants and other persons hired by IFAD under a non-staff contract, in breach of the terms of their respective appointments or contracts, or any other applicable internal IFAD policy, rule or procedure –including but not limited to the Code of Conduct- which may result in reputational or actual damage to IFAD or in litigation.</i></p>
<p><b>Talent capacity and capabilities</b>  <i>The risk arising from workforce and people-management issues, including inadequate staffing resources, skills, and volume of change/new initiatives that could impact IFAD's ability to deliver on its strategic framework.</i></p>
<p><b>Occupational health &amp; safety</b>  <i>The risk of lack of anticipation, recognition and/or control of health and safety hazards or standards related to the workplace, which may potentially lead to harm (illness, injury or death) of IFAD staff and/or an individual hired by IFAD under the provisions of the Handbook on consultants and other persons under a non-staff contract, and their eligible family members or the organization. The harm that may occur to the organization may include reputational damage, loss of property, loss of member state confidence, among others.</i></p>
<p><b>Security</b>  <i>The risk that IFAD is unable to ensure the safety and security of personnel, assets, and operations, which can lead to potential financial loss, reputational damage and/or the injury or death of personnel operating on behalf of or in partnership with the Fund.</i></p>
<p><b>Information technology &amp; cyber security risk</b>  <i>The risk that threats and vulnerabilities to IFAD's IT services and systems, including a cyber security attack, severely impact and compromise IFAD's ability to function, resulting loss of key data, business interruption, and/or reputational damage.</i></p>
<p><b>Business continuity</b>  <i>The risk that IFAD is unable to continue delivery of services at acceptable predefined levels following a event or incident, resulting in the disruption of IFAD's most prioritized activities.</i></p>
<p><b>Process execution</b>  <i>The risk that IFAD's internal processes and controls are inadequate or improperly executed resulting in business disruption, potential financial loss and/or reputational damage.</i></p>
<p><b>Partnering, corporate procurement &amp; outsourcing</b>  <i>The risk that key vendors, contractors (including outsourced core service providers), and partners (including financial intermediaries, private sector partners, and non-governmental organizations) fail to provide services, goods, or works requested by the Fund, which may result in business disruption or have adverse reputational and/or financial impact for IFAD.</i></p>



#### 4. Programme Delivery Risk Taxonomy

**Programme Delivery risk (Level 1)** is defined as risks to the ability to achieve the expected results in Fund-supported projects, programmes, or strategies, and the risk of unintended consequences.

<b>Programme Delivery Level 2 Risk Sub-Domain</b>
<p><b>Country Context</b>  <i>The risks to the achievement of project development objectives stemming from a country's context</i></p>
<p><b>Sector Strategies and Policies</b>  <i>The risks to the achievement of project development objective(s) stemming from a country's sector-level strategies and policies.</i></p>
<p><b>Environment and Climate Context</b>  <i>The risk that existing or possible future environmental or climate conditions may significantly undermine project implementation and the achievement of project development objectives.</i></p>
<p><b>Project Scope</b>  <i>The risks to the achievement of project development objective(s) stemming from factors related to the scope of the project.</i></p>
<p><b>Institutional Capacity for Implementation and Sustainability</b>  <i>The risk that the project executing agency, implementing partners and service providers lack the capacity to effectively and efficiently implement and sustain the activities supported by the project.</i></p>
<p><b>Financial Management</b>  <i>The risk that project activities are not carried out in accordance with the provisions of IFAD's financial regulations and that funding is not used for the intended purpose with due regard for economy, efficiency and effectiveness.</i></p>
<p><b>Project Procurement</b>  <i>The risk that project procurement activities including the procurement of goods, works and services financed from the resources of the Fund, are not carried out in accordance with the provisions of the Borrower/Recipient's procurement regulations, to the extent such are consistent with the IFAD Procurement Guidelines.</i></p>
<p><b>Environment, Social and Climate Impact</b>  <i>The risk that the project may cause significant environmental or social harm or increased vulnerability to climate change impacts of temporary, cumulative, irreversible or unprecedented nature, affecting the immediate project target area and/or areas beyond it.</i></p>
<p><b>Stakeholders</b>  <i>The risk that the project is negatively affected because relevant stakeholders are not appropriately identified, consulted or engaged during the project's lifecycle, and/or that grievances redress processes are ineffective.</i></p>

## 5. Strategic Risk Taxonomy

**Strategic risk (Level 1)** is defined as those risks having impact on the Fund's ability to achieve its mission, execute its strategies and meet its objectives.

<b>Strategic Level 2 Risk Sub-Domain</b>
<p><b>Strategy and Objective Setting</b>  <i>The risk that there is not a clear set of institutional priorities, cross-cutting objectives and activities to achieve its desired development impact in alignment with the Fund's mission and vision, leading to a potential negative impact on IFAD's position in the agricultural development landscape.</i></p>
<p><b>Sustainability and Adaptability Risk</b>  <i>The risk that IFAD is not alert to key developments and/or is not sufficiently responsive to events and trends that affect the sustainability of the Fund's business model and key activities, resulting in the inability to meet the Fund's strategic objectives.</i></p>
<p><b>Strategy Execution Risk</b>  <i>The risk that IFAD is ineffective in allocating and deploying resources and implementation support across the portfolio of corporate initiatives and programmes/projects, resulting in the inability to consistently execute the Fund's strategy and meet its strategic objectives.</i></p>
<p><b>Strategic Partner Relationship Risk</b>  <i>The risk that partnerships and collaborative relationships, such as member state contributors and private-sector partners, are not engaged appropriately to carry out resource mobilization activities or contribute to IFAD's programme delivery management, resulting in potential funding gaps, reputational impacts and an inability to meet the Fund's strategic objectives.</i></p>
<p><b>Governance and Culture Risk</b>  <i>The risk that IFAD's institutional and management culture, including leadership, roles and responsibilities across the organization and between the Board and Management, and the ability to sustain an open and engaging environment, is not conducive to achieving the Fund's strategy and mission, resulting in the inability to meet the Fund's strategic objectives.</i></p>

## Operationalizing IFAD's ERM Policy

The following work streams, broadly corresponding to the risk framework pillars (see image below), shall be considered when operationalizing the ERM Policy during its initial phase.

Note that some indications outlined in this Appendix II are prospective and are predicated on the existence on certain processes and procedures, which may not be fully in place at the time of the adoption of this ERM Policy. As IFAD continues its transition to a mature risk further management model, supporting processes and procedures will be needed, implemented, and improved, to facilitate the operation of the overall governance structure. Some of the processes highlighted here describe the target operating structure and, as such, may be implemented throughout a transition period.

- **Governance of risk:** the key priority for operationalizing the ERM Policy will be the implementation of Technical Risk Governance Committees as well as their embedding into the IFAD decision-making governance structure, to be achieved with the issuance of adequate operational guidelines.

The establishment of the Technical Risk Governance Committees will lay the foundation for support of the broader operationalization of the overall risk program.

Each Committee will oversee the timely review of risks according to the risk domain that it is responsible for, and will be organized according to the top risk categories for IFAD identified in the current taxonomy.

Each Committee shall have its own (i) terms of reference, (ii) rules of procedures and (iii) a committee secretariat to support its efficient and effective functioning over time.

The RMO will act as the secretariat for each of the committees and the CRO will be a member of each of them.

The RMO will develop business-as-usual committee risk reporting and escalation procedures to the top of the risk governance structure.

- **Risk metrics & appetite:** Represent a fundamental, critical area of focus for operationalizing the ERMF. Levels 1 and 2 of the risk taxonomy will be finalized into metrics with an associated risk appetite and tolerance statement.

For each risk category Executive Board-approved limits and management-approved warning thresholds shall be adopted and implemented, along with escalation process in case of limits/thresholds breaches.

- **Risk Reporting:** this will include embedding key risks in the Corporate Risk Dashboard and Technical Risk Governance Committee reporting.

The identified metrics will be an important tool for RMO and Management to track risk levels against Executive Board-approved risk appetite limits.

- **Risk-related policies and methodologies:** Several key policies, processes and methodologies will be developed and formalized to operationalize the ERMF and enable RMO and the Risk Governance Committees to perform their roles effectively.

Level 1 risk categories will need policies to provide guidance for management of key risks and methodologies for risks evaluation and tools implementation. This will include methodology for evaluating financial and non-financial risks and risk management practices within new businesses and product.

- **Risk Culture & Communication:** an internal communication programme on the newly established ERM Policy will be launched. This will include several initiatives, such as inter alia, (i) ERM Policy internal roadshow for management and workforce, (ii) an

organization-wide risk training program that will need to be developed and implemented in order to train workforce on risk management principles, on the three lines of defence risk governance model, on the role of RMO and its role in risk management.

The risk culture enhancements will be prioritized in the next two years of ERM policy operationalization.

- **RMO organization & operations:** Operationalization of RMO will be realized by establishing its charter and by completing its key function and unit setup from the organizational point of view.

Several other key initiatives need to be implemented by RMO. They will include, among other things, (i) RMO’s risk data repository and process, (ii) the process for evaluating emerging risks, (ii) risk work plans, (iii) the devising of the procedures for operationalizing the risk committees and those for the escalation of material risks to the ERMC and EMC, and if needed (iv) the top-down Corporate Risk Register.

