

Document: EB 2021/134/R.52/Add.1  
Agenda: 20(d)  
Date: 8 November 2021  
Distribution: Public  
Original: English

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## Control Framework for IFAD Investments

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Executive Board – 134<sup>th</sup> Session  
Rome, 13-16 December 2021

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**For: Information**

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## Abbreviations and acronyms

ADM	Administrative Services Division
ALM	asset and liability management
AML/CFT	anti-money laundering and countering the financing of terrorism
AVP	Associate Vice-President, Chief Financial Officer and Chief Controller
CM	Cash Management and Back Office
COSO	Committee of Sponsoring Organizations of the Treadway Commission
CRO	Chief Risk Officer
CVaR	conditional value at risk
ERM	enterprise risk management
ERMC	Enterprise Risk Management Committee
FCD	Financial Controller's Division
FMD	Financial Management Services Division
FOD	Financial Operations Department
FPM	Financial Planning, Modelling and Middle Office
FRMC	Financial Risk Management Committee
ICFRs	internal controls over financial reporting
IFI	international financial institution
IM	Investment Management and Front Office
IPS	Investment Policy Statement
IFRS	International Financial Reporting Standards
MLR	minimum liquidity requirement
RMO	Office of Enterprise Risk Management
TRE	Treasury Services Division
VaR	value at risk

## Preamble

1. The Control Framework for IFAD Investments<sup>1</sup> was first presented to the Executive Board at its 104<sup>th</sup> session in December 2011, in conjunction with IFAD's Investment Policy Statement (IPS). While the IPS provides overall guidance for the management of IFAD investments, the Control Framework encompasses the control structures, practices and procedures in place.
2. The first annual review of the IPS was presented to the Executive Board for approval at its 107<sup>th</sup> session in December 2012. Prior to that session, at its 125<sup>th</sup> meeting in November 2012, the Audit Committee requested that the annually revised Control Framework accompany the annually updated IPS for completeness.

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<sup>1</sup> The "Control Framework for IFAD Investments" was first adopted as the "Internal Control Framework for IFAD's Investments". In order to avoid confusion with the "Internal Control Framework" (EB 2019/127/R.39) approved during the 127<sup>th</sup> session of the Executive Board, this document has been renamed "Control Framework for IFAD Investments".

# Control Framework for IFAD Investments

## I. Overview of internal control best practices

1. Internal controls form an integral part of any organization's financial and business policies and procedures. The Control Framework for IFAD Investments is based on the widely used Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Framework). Although not independently audited or certified as compliant with the COSO Framework, the Control Framework refers to the COSO Framework for guidance on content and format.
2. The COSO Framework sets out five components with 17 associated principles. These components are defined as follows:
  - (i) **Control environment:** organizational values and culture; policies; organizational structure. The control environment is the foundation for all other components of internal control;
  - (ii) **Risk assessment:** identification and measurement of threats, and responses to them;
  - (iii) **Control activities:** the policies and procedures that help ensure management directives are carried out;
  - (iv) **Information and communication:** reliability, timeliness, clarity and usefulness; and
  - (v) **Monitoring activities:** processes used to assess the quality of internal control performance over time.
3. This paper describes how these five components pertain to activities related to the Control Framework. Section II focuses on aspects of the control environment, specific organizational structure, and the roles and responsibilities of the various key players. Section III describes the risk assessment, control, information and communication, and monitoring activities.
4. Annex II links the 17 COSO Framework principles to various investment-related policies and procedures as well as to relevant sections of the Control Framework itself.

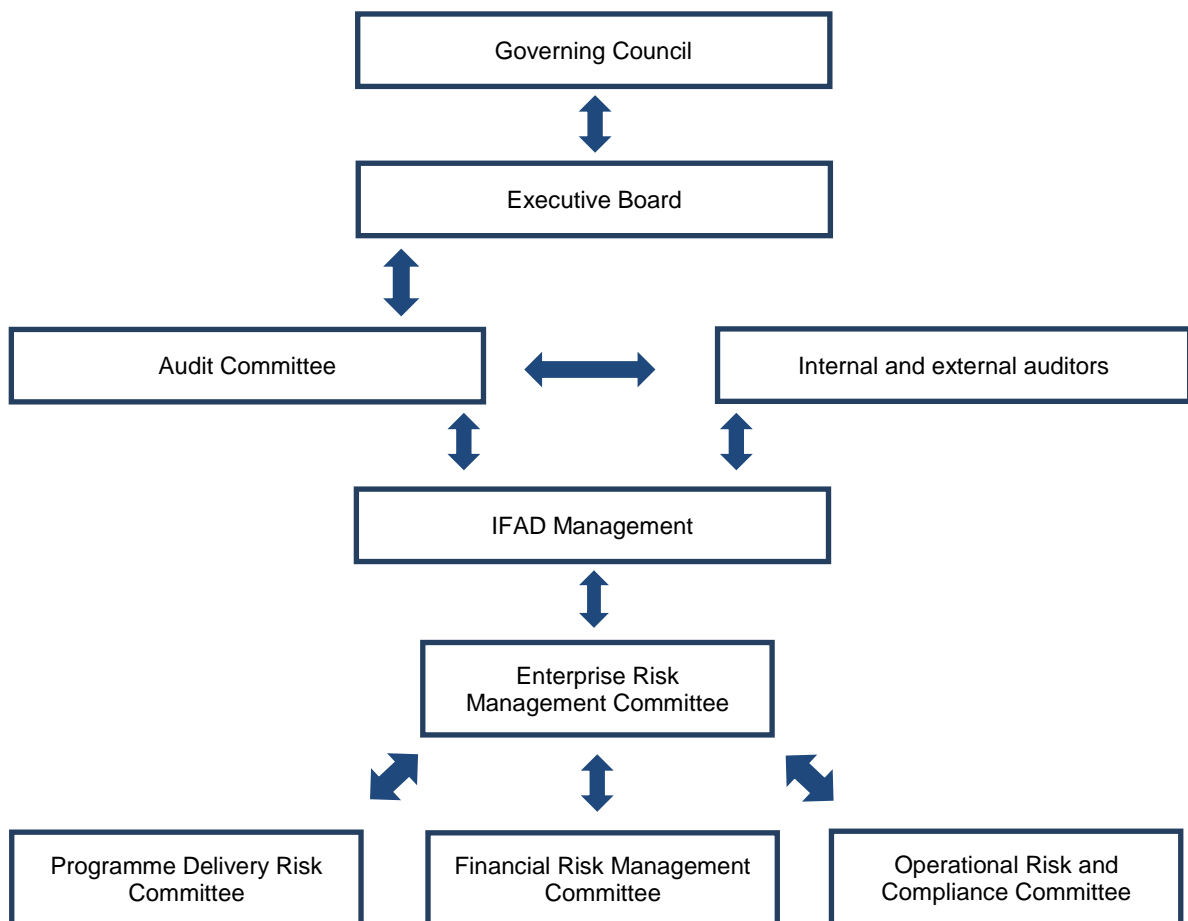
## II. Control environment: organizational structure, roles and responsibilities

### A. Actors and their roles

5. According to the framework, everyone in an organization has responsibility for internal control to some extent. Virtually all employees produce information used in the internal control system or take other actions needed to effect control. This responsibility extends to corporate governance, and translates, in the case of IFAD, to the following roles:
  - (i) The **Governing Council**, IFAD's principal decision-making body, is comprised of representatives of IFAD Member States. All powers of the Fund are vested in the Governing Council. Subject to the limitations stated in the Agreement Establishing IFAD, it may delegate powers to the Executive Board.
  - (ii) The **Executive Board** and the **Audit Committee**, which is appointed by the Board, supervise internal control and risk management. Assisted by the Audit Committee, the Board is informed and updated on any changes to the operating principles of internal control including the main features of the risk management process, a summary of risks, control objectives and common control points for financial reporting.

- (iii) The **internal and external auditors** of the organization also measure the effectiveness of internal control. They assess whether the controls are properly designed, implemented and working effectively while making recommendations on how to improve internal control.
  - (iv) **Management** is responsible for designing, approving and implementing the internal control and risk management process together with the Fund’s financial operations management team.
  - (v) The **Enterprise Risk Management Committee (ERMC)**<sup>2</sup> oversees IFAD’s enterprise risk management (ERM). It also reviews and monitors IFAD’s strategic and cross-cutting risks, including legal and reputational risks, as well as material emerging risks escalated by the:
    - Financial Risk Management Committee;<sup>3</sup>
    - Operational Risk and Compliance Committee; and
    - Programme Delivery Risk Committee.
6. Management and staff are subject to IFAD’s Code of Conduct,<sup>4</sup> which was established to regulate their conduct and align it with the organization’s interests.
7. The governance structure and reporting lines are presented in chart 1 below.

Chart 1  
**Governance structure**



8. Part B of this section examines in detail the flow of financial information within IFAD, the internal actors involved in the process of investment decision-making,

<sup>2</sup> See PB/2021/06.

<sup>3</sup> Formerly the Investment and Finance Advisory Committee (FISCO).

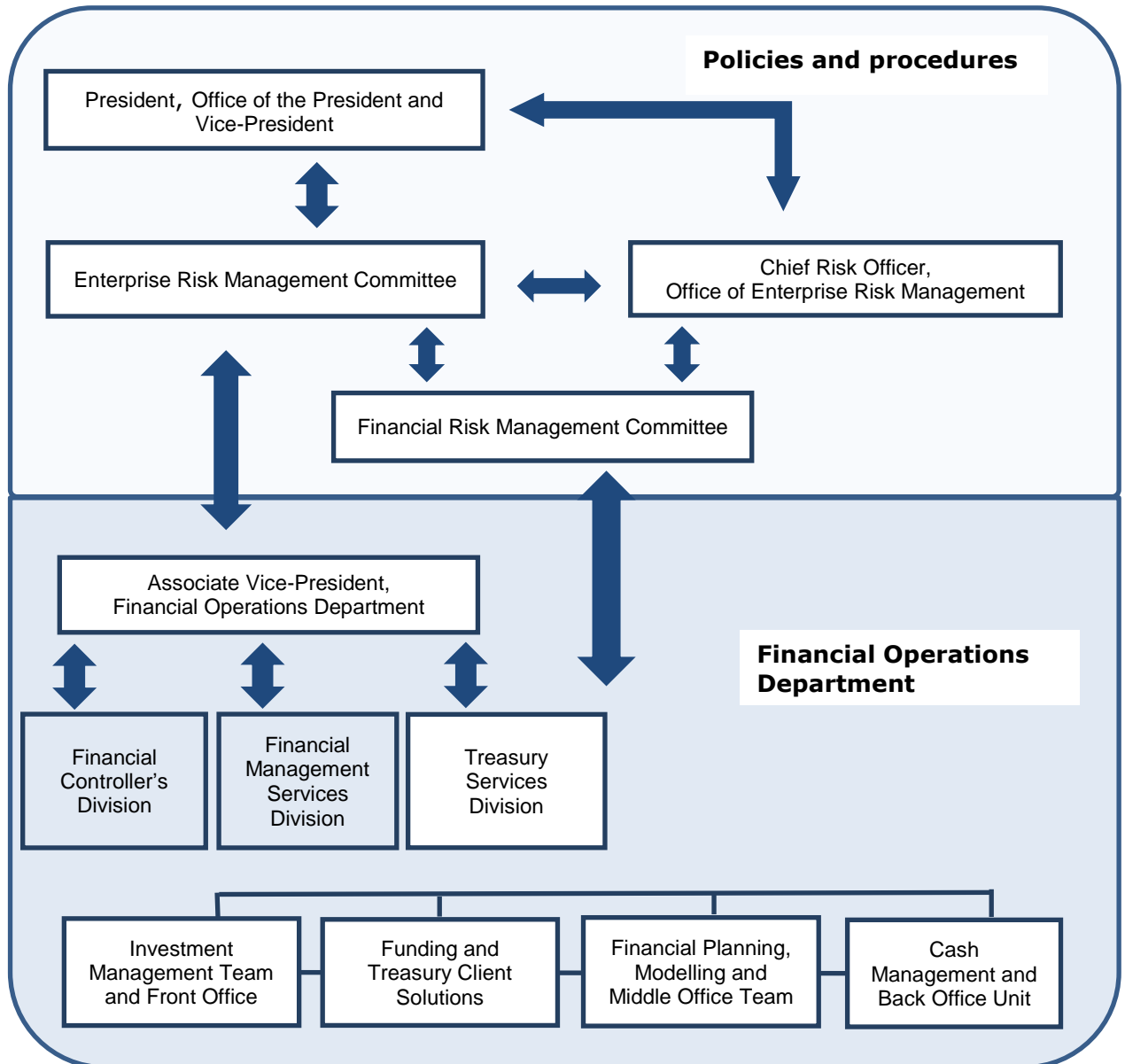
<sup>4</sup> See IFAD’s Human Resources Implementing Procedures – Chapter 1: Duties, obligations and privileges 1.7.9 (vi).

and the specific roles and responsibilities, as well as the flow of financial information as per chart 2.

## B. Investment-related roles and responsibilities in IFAD

9. IFAD's internal flow of financial information in terms of investments is presented in chart 2.

Chart 2  
IFAD's internal flow of financial information



10. The **President** has oversight and decision-making responsibility for the investment of the assets based on the approved Investment Policy Statement (IPS). The President may delegate authority for specific investment-related activities.
11. The **Chief Risk Officer (CRO)** reports directly to Vice-President, Office of the President and Vice-President. This direct reporting line ensures segregation of investment risk management duties from the investment function performed in the Treasury Services Division (TRE).
12. The **Enterprise Risk Management Committee** was established to oversee IFAD's ERM, as well as material emerging risks as escalated by the technical committees.

13. The **Financial Risk Management Committee (FRMC)** is charged with the supervision and oversight of the Fund's financial risk management. The rules of procedure and terms of reference of FRMC are presented in annex I.
14. **Associate Vice-President, Chief Financial Officer and Chief Controller (AVP)**. As head of the Financial Operations Department (FOD), the AVP/FOD is responsible for IFAD's financial resource management. Through the Financial Controller's Division, the Financial Management Services Division (FMD) and TRE, the AVP/FOD:
  - (i) Manages and reports on IFAD's financial resources in a framework of cost efficiency, risk containment, transparency and accountability;
  - (ii) Invests and manages financial assets not immediately needed, in line with operational requirements;
  - (iii) Safeguards and maximizes the resources available for operations through prudent financial management and investment of financial resources, and through appropriate accounting, reporting and projections on IFAD's use of these resources;
  - (iv) Works with internal and external partners in sharing knowledge, harmonizing financial management systems and procedures, and/or enabling their collaboration; and
  - (v) Performs functions delegated by the President, including updating the investment guidelines.
15. The **Financial Controller's Division (FCD)** is a specialized finance division focused on enhancing financial control and resources management within IFAD through: corporate and donor financial reporting; external audit and clean audit opinions; provision of payroll, payments, loan and grant cash disbursements globally; debt servicing, data integrity and protection; controllership; and financial crime compliance.

The main specialized services provided by FCD are the following:

- (i) Ensuring a clean external audit opinion and delivery of IFAD's corporate financial and donor reporting aligned with International Financial Reporting Standards (IFRS), providing leading-edge corporate financial services (including for trust and supplementary funds, and hosted entities), and capacity-building. As custodian of IFAD's corporate financial systems, FCD ensures that state-of-the-art technology solutions are provided for IFAD personnel globally. FCD also acts as secretariat to the IFAD Audit Committee.
- (ii) Partnering with IFAD's field offices and projects, providing rapid approval of disbursements of IFAD's loans and grants, and ensuring risk mitigation, optimal business efficiency and effective debt management. FCD ensures every IFAD staff member receives a monthly payroll and is responsible for all payments globally. It also ensures that rapid advances are made to United Nations Partners in 65 locations, with robust technology solutions for transaction validation and cash settlement.
- (iii) Protecting IFAD by providing optimal controls and monitoring all IFAD offices as per the COSO and IFAD's internal control framework through field visits and analytics. FCD deploys fraud-detection software and tools, anti-fraud procedures, and capacity-building to build a global culture of strong internal controls. It acts as custodian of the IFAD Accountability Framework and Delegation of Authority Framework, providing technology, tools and procedures to increase delegation and impact in the field while ensuring accountability and training. In addition, FCD supports business process re-engineering in all IFAD Offices.



- (iv) Reducing the risk that IFAD conducts activities with counterparties on a sanctions list or involved in money laundering or terrorism financing. FCD ensures compliance with IFAD's Anti-money Laundering and Counter Terrorism Financing Policy, administers Know Your Customer, AML/CFT questionnaires and uses state-of-the-art software databases to proactively screen parties. FCD also leads IFAD's data privacy and data protection functions to the highest personal data protection standards.
16. The **Financial Management Services Division** is a specialized technical division responsible for ensuring adequate financial management mechanisms in all IFAD-funded operations throughout the project cycle. The division promotes and directly supports the strengthening of financial management practices including project accounting, fund-flow arrangements, financial reporting, external audits and fiduciary compliance throughout the project lifecycle. It also leads the development of corporate finance policies and initiatives, and supports the rollout of IFAD's financial architecture with relevant financial instruments and client solutions, including debt management and loan pricing. The division is structured to:
- (v) Mainstream financial management procedures as an integral part of the development process in all IFAD-financed and -managed operations to ensure that funds are used for the intended purpose. FMD achieves this through the provision of risk-based financial direction and oversight during the preparation and implementation of country strategic opportunities programmes and during the design, supervision and implementation support of IFAD projects, programmes and grant activities;
  - (vi) Lead corporate advisory and financial services for the area of development finance and IFAD's developing financial architecture and enhanced business model, including but not limited to IFAD financing terms and criteria, debt issues, modernizing and diversifying IFAD's financial products and instruments, and increasing the flexibility of IFAD's financial offerings;
  - (vii) Engage IFAD's external stakeholders, including governments, project staff and auditors, as well as IFAD's workforce (including accredited consultants) to promote financial management knowledge-sharing and capacity-building;
  - (viii) Act as a first line of defence for risk management in operations, ensuring consistency of financial management practices across regions through a quality assurance unit. Lead financial management policies and procedures including the risk-based assurance framework and related system and tool development, including direct engagement with borrowers/recipients to facilitate the roll-out of IFAD's e-disbursement system, the IFAD Client Portal; and
  - (ix) Maintain strategic partnerships with other international financial institutions (IFIs) and multilateral platforms to promote sharing of best practices and to harmonize IFAD's financial management policies and operational practices where applicable and desirable.
17. The **Treasury Services Division** has a key fiduciary role in managing IFAD's liquidity and the cash flows of both replenishment-based and borrowed resources. This includes strategic portfolio and liquidity planning and long-term financial projections of cash flows and resources. The specialized services provided by TRE are designed to:
- (i) Formulate and implement financial policies and procedures, including the IPS;
  - (ii) Manage IFAD's operational cash and liquidity requirements for all funding sources;
  - (iii) Actively manage IFAD's liquidity portfolio;

- (iv) Coordinate strategic portfolio and liquidity planning by defining funding plans, quantify and set liquidity requirements and targets, and determine the resources available for commitment;
  - (v) Develop partnerships with the treasuries of other IFIs regarding the cash flow processes of disbursements and receipts through operational bank accounts; and
  - (vi) Act as focal point for IFAD's borrowing activity.
18. TRE relies on four operating units to deliver these services:
- (a) The **Cash Management and Back Office Unit (CM)** provides both cash management and post-trading services on investments. High-level responsibilities are to:
    - (i) Manage and report on all cash inflows and outflows for all IFAD and non-IFAD operational accounts and across funding sources with due regard to short-term liquidity and availability of funds;
    - (ii) Ensure accurate processing for all financial and cash flow transactions in operational bank accounts (including administrative payments, loan/grant disbursements, payroll, liquidity transfers, settlement of investment-related transactions) in both regular and business continuity working environments;
    - (iii) Ensure compliance with IFAD procedures and adherence to relevant international payment regulations and post-trading industry standards;
    - (iv) Manage and execute treasury reconciliation and first-level accounting across IFAD and non-IFAD accounts;
    - (v) Monitor and manage the liquidity of IFAD and non-IFAD operational accounts to ensure adequate funds for financial, investment and payment/disbursement transactions;
    - (vi) Be responsible for post-trade processing and investment settlement activities for financial transactions traded for internally managed portfolios across funding sources;
    - (vii) Develop, manage and maintain relationships with central and commercial banks and IFAD's global custodian, regarding cash flow operations for IFAD accounts;
    - (viii) Manage, administer and upgrade cash management systems, including but not limited to IFAD's SWIFT platform. Ensure that systems are in line with required industry standards and applicable international regulations;
    - (ix) Manage operational risk at the unit level through internal processes and production of reports on cash management and back office activities, with relevant key performance indicators;
    - (x) Manage TRE's activities in support of IFAD's decentralization, including negotiating financial and administrative arrangements with the relevant commercial banks. Provide support to IFAD Country Office local bank accounts and to channelling of funds in local currency;
    - (xi) Participate in accreditation process for cooperation initiatives (like Green Climate Fund) and their operational implementation; and
    - (xii) Participate in the review of IFAD's financial policies and in their operational implementation.

- (b) The **Investment Management and Front Office (IM)** monitors and manages IFAD's internally and externally managed portfolios. Responsibilities are to:
- (i) Directly manage the internal portion of the liquidity portfolio. This involves market research, credit analysis of issuers, trade execution and optimal portfolio construction;
  - (ii) Periodically review IFAD's IPS and investment guidelines to ensure alignment with investment strategies, in light of changing financial and market conditions;
  - (iii) Oversee and analyse the externally managed portion of the liquidity portfolio;
  - (iv) Implement currency and asset allocation of the overall liquidity portfolio;
  - (v) Implement foreign exchange and interest rate risk hedges;
  - (vi) Manage IFAD's relationships with trading counterparties, external fund managers and, jointly with the CM, the global custodian; and
  - (vii) Ensure the availability of funds for IFAD and non-IFAD operations through prudent liquidity management in collaboration with the CM.
- (c) The **Financial Planning, Modelling and Middle Office (FPM)** coordinates strategic portfolio and liquidity planning. Responsibilities are to:
- (i) Formulate strategies and policies to optimize the use of internal and external resources to finance IFAD's operations, including the planning, structuring and ongoing management of the optimal capital structure in compliance with asset and liability management (ALM) principles in liaison with the Financial Risk Management Unit (FRMU);
  - (ii) Design, enhance and maintain IFAD's financial models;
  - (iii) Produce short-term and long-term financial projections to test the financial sustainability of the programme of loans and grants under specific scenarios;
  - (iv) Compute and monitor liquidity levels against requirements and liquidity ratios using a forward-looking approach in compliance with internal policies and criteria set by external rating agencies;
  - (v) Define IFAD's IPS and investment guidelines to ensure alignment and compliance with IFAD's investment goals and adequacy in light of changing financial and market conditions, in liaison with the IM;
  - (vi) Administer the Treasury Management System (currently "Treasury database") and other Treasury systems (e.g. Bloomberg), and support the implementation of a new Treasury Management and Front Office System;
  - (vii) Provide portfolio analytics including performance on the internally managed business units and portfolios, including operational bank accounts managed by TRE/CM, and externally managed portfolios;
  - (viii) Provide data to IFAD's global custodian to enable portfolio analytics and reporting functions including on operational bank accounts;
  - (ix) Reconcile IFAD's global custodian figures and Treasury Management System for IFAD's position on a monthly basis;

- (x) Request and liaise with IFAD's global custodian compliance team to ensure correct implementation and alignment with all investment guidelines;
  - (xi) Analyse, implement and review IFAD's Liquidity Policy;
  - (xii) Monitor overall assets against the currency composition of IFAD's commitments to minimize exposure to currency risk, in liaison with the FRMU;
  - (xiii) Recommend benchmark concepts to be used and update benchmarks as required, reporting performance against the benchmark on a monthly basis;
  - (xiv) Ensure that IFAD's investments comply with the IPS and investment guidelines through pre- and post-compliance checks;
  - (xv) Support FCD in the production of notes to the financial statements related to the investment portfolio;
  - (xvi) Manage and administer the pre-trade compliance system and intradivisional workflow automation;
  - (xvii) Design and maintain ALM techniques and implement ALM scenario analysis and related reporting through dedicated systems and models; and
  - (xviii) Produce reporting on all output of the functions above for FOD, RMO, FRMC and governing body committees (e.g. Audit Committee, Executive Board and Replenishment Consultation).
- (d) The **Funding and Treasury Client Solutions Unit** is the focal point for IFAD's borrowing activity. Responsibilities are to:
- (i) Formulate strategies and policies for the optimization of IFAD's funding structure, with a focus on borrowed funds and in line with the organization's needs;
  - (ii) Identify and explore new funding sources, in an effort to have a diversified funding base and minimize funding costs;
  - (iii) Formulate policies related to IFAD's loan pricing reflecting cost of IFAD's funding;
  - (iv) Lead the development of pricing of IFAD's financing instruments and market-related financial solutions, drawing on data from IFAD's financial models;
  - (v) Analyse and propose funding plans to ensure alignment with IFAD's disbursement plans and Liquidity Policy in coordination with the Financial Planning Modelling and Middle Office, RMO and other relevant divisions, by drawing on data from IFAD's financial models;
  - (vi) Lead TRE's efforts in resource mobilization by liaising with existing and prospective lenders including Member States, development banks and private sector investors. These efforts will be undertaken in collaboration with internal divisions for the production of related documentation;
  - (vii) Lead and coordinate the production and update of financial information material for potential investors/Member States as well as for financial media and other external parties to support communications efforts for investor outreach; and

- (viii) Produce reporting on all output of the functions above for FOD, RMO, FRMC and governing body committees (e.g. Audit Committee, Executive Board, and Replenishment Consultation).

19. The **FRMU** has the following responsibilities related to the liquidity portfolio and financial risk:
- (i) Actively monitor, analyse and periodically report on IFAD's investment risk budget;
  - (ii) Contribute to setting and managing the Fund's risk budget on an ongoing basis by monitoring, analysing and reporting on financial risk exposure and by identifying potential new risk factors in IFAD's investments;
  - (iii) Perform stress tests and scenarios and propose mitigation strategies;
  - (iv) Oversee the global custodian compliance monitoring system to ensure correct alignment with all investment guidelines;
  - (v) Provide advice on potential risks to IFAD's financial soundness based on extended knowledge of IFI best practice and, inter alia, capital adequacy, credit and liquidity ratios;
  - (vi) Monitor adherence to the established capital adequacy ratios;
  - (vii) Formulate and propagate the Fund's ALM Framework;
  - (viii) Provide periodic investment risk and compliance reports to the CRO, Senior Management and FRMC; and
  - (ix) Review the investment guidelines proposed by the IM.

### **C. Investment policies and procedures**

20. IFAD's investment processes and controls are governed in reference to the following (as may be amended or updated from time to time):
- Financial Regulations of IFAD;<sup>5</sup>
  - IFAD Policy on Enterprise Risk Management;<sup>6</sup>
  - IFAD's Investment Policy Statement;
  - IFAD's Liquidity Policy;<sup>7</sup>
  - IFAD's Investment Framework;
  - IFAD's investment guidelines;
  - Control Framework for IFAD Investments;<sup>8</sup>
  - Investment management and master custody agreements;
  - Treasury Manual; and
  - Rules of procedure and terms of reference of FRMC, referred to in annex I;
21. **Financial Regulations of IFAD.** The Financial Regulations of IFAD govern the financial administration of the Fund and are interpreted in accordance with the Agreement Establishing IFAD.

<sup>5</sup> These Financial Regulations were adopted by the Governing Council at its First Session on 15 December 1977. See <https://www.ifad.org/en/-/document/financial-regulations-of-ifad>.

<sup>6</sup> Formerly entitled "Internal Control Framework for IFAD's Investments".

<sup>7</sup> See EB 2006/89/R.40 and EB 2020/131(R)/R.20/Rev.1. At the beginning of IFAD12, the provisions of the 2006 Liquidity Policy will be entirely superseded and replaced by the provisions of the updated Liquidity Policy. See <https://webapps.ifad.org/members/eb/131R/docs/EB-2020-131-R-R-20-Corr-1.pdf?attach=1>.

<sup>8</sup> Formerly entitled "Internal Control Framework for IFAD's Investments".

22. **IFAD Policy on Enterprise Risk Management.** The ERM policy<sup>9</sup> establishes a formal, systematic and integrated approach to identifying, managing and monitoring risks in IFAD and defines key roles and responsibilities for all stakeholders in ERM activities.
23. **IFAD's Investment Policy Statement.** The IPS is updated annually by TRE and then submitted to the Executive Board for final approval at its December session. The document provides the overarching principles regulating IFAD's key investment responsibilities, investment universe and acceptable risk parameters.
24. Specifically, the IPS aims to:
  - (i) Define the duties, responsibilities and governance over IFAD's investments;
  - (ii) Set out IFAD's investment objectives for risk and return, and define the eligible asset classes, credit rating requirements and tranching of the liquidity portfolio;
  - (iii) Define key components of investment guidelines;
  - (iv) Determine the risk budget for IFAD's overall liquidity portfolio; and
  - (v) Establish formalized criteria to measure, monitor and evaluate performance and risk.
25. **IFAD's Liquidity Policy.**<sup>10</sup> This policy provides a "means of monitoring and ensuring that the Fund has adequate liquidity available at all times".
26. **IFAD investment guidelines.** For each individual portfolio, IFAD's investment guidelines define the principles by which a fund is managed and monitored. The RMO, through daily oversight and monitoring, ensures strict compliance with investment guidelines through the compliance monitoring system provided by IFAD's global custodian.
27. These investment guidelines include at least the following components for each portfolio:
  - (i) Investment objectives: defining expected return and risk;
  - (ii) Risk budget;
  - (iii) Base currency;
  - (iv) Eligible currencies;
  - (v) Eligible instruments;
  - (vi) Minimum and maximum portfolio duration;
  - (vii) Minimum credit quality;
  - (viii) Diversification requirements;
  - (ix) Procedures for futures and options; and
  - (x) Comparative performance benchmark.
28. The benchmarks identified in the investment guidelines must be: (i) unambiguous, transparent and simple; (ii) investable and replicable; (iii) measurable and stable; (iv) appropriate to the investment purpose; (v) reflective of current investment opinions; and (vi) specified in advance.
29. **Investment management and master custody agreements.** These agreements document the terms of IFAD's appointment of investment managers and custodians from time to time in line with the IPS.

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<sup>9</sup> See EB 2021/133/R.7.

<sup>10</sup> See EB 2006/89/R.40 and EB 2020/131(R)/R.20/Rev.1.

30. **Treasury Manual.** This manual provides a detailed description of the specialized services provided by TRE, and defines how the division’s workload is divided among its various functions.
31. The manual is divided into two main sections: (i) the executive manual, providing a broad overview of the organization and its major processes; and (ii) the operational manuals (Cash Management, Investment Management, FPM and Funding and Treasury Client Solutions Units), which constitute a working document that provides the user with specific details, descriptions and examples of processes and procedures. Table 1 gives an overview of the Treasury Manual.

Table 1

**Overview of the Treasury Manual**

	<i>Executive manual</i>	<i>Operational manuals</i>
What is it?	An overview document that provides a concise description of TRE’s functions and procedures in a summary format.	A detailed description of the functions, tasks and processes that make up the responsibilities of TRE staff.
How is it used?	Contains embedded navigation links that take the user directly to relevant sections within the operating manual for additional information.	Contains specific listings of duties, activities, detailed process flows, and other “how-to” material. Can be used as a step-by-step instruction guide for most procedures.
Who are the prospective users?	Intended for use as a quick reference for those interested in how TRE operates and what its major functional responsibilities are.	Intended for use as a detailed reference for those tasked with carrying out TRE’s day-to-day functions.

32. To maintain flexibility, accessibility and adaptability, the Treasury Manual is published on IFAD’s local area network in portable document format (PDF). The electronic file is controlled by the TRE front office. In view of the constant revision of processes and the restricted nature of parts of the Treasury Manual, no hard copies are distributed.
33. **Confidentiality.** Due to the confidential nature of the information presented, parts of the Treasury Manual are restricted and can be viewed by authorized users only. Approved users may not divulge its contents to third parties without specific written permission by authorized senior staff. The public sections of the manual, i.e. the IFAD Treasury Executive Manual, are available to be viewed by all staff on the TRE intranet site.
34. **Financial Risk Management Committee.** IFAD has a FRMC. Its Rules of procedure and terms of reference are contained in annex I.

### **III. Risk assessment, control, information and communication, and monitoring activities pertaining to the investment portfolio**

#### **A. Risk identification**

35. IFAD’s investments are exposed to a variety of financial risks. Marked-to-market investments are affected by market risks, as well as liquidity, credit, counterparty and operational risks. A detailed definition of these risks and a summary of the key measures used to measure such risks in IFAD’s liquidity portfolio are given below.
36. **Market risk** is defined as the risk of losses arising from exposure to changes in financial market variables (prices and rates). IFAD is exposed to changes in interest and exchange rates.
37. **Interest rate risk** is defined as the potential risk that the value of a fixed rate security will decline as a result of an upward movement in the absolute level of interest rates, based on the spread between the two rates, and the overall shape of the yield curve. Interest rate risk is monitored on the overall portfolio and on the individual portfolios. Risk measurements include duration, standard deviation, value at risk (VaR) and conditional value at risk (CVaR).

38. **Currency risk** arises from the change in price of one currency against another. IFAD faces currency risk as its future commitments may be in different currency to that of its assets. Currency risk is monitored, and reported on, on a monthly basis.

#### **Liquidity risk**

39. Liquidity risk is the potential for loss resulting from being unable to meet cash flow needs in a timely manner. IFAD's principal objective is to hold sufficient liquid resources to enable it to meet all probable cash flow needs related to normal and predictable obligations – without the need to make unplanned requests of Member States for additional financing.
40. Liquidity risk is addressed through the minimum liquidity requirement (MLR).<sup>11</sup> This amount must be available at any point in time to ensure IFAD's ability to meet its disbursement obligation promptly and without additional costs.

#### **Credit risk**

41. Credit risk is defined as the risk of loss of the loan principal or loss of a financial reward stemming from a borrower's failure to repay a loan or otherwise meet a contractual obligation.
42. Credit risk is actively managed by TRE (for the investment portfolio) and FCD (for the loan portfolio) as a first line of defence (risk owner), and monitored by FRMU as a second line of defence (independent risk oversight). The minimum rating floors in the respective investment guidelines are an indicator of risk and used as a tool in managing credit risk. The eligibility of individual securities and issuers is determined on the basis of ratings given by the three major credit rating agencies: Fitch, Moody's, and Standard & Poor's. For investment management purposes, credit analyses by security and by issuer will be performed – for all internally managed investments and, on a selective basis, for externally managed assets, and for commercial and central banks – using financial information systems, credit analysis provider(s) and other sources. All other credit analysis will be performed and reported as an integral part of risk management. Moreover with the adoption of the impairment requirement of IFRS 9, an impairment allowance has been set up to reflect the expected credit loss of financial instruments designated at amortized costs. Monitoring activities of this credit risk are performed by FCD in conjunction with TRE and overseen by FRMU.

#### **Counterparty risk/trading counterparties**

43. Counterparty risk is defined as the risk to each party of a contract that the counterparty will fail to perform its contractual obligations.
44. Counterparty risk is managed for all investments through the establishment of a minimum rating for trading counterparties.
45. Counterparty risk is also managed by capping exposure to each issuer/bank. Counterparty risk analyses are performed for the purpose of investment management using financial information systems, credit analysis providers and other sources. All other counterparty risk analyses will be performed and reported as an integral part of risk management.

#### **Country risk**

46. Country risk is a collection of risks associated with investing in a country. These risks include political risk, exchange rate risk, economic risk, sovereign risk and transfer risk.
47. Country risk is managed for all investments through the establishment of maximum country exposure concentrations within the guidelines of every individual portfolio. Country exposures are monitored on a daily basis through the internal compliance system.

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<sup>11</sup> See EB 2006/89/R.40 and EB 2020/131(R)/R.20/Rev.1.



48. **Operational risk** is defined by the Basel Committee on Banking Supervision as “the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.” Operational risk is the risk that is not inherent in financial, systematic or market-wide risk.
49. Operational risk is addressed by defining a sound framework of responsibility and accountability within IFAD’s financial structure, by establishing back-up procedures and by performing reviews of relevant policies.
50. On a broader organizational level, the Revised IFAD Policy on Preventing Fraud and Corruption in its Activities and Operations<sup>12</sup> aims to: “reaffirm the Fund’s and its Member States’ continued commitment to the prevention and mitigation of fraud and corruption in IFAD-financed and/or IFAD-managed operations and activities and to ensure that the Fund has adequate safeguards and measures in place to this end”.
51. IFAD’s Anti-Money Laundering and Countering the Financing of Terrorism Policy<sup>13</sup> seeks to ensure that integrity risks are identified, assessed and adequately mitigated by taking the nature, scale and complexity of the Fund’s activities into account. The intent of the policy is to prevent the Fund’s exposure to serious reputational risk, financial loss or legal liability.
52. In addition, IFAD’s Human Resources Implementing Procedures specify that “Screening will be conducted with professional rigour ... and selection processes ensuring that candidates are assessed on the basis of the highest standards of competence, integrity, and appropriate experience to carry out IFAD’s objectives and avoid potential conflicts of interest”.<sup>14</sup>

## **B. Risk measurement and management**

### **Risk budgeting and risk tolerance**

53. The Internal Control Framework translates the Fund’s appetite for treasury investment risk in line with its risk appetite statement. This translates into risk metrics as defined in the IPS, investment guidelines, the Liquidity Policy as well as other policies and internal procedures (as may be amended or updated from time to time).
54. Specifically, risk budgeting is the procedure of allocating risk within and between funds. It entails setting predetermined limits for the liquidity portfolio – on an aggregate level and at the level of individual managers – monitoring these measures and adjusting the portfolio whenever they exceed the tolerance level. In more detail, risk budgeting is the process of:
  - (i) Measuring and decomposing the aggregate risk of a portfolio into its constituents on a quantitative basis;
  - (ii) Setting risk limits (risk budgets) for the overall liquidity portfolio and individual portfolios, ex ante through the definition of ranges of selected risk metrics in line with the organization’s risk appetite and tolerance level;
  - (iii) Allocating risks across the assets in compliance with risk budgets;
  - (iv) Monitoring the use or misuse of risk budgets on an ongoing basis;
  - (v) Expanding ALM;
  - (vi) Analysing the results (ex post); and
  - (vii) Changing investments when necessary to align the portfolio with the desired risk level.

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<sup>12</sup> See EB 2018/125/R.6.

<sup>13</sup> See EB 2019/128/R.41/Rev.1

<sup>14</sup> IFAD’s Human Resources Implementing Procedures, chapter 2: Staff recruitment and appointment 2.3.1 (ii).

55. IFAD's IPS sets the risk budget for IFAD's overall liquidity portfolio. The risk budget for individual portfolios is set in IFAD's investment guidelines and approved by the President of IFAD, unless otherwise delegated. Additional limits are set in the MLR, investment policies and other internal procedures. Table 2 details the risk measures selected for the risk management framework and their tolerance level as defined in these IFAD policies and guidelines.

Table 2  
**IFAD's investment risks, established limits and Control Framework\***

<i>Risk type</i>	<i>Risk measure and source</i>	<i>Established limit</i>	<i>Monitoring frequency/tool</i>	<i>Reporting frequency</i>	<i>Alert level/action taken</i>
Interest rate risk	Manager's duration (determined in IFAD's investment guidelines)	Duration must be no lower than zero (i.e. divesting into cash, lower limit) and no higher than five years above the benchmark duration (upper limit) as currently determined in IFAD's investment guidelines.	Daily through compliance system.	Monthly in the risk report to the Treasurer and the AVP/FOD.  Quarterly in the report on IFAD's liquidity portfolio to the Executive Board.	Should the duration upper or lower limit be breached, the issue will be reported by the FPM to the IM and the Treasurer. The IM will immediately liaise with the investment manager to: <ul style="list-style-type: none"> <li>• Verify the reason for the duration position/strategy.</li> <li>• Agree on a reasonable time frame for the manager to restore duration within allowable limits.</li> <li>• Upon execution of required trades, request written confirmation by the manager of the new duration level.</li> </ul> <p>The FPM will then re-evaluate the duration level and report to the Treasurer.</p> <p>The FRMU will independently assess any breach and report it to the CRO.</p>

\* Table 2 presents the internal procedures established under the risk management framework to monitor and manage risks within the corresponding risk-budgeting framework. The established limits are detailed only for reference purposes, however the limits might change when the corresponding policy or guideline is updated.

<i>Risk type</i>	<i>Risk measure and source</i>	<i>Established limit</i>	<i>Monitoring frequency/tool</i>	<i>Reporting frequency</i>	<i>Alert level/action taken</i>
Interest rate risk (continued)	One-year CVaR at 95 per cent confidence level (stated in IFAD's IPS and, for individual portfolios, in IFAD's investment guidelines)	Overall portfolio: as determined in the IPS.  Individual portfolios: according to the specific investment guidelines.	Monitored weekly through third-party financial data vendors' solutions (e.g. PORT or PORT Enterprise from Bloomberg). Monthly through risk management system.	At least monthly in the risk report to the Treasurer and the AVP/FOD. More frequently if alert level for measure is reached.  Quarterly in the report on IFAD's liquidity portfolio to the Executive Board.	Should the CVaR on the overall portfolio or on any single manager exceed its threshold the issue will be reported by the FPM to the IM, the Treasurer and the AVP/FOD. The following actions will be taken: <ul style="list-style-type: none"> <li>• The FPM will perform a breakdown analysis to identify the sources of increased CVaR.</li> <li>• Depending on the result of the breakdown analysis, the FPM will recommend to the AVP/FOD and to the Treasurer corrective measures on the overall portfolio or for a single manager. These measures may include, but are not limited to, increasing the cash exposure, decreasing duration and divesting from a certain sector.</li> <li>• The measures will be discussed within TRE and FPM and an action plan will be presented to the AVP/FOD and to the Treasurer.</li> <li>• Upon approval, the recommendations will be implemented with the concerned counterparty.</li> <li>• FRMU will provide oversight on the process and report any breach to the CRO.</li> </ul>

<i>Risk type</i>	<i>Risk measure and source</i>	<i>Established limit</i>	<i>Monitoring frequency/tool</i>	<i>Reporting frequency</i>	<i>Alert level/action taken</i>
Currency risk	Percentage deviation from target currency ratios	While the aim of the framework is to minimize any variance (i.e. zero variance), any deviation of more than 10 per cent per currency is considered above the absolute limit.	Monthly through internal analysis.	At least monthly to the Treasurer and the AVP/FOD. More frequently if the variance is close to the established limit.  Quarterly in the report on IFAD's liquidity portfolio to the Executive Board.	Should the percentage deviation in any single currency exceed the absolute limit, the following actions will be taken: <ul style="list-style-type: none"> <li>• The FPM will recommend a realignment strategy by one of the following tools: foreign exchange transactions on internally managed cash or change in currency composition of one or more of the externally managed individual portfolios.</li> <li>• An execution time frame for the realignment will be communicated by the FPM to the Treasurer and the AVP/FOD and to the concerned teams (the IM and/or the CM).</li> <li>• The concerned party will be instructed to execute the trades.</li> <li>• Upon execution, a new analysis will be performed to verify the realignment of the assets.</li> <li>• FRMU will provide oversight on the process and report any breach to the CRO.</li> </ul>
Liquidity risk	Percentage of gross disbursement (determined in IFAD's Liquidity Policy).	MLR set at 100 per cent of the next 12-months' total gross loan and grant disbursements, and debt service (to be officially implemented during IFAD12).  TLL set at 80–100 per cent of 24 months of stressed net cash flows <sup>15</sup> (to be officially implemented during IFAD12).	Monitored weekly as part of the Liquidity Report produced by FPM.	Weekly in the report on IFAD's liquidity portfolio to TRE and RMO, and quarterly in the report on IFAD's liquidity portfolio to the Executive Board.	If the MLR or TLL low limit is breached, the issue will be reported by the FPM to the AVP/FOD, the Treasurer and FRMU. If minimum liquidity is expected to be breached or is breached, in spite of the preventive measures, stricter project- and non-project-related measures should be taken, supported by external support measures.  FRMU will provide oversight on the process and report any breach to the CRO.

<sup>15</sup> As defined in IFAD's Liquidity Policy (EB 2020/131(R)/R.20).

Credit risk	Credit rating (determined in IFAD's investment guidelines) and fundamental analysis carried out in-house.	Minimum credit floor determined in the IPS.	Daily through compliance monitoring system.	<p>Weekly in the liquidity report produced by FPM. Monthly in the risk report to the Treasurer and the AVP/FOD.</p> <p>On a quarterly basis a credit rating analysis by portfolio will be presented in the report on IFAD's liquidity portfolio to the Executive Board.</p>	<p>Should a security be downgraded below IFAD's minimum credit floor, the manager has 30 days to propose a strategy to the FRMU to address the breach.</p> <p>Credit risk is reported and analysed by the FRMU. TRE also analyses the credit risk for internally managed investments, and, on a selective basis, for externally managed assets. Credit risk analyses for commercial and central banks are performed by using financial information systems, credit analysis providers and other market sources.</p> <p>Credit risk for securities designated at amortized cost is also monitored by the impairment allowance created to reflect the expected credit loss. Activities are carried out by FCD, TRE and FRMU.</p> <p>FRMU will provide oversight on the process and report any breach to the CRO.</p>
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<i>Risk type</i>	<i>Risk measure and source</i>	<i>Established limit</i>	<i>Monitoring frequency/tool</i>	<i>Reporting frequency</i>	<i>Alert level/action taken</i>
Counterparty risk	Credit rating for counterparties	Minimum credit rating for trading counterparties determined in IFAD's IPS.	Weekly as part of the liquidity report produced by FPM. Monthly through internal analyses.	Ad hoc basis, but if there is a credit event (e.g. downgrade) then a report will be written.	Should a trading counterparty be downgraded below IFAD's minimum credit floor, the issue will be reported by the FPM to the Treasurer, the AVP/FOD, the IM, the FRMU and the CM. Immediate action will, as appropriate, be taken with the investment manager. TRE performs analysis of counterparties for all investment activities, including trading, derivatives and banks eligible for investments. Monitoring is also performed on commercial and central banks' credit ratings and financial soundness. FRMU will provide oversight on the process and report any breach to the CRO.
Country risk	Maximum country risk exposure and concentration limits (determined in IFAD's investment guidelines).	Depending on liquidity portfolio guidelines.	Daily through compliance monitoring system.	Weekly as part of the liquidity report produced by FPM. Monthly in liquidity portfolio reports to FRMC and quarterly to the Executive Board.	Should a country concentration be exceeded, the issue will be reported by the FPM to the Treasurer, the AVP/FOD, the IM, the FRMU and the CM. Immediate action will be taken, as appropriate, with the investment manager. FRMU will provide oversight on the process and report any breach to the CRO.
Operational risk	Segregation of duties within TRE, back-up procedures, legal control (determined in the Treasury Manual and Operational Risk Management for Treasury, and Cash and Investment).  Segregation of duties of TRE and the RMO reported in this Control Framework document and various investment guidelines.	Not applicable	Continuous	Annually through the revision of the ICFRs.  From time to time through the update of the Treasury Manual in order to reflect changes in the structure and or/duties	With regard to payments, segregation of duties for core financial procedures within FOD exists between FCD, the Administrative Services Division (ADM) travel unit and TRE. FCD and ADM have the authority to instruct movements of IFAD funds to external parties. The TRE cash management unit reviews the transactions received and, with due regard to internal checks and liquidity availability, prepares and authorizes the execution of all financial and payment transactions through operational bank accounts.  FCD and TRE independently post accounting entries in the Fund's general ledgers, which are reconciled on, at least, a monthly basis.  With regard to internally managed investments, within TRE segregation of duties exists between the IM, which recommends (for the Treasurer's approval) and executes trades, and CM unit which performs trade settlement and post-trading activities. FRMU independently reports on the investment activities.  Additionally, with regard to the liquidity portfolio, the first level of sign-off is performed between the external portfolio managers and IFAD's global custodian, thereby ensuring accountability and segregation of duties.  Procedures are reported in the Treasury Manual and in the ICFR process flows. Audits are performed annually on processes and procedures.  Any incident should be reported by TRE to the lead risk officer responsible for operational risks.

### C. Control, information and communication, and monitoring activities

56. TRE reports externally certain risk measurement metrics and analyses to the Executive Board and the Audit Committee through the quarterly and annual liquidity portfolio report. Comprehensive weekly and monthly risk reports are also produced by the Unit and shared internally with the Treasurer, AVP/FOD and FRMC.
57. These comprehensive weekly and monthly risk reports inform, communicate and monitor activities that cover the following areas of risk monitoring:
  - (i) Liquidity risk (net asset value, haircut, stressed net asset value, MLR) and cash flows projections projected by the financial model;
  - (ii) Currency risk;
  - (iii) Market and credit monitoring, and risk levels compared to predetermined risk budget levels;
  - (iv) Compliance monitoring versus investment guidelines and subsequent actions, if any; and
  - (v) Portfolio and benchmark performance.
58. Whenever a risk measure reaches the "alert level", as defined in table 2, the FPM will inform the IM, the Treasurer and the FRMU. Appropriate risk-mitigating strategies will be recommended and actions will be taken, as described in table 2. Upon completion of the actions, the FPM will verify the risk level and report the new level to the concerned parties.
59. In addition to the risk measures established in IFAD's IPS for risk-budgeting purposes, a comprehensive set of risk measures is analysed through the risk management system. Whenever one of the risk measures, either on the overall portfolio or on a single manager, is deemed to be excessive or shows a significant change from the previous period, the FRMU will bring the issue to the attention of the CRO, the Treasurer and the IM.
60. The additional measures (whose definitions are given in annex III) include:
  - (i) Annualized standard deviation or returns by manager, individual portfolio, benchmark and for the overall portfolio and benchmark;
  - (ii) CVaR with a one-year forward-looking horizon and a 95 per cent confidence level, by manager, by individual portfolio benchmark, and for the overall portfolio and the overall benchmark;
  - (iii) Historical monthly CVaR for the historical period of the past two years;
  - (iv) Overall risk decomposition, by risk type; and
  - (v) Risk-adjusted return indicators.
61. FCD executes full data control and reconciliation of financial records against the custodian and/or third parties.
62. The risks in IFAD's investments are currently monitored with a variety of tools:
  - (i) **Enhanced risk management system.** IFAD is constantly strengthening its analytical resources to monitor risk in the liquidity portfolio, and enable TRE and the FRMU to perform ex-ante and ex-post analyses as well as stress tests on assets, on the individual portfolios and on individual managers;
  - (ii) **Compliance monitoring system.** This web-based application supplied by the global custodian enables the RMO to verify on a monthly basis the compliance of external portfolio managers with the respective investment guidelines. The majority of guidelines are currently coded in the system, and

the application flags breaches or alert levels on a daily basis. Guidelines that cannot be coded in the system are monitored through internal analyses and manual procedures;

- (iii) **Third-party financial data vendors such as Bloomberg.** Third-party vendors will be engaged through their solutions (currently PORT and in the future with Bloomberg, AIM and PORT Enterprise).
- (iv) Compliance checks on the internally managed portfolios are, for reasons of segregation of duty, performed by the global custodian who alerts the FPM and FRMU as soon as a breach occurs, and produces a monthly report;
- (v) In addition to the above, the IM performs qualitative analyses on selected issuers and counterparties; and
- (vi) Performance, risk and compliance reporting by the global custodian.



## **Rules of procedure and terms of reference of the Financial Risk Management Committee<sup>16</sup>**

### **1. Purpose**

- 1.1 The Financial Risk Management Committee (FRMC) is established to oversee the implementation and review of the Fund's financial risk management frameworks and policies. The FRMC shall exercise its authority to oversee the management, monitoring, mitigation and reporting of risks and controls as they relate to financial risks, and perform risk appetite monitoring for the financial risk domain. The FRMC is responsible for escalating all material issues related to financial risk to the Enterprise Risk Management Committee (ERMC) in a timely manner.
- 1.2 The FRMC will also provide oversight and guidance on issues related to balance sheet management and financial reporting.

### **2. Membership**

- 2.1 The FRMC shall be composed of the following members and a secretary:
  - Treasurer and Director, Treasury Services Division, TRE (Chairperson)
  - General Counsel, Office of the General Counsel, LEG
  - Director, Financial Management Services Division, FMD
  - Controller and Director, Financial Controller's Division, FCD
  - Director, Operational Policy and Results Division, OPR
  - Director, Global Engagement, Partnership and Resource Mobilization Division, GPR
  - Director and Chief Risk Officer, Office of Enterprise Risk Management, RMO
  - Lead risk officer responsible for financial risks, RMO (secretariat)
  - Director, Office of Audit and Oversight, AUO (permanent observer)
  - Other members at the discretion of the Chairperson

### **3. Meetings**

- 3.1 All Members are required to attend the meetings as a priority, and they may appoint another manager, with the appropriate level of expertise, approved by the Chairperson, as an alternate. In case of inability to attend a meeting, written comments can be submitted to the Chairperson for due consideration by the present members. Resource persons may attend at the discretion and invitation of the Chairperson in support of specific agenda items. Specific working groups comprised by dedicated technical staff shall meet prior to the meeting to deliberate and produce the necessary items for discussion at the committee.
- 3.2 Membership is functional and not personal in nature; however, any Member shall indicate any potential conflict of interest related to any issue discussed at the ERMC and recuse themselves as appropriate.
- 3.3 The FRMC shall meet quarterly or as needed, and at times the Chairperson may require. A quorum shall consist of the Chairperson and four (4) Members. Decisions shall be by majority or by consensus if chaired by the Alternate. In case of a tie, the Chairperson has an additional vote. Once the

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<sup>16</sup> PB/2021/06.

meeting is installed, the Chairperson and members have full decision-making authority in accordance with these terms of reference.

#### **4. Functions**

##### 4.1 The FRMC is responsible for the following:

###### 4.1.1 Policies, guidelines and risk frameworks

- (a) Providing technical reviews of policies related to financial risk and endorsing them for submission to the ERMC;
- (b) Reviewing corporate documents related to financial risk, as needed; and
- (c) Approving any decision related to other operational financial documents, frameworks or similar documents below the policy level.

###### 4.1.2 Risk oversight

- (d) Escalating all material issues and emerging risks related to financial risk to the ERMC in a timely manner;
- (e) Validating Management's establishment of an effective process for identifying, measuring, prioritizing, escalating and – when necessary – mitigating emerging risks related to financial risk, and escalating relevant risks to the ERMC as appropriate;
- (f) Ensuring that relevant divisions are properly identifying, measuring, monitoring and mitigating financial risks; and
- (g) At every meeting, reviewing Management's efforts to maintain an appropriate management programme focused on financial risk, including plans, milestones, resources and proposed changes.

###### 4.1.3 Risk appetite and risk reporting

- (h) Proposing level 1 and level 2 risk appetite statements, metrics and appetite levels for financial risk to the ERMC for endorsement to the Executive Board on an annual basis and upon recommendation from the Financial Operations Department (FOD);
- (i) Performing the following functions related to risk appetite monitoring, at each meeting:
  - i. Reviewing level 1, level 2 and level 3 key risk indicators related to the financial risk profile;
  - ii. Assessing alignment with the Executive Board-approved financial risk appetite; and
  - iii. Escalating breaches to the ERMC in a timely manner; and
  - iv. Recommending actions to the ERMC, where applicable.

###### 4.1.4 Committee effectiveness

- (j) On an annual basis, reviewing the effectiveness of FRMC functioning and confirming that all responsibilities outlined within these terms of reference have been carried out.

##### 4.2 The FRMC will also be responsible for the following additional functions:

###### 4.2.1 Investment portfolio

- (a) Reviewing reports on financial market trends and movements that address the impact of such activities on the investment portfolio based on investment portfolio performance updates or any other relevant source;

- (b) Reviewing reports on the financial results, composition and risk structure of the investment portfolio, evaluating the data and recommending any action arising from such review;
- (c) Monitoring adherence to the Investment Policy Statement and investment guidelines, as well as evaluating the policy statement and guidelines on an annual basis; and
- (d) Monitoring implementation of – and reviewing reports on – liquidity risk management in accordance with the Fund’s liquidity and stress test policy.

#### 4.2.2 Loan portfolio

- (e) Reviewing and approving proposals related to final risk ratings for countries and private-sector transactions;
- (f) Discussing and approving recommendations regarding the requests of selected borrowers and decisions related to pricing – making material pricing decisions as needed;
- (g) Reviewing adherence to the prudential ratio and reviewing and approving recommendations from FOD in the event of a ratio breach;
- (h) Reviewing quarterly reports on the status of the loan portfolio, including proposed changes in rating, updates on staging in accordance to IFRS 9 and reporting on the exposure management framework;
- (i) Monitoring adherence to the credit risk management framework, which includes types of loans, country limits and risk-adjusted pricing;
- (j) Evaluating any risk transfer initiative affecting the loan portfolio or significant financial matters related to the loan portfolio;

#### 4.2.3 Capital Management, funding and hedging operations

- (k) Reviewing and discussing the Fund’s current and forward-looking financial operations, including asset and liability management and financial risk management;
- (l) Reviewing and discussing the findings of regular Status of Contributions Reports;
- (m) Monitoring the Fund’s capital position in accordance with the Capital Adequacy Policy, stress test exercise, and strategic long-term capital planning;
- (n) Reviewing and monitoring the execution of the short- and long-term liquidity, projections and funding plan;
- (o) Overseeing the implementation of hedging operations and strategies conducted to offset interest rate and currency risk exposure in accordance with the Fund’s Asset and Liability Management Framework;

#### 4.2.4 Review of financial services providers to IFAD

- (p) Reviewing and approving recommendations from FOD on proposed changes to the relationships with financial service providers, eligible banks for time deposits, counterparties for foreign exchange transactions and other financial providers as needed, and recommending changes, where appropriate;

#### 4.2.5 Financial and statutory reporting

- (q) Reviewing and endorsing the quarterly financial reporting package to the ERM, Executive Board and Audit Committee;

- (r) Reviewing and endorsing other statutory external financial reporting requirements to the ERM, Executive Board and Audit Committee;
- (s) At least annually, and periodically if necessary, reviewing matters related to or affecting IFAD's external credit ratings; and
- (t) Reviewing other financial materials upon request of the Financial Controller's Division and escalating material matters to the ERM and when required, the Executive Board and Audit Committee.

4.3 The FRMC Secretary will be responsible for the following:

- 4.3.1 Calling ordinary meetings at the request of the Chairperson at least seven working days prior to the date of the meeting and at least 24 hours prior to the date of the meeting in the case of extraordinary meetings;
- 4.3.2 Preparing the agenda as approved by the Chairperson;
- 4.3.3 Requesting, screening and vetting supporting materials for the agenda items and distributing them to Member States at least five working days prior to the meeting date, or at a later date as determined by the Chairperson in extraordinary circumstances;
- 4.3.4 Drafting summaries of meeting proceedings and resolutions, including advice, recommendations, observations, dissenting views and decisions taken, along with the names of Members and others in attendance;
- 4.3.5 Submitting draft minutes to Members for inputs and subsequently to the Chairperson for review and approval;
- 4.3.6 Distributing the signed minutes to all Members, observers, resource persons and secretaries of all enterprise risk management committees;
- 4.3.7 Maintaining a schedule of matters arising in order to record and track the progress of actions delegated for action under each item; and
- 4.3.8 Liaising with the ERM to ensure the coordination of risks and facilitating a holistic reporting internally and to Members on all aggregated risks affecting IFAD (the FRMC will ensure the provision of all risk metrics pertaining to financial risks to be included in the Corporate Risk Dashboard); and
- 4.3.9 Coordinate with counterparts within relevant departments.

## Reference to the principles outlined in the COSO Internal Control–Integrated Framework in the context of IFAD’s investment-related activities

### I. Control environment

1. **The organization demonstrates a commitment to integrity and ethical values. IFAD’s Code of Conduct and Internal Control Framework require:** (a) annual certification of compliance with the IFAD Code of Conduct and declaration of non-IFAD income, goods, services or assets; (b) Management assertion and external audit attestation of ICFRs; and (c) financial disclosure statements for selected staff members. These points – referred to in section II.C of the Control Framework – demonstrate **a commitment to integrity and ethical values.**
2. **The board of directors demonstrates independence from Management and exercises oversight of the development and performance of internal control:** IFAD’s Governing Council, Executive Board and Audit Committee are independent from Management and exercise oversight as referred to in section II.A.
3. **Management establishes, with Board oversight, structures, reporting lines, and appropriate authority and responsibilities in the pursuit of objectives:** Section II.B describes the investment-related roles and responsibilities of key parties responsible for oversight and decision-making of investment-related activities. Chart 1 illustrates IFAD’s governance structure and chart 2 shows the internal flow of financial information in terms of investments.
4. **The organization demonstrates a commitment to attract, develop and retain competent individuals in alignment with objectives:** IFAD’s Human Resources Implementing Procedures state that “Screening will be conducted with professional rigour ... and selection processes ensuring that candidates are assessed on the basis of the highest standards of competence, integrity, and appropriate experience to carry out IFAD’s objectives and avoid potential conflicts of interest.”<sup>17</sup>
5. **The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives:** Section 3.1 of IFAD’s Human Resources Policy<sup>18</sup> states that IFAD staff pledge themselves to “discharge their functions and regulate their conduct solely with the interest and objectives of the Fund in view.”

### II. Risk assessment

6. **The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives:** The Governing Council adopted the Financial Regulations of IFAD. Regulation VIII, paragraph 2 states that “in investing the resources of the Fund, the President shall be guided by the paramount considerations of security and liquidity. Within these constraints ... the President shall seek the highest possible return in a non-speculative manner”.

<sup>17</sup> IFAD’s Human Resources Implementing Procedures – Chapter 2: Staff recruitment and appointment 2.3.1(ii).

<sup>18</sup> See EB 2004/82/R.28/Rev.1.

7. **The organization identifies risks to the achievement of its objectives across the entity and analyses risks as a basis for determining how the risks should be managed:** Through the Investment Policy Statement (IPS) the organization identifies an investment universe to achieve the above-mentioned objective as detailed in section III.A, whereby it stipulates asset classes, credit rating floors, durations and corresponding benchmarks. Section III.A identifies various risks (i.e. market risk, interest rate risk, currency risk, liquidity risk, credit risk, counterparty risk, country risk and operational risk) associated with IFAD's liquidity portfolio and describes how these risks are mitigated and managed by IFAD. Table 2 summarizes established limits, monitoring/reporting frequencies and what alert actions are to be taken.
8. **The organization considers the potential for fraud in assessing risks to the achievement of objectives:** IFAD addresses this through the Revised IFAD Policy on Preventing Fraud and Corruption in its Activities and Operations,<sup>19</sup> which aims to: "reaffirm the Fund's and its Member States' continued commitment to the prevention and mitigation of fraud and corruption in IFAD-financed and/or IFAD-managed operations and activities and to ensure that the Fund has adequate safeguards and measures in place to this end".
9. **The organization identifies and assesses changes that could significantly impact the system of internal control:** The annual review of the IPS and Control Framework provides a mechanism to identify the adequacy of IFAD's internal controls, which is then reported to the Executive Board and Audit Committee. In addition, the FRMC meets regularly to review emerging challenges and risks and to discuss and endorse mitigation strategies.

### III. Control activities

10. **The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels:** Sections III.B and III.C stipulate IFAD's risk assessment, controls and monitoring activities to mitigate risks. These are further summarized in table 2.
11. **The organization selects and develops general control activities over technology to support the achievement of objectives:** Section III.C highlights the control and monitoring activities, specifically in relation to IFAD's risk management and compliance monitoring systems (a web-based application supplied by IFAD's global custodian). Furthermore, IFAD is continuing to develop and improve the internal information technology systems pertaining to financial risks and controls.
12. **The organization deploys control activities through policies that establish what is expected and procedures that put policies into action:** Section II.C outlines the IFAD investment-related policies and procedures that govern IFAD's investment processes and controls. It makes reference to IFAD's Financial Regulations, the ERM policy, the IPS, the Liquidity Policy, investment guidelines, the Control Framework, investment management and master custody agreements, the Treasury Manual and FRMC's rules of procedure and terms of reference. Table 2 summarizes established risk limits, monitoring/reporting frequencies and procedures/actions to be taken in the event risk levels are breached.

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<sup>19</sup> See EB 2018/125/R.6.

## IV. Information and communication

13. **The organization obtains or generates and uses relevant, quality information to support the functioning of internal control:** As summarized in table 2, specifically under the column "monitoring frequency/tool", quality information is regularly collated by IFAD to generate compliance and risk reports to support the functioning of internal control.
14. **The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control:** Section II.B of the Control Framework, illustrates and details how financial information (in terms of investments) is communicated within the organization. This includes objectives and responsibilities for internal control. Risk levels are also reported to the FOD Management Team.
15. **The organization communicates with external parties regarding matters affecting the functioning of internal control:** The IPS and Control Framework, together with the annual revisions, provide a channel for the organization to communicate matters affecting the internal control over investment-related activities to external parties.

## V. Monitoring activities

16. **The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning:** The effective functioning of internal controls over investments are subject to separate independent reviews by IFAD's Office of Audit and Oversight, together with periodic reviews by the external auditors.
17. **The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including Senior Management and the board of directors, as appropriate:** The IPS and Control Framework are reviewed on an annual basis to identify any potential deficiencies with IFAD's internal controls in relation to its investment activities, with proposed improvements and changes reported to the Audit Committee and Executive Board. Furthermore table 2 summarizes the frequency and timeliness of communicating any investment-related internal control breach to relevant parties, including the Treasurer, AVP/FOD, IFAD's investment committees as well as the Executive Board and Audit Committee.

## Glossary of risk measures and related terms

**Active risk:** The risk a portfolio or fund acquires when it is actively managed, especially when its managers attempt to outperform some benchmark. More specifically, the more a fund or portfolio differs from the benchmark upon which it is based, the more likely it is to underperform or outperform that same benchmark. This extra risk is active risk. For example, a one-year forward-looking active risk of 0.2 per cent means that, over the coming year, the portfolio excess return over the benchmark is expected to be in the range of +/- 0.2 per cent of its mean value.

The active risk can be predictive (or ex ante), based on expected return, or ex post, derived from the actual returns of the portfolio.

**Alpha:** Alpha is a risk-adjusted measure of the so-called "excess return" on an investment. It is a common measure of assessing an active manager's performance as it is the return in excess of a benchmark index or "risk-free" investment.

**Benchmark:** A benchmark is a standard against which the performance of a security or manager can be measured. The benchmark should be an investment instrument that has certain characteristics of transparency and replicability so as to best represent the performance of a certain investment universe. In financial markets, the most popular indices are used as benchmarks. For example, the Standard & Poor's 500 is a widely used benchmark for United States "large-cap" equities markets.

**Beta:** Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison with the financial market as a whole.

**Conditional value at risk:** CVaR is a measure of the average expected loss of a portfolio assuming that the VaR has been reached. When it is assumed that the portfolio loss has exceeded the VaR, the CVaR gives an indication of the magnitude of the losses in "the tails" of the distribution, i.e. in extreme loss cases. The higher the CVaR, the more a portfolio is expected to lose in extreme scenarios and, hence, the riskier it is.

**Confidence level:** This is the range (with a specified value of uncertainty, usually expressed in percentage terms) within which the true value of a measured quantity exists. It is also the level of certainty with which an estimate can be trusted.

**Duration:** This is a measure of the sensitivity of a bond's price to changes in the level of market yields. For bonds, prices and yields have an inverse relationship. If the yields increase, the bonds' prices decrease. A bond with longer duration is more sensitive to changes in market yields meaning that, all else equal, its price will decline more for a given increase in yields than the price of a bond with shorter duration.

**Risk-adjusted return:** This is a measure of how much an investment returned in relation to the amount of risk it took on. It is often used to compare a high-risk, potentially high-return investment with a low-risk, lower-return investment. A simple risk-adjusted return measure is derived from dividing the portfolio's annual return by its annual standard deviation. This ratio gives an indication of the amount of return generated by each risk unit. The higher the ratio, the better the risk-adjusted return.

**Risk-free rate:** This is the theoretical rate of return of an investment with no risk of financial loss. The risk-free rate represents the interest that an investor would expect from an absolutely risk-free investment over a given period of time. Risk-free assets usually refer to short-dated government bonds. For United States dollar investments, usually United States Treasury bills are used, while a common choice for euro investments are German Government bills or the Euro Interbank Offered Rate (Euribor).

**Sharpe ratio:** This is a measure of risk-adjusted performance. It measures the relation between the portfolio's average excess return (in excess of risk-free return) and its standard deviation. The higher the Sharpe ratio is, the better the reward for market risk.



**Standard deviation:** This is a measure of the volatility of a certain value around its average. The higher the standard deviation, the more the value is dispersed around its average. In the case of portfolio returns, the higher the standard deviation of returns the more returns are expected to vary around the average expected return. Therefore, a portfolio with a high standard deviation is considered more risky than one with a lower one, all else being equal.

**Value at risk:** This is the maximum potential loss an investment can incur over a defined time horizon within a specified confidence level. If an liquidity portfolio of US\$100 million has a three-month VaR of 1.5 per cent with a confidence level of 95 per cent, the maximum amount that could be lost over the next three-month period is US\$1.5 million; and this estimate can be trusted with 95 per cent certainty, meaning that it is expected that the estimate is correct 19 times out of 20 (95 per cent of the times).

**Volatility:** This is a measure of the fluctuation in the market price of the underlying security. Mathematically, volatility is the annualized standard deviation of returns.