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Enabling poor rural people  
to overcome poverty

## **Report on IFAD's investment portfolio for the third quarter of 2009**

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For: **Information**

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# Report on IFAD's investment portfolio for the third quarter of 2009

## I. Executive summary

1. During the third quarter of 2009, IFAD's investment policy and high-quality instruments continued to protect the investment portfolio from the turmoil in the global financial markets.
2. The value of the investment portfolio in United States dollar terms increased by US\$113,104,000 equivalent, from US\$2,508,582,000 equivalent at 30 June 2009 to US\$2,621,686,000 equivalent at 30 September 2009. The main factors for this increase were net investment income, net cash inflows and foreign exchange movements.
3. The year-to-date investment portfolio's rate of return is 3.76 per cent, which translates into a year-to-date investment income amount of US\$93,516,000 equivalent, net of all fees and including income from securities lending cash collateral activities.

## II. Introduction

4. This report on IFAD's investment portfolio presents final data on the third quarter of 2009. It consists of the following sections: market conditions; asset allocation; investment income; rate of return; composition of the investment portfolio by currency; securities lending cash collateral; liquidity level in IFAD's investment portfolio; and risk measurement.

## III. Market conditions

5. During the third quarter of 2009, the financial markets continued to stabilize and IFAD's fixed-income investments performed positively under the favourable effects brought by the quantitative easing measures and programmes put in place by the central banks and governments. These measures continued to foster inflation expectations, which supported the performance of inflation-indexed bonds. IFAD's diversified fixed-interest bonds benefited from the markets' stabilization and the resulting increase in risk appetite. The government bonds' contribution to performance remained positive, although to a lesser degree than the other two asset classes, due to the amount of government debt issuance, which dampened the otherwise more positive price appreciation by the continuing demand for safe assets.
6. During the same period, the United States dollar depreciated against the euro (-4.04 per cent) and Japanese yen (-7.20 per cent) while appreciating against the British pound sterling (+2.97 per cent).

## IV. Asset allocation

7. Table 1 shows the movements affecting the investment portfolio's major asset classes during the third quarter of 2009 and compares the portfolio's asset allocation at the end of the quarter with the investment policy allocation.
8. During the period, there was a cash inflow of US\$16,458,000 equivalent from the internally managed operational cash portfolio, representing cash receipts and encashment of Member States' contributions net of disbursements for loans, grants and administrative expenses.
9. Despite the slight appreciation of the United States dollar against the pound sterling, the depreciation against the euro and Japanese yen resulted in an increase

in the portfolio balance in United States dollar terms of US\$55,439,000 equivalent during the third quarter of 2009.

10. The above movements, combined with an investment income of US\$41,207,000<sup>1</sup> equivalent, increased the overall investment portfolio value by US\$113,104,000 equivalent for the period.

Table 1

**Movements affecting the asset allocation within the portfolio, third quarter 2009**

(Thousands of United States dollars equivalent)

	<i>Operational cash<sup>a</sup></i>	<i>Held-to-maturity</i>	<i>Government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Total</i>
<b>Opening balance (1 July 2009)</b>	<b>113 533</b>	<b>413 015</b>	<b>1 124 214</b>	<b>449 792</b>	<b>408 028</b>	<b>2 508 582</b>
Investment income <sup>b</sup>	183	4 410	10 464	15 739	10 411	41 207
Transfers due to allocation	48 498	(6 364)	(40 406)	-	(1 728)	-
Transfers due to expenses/income	(1 054)	33	539	185	297	-
Net disbursement <sup>c</sup>	16 458	-	-	-	-	16 458
Movements on exchange	4 431	7 382	20 640	2	22 984	55 439
<b>Closing balance by portfolio (30 September 2009)</b>	<b>182 049</b>	<b>418 476</b>	<b>1 115 451</b>	<b>465 718</b>	<b>439 992</b>	<b>2 621 686</b>
Actual asset allocation (percentage)	6.9	16.0	42.5	17.8	16.8	100.0
Investment policy asset allocation <sup>d</sup> (percentage)	5.5	16.0	43.4	15.1	20.0	100.0
<b>Difference in asset allocation (percentage)<sup>e</sup></b>	<b>1.4</b>	<b>-</b>	<b>(0.9)</b>	<b>2.7</b>	<b>(3.2)</b>	<b>-</b>

<sup>a</sup> Cash and time deposits held with banks, readily available for disbursing loans, grants and administrative expenses.

<sup>b</sup> Investment income is further detailed in table 2.

<sup>c</sup> Disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.

<sup>d</sup> The investment policy allocation for the held-to-maturity portfolio is set to match the current 16.0 per cent asset allocation in the investment portfolio.

<sup>e</sup> The differences between policy and actual asset allocations are impacted by fluctuations in market prices and currencies. The asset allocation is reviewed and realigned from time to time.

## V. Investment income

11. During the first three quarters of 2009, the aggregate investment income amounted to US\$93,516,000 equivalent. All realized and unrealized gains and losses are included in the investment income. Table 2 presents a summary of the third quarter 2009 investment income broken down by asset class.

<sup>1</sup> This figure does not include the impact of the unrealized gain/loss of the securities lending cash collateral reinvestment shown in table 2. The reason is that the security lending cash collateral is not directly related to any asset classes within the investment portfolio and therefore its market value change does not affect the portfolio's asset allocation.

Table 2

**Breakdown of investment income by asset class and the impact of the reinvested securities lending cash collateral, third quarter and year-to-date 2009**

(Thousands of United States dollars equivalent)

	<i>Operational cash</i>	<i>Held-to-maturity</i>	<i>Government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Subtotal third quarter 2009</i>	<i>Subtotal year-to-date 2009</i>	<i>Year-to-date securities lending cash collateral impact</i>	<i>Total year-to-date 2009</i>
Interest from fixed-interest investments and bank accounts	158	4 688	8 949	3 899	2 276	19 970	62 732	-	62 732
Realized capital gains	53	-	4 346	2 539	1 994	8 932	31 548	-	31 548
Unrealized capital gains/(losses)	-	-	(2 292)	9 566	6 439	13 713	(12 720)	14 603	1 883
Amortization/accretion <sup>a</sup>	-	(244)	-	-	-	(244)	(637)	-	(637)
Income from securities lending	-	34	89	37	35	195	1 551	-	1 551
<b>Investment income before fees and taxes</b>	<b>211</b>	<b>4 478</b>	<b>11 092</b>	<b>16 041</b>	<b>10 744</b>	<b>42 566</b>	<b>82 474</b>	<b>14 603</b>	<b>97 077</b>
Investment manager fees	-	-	(443)	(219)	(241)	(903)	(2 631)	-	(2 631)
Custody fees/bank charges	(28)	(9)	(27)	(17)	(30)	(111)	(406)	-	(406)
Financial advisory and other investment management fees	-	(59)	(158)	(66)	(62)	(345)	(531)	-	(531)
Taxes recoverable	-	-	-	-	-	-	7	-	7
<b>Investment income after fees and taxes</b>	<b>183</b>	<b>4 410</b>	<b>10 464</b>	<b>15 739</b>	<b>10 411</b>	<b>41 207</b>	<b>78 913</b>	<b>14 603</b>	<b>93 516</b>

<sup>a</sup> A period's amortization amount represents a portion of the difference between the purchase price and the final redemption value of the held-to-maturity investments as per the International Financial Reporting Standards.

**VI. Rate of return**

12. The rate of return of IFAD's investment portfolio is calculated in local currency terms without reflecting the impact of foreign exchange movements, which is neutralized through the currency alignment.
13. The investment portfolio returned a positive 3.76 per cent in the first three quarters of 2009, net of all fees and including income from securities lending cash collateral activities.

Table 3  
**Year-to-date rate of return on IFAD's investments for third quarter 2009 and 2008**  
 (Percentages in local currency terms)

	<i>Rate of return</i>	
	<i>Year-to-date third quarter 2009</i>	<i>Year-to-date third quarter 2008</i>
Held-to-maturity	3.26	3.28
Government bonds	1.82	3.89
Diversified fixed-interest bonds	4.94	0.75
Inflation-indexed bonds	6.00	4.21
<b>Gross rate of return</b>	<b>3.91</b>	<b>3.33</b>
Less expenses	(0.15)	(0.15)
<b>Rate of return</b>	<b>3.76</b>	<b>3.18</b>

14. The differences between year-to-date returns for 2009 and 2008 are due to the different characteristics of asset classes and highlight the positive impact of portfolio diversification on the stability and safety of the overall portfolio return.

## VII. Composition of the investment portfolio by currency

15. The majority of IFAD's commitments are expressed in special drawing rights (SDRs). Consequently, the Fund's overall assets are maintained in such a way as to ensure that commitments for undisbursed loans and grants denominated in SDRs are matched, to the extent possible, by assets denominated in the currencies and ratios of the SDR valuation basket. Similarly, the General Reserve and commitments for grants denominated in United States dollars are matched by assets denominated in the same currency.
16. The Executive Board of the International Monetary Fund reviews the SDR valuation basket every five years to determine which currencies should be part of the basket and what their percentage weight should be at the date of reweighting of the basket.
17. The current units for each of the four currencies making up the SDR valuation basket were determined on 30 December 2005 in such a way that the value of the SDR was precisely US\$1.42927, in terms of both the old units and the new units, which became effective on 1 January 2006. The applicable units, together with their weights as at 1 January 2006 and 30 September 2009, are shown in table 4.

Table 4  
**Units and weights applicable to SDR valuation basket**

<i>Currency</i>	<i>1 January 2006</i>		<i>30 September 2009</i>	
	<i>Units</i>	<i>Percentage weight</i>	<i>Units</i>	<i>Percentage weight</i>
United States dollar	0.6320	43.7	0.6320	40.0
Euro	0.4100	34.3	0.4100	37.9
Yen	18.4000	10.9	18.4000	13.0
Pound sterling	0.0903	11.1	0.0903	9.1
<b>Total</b>		<b>100.0</b>		<b>100.0</b>

18. At 30 September 2009, assets in the form of cash, investments, promissory notes and contribution receivables from Member States under the Fifth, Sixth, Seventh and Eighth Replenishments, net of provisions, amounted to US\$3,057,183,000

equivalent, as summarized in table 5 (compared with US\$2,810,147,000 equivalent at 30 June 2009).

Table 5

**Currency composition of assets in the form of cash, investments and other receivables**

(Thousands of United States dollars equivalent)

<i>Currency</i>	<i>Cash and investments<sup>a</sup></i>	<i>Promissory notes<sup>a</sup></i>	<i>Contribution receivables from Member States</i>	<i>Total</i>
United States dollar group <sup>b</sup>	1 118 105	110 761	81 395	1 310 261
Euro group <sup>c</sup>	887 093	39 962	109 241	1 036 296
Yen	363 237	10 152	71 205	444 594
Pound sterling	252 729	-	13 303	266 032
<b>Total</b>	<b>2 621 164</b>	<b>160 875</b>	<b>275 144</b>	<b>3 057 183</b>

<sup>a</sup> Includes only assets in freely convertible currencies, and excludes assets in non-convertible currencies of US\$523,000 equivalent for cash and investments, and US\$1,399,000 equivalent for promissory notes.

<sup>b</sup> Includes assets in Australian, Canadian and New Zealand dollars.

<sup>c</sup> Includes assets in Swiss francs, Swedish kronor, and Danish and Norwegian kroner.

19. The alignment of assets by currency group against the SDR valuation basket as at 30 September 2009 is shown in table 6. The balance of commitments denominated in United States dollars at 30 September 2009 amounted to US\$163,852,000 equivalent, composed of the General Reserve (US\$95,000,000) and commitments for grants denominated in United States dollars (US\$68,852,000).

Table 6

**Alignment of assets per currency group with the SDR valuation composition as at 30 September 2009**

(Thousands of United States dollars equivalent)

<i>Currency</i>	<i>Asset amount</i>	<i>Less: commitments denominated in US dollars</i>	<i>Net asset amount</i>	<i>Net asset amount (percentage)</i>	<i>SDR weights (percentage)</i>	<i>Difference (percentage)</i>
US dollar group	1 310 261	(163 852)	1 146 409	39.6	40.0	(0.4)
Euro group	1 036 296	-	1 036 296	35.8	37.9	(2.1)
Yen	444 594	-	444 594	15.4	13.0	2.4
Pound sterling	266 032	-	266 032	9.2	9.1	0.1
<b>Total</b>	<b>3 057 183</b>	<b>(163 852)</b>	<b>2 893 331</b>	<b>100.0</b>	<b>100.0</b>	<b>0.0</b>

20. As at 30 September 2009, there was a shortfall in the euro currency group holdings (-2.1 per cent) and in the United States dollar currency group (-0.4 per cent), which was offset by an excess allocation in the pound sterling (+0.1 per cent) and in the Japanese yen (+2.4 per cent).
21. Temporary deviances from SDR weights at a specific point in time are due to the fluctuation in values of IFAD assets and its underlying currencies (i.e. cash, investments and Member contribution payments and receivables). IFAD's Treasury Division constantly monitors misalignments and takes active measures to bring the currency allocation more in line with the SDR basket.

## VIII. Securities lending cash collateral

22. The market value of cash collateral reinvested against securities lent as at 30 September 2009 was US\$257,670,000 equivalent, with a corresponding liability to the borrowers for US\$261,343,000 equivalent. The asset class as well as credit quality compositions of the cash collateral reinvested against securities lent are shown in table 7. The difference in the collateral reinvested and the corresponding liability as at 30 September 2009 shrank to US\$3,673,000 equivalent from US\$18,276,000 equivalent as at 31 December 2008 thus bringing an unrealized gain of US\$14,603,000 for the first three quarters of 2009, as shown in table 2.

Table 7

### Composition and credit ratings of the cash collateral reinvested against securities lent as at 30 September 2009

(Thousands of United States dollars equivalent)

	AAA	AA	A	BBB	Total	Percentage
Cash	100 275	-	-	-	100 275	38.4
Corporate bonds	-	19 110	11 305	-	30 415	11.6
Government agencies	11 299	-	-	-	11 299	4.3
Banking industry	-	2 818	22 601	-	25 419	9.7
Mortgage-backed securities	8 745	228	924	3 631	13 528	5.2
Asset-backed securities	76 135	1 515	361	2 396	80 407	30.8
<b>Total</b>	<b>196 454</b>	<b>23 671</b>	<b>35 191</b>	<b>6 027</b>	<b>261 343</b>	<b>100.0</b>
<b>Composition weight</b>	<b>75.2</b>	<b>9.0</b>	<b>13.5</b>	<b>2.3</b>	<b>100.0</b>	<b>-</b>

23. The maturity structure of the cash collateral reinvested against securities lent is shown in table 8.

Table 8

### Maturity structure of the cash collateral reinvested against securities lent, as at 30 September 2009<sup>a</sup>

(Thousands of United States dollars equivalent)

Period due	30 September 2009		31 December 2008	
	Amount	Percentage	Amount	Percentage
Due in one year or less	194 569	74.4	340 125	74.6
Due after one year through two years	48 624	18.6	76 296	16.7
Due after two years through three years	15 583	6.0	28 683	6.3
Due after three years through four years	1 445	0.6	10 849	2.4
Due after four years	1 122	0.4	-	-
<b>Total</b>	<b>261 343</b>	<b>100.0</b>	<b>455 953</b>	<b>100.0</b>

<sup>a</sup> The maturity structure represents the financial maturities of the reinvested cash collateral, not the legal maturities.

24. As evident from tables 7 and 8, the reinvested cash collateral maintains a high level of quality with over 75 per cent in triple A, while being fairly liquid – reflecting over 38 per cent in cash and over 74 per cent to be redeemed through maturity within one year. This implies that the cash collateral reinvestment will not make any meaningful impact on IFAD's liquidity level, which is already very high relative to the minimum requirement as reported in section IX.
25. IFAD has taken a conservative position so as to progressively scale back its securities lending exposure in 2009 in an orderly manner to avoid the realization of



market losses while benefiting from the positive impact of the current market recovery. IFAD also extensively revised its securities lending cash collateral reinvestment guidelines in late 2008 for better control and risk mitigation. A limited number of securities have been downgraded below credit quality requirements and remain subject to continuous monitoring by IFAD and its custodian bank.

## IX. Liquidity level in IFAD's investment portfolio

26. IFAD's Liquidity Policy states that IFAD's liquidity ("highly liquid assets")<sup>2</sup> should remain above the level of US\$437 million over the Seventh Replenishment period.
27. Highly liquid assets in IFAD's investment portfolio as at 30 September 2009 amounted to US\$1,297,500,000 equivalent, which comfortably meets the minimum liquidity requirement (table 9).

Table 9

### Liquidity level in IFAD's investment portfolio, as at 30 September 2009

(Thousands of United States dollars equivalent)

	<i>Actuals</i>	<i>Percentage</i>
<b>Highly liquid assets</b>	<b>1 297.5</b>	<b>49.5</b>
Short-term instruments	182.0	7.0
Government securities	1 115.5	42.5
<b>Fairly liquid assets</b>	<b>905.7</b>	<b>34.5</b>
Non-government securities	905.7	34.5
<b>Partially liquid assets</b>	<b>418.5</b>	<b>16.0</b>
Held-to-maturity	418.5	16.0
<b>Total portfolio</b>	<b>2 621.7</b>	<b>100.0</b>

## Risk measurement

28. With the exception of operational cash and held-to-maturity investments, the investment portfolio performance is subject to market movements. Historically, different asset classes have shown different levels of volatility, often referred to as "risk". Volatility is measured in terms of standard deviation of returns from their mean. At 30 September 2009, the standard deviation of IFAD's investment portfolio was 1.52 per cent, compared with 1.56 per cent for the investment policy.<sup>3</sup>
29. Value-at-Risk (VaR) is the measure of risk that IFAD uses to estimate the maximum amount that the portfolio could lose in value over a three-month forward time horizon, with a 95 per cent confidence level.<sup>4</sup> Table 10 shows the VaR of IFAD's investment portfolio and that of the investment policy as at 30 September 2009 and for previous periods.

<sup>2</sup> Defined as being convertible to cash quickly and without significant loss of value.

<sup>3</sup> The security lending cash collateral programme is not factored into this volatility measurement.

<sup>4</sup> The security lending cash collateral programme is not factored into this VaR measurement.

Table 10  
**Value-at-risk (VaR)**

(Forecast horizon of three months, confidence level at 95 per cent)

<i>Date</i>	<i>Investment portfolio</i>		<i>Investment policy</i>	
	<i>VaR (percentage)</i>	<i>Amount (thousands of United States dollars)</i>	<i>VaR (percentage)</i>	<i>Amount (thousands of United States dollars)</i>
30 September 2009	1.27	33 245	1.31	34 272
30 June 2009	1.44	36 232	1.58	39 564
31 March 2009	1.65	40 180	1.57	38 350
31 December 2008	1.46	36 182	1.60	39 533
30 September 2008	1.41	34 544	1.52	37 012

30. At 30 September 2009, the investment portfolio's VaR was 1.27 per cent, a decrease from the end of the previous quarter, and below the investment policy VaR of 1.31 per cent. It should be noted that the investment policy VaR is based on the policy asset allocation (see table 1).

