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Enabling poor rural people
to overcome poverty

Report on IFAD's investment portfolio for 2009

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Report on IFAD's investment portfolio for 2009

I. Executive summary

1. During 2009, IFAD's prudent investment policy and high-quality instruments contributed to protecting 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\$120,176,000 equivalent, from US\$2,478,511,000 equivalent at 31 December 2008 to US\$2,598,687,000 equivalent at 31 December 2009. The main factors for this increase were the net investment income and foreign exchange movements, which were partially offset by net disbursement outflows.
3. The investment portfolio's net rate of return for 2009 is 4.45 per cent – which is higher than the policy target return of 3.5 per cent – and translates into an annual investment income of US\$110,108,000 equivalent inclusive of all fees and securities lending cash collateral activities.

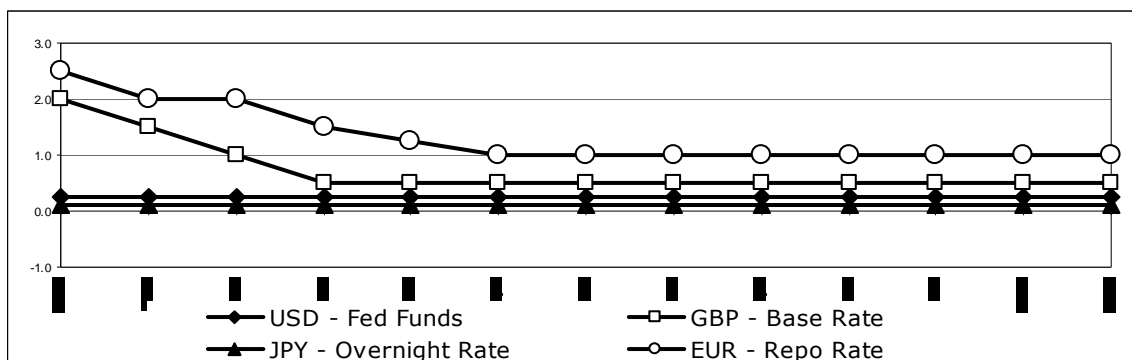
II. Introduction

4. This report on IFAD's investment portfolio covers the year ended 31 December 2009 and includes comparative figures, where applicable, for the year ended 31 December 2008.
5. The report consists of the following sections: market conditions; asset allocation; investment income; rate of return; composition of the portfolio; securities lending cash collateral; liquidity level in IFAD's investment portfolio; and risk measurement.

III. Market conditions

6. The following charts show trends for the countries whose currencies make up the valuation basket for special drawing rights (SDRs): Eurozone countries, Japan, the United Kingdom and the United States.
7. Chart 1 shows the evolution of central bank interest rates for SDR countries for 2009. The Federal Reserve Bank of the United States and the Bank of Japan maintained their central bank target rates unchanged for all of 2009, specifically at 0.25 per cent and 0.10 per cent respectively. In the first half of 2009, the European Central Bank continued to ease monetary policy to stimulate the Eurozone economy, by decreasing its refinancing rate four times from 2.50 per cent to 1.00 per cent, and left the rate unchanged for the remainder of 2009. Similarly, the Bank of England decreased its base rate three times in the first quarter of 2009, from 2.00 per cent to 0.50 per cent, and then maintained its base rate throughout 2009 unchanged.

Chart 1
Central Bank interest rates

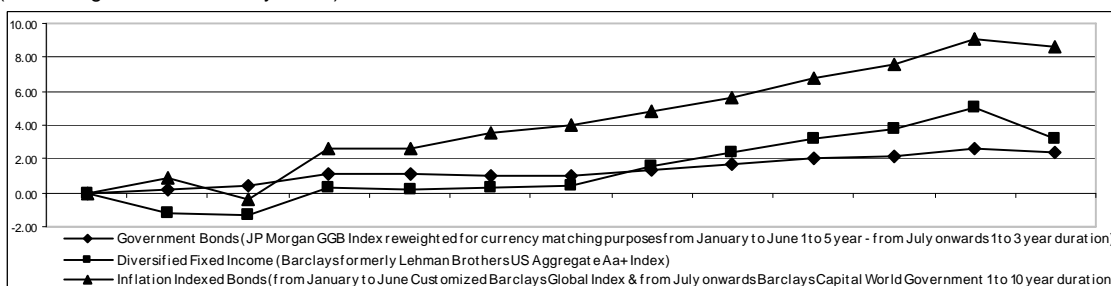


Source: Bloomberg

- Chart 2 shows the cumulative performance in 2009 of the fixed-income markets where IFAD's investment portfolio was invested and managed. Each line represents one of the benchmark indexes used by IFAD for the global government bonds, diversified fixed-interest bonds and inflation-indexed bonds portfolios. Fixed-interest markets showed a positive performance particularly during the second and third quarters of the year, benefiting from investors' flight-to-quality that followed the credit market turmoil. The inflation-indexed bond market recorded the highest performance during 2009, mostly thanks to the market overcoming earlier deflation fears, together with a steady performance from the diversified fixed-interest and government bonds market.

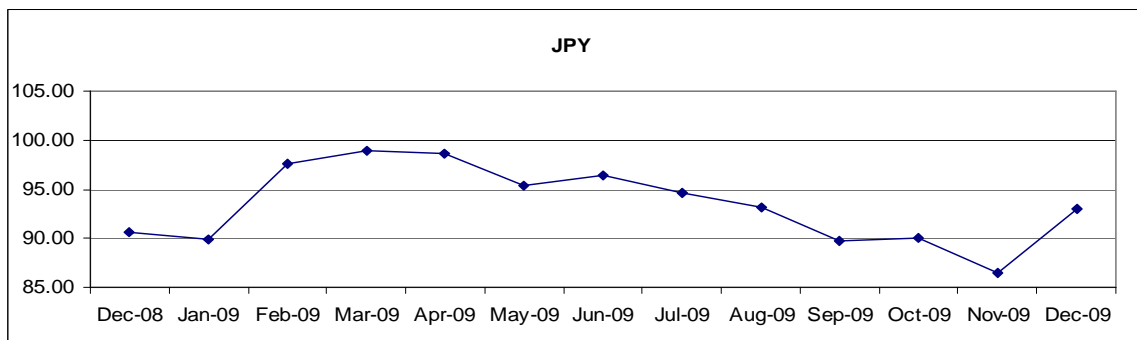
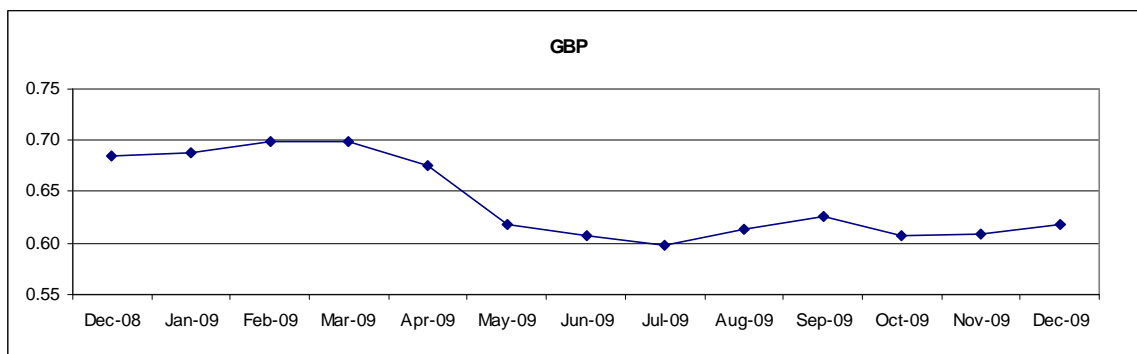
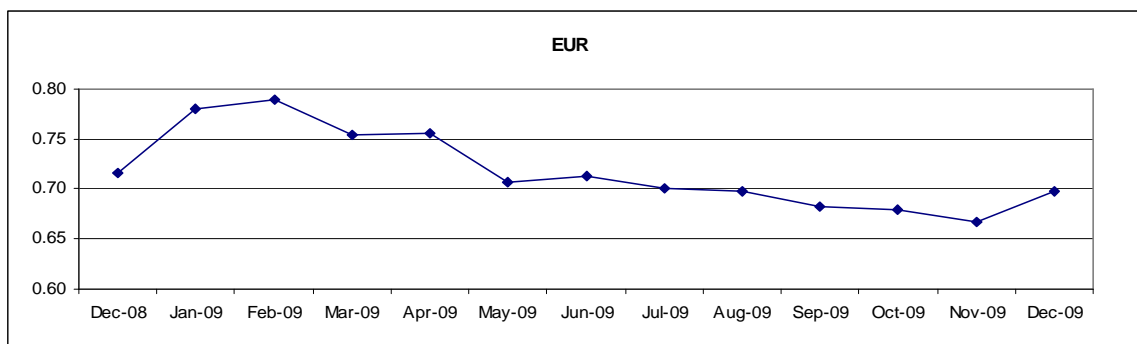
Chart 2
Fixed-interest market developments in 2009

(Percentage in local currency terms)



- Chart 3 illustrates month-end exchange rates for the United States dollar against the three other SDR composite currencies, specifically the pound sterling (GBP), euro (EUR) and Japanese yen (JPY). In 2009, the volatile foreign exchange markets saw an overall depreciation of the United States dollar against all three of the other SDR composite currencies, with the exception of a year-end rally against the JPY.

Chart 3
Value of US\$ versus other SDR currencies at month-end exchange rates



Source: Bloomberg

IV. Asset allocation

- Table 1 shows the movements affecting the value of investments within the portfolio by asset class in 2009 and compares the portfolio's year-end asset allocation with the policy allocation.

Table 1
Movements affecting the asset allocation within the portfolio in 2009

(Thousands of United States dollars equivalent)

	<i>Operational cash^a</i>	<i>Held-to-maturity</i>	<i>Government bonds</i>	<i>Diversified fixed-interest bonds</i>	<i>Inflation-indexed bonds</i>	<i>Total</i>
Opening balance (1 January 2009)	136 619	407 152	1 086 060	443 789	404 891	2 478 511
Investment income ^b	906	17 217	23 044	22 553	30 202	93 922
Transfers due to allocation	71 278	(29 139)	(40 411)	-	(1 728)	-
Transfers due to expenses and securities lending income	(3 140)	(90)	1 593	667	970	-
Net disbursement ^c	(23 226)	-	-	-	-	(23 226)
Movements on exchange	1 806	7 669	40 471	(16)	(450)	49 480
Closing balance by portfolio (31 December 2009)	184 243	402 809	1 110 757	466 993	433 885	2 598 687
Actual asset allocation (percentage)	7.1	15.5	42.7	18.0	16.7	100.0
Investment policy asset allocation ^d (percentage)	5.5	15.5	43.6	15.4	20.0	100.0
Difference in asset allocation (percentage)^e	1.6	-	(0.9)	2.6	(3.3)	-

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

^b Investment income is further detailed in table 2.

^c Disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.

^d The investment policy allocation for the held-to-maturity portfolio is set to match the current 15.5 per cent asset allocation in the investment portfolio.

^e 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. The closing balance and operational cash as at 31 December 2009 included an amount of approximately US\$40.0 million received from the European Commission for supplementary funds. This amount therefore temporarily impacted the portfolio's balance and asset allocation.

11. In August 2009, a transfer of US\$40,406,000 equivalent from the global government bonds portfolio to the operational cash portfolio, was performed to cover disbursement needs.
12. As at 31 December 2009, US\$10,257,000 equivalent was temporarily transferred from the held-to-maturity portfolio into the operational cash portfolio, pending the strategic reinvestment of the funds, which subsequently occurred in January 2010.
13. The balance of transfers due to allocation primarily consists of coupon income from the held-to-maturity and, to a lesser extent, the inflation-indexed and government bonds portfolios, all of which was progressively transferred to the operational cash portfolio during 2009.
14. There was a net outflow of US\$23,226,000 equivalent, representing disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.
15. The above movements, combined with an investment income of US\$93,922,000¹ equivalent and positive foreign exchange movements of US\$49,480,000 equivalent, increased the overall investment portfolio value in United States dollar terms by US\$120,176,000 equivalent during 2009.

¹ This figure does not include the interest income, realized and unrealized gains/losses from the securities lending cash collateral column shown in table 2. The reason is that the security lending cash collateral is not directly related to any asset class within the investment portfolio and therefore its market value change shall not affect the portfolio's asset allocation.

V. Investment income

16. In 2009, the net investment income amounted to US\$110,108,000 equivalent, inclusive of all realized and unrealized gains and losses. Table 2 presents a summary of the 2009 investment income broken down by asset class. The inflation-indexed bonds portfolio contributed most to generating the 2009 investment income, and was complemented with a solid contribution from the government and diversified fixed-interest bonds portfolios. The total 2009 net investment income was lower than 2008 and 2007 (respectively US\$126,623,000 and US\$142,572,000 equivalent) but significantly higher for the same period in 2006 (US\$57,906,000 equivalent).
17. Some of the securities in IFAD's investment portfolio are on loan through a subsidiary of the Global Custodian, which acts as an agent for the securities lending transactions. Under this scheme, IFAD receives cash or other securities as collateral, which is held or reinvested by the subsidiary of the Global Custodian for the purpose of generating income to offset the investment management expenses, including the custodial fees. IFAD's securities lending income for 2009 was US\$1,300,000 and this amount contributed to the overall investment performance. Although the reinvested value of the securities lending cash collateral was affected by the global financial crisis in 2008, proactive management in 2009 minimized this impact and contributed a positive US\$16,186,000 to IFAD's net investment income, (as shown in table 2 in the "securities lending cash collateral" column) which significantly reduced the unrealized loss of US\$18,276,000 equivalent reported as at 31 December 2008.

Table 2
Breakdown of investment income by asset class and the impact of the reinvested securities lending cash collateral in 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</i>	<i>Securities lending cash collateral</i>	<i>Total</i>
Interest from fixed-interest investments and bank accounts	970	18 006	37 705	16 095	9 166	81 942	1 570	83 512
Realized capital gains	86	-	21 170	10 798	5 202	37 256	(2 391)	34 865
Unrealized capital gains/(losses)	-	-	(34 238)	(3 518)	16 804	(20 952)	17 007	(3 945)
Amortization/accretion ^a	-	(879)	-	-	-	(879)	-	(879)
Income from securities lending	-	227	607	248	218	1 300	-	1 300
Investment income before fees and taxes	1 056	17 354	25 244	23 623	31 390	98 667	16 186	114 853
Investment manager fees	-	-	(1 776)	(860)	(940)	(3 576)	-	(3 576)
Custody fees/bank charges	(157)	(51)	(197)	(115)	(162)	(682)	-	(682)
Financial advisory and other investment management fees	-	(86)	(227)	(95)	(86)	(494)	-	(494)
Taxes recoverable	7	-	-	-	-	7	-	7
Investment income after fees and taxes	906	17 217	23 044	22 553	30 202	93 922	16 186	110 108

^a 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

18. 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.
19. The portfolio returned a positive 4.45 per cent in 2009, including the impact of investment expenses and securities lending cash collateral activities. This represented a higher rate of return than the annual policy target return of 3.5 per cent.

Table 3

Annual rates of return on IFAD's investments for 2007, 2008 and 2009

(Percentages in local currency terms)

	Annual rates of return in local currency		
	2007	2008	2009
Operational cash	n.a.	n.a.	n.a.
Held-to-maturity	4.19	4.30	4.36
Short-term tactical ^a	4.95	-	-
Government bonds	5.92	8.70	2.17
Diversified fixed-interest bonds	7.55	4.70	5.23
Inflation-indexed bonds	7.62	3.62	7.73
Net rate of return	6.10	5.41	4.45

^a The balance of this portfolio was transferred to the operational cash portfolio in 2008 to cover disbursement needs.

Note: n.a.: not applicable

20. The differences between annual returns among mandates for 2009, 2008 and 2007 are due to the different characteristics of asset classes and demonstrate the positive impact of portfolio diversification on the stability and safety of the overall portfolio return performance.

VII. Composition of the portfolio

A. Composition of the investment portfolio by instrument

21. Table 4 shows the composition of the investment portfolio by instrument as at 31 December 2009 in comparison with 31 December 2008.

Table 4
Composition of investment portfolio by instrument
 (Thousands of United States dollars equivalent)

	31 December 2009	31 December 2008
Cash ^a	285 778	264 255
Time deposits and other obligations of banks ^b	59 862	40 873
Global government bonds/government agencies	1 772 571	1 780 004
Mortgage-backed securities (MBS) ^c	187 338	273 046
Asset-backed securities (ABS) ^c	4 438	10 160
Corporate bonds	357 659	220 719
Unrealized market value gain/(loss) on forward contracts	(8 753)	26 752
Unrealized gain on futures	2 615	6 530
Options	(43)	122
Swaps	-	(773)
Subtotal: cash and investments	2 661 465	2 621 688
Receivables for investments sold	37 686	67 388
Payables for investments purchased	(100 464)	(210 565)
Total	2 598 687	2 478 511

^a Includes cash in non-convertible currencies amounting to US\$57,000 equivalent (US\$61,000 in 2008).

^b Includes time deposits in non-convertible currencies amounting to US\$458,000 equivalent (US\$488,000 in 2008).

^c MBS and ABS in IFAD's investment portfolio require a AAA rating by at least two credit rating agencies (CRAs) and corporate bonds need to be AA- or above. Some securities have been downgraded below these rating requirements due to CRA's aggressive rating reviews accelerated by the weakening economic conditions. IFAD acted immediately to contain the credit exposure by excluding non-agency mortgages from eligible instruments, and by a combination of aggressive monitoring of all security holdings other than government bonds and selling any downgraded securities wherever the market remains reasonably liquid.

B. Composition of the investment portfolio by currency

22. The majority of IFAD's commitments are expressed in special drawing rights. 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.
23. 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.
24. The 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 31 December 2009, are shown in table 5.

Table 5
Units and weights applicable to SDR valuation basket

<i>Currency</i>	<i>1 January 2006</i>		<i>31 December 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	40.4
Euro	0.4100	34.3	0.4100	37.6
Yen	18.4000	10.9	18.4000	12.7
Pound sterling	0.0903	11.1	0.0903	9.3
Total		100.0		100.0

25. At 31 December 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\$3,209,460,000 equivalent, as summarized in table 6 (compared with US\$2,796,422,000 equivalent at 31 December 2008).

Table 6
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</i>	<i>Promissory notes</i>	<i>Contribution receivables from Member States</i>	<i>Total</i>
United States dollar group ^a	1 120 886	194 759	66 901	1 382 546
Euro group ^b	864 712	69 687	188 265	1 122 664
Yen	355 143	44 004	34 241	433 388
Pound sterling	257 430	-	13 432	270 862
Total	2 598 171	308 450	302 839	3 209 460

^a Includes assets in Australian, Canadian and New Zealand dollars.

^b Includes assets in Swiss francs, Swedish kronor, Danish kroner and Norwegian kroner.

26. The alignment of assets by currency group against the SDR valuation basket as at 31 December 2009 is shown in table 7. The balance of commitments denominated in United States dollars at 31 December 2009 amounted to US\$175,818,000 equivalent, composed of the General Reserve (US\$95,000,000) and commitments for grants denominated in United States dollars (US\$80,818,000).

Table 7
Alignment of assets per currency group with the SDR valuation composition as at 31 December 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	1 382 546	(175 818)	1 206 728	39.8	40.4	(0.6)
Euro group	1 122 664	-	1 122 664	37.0	37.6	(0.6)
Yen	433 388	-	433 388	14.3	12.7	1.6
Pound sterling	270 862	-	270 862	8.9	9.3	(0.4)
Total	3 209 460	(175 818)	3 033 642	100.0	100.0	0.0

27. As at 31 December 2009, there was a shortfall in both the euro and the United States dollar currency group holdings of 0.6 per cent each together with a shortfall in the pound sterling of 0.4 per cent. This was offset by an excess allocation in the Japanese yen of 1.6 per cent.

C. Composition of the investment portfolio by maturity and duration

28. Table 8 provides details on the composition of the overall investment portfolio by maturity as at 31 December 2009 and compares this with the maturity composition at 31 December 2008.
29. The average duration, which takes into consideration the weighted average of the maturity of all income streams of the overall investment portfolio, was 2.6 years as at 31 December 2009, slightly lower than the previous year-end (3.0 years at 31 December 2008).

Table 8
Composition of the investment portfolio by maturity

(Thousands of United States dollars equivalent)

<i>Period</i>	<i>31 December 2009</i>		<i>31 December 2008</i>	
	<i>Amount</i>	<i>Percentage</i>	<i>Amount</i>	<i>Percentage</i>
Due in one year or less	412 334	15.9	321 083	13.0
Due after one year through five years	1 715 361	66.0	1 542 528	62.2
Due from five to ten years	203 320	7.8	238 624	9.6
Due after ten years	267 672	10.3	376 276	15.2
Total	2 598 687	100.0	2 478 511	100.0
Weighted average duration		2.6 years		3.0 years

VIII. Securities lending cash collateral

30. The market value of cash collateral reinvested against securities lent as at 31 December 2009 was US\$215.8 million equivalent, with a corresponding liability to the borrowers of US\$217.9 million equivalent. The asset class, as well as credit quality compositions of the cash collateral reinvested against securities lent, are shown in table 9.

Table 9

Composition and credit ratings^a of the cash collateral reinvested against securities lent as at 31 December 2009

(Thousands of United States dollars equivalent)

	AAA	AA	A	BBB	Total	Percentage
Cash	92 991	-	-	-	92 991	43.1
Corporate bonds	-	19 191	6 784	-	25 975	12.0
Banking industry	-	2 825	10 168	-	12 993	6.0
Mortgage-backed securities	8 303	-	592	168	9 063	4.2
Asset-backed securities	70 565	1 639	216	2 338	74 758	34.7
Total	171 859	23 655	17 760	2 506	215 780	100.0
Composition weight	79.6	11.0	8.2	1.2	100.0%	-

^a The above table applies the most conservative credit rating among Moody's, Standard & Poor's and Fitch.

31. The maturity structure of the cash collateral reinvested against securities lent is shown in table 10.

Table 10

Maturity structure of the cash collateral reinvested against securities lent, as at 31 December 2009^a

(Thousands of United States dollars equivalent)

<i>Period due</i>	<i>Amount</i>	<i>Percentage</i>
Due in one year or less	163 407	75.7
Due after one year through two years	36 589	17.0
Due after two years through three years	13 113	6.1
Due after three years through four years	2 671	1.2
Total	215 780	100.0

^a The maturity structure represents the financial maturities of the reinvested cash collateral, not the legal maturities.

32. As evident from tables 9 and 10, the reinvested cash collateral is fairly liquid with over 43 per cent in cash, while it maintains a high quality with almost 80 per cent in triple A and as much as 76 per cent will be redeemed 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.

IX. Liquidity level in IFAD's investment portfolio

33. IFAD's Liquidity Policy states that IFAD's liquidity ("highly liquid assets")² should remain above 60 per cent of the projected annual gross disbursement level of US\$437 million over the Seventh Replenishment period.
34. Highly liquid assets in IFAD's investment portfolio as at 31 December 2009 amounted to US\$1,295,000,000 equivalent, which comfortably clears the minimum liquidity requirement (table 11).

Table 11

Liquidity level in IFAD's investment portfolio, as at 31 December 2009

(Thousands of United States dollars equivalent)

	<i>Actuals</i>	<i>Percentage</i>
Highly liquid assets	1 295.0	49.8
Short-term	184.2	7.1
Government securities	1 110.8	42.7
Fairly liquid assets	900.9	34.7
Non-government securities	900.9	34.7
Partially liquid assets	402.8	15.5
Held-to-maturity	402.8	15.5
Total portfolio	2 598.7	100.0

X. Risk measurement³

35. 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 31 December 2009, the standard deviation of IFAD's investment portfolio was 1.48 per cent, compared with 1.57 per cent for the investment policy.⁴
36. 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.⁵ Table 12 shows the VaR of IFAD's investment portfolio and that of the investment policy as at 31 December 2009 and for previous periods.

² Defined as being convertible to cash quickly and without significant loss of value.

³ More comprehensive information pertaining to the Fund's risk management is provided in the 2009 consolidated financial statements in note 4 (document EB 2010/99/R.42).

⁴ The security lending cash collateral programme is not factored into this volatility measurement.

⁵ The security lending cash collateral programme is not factored into this VaR measurement.

Table 12
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^a</i>	
	<i>VaR (Percentage)</i>	<i>Amount (Thousands of US dollars)</i>	<i>VaR (Percentage)</i>	<i>Amount (Thousands of US dollars)</i>
31 December 2009	1.23	32 080	1.31	33 987
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

^a The investment policy VaR is based on policy allocation (see table 1).

37. At 31 December 2009, the investment portfolio's VaR was 1.23 per cent, a slight decrease from the end of the previous quarter, and below the investment policy VaR of 1.31 per cent. The gradual reduction of the VaR reflected the effects of the proactive tactical strategies implemented by IFAD to tighten the risk control of the investment portfolio management as a whole, including the shortening of the duration in the global government and inflation indexed bonds mandates, in the context of the fallout of the global financial crisis.

