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CASH AND INVESTMENT MANAGEMENT: LEVEL OF FINANCIAL INVESTMENT AND INVESTMENT POLICY

Note to the Executive Board

This document is submitted for consideration to the Executive Board.

The Secretariat invites members of the Board who may have questions of a technical nature with regard to this document to contact the WFP staff focal points indicated below, preferably well in advance of the Board's meeting.

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Should you have any questions regarding matters of dispatch of documentation for the Executive Board, please contact the Supervisor, Meeting Servicing and Distribution Unit (tel.: 066513-2328).

Executive Summary

This document is presented in response to a request made by the Executive Board, at its Annual Session in May 2001 and Third Regular Session in October 2001, for information and as basis for discussion on WFP's investment levels, policies and strategies. The scope of the paper is to:

- Describe the existing cash position of the Programme as the basis for determining investment levels;
- set out the cash and investment strategies that were adopted to achieve effective and transparent management of financial resources;
- outline the investment policies formulated by the Programme and implemented by investment managers;
- describe procedures for monitoring and reporting on investment performance;
- explain the use of interest income; and
- outline future action.

Draft Decision

The Executive Board approves the document and:

- takes note of the Programme's investment levels as well as the policies, strategies, and steps adopted by the Secretariat in managing the cash resources of the Programme in the most efficient, prudent and transparent manner;
- decides that it will review regularly the investment activities of the Programme at the time of the review of the audited biennial financial statement.

INTRODUCTION

1. This document is presented in response to a request made by the Executive Board, at its Annual Session in May 2001 and Third Regular Session in October 2001, for information and as the basis for discussion on WFP's investment levels, policies and strategies. The scope of the paper is to:

- describe the existing cash position of the Programme as the basis for determining investment levels;
- set out the cash and investment strategies that were adopted to achieve effective and transparent management of financial resources;
- outline the investment policies formulated by the Programme and implemented by investment managers;
- describe procedures for monitoring and reporting on investment performance;
- explain the use of interest income; and
- outline future action.

2. It should be noted that the financial figures used for 2000 and 2001 are based on provisional amounts prior to closure of accounts for the biennium ending 31 December 2001. The figures will be updated and reflected in the cash management section of the audited 2000–2001 financial statements, to be submitted to the Executive Board in October 2002.

BACKGROUND

3. Prior to January 1999, WFP's treasury operations were handled by the Food and Agriculture Organization (FAO) through a service agreement. Investment strategies adopted by FAO at that time included:

- retention of contributions received as term and bank deposits, allowing interest to be earned at rates ranging from 4.4 to 5.5 percent between 1994 and 1998; and
- management of long-term funds such as the compensation plan and the separation payment scheme for WFP staff, which were invested by FAO through an external investment manager.

4. In 1999, WFP and FAO agreed to transfer these functions to WFP, which led to the establishment of the Treasury Branch and the development of WFP's own cash and investment management strategies.

5. On assuming responsibility for management of its own financial resources, WFP decided that these resources should be managed more proactively in accordance with the Financial Regulations of the Programme and in response to recommendations from its external and internal auditors.

6. To that end, WFP adopted the following strategies:

For Overall Management:

- creation of a WFP Investment Committee, comprising senior officers of WFP as internal members and investment experts as external members, and including an observer from the Office of Internal Audit;
- formulation of investment policies (submitted to the Executive Board for information in October 1999);
- development of additional solutions for treasury operations in WINGS and creation of a comprehensive treasury manual (to be completed this year).

For Cash Management:

- pooling of cash resources throughout the Programme;
- daily monitoring of cash balances, prompt reconciliation of all bank accounts and closure of inactive accounts;
- monitoring of country office cash balances and implementation of monthly cash forecasting as the basis for remittances to country office bank accounts; supervision of relations with banks.

For Investment Management:

- appointment of an investment adviser for the Investment Committee;
- engagement of investment managers to handle WFP's portfolio;
- monitoring of investment managers' performance and continual dialogue with them;
- review of the performance and reports of the funds custodian.

LEVELS OF CASH BALANCES AND INVESTMENTS

7. The level of investment was established through a three-step process:

- **Step 1:** Determine the level of cash required as working capital for operations.
- **Step 2:** Estimate the amount of cash not immediately required for operations that was likely to be available after making provision for Step 1.
- **Step 3:** Aggregate cash not immediately required for operations and a portion of operating cash that could be invested on a short-term basis without jeopardizing WFP's operations.

8. These three steps are described in subsequent sections of this document.

Determining the Level of Cash Balances Required for Operations

9. The Secretariat determined the cash required for operations through:

- a trend analysis of monthly cash receipts and disbursements during the previous four years; and
- an analysis of the time gap between confirmation and receipt of contributions.

10. On the basis of these analyses, it was estimated that a cash level equivalent to three months' operational requirements (corresponding to US$210 million in 1999, US$225 million in 2000 and US$240 million in 2001) would be appropriate.

Determining the Level of Cash Not Immediately Required for Operations

11. Once the level of operational cash required had been established, the amount of cash not immediately required for operations was determined: US$531 (522.9 + 8.4) million in 1999, US$526 million in 2000 and US$401 million in 2001 (see Table 2).

12. This cash can be attributed primarily to the following:

- **Contributions received for large relief operations.** For most relief operations, cash contributions are received in one lump sum or in large tranches at the initial phase of an operation; disbursements, however, are made over the duration of an operation. For emergencies, it is vital for WFP to receive money up front to fund operations, otherwise the Programme's ability to respond quickly and effectively is severely constrained.
- **Time lag between obligations and disbursement.** Expenditures may be incurred on receipt of contributions, but disbursements against these obligations are made over a longer period. Average disbursement times vary for different cost components: food and transport, for example, may be contracted and disbursements effected within a matter of days, while associated costs, such as landside transport, storage and handling (LTSH), other direct operational costs (ODOC) and direct support costs (DSC), are disbursed over the duration of the project. Therefore, while cash resources are not immediately needed for operations, most of these are nevertheless already earmarked for obligations incurred for projects.
- **Fund balances of closed projects.** These are unspent contributions for closed projects for which all operational activity has been completed and all financial obligations settled. Discussions are ongoing for possible re-programming of fund balances or for cash refunds to donors.

Determining the Level of Cash for Investments

13. The level of cash for investment was determined by aggregating three elements:

- cash not immediately required for operations;
- other funds requiring special treatment; a portion of operational cash that could be placed in a short-term investment account without jeopardizing operations.

14. WFP's liquid assets (i.e. cash and cash equivalent) for the last three years are detailed in Table 1.

TABLE 1: WFP'S CASH HOLDINGS FOR 1999, 2000 AND 2001 (million US$)			
	1999	**2000**	**2001**
Total liquid assets as of end of year	828.8	967.0	859
Less: monetization fund for use in recipient countries	(10.4)	(22.1)	(23.3)*
Total cash available	**818.4**	**944.9**	**835.7**

* As at October 2001.

15. The available cash was managed externally, through investment managers, and internally, as shown in Table 2.

TABLE 2: MANAGEMENT OF AVAILABLE CASH (million US$)			
	Feb. 2000*	**Dec. 2000**	**Dec. 2001**
Externally managed			
Long-term liability (after-service medical coverage)	44.8	43.4	43.4
Special accounts (self-insurance, etc.)	32.3	44.5	44.5
Cash not immediately required for operations	522.9	526.3	401.3
Operational cash**		25.3	136.6
Subtotal	**600.0**	**639.5**	**625.8**
Long-term loan	-	-	106.0
Total	**600.0**	**639.5**	**731.8**
Internally managed			
Long-term loan		106.0	
Cash not immediately required for operations	8.4		
Operational cash	210.0	199.4	103.9
Total	**218.4**	**305.4**	**103.9**
Total cash available	**818.4**	**944.9**	**835.7**

* Investment managers were appointed in February 2000.

** Operational cash required in 2000 was 224.7 (25.3 + 199.4) and in 2001 was 240.5 (136.6 + 103.9).

16. In February 2000, when outsourcing of investment management started, the Programme had an initial investment of US$600 million (see Table 2). An aggressive but prudent investment strategy was implemented to maximize the time value of money. Investment managers are required to invest in higher-yield liquid investments that also allow immediate withdrawal when necessary. The Secretariat reported on the incremental benefits of this initiative in a paper on cash management presented to the Executive Board in May 2001.

DETAILED INVESTMENT POLICIES AND STRATEGIES

17. WFP's Financial Regulation 11.2 states that "monies not required immediately may be invested by the Executive Director, bearing in mind the need for safety, liquidity and profitability", which govern the investment activities of the Programme. The Programme took significant steps to manage its cash resources efficiently by adopting the strategies set out below.

Pooling of Cash and Maintenance of a Money Market Account

18. All cash resources were pooled and managed as a single resource. Cash balances in all bank accounts were monitored daily.

19. As reported in the paper on cash management presented to the Executive Board in May 2001, daily electronic monitoring of balances and transactions of Headquarters bank accounts became possible and enabled the Secretariat to consolidate in a money market account those cash balances that were not immediately required. This resulted in a reduction of the 1994–1999 average daily cash balance of US$80 million to between US$20 million and US$30 million. This strategy allows prompt cash consolidation in the money market account. Maintaining a money market account allows optimization of interest revenues; immediate withdrawal of funds, without prior notice, for operations; and prompt re-investment of maturing investments.

20. New banking arrangements for the receipt of non-US$ contributions were established, eliminating the risk of exchange rate fluctuations associated with holding cash balances in excess of operating requirements in non-US$ accounts.

Monitoring of Country Office Cash-flow Requirements

21. The cash balances and disbursement patterns of country offices were monitored to ensure that no more than one month's disbursement requirements were maintained. Country offices now maintain this cash level, which is replenished if it falls to one week's requirements or when the need for additional funds arises. To minimize cash balances and maximize interest revenue in country offices with large operations, the Secretariat maintains zero-balance accounts.[1]

Establishment of a WFP Investment Committee

22. Prior to the transfer of management of WFP's treasury functions to the Programme, investment activities of WFP and FAO were supervised by two committees:

[1] A zero-balance account is a centralized "master" account with sub-accounts. Local transactions are effected through the sub-accounts, which are automatically replenished if in deficit or zeroed if in surplus at the end of each working day.

- the high-level FAO Advisory Investment Committee, chaired by the FAO Director-General, which studies global economic trends and provides annual advice to FAO and WFP;
- the Internal Investment Committee in each organization, whose senior officers are members.

23. When WFP took over management of its treasury functions, it decided to continue using the services of the FAO Advisory Investment Committee and to strengthen the role of the Internal Investment Committee in management of the Programme’s cash and investments.

24. The Treasurer of IFAD and an external investment adviser were appointed by the Executive Director to WFP’s Internal Investment Committee to provide advice on investment strategies, comment on the suitability of performance benchmarks and share investment monitoring practices.

25. The Internal Investment Committee meets quarterly to review investment performance and issues related to treasury operations, such as banking relations, foreign exchange and cash management.

Formulation and Implementation of Investment Policies

26. In a circular issued in September 1999, the Executive Director set out the investment management policies of the Programme. The primary objective of these policies is the preservation of the value of resources, in US dollar terms. Within this general objective the principal considerations for investment management are, in order of priority: (i) security of principal, (ii) liquidity and (iii) rate of return.

27. These principles were set out in detailed investment guidelines that included liquidity requirements, investment periods, investment quality, eligible assets, investment limits, sovereign risks, restrictions and the performance benchmark of the investment portfolio.

28. Investment of WFP funds was allowed in six broad sectors of the fixed-income market: cash and equivalents, treasuries/agencies, corporates, mortgages, asset-backed securities and sovereigns.

29. For the year ending 31 December 2001, the allocation of the total investment portfolio is as shown in Table 3.

TABLE 3: ASSETS BY SECTOR, AS AT DEC. 2001	%	Million US$
Cash and cash equivalents	12.5	78.10
Treasuries/agencies	18.8	117.54
Corporates	31.7	198.12
Mortgages	7.6	47.86
Asset-backed securities	28.5	178.36
Sovereigns	0.9	5.80
Total	**100**	**625.78**

Selection and Appointment of Investment Managers

30. On 25 October 1999, following a competitive selection process, the Executive Director approved the appointment of five external investment managers: Credit Suisse, J.P. Morgan, Payden & Rygel, Wellington and Western Asset.

31. The investment managers started work in February 2000, each with a portfolio value of US$120 million; the total portfolio value was US$600 million.

32. Earnings were reinvested and retained with the external investment managers. However, in December 2001, due to reduced cash levels, the Secretariat withdrew US$10 million from each of the investment managers. Therefore, the level of investments with investment managers was lower at the end of 2001. The market values of investments held by them at the beginning, and at the end of subsequent years are as shown in Table 4.

TABLE 4: WFP INVESTMENT MANAGERS	Feb 2000	Dec 2000	Dec 2001
Credit Suisse	120.0	127.8	123.4
J. P. Morgan	120.0	127.5	125.6
Payden & Rygel	120.0	128.1	125.8
Wellington	120.0	128.2	125.2
Western Asset	120.0	127.9	125.7
Total	**600.0**	**639.5**	**625.7**

Appointment of a Global Custodian

33. The Secretariat retained Northern Trust, the then global custodian of FAO, as its global custodian, responsible for core custodial activities such as safekeeping of assets, settlement of transactions, collection of income, tax reclamation, valuations and portfolio accounting.

Monitoring Performance of Investment Managers

34. The Secretariat entered into discussions with FAO and IFAD in early 2000 for the potential outsourcing of monitoring the performance of investment managers. IFAD advised the Secretariat in December 2001 that it would not be in a position to provide investment monitoring services for other agencies in Rome as it needed to focus on its own investment activities. Therefore, the Secretariat intends to move towards alternative and permanent arrangements for investment monitoring while continuing with the interim procedures and mechanisms that were earlier put in place.

35. The interim system and procedures for monitoring investment managers' performance include:

- comparison of investment transactions and holdings against established guidelines with respect to instrument quality, eligible instruments and price changes; to date, the Secretariat has noted no violations of investment guidelines;
- review of independent reports from the global custodian;
- review of investment performance against benchmark.

36. The annualized benchmark since inception for the investment managers' performance is J.P. Morgan's US-dollar three-month cash index (6.03 percent) plus 0.75 percent, net of management fees. For the 22-month period ending November 2001, four out of five investment managers exceeded this benchmark by an average of 0.19 percent, the fifth investment manager's performance was 0.53 percent lower than the benchmark. The Investment Committee is monitoring this situation closely, and will make recommendations for appropriate action to be taken by the Executive Director.

37. Overall annualized investment performance for the 22 months ending 30 November 2001 stood at 6.93 percent. This is higher than the performance benchmark given to the investment managers. In monetary terms, this is US$0.90 million more than the benchmark. In addition, the overall investment performance is 32 percent more than the average interest rate of 5.26 percent on bank and term deposits for the same period. In monetary terms, WFP earned US$10.9 million more (US$4.8 million in 2000 and US$6.1 million in 2001) on investments through professional investment managers than it would have earned on bank deposits.

38. The Secretariat monitors monthly performance of investment managers, although the contract with them provides for review of annual performance.

USE OF INTEREST INCOME

39. Interest income earned in cash balances during the past three biennia is as follows:

- 1996–1997 US$73.8 million
- 1998–1999 US$80.1 million
- 2000–2001 US$90.0 million (provisional for 2001)

40. Interest earned during the 1996–1997 biennium was US$73.8 million, against an average cash balance of US$699 million and an average interest rate of 5.65 percent in United States term deposits. Interest earned during the 1998–1999 biennium was US$80.1 million, against an average cash balance of US$805 million and an average interest rate of 5.35 percent in United States term deposits. This biennium resulted in an 8-percent increase over 1996–1997. Interest earned in 2000–2001 was US$90.0 (provisional) million, against

an average cash balance of US$844 million. The interest income increased by 12 percent over the previous biennium.

41. Financial Regulation 11.3 states that “Income from investments shall be credited, where applicable, to the related special account, and in all other cases to the General Fund as miscellaneous income. Unless otherwise specified by the contributor, interest accrued on donor funds administered by WFP for bilateral services shall be credited to the IRA”.

42. During the past six years, most of the interest earned from investments has been credited to the General Fund, thereby increasing the balance of the unearmarked surplus of the General Fund.

43. Use of that unearmarked surplus has always been decided by the Executive Board on the basis of recommendations from the Executive Director. For instance, in 1998, the unearmarked surplus of the General Fund was used to fund the after-service medical liability with US$44.8 million.

FUTURE ACTION

44. The Secretariat believes that although there have been significant achievements in efficient and transparent management of WFP’s cash resources, there remain areas that require improvement to ensure that resources are used for programme and project implementation in country offices.

45. To this end, the Secretariat will adopt the following strategies:

- faster project implementation evidenced by increased and faster disbursement of funds; it should be noted that project implementation depends on host governments and implementing partners as well as on WFP;
- continuing review of obligations and start of payments or reversals of any unused funds;
- continued proactive management of cash balances and investments;
- proactive analysis and prompt operational and financial closure of completed projects, with identification of and action on unutilized funds for reprogramming or refund to donors;
- completion of the treasury manual;
- prompt access to better financial information through the implementation of WINGS, resulting in more timely financial decisions; and
- development and implementation of a new treasury system integrated with WINGS.

46. The Executive Director assures the Board that the Secretariat will continue to institute procedures to accelerate project implementation, in cooperation with implementing partners; and will continue to promote best practice in cash and investment management.

RECOMMENDATION

47. The Executive Director recommends that the Executive Board approve the document and:

- take note of the Programme's investment levels as well as the policies, strategies, and steps adopted by the Secretariat in managing the cash resources of the Programme in the most efficient, prudent and transparent manner;
- decide that it will review regularly the investment activities of the Programme at the time of the review of the audited biennial financial statement.