برنامج الأغذية العالمي

Programme Alimentaire Mondial

World Food Programme

Programa Mundial de Alimentos

Executive Board
Second Regular Session

Rome, 6–10 November 2006

RESOURCE, FINANCIAL AND BUDGETARY MATTERS

Agenda item 5

*For information**

E

Distribution: GENERAL

WFP/EB.2/2006/5-I/1

22 September 2006

ORIGINAL: ENGLISH

REPORT ON CHANGES IN WFP'S INVESTMENT POLICY

* In accordance with the Executive Board's decisions on governance, approved at the Annual and Third Regular Sessions, 2000, items for information should not be discussed unless a Board member specifically requests it, well in advance of the meeting, and the Chair accepts the request on the grounds that it is a proper use of the Board's time.

NOTE TO THE EXECUTIVE BOARD

This document is submitted to the Executive Board for information.

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.

Chief Financial Officer, CFO*:	Ms G. Casar	tel.: 066513-2885
Chief, CFOTT**:	Mr R. van der Zee	tel.: 066513-2544

Should you have any questions regarding matters of dispatch of documentation for the Executive Board, please contact Ms C. Panlilio, Administrative Assistant, Conference Servicing Unit (tel.: 066513-2645).

* Division of the Chief Financial Officer

**Treasury Branch

DRAFT DECISION*

The Board takes note of "Report on Changes in WFP's Investment Policy" (WFP/EB.2/2006/5-I/1).

* This is a draft decision. For the final decision adopted by the Board, please refer to the Decisions and Recommendations document issued at the end of the session.

INTRODUCTION

1. This document is presented in response to a request by the Board at its 2006 Annual Session for information about the changes in WFP's investment policy. It describes the cash and investment management strategies and the main elements of the new investment policy for WFP's short-term investment portfolio.

BACKGROUND

2. In 1999, WFP assumed responsibility for managing its financial resources, which led to the development of its cash and investment management strategies and formulation of its own investment policy. Management of financial resources is governed by Financial Regulation 11.2, which states: "Monies not required immediately may be invested by the Executive Director, bearing in mind the need for safety, liquidity and profitability." In line with these principles, the Secretariat prepared an Executive Director's circular on investment management policy, which took effect on 30 September 1999.

SHORT-TERM INVESTMENT PORTFOLIO

3. The short-term investment portfolio comprises surplus cash balances related to programme category funds, bilateral operations and trust funds, and the General Fund and special accounts. The total market value of assets in this portfolio was US$722 million as of 30 June 2006. The primary objective of the investment policy for the short-term investment portfolio is to preserve the value of resources in United States dollar terms. Under this objective and in line with Financial Regulation 11.2, the principal considerations for investment management are security of principal, liquidity and rate of return. The changes to the investment policy do not amend any of these principles. All investments of the short-term investment portfolio will continue to be made in fixed-income securities and money-market instruments with limited risk profiles.

4. The changes to the investment policy outlined in this document relate only to WFP's short-term investment portfolio. WFP has two other investment portfolios, to which the changes do not apply:

   - Staff benefit funds: market value US$78 million as of 30 June 2006; a segregated investment portfolio invested in equities and bonds, established to meet the liabilities of three staff compensation schemes. Investment of the staff benefit funds is made separately, pursuant to the recommendations of an asset-liability management study carried out in 2003; a new study is being prepared.

   - Long-term investments: market value US$77 million as of 30 June 2006; investments in United States Treasury bonds to be held to maturity to meet the interest and principal repayment obligations relating to a one-off long-term loan structure relating to the Emerging Matching Donor Fund.

Cash and Investment Management Strategies

5. In this section, the main cash and investment management strategies applied by the Secretariat are described to explain the context of the changes in the investment policy for the short-term investment portfolio.

Cash Management

Pooling of Cash Resources

6. The main principle underlying cash management relates to the pooling of cash resources throughout WFP. All cash resources not immediately required for disbursement are pooled at Headquarters, where most contributions are received and from where field offices are funded.[1] The benefits of pooling cash resources include optimization of interest income and reduced financial risks such as counter-party risk, country risk and foreign-exchange risk.

Maintaining Low Cash Balances in Field Offices

7. Cash balances held at field offices are limited to immediate operational disbursement requirements. Field offices provide monthly cash-flow forecasts to Headquarters; the maximum level of cash balances held in field offices is one month of disbursements, but most offices, particularly the larger ones, maintain much lower relative cash balances. This system is supported by electronic access by many countries to Headquarters "master" bank accounts, which provides instant access to funds and keeps local cash balances to a minimum. Over the past three years, the level of cash balances held in field offices as a proportion of overall cash and short-term investment has decreased from 4 percent to 2 percent.

Liquidity Management

8. Cash balances in Headquarters bank accounts are monitored daily; decisions on funding them take into account the level of disbursements at Headquarters, the amount of funding for field offices and receipts of cash contributions. Target balances are set to provide sufficient liquidity for operations; surplus funds are invested to optimize interest income. A portion of funds not immediately required in operational bank accounts is maintained as working-capital funds[2] to cover gaps between cash receipts and cash disbursements in the short term.

---

[1] Exceptions apply with regard to trust funds, in that restrictions on pooling funds apply to some country operations.

[2] The working-capital funds have no relation to the working-capital facility introduced as part of the Business Process Review.

INVESTMENT MANAGEMENT

Investment Management Governance Structure

9. In late 1999, the Executive Director established WFP's Investment Committee of senior directors, which meets quarterly and advises the Executive Director on investment policy and strategy, reviews investment performance and makes recommendations on treasury management such as cash management, foreign-exchange management and banking relations.

10. The committee is assisted by an investment adviser, currently the World Bank Treasury, to ensure access to expertise and to enable informed decision-making. The Secretariat is updating the terms of reference of the Investment Committee and is considering the appointment of external members with financial market experience at a senior level to enhance the committee's capabilities.

Use of External Investment Managers

11. Since February 2000, WFP has used external investment managers for its short-term investment portfolio. They are appointed after competitive selection and operate under strict guidelines on investment of the funds entrusted by WFP. Three investment managers currently manage the short-term investment portfolio.[3]

12. The performance of the current investment portfolio managed by the three investment managers has been an average 3.94 percent per annum between its inception in February 2000 and 30 June 2006. Investment managers' performance is measured against the JP Morgan Three Months Cash Index,[4] plus an excess return target of 50 basis points.[5] On average, the three investment managers have generated returns of 54 basis points per annum against the JP Morgan index as at 30 June 2006. The performance review period covers a full cycle of interest-rate decreases and of interest-rate increases by the Federal Reserve, a good timeframe for assessment.

Investment Monitoring

13. The performance of the investment managers and their compliance with the investment guidelines are monitored daily, monthly and quarterly. The bank used by WFP as its global custodian for the safekeeping and administration of its investment securities provides monitoring services, including performance analysis, risk analysis and compliance monitoring, that enable verification of the information provided by the investment managers. Compliance of the portfolio with the investment guidelines is reviewed daily using a web-based monitoring tool; potential discrepancies are investigated and where necessary investment managers are instructed to take corrective action. The monthly performance reports of the investment managers are analysed in a summary report to the Investment Committee. A report on the main performance indicators of the investment managers is reviewed quarterly by the Investment Committee.

---

[3] Six investment managers have been used for the short-term investment portfolio since its inception.

[4] The JP Morgan 3-Months Cash Index tracks total returns for constant maturity deposits with a tenor of 3 months.

[5] The excess return target was 75 basis points until 1 April 2002

NEW INVESTMENT POLICY FOR THE SHORT-TERM INVESTMENT PORTFOLIO

Review of the Investment Policy

14. At the request of the Investment Committee, the World Bank Treasury was commissioned in the second half of 2004 to review WFP's policy for its short-term investment portfolio and recommend a policy framework that would align WFP's management of liquidity more closely with its mission and operations. It reported in August 2005, and the Investment Committee instructed WFP's Treasury Branch to work with the investment adviser to develop the new investment policy and guidelines.

Main Elements of the New Investment Policy

15. The new investment policy aims to optimize the management of WFP's short-term investment portfolio by establishing clear investment objectives, investment horizons and risk-tolerance levels for each component of the portfolio.

16. The main components of the new investment policy are outlined in paragraphs 17–25.

Portfolio Tranches and Investment Horizon

17. To utilize WFP's risk-bearing capacity fully and to add value to the portfolio of short-term investments, the portfolio is divided into three tranches, each with its investment horizon:

- Portfolio tranche 1, the short-term portfolio or "P1", will accommodate the operational funds with a three-month investment horizon.
- Portfolio tranche 2, the medium-term portfolio or "P2", will accommodate funds and reserves with an investment horizon of about one year.
- Portfolio tranche 3, the longer-term portfolio or "P3", will cater for funds and reserves with an investment horizon of three years or longer.

18. The funds and reserves making up the short-term investment portfolio were analysed in detail, because their cash-flow characteristics are determined by the policies, rules and regulations governing individual funds and reserves and by the operational nature of the activities. Under the new investment policy, decisions on the composition of the portfolio tranches are taken by the Executive Director on the basis of the recommendations of the Investment Committee. In view of the policies and constraints on accessing funds, the Operational Reserve, Self-Insurance Account and Emerging Donor Matching Fund are expected to be fairly stable over time, and thus qualify for inclusion in P3. Cash balances related to development activities and the Programme Support and Administrative (PSA) Equalization Account have average lives of one year or longer, and so qualify for inclusion in P2. All funds that are operational in nature are to be (i) maintained in operational bank accounts for immediate disbursement, (ii) maintained as working capital or (iii) allocated to P1.

19. The initial composition of the short-term investment portfolio, had it been implemented by 30 June 2006, would have been P1: 43 percent; P2: 41 percent; and P3: 16 percent. The market value of the portfolio on that date was US$722 million.

Risk Tolerance Levels

20. To reflect the conservative nature of WFP's short-term investment portfolio, risk-tolerance levels for each tranche have been formulated in line with WFP's institutional risk-bearing capacity and on the basis of historical and forward-looking negative returns over the investment horizons provided by the World Bank Treasury. The operational nature of funds in P1 is expressed as "no tolerance for investment losses, or zero probability of negative returns over a three-month investment horizon". P1 serves as a pass-through vehicle for donor funds to projects and beneficiaries; it should bear no investment losses from the time the funds are expected to be invested until their disbursement.

21. Preservation of capital is an important objective of the P2 and P3 tranches, but generation of income requires a trade-off between additional levels of risk and potential higher return. Thus to make it possible to generate additional expected value to a portfolio within conservative risk parameters, risk budgets have been set for P2 and P3 with defined probabilities for negative return and maximum levels for such negative return.[6] The current investment policy does not include specific risk tolerance levels and risk budgets. The investment guidelines for P2 and P3 allow for investment in slightly riskier assets than previously but the investment guidelines for P1 are more restrictive than those in place since 2000.

22. The guidelines for investment managers include specific risk budgets to ensure that WFP's funds are managed within the risk-tolerance levels outlined in the investment policy. Historical analysis shows that the new investment policy would create enhanced returns compared with the current policy – an additional 0.59 percent per annum from 1978 to 2006 – but future market conditions may limit the potential for enhanced returns.

Review of Strategic Asset Allocation and Benchmarks

23. The new investment policy includes a framework for periodic review of the allocation of strategic assets and the benchmarks of the portfolio tranches to ensure that WFP (i) monitors the consistency of current asset allocations with prevailing risk-tolerance parameters in the market and (ii) takes action if needed. If interest rates increase or decrease by more than about 2 percent, a review of strategic asset allocation and benchmarks will be triggered.

Periodic Review of Investment Policy and Risk Tolerance Levels

24. The new investment policy also includes a framework for review of the structure of the short-term investment portfolio and the risk-tolerance levels to ensure that changes in WFP's mission and operations are accurately reflected. For example, changes in WFP's liquidity replenishment processes or significant changes in donor conditions governing the use of cash resources could lead to a revision of WFP's investment policy.

[6] P2: a 1 percent probability of a negative return over 1 year, with the worst possible outcome limited to minus 2 percent at the end of any one-year period. P3: a 5 percent probability of a negative return over three years, with the worst potential outcome limited to minus 2 percent at the end of any three-year period, further constrained by the worst potential outcome at the end of any year 1 or year 2 being limited to minus 3 percent.

25. In summary, the benefits of the new investment policy include:

- enhanced financial risk management as a result of the establishment of specific risk-tolerance levels and the use of risk budgets by the investment managers;
- enhanced framework for periodic review of strategic asset allocation, benchmarks, portfolio structure and risk-tolerance levels; and
- potential for enhanced returns on the short-term investment portfolio on the basis of historical performance figures.

Implementation of the New Investment Policy

26. As instructed by the Investment Committee and in cooperation with the investment adviser, the Treasury Branch has formulated a new investment policy that has been issued as an Executive Director's circular on investment policy, effective from 1 October 2006. Detailed investment guidelines for each portfolio tranche have been developed to guide external investment managers on the management of funds entrusted by WFP; the guidelines include risk budgets, eligible investment instruments and restrictions on credit risk, duration risk and currency risk.

27. The tranches into which new investment policy divides the short-term investment portfolio are all in the "low-duration domain" – they are investments in fixed-income securities with short-term to medium-term maturities, with limited interest-rate risk. The securities included in the short-term investment portfolio will continue to have restricted risk profiles and to be highly liquid, marketable securities, allowing for divestment at short notice if required.

28. The transition to the new investment policy has been prepared in collaboration with the investment adviser, the global custodian and the investment managers. WFP will continue to use external investment managers for its short-term investment portfolio; they will manage the portfolio tranches according to the strict investment guidelines that form part of the contractual relationship with the providers of financial services. The transition to the new investment policy will involve changing a portion of the securities in the portfolio, which can be achieved in a short time with limited transition costs. Implementation of the new investment policy is planned for the fourth quarter of 2006 and should be completed by the end of the year.