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January 6, 2022

**Statement by Mr. Bevilaqua, Mr. Velloso, and Ms. Florestal on Review of the Investment Account and Trust Assets Investment Strategy  
(Preliminary)  
Executive Board Meeting  
January 12, 2022**

We thank staff for the set of helpful papers and welcome the firming up of proposals regarding the Investment Account (IA) and Trust Assets (TA) Investment Strategy, as well as the refinements proposed to the Fund's Framework on Conflict of Interest related to the IA and TA. On the Issues for Discussion, we offer the following comments:

**Staff proposals to refine the Endowment Account (EA) investment strategy along the lines of Figure 9 on page 20**

Given the decision to maintain the 3 percent return target, realized performance to date and projected lower returns within the current strategy, we find that the refinements proposed by staff could reliably preserve, and possibly supplement, the Fund's income through the EA going forward. Hence, we support: (i) reducing the allocation to low yielding fixed-income assets and improving diversification within the fixed-income allocation, as well as (ii) expanding and diversifying the allocation towards real assets. On the latter, we share staff's views that volatility does not necessarily preclude mean reversion and the projected long-term desired return.

The current large allocation to Developed Markets (DM) Fixed-Income (FI) represents a risk to the EA in the current low return environment. Combining DM and Emerging Market (EM) bond allocations into global allocations for government and corporate bonds should effectively allow for reallocations from (lower yielding) DM investments into (higher yielding) EM investments. At the same time, it will be important to hedge currency risk for bonds denominated in EM currencies.

Reallocation from US TIPS to other real assets would improve the EA's return potential while maintaining long-term resilience against inflation. Indeed, a moderate increase in the Real Estate Investment Trusts (REITs) allocation and a dedicated allocation to publicly listed infrastructure equities could help achieve an adequate balance between expected returns and

maintaining long-term resilience against inflation. Also, we are encouraged by the greater proximity of the proposed strategy to that of the reference benchmark for a balanced equity/bond portfolio.

Staff's proposal to replace the 'core-satellite' model with a framework which would enable active management for selected asset classes is in line with the Board's June 2021 recommendations. The rules-based, buy-and-hold approach for investing in corporate bonds and for investing in private infrastructure debt has served the EA objectives effectively. At the same time, we welcome staff's recommendation for the Investment Oversight Committee (IOC) to consider indices with broader exposure to new sectors concurrently with its review of the existing REITs benchmark.

The gradual transition to active management of EM equities seems reasonable and we would expect the Board to be briefed at a higher frequency than the yearly annual report during the first years of implementation and/or for a formal review of the active management to be held in a year.

We agree to have the scope and modalities for active management in permitted asset classes delegated to the Managing Director as these decisions are of an operational nature.

**Staff proposals to refine the FI investment strategy along the lines of Figure 14 on page 29**

The proposal to diversify the FI to include more lower-rated assets must be accompanied with stronger risk control measures even if overall it does not materially alter the subaccount's risk profile. Nonetheless, with the proposed refinements more rather than less Board oversight is warranted. We expect the Board to be informed in a timely fashion of the effective modification by the IOC of the minimum credit ratings in the portfolio. *In the same manner, we remain to be convinced about the need for the Board to delegate to the Managing Director the selection of benchmark indices for Tranches 1 and 2. We consider benchmarking a strategic decision. Staff comments are welcome.*

**Staff proposals to refine the PRGT investment strategy along the lines of Figure 17 on page 34 and to add another investment option for PRGT contributor investments as described in Figure 18 on page 35**

We agree with the proposed refinements of the PRGT investment strategy as they pertain to the modification of the PRGT investment objective and the target asset allocation and eligible investments. These refinements should improve portfolio resilience and possibly even returns. We also support staff's proposal to offer to PRGT contributor resources an additional investment option to generate more income.

We concur with staff that a relatively short investment horizon continues to be appropriate for both the CCRT and the PRGT-HIPC Trust investable assets given uncertainty around resource needs linked to the unknown timing of qualifying events and upcoming policy reexamination for the CCRT and the expected short horizon (2024) to reaching the completion point for two out of three HIPC beneficiary country cases left.

With reference to the upcoming Board discussion on the Resilience and Sustainability Trust, we take note of the relative advantage of implementing investment strategies as pooled investments to save on costs.

**Staff proposals to formalize a commitment to responsible investing in the IA Rules and the TA Guidelines as described in paragraphs 46 through 48**

The formalization of the commitment to responsible investing is a positive step forward. However, we caution against the use of ESG guidelines to exclude certain class of assets and markets systematically/unduly. In this regard, we welcome staff's assurances that norms-based exclusions would be limited. That said, the Board should be regularly and formally informed of exclusions with reasons pertaining to the Fund's reputation risk and beyond general industry practices. That said, the Fund should also avoid creating its own "blacklisting" of investments.

**Proposed refinements to the conflicts of interest framework as set forth in paragraphs 51 through 53**

We take note of staff's assessment that the current framework has served the Fund well and commend efforts to improve it further. We also believe that peer-benchmarking is an efficient source of information for objective decision-making and take note that staff considers that the refinements and modifications proposed in the paper would not give rise to conflict of interest risks that could not be effectively mitigated. However, this assessment is largely based on the presumption/fact that an external manager would be handling investment decisions on behalf of the Fund. While we understand the relative advantage of having a third-party determine the universe of eligible issuers given the Fund's peculiar mandate, we could find helpful to include some flexibility for the Fund, under specific circumstances, so direct managers could exclude certain issuers. Such a decision could be taken after Board consultation.

Finally, we concur with staff that the credit rating threshold as proposed to be modified to include BBB+ rated investments will make it unlikely that the Fund would invest in debt of national agencies in IMF members receiving Fund financial support. *However, we wonder whether additional safeguards would not be warranted to completely preclude such occurrences, particularly as the world economy and our membership continue to be affected by an unprecedented crisis. Staff comments are welcome.*