GRAY/22/89

CONFIDENTIAL

January 7, 2022

Statement by Ms. Lim, Ms. Wongwaisiriwat, and Mr. Bautista on Review of the Investment Account and Trust Assets Investment Strategy (Preliminary)
Executive Board Meeting
January 12, 2022

We thank staff for the comprehensive report. We broadly agree with the proposed investment strategies for the two IA subaccounts and the TA, which we consider to be sensible and appropriately gradual at this review juncture.

<u>Endowment Subaccount (EA)</u>

We are pleased that the EA had met the 3 percent long-term real return target so far but are cognizant of the challenges in achieving the return objective in the future given the shifting market dynamics. The pandemic and ensuing policy responses have further led to a complicated inflation outlook, warranting measured refinements both to benefit from investment opportunities and ensure adequate protection against emerging risks. In this regard and recognizing the long-term nature of the portfolio and return target, we think it is more sensible to refine the investment strategy, before turning to reassess whether to lower the return target at the next 5-yearly review. Prior to the next review, we would also have time to operationalize the Principles of responsible investing and observe their impacts on the risk-return trade-offs and we look forward to staff's assessments of these issues then.

We agree with staff's proposal to embed more inflation protection in EA's portfolio by adding real assets like REITs and infrastructure equities while reducing the allocation to US TIPS. We note that some infra equities could overlap with existing DM and EM equity benchmarks but are assured by staff's clarification that they exhibit lower volatility over longer periods.

Regarding investment arrangement, we support the transition to more targeted use of active management for EM equities – both from a returns enhancement perspective and to accommodate more responsible investment (RI) at later stages.

<u>**Fixed-Income (FI) Subaccount**</u>

For FI assets, we see merit in staff's proposal to combine developed and EM bonds into global allocations for government and corporate bonds to improve the diversification of the EA's fixed-income holdings using a weighting system. This should improve the overall country diversification across all government bond issuers, as hedging instruments for eligible EM countries have become more cost effective.

With appropriate risk controls, we agree that lowering eligible credit rating threshold would help diversify investment portfolio by tapping more resilient issuers. Nevertheless, for factual validation, *staff may provide information on the size and nature of investments in these broadened potential markets and their performances during the ongoing pandemic.*

We find it reasonable to raise Group 2 assets limit from 35 to 40 percent on diversification ground, as it would provide greater flexibility in managing Tranche 1 and help improve the balance of credit and term risk premia. We also find the increase from the current implied maximum FI duration of around 2.5 years to 3 years to be acceptable and modest. Further, we agree to establish a numerical target in the IA Rules for expected return margin to guide the FI strategy's risk and return profile and *would appreciate staff's comments on how the proposed initial target margin compares to those of other IFIs given the current investment conditions.*

<u>**Trust Assets (TA)**</u>

We find it reasonable to maintain the PRGT's target return margin of 90 bps above the SDRi for the time being, in view of exceptionally high global demand for lending and the corresponding higher probability of investment return falling below the SDRi annually. We recommend that a revisit of the target be done in the next review. Meanwhile, we agree to the strategy for the SDFI component as an additional stand-alone investment option and *urge staff to explain further the rational for the 15 percent reduction in corporate bonds.*

<u>**Responsible Investing (RI)**</u>

We support the statement on the Principles on RI in Annex VII and agree that it is about time that we formalize its commitment in the IA rules and the TA guidelines. We encourage further work and progress updates on the establishment of a taxonomy on ESG investment, data requirements and reporting. We also urge the IOC to facilitate the development for future Board discussion of the best practices for the implementation of RI, especially on how to address data challenges. Moreover, we encourage staff to monitor how RI impacts the risk-return profile of the portfolios, and work with the ORM to assess their implications on Fund's risk management and mitigation measures. *Specific to the statement regarding exceptional cases, staff may comment on how this will be approached implementation-wise, for instance, where to draw the line for 'excessive reputational risk' and what will be appropriate communication strategy for the sake of transparency?*

We give merit for IOC to play an important role in developing bright-line rules such as asset exclusions or geographic restrictions and benchmarking to help with the assessment of compliance and for greater transparency. Clear rules also help ease the implementation of investment strategies. We underscore the importance of formulating the terms of reference for management as well as the measures to monitor and prevent potential conflicts of interests.

In between the staff's review of the framework on conflict of interest for IA and TA, we are open to an interim third-party review to ascertain the propriety of the changes in the investment strategies. A good check and balance by a third party serves well in strengthening credibility of Fund's investments and provides valuable insights on ways around assessing conflict of interest, particularly in rapidly evolving areas like digitalization as well as on the legal front