

SU/22/6

CONFIDENTIAL

January 20, 2022

The Acting Chair's Summing Up
Review of the Investment Account and Trust Assets Investment Strategy
Executive Board Meeting 22/3
January 12, 2022

Executive Directors welcomed the first concurrent review of the Fund's Investment Account and the Trust Assets Investment Strategy. They agreed with the proposed revisions to the Rules and Regulations for the Investment Account ("IA Rules") and the Guidelines for Investing PRG, PRG-HIPC, and CCR Trust Assets ("TA Guidelines").

Directors noted the continued strong and better than expected performance of the Endowment Subaccount (EA), which has exceeded its 3 percent real return objective. At the same time, the market outlook has become increasingly challenging, and the EA might face difficulties in meeting its real return target over an extended time horizon. Directors agreed with the proposal to retain the return target for the time being and to reassess it at the next 5-yearly review, although a few Directors thought that lowering the target could have been appropriate.

Directors broadly supported the continued evolution of the EA's investment strategy aimed at improving its return potential while maintaining long-term resilience. The proposed refinements would: (i) reduce the allocation to low yielding fixed-income assets and improve diversification within the fixed-income allocation; (ii) expand and diversify the allocation to real assets; and (iii) permit currency hedging for fixed-income securities denominated in emerging market currencies. In this context, a few Directors expressed concerns regarding the increased allocation to riskier assets and its potential effects on the overall risk profile of the portfolio. Directors also supported replacing the "core-satellite" model with a framework under which the Board would permit active management as well as investment in private markets for selected asset classes. Under this new framework, Directors broadly supported staff's proposal to gradually transition to active management for emerging market equities. A few Directors expressed caution regarding potential risks from this proposal, while a few others suggested exploring the scope to extend active management to other asset classes to support responsible investing.

For the Fixed-Income Subaccount ("FI"), Directors noted that the expanded strategy has been implemented effectively and has performed well in meeting its investment objective. Nevertheless, market conditions will limit future returns for fixed-income assets. Directors broadly agreed with the proposal to incorporate incremental refinements to the FI strategy to improve potential performance without materially altering the FI's overall risk profile. The proposed refinements include: (i) lowering the minimum eligible credit rating threshold; (ii) marginally increasing the Group 2 assets limit; (iii) delegating the selection of tranche-level benchmarks to the Managing Director and limiting portfolio duration to three

years as part of overall risk controls; and (iv) refining the definition of national agencies and supranational bonds. Directors also supported staff's proposal to establish in the IA Rules a numerical long-term target for the expected return margin of 50 basis points above the SDR interest rate (SDRi) to guide the desired risk-return profile of the FI. Some Directors noted the potential additional risk from lowering the minimum eligible credit rating threshold. Directors welcomed that additional risk controls will be put in place to ensure that the FI maintains a high overall credit quality and looked forward to reports on their application. A few Directors also emphasized the importance of continued Board oversight with respect to the delegation of the selection of benchmarks to the Managing Director.

For Trust Assets, Directors supported the proposal for limited refinements to the PRGT investment strategy while maintaining the investment strategy for other Trust Assets. Directors agreed with staff's proposal to maintain the PRGT's target return margin of 90 basis points above the SDRi rate. They also supported the proposal to decrease the corporate bond allocation and correspondingly increase the short-duration fixed-income component, which would also adopt an investment approach similar to the FI's. This refinement would augment the PRGT's reserve-like properties and improve portfolio resilience without materially changing the overall return outlook for PRGT. Directors agreed that the refined strategy for the short duration fixed-income component will be offered as an additional standalone investment option for contributor resources being invested for the PRGT.

Directors supported staff's proposal to formalize a commitment to responsible investing in the IA Rules and the TA Guidelines. This would include a requirement for the Managing Director to establish principles for responsible investing and to consult with the Executive Board on any material changes. The principles would guide how responsible investing supports the IA's and TA's financial objectives and upholds the Fund's reputation, while allowing practices to evolve over time as industry standards emerge. A few Directors stressed the need to clearly recognize climate risks and ensure that Fund investments are not directed to activities that are harmful to the climate. A few other Directors suggested exploring signing the UN Principles for Responsible Investing.

Directors appreciated the opportunity to review the conflict of interest framework for the IA and the TA. They took positive note that no conflicts have arisen since the prior review. Directors noted the results of staff's benchmarking exercise, which placed the Fund's framework well relative to its peers and identified two areas for potential refinement: (i) the formalization and strengthening by Management of the Designated Officer role performed by the Ethics Advisor; and (ii) the creation of bright-line rules by the Investment Oversight Committee to mitigate conflict risks for investments having a clear nexus to the Fund. Directors supported staff's future work in these areas.

Directors asked staff to report to the Board the implementation and impact of the agreed changes and to engage the Board when appropriate. Directors agreed to review the IA Rules, the TA Guidelines, and relevant conflict of interest policies in five years, or earlier if warranted by developments.