

BUFF/12/75

June 27, 2012

**The Acting Chair's Summing Up
Broadening the Fund's Investment Mandate—Additional Considerations
Executive Board Meeting 12/60
June 20, 2012**

Executive Directors welcomed the opportunity to continue the discussion on implementing the Fund's expanded investment authority through an endowment funded from the profits of limited gold sales. They broadly supported the proposed investment strategy and governance framework, and generally considered them adequate to reduce the main risks of actual or perceived conflicts of interest. Directors emphasized the need to move expeditiously to complete the remaining implementation issues this year.

Directors underscored that, given the Fund's central role in promoting global financial stability, strong protection against actual or perceived conflicts of interest involving the Fund's investment activities is critical. They agreed that the mitigating factors taken into account in the lead-up to approval of the new income model in 2008, including those identified in the context of an independent external review, remain valid to address conflicts of interest. In particular, Directors supported the proposed clear separation of responsibilities between the Executive Board, management, and external managers, as well as the exclusion of certain investment activities that by their very nature would be more susceptible to the appearance of conflict. They noted that the steps laid out in SM/12/111, including the outsourcing of specific investment decisions to external managers and the largely passive investment strategy, would further help prevent conflicts of interest.

Directors acknowledged that the 3 percent real return target, which had been endorsed by most Directors in the previous discussion, would be difficult to achieve in the near to medium term, given historically low yields on highly-rated government bonds. Nevertheless, and noting the long horizon of the endowment, most Directors considered it appropriate to retain long-term capital market assumptions to guide portfolio design, although a few were of the view that adopting a lower target for real return would be more prudent. Directors continued to support a strategic asset allocation along the lines of the "conservative diversified portfolio." They noted that the return target and the strategic asset allocation could be revisited in the future, with a few calling for more frequent reviews than the envisaged 3-5 years. Differing views were expressed with respect to allocation across asset classes and geographical diversification based on risk-return considerations. On balance, however, most Directors considered that the proposed portfolio provides a reasonable basis

for initiating the endowment, and could be adapted over time in light of experience and evolving market developments.

Directors agreed that the endowment's investment program should be phased in over a sufficiently long period of time to mitigate the risk of short-term losses. With a view to building a cushion and preserving the real value of the endowment, Directors also saw merit in a conservative approach to payouts in the early stages of implementing the endowment, and looked forward to further staff work in this area. A number of Directors pointed to the possibility of delaying the initiation of payouts if warranted.

As regards implementation arrangements for the investment strategy, Directors agreed that the endowment should build on the current approach used for the Investment Account. They supported using external managers with a mandate to track widely available benchmarks or, where warranted, appropriately customized benchmarks. Most Directors also supported active management for a very limited portion of the portfolio in cases of clear opportunities to add value, noting that this could also facilitate the evolution of the Fund's investment approach over time. While a few cautioned against taking such an approach at this stage, a few others saw scope for more active investment strategies. In order to ensure that the portfolio remains within the broad risk parameters to be adopted by the Board, Directors broadly supported a mechanistic, rules-based rebalancing of the portfolio to the strategic asset allocation. Most Directors supported the proposed policy bands that would trigger a portfolio rebalancing, although a few Directors preferred narrower bands and asked that staff revisit the width of the proposed bands.

Directors broadly supported the governance framework proposed in the staff paper, which builds on the current institutional arrangements. They agreed that the Board would continue to focus on strategic aspects of the Investment Account portfolios, determining their overall purpose, the strategic parameters for their operations, and reviewing regular financial reports for the Investment Account. With respect to the endowment portfolio, the Board would also determine its key strategic direction, including by setting its base currency and return target, strategic asset allocation and eligible and ineligible asset classes, and its spending policy. A few Directors called for greater Board engagement in the initial stages. A few Directors also saw merit in creating a Board-level committee to help the Board in the discharge of these duties.

Directors agreed that management would continue to have responsibility for implementing the strategy established by the Executive Board. Most also saw merit in management's establishment of an Investment Oversight Committee, with day-to-day responsibility left to the Investment Unit in the Finance Department. Some Directors encouraged the Fund to draw from the experiences of the Investment Office, which manages the Staff Retirement Plan.

Directors looked forward to staff proposals on the remaining strategic implementation issues, including the base currency of the endowment, the scope for currency hedging, the phasing of initial investments, the payout policy, and a possible minimum credit rating threshold. These and other relevant considerations should be embedded expeditiously into a proposal for new Rules and Regulations for the expanded investment authority of the Investment Account.