

SM/12/318
Supplement 1

CONFIDENTIAL

January 25, 2013

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Broadening the Fund's Investment Mandate—Proposed Rules and Regulations for the Investment Account—Decision**

Attached for the **records** of Executive Directors is the Secretary's understanding of the decision on the Rules and Regulations for the Investment Account, adopted at Executive Board Meeting 13/6 (1/23/13). A redlined version is also attached for the convenience of Executive Directors.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (2)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Broadening the Fund's Investment Mandate—Proposed Rules and Regulations for the Investment Account—Decision

January 23, 2013

1. The Rules and Regulations for the Investment Account adopted under Executive Board Decision No. 13711-(06/40), April 28, 2006 are repealed.
2. Pursuant to Article XII, Section 6(f)(iii), the Fund adopts the Rules and Regulations for the Investment Account that are set forth in the Annex to SM/12/318, Sup. 1 (1/25/13).

Annex: Rules and Regulations for the Investment Account

I. GENERAL PROVISIONS

Objective of the Investment Account

1. The objective of the Investment Account (IA) is to provide a vehicle for the investment of a part of the Fund's assets so as to generate income that may be used to meet the expenses of conducting the business of the Fund. Achieving this objective would help diversify the sources and increase the level of the Fund's income, thereby strengthening its finances over time.

Sources of Investment Account Assets

2. The IA may be funded with (a) currencies transferred from the General Resources Account (GRA) in accordance with Article XII, Section 6(f)(ii) of the Articles and (b) the placement of profits from the sale of pre-Second Amendment gold in accordance with Article V, Section 12(g) of the Articles, in amounts up to the total amount of the Fund's general and special reserves at the time of any decision authorizing such transfers; (c) the transfer of profits from the sale of post-Second Amendment gold in accordance with Article V, Section 12(k) of the Articles; and (d) income from the IA investment that is not transferred to the General Resources Account to meet the expenses of the Fund (Article XII, Section 6(f)(iv)).

Investment Account Subaccounts and Allocation of Assets

3. The IA shall have a Fixed-Income Subaccount, an Endowment Subaccount, and a Temporary Windfall Profits Subaccount, each of which has its own investment objective and shall be managed in accordance with Sections I and II, I and III, and I and IV, respectively, of these Rules and Regulations.

4. The assets of the IA in existence at the time of the effectiveness of these Rules and Regulations shall be allocated to the subaccounts as follows: (a) the Fixed-Income Subaccount shall be funded with the IA assets that are attributed to past transfers of currencies in accordance with Article XII, Section 6(f)(ii) of the Articles, and any retained income attributed to these assets; (b) the Endowment Subaccount shall be funded with (i) the IA assets attributed to profits from the sale of the holdings of the Fund's post-Second Amendment gold during 2009 and 2010 equivalent to an average sales price of US dollar 850 per fine ounce, (ii) any retained income attributed to these assets, and (iii) the retained income attributed to the SDR 0.7 billion of gold sales profits from the 2009 and 2010 gold sales at an average sales price above US dollar 850 per fine ounce that were transferred from the IA to the GRA on October 23, 2012 to fund a distribution of the Fund's general reserve; and (c) the Temporary Windfall Profits Subaccount shall be funded with IA assets attributed to profits of SDR 1.75 billion from the sale of the holdings of the Fund's post-Second

Amendment gold during 2009 and 2010 at an average sales price above US dollar 850 per fine ounce, and any retained income attributed to these assets.

5. Transfers of assets between subaccounts may be made with the approval of the Executive Board.

Responsibilities of the Managing Director

6. The Managing Director is responsible for implementing the investment policies for the IA set out in these Rules and Regulations.

7. In carrying out the Managing Director's responsibilities, the Managing Director shall (a) establish effective decision-making and oversight arrangements; (b) take the necessary measures, including the adoption of policies and procedures, that seek to avoid actual or perceived conflicts of interest; and (c) establish specific risk control measures and put in place mechanisms to monitor their observance by asset managers.

8. The Managing Director shall consult with the Executive Board regarding (a) the key conflict of interest policies and arrangements in the Managing Director's responsibility referred to in paragraph 7 and (b) the key aspects of the investment strategy for the actively-managed portion of the Endowment Subaccount referred to in paragraph 23 of these Rules and Regulations.

9. The Managing Director shall provide semi-annual reports to the Executive Board on the investment activities of the IA. Ad hoc reports shall be prepared as warranted by market or other developments.

External Managers

10. All assets of the IA shall be managed by external managers, except as otherwise set forth in these Rules and Regulations. The Managing Director shall only select external managers of the highest professional standards, in particular excellent compliance records, strong market reputation, and with sound investment processes. In selecting managers for passively-managed assets, the Managing Director shall take into account their ability to replicate selected benchmarks with minimal tracking error and cost, and in selecting managers for actively-managed assets, their proven skills and track record in generating excess returns after fees.

Custody Arrangements

11. The assets of the IA shall be held in safekeeping by one or more custodian banks or the Bank for International Settlements (BIS). The custodian(s) shall hold the assets of the IA in safekeeping, periodically value the assets held, and hold and invest short-term residual cash balances.

Use of Investment Account Income

12. The income from investment shall be invested, retained in the IA or used to meet the expenses of conducting the business of the Fund. The Fund shall decide on the use of the IA's income for each financial year, including whether any portion of such income will be transferred to the GRA for use in meeting the expenses of conducting the business of the Fund, provided that income generated from the Endowment Subaccount shall not be used in meeting the expenses of conducting the business of the Fund pending the completion of the phasing period for the passively-managed portion of the Endowment Subaccount specified in paragraph 30.

Termination or Reduction of the Investment Account

13. The IA shall be terminated in the event of a liquidation of the Fund and may be terminated, or the amount of the investment may be reduced, prior to the liquidation of the Fund by a 70 percent majority of the total voting power. The procedures specified in Article XII, Sections 6(f)(vii), (viii) and (ix) of the Articles will apply in the event of the termination of the IA or a reduction in its assets. The Fund's decision to reduce investments in the IA shall specify the subaccount from which assets shall be used to fund a reduction in investments.

Audit

14. The assets of the IA shall be audited by the Fund's external auditors and included in the Fund's annual financial statements.

Review of the Rules and Regulations and Conflict of Interest Policies

15. The Executive Board shall review these Rules and Regulations at least every 5 years.

II. FIXED-INCOME SUBACCOUNT

Investment Objective

16. The investment objective of the Fixed-Income Subaccount is to achieve investment returns that exceed the SDR interest rate over time while minimizing the frequency and extent of negative returns and underperformance over a 12-month investment horizon. The assets in the Fixed-Income Subaccount shall be managed against the 1-3 year government bond benchmark, weighted to reflect the currency composition of the SDR basket.

Eligible Investments

17. The assets of the Fixed-Income Subaccount may be invested only in marketable obligations of members or in marketable obligations of international financial institutions. Marketable obligations of a member shall include the obligations of its central bank and

official agencies. Marketable obligations of international financial organizations shall include without limitation deposits with the BIS and Medium-Term Instruments (MTIs) issued by the BIS. IA investments in the instruments specified above may only be made directly in the cash markets. Hedging is prohibited, as is the use of derivative instruments (including forwards, futures, options and swaps), short selling, or any form of financial leverage. Investments are limited to eligible investments that are denominated in SDRs or in the currencies included in the SDR basket.

18. Government and government agency bonds in which the Fixed-Income Subaccount invests shall be subject to a minimum credit rating by a major credit rating agency equivalent to A (based on Standard & Poor's rating scale). If the respective rating threshold is breached, assets shall be divested within three months from the rating downgrade.

Investment Arrangements

19. The assets of the Fixed-Income Subaccount shall be managed by external managers, provided that assets may also be invested by the Managing Director in marketable obligations of the BIS. The investment mandates for external managers shall provide for active management against the 1-3 year government bond benchmark within risk parameters established by the Managing Director. Investments in BIS obligations shall be guided by the 1-3 year government bond benchmark.

III. ENDOWMENT SUBACCOUNT

Investment Objective

20. The investment objective of the Endowment Subaccount is to achieve a long-term real return target of 3 percent in U.S. dollar terms. This is consistent with the objective of generating investment returns to contribute to the Fund's income, while preserving the long-term real value of these resources. The subaccount's real return shall be calculated by using the deflator that is used for purposes of the Fund's administrative budget, the Global External Deflator (GED), provided that the U.S. consumer price index (US CPI) component of the GED shall be adjusted to use the actual US CPI instead of the projected US CPI.

Strategic Asset Allocation and Investment Strategy

21. No less than 90 percent of the Endowment Subaccount assets shall be managed passively (the "passively-managed portion") under mandates that require the external managers to closely track benchmark indices selected by the Managing Director, with up to 10 percent of the Endowment Subaccount assets managed actively in accordance with paragraph 23 below (the "actively-managed portion"). Upon effectiveness of these Rules and Regulations, an amount equivalent to 95 percent of the Endowment Account assets shall be allocated to the passively-managed portion and an amount equivalent to 5 percent to the actively-managed portion.

22. The passively-managed portion shall be invested pursuant to the following strategic asset allocation (SAA) benchmark: 20 percent in developed market sovereign bonds; 20 percent in developed market inflation-linked bonds; 15 percent in developed market corporate bonds; 10 percent in emerging market bonds; 25 percent in developed market equities; 5 percent in emerging market equities; and 5 percent in real estate investment trusts (REITs).

23. The actively-managed portion may be invested only in the same asset classes as the SAA benchmark for the passively-managed portion, with a 65 percent share of fixed-income instruments and a 35 percent share for equities (including REITs) but no specific allocation requirements for each asset class within these two categories. The Managing Director, in consultation with the Executive Board, shall determine the investment strategy and investment arrangements for the actively-managed portion of the Endowment Subaccount, including the selection criteria and risk parameters for external managers, benchmark indices, the scope and instruments for currency hedging, the phasing of the actively-managed portion of the Endowment Subaccount, policy bands and rebalancing procedures, and additional key measures to avoid actual or perceived conflicts of interest.

24. The asset allocation benchmarks for both the passively- and actively-managed portions above shall not apply to temporary holdings of cash, bank deposits or short-term investments in cash instruments.

Rebalancing of the Passively-Managed Portion

25. The passively-managed portion of the Endowment Subaccount shall be rebalanced to the SAA benchmark (a) annually, either in the context of implementing the Fund's annual income disposition decisions or, absent such disposition decisions affecting the Endowment Subaccount, at end-July of each year, and (b) when the actual weight of any of the asset classes of developed market sovereign bonds, developed market corporate bonds, developed market inflation-linked bonds or developed market equities deviates by more than 8 percentage points from the SAA benchmark, or by more than 4 percentage points for any of the asset classes of emerging market bonds, emerging market equities, and REITs. A scheduled annual rebalancing under (a) shall not take place if a rebalancing under (b) is completed within three months prior to that scheduled annual rebalancing.

Prohibited Investment Activities

26. Short selling and any form of financial leverage as well as direct investments in gold are not permitted for the Endowment Subaccount. Derivative instruments, including options, forwards, futures and swaps, are only allowed for hedging operations authorized under these Rules and Regulations or to minimize transaction costs in the context of subaccount rebalancing and benchmark replication.

Currency Hedging

27. The exchange rate risk for fixed-income instruments denominated in developed market currencies *vis-à-vis* the U.S. dollar shall be hedged for the passively-managed portion of the Endowment Subaccount. Permitted hedging instruments include, but are not limited to, currency forwards, futures, swaps, and options. Currency hedging is not permitted for other assets of the passively-managed portion of the Endowment Subaccount. Hedging by external managers of the actively-managed portion of the subaccount is permitted, but not required, as determined by the Managing Director in accordance with paragraph 23 above.

Minimum Credit Ratings for Bonds and Divestment

28. The Endowment Subaccount shall only invest in bonds that have the following minimum credit ratings by a major credit rating agency: for sovereign bonds, a rating equivalent to BBB+ (based on Standard & Poor's rating scale); and, for corporate bonds, a rating equivalent to BBB- (based on Standard & Poor's rating scale). If the respective rating threshold is breached, assets shall be divested within three months from the rating downgrade.

Investment Management Arrangements

29. The assets of the Endowment Subaccount shall be managed by external managers within mandates established by the Managing Director in accordance with these Rules and Regulations. The Managing Director is authorized to manage Endowment Subaccount assets (a) during the phasing of the Endowment Subaccount in accordance with paragraph 30 of these Rules and Regulations, and (b) on an interim basis where this is necessary following the termination of a manager and pending the transfer of the assets to a new manager.

Phasing of Initial Investments

30. The investment of the passively-managed portion of the Endowment Subaccount shall be phased over a three-year period, with equal amounts to be made available to external managers for investment at quarterly intervals. In case of exceptional market conditions, the Managing Director may decide to suspend the phasing or extend this period by up to one year, and to adjust the quarterly installments accordingly. With respect to the actively-managed portion, the phasing of investments shall be decided in the context of the investment strategy in accordance with paragraph 23 of these Rules and Regulations. Pending investment in accordance with the rules for the passively- and actively-managed portions of the Endowment Subaccount, the assets of the Endowment Subaccount shall be invested in accordance with paragraphs 17 to 19 of these Rules and Regulations, provided that the investment objective for these amounts shall be nominal capital preservation while generating income.

IV. TEMPORARY WINDFALL PROFITS SUBACCOUNT

31. The assets of the Temporary Windfall Profits Subaccount shall be invested, pending their use in accordance with Executive Board Decision No. 15228-(12/95), adopted September 28, 2012, in accordance with paragraphs 17 to 19 of these Rules and Regulations, provided that the investment objective of this subaccount shall be nominal capital preservation while generating income.

32. The Temporary Windfall Profits Subaccount shall be terminated after the transfer in accordance with Executive Board Decision No. 15228-(12/95) has been completed. Any remaining assets, including any retained income, shall be transferred to the Endowment Subaccount for investment.

ATTACHMENT

REDLINED VERSION*

INTERNATIONAL MONETARY FUND

Broadening the Fund's Investment Mandate—Proposed Rules and Regulations for the Investment Account—Decision**January 23, 2013**

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2. Pursuant to Article XII, Section 6(f)(iii), the Fund adopts the Rules and Regulations for the Investment Account that are set forth in the Annex to SM/12/318, Sup. 1 ~~(12/28/12)~~(1/25/13).

* Redlined version is relative to the text of the Annex set forth in SM/12/318 (12/28/12), as corrected in SM/12/318, Cor. 1 (1/23/13).

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Sources of Investment Account Assets

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Eligible Investments

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official agencies. Marketable obligations of international financial organizations shall include without limitation deposits with the BIS and Medium-Term Instruments (MTIs) issued by the BIS. IA investments in the instruments specified above may only be made directly in the cash markets. Hedging is prohibited, as is the use of derivative instruments (including forwards, futures, options and swaps), short selling, or any form of financial leverage. Investments are limited to eligible investments that are denominated in SDRs or in the currencies included in the SDR basket.

18. Government and government agency bonds in which the Fixed-Income Subaccount invests shall be subject to a minimum credit rating by a major credit rating agency equivalent to A (based on Standard & Poor's rating scale). If the respective rating threshold is breached, assets shall be divested within three months from the rating downgrade.

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Currency Hedging

27. The exchange rate risk for fixed-income instruments denominated in developed market currencies *vis-à-vis* the U.S. dollar shall be hedged for the passively-managed portion of the Endowment Subaccount. Permitted hedging instruments include, but are not limited to, currency forwards, futures, swaps, and options. Currency hedging is not permitted for other assets of the passively-managed portion of the Endowment Subaccount. Hedging by external managers of the actively-managed portion of the subaccount is permitted, but not required, as determined by the Managing Director in accordance with paragraph 23 above.

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