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de las
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para la
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Agricultura

FINANCE COMMITTEE

Hundred and Forty-eighth Session

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Report on Investments 2012

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EXECUTIVE SUMMARY

- **Long-Term Investments:** This USD 373 million portfolio represents the accumulated assets set aside over a period of decades to fund the Organization's share of staff-related liabilities, which amount to 1.252 USD billion at 31 December 2012. The liabilities are comprised of: Staff Compensation Plan, Separation Payment Scheme, After Service Medical Coverage (ASMC) and the Termination of Service Payment Scheme. Invested assets are 50% in Equities and 50% in Fixed Income securities. In 2012 the long term portfolio yielded an excellent return of 13.79 % thanks to the remarkable Equity portfolio performance for the year. The long term portfolio benchmark return was 11.19%.
- **Short-Term Investments:** This USD 850 million portfolio represents mainly unspent Trust Fund balances held pending disbursements on project implementation. Funds are diversified as to type and holdings among five specialized asset managers. FAO's prudent , low risk investment style and the continuing near zero interest rate environment in 2012 kept returns very low, with a total return of 0.27% for the year. However, this exceeded the benchmark return by 0.22 %.
- **Investment Governance:** The investment policy of Short Term investments as fully described in annex 1 to this document, is designed in close collaboration with the Organization's technical advisor, the World Bank. Every few years, a detailed Asset and Liability study (ALM) is done by an external advisor on long-term assets. The last was completed at end December 2008. The asset allocation recommendations are reviewed and commented on by the internal Investment Committee and the external Advisory Committee on Investments with final authorization on implementation taken by the Director General.

GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

- The Finance Committee is invited to take note of this information document.

Draft Advice

- **The Finance Committee takes note of the Report on Investments 2012.**

BACKGROUND

1. This document is submitted to the Finance Committee for information, in accordance with Financial Regulation IX, which provides, in part, as follows: *“The Director-General may invest monies not needed for immediate requirements seeking, wherever practicable, the advice of an Advisory Committee on Investments. At least once a year the Director-General shall include in the financial statements submitted to the Finance Committee a statement of the investments currently held.”*

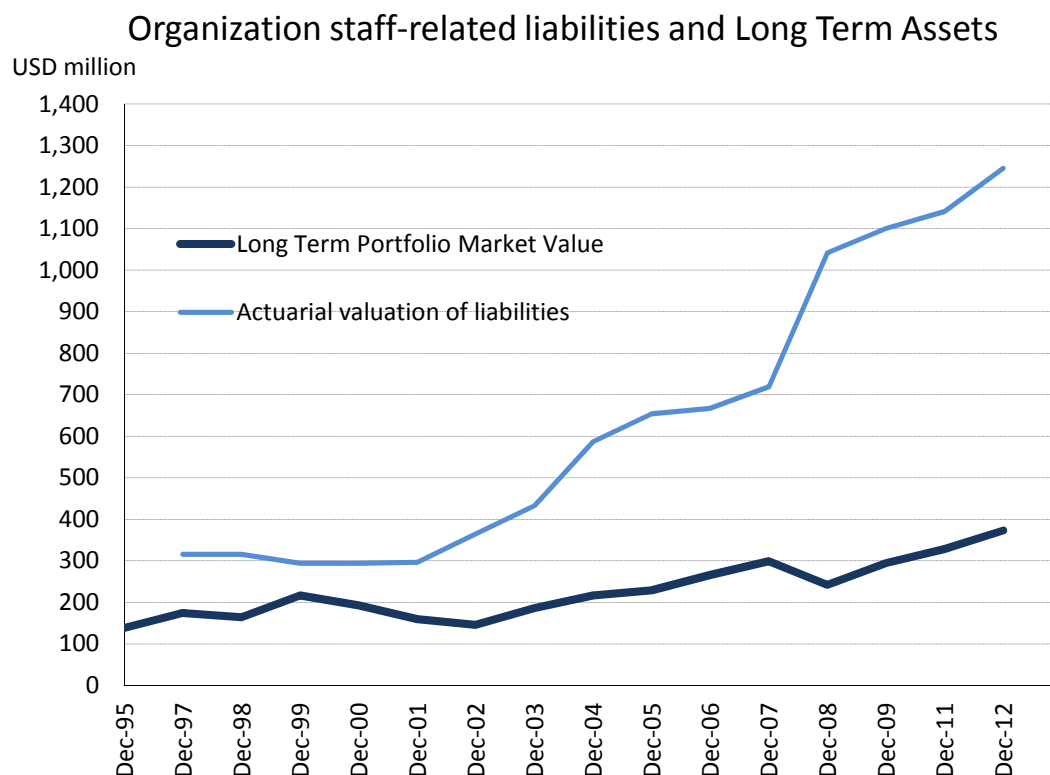
Long-Term Investments

2. The long-term investment portfolio represents an accumulation in the value of securities and re-invested income over more than 30 years.

3. The principal objective of the portfolio is to fund the Organization’s share of staff-related liabilities:

- 1) Staff Compensation Plan – Provides benefits in the event of injury, illnesses or death attributable to the performance of official duties.
- 2) Separation Payment Scheme – In conformity with the Flemming principle adopted in the UN system regarding local employment conditions, this scheme for General Service staff is similar to the separation scheme provided under Italian labour legislation.
- 3) After Service Medical Coverage (ASMC) – A medical insurance plan for eligible retired staff and their families where the cost of insurance is shared between the retiree and the Organization.
- 4) Termination of Service Payment Scheme – Consists of benefits payable to staff upon separation from service; Repatriation Grant, Repatriation Travel and Removal, Commutation of Accrued Leave, Termination Indemnity.

4. The chart below shows the evolution of the long-term investment portfolio since 1995 for market values compared to the actuarial valuations of the staff-related liabilities (from 1997).



5. An actuarial valuation of these liabilities has been performed each biennium since 1996-97. The last valuation as of 31 December 2012, carried out by a specialized firm, placed the Organization's share of total staff-related liabilities at USD 1.252 billion, above the figure for 2011 of USD 1.144 billion. Staff-related liabilities are under review by the Finance Committee in document FC 148/5 - *2012 Actuarial Valuation of Staff Related Liabilities*.

6. The latest actuarial estimation of all staff-related liabilities included USD 1.062 billion representing the liability of After Service Medical Coverage (ASMC). The Conference authorized biennial funding towards the past-service ASMC liability of USD 14.1 million in 2012-2013. The same amounts were authorized in 2004-2005, 2006-2007, 2008-2009, and 2010-2011.

7. The ASMC Funding for 2012-2013 was assessed in both EUR (67%) and USD (33%) in line with the currency mix of the liability. As agreed by the Finance Committee, assessed funds were transferred into the investment portfolio based on the percentage of total Member contributions actually received. Following this methodology, USD1.221 million and EUR 2.081 million were transferred to the long term portfolio in 2012.

8. The asset allocation of the portfolio provides for a 50/50 ratio between equities and bonds. The actual allocation at market value at 31 December 2012 was as follows:

2012 Long Term Portfolio Asset Allocation

Manager	% Portfolio	Assets
Equity		
PanAgora AM	50.40%	188,169,111.47
Fixed Income		
LGT AM	24.80%	92,592,546.33
FFTW AM	24.80%	92,593,654.91
TOTAL Fixed Income		185,186,201.24
TOTAL PORTFOLIO		373,355,313

9. Rebalancing of the funds occurs at month end if the ratio is out of balance by more than 5%. When possible, active rebalancing by FAO Treasury using ASMC contributions is carried out.

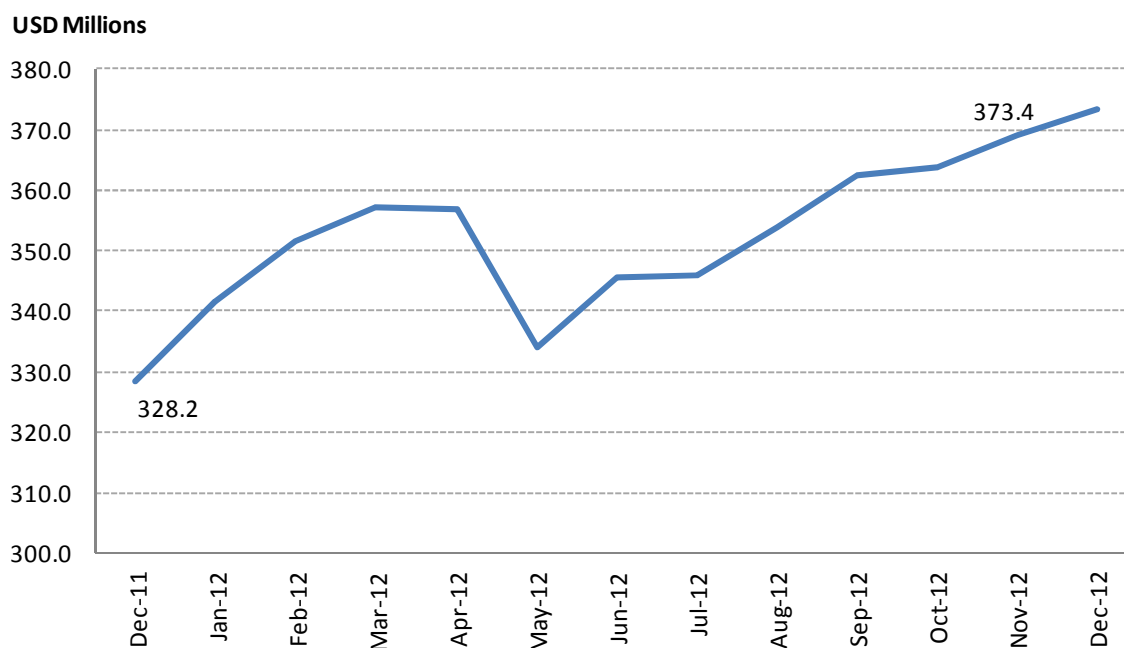
10. The measurement of performance is by comparison to the following benchmarks:

- For the equity portfolio: The Morgan Stanley Capital International Inc All Country Index
- For the fixed income portfolio: A blend of 80% Barclays World Government Inflation Linked Bonds Index + 20 % and Merrill Lynch EMU Direct Government AAA Bonds Index

11. These benchmarks fairly represent the geographical and sector allocation of the portfolio and have been reviewed by the Investment Committee and by the Organization's investment technical advisor, the World Bank.

12. The Chart below illustrates the evolution of the long-term investment portfolio in 2012.

2012 - Long Term Portfolio Market Values



13. Movements in the long-term portfolio during the year are summarized below. Non-USD values are expressed in USD using the exchange rate valid at 31 December 2012.

CASH FLOW 2012	Amount USD
Market Value 31/12/2011	328,209,082.58
Net variance of unrealized gain/loss	32,742,450.40
Realized gain/ loss	2,800,575.29
Income, dividends and interest	7,888,757.32
Management, custodial and advisory fees -	2,278,681.37
ASMC Funding	3,945,713.98
Accrued income change	47,414.61
Market Value at 31/12/2012	373,355,313

- a) It should be noted that equity investments are reported in USD, while fixed income investments are reported in EUR. Therefore, in order to obtain an overall return, fixed income returns were converted to USD. Consequently, the combined return reflects both the returns of the two funds and the currency effect of USD/EUR movements over the

year. This combined return in 2012 for the long term funds expressed in USD was 13.79% versus 11.19% for the benchmark.

2012 Long Term Portfolio Performance

Equity USD		
Manager	PanAgora AM	19.31%
Benchmark	MSCI World Index	15.83%
Fixed Income EUR		
Manager	Western AM and transition*	3.44%
	LGT AM*	1.66%
	FFTW AM*	1.63%
	TOTAL Fixed Income	5.08%
Benchmark	80% Barclays World Gov't Inflation Link'd +20% Merrill Lynch EMU Direct Gov't AAA Bond Index	5.94%
Total Portfolio Return USD		
Portfolio return (weighted average of equity and fixed income portfolios)		13.79%
Benchmark (weighted average of equity and fixed income benchmarks)		11.19%
Excess Return		2.60%

* The performance of Western AM is evaluated until 31.05.2012 (this figure included returns in the transition period), i.e. until disinvestment in favour of LGT AM and FFTW, the latter's performance is calculated from 01.06.2012.

Notes:

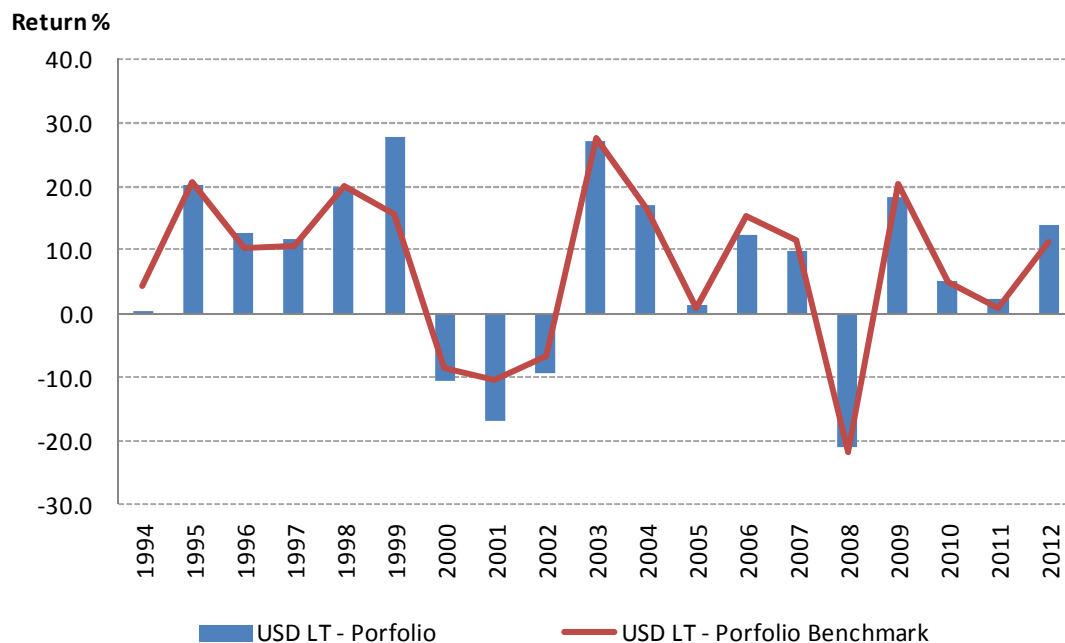
Equity Returns based in USD

Fixed Income returns based in EUR

Combined returns based in USD

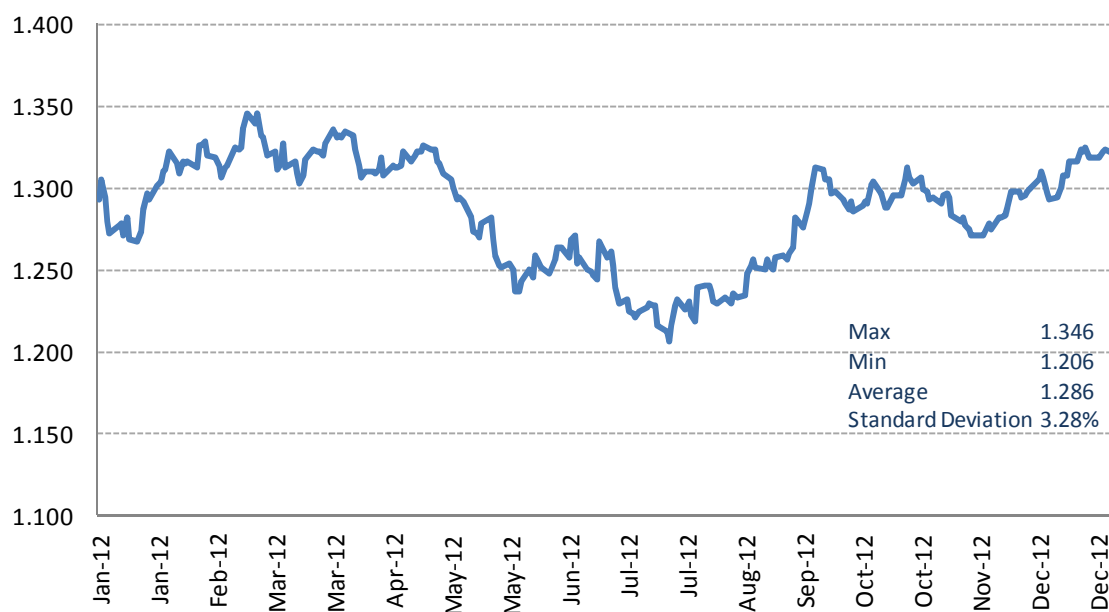
b) Yearly performance figures of the long-term portfolio from 1994-2012 are shown below.

Long Term Portfolio performance vs. benchmark since 1994



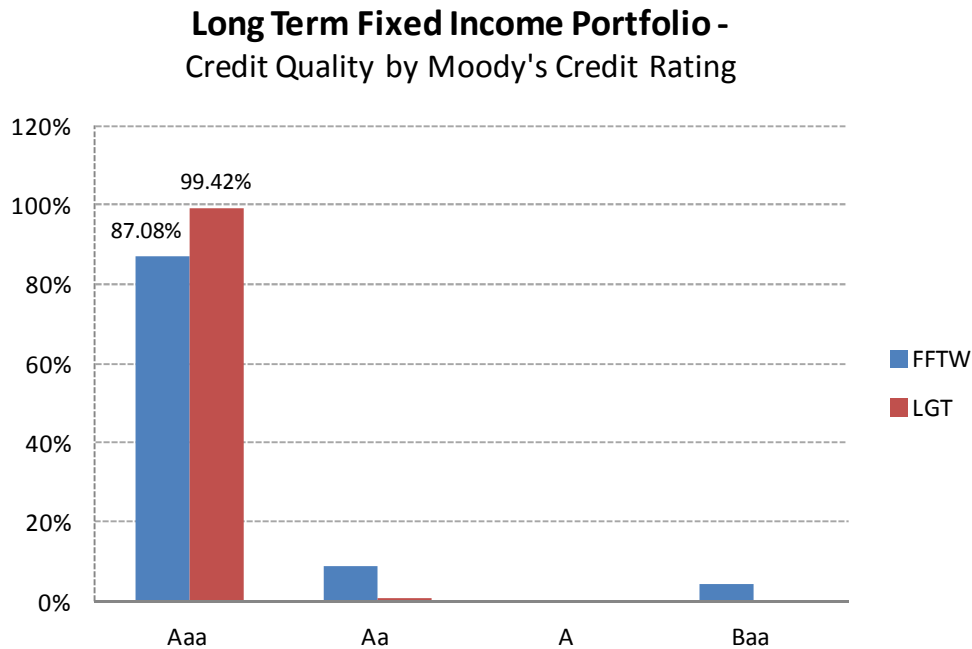
c) The chart below illustrates the movements in the USD/EUR rate over the course of 2012. USD/EUR volatility was less than in previous years. However, movement in the value of the EUR has a direct effect on USD measured returns.

EUR USD Exchange Rate in 2012

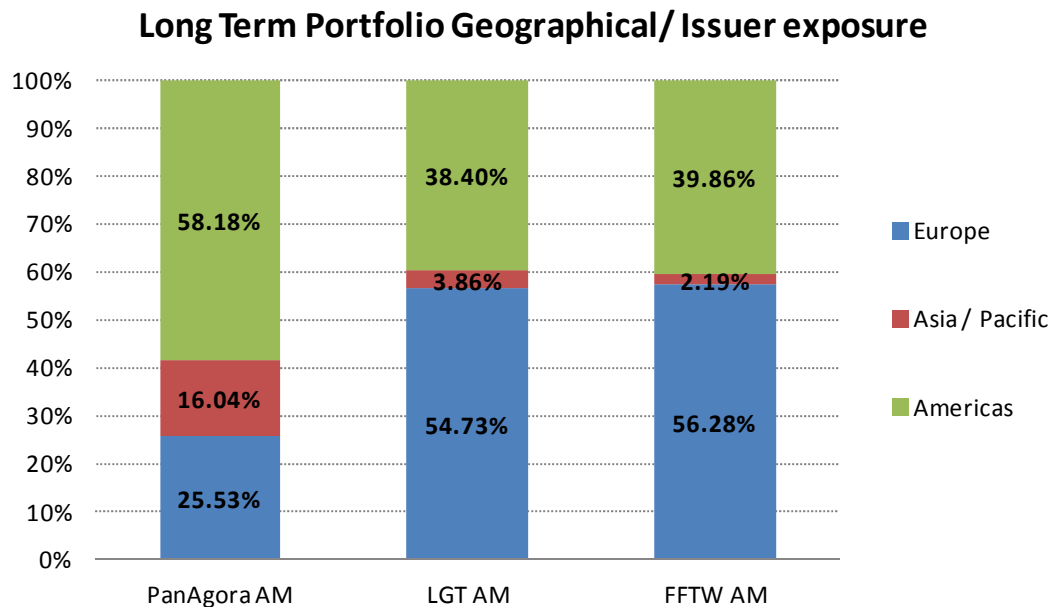


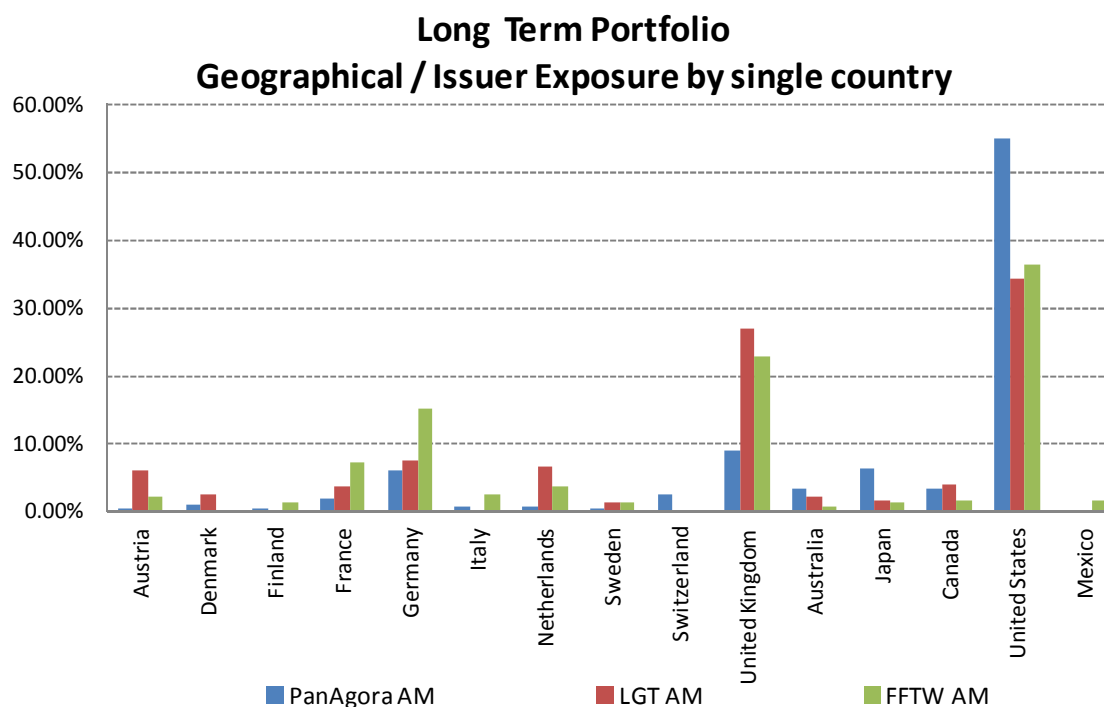
Source: Bloomberg

14. The chart below provides a breakdown of the assets in the long-term fixed income portfolio by credit quality. During the year, the percentage of assets in Aaa rated securities increased to 94 % as the Organization continued to reduce the risk profile of the portfolio given the persistently adverse conditions of financial markets.



The Long Term Portfolio's geographical exposure is analyzed below: the graphs show the funds' exposure by geographical area by single country. The exposure to peripheral European countries is very limited.





Short-Term Investments

15. Short-term investments consist largely of Trust Fund deposits held pending disbursements on project implementation and any cash representing the reserves of Regular Programme and other assets. The investments are managed by asset managers specialised in short-term investments: Wellington Management, the Northern Trust Company, HSBC and the World Bank or invested in deposits with the Bank for International Settlements.

The market value (in USD) in the short-term portfolios is illustrated below:

	At 31 December 2011	At 31 December 2012
Wellington AM	182,549,630.00	183,014,678.34
NT Government Select fund	171,925,600.00	1,532,341.26
HSBC EUR Liquidity Fund	10,796,349.00	9,751,049.21
Bank for International Settlements	300,003,194.00	455,035,019.44
World Bank	199,840,641.00	200,464,836.78
Total	865,115,414.00	849,797,925.03

16. During 2012, the Organization continued to keep a very low risk exposure of its short-term assets in light of the ongoing volatility and insecurity of financial markets and the very low interest rates in USD.

Specifically:

- a) Wellington Management: the Organization continued to impose very restrictive guidelines allowing only investments in very low risk instruments or instruments fully guaranteed by the US Government such as United States (us) Treasury Bills, US government agencies' and US government backed securities.
- b) Northern Trust: Holdings in the Northern Trust Government Select Fund offer relative safety as they are substantially (and at least 80 %) securities issued or guaranteed as to principal and interest by the U.S government or by its agencies, instrumentalities or sponsored enterprises.
- c) HSBC EUR Liquidity Fund: The Organization has traditionally had limited cash balances in EUR due to delays in the receipt of contributions. Consequently, balances invested in EUR remained proportionally low throughout 2012.
- d) BIS: Continuation of high level deposits at the BIS in view of its outstanding credit quality arising from its structural integration with 50 central banks and monetary authorities.
- e) World Bank : This portfolio has with restrictive guidelines and tight risk limits allowing only investments in government securities, government agencies, other official entities and multilateral organization securities and high ranked bank and other financial institution obligations.

17. The end result of such risk mitigating measures implies that the majority of FAO's short- term investment portfolio is currently secured in very low risk instruments.

18. The performance of short-term portfolios during the course of 2012 was dominated by the extreme low interest environment for very low risk USD investments. The overall performance was 0.27 % for the year.

2012 Short Term Portfolio Performance

Actively Managed

Manager	Wellington AM	0.42%
Benchmark	Merrill Lynch 3-Month T-Bills	0.11%
Excess Return		0.31%

Manager	World Bank	0.54%
Benchmark	BofA Merrill Lynch U.S. Treasury Notes & Bonds, 0-1 Yr Index	0.18%
Excess Return		0.36%

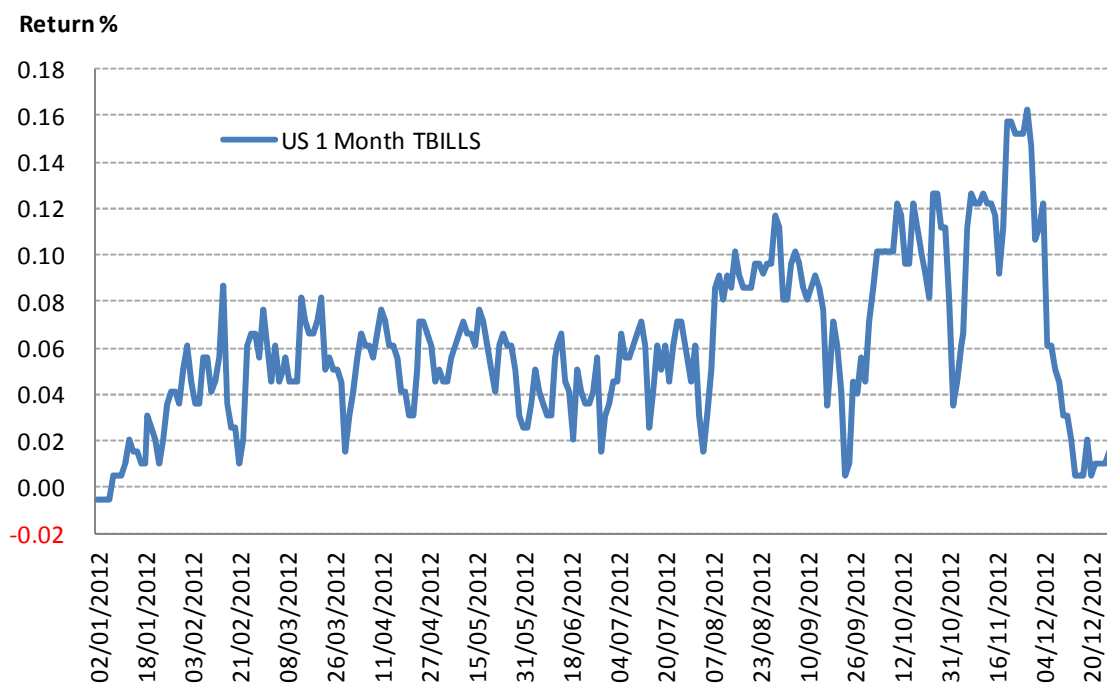
Deposits and Liquidity Funds

Manager	HSBC Liquidity Fund	0.00%
	Northern Trust Liquidity Fund	0.01%
Institution	BIS	0.10%
Benchmark	1-month TBILLS	0.05%

Total Portfolio Return

Portfolio return (weighted average)	0.27%
Benchmark (1 month TBILLS)	0.05%
Excess Return	0.22%

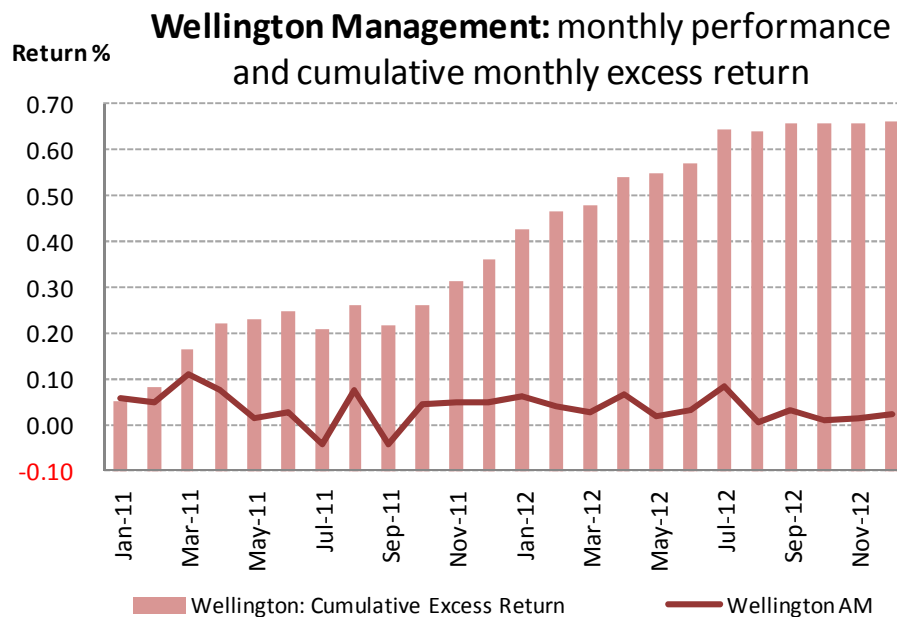
The annual returns for 1 T BILLS in 2012 are graphed below for further comparison.



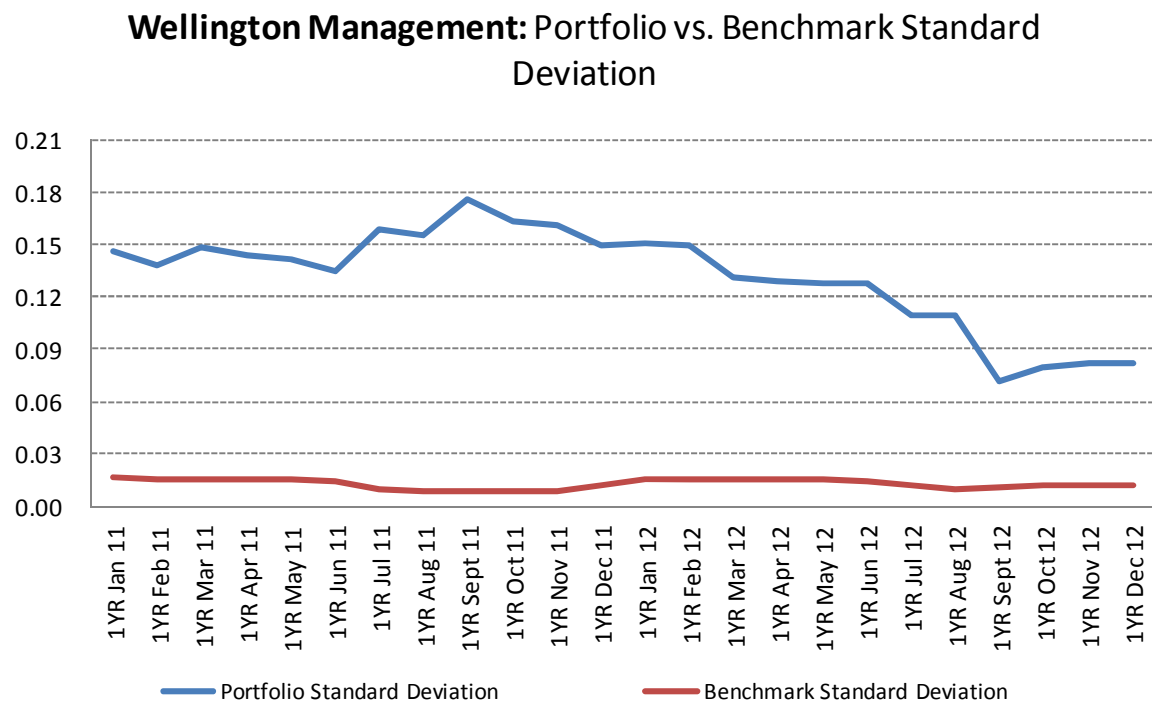
Short-Term Portfolio 2012 Excess Returns and Standard Deviation

19. The review of Short Term Investments includes an analysis of our two short duration managers, Wellington Management and the World Bank ' returns and standard deviation vs. Benchmark.

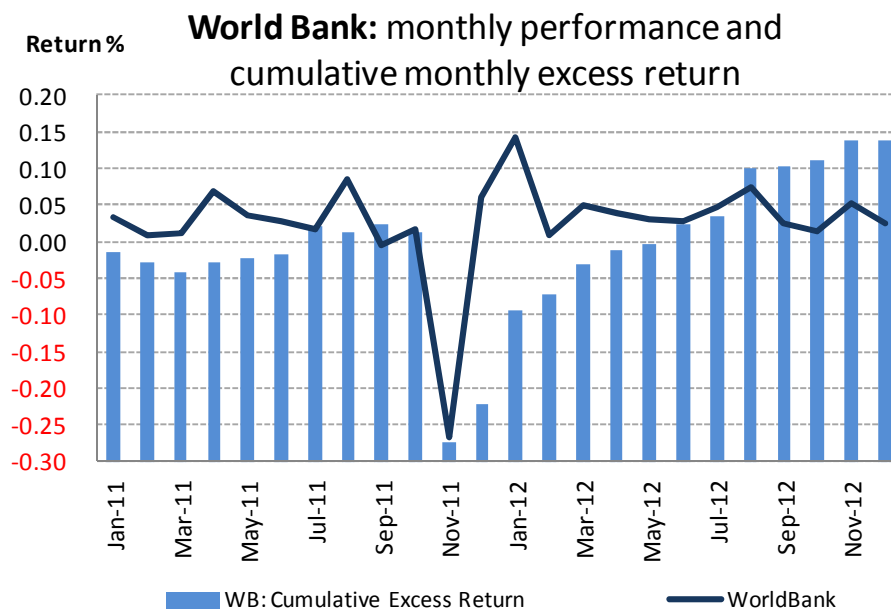
20. Monthly returns and cumulative monthly excess returns are graphed over the past two years, 2011 and 2012, as shown below. Also graphed below is the portfolio's standard deviation vs. that of its benchmark.



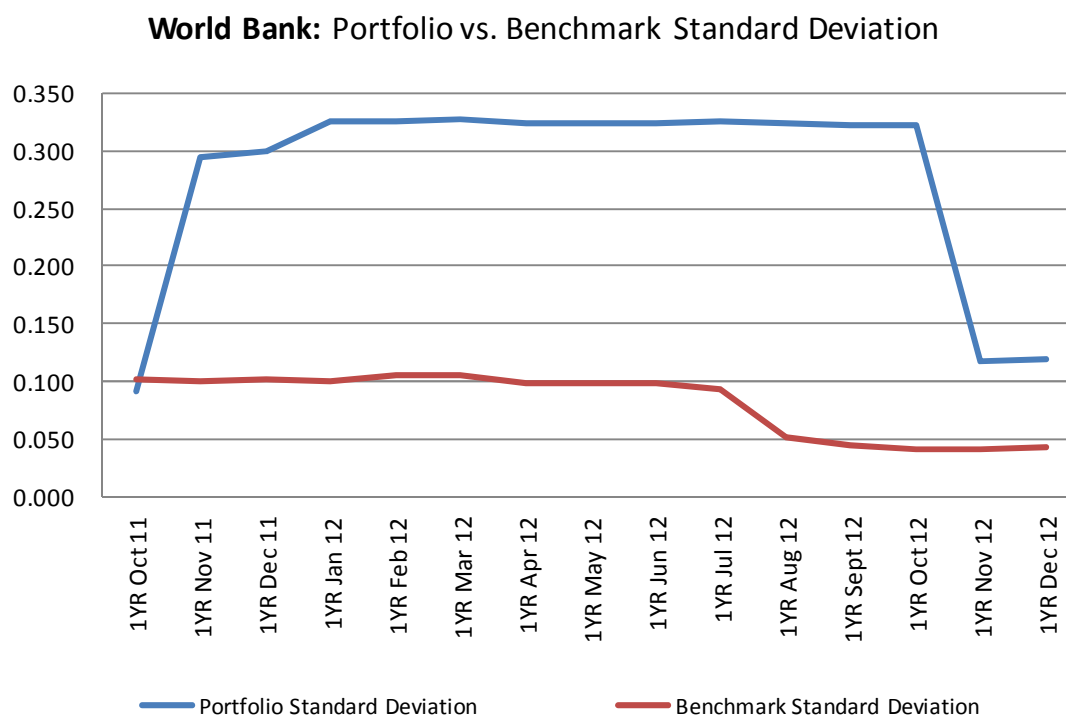
21. Over the two years, Wellington has provided constant excess returns, exceeding its benchmark almost all months, over the two years, excess returns totalled 0.66% . As shown below, the standard deviation of this portfolio has also been quite constant, approximately 0.12% above the standard deviation of its benchmark, Merrill Lynch 3-Month T-Bills.



22. The World Bank portfolio's excess return profile is less constant given one of the assets in the portfolio, representing 2.50% of market value, i.e. 5 MLN USD, experienced a downgrade in November 2011 and caused the portfolio returns to plummet. Excess returns recovered only 6 months later and reached approximately 0.15% over the two years as shown in the graph below.



23. Portfolio standard deviation was also affected by the asset's downgrade, the fall in returns caused the portfolio's standard deviation to move away from the benchmark standard deviation. Towards the end of the two year period, standard deviation is closer to the benchmark's standard deviation as returns have moved closer to their average value, as shown in the graph below.



Investment Governance at FAO

24. A detailed strategic asset allocation review for Long Term investments is conducted by specialized firms within the context of an Asset and Liability study (ALM). Reviews are conducted approximately every five years. A last study was undertaken and finalized in December 2008.

25. Short Term asset allocation strategies are designed in close collaboration with FAO's technical investment advisor, the World Bank.

26. The results of asset allocation studies are reviewed by FAO's internal Investment Committee. Final recommendations are forwarded to the Director General for approval. The Investment Committee is made up of the heads of finance, budget, legal, audit, the treasurers of IFAD and WFP and is chaired by the ADG of Corporate Services (CS).

27. The Organization also seeks investment advice from the Advisory Committee on Investments in accordance with Financial Regulation 9.1. The ACI is an external committee composed of high level experts from organizations such as World Bank, IMF, BIS and the African Development Bank. The World Bank also serves as the Organization's technical investment advisor.

28. The management of assets in the equity and fixed-income markets is carried out by specialized external asset managers in accordance with FAO's detailed written guidelines. These managers are chosen through open, international call for tenders with a final selection process carried out with the assistance of the World Bank.

29. Day-to-day control over the external managers, including daily compliance monitoring, is done by the Organization's Treasury Branch in Finance Division. The Treasury unit also provides regular reporting to the Director of Finance, internal Investment Committee and Senior Management.

On-site compliance visits to the external asset managers and the securities custodian are carried out by Finance Division annually.

30. The addition of a professional officer, as approved by the Finance Committee in its 140th Session (document CL 143/8), was finalized in October 2012.

31. Finally, a detailed report on FAO's investments is provided annually to the Finance Committee. This report is available on internet website of the Finance Committee.

32. The Investment Policy (for Short Term Investment) is provided in Annex 1.

Investment Expenses

33. The investment expense ratio slightly increased both in percentage and actual terms, from 0.17% in 2011 to 0.23% in 2012.

The main reason for this modest increase is the exceptional performance of the long term equity portfolio managed by PanAgora Asset Management. The substantially higher management fee for the year included a performance fee linked to the outstanding excess return achieved by the manager.

Total invested assets slightly increased from 1.193 billion in 2011 to 1.22 billion USD.

Investment Service Provided	2012 Expenditures in USD
Management, custodial and advisory fees	2,278,681.37
Treasury staffing (three professional posts)	493,746.00
Bloomberg Terminal	19,760.70
Advisory Committee on Investments Meetings	20,288.00
Annual Investor Compliance Meetings, Treasury Training	-
Total Expenses	2,812,476.07
Total Assets	1,223,153,237.84
Total Expense Ratio	0.23%

FAO Rome Investment Policy (for Short-Term Investments)

Purpose

The purpose of this policy is to set out the principles and broad parameters of investment of funds entrusted to FAO (the 'Organization'), which are not immediately required in programme implementation (the 'short term investments'). Investment of funds relating to the Employee Benefits Fund will be made separately, pursuant to the recommendations of an asset-liability management (ALM) study which will be done on a regular basis, but at least once every six years.

Authority

This Investment Policy is developed pursuant to Financial Regulation IX 9.1 which states that "The Director General may invest moneys not needed for immediate requirements seeking, wherever practicable, the advice of an Advisory Committee on Investments composed of not less than three and not more than five members appointed by the Director-General from persons outside the Organization having substantial experience in the financial sector. The investment of moneys standing to the credit of any Trust Fund, Reserve or Special account shall be subject to any directives of the appropriate authority".

Objectives

The primary objective of the Investment Policy is the preservation of the value of resources, in US dollar terms. Within this general objective the principal considerations for investment management are: (i) security of principal, (ii) liquidity, and (iii) rate of return. All statements in this Policy are based on mark-to-market accounting principles being used for valuation of investments, in accordance with internationally accepted accounting standards.

Investment Horizon

The investment horizon for any portfolio can be viewed as the minimum length of time or periodicity over which the rate of return on that portfolio, or changes in the market value of that portfolio, have meaningful significance for the Organization its governing body. The risk tolerance parameters are typically expressed with reference to the specified investment horizon.

Accordingly, the investment horizon for the total short term investments portfolio shall be six months, since FAO allocates income on trust fund balances (which constitute the majority of balances in the short term investments portfolio) monthly based on a prudent reference rate with 6 monthly additional distribution based on actual returns achieved.

Risk Tolerance

The Organization's risk tolerance for the total short term investments portfolio is expressed as a negligible probability of negative return over the specified investment horizon of six months. This reflects the operational necessity of minimizing the probability of negative returns over any 6-month period, taking into account current FAO practice relating to allocation of income on trust fund balances.

Portfolio Tranching and Benchmarks

In accordance with the investment principles mentioned above, the available cash balances shall be allocated to one of four tranches of the short term investments portfolio, as provided below.

The DL (daily liquidity) tranche shall not be benchmarked, and will be invested in 1-7 day Libor based instruments.

The ML (monthly liquidity) tranche shall be benchmarked against the BofA Merrill Lynch 1-month US T-bill index, and will be invested in US government, US government-guaranteed instruments or deposits with the BIS (Bank for International Settlements).

The 3 ML (3 month duration) tranche shall be benchmarked against the BofA Merrill Lynch 3-month US T-bill index, and will be invested in US government or US government-guaranteed instruments, or in US government agency securities. This tranche shall be managed by external investment manager(s).

The 6 ML (6 month duration) tranche shall be benchmarked against the BofA Merrill Lynch US Treasuries Notes & Bonds 0-1 year index, and will be invested in government securities, government agencies, other official entities and multilateral organization securities, and highly ranked bank and other financial institution obligations. This tranche shall be managed by external investment manager(s).

Composition and Rebalancing of different Tranches

The Chief of Treasury Operations is responsible for presenting proposals on the composition and sizes of the portfolio tranches to the Investment Committee. The Director-General will decide on the composition of the tranches of the short term investments portfolio based on the recommendations of the Investment Committee. The Chief of Treasury Operations will be responsible for periodically rebalancing the size of the portfolio tranches, as needed, in order to remain within the Organization's risk tolerance parameters.

Responsibilities of External Investment Managers

Subject to the contract between the Organization and the external investment manager, the external investment manager shall be responsible for making all investment decisions regarding the assets under its management, including the decisions to buy, sell and hold securities, and will be held accountable for following the investment guidelines and achieving the investment objectives as stated in the contract.

Performance Evaluation of External Investment Managers

The performance of external investment managers shall be measured relative to the benchmark, and excess return objective, as specified in the contract. In particular, the main criteria for evaluation will be:

- Excess Returns (defined as the total return on the portfolio less benchmark return; with total return calculated on a time-weighted basis combining capital gains and losses and interest income, adjusting for cash inflows and outflows, and compounding monthly) for rolling 12- and 36-month periods; and
- Information Ratio for rolling 12- and 36-month periods, determined by dividing the annualized Excess Return by the ex-post tracking error (defined as the annualized standard deviation of the monthly Excess Returns).

Termination of External Investment Managers

The contract of any external investment manager may be terminated for the following reasons:

- failure to take any actions specified in the contract;
- failure to meet the performance objectives specified in the contract;
- a significant change in investment style and/or investment process at any time subsequent to their selection as an investment manager by the Organization;

- a significant change in the composition of their investment team at any time subsequent to their selection as an investment manager by the Programme;
- any change in the Organization's investment policy which renders an external investment manager, in Organization's judgment, unsuitable to manage the funds entrusted to them; and
- any other developments which, in the Organization's judgment, render a manager unsuitable for continuing with their contract.

Responsibilities of the Global Custodian

Subject to the contract between the Organization and the Global Custodian, the Global Custodian is responsible for core custody products such as safekeeping of assets, settlement of transactions, collection of income, tax reclamation, valuations and portfolio accounting. The Global Custodian may provide other ancillary services such as risk analysis, performance measurement, and compliance reporting, in accordance with needs determined by the Organization.

Periodic Review of Strategic Asset Allocation and Benchmarks

The strategic asset allocation of the different tranches and their benchmarks shall be reviewed periodically to ensure that they are consistent with the risk tolerance parameters specified in paragraph 5, particularly in the event of significant changes in the market environment, such as the level of interest rates.

Periodic Review of Investment Policy and Risk Tolerance

The overall tranching structure of the short term investments portfolio and the risk tolerance parameters specified in paragraph "Risk Tolerance" shall be reviewed at least once every 3-5 years to ensure that the investment policy framework adequately reflects the evolving nature of the Organization's mission and operations.

Implementation and guidelines

The Investment Committee is instructed to ensure that the appropriate operational procedures and guidelines are prepared and approved in line with this policy.