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منظمة  
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# FINANCE COMMITTEE

**Hundred and Seventieth Session**

**Rome, 21 - 25 May 2018**

**Report on Investments 2017**

Queries on the substantive content of this document may be addressed to:

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FC170

### EXECUTIVE SUMMARY

- **Long-Term Investments:** This USD 536.7 million portfolio represents the accumulated assets set aside over a period of decades to fund the Organization's share of staff-related liabilities, which amounted to USD 1 527.4 million at 31 December 2017. Compared with the USD 1 319.2 million as per year-end 2016 this represents an increase of USD 208.2 million. 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 percent in Equities and 50 percent in Fixed Income securities. In 2017, the long-term portfolio yielded 19.56 percent, while its benchmark return was 20.64 percent, giving an underperformance of 1.08 percent. The EUR gained 14.15 percent of its value versus the USD in 2017, which boosted overall returns as the Fixed Income portion of the portfolio is based in EUR.
- **Short-Term Term Investments:** This USD 1 147 million portfolio represents mainly unspent Trust Fund balances held pending disbursements on project implementation. Funds are diversified as to type and holdings and are invested with specialized asset managers and in deposits with the Bank for International Settlements (BIS). In 2017, given FAO's prudent, low risk investment style and low but gradually increasing interest rate environment, the total return was 1.00 percent. This exceeded the benchmark return by 20 basis points.
- **Investment Governance:** The strategic asset allocations for short-term and long-term investments are designed in close collaboration with the Organization's technical adviser, the World Bank. Asset and Liability (ALM) studies are conducted by specialized firms, reviewed by both the Advisory Committee on Investments (a committee composed of high level experts from organizations such as the UN Joint Staff Pension Fund (UNJSPF), BIS, the Asian Development Bank and Cornell University), and the internal Investment Committee with the final approval of 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 took note of the Report on Investments 2017.**

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.”

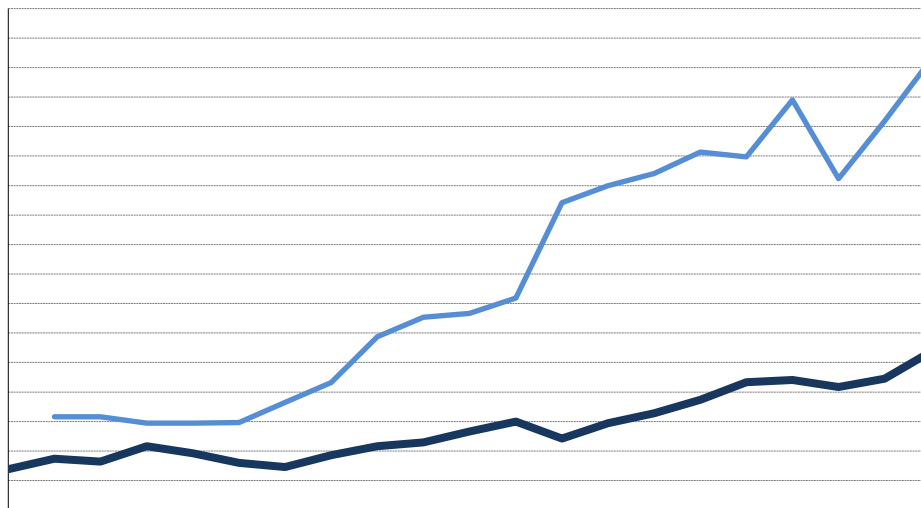
### **Long-Term Investments**

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; and
- 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 market value of the long-term investment portfolio since 1995 compared with the actuarial valuation of the staff-related liabilities (since 1997).



5. An actuarial valuation of these liabilities has been performed each biennium since 1996-97. The last valuation as of 31 December 2017, carried out by a specialized firm, placed the Organization's share of total staff-related liabilities at USD 1 527.4 million, USD 208.2 million above the figure for 2016 of USD 1 319.2 million. Staff-related liabilities are presented to the Finance Committee in document FC 170/4- 2017 Actuarial Valuation of Staff Related Liabilities.

6. The latest actuarial estimation of all staff-related liabilities included USD 1 395.9 million 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 2016-17<sup>1</sup>. The same amounts were authorized in 2004-2005, 2006-2007, 2008-2009, 2010-2011, 2012-2013 and 2014-2015.

7. The ASMC Funding for 2016-17 was assessed in both EUR (67 percent) and USD (33 percent) 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, USD 1.519 million and EUR 2.905 million were transferred to the long-term portfolio in 2017.

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 2017 was as follows:

#### 2017 Long Term Portfolio Asset Allocation

Manager	% Portfolio	Assets USD
	Equity	
	Fixed Income	
<b>TOTAL LT PORTFOLIO</b>		<b>536,695,144.00</b>

9. Rebalancing of the funds occurs at month end if the ratio is out of balance by more than 5 percent. 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:

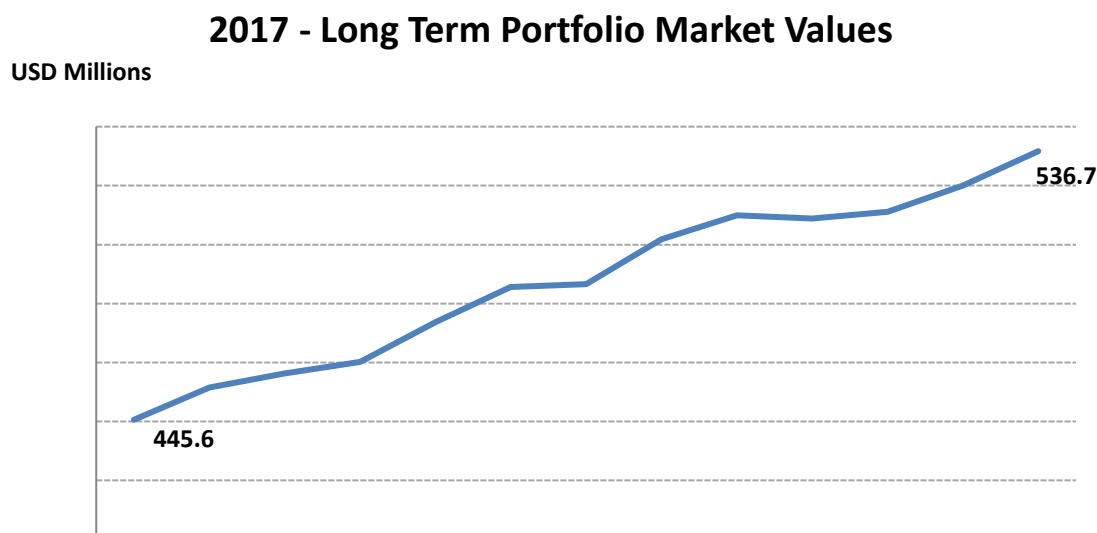
- For the equity portfolio: 80 percent The Morgan Stanley Capital International Inc All Country Index + 20 percent The Morgan Stanley Capital International Inc Emerging Markets Index;
- For the fixed income portfolio:
  - For the mandate awarded to LGT , A blend of 80 percent Barclays World Government Inflation Linked Bonds Index + 20 percent and Merrill Lynch EMU Direct Government AAA Bonds Index;

<sup>1</sup> No funding was authorized for the biennium 2018-2019.

- For the mandate awarded to BNP<sup>2</sup>, a blend of 55 percent Barclays World Government Inflation Linked Bonds Index + 15 percent and Merrill Lynch EMU Direct Government AAA Bonds Index + 15 percent Barclays EU Credit Corp + 15 percent Barclays US Credit Corp.

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 adviser, the World Bank.

12. The Chart below illustrates the evolution of the long-term investment portfolio in 2017.



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 2017.

CASH FLOW 2017	Amount USD
<b>Market Value 31/12/2016*</b>	<b>445,336,620.34</b>
<b>Market Value at 31/12/2017*</b>	<b>536,168,378.54</b>

<sup>2</sup> The brand and entity name of the fixed income manager Fischer Francis Trees & Watts, Inc. (FFTW) was changed to BNP PARIBAS ASSET MANAGEMENT USA, Inc., effective June 1, 2017. Investment management teams were not impacted by this rebranding.

14. It should be noted that equity investments are held in USD, while fixed income investments are denominated in EUR. The EUR based returns of the fixed income portfolios are shown in the right hand column of the below table. However, as FAO reporting is USD based, and to allow for a calculation of a total return on the Long-Term Portfolio, EUR returns are converted to USD. Consequently, the combined return reflects both the returns of the two funds and the currency effect of EUR/USD movements over the year. This combined return in 2017 for the long-term funds expressed in USD was 19.56 percent versus 20.64 percent for the benchmark.

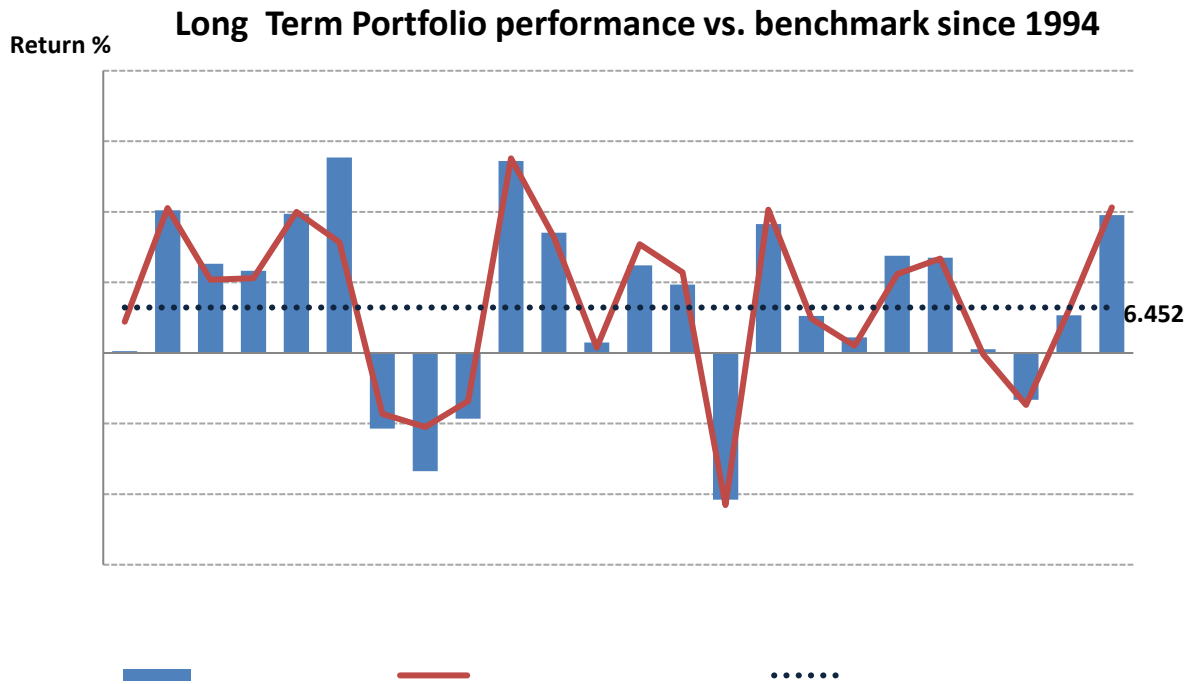
#### 2017 Long Term Portfolio Return

		USD RETURNS	EUR RETURNS
<b>Equity, USD Denominated</b>			
<b>Manager</b>	<b>PanAgora AM</b>	<b>22.92%</b>	
<i>Benchmark</i>	<i>80% MSCI World Index + 20% MSCI Emerging Markets Index</i>	25.53%	
<b>Fixed Income, EUR Denominated</b>			
<b>Manager</b>	<b>LGT AM</b>	<b>15.53%</b>	<b>1.48%</b>
<i>Benchmark</i>	<i>80% Barclays World Gov't Inflation Link'd +20% Merrill Lynch EMU Direct Gov't AAA Bond Index, hedged to EUR</i>	14.75%	0.80%
<b>Manager</b>	<b>BNP AM</b>	<b>16.00%</b>	<b>1.89%</b>
<i>Benchmark</i>	<i>55% Barclays World Gov't Inflation Link'd + 15% Merrill Lynch EMU Direct Gov't AAA Bond Index + 15% Barclays EU Credit Corp + 15% Barclays US Credit Corp, hedged to EUR</i>	15.60%	1.54%
<b>TOTAL LT PORTFOLIO USD RETURN</b>		<b>19.56%</b>	
<b>Excess Return (portfolio return over benchmark)</b>			
<i>EUR/USD Annual Performance</i>			14.15%

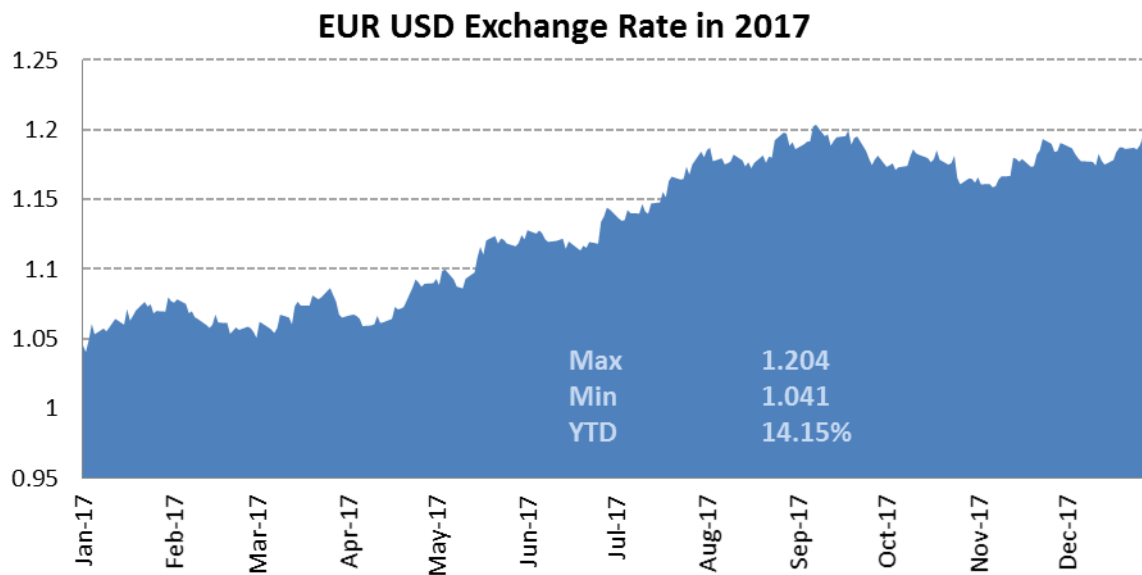
#### Notes:

Equity Returns based in USD  
 Fixed Income returns based in EUR  
 combined returns based in USD

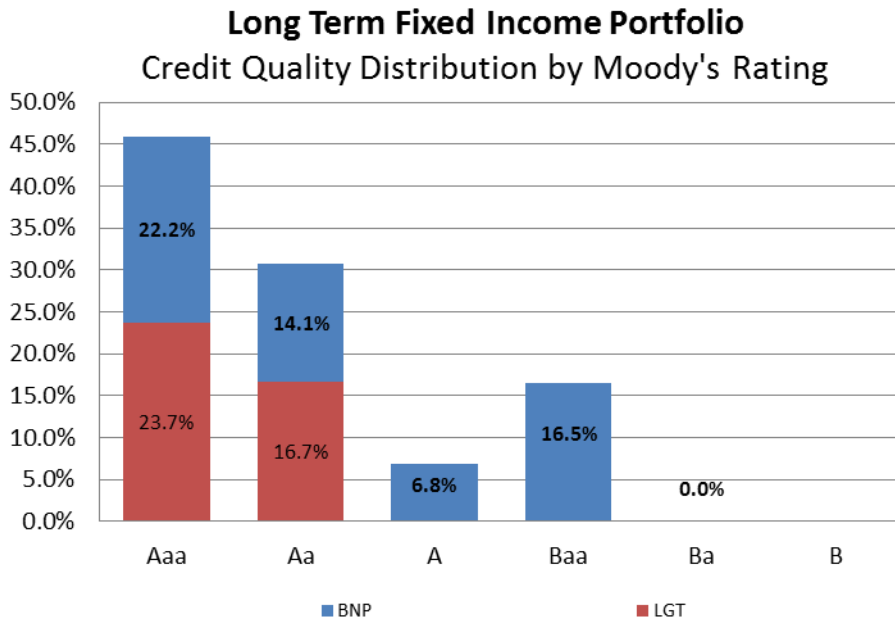
- a) Yearly performance figures of the long-term portfolio from 1994-2017 are shown below. The performance of the long-term portfolio is shown by the bar chart and compared with the performance of the combined benchmark for long-term investments. The dotted line in the chart is the geometrical average performance of the long-term portfolio since 1994, i.e. 6.452 percent.



b) The chart below illustrates the movements in the USD/EUR rate over the course of 2017. Movements in the value of the EUR have a direct effect on USD measured returns. Year to date, the Euro gained more than 14 percent of its value to the United States Dollar.

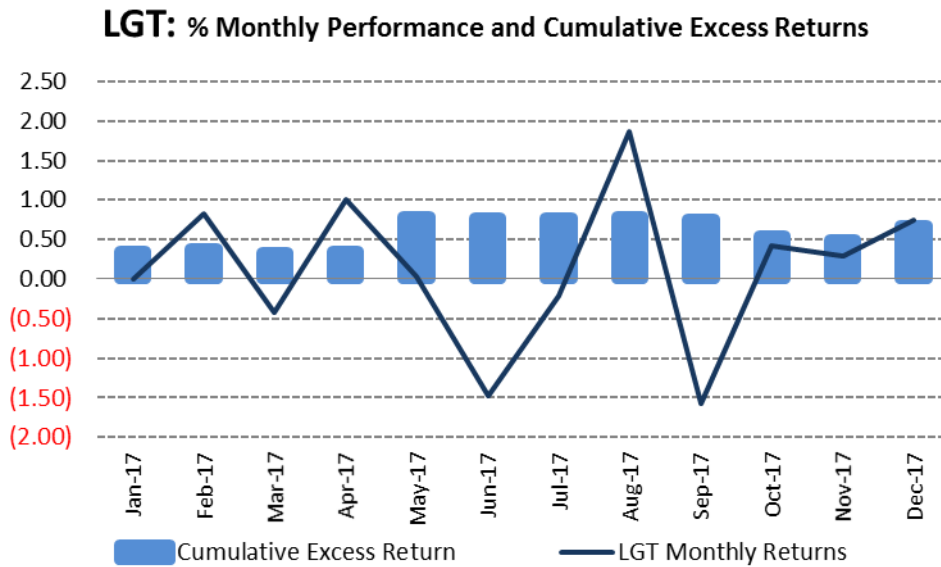


15. The chart below provides a breakdown of the assets in the long-term fixed income portfolio by credit quality. More than 76 percent of assets are rated at least Aa, confirming the low risk profile of investments.



### Long -Term Portfolio 2017 Performance and Excess returns

16. The review of Long Term Investments includes an analysis of performance and excess returns. Monthly returns and cumulative monthly excess returns are graphed over the past year, as shown below.

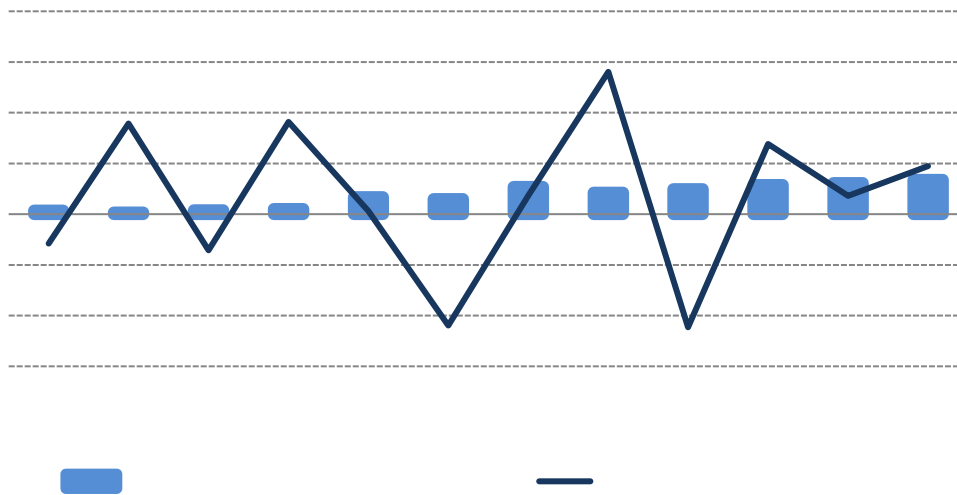




17. In 2017, the account managed by LGT experienced some volatility in absolute return, however excess return for the year was 68 basis points above the benchmark. The annual return was 1.48 percent versus 0.80 percent for its benchmark.

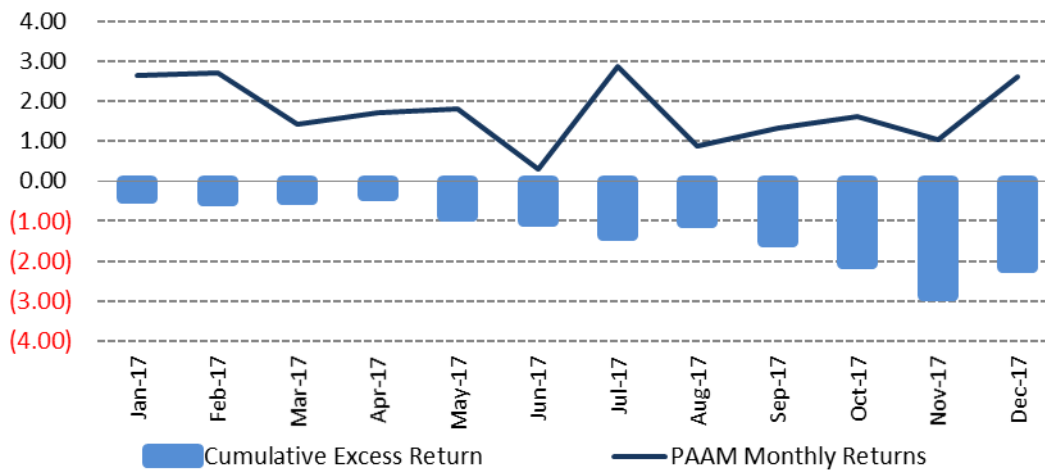
18. As shown below BNP finished the year above its benchmark, excess return for 2017 was 0.35 percent. The annual return was 1.89 percent versus. 1.54 percent for its benchmark.

**BNP: % Monthly Performance and Cumulative Excess Returns**



19. 2017 was a very positive year for equity markets. However, as shown below, the account managed by PanAgora underperformed the benchmark by 2.61 percent. The account return for the year was 22.92 percent versus. 25.53 percent for the benchmark.

**PanAgora: % Monthly Performance and Cumulative Excess Returns**



## Short-Term Investments

20. 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, the World Bank and Wells Capital Management or invested in deposits with the Bank for International Settlements.

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

	At 31 December 2017	At 31 December 2016
<b>Total</b>	<b>1,147,028,909.09</b>	<b>1,171,877,545.19</b>

22. During 2017, the Organization continued to keep a very low risk exposure of its short-term assets. The interest rate environment in USD was low but gradually rising.

23. Specifically:

- 1) Northern Trust: Holdings in the Northern Trust Government Select Fund offer relative safety, as they are substantially securities issued or guaranteed as to principal and interest by the Government of the United States or by its agencies, instrumentalities or sponsored enterprises;
- 2) 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;
- 3) Wellington Management: the Organization continued to impose very restrictive guidelines allowing only investments in very low risk instruments or instruments fully guaranteed by the Government of the United States such as United States (US) T Bills, United States government agencies and United States government backed securities;
- 4) World Bank: This portfolio has 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;
- 5) Wells Capital Management: This portfolio has 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;
- 6) 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 2017.

24. The 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.

### 2017 Short Term Portfolio Return

#### Actively Managed

<b>Manager</b>	<b>Wells Capital Management</b>	<b>0.99%</b>
<i>Benchmark</i>	<i>Bofa Merrill Lynch U.S. Treasury Notes &amp; Bonds, 0-2 Yr Index</i>	<i>0.60%</i>
<b>Manager</b>	<b>World Bank</b>	<b>1.02%</b>
<i>Benchmark</i>	<i>Bofa Merrill Lynch U.S. Treasury Notes &amp; Bonds, 0-1 Yr Index</i>	<i>0.83%</i>
<b>Manager</b>	<b>Wellington Management</b>	<b>1.13%</b>
<i>Benchmark</i>	<i>Merrill Lynch 3 Month T-Bills</i>	<i>0.86%</i>

#### Deposits and Liquidity Funds

<b>Manager</b>	<b>Northern Trust Liquidity Fund</b>	<b>0.71%</b>
<b>Institution</b>	<b>BIS</b>	<b>0.94%</b>
<i>Benchmark</i>	<i>1 Month T-Bills</i>	<i>0.80%</i>

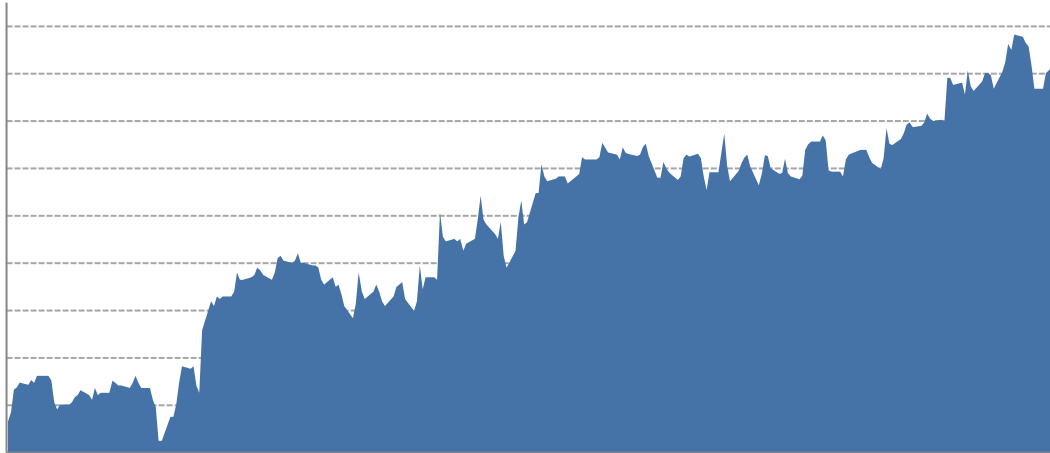
#### TOTAL ST PORTFOLIO

<b>Portfolio Return</b>	<b>1.000%</b>
<b>Benchmark Return</b>	<b>0.800%</b>
<b>Excess Return</b>	<b>0.200%</b>

25. The performance of short-term portfolios during the course of 2017 was dominated by the gradually rising interest environment for very low risk USD investments. The overall performance was 1.00 percent for the year.

26. The annual returns for one Month T-BILLS in 2017 are graphed below for further comparison.

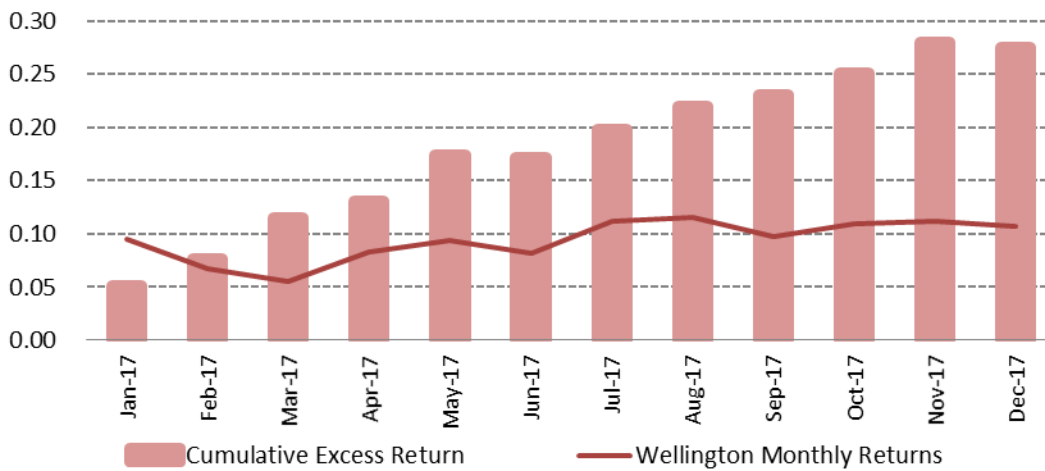
### Returns on the 1 Month T-Bills over 2017



### Short-Term Portfolio 2017 Performance and Excess Returns

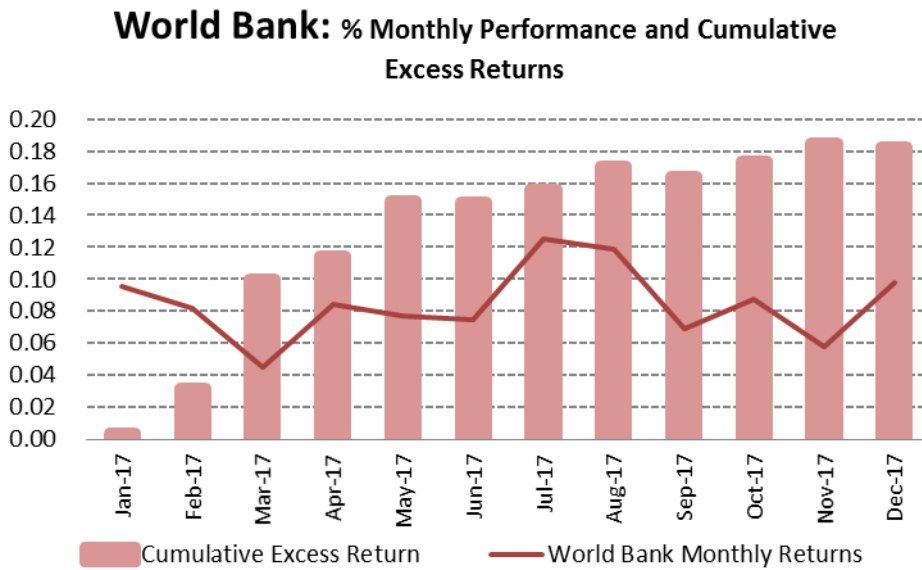
- 27. The review of Short Term Investments includes an analysis of our three short duration managers.
- 28. Monthly returns and cumulative monthly excess returns are graphed over last 12 months.

### Wellington Management: % Monthly Performance and Cumulative Excess Returns

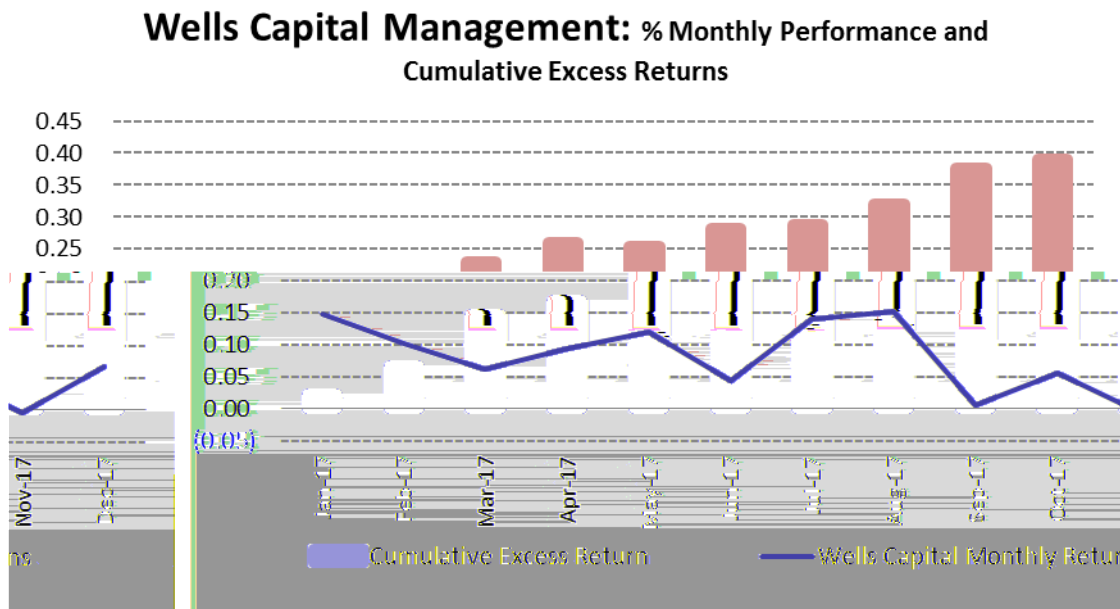


- 29. Over the past year, Wellington has provided constant excess returns, exceeding its benchmark by 0.28 percent.

30. As shown below, in 2017, the portfolio managed by the World Bank generated 0.18 percent excess return over the benchmark.



31. Over 2017, the Wells Capital portfolio also generated excess return over the benchmark, at year-end the cumulative excess return was 0.39 percent.



### **Investment Governance at FAO**

32. 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. This most recent study was conducted at the end of 2013. In late 2017 a new ALM study was mandated the results for which will be available in the second quarter of 2018.
33. Short Term asset allocation strategies are designed in close collaboration with FAO's technical investment adviser, the World Bank.
34. 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).
35. 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 the UNJSPF, Cornell University, BIS and the Asian Development Bank.
36. 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.
37. Day-to-day control over the external managers, including daily compliance monitoring, is done by the Organization's Treasury unit in the Finance Division. The Treasury unit also provides regular reporting to the Director of Finance, internal Investment Committee and Senior Management. On-site compliance visits and, since 2017, quarterly compliance calls, to the external asset managers and the securities custodian are carried out by the Treasury unit.
38. Finally, a detailed report on FAO's investments is provided annually to the Finance Committee. This report is available on the internet website of the Finance Committee.

### **Investment Expenses**

39. The table below outlines the investment expenses incurred in the year 2017.
40. Investment management fees for 2017 totalled, USD 2.4 million, of which USD 0.6 million was related to 2016 fees paid in arrears in 2017. Comparative year over year investment fees, however, were relatively stable as FAO is charged a fee as a percentage of assets under management. Total investment related expenditure has increased from USD 2.145 million to USD 3.14 million, mainly owing to the additional accrual of management fees for the fourth quarter 2017 and the provision of the ALM study fee.
41. Assets have increased from USD 1 617 million in 2016 to USD 1 683 million in 2017. The overall expense ratio for 2017 was 0.187 percent and excluding the amounts for 2016 paid in 2017, the expense ratio would be 0.149 percent.

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**Investment Service Provided****2017 Expenditures in USD**

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<b>Total Expenses</b>	<b>3,140,235.74</b>
<b>Total Assets at 31/12/2017</b>	<b>1,683,724,052.09</b>
<b>Total Expense Ratio</b>	<b>0.187%</b>
<b>Expense Ratio 2017</b>	<b>0.149%</b>