CLIMATE INVESTMENT FUNDS

INVESTMENT STRATEGY REVIEW

THE WORLD BANK

Treasury

May 12, 2015

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Executive Summary

- At the meeting in Washington D.C. in November 2014, CTF and SCF Trust Fund Committees requested the Trustee to review the investment management strategy and to propose appropriate changes for consideration at the next Committee meetings.

- The analysis of CIF Trust Funds' cash flow projections indicate the possibility to extend the investment horizon for the CTF from currently 3 years to 5 years.

- Trustee recommends the following changes in the investment strategy for CTF:

  - The participation of the CTF Trust Fund in Tranche 4 of the commingled investment portfolio, based on longer investment horizon;
  - The allocation of up to 5% of the CTF Trust Fund's liquidity to equities.

- SCF Trust Fund's liquidity projections indicate that the current 3-year investment horizon and the accompanying investment strategy remains appropriate for the fund.

Trust Funds Investment Pool

- Climate Investment Funds assets managed by the World Bank are invested in the commingled investment portfolio (the “pool”) where they benefit from the cost-efficient operations and economies of scale, and gain access to wide range of investment alternatives.
- Capital preservation is the primary objective of the investment pool, reflecting donor sensitivity to disbursement obligations of trust funds and to potential losses.
- In line with this objective, the pool assets are invested predominantly in high quality fixed income and money market securities.
- The liquidity in the commingled pool is invested according to different investment horizons, and based on available cash flow projections and risk tolerances of participating funds. These varying requirements have been accommodated through a tranching structure of the pool.

Trust Funds Investment Pool – Investment offerings

Increasing investment horizon

	Model portfolio 0 "Tranche 0"	Model portfolio 1 "Tranche 1"	Model portfolio 2 "Tranche 2"	Model portfolio 4 "Tranche 4"
	Cash Tranche	**Capital preservation over a 1-year horizon**	**Capital preservation over a 3-year horizon**	**Return optimization over a 5-year horizon**
Investment Objective	Enhance returns subject to ensuring liquidity and timely availability of cash when needed	Maximize returns subject to limiting the probability of negative return with a high confidence level over the specified horizon		Maximize returns over a five year investment horizon subject to downside risk constraints
Strategic Asset Allocation (SAA)/ Benchmark	Overnight cash	Dynamic (Government bonds and money markets)	Dynamic (Government bonds, money markets and US Agency MBS)	Various fixed income benchmarks and up to 20% of equities
Currencies	Multi-currency	USD and EUR	USD	USD

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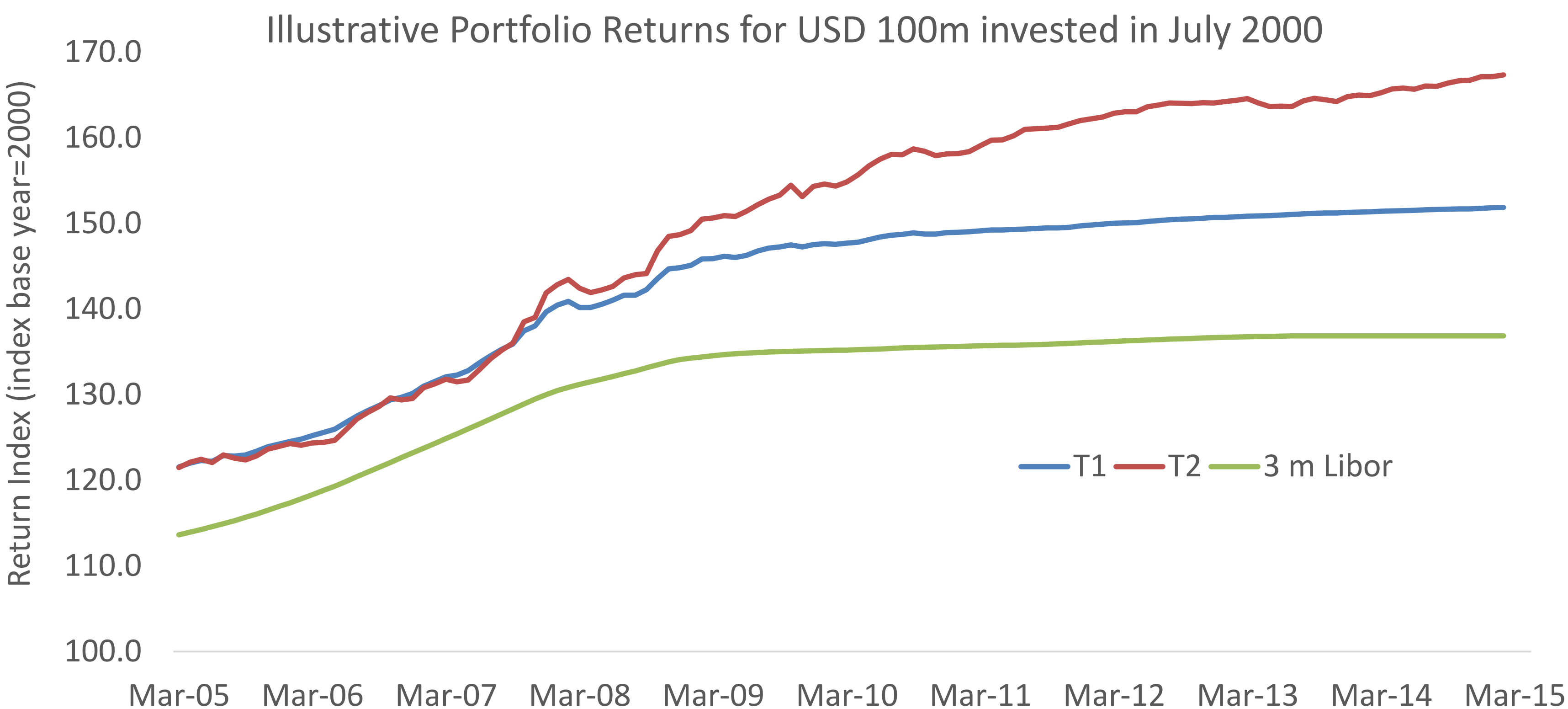
Investment Strategy Review

- The CIF Trust Funds' returns have been driven by the greater participation in Tranche 2. Balances invested in longer term tranches, such as Tranche 2, had the possibility of generating higher returns over the pre-specified investment horizon compared to shorter horizon alternatives.



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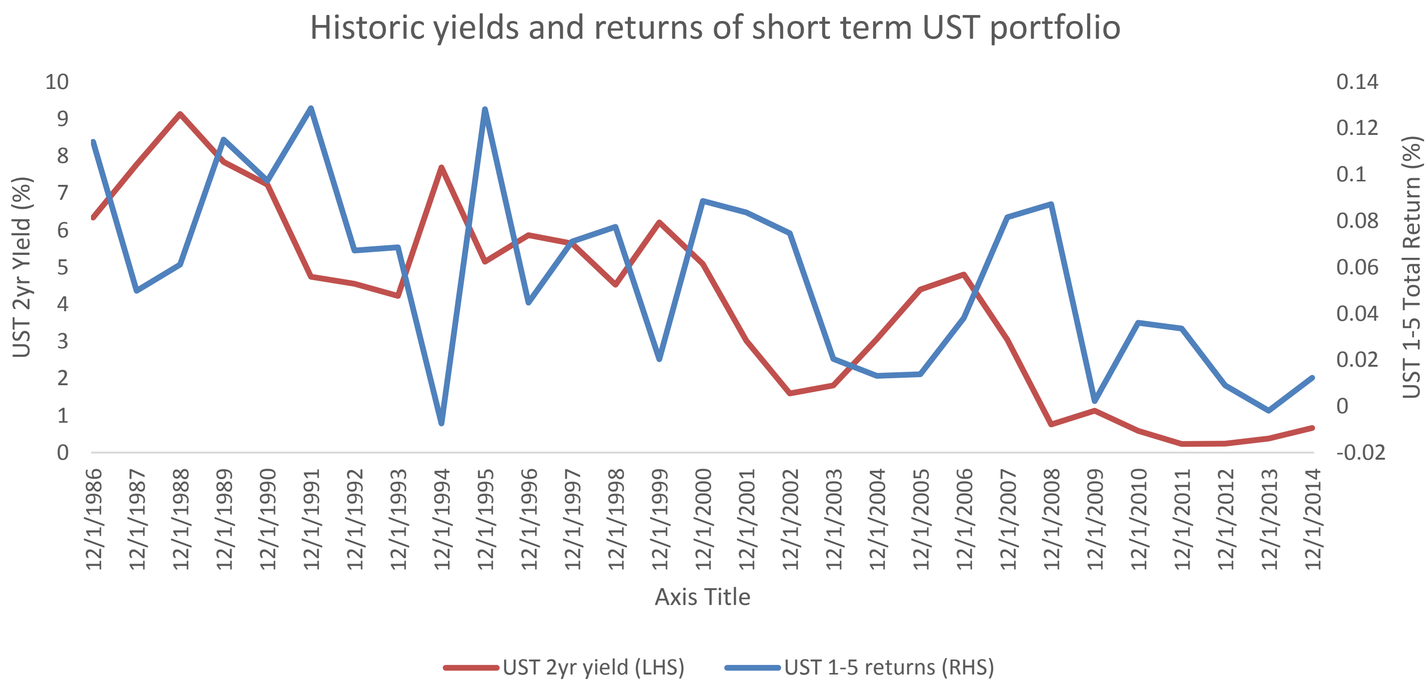
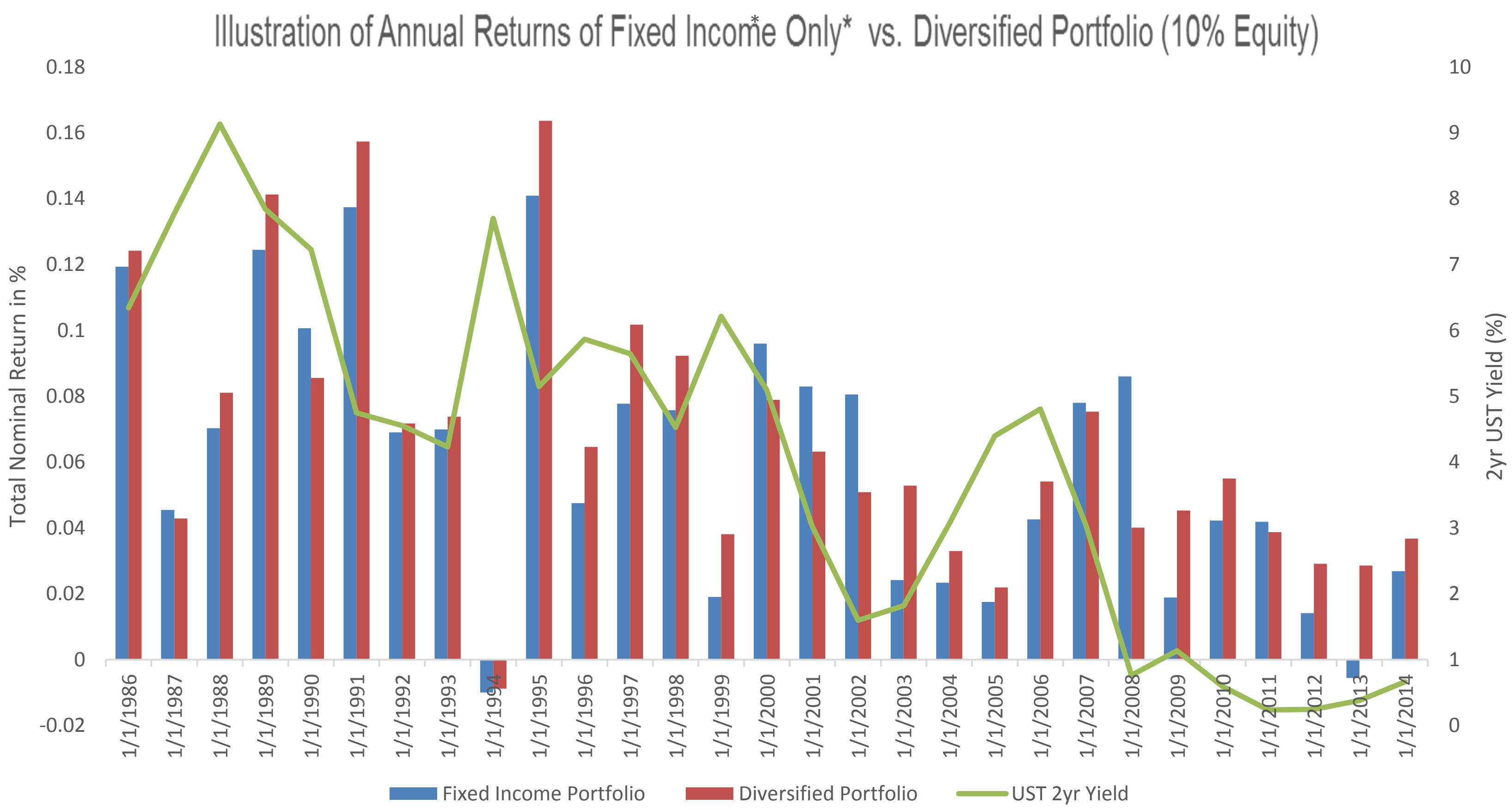
Investment Strategy Review (continued)

- However, with current yields at historic low levels and with the asymmetric risk for the interest rate outlook going forward, market environment poses major challenges for investors in conservative fixed income portfolios.



An Illustration of Returns: Fixed Income vs. Diversified Portfolio

- Historically, a diversified portfolio with a limited allocation to equity outperformed the fixed-income-only portfolio 21 out of 29 years. The outperformance is most apparent in low and rising interest rate environments.



Fixed Income Portfolio Illustrated as 70% UST 1-5 and 30% MBS

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CIF Trust Funds Portfolios – Looking Ahead

- The review of SCF's cash flow projections suggests that the current strategy remains appropriate.
- Cash flow projections for the CTF, however, indicate the possibility to extend the investment horizon for the CTF from currently 3 years to 5 years.
  - The extension of CTF's investment horizon to 5 years enables a more efficient framework for asset allocation, by expanding the asset classes beyond the fixed income universe into the public equities.

	Market Risk	Liquidity Risk	Return Enhancing	Diversification Benefit*
Money Markets	L	L	L	L
US Treasuries	L	L	L	L
US Agency MBS	L	L	M	L/M
Global Govt Bonds (hedged)	L	L	L	L/M
TIPS	L	L	L	M
Emerging Market Govt Bonds (hedged)	M	L/M	M	M
Corps (investment grade)	M	M/H	M	M
Public Equities (developed countries)	H	L	M/H	H

L = Low, M = Medium, H = High

*The Diversification Benefit is evaluated relative to 0-5Y US Treasuries or other US Treasury indices with shorter maturities, which is typically what trust funds invest in

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An Overview of Tranche 4

- As part of our fiduciary responsibility to create and communicate opportunities for investment diversification, a newer model portfolio, Tranche 4, in the current Trust Funds Investment Strategy was approved by the Bank's Finance Committee in June 2011. Recently, the same type of model portfolio was implemented for one of the largest trust funds (Tranche 5).

- Rationale behind Tranche 4:
  - To optimize diversification based on risk-return analysis
  - To address of the current market challenges of the fixed income market - rising interest rates from their current, historic low levels, could lead to very low and even negative returns

- Tranche 4 has a 5-year investment horizon and is managed with the same risk tolerance constraint used for Tranches 1 and 2 (limiting the probability of negative return to no more than 1% at the applicable investment horizon).

- A limited diversification into equities is recommended to reduce risk from the portfolio's exposure to nominal interest rate changes.

- Equity allocation for any individual Trust Fund will remain below 5% of the fund's long term stable assets.

CTF Trust Fund's Portfolio – Risk and Return Considerations

- Analysis shows that the CTF portfolio would benefit from a small allocation to equity in terms of higher expected returns; however it has to be noted that a higher volatility could also be expected.

- It is important for the Board to accept that the risk and returns should be evaluated at the 5 year investment horizon, and to understand the risk of more volatile returns in the interim periods.

Projected Risk/Return Profile at the 5-year Investment Horizon

	Current Scenario		Forward Scenario	
	Portfolio with 3.1% Equity Allocation	Current Portfolio	Portfolio with 3.1% Equity Allocation	Current Portfolio
Expected Annual Return	1.30%	0.63%	1.91%	1.66%
Annual Volatility	0.88%	0.66%	1.08%	1.21%
CVaR return (99%)	1.28%	0.98%	4.14%	3.93%
Probability of Negative Return	<0.1%	0.10%	<0.1%	<0.1%

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Q&A

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