

**INVESTMENT MANAGEMENT GUIDELINES FOR
HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE
RESOURCES**

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THE HIPC INITIATIVE

The HIPC initiative was established in 1996 to address the problems of external debt in low-income countries and provides a comprehensive debt relief framework for these countries. The main objective of the initiative is to reduce to a sustainable level, the debt of eligible countries with a proven track record of satisfactory implementation of policy reforms. In the HIPC framework, eligibility for debt relief is based on debt stock indicators such as the ratio of net present value (NPV) of debt to exports, or NPV of debt to government revenues. Currently 32 Regional Member Countries (RMCs) are eligible to benefit from the initiative. The NPV of debt relief for each country is determined in collaboration with the IMF and the World Bank and is derived by discounting the stream of future debt-service payments using the OECD's currency-specific six-month Commercial Interest Reference Rate (CIRR).

The Bank Group participates in the HIPC initiative by contributing to the HIPC Trust Fund and by applying HIPC Trust Fund Grants to provide relief to beneficiary countries on their debt obligations to the Bank Group. The Bank Group administers resources provided by the HIPC Trust Fund, pending their application to debt relief.

The practice under the HIPC initiative is that debt relief is provided in two stages. At the Decision Point for each country, the HIPC Trust Fund provides a Grant, which it transfers in annual installments to the Bank Group to finance debt relief to the country during the period between Decision Point and Completion Point (the "Interim Period"). The debt relief provided during the Interim Period should not exceed 40 percent of the country's total NPV amount of debt relief on debt obligations to the Bank Group. .

At the Completion Point, the HIPC Trust Fund provides a further Grant, calculated on the basis of the remaining NPV amount of debt relief to be provided, and including the Bank Group's contribution to the Trust Fund. The Grant is applied to finance debt relief over a number of years in accordance with the established schedule.

I. INTRODUCTION

1.1 This document sets out the guidelines (the "Guidelines") governing the investment management of the resources dedicated to the Heavily Indebted Poor Countries (HIPC) Debt Initiative, which are administered by the African Development Bank (ADB). The resources have been dedicated for the purpose of financing debt relief in accordance with the terms of the HIPC initiative, and the related agreements between the HIPC Trust Fund and the Bank Group on the one hand, and the Bank Group and beneficiary countries for whom debt relief has been approved, on the other hand.

1.2 Objective

The objective of the management of HIPC Initiative Resources is to meet the Bank Group debt relief obligations while:

- 1) maintaining adequate liquidity to meet foreseeable cash flow needs and debt service requirements of beneficiary countries;
- 2) ensuring the preservation of capital; and
- 3) ensuring that credit and liquidity risks are adequately controlled.

II. AUTHORITY AND POLICY FRAMEWORK

2.1 Authority

Pursuant to Resolutions of the Boards of Directors concerning the Bank Group's participation in the HIPC Initiative and to the agreements between the HIPC Trust Fund, the African Development Bank and the African Development Fund, and between the African Development Bank (ADB), the African Development Fund (ADF) and beneficiary countries, HIPC Initiative Resources not immediately required for debt service may be invested by the Bank. The investment periods should be consistent with the established debt service schedules under the relevant agreements, within the maximum and minimum durations authorized by these guidelines.

2.2 Interpretation and Implementation

Matters of the interpretation and proper implementation of the specific provisions of the Guidelines shall be referred to the Asset and Liability Management Committee ("ALCO" or "the Committee"). ALCO shall ensure the implementation and adherence to the Guidelines. Under the direct supervision of the Vice-President, Finance, the Director, Treasury shall be responsible for the day-to-day implementation of the Guidelines and the Director, Financial Management shall be responsible for monitoring compliance with the Guidelines.

2.3 Management of resources

2.3.1 The HIPC Initiative Resources to be managed under these guidelines can be categorized as follows:

- 1) Bank Group contribution to the HIPC initiative mobilized through ADB and NTF net income allocations, and ADF loan and grant cancellations and reflows. These “internal resources” contributed by the Bank Group are maintained in a pool and are not assigned to specific HIPC beneficiary countries. Allocations are made from this pool to provide the Bank Group’s contribution to the HIPC Trust Fund to be incorporated into the country-specific Completion Point Grants;
- 2) HIPC Trust Fund Grants for countries in the Interim Financing Period, which are received on an annual basis and cover the debt relief requirements for the following year;
- 3) HIPC Trust Fund Grants for countries that have reached the completion point, for which the Bank receives resources that cover the entire debt relief time horizon.

2.3.2 In principle, the HIPC Trust Fund Grants are not fungible. Grants are provided for debt relief for specific countries and therefore, a liability for a specific country can only be met if there is a corresponding asset, designated for that country. Due to the number of countries involved, and to facilitate the management of resources, separate custodial accounts will, however, not be set up for each participant. HIPC Trust Fund Grant proceeds will be pooled together, but each Grant and its investment will be recorded separately and monitored as such.

III. GUIDELINES

3.1 Interest Rate Risk

3.1.1 Interest rate risk is the potential for loss due to adverse movements in market interest rates. The methodology used for controlling interest rate risk is to measure the overall weighted average duration of the HIPC portfolios vis-à-vis their benchmark duration. Three benchmarks will be used depending on the type of resources managed: a benchmark for the resources contributed by the Bank Group, a benchmark for the interim financing period Grant resources and a benchmark for Completion Point Grant resources.

3.1.2 For resources contributed by the Bank Group, the strategy applied is to match investment to the estimated completion point calendar of each country to which the resources will be assigned. The benchmark is the weighted average duration of the estimated completion date of each country. The strategy will be linked to the completion point calendar, to be provided to ALCO, on a quarterly basis, by the Planning and Budgeting Department (PPLB). The weighted average duration shall be maintained inside a range of minus three (-3) months to plus three (+3) months around the weighted average duration of the benchmark.

- 3.1.3 Countries for which a completion point calendar is not available¹, are usually not expected to reach their completion point within two years. Therefore, when the completion point calendar is not available, the benchmark is defined to have a duration of two years. The weighted average duration of this benchmark shall be maintained inside a range of minus three (-3) months to plus three (+3) months around the weighted average duration of the benchmark.
- 3.1.4 For resources during the interim financing period, a passive strategy is applied by investing primarily in a cash sub-portfolio, and by matching the Interim Period debt service calendar. The benchmark for the cash sub-portfolio is therefore the duration of the Interim Period annual debt service calendar for each country. The weighted average duration of this benchmark shall be maintained inside a range of minus one (-1) month to plus one (+1) month around the weighted average duration of the benchmark.
- 3.1.5 For resources after the completion point, a more active strategy is applied by investing primarily in a bond sub-portfolio, comprising primarily liquid investments with the objective to meet debt service requirements. The benchmark of the bond sub-portfolio is the weighted average duration of liabilities corresponding to the debt service schedule of the debt relief program. However, because a perfect matching cannot always be achieved, the weighted average duration of investments should be maintained within a range of the duration of liabilities. The range will increase, as the duration of liabilities increases because of the scarcity of long term investment instruments with appropriate cash flows to match the debt service profile of resources.

The range for monitoring the duration of the benchmark after the completion point is as follows:

- Six (6) months for liabilities with durations below three (3) years.
- Twelve (12) months for liabilities with duration between three (3) years and ten (10) years.
- Eighteen (18) months for liabilities with duration above ten (10) years.

- 3.1.6 Negative weighted average durations are not permitted any of the benchmarks or portfolios.

3.2 Liquidity Risk

- 3.2.1 Liquidity risk is the potential for loss resulting from the inability to sell a long position or buy back a short position at a reasonable price within a reasonable period of time. In the management of the HIPC Initiative Resources, the asset manager shall ensure that all investments can be liquidated promptly and without incurring undue transaction or market costs under normal market conditions.
- 3.2.2 Treasury Investment Officers shall ensure that the purchase of an individual security meets the liquidity objectives for HIPC Initiative Resources. Measurements such as the trading

¹ Completion point calendars are in general expected to be available for all countries.

volume of a particular security, the number of broker/dealers providing two-way markets in the security, typical bid/ask spreads, and similar measures shall be used to gauge the overall liquidity of any investment.

- 3.2.3 No security should be purchased for HIPC Initiative Resources if the total amount outstanding of the issue is less than US\$100 million. For this purpose, an "issue" shall be considered to consist of the aggregate amount of a security or group of securities which have characteristics permitting them to trade interchangeably in the marketplace; the entire shelf registration under a medium-term note or a short-term commercial paper program shall be considered to constitute an "issue".
- 3.2.4 Investments in a specific issue shall not exceed 15% of the outstanding issue or a tranche of the issue as the case may be.
- 3.2.5 Exceptions to these liquidity restrictions shall be approved by the Director, Treasury and promptly reported to ALCO.

3.3 Credit Risk

Credit risk is the potential loss due to failure of a counterparty to honor an obligation. The objective of the guidelines is to minimize the risk of losses due to adverse credit events. To achieve this objective, HIPC Initiative Resources are managed within a framework of approved counterparties, minimum credit rating thresholds for specific instruments, and prudential exposure limits.

3.3.1 Approved Transaction Counterparties

Investment transactions will be conducted for the HIPC Resources account only with counterparties such as brokers, dealers, and exchanges, which have been approved by the Director, Treasury.

All counterparties to investment operations should be located or controlled by entities based in member countries of the Bank. Counterparties must provide relevant trading authorizations, credit and business information. For un-rated brokers/dealers this will also include audited financial statements.

3.3.2 Approved Credit Rating Agencies

For the purpose of the Guidelines, approved credit rating agencies include Standard and Poors, Moody's Investors Services, Fitch-IBCA or any other rating agency approved by the Vice-President, Finance.

3.3.3 Counterparty Exposure Limits

ALCO, on the recommendation of the Director, FFMA, will set and monitor specific counterparty credit exposure limits. These risk limits shall be set as a percentage of the HIPC funds' total liquidity and will be reviewed at least on a quarterly basis.

3.3.4 Credit Rating Limit Exceptions

Specific credit rating limitations have been set for each type of investment using the HIPC Resources. Exceptions may be authorized upon the written approval of the Vice-President, Finance. Such exceptions shall be promptly reported to ALCO.

3.3.5 Credit Downgrades

If an investment security or counterparty suffers a credit downgrade below the minimum level stated in the Guidelines, the Director, Financial Management Department, shall inform ALCO, which will decide on the appropriate action to be taken.

No investments shall be made where an investment or counterparty is known to be under review for a credit rating downgrade that may bring it below the minimum rating allowed by the Guidelines.

3.4 Authorized Investments and Foreign Exchange Transactions

3.4.1 Money Market Instruments

Any certificates of deposit, time deposit, bankers' acceptance, commercial paper or any sale of federal funds in the United States inter-bank market through US Federal Reserve Banks is eligible for investment if it is issued or guaranteed by a bank or other financial institution whose long-term credit rating is at least A/A2 or its equivalent by an approved credit rating agency. The final maturity of money market instruments whose long-term credit rating is between AAA/Aaa and AA-/Aa3 shall not exceed one year. The final maturity of money market instruments whose long-term credit rating is between AA-/Aa3 and A/A2 shall not exceed six months.

3.4.2 Money Market Mutual Funds

Any money market mutual funds or unit trusts is eligible for investments provided that the fund or unit trust is rated AA-/Aa3 or above by an approved credit rating agency. The final maturity of money market mutual funds instruments shall not exceed one year.

3.4.3 Government Securities

Any marketable bonds, notes or other obligations issued or unconditionally guaranteed by governments of member countries of the Bank are eligible for investment if the obligation is rated AA-/Aa3 or above by an approved credit rating agency. The final maturity for Government securities shall not exceed 30 years for AAA/Aaa rated securities, and 15 years for securities rated between AAA/Aaa and AA-/Aa3.

3.4.4 Government Agency, Other Official Entities and Multilateral Institution Securities

Any marketable bonds, notes or other obligations issued or unconditionally guaranteed by an agency or instrumentality of a Government of a country, any other official entity (other than the Government of a country), or a multilateral institution are eligible for investment if the obligation is rated AA-/Aa3 or above by an approved credit rating agency. The final maturity for Government agencies, official entities and multilateral institutions securities shall not exceed 30 years for AAA/Aaa securities, and 15 years for securities rated between AAA/Aaa and AA-/Aa3.

3.4.5 Obligations of Banks and Financial Institutions

Any obligation issued or unconditionally guaranteed by a bank or other financial institution is eligible if the obligation is rated AA-/Aa3 or above by an approved credit rating agency. The final maturity for obligations of banks and financial institutions shall not exceed 10 years for AAA/Aaa securities, and 5 years for securities rated between AAA/Aaa and AA-/Aa3.

3.4.6 Corporate Securities

Corporate securities are eligible for investment provided that the security is rated AA-/Aa3 or above by an approved credit rating agency. The final maturity for corporate securities shall not exceed 10 years for AAA/Aaa securities, and 3 years for securities rated between AAA/Aaa and AA-/Aa3.

3.4.7 Mortgage and Asset-Backed Securities

Mortgage-backed (MBS) or asset-backed securities (ABS) are eligible for investment provided that the obligation is not rated below AAA/Aaa by any approved credit rating agency. The final maturity for Mortgage and Asset-Backed securities shall not exceed 40 years.

The following securities are not eligible for investment regardless of credit rating: Asset-backed securities, whose underlying collateral is high-yield bonds or emerging market debt; Principal Only (POs) MBS; Inverse Floaters (IFs); and Super Floaters (SFs).

The value of investments in mortgage and asset-backed securities shall not exceed 35% of total investments of the HIPC Initiative Resources.

IV. COMPLIANCE AND REPORTING

- 4.1 Each limit set forth in the Guidelines that requires a calculation shall be applied as of the close of business unless otherwise specified. In certain instances, the limitations set forth in the Guidelines cannot be monitored with precision, even on a close of business basis. In such cases, the applicable limits will be complied with on a best effort basis.
- 4.2 It is the responsibility of each Treasury Investment Officer and the Division Manager of the Treasury Investments Division, to be familiar with the Guidelines. Each Officer and Division Manager shall only enter into transactions that are consistent with the limitations contained in the Guidelines.
- 4.3 The Financial Management Department (FFMA) shall be responsible for monitoring compliance with the Guidelines. The Treasury Investment Officers involved in implementing these Guidelines shall report any breach of the Guidelines to their Division Manager, who will inform the Director, Treasury for remedial action. All breaches shall be promptly reported to the Financial Management Department, who shall in turn inform ALCO.
- 4.4 The Financial Management Department shall submit to ALCO a monthly report on the HIPC Initiative Resources' investment performance and compliance with the Guidelines. It shall promptly submit an "Exception" report to ALCO on any deviation from compliance with the Guidelines and shall monitor the process of correcting such deviation and submit periodic reports to ALCO thereon.

V. ENTRY INTO FORCE AND AMENDMENTS

- 5.1 These Guidelines shall enter into force immediately upon their approval and signature by the President.

SUMMARY OF GUIDELINES

Interest Rate Risk

<i>Duration Limits and Benchmark</i>	
Internal Resources contributed by the Bank Group	<p>1) When the estimated completion point calendar is available.</p> <ul style="list-style-type: none"> - Weighted average duration of estimated completion point date for each country - Average duration within a -3/+3 month band around the benchmark. <p>2) When the estimated completion point calendar is not available.</p> <ul style="list-style-type: none"> - 2 year duration benchmark - Average duration within a -3/+3 months band around the benchmark.
HIPC Trust Fund Grant Resources during the interim financing period	<ul style="list-style-type: none"> - Duration of the decision point annual debt service calendar for each country - Average duration within a -1/+1 month band around the benchmark.
HIPC Trust Fund Grant Resources after the completion point	<ul style="list-style-type: none"> - Weighted average duration of liabilities - Average Duration around the benchmark within the following bands: <ul style="list-style-type: none"> a) 6 months for duration of liabilities below 3 years b) 12 months for durations of liabilities above 3 years and below 10 years c) 18 months for durations of liabilities above 10 years <p>Negative durations are not permitted for any benchmark or portfolio.</p>

Liquidity Risk

<i>Liquidity Restrictions</i>	
All HIPC Initiative Resources	<ul style="list-style-type: none"> - Readily marketable securities. - Minimum outstanding issue size is \$100 million for investments. - Bank's exposure shall not exceed 15% of outstanding issue size.

Credit Risk and Maximum Tenor

<i>Type of counterparty and instrument</i>	Minimum Rating	Maximum maturity/ Tenor
Sovereign governments	AAA/Aaa AA-/Aa3	30 years 15 years
Government agency, Official entities and Multilateral institutions	AAA/Aaa AA-/Aa3	30 years 15 years
Money market instruments, Certificates of Deposit, Time Deposits, Bankers Acceptances, Commercial paper and Fed funds.	AA-/Aa3 A/A2	1 year 6 months
MBS and ABS	AAA/Aaa	40 years
Banks and Financial Institutions	AAA/Aaa AA-/ Aa3	10 years 5 years
Corporates	AAA/Aaa AA-/ Aa3	10 years 3 years
Money Markets Mutual Funds	AA-/Aa3	1 year

Eligible Instruments and Transactions

<i>Type of instruments and securities</i>	
Government Securities	Authorized
Agency Securities	Authorized
Financial Institutions	Authorized
Multilateral Institutions	Authorized
Deposits, CDs, Bas	Authorized
Corporate Securities	Authorized
Asset-Backed Securities	Authorized
Mortgage-Backed Securities	Authorized
Money Market Mutual Funds	Authorized

APPENDIX

SCHEDULE OF DEFINITIONS

“Approved credit rating agency”	means an institution approved by the Vice-President, Finance, whose primary business is to assess the creditworthiness of public and private sector institutions and their obligations.
“Approved exchange”	means an exchange approved by the Director, Treasury.
“Asset-backed Security”	a security backed by notes or receivables against assets other than real estate. Some examples are autos, credit cards, and royalties.
“Asset-Liability Management	means the Asset Liability Management Committee of Committee (ALCO)” the Bank, chaired by the VP Finance. Members of the ALCO include the Directors Financial Control, Treasury, Legal Service, Financial Management, Operations Policy and Review, Planning and Budgeting. The ALCO supervises and monitors the implementation and proper application of sound asset liability management policies, guidelines and procedures primarily for the Bank Group.
“Authorized Bank Officer”	means an Officer of the Bank who has been expressly authorized by the Treasurer to engage in financial transactions on behalf of the Bank.
“Benchmark”	means the reference benchmark used as a yardstick to measure the Bank's Asset-Liability Management performance and to ensure adequate control of investment risks.

“Completion Point”	This is the point at which eligible countries declared to have completed the requisite structural reforms to qualify for irrevocable debt relief. The decision is taken by the Boards of Directors taking into account the corresponding decisions of the Boards of Directors of the other participating Multilateral Financial Institutions notably the World Bank and the IMF.
“Decision Point”	This is the initial point at which debt relief is approved for a country under the enhanced HIPC Initiative. The decision is taken by the Boards of Directors taking into account the corresponding decisions of the Boards of Directors of the other participating Multilateral Financial Institutions notably the World Bank and the International Monetary Fund. The country begins to receive debt relief from then and is expected to progress to Completion Point at which debt relief is granted irrevocably. Debt relief may however, be suspended or terminated during the Interim Period if the country ceases to meet the prescribed criteria.
“Director Treasury or Treasurer”	means the Director of the Treasury Department of the Bank or any other person designated to act in behalf.
“Duration”	in relation to any financial instrument is a measure of the volatility of the price of such instrument in response to changes in market interest rates. The duration of a fixed income instrument is calculated by aggregating the present value of each future cash flow weighted by the number of years from the present that each cash flow is due. The duration of a bond is measured in years and is always equal to or less than its maturity in years.
“Financial institution”	means a corporation, organization or institution, other than a bank, having judicial personality and whose sole or principal object, as defined in its constitutive instrument or the enabling instrument in the country of its incorporation or the country of its principal place of business, is to provide financial services in any form.

“High yield bonds”	high yield bonds are also known as non-investment, speculative grade, or “junk” bonds. Because of the additional credit risk, investors demand a higher yield for these bonds. The rating of high yield bonds is usually BB+ or lower.
“HIPC Initiative”	Heavily Indebted Poor Countries Debt Relief Initiative. A debt relief initiative to allow poor countries to achieve sustainable debt levels.
“HIPC Initiative Resources ” or “HIPC Resources” or “HIPC funds”	Refers to the Bank Group contribution of its internal resources as well as HIPC Trust Fund Grants received and managed by the Bank in order to meet the debt relief payments.
“Interim Financing Period” or “Interim Period”	Period between a country’s Decision Point and its Completion Point during which funds are received from the HIPC Trust Fund for debt relief. This period is generally expected to last no more than 3 years. Debt relief to be provided during the Interim Period must not exceed 40% of the total amount of the Bank Group’s overall debt relief to the country.
“Investments”	means any instrument purchased or sold using HIPC Initiative resources not immediately needed for debt relief with a view to earning a return.
LIBOR	means London Interbank Offer Rate. This rate is compiled by the British Bankers Association (BBA) and released to the market at about 11.00 am each day. It is the rate of interest at which banks borrow funds from other banks, in marketable size, in the London interbank market. LIBOR is the most widely used benchmark or reference rate for short-term interest rates.
“Liquidity”	means the ease, speed, and cost-effectiveness at which a long position can be sold or a short position can be bought back.
“Mark to market”	means the process of assessing the current market price at which a long position can be sold and a short position can be bought back.

“Market Risk”	the risk that unexpected changes in interest rates, exchange rates or other market variables will result in the decline in the value of an asset or an increase in the value of a liability.
Mortgage Backed Security	is a debt obligation backed by a pool of mortgages. Mortgage backed securities usually have a pass-through feature, which means that multi-payments of interest, principal, and sometimes pre-payment of mortgages, are passed through to the investor.
“President”	means the President of the Bank and the Fund or any other person designated to act on his behalf.
“Principal-Only (PO)”	refers to the principal payment portion of a stripped mortgage backed security. Holders of such securities are entitled to the principal payment of an underlying mortgage backed security.
“VP Finance”	means the Vice-President, Finance of the Bank or any other person designated to act on behalf.