INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

Thursday, May 31, 2007

Washington, D.C.

The Informal Meeting of the Executive Directors of the Bank and IDA convened at 11:44 a.m., in the Board Room, 1818 H Street, N.W., under the chairmanship of Mr. Vincenzo La Via, Chief Financial Officer.

C O N T E N T S

P R O C E E D I N G S

MR. LA VIA: This Bank/IDA Informal Meeting will come to order.

The item for discussion is entitled "Financial Operations for Reducing Interest Rate Sensitivity and Increasing IDA's Allocable Net Income."

This report was discussed at the Audit Committee on March 14, and a Green Sheet was issued. Executive Directors also received a Legal Note on May 29.

Let me acknowledge the statements including a join statement that Executive Directors circulated in advance.

Let me read an opening statement, and then I'll give it to John to introduce the discussion.

Before we start the discussion, I would like to give you a brief reminder of the background to this meeting.

Today's paper is Management's response to the request of Board members to explore innovative ways to boost the Bank's income generation ability by taking more risk on the investment side of the income equation. This interest was first expressed at the Net Income discussion two years ago. A preliminary paper on this topic was

discussed by the Audit Committee in July 2006. At that meeting, members of the Audit Committee requested specific options to make more efficient use of IBRD's risk-bearing capacity.

Today's paper contains Management's technical advice on how to use IBRD's enhanced risk-bearing capacity to stabilize income, and the advice here is to extend the duration of equity, but also contains Management's advice on how to best use risk-bearing capacity to increase income, and this can be best done by widening the portfolio investment assets to include asset classes with a higher risk-reward profile.

What we are seeking at this point is the Board's guidance on whether members are interested in principle in these two policy changes, and if so, whether there are nay modifications they would like to the approaches described in today's paper.

If the Board agrees to move in the direction proposed to extend equity duration, we would expect to come back to you in the fall with a formal proposal. A formal proposal for widening the asset classes of our investment portfolio will likely take more time. This would mean that it could be prepared in parallel and should be consistent

with the Bank's longer-term strategy as stated by a number of EDs.

Now let me hand it over to John to respond to some of the more technical questions that have been raised, and then we'll open it up for discussion.

John?

MR. HERLIHY: Thanks, Vincenzo.

I would like to start by just looking at the question of the consistency of the proposals with the Bank's overall strategy, and while it would certainly be useful to have a fully comprehensive operational and financial strategy in place, I would like to illustrate with some slides why we believe the proposed strategies in the amounts indicated would be useful even with the prospect of some changes in the strategies going forward.

First, I want to show where the Bank has been over the last 10 years and what has our current strategy been in terms of the sources and uses of funds, and these are the annual averages over that 10-year period.

So, on the sources side, you have the loan spread which over that period was significantly augmented by the Special Adjustment Loans with 400 basis-point spreads; you had a small spread of the liquid portfolio, and then you

have the equity contribution averaging almost $1.5 billion.

And on the uses side, you had administrative expenses of close to $1 billion; transfers--these are to reserves, additions to reserves of about $750 million average; and then, transfer out of the institution, including both IDA and uses of surplus, et cetera, of about $600 million annually.

So implicitly, and maybe we can net out the administrative expenses, the three categories that were covered by this period by equity contribution, and that extraordinary spread that we are charging during the period on the Special Structural Adjustment Loans, which has disappeared now since those loans are gone, so where we are now is that we have, really, three uses of the Bank's allocable income that need to be met out of the equity contribution. Those are transfers out of the institution, maintaining the real value of the equity by adding to reserves, and these administrative expenses that are not covered by loan charges.

Now, we believe that all of these uses are likely to be there going forward, and the relative importance of them will depend on the importance attached to public goods versus the importance of transfers to IDA or transfers to

other uses and the importance of maintaining the real value of equity. Those are going to be important decisions, and the strategic process that is underway may help to clarify the relative importance of these various sues. However, in our view, the uses are not going to diminish, although that's one option the Board has, to cut back to what we can afford; however, we believe that there are very important purposes going forward that will need to be served and that the difficulty is to decide between then. And to the extent we can effectively increase the return on equity to make it possible to achieve more in terms of those development purposes, we should do so to the extent that it doesn't interfere with the Bank's capital adequate. That is ultimately the question.

So the second question is the capital adequacy issue which we have addressed in the paper, and we have shown some very stringent tests of capital adequacy in the light of the proposals, but we would like to present it in another way, which is a question of how does this impinge on the Bank's ability to grow loans. Currently, have a statutory lending limit which will grow over time with additions to equity to above $200 million. So that is, if you like, the ultimate limit on what we can grow loans.

But in terms of if we require that we can only grow loans to the point that we would continue to meet our current stress test over the next 10 years, then that is the limit that our risk management capacity puts on the ability to grow loans, that we have shown right there. Without an endowment, we have an ability to grow loans to something above $200 million, to more than double the loan portfolio.

Now, that is in the expected case of--the base case. That's what we can do.

Now I want to show that if we look at what happens in the worst one percent, meaning the return on equity is in the lowest 1 percent scenario--that would now be a low interest rate scenario--here, we are even assuming we implement the duration proposal which improves the situation, but we are still sensitive over time, and particularly over a long period of time, to a low interest rate scenario. The result in that scenario would be that it reduces us down, and we can get to about $200 billion of lending. Still, it is a significant ability to grow loans over time even in that worst case scenario.

If we add the endowment to that--now, the endowment in the expected case, of course, will increase, will support further increases in lending; it is one

possible use of the endowment, because it will be generating additional income over time.

Now, if we look at the worst case, the one percent case, with the endowment, the lowest one percent returns on the endowment assets, I should say, it reduces it but actually very marginally compared to the risks that are already there, in part because of course it is an independent risk; it is very little correlation between the interest risk we have and the risk on the endowment.

All of that is just illustrative--and we could show worst case scenarios and vary things around, but I think in the volumes--and I should mention that this is assuming $10 billion. Obviously, the effects are even smaller with $3 billion which is what we are proposing at this time. So this is to say that even though it would be useful to have a fully evaluated strategy before moving forward, in practice, we know that the amounts that we are proposing are not inconsistent with anything that we are likely to want to do in relation to lending or our other objectives.

I think Vincenzo has already referred to the other issue of moving forward with the two proposals in parallel, and we listened to the discussion. However, I

think we need to recognize that no significant issues have been raised on the duration proposal that would really delay in a major way the implementation of that proposal, and given the consensus that exists around the duration proposal, we believe that we could present something for implementation in the fall.

On the other hand, there are a number of concerns on the endowment asset proposal that need to be addressed before the proposal is brought for Board consideration. In particular, the issue of arriving at a fully-articulated Bank strategy may take some time to reserve.

So the process of moving forward with this proposal is likely to take a longer time frame. We would not wish to delay our approach to the duration question while issues concerning the endowment assets proposal are being addressed. Inordinate delays in implementing the duration extension may result in less effective protection to the Bank in the event of plausible declines in short-term interest rates.

Thanks.

MR. LA VIA: Thank you, John.

Before calling on the Executive Directors, let me ask if Mr. Duquesne, as Chairman of the Audit Committee,

wants to make some remarks about the meeting we had on March 14.

MR. DUQUESNE: With pleasure, Chair, and I will be brief.

We had, as you said, on March 14 a long but productive meeting on this matter, as the rather long Green Sheet demonstrates. But first, let me say that the Committee expressed appreciation to Management for this paper, which members felt responded to the request made by then last July, or even two years ago. If I may add to those words of congratulation on a more personal note, as a dual ED, I am very happy to have a Finance Complex that is capable and that is ready to present a paper of such good quality when the sister institution had to use half a dozen central bankers--Governors--to deal with a similar situation. Here, I am referring to the so-called Crockett Report. So I think the Bank is at its best here when dealing with the real matters without having to use the services of big names.

Coming back to the Committee work, I think most speakers expressed sympathy for Management's proposals and noted recent developments worldwide in the area of portfolio management and also the Board's fiduciary duty to

optimize the utilization of the capital, as was just recalled by John.

I think the idea of duration extension to perhaps something like four-plus years was generally supported.

With respect to the endowment-type investment strategy, several interventions emphasized the need for careful deliberation and for any decision taken to be fully informed, and this is consistent with what you said.

There were a number of technical issues raised and also more fundamental questions of policies, that is, that the investment policy change could suggest a trend for the future of IBRD and especially its business and whether it will enhance the relationship with the strategy.

It should also be noted that the Legal Department answered questions regarding legal aspects and confirmed the consistence of the endowment-type proposal with the Bank's mandate and with the Articles of Agreement, and a Legal Note was circulated recently, responding to the Committee's request on that. And here also, thanks to Legal, which is sometimes more cautious and less innovative, but this should be noted, too.

It should also be noted that one member of the Committee was emphatic that in principle, the endowment

proposal is incompatible with the purposes for which IBRD shareholders have contributed capital, and a few other speakers expressed some concerns about the endowment-type proposal, citing among other issues reputational risk.

For those in favor, the Committee generally agreed that $3 billion was a prudent amount to the endowment-type portfolio and was strongly of the view that pursuit of this proposal should be accompanied by discussion and elaboration of a wide range of issues, including management and oversight, performance measurement, and income distribution considerations that were also addressed in the presentation by John.

So, this is for my task as Committee chair. I do not totally exclude coming back later in the discussion very shortly on one aspect as French chair, but I have been part of an interesting written statement with 10 colleagues.

Thank you.

MR. LA VIA: Thank you.

Let's open it up for discussion now.

Mr. Ong Seng?

MR. ONG SENG: Thank you, Mr. Chairman.

Let me start by saying that I welcome very much

this discussion. The market environment, Mr. Chairman, has undergone substantive mutations since the inception in the mid-nineties of the current Bank policy on equity duration that we must take stock of. In this regard, insulating the market value of the equity-to-loans ratio from interest rate shocks that is the main objective of the Bank's current policy appears to be outdated in today's low interest rate environment, particularly in view of the growing preference of borrowers for floating rate loans.

So I commend the Audit Committee for the leading role that it has played in triggering this review that led to today's discussion.

I particularly thank Mr. Pierre Duquesne and the Committee members for their insights that have led to the long Green Sheet which Pierre Duquesne just mentioned and which have provided very good insights to the Board.

I would like to stress the following three points. Number one, I support the proposed move toward lengthening the duration of equity to four to four-and-a-half years using a laddered approach. Like many colleagues, I believe it would greatly contribute to reducing the volatility of the Bank's net income.

I find in the meantime that such a move must be

combined with an accompanying strategy that carries a greater mitigating effect as regards the tradeoff that such a move could present for boosting the Bank's net income-generating capacity.

I therefore see a lot of benefits in considering the two proposals that are contained in this paper as complementary to each other. I am pleased to support them both as a package.

Let me now make my second point, Mr. Chairman. The ongoing effort for reducing the volatility and increasing the Bank's net income will be of no avail unless it is followed by a trickle-down effect on enhancing the actual contribution of the institution to the ongoing global effort for scaling up the support to development and poverty reduction, including in the poorest member countries.

I therefore do hope that the inherent benefits of this exercise could pave the way for more competitive products for IBRD borrowers as well as for a stretch of the amount of future transfers to IDA to the optimal level possible.

Finally, a personal view. The most sustainable long-term growth potential for IBRD and its net income

resides, in my view, in the institution's ability to increase both the volume and the predictability of its loan portfolio. We therefore urge Management not to lose sight of this priority as we consider the proposed shift in the Bank's financial strategy.

Thank you.

MR. LA VIA: Thank you.

Mr. Kanda?

MR. KANDA: Thank you, Mr. Chairman.

I very much appreciate Management and staff for this very useful and interesting paper, and I thank staff for their responsiveness and constructiveness to our request. And surely I appreciate the initiative of the Audit Committee.

As I have distributed my written statement, I will try to be brief. First, the extension of equity duration is okay with me. As staff has proposed in the introductory remarks, we should move forward with this path.

Second, I have to say that I strongly oppose the alternative investments amongst an endowment-like strategy. I have detailed the reason why in my written statement, so I won't repeat it. But actually, I believe the

diversification of the portfolio is theoretically quite right in terms of more stability and some increase in the return from a set of investments for the long term.

However, when we apply this to the public sector, we have a host of difficult hurdles to implement it, some of which are almost impossible to overcome in my view.

In Japan, we tried to diversify the portfolio of our official reserves and other public money when I was in charge of fund management, looking at the well-known Singapore GIC as one of the extreme models, and to be honest, we retreated, as we found it at least premature. Still now, all over the world, I observe only a minority invest in alternative assets as far as the public sector is concerned. This is a reality and with good reason.

The joint statement by 11 chairs and Mr. Alkhalifa and others has provided a good list of concerns, although they are more positive.

Many chairs are concerned about reputational risk. Perhaps this is a more serious problem in the actual political sense. Mr. Debevoise, Mr. Amr, Mr. Khan and others caution about the risk to contradict against the mandate and purpose of the capital or our existing business model. Of course, we could interpret that this might be

legal, but the point is how the world outside this building, particularly taxpayers, who contribute to the capital, would feel about it. I think it would be extremely dangerous and counterproductive in maintaining and mobilizing the support to the Bank Group.

Mr. Watson pointed to over-capitalization. Indeed, at the EBRD, even paying back dividends to shareholders is under discussion. I never want to have a risky potential trigger for such a discussion here in the Bank.

But my most serious concern is the longer-term nature of this asset class. It cannot be accountable for the rather short-term results. I cannot be consistent with our future strategy because nobody knows, decades later, what will be our strategy. We don't even have a strategy for next year. We cannot hold managers accountable. We cannot evaluate the performance properly. We cannot provide managers with the right incentives. We don't have transparency and accountability program and so on. That is why I oppose it in spite of the very good intention of Management responding to the very legitimate concerns, which I highly appreciate, and my full confidence in the capacity of Bank Management in this operation.

Third, the residual is higher risk-rated bonds and public equity investment which might be worth further consideration, although some difficult issues that I have outlined in my written statement should be sorted out.

Thank you, Mr. Chairman.

MR. LA VIA: Thank you, Mr. Kanda.

Mr. Kariniemi?

MR. KARINIEMI: Thank you, Mr. Chairman.

We have signed a joint statement with colleagues, so I will try to be brief, but I want to stress a couple of points given that we are not members of the Audit committee, and we have been less involved in the discussions at that stage.

First of all, we commend Management for and fully support the proposal for extending the equity duration of the IBRD portfolio to improve income stability. Moreover, and given the large needs of the Bank to provide global and regional public goods as well as the need to preserve the real value of its equity, we welcome Management's efforts to strengthen the Bank's income position and support the proposal to invest a part of IBRD's earning equity in a less conservative way, in more diversified classes of assets. In our view, there is clearly a need to utilize

the Bank's capital more efficiently.

In our view, this proposal to invest in somewhat higher-risk and higher-yield instruments to enhance expected income, while certainly important and significant, is not an extraordinary divergence from the current and past investment practices of the Bank. This should be done, and in our view, the proposal is clearly presented in a prudent manner.

First of all, as just noted in the opening remarks and in the slide presentation, the proposed amount of US$3 billion will not compromise the IBRD's ability to support strong loan growth.

Secondly, it will be phased in over a three-year period in order to reduce the timing risk.

Thirdly, a buffer in the surplus account will be created to address income volatility in the intermediate periods.

Fourthly, investment choices will be governed by guidelines to assure consistency with the Bank's ethical and social values.

Finally and fifthly, management of funds will be outsourced to avoid any potential back door lending, as explained in the Legal Note.

In this context, we just want to emphasize the utmost importance of committing ourselves, "ourselves" meaning the Board and the shareholders, to the long-term perspective. In our view, this is key in achieving the objective of higher returns, and we must be prepared to tolerate periods of negative market value performances and must not coward out from this long-term commitment if adverse developments happen.

Finally, and in response to the Chairman's request, we certainly remain interested in both proposals, and we look forward to receiving further operational details on both of them.

Thank you very much.

MR. LA VIA: Thank you.

Mr. von Kleist?

MR. VON KLEIST: Thank you, Mr. Chairman.

We too have signed a common statement, so I can be very brief.

We welcome this, and we thank staff for the innovative thinking they put into this. We welcome today's discussion, and we in principle support both proposals.

The equity duration extension strategy, as others have noted, is much more straightforward and has less open

questions attached to it, so we fully support that.

On the diversified portfolio of assets, or the endowment fund strategy, we have in our joint statement posed a number of open questions, so we feel on this second part of the strategy that today is more a technical discussion, and we look forward to having these open questions answered, or to put it otherwise, that we have a skeleton, and now we need to put meat on the bones, and that the actual decision on whether to go forward with the endowment strategy will be taken at a later stage when the proposals are more fully fleshed out.

At the same time, as others, we feel that on the one hand, one has to develop the strategy of the Bank Group as such to make sure that these financing mechanisms are aligned to that--a point that Mr. Kanda just raised; and on the other hand, there is no use in wasting time. So in that sense, we would be willing to or we would look forward to having work proceed on both proposals, but if at one point it should become apparent that the endowment strategy should keep the other proposal from being implemented, we wouldn't have a problem against unbundling.

Thank you.

MR. LA VIA: Thank you, Mr. von Kleist.

Mr. Boersma?

MR. BOERSMA: Thank you, Mr. Chairman.

We signed a statement with many other chairs, so in this round, I would like to reply to some of the interesting points of other chairs in their statements.

First of all, we started the process more than two years ago by the request of the Audit Committee, on March 9, 2005, so we have been more than two years working on this, and we have come a long way, if you look at where we started and where we are now.

First of all, I would like to thank John and his team for all the work they have done and accumulated in this very interesting and well-written paper. I have five or six arguments, depending on the mood, and I will pitch these arguments in favor of the second proposal--investing in a diversified asset class.

First of all, on the demands, as we all know and as we all know and as we all do ourselves many times, we ask a lot of this Bank. We ask for more technical assistance. We ask for more waivers for middle-income countries. We ask for demands to IDA. We ask the Bank to do global public goods. We see these trends continuing and even strengthening in the future, so there will be more of

these kinds of demands because the Bank is doing a good job. Therefore, we need money. We need a lot of money to help all those people who depend on us. So we need this money by looking creatively, and I think that is the proposal that we are discussing today.

On the change in the business model, we consider the proposals today as a technical issue. While Mr. Amr and Mr. Khan argue that we should maintain the current business model of the Bank, and especially the ability to lend, I think that's a fair point, and we also share the view fully. This is not the time to start a discussion. We are doing that in the strategy discussion, and I cannot imagine that the outcome of the strategy discussion will be something where we don't need money, so regardless of the outcome, we always need more money.

On the fiduciary duty, some people say that we are not in the business to make money because that is not in our development mandate. Well, we have the clear Legal Note, and we don't share the view that we are not here to make money. We find it our fiduciary duty as a Board to the Bank but also to our shareholders back home who ask, "Why don't you do more with this capital? Why don't you help more people by generating more income?"

On best practices, Mr. Dib pointed out in his statement that it is just simply best international practice to diversify the assets and that the Bank should also do that. We fully share this view and think that modern portfolio theory highlights that diversifying assets increases yields with little or no additional risk, as Mr. Markowitz outlined in his article in 1953 and even won the Nobel Prize for it.

Why should we combine the strategies? Mr. Amr also mentioned this, that combining strategies, these two together, over a 10-year period will give with a 99 percent confidence level a higher income of $190 million. By combining the options, we will also reduce the volatility and increase the expected income.

On next steps, we have a preference for combining the proposals or keeping them combined and coming back to the Board as soon as possible--the fall seems an adequate time of the year to discuss it. We definitely see that everybody is unanimously on board for the first one, so maybe if the Board is willing to say, well, let's separate them out for the second one, we could consider that, although we are not in favor of that approach, but we have to make sure that we don't delay too long. We have been

doing it for two years, so I think the fall also for the second one would be an excellent time. And also, a new iteration with the Board or a new paper that reflects all the comments made by the Board could be helpful to get more consensus, although if we count the statements, we think there is already a majority for the second one.

Having said that, I want to wish Management all the best in the next steps and look forward to the new papers.

Thank you.

MR. LA VIA: Thank you, Mr. Boersma.

Mr. McCoy?

MR. McCOY: Thank you.

We agree that there seems to be relatively broad support in the Board for Management to go forth and develop proposals or options for investing in the longer-term asset proposal, what Management calls "equity duration." We also think that that proposal should not be held hostage to the second proposal, which a number of other chairs have concerns about.

With respect to the second proposal, we do not agree with Management in its opening statement where they propose going forward and preparing a proposal for an

endowment-like fund in parallel with the Bank's Strategic Review. We believe that this is premature and implies that today we are making a decision to go forth with some form of an endowment-type fund.

Last July, Management promised the Audit Committee that it would prepare a document describing alternative options for investing the IBRD's short-term liquid assets. As I recall, there were various types of financial instruments listed, but there was no indication by Management of what type of proposal they were going to make. A few months ago, Management came forth with a revolutionary proposal of having the IBRD investment in an endowment-type fund composed of investments in publicly-issued stocks, privately-issued stocks, hedge funds, and real estate.

The proposal to adopt an endowment-type fund raises major questions regarding whether we are changing the Bank's mandate and business model. The IBRD was set up as a lending and guarantee institution, not an endowment. The Legal Note says it might be legal, but it does not say that it is consistent with the Bank's mandate.

Our taxpayers did not invest in this institution so that it can invest in hedge funds, equities, and real

estate. As Mr. Kanda notes in his statement, we do not believe that our taxpayers would consent to having their tax money invested in alternative assets such as hedge funds and real estate.

To date, IBRD nonlending investments have been for the purpose of maintaining liquidity and have been restricted to high-quality assets composed mostly of assets with an AAA or AA rating. To date, we have had one MDB, IFAD, adopt an endowment-like portfolio. Since then, their management has been changed. They have suffered a substantial loss.

When the IBRD was set up, it was not envisioned that it would be investing in relatively risky financial assets.

We agree with the statement made by the Canadian chair, that this is an issue being treated as a financial policy issue as opposed to a strategic one. We agree with Mr. Khan that such a fundamental shift in the IBRD's policy should be preceded by a clear articulation of the Bank's strategy and mandate. So far, we have had one Audit Committee meeting this spring, and today's informal Board meeting, which is occurring bunching season, to discuss a major issue which could have huge implications for the

Bank's future. This is also at a time when the Bank is undergoing a change in Management. We do not believe that at this time, Management should consider that it has a green light to go forward and develop specific proposals for an endowment-like trust fund. We believe that more issues need to be discussed, including the Strategic Review, issues such as what are the implications of locking up a portion of the Bank's equity? What would be the implication if we have an Asian financial-like crisis in the future? Does this mean that it is more likely if we have a crisis that we have to raise loan charges because we have locked up a portion of our equity? What are the implications for contributions to IDA in the near term?

Thank you.

MR. LA VIA: Thank you.

Mr. Choi?

MR. CHOI: Thank you.

I appreciate Management's efforts to give us a fine paper, and I think this is a case where we can see a clear divide among Board members, with clear opposition and very clear support.

I am a little overwhelmed by the joint statement signed by 11 EDs, but I am also happy to see Mr.

Debevoise's and Mr. Kanda's and other EDs' written statements and interventions.

Regarding the first proposal, the extension of duration period, this chair does not see any problem, so we can go ahead.

Regarding the second proposal on the endowment fund, this chair has some concern and is very hesitant to give the green signal. As other chairs have said, diversification is a good direction, and enhancement of net income generation power is also a good direction. But we have to think about what is the basic solution if there exist excessive retained earnings or excessive liquidity. What is the basic solution?

I think the basic solution number one is to make IBRD loans cheaper and more competitive or attractive. The second solution could be to transfer more net income to IDA--or retained earnings--maybe retained earnings is the exact expression.

So, as Mr. Ong Seng said, how to increase net income generating power should be found in the lending operation products, so how to make the projects and operations more attractive--I think that should be the basic approach.

My second point is on the reputational risk and possible mandate creep issues. I think the endowment fund is kind of a creation of a small investment bank inside the IBRD, and this small investment bank will put money into hedge funds and real estate, very risky assets, so I don't think this image can go a long way to the image of the IBRD.

The investment bank image is like a ferocious profit-seeker, but IBRD is not a ferocious profit-seeker, so the question is how to harmonize or reconcile these mutually [inaudible] images. That is a very important task to be addressed.

Second, on the mandate creep issue, the General Counsel issued the Legal Note, but I think there are several questions to be answered on this Note. First, the General Counsel is saying that this endowment strategy is in line with the historical evolution of the Bank's investment policy. But looking into the historical evolution including time deposits, including ripples or interest rates swaps and so on, including the fixed-income assets, now the risk assets, and expanding into risky hedging areas, not taking heavy risks--so what is the definition of "evolution" here? Evolution into what?

Evolution from less risky into heavily risky, or standing in line with the risk-free assets? This is a little bit of a vague interpretation of a past evolution of investment strategy, so I need some clarification here.

Second, according to the Legal Note, "Segregating investment assets for uses other than disbursement and debt service," at page 4--segregating investment strategy is not a new one, so this is to justify in a sense the segregated endowment fund. But according to the explanation, the example given here is that "in the 1990s, the Bank held a sterling 'held-to-maturity' portfolio to offset long-term sterling bond borrowings." I don't see this as segregation. This is just investment restriction or investment doctrine, one branch of investment doctrine, not the creation of a separate fund or a separate pool. That is my interpretation. So I need clarification here.

Last, the Legal Note says "'back-door; lending without due consideration of the Bank's lending policies and outside the overall country limits"--this means that when the endowment fund money is invested into developing economies, this is another way of assistance without proper process. So the answer is that the Bank Management will intervene in daily decisionmaking, and the outside

outsourcing partners will make daily decisions. But I think this is a matter of the degree of specificity of the mandate you give to the outsourcing partners. So even if you don't intervene into the daily business, if you give them a specific guideline, then that guideline could make some barrier or a propeller to get into or get out of certain economies. So this is a matter of the degree of specificity of your mandate given to the outsourcing partners.

So this Legal Note needs some improvement to answer my questions.

My third point is on the exit policy. So the IBRD puts money into one economy, and sometimes comes to get out of that country. Assume that if that country is on the verge of financial crisis, then your behavior could trigger excessive herd behavior of an exodus and put the country into serious crisis. So, how do you handle this kind of risk? Even if you hire outsourcing partners, there are no secrets in the market, so outsourcing partner A is hired by the IBRD, and now that partner is leaving the market, and this is a good signal for other investors to leave. How to handle this kind of risk is a big question for me.

So, to avoid this risk, as some Directors suggested, the money will be put into only advanced economies, not economies with potential risk. Then, if IBRD money goes into advanced economies, that also causes some dispute as to why IBRD is putting money into advanced economies. This is again not matching the original mandate.

I propose a step-by-step approach here. As Mr. McCoy said, the first proposal should not be used as a hostage to pass the second proposal. So the first proposal first and then discuss more about the second proposal. We have to cut the first proposal from the second proposal and let the first proposal go. That is my final point.

Thank you

MR. LA VIA: Thank you.

Mr. Panov?

MR. PANOV: Thank you, Mr. Chairman.

I think I'll try to be simplistic at this point rather than try to over-complicate things. The particular image that I take from the previous speaker of a "ferocious" financial best--of course, in the eyes of a client country, the Bank is "ferocious" because they charge interest on loans. On the other side, I have no problem

with that. Usually, the problem becomes when the Bank comes not only with interest charges but with a lot of conditionalities.

I recall in 1998 in the middle of the crisis in my country, we had a loan with 120 conditions attached to it, which basically made it impractical to pursue. But this is a different line of argument. We, as opposed to some of the clients, definitely support both proposals. The first one is pretty straightforward, and everyone has spoken about that. The second one, we definitely support in principle, although some of the details of that approach could be worked out at a later stage. And we join the caveats expressed by a number of Directors that certain asset classes may not fit at this moment and have to be excluded outright, but that doesn't really mean to say that the proposal cannot be pursued and details should not be worked out beginning as of now.

So we would urge the Management to follow the majority of the mood expressed today and work on that option as well as the first one. And we still consider it to be a purely technical rather than a strategic deviation from the business model that we have. It is liquidity management. It is pretty common in the industry to have a

layered approach to your liquidity needs, and we definitely support that.

Thank you.

MR. LA VIA: Thank you.

Mr. Familiar?

MR. FAMILIAR: Thank you, Chair.

I signed a written statement, so I think our position on both proposals is quite clear.

I want to bring to the table an additional set of issues which are related to these proposals. They have to do with our risk management philosophy, the dynamic nature of risk management, and the governance arrangements in place for risk management.

Now we follow a philosophy that minimizes exposure to certain risks, and when it comes to the management of the risk we do take, the governance arrangements and in particular the Board's role are mostly a transaction-by-transaction approach. And I think that if these initiatives are going to move forward, we will have to address the governance arrangements we now follow. Even if these initiatives don't move forward, I think that we would benefit from having periodic discussions of the risk management practices we follow and the risk profile of the

institutions in our group--not just the Bank, but this would apply also, of course, to IFC and MIGA. And I think that in this particular area, we are not at the top of the line in terms of governance arrangements. So I think we should look into this and actually do something about it.

Thanks.

MR. LA VIA: Thank you.

Mr. Nemli?

MR. NEMLI: Thank you, Mr. Chairman.

We also joined the joint statement with the other 10 colleagues, I will be brief.

We strongly support both of the proposals and congratulate and thank Management for that.

I would like to touch upon two issues for emphasis. One is that neither of the proposals should be hostage to the other, and none should be hostage to the argument that we haven't finalized this strategy yet. Of course, everything should be compatible with the strategy, but I believe that this more efficient use of the IBRD capital is compatible with a very wide range of strategies provided that these strategies involve the ability to translate additional income to development impact, and I cannot imagine right now any kind of strategic vision that

would not require any additional income. It is very clear that we need more income to serve our mandate better, so I don't see any reason that we should delay the implementation of these suggestions.

The second issue that I would like to touch upon is the public money argument and the taxpayer money and whether the taxpayers would agree to invest in relatively more risky assets. Of course, it goes without saying that we have high responsibility in using the taxpayers' money, but our responsibility is not only to find the most secure and risk-free asset. We should explain to the taxpayers at the same time not only why we take some risks but at the same time why we have not used their money in the most efficient way and why we have foregone a reasonable amount of additional income without taking any undue risk. So it is basically a technical issue, and finding the most risk-free asset is not the best practice and is not in line with the modern portfolio theories, so it is not whether we are a "ferocious" animal, but we are financial institution and dealing with the money, and it is a purely technical issue to use the IBRD capital in the most efficient way by applying the best practices.

So we strongly support Board initiation and to

move ahead quickly.

Thank you.

MR. LA VIA: Thank you, Mr. Nemli.

Ms. Zou?

MS. ZOU: Thank you, Mr. Chairman.

Since I already cosigned a joint statement with a couple of colleagues, I won't repeat that statement. I have just two points.

Basically, I think we also strongly support both of the initiatives, but we have two additional comments here. The first one is regarding the extension of the duration. We support the initiative, but I think the one question that Management needs to consider is that there is a judgmental issue here, because the current duration matching was decided during the mid-nineties when the interest rate was unusually high with an increasing trend. Now the trend of the interest rate has changed, and now, probably our change in the duration is based on the judgment that in the near future, we will see a declining trend of the interest rate movement.

But I think our judgment could be right or could be wrong and that the basic trend of the interest rate could also shift. So I would invite Management to look

into this issue and make the duration matching more adjustable in order to be responsive to the changing market.

The second thing is about the endowment type of strategy. Basically, we are supportive of this idea. Of course, I think we should take both a cautious and proactive attitude. On the cautious side, of course we want to maintain the AAA status of this institution, and we also want to make sure that the risk is manageable. But on the other hand, I think we should also be proactive. I don't see a reason why we should be hesitant and wait. I would encourage Management to go ahead and design the specific program for this. I listened to the previous speakers very carefully, including Mr. Choi and Mr. McCoy, about whether this approach is going to fit into our mandate, and I don't see any problem with our mandate, because I think there is no problem for us to generate income; the question is what is the income for. If we generate income for the development purpose, then it is fully consistent with our mandate.

Then, how about investment in hedge funds? I think it is a very interesting question that involves a philosophical or ethical issue here. Like Mr. Choi, I also

come from an East Asian country, and we had a bad experience with the East Asian financial crisis, and part of the reason was the attacks by the hedge funds. So hedge funds to not have a very good reputation in my country, actually. So, when you mentioned that you want a development institution to make investments in a hedge fund, naturally, we got alerted, just like a parent would want to warn his or her children against making friends with hooligans. But I think we need to look at this issue from another perspective. Hedge funds are not hooligans. Sometimes they create challenges and problems for the stability of the financial market, but on the other hand, they apply more than financial techniques and provide services to investors and generate a higher rate of return for investments. So I don't see any problem if the World Bank can take advantage of these modern techniques to serve the global poor.

I agree with Mr. McCoy that usually, ordinary people, the taxpayers, don't invest in hedge funds, but I think things are changing nowadays, and hedge funds should not only be a privilege for the rich. We can make them serve the interests of the poor as well.

Also, even in the United States, I think you can

see more and more institutional investors like the pension funds investing in hedge funds. So the hedge funds have started to serve the interests of ordinary people as well, and I think we should welcome this trend, and we should make it happen, actually, to take advantage of the modern financial technology to serve the poor instead of solely serving the rich.

So I think this should be a welcome direction for us to at least try.

Thank you, Mr. Chairman.

MR. LA VIA: Thank you, Mr. Zou.

Ms. Ketsela?

MS. KETSELA: Thank you, Chair.

Since I am a member of the Audit Committee, and I am in full agreement with the intervention made by Mr. Duquesne--in other words, our comments are already incorporated in the Audit Committee report--I would just like to emphasize some points.

As the document indicates, the recently decline in IBRD's core allocable net income and its increased sensitivity to short-term interest rate changes need to be redressed urgently through innovative financial solutions. In other words, we are in total agreement with the

proposal.

If unresolved, these problems will seriously affect the Bank's long-term capital adequacy and its capacity to scale up resources to IDA and to enhance the Bank Group's effectiveness in achieving its development objectives.

Tackling the problems of declining levels and increasing volatility of IBRD's net allocable income requires the application of a combination of mutually reinforcing innovative financial solutions. To the extent that the combination of the proposed financial strategies will mitigate the relative instability and also increase the level of IBRD's allocable net income, we favor the adoption of both strategies.

To mitigate the potential institutional reputational risk of the proposed financial solutions which some chairs have raised, we believe that Management should design and implement two things. One would be a comprehensive communication strategy to market the objectives and rationale of the financial strategy's stakeholders, and second would be to design and implement a robust management information system for monitoring and reporting the strategy's performance results.

Finally, I would just like to reiterate my support and also comment Management for a well-written document.

Thank you

MR. LA VIA: Thank you, Ms. Ketsela.

Mr. Duquesne?

MR. DUQUESNE: Thank you, Chair.

I was very, very pleased to participate in a joint statement with 10 other chairs representing the European countries as well as emerging economies. That does demonstrate a strong desire for consensus and not division, as acknowledged by Mr. Choi.

Let me focus rapidly on some specific points. I really think that--and of course, I will limits my words on the second proposal--I really think that reputational risk--which is the political risk, Mr. Kanda; it is the same thing--should not be underestimated. More precisely, there are two sets of risks--first, that the name of the Bank might be associated with the name of one of its investees, be there a financial loss or not. The second is that market stakeholders would interpret some investment decisions as reflecting the Bank's views on sectors or regions. This also raises a potential conflict of interest

issue with the Bank's other activities in the global economy. But even if we must deal with this reputational risk, as we recall in our common statement, we think these issues can be addressed.

As some socially responsible investment vehicles screen the kinds of investments they select, the Bank should apply strict selection rules. We take note of the potential tradeoff between return on investment and strict selection criteria, and this is suggested by Footnote 40 on page 25, but we think that some reputational risk cannot be monetized. Therefore, we would invite staff to go beyond the statement on page 25 that, and I quote, "Investment choices could be governed by guidelines." I think such choices "should"--not "could"--be governed by strict guidelines.

In that regard, I may understand some concern in Mr. Kanda's written statement regarding alternative investments, especially hedge funds, and I took note of the positive vision of hedge funds just given by Ms. Zou. Hedge funds are by definition nontransparent, and their high returns derive directly from this lack of transparency. And prospects for regulation might not matter as in the short term, even if my country, with

others, would be in favor of such regulation. So we would be pleased by seeing the U.S. joining us in that effort, beginning in 10 days in Heiligendamm.

Therefore, limiting or excluding up front any investment in this type of asset could be an appropriate answer.

As shareholders, we must understand that such an investment strategy requires a long-term vision and consistency over time even in the case of downturns--and I underline, even in the case of downturns--and if IFAD has lost money, it is indeed because the strategy was abandoned at the worst moment. But for us to keep this long-term approach, all conditions must be put into place by Management to smoothen the effects of volatility on returns.

Having said that, we think that this solution, provided the mentioned caveats are lifted, should be swiftly implemented. We ask Management to elaborate further on their proposal to make it fully operational, and as Mr. Panov said and as I alluded to, the main question is which asset classes we want to invest in. So it is not a philosophical question; it is a very classical practical question. And this is a reasonable one.

Let me put it another way, and I did so many times in the Audit committee. Even in terms of the Bank's image, is it good that we invest essentially in Treasury bonds of developed countries? Is it the mandate of the Bank to finance the public deficits of developed countries including mine, and is it better to do so rather than to invest on the markets? This is a question for those who say we cannot do so.

Of course, the investment strategy should remain consistent with the conclusion of the Strategic Review, but let us be pragmatic. Whatever we conclude on the Bank strategy, and in line with what was said by Mr. Nemli, it is more than likely that we will end up saying we need to extend the income basis. There are several options for that, and none of them should be excluded ex ante, but I cannot imagine the diversifying and optimizing our liquidity would not be part of the proposed solution with regard to the opportunity cost involved in maintaining the current policy.

Let me conclude by saying that Mr. Ong Seng has responded in advance to the final questions of Mr. McCoy. This pilot program of a relatively small amount will help to maintain transfers to IDA and will help to maintain

competitive rates for IBRD borrowers.

Thank you, Chair.

MR. LA VIA: Thank you, Mr. Duquesne.

Mr. Rab?

MR. RAB: Thank you very much, Mr. Chair.

We have also expressed our support in the joint statement, so I will be very brief.

I just wanted to come back on the point of the mandate in relation to investment in a diversified portfolio and just to ensure that we don't mix the means and the end. I think that despite the divisions, there seems to be a clear consensus on the end, which is to generate more return for development purposes. And in recent presentations, Management has shown us that it is clear that with the current investment strategy, even in steady state, something needs to be done in relation to net income given the increasing demands on net income on the one hand and the declining or eventual declining real value of the equity on the other. But given some of the concerns raised, I think it would be useful to have another iteration on more detailed proposals from Management on the second option.

Lastly, I would like to support Mr. Khan, Mr.

Amr, and what Mr. Duquesne has just said on the importance of developing principles for the prioritization on the use of net income.

Thank you very much, Mr. Chairman.

MR. LA VIA: Thank you, Mr. Rab.

Mr. Vualnam?

MR. VUALNAM: Thank you, Mr. Chairman.

Firstly, Mr. Chairman, we support the first proposal, and our concerns about the second proposal, Mr. Chairman, are on a few issues.

Number one, it is very clear from the paper that IBRD does have the capacity to bear the financial risk, but on this issue of reputational risk, which has been elaborated eloquently by several speakers, at this moment when we are in a rebuilding phase in the Bank, we really do not think we can add any reputational risk to the preferred status of the Bank.

On the issue of additional income, Mr. Chairman, it is a concern, and it is one of the primary drivers. One speaker mentioned the combined strategy resulting in a higher income at 99 percent confidence level, but our understanding is that within that, the endowment fund in fact has a lower income at the 99 percent confidence level

in a downside scenario, and successive Medium-Term Strategy Papers have been informing us that downside scenarios where income declines are the most worrying situations. So the endowment fund in good times can raise the income, but it has a downside scenario which is in fact contradicting the equity extension. So on the income issue, there is some doubt in our minds.

Finally, Mr. Chairman, on the issue of mandate, helping developing countries definitely remains there, but the issue is whether IBRD remains a lending bank or do we change the model--is this the beginning of a change in the model--and linked to that is, for instance--in our minds, an issue which needs to be addressed going forward is the preferred creditor status which borrowing countries have given because IBRD has been until now doing borrowing solely for the purpose of onlending to the developing countries.

So these are some of the issues which give us concern about the endowment fund.

Thank you, Mr. Chairman.

MR. LA VIA: Thank you, Mr. Vualnam.

Mr. McCoy?

MR. McCOY: Thank you, and I'm sorry to come

back. I just want to make a couple of responses to some things that some of the chairs have made statements about.

Regarding parking liquid assets into advanced countries, the Bank doesn't do this to help finance the fiscal deficits of advanced countries. They park those assets because those are safe assets with very low probability of principal loss. So this is an issue of protection and maintenance of liquidity and the value of their investment for the Bank.

With respect to the issue of does the endowment proposal help transfers to IDA--well, maybe in 10 or 15 years. But it is definitely true that there is a higher risk. There will be less transferred to IDA in the next few years if that endowment-like facility experiences a market loss. So in the near-term future, it is much more risky, the ability of the Bank to transfer funds to IDA.

Finally, there have been a number of statements about let's eliminate certain asset classes--let's not do hedge funds; let's not do private equity issue. I find it would be very difficult for Management then to say from this meeting, "Okay, I will come forth with a proposal for decision by the Board on an endowment-type fund," with these issues not resolved yet. I believe there should be

more discussion on the appropriateness of adopting an endowment-type fund before the green light is given to make recommendations for Board consideration.

Thank you.

MR. LA VIA: Thank you, Mr. McCoy.

Mr. Kanda?

MR. KANDA: Thank you, Mr. Chairman.

I'm sorry to come back. I carefully listened to my colleagues' very thoughtful comments, particularly Mr. Duquesne's professional comments, which I appreciate, but I still strongly oppose going forward particularly with the alternative asset class including private equity, hedge funds, and real estate. I won't repeat the issues of reputation, transparency, accountability, and so on, but I would just like to reiterate one issue or explain the time horizon issue.

I think there is theoretically relatively high probability that we would have more return in a rather long period of time--nobody can be sure or guarantee, of course--but when we have a loss with, again, a relatively high probability with similar magnitude of the increased return over a long period of time, can we just say, "Don't worry, we'll recover the loss--just wait 40 years"? We can't. So

the time horizon of decades for this investment type is actually not compatible with our accountability system, and this is very important.

Thank you, Mr. Chairman.

MR. LA VIA: Thank you very much, Mr. Kanda.

Let me ask John to answer some of the technical questions, and then I'll ask Scott White to answer some of the legal questions.

John?

MR. HERLIHY: One question I want to deal with is on the duration and the issue of the view that it was based on a view on interest rates--Ms. Zou's point. That isn't the reason why we are undertaking it. It was certainly a concern that interest rates might decline, not a projection that interest rates would decline, but that it is important for the Bank to protect itself against that scenario which would be a very negative scenario for the Bank.

Also, in the implementation of the proposal to avoid that time issue, we would introduce it in some type of phased fashion which would be less sensitive to the moment in which it was implemented, which is one of the reasons why we would like to begin as soon as we can in some sense in the implementation of that proposal.

And again I would say for those who still see value in the two proposals moving together that moving forward with the duration proposal does not in any way detract from moving later with the other proposal. In fact, by stabilizing income, it prepares and makes more attractive and easier to implement the other proposal, so in fact it prepares the ground for that second proposal.

MR. LA VIA: Scott?

MR. WHITE: Thank you, Mr. Chairman.

We appreciate and note all the comments that have been made in the written statements as well as the oral statements that relate to the Legal Note. I am always on safe ground by apologizing, but I apologize for the lateness of the Note getting to you all; we intended for it to be there sometime last week, and for various reasons, that didn't happen.

On the particular point made by Mr. Choi--and of course, we particularly appreciate people who look with great care at our Legal Notes, so I appreciate the very specific comments that he has raised--they are all fair observations. I would simply say that we don't think they rise to the level of being legal concerns per se, and let me just mention each of them in turn.

On the first point concerning what I'll call the continuum of risk instruments--I believe Mr. Choi's comment had to do with the fact that the instruments that have been approved in the investment authorization are essentially fixed income, and there are other asset classes here that are perceived as riskier, and don't take issue with whatever the perception may be on it--however, the instruments that have been approved under the General Investment Authorization over the 60 years of the Bank's history involve varying degrees of risk. If you are in an overnight commercial bank deposit, you have a particular risk. If you are in a short-term U.S. Treasury instrument or an instrument of another country, you have a particular short-term risk. If you are in a 30-year U.S. Treasury Bond or a perpetual bond, even thought it is fixed income, you have a particular risk profile. And from a legal standpoint, these are simply a set of additional asset classes with different risk characteristics both individually and taken together as part of a strategy which in our view can be authorized by the Executive Directors, and it is in your wisdom and judgment as to whether or not it is an appropriate risk profile. So it is not the fixed income versus non-fixed income--that doesn't rise to the

level of being a legal question.

The second point I believe had to do with segregation and the fact that we observed that that is not new. That goes to the issue of why these assets are held, and I will note that in the Preamble to the General Investment Authorization that we have used for many years, we refer to the fact that it is seen as desirable that the Bank invest all or any part of the moneys held by it from time to time, and not immediately required for use in its operations. The issue there is how "not immediately required." Is it "not immediately required" perhaps for some months or a few years, but it is part of the Bank's minimum prudential liquidity because these are seen as being on-deck funds for disbursement on loans, or might it even go beyond being that level of availability, and these are funds which are really remotely available?

So the reason we referred to the sterling portfolio as an example of going maybe a little bit beyond normal liquidity was that those funds were for their time stated to be held to maturity, so Management was signaling that even though it was counted as part of liquidity, it was more segregated than the rest of liquidity.

This again is not a legal issue. The degree of

ringfencing that takes place with respect to the assets is a judgment call. There is also a judgment by this Board as to what the minimum prudential liquidity should be and what is counted as part of liquidity and what isn't. But when it comes to the basic legal issue, we say it is what the Board authorizes under its investment authorization based on the implied powers of the Bank.

So again, I can take Mr. Choi's point with respect to segregation and say that ringfencing is not the legal issue. It is a judgment call by the Board--what should be part of the immediate liquidity funds and what should be perhaps more ringfenced.

A third point relates to our commenting on emerging markets. The reason we even raised that was to indicate that there are risks associated with investments even by outside managers that may be in asset classes in countries where the Bank is doing direct lending in those countries, and could there be a perception that the Bank is doing back-door lending. Well, there is a different motivation for this strategy than the Bank's lending, clearly, and therefore, there is a different legal basis for the investment. But that said, we actually raised this point intending to highlight it for the Executive Directors

so you can give consideration to how that should be handled.

What we say in the Legal Note is that we believe those issues would need to be further considered in the context of the final proposal, not because there is a legal problem with them, but precisely for the kinds of reasons Mr. Duquesne was mentioning more generally in terms of whether you want to have guidelines or not. There are reputational risks associated with this if these funds end up in markets, and it becomes known for one reason or another that the Bank's endowment-type strategy is in those markets, and we would hope that the EDs would consider that in terms of a final proposal if and when a final proposal goes forward.

So, on each of these three points, to summarize--very fair observations, but we don't think that these affect the fundamental legal basis of the proposal, and they are more in the nature of discretionary judgments by the Board.

Thank you.

MR. LA VIA: Thank you, Scott.

Mr. Choi?

MR. CHOI: I'm sorry for coming back. I

appreciate Mr. White's explanation. I appreciate Mr. White's point that these three points are more related to discretionary judgments, but those three points are the major pillars of the Legal Note, so I think we need more discussion on this issue legally and practically. I think we believe that the second proposal is based upon too lousy scenarios--number one, that the Bank will not make any mistakes in inviting outsourcing partners, and the Bank itself has some degree of in-house capacity to deal with these kinds of risky assets, and there will be no major crisis. But looking back into the Korean crisis as a Government official at that time, nobody predicted the crisis, but it came suddenly, and many well-known investment bankers suffered big losses--they recovered later with time.

So, as Mr. McCoy eloquently pointed out, there is a chance to give more money to IDA, but there is also a big chance to give far less money to IDA, and we have to handle this risk. Why should the IBRD take this risk instead of finding a basic solutions? This is a very basic question. The U.S. and Japan and the Indian chair have a strong concern, and I am also very hesitant to give a green signal to the second proposal.

So, why not take a step-by-step approach. The first proposal, okay, let it go, but we need more discussion on the second proposal.

Thank you.

MR. LA VIA: Thank you.

Mr. Duquesne?

MR. DUQUESNE: Chair, just one word to Mr. Choi. I do agree with him, and this is something that I have said many times, that there might be a financial crisis, but Joong-Kyung, you should have in mind that in the case of a financial crisis, there will probably be two events that will help the generation of income--the interest rates will go up, and the lending activity will go up.

Thank you.

MR. LA VIA: Thank you.

Mr. McCoy?

MR. McCOY: Just a little addition. Also in a financial crisis, if we lock these funds into an endowment, and during the financial crisis, the endowment funds would probably lose value, you have increased the chance that we would have to raise loan charges for IBRD loans.

Second, I would like to ask Mr. White, on all those other decisions regarding the history of investing

liquid assets, my understanding is that it was almost always confined to AA and AAA securities, and maybe this is legal, but it seems to be a major departure from the mandate or the vision of what the IBRD was supposed to be.

Thank you.

MR. LA VIA: Mr. von Kleist?

MR. VON KLEIST: Thank you, Mr. Chairman.

I think I made that point during my first statement. Today is an informal Board meeting, so we are not taking a decision today; we have just received information from staff, we have evaluated that information, and a large number feel that we need more information on that, and we need more concrete information on that, and we need something where we can really take up and measure if the concerns that have been voiced hold up if we see the final product, and then we can still decide whether we want to change the final product or whether we want to go ahead with the final product or whether we want to at that point in time say, "No. Concerning the strategy discussion we had, we don't agree at all, and we should drop this."

So I think that what we are doing at the moment is that at least a large number of Directors are asking staff to simply continue thinking, and I think that should

be a good thing in this institution--continue thinking, and give us more information on the open points we have, and then we will come to the decision point later on.

So in that sense, while I can share many of the concerns that have been voiced by other chairs, I don't think we are at the point of no return at the moment; we are just simply moving forward and fleshing out and discussing further.

That's what I want to say. Thank you.

MR. LA VIA: Mr. Boersma?

MR. BOERSMA: Thank you, Mr. Chairman, and I'm sorry for coming back as it is already lunch time.

I just wanted to react to some of the statements and the feelings that they have tried to give to people. In the paper, it is very clear that Management has looked at what happens if there is a financial crisis, and the paper is very clear. We are well-funded, and there is enough money, and it is no problem in our current RAAC model--if I can use the acronym. And even in that calculation, Management did different assumptions than in a normal system--they took tougher assumptions--so even what is in the paper, the picture is even better than we normally do.

So I don't see how this in the short term, long

term or whatever can be any problem for transfers to IDA or more waivers to middle-income countries unless we abandon the strategy halfway--but that, we learned from the nice example of Mr. Choi, we should not do.

So the second point we are discussing, and we are discussing it a lot, and I think we are discussing while we are learning, or we are learning while we are discussing, but I only heard four chairs who had various ways of viewing different concerns, and I heard many chairs, including ours, who asked Management to come back with a paper that addresses our concerns, and we have a long list of those in the statement.

So we are not there, but I think we are getting there, and therefore, I would like to see Management come back in the fall on both proposals, preferably combined, and let's see what we do then.

Thank you.

MR. LA VIA: Mr. McCoy?

MR. McCOY: One minor point I want to make is that I think only recently--maybe in the past two or three years--did the IBRD finally pass this stress test. Therefore, I think that if you had a significant financial crisis, you could see where there might be a need for

increased loan charges.

But more importantly, my point is that I agree with what Mr. von Kleist just said. Let's not lock ourselves into the idea that we are going to do bless Management going forward and writing up specific proposals on endowment. Let's address these other issues before we consider going forward with a recommendation for an endowment-type fund. Many of these other questions need to be answered and discussed by the Board and committees before a green light is given.

Thank you.

MR. LA VIA: Thank you, Mr. McCoy.

Let me try to wrap it up here, because this is obviously a discussion that will go on forever, and I'm sure we'll have plenty of opportunities, plus we all want to say farewell to Mr. Canuto.

Mr. Duquesne?

MR. DUQUESNE: I share the assessment of Mr. Boersma.

MR. LA VIA: Thank you.

Let me try to suggest a way forward here. As I said, thank you very much for the excellent discussion, and I'm sure we'll have plenty of opportunities.

With respect to the equity duration extension, given the consensus that we have heard today, we propose to come back to the Board in the fall with a formal proposal for approval, which will include details of the policy guidelines and implementation plans that have been requested.

On the diversified risk asset investment portfolio, there is not complete consensus, to say the least, and there are also numerous technical questions that several Executive Directors, who support the idea in principle, have asked for more clarification on. These include how the proposal would mesh with the outcome of the Bank's Strategic Review exercise currently underway; how the allocation of the additional income generated would be incorporated in the annual net income discussions; the asset classes that will be proposed for the diversified portfolio, particularly taking into account the concerns expressed by some members regarding investments in alternate asset classes, and given the strength of concerns on this issue, we would focus on fixed income and traded equities; how we would propose to address and minimize the possible reputational risks; what specific detailed governance arrangements we would propose to ensure that all

the key objectives and concerns are addressed to the satisfaction of the Board; and the implementation timetable for the pilot investment should the technical issues be resolved to the satisfaction of shareholders.

We would suggested that we move forward on the endowment-type portfolio option by our working on these issues, coupled with continued consultations with Executive Directors and Audit Committee members, with the objective of bringing a revised proposal to the Audit Committee for review of the technical and legal issues before finalizing any proposal for Board consideration.

Realistically, all of these actions will likely mean that it may be the second half of next fiscal year before we can proceed to the next steps.

Thank you.

Mr. Duquesne?

Mr. DUQUESNE: I think it is a bit too much, the second half of next fiscal year. I know that everything in the Bank takes a minimum of three years, so this is also an answer to the time horizon point made by Mr. Kanda. My strong preference would be before the end of this calendar year, so in other words, the first half of the next fiscal year.

Thank you.

MR. LA VIA: Pierre, we will look into that, obviously, and try to accommodate that.

Thank you, and thanks a lot to the team.

[Whereupon, at 1:20 p.m., the Informal Meeting was concluded.]