International Oil Pollution Compensation Funds

Agenda Item 5	IOPC/NOV23/**5/5**	
Date	12 September 2023	
Original	English	
1992 Fund Assembly	92A28	●
1992 Fund Executive Committee	92EC81	
Supplementary Fund Assembly	SA20	●

REPORT OF THE JOINT INVESTMENT ADVISORY BODY

Note by the joint Investment Advisory Body

Summary:	The joint Investment Advisory Body reports on its activities since the October 2022 sessions of the governing bodies of the 1992 Fund and the Supplementary Fund.
Action to be taken:	<u>1992 Fund Assembly and Supplementary Fund Assembly</u> Information to be noted.

1 <u>Introduction</u>

1.1 Pursuant to the mandate of the joint Investment Advisory Body (IAB) of the 1992 Fund and the Supplementary Fund, this Body shall submit, through the Director, to each regular session of the governing bodies, a report on its activities since the previous regular session. The report is set out at the Annex to this document.

1.2 In view of the fact that the governing bodies decided in March 2005 that there should be a joint IAB for the 1992 Fund and the Supplementary Fund, it has been considered appropriate for this Body to present a single report to the governing bodies for the two organisations.

2 <u>Action to be taken</u>

<u>1992 Fund Assembly and Supplementary Fund Assembly</u>

The 1992 Fund Assembly and Supplementary Fund Assembly are invited to take note of the information provided in the joint IAB's report contained at the Annex.

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ANNEX

REPORT OF THE JOINT INVESTMENT ADVISORY BODY OF THE 1992 FUND AND THE SUPPLEMENTARY FUND FOR THE PERIOD OCTOBER 2022 TO SEPTEMBER 2023

1 Introduction

1.1 This report has been issued in the name of the joint Investment Advisory Body (IAB) of the 1992 Fund and the Supplementary Fund. It has been prepared in August 2023 to allow sufficient time for it to be distributed on a timely basis, and any material updates will be included in the IAB's verbal presentation.

1.2 The mandate of the IAB, as laid down by the governing bodies of the two Funds, is:

(a) to advise the Director in general terms on investment matters;

(b) in particular, to advise the Director on the tenor of the Funds' investments and the suitability of institutions used for investment purposes;

(c) to draw the Director's attention to any developments which may justify a revision of the Funds' investment policy as laid down by the governing bodies;

(d) to advise the Director on the management of currency exposure relating to incidents[1]; and

(e) to advise the Director on any other matters relevant to the Funds' investments.

1.3 At its December 2020 session, the 1992 Fund Assembly appointed the following persons as members of the IAB for a term of three years:

- Mr Alan Moore, a financial and investment consultant, formerly head of Global Markets (Europe), State Street Bank & Trust and co-founder and advisor to Molten Markets Inc.;

- Ms Beate Grosskurth, an experienced international banker, who has held senior positions with State Street Bank of Boston, Brown Brothers Harriman and CME Group.

1.4 At its October 2022 session, the 1992 Fund Assembly appointed the following person as a member of the IAB for a term of one year from 1 November 2022 up to the next regular sessions of the IOPC Funds' governing bodies in 2023, when the 1992 Fund Assembly would appoint the members of the IAB for the following three years:

- Mr Marcel Zimmermann, former Head of Money Markets and Foreign Exchange at the Swiss National Bank in Zurich.

2 Meetings

2.1 At the time of preparing this report, the IAB had held three meetings with the Secretariat during the period covered by this report, namely on 6 December 2022, 24 March 2023 and 15 June 2023. Another meeting is scheduled for 27 September 2023. All the meetings were held at the IOPC offices.

[1] The mandate of the IAB is contained in Annex I of the Financial Regulations. Due to an oversight, the formal amendment of the mandate of the IAB to include this specific point, which is a task that has been undertaken and referred to by the IAB in its report for some time, was not previously submitted to the governing bodies. Since it is a useful clarification of the role and responsibilities of the IAB, the Director is proposing in document IOPC/NOV23/6/6 that the Financial Regulations be amended accordingly to include this new point (d).

2.2 The IAB has met regularly by videoconference, and also prior to the quarterly meetings with the Secretariat. The IAB also discusses market events and any matters concerning the IAB through other electronic communication channels. There has also been frequent contact between members of the IAB and the Secretariat on various issues that have arisen.

2.3 The members of the IAB met with the External Auditor on 6 December 2022 to provide an update on the IAB's activities. The IAB is also scheduled to attend a meeting with the Audit Body on 7 December 2023.

3 Main issues considered

The main issues are detailed under the following headings:

- Economic summary;
- Credit markets;
- Hedging the currency risk arising from incidents;
- Other important issues; and
- Objectives for the coming year.

4 Economic summary (covering the period from November 2022 up to August 2023)

4.1 Over the reporting period, the two major global trends that have dominated financial markets for the past two years continued to prevail. Above-target inflation and rising interest rates in most major economies, except China and Japan.

4.2 Headline inflation came down from the peaks reached in 2022, falling quite notably in most cases, but core inflation proved persistent, either stabilising or continuing to rise. Almost everywhere, inflation currently still remains well above inflation targets.

4.3 The inflation surge has led to the most synchronised and intense monetary policy tightening in decades. At their latest monetary policy meetings, the Federal Reserve (to a target range of 5.25% to 5.50%), the Reserve Bank of Australia (to 4.10%), the Bank of Canada (to 5.0%), the Bank of England (to 5.25%), the European Central Bank (rate on the main refinancing operations to 4.25%) and the Swiss National Bank (to 1.75%) have continued to raise rates. In China, where inflation is well below target, the central bank recently cut policy interest rates. The Bank of Japan has kept interest rates near zero but decided to conduct yield curve control with greater flexibility.

4.4 The transmission of monetary tightening to lending rates was mostly swift and began to weigh on aggregate demand. Borrowing costs rose for corporates and households alike. Bank lending standards tightened, and bank credit contracted, especially in advanced economies. Consequently, spending weakened. Also, the housing market cooled in many economies.

4.5 Overall, global growth slowed from 6.3% in 2021 to 3.4% in 2022, weakening further in the first half of 2023. Still, activity held up better than expected in a number of key jurisdictions, and the much-feared global recession did not materialise. The International Monetary Fund (IMF), in its July 2023 update to the World Economic Outlook (WEO), projects global growth in 2023 and 2024 will reach 3.0%. The balance of risks to global growth remains tilted downwards, but adverse risks have receded lately.

4.6 IMF WEO GDP growth forecasts

(Percent change, unless noted otherwise)

	Year over Year						Q4 over Q4 2/		
					Difference from April 2023 WEO				
		Estimate	Projections		Projections 1/		Estimate	Projections	
	2021	2022	2023	2024	2023	2024	2022	2023	2024
World Output	**6.3**	**3.5**	**3.0**	**3.0**	**0.2**	**0.0**	**2.2**	**2.9**	**2.9**
Advanced Economies	**5.4**	**2.7**	**1.5**	**1.4**	**0.2**	**0.0**	**1.2**	**1.4**	**1.4**
United States	5.9	2.1	1.8	1.0	0.2	–0.1	0.9	1.4	1.1
Euro Area	5.3	3.5	0.9	1.5	0.1	0.1	1.8	1.2	1.5
Germany	2.6	1.8	–0.3	1.3	–0.2	0.2	0.8	0.5	1.5
France	6.4	2.5	0.8	1.3	0.1	0.0	0.6	0.9	1.6
Italy	7.0	3.7	1.1	0.9	0.4	0.1	1.5	0.9	1.1
Spain	5.5	5.5	2.5	2.0	1.0	0.0	3.0	1.8	2.2
Japan	2.2	1.0	1.4	1.0	0.1	0.0	0.4	1.5	1.0
United Kingdom	7.6	4.1	0.4	1.0	0.7	0.0	0.6	0.5	1.3
Canada	5.0	3.4	1.7	1.4	0.2	–0.1	2.1	1.6	1.8
Other Advanced Economies 3/	5.5	2.7	2.0	2.3	0.2	0.1	1.0	1.8	2.1
Emerging Market and Developing Economies	**6.8**	**4.0**	**4.0**	**4.1**	**0.1**	**–0.1**	**3.1**	**4.1**	**4.1**
Emerging and Developing Asia	7.5	4.5	5.3	5.0	0.0	–0.1	4.2	5.3	4.9
China	8.4	3.0	5.2	4.5	0.0	0.0	3.1	5.8	4.1

Source: International Monetary Fund (July 2023 WEO Update)

Notes: 1/ Difference based on rounded figures for the current and April 2023 WEO forecasts. 2/ For World Output (Emerging Market and Developing Economies), the quarterly estimates and projections account for approximately 90 percent (80 percent) of annual world (emerging market and developing economies') output at purchasing-power-parity weights. 3/ Excludes the Group of Seven (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries.

4.7 According to the latest IMF WEO, global headline inflation is set to fall from an annual average of 8.7 percent in 2022 to 6.8 percent in 2023 and 5.2 percent in 2024, thus remaining above pre-pandemic (2017–19) levels of about 3.5 percent.

4.8 In terms of other risks, geopolitical factors also influenced financial markets – in particular the ongoing Russian invasion of Ukraine and its effect on energy security and commodity prices, rising tensions in the Middle East, and the contentious relationship between the US and China.

4.9 The resolution of US debt ceiling tensions has reduced the risk of disruptive rises in interest rates for sovereign debt, which would have increased pressure on countries already struggling with increased borrowing costs. Ultimately, a crisis was avoided by negotiation of the Fiscal Responsibility Act of 2023, which will suspend the debt limit until 1 January 2025, but will cap discretionary spending during fiscal years 2024 and 2025.

Inflation

United States of America

4.10 With the US Consumer Price Index (CPI) down to the relatively manageable level of 3.2% year-on-year in July 2023, the US Federal Reserve is now seen to be fading out of further interest rate rises, with cuts predicted by the second quarter of 2024.

United Kingdom

4.11 The UK wage growth is at record levels, still fuelling inflation, while CPI (6.8% in July 2023) and core (excluding energy, food, alcohol, and tobacco) CPI (6.9%) are only just showing signs that they may have peaked.

4.12 At the time of writing, the Bank of England (BoE) cited the importance of upcoming inflation and labour market data, which could see wage growth outstrip inflation for the first time in two years, potentially marking the beginning of the end of the cost-of-living crisis in the United Kingdom. With gas and electricity prices set to fall further in October 2023, the BoE forecasts that inflation could end the year at around 5%.

European Union

4.13 Similar to the United Kingdom, eurozone inflation remained at undesirable levels with the harmonised index of consumer prices (HICP) standing at 5.3% in July 2023.

4.14 The European Central Bank (ECB) has been raising rates and shrinking its balance sheet. Since the ECB stopped fully reinvesting maturing securities bought under the asset purchase programme (APP), an important source of demand for euro area public sector bonds diminished. While this allows for intra-European sovereign bond spreads to reflect the respective risks more accurately, it could also potentially hamper debt financing in weaker eurozone countries.

Outlook for the third quarter and beyond

4.15 There is a question mark over whether the United Kingdom can sustain its current downward inflation momentum, or whether there will be more volatility and adverse economic pressure. Currency volatility could rise as the interest-rate increases continue to bite, causing greater economic uncertainty.

4.16 The Federal Reserve and private-sector economists are tentatively predicting that the United States will stay out of recession, as the battle against inflation continues, targeting an economic soft landing.

4.17 There does appear to be a consensus however, on a further decline in energy prices. Supply chains are no longer restrictive, with the Organization of the Petroleum Exporting Countries (OPEC) behind in its production cuts, and given the drop in global demand.

5 <u>Credit Markets</u>

5.1 Considering the challenges facing the global financial markets throughout the reporting period, credit markets remained relatively calm, and were resistant to much of the uncertainty around inflation, interest rate rises and cooling global economic growth.

5.2 Equity and bond markets continued to recover after the political upheaval in the United Kingdom at the start of the fourth quarter of 2022, which culminated in a revision of the United Kingdom's sovereign credit outlook by major ratings' agency Fitch, to negative from stable.

5.3 The Credit Suisse Group was removed from the counterparty list of banks, due to concerns over its financial wellbeing, which later required an emergency takeover by Swiss banking rival, UBS AG.

5.4 Against the backdrop of substantial tightening in US monetary policy, in the first quarter of 2023 three US banks with risky business strategies (in particular significant unhedged asset/liability mismatches) collapsed in quick succession, creating market concerns not seen since the global banking crisis in 2008. Swift intervention by the US regulatory authorities and concerted action from major central banks to enhance the provision of liquidity was required, with many economic forecasters predicting a repeat of the previous banking crisis.

5.5 Markets did eventually regain their composure, and throughout this period of uncertainty, the main ratings agencies were relatively quiet in terms of ratings adjustments, with only a small number of the Funds' banks subjected to changes in their credit-rating outlooks.

5.6 CDS spreads over the reporting period stayed mainly within tight ranges, with only the odd exception, and capital ratios remained at perfectly acceptable levels, with no detectable trend.

5.7 There were no changes to the list of counterparty banks, other than the removal of Credit Suisse, with 34 banks remaining in the Group One and Group Two list.

6 Hedging the currency risk arising from incidents

6.1 Hedging activity to minimise the risk of adverse currency movements has been minimal in the past 12 months, but the exchange rates of currencies to which the Funds have an exposure to, or other currencies that are also likely to also have an impact, were monitored on a daily basis.

6.2 The Director has updated the IAB with regard to all incidents on a quarterly basis, although some may not have a financial impact on the Funds.

6.3 There are four incidents at present for which compensation is payable and require currency management.

Agia Zoni II incident

6.4 As of 7 June 2023, the amount of euros held, stood at fifty-five percent of the total balance payable from the Major Claims Fund of EUR 38 035 269. Current hedging levels are considered appropriate, although the GBP/EUR currency pair was monitored by the IAB at the end of January 2023, when it fell below 1.1150. It has since recovered to stand around 1.1600 in early September.

Incident in Israel

6.5 The General Fund limit of liability for this incident is some £4 million and total levies for the Major Claims Fund so far stand at GBP 7 million. GBP 4 million has previously been converted into Israeli shekels (ILS) on a spot and forward purchase basis. An additional GBP 1.5 million worth of ILS was purchased using a three month forward currency contract in May 2023 and delivery of the currency was extended by a further three months in early September.

6.6 The total amount of compensation payable is anticipated to be approximately GBP 13 million, of which 39% is hedged. Funds and hedged amounts are considered appropriate at present.

Bow Jubail incident

6.7 The *Bow Jubail* incident has an estimated liability of EUR 60 million, with SDR 20 million covered by the P&I Club, leaving some EUR 35 million to be financed by the IOPC Funds. A Major Claims Fund (MCF) levy will be required, with a levy to be proposed to the 1992 Fund Assembly in November 2023 for payment by 1 March 2024.

6.8 Payments of compensation from the MCF are expected before 1 March 2024, so discussions are ongoing with regard to the funding of the expected payments.

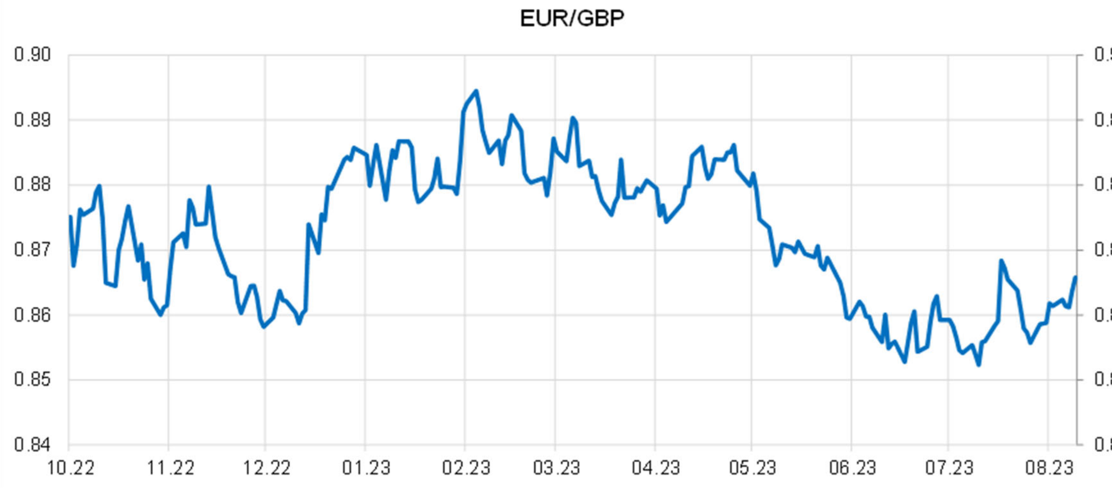
Princess Empress incident

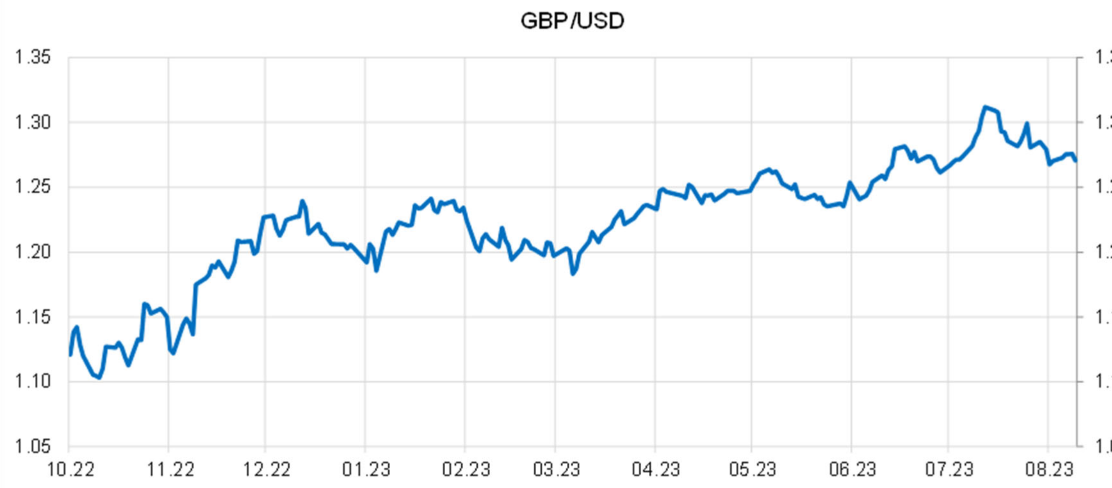
6.9 The Philippine-flagged *Princess Empress* incident has a provisional estimated liability of some USD 60 million, and the STOPIA 2006 liability limit of SDR 20 million has been reached. Given the complexity surrounding compensation payments, in terms of settlement currency and paying agent, discussions regarding hedging for this incident are ongoing. The IAB advised the Secretariat on possible payment channels and correspondent banking relationships to be explored.

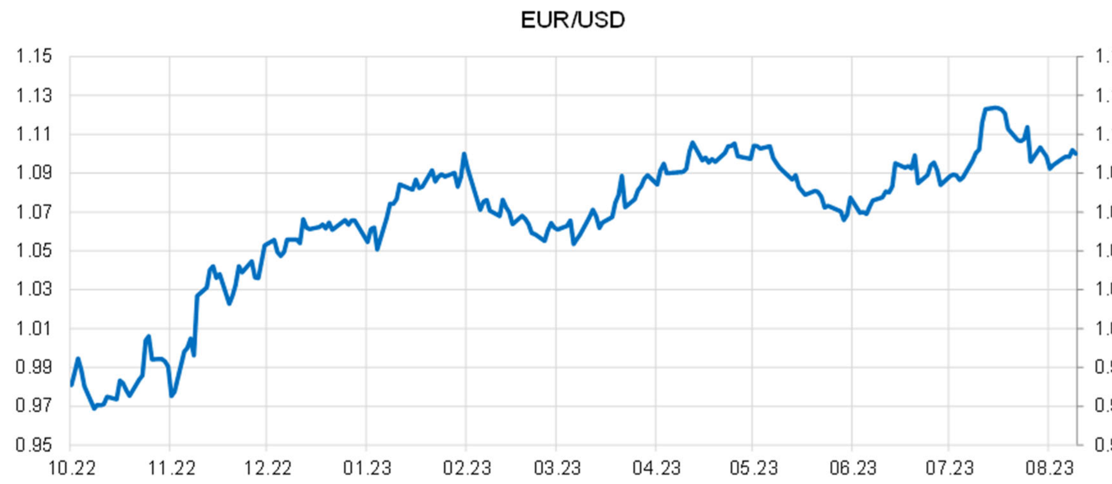
Currency charts

6.10 Charts for the EUR/GBP, GBP/USD and EUR/USD currency pairs covering the period 1 October 2022 to

11 August 2023 have been included to illustrate the movements that have taken place:







6.11 Foreign exchange movements largely followed those of financial conditions, taking their cue from the relative strength of the economies and the corresponding monetary policy outlooks. At the beginning of the reporting period, the US dollar touched multi-decade highs against the euro and the Japanese Yen, before weakening between November 2022 and January 2023. Thereafter, the US dollar remained rangebound for several months. Lately, as cooling inflation in the United States bolstered expectations that the Federal Reserve's interest rate hiking cycle would soon peak, the US dollar again marginally depreciated.

6.12 In the aftermath of the UK 'mini-budget' announcement in September 2022 which created a period of volatility across the financial markets, the pound sterling was later mainly influenced by the factors mentioned above – i.e., with the market focussing on the benign decline in UK inflation since the start of the Bank of England's tightening cycle, and an increasing degree of economic slack expected to emerge after the middle of next year.

6.13 The economic summary provides a more detailed explanation of events concerning the global economies and the related macroeconomic data.

7 <u>Other Important Issues</u>

Internal procedures for investment and cash management controls

7.1 The IAB has reviewed the Internal Investment Guidelines and the Hedging Guidelines at each of its meetings since its report to the governing bodies on 26 October 2022. These guidelines were last reviewed at its meeting on 15 June 2023 and will be reviewed again at its meeting scheduled for 27 September 2023.

7.2 At the meeting of 15 June 2023, the decision was taken to adapt Internal Investment Guideline #8 to remove the requirement to call back funds if the number of rollovers exceeds three, or the cumulative deposit and rollover period exceeds 12 months.

7.3 The IAB noted that payment risk (of moving cash between accounts) is very low, but the repeated calling back of funds does not mitigate exposure risk. The priority when making decisions about whether to roll funds over should always be the credit situation of the bank, and the rates being offered. Copies of both sets of Guidelines are attached to this report.

Monitoring of the IOPC Funds' financial risks

7.4 The IAB has continued to monitor the Funds' financial risks on a daily basis. The US regional banking sector came under extreme pressure with the failure of several high-profile regional banks, requiring intervention from the US authorities, and liquidity support from major central banks. The financial markets required close scrutiny to ensure that there was no contagion impact, and that the IOPC Funds' counterparty banks were unaffected.

7.5 Continued inflationary pressures and high global interest rates continue to be of particular interest, and the IAB continues to monitor the impact on the UK economy, and the pound sterling.

ESG principles in Investing

7.6 Following on from the document produced by the IAB in October 2021 with regard to the emergence of Environment, Social and Governance (ESG) guidance and its application within financial markets, the IAB has continued to ensure those ESG principles are maintained in the execution of its responsibilities and duties. The IAB will also review the development of ESG guidance on an annual basis and report any changes to the Secretariat at its quarterly meetings.

8 Objectives for the coming year

8.1 The IAB intends to continue to focus on its responsibilities set out in section 1.2 during the course of the coming year.

8.2 The IAB will also conduct its three-year performance management review and provide a summary report for the Secretariat to consider.

Beate Grosskurth | Alan Moore | Marcel Zimmermann

27 September 2023

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ATTACHMENT I

Internal Investment Guidelines

As reviewed on 15 June 2023

The IOPC Funds may only invest with banks and building societies and the following guidelines should apply:

1. In order to be eligible for investments, a bank or building society should satisfy the following:
   (a) Common Equity Tier 1 (CET1) capital ratio of at least 9.5% or higher;
   (b) A five-year credit default swap (CDS) spread of a maximum of 100 basis points. A breach of which would trigger a review to ascertain whether the credit markets were weaker in general, or whether the credit worthiness of the counterparty concerned was subject to a particular credit-negative event, that would warrant its temporary, or permanent exclusion from the lending list;
   (c) Minimum short-term credit rating from two of the three main credit rating agencies, Fitch, Moody's and Standard & Poor's as follows:
      - For maturities of up to 12 months (Group 1) of F1+, P1 and A1+; and
      - For maturities of up to six months (Group 2) of F1, P1 and A1.
2. A banking institution should be either a parent bank, a full branch of its parent bank or a wholly owned subsidiary meeting the above criteria.
3. The normal limits for investments in any financial institution laid down in Financial Regulations 10.4(c) and 10.4(d)[<1>] should apply to deposits with any given institution or banking group.
4. The house banks should be the Funds' main operational banks, i.e. with which current accounts are held for the day-to day banking needs and banks used for specific incidents (which meet the Funds' investment criteria) to hold currency other than pounds sterling should be categorised as temporary house banks in order to utilise the higher limit.
5. Subject to the normal limits referred to in paragraph 3 above, deposits with banks and building societies should not exceed 25% of the 1992 Fund's and the Supplementary Fund's combined deposits. Deposits in the Supplementary Fund should be held with more than one institution.
6. For liquidity purposes a minimum amount equivalent to the respective Fund's working capital should be maturing within three months.
7. Investments should not exceed one year.
8. Rollovers of deposits are permitted without limit to the number of rollovers or the cumulative deposit and rollover period, provided that the banking institution continues to satisfy the criteria in paragraphs 1-5 of these guidelines.
9. In consultation with the joint Investment Advisory Body, the Director will maintain a list of approved institutions.

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<1> Financial Regulations 10.4 (c) and 10.4 (d) read:

10.4 (c) the maximum investment in any bank or building society of the 1992 Fund's [and the Supplementary Fund's combined] assets shall not normally exceed 25% of these assets or £10 million, whichever is the higher;

10.4 (d) the maximum investment in any bank or building society by the 1992 Fund and the Supplementary Fund shall not together normally exceed £15 million or £20 million in respect to the Funds' house bank(s) or not normally exceed £25 million when the three Funds' combined assets exceed £300 million.

ATTACHMENT II

Hedging Guidelines

As reviewed on 15 June 2023

1. For an incident in respect of which compensation will be paid in a currency other than pounds sterling the Director may hedge:
   (a) up to 50% of the levies received for compensation due for an incident (excluding claims related expenses);
   (b) within a six-month period after the levies have been received.
2. If circumstances so warrant, the Director may determine a hedging level higher or lower than 50% and/or a period shorter or longer than six months within which the determined hedging level should be reached. The reasons for such decisions will be laid down in the minutes of the next session of the Investment Advisory Body (IAB).
3. The method of hedging, the percentage of hedging (hedging level) and the period within which that percentage should be reached, is determined by the Director following consultation with the joint IAB.
4. The determined hedging level is continually monitored by the Director and the IAB to ensure it continues to reflect any changes in the anticipated amount of compensation payable and other relevant circumstances. The hedging level should also be adjusted to take account of any payments made in respect of the relevant incident to ensure that the determined hedging level is maintained.
5. Foreign exchange transactions for hedging purposes should not exceed a term of two years. Foreign exchange transactions for hedging purposes exceeding a term of one year require the specific authorisation of the Director.
6. Counterparty banks for foreign exchange transactions should meet the credit criteria set out in the Investment Guidelines. If, for exchange control or operational reasons, a hedging strategy needs to be transacted in a country where these criteria cannot be met, the Director can approve an exception to this guideline.
7. The total foreign exchange exposure with any one financial institution should not exceed four times the available deposit limit approved for that counterparty without the approval of the Director.
8. If it is necessary for the Funds to implement their hedging strategy in case of an incident in a Member State whose currency is not freely convertible, the amounts held with any one financial institution may exceed the investment limits set out in the Funds' Financial Regulation 10.4(d) for considerable periods of time. The investments in excess of the normal limits shall be reported to the regular sessions of the governing bodies and explanation shall be given regarding the need to exceed the applicable investment limits for the purpose of applying the Funds' Hedging Guidelines.

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ATTACHMENT III

IOPC Funds

Investment Advisory Body (IAB) Self Evaluation

August 2020–August 2023

Introduction

At the April 2018 sessions of the governing bodies it was noted that, in the Director's view, the Investment Advisory Body (IAB) had shown over the years to be an effective body and had discharged its mandate efficiently. The Director also concurred with a conclusion of a self-evaluation process undertaken by the IAB, that it was more difficult to measure the performance of an advisory service than an operational service (document IOPC/APR18/6/1, Annex II).

At the 2018 sessions, the governing bodies further noted that the Director did not see any merit in introducing a performance measurement benchmark for the IAB, as any such measure would be difficult to evaluate due to the priority given to the security of the assets and liquidity requirements of the IOPC Funds' cash management process, followed by the return on investment.

The governing bodies also noted that the Director was in favour of the IAB providing a self-evaluation analysis every three years, as part of its report to the governing bodies, with the first such formal evaluation presented at the December 2020 meeting (document IOPC/NOV20/5/4, Attachment III).

This document is the second IAB self-evaluation review, covering the 2020–2023 period.

Executive Summary

As was noted in the self-evaluation document presented in 2020, the role of the IAB is an advisory one, and quantifying the value of that advice is not straightforward. The advisory role that the IAB encompasses is a generic and supportive one, rather than a one-off product or service that can be valued either by metrics or percentage returns. The advice given is usually of a broad nature, covering every aspect of the global financial markets, and often provides insight and support in times of financial stress or geopolitical upheaval. The varied experience and professional background of the IAB members also means that the advice can provide solutions on matters regarding currency or interest-rate risk, or the complexities surrounding global payments and settlement. The advice can also provide clarity on financial regulations or matters of a legal nature pertaining to financial institutions and regulatory compliance. And of course, that advice can be acted upon if desired, or an alternative course of action can be pursued.

Over the self-evaluation period, the IAB has responded to email requests, held telephone conversations, written papers at the request of the Director and Deputy Director, and discussed various issues, both with the Secretariat and within the IAB, that are pertinent to the day-to-day business of the IOPC Funds and security of the IOPC Funds' capital. This is time spent outside of the normal quarterly meetings, and meetings with the Audit Body and External Auditor, and the administrational requirements leading up to them.

For the purposes of this document and to meet the requirement to formerly assess the performance of the IAB, the three-year period from **August 2020 to August 2023** was reviewed, in readiness for the sessions of the governing bodies in November 2023.

As with the previous self-evaluation review, the IAB considered that in quantifying value, a more general approach to value measurement was again required, as intrinsic value is not a quantitative measure. When determining the value that the IAB provides, the IAB considered that it would be useful to utilise the three key component measures that were used in the last self-evaluation:

1. Does the IAB meet its commitments?

2. Does the advice offered by the IAB add value to the work of the IOPC Funds?

3. Does the supportive role of the IAB improve the performance of the Secretariat in the execution of its duties?

This performance review will be facilitated by referencing the time spent on IAB advice and support, over the most recent three-year period. The review will include a summary of the actions undertaken, and in some cases where it is has been tangible, record the evidence of a beneficial outcome.

<u>IAB highlights and achievements</u>

Over the review period, the IAB has attended four quarterly meetings a year with the Secretariat, held meetings with the External Auditor and attended meetings with the Audit Body, as and when required. Due to the global pandemic and the restriction of movement, these meetings were held both via videoconference and in person at the offices of the IOPC Funds when conditions allowed. The IAB has engaged with the External Auditor and the Audit Body to further explain the role of the IAB, address any issues at hand, and offer guidance on current events and market developments. The IAB has prepared documents for those meetings and prepared both written and verbal reports.

During the course of the three-year period under review, for the second successive review period, there was a rotation of IAB members and a new member of the IAB was elected in 2022. In order to provide a choice of appropriate candidates for interview, the IAB used its market network, sought professional recommendations and conducted informal meetings to identify suitable candidates. Before and after Mr Marcel Zimmermann was selected by the Director and appointed at the sessions of the governing bodies in October 2022, the IAB undertook a series of extra meetings, in order to accommodate the new member, to provide background information on the duties of the IAB and to discuss ways in which the IAB can continue to provide a balanced advisory service, incorporating the experience of the new member. The requirements placed upon the IAB by the IOPC Funds were also discussed, including the IOPC Funds' investment and hedging policies. Active changes to IAB roles were also explored and instigated to ensure continuity of service in order to maintain the required levels of performance expected.

It should also be noted that around the same time of the latest IAB rotation, there were also major changes in the personnel and organisational structure of the Secretariat, which have required a period of adjustment in order to achieve an optimal balance in the level of advisory support.

The core duties of the IAB have not fundamentally changed or been less than those stated in this document. However, geo-political events such as the war in Ukraine, with its implications for global food and energy prices, and supply-chain problems in the aftermath of the global pandemic when demand recovered remarkably, have increased uncertainty and added to market volatility. While understandable as the pandemic broke out, with the benefit of hindsight it is now clear that the fiscal and monetary policy support was too large, too broad-based and too long-lasting. Therefore, inflation in most major economies increased substantially above target levels and the subsequent rapid rise in interest rates added to the market surveillance work undertaken by the IAB, especially around the time of the US regional banking problems, with concerns over contagion, and the implication that would have for the stability of the global financial system.

To enhance communication between the members of the IAB during these periods of increased market volatility, the IAB held meetings between themselves on a regular basis, both in person and via videoconference.

For the purpose of this review, the IAB has highlighted a select number of interactions with the IOPC Funds, the affiliated bodies and the Secretariat, whereby it considers that it has added value to the work of the organisation. These are listed under the headings of the duties of the IAB which are reviewed on a regular basis**. It is stressed that the main task of the IAB is to assist the Secretariat in ensuring the safety of the IOPC Funds' assets**.

The duties of the IAB are as follows:

- **to advise the Director in general terms on investment matters**

Throughout the reporting period, the IAB has continued to inform the Director and other members of the Secretariat of any events or circumstances that might have an impact on the day-to-day business of the IOPC Funds or might affect the security of the IOPC Funds' assets.

Also, at its quarterly meetings, the IAB has provided updates on the foreign exchange and investment markets, delivered an up-to-date economic report and reviewed any changes in the credit markets that might pertain to the creditworthiness of the list of counterparty banks that the IOPC Funds places its investments with.

- **in particular, to advise the Director on the tenor of the IOPC Funds' investments and the suitability of institutions used for investment purposes**

In the area of market data access, the IAB helped the Secretariat on various occasions over the reporting period, to gather additional or missing information on CDS prices from other data sources and provided guidance in understanding the various FX cross rates published by Refinitiv, the market data vendor used by the Secretariat. The IAB has also provided advice and recommendations on the suitability of many financial institutions as potential investment counterparties including Qatar National Bank, Aldermore Bank, National Bank of Kuwait and Al Rayan Bank.

In the fourth quarter of 2022, the IAB was asked for its recommendations on the most suitable tenor for the IOPC Funds to lend GBP deposits. As inflation was increasing month-on-month and the Bank of England was raising interest rates at consecutive monetary policy meetings, the timing of placing GBP deposits was crucial to ensure the best return on the capital of the IOPC Funds.

- **to draw the Director's attention to any developments which may justify a revision of the IOPC Funds' investment policy as laid down by the governing bodies**

In October 2021, the IAB drew the Director's attention to the growing importance of the environmental, social and governance (ESG) principles of ESG in sustainable, responsible and ethical investing. The IAB provided a factsheet for the Deputy Director on ESG principles in the financial markets and at the request of the Director, followed that up with a paper titled 'The Emergence of ESG Principles in Investing'.

- **to advise the Director on the management of currency exposure relating to incidents**

In January 2023, the IAB supported the Secretariat in analysing the pricing in the FX forward market for Israeli Shekel (ILS). It provided a pricing decomposition spreadsheet, comparing a spot market purchase followed by holding the ILS proceeds on account until needed versus an FX forward purchase.

In June 2023, when the Secretariat was investigating payment channels in the Philippines, the IAB organised two contacts at Manila-based banks who could be approached for correspondent banking relationships. Furthermore, it referred the Secretariat to a website with data on costs and providers for cross-border payment services (remittances), maintained by the World Bank.

- **to advise the Director on any other matters relevant to the IOPC Funds' investments**

In November 2020, the IAB was asked by the Director to examine all the foreign exchange trades that were executed in G10 currencies during the period of December 2007 to January 2013 with certain named UK banking entities. The Audit Body had raised the issue of a collective UK action claim against a group of UK banking entities that were found by the European Commission to have participated in two foreign exchange spot trading cartels which was in breach of European Union competition law. After forensically examining all the relevant FX trades from that period and examining the pricing and volumes of the foreign exchange market around the time the highlighted trades were executed, the IAB was able to conclude that there was no financial impact whatsoever on the IOPC Funds. The Deputy Director informed the IAB that its forensic examination into the UK action claim had provided 'most useful information'.

- **to have at least four meetings each year with the Secretariat to review and discuss relevant investment matters and recommend any policy changes that it considers appropriate**

Over the reporting period the IAB has provided a quarterly economic report which includes geopolitical commentary and analysis. This provides the Secretariat with an idea of investor sentiment and future economic performance. This has been beneficial when considering decisions with regard to hedging, and assisted in the security of the IOPC Funds' assets when negative events have exerted influence on currencies and money markets.

The IAB has reviewed the Internal Investment Guidelines and the Hedging Guidelines at each of its quarterly meetings with the Secretariat covering the three-year reporting period. At its quarterly meeting with the Secretariat on 15 June 2023, the decision was taken to revise the Internal Investment Guidelines to remove the requirement to call back investment funds if the number of deposit rollovers exceeded three, or the cumulative deposit and rollover period exceeded 12 months. The IAB had noted that the repeated calling back of funds did not mitigate counterparty exposure risk and that the payment risk of moving cash between accounts was very low, and therefore the guidelines should be amended to reflect that. The priority when making decisions about whether to roll funds over should always be the creditworthiness of the bank and the rates being offered.

- **to meet as a body at least four times each year to review the IOPC Funds' investment activities and ensure they comply with current policies. These meetings usually to precede the meetings with the Secretariat**

When timings have allowed, the IAB has met immediately prior to each meeting with the Secretariat. If a morning meeting has been scheduled, the IAB has met in the days leading up to the meeting, or the evening before, either in person or via videoconference. The IAB has also met on other occasions to discuss various matters of importance, as and when market conditions dictate or the need has arisen.

- **to meet with the Audit Body and with the External Auditor on at least an annual basis, or more frequently when requested, to explain and discuss its activities, and respond to any questions, concerns or matters raised**

The IAB has fulfilled this requirement and engaged with both the Audit Body and the External Auditor whenever it has been asked to do so.

On 25 September 2020, the IAB met with the Audit Body and presented three papers that it had been asked to prepare, including in some cases, the IAB's recommendations:

1. Safeguarding the Capital of the IOPC Funds;

2. The Base Currency for the IOPC Funds; and

3. Hedging the IOPC Funds Currency Exposure – A Better Understanding of the Cashflows.

The Deputy Director noted his appreciation for the three papers and said that the papers were informative and all well received by the members of the Audit Body.

At a meeting with the Audit Body on 8 July 2022, the IAB prepared and presented a follow-up paper to 'Hedging the IOPC Funds Currency Exposure' that it had presented in 2020, titled 'The Rationale Behind the Hedging Guidelines'. In this paper the IAB discussed the benefits of currency hedging and also looked at the annual accounting revaluation process explaining why variations in profit and loss occur. Both the Director and the Chair of the Audit Body recorded their appreciation for the paper which was well received.

- **to attend the regular sessions of the IOPC Funds' governing bodies and present its report on its activities and findings for the year**

The IAB has fulfilled this requirement each year and presented the written report on its activities. The IAB has continued with its restyled annual report to the governing bodies to make it less formal, more current and easier to engage with. Mr Marcel Zimmermann, a former member of the Swiss National Bank in Zurich, also brings a central bank perspective to the work of the IAB, which is reflected throughout parts of the written report.

- **to monitor market activities and conditions on an ongoing basis and be available to discuss such matters with the Secretariat at any time**

Throughout 2021, investments in the euro (EUR) deposit market were especially complex given that EUR deposit rates in the wholesale markets were trading at negative rates of interest. This unconventional monetary policy tool enacted by the European Central Bank, i.e., the negative interest rate policy, meant that banks were charging investors to place deposits, rather than paying interest on those investments. The IAB provided the Director and Deputy Director with investment advice that highlighted alternatives to paying negative rates of interest, and in June 2021 prepared a paper for the Director explaining why euro deposits were attracting negative rates of interest with comparisons across the European banking sector. In September 2021, the IAB prepared a follow-up paper for the Director on the 'Justification and Practicability of Placing Deposits at Negative Interest Rates', which greatly assisted in the understanding of this unusual investment phenomenon.

In the first quarter of 2023, against the backdrop of substantial tightening in US monetary policy, three US banks with significant unhedged asset/liability mismatches collapsed in quick succession. This created market fears not seen since the global banking crisis in 2008 and raised concerns that contagion could undermine the security of the global financial system. The IAB made swift contact with the Secretariat to discuss the prevailing conditions in the financial markets and provided an update on the banks associated with the crisis and its monitoring of the IOPC Funds' counterparty banks to ensure the safety of the IOPC Funds' capital.

- **to respond to requests from the Secretariat for information and recommendations on a timely basis and on a broad base of topics**

In March 2021, the IAB was asked by the Secretariat about the relationship between the fixed income market and the money markets, and in particular the connectivity of bonds and interest rates. To help explain how these asset markets interconnect and how bond prices and interest rate yields relate to each other, the IAB wrote a paper on 'Bonds and the Connectivity of Bonds and Interest Rates'.

In March 2022, and again in November 2022, the IAB's advice and comments were sought in connection with the IOPC Funds' Risk Review, when the IAB provided its insight on the Risk Review section regarding 'Financial Institutions Becoming Insolvent'.

Over the review period between August 2020 and August 2023 the IAB has participated in excess of 1 200 emails, both with the Secretariat and between the individual members of the IAB, in pursuit of the advice and support provided to the IOPC Funds. All members of the IAB have been available to discuss any topic by telephone as and when required, with regular weekly contact to discuss matters taking place up until June 2022, and since then, on an ad-hoc basis up to the end of the reporting period.

The experience levels required of the IAB are set out in the Appendix.

Investment Advisory Body

September 2023

Appendix

Experience levels of the IAB

It has previously been identified that the following in-depth experience is required of the IAB:

- cash management;
- foreign exchange management;
- risk management;
- counterparty bank risk analysis;
- credit policy;
- current financial market practices and market innovation;
- current and evolving financial market legislation and regulation;
- new financial market products;
- a knowledge of other asset classes; equities, commodities, credit markets, derivatives;
- macro-economic indicators and their potential impact on the IOPC Funds' business;
- pension fund and investment portfolio management;
- a sound understanding of geo-political events and the implications thereof; and
- knowledge of a broad network of financial institutions and their related market professionals

Over the reporting period, the members of the IAB have continued to provide recommendations and advice to the IOPC Funds utilising their industry knowledge and professional experience encompassing all of the experience requirements as set out above.

The new members of the IAB have added to that experience, with Ms Beate Grosskurth bringing multi-asset settlement and transactional processing knowledge, and contributing a more diverse and insightful European perspective to economic and geo-political reports and events. As a former central banker, Mr Zimmermann has added greatly to that perspective, and also brings an informative and insightful background to the experience levels of the IAB, which has already added value to the advice and recommendations that the IAB has provided.