International Oil Pollution Compensation Funds

Agenda Item 5	IOPC/NOV24/**5/5**	
Date	26 September 2024	
Original	English	
1992 Fund Assembly	92A29	●
1992 Fund Executive Committee	92EC83	
Supplementary Fund Assembly	SA21	●

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 November 2023 sessions of the governing bodies of the 1992 Fund and the Supplementary Fund.
Action to be taken:	1992 Fund Assembly and Supplementary Fund Assembly Information to be noted.

1 Introduction

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 Action to be taken

1992 Fund Assembly and Supplementary Fund Assembly

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 NOVEMBER 2023 TO SEPTEMBER 2024

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 2024 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; and

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

1.3 At its November 2023 session, the 1992 Fund Assembly reappointed the following persons as members of the IAB for a term of three years, until the regular sessions of the governing bodies in 2026:

- 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; and

- Mr Marcel Zimmermann, a financial and investment consultant, 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 7 December 2023, 19 March 2024 and 18 June 2024. Another meeting is scheduled for 26 September 2024. All the meetings were held at the IOPC Funds' offices.

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 Audit Body on 12 July 2024.

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 2023 up to August 2024)

4.1 The global economy remained remarkably resilient over the reporting period, with growth holding steady as inflation returned to target. According to the latest projections from the International Monetary Fund (IMF), growth for 2024 and 2025 will remain around 3.2 percent (table 1), with median headline inflation declining from 2.8 percent at the end of 2024 to 2.4 percent at the end of 2025.

Table 1: Key economic indicators for selected regions/countries

	Real GDP			Consumer prices (a)			Central bank rates		
	2023	2024p	2025p	2023	2024p	2025p	latest		Δ Nov23
World	3.3%	3.2%	3.3%						
United States	2.5%	2.6%	1.9%	4.1%	2.9%	2.0%	5.25%	(1)	0.00%
Euro Area	0.5%	0.9%	1.5%	5.4%	2.4%	2.1%	3.75%	(2)	-0.25%
Germany	-0.2%	0.2%	1.3%	6.0%	2.4%	2.0%			
France	1.1%	0.9%	1.3%	5.7%	2.4%	1.8%			
United Kingdom	0.1%	0.7%	1.5%	7.3%	2.5%	2.0%	5.00%	(3)	-0.25%
Japan	1.9%	0.7%	1.0%	3.3%	2.2%	2.1%	0.25%	(4)	0.35%
China	5.2%	5.0%	4.5%	0.2%	1.0%	2.0%	1.70%	(5)	-0.10%

Sources: International Monetary Fund (July and April 2024 World Economic Outlook), central banks
Note: (a) annual average (p) projection (1) Target range for the federal funds rate, lower bound (2) Deposit facility (3) Official bank rate (4) Target for the short-term interest rate (uncollateralized overnight call rate) (5) Seven-day reverse repo rate

4.2 Not all regions proved equally resilient, however, and differences in growth became more apparent as the year progressed. Growth was remarkably strong in the United States, supported by substantial fiscal spending. Latin American economies, most notably Brazil and Mexico, performed well, also benefiting from the proximity to the United States. By contrast, the euro area, the United Kingdom and several small open advanced economies registered barely positive growth.

4.3 Global inflation continued to recede from the peak it reached in 2022. Inflation was back to around central bank targets across a range of countries, including several euro area economies. In the United States, the disinflation journey largely followed the forecasted path, notwithstanding the upside surprises in early 2024, and inflation remained a little above target (in July 2024, the all items consumer price index increased 2.9 percent over the last 12 months).

4.4 After a notable period of synchronisation, divergence eventually emerged in monetary policy stances across countries. With notable progress towards meeting their inflation targets, some central banks reduced policy rates and others signalled easing ahead. Among advanced economies, the Swiss National Bank was the first to cut and was followed by Sveriges Riksbank, while the European Central Bank (ECB) and the Bank of Canada both lowered their policy rates in June 2024. The Federal Reserve kept policy rates constant, reiterating the need for greater confidence in inflation converging to target before considering an easing. Changes in policy rates in Asia were more varied. The People's Bank of China eased monetary policy further in response to weak domestic conditions. The Bank of Japan increased the policy rate for the first time since 2007 in response to accumulated evidence that inflation could finally rise to the 2 percent target on a durable basis.

4.5 Financial markets anticipated a smooth landing, in part helped by a lack of major incidents like those in March 2023 when some US regional banks failed, and Credit Suisse had to be taken over by UBS. The prospects of lower policy rates and resilient growth, alongside improving earnings, propelled equity markets in most countries. The rally was particularly strong in technology stocks, which benefited from optimism related to artificial intelligence. In early August, worries over a slowing US economy and an unwinding of positions funded by Japanese Yen (JPY) borrowings (so called 'carry trades') caused a correction to some assets trading at lofty valuations.

4.6 Primary commodity prices are roughly unchanged versus November 2023. Oil trades at USD 75 per barrel (West Texas Intermediate). Supply growth in the Americas surprised on the upside, buffering the impact of geopolitical tensions in the Middle East. Gold prices were supported by safe haven demand and have recently reached a record high above USD 2 500 per ounce.

Outlook for the third quarter and beyond

4.7 Among advanced economies, growth is expected to converge around 2 percent over the coming quarters. The forecast for growth in emerging market and developing economies has shifted upward; the projected increase is powered by stronger activity in Asia, particularly China and India. Global inflation will continue to decline, albeit more slowly.

4.8 Overall, risks to the outlook remain balanced, but some near-term risks have gained prominence. These include upside risks to inflation that stem from a lack of progress on services disinflation and price pressures emanating from renewed trade or geopolitical tensions.

4.9 The potential for significant swings in economic policy as a result of elections this year, with negative spillovers to the rest of the world, has also increased the uncertainty. These potential shifts entail fiscal profligacy risks that will worsen debt dynamics, adversely affecting long-term yields and ratcheting up protectionism.

5 Credit markets

5.1 Credit markets also reflected the general risk-on sentiment. Credit spreads of investment grade and high-yield bonds continued their downward trajectory.

5.2 The United Kingdom's sovereign credit outlook stabilised, but rating agencies reiterated that UK public finances are under heavy strain. In March 2024, Fitch Ratings reversed its October 2022 decision to assign a negative outlook to the UK's AA- rating.

5.3 The financial system remained resilient despite the challenges posed by the higher interest rate environment. Some signs of strain did emerge. In early 2024, US regional banks were in the spotlight again, following losses in New York Community Bancorp. Chinese banks remained under pressure as the problems in the real estate sector continued. However, the strains were localised and were nothing like those seen in March 2023 among regional banks in the United States or in Europe, where a global systemically important bank, Credit Suisse, had gone under. Any incipient stress was absorbed in an orderly manner.

5.4 The review of ratings for the Funds' eligible counterparties by the main ratings agencies resulted in some adjustments of single ratings, however, on an aggregate basis the situation remained unchanged.

5.5 Credit default swap (CDS) spreads over the reporting period stayed within moderate ranges and capital ratios remained at perfectly acceptable levels.

5.6 There were no changes to the list of counterparty banks, with 34 banks remaining in the Group One and Group Two list.

6 <u>Hedging the currency risk arising from incidents</u>

6.1 Hedging activity to minimise the risk of adverse currency movements has been moderate in the reporting period. Nevertheless, 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 have been routinely monitored by the IAB.

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.

Table 2: Incidents requiring currency management

	Estimated amount to be paid			Currency held for compensation*		
	local currency		equivalent in GBP	local currency		Coverage
Agia Zoni II	EUR	37.7	31.8	EUR	21.0	56%
Incident in Israel	ILS	47.3	10.0	ILS	21.2	45%
Princess Empress	PHP	1421.1	19.0	PHP	0.6	0%
Bow Jubail	EUR	35.2	29.7	EUR	10.1	29%

Note: data as of 14 June 2024 | in millions of currency units, except as otherwise noted | * including forward transactions
EUR = euro | ILS = Israeli shekel | PHP = Philippine peso | GBP = British pound

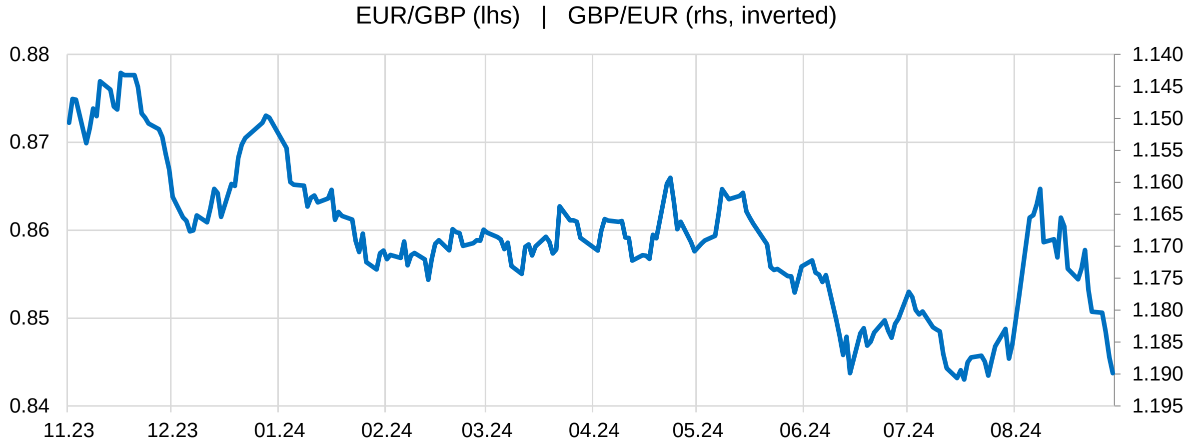
6.4 The hedging levels for *Agia Zoni II* and the incident in Israel remain close to the benchmark level of 50 percent of levies received for compensation due for an incident, as stipulated in the hedging guidelines. These levels are considered appropriate.

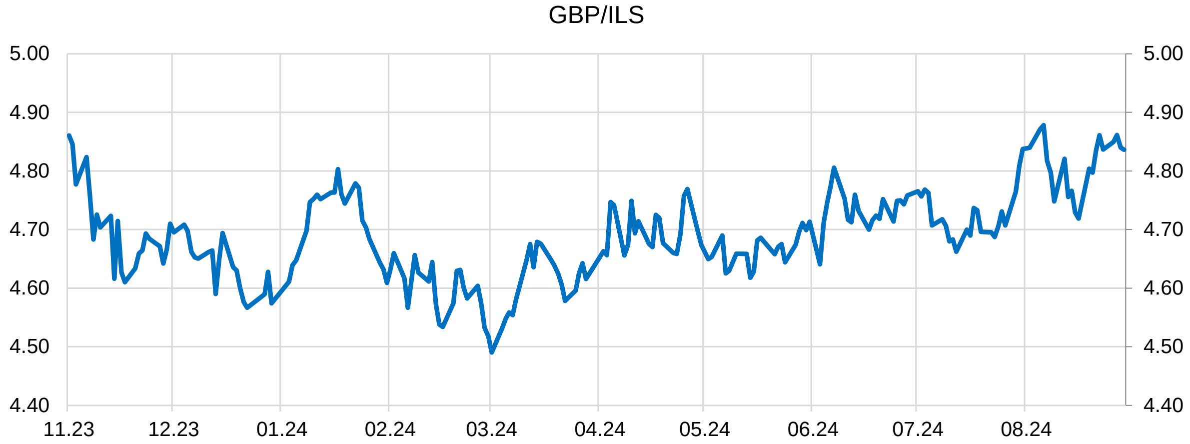
6.5 During the reporting period, now, payments for the *Princess Empress* incident consisted mainly of small-value money transfers processed through a remittance service that allows recipients in the Philippines to collect the money from a nearby branch of the remittance service, i.e. without necessitating a bank account. With this approach, the remittance service provider is paid in GBP and direct currency hedging is thus not possible. However, for future large-value payments to be made by direct bank-to-bank transfers, a correspondent banking relationship was recently established in the Philippines. Consequently, this will also allow the settlement of FX hedging transactions, if needed.

6.6 After the first levy in the amount of GBP 20 million for the *Bow Jubail* incident was raised on 1 March 2024, the IAB advised at the 19 March 2024 meeting to build up a hedging position in line with the guidelines. Accordingly, EUR 10 million were purchased on a forward basis. Based on the levies received, the hedge ratio stands at 42 percent.

Currency charts

6.7 For the three exposure currencies (EUR, ILS, PHP) as well as the US dollar (USD) as the dominant vehicle currency for the global goods trade, currency charts against the British Pound (GBP) covering the period 1 November 2023 to 29 August 2024 have been included to illustrate the movements that have taken place:


EUR/GBP (lhs) | GBP/EUR (rhs, inverted)
0.88
0.87
0.86
0.85
0.84
1.140
1.145
1.150
1.155
1.160
1.165
1.170
1.175
1.180
1.185
1.190
1.195
11.23
12.23
01.24
02.24
03.24
04.24
05.24
06.24
07.24
08.24


GBP/ILS
5.00
4.90
4.80
4.70
4.60
4.50
4.40
11.23
12.23
01.24
02.24
03.24
04.24
05.24
06.24
07.24
08.24


GBP/PHP
77.00
76.00
75.00
74.00
73.00
72.00
71.00
70.00
69.00
68.00
67.00
11.23
12.23
01.24
02.24
03.24
04.24
05.24
06.24
07.24
08.24


GBP/USD
1.34
1.32
1.30
1.28
1.26
1.24
1.22
1.20
11.23
12.23
01.24
02.24
03.24
04.24
05.24
06.24
07.24
08.24

6.8 Foreign exchange movements during the reporting period were mostly moderate. The GBP appreciated overall, particularly after a significant decrease in the UK's consumer price index was published on 22 May 2024 and, on the same day, Prime Minister Sunak announced he had requested permission from the King to dissolve parliament and called a general election to be held on 4 July 2024. However, in August 2024, following the Bank of England's bank rate cut, the GBP/EUR exchange rate reverted temporarily to the reporting period's average before reclimbing to the reporting period's high, near EUR 1.19.

6.9 In certain currency pairs, where financial market participants expected greater divergence in policy rate trajectories, movements were more pronounced. This especially applied between the USD (used as an investment currency) and the JPY (used as a funding currency, together resulting in a so-called 'carry trade'). When investors got spooked in early August 2024 by fears of an economic slowdown in the United States following a weaker jobs report and by the Bank of Japan's decision to raise interest rates to 0.25 percent, some JPY short positions were unwound rapidly. However, market jitters were short-lived and some of the correction was reversed within a few days.

7 Other important issues

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 8 November 2023. These guidelines were last reviewed at its meeting on 18 June 2024 and will be reviewed again at its meeting scheduled for 26 September 2024. No changes were made during the reporting period.

Monitoring of the IOPC Funds' financial risks

7.2 The IAB has continued to monitor the Funds' financial risks on a daily basis. Given the benign environment, as described in paragraph 5.3 above, no actions were warranted.

General Fund working capital

7.3 The General Fund maintains a working capital of GBP 15 million, 50 percent of which is held in USD. As the GBP value of USD holdings had fallen below GBP 7.5 million and additional USD were forecasted to be required for *Princess Empress* incident costs, the IAB advised at the 19 March 2024 meeting to purchase USD 1.5 million to rebalance the currency allocation.

8 Objectives for the coming year

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

Beate Grosskurth | Alan Moore | Marcel Zimmermann

26 September 2024

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ATTACHMENT I

Internal Investment Guidelines

As reviewed on 25 September 2024

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.

* * *

[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 25 September 2024

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.