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AMENDMENTS TO THE INTERNAL REGULATIONS

Note by the Director

Introduction

1 In document FUND/A.11/10/Add.1, the Director proposed that an amount of £13.9 million of the balance on the TANIO major claims fund should be distributed to the contributors to that major claims fund, and that any amount in excess of £13.9 million should be transferred to the general fund.

2 In paragraph 7 of document FUND/A.11/10, the Director set out three options for the reimbursement to contributors of the balance on the TANIO major claims fund. For the purpose of this document, options (b) and (c) are relevant, since their adoption would result in substantial amounts being credited to the accounts of a number of contributors. Under option (b), each contributor's account with the IOPC Fund would be credited with the amount to which he is entitled, and the credited amount would be set off against contributions to be levied in subsequent years. Option (c) would give each individual contributor the right to decide whether he wishes the amount to which he is entitled to be repaid to him, or whether he prefers to have the amount credited to his account with the IOPC Fund to be set off against future annual contributions. The Director has examined further the implications of these options and deems it appropriate to submit to the Assembly for consideration the question as to the rate at which interest should be calculated on the credit balances on the contributors' accounts. In addition, the Assembly is invited to consider whether the IOPC Fund should be entitled to take loans from the contributors' accounts.

3 The Director also submits to the Assembly for consideration the question of simplifying the method of calculating interest on overdue annual contributions.

Interest on Credit Balances on Contributors' Accounts

4 Under Internal Regulation 3.11, any credit balance on a contributor's account with the IOPC Fund shall bear interest at the rate of the lowest London clearing bank base rate, taking into account any changes in the London clearing bank base rates.

5 The principle of paying interest to contributors on credit balances on their accounts was adopted by the Assembly at its 4th session in respect of amounts that had been levied for the ANTONIO GRAMSCI major claims fund but had not been exhausted for settling claims arising out of the ANTONIO GRAMSCI incident. A special provision to this effect was inserted as a new Internal Regulation 4.4.3 (document FUND/A.4/16, paragraph 13). At its 6th session, the Assembly decided to extend the scope of this principle and adopted the present Internal Regulation 3.11, deleting at the same time Internal Regulation 4.4.3 (documents FUND/A.6/14 and FUND/A.6/16 paragraph 17.2). When Internal Regulation 4.4.3 was adopted, the Assembly determined the amount to be distributed to contributors at £750 000 (document FUND/A.4/16, paragraph 13). Out of this amount, £397 425 was set off against the 1981 annual contributions, leaving a balance of £352 575 to which Internal Regulation 4.4.3 applied. At that time, the total assets of the IOPC Fund amounted to £2 450 877.

6 Credit balances on contributors' accounts are invested together with the assets of the IOPC Fund. The rate of interest obtained on the IOPC Fund's investments is usually higher than the London clearing bank base rate. Consequently, the average interest earned on the IOPC Fund's investments tends to be higher than the average base rate. This is due to the fact that the banks generally offer rates above the base rate in order to attract sizeable funds. It should be noted, however, that the rate offered can on occasions be lower than the base rate, when there is no shortage of funds. The maturity dates of the IOPC Fund's investments are spread over the whole year, and the Director endeavours to take advantage of occasionally higher-than-average rates to place investments of over £500 000 for the maximum period of one year laid down in Financial Regulation 7.1(b).

7 When Internal Regulation 4.4.3 and later Internal Regulation 3.11 were adopted, it was not envisaged that the aggregate credit balance on the contributors' accounts would exceed the assets of the IOPC Fund but, rather, that it would be far lower than the Fund's assets. On this assumption, the solution of linking the interest on the credits on contributors' accounts to the base rate was convenient and unlikely to cause any major problems. This would be so, even if the base rate increased above the level at which the major part of the IOPC Fund's investments had been made, since the total amount of interest on the aggregate credit balance would be much smaller than the interest on the assets of the IOPC Fund.

8 However, the adoption of either option (b) or option (c) set out in paragraph 7 of document FUND/A.11/10 for the reimbursement to contributors of the balance on the TANIO major claims fund would radically change the situation. Under option (b), the aggregate amount of the credit balances on the contributors' accounts would, at least in 1989 and possibly for several years to come, be much higher than the assets of the IOPC Fund. The same situation would arise under option (c), if a number of major contributors were to chose to have their share of the reimbursement credited to their accounts with the IOPC Fund. In a period of rising base rates it is possible that a major part of the IOPC Fund's investments, including a major part of the investments of the monies in the contributors' accounts, would yield interest

at a rate lower than the base rate. In addition, the interest on IOPC Fund investments can occasionally be lower than the base rate, when there is no shortage of funds. If interest on contributors' accounts in these situations were to be calculated at the base rate, it would be necessary to use money from the general fund to pay part of that interest.

9 One possible way of dealing with this problem would be to continue to invest the amounts credited to the contributors' accounts together with the assets of the IOPC Fund only if the aggregate credit balance on these accounts does not exceed a fixed amount, say £500 000. In this case, interest on the credit balances would be calculated at the base rate. However, if the aggregate balance is higher than £500 000, the entire credit balance should be invested separately from other amounts held by the IOPC Fund, and the interest rate actually obtained on these investments should be applied when calculating the interest to be credited to the contributors' accounts.

10 The Director foresees certain practical difficulties in the application of the option mentioned in paragraph 9 above. It would be very difficult to maintain a strict separation, for investment purposes, between the amounts credited to the contributors' accounts and other monies held by the IOPC Fund. In addition, the maturity dates of the investments made from the credit balances on the contributors' accounts would have to be arranged to coincide with the date when contributions were due, in order to enable a set-off to be made. As indicated in paragraph 9 of document FUND/A.11/10, the Director proposes under option (c) that a contributor who has chosen to have the amount to which he is entitled credited to his account with the IOPC Fund should be entitled to request repayment at any later date. In order to be able to make such repayments rapidly, the repayments would have to be made from the general fund unless there were sufficient amounts maturing on the credit balance investments.

11 Another method would be to invest the entire credit balance on the contributors' accounts together with the IOPC Fund's assets and calculate the interest pro rata. However, this method would also have disadvantages. The calculation of interest pro rata would give rise to practical difficulties. This would be the case, in particular, if there were small credit balances on a large number of contributors' accounts. For this reason, in the view of the Director, this is not a viable solution.

12 As set out above, the application of either of the options discussed in paragraphs 9 to 11 would lead to considerable difficulties. For this reason, despite the problems set out in paragraph 8 above, the Director proposes that the present method of calculating interest on the credit balances on the contributors' accounts should be retained, ie that interest should be calculated at the base rate, pursuant to Internal Regulation 3.11 as it is worded at present.

13 However, the Assembly may wish to consider an alternative solution under which interest would be calculated on the balances on the contributors' accounts at a rate somewhat lower, say 1%, than the lowest London clearing bank

base rate. Although such a solution would not eliminate the risk of payments having to be made from the general fund to cover part of the interest on the credit balances on contributors' accounts, the risk would be reduced. In the event of this alternative solution being preferred by the Assembly, the Director submits the following draft text of a revised Internal Regulation 3.11 to the Assembly for consideration (amendments underlined):

"3.11 Any credit balance on a contributor's account with the Fund shall bear interest at <u>an annual</u> rate of <u>1% lower than</u> the lowest London clearing bank base rate, taking into account any changes in the London clearing bank base rates."

<u>Loans from Contributors' Accounts</u>

14 The Director's authority to take loans is governed by Internal Regulation 10.1, which reads:

"10.1 Where annual contributions determined by the Assembly do not in fact produce sufficient and timely funds for the payments to be made by the Fund for the satisfaction of claims, provisional payments or other expenses incurred in the operation of the Fund, the Director may make arrangements for obtaining short-term credit facilities or loans meeting the cash-flow requirements of the Fund. If the Director is unable to arrange the required credit facilities or loans on terms which he feels are reasonable, he shall refer the matter to the Assembly."

15 As set out in paragraph 8 above, the aggregate balance on the contributors' accounts would represent a substantial amount, if the Assembly were to adopt option (b) or option (c) in respect of the reimbursement to contributors of the balance on the TANIO major claims fund. The question would then arise as to whether the IOPC Fund should be entitled to take loans from the contributors' accounts, in order to expedite payments of claims without having to resort to bank loans.

16 Any amount credited to a contributor's account would be used to off-set future annual contributions levied against the contributor in question, and any credit balance would be invested on behalf of the contributor. Nevertheless, it could sometimes be to the benefit of the IOPC Fund, and thus also to the contributors, if the Fund were to be able to take loans from the aggregate balance on the contributors' accounts rather than from external sources. The IOPC Fund would obviously have to pay interest on such loans at a rate to be fixed in the Internal Regulations, say at an annual rate of 1.5% higher than the lowest London clearing bank base rate. On the basis of information given by banks, it is estimated that if the IOPC Fund were to take loans from external sources, the Fund would have to pay interest at approximately that rate.

17 If the Assembly were to decide that the IOPC Fund should be entitled to take loans from the contributors' accounts, amendments would have to be made to the Internal Regulations. The Director suggests that the present Internal

Regulation 10.1 be renumbered 10.1.1, and that a new Internal Regulation 10.1.2 be inserted. He submits the following text of a new Regulation for consideration by the Assembly:

"10.1.2 If the Director considers it to be in the interest of the Fund and its contributors, he may take loans from the aggregate balance on the contributors' accounts. Interest shall be paid on such loans at an annual rate of 1.5% higher than the lowest London clearing bank base rate, taking into account any changes in the London clearing bank base rates during the period of the loan."

Interest on Overdue Annual Contributions

18 Interest is charged on overdue annual contributions pursuant to Internal Regulation 3.10, which reads:

"3.10 Interest shall be charged on unpaid annual contributions from the date on which payment is due at an annual rate of 2% higher than the lowest London clearing bank base rate, taking into account any changes in the London clearing bank base rates while an annual contribution remains unpaid."

19 As a result of this provision, the rate of interest charged on overdue annual contributions changes every time the base rate is changed. For instance, during 1988 the base rate has been changed 12 times up to 30 September 1988. The calculation of interest on unpaid annual contributions is time-consuming, therefore, for the IOPC Fund's Secretariat, at times of frequent changes in the London clearing bank base rates. This is so even though these calculations are carried out, to a large extent, by computer. In addition, the method of calculating this interest makes it very difficult for a contributor who is in arrears to calculate for himself the exact amount due to the IOPC Fund at any given time. It should also be noted that the amount of the arrears is very low in most cases, and a change in the rate of interest on overdue contributions is therefore of very minor importance to most contributors.

20 For these reasons, the Director is of the opinion that the method of calculating interest on overdue annual contributions should be simplified. An appropriate method, in his view, would be to link this calculation to the base rate on the date when the annual contributions are normally due, pursuant to Internal Regulation 3.8, ie 1 February. If this proposal were adopted, the rate of interest charged on overdue annual contributions would not be affected by changes in the base rate during the year. The Director submits, therefore, the following draft text of a revised Internal Regulation 3.10 to the Assembly for consideration (amendments underlined):

"3.10 Interest shall be charged on unpaid annual contributions from the date on which payment is due at an annual rate <u>which for each period of twelve months from 1 February shall be</u> 2% higher than the lowest London clearing bank base rate <u>prevailing on 1 February</u>."

Action to be Taken by the Assembly

21 The Assembly is invited to consider:

(a) the options for the calculation of interest on the credit balances on contributors' accounts (paragraphs 12 and 13); and

(b) the Directors' proposals for amendments to Internal Regulations 3.10 and 10.1 (paragraphs 20 and 17).