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## REVIEW OF INVESTMENT POLICY

Note by the Director

### Introduction

1 Under Internal Regulation 10.2, the Director may invest any funds which are not required for the short term operation of the IOPC Fund, with a view to securing the Fund's assets. In making investments, all necessary steps should be taken to ensure the maintenance of sufficient liquid funds for the operation of the IOPC Fund, to avoid undue currency risk, and generally obtain a reasonable return.

2 Financial Regulation 7.1 states that the assets of the IOPC Fund shall be invested by the Director in accordance with Internal Regulation 10.2 and the following principles:

- (a) the IOPC Fund's assets shall be held in pounds sterling or, as appropriate, in the currencies required to meet claims arising out of a specific incident;
- (b) the assets shall be placed on term deposit with banks enjoying a high reputation and standing in the financial community, or they shall be invested with discount houses which are members of the London Discount Market Association by the purchase of bank bills; the term of these investments shall in neither case exceed one year;
- (c) the maximum investment in any bank or discount house shall not normally exceed £2 million;
- (d) any exceptions to the normal limit in paragraph (c) shall be reported to the Assembly at its next meeting.

3 Financial Regulation 7.1 also provides that the principles laid down therein shall be reviewed from time to time.

### Previous Review

4 Financial Regulation 7.1, in its original version, only permitted investment with banks. At its 5th session, in 1982, the Assembly approved a proposal by the Director to broaden the IOPC Fund's investment policy so as to allow investments with certain discount houses by the purchase of bank bills and adopted amendments to Financial Regulation 7.1 to this effect (documents FUND/A.5/4 and FUND/A.5/15, item 5).

5 Although the purpose of the review of the investment policy in 1982 was to allow the purchase of bank bills from discount houses, no bank bills have yet been purchased. The reason is that on the occasions when quotations for investments in the form of bank bills have been taken, the yield on bank bills have been lower than on bank deposits.

6 As a result of the inclusion of discount houses in Financial Regulation 7.1, the IOPC Fund has made investments in the form of term deposits with those discount houses which are also recognised under the United Kingdom Banking Act 1987 as banks.

### Review of Present Policy

7 There are different types of investments, such as cash, stocks and shares, bond and commodity investments. Separate markets exist for the different categories and within the same category. As a general rule, investments yielding higher returns normally involve greater risks. In the view of the Director, only cash investments not involving greater risks should be considered by the IOPC Fund.

8 Cash investment means that investors make loans to financial institutions. Such loans can be made by various means, such as deposits in pounds sterling or other currencies, as well as the purchase of treasury bills, bank bills, local authority deposits and certificates of deposits. The rate of interest obtainable usually depends on the amount of money invested, the period of investment and the liquidity of the instrument. So far, the IOPC Fund has only made investments in the form of deposits.

9 In recent years, the Director has held several meetings with banks and discount houses with a view to exploring the advisability of amending the IOPC Fund's investment policy, in order to obtain a better return. Areas of interest for lenders like the IOPC Fund were discussed, such as deposits in sterling, treasury bills, bank bills, certificates of deposit, and local authority deposits. It was found that, with the exception of local authority deposits on a few occasions, term deposits in sterling produce the best yield. During these meetings, the Director raised the issue of whether there were types of investments other than those mentioned above which would be more advantageous. It was generally agreed that, in view of the operations of the IOPC Fund, it was not likely that any other kind of investment would give higher yields, considering the needs of the IOPC Fund regarding liquidity and security.

10 So far, the IOPC Fund's investments have been placed only with banks and discount houses in London which are recognised under the United Kingdom 1987 Banking Act and satisfy the requirements of Financial Regulation 7.1(b). In order to enable the IOPC Fund to make Sterling deposits at more competitive rates, it would be necessary to broaden the range of financial institutions with which investments may be made.

11 Cash investments can be made with financial institutions other than banks and discount houses, ie finance houses or building societies. Finance houses may offer higher rates of interest. However, as such higher rates are paid to depositors, funds must be lent at correspondingly higher rates to borrowers who are often involved in above-average risks. The investment of the IOPC Fund's assets with such institutions would be incompatible with the policy of avoiding unnecessary risks. Building societies, on the other hand, may not offer such high rates as finance houses, but their lending is less risky, since they normally secure their lending by mortgages, whereas finance houses only use mortgages for security on rare occasions. Cash investments with building societies can be made by placing Sterling deposits, which can sometimes attract higher rates of interest than deposits with banks or discount houses. Such investments are on a secure basis, because most building societies are as sound as banks and discount houses.

#### Use of Money Brokers

12 The Director also had discussions with money brokers. Money brokers act for major banks, discount houses, institutional investors, industrial companies, local authorities and building societies, placing deposits and arranging loans and specialist funding. No payment is made by the lender to the money brokers, whose commission is paid by the borrower. The money brokers are regulated by the Bank of England Wholesale Markets Supervision Division. Major money brokers are constantly in touch with over 100 financial institutions at any given time. When the Director is unable to find a bank willing to borrow at a competitive rate of interest, a money broker would be able to put forward a suitable institution.

13 In view of the small size of its Secretariat, the IOPC Fund can only contact a limited number of institutions when investments are to be made. The Secretariat regularly takes quotations from a number of banks and discount houses which are on a list kept by the Secretariat, which contains at present around 20 institutions. However, by using the services of money brokers, the Director can have access to a large number of institutions, and some of these may in some cases offer better rates than the institutions contacted by the IOPC Fund directly. The money broker used by the Director has on a few occasions been able to arrange investments at better rates than those offered by the institutions on the above-mentioned list. So far, the Director has made one investment through a money broker.

#### Director's Proposal

14 In view of the considerations set out above, the Director proposes to broaden the IOPC Fund's investment policy to allow investments to be made with building societies. Only those building societies should be considered which,

as members of the Building Societies Association, enjoy as high a reputation and standing in the financial community as banks listed at the Bank of England.

15 In order to open the possibility of investing the IOPC Fund's assets with building societies, the Director proposes that Financial Regulations 7.1(b) and 7.1(c) be amended to read as follows (amendments underlined):

"7.1(b) the assets shall be placed on term deposit with banks or building societies enjoying a high reputation and standing in the financial community, or they shall be invested with discount houses which are members of the London Discount Market Association by the purchase of bank bills; the term of these investments shall in neither case exceed one year;"

"7.1(c) the maximum investment in any bank, building society or discount house shall not normally exceed £2 million;"

Action to be Taken by the Assembly

16 The Assembly is invited:

- (a) to take note of the information contained in this document; and
- (b) to take such decisions in respect of the proposed amendments to Financial Regulations 7.1(b) and 7.1(c) as it considers appropriate.