INTERNATIONAL OIL POLLUTION COMPENSATION FUNDS 1971 AND 1992

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REPORT OF THE INVESTMENT ADVISORY BODIES

Note by the Director

Summary:	The Investment Advisory Bodies report on their activities since the October 2001 sessions of the governing bodies.
Action to be taken:	Report to be considered.

1 Introduction

1.1 Pursuant to the respective mandates of the Investment Advisory Bodies of the 1992 and the 1971 Funds, these Bodies shall submit, through the Director, to each ordinary session of the respective Assembly, a report on their activities since the previous session.

1.2 In view of the fact that the mandate and composition of the two Investment Advisory Bodies are the same, it has been considered appropriate for these bodies to present a joint report to the governing bodies of the two Organisations. This report is reproduced at the Annex.

2 Action to be taken by the governing bodies

The governing bodies are invited to consider the Report of the Investment Advisory Bodies.

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ANNEX

REPORT OF THE INVESTMENT ADVISORY BODIES OF THE 1992 FUND AND 1971 FUND FOR THE PERIOD OCTOBER 2001 TO SEPTEMBER 2002

1 Introduction

1.1 The mandate of the Investment Advisory Bodies as laid down by the Assemblies of the 1992 Fund and 1971 Fund is:

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

(b) in particular, to advise the Director on the tenor of the respective Organisation's 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 investment policy of the Organisations as laid down by the respective Assembly; and

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

1.2 At their October 2001 sessions, the Governing bodies of the 1992 Fund and the 1971 Fund reappointed the following persons as members of their Investment Advisory Bodies for one year:

(a) Mr Clive M Ffitch, formerly Senior Operations Officer, Banca Monte Dei Paschi di Siena, SpA, London Branch;

(b) Mr David Jude, Vice Chairman, Family Assurance Friendly Society Ltd, and formerly Director of Cater Allen Ltd;

(c) Mr Simon Whitney-Long, Managing Director, Global Treasury Services (Management) Ltd and Director, The Bank Relationship Consultancy.

2 Meetings

2.1 The Investment Advisory Bodies have held four meetings with the Secretariat during the period covered by this Report, namely on 21 November 2001 and 26 February, 22 May and 4 September 2002. The Director, the Head of the Finance and Administration Department and the Finance Officer were present at these meetings.

2.2 The members of the Bodies have met further, formally on four occasions and informally on other occasions. There have also been frequent contacts between members of the Bodies and the Head of the Finance and Administration Department and the Finance Officer on various issues.

3 Main issues considered

3.1 At their October 2001 sessions, the Assembly of the 1992 Fund and the Administrative Council of the 1971 Fund, acting on behalf of the Assembly, were informed that the Investment Advisory Bodies of these Organisations intended to address the following issues in the coming year:

(a) to consider any implications that might arise from an investment perspective of the winding up of the 1971 Fund;

(b) to consider the extent of the use of spot purchases of currencies other than pounds sterling in anticipation of meeting specific claims in any currencies;

(c) to monitor the internal procedures for investment and cash management controls and recommend such amendments to these procedures as may be required;

(d) to monitor credit ratings of financial institutions and to review on a continuing basis the list of the financial institutions which meet the investment criteria laid down by the Assemblies; and

(e) to review regularly the investment and foreign exchange exposures of the 1992 and 1971 Funds and the quotations for investments in order to ensure that reasonable investment returns are achieved without compromising the safety of the Funds' assets.

3.2 The following main issues were considered by the Investment Advisory Bodies during the period covered by the Report:

(a) As regards the winding up of the 1971 Fund reference is made to Section 6 of the 2001 Annual Report and document 71FUND/AC.9/14. As a result of the entry into force of the 2000 Protocol to the 1971 Fund Convention and further denunciations of the 1971 Fund Convention, that Convention ceased to be in force on 24 May 2002. The Investment Advisory Bodies can report that in the period 4 September 2001 to 4 September 2002 the financial viability of the 1971 Fund was adequately protected.

(b) As reported to the governing bodies at their sessions in October 2000 the members of the Investment Advisory Bodies had met with a representative of the External Auditor on 8 March 2000. Further meetings were held on 22 May 2001 and 21 May 2002. Issues discussed at the May 2002 meeting included the practical aspects of the investment process, namely the criteria for selection of institutions with which investments were made and the reporting process. The Members of the Bodies explained that they made recommendations to the Director on the internal procedures for the wording of confirmation letters, signing authorities and the use of security PINs for authorising payments transacted electronically. They reported that at their meetings they considered the benefits that might arise from swaps, options and hedging opportunities. They expressed their views that it would be valuable for the IOPC Funds having an Audit Body and offered to meet such a Body when set up. Regarding the current limit of £15 million for investment in any one institution, they emphasised to the External Auditor's representative the importance of not weakening the present strict investment criteria even though it would mean that the Funds could only make deposits with a diminishing number of financial institutions. They stated that they would recommend to the Director increasing the limit from its current level of £15 million rather than weakening the criteria but explained that it was not necessary at present.

The representative of the External Auditor expressed particular interest in the contacts that existed outside the formal meetings between the Director, the Head of the Finance and Administration Department, the Finance Officer and all three members of the Advisory Bodies, particularly on the subject of the purchase of currencies, other than pounds sterling to meet claims.

(c) Financial Regulation 10.4 (a) provides that the Funds' assets shall be held in pounds sterling or, if the Director considers it appropriate, in the currencies required to meet claims arising out of a specific incident which have been settled or are likely to be settled in the near future. The Advisory Bodies have kept under review the holding of currencies, other than pounds sterling, as part of the Funds' normal assets.

The 1992 and 1971 Funds held Japanese yen in respect of the *Nakhodka* incident and the 1992 Fund held French francs and, from 1 January 2002, euros in respect of the *Erika* incident which were bought for sterling and invested. Payments made in the foreign currencies were for accounting purposes converted into sterling at the rate of exchange at which the currency was purchased, on a first in first out basis, and not at the date of the payment. The gain or loss in exchange at the date of the payment is therefore not

recorded. Any gains or losses at the end of the financial year arising from these deposits are credited or debited to the respective Major Claims Funds.

(d) The Internal Investment Guidelines are reviewed as and when necessary and in any event at least once each year. When reviewed in February 2002 the Investment Advisory Bodies did not recommend any amendments to these guidelines. The current Guidelines are attached to this report.

(e) At each meeting, the Investment Advisory Bodies have monitored the internal procedures for investment and cash management controls, which have always appeared to be satisfactory.

(f) The Investment Advisory Bodies have at each meeting monitored the credit ratings of financial institutions and, where necessary, made recommendations to the Director to amend the list of financial institutions with which deposits may be placed. The current list contains 66 financial institutions. It should be noted that between November 1996 and September 2002, 39 institutions have been deleted and 25 institutions have been added to this list – a net reduction of 14 institutions. Since the previous report to the governing bodies, call deposits, reserve deposits and fixed deposits have been placed with the Bank of Scotland, which is now regarded as an in-house bank. It should be noted that Barclays Bank remains an in-house bank.

(g) At their meeting on 21 November 2001, the Investment Advisory Bodies received a presentation from the Managing Director of AIM Global, a division of Invesco Asset Management, on the subject of Money Market Funds. Money Market Funds' instruments include repurchase agreements, commercial paper, Certificates of Deposit and medium term notes. Although the Money Market Funds had received a triple A rating, which met the Internal Investment Guidelines criteria, the Bodies recommended to the Director that the Funds should not pursue this type of investment as investors bought part of that fund through the issue of shares, and although the price normally fluctuates at or above par, it was conceivable that the price could fall below par and that the capital invested could be eroded.

(h) At their meeting on 26 February 2002, the Investment Advisory Bodies considered a proposal to invest sterling in the form of Dual Currency Deposits (DCD) operated by banks that meet the investment criteria. DCDs allow the Funds to undertake without any costs foreign exchange hedging between sterling and euros, both currencies that the Funds require. At the time a DCD is made a certain conversion rate between the sterling and the euro is agreed and if at the maturity of the deposit, the sterling/euro rate is above the strike price, the capital and interest would be repaid in sterling; if on maturity the sterling/euro rate is below the strike price, the capital would be paid in euros. The interest is normally repayable in sterling. The IABs recommended to the Director that an overall limit of £6 million for DCD transactions should be set, providing the individual limit of £15 million in any one financial institution was adhered to. To date six DCD deposits have been made resulting in a better return than that if the funds had been placed in a normal sterling deposit.

(i) At each meeting, the Advisory Bodies have reviewed the individual investments, maturities and overall exposure. The investment policy has been discussed in the light of the market situation at the time.

4 Revision of the IOPC Funds' investment policy

4.1 Under their mandates, the Investment Advisory Bodies are required to draw the Director's attention to any developments which may justify a revision of the Funds' investment policy, as laid down by the Assemblies.

4.2 The Investment Advisory Bodies have reviewed the Funds' investment policy in the light of Financial Regulation 10.1 and considered it to be entirely appropriate in terms of safety, liquidity and yield. Therefore the Bodies recommended to the Director that there should be no amendment to that policy.

5 Objectives for the coming year

The Investment Advisory Bodies intend to address the following issues during the coming year:

(a) to consider the extent of the use of spot purchases of currencies other than pounds sterling in anticipation of meeting specific claims in any currencies;

(b) to monitor the internal procedures for investment and cash management controls and recommend such amendments to these procedures as may be required;

(c) to monitor credit ratings of financial institutions and to review on a continuing basis the list of the financial institutions which meet the investment criteria laid down by the Assemblies;

(d) to review regularly the investment and foreign exchange exposures of the 1992 and 1971 Funds and the quotations for investments in order to ensure that reasonable investment returns are achieved without compromising the safety of the Funds' assets; and

(e) to liaise with a representative of the External Auditors and with the Audit Body, when set up.

Clive M Ffitch | David Jude | Simon Whitney-Long

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ATTACHMENT

Internal Investment Guidelines

Amended 9 March 2000
(Reviewed by Funds' IABs on 26 February 2002)

Money Market Investments

A For investments by the IOPC Funds, the following guidelines should apply:

1 In order to be eligible for investments, a bank or building society should satisfy at least two of the following three short term ratings:

Standard & Poor's A1+
Moody's P1
Fitch/IBCA F1+

2 Banks should, in addition, have a long term rating of A or better, with at least one of these three rating agencies.

3 A banking institution should be either a parent bank or a full branch of its parent bank.

4 The normal limit of £15 million laid down in the Financial Regulations should apply to the total amount of the IOPC Funds' deposits with a given institution.

5 Subject to the normal limit of £15 million laid down in the Financial Regulations for investment in any given institution, deposits with building societies should not exceed 25% of the IOPC Funds' total deposits.

B The Director will keep a list of approved institutions, which should be updated regularly, in consultation with the Advisory Bodies.