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COMPENSATION
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Agenda item 18

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LEGAL STATUS OF THE PROVIDENT FUND

Note by the Director

Introduction

1 At the 15th session of the Assembly, the Director raised certain questions concerning the legal status of the assets of the Provident Fund and the investment of these assets (document FUND/A.15/12, paragraph 11). The Assembly noted the information given by the Director. It instructed him to pursue his study of these issues and invited him to submit this matter for consideration by the Assembly at its 16th session (document FUND/A.15/28, paragraph 15.10).

2 The present document contains the Director's study of the questions relating to the investment of the Provident Fund and contains his proposal for a solution to the problems involved, namely that the Provident Fund should be constituted as a trust in accordance with the principles of trust law in operation in England and Wales. The study has been made in consultation with the External Auditor.

3 During his study, the Director has encountered a number of legal problems as well as important questions concerning accounting and audit arrangements which have to be examined in depth. For this reason, the Director proposes that the Assembly should consider these problems with a view to making a decision of principle and give the Director such instructions as it may deem appropriate as to the further procedures.

Provident Fund

4 The IOPC Fund operates a Provident Fund instead of a pension scheme, pursuant to Staff Regulation 23(b). Both staff members and the IOPC Fund contribute to the Provident Fund, on such terms and conditions as are approved by the Assembly. Provisions concerning the operations of the Provident Fund are contained in Staff Rule VIII.5. The rates of contributions to the Provident Fund are currently 7.9% for staff members and 15.8% for the IOPC Fund, calculated on the basis of the pensionable remuneration of the staff member concerned. The auditing of the Provident Fund is carried out in conjunction with the annual auditing of the accounts of the IOPC Fund.

5 The share of the staff member in the Provident Fund is, at the discretion of the Director, payable to the staff member concerned upon separation from the Fund or to his or her nominated beneficiary on his or her death. The share of a staff member in the Provident Fund is the contribution paid by him or her and the contributions paid by the IOPC Fund in respect of that staff member together with interest thereon, less a proportion of any administrative expenses or banking charges incurred in respect of the Provident Fund.

6 Staff Rule VIII.5(d) provides that the administration, investment and control of the Provident Fund is the responsibility of the Director.

7 Since the establishment of the IOPC Fund, the Provident Fund has been merged with the General Fund, the Major Claims Funds and the Contributors' Account for investment purposes, in order to enable the Provident Fund to benefit from the higher interest rates which the investment of the IOPC Fund's assets can attract. The basis of calculation of interest on the Provident Fund is the one laid down by the Executive Committee at its 2nd session (document FUND/EXC.2/6, item 6). In the balance sheet of the IOPC Fund, the assets of the Provident Fund are shown as a liability for the General Fund.

The Problem

8 The present legal situation appears to be that the assets of the Provident Fund are under the legal control of the IOPC Fund. Under English law, the IOPC Fund might be considered as a trustee holding the Provident Fund for the benefit of the IOPC Fund staff members, but the situation is not absolutely clear. The Provident Fund does not have a separate legal personality.

9 On joining the IOPC Fund, a staff member enters into a contract of employment contained in a letter of appointment. The letter incorporates, by reference, the Staff Regulations and Staff Rules. Pursuant to Staff Rule II.1, the contractual entitlements of the staff member are limited to those contained expressly, or by reference, in the letter of appointment. The rights of the staff member to his or her respective share in the Provident Fund appear to be contractual in nature.

10 In the context of his review of the IOPC Fund's investment policy carried out in 1992, the Director came to the conclusion that the legal status of the Provident Fund was not clear. In his view, this was not satisfactory, since the interests of the staff members were of paramount importance as regards the Provident Fund. The Director informed the Assembly at its 15th session that, after discussion with the External Auditor, he was taking legal advice on this issue in order to establish whether the procedure for the management of the Provident Fund should be amended, for example by creating a form of trust.

Position of Some Other Organisations

11 The Director has contacted six London based intergovernmental organisations which are known to operate Provident Funds, to establish the solutions adopted by these organisations. The International Lead and Zinc Study Group, the International Sugar Organization, the International Rubber Study Group and the International Wheat Council have constituted their Provident Funds in the form of Trusts. In the International Cocoa Organization and the International Coffee Organization, on the other hand, the Provident Funds do not constitute separate legal entities, but each Provident Fund's assets are invested separately from the assets of the Organisation. In the latter two organisations, the administration, investment and control of the Provident Fund is the responsibility of the Executive Director who, in carrying out his duty, is assisted by an Advisory Committee with staff participation.

Director's Considerations and Proposal

12 The Director instructed a firm of London solicitors, Lee & Pembertons, to study the issues involved. The solicitors consider that, although the present legal situation has not created and is unlikely to create any problems, the status of the Provident Fund need to be clarified.

13 After discussions with the Director and after consideration of all aspects of the problem, the solicitors recommended that the Provident Fund should be constituted as a trust in accordance with the principles of trust law in operation in England and Wales. In their view, this Provident Fund Trust should be modelled on the structure normally used in Occupational Pension Schemes in the United Kingdom. The Director agrees with the solicitors' recommendation.

14 The constitution of a trust as regards the assets of the Provident Fund would ensure that these assets would be kept separate from the IOPC Fund's assets. It would also allow a proper codification of the basis upon which the Provident Fund operates and avoid any uncertainty as to the precise rights of staff members.

Concept of a Trust

15 A Trust is an arrangement dealing with the ownership of property. The legal rights of ownership are separated from the beneficial rights of enjoyment. The persons who own the property legally are usually referred to as "Trustees".

16 Although the Trustees own the property, they cannot do what they like with it but must deal with it in accordance with predetermined instructions. Such instructions, which may give the Trustees some element of discretion, are usually contained in a document known as the "Trust Deed", executed by the person creating the Trust. The Trust Deed will identify the persons who are actually to enjoy the benefits of the property in question. Such persons are normally described as "beneficiaries". The significance of this structure is that the beneficiaries have rights which they can enforce against the Trustees. It is not necessary to have any form of contract giving rise to such rights.

17 In the context of pension fund arrangements a Trust provides a useful means of segregating the assets of the Pension Scheme from those of the employer, thereby protecting such assets in the event of the employer becoming insolvent.

Trust Deed

18 If the Assembly were to decide that the Provident Fund should constitute a trust, a Trust Deed would be drawn up to provide the legal mechanism for constructing the Provident Fund Scheme in question as a separate entity. The Deed would set the parameters of the legal powers conferred upon the persons in charge of administering the scheme. The precise terms of the Scheme would be contained in a separate set of regulations which could be amended from time to time.

Provident Fund Regulations

19 It is proposed that the details of the administration of the Provident Fund shall be set out in a set of Provident Fund Regulations to be adopted by the Assembly, which may amend them from time to time.

Accounts and Audit

20 It is proposed that the accounts of the Provident Fund should be kept by the Finance Officer of the IOPC Fund. The provisions of Financial Regulation 9, which deals with the accounts of the IOPC Fund, should apply mutatis mutandis to the Provident Fund. It would be necessary, however, to discuss the details of the accounting with the External Auditor.

21 As for auditing, one possible solution is that the Provident Fund Trust should be audited by the same External Auditor as that of the IOPC Fund, at present the Comptroller and Auditor General of the United Kingdom, provided that he would be prepared to assume this task. Alternatively, a different auditor could be appointed by the Assembly.

Cost of Operating the Trust

22 In the view of the Director, the restructuring of the Provident Fund in the form of a Trust should not reduce the benefits of the staff members. The Assembly may wish to consider, therefore, that the cost of setting up and operating the Provident Fund Trust should be borne by the IOPC Fund as a general administrative expense. The yearly cost of operating the Trust is estimated at around £1 000. It is likely that there will also be a separate audit fee.

Investments

23 It is suggested that the investments of the Provident Fund Trust assets should be subject to more stringent restrictions than the investments of the IOPC Fund's assets (cf document FUND/A.16/14). The Trust's assets should thus only be invested in banks enjoying a high reputation and standing in the financial community. The investments should be made only in Pounds Sterling. The term of investment should not exceed one year. However, in view of the fact that the total assets of the Provident Fund are relatively low (at present some £500 000), it is suggested that investment of the total amount in the same institution should be allowed.

Taxation

24 - The exemption of the IOPC Fund's assets from taxes is governed by Article 8 of the Headquarters Agreement between the Government of the United Kingdom and the Fund. Within the scope of its official activities, the IOPC Fund, its property and assets, and its income including contributions made to the Fund, are exempt from all direct taxes including income tax, capital gains tax and corporation tax. The Fund is accorded a refund of value added tax paid on the supply of goods or services of substantial value necessary for the official activities of the organisation. From the date on which a tax was imposed by the Fund for its benefit on salaries and emoluments paid by the Fund to its staff members, such salaries and emoluments are under Article 9 exempt from United Kingdom income tax. In the event that the Fund were to operate a system for payment of pensions and annuities to its former staff members, the exemption from income tax would, however, not apply to such pensions and annuities.

25 In the Director's view, the assets of the Provident Fund, even if held in the form of a Trust, should enjoy the same tax treatment as the assets of the IOPC Fund itself. The assets of the Trust and the yield on those assets as well as any sums paid to staff member by the Trust should therefore be considered as covered by Articles 8 and 9 of the Headquarters Agreement referred to above, which grant exemption from all direct taxes, including income tax, capital gains tax and corporation tax.

26 In order to eliminate any uncertainty as regards the situation in respect of taxes for a Provident

Fund Trust, the Director has asked the United Kingdom Government to confirm that the assets of the proposed Trust, the yield on its assets and any payments to staff members would be covered by the exemption from taxes laid down in the Headquarters Agreement. When received, the reply of the United Kingdom Government will be reported to the Assembly.

Internal Regulations and Financial Regulations

27 The Internal Regulations of the IOPC Fund do not make any reference to the Provident Fund.

28 The Financial Regulations refer to the Provident Fund only in Regulation 5.3 which reads:

"A Provident Fund shall be established in accordance with Staff Regulation 23. Contributions to be paid by each staff member and by the Fund in respect of that staff member shall be shown separately".

29 It is suggested that Financial Regulation 5.3 should be deleted if the Provident Fund were to be constituted in the form of a Trust.

Procedures to be Followed

30 As stated in paragraph 3 above, the Director submits for consideration by the Assembly whether, in principle, it agrees with the Director that the Provident Fund should be constituted into a Trust. If the Assembly were to agree in principle with this proposal, the Director would pursue his study of the remaining issues, and elaborate the necessary Regulations, in the light of any opinions expressed by the Assembly.

31 If the Assembly were to agree in principle with the Director's proposal, the Assembly may wish to consider whether to authorise the Executive Committee to take the necessary decisions for the creation of the Trust, including the adoption of the Trust Deed and the adoption of the Provident Fund Regulations.

Action to be Taken by the Assembly

32 The Assembly is invited to:

- (a) take note of the information contained in this document;
 - (b) consider the Director's proposal that the assets of the Provident Fund should be constituted into a Trust (paragraphs 12-14 above); and
 - (c) give the Director such instructions as it may deem appropriate concerning the procedure to be followed in respect of the Provident Fund.
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