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REVIEW OF INVESTMENT POLICY

Note by the Director

1 Introduction

1.1 The IOPC Fund's investments are governed by Internal Regulation 10.2 and Financial Regulation 7.1.

1.2 At its 15th session, the Assembly reviewed the IOPC Fund's investment policy, on the basis of an examination made by the Director and a report presented by the External Auditor (document FUND/A.15/12). The Assembly considered, in particular, the types of investments which the IOPC Fund should make, which kinds of institutions should be used for investment purposes, the extent to which investments should be made in currencies other than Pounds Sterling, the maximum investment in any one institution, the maximum period of investments and the internal procedures of the Fund relating to investments. The Assembly instructed the Director to make further studies of some issues and to submit these issues to the Assembly for consideration at its 16th session (document FUND/A.15/28, paragraph 15).

1.3 The present document contains the Director's study requested by the Assembly. The study has been carried out in consultation with the External Auditor.

2 Consideration at the 15th Session of the Assembly

2.1 As mentioned in paragraph 1.2 above, the Assembly considered at its 15th session a number of important points. During the discussions it was emphasised that the IOPC Fund was not an investment bank. The point was made that, in view of the large amounts which were held by the IOPC Fund, it would be necessary to ensure that there were adequate procedures for investing the IOPC Fund's assets and for controlling the management of these assets. The question was raised whether, in view of the expanding activities of the IOPC Fund, in particular in respect of the size of its investments, it would not be appropriate to consider increasing the resources of the Secretariat to handle these matters. It was considered that a study should be made as to whether a special body should be established which could advise the Director on investment matters. It was also stated that the Assembly should regularly examine the IOPC Fund's investment policy and give the Director such instructions in this field as it may deem appropriate.

2.2 The Assembly made the following decisions:

(a) the IOPC Fund should not, at least for the time being, broaden its investment policy beyond deposits and bank bills;

(b) the IOPC Fund should maintain, at least for the time being, its policy of investing only with banks, building societies and discount houses;

(c) the Director should retain the possibility of keeping assets in any currency required to meet payments of claims arising out of a particular incident which have been settled or are likely to be settled in that currency in the near future; he should also retain the possibility of buying currencies other than pounds sterling through forward contracts or through options, to cover payments of such claims;

(d) as regards incidents which have given rise to substantial claims against the IOPC Fund, significant investments in the relevant currency at an early stage to meet such claims should require prior approval by the Assembly;

(e) the normal limit for investment in any one institution should be 25% of the IOPC Fund's total assets, provided however that investments with any one institution should not normally exceed £4 million; and

(f) the maximum period for investments should be maintained at one year.

2.3 In view of these decisions, the Assembly decided to amend Financial Regulation 7.1(a) to read as follows:

> The assets of the Fund shall be invested by the Director in accordance with Internal Regulation 10.2 and the following principles:
>
> (a) the Fund's 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. Subject to prior approval by the Assembly, investments may also be made in currencies other than pounds sterling to meet payments in respect of a particular incident which has given rise to significant claims against the Fund.
>
> (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;
>
> (c) the maximum investment in any bank, building society or discount house shall not normally exceed 25% of the Fund's total assets, subject to a maximum of £4 million;
>
> (d) any exceptions to the normal limit in paragraph (c) shall be reported to the Assembly at its next meeting.
>
> These principles shall be reviewed from time to time.

2.4 The Assembly also instructed the Director to :

(a) study further the question of the investment of the IOPC Fund's assets in currencies (including the European Currency Unit) other than Pounds Sterling;

(b) examine, in consultation with the External Auditor, whether it would be appropriate for the IOPC Fund to set up a special body to advise the Director on investment matters and to consider the composition of such a body; and

(c) consider whether the fact that the IOPC Fund will be holding significant amounts of money would necessitate any increase in the resources of the IOPC Fund Secretariat to deal with matters relating to the IOPC Fund's finances in general, and investment matters in particular,

3 Investment in Currencies other than Pounds Sterling

3.1 Before the 15th session of the Assembly, Financial Regulation 7.1 provided that the IOPC Fund's assets should be held in Pounds Sterling or, as appropriate, in the currencies required to meet claims arising out of a specific incident. The scope for investing the IOPC Fund's assets in currencies other than Pounds Sterling was thus restricted. The question raised by the Director was whether to broaden the scope for such investments, in order to protect the IOPC Fund against losses resulting from depreciation of the Pound Sterling against other currencies in which payments will or may have to be made.

3.2 The Director drew attention to the practice in the private sector of "matching liabilities and assets", ie for a company to invest in various currencies in proportion to its estimated liabilities in the respective currencies. It was mentioned that some of the insurers of shipowners' third party liabilities, the P & I Clubs, had such an investment policy. The Director stated that, in the case of the IOPC Fund, it was very difficult to assess beforehand in which currencies the Fund would be called upon to pay compensation and indemnification, since it was neither possible to foresee in which Member States incidents involving the IOPC Fund would occur nor the extent of the Fund's financial involvement in various States. For that reason, the Director maintained that it would not be justified to change the IOPC Fund's policy by allowing for investments in currencies other than Pounds Sterling so as to match liabilities and assets in respect of incidents which have not yet occurred (document FUND/A.15/12, paragraphs 6.2 and 6.3).

3.3 The Director considered that he should retain the possibility of keeping assets in any currency required to meet payments of claims arising out of a particular incident which have been settled or are likely to be settled in that currency in the near future. He should also retain the possibility of buying foreign currencies through forward contracts, as was done in the TANIO case, or through options, to cover payments of such claims. The Director suggested that it might be worth considering whether, in the case of an incident which has given rise to significant claims against the IOPC Fund, the Financial Regulations should permit significant investments in the relevant currency at an early stage. If such investments were to be made, this would necessitate a thorough analysis of likely currency fluctuations as well as predictions as to the relationship between interest rates on investments in Pounds Sterling and in the other currency concerned. In the Director's opinion, any such investment should need prior approval by the Assembly or the Executive Committee.

3.4 The Assembly agreed with the Director's position as set above in respect of the extent to which the IOPC Fund should be allowed to invest in currencies other than Pounds Sterling, and as a result thereof adopted the wording of Financial Regulation 7.1 reproduced in paragraph 2.3 above.

3.5 As previously mentioned, the Assembly nevertheless instructed the Director to study further the question of the investment of the IOPC Fund's assets in currencies other than Pounds Sterling. Having examined this matter further, the Director would like to submit the following elements for consideration.

3.6 The main problem attendant on foreign currency transactions is that of exchange rate fluctuations, caused by currency speculation, political unrest or ordinary market forces. One recent example of this problem is the fluctuations which took place in September 1992 caused by heavy speculation against the Pound Sterling, the Italian Lira and the Spanish Peseta. This led to the withdrawal on 17 September 1992 of the Pound and the Lira from the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS). Sterling dropped around 9% from its old ERM floor against the Deutsche Mark, and the Lira dropped some 10%. The Spanish Peseta was devalued 5% within the ERM. The French Franc, Irish Punt and Danish Krone also lost ground against the system's "hard currencies" - the Deutsche Mark, Belgian Franc and Dutch Guilder - while the Portuguese Escudo required higher interest rates to support its Deutsche Mark parity. In July 1993, the French Franc and the Danish Krone faced heavy speculations. The result was the widening of the bands within which the French Franc and other currencies in the ERM are permitted to float from plus or minus 2.25% to plus or minus 15%.

3.7 The Director has made a study of the yield from investing in some of the main currencies on the Euro-currency market. The study is based on the investment of the equivalent of £2 million for twelve months fixed. The exchange rates and Euro-currency interest rates quoted in the Financial Times on 11 September 1992 have been applied. For converting amounts maturing at the end of the investment period back into Sterling, the exchange rates on 6 September 1993 have been used. The result of the study is given in the following table:

Currency	Rate of Conversion 11.9.92	Interest Rate 11.9.92	Rate of Conversion 6.9.93	Amount at Maturity in Pounds Sterling
Deutsche Mark	2.790	9 7/16	2.463	2 479 339
Dutch Guilder	3.145	9 7/16	2.760	2 494 065
French Franc	9.495	10 1/4	8.678	2 412 592
Italian Lira	2 135.000	17	2 381.000	2 098 236
Japanese Yen	239.000	3 5/8	159.000	3 115 267
Spanish Peseta	181.100	13 7/8	201.100	2 050 996
US Dollar	1.924	3 1/4	1.527	2 601 873
Pound Sterling	1.000	10 11/16	1.000	2 213 750

3.8 It can be seen from the table that there would have been a significantly better return on investments in five of the currencies studied (Deutsche Mark, Dutch Guilder, French Franc, Japanese Yen and US Dollar) than on a Pound Sterling investment, whereas the yield would have been lower on investments in Italian Lira and Spanish Pesetas. The result would obviously have been different if Sterling had appreciated rather than depreciated.

3.9 The unpredictability and the speed with which currencies under speculative pressure can be devalued show that investment in foreign currencies involves great risks. Although investment in "strong" currencies would protect the IOPC Fund's assets against depreciation of the Pound, experience shows that it is virtually impossible to predict which currencies will be "strong" and which will be "weak". It must be emphasised that any currency used for the IOPC Fund's investment could fluctuate both ways in relation to the Pound Sterling. Even with the assistance of the best advisers available, it would be very difficult for the Director to make assessments as to future currency movements. In addition, since the IOPC Fund will have to keep a high degree of liquidity so as to be able to make prompt payments to victims of pollution damage, a considerable part of the IOPC Fund's assets will have to be placed on short term investments. If the IOPC Fund were to hold a significant part of its investments in currencies other than Pounds Sterling, there would be a risk that these currencies would have to be sold at a moment when the respective rates were unfavourable, in order to obtain the necessary liquid funds.

3.10 As mentioned above, the Assembly has emphasised that the IOPC Fund is not an investment bank. Internal Regulation 10.2 provides that in making its investments the IOPC Fund should take the necessary steps to avoid undue currency risks.

3.11 Having regard to the foregoing, the Director considers that it would not be in the IOPC Fund's interest to abandon the present approach of a prudent and cautious investment policy. In his view, the IOPC Fund's investment in foreign currencies should be limited to the situations outlined in paragraph 3.3 above, as set out in Financial Regulation 7.1(a).

3.12 If the Assembly were to decide to allow for investments in currencies other than Pounds Sterling on a larger scale, it might be necessary for the IOPC Fund to employ additional staff or make use of expensive outside expertise.

4 Investing in the European Currency Unit (ECU)

4.1 The Assembly also instructed the Director to study further whether it would be appropriate to invest the IOPC Fund's assets in the European Currency Unit (ECU).

4.2 The ECU is a monetary unit created from a basket of currencies of the States which are members of the European Community in fixed amounts which are set according to the relative size of national economies. The basket is at present composed of the following eleven currencies: Belgian Franc, Danish Krone, Deutsche Mark, Dutch Guilder, French Franc, Greek Drachma, Irish Punt, Italian Lira, Portuguese Escudo, Pound Sterling and Spanish Peseta. The ECU is provisionally backed by central bank deposits - the central banks transfer 20% of their gold reserves and 20% of their dollar reserves to the European Monetary Co-Operation Fund. Each currency has a fixed weight in the basket determined by its central rate against the ECU but, as market exchange rates change, each currency's market-related weight in the basket will differ slightly from this as the currency's value against the ECU moves. The composition of the basket is reviewed every five years, or if the weight of a currency alters by 25%.

4.3 The ECU, like any national currency, fluctuates in value against other currencies, including Pound Sterling. This is because it represents the sum of the value of its constituent currencies. The value of the ECU changes as the individual ECU currencies fluctuate in value. This results in changes in their value against the ECU, and also in changes in the ECU's value against currencies not included in the basket.

4.4 As a basket currency, the ECU includes both "strong" and "weak" currencies. This combination tends to make the basket currency less volatile than individual currencies. In the case of the ECU, the quality of stability inherent in a basket is less important than the special characteristics of the ECU which derive from the relatively fixed exchange rate mechanism of the European Monetary System. For the ECU's constituent currencies, the fixed exchange rate system is designed to impose limits on their movement. The result is that, realignment aside, the eleven currencies broadly move together as a block, showing little variation amongst themselves or against the ECU.

4.5 The attributes of the ECU have brought about its increasing use in European trade and financial instruments, although it was originally developed for use as a unit of account for Governments of the Member States of the European Community and for European Community institutions. Private use of the ECU has grown very rapidly in the last few years. ECUs can be deposited and borrowed or bought and sold for other currencies, and an ECU account with a bank can be operated by means of cheques or similar instruments in the same way as an account in any other currency. The ECU is also widely used as an investment currency.

4.6 Interest rates on investments in ECUs are based upon a weighted average of the interest rates of component currencies, with the weight reflecting each currency's share in the basket. Since there is a fairly active market in short term investments for all component currencies, short-term rates in the ECU deposits cannot diverge significantly from this average. The inclusion in the ECU of "strong" and "weak" currencies results in short-term ECU interest rates being between the relatively low rates on investments in Deutsche Mark and Dutch Guilder and the higher rates on investments in Spanish Peseta, Danish Krone and Portuguese Escudo.

4.7 The Director has made the same investment study for ECU as the one referred to in paragraph 3.7 above. On 11 September 1992, the ECU stood at 1.375 to the Pound Sterling. On the same day, the one year ECU Linked Deposit Offered rate was 11 1/4%. The principal plus interest maturing on 6 September 1993 and converted at 1.302 on the same day would have yielded £2 349 750. This would have represented a gain of £136 000 above a similar investment in Sterling. If, however, the Pound Sterling had in the period studied strengthened significantly in relation to the other basket currencies, an investment in ECU could have been less favourable than an investment in Pound Sterling.

4.8 It should be noted that investments in ECU are normally made in amounts of £10 million or higher. Some dealers accept investments for £100 000, but at very low rates, whereas most dealers will only accept a minimum of £5 million. Under Financial Regulation 7.1, the normal limit for investment of the IOPC Fund's assets in any one institution is £4 million. The Director does not consider it advisable to increase this limit very significantly.

4.9 In view of the foregoing, it is the Director's opinion that it would not be advisable to invest the IOPC Fund's assets in ECU.

4.10 If the IOPC Fund were to decide to make investments in ECU, it might be necessary to employ additional staff or to make use of expensive outside expertise.

5 Investment Advisory Body

The Assembly instructed the Director to examine, in consultation with the External Auditor, whether it would be appropriate for the IOPC Fund to set up a special body to advise the Director on investment matters and to consider the composition of such a body. This issue is dealt with in a separate document submitted to this session of the Assembly (document FUND/A.16/17).

6 Increase of Secretariat Resources

6.1 The Assembly instructed the Director to consider whether the fact that the IOPC Fund will be holding significant amounts of money would necessitate any increase in the resources of the IOPC Fund Secretariat to deal with matters relating to the IOPC Fund's finances in general, and investment matters in particular.

6.2 It is recognised that there has been a significant increase in work relating to the IOPC Fund's finances in the last few years. In the view of the Director, however, this does not at present necessitate the employment of further staff to deal mainly with such matters. In document FUND/A.16/12 relating to the 1994 budget, the Director has proposed that he be authorised to employ one more professional staff member. If such an additional staff member were to be employed, the Director would consider whether to ease the burden on the Finance Officer by a redistribution of certain tasks.

6.3 As stated above, it might be necessary to increase the resources of the Secretariat further or make increased use of expensive outside expertise if the Assembly were to decide that the IOPC Fund should make major investments in currencies other than Pound Sterling or in ECU.

7 Internal Investment Procedures

7.1 At its 15th session, the Assembly also took note of the internal procedures applied by the IOPC Fund for investment purposes (as set out in document FUND/A.15/12), the External Auditor's observations, proposals and recommendations in respect of these procedures, and the Director's intentions as to the formalisation and modification of these procedures.

7.2 The Director has examined further the IOPC Fund's internal procedures for investments and has discussed these procedures with the External Auditor. As a result of this examination he has elaborated, in consultation with the External Auditor, a note setting out in some detail the investment management procedures of the IOPC Fund. This note is reproduced at the Annex to the present document.

8 Provident Fund Investments

At its 15th session, the Assembly also noted the information given by the Director concerning the legal status of the assets of the Provident Fund and the investment of these assets. A separate document on this matter is submitted to the 16th session of the Assembly (document FUND/A.16/15).

9 Investment of General Fund and Major Claims Funds Assets

At its 15th session of the Assembly, the Director stated that, in the light of the discussions at that session, he intended to carry out a general review of the IOPC Fund's Financial Regulations in order to establish if modifications should be made to meet the concerns expressed during the discussions, for example with regard to the relationship between the General Fund and Major Claims Funds, and to adapt these Regulations to the needs of the expanded activities of the Organisation. The review of the Financial Regulations is dealt with in a separate document (document FUND/A.16/18).

10 Action to be Taken by the Assembly

The Assembly is invited to:

(a) take note of the information contained in this document;

(b) give the Director such further instructions regarding the IOPC Fund's investment policy as it may deem appropriate; and

(c) consider in particular:

    (i) the extent to which investment of the IOPC Fund's assets should be made in currencies other than Pounds Sterling (paragraph 3 above);

    (ii) whether investments should be made in the European Currency Unit (ECU) (paragraph 4 above); and

    (iii) the need for an increase in the resources of the IOPC Fund Secretariat to deal with matters relating to the IOPC Fund's finances in general, and investment matters in particular (paragraph 6 above).

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ANNEX

IOPC FUND'S INVESTMENT MANAGEMENT PROCEDURES

Note by the Director

1 Regulatory Provisions on Investments

1.1 The IOPC Fund investments are governed by the provisions of Internal Regulation 10.2, Internal Regulation 10.3, Financial Regulation 7.1 and Financial Regulation 7.2, as follows.

1.2 Internal Regulation 10.2:

> "With a view to securing the assets of the Fund, the Director may invest any funds which are not required for the short-term operation of the Fund. In making any investments all necessary steps shall be taken to ensure the maintenance of sufficient liquid funds for the operation of the Fund, to avoid undue currency risks and generally to obtain a reasonable return on the investments of the Fund."

This Regulation therefore lays down the four main principles guiding the IOPC Fund's investments policy, viz:

(i) Security of assets;
(ii) Maintenance of liquidity;
(iii) Avoidance of undue currency risks; and
(iv) Securing a reasonable rate of return.

1.3 Internal Regulation 10.3:

> "The Director shall submit to each session of the Assembly particulars of the current investments of the Fund and of any changes which have taken place since his previous report."

1.4 In conformity with this requirement, the Director submits to each session of the Assembly a "Report on Investments", detailing the investments made with the various institutions over the preceding twelve months, usually from 1 July to 30 June. In this way, the Assembly performs an "arms length" monitoring of the Fund's investments.

1.5 Financial Regulation 7.1:

> "The assets of the Fund shall be invested by the Director in accordance with Internal Regulation 10.2 and the following principles:
>
> (a) the Fund's 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. Subject to prior approval by the Assembly, investments may also be made in currencies other than pounds sterling to meet payments in respect of a particular incident which has given rise to significant claims against the Fund;
>
> (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;

(c) the maximum investment in any bank, building society or discount house shall not normally exceed 25% of the Fund's total assets, subject to a maximum of £4 million;

(d) any exceptions to the normal limit in paragraph (c) shall be reported to the Assembly at its next meeting.

These principles shall be reviewed from time to time."

1.6 Financial Regulation 7.2:

"Instructions relating to the Fund's investments shall be given by the Director. Such instructions shall be given or confirmed in writing by him. The Director may empower another officer or officers to act, if necessary, on his behalf."

1.7 This Regulation emphasises that the overall responsibility for the IOPC Fund's investments rests ultimately with the Director. Subject to any instructions which the Assembly may have given, the Director will therefore approve the institutions to be used for investment purposes and decide on the amount to be invested, the period of investment and the rates accepted.

2 General Statement by the Assembly

In the context of a general review of the IOPC Fund's investment policy, the Assembly emphasised that the Fund was not an investment bank (document FUND/A.15/28, paragraph 15.3). The Assembly also stated that it should regularly examine the IOPC Fund's investment policy and give the Director such instructions in this field as it may deem appropriate.

3 General Limitations as Regards Investments

The investments which the Director can make are thus limited in a number of respects.

(a) Types of Investments

The assets of the IOPC Fund may be placed on term deposit or by the purchase of bank bills.

(b) Institutions Used for Investment Purposes

The IOPC Fund's assets may only be invested with banks or building societies enjoying a high reputation and standing in the financial community, or with discount houses which are members of the London Discount Market Association by the purchase of bank bills. The criteria which any given institution shall fulfil in order to qualify for investments are dealt with in paragraphs 6.1 – 6.12 below. It should be noted that investments in the form of term deposits may be made with those discount houses which are also recognised as banks under the United Kingdom Banking Act 1987.

(c) Maximum Investment in Any One Institution

The maximum investment in any bank, building society or discount house shall not normally exceed 25% of the Fund's total assets, subject to a maximum of £4 million. This maximum should be exceeded only in special cases, for example when exceeding this limit for a short period of time would give benefits to the IOPC Fund without any undue additional risk.

(d) Maximum Period of Investments

The term of the IOPC Fund's investments shall not exceed one year.

(e) Currency of Investments

The investments should normally be made in Pounds Sterling.

4 Investing in Currencies Other than Pounds Sterling

4.1 As mentioned above, the IOPC Fund's assets should be held in Pounds Sterling. The Director has the possibility, however, of keeping assets in any currency required to meet payments of claims arising out of a particular incident which have been settled or are likely to be settled in that currency in the near future. He also has the possibility of buying foreign currencies through forward contracts, or through options, to cover payment of such claims.

4.2 Investments may also be made in currencies other than Pounds Sterling to meet payments in respect of a particular incident which has given rise to significant claims against the IOPC Fund. Such investments require the prior approval of the Assembly. Before the Director makes a proposal for such investment, he should make a thorough analysis of likely currency fluctuations as well as predictions as to the relationships between interest rates on investments in Pounds Sterling and in the other currency concerned.

4.3 The turbulence which took place in the currency markets in the middle of September 1992 showed the difficulties attendant on any investments in foreign currencies. This should always be taken into account when investments in currencies other than pounds sterling are considered.

5 Use of Money Brokers

5.1 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. By using the services of money brokers, the Director can have access to a greater number of institutions, including building societies, and some of these may offer better rates than the institutions contacted by the IOPC Fund directly. Investment with any institution proposed by a broker may only be made after the institution has been approved by the Director. It should be noted that no commission is paid by the Fund to the money broker, whose commission is paid by the borrower.

5.2 Only those money brokers which have been specifically approved by the Director for this purpose may be used. The money brokers approved by the Director are among those listed by the Bank of England as money market institutions under the Financial Services Act 1986. Those listed are regulated by the Bank of England's Wholesale Markets Supervision Division. The following brokers have been approved by the Director:

- Barclays de Zoete Wedd
- City Deposit Brokers
- Harlow Butler Ueda Ltd

6 Internal Procedures of the IOPC Fund Relating to Investments

Criteria for Approval of Institutions

6.1 Investments are only made with institutions which have been approved for this purpose by the Director. Such approval is based on an examination carried out by the Finance Officer into the financial standing of the institution.

6.2 When approving institutions for investment purposes, the Director is acting on the basis of Financial Regulation 7.1(b), which allows investments with "banks or building societies enjoying a high reputation and standing in the financial community" and with "discount houses which are members of the London Discount Market Association".

6.3 In the case of banks and discount houses, the first condition for approval applied by the Director is that the institution should appear on the prevailing list of Authorised Institutions recognised by the Bank of England under the Banking Act 1987. The list, as well as any amendments thereto, is supplied to the IOPC Fund by the Bank of England. As far as banks are concerned, the second requirement is that the bank in question should enjoy a good credit rating by renowned debt-rating agencies such as Standard & Poor's Corporation, Moody's Investors Service and the International Banking Credit Analysis. Where discount houses are concerned, however, it is sufficient that the discount house in question is a member of the London Discount Market Association. Discount houses are not normally rated by debt-rating agencies because their operations are short term and they are an integral part of the London Money Market System. Besides, the generally held view is that it is inconceivable that a discount house would not be automatically supported by the Bank of England in the unlikely event of financial difficulties.

6.4 As for building societies, most of them are not credit-rated. If a building society is credit-rated, the Director would apply the same rating criteria as mentioned above regarding banks. In respect of building societies which are not credit-rated, the Director makes an assessment on the basis of the published accounts and information supplied by the Building Societies Commission as to their financial standing. Of significant relevance is Butlers Building Society Guide, a statistical analysis of the Building Society Movement compiled annually by Harlow Butler Ueda Ltd.

6.5 As regards the meaning of the requirement laid down in the Financial Regulations that an institution, in order to be approved by the Director for investment purposes, should enjoy a "high reputation and standing in the financial community", it is not easy to lay down clear criteria in this regard. For example, the rating criteria applied by various credit-rating agencies differ, and discount houses and some building societies are not included in rating lists. The Director will therefore have to assess each institution individually in order to form an opinion as to whether the institution should be approved.

<u>General Criteria to be Applied for the Director's Approval of Institutions for Investment Purposes</u>

6.6 With respect to the criteria to be applied by the Director in approving institutions, it should be emphasised that the institution should not only fulfil the requirements set out in paragraphs 6.2 and 6.3 above but should also be generally considered as a "fit and proper" institution by other institutions. Therefore, the institution should not be the subject of adverse speculative market rumours.

6.7 Another criteria is that the institution should be located in a State with a low commercial and political risk. Such a State should enjoy a good credit rating in the Sovereign Ratings and Assessments carried out by renowned debt-rating agencies, such as Standard & Poor's Corporation or Moody's Investors Service. Typically, the Fund selects countries with AAA or AA long term or A1+ under Standard & Poor's, and Aaa or Aa long term or P-1 short term under Moody's.

6.8 Thirdly, the institution should have a strong capital asset base, reflected in a strong balance sheet.

6.9 When an institution meets these criteria, a meeting is arranged between the management of the institution and the Director and Finance Officer of the IOPC Fund. Such meetings are usually held in the Fund offices. These meetings are used for giving a detailed explanation of the functioning of the Fund, with a view to conveying the necessity for sound investment management and custody of funds. The following IOPC Fund documents are made available to the institution:

- text of the 1971 Fund Convention
- latest Annual Report

- General Information booklet
- latest IOPC Fund Statistics
- Financial Regulations.

6.10 The Fund's Letter of Mandate, with the authorised signatures is also sent to the institution. Where it is considered necessary, the Director and the Finance Officer visit the offices or dealing room of the institution to see at first hand how its business is conducted.

6.11 Meetings are not arranged with institutions with which the Fund invests through the medium of a money broker. Before a money broker is chosen, however, the procedure outlined in paragraph 6.9 above is applied to the broker. Nonetheless, investments are never made with any institution put forward by the broker unless that institution meets the criteria applied by the Director for institutions with which investments are made directly. In any case, the broker has previously been made conversant with the requirements of the Fund in this respect.

6.12 The institutions which may be used at any given time for investment purposes are included in a list approved by the Director. This list should be kept under constant review and should be amended when circumstances justify it. For instance, the appearance of an institution in the Creditwatch Lists of Standard & Poor's or Moody's should lead to a review of such an institution. Market rumours concerning a particular institution should obviously also lead to a review.

Procedure for Making Investments

6.13 When an investment is to be made, the Director decides the period of investment and gives the Finance Officer instructions as to the institutions to be approached for quotations. For determining the term of the investment, the Director takes into account the need to maintain liquid funds and the projected cash flow requirements. He also considers the desirability to spread the risks between several institutions and the IOPC Fund's interest in obtaining a reasonable return on its investments.

6.14 The Finance Officer makes the investments within the parameters of the Director's instructions, after having taken quotations from an appropriate number of institutions, having regard to the London Interbank Offered Rate (LIBOR) published daily in such papers as the Financial Times and The Times. If the Finance Officer finds that the market situation is different from what was expected when the Director gave his instructions, the Finance Officer should refer the matter back to the Director for new instructions. If the Director is not available in the office to give new instructions, the Finance Officer should place the investment either overnight or in the short dates until the Director is available to give new instructions. The Finance Officer is not allowed to make an investment with any institution not approved by the Director.

6.15 For the purpose of securing the Fund's assets, investments made through the intermediary of money brokers are accompanied by repayment instructions. In all such cases, at maturity the principal plus interest are to be repaid direct to the IOPC Fund's current account with Barclays Bank Plc, Westminster Abbey Branch. This is to ensure that at no time can the control of the movement of funds pass out of the hands of the IOPC Fund staff into those of the money brokers. It should be noted that institutions holding the IOPC Fund's Letter of Mandate would be legally liable to the Fund in cases of negligence or conversion. In the event of negligence or conversion by an employee of a money broker, it may be more difficult for the Fund to proceed against the borrowing institution, who, after all, could argue that they were only carrying out the instructions of their client, the money broker. Furthermore, although the money broker would be in possession of the Fund's Letter of Mandate, it may prove difficult to hold the broker directly liable for any act or omission of its employees, because of the absence of any consideration between the money broker and the IOPC Fund.

6.16 If the Finance Officer is absent from the office when investments are to be made, either because of annual leave or due to illness, the investments are made by the Director. Investments should, if possible, be made so as to avoid major amounts maturing during the periods when the Finance Officer is expected to take annual leave. It would often be appropriate that investment of amounts maturing when the Finance Officer is absent be postponed until his return to the office; the amounts in question would then be rolled over for the required number of days.

6.17 In the event that the Finance Officer were to be absent during a significant period of time, special arrangements may have to be considered, for example to employ a replacement for the Finance Officer on a temporary basis.

Concept of "Reasonable Return"

6.18 The concept of "reasonable return" on the IOPC Fund's investments which is laid down in Internal Regulation 10.2. is very difficult to define. The IOPC Fund should not necessarily aim at obtaining the highest possible return, since there are many considerations which have to be taken into account when the IOPC Fund's investments are made. As mentioned above, the Assembly has emphasised that the IOPC Fund is not an investment bank. One criterion could be the average return from major banks in the United Kingdom. There are also other criteria, however, in particular the paramount requirement of not exposing the IOPC Fund's assets to undue risks and the IOPC Fund's cash flow requirements. The level of return often depends on the period of investment.

Advice and Information from External Sources

6.19 The Director and the Finance Officer should, to the extent they consider it useful, seek independent advice on investment matters from external sources, such as debt-rating agencies. Apart from the use of Ratings Handbooks, the contacts established between the Finance Officer and various debt-rating agencies, Barclays Bank Economics Department, the Nomura Research Institute and the Bank Relationships Consultancy, should be used, as appropriate. Use should also be made of information on cash management and investments which the United Nations Consultative Committee on Administrative Questions provides for United Nations bodies.

Crediting of interest

6.20 Interest on investments should be credited to the General Fund and the Major Claims Funds, as the case may be, in accordance with Financial Regulation 5 and the practice followed so far. Interest on the Provident Fund shall be calculated on the basis laid down by the Executive Committee at its 2nd session (document FUND/EXC.2/6, item 6).

7 Investment of Assets of the Provident Fund

7.1 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).

7.2 In reviewing the IOPC Fund's investment policy, the Director has come to the conclusion that the legal status of the assets of the Provident Fund is not clear. In his view, this is not satisfactory, since the interests of the staff members are of paramount importance as regards the Provident Fund. The Director is at present taking legal advice on this issue in order to establish whether the procedure for management of the assets of the Provident Fund should be amended, for example, by creating a form of trust. He will submit this matter for consideration by the Assembly at its 16th session (document FUND/A.16/15). Pending the Assembly's decision on this issue, the investment of the Provident Fund's assets should be made in accordance with the procedures set out above.

1 September 1993