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International Oil Pollution Compensation Funds

Agenda Item 5	IOPC/NOV20/**5**/**4**	
Date	9 September 2020	
Original	English	
1992 Fund Assembly	92A25	●
1992 Fund Executive Committee	92EC74	
Supplementary Fund Assembly	SA17	●

REPORT OF THE JOINT INVESTMENT ADVISORY BODY

Note by the joint Investment Advisory Body

Summary:	The joint Investment Advisory Body reports on its activities since the October 2019 sessions of the governing bodies of the 1992 Fund and the Supplementary Fund. In addition, the joint Investment Advisory Body is providing its first three-year self-evaluation as part of its report to the governing bodies. The three-year self-evaluation is at Attachment III to the report.
Action to be taken:	1992 Fund Assembly and Supplementary Fund Assembly Information to be noted.

1 Introduction

1.1 Pursuant to the mandate of the joint Investment Advisory Body (IAB) of the 1992 Fund and the Supplementary Fund, this Body shall submit, through the Director, to each regular session of the governing bodies, a report on its activities since the previous regular session. The report is set out at the Annex to this document.

1.2 In view of the fact that the governing bodies decided in March 2005 that there should be a joint IAB for the 1992 Fund and the Supplementary Fund, it has been considered appropriate for this Body to present a single report to the governing bodies for the two organisations.

1.3 The IAB is also providing its first three-year self-evaluation as part of its report to the governing bodies which is at Attachment III.

2 Action to be taken

1992 Fund Assembly and Supplementary Fund Assembly

The 1992 Fund Assembly and Supplementary Fund Assembly are invited to take note of the information provided in the joint IAB's report contained in the Annex.

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ANNEX

REPORT OF THE JOINT INVESTMENT ADVISORY BODY OF THE 1992 FUND AND THE SUPPLEMENTARY FUND FOR THE PERIOD OCTOBER 2019 TO SEPTEMBER 2020

1 Introduction

1.1 This report has been issued in the name of the joint Investment Advisory Body (IAB) of the 1992 Fund and the Supplementary Fund. Any material updates will be included in the IAB's verbal presentation at the forthcoming governing bodies meeting in December 2020.

1.2 The mandate of the IAB as laid down by the governing bodies of the two Funds is:

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

(b) in particular, to advise the Director on the tenor of the Funds' 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 Funds' investment policy as laid down by the governing bodies;

(d) to advise the Director on the management of currency exposure relating to incidents; and

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

1.3 At its October 2017 session, the 1992 Fund Assembly appointed the following persons as members of the IAB for a term of three years:

- Mr Alan Moore, a financial and investment consultant, formerly head of Global Markets, State Street Bank (Europe) and co-founder and advisor to Molten Markets Inc.;
- Mr Brian Turner, a treasury consultant, and formerly Group Director Treasury, Henderson Global Investors Ltd;

1.4 In addition, Mr Simon Whitney-Long was reappointed for a period of six months, during which time the Director sought a suitable replacement.

1.5 In April 2018, the 1992 Fund Administrative Council approved the Director's proposal to appoint Ms Beate Grosskurth to the joint Investment Advisory Body until October 2020. Ms Grosskurth is an experienced international banker and has held senior positions with State Street Bank of Boston, Brown Brothers Harriman and CME Group.

2 Meetings

2.1 At the time of preparing this report the IAB had held four meetings with the Secretariat during the period covered by this report; namely on 2 December 2019, 15 April, 9 June and 9 September 2020. The April, June and September 2020 meetings were held remotely. The Director, the Deputy Director/ Head of the Finance and Administration Department and the Finance Manager were present at these meetings.

2.2 The IAB hold virtual meetings amongst themselves regularly and also prior to the quarterly meetings with the Secretariat. There has also been frequent contact between members of the IAB and the Secretariat on various issues.

2.3 At the time of this Report, the members of the IAB have not had an opportunity to meet with the Audit Body or the External Auditor, but a meeting is scheduled for 25 September with the Audit Body where the External Auditor will also be present. Matters to be discussed at this meeting will include an update on the Funds' hedging process, the IAB's views on the pound sterling as the Funds' base currency and the approach adopted to protecting the Funds' assets.

3 Main issues considered

The main issues are detailed under the following headings:

- Economic summary
- Credit markets
- Hedging the currency risk arising from incidents
- Other important issues
- Objectives for the coming year

4 Economic summary (covering the period up to 31 July 2020)

4.1 Recession risks, which were elevated during the middle part of 2019, diminished in the fourth quarter of 2019. The global economy was helped by additional monetary easing; a trade truce between the United States of America (USA) and China, better prospects for an orderly withdrawal of the United Kingdom (UK) from the European Union (Brexit), and early signs of a rebound in the global purchasing managers' indices (PMIs). Hence, the baseline outlook for 2020 presented positive with a moderate expectation on recovery for global growth.

4.2 Fiscal and monetary policy were working in the same direction, further easing, in almost all major economies but monetary policymakers now had less space left to guard against future recessions, geopolitical risks or the unexpected event of disruption. The disruption materialised in the form of COVID-19.

4.3 Over the first two quarters of 2020, global financial markets saw huge trading volatility and data superlatives. The Financial Times Stock Exchange (FTSE) 100 index of UK equities fell by 35% in the three months to the end of March and then settled at 20% down by the end of the second quarter, while the USA's S&P 500 was down more than 30% before rallying back to 3.4% down by the end of the second quarter. Gold saw its biggest gain since 2008 and the US dollar (USD) had its biggest weekly decline since 2009.

4.4 Economists from the International Labour Organisation (ILO) estimated that the global economy would be hit by an estimated 25 million global job losses, would suffer an income loss of USD 860 billion to USD 3.4 trillion, and global household debt would rise to USD 47 trillion, equating to 60% of global gross domestic product (GDP) and USD 12 trillion higher than in the run up to the 2008 financial crisis.

4.5 Oil prices fell significantly, with one contract falling as low as negative USD 40 per barrel due to excess liquidity driven by the economic consequences of the global pandemic, and an ongoing price war between Saudi Arabia and Russia. The Organization of the Petroleum Exporting Countries (OPEC) and its allies reacted by signing off on a deal to cut almost 10% of global supplies, to prop up the market, where demand had fallen by as much as a third.

4.6 Hence, to mitigate the COVID-19 crisis, global policy makers coordinated/compromised on a response and agreed on various packages and measures.

European Union

4.7 The GDP in the European Union (EU) contracted by 14.4 % annualised in the second quarter of 2020 over the same quarter in 2019.

4.8 The European Central Bank committed to purchase at least EUR 750 billion (USD 820 billion) of government and corporate bonds from 2020 through its flexible new Pandemic Emergency Purchase Program (PEPP), in addition to its previously announced EUR 360 billion worth of quantitative easing.

4.9 The package brought the EU's total monetary response to the epidemic to EUR 3.2 trillion (USD 3.5 trillion), the largest in the world.

4.10 The European Council's approval of the EUR 750 billion COVID-19 recovery package and a EUR 1 074 billion seven-year budget followed. The European project had taken a politically and philosophically important step towards the mutualisation of debt and embarked on its first jointly funded programme.

United States of America

4.11 For the second quarter of 2020, the GDP in the USA shrunk by a record 32.9% annualised, versus 34.7% expected. This was the sharpest drop ever recorded and followed a first quarter drop of 5%.

4.12 The Federal Reserve resumed purchasing substantial amounts of securities, a key tool employed during the Great Recession of 1929 and aimed at restoring orderly market functionality and allowing credit to flow.

4.13 The Federal Reserve initially committed to buy USD 500 billion in Treasury securities and USD 200 billion in government-guaranteed mortgage-backed securities, and subsequently made it open ended to also include commercial mortgage-backed securities. It is now extending its menu of lending programs to businesses, governments and individuals to the end of 2020 with market participants expecting the Federal Reserve to maintain short-term interest rates at near zero yields well into the future.

United Kingdom

4.14 The GDP in the UK contracted -24% in May year-on-year after a -24.5% drop in April, while rising 1.8% monthly in May from April's drop of -20.3%.

4.15 The Bank of England made two emergency interest-rate cuts, dropping the official interest rate to the current yield of 0.1%.

4.16 Some £350 billion was injected into the UK economy, in various forms of government financial support, and the UK's five largest banks suspended dividend payments until 2021, freeing up £190 billion for use in lending to businesses.

Third quarter and beyond

4.17 Oil prices registered their best quarterly performance in 30 years during the three months through to the end of June, staging a dramatic comeback after falling to the record lows seen in April. However, strangled demand and obstructed supply chains will be a severe constraint on the global economy for 2020 and beyond.

4.18 Recovery timeframe: At the time of writing, it is still difficult to determine the impact of the global pandemic long-term, the more structural impacts to the market that might materialise and what shape the global recovery will take. However, as local and national lockdown measures are reintroduced, the most likely routes for the economic recovery to take are:

- U-shaped recovery: global slowdown until the fourth quarter of 2020 and recovery over the course of 2021; or
- L-shaped slow recovery: global pandemic driving a recession that lasts at least until end of the fourth quarter of 2020 into 2021 and beyond.

4.19 Brexit: there is also still considerable uncertainty about how EU-U.K. trade ties will look in 2021 and ahead.

4.20 The UK and EU did agree not to extend the transition period beyond December 2020. However, whilst both sides want to reach a deal, the EU's push for the UK to remain aligned with single market regulations, such as EU access to British fishing waters and UK demands for a permanent deal for its financial services' sector, will likely create obstacles to a comprehensive free trade agreement.

4.21 Further afield, according to forecasts, the pandemic will likely cause China's purchases of the USA's goods this year to fall short of what was agreed to in the phase one trade deal. With President Trump preoccupied with securing a second term and China finding it difficult to live up to its end of the trade deal it might delay constructive developments until after the election.

4.22 All of these structural impacts in the coming years are set against a backdrop of low global growth and the monetisation of fiscal deficits. Economists debate that the possibility of an occurrence of the rare phenomenon, 'stagflation', cannot be ruled out.

5 Credit markets

5.1 Overall, the latest reporting period has been a fairly busy one for the three main ratings agencies, Fitch, Moody's and Standard & Poor's.

5.2 Towards the end of 2019, although credit markets were stable, there was a slight bias towards capital weakening and earnings deterioration of some of the 34 banks in the Group One and Group Two list of banking counterparties.

5.3 The emergence of the COVID-19 pandemic in the first quarter of 2020, however, precipitated an eruption of credit activity, with asset markets and global currencies also becoming increasingly volatile. Over a period of two months, there were over 60 changes to credit outlooks, almost all of a negative inclination, and five downgrades to the short-term credit ratings, as the economic impact and escalating costs of the pandemic became clearer. The cost of insuring against corporate default also rose, which was reflected in an increase of Credit Default Spread (CDS) prices across the board.

5.4 Despite the surfeit of negative adjustments to the credit ratings, there were no changes to the Group One and Group Two constituents at the time of writing, although many of the counterparties in Group One are only one short-term downgrade away from dropping into Group Two.

5.5 Towards the end of the second quarter of 2020, along with a strong recovery in the equity markets, Credit Default Spreads also continued to improve. However, with the release of the quarterly reports from the banks, the first tangible signs of a decline in capital adequacy started to appear, along with a sharp decline in earnings.

5.6 The third and fourth quarters of 2020 will likely be challenging from a credit perspective, as further evidence of the economic impact of the global pandemic emerges. The steep increase in debt and burgeoning government deficits will likely also impact sentiment, as will any further major decline in the asset markets or increase in corporate default risk. This was underlined at the end of July, in an analysis of the next phase of the COVID-19 crisis by Fitch Ratings, with a warning that 'the scale of policy response and the corresponding sharp rise in an already-high global debt burden mean that recovery will not be linear or predictable'.

5.7 The IAB continues to remain vigilant and monitors the credit markets on a daily basis and currently presents a credit market review to the Director monthly, rather than quarterly as usual.

6 <u>Hedging the currency risk arising from incidents</u>

6.1 Hedging activity to minimise the risk of adverse currency movements has been minimal in the past twelve months, but the exchange rates of currencies to which the Funds have an exposure are monitored on a daily basis.

6.2 The Director updates the IAB with regard to all incidents on a quarterly basis, although some may not have a financial impact on the Funds.

Prestige incident

6.3 In April 2019, EUR 27.2 million was paid to the Spanish Court resulting in 99.5% of the total amount in relation to this incident having been paid, and a balance of some EUR 834 600 is being held for future claims related expenses. There is no additional currency risk associated with this incident.

Hebei Spirit incident

6.4 In April 2019, the sums of KRW 22 billion were paid to the P&I Club (Skuld Club) and KRW 27.5 billion to the Korean Government. The final balance of some KRW 3.4 billion was still to be paid to the Skuld Club when the legal proceedings had been concluded and it was anticipated that this payment would be made in US dollars. A sum of some USD 2.8 million, the equivalent of the Korean won payment due, was held for this purpose and payment was made to the Club in July 2020. There is no additional currency risk associated with this incident.

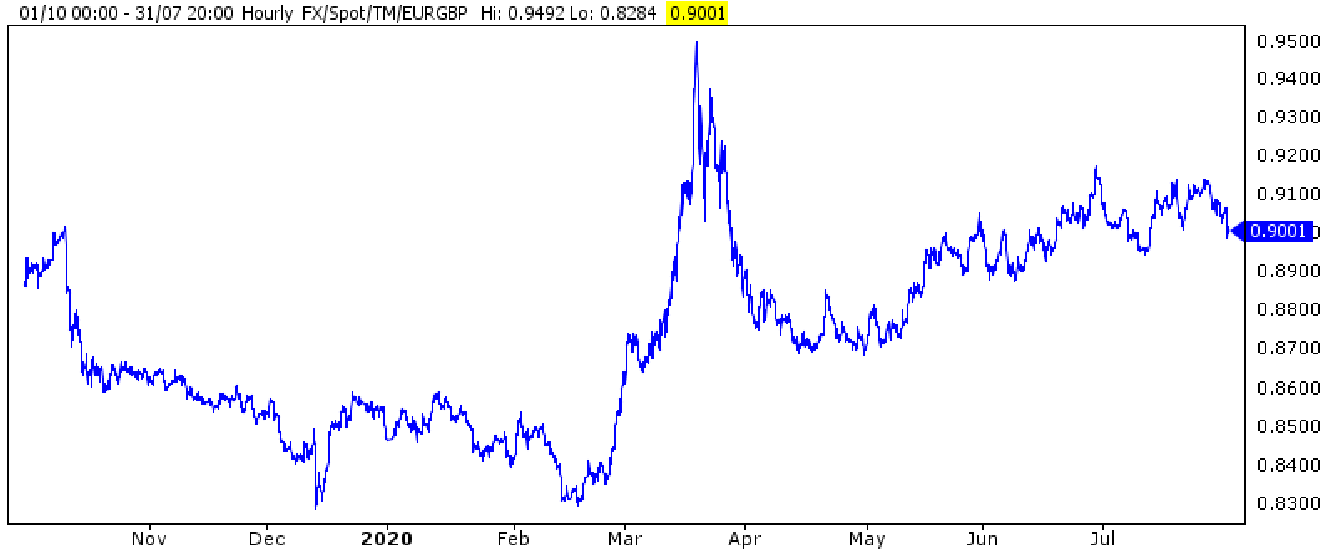
Agia Zoni II incident

6.5 The compensation payable for this incident is estimated to be EUR 56 million but this amount is not fixed. A total of some EUR 14 million has been paid and a balance of approximately EUR 20 million is being held, which represents 48% of the amount required. It has been decided not to increase this hedging ratio until there is further clarity on the amount of compensation payable. It should be noted that deposits in euros yield negative interest rates and hence, the current balance of euros are held by the Secretariat in current accounts, yielding no interest.

<u>Currency charts</u>

6.6 Charts for the EUR/GBP and GBP/USD currency pairs covering the period 1 October 2019 to 31 July 2020 have been included to illustrate the movements that have taken place.

EUR/GBP



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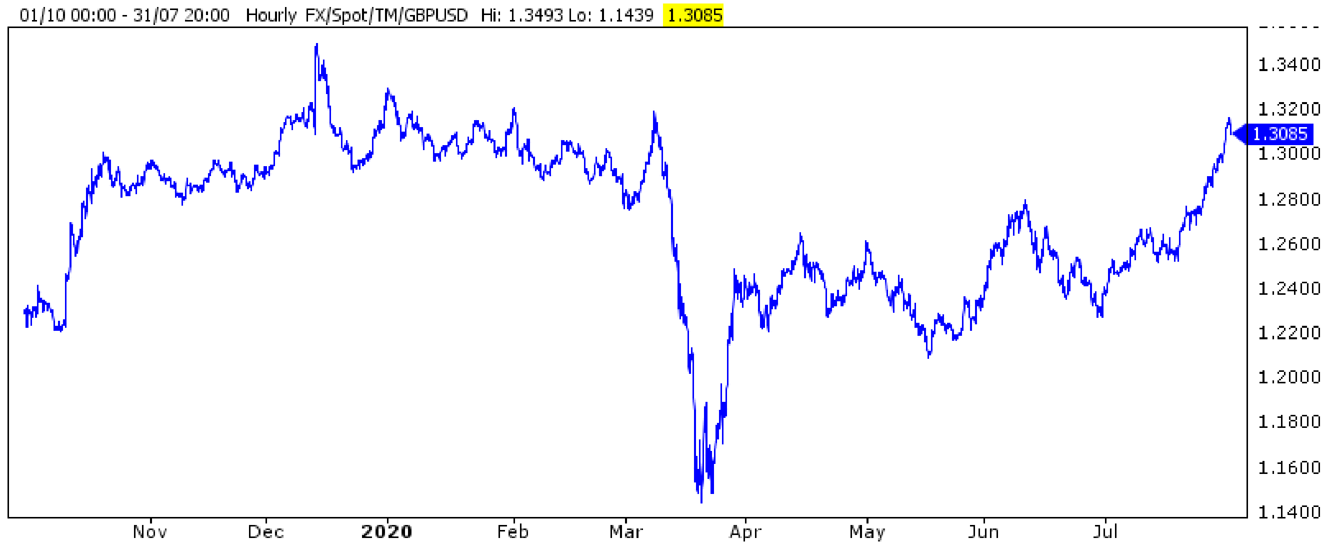
GBP/USD



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6.7 The pound sterling had edged higher against the US dollar and the euro during the period 1 October 2019 until 31 July 2020 and had reached highs of 1.35 and 1.21 (0.83) respectively before the market volatility triggered by COVID-19 caused the pound sterling to reverse sharply to levels of 1.14 and 1.05 (0.95) before recovering to 1.31 and 1.11(0.9).

6.8 The economic summary in section 4 provides a more detailed explanation of events.

6.9 The IAB prepared a paper on hedging currency exposure in August 2020 following an earlier document prepared in April 2018. The latest paper will be discussed with members of the Audit Body at its meeting on 25 September 2020.

7 Other Important Issues

Internal procedures for investment and cash management controls

7.1 Under the 1992 Fund and the Supplementary Fund's respective Financial Regulation 10.4(c), the maximum investment in any bank or building society of each Fund's assets individually shall not normally exceed 25% of these assets or £10 million, whichever is the higher. Financial Regulation 10.4(d) sets the maximum investment in any bank or building society by the two Funds together at £15 million, or, when the two Funds' combined assets exceed £300 million, at £25 million. Following the IAB's recommendation at the October 2009 sessions of the governing bodies, the maximum investment with the Funds' house banks was increased from £15 million to £20 million. The respective Financial Regulation 10.4(d) of the two Funds was amended accordingly. As the Funds' combined assets on the date of this report are some £60 million, the normal limit for investing in any one financial institution of £15 million remains applicable, except for house banks, whose normal limit is £20 million. The IAB continually monitors these limits and would recommend any adjustments to the Director.

7.2 The IAB has reviewed the Internal Investment Guidelines and the Hedging Guidelines at each of its meetings since its report to the October 2019 sessions of the governing bodies. These guidelines were last reviewed at its meeting on 9 September 2020. Copies of both sets of Guidelines are found in Attachment I and Attachment II to this report.

Monitoring of the IOPC Fund's financial risks

7.3 In last year's report the IAB stated that it had reviewed the IOPC Funds' financial risks, and this process has continued during the current year. Brexit continues to be an ongoing risk and the IAB had reported on this at previous sessions of the governing bodies. This risk is continuously being monitored by the IAB as the outcome of the Brexit negotiations is still very uncertain.

7.4 Since the March 2020 meeting of the IAB focus has also been on managing the finance risks associated with the global pandemic and the impact on financial markets, stability of counterparty banks and the overall management of the assets of the IOPC Funds.

Review of the Investment of the Staff Provident Fund

7.5 The Staff provident Fund is made up of two schemes, Provident Fund 1 (PF1) which is invested with the assets of the 1992 Fund, and Provident Fund 2 (PF2) which is managed by an independent financial adviser in the name of the 1992 Fund. Participation in PF2 is entirely voluntary with fees borne by participants in proportion to their share of investment.

7.6 The IAB has reviewed the investments in the portfolio of the PF2 on a quarterly basis and commented on their suitability for a fund of this nature.

COVID-19 Pandemic

7.7 The volatility in the financial markets has been more evident in global stock markets than in the foreign exchange market and therefore, the impact on the Funds' assets has been limited to a lower return as interest rates have fallen. The IAB has continued to monitor events and has reported its views to the Director on a regular basis. A full assessment is contained within the sections of this document covering the economic summary and credit markets. The IAB has also prepared a paper on the suitability of the pound sterling as the Funds' base currency as a result of the economic disruption caused by the pandemic and this will be discussed with the members of the Audit Body on 25 September 2020.

Investment Advisory Body Self Evaluation

7.8 The IAB has prepared a paper evaluating its performance over the past three years and this is found in Attachment III.

8 **Objectives for the coming year**

The IAB intends to continue to focus on its responsibilities set out in section 1.2 during the coming year.

Beate Grosskurth | Alan Moore | Brian Turner

9 September 2020

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ATTACHMENT I

Internal Investment Guidelines

As reviewed on 9 June 2020

The IOPC Funds may only invest with banks and building societies and the following guidelines should apply:

1. In order to be eligible for investments, a bank or building society should satisfy the following:
    (a) Common Equity Tier 1 (CET1) capital ratio of at least 9.5% or higher;
    (b) A five-year credit default swap (CDS) spread of a maximum of 100 basis points. A breach of which would trigger a review to ascertain whether the credit markets were weaker in general, or whether the credit worthiness of the counterparty concerned was subject to a particular credit-negative event, that would warrant its temporary, or permanent exclusion from the lending list;
    (c) Minimum short-term credit rating from two of the three main credit rating agencies, Fitch, Moody's and Standard & Poor's as follows:
        - for maturities of up to 12 months (Group 1) of F1+, P1 and A1+; and
        - for maturities of up to six months (Group 2) of F1, P1 and A1.
2. A banking institution should be either a parent bank, a full branch of its parent bank or a wholly owned subsidiary meeting the above criteria.
3. The normal limits for investments in any financial institution laid down in Financial Regulations 10.4(c) and 10.4(d)[1] should apply to deposits with any given institution or banking group.
4. The house banks should be the Funds' main operational banks, i.e. with which current accounts are held for the day-to day banking needs and banks used for specific incidents (which meet the Funds' investment criteria) to hold currency other than pounds sterling should be categorised as temporary house banks in order to utilise the higher limit.
5. Subject to the normal limits referred to in paragraph 3 above, deposits with banks and building societies should not exceed 25% of the respective Fund's total deposits.
6. For liquidity purposes a minimum amount equivalent to the respective Fund's working capital should be maturing within three months.
7. Investments should not exceed one year.
8. An initial deposit plus a maximum of three rollovers are permitted providing the initial deposit period and rollover periods cumulatively do not exceed 12 months. The deposits should be repaid after the third rollover. Rollovers through brokers should be treated the same as rollovers with direct contacts.
9. In consultation with the joint Investment Advisory Body, the Director will maintain a list of approved institutions.

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[1] Financial Regulations 10.4 (c) and 10.4 (d) read:

10.4 (c) the maximum investment in any bank or building society of the [1992 Fund's] [Supplementary Fund's] assets shall not normally exceed 25% of these assets or £10 million, whichever is the higher;

10.4 (d) the maximum investment in any bank or building society by the 1992 Fund and the Supplementary Fund shall not together normally exceed £15 million or £20 million in respect to the Funds' house bank(s) or not normally exceed £25 million when the three Funds' combined assets exceed £300 million.

ATTACHMENT II

Hedging Guidelines

As reviewed and amended on 9 June 2020

1. For an incident in respect of which compensation will be paid in a currency other than pounds sterling the Director hedges:

   (a) up to 50% of the levies received for compensation due for an incident (excluding claims related expenses);

   (b) within a six-month period after the levies have been received.

2. If circumstances so warrant, the Director may determine a hedging level higher or lower than 50% and/or a period shorter or longer than six months within which the determined hedging level should be reached. The reasons for such decisions will be laid down in the minutes of the next session of the Investment Advisory Body (IAB).

3. The method of hedging, the percentage of hedging (hedging level) and the period within which that percentage should be reached, is determined by the Director following consultation with the joint IAB.

4. The determined hedging level is continually monitored by the Director and the IAB to ensure it continues to reflect any changes in the anticipated amount of compensation payable and other relevant circumstances. The hedging level should also be adjusted to take account of any payments made in respect of the relevant incident to ensure that the determined hedging level is maintained.

5. Foreign exchange transactions for hedging purposes should not exceed a term of two years. Foreign exchange transactions for hedging purposes exceeding a term of one year require the specific authorisation of the Director.

6. Counterparty banks for foreign exchange transactions should meet the credit criteria set out in the Investment Guidelines. If, for exchange control or operational reasons, a hedging strategy needs to be transacted in a country where these criteria cannot be met, the Director can approve an exception to this guideline.

7. The total foreign exchange exposure with any one financial institution should not exceed four times the available deposit limit approved for that counterparty without the approval of the Director.

8. If it is necessary for the Funds to implement their hedging strategy in case of an incident in a Member State whose currency is not freely convertible, the amounts held with any one financial institution may exceed the investment limits set out in the Funds' Financial Regulation 10.4(d) for considerable periods of time. The investments in excess of the normal limits shall be reported to the regular sessions of the governing bodies and explanation shall be given regarding the need to exceed the applicable investment limits for the purpose of applying the Funds' Hedging Guidelines.

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ATTACHMENT III

IOPC Funds

Investment Advisory Body (IAB) Self Evaluation

January 2017 - July 2020

Introduction

At their sessions in April 2018 the governing bodies noted that, in the Director's view, the Investment Advisory Body (IAB) had shown over the years to be an effective body and had discharged its mandate efficiently. Also, the Director had concurred with a conclusion of a self-evaluation process undertaken by the IAB, that it was more difficult to measure the performance of an advisory service than an operational service (document IOPC/APR18/6/1, Annex II).

The governing bodies further noted that the Director did not see any merit in introducing a performance measurement benchmark for the IAB, as any such measure would be difficult to evaluate due to the priority given to the security of the assets and liquidity requirements of the Funds' cash management process, followed by the return on investment.

The governing bodies also noted that the Director was in favour of the IAB providing a self-evaluation analysis every three years, as part of its report to the governing bodies, with the first such formal evaluation to be presented at the December 2020 meeting.

Executive Summary

Given that the role of the IAB is an advisory one, it is not a straightforward process to quantify the value of that advice. More generally, value would be measured by using a Net Promoter Score (NPS) metric for measuring value delivered to customers.

With an advisory service, however, an NPS approach would not accurately reflect value. Advice can be acted on or ignored. The advisory role that the IAB provides is a much broader and more supportive process, rather than a one-off product or service that can be valued either by metrics or percentage returns.

Since August 2016, the IAB has kept a record of the time spent responding to email requests, writing papers and discussing various issues, outside of the normal quarterly meetings and the requirements leading up to them. It was intended that this would better illustrate the IAB's overall workload, in addition to improving the audit trail of such and furthermore, the Secretariat could record its satisfaction or dissatisfaction with the quality, value and promptness of the IAB's responses. The latest such record was completed and shared with the Director and Secretariat in February 2020.

For the purposes of this document, and the requirement to more formerly assess the performance of the IAB, the three-year period from **January 2017 to January 2020** was chosen to be reviewed, with the data updated in July 2020, in readiness for the sessions of the governing bodies in December 2020.

The IAB considered that, in quantifying value in this instance, a more general approach to value measurement was required, as intrinsic value is not a quantitative measure. When determining the value that the IAB provides, the IAB deliberated that it might be useful to bear in mind three key component measures:

1. Does the IAB meet its commitments?
2. Does the advice offered by the IAB add value to the work of the IOPC Funds?
3. Does the supportive role of the IAB improve the performance of the Secretariat in the execution of its duties?

This performance review will be facilitated by referencing the data of time spent on IAB advice and support, over the most recent three-year period. The review will include a summary of the actions undertaken, and in some cases where it is has been tangible, record the evidence of a beneficial outcome.

<u>IAB highlights and achievements</u>

Over the review period, the IAB has attended four quarterly meetings a year, held meetings with the External Auditor and attended meetings with the Audit Body, as and when required. It has engaged with the External Auditor and the Audit Body to further explain the role of the IAB, addressed any issues at hand and offered guidance on current events and market developments. The IAB has prepared documents for those meetings and prepared both written and verbal reports.

It should also be noted that during the course of the three-year period under review, for the first time since 2011 there was a rotation of IAB members and a new member of the IAB was elected. In order to maintain IAB levels of service during the rotation, additional off-site meetings of the IAB were required over an eighteen-month period, in order to accommodate the new member, to provide background information on the duties of the IAB and to discuss ways in which the IAB can continue to provide a balanced advisory service, incorporating the experience of the new member. The requirements placed upon the IAB by the Funds were also discussed, including the IOPC Funds' investment and hedging policies. Active changes to IAB roles were also explored and instigated to ensure continuity of service and maintain the required levels of performance expected.

The core duties of the IAB have not fundamentally changed or been less that those stated in this document. However, additional geo-political events such as the withdrawal of the United Kingdom from the European Union (Brexit), and the global coronavirus pandemic (COVID-19), with all the uncertainty and market volatility surrounding these events, has added to the research burden and market surveillance work undertaken by the IAB.

To enhance communication between the members of the IAB, especially in light of increased financial market volatility, the IAB also communicates remotely amongst themselves on a regular basis.

For the purpose of this review, the IAB has highlighted a select number of interactions with the Funds, the affiliated bodies and the Secretariat, whereby it considers that is has added value to the work of the organisation. These are listed under the headings of the duties of the IAB which are reviewed and agreed each year**. It is stressed that the main task of the IAB is to assist the Secretariat in ensuring the safety of the Funds' assets**.

The duties of the IAB are as follows:

- **to advise the Director in general terms on investment matters**

The IAB has continued to support the Secretariat in achieving ‘best execution’ on the pricing of all transactional business with the counterparty banks. This was never more in evidence than when HSBC was asked to recalculate the GBP/KRW DCI quoted in Jan 2017, when an improvement in yield of around 50 basis points for a period of 12 months was achieved.

The knowledge and support of the IAB has been effective in the changing regulatory environment. The IAB’s assistance with the European Market Infrastructure Regulation (EMIR) and Markets in Financial Instruments Directive (MiFID) II regulatory requirements with the various counterparty banks was successful, as was its assistance and advice in the Legal Entity Identifier (LEI) regulatory process.

- **in particular, to advise the Director on the tenor of the Funds' investments and the suitability of institutions used for investment purposes**

  Further to the ongoing preservation of capital, the IAB has maintained a constant daily vigilance on the credit and risk markets throughout the period under review and responded to the Secretariat on the creditworthiness of many counterparty banks, including, but not exclusively, Caixa Bank, Kutxabank, Arbuthnot Latham, First Abu Dhabi Bank, The National Bank of Abu Dhabi, China Construction Bank, Lloyds Bank, the Canadian banking system in May 2017, the Italian banks with associated contagion problems in May 2018 and the Singaporean banks in February 2019.

- **to draw the Director's attention to any developments which may justify a revision of the Funds' investment policy as laid down by the governing bodies**

  To ensure the ongoing safety and protection of capital, the IAB has continued to monitor and report on market innovation and developments in terms of technology, product development, transactional pricing and settlement security. In this regard the IAB attended a morning session at the Chicago Mercantile Exchange (CME) in July 2018, to better understand the development and growth of the Foreign Exchange (FX) Futures market. The role of the London Clearing House (LCH) and the future clearing of FX trades has also been documented and discussed.

- **to advise the Director on the management of currency exposure relating to incidents**

  In March 17 recommendations to hedge working capital from pounds sterling into US dollars were proposed with accompanying ideas on currency hedging strategies. A final decision was made to hedge 50% of the working capital into US dollars (USD), which began in June 17 and proved to be a successful strategy. IAB recommendations to hedge against long euro (EUR) exposure have also proved to be successful.

- **to advise the Director on any other matters relevant to the Funds' investments**

  In July 2018, the IAB supported the Secretariat in the Barclays Bank International Payments overpayment issue. The IAB analysed the data at length, verified the compensation amounts, and took part in conference calls and remedial discussions. This resulted in improved FX pricing for international payments, migration to a more advanced currency pricing technology in BARX (Barclays’ cross-asset electronic trading platform), and improved controls on best execution.

In March 2018, the IAB used its in-depth knowledge of the FX benchmarking process to resist an argument from the Audit Body that there was a case to answer to, in a US-based class action regarding the FX rate fixing scandal and the Funds' FX trades. Inappropriately entering into a litigation against the counterparty banks had the potential to negatively impact the reputation of the IOPC Funds and damage the existing banking relationships on which the Funds rely. The IAB supported the Secretariat in discussions with the US class action legal team and with the Audit Body to achieve a satisfactory outcome.

In January 2017, the IAB presented a paper which examined the potential benefits and disadvantages of holding part, or all of the balances of the General Fund and Major Claims Funds in currencies other than pounds sterling.

- **to have at least four meetings each year with the Secretariat to review and discuss relevant investment matters and recommend any policy changes that it considers appropriate**

  In pursuit of the best investment yields for Provident Fund (PF) 1, in November 2019 the IAB used its current knowledge of the pension fund markets to investigate new investment products such as Buy & Maintain Funds and Liability Driven Investments (LDIs) and will continue to do so. Throughout the review period, the IAB has provided various alternative investment proposals for the PF1, PF2 and a PF3 variant with a very established financial advisor. In-depth knowledge of the pension fund and investment management industry has facilitated a better understanding of the issues in hand and provided alternatives and options.

- **to meet as a body at least four times each year to review the Funds' investment activities and ensure they comply with current policies. These meetings usually to precede the meetings with the Secretariat**

  The IAB has met immediately preceding each meeting with the Secretariat and on other occasions to discuss various matters as the need has arisen.

- **to meet with the Audit Body and with the External Auditor on at least an annual basis to explain and discuss its activities, or more when requested, and respond to any questions, concerns or matters raised**

  The IAB has fulfilled this requirement whenever it has been asked to do so.

  The IAB has worked with the Audit Body to harness a better understanding of the currency hedging process. To facilitate that, the IAB wrote a paper in April 2018 on currency hedging. In 2020, the IAB prepared a supplementary paper presenting a case study on hedging, with the associated cash flows to be shared with the Audit Body at the next meeting of the IAB with the Audit Body.

- **to attend the Funds' annual assemblies and present its report on its activities and findings for the year**

  The IAB has fulfilled this requirement each year and presented its report on its activities. The IAB has restyled its annual Report to the governing bodies to make it less formal, more current and easier to engage with.

- **to monitor market activities and conditions on an ongoing basis and be available to discuss such matters with the Secretariat at any time**

  The IAB monitors market activities, conditions and events on a daily basis, across all the asset markets, and reports as appropriate to the Secretariat.

  In February 2018, the IAB made a presentation on investment markets to staff members which was well received. Predictions regarding asset markets and crypto currencies were extremely accurate.

- **to respond to requests from the Secretariat for information and recommendations on a timely basis and on a broad base of topics**

  Over the review period of three years, individual IAB members have sent and received in excess of 1600 emails each, in pursuit of the advice and support to the Funds and the Secretariat. Extrapolating the archived data shared with the Director and Secretariat in February 2020, there has been contact between the Funds and the IAB on at least 13 days in every 21-day working month (averaged), throughout the three-year review period. Although not recorded in the data, daily contact has also been available and maintained by phone when required, even when individual IAB members might be travelling, meeting clients, or in pursuit of their other businesses.

The experience levels required of the IAB are set out in Appendix 1.

Investment Advisory Body

August 2020

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Appendix 1

Experience levels of the IAB

It was identified that the following in-depth experience was required of the IAB:

- cash management;
- foreign exchange management;
- risk management;
- counterparty bank risk analysis;
- credit policy;
- current financial market practices and market innovation;
- current and evolving financial market legislation and regulation;
- new financial market products;
- a knowledge of other asset classes; equities, commodities, credit markets, derivatives; and
- macro-economic indicators and their potential impact on IOPC Funds' business.

The new member of the IAB has added to that experience, in bringing multi-asset settlement and transactional processing knowledge, and contributed a more diverse and insightful European perspective to economic and geo-political reports and events.