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COUNCIL 116th session Agenda item 5(c)	C 116/5(c) 9 May 2016 Original: ENGLISH

RESOURCE MANAGEMENT

(c) Report on Investments

Note by the Secretary-General

SUMMARY

Executive summary:	This document reports on the investment of the Organization's monies during 2015
Strategic direction:	4
High-level action:	4.0.1
Output:	4.0.1.4
Action to be taken:	Paragraph 17
Related document:	C 114/4(c)

Introduction

1 Article IX of the IMO Financial Regulations requires the Secretary-General to report periodically to the Council on the investment of the Organization's monies not needed for immediate use. This document therefore provides the Council with an update on investment levels during 2015 and investment performance over the same year.

Change in investment policy

2 The Organization's Treasury Committee had for some time been considering ways of refining its assessment of counterparties to better reflect financial risk, taking into account factors other than simple credit ratings from the three main credit rating agencies. After considering advice from the Organization's independent treasury advisor, the Treasury Committee sought to incorporate three elements into the assessment of which counterparties the Organization is prepared to invest with, to what maximum value, and for what period of time. Following the recommendation of the Treasury Committee, during 2015 the Secretary-General approved the revised Investment Policy for the Organization attached in annex 1, which takes a similar tiered approach to that used in the past, but taking into account the above-mentioned three elements, namely:

- **Short-term agency credit ratings** – which better reflect the degree of financial risk for short-term deposits than the long-term credit ratings considered in the past;

- **Credit Default Swaps (CDS)** – which provide a real-time market view of the risk associated with each counterparty, essentially representing the cost of purchasing insurance against a default by that financial institution; the lower the CDS value is, the cheaper the insurance and consequently the lower the perceived risk; and

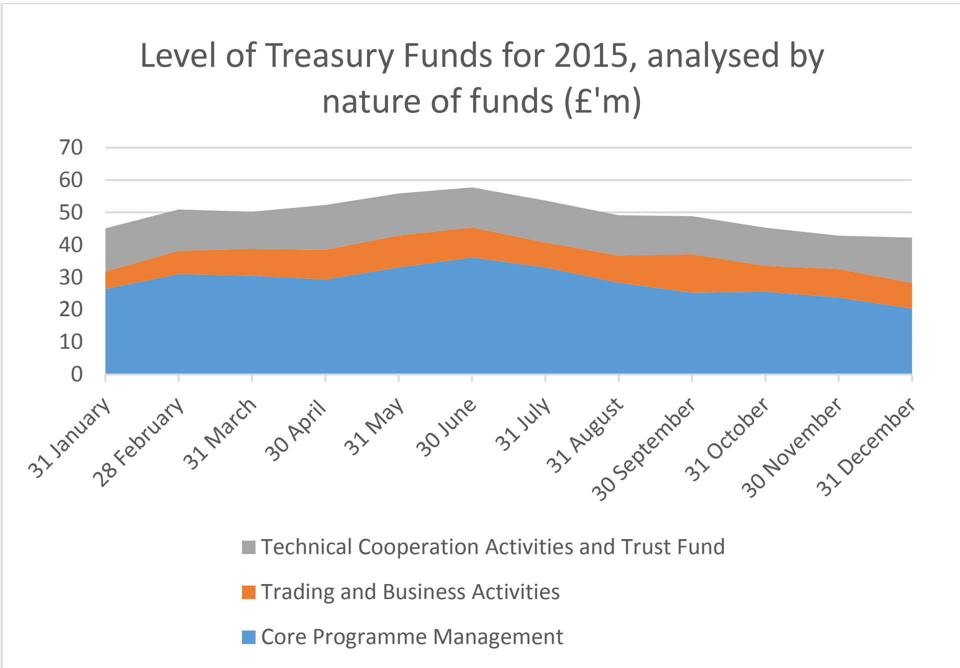
- **Tier 1 capital ratio** – which provides a quarterly view of the level of capitalization held by each institution and the proportion of shareholder funds which would be at risk before any loss to those making deposits, with a higher ratio reflecting a greater financial "cushion" before the Organization's funds would be at risk.

3 This combination of factors presents a broader and more responsive view of financial risk, addressing the concerns of relying solely on agency ratings, which can lag behind actual events and were shown, during the recent financial crisis, to be less than perfect. The continued use of tiering in maximum amounts and duration of deposits allows for a balance to be struck between maximizing return while minimizing risk to the Organization's capital through effective diversification.

Level of investments in 2015

4 Figure 1 shows the monthly investment levels over the last year, which also breaks down the overall treasury balance to show the purpose of the funds held, whether for core programme management, trading activities or technical cooperation and related trust funds.

Figure 1: Level of Treasury Funds for 2015, analysed by nature of funds



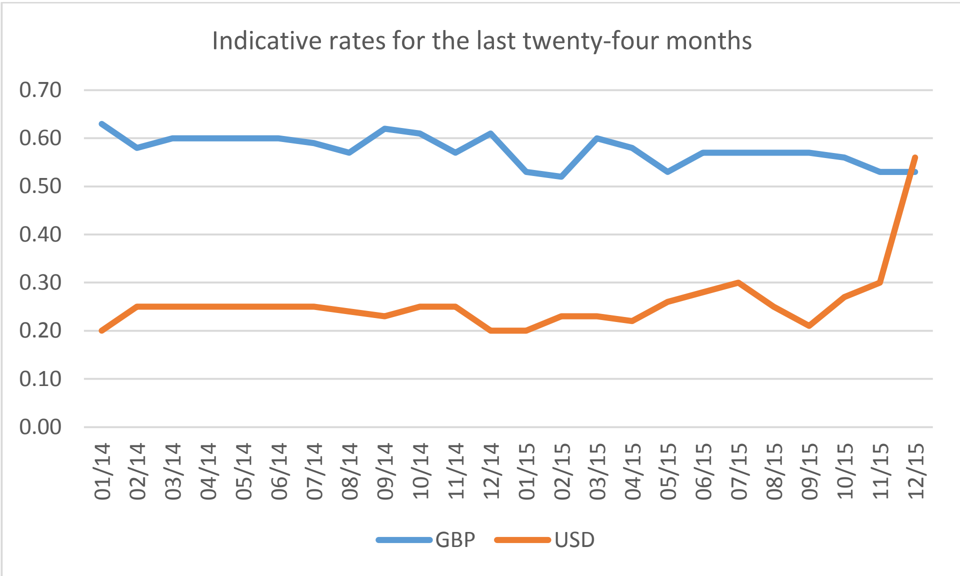
5 Cash balances are held only to the extent considered necessary to meet immediate cash flow needs, taking into account an appropriate level of headroom.

6 The level of funds invested in short-term deposits at the end of each month for the respective Funds is shown in annex 2 to this document, which also shows the interest earned during 2015. The total investments as at 31 December 2015 amounted to £42,193,721.

Investment performance

7 The total Treasury interest income earned for the year amounted to £258,580 (2014: £233,126). The highest three-month rate available from counterparties since the start of 2014 is shown in figure 2.

Figure 2: Indicative rates for the last twenty-four months



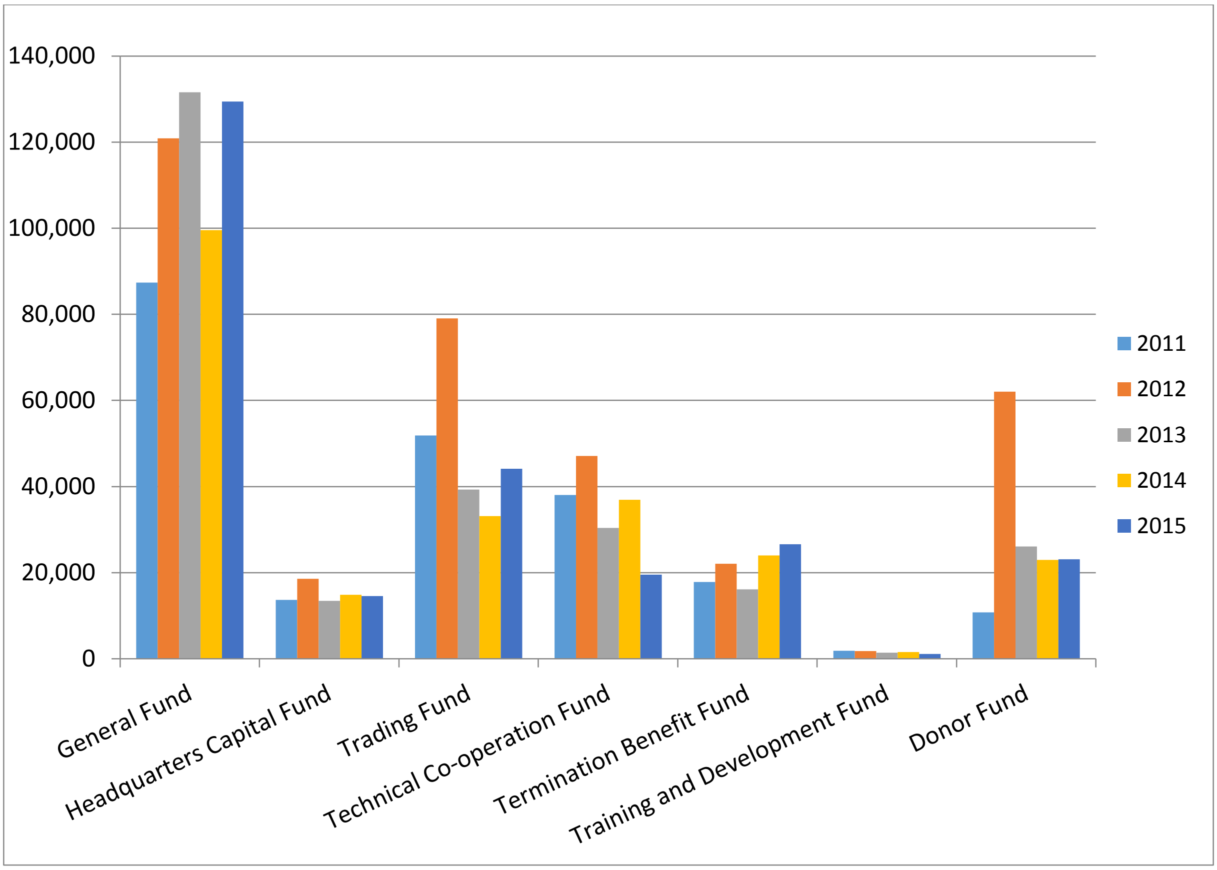
8 The Organization's independent treasury adviser had informed the Treasury Committee that the overall United Kingdom (UK) economic growth slowed down in 2015, whilst the revision of quarter 4 growth forecast, from the previous 0.4% to 0.5%, indicates steady expansion of the UK economy. With inflation continuing to remain low, the Bank of England base interest rate is expected to remain unchanged at least until the end of spring 2017.

9 The target rates on investments contained in the Divisional Business Plan for 2014-2015 range from 0.4% or above for excellent performance to 0.2% or below for poor. The annualized rate of return achieved on investments in 2015 was 0.45% which meets the target for excellent performance.

10 Figure 3 below sets out the interest earned by the General[1], Headquarters Capital, Trading, Technical Cooperation, Termination Benefit, Training and Development and Donor Funds for the last five years.

[1] The General Fund balance includes interest received on investments held on behalf of the Working Capital Fund and interest due to Member States through the Contributions Incentive Scheme

Figure 3: Interest earnings by fund



11 The Contributions Incentive Scheme (CIS), which commenced in 1988, provides for interest earnings on contributions to be returned to Member States in proportion to the timing of payment of their contributions each year. The interest earned on contributions receipts during 2015, of £44,467, will be available for distribution in the year 2017 in accordance with resolution A.1066(28) and will be dependent on the availability of a cash surplus in the General Fund as at 31 December 2016.

Investment of funds set aside to meet post-employment liabilities

12 The Organization's liability for post-employment benefits was valued, as at 31 December 2015, at £32,585,742, the majority of which relates to the After Service Health Insurance (ASHI) scheme. While such benefits are presently funded on a "pay as you go" basis, the effect of interest costs means that the liability has been steadily increasing over time.

13 In response to this the Assembly, by means of resolution A.1100(29), approved the transfer of £6,000,000 from the General Fund to the Termination Benefit Fund to "build up a solid funding base which matches the movement of the Organization's post-employment liabilities".

14 In order to achieve the above-mentioned objective, however, changes will be necessary to the Organization's Investment Policy. The current Investment Policy is appropriate for the short-term investment of a cash surplus until such time as that cash is required and, as such, it emphasizes the retention of capital as the primary objective to be achieved when investing funds. This effectively limits the types of investment which can be made to short-term timed deposits with fixed interest rates, as other investment placements,

such as bonds, equities or investment funds, inherently fluctuate in value over time, while the only risk to a fixed-term investment is the collapse of the financial institution with which the investment is placed.

15 For the funds set aside under resolution A.1100(29), however, the objective is not to avoid a short-term loss of capital but rather to achieve a long-term growth of that capital to offset to the extent possible – given that the funding is only a fraction of the size of the liability – the increase in the size of the liability over time. This is a new area for the Organization and consultations are ongoing with the independent financial advisor, along with the Organization's primary banking partner, to develop an investment policy for these and any future funds set aside for the long term, which achieves a balance of risk mitigation with the delivery of long-term growth. The Council should note, however, that:

- the need to carefully manage risk will remain a key part of the investment approach for these funds, but that the priority will be long-term growth rather than avoiding short-term loss;

- in order to achieve long-term capital growth it will be necessary to invest these funds in financial instruments other than fixed-term deposits;

- because such instruments necessarily change in value over time, and with an increase in the exposure to fluctuation in financial markets being beyond the control of the Organization, there may be periods over which the Organization makes a loss on the value of its investments; and

- the Organization, through its Treasury Committee, will ensure that appropriate governance, policies, guidelines and monitoring arrangements are established to minimize that risk as far as is practicable.

16 The Council may also wish to note that since any investments in bonds, equities or funds would be liquid investments which could be realized at any time, such investments would continue to be consistent with Financial Regulation 9.1 which requires that investments should be for a period of less than one year.

Action requested of the Council

17 The Council is invited to take note of the information contained in this document.

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ANNEX 1

IMO INVESTMENT POLICY

Introduction

The investment of the Organization's funds is the subject of Article IX of the Organization's Financial Regulations, attached at annex 1. This document represents the Organization's investment policy, as required by Regulation 9.1.

The investment policy is established by the Secretary-General and may only be amended by the Secretary-General. It is the responsibility of the Organization's Treasury Committee to implement the investment policy

Investment objectives

The Organization has a low tolerance of risk in the area of treasury management, and consequently the principal purpose when investing surplus funds is the retention of capital, to be achieved through restrictions on appropriate investment instruments, selection of investment counterparties, and diversification of investments.

Within these constraints, the Organization's secondary objective is to maximize the level of investment return on placements made.

Appropriate investment instruments

The Organization will normally invest only in fixed-term deposits for a period of twelve months or less. Investments for a period in excess of twelve months may only be made after consultation with the Council, as required by Financial Regulation 9.2.

The Treasury Committee may consider the use of other investment instruments if it believes them to be consistent with the investment objectives. Any such investments will require the prior written approval of the Secretary-General.

Selection of investment counterparties

The Organization will maintain a list of major financial institutions, normally banks or building societies, as approved counterparties. In order to be considered as a counterparty, a financial institution must have a maximum Credit Default Swap (CDS) level of 100, a Tier 1 Capitalization in excess of 9.5%, and have a minimum short-term credit rating of F1 or equivalent from at least two of the three major credit ratings agencies (Standard & Poor's, Fitch and Moody's).The maximum amounts and terms of investments are set out under "Diversification of Investments" below. Investments may only be placed with counterparties on the approved list.

The Treasury Committee may add new institutions to the approved list at its discretion provided that they meet the minimum criteria specified.

Any institutions on the approved list will immediately be removed from that list should the above no longer satisfy the specified criteria. The Treasury Committee may also, at its discretion, remove institutions from the approved list.

Diversification of investments

To diversify the risk to its investment portfolio, the Organization will limit its exposure in amount and term limit with any one counterparty or counterparty group as below:

Counterparty category	CDS maximum	Tier 1 capital % minimum,	Short-term rating minimum [2]	Placement for maximum amount, £m	Placement for maximum duration, months
A	75	13.0	F1+	15	12
B	90	11.5	F1+	15	6
C	100	9.5	F1+	10	3
D	100	9.5	F1	5	3

Balance available for investment

The Organization will utilize a cash forecasting mechanism to allow the identification of immediate operational cash requirements arising in the coming months, and will use this as the basis to determine the appropriate amount of liquid cash to be retained for that period. The Treasury Committee will consider this cash flow analysis when reviewing the proposed placements for the period.

[2] With a minimum of two of the three major ratings agencies.

Annex 1 – Relevant Financial Regulations

Article IX

INVESTMENT OF FUNDS

REGULATION 9.1 The Secretary-General shall establish an investment policy on the investment of surplus cash and, within the terms of that policy, may make investments for less than one year of cash not needed for immediate requirements and shall inform the Council periodically of such investments.

REGULATION 9.2 The Secretary-General may, within the terms of the investment policy and after consultation with the Council, make investments for longer than one year of cash not needed for that period based on projected cash flow estimates.

REGULATION 9.3 Income derived from investments shall be credited as provided in the rules relating to each fund.

Annex 2 – IMO Treasury Committee (ITC) – Terms of reference

Purpose of the ITC

The ITC will:

- review investment performance over the preceding month;
- endorse ad hoc investments placed in that time;
- consider the current cash position, cash flow projections and consequently the balance available to invest; and
- review investments for the upcoming period based on a report presented by the responsible Treasury Officer, which will for each investment show:
  - the amount of the investment
  - the proposed counterparty;
  - that counterparty's category, taking into account the criteria established in the Investment Policy; and
  - any other information required pertaining to the risk profile of that investment.

The ITC may:

- approve the investments as proposed;
- request additional information on one or more placements; or
- reject one or more proposed investments and request alternative options.

In the latter two cases, the ITC shall reconvene after the necessary information or options have been prepared by the responsible Treasury Officer. The ITC may also make such recommendations as it considers necessary to the responsible Treasury Officer regarding future submissions.

The ITC may also from time to time, review the Organization's Treasury Policy and, if necessary, propose changes to the Secretary-General for consideration.

Members

The ITC will be formed of:

- the Director, Administrative Division
- the Head, Financial Services
- the Head, Management Accounting and ERP Services;
- the Chief, Office of General Services;
- the Finance Officer (Accounts); and
- an external expert adviser with terms of reference as attached.

Operation of the ITC

The ITC will meet monthly, requiring a quorum of three members. The Director of Administration may appoint an alternate to attend any meeting where a quorum may not otherwise be achieved. Reports to the ITC shall be submitted by the responsible Treasury Officer at least 24 hours in advance of the meeting. Decisions of the ITC will be minuted by the responsible Treasury Officer and signed by the attendees.

The ITC may review its own Terms of reference from time to time, amendments being agreed by consensus and notified to the Secretary-General in writing.

Annex 3 – Terms of reference for External Expert Adviser for IMO Treasury Committee (ITC)

1. Attendance at monthly ITC meetings via conference call but to attend in person at least quarterly and additionally when requested.

2. To provide the following verbal and/or written reports:

   - Overview of financial markets and interest rate environment;
   - Review of the category of IMO's approved counterparties taking into account the criteria established in the Investment Policy;
   - Make recommendations for additions or deletions of counterparties;
   - Changes or amendments to the regulatory regime;
   - Recommend periods for investment of funds based on prevailing and expected interest rates, subject to cash flow requirements; and
   - Provide advice on the overall risk profile of the Organization's investments.

3. Monitor regularly the category of the approved counterparties and update the ITC as and when necessary.

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ANNEX 2

INVESTMENTS PLACED DURING 2015 BY FUND

	General fund	Headquarters Capital Fund	Trading Fund	Technical Cooperation Fund	Termination Benefit Fund	Training & Development Fund	Donor Fund	Total
2015	**£**	**£**	**£**	**£**	**£**	**£**	**£**	**£**
31 January	18,335,828	2,690,506	5,261,478	3,225,818	5,164,905	263,669	10,121,166	45,063,370
28 February	22,812,716	2,693,843	7,180,395	3,236,006	5,177,264	264,022	9,512,477	50,876,723
31 March	22,318,238	2,691,745	8,340,978	3,236,941	5,175,783	264,045	8,211,357	50,239,087
30 April	21,167,881	2,692,408	9,173,966	3,238,423	5,178,182	264,127	10,561,080	52,276,067
31 May	24,914,242	2,691,007	9,829,399	3,235,522	5,173,803	263,771	9,697,961	55,805,705
30 June	27,963,966	2,691,007	9,322,570	3,235,522	5,173,803	263,771	9,034,691	57,685,330
31 July	25,352,787	2,274,007	7,726,930	3,242,762	5,118,575	264,327	9,734,246	53,713,634
31 August	21,372,201	2,274,662	8,377,448	3,236,462	4,386,900	264,121	9,181,098	49,092,892
30 September	18,838,372	2,338,117	11,840,597	2,681,439	3,878,362	178,459	9,059,318	48,814,664
31 October	19,101,795	2,339,177	8,043,028	2,681,624	3,879,318	178,387	9,025,796	45,249,125
30 November	17,374,640	2,337,901	8,759,439	2,481,246	3,878,029	178,351	7,838,054	42,847,660
31 December	15,330,271	2,360,225	7,929,889	5,291,174	2,384,385	206,746	8,691,031	42,193,721
Interest Earnings 2015	129,439	14,604	44,177	19,537	26,599	1,137	23,087	258,580

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