INTERNATIONAL MARITIME ORGANIZATION

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COUNCIL 118th session Agenda item 4(c)	C 118/4(c) 3 May 2017 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 2016
Strategic direction:	4
High-level action:	4.0.1
Output:	4.0.1.4
Action to be taken:	Paragraph 17.
Related document:	C 116/5(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 2016 and investment performance over the same year.

Changes in Investment Policy

2 The Council will recall that to better reflect financial risk in assessing potential counterparties and determining appropriate maximum investment amounts and terms, three factors are considered:

- **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, 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 The Treasury Committee has monitored the situation on a monthly basis since the implementation of the revised Investment Policy during 2015, noting on a number of occasions that the requirement for a maximum CDS price of 100 has in some months significantly reduced the number of counterparties with which the Organization can place funds, and also that the CDS prices themselves can move significantly, not just for individual counterparties but for the market as a whole. This raises two issues:

- for market-wide movement, the Organization can be excessively restricted by relatively small movements in CDS levels; and

- for individual counterparties, a brief "spike" in CDS rates can make them unavailable for deposits when all other evidence points to them being relatively low risk, at least in the short-term.

4 With these two issues in mind, the Treasury Committee proposed, and the Secretary-General agreed, to amend the Investment Policy to:

- increase the "ceiling" for CDS rates from 100 to 120: it was the view of the Treasury Committee, including the independent financial advisor, that this does not expose the Organization to significant additional risk, while allowing for flexibility should the overall market for CDS of financial institutions rise; and

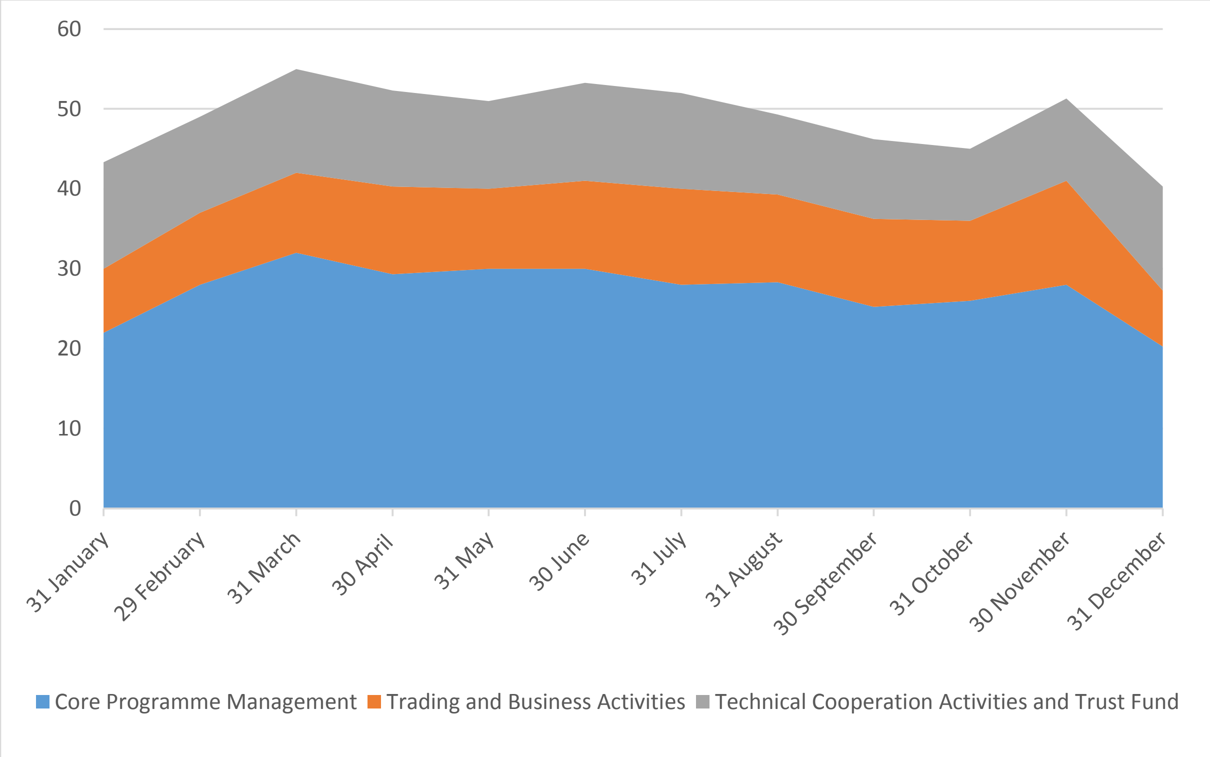
- at the same time, requiring that a counterparty must have had a CDS level below 100 at two of the three previous monthly Treasury Committee meetings.

5 In addition, the Investment Policy now provides for lending outside of the established ratings with the written approval of the Secretary-General. This makes explicit an authority which is already implicit in the relevant Financial Regulation, Article IX, and provides for exceptional situations where no alternative is available. The current Investment Policy is shown in annex 1.

Level of investments in 2016

6 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: Monthly level of treasury funds for 2016 by nature of Funds (£m)



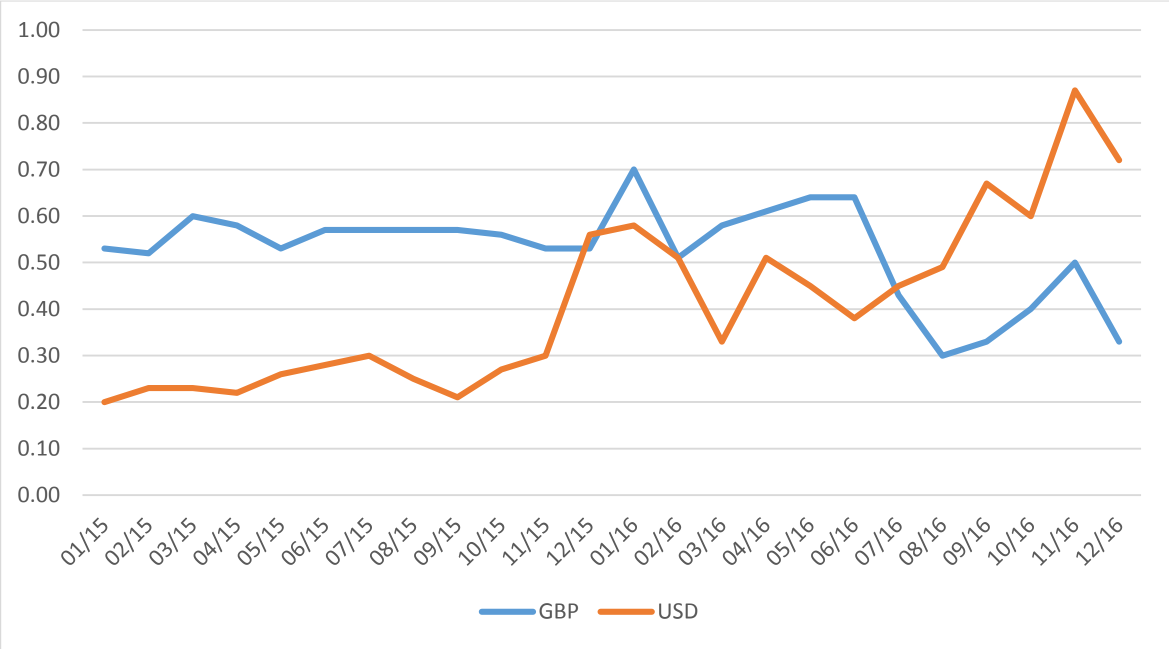
7 Cash balances are held only to the extent considered necessary to meet immediate cash flow needs, taking into account an appropriate level of headroom.

8 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 2016. The total investments as at 31 December 2016 amounted to £40,534,966.

Investment performance

9 The total Treasury interest income earned for the year amounted to £264,157 (2015: £258,580). The highest three-month rate available from counterparties since the start of 2015 is shown in figure 2.

Figure 2: Indicative rates for the last 24 months



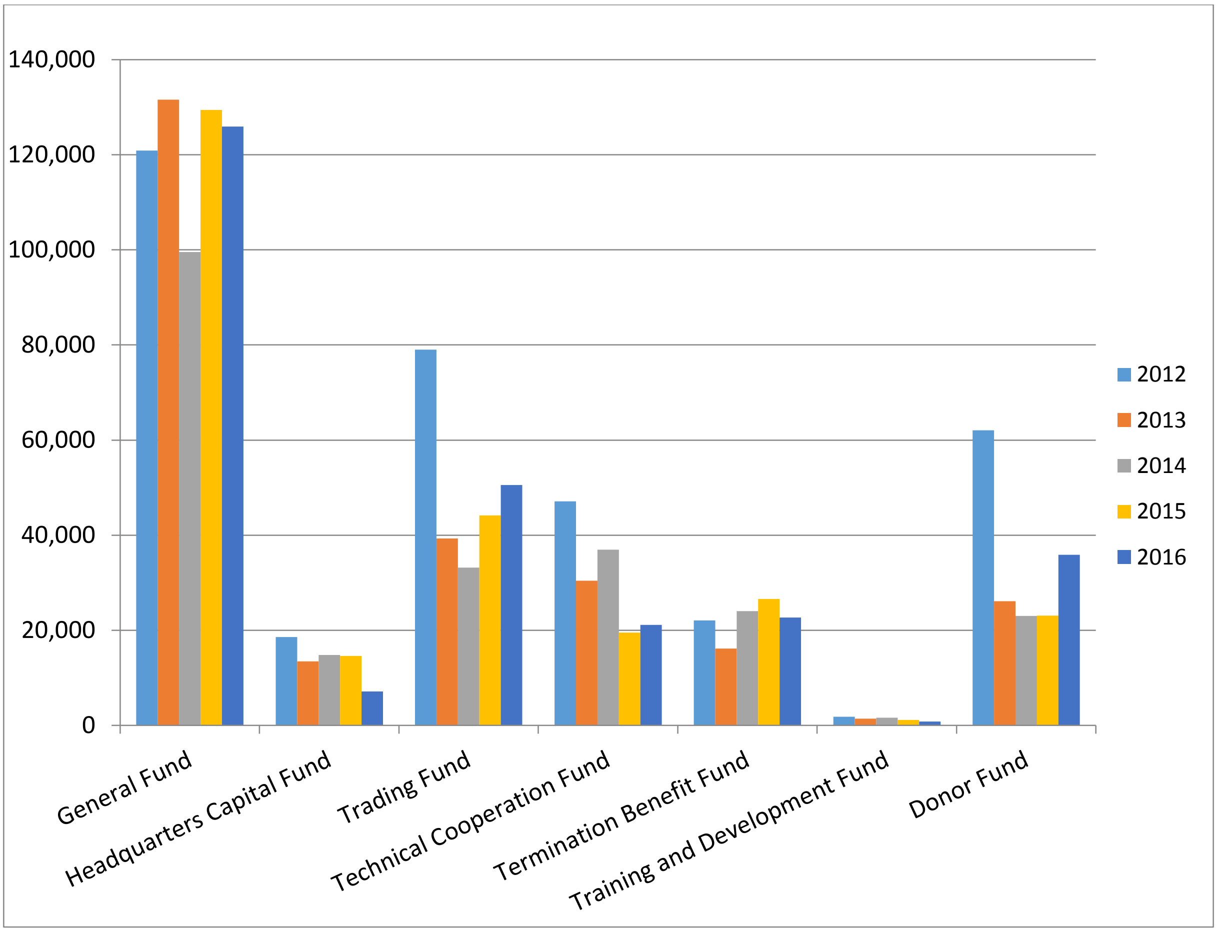
10 The annualized performance rate of return achieved on investments in the last quarter of 2016 was 0.36%, which is slightly below the Divisional Business Plan target of 0.40%. This is primarily the result of the fall in GBP rates available following the "Brexit" vote in June. There remains significant uncertainty and volatility in both foreign exchange rates and interest rates for GBP and USD as the markets absorb recent political changes. We continue to carefully monitor our GBP and USD holdings to minimize the risk to the extent possible.

11 The Organization's Treasury Adviser had informed the Treasury Committee that overall UK economic growth was 0.6% for the last quarter of 2016 and early indications suggested strong economic growth to continue in 2017. As inflation is to rise over the coming months, the Bank of England interest rate may have to be raised although some economists predict there is unlikely to be a rate increase in 2017.

12 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 for 2012 to 2016 by fund



13 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 2016 (£39,193) will be available for distribution in the year 2018 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 2017.

Investment of funds set aside to meet post-employment liabilities

14 The Organization's liability for post-employment benefits was valued, as at 31 December 2016, at £41,094,497, 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.

15 The Organization has gone out to tender for investment management services. The services required from the successful bidder can be broadly categorized as:

- development of investment strategy (work with the Organization to develop an investment strategy); and
- implementation of investment strategy (manage and invest the Organization's surplus funds in accordance with that strategy).

16 This broadening of approach to look beyond short-term deposits will allow the Organization to improve the return on investments both for long-term ASHI funds and more generally on surplus cash held, whilst carefully managing risk through asset diversification.

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. 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, and where circumstances dictate that investments must be placed outside of the policy, this requires the written approval of the Secretary-General.

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 120 at the time of placement and below 100 at the time of at least two of the three previous meetings of the Treasury Committee, a Tier 1 Capitalisation 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 not be used for new placements should they no longer satisfy the specified criteria. The Treasury Committee may also, at its discretion, permanently 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 [1]	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	120[2]	9.5	F1+	10	3
D	120[3]	9.5	F1	5	3

Balance available for investment

The Organization will utilise 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.

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

[2] CDS must have been below 100 at the time of at least two of the three previous meetings of the Treasury Committee.

[3] CDS must have been below 100 at the time of at least two of the three previous meetings of the Treasury Committee.

ANNEX 2

INVESTMENTS PLACED DURING 2016 BY FUND

2016	General Fund[1]	Headquarters Capital Fund	Trading Fund	Technical Cooperation Fund	Termination Benefit Fund	Training & Development Fund	Donor Fund	Total
	£	£	£	£	£	£	£	£
31 January	17,137,486	2,360,202	8,438,365	4,747,476	2,385,312	206,833	8,427,285	**43,702,959**
29 February	23,391,508	2,361,272	9,692,981	4,776,652	2,386,489	206,923	7,662,158	**50,477,983**
31 March	27,483,420	2,362,561	10,151,186	4,778,988	2,387,748	206,958	7,743,320	**55,114,181**
30 April	24,565,231	2,363,633	10,735,743	4,780,860	2,388,632	206,884	7,675,423	**52,716,406**
31 May	23,588,156	1,602,798	10,455,358	3,743,338	4,840,508	183,750	7,492,703	**51,906,611**
30 June	23,308,214	1,602,190	11,302,250	3,745,124	4,840,900	183,766	8,149,823	**53,132,267**
31 July	21,634,891	1,599,112	11,931,776	3,744,416	4,842,223	183,644	8,002,036	**51,938,098**
31 August	21,644,196	1,599,610	11,379,564	3,745,743	4,843,437	183,696	6,066,059	**49,462,305**
30 September	18,663,924	1,599,610	11,379,564	3,745,743	4,843,437	183,696	6,003,113	**46,419,087**
31 October	22,055,148	217,517	10,208,987	2,687,340	3,486,318	177,489	6,457,403	**45,290,202**
30 November	24,131,817	217,026	13,091,634	2,687,248	3,485,033	177,426	7,427,783	**51,217,967**
31 December	9,333,229	1,050,170	6,826,262	7,430,946	9,839,400	206,790	5,848,169	**40,534,966**
Interest Earnings 2016	**125,934**	**7,164**	**50,577**	**21,126**	**22,699**	**792**	**35,865**	**264,157**

[1] Includes Working Capital Fund.