

AFUS Information Meeting on Pensions

9 December 2008

Introduction

Starting in August 2008, many colleagues began questioning AFUS, by phone, e-mail and ordinary mail, regarding the possible impact of the current financial crisis on our pensions. As a result, the Executive Committee decided to call an information meeting at Headquarters on 9 December 2008. I am grateful to Alan Blythe for having accepted our invitation to explain the situation and answer questions.

No one could have been better qualified. He is Chief of the Geneva Office of the United Nations Joint Staff Pension Fund since 1 August 2008. Born in the United Kingdom, he studied accountancy and has 25

years practical experience in this field. From 1992 to 2002 he headed the financial services of the Pension Fund of CERN (European Organisation for Nuclear Research). He was then recruited by the United Nations to be Chief of the financial services of the Pension Fund. He has recently been promoted Chief of Operations.

I also invited Matebe Ghelaw, Secretary of the Local Pensions Committee, and Witold Zyss, former Chairman of AFUS and President *emeritus* of FAFICS (Federation of Associations of Former International Civil Servants).

Georges Kutukdjian

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Mr Alan Blythe:

I appreciate the opportunity to come to talk to you about the Pension Fund. The title of this talk is “**Crisis, What Crisis?**” – I don’t like the word but that is the way everybody refers to it and I thought it would do good to do some marketing by attracting people’s attention by strong words.

The Chairperson has, actually, already gone over the first four or five slides because when I was invited to come, they invited me to do some biographical details, so he’s already done a splendid job of introducing me

I’ll fly through the first slides: Biography; Pension Fund – Basics, I want to recall one or two basic features of the Pension Fund which you belong to, which is a defined benefits scheme as opposed to a defined contribution scheme. I hope I don’t insult anybody’s intelligence by going back to basics, but even in this week’s *Economist* they had to draw out a distinction between defined benefits schemes and defined contribution schemes. Defined contribution schemes in the US context are referred to as the 401K schemes and they are actually suffering the most in this crisis as I hope to demonstrate through the course of this talk. I will then go on to talk about Pension Fund – Crisis? What Crisis?, because I hope that by the end of my intervention you will be a little bit assured as far as your own scheme is concerned though there is clearly a major financial crisis out there at the moment. And then I will give you three or four slides about the current position of the UNJSPF, its market value, and try and illustrate through one or two pertinent slides why we are actually on the down-side of a situation which existed between 2003 and 2007 and there is all hope to say that the Fund will survive and maybe even come out a little stronger.

So, my name is Alan Blythe. I was born in the UK. I am married and I have two children. I once got into dreadful trouble with my wife for forgetting both those last two things, so I put them out first there: married and two children. I qualified as an *expert-comptable* after university. I didn’t read accounting at university – I’m a humanities man, I read English literature and French language and literature. So I have a little strangeness in my background, which I think helps. As pointed out, I’ve got 25 years of experience in accounting and finance, principally in fact in pension funds, so I hope I know a little bit about what I’m about to talk about. I started my international career at CERN, so as already has been said, it’s a bit like coming home again, because it was created here in UNESCO. I actually went to CERN as part of their internal audit service. I was an internal auditor and, eventually took over as head of the financial services of their Pension Fund from 1992 to 2002. Then I was recruited to UNJSPF in New York. I took over from Dulcie Bull as Chief of Operations and was then asked to come and take over as the Head of the Geneva Office – Europe, Middle East and Africa, as you all know. So, that’s me.

Pension Fund – Basics

We’re going right back to the very beginning of the Fund which provides you your pensions or will provide your pensions. In the scope and preamble of the Fund it very clearly states that the United Nations Joint Staff Pension Fund is a fund established by the General Assembly of the United Nations to provide retirement, death, disability and related benefits for the staff of the United Nations and the other organizations admitted to membership of the Fund. Now, this is a Fund established by the General Assembly. Why is that important? Because that means that it has been

decided by the General Assembly that the UNJSPF is a defined benefits scheme. Basically, in simple pension fund structure there is a defined benefits scheme, or final salary scheme, and a defined contribution scheme. A defined contribution scheme is where the employee will make a contribution to the scheme, possibly by making a contribution to an investment account, but the funds are invested and it is only the resulting investment of that fund that will then buy you a pension at the end. Again, a defined contribution is the 401K scheme in the US.

The market risk that that opens is entirely upon the participant. So in other words, in a very simple model, you participate for 20, 25 or 30 years, you put money aside from a withdrawal or reduction from your salary, the employer also puts in a certain percentage – probably less than the individual does – those funds are invested and the market returns on those funds and the capital that has been accumulated over the years is then used upon retirement to purchase an annuity. The market risk falls upon the individual. The employer has no further commitment, no obligation to pay anything further to you as an individual once you reach retirement. A defined benefit scheme is referred to as a final salary scheme, and here the employer does have an obligation to make good shortfall. So the market risk is in fact shared between or eventually falls on the employer, in other words the employing organization. And I refer – and I promise this is the only time that I will refer to the Regulations – Article 26 of the Fund’s Rules and Regulations specifies that in the event of a shortfall – an actuarial shortfall – in the UNJSPF, member organizations could be asked to make good and refinance the Fund. So the market risk is borne by the employer. That’s why it is important for the UN and the other member organizations that we keep ourselves up to speed with actuarial evaluations. But be absolutely clear, your pension is, to a certain extent, guaranteed by the General Assembly and the terms of the market risk is borne by the employer. If there is a shortfall in funding – which there isn’t, but if there were – then the market risk would fall on the employing organizations.

So, just a question and answer about maturity, because that is one of the big things I’ll be discussing. These are rhetorical questions; I’m not going to ask you to put your hand up.

How old is the Fund?

Well, it was set up in 1948-1949, so it is coming up for 60 years old...

How many participants?

We are up to around 108,000-110,000 – I’m sorry not to be more precise. We’re going through our year-end exercise, here, and we’ll know a precise figure as at 31 December, but it will be somewhere between 108,000 and 110,000.

How many beneficiaries?

56,000-58,000, maybe even 60,000, depending on how quickly people are going into pension. That’s a significant figure. I’d like to go back over the last two figures and say that we have approximately 110,000 participants and we have approximately 60,000 – slightly less – beneficiaries. That’s a good ratio. Most of you have probably read in the press that State-funded pension schemes are having a demographic problem because they have a decreasing number of participants-contributors funding a larger number of people who are drawing funds. We are not there yet, although we’re mature, we are not in the same state. The ratio keeps improving, surprisingly enough, because we keep getting more participants, largely because we keep opening missions, the UN keeps opening missions. That’s fortunate from a financial point of view, unfortunate in that it usually means that there is a significant problem somewhere in the world that the UN is trying to cope with. But in purely selfish financial terms, it means that the ratio of participants to beneficiaries is quite favourable for us. And that has a significant impact, as you will see later on, in terms of contributions over payments. So in other words, in pure liquidity terms, we are far from in a crisis position. As was mentioned previously, my previous role within the UNJSPF, before being Chief of Operations, was head of financial services in New York and there I supervised on a day-to-day basis the cashier and so saw, on a monthly basis, exactly what was coming in and what was going out. I would just like to share some details with you because monthly contributions used to be paid from the organizations on the second business day of every month and we would take in somewhere in the region of between US \$105 million and \$110 million on a monthly basis – US equivalent. The figures varied because some organizations contributed in euros, some in GBP, so the total amount varied according to the number of heads they were remitting for as well. And then in terms of payments, the payroll is paid at the end of the month – that’s the principal outgoing, and there we’d be talking about something in the region of \$110 to \$115 million. So in terms of actual net outflow on a monthly basis, we’re talking about US \$10 million. Now that’s a lot of money to you and I – But, when you compare that \$10 million to the fortune of the Fund – even today’s fortune of the Fund, which is still in the region of \$30 billion, you can see that we have absolutely no problem as far as liquidity or solvency is concerned. That’s the point that I’d really like to make about contributions over payments. As a going concern on a monthly basis, we have absolutely no problem with regards to liquidity. So your pensions, if your question is, is my pension safe? My reply is yes, because we have a shortfall of \$10 million. And where does that \$10 million come from? Well, that \$30 billion that’s left is still invested. It’s invested in fixed-

income investments which generate an interest. The interest is accumulated, so there is an interest stream. It's also invested in equities and the equities also produce a dividend stream. So even without having to sell any of our investments, from the income stream which is derived from our investment portfolio, we can make good the monthly shortfall contributions compared to payments.

So moving on to the next stage. **Crisis? What Crisis?** I can't stand here in all honesty and say, well, UNJSPF is not affected. Yes, the UNJSPF is affected. Why? Because the value of our investments has gone down. The investments of the Fund are diversified, they're liquid, they're steady, they're stable, they're convertible, but, as with every other investment, they have been affected by the crisis. All markets are going down. It's very difficult to make money when all markets are heading south. I've said that I've had 25 years of experience. I have colleagues who have much longer experience. But that's not any good because they haven't seen anything like this at all either.

I apologise again. There is something designed as a foolproof system and I am the fool that's normally designated to see if it is actually foolproof!

I was saying that it is difficult to pretend that the UNJSPF is not affected by the crisis. The point I'm trying to make is that although we're affected on the investment side, my previous comments with regard to the flows of contributions and of payments should not cause you to be worried. If there is one thing that I want you to take away from this meeting, it's the sense that, yes, we're not very comfortable with the fact that the fortune of the Fund has declined by \$10 billion. What I'm trying to get across to you is that although that's a significant impact on the Fund as a whole, it's nothing for you to worry about because as a going concern the contributions still match the greater part of the payments and we have a long way to go before we actually eat through all the reserves of the Fund. So this slide: Is the UNJSPF affected by the crisis? Yes, of course, because we're a fully invested investment vehicle. We're an institution. We have incurred a number of devaluations across our portfolios. Is the UNSJPF put at risk by the crisis? No, not immediately and I don't think it is likely to be the case. So, I don't think you have anything to worry about immediately, or in all likelihood in the longer term. Your pensions are safe.

The Fund is subject to the effects of the crisis. Decreasing value of the investments is obviously the headline figure. You've possibly seen comments in certain parts of the press saying that we've lost \$10 billion; we've lost \$12 billion. What are we going to do to make up the funding? Well, I'd refer you to two documents or two interventions. Firstly, the intervention by Mr Warren Sach, who is the Representative of the Secretary-General for investments with the

ACABQ in New York. This was back in September already. And also the article published by the CEO of the Fund, Mr Bernard Cochéme, both in English and French. It's available on our website. I would encourage everybody to look at that article if they do have access to the web. I have copies available here should you need one. The theme of both of those interventions is exactly as has already been outlined, that the decrease in the value of the investments is not putting the Fund at risk.

How has the recent turmoil affected the Fund? Decrease in value of investments. Most recently the value of the Fund – total asset value, net asset value is now some \$30 billion. But at the highest point, which I will show you in a subsequent slide, which was back in October 2007, we were somewhere in the region of \$42 billion. Obviously the difference between 42 and 30 is 12. At the moment we're in the region of \$29 and \$30 billion. I can't give you a more precise figure because the volatility in the market is such that this portfolio from one day to the next can vary in the region of about \$1 billion a day. So if you want me to say how much the Fund is worth, I can give you somewhere between \$29 and \$30 billion, but I would hesitate to be more precise because of the volatility that we see across most of the markets and in exchanges rates as well.

I'd like to take one theme that was developed by Mr Sach, that the investments of the UNJSPF are based on a very long-term strategy. So objective criteria for that asset allocation are diversity and liquidity of investments. So we don't have all our eggs in one basket. We don't have all our eggs in one market. We don't have all our eggs in one currency, either. What that asset allocation is designed to do is to generate over time – and here we're talking about a very long timescale – designed to generate the rate of return required to keep the Fund in balance over a very long time period. Fortunately for the people here, life expectancy is going up all the time. That means that we are looking at the time span of the Fund for something like, I would say, between 60 and 75 years from today. So we are looking over a very long time period. We are more or less inured to monthly evaluations or even annual evaluations. We're obviously not comfortable with the fact that we lose money because that gives us less scope for going forward and making investments that will generate return, but we are looking over a very long time period.

And this slide I hope will give you some comfort. Over the last 48 years – the Fund has generated a 4.4% real rate of return on an annual basis. That means after reduction of inflation, we're making a 4.4% rate of return. And that's in excess of the target rate which the Fund is expected to make. So we're ahead of the game in simple terms on that basis.

To follow on from that. Does the current market turmoil place the Fund at risk? I hope that I have already identified that on the question of liquidity, is there an immediate short term problem? No. The contributions are sufficient against payments. We're in a healthy position. For as long as the Fund is a going concern, as long as the Fund is receiving its contributions on a monthly basis from the organizations – which it is –, as long as we continue to have that income flowing across our books, we should be able to meet the payments for a long, long time.

As I said, net inflow \$105-\$110 million. Outflow \$110-\$115 million. Net outflow of \$10 million. So as long as the Fund is a going concern, we should be fine. In fact, I think we are in a good position. We should continue to be in good shape. I know that Mr Cochéme is intending to make a further communication in January, once the year-end figures are end, but at the moment we don't see any reason to change that overall position.

We have a substantial investment income stream. That means that we have the dividends and the interest on fixed income. Over the last few biennia, the investment management service has been adding to that income stream by realizing profits on the sale of investment positions. So we have a substantial income stream above and beyond that simply generated from the receipt of contributions.

So how can the Fund avoid future financial difficulties? What we try to do to minimize the risk is that we monitor investment performance and we are very keen on the relationship between commitments and the assets. So the commitments are the future obligations we have to people like you to pay pensions, to make good on the pension promise. And we try and monitor that on the longer-term basis, again, by completing an actuarial review. And this is where it steps out of my range of expertise and we hand over to people who are called actuaries who do all sorts of sophisticated calculations, projecting forward on all sorts of factors and criteria. The result depends on the assumptions you read into your calculation. But the actuarial review is carried out every two years. We have to do one every three years – we do it every two years in fact just to try and keep on-board. And here we examine very closely the relationship between commitments and assets. The one thing that you should know in this is that the assets, the current actuarial asset value are a moving average; we don't take the latest asset value, market value of the assets. We take a moving average. For the last five actuarial reviews, the result has been a surplus. Now, what does the actuarial surplus mean? It means that the rate of contributions that we are asking people to make is actually greater than is required to keep the Fund in balance. So again, on a going concern basis, the rate of contributions I am making and that the UN

is making on my behalf is greater than is actually required to make good the pension promise, all other things being equal, if the expected rates of return, expected demographic developments play out as planned, or as envisaged.

In terms of funding, we're actually in a stronger position than that. This again is simply a comparison of the rate of contribution that is being made to that that would be required to keep the Fund in balance.

So is the Fund's financial position safe? I think it is, but what do I know? I was saying before I broke the microphone that I have never seen conditions like this and I wasn't referring to the microphone. People who have a lot more experience than me have never seen conditions like this. So we are all learning a bit as we go along. So all sectors have been affected at the same time. A very simple model: what did you used to do in investments? Well, if equities are going down, let's go for fixed income; if fixed income is going down, let's go for equities. If both fixed income and equities are going down, what do you do? You go for cash. If cash is being invested with some of these banks, if you happen to have money with an Icelandic bank, or with Lehman Brothers or with AIG, that wasn't a good idea either. Theoretically there is a bottom out there somewhere. The question is identifying where that somewhere is and being ready to take advantage of it when eventually it comes. It's a question of timing. Portfolio management means that if you want to take advantage of the upside when it comes, you have to be invested because if you're not invested on the ten best days that the performance comes, you miss out altogether; you'll never recover that performance again. The markets will go up and when you look back it seems like it's a smooth progression. Yes, it made 4% over the year; in fact it goes up in discreet lumps. It jumps and then it plateaus, and then it jumps again. So you have to take on that exposure; you have to be prepared to tolerate the risk reward profile that you want and our risk reward profile is the asset allocation that we think will generate the returns required over the long term. Just to put more words on the back of that – our investment criteria of the Fund are profitability, safety, liquidity, convertibility. Well, we've got three of the four at the moment: safety, liquidity and convertibility. Profitability will come back. As we diversify we try and meet those criteria. We diversify over asset category, region, currency and sector. So again, we don't try and focus in one area. We don't try and focus too much on a particular industry. We try and keep a broad spectrum so that we increase the possibilities of getting the upside. That's again, the investment criteria – that's the financial position. That is your guarantee of safety, if you like. If you respect those criteria and you respect that diversification, all experience suggests that you will generate the returns that are required. And we have no reason to suppose that continued prudent investment and well-diversified

assets, with a very long-time horizon – again, 60-75 years – will not yield similar results over the next decades.

What's actually the current position? I apologize, I was trying to get the absolute latest position for you, but I've used the end of November figures. So I would like to draw your attention to this graph. I hope you can see it. The bar that's in red is at 31 October 2007 and that's the highest point the Fund ever reached, the net assets of the Fund ever reached. That was at \$42 billion. That was in October 2007. Since then it doesn't take a genius to work out that we've fallen down slightly. The scale is slightly deceptive because on the left-hand side, it's annual figures. Each bar is basically a year – it goes from March 1998, 1999, 2000. From the red bar onwards, which is already October 2007 as opposed to March 2008, I then take quarterly figures and then at the end it's daily figures. You can see the lowest point was reached around about the 20 November, which is the seventh from the end, the low bar where we are at something like \$28 billion; that sounds about right, \$27.5-\$28 billion. And then at the 28 November, which was the month-end, we were back up to just under \$30 billion. That's a breakdown of the daily portfolio evaluation analysis. Again, just to be purely precise, that's \$29.895875 billion, so that's quite a lot.

You can see the asset breakdown. You can see the percentages. In equity, we're at 51.8%; fixed-term, we're at 37%; liquidities, we're at 5.3% and real estate, we're at 5.3%. The real estate is a little deceptive in that the real estate market is a very sticky market. We have discreet evaluations done at particular points in time, so the real estate portfolio hasn't actually been revalued. So there's probably some negativity that's undisclosed. Equity and fixed-income are valued on a daily basis or on a monthly basis. The latest figures are up to date as at 28 November. Already you can see that in comparison to the lowest figure of \$27.5 billion, we've come back in dollar terms to \$29.89 billion or \$30 billion.

The interesting feature, for those of you who do research on these sorts of things, the equity proportion is at 51. The target asset allocation for equity investments is between 40 and 60%. The portfolio should be in equities. That means that we're at the half-way mark, but actually it means that we're under-exposed. The Investment Committee met a couple of weeks ago and opinions were divided but one opinion was that we had to increase the equity exposure again back towards the 60%.

This is a graph which gives you just how bleak it is out there - an impression, a pictorial representation, as all graphs are, of what's happening. Most other times, if I came and made this sort of presentation, at least one of those lines would have been going up. It's all "heading south" at the same time. That can't continue. Somewhere out there, there has to be a bottom, there has to be people who will buy these assets no matter how distressed they become.

This is the key. This is the benefit payments compared to contribution income. You can see for 2006, 2007, 2008 – 2008 is obviously a projection. We're nearly at the year-end, but, technically, there is still an adjustment to make. You can see the same pattern holds. Contributions are only marginally less than the payments that we have to make. And we confidently expect that pattern to continue.

Conclusion: don't panic! You will continue to receive your pensions. There is no intention to stop or reduce the pension at the moment. Yes, the Fund has reduced in value, but we are a very, very long-term investor and we will be invested when the reverse kicks in, which, hopefully, it will at some stage.

I would like to go back to this slide, because I think what I would like to draw your attention to is that, from the low point at the sixth column in from the left – 31 March 2003 – you can see that we were just over about \$20 billion at that stage. From there to the top of the red column – 31 October 2007 – it's an absolutely incredible increase in asset values. People were throwing money at anything that moved, at lots of things that didn't move, and when they ran out of money they found some more money to throw at it, because there was no way you could lose. That was the way things were going. Nobody complained about that rate of increase there – and that's where the real problem was. Because it was too quick. You can see on the other side, after that red thing there, it's tailing off and it's coming back down. But it hasn't gone back down to the \$20 billion mark. You're still looking at a 50% increase in comparison to the low point in 2003. Have we reached the bottom? – I don't know. But together with the contributions and payments picture, where there's a minimal difference between inflows and outflows, we still have some scope,

So, thank you for your attention. I hope you are reassured by the long-term outlook. You will be getting your pension at the end of the year. You will be getting your pension in January.

Thank you for your attention.

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Summary of Discussion

Alan Blythe provided a clear and reassuring description of the principles underlying the management of our Fund; he stated that it could face up to the present world financial crisis.

The discussion was opened by AFUS Chairman Georges Kutukdjian. Several practical questions were raised. Concerning inflation, Alan Blythe explained that the income from long-term investments of the Fund amount to 4.4%, taking into account inflation as recorded by the IPC Index of the United States (the assets of the Fund are expressed in US dollars). Concerning the investment policy of the Fund, the speaker stated that the currency question was under constant scrutiny by the Investment Committee, mainly to accommodate the functioning of the "double track" system which amount to about 30% of paid pensions. Account is also taken of the fact that contributions to the Fund are not all paid in dollars, but also in euros and pounds sterling, thus diversifying currency policy. In any event, it remains the responsibility of the Fund to ensure the best possible return on investments.

A participant mentioned Article 26 of the Statutes of the Fund which specifies that affiliated organizations are held responsible for compensating potential deficits. He wanted to know if there existed a reserve for this purpose. Witold Zyss recalled that in the 1980s the Fund had incurred a serious actuarial deficit and that the Member States had then agreed to increase contributions from 21 to 23.7% of pensionable remuneration. It could be assumed that, in similar circumstances, similar measures would be taken.

In answer to a question concerning the 0.5% present reduction of pension adjustments, Alan Blythe did not think that a change was envisaged at present. The proposal had been rejected by the Joint Pensions Committee at its meeting of July 2008 in Rome. However the question could be reconsidered by a Working Group created by the Joint Pensions Committee to examine all benefits, including prior measures currently under suspense. Witold Zyss recalled the history of this measure, taken in the 1980s. At the time, the actuarial balance of the Fund had to be re-established by a reduction of benefits. It was decided that the first cost-of-living adjustment of pensions would be reduced by 1.5%. Since 1997, however, the Fund has shown a positive actuarial balance for six consecutive evaluations. Representatives of participants and of retirees therefore asked for the abolition of this reduction. This has been only partially obtained by two consecutive reductions of 0.5%. This year the Fund found it impossible to further reduce this penalty by the last 0.5% given the actuarial evaluation of end 2007 which, although 0.49% positive, was insufficient to permit an improvement of benefits. Moreover the actuaries, at their last evaluation, had to take into account the recent mortality statistics. These showed a commendable trend

of longer life expectancy, especially for males. It is understood that the restoration of the 0.5% is not directly affected by the current crisis, but rather by actuarial results. Participants and retirees will continue to ask for restoration as a question of principle.

Another question concerned the possibility that an extended crisis might lead Member States to reduce staff in the UN and Specialized Agencies, resulting in less contributions to the Fund. Alan Blythe replied that it seemed that Member States were not inclined to reduce their solicitation of the UN and the Specialized Agencies for peace and humanitarian missions. Moreover, the Chairman of AFUS pointed out that the number of participants in the Fund had not diminished, but had actually increased each year.

As regards the decision taken three years ago to externalize the management of part of our assets, this had had no effect since it fortunately had not been materialized.

One member of the assistance mentioned the increase of short-term contracts (ALD, peace missions, etc.) which reduced the duration of participants' careers. Alan Blythe replied that the actuaries took account of this situation in their analyses. In fact, this situation is not a cause of concern for the Fund as it has a favourable effect. Participants who leave before having accomplished the minimum statutory five years of contribution are re-embursed their own contributions (one third) while the two thirds contributed on their behalf by Member States remain property of the Fund.

Finally, the recurrent question was asked: is it possible, after having opted for the double track, to change to the dollar track? It seemed that, at the present stage, a change of policy was unlikely. The choice of the double track is definitive except in rare exceptional cases. However, participants could continue to change the currency of their benefit if they changed their country of residence.

In conclusion, the meeting was told that it was too early to forecast the actuarial results of the Fund for 2009. However it is possible that the intensity and duration of the crisis could, in the long run, affect the actuarial situation, although the Fund basically remains sound and competently managed.

Josiane Taillefer

Closure

The discussion was animated, the questions pertinent and the answers precise.

I want to thank Josiane Taillefer for her summary of the discussion (herewith reproduced and translated) as well as all those who participated in this important meeting, especially Witold Zyss. Finally, the appreciation of AFUS goes to Alan Blythe for having come to provide the retirees of UNESCO with a concise and balanced account.

Georges Kutukdjian