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Summary record of the 20th meeting
Held at Headquarters, New York, on Friday, 10 November 2006, at 10 a.m.

Chairman: Mr. Yousfi . . . . (Algeria)
Chairman of the Advisory Committee on Administrative and Budgetary Questions: Mr. Saha

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The meeting was called to order at 10.05 a.m.

Agenda item 126: United Nations pension system (A/61/9 and A/61/545; A/C.5/61/2)

1. **Mr. Yossifov** (Chairman of the United Nations Joint Staff Pension Board), introducing the report of the United Nations Joint Staff Pension Board (A/61/9), said the length and scope of the report were in part due to the General Assembly's decision to consider the situation of the United Nations pension system on a biennial basis. The Fund currently had 21 member organizations, covering nearly 150,000 participants and beneficiaries. He drew the Committee's attention to chapter II of the report, which contained an overview of decisions taken by the Board; annex XXI to the report contained a draft resolution for consideration by the Committee.

2. The United Nations Joint Staff Pension Fund (UNJSPF) had recorded its fifth consecutive surplus, amounting to 1.29 per cent of pensionable remuneration, as at 31 December 2005. On that date the market value of the Fund's assets had been $31.9 billion, $4.1 billion greater than the actuarial value of the assets — the basis for the valuation of the Fund. He noted for the information of the Committee that as at 31 October 2006 the market value of the Fund had been over $35 billion. Based on those results, the Committee of Actuaries and the consulting actuary were of the opinion that the current contribution rate continued to be sufficient to meet the benefit requirements of the plan.

3. Given the positive results in five consecutive actuarial valuations and taking into account the opinion of the Committee of Actuaries that a portion of the surplus could be made available to improve benefits, the Board had recommended action to reverse some of the economy measures taken in the 1980s. Recalling that certain measures had already been agreed to by the Board and approved in principle by the General Assembly in 2002, the Board had reiterated its recommendation to eliminate the limitation on the right to restoration based on the length of prior contributory service. The actuarial cost of that measure had been estimated at 0.17 per cent of pensionable remuneration. The Board had also agreed to recommend that the reduction in the first consumer price index adjustment due after retirement should be further lowered from 1 per cent to 0.5 per cent. The actuarial cost of that measure had been estimated at 0.15 per cent of pensionable remuneration.

4. The Board had considered a report on the costs and savings relating to the recent modifications to the two-track feature of the pension adjustment system confirming the initial estimates. It had agreed that the costs of the two-track system should continue to be monitored in conjunction with actuarial valuations. It had also considered other matters that would have actuarial implications and required the approval of the General Assembly. The Board had recommended that the General Assembly should concur with the revised UNJSPF-World Bank Group Transfer Agreement and the proposed new transfer agreements between the Pension Fund and each of the six Coordinated Organizations, including the Organization for Economic Cooperation and Development (OECD). The Board had also recommended that the International Organization for Migration (IOM) should be admitted to membership of the Pension Fund. He noted that the Executive Secretary of the International Civil Service Commission (ICSC) had confirmed that IOM practices were in keeping with those of the United Nations common system.

5. The annualized nominal rate of return on the investment of the Fund's assets for the 46-year period ending 31 March 2006 had been 8.7 per cent, representing an annual long-term real rate of return of 4.3 per cent. That rate of return, which took into account adjustment for the United States consumer price index, continued to exceed the Fund's long-term objective of 3.5 per cent. With regard to the overall management of the Fund's investments, the Board had concluded that the staffing levels devoted to investments had not kept pace with the assets of the Fund and it had therefore recommended that a number of new posts should be added to the existing team of five investment officers.

6. At its meeting in Nairobi, the Board had decided to endorse the intention of the Secretary-General to adopt a passive rather than an active approach to management of the portfolio invested in North American equities. Passive management referred to setting up a portfolio to track, rather than outperform, a specific benchmark index. Under such an arrangement, the North American equities portfolio, representing approximately $9 billion, or more than 25 per cent of the total portfolio, would be managed passively using the current benchmark indices.

7. The Board's decision had not, however, met with the approval of the participants' representatives, who had reaffirmed that any shift in investment practices should be based on the results of the asset liability management study approved in 2005 and currently under way. The study should provide a more comprehensive understanding of the overall risk/return profile of the Fund's total portfolio; the results of that analysis, together with the recommendations of the Committee of Actuaries and the Investments Committee, would be submitted to the Board at its next session, in 2007. The participants' representatives had also stressed that a shift in management policy should include the submission of a proper business plan clearly identifying costs, legal and operational issues, and risk level, and required the full involvement of the Investments Committee, the Committee of Actuaries, the Chief Executive Officer and the Board.

8. Furthermore, the participants' representatives had been of the view that without an investment policy, an asset liability management study or an approved risk tolerance level for the Fund, the proposal for passive management of the North American equities portfolio seemed at best premature and at worst not in compliance with best practices and transparency. They believed no change in policy should be made before fuller consideration of the matter.

9. The participants' representatives had also requested the Chief Executive Officer and the Representative of the Secretary-General to review the memorandum of understanding of 1998 on strengthening the coordination process between the secretariat and investment sides of the Fund, in particular with regard to the establishment of a common information technologies platform. In endorsing the request for five new posts, the participants' representatives had also strongly recommended that the posts approved by the Standing Committee in 2005 should be filled first.

10. Turning to the operations of the Fund, he said that as at 31 December 2005 the number of participants in the Fund had increased by 9.9 per cent, to 93, 683; the number of benefits in payment had increased by 5 per cent, to 55,140; the biennial payroll for benefits in payment had increased by 14.9 per cent, to $2.7 billion.

11. The Board had reviewed the internal audit arrangement and noted the need to ensure that reporting lines reflected the governance process. Reports on the operational activities of the Fund would first be transmitted to the Chief Executive Officer, who would report to the Board, which would report to the General Assembly. Audit reports concerning the Fund's investments would be submitted to the Secretary-General, through his Representative for the Investments of the Fund, and to the Chief Executive Officer. Given concerns about the cost-effectiveness of maintaining the Office of Internal Oversight Services (OIOS) as the internal auditors of the Fund, it had been suggested that the Chief Executive Officer should explore the possibility of establishing a separate internal audit function within the Fund.

12. The Board had decided to recommend additional resources for administrative expenses for the biennium 2006-2007 in the amount of $2.4 million; the revised total would therefore be $110,665,500, with $57.6 million for administrative costs, $51.1 million for investment costs and $1.9 million for audit costs. The Board's recommendation for additional resources was based on the change to passive management of the North American equities portfolio, the addition of five new posts in the Investment Management Service, consultant services for recordkeeping, monitoring and custodian services, indexation fees and one-time transition costs.

13. The Board had also confirmed its recommendation for the reclassification of two P-4 posts to P-5 to reflect added responsibilities for managing all global applications and the overall computing infrastructure of the Fund. In that regard, progress had been made in consolidating certain information technology services and those efforts would continue. Consolidation was justified by the need to enhance security and efficiency and coordination of cash management.

14. The Board had also requested $50,000 for the Audit Committee to provide enhanced communications between the internal and external auditors and the Board, and had agreed that the Audit Committee should review the scope of the audit and evaluate the internal audit arrangements. The Board had also recommended approval of $85,900 for audits of information technology and management services not previously audited and $132,400 for the internal audit function.

15. The Board had considered the report of its Working Group established to review the size and

composition of the Board and its Standing Committee, and had decided to maintain the existing arrangements. It had, however, adopted several recommendations for improving its efficiency, and had agreed to revert to annual sessions beginning in 2007. The Board had also agreed that during odd-numbered years, when the Board considered the budget of the Fund, efforts would be made to limit its agenda.

16. The Chief Executive Officer had been requested to carry out several reviews relating to the benefit provisions of the Fund and to report thereon in 2007. At its next session the Board would consider the existing provisions governing special adjustments for small pensions, a comprehensive study on the benefit provisions relating to family and former family members of participants, a study on disability matters to be prepared in conjunction with the Medical Directors of the common system, and a further analysis of the impact of dollarization on the Fund's retirees living in Ecuador.

17. **Mr. Sach** (Controller), outlining the changes made during the biennium, said that on the recommendation of the Investments Committee a new strategic asset allocation and a consequent change in the Fund's performance benchmarks had been adopted to reflect better the Fund's long-term exposure to different asset classes. In April 2006 the Fund had changed its custodian and master record keeper arrangements to include only one global custodian. Following global competitive bidding the contract had been awarded to the Northern Trust Company. In May 2006 the Fund had terminated its contract with Lombard Odier Darier Hentsch & Cie, one of its European small-capitalization account managers, on the ground of persistent underperformance. The recruitment of a replacement was under way.

18. With regard to performance, the Fund's investments had continued to grow. The market value of the assets as at 31 March 2006 had been $33.118 million, an increase of 24.6 per cent in two years, and had reached an all-time high of $35.145 million as at 1 November 2006. The annualized performance for the two-year period ending 31 March 2006 had been 11.8 per cent, as against the 10.8 per cent performance of the new 60/31 benchmark and the 8.8 per cent of the old 60/40 benchmark. The real annualized return had been 8.3 per cent adjusted to the United States consumer price index. As for investment strategy, equities had been consistently above the neutral level of 60 per cent during the biennium, while bonds had remained underweighted and real estate strategy had changed from overweight to neutral. The Fund remained one of the most diversified pension funds in the world. As at 31 March 2006 it had had investments in 47 countries and 26 currencies and had made direct and indirect investments in developing countries totalling $1.8 billion, an increase of 8 per cent over two years.

19. Turning to important issues to be addressed, he said that while investments were generally handled well the Fund had a fiduciary responsibility to strive to improve their management: careful analysis of past performance revealed some room for improvement, and it was always important to plan ahead to cope with the ever-changing investment environment. A pension fund management could not extrapolate past performance into the future without maintaining and developing investment expertise and infrastructure in line with new market requirements; and it must assess accurately the level of investment risk necessary for the returns expected in the light of its liability obligations and try to eliminate risks which would not produce returns to the Fund.

20. The most immediate problem was that the Fund still managed $33 billion as if it were a few million dollars: one person was responsible for the management of over $15 billion. Another problem was the chronic underperformance of the North American equity portfolio, admittedly in a market which was difficult to outperform. It ought to be possible to improve the Fund's risk/return profile by breaking the total portfolio down into individual portfolios in each market and by analysing market characteristics. In fact, risk control within the Investment Management Service now needed to shift to a more coordinated and comprehensive risk-budgeting approach. The mandate of the Service was to generate the returns required to meet the liability demands while taking on the minimum necessary level of risk. That would require an appropriate allocation of risk budget to individual mandates/asset classes and coordinated monitoring of the portfolio to ensure that the total risk budget was not exceeded. The clear message was to take only those risks which would generate appropriate returns.

21. A number of recommendations were being made in order to enhance the capacity of the Investment Management Service to manage the portfolio and improve risk control: an increase in the staff of the

Service by five Professional posts, for the staffing level had not kept pace either with the increase in the Fund's assets or with the increased complexity of the markets; management of the North American portfolio to the benchmark, since such passive management would lower the overall risk level — the Secretary-General regretted that the Board had had to take a vote on the issue and would endeavour to ensure better coordination in future; and recruitment of a consultant to review the keeping of records on real estate investments and the monitoring of the new global custodian — in July 2005 the Office of Internal Oversight Services had recommended that the Investment Management Service should review the procedures followed by the master record keeper, with particular reference to real estate investments.

22. Having consulted the Pension Board and the Advisory Committee on Administrative and Budgetary Questions (ACABQ), the Secretary-General had appointed Mr. Cárdenas to replace Mr. Pillay on the Investments Committee for a three-year term from 1 January 2007. He had reappointed Mr. Pardo and Mr. Ngqula for three-year terms and intended to appoint Mr. Pictet and Ms. Beschloss as ad hoc members for 2007.

23. **Mr. Saha** (Chairman of the Advisory Committee on Administrative and Budgetary Questions), introducing the Advisory Committee's report on the United Nations pension system (A/61/545), said that the Advisory Committee noted the further improvements in the format of the Pension Board's report but felt that information on the same subject matter should be grouped together instead of scattered in various parts of the report. With regard to the decision of the Representative of the Secretary-General to adopt a new long-term strategic asset allocation, the Advisory Committee agreed with the Board of Auditors that the new benchmarks should have been submitted to the Pension Board and the General Assembly for approval. It agreed in principle to the decision on the passive management of the North American equities portfolio, but recommended that the activity should be in the hands of the Investment Management Service itself; any decision on outsourcing should be taken only after a comprehensive review.

24. He drew attention to the Advisory Committee's comments on the reporting lines for internal audit matters (A/61/545, paras. 19-21). The newly established Audit Committee should be composed of members, selected as soon as possible, with relevant experience in internal audit and expertise in accounting and financial and risk management. With regard to the report of the Board of Auditors, ACABQ was concerned about the findings of the Board on the Investment Management Service trade order management system and about the fact that the Service's investment infrastructure was still at the stage at which trade orders were placed by facsimile with no compliance monitoring system. Urgent measures should be taken to bring the infrastructure up to industry standards. The Service should also expedite recruitment to risk-management and compliance-officer positions.

25. The Advisory Committee had supported all of the Pension Board's recommendations on the revised budget for the biennium 2006-2007, except for the additional provision of $1,945,000 for indexation fees and one-time transition costs, consideration of which should be deferred pending action on the measures indicated in paragraph 17 of the ACABQ report.

26. **Ms. Pehrman** (Finland), speaking on behalf of the European Union; the acceding countries Bulgaria and Romania; the candidate countries Croatia, the former Yugoslav Republic of Macedonia and Turkey; the stabilization and association process countries Albania, Bosnia and Herzegovina, Montenegro and Serbia; and, in addition, Iceland, Liechtenstein, Moldova, Norway and Ukraine, said that the agenda item was a very important one because the Fund's assets of over $34 billion safeguarded the retirement of the staff of the United Nations and 20 other organizations, who needed to be reassured that their savings were being well managed. The European Union noted with satisfaction the Fund's investment performance, which had shown a positive result for the fifth consecutive year. It noted the 8 per cent increase in investments in developing countries and counselled prudence in the investment policy: the current surplus must be managed wisely.

27. The European Union shared the concern of the Board of Auditors about the lax monitoring of performance by the Investment Management Service, the deficiencies in the trade order management system, and the unfilled risk-management and compliance post. However, it welcomed the decision to implement the recommendation of the Board of Auditors for the establishment of an audit committee, whose membership should meet the criteria specified by

ACABQ, and endorsed the ACABQ recommendations on the management of the Fund's investments.

28. **Ms. Lock** (South Africa), speaking on behalf of the Group of 77 and China, said that improvements to the pension system should be implemented in such a way that they benefited existing participants and retirees. It was essential for there to be transparency and accountability in the pension system.

29. The Group appreciated the improvements in the report; it would be beneficial to receive an executive summary of the Fund's performance and the effects on that performance of global economic developments. Future reports should contain detailed information regarding non-implementation of the recommendations of the Board of Auditors, although the Group expected those recommendations to be implemented expeditiously.

30. Noting with appreciation the increase of $6.5 billion in the value of the Fund's assets, the Group believed that further efforts were required to invest in developing countries, for example in Latin America. The Fund had a small team of managers, and expecting one manager to be accountable for a portfolio of, in one case, over $15 billion and, in another, $9.5 billion seemed to represent a high risk for the Organization. The Group sought clarification as to why such huge responsibilities had not been assigned to a team of first-rate managers. The substantial real estate portfolio was being managed passively, which prompted the question of whether competitive remuneration packages should be used to attract suitably qualified and experienced managers. It would be prudent to clarify the delegation of authority for the Fund's investments from the Secretary-General to his Representative, and to review issues relating to the Fund's governance.

31. The Group was concerned by indications that due to a lack of staff in the Risk and Compliance Section of the Investment Management Service, the Fund had suffered a loss of $8.7 million; she requested an explanation of the fact that no accountability mechanism seemed to have been in place to ensure that disciplinary action was taken against the individual responsible. The Group fully supported the ACABQ recommendation that expeditious action should be taken to fill all existing vacancies in the secretariat of the Fund, and especially in the Investment Management Service. Appointments should be made promptly and with due respect for equitable geographical distribution. It would be helpful for investment managers to be subject to regular, independent performance appraisals.

32. Important matters regarding the investment strategy of the Investment Management Service needed to be clarified. The Joint Staff Pension Board report (A/61/9) claimed, on the one hand, that North American equities were difficult to outperform, and, on the other, that they had chronically underperformed, yet it also favoured indexing the Fund's equities to North American equities because it would have resulted in a lower risk and a higher return. The Group requested clarification of those seemingly contradictory positions, and of alternatives to North American equities as benchmarks. The Group also sought clarification of the fact that no benchmarks had been established for small-capitalization equities.

33. The Group was concerned at the conduct of the Representative of the Secretary-General, who, without consulting the relevant parties, had taken the decision to work out a new formulation for the Fund's strategic asset allocation and its performance benchmark. It was improper to disregard established procedures and make such decisions without due consultation, and raised serious concerns regarding the exercise of delegation of authority and accountability mechanisms. It was imperative for corrective measures to be taken immediately. She asked what action had been taken to deal with the matter.

34. The Group concurred with the Advisory Committee that before any decisions to effect further significant changes in investment policy were taken, comprehensive, clear and convincing information should be presented to the Board indicating the level of tolerance for the risks involved. That crucial aspect seemed to have been ignored. It would also be helpful if light could be shed on the actuarial dimension of the Fund's operations and on the assumptions for actuarial valuations. There should be greater transparency in the selection of the consulting actuary.

35. The Group was concerned by the Board's lack of action in response to the request in General Assembly resolution 59/269 to provide information on the special situation of pensioners living in countries that had undergone dollarization and on proposals to mitigate the adverse consequences. Ecuador had been identified in that regard, and the Group was concerned that only

now had the Board requested the Chief Executive Officer to visit Ecuador to study the matter further. The Group looked forward to expeditious action by the Board, and expected measures to be drawn up to mitigate the adverse consequences for beneficiaries living in Ecuador. The Group was concerned by indications that many beneficiaries faced reductions in their compensation due to bank transfer fees as a result of the decision to centralize banking services in the United States and requested an explanation, as well as an indication of remedial measures.

36. **Mr. Torrington** (Guyana), speaking on behalf of the Rio Group, welcomed the 13.7 per cent increase in the investment performance of the United Nations Pension Fund. The secretariat and the Board should comply fully with the regulations established by the General Assembly and continue to improve the working methods of the Fund in order to avoid any future conduct that might exceed their mandates.

37. He expressed special concern that despite the mandate given the Board in General Assembly resolution 59/269, no effective action had been taken to provide information on the situation of pensioners living in countries having undergone dollarization. The Board should prepare a comprehensive report containing proposals to attenuate the adverse consequences of dollarization in Ecuador for the adjustment of pensions. Finally, he welcomed the Board's recognition of the need to increase investments in developing countries, but noted with concern that investment was in fact declining in Latin America; more information on that situation would be welcome.

38. **Mr. Garcia** (United States of America) welcomed the increase in the market value of the Fund's assets to over $33 billion as at 31 March 2006, a new all-time high, which testified to the benefits of sound long-term financial planning and strong management. He also welcomed the decision of the Board to approve the Secretary-General's proposal to passively manage the Fund's North American equities portfolio and outsource it to a private entity, but hoped that the members of the Board would return to their usual practice of taking decisions by consensus based on dialogue and negotiation.

39. The change in the management of the North American equities portfolio was in the best interests of the Fund and would eliminate the need to maintain a staff of managers for those investments, thereby incurring long-term savings; the shift would however cost $2.9 million to pay for transition services. In order to ensure that the money was spent wisely, the Secretariat should report on progress made in implementing the new arrangement. In that context, he took note of the recommendation of the Advisory Committee that the General Assembly should be provided with a report on the financial impact of the decision and that management of the portfolio should be outsourced only after a comprehensive review.

40. He welcomed the 1.29 per cent increase in the actuarial valuation of the Fund, reversing a downward trend first noted in 1999. The Board attributed the increase to gains from continuing moderate levels of inflation and changes in the participant growth assumptions. His delegation agreed, however, with the Committee of Actuaries that it could not be assumed that that positive trend would continue and that care should be taken to ensure the Fund's position remained healthy.

41. While noting the decision of the Board to spend a portion of the surplus for restoration, he requested clarification as to why the Board had allowed the Fund to dip below the 1 per cent surplus level considered prudent by most actuarial experts. His delegation also opposed the Board's decision to send the Chief Executive Officer to review the plight of economically disadvantaged retirees. The General Assembly had already decided not to approve any benefit improvements until benefit reductions were fully restored and such a trip would therefore be a waste of resources.

42. He did not understand why the Board had not responded to the request in General Assembly resolution 57/286 to reallocate seats on the Board to more fairly reflect the actual distribution of active participants. The Board had spent several hundred thousand dollars studying the matter and had then rejected the recommendation of its own Working Group that the size of the Board should be reduced from 33 members to 21. The Board's statement that it would review the issue again in three years and produce a policy paper on membership issues in 2007 was not acceptable.

43. He expressed appreciation for the Board's efforts to improve governance, for example, the decisions to meet annually beginning in 2007 and to reduce the role of the Standing Committee. He commended the Board

for establishing the Audit Committee, which should help the Board grapple with oversight, accountability and governance questions, and agreed with ACABQ that the Audit Committee should be composed of qualified experts. In that regard, he wondered what the Board had done to ensure that the Audit Committee members in fact possessed the necessary expertise and asked whether their résumés had been circulated to the members of the Board.

44. Given the increase in the Fund's assets and participants, it was particularly important that effective oversight should be a cornerstone of its operations. He therefore welcomed the Board's agreement that the Audit Committee should give priority to monitoring the Fund's internal audit arrangements. In addition, since the General Assembly had primary authority over budget and other issues relating to the Fund, Member States should have full access to audit and oversight information. Finally, he expressed satisfaction with the Board's decision to approve the membership of the International Organization for Migration in the Fund, but emphasized that potential members must strictly comply with the rules for membership.

45. **Mr. Riofrío** (Ecuador) said that in the six years since his country had adopted official dollarization the Fund's beneficiaries living there had been directly and adversely affected by high rates of domestic inflation and by their pensions, whether received in the local currency or in dollars, being adjusted in line with United States rather than local inflation. The Fund had taken no action to deal with the problem or to mitigate its consequences. The United States dollar had lost 60 per cent of its purchasing power in Ecuador since 2000, and over that period the majority of United Nations agencies in the country had implemented salary adjustments for their employees.

46. The Federation of Associations of Former International Civil Servants in Ecuador had raised the matter with the Fund, and after a tedious and bureaucratic correspondence had come away with the impression that the Fund did not regard it as urgent. The spirit of the system under which United Nations pensions were adjusted was that the purchasing power of pensions should be preserved so as to ensure that pensioners enjoyed a decent retirement. His delegation did not understand why no concrete proposals had been put forward to deal with a case that so clearly deserved attention. His delegation regretted the fact that two years had passed since the General Assembly had established a mandate for the Board's Chief Executive Officer to visit Ecuador to meet the Fund's beneficiaries with a view to the adoption of special measures to reduce the adverse effects of dollarization on their pensions; the visit should take place as soon as possible.

47. **Mr. Kovalenko** (Russian Federation), noting the further increase in the Fund's assets and the good return on its investments in the previous biennium, expressed confidence that the Board would continue to give careful attention to the results of actuarial valuations and that any recommendation to change the parameters of the pension system and contribution rates would take into account the actuarial situation. The Board's decision to endorse the intention of the Investment Management Service to shift to passive management of the North American equities portfolio and to index it was justified. His delegation had some doubts, though, about the Advisory Committee's recommendations concerning management of the portfolio by the Investment Management Service itself, as it seemed to be the most costly option in that it required additional expenditure to provide the necessary infrastructure.

48. He was pleased to note that the Board had managed to agree on the mandate of its Audit Committee; that experience could be used by the Fifth Committee when it came to consider the establishment of an audit committee of the General Assembly. He noted the Board's productive work, and supported its decisions to move to an annual work format with shorter sessions, as that would enhance the effectiveness with which it performed its duties.

49. **Ms. Udo** (Nigeria) said that her delegation welcomed the growth in the Fund's assets and the increase in its market value to a record level but stressed once again the undesirability of making a single person responsible for managing a large proportion of the Fund's investments without sufficient oversight. It noted the 13 per cent increase in investments in the African region, which remained a large and untapped investment market, and trusted that the trend would continue. The Board should continue the practice of holding meetings in Nairobi, where it had greater exposure to African investment opportunities, and it would be welcome to visit Nigeria. Against the background of a generally positive investment trend the Investment Management Service should take care to monitor opportunities as well as risks.

The meeting rose at 12.30 p.m.