Analysis: Pension Fund Assets Management and Performance (July 2016)

Based on the preliminary performance as of 30 June 2016 (2Q 2016), the total Fund performance was 1.06% for the 2Q 2016, underperforming the benchmark of 1.55% by 50 basis points (bps).

For the first 6 months in 2016 (1H 2016), the total Fund returned 2.18%, underperforming the policy benchmark of 3.71% by 154 bps.

- Both the global fixed income and equity portfolios underperformed their relevant benchmarks.
- The FI return was 5.20% YTD, underperforming its benchmark of 8.96% by 376 bps.
- The total internally managed equity return was 0.69%, underperforming the benchmark of 1.58% by 88 bps.

In the longer term, the Fund return for the last 12 months was -0.43%, underperforming the benchmark of +1.41% by 1.84%.

For the last 2 years, the Fund return was -0.25%, underperforming the benchmark of +0.30% by 55 bps (annualized). The Fund is now underperforming in the 3 and 5 year horizon.

The North American equity and Fixed Income portfolios, the two largest Fund's portfolios, are both underperforming. As of 30 June 2016, the North American (NA) portfolio has underperformed in the last 1, 3, 5, 7, 10, and 15 years while Fixed Income (FI) underperformed in the last 1, 3, 5, 7 and 10 years.

(1) Poor investment judgment and implementation of strategy:

Since joining in in 2014, the RSG has been promoting a "risk-off" strategy against the policy benchmark. If this strategy had been successfully implemented, the Fund performance would have been *in-line* with the Policy benchmark return. The fact of the Fund's significant underperformance raises the question of why this strategy could not be implemented. The Fund was unfavorably impacted due to inconsistencies between the so-called strategy and actual fund management.

(2) Poor Risk management:

The Fund is facing significant concentration risks from the two biggest portfolios; i.e. North American Equity and Global Fixed Income. The asset value of the internally managed North American Equity portfolio is USD 17.3 billion (bn), while the fixed income portfolio is USD 13.2bn. In addition, the cash portfolio is USD 2.2bn. All combined, USD 32.7bn portfolio which accounts for 62% of the total Fund, was managed under the responsibility of just two (2) P-5 Senior Investment Officers.

At the same time, the risk budgets were poorly monitored:

- The underperformance of Global Fixed Income by 376 bps was just in the first 6 months of 2016. This is *more than double* its annual risk budget of 173 bps. Please note that the OIOS report of 29 June 2016 mentions the "exposure to high currency risk" (Para 8 (f) on page 3).
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- The North American underperformance is 120 bps during the first 6 months while the risk budget is 135bps.
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The Total Fund's estimated tracking risk is approx. 500 bps while the "red zone" of the risk monitoring is 205 bps. Please see para 60 and the Risk Budget annex on page 17 of the Investment Policy Statement (R.11). The D1 post - Director for Risk Assessment has been vacant since October 2015.

(3) Vacancies in IMD/Weak governance:

The underperformance was observed notably when senior posts of IMD were kept vacant for a long period, with no Officers in Charge (OICs) assigned. In particular, the vacancy of the Director (D2) and Deputy Director for Risk (D1) were vacant. Designating OICs are clearly in line of the UN's "Empowering Others/ Delegating Responsibility" Managerial Competency framework. In addition, functioning OICs to these posts would provide a structurally healthy check and balance. As mentioned above, the risk budget was poorly monitored.

The Risk Budget was updated and included in the Investment Policy Statement while the D-1 for Risk is absent.

In addition, there was no check and balance when the RSG decided to liquidate the All Weather Fund (approx. USD 500mil) managed by the Bridgewater.

At the same time, complaints to the MEU and the Tribunal have been brought by staff members for discrimination and abuse of power. These merit serious consideration, given the UN's core values of Integrity, Respect for Diversity and Professionalism.

(4) Cost issues/Potential conflicts of interest:

At the same time, structural costs for investments are rising. Of note, IMD's investments in ETFs have been increasing in the last few years, particularly in the

North America and Global Emerging markets portfolios. ETFs are index-linked products managed by external managers. These allow investors to buy into a pre-constructed portfolio of stocks for a sector, index or region without the need for the investor making any active stock selection, or active management. The fees are high for those products since these are developed for retail investors with small investment accounts. As fees are deducted directly from ETF net assets, there is no explicit budget item which the Pension Board can monitor. Due to the high cost of heavily utilizing ETFs, it is getting more challenging to outperform the benchmark return in a sustainable manner, particularly for North American equities. Please note that Investments in these ETFs include investments in prohibited securities; i.e. tobacco and defense/armaments.

The RSG's appearance in the media at an NYSE closing bell ceremony, sponsored by Blackrock, one of the largest ETF providers, creates a perception that the UN supports/endorses one particular private corporation, which raises questions on the RSG's potential conflict of interest in fulfilling her fiduciary responsibility.

To enhance the Fund's sustainability, the strategic vision of IMD, including its governance, strategic approach to investment management, risk management, and resources, should be stringently reviewed, clearly defined and articulated.

To this end, the following list of questions require urgent answer from IMD:

>Vision/Investment Objectives/Strategies

- *What is IMD's vision for the investment of the Fund's assets? What has been changed since the RSG joined? And what does IMD want to achieve in the next 1-2 years?* !

- *Is IMD targeting "the highest possible investment return" (Para 6 and 10 of IPS (R.11)? or capital preservation (para 2 of R.8)? Is staying with the Strategic Asset Allocation (SAA) as close as possible, consistent with the investment objective? How you can IMD achieve capital preservation given the market's volatility? For example, what were the efforts/investment actions that IMD took for capital preservation during Brexit?* !

- *The Strategic Asset Allocation (SAA) is based on the long-term capital market assumptions which are relatively optimistic compared to current market environments, i.e. 8.82% of global equity return in the next 10 years, 2.46% of global fixed income, and 1.95% of cash (!). What is IMD's view or confidence level in the next 1-2 years to meet these returns? What will the IMD do, i.e., does IMD* *have any action plan, on a possible scenario? Is it prudent to maintain the Fund's asset allocation close to the SAA when the current market environment/volatility, is clearly not as favorable as the Long-term capital market assumptions?!*

- *What does the language in Para 2 of the R8 document mean, "the Fund's conservative and risk-averse approach resulted in capital preservation" when in fact the total Fund had negative return in the last 2 years through 30 June 2016 and underperformance against the policy benchmark in the last 1, 3, 5, and 7 years?!*

- *Some studies show that, given the efficiency of the US equity markets, more than 80% of active managers of US equity cannot outperform the benchmarks. Does IMD have enough resources to generate excess returns over the benchmarks in a sustainable manner? !*

>Investment Performance

If the Fund is currently managed close to the SAA, why did the Fund's investments underperform against the policy benchmark, particularly in 2016? The Fixed Income portfolio and North American equity, the two biggest portfolios of the Fund, are underperforming against their relevant benchmarks. Where are the risks coming from, and who is responsible for the decision making?

- *Can IMD discuss the long-term performance of the Fund in each portfolio level? What are the driving factors for the performance? For underperforming portfolios, what are the measures to improve the performance in the future?*

- *Does the Fund continue to invest in any Hedge Funds? Please disclose the names, performance, and the fee structure as of 31 December 2015.*

>Risk management

- *The yellow zone of the risk tolerance was defined as 205 bps in the Risk budget annex of IPS (page 17 of R.11). Does this mean that the Fund can reasonably expect to underperform by 2.05% a year? 2% of the USD 53 bn Fund translates into USD 1 bn+. How was the risk tolerance defined? !*
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- *What is the impact to the Fund's sustainability when the Investment return underperformed by 2%? !*

- *What are the current levels of the estimated tracking risks of the Fund's portfolio? Can IMD comment on the current risk levels in the context with the Risk budgets stated in the Annex table of IPS (R.11)? The Fund is experiencing underperformance against the Policy benchmark. How can IMD monitor the tracking risks and what is the mechanism to prevent the underperformance exceeding the risk budget? How did IMD manage the risks while the D1 for Risk was vacant since October 2015?* !

- *How has IMD handled the investment decision making during the period when the Director of IMD and the D1 for Risk and Compliance were vacant? How is it that the RSG can act on both investment and risk aspects without the check and balance, specially given that investment recommendations are inherent in these vacant senior posts? For example, what are the discussions the RSG had with the Risk and Compliance section when the RSG liquidated the hedge fund (i.e. All Weather fund managed by Bridgewater)? We recall that this particular Fund was under the "Risk Control" portfolio and the Deputy Director for Risk and Compliance had conducted an intensive review. However, this was liquidated when the D1 Director for Risk post was vacant.* !

>Governance/vacancies/resources/costs

- *Why did the selection process of Director of IMD take so long? The predecessor retired in March 2015. Even though the Pension Board, ALM Committee, and Audit Committee clearly expressed concerns about the vacancy last year, the Job Opening was reopened in February 2016, seven months after it closed in July 2015. The OHRM guideline prohibits any changes in the JO after it was published. What was the involvement of the CEO in this process? Has he been consulted as required by the MOU?*!

- *After 15 months of vacancy, the Director of IMD was finally on board. Now that the Director is on board, what will be the delegation of authority to the Director?* !

- *What is the status of the recruitment of the Deputy Director for Risk and Compliance which has been vacant since October 2015? Has the RSG assigned an Officer-in-Charge for the Deputy Director for Risk and Compliance? This is a crucial check and balance function; and apart from this, assignation of OIC falls under the Managerial Competency "Empowering Others" under the UN Competency framework.* !

- *Substantial resources were added to IMD both in the past several budget cycles, particularly in the 2014-2015 biennium budget. What was the impact in the form of* *the investment return? Can these be quantified? If there is a time frame to expected return, what time frame would that be? The Board needs a specific, time and objective bound method to measure if additional resources granted, truly benefited the Fund. What would be the direction of the Investment management going forward?* !

- *What is the role of the Investments Committee in providing advice on the Tactical Asset Allocation? Participation in recent Investments Committees meetings by the IC members has dropped lately. Has IMD received sufficient advice from the Committee? What is the benefit of having IC meetings, and notably some of these were outside NYC, incurring travel costs --- if the RSG's intention is stay with the SAA as close as possible? For example, what were the decisions of investments after the meetings in Mexico City, Bahrain, Shanghai, and Berlin?* !

- *It has been noted that IMD's top management had appeared in the public media several times in the events of Closing Bell ceremonies at NY Stock Exchange sponsored by Blackrock, one of the largest ETF providers. This gives the impression to the public that the UNJSPF supports Blackrock business. How much business does the Fund have with Blackrock? Is it appropriate that the RSG appears to support any particular private corporation? Is the office of the Secretary-General aware of this?* !

Note:&(See&questions&to&the&Investment&Committee&on&page&7)&

Suggested Questions to the Investments Committee

- The capital market assumptions adopted in the ALM study last year look relatively optimistic compared to current market environments after introduction of negative interest rates and Brexit, i.e. 8.82% of global equity return in the next 10 years, 2.46% of global fixed income, and 1.95% of cash. Do you think they are still reasonable? Do you think it is prudent to stay with the strategic asset allocation in the next 12-24 months?

- The Fund is experiencing negative returns in the last 2 years as of 30 June 2016. What is your view on investment returns in the next couple of years?

- What advice can you give on a mechanism to review the Fund's capital market assumptions, to make sure the Fund's investment is optimum? What is your opinion on Tactical Asset Allocation? The Fund has benefitted from the tactical asset allocation strategy historically with the support of the IC. Can we continue to expect the tactical asset allocation strategy will be utilized, going forward?

- What were the discussions in IC meetings with regard to the Brexit?

- Some study shows that, given the efficiency of the US markets, more than 80% of the active managers of US equity cannot outperform the benchmarks. Are you confident that IMD has enough resources to generate excess returns over the benchmarks in sustainable manner?

- What are your thoughts on the fees for ETFs? Are there any alternative ways to reduce the fees?