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UNITED NATIONS PENSION SYSTEM

Investments of the United Nations Joint Staff Pension Fund

Report of the Secretary-General

I. INTRODUCTION

1. Pursuant to the decision of the General Assembly in 1992 to take up pension matters biennially, in even-numbered years, there was no report by the Secretary-General to the General Assembly on the investments of the United Nations Joint Staff Pension Fund (UNJSPF) in 1993. The present report on the management of the investments of UNJSPF therefore covers the period from 1 April 1992 to 31 March 1994. The investment environment that prevailed in the reporting period ended 31 March 1994 is described and information is provided on the investment returns, portfolio diversification and the development-related investments of the Fund. The data are based on the audited financial statements for the two calendar years 1992 and 1993 and the unaudited appraisals for the quarter ended 31 March 1994. In order to provide the General Assembly with the most timely information available, some data have been updated to 30 June 1994. Also included in the report is a special section on the new custodial arrangements for the assets of the Fund.

* A/49/150.

II. ECONOMIC AND INVESTMENT CONDITIONS

2. The world-wide economic environment for the two-year period ended 31 March 1994 was characterized by a combination of slow economic growth in some major industrialized countries and recession in others, a general decline in aggregate of interest rates and inflation rates in most countries, volatility in currency exchange rates, lower commodity prices, relatively stable oil and gold prices and the continued restructuring of economic systems in Eastern Europe, Latin America and Africa. In the beginning of the period under review, the North American economies were showing weak signs of recovery from a severe recession, while the major European economies and Japan slipped into recession. By the end of the period under review, economic growth was relatively strong in the North American, United Kingdom and Australian economies, and the other major industrialized European economies were showing visible signs of coming out of recession. The economic recovery world wide was aided by a combination of lower interest rates and lower inflation, and extensive restructuring and rationalization in economies and industries.

3. The world financial markets were relatively volatile and the movements were not always synchronized with the economic fundamentals or cycles during the period. In the United States of America, the stock market, boosted by declining interest rates and stronger economic growth, increased during most of the period. It achieved a record high in early March 1994 before experiencing a sharp decline during the last 10 days of the period, as a result of the first increases in short-term rates in five years in the United States in February and March. In Europe, most equity markets were weak in the beginning of the period but registered strong advances in 1993 and achieved record highs in the beginning of 1994 before declining with the interest rate increases in the United States. In the Far East, the Japanese market reached a five-year low in August 1992 before recovering some strength, but was volatile during much of 1993, before rebounding towards the end of the period under review. The smaller Asian markets, including Hong Kong, achieved strong market advances and reached record high levels before reacting to interest rate increases in the United States.

4. Most of the major bond markets performed well during most of the period under review, mainly owing to the continued decline in interest rates and lower inflation rates. Just before the end of the reporting period, however, the interest rate increases in the United States prompted sharp declines in the bond markets world wide. In the United States, bond prices reached their peak in October 1993 before declining to their lowest levels in the first quarter of 1994, as a result of the increase in short-term rates. In Europe, both short-term and long-term interest rates declined during the period, resulting in good performance in most of the bond markets until the United States Federal Reserve Bank started to raise interest rates and prompted a sell-off in bonds. Over all, Japan was the best performing bond market, benefiting not only from interest rate declines but also from the strength of the yen against the United States dollar.

5. In Latin America, significant progress was made towards transforming the economies into free market economies. South-East Asian countries experienced very high levels of growth despite the recession in the major industrialized

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countries. Substantial gains were seen in most of the stock markets of these two regions. In Eastern European countries, liberalization and restructuring of economic and political systems also continued, and significant progress was made towards free market economies in some countries. In Africa, restructuring of political and economic systems and the development of capital markets continued.

III. INVESTMENT RETURN

6. The market value of UNJSPF assets increased to US$12,534 million on 31 March 1994 from US$ 10,111 million on 31 March 1992, an increase of US$ 2,423 million, or 24 per cent. This represents US$ 1,321 million above the book value. Over the past 44 years, the total book value of the portfolio has risen from $13 million to $11,213 million, a compound increase of about 17 per cent a year. Investment income from interest and dividends amounted to $532 million in 1992 and $568 million in 1993. The total of new funds that became available for investment (contributions plus investment income, less benefit payments and investment expenses) amounted to $573.9 million in 1992 and $588.5 million in 1993. Realized capital gains amounted to $354.6 million in 1992 and $326.2 million in 1993.

7. The total investment return for the year ended 31 March 1993 was 11.6 per cent, which, after adjustment for inflation, represents a "real" rate of return of 8.2 per cent. For the year ended 31 March 1994, the total investment return was 9.7 per cent, with a "real" rate of 7 per cent. The method of calculation of the investment return takes into account actual income received from interest and dividends as well as realized capital gains and losses and changes in the market value of the investments (unrealized capital gains or losses and exchange rate fluctuations). The impact of the flow of new money into the Fund at different times throughout the year is also incorporated on a prorated basis in the calculations. The techniques used in measuring the investment return are in accordance with the standards used by most pension funds. The calculations of the investment returns for the Fund are carried out by an outside consultant.

8. As the purpose of the Fund is to secure retirement and other related benefits for its participants, the policy of the management of the Fund's investments is geared to preserving the principal of the Fund by maintaining a careful balance between risk and reward. At the same time, the investments are assessed over the medium and longer term rather than acting on the basis of short-term investment results, which are not in themselves particularly meaningful for a fund such as UNJSPF that has long-term investment objectives and liabilities. Periods of five years or longer are usually considered to be reasonable periods in which to assess the investment results.

9. To provide a longer-term perspective, the annual rates of return over selected periods are shown in table 1 below.

Table 1

Total Fund: compound annual nominal and real rates of return for selected periods to 31 March 1994

(In percentages)

	5 years through 1994	10 years through 1994	15 years through 1994	20 years through 1994	25 years through 1994	34 years through 1994
Nominal	9.9	12.8	12.1	10.8	9.4	8.6
Real (inflation adjusted)	5.9	8.8	6.7	4.7	3.4	3.5

IV. INVESTMENT DIVERSIFICATION

10. The policy of broad diversification of the investments by type of security, industry groups, countries and currencies is a basic feature of sound and prudent investment management and has been advocated repeatedly by the Investments Committee, the United Nations Joint Staff Pension Board (UNJSPB) and the General Assembly. 1/ The geographic and currency diversification of the assets of the Fund, which began in 1960, makes the Fund one of the most diversified pension funds in the world. The proportion of the assets allocated to particular geographic regions, currencies or types of security is based on long-term assessments of the economic and financial market environment at the time of decision-making. The proportions are adjusted as new information becomes available to minimize risk and to benefit from new opportunities.

11. The diversification of the portfolio as at 31 March 1994 is detailed in the various tables in the annex to the present report. Investments were exposed to 27 different currencies and 41 countries; 56.7 per cent of the assets were exposed to currencies other than the United States dollar, which is the Fund's unit of account. Of the Fund's investments, 68.2 per cent were in markets outside the United States. The decline in the relative value of the United States dollar at the end of the period under review influenced the market values of investments outside the United States when expressed in dollars, and has consequently also positively affected the rates of return in local currencies when expressed in dollar terms.

12. As shown in the figure below, equities constituted 55 per cent of the assets as of 31 March 1994, an increase from 47 per cent as at 31 March 1992; 37 per cent of these were in United States equities and 63 per cent in other equity markets. The bond proportion had declined to 33 per cent from 37 per cent, and the breakdown between United States dollar-denominated bonds and other currency bonds was 35 and 65 per cent respectively. Investments in real estate-related securities amounted to 6 per cent, compared to 9 per cent two years earlier. Short-term investments and reserves, i.e., cash and

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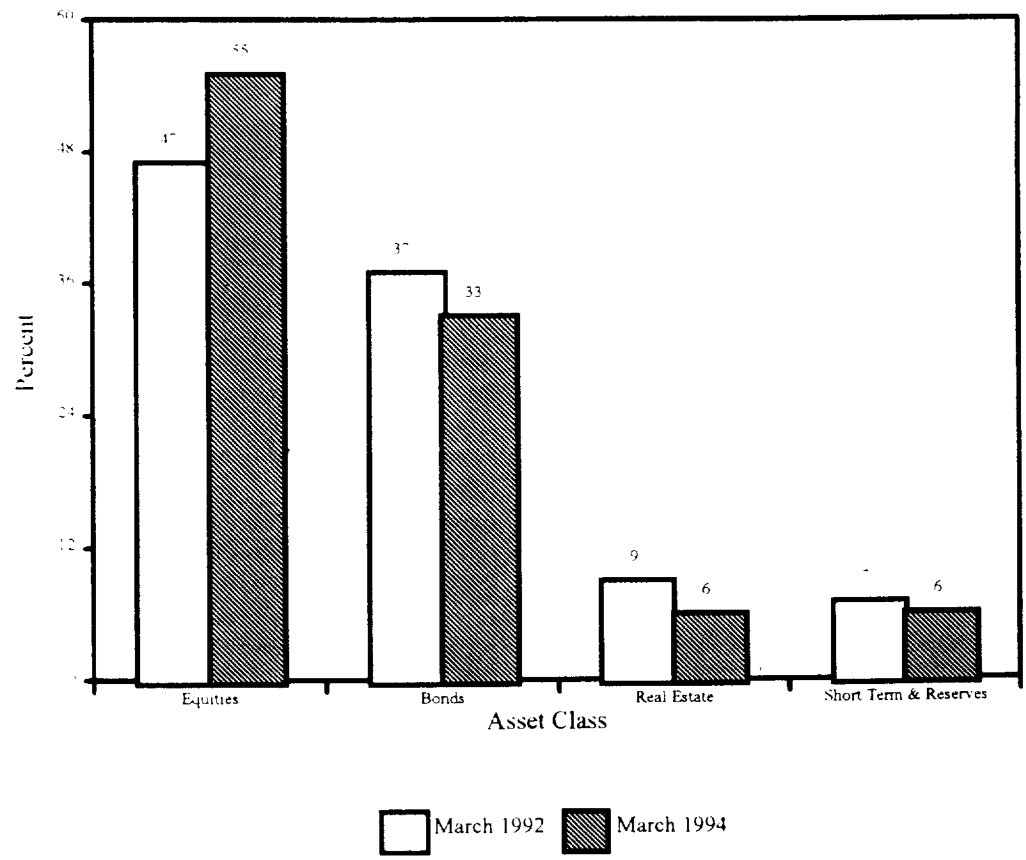
Total Fund: diversification of assets

March 1992 and March 1994



fixed-income investments with maturity dates of less than one year, had decreased to 6 per cent from 7 per cent. In order to preserve the principal of the Fund, the defensive policy adopted in the mid-1980s was continued but slightly changed. It consisted of increasing holdings in selected equities that appeared undervalued and with potential for future appreciation.

V. IMPLEMENTATION OF GENERAL ASSEMBLY RESOLUTIONS

13. In response to the requests of the General Assembly, investments in developing countries continued to show an increase as set forth in tables 2 and 3 below, and the book value of development-related investments increased in total by 13.9 per cent over the last two years, to $1,751.2 million as at 30 June 1994 from $1,537.6 million as at 30 June 1992. The investments in development institutions amounted to $1,081.1 million compared with $1,050 million two years ago, an increase of 3 per cent; direct investments in specific developing countries increased by 37.4 per cent to $670.1 from $487.6 million. Table 3 shows that the Fund's direct investments and those through regional development institutions in Africa increased by 41.2 per cent to $269.9 million from $191.2 million; Latin America increased by 51.9 per cent to $411.3 million from $270.8 million; and Asia increased by 13.7 per cent to $662.9 million from $583 million. The combined development-related assets as at 30 June 1994 represented 15.4 per cent of the total book value of the Fund. The level of investment made over the past five years is shown in table 2 below.

14. Close contacts are maintained with international organizations, regional development institutions, Governments and private sources to ensure full awareness of all investment opportunities in developing countries. Follow-up missions to Africa, Latin America, the Middle East and Asia were undertaken during the biennium.

Table 2

Development-related investments (book value) as at 30 June 1994

(In millions of United States dollars)

	1989	1990	1991	1992	1993	1994
Specific countries a/	225.0	240.6	298.0	487.6	506.4	670.1
Development institutions b/	909.4	1 036.6	1 137.2	1 050.0	1 139.7	1 081.1
Total	1 134.4	1 277.2	1 435.2	1 537.6	1 646.1	1 751.2

a/ Includes multicountry funds.

b/ Includes regional and other development institutions.

Table 3

Summary of development-related investments (book value) as at 30 June 1994

(In millions of United States dollars)

	Currencies other than United States dollars: 1994	United States dollars: 1994	Total 1994	Total 1992	Percentage change
Africa	142.3	127.6	269.9	191.2	41.2
Asia	388.1	274.8	662.9	583.0	13.7
Europe	41.5	40.0	81.5	0.0	n/a
Latin America	142.4	268.9	411.3	270.8	51.9
Other development institutions a/	56.7	253.9	310.6	482.2	(35.6)
Multicountry funds	0.0	15.0	15.0	10.4	44.2
Total	771.0	980.2	1 751.2	1 537.6	13.9

a/ Includes World Bank but excludes regional development institutions.

VI. CUSTODIAL ARRANGEMENTS

15. In its review of the budget proposals for investment costs for the biennium 1994-1995, 2/ the Advisory Committee on Administrative and Budgetary Questions (ACABQ) requested a report on custodial arrangements to address specifically matters relating to cost-effectiveness and legal and security issues. The background and the specific issues are summarized below.

16. The custody arrangements for the assets of UNJSPF have not changed much since the inception of the Fund. From 1946 to 1989, the custodial and advisory services were contracted to Fiduciary Trust Company International (FTCI) under one single contract. While FTCI provided advisory services, it subcontracted global custodial services to Williams and Glyns, which subsequently merged with the Royal Bank of Scotland in 1985. The Royal Bank of Scotland in turn contracted with local sub-custodians around the world. Under this arrangement, all the assets of the Fund were registered in the name of the Royal Bank of Scotland for the account of FTCI on behalf of UNJSPF. The Fund had no direct control over the custodial arrangements made by both FTCI and the Royal Bank of Scotland.

17. The initial plan for the diversification of the custodial arrangements envisaged that the United Nations would ultimately enter into a direct relationship with a world-wide network of custodians, with the goal of having one custodian in every market where the Fund held assets. To ensure the minimum amount of disruptions to the operations of the Fund, a transitional arrangement was made whereby FTCI would assist the Investment Management Service of UNJSPF with the implementation of the custody project. Two separate contracts for advisory and custodial services were negotiated and signed with FTCI for two years, effective 30 June 1989.

18. A brief business plan, which addressed major considerations of effective risk management, cost-effectiveness, more control and flexibility, was prepared to take advantage of continuing developments in the custody business and changes in the United Nations requirements. In order to achieve these, a more detailed study by an industry specialist was necessary to enable the Investment Management Service to consider fully the Fund's options relating to custody, settlements and reporting and to review the custodial services being offered by FTCI. In May 1992, Global Securities Consulting Services Inc. (GSCS) was engaged to conduct this study and it recommended an arrangement under which the Fund would benefit from substantial reduction of risk in the following areas:

(a) Counterparty risk. The use of multiple custodians, all of whom are based in well developed markets, ensures that counterparty risk is diversified. The number of counterparties, as well as the fact that the option allows for easy extension into relationships with new counterparties, means that it is always likely to be able to provide the level of risk diversification that the Fund would require. The quality of counterparties involved and the fact that there is no need to operate directly in markets where adequate counterparties do not exist provide additional opportunity for risk reduction;

(b) Legal risk. Although there are some legal risks owing to the need to bind contractually counterparties outside the United States, the markets in

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which direct links will be established are well developed and the custody business is mature; therefore, these risks are very modest. Additionally, by contracting directly with multiple custodians, as compared to the subcustody network of a global custodian, securities registration requirements (i.e., in the name of the United Nations) can be more easily met;

(c) Operational risk. The existence of prudent settlement and safekeeping procedures can be more easily monitored with this arrangement. Since the Fund will have direct contact with custodians, procedural as well as financial audits can be contractually guaranteed;

(d) Internal control. The Fund would gain considerable internal control over the quality of the services it receives as well as over parts of the investment process. By contracting directly with custodians, the Fund enhances the flow of information and monitoring process by cutting out one entire level of filtering, the global custodian, making custody operations more transparent. Additionally, the level of filtering is replaced by an added level of monitoring and verification in the record-keeping function.

19. The implementation of the consultant's recommendation started in 1992. It was decided that the business plan was to be reviewed by a law firm to ensure that all the safety aspects were covered adequately in the plan. As the Office of Legal Affairs of the United Nations Secretariat had neither the resources nor the expertise in investment law and in order to avoid any further delays, the assistance of outside legal counsel with expertise in investment law and security administration was necessary to help the Investment Management Service with legal matters relating to the custody project. A request for proposal was prepared and sent to eight law firms in order to establish a roster of law firms to be used in the custody project. The four law firms selected were Kirkpatrick & Lockhart; Mayer, Brown & Platt; Debevoise & Plimpton; and Paul, Hastings, Janofsky & Walker. The actual implementation process of the new custodial arrangements formally began in early 1993, by identifying specific areas needed in the process. These included the upgrading of the technological capabilities of the Investment Management Service, the introduction of a master record-keeper to provide parallel accounting and reporting systems and finally the establishment of regional custodians.

20. While there has been considerable delay in implementing the new custody arrangements, the Investment Management Service was able to explore better alternatives in an environment of increased competition, declining fees and more advanced technology and efficiency. It also provided the Investment Management Service enough time to acquire some expertise to prepare for new responsibilities. The Fund will benefit from the new custody arrangements through improved internal control as well as reduced counterparty risk, legal risk and operational risk. As the Fund continues to grow, a structure will be in place that will ensure efficient and safe investment management and operations activities.

21. In addition, the Fund will experience a considerable reduction in costs. Under the old arrangement, custody fees for 1993 were in excess of $5.8 million dollars. A review of the costs involved for each component of the new custody arrangements indicates that the total estimated cost for the first year will be

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about $2.8 million, including all custodian fees, the master record-keeper fee and the initial cost of the installation and licensing of a portfolio management system. For the subsequent two years the total annual cost is estimated to be $2.5 million per year, reflecting the reduction in the portfolio management system-related fees. Consequently, the new custody arrangements are anticipated to result in savings of about $3 million per annum. However, it should be mentioned that the estimated costs are determined by changing parameters (the market value of the Fund and the volume of transactions). Therefore, absolute dollar amounts will definitely change over the years. The contract negotiations with custodians have been completed for all assets except those in Japan.

VII. CONCLUSION

22. Considering the world-wide slowdown in economic growth, the volatility of the financial markets and fluctuations of exchange rates in the last two years, the investment returns of 11.6 per cent for the year ended 31 March 1993 and 9.7 per cent for the year ended 31 March 1994, when measured in United States dollars, were satisfactory. The defensive strategy of taking profits where appropriate and increasing investments in those markets and instruments that performed better contributed to the satisfactory performance of the Fund.

23. The Secretary-General considers the policy of diversification and careful selection of investment instruments, including consistent investigation of opportunities in developing countries, to be the best way to achieve the goal of preserving the principal and enhancing the investment return of the Fund over the medium and long terms. He will continue to discharge his fiduciary responsibilities through investment decisions that adhere to the principles of sound investment management and meet the requirements of safety, profitability, liquidity and convertibility, which have been endorsed by the General Assembly. 3/

Notes

1/ See General Assembly resolution 36/119 of 10 December 1981 and earlier resolutions cited therein.

2/ A/48/517.

3/ A/C.5/32/25.

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Annex

TABLE 1

Total Fund: components of portfolio (book value and market value) as at 31 March 1994

(In millions of dollars and percentages)

	Book value		Market value	
	($)	(%)	($)	(%)
Equities				
United States	2 026	18	2 503	20
Outside United States	3 459	31	4 347	35
Subtotal	5 485	49	6 850	55
Bonds				
United States	591	5	592	5
Outside United States	3 514	31	3 569	28
Subtotal	4 105	36	4 161	33
Real estate				
United States	715	6	612	5
Outside United States	193	2	188	1
Subtotal	909	8	800	6
Short-term investment and reserves				
United States	283	3	283	2
Outside United States	431	4	440	4
Subtotal	714	7	723	6
Total	11 213	100	12 534	100

TABLE 2

Total Fund: countries or areas of investment a/

Market value as at 31 March 1994

(In millions of United States dollars)

Countries or areas	Currencies other than United States dollars	United States dollars	Total	Percentage
Argentina	0.0	47.4	47.4	0.4
Australia	342.0	0.0	342.0	2.7
Austria	64.8	0.0	64.8	0.5
Belgium	80.4	0.0	80.4	0.6
Brazil	0.0	22.4	22.4	0.2
Canada	492.7	110.6	603.3	4.8
Chile	0.0	14.0	14.0	0.1
China	9.7	34.7	44.4	0.4
Colombia	0.0	10.5	10.5	0.1
Denmark	206.2	10.3	216.5	1.7
Emerging markets	0.0	25.7	25.7	0.2
Finland	125.6	11.1	136.7	1.1
France	673.7	8.9	682.6	5.4
Germany	632.6	40.3	672.9	5.4
Greece	9.6	0.0	9.6	0.1
Hong Kong	287.8	14.4	302.2	2.4
Hungary	12.4	8.0	20.4	0.2
India	15.5	22.2	37.7	0.3
Indonesia	0.0	13.7	13.7	0.1
International institutions	60.6	267.4	328.0	2.6
Ireland	28.6	20.8	49.4	0.4
Italy	0.0	16.4	16.4	0.1
Japan	1 225.8	11.0	1 236.8	9.9
Jordan	4.7	0.0	4.7	0.0
Kenya	2.7	0.0	2.7	0.0
Malaysia	123.3	22.2	145.5	1.2
Malta	0.0	5.0	0.0	0.0

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Countries or areas	Currencies other than United States dollars	United States dollars	Total	Percentage
Mauritius	0.0	3.6	3.6	0.0
Mexico	43.0	84.2	127.2	1.0
Netherlands	493.9	0.0	493.9	3.9
New Zealand	106.3	0.0	106.3	0.8
Norway	66.8	15.5	82.3	0.7
Pakistan	0.0	3.3	3.3	0.0
Philippines	22.3	34.1	56.4	0.4
Portugal	4.8	20.9	25.6	0.2
Regional institutions - Africa	168.1	126.2	294.4	2.3
Regional institutions - Europe	43.0	47.2	90.2	0.7
Regional institutions - Latin America	154.0	146.8	300.7	2.4
Regional institutions - South-East Asia	110.0	114.0	223.9	1.8
Republic of Korea	0.0	80.3	80.3	0.6
Russian Federation	15.5	0.0	15.5	0.1
Singapore	103.0	0.0	103.0	0.8
Sweden	234.2	0.0	234.2	1.9
Switzerland	252.1	0.0	252.1	2.0
Turkey	6.6	4.8	11.4	0.1
United Kingdom of Great Britain and Northern Ireland	882.0	20.4	902.4	7.2
Total outside United States of America	(56.7%) 7 104.1	(11.5%) 1 438.4	8 542.5	68.2
United States of America	(0.0%) 0.0	(31.8%) 3 991.8	3 991.8	31.8
Total Fund	(56.7%) 7 104.1	(43.3%) 5 430.2	12 534.3	100.0

a/ Country of investment is generally based on domicile of issuer. Convertible securities are classified according to currency into which they are convertible. Various investment trusts, which trade in currencies other than the currencies of the investments, are classified under the countries.

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TABLE 3

Total Fund: currencies other than United States dollars a/

Market value as at 31 March 1994

Currency	United States dollar equivalent (millions)	Percentage
Australian dollar	338.5	4.8
Austrian schilling	64.8	0.9
Belgian franc	80.4	1.1
Canadian dollar	552.0	7.8
Danish krone	206.2	2.9
Deutsche mark	685.3	9.6
European currency unit	89.7	1.3
Finnish markka	125.6	1.8
French franc	683.6	9.6
Greek drachma	9.6	0.1
Hong Kong dollar	287.8	4.1
Irish pound	28.6	0.4
Japanese yen	1 418.1	20.0
Jordanian dinar	4.7	0.1
Kenya shilling	2.7	0.0
Malaysian ringgit	110.0	1.5
Netherlands guilder	493.9	7.0
New Mexican peso	43.0	0.6
New Zealand dollar	109.7	1.5
Norwegian krone	66.8	0.9
Philippine peso	22.3	0.3
Pound sterling	891.4	12.5
Singapore dollar	116.2	1.6
Swedish krona	234.2	3.3
Swiss franc	465.0	6.6
Turkish lira	3.7	0.0
Total non-United States dollar	7 104.1	100.0

a/ Convertible securities are classified according to currency into which they are convertible.

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TABLE 4

Total Fund: components of portfolio

Market value, 1989-1994

(In millions of United States dollars)

	31 March 1989		31 March 1990		31 March 1991		31 March 1992		31 March 1993		31 March 1994	
Equities	3 219	42%	3 461	40%	3 621	39%	4 735	47%	6 094	53%	6 850	55%
United States	1 284	17%	1 465	17%	1 576	17%	2 115	21%	2 738	24%	2 503	20%
Outside United States	1 935	25%	1 996	23%	2 045	22%	2 620	26%	3 356	29%	4 347	35%
Bonds	2 555	34%	3 322	39%	3 680	39%	3 764	37%	4 231	37%	4 161	33%
United States	1 168	16%	1 475	17%	1 400	15%	1 445	14%	719	6%	592	5%
Outside United States	1 387	18%	1 847	22%	2 280	24%	2 319	23%	3 512	31%	3 569	28%
Real estate	913	12%	995	12%	934	10%	869	9%	791	7%	800	6%
United States	715	9%	751	9%	736	8%	678	7%	612	5%	612	5%
Outside United States	198	3%	244	3%	198	2%	191	2%	179	2%	188	1%
Short term	945	12%	780	9%	1 102	12%	743	7%	291	3%	723	6%
United States	666	9%	384	4%	504	5%	261	2%	214	2%	283	2%
Outside United States	279	3%	396	5%	599	7%	482	5%	77	1%	440	4%
Total	7 632	100%	8 558	100%	9 338	100%	10 111	100%	11 407	100%	12 534	100%
Year-to-year change	5.6%		12.1%		9.1%		8.3%		12.8%		9.9%	
