Meeting of the Standing Committee of the Council of Diplomatic Representatives – 23 March 2017

Title	Pension / Pension Reserve Fund update for the meeting of the Standing Committee of the Council of Diplomatic Representatives (23 March 2017) for information – *provisional edition, pending the completion of the French version*
Author	Permanent Bureau
Agenda item	No 3
Mandate(s)	Conclusion and Recommendation No 43 of the March 2017 meeting of the Council on General Affairs and Policy
Objective	To identify priorities for review relating to the Pension Reserve Fund and for consideration of the Council of Diplomatic Representatives
Action to be taken	For Approval ☐ For Decision ☐ For Information ☒
Annexes	N/A
Related documents	N/A

Introduction

The Council of Diplomatic Representatives (CDR) decided to establish a Pension Reserve Fund (PRF) on 6 July 2010. The Fund was originally composed of liquid assets kept on bank accounts, and of the office building of the Permanent Bureau at Scheveningseweg 6. Following the CDR's approval of the Strategic Asset Allocation (SAA) on 6 July 2012, some assets were invested in the financial markets (bonds and equities). The general premise was that the total return from the investments and the envisaged sale of the building, and projected income / expenses would allow the PRF to reach sustainability over the next decades.

Sale of Scheveningseweg 6 and new SAA

When the PRF was established, the building at Scheveningseweg 6 was valued at € 2.1 million and a mechanism for paying rent to the PRF for occupation of the building was also devised. The CDR however elected to pay a rental amount that was lower than recommended in Financial Year 2012-2013 (€ 100,000 vs. € 150,000). In Financial Year 2013-2014, the rental amount was adjusted to the recommended level of € 150,000, but the rent mechanism ceased when the Permanent Bureau relocated to Churchillplein in July 2014. Finally, the building at Scheveningseweg 6 sold in December 2016 for € 1.425 million, a significantly lower price than its value when the PRF was established. These developments have resulted in a lower return and income for the PRF, while expenses and projections have continued to increase.

Following the sale of Scheveningseweg 6, some of the proceeds were invested in the financial markets according to the terms of the SAA adopted in 2012 and which is still in force. The objective of the current investment strategy for the PRF is a net annual real return of 2.78% to obtain sustainability of the PRF in the long term. To achieve this objective, 81% of the available assets have been invested in Euro-area government bonds, and 19% of the available assets in Euro-area equity. The 2012 SAA was put in place until the end of 2016 or until the building was sold. Since both of these conditions have transpired, **an assessment of the sustainability of the PRF and new SAA is now necessary**.

As a result, a new actuarial study is currently being conducted by the International Service for Remunerations and Pensions (ISRP) in Paris to determine the appropriate targets for the new SAA, taking into account the impact of the decreased building value and the projected future income and expenses. The recommendations for a new SAA will be shared with Members as soon as they are available from the ISRP, in any case before the CDR in May 2017. The aim would be to have the new SAA approved by CDR in May 2017. Once the new SAA is in force, all investments of the PRF will be made in accordance with the new terms, including the investment of the balance of the proceeds of the sale of Scheveningseweg 6 that are currently being held in a cash account of the PRF. It is suggested that until the new SAA is adopted, the current SAA remain in force.

PRF assets at 31 December 2016 (information from ISRP)

At 31 December 2016, the value of the PRF financial assets amounted to € 6.45 million (as confirmed by the ISRP; at this point the proceeds from the sale of the building were not yet invested in the financial markets). The total assets consisted of portfolio investments valued at € 5.77 million and of € 0.68 million in treasury. The latter is composed of cash in transit (to be invested in the long-term portfolio) and of treasury allocated to complement the staff contributions that serve to pay monthly pension benefits and administration costs.

From 14 December 2012 (date at which the PRF started its long-term investments) to 31 December 2016, the investment portfolio increased from € 2.61 million to € 5.77 million. This increase of € 3.16 million in value is the result of € 2.17 million in net contributions from staff and Member States, of € 0.55 million in unrealised gains on investments, and of € 0.44 million in realised gains on investments.

Retirement or survivors pensions ('active' pension payments covered from Organisation's Budget)

Another important element that needs review is the division of current costs for payments of retirement and survivor's pensions between the PRF and the Organisation's Budget. In the past, in order to not increase pressure on the PRF further due to the significant unfunded liabilities, it was decided that costs for active pensioners would be covered by the Organisation's Budget (at the time budgeted at approx. 22% of salary costs). However, obligations for active pensions have since significantly increased and are generally higher than the amount budgeted now. As a result, the gap between budgeted pension amounts and actual payments made to pensioners has increased significantly over the past years. The Permanent Bureau currently has eight pensioners and this number will continue to grow in the future. It is, therefore, important to re-evaluate how best to cover current pension expenses: if the expenses for active pensions payments are to be fully covered by the Organisation's Budget, the budget would have to be increased; if, on the other hand, these expenses would have to be paid out of the PRF, even more pressure would be put on the PRF which is already significantly and increasingly underfunded. Either approach will no doubt raise difficult questions; the real challenge will probably be to find the most appropriate balance between both approaches.

Pension liability (information from PWC's Accountant's Report)

The pension liability at 30 June 2016, as confirmed by PricewaterhouseCoopers, was € 17,231,430 (compared to € 12,671,219 at 30 June 2015). As a result, an amount of approximately **€ 10.8 million remains unfunded** (liability of € 17.2 million minus pension assets of € 6.45 million).

The calculation of the pension liability was performed in accordance to methodology used in previous years, although the use of a different mortality table and a lowered interest rate have contributed to a higher liability. A further element to consider is the change in accounting standards and the impact this would have on the pension liability. A valuation of pension liability in accordance to International Public Sector Accounting Standards (IPSAS) will lead to a higher pension liability.

In sum, it is crucial to consider how to fund the pension liability in the future.

Next steps

While pension matters fall under the purview of the CDR and its Standing Committee, given the significant developments since matters were last reviewed by Member States, and the need to allocate proper resources from the Permanent Bureau to this important subject matter, the Secretary General asked the Council on General Affairs and Policy (CGAP), during its meeting in March 2017, to take this development into account when determining the work programme of the Organisation. In response, the CGAP "mandated the Permanent Bureau to work on the sustainability of the Pension Reserve Fund" (C&R No 43 of the 2017 CGAP meeting).

The priorities as identified by the Permanent Bureau are:

- **how to fund growing pension liability and to ensure long-term Fund sustainability;**
- **how to cover current expenses for retirement and survivor's pensions (balance between the Budget and the PRF).**

It is recalled that *all* Member States have to cover the costs relating to present and future pension liabilities, irrespective of when they became a Member of the Organisation and whether or not they had or still have to pay their full share of the accrued unfunded liabilities for past liabilities.