Council

PENSION BUDGET AND RESERVE FUND (PBRF): REPORT BY THE CHAIR OF THE MANAGEMENT BOARD
1. In accordance with the Pension Budget and Reserve Fund (PBRF) Statute [C(2005)49, Article 5.2], the Management Board of the PBRF is required to report to Council at least twice annually. This second report, following the one made in April [C(2008)39], briefly summarises the work carried out so far in 2008, and presents the performance of the PBRF at the end of October.

Composition of the Board

2. The Management Board of the PBRF, which comprises six members, was chaired by Ambassador Kwon (Korea) (who left the Korean Delegation to the OECD at the end of his term in September). The three other members named by the Council from Member countries were Ambassador Erozan1 (Turkey), Vice-Chair, Ambassador Marland2 (France) and Mr Kekel3 (Netherlands). Mr Juan Yermo (Directorate for Financial and Enterprise Affairs) was named by the Council on the proposal of the Secretary General, and Mr Ivan Divoy was named on the proposal of the Staff Association.4

3. The Secretariat of the Board is carried out by the Joint Pensions Administrative Section (JPAS) mandated by the Secretary-General, following a recommendation from the Board.

Activities of the Management Board during 2008

4. During 2008, the Management Board held four meetings - in February, June, July and November. The major part of the Board activities was devoted to the implementation of the new PBRF Investment Guidelines, approved by the Budget Committee on 6 November 2007 [BC/PBRF(2007)3/REV], more precisely to the selection of asset managers for the new strategic asset allocation, but also to consideration about the most appropriate market timing strategy.

During the meetings, the Board received information on:

- Pension Reserve Funds in International Organisations
- The evolution of PBRF’s liabilities vs. assets
- Status report on the implementation of the new strategy,

and discussed and approved the following:

- New Asset Managers (see paragraphs 18-20)
- Selection of consultant to provide a consultation on the best moment and the most appropriate strategy to enter the real estate, emerging equity and hedge funds markets.
- Timing strategy
- Implementation of the new investment strategy in view of the current financial environment.

5. The Secretariat informed the Management Board on procedures put in place to closely monitor the financial markets under the current turbulent period and the risk exposure of the funds where the assets of the PBRF are invested.

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1 Since September 2007.
2 Since January 2008.
3 Since October 2006.
4 Both since December 2005.
Composition of the PBRF as of 31 October 2008

6. At the end of October 2008, the PBRF amounted to a total of 180 million euro, of which 13 million euro were held in cash and in cash equivalents in order to pay pension benefits and administrative expenses. In accordance with its investment strategy, the long-term part of the Fund was invested at about 40% in an indexed fund of euro area government bonds, and at about 60% in an indexed fund of euro area equities. Though, as of 31 October, the weightings of the respective asset classes were 46% equity and 54% fixed income. The cash was placed in the custodian bank account, remunerated at the Euro Overnight Index Average rate (EONIA) and in term-deposits with various banks, remunerated at market deposit rates.

7. By the end of October, most of the Member countries had paid their contributions for 2008, although the June deadline of payment was not observed by some countries.

Performance during the period January to October 2008

8. Compared to the 4% target long-term real rate of return, the Fund underperformed significantly in 2008. This is mainly explained by general market conditions, reflecting the severe ongoing and escalating credit crisis. The negative result in 2008 so far stems from a big drop in equity markets. The benchmark has been defined as 60% FTSE Euro 100 and 40% Citigroup Euro Government Bond Index.

9. The table below presents the evolution in monthly performance (nominal) of the long-term assets of the PBRF and its benchmark since the beginning of the year 2008 (in percent):

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<tbody>
<tr>
<td>PBRF</td>
<td>-7.01</td>
<td>-0.46</td>
<td>-1.83</td>
<td>3.46</td>
<td>0.13</td>
<td>-7.56</td>
<td>-0.04</td>
<td>1.17</td>
<td>-6.27</td>
<td>-8.27</td>
<td>-24.34</td>
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<tr>
<td>Benchmark</td>
<td>-6.90</td>
<td>-0.63</td>
<td>-1.87</td>
<td>3.52</td>
<td>0.21</td>
<td>-7.48</td>
<td>0.39</td>
<td>0.84</td>
<td>-6.10</td>
<td>-9.08</td>
<td>-24.69</td>
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<td>Difference</td>
<td>-0.11</td>
<td>0.17</td>
<td>0.04</td>
<td>-0.06</td>
<td>-0.08</td>
<td>-0.08</td>
<td>-0.43</td>
<td>0.33</td>
<td>-0.17</td>
<td>0.81</td>
<td>0.35</td>
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</table>

Source: EURO-VL.

10. The performance per asset classes was as follows (in percent):

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<tr>
<td>PBRF Equity</td>
<td>-40.76</td>
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<tr>
<td>FTSE Euro 100</td>
<td>-40.35</td>
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<tr>
<td>MSCI EMU</td>
<td>-41.07</td>
</tr>
<tr>
<td>PBRF Bond</td>
<td>3.54</td>
</tr>
<tr>
<td>CGEGBI Index</td>
<td>3.90</td>
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</tbody>
</table>

Source: EURO-VL.

11. It should be noted, however, that the PBRF’s investment strategy is based on long-term objectives. The strategy places the emphasis of investment over the long term because the corresponding pension liabilities have a long term horizon. A suitable long-term investment strategy is chosen bearing in mind that it should also withstand years of possible negative returns.

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5 The initial objective of the PRF was 6% real. This objective was decreased to 4% in 2005 [C(2005)49]. Following an Asset Liability Management (ALM) study, the new investment strategy (approved by the Budget Committee on 6 November 2007 [BC/PBRF(2007)3/REV]), not yet implemented, sets the objective at 4.6%.
The current financial environment

12. The ongoing turbulence in global financial markets is a major concern. The turmoil on asset markets has provoked violent price swings and prompted an upturn in volatility. In view of the current financial environment, the Management Board closely followed the PBRF situation and, at its last meeting in November, took the following conservative measures.

13. It was agreed to allow holdings of cash up to 10% of the portfolio (excluding cash earmarked for paying benefits). The cash allocation will be allowed to exceed 10% pending the implementation of the new investment strategy. Cash will be invested on a short term basis (up to 6 months) in term-deposits with various banks.

14. Until the new strategy is implemented, no rebalancing will take place. This implies that deviations from the neutral 60% equity and 40% fixed income strategy might exceed the limits of +/- 3%-age points.

15. The Secretariat will prepare a document on the methodology of rebalancing and some benchmarking, to be presented to the Board in the March 2009 meeting. In the meantime, rebalancing will only take place with new net contributions after the implementation of the new investment strategy.

16. Should any serious event intervene before the next meeting which the JPAS or one of the Management Board members feels might justify a review of the above measures, this will be communicated to the members of the Management Board immediately.

Implementation of the investments

17. The implementation of the new investment strategy of the PBRF involved the selection of investment vehicles and asset managers and the negotiation of contracts with asset managers. The timing strategy and the accounting issues were also examined. The actual investing should start at the beginning of 2009, as the last administrative procedures (reviewing of the contracts/rebate letters by the OECD Legal services and approval of OECD’s amendments by asset managers) are expected to be completed by the end of 2008.

18. In its second meeting of 2008, the Management Board was invited to select a fund of hedge funds investing in diversified multi-strategy hedge funds. The selection of the diversified hedge fund was carried out with the assistance of a consulting firm that provided a shortlist of the three mutual funds investing in hedge funds they deemed the most satisfactory. All funds are compliant with the PBRF’s Investment Guidelines. At the time, the Management Board decided to postpone its decision, expressing a wish to seek further expert opinion.

19. In the third meeting, the Management Board selected the mutual fund investing in Global Emerging Market equities (of JPMorgan Asset Management) and decided to invest the Liability Hedging Bonds allocation in a medium-duration fund (of ING IM Europe) and a long-duration fund (of Barclays Global Investors). All funds selected are compliant with the PBRF’s Investment Guidelines.

20. At its last meeting in November, the decision to invest in a fund of hedge funds was again postponed, pending new developments in these products and their underlying regulations. Moreover, the investment of the real estate allocation was also postponed and will be reviewed at the Management Board meeting in March.

21. As for the timing of the implementation, the European and the Global equity funds, as well as the Liability Hedging bonds funds, are to be invested in as soon as the administrative and legal procedures are
completed. For the emerging markets, real estate and fund of hedge funds, the Management Board decided at the July 2008 meeting to spread out the investments by thirds over a period of two years. In conformity with this timing strategy, only the first third of the emerging market equity allocation will be invested simultaneously with the European and Global equity funds and the liability hedging bond funds. Meanwhile, the non-invested portions are to be kept in cash, with surpluses (the part above the 10% threshold) being spread out over the normally invested asset classes of the new strategy.

22. With regard to the weightings of the asset allocation, it should be noted that as a consequence of the spreading out of the non-invested parts of the allocation over the new asset classes due to the timing strategy, the weightings of the new asset classes will be biased towards the upper limits of their tolerance band, compared to the neutral weightings as set out in the PBRF Investment Guidelines.

23. As for the evaluation of the performance, the spreading procedure implies that the performance of the allocation spread out will not be included in the performance of the asset class it is reserved for. Further, the benchmark to which the PBRF asset allocation will be compared will remain the one referred to in the PBRF Investment Guidelines. This means that some discrepancies may be observed.

Socially Responsible Investments (SRI)

24. At the request of the Management Board, and following the interest shown by the Budget Committee, the Secretariat started to investigate Socially Responsible Investments (SRI). A first report was presented to the PBRF Management Board at its meeting of 18 November 2008.

Proposed Action

25. In the light of the preceding, the Council is invited to adopt the following draft conclusion: