

United Nations



Nations Unies

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2 March 2006

TO: Mr. Christopher Burnham, Under-Secretary-General
A: Representative of the Secretary-General
for the Investments of the UNJSPF

FROM: Patricia Azarias, Director
DE: Internal Audit Division I, OIOS

A handwritten signature in blue ink that reads "P. Azarias".

SUBJECT: **OIOS Audit of Brokerage and Investment Advisory Services (AS2005/801/02)**

1. I am pleased to present the final report on the audit of the above subject, which was conducted at United Nations Headquarters in November and December 2005. Management's comments, as transmitted in your memorandum dated 21 February 2006, have been incorporated as appropriate in this report and are marked in italics.

2. Based on the response, we consider all of the recommendations as being in progress of implementation and will remain open pending receipt of additional documentation and information once action has been completed. Please note that OIOS will report on the progress made to implement its recommendations in its annual report to the General Assembly and semi-annual report to the Secretary-General.

3. OIOS is assessing the overall quality of the audit process. I therefore kindly request that you consult with your managers who dealt directly with auditors, and complete the attached client survey form.

4. I would like to take this opportunity to thank the management and staff of the IMS for the assistance and cooperation provided to the OIOS team in connection with this assignment.

Copy to:
Ms. Okuda
Mr. Cochemé
Board of Auditors
Programme Manager, OIOS

UNITED NATIONS



OIOS Client Satisfaction Survey

Audit of: Brokerage and Investment Advisory Services

(AS2005/801/02)

	1	2	3	4	5
By checking the appropriate box, please rate:	Very Poor	Poor	Satisfactory	Good	Excellent
1. The extent to which the audit addressed your concerns as a manager.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. The audit staff's understanding of your operations and objectives.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Professionalism of the audit staff (demeanour, communication and responsiveness).	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. The quality of the Audit Report in terms of:					
• Accuracy and validity of findings and conclusions;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Clarity and conciseness;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Balance and objectivity;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Timeliness.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. The extent to which the audit recommendations were appropriate and helpful.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. The extent to which the auditors considered your comments.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Your overall satisfaction with the conduct of the audit and its results.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please add any further comments you may have on the audit process to let us know what we are doing well and what can be improved.

Name: _____ Title: _____ Date: _____

*Thank you for taking the time to fill out this survey. Please send the completed survey as soon as possible to:
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United Nations
OFFICE OF INTERNAL OVERSIGHT SERVICES
Internal Audit Division I



Audit subject: Audit of Brokerage and Investment Advisory Services
Audit No.: AS2005/801/2
Report date: 2 March 2006
Audit team: William Petersen, Auditor-in-Charge
Victor Felszegi, Consultant
Teng Jiang, Intern

Audit of Brokerage and Investment Advisory Services (AS2005/801/2)
Executive Summary

The Investment Management Service (IMS) of the United Nations Joint Staff Pension Fund (UNJSPF or the Fund) is responsible for managing the investment portfolio of the Fund which had a market value of \$30.84 billion as of 30 September 2005. The portfolio is managed by the Director of IMS with six investment officers who are assisted by four non-discretionary advisors (the fourth advisor, for real estate, was already reviewed by OIOS in its 2005 audit of real estate investments) and six discretionary advisors. In view of the significance of the brokerage commissions incurred by the Fund and the fees paid to the advisors, in November and December 2005 the Office of Internal Oversight Services (OIOS) conducted an audit of the Fund's use of the advisory and brokerage services.

Significant findings

In general, the audit found that the services provided by the advisors and brokers were adequate. The non-discretionary and discretionary advisors provided good value for these services based on the level and quality of the services provided and the ratio of fees paid to each advisor to the total portfolio value under management. However, the audit found that relatively high brokerage fees were being paid by the Fund in certain countries.

The advisors provide the Fund with investment advice on the types of securities, economic sectors and degrees of risk, as well as the tax-exempt status of for the Fund's assets. However, it was not clear to OIOS how the risk analysis was measured or how it was used by the advisors to manage the risks to the Fund. A new evaluation process is being implemented for the non-discretionary advisors for equities, real estate, and fixed income. The first evaluation results are to be assessed for the 6 months ended 31 March 2006 .

The procurement rules and procedures for the selection of discretionary and non-discretionary advisors were properly followed. In the case of the small capitalization accounts, the Headquarter Committee on Contracts (HCC) established a five-year ceiling of \$21.5 million on the total management fees. However, since the amounts under management by the small capitalization advisors has grown significantly, there is a good chance that the five-year ceiling will be surpassed. IMS therefore needs to track the cumulative amounts paid to the advisors in comparison to ceiling amount approved by the HCC.

Recommendations

OIOS made a total of eight recommendations to the Investment Management Service aimed at, *inter-alia*: reviewing the funds budgeted for non-discretionary advisors, explaining and clarifying the risk analysis process, considering the award the contracts to other non-discretionary advisors, monitoring the performance of small capitalization advisors and tracking cumulative fees, and negotiating lower brokerage commission rates.

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I. INTRODUCTION

1. The investment of the assets of the United Nations Joint Staff Pension fund (UNJSPF) is a fiduciary responsibility of the Secretary-General of the United Nations, which is delegated to the Representative of the Secretary-General (RSG) for the investments of the Fund. The RSG, also the Under-Secretary-General for Management, is assisted by the staff of the Investment Management Service (IMS), which manages the fund's portfolio.

2. The investment policy of the Fund is conservative and its overall objective is to achieve a balanced portfolio through diversification, once certain safety, profitability, liquidity, and convertibility criteria have been satisfied. As of 30 September 2005, the Fund had a market value of \$30,842 million and a return of 15.8 per cent over the last year, investing in a global portfolio of equities (61%), fixed-income (27.9%), real estate (4.8%) and short-term instruments (6.3%).

3. The portfolio is managed by the Director of IMS with six investment officers who are assisted by four non-discretionary advisors (the fourth advisor, for real estate, was already reviewed by OIOS in its 2005 audit of real estate investments) and six discretionary advisors. The non-discretionary advisors provide advice on more than 95 per cent of the Fund's investment assets. The Fund also uses six discretionary advisors to manage the small capitalization accounts.

4. Although non-discretionary advisors neither manage funds nor are accountable for performance, they provide valuable advice for decision-making. Each recommendation approved by IMS and the RSG to invest in individual securities has to include the opinion of one advisor. According to the IMS director, this service by the non-discretionary advisors, which has existed for many years, provides a "check and balance" for the investment process.

5. The contracts between IMS and each of the non-discretionary advisors specify that these advisors will provide:

- (i) written quarterly reports on global investment and asset allocation;
- (ii) documentation of investment recommendations on purchase/sales and the Approved List;
- (iii) on-going interaction and emergency ad-hoc meetings;
- (iv) notification of required major changes in investment action; and
- (v) IMS with access to the advisors' research and databases.

Nevertheless, it is impossible to determine the individual costs of each service provided within the agreements because the cost components are not broken down.

6. Six discretionary advisors manage the fund's small capitalization accounts which as of 30 September 2005, represented approximately 7.5 percent of the Fund's equity

position. Of these six advisors, three manage accounts for the North American market, two for the European market, and one for the Japanese market.

7. Performance of the discretionary advisors is monitored through regular presentations by discretionary managers to IMS and quarterly performance reports which are presented to the Investments Committee via the Blue Book.

8. Additionally, “full service” brokers provide advice without additional direct cost to IMS beyond the commissions paid for transactions. IMS Investment Officers also perform their own research and analysis.

9. OIOS audited IMS’ investment management function (AS/2001/95/1) and investment performance measurement system (AS2003/72/1), in 2002 and 2003, respectively. Weaknesses were identified in IMS policies and procedures for the selection, retention and evaluation of advisors and brokers, as well as in the documentation and processes of transactions. Eleven recommendations were made directly related to IMS advisors: five have been closed, one was withdrawn, and the remaining five were outstanding at the time of this review.

10. The five outstanding recommendations relate to: a) hiring additional discretionary advisors; b) outsourcing the fixed income portfolio (Budgetary requests for both a. and b. were rejected by the UNJSPB Standing Committee in 2005); c) reviewing full-service brokers and non-discretionary advisors (according to IMS, evaluation of brokers has been established and evaluation manual for advisors is being discussed); d) monitoring and reviewing small capitalization managers (IMS is in the process of reformulating the methodology and documentation for evaluating both small capitalization managers and non-discretionary advisors); and e) reviewing the value added by non-discretionary advisors (referred to in the Deloitte & Touche report¹). The status of these recommendations was reviewed as part of the fourth annual UNJSPF meeting on the status of internal audit recommendations that was held on 13 January 2006.

11. Some of the recommendations of the comprehensive review of IMS investment operations, policies and practices, performed by Deloitte & Touche, were reviewed as part of this audit. Among them were the adoption of more appropriate benchmarks and targets for better performance analysis, and additional outsourcing of the Fund’s investments.

II. AUDIT OBJECTIVES

12. The objectives of this audit were to: 1) determine whether IMS policies and procedures to obtain the services provided by the non-discretionary and discretionary

¹ In July 2004, the United Nations engaged Deloitte & Touche, LLP to conduct an overall operational, organizational and investment process assessment of the IMS. This included, *inter alia*, the functions performed by both discretionary and non-discretionary advisors.

advisors as well as the brokers are adequate; 2) determine if these services are effective and provide value for the money; and 3) quantify and evaluate the services provided by the non-discretionary advisors. The audit also sought to determine whether UN procurement rules and procedures were followed.

III. AUDIT SCOPE AND METHODOLOGY

13. OIOS conducted this audit in accordance with the standards for the professional practice of internal auditing in United Nations organizations. OIOS worked closely with IMS in coordinating the audit activities. Contracts for each of the three non-discretionary advisors were reviewed and compared. Similarly, contracts for the six discretionary advisors were also reviewed and compared.

14. IMS officers and the director were interviewed to obtain a detailed description of the services offered by the advisors and brokers. The investment officers discussed their geographical regions and described their experiences with the relevant advisors and brokers. In some cases, to clarify the impact the advisors and brokers had on the Fund, they also provided supporting material such as sale and buy orders, and brokerage commission statistics.

15. In addition, the Investments Committee's Blue Books containing sample quarterly presentations by the non-discretionary and discretionary advisors in 2005 were examined. Three sample quarterly presentations made by non-discretionary advisors were examined along with six sample quarterly presentations made by discretionary advisors. The evaluation process for the non-discretionary advisors was also examined.

16. The rates of return achieved by the investment officers for their respective regions with the advice of non-discretionary advisors and by the discretionary advisors were compared to relevant benchmarks. Brokerage commissions were also examined worldwide. Costs were analyzed both in terms of dollar cost per share, typical in North America, as well as represented as basis points to the total transaction cost in the rest of the world. Finally the procurement process and results for both non-discretionary and discretionary advisors were analyzed.

IV. OVERALL ASSESMENT

17. In general, the audit determined that the services provided by the advisors and brokers were adequate. The non-discretionary and discretionary advisors provided good value for these services based on the level and quality of the services provided and the ratio of costs paid to each advisor to the total portfolio value under management. The procurement rules and procedures for the contracting of the discretionary and non-discretionary advisors were properly followed. However, the audit did find that relatively high brokerage fees were being paid by the Fund in certain countries.

V. FINDINGS AND RECOMMENDATIONS

A. Non-Discretionary Advisors

18. The non-discretionary investment advisors currently contracted by the Fund are Fiduciary Trust International (FTI), BNP Paribas Asset Management, and Nikko Asset Management.

19. The non-discretionary advisor agreements provide for the payment of a single fixed annual fee per non-discretionary advisor which for 2006-2007 biennium was budgeted at a total of \$13 million. According to the Director, IMS, the budget request for 2006-2007 was set at this amount because IMS had requested additional funding for outsourcing investments in fixed income securities, real estate, and certain developed markets (North America, Europe, Japan), as recommended by the Deloitte & Touche study. However, this request was ultimately not approved.

20. The current contract for all non-discretionary advisors is approximately \$7.5 million annually or \$15 million for two years. Consequently, the biennium budget request was \$2 million lower than the current contracts would imply. (See A/60/183, Contractual Services, pages 70-71). This budget item should be carefully re-examined because, without outsourcing approval, the Fund may need more rather than less advice from the non-discretionary advisors.

21. FTI advises on the equities in North America and the emerging markets of Latin America, Middle East, and Africa as well as global fixed income investments. Both the total equities in this group and the global fixed income are each over \$10 billion for a total of over \$20 billion or more than two-thirds of the value of the Fund on which FTI advises.

22. BNP advises on European equities and the emerging market equities of Eastern Europe, Russia, Turkey, Greece, and Israel. This represents approximately \$5.8 billion or approximately 19 per cent of the Fund's investments. Nikko advises on Asian equities and emerging markets including India. This represents approximately \$5 billion or approximately 16 per cent of the investments of the Fund.

Selection and Procurement

23. According to the IMS investment officers, at least two criteria are used for selecting and maintaining non-discretionary advisors. First of all is the price. The second criterion for selecting the advisors is the quality of the services to be provided. The Procurement Division, according to the senior investment officer, North American equities, insists that IMS use the lowest cost advisor as long as it provides adequate service.

24. In 1996, the then Representative of the Secretary-General for the Investments of UNJSPF, acting in his capacity of Under-Secretary-General for Administration, established a Special Committee for Investment Advisory Services to review the future investment advisory arrangements, together with its terms of reference. After 2002, the subsequent RSG had decided to discontinue the Special Committee and IMS now utilizes the services of the UN Procurement Service and HCC to conduct all procurement actions.

25. In January 2001, the Procurement Division issued requests for proposals to 35 firms from 10 countries that had responded to the UN's expression of interest transmitted to 75 firms worldwide. By the designated closing date of 6 March 2001, fifteen firms submitted proposals. The proposed fees ranged from as little as \$300,000 by Daiwa Investments for Asian Equities to as high as \$17,300,000 by Capital Group Companies for North American Equities (See table if fees proposals). Fees proposed by FTI and BNP Paribas were negotiated and reduced by 8 and 12 per cent, respectively, and were awarded along with Nikko's bid.

26. It was surprising to note that in some cases the lowest bidder was not selected even though the institutions technical ratings were comparable. For example, the contract was awarded to FTI (843 technical score) for a total of \$1,980,000 fee for Global Fixed Income vs. the \$1,750,000 fee proposed by BNP Paribas (technical score 842) or the \$1,250,000 fee proposed by Julius Baer Holding (technical score 643). In the case of Asian Equities the contract was awarded to Nikko at a fee of \$1,490,000 (technical score 857) rather than to Daiwa who proposed a fee of \$300,000 (technical score 769).

27. The IMS officers subsequently informed OIOS that a two tier approval was used in the procurement of these services. First, they conducted a technical review, for which it was agreed with PD that a minimum score of 800 was required. The second step in the process was the selection of the lowest acceptable bidder based on the proposed fee.

Services

28. In addition to the advisor's responsibilities and activities, under the contract's section on "Investments and Objectives", the advisors are to provide the Fund with investment advice on the types of securities, economic sectors and degrees of risk, as well as the tax-exempt status of for the Fund's assets. FTI has, for example, provided Barra risk analysis in its 21 November 2005 presentation to the Investments Committee, one of the investment officers for Europe receives "supplemental" Barra risk analysis from BNP, and the Asia/Pacific investment officer has received similar risk analysis from Nikko. It was not clear to OIOS what exactly the Barra risk analysis measured or how it was used by the advisors to manage the risks to the Fund.

29. The tax-exempt status of the recommendations by the advisors has not been an issue according to the senior investment officer, North American equities. The Fund assumes that the advisor recommends only tax-exempt investments. Nevertheless, recent UNJSPF investments in Jordanian companies were determined to have no tax exemption entitlement from distribution taxes imposed on the companies under Jordanian law.

30. There is a weekly dialogue between IMS investment officers and the advisors. Issues are resolved in the same day or the next day. However, one advisor (BNP) sometimes takes up to one week to respond, according to the investment officer. According to one of the investment officers for European equities and the investment officer, Asia/Pacific equities, BNP and Nikko, respectively, provided good to high quality service. The other investment officer for European equities found the service of BNP to be only adequate. The IMS staff is small and relies heavily on the non-discretionary advisors' advice.

Fees

31. The total annual fees are approximately \$7.3 million for all three non-discretionary advisors. This represents less than 2.5 basis points per year for the funds under management. FTI receives the largest fee, \$4,278,000 because it advises on more than \$10 billion of the equities portfolio in North America, Latin America, Middle East, and Africa; and on the \$10 billion global fixed income portfolio. For equities, FTI receives \$2,298,000; for fixed income, \$1,980,000.

32. The remaining two portfolios are approximately identical in size and the corresponding advisors receive similar fees. BNP receives \$1,549,800 or 3 basis points per annum for a total portfolio of approximately \$5 billion. Similarly, Nikko receives \$1,490,100 or 3 basis points per annum for a total portfolio of approximately \$5 billion.

Evaluation

33. A new evaluation process is being implemented for the non-discretionary advisors for equities, real estate, and fixed income. The first evaluation results are to be assessed for the 6 months ended 31 March 06. For the equities there is a system of points from 2 to 25 up to a maximum of 110 based on the performance of the securities, portfolio structure advice, number of recommendations, quality of return and risk analysis, clarity of presentations, etc.

34. The evaluation of the fixed income advisor is similar. A system of points has been developed and covers such areas as the number and performance of recommendations, quality and depth of performance analysis, and clarity of presentation. Furthermore, as in the case with equities, compliance and organizational issues are covered by the evaluations.

Tracking advisory requests

35. Non-discretionary advisors' recommendations concerning equity transactions initiated by the Fund or by the advisors are documented and filed by the individual IMS investment officers. According to equity the investment officers, it is the IMS officers rather than the advisors who initiate most of these requests.

36. This new process to document all recommendations by the advisors whether transacted or not is experimental and is currently under review. The recommendation form specifies whether the IMS officer or the advisor initiated the recommendation. Furthermore, it tracks the stock price for up to one year or until the transaction is terminated. Additionally, assets and liabilities of the company are listed as well as a history of earnings and price per share. Finally, the advisor specifies whether or not it recommends purchasing or selling the security for the Fund, and provides a summary of the reasons therefore.

37. Although in the past, unexecuted recommendations were not recorded, they are currently being recorded commencing from 1 October 2005. Maintaining documentation of unexecuted recommendations was not required by the IMS Organization, Policies, and Procedures Manual in the past. Nevertheless, a new form has been prepared that will record all recommendations – both executed and unexecuted.

Fixed Income

38. In general, the fixed income portfolio has outperformed relevant benchmarks for the last several years. The fixed income market has become more complex resulting in increased investment opportunities. Unlike equities, recommendations for the purchase of fixed income securities originate almost completely from the non-discretionary advisor, FTI. FTI provides almost all of the services for IMS. In general, the investment officer provides the advisor with the amounts to be transacted followed by the advisor's recommendation of security type and maturity (all bonds required to be rated single A and above), and arranges the transaction with an approved broker. IMS, however, has complete veto power like with all the other recommendations by the non-discretionary advisors for equities. No brokerage commission is charged for fixed income securities since the fees are built into the bid-asked price spread of the transacted security.

Recommendations 1 to 4

OIOS recommends that the Investment Management Service:

- (i) Consider the effects of outsourcing additional investment functions, if approved by the Board, on the level and scope of services that will continue to be required from the non-discretionary advisors. (AS2005/801/02/01);
- (ii) Request that the non-discretionary advisors explain and clarify their risk analysis to the IMS investment officers and the Investments Committee. (AS2005/801/02/02);
- (iii) Clarify with each advisor that all recommended investments should be tax-exempt. (AS2005/801/02/03)

(iv) Consider awarding business to other non-discretionary advisors when the contracts are renewed after December 31, 2006. Although IMS has considered this in the past, new candidates might offer lower annual fees and/or better services to the Fund. IMS should especially examine FTI because it advises on approximately two-thirds of the value of the Fund's total investments. (AS2005/801/02/04)

39. *In a memorandum dated 21 February 2006, The Representative of the Secretary-General for the investments of the UNJSPF provided management's comments on the recommendations in this report. In respect of recommendation 1, management stated that IMS is currently pursuing a Request for Proposal to explore, among other things, further outsourcing opportunities of all kinds and at all levels of IMS. A report resulting from this project will be submitted to the Pension Board in July 2006. Concerning recommendation 2, management responded that the non-discretionary advisors will include an explanation of their risk analysis in the presentations distributed to IMS investment officers and members of the Investments Committee. Going forward, the risk analysis function will be assumed by the new Risk Officer post. OIOS considers the implementation of recommendations 1 and 2 as being in progress.*

40. *Management agreed with recommendation 3 and stated that IMS would inform its investment advisers, including its custodians and their sub custodians, of the tax status of the Fund, by country, under the UN Charter and the 1946 Convention of Immunities and Privileges of the United Nations. In addition, IMS will bring to their attention, which Member States have affirmed in writing to the Fund, the tax-exempt status of the Fund. Concerning recommendation 4, management commented that evaluation forms have been developed for each asset class and the evaluation process was made effective as of 1 October 2005 for all of the advisors. After March 2006 an initial assessment will be made for all of the advisors based on those evaluations. If any of them is showing significant negative contribution, IMS will go and look for potential new advisor. If there is no need revealed IMS will look for their renewal after October 2006. Implementation of recommendations 3 and 4 is in progress.*

B. Discretionary Advisors

41. Management of approximately 7.5 per cent of the Fund's equities is outsourced to six small capitalization accounts: 3 in North America, 2 in Europe, 1 in Japan.

Selection and Procurement

42. The selection of the discretionary advisors was based on performance in conjunction with on site visits and personnel interviews. On 1 June 2001, the Procurement Division issued three requests for proposals. A total of 22 firms were identified through an expression of interest exercise conducted by Procurement Department, which resulted in 10 firms being invited for the North American solicitation, 9 firms for the European solicitation and three for the Japan portfolio. On the established

closing date of 28 June 2001, proposals were received from all 22 firms, for the respective solicitations that they were invited.

43. The Headquarters Committee on Contracts (HCC) recommended on 20 November 2001 that Dimensional Fund Advisors, Credit Suisse, and Jennison Associates (or William Blair or Putnam Investors) be awarded the North American contract, that Baille Gifford and Darier Hentsch, Cie be awarded the European contract, and that SG Pacific be awarded the Japanese contract. Contracts were subsequently awarded on 1 January 2002 to all of these fund advisors (except for William Blair and Putnam Investors).

Services

44. Each of the six small capitalization discretionary advisors provides performance presentations to the IMS twice a year and at least once a year to the Investments Committee if requested. According to one investment officer, the service provided by these advisors is extremely valuable because it takes approximately 30 people to analyze, visit and research these investment portfolios.

Fees

45. The management fees for the small capitalization accounts are expressed in basis points. The budgeted amount for fees has been approved by the Standing Committee. However, there is a five-year ceiling on the total fees of \$21,150,000 which was established by the HCC on 20 November 2001 (see report annex). The current portfolio balance under management by the small capitalization advisors has significantly exceeded the initial allocation. Consequently, there is a good chance that the five-year award amount will be surpassed. Furthermore, there is no indication that IMS is tracking the total amounts paid to the advisors in comparison to ceiling amount approved by the HCC.

46. The annual fees for the six discretionary accounts range from 25 to 60 basis points of the outstanding assets under management. In North America, the annual fees range from a low of 43 basis points for Credit Suisse Asset Management to a high of 60 basis points for Jennison Associates. Dimensional Fund Advisors is in between with 51 basis points annually. In Europe, Lombard Odier Darier Hentsch's annual fee is 25 basis points while Baillie Gifford's is almost double at 47.5 basis points annually. In Japan, Societe Generale Asset Management (Japan) charges 27 basis points annually.

Fund performance

47. For the recent year to date performance as of 30 September 2005 presented to the Investments Committee, each small capitalization account performed near or better than the corresponding benchmark, except for Credit Suisse Asset Management. Although the relevant benchmark produced a return of 2.5 per cent for this period, Credit Suisse achieved only a 0.67 per cent return. It should be noted that performance can vary

greatly in the short term, and that the IMS monitors the funds' performance on a monthly, quarterly and bi-annual basis.

48. All 2004 small capitalization account returns presented to the Investments Committee in 2005 were net of the investment fees listed above. Prior to those presentations, all returns were on a gross basis before deduction of management fees.

Contract Termination

49. The termination date for all of the contracts for the discretionary advisors is five years after the date the contracts were executed, 1 January 2002. There are also escape clauses that permit the Fund to terminate the services.

Recommendations 5 to 7

The Investment Management Service should:

(i) Continue to monitor the performance of the small capitalization discretionary advisors and consider replacing one or more of the advisors based on annual evaluation results. The management fees could possibly be reduced and/or better returns might be achieved. (AS2005/801/02/05)

(ii) Alert the discretionary advisors about the requirement for re-bidding the contracts well before the contract termination date. This will provide an incentive for the advisor to perform well. (AS2005/801/02/06)

(iv) Track the cumulative fees paid to each small capitalization fund advisor and should they exceed the five-year ceiling amount established by the Headquarters on Contracts, IMS should request, through the Procurement Service, for the HCC to approve an increase in the ceiling amount. (AS2005/801/02/07)

50. *IMS management accepted recommendation 5, and stated that it would continue to monitor closely the small capitalization discretionary advisors. Dependent on the qualitative as well as quantitative performance evaluation of those managers, IMS will make recommendations to RSG as to whether an RFP should start immediately to replace the managers. IMS plans to make the recommendation by the next Investments Committee meeting in May 2006. Investment results, organizational depth and capabilities, and fees will be the main considerations for any changes in discretionary advisors. IMS agreed with recommendation 6 and indicated that discretionary advisors will be informed of contract re-bidding procedures in advance of the contract renewal dates. Concerning recommendation 7, IMS management stated that if the ceiling is exceeded IMS will follow up on this recommendation. However, IMS pointed out that if the small capitalization fund advisors outperform their benchmarks consistently over a long period therefore positively contributing to the Fund, this should carry more weight*

on the decision than a mere static procurement rule. OIOS considers the implementation of recommendations 5 through 7 to be in progress.

C. Brokers

Selection

51. Only brokers on the Approved List may be used for transactions. The Fund must observe a broker for 6 months before it will place it on the Approved List. The criteria used for selecting brokers are market coverage, research, trade execution, ranking and financial strength. In general, the IMS investment officers try to divide business evenly among brokers as well as to award business to those brokers that provide the officers with good investment ideas.

Services

52. In addition to executing transactions, the broker provides research as well as access to analytical tools. Since the IMS staff is small, it relies heavily on these resources.

Brokerage Commissions

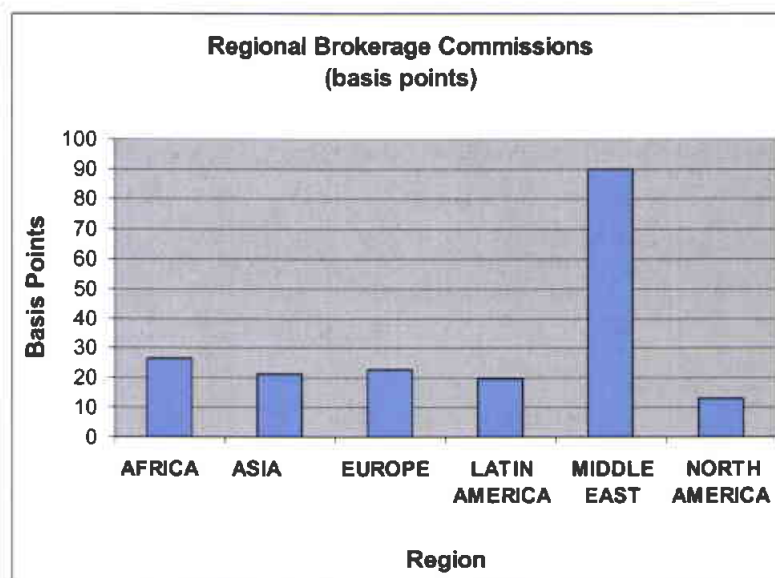
53. The total commissions paid for global equity transactions were approximately \$12 million for the period from 1 January to 8 December 2005, or approximately 11 months. The commissions represented total transactions of approximately 382 million securities having a principal value of \$6.2 billion. (see Table I “Broker Commissions Detailed”)

54. The highest commission costs were in Europe, where the Fund incurred a total commission cost of approximately \$6 million for the period which accounted for 52 per cent of the total commissions. This represented securities having a principal value of approximately \$2.7 billion. North America, with nearly the same transaction value (\$2.3 billion) represented less than half the commissions paid for European securities (\$3 million), or in this case 25 per cent of total commissions paid. The lowest commissions, \$65,288, were in the Middle East, representing less than 1% of total commissions and represented approximately \$7.3 million of principal value (see “Broker Commissions Detailed” for Europe, North America, and the Middle East).

55. Brokers in North America, in general, use cost per share for charging commission fees, while the rest of the world uses basis point in pricing. Each basis point is 0.01 percent of the face value of the principal. Cost per share can also be represented in basis points. The average cost per share paid by the fund for all securities transactions was approximately 3 cents, or the equivalent of approximately 19 basis points (see Table I).

57. In commenting on a draft of this report, IMS stated that it is important to note that U.S. commission rates, though higher on a per share basis, are by far the lowest of any region as measured by percentage of principal, the method used by most of the world's markets and brokers, as documented by OIOS in their report. U.S. markets, the deepest and most efficient in the world, should indeed have the lowest commission rates and by the dominant metric, the Fund is paying commissions in the U.S. far lower than anywhere else, as should be the case. Fiduciary Trust, our North American equity advisor, confirms that they pay \$0.05 per share on large capitalization equity trades in the U.S. markets.

58. Regarding commissions measured in basis points, the highest commission rate, 90 bp, also occurred in the Middle East because that market is less liquid than other regions. Conversely, the North American market enjoys greater liquidity and the average face value per share is larger in North America (where commission fees are charged in cents/share), which resulted in the lowest basis points, in this case, approximately 13 bp. (see chart below)



Industry Practices

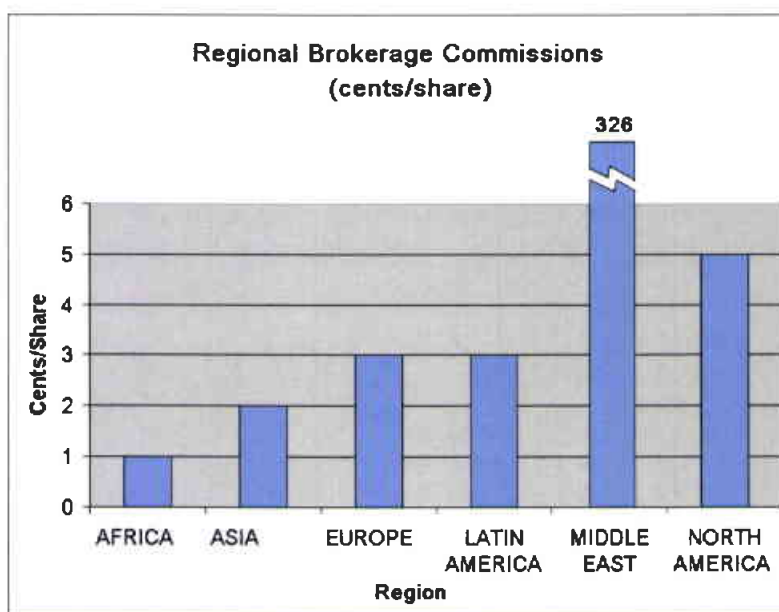
59. There are currently three ways to charge for brokerage commissions: 1) electronic trading resulting in significantly lower commissions, typically 1 cent per share or less; 2) bid/asked spreads can be charged instead of commissions on larger trades, which results in a higher per share cost; and 3) “bundled commissions” where brokerage commissions are based on transaction costs as well as the research provided. IMS currently applies the last two methods to pay for brokers.

60. “Unbundling” is the beginning of an industry trend where the investor pays separately for the transactions and negotiates a fee for research. As stated in a recent Wall Street Journal article dated 7 December 2005, Shift on ‘Soft Dollars’ Reverberates, unbundling the research and trading results in a cost of “2 to 2.5 cents/share for trading”. Without unbundling, “Big fund companies are paying three to four cents a share on

TABLE I
Brokerage Commissions Detailed
Total Equities
01/01/2005 – 12/08/2005
Base Currency: US Dollar

Region	Number of Securities	Principal	Total Commission	Commission as Percentage	Commission Rate Cents /Share	Commission Rate Basis Points
AFRICA	17,535,000	\$97,271,453	\$254,151	2.2%	1	26.1
ASIA	110,287,340	\$979,638,410	\$2,078,063	17.8%	2	21.2
EUROPE	185,982,787	\$2,668,719,909	\$6,035,112	51.7%	3	22.6
LATIN AMERICA	9,148,055 ²	\$145,073,861	\$285,460	2.4%	3	19.7
MIDDLE EAST	20,000	\$7,254,216	\$65,288	0.6%	326	90.0
NORTH AMERICA	59,521,210	\$2,300,567,706	\$2,956,861	25.3%	5	12.9
TOTAL EQUITIES	382,494,392	\$6,198,525,555	\$11,674,935	100.0%	3	18.8

56. The highest commission rate paid in cost/share was in the Middle East (\$3.26), which was due to an extra-ordinary circumstance requiring the divestiture of a security holding in conjunction with the illiquidity of this market. Apart from the Middle East, the Fund paid the highest commissions per share in North America, which were approximately 5 cents per share. The lowest commissions paid were in Africa where the rate paid was approximately 1 cent per share. (see chart below)



² This number has been adjusted for the transaction of CEMIG in Brazil due to the special 1000-lots-per-share quoting custom in Bloomberg for most Brazil utility stocks. The original trading volume of 275 million has been divided by 1000 to make the calculation of commission rates consistent and correct.

average in exchange for research.” As discussed above, the Fund pays on average three cents per share overall and five cents per share in North America.

Recommendation 8

The Investment Management Service should:

- (i) Attempt to negotiate lower commission rates with the brokers currently used by the Fund;
- (ii) Consider implementing electronic trading for large volume transactions, thereby lowering its brokerage commissions on those trades; and
- (iii) Consider unbundling commission rates with the brokers and consider paying separately for research to determine if this would result in cost savings to the Fund. (AS2005/801/02/08)

61. *With regard to recommendation 8(i), IMS stated that while it agreed to endeavour to achieve the most competitive commission rates for brokerage trading, it should be pointed out that quality research is part of the price of broker commissions and access to quality research is critical to generating capital gains to fund the payment of liabilities of the UNJSPF. Should this access be limited there would be a direct impact on the amount of capital gains generated by IMS for the Fund. Concerning recommendation 8 (ii), IMS commented that it was in the process of implementing an electronic trading system and once implemented, it will use this system for all trading regardless of the size of the trade. In cases when IMS needs to execute a large volume transaction, IMS should be able to negotiate the transaction fees with the brokers on an ad-hoc basis. Moreover, concerning recommendation 8 (iii), IMS commented that due to the comparatively low scale of trading volumes of the Fund, an unbundling of commission rates would result in a costlier and deteriorated access to broker’s research and eventually in a poor investment performance. Therefore at this stage unbundling of commission rates may not be beneficial to the Fund.*

62. *In summary, IMS management agreed with OIOS’ recommendation and stated that achieving the most competitive commission rates possible for the Fund is an important objective and stated that it will continue to make every attempt to obtain the most favourable treatment for the Fund from the brokerage community worldwide while maintaining the highest level of service quality in execution as well as in research at the disposal of the Fund. In doing so, IMS stated that it would hire a consulting company to articulate the best balance between the explicit fee payment to brokers and the implicit benefit from execution research support, provided the resource for the study is approved. OIOS will keep this recommendation open pending further action by the Fund.*

VI. ACKNOWLEDGEMENT

63. We wish to express our appreciation for the assistance and cooperation extended to the auditors by the staff of the Investment Management Service during the course of this review.



Patricia Azarias, Director
Internal Audit Division I, OIOS

HEADQUARTERS COMMITTEE ON CONTRACTS

INVESTMENT MANAGEMENT SERVICE/UNJSPF

2322
DEC 7 '01

TO: JM
1 40 2
3

HCC MEETING DATE: 20 November 2001

TO: Frank Eppert, Chairman
Headquarters Committee on Contracts

FROM: Christian Saunders, Chief
Procurement Division

ACTION:
Put Away _____
Bring Forward _____
File No. _____

REQUISITIONING OFFICE OR MISSION: IMS/UNJSPF
CONTACT NAME: Mr. Henry Ouma
TELEPHONE EXT: 3.2084

DATE GOODS OR SERVICES REQUIRED
AND DURATION: Five Year Contract

VALUE SUBMITTED FOR APPROVAL
A) Japan
SG Pacific Asset Mngt. \$ 1,350,000
B) Europe
Baille Gifford \$ 5,200,000
Darier Hentsch & Cie \$ 875,000
C) North American
Dimentional Fund Advisers \$ 4,725,000
CS Warburg Pincus \$ 4,500,000
*Jennison Associates \$ 4,500,000
*William Blair \$ 4,800,000
*Putnam Investors \$ 5,400,000
(* Only one to be awarded after negotiations)

PROCUREMENT OFFICER: Brian K. Streb

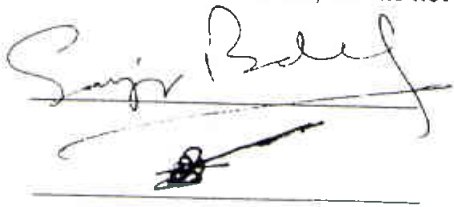
TELEPHONE EXTENSION: 3.6226

SIGNATURE: 

SUBJECT: Five-year contracts for provision of small cap advisory investment services for the United Nations Joint Staff Pension Fund's, Investment Advisory Service, for its North American, European and Japan portfolios.

PD RECOMMENDATION: A) Five year contract award in the not-to-exceed amount of \$ 1,350,000 to SG Pacific Asset Management for Japan portfolio requirement on the basis of UN FR 110.21 – lowest bidder; B) award of contracts to Darier Hentsch & Cie and Baille Gifford under UN FR 110.21 – Lowest Acceptable, subject to negotiation for five-year contract period for the European portfolio requirements for the not-to-exceed amounts indicated above; and C) rejection of the five technical acceptable bids for the American portfolio and enter into negotiated contracts (UN FR 110.21) with Dimentional Fund Advisers and Credit Suisse Warburg Pincus for five-year contract awards, and to make a third five year contract award for an allocation of the American Portfolio, to one of the three remaining advisory firms, e.g., Jennison Associated, William Blair or Putnam Investors, for the not-to-exceed amounts indicated above.

Sanjay Bahel, Chief:
MPPS/PD



Date: 16/11/01

Christian Saunders, Chief
PD

Date: 16/11/01

RECOMMENDED SUPPLIER(S): (1) Dimentional Fund Advisors; (2) CS Warburg Pincus; (3) Jennison Associates or William Blair or Putnam Investors; (4) Baille Gifford (5) Darier Hentsch Cie; and (6) SG Pacific

Background:

1. Through memorandum dated 23 May 2001, the United Nations Joint Staff Pension Fund's Investment Advisory Service (IMS) requested PD to undertake a solicitation to identify financial institutions for provision of Small Cap Investment Advisory Services for three portfolios, North American, Europe and Japan, respectively. PD was informed by IMS that the term of the current contracts for these service requirements expired on 30 June 2001 and are currently being extended until such time that new contracts can be put in place with firms to be selected through the subject presentation.

Solicitation:

2. PD issued three requests for proposals dated 1 June 2001. A total of twenty-two (22) firms were identified through an expression of interest exercise conducted by PD, which resulted in ten (10) firms being invited for the North American solicitation requirements (RFPS-237), nine (9) firms for the European solicitation requirement (RFPS-238) and three (3) for the Japan portfolio solicitation requirement (RFPS-236). The Committee is informed that a pre-proposal meeting was also convened on 18 June 2001, at the request of IMS. On the established closing date of 28 June 2001, proposals were received from all twenty-two (22) firms, for the respective solicitations that they were invited. The technical proposals were forwarded to IMS for its technical evaluation.
3. Based on established criteria only those firms that had received a technical score of at least 800 out of 1,000 points would be acceptable to IMS and would be subjected to due diligence visits by IMS and PD, jointly. The purpose of the due diligence visits would be to confirm the accuracy of the information contained in the proposals. In July PD received IMS' technical findings and due diligent visits were subsequently undertaken. Subsequent to the due diligent visits and finalization of the technical scoring, PD shared with IMS the financial proposals submitted by the qualified short listed firms.
4. IMS and PD determined that for the Japanese portfolio there was only one offer, which was considered both technically acceptable and commercially reasonable, made by SG pacific. With respect to the European portfolio both Darier Hentsch and Baillee Gifford were found technically acceptable, however, negotiations are recommended with a view to achieve lower fee structure. As far as the North American portfolio is concerned, the offers of CS Warburg Pincus and Dimensional Fund Advisers were similarly both found technically acceptable and their fee proposals in the desired range. However, the commercial proposals of the remaining three technically acceptable banks presented fees that were considered high.

In consideration of the forgoing, IMS and PD propose to recommend award to CS Warburg Pincus and Dimensional Fund Advisers subject to negotiation of fee with a view to achieve reductions and make a third contract award to the lowest acceptable of the remaining three banks, Jennison Associated, William Blair or Putnam Invest, after negotiations.

Recommendation:

5. Through memorandum dated 17 October 2001, PD was requested by IMS to prepare a presentation to HCC recommending: A) award of a five year contract in the amount of \$ 1,350,000 to SG Pacific Asset Management, for the Japan portfolio requirement, on the basis of UN FR 110.21 – lowest bidder; B) five year contracts to Darier Hentsch & Cie and Baille Gifford under UN FR 110.21 – lowest acceptable subject to negotiations for not to exceed amounts of \$ 875,000 and \$ 5,200,000, respectively; and C) rejection of the five technical acceptable bids submitted and enter in negotiated contracts with Dimensional Fund Advisers and Credit Suisse Warburg Pincus, respectively and to make award to the lowest acceptable proposer pursuant to negotiations with firms either Jennison Associated, William Blair or Putnam Investors.
6. The Committee is advised that the final awards for the European and North American portfolios will be advised to the Committee.
7. The Committee's advise and recommendation is hereby sought.

Attachment A: IMS' Technical Evaluation dated September 2001 (binder).

Attachment B: PD's Commercial Evaluation

Attachment C: IMS' memorandum dated 17 October 2001 to PD (S. Bahel)

SMALL CAP ADVISORY SERVICES
UNJSPF - INVESTMENT ADVISORY SERVICE

BANKS	BASIS POINT	PORTFOLIO ALLOCATION	YEARLY AWARD AMOUNT	FIVE YEAR AWARD AMOUNT
NORTH AMERICAN				
DIMENTIONAL FUND ADVISORS	0.00525	\$ 180,000,000.00	\$945,000.00	\$4,725,000.00
CS WARBURG PINCUS	0.0045	\$ 200,000,000.00	\$900,000.00	\$4,500,000.00
JENNISON ASSOCIATES	0.0075	\$ 120,000,000.00	\$900,000.00	\$4,500,000.00
WILLIAM BLAIR	0.008	\$ 120,000,000.00	\$960,000.00	\$4,800,000.00
PUTNAM INVESTORS	0.009	\$ 120,000,000.00	\$1,080,000.00	\$5,400,000.00
EUROPEAN				
BAILLE GIFFORD	0.008	\$ 130,000,000.00	\$1,040,000.00	\$5,200,000.00
DARIER HENTSCH	0.0025	\$ 70,000,000.00	\$175,000.00	\$875,000.00
JAPAN				
SG PACIFIC	0.0027	\$ 100,000,000.00	\$270,000.00	\$1,350,000.00