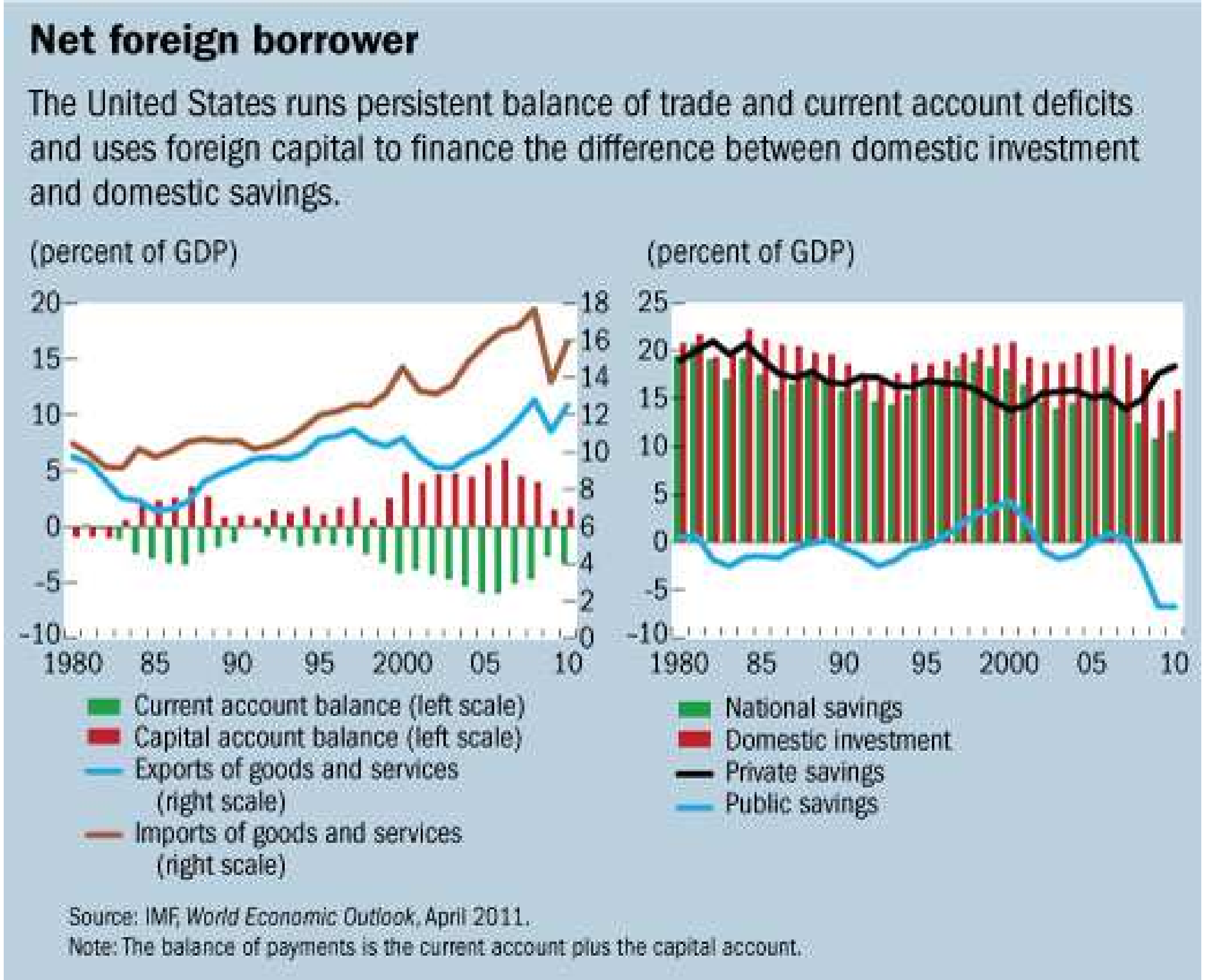
« In difficult times, preserving value through finance is already quite a challenge»

Retraite Additionnelle de la Fonction Publique

SRI DAY

12 November 2014 , Palazzo Mezzanotte, Milan

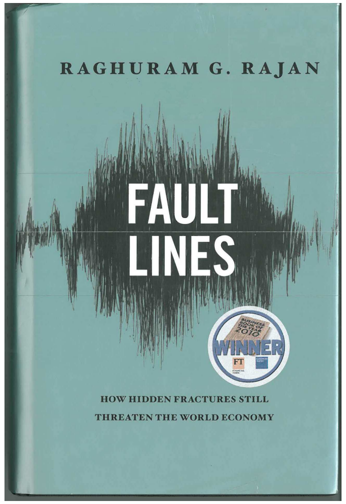
Was pre crisis growth sustainable ???

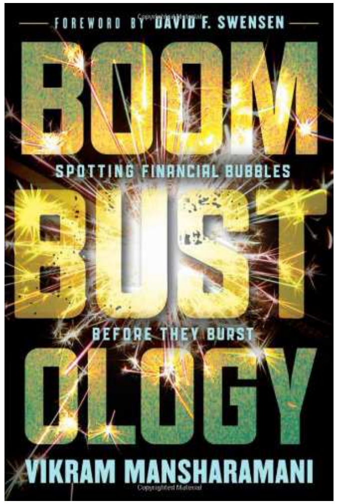


An inconvenient truth: the last 30 years growth was not sustainable???

"As long as the music is playing, you've got to get up and dance. We're still dancing".

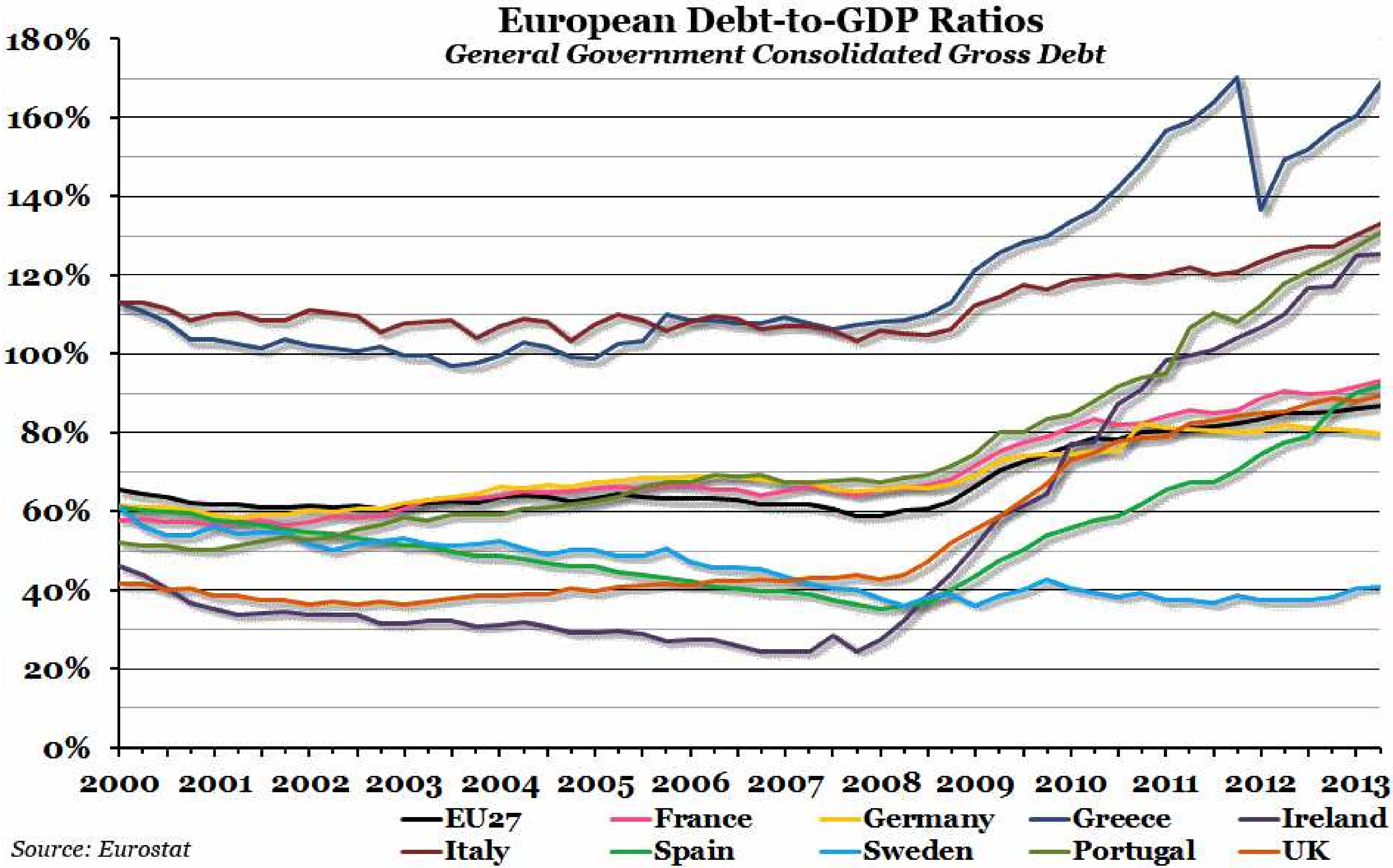
Chuck Prince, ex Citi CEO





30 years of a one side bet

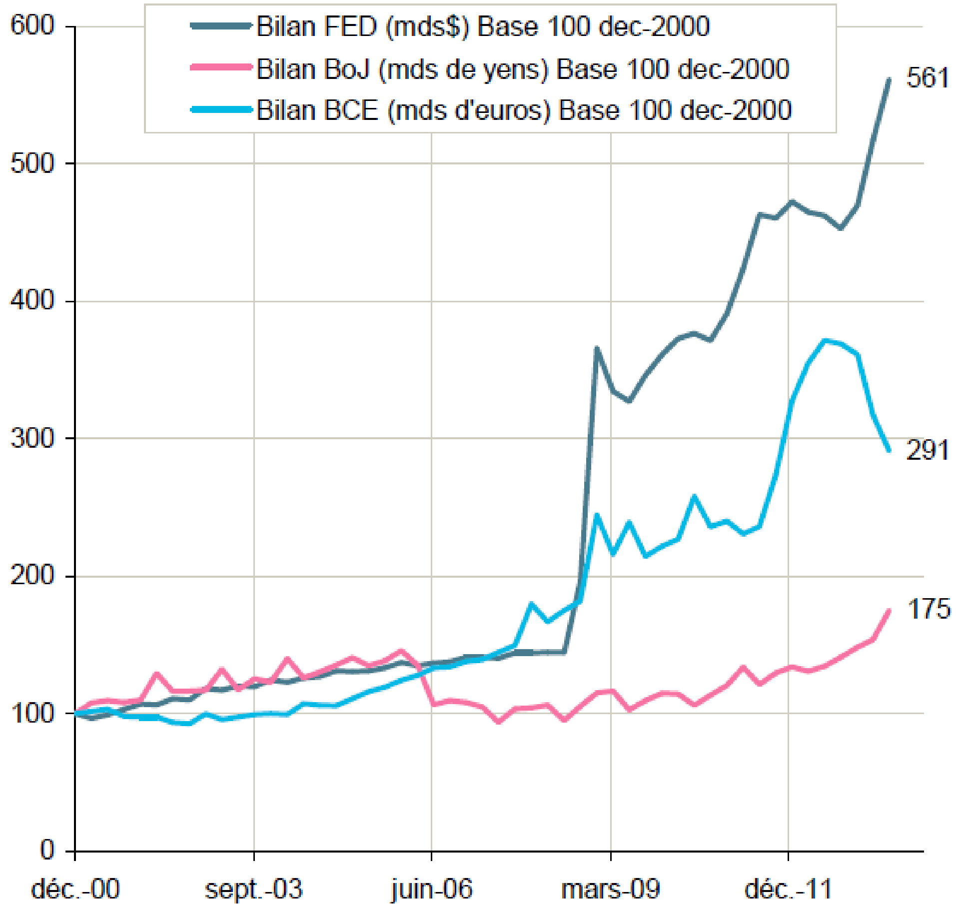
Public indebtedness was already high before the crisis



Central banks do their best !

Monetary base has strongly increased

But with what impact:
- **on prices,**
- **on demand**

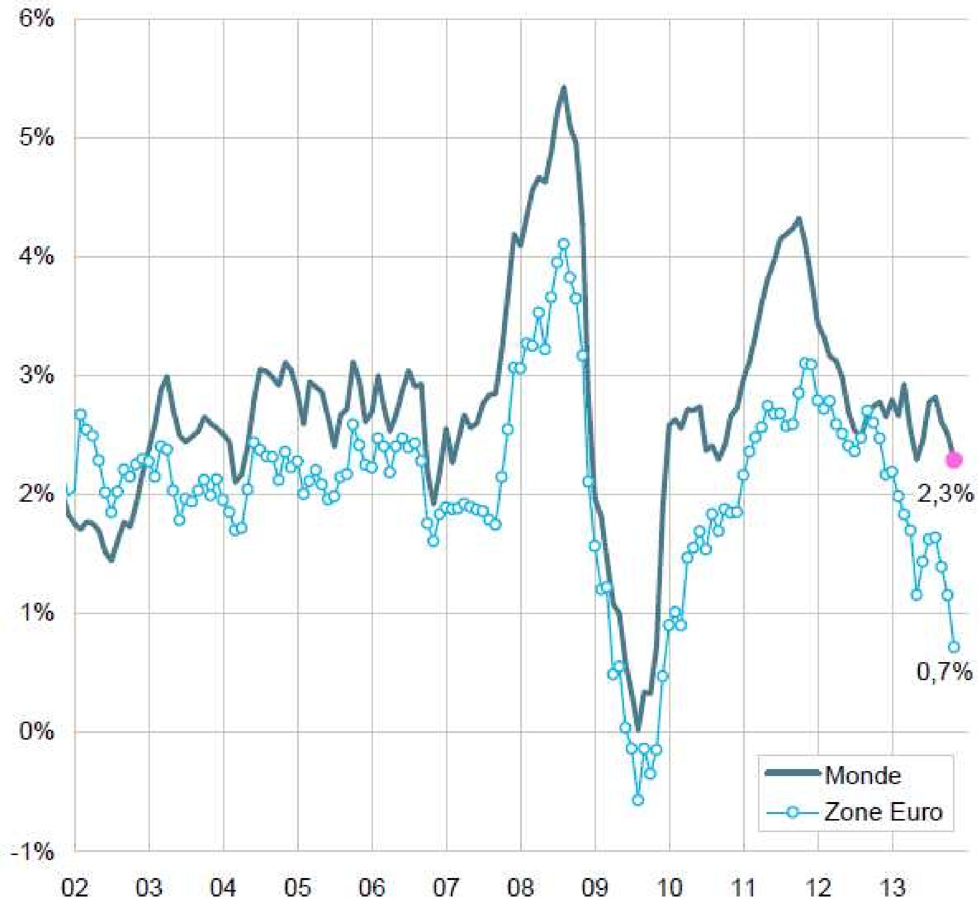


Sources : MACRORAMA, Feri

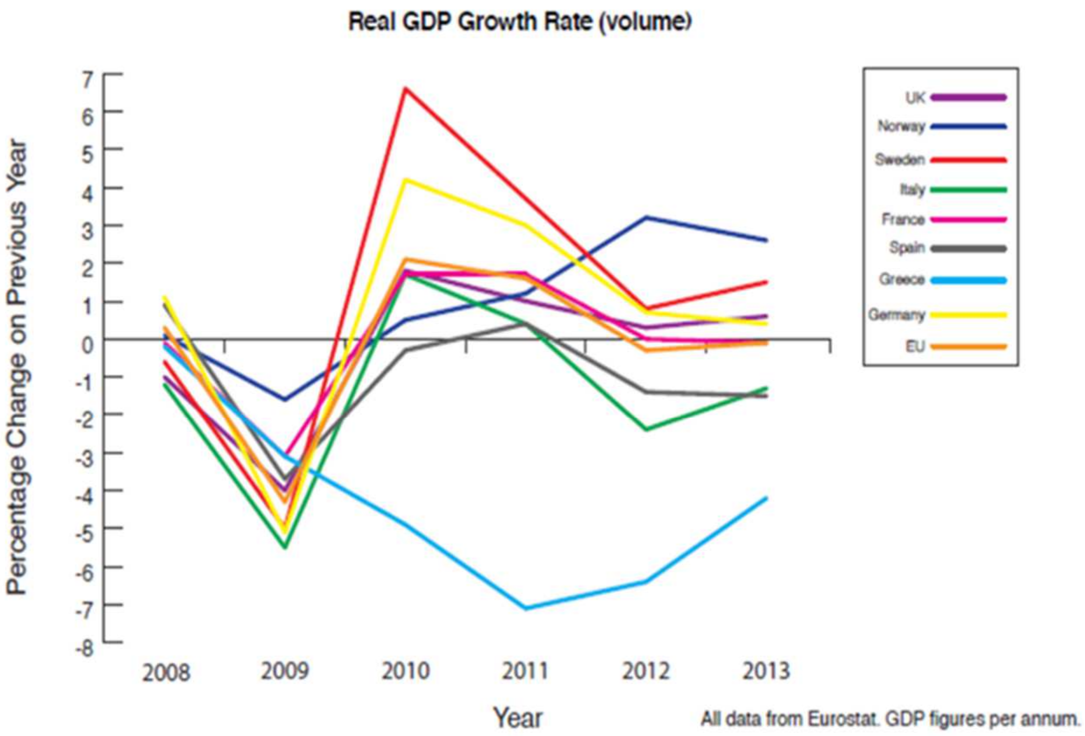
Getting closer to a very scary situation

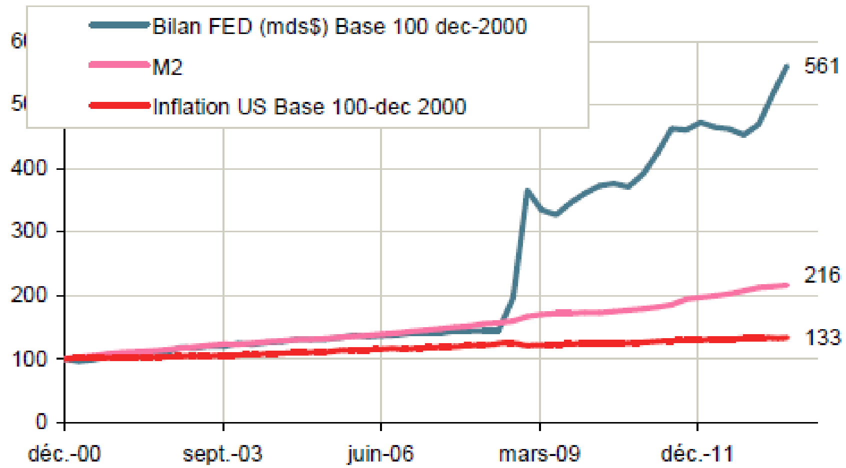
Euro zone is getting closer to outright deflation

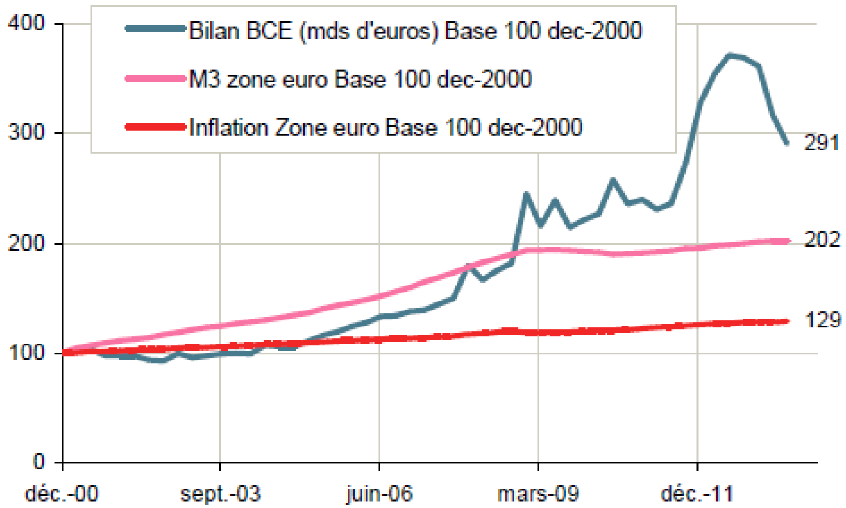
Inflation mondiale, glissement annuel



Activity remains weak







Entering uncharted territories?

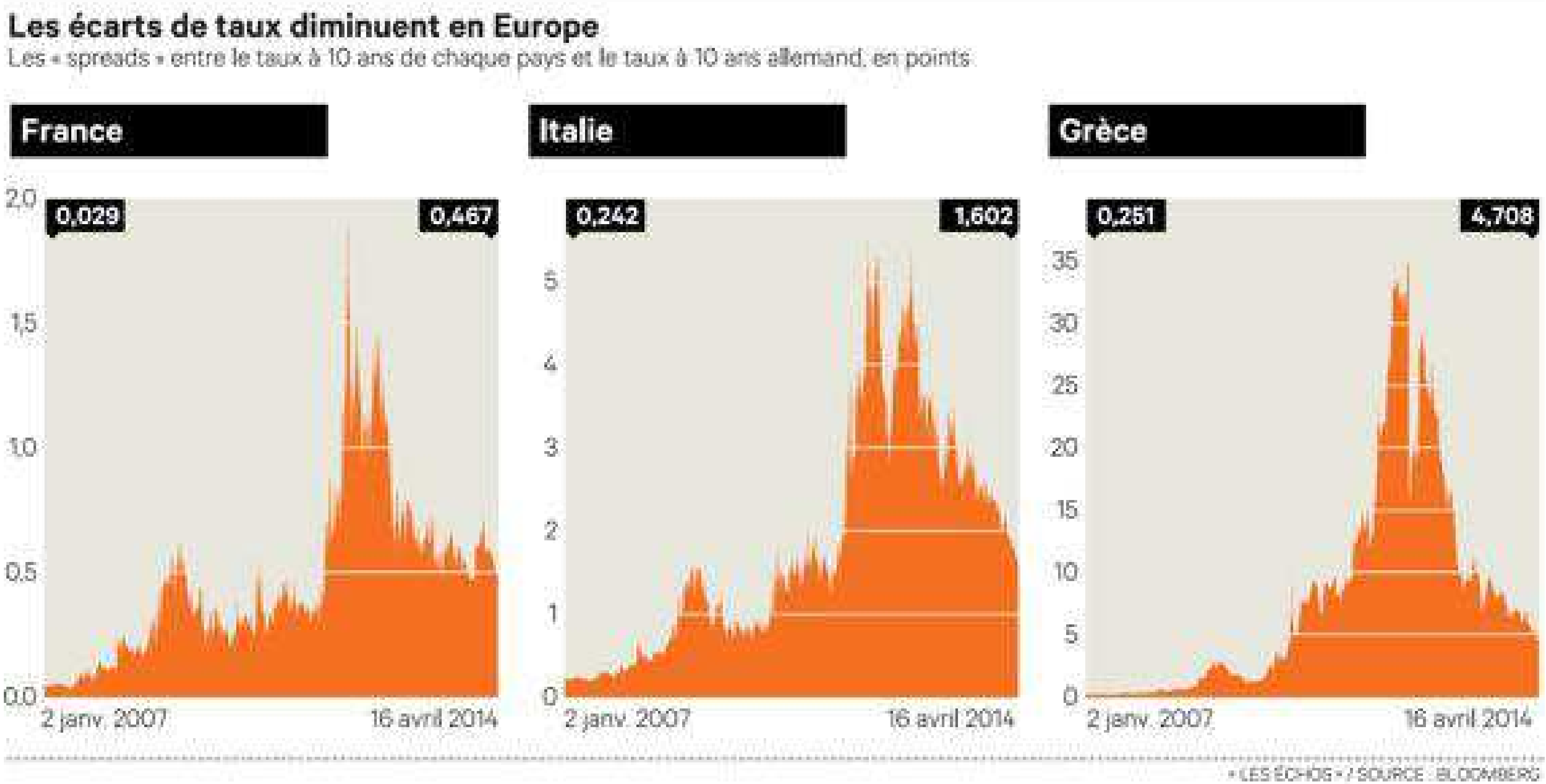
You would not buy that asset, now……Would you?

« Funny » that pension funds are encouraged to « derisk » their balance sheets by buying more bonds………

When those bonds have never been so pricey!!!!!

Liquidity has to go somewhere…A lasting low yield environment????

After too much pessimism back to too much optimism???



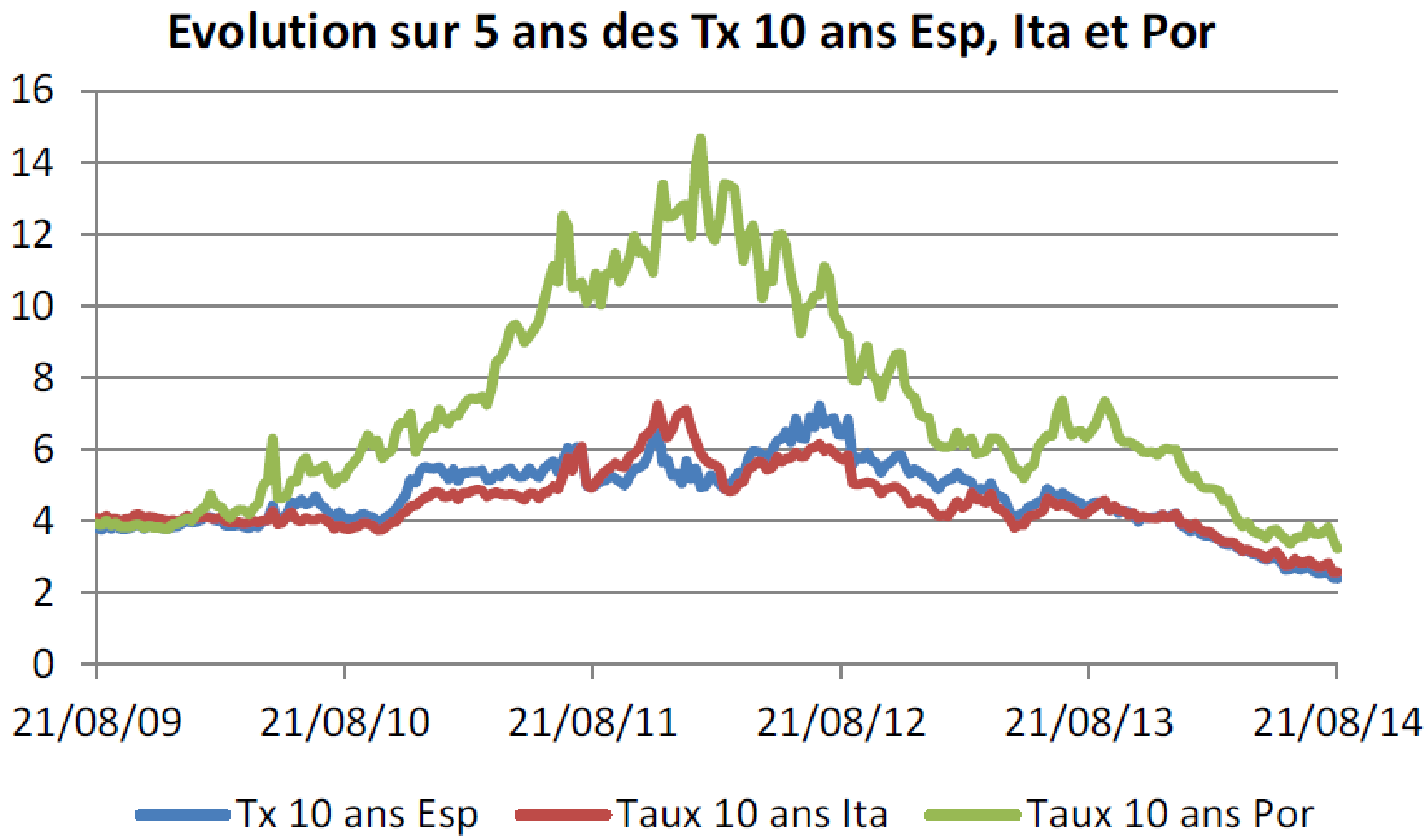
Buying peripherals: still an option ???

Govies

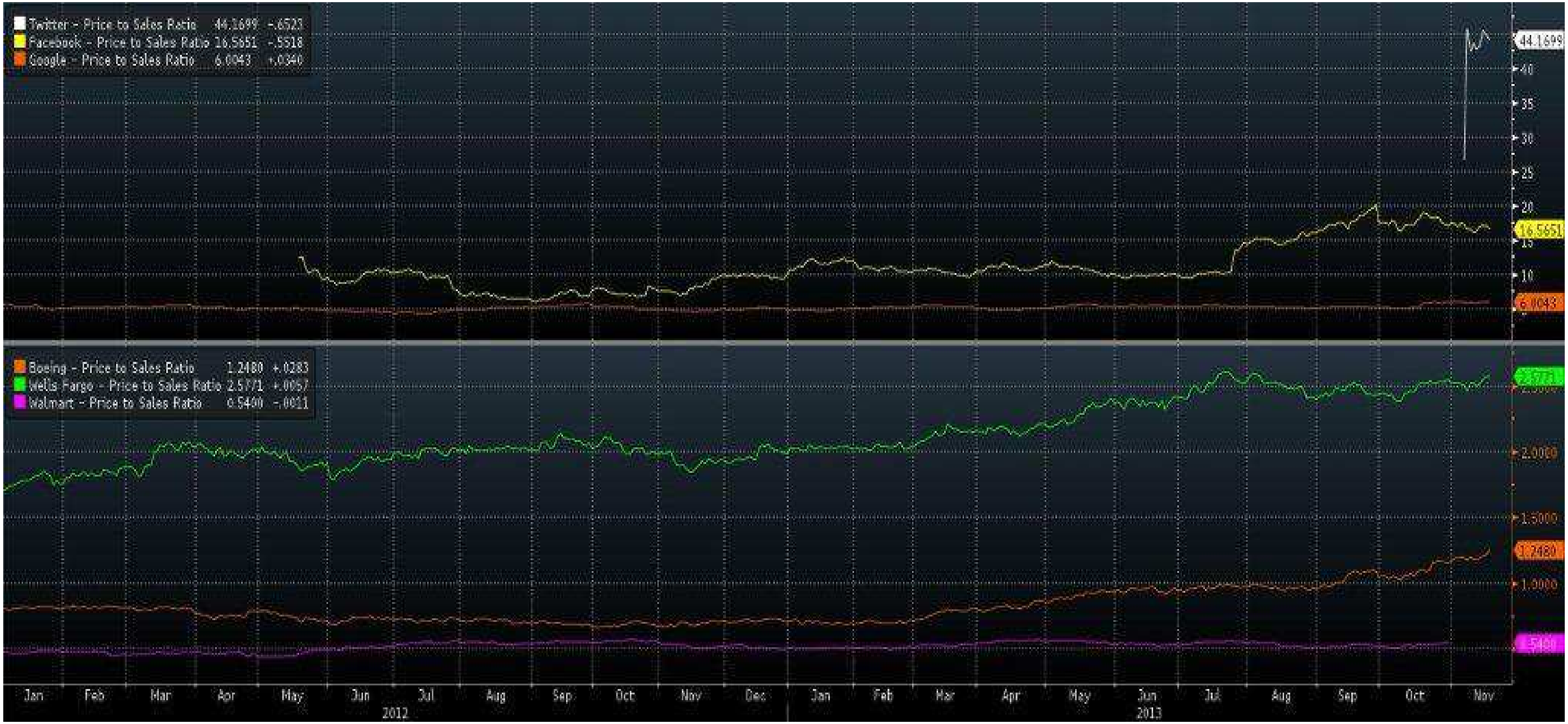
From risk free asset

to

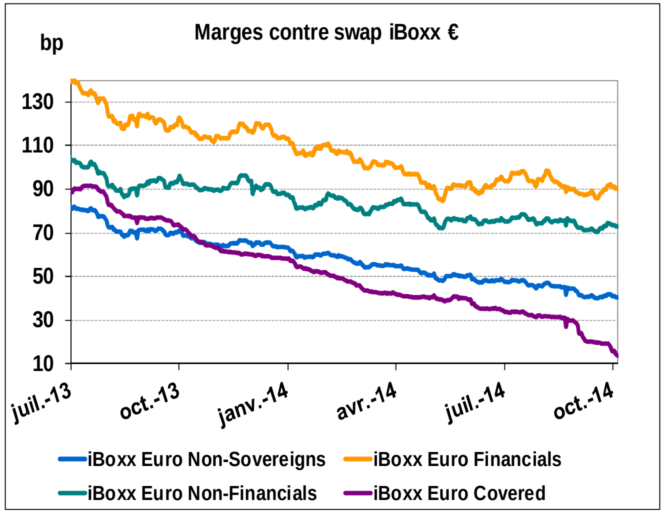
High risk no return asset

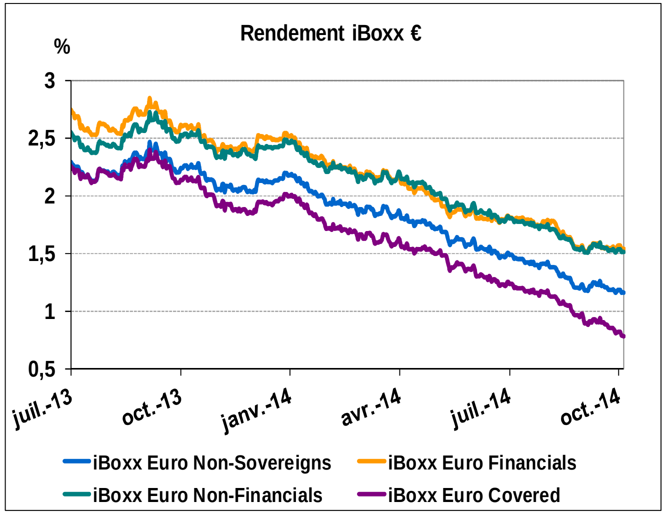


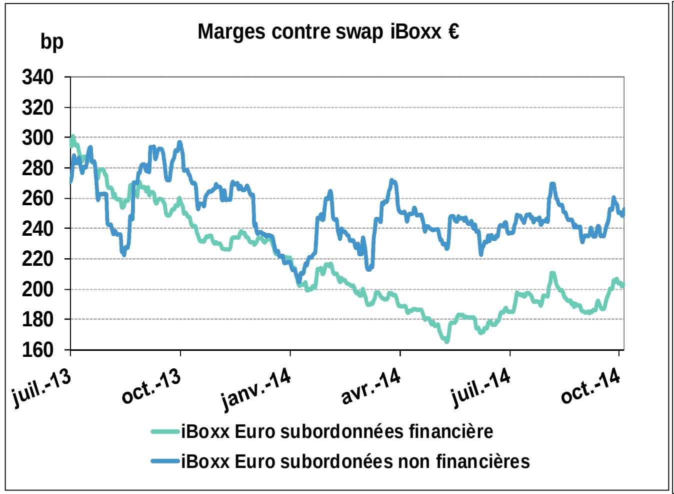
Liquidity has to go somewhere !

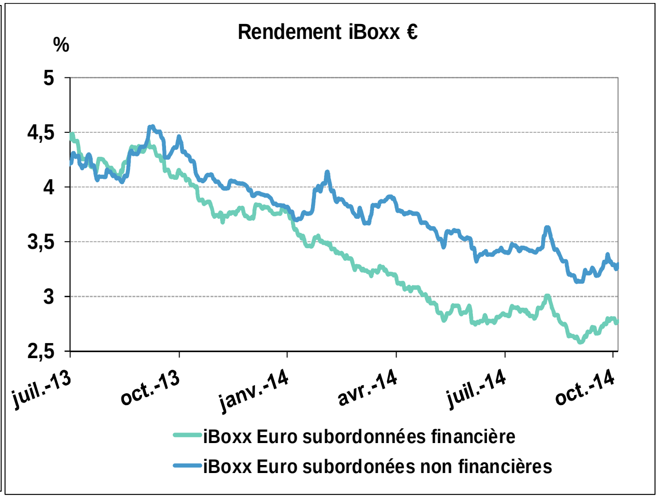


Corporate bonds: Should I stay or should I go ?







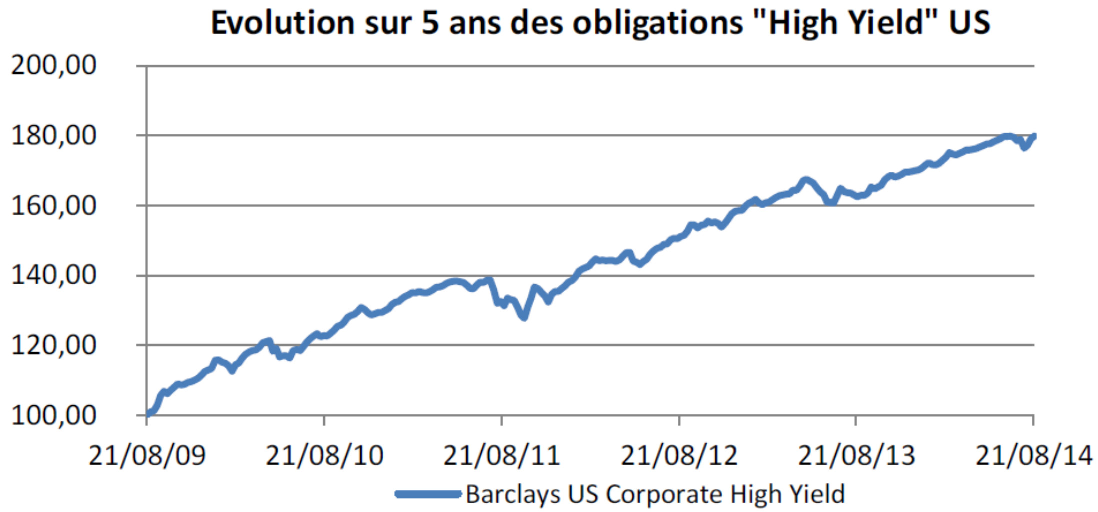


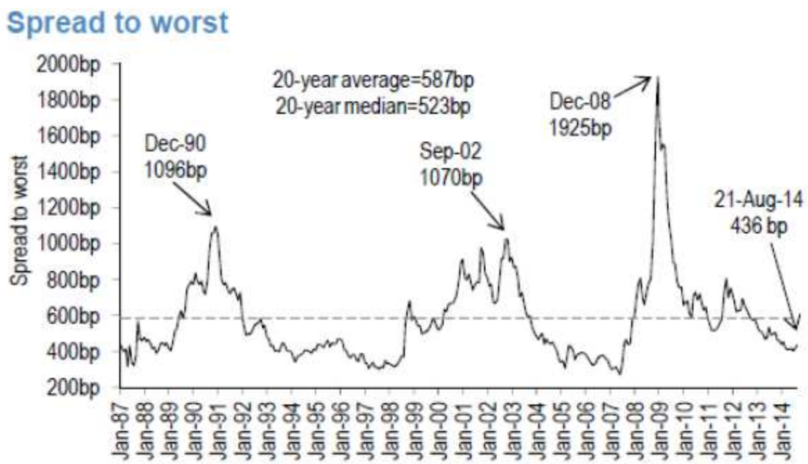
High yield is pricey too

Becoming pricey

But

Expected default still reasonable





Source: J.P.Morgan

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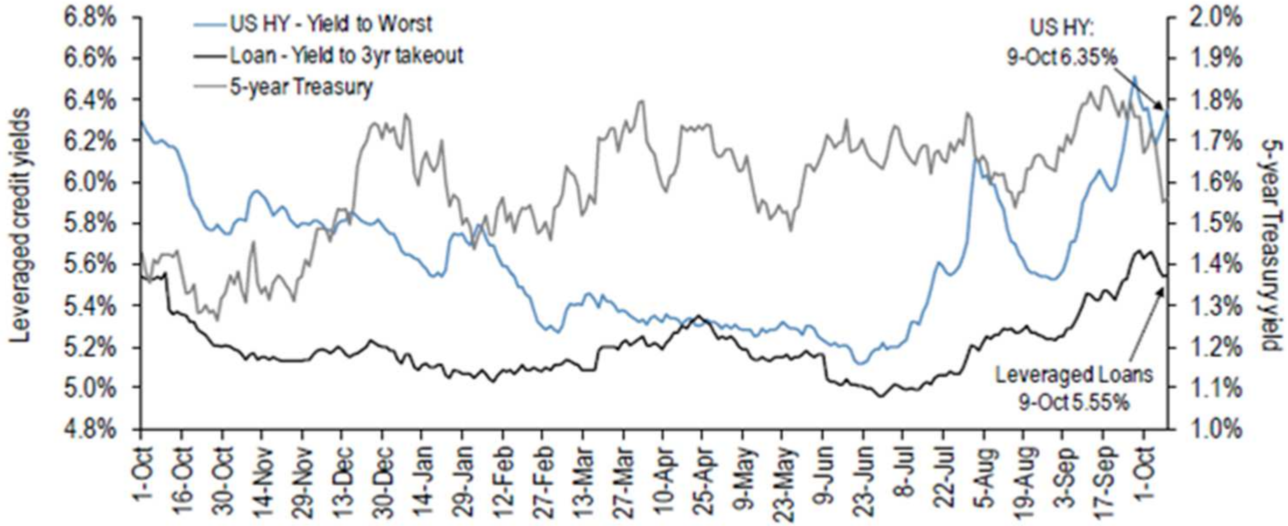
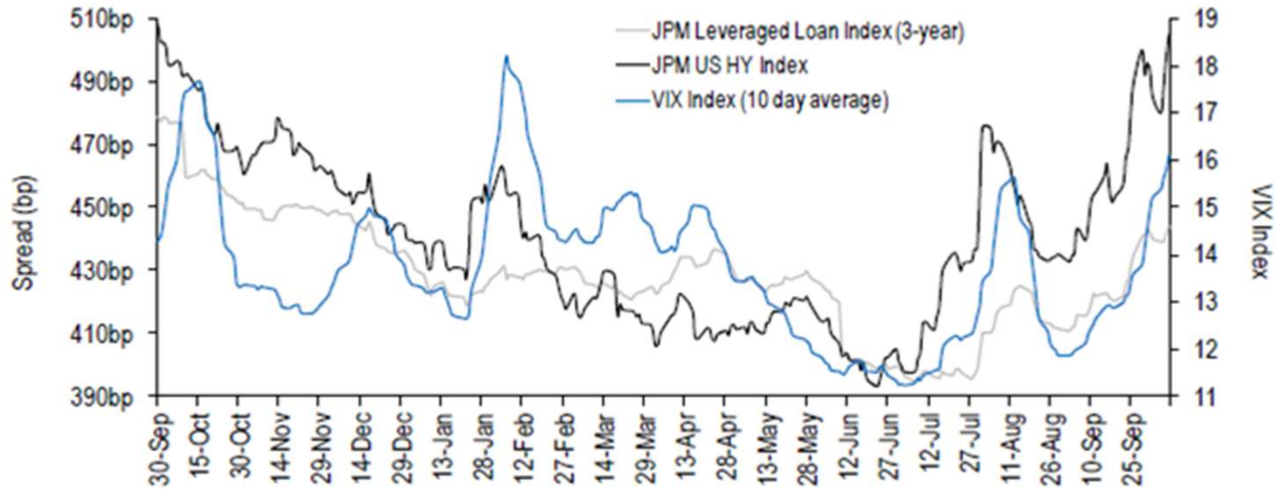
For the patient long term investor High yield is still worth considering

High yields rates are stepping up and spreads widen, although defaults are anticipated stable



Source: J.P. Morgan.

Equities volatility is picking up (cf VIX, S&P500 options volatility) which is consistent with wider spreads



Source: J.P. Morgan.

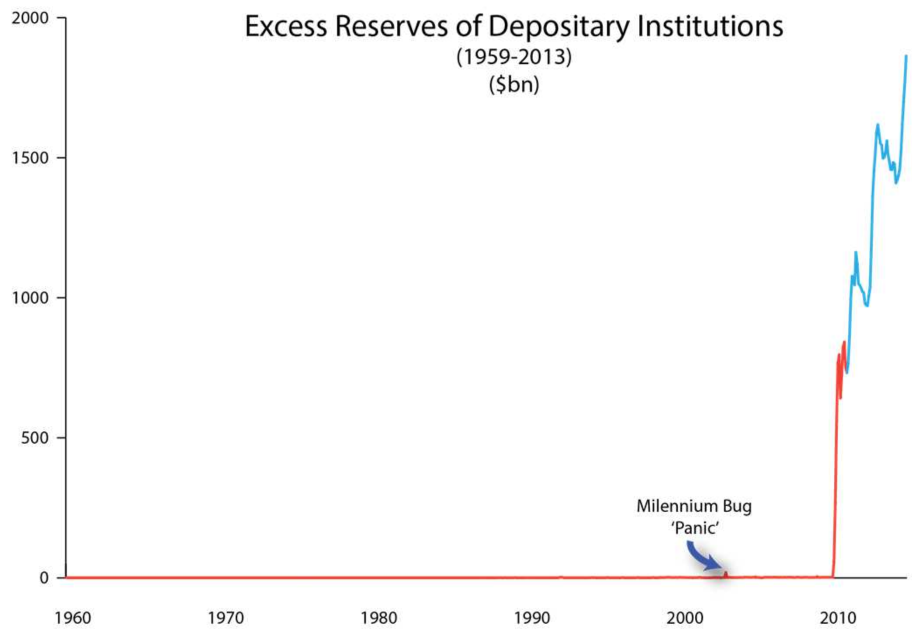
How do we get out of QE ?

Taper: ta■per:
v. a) to gradually decrease, as in action or force
b) to grow gradually lean

The roll over option :

There is still an open question : are those assets bought by central banks supposed to be sold back to investors?

The furnace option : let’s burn them all !!!!



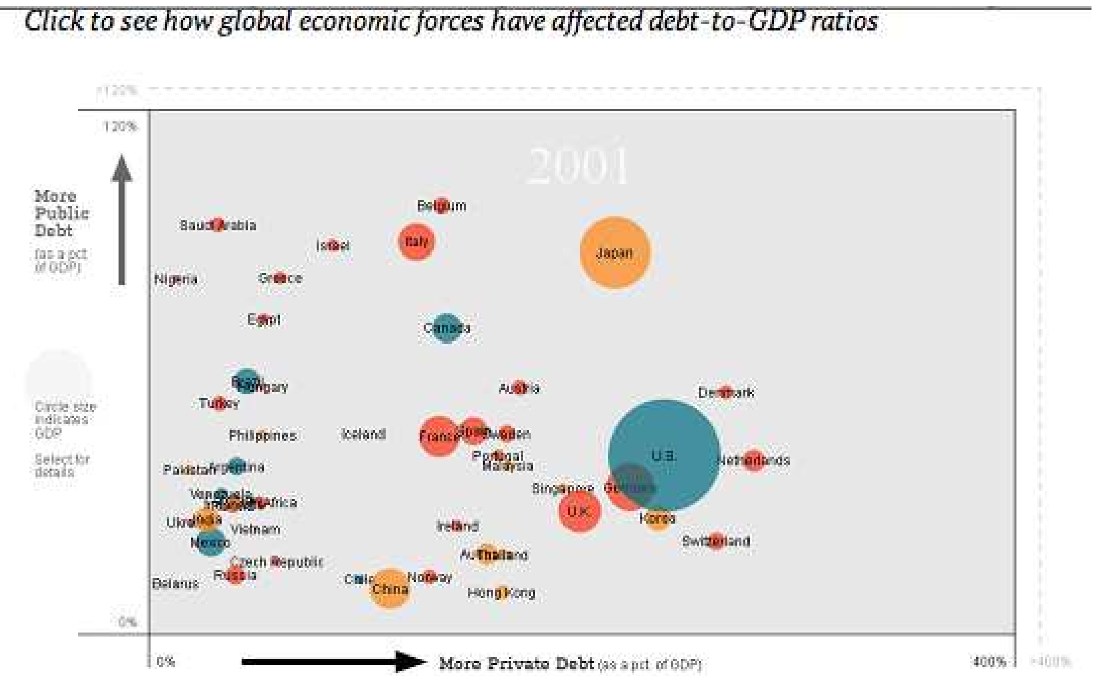
There is just one little problem: **Can you push on a string?**

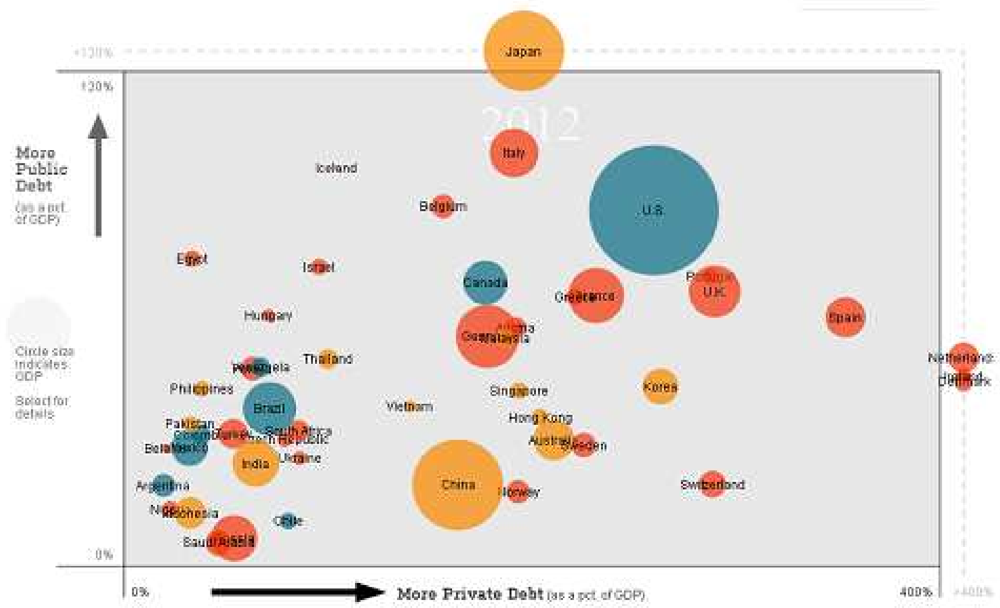
Will there be a restructuring of the debt?

BCG 2011 : the looming threat of debt restructuring

Financial debt can be restructured

A NEW GLOBAL THREAT : debt overhang and the risk of deflation ?





Source: Real Time Economics

Actually, the deleveraging ***has not started***

http://www.riskreversal.com/2013/05/28/chart-of-the-day-global-debt-dynamics/

Govies: a risk free asset?

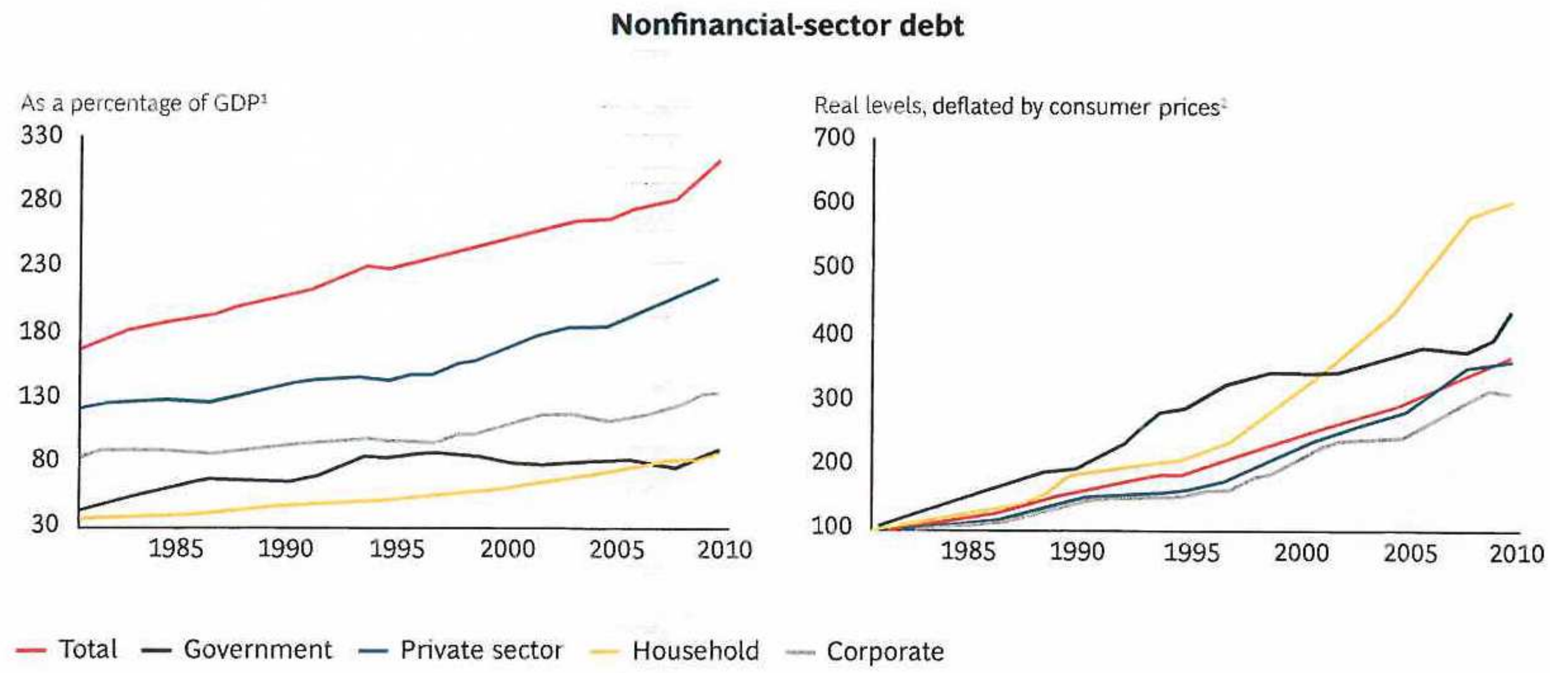
Collateral Damage

Back to Mesopotamia?

The Looming Threat of Debt Restructuring

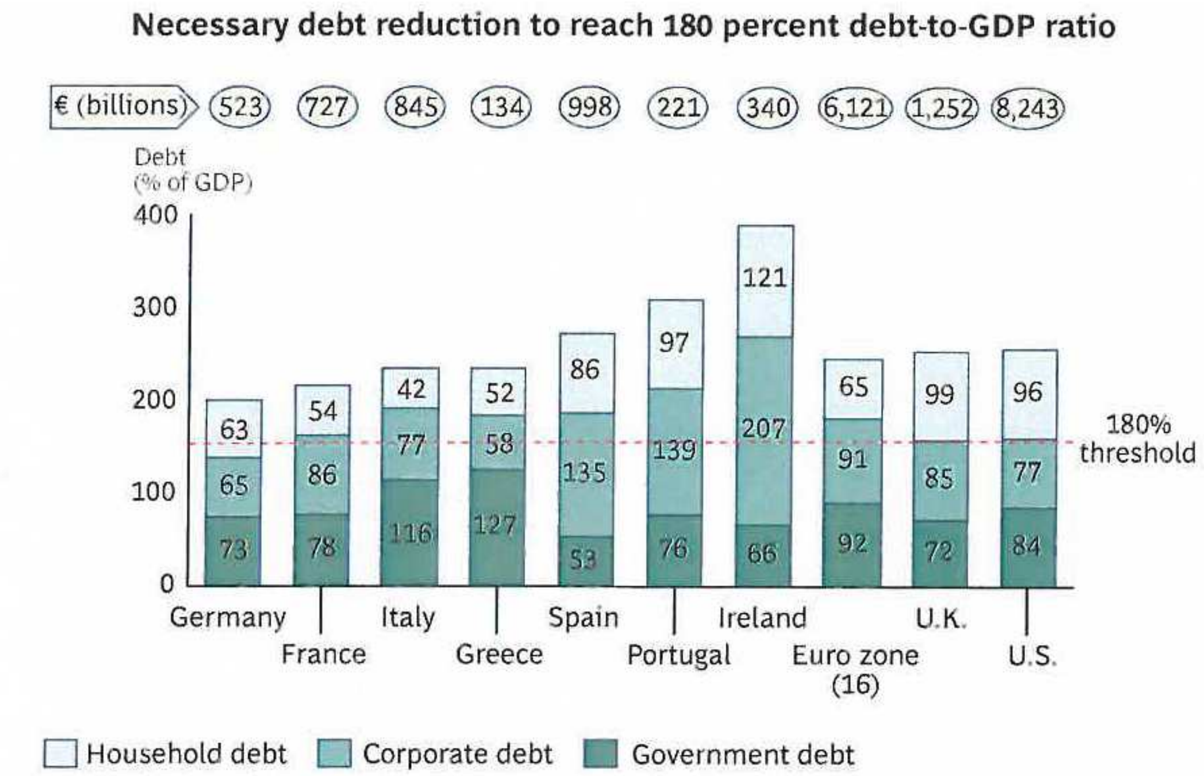
BCG
THE BOSTON CONSULTING GROUP

EXHIBIT 1 | Real Total Debt Levels Have Almost Quadrupled Since 1980



Source: Stephen Cecchetti, Madhusudan Mohanty, and Fabrizio Zampolli, "The Real Effects of Debt," BIS Working Paper No. 352, September 2011.
[1]Simple averages for 18 OECD countries and the U.S.
[2]1980 = 100; simple averages for 16 OECD countries.

Govies: a risk free asset?



Sources: Eurostat; Federal Reserve; Thomson Reuters Datastream; BCG analysis.
Note: All data as of 2009.

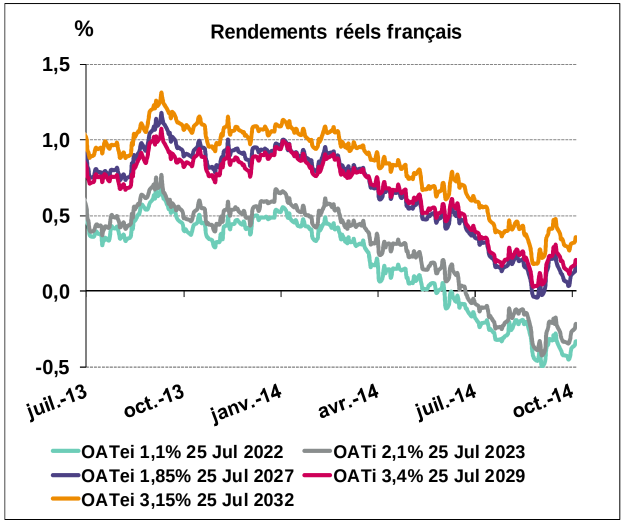
Changes proposed by the IMF:

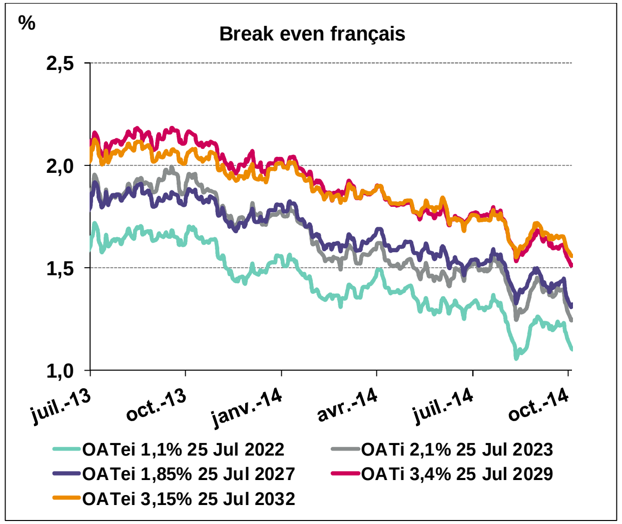
- a modification of the equal treatment "pari passu" clause used by US hedge funds to claim full repayment on Argentine bonds.
  ➔ to explicitly exclude the obligation to pay holdout investors.

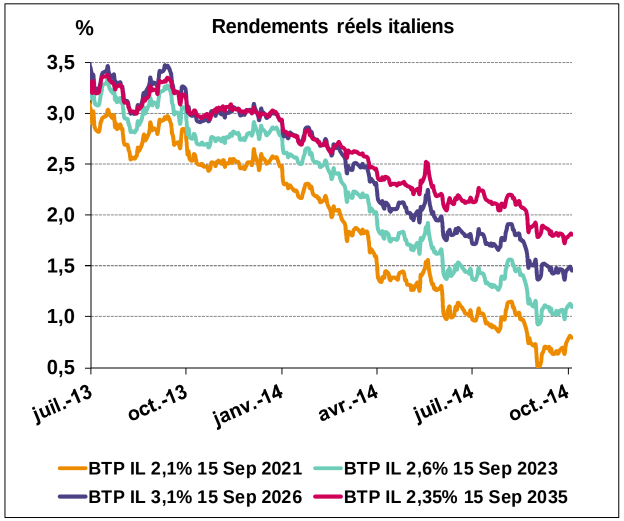
- inclusion of a clause that can bind all investors to a decision made by a supermajority of 75 per cent of creditors if a country defaults and attempts to restructure its debt.

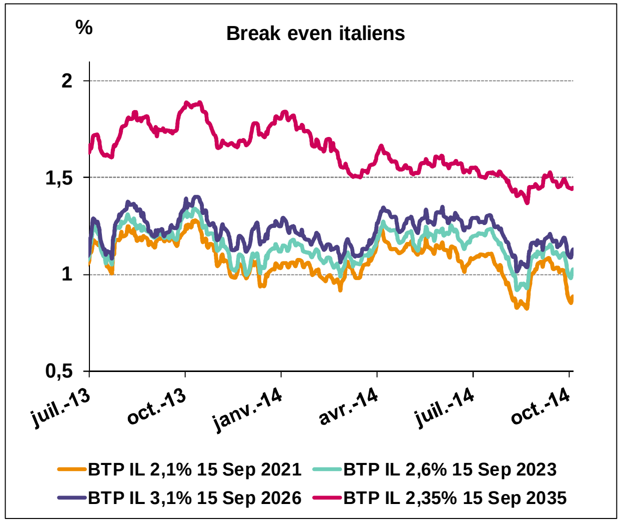
Is there an urgency exit through inflation?

Quick buck artists come and go with every bull market but the steady players make it through the bear markets.
Mannheim (Wall Street)









How to make good on promises to pay underpriced benefits?

Towards social benefits restructuring?

Over optimistic assumptions and enduring investment ?

- Liabilities have been "underpriced"

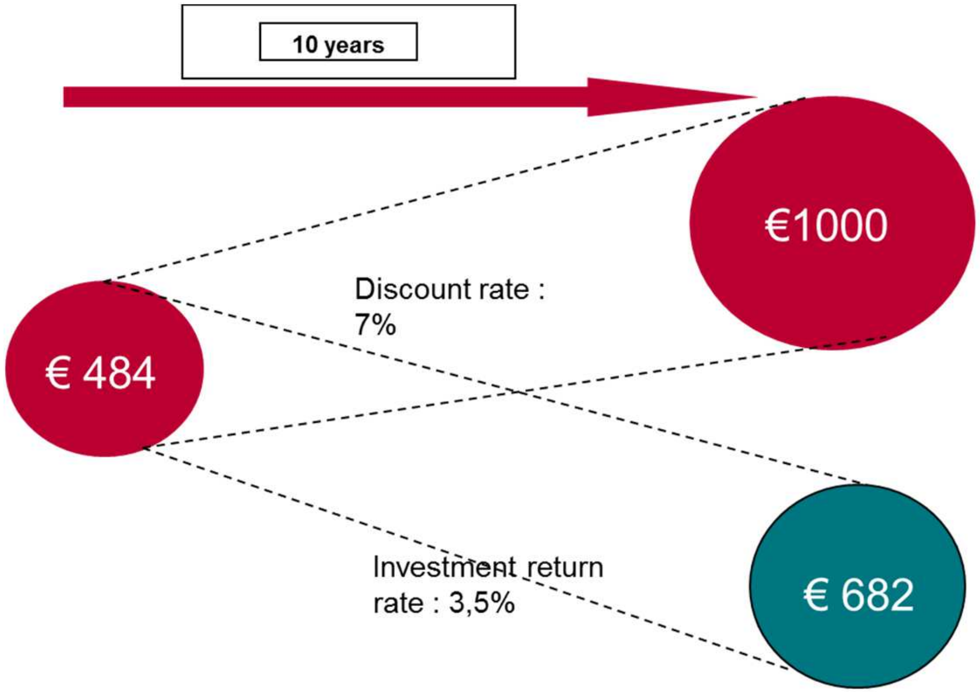
⟵ Retirement benefits too generous

- The higher the discount rate the cheaper the cost

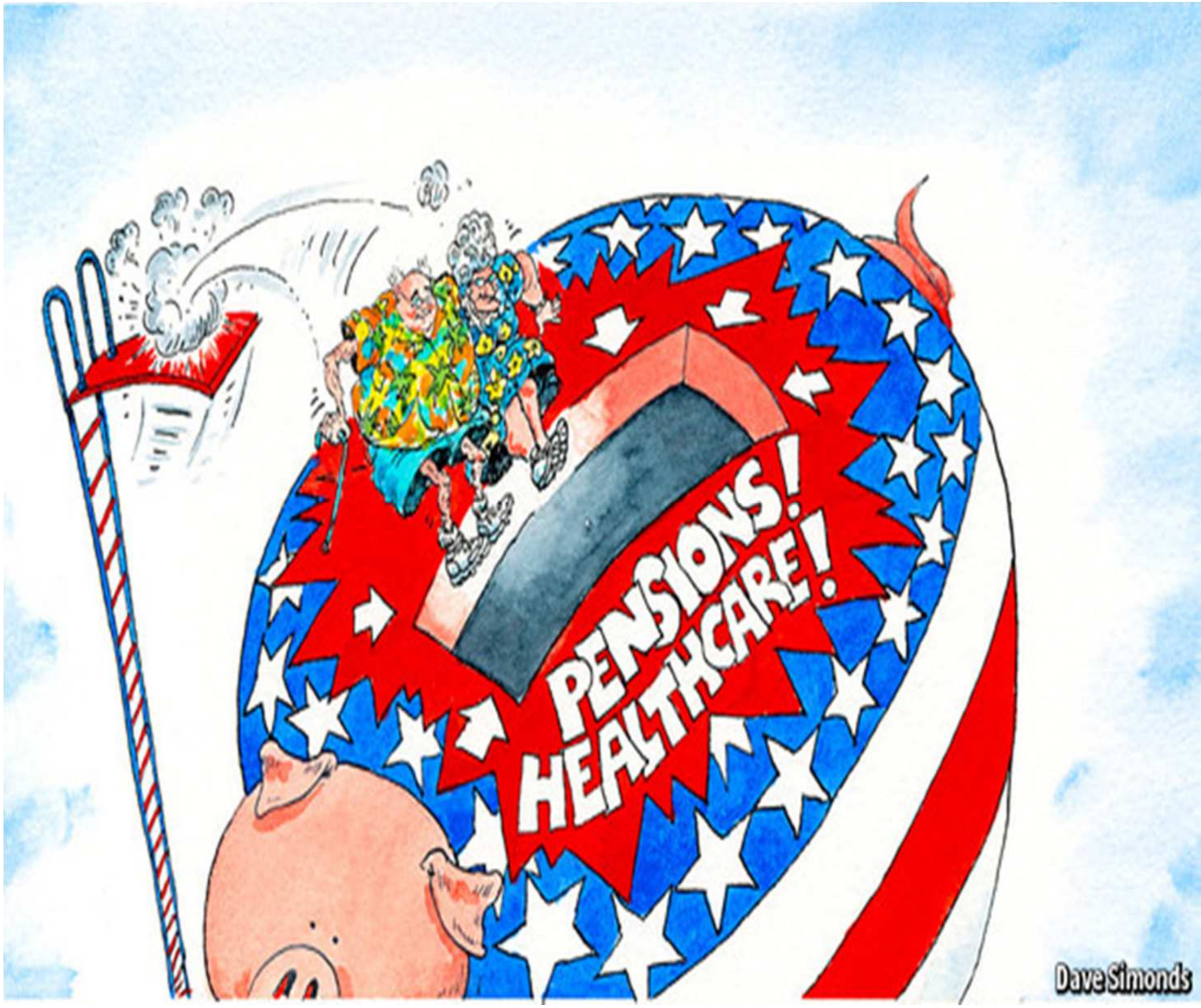
- What happens if the actual rate of return is much lower than the discount rate

- If the actual return is 3,5% (vs. an expected return of 7%),

⟶ I am short by 318



WHAT HAPPENS WHEN YOU HAVE BEEN TOO OPTIMISTIC ?



With three, five and 10-year stock returns negative

➔ there is *no* way companies should be assuming **8 percent returns** on their pension funds.

RUDE AWAKENING OR HARD LANDING!!!!

Pension funding gaps, big and small

Adjusted net pension liabilities
as % of state revenues, 2012 or latest available

Rank	State	%	Rank	State	%
1	Illinois	241	41	S. Dakota	21
2	Connecticut	190	42	Ohio	20
3	Kentucky	141	43	Tennessee	19
4	New Jersey	137	44	Florida	19
5	Hawaii	133	45	N. Carolina	18
6	Louisiana	130	46	New York	17
7	Colorado	118	47	Iowa	16
8	Penn.	105	48	Idaho	15
9	Mass.	100	49	Wisconsin	14
10	Maryland	100	50	Nebraska	7

Source: Moody's

The first bolts are popping up?

Retraite des fonctionnaires : l'UMR va réduire de 30% les rentes de 110 000 ex-adhérents du Cref

Stockton bankruptcy puts legal limits to test

Other towns watch to see what happens to retiree benefits

By Dennis Cauchon and Judy Keen |USA TODAY

The bankruptcy of Stockton, Calif., could be the crucial test case that determines whether local governments can use the federal courts to shed burdensome retirement benefits in a way that corporations often do.

The struggling city of 291,000 has been firing police, firefighters and other workers for several years to reduce payroll costs so it can pay retirement benefits and debt. The City Council and city manager decided Tuesday – with regret but little disagreement – that it cannot cut more and, instead, the knife must be taken to pension and health care benefits of former workers.

COVER STORY

"We have used every tool in our toolkit to try to resolve our financial situation without going into Chapter 9 (bankruptcy)," says Mayor Ann Johnston. "It truly is bad that we're in this position, but it's good that we have a way to resolve our financial situation."

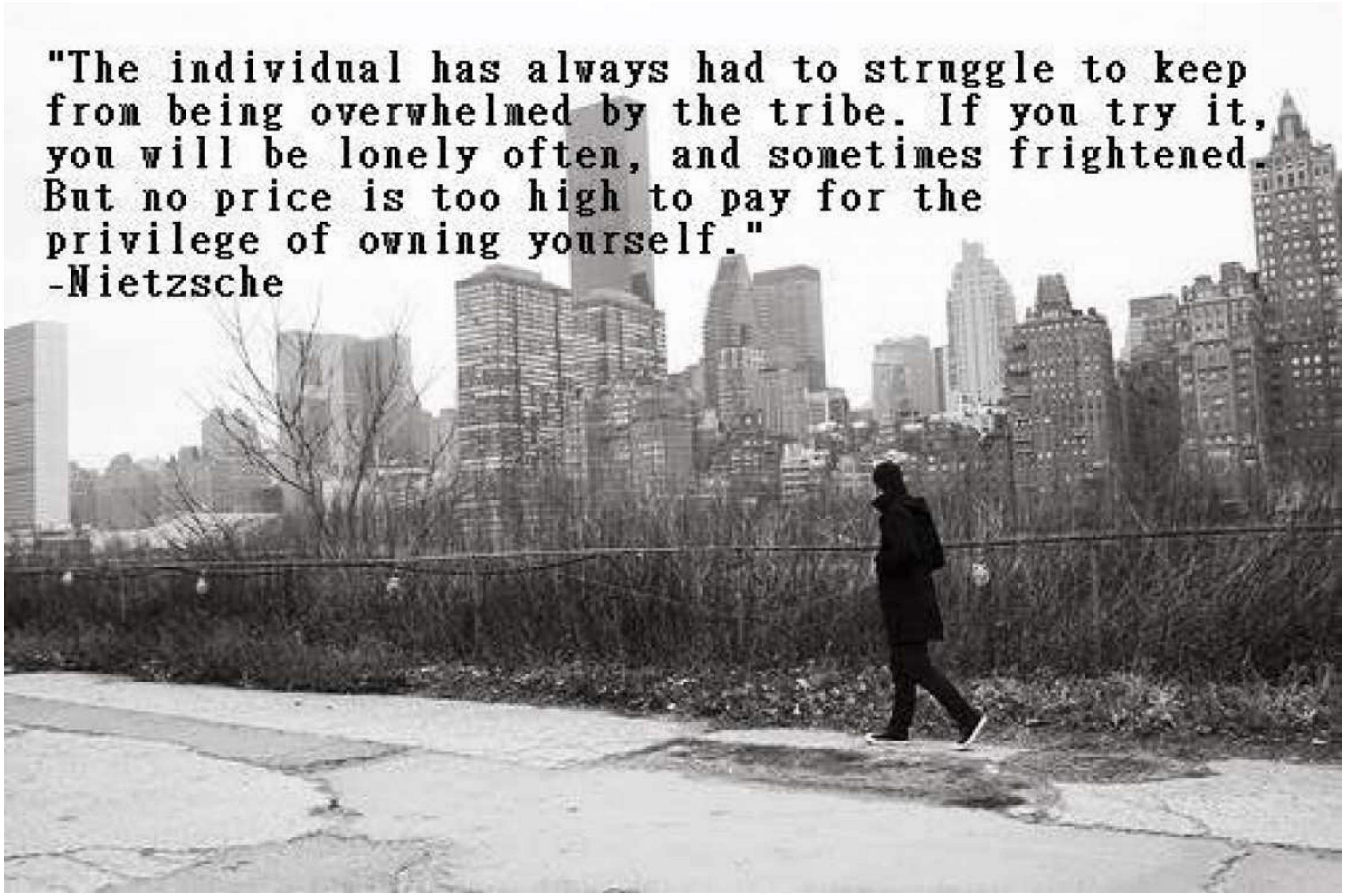
What's significant about the Stockton bankruptcy is that a substantial-sized city is confronting head-on a multitrillion-dollar problem facing states, cities and school districts nationwide: unfunded promises for pensions and retiree health care. With unusual frankness, City Manager Bob Deis compares Stockton's strategy with that of General Motors and American Airlines, recent examples of a decades-old business technique to abandon costly retirement promises by filing for bankruptcy.

Please see COVER STORY next page ►

[Detroit](#)'s proposal to restructure its \$18 b of debt by paying pensioners at more than twice the rate of some municipal bondholders threatens to increase borrowing costs for localities throughout [Michigan](#).

The draft plan given to creditors this week by Emergency Manager Kevyn Orr offers different recovery rates for classes of unsecured creditors. Pensions would get 45 to 50 cents on the dollar, though retiree health-care liabilities would recoup just 13 cents, according to the plan. By comparison, those who loaned \$1.4 billion to shore up the two pension funds would receive 20 percent of their claims. Holders of \$369 million in unlimited-tax general obligations would recover 46 %.

Time to change tack?



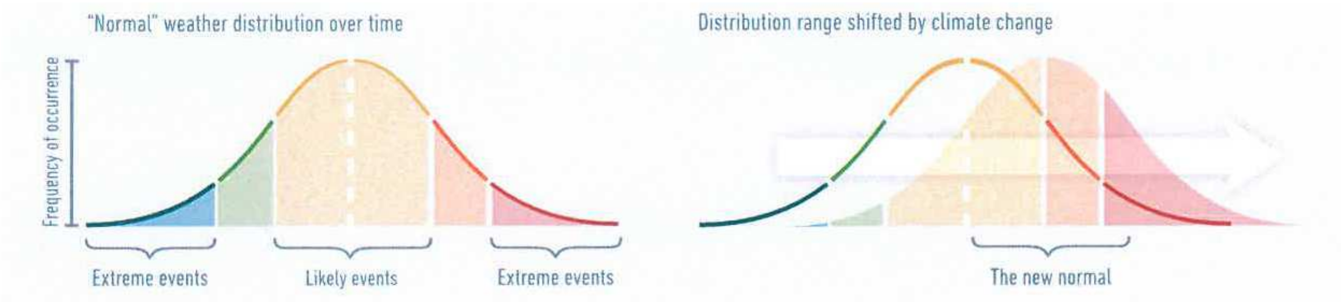
Carbon debt: the only debt we cannot restructure?

We have almost overspent our allocated carbon budget

Fiduciary duty and carbon footprint transparency

Some still discuss mankind responsibility in Global warming!

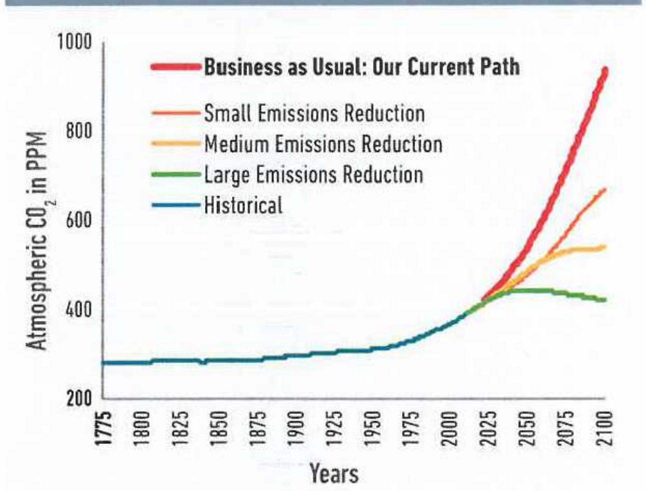
But who can argue against carbon being a risk?



Human society is structured around "normal" weather, with some days hotter than average and some colder. At the distant "tails" are extreme events such as catastrophic weather. Climate change shifts the entire distribution curve to the right. Old extremes become the new normal, new extremes emerge, and the process continues until we take action.

Source: Risky Business

Figure 1: Global Emissions Scenarios

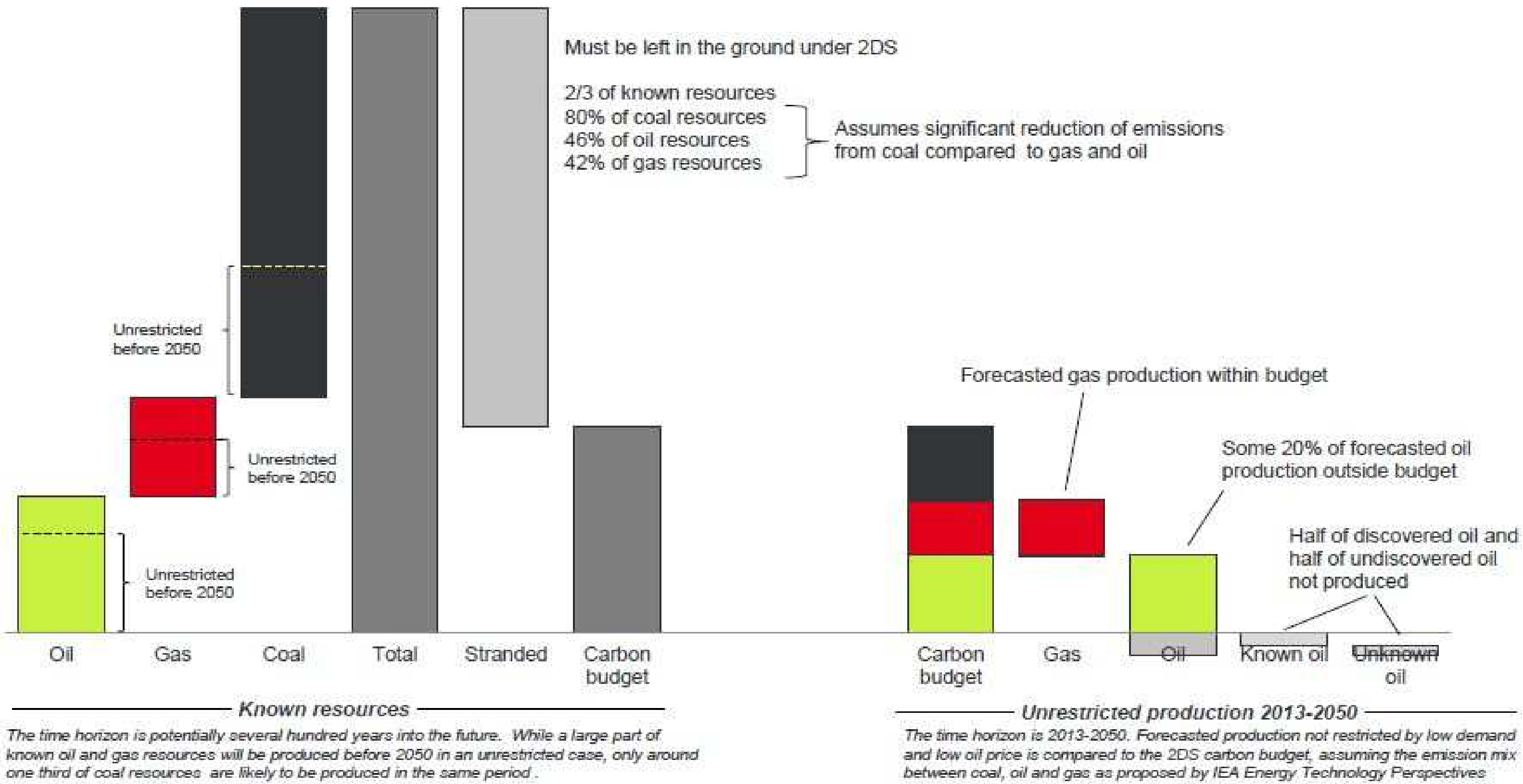


Our research examines the risks of the U.S. continuing on its current path, or "business as usual." Alternate pathways that include investments in adaptation or policy efforts to mitigate climate change through lowering carbon emissions could significantly reduce these risks.

Data Source: Rhodium Group

If carbon is a risk? Some of our assets may already be stranded

CO_2 emission balances under the two degree scenario



http://www.carbontracker.org/site/norwegian-government-assess-exposure-to-stranded-oil-gas-assets

Fiduciary duty and carbon footprint transparency

Is carbon a risk?

➔ **For an answer read the Risky Business report**

http://riskybusiness.org/

How can large institutional investors

- ➔ **Some of them being public**
- ➔ **Some of them being entrusted money to be managed for a very long time (pension funds or insurance companies)**

Justify that

- **They will not do their best effort to assess that risk and what it means for the value of the stakeholders' rights and there after mitigate**
- **That having that information they consider it has not to be communicated to the stakeholders**

The very definition of Fiduciary duty seems to answer that question!

How to quick start a virtuous circle: Making mandatory for public investors to release the carbon footprint of their portfolios

Those who won't make public their carbon footprint
➔ will have to justify to ever more pressing stakeholders

Index providers will be encouraged to propose new benchmarks

Asset managers having to take into account a growing demand, will have to design new solutions or products.

- **Decarbonizing products is already happening (BlackRock, Amundi,…)**
- **Best in Class policies could be tilted**

What could be done by the international stakeholders?

In respect of the trillion dollars that is called to be invested in transition,

➔ Should be **included the investments by pension funds and other investors, which would demonstrate:**

that their investment policies significantly reduce the carbon footprint of their portfolios relative to that of their benchmarks i.e. over and above the minimum threshold to be defined in respect of the objective of limiting the average temperature increase to 2° by 2050.

What is really urgent: at EU level to adopt the ***2030 Package***

➔ To fix the market so it can work

that means to have a price on carbon

➔ To convince large institutional investors to act together

that's what IIGCC is aiming at (cf. Memo sent to European Commission)

➔ To get public opinion on board by stressing the unique opportunity to unleash a wealth of investments if we set up the right framework

The time is now!

I see the the heat arising.
I see trouble on the way.
I see hurricanes and lightnin'.
I see bad times today.

Don't go around tonight,
Well, it's bound to take your life,
There's a bad moon on the rise.

(with my apologies to Creedence Clearwater Revival)

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THANKS FOR YOUR ATTENTION

www.rafp.fr

ERAFP’s key characteristics

45,000
employers

Mandatory, Defined contribution, Fully funded additional pension scheme

€ 20bn
AUM
Fair Value

Created in
2005

100%
SRI

Positive net cash flows above
€2bn per
year until 2023

4,5 million
beneficiaries

Funding Ratio
106,3%

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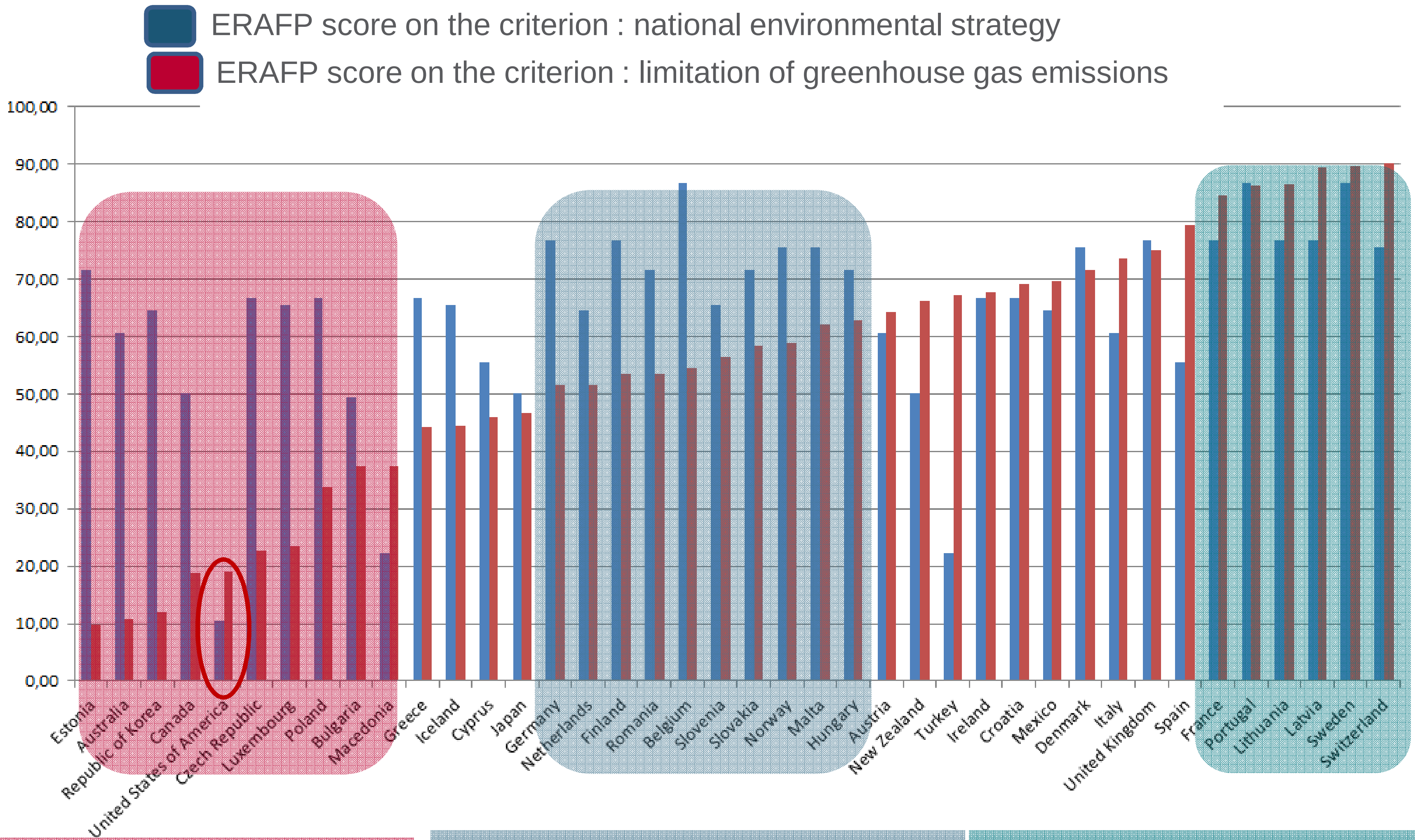
How governments address the urgency to tackle Greenhouse Gas Emissions



Laggards: countries at risk given the very low results obtained in terms of limitation of GES emissions. The US are particularly exposed.

Opportunities: advanced policies but mixed results which might improve if ambitious targets are set at national level

Leaders: advanced policies have already resulted in positive results