

Keeper of France's pension fund savours a new vintage of mandates

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By Sophia Grene

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Like most of Europe, France is facing a funding problem for its pension system. Five years ago, it decided to do something about this and set up the Fonds de Réserve pour les Retraites (FRR).

The fund currently receives about €1.4bn (£1.1bn, \$2.2bn) a year from French tax revenues, but will not start to disburse cash until 2020. At the end of March, it had €31.1bn in the pot. Although its mission is "to ensure the long-term viability of the French pension system", according to its website, chief investment officer Nicolas Sobczak is disarmingly honest about how vague this objective is.

"The government has not yet defined our liabilities. That makes it a little difficult to do an asset liability model," he says.

In the meantime, does the FRR have a strategic plan? Mr Sobczak explains how he justifies the fund's existence. "There's short-term temptation [for the government] to take the money and use it to pay down debt," he says.

"So we want to outperform the cost of public debt," - approximately 4.4 per cent.

At the end of June 2007, the FRR was beating that target comfortably, with an annualised return of 10.8 per cent for all its assets including money market funds. Its equity and fixed income funds, all delegated to external asset managers, had returned a more than respectable 15.8 per cent annually.

Since then, the fund has been buffeted by a stormy market. In the first quarter of 2008 alone, it fell by 8.4 per cent. This helped drag the cumulative annualised performance down to 5.7 per cent. Although this is still ahead of the target, it is notable that the fund has recently terminated two mandates (with Crédit Agricole Asset Management and Capital International) as a result of poor performance.

This setback has not dispirited Mr Sobczak, who is full of enthusiasm for what he regards as "a new vintage of mandates". A recent tender for an equity mandate using a fundamentally weighted index indicates two of the fund's new tendencies.

First, Mr Sobczak looks forward to a more experimental approach to investment, with commodity mandates and investment funds definitely on the agenda and experimentation with new asset classes such as carbon trading on his wish-list.

So far, the mandates have gone to large firms that are able to deal with the administrative demands of a client owned by the French state, well known for its love of red tape, says Mr Sobczak. The very size of the mandates, starting at €0.5bn, is a deterrent for boutique investment firms. However, he and his colleagues are exploring the possibility of "a nursery activity, whereby we would give some seed money to very small funds to try out new processes".

Currently, the FRR's allocation to alternative asset classes is 1.3 per cent. This caution is due to the institution's youth and inexperience, says its CIO. "It takes time to learn about these alternative assets. You need a lot of resources internally, and with private markets, you need to be closer to the markets."

The other tendency illustrated by the fundamental index tender is a shift in favour of passive managers, away from active managers. "The first vintage had a high level of active management - close to 60 per cent," he says. "We're now going into a more standard core-satellite structure."

Some active managers may breathe a sigh of relief at this, as the FRR caps the fees it pays to 20 basis points, which must cover the total expense ratio. "On fees we do not negotiate," says Mr Sobczak firmly, adding that this is a legal restriction. As a state fund, the FRR is subject to a number of such restrictions, including how long a mandate it can give.

"External managers are happy to accommodate us," says Mr Sobczak. "The label is good for them." Critics have accused the FRR of French chauvinism, allocating more money to French managers than is justified on investment grounds. Mr Sobczak is defensive about this, claiming that the spread of asset managers is balanced. He lists a number of French houses, including Axa Investment Managers and Société Générale Asset Management, and a number of foreign firms, such as BlackRock, Goldman Sachs Asset Management and Nicholas Applegate Asset Management.

However, he does admit there are aspects to the FRR's structure that are "very French". It has a supervisory board made up of "social partners": half of them are politicians, civil servants and industry experts and the other half represent trade unions and workers. Mr Sobczak says that persuading the latter cohort to get involved in something that has "exposure to public markets" is "revolutionary for France".

Perhaps the social partners have been swayed by the fund's positive attitude to socially responsible investing. The decision in 2006 to award five SRI mandates highlighted the fund's interest in this area; since then, it has monitored the mandates' performance and continues to consider the options.

"We reviewed this approach and gave some experimental mandates," says Mr Sobczak. "At this stage, they do not underperform." He refuses to be drawn in more detail about those particular mandates, but admits that there are difficulties in delegating decisions that are essentially ethical in nature.

Instead of allocating some of its assets to be managed in a socially responsible manner by external managers, who therefore have to decide on the criteria for SRI, the FRR is planning to impose an overlay on its entire fund. This overlay will be run, or at least overseen, by internal staff, who are yet to be appointed, although a committee has been set up to find them.

Mr Sobczak thinks the FRR's long investment horizon makes it especially suitable for such initiatives. He is also interested in exploring how such a long-term investor can take advantage of any illiquidity premium available.

These issues are not unique to the FRR, so it has regular contact with its longer-established peers around the world.

"We're learning from our older cousins, such as ABP and PGGM," says Mr Sobczak, referring to a couple of large Dutch pension funds.

"We talk about a range of things from governance issues to how to find active managers that are profitable."

Other contributors to the debate include the Irish National Pension Reserve Fund and the Australian Superannuation and Future Funds.

Mr Sobczak's enthusiasm for the conversation, which he describes as "fascinating and very exciting", is infectious. His self-imposed task of raising the profile of the FRR during the forthcoming national debate about how to deal with future state pension liabilities will come naturally to him.

Curriculum Vitae

Nicolas Sobczak

Born: 1968

Education: École Polytechnique and ENSAE (Paris graduate school of economics, statistics and finance)

1991-1997: Economist, French Ministry of Finance

1997-1998: Secondment to International Monetary Fund

1998-2000: Economist, Ministry of Finance and INSEE (National Institute for Statistics and Economic Studies)

2000: Economist, Goldman Sachs

2007: Chief investment officer, FRR

Fonds de Réserve pour les Retraites

Established: 2001

Ownership: publicly owned

Headquarters: Paris

Assets under management: €31.1bn

(£24.6bn, \$47.9bn)

(as of March 30, 2008)

Number of employees: 48

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