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Zentraler Personalausschuss
Central Staff Committee
Le Comité Central du Personnel

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Different views on the "Interview on Financial Study"

On 22 October 2019 the President and VP4 invited four Team Managers to discuss the Financial Study with them. We congratulate our colleagues on stepping forward on this occasion, as they are usually more concerned with managerial tasks than details of Office finances and funding strategies.

Having attentively watched and listened, we would like to add some comments and diverging views on some of the questions posed and the answers the President and VP4 gave.

Do we have a financial problem?

The President's answer was that "*we might face a gap*". The answer hints at the speculative nature of the exercise.

Let's focus on facts:

The RFPSS is at an all-time high[1], and has already reached the level the Financial Study predicted only for 2025. This year's return is in excess of 11%, and thus the second best in the history of the RFPSS. It more than offsets the losses of last year. The EPOTIF is likely to have had similar results. It is also not apparent how an increasing demand for European Patents fits into a scenario where the EPO can no longer set fees at a level to cover its needs. Our series of publications "The Financial Study: Yet another hoax" and the letter which the EPO Pensioners' Association sent to the Budget and Finance Committee offer a comprehensive analysis on that topic.

The liabilities figuring in the Financial Study result from a combination of assumptions not reflecting today's reality, as the President himself admits.

Why the extra EUR 2 billion?

The President argues that the extra €2 billion were due to a further drop in interest rate from about 2% in June to about 1.44% today, contrary to the assumptions in the financial study. Interest rates have indeed decreased since June. However, assuming that this will continue is speculative as also interest rates are volatile. Despite such a low-interest environment the return on the interest-bearing portfolios of the RFPSS[2] seems all the more remarkable. From January to September 2019 it yielded between 7.14% and 11.96%. There are several reasons why there is so much of a discrepancy between the interest-rate and the return of the fixed-income portfolio. First of all, bonds already owned increase in value if interest decreases. Secondly, fund managers don't pursue a "buy and hold" strategy, but rather add value through active strategies (i.e. trading). The major part of both the RFPSS and the EPOTIF is invested in stocks. Stocks show a certain volatility which is, however, rewarded by a significantly higher return.

The additional €2 billion contingency fund has been added without any apparent need. €2 billion is equivalent to a cut in income of almost €290 000 per active staff member. Such a move requires a more solid basis.

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[1] RFPSS/SB 63/19, Figure 1: almost €9.2 billion by end of September, which increased further since. As of today, this year's return is in excess of 14%. In the Financial Study 2019, this value is forecasted for 2025.

[2] RFPSS/SB 58/19, Figure 6:
Domestic Government Bonds (year-to-date (YTD) performance: 10.37%),
Domestic Corporate Bonds (YTD: 7.14%),
Foreign Bonds (YTD: 11.10%),
Emerging Market Bonds (YTD: 11,96%)

Why are EPOTIF and RFPSS not enough to guarantee our future?

The President anticipates extreme reluctance by the member states to activate the money in the RFPSS. But the fund was "*designed to support the Organisation's pension scheme by providing the appropriate reserves*" (Art. 38(b) EPC). We hope that the Member States are at least aware of this design feature. If the fund were never touched it couldn't support the Organisation's pension scheme and comply with the EPC. In fact, money would not be needed from the fund until 2022, and the yearly amounts needed would then be low. Only after 2036 would the yearly amount needed exceed the forecasted RFPSS-return[3].

Are the measures reversible?

To recall how the assumptions were made:

For several years now, the consultancy-firm PPCmetrics[4] performed the asset allocation studies, and calculated the expected return for the RFPSS[5]. This consultant also did the EPOTIF audit[6]. We therefore assume that the Office trusts this consultant who stated in autumn 2018 that the current portfolio will achieve a return of 3.25% with a probability of around 50%.

There is an Actuarial Advisory Group (AAG) which in the most recent report, from summer 2019, also set the expected return to 3.25%, adding that "*some valuations explicitly* ***include a margin for prudence*** *in setting each of the various assumptions* ***particularly as far as the discount rate is concerned***" [emphasis added]. In an earlier paragraph they compare the accounting system, IFRS, and the actuarial funding strategy and conclude that "*there is often a* ***mismatch*** *between the prescribed basis* [i.e. IFRS discount rates] *and what the* [funding for the pension] *scheme expects to happen* ***in real life****."*[7]
[Remarks in square brackets; emphasis (bold) added]

The Central Staff Committee considers the calculations of both the consultants for the RFPSS Supervisory Board and the Actuarial Advisory Group to be transparent and consistent over time.

The consistency of the results of financial studies gives a completely different picture. At the beginning of his term, Mr Campinos contracted two further consultants (Mercer and Oliver Wyman GmbH) to conduct the "Financial Study 2019", which concludes that the EPO is in serious trouble. This study came just months after his predecessor, Mr Battistelli, presented the results of the previous financial study claiming the exact opposite based on the reforms (read: salary cuts) he undertook.

During both of these studies, there was no contact with the CSC. As to the "Financial Study 2019", the CSC is not represented in the newly created Financial Study Steering Group, even as an observer.

After this exercise behind closed doors, the Office presents a Financial Study which contradicts the established consultants, PPCmetrics and the AAG, and uses unprecedented assumptions, thus creating an urgency which even the President admits is not apparent today but only, perhaps, in 20 years' time.

Coming back to the question whether the measures are reversible, the management's answer is yes. But are we ready to give present and future decision-makers the benefit of the doubt? Even if a road map defining the reversibility criteria were in place, as proposed by the President, it is unlikely that it legally binds the Office. A freshly created urgency with still more "prudent" assumptions could be used for setting aside such a road map. A projected time-horizon of 20 years may be considered by a future President as not binding to him/her, anyway. And we can surrender all hope that funds unnecessarily withheld will be paid back in the event of reversing measures.

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[3] see CA/56/19, para. 104

[4] https://www.ppcmetrics.ch/de/home/

[5] see RFPSS/SB 55/18

[6] see CA/F 27/19

[7] see CA/56/19, para. 28

Why is 2.1% the assumed return for the RFPSS?

The President again explained that the return of 2.1% for the RFPSS stems from a more prudent approach and is the result of taking a probability of 60% for reaching the investment target.

Why taking 60% and not 50% or any other more prudent probability? PPCmetrics carefully chose a probability of 50%, and their reasons have been explained [8].

1. Typically, long-term oriented pension funds look at median (or average) equilibrium. Thus even pension funds, which usually follow a more prudent approach than pension reserve funds, such as the RFPSS, use a 50% probability.
2. A 50% probability is based on intergenerational fairness, a concept which should matter for a President claiming to be serious about fairness. Setting the return so low that the target is achieved by a probability of more than 50% immediately translates into higher contributions. On the other hand, since the probability of achieving the target is higher than 50%, later generations will have a high probability that the funds are overfunded when they start to contribute to the scheme, thus allowing a decrease in contributions below an amount which would correspond to 50% probability of meeting the target.

In short, assuming a 2.1% return means that effort and risk are hence not balanced over the generations.

Fairness Old Pension System (OPS) vs. New Pension System combined with the Salary Savings Plan (NPS + SSP)

It is really surprising that the Office suddenly now thinks that there can be savings by aligning the OPS to the NPS + SSP. Up to now, the Office has always insisted that the only difference between being in one or the other is market volatility as far as the SSP is concerned, with no difference in average outcome when comparing the OPS and the NPS + SSP[9].

On the fairness of the distribution of the SSP-cash injections, we refer to our publication "Self-Service of Top Managers?" which shows that cash injection into the SSP accounts can differ by up to factor 15, dependent on which grade you are in.

When introducing the NPS and the SSP the idea was to cover about 50% of the pension by the NPS and the other 50% by the SSP[10]. The idea continues that the SSP lump sum is treated as tax free by the member states, while the NPS is taxed. This would match with the OPS situation where pensioners receive a tax compensation of only 50% of the tax paid on the total.

Strangely, the Office now proposes "*solidarity taxes*" which would only affect the OPS as, by design, the NPS without the SSP would remain under the threshold of twice G1(4). Another measure proposes to reduce the tax compensation for the OPS while leaving the SSP untouched, which appears as a single sided approach in view of the original idea as explained above.

Fair Contribution by the Applicants

A fee evolution which merely offsets inflation can hardly be considered a fair contribution. After all, it is only the same contribution as today. Apparently, Oliver Wyman GmbH[11], one of the authors of the Financial Study, has a major client basis in the IP business, who would be more than happy to see the fees drop to the level the NPOs[12]. So it does not surprise us that this consultant expressed the opinion in the meeting with the CSC that the EPO will not be able to maintain the fees at the current level, let alone increase it.

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[8] RFPSS/SB 55/18 page 20

[9] Some of our colleagues may consider informing the ILOAT about this change in assessment.

[10] see CA/56/19, para. 87 et sqq, in particular para. 90.

[11] https://www.oliverwyman.com/content/marsh/americas/us/en/services/financial-professional-liability/intellectual-property.html

[12] The Member States set the fees based on political considerations, not on economic needs as they can subsidise the NPOs from the general budget.

Moreover, next year, the fees for PCT applications will not even be adjusted[13]. Why? Many applicants currently request an EPO search under the PCT simply because the USPTO has higher fees and ontop of it outsourced the search to a service provider while in the EPO, it is done by a search examiner. Thus, also applicants with no intention of getting a European Patent file a PCT application with the EPO. This leaves us deeply in the red as the product cost for a PCT search is significantly higher than the charged search fee.

Around 40% of PCT applications searched by the EPO never enter the European phase.

Fair Member States' Contribution

Presumably based on the Administrative Council's (AC) decision in the 1980s to transfer all cash surpluses into the RFPSS, the President considers RFPSS cash injections as representing contributions from the Member States. However, because the RFPSS is exclusively an asset of the European Patent Organisation, and thus the Member States, moving money from the EPO's cash accounts into the RFPSS is like rewarding your children for cleaning up their room by moving EUR 10 from your pocket to your wallet.

The creation of the EPOTIF, which effectively sets aside the decision to transfer *all* cash surpluses into the RFPSS, was also made under questionable circumstances, as it was only discussed in the Budget and Finance Committee (BFC) but not in the AC.

As fees are paid by the applicants they can hardly be considered as a fair contribution by the Member States.

There are two immediately apparent measures for the Member States to contribute their fair share, namely

- the distribution key for the national renewal fees, which in the early years was already 60% in favour of the EPO, and
- an internal taxation of the pensions with a corresponding non-taxation in the member states. This solution is implemented in many international organisations.

However, the President sees no possibility to ask for a change of the distribution key or for not taxing pensions by the Member States since the EPO has an annual cash surplus in excess of €400m [sic.].

Conclusion: Financial Study or "Gefälligkeitsgutachten"?

*The General Assemblies in all four places of employment had resolved by vast majority that document CA/83/19 should be removed from the agenda of the BFC. Our previous publications had all been shared with the delegations in the BFC and the AC. Critical interventions by our representatives in the meetings fell on deaf ears. In the BFC-meeting this week in Munich the **17 measures**-document was **passed with a unanimous positive opinion**. Apparently, the Office spent €3m on a "Financial Study" based on wrong assumptions and unnecessary scenarios. Well, they got from Wyman what they paid for.*

Sound reasoning and counter-arguments, dialogue with the President and interventions in BFC and AC quite clearly are not enough.

We will all together have to voice our dismay and discontent to ensure that the negotiations the President is planning are conducted in the staff's interest and to convince the AC to not pass the document in December.

The Central Staff Committee

Annex

[13] see CA/80/19

Note that the numbers in the figure[14] below are not exact, as they are sometimes hard to estimate. However, you should be able to grasp the order of magnitude and so compare it to the potential salary loss of strike-days.

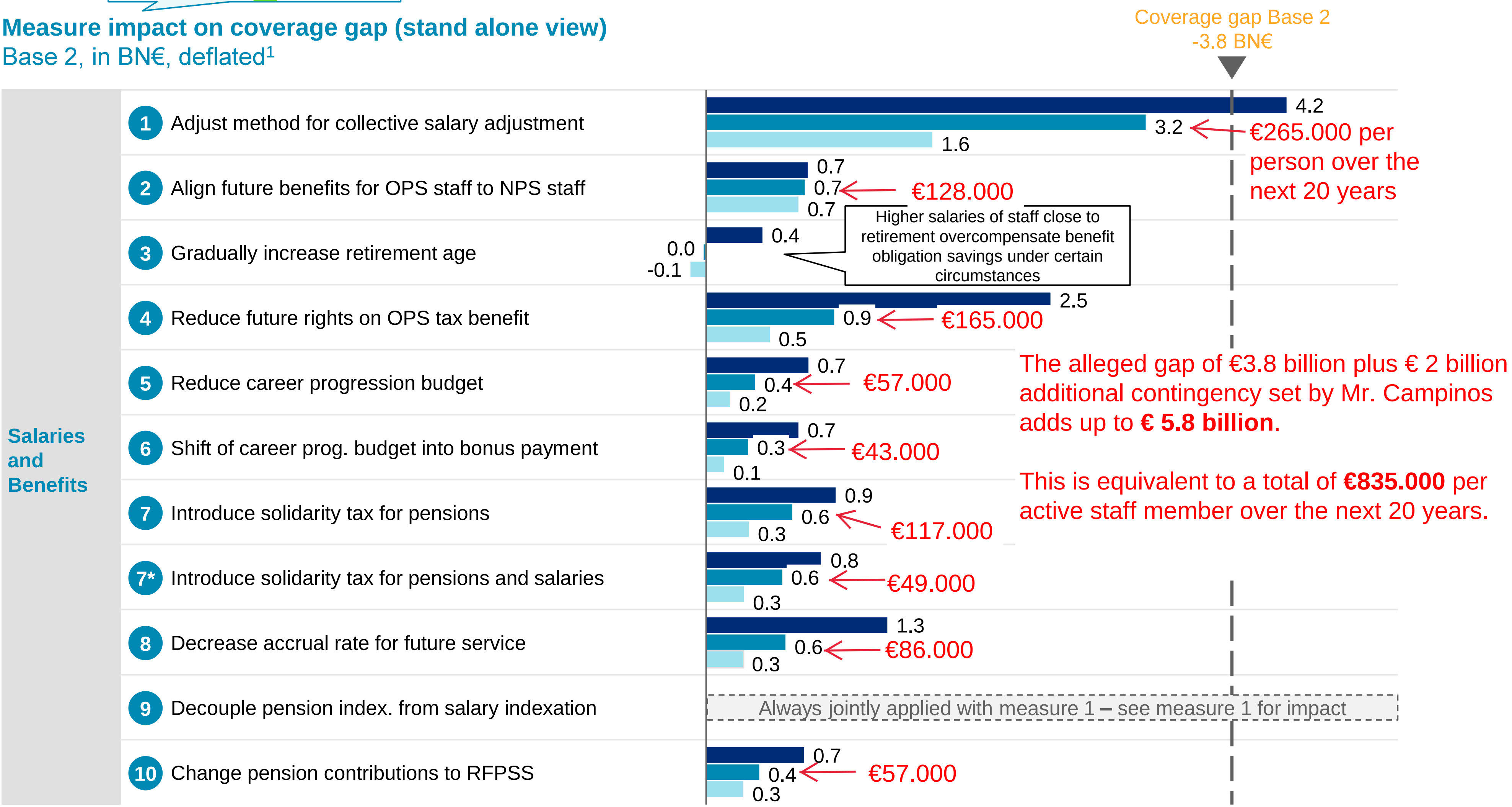
2 Measure impact on coverage gap in Base 2 scenario (1/2)

Adjusting method for collective salary adjustment has largest impact of all measures

Basis: approx. 6950 active staff in the average over the next 20 years (CA/83/19 p.101)
whereof 1500 are in the NPS today (see SSP-SC report to the president)
5115 pensioners in the average over the next 20 years, whereof 2849 already today (CA/56/19 para. 104)

Difference to baseline

Measure impact on coverage gap (stand alone view)
Base 2, in BN€, deflated[1]



1. Deflated to 2018 values with scenario-specific EU HICP inflation

Intensities High Medium Low

[14] figure based on CA/83/19 page 9
Responisbilities / owners acc. to CA/83/19:
external Oliver Wyman GmbH; internal: Elodie Bergot, Vincent Kos, Gurvan le Guern, Nicolas Kopp