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FINANCE COMMITTEE

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Funding of After Service Medical Coverage (ASMC) Liabilities

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EXECUTIVE SUMMARY

- FAO's obligation towards meeting a share of the medical expenses of retirees (After Service Medical Coverage (ASMC)) has been recognized for many years. The presentation of these liabilities in the financial statements as part of the Organization's move towards implementation of International Public Sector Accounting Standards (IPSAS) has further highlighted the issue of the Organization's unfunded accumulated liabilities for these benefits.
- At its 154th session in May 2014, the Finance Committee reviewed document FC 154/3 on the 2013 Actuarial Valuation of Staff Related Liabilities and Addendum I to this document which included detailed information on the level of the accumulated liability for ASMC and options to address the funding gaps of the ASCM. The Committee requested the Secretariat to schedule an informal meeting of the Committee¹, prior to its Autumn session, where the options could be discussed in greater detail.
- This document outlines and further explains a number of options relating to the ASMC liability, provides details of the latest UN system discussions including at the last meeting of the United Nations Joint Staff Pension Board (UNJSPB) as well as the International Civil Service Commission (ICSC) meeting, and provides additional information for the consideration of the Committee.

GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

- This document has been prepared to assist in the debate which is currently under way in FAO and in the United Nations System on ASMC. It is presented for information and for any guidance the Committee may wish to provide.

Draft Advice

The Committee:

- **noted the updated options presented by the Secretariat to address the funding gap of the ASMC liability;**
- **encouraged the Secretariat to further review these options in the context of the considerations of this matter by the United Nations General Assembly, emphasizing the importance of adopting a common approach to this issue by the Organizations of the United Nations System; and**
- **urged the Secretariat to continue its efforts to contain costs of the current medical insurance plan.**

¹ An Informal Meeting was scheduled for 20 October 2014

A. Introduction

1. A medical expenses plan has been an essential part of FAO's staff compensation since 1951, as part of the Social Security plans envisioned in the Staff Regulations: "MS 301.6.2 The Director-General shall establish a scheme of social security for the staff, including provisions for health protection, sick leave, and maternity leave, and reasonable compensation in the event of illness, accident or death attributable to the performance of official duties on behalf of the Organisation."
2. ASMC liabilities arise because FAO has committed itself to providing medical expenses compensation to qualifying staff once they retire from FAO and that responsibility continues until the death of the individual (and possibly after if families have been included).
3. The cost of After-Service Medical Coverage (ASMC) has increased over the years as the costs of medical services and life expectancy have increased. As part of the Organization's efforts to implement International Public Sector Accounting Standards, these liabilities have also become much more visible in the financial statements. While these standards do not obligate FAO to fund these liabilities, they do require FAO to recognize the cost of the benefits for current and future retirees on their financial statements over the active employees' service periods (accrual basis) rather than on a pay-as-you-go basis.
4. ASMC liabilities are present on a similar scale throughout the UN System, and organizations are actively pursuing individual funding strategies to face this challenge. In the case of FAO, some positive actions have already been taken.
5. The requirement to fund the the accruing liabilities of active staff as a result of their current service was recognized in 1997 and since 1 January 1998 the current service cost related to Regular Programme staff members is funded each biennium from the Regular Programme Budgetary appropriation and expensed in the official accounts among costs to deliver the programme of work of FAO. Current service cost for Extra Budgetary staff members is charged to trust fund project expense and funded through project revenues.
6. With respect to the ASMC past service liability (i.e. that part of the liability earned by staff members in prior periods) additional biennial assessments on Members of USD 14.1 million have been approved by Conference since 2004-05 to partly address this liability. These assessments are separate from and in addition to the budgetary appropriations approved to fund the programme of work.
7. FAO has also continued to review ways to reduce the ASMC unfunded liabilities through additional direct funding and investing earmarked assets, exploring various insurance arrangements and plan design changes, including the cost-sharing arrangements as presented in this document.

B. FAO Liabilities

8. The present ASMC liabilities have been calculated by the actuaries based on a total of approximately 3,600 active staff participants in the medical plan and 4,400 retired participants. Dependents are added to this at a ratio of 2 to 1 for staff and 0.6 to 1 for retirees.
9. Over recent years the liability for ASMC in the accounts has been increasing, and will continue to increase if no action is taken. While this has not yet had any negative consequences to date for the practical operation of FAO, the risk of such impact will increase over time.

10. The table below presents the total ASMC Defined Benefit Obligation (DBO) liability on both an accounting and funding basis. While the liability on a funding basis recognizes that there is an inherent cross-subsidization of retire medical claims provided through future active staff member contributions, the accounting valuation of the liability does not reflect this, consistent with standard actuarial and accounting practice (see paragraphs 25 to 26 below for further discussion of the cross subsidy).

| Valuation Basis | Accounting | Funding |
|---------------------------------------|--------------------------|------------------------|
| Assumed FAO Cost Share | 77.0% | 64.5% |
| Discount Rate | 4.30% | 4.30% |
| ASMC Liabilities (DBO)*: | | |
| Retirees/Inactive Participants | USD 648,134,143 | USD 542,917,561 |
| Active Participants | USD 389,292,804 | USD 326,095,921 |
| Total Obligation | USD 1,037,426,947 | USD 869,013,482 |
| Assets set aside to cover liabilities | N/A** | USD 344,494,888 |
| Unfunded DBO | N/A | USD 524,518,594 |
| Funded % | N/A | 39.6% |

* Defined Benefit Obligation, is the present value of employer-provided benefits attributable to service rendered to date. For retirees and active participants currently eligible to retire, the DBO equals their full liability; for active participants not yet eligible to retire, the DBO is a prorated amount of the full liability. Liabilities are discounted based on the yield curve for AA rated bonds, as prescribed by the IPSAS 25 standard, and reflecting the timing of expected benefit payments.

**Not defined as assets have not been ring-fenced. Ring-fencing means the segregation of assets in a trust or other vehicle such that the assets are recognized as being exclusively to fund these benefits.

11. It is important to note that the funding liabilities shown in the above Table are based on a 4.3% discount rate, which would imply the need for a reserve based on an expected return of 4.3% on earmarked assets. To the extent that the assets are invested in a more diversified portfolio with a portion invested in equities, the expected investment returns would be greater than implied by the accounting discount rate, allowing for the use of a higher funding interest rate and therefore a lower funding liability.

C. UN System

Apportionment of Health Insurance Premiums

12. In compliance with a request from the General Assembly (A//RES/68/253), the International Civil Service Commission (ICSC) reviewed earlier this year the apportionment of the health insurance premiums between the United Nations and participants in both the United States and non-United States plans.

13. Based on the substantive data provided to the Members of the Commission, it was observed that, in the light of the situation and practice in the comparator civil service, in Member States where most United Nations staff retire and in many other international organizations, if the Commission were to revise the apportionment, the employer's portion would most likely increase.

14. The Commission decided to recommend to the General Assembly that the current apportionment of health insurance premiums between the Organization and both active and retired staff in United States and non-United States health insurance plans be maintained at their existing ratios.

United Nations Joint Staff Pension Board (UNJSPB)

15. In Autumn 2013, the General Assembly also considered a report of the Secretary-General (A/68/353) and the related report of the Advisory Committee on Administrative and Budgetary Questions (ACABQ) (A/68/550) on managing after-service health insurance (ASHI) liabilities. Following its consideration of these two reports, the General Assembly approved resolution A/RES/68/244, which requested the Secretary-General to examine the option of broadening the mandate of the UNJSPF to include administration of After-Service Health Insurance benefits.

16. Given the possible ramifications of the General Assembly's resolution on the UNJSPF, the Pension Board's Assets and Liabilities Monitoring (ALM) Committee at its first meeting in February 2014 requested that the Consulting Actuary prepare a note on the "Option of Broadening the Mandate of the UNJSPF to Include Administration of After-Service Health Insurance (ASHI) Benefits". The note concluded that there would be no economies of scale or efficiency gains if UNJSPF were to administer these benefits.

17. At its summer session in 2014 the Pension Board took note of the General Assembly's request and expressed its agreement with the conclusions presented in the Consulting Actuary's note. The Board also endorsed the conclusions of the ALM Committee on this matter that it would not be advisable to broaden the mandate of the Pension Fund to include the administration of ASHI benefits, noting that this option could jeopardize the Fund's operational viability and could also negatively affect the long-term sustainability of the Fund depending upon the extent of the adopted measure. The Pension Board also supported the participation of the Fund's CEO in the discussion of the HLCM Finance and Budget Network Working Group on ASHI and requested that the CEO clearly communicate the concerns of the Board of exploring or pursuing any options that would potentially broaden the mandate of the Fund to include the administration of ASHI, and recommended that the HLCM Finance and Budget Network Working Group on ASHI pursue other possible options for ASHI. The Board also noted that the investments objectives of the Fund differed from those of ASHI. Therefore, it might be inappropriate for the Fund to manage the resources related to ASHI.

18. The General Assembly is due to consider the report and recommendations of the ICSC and the UNJSPF this Autumn at its current 69th session .

D. Options to Address the Funding Gap for ASMC

The options listed below are not mutually exclusive and could be combined in certain cases.

(a) Provide additional funding towards the liabilities

19. The total ASMC liability can be funded in a progressive manner by increasing the annual medical expenses assessment on Member States.

20. At present, assessments on Members for this purpose for the biennium 2014-2015 amount to USD 7.05 million annually (based on USD 14.1 per biennium). This level of funding has remained unchanged since it was first approved by the Conference for the 2004-2005 biennium. Based on the results of the 2013 actuarial valuation, this level of contributions would be insufficient to fully fund the obligations over any reasonable period.

21. Additional direct funding to the current USD 345 million earmarked to cover the ASMC benefit costs (with or without ring-fencing) would lower the funding deficit. Assets accumulated would be invested in some prudent manner, with the earnings used to reduce future contribution requirements.

22. It is noted that assets that are to be used to fund ASMC benefit can offset the liabilities on the balance sheet, but only if those assets are ring-fenced. If assets are not ring-fenced, they cannot

directly offset the ASMC liabilities under IPSAS 25. However, any such assets would appear elsewhere on the balance sheet.

(b) Adjust Plan Design and Cost Sharing Arrangements

23. The FAO medical plan is broadly comparable with that of other agencies², both in respect of eligibility and medical coverage. The eligibility provisions address the age and service requirements needed in order to qualify for ASMC in retirement and also define the covered dependents eligible for ASMC. FAO considered a number of changes to the eligibility provisions in 2012, including increasing the normal retirement age as well as the period of service needed to qualify for coverage. FAO might also consider other eligibility changes to reduce ASMC costs, such as reducing the level of coverage provided to covered dependents of retirees. Finally, FAO might also consider pursuing options relating to use of national insurance schemes as primary coverage for retirees.

24. Any combination of changes in these features could result in a reduction of the ASMC liabilities. However, the degree by which the liabilities would be impacted over time would depend on which cohorts of plan participants are affected by any changes. For example, the liabilities will be reduced more in the short-term if changes are applied to the current retirees as well as future retirees. On the other hand, there will be very little short-term impact on the liabilities if changes apply only to future new entrants to the FAO staff. FAO will need to assess whether changes can be made to the plan for the various participant cohorts.

25. The underlying principle of the current cost-sharing arrangement is that FAO and active or retired staff members should equally share the cost of the Basic Medical Insurance Plan (BMIP)³. However, as the retiree contributions may not exceed a certain percentage of their UNJSPF pension or final average pay, this results in many retired participants paying less than 50% of the BMIP premium.

26. The medical plan covers active and retired participants (and their beneficiaries) and the BMIP premiums are based on the claim experience for all participants. However, the average cost of medical coverage for retired participants is usually greater than the average cost for active participants because medical costs typically increase with age. Therefore, a “cross-subsidy” exists between the active and retired populations. For retired participants, this arrangement results in BMIP premiums that are lower than they would be if the ASMC coverage were a stand-alone scheme with no active participants.

27. As a result of these caps and cross-subsidies, retirees are estimated to pay on average 23% of the cost of their ASMC. It is estimated that the current active staff are paying about 12.5% of the remaining ASMC cost through cross-subsidies that are included in their contributions and FAO is responsible for the remaining 64.5% of the cost.

28. It is also possible to consider changes such that the beneficiaries of the insurance should pay more and which would reduce share of the liability to be paid by FAO. Any changes in this area would affect the financial situation of pensioners and/or serving staff and need to be considered in the overall context of health insurance schemes throughout the UN system .

(c) Cost Containment Measures

29. FAO have introduced numerous cost-containment measures and continues to review other measures that could result in future potential savings. However, it would seem that while the work on ensuring efficiencies and economies in the medical plan arrangements is vital to containing current staff costs and needs to continue, these actions in themselves will contribute to a relatively small extent to resolving the ASMC liability issue.

² A detailed comparison may be found in document FC 143/4, Part B.

³ The active or retired staff member is required to pay the entire cost of the Major Medical Benefit Plan (MMBP), which provides coverage for the expenses not covered under the BMIP.

30. The current contract for medical insurance is due to terminate at the end of 2014 and the Secretariat has reviewed the options for a new contract, with a view to ensuring optimal pricing whilst maintaining the coverage. In addition work will continue to maximize opportunities to contain costs overall. It is expected that the contract will be awarded shortly and an update on developments will be given to the Committee during its 156th session in November 2014.

(d) Settle Liabilities with an Insurer

31. FAO recently explored the option of purchasing a separate insurance policy to cover all or part of the amount of the current ASMC accumulated liabilities. The ASMC policy would cover the ASMC claims costs and have a long term guaranteed period during which it would remain in force so that the total period is approximately equal to the time required to fully fund the accumulated liabilities. In addition there would need to be a long-term commitment on the part of FAO to pay the premiums each year in full and neither FAO nor the insurer could cancel the policy early. After reviewing proposals from two insurance companies, it was determined that these policies would be prohibitively expensive with the companies requiring a significant additional premium to cover the uncertainty of the cost of the future benefits

E. Conclusion

32. The issue of funding of ASMC liabilities is now under review in all Organizations of the UN system. The situation in FAO is in most respects similar to that of many other Organizations. As requested by earlier sessions of the Finance Committee the Organization is participating fully in inter-secretariat discussions on this matter and will be participating in the ASHI working group, led by the UN Secretariat. The FAO Secretariat will continue its work to contain costs of the current medical insurance plan and monitor closely the progress of the discussions at the United Nations in New York.