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## FINANCE COMMITTEE

**Hundred and Fifty-first Session**

**Rome, 11-15 November 2013**

**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 but the introduction of the International Public Sector Accounting Standards (IPSAS) has highlighted the issue of the Organization's accumulated liabilities for this obligation.
- This issue affects all UN system organizations and there is currently a wide ranging debate on how to react to it.
- At its 148<sup>th</sup> session in March 2013, the Finance Committee reviewed document FC 148/5 on the 2012 Actuarial Valuation of Staff Related Liabilities, which included detailed information on the level of the accumulated liability for ASMC. The subject was also debated during consideration by the Committee of the proposed Programme of Work and Budget for 2014-2015.
- The Committee requested the Secretariat to present alternative options to address the funding gap of the ASMC liability, including proposals which would lead to a reduction in the liability, and also provide additional data relating to the issue, including in particular the composition of plan members and plan benefits for consideration by the Committee at its next regular session.
- This document outlines a number of options relating to the ASMC liability, gives details of UN system discussions, 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 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.**

## 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). The liability has to be accounted for in each year's financial statements.
3. The cost of this benefit, shared between the Organization and staff, has increased over the years due to increased life expectancy and increased costs of medical services worldwide. While measures have been taken over the years to set aside funds to meet these liabilities, the total available funding remains insufficient to cover the liability, and moreover the liability is forecast to grow over coming years.
4. There are various ways of responding to the issue of ASMC accumulated liabilities, depending on the point of view of the observer but there is no universally agreed solution. All of the organizations of the United Nations system have been seeking to find solutions. At its present (68th) session, the United Nations General Assembly will consider a detailed report by the Secretary-General outlining a way of financing the liability of the United Nations itself, which is approximately three times larger than that of FAO<sup>1</sup>. The Finance Committee will be informed at its meeting on developments in New York.

## B. FAO Liabilities

5. 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. Dependants are added to this at a ratio of 2 to 1 for staff and 0.6 to 1 for retirees.
6. As was noted in the 2012 Actuarial Valuation of Staff Liabilities<sup>2</sup>, the liability for ASMC for 2012 in FAO amounted to USD 1,062.1 million. In 2012 there were USD 266.5 million in Long-term Investments earmarked to partially meet this obligation.
7. Over recent years the liability for ASMC in the accounts has been increasing, and will continue to increase if no action is taken. The fact that Member States have decided not to accept earlier proposals of the Secretariat to increase their funding so as to stabilize or reduce the liability has not yet had any negative consequences to date for the practical operation of FAO. But, it is uncertain how Member States and third parties who deal with FAO will come to view this large liability on the Organization's books and there is a risk that at some point it could lead to a qualified audit opinion based on consideration whether the Organization is a going concern.

## C. UN System

8. The most recent review of this issue took place in June 2013, at the Finance and Budget Network which is a subsidiary body of the Chief Executives Board for Coordination. The meeting generally comprises the chief officers responsible for financial affairs in the organizations of the UN system.
9. The UN Secretariat informed the meeting that options that would be presented by it to the General Assembly this year to address the United Nations ASMC liability, which now amounts to

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<sup>1</sup> Document A/68/353

<sup>2</sup> Document FC 148/7, para 6

USD 3,943 million for 2012. The proposal at the United Nations presented in document A/68/353 would involve two separate charges to common staff costs.

10. The first charge would involve funding the accruing liabilities of active staff as a result of their current service and would amount to a 4.5% charge on staff costs to begin in 2016. The Governing Bodies of FAO already recognized this requirement to fund current service costs in 1997. 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 current programme of work of FAO. Current service cost for Extra Budgetary staff members is charged to trust fund project expense and, therefore, funded through project revenues.

11. The second charge would involve funding the accrued liabilities of existing retirees and active staff, also through charge on common staff costs, but of 2% and for a period estimated at 20 years starting in 2016. At FAO, additional biennial assessments on Members of USD 14.1 million have been approved by Conference since 2004-05 to partly address this liability, after giving consideration to information provided by the Secretariat in subsequent biennia of the increasing funding requirement. These assessments are separate from and in addition to the budgetary appropriations approved to fund the programme of work. Applying a similar approach in FAO to that proposed at the United Nations would bring this funding within the net appropriation and the consequent increase in staff cost could affect delivery of the Programme of Work.

12. The meeting of UN agencies also noted that changes in the discount rate used had had substantive impacts on all agencies liabilities in recent years. In FAO, for example, the change from a discount rate of 4.3% for the 2011 actuarial valuation to 3.9% for the 2012 valuation increased the liability by USD 73 million.

13. The meeting of the Network also recognized that the extremely complex nature of the subject and the large differences within the UN system on this issue indicated that a common approach for funding was not yet possible. Nevertheless it agreed to set up a working group, led by the UN Secretariat, to share further information, consider how to decrease costs of ASMC, propose common criteria for a review of the assumptions underlying the liability drawing on work done by the UN secretariat with the Board of External Auditors of the UN, and explore harmonized criteria for the actuarial valuations. FAO is a participant in this working group.

#### **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*

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

15. As at 31 December 2012, in order to fully fund the US dollar value of the unfunded ASMC liability of USD 798.8 million, and based on a 30 year amortization period, an estimated annual amount of USD 26.8 million at present, increasing to USD 59 million at the end of the period, would be needed. At present, assessments on Members for this purpose for the biennium 2014-2015 amount to USD 7.05 million annually. This level of funding has remained unchanged since it was first approved by Conference for the 2004-2005 biennium, which is insufficient to resolve the problem.

16. As an alternative to a direct payment towards the liabilities, it would also be possible to proceed as is being proposed by the United Nations Secretariat, namely making a separate charge on staff costs to cover the existing accrued liabilities of active staff and retirees within the net budgetary appropriation, with possible negative effects on delivery of the programme of work.

17. It is also possible to consider that the beneficiaries of the insurance should pay more, which would have the effect of reducing the liability of FAO in the accounts. At present, because of ceilings on maximum amounts payable as a percentage of income, retirees pay on average 23% of the cost of

their ASMC, serving staff are estimated to pay a further 12.5% of this cost through a cross-subsidy from their own medical insurance payments, and the Organizations meets the balance of 64.5%.

18. An increase in the percentage of payment shared by staff and/or retirees could however only contribute a relatively small share to the resolution of the problem. Each 1% shift in the burden of the liability from Member States would decrease the liability in FAO's accounts by approximately USD 14 million at present. Any change would of course 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 .

*(b) Insure the liabilities*

19. In certain circumstances it may be possible to purchase an insurance policy to cover all or part of the amount of the current ASMC accumulated liabilities. While the existing medical expenses insurance policy (the primary policy) would be kept in place (funding the medical expenses for active staff/dependents as normal), a new second medical expenses insurance policy (the ASMC policy) might be arranged to cover ASMC members and which would sit alongside the primary policy with the same scope of cover. This second policy however, would only pay claims for ASMC while the primary policy would continue to pay active staff claims.

20. The ASMC policy would have a long term guaranteed period during which it is 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.

21. This option is currently under study. The cost of such an option still needs analysis, as would be the need for long-term funding guarantees. Its impact on the current insurance arrangements would be need to be reviewed and it would also be necessary to ensure with the actuaries and auditors that fully funding the liability via a guaranteed insurance policy over the term determined by the actuary would indeed meet the Organization's obligations .

*(c) Reduce future "new" liabilities*

22. The present obligation to provide a medical scheme for ASMC by FAO is regarded in IPSAS as a defined benefit obligation and it is this type of obligation that gives rise to the liability in the accounts. It might be possible, but only for new entrants to the FAO staff, to consider an alternative, namely providing some form of ASMC coverage through a scheme based on defined contributions. Funds paid in by the Organization and the staff Member during service would be set aside and be made available on retirement to purchase health insurance. No liability arises in respect of defined contribution schemes.

23. This option would need to be studied in depth as it has both implications for the current scheme, for the overall cost of medical insurance, and for the compensation package that FAO could offer to attract and retain staff.

*(d) Adjust the medical plan*

24. In document FC 143/4 Part B, presented to the Finance Committee at its 143rd Session in May 2012, the Secretariat outlined details of the medical plan and possible strategies to contain current costs of the plan, which would at the same time contribute to a reduction in the liability for ASMC. It noted that cost containment relating to the plan had been a continuous concern and outlined a range of measures already introduced. The Finance Committee at that time stressed the importance of adopting a common approach to the settlement of ASMC liabilities by the organizations of the common system under the guidance of the General Assembly of the United Nations and urged the Secretariat to continue with cost containment efforts.

25. The FAO medical plan is broadly comparable with that of other agencies<sup>3</sup>, both in respect of eligibility and medical coverage. Measures relating to adjustments to the plan are critical to ensuring

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<sup>3</sup> A detailed comparison may be found in document FC 143/4, Part B.

efficiencies and potential savings in current and upcoming budgets and can have an impact also on ASMC liabilities. New measures which would reduce specifically ASMC costs might include retirees no longer being able to enroll dependants, and pursuing options relating to use of national insurance schemes for retirees. This latter would almost certainly need to be done on a UN system basis.

26. The current contract for medical insurance is due to terminate in the near future and the Secretariat is currently reviewing the options for a new contract, with a view to ensuring optimal pricing. In addition work will continue to maximize opportunities to contain costs overall.

27. It would seem however 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.

### **E. Conclusion**

28. 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. The upcoming consideration at the General Assembly in New York will provide important guidance for the UN system as a whole.

29. It remains the FAO Secretariat's perspective that a solution will have to be found to this issue as soon as possible through providing additional funding, for example using the assessment mechanism currently in place, or possibly by adapting the proposed solution being put forward at the United Nations adapted to FAO's circumstances. In the meantime, 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.