FC 118/11

April 2007

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منظمة الأغذية والزراعة للأمم المتحدة

联合国粮食及农业组织

Food and Agriculture Organization of the United Nations

Organisation des Nations Unies pour l'alimentation et l'agriculture

Organización de las Naciones Unidas para la Agricultura y la Alimentación

FINANCE COMMITTEE

Hundred and Eighteenth Session
Rome, 17 - 25 May 2007
After Service Medical Coverage Liability Funding in 2008-09

Introduction

1. The Finance Committee reviewed document FC 110/16 at the May 2005 session and considered various funding options for the After Service Medical Coverage (ASMC) liability. The Committee noted that a report of the United Nations Secretariat to the General Assembly on the UN after-service health insurance liability (ASHI) was about to be released. While the UN report would have no impact in terms of FAO's financial obligations for the ASMC liability, some members of the Committee expressed a preference to wait for the UN report in order to consider whether a consolidated approach to the UN system-wide liability would emerge. Therefore, the Committee recommended to Council to continue the funding of the amortization of past service ASMC liabilities for the 2006-07 biennium at the 2004-05 level of US$14.1 million, which had been based on the 2001 actuarial valuation. The Council agreed to the recommendation in November 2005, noting that the Finance Committee would further address the funding issue for 2008-09, with the objective to recommend funding at the level prescribed in the latest actuarial valuations in future biennia[1].

2. The Finance Committee at its 113th session noted that the recommended funding of the amortization of past service ASMC liabilities for the 2006-07 biennium as per the 31 December 2005 actuarial valuation had in the meantime increased by US$31.8 million to US$45.9 million[2]. The Committee also considered the UN ASHI report and expressed the view that the decisions of the General Assembly with respect to the recommendations of the report could be expected to provide valuable insight regarding the accounting and funding of ASHI liabilities at the UN

[1] See CL 129/Rep paragraph 44.

[2] The reasons for the increase were reported in detail to the Finance Committee and Council (see Council Report CL 127/REP paragraphs 84 to 87).

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common system level, and which should guide Member Nations towards a more efficient and cost effective approach in addressing ASMC within the UN system.

3. The General Assembly considered the UN ASHI report in its sixtieth session in September 2006. In its resolution 60/255 the Assembly requested the Secretary-General to submit a report to the sixty-first Assembly session, providing updated information on the status of the liabilities, clarifications regarding the assumptions used to determine the liabilities and alternative strategies to fund the liabilities. It also requested the Secretary-General to take the necessary steps to disclose those liabilities in the UN financial statements. The UN's ASG/Controller is carrying out the Secretary-General's instructions to recognize all accrued liabilities in their interim financial statements through 31 December 2006 and for subsequent financial periods. The Controller has written to all funds and programmes informing them of the UN's action and asked that they take steps to reflect parallel changes within the same timeframe in their financial statements being prepared as at 31 December 2006.

4. The General Assembly considered the latest ASHI report of the Secretary-General in its sixty-first session, and is considering adoption of a series of measures to accrue and fund such liability ranging from utilization of unspent peacekeeping funds and other savings, to the introduction of a special charge to the budget equal to 8% of salary costs. A summary view of such measures is provided in paragraph 8 below based on extracts from UNGA A/61/730 of 7/02/2007.

The ASMC in the UN and in other UN Organizations

5. A comparison between the situation of FAO and that of the UN in New York as well as other large UN organizations as at 31 December 2005 (31 December 2006 for FAO) is detailed in table 1 below:

Table 1

Comparative Analysis of ASMC Liability for UN Organizations as at 31 December 2005

	Total Liability US$ millions	Funding Available US$ millions	Liability recorded on the Balance Sheet US$ millions	Liability not yet recorded on the Balance Sheet US$ millions
FAO*	526	153	173	353
WHO	371	272	206	165
UNICEF*	292	90	90	202
UNDP	407	171	162	245
WFP	95	63	80	15
IFAD	28	28	28	0
UN	2,073	0	0**	2,073
UNESCO	601	0	0	601
ILO	389	0	0	389

* 31 December 2006

** UN will record the liability in full in its Balance Sheet as at end of 2006

6. Every Organization with the UN system will have to individually fund its own ASMC liability. No UN-wide solution is contemplated as each agency has a different magnitude of liability and funding approach.

7. As detailed in Table 1 above, the updated actuarial value of the UN's accrued after-service health insurance liabilities as at 31 December 2005 was calculated at US$2.1 billion. As mentioned in paragraph 3 above, the UN will record all such liabilities in their Financial Statements as at 31 December 2006 and for subsequent periods.

8. The current UN budget provides for only "pay-as-you-go" costs of the after-service health insurance programme for the biennium 2006-07, without setting aside finances to begin funding the actual amount of after-service health insurance liabilities. In view of the expected continued growth of the programme and the rising level of the associated liabilities, the Secretary-General considers it essential to adopt a funding policy that supports the process of ensuring that adequate funds are put aside to meet the costs of current plan participants and future benefit liabilities with the aim to fully fund such liabilities. To this end five different alternatives are currently under consideration within the UN. The fifth alternative combines options present in the first four alternatives and potential funding strategies under consideration as part of alternative 5 are summarised below:

a) Establishment of an independently segregated special account for an after-service health insurance reserve fund to be used to meet current and future after-service health insurance liabilities;

b) Funding of current and future after-service health insurance liabilities of the United Nations with effect from 1 January 2007 and transfer to the special account for the after-service health insurance reserve fund the following:
   - Initial funding of US$503.5 million comprising a transfer of US$410.0 million from unencumbered balances and savings on or cancellation of prior-period obligations of active peacekeeping missions as at the end of the 2005/06 fiscal year; US$61.5 million to be transferred from the medical and dental reserves; and US$32.0 million to be transferred from the compensation fund to partially fund the United Nations liability;

c) Ongoing funding entailing a) continuation of biennial appropriations and partial funding under annual peacekeeping support account appropriations to cover contribution payments in respect of current after-service health insurance participants; b) establishing a charge equivalent to 8 per cent of salary costs to be applied against the budgets to which staff salaries are charged; c) utilization of unspent budget appropriations in the United Nations regular and peacekeeping budgets; d) transfer of any excess of actual overestimated miscellaneous income; e) transfer of savings from liquidation of prior-year obligations.

Proposal a) was approved by the General Assembly while b) and c) will be considered in more detail at the General Assembly's Sixty-third Session.

Frequency of Actuarial Valuations at FAO

9. The Council in November 2004 decided that biennial funding should match the amortization of past service ASMC liabilities. The need to adjust the amount of biennial funding in accordance with the latest actuarial valuation was recognized by the Council when it endorsed the Finance Committee's recommendation in 2003 to include US$14.1 million in the 2004-05 Budget Resolution towards the ASMC liability. Paragraph 37 of the Report of the Council's 125th Session is reproduced below:

Liabilities for After-Service Medical Costs

37. The Council noted that the Finance Committee considered that the current arrangements for funding After-Service Medical Costs (ASMC) liabilities were clearly insufficient and that the issue needed to be addressed as a matter of urgency. The Council endorsed the Finance Committee's recommendation that the 2004-05 Budget Resolution include an amount of US$14.1 million to offset the amount of the liability to be amortized during the biennium, according to the biennial actuarial valuation, and that this amount should be reviewed in each subsequent biennium and adjusted accordingly to reflect the current valuation.

10. The Council in June 2005 noted that an actuarial valuation of the liability was performed at the close of each biennium for the purpose of providing figures for the official audited accounts. It expressed concern that the estimate had changed significantly from that provided at the time of the 2003 Conference due to a one-time change in demographic assumptions and the impact of the Euro exchange rate. The Council stressed the importance of making recommendations regarding funding level decisions on the results of an up-to-date actuarial valuation, based on the latest assumptions and exchange rates.

11. The Finance Committee reviewed document FC 115/12 at the September 2006 session and noted that the Organization was engaged in a joint tender for the provision of an annual actuarial valuation to cover all the Rome-based agencies. The tender was awarded in December 2006 and annual actuarial valuations instead of biennium-end valuations would henceforth be performed in order to provide more up-to-date cost estimates for budgetary and funding purposes in addition to allowing conformity with annual IPSAS requirements.

12. This paper presents the results of the latest actuarial valuation of the ASMC as at 31 December 2006, and funding options for 2008-09.

13. The external actuaries have recently completed the actuarial valuation of the ASMC liability as at 31 December 2006. The actual claims performance for 2006 was considered, while financial, demographic and other assumptions were reviewed and updated to reflect the period covered by the 2006 valuation. The significant changes from the 2005 valuation assumptions applied by the actuaries include:

- an increase in the general inflation rate from 2% to 2.5%
- changing the initial medical inflation rate of 6.5% grading down to an ultimate rate of 4.5% over 10 years to a medical inflation rate of 5.0% for all years.
- an increase in the discount rate from 4.5% to 5.0% ; and
- an increase of the average USD/Euro exchange rates from 1.14 U.S. dollars per euro to 1.22 U.S. dollars per euro.

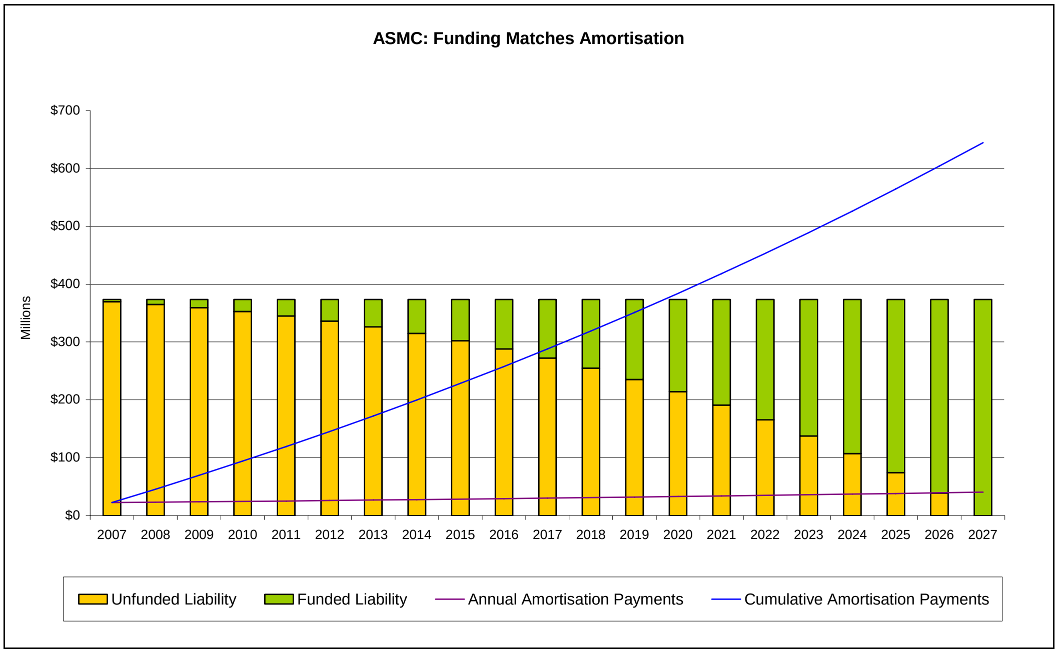
14. The estimated past service ASMC liability as at 31 December 2006 amounted to US$526.3 million, representing a slight decrease of US$7.1 million compared to the liability of US$533.4 million as at 31 December 2005. The result of the 2006 valuation shows that the ASMC past service amortization funding necessary for the 2008-09 biennium, using the original 30 year amortisation period which began in 1998, amounts to US$45.0 million compared US$45.9 million of the 2005 valuation. As per the 2006 valuation, the annual current service cost to be met by the Regular Programme Budget had declined to US$12.9 million compared to US$13.6 million per year in the 2005 valuation.

15. Further details of the 2006 valuation can be found in Appendix A "Summary of Results – 31 December 2006 Preliminary Valuation of the After Service Medical Plan" as issued by the actuaries.

FAO Funding in 2008-09

16. When past service amortization is matched with funding for each biennium at the level prescribed by the latest 2006 actuarial valuation, in accordance with the Council's position expressed in its 125th session and in line with the expectation expressed by Council in November 2005[3], this approach aims to assure full funding of the ASMC liability by 2027. On the basis of the latest 2006 actuarial valuation, the biennial amortization required starting in 2008-09 would amount to US$45.0 million. This represents an increase of US$31 million from the 2004-05 and 2006-07 biennial funding of US$14.1 million. Table 2 below shows the schedule for the funded and unfunded ASMC liabilities with annual and cumulative amortisation payments. The table illustrates full funding of the past service amortization in each biennium.

Table 2



Conclusion

17. The Committee is requested to recommend to Council the level of funding of the amortization of past service ASMC liabilities which Member States should be assessed in 2008-09. As mentioned in FC 109/17, it is recommended that the ASMC funding decided by Member Nations should be made in both US Dollars and Euro in the proportions recommended in the Asset and Liability Study, i.e. 60% in Euro and 40% in US Dollars, at the agreed budget rate for the 2008-09 biennium.

[3] see CL 129/Rep paragraph 44.

APPENDIX A

SUMMARY OF RESULTS – 13 DECEMBER 2006 PRELIMINARY VALUATION OF THE AFTER SERVICE MEDICAL PLAN

Past Service Liability

The chart below shows the slight decrease in FAO's past service liability for the After Service Medical Plan from 31 December 2005 to 31 December 2006 as per the preliminary valuation. The sources of the decrease of the past service liability are as follows:

	Past Service Liability
As at 31 December 2005	$ 533,442,261
As at 31 December 2006	526,324,230
Decrease	$ (7,118,031)
Source of Increase/(Decrease) in Past Service Liability:	
Expected Increase Based on 2005 Valuation (1)	$ 22,620,840
Increase in Expected Medical Claims Costs (2)	12,544,122
Changes in Assumed General and Medical Inflation (3)	(2,376,549)
Increase in IAS 19 Discount Rate (4)	(43,011,457)
Change in Mortality Assumptions (5)	1,409,288
Miscellaneous Demographic Experience (6)	1,695,725
Total	$ (7,118,031)

As shown above, the past service liability for the After Service Medical Plan has decreased since 31 December 2005. The primary cause of the decrease in liability is the increase in the IAS 19 discount rate. This decrease is partially offset by active staff members earning an additional year of service toward benefit eligibility and by an increase in expected medical claims costs and administrative expenses.

Assumptions

1. The increase is the sum of FAO's interest cost and service cost for 2006 based on the 31 December 2005 valuation, less the benefits expected to be paid during 2006 based on the valuation. This is essentially the expected growth in the liability due to: (a) the passage of time; and (b) active staff members earning an additional year of service toward benefit eligibility; offset by (c) any benefits paid during the year.

2. The increase from 2005 to 2006 is partially due to exchange rate movements. Although the valuation results for the After Service Medical Plan are expressed in U.S. dollars, approximately 2/3 of the claims in the After Service Medical Plan are actually incurred in euros. The 31 December 2006 valuation of the After Service Medical Plan is based on an average exchange rate of 1.22 U.S. dollars per euro. This rate is approximately equal to the average exchange rate for the period from 1 January 2003 through 31 December 2006. The 31 December 2005 valuation was based on an average exchange rate of 1.14 U.S. dollars per euro. As a result, the expected claims costs used in the valuation increased approximately 5.3% due to the movement in the exchange rate. This is in addition to the increase in expected claims costs due to underlying medical inflation.

3. The 2005 valuation assumed a general inflation rate of 2.0% and an initial medical inflation rate of 6.5% grading down to an ultimate rate of 4.5% over 10 years. The 2006 valuation assumes a general inflation rate of 2.5% and a medical inflation rate of 5.0% for all years. The increase in the ultimate rate of medical inflation approximately offsets the decrease in the initial rate of medical inflation, resulting in a slight reduction in the liability for the After Service Medical Plan.

4. The IAS 19 results assume a discount rate of 5.0% versus 4.5% in the 31 December 2005 valuation. The discount rate has been determined as approximately 2/3 of the current yield on high-quality Eurozone corporate bonds plus 1/3 of the current yield on high-quality U.S. corporate bonds.

5. The 31 December 2006 valuation uses the 1993 U.N. mortality table with mortality improvements projected through 2006. In contrast, the most recent valuation of the U.N. Joint Staff Pension Fund used the 1993 U.N. mortality table with mortality improvements projected through 2021.

6. The increase refers to the change in liability that is attributable to movements in the covered population that were not precisely predicted in our valuation assumptions. For example, if individuals who are eligible for the After Service Medical Plan retire a bit earlier than assumed in the valuation, this can result in an increase in the liability from one valuation to the next.

Recommended Contribution – Past Service Liability and Service Cost

The chart below shows the recommended contribution to the After Service Medical Plan based on the 31 December 2006 preliminary valuation. For comparison purposes, the recommended contribution from the 31 December 2005 valuation is also shown.

	31/12/2006	**31/12/2005**
Funding–Liabilities and Assets		
Past Service Liability	$ 526,324,230	$ 533,442,261
Assets	152,839,454	135,807,664
Surplus/(Deficit)	$ (373,484,776)	$ (397,634,597)
Contribution Assuming Assets Count As Plan Assets		
Service Cost	$ 15,429,513	$ 16,069,682
Amortization	22,481,378	22,963,398
Total Contribution	$ 37,910,891	$ 39,033,080