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RESOURCE MANAGEMENT

(f) After Service Health Insurance (ASHI) liability management and funding

Note by the Secretary-General

SUMMARY

Executive summary:	This document provides an update for the Council on the Organization's After Service Health Insurance (ASHI) liability, the ASHI funding position across the United Nations system, and outlines a package of funding measures to provide a long-term solution to the issue
Strategic direction, if applicable:	7
Output:	Not applicable
Action to be taken:	Paragraph 44
Related documents:	C.ES/29(5), C 118/5, C 117/5(d), C 102/8, resolutions A.1112(30), A.1100(29) and A.1063(28)

Introduction

1 During the Council's consideration of the Organization's results-based budget for the 2018-2019 biennium, the Secretary-General raised the matter of funding the Organization's After Service Health Insurance (ASHI) liability, first in document C 117/5(d) and subsequently in document C 118/5. The Council agreed to a proposal to make a transfer of £1,400,000 from the resources remaining in the regular budget for 2016-2017 as an interim measure while a holistic funding approach was developed which is consistent with good practice from the United Nations system.

2 This document provides:

.1 a summary of the ASHI situation, funding mechanisms and current funding levels elsewhere in the United Nations system;

.2 a background to the Organization's own ASHI liability situation, including those interim funding measures taken to date, two separate but related funding challenges; and

.3 an outline package of funding measures to address the funding shortfalls.

3 While positive steps have been taken to date through interim funding measures, the ASHI liability requires urgent attention in order to avoid exposing Member States to an increasing financial burden in the future.

ASHI funding in the United Nations system

4 United Nations staff members are international civil servants and on retirement often will not qualify for health insurance in the country of residence during retirement. The standard United Nations staff member's contract of employment allows retiring staff to continue to participate in their organization's health insurance schemes, with the organization continuing to pay a proportion of the premium associated with that insurance.

5 In principle, therefore, the cost in "cash" terms of employing a staff member continues into retirement years for health insurance. During the period 2008-2014, the United Nations system moved to financial reporting under International Public Sector Accounting Standards (IPSAS) which, in common with most accruals-based accounting methodologies, requires the recognition of the full cost of employing staff including future liabilities reported upon in the financial statements.

6 Many United Nations system organizations, even prior to the adoption of IPSAS, had funding in place for the liabilities associated with ASHI. For the majority of United Nations organizations, however, the introduction of IPSAS resulted in a significant financial liability showing on financial statements for the first time, bringing it to the attention of auditors and stakeholders.

7 IPSAS therefore highlighted the issue of funding ASHI, both in terms of establishing a funding plan for existing deficits and ensuring that looking ahead the full cost of employees is budgeted during their time of service. A United Nations working group has been established to address the ASHI-related issues in a systematic way, and has, inter alia, recommended that each organization ensure that adequate funding is in place to meet the ASHI liability. The external audit teams have systematically called for all United Nations entities to put in place adequate funding for ASHI.

8 The United Nations system periodically conducts surveys to determine the current status of each organization with respect to ASHI funding, and the results are summarized in table 1.

Table 1 – overview of ASHI liability and funding levels for those organizations with a funding plan in place

Funding area	UN system average[1]	IMO
ASHI liability, £'000	731,281	40,303
ASHI funding in place, £'000	312,515	7,505
Funding percentage	43%	18%

9 There is no single approach being taken by United Nations organizations, and in part this reflects the different funding systems used to deliver differing mandates – a programme-funded organization with a focus on delivering aid, with a large field presence and proportionately high levels of project staff, would require a different funding approach to a largely headquarters-based, normative organization where the proportion of staff funded on permanent posts through the regular budget is higher. Of those organizations with a funding plan in place, some models are more mature than others. Five organizations already have over 50% of their liability funded, two have over 70% funding while four have just started. Nevertheless, there are some lessons to be drawn from the information across the United Nations system:

.1 **Full funding of current costs** – the United Nations ASHI Working Group recommended as an absolute minimum that organizations:

"…**fund the additional cost accrued during the current period, represented by service cost plus the corresponding interest costs. For those organizations that are still following a pay-as-you-go approach in relation to their after-service health insurance liabilities, that would mean a move to a pay-as-you-accrue approach, reflecting the true cost of current operations.**"

As a result, most United Nations organizations now have in place a means of budgeting which allows them to fund the full costs of employing staff at the time they work for the organization, rather than when the payments fall due. In the case of ASHI, the payments can continue for decades after a staff member retires, and the Working Group recognized the importance of ensuring that those payments are also properly funded. For organizations without a funding plan for the overall liability, moving to a full funding approach for current costs at least ensures that the situation will not continue to deteriorate;

.2 **Overall funding levels –** while funding levels do vary, most organizations have at this point established a minimum funding for ASHI and many have identified a long-term funding target to which their funding strategy is aligned; and

.3 **Methodical approach to funding the long-term liability –** it is widely recognized that it is not practicable for Member States to fund ASHI liabilities in a single biennium, and that a long-term, methodical funding plan is an

[1] For organizations with a funding plan in place for either full current year costs and/or funding historical liabilities.

essential component of addressing the issue which balances the short-term budget pressures of Member States while allowing them to address the funding issue effectively over time.

10 In the following paragraphs, these lessons are used as the basis for developing a long-term funding mechanism for IMO.

IMO's ASHI liability – background and trends

11 IMO first reported its ASHI liability in the 2010 financial statements with the first set of IPSAS compliant financial statements. Prior to this and in preparation for IPSAS adoption, an actuarial assessment of the ASHI liability (along with similar liabilities for repatriation benefits and accrued annual leave) was conducted for the first time in 2008-2009, then estimating the ASHI liability at £15,000,000. The issue of funding for the liability was drawn to the attention of the Council in document C 102/8 (paragraphs 14.2 and 14.3).

12 Since that time, the Organization has taken two steps to address ASHI funding:

.1 The approval of interim ASHI funding at the Assembly's twenty-ninth and thirtieth sessions, by means of Assembly resolutions A.1100(29) and A.1112(30) for amounts of £6,000,000 and £1,400,000 respectively; and

.2 The approval of a charge on project staff of 7%, to be transferred to the Termination Benefit Fund for the purposes of funding ASHI, by means of resolution A.1063(28).

13 There is, however, no long-term funding mechanism in place either to meet the full cost of staff or to address the liability. As the funding has continued to be on a "pay as you go" basis rather than recognizing the full current cost of staff, the unfunded part of the liability has in fact increased significantly since 2010 and will continue to grow unless adequate funding is made available. Table 2 shows the movements in the ASHI liability and the corresponding funding set aside for it since the adoption of IPSAS in 2010.

Table 2: After Service Health Insurance liability and assets - annual movements *(in £'000)*

	2010	2011	2012	2013	2014	2015	2016	2017
Liability movement:								
Opening liability	17,146	17,675	24,255	25,688	28,868	30,634	29,302	35,508
Increase/(decrease) from actuarial assumptions	(609)	5,426	-	1,726	-	(3,129)	4,576	3,004
Increase from funding gap between 'full cost' and 'pay as you go'	1,138	1,154	1,433	1,454	1,765	1,798	1,630	1,792
Closing liability	***17,675***	***24,255***	***25,688***	***28,868***	***30,634***	***29,302***	***35,508***	***40,303***
Assets for ASHI purposes:								
Opening assets	-	-	-	-	-	4	22	6,061
Assets provided by transfer	-	-	-	-	-	-	6,000	-[2]
7% charge on project staff	-	-	-	-	4	18	39	44
Closing assets	***-***	***-***	***-***	***-***	***4***	***22***	***6,061***	***6,105***
Net deficit	**17,675**	**24,255**	**25,688**	**28,868**	**30,630**	**29,280**	**29,447**	**34,198**

2 The additional transfer approved by the Assembly at its thirtieth session of £1,400,000 is not included in this table as it will take effect during 2018.

14 The funding gap has increased significantly, as a result of:

.1 a significant annual gap between the "full" expenditure figure and the "pay as you go" figure for which resources were provided in the budget; and

.2 adjustments to the actuarial assumptions which in aggregate have increased expectations about inflation and reduced the discount rate used to calculate the present value of future payments, both of which increase the liability estimate.

15 Without a more permanent solution, the liability will continue to grow and will increasingly burden Member States and detract from the core work of the Organization in the years ahead. Indeed the Organization's External Auditor warned in 2015 that:

> "The trend analysis indicated that the "pay as you go" financing model being operated for ASHI could expose the Organization to the risks of escalated costs, arising from increases not only in the liability itself but also its servicing expenses, and may consequently begin to consume a greater proportion of the annual budget of the Organization… Our review disclosed that some United Nations agencies have developed medium-term funding plans with the aim of fully funding their employee benefit liabilities instead of the "pay as you go" model. In our view, this funded approach to end-of-service benefit liability will create an asset base which matches the movement of the liability, reducing the Organization's exposure to increases in the liability."[3]

16 The need for a long-term funding solution is increasingly urgent, and such a solution is proposed in the remainder of this document for the Council's consideration.

Addressing the challenges – funding mechanisms

17 There are two separate but related funding challenges which the proposals in subsequent paragraphs seek to address:

.1 to ensure that for future biennia the full current cost of staff members is included in the Organization's results-based budget, and thereby to prevent the unfunded liability from increasing significantly in each biennium; and

.2 to address, by means of a long-term plan, the funding of the substantial current ASHI liability and consequent deficit in the Organization’s Termination Benefit Fund, and thereby to ensure the long-term financial health of the Organization as a whole.

18 The Council and the Assembly stated their intention to find a more stable and sustainable funding solution to the ASHI issue, but that a holistic approach was necessary which addresses the issue not just for the current biennia but forms a part of the Organization's financial framework for the future in a sustainable way.

[3] Document C 114/4(b)/1 paragraphs 22 and 25.

Budgeting for full current costs

19 The funding gap between the "pay as you go" budget model and the annual cost of the ASHI scheme as determined by the actuaries has averaged £1,520,000 per year since 2010, leading to over £10,000,000 of the increase in the current liability since that time. In order to ensure that the budget reflects the full staff costs each year, the staff costs budget for staff employed in all funds should include the ASHI element.

20 This would most effectively be achieved by adding a percentage "ASHI charge" on all staff cost budgets. That charge would then be transferred to the Termination Benefit Fund to provide the funding to meet the future ASHI liability. This mechanism is similar in principle to that applied for project staff as approved by the Assembly by means of resolution A.1063(28), and would therefore have the advantage of maintaining a consistent approach. It is also the approach used by many other United Nations entities and is recognized as good practice in the United Nations system and by external auditors.

21 This approach is also consistent with a move towards a "standard costing" budgeting approach and allows for the full cost of the staff in each division to be more clearly tracked and assigned to the Organization’s strategic directions.

22 Based on the 2018-2019 results-based budget and using a 7% ASHI overhead figure which is both consistent with practice elsewhere in the United Nations system and which would result in a total budget charge matching the current cost determined by the actuary, this would have impacted the Organization's funds as shown in table 3.

Table 3: Budgetary impact of a 7% ASHI premium on staff costs

Approved budgets (£'000)			**Indicative revised budgets (£'000)**	
2018	**2019**		**2018**	**2019**
34,141	35,429	Regular budget	35,515	36,802
6,576	6,729	Trading Fund	6,692	6,845
1,144	1,167	Headquarters Capital Fund	1,144	1,167
859	859	Termination Benefit Fund	859	859
115	115	Training and Development Fund	115	115
5,150	4,850	Technical Cooperation Fund	5,180	4,880
47,985	**49,149**	**Total Annual Expenditure**	**49,505**	**50,668**
		Impact on year on year resource requirement	1,520 **3.2%**	1,519 **3.1%**
	97,134	**Biennial Total**		**100,173**
		Impact of biennial resource change		3,039 **3.1%**

23 The introduction of such an ASHI charge on staff costs for the 2020-2021 results- based budget would therefore reflect the full current cost of IMO staff, and would ensure that the unfunded portion of the ASHI liability would no longer increase.

Developing a long-term approach to address the accumulated ASHI deficit to date

24 As at 31 December 2017 the Organization's ASHI liability stood at £40.3 million, with the funding gap for ASHI shown in table 2 having reached approximately £32.9 million.

25 In developing a proposal to address this issue, the Secretary-General has sought to provide a long-term funding solution which is balanced in terms of its demands on Member States while ensuring that funds are in place to avoid Member States facing a serious funding challenge many years in the future.

26 The Organization's Termination Benefit Fund holds both the ASHI liability and the funds set aside to meet it – while the Fund also has other matters within its terms of reference, its primary purpose remains the funding of termination and post-employment benefits, with ASHI funds being segregated from other balances. The Secretary-General then proposes a two-step approach to building up funds for the accumulated ASHI liability. These are:

Step 1 – an immediate enhancement of the Organization's ASHI reserves to a target level of 35% of the liability, building on funds already provided, and transfers of available resources from other funds; and

Step 2 – an annual funding mechanism to add to those funds, drawing on sources of revenue aside from the annual assessment on Member States.

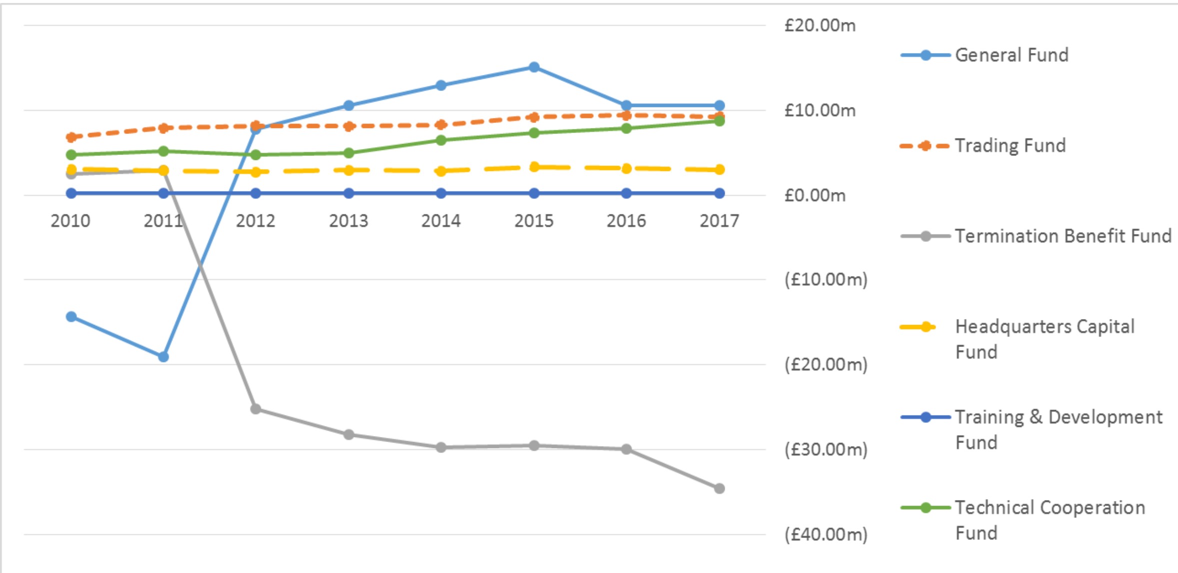
27 These steps are set out below.

Immediate enhancement of ASHI reserves

28 Table 1 shows an ASHI liability of over £40 million, and the Secretary–General proposes to put in place funds to meet approximately 35% of that liability during the current biennium, which would provide a strong starting point for longer-term efforts. The Council will recall that two transfers have already been made from resources available in the General Fund, one for £6,000,000 by means of Assembly resolution A.1100(29), and a second for £1,400,000 by means of Assembly resolution A.1112(30).

29 To further add to the reserves it is proposed that the Organization could first seek to utilize reserves available in other funds. The reserves position for each of the Organization's funds from 2010 is shown in the chart below[4]:

Chart 1 : Showing the reserves of the Organization's funds from 2010 to 2017
(in £'000)



4 The Working Capital Fund has a specific purpose and no annual budget, and consequently is excluded from this analysis

30 The ASHI liability is included in the Termination Benefit Fund, and consequently the reserves of that Fund show a significant deficit. In other funds, however, the reserves which have accumulated over time are a valuable source of contingency for unexpected expenditure, but have now reached a level that is higher than is necessary for that purpose. As a matter of prudence, it is reasonable to hold two months' of expenditure as a year end reserve figure, with amounts in excess of this being available for transfer.

31 A first step in providing a ring-fenced funding base would therefore incorporate transfers from general reserves to ASHI-specific reserves of the amounts shown in table 4, following the Assembly's approval at its thirty-first session.

Table 4: Fund reserve levels and available transfers for ASHI

Fund	Reserve level, 31 December 2017	Required reserve level, £'000	Proposed transfer from reserves to ASHI reserve
General Fund	10,587	5,690	4,897
Trading Fund	9,285	7,696[5]	1,589
Total			**6,486**

32 This would allow the Organization to set aside a total of £14.0m 6 against its ASHI liability of £40.3m, a funding level of 34.7%, without impacting the Organization's work or requiring additional funding from Member States.

Establishing an annual funding mechanism to meet the existing liability

33 While a funding level of approximately 35% is a positive position, for most organizations which have set a long-term funding target, that target is between 80% and 100% of the liability, and by that measure the Organization still has a funding shortfall that needs to be addressed. As an organization which has a long-term standard setting purpose and a normative nature, there is no immediate pressing need to fully fund the liability in the medium term, and a target funding level of 80% is more appropriate. With this in mind, a mechanism is needed to move from the initial funding base to that target level, which for the current liability level would require funds set aside of £32,242,000.

34 The Council will recall that the Organization's Trading Fund generates a significant annual surplus which is then distributed using the approved Trading Fund surplus distribution formula, to support the Organization's other work, most notably the Technical Cooperation Fund. The full Trading Fund distribution formula for the current biennium is showing in table 5 below.

5 Taking into account the annual transfer from the Trading Fund of approximately £6,600,000.

6 Representing the £6,105,000 from table 2, the additional £1,400,000 approved by the Assembly at its thirtieth session, and the £6,486,000 shown in table 4.

Table 5: Approved transfers from Trading Fund surplus for the 2018-2019 biennium

	TCF	HQCF	TBF	TDF	RB
Percentage of surplus	76.0%	12.5%	1.0%	1.5%	9.0%
Approximate amount for 2018-2019, £'000	8,220	1,352	108	162	974

35 From table 5 above, applying the 9% used by the regular budget for the current biennium and maintaining it to support the Termination and Benefit Fund would generate approximately £1,000,000 per biennium, at current sales levels, as a funding source for ASHI, and without impacting on the Organization's Technical Cooperation activities.

36 In addition, the Council may decide that, as a matter of course, any funds remaining in the regular budget would be ring-fenced within the Termination Benefit Fund for the purposes of funding ASHI – if the annual underspend amounted to only 1% of the total regular budget, this would provide a further £700,000 per biennium.

37 On the assumption that full current costs are included in the results-based budget as set out in paragraph 22 and consequently the unfunded amount of ASHI will not increase annually, with a target funding level of £32,242,000 and the one-off funding from reserves set out in paragraph 32, these additional funds of £1,700,000 per biennium would allow the Organization to reach its funding target in approximately twenty years.

38 Such a funding timeframe is not uncommon in the United Nations system, and at IMO could be achieved without a disproportionate or dramatic impact on Member States. Nevertheless, this approach relies on maintaining revenue levels in the Trading Fund, and on low consistent transfer of resources from those available in the regular budget at the end of each biennium – the uncertainties associated with the exact funding available from each of these sources, coupled with the impact on the liability itself arising from any changes in actuarial assumptions, means that the funding approach should be kept under review on a biennial basis, and adjusted where necessary.

39 In addition, as the balance of funds available increases, these can be appropriately invested with interest earned further contributing to the ASHI funding – discussions have already taken place with other United Nations organizations to determine whether it is feasible to pool IMO's funds for investment purposes with those of other United Nations entities and thereby benefit from their scale and expertise. However, the profile and amount of IMO's ASHI funds available for long-term investment do not lend themselves to investment with other United Nations entities. The other United Nations entities have significantly larger amounts to invest for different timelines, diverse investment policies and they do not have GBP to invest. With that in mind, IMO will seek to maximize its investment potential in GBP offerings in line with its investment policy which suits IMO funds profile and avoids exposure to foreign exchange and administrative costs associated with funds management in the other United Nations entities.

Summary and budgetary impacts

40 Paragraphs 18 to 37 have established a package of measures to address the ASHI funding situation, working together to reach a reasonable funding target over a long-term but realistic time frame. These measures, and their budgetary impact, can be summarized as:

.1 A results-based budget which recognizes full current costs for ASHI for all funds, thereby avoiding an annual increase in the unfunded ASHI liability (paragraphs 18 to 22). Based on the 2018-2019 budget this would have impacted the Organization's budgets as shown in table 3 above.

.2 Measures to fund the existing ASHI liability (paragraphs 23 to 37):

.1 An immediate enhancement of the funds set aside for ASHI in the Termination Benefit Fund through a transfer of reserves totalling £6.486m (paragraphs 27 to 31) in the current biennium; and

.2 A biennial contribution of approximately £1.7m from a combination of the Trading Fund surplus and remaining regular budget funds (paragraphs 35 to 37). All else being equal, the removal of the Trading Fund subsidy of the regular budget in favour of a transfer to fund ASHI would result in an increase of 1.6% in the assessment for 2020 and 1.3% for 2021, although this would be a one-off increase as it represents a change in the assessment baseline rather than an ongoing increase.

41 Through this combination of measures, IMO might anticipate meeting a funding target of 80% of the ASHI liability by 2040, although this would continue to require regular review to ensure that interim targets were being met.

Repatriation costs

42 Similar in nature to the ASHI liability is that related to repatriation costs for Professional staff members. Staff recruited internationally are entitled, on conclusion of their time at IMO and subject to meeting appropriate criteria, to claim repatriation expenses of various sorts including a repatriation grant, travel and relocation costs. The amounts for repatriation costs included in the results-based budget have, in common with most other United Nations organizations, been on a pay-as-you-go basis, and for the same reasons under IPSAS accounting this has resulted in a smaller but not insignificant accumulated liability, as shown in table 6 below:

Table 6: Repatriation liability since the introduction of IPSAS reporting, £'000

	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Liability movement:								
Opening liability	3,186	3,217	2,591	2,729	2,830	2,615	3,034	3,374
Increase/(decrease) from actuarial assumptions	(110)	(716)	-	(3)	-	398	244	(53)
Increase from funding gap between "full cost" and "pay as you go"	141	90	138	104	(215)	21	96	84
Closing liability	***3,217***	***2,591***	***2,729***	***2,830***	***2,615***	***3,034***	***3,374***	***3,405***

43 In the first instance, the immediate priority is to ensure that the full current cost for repatriation costs is included in the results-based budget for 2020-2021, a relatively small difference of approximately £80,000. As the current liability itself is significantly smaller than that relating to ASHI, it can in due course be addressed either through extending the period of the ASHI funding mechanisms set out in paragraphs 34 and 35 or by such other mechanism as may be determined in due course.

Action requested of the Council

44 The Council is invited to:

.1 note the information provided in this document;

.2 note that detailed figures will be included in the 2020-2021 budget proposal once the current biennium's position is clearer;

.3 agree that the Secretariat should prepare budget proposals for future biennia on a fully-costed basis for staff costs and in particular for both ASHI as set out in paragraph 22 and for repatriation costs as set out in paragraph 42;

.4 agree to the transfer of reserves of approximately £4,900,000 from the General Fund and £1,600,000 from the Trading Fund to enhance the funding set aside for ASHI in the Termination Benefit Fund, as set out in paragraphs 31 and 32;

.5 agree, in principle, to the amendment to the Trading Fund surplus distribution formula as set out in paragraph 35 to transfer 9% of the annual Trading Fund surplus to the Termination Benefit Fund to fund the ASHI liability;

.6 agree to the assignment of resources remaining in the regular budget to the Termination Benefit Fund to fund ASHI as set out in paragraph 36; and

.7 note that this package of measures would, in principle, achieve a funding target of 80% of the ASHI liability by 2040, but that the achievement of this target would be kept under review by the Secretary-General, who may make amended proposals from time to time as necessary (paragraph 41).