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FINANCE COMMITTEE

Hundred and Ninety-ninth Session

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2023 Actuarial Valuation of Staff Related Liabilities

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EXECUTIVE SUMMARY

- This document updates the Finance Committee (the "Committee") on the preliminary results of the actuarial valuation of the Organization's liability for staff-related plans (the "Plans") as at 31 December 2023. It contains three sections as follows:
  - *Section I. Introduction* describes the Plans, which provide distinct benefits to staff either on completion of service or as a result of work-related illness or injury. It also explains the purpose of annual actuarial valuations.
  - *Section II. Results of Actuarial Valuations* summarizes the total liability of the Plans as at 31 December 2023, 2022 and 2021 and provides the key assumptions used in those valuations. During 2023, the total liabilities of the Plans decreased by an amount of USD 10.4 million from USD 992.7 million at 31 December 2022 to USD 982.3 million at 31 December 2023. The various reasons for the decrease are detailed in this section.
  - *Section III. Current Financial Situation* provides the total recorded, unrecorded and net balance sheet liabilities for the Plans based on the actuarial valuations, as well as the total funded and unfunded liabilities for the Plans as at 31 December 2023, 2022 and 2021, respectively. The total unfunded liability of the Plans as at 31 December 2023 was USD 374.2 million compared with USD 458.6 million at 31 December 2022. Following the request of the Committee at its 198th Session in November 2023, this section also provides a status update on cost containment measures and options to reduce the funding gap on the After Service Medical Coverage liability.

GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

- The Committee is invited to note the results of the 2023 actuarial valuation and the current financial situation, accounting and funding of the Organization's liability for staff-related plans at 31 December 2023.
- The Committee is invited to acknowledge the ongoing efforts to review alternative strategies and options for funding staff related liabilities, and to provide guidance thereon.

Draft Advice

The Committee:

- **noted that total staff related liabilities as at 31 December 2023 amounted to USD 932.3 million, representing a net decrease of USD 10.4 million from the valuation at 31 December 2022;**
- **noted that despite the decrease in total liabilities, the After Service Medical Coverage (ASMC) liability remained seriously underfunded; and**
- **welcomed the update provided on cost containment measures and the proposals to reduce the funding gap for ASMC, and noted that further analysis would be presented by the Secretariat at a future session of the Committee.**

I. Introduction

1. FAO (the "Organization") has five staff-related plans (the "Plans") that provide benefits to staff members either upon completion of service or as a result of work-related illness or injury. The Plans are as follows:

- Separation Payments Scheme (SPS): the provisions of the SPS apply only to staff members in the General Service category at headquarters and are paid on separation from the Organization or on promotion to the Professional category;
- Termination Payments Fund (TPF): the TPF comprises benefits payable to staff upon separation from service, specifically Repatriation Grant, Repatriation Travel and Removal, Commutation of Accrued Leave, Termination Indemnity, and where applicable, Death Grant;
- After Service Medical Coverage (ASMC): a medical insurance plan for retired staff and their families meeting certain eligibility criteria. The in-service equivalent of ASMC is the Basic Medical Insurance Plan (BMIP) for active staff members. Both ASMC and BMIP provide partial reimbursement for certain hospital, physician, dental, psychiatric, physical therapy, hospice and eyeglass charges subject to various limits and exclusions. The premium of the ASMC is nominally shared between the retired staff member and the Organization;
- After Service Medical Insurance (ASMI): an alternative plan, ASMI, is offered to active national staff hired after 30 September 2016 in duty stations categorized other than headquarters 'H'. The plan details were ratified by the Organization in 2023, with retroactive application to 1 January 2022. At 31 December 2023, there were no retirees eligible for ASMI. Historically, active staff in the Medical Insurance Coverage Scheme were reflected as hypothetical participants in the ASMC valuation, pending establishment of a separate ASMI. With the adoption of a separate ASMI, these staff were moved to a separate ASMI valuation at 31 December 2023. Due to the small size of the ASMI population, this group has been valued under ASMC assumptions and provisions; and
- Compensation Plan Reserve Fund (CPRF): the CPRF provides benefits subject to certain limitations to staff members and Non-Staff Human Resources (including, *inter alia*, consultants and persons holding Personal Service Agreements) in the event of injury, illnesses, or death attributable to the performance of official duties. The benefits include annuities or lump-sum payments (supplementing the UN Pension benefits, if applicable) in the event of death or disability, and reimbursement of reasonable medical, hospital and directly related expenses.

2. All of the above-mentioned Plans are treated by the Organization as defined benefit plans. To meet the financial reporting requirements the Organization obtains annually a valuation of all plans from an external actuarial firm. This allows the Organization to:

a) Determine the Organization's overall liabilities associated with the Plans.

b) Establish the annual expense related to the Plans' maintenance.

c) Quantify recommended rates of contributions to fully fund the liabilities.

d) Obtain information necessary to meet financial reporting requirements.

3. The actuarial valuations for 2023, 2022 and 2021 were all performed by Aon Hewitt (www.aon.com). This document refers to the results of the actuarial valuation as at 31 December 2023 and the current financial situation, and accounting and funding of the Organization's liability with information as at 31 December 2022 and 2021 provided as comparisons.

II. Results of Actuarial Valuations

4. A comparison of the total actuarial liability by plan as at 31 December 2023, 2022 and 2021 is detailed in Table 1.

Table 1

(in USD Millions)		Increase/ (Decrease)			Increase/ (Decrease)		
Plan	**2023**	***USD m***	***%***	**2022**	***USD m***	***%***	**2021**
CPRF	16.0	*(2.1)*	*-11.5%*	18.1	*(5.0)*	*-21.7%*	23.1
TPF	66.7	*2.9*	*4.6%*	63.8	*(12.0)*	*-15.9%*	75.8
SPS	38.4	*1.9*	*5.3%*	36.5	*(11.0)*	*-23.2%*	47.5
ASMC	855.4	*(19.0)*	*-2.2%*	874.4	*(519.0)*	*-37.2%*	1,393.4
ASMI	5.8	*5.8*	*n.a.*	-	*0.0*	*n.a.*	-
Total actuarial liability	**982.3**	***(10.4)***	***-1.0%***	**992.7**	***(547.1)***	***-35.5%***	**1,539.8**

5. The net decrease in the actuarial liability between 2023 and 2022 amounted to USD 10.4 million. Table 1a below provides a breakdown of the reasons for this decrease, with the most significant impact coming from the updates to expected medical claims and trend rates, offset by a decrease in the discount rate across all four plans:

Table 1a

Sources of Changes of the Plans from 2022 to 2023	**Variations USD millions**
Expected change, without new entrants *	32.6
Decreases in Discount Rates	44.1
Updates to Expected Medical Claims and Trend Rates	(96.5)
Movement in Year End Euro-Dollar Exchange Rate	18.8
2023 Net Accounting Benefit Payments Different Than Expected**	(7.8)
All Other Experience and Assumption Changes***	(1.6)
Total net decrease	**(10.4)**

** Expected change due to interest cost and service cost, offset by expected decrease due to actual benefit payments made*
*** Excludes the effect of the movement in the spot euro-dollar exchange rate in the prior year*
**** Includes the liability for new hires and the impact of decrease in general inflations, salary increases, separations, and other demographic items.*

6. The actuarial valuation of the Plans requires the Organization to make certain assumptions in order to best estimate the cost of providing these benefits to its staff members. These include demographic assumptions (e.g. mortality rates/estimates, rates of staff member turnover, claim rates under medical plans, etc.) and financial assumptions (e.g. discount rate, future salaries and benefits, future medical costs, etc.). Owing to changes in both internal and external factors, the Organization, together with the actuaries, performs an annual review of the assumptions used in the actuarial valuation and adjusts them where it is deemed necessary for a more accurate calculation of the Plan liabilities. Like most actuarial calculations, annual valuations are subject to significant uncertainty and unpredictability. In particular, the values of the Organization's liabilities for the Plans are highly sensitive to changes in the Euro-United States Dollar exchange rate, the discount rate, medical claim rates and anticipated medical inflation.

7. The key assumptions used in the valuations of the Plans for 2023, 2022 and 2021 are presented in Table 2.

Table 2

Key Assumptions	2023	2022	2021
Economic			
Discount rate			
ASMC & ASMI	4.2%	4.5%	2.2%
SPS	3.2%	3.8%	0.7%
TPF	4.3%	4.6%	2.0%
CPRF	5.0%	5.2%	3.0%
Medical cost inflation rate	4.45% during 2024, decreasing 0.05% annually to 3.8% in 2037 and later years	4.5% during 2023, decreasing 0.05% annually to 4.0% in 2033 and later years	4.4% during 2022, decreasing 0.05% annually to 3.85% in 2033 and later years
General inflation rate	Varies by plan (2.1% - 2.5%)	Varies by plan (2.2% - 2.5%)	Varies by plan (2.1% - 2.5%)
Year end spot rate €/USD	1.1099	1.06	1.14

III. Current Financial Situation

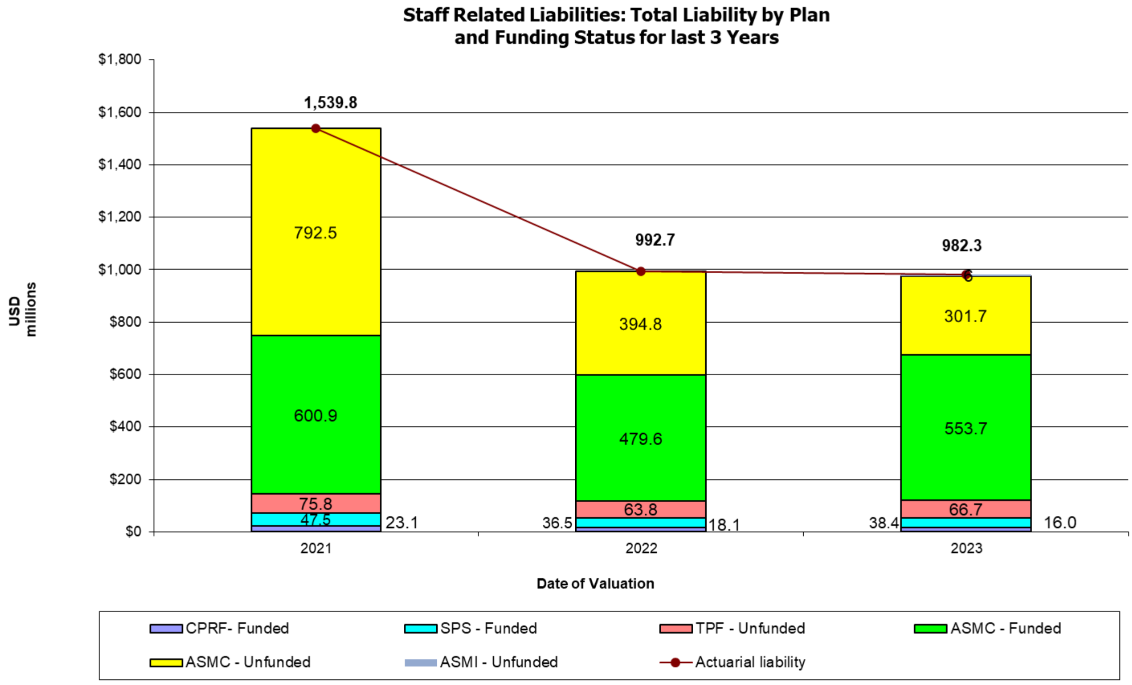
8. Table 3 below shows the total recorded liabilities for the Plans based on the actuarial valuations, as well as the total funded and unfunded liabilities for all Plans as compared with the fair market value of earmarked long-term assets at 31 December 2023, 2022 and 2021 respectively.

Table 3

USD millions	2023	2022	2021
Plan			
Fully Funded			
CPRF	16.0	18.1	23.1
SPS	38.4	36.5	47.5
Partly Funded			
ASMC	553.7	479.5	600.9
Total Funded	608.1	534.1	671.5
Funded by:			
Earmarked long-term investments (at Fair Market Value)	**(608.1)**	**(534.1)**	**(671.5)**
Unfunded			
ASMC	301.7	394.8	792.5
ASMI	5.8		
TPF	66.7	63.8	75.8
Total unfunded liabilities	**374.2**	**458.6**	**868.3**
Total actuarial laibility	**982.3**	**992.7**	**1,539.8**

9. Conference resolutions 10/1999 and 10/2001 provide that long-term investments and any income which they generate are to be applied first to ensure the adequacy of funding of the SPS and CPRF. The resolutions also provided that any additional investments and related income then be earmarked for the ASMC and subsequently for the TPF. As at 31 December 2023, both the ASMC and TPF continue to be underfunded as shown in Graph 1.

Graph 1

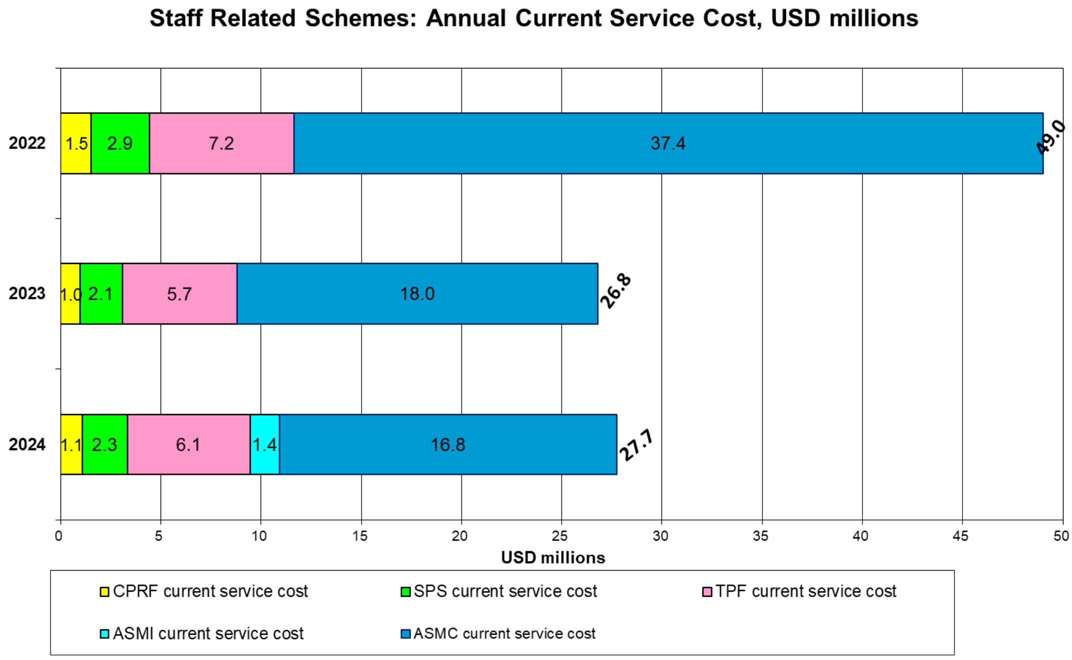


10. During 2023, the carrying value of long-term investments earmarked by the Organization for the Plans increased by USD 74.0 million from USD 534.1 million at 31 December 2022 to USD 608.1 million at 31 December 2023. Further details on these investments are presented in the *Report on Investments 2023* (document FC 199/3).

11. In addition to the unfunded past liabilities, all schemes contain a current service cost. The current service cost is a standard component of staff costs and arises each year as active staff members provide their services in exchange for these benefits to be paid in the future. Only the Regular Programme portion of the current service cost is met from the budgetary appropriations of the Programme of Work (PWB). The PWB is prepared on the basis of the last available estimate of current service costs as prepared by the external actuaries. The Trust Fund portion is charged to Trust Fund projects.

12. Graph 2 shows the annual Current Service Costs for all schemes for the three years ending 31 December 2024. These costs are based on the actuarial valuations for the preceding years at 31 December 2023, 2022 and 2021, respectively.

Graph 2



13. At its 198th Session in November 2023 the Finance Committee "requested Management, working closely with the United Nations and United Nations affiliated agencies, to continue to explore viable options, other than reinstituting a special assessment, to address the underfunding of After Service Medical Coverage (ASMC) liabilities in coordination with other organizations of the United Nations common system for concrete presentation to the Committee as soon as possible" (CL 174/9, paragraph 9(c)). An update on the progress of this review, along with strategies taken to-date by the Organization to address this issue and details of further analysis required, is presented below.

14. The Organization is in the process of reviewing the following options in order to evaluate their individual and collective contribution to funding the ASMC amortization payments. Some of these studies have been completed and are reported below, while others are ongoing and will be reported at a future session of the Finance Committee for Members, including on:

i) National Health Insurance Schemes: A comprehensive and more financially beneficial medical insurance plan for retirees who have access to high-quality national health insurance schemes;

ii) Subsidization: A policy to fully or partially subsidize the contribution to the national health systems in high-cost medical care locations;

iii) Liability Settlement: Settlement of liabilities with an Insurer;

iv) Uniform Charge on voluntary contributions: Application of a uniform symbolic charge of 0.5 percent on voluntary contributions to contribute towards the funding of past after-service medical coverage liabilities, as recommended by the Joint Inspection Unit in JIU/REP/2023/5;

v) Uniform Charge on the Regular Programme budget: Application of the same 0.5 percent surcharge as option iv) above, on the Regular Programme budget; and

vi) UN Best Practices: Review of other best practices within UN system organizations, including comparative reviews of investment funding policies, in conjunction with an Asset-Liability Management study.

15. **National Health Insurance Schemes and Subsidization:**

i) **US Medicare and Subsidization**: The Organization continues to explore solutions to contain the cost of providing health care benefits to its retiree population through integrating national health insurance schemes or its equivalent into ASMC. Based on recommendations from an external consulting firm, best practices of other UN organizations, and with the approval of the FAO Advisory Committee on Medical Coverage (FAC/MC), a pilot initiative to integrate the national health insurance scheme in the United States of America (US Medicare) was launched in 2024 (Pilot Project).

ii) The Pilot Project will have significant financial benefits for both FAO retirees and the Organization. US Medicare will act as primary coverage and ASMC will act as secondary, top-up coverage for medical expenses incurred in the United States of America, providing 80 percent and 15 percent of expenses, respectively. In 2022, claims paid for 380 retirees and their dependents who resided in the United States of America and were covered under ASMC totalled USD 5.8 million, representing approximately 18 percent of the total USD 31.3 million retiree claims paid for that year. Such high costs are not unusual in the United States of America, and FAO retirees will continue to incur significant medical expenses every year.

iii) It has been estimated that annual cost reductions due to FAO retirees voluntarily enrolling in US Medicare prior to this Pilot Project amounted to USD 2.1 million. Analysis further indicates that if the Organization had required all current FAO retirees to enrol in US Medicare when they first became eligible, USD 3.8 million per year in savings could have been realized (USD 1.7 million additional annual savings than currently).

iv) In light of the significant potential benefits of recommending US Medicare as the primary coverage for United States retirees, in launching the Pilot Project, the Organization has held various townhall meetings with FAO retirees and published related policy and procedural documents. The Pilot Project has been met with widespread support from FAO retirees during FAO Human Resources Division outreach efforts that were conducted in March 2024, and could lead to valuable lessons learned that will benefit future integrations of national health insurance schemes of other high-cost countries with ASMC.

v) Management has performed preliminary studies to assess the potential cost savings of encouraging the adoption of US Medicare by way of offering a premium subsidization to the retired United States population which would benefit from such coverage. This non-mandatory initiative started in February 2024. Management anticipates that at least a year's data will be necessary to assess the effective cost reduction generated by this initiative and will report these results at a future session of the Finance Committee.

16. **Liability Settlement with an Insurer**: Sponsors of defined benefit pension plans have bought out part or all of the current retirees' liability via a one-time payment to an insurance company from plan assets. The Organization outsourced a feasibility study of settling the health care liabilities with an insurer. Based on the analysis undertaken, liability insurance is considered unsuitable for FAO for the following two reasons.

i) The current ASMC liability reflects the ASMC benefits earned to date for current retirees (including their dependents and survivors) and active staff eligible for retirement, plus an accrual from hire date to retirement eligibility date for other active staff. Therefore, the liability is for benefits payable up to 50 years or more in the future. To insure the ASMC liabilities, the Organization would need to contractually agree with an insurer which benefits would be included. This would limit the bought-out retirees' access to new medical treatments and technologies that will become available over a long-term horizon while also creating inequities between their benefits and those for active staff participants, rendering the Organization a non-competitive employer within the UN system.

ii) Due to the duration of the ASMC liabilities, and high levels of uncertainty in future medical claims and medical costs, there is little or no existing market for buyouts of similar benefits.

The implication of not having access to a competitive marketplace is that any potential bidder would charge a large markup over the existing liability, and which could not be funded by the existing asset base available.

17. **Uniform Charges on voluntary contributions**: During a recent management and administration review of the Organization by the Joint Inspection Unit (JIU), the JIU recommended that the Council should request the Director-General to present a proposal to introduce, by the end of 2024, a uniform symbolic charge on voluntary contributions (e.g. 0.1 to 0.5 percent of their total value) to supplement the funding of past after-service medical coverage liabilities that has already accumulated through assessed contributions and the interest on them. To address this recommendation, Management engaged its external actuaries to model five scenarios for funding the ASMC. In all five scenarios, it is assumed that payments to cover the Service Cost have been paid in to the plan and that the available asset base earns the same percentage returns as the interest rate applied to liabilities. The impact on the ASMC funding ratio was quantified for each of the following proposals over a 30-year period:

i) Scenario #1 (baseline) – make no amortization payments;

ii) Scenario #2 (target 90 percent funding in 30 years) – quantification of the level of amortization payments, starting in 2024, required to target 90 percent funding by 31 December 2053;

iii) Scenario #3 (annual amortization charge of 0.5 percent on voluntary contributions) – a charge equivalent to USD 7.5 million per year based on estimated annual voluntary contributions of USD 1.5 billion, to be approved to start in 2026, until 2053, with quantification of the funding ratio that would be achieved by 31 December 2053;

iv) Scenario #4 (make annual amortization payments 0.5 percent of the current Regular Programme annual budget) – a charge equivalent to USD 2.55 million per year based on the current annual budget of USD 511 million, to be approved to start in 2026, until 2053, with quantification of the funding ratio that would be achieved by 31 December 2053; and

v) Scenario #5 – quantification of funding ratio that would be achieved by 31 December 2053 by increasing the value of amortization payments to USD 10.05 million per year from 2026 onwards, based on implementing both Scenarios #3 and #4 above.

18. The results of the aforementioned studies are presented in Table 4 below.

Table 4

Summary of Results of 31 December 2023 Funding Projections

Scenario	Annual Amortization Payment in USD millions	First Year with Amortization Payment	Projected Funded Ratio at 31 December 2053
Scenario #1 (Baseline)	0.0	Not applicable	40%
Scenario #2 (Target 90% Funding in 30 Years)	14.1	2024	90%
Scenario #3 (USD 7.50M Amortizations in 2026+)	7.5	2026	64%
Scenario #4 (USD 2.55M Amortizations in 2026+)	2.6	2026	48%
Scenario #5 (USD 10.05M Amortizations in 2026+)	10.1	2026	72%

19. The analysis performed predicts that benefit payments will increase over time due to anticipated growth in per capita medical costs, whereas the current Service Cost, funded through appropriations and charged to Trust Fund projects, is heavily impacted by the discount rate. Due to the sharp rise in the discount rate in 2022, there is a significant disconnect between these two sources of change in the value of the ASMC liability.

20. The results of the analysis in Scenario #1 demonstrate that the funded ratio is projected to decrease over time. This outcome is as expected as the unfunded liability is projected to grow with interest each year if FAO makes no amortization payments.

21. In Scenario #2, a USD 14.1 million annual amortization payment is projected to attain 90 percent funding by 31 December 2053. The other scenarios fall in between Scenarios #1 and #2, producing correspondingly intermediate projected funded ratios. Notably, Scenario #3, which would generate the same amount of funding as the ASMC assessment made on Member Nations of USD 7.5 million per annum through biennium 2016-17, approximately maintains the current funded ratio over the course of the projection. Had the ASMC assessment not been suspended, due to the benefit of compounding returns, an additional USD 48.9 million of funding would have been available, resulting in a funding ratio of 69.8 percent as at 31 December 2023.

22. Based on current conditions regarding real salary increases, mortality, and disability assumptions, medical cost increases, and asset returns, if Members and Trust Fund donors were to approve strategies presented under Scenarios #3 and #4, the Organization could aim to achieve approximately 72 percent funding of the ASMC by 31 December 2053.

23. **The Secretariat requests the Committee to provide guidance on the aforementioned proposals as well as the forthcoming study on the effects of US Medicare on the liability and advise as to how the Organization should take forward the underfunding issue.**

24. **Asset-Liability Management study**: The Investment Committee requested the Secretariat to review FAO’s strategic asset allocation, with specific mention to review the benefit of additional assets classes on funding ratios within the wider asset and liability management (ALM) review which was tendered for in Q3 2023. The tender identified a consultant for this review which will start in Q2 2024, and the results will be reported to the Finance Committee in a future session.

25. The Organization remains committed to containing those costs of its health plans that are within its control and to work with the Members to provide long-term solutions to addressing the unfunded ASMC liability.