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FINANCING PLAN TO MANAGE RISKS ARISING FROM LONG-TERM EMPLOYEE BENEFITS AT WIPO

prepared by the Secretariat

Background

1. Following the discussions on agenda item 7, Report by the External Auditor (document WO/PBC/33/15) during the October 2021 session of the Program and Budget Committee (PBC), the PBC recommended to the Assemblies of WIPO, each as far as it is concerned, to take note of the recommendations from the "Report by the External Auditor" on this agenda item:

> *"(…) recommend that WIPO: (a) in consultation with Member States, establish a target level of earmarked funds for its ASHI liabilities; b) consider the risks and benefits of formally designating earmarked ASHI investments as plan assets to enhance transparency over net liability; c) consider and engage Member States on the options for mitigating the potential future growth in ASHI liabilities."*

2. Furthermore, during the 33rd Session of the PBC, some delegations raised concerns regarding the significant growth of employee benefits liabilities and the related funding risks to WIPO's After-Service Health Insurance (ASHI) liability and requested that these be addressed.

Current financing and the coverage of long-term employee benefit liabilities at WIPO

3. Staff members at WIPO are entitled to certain long-term employee benefits which are payable by WIPO following the separation of service or the retirement of a staff member. These long-term benefits include ASHI, accrued annual leave (AAL) and repatriation grant and travel (RGT) and they have been recognized as liabilities of the Organization since the introduction of the International Public Sector Accounting Standards (IPSAS) by WIPO in 2010.

4. Since the 2004/05 biennium, WIPO's budget has included a charge on personnel costs which has been used to fund cash payments for ASHI, AAL and RGT entitlements for staff separating from the Organization. From 2004/05, a six per cent charge was applied in each biennium, with the exception of the 2012/13 biennium when the charge was two per cent. This was increased to an eight per cent charge for the 2020/21 biennium, and eight per cent has been maintained for the current biennium 2022/23. In 2013, it was agreed during the fifty-third session of the Assemblies that an amount equivalent to 50 per cent of the total long-term employee benefit liabilities as at December 31, 2013 would be held in a separate bank account by way of funding for the liabilities. It was also agreed that any cash balance remaining from the charge on personnel costs would be added to this funding. Additionally, the Organization has applied a one-off charge in the final month of the biennia 12/13, 14/15, 16/17, and 18/19 and reported on this in subsequent Financial Management Reports/WIPO Performance Reports. This charge was made in order to further augment the funding coverage of the long-term employee benefits liabilities. Furthermore, a lump sum amounting to 38.3 million Swiss francs was approved during the fifty-ninth series of meetings of the Assemblies (2019) in order to restore the coverage level to 50 per cent of the long-term employee benefit liabilities.

Proposed financing plan to mitigate financing risk of long-term employee benefit liabilities at WIPO

5. Actuarial calculations of WIPO's long-term employee benefit liabilities are performed annually by an independent actuary for inclusion in the financial statements, in accordance with IPSAS. In 2019, following a Request for Quotes procurement exercise, WIPO changed its actuary to AON. In order to align the calculations more closely with the underlying benefits and the requirements of IPSAS, AON modified a number of WIPO's actuarial assumptions and methodologies. Most significantly, the calculation of the ASHI liability was updated to take account of the underlying medical costs of retirees and their dependents rather than their medical insurance premiums. The gradual implementation of this specific assumption change between 2019 and 2021 led to an increase of 324.3 million Swiss francs in the ASHI liability. At the end of 2021, WIPO's total reported liabilities under IPSAS for ASHI, AAL and RGT were 607.6 million Swiss francs, of which 573.7 million Swiss francs related to ASHI.

6. The ASHI liability calculated in compliance with IPSAS is the present value of all expected future benefits to existing retirees and their dependents, and all accrued benefits of active staff approaching eligible retirement age. This population represents a "closed group", as it does not take account of younger active staff and new joiners. Basing the ASHI calculation on underlying medical costs as opposed to premiums is aligned with this approach, as the premiums of retirees are subsidized by the active staff. The "subsidy effect", which is known to exist within such schemes, is therefore not considered. This subsidy arises where staff members for whom premium payments exceed medical costs claimed, effectively subsidise other staff members whose medical claims exceed the premiums paid. Staff members during their younger age may have subsidized older staff members and retirees, and might later benefit from the same subsidy while getting older and after retiring.

7. In 2021, WIPO commissioned AON to prepare an Asset and Liability Management (ALM) Study in respect of the long-term employee benefit liabilities. Such a study endeavours to match assets with liabilities, and to develop considerations required for an appropriate investment strategy for such assets. For the purposes of the study, AON and WIPO opted to consider the ASHI liability as an "open group", thus allowing for new entrants, leavers and the afore-mentioned subsidy effect. This approach reflects the fact that to manage the cost and risk of its collective medical insurance plan, WIPO has secured an insurance contract with a flat premium rate per person for retirees and active staff, thus reducing the cash paid on behalf of older retirees relative to their incurred medical cost. In addition, in making their calculations, AON considered that the targeted return on the investments (two per cent) should be applied as a discount rate when calculating this "revised" liability. Using a liability discount rate equal to the investment asset return aligns the present value of liabilities with the current asset balance.

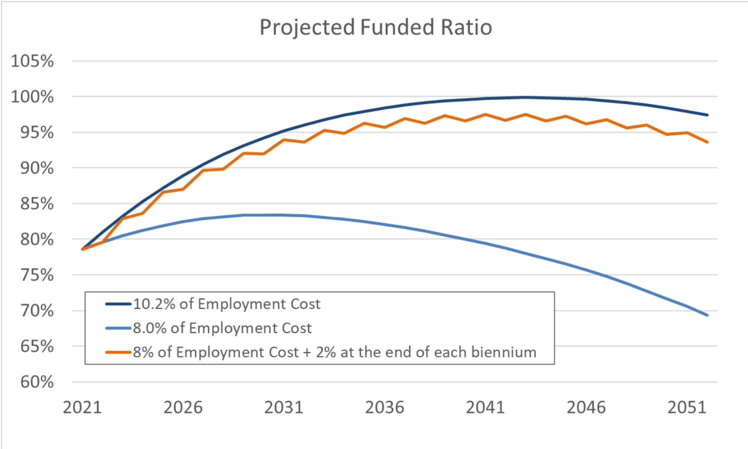
8. Incorporating the "subsidy effect" (which effectively means considering premiums payable rather than actual medical costs) and applying a two per cent discount rate results in a significantly lower liability of approximately 302 million Swiss francs (279 million - ASHI, 10 million - RGT and 13 million - AAL) as at December 31, 2021. This can be compared with total strategic investments (including cash to be invested) of 237.2 million Swiss francs, giving an overall funded percentage for ASHI of approximately 79 per cent at the end of 2021. With these numbers as their base, AON then looked at various funding options, one of which is shown below:

	Asset Return	Funding Target	Tenor	Contribution (% of employment cost)	Contribution (mCHF)
Fixed % of personnel costs to be projected to maintain current funded ratio (80%) by end of tenor period	2%	80%	20 yrs	8.0 %	16 m in 2022 to 22 m in 2041

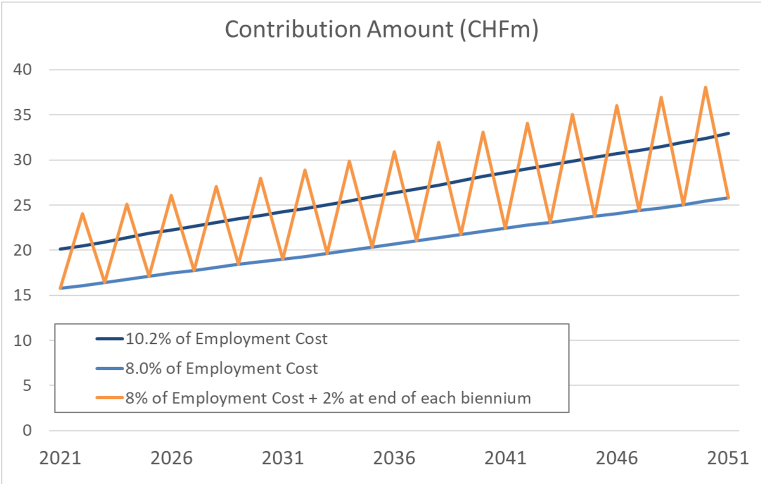
9. This option allows WIPO to maintain the charge against personnel costs at eight per cent and would expect to achieve a funding ratio of approximately 80 per cent over a 20 year time horizon.

10. The liability service cost represents the additional benefits accrued by staff during the year and is currently equal to approximately seven per cent of personnel costs. According to the actuary, this cost is projected to increase to be approximately 10 per cent by 2041 and will continue to increase thereafter, mainly because medical costs are projected to increase faster than personnel costs. To cover this future increase in the service cost until approximately 2041, the 8 per cent charge (basic charge) will be supplemented at the end of every biennium with a lump sum contribution (top-up charge) designed to bring the overall contribution up to a maximum of 10 per cent of total personnel costs for the biennium, assuming that there are sufficient savings available within the biennial personnel budget Graphs 1 and 2 below show respectively the funding coverage percentage which will be achieved by 2051 and the amounts contributed to the funding over this same time period assuming there will always be sufficient personnel cost savings available for a maximum top-up charge of 2 per cent (the 'jagged' line in both graphs). By way of comparison, the graphs also indicate the funding cover and amounts contributed for an 8 per cent charge only and for a charge of 10.2 per cent. The latter aims to achieve a liability cover of 100 per cent as further explained in the following paragraph.

Graph 1



Graph 2



11. Other options considered by AON aimed to achieve a funding target of 100 per cent within 20 years. These options would require a higher annual basic charge against employment costs, ranging from nine per cent to 11.3 per cent by 2041. Given the many uncertainties which underlie the calculation of the ASHI liability, it is not considered necessary to achieve a funding level of 100 per cent.

Adverse sensitivities

12. As already referenced, the calculations of the actuary are based upon certain assumptions. Adverse changes to these assumptions would inevitably have a negative impact on WIPO's ability to achieve its funding target. The sensitivities considered by the actuary and the resulting percentage to be charged upon personnel costs that would be necessary to be projected to achieve a funding ratio of 80 per cent over a 20 year time horizon (or 40 year time horizon for Sensitivity D) are as shown below:

Sensitivity A: Minus 10% asset return	8.8 %
Sensitivity B: Excessive Medical Inflation	9.3 %
Sensitivity C: Salary Freeze	9.2 %
Sensitivity D: Tenor of 40 years	9.5%

Details of the sensitivities are as follows:

Sensitivity A – this assumes that strategic cash will lose 10 per cent during 2022 and then earn its expected two per cent return from 2023.

Sensitivity B – this assumes that medical inflation will be greater than expected until the end of 2027, returning to its expected rate in 2028.

Sensitivity C – this assumes that salaries will not increase over the next ten years with older staff being replaced by new hires on lower salaries. Salaries will increase as expected from 2032.

Sensitivity D – this considers a funding horizon over 40 years. In order to maintain a similar funded ratio, the contributions would need to increase to keep pace with medical inflation.

For the sensitivities considered above, the additional top-up which brings funding to 10 per cent of biennial personnel costs would exceed the percentage necessary to be projected to achieve a funding ratio of 80 per cent over the given time horizon. Clearly, other variants of these sensitivities could be considered. Should any of these sensitivities (or variants thereof) materialize, the biennial supplement will be adjusted accordingly as part of the next ALM study, assuming that sufficient surpluses exist.

13. The Policy on Investments requires that an ALM study be carried out every three years. Once a study has been prepared, the Secretariat will compare the results with the funding plan in place. The basic charge percentage applied against personnel costs may be adjusted as a consequence, but any required increases exceeding two per cent will be referred to the PBC for further discussion.

Formal Designation of Plan Assets

14. Currently WIPO's long-term employee benefit liabilities and the associated funding (strategic cash/investments) are recorded separately in WIPO's financial statements. The liabilities are shown at their gross value as part of the Organization's total employee benefit liabilities, and strategic cash/investments are shown at their gross value as part of the Organization's assets. Disclosure is provided with the financial statements to explain that strategic cash/investments are held for the future financing of long-term employee benefit liabilities.

15. In order for WIPO's long-term employee liabilities to be considered "funded" for the purposes of IPSAS, it would be necessary for any funding to be paid into an entity or fund that is considered legally separate from WIPO, and from which the corresponding employee benefits would be paid. With this structure in place, the funding would be formally designated as plan assets, and the employee benefit liabilities would be presented net of these assets in WIPO's financial statements. The plan assets would be included in the annual actuarial calculations, and would be presented in the employee benefit liability disclosures in the financial statements.

16. While this formal designation of plan assets may achieve enhanced transparency around the net liability position in the financial statements, careful consideration would have to be given as to how a separate fund or entity should be structured to meet the requirements of IPSAS, and any resulting legal or governance issues.

Options for mitigating the potential future growth in ASHI liabilities

17. The WIPO Collective Staff Insurance Management Committee comprising staff and retiree representatives, together with members of WIPO administration, is responsible for supervising the operation and financial situation of the collective staff insurance schemes. The Committee actively engages with CIGNA on an ongoing basis in order to assist in devising and

implementing cost containment measures and to design health service plans that will keep health benefit costs under control. In this regard, the Committee has helped to monitor and adjust as needed health insurance premiums in response to rising medical costs. As a consequence, insurance premiums, borne in part by staff, have increased five times in the last 15 years. Through the Committee's actions and recommendations, and the cooperation of the WIPO insured population, the health insurance premiums have remained unchanged for five years despite rising medical costs, until the last increase was implemented in January 2022.

18. When determining the provisions of the collective contracts with CIGNA, the primary consideration was that of defining a health plan offering an adequate coverage in line with the guidance of the host country while mitigating the associated medical costs. In a continued effort to limit the potential future growth in ASHI liabilities, several cost containment measures have been brought to the attention of the Committee for consideration. These include measures such as the increase of annual deductibles, incentives to use medical providers within an agreed network offering low tariffs negotiated with CIGNA, or the promotion of the use of care from less expensive regions through medical tourism.

19. In addition, the Organization will continue to ensure that the subject of ASHI and cost containment measures remains a regular feature on the agenda of the Finance and Budget Network and of other inter-organizational meetings in order to closely follow developments amongst sister organizations in this area.

20. The following decision paragraph is proposed.

21. The Program and Budget Committee (PBC) recommend to the Assemblies of WIPO, each as far as it is concerned, (i) to approve the funding proposal for long-term employee benefits outlined in document WO/PBC/34/14, namely to have an annual charge (basic charge) of 8 per cent of personnel costs, to be supplemented at the end of every biennium with a lump sum contribution (top-up charge) of up to 2 per cent of total personnel costs for the biennium, assuming that there are sufficient savings available within the biennial personnel budget; (ii) take note of the risks and benefits of formally designating ASHI investments as dedicated plan assets and (iii) take note of the ongoing efforts of the WIPO Collective Staff Insurance Management Committee to contain the growth of actual medical costs and thus the growth of the ASHI liability.

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