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IMMEDIATE ATTENTION

EB/CAP/96/5

July 25, 1996

To: Members of the Committee on Administrative Policies

From: The Committee Secretary

Subject: **Proposed Changes to Financing the Group Life Insurance Plan**

Attached for consideration by the Committee on Administrative Policies is a paper on proposed changes to financing the Group Life Insurance Plan.

In the absence of a request to the Committee Secretary by noon on Tuesday, July 30, 1996, that this matter be considered in Committee, the report and recommendation will be deemed approved by the Committee for submission to the Executive Board on a lapse of time basis.

Mr. Kevin Craig (ext. 38212) or *Mr. Nicoson (ext. 38223) is available to* answer questions relating to this paper.

Att: (1)

Other Distribution:
Members of the Executive Board

INTERNATIONAL MONETARY FUND

Funding of Group Life Insurance Plan

Prepared by the Administration Department

Approved by Ulrich Baumgartner

July 25, 1996

I. Introduction

This paper requests the Committee on Administrative Policies to consider changes in the way the Fund's Group Life Insurance Plan (GLI) is administered and to recommend these changes to the Executive Board for adoption. The main proposal is to reduce, on average, contribution rates for both the Fund and staff to a level that would obviate the need for refunds of contributions to participants which has, over the years, become a regular feature of the Plan. In conjunction with the reduction in contribution rates, the rate schedule would be changed from 10-year age to five-year age brackets. In addition, a "premium stabilization reserve" would be established that would be drawn down in years when experience was unusually adverse and would increase when experience was unusually favorable. Finally, it is recommended that the amount of the death benefit at age 75 or older be increased from the current level $3,000 to $15,000 to bring the Plan into line with market practice.

This paper is organized as follows. Section II describes the present procedures; Section III sets out the proposals for simplifying the Plan's financial structure; and Section IV puts forward draft recommendations by the Committee to the Executive Board.

II. The Present Financial Arrangements

The GLI Plan provides a death benefit to Fund staff and retirees through an insurance contract with the John Hancock Mutual Life Insurance Company. Participants in the Plan may elect between three levels of coverage based on one, two, or three years' salary. 1/ The Fund contributes one-third of the cost of this insurance, and the participant pays the remaining two-thirds. The Plan design and level of subsidy are competitive with what is

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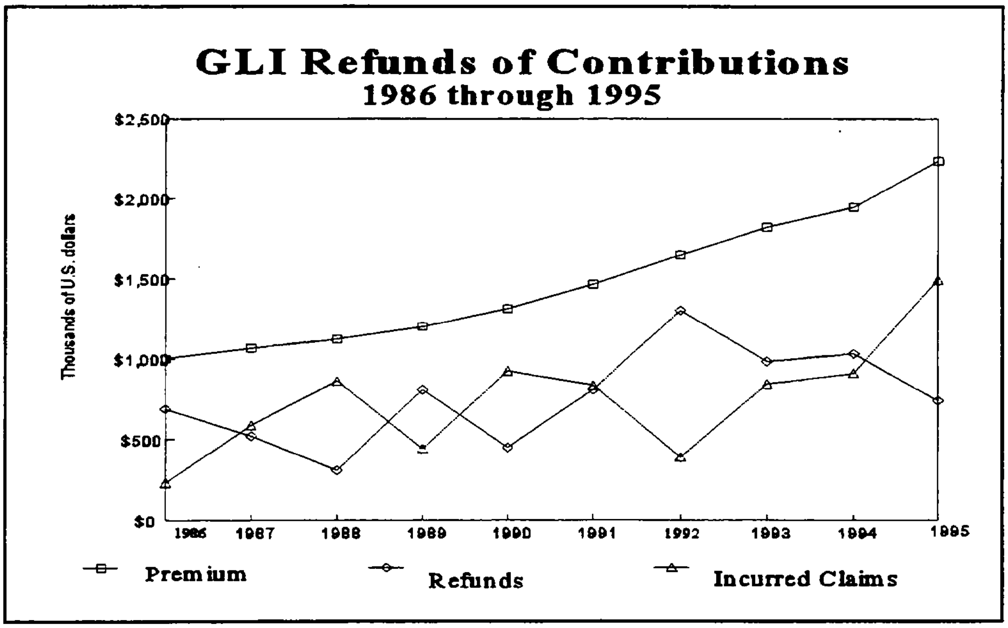
1/ Retirees' coverage prior to age 65 can be no more than two times final net salary. At 65, coverage decreases to the lesser of $50,000 or one times net salary. Coverage in retirement at ages 70 and 75 falls to $25,000 and $3,000, respectively.

offered by other international organizations headquartered in the United States (see Attachment I for additional details). 1/

The premiums paid by participants and the Fund are intended to cover claims incurred under the Plan and the Plan's administrative expenses. For many years, the Plan's income has exceeded claims, and a refund of contributions has been made on an annual basis to participants and the Fund. Over the past five years, for example, the GLI has covered its expenses and has still been in a position to refund to participants and the Fund an average of $972,000 annually, equivalent to about 53 percent of the premiums paid. The refund for 1995 was about $742,000, or 33 percent of premiums paid, which was unusually low. The figure below summarizes the GLI's refund of contributions in 1986-1995.



The experience over the last five plan years provides a firm basis for the conclusion that the GLI is being overfunded at the current level of premiums, and that a lower level of premiums would maintain the Plan on a sound financial footing and would eliminate the administrative effort resulting from the refunding of the excess contributions to

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1/ In the 1993 Quadrennial Benefits Survey, the Fund was somewhat below most comparators for all death benefits combined, as well as life insurance considered separately. The employer-provided value of all death benefits as a percent of net salary at the $60,000 level was 1.5 percent for the Fund, 1.6 percent for the Bank, 1.5 percent for the United States, 2.1 percent for France, and 2.0 percent for Germany. Assuming a median net salary of $60,000, the employer-provided value of group life insurance as a percent of net salary was 0.2 percent for Germany, 0.3 percent for the Fund, 0.4 percent for the Bank, 0.7 percent for the United States, and 1.0 percent for France.

participants. 1/ This view is supported by the fact that actuaries consider 8,000 to 10,000 "life years" of plan experience as statistically credible (e.g., 5 years of plan experience for 2,000 participants amounts to 10,000 "life years"). The current number of lives covered by the Plan is 2,868 and the total number of lives covered by the GLI in the last five years was 12,951.

John Hancock credits the Plan with interest on the "positive cash flow" arising from the overfunding of the Plan. The interest rate applied is the average of the discount rate for six-month U.S. Treasury bills at the first weekly auction of each calendar month during the policy year, plus one percentage point; interest is credited once a year at the time of the refund calculation. These interest credits increase the Plan's income and are used to partially offset John Hancock's expenses in running the Plan. However, during the period after the end of the policy year (calendar year) and before the financial reconciliation is completed in the first quarter of the following year, John Hancock does not credit interest on the refund as a matter of company policy. This cost is estimated at about $10,000 per year.

A policy of charging insurance premiums in excess of what is actuarially necessary is found in some countries, where governments require sizable margins, or "tariffs," to assure the solvency of insurers. It is also a financing technique that is sometimes used in smaller organizations where a plan's claims experience can be very erratic and unpredictable. Neither of these reasons provide justification for continuing this practice in the Fund's Plan.

It is, therefore, proposed that the contribution rates be amended as indicated in Attachment II. At the same time, an interest-bearing reserve would be established that would, normally, be adequate to absorb annual fluctuations in claims experience. It would increase in years when claims experience is unexpectedly favorable and decline when claims experience is adverse. These changes would simplify the administration of the Plan and, in particular, obviate the annual exercise of returning contributions to participants. 2/

III. Proposed New Financial Arrangements

1. Contribution schedule

At the Fund's request, John Hancock prepared a new set of contribution rates, based on the Plan's actual and expected experience, and reflecting the mortality rates applicable at the different age brackets more accurately than the present schedule of contributions.

Attachment II shows four columns comparing the current rates, the estimated rates after the 1995 refund of contributions, the actuarial rates, and the proposed new rates. The estimated rates after the 1995 refund are based on the pro rata payout to individual participants and do not reflect the mortality experienced by each age bracket. If the refund

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1/ The current process requires determining how much should be distributed to each plan participant, distributing the refunds, as well as answering numerous queries by staff.

2/ The World Bank reduced its rates in 1992 and ceased making refunds to participants.

had been made on an actuarial basis, younger participants would have received a higher proportion of the refund while older participants would have received a smaller proportion. The actuarial rates reflect the Plan's claims experience and what should be charged if each age bracket was to be entirely self-supporting. It was, however, felt that adopting the actuarial rates as the basis for making contributions would represent too radical a departure from the Plan's historic contribution philosophy, which has implied that younger participants support older ones. 1/ A compromise was, therefore, sought and the proposed rates represent a middle ground between the current and the actuarially calculated rates. John Hancock supports the new contribution rates.

The proposed contribution schedule is based on 5-year age brackets instead of the current 10-year brackets, a method which apportions the cost more equitably among participants. On average, the proposed rates are about 40 percent less than current contribution rates, with younger participants benefiting from larger reductions. There would be no change in the rate for retirees aged 70 - 74 and the Fund would continue to pay the entire contribution of retirees older than 74.

Compared with 1996 premiums, these changes would reduce the Fund's annual contributions to the Plan by about $300,000, eliminate the annual refund of contributions and avoid the associated administrative costs. The reduction in contributions would amount to a cash flow advantage for both staff and the Fund. The new contribution schedule incorporates a small factor that will be sufficient to meet the GLI's administrative expenses, which will continue to be borne in the same proportions between participants and the Fund as in the past.

2. <u>Establishment of a reserve</u>

With the implementation of the new schedule of contributions, it is recommended that a Premium Stabilization Reserve (PSR) be established, which would initially be set at 20 percent of the expected annual premiums ($253,000) 2/; a portion of the expected surplus contributions in 1996 would be used to fund this reserve initially, and the balance of the surplus would be refunded to the Fund and participants in mid-1997. The purpose of this reserve would be to to meet claims that exceeded the actuarial assumptions on which the schedule of contributions is based. This reserve will be credited interest annually using an average of the six-month rate on U.S. Treasury bills at the first weekly auction of each calendar month during the policy year, plus one percentage point. An excess of premium and interest income over claims and expenses would be allowed to augment the PSR. An

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1/ In EBAP/74/129, the concept of age-related contribution rates was first introduced for the GLI with an implicit support of older participants by younger participants. Previously, a flat contribution rate applicable to all staff was used which, being quite high, tended to discourage participation by younger staff.

2/ The insurance industry considers a reserve at this level adequate for Plans of the GLI's size. Consequently, John Hancock, the GLI's insurer, recommended this level for the reserve.

excess of claims and expenses over premium and interest income would be met by drawing down the PSR. The schedule of contributions would be examined annually with John Hancock at the time of the financial reconciliation for the past policy year to determine the appropriateness of the level of the PSR and the contribution schedule.

3. New minimum death benefit for retirees

It is recommended that the death benefit of $3,000 at ages 75 and older be increased to $15,000. The current benefit has been in place since the early 1970s and has never been adjusted for inflation. This change will bring the Fund's GLI design into line with current market practice.

4. Advantages of proposals

The advantages for the Fund and staff include actuarially more correct and stable contribution rates, a cash flow improvement, avoidance of the opportunity cost (valued at $10,000) arising from the nonpayment of interest on the refund after the end of the policy year, and modest administrative savings from eliminating the need for refunding contributions at the end of the policy year.

IV. Recommendations

It is proposed that the Committee on Administrative Policies recommend the following draft decision for adoption by the Executive Board:

The Managing Director is authorized to implement the following changes in the administration of the Fund's Group Life Insurance Plan with effect from September 1, 1996:

1. Reduce contribution rates and modify the rate structure by reducing the age brackets from 10-year to 5-year increments, in accordance with the attached contribution schedule (Attachment II);

2. Establish a Premium Stabilization Reserve from the excess premium paid in 1996 (to be initially set at 20 percent of total annual premium), which will be drawn down in the case of Plan deficits;

3. Discontinue the refunding of any Plan surplus to the participants and the Fund at the end of each policy year and instead deposit such surplus as might accrue to the Premium Stabilization Reserve; and

4. Increase the minimum death benefit for retirees to $15,000.

Comparison of Life Insurance Programs
of Several International Organizations

Organization	Amount of Coverage	Employer Subsidy	Total Monthly Rates 1/
International Monetary Fund	1, 2, or 3 times net salary	One-third of total cost	Based on age. Current composite rate of $0.40 per $1,000 vs. proposed rate of $0.27 per $1,000
United Nations	2 times pensionable remuneration up to $130,000 maximum	None	$0.30 per $1,000
World Bank	Up to 6 times net salary	100 percent of 1 times salary	Raised by 20 percent recently to $0.25 per $1,000 on average
Pan-American Health Organization (PAHO)	In flat amounts but about 2 times pensionable gross remuneration up to $130,000 maximum	None	$0.28 per $1,000
	Second program in addition to the one above - up to 6 times pensionable gross remuneration to maximum of $600,000	None	$0.38 per $1,000 below age 63; higher thereafter for amounts over $600,000

1/ Rates are expressed as a monthly contribution per $1,000 of coverage unless otherwise specified.

ATTACHMENT I

Organization	Amount of Coverage	Employer Subsidy	Total Monthly Rates 1/
International Labor Organization (ILO)	Choice of 1, 2, 3, or 4 times pensionable gross remuneration	None	Flat 0.525 percent of salary
Organization of American States (OAS)	2 times salary	100 percent	--
	Second program all voluntary in flat amounts up to $350,000	None	Similar to current Fund rates but higher for older ages
Inter-American Development Bank	1.5 times net salary	100 percent for first $10,000, then 50 percent	Flat $0.24 per $1,000
	Second, voluntary program with choice of 0.5, 1, or 1.5 times net salary	None	Flat $0.38 per $1,000
Intelsat	The lesser of $50,000 or 1.5 times net salary	100 percent	--
	Any difference between $50,000 and 1.5 times can be bought by staff member	None	Flat $0.33 per $1,000

1/ Rates are expressed as a monthly contribution per $1,000 of coverage unless otherwise specified.

International Monetary Fund

Comparison of Current Life Insurance Rates
With Rates Based on Plan Experience 1/

Age	Current Rates	Estimated Rates after 1995 Refund	Actuarial Rates	Proposed Rates
Under 30	0.12	0.07	0.05	0.06
30 - 34	0.12	0.07	0.06	0.08
35 - 39	0.22	0.13	0.08	0.12
40 - 44	0.22	0.13	0.09	0.15
45 - 49	0.36	0.22	0.15	0.20
50 - 54	0.36	0.22	0.26	0.22
55 - 59	0.54	0.33	0.38	0.48
60 - 64	0.54	0.33	0.68	0.49
65 - 69	0.62	0.38	1.00	0.60
70 - 74	0.62	0.38	1.68	0.62
75 - 79	no charge	na	2.26	no charge
80 - 84	" "	"	3.55	" "
85 - 89	" "	"	7.51	" "
90 - 94	" "	"	10.79	" "

1/ Rates are expressed as the monthly contribution per $1,000 of coverage. The first $5,000 of coverage is paid in dollarsd entirely by the Fund.