IMMEDIATE ATTENTION

EB/CAP/01/1

August 21, 2001

To: Members of the Committee on Administrative Policies

From: The Committee Secretary

Subject: **Finances of the Group Life Insurance Plan**

Attached for consideration by the members of the Committee on Administrative Policies is a staff paper on the following two recommendations affecting the finances of the Group Life Insurance Plan (GLI):

- a reduction in the GLI's contribution schedule for participants and the Fund with effect from October 1, 2001; and
- a one-time return of premium of about $5.3 million to participants and the Fund to bring the premium stabilization reserve down to the authorized level of 20 percent of annual premium or about $450,000.

In 1996 (EBAP/96/84, 8/01/96), the Executive Board approved a new scale of contributions, the establishment of a new reserve, and the elimination of the annual dividend payment. Based on claims experience since 1996, that contribution scale has since proven to be too high, resulting in an over-funded reserve. The two measures mentioned above are expected to address the over-funded reserve.

Questions may be directed to Mrs. Shannon (ext. 37258) and Mr. Nicoson (ext. 38223).

It is not proposed to bring this matter to the agenda of a meeting of the CAP for discussion unless an Executive Director so requests by noon on Wednesday, August 29, 2001. In the absence of such a request, the proposed recommendations on page 6 will be forwarded for lapse-of-time consideration by the Executive Board.

Att: (1)

Other Distribution:
Members of the Executive Board

INTERNATIONAL MONETARY FUND

Finances of the Group Life Insurance Plan

Prepared by the Human Resources Department

Approved by Margaret R. Kelly

August 17, 2001

Contents

I. Introduction

1. The purpose of this paper is to propose that the Committee on Administrative Policies recommend to the Executive Board the approval of two changes affecting the finances of the Group Life Insurance Plan (GLI) as follows:

- a reduction in the GLI's contribution schedule for participants and the Fund with effect from October 1, 2001; and

- a one-time return of premia to participants and the Fund to bring the premium stabilization reserve down to the authorized level of 20 percent of annual premium.

2. In 1996 (EBAP/96/84, 8/01/96), the Executive Board approved a new scale of contributions, the establishment of a new reserve, and the elimination of the annual dividend payment. Based on claims experience since 1996, that contribution scale has since proven to be too high, resulting in an over-funded reserve. This paper proposes measures to address the over-funded reserve. Section II describes the Plan's financial developments since the 1996 changes; Section III sets out the proposals for a revised contribution schedule and adjustment to the premium stabilization reserve; and Section IV puts forward the proposed decision the Committee is asked to endorse.

II. Developments

3. The GLI Plan provides a death benefit for Fund staff and retirees through an insurance contract with the John Hancock Life Insurance Company. Active staff who are participants in the Plan can elect three levels of coverage based on one, two, or three years' salary. The Fund pays the full cost for the first $5,000 of this insurance as well as the full cost of the coverage for retirees age 75 and older and contributes one-third towards the cost of the remaining insurance, while the participants pay two-thirds of the cost.

4. Based on recommendations by the GLI's insurer, John Hancock, the Fund reduced the contribution rates of the GLI in September 1996 and established a premium stabilization reserve (PSR) of 20 percent of the annual premia.[1] The contribution rate reduction was about 40 percent on average. For many years prior to 1996, the Plan's income had exceeded claims, and a return of contributions was made annually to participants and the Fund.[2] This approach

[1]EBAP/96/84, 8/01/96.

[2]In the five years before 1996, the Plan returned to participants and the Fund an average of $914,000 annually, or about 56 percent of the premiums paid. The process of paying out a refund was administratively cumbersome and time-consuming. It required determining how much should be distributed to each plan participant, distributing the refunds, and answering the staff questions as to whether there will be a return of contributions, when it will occur, and how the calculation will be (or has been) made.

was inefficient and cumbersome and the reduction in premia was intended to obviate the need for an annual refund.

5. The purpose of the PSR was to have funds available to meet claims experience that exceeded the actuarial assumptions on which the schedule of contributions is based. An excess of premium and interest income over claims and expenses would be allowed to augment the PSR, while an excess of claims and expenses over premium and interest income would be met by drawing down the PSR. The Executive Board agreed that if there was a longer-term build-up of the PSR, or reduction of the PSR, the level of contributions could be reexamined.

6. The new rates have since proven to be higher than needed because Plan experience was better than expected and the PSR has far exceeded the 20 percent level reaching 200 percent of premia at the end of 2000. Due to this favorable claims experience, the insurer believes that a further reduction in the rates of 20 percent, on average, is appropriate in addition to a refund of contributions.[3]

7. Attachment I shows the Plan's finances since 1995, the year before the establishment of the PSR. In 1996, the actual PSR was set up with funds that amounted to 19.6 percent of annual premia. In 1997, the PSR rose to 74.2 percent of the annual premia. Given the relatively small size of the group of participants (about 3,000), a degree of volatility was to be expected in the claims experience. Consequently, a conservative approach was taken during 1998–2000. After five years of favorable experience, the insurer concluded that the rates could be further reduced and the amount of the PSR in excess of the 20 percent threshold could be returned to participants and the Fund.

III. Proposed Changes To Contribution Schedule And Reserve

A. Contribution Schedule

8. At the Fund's request, John Hancock has prepared a revised set of participant contribution rates, based on the Plan's actual experience over the last five years.

9. Attachment II shows both the current and proposed rates for GLI participants. With the exception of those age 75 and older, the Fund's contribution is one-half of the rates, i.e., one-third of the total premia. The proposed rates are about 20 percent less, on average, than current contribution rates, and the majority of Plan participants (those under age 70) would contribute less than they are currently paying for their group life insurance coverage. The contribution rates for those ages 70 to 74 would not change because the experience of this group does not justify a reduction. Those retirees older than 74 receive their coverage paid

[3] A temporary suspension of contributions, or 'premium holiday' was considered but discounted because it is more complex to administer than a simple refund of contributions.

for entirely by the Fund. The implementation of the new schedule of contributions would take effect from October 1, 2001.

B. Reduction of the Premium Stabilization Reserve

10. It is recommended that the PSR be reduced to the level approved by the Executive Board in 1996 of 20 percent of the expected annual premiums. The amount to be returned to the participants and to the Fund is estimated to be about \$5.3 million, reducing the PSR to about \$450,000 for CY 2001.[4]

C. Budgetary Implications

11. Since 1996, the average annual contributions by the participants and the Fund for the cost-sharing and fully Fund-paid portions of the GLI have been as follows.

	Average Annual Contributions	Percent of Total	Cost-sharing Formula	Difference from Formula
Cost-Shared:				
Fund	\$ 425,000	20.5	33.3	(12.8)
Participants	\$1,645,000	79.5	66.7	12.8
SubTotal	**\$2,070,000**	**100.0**	**100.0**	
Fully Fund Paid:				
Fund	-0-	0.0	100.0	(100.0)
Participants	\$80,000	100.0	0.0	100.0
SubTotal	**\$80,000**	**100.0**	**100.0**	
Total	**\$2,150,000**			

12. As mentioned earlier, the portion of the GLI to which both the Fund and participants contribute uses a cost-sharing formula of two-thirds by participants and the Fund paying one-third. Since 1996, the Fund's contribution to the cost-sharing portion of the GLI has averaged about 20.5 percent of the annual premium, resulting in an average shortfall in the Fund's share of 12.8 percent of annual premium, or about \$265,000 per year. Underfunding for the cost-sharing portion of the GLI totals about \$1.2 million. In addition, the Fund had not paid the full cost for the first \$5,000 of insurance or the full cost of the coverage for retirees age 75 and older. The annual underfunding for the coverage the Fund is fully responsible for is estimated at \$80,000 on average or about \$373,000 in total since 1996. Consequently, the Fund's total under-contribution to the Plan amounts to about \$1.6 million, which has now been paid into the Plan to determine the proper amount of the surplus to be returned. The

[4] A participant's refund is based on a percentage where the numerator is the participant's total annual contributions and the denominator is the total annual contributions paid by all participants. The individual percentage is then applied to the participants' portion of the total refund, i.e., about \$3.5 million of the \$5.3 million. The average participant refund is expected to be about \$1,000.

following table summarizes the shortfall in the Fund's contributions. The second column shows how the contributions should have been proportioned between the Fund and the participants.

	Average Annual Contributions	Formula-Based Contributions	Average Annual Difference	Total Shortfall Since 1996
Cost-Shared:				
Fund	$ 425,000	$690,000	($265,000)	($1,237,000)
Participants	$1,645,000	$1,380,000	$265,000	
SubTotal	**$2,070,000**	**$2,070,000**		
Fully Fund Paid:				
Fund	-0-	$80,000	($80,000)	($373,000)
Participants	$80,000	-0-	$80,000	
SubTotal	**$80,000**	**$80,000**		
Total	**$2,150,000**	**$2,150,000**	**+/-$345,000**	**($1,610,000)**

13. The absence of adequate controls to monitor and to test the cost-sharing formula between participants and the Fund resulted in the Fund contributing less than it should have during this period. The Treasurer's Department (TRE) and the Office of Budget and Planning (OBP) have agreed with the Human Resources Department (HRD) to review the GLI's finances annually and to reconcile any discrepancies so that the proper cost-sharing formula is maintained in the future.

14. As a consequence of the reduction in contribution rates and the correction of the cost-sharing arrangements, the Fund's contribution to the GLI will increase going forward. The estimated impact is as follows:

	Estimated Annual Contribution in FY2002	Percent of Total	Percentage Change from FY2001
Cost-Shared:			
Fund	$ 562,500	33.3	35.6
Participants	$1,126,600	66.7	(31.4)
SubTotal	**$1,689,100**	**100.0**	**(17.8)**
Fully Fund Paid:			
Fund	$99,400	100.0	100.0
Participants	-0-	0.0	(100.0)
SubTotal	**$99,400**	**100.0**	**100.0**
Total	**$1,788,500**		
Total Fund-Paid	**$661,900**	**37.0**	**59.6**

IV. Proposed Recommendations

It is proposed that the Committee on Administrative Policies recommend the following draft decision for adoption by the Executive Board on a lapse-of-time basis.

The Managing Director is authorized to implement the following changes affecting the finances of the Group Life Insurance Plan with effect from October 1, 2001:

- adopt a revised contribution schedule for Plan participants and the Fund in accordance with the schedule shown in Attachment II; and

- return the Premium Stabilization Reserve by October 2001 to the level of 20 percent of total annual premium, by returning the amount of the Plan surplus in excess of 20 percent of total annual premium to the participants and the Fund in proportion to their respective contribution to the surplus.

Table 1. Group Life Insurance Plan Finances
CY1995 through CY2000

Year	Covered Lives[1/]	Total Premium	Claims	Expenses	Dividend	Incurred Reserve[2/]	Premium Stabilization Reserve	PSR as Percentage of Premia
1995	2,852	$2,234,792	$1,429,970	$62,571	$742,251	$203,032	n.a.	n.a.
1996	2,899	$2,087,267	$1,462,060	$119,517	0	$438,392	$409,912	19.6
1997	2,949	$1,648,779	$1,046,000	$86,286	0	$144,601	$1,223,938	74.2
1998	3,031	$1,773,988	$605,325	$80,413	0	$117,435	$2,226,006	125.3
1999	3,055	$1,913,101	$1,164,467	$86,449	0	$522,022	$2,817,292	147.3
2000	3,264	$2,070,991	$617,728	$85,788	0	$482,141	$4,153,054[3/]	200.9

[1/]Includes staff, contractual employees, and retirees.
[2/]Until September 1996, the Plan's reserve was limited to known, or 'incurred,' claims that were pending resolution. Claims can be pended, for example, if documentation is slow in coming. From September 1996, a Premium Stabilization Reserve was established to deal with large fluctuations in claims in addition to the reserve for known pending claims.
[3/]Reserve before the addition of the $1.6 million make-up contribution by the Fund.

Table 2. Comparison of Current Participant Life Insurance Rates With Proposed Rates[1/]
(In U.S. dollars)

Age	Current Rate	Proposed Rate
Under 30	0.06	0.02
30–34	0.08	0.02
35–39	0.12	0.03
40–44	0.15	0.05
45–49	0.20	0.09
50–54	0.22	0.15
55–59	0.48	0.26
60–64	0.49	0.36
65–69	0.60	0.58
70–74	0.62	0.62
75 and above	0.00	0.00

[1/] Rates are expressed as the monthly contribution per $1,000 of coverage. The first $5,000 of coverage and the full cost of the coverage for retirees age 75 and older are paid for entirely by the Fund.