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April 1, 2010

To: Members of the Executive Board

From: The Secretary

Subject: **The Medical Benefits Plan—Finances**

Attached for the **information** of Executive Directors is a paper on the finances of the Medical Benefits Plan. Conclusions appear on page 6.

Questions may be referred to Mr. Clarke (ext. 34086) and Mr. Nicoson (ext. 38223) in HRD.

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The Medical Benefits Plan—Finances

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and the Office of Budget and Planning

Approved by Shirley Siegel

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Contents Page

Tables

Appendix

I. Introduction

1. This paper reviews the finances and medium-term sustainability of the Medical Benefits Plan (MBP) and describes a change to the MBP target reserve methodology. The methodology change is to move from the use of "Incurred But Not Reported" (IBNR) claims plus a 5 percent claim stabilization reserve to "Incurred But Not Paid" (IBNP) claims plus a 5 percent claim stabilization reserve.[1]

2. The MBP's contribution rate is assumed to increase by 2.6 percent effective May 1, 2010.[2] The increase follows the Executive Board's 2008 decision to introduce an automatic contribution rate increase aligned with the Fund salary structure increase to ensure continued financial stability for the Plan for the medium term.[3]

3. During FY 2010, the Plan's cash flow is estimated to increase the level of the reserve by approximately $14.3 million or 46 percent. These positive results are primarily due to the network utilization and discounts resulting from the move to Aetna as the MBP's administrator.

4. This paper is organized as follows: Section II discusses the Plan's current financial status for FY 2010; Section III discusses the new target reserve methodology; Section IV summarizes the funding model previously adopted by the Executive Board and provides FY 2011 and 10-year projections; and Section V provides the conclusion.

II. Current FY 2010 Financial Status

Income and expenses

5. The finances of the Plan have improved further since May 2009, as the Plan's cash flow has been positive by $10.3 million through December 2009 (i.e., income of $42.8 million and expenses of $32.5 million). The cash reserve rose from $31.3 million in April 2009 to $41.6 million in December 2009. This situation is due primarily to higher savings from using providers within the Aetna network, which rose from $17.2 million in

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[1] The target reserve is calculated by the actuary as IBNR claims plus 5 percent of projected incurred claims as a claim stabilization reserve. IBNR represents a liability accrued, but not paid. Such claims can include those pending with the claims administrator for the Plan and those that have not yet been submitted to the claims administrator by the provider or participant. IBNR liabilities for health plans are typically calculated using the actuarial development (or Lag) method, which groups historical claims data into time periods (usually months) in which the claims were incurred and the time periods in which they were processed (or paid). These groupings, in turn, provide a pattern that is used to estimate the unprocessed (and unpaid) portion of incurred claims.

[2] Commencing with the first full payroll period in May 2010.

[3] *Medical Benefits Plan—Review and Proposed Further Reform*, (EBAP/08/73, 7/11/08).

CY 2008 to $22.1 million in CY 2009, a 28 percent increase. Similar to the previous year, 76 percent of claims were paid within the network.

6. For the entire FY 2010, the Plan's actuary, Mercer Health & Benefits, has projected total income of $64.7 million and total expenses of $50.4 million.[4] The projected cash reserve of $45.6 million is expected to exceed the target reserve (proposed IBNP plus 5 percent—see Section III) of $11.3 million by $34.3 million (Table 1).

Table 1. Medical Benefits Plan FY 2010 Actual and Projected Funding
(In millions of U.S. dollars)

	Actual May–December	Projected January–April	Total FY 2010
A. Beginning Cash reserves	31.3		31.3
B. Total contributions	42.8	21.9	64.7
C. Expenditures	32.5	17.9	50.4
D. Surplus/Deficit (B–C)	10.3	4.0	14.3
E. Ending Cash Reserve	41.6		45.6
F. Target Reserve (IBNP)	9.3	2.0	11.3
G. Surplus Cash Reserve (E–F)	32.3	2.0	34.3

III. Change in Target Reserve Methodology

7. Following the actuary's recommendation and industry best practice for determining target reserves, the MBP's target reserve has been developed using the IBNP method.[5] The new method includes IBNR plus an estimate of the float for checks issued but not cleared through a bank plus a margin for uncertainty in the timing and volume of the IBNR and float estimates.[6] Thus, IBNP reflects total unpaid liabilities and provides a margin against fluctuations in those liabilities. The target reserve is then based on IBNP plus a 5 percent claim stabilization reserve. The effect of this change in the calculation of the target reserve is illustrated in Table 2.

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[4] Last year's projections for FY 2010 were $62.5 million and $51.6 million, respectively, for contributions and expenditures. The current projections reflect higher contributions due to more enrollees and lower claims costs due to slightly more network savings than previously expected.

[5] In FY 2007, the Executive Board approved a change in the way the target reserve was calculated from paid claims to IBNR plus a claims stabilization reserve of 5 percent of incurred claims. *The Medical Benefits Plan—Increase in Contribution Rates,* (EBAP/07/58, 4/18/07).

[6] Claims experience indicates that the dollar volume of checks outstanding in a given month is about $1 million. The additional uncertainty for IBNR is estimated at about $600,000.

Table 2: Comparison of FY 2010 Forecast of End-of-Year Cash and Target Reserves Using IBNR and IBNP

(In millions of U.S. dollars)

	Cash Reserve	Target Reserve	Surplus Reserve
IBNR	45.6	9.7	35.9
IBNP	45.6	11.3	34.3

8. Use of IBNP increases the target reserve by $1.6 million, thereby reducing the surplus. There is no change in the cash reserve, only in the amount of the surplus. The projections in Section IV reflect the use of IBNP.

IV. FY 2011 and Ten-Year Financial Projections

9. In July 2008, the Executive Board approved a modification to the pay-as-you-go funding model in line with the Medium-Term Budget (MTB) multiyear budgeting framework. The modification ensures that contribution increases are smoothed to avoid unanticipated increases that would put pressure on other budget priorities.

10. For FY 2011, assuming a salary structure increase of 2.6 percent is applied to the MBP contribution schedule, the actuary has projected total income of $67.9 million. Total expenses are expected to rise by 10 percent to $56.9 million.[7] The FY 2011 year-end reserve of $56.6 million would surpass the target reserve of $12.6 million by $44.0 million (Table 3).

[7] Projections are based on data through December 2009.

Table 3. Medical Benefits Plan Funding Projection FY 2010–FY 2020
Automatic Contribution Increases
(In millions of U.S. dollars)

	Fiscal Year										
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
A. Beginning reserve	31.3	45.6	56.6	65.4	71.7	75.0	74.8	70.6	61.7	47.3	26.8
B. Total contributions 1/	64.7	67.9	71.4	75.2	79.1	83.2	87.5	92.0	96.6	101.6	136.5
Change in Percent	10.6	4.9	5.2	5.3	5.2	5.2	5.2	5.1	5.0	5.2	34.4
C. Expenditures 2/	50.4	56.9	62.6	68.9	75.8	83.4	91.7	100.9	111.0	122.1	134.3
D. Surplus/deficit (B–C)	14.3	11.0	8.8	6.3	3.3	-0.2	-4.2	-8.9	-14.4	-20.5	2.2
E. Ending reserve	45.6	56.6	65.4	71.7	75.0	74.8	70.6	61.7	47.3	26.8	29.0
F. Ending target reserve	11.3	12.6	13.8	15.1	16.5	18.1	20.0	21.9	24.0	26.4	29.0
G. Reserve surplus/deficit (E–F)	34.3	44.0	51.6	56.6	58.5	56.7	50.6	39.8	23.3	0.4	0.0

1/ Assumptions: automatic contribution increase of 2.6 percent on May 1, 2010; 4.0 percent automatic contribution increases thereafter; and additional contributions as needed (beginning in FY 2020) to meet the reserve target. Contributions assume additional interest on reserves using September FY2010 rate. Projections also incorporate the impact on total contribution growth from staff/retiree movement upward in income-based contribution bands.

2/ Expenditures are projected to increase 10 percent per year.

11. The projections indicate that the MBP would continue to generate surpluses through FY 2014. After an assumed 2.6 percent contribution increase in FY 2011, contributions are assumed to increase by 4.0 percent annually in subsequent years. Assuming that the MBP's costs rise in line with projected increases for plans of similar design, i.e., averaging 10 percent annually, contributions would remain above expenses through FY 2014.[8] Although reserves are expected to reach nearly $60 million by FY 2014, this is prudent given the expected cost increases in the U.S. health care market, the uncertainty about healthcare developments and MBP costs over the medium term, and the resulting possibility of financial deficits in the MBP after FY 2014.

12. After FY 2014, the Plan's expenses would exceed contributions with cost increases accommodated by a combination of the automatic contribution increases and reserve drawdown. This pattern is similar to previous years' projections, although because of the favorable results since the 2007/2008 reforms, reserves are larger and last somewhat longer than projected earlier: surplus reserves would be depleted in FY 2020 and the contribution rate would need to increase by more than the salary adjustment rate. Unless costs rise by less than projected, a 34 percent increase in contributions would then be needed to meet the actuarially determined reserve target. To avoid this significant increase in contributions in a

[8] The MBP's actual year-to-year claim cost increases in recent years have been relatively flat due to the change in network. The actuary expects health care costs to increase over the medium-term varying by plan design, and that such increases should be reflected in the MBP's projections.

single year, additional contributions and/or changes in Plan benefits could be made prior to FY 2020 to smooth the effect of the increase needed in FY 2020.

V. Conclusion

13. The Plan's finances have continued to improve in FY 2010. Income has exceeded costs and, as a result, cash reserves exceed the target level even after applying the new IBNP reserve methodology. The 10-year projections indicate the Plan's finances are expected to remain reasonably healthy over the medium term with the continuing application of automatic increases in MBP contributions based on the increase in the salary structure. The Plan's financial outlook will continue to be monitored closely to ensure early action will be taken on the Plan benefits and/or contributions scale, to ensure the financial sustainability of the Plan, and to avoid the need for abrupt hikes in contribution rates.

14. Consequently, pursuant to the Board's decision of July 25, 2008, Plan contributions will be increased by the assumed salary structure increase, i.e., 2.6 percent as of May 1, 2010, commencing with the first full pay period in FY 2011 as reflected in the contribution schedule set forth in Appendix I of EBAP/10/28. This increase will result in a contribution from the Administrative Budget to the MBP of $ 36.4 million.[9] This increase has been included in the Fund budget recommendation for FY 2011.

[9] The Retired Staff Benefits Investment Account (RSBIA) will contribute an additional funding of $13.9 million. The RSBIA was established in 1995 to hold, invest, and administer resources contributed by the Fund for meeting the accruing obligations of the Fund with respect to medical and life insurance costs of current and future retirees. Additional plans related to post-separation benefits were added in later years.

APPENDIX: CURRENT AND PLANNED CONTRIBUTION SCHEDULES

Current Schedule of the Monthly Enrollee Contributions
for the Medical Benefits Plan
MBP Contribution Rates Effective May 1, 2009

	Types of Coverage				
Annual Income in U.S. dollars 1/	Single	Couple	One-Parent Family	Two-Parent Family	Each "Other Dependent"
25,269 & below	$42.37	$84.75	$74.15	$105.93	$168.47
25,270–28,319	$44.93	$89.86	$78.63	$112.33	$178.63
28,320–31,679	$50.31	$100.61	$88.03	$125.76	$200.00
31,680–35,489	$56.32	$112.63	$98.55	$140.79	$223.90
35,490–39,809	$63.13	$126.27	$110.48	$157.83	$251.00
39,810–44,479	$70.67	$141.34	$123.67	$176.68	$280.97
44,480–49,889	$79.12	$158.24	$138.46	$197.80	$314.57
49,890–55,879	$88.68	$177.36	$155.19	$221.70	$352.57
55,880–59,409	$96.66	$193.32	$169.16	$241.65	$384.30
59,410–68,359	$107.13	$214.25	$187.47	$267.81	$388.70
68,360–78,509	$123.14	$246.28	$215.49	$307.85	$388.70
78,510–87,909	$139.53	$279.06	$244.18	$348.83	$388.70
87,910–98,499	$156.29	$312.58	$273.51	$390.73	$388.70
98,500–110,309	$175.07	$350.14	$306.37	$437.68	$388.70
110,310 & above	$184.97	$369.94	$323.70	$462.43	$388.70

1/ Fund net salary or gross pension, as applicable, on annual basis.

New Schedule of the Monthly Enrollee Contributions
for the Medical Benefits Plan
MBP Contribution Rates Effective May 1, 2010

	Types of Coverage				
Annual Income in U.S. dollars 1/	Single	Couple	One-Parent Family	Two-Parent Family	Each "Other Dependent"
25,269 & below	$43.48	$86.95	$76.08	$108.69	$168.47
25,270–28,319	$46.10	$92.20	$80.67	$115.25	$178.63
28,320–31,679	$51.61	$103.23	$90.32	$129.03	$200.00
31,680–35,489	$57.78	$115.56	$101.12	$144.45	$223.90
35,490–39,809	$64.77	$129.55	$113.36	$161.94	$251.00
39,810–44,479	$72.51	$145.02	$126.89	$181.27	$280.97
44,480–49,889	$81.18	$162.36	$142.06	$202.95	$314.57
49,890–55,879	$90.99	$181.97	$159.22	$227.46	$352.57
55,880–59,409	$99.17	$198.35	$173.56	$247.94	$384.30
59,410–68,359	$109.91	$219.82	$192.34	$274.78	$398.81
68,360–78,509	$126.34	$252.68	$221.10	$315.85	$398.81
78,510–87,909	$143.16	$286.32	$250.53	$357.89	$398.81
87,910–98,499	$160.35	$320.71	$280.62	$400.88	$398.81
98,500–110,309	$179.62	$359.25	$314.34	$449.06	$398.81
110,310 & above	$189.78	$379.56	$332.12	$474.45	$398.81

1/ Fund net salary or gross pension, as applicable, on annual basis