WORLD HEALTH ORGANIZATION
PROPOSAL FOR ASSESSMENT IN SWISS FRANCS
FREQUENTLY ASKED QUESTIONS
SEPTEMBER 2012
**What is currency risk and how does it arise?**

Currency risk (also known as exchange rate risk or foreign exchange risk) is a financial risk caused by an exposure to unanticipated changes in the exchange rate between two currencies. In the case of WHO this risk arises due to mismatches between the currencies of income and expenditure which can have significant financial consequences and so needs to be mitigated and managed appropriately.

**What is currency hedging?**

Currency hedging refers to the range of measures which can be taken to manage currency risk. The only effective long term currency hedge is to match the currencies of receivables and payables. Short term currency hedging can be achieved over a time horizon of one to two years by contracting with banks financial instruments such as forward currency contracts and or currency options which lock in future exchange rates. These instruments can only provide short term currency hedging over that time horizon, they cannot protect against long term currency movements, and in the case of currency options the premium cost of the hedging instrument can be expensive.

**What is the background to the proposal to assess some or all of Member States’ contributions in Swiss Francs?**

The Organization has total net Swiss Franc expenditure of c. US Dollars 1 billion per biennium. The total Assessed Contributions for 2012-13 is US Dollars 949 million. Other voluntary contributions may be received in any currency, but the majority are received in US Dollars. If all Assessed Contributions were assessed in Swiss Francs rather than US Dollars this would hedge the Organization’s long term Swiss Franc currency exposure.

The 15th meeting of the Programme Budget and Administration Committee requested the Secretariat to provide further analysis of the different options for adjusting the currency of Assessed Contributions to reduce or minimise The Organization’s long term Swiss Franc net expenditure currency exposure.

**Why is this proposal being raised now?**

The Reform Process provides an ideal forum to revisit fundamental financing issues such as the currency of assessment. Over the last decade the growing proportion of expenditure funded by voluntary contributions has caused the currency imbalance to increase. Recent Swiss Franc to US Dollar exchange rate volatility has caused the currency mismatch to become more problematic.

As the diagram overleaf illustrates, between 2000 and 2010 there was a 34% erosion in the weighted purchasing power of the US Dollar for the Organization’s payroll costs. This problem of purchasing power erosion has built up over the past decade cumulatively, and has been highlighted in the Financial Reports and discussed with the PBAC in recent years. The extreme currency volatility and the sharp decline in the value of the US Dollar during the global financial crisis in 2011 led to this currency issue being focused upon in recent Executive Board and PBAC meetings.
**What is assessment in Swiss Francs?**

Currently the budget is approved in US Dollars and Members are assessed in US Dollars. Under assessment in Swiss Francs the budget would still be developed in US Dollars but some or all of the amounts assessed to Member States would be denominated and settled in Swiss Francs. The Swiss Franc to US Dollar exchange rate used to calculate the Swiss Franc assessments will be the same rate as that used for budgeting expenditure.
How would assessment in Swiss Francs help the Organization?

The Organization spends a large proportion of its budget in Swiss Francs (approximately 30%). Because it receives all of its assessed contributions in US Dollars, it has to buy Swiss Francs to meet those Swiss Franc expenditures. These purchases generate exchange rate gains or losses between the rate at which expenditure was budgeted and the rates actually transacted. Assessment in Swiss Francs would allow the Organization to match income to expenditure in Swiss Francs in the long term and reduce the need to purchase Swiss Francs, and thus significantly reduce its biggest currency risk of generating such currency exchange gains or losses.

What do other UN agencies and similar international organizations headquartered outside the US do?

Other non-US-based agencies and similar international organizations assess at least partly in the currency of their headquarters:

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<tr>
<th>Organization</th>
<th>Currency of HQ</th>
<th>Currency of Assessment</th>
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<tbody>
<tr>
<td>WHO</td>
<td>CHF</td>
<td>USD</td>
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<tr>
<td>ILO, ITU, UPU, WIPO, WMO, WTO, IUCN</td>
<td>CHF</td>
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<tr>
<td>IAEA, FAO, UNESCO</td>
<td>EUR</td>
<td>Split assessment EUR &amp; USD</td>
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<td>UNIDO, IARC, OECD</td>
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<td>IMO</td>
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<td>ICAO</td>
<td>CAD</td>
<td>Split assessment CAD &amp; USD</td>
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<td>IFAD, WFP</td>
<td>EUR</td>
<td>No assessed contributions</td>
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<tr>
<td>UNHCR</td>
<td>CHF</td>
<td>No assessed contributions</td>
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WHO’s currency risks are somewhat more complex than those of some other UN agencies due to its high proportion (c. 75%) of total funding which comes from voluntary contributions in a range of currencies.

Which Financial Regulation defines the currency of assessment?

Assessed Contributions for Member States are governed by Regulation VI of the WHO Financial Regulations:

“6.6 Contributions shall be assessed in United States Dollars, and shall be paid in either United States Dollars, euros or Swiss Francs, or such other currency or currencies as the Director-General shall determine.
“6.9 Payments in currencies other than United States Dollars shall be credited to Members’ accounts at the United Nations rate of exchange ruling on the date of receipt by the World Health Organization.”

If payment in currencies other than the US Dollar is already permitted, why is this not sufficient?

The currency imbalance is caused by the currency of assessment rather than the currency of payment. Under the current regulation, Member States are assessed in US Dollars. If a Member State settles in a currency other than the US Dollar, that payment will be recorded in US Dollars at the current exchange rate.

How has the currency risk been dealt with up to now?

The impact of Swiss Franc exchange rate movements was absorbed by an Exchange Rate Facility up until 2001. This involved adjusting the budget up or down by a maximum of US Dollars 31 million funded from casual (Miscellaneous) income. From 2002 until now the currency risk has been hedged using short term currency hedging instruments such as currency options and forward purchase contracts transacted with banks. These hedging mechanisms only addressed the currency risks of the part of the budget funded by assessed contributions.

At present there are forward purchase contracts in place to lock in the Swiss Franc exchange rate for the next twelve month period, and these now cover all expenditure funded by both assessed and voluntary contributions.

Is this the right time to switch to assessment in Swiss Francs?

The WHO budget would still be prepared in US Dollars but under Swiss Franc assessment some or all of the amounts assessed to Member States would be denominated and settled in Swiss Francs. The Swiss Franc / US Dollar exchange rate at which the assessments would be translated into Swiss Francs for each biennium would be set at the time of approval of the budget, and so would only be fixed for that biennium. So in terms of long term exchange rate movements there is no “right time” or “wrong time” to switch to Swiss Franc assessments.

The Swiss Franc strengthened by 39% against the US Dollar from 1.28 at the beginning of 2006 to its peak in August 2011 of 0.78, but since then it has weakened by 22% to its September 2012 level of 0.95. The Swiss Franc is currently maintained at an exchange rate of 1.20 against the Euro by the intervention of the Swiss National Bank (SNB) and it is expected that the SNB will maintain this exchange rate for the foreseeable future. There is of course no way of knowing if the Swiss Franc will strengthen or weaken against the US Dollar in the future months or years. Over the past seven years there has been a great deal of volatility in the Swiss Franc / US Dollar exchange rate, and there continues to be volatility in the exchange rate, which is now driven by volatility in the Euro / USD Dollar exchange rate. This exchange rate volatility creates difficulties for WHO in its long term budgeting for future HQ Swiss Franc based expenditure.
Who carries the risk of exchange rate gains or losses under Swiss Franc assessments?

Under Swiss Franc assessment, the long term Swiss Franc to US Dollar exchange rate risk is shared among the Member States.

Will a Swiss Franc assessment increase Member States’ currency risk?

Under the existing assessment mechanism in US Dollars, all members whose national currency is not US Dollars or US Dollar-linked are exposed to a currency risk. For those members, being assessed in Swiss Francs does not necessarily increase that currency risk. Rather, it replaces the risk of movements in their national currency against the US Dollar with the risk of movements in their national currency against the Swiss Franc. For members whose national currency is the Swiss Franc or a currency to which the Swiss Franc is linked (e.g., at present the EUR based countries), the currency risk of their assessments will be eliminated or reduced. For those members whose national currency is the US Dollar or a currency pegged to the US Dollar, there will be an increase in the currency risk of their assessments.

Does the exchange rate adopted for the budget affect how much each Member State will be assessed in each currency?

No, the absolute amount assessed in US Dollars is translated into Swiss Francs at the exchange rate at the time of approval of the budget and it is fixed at that amount for the biennium. The cost to each Member in their own currency will, as it always has in the past, depend upon the rate of exchange between the Member’s currency and the assessed currency on the date of payment.

Will assessment in Swiss Francs mean that the Member States will have to pay more in national currency terms since the Swiss Franc is always appreciating against the US Dollar?

The Swiss Franc has strengthened a great deal against the US Dollar over the past decade which has led to the negative exchange rate impacts on the Organization’s US Dollar based budgets during that time. Evidently it is impossible to predict future exchange rate movements and there is no way of knowing for certain if the Swiss Franc will remain so strong against the US Dollar in the long term. Indeed since August 2011 the Swiss Franc has fallen back against the US Dollar from its peak. The OECD uses “purchasing power parity” (PPP) to estimate long term exchange rates by comparing the cost of a basket of goods and services in different countries, and calculating implicit exchange rates from that. The current OECD PPP long term equilibrium exchange rate for the Swiss Franc against the US Dollar is 1.50. This implies that the Swiss Franc is currently more than 60% over valued against the US Dollar in the long term, but it can take many years or even decades for exchange rates to revert to the PPP long term norms.

Has the Organization taken expert advice on the best way to protect itself from long term exchange rate movements?

The Independent Expert Oversight Advisory Committee considered this matter and recommended full denomination of assessed contributions in Swiss Francs because it agreed...
this would be simple to understand and implement, and would provide a good currency balancing mechanism.

**Would currency forward purchase contracts solve the problem?**

Currency forward purchase contracts can provide protection for up to a 30 month period so it would be possible to enter into forward purchase contracts to buy forward the Organization’s Swiss Franc needs for the entire biennium. The Organization is currently doing this on a 12 month basis which provides exchange rate stability 12 months forward for the staff costs in its six major currencies of non US Dollar expenditure (Swiss Francs, Euros, Indian Rupees, Philippine Pesos, Egyptian Pounds and Malaysian Ringgits). However, the currency forward contracts do not provide full protection within a biennium when the forward rate is different from the budget rate, and when market rates move against the forward rates contracted, currency gains and losses are generated. More importantly, the forward foreign exchange market only extends around 2 ½ years forward so forward purchase contracts cannot be used to hedge exchange rate movements in the longer term across biennia. Hedging cannot protect the Organization from any long term decline in the value of the Dollar, such as the one experienced between the end of 2010 and the end of 2011.

**Can we re-establish the Exchange Rate Facility that was used until 2001 to absorb gains and losses as they arise?**

That is a possible alternative solution. Such a facility does not eliminate the currency risk, it creates a buffer to absorb the likely level of gains and losses. The previous Exchange Rate Facility was a fund of US Dollars 31 million and funding for this came from Casual Income (savings on Regular Budget). Since 2002, any such Regular Budget savings revert to the Member States by means of a reduction to the assessments required to fund the approved Regular Budget. This funding is therefore no longer available. An Exchange Rate Facility would now require to be funded by around 10% ($100 million) of the Assessed Contributions Budget to be sufficiently large to absorb potential budget shortfalls that may be caused by large adverse currency movements such as were experienced in 2011.

**What will a switch to assessment in Swiss Francs cost?**

The total cost of a switch to Swiss Franc assessments has not been determined, but it is expected that the work to adjust The Organization’s billing and accounting systems would not be expensive.

**What are the options for assessment in Swiss Francs?**

The two main options for assessment in Swiss Francs Assessments are described below in terms of their relative advantages and disadvantages.
Option 1: All Member States (MS) are assessed 50% in CHFs and 50% in USDs

For example:
- MS is assessed CHF 5m and USD 5m for 2014 when the CHF/USD exchange rate is 1.00, so equivalent to USD 10m
- MS settles CHF 5m and USD 5m contribution in February 2014 when the exchange rate is CHF 0.90
- MS has settled the equivalent of USD 10.6m in total (USD 5m + CHF 5m @ 0.90)
- This USD 0.6m extra Dollar value of the AC settled offsets half the increased cost to the Organization of its CHF expenditures expressed in USD

Advantages:
- Reduces risk of budget shortfalls and need for budget recosting due to adverse exchange rate movements
- For European MS, the CHF may be less volatile against their own currencies than the USD
- CHF currency risk is shared among 194 MS rather than all being borne by the Organization
- Reduces the requirement for MS to settle in CHFs rather than USDs

Disadvantages:
- Creates increased currency exposure for MS whose currencies track the USD more closely than the CHF
- Billing assessments in two currencies increases complexity of settlement accounting for MS and the Organization
- The proportion of the budget not covered by CHF assessments would require to be hedged short term

Option 2: All Assessed Contributions (AC) are assessed to Member States (MS) in Swiss Francs (CHFs):

- 2014-15 AC budget calculated in Jan 2013 for Executive Board using current CHF/USD exchange rate and approved at May 2013 World Health Assembly (WHA)
- 2014-15 AC advised to MS in CHFs in June 2013
- 2014 AC assessed to MS in CHFs in Nov 2013
- All MS settle AC in CHFs

For example:
- MS is assessed CHF 10m for 2014 when the CHF/USD exchange rate is 1.00, so equivalent to USD 10m
- MS settles its CHF 10m AC in February 2014 when the CHF/USD exchange rate has moved to 0.90
- USD equivalent of contribution when settled is USD 11.1m (CHF 10m @ 0.90)
- This USD 1.1m extra Dollar value of the AC settled offsets the increased cost to the Organization of its CHF expenditures expressed in USD

Advantages:
- 100% of the Organization CHF long term expenditure exposure is eliminated
- Reduces risk of budget shortfalls and need for budget recosting due to adverse exchange rate movements
- For European MS, the CHF may be less volatile against their own currencies than the USD
- CHF currency risk is shared among 194 MS rather than all being borne by the Organization
Disadvantages:
- Creates increased currency exposure for MS whose currencies track the USD more closely than the CHF
- Some MS may have more difficulty obtaining CHFs than USDs to settle AC

**Which of the above assessment options does the Secretariat recommend?**
The Secretariat recommends that option 1 be considered as it would significantly reduce the Organization’s long term CHF currency exposure while at the same time minimising the assessed amounts that Member States would be required to settle in CHFs rather than USDs.

**What would be the impact upon the net expected biennium surpluses and deficits by currency for WHO of switching to 50% assessments in Swiss Francs or to 100% assessments in Swiss Francs?**
The below graphs illustrate the expected impact upon the net expected biennium surpluses and deficits by currency for WHO of switching to 50% assessments in Swiss Francs or to 100% assessments in Swiss Francs. The figures are based upon the 2010 / 11 currencies of income and expenditure. For each scenario (current situation with all assessed contributions in US Dollars, switch to 50% assessments in Swiss Francs, and switch to 100% assessment in Swiss Francs) the predicted impact is shown in terms of the Assessed Contributions budget, and then in terms of the total budget of both Assessed and Voluntary Contributions.

**Predicted Impact on Assessed Contributions Income & Expenditure:**

- **Current Situation: All Assessed Contributions in USDs**
- **50% Assessed Contributions in CHFs**
- **100% Assessed Contributions in CHFs**
In summary, a switch to 50% assessment in Swiss Francs would reduce the currency imbalance within the overall balanced WHO budget. The net Swiss Franc biennium shortfall would reduce from $-1.2 billion to $-700 million, and a switch to 100% assessment in Swiss Francs would reduce that net Swiss Franc biennium shortfall to $-200 million.