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|  | NATO | NORTH ATLANTIC COUNCIL |
| | OTAN | CONSEIL DE L'ATLANTIQUE NORD |

NATO UNCLASSIFIED

16 December 2015

DOCUMENT
C-M(2015)0086-AS1

**IBAN REPORT ON THE AUDIT OF
THE RETIREES MEDICAL CLAIMS FUND (RMCF) FOR 2014**

ACTION SHEET

On 15 December 2015, under the silence procedure, the Council noted the IBAN report IBA-AR(2015)24 attached to C-M(2015)0086 and agreed the RPPB recommendation regarding public disclosure.

(Signed) Alexander Vershbow
Deputy Secretary General

NOTE: This Action Sheet is part of, and shall be attached to C-M(2015)0086.

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9 December 2015

DOCUMENT
C-M(2015)0086
Silence Procedure ends:
15 Dec 2015 18:00

**IBAN REPORT ON THE AUDIT OF
THE RETIREES MEDICAL CLAIMS FUND (RMCF) FOR 2014**

Note by the Deputy Secretary General

1. I attach the International Board of Auditors for NATO (IBAN) report on the audit of the financial statements of the Retirees Medical Claims Fund (RMCF) for the year ended 31 December 2014. The audit report sets out an unqualified opinion.
2. The IBAN report has been reviewed by the Resource Policy and Planning Board (RPPB). In line with PO(2015)0052, the RPPB disclosure notice, agreed on 25 November 2015, recommends to Council that the IBAN report on the audit of the RMCF for the year 2014, together with the related financial statements, be made available to the public (Annex).
3. I consider that no further discussion regarding this report is required. Consequently, **unless I hear to the contrary by 18:00 hours on Tuesday, 15 December 2015**, I shall assume that the Council has noted the IBAN report IBA-AR(2015)24 and agreed the RPPB recommendation regarding public disclosure.

(Signed) Alexander Vershbow

4 Annexes
1 Enclosure

Original: English

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RPPB DISCLOSURE NOTICE

**IBAN REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS OF THE
RETIREES MEDICAL CLAIMS FUND (RMCF) FOR 2014**

References: (A) IBA-A(2015)179 & IBA-AR(2015)24

(B) Cover letter to the 2014 Retirees Medical Claims Fund (RMCF) – reference
FC(2015)045

1. Council agreed with PO(2015)0052 that, in principle, unclassified IBAN audit reports, together with any related financial statements, should be made publicly available after they have been dealt with by Council.
2. The IBAN issued an unqualified audit opinion on the Retirees Medical Claims Fund (RMCF) 2014 Financial Statements. The unqualified audit report (reference (A)) will be forwarded to Council for notation, as per agreed procedures.
3. In reference (B), the International Staff Financial Controller concludes that the 2014 RMCF Financial Statements can be disclosed.
4. With regard to public disclosure, the RPPB concludes that the subject IBAN report does not contain information which, according to NATO Policy on Disclosure of NATO Information, shall be withheld from public disclosure, and in line with the agreed policy in PO(2015)0052, therefore recommends that the Council agree to the public disclosure of the subject IBAN report and the related financial statements.

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**Summary Note for Council
by the International Board of Auditors for NATO (Board)
on the audit of the Financial Statements of the
NATO Retirees Medical Claims Fund (RMCF)
for the year ended 31 December 2014**

The NATO Retirees Medical Claims Fund (RMCF) was set up with effect from 1 January 2001 pursuant to Council approval of PO(2000)123. The purpose was to establish a reserve to ensure that sufficient funds are available for the years to come to enable NATO to meet its obligations to pay the medical expenses of eligible retired staff members and their recognised dependants.

The fund has a Supervisory Committee established to oversee the management of the fund. The Committee meets at least twice a year.

In 2014, receipts from NATO bodies and staff remained constant at EUR 22.6 million (in 2013 - EUR 22.2 million). Insurance premiums paid out of these receipts were EUR 16.6 million in 2014 (EUR 14.8 million in 2013). At the end of 2014, the fund manager held EUR 272.9 million on behalf of NATO (at the end of 2013 - EUR 232.1 million), and the actuarial present value of the long term post-employment medical care obligation was approximately EUR 1.8 billion (at the end of 2013 – EUR 1.1 billion).

The Board issued an unqualified opinion on RMCF Financial Statements and on compliance for the year ended 31 December 2014.

During the audit, the Board had no observations to be included in the audit report.

The Board also followed up on the status of observations from previous years' audit reports and noted that one has been settled and two are still outstanding. The status is summarised in the Letter of Observations and Recommendations (Annex 4).

For the IS Financial Controller's formal comments, see Annex 4.

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INTERNATIONAL BOARD OF AUDITORS FOR NATO

AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS OF

THE NATO RETIREES MEDICAL CLAIMS FUND

(RMCF)

FOR THE YEAR ENDED 31 DECEMBER 2014

**REPORT OF THE INTERNATIONAL BOARD OF AUDITORS
FOR NATO TO THE NORTH ATLANTIC COUNCIL****Report on the Financial Statements**

The International Board of Auditors for NATO (Board) audited the accompanying financial statements of the NATO Retirees Medical Claims Fund (RMCF), which comprised the Statement of Net Assets Available for Benefits as at 31 December 2014 and the Statement of Changes in Net Assets Available for Benefits, the Cash Flow Statement for the year then ended, and Notes to the Financial Statements, including a summary of significant accounting policies.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Accounting Standard (IAS) 26¹ *Accounting and Reporting by Retirement Benefit Plans* and the requirements of the NATO Financial Regulations as authorized by the North Atlantic Council (NAC). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit, which is conducted in accordance with our Charter and international standards on auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, due to fraud or error. In making those risk assessments, internal control relevant to the entity's preparation and presentation of financial statements is considered in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. An audit also includes evaluating the appropriateness of accounting policies used, the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

¹ As the NATO Accounting Framework does not have a standard specific to accounting and reporting by retirement benefit plans, the NATO International Staff presents the RMCF Financial Statements in accordance with IAS 26.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion on Financial Statements

In our opinion, the financial statements present fairly, in all material respects, the financial position of RMCF as of 31 December 2014, the changes in financial position thereof for the year then ended in accordance with IAS 26.

Report on Compliance

Management's Responsibility for Compliance

In addition to the responsibility for the preparation and presentation of the financial statements described above, management is also responsible for ensuring that the financial transactions and information reflected in the financial statements are in compliance with the NATO Financial Regulations and the NATO Civilian Personnel Regulations as authorised by the North Atlantic Council (NAC).

Auditor's Responsibility

In addition to the responsibility to express an opinion on the financial statements described above, our responsibility includes expressing an opinion on whether the financial transactions and information reflected in the financial statements are, in all material respects, in compliance with the NATO Financial Regulations and the NATO Civilian Personnel Regulations. This responsibility includes performing procedures to obtain reasonable assurance about whether the funds have been used for the settlement of authorised expenditure and whether their operations have been carried out in compliance with the financial and personnel regulations in force. Such procedures include the assessment of the risks of material non-compliance.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion on Compliance

In our opinion, in all material respects the financial transactions and information reflected in the financial statements are in compliance with the NATO Financial Regulations and the NATO Civilian Personnel Regulations.

Brussels, 30 October 2015

Lyn Sachs
Chairman

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ANNEX 4
C-M(2015)0086
IBA-AR(2015)24

INTERNATIONAL BOARD OF AUDITORS FOR NATO

**LETTER OF OBSERVATIONS AND RECOMMENDATIONS
FOR THE NATO RETIREES MEDICAL CLAIMS FUND FINANCIAL STATEMENTS
(RMCF)**

FOR THE YEAR ENDED 31 DECEMBER 2014

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Introduction

The International Board of Auditors for NATO (Board) audited the NATO Retirees Medical Claims Fund (RMCF) Financial Statements for the year ended 31 December 2014, and issued an unqualified opinion on the financial statements and on compliance.

Observations and Recommendations

During the audit, the Board had no observations to be included in the audit report.

The Board also followed up on the status of observations from previous years' audit reports and noted that one has been settled and two are still outstanding. The outstanding observation on weak internal controls in contribution receipts has been outstanding since the Board's audit of the 2010 financial statements and needs management focus to address the weaknesses.

The IS Financial Controller's Formal Comments have been included herein.

FOLLOW-UP OF PREVIOUS YEARS' OBSERVATIONS

The Board reviewed the status of the observations and recommendations arising from previous years' audits. These observations and their status are summarised in the table below.

Status of previous years' observations

| OBSERVATION/RECOMMENDATION | ACTION | STATUS |
|---|---|---|
| <p>(1) Financial year 2013 IBA-AR(2014)13, paragraph 1 No Supervisory Committee meetings held in 2013</p> <p>The Board found that no meetings of the Supervisory Committee were held in 2013 as required by the CPRs. The Chair of the Committee stated to the Board that there were no such meetings because:</p> <ol style="list-style-type: none"> 1) No changes were made to the investment strategy during the year, including that all funds continued to be held in index funds, 2) Each member of the Committee received monthly statements from the Investment Manager, and 3) No other business was required to be discussed. <p>Furthermore, the results of the asset and liability management study that had been ordered in 2012 had still not yet been received as of the date of this letter. As a result, the Committee did not feel it was necessary or economical to hold such meetings in 2013.</p> <p>Recommendation In general, the Board recommends compliance with the CPRs. However, if the Committee does not believe that it is necessary or economical to hold a particular meeting, the reasons for this should be clearly documented by the Chair of the Committee and communicated in writing to all members of the Committee for their written agreement. Such documentation should be properly filed in order to demonstrate that the Committee has fulfilled its responsibilities in relation to the RMCF.</p> | <p>There were 2 Supervisory Committee meetings held in 2014. Meeting minutes provided to the Board.</p> | <p>Observation Settled.</p> |

| OBSERVATION/RECOMMENDATION | ACTION | STATUS |
|---|---|--|
| <p>(2) Financial year 2012 IBA-AR(2013)25 – paragraph 5.1 Retirees Medical Claims Fund (RMCF) Net Assets Inadequate to Fund Promised Future Expected Benefits</p> <p>The Board draws the attention of the Council that there are currently not sufficient funds available to enable NATO to meet its promised future obligations as was the intention of the plan, and recommends that, as was proposed in SG(2009)0302, on the basis of the results of the asset and liability study presented in the December 2012 Supervisory Committee and the related final report issued dated 30 April 2013, that the IS provides an estimate of the minimum financial injection necessary to make the RMCF sustainable.</p> <p>The Board recommends also that the IS provides all necessary information and any remedial actions undertaken to limit the level of obligations. This should be presented to the nations as soon as possible in order to allow for appropriate remedial actions, where still feasible, to be made.</p> | <p>The ISRP (International Service for Remuneration and Pensions) has presented the draft of the first part of the Asset & Liability Management Study to the Supervisory Committee. The presentation provided an update of the estimated future expenses and incomes charged to the Fund.</p> <p>Nevertheless, the final version of the abovementioned study still has not been issued.</p> | <p>Observation Outstanding.</p> |
| <p>Comment of the Financial Controller, International Staff</p> <p><i>The Asset and Liability Management Study is planned to be presented to the RMCF Supervisory Committee by the end of the year and, further to eventual acceptance by them, to the Budget Committee.</i></p> | | |
| <p>(3) Financial years 2010 and 2011 IBA-AR(2013)06 – paragraph 5.3 Weak internal controls on contribution receipts</p> <p>The Board recommends that the IS continue developing control procedures that will allow it, in a timely and systematic manner, to determine that the monthly cash receipts from the Agencies for the RMCF contributions are accurate and complete.</p> | <p>The Treasury team is still not being provided with sufficient information by the NATO Agencies and NATO Bodies, who are not part of PMIS, to confirm the completeness and accuracy of the contributions received.</p> <p>The RMCF Supervisory Committee in the Letter of Observations and Recommendations for 2013 (IBA-AR(2014)13) commented that the IS OFC has also introduced an end-of-</p> | <p>Observation Outstanding.</p> |

| OBSERVATION/RECOMMENDATION | ACTION | STATUS |
|--|--|--------|
| | <p>year process to check mutual balances with NATO bodies which are not part of the PMIS system.</p> <p>However, the Board was unable to get reasonable assurance that this control is already implemented and is operating more priority effectively.</p> | |
| <p><i>Comment of the Financial Controller, International Staff</i></p> <p><i>An end-of-year process to check mutual balances with NATO bodies which are not part of the PMIS system was applied for 2013 and will be reintroduced for 2015.</i></p> | | |

NATO RETIREES MEDICAL CLAIMS FUND
Statement of Net Assets Available for Benefits

(All amounts in EUR)

| | Notes | Current Year 31-Dec-14 | Current Year 31-Dec-13 |
|--|-------|---------------------------|---------------------------|
| Assets | | | |
| Cash in ING Bank current account | 4 | 128,350.17 | 1,484,004.56 |
| Investments at market value | 5 | 272,937,693.15 | 232,110,197.88 |
| Accounts Receivable | 6 | 302,707.63 | 4,552,455.91 |
| Total Assets | | 273,368,750.95 | 238,146,658.35 |
| Liabilities | | | |
| Accounts Payable | 7 | 9,061.26 | 226,714.84 |
| Total Liabilities | | 9,061.26 | 226,714.84 |
| Net assets available for benefits | | 273,359,689.69 | 237,919,943.51 |

NATO RETIREES MEDICAL CLAIMS FUND

Statement of Changes in Net Assets Available for Benefits

| (All amounts in EUR) | Notes | Current Year | Current Year |
|--|-------|-----------------------|-----------------------|
| | | 31-Dec-14 | 31-Dec-13 |
| Increase in net assets | | | |
| Net unrealized gain in market value of investments | 5 | 30,233,783.72 | 22,604,657.46 |
| Contributions for current year | 8 | 22,573,655.20 | 22,226,989.20 |
| Contributions for future years | 8 | 0.00 | 19,129.88 |
| Profit sharing per agreement with insurer | 9 | 0.00 | 4,239,661.00 |
| Fund rebates | 5 | 393,711.55 | 486,413.97 |
| Interest income | 10 | 5,963.23 | 5,756.18 |
| Impact of change of accounting estimate | | | |
| Total increase in net assets available for benefits | | 53,207,113.70 | 49,582,607.69 |
| Decrease in net assets | | | |
| Insurance premiums | 11 | 16,638,680.04 | 14,770,498.04 |
| Insurance management fee | 11 | 1,127,544.48 | 1,007,444.64 |
| Contributions for future years | 7 | 0.00 | 19,129.88 |
| Fund purchase fees | 5 | 0.00 | 3,398.00 |
| Administrative fees | 11 | 1,143.00 | 0.00 |
| Total decrease in net assets available for benefits | | 17,767,367.52 | 15,800,470.56 |
| Net increase for the year | | 35,439,746.18 | 33,782,137.13 |
| Net assets available for benefits, beginning of year | | 237,919,943.51 | 204,137,806.38 |
| Net assets available for benefits, end of year | | 273,359,689.69 | 237,919,943.51 |

**EXPLANATORY NOTES TO THE
2014 FINANCIAL STATEMENTS OF THE
NATO RETIREES' MEDICAL CLAIMS FUND**

NOTE 1: GENERAL INFORMATION

The Retirees' Medical Claims Fund (RMCF) was set up with effect from 1 January 2001 pursuant to Council approval of PO(2000)123. The purpose was to establish a reserve to ensure that sufficient funds are available for the years to come to enable NATO to meet its obligations to pay the medical expenses of eligible retired staff members and their recognised dependants.

Description of the Fund

Staff leaving the Organization after 10 consecutive years of service and having reached the age of 55 are eligible to reimbursement of medical costs for themselves and their recognized dependants (Article 51.2 of the Civilian Personnel Regulations (CPR)).

Until 31 December 2000, any staff who had at least 10 years consecutive service and reached 65, was covered for life for their medical expenses through Organization's insurers. However, with the rise in the number of retirees and the increasing medical costs, the insurers were no longer able to cover the expenses. Accordingly, the Organization assumed this responsibility as from 1 January 2001.

For this purpose, the Retirees' Medical Claims Fund was set up with effect from 1 January 2001 pursuant to Council approval of PO(2000)123. The Council agreed to the establishment of a reserve to ensure that sufficient funds are available for the years to come to enable NATO to meet its obligations.

However, on the date of the creation of the RMCF there existed a potential liability towards staff who filled the age and service conditions mentioned above but had not yet retired. No asset was provided to fund this initial liability; therefore, from its inception the RMCF was underfunded.

The Fund only finances retirees from the age of 65. Former staff between the ages of 55 and 65 are insured under a different financing scheme.

The RMCF is maintained primarily by the annual premiums paid as continuing insurance. The surplus funds collected, which represent the bulk of contributions, are invested with the Investment Manager.

Financing

The Fund receives the following contributions:

- 4.5% of the active agents' emoluments (1/3 borne by the staff, 2/3 by NATO).
- 5% of the last basic salary of the retirees who are required to contribute (1/3 borne by the staff, 2/3 by NATO). This rate was increased, from 3%, as from 1 January 2013.

Governance

The rules and principles governing the RMCF are provided at Annex XIII of the NATO CPRs.

A consultative committee, called the Supervisory Committee, oversees the management of the RMCF with the object of ensuring that sufficient funds will always be available to cover medical costs until the last NATO pensioner or his/her dependants die. It acts as advisor to the NATO Secretary General.

The composition of the Supervisory Committee is as follows: a Chair appointed by the Secretary General (Director of Economics or Financial Controller, NATO-IS - the Chair shall be neutral); one representative of the International Staff (Director of Economics or Financial Controller, NATO-IS); two representatives for the NATO Production and Logistics Organisations; one representative for bodies governed by the Paris Protocol; two staff representatives appointed by the Liaison Committee of NATO Staff Associations; two representatives appointed by the Confederation of Retired Civilian Staff Associations.

The Fund, held in the name of NATO, is entrusted to an independent investment manager.

The Supervisory Committee determines the investment strategy and decides in which funds to invest. The Investment Manager executes purchases and sells according to instructions received from NATO-IS Treasury, which are in accordance with Supervisory Committee decisions.

The Investment Manager keeps the Supervisory Committee informed of all matters relating to the composition and performance of the funds through regular meetings with the Committee members.

Members of the RMCF Supervisory Committee do not receive any additional remuneration or benefits in return for their responsibilities.

Investment strategy

For 2014, as since 2009, the Supervisory Committee decided to maintain the strategy of investing in index funds and to maintain holdings approximately as follows:

50% in European government (sovereign) bonds
25% in global equities
25% in European equities

Vanguard Investment Series plc, a prominent index-fund manager, buys and sells bonds and equities on behalf of the Fund within the objectives and restrictions set out in the contract signed with the Organisation. Investments are in Euro.

An asset-liability study was initiated in order to reassess the investment strategy and funding of the Fund.

Management of the RMCF

NATO International Staff, in particular Executive Management – Human Resources and the Office of Financial Control, are responsible for the day-to-day management of the RMCF. Financial services are provided by the Office of Financial Control, NATO-IS. Administrative services and secretarial support are provided by Human Resources, Personnel Support.

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below.

Declaration of conformity

The financial statements of the NATO DCPS have been prepared in accordance with the NATO Financial Regulations and International Accounting Standard 26, "Accounting and Reporting by Retirement Benefit Plans". The NATO Accounting Framework, which is an adapted version of the International Public Sector Accounting Standards (IPSAS), does not have a specific standard for accounting and reporting by retirement benefit plans

The accounting system currently used by the NATO RMCF is accrual based.

The financial statements summarize the transactions and net assets of the Fund. The statements do not take into account the liability to pay benefits that fall due after the year end of the reporting period. The actuarial position of the NATO RMCF, which takes these liabilities into account, is presented in Note 3.

Basis of presentation

The financial statements have been prepared on a going-concern basis: the RMCF will continue in operation for the foreseeable future.

The amounts shown in these financial statements are presented in EUR.

Changes in accounting policy

There are no changes to report.

Use of estimates

In the application of accounting policies, which are described below, management is required to make judgments, estimates and assumptions about carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. Estimates include, but are not limited to: the long term obligation of the continued medical coverage and contingent assets.

Foreign currency transactions

The insurance premiums are calculated and paid in EUR and the accounting is in EUR. Since mid-2009, contributions are made in EUR; consequently, foreign currency transactions are not material. Realized gains and losses resulting from such transactions appear in the cash flow statement.

Cash and Cash Equivalents

Cash and cash equivalents are defined as short-term assets. They include deposits held with banks and short term highly liquid investments.

Investments

Investments reported under these RMCF financial statements consist of equities and government bonds in index investment funds. These investments are reported as non-current assets reflecting the long term financial strategy of the RMCF.

An index fund is a collective investment scheme that aims to replicate the movements of an index of a specific financial market, regardless of market conditions. It does not aim to outperform the market. Index funds are commonly composed of a representative sample rather than all the securities in a given market, in appropriate weights. They are subject to a form of passive management rather than active management.

At the end of each reporting period a valuation is made by the investment manager at fair value by reference to official prices quoted on the day of valuation. The Account Statement received from Vanguard's transfer agent uses the Generally Accepted Accounting Principles (GAAP) methodology to calculate the Daily Net Asset Value (Daily NAV), a tradable, realisable value on the last trading day of the month. These are the values generally reported in financial statements by fund investors.

Amounts are net of purchase costs and increased by rebates.

Receivables

Receivables are stated at net realisable value. No allowance for loss is recorded for receivables relating to NATO bodies' statutory contributions.

Payables

Payables are amounts due to third parties based on goods received or services provided that remain unpaid. This includes, as required, an estimate of accrued obligation for goods received or services provided but not yet invoiced.

Net Assets

The net assets available at year-end correspond essentially to the surplus contributions that were not used to pay the insurance premiums and were invested with the Investment Manager or awaiting transfer.

Financial Risks

The RMCF uses only non-derivative financial instruments as part as its normal operations. These financial elements include cash, indexed investment funds, bank accounts, deposit accounts and accounts receivable.

All financial instruments are recognised in the statement of financial position at their fair value.

The RMCF is exposed to a variety of financial risks, including credit risk, market (price) risk and liquidity risk. The maximum exposure as at 31 December 2014 is equal to the total amount of bank balances, short term deposits, investment funds, and receivables.

Credit risk

The RMCF incurs credit risks from cash and cash equivalent held with banks and receivables. There is very limited credit risk associated with the realization of these elements.

Concerning cash and cash equivalent the RMCF credit risk is managed by holding current bank accounts and short term highly liquid deposits that are readily convertible to a known amount of cash held with ING Bank (Belgium) which has the following short term credit ratings as of 31 December 2014:

| ING Bank | Credit Ratings as at 31/12/2014 | | | |
|------------|---------------------------------|---------|-----|----------------------------|
| | Fitch | Moody's | S&P | Date of last rating update |
| Short Term | A+ | A2 | A | 16/12/2014 |

Concerning receivables, the credit risk is managed by maintaining control procedures over receivables. These consist essentially of contributions due by NATO agency payroll centres and the NATO Coordinated Pension Scheme. This risk is considered limited since these entities are funded by member nations which are considered credit worthy.

Price risk

The RMCF is exposed to equity securities market risk.

The two index equity funds in which RMCF funds are invested are not rated. The European Government Bond Index Fund is comprised of bonds with ratings as indicated below:

| Rating | AAA | AA | A | BBB | <BBB | Not rated | Cash |
|---------------|-------|-------|------|-------|------|-----------|------|
| At 31.12.2014 | 29.6% | 33.2% | 3.1% | 33.6% | 0.0% | 0.5% | 0.0% |

Credit ratings are derived from Moody's, S&P and Fitch. When ratings from all three are available, the median rating is used. When ratings are available from two of the agencies, the lower rating is used. When one rating is available, that rating is used.

Currency risk

Since mid-2009, RMCF is not exposed to foreign currency exchange risk arising from fluctuations in currency rates. The scheme receives contributions only in EUR. As explained above, funds are invested in EUR and insurance premiums are due in EUR.

Liquidity risk

A liquidity risk could arise from a short term liquidity requirement. There is a very limited exposure to liquidity risk because contributions from NATO payroll centres are received on a monthly basis, are higher than the insurance premiums and are paid by NATO bodies; the NATO bodies receive either contributions from their member states or income from their

customers, generally are other NATO bodies funded through their approved budgets. It is only the excess funds (after payment of insurance premiums) that are invested with Vanguard Investment Series plc with the aim of increasing the assets available for benefits over time.

Interest rate risk

The RMCF is restricted from entering into borrowings.

A portion of RMCF is invested in bonds. The market value of bonds fluctuates according to market perception of the issuer's creditworthiness and to projected interest rates. The value of assets available for benefits is therefore subject to some interest rate risk.

NOTE 3: ACTUARIAL VALUATION

An actuarial study was conducted in 2015 by the OECD International Service for Remunerations and Pensions (ISRP) to assess the value of the long term NATO post employment medical care obligation.

The evaluation of the situation end 2014, further to the study conducted in 2015, results in an overall present value of MEUR 1,797, of which MEUR 1,745 for the obligation related to the continued medical coverage of retirees funded through the RMCF and MEUR 52 for the obligation related to the specific category of staff called "bridgers" (see below).

The methodology is based on the Projected Unit Credit Approach, the method recognised by the IFRS/IPSAS standards.

Endogenous assumptions taken into account are:

- Probability that a staff member leaves the Organisation, retires, or becomes invalid.
- Annual salary increase and impact due to career progression (0.27% above inflation)

Exogenous assumptions taken into account are:

- Discount rate in nominal value for post-employment medical care: 1.41%
- Price inflation in the long run: 2%
- Rates of mortality for both active staff and pensioners (mortality table International Civil Servant Life Table 2013 – ICSLT2013, source ISRP/EUROSTAT).
- Medical inflation in the long run: 4% annually (based on an analysis of medical expenses data for the period 2008-2013).
- Long term expected return on plan assets: 5% annually.

The previous actuarial study dated from 2014 estimated that the value of the obligation for post-employment medical care at the end of 2013 was MEUR 1,084. The current projection of this liability at the end of 2014 can be obtained as follows:

(amounts in MEUR)

| | | |
|--|---------------|--------------|
| Evaluation of the obligation at year end 2013 | (a) | 1,084 |
| Benefits paid | (b) | 16 |
| Interest costs | (c) | 31 |
| Current service costs | (d) | 73 |
| Obligation at year end 2013 projected into 2014 | (e)=(a-b+c+d) | 1,172 |
| Actuarial loss (gain) on obligation | (e-f) | 625 |
| Evaluation of obligation at year end 2014 | (f) | 1,797 |

The value of the obligation includes an amount of EUR 52.4 million corresponding to a specific category of staff referred to as “bridgers” (see below). The obligation corresponding to continued medical coverage of retirees funded through the RMCF is therefore MEUR 1,745 million.

The actuarial loss (i.e. the difference between the obligation of 2013 projected into 2014 resulting from the previous study and the obligation estimated at year end 2014 by the new study) is MEUR 625. The actuarial loss represents 53% of the obligation projected in 2014. The sharp decrease of the discount rate used for the calculations explains most (92%) of this actuarial loss.

Assumptions taken into account in the previous actuarial study were:

Discount rate: 2.84%

Price inflation: 2%

Future salary increase: 0.27% above inflation

Medical inflation: 4%

By definition actuarial valuations are largely dependent on the endogenous and exogenous parameters. Therefore any changes to the latter can result in material changes to the final evaluation of the obligation. In this case, the discount rate was decreased, by 143 basis points, from 2.84% to 1.41%. Sensitivity tests were conducted for the purposes of the study showing that a discount rate of 2.41% (i.e. an increase of 100 basis points) would result in a decrease of the actuarial liability of MEUR 431 and that a discount rate of 0.41% (i.e. a decrease of 100 basis points) would result in an increase of the actuarial liability of MEUR 614.

The discount rate refers to market yields on high quality corporate bonds. For the purpose of this actuarial study, in the absence of a market for Eurozone corporate bonds with maturities longer than 18 years, the Euro area government bond yield curve was used instead as a reference to discount the liabilities of the RMCF. This resulted in the discount rate of 1.41%, compared to the previous 2.84%.

Use of the ever-changing market value reference discount rate is likely to result in substantial changes of the actuarial valuations. Considering that the present interest rates used for the actuarial study are historically low, the use of a higher discount rate in the future would result in a decrease in the valuation of the liability.

Sensitivity tests were conducted for the purposes of the study showing that an increase of 100 basis points of the medical inflation rate to 5% would result in an increase of the actuarial liability of MEUR 589 and that a decrease of 100 basis points of the medical inflation rate to 3% would result in a decrease of the actuarial liability of MEUR 425.

The present actuarial study has used a new mortality table developed jointly by ISRP and EUROSTAT (ICSLT2013). It is based on data covering several international organizations in Europe, including NATO and the European Union.

It should be noted that medical claims for eligible former staff between the ages of 55 and 65 (referred to as "bridgers") are not funded through the RMCF. They are insured under the terms of the "bridging-cover" whereby the related annual contributions and reimbursements are included in the medical claims insurance system of active staff. Contributions based on the "bridgers" last salary (5% since 2013 (3% previously), on a 1/3 "bridger" to 2/3 employer proportion) are made to the medical claim insurance company. No specific fund was set up to resource these requirements; they are handled on an annual basis. No payments to the RMCF are required from "bridgers" in the intervening years between their retirement from the organization and their reaching the age of 65, at which point they benefit from RMCF insurance coverage and contribute to its funding.

Based on the same actuarial study as above, the potential liability relating to medical coverage for staff pertaining to the "bridging cover" was estimated EUR 52.4 at year end 2014 (44.5 million at year end 2013).

NOTE 4: CASH AND CASH EQUIVALENTS

The various NATO entities and pensioners pay their contributions into a suspense account. This account serves to pay insurance premiums and affect the transfers of funds to be invested by the Investment Manager. Short term investments are made as required.

The table below analyses the flows of cash:

| (All amounts in EUR) | 2014 | 2013 |
|--|----------------------|------------------|
| Opening cash balance | 1,484,004.56 | 1,410,335.19 |
| Contributions received | 22,573,723.61 | 22,279,089.07 |
| Net Premiums' profit-sharing agreement | 4,239,661.00 | 0.00 |
| Financial Results | 5,913.48 | 8,379.28 |
| Contributions invested | -10,200,000.00 | -5,200,000.00 |
| Insurance - premiums, fees & studies | -17,973,809.48 | -17,008,479.92 |
| Miscellaneous Receipts/(Disbursements) | -1,143.00 | -5,319.06 |
| Closing cash balance | 128,350.17 | 1,484,004.56 |
| Net cash flow | -1,355,654.39 | 73,669.37 |

NOTE 5: FUNDS HELD BY THE INVESTMENT MANAGER

Distribution of Assets as of 31 December

| | 2014 | | 2013 | |
|----------------------------|-----------------------|----------------|-----------------------|----------------|
| | EUR | % | EUR | % |
| Euro Gov't Bond Index Fund | 132,406,665.69 | 48.51% | 108,495,531.27 | 46.74% |
| Europe Stock Index Fund | 67,407,528.74 | 24.70% | 62,450,652.99 | 26.91% |
| Global Stock Index Fund | 73,123,498.72 | 26.79% | 61,164,013.62 | 26.35% |
| TOTAL | 272,937,693.15 | 100.00% | 232,110,197.88 | 100.00% |

Details of the changes in investment fund balances available for benefits over the past two years are as follow:

| in EUR | Euro Govt Bond INS Euro Shares | Europe Stock Index Fund INS Euro Shares | Global Stock Index Fund INS Euro Shares | TOTAL |
|--|--------------------------------------|---|---|--------------------|
| 31 Dec 2012 balance | 101,172,334 | 52,204,053 | 50,446,137 | 203,822,524 |
| Purchases before purchase fees | 5,200,000 | 0 | 0 | 5,200,000 |
| Withdrawals | 0 | 0 | 0 | 0 |
| Distributions | 0 | 0 | 0 | 0 |
| Rebates received | 125,339 | 181,489 | 179,586 | 486,414 |
| Purchase Fees | -3,398 | 0 | 0 | -3,398 |
| 2013 net transactions | 5,321,941 | 181,489 | 179,586 | 5,683,016 |
| Sum of 31 Dec 2012 balance and 2013 net transactions | 106,494,275 | 52,385,542 | 50,625,723 | 209,505,540 |
| Gain/loss in market value excluding 2013 net transactions | 2,001,256 | 10,065,111 | 10,538,291 | 22,604,657 |
| 31 Dec 2013 balance | 108,495,531 | 62,450,653 | 61,164,014 | 232,110,198 |
| Purchases before purchase fees | 9,900,000 | 300,000 | 0 | 10,200,000 |
| Withdrawals | 0 | 0 | 0 | 0 |
| Distributions | 0 | 0 | 0 | 0 |
| Rebates received | 142,786 | 141,829 | 109,097 | 393,712 |
| Purchase Fees | 0 | 0 | 0 | 0 |
| 2014 net transactions | 10,042,786 | 441,829 | 109,097 | 10,593,712 |
| Sum of 31 Dec 2013 balance and 2014 net transactions | 118,538,318 | 62,892,482 | 61,273,110 | 242,703,909 |
| Gain/loss in market value excluding 2014 net transactions | 13,868,348 | 4,515,047 | 11,850,388 | 30,233,784 |
| 31 Dec 2014 balance | 132,406,666 | 67,407,529 | 73,123,499 | 272,937,693 |

Fund's Overall Performance

In 2014, Vanguard Investment Series plc index funds closely tracked their respective benchmarks during the period. Their returns, net of expenses and including the effect of reinvested dividends, are compared below to that of the corresponding benchmarks for the past two years:

| Returns in % | | | | | |
|---------------------|-------|-------|---|-------|-------|
| Vanguard index fund | | | Benchmark | | |
| | 2014 | 2013 | | 2014 | 2013 |
| Euro Gov't Bond | 1.03 | 2.07 | Spliced Euro Gov Bond Float Adj Index | 1.03 | 2.13 |
| Europe Stock | -1.40 | 20.05 | MSCI Europe | -1.41 | 19.82 |
| Global Stock | 1.37 | 21.25 | MSCI World | 1.36 | 21.20 |

The number of units and Daily NAV per unit for the RMCF at year end, together with the resulting year-end market values, were as follows:

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RMCF Investment Fund Units and NAVs as of 31 December

| | <u>2014</u> | <u>Units</u> | <u>NAV in EUR</u> | <u>Market Value in EUR</u> |
|----------------------------|--------------|--------------|----------------------|----------------------------|
| Euro Gov't Bond Index Fund | 621,791.89 | 212.9437 | 132,406,665.69 | |
| Europe Stock Index Fund | 4,102,135.96 | 16.4323 | 67,407,528.74 | |
| Global Stock Index Fund | 4,202,813.93 | 17.3987 | <u>73,123,498.72</u> | |
| TOTAL | | | | 272,937,693.15 |
| | <u>2013</u> | <u>Units</u> | <u>NAV in EUR</u> | <u>Market Value in EUR</u> |
| Euro Gov't Bond Index Fund | 571,620.89 | 189.8033 | 108,495,531.27 | |
| Europe Stock Index Fund | 4,074,099.76 | 15.3287 | 62,450,652.99 | |
| Global Stock Index Fund | 4,195,839.67 | 14.5773 | <u>61,164,013.62</u> | |
| TOTAL | | | | 232,110,197.88 |

NOTE 6: ACCOUNTS RECEIVABLE

Contributions are paid on a monthly basis. Receivables at the end of 2014 were as follows:

| (amounts in EUR) | 2014 | 2013 |
|--|-------------------|---------------------|
| Contributions | 296,401.65 | 306,567.88 |
| Receivable from insurer under profit sharing agreement | 0 | 4,239,661.00 |
| Interest receivable | 6,305.98 | 6,227.03 |
| Total accounts receivable | 302,707.63 | 4,552,455.91 |

At the date of issuance of these financial statements, no contributions were a year or more past due. In 2014, the amount due by the insurer under a profit sharing agreement was received. A similar agreement is in place for the period 2012-2016, and is considered under the contingent asset note. This explains the large decrease in accounts receivable.

NOTE 7: ACCOUNTS PAYABLE

Accounts payable consisted mainly of EUR 9,032.06 in contributions received for future years. All amounts due to the insurer and the third party administrator were paid by end 2014. End 2013, EUR 190,964.00 was due to the insurer for insurance premiums and EUR 16,620.96 to the third party administrator for management fees. End 2013, EUR 19,129.88 corresponded to contributions received for future years.

NOTE 8: CONTRIBUTIONS RECEIVED

Contributions received in the course of the year on a cash basis were as follows:
(amounts in EUR)

| Contributions from | 2014 | 2013 |
|--|----------------------|----------------------|
| Active Staff and NATO Employer for current year | 22,185,932.20 | 21,540,670.71 |
| Active Staff and NATO Employer for future years | 0.00 | 19,129.88 |
| Active Staff and NATO Employer for Y-1 | 0.00 | 348,666.64 |
| Retired Staff from Def Benefit Pension Scheme | 382,253.22 | 364,487.46 |
| Retired Staff from Def Contribution Pension Scheme | 1,457.40 | 1,485.05 |
| Other Retired Staff | 3,411.71 | 4,649.33 |
| Total | 22,573,054.53 | 22,279,089.07 |

NOTE 9: PROFIT SHARING AGREEMENT WITH INSURER

According to a profit-sharing agreement with the insurer, a portion of the excess of premiums over reimbursements is refunded to the RMCF. For the years 2006-2011, the formula for the refund was $\text{Refund} = [(\text{Premiums} \times 97\%) - \text{Reimbursements} \times 85\%]$. This formula was renegotiated, effective 2012, to the advantage of RMCF, reducing the premium per covered party and raising the final multiplier to 100%.

RMCF's share of profits for the period 2006-2011 amounted to EUR 4,239,661.00, recorded as a receivable as at 31 December 2013. It was received in 2014.

A similar arrangement has been entered into, covering the period 2012-2016, whereby NATO would be refunded the totality of the difference $\text{Premiums} \times 97\% - \text{Reimbursements}$, if it is positive. The final settlement is foreseen during the first quarter of 2018. At this stage it is not possible to assess whether this would result in any inflow of cash to NATO, neither to estimate its amount: claim cases can last two years and amounts at a given moment can be affected by unusually high settlements of unresolved claims. Therefore no revenue or asset is recognized at this time.

NOTE 10: INTEREST

Interest is earned on the bank account for the period during which cash holdings are pending investment. Amounts presented are netted of bank charges.

NOTE 11: INSURANCE PREMIUMS AND MANAGEMENT FEES

The insurance premium to cover the medical expenses of the retirees is paid monthly to the third party administrator on the basis agreed under the NATO Group Insurance Policy.

The value of the insurance premium paid to the insurance company is essentially based on the number and age of the beneficiaries. The premium includes a management fee of EUR 1,127,544.48 (EUR 1,007,444.64 for 2013). The increase in net insurance premiums and management fees is mainly due to a larger number of beneficiaries.

Other administrative expenses relate to the reimbursement of actuaries' travel expenses (EUR 1,143.00).

NOTE 12: CONTINGENT ASSETS

As indicated above, there is a profit-sharing agreement with the insurer.

The arrangement covers the period 2012-2016, whereby NATO would be refunded the totality of the difference Premiums X 97% – Reimbursements, if it is positive. The final settlement is foreseen during the first quarter of 2018. At this stage it is not possible to assess whether this would result in any inflow of cash to NATO, neither to estimate its amount: claim cases can last two years and amounts at a given moment can be affected by unusually high settlements of unresolved claims. Therefore no revenue or asset is recognized at this time.

The past agreement resulted in an economic benefit to the RMCF.

NOTE 13: CONTINGENT LIABILITIES

There are no material contingent liabilities arising from legal actions and claims that are likely to result in significant liability to the RMCF.

NOTE 14: RELATED PARTY TRANSACTIONS

The following related party transactions took place during the year ended 31 December 2014.

NATO International Staff, in particular Executive Management – Human Resources and the Office of Financial Control, are responsible for the day-to-day management of the RMCF. None of the costs related to the administrative services provided by NATO International Staff are charged to the RMCF.

NOTE 15: KEY MANAGEMENT PERSONNEL

For the purpose of these financial statements, key management personnel are considered to be the Assistant Secretary General for Executive Management and the Financial Controller of the International Staff. Their remuneration is entirely covered by the International Staff.

Members of the RMCF Supervisory Committee do not receive any additional remuneration or benefits in return for their responsibilities. The International Staff Financial Controller was appointed Chairperson of the Supervisory Committee end 2010.

The Fund does not hold any securities of the employer sponsor or, directly, of its related parties.

NOTE 16: STATISTICAL INFORMATION

| Evolution of RMCF membership (number of affiliates) | | | |
|---|------|------------|-------|
| year-end | 2000 | Affiliates | 0 |
| | 2001 | Joined | 166 |
| | 2001 | Exited | 0 |
| year-end | 2001 | Affiliates | 166 |
| | 2002 | Joined | 250 |
| | 2002 | Exited | -1 |
| year-end | 2002 | Affiliates | 415 |
| | 2003 | Joined | 229 |
| | 2003 | Exited | -4 |
| year-end | 2003 | Affiliates | 640 |
| | 2004 | Joined | 242 |
| | 2004 | Exited | -14 |
| year-end | 2004 | Affiliates | 868 |
| | 2005 | Joined | 328 |
| | 2005 | Exited | -15 |
| year-end | 2005 | Affiliates | 1,181 |
| | 2006 | Joined | 258 |
| | 2006 | Exited | -27 |
| year-end | 2006 | Affiliates | 1,412 |
| | 2007 | Joined | 259 |
| | 2007 | Exited | -25 |
| year-end | 2007 | Affiliates | 1,646 |
| | 2008 | Joined | 333 |
| | 2008 | Exited | -37 |
| year-end | 2008 | Affiliates | 1,942 |
| | 2009 | Joined | 330 |
| | 2009 | Exited | -32 |
| year-end | 2009 | Affiliates | 2,240 |
| | 2010 | Joined | 316 |
| | 2010 | Exited | -37 |
| year-end | 2010 | Affiliates | 2,519 |
| | 2011 | Joined | 401 |
| | 2011 | Exited | -39 |
| year-end | 2011 | Affiliates | 2,881 |
| | 2012 | Joined | 265 |
| | 2012 | Exited | -27 |
| year-end | 2012 | Affiliates | 3,119 |
| | 2013 | Joined | 268 |
| | 2013 | Exited | -63 |
| year-end | 2013 | Affiliates | 3,324 |
| | 2014 | Joined | 533 |
| | 2014 | Exited | -62 |
| year-end | 2014 | Affiliates | 3,795 |

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