Introductions

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Agenda

- Global Employee Benefit Liabilities
- Managing Risk Exposure
- Financing the Plans
  - The Value of Pooling
  - Captive Reinsurance
- Information Utopia
Background

- Many multinationals are seeking new options to finance their employee benefit liabilities, including coverage for death, disability, accident, medical and pensions for both active and retired employees.
- Like any risk exposure, employee benefit risks need to be managed and financed efficiently.
- Financing options include traditional insurance, self-insurance, and increasingly in recent years, pooling and captive reinsurance.
- This session is a brief overview of benefit risk financing techniques with examples.
Global Benefit Costs

Benefits range from 15% to 50% of total compensation costs

Typical plans include financial support and services to employees for events of:

- Death
- Disability
- Accident
- Sickness
- Retirement
Global Benefit Landscape

“Centralization of operations and governance of employee benefit plans is expected to increase significantly in the short term.”

-- American Benefits Institute, 2012 Study*

- “…organisations struggle to know what benefits they offer, …, how much they cost, and what types of risks they pose…”

- “Financial costs and risks due to employee benefits are driving corporate involvement in local benefits decision more than other factors…”

* 2012 Corporate Governance of Global Benefits Study. American Benefits Institute and Aon Hewitt
L-3 Global Benefit Landscape

- L-3 grew by acquisition
- Multiple businesses with multiple locations operating independently
  - Keep ownership of financial bottom line
  - Do not want corporate headquarters interference
  - Fear of losing decision making control
- Different plan coverage and structure
  - Business Culture
  - Group size
  - Country regulations
  - Country best practice

“No Economies of Scale”
Risk Fundamentals

Benefit risk liabilities can be managed

- Identify the risk exposures
- Prevent and control losses
- Finance efficiently

Economies of scale derive from aggregation of volume

- Pool common risks across jurisdictions
- Coordinate with other enterprise risks in a strategic framework
Global pooling of premiums achieves economies of scale in reducing administrative costs and returning dividends from good underwriting results.

Captive reinsurance of the pooled premiums gives control of information and assets and creates opportunities for custom coverage and underwriting and investment income.

Approx. 4,000 companies use pooling

Approx. 75 global companies use captives to finance benefits

Financial Efficiency

Continuum of Savings and Control
Pooling

**Pooling Advantages**

- Claim costs are more predictable (actuarially “credible”)
- Insurers are more confident in their loss picks and charge less for volatility and solvency capital
- Fixed costs are spread wider, resulting in lower per unit expenses
- Underwriting dividends are paid
- Underwriting experience is understood by cost components

This group remains “stand-alone” until pooling solutions are feasible. Work progresses locally to collect risk exposure and claims data.
Financial Benefits of Pooling

Without Pooling

- Claims
- Local Dividends
- Local Service
- Insurer expenses, risk charges & profit
- Retained by Insurer(s)

With Pooling

- Claims
- Local Dividends
- Local Service
- Insurer expenses, risk charges & profit
- International profit sharing
- Dividend Payment
L-3 experience with pooling

- L-3 entered into first “pooling” arrangement for insured life product in the United Kingdom in 2006
  - Reduce annual benefit cost
  - Insurance carrier must be willing to participate (our U.S. carrier does not want to participate)
  - No cost increase if “pool” sustains excessive claim experience

- Expanded to Hong Kong and Germany in 2009
- Thus far, participating business units have realized a 15% premium savings each year through dividend payments
- Business and country culture create difficulties for pooling expansion but........
  - Expand to include insured income replacement product and capture other countries (e.g. Canada, Italy, Norway, Costa Rica)
How captives work

Captive

Capital
Premiums

Underwriting Profit
Investment Income

Losses
Expenses
Reinsurance
Captive Reinsurance

Captive Advantage

- Premiums flow to captive
- Captive sets reserves
- Assets are invested
- Earnings accrue to Group
- Risk exposure and claims information is centralized
- Decisions about plan design and loss control are informed

This group remains “stand-alone” until pooling and reinsurance solutions are feasible. Work progresses locally to collect risk exposure and claims data.
Benefit Captive Evolution

1982-2000
- Large P&C captives add EB risks, reinsured from Pooling Networks:
  - 1982 - ALICO (Maxis)
  - 1984 - Generali
- Attempts to gain Labor agency approval to reinsure ERISA regulated plans, e.g. CSX

2000-2002
- Growth in number of Global EB captives
- Columbia Energy exemption for U.S. disability
- ADM exemption
- “ExPro” expedited process is allowed

2002-2013
- Other global pooling networks introduce captive reinsurance capability (All Net, IGP, Insurope, and Zurich)
- 25 more U.S. DOL approvals, including post-retirement medical
- First pension captives
- Changes at DOL: new team “suspects” expedited process for comprehensive review
Operational Value

Captive insurance can improve risk management governance

- Pooling risks of individual business units
  - Smoothens results
  - Permits risk sharing and allocation methodologies

- Insurance company structure with accountant, auditor and actuary oversight improves regulatory compliance of self insured plans

- Assets that support enterprise risks are consolidated

- Captive can add customized coverage not otherwise available in the market, e.g. certain perils, limits, plan provisions

Perhaps the most significant advantage is transparency

- Timely access to claims data and focus on trends creates “feedback loop” that ultimately reduces costs
Global EB Captive Feedback Loop

Employee Benefit Program Diagram

DHL Business Units

=80m Annualised Premiums

MetLife ALICO / Generali Insurance

Primary Claims

- Shock Losses
- Chronic Diseases
- Mental & Nervous
- Muscular Skeletal

Current Cost Control
1. Plan design change
2. Network discounts
3. Rate increases
4. Claims shift

Marias Falls

€56m Net Annual Premiums

Claims

Country Medical Inflation ranges from 3%-60% pa

Proactive

1. Global HR
2. Regional HR
3. Country HR
4. Employees

Reactive

1. 2.
2. 3.

Source:
2012 World Captive Forum Presentation by Bill Fitzpatrick, Deutsche Post DHL
Global EB
Savings Example

€10mm of pooled premium can deliver €1.5mm or more of savings

- Increased risk retention can recover insurer margins
- Volume from pooling can decrease per-unit expenses
- Long term, centralised focus can reduce claims

Note that the reported loss ratios in Switzerland are 24%, implying margin much greater than 15%

€10mm of pooled premium can deliver €1.5mm or more of savings

- Risk Margin
- Expenses
- Claims
For each of the following, rate your organisation's current position as being more like description A (on the left) or B (on the right) today as well as expected position within next three years.

**Data and information access**
- **Description A**
  - Information is not readily available or reliable:
    - Current: 20%, 35%, 36%, 9%
    - In 3 years: 3%, 1%, 24%, 72%
- **Description B**
  - All required information available, reliable and readily accessible

**Risk and opportunity assessment**
- **Description A**
  - Opportunities and risks are not identified:
    - Current: 15%, 47%, 35%, 4%
    - In 3 years: 1%, 5%, 40%, 54%
- **Description B**
  - All opportunities and risks are identified and organisational impact measured

**Strategic policies**
- **Description A**
  - No corporate policies/guidelines established:
    - Current: 16%, 27%, 40%, 17%
    - In 3 years: 2%, 3%, 34%, 61%
- **Description B**
  - Specific corporate policies/guidelines established to manage opportunities/risks

**Formal governance structure for executing strategic decisions**
- **Description A**
  - A formal or informal governance structure does not exist to manage employee benefit plans:
    - Current: 22%, 31%, 35%, 12%
    - In 3 years: 2%, 8%, 38%, 52%
- **Description B**
  - Global, regional, and local committees are established

**Operating model for reporting, approvals, and monitoring**
- **Description A**
  - Ad hoc processes:
    - Current: 25%, 30%, 31%, 14%
    - In 3 years: 2%, 7%, 31%, 60%
- **Description B**
  - Approval and reporting processes are documented and followed
QUESTIONS?