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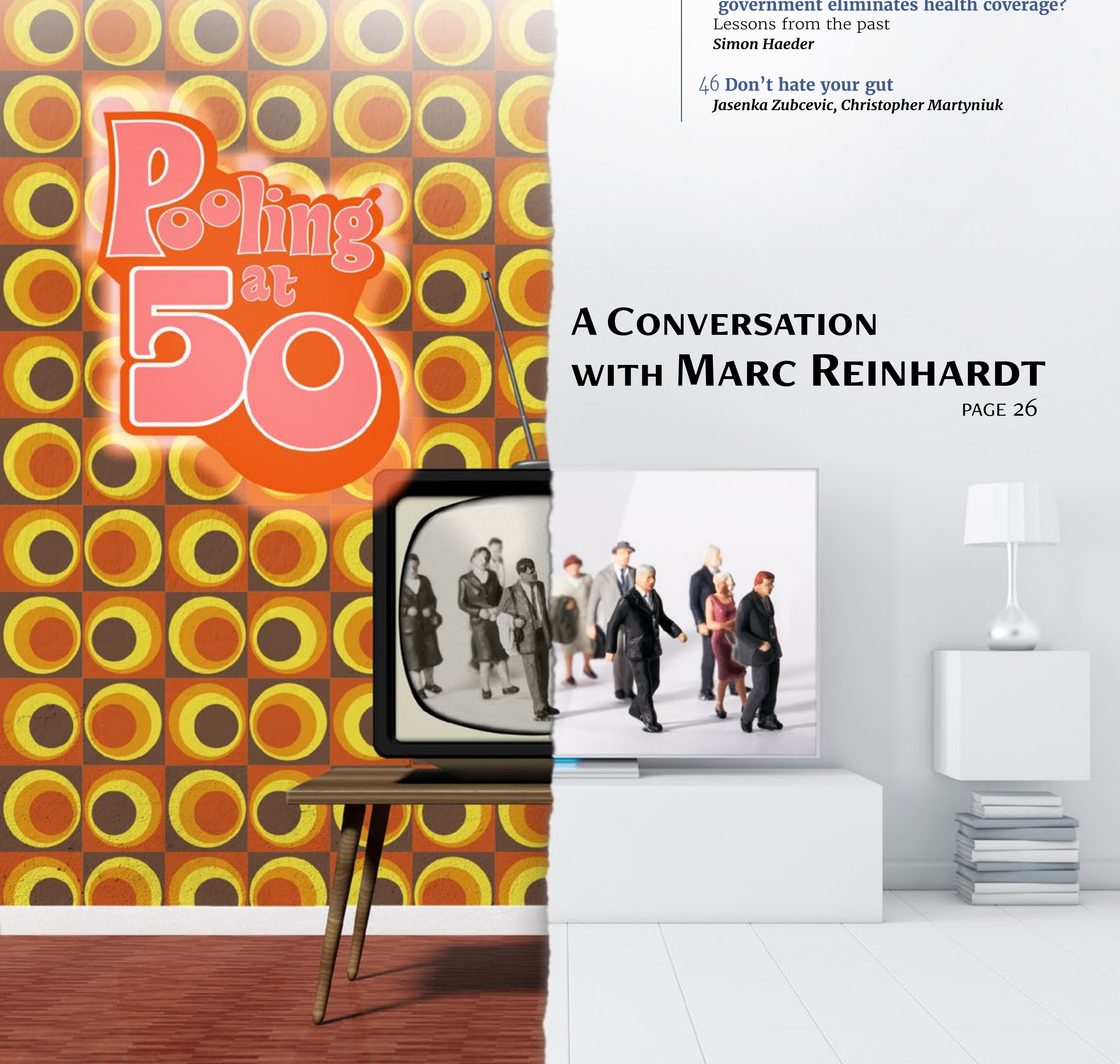
Global Benefits Vision

Knowledge & Wisdom for Global Employee Benefits Professionals



A Conversation with Marc Reinhardt

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GLOBAL BENEFITS VISION
Knowledge & Wisdom for Global Employee Benefits Professionals

NOTICES

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Marc Reinhardt

reinhardt@geb.com

GEB – Generali Employee Benefits

Director – Sales & Distribution

Marc has worked with Generali since 1991 in Germany, Italy, and the USA. While in Germany, Marc specialized in Tax and Labor Law as well as actuarial aspects of employee benefit plans for international companies based in Germany. His assignment in Trieste, Italy, focused on the technical aspects of multinational pooling & captive business in the central reinsurance department of Generali's home office.

Marc was permanently assigned to the U.S. where he had operational responsibility for the Generali Employee Benefits' (GEB) Americas region which includes Canada, USA, Central and South America. In addition, he was responsible for ongoing and future partnerships for the network in the region. Effective April 1, 2016 he was appointed Director of Sales & Distribution with the responsibility of managing GEB's commercial teams in 11 regional offices across the globe.

Marc Reinhardt has the equivalent of a combined Post-Grad/Master's Degree in Economics and Insurance from the University of Frankfurt.

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A Conversation with Marc Reinhardt

> "As a concept, pooling took some time to gain traction.

Global Benefits Vision: ***Looking at the concept of multinational pooling, which has been around for about five decades, what has changed over the decades, and what has changed recently, in terms of insurance markets and the way multinationals manage benefits and ultimately utilize the concept of pooling?***

Marc Reinhardt: Let's take a look at the initial starting point of pooling and recap how the concept started, and why companies were interested in this management tool.

It dates back to a time when U.S. multinationals in particular began to obtain what we call "*experience-rated rates,*" and were getting very competitive insurance conditions because they were able to utilize economies of scale domestically. The first pool I believe was set up in the mid-1950s. In the 1960s, companies began taking advantage of their larger international scale to get better conditions for their benefit plans around the world.

In much of Europe up to 1992 (introduction of the 3rd EC Life Directive), for example, we were dealing with so-called tariff markets where rates were not determined by the insurers based on their portfolio experience, but were literally set by regulators, and so obviously contained high safety margins. So multinational companies began trying to get their arms around this, and anywhere where they had a presence of local nationals, combine these employee groups under one umbrella to gain from economies of scale. So, the concept of multinational pooling as a profit sharing arrangement was born. GEB's first pools date back to the late 60s.

As a concept, it is quite prevalent today but took some time to gain traction, especially outside Europe and the US. If you look back to the early '90s when I started being involved in pooling and literally heard about the concept for the first time, many multinationals still did not utilize the concept of pooling in any way, shape, or form.

Then in the late 1990s Japanese companies entered the pooling arena. So initially U.S. corporations, later European multinationals, then Japanese companies became interested—and today it is applied by companies all across the globe. It has worked very well for many decades. Today, we have a few pooling clients in Latin America and companies in China and Singapore that are utilizing the concept for the first time.

Of course, a lot has changed in the recent past, and I can certainly attest to that, having been in this business for over 25 years. For us, as an employee benefit network, multinational pooling was always our bread-and-butter business. For many years it was our core business activity, and all the players in the industry were referred to as "*pooling networks,*" because that's what we were: we did pooling and anything associated with pooling. But over the past few years, many aspects in the way companies manage benefits have changed and also in the way insurance markets operate on the employee benefits side.

One major shift is a technical one related to the fact that tariff markets, where regulators set the insurance rates, are few and far between.

Japan comes to mind; South Korea to some extent. But in most cases insurance markets have been liberalized and group insurers can set rates within certain parameters based on their portfolio experience. I recall that in the early 90s when I was working for Generali in Germany, EU wide directives were passed that allowed insurers to use their own portfolio experience to develop their pricing models, and we saw a significant decrease in rate levels.

What that meant, over time, is that pooling arrangements offer less savings potential: rates went down and some of the technical margin that was available through the pooling mechanism has decreased. In addition, insurance markets, like other markets, have become much more competitive, so rates even for smaller groups are decreasing.

Also, back then it was not as easy to access information on international employee benefit plans. When a company would look at expansion and set up shop in Brazil or in Malaysia for the first time with a small number of employees, it was more difficult to accomplish this. It's much easier today. There is more information available, and obviously more support from networks, broker and consultant groups, so there is more availability of international expertise that companies can tap into.

Looking at this concept from the perspective of a multinational corporation, the way benefits are managed today has changed to some degree. Any type of engaged international employee benefits management requires a certain level of control and centralization at the head-office level. I remember the days when clients' companies had dedicated international employee benefits managers who focused on managing benefits outside of their home countries. The people responsible for the pool for the most part had an H.R. background; they were not risk managers or finance managers or procurement managers. And so, they managed benefits from an HR perspective. In many instances, they exerted a lot of control over benefits decisions within their organizations. Much of that has changed over the years. There is less centralization in the sense of ultimate decision making.

Centralization today, in our experience, has shifted to more of a governance approach, to having certain corporate governance guidelines to be adhered to companywide. "*We try to apply criteria globally as a corporation when we select vendors, whether they be insurance vendors or others; there are governance rules and regulations; we may select a number of preferred EB networks from which local subsidiaries can choose. But at the end of the day, the decision of whom you work with is yours.*" One very important element in that decision-making process is cost, especially if the local subsidiaries are large and have operated fairly autonomously. The objective of obtaining savings nowadays is driven less by pooling considerations. It's really more about achieving savings on a local basis first, so, in other words, it's the local benefits manager or risk manager's P&L, and yes, if pooling works for them as a second step, that's great. But first and foremost, they have to find a cost-effective solution locally and that has to be in line with their governance model.

In keeping with the focus on cost, we have, over

> ***One major shift is that markets where regulators set insurance rates, are few and far between.***

the years, sustained stronger involvement today by finance management, and increas-ingly by procurement, which is very new and very different from the past in terms of decision-making.

GBV: ***In terms of tariffs and margins, do your own observations square with the fact that, 30 or 50 years ago, typical pooling dividends would be in the 30%–40% of premiums range, and now they're down to 5%–10%?***

MR: That's a reflection of the fact that the pricing model of employee-benefit plans around the world has changed, that we're working in a much more competitive market environment. It's also true that the profile of many pools has changed. If you think about it, the basic concept was predicated on combining a number of smaller contracts around the world to make a bigger arrangement, obtaining economies of scale by combining smaller groups that, by themselves, would not qualify for self-insurance or local experience rating. They would be priced based on "manual rates." There wasn't much leeway to reduce rates based on experience because these groups were simply not credible.

So, we try to build that credibility and balance in risk composition by expanding the pool. That has also changed, by the way; we have and are seeing very large contracts entering pools. As we all know, the bigger the contract, the more competitive pricing and underwriting become. These contracts are typically based on lower rates, encompass plan designs with higher benefit levels while underwriting requirements tend to be less stringent. So, all these elements can play into underlying pool experience volatility. So, we are seeing a number of contributors to the overall reduction in pooling dividends.

> ***"Many corporations view pooling as a tool to establish robust governance.***

GBV: ***So, you are saying, essentially, that we are seeing guidelines replacing older, binding policies, as might have been the case in the past?***

MR: Yes, exactly. Again, it's about corporations issuing corporate governance guidelines to say, "*Here's what we expect you to do locally.*" But in the process, in many cases, they are leaving decision-making to locals or regional benefit or finance managers, as long as they comply with corporate governance rules and regulations.

I don't want to imply that the pooling concept is no longer part of that governance structure. In fact, many corporations view pooling as a tool to establish robust governance and to retain a certain level of control as well as a line of sight into what's going on globally. But I think the decision-making process has changed and has been pushed out more to the locals and the regionals.

GBV: ***Several networks, including GEB, AXA, and Zurich, have recently introduced global underwriting products. Doesn't product require the corporation to be very centralized?***

MR: That is correct, and that is a key element. You definitely need to have centralized control and someone owning the project for these global underwriting programs, because you need to get the locals on board. To run effectively and be financially attractive to insurers, these programs have a lot of data requirements because you're dealing with up-front discounting, so you need a very clear line of sight into the underlying claims experience. This is similar to captive programs. Captives are a classic example of companies taking very strong control of their risk and managing benefits that way.

GBV: ***Aren't both captives and global underwriting programs geared more toward risk managers and C-level decision-makers in the corporation than to HR departments?***

MR: Absolutely. With these programs, you are dealing with risk and finance managers and also procurement managers because the point is obtaining cost savings, actively managing risk. In fairness to captive and global underwriting programs, for them to work efficiently across the board, you certainly have to get HR benefits management into the boat. We can't do it without them. But in reality, the decision-makers driving these programs are from the finance side. That is very clear.

GBV: ***Are you seeing a separation of responsibilities between plan design that would rather be done by comp and ben teams (the HR side) and insuring/not insuring decisions being made by the finance side of the business?***

MR: Yes, you do still see that: the basic plan design, questions, and discussions take place with HR because they're oftentimes much closer to the ground in understanding what is required to keep the employees happy. It's for the financial parameters—the pricing and free coverage limits, maximum benefit levels, anything related to assuming the risk itself — that you get more involvement from risk and finance management. But again, for many of these programs to run successfully, there needs to be that cooperation and in reality, that's not always so easy; it's still something that many corporations struggle with. It's one thing to get all these individual stakeholders into the boat, and another to get them all to row in unison, because they have different perspectives on what benefits are meant to achieve.

GBV: ***Can you comment on the long-term view of the past versus the shorter-term view of the present?***

MR: Pooling was a management tool that took the longer-term view in the sense of achieving savings over time. Today, with obvious business and economic pressures on multinationals, managers in finance, risk and procurement have to show cost savings as soon as possible. It's no long feasible to say, "*well, through a pooling arrangement I can attain cost savings in 18 or 24 or 36 months.*"

The same goes for switching contracts. Pooling used to be very "*sticky,*" where once you signed an agreement with a company it lasted for 20 or 30 years. We still have one program in force that is 50 years old. I don't want to overgeneralize; there are still companies that deploy the pooling concept in that way.

I would also like to differentiate between large multinational corporations and smaller companies, like startups, who are just beginning to set up shop in many countries and expand their benefits plans overseas. Obviously, for them, the pooling concept is still a very attractive, easy way to attain a number of benefit management objectives, especially with multiemployer pool options available from some networks. There's no downside to pooling other than possibly having to move some local contracts. But for the larger multinational corporations, single employer pooling arrangements are just one of the programs available in managing benefits globally.

> ***We are still a very small community of people in the international employee benefits environment.***

GBV: *What about consultants?*

MR: Looking back 20 years ago or more, the benefit consulting industry was still very much involved in the Request for Proposal **(RFP)** process, in selecting benefit networks and assisting multinational corporations in implementing pools and really taking a very active and engaged role in managing benefit programs around the world.

RFP
Request for Proposal

A lot of our business in those days came through those formal global **RFPs**. That has declined to a large extent, and one of the reasons, frankly, is that consulting budgets are not what they used to be for these projects. The way benefits are managed today is probably not as conducive to these broader-based projects. Today it's more of an ad-hoc "*natural pool*" approach; if you already have business in force, you try to put that together and see what happens. We're experiencing less of the "*why don't we start this major pooling project and perhaps turn things upside down and move benefit plans to select the best vendors for us and make this into a full-fledged, consultant-supported project.*"

But consequently, because of that shift to local and regional control, the consulting and brokerage networks have rolled out "*global broker mandates*" that, in essence, allow them to assist clients with that local decision-making process on the ground in the various countries. And they've been very successful, I think. So, there is a bit of a shift away from consulting, but on the other side, in line with shifting benefit management strategies, there is that support function now through brokers on the ground through these global broker agreements.

GBV: *I've heard repeatedly that ours was very much a "cottage industry," comprised of maybe 500 people who are very knowledgeable about it. Do you think that has changed? Or do we see the same people as 10 or 20 years ago at industry events?*

MR: I think that's a fair statement. We are still a very small community of people in the international employee benefits environment. Obviously, there's a new generation of employee benefit managers coming in, there's a new generation of consultants and brokers, and there's certainly a new generation coming in on the networks side as well. But it's still a very small community, and I think we'll stay a niche industry for the foreseeable future. If you want to work in insurance, I think this is still a cool place to be.

GBV: *That is perhaps one of the things that hasn't changed in the past 50 years. But let's go back to the matter of collecting and analyzing data and information from the contracts.*

MR: That's an area that certainly has seen a major change over the years. Pooling was always meant to provide data to the client—I think that's part and parcel of the concept of providing benefit, risk or finance managers with information they would otherwise have a difficult time obtaining. That is a main benefit of the pooling report itself: once a year I get a snapshot of my benefit world. In essence, it was fairly basic data: premiums, claims, broken down by country and contract, but still, for the most part, on an aggregated basis. Obviously, what has changed over the past few years is that data analytics are key. It's so important for managing benefits cost effectively, especially when you consider medical plans: medical inflation and trend are a major challenge for most corporations around the world today; they're spending more on benefit plans than they ever did and bending that famous cost curve is so important. The way corporations try to get a better handle on this is through access to reliable data.

As benefit networks, we're now tasked with taking that aggregated data and breaking it down for employers to the greatest extent possible. We obviously run into confidentiality limitations, etc., but we try to break it down so corporations can better manage their benefit plans, together with us and the brokers, through a better line of sight into the underlying claim drivers. So, we've developed various tools, medical reporting capabilities that we didn't have as recently as 10 years ago. We can now break down the underlying claims experience in various countries into utilization patterns by claim categories and diagnostic codes, so we are able to give benefit managers a much clearer understanding of what drives their claims experience.

GBV: *Did this result in GEB launching any specific products using data analysis?*

MR: In terms of local insurance products, it has not resulted in vastly different medical plan designs. But the medical reporting capabilities have led captive clients, in particular, to look at their plan designs and say, "look, maybe we have to tweak a few elements here and there when we see overutilization of a certain benefit component, what's the reason for that spike in claims experience. But I don't think there's a new product out there that is solely driven by analytics at this point in time.

GBV: *Let's move on to risk management tools.*

MR: Today, pooling itself is more of a financial tool and more of a risk management tool. Again, it is a clear shift in the risk management/finance/procurement perspective, that goes back to what we discussed earlier. It's a bottom-line focus on, "*how can we get savings and still do the right thing for the employees in offering competitive benefit plans?*" We want to keep HR happy but ultimately, it's a question of affordability and managing costs over time and of course that entails having a good risk-management approach and philosophy within the company. In the recent past, we've also seen large corporations migrate from pooling to a captive approach or a global underwriting approach; they use pooling as the initial risk management tool, but then go on to the next step to manage risk more closely.

GBV: *Are we not seeing the same kind of combination in many very large companies, that use a pool or several pools for some risks, self-insurance for other risks, perhaps a medical stop-loss here and a bit of a captive there. So, it's not an "either/or" proposition, but rather an "and" kind of proposition?*

MR: You make a good point. Obviously, there's no one-size-fits-all, the captive industry has different rationales for utilizing the captive concept. My personal observation is that our captive clients, for the most part, utilize the captive concept only and have dissolved their pools over time and tried to move all of their eligible business into the captive. They might utilize one or more captive providers, but they ultimately try to move as much as possible into their captive programs. There obviously are still a number of large companies that run several pools. Often that's an indication of a decentralized benefit management approach.

GBV: *If we look at a pooling network as an organization, it has a network of local insurance companies that can underwrite locally, and usually that is necessary if you want to set up a captive as well. So, couldn't pooling networks actually morph into providing insured and noninsured employee benefits locally, always featuring global coordination, and in addition to that, leaving it to the client to decide where the ultimate risk should lie, depending on its risk appetite?*

MR: You're absolutely right, of course in order to work with these large multinational corporations you have to have the requisite global footprint and the local capabilities. At the end of the day, with captive clients, we work with whatever is within the realm of possibility to align with local regulations and market practice, as well as local tax and labor law. These plans are ultimately controlled by captive management, both in terms of design and pricing. Pooling is different as the risk ultimately remains with the network.

GBV: *Is there anything else that you would like to address now?*

MR: Sure; I think one thing to keep in mind is that we are dealing with changes within corporations: mergers, acquisitions, spinoffs, ever faster paced change. That has had an influence on the managing of benefits and the way pooling is utilized as a concept.

GBV: *Before we move on to the current challenges faced by traditional pooling, I have a few suggestions in terms of what has not changed that I would like to throw at you for your comments, would that be all right?*

MR: Absolutely.

GBV: *Back in the old days and today as well, the market penetration of pooling is still very low. We may say it's 5%, but in reality, it's more like 2% or 3% and after 50 years, so the number of multinationals not having a pool or a captive is underwhelming. Would you agree with those numbers?*

MR: The number frankly surprises me because if I look at a Fortune 500 or 1000, the number of corporations using one of those concepts is much higher. Five percent seems awfully low based on the book of business that we as networks have in place.

That being said, I am still surprised when you engage with a corporation and see they are not utilizing the concept. You wonder why companies haven't gone down that route, and for the most part the number seems very high. I would say the number of companies utilizing these concepts in our experience is not as many as we probably would like, but I think it is higher than you suggest. I would also qualify this by saying that merely having a presence in a few countries is not enough to make a company automatically suited for pooling. There needs to be a modicum of an international benefits management strategy in place.

GBV: *Well, the number of pools around is said to less than 5,000, but covering approximately 3,000 to 3,500 different corporations because many corporations have several pools. That's one side of the number. The other number comes from the United Nations and they count just shy of 100,000 multinationals today[1]. Obviously, it does include a large number of SMBs.*

MR: I think they look at Asia, Latin America, and the Middle East, but I was thinking more in terms of the Fortune-500-type companies, companies that make up most of the major stock market indexes—and those all have

1 Organizations that have fully owned, or at least controlled, operations in at least two countries utilized the concept for a long time. But you are correct that a lot of companies out there are not familiar with the concept. We're seeing a bit of an increase in interest in Asia; we have engaged with some Chinese multinationals who are looking at it for the first time, Malaysians, companies in Singapore as well as Multilatinas in Brazil and Mexico.

GBV: *It seems to me that what hasn't changed much is that it's still very difficult to achieve cross-selling with P&C portfolios. Is that changing?*

MR: Over the years we've seen attempts to change this. Based on my limited experience, we've had some success in it from time to time, but as a general concept I will be so bold as to say it is difficult and will remain so for some time.

GBV: *What has not changed is that there seems to be no club or industry or trade association of pooling networks.*

MR: Given that the number of networks is relatively small and as you said is on a decreasing trend, I think there was always an attempt to avoid an impression of collusion or somehow getting together because the industry is so small.

GBV: *Perhaps that's the reason for the last point I have, which is that there is very little sharing of market information among networks, and market statistics are very hard to come by.*

MR: They are very hard to come by, because we're a very small industry, we know each other very well, and at the end of the day, we're still competitors. In many cases it's friendly competition in a positive spirit. But there is little if any sharing. Everyone tries to steer clear of that and I think it's understandable why.

GBV: *Could you comment on the challenges faced by the pooling industry today?*

MR: For one thing, I think there is still untapped potential as you mentioned earlier when looking at broader market statistics. We're seeing a focus on what we refer to as SMEs or international middle market companies. Given the market potential of companies that are embarking on pooling or other benefit management tools for the first time—including startups, which don't have the experience in managing international employee benefits—there is still a lot of potential out there. So we view this as a positive challenge.

Another thing is that for employee benefits networks that are based on the concept of reinsurance, the trend toward captives by has been a positive development. It's very easy for such networks to work with them because the reinsurance infrastructure (risk transfer capability), which is also required for global underwriting programs, is in place. A number of technical networks have developed sophisticated underwriting expertise and I think that also helps us engage with clients that are interested in managing risk in a more sophisticated way.

Of course, the changes that we're seeing in the traditional pooling concept do have an impact on our business. But we have positive challenges on the other side, and we're certainly adapting to those changes in the marketplace.

We've heard about the decline and even potential demise of pooling in the past, prematurely I may add. In my opinion, it is still a great concept; it will continue as one of the best international employee benefit management tools available to companies.

> *There is more volatility and turmoil today than in the past; that's the age in which we're living.*

GBV: *Are there any other points you would like to cover?*

MR: If you look at merger and acquisitions activity or spinoff restructuring, of course that could have a tremendous impact on the EB plan of the local operation. As an example, if you're going through a spinoff phase, cutting back from perhaps 1,000 employees down to 200, that will impact the plans that are available and the funding method. So, we as employee benefit networks, together with our local partners, have to adapt to those changes that are happening very quickly today.

Of course, there have always been mergers and spinoffs, but there is more volatility and turmoil today than in the past; that's just the age in which we're living. So, we have to adapt to the changing profiles of corporations as well as the decision-making changes that happen when there is major restructuring at a corporation.

You've been dealing with one head office and managing staff and suddenly you're dealing with a completely different part of the world, and they have a very different philosophy for managing benefits; they have their own pools in place; they have a different perspective on what that means. You have to shift and adapt as your clients change. It's not easy but it's something that we've learned to deal with over time.

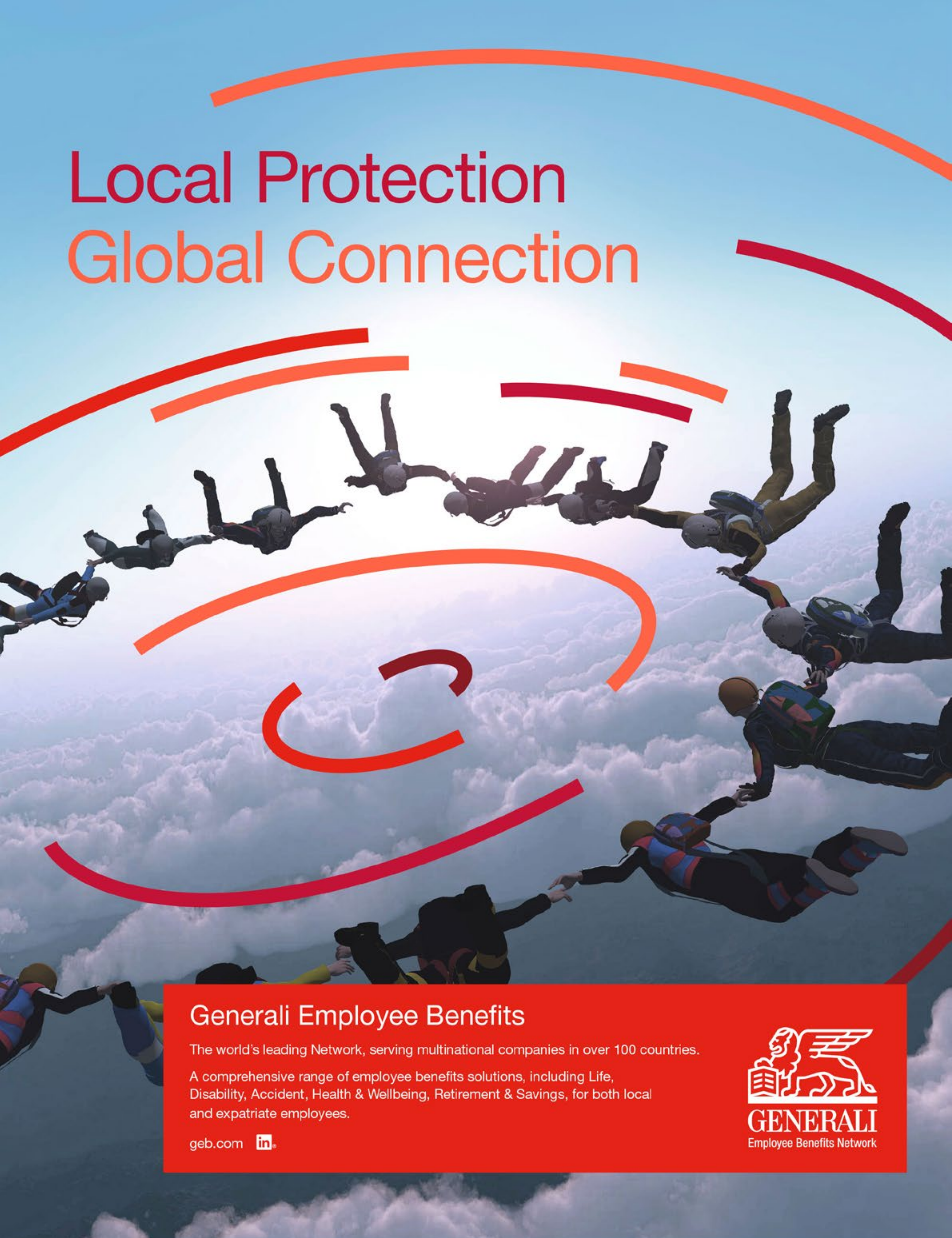
GBV: *How has the role of the intermediary, the global broker, changed over time? How does it influence your own flexibility?*

MR: We see brokers as partners. They play a very important role, especially in light of the fact that the benefits management approach of companies has changed. They have farmed out more of the decision-making locally and they require more of a support structure. Brokers have frankly stepped up to fill that need, and in fairness, they're doing a good job.

Of course, brokers have their own business models and sometimes, like in any other business, their model may not align perfectly with the business model of an insurance network. So you can have some discussions and sometimes different points of view on what is the right decision globally or centrally. What makes sense from a global perspective doesn't fit into the local perspective all the time everywhere, and so some discrepancies exist. But it's a partnership. The client plays a crucial role here as well, to align the networks, the brokers, and its own strategy. If we're not all rowing in the same direction, there's a problem.

As a final word, I would like to mention the importance of data analytics, an investment in technology that I think is key. It's important to get information to clients accurately and as soon as possible. I think we're seeing that as an element in staying competitive in this industry.

GBV: *Thank you very much, Marc.* ∞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