That would be ideal

Captives are increasingly including employee benefit schemes in their businesses, notes Ludovic Bayard of Generali Employee Benefits Network

BECKY BUTCHER REPORTS

Are you seeing an increase in employee benefits being funded through a captive?

We have been observing a trend towards a growing inclusion of employee benefits schemes into captive arrangements, and this trend has been intensifying over the last few years. From about 20 such arrangements only a few years ago, we count today well over 80 captives writing employee benefits business.

Several converging factors are driving this trend, starting from the growing role played by employers in providing social security against the backdrop of shrinking state budgets. The growth of the employee benefits market has certainly helped put this sector on risk managers' radar. So, while areas traditionally covered by captive arrangements, such as property and casualty and workers' compensation, are still predominant, we see that new lines of business, from healthcare to life and accident, are acquiring a larger share within the risks placed with the captive.

Perhaps even more tellingly we see that more and more requests for proposals regarding pooling solutions specifically enquire about the captive capabilities of the provider. This means that companies are keenly considering this approach while adopting a long-term vision.

They are aware that transferring employee benefits to captives is a complex process, which requires thorough preparation and planning, as well as a very careful selection of the right partner.

What are the key advantages to placing employee benefits in a captive?

Funding employee benefits through a captive can create value for a company in several ways, depending on specific priorities and needs. A first key advantage for the parent company is the opportunity to achieve risk diversification in the captive's portfolio, thus reducing the volatility of the overall financial experience.

Including employee benefits adds to the portfolio a large number of risks that are of relatively low severity, geographically spread and often uncorrelated to casualty exposures. Employee benefits, with their additional premiums and relative stability of results, represent an 'ideal candidate' to help the captive achieve risk diversification, meet capital requirements and ultimately finance the company's risks.

It is further increasingly relevant for risk managers and HR managers to use the captive as a strategic tool to manage more effectively the growing relevance of their employee benefits solutions worldwide. Owning the risk allows them more central control on a wide range of areas, from underwriting terms and benefits design to pricing decisions and claims management. For some of our clients, the captive has increased transparency and accountability in handling claims in order to control costs and allowed them to directly respond to emerging challenges, such as rising healthcare costs.

Favourable tax treatment and overall cost savings, from improved cash-flow and interest on reserves, are certainly part of the debate. All these aspects should be carefully evaluated in the context of such a complex and strategically relevant decision. It is important for companies to start with a high level evaluation of the overall enterprise risk management strategy, in order to establish priorities and objectives, and then to assess their experience over time, to make well-informed decisions in the implementation of their plans, for example, countries to be included, pricing assessment, and so on.

And are there any drawbacks?

We can consider as a drawback the higher effort and level of involvement required of the parent company, in terms of risk management expertise and understanding of insurance, to grasp the advantages we have just discussed.

To justify this effort, two main factors should be considered: size, in terms of critical mass of employees needed to make the captive economically viable, and central control and coordination of the local subsidiaries, in order to collect data and cascade the implementation of the insurance local plans.

Data analytics and reporting capabilities are among the services captive's parents are most interested in when evaluating a service provider. Companies need to have access to meaningful data, to gain both a global overview at head office level and insight into local performances. They have to establish central underwriting control and ensure that each local quote is aligned to the overall underwriting results of the global programme. The reporting and monitoring framework is key to facilitating understanding of the experience over time, and sustaining long-term planning, as well as to promptly addressing emerging issues.

Local compliance requirements represent another key aspect companies need to look at. Locally admitted insurers must issue employee benefits contracts in order to comply with local labour and fiscal regulations. Relying on a network of commercial insurers as fronting vehicle allows for each local contract to be issued on a fully admitted basis, thus benefiting from the best fiscal treatment possible and complying with local provisions.

> "Solvency II provisions on capital assessment and governance should be applied to captives, according to the principle of proportionality, in a simplified manner compared with commercial insurers, and based on the specific business model of the captive"

This explains why the geographic match between the company's global presence and the network's geographic reach is another important criteria in the selection of the provider.

What are the regulatory implications of placing employee benefits in a captive insurer?

Regulatory implications need to be considered from the very beginning, starting from the choice of the domicile. The location where the captive is based will have direct implications on the fiscal treatment, solvency requirements and overall regulatory provisions. While offshore jurisdictions are still the most popular choice, mainly because of their lower capital requirements, we expect to see a trend of increasing captive formation in onshore domiciles, particularly in Europe with the Solvency II regime, but also in US-based captives.

The Solvency II regime, to be implemented as of January 2016, will harmonise the prudential framework for insurance undertakings across Europe and third-party countries that have been granted equivalence, starting from a first package approved in June by the European regulators and including Switzerland, Australia, Bermuda, Brazil, Canada, Mexico and the US.

The new provisions update the assessment of the risk with a more sophisticated approach where the diversification benefits we were discussing before are recognised as key to contributing to the optimal allocation of capital. Solvency II provisions on capital assessment and governance should be applied to captives, according to the principle of proportionality, in a simplified manner compared with commercial insurers, and based on the specific business model of the captive.

US companies that wish to include employee benefits in a captive arrangement need to seek prior approval from the Department of Labor as employee benefits may constitute a prohibited transaction according to employees' protection rules.

Do you think the popularity of using a captive to fund employee benefits will continue to increase or decrease?

We expect that the employee benefits industry will continue to grow and to gain importance in companies' risk strategies. They will be increasingly part of employers' corporate social responsibility strategies, as business players are called on to step in their involvement in ensuring societal wellbeing, and of their talent acquisition and retention strategies to improve their global competitiveness.

Employers are willing to contribute to delivering innovative solutions to respond to societal challenges and to sustain their growth objectives.

They are willing to discuss and explore new lines of business that can be included in the captive's portfolio such as voluntary coverages, wellness and assistance solutions. CIT

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