FINAL WORD

Kirk Watkins, strategic business development leader at Trion Group, a Marsh & McLennan Agency LLC, shares his thoughts on what is driving increased activity around employee benefits

Why are employee benefits increasingly interesting to captive owners?

Some employee benefit costs continue to rise at rates higher than inflation. Employers constantly search for new ways to control these costs, while maintaining current levels of coverage for their employees.

As the mature American captive market grows past traditional property and casualty risks, employee benefits naturally present themselves as an opportunity. Captives may offer additional financial control over employee benefits spend, and require productive interaction between the human resources and risk management disciplines.

By including captives in their evaluation of financial controls, employers are able to opportunistically decide which risks to self-insure, reinsure and fully insure. Final decisions will be shaped by opportunities within the traditional fully insured marketplace, the incidence of claims relative to claim exposure and volatility, Department of Labor (DoL) and ERISA regulatory requirements and the willingness of insurers to act as fronting carriers and reinsurers.

Employee benefit plans have significant compliance requirements. The DoL offers an expedited process (ExPro) for those seeking to run programmes, which otherwise might be considered prohibited transactions under ERISA, through their captives. ExPro requires the DoL to respond to applications for exemption within 45 days and the entire regulatory process may take fewer than 90 days. Without ExPro, typical approval processes may take longer than one year.

Marsh's reports a 143% increase in its captives writing EB. Why the jump?

Europe permits employers to defuse pension and welfare obligations through a buy-in approach. In this scenario, an annuity equal to outstanding liabilities is purchased by a trust, which is then reinsured by a captive. Large multinationals are seeking to harmonise governance, unify plan designs and contracts, and optimize financing through risk aggregation by using captives to reinsure multinational pooling arrangements.

Additionally, US-based HR teams are realising that a captive strategy doesn't affect operational control or the strategic direction of their programmes and may provide meaningful cost savings. Risk managers recognise the opportunity to diversify portfolio risk and maximize financial efficiency within their captive structures.

What are key obstacles for corporations considering running EB through a captive?

An employer's culture may be the greatest obstacle to objective evaluation. HR and financial risk teams often exist in separate channels with autonomous executive leadership, often representing different employer objectives and interests.

Evaluating the placement of benefits in captives requires integrated activities that might not be supported by an employer's organisational map. The compliance burden alone can preclude effective action. Because of the large, established insurance and administrative marketplace existing for traditional employee benefits, employers must carefully evaluate the true value of assuming risk through their own captive structures.

Many benefits are available through soft markets that offer pricing near or even below claims cost. Other benefits may represent significant claim volatility with cost trends that far exceed inflation rates. The relationship between financial gain and volatility must be explored and understood in terms of claim incidence, exposure and potential financial gain. Fronting carriers must be available to provide admitted paper and critical provider network, claims management and administrative services.

What kind of benefits can be made by corporations able to write EB through the captive?

Expense reduction, tax savings and greater programme control are often possible for employers running benefit programmes through captive arrangements. HR can control costs while increasing coverage to employees. Risk managers can diversify their portfolios and add unrelated, uncorrelated business. With careful evaluation, connecting the dots between HR and risk via captive opportunities can create major opportunities.

Do you expect to see this trend continuing in 2016 and beyond?

Yes; in the US, if there is no change to the DoL's ExPro programme, we expect the number of applications to increase roughly by six this year and up to a dozen in 2017. Internationally, we expect a steady increase in the number of companies exploring multinational EB pooling over the next several years, as well as continued interest in captive annuity programmes intended to de-risk complex pension obligations.