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viewpoint

From a pool to captive – how can centralised multinationals offer better benefits at a time of rising costs?

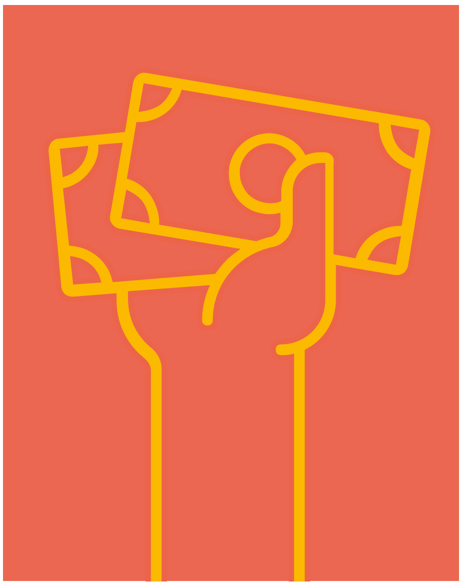
Managing their global employee benefits (EB) programmes still represents a significant challenge for multinationals in 2020. With ever rising costs and many employees now demanding more than a standard one-size-fits-all EB package, multinational employers are having to try and meet these demands while protecting their spending.

Understandably, managing EB costs is a major focus for multinationals. Willis Towers Watson's most recent Benefits Trend Survey cites the rising cost of employee benefits as the key concern by EB professionals, including some 79% of employers in North America.[1]

With employees wanting tailored, flexible packages that fit their lifestyle – from fertility treatments to telemedicine, ride-to-work schemes and mental health support – multinationals are now having to offer more sophisticated EB programmes than ever before.

And, given the role that EB plays in attracting and retaining top talent, it's unsurprising multinationals are looking at how they can care for their employees and offer them the support they want and need.

To balance managing costs and providing the right benefits, multinationals have been turning to global programmes for a long time, particularly pooling. Yet, as costs continue to rise and the demand for flexibility only increases, is pooling the most effective method for the most centralised multinationals?



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Pooling EB programmes

Since the 1950s, pooling has been considered an effective financial arrangement for managing global EB programmes, bringing local policies into a global pool through reinsurance. Pooling allows a multinational employer to leverage its purchasing power, scale and size to take advantage of cost efficiencies, stronger risk management, better global governance and potentially receive a dividend based on the pool performance.

And importantly, pooling has helped manage costs. According to a report from Willis Towers Watson "Multinational pooling is profitable for many companies. Nearly two-thirds of the 1,426 pooling reports we reviewed [for the period 2016/2017] resulted in dividends. The average dividend was 6.0%, and 29% of reports produced dividends greater than 10%.[2]"

But while traditional pooling arrangements continue to operate and generate value for many large multinationals, the EB environment is changing. Increasingly complicated regulation and the pressure to better manage and anticipate benefits spending is driving employers to explore new ways to manage their global programmes. Much of this momentum is towards captive structures and the increased flexibility they provide.

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Captives and COVID-19

As well as needing to manage costs and provide new benefits to employees, the COVID-19 pandemic and global health crisis is driving employers to look to captives to manage EB.

According to Sven Roelandt, Global Expert Employee Benefits Financing Strategies at Aon Global Benefits, the COVID-19 pandemic is "destined to accelerate this trend," towards employee benefits captives.[3]

He explained that most international clients are trying to anticipate the impact of local policy terms and conditions with regards to COVID-19. He said: "Employee benefit policies, for example, are beholden to local law and insurance practices. In order to facilitate as much as possible equal treatment of employees across the globe, the latter can most often be 'overruled' by leveraging on the flexibility of reinsurance to captive approach."

Simply put, as the ultimate risk bearer, a captive can choose the coverage they offer in each country. For example, if a local policy has a pandemic exclusion, those companies with a captive can decide to offer the coverage to care for their employees despite the exclusion.

In a new report[4], Willis Towers Watson found that over two-thirds of employers expect increases in employee benefits plan costs over the next 12 months and 60% of companies believe the increases in healthcare costs will be moderate or significant. It states:

"Companies will inevitably be looking to find ways to manage these cost impacts, and those that have active EB captive programmes in place today are likely to use the control, oversight, and flexibility these afford them to support the business in doing so."

Can captives provide new benefits for multinationals?

Captive structures can deliver much greater operational and strategic benefits to multinationals compared to pooling arrangements. Advantages include eliminating insurer risk charges, benefitting from underwriting profits, better control over cash-flow, improved control of claims and claim management, and enhanced control over pricing and rate setting.

And the cost benefits can be significant. While well-managed multinational pools can give savings of 15% or more, well-managed captives can deliver savings of over 25%.[5]

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Valerie Alexander, Head of Corporate Insurance at Deutsche Bank in the UK, said using a captive makes the job of coordinating and financing a global programme much easier. "The captive also helps with data analysis because it captures the data on a uniform basis and enables you to see what is driving the claims and costs across the organisation… Using a captive is good way to increase transparency."[6]

All of this means that, using an EB captive, local offices of multinationals have the potential to offer better coverage flexibility and potentially offer extended benefits to their employees, while maintaining a healthy control of costs.

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A captivating opportunity for centralised multinationals

With so many opportunities to offer extended benefits while managing costs, it's not surprising that many multinationals are turning to captives to manage EB, but a captive isn't necessarily the right platform for every company. Typically, the most centralised companies with great internal collaboration and strong governance levels are the ones who will benefit from the transition from pool to captive.

Companies that are used to using captives to manage their global property and casualty (P&C) business centrally tend to have the easiest journey when setting up a global captive for their EB programmes. Although it is more typical for a company with an existing P&C captive to add EB, there are a small number of cases where the captive model has been used solely for EB purposes.

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Journey to a captive – The Dow Chemical Company

The Dow Chemical Company (Dow) is a US multinational chemical corporation headquartered in Michigan. We were lucky enough to be able to speak with Bryan Jendretzke and Thomas Just from Dow, and also to Drew Hilger from one of its captives Dorinco, about the firm's transition from multiple pools to a captive to better manage their EB programme.

Dow has worked with captives since the mid-1970s and used them to manage its P&C business. The team started having discussions internally about moving EB fully into the captive back in 2012 and this move became a reality during the last five years.

"The pools we had were 'natural pools' and, when I joined, we were looking at putting a strategy in place to make the most of the pools. Eventually, we ended up looking at the captive to really contain costs and give us more control over our benefits offering – for example to remove, the exclusions in place or advance specific HR initiatives," Bryan said.

3 reasons to move to a captive

According to the team, there were three other reasons behind the move to a captive model.

1. "For us, the EB captive is a zero-sum game. The end goal isn't to make lots of money from employee benefits. We obviously don't want it to be loss-making, but the captive model means that we can stagger premium increases and have more leeway in setting premium levels for our local HR teams."
2. "The captive gave us a global perspective and better governance over what was happening at a local level, such as policy changes."
3. "Also it was great for our existing P&C captive. To be tax effective, we needed to have a certain amount of 'unrelated business'. As you are insuring employees and not the business, employee benefits are great for diversifying the portfolio of a P&C captive. And, of course, having that captive in place prior to moving was an important part of the decision-making process."

As Bryan mentioned, adding EB to the captive has also given Dow control over exclusions, helping it to push certain HR initiatives. One of the initiatives they have been driving, for instance, is adding same sex domestic partners to coverage, which is much easier to do when the captive is reinsuring the risk.

Thomas added: "We removed exclusions on pre-existing conditions, and we've slowly worked on removing transgender exclusions too. With the ongoing coronavirus pandemic, we have had to look into the exclusions of all of our providers on both the life and medical insurance side to ensure we have the right coverage in place for our people."

Growing the EB captive slowly

The journey of adding EB to an existing captive can bring about regulatory and accounting challenges, but Bryan pointed out the need for taking the time and moving business to the captive slowly but surely. "We grew our captive business quite slowly, adding in the business when it felt right – we didn't rush to add all the business in right away which I think was an important step. There were a few regulatory challenges in specific countries to move the business into the programme, which was unavoidable."

But the importance of good internal communication and collaboration is as important as timing, the team at Dow said. When asked what advice he would you give to a multinational looking to move from a pooling to a captive solution, Bryan said: "You need to make sure you have the right relationships in place with the reinsurance company and make sure they are ready to take on employee benefits business.

"We have the good fortune of having a good relationship with the captive for decades. They partnered with us when we had a pool so that partnership has allowed our EB captive to be successful."

Drew added, "From the underwriting side, it is important to maintain pricing integrity and not use different lines of business that is profitable to subsidise others. That isn't necessarily exclusively a rule for captives, but it impacts more when your captive is the ultimate risk bearer."

The unexpected benefits of a captive

Bryan added that there are other benefits of using a captive. "Based on the savings we were seeing using the captive and moving to the global broker model, we were able to internally sell the idea of a global administration system – a platform that gives our employees a better experience to see and choose their benefits.

"Without the savings from the captive we wouldn't have been able to look into that global administration system. The savings you make can either help improve your bottom line or to give your employees that better experience.

"The other area we haven't fully made the most of yet is using our employee benefits data, particularly from a health and wellness standpoint, and using that to make improvements and be more proactive with our wellness campaigns. That's a benefit of the captive model we are still trying to get more out of and will look to use more in the future."

Paul Miehlke, Regional Manager, Central & West USA, MAXIS GBN worked with Dow to help them transition to a captive. He was delighted with the outcome "the move to captive has been great for the team at Dow, allowing them to drive new HR initiatives while managing the risk to suit their own requirements. Adding EB to their captive has been a really effective step but, as Bryan says, there's always more that can be done."

Pooling has been – and continues to be – an established way to improve the management of global EB programmes. But, for many businesses, captives offer greater benefits and the next step in their journey to managing EB at a global level. This push towards captives is even more apt at a time of rising EB and healthcare costs and better informed employees who want more flexibility and choice in their benefits.

In another recent report[7] Willis Towers Watson noted that employee benefits represent a significant cost for every multinational company.

"For companies that exceed 10,000 employees globally it is not uncommon for global life, disability and healthcare costs to be upwards of $20 million per annum. And with over two-thirds of this spend being allocated to company-sponsored healthcare benefits, which are increasing at an average rate of over 7% per annum globally, controlling these costs continues to be a top priority for most multinational companies."

As Paul Miehlke, confirmed "as costs continue to outpace inflation, centralised multinationals would be wise to look at captives to control their costs, retain their staff and help their businesses thrive. It can be a long journey but will be a worthwhile one."

Thanks to Bryan Jendretzke and Thomas Just from the employee benefits team at Dow and to Drew Hilger from Dorinco for their insight and contributions to this article.

1 Anon, Willis Towers Watson https://www.willistowerswatson.com/en-GB/Insights/2019/10/willis-towers-watsons-benefit-trends-global-insights (sourced June 2020)
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