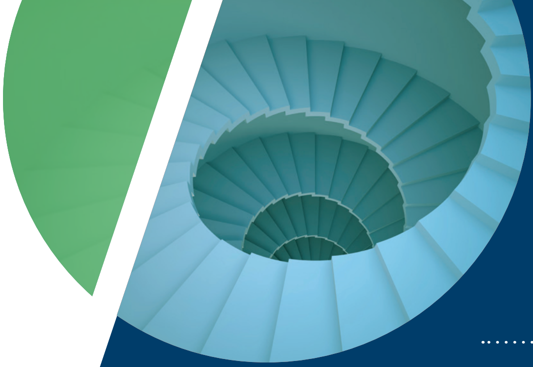


July 2018

viewpoint

Captive structures: why should you use them in managing your Employee Benefits?

As most readers will be aware, at MAXIS GBN, we are a passionate advocate of the use of captive reinsurance companies to help multinational businesses better administer a global risk management programme.

But why are we so in favour of them?

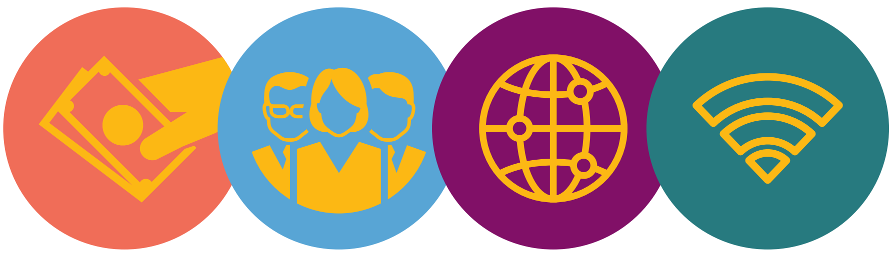
In many instances, if managed successfully, multinationals can realise global cost savings through reduced risk charges and administration fees. In addition, in terms of enhanced benefit design and policy terms such as exclusions, free cover limits and event limits, establishing a captive employee benefits programme enables a business to improve control over benefits programmes globally while increasing flexibility in plan design along with policy terms and conditions.

Willis Towers Watson's study Multinational Pooling and Benefit Captives research report 2016/2017[1] examined the performance of multinational pooling and employee benefits captive arrangements. The study found average dividend returns for multinational pools of 6%, with top quartile results producing dividends of over 14%. For employee benefits captives it identified the savings could be even greater, with median surpluses of 15% and the top quartile producing 25% or more.

Some captive arrangements delivered even higher returns because companies actively discounted premiums up-front, before reinsuring them to their captives.

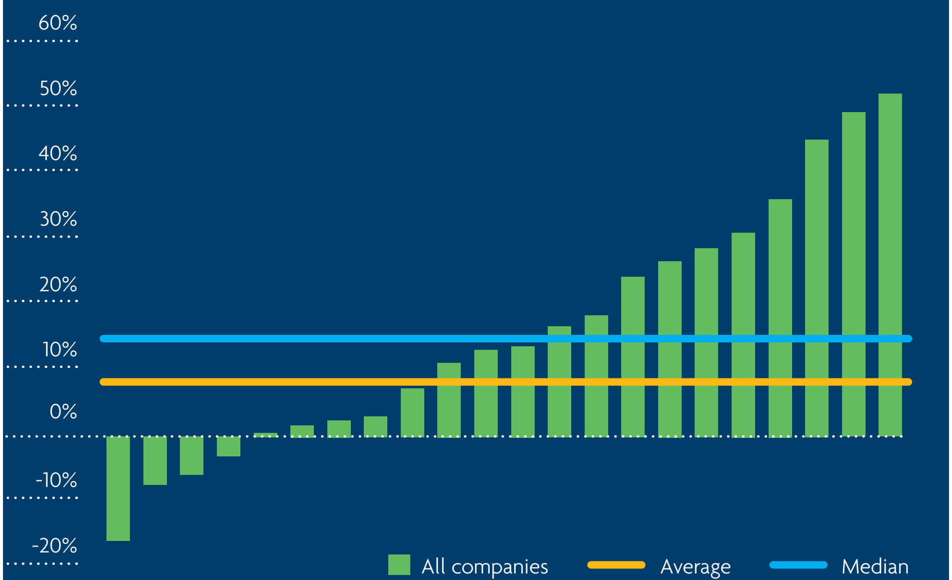
Among other points, Willis Towers Watson's study stated that life insurance contracts were the most consistently profitable, with returns of nearly 27% for employee benefits captive business.

While the size of the employee benefits captive market remains small in comparison to the Property and Casualty (P&C) captives sector, there is clearly an increasing appetite from multinationals to explore the rewards that captives bring when reinsuring employee benefits programmes in terms of control, governance, cost reduction and data strength.



MetLife and AXA in partnership

MAXIS GLOBAL BENEFITS NETWORK



Source: Willis Towers Watson's study Multinational Pooling and Benefit Captives research report 2016/2017

The increasing role risk managers are playing in managing employee benefits

One of the drivers behind this market activity is the increased role risk managers are playing in managing employee benefits. Once the preserve of the HR function, employee benefits are more and more often coming under the remit of risk and finance functions. This is due to the growing need to govern employee benefits lines financially, including being able to gain access to underwriting profits. The development of this approach has accelerated ever since the 2008 financial crisis.

Naturally, the majority of risk managers have a P&C background and it is apparent that many are seeking to apply common P&C approaches to the employee benefits space. This poses interesting challenges to common employee benefits structures.

Another trend that is reinforced by rising costs for letters of credit and the current low interest environment, is the way in which clients wish to reinsure their employee benefits risks to their captive. Traditionally, a key reason for implementing an employee benefits captive was to hold the assets required for the delivery of the benefits programmes at a later date.

Recently, however, a growing number of clients are preferring to work on a funds-withheld basis, which allows for lower collateral requirements. This is because the reduction in costs for maintaining collateral can outweigh the expected higher returns on investment holding assets within the captive. This preference could, of course, change once interest rates rise, which is what many economic commentators are forecasting.

Health and well-being programmes coming to the fore

Consequently, multinationals are looking at ways to break this trend of increasing claims and medical cost inflation, which helps explain why health and well-being programmes are now so prominent and increasingly command significant investment. Captive structures are playing their part by centralising underwriting processes and allowing much greater control from HR and risk teams.

At MAXIS GBN, we have been at the forefront of providing clients comprehensive data that allows for a deeper understanding of cost drivers. With MAXIS Global Wellness recently launched, we are aiming to meet the demand from multinationals for further analytics that can support the implementation and optimisation of effective health and wellness programmes.

The use of captives to manage pension liabilities continues to be a topic of interest, albeit still only really relevant to a select set of clients and multinationals. Of course, the de-risking of defined benefit pension schemes has been a strong focus over the past decade, yet a number of companies still find that captives can help them to optimise their strategy, either by pooling their pension assets or by calibrating the biometric and or financial risks they are willing to take on their books. This is supported by an increasing availability of financial instruments that allow for such calibration.

We are fortunate that AXA, one of our two parent companies, along with MetLife, is at the forefront of this market.

> "... the majority of risk managers have a P&C background... This poses interesting challenges to common employee benefits structures."

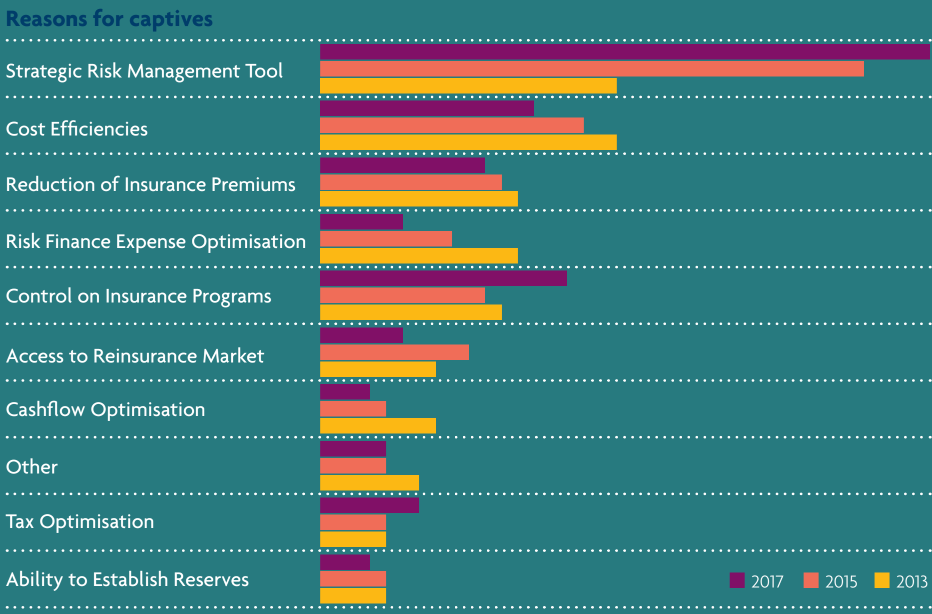
> "For employee benefits captives ... savings could be even greater, with median surpluses of 15% and the top quartile producing 25% or more."

The three advantages of captives

In its Global Risk Management Survey 2017[2], consultancy Aon said it expects to see more multinational companies "use captive programmes to manage employee benefits so they can reduce expenses, retain cash flow inside the organisation, align risk retention with group risk appetite, and gain greater transparency of the program data".

This interest, Aon added, "is fuelled by changes in global talent profiles due to demographics, location of work, nature of work, digitalisation and the like."

Willis Towers Watson's study highlighted the number of employee benefit captives has doubled in the last five years. Based on current activity, the global consultant predicted the number will double again in the next three years – an indication of the compelling dynamics driving the market.



Organisations that use captives (including current and future use) by category	<USD 1B	USD 1B – USD 4.9B	USD 5B – USD 9.9B	USD 10B – USD 14.9B	USD 15B – USD 25B+
Currently have an active captive or PCC	5%	20%	33%	55%	53%
Plan to create a new or additional captive or PCC in the next 3 years	3%	11%	14%	13%	10%
Have a captive that is dormant / run-off	0%	4%	6%	8%	6%
Plan to close a captive in the next 3 years	1%	3%	0%	3%	2%

Source: Aon Global Risk Management Survey 2017

We believe that, overall, by using captives to manage employee benefits risks, multinationals benefit in three ways. Firstly, they are retaining the underwriting profit for themselves. Secondly, they can capitalise on the diversification benefits that this brings, employee benefits are higher frequency, lower impact compared to P&C risks and represent a welcome diversification for risk managers.

Finally, by centralising processes they are getting much more control of their employee benefits programmes something that HR, risk and finance teams greatly appreciate. And that's why, at MAXIS GBN, we believe in Captives.

If you have any questions about Captives don't hesitate to get in touch.

[1] https://www.willistowerswatson.com/en/press/2017/03/Multinational-Pooling-and-Captives-increasingly-used-to-limit-cost-of-insurable-employee-benefits
[2] http://www.aon.com/2017-global-risk-management-survey/pdfs/2017-Aon-Global-Risk-Management-Survey-Full-Report-062617.pdf