Pooling and Reinsurance to Captive

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Deutsche Post AG (DHL)

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Director/President Generali Employee Benefits Network- The Americas
Insurance for Employee Benefit Plans as a Progression

Multinational Corporations insurance requirements change due to:
- Growth
- Risk Management Philosophy

Local
- Fully Insured
- Self insured (some countries)

Traditional
- Multinational Pooling

Loss Free
- Pools

Global Self
- Insurance/Captives
What drives decision making for Employee Benefit Plans?

- Law/Social Expectation
- Competitive Environment
- Cost
- Tax Code
- Risk Tolerance of Employer (Fully Insured or Self Insured)
- Information/Transparency

Traditional Multinational Pooling
History of Pooling

• Concept introduced in the 1950’s
• Pooling arrangements as they are today (with second stage accounting and dividends) arose in the 1960’s
• Primarily European market practice and regulation drove creation of pools
  – Inflated insurance costs from high premium tariffs
  – Local underwriting principles that were more geared towards smaller groups
• 1992 3rd EC Life Directive has since deregulated rates in EU Markets
• Japan, South Korea and Turkey are still considered “tariff” countries
  • Combining locally established group insurance contracts to form a pool with large spread of risk justified experience rating

History of Pooling (continued)

• Pooling became a way for multinationals to overcome these obstacles and move closer towards self-insurance type concepts
• Driven by US/European multinationals (most have some type of pool in place
• Japanese multinationals are increasingly driving market
• Companies in emerging markets are potential future market leaders in pooling (Brazilian/Chinese/Indian/Russian)
What is Multinational Pooling?

“A scalable, centralized profit & loss account, combining the financial performance (and underwriting margins) of a company’s global Employee Benefits contracts with worldwide experience rating.”

- Local admitted fully insured contracts, services and expertise
- Central coordination and control
- Flow of information
- Full report based on annual experience (usually within 4-6 months of year end)
- Financial return (pooling dividend)

Without Pooling

- Local contracts in each country driven exclusively by local market forces
- No economies of scale – lack of global purchasing power
- Positive margins, if any, fully retained by local insurers
- No coordination or global overview of benefits
Multinational Pooling
A global approach with customized local employee benefit solutions

Multinational Inc., Italy
Multinational Inc., Canada
Multinational Inc., Japan

Local risks centralized through reinsurance
Central Reinsurer

Annual reporting, Information, Dividend

Multinational Corporation Head Office

Insurance Companies have a vested interest in pool performance

• Even under a Loss-Carried-Forward contract (LCF) the losses are still held by the insurance network
• Stop loss credits and non-rated claims (pooling point) are also absorbed by the insurance company
• Results in managing pool performance collaboratively with clients

Transparency

• Pooling provides an easy way to see how countries contribute to the pool and experience
• Availability of information—Quarterly premium and claims updates available

Proactive Management of Pools

<table>
<thead>
<tr>
<th>Metric</th>
<th>USD</th>
<th>% of data_total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premiums &amp; Reserve Change</td>
<td>1,223,844.92</td>
<td>100.00%</td>
</tr>
<tr>
<td>Person Year-End Revenue</td>
<td>914,504.71</td>
<td>74.35%</td>
</tr>
<tr>
<td>High Expenses</td>
<td>1,284,712.36</td>
<td>104.36%</td>
</tr>
<tr>
<td>Premiums Deduc. Reins.</td>
<td>(184,712.36)</td>
<td>(15.11)%</td>
</tr>
<tr>
<td>Premiums Inv. Revenue</td>
<td>7,194.33</td>
<td>0.61%</td>
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<tr>
<td>Claims &amp; Reserve Change</td>
<td>(598,597.08)</td>
<td>(48.71)%</td>
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<tr>
<td>Loss Adjusting Reserves</td>
<td>710,202.23</td>
<td>57.62%</td>
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<tr>
<td>Paid Claims</td>
<td>642,229.35</td>
<td>52.16%</td>
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<tr>
<td>Loss Adjusting Reserves</td>
<td>666,257.40</td>
<td>54.12%</td>
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<tr>
<td>Local Deduct.</td>
<td>867.32</td>
<td>0.07%</td>
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<tr>
<td>Global Contributions</td>
<td>68,747.75</td>
<td>5.55%</td>
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<tr>
<td>Non-Rated Premium &amp; Adjustment</td>
<td>138,948.92</td>
<td>11.18%</td>
</tr>
<tr>
<td>Non-Rated Premium</td>
<td>138,948.92</td>
<td>11.18%</td>
</tr>
<tr>
<td>Non-Rated Premium Adjustment</td>
<td>138,948.92</td>
<td>11.18%</td>
</tr>
<tr>
<td>Total Deduct.</td>
<td>0.03</td>
<td>0.00%</td>
</tr>
<tr>
<td>Premiums &amp; Reserve Change</td>
<td>(1,140,535)</td>
<td>(93.72)%</td>
</tr>
<tr>
<td>Gross Revenue</td>
<td>249,289.03</td>
<td>20.11%</td>
</tr>
<tr>
<td>Actual Reserve Change</td>
<td>(51,405.03)</td>
<td>(4.08)%</td>
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<tr>
<td>Paid Claims</td>
<td>67,496.31</td>
<td>5.44%</td>
</tr>
<tr>
<td>Gross Liability</td>
<td>204,792.73</td>
<td>16.77%</td>
</tr>
<tr>
<td>Gross Liability</td>
<td>204,792.73</td>
<td>16.77%</td>
</tr>
<tr>
<td>Expenses &amp; Taxes</td>
<td>0.08</td>
<td>0.00%</td>
</tr>
<tr>
<td>Interest Revenue</td>
<td>1,214,642.11</td>
<td>99.96%</td>
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<tr>
<td>Non-Rated Premium</td>
<td>6.98</td>
<td>0.00%</td>
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<tr>
<td>Gross Premium Earned</td>
<td>0.03</td>
<td>0.00%</td>
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</tbody>
</table>

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Flexibility in Premium Setting

• Because of a global spread of risk, positive experience in other countries can mitigate drastic premium increases in countries with poor experience in a given year

<table>
<thead>
<tr>
<th>Loc Ins Country</th>
<th>China</th>
<th>France</th>
<th>Russia</th>
<th>Brazil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premiums</td>
<td>100,000.00</td>
<td>75,000.00</td>
<td>200,000.00</td>
<td>50,000.00</td>
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<tr>
<td>Investment Inco</td>
<td>3,616.90</td>
<td>-</td>
<td>7,500.00</td>
<td>1,500.00</td>
</tr>
<tr>
<td>TOTAL Income</td>
<td>103,616.90</td>
<td>75,000.00</td>
<td>207,500.00</td>
<td>51,500.00</td>
</tr>
<tr>
<td>TOTAL Outgo</td>
<td>(75,000.00)</td>
<td>(125,000.00)</td>
<td>(125,000.00)</td>
<td>(15,000.00)</td>
</tr>
<tr>
<td>NET BALANCE</td>
<td>28,616.90</td>
<td>-</td>
<td>82,500.00</td>
<td>16,500.00</td>
</tr>
<tr>
<td>Total Experience</td>
<td>77,616.90</td>
<td>18%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

• With a total experience of 18% in this simplified scenario, France’s rates can be more stable in the pool compared to being only locally insured

“Loss Free” Pooling

• “Hybrid” of traditional pooling and reinsurance to captive programs
• Flexibility with certain technical elements (Risk Charge, Pooling Point, Central IBNR Reserve, and Aggregate Stop Loss)

Employee Benefit Network

Hold Harmless Agreement

Multinational Inc. Head Office

• Positive Experience: Large dividend
• Negative Experience: Losses refunded to Employee Benefit Network
Insurance Approaches in International Markets

• Most local markets (outside USA) require that employee benefit programs are fully insured
• Markets where forms of local self-insurance are available
  – Canada
    • Short-Term Disability and Medical can be self insured
  – Brazil
    • “Autogestao” (Insurance company operated by large employers)
    • Plano Administrado (TPA)
    • Medical benefits can be self insured
• Most countries such as China, France, India, and Russia require full insurance on the local level. A common benefit plan would include Accident, Disability, Group Life, and Medical insurance.

Reinsurance to Captive
**CAPTIVE INSURANCE**

*Net Premium = Gross Premium less the global program discount (20-25%)*

*Ceded Premium = Net premium less administration, taxes & fronting fees*

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**Captive Cashflow Diagram**

Local Subsidiary

Market Premium

Insurance Policy

Local Network Insurer

Central Reinsurer

Ceded Premium & 100% Risk

Claims

Corporate Reinsurance Facility

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**Captive Underwriting Diagram**

**Conventional Insurance Underwriting Methodology**

<table>
<thead>
<tr>
<th>Losses</th>
<th>Admin Costs</th>
<th>Broker Comm. &amp; Insurer Profit</th>
<th>Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>70</td>
<td>15</td>
<td>15</td>
<td>100</td>
</tr>
</tbody>
</table>

**Underwriting Methodology (break-even underwriting)**

<table>
<thead>
<tr>
<th>Losses</th>
<th>Admin Costs</th>
<th>Investment Income</th>
<th>Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>70</td>
<td>10</td>
<td>(5)</td>
<td>75</td>
</tr>
</tbody>
</table>
### Brazil

- Blocked Currency Country – regulated by the IRB
- Strong Local Insurance Companies especially for Medical
- TPA’s cannot administer medical under an insured arrangement
- Quota share arrangements can be secured, but must be approved by the IRB
- Competition of a “HMO” style cover started by physicians creates competitive issue
- Remote locations and access to hospital networks can be difficult

### China

- Restricted Currency Country
- Local Insurance Regulations require JV setup for networks
- Quota share arrangements can be secured
- Local insurers can try and buy business
France

- Unions, Unions and more Unions
- Unions will partner or own TPA's/Insurers
- Intermediary market “brokers” control medical administration & claims
- Entitlement attitude towards employee benefits
- Cost shifting continues from the public to the private sector
- Managed disability is still being refined
- Securing timely claims data/analytics can be difficult

India

- Blocked Currency Country
- Strong Local Insurance Companies especially for medical
- Medical has normally been written at a significant loss
- Quota share arrangements can be secured
- Caste system creates inequalities on treatment levels
Russia

- Insurers are mostly post-Soviet era
- Data collection & timeliness can vary greatly
- Medical costs subject to Fx movements against hard currencies
- Limited centers of expertise exacerbate medical trend
- Social issues: Alcohol, diet, exercise

Captive Advantages for Emerging Markets

- Break-even pricing can ward off local market “buyers of business”
- Increased transparency of claims data allowing for better health management possibilities
- Can help avoid Union administrators/insurers which normally lag behind the private market in terms of market solutions and creativity
- Certain countries will allow 100% quota share when utilizing a local reinsurer
- Develop private medical networks based on corporate needs and location
- Creates long-term longevity with a limited number of carriers
- Increased plan & questionable claim flexibility