



Employee Benefits in Captives

Captive Insurance Council of the District of Columbia

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Jon Bourgault, Groom Law Group

Gary Lefkowitz, U.S. Department of Labor

Kathleen Waslov, Towers Perrin

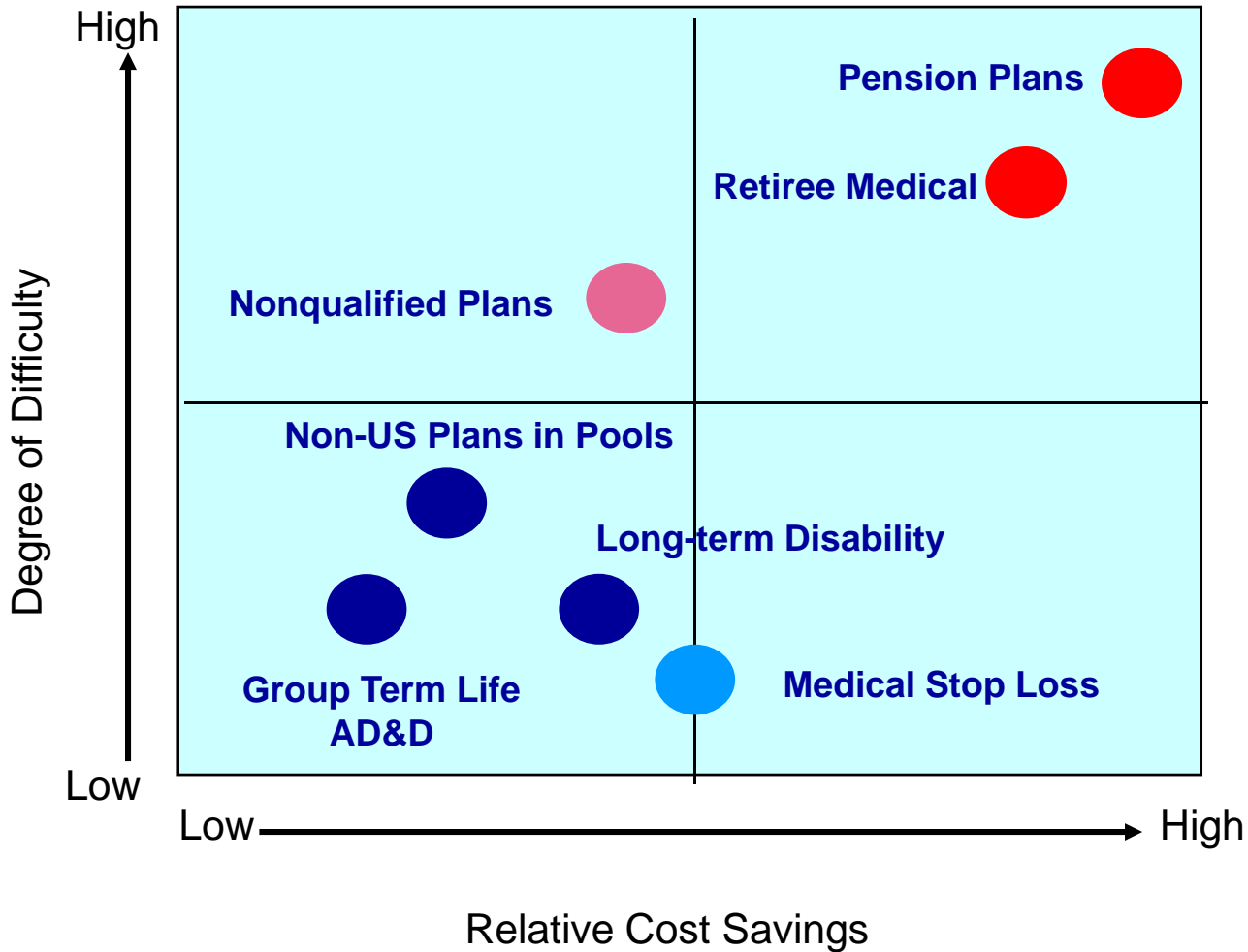
Views from the Experts

- Financial view
 - Why are companies using captives to finance U.S. employee benefits?
 - Who has done it?
 - How do you measure the value?
- Legal view
 - What are the rules for legal compliance?
 - When are exemptions *not* required?
- Department of Labor view
 - How are exemption applications evaluated?
 - What are some examples of benefit enhancements for “ExPro”?

Reasons for Benefit Captives

- Save 5% to 15% over a traditional commercial insurance program
 - Control cash flow and investment earnings
 - Reduce or eliminate underwriting profit margins, broker commissions, and the cost of using third-party capital to finance risk
- Stabilize premium rates
- Provide coverage customized to employee benefit plan designs
- Centralize data on global benefits experience
 - Spot trends early
 - Respond with cost-efficient solutions

Benefit Plan Types



Who has US Benefit Captives

Companies	Benefit Plan	Fronting Company	DOL Date
1. Columbia Energy (now NiSource Inc.)	LTD	Wausau	11-Oct-00
2. ADM	Life	MN Life	5-May-03
3. International Paper	Life, AD&D	MetLife	7-Nov-03
4. SCA	Life, AD&D, LTD	Aetna	7-Jul-04
5. Alcon Labs	Life, LTD	Aetna	19-Aug-04
6. Alcoa	Life	MetLife	8-Jan-05
7. Sun Microsystems	Life	AIG	29-Sep-05
8. Astra Zeneca	Life, LTD	Prudential (Life); MetLife (LTD)	5-Jan-06
9. AGL Resources Inc.	Life, AD&D, LTD	Hartford	1-May-06
10. H. J. Heinz Co.	Life	MN Life	17-Sep-06
11. Wells Fargo	Life and LTD	MetLife (LTD); MN Life (Life)	31-Jan-07
12. NiSource Inc. (2)	Life	Prudential	20-Jul-07
13. Cephalon	Life, AD&D, LTD	Prudential	14-May-08
14. H. J. Heinz Co. (2)	Life, AD&D, LTD	Liberty (LTD); CIGNA & MN Life (Life)	25-May-08
15. YKK Corporation	Life, AD&D	AIG	20-Jun-08
16. ConAgra	Life, AD&D	Prudential	04-Oct-08
17. Astra Zeneca (2)	Business Travel Accident	Zurich	20-Dec-08
18. Deutsche Post/DHL	LTD	Prudential	22-Dec-08
19. UTC	Life, LTD	CIGNA (Life); Liberty Mutual (LTD)	26-Dec-08
20. Memorial Sloan-Kettering Cancer Center	Life, LTD	Prudential (Life); Unum (LTD)	31-Dec-08
21. ADM (2)	LTD	Aetna	25-Jan-09
22. Banner Health	Life	MN Life	29-Jun-09

How to measure captive value

- Two measures are:
 - Short- or long-term captive net operating profits
 - Net present value of cash flows from captive financing relative to a baseline or current financing method
- Financial models are used to estimate net income and cash flows
- Assumptions should be tested to show how results can change if claims or expenses vary

Simple Illustration	Fully Insured	With Captive Reinsurance
Premium	100	100
Claims	80	80
Expenses	10	10
Risk Charge	5	0
Reinsurance	0	3
Captive Operations	0	2
Underwriting Profit	5, to insurer	5, to captive
Interest on Cash Flow	To insurer	To captive

Compliance with ERISA

- Is the transaction covered by ERISA?
 - Most life, health, disability and pension plans are covered
 - Affinity coverages like auto and homeowners not covered
 - Workers compensation not covered
- Is the transaction “prohibited”?
 - ERISA prohibits certain direct and indirect transactions between a plan and a “party in interest,” including the employer and certain entities affiliated with the employer
 - ERISA also prohibits a plan fiduciary from using the assets of the plan in the fiduciary’s own interest
- Does it matter how the benefits are funded?
 - If separate trust for benefit assets buys the policy, then ERISA issue
 - If employee money is used to buy the coverage, then ERISA issue
 - Most employer funded plans present an ERISA issue and require an exemption
 - But medical stop loss perhaps not covered

ERISA Exemptions

- Three kinds of exemptions in ERISA and all are potentially applicable to captive transactions
- In the Statute
 - Can only use if benefit premiums will be less than 5% of the premiums written by the insurance companies affiliated with the employer plan sponsor
 - If you can comply, you do not need to obtain permission from DOL
- Class exemptions
 - DOL adopts exemptions if needed for a transaction that occurs frequently and they have determined it does not present risks to a plan if certain conditions are met. No additional filing with DOL required if conditions are met
 - PTE 79-41 for direct insurance transactions with insurers affiliated with the plan sponsor
 - Most important condition is that benefits and company-related premiums are less than 50% of all premiums written
- Individual Exemptions
 - Must get permission from DOL if do not meet statutory or class exemption
 - Eighteen employers have obtained individual exemptions for captive transactions
 - EXPRO available if there are two prior substantially similar exemptions

Requirements for a Captive EXPRO Exemption

- Captive or Branch is Licensed by State
- Captive has one year of audited financials
- Charges are consistent with market rates and calculated using the same methodology as typically used by insurers
- Benefit enhancements
- Fronting Carrier Must be A Rated
- Independent Fiduciary
 - Review of Transaction
 - Communication with DOL
 - Preparation of Report
 - Ongoing Oversight
- Notice to plan participants

DOL Process

- History of cases
- Role of the fiduciary
- Key to a successful application
 - Form and content
 - Examples of benefit enhancements
- Reasons why applications may be denied