Global Approaches to Effective Benefit Financing

2014

Multinational Pooling and Benefit Captives Research Report

TOWERS WATSON

Multinational pooling and captives offer untapped potential for multinational companies to save money on their insurable benefits around the world.

Most companies would improve the return on their investment in employee benefits if they took a more proactive and robust approach to the use of preferred multinational pooling providers and employee benefit captives.

Global Approaches to Effective Benefit Financing

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Executive Summary

For multinationals, the annual costs of employee health and risk benefits, including medical, life and disability protection, are enormous. Yearly expenses for a company with 50,000 employees throughout the world can easily exceed US$50 million. When a substantial portion of a company's workforce is based in the United States, the numbers can climb even higher, often surpassing US$100 million per year. State and mandatory programs can add even more to the final tally.

Global benefit leaders must manage these long-term costs if their companies are to remain competitive in the global war for talent and keep pace in their marketplaces.

Accomplishing this typically requires a combination of demand-side and supply-side tactics. Demand-side approaches focus on increasing consumer awareness and financial participation in health care decisions. Supporting healthier lifestyles for employees can eventually lead to lower utilization of employee benefit plans. In comparison, supply-side approaches apply financing strategies and leverage vendor relationships to create cost efficiencies.

The Towers Watson Multinational Pooling and Benefit Captives Research Report 2014 concentrates on the supply side, thoroughly examining two of the most popular benefit financing strategies. The study, one of the largest of its kind, explores the way companies use multinational pooling and captive arrangements to their advantage and answers many of the questions commonly asked by global benefit leaders about these approaches, including:

- How effective are multinational pools and/or captives in mitigating employee benefit program costs?
- How do our multinational pooling or captive results compare with others?
- Which countries and contracts are best and worst for pooling or reinsuring to a captive?
- What type of risk mechanism is likely to be best for my company's multinational pool, and how do different risk mechanisms compare?
- What are the most successful companies doing to ensure their multinational pooling or captive strategies are effective?

About the Research Study

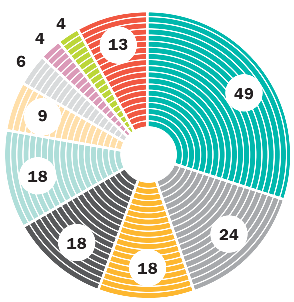
To assess the state of multinational pooling and employee benefit captive solutions, Towers Watson collected and analyzed pooling and captive annual reports for 2011 to 2013 and portions of 2010. The study incorporates all participating benefit plans, including life, accident, disability, medical and some retirement plans (e.g., risk-related elements such as spouse or orphan benefits).

Nearly 800 annual reports were submitted by 163 multinational companies, covering US$3.1 billion in premiums across 93 countries.

Participants include 34 of the FTSE Global 100 Companies, eight of which are listed among the FTSE Global 20.

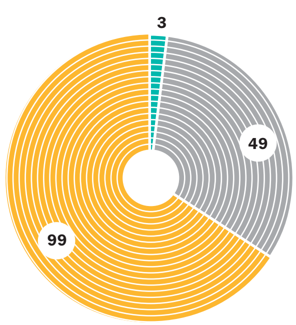
This large volume of data generated statistically credible results and observations that organizations can use to compare and benchmark their approaches. It also provides a framework to better understand the tools others are using to effectively execute benefit financing strategies on a global scale.

Industry sector distribution



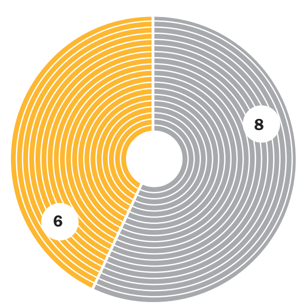
49	Manufacturing
24	Technology
18	Financial Services
18	Health Care
18	Professional and Business Services
9	Food and Beverage
6	Telecommunication
4	Property and Construction
4	Transportation
13	Others

Company HQ (Pools)*



3	Asia
49	Europe
99	North America

Company HQ (Captives)*



0	Asia
8	Europe
6	North America

*Two participants provided both pooling and captive reports.

Key Findings

Multinational pooling continues to be a viable long-term cost-savings tool for companies. The multinational pools included in this study returned average international dividends of US$147 million — a 6.1% ROI — over three years, with the top quartile of pools producing dividends greater than 10%. At the other end of the spectrum, one in every three pools returned no money, pushing overall median results down to 1.4%.

Captive arrangements offer additional savings for some companies. Captives are most effective when companies have significant experience applying risk management principles to employee benefits. Captive arrangements returned average surpluses of 5.1%, while the median captive return was significantly higher at 11.3%. The difference between the median and mean is largely attributable to the experience of one company with significant losses. When that captive is excluded, the mean and median returns are very similar, and both are higher than the results achieved under pooling.

There are wide variations in profitability based on geography. For multinational pooling, Indonesia produced the largest savings as a percentage of total premium pooled at +36%, while benefit contracts in Hungary were the worst performers with average returns of -36%. For captives, geographic variations in profitability were even wider. Guernsey produced the largest dividends at +65%, while benefit contracts in Denmark were the worst performers with average returns of -77%.

This doesn't mean companies should automatically pool every benefit plan in Indonesia or never consider a captive arrangement in Denmark. Instead, they should conduct due diligence and consider their own objectives, claims experience, premium rates, network retention levels and other factors before adding or continuing to include any contract in their pool.

Benchmarking

Understanding the different approaches taken by companies when managing multinational pools and captives is critical to interpreting the study's results. Some companies seek to drive consistent dividends, while others use these arrangements to reduce up-front premium costs. Before benchmarking against the performance of any multinational pools and/or captives, companies should take their individual objectives into account.

Returns vary based on coverage types. As anticipated, life and accident insurance contracts were the most consistently profitable, with returns of 23% for both pooling and captive business. Stand-alone medical contracts were consistent deficit producers, with average returns of -8% in multinational pools and -2% in captives. Companies should be cautious about pooling stand-alone medical contracts in most countries, proceeding only where projected claims experience and network retention levels support inclusion.

The right risk mechanism for multinational pooling depends on the pooling strategy and the types of coverage. Almost all multinational pools include risk mechanisms that provide varying levels of protection against losses. Companies need to understand the available risk mechanisms and select the one that matches their tolerance for risk. If, for example, a company wants to drive consistent dividends rather than minimize up-front premiums, loss carry-forward (LCF) pools may be a better option since their lower retentions — or amounts retained to cover administrative and other costs, including profits — provide opportunities for higher dividends. Conversely, companies using pools to drive down premium rates may prefer stop loss (SL) pools, so that one or two bad years don't leave their pools with large deficits.

Average dividend returns for multinational pooling were similar between LCF (6.7%) and SL (6.2%) pools. This appears counterintuitive because stop loss pools carry higher risk retentions, so profits should be lower on a like-for-like performance basis than under an LCF approach. One possible explanation is that many LCF pools are stuck in large deficit positions, which means that even though they had positive results in a given year, no dividends were returned due to historic losses being carried forward.

The companies that benefit the most from pooling and captives share several characteristics. In general, they systematically strive to actively manage their arrangements, expand their use of pools and captives, ensure balance and explore new opportunities, while ending arrangements that perform poorly. The best outcomes are achieved when companies eliminate distractions, such as decisions that are not in line with the global remit or preferred providers acting in undesirable ways, and make informed decisions based on their strategic priorities.

Multinational Pooling

What Is Multinational Pooling?

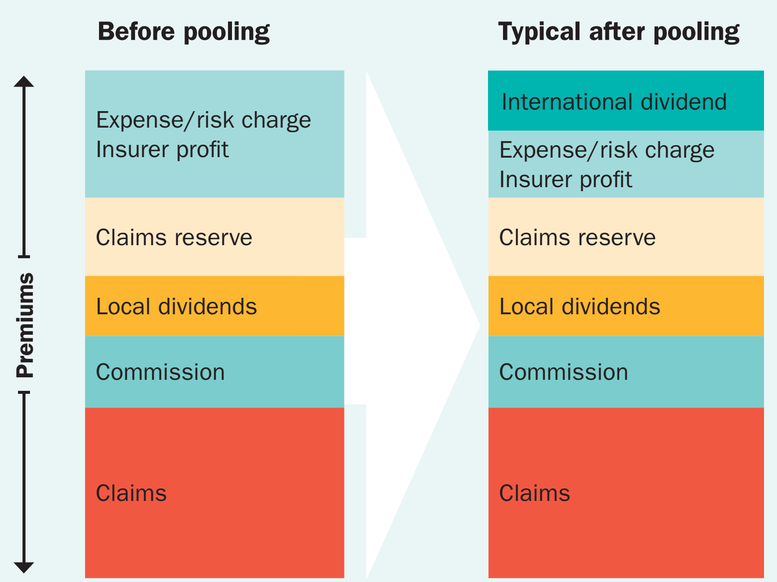
Multinational pooling combines a company's group insurance contracts for employee benefits in different countries under one financing arrangement to create savings through economies of scale. Sources of these economies of scale include risk reduction, administrative efficiencies and experience rating.

There are eight multinational insurance networks that support multinational pooling.

A company gains financial savings through them from:

- Favorable claims experience
- Reduced insurer profit in return for contracts remaining with the insurer longer
- Global purchasing power to leverage local premium rates

Figure 1. Before and after pooling



Nonfinancial benefits include improvement in service and improvement in contract terms, such as underwriting limits.

> "Multinational pooling helps companies take advantage of economies of scale to realize relatively easy savings."

Figure 2. Number of pool reports by network and type

Network	Loss carry forward	Small groups	Stop loss	Total pool report per network
Allianz	0	12	5	**17**
Generali	77	0	30	**107**
IGP	168	113	4	**285**
ING	21	12	0	**33**
Insurope	68	33	30	**131**
MAXIS	45	2	1	**48**
Swiss Life	65	15	43	**123**
Zurich	9	0	0	**9**
Total pool reports by type	**453**	**187**	**113**	**753**

Three Main Risk Mechanisms

The three main risk mechanisms used by companies participating in this report are:

Loss carry-forward (LCF): In LCF pools, any deficit at the end of the year is carried forward to the next year. Variations include limited LCF and pools that write off deficits after a specific time period.

Small groups (SG): An SG pool is a multiemployer pool where surpluses and losses are shared among participants. SG pools are typically used when a company's business with the multinational pooling network does not meet certain thresholds for premium volume or spread of lives.

Stop loss (SL): In SL pools, all losses are borne by the multinational pooling network in return for a higher retention charge, and any surpluses are taken by the company.

A small minority of multinational pools do not include any risk mechanism.

Multinational pooling is profitable for many companies. Nearly two-thirds (61%) of the 753 pooling arrangements we reviewed resulted in dividends. The average dividend was 6.1%, and more than one-quarter (28%) of arrangements produced dividends greater than 10%. The median dividend was much lower (1.4%), reflecting a minority of companies receiving the biggest returns. *Figure 2* provides a complete listing of all the pooling reports, by network, examined in this study.

Different Strategies Yield Different Results

Because different companies often have different strategic objectives that influence the size of their dividend, assessing dividend performance can be complex. Some companies, for example, prefer to leverage multinational pooling providers at their renewal dates to reduce the premiums paid up-front, thus achieving immediate savings but reducing the potential for dividend returns within a pool.

This approach is most effective for life and accident coverage because the purchasing decision depends largely on price. In contrast, medical and long-term disability decisions often rest on quality of service, such as timely payment of claims.

Other companies aim for higher, more consistent dividends from their multinational pools, using the proceeds to finance corporate activities or to reward the local business operations whose positive performance contributed to the dividend. Often companies adopt a mixed approach, keeping a portion of a dividend for corporate activities, such as covering the expenses associated with managing the pool or providing "seed money" for other initiatives, and sharing back the balance with local affiliates.

Risk Mechanisms

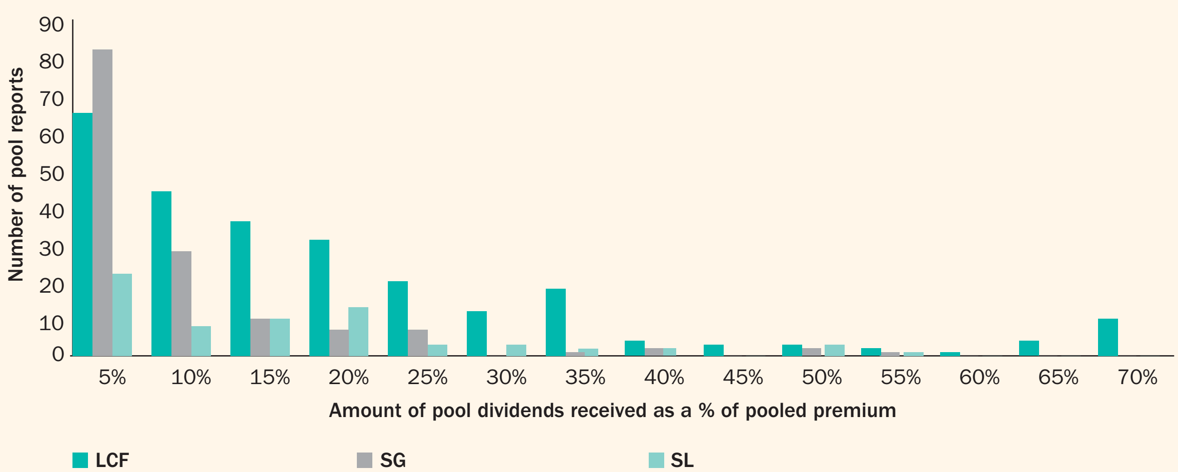
Because many companies prefer to take a long-term approach and benefit from the lower network retentions offered for LCF pools, LCF pools are the most commonly used risk mechanism. Still, at 6.7% and 6.2% respectively, LCF and SL pools yielded comparable average dividends. In contrast, dividends from SG pools were much lower.

“Companies that actively manage their multinational pools with a particular approach in mind increase the chances that their pool will be financially successful.”

Because LCF and SL pools both returned healthy dividends, neither seems to be more valuable than the other. Instead, companies are choosing between them based on their appetite for risk and the mix of employee benefit business in the pool. SL pools, for example, tend to be better suited for multinational pools that are less balanced (e.g., one country makes up 50% or more of the total lives or premium of the pool), or have a smaller spread of lives or risks.

Most companies in SG pools should move beyond them as soon as they have sufficient scale in terms of head count and premiums. Several of the largest multinational networks' results have been at historic lows over the past few years, as reflected by the average international dividend of just 1.6% of pooled premiums for SG pools.

Figure 3. Pooling dividends received split by pool type



Pool type	Percentage of reports showing dividend	Average dividend	Median dividend	Average retention	Number of reports	Premium volume $
Loss carry forward	56%	6.7%	1.8%	14.1%	453	1,783m
Small groups	75%	1.6%	1.1%	17.2%	187	240m
Stop loss	59%	6.2%	1.8%	18.8%	113	390m

*Those pool reports generating dividends of 70% or over are consolidated in the 70% column.

Results by Risk Mechanism

Insurers' retention levels are typically higher for SL and SG pools. Retention covers administration costs, risk charges, underwriting margins or profits, and risk protection costs related to the risk mechanism, such as stop loss charges for SL pools. Stop loss charges also apply for some SG pools, depending on their structure.

The average claims ratio, defined as the total annual claims paid out divided by total gross annual premium, was considerably lower for SG pools than for LCF pools or SL pools. With average claims ratios of approximately 40%, SG pools experienced much lower claim levels compared with premiums than LCF pools (75%) or SL pools (80%).

SG pools added premiums to reserves at significantly higher levels than LCF pools or SL pools. The level of premiums added to reserves for SG pools was 68%, compared with 17% for LCF pools and 7% for SL pools. In several instances, over 90% of premiums were added to reserves, typically in SG pools with very small pooled amounts of risk benefits compared with significant pension benefits, most notably in Switzerland. These findings reinforce our recommendation that companies investigate alternatives and move beyond an SG pool approach as soon as possible.

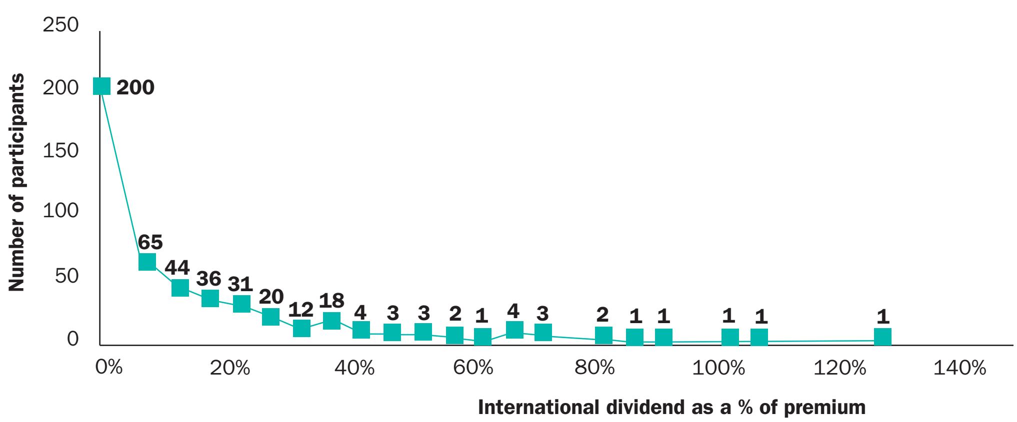
Because more of the premium was moved into insurers' reserves under LCF pools than under SL pools, international dividends were only slightly higher in LCF pools than in SL pools, even though claims ratio and retention charges were lower. As a result, companies should periodically review insurers' reserving levels under their multinational pooling arrangements, with the aim of releasing any unnecessarily held reserves that can then flow through to improve the pools' profitability and therefore dividend generating potential.

Because there are always exceptions and variations as well as changing needs, all multinational companies should periodically review their pools and their risks to identify the pool type best suited to their current risk profile and risk tolerance.

Figure 4. Results by risk mechanism

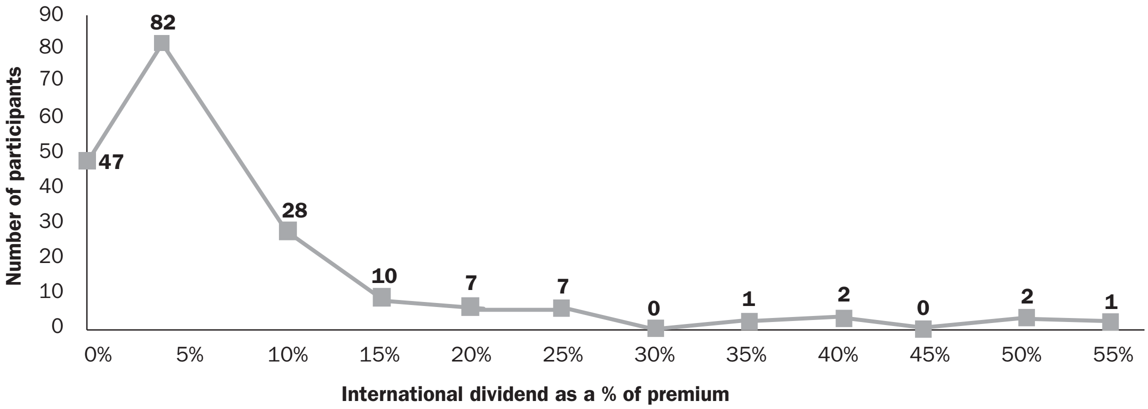
The spread of results follows a broadly similar pattern for each risk mechanism

Loss carry forward results



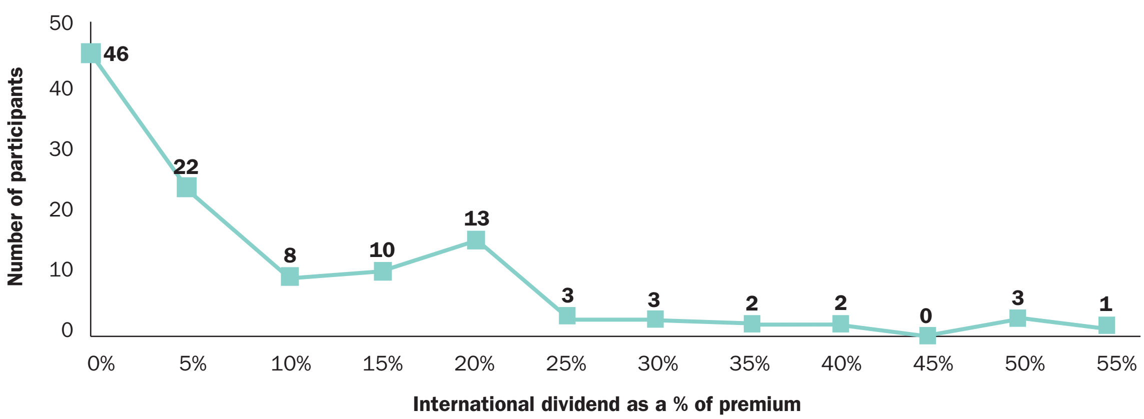
Total premium	US$1.8 billion
Total dividend paid	US$119 million
Average claims ratio (premium weighted)	75.6%
Average commission ratio (premium weighted)	2.8%
Average retention charges ratio (premium weighted)	14.1%
Median international dividend as % of premium	1.8%
Average international dividend ratio (premium weighted)	6.7%

Small groups pool results



Total premium	US$240 million
Total dividend paid	US$4 million
Average claims ratio (premium weighted)	39.8%
Average commission ratio (premium weighted)	2.1%
Average retention charges ratio (premium weighted)	17.2%
Median international dividend as % of premium	1.1%
Average international dividend ratio (premium weighted)	1.6%

Stop loss results



Total premium	US$390 million
Total dividend paid	US$24 million
Average claims ratio (premium weighted)	81.2%
Average commission ratio (premium weighted)	3.0%
Average retention charges ratio (premium weighted)	18.8%
Median international dividend as % of premium	1.8%
Average international dividend ratio (premium weighted)	6.2%

Geographic Considerations

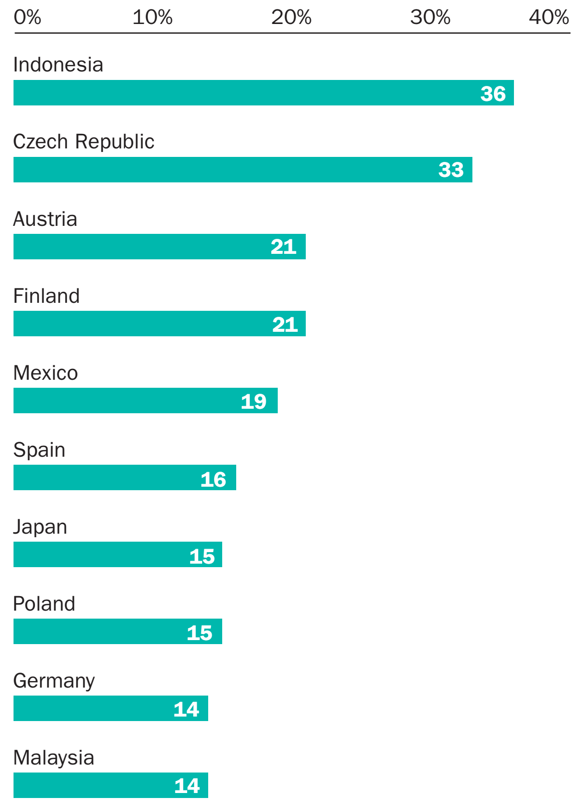
The profitability of pooled business varies significantly by country. Indonesia was the top performer with 36% profitability, expressed as a percentage of all pooled premiums paid. The Czech Republic, Austria, Finland and Mexico rounded out the top five.

At -36% profitability, the worst-performing country was Hungary, followed by Australia, Canada, Singapore and Denmark. Hungary's pooled premiums were split with US$789,000 in "life," US$58,000 in "medical" and US$627,000 in "other." This means that Hungary's poor performance cannot be explained purely by the poor performance of medical business.

These results do not mean companies should automatically pool every benefit plan in Indonesia or never pool any plans in Hungary. Instead, they should consider their own claims experience, premium rates and network retentions before including any contract in their pool.

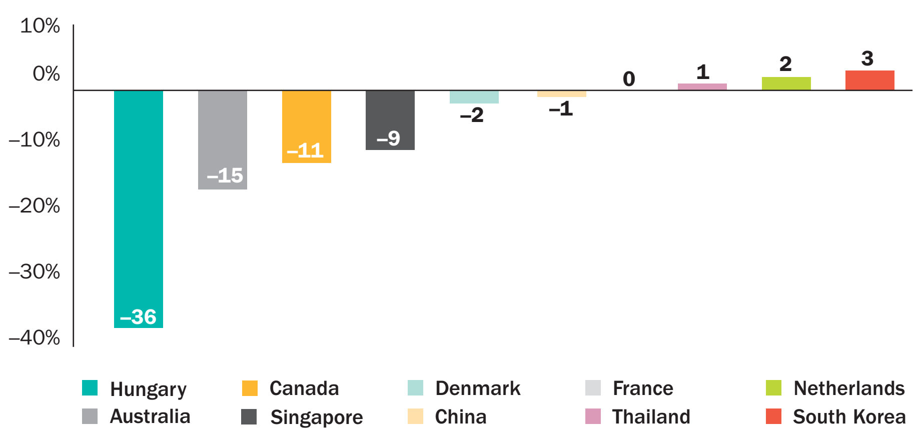
The data does, however, offer companies the opportunity to compare their experiences with those of others in different countries. Australia, Canada and Singapore, for example, are three of the most commonly pooled countries, but they are also three of the worst-performing options. Any companies pooling benefits in these countries should keep a careful watch on their performance each year, taking action to remove them from pools if they start contributing consistent deficits to the pool for a period of three years or more.

Figure 5. Ten most profitable countries for all pooled business



Companies not currently including these countries in their pools should examine their own contracts to see if these countries should be added.

Figure 6. Ten least profitable countries for all pooled business



Perhaps not surprising, as insurance companies are profit-making businesses, even three of the bottom 10 countries produced surpluses.

Differences by Business Type

The type of business being pooled matters. Within the research study database, the pooled premiums were grouped into life-only contracts, medical-only contracts and other pooled business. The respective premium volumes associated with this split are:

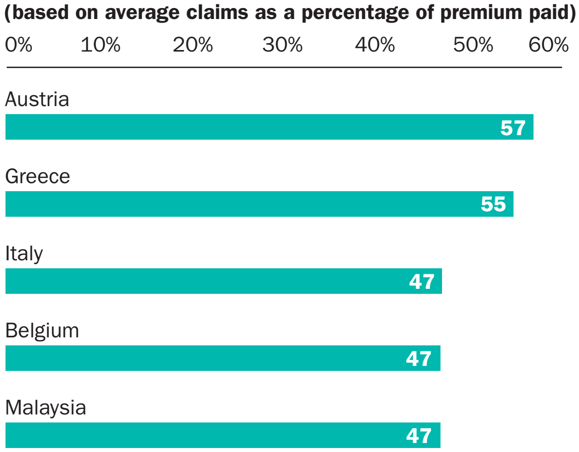
- Life-only contracts: US$485 million
- Medical-only contracts: US$403 million
- Other: US$1,468 million

Other pooled business includes disability plans, bundled contracts, such as combined group life and accident, and the risk-related elements of retirement plans, such as spousal and orphan benefits. It represents the most significant volume of premium because many contracts are bundled.

In life-only business, Austria was the top-performing country. On the face of it, Ireland was the worst performer, but the experience there illustrates the importance of looking beneath the surface when reviewing raw data. While life-only business in Ireland produced a 45% loss on US$15 million of premium, we found a profit of 47% on US$15.3 million of other bundled business in the database, which produced a small overall profit of 3% on a total portfolio of US$30 million. The Irish market has been competitive in recent years, so premiums may be squeezed with the intention of cross-subsidizing other business.

Figure 7. Five most profitable countries for life-only business

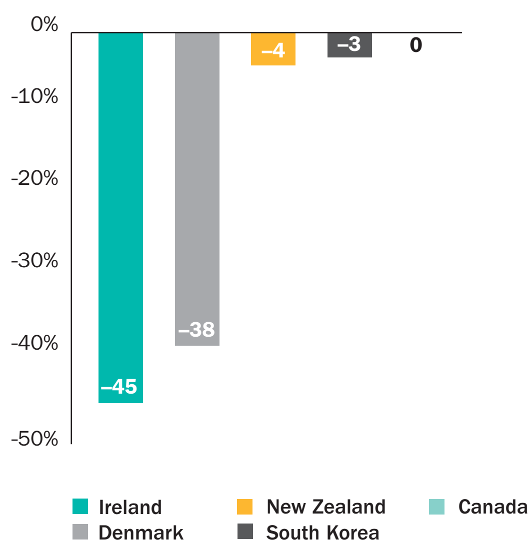
(based on average claims as a percentage of premium paid)



High-performing life-only business is often packaged with poorly performing medical-only business. Companies should try to separate them.

Figure 8. Five least profitable countries for life-only business

(based on average claims as a percentage of premiums paid)



Only a few countries produced positive returns for medical-only business. Overall, profitability of medical-only business was -8%, which may reflect factors such as medical cost inflation and an increasing number of claims.

South Korea was the top-performing country for medical-only business, while Greece was the worst performing. The positive performance of the medical-only business in the U.K. was a surprise, challenging the oft-cited thinking that the U.K. medical business should automatically be excluded from pools.

Most of the countries in the top and bottom five for performance experienced negative profitability, some by a large margin. Still, just as with pooling in general, companies should not automatically avoid lower-performing countries for medical business. Instead, they should review all medical contracts on their own merits to evaluate whether to include them in a pool.

The range of profitability was much wider in other bundled business contracts than in life-only or medical-only contracts, exceeding 40% in several countries. At the same time, large deficits also exist, which means that companies must monitor their other bundled business arrangements closely and consider removing poorly performing contracts from their pools if necessary.

Figure 9. Five most profitable countries for medical-only business
(based on average claims as a percentage of premiums paid)

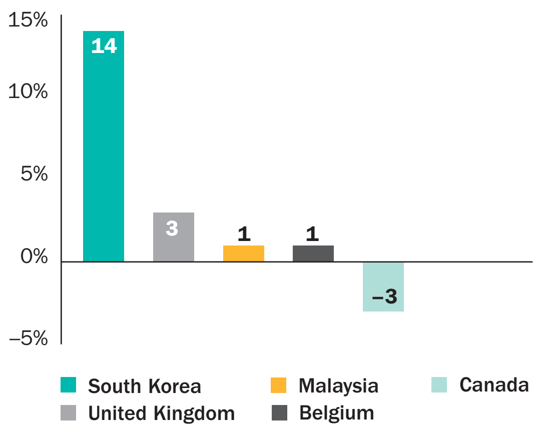


Figure 10. Five least profitable countries for medical-only business
(based on average claims as a percentage of premiums paid)

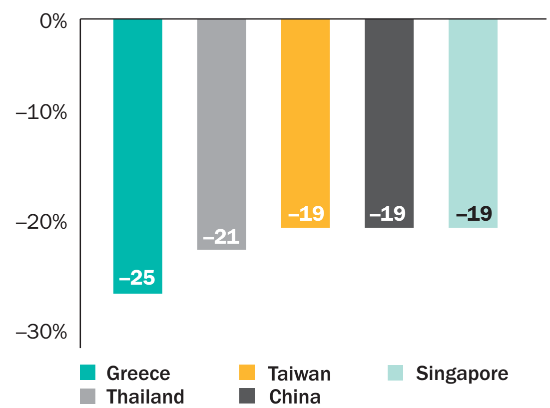


Figure 11. Five most profitable countries for other business in pooling
(based on average claims as a percentage of premiums paid)

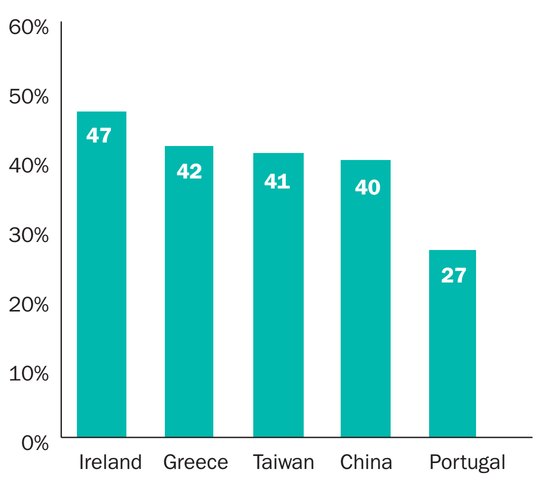
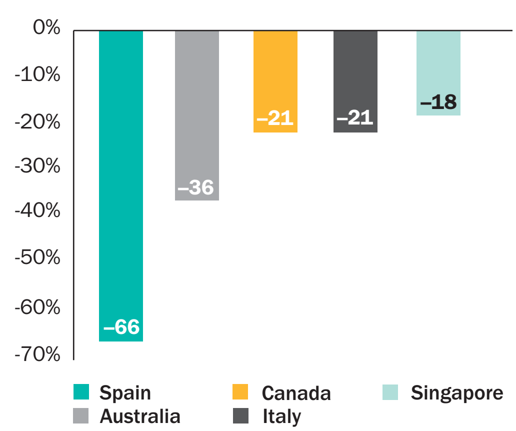


Figure 12. Five least profitable countries for other business in pooling
(based on average claims as a percentage of premiums paid)



Other business can be a source of large gains but also large losses, so careful examination is required.

Benefit Captives

What Is a Captive?

A captive is an insurance company that is a wholly owned and wholly operated subsidiary of a company not otherwise in the insurance business. In an employee benefit context, a captive usually acts as a reinsurer. Local insurers — often called “fronting” insurers because they “front” the employee benefits for the captive — will issue policies and pay claims as they arise, with the captive settling balances on a quarterly or other basis.

Financial savings result from:

- Eliminating insurer risk charges and underwriting profits
- Cash-flow advantages (e.g., paying premiums at the beginning of the year under annual “in-advance” or “pre-cession” models, with claims paid out after they occur each quarter; investment returns on long-tail risk reserves)
- Improved control of claims and claims management
- Enhanced control over pricing and rate settling

Nonfinancial benefits include:

- More control over benefit design and policy terms, such as exclusions, free cover limits and event limits
- Flexibility to make *ex gratia* payments that a commercial insurer would decline to accept
- Access to better financial and claims data to help design and carry out demand-side initiatives

The chart below compares typical multinational pooling and captive approaches to a “before” starting point, which is typically commercial insurance. Moving to the right reduces frictional costs, including insurer profit loadings and risk charges. A key element under a captive model is that the fronting insurers/insurance networks typically serve as third-party administrators, and they are passing back (or retroceding) the risk to the captive.

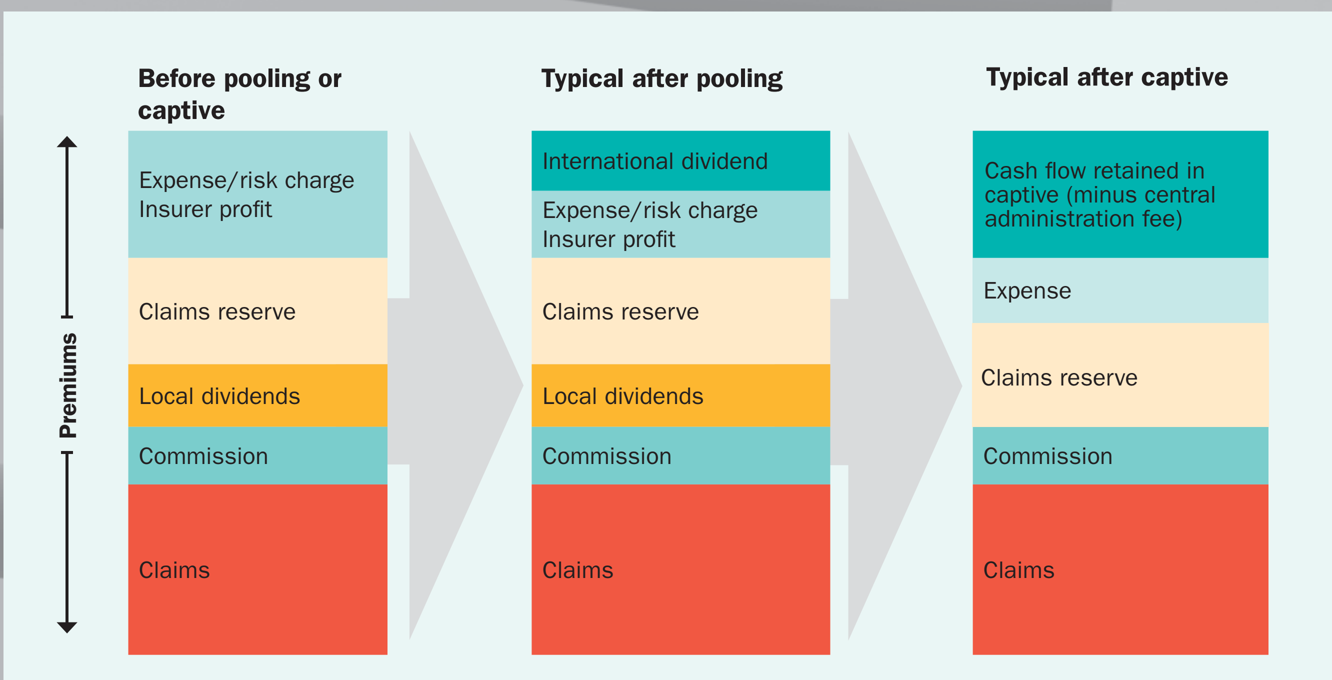
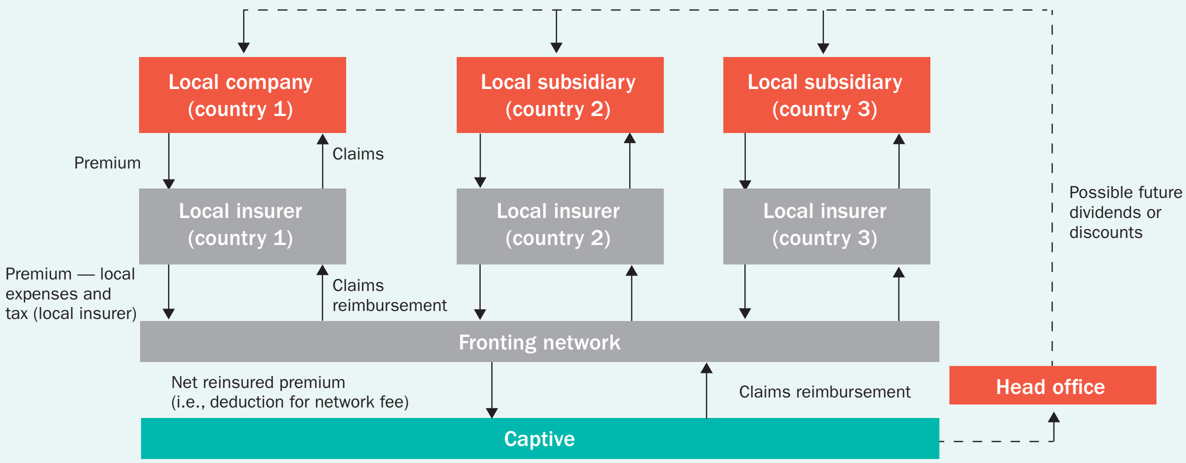


Figure 13. Overview of reinsurance-to-captive model



The graphic illustrates a typical reinsurance-to-captive setup. This is the most prevalent captive approach for financing employee benefits across multiple countries.

"The number of employee benefit captives has doubled in the last five years. Based on current activity, they likely will double again in the next three years.

Fifty-two captive reports spread across five insurance networks were submitted by 14 research study participants. Two-thirds of the reports (67%) showed a positive cash-flow balance.

Companies retained US$37 million in earnings from premiums of US$726 million, after claims and expenses were settled.[1] This produced an average captive surplus of 5.1% of premiums reinsured (or transferred) to a company's captive, calculated as total captive surplus divided by total premium reinsured.

Figure 14. Number of captive reports received by network

Network	Number of captive reports
Allianz	2
Generali	30
IGP	3
ING	0
Insurope	0
MAXIS	13
Swiss Life	0
Zurich	4
Total	**52**

This 5.1% result for captive arrangements is similar to the average return in the multinational pooling data (6.1%). At first glance, this is surprising because we would expect the average return to be higher than for multinational pooling, since insurer risk retentions and other costs have been stripped away in a captive solution.

The source of the difference is found in the medians. The median profit for a benefit captive is 11.3%, compared with 1.4% for multinational pooling. The data show that most captives make a profit, but a small handful of captives with very poor results bring the average down.

In addition, some companies run their captive programs close to break even, rather than as profit centers, and they provide significant local premium discounts through a centralized approach to pricing. These discounts represent additional savings beyond the results shown above. If we exclude these captives from the data, the average profit generated more than doubles, to over 11%. This suggests that the overall value of using a captive for financing employee benefits around the world can be understated.

[1]These statistics do not take into account direct writing models and independently fronted agreements, such as those made with an expatriate medical vendor. These transactions would typically occur outside of the multinational insurance networks.

Note: Premium amounts included in the study are premiums paid by local subsidiaries. In some cases, these reflect discounts such as those generated by a centralized approach to pricing.

Geographic Considerations

For captive premium volume, the top five countries are Canada, France, Mexico, the U.K. and the United Arab Emirates. Canada and France together account for 44% of the total premium volume, and most of the captives include significant premium volumes for these two countries. Captives in all of the top countries have large volumes of medical plans and disability annuities.

Although we do not go into detail here, it is interesting to note that the top countries vary between multinational pooling and captives in large part because overall multinational pooling premium volumes include retirement plans that are insured, but captive premiums do not. Retirement plans often have large annual savings premiums associated with them, distorting the true picture of risk benefit premium volumes. Also in some countries, the premiums are often difficult to break out under bundled contracts of retirement pensions, death benefits, dependents' pensions and disability pensions.

> "1.5 is the average number of reinsurance agreements with insurance networks, per company."

Profitability of captive business also varies by country. The five best performers are Guernsey, Japan, Germany, Belgium and Italy. Again, most of the countries differ from the multinational pooling top 10, with only Japan, Mexico and Spain making both lists. The lowest five performers are Denmark, India, Egypt, the U.K. and Guatemala.

As with multinational pooling, companies need to assess their experience over time and make informed decisions about inclusion of specific countries in their program and pricing decisions.

Figure 15. Ten most profitable countries for captive business

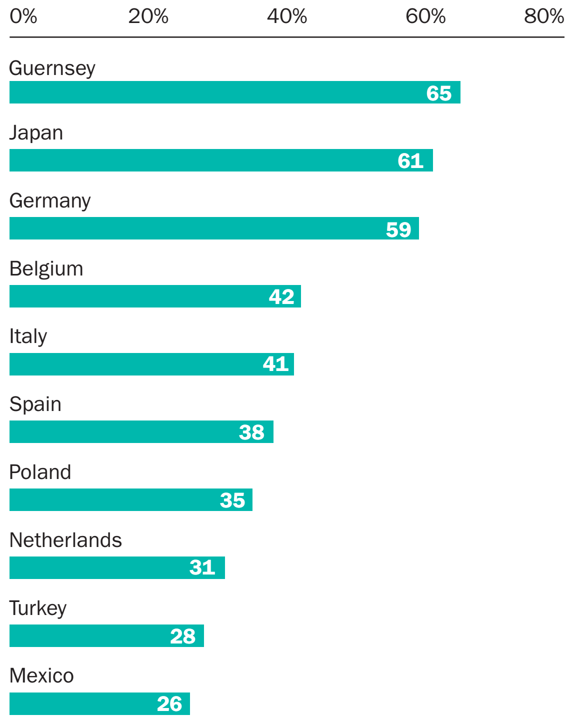
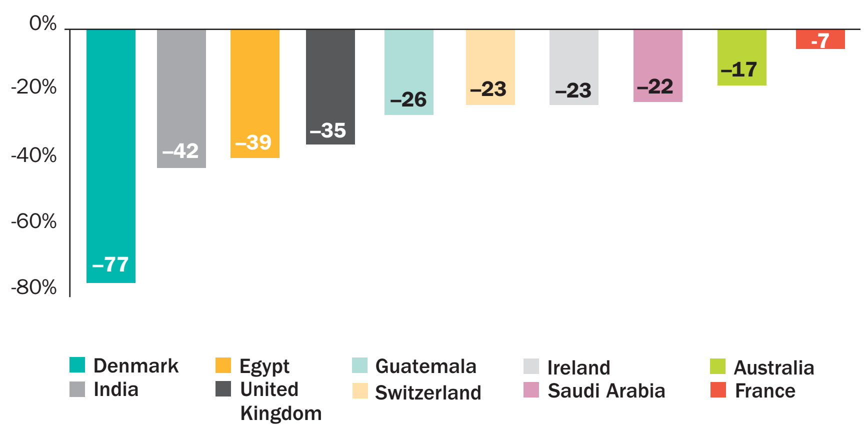


Figure 16. Ten least profitable countries for captive business



"By using a captive, companies can take advantage of the large risk and profit margins found in many countries."

For life-only contracts in captive arrangements, the most profitable countries delivered well over 50% of the premium volume as retained profit. In Belgium and Japan, which are tariff countries, local insurance pricing is mandated by the regulator. Tariff-related pricing is typically more prudent than in an open commercial market, so including such contracts in a captive can release significant value.

The U.K. and Ireland stand out as poor performers. Ireland, in particular, has produced significant losses for captive participants, and the U.K. is struggling with competition pressures in its markets. Companies should regularly assess these two countries when making captive decisions.

Variations by Type of Business

Italy is the best-performing country for medical-only contracts in captive arrangements. India is the worst, likely because pricing in India is not in line with medical cost inflation trends and the underlying risk. As a result, we see big losses as insurers look to buy business. This likely will change over time, but companies should set pricing for medical-only contracts in India at a sustainable rate when considering it for their captives. Companies also should regularly evaluate the U.K., as the same competitive pressures negatively affecting life-only contracts also are affecting the performance of medical-only contracts.

Companies often express concern about placing medical-only business in a captive, but the study validates our experience that it can be effective to transfer some medical-only business to a captive as long as the company understands and monitors the plan and its experience.

Contracts for other business can yield profits greater than 60%. Other business, which includes disability plans and bundled contracts, such as combined life and medical plans, shows profits of more than 60% in the five most profitable countries. This represents huge economic value that companies can tap.

Of the bottom five countries for other business, Denmark was the greatest concern, with high claims and reserving resulting in deficits greater than 100% of total premium.

Figure 17. Five most profitable countries for life-only business captives

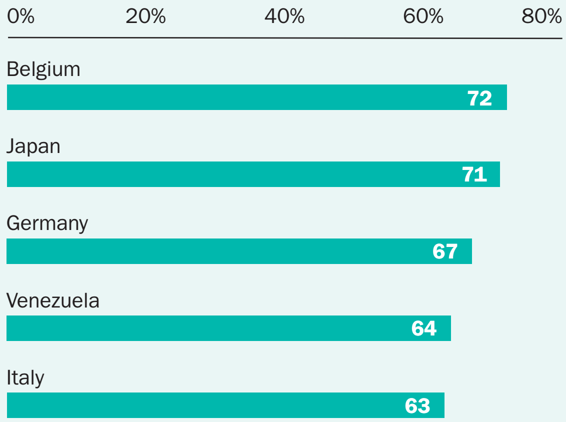


Figure 18. Five least profitable countries for life-only business captives

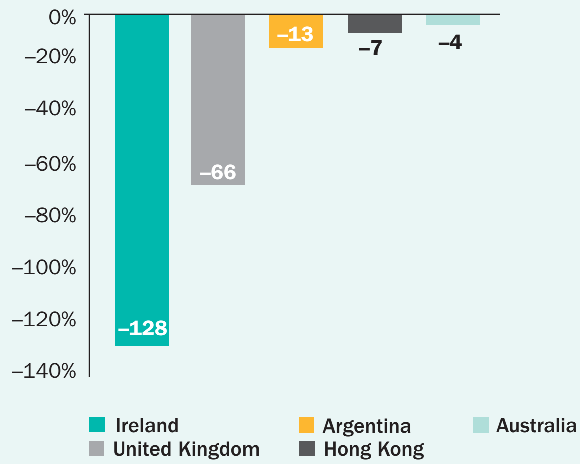


Figure 19. Five most profitable countries for medical-only business captives

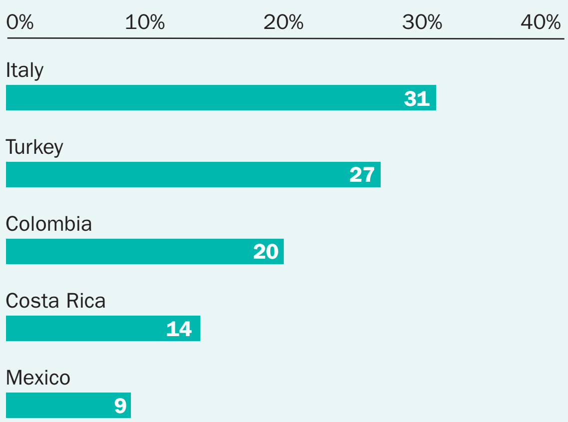


Figure 20. Five least profitable countries for medical-only business captives

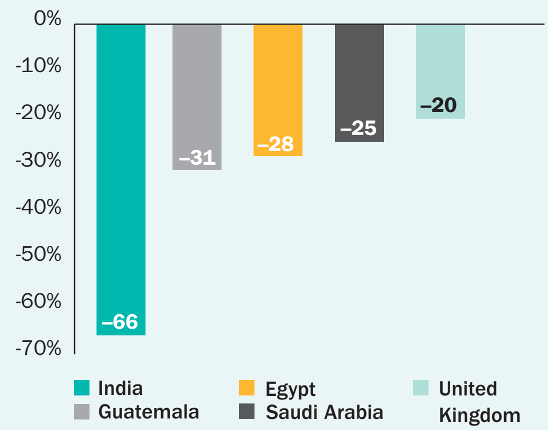


Figure 21. Five most profitable countries for other business captives

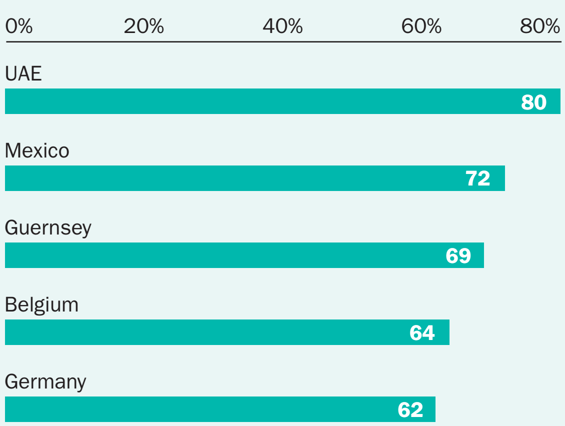
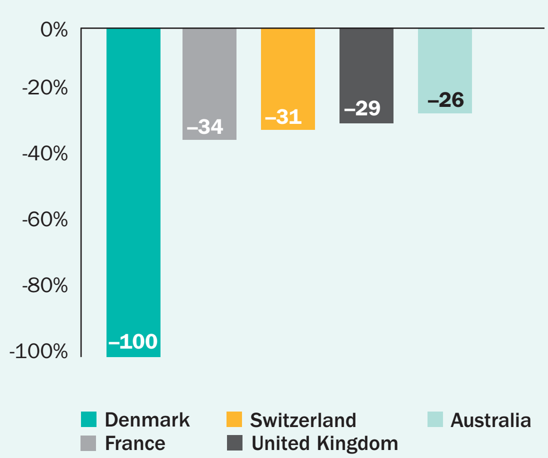


Figure 22. Five least profitable countries for other business captives



Enhancing Success

Following are lessons learned from the companies finding the greatest success with their multinational pooling and captive strategies:

Active management is critical. We examined more than 250 pooling reports that reflected negative returns as well as a large number that showed several years of deficits. Many of these pools seem to have been set up on a "convenience" basis (e.g., a multinational pooling overlay added to contracts already in place) and given only limited attention.

Successful companies are taking steps traditionally associated with risk management in other fields, such as property and casualty risk programs. They are, for example, regularly reviewing contracts within and outside their multinational pooling programs, so they can make informed assessments at renewal time about whether to keep or add a contract in a pool. Factors they are considering include the level of network retentions and reserves being held, and whether the most appropriate reinsurance mechanisms and risk methods are being applied, given the nature of the covered risk.

Prudent companies are also reviewing their local profit-sharing arrangements to assess their net value. Removing them may result in lower up-front premiums and/or higher returns for the multinational pool. Local profit-sharing returns averaged 4.35% of pooled premiums across the studied pools. Similarly, commissions paid to intermediaries should be assessed periodically to ensure that the services rendered represent good value for the money.

Relationships should be leveraged. Leveraging global relationships internally, and using fewer preferred pooling providers externally, is critical to securing the best terms and expanding pools.

Building good relationships across its businesses and geographies improves a company's ability to influence and enhance local insurer appointments. Today, only a small (albeit growing) minority of headquarters teams have the power to control decisions about local appointments.

Benefit leaders need to engage local country management better in the rationale for aligning with the company's multinational pooling or captive strategy. Savings can be made both in up-front premiums and from enhanced returns from expanded multinational pools or captives as new contracts are added. In addition, the larger spread of risk included in the multinational pool or captive can be expected to reduce the overall volatility of experience, depending on the risks included. In turn, this can reduce risk charges in multinational pools, or the need for reinsurance within a captive.

Improvements in contract terms and provider service through the application of global and local service-level agreements should also be a goal. While these concepts are not new, the study confirms that multinational companies that apply them systematically and thoroughly save more money on a global basis over the long term.

Ensure multinational pools/captives are balanced. Our results show the importance of maintaining a balance of contracts included in multinational pools. Pools comprising greater than 50% medical-only business and/or similar volumes of U.K. disability or life risks are likely to be extremely volatile and therefore require a higher (and more costly) degree of protection.

At a more strategic level, leading companies are identifying the global strategy that best balances their overall risk exposure with their risk tolerance, and applying it consistently. Many focus on employee benefits initially, but some also consider the interaction with other risks for their organizations, such as property and casualty risks.

Explore opportunities to reduce up-front premiums. Multinational pooling and captives provide excellent information on premium and claims ratio history that can be used to help negotiate lower premiums, instead of waiting for annual dividends to be distributed from pools. For example, many multinational pooling reports showed returns of 15% or more annually. In some countries, the returns for life-only, and combined life/medical contracts, exceeded 20% for three years or more.

Remove poorly performing contracts. There is potential to exploit market dynamics when insurers seek to maintain market share at the expense of profit margin, particularly in competitive market conditions. This has occurred recently in some economies hit particularly hard by the world economic crisis, and on a more sustained basis for certain countries and/or contract types. Exploiting such conditions requires removing contracts from multinational pooling or captive arrangements when local premiums are so low that they lead to contract losses.

Achieving this requires:

- Market intelligence about different countries and contract types
- Effective management information about the multinational company's contracts in these countries
- Access to experience and insights about strategy and tactics to exploit these opportunities
- Effective governance and decision making within the multinational company, including between headquarters and local offices, to translate this intelligence into cost savings

Companies that do not have this market intelligence or the resources to obtain it and keep it updated in different markets may look for sustainable long-term pricing rather than shopping around each year.

Explore feasibility of a captive. The number of employee benefit captives has doubled in the last five years to approximately 70, and captives are now an established part of the employee benefit landscape for multinational companies. Companies with large multinational pooling arrangements tend to have an easier transition to a captive strategy and solution, especially if they pool with a network that is also strong in captives. As our data illustrates, captives can provide even greater opportunity for financial savings, particularly for companies with the capacity to take on additional risk in employee benefits on a global basis. So captive strategy and solutions should be considered carefully: Most large-to-midsize multinational companies that assess this properly find they have such capacity.

Avoid common pitfalls. A number of common pitfalls reduce the returns companies achieve from multinational pooling and/or captive solutions, including:

- Inconsistent service at local and headquarters levels
- Inadequate or inflexible support and lack of transparency
- Disproportionate focus on companies' larger operations versus their smaller operations
- Weak data management, especially to inform financing decisions
- Poor alignment with overall strategies

Some multinational companies are adopting approaches and techniques to address these pitfalls and enable sustained success, in particular by combining clear strategic priorities, aligning excellent execution to support the strategic direction and avoiding distractions.

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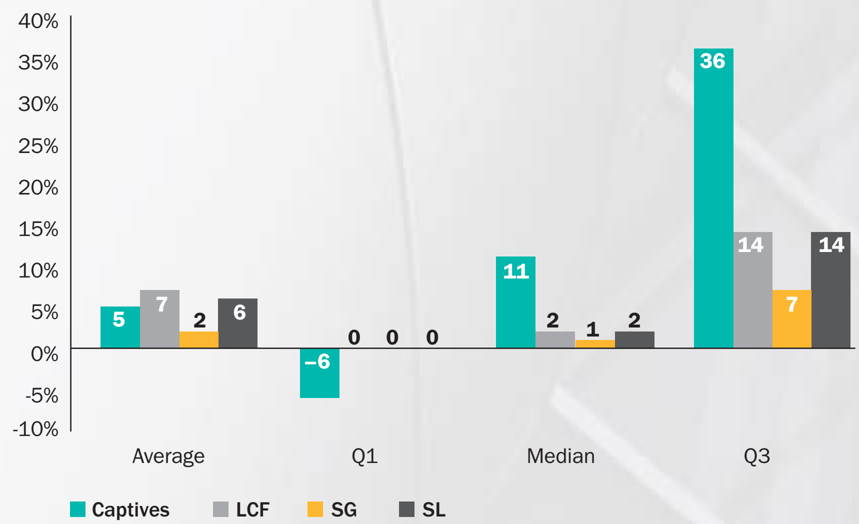
Conclusions

Multinational pooling and captive solutions can help companies manage their global benefit costs, while providing data and insights that are critical to effectively managing their employee benefit programs around the world.

Our study confirms that:

- Multinational pooling is profitable for most companies.
- We see significant cost-saving opportunities for many companies, in return for taking a more proactive approach to the management of their pooling arrangements.
- A captive approach can yield high returns.

Figure 23. Profitability of multinational pools and captives



Multinational pooling is profitable for most companies and the rewards for well-run pools can be significant. Captives can yield even further savings.

Determining the optimal position for your company

Figure 24 provides a frame of reference to help companies determine the optimal approach for their circumstances. For example, multinational companies with 1,000 employees make different choices, and have different risk tolerances, than organizations with more than 50,000 employees.

Figure 24. Optimal benefit financing approaches by size and spend

Frame of reference to help determine optimal financing strategy for insurable benefits

Number of employees worldwide	Under 1,000	1,000 to 10,000	10,000 to 30,000	30,000 to 50,000	Over 50,000
Annual spend on risk benefits	<$1m	$1m to $5m	$5m to $15m	$15m to $30m	Over $30m
Typical optimum approach	A multiemployer pool	Managed multinational pooling • 1 network • Could include traditional or natural pooling	Managed multinational pooling • 2 – 3 networks • Proactivity on "key" success factors	Pooling or captive as primary vehicle • 2 – 3 networks • Could involve pooling "on the side"	Coherent, multitier strategies **Example A** / **Example B** Tier 1: Self-insured / Self-insured managed Tier 2: Captive / Multinational pools Tier 3: Low priority for cost / Oversight of "placement"

Advantages	• Some cost synergies
	• Best available for smaller multinationals
		• More cost synergies for limited management time commitment	• Further cost synergies
			• Optimal use of multinational pooling
				• Closer to self-insurance
				• More direct control/ governance
					• Optimal strategy recognizing:
					  • Different sizes of operations
					  • Specifics of business

Factors to consider in addition to global scale	• Where employees are located — concentration; particular countries/regions • In-house expertise/experience in this field — typically in HR and risk management • Risk tolerance • Concentration of risks relating to risk benefits (e.g., high earners)				

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AECOM Technology Corp.
Air Products and Chemicals Inc.
Alcoa Inc.
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Harlequin Enterprises Ltd.

[C] participants submitted a captive report. [C+P] participants submitted both a captive and pooling report.

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