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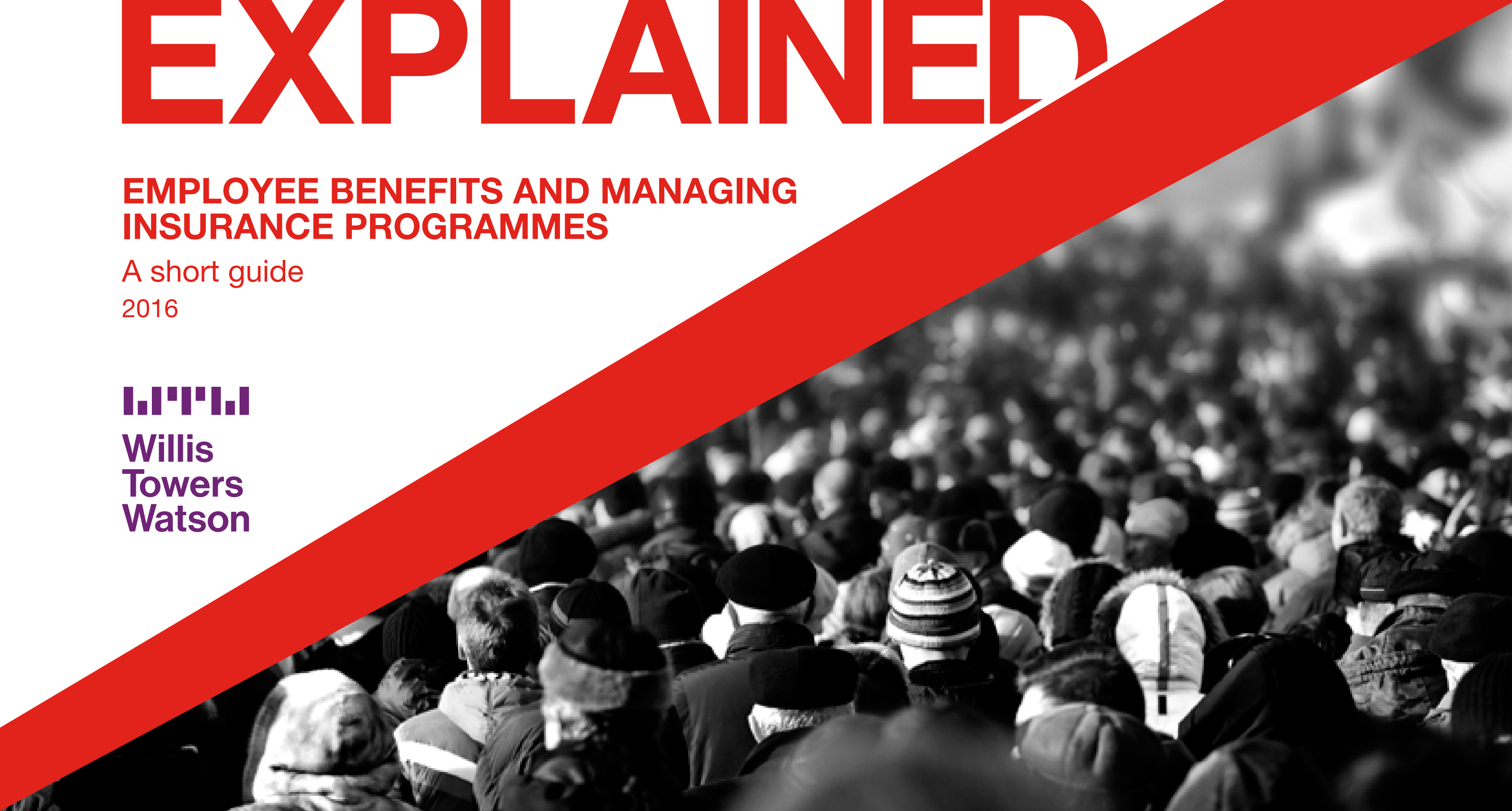
EXPLAINED

EMPLOYEE BENEFITS AND MANAGING INSURANCE PROGRAMMES

A short guide

2016



Willis Towers Watson

Acknowledgements

About Willis Towers Watson

Willis Towers Watson (NASDAQ: WLTW) is a leading global advisory, broking and solutions company that helps clients around the world turn risk into a path for growth. With roots dating to 1828, Willis Towers Watson has 39,000 employees in more than 120 countries.

We design and deliver solutions that manage risk, optimize benefits, cultivate talent, and expand the power of capital to protect and strengthen institutions and individuals. Our unique perspective allows us to see the critical intersections between talent, assets and ideas — the dynamic formula that drives business performance.

Our distinct, connected perspective across talent, assets and ideas unlocks potential for our clients. While many just look at mitigating the downside, we see how a unified approach to people and risk is a path to growth.

Powered by market analytics and behavioural insight, our integrated teams reveal hidden value within the critical intersections of our clients' organisations. We design and deliver solutions that manage risk, optimise benefits, cultivate talent and expand the power of capital to protect and strengthen institutions and individuals.

Willis Towers Watson

Tracey Skinner

Tracey Skinner acted as Executive Editor for this Guide and thanks for performing this role are extended to Tracey by Airmic.

Tracey joined BT Group plc in October 2012 as Director, Group Insurance & Risk Financing.

Her responsibilities are to provide the optimal risk financing solutions for BT Group lines of business and to give advice and support to the business to enable them to manage their risks more effectively. Tracey's team has responsibility for financing all corporate general risks, employee benefits and any external insurance for customers.

Tracey started her career with Broker Aon where her working life commenced in a claims broking environment. She transferred to a client management role after a short time. Later she transferred to broker Marsh where in 2000 she worked in the telecommunications and media area, looking after a selection of global clients in this fast developing industry.

She transferred to the client side working as Global Risk and Insurance Manager for Orange Business Services (global arm of France Telecom) in 2003, in the UK and later in France. In 2009 Tracey took on the role of VP Mainland Europe for Deutsche Post/DHL, where she had the responsibility of first building her team to develop solutions and service for over 150 business partners in 38 countries. Finally in 2012 she joined BT in her current role.

Chris Mcgloin

Thanks are also extended by Airmic to Chris Mcgloin, a past chairman of Airmic, for his contribution to the production of this Short Guide

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1 Executive summary

In today's world of rapid change and new developments, business leaders recognise the importance of the need to take a holistic approach to managing exposures and risks across their organisation.

In addition to new risks caused by changing legislation, emerging technologies and sustainability issues, there are emerging cultural pressures due in part to people mobility driven both by opportunity and economic uncertainty. Changes and developments have an impact across all areas of the business, including exposures and risks associated with employee benefits (EB).

Organisations have sought to formalise an integrated approach to risk through the development of business wide risk management programmes. These are often termed enterprise risk management (ERM) programmes as they apply across the whole business enterprise.

A successful ERM programme should operate within existing business processes and structures and drive a shared understanding of risk - and risk responses - across the organisation.

Historically EB have not always been a priority for full inclusion within the ERM strategy. This is changing through recognition of the real advantages to the organisation. The techniques of risk financing and risk management are being focused on understanding EB risk - and how to shape and manage it.

This guide outlines the evolution of the management of EB risks and highlights the opportunity for companies to manage such risks to bring additional financial and other value to their organisations.

This guides is intended to be used by Airmic members starting out in their career in the profession, for those who may be new to this subject, or to share with their business colleagues in areas such as procurement, finance, human resources, IT and internal audit.

This short guide covers:

- How ERM as emerged as an important tool for organisations
- The critical role for employee benefits in a successful business
- The costs of employee benefits
- Risks associated with the provision of employee benefits
- How multinational companies manage employee benefit risks

Readers will find it useful to read this guide in conjunction with the following Airmic short guides:

- "Explained - Risk and Managing Risk " summarises current approaches to ERM referencing relevant international standards

- "Explained - Insurance and Managing Insurance" outlines the insurance buying process for EB and other insurances

- "Explained - Captives and Understanding Captives" provides a useful introduction of the role of the captive insurance company in financing EB and other risks.

2 Evolution of employee benefits

Traditionally, risk financing was a local decision - typically around the use of insurance. It was a matter of finding the best insurance program that could be purchased from the market usually by selecting a local insurance broker to approach insurers.

For multinational companies, there was little coordination of approaches across countries or even within countries on different lines of risk or for different parts of the company. This applied across all forms of risk/ insurance for the enterprise including general insurance and life insurance. Similarly, management of EB including pensions was decided by each local business operation rather than with help or involvement at the global/ group level.

2.1 Emergence of enterprise risk management

Risk financing approaches evolved during the 1980s/1990s towards a more coordinated sourcing of brokers and insurers. This coordinated approach also aided risk managers in their quest to gain better understanding of the risk profiles of exposures across business and geographical lines, which led to improved and co-ordinated risk management techniques.

Another key development - starting in the early 2000s, spurred by the Sarbanes Oxley Act (in 2002) in the US and reinforced by the 2008 financial crisis - was the requirement of public companies to ensure risk management was at the top of the boardroom agenda.

Understanding risk and being able to demonstrate risk oversight and management became a real priority for business leaders. These developments meant that there is a higher expectation for companies to understand their risk exposure. Increasingly, risk and insurance teams in companies are tasked with understanding the full suite of risk exposures, identifying tolerance levels and ensuring a strategic approach to the balance between risk retention and risk transfer, as well as risk mitigation and control.

As a result, businesses now seek to develop coordinated global risk management strategies. Figure 1 illustrates how risk management has evolved over recent decades.

Figure 1 Evolution of risk financing and risk management

Traditional

Local decisions:

- Insurers
- Brokers
- What to insure/self-insure

Little / no coordination

Lack of understanding of data/risk profile

Service providers as a commodity

Coordinated Sourcing

Use of preferred providers (insurers, brokers) as trusted advisers to enhance risk management

Globalisation of some insurances, potentially including global underwriting e.g. property, liability

Some understanding of risk profile e.g. site assessments, risk modelling

Coordinated by Group team e.g. risk/insurance/in-house broker

Enterprise Risk Management

Local and group levels standard approach:

- Risk assessment
- Risk tolerance

Strategy informs key decisions e.g. risk retention vs risk transfer

Global infrastructure to facilitate risk management strategy e.g. captives

Full understanding of loss scenarios

Centralised provider service models, including fee transparency and governance

Provider activities support risk management strategy

Coordinated by Group team e.g. risk/insurance/in-house broker/ captive manager

2.2 Embracing employee benefits within enterprise risk management

This approach is now being adopted across employee benefits. Increasingly the management of EB is being considered on an enterprise-wide basis, with a growing understanding of the business advantages and financial gains available. Increasingly, multinational companies are taking a global view of risk - with risk budgeting at group level - leading to an understanding between and across different risks. This increased focus is leading to a data-informed strategy, rather than transactional risk mitigation, for example through traditional insurance placement.

For EB, key financial risks relate to defined benefit (DB) pension/ retirements, healthcare and other insurable employee benefits.
For some companies, applying an ERM approach to EB risks is validation of a journey they are already on; whereas for others, it can help make a fast start.

> "Risks associated with people are climbing up the risk management and risk financing agenda. This reflects an increasingly challenging and competitive world where people are recognised as a source of risk and talent a source of competitive advance"
>
> *Julia Graham Deputy CEO and Technical Director Airmic*

3 Employee benefits - explained

Taking a holistic view of EB risk involves considering the role of employee benefit plans.

3.1 Managing human capital

A key asset that every organisation needs to manage effectively is its people, or in other words, its "Human Capital". Effective management of human capital within the overall HR strategy is critical to business results and therefore maximising shareholder value. Aligning the human capital model to the business strategy is important for achieving the desired outcomes as illustrated in Figure 2.

There are different risks attaching to human capital and how they interact is important. To get the most value from their human capital companies focus on the key areas of:

- Ensuring an appropriate total rewards package for employees which includes the elements of compensation and employee benefits

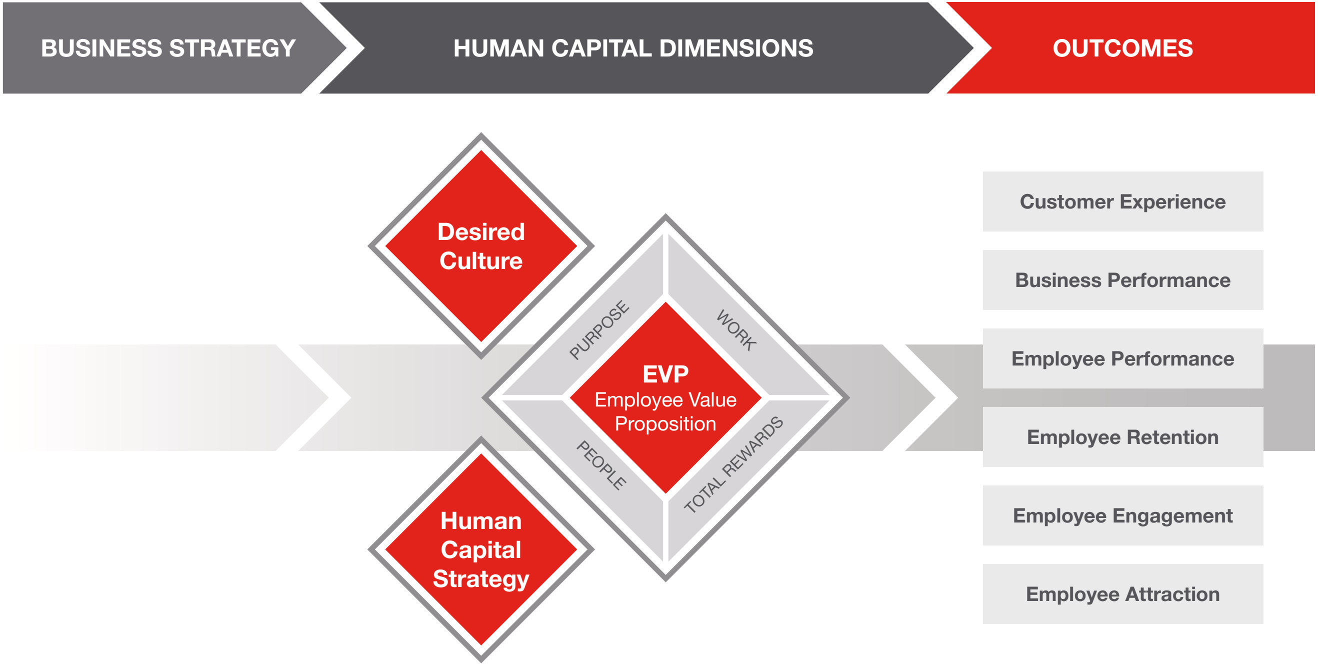
- Improving employee engagement to maintain a motivated workforce and also drive down absenteeism

- Managing key talent, including tailoring rewards to fit the individual career objectives of promising management staff.

- Managing the financial risks and exposures embedded in EB

The Employee Value Proposition is central to the model and a significant part of this is total rewards. An employee's total reward package is fundamental to ensuring the right talent is attracted and secured by every organisation.

Figure 2 Aligning human capital to business strategy and the business model



2.2 Employee benefits – summarised

Employee benefits (EB) are a key part of the reward strategy - and the focus of this guide. EB vary in different countries across three pillars of provision:

- Government
- Employer; and
- Employee

Government-provided benefits are often called Social Security or referred to as state benefits. The underlying level of benefits usually covers all citizens and is paid for typically through payroll and income taxes.

Employer-provided benefits include:

- Employee benefits which employers are required to provide by law, also referred to as statutory or mandatory benefits. These plans are often managed by employers. There is an increasing trend by governments to move to these plans instead of - or to supplement - social security

  These include benefits required under labour law – either directly, or under Collective Bargaining Agreements or similar agreements with employee representative groups of various forms, such as Works Councils or unions. Examples include termination indemnities that are paid on an employee leaving service of an employer and requirements relating to time-off.

- Employee benefits which employers provide voluntarily. Such employer-provided benefit plans have typically grown up within the social security/ mandatory environment in the relevant country, which tends to influence the level and design of benefits provided by the plans which employers provide voluntarily.

We should note that EB provided by companies can include an array of options. They include:

- Retirement savings and pension benefits
- Healthcare coverage including medical, dental and optical benefits
- Other insurable benefits such life coverage, short and long disability, accident and travel accident plans
- Vacation and other leaves of absence, including health-related absence
- Allowances, eg for housing or education
- Profit sharing plans based on performance measures
- Company cars or allowances
- Other perquisites, such as catering arrangements/meal allowances, travel support, sports/fitness arrangements, arranged discounts,

This list is by no means complete, but illustrates some of the benefits that are provided. EB provision in each country tends to be driven by a number of factors: legislation, extent of social security provision, market dynamics such as provider capability and the company's total reward strategy.

Retirement, healthcare and other insurable benefits typically represent the most significant financial risks for multinational organisations. Figure 3 summarises key features of these benefits.

"High-performing companies have health, well-being and associated employee benefits at the heart of their strategic thinking. Employee benefits can help the company attract and retain talent - but these covers must be integrated into the overall business model and operate to the same professional standards and budgetary considerations as any other aspect of risk management or insurance."

John Hurrell CEO Airmic

Figure 3 Retirement, healthcare and other insurable benefits

Empoloyee Benefit Type	Description
Retirement / pension plans	Retirement benefits are essentially to assist employees in their retirement. Social security in most countries is the baseline assistance an employee will get when they are no longer working due to old age. However, social security benefits tend to be limited in amount and/or in the portion of pay which they replace. Hence employers provide additional retirement benefits which are usually able to be accessed from a certain age, typically over age 60 or 65. Other terminology often used includes Pension Plan, Pension Scheme, Savings Plan, End-of-service service benefits (common in the Middle East), Severance or termination benefit (which may include benefits on retirement), Deferred compensation (eg deferred until age 60 or 65) There are two key types of retirement benefit provision; Defined Benefit and Defined Contribution. **Defined Benefit** • These plans promises to pay pre-arranged pension benefits, regardless of the amount of any assets in any pension fund • Benefits are determined by a benefit formula, generally based on years of service and pay • The investments of any are usually determined by the pension fund manager • The employer bears the financial risk under these plans. **Defined Contribution** • There is no promise by the sponsor of paying a particular pension. The employee's retirement benefits depend on the balance of their account at retirement, so depend on investment returns within the pension fund, and other factors • Plan members may have some involvement in choosing how their funds are invested • The employee bears the financial risk under these plans

Healthcare	Many countries provide some level of care to which its citizens are entitled. Company plans pay for supplemental provision, such as • Private hospitals, networks • Higher rebates than provided by government arrangements • Inpatient (Hospitalization) vs. Outpatient (Clinical) • Ancillary services Dental and vision cover in some cases
Death benefit	There are two main types of benefit to be aware of: • Lump sum, often paid tax free (May be referred to as life insurance or life assurance) • Pension/annuity/income to spouse and/or children. Sometimes called Survivor income. Lump sum provision is most common around the world, but the level and complexity of such provision varies by country. In some cases, pensions may be provided in addition to - or instead of - lump sums. Death benefits are sometimes provided as part of the retirement plan
Other insurance that maybe connected to life insurance	**Accidental Death & Dismemberment (AD&D)** covers an employee for loss of life or loss of body parts or body function due to an accident **Business Travel Accident (BTA)** insurance covers an employee for dismemberment or loss of life while traveling on business. May be travel only in country of residence or overseas Some companies have a global BTA policy **Occupational Accidental Death (OAD)** is traditionally a flat sum amount for an employee who dies while working

Disability	Two types of benefit: • Pension/annuity/income • Lump sum, often known as Total and Permanent Disability Pension/annuity/income is most common for disability benefits Short term disability (STD) is paid for absence of up to 3-6 months Long term disability (LTD) “kicks in” once the STD has ended if the individual is still disabled. This may be paid for a maximum period, or until the individual recovers or retires.

Alongside more tangible aspects of the Employee Value Proposition, companies are increasingly interested in the supporting the wellbeing of their employees.

They recognise the link between improved wellbeing and:

- Greater and more sustained engagement;
- Higher productivity;
- Lower absenteeism, presenteeism and medical costs; and
- Better business outcomes.

To this end, we see companies developing health and wellbeing strategies, setting up frameworks that can encompass existing benefit plans, e.g. healthcare/medical plans, occupational health, disability and employee assistance programmes, and link them to specific initiatives, such as healthy eating, physical activity and tobacco cessation. With appropriate leadership and communication, these can become a strong component in support of a company’s EVP.

Typically, the most financially tangible risks within EVP/total rewards relate to employee benefits and, in particular, pensions/retirement benefits, healthcare and other insurable benefits.

Providing these benefits brings inherent costs and risks that need to be managed. The risks and costs are often significant enough that they affect the risk strategy of the whole organisation which means that increasingly the group reward strategy must link with and form part of the overall enterprise risk strategy for the business.

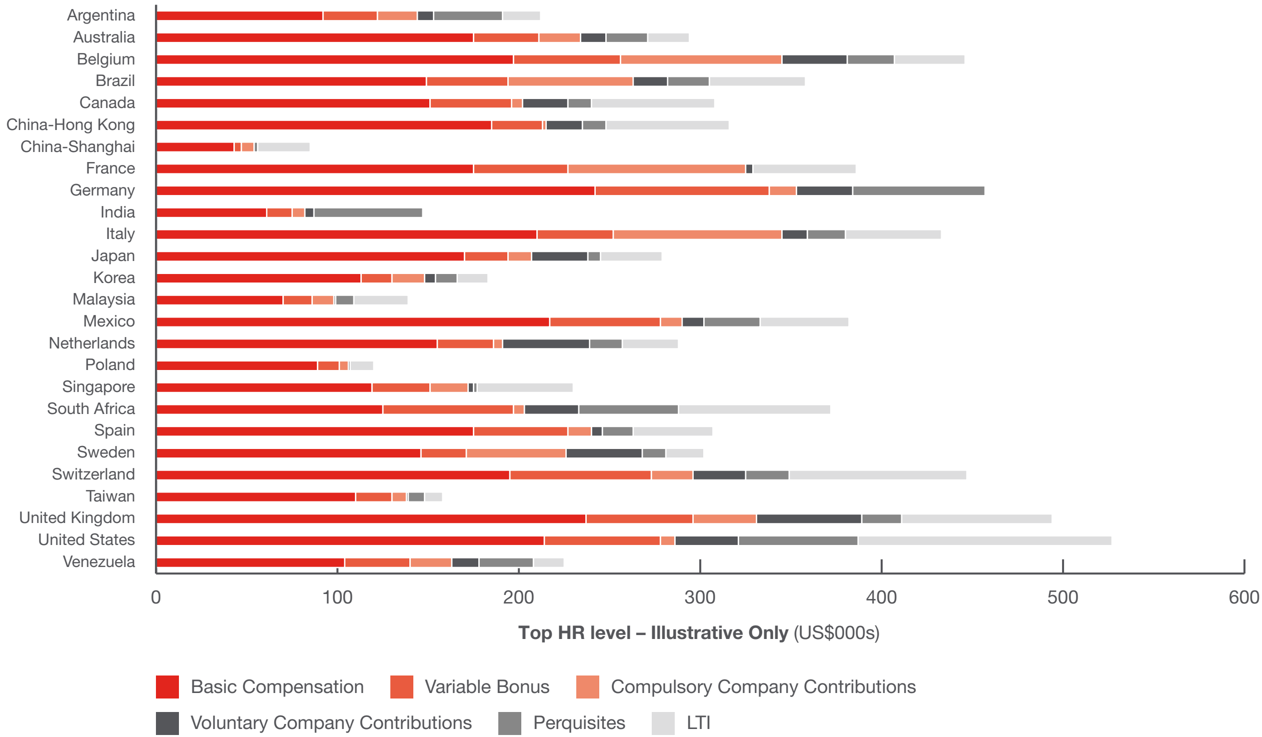
4 Understanding employee benefits costs

4.1 Illustrating country differences

Multinational organisations deploy employee benefit packages which are extensive and complex. They are tailored to the company's organisational structure, industry sector, and geographical footprint. The nature of benefits provided will be developed to reflect the requirements of each country.

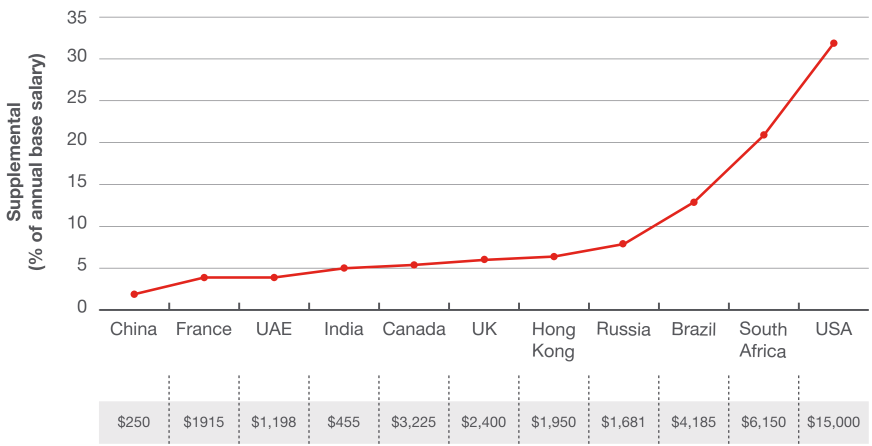
Figure 4 illustrates the differences in employee benefit provision across different countries. The chart shows, for the same level of employee across markets, the difference in compensation and benefits which a company typically provides, whether mandatory
or voluntary.

Figure 4 Benefits vary by country - in design and value and in proportion of overall package



Retirement, healthcare and other insurable benefits typically make up the lion's share of employee benefit spend for multinational organisations. Costs of these benefits vary in different countries. Let's take an example. Figure 5 compares costs of a typical medical plan across different countries for the same level of employee. A typical plan that costs 2% of basic annual salary in China, all the way to 32% of basic annual salary in the US. In absolute terms, the US has an average annual cost of USD 15,500, whereas the UK is USD 2,400 and China is USD 250.

Figure 5 Comparing the cost of a typical medical plan in different countries



What is consistent is the significance of the annual spend on employee benefits for companies.

Example: Sanofi
Consider the employee benefit risks for Sanofi (a multinational French pharmaceutical). Identified, in the table opposite, are the annual costs for the key EBs. The numbers were so large that the company began looking at a better risk financing strategy. ”What really worried us were the amounts we are spending on our medical benefits around the World and the potential damaging impact of global healthcare inflation” said Peter Blake, International Benefits Director for Sanofi.

Table 1 Summary of global employee benefit costs in 2014

Major cost components	Cost
Defined Benefit pension:	Euro 231m / 3.8% of base and bonus
Defined Contribution pension	Euro 321m / 5.3%
Healthcare, death and disability: (about 80% healthcare)	Euro 396m / 6.5% (of which US was the largest)

Total: Euro 950m which was 15.6% of base salary and bonus

Health-related costs – such as costs of absence and presenteeism – are in addition to the costs identified above, and also tend to be significant.

4.2 Facilitation through Data and technology

Few multinational companies have a good understanding of the true financial costs of their global EB portfolios. Additional focus on developing a coherent strategy is often triggered when senior leaders see the figures. Accurate and timely information will drive senior management decision.

Some companies make good use of the data and information available to them to make informed business decisions. This is facilitated through the use of preferred providers – such as insurers, brokers/consultants or administrators. Having a global strategy and platform to deliver benefits is only workable if you can receive consistent data to enable you to monitor risk exposures and costs in a timely manner to assist in making interventions that support the overall business strategy.

Sanofi are a good example. Following the identification of the EB spend and covered benefits, Sanofi put in place a captive reinsurance vehicle for all its life, disability, accident and medical plans. This allows their insurance fronting partners to deliver consistent quarterly data. Sanofi is now able to monitor claims trends, particularly on healthcare plans, which allows them to have conversations with local businesses around changes to make. Changes can range from benefit design adjustments, to co-sharing costs with employees or to introducing preventative or wellbeing initiatives. Good health and wellbeing strategy ios considered further in section 5.

5 Risks of providing employee benefits - explained

There are risks associated with providing EB programs, including the intrinsic risk of not offering a competitive package to current and prospective employees.

If EB programmes offered are less than those of competitors, there is a risk of losing good people; however if they are higher than others', the drag on company profits will concern shareholders. Companies that manage EB risks effectively do so within the risk management framework of their organisation. Understanding the correlation between EB risks and other business risks is an important part of enterprise risk management.

5.1 Outlining risks to organisations

Seven core risks come with providing employee benefits. From a risk management perspective, there is an opportunity to manage these risks efficiently. See figure 6.

Figure 6 Risks and opportunities of providing EB

Risks

- Financial
- Accounting
- Compliance
- Talent / resourcing strategy
- Fiduciary / governance
- Operational
- Reputation

→

Opportunities

- Pensions & benefits around the world:
  - Align fully with business needs and reward strategy
  - Help the workforce to be effective and engaged
- Confidence that reputation, compliance and governance issues:
  - Will not arise; and / or
  - Can be addressed without incident
- Financial optimisation
  - Cost savings
  - Pensions / benefits risk optimised in alignment with overall business financing
- Ability to demonstrate robust
  - Global pensions & benefits accounting
  - Assessment and management of underlying pensions / benefits risks
  - Actuarial planning to mitigate future cost increases

HQ Goal

Make the whole greater than the sum of the parts

5.2 Understanding pension / retirement plan risks

Pension/retirement benefits take a variety of different forms across different companies and territories. The historic approach to providing pension/retirement benefits was to make a definitive promise (or provide a defined benefit – DB) to employees, guaranteeing a set level of income each year for the rest of an individual's life after retirement. But this became increasingly costly and uncertain as bond yields and investment returns for retirement funds have varied dramatically. In an effort to reduce the costs and uncertainty of external risks associated with providing retirement benefits, the 21st century has seen a shift away from such guaranteed promises. The shift to Defined Contribution (DC) arrangements eliminates many of the external risk factors for companies.

While the shift to DC retirement programmes removes risks for the future, DB programmes still represent an historical long term obligation as these programmes wind down. For example, if a company closes its DB plan to future participants today, the plan can expect to be paying benefits over the next 60 years.

While the details of such pension benefits vary for different countries, the underlying nature of the risks involved is similar – so can be addressed coherently on a global basis.

Multinational banks are a good example of the integration of pension/ retirement plan risks with business risks. In the last few years, low interest rates and declining bond yields have contributed to increasing pension liabilities and therefore deficits in DB plans, which will have a negative effect on profits. However, at the overall enterprise level, these same factors also impact the rest of the Bank's balance sheet and overall profits. The impact on the bank's capital can have a significant impact on its ability to invest in its core business activity. So, many banks have increased their focus on their pension risks. In some cases, this includes assessing whether pension risks correlate with or offset similar risks in their broader business, eg interest rate risk, credit risk.

Figure 7 illustrates a pension risk management framework which brings together strategies of several different types. We find that “Assess” and “Monitor” are as key to success as the action types.

It should be noted that some of the actions for risk management strategy in the table above have opposing effects. For example, hedging the risk could actually increase the cost rather than shrinking it. Therefore it is imperative that the right balance is understood and achieved.

5.3 Addressing risk through co-ordinated response strategies

Financial risk is a principal risk of every DB pension plan across the world. Falling interest rates and growing life expectancy lead to increasing deficits, deteriorating balance sheets and increasing P&L costs. The role of an effective investment strategy is critical for funded plans. In particular, seeking a portfolio of assets that most closely matches the scheme liabilities, without adverse impact on asset returns.
To a large extent, managing interest and inflation risk can be mitigated by purchasing assets that behave in a similar way to the scheme liabilities. For example, purchasing a portfolio of inflation linked bonds can hedge against adverse inflation movements. Hedging against changes in mortality experience on the other hand can be more problematic; in particular where scheme members live much longer than expected, and hence continue to receive pension benefits further into the future.

To hedge against mortality risk, one option for pension plans is to access the reinsurance market to obtain a mortality hedge, whereby fixed premiums are paid from the pension plan, to the reinsurance company (via an insurer) in exchange for variable payments that are linked to actual mortality experience of the scheme.

As an example, in 2014, Willis Towers Watson set up a Guernsey based insurance cell to facilitate direct access to the reinsurance market for pension plans to allow them to avoid the additional frictional costs incurred by going through a fronting insurer. Figure 8 illustrates this structure.

Figure 7 Pension risk management strategies

ASSESS

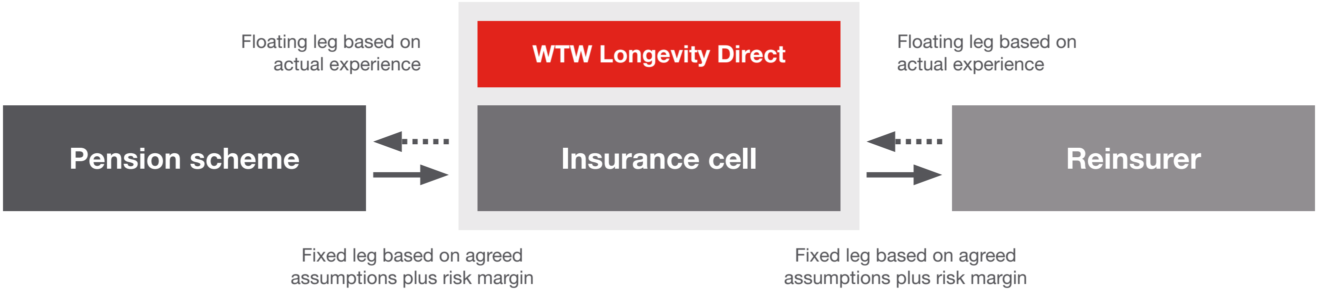
- Key metrics
- Effects of changes: corporate actions, regulatory, etc

Key Actions	Description	Typical Examples
Contain	Restrict pace of growth of defined benefit footprint	Switch benefit accrual from DB to DC: • New hires • Existing employees
Shrink	Extinguish (past) defined benefit commitments/ exposures	• Buy-out with insurer • Pay-out to individuals
Hedge	Limit volatility of financial impacts from retained commitments	• Invest pension plan assets to match liability movements
Simplify	Adjust infrastructure and/or measurements to improve ability to manage risks	• Refine actuarial assumptions • Change pension plan vehicle

MONITOR

Figure 8 Captive structure removing longevity risk from a pension plan

An insurance cell structure can be created and managed to facilitate longevity risk transactions with the reinsurance market.
The insurance cell would not retain any of the longevity risk.
Willis Towers Watson have invested in establishing a structure which will facilitate this approach for our clients.



Benefits	• The fixed costs of the longevity hedge could be lower than the traditional intermediary model • The costs are only payable for the length of time the scheme is the counterparty to the hedge • Not reliant on intermediary capacity or their preference for reinsurers • Pension scheme and reinsurer requirements for the contract may be more aligned
Challenges	• Non traditional structure so potentially more due diligence required • The economics of the transaction will vary according to the scale of the proposed hedge

It is common for employers to provide "protection" benefits to their employees. Generally social security benefits are modest, so companies provide additional support to employees. While provision will differ significantly across markets, examples of typical protection benefits include:

- Healthcare / medical
- Workers compensation (accident at work)
- Salary continuation if an employee is on long-term sick leave (or disabled/unable to work)
- Lump sum pay out on death in service, and/or pension benefits to spouse / children

Again, the details of such employee benefits vary for different countries, but the underlying nature of the risks involved is similar – so can be addressed coherently on a global basis.

5.4 Developing wellness strategies to enhance business performance

For employers, the effect of programs covering death, disability and medical expenses goes beyond immediate cost considerations. Their impact extends to employee wellbeing, productivity and engagement links. These in turn have an impact on business performance. Therein lie the principal risks associated with these EB programs. The key driver of protection and health related risks, and the principal impact of these to an organisation is the measure of how healthy the workforce is. Not only does a healthy workforce lead (through the introduction of wellbeing strategies such as healthy eating, fitness promotions and even basic education on healthy living) to overall reduced costs of health benefits, it is also known to foster higher levels of employee engagement and productivity, ultimately leading to improved business performance.

On health and wellbeing strategy, the Willis Towers Watson research through our Staying @ Work survey finds that:

"High-effectiveness organisations take a holistic view of health and productivity, and focus primarily on four vital elements:

- **Prevention**
  They offer programs that aim to keep employees healthy and encourage them to adopt and maintain healthy lifestyles.
- **Personal support**
  They address the specific health needs of employees who have health-related risks and chronic conditions. And with disabled employees, they use best-in-class return-to-work approaches.

- **Organisational support**
  They work at building a healthy workplace culture and aligning their health and well-being programs with that culture.

- **Design and delivery**
  They align their health and well-being programs with the organization's EVP, provide employees with an array of choices, leverage the latest technology and use targeted communication to reach employees where and how they prefer"

5.5 Understanding the impact of poor EB management

Figure 9 opposite summarises the consequences of ineffective employee benefit risk management, which can be severe.

As illustrated in Figure 9, three key areas are affected by ineffective EB management. People are key to most, if not all, organisations. So EB plans which do not support attraction, retention and engagement impacts business performance. In terms of the financial impact, not having a global EB strategy around the control and performance of the EB plans will mean opportunities to save money will be left on the table. Finally, legal, compliance and reputational risks are important consequences of ineffective EB management.

5.6 Illustrating roles and responsibilities

A consequence of the variety of risks (and opportunities) associated with EB, many stakeholders have an interest and/or role to play in EB management, both internal and external.

Internally there are often representatives from HR, Finance (both Treasury and Accounting), Risk/Insurance, Legal, Tax and often now Procurement. Externally, companies use a series of providers including consultants, actuaries, brokers, lawyers, tax advisers, insurers, administrators, health & wellbeing providers and investment managers. Companies vary in how they resource their activity around EB management - often depending on capacity and expertise that is available in house.

However, it is critical for effective EB management for a company to have a clear and robust governance framework which spells out the guiding principles of EB provision and how to finance and deliver them and - as importantly - the roles and responsibilities of internal and external stakeholders.

Figure 9 Consequences of ineffective employee benefits management

People Impact

Attraction, Retention and Motivation Objectives:
Plans not aligned with attraction, retention, and motivation objectives

Workfore management:
Plans misaligned with global workforce plans

Employee relations:
Changes due to financial constraints may cause workforce unrest

Financial Impact

Financial control:
Lack of control over timing and amount of financial impact

Financial performance:
Unanticipated balace sheet, P&L and cash flow effects with impact on borrowing ability, cost and credit rating

Missed opportunities:
Cost savings and synergies (investment and insurance) not realized

Legal Impact

Compliance risks:
Lack of local resources may lead to lack of focus on compliance-related matters

Impact of lawsuits:
Exposure to shareholder and participant litigation

Reputational Risk:
Impact on your brand or reputation

6 Opportunities for multinationals - explained

6.1 Optimisation through risk management

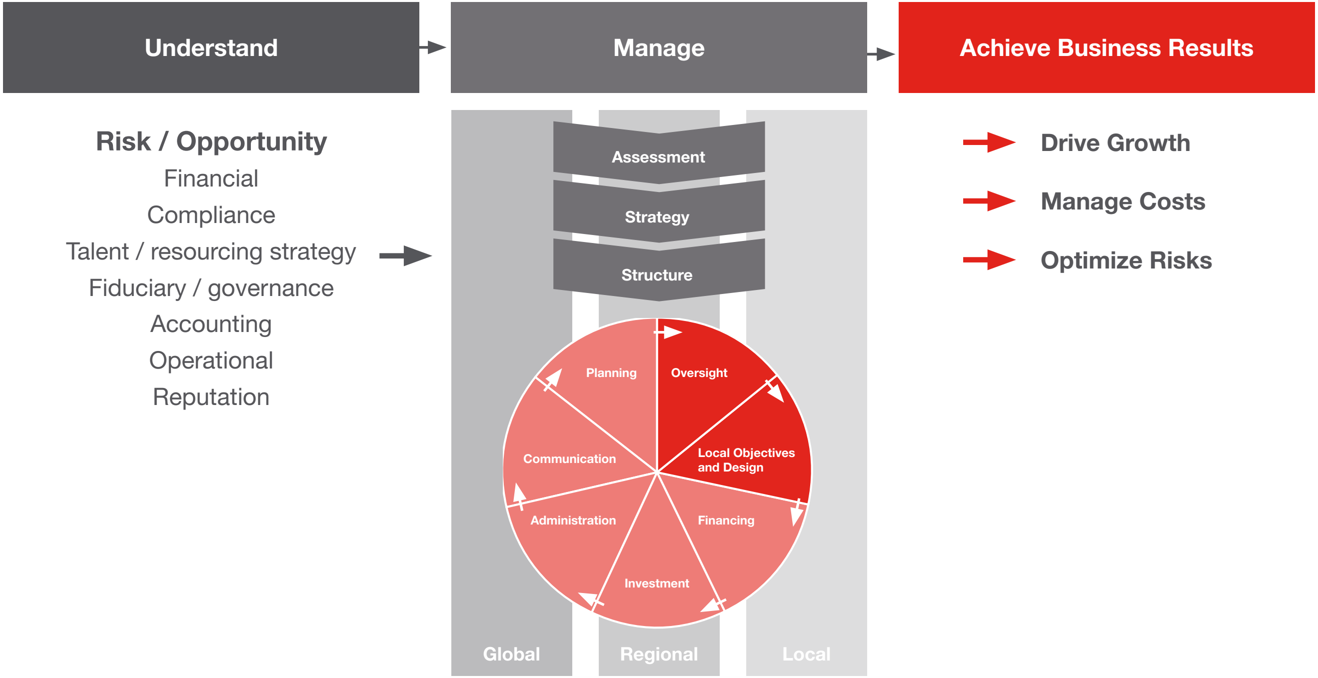
So how do companies approach the management of EB risk within the context of their enterprise risk management framework? Figure 10 illustrates key elements of an integrated approach.

If we go back 30 years or so, the traditional approach to management of EB risk was very much a local approach. The assessment of the local programs and their associated financial impacts were very much driven by the local business units that sponsored each employee benefit plan. Each business unit's tolerance for risk and willingness to engage in some management of the risk dictated how that entity dealt with the EB risk.

In the case of risk and healthcare benefits, for example, the traditional approach has been to insure, until population sizes became significant.

For multinational companies, beginning in the 1990s and into the early 21st century, there has been a shift in attitude to the management of employee benefit programs and the risks associated with them. This has been encouraged by the considerable improvement in their information and data management systems. Companies are now taking a more sophisticated and globally coordinated approach to assessing and managing employee benefit risk.

Figure 10 Effective employee benefits risk management



Focussing on financial risks, key activities are:

1. **Understanding and Analysis:** The centralised, or global approach to EB risk management begins with assessing and understanding the aggregation of risks at the group level, by first understanding the risks of the individual local plans. This analysis can uncover inefficiencies and mismatches. Once the underlying local risks are understood, they can also be correlated against other risks across the enterprise – although this is typically a later phase.

2. **Risk Appetite:** The enterprise needs to assess its tolerance for retaining EB risk, within its broader risk appetite framework.

3. **Risk Retention and Optimisation:** Once the appetite for EB risk is understood within the context of the enterprise, the strategy for risk retention needs to be determined. The most appropriate form of mechanism to deal with each risk can then be identified:

    - Avoid/contain: for example, stop offering certain benefits

    - Retain: Exposure that can be tolerated. Self- or non-insurance may be the most efficient form of financing. Risk which is to be retained should be optimised.

    - Insure: Exposure cannot be tolerated at the business unit, or indeed group level

    - Share: Partly insure, partly retain. For example, by reinsuring multinational pooling of insured employee benefits to a captive reinsurance company

    - Transfer: Pass the exposure to another party, e.g. convert accrual of DB pensions to DC, passing much of the investment and longevity risks to employees.

4. **Risk Monitoring** Introducing a framework to capture and report on key data metrics that can be used to inform the risk management process.

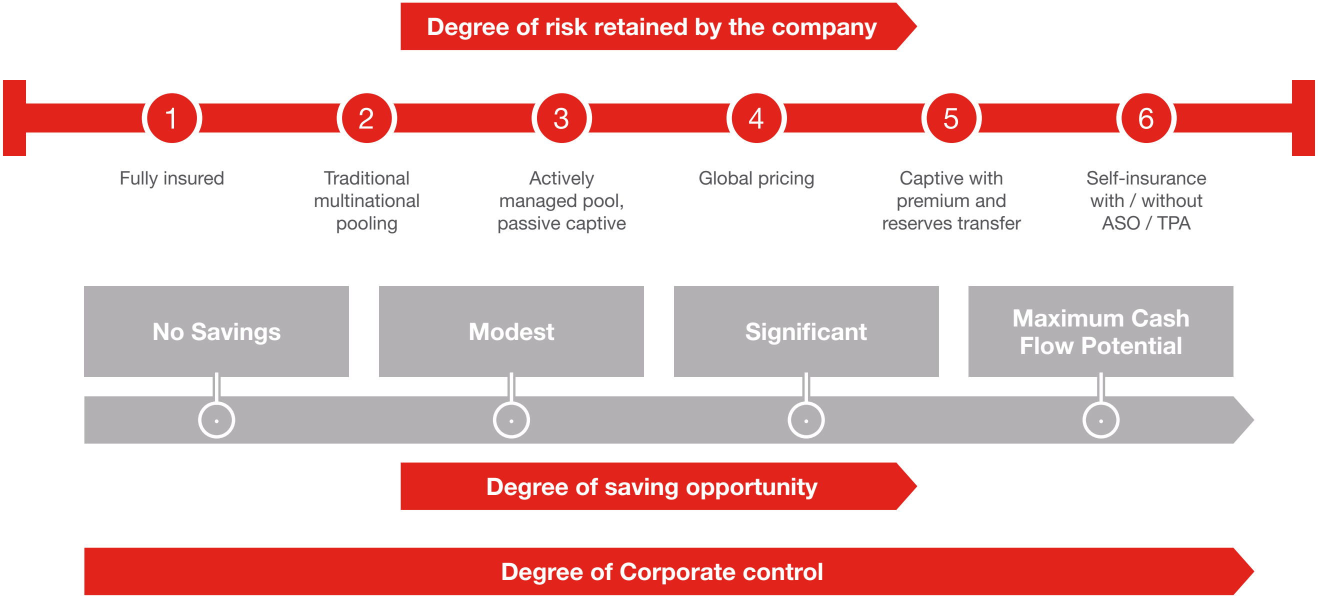
For global organisations, EB risks will typically be optimised by combining global/cross-border approaches and local approaches. Some of the global approaches adopted in other risk management/insurance fields do not translate directly for EB risks, but similar effects can be achieved.

6.2 Developing cross-border risk financing

Effective financing of employee benefit risk is an extremely powerful tool in controlling employee benefit risk. Whether we are talking about a pension plan or healthcare benefits, delivery through the most efficient financing vehicle is fundamental in delivering employee benefits in the most effective way. Many companies are reviewing their financing approaches and recalibrating them in accordance with their group risk strategy. Taking more risk, where it is in keeping with the group risk strategy, can mean reducing costs to the organisation.

Figure 11 outlines the spectrum of financing approaches applicable to employee benefits. Many companies have looked to use one or more of these approaches to help manage insurable EB risks coherently and effectively.

Figure 11 Effective employee benefits risk management



Note: In the above diagram, ASO / TPA means Administration Services Only / Third Party Administrator.

Multinational pooling of EB insurance started in the 1950s and is widely used today. Some companies manage their multinational pooling arrangements effectively to optimise the contribution to their business. Others take a more passive approach, thereby leaving “money on the table”.

The use of captives to finance global risk and healthcare is a growing trend. In 1995 companies including DHL and AstraZeneca embarked on this journey for the first time. As of today, around 80 companies are utilising employee benefit captives, with around half of those setting up in the last 5 years. The numbers continue to grow with the opportunity to benchmark and optimise such arrangements.

Some companies are using cross-border structures to facilitate consolidation of pension risks across country borders – for example, as cross-border IORPs (Institutions of Retirement Provision), asset pooling vehicles and/or pension captives. To date, this is primarily major global organisations.

6.3 Focussing on multinational pooling and captives

Willis Towers Watson undertook a research on multinational pooling and captives in 2015. The study covered over 160 companies who submitted 3 years' worth of pooling and captive reports, totalling over USD3bn in annual premiums. The study was conducted with the aim to help answer some commonly asked questions:

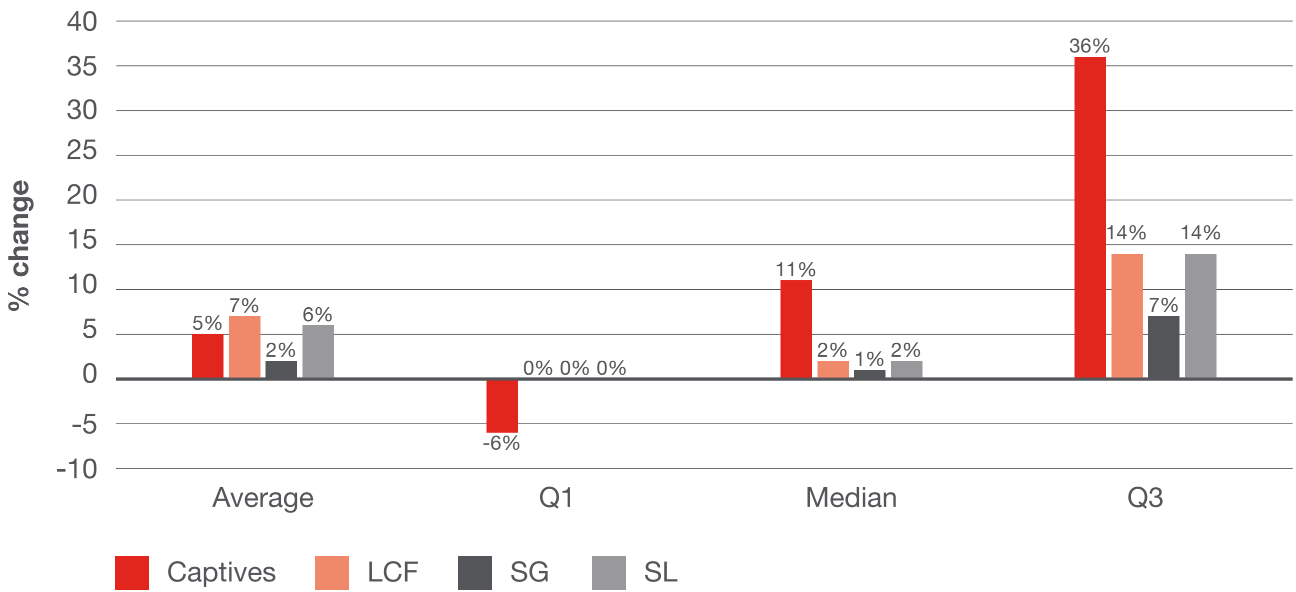
- Which countries and contracts are best for pooling and captive reinsurance, and which should be avoided?
- How do our captive results compare with others?
- How do pooling and captive results compare with each other?
- For those not involving their captive at the moment, should they consider doing so, i.e. is the gain worth the pain?

The research analysed all participating benefit plans, including life, accident, disability, medical, and some retirement plan risk related benefits, such as spouse or orphan benefits. The figure below shows how multinational pooling results across different types of pooling approach compare to a captive strategy.

The chart compares the dividend generated under different pooling methods (Loss Carry Forward, Small Groups Pool and Stop Loss) with retained "profits" under a captive approach. Whilst the averages are similar, the median and the spread between the quartiles are much higher for a captive approach.

This suggests that there is significant upside for companies which have an effective EB captive strategy – and there is more potential to be unlocked from many companies' multinational pooling or captive strategies.

Figure 12 Comparing multinational pooling results to captive reinsurance results



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

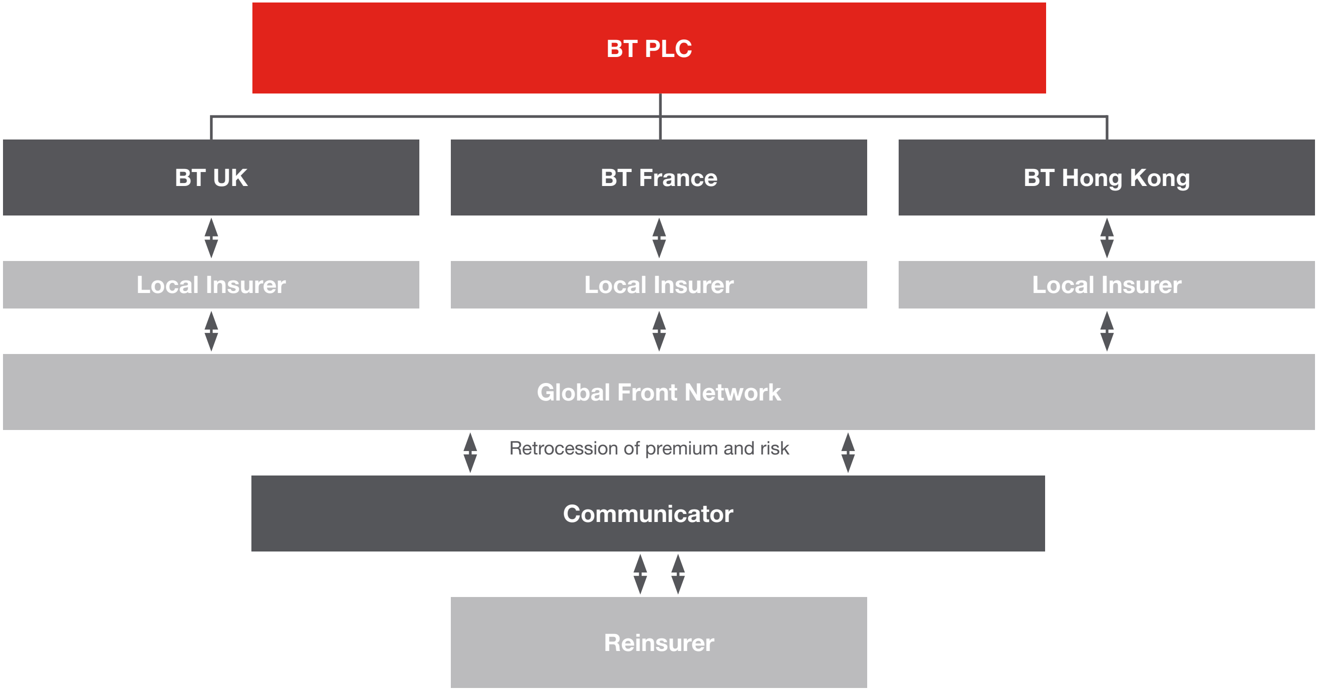
Case study

In 2010, the BT Group changed its financing strategy for delivering healthcare and insurable employee benefits globally. It switched from an insured model to a global self-insured model, by utilising its Isle of Man based captive insurance company, Communicator. Its philosophy was that, while insurance was the most efficient form of financing for its local business units, at the enterprise level it was more appropriate to retain the risk and hence profit margins that would otherwise be absorbed by insurers. With the use of Communicator for EB, BT has managed to roll in 65% of suitable business and are now looking at break-even pricing. On top of the financial benefits, BT is also gaining further control from consistent and regular data that allows the team to make real time informed decisions and interventions. Before they adopted this approach this visibility was virtually non-existent. Figure 12 previous shows the framework of the BT captive model for EB.

Tracey Skinner, Director of Insurance and Risk Financing at BT Group said "Use of the captive in this way has enabled us to diversify the risks in the portfolio. We have extended our cross class aggregate stop-loss protection purchased for the General Insurance to stretch across to the EB business. It has enabled to look at the loss data and start to identify trends and issues". Figure 13 shows BT's captive model for EB.

For many multinational companies, employee benefits represent a significant global portfolio of opportunities and risks – with a great potential to exploit and optimise.

Figure 13 BT captive model



7 Where to look for further information

- **www.airmic.com**
  EXPLAINED: Captives and Understanding Captives - A short Guide

Notes

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