airmic

EXPLAINED GUIDES

EMPLOYEE BENEFITS AND MANAGING INSURANCE PROGRAMMES

In association with: wtw

Acknowledgements

About Airmic
The leading UK association for everyone who has a responsibility for risk management and insurance in their organisation, Airmic has over 450 corporate members and more than 1,500 individual members. Individual members are from all sectors and include company secretaries, finance directors, and internal auditors, as well as risk and insurance professionals. Airmic supports members through learning and research; a diverse programme of events; developing and encouraging good practice; and lobbying on subjects that directly affect our members and their professions. Above all, we provide a platform for professionals to stay in touch, to communicate with each other, and to share ideas and information.

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About WTW

Our purpose and values

Our purpose is why our company exists. At WTW, we transform tomorrows. And our values are more than words. At the core of WTW's rich history, our values continue to define how we work with you:

- Client focus
- Teamwork
- Integrity
- Respect
- Excellence

We've been putting clients first since 1828. Many of our clients have been with us from the earliest days of our founding. Whether they first came to us for brokerage services or actuarial work, they were met with respect, a strong sense of advocacy and an emphasis on excellence. These values will continue to define our approach to business and our relationship with our clients, now and in the future.

Actionable solutions for today's — and tomorrow's — challenges

WTW is uniquely positioned to see the connections between talent, assets and ideas, and how they lead to strong performance for our clients.

wtw

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Executive summary

In the 21st century, populations of people around the world are connected like never before. We are well connected physically, socially and economically.

World events of the last few years have demonstrated that if a population in one corner of the world suffers a crisis in any of these areas, then implications can reverberate to all corners of the globe. Such people issues may then present employers with risks within their business that need to be managed. The impact that the Covid-19 global pandemic has had on the world's global workforce is an example of such an event.

Multinational companies continually face challenges to manage new risks caused by the traditional channels of changing legislation, emerging technologies and sustainability issues, as well as cultural pressures due in part to people mobility driven both by opportunity and economic uncertainty. The more recent social health issue of Covid-19 has highlighted the need for business leaders to recognise the importance of taking a holistic approach to managing exposures and risks across their organisation. These events have an impact across all areas of the business, including exposures and risks associated with employee benefits.

To minimise the impact of such risks, organisations typically formalise an integrated approach to risk through the development of business-wide risk management programmes. These are often termed enterprise risk management programmes as they apply across the whole business enterprise. A successful enterprise risk management (ERM) programme should operate within existing business processes and structures, and drive a shared understanding of risk and risk responses across the organisation.

Historically, employee benefits have not always been a priority for full inclusion within the enterprise risk management strategy. This is changing through recognition of the real advantages to the organisation that can be achieved by doing so.

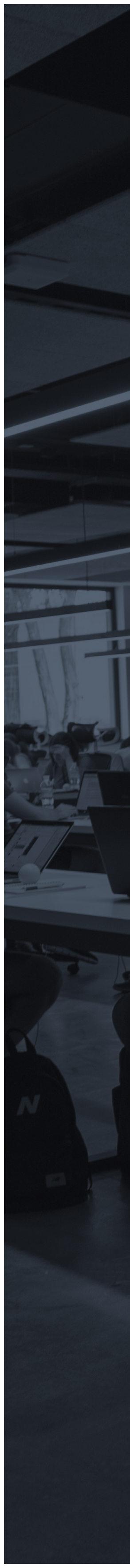
The techniques of risk financing and risk management are being focused on understanding employee benefit risks, and how to shape and manage it.

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

1. How enterprise risk management has emerged as an important tool for organisations
2. The critical role employee benefits play in a successful business
3. The costs of employee benefits
4. Risks associated with the provision of employee benefits
5. How multinational companies typically manage employee benefit risks

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

- *Risk and Managing Risk*, which summarises current approaches to enterprise risk management, referencing relevant international standards
- *The Purpose, Principles and Practice of Buying General Insurance*, which outlines the otricall insurance buying process for employee benefits and other insurances
- *Captives and Understanding Captives*, which provides a useful introduction to the role of the captive insurance company in financing employee benefits and other risks.



Historically, employee benefits have not always been a priority for full inclusion within the enterprise risk management strategy. This is changing through recognition of the real advantages to the organisation that can be achieved by doing so.

01 Evolution of enterprise risk management

Traditionally, risk financing was a local decision – typically around the use of insurance.

It was a matter of finding the best insurance programme that could be purchased from the market, usually by selecting a local insurance broker to approach insurers.

For multinational companies, there was little co-ordination 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 and insurance for the company (or enterprise), including general insurance and life insurance. Similarly, management of employee benefits, and more widely including pensions, was traditionally decided by each local business operation rather than with help or involvement at the global/group level.

1.1 Emergence of enterprise risk management

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

Another key development that began in the early 2000s (spurred by the Sarbanes-Oxley Act of 2002 in the US and reinforced by the 2008 global 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 have resulted in companies having a need to understand their risk exposure.

This higher understanding of the risks inherent in companies and the provision of evidence to show how this is managed (governance) is now expected by shareholders and financial stakeholders alike. Increasingly, the enterprise's internal risk and insurance teams 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 co-ordinated global risk management strategies. Figure 1 illustrates how risk management has evolved.

1.2 Embracing employee benefits within enterprise risk management

This enterprise risk management approach is now being adopted across employee benefits being offered within the organisation. Increasingly, the management of employee benefits is being considered on an enterprise-wide basis. Risk and insurance managers of organisations are increasingly understanding the resultant business advantages and financial gains that are available.

Increasingly, multinational companies are taking a global view of risk, with risk budgeting occurring at the group level. This is leading to an understanding between and across different risks that exist within the organisation. This increased focus is leading to companies adopting a data-informed risk management strategy, rather than employing a traditional risk mitigation transaction, for example, through traditional insurance placement.

For employee benefits, key financial risks relate to:

- Defined benefit pension benefits
- Healthcare
- Other risk protection employee benefits such as death benefits or income protection benefits

For some organisations, applying an enterprise risk management approach to employee benefit risks is the validation of a journey they are already on. For others, it can help make a fast start.

Figure 1: Evolution of risk financing and risk management

TRADITIONAL

Local decisions:
- Insurers
- Brokers
- What to insure/self-insure
- Little/no co-ordination
- Lack of understanding of data/risk profile
- Service providers viewed as a commodity

CO-ORDINATED 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

ENTERPRISE RISK MANAGEMENT

At 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

Co-ordinated by Group team, e.g. risk/insurance/in house broker/captive manager

‘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 as a source of competitive advantage’

Julia Graham, CEO, Airmic

02 Employee benefits

Before a risk or insurance manager can evaluate employee benefit risks, one must understand what employee benefits are and the critical role that such employee benefits play in a successful business.

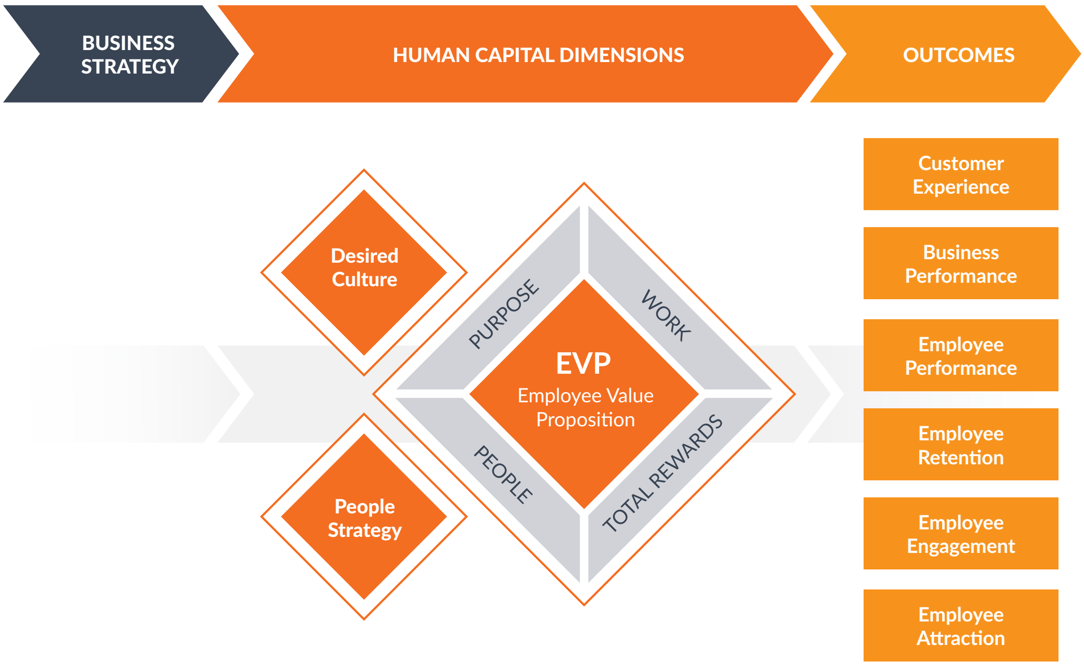
Employee benefits are a key factor in managing people, and vary from organisation to organisation, and from country to country.

This section of the guide outlines how employee benefits help in the management of people within an organisation and the types of employee benefits that could be offered.

2.1 Managing people

A key asset that every organisation needs to manage effectively is its people, or in other words, its 'talent' or 'human capital'. Effective management of people within the overall human resources strategy is critical to maximising the business results of an organisation and therefore maximising value for shareholders or other financial stakeholders. Aligning the people strategy to the business strategy is important for achieving the desired outcomes as illustrated in Figure 2.

Figure 2: Aligning people strategy to business strategy and the business model



There are different risks attaching to employing people and how they interact is important. To get the most value from their people, companies typically 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 to drive down absenteeism;
- managing key talent, including tailoring rewards to fit the individual career objectives of promising management staff; and
- managing the financial risks and exposures embedded in employee benefits.

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.

2.2 Types of employee benefits that can be offered

Employee benefits are a key part of an organisation's reward strategy. Employee benefits vary in different countries across three pillars of provision:

- Government-provided
- Employer-provided, mandated by local legislation, and
- Discretionary employer-provided employee benefits.

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.

Mandated employer-provided benefits include employee benefits that employers are required to provide by law. These are referred to as statutory or mandatory benefits. These plans are often managed by employers. There is an increasing trend by governments to increase utilisation of these plans instead of, or to supplement, social security benefits.

Statutory or mandatory benefits 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 the service of an employer and requirements relating to time off.

Discretionary employer-provided benefits have typically evolved within the social security/mandatory environment in the relevant country. This tends to influence the level and design of the benefits that employers then provide voluntarily.

Employee benefits provided by employers can include an array of options, including:

- Retirement savings and pension benefits
- Healthcare coverage, including medical, dental and optical benefits
- Other insurable benefits such as life coverage, short and long disability insurance, accident and travel accident plans (these are often called 'risk' insurances)
- Vacation and other leaves of absence, including health-related absence
- Allowances such as for housing or education
- Profit-sharing plans based on performance measures
- Company cars or allowances, and
- Other perquisites, such as meal allowances, travel support, sports/fitness arrangements, negotiated corporate discounts.

This list is by no means exhaustive, but it illustrates some of the benefits that are provided.

The employee benefits provision in each country tends to be driven by a number of factors:

- The legislative and regulatory environment
- The extent of social security provision
- Market dynamics such as provider capability, and
- The company's total rewards 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.

"Companies are currently experiencing the effects of The Great Resignation. Those companies that have a highly competitive employee benefits offering that is tailored for their employees and aligned with their business strategy will be able to attract new talent, retain their existing people and deliver on their business objectives."

Stephanie Ings, Director, WTW

Figure 3: Retirement, healthcare and other insurable benefits

<table>
<tr><th>Employee Benefit Type</th><th>Description</th></tr>
<tr><td>Retirement / pension plans</td><td>Retirement benefits are essentially to assist employees financially in their retirement. Social security in most countries is the baseline financial assistance an employee will receive 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 that 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 benefits (common in the Middle East), severance or termination benefits (which may include benefits on retirement), deferred compensation (for example, deferred until age 60 or 65).

There are two key types of retirement benefit provision: defined benefit and defined contribution.

Defined benefit
• These plans promise to pay pre-arranged pension benefits regardless of the amount of any assets in the pension fund.
• Benefits are determined by a benefit formula, generally based on years of service and pay.
• The investments of any defined benefits pension fund 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 to pay a particular pension benefit. The employee's retirement benefits depend on the balance of their pension plan account at retirement. Thus, any benefit depends, amongst other factors, on the investment returns within the pension fund.
• Plan members may have some involvement in choosing how their funds are invested.
• The employee bears the financial risk under these plans.</td></tr>
<tr><td>Healthcare</td><td>Many countries provide some level of healthcare to which their citizens are entitled. Company plans may pay for supplemental provision, such as:
• Private hospitals, networks
• Higher rebates than provided by government arrangements
• Inpatient (hospitalisation) versus outpatient (clinical) care
• Ancillary services

Dental and vision cover in some cases may be offered by the employer.</td></tr>
</table>

Figure 3: Retirement, healthcare and other insurable benefits (cont'd)

Employee Benefit Type	Description
Death benefit	There are two main types of death benefit to be aware of: • A lump sum benefit, often paid tax free. This may be referred to as life insurance or life assurance. • A pension/annuity/income benefit paid to a spouse and/or children. This is sometimes called a survivor income benefit. Lump sum benefit provision is the most common around the world. The level and complexity of such a provision varies by country. In some cases, pensions may be provided in addition to, or instead of, lump sum death benefit payments. Death benefits are sometimes provided as part of the retirement plan.
Other insurance that may be connected to life insurance	**Accidental Death & Dismemberment** covers an employee for loss of life or loss of body parts or bodily function due to an accident. **Business Travel Accident** insurance covers an employee for dismemberment or loss of life whilst travelling on business. Some companies have a global Business Travel Accident policy. **Occupational Accidental Death** is traditionally a flat sum amount for an employee who dies whilst working.
Disability	There are two types of disability benefit: • A pension/annuity/income benefit; and • A lump sum benefit, often known as Total and Permanent Disability. A pension/annuity/income benefit is the most common form for disability benefits. A short-term disability benefit may be paid for an employee's initial absence from work, say for three to six months. A long-term disability benefit may commence once the short-term disability benefit has ended and if the individual is still disabled. This may be paid for a set period (say two years or five years), or until the individual recovers or retires.

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

They recognise the link between improved wellbeing and:

- greater and more sustained employee engagement
- higher employee productivity
- lower employee absenteeism, presenteeism and medical costs, and
- better business outcomes.

To this end, companies are increasingly developing health and wellbeing strategies, setting up frameworks that can encompass existing benefit plans (for example, healthcare/medical plans, occupational health, disability and employee assistance programmes), and linking them to specific initiatives, such as healthy eating, physical activity and cessation of smoking.

With appropriate leadership and communication, wellbeing strategies can become a strong component in support of a company's Employee Value Proposition.

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

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

03 Understanding employee benefits costs

3.1 Highlighting country differences

Multinational organisations deploy employee benefits packages that are extensive and complex. They are tailored to the company's organisational structure, industry sector and geographical footprint. Multinational companies are increasingly developing their employee benefits strategy at a global level, while ensuring that it reflects the requirements of each country. Thus, the global employee benefits strategy remains locally relevant.

Retirement, healthcare and other insurable benefits typically make up the majority of employee benefits spend for multinational organisations. When employee benefits vary by country in design, value and proportion of the employee's overall package, the costs of these employee benefits will also vary.

3.2 Understanding the cost of employee benefits via data and technology

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

Some companies make good use of the data and information available to them to make informed business decisions. This is often facilitated through the use of preferred providers – such as insurers, brokers/consultants or administrators. Having a global strategy and a global technological platform to deliver benefits is only workable if a company can receive consistent year-on-year data to enable it to monitor risk exposures and costs in a timely manner. This assists in implementing interventions when required that support the overall employee benefits business strategies.

Good health and wellbeing intervention strategies are considered further in Section 4 of this guide.

04 Risks associated with providing employee benefits

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

If the employee benefits programme offered is less than those offered by competitors, there is a risk of losing good people. However, if the employee benefits programme offered is higher than those offered by competitors, the cost impact on company profits will concern shareholders. Companies that manage their employee benefit risks effectively do so within the risk management framework of their organisation.

Understanding the correlation between employee benefit risks and other business risks is an important part of enterprise risk management. Seven core risks arise when an organisation provides employee benefits to its workforce. Further, the employee benefits themselves can contain intrinsic risks and these may need to be explicitly managed by the employer.

4.1 Outlining risks to organisations

The seven core risks that arise when providing employee benefits are:

1. Financial
2. Accounting
3. Compliance
4. Talent/resourcing strategy
5. Fiduciary/governance
6. Operational
7. Reputational

From a risk management perspective, there is an opportunity to manage these risks efficiently. See Figure 4.

Figure 4: Risks and opportunities of providing employee benefits

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

OPPORTUNITIES
- **Attract and retain talent:**
  - Align the pension and other employee benefits around the world with business needs and the reward strategy
  - Help the workforce to be effective and engaged
- **Confidence with your business reputation:**
  - Protect your employees via providing 'protection' benefits such as healthcare, income protection and death in service benefits
  - Be confident that compliance and governance issues related to managing people will not arise and/or can be addressed without incident
- **Financial optimisation**
  - Cost savings of the employee benefits programme via leveraging global providers
  - Pension/benefits risks optimised in alignment with overall business financing
- **Ability to demonstrate robust**
  - Global pensions and benefits accounting
  - Assessment and management of underlying pensions/benefits risks
  - Actuarial planning to mitigate future cost increases

HQ Goal Modernise your employee benefits and optimise your financial spend on employee benefits

Example of how a risk can impact a business

Multinational banks are a good example of the integration of pension/retirement plan risks with business risks. In years of low interest rates and declining bond yields, pension liabilities and therefore deficits in defined benefit plans typically increase. This has a negative effect on profits. However, at the overall enterprise level, these same factors 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 has included assessing whether pension risks correlate with or offset similar risks in their broader business, for example, interest rate risk, credit risk.

4.2 Some intrinsic risks that may exist in employee benefits

4.2.1 Risks that may exist in pension/ retirement plans

a) Understanding the potential 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. However, this became increasingly costly and uncertain for organisations as:

a) bond yields and investment returns for retirement funds have varied dramatically, and
b) people are increasingly living longer; therefore, companies are increasingly needing to absorb this longevity risk.

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 defined contribution retirement programmes removes risks for the future, defined benefit programmes still represent a historical long-term obligation whilst these programmes wind down. For example, if a company were to close its defined benefit plan to future participants today, the plan could 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. They can therefore be addressed coherently on a global basis.

Figure 5 illustrates a pension risk management framework that brings together strategies of several different types. We find that 'Assess' and 'Monitor' are as integral to success as the 'Key Action' strategies.

It should be noted that some of the actions for risk management strategy shown in Figure 6 below have opposing effects. For example, hedging the risk could actually increase the cost rather than shrink it. Therefore, it is imperative that the right balance is understood and achieved.

Figure 5: 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

b) Addressing pension/retirement plan risk through co-ordinated response strategies

Financial risk is a principal risk of every defined benefit pension plan across the world.

Falling interest rates and growing life expectancy lead to increasing deficits, deteriorating balance sheets and increasing Profit & Loss costs. An effective investment strategy is critical for funded plans. In particular, this means investing in a portfolio of assets that most closely matches the scheme liabilities, without adverse impact on asset returns.

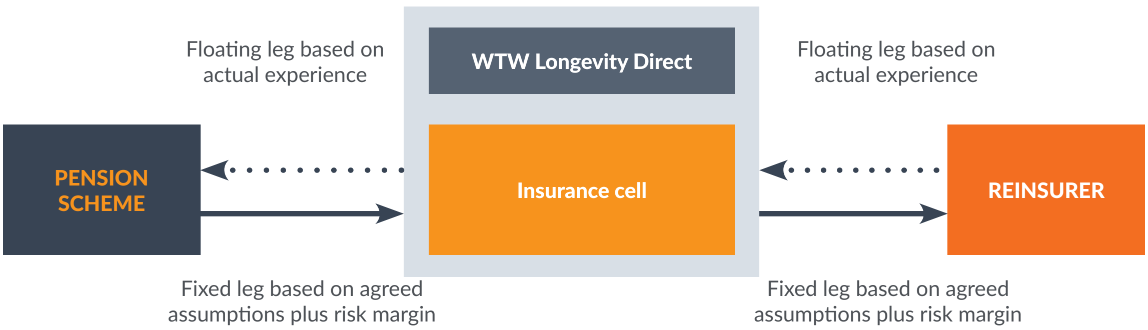
To a large extent, managing interest and inflation risk can be mitigated by purchasing assets that behave in a similar way to the scheme liabilities. For example, purchasing a portfolio of inflation-linked bonds can hedge against adverse inflation movements. Hedging against changes in mortality experience 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 this 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 the actual mortality experience of the scheme.

In 2014, WTW 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 6 illustrates this structure.

Figure 6: 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.
WTW has invested in establishing a structure that 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

4.2.2 Risks that may exist in 'protection' benefits

a) Understanding the potential risks in 'protection' benefits

It is common for employers to provide 'protection' benefits (also known as 'risk' benefits) to their employees in the event that they suffer an accident or illness and are unable to work. Generally, social security benefits are modest, so companies may 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 payment 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. Therefore, these can be addressed coherently on a global basis.

For employers, the effect of programmes covering death, disability and medical expenses goes beyond the immediate costs associated with such programmes. Their impact extends to ensuring an employee's wellbeing, productivity and engagement. These in turn have an impact on business performance. Therein lie the principal risks associated with these employee benefits programmes.

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 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.

b) Addressing the potential risks in 'protection' benefits through developing wellness strategies to enhance business performance

Many companies are introducing wellness strategies to their workforce to ensure an employee's wellbeing, productivity and engagement. Optimising an employee's health and wellbeing has an impact on an organisation's business performance. A health and wellness strategy could focus on four elements:

- *Prevention*: Aim to keep employees healthy and encourage them to adopt and maintain a healthy lifestyle.
- *Personal support*: Address the specific health needs of employees who have health-related risks and chronic conditions. Further, if an employee has suffered an absence from work due to an accident or illness, programmes that assist the employee with a return to work strategy could be activated.
- *Organisational support*: Build a healthy workplace culture and align the specific health and wellbeing programmes with that culture.
- *Design and delivery*: Align the health and wellbeing programmes with the organisation's Employee Value Proposition and provide employees with an array of wellbeing choices to engage with. Leverage the latest technology to communicate with employees and use targeted messaging to reach employees via their preferred method and timing of such communication.

4.3 Understanding the impact of ineffective employee benefit risk management

The consequences of ineffective employee benefit risk management can be severe and, as illustrated in Figure 7, there are three key areas:

1. People impact
2. Financial impact
3. Legal impact

Figure 7: Consequences of ineffective employee benefits management for organisations

PEOPLE IMPACT

Attraction, retention and motivation objectives
Employee benefit plans not aligned with attraction, retention, and motivation objectives

Workforce management:
Employee benefit plans misaligned with global workforce strategies

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

FINANCIAL IMPACT

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

Financial performance:
Unanticipated balance 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 alignment) not realised

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:
Negative impact on brand or reputation

People are key to most, if not all, organisations. Therefore, employee benefit plans that do not support attraction and retention of talent and employee engagement can negatively impact business performance. In terms of the financial impact, not having a global employee benefits strategy around the control and performance of the employee benefit plans will mean that opportunities to optimise the financial spend associated with the programme will be missed. Finally, increased legal, compliance and reputational risks are important consequences of ineffective employee benefits management.

4.4 Who is responsible for effective employee benefits risk management

A consequence of the variety of risks (and opportunities) associated with employee benefits is that many stakeholders have roles and responsibilities in the management of employee benefits, both internally and externally.

Internally, there are often representatives from Human Resources, Finance (both Treasury and Accounting), Risk/Insurance, Legal, Tax and Procurement, who all have an interest in managing the employee benefits programme successfully. Externally, companies use a series of providers, including consultants, actuaries, brokers, lawyers, tax advisers, insurers, administrators, health and wellbeing providers, and investment managers to assist in managing their employee benefits programme. Companies vary in how they resource their activity around employee benefits management – often depending on capacity and expertise that is available in house.

For effective employee benefits management, it is critical for a company to have a clear and robust governance framework that spells out the guiding principles of the employee benefits provision, and how to finance and deliver this.

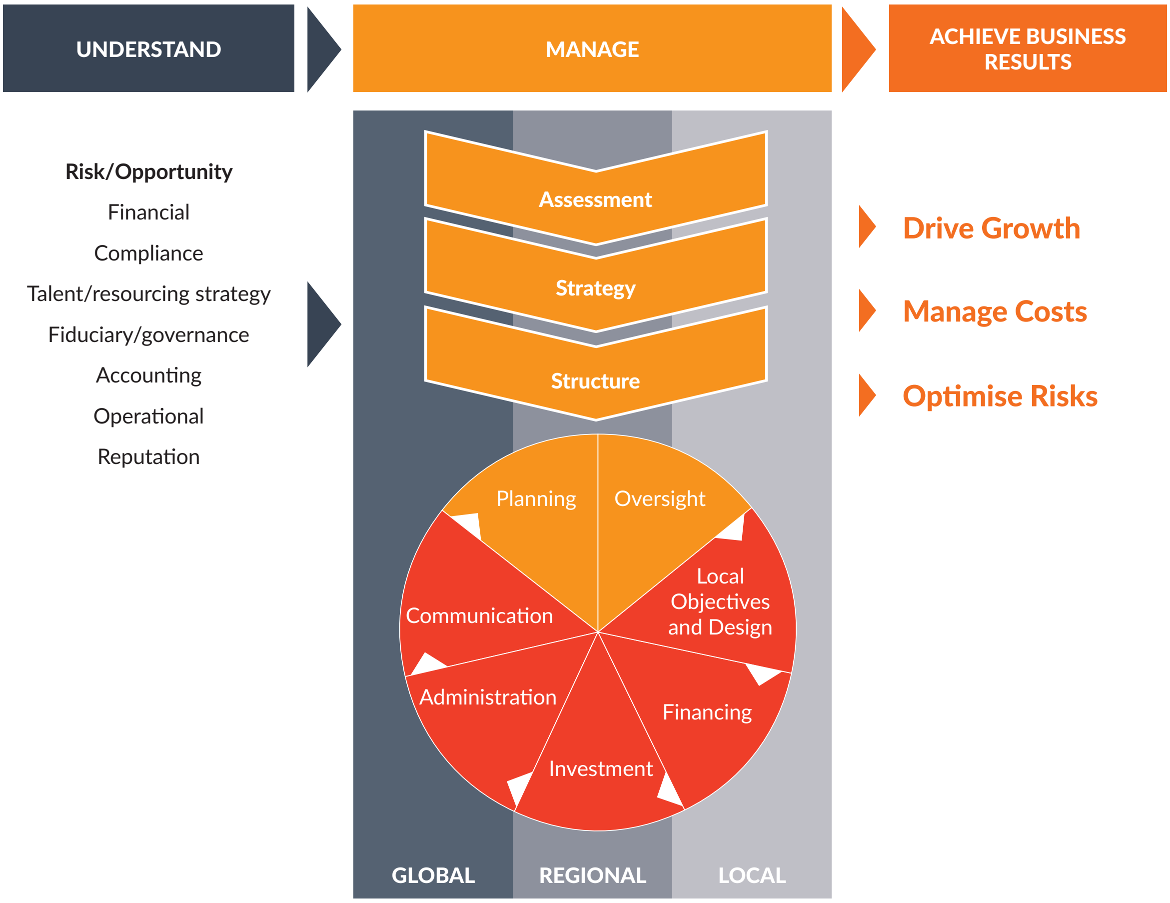
05 How do multinational companies typically manage employee benefit risks?

5.1 Optimisation through risk management

So how do companies approach the management of employee benefit risks within the context of their enterprise risk management framework? Figure 8 illustrates the key elements of an integrated approach.

Historically, the traditional approach to management of employee benefit risks was very much a local approach. The assessment of the local programmes and their associated financial impacts were 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 employee benefit risk.

Figure 8: Effective employee benefits risk management



For example, in the case of risk and healthcare benefits, the traditional approach has been to insure these – at least 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 benefits programmes 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 co-ordinated approach to assessing and managing employee benefit risks.

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

Focusing on financial risks, the key activities that multinational companies should consider are:

1. Understanding and analysis: The centralised or global approach to employee benefit 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.

2. Risk appetite: Companies then need to assess their tolerance for retaining employee benefit risk, within their broader risk appetite framework.

3. Risk retention and optimisation: Once the appetite for employee benefit risk is understood within the context of the organisation, the strategy for risk retention needs to be determined. The most appropriate mechanism to deal with each risk can then be identified:

    - Avoid/contain: For example, stop offering certain benefits.
    - Retain: Determine the level of exposure that can be tolerated. Self-insurance or non-insurance may be the most efficient form of financing. Risk that is to be retained should be optimised.
    - Insure: If the exposure cannot be tolerated at the business unit, or indeed group level, then consider transferring the risk to the insurance market.
    - Share: One mechanism is to partly insure and partly retain a risk. For example, by reinsuring insured employee benefits to a captive reinsurance company.
    - Transfer: Pass the exposure to another party. For example, convert the accrual of defined benefit pensions to defined contribution plans, and thus pass much of the investment and longevity risks to employees.

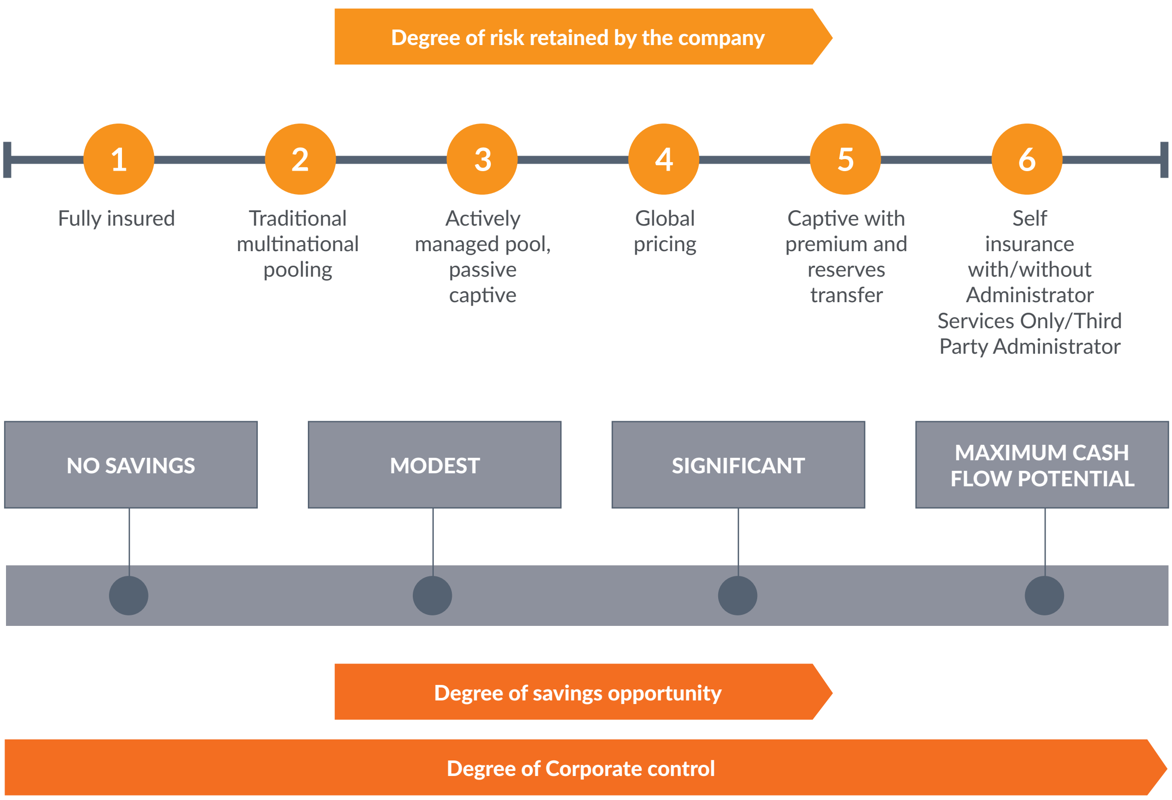
4. Risk monitoring: Once the risk strategy has been implemented, introduce a framework to capture and report on key data metrics that can be used to inform the risk management process.

5.2 Developing a global employee benefits financing strategy

Effective financing of an employee benefits programme 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 cost-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 9 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 employee benefit risks coherently and effectively.

Figure 9: The employee benefits risk financing spectrum



HOW DO MULTINATIONAL COMPANIES TYPICALLY MANAGE EMPLOYEE BENEFIT RISKS?

Multinational pooling of employee benefits insurance started in the 1950s and is still widely used today. Some companies manage their multinational pooling arrangements effectively to optimise the contribution to their business. Others take a more passive approach, which can be more costly to the organisation.

The use of captives to finance global risk and healthcare is now more than a growing trend. In 1995, companies including DHL and AstraZeneca embarked on this journey for the first time. As of today, around 150 companies are utilising employee benefits captives, with around half of those setting up in the last five 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. Some examples are cross- border IORPs (Institutions of Retirement Provision), asset pooling vehicles and/or pension captives. To date, such cross-border structures have been utilised primarily by major global organisations.

Looking to the future, what new areas within employee benefits may companies need to consider managing within their risk management framework?

The employee benefits landscape is ever changing and, as such, any organisation, whether multinational or national, needs to regularly review its risk management framework to accommodate the new environment. Below is a list of topics and trends that are emerging in the global employee benefits arena. These are mentioned here to flag to risk managers of such multinational organisations that these topics and trends may need to be considered and assessed into the future.

- ***Environmental, social and governance corporate policies:*** This topic may have a long-term impact on captive financing structures, which may then face increasing attention from the regulators of such structures. Governance, for example, has been high on the agenda of captive regulators for many years, with strategic decisions often made in domicile; whereas, environmental implications continue to emerge around socially acceptable and 'green' investments in company activities. There is clearly more coming in this space.

- ***Diversity, equity and inclusion corporate policies:*** Employee benefits captives are exploring how to incorporate these corporate policies into their benefit financing strategies.

- ***The 'Great Resignation':*** As we emerge from the global pandemic, employers may find that employee dynamics are changing. Employee benefits will become more important in attracting and retaining talent. Changes in an organisation's employee benefits programme may have cost implications, may require a communications strategy to staff and may have implications for the employee experience as the updated programme is implemented.

- ***Managing Covid-19 related and post-pandemic claims experience of risk policies:*** During the Covid-19 pandemic, many companies negotiated the waiving of policy exclusions and increases in limits of benefit levels to assist in covering Covid care costs. Further, the global pandemic may have resulted in employees deferring medical consultations on other medical conditions. These factors may result in adverse claims experiences and potentially increased premiums on risk policies, as an organisation's workforce emerges from the global pandemic environment.

Recent research conducted by WTW has identified the following trends in this area, which insurance and risk professionals should be aware of:

1. ***Anticipated medical trends 2022 and beyond:**** Risk and medical insurance policies may experience a rise in musculoskeletal disorders in their claims experience (potentially attributable to poor ergonomics in employees' work-from-home environments) followed by cardiovascular diseases and respiratory conditions.

   Insurers expect mental and behavioural disorders to be the fastest-growing condition by incidence in the next 18 months, followed by cancer and musculoskeletal disorders. Insurers expect cancer to be the fastest-growing condition by cost in the next 18 months, followed by cardiovascular and musculoskeletal disorders.

2. ***Insured coverages continue to see restrictions:**** Gaps in coverage persist for conditions that are prevalent in the covered population and for which treatments exist. Over half of group policies, regardless of size, have exclusions for HIV/AIDS (54% to 56%) as well as alcoholism and drug use (52% to 53%). Employers should continue to try to remove these exclusions and leverage their consultants/brokers to help negotiate inclusion coverages that are part of global benefit philosophies and of critical value to many employees.

3. ***Telehealth emerges as a top cost management method:****

   Insurers ranked contracted networks of providers (75%) and pre-approval for scheduled inpatient services (67%) as the top two cost management methods. Telehealth (63%) moved up from number five in last year's survey to number three, suggesting that more insurers are recognising the potential for improved cost management through remote diagnosis and treatment of patients.

4. ***Overuse of care continues to affect medical costs:****

   Overuse of care by medical practitioners (64%) recommending too many services continues to be the most significant factor contributing to rising medical costs related to employee/provider behaviour. Fifty-nine percent of insurers also think that overuse of care by insureds is driving up costs.

5. ***Volatility will continue in the short term:****

   Covid-19 has produced the biggest impact to global medical trend variation that the healthcare industry has seen. Volatility is expected to continue beyond 2022. Countries and employers are experiencing the impact at different times and rates. For some countries, the impact of a recovery in demand for regular medical services will occur in 2022, while for others this might not happen until 2023. Covid-19, combined with the changing face of the work environment, has had a significant impact on medical trends, service delivery and the future drivers of medical claims.

*Source: WTW 2022 Global Medical Trends Survey Report

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GUIDES

Marlow House
1a Lloyd's Avenue
London
EC3N 3AA

Tel: +44 207 680 3088
Fax: +44 207 702 3752
Email: enquiries@airmic.com
Web: www.airmic.com