



Maximizing The Value Of Employee Benefits:

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The Collaborative Opportunity
For Risk Management



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The Collaborative Opportunity For Risk Management and HR

Double-digit annual cost increases for medical care. Underfunded pensions. Soaring workers' compensation costs. These are just a few of the human capital expenses setting off financial "alarms" in Corporate Risk Management departments, especially for multinationals seeking to get a handle on rising costs in dozens, if not hundreds, of countries. Employee benefits, even in the developing world, are often the biggest expense on a company's balance sheet

At the same time, forward-thinking HR departments know that a competitive and affordable employee benefit offering is a fundamental part of their organizations' growth strategies. Long-term projections show labor shortages for experienced and talented employees on all continents,¹ so offering benefit programs to attract and retain the best employees is critical. In addition, the pressure for companies to demonstrate their "social balance sheet" to investors requires HR departments to take a closer look at how to fund wellness programs, work-life balance offerings, and other employee-friendly initiatives. Managing the human capital portion of the corporate spend can greatly affect the success or failure of strategic plans.

One thing is clear in today's increasingly complex challenge of controlling benefit costs while maximizing benefit design: neither the Risk Management or HR Department can do the job alone—the formation of a collaborative and disciplined partnership is necessary. To do so, Corporate Risk Managers need to understand that HR spend cannot be viewed through the prism of cost reduction only. Opportunities that are underfunded—such as talent acquisition and retention programs—can result in missed profit goals. Similarly, risks that are underfunded, such as pension liabilities, can result in damage to shareholder value. Determining the appropriate funding levels for succession planning, compensation, life and health plans, severance and outplacement, executive coaching and other HR expenses help ensure that an organization will be able to achieve its short and long-term business goals. On the other hand, HR needs to appreciate the role Risk Managers can play in identifying human capital risks and implementing new ways to fund programs. Only by working together can the Risk Management and HR functions strategically guide the organization to help meet its business and financial goals.

Incorporating HR risks into enterprise risks

Many Corporate Risk Managers today have a comprehensive Enterprise Risk Management (ERM) process in place for analyzing many of their organizations' risks, but they may not be incorporating human capital risks into their approach. While Risk Management is aware of potential political and economic risks around the globe, human capital risks are often overlooked. One reason is that employee benefits are often country-specific, and HR risk profiling for the overall portfolio is not often undertaken.

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How ERM supports shared HR and Risk Management goals:

- Minimizes barriers to achieving objectives and maximizes strategic growth opportunities
- Reduces variability in expected business outcomes to enhance value creation
- Enables informed decision-making
- Decreases total cost of capital by optimizing the balance between risk and opportunity
- Identifies key exposures and quantifies critical activity
- Demonstrates the benefit of increased risk transparency across the organization
- Utilizes additional risk information to improve risk transfer and decrease negative events
- Protects tangible and intangible assets to minimize the impact on bottom line profitability

Today's most forward-looking organizations use an ERM process to become more mindful of and plan against all their risks—including those found within their HR benefit programs. ERM is a disciplined process whereby an organization assesses all opportunities and risks that must be funded. When HR and Risk Management use an ERM approach to determine the potential risks of HR benefit programs, they can prioritize spending allocations for all human capital programs together. Areas for review as part of the ERM process typically include:

- **Strategic risks:**
What are the HR programs and issues that could affect success in achieving both short-term and long-term business strategy? This can include everything from a company's culture and communications to workforce planning and compensation strategy.
- **Operational risks:**
How effective are the HR programs? Metrics that can be analyzed include recruitment success, labor contracts, performance plans, talent identification programs and employee engagement activities.
- **People risks:**
Is the organization experiencing a "brain drain"—the departure of high-performing talent—leaving a critical skill gap for the development of new products? Is the organization spending too much on expatriate benefits? Is there a more efficient way to address global workforce needs, such as hiring in-country?
- **Market risks:**
Is there too little incentive for the sales force to react to fast-changing marketing conditions? Are people being trained in the latest use of technology or other new processes to keep pace with customer needs?
- **Financial risks:**
What is the return on investments in workforce? Are they paying off? How are investments in talent development programs paying off, when measured against business performance? Are there underfunded pension liabilities? Are retiree medical benefits ballooning out of control?
- **Compliance risks:**
How exposed is the organization to legal action? Lawsuits can stem from regulatory violations, employee harassment charges, diversity issues, and more.

Risk and HR managers can jointly apply an ERM process to human capital programs as part of the enterprise-wide strategic planning and budget allocation. By doing so, human capital risks associated with benefits programs can be minimized and the value of these programs optimized. In short, the Risk Management-HR partnership can help bring out the best in the organization and for the organization, while removing barriers to its success in the global marketplace.

Not including human capital costs in the ERM process is a dangerous oversight. Experience shows that as a proportion of payroll, benefits can account for in excess of 10% of this number.² Given the magnitude of this spend, it is critical that benefit programs, including health and welfare, be managed with the same attention as property and casualty risks. All are

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risks that a company may suffer, with damages to be paid. By working together during the ERM process, HR and Risk Management can develop a more comprehensive view and better understanding of the human capital opportunities and risks their organization faces.

Closer look at controlling benefit risks: Coca-Cola and DHL

Some of the world's leading multinational companies have addressed the cost and risks of their employee benefits with innovative solutions that manage risk, improve investment returns and exercise greater control — all while providing employees with more robust and affordable benefit programs. Two of these solutions — multinational pooling and captive benefit financing — have been proven to maximize the value of an organization's benefit programs. The Coca-Cola Company ("Coca-Cola") and DHL are global organizations that have begun to implement these approaches to reduce benefit spend while enhancing their program delivery.

Coca-Cola: actively managing its global risks

For years, Coca-Cola had used two global pools to provide a range of medical, life and disability benefits to international employees. At the height of the program, the pools included more than 100 contracts in some 50 countries.

Coca-Cola's analysis showed that a captive model would have several advantages over a pooled model. "We anticipated that moving to a captive model would allow us to take advantage of a more actively managed program, resulting in more efficient pricing, more detailed claim data to manage utilization and a more detailed framework for managing the program on a global scale," explains Stacy Apter, Director of Global Benefits Financing and Asset Management.

The move from pooling to the captive model began in 2007. In the first year, Apter explains that the company shifted only 7% of the premium that was formerly in the pools, yet the results were immediate. "Depending on the market, we reduced premium by 15% to 25%," Apter explains. In addition, the captive model provided Coca-Cola with claim and financial data that was never available before. This allowed the HR benefit teams to actively use this data to align their health and wellness strategies for the future, and improve program design. "We take our HR programs very seriously in terms of how we can impact employees' lives in each country," Apter adds. As an example, she cites how Coca-Cola waives HIV exclusions for medical care globally for contracts participating in the captive program.

By 2009, the captive was insuring about 80% of the premium formerly held in the multinational pools. "Given that local medical inflation in many countries is double digit, we are positioned to manage our utilization most effectively," says Apter. "All in all, the captive strategy allows for an infrastructure to manage our employee benefit programs and risks in more than 200 countries around the world, providing great efficiencies and benefits for both the company and employees."

Apter has a few suggestions for other companies beginning to implement an ERM approach between HR and Risk Management for managing benefit spend to improve design and delivery. "Make sure you develop a true partnership, where both sides appreciate what the other brings to the table.

Have a good understanding of the global expertise you need to deliver locally while staying competitive from a cost standpoint. And be sure to have the resources in place to manage the captive on an ongoing basis to be as efficient as possible.”

DHL: delivering local benefits to enhance productivity

DHL is one of the world’s top 10 employers, with more than 500,000 employees around the globe. “For us, a quality workforce is key. More than salary, employee benefits is one of the most effective tools in attracting and retaining talented and productive employees,” says Bill Fitzpatrick, Vice President Corporate Risk Benefits.

Like many companies, DHL had used its captive for property and casualty risks for quite a few years. By 1996, the company realized that a captive could be equally effective for employee benefits. “At that point, we decided to expand our current captive’s license to include life-based products in an effort to provide location specific employee benefits such as group medical, life, accident and disability,” Fitzpatrick explains.

DHL’s captive-based model enables the company to develop benefit packages that are required in order to compete in most local markets. “We coordinate our efforts closely with HR, which benchmarks the types and levels of benefits typically offered in a new market within the transport and logistics sector. It is the function of HR to advise us as to the types and levels of benefits that are needed for a particular market,” says Fitzpatrick. He notes that what employees need in Canada is very different from what is needed in Hong Kong or France. The DHL Risk and Insurance Team then develops the appropriate insurance plans by using the captive to achieve breakeven pricing, thereby maximizing cost efficiencies for DHL’s local business unit. “By using our captive as a way to minimize insurer profit and frictional costs, we are typically able to provide those benefits for 20% to 25% less than if these plans were purchased through a local commercial carrier,” says Fitzpatrick.

Like Coca-Cola, DHL uses the robust claims data available through its captive to monitor trends in medical conditions and take proactive measures to manage spend in specific countries. For example, a claims spike in Malaysia for chronic diseases such as hypertension and diabetes alerted the HR benefit team to look closer at developing health and wellness programs in that country. In Mexico, the company discovered that pregnancy was becoming the second highest medical spend, due to C-Sections being performed for 50-percent of employee pregnancies. The HR team then used that information to develop a communication strategy for employees to understand the impact of C-Section births both to the child and the business. “The captive gives us the flexibility to address very different issues around the world, yet with a risk financing model that works across geographic borders,” Fitzpatrick explains.

How multinationals use Multinational Pooling

Multinational Pooling is an approach that groups multi-country, local benefit insurance contracts into one experience-rated pool. At the local level, benefits are provided and the insurance contracts are unaffected. On a multi-country scale, it works as if the company has one experience-rated

How Multinational Pooling works:

- Benefit plans are negotiated locally on a country-by-country basis and insured through local insurers
- Premiums are collected, claims are paid and other services provided – all at a local level
- After the contracts have been placed with the local insurer, the multinational company may then decide to pool the local contract. Life, disability, health, accident and insured retirement plans can all be pooled
- Contracts are then brought together in a pool, where the contracts can be treated as a single item for experience rating purposes

insurance product. Insurance benefits that a pooling agreement includes are:

- Group life and survivors benefits
- Disability
- Accidental death and dismemberment
- Health
- Mixed contracts (risk and retirement under the same policy).

Many international benefits programs today are multinational pools of one type or another, whereby local employee benefit insurances are reinsured to a pooling network.

Once elements, such as insurers' profit, risk charges, intermediaries' fees and local profit sharing are factored in, a credible, diversified portfolio will potentially return around 8 to 15 percent that is then reimbursed as dividends.³

Traditional approaches to pooling are being replaced by new and flexible methods. These include a technique where corporate buyers approach insurers as vendors to obtain the highest possible service at the lowest possible price at all local levels. This involves negotiating a global 'deal' centrally, and the infrastructure and reinsurance techniques that apply for pooling are used in this solution. Under such a solution, the reinsurer of the pools continues to bear all the risk (like with pooling). The employer benefits from guaranteed economies of scale at the local level, rather than the uncertain multinational dividends that the head office would be entitled to under traditional pooling solutions.

Captives as an evolution of pooling

A captive is an insurance company owned by the parent company that insures or reinsures the company's own risks. Captives have a 50-plus year history in covering property and casualty risks. They are the natural evolution of pooling as they offer the opportunity for an organization to increase self-insurance.

Captives allow an organization to use its capital for its core business, while relying on the insurer's capital for benefits coverage. A critical factor in the use of captives is that there is a strong balance sheet and sound financial discipline in place as the organization is assuming more risk with a captive.

The Risk Management team must have a very in-depth understanding of the risks they are taking, and the HR department should be ready to implement proper risk management programs on the benefits side. For instance, if workers' compensation claims are high, an enhanced ergonomics program may be implemented to reduce costs. This is where both Risk Management and HR need to collaborate on analyzing the global claims data to manage the risks and costs of the benefit programs in each of the countries.

A full transfer of benefit risk into a captive from the start is a decision made by some companies like DHL. However, an organization can also decide to transfer a portion of such risks, either by benefit line or geographic region depending on the appropriate data available to fully understand the risk impact.

Employee benefits that can be included in a captive:

- Basic and Supplemental Life
- Long Term Disability
- Pension
- Active Medical
- Retiree Medical
- Workers' Compensation
- Accidental Death & Dismemberment
- Business Travel Accident

Benefits of a captive for Risk Management and HR

Risk Management	HR
Centralize cash flow management for benefit programs	Allow customization of benefits
Increase program cost effectiveness	Enable global harmonization of benefits
Improve cost savings by eliminating risk charges and broker commissions	Provide global data warehouse on all programs
Provide higher investment return on reserves for the benefit programs	Centralize portfolio review: renewals, claims data, provider usage, medical diagnosis
Experience rated premium	Offer better control of benefit programs:
Accelerate tax deduction	- In-time claims data to monitor design effectiveness and efficiency (cost drivers and holistic benefit coverage)
Add third-party risk for captive premium deductibility	- Targeted provider and/or network negotiation
Diversify captive risk exposure	Provide benefit enhancement
Reduce claims volatility	
Reduce capital requirement	
Aggregate protection on overall risk exposure	

Creating a virtuous circle

The potential savings from pooling and captives are real dollars that can be invested in other HR programs or in other areas of a corporation. For example, if an organization facing high workers' compensation claims allocates its medical plan savings to safety programs, this investment in the well being of employees will likely generate fewer claims, thus improving the overall cost-benefit equation.

The use of a comprehensive ERM process and innovative approaches like multinational pooling and captives can deliver a win-win for both the HR and Risk Management functions: benefit costs can be reduced while employee engagement and productivity improves.

- ¹ Talent Shortage Survey Results 2011, Manpower Group
- ² Employer Costs for Employee Compensation, U.S. Bureau of Labor Statistics, March 2012 <http://www.bls.gov/news.release/ecec.nr0.htm>
- ³ Multinational Pooling in Today's Climate, Aon Consulting, 2009

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