

DOL exemptions help benefit funding

Regulatory rulings map out routes for captive owners

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BURLINGTON, Vt.—Employers have to meet regulatory requirements before they can use their captive insurance companies to fund employee benefit risks, experts say.

While such arrangements are considered prohibited transactions under the Employee Retirement Income Security Act, the Labor Department has approved just more than 20 exemptions since 2000, when regulators eased exemption requirements in a groundbreaking ruling.

Until that ruling, which involved then-Virginia-based Columbia Energy Group, Labor Department rules had required that at least 50% of a captive's premium volume be from third-party risks in order for its parent to cover employee benefit risks through the captive. Few captives have that much unrelated business.

But in the Columbia Energy case, the Labor Department effectively said the 50% premium test for captive benefits funding could be disregarded if alternative requirements were met, said P. Bruce Wright, a partner with Dewey & LeBoeuf L.L.P. in New York.

Speaking at a session at the 25th annual Vermont Captive Insurance Assn. conference this month in Burlington, Mr. Wright outlined some of those requirements.

Under the alternative test, employers are required to enhance benefits for participants in the plan that will be funded through the captive, Mr. Wright said in citing one example.

"You have to give employees something extra," he said.

For example, Decatur, Ill.-based Archer Daniels Midland Co., which won final Labor Department approval in 2003 to use its Vermont captive to fund life insurance risks, substantially boosted its basic and supplemental life insurance benefits.

Under the company-paid basic life insurance plan for salaried employees, ADM increased the maximum benefit to be equal to the individual's base salary up to \$1 million, from a maximum of \$100,000.

For the supplemental life insurance benefit plan for salaried employees, which is employee paid, ADM increased the maximum benefit to five times the base salary up to a maximum of \$2 million, from four times base salary up to \$1 million.

The Labor Department also requires the employer to retain an independent fiduciary to ensure that all conditions of the exemption are met, Mr. Wright said.

The Labor Department also requires the captive to be in business at least one year.

"You need at least one year under your belt," Mr. Wright said.

In cases where the captive is not licensed in a U.S. state, it must use a U.S. branch to fund the benefit risks. Several captive domiciles, including Vermont, allow branches to fund benefit risks.

The time involved in obtaining Labor Department approval under an expedited review process is relatively short. It is about a 75-day process, though employers should figure on an extra week or two, Mr. Wright said. To qualify for this fast-track procedure, an applicant must, under one regulatory procedure, cite two “substantially similar” exemptions approved by the Labor Department within the past five years.

Even if the Labor Department denies approval under an expedited review, “it is not the worst thing in the world,” Mr. Wright said. “It will just take a little longer.”

While the Labor Department denied Coca-Cola Co.'s trailblazing plan to fund retiree health care benefits through its South Carolina captive insurer and a voluntary employees' beneficiary association, it gave final approval to the Atlanta-based beverage giant's application under its regular review process this year (BI, April 5).

Another approach employers are taking is using their captives to provide medical stop-loss coverage, said Kathleen Waslov, a senior vp and senior resource consultant in Boston with Willis Group Holdings P.L.C., who also spoke at the session.

Through such an approach, employers can reduce costs—compared with purchasing the coverage in the commercial market—as well as have better access to claims information, Ms. Waslov said.

The panel was moderated by Jeff Fitzgerald, an associate director in the Charleston, S.C., office of captive manager Strategic Risk Solutions.

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