

Cash flow, other advantages seen in funding benefits through captive

By JERRY GEISEL
Nov. 21, 2005

AVENTURA, Fla.—The biggest advantage of funding employee benefit risks through a captive insurance company is improved cash flow, say corporate financial executives.

"It was cash flow, cash flow and cash flow," according to Greg Davies, executive director and treasurer at AstraZeneca Pharmaceuticals L.P., that was the main driver behind the company deciding to seek permission to fund benefit risks through a Vermont captive. The Wilmington, Del.-based unit and another U.S. affiliate of U.K. pharmaceutical giant AstraZeneca P.L.C. sought permission from the U.S. Department of Labor last month.

Speaking earlier this month at the 15th annual World Captive Forum in Aventura, Fla., Mr. Davies noted that there can be significant cash flow advantages, for example, in funding long-term disability risks through a captive compared with purchasing coverage from a commercial insurer.

Given the long-tail nature of LTD, premiums paid to a captive can generate investment income over a long period while the claims are paid out slowly.

"The cash flow is always positive," said Allan Harris, finance manager in the risk management department at Wells Fargo in Castle Rock, Colo. "You take in the premiums and pay out benefits slowly," he added.

Wells Fargo is now in the final stages of deciding whether to apply to the Labor Department to fund benefit risks through a 15-year-old Vermont captive.

The cash flow and other advantages associated with funding employee benefits through captives are prompting a small but growing number of employers to take a look at the innovative funding arrangement. Of the nine employers that have sought Labor Department permission to fund benefits in their captives since the agency liberalized its rules in 1999 allowing the arrangements, six have done so since 2004.

And more employers could join the movement to fund benefits through captives. "This could move us in a direction we have not gone before," said Laurie Solomon, risk manager at The Coca-Cola Co. in Atlanta, who moderated the WCF session.

Improved cash flow, while perhaps the most significant incentive for companies to consider funding benefits through their captives, is not the only reason. Mr. Davies of AstraZeneca, for example, noted that employers can obtain more flexibility in the design of their benefit plans by funding them through captives.

Additionally, adding benefit risks to an existing captive can broaden the captive's book of business. "We like that spread of risk," said John Wilson, president of Three Rivers Insurance Co., a Vermont-domiciled insurance subsidiary of Alcoa Inc. Earlier this year, the Labor Department granted Alcoa approval to use Three Rivers to reinsure group term life insurance policies written by Metropolitan Life Insurance Co.

"It's nice to get that extra diversification," Mr. Harris agreed.

But panel members warned that funding benefit programs through captives is not something that can be accomplished quickly. To begin with, such projects almost always require that at least two corporate departments—typically risk management and human resources—work together.

"You have to respect the turf of HR," Mr. Wilson.

At the same time, the commercial insurers that previously covered the exposures have to be educated on their new role. Typically, commercial insurers involved in captive benefit funding arrangements will issue the policies and then be reinsured-in full or part-by the captive.

"The big challenge is to get carriers to look at this differently," Mr. Harris said.

There are other issues as well. An employer has to decide whether to use in-house or external counsel to prepare the necessary filings for the Labor Department, and it must select an external fiduciary.

Because the Labor Department has already approved seven captive benefit funding applications, employers by now have a good idea of what it takes to win regulatory clearance. Among other things, the Labor Department requires that a top-rated insurer be selected to issue policies and that plan participants benefit from the arrangement, such as through a sweetening of benefits.

"There is a road map. You don't have to reinvent the wheel. You can look at what other companies have done," Mr. Davies said.

In the end, though, an employer has to see if the arrangement truly makes sense for it. "You have to see what works best for you," he said.

The session was coordinated by James Waters, retired head of employee benefit services for Towers Perrin in New York.

Entire contents © Crain Communications, Inc.
Use of editorial content without permission is strictly prohibited.
All rights Reserved