Employers Waking Up to Benefits Captives

By Dick Goff

“Benefits in Captive Insurance Companies – Where Are You Corporate America?” is the snappy title of a panel presentation at next month’s Southern Employee Benefits Conference (www.sebc.org).

The answer is that corporate America may be paying more attention than we thought to the idea of forming captive insurance companies to cover employee benefits. One of the SEBC panelists, Bill Thompson, who directs the healthcare consulting practice in the Hartford office of actuarial firm Milliman, Inc., says to watch for a flurry of upcoming applications to the Department of Labor for exemptions under ERISA rules. Here’s how our recent conversation went:

After the first few DOL exemptions for benefits captives it appeared the idea was stuck in neutral.

It was quiet until recently. This summer we’re involved in four DOL applications at one stage or another and I think you’ll see a handful of them surfacing elsewhere.

What coverages are they contemplating?

They follow the existing patterns, primarily employee life, long-term disability, AD&D and at least one will consider expanding coverage to employee medical over time.

Let’s review the process. Why were employee benefits captives resisted by DOL?

I can’t speak for DOL, but of course that agency is responsible for enforcing ERISA and protecting plans and beneficiaries. The fact that the employer owns a captive means it will have to pass stringent requirements. But recently DOL has adopted an expedited approval process called ExPro that can cut the processing time from 18 to 24 months down to two or three months.

What are example requirements for an ExPro application?

Four of the major requirements are that the captive be domiciled in the U.S. for regulatory access, that a highly rated (at least “A” from AM Best) traditional insurance company provides fronting, that the plan sponsor provides benefit enhancements to improve coverage, and that the premiums are at competitive market rates.

Of those, what would be examples of enhanced benefits?

There could be increased life insurance, a better long-term disability benefit or services such as free preparation of wills. There could be any number of enhancements.

How does ExPro work?

If an applicant can demonstrate that its plan is basically similar to two other previously approved plans, then it can move through the system more quickly. In my experience, DOL isn't there to create obstacles as long as it's satisfied that plan participants are protected. And they're open to new ideas. Applicants are welcome to contact them about aspects of their plans and DOL will discuss them.

Why have employers been slow to adopt the idea of benefits captives?

There could be many reasons, but one I've noticed is that a benefits captive requires orchestrated effort between a company's risk management and employee benefits managers. In large organizations, these two groups may not even know each other, and their dynamics are different. Risk managers are concerned about financial exposure and cash flow while human resources and benefits people are concerned about providing the best benefits they can afford, within their regulatory environment.

Are companies that already self-insure benefits more likely to move to a captive?

Captives are part of the alternative risk transfer universe, as are self-insurers. But in a way, forming a captive brings self-insured employers back into dealing with traditional insurers because of the required fronting contracts.

Is the traditional insurance industry an obstacle or an ally in the growth of benefits captives?

For a while it was difficult to find fronting arrangements but recently several mainstream insurers have become interested in participating as fronting carriers. They're seeking fee business as a new revenue avenue through their involvement in this growing and important funding segment.

What are some financial advantages to sponsors of benefits captives?

There can be several. One good example is on long-tail liabilities such as retiree programs or disability coverage. Self-insured companies deduct expenses when benefits are paid. But employers now may deduct the expense when premiums are paid. That accelerates the tax savings. There's also leveraging of the value of the capital in the captives. Traditionally, captives cover P&C exposures; the financial risks from employee benefit plans are pretty much independent from the P&C risks, so the combined capital needed to cover all coverages in the captive can be much less than the separate components for P&C and for benefits.

Will we see an employee medical captive anytime soon?

Keep your eyes open for new developments. Some employers are considering captives for retiree or active medical plans. Medical plans could provide a tax benefit to the captive because, to the IRS, benefits are an unrelated business that, when added to the related business of the P&C coverage, can improve the tax-deductibility of the captive as a whole. We believe an employee medical captive would be considered by the DOL under the ExPro application method.

So there's a bright future for those whose business is advising employers on how to form benefits captives or managing them?

That appears to be true.

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