Clearing the hurdles

Walter Ralph and **Brian Quinn**, of **Granite Management**, talk to *Captive Review* about the internal and external obstacles of implementing an IEB captive reinsurance arrangement

WALTER RALPH, director of Granite Management, specialises in assisting companies with implementation and management of a captive reinsurance arrangement for financing their global employee benefit programmes. Formerly he worked for General Motors with responsibility for non-US employee benefits. Walter received a Bachelor of Business and Juris Doctor Degree from the University of Toledo, Ohio, US.

While transferring international employee benefits (IEB) programmes into a captive reinsurance arrangement can lead to reduced costs and other advantages, obstacles in implementing this arrangement will likely be experienced along the way. *Captive Review* talks to Walter Ralph, director of Granite Management, and Brian Quinn, director and CUO of Granite Management, to find out more about these obstacles and how they can be overcome.

Captive Review (CR): What are some of the early internal obstacles organisations normally confront when seeking approval to implement a captive reinsurance arrangement and what are some effective ways to deal with these?

Walter Ralph (WR): The first obstacle you encounter is what I call complacency and it is born out of the fact that many top executives don't really understand employee benefit programmes so they tend to avoid them – in particular those involving insurance which are seen to be complicated and boring. Second, concepts such as reinsurance and captive reinsurance are totally foreign concepts to the human resource managers and, because they don't have the time to become knowledgeable in this area, they often simply ignore the issue and accept to keep the status quo.

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Brian Quinn (BQ): What this complacency leads to is a lack of understanding of the true cost of buying employee benefits locally. The ability to save costs by taking the risk of these programmes into your captive, which is not actually understood by corporate managers, is one of the great advantages of bringing employee benefits into a captive arrangement. You not only get a full appreciation of what your local premium levels are, but you can manage that cost downwards either through benchmarking local costs or, as you develop your programme, by controlling your claims.

One of the critical things to understand is that although they are "risk" programmes, employee benefits are generally controlled by the human resources department as opposed to being controlled by the treasury or finance department. While the human resources department may need to control the programmes, finance departments should be more aware of the financial exposures than they are. With recent changes in corporate accounting rules, finance teams are beginning to ask for information on these exposures and future liabilities but in the typical insured model the data is not satisfactory. One of the great advantages of the captive model is that, as the entity that is ultimately responsible for the financial risk, you do get detailed information and this is essential in understanding the true financial exposure of the company.

WR: With regard to dealing with these obstacles, I think the best way is to show them what the financial impact is. You need to keep bringing up the issue about the cost disadvantages of the status quo and the cost advantages of implementing a captive reinsurance arrangement until you get a receptive audience within your company. Eventually you'll run into somebody who's willing to listen and can appreciate the potential savings.

CR: Once corporate approval has been obtained, what further internal obstacles are normally encountered?

BQ: An important obstacle is from the financial side. You need to get your treasury or your finance division happy with the exposure that has been assumed. A lot of times it's a lack of understanding as opposed to them being risk averse. Once they realise that the exposure you're assuming into the captive is no different than the exposure undertaken when you implemented the employee benefit programme, you can get the finance department comfortable with it.

WR: It is the corporate finance department that has that concern, rather than local finance or HR departments. Local obstacles are generally manifested in HR resistance – often due to them already having a long-term relationship with their current provider which they don't see a need, or have a desire, to disturb. Local HR managers are more concerned about the impact of change on employees and the disruption this causes. This resistance needs to be overcome and the best way to do that is to engage with the local finance staff and ensure they understand the savings they will get. Local finance can then help convince local HR that the savings due to the change is worth the effort.

CR: How do you deal with the elimination of local dividends?

WR: Again you have to get the finance department in the conversation because they need to understand what is happening. You need to explain that a dividend means you're paying too much money at the beginning and getting some of it back as a dividend approximately 18 months later. That's just not a cost effective way of doing things as any finance manager will quickly appreciate.

BQ: You need to ensure the finance department really educates the HR staff that, while it looks like you're getting a dividend back, you're actually paying up front costs which are not being returned to you. So dividends are paying extra for the promise of less money in the future whereas, when you bring it in to a captive arrangement, you're getting those savings upfront and you're retaining the cash within the corporation.

CR: Any special issues when unions/trustees/works councils are involved?

WR: Unions are usually more concerned with employer service issues rather than the costs of the programmes to the company; unless it's also a plan that is partially paid for by employees. If it is partly employee paid, you need to show the union that by moving to this new model, there will be savings in the cost of the plan with no impact on service. Getting union support requires some good face-to-face discussions to help them understand exactly why this is happening and maybe even introduce them to the local service providers so they can start developing relationships.

BQ: The important thing for the union or works councils to understand is that you're not looking to change anything; you're just trying from a corporate point of view to finance this more efficiently. There shouldn't be any issues, but unions and work councils will of course want to ensure that any concerns they've outlined are not going to happen and employees are not going to suffer. That's something you need to do which your local provider should be able to help with.

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BRIAN QUINN, director and CUO of Granite Management, specialises in reinsuring and/or financing IEB programmes into captive entities designed to reduce costs without changing terms and/or conditions of the employees' benefits. Previously Brian was the CUO for General Motors' captive.

WR: You need to understand that historically they have only seen cost savings through a reduction in the programme terms and conditions and that is how they are viewing this cost savings effort. You need to convince them that you're not changing any of the terms and conditions and I have found the best way to do this is to state that you will take the current contract and simply "erase" the name of the current provider and insert the name of the new one. That way they can be assured that you have not changed one word in the former contract and that all current terms and conditions are unchanged.

CR: What are some of the external obstacles and some effective ways to deal with them?

BQ: The external obstacles are generally the current local insurer or local broker. The local insurer may become an obstacle if they are not associated with the network you chose as your global partner and you need to change to a different insurer. It is quite understandable that the former local insurer will resist in this case so you need to persuade your local business that the new insurer will provide at least the same, if not better, level of service than they currently have together with long term savings in the programme cost.

Another external obstacle concerns the broker and the local broker relationship. In a captive arrangement, the typical broker function of annually marketing the contract is not required and captives may choose to eliminate them. However, in some cases brokers are also providing additional services and these should be looked at as to whether they are providing any added value and if so, their cost should be benchmarked.

WR: With regards to the local brokers and local insurers, you also need to be aware of the relationship those people have with your local HR director. What you're doing is you're very clearly disturbing that relationship and you need to help your locals understand why it's necessary for that relationship to change as well.

All of these obstacles are real and important to deal with but they are not insurmountable. Importantly, the savings realised by a captive reinsurance arrangement are real and worth the effort required to overcome the obstacles.