Healthcare Financing

Global Trends

Rajesh Daswani

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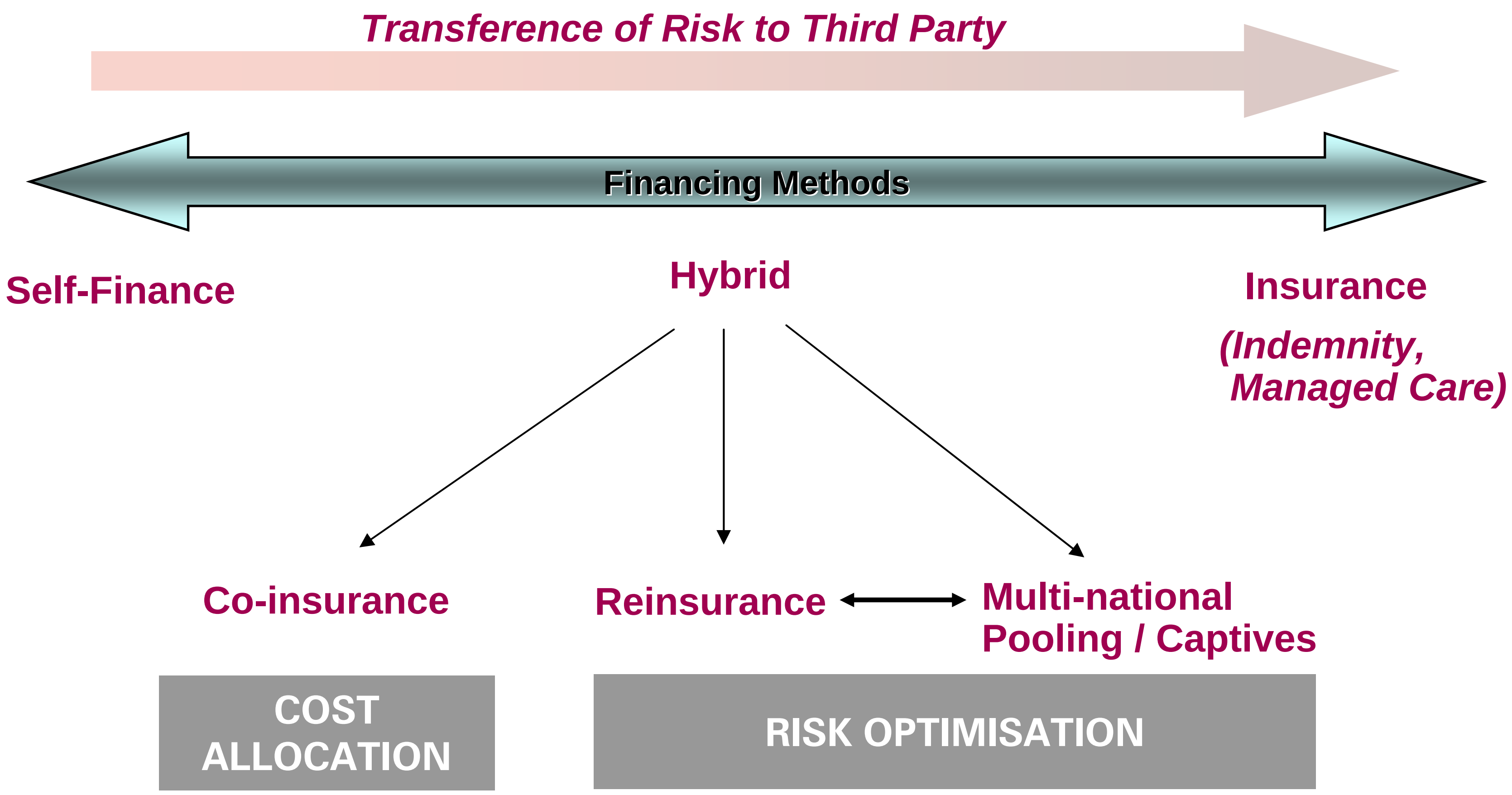
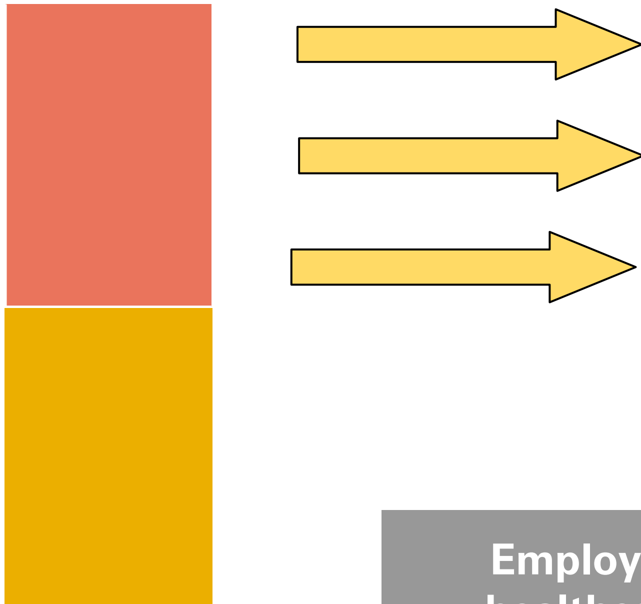
TOWERS WATSON

Spectrum of Healthcare Financing



Cost Allocation

Co-Insurance - Cost Allocation



Annual / Disability Limits

Co-sharing

Deductibles

Employers are increasingly shifting the cost of healthcare to their employees so they can take responsibility in managing their health

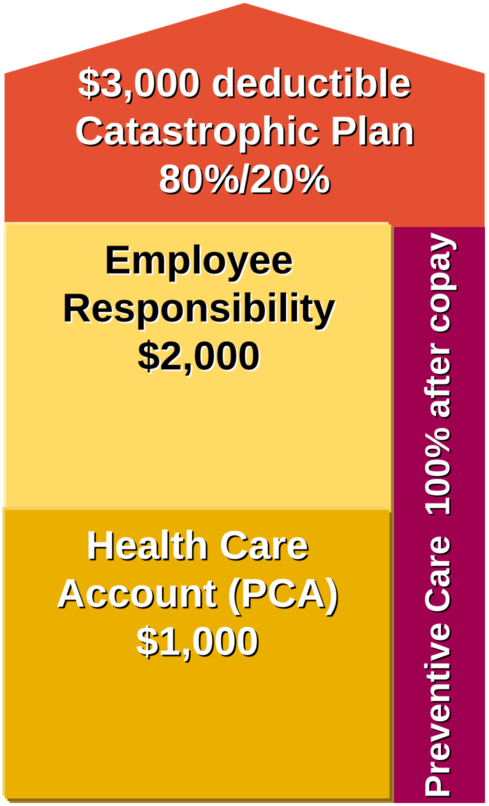
Health Savings Accounts (HSAs)

Key: Who carries risk?

- Company
- Third Party
- Employees

What might a Health Savings Account look like?

- A basic plan design might be as follows:
- Each employee receives a deposit into a health account from the employer, in this instance $1,000
  - Basic preventive care is covered at 100% after applicable co-pays
- Employees are also offered a supplementary catastrophic plan, with a large deductible of $3,000
  - Once the $3,000 deductible has been met, all additional medical care is covered at 100%
- Employees might be able to roll-over any unused dollars from the health account



Advantages/disadvantages of HSAs — employer perspective

Advantages

- Minimizes employer liability
- Maintains current tax advantages
  - Employer tax deductibility
  - Employee contributions (pre-tax)
- Potential for program cost savings if employer contribution is set below current program costs PEPY
- Potential for long-term administrative cost savings
- Promotes employee choice and responsibility
- Establish employer as “employer of choice”
- Elucidates real costs of medical care to employees and users

Disadvantages

- Might be viewed by employees as less attractive
- May require multi-year transition
- Could possibly increase cost in the short term
- Requires detailed communication/education

Advantages/disadvantages of HSAs — employee perspective

Advantages

- Empowers employees to become more informed consumers
- Provides more choice for employees
- Simplifies access to health care services
- Maintains tax efficiency (most models)

Disadvantages

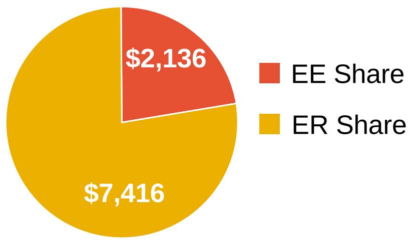
- Requires computer literacy for maximum efficiency
- Places more responsibility with employee
- Likelihood of increased cost-shifting
- May increase out-of-pocket costs

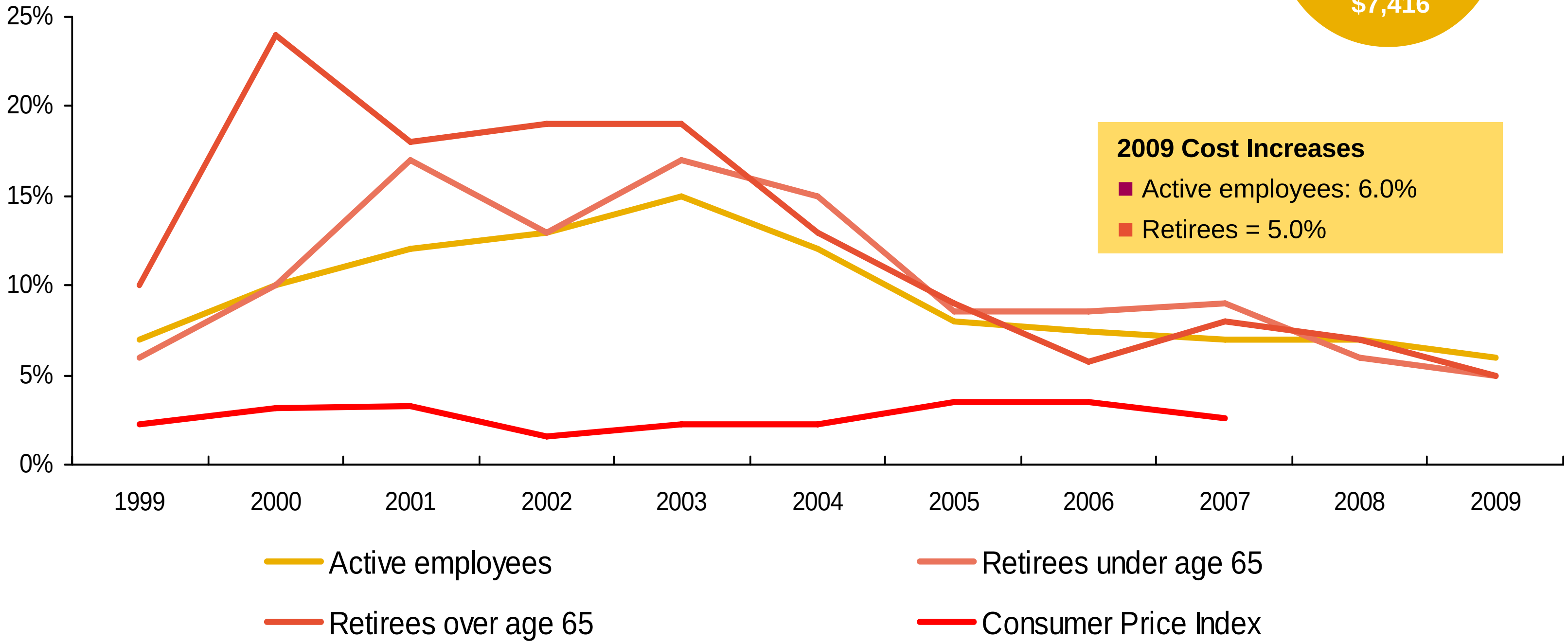
Medical Inflation Trends in the US

1999 – 2009 Health Care Cost Survey

- Active health care costs have increased by approximately 150% since 1999

2009 Total Cost - $9,552





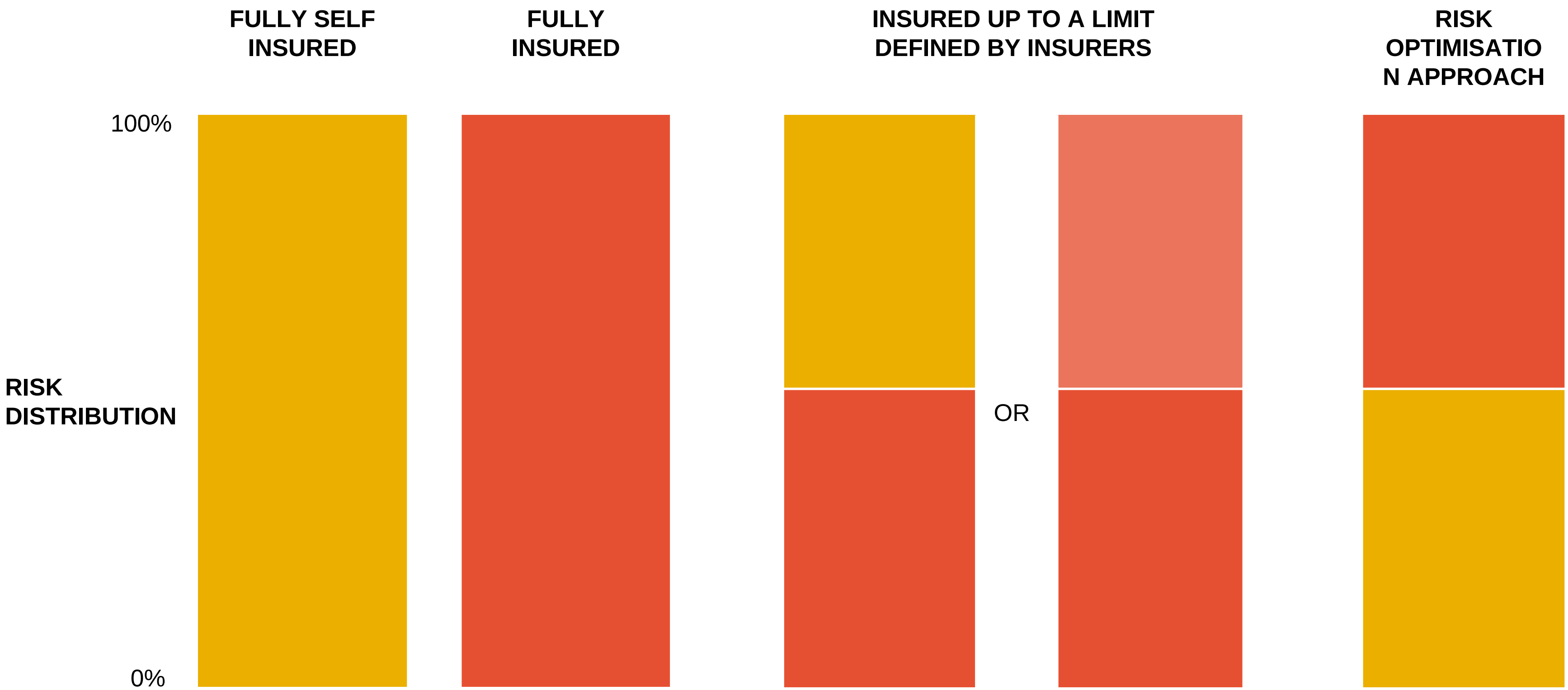
2009 Cost Increases

- Active employees: 6.0%
- Retirees = 5.0%

Source: Towers Perrin *Health Care Cost Survey (1993 – 2009)* (active employee data) and Bureau of Labor Statistics, Consumer Price Index, U.S. City Average of Annual Inflation, April-April, 1988-2007, Bureau of Labor Statistics.

Risk Optimisation

Reinsurance / Pooling / Captives - Risk Optimisation



Key: Who carries risk?

- Company
- Third Party
- Employees

Risk optimisation approach - using relevant tools/ techniques to achieve desired outcome, eg:

- multinational pooling
- reinsurance
- captive(s), eg as a facilitator
- alternative routes

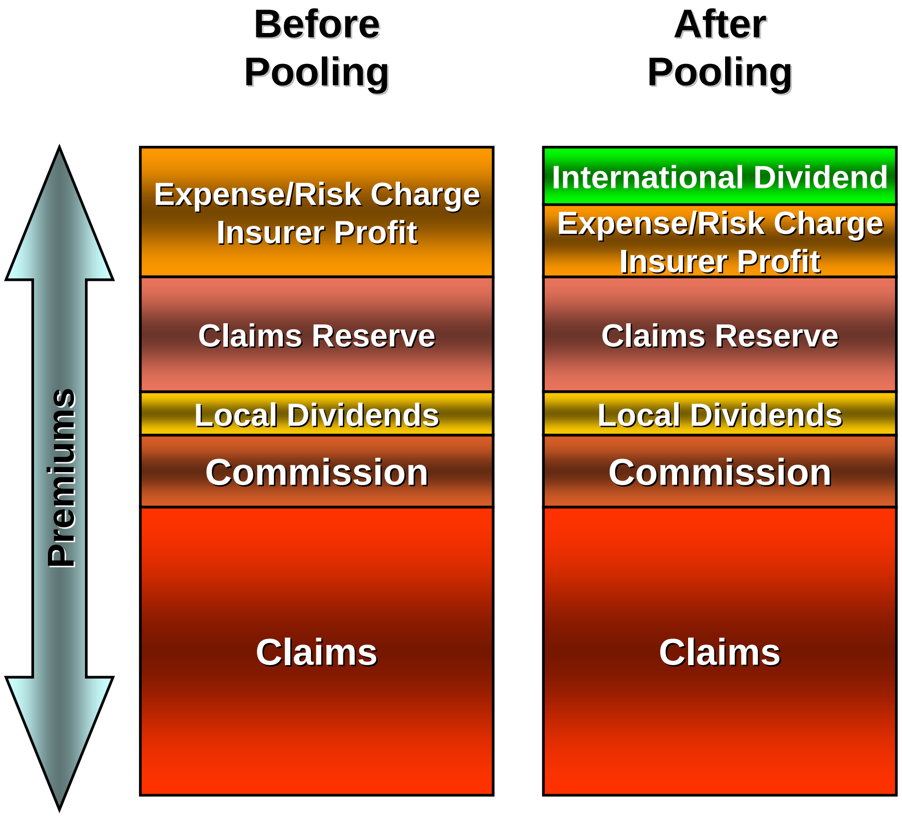
Multinational Pooling

What Is Multinational Pooling?

Multinational Pooling is a financial accounting system used to reduce employee benefit costs by ‘experience rating’ group insurance contracts in multiple countries under an umbrella arrangement.

Where do Financial Savings Come From?

- Favourable claims experience
- Reduced insurer profit in return for longevity of contract
- Global purchasing power leveraging lower local premium rates

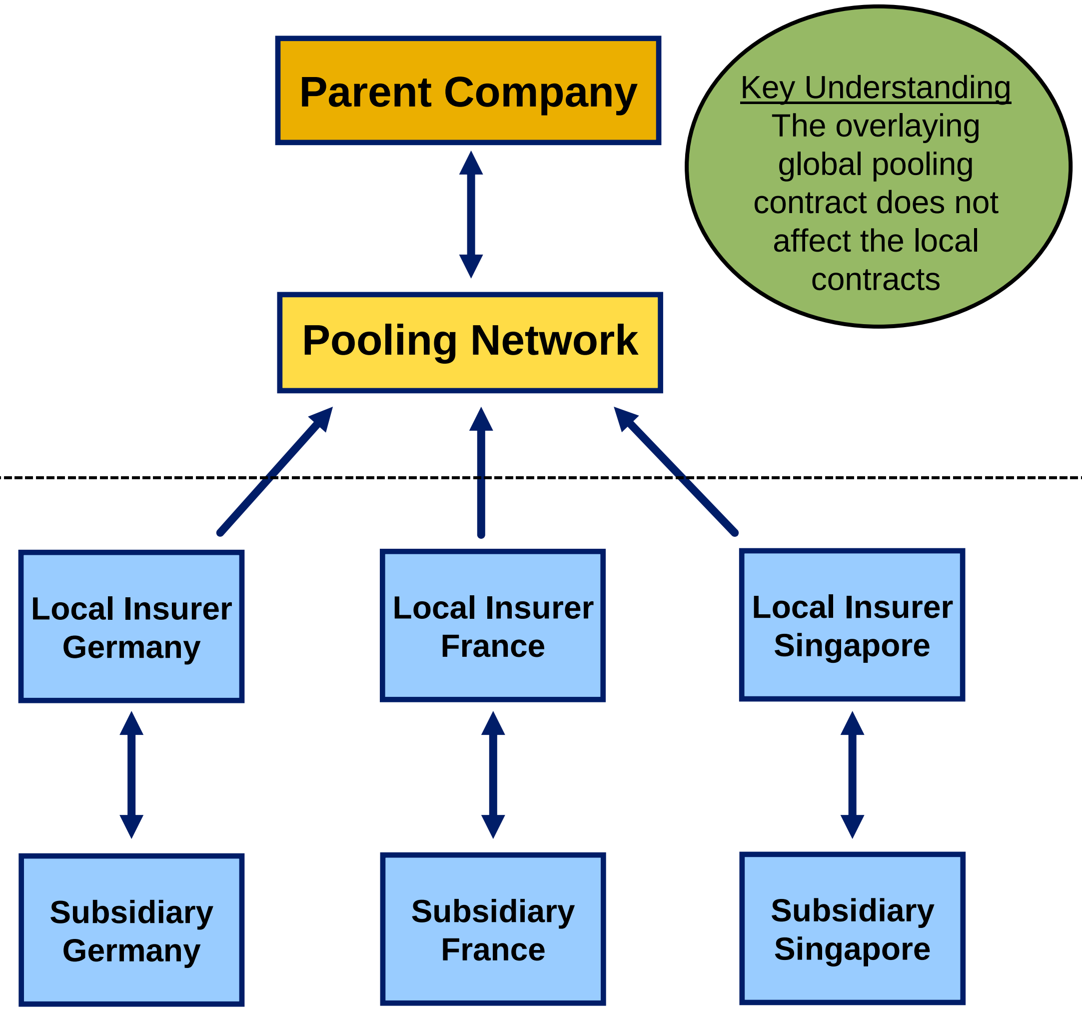


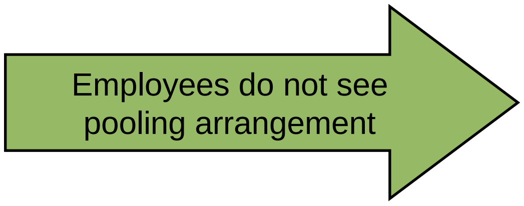
How Does Multinational Pooling Operate?

Pooling operates on 2 levels:

GLOBAL pooling contracts &

LOCAL contracts (life disability, medical & pension)





Summary Of Opportunities Of Maximising Pooling

	Financial	Non-Financial
Corporate	■ Overall annual cost savings ■ Improved financial reporting to corporate ■ Opportunities to understand and evaluate claims and risk to the group, on a consistent and regular basis. ■ Potential for international dividends to use as required	■ Central point of contact for corporate to discuss local risk contracts (performance, status etc.) ■ Greater leverage with local providers ■ Opportunities for corporate to align risk provisions with global business needs ■ Opportunities to improve the efficiency of transferring employees between countries ■ Consistent and regular information to corporate
Local	■ Opportunities for annual local cost savings – either directly upfront, over time or in other formats ■ Opportunities to understand the need and necessity of peripheral costs such as broker fees and make decisions of whether they bring value (financial or otherwise) to the local operation.	■ Leverage to manage underwriting requirements ■ Opportunities to work with Corporate to understand global benefits and risk principals ■ Improved service from local provider ■ Greater influence with local insurers ■ Opportunities to increase guaranteed coverage levels

The establishment of a comprehensive and pro-active risk benefit financing strategy is a fundamental step for any global organisation in pursuit of cost control and management of employee benefit insurance arrangements worldwide.

How Do “Best Practice” Companies Manage Their Insured Employee Benefits?

- The world economic turndown has prompted multinational pooling arrangements to be more actively managed in order to help cut costs.
  - Annual review of the pools covering financials, structure and service.
  - Annual negotiations over cost. – risk and retention
  - Optimising pool protection – specific and aggregate stop loss
  - Looking out for expansion opportunities.
  - Consolidation of pooling arrangements and focus on preferred provider approach.
  - Introduce Service Level Agreements with preferred Networks.
  - Ongoing claims management and reserving practice reviews.
- Shift in “ownership” from HR towards to joint management with insurance/risk teams.
- More formalised approach to contract renewals and roles and responsibilities.
- More companies with large insured benefit spend, with an appetite for self-retention of risk, are considering including employee benefit risks within a captive arrangement in order to maximise savings.

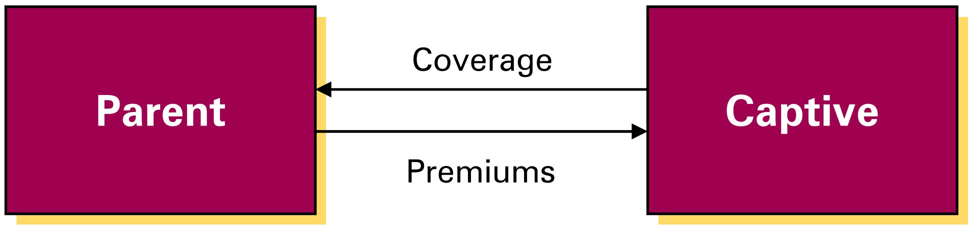
Captives

What is a Captive?

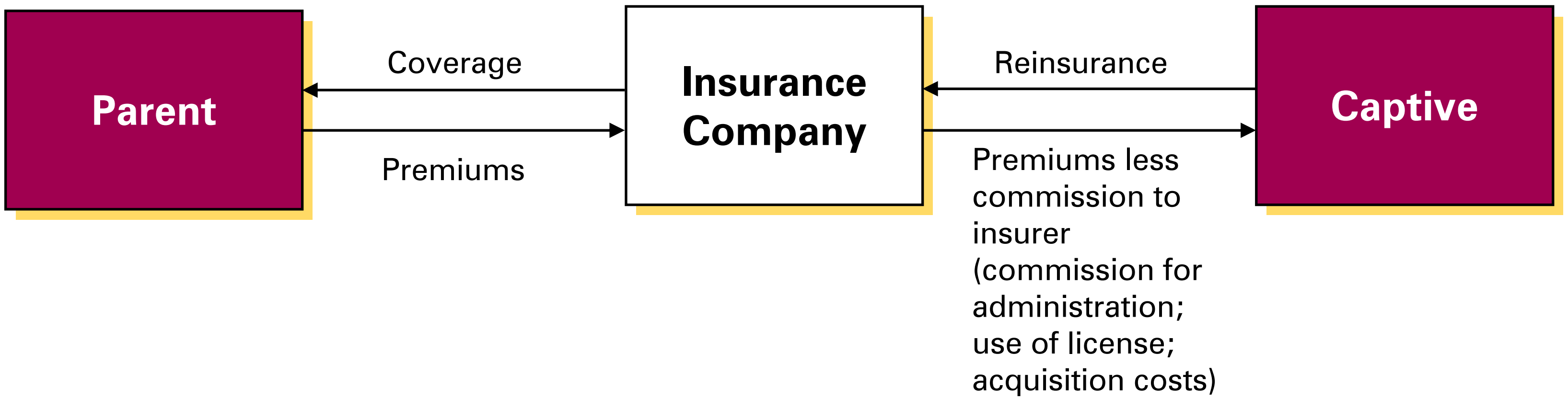
A captive insurance company is an insurance or reinsurance company wholly or mainly owned by an organization and used to insure or to reinsure the organization's employee benefits risks, hazard risks, or other risks of the enterprise

A captive can be used to either insure or reinsure risk

… direct insurance



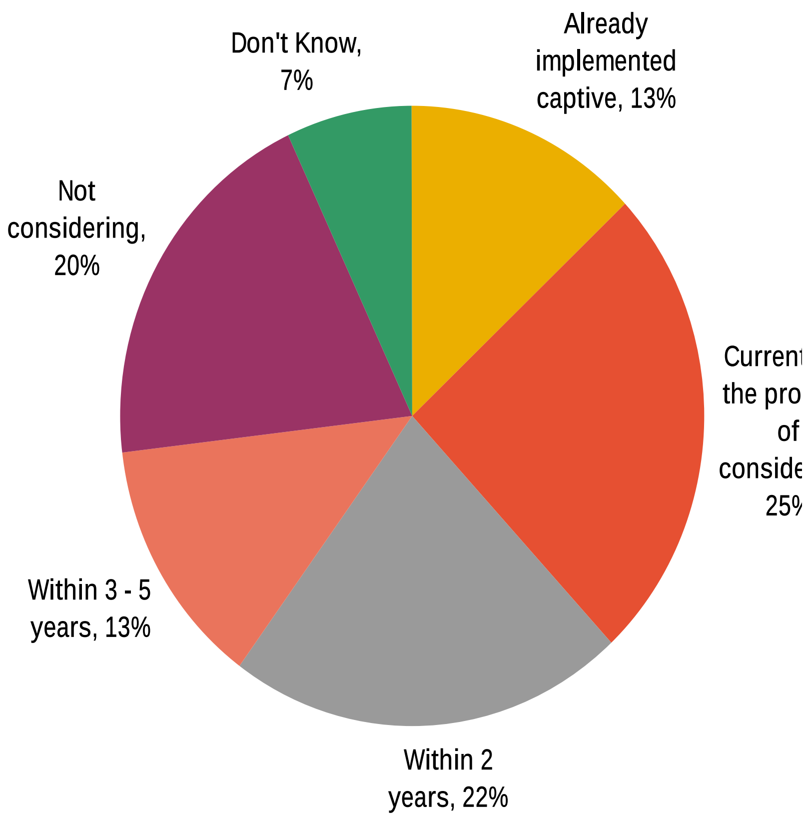
… reinsurance



Captives generally operate like an insurance company

Essential Functions	Typical Practice	Commentary
Underwriting and pricing	Insurance or benefits head as underwriting officer, with consultation of treasurer and insurance broker(s)/ consultant(s); actuary used to set pure premium	Premium usually based on parent loss experience with some sensitivity to commercial rates
Claims	Claims adjuster or commercial insurer (for claims services only)	Many captives audit claim reserves just like commercial insurers
Accounting/ administration	Captive management companies - Accounting - Annual filing of insurance and accounting records with domicile	Some captives are self-managed (e.g., AstraZeneca, ExxonMobil, ABB) Captives follow statutory and financial accounting guidelines of their domicile
Governance	Board generally includes treasurers and/or CFO, risk manager, outside counsel in domicile, other parent executives	A few captives include HR executives when benefits are included

Use of captives for employee benefits is increasing… and the advantages include



Source: Towers Perrin Captive Survey 2004.

Financial Advantages

- Cost savings
  - Accelerate cash flow
    - Premiums
    - Claims
    - Reserves
  - Capture investment return
  - Eliminate risk charges
  - Reduce expense
  - Remove insurers' profit loading

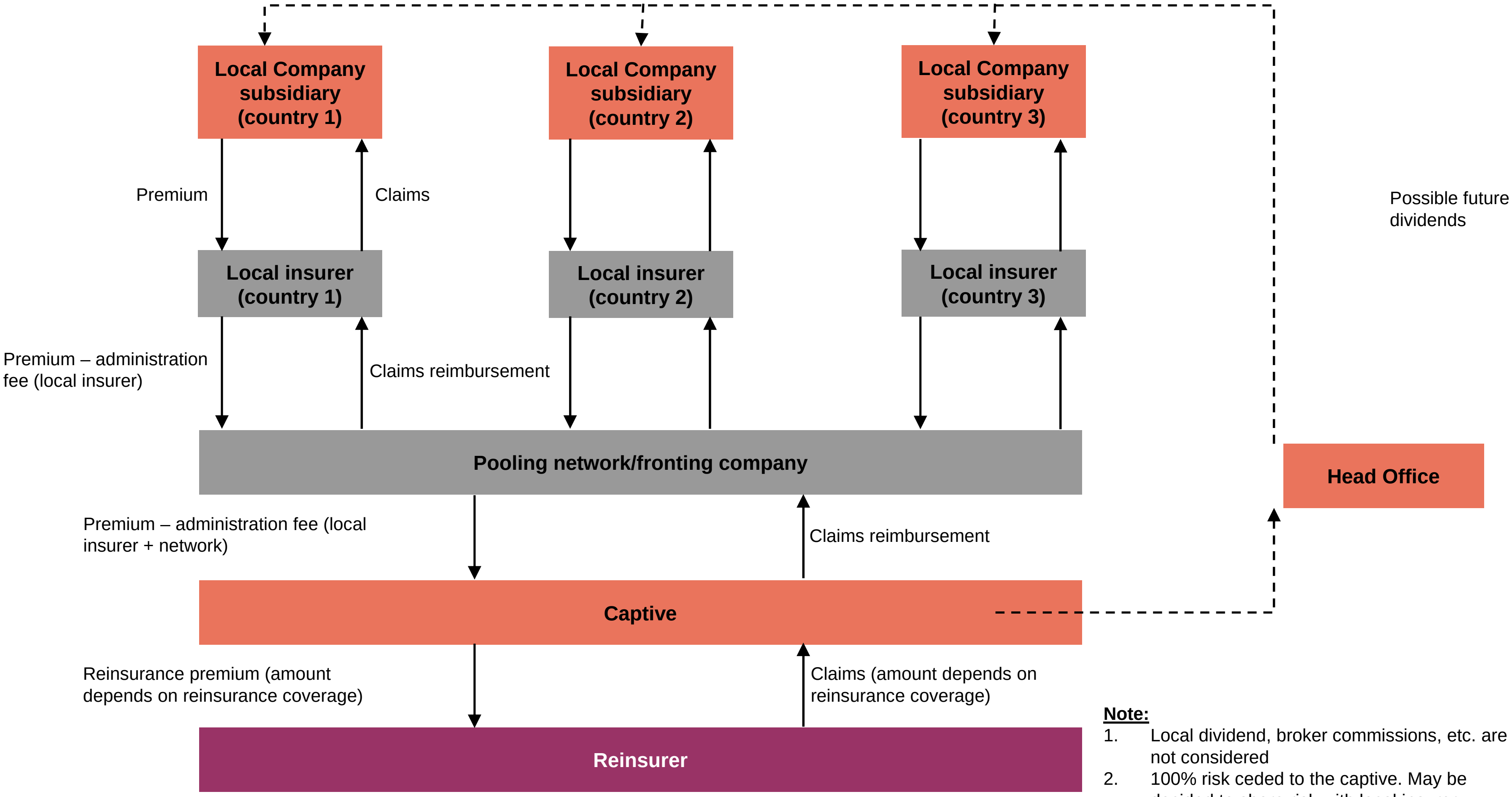
Non-Financial Advantages

- Increase control
  - Custom design coverage and the provision of benefits to meet the company's definition of benefits rather than insurer's definition
  - Ex gratia payments
  - Data warehousing
- Spread of risk

Use of captives — the "Evolution"

Ten Years Ago	Now
• Captives had largely been absent from International benefits financing: • Companies often perceived obstacles (e.g., reinsurance restrictions) • Territorial restrictions, i.e. US • Relatively few multinational pools reinsured by captives — Limited HR familiarity with captives — Insurer reluctance	• More people involved: • HR, finance and risk • Consolidation of multinational pools • Companies looking at captive solutions as next step in cost savings and control • Active management increasing: • Communications • Formal guidelines • Annual review and changes • Quarterly claims management

A typical captive structure showing cash flows



Note:

1. Local dividend, broker commissions, etc. are not considered
2. 100% risk ceded to the captive. May be decided to share risk with local insurer
3. Captive reinsures the risk on the reinsurance market. Could also use Network if offered

Magnitude of Savings

Client Example

Six Pools
Total Premium
£8M

→ Conducted Pooling Audit

→ Pooling Study

→ Pooling Results
12 months later:
£1.32M annual savings

→ Develop Captive Strategy

→ Captive Implementation

→ Captive Results
24 months later:
£2.31M annual savings

→ Future Objectives

- Add key countries
- Add more benefits
- Include US
- Review retiree medical

a European-based bank achieved 28% cost reduction over three years

Questions?