

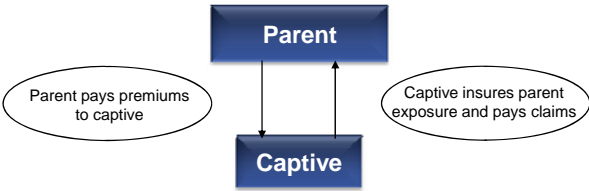



Liberty Mutual Group Insurance	
	<h2 style="color: #003366;">Employee Benefit Captives</h2> <p style="color: #003366;">Joe Poplaski September 24, 2009</p>

Liberty Mutual Group Insurance	<h3 style="color: #003366;">Microsoft seeks to fund LTD through captive</h3>
	<p>Microsoft Corp. has asked the Labor Department for authorization to fund benefit risks through the Vermont branch of its Bermuda-based captive insurance company. If the captive benefits funding application is approved, Microsoft, would be the fourth Fortune 50 company to get Labor Department permission for such arrangements. Previously authorized Fortune 50 companies are jet engine manufacturer United Technologies Corp. in Hartford, Conn., Wells Fargo & Co. in San Francisco and Archer Daniels Midland Co. in Decatur, Ill.</p> <ul style="list-style-type: none"> ▪ More applications are likely, experts say. Experts say captive benefit funding can cut benefit costs about 5% to 10% a year compared with buying coverage directly in the commercial market. Such savings are possible because underwriting gains go to the captive and not a commercial insurer. <p>Source: Business Week</p> <div style="text-align: right;">  </div>


Liberty Mutual Group Insurance	<h2 style="margin: 0;">What is a Captive?</h2>
	<ul style="list-style-type: none"> ▪ A captive is a formal insurance subsidiary established in order to finance exposures primarily of its owners / controllers ▪ Acts as an alternative funding mechanism for insurance buyers ▪ Over 50% of fortune 500 companies own their own captives ▪ Bermuda is the largest with 1/3 of all active captives <div style="text-align: right; margin-top: 20px;">  </div>

Liberty Mutual Group Insurance	<h2 style="margin: 0;">Pure (Single Parent) Captive</h2>
	<ul style="list-style-type: none"> ▪ Most common structure ▪ Owned and controlled by one owner ▪ Licensed and regulated by captive domicile ▪ Insures the risks of the parent only ▪ Some captives write unrelated business <div style="text-align: center; margin-top: 20px;">  </div> <div style="text-align: right; margin-top: 20px;">  </div>

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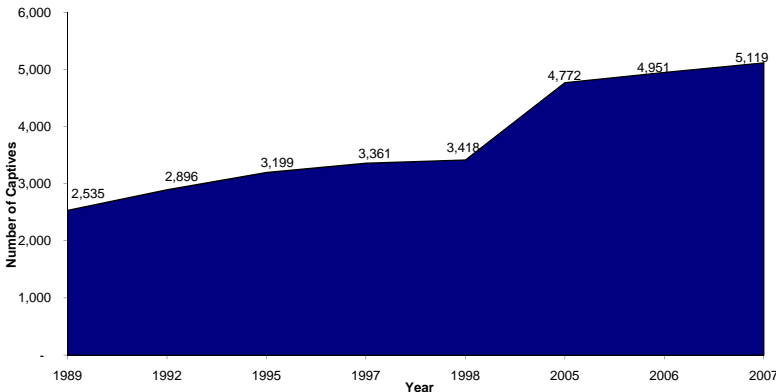
Background

- Use of captives for P&C coverages became prevalent in the 1950s
- The 1980s liability crisis – mostly in the medical/professional/product arena brought additional interest
- Previous “hard” insurance markets expanded the use of captives
- Legal and regulatory changes allowed expansion from property/casualty into employee benefit coverages
- Current downward trending economy is expected to spur growth of captives




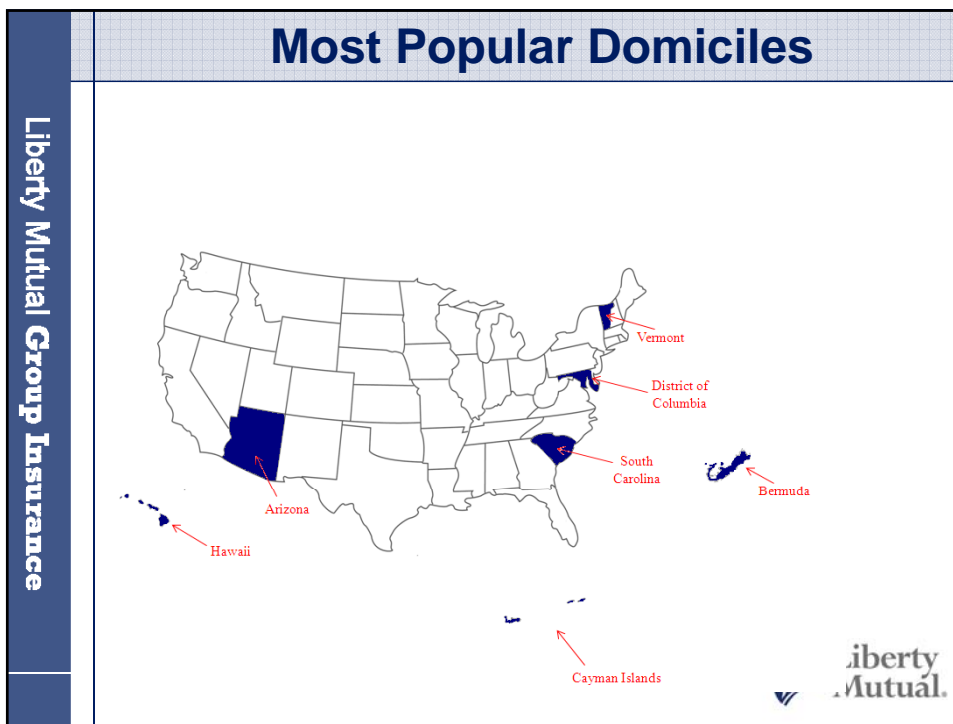
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Growth of Captives Over Time





Year	Number of Captives
1989	2,535
1992	2,896
1995	3,199
1997	3,361
1998	3,418
2005	4,772
2006	4,951
2007	5,119







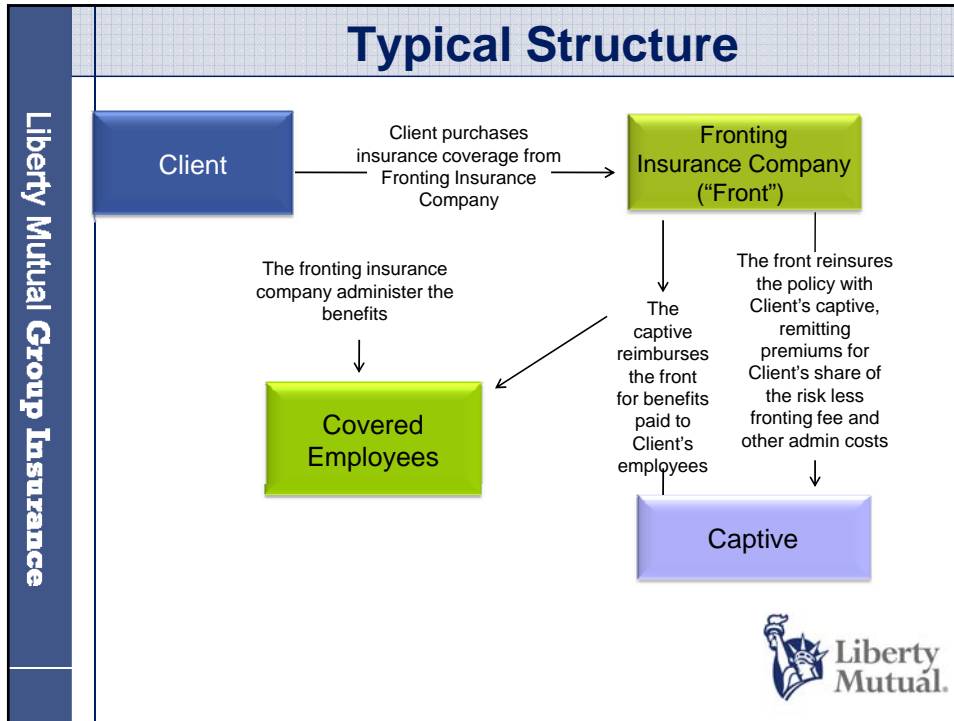
- ### Why Captives?
- Liberty Mutual Group Insurance
- Lower overall coverage costs for insurance
 - Greater risk management
 - Improved cash flow
 - Possible tax advantages
 - Enhanced investment returns
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- The Liberty Mutual logo, featuring a stylized figure holding a torch and the text "Liberty Mutual", is located in the bottom right corner of the slide.


Liberty Mutual Group Insurance	Why Were EE Benefits Excluded?
	<ul style="list-style-type: none">▪ Casualty funding mechanism▪ ERISA prohibition due to party of interest▪ Department of Labor required 50% of captive business must be 3rd party▪ Another vehicle already exists – self insurance 


Liberty Mutual Group Insurance	Why Now?
	<ul style="list-style-type: none">▪ DOL ruling on Columbia Energy LTD Plan:<ul style="list-style-type: none">▪ Prohibited Transaction Exemption (PTE) granted if certain conditions are met.▪ EE benefit premium is 3rd party premium, since payments are not made to the employer▪ Now there is an expedited PTE procedure in place 


Liberty Mutual Group Insurance	DOL Conditions - Captive
	<ul style="list-style-type: none">▪ Captive is a party of interest▪ Captive is licensed to sell insurance or conduct reinsurance in at least one state as defined by the ruling▪ Independent CPA must examine the last completed tax year prior to the reinsurance transaction▪ State of domicile must conduct a financial examination of the captive 


Liberty Mutual Group Insurance	DOL Conditions - Plan
	<ul style="list-style-type: none">▪ In the initial year, there will be an immediate and objectively determined benefit to the Plan's participants in the form of increased benefits▪ The pricing methods used by the (fronting) insurance company and premium charged will be similar to those of other insurers providing LTD under similar programs.▪ The insurer (fronting carrier) will not be relieved of liability under the Plan should the captive be unable or unwilling to cover any liability▪ An independent fiduciary is to analyze the transaction and confirm that the above requirements have been met 




- ### Cost Savings
- Eliminates insurer's risk & profit charges
 - Spreads captive expenses over a larger premium base
 - Captures investment return
 - Allows for selection of own reserve assumptions
 - Removes commission from the transaction (a DOL requirement)
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Liberty Mutual Group Insurance	<h2 style="margin: 0;">Increase Unrelated Business</h2>
	<ul style="list-style-type: none"> ▪ Revenue Ruling 92-93 concluded that employee benefits coverage written in a captive is unrelated business since it is insurance for the employee and not for the company ▪ Adding unrelated business to an existing P&C captive can improve the captive's overall financial efficiency and create additional savings <ul style="list-style-type: none"> ▪ Captive treatment as insurance is important ▪ Specific results can increase the potential for premiums paid to the captive and reserves held by the captive to be tax deductible <div style="text-align: right; margin-top: 20px;">  </div>

Liberty Mutual Group Insurance	<h2 style="margin: 0;">Increased Employer Control</h2>
	<ul style="list-style-type: none"> ▪ Design coverage and provisions of benefits ▪ Improve data management ▪ Improve claims cost management ▪ Increase investment returns ▪ Long-tailed claim reserves can grow to many times annual premiums, quickly expanding the captive's assets, and provide positive cash flow to the captive for many years ▪ Increased assets can make it possible to diversify the captive's investment portfolio, reduce risk and increase returns <div style="text-align: right; margin-top: 20px;">  </div>

Liberty Mutual Group Insurance	Common Risk Management Philosophy
	<ul style="list-style-type: none"> ▪ Utilizes similar approaches for P&C and employee benefits ▪ Operates as central risk pool ▪ Can pool across countries ▪ Leverages access to reinsurance markets ▪ Reduces overall cost of risk <div style="text-align: right;">  </div>

Liberty Mutual Group Insurance	Using a Captive vs. ASO	
	<u>Captive</u>	<u>ERISA Self-insurance</u>
	+ Can increase overall 3 rd party premium in the captive	+ Can get an immediate tax deduction for funded reserves
	+ May allow other captive premium to become tax deductible	+ Don't have to fund an ERISA trust
	+ Makes self-funding Group Life possible	+ No premium tax
	- Need to provide better benefits	+ No insurance regulation
	- Additional expenses (fronting fees, captive requirements)	- Can't combine risk with insured programs



<p>Liberty Mutual Group Insurance</p>	
	<p>Questions?</p>