Compensation
Advisory Partners

Industry Report // 2017-2018

Insurance

CAP examined 2017 compensation and financial performance across two segments of the insurance industry including eighteen of the largest Property & Casualty (P&C) and Life & Health (L/H) Insurance companies[1]. 2017 median revenue of these companies was approximately $19B compared with 2016 median revenue of $18B. The study focused on performance and pay trends and industry dynamics affecting pay practices within the industry.

1 See Exhibit 1 for list of companies included.

1133 Avenue of the Americas | New York, NY 10036 | Phone: (212) 921-9350 | Fax: (212) 921-9227 | capartners.com

Key Takeaways

- Insurance industry bonuses for 2017 performance were up year over year in spite of major catastrophes that weighed on the P&C industry.
- Annual incentive plans in the P&C industry take varying approaches to deal with the impact of catastrophes on earnings.
- We expect to see increased focus on digital innovation and improved customer experience in annual incentive plan designs.
- Long-term incentives continue to emphasize performance plans with Operating Income, ROE and Relative TSR as the primary measures used.

2017 Performance: Financial Results Improve Despite Industry Challenges

The insurance industry saw an uptick in financial performance in 2017 compared to 2016. While 2017 presented some significant challenges for certain segments of the industry, revenue and operating income growth overall were stronger in 2017, and ROEs overall were flat, though stronger in some industry segments. Notwithstanding such improvements, the insurance industry slightly underperformed the broader stock market, with median TSR of 16%, just below the S&P 500 median TSR of 20%.

The P&C industry experienced record catastrophe (CATs) losses and continued to be challenged by loss frequency and severity. Some of the earnings pressure was eased however, by improved investment income results, operational improvements, and adequate capital levels that helped companies withstand losses.

L/H companies did not experience as strong of an interest rate environment as originally expected yet did benefit from modest economic improvement/healthy economy and continued demand for certain products. L/H companies were challenged by the uncertainty surrounding the U.S. DOL's fiduciary rule, weaker annuity sales, and changing consumer preferences.

P&C Financial Performance

- Revenue growth of 4.6% at median for the P&C businesses this year outpaced prior year increase of 2.6% at median.
- Operating Income increased by 11% at median, an improvement over 2016. Results varied dramatically by company however, with the degree of CAT losses impacting profitability.
- Operating Income ROE was approximately 8%, reflecting a decline versus the prior year, yet ROE increased for five of nine P&C companies.

L/H Financial Performance

- Revenue increased by 2.5% at median, in line with the prior year increase.
- Operating income increased 11% at median, an improvement from 2016.
- Operating Income ROE improved from 12% to 13%, with stronger ROE at seven of nine L/H companies.

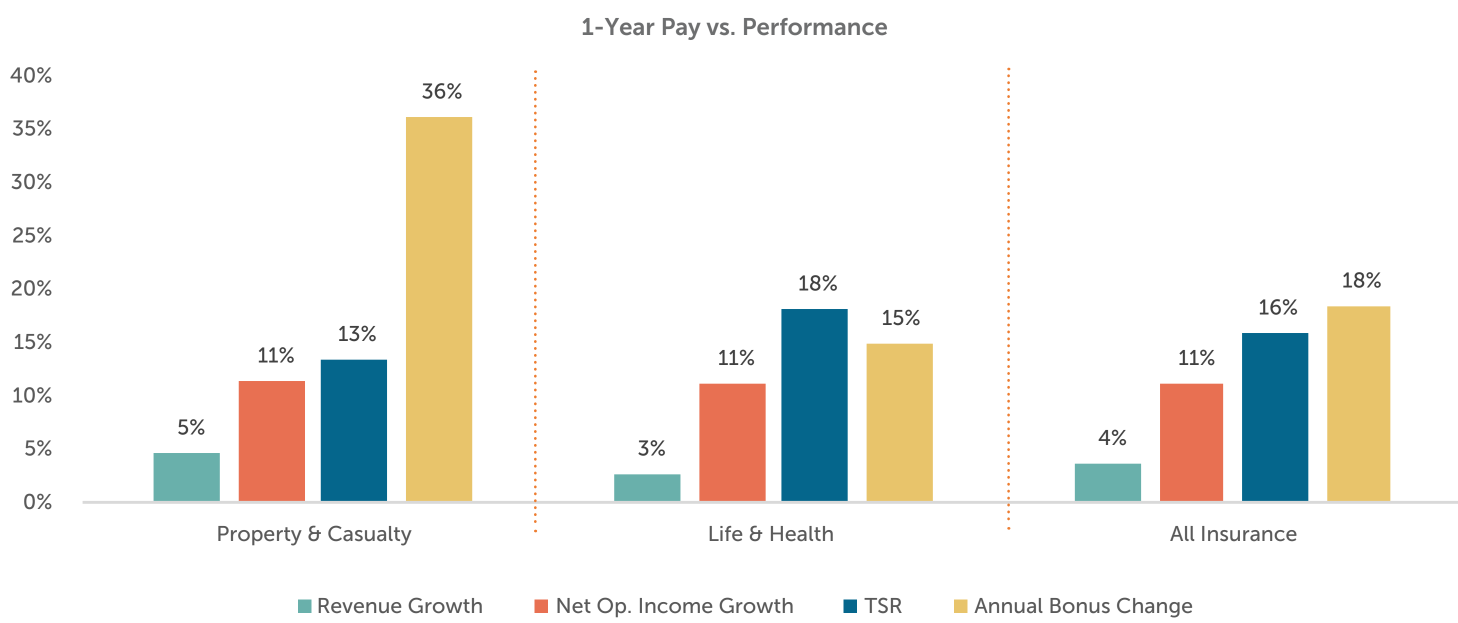
2017 CEO Pay for Performance: Bonuses Align with Performance

CEO Bonuses	Median Annual Incentive Payouts (% of Target)			Median Annual Incentive Payouts (% of Salary)		
	2017	2016	2015	2017	2016	2015
P&C (n=9)	170%	74%	126%	393%	225%	245%
Life and Health (n=9)	142%	120%	93%	300%	264%	186%
Total Sample (n=18)	**145%**	**100%**	**102%**	**309%**	**254%**	**243%**

Property & Casualty: 2017 was a turbulent year for the P&C industry; notably, CAT losses increased 122% at median for the companies in our study. While profitability was impacted at some companies more than others, 2017 results were generally stronger than 2016. Five of the nine P&C companies had an increase in Operating Income for the year.

Results for P&C companies translated to an increase in CEO bonus payments from 225% of salary in 2016 to 393% of salary in 2017. In all but one company, CEO bonuses changed in the same direction as the change in Operating Income results; five of nine companies saw bonuses increase, while four were flat or down. The median bonus increase was 36% compared to an overall decrease last year.

Life & Health: The L/H industry delivered positive results in 2017, somewhat stronger than in 2016. Operating Income increased in seven of the nine companies. After seeing an increase in bonuses for 2016, L/H companies saw bonuses increase again in 2017 from 264% to 300% of salary at median, and all but two companies had an increase in CEO bonuses over the prior year. The median bonus increase was 15% overall.



Despite some challenges in certain industry segments, the general direction of CEO bonuses was even more aligned with financial performance results among insurance companies in 2017 vs 2016.

Annual Incentive Plans

The financial metrics underlying annual incentive plans are often tied to short-term growth and profitability. Accordingly, the most common annual incentive financial metrics used by companies in our study are Operating Income (used by 83% of companies), followed by ROE (39%) and Revenue/ Premiums (39%). Approximately two-thirds of the companies in CAP's sample include an assessment of individual performance in the determination of the CEO bonuses.

	Most Prevalent Annual Incentive Plan Metrics		
	Metric #1	Metric #2	Metric #3
Property & Casualty	Op. Income (67%)	Op. ROE (33%)	Combined Ratio (33%)
Life & Health	Op. Income (100%)	Revenue (56%)	Op. ROE (44%)
All Insurance	Op. Income (83%)	Op. ROE (39%)	Revenue/Premiums (39%)

Insurance companies can experience a great deal of volatility in their financial results from year to year, impacted by interest rates, catastrophic events, and regulatory changes, among other things. Further, gains/ losses from various insurance products are realized over differing time periods and investments are longer term in nature.

Incentive plan payouts are generally driven by the degree to which financial results meet pre-established goals. To date, however, companies have employed various approaches to mitigate some of the volatility in financial results and ensure that incentives reflect results controllable by, and reflective of, management actions and decisions. A few select companies use budgeted CATs or a protective "collar" around CATs or investments to determine incentive plan results, and others use discretionary funding to allow for consideration of external factors.

In the future we expect to see greater use of performance measurement around what we classify as strategic objectives. These may include new business, strategic investments/ acquisitions, customer service, technology improvements/ capabilities, as well as diversity and risk management. Companies incorporate these criteria through an individual performance assessment and resulting award modification, or in some cases, by funding a small award component based on strategic or individual performance results.

In particular, we believe that innovation/digital capabilities and the customer experience, will increasingly be a part, albeit small, of incentive decisions. Measuring results and defining success in these areas is challenging, yet most companies are already having discussions around these critical issues.

Long-term Incentive Plans

A strong majority of insurance companies use long-term performance-based incentive plans. These performance plans account for at least 50% of the overall executive LTI program for all but one company, and on average they account for 62% of the CEO's LTI program. Almost all companies use a 3-year performance period.

	CEO LTI Mix			Other NEOs LTI Mix		
	Stock Options	RS/RSU	Performance Plan	Stock Options	RS/RSU	Performance Plan
Property & Casualty	19%	14%	66%	19%	16%	65%
Life & Health	19%	23%	58%	23%	21%	57%
All Insurance	19%	19%	62%	21%	18%	61%

The most commonly used metrics in long-term performance plans are Return on Equity (67%) and Relative TSR (56%), and the combination of ROE and Relative TSR is used by 39% of companies. The use of a relative metric (most often TSR) in conjunction with an absolute financial metric helps provide balance and can offset issues associated with setting three-year goals in a volatile industry.

	Most Prevalent Long-Term Incentive Plan Metrics		
	Metric #1	Metric #2	Metric #3
Property & Casualty	TSR (56%)	OI ROE (44%)	Book Value (44%)
Life & Health	OI ROE (89%)	TSR (56%)	Op. Income (33%)
All Insurance	OI ROE (67%)	TSR (56%)	Op. Income; Book Value (28%)

To date, we have not seen individual or 'strategic' performance considerations impact LTI award grant levels or payouts, as they do for many companies in the annual incentive plan.

Conclusion

We expect the insurance industry will continue to see improvements in performance in the near future. Insurance companies should benefit from the rising interest rates, a faster-growing economy, and a more business-friendly regulatory environment, including the recent developments around the DOL fiduciary rule.

The insurance industry is competitive however, and companies will increasingly need to compete not only on pricing and customer service, but also on the ability to tailor product offerings and delivery methods for the new generation of consumers. Consumers are becoming more tech savvy and may purchase many of their products and services online. Companies will need to focus on new methods of consumer outreach and improving their digital platforms.

While we expect the industry overall to continue to grow, some companies will struggle and some will thrive depending on their abilities to react to the shift in consumer demographics and demand preferences, to reach even greater operational efficiencies, and to respond to the need for digitalization. While most Compensation Committees strive for simplicity in pay programs, we expect companies to increasingly incorporate progress in key strategic areas in the annual incentive program given their importance. We also expect companies to continue to spend great effort on the goal setting process given the inherent volatility in the industry.

Additional Information – New CEO Pay Ratio Disclosure

Seventeen of the companies in CAP's sample were required to disclose the ratio of their CEO pay to that of the median employee in 2018. The reported CEO pay ratios among CAP's sample ranged from 84:1 to 301:1 with a median ratio of 178:1. Given company business models and the flexibility that companies have in the methodology/assumptions used to calculate the ratio, comparisons of ratios between companies are less meaningful. To date, institutional investors and proxy advisory firms have not used disclosed CEO pay ratios to inform their voting decisions. We may see some year-over-year comparisons in the second year of disclosure.

For questions or more information, please contact:

Melissa Burek
Partner
melissa.burek@capartners.com
212-921-9354

Kyle Eastman
Associate
kyle.eastman@capartners.com
212-921-9370

Roman Beleuta
Senior Associate
roman.beleuta@capartners.com
646-532-5932

Joanna Czyzewski
Associate
joanna.czyzewski@capartners.com
646-486-9746

Kyle Clemenza provided research assistance for this report.

CAP's Insurance Industry Sample

P&C Companies

Allstate Corporation
American International Group, Inc.
Assurant, Inc.
Chubb Limited
CNA Financial Corporation
Hartford Financial Services Group
Progressive Corp.
Travelers Companies, Inc
XL Group plc

Life & Health Companies

Aflac Incorporated
Genworth Financial, Inc
Lincoln National Corporation
Manulife Financial Corporation
MetLife, Inc.
Principal Financial Group Inc.
Prudential Financial, Inc.
Torchmark Corporation
Unum Group