Compensation
Advisory Partners

Industry Report // 2018-2019

# Insurance

This report examines 2018 compensation and financial performance across two segments of the insurance industry, including seventeen of the largest Property & Casualty (P&C) and Life & Health (L/H) Insurance companies. 2018 median revenue of these companies was approximately $22B. CAP focused on key compensation trends, financial performance, and industry dynamics affecting pay practices within the industry.

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## Key Takeaways

- Insurance industry bonuses for 2018 were down compared to 2017 bonuses, however payouts were still above target.
- 2018 performance results indicated another strong year for insurance.
- Annual incentive plans are slowly beginning to incorporate strategic objectives, including environmental, social and governance (ESG) issues, in bonus determinations. We expect to see increased focus on strategic measures in annual incentive plan designs.
- Long-term incentive practices remained almost unchanged since 2014 in terms vehicle prevalence and mix of awards.

## 2018 Performance: Solid Financial Results

The insurance industry overall generally experienced stronger financial performance in 2018 compared to 2017. Companies saw higher revenue growth, at a similar pace with 2017, while Operating Income results were more favorable. The stronger results however did not produce shareholder returns in line with financial results. Total shareholder returns of -17% at median for the companies studied was three times lower than the S&P 500 median of -6%, indicating a skeptical shareholder outlook for the insurance sectors.

The P&C industry experienced higher revenue growth in 2018. As far as profitability, Operating Income increased for all but two companies studied, and the median increase was 17.7% compared to 11.1% in 2017. Higher profitability was partly driven by lower catastrophe (CAT) losses in 2018, which declined by approximately 25%, but were still high, because of increased number of wildfires. Climate change has introduced additional uncertainty for property insurers and CAT loss volatility continues to have the potential for significant impact on results.

L/H companies also performed well but revenue only grew 2.8% at median (not a significant improvement compared to prior year). Operating Income results were stronger for the majority of companies. Shareholder sentiment resulted in a TSR decline of 23%, which was impacted by the continued flattening of the yield curve, fee pressure from asset management, and constant/slow increase in inflation.

### P&C Financial Performance

- Revenue growth of 5.5% at median in 2018 outpaced 2017 growth of 4.6% at median.
- Operating Income increased by 17% at median, higher growth compared to 2017. Similar to prior years, results varied by company based on the degree of CAT losses.
- Median Operating ROE of 11% improved by 130 basis points.

### L/H Financial Performance

- Revenue increased by 2.8% at median, in line with the prior year.
- Operating income grew 17.3% at median, a meaningful increase from 11% in 2017.
- Median Operating ROE of 13.5% improved by 60 basis points.

## 2018 CEO Pay For Performance: Bonuses Continue to Align with Performance

| CEO Bonuses | Median Annual Incentive Payouts (% of Target) | | | Median Annual Incentive Payouts (% of Salary) | | |
|---|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2018 | 2017 | 2016 |
| P&C (n=8) | 135% | 142% | 87% | 409% | 396% | 189% |
| Life and Health (n=9) | 125% | 138% | 120% | 281% | 300% | 264% |
| **Total Sample (n=17)** | **125%** | **138%** | **100%** | **283%** | **318%** | **258%** |

**Property & Casualty:** 2018 was a good year for the P&C industry. Total CAT losses, while representing an approximate 25% (favorable) decrease from 2017, approximated $11B in 2018 for the 8 companies in our study. All eight companies had lower CAT losses in 2018 and only two of the eight P&C companies had a decrease in Operating Income for the year. Median Operating ROE showed a solid improvement of 1.3%

Results for P&C companies translated to CEO bonus payments as percentage of target that were generally in line with 2017 payments (approximately +/-10%). Three companies had an increase in bonus funding as percent of target that was between 10% and 25% and four companies saw a slight decrease between -3% and -10%. The actual median bonus value however, increased 6.7% for the eight companies driven by higher target bonuses or base salaries.

**Life & Health:** Although the L/H industry had good Operating Income growth in 2018, the somewhat flat revenue growth put pressure on bonus payouts. Bonus payouts as a percentage of target decreased and are generally back to 2016 levels, however still above target. Only two companies had higher bonuses in 2018 compared to 2017. The median bonus value decreased 16.7% for the nine companies.

### 1-Year Pay vs. Performance

| | Median Revenue Growth | Median Op. Income Growth | Median Op. ROE Improvement | Median TSR | Median Bonus Payout Change |
|---|---|---|---|---|---|
| **Property & Casualty** | 5.5% | 17.7% | 1.3% | -10.4% | 6.7% |
| **Life & Health** | 2.8% | 17.3% | 0.6% | -23.2% | -16.7% |
| **All Insurance** | 3.6% | 17.3% | 0.9% | -17.2% | -0.2% |

Directionally, bonus funding was slightly lower compared to 2017, yet still above target. Above target payouts are in line with overall good financial results.

## Annual Incentive Plans

Annual bonuses for the companies in the study were generally based on financial metrics tied primarily to short-term profitability. The most common annual incentive financial metrics among our sample include Operating Income (used by 82% of cos.), followed by Operating ROE (41%) and Revenue/Premiums (35%).

| | Most Prevalent Annual Incentive Plan Metrics | | |
|---|---|---|---|
| | **Metric #1** | **Metric #2** | **Metric #3** |
| **Property & Casualty** | Op. Income/EPS (63%) | Op. ROE (38%) | Combined Ratio (38%) |
| **Life & Health** | Op. Income/EPS (100%) | Revenue/Premiums (44%) | Op. ROE (44%) |
| **All Insurance** | **Op. Income/EPS (82%)** | **Op. ROE (41%)** | **Revenue/Premiums (35%)** |

Approximately 70% of companies in the sample include an assessment of individual or strategic performance in the determination of CEO bonuses. While most of these companies use a more holistic and subjective review of individual performance, three companies fund a discrete portion of the bonus (between 10% and 25%) based on specific strategic goals. The goals disclosed by these companies include customer experience/satisfaction, technology milestones, employee retention, broader ESG measures (including diversity and inclusion).

Companies design their plans to reward executives for financial results that meet pre-established goals and often make adjustments to financial results for events outside the company's control. This is not unique to companies in the insurance industry. Insurance companies continue to employ certain approaches to mitigate volatility in financial results and ensure that incentives reflect results controllable by, and reflective of, management actions and decisions. For example, a few P&C companies use budgeted CATs or protective collars around planned CATs or investments to determine incentive plan results, and some others use a more discretionary approach to funding incentives to account for external factors.

More broadly in the market, strategic measures, with specific focus on ESG issues, are becoming more prominent in annual incentive plans. The shift towards a focus on ESG issues in executive incentives is partly driven by select shareholders, as well as continuously evolving state regulations that encourage companies to be more socially responsible. Boards are listening to these concerns and some companies have introduced measures in their incentive plans to support company efforts. Other companies are debating whether executives should be rewarded, through incentives, for becoming better corporate citizens or whether those goals should be implicit as part of company's culture and vision.

We expect companies to continue to focus on non-financial measures in incentive plans that align with their long-term goals and priorities and support organizational change and culture. The focus on corporate social responsibility will increase and we believe companies will be under more external demands to take specific actions on such issues beyond financial results.

## Long-Term Incentive Plans

All companies studied use long-term performance-based incentive plans. Performance plan awards generally represent at least 50% of the overall executive LTI program, and on average account for 61% of the CEO's LTI program. Stock options and time-based RSUs are used by more than 50% of the sample and on average, each approximate 20% of the remaining LTI value.

| | CEO LTI Mix | | | Other NEOs LTI Mix | | |
|---|---|---|---|---|---|---|
| | Stock Options | RS/RSU | Performance Plan | Stock Options | RS/RSU | Performance Plan |
| **Property & Casualty** | 23% | 12% | 65% | 22% | 15% | 63% |
| **Life & Health** | 19% | 23% | 58% | 21% | 15% | 64% |
| **All Insurance** | **21%** | **18%** | **61%** | **22%** | **15%** | **63%** |

Since 2014, three companies in the study added time-based RSUs to their LTI vehicle mix. This increased the average RSU portion of LTI by approximately 5%, with a slight decrease in the stock option component.

| | CEO LTI Prevalence | | CEO LTI Mix | |
|---|---|---|---|---|
| LTI Vehicle | 2018 | 2014 | 2018 | 2014 |
| **Stock Options** | 65% | 65% | 21% | 25% |
| **RS/RSU** | 59% | 41% | 18% | 12% |
| **Performance Plan** | 100% | 100% | 61% | 63% |

Within performance plans, the most commonly used metrics include Operating ROE (71%) and Relative TSR (47%). Five of the eight companies using TSR include it as a discrete award component (approximately 50% of the award), and three companies use it as an award modifier. There has not been any significant shift in the use of TSR as a metric. Using a mix of a relative and absolute performance metric helps provide balance and can offset issues associated with setting three-year goals in a volatile industry. Unlike annual incentive plans, we have not seen adoption of individual or strategic performance in LTI awards.

| | Most Prevalent Long-Term Incentive Plan Metrics | | |
|---|---|---|---|
| | Metric #1 | Metric #2 | Metric #3 |
| **Property & Casualty** | Op. ROE (50%) | TSR (38%) | Book Value (38%) |
| **Life & Health** | Op. ROE (89%) | TSR (56%) | Op. Income/EPS (22%) |
| **All Insurance** | **Op. ROE (71%)** | **TSR (47%)** | **Book Value (29%)** |

## Conclusion

The fundamentals for the industry have generally been strong so far into 2019. To date, CATs have been 20% lower among the companies studied vs. 2018, and returns for both the P&C and Life/Health segments have rebounded with year to date total shareholder return at approximately 30% and 20%, respectively. Like many industries however, companies will be impacted by interest rate declines and slower economic growth.

Transformation in the industry is significant and continues to require not only investment and innovation, but workforce skills and competencies that keep pace with the changing nature of the business. The insurance industry relies on data analytics, digitization of products and services, and a customer experience that is faster and more transparent. Companies are working to upskill existing talent, attract and retain new talent, and maintain a culture that supports workforce development and customer focus.

Compensation strategies need to be flexible with changing HR needs. Organizations are developing different pay schemes for specific, high demand talent (such as IT) and for specific businesses (such as online sales/ distribution, and emerging niche businesses). As with all facets of HR, successful compensation programs will continue to require flexibility and adaptability, in addition to competitive and performance-based design.

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## CAP's Insurance 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.

### Life & Health Companies

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