

# CAP REPORT

**CAP** COMPENSATION ADVISORY PARTNERS INDUSTRY REPORT | JUNE 2016

# INSURANCE

2015/2016 INDUSTRY REPORT

CAP is a leading independent consulting firm specializing in executive and director compensation and related corporate governance matters. Our consultants have served as independent adviser to Boards and senior management at many leading companies in the areas of compensation strategy, program design and in promoting sound corporate governance principles.

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Compensation Advisory Partners (CAP) examined 2015 pay levels and financial performance across two segments of the insurance industry including eighteen companies with median revenue of approximately \$18B. The segments included Property & Casualty (P&C) and Life & Health (L/H) Insurance companies<sup>1</sup>. The study focused on performance trends and industry dynamics affecting pay practices within the industry.

## 2015 FINANCIAL PERFORMANCE: MODERATE AND MIXED RESULTS

Broadly, 2015 performance was not strong for U.S. companies; median performance results for the S&P 500 included:

- Lower revenue growth from +6% in 2014 to +1% in 2015
- Profitability, as measured by EPS growth, declined from +11% to +4%
- Total shareholder returns (TSR) were flat after a +16% increase in 2014

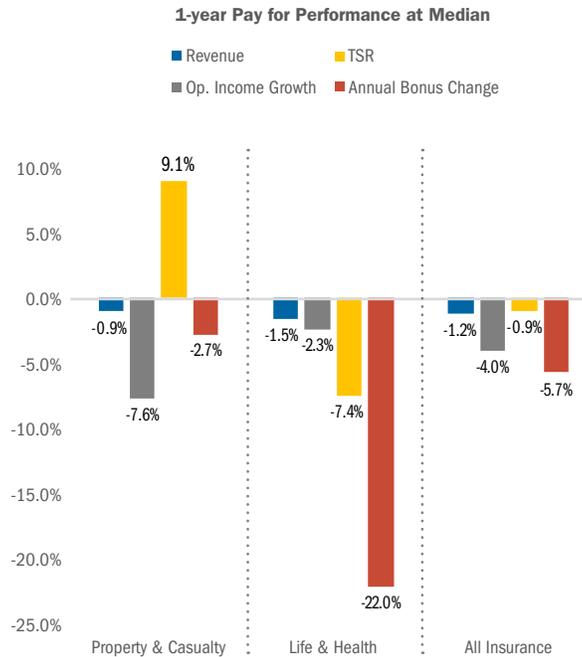
The insurance industry overall had moderate performance results, which varied by sector. Results in 2015 were generally lower than in 2014, which was a good year for the industry. Several factors influenced 2015 results, including low interest rates, increase in auto claims, a modest CAT loss year, weaker investment performance, and the strong US dollar.

Of the eighteen insurance companies in our study, results were varied across sectors and among individual companies:

- P&C Revenue growth was flat and L/H companies had slight decline in Revenue
- Operating Earnings declined in P&C companies by 8% on average, compared with a 2% decline in L/H companies. 1 of 9 P&C companies and 3 of 9 L/H companies had positive growth
- Combined ratios worsened slightly among P&C companies, at 90.1% in 2015, compared with 89.9% in 2014
- Investment income was down 5% on average among P&C companies, and down 1% in L/H
- ROE was slightly lower year over year in both segments

<sup>1</sup> See Exhibit 1 for list of companies included.

## 2015 CEO PAY FOR PERFORMANCE: BONUSES ALIGN WITH PERFORMANCE

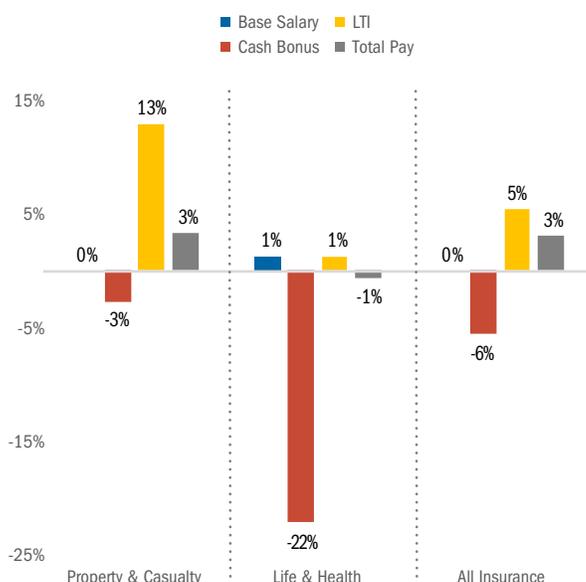


Property & Casualty: While profitability was down in P&C companies, stock price performance (TSR) was up in most companies, signaling a positive outlook for the industry in 2016, despite some economic headwinds. Correspondingly, CEO annual bonuses for 2015, while mixed, were generally flat or lower compared with 2014. Within our study, those companies with relatively stronger year over year performance paid bonuses higher than in the prior year. Long-term incentive award opportunities increased somewhat, directionally aligning with P&C companies' stock performance, which outpaced the S&P 500 in 2015.

**Annual bonuses for 2015 while mixed, were generally flat or lower compared to 2014.**

Life & Health: Earnings were also down in this sector, and bonuses for 2015 declined by nearly 20% at median. When setting bonus plan goals, L/H companies may not have adequately planned for the degree to which lower interest rates could impact results. In contrast to P&C companies, 2015 TSR declined and the year over year change in long-term incentives was flat overall.

Median Change in CEO Compensation (2015 vs. 2014)



### ANNUAL INCENTIVE PLANS – STRUCTURE

Compared to general industry, the insurance industry has a relatively high percentage of companies with discretionary annual incentive plans. Among the companies reviewed, 27% have discretionary plans, and 6% have plans based on discretionary allocation of a pool funded on a pure formulaic funding approach. Companies with discretionary plans generally compare overall performance with the prior year to inform decisions around the level of bonus payments for the current year.

The majority of companies, however, use a “goal attainment” plan (67%) in which actual results are compared to preestablished performance goals to determine the degree to which awards are earned. The companies that use goal-attainment funding plans generally provide for some ability to use discretion or individual performance considerations in determining individual payouts.

### ANNUAL INCENTIVE PLANS – PERFORMANCE ADJUSTMENTS

Given the potential for significant volatility in the industry, business plan forecasting and incentive plan goal-setting can be challenging. There are unique industry dynamics that insurance companies factor into their incentive decisions, either directly through plan design, or based on retrospective, year-end review. Companies strive to balance rewarding executives for results within their control and not fully protecting them from issues impacting shareholders.

**Catastrophes (CATs):** P&C companies face the difficult task of forecasting the impact of CATs on annual earnings. A significant unplanned CAT, or the absence of CATs, can drastically impact incentive plan results. Among the P&C companies studied, 44% have built an adjustment for CATs into their annual incentive plan design. A common approach is to use a “collar” (+/- 10–20%) around the budgeted amount of CATs and if actual CATs are outside the collar, they are adjusted back to the collar limit. This approach still allows for fluctuation in incentive plan results, yet limits the impact so that executives are not fully accountable for extreme events beyond their control. Two of the companies in the study completely exclude the impact of CATs.

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Given the significant volatility in the industry, companies may adjust results for the impact of CATs, FX rates or highly volatile investments.

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**Foreign Exchange (FX) Rates:** Given the global economic environment and the increased strength of the U.S. dollar, many companies also face challenges with the potential impact of FX rate fluctuation on financial results.

Some insurance companies in our study faced headwinds from volatile FX rates in 2015, and half adjusted results in some way for unplanned currency fluctuations. Of these companies, nearly 90% determined at the beginning of the performance year that they would exclude the impact of FX changes and instead measured results on a “constant currency” basis. One company made a discretionary adjustment at year-end. The expectation is that more companies will build FX adjustments into their plans, or use an FX collar approach around budgeted levels.

**Investment Income:** Only two companies made an adjustment in 2015 to investment income results, using a collar approach. When used, companies tend to adjust only a component of investment income, generally those investments that are most volatile.

### LONG-TERM INCENTIVES – EMPHASIS ON LONGER TERM PERFORMANCE PLANS

Notwithstanding the challenges of goal setting within the industry, all insurance companies studied use a long-term performance plan (share or cash based), with

P&C companies emphasizing these plans more heavily in the overall LTI mix than L/H companies (72% vs. 58%, respectively). All P&C companies use LTIPs for at least 50% of their LTI program, which is consistent with the trend in the broader market. In contrast, 55% of L/H companies use restricted stock in their executive pay programs compared with 22% of P&C companies. Among P&C companies using restricted stock, none weight it more than 25%. In both groups, stock options continue to have a role, albeit a declining one, at approximately 25% of LTI.

	CEO LTI MIX			OTHER NEOS LTI MIX		
	STOCK OPTIONS	RS/RSU	PERFORMANCE PLAN	STOCK OPTIONS	RS/RSU	PERFORMANCE PLAN
Property & Casualty	23%	5%	72%	23%	10%	67%
Life & Health	23%	19%	58%	29%	20%	51%
<b>All Insurance</b>	<b>23%</b>	<b>12%</b>	<b>65%</b>	<b>26%</b>	<b>15%</b>	<b>59%</b>

The majority of companies use 3-year performance periods, which is appropriate in driving longer term sustained results that lead to shareholder returns. Most companies use share based plans, and all but two use cumulative 3-year measurement, vs. unbundling performance measurement into multiple annual periods, which was more common after the economic downturn in 2008/2009. Companies choose to link executive pay with long-term success, measured most often by Relative TSR, ROE or Operating Income.

## CONCLUSION

Companies within the insurance industry are not strangers to the volatility inherent in their business. The impact of interest rates, equity markets, the weather, and changing consumer preferences on performance results can be dramatic and difficult to predict. Changes in industry regulation, and multiple regulators, add another layer of complexity. Yet insurance companies have maintained responsible pay practices, which support their business planning and sophisticated forecasting. Through their incentive programs, the majority of companies hold executives accountable to longer-term (3-year) performance standards while maintaining an appropriate degree of retrospective assessment of the market in their annual incentive plans.

Looking forward to 2016 and beyond, what is certain – is the degree of uncertainty – that faces the industry. Healthcare reform looms large over the business model of companies in the health sector. Changing insurance attitudes and expectations among millennials will further affect the use of the life insurance products and distribution channels. The regulatory environment has grown vastly more complex and the uncertainty around the Dodd-Frank Wall Street Reform and Consumer Protection Act, the FSOC’s designation of non-bank SIFIs, the proposed DOL fiduciary standards, and evolving enterprise risk management requirements could have significant impact on all sectors of the industry.

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Looking forward to 2016 and beyond, the industry faces uncertainty around the regulatory environment, healthcare reform, changing consumer behavior, and enterprise risk management requirements.

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In short, the industry will undoubtedly go through change in the upcoming years. Compensation programs will need to ensure that the correct behaviors and results are being rewarded. A rigid approach to compensation will most likely not be an effective approach. Compensation programs that balance a company’s internal business plan with industry standards and relative performance, will best serve to satisfy both shareholders and executives.

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**Exhibit 1.**

**P&C COMPANIES**

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

**LIFE & HEALTH COMPANIES**

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



Please contact us at (212) 921-9350 if you have any questions about the issues discussed above or would like to discuss your own executive compensation issues. You can access our website at [www.capartners.com](http://www.capartners.com) for more information on executive compensation.