



# **GEN RE EXECUTIVE FORUM**

## **Industry Trends and Executive Compensation**

January 19, 2016

## Looking at First Half 2015


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**Net Premiums grew 3.9%**  
(versus 4.3% in the first half of 2014)



\$8.0B favorable development  
Indications of a tenth consecutive year of reserve release

**Combined Ratio was down 1.2 points**  
97.8% versus 99.0% first half of 2014



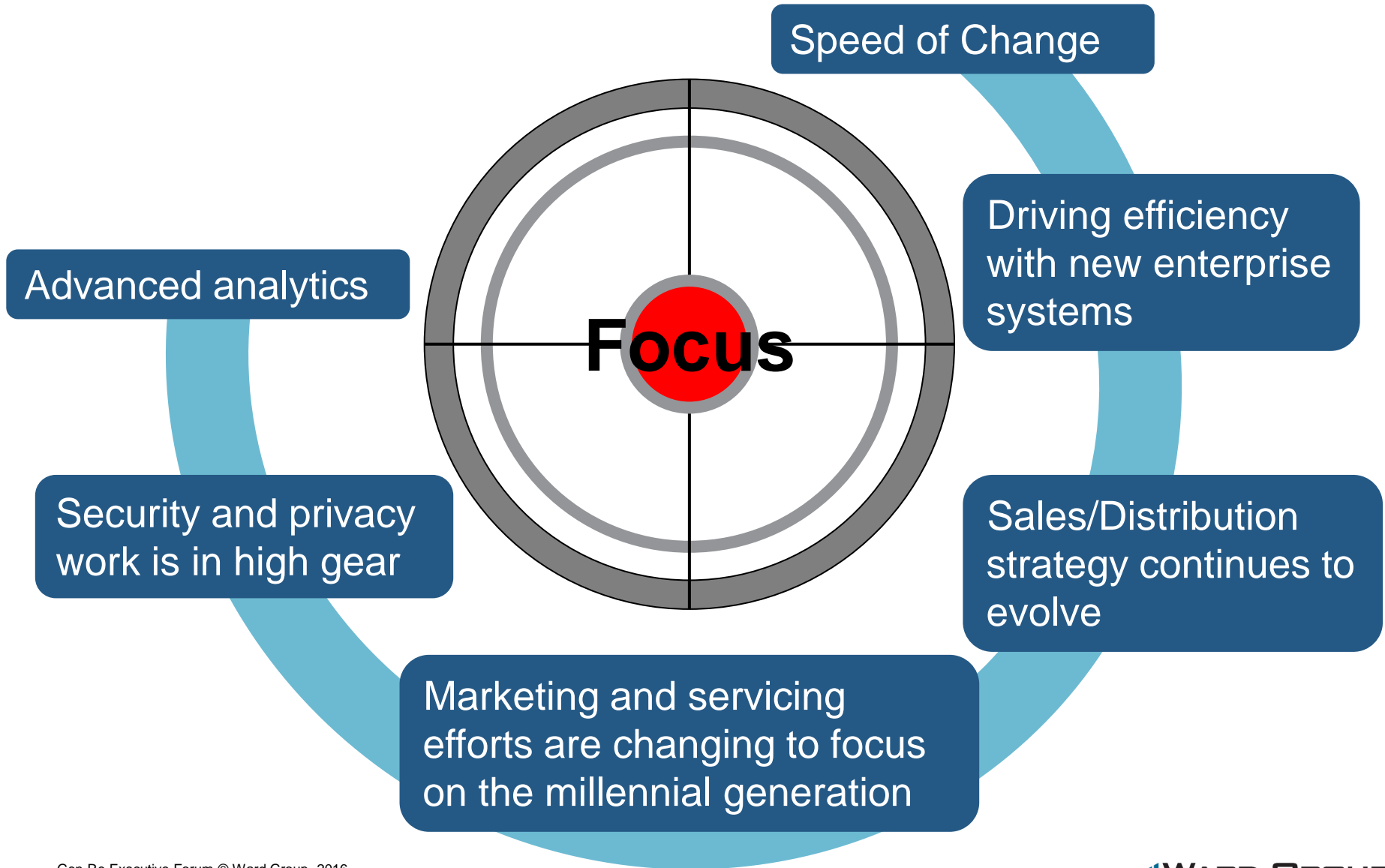
**CAT losses are down 35%**  
\$8.0B versus \$12.4B first half of 2014



**Net Income increased 1.2%**  
despite equity holdings declined by 1.9%.



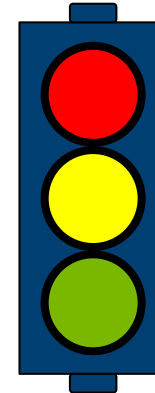
# An Active Industry



## Industry Challenges / Concerns

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- Maintaining profitable growth
- Keeping up with and managing technology and advanced analytics
- Handling exposures, related to both CAT and medical costs
- Data security and privacy concerns
- Succession planning
- Entrance of non-insurance companies to the marketplace (i.e. Google)

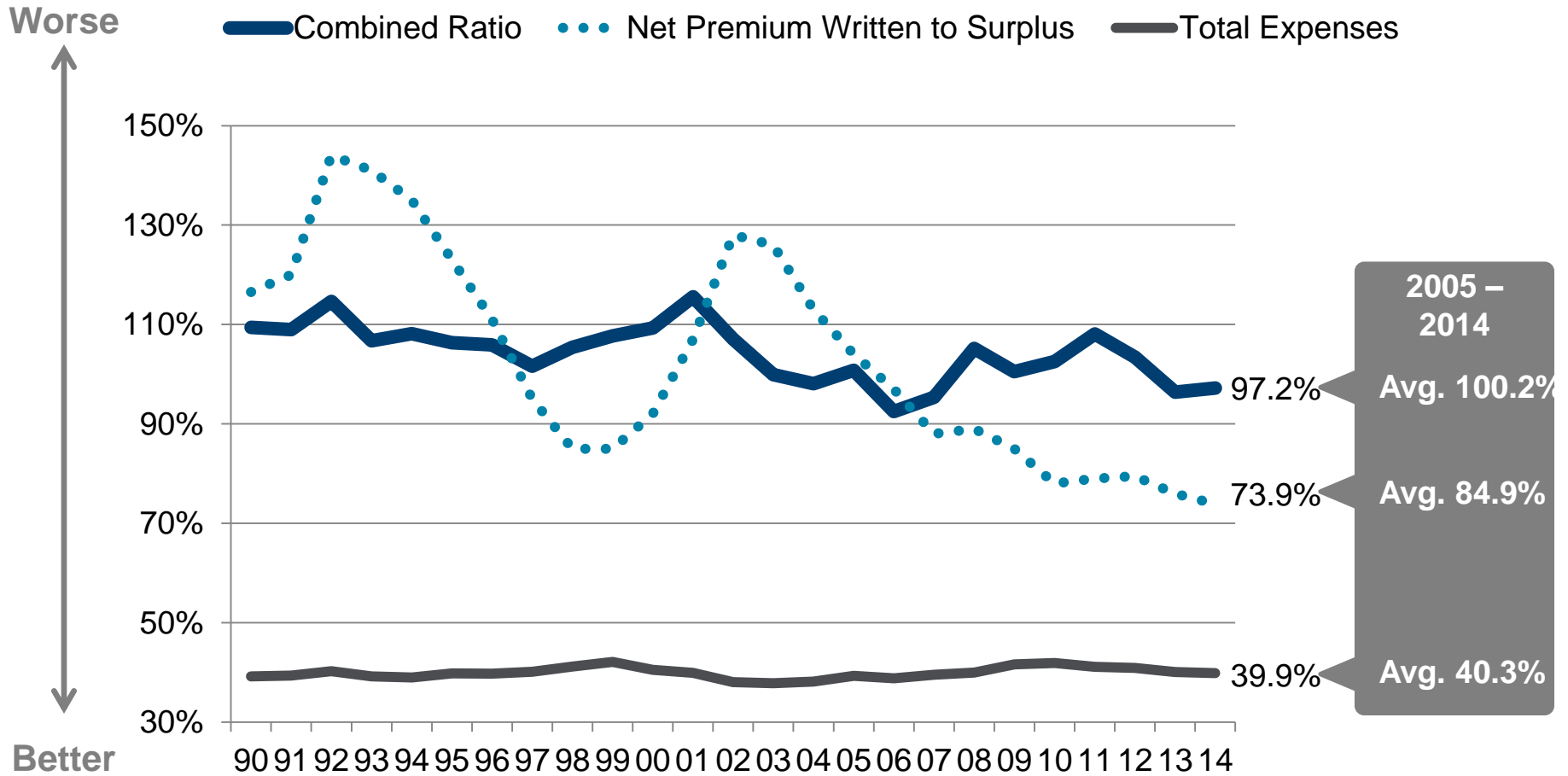


Significant threat

Presents challenge

Responding well

# Key Performance Measures

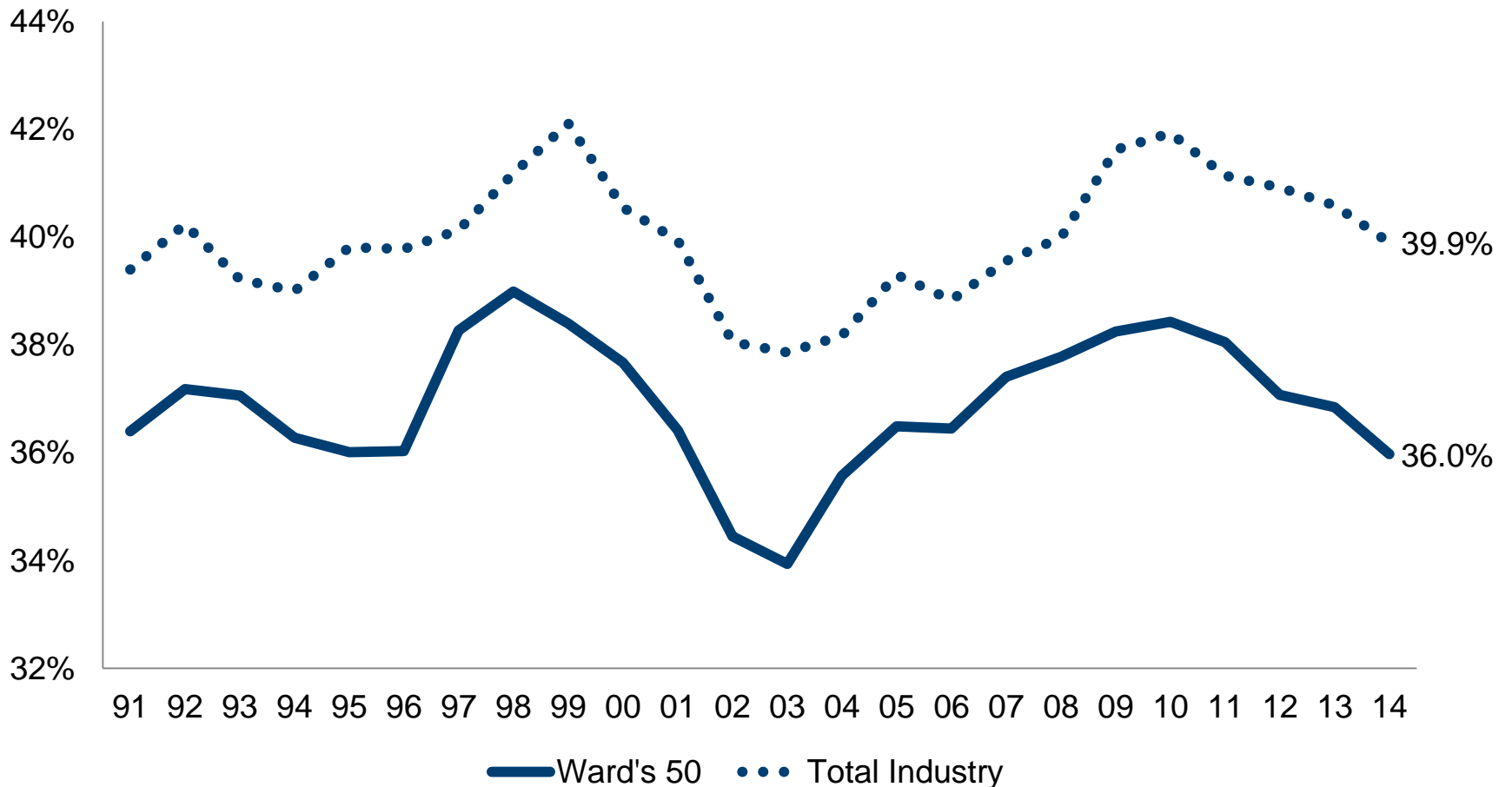


Combined ratio is prior to effect of policyholder dividends

Expenses include Underwriting, Loss Adjusting and Investment

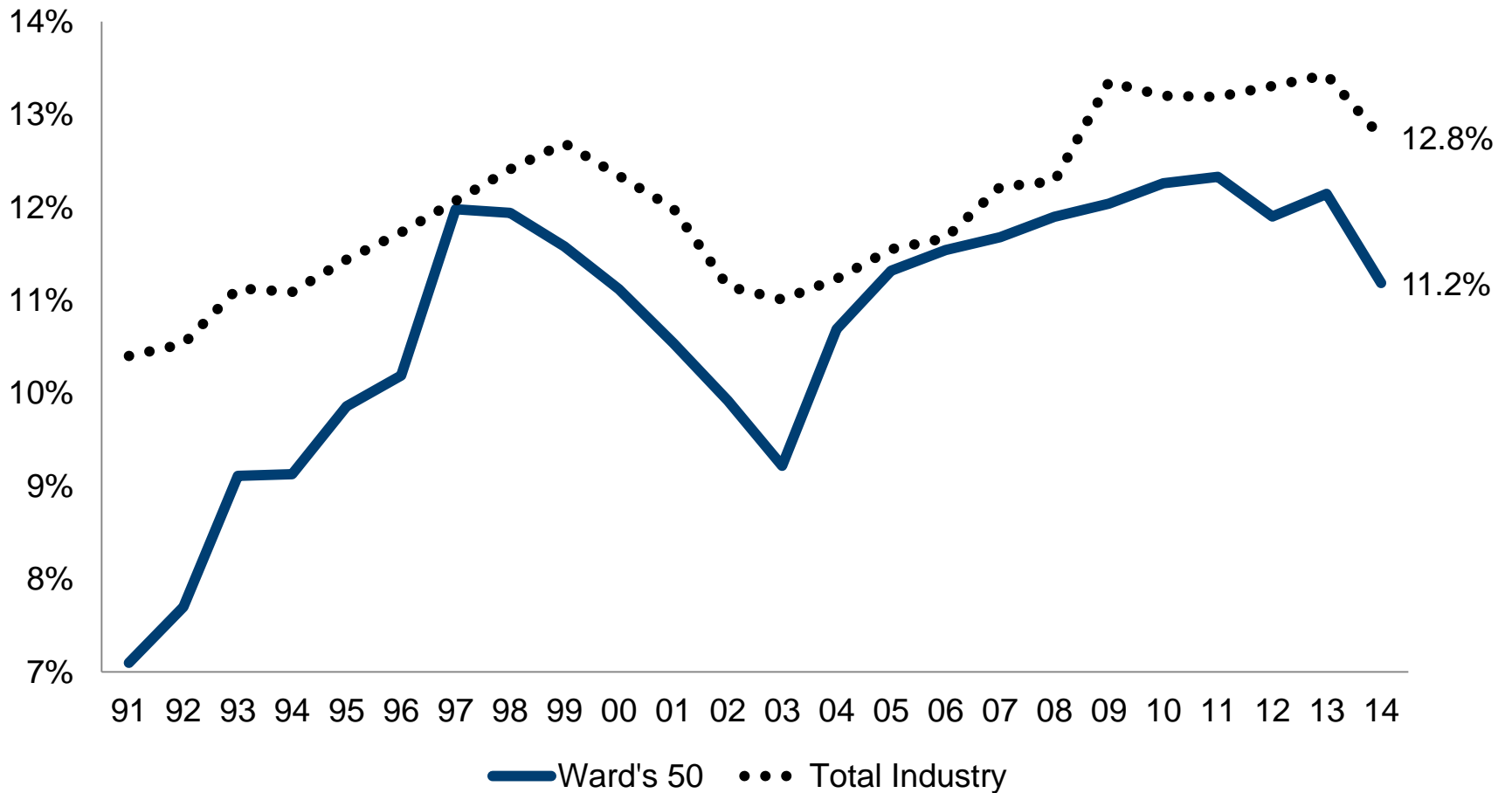
# Expenses Continue to Improve

## Total Expenses as % of Net Premiums Written

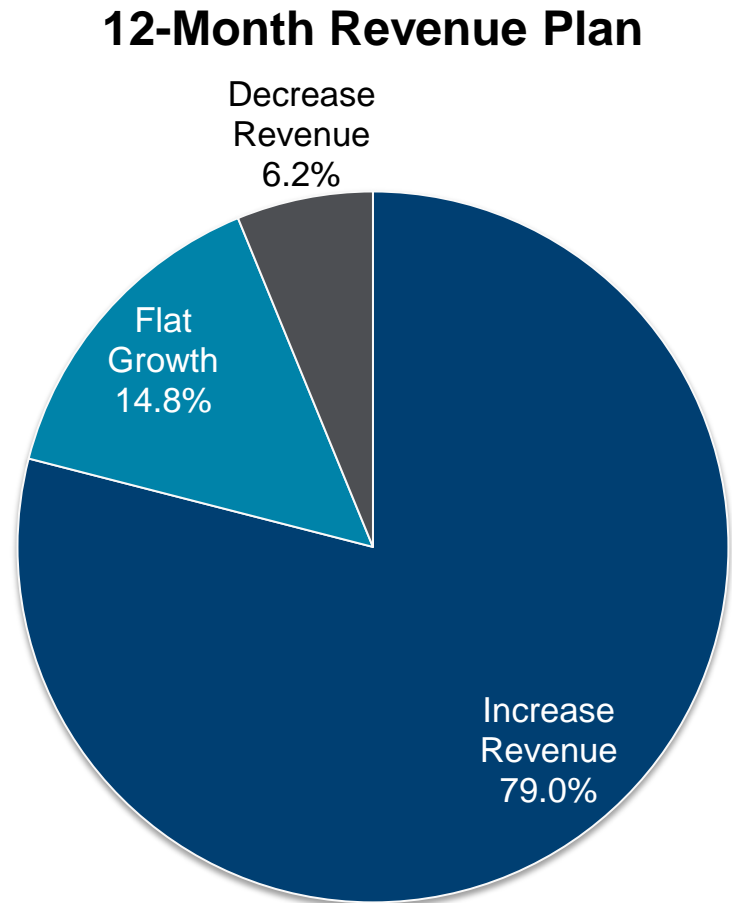
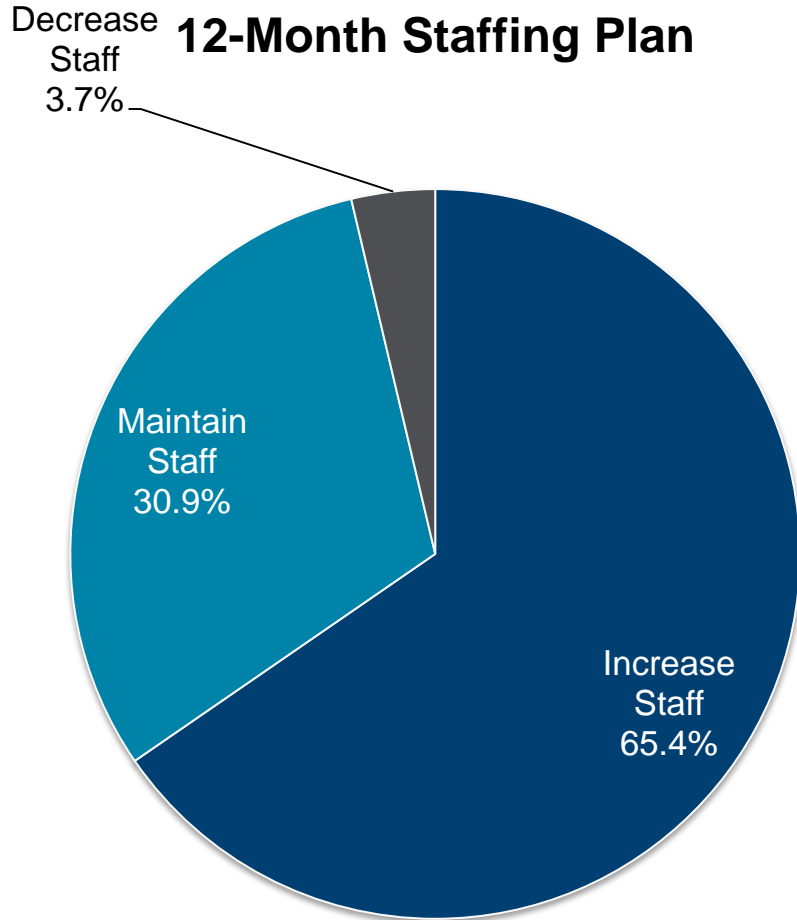


# Employee Costs in Decline (finally!)

## Salaries & Benefits as % of Net Premiums Written



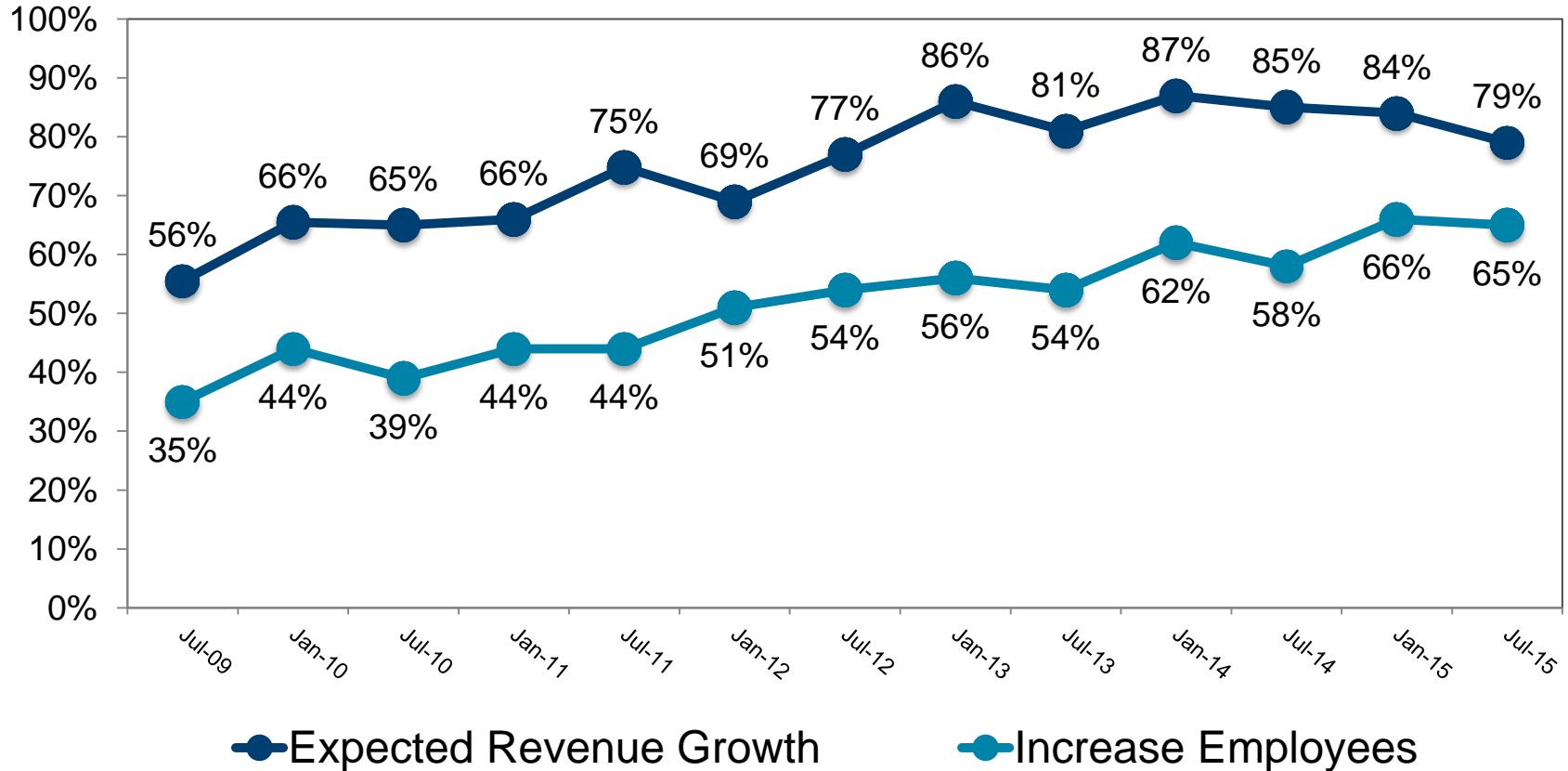
# Revenue and Staffing Expectations



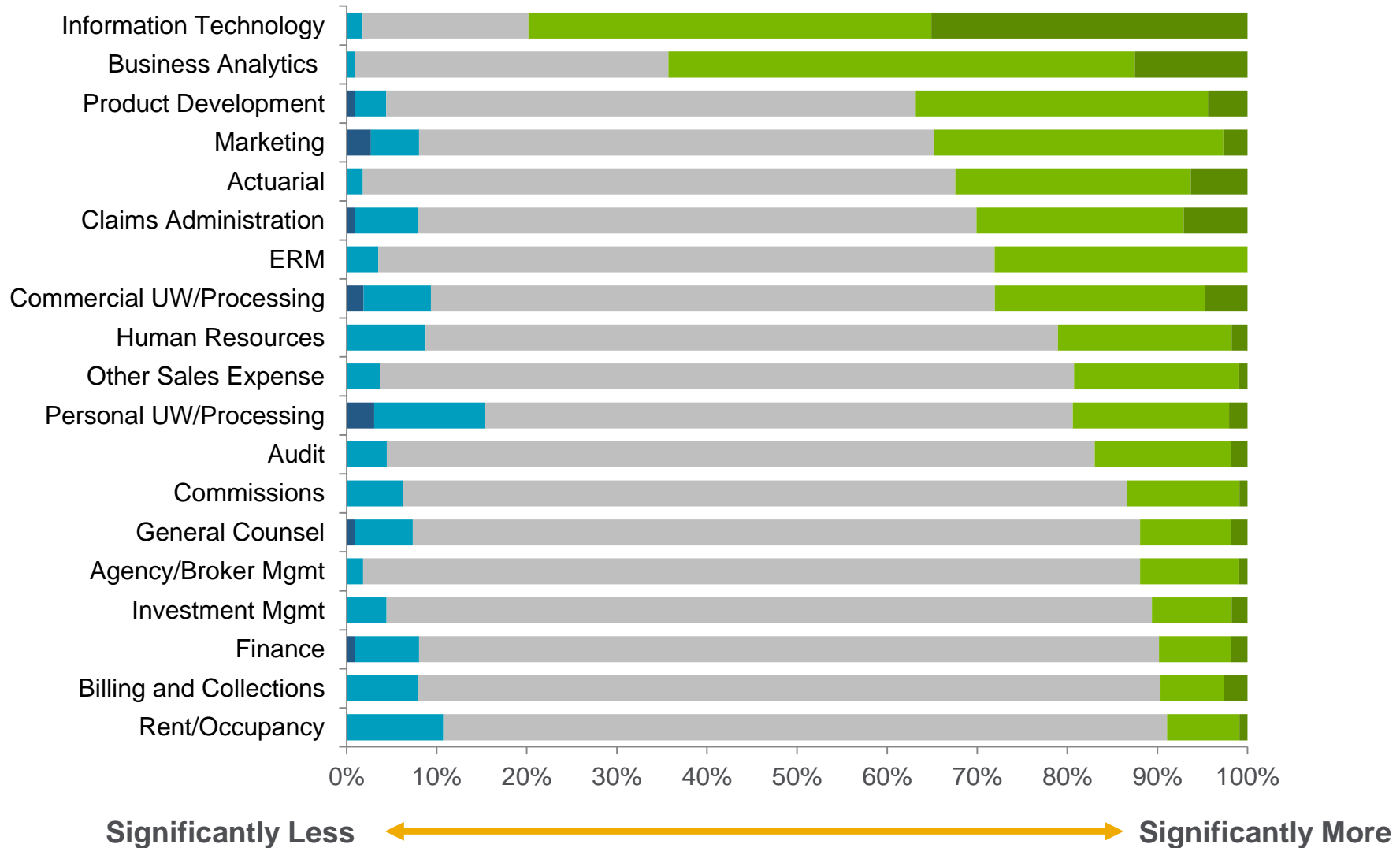


# Companies Expecting Revenue and Staff Increases

July 2009 – July 2015



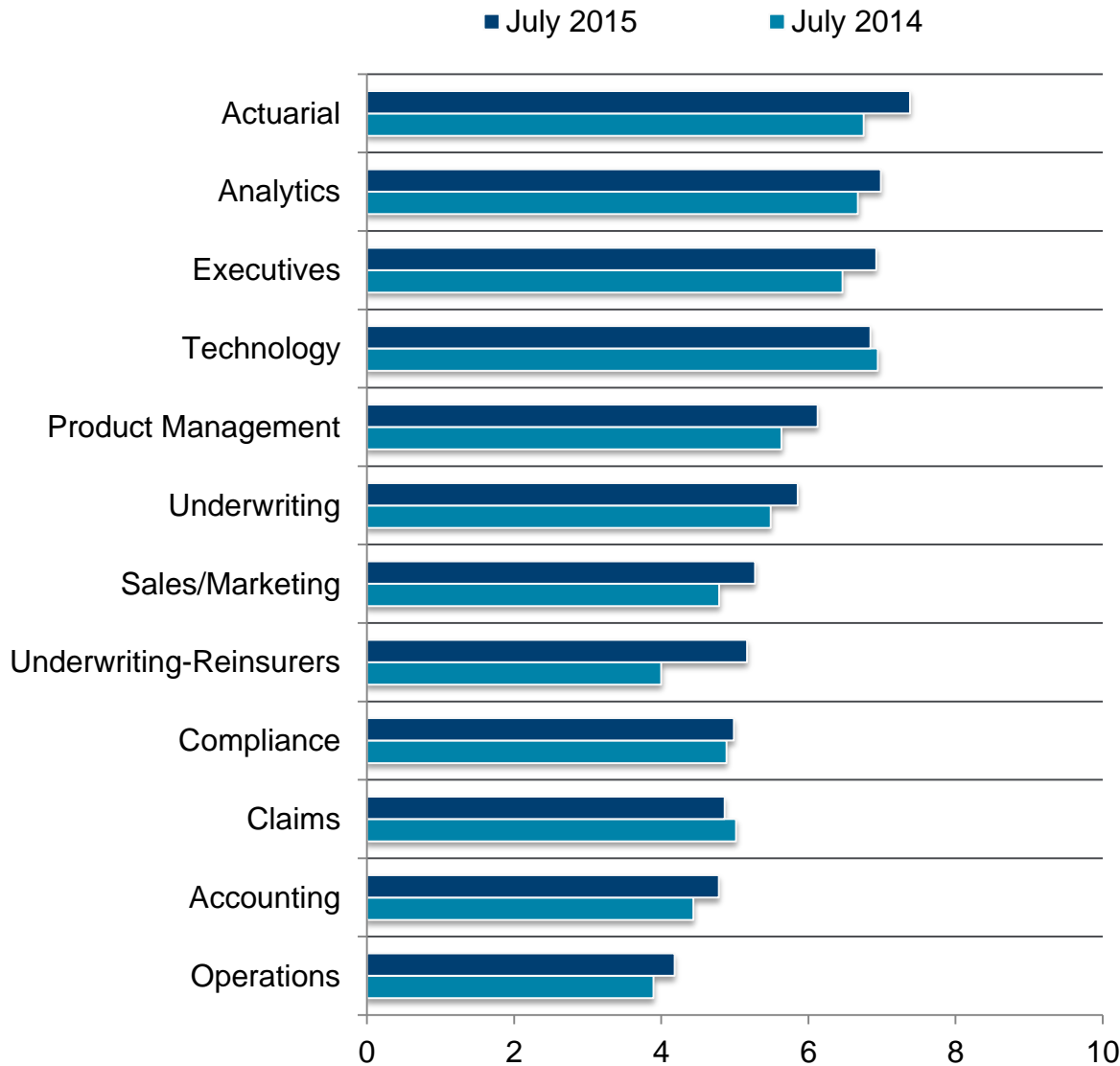
# 2015 Spending Changes – By Function (spend levels compared to 2014)



Source: Ward Group 2015 Business Environment Survey

Gen Re Executive Forum © Ward Group, 2016

# Recruiting Difficulty Intensifies



- On a scale of 1 – 10 (10 being most difficult), companies responded that positions are still moderately difficult to fill and recruiting is more difficult in most disciplines than it was a year ago.
- Positions rated 5 or above are considered moderate or difficult to fill.
- 10 of 12 categories have seen recruiting difficulty increase over the past year.

Agent compensation is up  
each of the past 5 years

State  
expansion is  
picking up

Agency  
appointments  
continue to  
outpace agency  
terminations

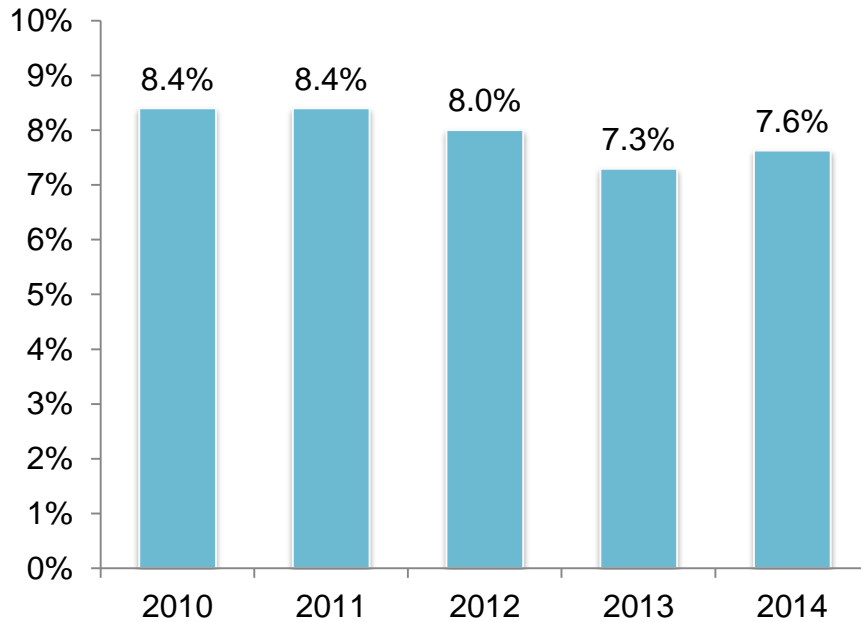
Digital marketing  
in full force

Agency segmentation  
more prevalent

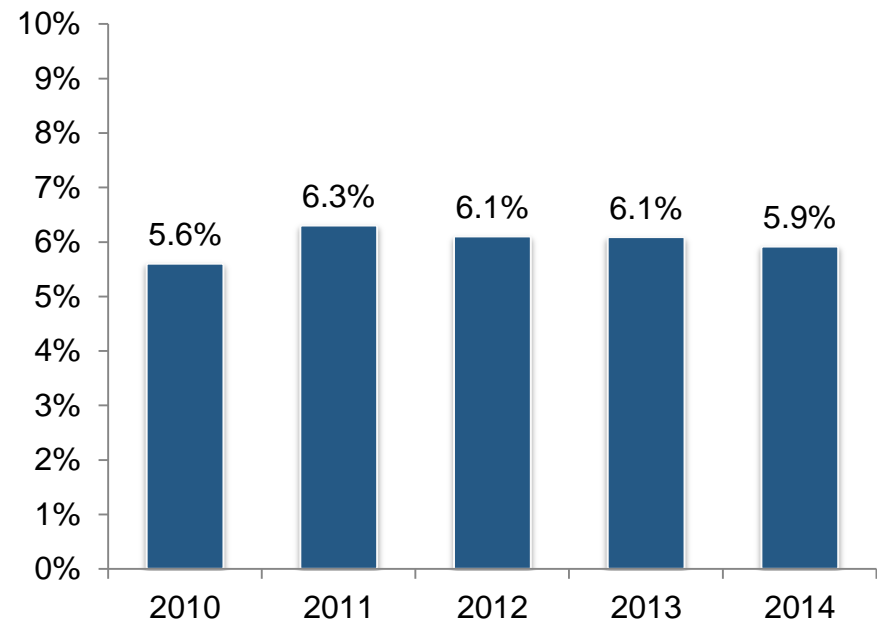
Online capabilities growing

# Expanding the Agency Footprint

## New Agency Appointments



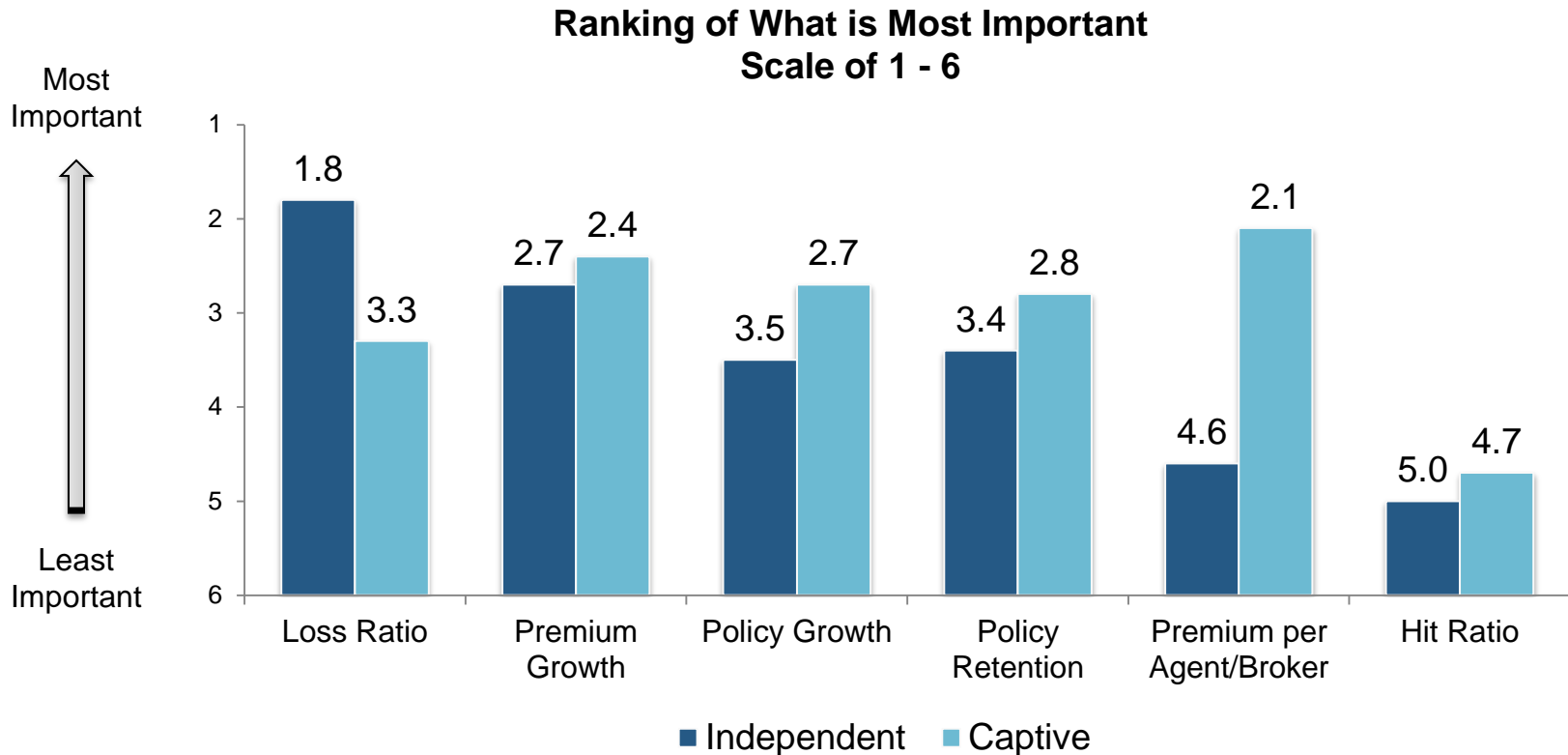
## Percentage of Agencies Terminated



- New agency appointments are down as both independent and captive writers have had difficulty recruiting new producers
- Terminations are still lower as companies would rather rehabilitate and may be less aggressive managing producers
- Regional expansion is picking up again since the 2008 – 2010 timeframe

Source: Ward 2013 and 2015 Agency Management and Compensation Study

# Most Important to Companies Within Agency Force



- Profitability ranks as the most important issue for Independent Companies
- Premium per Agent ranks as the most important issue for Captive Companies followed closely by Premium Growth

Source: Ward 2015 Agency Management and Compensation Study

## Succeeding with the Independent Agent

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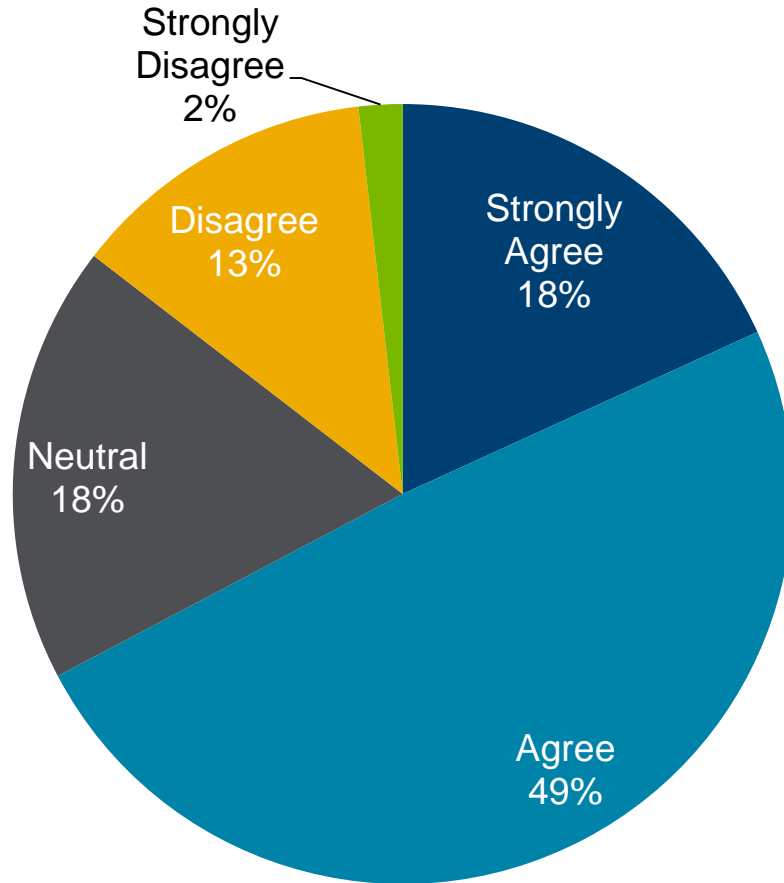
- Companies must focus on building long-term relationships with agents that are prepared to transform their business models:
  - Identity clear goals and objectives
  - Enable agents with capabilities to remain relevant and competitive in the marketplace
  - Provide fair and competitive compensation
  - Help agents develop leads and identify quality business
  - Design pro-active investment strategies with key agents
  - Provide more standardized processes enabled with technology (i.e. ease of doing business)
  - Develop the tools and technology necessary for carrier and agent to compete with the consumer
  
- Succeeding with the independent agent may require parting ways with poor performers. Agency tiering and similar analytics help automate the process and provide objective guidance

Are Executive Compensation Practices Aligned  
to Meet Business Challenges?



# Company View on Executive Compensation

“Does my company has the right total compensation policies/practices in place to attract and retain its top leaders?”



- 92% of companies paid bonus in 2015 for 2014 results.
- 57% of companies have a bonus plan that is different than the rest of the staff bonus plans.
- 16% of companies responded they made substantial changes to executive total compensation program in 2014
- Average executive annual pay increases were notable higher than rest of the employee population

## What Has Changed to Compensation – A Look Back

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- **Economic crisis in the fall of 2008**
  - Bailout of banks
- **Financial markets in a tailspin**
  - Retirement plans wiped out; mortgages under water
  - Historic unemployment
- **Main St. outrage at Wall St.**
  - What did banks do with taxpayer money?
- **Financial markets start improving**
  - Banks start paying bonuses again
- **“Occupy” movements across the country**
  - Bus tours of AIG executive’s homes

# New Regulatory Environment

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- **Dodd-Frank reforms to Proxy Statements**

- Say on Pay
- Confirm Consultants' Independence
- Clawbacks
- Ratio of median employee total compensation to that of the CEO
- Risk mitigation in incentive plans

## Different Board & Compensation Committee Dynamic

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- **Empowered Boards**

- Selecting members and committee assignments based on expertise
- Challenging management's plans
- Demanding results
- Better informed about the business

- **“No” & Less is Better**

- Default response is now “no, why?”
- Much more skeptical/prudent
- No more rubber stamp

- **Concerns About Personal Liability**

- Shareholder lawsuits
- Congressional hearings
- Say on Pay liabilities

## Empowered Shareholders/Policyholders/Advisors

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- **Shareholders are Vocal**

- Hedge fund manager breaks up The Hartford – *Carl Icahn and AIG !!!*
- Concern over compensation design/levels
- Employment terms (e.g. CIC, severance)

- **Institutional Shareholders/Advisors Applying Pressure**

- Proxy voting policies
- Financial Considerations (e.g. dividend, share buyback)
- Advisor voting recommendations
  - Say on Pay
  - Director Election
  - New/Revised Equity Plans
  - Peer Group Selection

## Mutual Insurance Considerations

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- Many mutual insurers were founded more than 100 years ago
  - Cooperative structure to share common risks
- Mutual companies benefit policyholders, not stockholders
  - Can take a longer view vs. quarterly results
- Mutual companies have remained dedicated to this ideal:
  - The cooperative structure of mutual insurance helps companies maintain their focus where it needs to be – with the interests of its policyholders
- Mutual insurers must compete for talent with stock companies
  - The supply of qualified industry leadership is limited
- Mutual companies coming under greater scrutiny
  - Greater state and public exposure (i.e. Boston Globe/Liberty Mutual)

# The Pay Landscape Has Changed

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As a result of regulatory and competitive pressures, compensation approaches throughout the industry have changed.

## 1. Process

- Have a strategy and justify decisions

## 2. Approach to Pay

- Moving from total reward to total incentive

## 3. Approach to Performance Measurement

- From formulaic approach to “structured discretion”

## 4. Performance Measures

- Employ a broad range of goals that align with stakeholders
- Relative measures

## 5. Adjust for Risk

## 6. Long-Term Incentive Design

- Align with stakeholders’ long-term benefit
- Performance-based

## 7. Claw backs





# Make the Compensation Discussion Meaningful

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1. Define Your Compensation Philosophy
2. Define the Pay Elements and How to Deliver Them
3. Benchmark Compensation against the Market
4. Define What Success Looks Like
5. Do it All Over Again – Not Just a Point in Time Discussion

# The Importance of Market Comparators

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- Pay decisions should be made in the context of business and pay philosophies and strategies.
- Pay philosophies should include definitions of market comparators and desired positioning.
- Market comparators form the basis for establishing benchmarks that guide internal decision-making:
  - Setting competitive performance goals
  - Measuring performance results
  - Gauging the reasonableness of pay, particularly relative to performance
  - Establishing internal pay policies and plan design
- A diligent approach to selecting comparator groups is essential in effective benchmarking. Your peer group should reflect the true nature of the company's:
  - Business activities
  - Scale and scope of operations
  - Markets in which it competes for business and talent

## Maximizing Pay Efficiency With the Right Mix of Pay

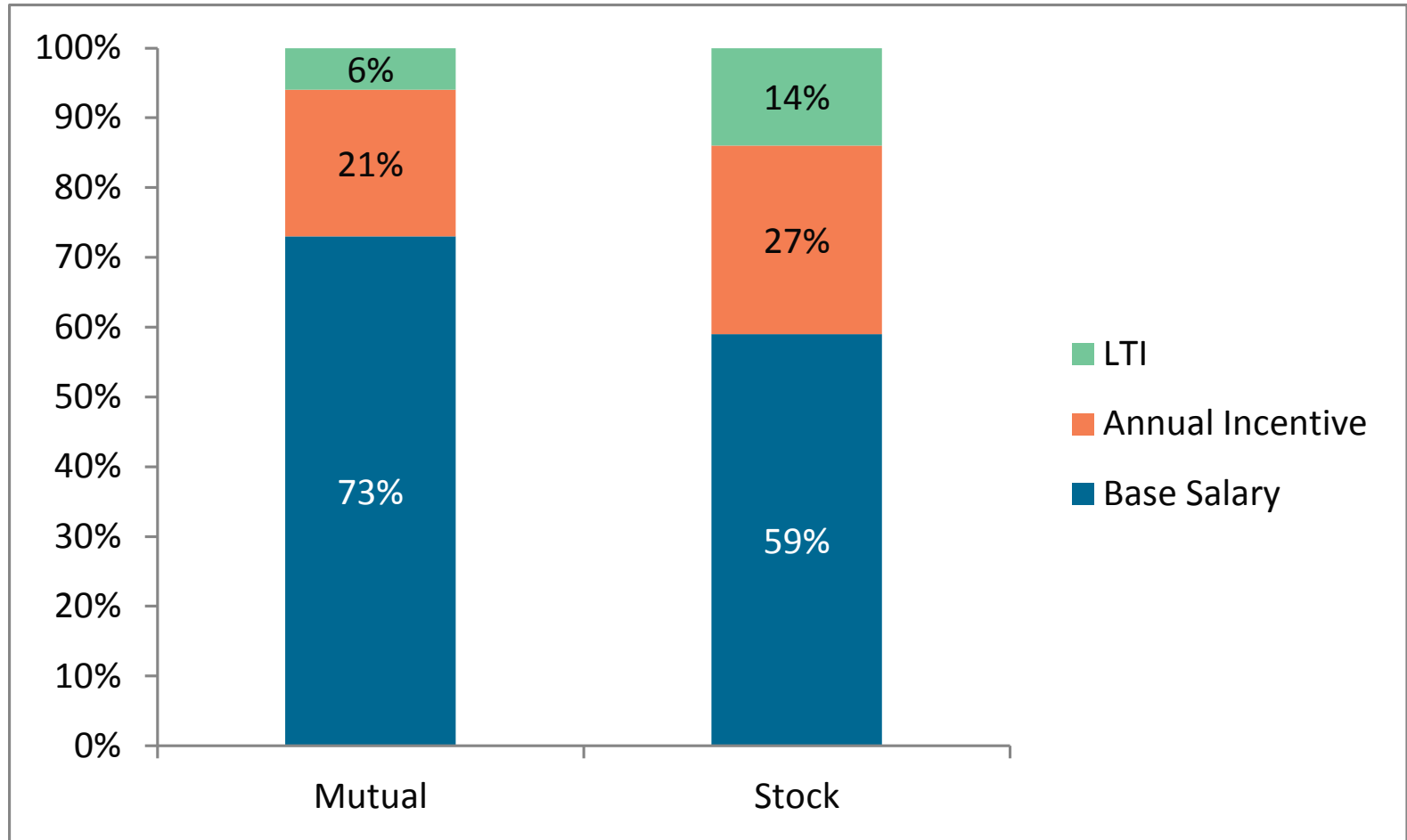
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- Each component has a purpose
    - Base Salary: price of entry; 25-45% for CEO to 90-95% for front line
    - Annual Incentive: annual results; 20-30% for CEO to 5-10% for front line%
    - Long-Term Incentive: build for the future; 20-30% (or more) for CEO
- Overall mix of pay/leverage should coincide with relative degree of responsibility and control



- Maximize the economic efficiency
  - Perceived value
  - Reported value
  - Communicated value

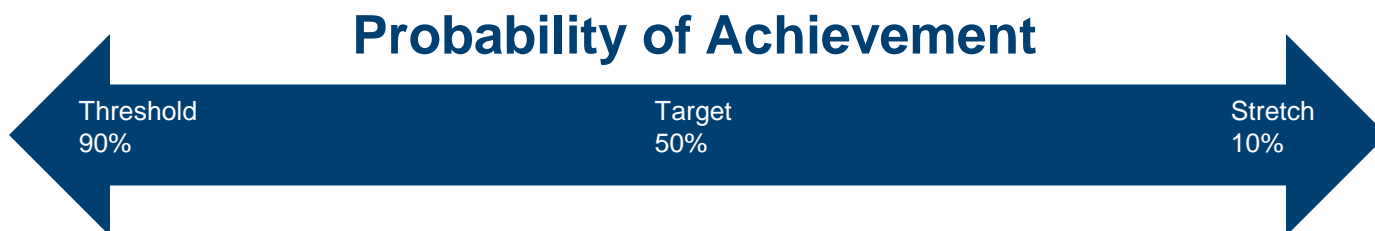
# Average CEO Pay Mix at Mutual & Stock Companies



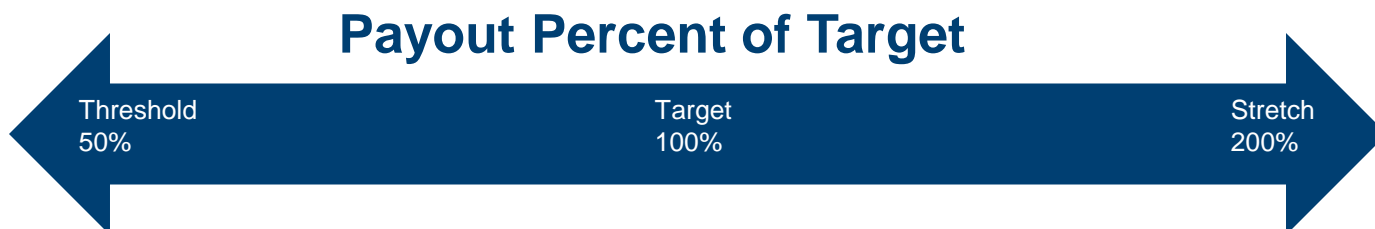
## Compensation Design Review – Goal Setting

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- It is typical for executive plans to have threshold, target, and stretch goals with the following general probabilities of achievement:



- And the following payout percentages:



- Companies should assess the relative difficulty of achieving plan goals in the context of the probabilities above and relative to peers:
  - Is there a 10% chance of stretch goals being achieved? If not, would more improvement from target to stretch be warranted given incentive payout levels?
  - If achieved, do stretch goals put the Company into a top competitive positioning among peers (e.g., top quartile) with regard to performance?

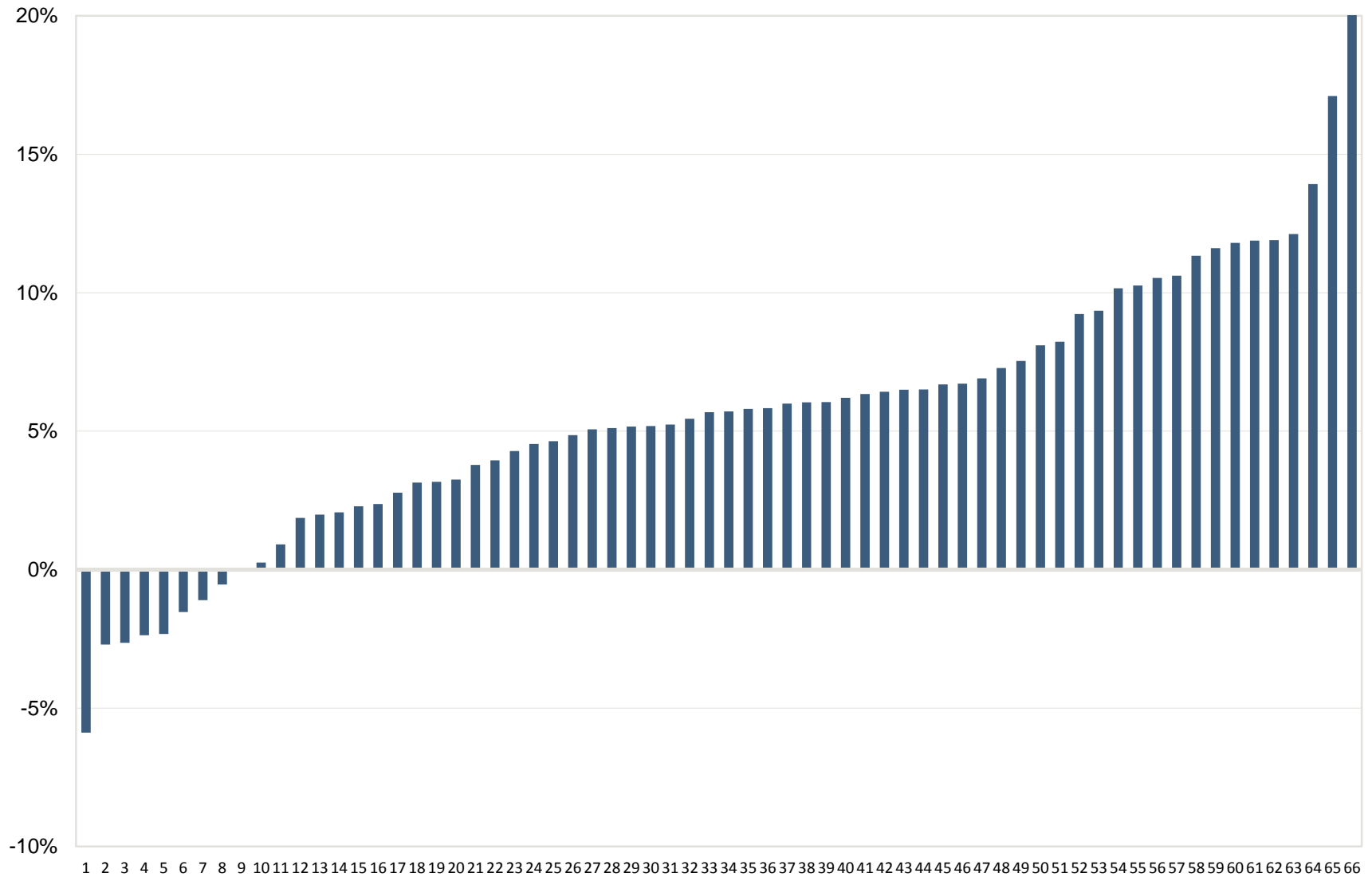
## Defining Success - Performance Measures Used for Annual Plans

Performance Measure	Frequency Used
Combined Ratio Target	57%
Premium Growth	45%
Net Income/Profit	41%
Surplus Growth	24%
Net Underwriting Income	20%
Return on Equity/Surplus	18%
Policy Growth	18%
Retention	18%
Customer Satisfaction	16%
Expense Ratio	10%
Combined Ratio Improvement	8%
Complete Discretion	6%

- 76% of plans are formula driven based on performance (versus discretionary or pure profit sharing)
- Top Quartile companies:
  - Established higher payout ratios
  - More aggressive targets ratios
  - More likely to measure on relative basis
  - Had 4 measures in plan, on average

Source: NAMIC Executive Pay Practices Study

# Total Comp Changes - 2013 to 2014

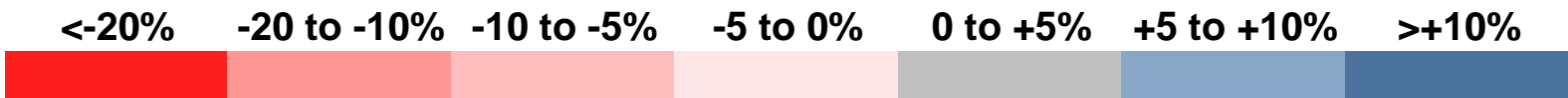


# Pay Change by Job Function

20,040 constant incumbents

## Percent Change in Total Comp 2013 to 2014

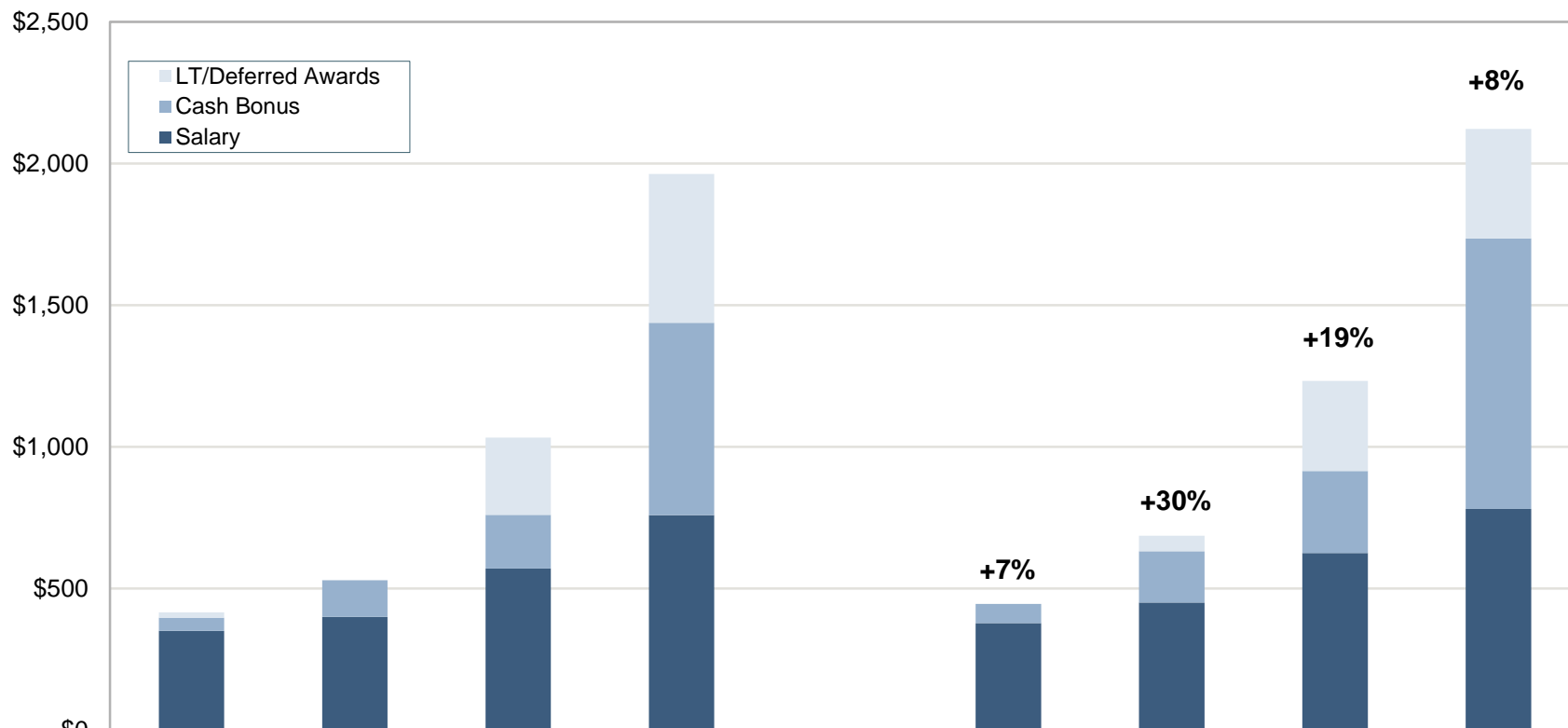
	# Incs.	% All	\$0-100K	\$100-250K	\$250-500K	\$500-750K	\$750-\$1M
Top Management	124	6.0%			5.8%	3.9%	7.0%
Actuarial	351	5.0%	5.8%	4.9%	5.8%	4.5%	4.8%
Underwriting	5,805	4.1%	5.4%	3.9%	3.1%	2.2%	3.5%
Customer Service	1,062	3.8%	3.9%	3.8%	1.8%		
Claims	7,114	4.1%	6.2%	3.8%	3.4%	3.0%	2.6%
Finance and Business	553	3.9%	3.9%	4.0%	3.9%	3.9%	3.4%
Human Resources	398	4.2%	4.6%	4.9%	2.6%	5.4%	0.0%
Legal	227	3.9%	4.9%	3.5%	3.8%	7.5%	6.7%
Communications and Marketing	382	5.2%	8.1%	5.7%	3.4%	-1.8%	
Information Technology	2,467	4.2%	5.4%	4.0%	3.8%	6.5%	0.1%
Risk Management	71	4.7%		4.5%	5.1%	2.2%	
Administrative Support	1,486	3.5%	3.5%	3.3%	-0.7%		
<b>Total</b>	<b>20,040</b>	<b>4.0%</b>	<b>4.7%</b>	<b>3.9%</b>	<b>3.4%</b>	<b>3.4%</b>	<b>3.0%</b>





# CEO Pay Comparisons

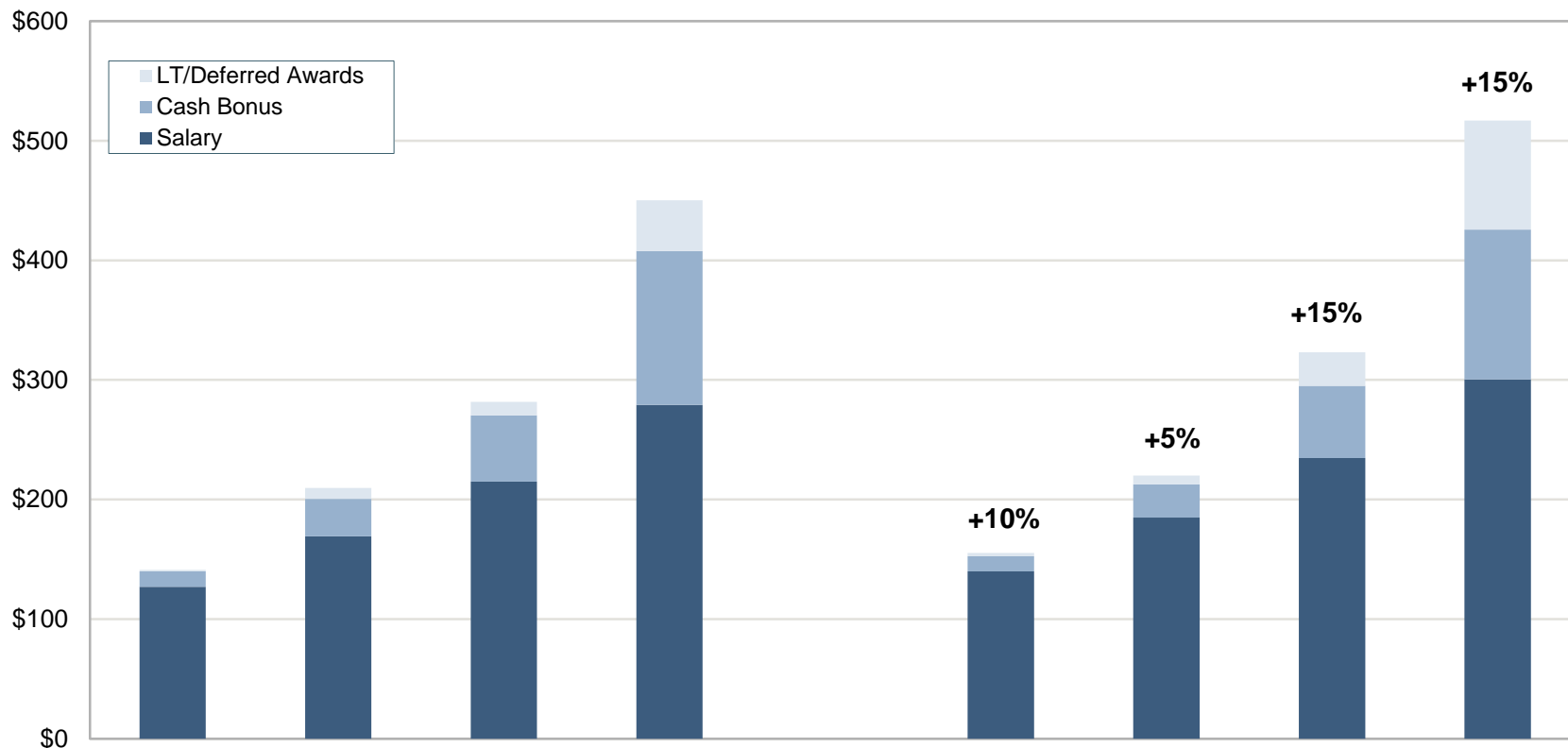
## Constant Incumbents



Comp Year	2013				2014			
	<u>LowQ</u>	<u>Med</u>	<u>HighQ</u>	<u>TopD</u>	<u>LowQ</u>	<u>Med</u>	<u>HighQ</u>	<u>TopD</u>
Salary	\$350	\$400	\$570	\$759	\$377	\$450	\$625	\$781
Total Cash	\$397	\$529	\$760	\$1,438	\$445	\$631	\$915	\$1,736
Total Comp	\$415	\$530	\$1,032	\$1,964	\$445	\$686	\$1,232	\$2,122
#Firms/Incs		47/47				47/47		

# Other C-Suite/Top Management Pay Comparisons

## Constant Incumbents



Comp Year	2013				2014			
	LowQ	Med	HighQ	TopD	LowQ	Med	HighQ	TopD
Salary	\$127	\$169	\$215	\$279	\$140	\$185	\$235	\$300
Total Cash	\$140	\$201	\$270	\$408	\$153	\$213	\$295	\$426
Total Comp	\$141	\$210	\$282	\$450	\$155	\$220	\$323	\$517
#Firms/Incs	64/555				64/555			

## Closing Thoughts

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- **Financial results are still favorable but likely to lose steam in 2016**
  - Commercial markets are softening at greater pace
  - Substantial surplus positions will affect growth and operational strategies
- **Starting to see operational efficiencies within companies**
  - Positive staffing relative to premium and lower expense ratios
  - Capacity from new systems in production now being leveraged
- **Data analytics driving more company-wide decisions but still underinvested**
  - Trying to be more proactive rather than reactive
  - Companies still struggle with where and how to use analytics
- **Customer experience is driving more strategy**
  - Need to define what value to agent/policyholder means
  - Business strategies need to be deployed against customer expectation
- **The labor market is very competitive**
  - Companies need to sell themselves
  - Compensation programs must be updated to attract and retain key staff
- **There is no time to rest**
  - Virtually every aspect of the business is challenged to operate smarter
  - Companies must address rapid pace of change and integrating technology

# Questions and Discussion

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