Executive Pay Practices and Trends

Tuesday, September 29, 2015

Greg Jacobson
Co-CEO
The Jacobson Group
Chicago, Ill.

Greg Jacobson is co-chief executive officer of The Jacobson Group, the leading provider of talent to the insurance industry. Greg has successfully guided the firm through substantial growth throughout the years, as demonstrated by the company’s recognition as one of the fastest-growing private staffing firms on multiple occasions. In addition to overseeing the organization, Greg manages select search assignments for the firm’s executive search practice. He has consulted companies internationally in all areas of the life, health, property/casualty insurance communities. He has successfully assisted leading industry organizations in the acquisition of critical senior-level talent, including board members, CEOs, and other C-suite roles.

Greg is an active participant in the insurance community. He contributes to many industry association events, including those of the International Insurance Society, the Property and Casualty Insurers Association of America, the National Association of Mutual Insurance Companies, and the Physician Insurers Association of America. He is considered an expert on the industry’s labor market and is often called upon to share his perspectives on the industry’s talent outlook, human capital strategies, talent acquisition, and succession planning. Greg is a board member of the National Insurance Industry Council for the City of Hope and a former board member for the Chicago Sinfonietta, the United States’ most diverse orchestra. He is a member of the Economic Club of Chicago and an independent director of a New York-headquartered specialty property/casualty insurer. Greg graduated from Illinois State University.

Jeff Rieder, CPA, CPCU
Partner, Head of Ward Group
Ward Group
Cincinnati, Ohio

Jeff Rieder is partner and head of Ward Group, a management consulting and research firm specializing in the insurance industry. He has overall leadership and responsibility for the firm. Jeff has significant experience in the insurance industry, with expertise in the property/casualty and life segments. Throughout his 20-year career, he has been involved with more than 400 projects for numerous domestic and international insurance companies, covering a diverse range of technology, performance, and operational evaluations. In 2011, Jeff led the sale of Ward Group to Aon; he now leads Aon’s global performance benchmarking practice for

Jeff holds a Bachelor of Science in accounting and an International Business Certification from the University of Cincinnati. He is a certified public accountant and holds the Chartered Property Casualty Underwriter designation.

**Session Description:**
Total compensation trends and the war for talent affect mutual insurers of all sizes. Join this session for a discussion on current executive pay practices and trends as well as highlights from the recently completed NAMIC 2015 Executive Pay Practices Study and extensive first-hand experience with property/casualty insurers.

**Top Three Session Ideas**
*Tools or tips you learned from this session and can apply back at the office.*

1. _______________________________________________________________________

2. _______________________________________________________________________

3. _______________________________________________________________________
Executive Pay Practices and Trends

Jeff Rieder  
Partner, Head of Ward

Greg Jacobson  
Co-CEO, The Jacobson Group

Agenda

- Thoughts on Recent Performance
- Employment Trends
- Changing Landscape of Executive Pay
- Closing Summary
Management Perspective

Senior leadership becoming less optimistic about the state of the industry.

State of the Industry Compared to 2014

- **Moderately better**: 15% (Commercial Lines), 21% (Personal Lines), 28% (Overall Benchmark)
- **About the same**: 62% (Commercial Lines), 62% (Personal Lines), 62% (Overall Benchmark)
- **Moderately worse**: 8% (Commercial Lines), 23% (Personal Lines), 17% (Overall Benchmark)
- **Significantly worse**: 2% (Commercial Lines), 1% (Personal Lines), 0% (Overall Benchmark)


---

Key Performance Measures – U.S.

- Combined ratio is prior effect of policyholder dividends
- Expenses include Underwriting, Loss Adjusting and Investment

Source: Ward's Results

- **Combined Ratio**
  - 1990 – 2014 Average: 104.3%
  - 1990 – 2014: 102.8%
  - 2000 – 2014: 39.9%

- **Net Premium Written to Surplus**
  - 1990 – 2014: 97.2%
  - 2000 – 2014: 73.9%

- **Total Expenses**
  - 1990 – 2014: 39.9%
Return on Equity

Return on Average Equity

Measurable Improvement of Various Levels

Staff Productivity Improvement per Policy or Reported Claim from 2009 - 2013

<table>
<thead>
<tr>
<th>Category</th>
<th>Improvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial UW</td>
<td>-4%</td>
</tr>
<tr>
<td>Personal UW</td>
<td>-2%</td>
</tr>
<tr>
<td>Claims Adjusting</td>
<td>4%</td>
</tr>
<tr>
<td>Billing</td>
<td>7%</td>
</tr>
<tr>
<td>Commercial Processing</td>
<td>8%</td>
</tr>
<tr>
<td>Claims Support</td>
<td>11%</td>
</tr>
<tr>
<td>Personal Processing</td>
<td>15%</td>
</tr>
<tr>
<td>Overall</td>
<td>4%</td>
</tr>
</tbody>
</table>

Unit Cost Change from 2009 - 2013

<table>
<thead>
<tr>
<th>Category</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial UW</td>
<td>19%</td>
</tr>
<tr>
<td>Personal UW</td>
<td>11%</td>
</tr>
<tr>
<td>Claims Adjusting</td>
<td>5%</td>
</tr>
<tr>
<td>Billing</td>
<td>9%</td>
</tr>
<tr>
<td>Commercial Processing</td>
<td>0%</td>
</tr>
<tr>
<td>Claims Support</td>
<td>9%</td>
</tr>
<tr>
<td>Personal Processing</td>
<td>-9%</td>
</tr>
<tr>
<td>Overall</td>
<td>9%</td>
</tr>
</tbody>
</table>

* Indicates function is less productive relative to unit count

Source: Ward CEO Benchmarking
Insurance Carrier Employment

[Graph showing employment trends over time with a note indicating 88,500 new jobs since April 2011]

Revenue and Staffing Expectations

12-Month Staffing Plan
- Increase Staff 65.4%
- Maintain Staff 30.9%
- Decrease Staff 3.7%

12-Month Revenue Plan
- Decrease Revenue 6.2%
- Flat Growth 14.8%
- Increase Revenue 79.0%

Source: U.S. Bureau of Labor Statistics
12-Month Staffing Plans

Prior Survey Results

Job Openings in Finance and Insurance

Source: U.S. Bureau of Labor Statistics

2015 Connect Differently - Jacobson & Rieder
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.
- Product line has a significant impact on the ease of filling positions.
- 10 of 12 categories have seen recruiting difficulty increase over the past year.

The Changing Landscape of Executive Compensation
Changing Executive Compensation – A Look Back

- 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’s executive’s homes

New Regulatory Environment

- SEC changes to Proxy requirements = transparency
  - Say on Pay
  - Independent Consultants
- Dodd-Frank reforms
  - Clawbacks
  - Minimum 50% deferrals on incentive compensation
  - Risk mitigation in incentive plans
Board & Compensation Committee Dynamics

• Empowered Boards
  - Selecting members and committee assignments
  - Firing CEOs
  - 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

• Concerns About Personal Liability
  - Shareholder lawsuits
  - Congressional hearings
  - Say on Pay liabilities

Empowered Shareholders/Policyholders/Advisors

• Shareholders are Vocal
  - Hedge fund manager breaks up The Hartford
  - 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
Institutional Shareholder Services (ISS) Hot Buttons

- The following problematic pay practices as defined by ISS can result in a “withhold” or “against” vote recommendation for:
  - Noncompliance with any single practice
  - Repricing of underwater stock options/SARS without prior shareholder approval
  - Excessive perquisites or tax gross-ups, and/or
  - Excessive CIC/severance provisions
  - Egregious employment contracts
  - New CEO with overly generous new hire package
  - Dividends as equivalents paid in unvested performance awards
  - Options backdating
  - Indirect pay disparity

- The following are problematic risk taking factors that may lead to a “withhold” or “against” vote recommendation:
  - Multiyear guaranteed bonuses
  - Single performance metric used for both short- and long-term plans
  - Mega equity grants that provide unlimited upside with little or no downside risk.

Mutual Insurance Considerations

- Many mutual insurers were founded more than 100 years ago
  - Cooperative structure to share common risks

- Mutual companies benefit policyholders, not stockholders
  - Take a longer view vs. quarterly results
  - Focus on investment in company vs. generating profits/returns

- 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 Insurance in the News

• **Lawmakers Target Big Pay Deals at Mutual Companies** – Boston Globe, May 23, 2012
  - A response by some Massachusetts’s lawmakers over the public outcry when the Boston Globe reported that Liberty Mutual’s retired CEO was paid nearly $50 million per year from 2008 to 2010.
  - Lawmakers said mutuals should:
    - Publicly disclose executive pay
    - Allow policyholders a “Say on Pay” vote
    - Confirm that compensation committee directors are independent
  - Current Liberty Mutual CEO David Long responded by saying that the company will begin disclosing top executive pay next year in a format similar to public company SEC filings, adding:
    - “Unfortunately, in today’s environment, I think people think you’re not doing something above board if you don’t [disclose it].”
    - “I don’t want people to assume the worst with us.”
  - “Liberty Mutual was born to protect ordinary workers. Today, by funneling money from regular families into the hands of executives, it has inverted its very reason to exist. Sadly, this case is not unique.” – The Atlantic, May 2012.

And The Result is...

  - The Commissioner of Insurance is seeking 2010 and 2011 data:
    - A list of any employee or board member who makes more than $100,000
    - All minutes and supplemental information from board and compensation committee meetings where pay issues were discussed
    - Company by-laws specific to compensation

• **What the public didn’t hear…**
  - During Kelly’s tenure Liberty Mutual:
    - Increased NPW from $18 to $22 billion
    - Increased Surplus from $8.5 to $16 billion
    - Delivered nearly $700 million back to policyholders in dividends
The Executive Pay Landscape Has Changed

As a result of regulatory and performance pressures, executive compensation throughout the insurance 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

The Importance of Market Comparators

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

- Each component has a purpose
  - Base Salary: the price of entry (25-35%)
  - Annual Incentive: important operational/annual results/priorities (20-30%)
  - Long-Term Incentive: building for the future/aligned with policyholders’ interests (40-50%)

Overall mix of pay/leverage should coincide with relative degree of responsibility and control.

<table>
<thead>
<tr>
<th>Base Salary</th>
<th>Annual Incentive</th>
<th>Long-Term Incentive</th>
</tr>
</thead>
</table>

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

Compensation Design Review – Goal Setting

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

  **Probability of Achievement**
  
<table>
<thead>
<tr>
<th>Threshold</th>
<th>Target</th>
<th>Stretch</th>
</tr>
</thead>
<tbody>
<tr>
<td>90%</td>
<td>50%</td>
<td>10%</td>
</tr>
</tbody>
</table>

- And the following payout percentages:

  **Payout Percent of Target**
  
<table>
<thead>
<tr>
<th>Threshold</th>
<th>Target</th>
<th>Stretch</th>
</tr>
</thead>
<tbody>
<tr>
<td>50%</td>
<td>100%</td>
<td>200%</td>
</tr>
</tbody>
</table>

- 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?
ATTRACTING AND RETAINING EXECUTIVE TALENT

KEY QUESTIONS

SELLING VISION AND VALUE

Just like differentiating a company in the market, organizations must set themselves apart in the fight for labor.

- Compelling marketing materials
- Prepare an elevator speech
- Conduct a bi-lateral interview
- Talk money early and often – it’s no longer taboo
- Remember – hiring takes momentum
- Make your best offer first
NEW OPPORTUNITIES – DECISION TREE

INTERESTED

• Location | Job Title | Company Reputation

• Current Compensation | Scope of Responsibilities

• Relationship with Hiring Manager, Board and Peers

• Opportunity to Make an Impact | Company Vision

• Total Compensation Offered

NOT INTERESTED

SHOULD I STAY OR SHOULD I GO?

• Culture

• Growth Opportunity

• Perks (such as flexibility)

• Competitive Compensation

• Organizational Mission and Vision
OVERCOMING THE SCARCITY OF EXPERIENCE

Remember that the goal is to find talent. A professional performing the same job at a different organization may not be a realistic candidate.

Questions and Discussion