ALIGNING EXECUTIVE PAY WITH PERFORMANCE

2018 INSURANCE INDUSTRY TRENDS

MAKE TOMORROW, TODAY
DEEP KNOWLEDGE OF THE INSURANCE INDUSTRY

The insurance industry is a large and important client sector for Mercer. Our clients include property/casualty, life, health and specialty insurance companies, both public and mutual. Our support for these clients covers all areas of our business, including health, wealth and careers.

We maintain a global insurance industry network of consultants who monitor trends, best practices, emerging issues and innovation in the industry. This group is composed of senior Mercer consultants who advocate the knowledge-sharing of insurance-specific information.

As a part of Marsh & McLennan Companies, Mercer also has a unique ability to provide intellectual capital and integrated solutions to meet the risk, strategy and human capital challenges of insurance companies.
ALIGNING EXECUTIVE PAY WITH PERFORMANCE

EXECUTIVE COMPENSATION LEVELS

Mercer reviewed the compensation levels of executives at the 50 largest US publicly traded insurance companies, covering more than 200 executives who have been employed in their positions for at least a year. The group represented a cross-section of types and sizes of insurance companies.

LEADERSHIP INSIGHTS

Over the past decade, much discussion has centered around the separation of chairperson duties from those of the CEO. Among the 50 largest insurance companies, the majority (57%) have separated these roles. Separation is generally viewed as a good governance practice, as it creates transparency and independence by giving the CEO the opportunity to commit his or her full attention to running the organization and the chairperson the ability to identify issues and monitor the governance of the organization.

Our research found that the most prevalent age of individuals with the dual role of CEO and chairperson was greater than 60 years old. This compares to the typical age of those holding just the CEO role, which was between 50 and 60 years old. Based on our experience, many companies separate the roles at the time of a CEO transition, and we expect this trend to continue.
CHANGE IN EXECUTIVE OFFICER PAY LEVELS

Overall, our research revealed that executive compensation increases were modest among insurance companies at the median (50th percentile). We saw much more significant changes at the 25th and 75th percentiles for actual cash compensation (base salary plus short-term incentives paid) and total direct compensation (actual cash compensation plus grant value of long-term/equity compensation).

<table>
<thead>
<tr>
<th></th>
<th>Base salary</th>
<th>Actual total cash</th>
<th>Total direct compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>75th percentile</td>
<td>$1,000,000</td>
<td>$4,054,942</td>
<td>$8,790,000</td>
</tr>
<tr>
<td>50th percentile</td>
<td>$961,796</td>
<td>$2,565,710</td>
<td>$4,831,143</td>
</tr>
<tr>
<td>25th percentile</td>
<td>$884,858</td>
<td>$1,623,132</td>
<td>$2,266,622</td>
</tr>
</tbody>
</table>

EXECUTIVE OFFICER PAY LEVELS

The average executive officer compensation level has a wide range, which can be attributed to different pay philosophies, jobs, company sizes and performance levels.

CEOs Only

<table>
<thead>
<tr>
<th></th>
<th>Base salary</th>
<th>Actual total cash</th>
<th>Total direct compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>75th percentile</td>
<td>$ 848,125</td>
<td>$2,407,635</td>
<td>$4,299,006</td>
</tr>
<tr>
<td>50th percentile</td>
<td>$ 595,417</td>
<td>$1,323,249</td>
<td>$2,174,500</td>
</tr>
<tr>
<td>25th percentile</td>
<td>$ 460,534</td>
<td>$806,629</td>
<td>$1,212,918</td>
</tr>
</tbody>
</table>

Change in Compensation Level

- 25th percentile
- 50th percentile
- 75th percentile

Note: Percentages reflect the median change in compensation calculated company by company as compared to the same data point in the prior year.
Generally, total direct compensation levels increase with the size of the company. In addition to size, other factors (such as performance, experience, and pay philosophy) are important when determining pay levels within these broad size ranges. We found this to be consistent when reviewing all named executive officer positions or only positions such as the CEO or CFO.

**Total Direct Compensation Based on Revenue Size — CEOs Only / Other Named Executive Officers**

![Bar chart showing total direct compensation by revenue size range for CEOs and other named executive officers.](chart.png)

- **$0–$5 billion**
  - Total Revenue: $3,970,920
  - Total Direct Compensation: $1,873,315
- **$5–$10 billion**
  - Total Revenue: $5,889,489
  - Total Direct Compensation: $3,678,212
- **$10–$20 billion**
  - Total Revenue: $10,150,835
  - Total Direct Compensation: $5,250,303
- **$20–$40 billion**
  - Total Revenue: $15,898,785
  - Total Direct Compensation: $7,464,702
- **$40–$80 billion**
  - Total Revenue: $16,375,327
  - Total Direct Compensation: $10,601,599
INCENTIVE COMPENSATION

Pay mix is an essential element of executive compensation program design in that it enables the alignment of pay and performance. Executives should have a pay mix that is heavily weighted toward incentives, allowing companies to align pay and performance. With such a mix, the degree of actual pay and performance alignment depends on the performance measures and goals. The pay mix of insurance company executives is significantly weighted toward incentives (see below).

Given that long-term incentives typically represent the majority of the incentive mix, we also reviewed the prevalence of different equity vehicles used by insurance companies. We found that the majority of insurance companies use two or more types of equity vehicles: the prevalence of performance awards/units is the highest (seen at 75% of companies) and stock options and time-based restricted stock/units are both used by approximately 40%–50% of companies.

Long-Term Incentive Vehicle Prevalence

- Performance-based units/shares: 75%
- Stock options: 50%
- Time-based restricted stock/units: 42%
- Cash awards: 17%
The overall average mix of equity is weighted more toward performance-based vehicles.

We reviewed the measures used by insurance companies in their performance-vested awards and found that the majority of organizations use two or more performance measures. Return on equity is the most prevalent, followed by total shareholder return (TSR) and an earnings measure (EBITDA, net operating income or EPS).

**Performance-Vested Equity Measures**

<table>
<thead>
<tr>
<th>Measure</th>
<th>Weight</th>
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<tbody>
<tr>
<td>Return on equity</td>
<td>51%</td>
</tr>
<tr>
<td>Share price/TSR</td>
<td>29%</td>
</tr>
<tr>
<td>Earnings/income/ EPS</td>
<td>24%</td>
</tr>
<tr>
<td>Book value</td>
<td>24%</td>
</tr>
<tr>
<td>Direct/net written premium</td>
<td>20%</td>
</tr>
<tr>
<td>Combined ratio</td>
<td>17%</td>
</tr>
<tr>
<td>Other</td>
<td>12%</td>
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</table>

*Note: “Other” includes measures such as pre-tax margin and invested assets growth.*
Given the significant focus on performance-based compensation, setting challenging but reasonable goals is critical. Companies are now considering multiple viewpoints in goal-setting, including correlation, forecast and peer analysis; strategic planning and expectations implied in market value; historical performance of volatility results; and peer performance ranges. Taking into account these key metrics enables companies to design better programs that are more aligned with employee and shareholder perspectives. Furthermore, rather than setting company-performance goal levels, some organizations are measuring performance relative to peer performance to determine incentive payout levels. Compensation committees will need to pay more attention in the future to the selection of performance measures and determination of goal levels.

**PAY AND PERFORMANCE ALIGNMENT**

We assessed the relationship between executive officer pay and performance by gathering performance and compensation data for a three-year period. Performance was measured using TSR levels; pay levels were total actual (that is, realized) pay, which included base salary plus actual bonus plus realized long-term incentive/equity value.

Because company size has such a significant impact on pay magnitude, our analysis focused on 25 similarly sized companies with revenues between $0 and $5 billion. We categorized companies into three bands based on performance levels (low, middle and high). Our conclusion was that, overall, actual compensation levels are aligned with performance. Companies in the lowest performance category pay executives lower at the median than companies in the medium- or high-performance categories. In 2017, the median compensation levels for the lowest performers was less than half of the highest performers.

**Actual Total Direct Compensation by Performance Level**
EXECUTIVE BENEFITS

Executive Retirement Benefits
Using Mercer’s proprietary databases and surveys, we also evaluated the prevalence and value of retirement benefits offered to executives. In addition to cash and equity compensation, retirement benefits represent a critical component of total remuneration for executives.

Qualified Retirement Plans
All insurance companies in the study provide employer-paid qualified retirement plans to all employees. These typically take the form of a defined contribution (DC) plan; for example, 401(k) matching and/or nonelective contributions. Approximately 20% of insurance companies continue to provide an active defined benefit (DB) pension plan to new hires.

The prevalence of DB plans has declined over time as a result of accounting and cost considerations, among other things, but the prevalence has held relatively steady in recent years.

NONQUALIFIED EXECUTIVE RETIREMENT PLANS

Because significant amounts of total cash compensation for executives can exceed Internal Revenue Service limits on pay permissible under qualified retirement plans, supplemental employer-paid nonqualified retirement plans are also highly prevalent among insurance companies (62%) and the market as a whole (general industry prevalence is approximately 60%). Similar to qualified plan trends, the vast majority of employer-paid nonqualified retirement plans are DC plans. Only 16% of insurance companies provide nonqualified DB plans to new-hire executives.
These plans are typically structured as either restoration plans, which provide the same benefit as the qualified retirement plans but without limitations on pay, or supplemental executive retirement plans (SERPs), which provide additional benefits above and beyond the structure of the qualified retirement plans.

In assessing the value these retirement benefits add to total remuneration, the median value is approximately 6% of pay. This is largely due to the fact that median benefits are simply a restoration of the contributions/benefits provided under the qualified plans.

<table>
<thead>
<tr>
<th>Percentage of total cash compensation</th>
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<tbody>
<tr>
<td>75th percentile</td>
</tr>
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<td>50th percentile</td>
</tr>
<tr>
<td>25th percentile</td>
</tr>
</tbody>
</table>

Although the prevalence data above reflect public insurance companies, Mercer’s research suggests similar trends among mutual insurance companies as well (that is, DC plans are more common than DB plans). However, because of the lack of equity among mutual insurance companies, the overall prevalence of nonqualified retirement plans (especially DC and DB SERPs) and the median value of these benefits are typically higher than we see for public insurance companies. Among mutual insurance companies, nonqualified retirement plans are frequently used in lieu of providing equity compensation, and the median values of these benefits typically exceed the 75th percentile of what we see for public insurance companies.

In addition to employer-paid executive retirement benefits, many insurance companies commonly offer voluntary deferred compensation plans (approximately 76% of companies). These plans allow executives to defer additional compensation (for example, base salary and short-term/long-term incentives) above what is permitted under a 401(k). The objective of these plans is to provide additional pre-tax savings opportunities for highly paid executives.
Mercer Executive Rewards Consulting

Trusted Advisors for Today’s Rapidly Changing World
The executive rewards and governance landscape is increasingly complex. These programs need to attract key talent, motivate appropriate performance and create an alignment with business imperatives and other talent strategies.

At the same time, scrutiny abounds from shareholders, proxy advisors, governments and the media, who are all demanding that executive pay be aligned with performance and appropriate levels of risk-taking.

Mercer’s executive rewards consultants are trusted advisors to public- and private-company senior management and boards of directors. Mercer’s Executive Compensation professionals provide best-in-class expertise in the areas of executive and director compensation and benefits, pay-performance alignment and corporate governance.

How We Can Help
Let us shape your executive compensation and rewards programs with Mercer’s expert consulting and comprehensive data, trusted by many firms before you.

- Improve your ability to attract, retain and motivate key executive talent.
- Align pay with your organization’s strategic needs and relevant talent comparators.
- Realize value in ownership transactions.
- Remain compliant with regulatory, legislative and shareholder requirements and guidelines.

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