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Are insurance managers appropriately incentivised?

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Setting the scene

- Why are incentives important?
- Who are the stakeholders of insurance businesses?
- What currently defines success?
- How is success being measured?
- Will success be defined differently in future? Should it be?

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Disclaimers

- Clearly a controversial topic!
- Not intended to criticise, but to encourage debate
- We don't have the answers
- We welcome the audience's perspective…please do interrupt

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Why are incentives important?

- Align interests of owners of the business and its managers
- Attract and retain talent
- Encourage desired behaviours/actions
- Steer appropriate levels of risk-taking

…ultimately make money!

But what about other stakeholders? And non-financial interests?

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Who are the stakeholders of insurance businesses?

Financial beneficiaries
- Other financiers (e.g. debt providers, reinsurers)
- Tax receipts

Shareholders
- Sustainable profitability
- Share price growth
- Dividends

Policyholders
- Policy benefits
- Security
- Good service

Mutual members
- Bonuses / distributions
- Reputation?
- Having a say / vote ?
- Wider role in society

Employees
- Income
- Quality of work / life
- Job security
- Pension scheme safety / contributions

Regulators
- Policyholder protection
- Appropriate levels of risk

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Structure of incentives

Usually a combination of:

- Base salary + benefits + pension
- Short-term (usually annual) variable element (AIP or STIP)
- Long-term (usually 3 years) variable element (LTIP)
- Plus, usually a deferment period (3-5 years)
- Minimum shareholding
- Clawback / malus provisions

We'll focus on these

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What currently defines success?

Profit	Cash flow / capital	Growth	(EV) Embedded value (or a proxy)	Non-financial
Operating Earning per Share (EPS)	Net release from operations	EEV New Business (NB) profit	Adjusted SII Own Funds	Strategy implementation
Operating profit	Free surplus generated	Risk-adjusted NB profit	EV profit	Employee engagement
Adjusted Return on Equity (RoE)	Cash flows	EV of new business	Economic Net Worth (ENW) profit	Customer outcomes
Existing business profit	Cash generation	Gross Written Premiums		Personal objectives
Operational efficiency	Operating surplus	Net income		Environmental
Manufacturer profitability	Dividend flow	Value New Business		Riskmanagement / governance
Post-tax earnings	Capital generations			
Pre-tax return on economic capital (RoC)	Management actions			
Net profit	Total shareholder return (TSR)			

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How is success being measured?

	Metric	Short-term incentives	Long-term incentives
Profit	EPS	5%	9%
	Accounting profit	18%	14%
	RoE/RoC	5%	8%
	Efficiency / cost	6%	2%
Cash flow / capital	Capital / surplus generation	8%	6%
	Cash flows / dividends	5%	3%
	TSR	0%	31%
Growth	NB profit (accounting)	6%	3%
	NB profit (EV)	5%	3%
	Revenue / GWP	7%	2%
EV	EV (or a proxy) / EV profit	5%	4%
Non-financial	Strategy / personal objectives	13%	10%
	Employee engagement	5%	3%
	Customer outcomes	11%	4%
	Risk management / governance	2%	1%

- 17 life insurers sampled
- % represents average weights of incentive pay-outs allocated to each metric
- Higher % = Higher perceived contribution to “success”

Appendix outlines the companies included in the sample and the methodology for collating the statistics

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Summarising the rankings: all sampled insurers

- Profit and shareholder returns clearly dominate
- Strategic and personal objectives are common
- Positive customers outcomes highly ranked

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Comparing mutuals to public companies

Mutuals

	Metric	Short-term incentives	Long-term incentives
Profit	EPS	0%	0%
	Accounting profit	14%	16%
	RoE/RoC	0%	6%
	Efficiency / cost	8%	6%
Cash flow / capital	Capital / surplus generation	4%	6%
	Cash flows / dividends	0%	0%
	TSR	0%	0%
Growth	NB profit (accounting)	14%	11%
	NB profit (EV)	0%	0%
	Revenue / GWP	10%	9%
EV	EV (or a proxy) / EV profit	0%	0%
Non-financial	Strategy / personal objectives	14%	24%
	Employee engagement	10%	9%
	Customer outcomes	21%	13%
	Risk management / governance	5%	0%

Public companies

	Metric	Short-term incentives	Long-term incentives
Profit	EPS	6%	11%
	Accounting profit	20%	12%
	RoE/RoC	8%	10%
	Efficiency / cost	4%	0%
Cash flow / capital	Capital / surplus generation	8%	5%
	Cash flows / dividends	6%	6%
	TSR	0%	40%
Growth	NB profit (accounting)	5%	0%
	NB profit (EV)	6%	3%
	Revenue / GWP	5%	0%
EV	EV (or a proxy) / EV profit	6%	5%
Non-financial	Strategy / personal objectives	11%	5%
	Employee engagement	4%	1%
	Customer outcomes	8%	1%
	Risk management / governance	2%	2%

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Summarising the rankings: mutuals vs public companies

- Mutuals more focussed on employee and customer outcomes
- Mutuals focus on accounting profits and NB profits & growth
- Mutuals more focussed on qualitative metrics, e.g. non-financials & strategic personal objectives

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Comparing UK companies to international groups

UK-based companies

	Metric	Short-term incentives	Long-term incentives
Profit	EPS	3%	17%
	Accounting profit	18%	8%
	RoE/RoC	6%	6%
	Efficiency / cost	3%	0%
Cash flow / capital	Capital / surplus generation	12%	10%
	Cash flows / dividends	8%	7%
	TSR	0%	47%
Growth	NB profit (accounting)	6%	0%
	NB profit (EV)	0%	0%
	Revenue / GWP	0%	0%
EV	EV (or a proxy) / EV profit	10%	6%
Non-financial	Strategy / personal objectives	19%	0%
	Employee engagement	3%	0%
	Customer outcomes	12%	0%
	Risk management / governance	0%	0%

Large international groups

	Metric	Short-term incentives	Long-term incentives
Profit	EPS	8%	6%
	Accounting profit	22%	15%
	RoE/RoC	9%	14%
	Efficiency / cost	6%	0%
Cash flow / capital	Capital / surplus generation	5%	1%
	Cash flows / dividends	4%	5%
	TSR	0%	35%
Growth	NB profit (accounting)	5%	0%
	NB profit (EV)	12%	6%
	Revenue / GWP	9%	0%
EV	EV (or a proxy) / EV profit	2%	5%
Cash flow / capital	Strategy / personal objectives	5%	9%
	Employee engagement	4%	1%
	Customer outcomes	5%	2%
	Risk management / governance	3%	3%

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Summarising the rankings: UK vs. International

- For LTIPs, UK companies favour EPS whereas international groups favour RoE/RoC; both peer groups focus on TSR
- Cash & surplus generation more prevalent in UK
- Growth metrics more commonly used for international groups, however many metrics oriented towards general insurance product lines

Playing Devil's advocate

- Should such a high weighting be applied to qualitative / difficult to measure outcomes for strategic / personal objectives?
- Do existing incentive structures overly-encourage share buybacks?
- Should accounting profit continue to define success? Profit not always same as shareholder returns
- Should mutuals focus more on policyholder distributions to members as opposed to growth in member base? Again profit does not necessarily translate to member bonuses

Will success be defined differently in future?

- "Investor base" is important: growth vs. income investors, specialist vs. generalist investors, members vs. shareholders
- TSR arguably captures all shareholder value created and more a objective measure of value returned compared to other metrics
- Accounting profits loosely correlated to TSR, however, generalist investors still use accounting multiples for valuations so will likely continue to be important
- Decent alignment between business models and incentives, e.g. mature life companies focus on cash and capital generation, and so will likely continue
- International groups pivoting towards growth metrics as they reduce exposure to life and market risks

Should success be defined differently?

Significant attention in the media around focus beyond profits:

- Profit and purpose
- Responsible capitalism
- Sustainable business
- Environmental, social and governance (ESG)
- Ethical investing
- Corporate social responsibility (CSR)

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Poor ESG models are being punished by investors

Environmental

Over €30bn in costs
(as of May 2019)

Social

US$134bn fall in market
cap in one week
Failure of one company

Governance

At least US$23bn
reduction in value

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Can insurers do more?

Insurance companies in Europe including Axa, Allianz, Scor, Zurich, Swiss Re and Munich Re have over the past two years announced a series of measures to divest from coal or to stop selling insurance to companies involved in its production and use.

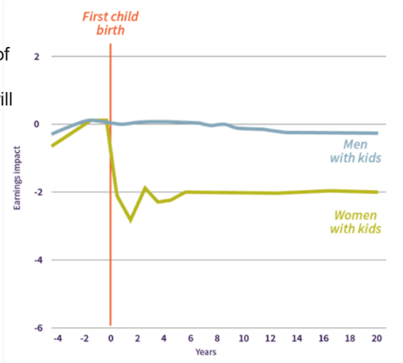
The Financial Times, 1 July 2019

Research from the Association of British Insurers earlier this year however revealed a small drop in BAME representation, down to 13% from 15% the previous. (Across England and Wales, roughly 14% of the population defines itself as being non-white, according to the 2011 census.)

Insurance ERM, June 2019

Why aren't there more women in senior roles?

The dominant reason for the gap is the 'motherhood penalty'. Women are more likely to take on the bulk of the childcare responsibilities and work part-time, but once you work reduced hours it is unlikely that you will progress. You get stuck.



Association of British Insurers, Tackling the gender seniority gap: what works for the insurance and long-term savings industry?

Policy direction

Possible implications of the 'market-consistent' valuation approach currently applied in Solvency II on long-term products and investments should be investigated. Attenuation of some constraints to enable investment in equity and long-term assets should be considered. European supervisors could insist and ensure that long-term sustainability factors are incorporated in the ORSA made by insurance companies.

EU High Level Expert Group on Sustainable Finance, June 2017

Manulife was the first life insurer to issue a green bond, with a SGD 500m ($362m) deal in November 2017. This year Sun Life issued a C$750m ($564m) sustainability bond in August while Generali became the first European insurer to tap the sustainable financing market with a €750m ($824m) green bond last month and has committed to allocate €4.5bn to green and sustainable investments between 2018 and 2021.

Insurance ERM, October 2019

In some cases, we have taken the view that an insurer's credit profile is negatively affected due to its ownership by, or affiliation with, groups that lack transparent control and governance structures, or are facing regulatory challenges. Last year, we changed the outlook for VIVAT NV's main operating subsidiaries, SRLEV NV and REAAL Schadeverzekeringen NV, to negative from stable following regulatory action against its parent, Anbang Insurance Group Co. Ltd. (Anbang) and concern over VIVAT's future ownership.

Moody's, The impact of environmental, social and governance risks on insurance ratings, July 2019

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Should insurers be incentivised to do more? How?

- Rewards for allocating more capital to sustainable finance and assets with a social purpose, e.g. green bonds, infrastructure assets
- Higher weightings on incentive pay-outs for risk management and governance process, e.g. incentives for prevention of cyber attacks, external reviews of governance frameworks
- Link incentives to ESG scores from ESG data providers such as MSCI and Dow Jones Sustainability Index
- Implement investment guidelines to discourage/block investment in companies and assets with low ESG scores

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Key conclusions

- Insurers' incentives now more focussed on TSR, an objective measure of shareholder value
- Mutuals (perhaps unsurprisingly) more customer focussed, but no apparent linkage to bonuses, rather operating profits and NB growth
- UK companies have a clear focus on TSR vs accounting profits; international companies catching up on TSR
- International groups more focussed on NB growth than UK counterparts
- Limited evidence of ESG-focussed metrics despite a clear media focus
- What role should actuaries have?

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Questions

Comments

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Appendix: Overview of data collection approach

- Data collected using year-end 2018 Report and Accounts and recent prospectuses (for ReAssure and M&G Pru)
- Most data is based on CEO and CFO incentive plans; in few cases other directors' incentive plans were disclosed
- Sample included 17 insurers, with those insurers subdivided into 'peer groups' of (a) UK mutuals, (b) UK companies and (c) international companies. The insurers included in the sample are as follows:
  - UK mutuals: LV=, Royal London, NFUM, Wesleyan
  - UK companies: Aviva, M&G Pru, ReAssure, Phoenix, L&G, Just
  - International companies: Pru Plc, Allianz, Generali, AIA, Aegon, AXA, Zurich
  - Public companies includes all insurers in the sample except UK mutuals
- Incentives are usually allocated by a weight (e.g. 50% TSR and 50% accounting profit). These weightings have been used in compiling the overall weights for each grouping
- While some metrics used by insurers do not directly map to our labels we have used our judgement to allocate them to the labels that we have prescribed in order to derive a sensible number of groupings

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Thank you

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