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Aligning Proper Incentives with Decision-Making

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The economic crisis and life insurance

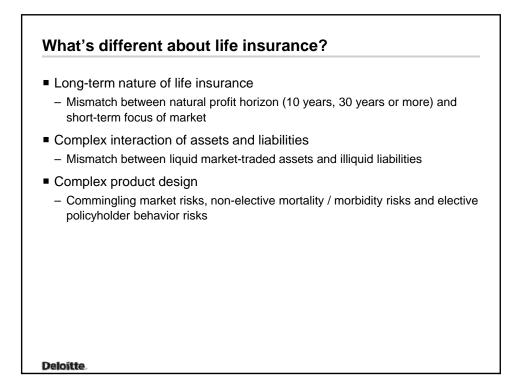
The crisis impacted life insurers in a number of ways – primarily through the availability of capital and enhanced regulatory considerations.

A multiple choice question

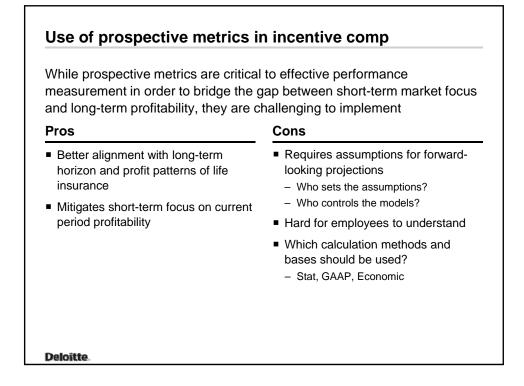
No major insurance went under as a result of the crisis. Why?

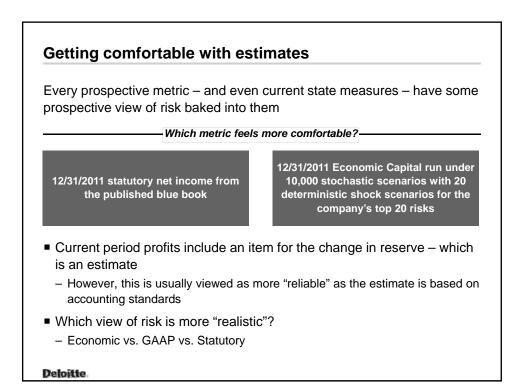
- A. Better use of models in life insurance to project and analyze risk
- B. Existing capital requirements (RBC) were sufficient
- C. Long-term horizon of life insurance meant companies had more time to react and course correct
- D. Non-elective nature of many life insurance benefits mitigated effects
- E. Life insurance companies were just lucky
- F. Life insurance actuaries and CROs are the rock stars of risk management

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There are a n performance	umber of different metrics that companies use in measuring
Current period metrics	 Measure the performance over the past financial period (year or quarter) or at the current time
	 Directly observable from financial statements or internal reports based on standard accounting approaches
	 Include profit, revenue, stock price, capital, ROE, ROIC
Prospective metrics	 Measure the profitability or value inherent in the company's current book of business that will be released in future periods and the change in that prospective value in the current period
	Must be calculated using forward-looking models
	Include economic capital, embedded value, RAROC





Conclusion and Recommendations

Inclusion of prospective metrics provides an enhanced framework for managing incentives and is worth the additional effort required for implementation

- 1. Use a combination of metrics in a holistic framework to drive incentives
 - Should be aligned with stakeholders' view of risk and return trade-offs
 - Stakeholders with a short-term focus will want more current period metrics (although perhaps they shouldn't be investing in life insurance companies?)
 - Stakeholders with a long-term focus will want more prospective metrics
- 2. Align incentive comp metrics for individuals with how performance is measured and reported for the company as a whole
 - Eliminates misalignment between company strategy and individual incentives
- 3. Ensure that prospective metrics are calculated in a controlled environment with appropriate delegation of authority, policies, and change management protocols
 - May need to provide different incentive plan for the people doing the calculations

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