2021/2022 HEALTH INSURANCE EXECUTIVE INSIGHTS REPORT

Strategically Leveraging Compensation to Drive Business Results

Introduction

The recently published ***2021 BDO Health Insurance Industry Executive & Management Total Potential Remuneration (TPR) Survey*** is a valuable source of information about executive compensation relied upon by boards and management to make well-informed executive compensation decisions.

BDO's TPR Survey includes insights related to compensation and performance measures that enable health insurers to focus on executive compensation strategies that drive desired business results. This summary highlights some of the key findings from the full report, which contains extensive data that allows health insurance companies to address critical issues, including:

- Should companies redesign pay and delivery to attract and retain an executive leadership team that will drive the business strategy?
- Should current performance metrics be adjusted to support the behaviors that will achieve the goals of the business?
- How much of an executive's pay should be at risk (i.e., variable pay that is only earned if specific performance metrics are achieved) and does it effectively align with business objectives?
- How much pay should be allocated to Supplemental Executive Retirement Plans (SERPs) and Change of Control (COC) agreements?
- Is there adequate communication between management and the board to ensure awareness and preparedness for the impact of external influences?

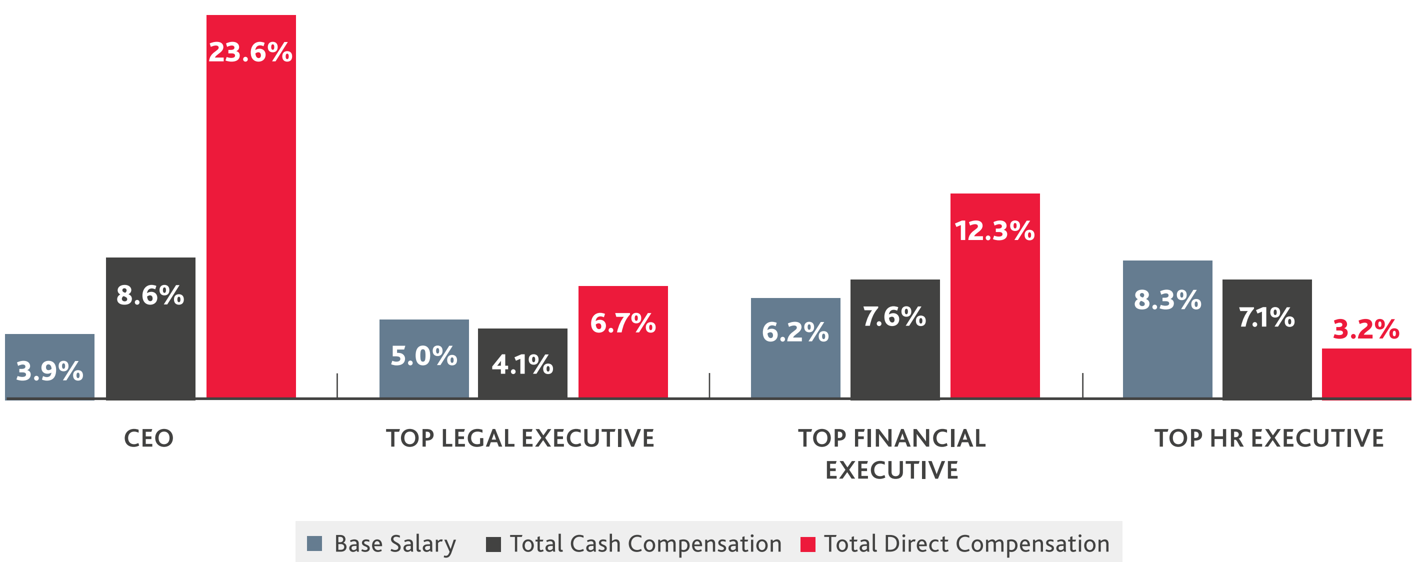
Top Executive Pay Matches or Exceeds Revenue Growth

Overall, the change in executive pay from 2020 to 2021 was higher than typical merit increase budgets, which hover around 3%. Total cash compensation (TCC[1]) and total direct compensation (TDC[2]) were, in some cases, close to, or higher than, the increase in revenues which averaged 7.2%. The current economic environment challenges companies to control administrative costs including compensation levels which may be increasing at a faster rate than revenue.

Change in executive pay from 2020 to 2021 is assessed two ways:

- Change in pay for **current incumbents** which includes the average increase or decrease in pay that was experienced by each individual executive. This analysis is based on companies with the **same incumbent** for the two years (see exhibit 1).
- Change in pay based on year-over-year change for a **position**. This compares company by company including those companies where the incumbent changed (see exhibit 2).

EXHIBIT 1: AVERAGE CHANGE IN ACTUAL PAY FROM 2020-2021 – SAME INCUMBENTS[3]

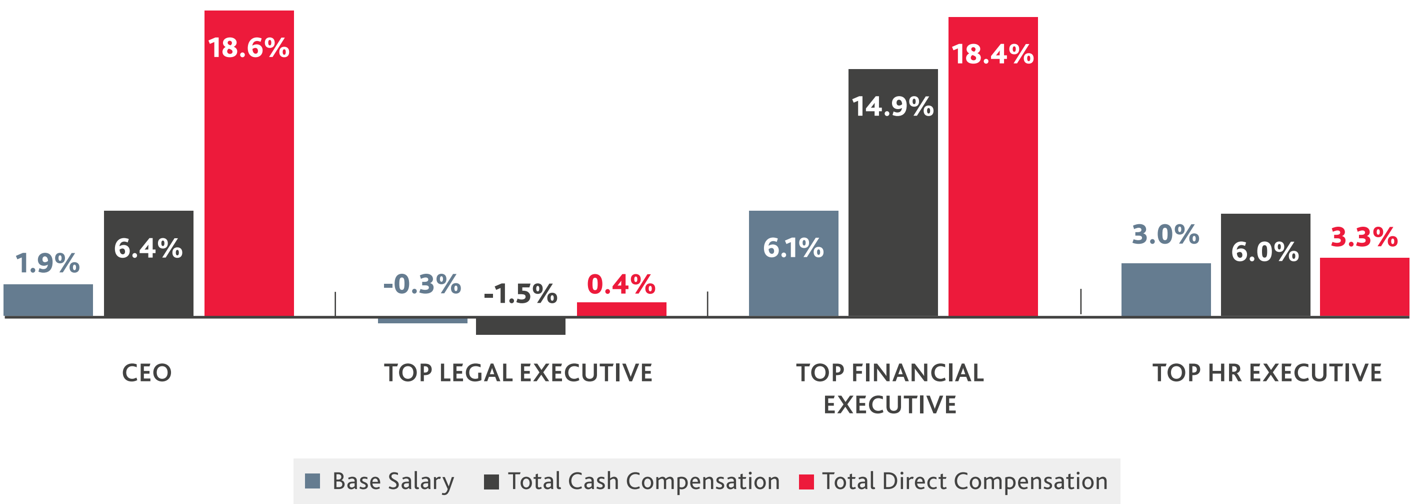


1 Sum of base salary and annual incentives (AI)

2 Sum of base salary plus AI and long-term incentives (LTI)

3 Analysis is based on companies matching the same incumbent to the job in both the 2020 and 2021 TPR Survey editions.

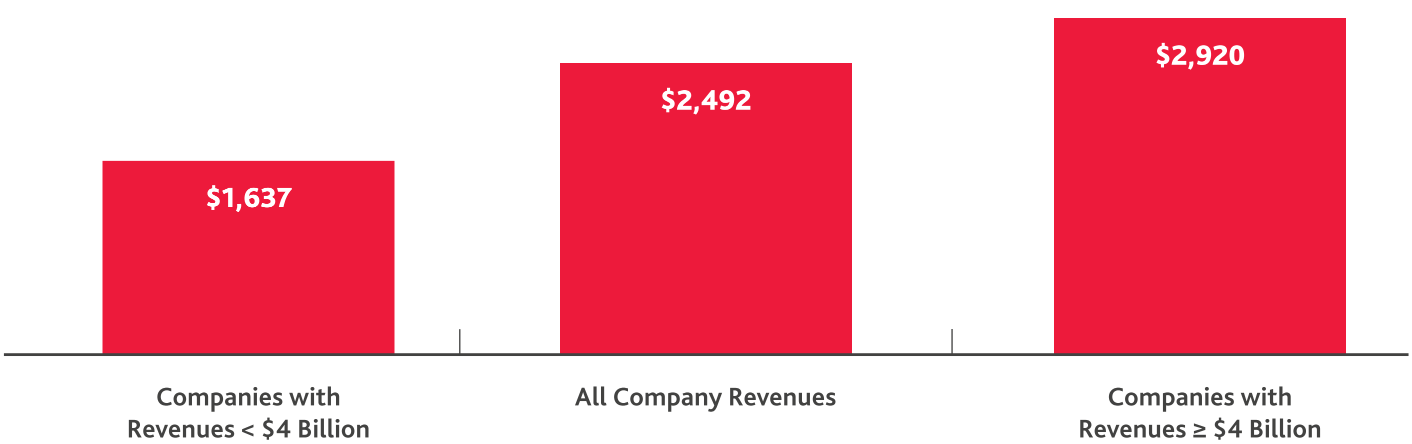
EXHIBIT 2: AVERAGE CHANGE IN ACTUAL PAY FROM 2020-2021 – ALL INCUMBENTS[4]



The change in pay for all incumbents shows that salary levels increased at a slower rate, indicating that the new hires were brought in at a lower pay level than their predecessor. Our analysis revealed that, on average, 34% of these top executives were newly hired, and base salary was lower for 40% of those newly hired incumbents. While TCC appears to increase more for this group, this may be a result of comparison of a full-year bonus to a partial-year bonus paid to new hires in their first year. This is also true of TDC which typically fluctuates more from year to year under any circumstance. It is quite interesting to see that pay for all positions went up except for the Top Legal Executive. This may reflect higher demand for CEOs and CFOs.

In addition to absolute compensation levels, it is interesting to consider compensation in the context of revenues. Executive pay levels typically increase in concert with company size. For instance, the mean salary for CEOs in companies with revenues greater than or equal to $4 billion is about 29% higher than the mean salary for CEOs at companies with revenues of less than $4 billion. However, this does not necessarily mean that larger companies overpay their CEO. We compared pay levels relative to revenues and found that larger-sized companies were able to achieve a greater return (revenue) on their investment (CEO pay).

EXHIBIT 3: AVERAGE REVENUE PER DOLLAR OF CEO TOTAL DIRECT COMPENSATION (IN THOUSANDS)



4 Analysis is based on companies matching to the job, irrespective of the same incumbent, in both the 2020 and 2021 TPR Survey editions.

Setting Metrics to Align Executive Incentive Pay to Corporate Results

Incentive pay, including both annual or short-term incentives (STI) and long-term incentives (LTI), is generally considered and used as an effective means of aligning the financial interests of top executives to that of the company and other stakeholders. However, the process in determining what metrics to use and how to set results-oriented goals is a constant challenge.

Our survey identified the metrics that companies most often use in the design of annual and long-term incentive plans for health insurance executives. Contract/member growth is on top of the leaderboard of metrics used for annual incentive plans — this is an excellent indicator of true organic growth. Organizations are balancing this with an eye on other financials in their long-term plan such as risk-based capital and net income/profit growth. The prevalence of each is indicated below:

EXHIBIT 4: PREVALENCE OF METRICS USED FOR INCENTIVE PLANS

Annual Incentive Metrics	Long-Term Incentive Metrics
Contract/Subscriber/Member Growth **(71%)**	Risk-Based Capital Ratio **(41%)**
Customer Satisfaction **(71%)**	Net Income/Profit Growth **(35%)**
Net Income/Profit Growth **(41%)**	Membership Growth **(29%)**
Individual Performance **(41%)**	Contribution to Surplus/Reserves **(24%)**
Revenue Growth **(41%)**	

While increases in revenue and profits are commonly used measures, it is important to keep in mind that they do not necessarily reflect true organic growth. Revenue increases can be a result of pricing increases and profits can be impacted by reduced utilization. Market share metrics are the best indicator of true organic growth.

EXHIBIT 5: EFFECTIVENESS OF METRICS USED IN INCENTIVE PLANS

INDICATOR OF GROWTH

MODERATE	BETTER	BEST
Revenue Growth	**Net Income/Profit**	**Membership/Enrollment/Market Share**
Can be influenced by price increases	*Can be influenced by operating costs, revenues, expenses*	*Signifies new membership*

It continues to be difficult to model the impact of COVID-19 and other related economic impacts on the future financial performance. Ugo Okpewho, Managing Director in BDO's Insurance Advisory practice, explains some of the difficulty in predicting financial outcomes as a result of the pandemic. "Earlier thinking was that COVID-19 would exert tremendous financial pressures on health insurers, but that didn't turn out to be the case because health screenings, dental visits, wellness activities and elective procedures were shelved — which drove down claim costs. There were more closures among smaller businesses less likely to offer group benefits and larger employers were able to avoid revenue blows due to government payroll protection programs." Our clients are taking steps to effectively deal with this uncertainty by increasing their communication with their boards, providing them with more updates to the financial status of the organization and the potential impact on the incentive plans.

> *The silver lining of the recent disruption is that management and boards are increasing the frequency and level of communication. This is good for the health of the company and helps avoid year-end surprises.*

JUDY CANAVAN
Global Employer Services Managing Director

> *An incentive program, including both membership and financial metrics, can be a powerful tool to focus participants on managing not only short-term enrollment, but also the longer-term financial impact of bringing in new customers.*

JASON BROOKS
Global Employer Services Managing Director

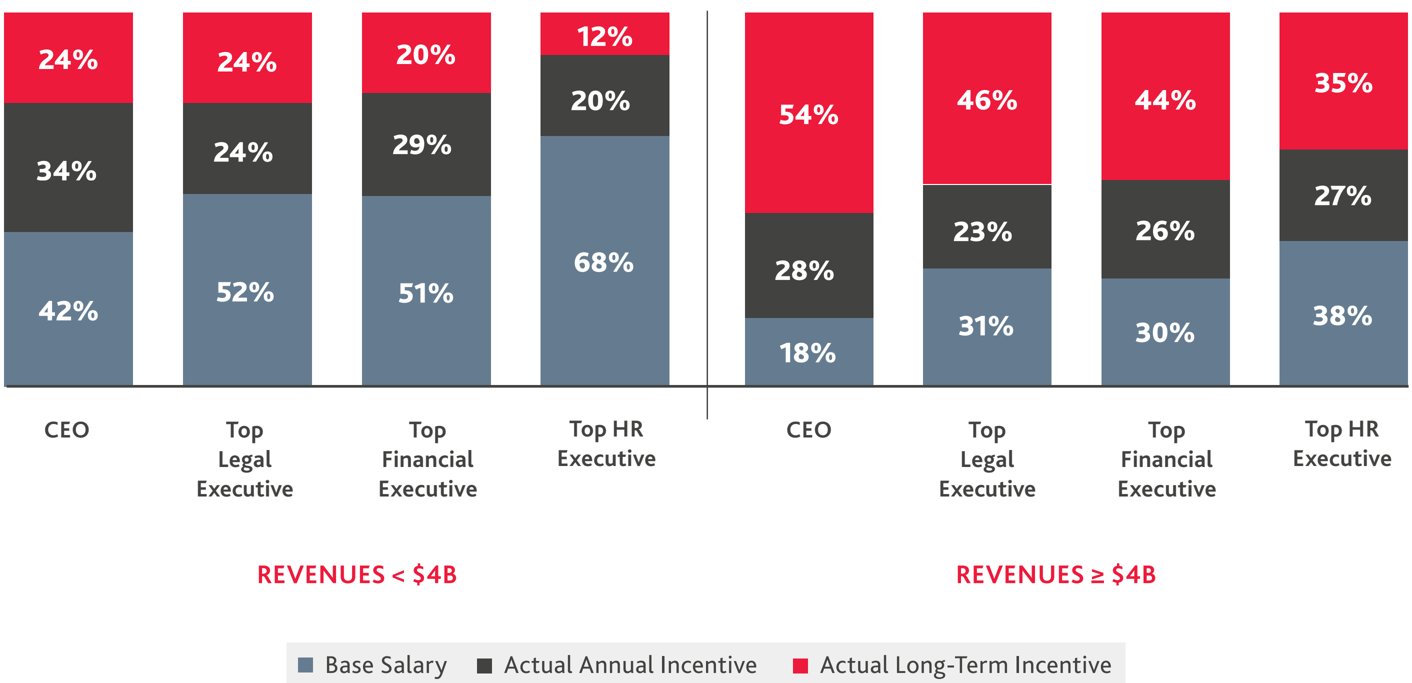
Variable Pay is a Key Element of Health Insurance Executive Compensation

Variable pay for health insurance executives continues to be prominent in terms of usage and target incentive opportunity[5].

In fact, the 2021 TPR Survey results showed that all but one company reported having either an annual incentive plan or a long-term incentive plan.

Pay is significantly more leveraged for executives working for companies with $4 billion or more in revenue, as illustrated below. This is in large part driven by long-term incentives, which represent the largest component of executive pay in these organizations. A portion of what drives this is the inclusion of public companies in the $4 billion or more in revenue company cut.

EXHIBIT 6: 2021 AVERAGE MIX OF PAY BY REVENUE SIZE*



*Values may not sum to 100% due to rounding.

5 Target incentive opportunity is the amount of annual or long-term incentive earned if performance expectations are met

SERPs and COC Agreements Can Strengthen an Executive Pay Package

In addition to cash compensation, executives may be eligible for Supplemental Executive Retirement Plans (SERPs) or Change of Control (COC) agreements:

- SERPs provide benefits above and beyond those covered in other retirement plans.
- COC agreements may provide a severance, bonus payments or accelerated vesting of equity awards. They are designed to incentivize executives to remain with the company upon a change in control/acquisition by another company.

These plans are very common as offered by nearly two-thirds of health insurance companies. They serve as important executive retention devices. Unfortunately, upon a triggering event[6] (46% of surveyed companies require a double trigger), the size of the payouts can be newsworthy. Boards, management and other stakeholders are advised to be cognizant of the size of these potential payouts and ensure that the amounts are appropriate and defensible. For instance, the potential annual annuity of retirement benefits, including SERPs, is 58% of the CEOs salary level.

EXHIBIT 7: POTENTIAL ANNUALIZED VALUE OF SERPS EXPRESSED AS A PERCENTAGE OF CURRENT BASE SALARY[7]

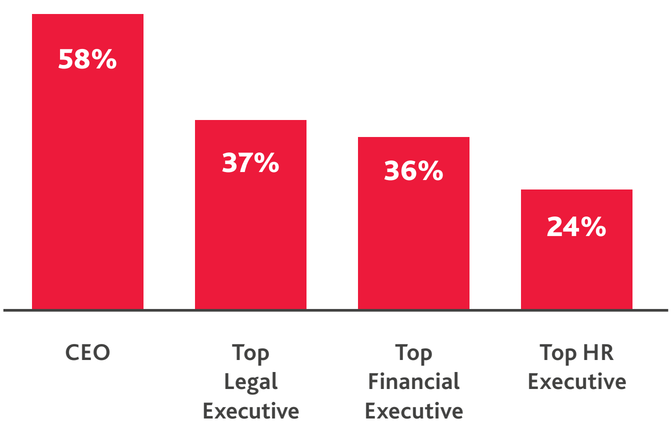
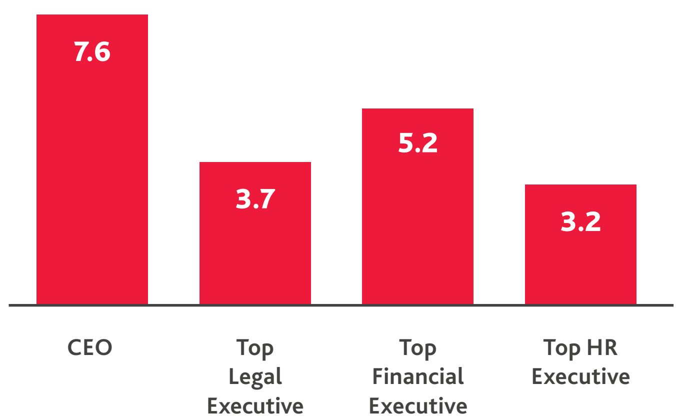


EXHIBIT 8: POTENTIAL CHANGE OF CONTROL PAYOUT EXPRESSED AS A MULTIPLE OF CURRENT BASE SALARY[8]



The potential payout for a change of control agreement is over seven times the CEO's salary level — which can translate to a payout of several million dollars. While the payouts for other executives are lower, they are still significant.

6 Examples of a triggering event include the sale or merger of the company or termination of the executive without cause.

7,8 2021 Health Insurance Industry Executive & Management Total Potential Remuneration Survey.

Conclusion

The role of organizational leaders is to ensure that the company fulfills its mission and provides value to its stakeholders, including policy holders, providers, investors and the community. Executives bring to the table a wealth of experience and insight. In the ideal situation, compensation programs reinforce the strategic goals of the organization and reward executives for their success. However, it is important to avoid "unintended consequence" whereby the compensation program clouds judgement or misdirects actions. While this can be a result of plan design, it is just as likely a result of changing circumstances. The fast pace of change to the economy and markets requires monitoring, communication and flexibility.

Learn more about BDO's Compensation Surveys, including how to participate. ▶

About Our Survey

BDO's annual **Health Insurance Industry Executive & Management Total Potential Remuneration (TPR) Survey** reports compensation, benefits, perquisites and contract agreements for over 40 executive and senior management positions in health insurance organizations. Survey responses are gathered annually from participating health insurance organizations with three categories of analyses:

COMPENSATION LEVELS

TOTAL POTENTIAL REMUNERATION LEVELS

POLICIES AND PRACTICES

About BDO's Global Employer Services Practice

The professionals in BDO's Global Employer Services practice are dedicated to helping companies achieve their business and financial goals by effectively managing their most important asset—**their people.**

GLOBAL MOBILITY

Expatriate Tax
Working with multinational employers to minimize tax burdens and compliance risk while providing integrated services and essential tools, such as our business traveler tracking application, to enable seamless global and domestic employee transitions.

Mobility Consulting
Developing strategies with company stakeholders to determine key objectives and create or modify a global mobility program to meet these objectives through enhanced assignee selection criteria, policy design, repatriation strategies, cost analysis, market analysis, and effective communication.

Global Equity
Helping employers with multinational stock compensation programs to minimize tax burdens and compliance risk through our international network and tools like the BDO Global Equity Mobility Solution and Global Equity Rewards Matrix.

GLOBAL REWARD TAXATION

Global Payroll
Providing payroll review, recommendation and implementation; assignment benefit and compensation gathering; and compensation schedules to reconcile U.S. and foreign payrolls.

U.S. Employment Tax
Identifying and implementing strategies to help reduce current and future employment tax burden and exposures; taking advantage of federal, state, and local opportunities to recover overpayments and maximize credit opportunities; and managing the unique complexities of remote and flexible work arrangements.

Executive Tax
Providing tax consulting for nonqualified deferred compensation plans, stock options and other equity-based plans, golden parachute (280G) analysis, 162(m) compliance, fringe benefits, transfer of partnership interests and review for IRC 409A compliance.

PEOPLE AND ORGANIZATION STRATEGY

Employee Stock Ownership Plan (ESOP) Advisory

Helping companies evaluate and transition to a shared ownership with employees through an ESOP, a tax-advantaged mechanism for business owners who are looking for liquidity for part or all of their business while maintaining a legacy for valued employees.

Compensation Consulting & Surveys

Providing total compensation program design and benchmarking, long-term incentive strategy development, board briefings and support on the executive compensation regulatory environment, preparation of executive compensation disclosures and performance management.

Workforce in Transactions

Helping companies assess risks, costs, and exposures relating to the people and HR elements of all transaction types by providing workforce due diligence and post-deal strategy services spanning the full people and organization continuum.

RETIREMENT PLANS

ERISA Consulting

Providing design, administration and support for qualified retirement plans, including traditional defined benefit pension and cash balance plans, 401(k) Profit Sharing, 403(b) and ESOPs; annual compliance testing, preparation of plan documents and government filings, plan corrections, compliance reviews and M&A due diligence.

Actuarial Services

Providing cash balance and other tax-qualified defined benefit plan services in addition to retiree health/welfare and non-qualified plans; design, implementation and administration of employer-tailored cash balance plans; resources for long- and short-term planning, funding, accounting, termination, and M&A.

Contact Us

If you have any questions, comments or suggestions, please contact us.

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