



## **Appendix 2: Compensation Model**

### **Overview**

Southeastern believes that compensation influences behavior. All stakeholders benefit from a transparent system that links management compensation directly to long-term value growth. In many industries, measuring value poses great difficulty. Fortunately, the non-life insurance industry provides a simple metric that approximates intrinsic value: Net Asset Value (“NAV”) per share.\* Southeastern has worked with many non-life insurance partners around the world over the past thirty-four years. The best managements focus on growth NAV per share because they recognize that this metric captures the success of their underwriting and investing policies. They understand that growth in NAV per share best satisfies customers, employees, and shareholders. They know that a non-life insurer that grows its NAV per share through any combination of investing and underwriting should trade at a premium to its NAV per share in both the public market and in private transactions. They also understand that declining NAV per share will ultimately destroy any non-life insurer, regardless of the strength of its customer relationships, the integrity of its management, or the dedication of its employees.

Managements at non-life insurers in Japan focus primarily on premium growth, market share, and relative solvency within the domestic industry. Managements generally ignore movements in NAV per share because they disclaim responsibility for dramatic value changes caused by investment performance. Regulatory and accounting conventions unique to Japan excused this ignorance twenty years ago. As Japan has modernized and deregulated its financial markets, these excuses no longer apply. Non-life managers ignore NAV per share today primarily because they do not think as if they were owners of their companies. This refusal to confront the implications of their policies has led to low returns and extraordinary value destruction across the industry over many years without management accountability.\*

We propose a plan that will align the interests of the Board of Directors, management, and shareholders. We believe that this plan will provide enormous benefits to customers, regulators and employees while improving relations between investors and management. No compensation system guarantees success, but we believe that a plan that incorporates our proposals would position NipponKoa for greatness.

\*see Definitions

## **Explanation**

The compensation system for all managers at the level of Bucho and above would consist of a basic salary and a performance bonus. The bonus would be determined as follows:

1. Individual performance: 0-50% of base salary determined by superiors and/or the Compensation committee of the Board in accordance with transparent key performance indicators tailored to the manager's individual responsibilities.
2. Company performance:
  - a. Short term (measured over one year)
    - i. NAV/share growth between 6% and 10%: 50% of base salary
    - ii. NAV/share growth > 10% additional 50% of base salary
  - b. Long term (measured using Compound Annual Growth Rate (CAGR)\* over preceding three years)
    - i. NAV/share growth between 6% and 10%: 50% of base salary
    - ii. NAV/share growth > 10% additional 75% of base salary

Example: if NipponKoa's NAV/share increases at a rate of 6% a year for three years and an employee's base salary is 100yen, the company performance bonus at the end of year three would equal 100% of base salary. In years 1 and 2, the company performance bonus would equal 50% of base salary.

Directors would receive base fees and performance options

1. Base fees must be invested in company shares held at least three years or until a director retires, whichever comes first.
2. Performance options
  - a. Options to purchase 1,000,000 shares
    - i. 250,000 shares with strike price set at NAV/share
    - ii. 750,000 shares with strike price set at 1.25x NAV/share
    - iii. Five year life
    - iv. Strike price increases each year by 6%, adjusted for dividends
  - b. Options will be granted when directors begin their first term under the plan. Directors will not receive annual grants, but will receive a new grant after five years of service, whether or not the initial options have been exercised.
  - c. Options expire if a Director leaves the board for any reason

Insurance Agents and Employees below Bucho level would both receive special bonus awards based on the above philosophy. The specific mix between individual and company bonus awards would be decided in consultation with the unions, the human resources department, and the Board's compensation committee. In principle, all employees will have a direct stake in the company's success.

The Board's compensation committee would tailor all of the above proposals to ensure that they take into account applicable tax, accounting and labor laws.