



# General Insurance Industry Review 2018

With the top 10 trends  
impacting the sector

November 2018

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The *KPMG General Insurance Insights Dashboard* which accompanies this report has been enhanced in the current year and contains a range of interactive charts and graphs presenting the key industry metrics for the past 5 years. The interactive dashboard enables the data to be filtered to view the metrics for a particular year or insurer. It also enables comparison of metrics for an individual insurer to others in the market.

**The dashboard can be accessed  
via our website at:  
[www.kpmg.com/au/insurancereview](http://www.kpmg.com/au/insurancereview)**



# Foreword

KPMG's General Insurance Industry Review 2018 includes the financial results up to 30 June 2018 of all Australian general insurers.

The format, content and presentation of the 2018 General Insurance Industry Review comprises three segments:

1. **The year in review** — a concise but insightful analysis of how the general insurance sector performed throughout the year
2. **Top 10 emerging trends** — KPMG's views on what are the top 10 trends that will shape and influence the industry in 2019 and beyond. In this section we reflect on the implications of these current and emerging themes, which may require Australia's general insurers to significantly adapt the way they do business
3. **KPMG General Insurance Insights Dashboard** — this interactive dashboard has been enhanced in the current year and contains a range of interactive charts and graphs presenting the key industry metrics for the past 5 years. The interactive dashboard enables the data to be filtered to view the metrics for a particular year or insurer. It also enables comparison of metrics for an individual insurer to others in the market.

As always, we appreciate the insurer and author contributions to the report.



**Scott Guse**  
Partner,  
Insurance



**David Kells**  
Partner,  
National Sector  
Leader, Insurance

# The highlights

Overall a very positive year for the general insurers, which continues the increasing profitability trend the sector has experienced for the past 4 years.

The positives	The negatives
<ul style="list-style-type: none"> <li>↑ Net earned premiums</li> <li>↑ Underwriting result</li> <li>↑ Insurance profit</li> <li>↑ Insurance margin</li> <li>↓ Loss ratio</li> <li>↓ Expense ratio</li> </ul>	<ul style="list-style-type: none"> <li>↓ Gross written premium</li> <li>↓ Capital ratio</li> <li>↓ Investment income</li> </ul> 

## 2018 results snapshot

**↓ Gross written premium**

\$42,746m	2017/18
\$42,971m	2016/17
\$40,898m	2015/16

**↑ Insurance profit**

\$5,010m	2017/18
\$4,835m	2016/17
\$3,889m	2015/16

**↓ Loss ratio**

62.7%	2017/18
63.5%	2016/17
66%	2015/16

**↓ Expense ratio**

24.6%	2017/18
24.8%	2016/17
26.2%	2015/16

**↓ Capital ratio**

x 1.82	2017/18
x 1.85	2016/17
x 1.74	2015/16



Top

# 10 emerging trends

+ Click on each trend to read our insights



## Technology



## Regulatory/Products/Trends



# Results and analysis

 \$5,010m

## Insurance profit

(year ended 30 June 2018)

 \$42,746m

## Gross written premiums (GWP)

(year ended 30 June 2018)

## At a glance

		Total 2017/18	Total 2016/17	Total 2015/16
Gross written premium \$m	↓	42,746	42,971	40,898
Net earned premium \$m	↑	30,832	30,139	28,534
Underwriting result \$m	↑	3,912	3,536	2,222
Insurance profit \$m	↑	5,010	4,835	3,889
Loss ratio	↓	62.7%	63.5%	66%
Expense ratio	↓	24.6%	24.8%	26.2%
Combined ratio	↓	87.3%	88.3%	92.2%
Insurance margin	↑	16.2%	16.0%	13.6%
Capital ratio	↓	1.82	1.85	1.74

Source: APRA Quarterly General Insurance Performance Statistics June 2018. (Direct Insurers only) and KPMG analysis.

## Year in review

Insurance profit for the year ended 30 June 2018 was up 4 percent to \$5,010 million, a further improvement on the previous year's strong result. Favourable net perils experience and higher than expected reserve releases contributed to this result. This is line with our prediction last year as the industry benefits from the long awaited upswing in the insurance cycle.

Whilst headline gross written premiums (GWP) decreased by 1 percent to \$42,746 million, this was largely driven by the one-off impact of regulatory changes to NSW Compulsory Third Party Insurance (NSW CTP), which became effective on 1 December 2017. This

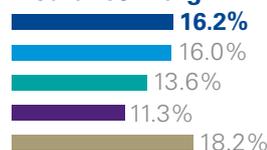
reform has resulted in lower premiums for customers and an expected improvement to the claims experience, however it is also expected to lead to reduced margins for the insurers, combined with reduced volatility.

The decrease in CTP GWP, has been largely offset by ongoing growth in premiums for other consumer and commercial classes, driven primarily by rate increases, as the industry continues with re-pricing for claims cost inflation.

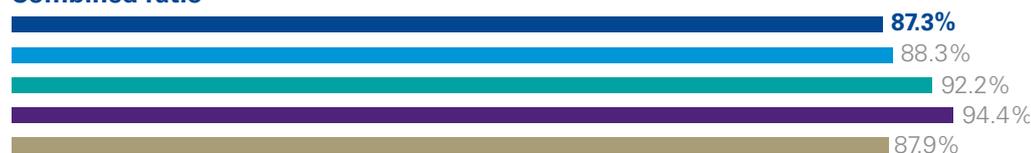
Net earned premiums increased by 2 percent reflecting the premium rate increase passed through in the prior year.

## Key ratios

### Insurance margin



### Combined ratio



### Expense ratio



### Loss ratio



■ 2017/18 ■ 2016/17 ■ 2015/16 ■ 2014/15 ■ 2013/14

Source: APRA Quarterly General Insurance Performance Statistics June 2018 issued 23 August 2018 (Direct Insurers only) and KPMG analysis.

The loss ratio (claims cost) improved in 2017/18 to 62.7 percent (down 0.8 percent). Improvement in the loss ratio is on account of the relative increase in net earned premiums outweighing the increase in net incurred claims of 1 percent. Whilst gross incurred claims have decreased by 6 percent on account of benign catastrophe claims experience and higher reserve/risk margin releases, there has also been a decrease in reinsurance and non-reinsurance recoveries revenue since the prior year.

The cost discipline of insurers is continuing with a further 0.2 percent decrease in the expense ratio to 24.6 percent. This improvement demonstrates the continued move to automation, outsourcing and more 'cost effective' distribution channels,

and comes despite a number of insurers continuing to invest in order to deliver future costs savings. During FY18, Suncorp reported net benefits of \$40 million from its Business Improvement Program, focused on digitalising customer communications and interactions, optimising sales and service channels, and re-designing claims supply chain processes to drive efficiencies. IAG has reported a broadly cost-neutral impact this year from its optimisation program, with meaningful benefits expected to emerge in future periods.

The impact of these factors contributed to an industry insurance result of \$5,010 million and an insurance margin of 16.2 percent. The 'Key ratios' graph shows the trend in insurance margins over

the past 5 years. As can be seen, the insurance margin has improved in recent years, continuing the trend back towards historic higher levels.

Investment income allocated to insurance funds was \$1,117 million down from \$1,320 million in 2016/17 on the back of the continued depressed interest rate environment and conservative investment portfolios. With these ongoing low returns, some insurers have looked to diversify investment portfolios.

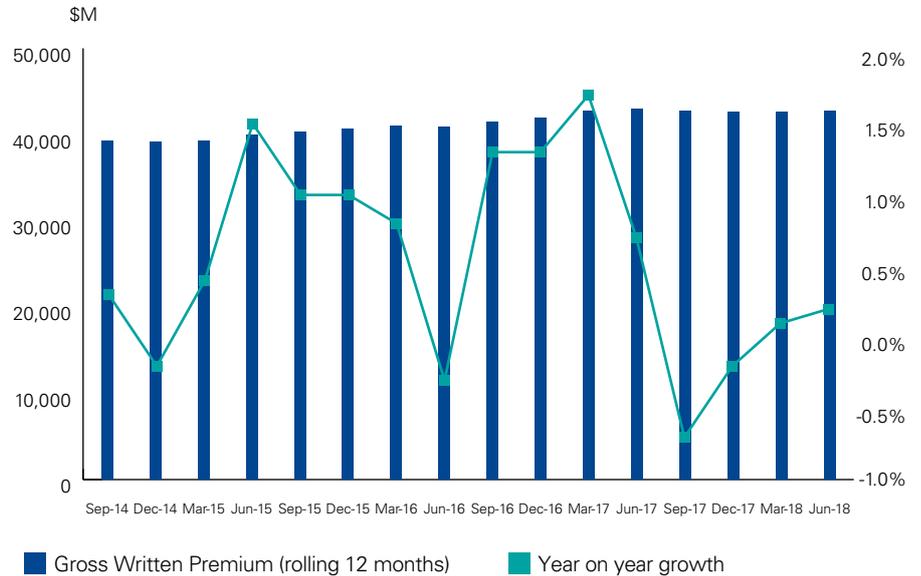
The industry's capital coverage at 30 June 2018 for direct insurers was 1.82 times the APRA prescribed capital amount. This compares to 1.85 times at 30 June 2017.

## Market outlook

The average GWP quarterly decline for 2017/18 was 0.1 percent (refer to 'Gross written premium — rolling 12 months YOY growth' graph). Excluding the impact of regulatory changes in NSW CTP, industry GWP has grown in 2017/18 which is largely rate driven. These rate rises are expected to continue into 2018/19 across both personal and commercial classes.

This hardening market is in line with our predictions 12 months ago, and whilst it has contributed to an improved result this year, we continue to see the industry achieving returns below the results achieved in 2012, 2013 and 2014, so there is still a way to go.

**Gross written premium (rolling 12 months)**



Source: APRA Quarterly General Insurance Performance Statistics June 2018 issued 23 August 2018 (Direct Insurers only) and KPMG analysis.

We continue to see a number of emerging trends that will impact the industry in both the short and long term. These trends are largely split between those driven by technological advances and those impacted by regulatory developments. Our Top 10 trends are listed below and are discussed in more detail later on:

- 1 **Digital**
- 2 **Insurtech**
- 3 **Blockchain**
- 4 **Artificial Intelligence and robotics**
- 5 **Internet of Things**
- 6 **Climate change**
- 7 **Directors and Officers Insurance**
- 8 **IFRS 17**
- 9 **Royal Commission**
- 10 **Outsourcing and managed services**

Technological advances globally continue at pace, however to date, we are seeing varied levels of progress by the established Australian insurers. The use of technology is critical for insurers; not only to enhance digital capabilities and to automate businesses, but also to improve product offerings and enhance the customer experience. It is therefore not surprising that five of our top 10 trends relate to technology.

On the regulatory front, it has been a challenging year and regulatory scrutiny is not expected to reduce. The *Royal Commission Interim Report* excludes the Commission's conclusions from the hearings into the insurance sector, however many of the findings from other industries apply to general insurance. With significant findings already reported in relation to industry participants and regulators, 2019 looks to be an ongoing regulatory challenge for the entire financial services industry.

The implications of the Royal Commission are not the only regulatory areas of focus for the insurers, as they also continue to embed operational changes arising from changes to statutory schemes including NSW CTP and iCare, whilst also focusing on the implementation of the long awaited global accounting standard, IFRS 17 Insurance Contracts.

### Share price performance

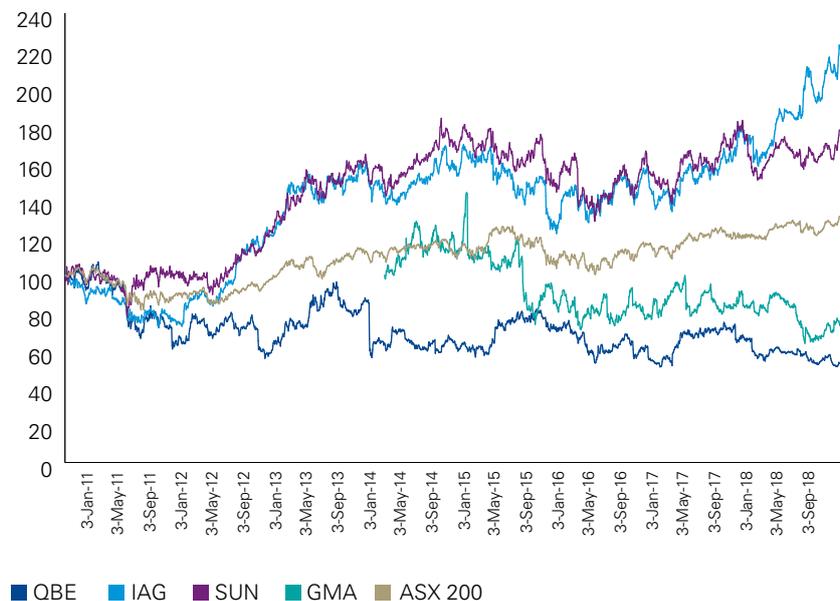
The 'Insurance companies share price performance since July 2011' graph depicts the share price performance of the four listed Australian General Insurers — IAG, QBE, Suncorp (SUN) and Genworth (GMA) — and their performance against the Australian Stock Exchange (ASX) 200 Index for the period from July 2011 to October 2018.

The share price performance of the Australian listed insurers has been varied this year. With the exception of IAG, a decline in the share price was

experienced in the year to 30 June 2018 by all insurers. QBE was down 17.5 percent, Suncorp by 1.6 percent and Genworth by 12.3 percent, whereas IAG saw an increase in its share price of 25.8 percent, exceeding the ASX 200 index increase of 8.3 percent.

In the volatile period from 30 June 2018 to 10 October 2018, the overall movement in the ASX 200 a 2.1 percent decline. IAG, Suncorp and Genworth also saw declines, however QBE saw an increase in share price of 18.7 percent over the same period.

### Insurance companies share price performance since July 2011



Source: KPMG analysis.

# Top 10 industry trends



Here we identify 10 emerging trends in the global general insurance sector, and consider their implications for Australian general insurers.



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Insurers can no longer do 'more of the same' and expect to succeed.

The list comprises new trends, and previous trends that are still prevalent. It continues to be dominated by technology and innovation, which are creating a new world of opportunity for individuals, businesses and society.

Insurers can no longer do 'more of the same' and expect to succeed. Customers, investors and employees demand innovation from insurance organisations. It is only by recognising opportunities and challenges, and responding quickly, that insurers will continue to be competitive.

# Technology



**Insurance companies in Australia are gradually transforming into 21st century digital enterprises, with some common characteristics:**

<p><b>Customer engagement</b></p> <p>A 21st century enterprise delivers the best customer experience, leveraging data collected from customers to learn and personalise experiences.</p>	<p><b>Changing nature value of assets</b></p> <p>A 21st century enterprise unlocks value from non-traditional assets — data alliances, networks, agility and other intangibles.</p>	<p><b>Everything as a service</b></p> <p>A 21st century enterprise is more nimble and scales infinitely faster by accessing services versus growing internal functions and infrastructure.</p>	<p><b>Workforce of the future</b></p> <p>A 21st century enterprise is lean, utilises intelligent automation, and accesses skills on demand through platforms and alternative employment models.</p>
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Enabling technologies and business models						
Mobile	Augmented and virtual reality	Data and analytics	AI/cognitive automation	Internet of Things	Voice/natural language processing	Drones
Blockchain	APIs	Cloud	Platform business model	Cyber security	3D printing/ additive manufacturing	

**The opportunities are immense. For example:**

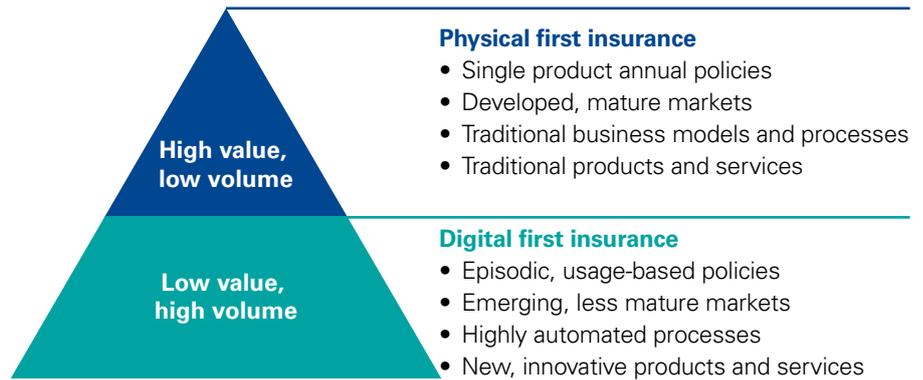
- New types of risk that will need to be managed such as cyber (business and personal lines), drones, equity crowd-funding, sharing economy, smart locks and virtual assets;
- New customers that need services such as segment-of-one insurance, social aggregators identifying groups with the same needs, and conducting Dutch auctions to win their business;
- New products such as Internet of Things-based (IoT) connected insurance (bundled, often ‘invisible’ insurance), event-based insurance, just-in-time insurance, and micro-coverage (e.g. phone batteries, headsets);
- New ways to support customers such as education on risk, value-added services, adjacent services (e.g. aged care for health), monetising data assets (e.g. house purchase risks as well as house insurance), and holistic preventative services (risk avoidance, not just risk mitigation and loss cover).

Until recently, the insurance model could be characterised as ‘physical first’; offering annualised policies for a single type of risk, mostly only available in mature, developed markets using business models and processes. The target has been high value, but relatively low-volume customer services.

While this traditional approach undergoes significant change, entirely new market opportunities are also within reach through digital technologies.

In the pyramid, the traditional insurance business model sits at the top. The opportunities for 'digital first' approaches are represented as the lower part.

**The insurance opportunity**



New models are focused on high volume, lower-value customer opportunities, often in emerging markets, or to previously under-served parts of the community, and also with offerings that could not be profitably considered prior to new digital technologies.

**Offerings in the digital first area:**

- Are on-demand, episodic and usage-based;
- Utilise cloud-based insurance-as-a-service modular components from a variety of providers;
- Are automated end-to-end;
- Easily able to support being bundled into other non-insurance products and services;
- Might be parametric (make an agreed fixed sum payment rather than try to calculate losses when a claim is processed);
- Are perhaps implemented through smart contracts (automatic payment of a benefit based on a triggered event, with no need for claims process).

Insurers will need to excel in both parts of the pyramid. They will need to balance the innovations required to remain competitive in the traditional world, with the new digital world. And they will have to offer complex services across multiple channels, with many entities involved in the end-to-end value chain, in a simple and easy-to-digest form for the end customer.



New start-up ventures targeting various aspects of the insurance industry have rapidly emerged. They take advantage of new technologies and changing customer needs, the slow response by incumbents, the availability of plentiful investment funds, supportive regulators and accelerators/incubators/hackathon innovation hubs, and are transforming the industry.

Most began with ambitions to disrupt, but their enthusiasm has been tempered by the reality of investments, regulations, capital requirements, and the risks and challenges of offering something new to cautious customers.

InsurTechs have therefore largely recast themselves as enablers of innovation — collaborating and partnering with incumbents to bring their ideas to market. Their attention has shifted from customer facing to behind the scenes, offering personalisation, client engagement and data analytics. They are exploring how technology can help improve claims, fraud and other core functions to be performed at lower cost and 'as a service'.



#### Key trends include:

- Automating hand-offs between legacy systems, claims transformation and adding API layers to connect emerging technologies and data;
- Exploration of the potential for advanced Artificial Intelligence (AI) techniques such as NLP (Natural Language Processing), machine learning and deep learning.

The increased collaboration between incumbents and InsurTech is positive. The incumbents gain innovation, new products/services and new/enhanced core capabilities; the InsurTechs get revenue, access to broader market, customers and credibility.

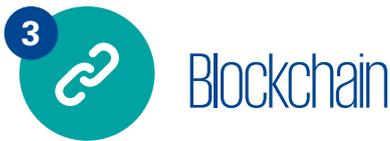
Australian InsurTechs need access to distribution channels to scale their businesses, so there is a strong symbiotic relationship between them and the larger market incumbents. Many InsurTechs don't have the time, patience or money to get involved in the regulatory and capital intensive parts of insurance, so they partner with established insurers which have the capital and regulatory expertise.

#### Almost every incumbent in Australia has some form of collaboration underway with InsurTechs. Examples include:

- **IAG's** Sydney-based InsurTech incubator Firemark Labs which is focused on co-creating new products and services. IAG also set up a \$75 million new-ventures fund to invest in and partner with start-ups and established businesses that have potential to disrupt.
- **Suncorp** collaborated with Traity to develop a peer-to-peer micro-insurance platform using Traity's chatbot 'Kevin'.
- **QBE** announced its intention to partner with InsurTech companies and has a war chest of \$50 million to invest.

While 'collaboration' is the dominant theme locally, at a global level 'ecosystems' are emerging. An ecosystem is a community of companies from different sectors that interact to create new products and services. They could influence the incumbent insurance domain in the long term.

For example, Japanese telecom and investment powerhouse Softbank has made a series of seed investments in platforms (e.g. e-commerce portals), techs and InsurTechs via its US\$100 billion venture fund. Its recent investments in ride-share companies, including Uber, Grab and OLA, shared-workspace pioneer WeWork, peer-to-peer insurer Lemonade, and various other AI, Virtual Reality and Augmented Reality technologies suggest the vision to build an ecosystem where risk prevention, transfer and incident resolution are ingrained in ecosystem components.



Blockchain is a distributed ledger technology that provides a platform for multiple parties (internal or external to the business) to ensure consensus and validation on data transactions with non-repudiation, immutability and accountability, forming the basis for distributed trust.

Blockchain is gaining traction in the financial world as a seemingly hack-proof method of ordering and verifying transactions. There are multiple ways that it can be usefully deployed by insurers.

A consortium of banks formed an organisation called R3 to explore the use of Blockchain in finance, and developed a variation of Blockchain called Corda. Now there are at least three organisations pursuing Corda within Insurance: B3I (European orientated, re-insurance sector focus), Risk Block Alliance (RBA-USA oriented, P&C and life sector focused), and InsurWave (USA oriented, shipping and marine sector focused).

RBA has introduced 'Canopy', a framework for insurers based on Corda. It is an open platform upon which insurance applications can be built using common Blockchain services. There are 15-20 applications available with many RBA members building more, including InsurTechs and established software companies which already have a significant presence within global insurance firms' IT stacks, such as Guidewire and Salesforce.

### Popular insurance use cases for Blockchain include:

- **Travel and life insurance:** 'Pay as you travel' insurance that provides immediate payouts in the event of delays or cancellation (Parametric insurance).
- **Personal accident insurance:** A transparent and seamless claims journey that improves customer satisfaction.
- **Record keeping:** Create, organise and maintain company records in a single, reliable and accessible repository.
- **Digital identities:** Blockchain and digital ledgers to digitise and validate customer information and improve compliance.
- **Claims management:** Automated verification of coverage, and streamlined claims settlement to improve operational efficiency and remove costs.
- **Reinsurance claims:** Automation of straightforward claims triggered by smart reinsurance contracts and models (e.g. weather incidents - pay farmer; flight cancelled - pay traveller).
- **Surety insurance:** A 'golden source' of information on surety bonds available in real-time to all participants.
- **Peer-to-peer insurance:** A peer-to-peer network to establish smart contracts without the need for an intermediary or administrator.
- **Smart contracts:** Guarantee the trigger of pre-coded actions (e.g. settlement of a claim) based

on a certain event taking place (e.g. extreme weather event). Highly automated, low cost, micro-insurance that helps to overcome customer trust issues with insurers.

Common use cases for Blockchain are around customer on-boarding and fraud analytics of claims. Some InsurTechs are basing their technology stack on Blockchain (e.g. Kasgo2go or Galileo), while established insurers have multiple initiatives underway, such as AIA using the Hyperledger Blockchain platform to connect to banks' systems (in support of Bancassurance synergies).

Future opportunities to use Blockchain will include documents and transactions, inspections, policies, claims, medical reports and settlements. Blockchain could accelerate the use of peer-to-peer insurance and other emerging insurance business models.



## Artificial Intelligence and robotics

Emerging Technology Risks is the number one threat to growth as seen by 58 of Australian CEO's.<sup>1</sup>



According to the KPMG's *Global CEO Outlook 2018* report, 96 percent of Australia's CEO's are piloting/trialling, or have undertaken limited process implementation using AI. In an era of low growth and low policyholder trust, how can general insurers leverage AI and avoid common traps other industries have experienced in the race to get better policyholder, risk and financial outcomes?

**All forms of AI such as machine learning, Robotic Process Automation (RPA) and NLP are seen as a game changer for the general insurer to:**

- 1. Increase agility and speed** – allowing general insurers to partner up and move forward with InsurTechs.
- 2. Improve customer experience** – allowing general insurers to focus on continuous, seamless interactions from buying policy cover, claims and renewal.
- 3. Improve data and analytics capability** – assist with better pricing, underwriting decisions and policyholder experience.
- 4. Improve risk management** – identify conduct issues, systemic issues and overall risk profile.

**General insurer C-suites embarking on the AI and other emerging technologies journey, face four challenges in deploying and maximising the value:**



### 1. Organisational readiness



### 2. Funding



### 3. Risk management



### 4. Capability

1. <https://home.kpmg.com/au/en/home/insights/2018/05/global-ceo-outlook-2018-australia.html>

Here are some practical questions and actions General Insurers Boards and c-suites can take:



### 1 Organizational readiness

What can an organisation do to take full advantage of AI and associated technologies?

1. Analyse the organisational strategy and identify which emerging technologies will complement and maximise value impact to the strategic outcomes.
2. Identify the policyholder, risk, strategy and financial outcomes.
3. Consider organisational programs and IT/digital projects, and develop a clear sequenced roadmap for organisational buy-in.



### 3 Risk management

The implementation of AI and its various forms introduces new risk and compliance considerations. An often forgotten consideration is not the 'new' risks, but the impact to the existing risks and the flow on impacts given the interconnectedness of risks.

#### Questions board and c-suites should explore:

1. What new risk and compliance issues are we introducing to our organisation?
2. How are we going to manage them?
3. What is the impact to the entire organisation's risk profile?



### 2 Funding

Securing funding is challenging, especially given the unknowns and risks of investing in new technology. Australian CEO's indicated that 56 percent neither agree/disagree they have suffered significant financial losses by investing in wrong emerging technology, and 34 percent confirmed they have. A clear roadmap combined with proof-of-concepts that takes a return on investment and maximum value lens is key.

#### Questions boards and c-suites should explore:

1. How do we know we are getting the ROI?
2. How do we set this up to be a self-funding journey?



### 4 Capability

General insurers face a shortage of capability. This explains why the third most important skill CEO's are wanting to hire is emerging technology specialist (AI experts) according to the *Global CEO Outlook 2018* report. How do general insurers build and gain the capabilities required in this space?

#### Questions boards and c-suites should explore:

1. How are we building our existing workforce to be more diverse and learn the AI and technology skills that the organisation requires?
2. How do we leverage external emerging technology experts to build internal capability and knowledge transfer to our workforce through co-collaboration models?

## Robotics — towards IA

Insurers have been exploring the use of automation technologies such as RPA to automate time-consuming manual and repeatable processes. The key focus has been to achieve benefits such as operational efficiency, cost reduction and improved governance. Processes such as reconciliations, transactions, and production of financial and management reports have been the target. The use of RPA has also been explored in sales/distribution, underwriting and claims management.

RPA maturity varies across the industry, partly driven by funding constraints and differences in business size and complexity. The more advanced insurers are experimenting with automation of complex processes, for example: pricing, reserving or customer management. Such processes involve significant judgement, use of advanced data and analytics technologies, and management decisions that can result in financial and non-financial (e.g. reputational) impacts.

Actuarial teams have used advanced data and analytics technologies for pricing and other risk and financial analysis purposes for the last two decades. With the explosion of data and computing power, models utilising these technologies have become highly sophisticated and granular.

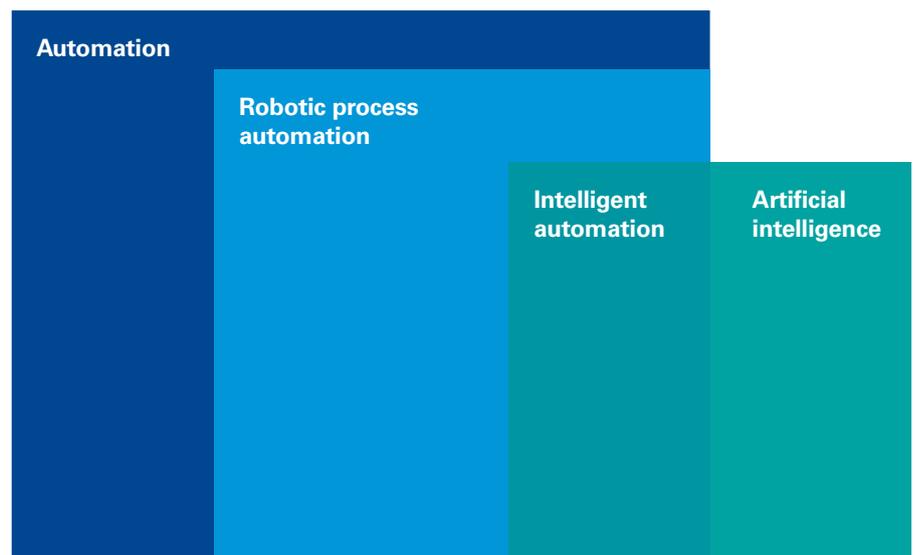
To automate complex processes, insurers look towards more sophisticated automation solutions, broadly referred to as Intelligent Automation (IA). IA is expected to help generate more informed decision making, and increase the focus of the workforce on value creating activities.

## Ingredients of IA

IA describes the application of a variety of technologies working together to achieve the desired business automation outcomes — combining AI and automation.

AI uses machines capable of perception, logic and learning to predict outcomes or

recommend actions. It includes machine learning algorithms, language and image recognition, neural networks, statistical analysis and more. RPA seeks to replace human activity with digital technology across the entire business process.



## Regulatory context

Events occurred during 2018 that are likely to impact the use of AI across all industries. In insurance, ethical and privacy implications may result in certain data not being allowed for pricing purposes, or AI may need to be limited to ensure fair outcomes for customers.

The US election issue involving Facebook and Cambridge Analytica highlighted some risks associated with data and analytics, and its implications on privacy. The scandal was followed by the release of the General Data Protection Regulation (GDPR) in the European Union and, locally,

government's commitment to the implementation of Open Banking. These initiatives will give consumers greater rights to protect their privacy and to access their data held by companies.

The Australian Human Rights Commission has launched a widespread review into the ethics of technology, with a large focus on AI. It will likely result in important implications for the use of AI.

Issues highlighted by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry are likely to have implications for the use of data and analytics in the insurance industry.



## Internet of Things

The IoT describes the network connectivity of just about anything to everything else, including to platforms that can be mined for information by insurers. It is the world of the connected car, home, health, industrial equipment, utilities, pipelines and power grids.

IoT also includes satellites, and one company, Planet Labs, is able to take daily detailed photos of every part of the planet, using over 200 satellites in orbit. This information can feed insurance pricing models, valuation methodologies, and claims investigation protocols.

Connected drones are a part of IoT, and are being used to gather data before a risk is insured, to help in preventative maintenance, and to assess damage after an event. Australian firm Nearmap uses drones and low-flying aircraft to deliver detailed images to insurers. Insurance firms will be using drones as standard by the mid-2020s; to reduce operating costs, improve safety and obtain data quickly.

IoT will gradually include information from the connected human, an area of technology innovation undergoing such a huge amount of interest and investment that a new term 'domotics' is gaining traction to describe this phenomenon.

Current personal use of IoT will dramatically expand beyond smart watches and exercise devices to include wearables (e.g. smart glasses, sensors in clothing), implants (already becoming popular in Sweden as an alternative to carrying a wallet), and temporary tattoos (a skin bio patch).

Over time, and before 2030, the connected person will include information gleaned from an array of human augmentation and enhancement devices (transhumanism) that can amplify human capabilities beyond current physical and mental limitations.

IoT instrumentation from neural implants (e.g. memory enhancement chips), smart prosthetics and powered exoskeletons may be accessible. One company is already exploring the use of monitors in footwear that can flag issues to diabetics to avoid possible amputation.

This information will allow insurers to fine tune highly personalised insurance products delivered on demand and in the context of a specific risk. The assessments of risk will be more accurate, leading to dynamic pricing models. Using AI techniques, insights gained from all the data passing through the insurance value chain will point the

way forward for the entire industry: IoT enables and accelerates the shift from transactional risk protection insurance products to relationship risk prevention services.

But IoT also poses a threat to incumbent insurers as insurance will be more easily 'bundled' into other services delivered by the IoT dominant provider (i.e. invisible insurance). The future of many insurance products, enabled through connectivity and IoT, is destined to be increasingly invisible.

It is hard to predict who will emerge as 'the winner' to control access to risk services in the connected car or connected home. It could be insurers, or utilities, or specialist home security firms, or auto manufacturers, or the hyper-scale consumer platforms. A strong candidate will be whoever emerges as the dominant provider of human-computer interaction, which is likely to be the voice personal assistant (VPA). Insurers will need to understand the emerging IoT marketplace to forge new relationships with the providers of beacons, monitors, sensors, standardised IoT platforms and any firm that looks likely to control how humans seek out information.

### 1. Connected cars

- Run on operating systems (apps can be installed) and are connected to the internet
- Gather and transmit information on every part of the vehicle
- Communicate with other cars to prevent accidents

### 2. Connected homes

- Monitor key metrics (e.g., temperature) and automatically modify the environment accordingly based on learning
- Identify risk factors (e.g., smoke) and take adequate actions for prevention/triaging
- Communicate with the environment to adapt to surrounding environments

### 3. Connected lifestyles

- Quantify, track, monitor and manage daily activities through wearable devices
- Identify trends, patterns and recommendations based on quantified data
- Measure, track and analyse vitals relevant for specific conditions and illness

### 4. Standardised platforms

- Increase interoperability; facilitate data gathering, management and utilisation; and improve coordination among connected devices

## Regulatory/Products/Trends



### Climate change

Climate-related losses in 2017 were the highest on record at US\$340 billion, as reported in the Munich Re report, *A stormy year, on natural catastrophe trends*<sup>2</sup>. Severe flooding from Hurricane Harvey in Houston, USA, in combination with the accumulated losses from hurricanes Irma and Maria was costly. Disaster events claimed more than 11,000 victims in 2017. Climate experts predict that extreme weather events are likely to become the norm.

According to the latest Intergovernmental Panel on Climate Change (IPCC) report<sup>3</sup> (the United Nations group tasked with assessing the scientific evidence on climate change), “human activities are estimated to have caused approximately 1.0°C of global warming above pre-industrial levels. Global warming is likely to reach 1.5°C between 2030 and 2052 if it continues to increase at the current rate.”

Nations’ current commitments to the 2015 Paris Agreement (aimed at limiting global warming to under 2°C) currently indicate global average warming closer to 3°C by 2100. However, some nations are failing to act on Paris Agreement commitments, with the planet currently heading towards a 4°C or higher trajectory. This increases risks to insurers.

The Asset Owners Disclosure Project (AODP), a research group dedicated to measuring the management of climate change risks and action on climate change, states that “weather-related financial losses, regulatory and technological changes, liability risks, and health impacts related to climate change have implications for the business operations, underwriting, and financial reserving of insurance companies.”

The AODP survey<sup>4</sup> ranked AXA, Aviva, Allianz, and Legal & General as global leaders on climate, with American and Australian insurers receiving much lower performance scorecards. Thomas Buberl, AXA’s CEO indicated that a “plus 4°C world is not insurable.”<sup>5</sup> Even at lower degrees of warming, the insurance sector is concerned, with Mark Wilson, CEO of Aviva, saying that “if we do not take urgent action to limit

global temperature increases to within 2°C, the impacts upon the economy, society and our business will be nothing short of devastating.”<sup>6</sup>

To respond, insurers can assess how climate-related impacts may affect their loss ratios and underwriting practices, and then act to manage these risks. Insurers can examine their investments and how they contribute to, or could mitigate, climate change.

According to an AODP survey of more than 80 global insurers, the analysis of value at risk from weather-related events was common, but few insurers reported assessing their liability risk (e.g. class action for underwriting insufficient policies in the face of known climate impacts), or other transition risks (e.g. carbon pricing exposure). Carbon foot-printing is the most commonly reported technique used for investment portfolio risk analysis. Ceasing to underwrite thermal coal and other fossil fuel-based assets was also common among leading insurers, with a number of these same insurers increasing investment in low carbon options such as renewable energy or green bonds.

2. Munich Re produces an annual report showing the proportion of insurance losses that can be accounted for by climate change: <https://www.munichre.com/topics-online/en/climate-change-and-natural-disasters.html#continueReading>

3. The IPCC special “Global Warming of 1.5 degrees” report: <http://www.ipcc.ch/report/sr15/>

4. The Asset Owners Disclosure Project (AODP) survey of climate responses in 80 global insurers <https://aodproject.net/wp-content/uploads/2018/05/AODP-Got-It-Covered-Insurance-Report-2018.pdf>

5. <https://www.axa.com/en/newsroom/press-releases/axa-accelerates-its-commitment-to-fight-climate-change>

6. <https://www.aviva.com/social-purpose/environment/>



## Directors and Officers liability insurance

Directors' and Officers' (D&O) liability insurance offers liability cover for directors or senior officers, to protect them against claims arising from decisions or actions taken as part of their duties. There are usually three types of coverage:

- 1 **Side A cover** – covers personal liability of company directors and officers as individuals.
- 2 **Side B or Company Reimbursement Cover** – reimbursement of the insured company in the case it pays a claim of a third party on behalf of its directors or senior officers.
- 3 **Side C or Securities Entity Cover** – Listed stock exchange companies take this out for claims against the company itself for a wrongful act in connection with trading of its securities.

The total gross premium pool for the D&O market (in Australia) is approximately \$450 million. The claims experience in the last few years has been unfavourable, driven by an increase in the frequency of claims from securities class action (side C coverage) for publicly listed companies.

In the last 5 years, class actions have tripled, mainly driven by publicly listed companies failing to meet their disclosure obligations. The average settlement cost has increased to be greater than \$50 million, with 'unsuccessful' class actions often greater than \$20 million. Major banks paid on average \$2 million to \$3 million in premium for \$500 million of securities class action (side C coverage).

### Some notable class action settlements:

- QBE disclosure regarding profit downgrade (\$132.5 million, 2017)
- Centro disclosure regarding debt position (\$200 million, 2012)
- NAB disclosure regarding business risk (\$115 million, 2012)
- Aristocrat disclosure regarding misstated earnings (\$144 million, 2008).

The unfavourable claims experience has seen the market harden for listed companies with premium increases ranging from 20 percent to 400 percent. There is an expectation from insurers to see increased minimum retentions by listed companies (side C coverage). Some insurers have faced challenges in getting substantial premium increases, resulting in reduced appetite for mid-to-large listed companies, this has seen the London market emerge and play a stronger role in this space.

Whilst the profitability of D&O has been poor, the net results have been better with favourable reinsurance protection being in place over these periods. In the June 2018 reinsurance renewal period, reinsurers significantly increased prices, driven to some extent by capital erosion resulting from exposure to catastrophe losses globally. The impact of this will see continued upward pressure on premiums for D&O policies in the Australian market.

The ongoing Financial Services Royal Commission presents another unknown. To date, there have been several class actions lodged with the emergence of adverse findings. The expectation is that the likelihood of more class actions is high, with the Royal Commission due to wrap in February 2019. Some insurers, in order to minimise potential fallout, have been inserting 'Royal Commission exclusions' into class action (side C coverage) policies offered, while some insurers are simply choosing to 'walk-away'. All this uncertainty points to more turbulence for the D&O market.

8  IFRS 17

**The journey continues**

Almost 18 months has passed since the IFRS 17 Insurance Contract were issued by the IASB in May 2017. The new standard is effective from financial years commencing 1 January 2021, and will give users of financial information a whole new perspective on insurers' financial statements.

Whilst general insurers are less impacted by the standard than life insurers (given the ability to use a simplified premium allocation approach for qualifying short term insurance contracts), there is still considerable effort required to meet the new accounting and reporting requirements.

The new requirements go beyond financial reporting to also encompass actuarial valuation, asset liability management and risk management.

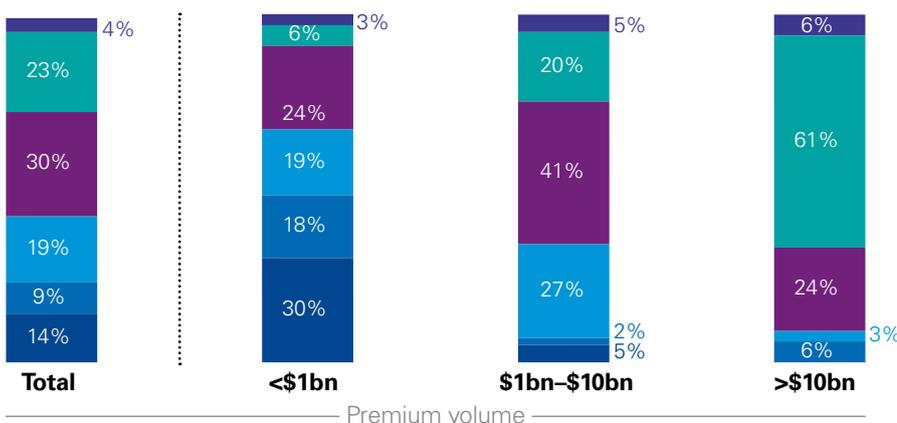
Coordination between functions such as Finance, Actuarial, IT and Risk is essential, and insurers will need to invest significant time and capital into their systems, processes and controls to prepare and implement the new standard.

So how are Australian insurers progressing in their implementation plans? In December 2017, KPMG launched the [report Navigating change](#)<sup>7</sup> to find out how prepared insurers are for implementation of IFRS 17 and IFRS 9. A second report was issued in September 2018, *In it to win it*<sup>8</sup>, which surveyed 160 insurers from over 30 countries. Ten percent of the insurers surveyed were Australian and the results indicate that they are slightly behind their global counterparts when it comes to commencing and implementing their transition to the new requirements of IFRS 17.

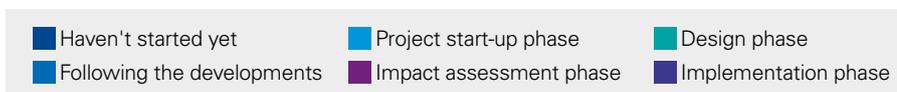
**Where are insurers in their preparations?**

**Smaller insurers need to get started**

**Current IFRS 17 project phase** (% of respondents)



- Larger and more complex insurers are further ahead
- The time to watch and wait is over



Source: KPMG analysis

7. <https://home.kpmg.com/xx/en/home/insights/2017/12/navigating-change-feedback-from-insurers.html>

8. <https://home.kpmg.com/au/en/home/insights/2018/09/in-it-to-win-it-ifs-key-findings-fs.html>



**Key findings from the Navigating change report:**

- Time pressure is already becoming acute — there is a significant amount to do;
- The organisations that are furthest along with their projects are feeling the time challenge the most;
- While working on implementation, the leading insurers are seeking to optimise systems and processes in order to reap longer-term enterprise-wide benefits too — recognising that this may take longer than 2021;
- Smaller insurers have done the least to date — many urgently need to get started.

A number of national industry associations and regional bodies are lobbying for more time to implement IFRS 17, and for further changes to the standard. In recent weeks the momentum pushing for a delayed implementation have increased. There is a possibility of potential deferral of the implementation date, it is important to start planning, as a two year parallel run is preferable to reduce risk.

To support implementation and reduce the potential for diversity in practice, the IASB set up a Transition Resource Group (TRG), which held its third meeting in September 2018. The TRG does not have standard-setting authority, and its purpose is to provide a public forum for stakeholders to follow the discussion of questions raised on implementation. The next TRG is scheduled for early December 2018.



## The Royal Commission Interim Report & general insurance

The Royal Commission released its *Interim Report* on 28 September 2018. The *Interim Report* identifies dishonesty and greed as the two main drivers behind sector misconduct, and sets out the Commission's observations from rounds one to four of its hearings. Although the *Interim Report* excludes the Commission's conclusions from the subsequent hearings into the insurance sector, many findings apply to general insurance.

### Consumer lending

#### 1. Intermediaries and confusion of roles:

The Commission examines the role of intermediaries between lenders and borrowers, noting that even if a borrower expects an intermediary to be acting in their best interests, in most cases the intermediary owes no general duty to the borrower to seek out the best and most appropriate deal. Instead, submissions indicate that, at least in the eyes of some lenders, the broker's task is to sell that lender's products. This includes selling forms of add-on insurance on home loans, car loans, and credit cards.

#### 2. Communication with customers:

The Commission evaluates the conversations between financial institutions and customers, observing that a 'conversation' with a customer is treated as an opportunity to sell or gather information, and too often involves the institution's representative telling the customer what they need. The Commission uses the example of a customer being sold add-on insurance when they are only seeking a credit card.

**3. Responsible lending:** In its assessment of lending practices, the Commission examines the tension between responsible lending and

add-on insurance, questioning whether certain types of add-on insurance are, by their nature, poor value propositions for customers.

### Financial advice

**1. Conflicts of interest:** In its assessment of conflicts of interest in the context of financial advice, the Commission concludes that the conflict may be better seen as a conflict between the financial interests of the adviser or licensee, and the duty that each owes to the client. The Commission notes that the choice between interest and duty is too often resolved in favour of the adviser's self-interest. Crucially, the *Interim Report* indicates that a fundamental premise of the FoFA reforms (the notion that conflicts of interests can be 'managed' by introducing the best interests duty) is flawed.

#### 2. Conflicted remuneration and culture:

The Commission notes that, while the prohibitions on conflicted and other forms of banned remuneration may appear to be comprehensive, there are exceptions relating to general insurance, life risk insurance products, and basic banking products, along with provisions permitting grandfathered benefits. On this point, the Commission appears unequivocal in its acceptance of ASIC's position that "any exception to the ban on conflicted remuneration, by definition, has the ability to create misaligned incentives, which can lead to inappropriate advice."

**3. Vertical integration:** In its commentary on the vertical integration of financial product manufacture with financial product sale and advice, the Commission observes that the internal efficiency of the 'one stop shop' does not necessarily produce efficiency in outcomes for customers. It acknowledges that, from the banks' perspective, vertical integration always promised the benefit of cross-selling financial products, including

add-on insurance. This observation, coupled with the Commission's dismissal of past characterisations of what has occurred as a 'few bad apples', indicates that the Commission may be contemplating a recommendation designed to address systemic issues associated with vertical integration.

### Regulation and the regulators

**1. ASIC:** The Commission highlights ASIC's expressed preference for negotiated outcomes over civil proceedings, observing that ASIC's enforcement approach to date has not had the desired deterrent effect. The *Interim Report* goes on to question whether ASIC's remit should be reduced or detached.

**2. APRA & BEAR:** The Commission notes that APRA's chief focus is governance and risk culture, and considers the impact of its report on governance, culture and accountability within CBA. It questions whether the newly-introduced Banking Executive Accountability Regime (BEAR) should be extended.

**3. Dispute resolution:** In assessing the outcomes of the Financial Ombudsman Service (FOS) and Australian Financial Complaints Authority (AFCA) proceedings, the Commission highlights that customers who were wholly or partly successful in their claims nonetheless failed to achieve what they believe to be a satisfactory outcome. The Commission goes on to question whether AFCA should be empowered to award compensation for losses or harm caused.

### Next steps

The next round of public hearings will commence in November, and the Commission's Final Report is due to be submitted to the Governor-General by 1 February 2019.



## Outsourcing and managed services

Remaining relevant in the insurance market requires focus, leadership, innovative thinking and resources for strategic direction. Having a clear service delivery strategy and leveraging external expertise from demonstrated providers who have the ability to enter into partnerships with their clients will provide the ability to focus on future direction, whilst drawing on strengths and investments in core capabilities.

Outsourcing is obtaining services from an external partner; and managed services is the practice of outsourcing on a proactive basis as a strategic method for improving operations. A service delivery strategy (what gets done where and by whom — including automation) provides the direction.

### Key trends in outsourcing and managed services that insurers will be able to leverage include:

- Service delivery strategies — that determine if partners will be used to deliver services;
- Supply chain risk management by thoroughly understanding all partners; and
- Managing costs by avoiding leakage with data-driven insights.

### Service delivery — uplifting capability

The evolution and impact of IA and data and analytics on service delivery requires investment and scale, which leads to specialisation and an increase in capability. Established industry trends across Financial Services include having an understanding of provider capability and the potential impact for the organisation's future and its customers, before entering into strategic partnerships.

Processes being worked on are for higher volume and repeatable tasks — and as the partnership and demonstrated capability evolves, services can increase.

Core functions that lend themselves to successful shared services partnerships predominantly sit across Finance, HR and IT — and provided the partnership allows for the provider to own process control whilst delivering the agreed outcome, enhanced capability can be delivered. This will reshape workforce requirements, changing the skills and capabilities that will be required.

### Governance, Risk and Compliance

A key issue is the importance of managing third parties, and the risks that they can pose to an organisation. The first step is to address core activities within Governance, Risk and Compliance (GRC) functions, namely ensuring that technology, policies, procedures and organisational capability are in place to support a fit-for-purpose third party management strategy.

The primary focus for organisations should be to implement a transformation effort of the corporate-wide strategies, policies and procedures to lean out transactional activities, focus attention on strategic decision making, and ensure compliance requirements are met.

Within the technology space, leading providers currently offer a wide range of solutions within the GRC, third party risk management and contract management fields; however a true end-to-end solution or provider has yet to present itself, resulting in a multi-service provider solution to address the full suite of services required.

### Claims leakage — analytics driven cost containment

Pressure on revenue, margins, and the ease at which customers can change service providers necessitates a greater focus on cost containment. There is increased importance on the tight management of paying appropriate claims. This needs the right technology and continual, independent analytics which cannot be provided from within a single entity. Industry-wide analytics, provided externally through an outsourced/managed approach, facilitates the identification of opportunities for tighter cost control and minimises potential claims leakage.

# Contributors

KPMG would like to acknowledge the following individuals contribution to this year's publication.

Adrian King	Julia Gunn
Amanda Sattler	Maurice van den Heuvel
Amber Johnston-Billings	My Salakas
Ammar Khan	Nicholas Alexander
Anu Kukar	Richard Yee
Bartosz Piwcewicz	Sue Kong
Bob Hayward	Thomas Irons
Jaya Kapur	Yoshi Makita
Jefferson Gibbs	

# Contact us

## **Scott Guse**

### **Partner**

### **Insurance**

**T:** +61 418 877 674

**E:** [sguse@kpmg.com.au](mailto:sguse@kpmg.com.au)

## **David Kells**

### **Partner**

### **National Sector Leader, Insurance**

**T:** +61 2 9455 9602

**E:** [dkells@kpmg.com.au](mailto:dkells@kpmg.com.au)

**[KPMG.com.au](http://KPMG.com.au)**

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