4th Annual Canadian Insurance Industry Opportunities & Risks Survey
Welcome to KPMG
Canada’s Insurance Industry
Opportunities & Risks Survey

In our fourth year of this survey, we reflect the current state of the Canadian Insurance Industry, identify key trends and provide KPMG insights.

In late 2016, we conducted a survey of opportunities and risks facing the Canadian insurance industry with the goal of identifying and reflecting on the most important matters facing the Canadian insurance market. Many of you reading this publication may have responded to our survey and shared the opportunities you see and the risks facing insurers. Our respondents covered a wide range of views from all aspects of the Canadian insurance sectors – from life and health insurers, P&C insurers, reinsurers, brokers and other specialized service providers. In addition, the cross section of responses covered executives, board members, finance and actuarial professionals.

Please get in touch with us if you have any comments or questions about the survey’s findings.

Stephen Smith
Partner,
Audit Financial Services

Amit Chalam
Senior Manager,
Audit Financial Services
Respondent profile

**Sector**

40% are P&C insurance providers
97% of P&C respondents indicate they are primary insurers (3 percent reinsurers)

39% are Life insurance providers
82% of Life respondents indicate they are primary insurers (18 percent reinsurers)

4% are Intermediaries

17% Others

**Functional area**

31% are executive management

21% are external board members

18% are finance/accounting

11% are actuarial; 10% risk & compliance; 2% IT; 2% operations; 5% other
Overview of survey results

The Canadian Insurance industry is stable, but innovation and disruption are everywhere, and it’s not immune from these changing dynamics. Are you ready to embrace these changes and turn a risk into your opportunity for tomorrow?

Top opportunities to companies

1. Enhanced operational processes and use of technology
2. Offering better customer experience
3. Improved management of risk and use of capital
4. Data analytics to enhance product design, marketing and pricing
5. Strengthening customer loyalty and reducing market conduct risk

The opportunities

– Taking the spot as the top opportunity in our survey this year is enhancing operational processes and technology. Insurers are seeing the need to change, enhancing operations to be leaner and more efficient with technology a catalyst for this change. Technology is also a driver in new digital strategies and enhancements to reaching and interacting with customers.

– Customers, although second overall, is the opportunity to offer better customer experience – the results revealed that the customer is king! The customer not only ranked at number 2, but two of the other top 5 opportunities centered around the customer.

– At number 4 is the use of data and analytics to enhance product design, marketing and pricing.

– Strengthening customer loyalty takes the 5th place. It’s clear that the Canadian insurers see major opportunity in being customer centric.

And we say this with excitement: We predict that the next 5 years will be the time that future generations will remember as the years that the insurance sector reinvented itself. The question simply is: How will you define this story?
The risks

Although the economic environment continues to be slow with very low interest rates, this is now seen as the new “Normal”. While still considered as a major risk, low interest rates and the equity market has shifted from top spot and is no longer the top risk in the immediate term. KPMG observes that many insurers have come to terms that low interest rates is now the new reality.

The top risk this year is around the regulatory and compliance burden. Insurance companies are heavily regulated around the world, but these regulations can be complex, disjointed, incongruent and forever increasing. This regulatory and compliance burden is the risk that all insurers around the globe grapple with, and is the top risk in the immediate term for Canadian insurers.

In this inter-connected world, no single risk or opportunity stands on its own! We have drawn the lines of congruence between the opportunities and the risks in the Canadian context, and have identified the key topics that we consider... “The Canadian MegaTrends”:

- Technology: Enhancing operational processes and technology is the major opportunity, while the related costs represent a significant risk. (Opportunity #1, Risk #3, Risk #4 and Risk #5)
- The Customer: your biggest opportunity. (Opportunity #2 and #5)
- Big data: It’s big. (Opportunity #4)
- Regulatory: While regulatory and compliance burden is seen as the biggest risk, it also represents a significant opportunity for managing risks and the best use of capital. (Risk #1 and Opportunity #3)
- Low interest rates: the new normal. (Risk #2)

In the following pages, we take a deep dive on each of these trends.

Top risks to companies

1. Regulatory and compliance burden
2. Low interest rates and equity market risks
3. Cyber security risks
4. Cost and risks of IT investment
5. Cost reduction pressures increasing operational risks
Insurers see operational excellence and the use of technology as a significant opportunity, but the path of technological changes can be broad, and does pose the risk of significant cost implications. Technological disruption is already out there in many industries and insurance is not immune from this change.

The great news is that insurance companies are keeping a close watch of the emerging trends. In 2016, we saw the use of drone technology to survey damage at Fort McMurray. We also saw the introduction of a life insurance product with product features closely linked to the data from wearable health monitors. We also saw various cases of internet-based distribution of insurance products to consumers.

Technology can transform insurance companies in multiple facets (both internally and externally), which could include:

- Legacy system replacements/enhancements
- Policy administration as a service
- Enhancements to telematics
- Artificial intelligence, robotics, and automation of product distribution, claims processing and customer service and interaction
- Internal process automation
- Digital strategies
- Blockchain applications
- The internet of things
- Autonomous vehicles

And on another layer, is adding new insurance needs in the marketplace that insurers need to fill with insurance products.

**Artificial intelligence in insurance**

What was out-of-the-box technology last year is going to be commonplace before you can imagine. Think about robotic process automation, robo advising, predictive modeling, self-serve products, and data analytics. Every facet of product design, product distribution and product pricing has the potential to be transformed with automation.
Significant opportunity for the insurance sector lies in the reduction of customer acquisition expense as well as an improved experience that eliminates the need to fill out complicated paperwork and reduces wait times for decisions from insurers.

Artificial intelligence can also be applied to claims management, fraud detection and dynamic risk modelling. Again, this represents an opportunity to not only be more efficient and reduce costs, but also to provide a better customer experience.

What about changing customer preferences, from health and fitness wearable technology, home automation, voice interfaced AI gadgets, and the emergence of self-driving cars? Have you embraced these changing trends in your product design and pricing? Does cycling to work reduce life insurance premiums? Or provide an opportunity to sell additional liability insurance? How do you harness all the data!

**Blockchain**

What is blockchain? Blockchain is essentially a permanent and immutable record of transactions within a network. At the root of the blockchain are ‘digital ledgers’ that are distributed amongst all network participants to serve as a common source of truth. When a transaction is conducted, it is recorded in sequence in the digital ledger and these ‘blocks’ are then tied together into a blockchain. Since the system relies on references to other blocks that are cryptographically secure within the digital ledger, it is almost impossible to falsify. Most observers therefore believe the system to be immensely more trustworthy and transparent than traditional approaches to sharing data across a value chain or even within an enterprise.

The reality is that these are still ‘early days’ for blockchain in the insurance sector. However, evidence from across the financial services industry strongly suggests that blockchain technologies could help enable greater efficiency, growth and competitive advantage.

Source: KPMG International, 2017

**Associated risks**

With any planned technology changes there is a significant balance of risk that needs to be considered. From the risk on capital to embark on a technology change program if the benefits planned for the new technology do not come to fruition, or the ever increasing risk of cyber security. Embarking on a new technology platform or digital strategy brings into play an even greater risk of a cyber security breach, while hackers continue to get more sophisticated. From recent news events from cyber breaches, reputational damages are high and with changes in privacy laws and new mandatory reporting requirements, the potential for reputational risk will only increase.
The customer

An overwhelming proportion of our respondents identified the need to be customer centric. Combined, more than 90 percent of our respondents identified one of “offering better customer experience” or “strengthening customer loyalty” as one of their top opportunities this year.

The customer is certainly a mega trend that we noted in our survey this year, and that was no surprise to us. In an environment where competition is becoming ever more intense, yet, except for very few examples, insurance products remain almost entirely undifferentiated. To date, the primary driver to sell insurance is that it is required by law or by lending institutions. There is very little customer-focused innovation in Canada, but that story is changing rapidly, as it will become increasingly important for insurers to:

– develop differentiated propositions targeted at particular market segments
– focus on improving persistency to reduce pressure on new business volumes
– differentiate their brands through enhanced customer service
– maximize value for customers.

Customer centricity – Value cycle

As KPMG explored in its publication on The Valued Insurer, changing preferences of the next generation of insurance customers demand alterations in propositions and distribution – constantly evolving new technologies will be key. Opportunities for face-to-face sales will decline, making it more challenging to know your customers. It will be crucial to leverage segmented customer data and use predictive analytics and propensity modeling to help differentiate propositions. Valued insurers have transformed how they do business, placing their customers at the heart of everything they do, including strategic decision-making, business and operating model design and product, service and delivery strategies. They leverage the opportunity to win over customers at every touch point.

By doing so they:

– are more innovative and productive, through greater collaboration and information sharing within their own business and with partners;
– improve customer experience, creating greater propensity to buy additional products where these are appropriate for customers’ needs;
– increase efficiency through rationalization and elimination of redundant products and processes, aligning propositions to customers’ changing needs;
– enjoy greater customer loyalty, retention and increased referrals.

While the appetite to be customer-centric is compelling, it conflicts with a corporate mind-set that emphasizes near-term priorities and the delivery of short-term shareholder value. The time required to gather customer perspectives, refine propositions and take them to market spans more than a few quarters. However, we believe those insurers focused on long-term sustainable value creation for their customers will be rewarded by their investors. To deliver a customer-centric business model, we see four strategic building blocks supported by a number of tactical enablers.

Components of a customer-centric business model

<table>
<thead>
<tr>
<th>Customer-centric business model</th>
<th>Better knowledge of customers</th>
<th>Relevant propositions at the right time</th>
<th>Optimal distribution for each customer segment</th>
<th>Optimal servicing for each customer segment</th>
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<tbody>
<tr>
<td></td>
<td>Do you understand the needs of customers and develop propositions to match?</td>
<td>Are your propositions based on customer needs and do your customers reward you through greater loyalty, referrals and retention?</td>
<td>Do you understand how customers want to buy and have you aligned your distribution strategy?</td>
<td>Do you understand how your customers want to be serviced and through which channels?</td>
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<td></td>
<td>Do you use predictive analytics and propensity modeling to target and cross sell?</td>
<td>Can you comply with more consumer-focused regulation?</td>
<td>Have you optimized the cost of acquiring your customers based on the value created by your propositions?</td>
<td>Do you promote a positive customer experience at every touch point?</td>
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Source: The Valued Insurer, KPMG International, 2013
Transforming your organization to be customer centric is not easy. Some practical steps to being customer centric are:

1. Understand customer’s behaviour after stratifying them by channel, age and other demographics
2. Get a full understanding of customer needs in each stratum
3. Define what drives value and what does not
4. Act on customer understanding
5. Measure effect of each customer specific action
6. Go back to step 1

Understanding goes beyond just knowing your customer – it’s about truly understanding their needs and preferences. Recognize that customer behaviour changes across demographic groups as well as by channel. Insurers need to understand how customer behaviour can be better understood at each touch point – not just when a policy is issued, but also every time the customer interacts with the broker, every month when premiums are collected, every time when claims are made or when life events occur.

The industry can tailor its approach and offering to individual customers by developing a single 360° view of customers. Identify customer data gaps and prioritize correction by value and importance. Monitor your customers’ defining moments of truth through customer satisfaction surveys, net promoter analysis and social media, including a sentiment index. Successful organizations position customer insight as a Center of Excellence rather than separate data collection points distributed between Marketing, IT and Finance.

Not all customers are equal. Insurers should identify and prioritize customers based on their long-term value to their organization. Capture the financial value of your ‘voice of the customer’ projects by measuring changes in customer loyalty and revenue. Use this to focus on setting a clear direction.

Then it’s time to act and measure your actions. Consider running pilot projects to ‘test and learn’ and achieve stakeholder buy-in, with more measured expansion following initial successes. Use this more agile approach to continuously develop in-house capability and drive cultural change. Consider a ‘test lab’ approach to analytics – develop hypotheses from mining data that you market test to refine customer understanding. Move from product development based on competitive positioning or distributors’ demands to a customer needs basis. Apply customer insights to rationalize your existing product portfolio and match product segments to identify gaps in the product matrix. Clarify the attributes that your customers value: is it an outstanding proposition, ease of access, your ability to price risk or your scale – and focus investment accordingly. Can you fill the gaps or would you do better to partner with a specialist?

For commoditized products, especially homeowner’s and auto, consider what further steps could give customers greater control of pricing, e.g., telematics, ‘pick and mix’ product features. Create simple and easy to understand policy terms. Keep it short and concrete.

Stay agile and re-assess customer needs frequently – include behaviour and needs questions in selling and servicing. Use social media and surveys to capture change. Get product, marketing and sales teams to work across distribution channels.
We talked about technology and customer centricity, but right alongside these changes is Big Data! The phenomenon of Big Data has changed the business world like never before and insurers are no exception. The most important part of this transformation is the strong emergence of analytics to support the shift in modern insurers from a process-centric viewpoint to one that is more data-centric and data-driven. Our respondents’ message is that the data that surrounds an insurance company needs to be harnessed into information that informs, supports and drives decision making in a timely, repeatable manner.

Certainly, the tools, techniques and processes that comprise the field of data & analytics (D&A) are critical to improving standard, day-to-day data and transaction processing.

However, the power of data to deliver “higher-value” business insights that drive strategic decision making at insurers is something that makes D&A even more central to a strategic insurer.

Despite the obvious benefits, the goal of being a data driven insurer is a lofty goal. Most insurance companies in the world, not just in Canada, find themselves ‘buried in data’, and are still evaluating how to harvest data and convert them into more meaningful and informative sources to take strategic action. The reasons are aplenty – starting from inflexible legacy datawarehouses, to disjointed silos of data, to data quality issues, to technology limitations to unfilled talent requirements.

Start small. Take a small pool of data, make a topical hypothesis and analyze the data to see the insights it can provide. After success with this small pool, move this data analytics into larger pools and then into the entire organization.

As you are doing this, think about the technology backbone that is needed behind this data and analytics effort. Think about the quality of data, and take efforts to sanitize the data. Mine, analyze, sanitize and optimize the data. Identify themes and apply them to larger pools and across the organization.

Big data is big

Reaping the data dividend

“The Data Debate has ended; today’s organizations are now looking for the Data Dividend. Executives and their Boards know that data offers tremendous opportunity and, at the same time, exposes more risks. But few Canadian organizations have been able to derive meaningful insight from the vast amounts of enterprise data at their disposal. With global competitors shifting their focus from activities of “data production” to “data consumption”, we believe it is time for executive teams and their Boards to reassess their Data and Analytics capabilities and redefine their competitive position.”

Shreeshant Dabir
Partner and National Leader,
Data & Analytics, KPMG in Canada
KPMG At Risk publication, 2016
Also think about how you are analyzing the data. The speed of decisions will be a competitive advantage. Make clear relationships between the fundamental decision drivers and fundamental data relationships. Smart insurers will use real-time analytics to channel real growth.

Data analytics can be used by insurers in a wide variety of applications, including claims handling, underwriting, pricing decisions, marketing decisions and other expense related decisions. Naturally, the effort to harness the data should be an effort that includes all functions working to the same goal. Having data analytics specific cross functional collaboration teams will be the next important step to the progression.

Cutting back to the theme around the customer, insurers can use analytical techniques and big data to focus marketing expenditure on the most receptive client segments and channels by predicting possible outcomes and results. With social media, the customer experience is visible and widely shared. In addition to data created from internal sources, social media and external data that can be actionable for use by insurers, such as technology in “Social Media Listening”.

Younger generations get their news and information for decision making much differently from just a few years ago. Social media has overtaken the internet as the most important news source, although it lacks essential processes to check and validate facts from the ‘fake news’. Companies in all sectors are learning to respond rapidly and meaningfully on social media. With social media, the channels of communication can be very dynamic – news no longer always comes from the large media houses, but from hashtags that trend globally or regionally. Messages can turn viral within hours, and likewise planned social media campaigns can go obsolete within hours. How do insurance companies harvest the power of social media? How do you stay relevant with the conversation? How do you always say the right thing (and more importantly, at the right time)?

Participating in social media is one thing, but harvesting the data from social media into meaningful information is another! Forget mining social media data, mining customer, claims, marketing and underwriting data from existing owned databases can be a big challenge for insurance companies, especially those with legacy systems and paper files. Data is power, and we know the executional challenges of harvesting data – nevertheless, making that decision to make an investment into data analytics without completely knowing the hidden insights can be difficult. In some cases, it could be like investing in a scientific research project.
Regulatory

Regulatory burden has become the leading risk in the immediate term, while operational risk management and the use of capital has become a key opportunity. So how does an insurer leverage the immediate term regulatory obligations into an opportunity for the future.

The introduction of the Office of the Superintendent of Financial Institutions guideline E-21 on Operational Risk Management for all federally regulated financial institutions and Life Insurance Capital Adequacy Test, LICAT, are two examples of recent regulatory changes. In addition to regulation changes, many insurers also have changes to financial reporting with forthcoming IFRS changes on their minds. All of these items add to a feeling of burden. Although there may be a feeling of burden, risk management is a critical business tool, and when applied correctly, becomes a competitive advantage for insurers. Insurance is all about taking on risks…but the risk management processes will ensure you are taking on the right risks and at the right price.

As KPMG in Canada explored in At Risk, the articulation of the value within an ERM program can be challenging. Measuring the “upside” of good risk management can be notoriously difficult. What is the monetary value of stopping a reputational crisis or cyber attack? What is the ROI metric that best describes the investment in risk management? Instead of focusing on this question, we challenge you to leverage the investment you have made in risk management to support the organization. How can you leverage your risk register to help with pricing for the future, or creating a new insurance offering for an emerging risk….just like we have seen with the emergence of cyber insurance.

“Regulatory changes are perceived as the greatest threats to organizational transformation objectives.”

Source: Global transformation study, KPMG International, 2016
Continuing with the trends identified in the previous year, our survey respondents continue to identify low interest rates as a key risk that affects both their company as well as the industry. It hurts, but seems to be the new normal.

A insurer’s investment portfolio plays a significant role in the risk and return profile of the company. The objectives and requirements of the underwriting operations will impact an insurer’s optimal strategic asset allocation, liquidity and taxes.

Our research shows that insurance company investment practices vary considerably across the industry. Factors such as company size, financial strength and business mix often influence portfolio strategies. Leading practices can be informative but must not be taken out of context. An appropriate investment strategy should support the insurer’s overall objectives, while also providing the portfolio manager with the ability to react to market conditions. The oh-so-low interest rates have made the job of optimizing investment decisions so much more critical.

An insurer’s investment portfolio has a multifaceted set of objectives, many of which are in conflict. It is fair to expect that high credit quality, fixed income investments are likely to dominate most company allocations. Striking a balance between income targets, liquidity, returns and capital preservation provides ample opportunity for debate. Constantly changing capital market conditions and the variety of accounting lenses through which we view the portfolio further complicates the task.

The role of the portfolio as a source of income and/or capital appreciation is a risk appetite decision for management. In part it defines how insurers operate; of course, recognizing that insurers options are constrained by the obligation to support the underwriting side of the operation. We believe that insurers benefit from the clarity of purpose that comes from well-conceived principles that govern development of your investment strategy and a corresponding investment policy statement.
Risk of transformation

“Our experience suggests that one of the enablers of successful transformation, not exclusively but especially in insurance, is a change team who manage to break through organizational silos and truly work together. The team needs to share a belief in the value of change, a passion for delivering results, the right mix of skills and knowledge, and confidence to assertively challenge each other. And sponsors can help by actively empowering those teams – enabling experimentation without imposing the same degree of operational risk control as in business-as-usual operations.”

Doron Melnick
Partner,
Insurance Management Consulting
KPMG in Canada

In addition to identifying the top opportunities and risks, in our survey, we asked respondents how optimistic or pessimistic they felt when compared to this time last year. Unlike previous years, a larger portion of the respondents were on the pessimistic side, a complete shift from the previous year. There is also a shift for respondents to be more pessimistic of their organization vs. the industry!

As we interpret this result, we recognize, that the insurance industry finds itself surrounded by disruption. There is significant change on the horizon, whether it comes from technology, customer preferences, regulation, disrupters, big data or the economic environment, or a combination of all factors.

We asked ourselves the question: In light of the disruption in other industries, do insurers wonder if they are falling behind their peers? Or do they feel they are less equipped for the future challenges? Is that the cause for the pessimism? If so, isn’t that actually a positive?

We believe that change is opportunity, but is laced with uncertainty. In our opinion, this pessimism is a reflection that companies have started thinking about the journey towards transformation, and have started having a realization of the significant changes ahead.
Wrap up

As a recap, our 4th Annual Canadian Insurance Industry Opportunities & Risks Survey has a clear message:

We see radical changes coming to the insurance industry. The catalysts of change can be different for each insurer, but we see an increased awareness about disruption and an increased focus on innovation.

The successful insurer will both embrace change, and redefine “how” they provide risk coverage and policyholder protection, at a competitive price to its customers.
Appendix: detailed survey results

Organizational opportunities

**Next year**

Top opportunities for their organization over the next year are:
- Enhanced operational process and use of technology (61 percent)
- Offering better customer experience (48 percent)
- Improved management of risk and use of capital (44 percent)
- Data analytics to enhance product design, marketing and pricing (43 percent)
- Strengthening customer loyalty and reducing market conduct risk (30 percent)

**3 to 5 years**

Top opportunities for their organization over the 3 to 5 years are:
- Data analytics to enhance product design, marketing and pricing (49 percent)
- Improved management of risk and use of capital (49 percent)
- Enhanced operational processes and use of technology (44 percent)
- Offering better customer experience (40 percent)
- Changing customer needs and expectations (36 percent)

### 3 to 5 year increases (largest difference from 2015 survey)

- Improved management of risk and use of capital (12% increase)
- Customer preferences for direct and digital channels (10% increase)
- Data analytics to enhance product design, marketing and pricing (9% increase)
- Changing customer needs and expectations (9% increase)
Respondents were asked to select the top 5 opportunities for their *organization*

<table>
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<th>Opportunities</th>
<th>2016</th>
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<th>2015</th>
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<td>Next year (%)</td>
<td>3 to 5 years (%)</td>
<td>Next year (%)</td>
<td>3 to 5 years (%)</td>
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<td>Enhanced operational processes and use of technology</td>
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<td>Offering better customer experience</td>
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<td>Improved management of risk and use of capital</td>
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<tr>
<td>Data analytics to enhance product design, marketing and pricing</td>
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<td>49</td>
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<tr>
<td>Strengthening customer loyalty and reducing market conduct risk</td>
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<tr>
<td>Customer preferences for direct and digital channels</td>
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<td>Changing customer needs and expectations</td>
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<td>Cost reduction initiatives</td>
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<tr>
<td>Enhancing investment yields e.g., through investing in infrastructure assets</td>
<td>23</td>
<td>14</td>
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<tr>
<td>Greater client or product segmentation</td>
<td>20</td>
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<td>27</td>
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<tr>
<td>Mergers and acquisitions to enhance market position</td>
<td>20</td>
<td>32</td>
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Top organizational risks

Next year

Top risks for their organization over the next year are:

- Regulatory and compliance burden (40 percent)
- Low interest rates and equity market risks (39 percent)
- Cyber security risks (37 percent)
- Cost and risks of IT investment (35 percent)
- Cost reduction pressure is increasing operational risks (30 percent)

3 to 5 years

Top risks for their organization over the 3 to 5 years are:

- Low interest rates and equity market risks (35 percent)
- Failure to adopt new technologies successfully (35 percent)
- Failure to adapt to changing customer preferences and insurance needs (35 percent)
- Regulatory and compliance burden (33 percent)
- Cyber security risks (33 percent)

3 to 5 year increases (largest difference from 2015 survey)

- Legacy systems constrain ability to adapt to change (10% increase)
- Failure to adopt new technologies successfully (8% increase)
Respondents were asked to select the top 5 risks facing their organization

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<th>Risks</th>
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<td>Next year (%)</td>
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<td>Regulatory and compliance burden</td>
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<td>Cost reduction pressures increasing operational risks</td>
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<tr>
<td>Legacy systems constrain ability to adapt to change</td>
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<td>23</td>
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<tr>
<td>Competition from established insurance sector players</td>
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<tr>
<td>Customer preferences for direct end digital channels</td>
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<tr>
<td>Slow to adopt data analytics</td>
<td>20</td>
<td>19</td>
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<tr>
<td>Failure to adopt new technologies successfully</td>
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<td>35</td>
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<td>Competition from new entrants</td>
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<td>Failure to adopt to changing customer preferences and insurance needs</td>
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<td>Increased capital requirements</td>
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