Life Insurance Update

May 2021

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> We hope to provide useful insights to companies large and small as they work to make IFRS 17 a reality.

Mary Trussell
Global Insurance Accounting Change
Lead Partner, KPMG

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Foreword

Nick Moss Partner, Head of Insurance

Our inaugural **Life Insurance Update** highlights the scale of accounting and regulatory change on the horizon and provides you with access to our KPMG Life Insurance Insights Dashboard.

Our Insights Dashboard brings to life key financial information from life insurers' filed financial statements through a range of interactive charts and graphs presenting key industry metrics, financial position and results up to 30 June 2020. It enables the data to be filtered to view the metrics for a particular year or insurer, and provides comparison of metrics for an individual insurer to others in the market. On page 5, Kris Velonza provides a snapshot of the Insights Dashboard and profiles the sector result to 30 June 2020.

With a little more than one year to run before the date of the new insurance accounting standard's IFRS 17 opening balance sheet, the clock is ticking. In KPMG's Global IFRS 17 readiness assessment, we focused on a selected group of 18 insurers, headquartered in 12 countries and territories, from the Forbes 2020 Global 2000 which have had IFRS 17 implementation programs running for several years. On page 8, Ann Au draws out the themes from the survey to provide useful insights to companies as they work to make IFRS 17 a reality. Moving forward with implementation plans in 2021 will be key to achieving the 2023 effective date.

While IFRS 17 might be the biggest change to insurance-related accounting standards in more than a decade, the change for New Zealand insurers certainly doesn't stop there.

We are facing into a period of regulatory change that is unprecedented. On page 12, James Brownell talks about getting ahead of this change, including some of the likely changes that will follow the Reserve Bank of New Zealand's review of the Insurance Prudential Supervision Act and Insurer Solvency Standards, as well as the Conduct of Financial Institutions Bill which is coming and the Privacy Act 2020 which is already here. There are a lot of moving parts and insurers that are proactive to this change can shift attention earlier to the emerging regulatory landscape and focus on the strategic implications and opportunities. Those that aren't, unfortunately, risk getting bogged down with issues and remediations associated with non-compliance.

On behalf of KPMG, we hope you enjoy the read. Please do not hesitate to contact one of the team at KPMG to assist your organisation in addressing any of the matters raised in this publication.

> "The international experience, and what we see from the banking sector, tells us that you should be on the front foot, planning for material changes not just to your risk management and compliance functions but also for wider implications to your business.

Dashboard analysis

New Zealand Life Insurance Market: Results and analysis

Kris Velonza Manager, Financial Services

Life Insurance Insights Dashboard

KPMG's 2020 New Zealand Life Insurance Insights Dashboard contains a range of interactive charts and graphs presenting key industry metrics for the past five years. It also enables comparison of metrics for an individual insurer to others in the market.

The highlights

Overall, the life insurance market has demonstrated continuous growth over the past five years, showing a steady increase in gross premium revenue year on year between 2015/2016 and 2018/2019. Gross claims expense increased from $1,680m in 2018/2019 to $2,004m in 2019/2020). Gross claims ratio remained relatively stable throughout this five-year period.

An overall decline in the insurance profit has been seen for the past two years. Insurance profit declined by 24% ($101 million) in 2019/20, and by 21% ($112 million) in 2018/19. This compares to 8% ($44 million) growth from 2017/2018 to 2018/19.

Results and analysis

Across the life insurance market, in aggregate, gross premium revenue has significantly increased - up 17% from $3,178 million in 2018/19 to $3,725 million in 2019/20. This compares to 8% growth between 2017/18 and 2018/19.

In general, the steady upward result in gross premium revenue across the life insurance market can be attributed to the performance of some of the largest life insurers and reinsurers, including Swiss Re Life and Health Australia Limited ($31 million increase from $258 million in 2018/19 to $569 million in 2019/20) and Partners Life Limited ($40 million increase from $247 million in 2018/19 to $287 million in 2019/20).

On the other hand, a significant decline in gross annual premium as well as commission received from reinsurers of 35% ($227 million) in 2019/20 as compared to 2018/19 was noted for AMP Life Limited - NZ Branch.

Over the five-year period, gross claims expense continued to increase in the life insurance market. Consequently, gross claims ratio appeared to be consistent throughout these five years, averaging at 54%. There was also a proportionate growth in reinsurance expense and reinsurance recoveries compared to gross premium revenue and gross claims expense, respectively. This is a good indication that the life insurance market makes great use of reinsurance.

Notwithstanding the challenging current operating environment, life insurers remained well capitalised. This is with the exception of Lifetime Income Limited, which fell to 86% solvency margin ratio in 2019/20.

2020 Results snapshot

Across the life insurance market, in aggregate, gross premium revenue has significantly increased - up 17% from $3,178m in 2018/19 to $3,725m in 2019/20.

Gross premium revenue

$3,725m	2019/20
$3,178m	2018/19
$2,951m	2017/18
$2,615m	2016/17
$2,497m	2015/16

Reinsurance expense

$1,571m	2019/20
$928m	2018/19
$636m	2017/18
$469m	2016/17
$445m	2015/16

Claims expense

$2,004m	2019/20
$1,680m	2018/19
$1,636m	2017/18
$1,362m	2016/17
$1,403	2015/16

Reinsurance recoveries

$759m	2019/20
$529m	2018/19
$349m	2017/18
$308m	2016/17
$305m	2015/16

Claims Ratio

54%	2019/20
53%	2018/19
55%	2017/18
52%	2016/17
56%	2015/16

Insurance Profit (NPAT)

$323m	2019/20
$424m	2018/19
$536m	2017/18
$492m	2016/17
$521m	2015/16

Testing times

Testing times: Feedback from leading insurers on IFRS 17 implementation

Ann Au Director, Financial Services

With a little more than one year to run before the date of the IFRS 17 opening balance sheet, the clock is ticking. In KPMG's Global IFRS 17 readiness assessment, we focused on a selected group of 18 insurers, headquartered in 12 countries and territories, from the Forbes 2020 Global 2000 which have had IFRS 17 implementation programs running for several years. By sharing this knowledge on an anonymized basis, we hope to provide useful insights to companies as they work to make IFRS 17 a reality.

Questions in our global survey were grouped into four phases, corresponding to key blocks of tasks from project launch to go live as follows:

- Setup, impact assessment and design.
- Implementation: build, configure and test.
- Implementation: dry runs.
- Optimisation, building comparatives and readiness for going live.

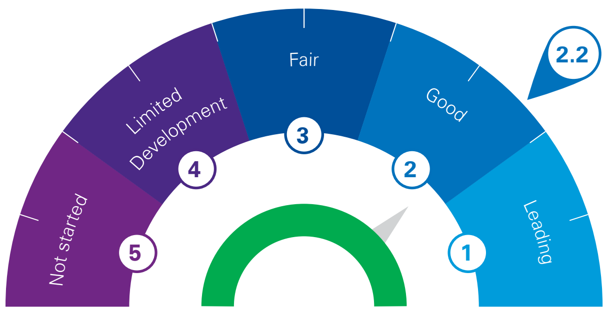
Detailed questions in each phase had five possible answers ranging from 1 (most sophisticated) to 5 (not yet started). Some insurers, particularly operational-focused filers who do not use IFRS as their primary basis of reporting, may choose not to position themselves at 1. Responses have been moderated for consistency.

IFRS 17 implementation in four phases: overview

Two thirds of respondents have completed updating their target finance systems architecture and are deep into testing their preferred IFRS 17 solution. Twenty percent of companies in our survey have completed end to end dry runs across at least part of their business, although the majority are not there yet, completing builds and initial testing. Among the companies surveyed, trends by size and geography are not significant, although composites and life insurers generally appear further advanced than property casualty insurers.

1. Set up, impact assessment and design

All the companies in our survey have multi-year and multi-jurisdiction programs which have been in flight for several years. On average the respondents rated their impact assessment and design as 2.2 out of 5, with two thirds having developed their target finance systems architecture and selected and designed relevant IT solutions, and two thirds having developed a full suite of policy and methodology papers to guide design and implementation.



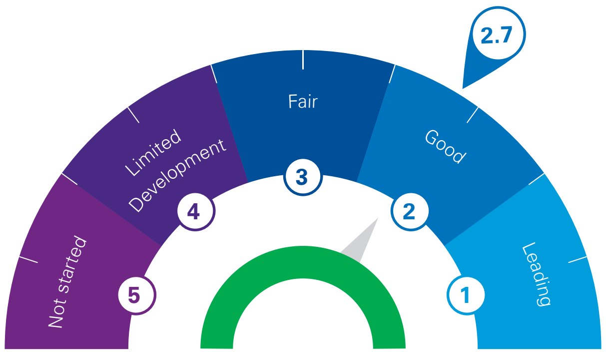
Average score across all respondents

When asked what could work better:

- 80 percent of companies have refreshed their finance target operating model but only a minority use it to guide design decisions.
- Two thirds of companies find it a challenge to deliver appropriate functional training to relevant staff at the right time.
- Even among leading companies, developing designs for updated processes and controls is lagging — this is the least advanced of all tasks in this phase.

2. Implementation: build, configure and test

The average response was 2.7, with half of respondents having fully updated IT systems which have either been tested or are ready for testing, half having completed updating actuarial models, and one third having updated new data feeds.



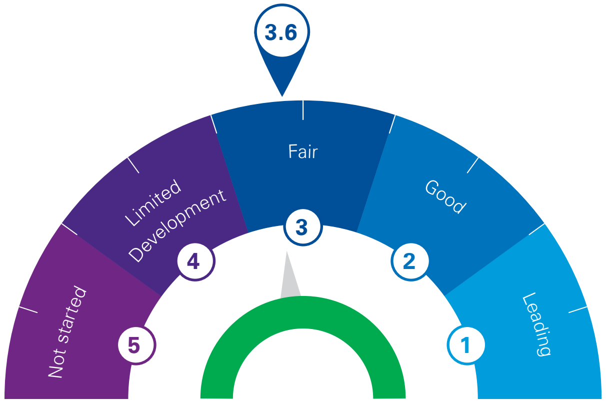
Average score across all respondents

When asked what could work better:

- Only 10 percent have involved all three lines of defence in testing updates to IT systems.
- Half do not yet have a reasonably complete draft of their updated financial statements and have not yet updated their chart of accounts and posting schemes - an important proof point to define data requirements - with one third acknowledging there is still further work needed to identify new data requirements and sources.
- Nearly 80 percent are still developing their approach to transition and building their opening balance sheet.

3. Implementation: dry runs

The average score for the implementation of dry runs was 3.6. Twenty percent of companies have completed end to end dry runs across at least part of their business. One third have developed plans to handle parallel running once their opening balance sheet has been developed, although only two companies have completed updating their consolidation systems, so several of those that have completed dry runs are using workarounds to collate the data.



Average score across all respondents

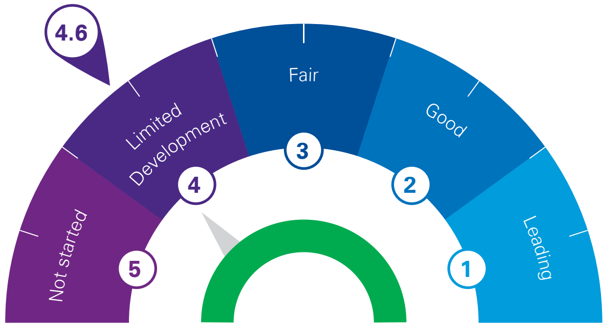
When asked what could work better:

- Forty percent of companies are not tracking and prioritizing open issues, workarounds and matters of interpretation, creating greater challenges in demonstrating governance and oversight compared with earlier phases.
- Eighty five percent of companies have not yet designed quantitative IAS 8 disclosures (disclosure of the impact of forthcoming changes), an important public disclosure of the impact of these changes.
- Updating planning and forecasting, management reporting and key performance indicators is a major task for those where IFRS is the group's main basis of reporting.

4. Optimization, comparatives and readiness for go live

Unsurprisingly, few companies have yet to develop detailed plans for this phase of activity, with an average score of 4.6 out of 5. Of those that have developed plans to tackle transition and build comparatives, a quarter have developed plans to test their interim reporting capability separately from their full close — a subtlety often overlooked.

We will revisit and share progress in the future.



Average score across all respondents

Conclusion

In New Zealand, we observed that insurers slowed down their IFRS 17 implementation programs in 2020 following disruptions created by COVID-19 lockdowns. Insurers shifted their focus, including people and financial resources, from other projects such as IFRS 17 to more urgent and pressing demands. Based on this and the key themes drawn out from the survey, outlined below are thoughts on how insurers can re-focus on their IFRS 17 implementation programs.

Early analysis of data and disclosures: Front runners identify disclosure requirements rigorously at an early stage of their implementation program and use this to guide data requirements and design decisions, avoiding costly re-work.

Effective use of working assumptions: Allows multiple tasks to proceed in parallel rather than sequentially, accelerating progress in a compressed time frame. Front runners define working assumptions, keep them under careful review and refine them as interpretations evolve, rather than back end loading critical decisions.

Staying in control: Front runners implement effective governance and oversight from the get-go, allowing them to identify slippages and correct where needed. They understand the need to design and test controls throughout implementation as well as controls over new reporting processes, avoiding a scramble to back-fit controls close to the finish line.

Rigorous testing: Closely linked to controls, front runners understand the importance of testing: testing new data feeds, new systems, new processes and new reports and results. They plan for rigorous testing and know they need to allow the time for re-work and re-testing in order to face the new world of IFRS 17 in confidence.

We expect 2021 to be a pivotal year for life insurers to change gears and ramp up their implementation of IFRS 17 to ensure that they are ready to go live with confidence in 2023.

With a little more than one year before the date of the IFRS 17 opening balance sheet, the clock is ticking. There is no time to further delay implementation projects, with few programs having as many dedicated and experienced people as they would like. Further, there will be increasing pressure to begin disclosing the impacts of the new standard in line with the requirements of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors as IFRS 17 may significantly impact the financial results on transition. Urgent actions to take include:

- Further developing and strengthening implementation plans;
- Cultivating expertise which includes building an IFRS 17 proficient team to assist not just with implementation, but also to help embed new accounting and actuarial methodologies from 2023 onwards;
- Managing implementation project fatigue;
- Reassessing time required to test, validate and configure IT solutions with software vendors (finance and/or actuarial software programmes);
- Boosting current infrastructure for data capture, storage and integration to actuarial and finance systems to ensure future state of completing required disclosures is practical and a less time-consuming process;
- Considering the option of parallel runs;
- Engaging with stakeholders on the expected impacts of the standard;
- Identifying opportunities to make further process changes, particularly in finance and actuarial areas; and
- Using the change as an opportunity to enhance current financial reporting processes and infrastructure.

Adding to the complexity is the potential impact of a changing regulatory environment, including a review of the Insurance (Prudential Supervision) Act and Insurance Solvency Standards.

It's critical that momentum is maintained and that insurers don't lose sight of the ultimate goal of having a global standard that aids comparability and transparency of reporting.

Regulatory change

Regulatory agenda and change

James Brownell Director, Insurance Consulting Lead

We are facing into a period of regulatory change that is unparalleled, and we believe Insurers shouldn't wait for the regulations to be finalised to get started. Now is almost too late. Even prior to the impact of COVID-19 in 2020, the sheer volume of regulatory change on the horizon for insurance companies in New Zealand was unprecedented. This will result in significant challenges for both management and boards over the coming years.

The current situation

The regulatory agenda for 2021 has been driven by a combination of international events, reviews and technical changes, together with local events which have highlighted the need for greater regulatory oversight and supervision of the insurance sector within New Zealand.

Although all of the initiatives highlighted in the timeframe overleaf will impact insurers, we have focused on three of the key changes in this article.

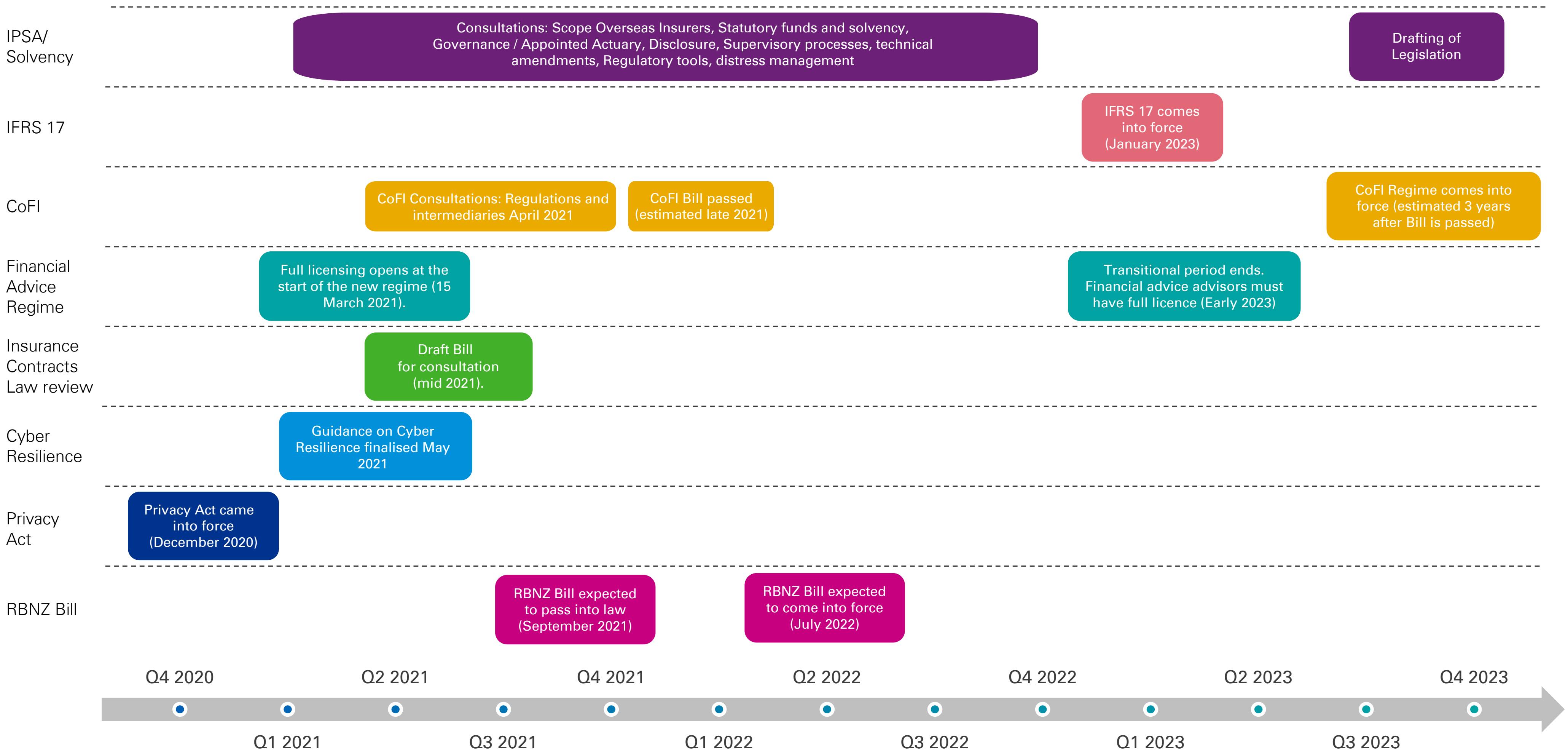
1. Significant changes to the prudential regulatory regime / solvency standards on the horizon

After deferring the initial review in 2020, the Reserve Bank of New Zealand ("RBNZ") has relaunched its review of the Insurance Prudential Supervision Act (IPSA) 2010 and associated Insurer Solvency Standards. Consultations are due to take place throughout 2021 and 2022 with final standards likely to be in place late 2023.

The review has been driven by the identification of the need to:

- Issue enforceable prudential standards on key risks, governance, risk management and controls to make the RBNZ's supervisory expectations more transparent and support supervisory preventive action.
- Modify the Solvency Standards so they operate as a graduated and flexible set of solvency measures and triggers, with a prudential capital buffer and an escalating supervisory response as the buffer reduces.
- Introduce group level supervision for insurance groups using non-operating holding companies and insurance subsidiaries in order to ensure capital integrity and protection against contagion risk within the group.
- Introduce outsourcing requirements for all insurers (especially for underwriting agencies, third party claims managers and reinsurance).
- Enhance conduct regulation and insurance intermediary supervision.
- Now is your opportunity to participate and have your say in shaping the regulations that will direct the industry for the next decade.

Upcoming regulatory timeframes:



2. Conduct of Financial Institutions Bill (CoFI) is coming

If you're not talking to your board about CoFI, you have missed another substantial shift in the landscape, this time on Conduct. The amendments to CoFI were submitted by the Finance and Expenditure Committee (FEC) in August 2020. This will introduce greater clarity around fair conduct programmes which include requiring effective policies, processes, systems and controls to:

- Design and manage the provision of services and products
- Identify, monitor and manage conduct risks
- Identify and mitigate conduct breaches
- Initiate and maintain regular training for employees, agents and intermediaries
- Manage or supervise employees, agents and intermediaries

This bill will give regulators, specifically the FMA, real power going forward that they haven't previously had. Insurers can expect a more intensive supervisory regime with respect to conduct.

3. Privacy Act 2020 is here

While the Privacy Act 2020 came into force on 1 December 2020 (replacing the Privacy Act 1993), this wasn't a tinkering of the 1993 Act but rather a substantial update that brings the Act into the 21st century. It imposes significant new regulations for data that is provided and stored digitally. Key additions include:

- Prescriptive requirements to report a privacy breach
- The Privacy Commissioner may issue compliance notices and enforce access
- Stricter guidelines on the collection of personal information
- Stricter guidelines for cross-border data flows

What needs to be done

There is a saying that 'it never rains, it pours' and these regulatory changes come at a challenging time as New Zealand insurers grapple with COVID-19, rapid technological transformation and general industry disruption. The international experience, and what we see from the banking sector, tells us that you need to be on the front foot, planning for material changes to not just your risk management and compliance functions but also for the wider implications to your business, strategy and capital.

Get ahead of the change

We encourage insurers to be proactive in terms of managing their regulatory response and associated change, engaging in the relevant consultations either directly or through industry forums. These should include establishing the likely changes and relevance to your business.

Policies and procedures will need to be updated to reflect any changes, and training

> “These regulatory changes come at a challenging time as New Zealand insurers grapple with COVID-19, rapid technological transformation and general industry disruption.

will need to be provided to employees and directors to help them ensure the new regulations or guidelines are being followed.

Insurers that are proactive to this regulatory change can shift attention earlier to the emerging risk and regulatory landscape and focus on strategic implications. Those that aren't, risk getting bogged down dealing with issues and remediations associated with non-compliance.

Ensure risk governance is fit for purpose

The introduction of comprehensive additional standards on risk management is likely to increase reporting across customer outcomes, third parties and reinsurers as well as the requirement for more formal consideration of non-underwriting risk.

As the risk management environment increases in complexity, reporting will need to be strengthened to ensure risks and issues are escalated appropriately to enable Risk Committees and Boards to consider these from a strategic perspective. Reporting should be more focused on lead indicators such as risk capability and demonstrating that policies and procedures are working rather than simply reporting when they are not.

Clarity on accountability, roles and responsibility across the three lines of defence

How comfortable are you that you have clear accountability for the maintenance of obligations as these are introduced? Insurers that clarify roles, responsibilities and accountabilities for risk management across the 3 Lines of Defence set a solid foundation for changes going forward.

Could great risk management be a strategic advantage?

Insurers that raise the bar in terms of risk management standards and reporting, will be able to leverage strategic benefits from risk and customer insights.

Furthermore, the likely formal prudential requirements around production of an Internal Capital Adequacy Assessment Process (ICAAP) or Own Risk and Solvency Assessment (ORSA) should also allow insurers to align various stakeholder objectives and better balance risk appetite, capital and strategy. Is your firm considering these implications?

Where to Next?

As countries and governments across the globe begin to overcome the initial shock of COVID-19, and the temporary hiatus from regulatory scrutiny draws to a close, it is likely that more items will be added to the regulatory agenda in the coming years with Environmental, Societal and Governance (ESG) and Operational Resilience being focus areas in the UK and Australia.

Insurers in NZ will need to get used to this increased level of regulatory focus, take the lessons learned elsewhere to maintain their competitive position and leverage strategic benefits associated with these changes.

Contributors

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Jamie is the National Industry Leader and Head of Financial Services at KPMG New Zealand. Jamie has worked in a variety of leadership roles in professional services and the corporate world both in New Zealand and the United Kingdom. He has specialist experience in audit and consulting work in the financial services sector. His current audit and consulting clients include New Zealand's largest financial institutions, including insurers, banks and finance companies.

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Nick is a Financial Services Partner and Head of Insurance at KPMG New Zealand. Nick has substantial general and life insurance experience from his involvement at a senior level in large insurance audits, industry presentations, and thought leadership. Nick has specialist experience in audit, regulatory and other assurance services.

Kris Velonza

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Kris is a Manager in the Financial Services Audit team at KPMG New Zealand. He has more than 10 years of global audit experience within the financial services sector which includes life and general insurance, banking, investment funds, finance companies, and real estate funds. Since joining KPMG New Zealand in 2014, he has been mainly involved in the audit of both life and non-life insurance clients.

Contributors

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Ann is a Director in the Financial Services team at KPMG New Zealand. She has 18 years' experience in audit and accounting advisory work across the insurance sector. Ann has presented at a number of technical accounting updates, notably on IFRS 17 to finance and actuarial teams, and board members of insurance entities and the Reserve Bank of New Zealand.

James Brownell

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James is a Director and Head of Insurance Consulting at KPMG New Zealand. Over the last 2 years James has supported a number of insurers and financial services services firms with their responses to emerging risk and regulatory change, specifically in the context of conduct and third party risk management. James has 12 years’ experience in financial services consulting, primarily based in the United Kingdom, and has a wide range of expertise across risk management including risk governance, outsourcing and capital planning and management.

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