General Insurance Update 2018

Making your mark in a changing landscape

November 2018

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Foreword

Jamie Munro Financial Services Partner, Head of Insurance

The latest edition of our annual KPMG publication, the General Insurance Update 2018, highlights industry views and examines how insurers can make their mark in this fast-changing environment.

Contributors to our publication have this year explored customer experience, sustainability, culture and conduct, cyber security, financial reporting, and regulatory change in the sector. For New Zealand's economy to prosper, insurers will need to adapt and innovate in response to changing customer needs, community expectations, technology advances and regulatory demands.

Our first article draws out the themes from our latest KPMG Global CEO Outlook Survey of some 1300 CEOs. Particular focus is provided on the views of insurance sector leaders internationally, paired alongside local perspectives from the New Zealand CEOs surveyed. We tested those themes with the CEOs of the two largest insurance companies in New Zealand, and share some of their insights in this article.

Elevation of the customer, digital transformation, and culture and workforce transformation, are all areas of high focus for our insurance CEOs.

Success, in this context, will require fundamental business model change.

> Elevation of the customer, digital transformation, and culture and workforce transformation, are all areas of high focus for our insurance CEOs.

Our resident KPMG expert on customer experience, Baxter McConnell, picks up the theme of customer experience for closer consideration. In an environment of heightened customer and community expectations, we believe that to become truly customer-centric, insurers will require new insights, cultures and partnerships that put the customer at the core of the business. For most insurance organisations, this will mean radical change throughout the business and ecosystem.

Major external forces, equally, are shaping our insurance industry. Climate change is associated with an increase in both the intensity and frequency of extreme natural events such as storms, floods, hurricanes/typhoons and droughts. Insurers are on the front line when it comes to helping society mitigate and adapt to the impacts of climate change. Dr Charles Ehrhart, a leader in our KPMG Sustainable Value team, discusses mitigation, adaptation and a way forward.

Ian Jameson highlights the opportunity for insurers, through better business reporting, to better connect and engage with their stakeholders on important matters of purpose, strategy and performance.

Legislative and regulatory reform is also abound in the changing landscape.

Our previous annual publications considered the reform of two major New Zealand Crown entities with fundamental connections to the general insurance industry: Fire and Emergency New Zealand and the Earthquake Commission (the EQC) and insurance legislation review underway on prudential supervision and contract law.

Initial findings from an Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry were published in September 2018. Public hearings are ongoing. The Reserve Bank of New Zealand and Financial Markets Authority have jointly been monitoring Australian developments since the Royal Commission was initiated and have undertaken a formal review of culture and conduct of New Zealand banks and life insurers.

While the local regulator focus, has to date, excluded general insurers, a separate commission of inquiry into the EQC's handling of the Canterbury earthquakes, may shift the spotlight closer, particularly with respect to claims behaviours and management.

There is change too, on the accounting front. The long anticipated insurance contracts standard – IFRS 17 Insurance Contracts – has finally been published, heralding fundamental changes to international insurance accounting. The new standard brings both benefits and challenges for insurers. The date the new standard comes into effect is 1 January 2021, although international standards setters have recently proposed a one-year deferral, following a significant pushback from the industry.

Sean Ferris and Ceri Horwill provide further background on these developments.

Lastly, Phillip Whitmore picks up from his previous cyber security contributions to our General Insurance Update series, and addresses the commercial opportunity for insurers. That opportunity, we suggest, needs to be balanced with a serious focus on insurers' own platforms and operational risk, particularly in the current environment of technological change, implementation of new operating systems, and strategic alliances with third-party technology partners.

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.

> To prosper and fuel New Zealand's economy, insurers must continue to adapt their business strategies to respond to changing customer needs, community expectations, technology advances and regulatory demands.

1 CEO OUTLOOK

Navigating Internal Connectedness

Nicholas Moss Director, Financial Services Audit

> Let's hone in on a "more connected enterprise" – from a data, IT and systems perspective, as well as from a vision, culture and objectives perspective. What are some of the ways we can achieve this?

The 2018 KPMG Global CEO Outlook, which surveyed 1,300 CEOs, including 50 New Zealand CEOs, found that eight-in-ten insurance CEOs believe they are now meeting (or even exceeding their customers' expectations for a personalised experience.

For an industry where connection to customer hasn't always come easily, this dedication is clearly paying off. In a recent KPMG International survey of nearly 55,000 customers across 14 countries, that insurance brands were ranked first for customer experience across all sectors in four of the 14 countries.

Clearly with the right support and direction from their C-suite, it is possible for insurers to differentiate themselves based on customer experience. Let's take a look at some of the ways this is being achieved through digital transformation, culture and workforce transformation and the use of big data.

Firstly, what do customers want?

What CEOs are telling us is that it takes more than just good customer service and fast claim processes to deliver a truly differentiating customer experience in the insurance industry. Rather, it requires insurers to radically sharpen their value proposition in a way that responds to their target customers' expectations.

That won't always be easy; it will require insurers to meet customer expectations from beginning to end.

So what does this mean? In part, it means becoming better connected to their policy holders and insured risks. The emergence of smart home technologies, autonomous cars and the shift towards the sharing economy are already changing the dynamics in the non-life sectors. The introduction of wearable technologies and the adoption of health and fitness apps may lead to similar changes in the life sector.

> In today's hyper-competitive and customer-centric world, it is those that know the most about their customers that achieve the greatest success.

It also means becoming a more connected enterprise – from a data, IT and systems perspective, as well as from a vision, culture and objectives perspective. The reality is that customer expectations are not easily met when organisations operate in silos; those that are able to connect and align their organisation behind their customer agenda stand to gain the greatest traction with their target customers.

Digital transformation – digital wins

The 2018 KPMG New Zealand CEO Outlook Survey shows that something has changed for New Zealand CEOs around digital transformation, and it's a step backwards. Compared to their global cohort, and their own responses from a year ago, New Zealand CEOs have lost confidence in their organisations to deliver digital transformation.

If digital transformation is focused on enhancing customer experience, developing new products and services, or re-inventing internal processes, the survey data tells a concerning story for New Zealand organisations.

In the 2017 New Zealand CEO Outlook Survey, 88% of CEOs surveyed were confident they were disrupting their sector rather than waiting to be disrupted. In 2018, that has dropped to 28% - a major change in sentiment.

A little more than half of New Zealand CEOs (58 percent) are "personally prepared to lead their organisation through a radical transformation of its operating model to maintain competitiveness" compared to a global metric of 71%.

Perhaps more concerning is that only 26% of New Zealand CEOs are "confident that existing leadership is fully equipped to oversee the transformation" compared to a global response of 44%.

Yet, the data suggests that New Zealand CEOs understand the challenge, with nearly all (98%) viewing digital transformation as an opportunity rather than a threat. However, the majority (64%) acknowledge that their organisation is struggling to keep pace with technology innovation (versus the global response of 36%).

There will be a number of factors behind these survey results but I wonder how much impact legacy systems have on our confidence to execute digital transformation?

Transforming the legacy platforms

Legacy insurance platforms are built on sustainable and scalable mainframe technologies suited to processing a large volume of transactions. However, as a result of historical mergers and acquisitions, pressure to launch new products under time constraint and the need to fulfil specific distribution channel requirements, most legacy systems have added peripheral features, become siloed across lines of business and bound by inflexible integrations.

As insurers embrace the new digital future, change to the organisation's technology infrastructure becomes increasingly critical not only for current performance but also long-term viability and competitive differentiation.

> "At Suncorp New Zealand, we use insights to understand and meet customer needs, and continue to embed a customer-centric culture. Our goal is to deliver customer experiences that are consistently great, and brilliant in the moments that matter."
>
> **Paul Smeaton, CEO Suncorp New Zealand**

So where to from here?

Organisations looking to evolve their tech stack to keep pace with current innovation are recommended to:

1. **Take a holistic, top-down view**

   Legacy platforms such as policy administration systems touch upon many areas of insurance value chain and affect multiple operating layers: not only technology but also customer segment, channels, process, people and organisation. To capture all possible options of transformation, organisations should look at the issue from the perspective of optimising the overall operating model rather than treating this as a system upgrade or replacement endeavour.

2. **Clarify the objective and opportunities**

   Each insurer has unique motives for legacy transformation. Some may plan to divest non-core lines of business or the legacy book of business in a future timeframe, while others are looking to launch new products targeting new customer segments via new channels. These parameters will determine the archetype of legacy transformation, such as the two-speed model where legacy portfolio is ring-fenced from the strategic growth platform, as well as the sequence of migration.

3. **Leverage emerging API technologies**

   As an alternative to full system replacement, organisations should look to use open APIs to repurpose and modernise existing legacy systems. Open APIs can help downsize legacy functionalities, integrate InsurTechs' advanced innovations, and minimise disruption during the transformation process.

4. **Promote business accountability**

   To better respond to evolving customer and market needs, the business needs to be involved in key aspects of solution delivery. It has been some time since we heard 'agile' among insurers, and organisations have been trying to find the right agile model for their businesses. While it works well with front-end applications, a pure agile approach often poses a challenge for the back-end core insurance platform. Organisations should consider alternative ways to promote business accountability in core insurance applications, delivering a clear direction for the legacy transformation blueprint based on true market needs.

5. **Create a structure that supports innovation across the organisation**

   While leadership is critical for any innovation or transformation process, sometimes the top-down approach can create disconnects at the local level. Information and feedback from local businesses needs to be fed into the larger innovation process to ensure that the strategy is relevant to the on-the-ground needs of the local office. When approaching the transformation process, organisations should consider a satellite model for innovation where a centralised R&D team works in coordination with the business to develop the innovation strategy.

Responding to evolving customer expectations and shifting market pressures requires insurers solve legacy platform challenges and create a nimble, sustainable and connected platform. Whether investing in customer-facing digital apps, intelligent automation to streamline processes, smart contracts for claims, or more, it is critical that insurers take the optimal approach to transform legacy and accelerate the delivery of exemplary service in pursuit of the corporate vision.

Culture and workforce transformation – shifting sands

Clearly, it is possible for insurers to differentiate themselves based on customer experience. What is also clear is that differentiation will not be achieved through a single 'silver-bullet' solution. It will require far broader transformation – transformation of all aspects of the business.

Whilst 58% of New Zealand CEOs' are personally prepared to lead a radical transformation of their business to maintain its competitiveness, more than 70% of global CEOs' are making transformation a personal priority.

But it's hard. Our CEOs highlight the importance of acting with agility, linking growth strategies to societal purpose, and improving how market disruption is monitored. Almost all New Zealand CEOs are finding the lead times to achieve progress with transformation projects 'overwhelming', and technology is not the only source of disruption.

And although only eight percent of New Zealand CEOs view talent as one of their top three risks, a third don't believe they have the right leadership team to oversee transformation, and over three quarters think their board's expectations of return on investment from transformation is 'unreasonable'.

CEOs need to ask if their culture, strategies and business models are facilitating growth or inhibiting it. And they need to ensure efforts to improve supply chains, embed smart technology and go digital are not just internal projects but are responsive to the needs of their customers – and executed fast enough to ensure their customers don't become their competitors' customers!

> "Change is happening and as an industry, we have the opportunity to embrace this and to be the architects of the future. The future is about both augmentation and automation. There will still be jobs to do, but the tasks and skills required will be different than today with a greater emphasis placed on communication, connecting, empathy and relationship skills."
>
> **Craig Olsen, CEO**
> **IAG New Zealand**

Transforming an insurance company takes more than new technologies and new business processes. It also takes an entirely new approach to workforce planning and development. It's one thing to acknowledge that processes and capability requirements are changing – are you ready to start making major changes to your workforce today?

The bots are coming, AI is a slower burn

For years, experts have forecast that robots would invade the workplace, and now, the fact that automation will soon be embedded in processes across the insurance organisation is undeniable. While the basic automation referred to as bots is more prevalent, it is clear that artificial intelligence (AI) is starting a slow steady move into the world of insurance. Our Global CEO Outlook Survey indicates that 12% of insurers have already started to implement AI in some of their processes and another 51% have started limited implementations around the organisation. More than half also say they expect to start seeing significant returns on their investments into AI within the next three years.

One would expect this massive rate of automation to have some very significant impacts on the workforce. For one, new skills and capabilities will be required. The CEOs in our survey were quick to note they would need more data scientists, more cyber security specialists and more digital transformation managers in particular.

Yet, at the same time, exactly half of our respondents admitted they probably wouldn't start thinking about hiring these new skills until they start to achieve certain growth targets. My concern here is two-fold: first is that they will not have the skills required to help them achieve their transformation goals; the second is that they may join the war for talent too late to score any significant wins.

Looking at the leaders

In the end, the answer for most insurers will likely be a combination of multiple strategies. Automation will be applied everywhere; employees will be retrained where possible; contingent workers and partnerships will be used to fill gaps; new roles and ways of working will be developed.

Based on our work in the industry, here are five things that many of the leading insurers are getting right as they start to think about creating the optimal insurance workforce of the future:

- They are breaking down the silos. The leading insurers recognise that their workforce needs to be aligned around the customer, not the business function. And that means finding ways to remove the traditional functional barriers and silos.
- They are integrating their workforce plan into their transformation journey. Leading insurers develop their workforce plan alongside their transformation strategy, ensuring they have access to the right skills and capabilities at the right time in their transformation journey.
- They are finding the right balance between growth and cost/disruption. They are carefully and deliberately adjusting their workforce and their capabilities to grow in line with the demands of the business (reflecting the growth/cost balance).
- They are thinking about the workplace dynamics. Recognising that the workplace of the future will also change, the leading insurers are now thinking about how they engage and motivate employees that may not work in an office or may not even be human.
- They are encouraging a culture of innovation. The leading insurers are proactively addressing employees' resistance to change and fears about automation by encouraging innovation and transformation across the enterprise.

Too little, but not too late

Many insurers are making transformational changes. But in our experience, few are doing it at the scale required to achieve true enterprise-wide impact. When we talk to insurance CEOs, they are often quick to share their innovative pilot projects and capabilities. But there is often a struggle with how to leverage these new technologies and capabilities across the enterprise.

Insurance leaders recognise the challenge; 47% of the CEOs in our Global survey told us that most of their technology investment is tactical - focused on solving today's business challenges - rather than strategic and focused on a long-term plan. And in a separate survey of insurance CIOs conducted by KPMG International and Harvey Nash, just 28% said they had a clear enterprise-wide digital business vision and strategy.

It all starts with balance

Fundamentally, this comes down to the age-old challenge of balancing cost against growth and risk against opportunity.

Insurers know they need to transform in order to grow in the future, but they hesitate to disrupt their current books of business or business models. They seem to want to implement new technologies across the enterprise, but aren't yet willing to tear out their legacy systems and rethink their IT estate. They also seem keen to capture new capabilities and skills, but are slow to hire until they see positive growth. Every insurer struggles to find the right balance.

Yet, in our view, finding that balance will be the defining challenge facing insurance CEOs over the coming decade. And it will permeate almost every decision they make as they work to execute (and, where necessary, pivot) their transformation journeys.

Data transformation – data versus intuition

The explosion of 'big data' and the increase of computing power has allowed us to make advances in machine learning, AI and automation. These analytical techniques can be applied to everything from predicting which valuable customer might leave, to anticipating the next best product. With this increasingly data-driven and rational approach, it's easy to wonder if there will still be a place for intuition in the future of business. There clearly is.

Nearly three quarters (74%) of New Zealand CEOs have overlooked insights provided by data analysis or computer-driven modelling because they were contrary to their own experience or intuition.

One way to approach this is to think of intuition as a starting point and input to decision making. For example, a hypothesis is an intuition about what is going on in your business, where the risks, issues, and opportunities may be, which products to develop, or which future direction to take. You can test these hypotheses by performing experiments, gathering and analysing the data.

The combination of intuition and information remains powerful. As analytical tools and approaches become more intuitive, through the rise of 'augmented analytics', increasingly we will see that the combination of humans and machines working in unison gives rise to the greatest success.

Integrating risk, finance and actuarial for data transformation

Leading insurers are talking about integrating risk, finance and actuarial operations with the aim of securing a single, consistent, and multidimensional view of their business. Until relatively recently, insurers have regarded data management activities as primarily operational rather than a potentially value-generative asset. In this context, individual functions have been allowed to remain entrenched in their own siloes, building data structures that work for them but not for the enterprise as a whole.

There are many benefits of risk, finance and actuarial joining forces to add value to the business and help make better and faster decisions:

- Risk, finance and actuarial integration can deliver a much more consistent and standardised view of the risk-adjusted returns insurers are achieving throughout their business;
- Data transformation provides crucial insight into customer behaviours, enabling the development of better products;
- Exploiting these gains will make it possible to allocate capital much more efficiently;
- Integrated ways of working and a common infrastructure will not only improve control but will undoubtedly lead to elimination of duplication and efficiencies.

The case for integration is further strengthened by the increasing regulatory demands for transparency. Insurers must not only meet more demanding reporting requirements but also build understanding of the implications of their reporting throughout the business. This will ensure business leaders have a much clearer understanding of the impact on capital of their decisions.

As the reporting regimes of risk, finance and actuarial continue to converge, maintaining separate reporting structures is not sustainable.

Envisioning a new model for integrated risk, finance and actuarial

Few insurers have set out a vision of an integrated risk, finance and actuarial function, let alone begun to move decisively towards it. However, it is possible to draw on the learnings of those organisations that have already embarked on the transformation journey to think about what an integrated function might look like.

This will be a significant exercise, carving out resources from each function – and augmenting those resources with new talent – in order to create an independent new function. This function will have operational responsibilities to risk, finance and actuarial but will not reporting directly to either.

The aim should be to create a shared service that is capable of providing data quality and data management services as well as integrated reporting and advanced analytics functionally to every other part of the organisation; not only risk and finance. The newly integrated function will be the insurer's data management 'Centre of Excellence' with a single underlying structure.

Staffing the new function will require the relocation of key personnel from risk, finance and actuarial. But these individuals will need to have both the right skillset for their roles and the adaptability to ensure a good cultural fit. Insurers will also seek to recruit new talent, securing new skills in areas such as data science and advanced analytics.

Therefore, it will be crucial to ensure such a function is widely regarded as an attractive place to work, both to persuade existing staff to consider transferring and to attract new talent. This imperative underlines the need to shift the narrative around data in insurance. The insurers support for – and incentivisation of – staff employed in this data Centre of Excellence will represent proof for its claims that data really is now seen as an asset where value is created.

Meanwhile, separate risk, finance and actuarial functions will remain in place. These functions will be smaller and leaner than in their previous incarnations but also more specialised. Empowered by the improved quality and granularity of data insights available from the new function, risk, finance and actuarial will have opportunities to create additional value of their own.

For the organisation as a whole, this will be a profound transformation. The opportunity is to create an enterprise-wide asset that delivers greater actionable insight than existing functions could hope to create individually. Its activities will go to the core of the insurers operations and strategy, including management of capital – far beyond work that could comfortably be procured from third party providers or advisors.

Making the transition

There will inevitably be challenges to face in the move towards integration – both organisational and technical – but these can be overcome if clarity of vision and purpose is in place from the beginning.

Above all, this is a transformation project that will require leadership buy-in and support right from day one. Not only is this an enterprise-wide decision that must come right from the top of the business – the C-suite, including both CFO and CRO – but it will require strong leadership to keep the transformation process on track.

The entrenched interests in existing structures and silos may be powerful; to prevail leaders will need to invest considerable energies in convincing the organisation that transformation is required.

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Final reflection

Significantly more than half (64%) of New Zealand CEOs perceive that growth over the next three years will be harder earned than ever before, more than double the global average. The challenge of moving toward an agile business model and linking the growth strategy to wider societal purpose were two themes which underpinned the responses to this question.

New Zealand's CEOs are conscious of the need to respond to change by fostering innovation and building agility but are equally conscious that the ability to achieve growth at scale in the domestic market is limited. Accordingly the combination of the domestic and global outlook means New Zealand's CEOs are now looking for "realistic growth".

Given that New Zealand has come through a period of robust growth, a little tempering of confidence is both realistic and expected. It's also an opportunity for us to refocus our collective attention on what's needed – and relentless focus on the customer and using technology to deliver an outstanding customer experience are certainly fundamental principles for us to focus on.

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CUSTOMER EXPERIENCE EXCELLENCE

Setting the Standard

Baxter McConnell Customer Experience Lead

Across all industries, and the insurance industry is no exception, the way organisations interact with their customers is becoming increasingly important to creating a point of differentiation. They want an insurer to be trustworthy and transparent, promote social good and interact with them via their preferred channel at whatever time suits them best.

73% of CEOs surveyed are concerned that they are not keeping up with customer needs.

67% agree that building greater trust among customers is among their top three priorities.

In an effort to help organisations better understand how to achieve customer experience excellence, KPMG has conducted research for the past eight years in our Customer Experience Excellence report. The research has evaluated over two million consumers across nine industries in 14 countries, including New Zealand for the first time this year. The foundation of this research are the Six Pillars of customer experience excellence, which analysis has found to be the core DNA of every outstanding customer experience.

The Six Pillars of Customer Experience Excellence

Personalisation

Using individualised attention to drive an emotional connection.

Time and effort

Minimising customer effort and creating frictionless processes.

Expectations

Managing, meeting and exceeding customer expectations.

Integrity

Being trustworthy and engendering trust.

Resolution

Turning a poor experience into a great one.

Empathy

Understanding customer's circumstances to drive rapport.

The organisations who have excelled across the Six Pillars are realising significantly greater brand advocacy and loyalty compared to their competitors, which in turn translates to superior top and bottom line growth. The 2018 global report quantified this economic value by comparing the financial performance of the top 50 companies against the bottom 50 companies across the Six Pillars. The analysis showed that the 50 top rated companies had 54% higher revenue growth and 202% higher EBITDA growth, at an aggregated level. Additionally, the top 50 brands generated $25 billion more revenue.

Highlights from the CEER affecting insurers

From our study of 55,000 global consumers in 2018 - including 83 insurance brands across 14 markets - we found that leading insurers are leveraging technology and insights to understand and cater to the full needs of customers across their various stages of life. Not only do these organisations leverage data to deliver personalised experience, but they understand that doing business needs to be easy for customers, who need to believe they can rely on their insurer when things go wrong.

Driving personalisation through consumer insight

Customer insights are the life blood of modern business. So, the more companies know about their customers, the better they can innovate and compete. But it can be challenging to have the right insights, at the right time, and have access to them consistently over time.

There are two types of insights that drive personalised individual experiences: specific unique knowledge about the individual customer and contextual knowledge about customers who have experienced their life circumstances. The combination of the two enable experiences to feel personalised, even if they are delivered in the same way to everyone in similar circumstances.

Insights that fuel these two conditions consist of:

1. Anticipation and prediction

USAA uses life events to create a deep understanding of the issues and tasks customers face as they deal with different life events. They are then able to orchestrate their resources in a way that feels unique to the individual because it locks onto their life circumstances. Historically, USAA states they were able to detect when a life event occurred for one of their members. Now, with new technologies, they can predict when a member is about to enter a life event. So, they are meeting customers' needs before they even realise they have them.

2. Personalised communications

Similarly, USAA converts this knowledge into a communications strategy that varies for each life event. A series of highly targeted life event specific communications ensure that USAA is always present when customers are making financial decisions.

Reputedly, USAA has a database of communication assets that can be triggered by knowledge of the individual customer in millions of different combinations, ensuring a deeply personalised communications experience.

Key takeaways

- Insight is fragmented within organisations – deep insight requires harnessing the insight ecosystem to unite internal data, primary research and customer feedback
- Needs and expectations are volatile. Keeping abreast of this requires 'customer surround sound' continually bringing the customer into the organisation
- Insight is derived from behaviour, transactional activity, opinions, attitudes and psychological signals and responses to actual experiences
- Ultimately you have to understand your customer

In search of truth –
the integrity economy

Trust is in crisis around the globe. Indeed, with few exceptions, trust has declined in nearly every major economy and many developing ones. All brands operate within a larger narrative and the narrative of today is cynical and mistrusting. Against this backdrop, what consumers conceive a brand to be is changing rapidly. Customers form their perceptions of a brand based on their experiences; it is built in every interaction, at every touchpoint and in every social media post. A brand is the sum total of its words, deeds and operating philosophy. Millennials, in particular, are drawn to organisations that display values and convictions beyond simply making money. They seek organisations that communicate their core beliefs openly and credibly; that are built around a compelling purpose; and where the 'why' and the 'how' is as important as the 'what'.

The successful brands in our study have mastered the art of trust-based brand building. They have moved from an era where trust can be bought with advertising and product quality to an era where trust is built slowly over time, interaction after interaction. This is not consumption; it is a relationship. And at the heart of every successful relationship is trust.

Customers of LALUX in Luxembourg say they love how the organisation delivers on its core values: service, stability, honesty, and integrity. The brand strategy of delivering tradition, expertise and strong values at the heart of internal and external interactions resonates with consumers and employees alike, as

> What we consume says something about who we are and who we want to be. And, increasingly, so does who we buy it from. Customers not only buy what brands do, they buy why they do it. Perhaps not surprisingly, Integrity is the most important pillar for driving recommendation in our study overall.

evidenced by a very low staff turnover rate. The company's Head of People and Communication, Marc Parage, confirms that "employees usually stay until retirement, and we are proud of that." The empowerment of staff as agents with their own client portfolios is further testament to a highly cross-functional and customer oriented organisation, from front to back office. This contributes to LALUX's high ratings in Empathy as agents offer personalised, family-focused solutions, building relationships and making customers feel as if they are in good hands. Agents see customers as "part of the family" and focus not only on customers, but their families as well.

In China, where consumers have become wary of false advertising and false products, mobile payments platform Alipay has developed an escrow account where customer money is held until the goods arrive in a satisfactory condition. Steps like this have helped build confidence in the platform and eased consumer fears while accelerating the adoption of online purchasing.

Our experience suggests that, in every interaction a consumer has with an organisation, there is a perceived moral code – a way of being that must align with the values of the consumer. The leading brands share a common characteristic: they seek to build trust wherever and whenever possible. And they establish a two-way relationship with their customers, encouraging them to participate – to be involved as active shapers of the products and experiences that improve their lives.

Trust framework

The following trust framework illustrates the key areas for focus:

Brand principles

Purpose

- Stand for something
- Moral code
- Dependable and consistent
- Deliver the brand promise

Experience interaction level

Act in my best interest

- Show concern
- My welfare is key
- Act fairly
- Open and honest
- Put me in control
- Care about the outcomes

Ability

- Skill
- Competence
- Likeable
- Knowledgeable
- Resourceful
- Capabilities
- Diagnostic capability
- Demonstrate expertise

Behavioural Integrity

- Credibility of communications
- Deliver on promises
- Commitment to standards
- Congruence of word and deed
- Meeting deadlines
- Consistency of interactions
- Keep commitments

Key takeaways

- Integrity and its outcome - trust - are the basis of all relationships.
- It is gained in drops and lost in buckets.
- In these days of cynicism and mistrust, organisational integrity is vital to attract customers.
- Social media and 24-hour news coverage requires extensive risk management - organisations can no longer afford to continue doing things they are not proud of.
- 'Caveat emptor' has been replaced by demonstrably acting in the customer's best interest.

Where to from here?

Insurers require fundamental business model change. This lack of progress stems from a general reluctance on the part of traditional insurers to make fundamental changes in their business models, likely due to the sheer complexity of the task. Indeed, becoming customer-centric requires a new vision, insights, cultures and partnerships that put the customer at the core of the business. For most insurance organisations, this will mean radical change throughout the business and ecosystem.

- Fragmenting customer journeys
  Customers are increasingly 'mixing and matching' as they unbundle and then reconfigure their buying experience to suit their individual needs. Insurers that react to the connected consumer and enable customers to re-bundle in unique and personalised ways are beginning to achieve a market advantage. The leading insurers in our research are those that are connecting their customer in unique and exciting ways by developing a network of ecosystem partners that enable and empower the customer to bundle services and products in ways that suit them best. These organisations realise they cannot do everything themselves, but they can create an integrated environment where consumers can construct seamless journeys using the power of connected digital technology.
- Tomorrow's employees
  The leaders in our research are grappling with advancements in technology, multigenerational workforces and global economics. Engagement of employees requires organisations to get a number of factors right. The environment, the culture, the purpose of the business, the internal communication and guiding how people grow and develop and how they are managed and led all contribute to employee motivation and loyalty.
- Digital focus
  Leading global insurers are elevating the shift to digital channels as a first priority. Any new transformation initiative should be assessed in terms of how it improves the shift to digital and the development of seamless omni-channel experiences. It is vital to ensure that any digital proposition is focused on what the customer actually wants and that it will add value by improving the interaction, rather than just make the service look better. For large insurers, it's essential to resolve legacy infrastructure issues as well as build new digital front-ends.
- Product simplification
  Increasingly, products are being tailored to specific needs, e.g. on-demand insurance, and, in the case of managing commercial risk, being consolidated into fewer products. By drawing on a broader range of insight and data, insurers can provide more bespoke products that meet individual needs. The providers who can simplify and make insurance 'easy' will be the winners in a market that is poised for further disruption.

How we can help

KPMG has a team of experienced professionals that can help insurance organisations generate value by achieving customer excellence. These services include:

Customer Strategy

Using innovative approaches to growth strategy, product development and new business models. KPMG helps clients on their customer and market strategy. Our accredited strategy practitioners help organisations answer the questions such as 'what to aim for' (strategic investment) and 'where to play' (market and brand strategy).

Customer Profitability

KPMG's Customer Profitability team can take the traditional P&L of any business and derive insights into the hidden problems and opportunities. We accomplish this by using our multi-dimensional profitability tool to identify the most profitable combination of customers, products and channels.

Customer Experience

Using the KPMG Customer Experience Excellence Centre that has led this research, we create winning customer experience strategies. This includes customer journey redesign across digital and non-digital channels, customer loyalty and mastering CX economics to maximise customer lifetime value. For many organisations, a good starting place is a maturity assessment where can baseline your current state customer experience and help you to understand where to prioritise investment.

Marketing, Sales and Service Transformation

The KPMG team can help you to digitally enable and transform the effectiveness of your marketing, sales and service functions to create a connected enterprise – integrating front, middle and back office operation – to enable a more agile and responsive business.

Customer-centric Organisation

KPMG's customer team can help you to cohesively mobiles your business around your customers. We do this through operating model optimisation to empower employees to proactively and efficiently serve customers.

Customer Pricing, Analytics and Insights

KPMG's customer analytics solutions and decision engines can help you to understand customer and quantify customer insights. This includes leveraging customer experience insights create more economic value through value-based pricing strategies.

3

SUSTAINABILITY

Reins of Responsibility

Charles Ehrhart Director, Sustainable Value

> Major actors in the insurance sector have already begun working together to better understand and model the impacts of climate change, incorporate climate change into their investment decisions, and take responsibility for their carbon footprint.

Introduction

The UN Intergovernmental Panel on Climate Change (IPCC) released a sobering report in mid-October of this year that details the dramatic effects of climate change under a best-case scenario (1.5°C temperature increase this century), emphasises the severity of impacts under a moderate 2°C scenario, and urges immediate action at an unprecedented scale.

The Earth is currently warming at 0.2°C per decade due to past and current emissions. At this rate, we will exceed 1.5°C of warming by 2040… at latest. A 2°C rise in temperature, the commonly accepted tipping point for a catastrophic cascade of cause-and-effects, is increasingly likely.

Climate change directly impacts sea level and is associated with an increase in both the intensity and frequency of extreme natural events such as storms, floods, hurricanes/typhoons and droughts. As part of the safety net underpinning our global economy – and as some of the world's largest investors – insurance companies, across all lines of business (property, health and life), are on the front line when it comes to helping society mitigate and adapt to the impacts of climate change.

Mitigation

Within the context of climate change, 'mitigation' refers to action that limits the magnitude or rate of long-term warming. Climate change mitigation generally involves reductions in greenhouse gas (especially, but not limited to CO2) emissions. Mitigation can also be achieved by increasing the capacity of carbon sinks (e.g., through reforestation). As part of their social license to operate, insurance companies are increasingly expected to reduce emissions across their operations, supply-chains and investment portfolios. Failure to do so compromises legitimacy and increases exposure to costly litigation.

Adaptation

'Adaptation' means anticipating the adverse effects of climate change, taking appropriate action to avoid or minimise damage, and taking advantage of new opportunities that may arise. Relevant examples of adaptation include staged retreat from rising seas (i.e. reducing exposure to the impacts of climate change), revision of building codes to accommodate the growing intensity of meteorological hazards (i.e. increasing resilience in the built environment), raising dam/dyke levels, and developing drought-resistant crops.

These examples demand a number of pro-active responses from the insurance sector, including:

- *Closer collaboration with insured parties* to better understand and more effectively manage climate related risks to property, health, life and other assets (private as well as public). This poses profound challenges to existing business practices. For example, provisions in most household insurance contracts do not provide for 'betterment'. This means, for instance, that an insurer will repair a home which is at risk of future flooding but will not contribute to relocation or the construction of a new home on a safer site. As a result, risk exposures becomes entrenched and some residents will, eventually, be unable to secure adequate insurance for their properties.
- *Closer collaboration with government authorities* to better understand and more effectively manage systemic risks. This should include more consistent pressure for prudent land use and planning, as well as stronger building codes to level the playing field between insurers.
- *Accelerated innovation* of new products and services that drive positive changes in consumer behaviour (e.g. renewable energy project insurance, green-buildings insurance, and differential pricing that reflects exposure/response to climate-related risks), spread risk across the globe (e.g. through reinsurance), and provide the long-term risk protection (e.g. through catastrophe bonds) that governments need and insurance companies have historically failed to provide.
- *Climate-smart investing* that considers the state of business planning and preparedness for the adverse impacts of climate change, their emissions-related liabilities, compliance risks, litigation risks, supply-chain risks, and the possibility of 'stranded assets.'

Way forward

Major actors in the insurance sector have already begun working together to better understand and model the impacts of climate change, incorporate climate change into their investment decisions, and take responsibility for their carbon footprint. Nonetheless, they (and the sector as a whole) continue to struggle against the inherent short-termism of business decision-making and fall well short of the ambitious, immediate action urged by the IPCC in its latest report.

Extreme weather is already the new norm. Insurance companies should continue serving society by transferring/redistributing climate-related risks. However, they also need to play a central role in helping clients *understand* climate-related risks (e.g. assess the severity, frequency, velocity and interconnectedness of risks), *reduce* climate-related risks (by, for instance, using data to assess property-related risks, differentiate premiums, and encourage low-risk choices), *build* resilience to climate-related risks, and *disclose* climate-related financial risks.

About KPMG Climate Change and Sustainability services

KPMG New Zealand offers a wide range of Climate Change and Sustainability services, including comprehensive emissions management, dynamic adaptation planning, the preparation of climate-related financial disclosures, and integrated reporting.

Dr. Ehrhart leads our climate change team, which is part of KPMG's global network linking more than 500 sustainability experts. Dr. Ehrhart has more than 20 years of experience working within the UN, civil society and the private sector to address climate change and advance sustainable development goals. He has designed and led major climate change projects for AXA, the International Federation of Red Cross and Red Crescent Societies, the UN Office for the Coordination of Humanitarian Affairs, the Danish International Development Agency and the UK Department for International Development.

Optional Case Study

If it's expensive to insure a house in flood-prone areas, people will have an incentive to build elsewhere. If insurers offer a discount for climate-proofing homes, homeowners will be motivated to make that investment. However, for insurers to encourage risk-reducing choices, they must get better at using data.

Imagine a scenario where everyone that lives in the same postcode is charged the same home insurance premium. Given that postcodes can cover a lot of area, this pricing policy can implicitly subsidise people who live in more flood-prone areas at the expense of those living on higher ground.

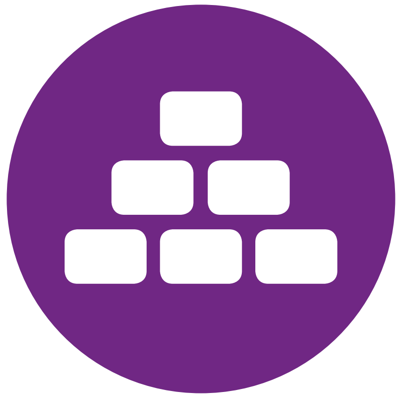
Improvements in geospatial science and the use of artificial intelligence (a service provided by KPMG's Lighthouse centre of excellence in data & analytics) create the possibility of much more precise price discrimination. Aviva Insurance, for instance, is already using detailed topographic data to assess varying flood risks for coastal houses. This can generate a powerful market signal that discourages building in areas that are especially vulnerable to the impacts of climate change and/or encourages homeowners to invest in self-protection.

4

BETTER BUSINESS REPORTING

Pieces to the Puzzle

Ian Jameson Associate Director, Sustainable Value

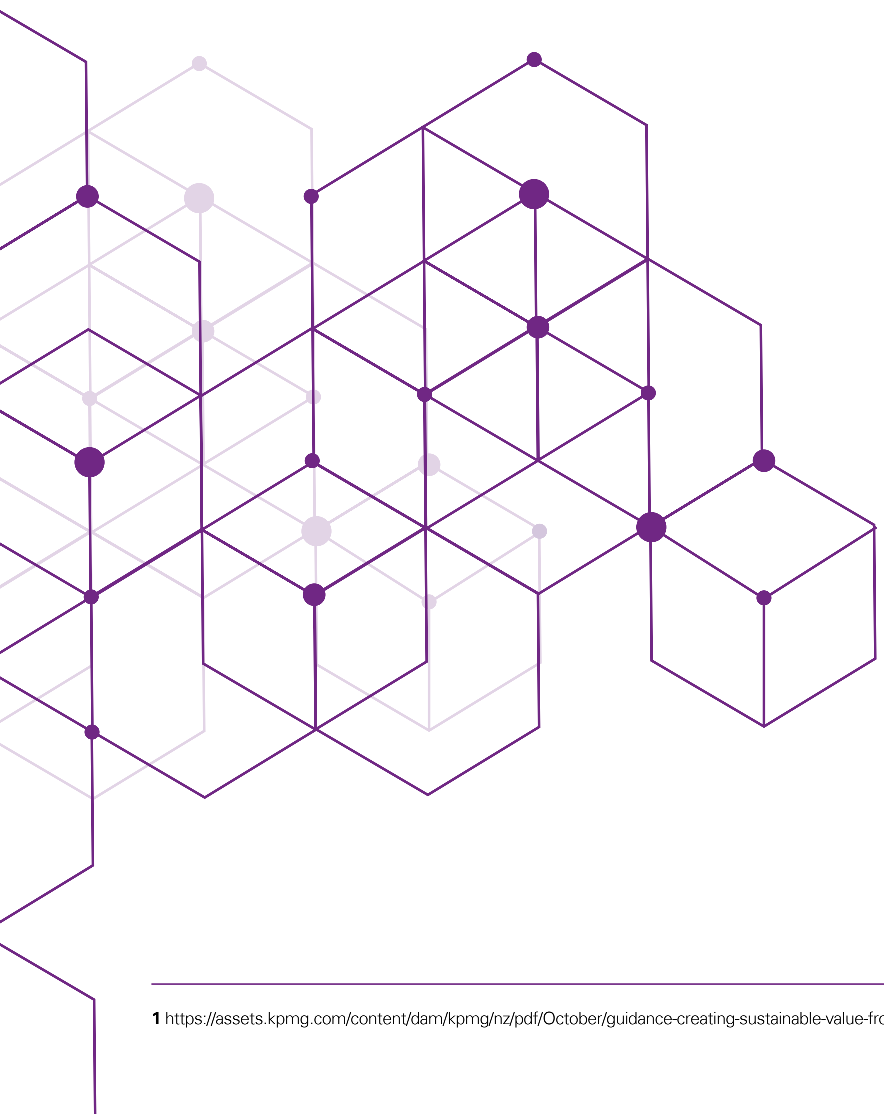


What are the drivers of change?

The transparency and reporting 'expectation-bar' has been raised – investors, regulators, key stakeholders, employees are all demanding a better view of an organisation's purpose, strategy (and how it intends to deliver on this strategy) and what are the outcomes that it seeks to achieve and the related impact to society.

This 'expectation-bar' has manifested in various forms. The NZX code of corporate governance, the FMA guideline (which was modelled on the NZX code), various reporting frameworks (e.g. the International Integrated Reporting <IR> Framework) and standards (Global Reporting Initiative (GRI) – each developed with a common purpose of helping organisations to do better, through reporting and disclosure. This is not a private sector exclusive bar. Government has also taken bold steps to improve its own reporting and disclosure in line with international leading practice. The Living Standards Framework has set the ball rolling to reform reporting within the public sector – using a four capitals approach (aligning with four of the six capitals of the IIRC Framework).

In the context of the insurance industry – it is clear that they are not immune to the fast-paced demands of disruption. It has been reported that employees within the industry have less confidence in management's ability to deal with the most material risks and opportunities (material matters) affecting their own sustainability. This industry is well placed for reporting reform - to communicate their unique value proposition to the market and its key stakeholders.



1 https://assets.kpmg.com/content/dam/kpmg/nz/pdf/October/guidance-creating-sustainable-value-from-good-governance.pdf

> The insurance industry has a role to play, not only through their own reporting and communication to investors and key stakeholders, but they should be seen as a 'leading indicator' of the material matters that organisations need to deal with more broadly.

Reporting with purpose – a strategic response

The need to have clarity and purposeful reporting is evident. The likes of Larry Fink, in his 2018 letter to the worlds business CEOs, confirmed the need for organisations to demonstrate leadership and clarity to not only drive their own investment returns, but also the prosperity and security of their fellow citizens. This implies a broader level of accountability, stewardship and reporting within business – and a greater emphasis on societal purpose.

The insurance industry has a role to play, not only through their own reporting and communication to investors and key stakeholders, but as a 'leading indicator' of the material matters that organisations need to deal with more broadly. The top risks and opportunities currently affecting the industry such as cyber security, technology are echoed across other sectors at varying levels of maturity and the insurance industry should take a firm view and report with purpose in response to these issues.

Understanding Better Business Reporting

Better Business Reporting [integrated reporting] is a term for a holistic approach to understanding and communicating your business value. It is not just about environmental sustainability and good citizenship; it brings real commercial value to your organisation and represents an investor-led step change to move reporting beyond the financials. It is, foremost, a strategic tool for the Board and C-suite, supporting top down integrated thinking and better decision making.

Getting started with Better Business Reporting

The first step is to appreciate that reporting is very much the output of a process and that the organisation must first consider their own strategic response to the most material risks and opportunities (material matters) affecting its ability to create, protect and sustain value. Therefore conducting a proper materiality assessment - as a precursor to developing the organisation's strategy is critical.

Organisations that look to try and shoe-horn their reporting into a pre-defined framework or standard in an effort to 'comply' are often those that struggle to connect with their investors and key stakeholders. We have observed that the leading practice in reporting is when there is alignment of internal reporting (organisation's own 'management reporting') and external reporting – applying better business reporting frameworks like the International Integrated <IR> Reporting Framework. This particular framework allows organisations to own their reporting – tell their unique value creation story to the market. The framework seeks to help organisations inform their own thinking and strategy development process, to the extent that if it is applied correctly, will help unlock value (beyond financial returns) for the organisation.

The following schematic provides a high-level approach to support an organisation in its Better Business Reporting journey:

Step 1

Set yourself up for success

- Establish an executive-led steering committee.
- Confirm your reporting drivers and strategy and obtain leadership (board) buy-in.

Step 2

Understand your reporting maturity

- Benchmark your external reporting against local and global peers.
- Review your current internal reporting practices against the <IR> Framework and other relevant frameworks and standards.
- Develop action plans to address shortcomings.

Step 3

Define and assess your material matters (risks and opportunities)

- Undertake a thorough materiality assessment – those risks and opportunities that can affect the organisation's ability to create, protect and sustain value.
- Link the material matters to the organisation's strategic response (i.e.: Is the strategy responsive to these material matters).
- Integrate the material matters into business management processes (e.g.: Enterprise risk management).

Step 4

Alignment - Engage and report

- Align the organisation's stakeholder engagement (external and internal) in the context of the material matters and the strategic response.
- Align internal reporting processes to support external reporting expectations and leading practice.

Where to from here?

This approach and thinking is fast becoming the norm. The new generation of investors and providers of financial capital need new thinking and reporting – a more holistic approach to understanding risks and opportunities. The insurance sector is uniquely positioned to respond to these developments and will have to embed this thinking to be a catalyst for positive change and also be relevant and viable in the long term.

5

ACCOUNTING & REGULATORY CHANGE

The Open Book

Sean Ferris Senior Manager, Financial Services Audit

In KPMG's 2017 General Insurance Update publication, the article "Are you prepared?" discussed some of the technical accounting impacts of NZ IFRS 17.

This concluded that early planning, performing a gap analysis and assessing your strategy were the key first steps in the transition.

Having been a year since the standard was issued, providing time to digest the technical implications and requirements of the standard and to start considering, planning or commencing the transition, it is timely to take a step back from the detail and consider the wider implications and opportunities of the transition.

Making the most of change

It is widely recognised that a significant amount of time and effort is required to transition to NZ IFRS 17, and it is not just accountants that need to be involved - many aspects of the business will be impacted as part of this change

In December 2017, KPMG Global issued a report *Navigating Change – IFRS 17 & 9 Benchmarking Report* ("Navigating Change"), where 80 global insurers responded to various survey questions on their own transition journeys to IFRS 17. In this, the business areas that these insurers expected to be most impacted by the transition were:

- Product design and pricing
- Costs/cost allocation
- Investment policy
- Risk management

Given the change that is already required in these areas to transition to IFRS 17, it is only logical to consider whether any improvement or transformation changes could be made at the same time. This is exactly what many global insurers are looking at, with 69% of respondents to Navigating Change having plans to explore related opportunities at the same time as implementing IFRS 17. This was especially pronounced in the larger companies that responded.

The top areas that they looked to seize the opportunity to transform were:

- Systems
- Process
- Actuarial
- Finance

Looking at just systems, many insurers will require a significant upgrade or overhaul to capture and report the level of granular information required by the new standard. This includes the need to drill down into the detailed aggregation level of portfolios and more disclosures requiring actuarial input. Given this and the fact that many insurers have large 'legacy' systems, it makes sense that insurers want to make the most of the required change to improve business processes and system functionality, either by upgrading, replacing or amalgamating some of their systems. Given some sources suggest the financial statements will predominately be prepared by the actuarial teams, this further raises the potential benefits for integrating the financial reporting and actuarial systems.

Insurers should also consider the value in all of the new information being captured and reported by these systems as a result of the transition to NZ IFRS 17. Whilst the base purpose for capturing this information is for being able to comply with NZ IFRS 17, this information can provide extremely valuable insights for management. There will likely be a greater level of granularity for analysing profitability of portfolios and products and redesigning KPIs and targets. With improved information, better business decisions can be made - as is commonly said, "knowledge is power".

Other drivers of required change

While NZ IFRS 17 is requiring insurers to challenge their current systems and processes, there are many other changes happening that are impacting the industry that could also drive the need for significant system and process change. These include the overhaul of the Fire & Emergency New Zealand (FENZ) levy, which will likely require large changes to systems, and the Financial Services Legislation Amendment Bill. The deadline for projects relating to these changes will be staggered over the next few years, but insurers should look to ensuring that their response to each of these changes are co-ordinated and complimentary, as there could be significant savings in aligning the projects from the outset.

Conduct is also front and centre of directors and senior management of insurers in light of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Banking Commission) in Australia and the response by the RBNZ and FMA locally. Good conduct requires that insurers put the customer and their needs at the heart of decisions made and the organisation as a whole, and to do this requires understanding the customers' needs. One aspect of this will be to capture and analyse customer data to more effectively understand the needs of individual customers, identify changes in these needs over time, and identify any potential conduct issues. As such, insurers should take the time to look at what data they can capture and analyse to help make better decisions for the customer at the same time as looking what data is needed to comply with regulatory change.

> Looking at just systems, many insurers will require a significant upgrade or overhaul to capture and report the level of granular information required by the new standard.

Constraints to maximising the impact of change

However, with the large amount of change already required to transition to NZ IFRS 17, time, capacity and budget constraints may limit the opportunity to make the most of the change that is already happening.

There are clear indications many insurers are worried about even having enough resources to make just the required changes, with 80% of respondents to the 2018 KPMG CEO Outlook Survey concerned about getting enough of the right people for the transition, and 60% worried about securing the necessary budget.

This concern about securing the necessary budget is reinforced by findings in the *KPMG CEO Outlook 2018 New Zealand Survey* (KPMG NZ CEO Survey), where the purse strings appeared tight for transformation projects, with over 75% of NZ CEOs surveyed believing that their boards have unreasonable expectations of the return on investment from transformation. Interestingly, only 8% of the NZ CEOs surveyed viewed 'talent' as one of their top three overall risks for their businesses.

The trend for these transition projects appears to be that the main concern at the start of the project planning is securing the required budget needed, but once the scope of the transition project and the extent and complexity of change required is realised, the main concern quickly shifts to getting enough of the right people to get the project done on time. Project lead times in general appeared to be a general concern amongst NZ CEOs, with 96% of NZ CEOs surveyed as part of the KPMG NZ CEO Survey saw project lead times in their businesses as "overwhelming".

There are clear indications many insurers are worried about even having enough resources to make just the required changes, with 80% of respondents to the 2018 KPMG CEO Outlook Survey concerned about getting enough of the right people for the transition, and 60% worried about securing the necessary budget.

Are you prepared to make the most of change?

Let's say:

- You work out how to make the most of the changes required for the new standard, allowing you to radically transform the operating model of the business;
- You secure the budget required for the transformation; and
- You recruit the right people on the ground to implement the change.

Are you ready to lead this transformation?

Only 58% of NZ CEO's surveyed in the KPMG NZ CEO Survey were personally prepared to lead their organisation through a radical transformation of its operating model, and only 67% believed they had the right leadership to oversee transformation.

So whilst there may be great aspirations for transformative change to be made with the transition to NZ IFRS 17, insurers should make sure they have the right people at the top who are prepared and capable to execute this transformation successfully.

Where do you start?

Every big change or transformation starts with a first step, and if you haven't made this first step yet, now is this time.

Getting the right people together to critically think about how you can make the most of this change is important. The right people includes ensuring you get people from across the business, as discussed earlier this is not just an accounting change.

If you have already started on the transition journey, it is taking the time to look at the bigger picture and seeing whether the project is appropriately scoped to take full advantage of the large investment being made for the wider business, and ensuring the business is well placed for the future.

6

AUSTRALIAN ROYAL COMMISSION

Fronting up to the Question

Ceri Horwill Partner, Head of Financial and Regulatory Risk Management

Introduction

The Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Commission) concluded its sixth round of hearings at the end of September, during which the Commission conducted two weeks of rigorous analysis of Life and General Insurance in Australia. The Commissioner has taken a rigorous approach to the inquiry by examining a series of case studies which have highlighted systemic issues in the Industry. On the back of misconduct examined during the hearings, both alleged and admitted, Commissioner Hayne has not hesitated to criticise the Australian Financial Services Entities in the strongest terms. Although the work of the Commission has largely focused on Banking and Superannuation, the themes (Fig.1) from the previous rounds of hearings were reflected in the insurance case studies as well. This article seeks to take a simplified model of the insurance lifecycle (Fig. 2) and explore these themes in light of the various stages of this model, and case studies drawn from the Commission's inquiry.

Strategic

Insurance is sold through a wide variety of channels. Depending on the product, an insurer may be dealing with employees, agents and third parties, all of whom sell in different ways, and to customers with different needs. In Australia the insurer, as the holder of the licence, is responsible for the compliance of the people and entities who sell products on its behalf. This responsibility is non-delegable; the insurer cannot just contract with a third party to be responsible for its own compliance. If a third party is non-compliant, the responsibility will always come home to the licence holder (the insurer). This principle holds in New Zealand.

The Commission highlighted that some insurers were not meeting these responsibilities. In one example, an insurer's oversight of an authorised third party was limited to a training session, and an electronic questionnaire from time to time. The Commission rightly noted that while training tells the salesperson what they should say, it does not tell the insurer what they are actually saying. The Commission ultimately found that the reason for the insurer's failure to properly monitor its agents was a lack of compliance and quality assurance resourcing. In the commission's view, the Insurer did not value compliance as a core aspect of its business, and was not willing to invest in that function. The case of an insurer that identified its web content as a compliance risk also showed a similar absence of prioritisation for compliance.

1 Commissioner Hayne, Interim Report, Volume 1, page 302.
2 Commissioner Hayne, Interim Report, Volume 1, Page 303.
3 Commissioner Hayne, Interim Report, Volume 1, page 91.

When quoted AUD$30,000 by a law firm to investigate the risk, the insurer chose to use internal resources. As a consequence, a task that could have been completed in a month took close to two years. As a result, thousands of customers were potentially misled about their insurance cover.

> *"Often enough a large part of the short term incentive payment has been payable if the employee has performed satisfactorily… for an employee doing what the employee is employed to do"*[1]

The Commission found that compliance functions have been under resourced across the insurance, banking and the wider Financial Services industries. Work programmes were reactive, dealing with issues as they arose. Rarely did they have the capacity to proactively manage emerging risks. The Commission has been sharply critical of entities that saw compliance as a cost of business, to be minimised like any other cost, rather than a foundational tenet of their approach to ensuring good customer outcomes.

Core Product

Investing in compliance on its own is not enough. This is particularly true for the core aspects of an insurer's business such as sales and claims. The Commission repeatedly showed the challenges of managing compliance results and managing employees who failed their Quality Assurance controls. For sales staff whose remuneration included a variable component, this was generally paid when the sales agents met certain threshold requirements – either for sales, or a combination of sales and quality. Sales agents with no quality requirements were effectively given free rein to use whatever sales tactics they wanted, in order to maximise their commission. This led to some of the worst excesses of the sales culture examined during the hearings. However, when quality requirements were introduced, to encourage good behaviour and compliance, customer outcomes did not necessarily improve. In the Commission's view these requirements introduced a number of new risks. Firstly there was the risk that when a sales agent lost income because they did not meet quality requirements, they would increase their hard selling tactics to make up for the loss of income. The second risk was that they would focus as much on hiding their misconduct, as on avoiding misconduct itself. These were both particularly true when the agents were aware that the function responsible for Quality Assurance was under resourced.

> *"Management by measurement assumes, wrongly, that measurement can capture all that matters in dealings between [staff] and customer. It cannot and does not."*[2]

With the work of the Commission still ongoing, particular attention has been paid in the Interim Report to the ways in which employees are paid variable remuneration. The Commission builds on the work of the Sedgwick Review into remuneration in the banking industry. This review highlighted a need to eliminate incentives solely or directly related to sales, and reducing the influence of sales in performance scorecards. But even these 'balanced scorecards' can create incentives misaligned with good customer outcomes. Scorecards might reflect a range of metrics, including financial targets, 'customer needs', reputation, and risk & compliance, but the commission found that these metrics were often sales targets by another name.

'Customer needs' was one metric examined by the Commission that rewarded employees for actioning leads (which feed into the sales pipeline), signing the customer up for a digital solution (to reduce costs), and having a 'needs based conversation' (to provide an opportunity for cross-sales). Although these metrics are not explicit financial targets, profits lie at the heart of their purpose. Similarly the Commission examined the scorecards of Claims Managers and found that in some cases, up to 50% of the Key Performance Indicators (KPIs) had a profit motive. KPIs referenced 'claims management' or 'claims closing' but the Commission carefully uncovered that these metrics were pegged to financial targets. The KPIs were framed as measuring, and rewarding customer outcomes, when in reality they were incentivising better commercial outcomes. These concerns cut across the Insurance Product Lifecycle.

> *"Experience shows that conflicts cannot be 'managed' by saying 'Be good. Do the right thing'. People rapidly persuade themselves that that what suits them is what is right"*[3]

Even where frontline and claims are not given explicit or implicit financial targets, the targets of their managers may affect their conduct, and the culture of the team. If a manager's remuneration is dependent on financial targets, then those managers will encourage and reward profit seeking behaviours in the people they manage.

Support

A common refrain from the witnesses during the hearings was that the misconduct was attributable to a few bad apples in the company. Given the extent of similar misconduct, both within entities, and across the FS industry, the Commissioner did not find this claim credible. Instead, he has underscored the importance of looking to the root causes of the misconduct – systems, processes, and most importantly, culture. When an entity conducts its internal analysis of misconduct, it needs to be able to look past the narrative of 'a few bad apples', even where this represents its own communications strategy, to these root causes if it wants to affect real change.

Law and regulation is only one half of the equation when it comes to effectively managing conduct risk. These rules affect, and are affected by, the culture and governance of an organisation. The Commissioner has stated that all the conduct identified and criticised in the interim report was conduct that provided a financial benefit to those concerned. He found that the governance and risk management practices of the entities, even where they were well designed on paper, did not prevent the misconduct examined by the Commission.

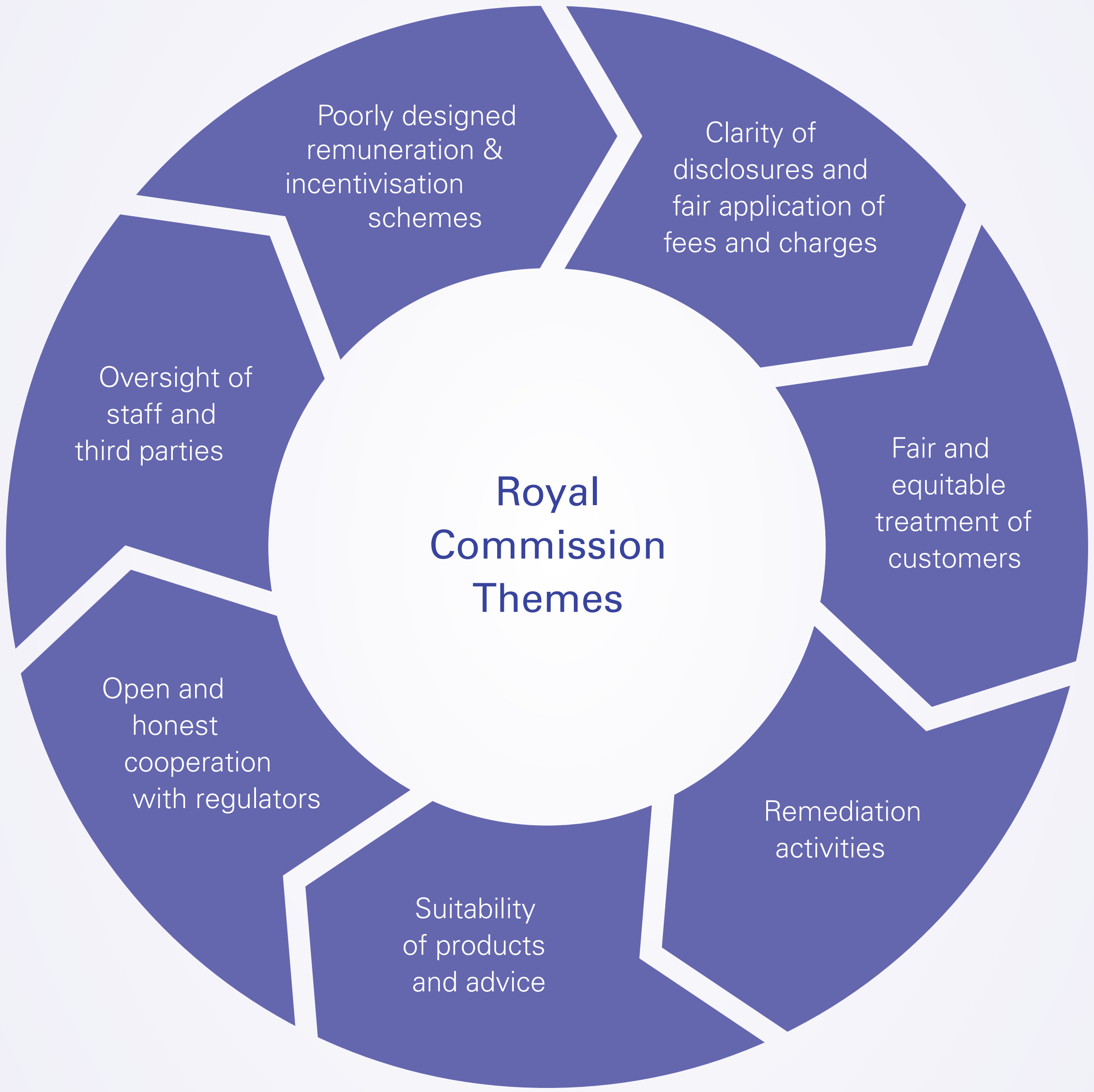
Systems and processes rely on people; people applying the right standards and, ultimately, people doing their jobs properly. Across the case studies, the Commission consistently found that remuneration and incentives were the primary driver of company culture. Where the remuneration of employees or their managers was, at least in part, determined by financial targets, these employees generally conducted themselves in a way that maximised that income.

Conclusion

Early on in the hearings, the Commissioner spoke of the two 'poles' that lie at the heart of the Commission's inquiry: 'commercial outcomes' and 'consumer outcomes'. An insurer is a commercial enterprise and it exists to make profits and the Commission was clear that this is not a fact to lose sight of; neither commercial, nor consumer outcomes should necessarily be preferred over the other. However, the Commissioner suggested that, when making strategic and business decisions, there is a need to have a clear explanation for why one pole was preferred in that particular circumstance. This explanation will acknowledge the business's decision to prefer commercial or consumer outcomes in each case. This would suggest it is not enough to simply frame a decision with reference to consumer or commercial outcomes, the true effects must be considered. An honest assessment of the effects of a decision allows an entity to properly identify both risks and responsibilities. The Commissioner's challenge to the Financial Services Industry of Australia is to front up to this question.

The New Zealand Government, Parliament and the Regulators will all be paying close attention to the results of the Commission. The final recommendations of the Commission are yet to be released, however, Commissioner Hayne has not held back on his criticism. Already, Parliament's Finance and Expenditure Select Committee has held a briefing, with submissions from RBNZ and the FMA, as well as the New Zealand Bankers Association, Consumer Advocacy Groups and Union representatives. Although for now there does not seem to be the same appetite for an inquiry this side of the Tasman, the missteps of the Australian Industry provide an opportunity for New Zealand to revaluate conduct and culture and strengthen the reputation of the industry by being seen to work proactively to ensure good customer outcomes.

Royal Commission Themes (Fig. 1)



Simplified Insurance Product Lifecycle (Fig. 2)

Developing strategy and business planning

Developing products | Managing Distribution Channels

New Business | Servicing policies | Handling Claims

Managing risk and preventing losses

Managing Change | Managing Quality | Managing Comms.

Managing Governance & Compliance

Strategic

Developing Products

The insurer recognised that customers ran the risk of under insurance because they struggled to appropriately judge the value of their house. The insurer offered a Complete Replacement Cover solution that they promoted as a product that would replace a house, no matter the cost. The insurer's preference to cash settle, instead of rebuilding led to a misalignment between customer expectations, established by marketing, and outcomes.

Distribution Channels

An insurer treated the car-dealers that comprised its primary distribution channel as its true customers. The needs of the policyholders, to whom the products were sold, were treated as secondary to the needs of the dealers. Insurers locked in their market share by offering high commissions to dealers – sometimes in excess of the statutory caps.

Core Product

New Business

A life insurance sales agent had his commission cut by his employer for failure to meet the required Quality Assurance standard. The agent's manager then counselled him to increase his sales to make up for the lost income, which lead to the agent using pressure selling techniques.

Handling Claims

An insurer wanted to cash-settle quickly for $30,000 with a policy holder for damage to their house following a large storm. The policyholder was unsatisfied with te rushed work of the insurer's contractor who inspected the property, and they commissioned their own report. Delays by the insurer over two years in managing the claim left the family in a house that was unsafe. After the policyholder received legal aid and complained, FOS* decided in favour of the policyholder for $744,000 including $48,000 in interest.

Support

Managing Communications

ASIC fined one insurer for their misleading marketing materials identified on their website. The insurer knew the information had been online for several months, but did not take the site down because doing so would have impacted sales.

Managing Governance & Compliance

A difficult claim had been raised with the Internal Dispute Resolution (IDR) Service and FOS*. The Senior Dispute Resolution Officer provided thoughtful and considered advice that engaged with the customer's concerns, and the terms of their policy. The IDR Officer's advice was not accepted, and no explanation was given for why the advice was ignored. This lead to poor outcomes for the policyholder, and ultimately an unfavourable decision from FOS.

*Financial Ombudsman Service

7

CYBER SECURITY

Translating Technology to Trust

Philip Whitmore Partner, Head of Cyber Security

More than three quarters of insurance CEOs see cyber security as more of an opportunity than a threat. The obvious opportunity, cyber insurance, is becoming a booming business for many insurers with steadily climbing revenues. Similarly, insurers are exploring how they can extend their capabilities into emerging areas such as protecting the connected home, automated vehicles and personal information.

Besides creating new revenue streams, cyber security is critical to the existing business. Indeed, many insurers are digitising their enterprise and creating new front-end platforms to get closer to their customers - that requires a keen focus on delivering really strong cyber security. If you can't offer your customer a secure digital experience, you probably won't keep your customers.

Are insurers ready yet?

It is somewhat worrying that, according to KPMG's recent survey of insurance CEOs, 57% of insurers are only `somewhat' prepared for a cyber event. Only 26% said cyber security is one of their `top of mind' risks, and just 28% will `significantly increase' investment into cyber security in the next three years.

> If you can't offer your customer a secure digital experience, you probably won't keep your customers.

Yet it is apparent that some insurance companies have already had an unexpected wakeup call - some have suffered their own breaches, and some have learned from the negative experience of others and want to avoid a similar fate. Most recognise that, if they don't improve on their own, regulators may do it for them.

With a new Privacy Act on the horizon for New Zealand, which will include the introduction of mandatory reporting for privacy breaches, robust cyber security has become an imperative. The brand and reputation that has taken years to establish could be destroyed in a nanosecond.

Not an easy task for insurers

There is no denying that many traditional insurers that come from a classic paper-based business model face an uphill battle when it comes to cyber security. They are working in difficult IT environment, often with legacy systems. Nonetheless, they know it will take significant work to remediate their past issues, and even more work to create the right long-term programs to properly protect their business from the ever-evolving and growth risk. Many are now starting to make significant progress on their journey to cyber readiness.

Time for action for insurers

Our work with insurance organisations suggests that there are a number of actions that insurers should be taking if they hope to survive and thrive in the new environment:

1. **Improve the understanding and awareness of cyber risk at the executive and board level.**

   This requires boards and executives to work closely with their 'three lines of defence' to improve awareness and understanding, and it also requires them to have regular discussions and debates on the topic rather than simply waiting until an issue arises or a regulator asks questions.

2. **Prepare for the likely eventuality that they will suffer a debilitating attack.**

   Boards and executive teams should be running regular exercises that simulate a cyber-attack and think carefully about how they will react and respond. Conducting these exercises in a safe and controlled environment will allow decision-makers to move quickly and decisively when an attack does occur.

3. **Work closely with the business to identify and assess the risks, goals and solutions for cyber security.**

   Those responsible for cyber security within the organisation need to help the business identify which programs and platforms are critical to business operations and understand the vulnerabilities of each. They need to have conversations around what needs to be done, at what cost, to secure those systems without reducing business flexibility.

The journey of a thousand miles begins with one step

There are no quick fixes or silver bullets to becoming cyber defensible. The journey will take time, resources and patience, and it will require boards and executives to have awareness to be able to challenge the decisions made by the business, and it will require the business to be in the 'lead'.

We must also remember that the opportunities created through a strong cyber position and robust controls are massive and vital to future growth.

We believe that the most successful organisations going forward will be the ones that are able to create a smart balance between corporate opportunity and operational risk; to protect their reputations and grow their business and to build trust with clients and regulators - they will be the ones that are best positioned to seize new market opportunities.

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Jamie is a financial services partner and head of our Insurance practice at KPMG New Zealand. Jamie has significant experience in the financial services sector and a proven track record of working with New Zealand insurers, banks and other financial institutions. Jamie has relationships across the sector, with market participants, industry groups and local regulators. Jamie also leads our Corporate Citizenship programme, and is responsible for the work KPMG does in the community, including community partnerships, pro bono work, and team volunteering.

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Baxter leads the Customer Experience Advisory team for KPMG New Zealand. Originally from the United States, Baxter's international experience focuses on advising clients on a range of customer issues across the 'front office'. His specialty is in helping organisations to gain insight into how customers feel, what they expect and what they want in the future to drive top and bottom line growth.

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Nick is a director in our Financial Services audit team. He has worked with the insurance industry for more than 12 years. In addition to working with a wide range of both general and life insurers in New Zealand, he has worked on Solvency II implementation projects in Ireland and with the industry in Mongolia to help develop insurance knowledge – primarily around the accounting for insurance contracts. Nick has been involved in presenting training to general insurers on NZ IFRS 17 – the new insurance contracts accounting standard.

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Philip is a partner of the IT Advisory team. Philip leads KPMG's Cyber Security and Technology Risk practices in New Zealand. Philip has talked the same language as both IT specialists and non-IT management, and has the ability to relate technical risks into a pragmatic business context. Philip has very in-depth and practical IT security experience across a broad range of subject matters, with particular specialism in penetration testing, incident response, security risk management, security governance, privacy risk management, computer forensics, security frameworks and policy, security architecture and IT assurance.

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Ian Jameson is an Associate Director in KPMG's Sustainable Value practice and specialises in better business reporting solutions. He has worked in Corporate reporting for more than 10 years, both in corporate and consulting. Ian was previously the programme lead for the Corporate Reporting Dialogue, an initiative convened by the International Integrated Reporting Council (IIRC) designed to respond to market calls for greater coherence, consistency and comparability between corporate reporting frameworks , standards and related requirements.

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Ceri is a partner of the Financial Risk Management team. Ceri leads KPMG's financial and regulatory risk management practice in New Zealand, a team that provides regulatory, risk, treasury, accounting and compliance advice for financial services clients and businesses facing financial risk and regulatory change. Ceri specialises in financial services risk advisory work, financial services regulation and accounting for financial products, which has given her an excellent understanding of the New Zealand financial services sector and how financial services businesses work. She often reports to or on behalf of regulators, including the FMA and the RBNZ.

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Director, Sustainable Value

Charles is a director in our Sustainable Value team, where he is responsible for leading the development of KPMG New Zealand's climate change and sustainability (CC&S) service-line; managing key engagements (especially complex cross-border and multi-disciplinary projects); and contributing to CC&S thought-leadership across KPMG's global network. Dr. Ehrhart has more than 20 years of experience working within the UN, civil society and the private sector to address climate change and advance sustainable development goals. He has designed and led major climate change projects for clients including AXA, the International Federation of Red Cross and Red Crescent Societies, the UN Office for the Coordination of Humanitarian Affairs, the Danish International Development Agency and the UK Department for International Development.

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Sean is a senior manager in our Financial Services audit team. He has over 7 years' experience working with the general insurance industry with a number of insurers, managing the audits of some of New Zealand's largest general insurers. Sean also has experience in the banking, finance and investment management sectors. Recently, Sean has begun working with an insurer to map out their NZ IFRS 17 transition plan.

Our thought leadership

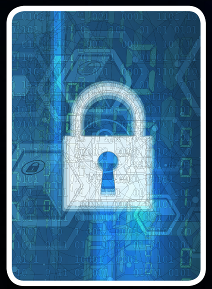
To view full report, please click on the thought leadership images.

2018 New Zealand CEO Outlook

Navigating the future.
Discover insights from 50 of New Zealand's leading CEOs.

Tomorrow's experience, today.

2018 KPMG New Zealand Customer Experience Excellence Report.
Our inaugural report reveals what New Zealand consumers value most from their favourite brands.

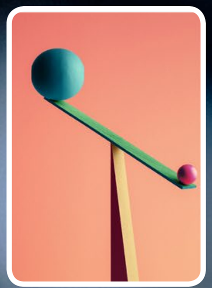


Lead in cyber insurance

How insurers can raise awareness and uptake for cyber insurance to support their customers. Growing need for cyber protection create significant opportunity for insurers to proactively raise cyber insurance uptake and build customer trust.

Creating the workforce of the future

Transforming insurers require a skilled workforce of the future.

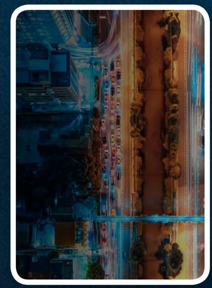


The search for balance

Insurers are balancing cost against growth and risk against opportunity.

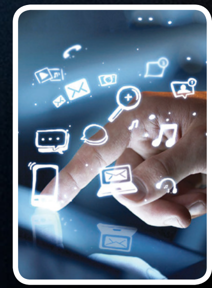
Technology infrastructure for insurers

How insurers can establish a sustainable, nimble and connected digital infrastructure.



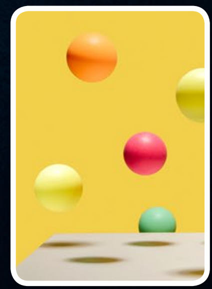
Revenue acceleration for digital leaders

Many organisations are struggling to turn digital strategies into a reality but three key factors are helping 'digital leaders' stay ahead of the pack.



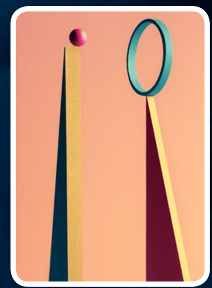
FIPS: June Quarterly 2018

KPMG's Financial Institution Performance Survey (FIPS) quarterly analysis highlights results from the New Zealand banking sector for the quarter ending June 2018.



Accelerating the transformation

Insurance CEOs need to identify and overcome barriers to transformation.



Getting value from partnerships

Partnerships are key to achieving growth and transformation for insurers.

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