General Insurance Update 2019

November 2019

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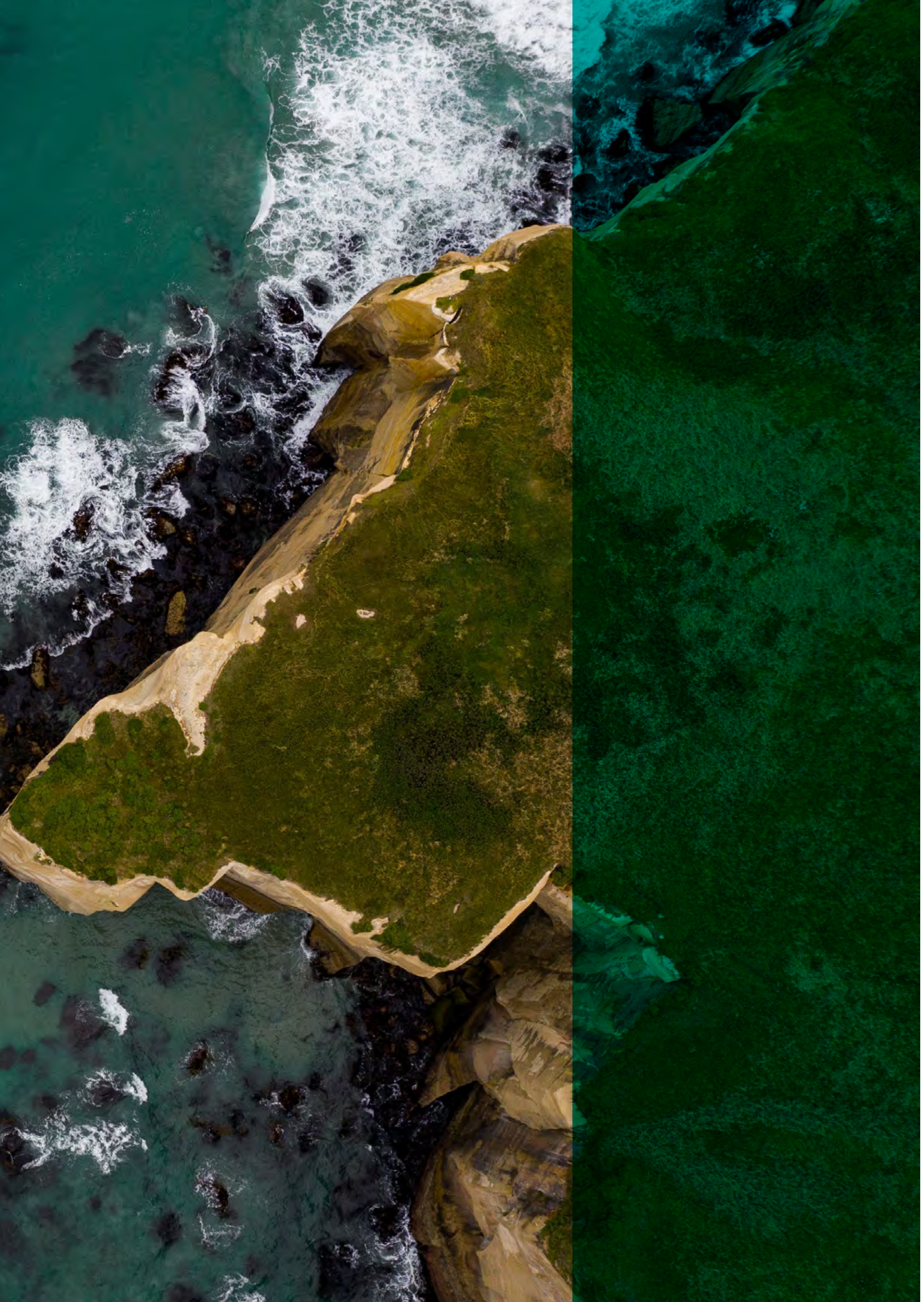

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Foreword

Jamie Munro Financial Services Partner, Head of Insurance

For New Zealand's economy to prosper, insurers must adopt agile operating models to build resilience, and continue to evolve to respond to changing customer needs, community expectations, technology advances and regulatory demands.

This edition of our annual General Insurance Update highlights industry views and provides commentary around trends, challenges and opportunities influencing the New Zealand insurance industry. Contributors to this edition have focused on themes of sustainability and resilience, customer and conduct, and legislative, regulatory and accounting change.

The release of this year's publication also marks the inaugural launch of our KPMG General Insurance Insights Dashboard, which brings to life key financial information from general insurers' filed financial statements in a publicly-available online interactive dashboard.

Our Insights Dashboard includes the financial position and results up to 30 June 2019 of all New Zealand general insurers and contains a range of interactive charts and graphs presenting key industry metrics for the past five years. It enables the data to be filtered to view the metrics for a particular year or insurer, and provides comparison of metrics for an individual insurer to others in the market. On page 8 we provide a snapshot of the Insights Dashboard and profile the sector result to 30 June 2019.

On page 12, Nick Moss draws out the themes from our latest KPMG Global CEO Outlook Survey. Particular focus is provided on the views of insurance sector leaders internationally, and local perspectives from New Zealand CEOs.

Although the competitive landscape is shifting, CEOs are confident in business growth over the next three years. There is widespread recognition that organisations must change from within, embrace culture change, technology transformation and greater customer focus.

Disrupting themselves and the marketplace is top of mind among insurance industry CEOs, while they strive to instil organisation-wide innovation and make the most effective technology and workforce investments. These leaders feel the need to upgrade their own skills as they try to overcome an internal 'innovation disconnect,' forge strong external partnerships, and embed the agility and resiliency to develop holistic, flexible strategies for new opportunities and threats in an uncertain future.

As concluded by Laura Hay, KPMG's Global Head of Insurance "To become the resilient insurer for the future, organisations must adopt agile operating models and complementary technology and data capabilities, increase partnerships to spark greater innovation, and embrace new ways of collaboration and automation to build the required digital workforce. Our survey findings suggest that, despite the many challenges, insurance CEOs are eager to tackle these opportunities."

Arguably, front and centre in this changing landscape is the heightened regulator and public focus on conduct and culture. We've previously explored findings from the 2018 Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, and the thematic reviews of New Zealand banks and life insurers, which were jointly conducted by the Reserve Bank of New Zealand (RBNZ) and Financial Markets Authority (FMA).

Those regulatory reviews identified significant weaknesses in the governance and management of conduct risks. In its 2019 annual report, the FMA admonished life insurers for being too complacent around risk and highlighted practices that were 'materially worse' than those in the banking sector. And more recently, a new regime to regulate financial conduct has been announced for banks, insurers and non-bank deposit takers regarding their general conduct.

This year, regulators requested that our general insurers were complete an internal review of conduct and culture. On page 18, James Brownell, our Insurance Conduct Lead, focuses on the challenges and lessons learned so far, the questions that organisations should be asking to ensure they have done enough to address regulators concerns, and the future outlook for the general insurance market, including how conduct and culture should be integrated into insurers' strategies going forward

An unprecedented level of legislative and regulatory reform is also abound.

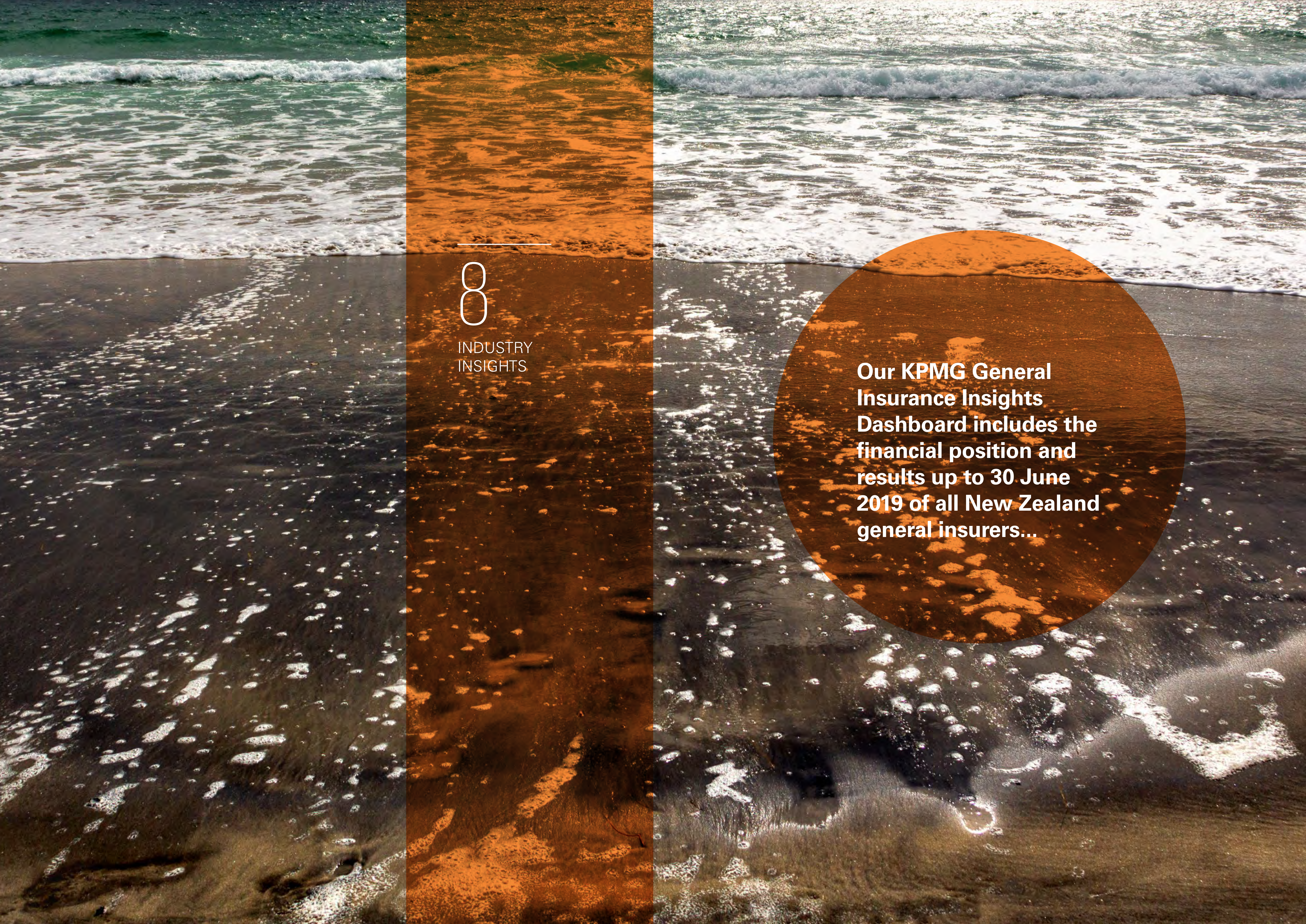
A new conduct regime will be before Parliament by Christmas. A Bill to revise and consolidate New Zealand's insurance contract law will be fast on its heels. A review of the Insurance Prudential Supervision Act start shortly. No aspect of insurance will escape change. But how well co-ordinated will these changes be?

On page 24, we hear from Insurance Council of New Zealand CEO, Tim Grafton, on the key features of regulatory and legislative change from an industry perspective.

There is change too, on the accounting front. The long anticipated insurance accounting standard – IFRS 17 Insurance Contracts – which was published in 2017, reflects a wholesale change in the accounting for insurance contracts. That standard is getting tuned up by standards setters, with the aim of supporting implementation and addressing challenges raised by insurers. An exposure draft has put forward a number of key amendments to the accounting standard and is expected be finalised in mid-2020. We summarise the amendments in our article from KPMG director, Ann Au, on page 28.

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. Niels Chlupka, a leader in our KPMG Sustainable Value team, discusses climate change, insurance perspectives, and what can be done to mitigate, adapt and meet the challenge in our final article, on page 34.

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.



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INDUSTRY
INSIGHTS

Our KPMG General Insurance Insights Dashboard includes the financial position and results up to 30 June 2019 of all New Zealand general insurers...

Industry insights: 2019 Results and analysis

KPMG's 2019 New Zealand General Insurance Insights Dashboard contains a range of interactive dashboards, available online, that bring to life key financial information for the past five years from general insurers' filed financial statements.

Our Insights Dashboard includes the financial position and results up to 30 June 2019.

You can access the General Insurance Insights Dashboard below:

General Insurance Insights Dashboard

The highlights

Overall, 2018/19 has been a very positive year for the general insurance market. Insurance profit has grown by $488 million from $1,589 million in 2017/18 to $2,077 million in 2018/19. This has been driven by a combination of strong gross written premium ("GWP") growth and positive claims experience.

Results and analysis

Across the general insurance market, GWP has increased 9% from $6,388 million in 2017/18 to $6,959 million in 2018/19. This strong growth stems primarily from premium rate increases initiated in 2018, earning through in the 2019 financial results. Rates are now levelling off as we head into 2020.

Whilst this strong GWP growth is seen across the market, some of the largest contributors are IAG New Zealand ($140 million increase from $2,696 million in 2017/18 to $2,836 million in 2018/19); Vero Insurance ($67 million increase from $1,047 million in 2017/18 to $1,114 million in 2018/19); and Hollard Insurance ($61 million increase from $41 million in 2017/18 to $102 million in 2018/19).

Compared to GWP growth, net earned premium has increased only 8% from $4,145 million in 2017/18 to $4,474 million in 2018/19. This reflects the increasing cost of reinsurance to New Zealand insurers.

Net claims expense has decreased 6% from $2,561 million in 2017/18 to $2,403 million in 2018/19, with a relatively benign year for weather and little in the way of natural perils.

This has been a welcome experience after a number of years of severe weather events and natural disasters. Insurance Council of New Zealand data shows just four natural disaster events in the June 2019 year at a total cost of $14.7 million. There were nine events at a total cost of $263.4 million in the June 2018 year. Excluding the estimated $2.12 billion cost of the Kaikōura quake, the 10 other natural events in the June 2017 year cost the industry $213.7 million. Whilst we would all welcome the benign weather and lack of natural events of 2019 to continue, trends in recent years suggest 2019 was a favourable year, rather a return to normal.

As a result of strong GWP and positive claims experience, we have seen an improvement in loss ratios, with a market average of 54% in 2018/19.

Result announcements from some of the large insurers indicate that the 2018/19 profits will contribute to the significant and necessary investment in products and services, including digital platform offerings, in order to respond to changing customer needs.

2019 results snapshot

Gross written premium

$6,959m	2018/19
$6,388m	2017/18
$5,984m	2016/17

Insurance profit

$2,077m	2018/19
$1,589m	2017/18
$1,339m	2016/17

Loss ratio

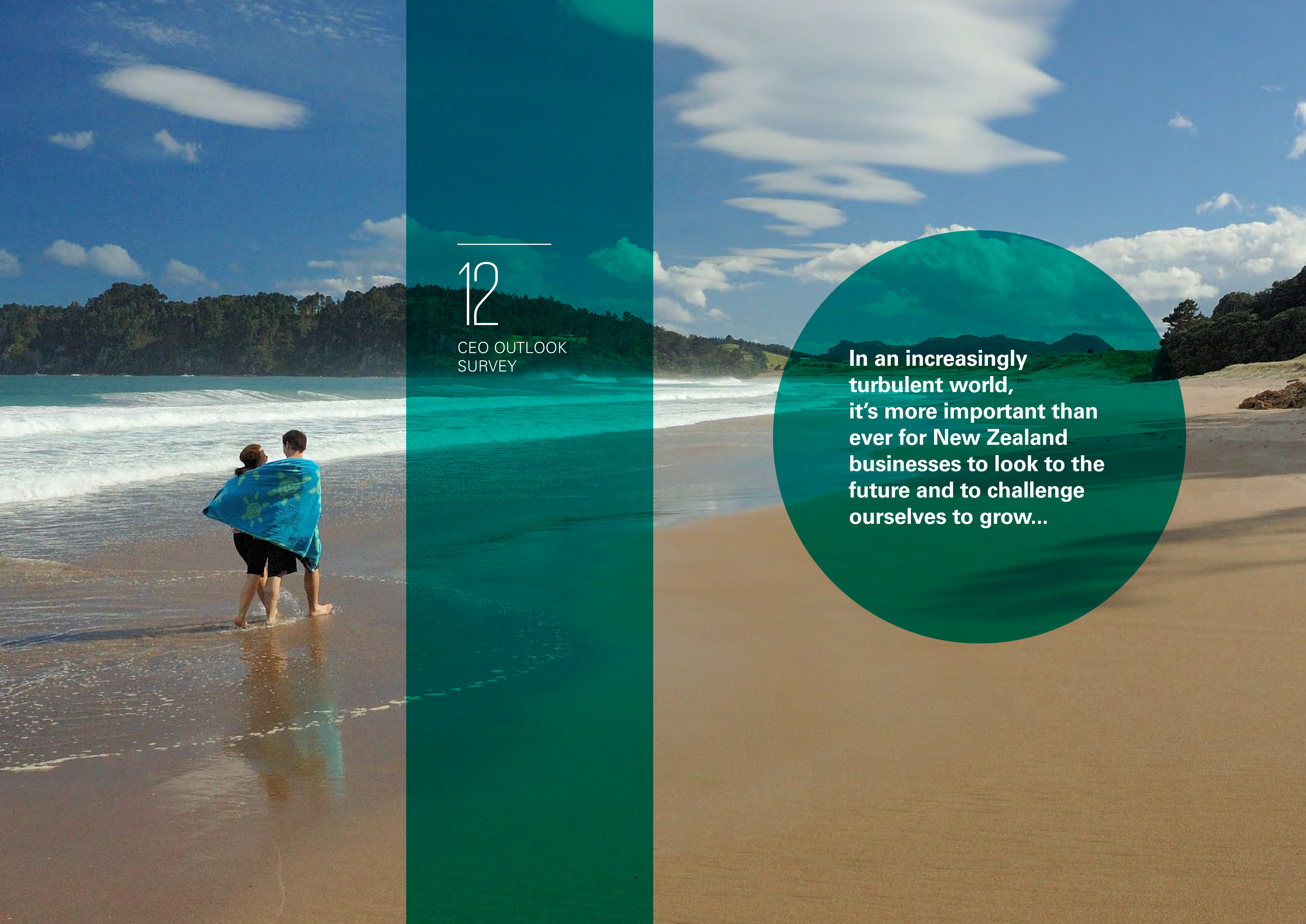
54%	2018/19
62%	2017/18
67%	2016/17

Net incurred claims

$2,403m	2018/19
$2,561m	2017/18
$2,690m	2016/17

Net earned premium

$4,481m	2018/19
$4,150m	2017/18
$4,029m	2016/17



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CEO OUTLOOK SURVEY

In an increasingly turbulent world, it's more important than ever for New Zealand businesses to look to the future and to challenge ourselves to grow...

CEO Outlook Survey: Confidence from resilience

Nick Moss Director, Insurance, KPMG New Zealand

"We've seen CEOs' optimism rise in tandem with their considerable work to increase resilience. Their confidence has gone up as they take action and they know their activities are going to pay off."

– Laura Hay, Global Head of Insurance at KPMG

In KPMG's fifth annual Global CEO Outlook survey, we spoke to 1,300 CEOs, including 50 New Zealand CEOs, to discuss how they are confronting long-held market beliefs and assumptions that govern decision-making. The CEOs operate in 11 key industries including insurance.

It's clear from our discussions that insurance CEOs are confident in business growth over the next 3 years, despite a widespread recognition that they must change from within, embrace culture change, technology transformation and greater customer focus.

Confidence amid uncertainty

"In an increasingly turbulent world, it's more important than ever for New Zealand businesses to look to the future and to challenge ourselves to grow. A growth mind-set is essential. Without it, we don't create opportunities, embrace change and contribute to New Zealand's prosperity." – Godfrey Boyce, KPMG New Zealand Chief Executive

Our survey shows some heartening results. New Zealand CEOs are confident in the growth prospects for their organisation and industry (almost 90 percent of CEOs) and country (78 percent of CEOs). You can access the 2019 New Zealand CEO Outlook **here.**

Global insurance CEOs are equally confident in their growth prospects. 85 percent are highly confident in the growth of the insurance industry and 97 percent about growth in their own organisation. You can access the 2019 Global Insurance CEO Outlook **here.**

In the context of an increasingly turbulent world, we asked CEOs what a truly resilient business means. 42 percent of New Zealand CEOs believe a truly resilient business is one that can adapt quickly to the changing business environment.

"We've seen CEOs' optimism rise in tandem with their considerable work to increase resilience. Their confidence has gone up as they take action and they know their activities are going to pay off." – Laura Hay, KPMG Global Head of Insurance

Confidence from resilience

This strong show of confidence by insurers can be linked back to insurers' recent efforts to ramp up transformation initiatives and closely aligns with observations by KPMG professionals over the past 2 years as clients initially defined their transformation plans. Now, many insurers are immersed in significant, multi-function, multi-year efforts — on an enterprise-scale or business-unit wide — to transform their business, either to drive strategic growth or cost objectives.

The story in New Zealand is the same. We see a number of insurers on their transformation journeys to drive strategic growth or cost objectives and at the heart of these strategies is typically the customer.

64 percent of global insurance CEOs and 60 percent of New Zealand CEOs believe that they need to significantly improve their understanding of customers. These insurers realise that the customer experience goes beyond the moment of sale to other key touch points, for example, when a customer experiences an event and needs to submit a claim.

77 percent of global CEOs and 80 percent of New Zealand CEOs agree that, to elevate the end-to-end customer experience, they must transform their front, middle and back office functions.

Technology supported growth

Not surprisingly, insurance CEOs pointed to the crucial role of technology investment in support of future growth and 95 percent of these leaders agreed that they see technological disruption as more of an opportunity than a threat.

In light of the pressing importance of technology, an astounding 85 percent of global CEOs and 70 percent of New Zealand CEOs say they are directly involved in devising and leading the technology strategy of their organisation.

Despite CEOs' stated enthusiasm for technology, we found lower levels of action in new technology implementation. Specifically, when we asked global insurance CEOs about the actual application of AI in automation processes, only 14 percent claim to have already implemented such programs. Most companies were still piloting or conducting limited implementation with a few processes. However, KPMG technology professionals note that insurers' progress to date with AI is not surprising, in light of the complexity of this new technology. As with any new technology, there can be a lot of hype about its potential, which can often exceed its actual delivery capability.

In addition, considerable lead time is required for any organisation, including insurers that may face significant legacy technology challenges, to reach a point of readiness to successfully incorporate new technology. As an example, in recent years insurers experienced similar extended timelines to prepare for and adopt related advancements such as robotic process automation and machine learning. AI is expected to be equally challenging for companies to incorporate, since it will require them to build out both their cultural and physical infrastructures first. That encompasses both improving their data capacity and accelerating their migration to the cloud.

"And of course,insurers need to find the right usage for AI, since it will not be the answer for everything. Companies must not equate automation with customer satisfaction, and insurers will have to experiment with the right mix of automation and human agents to enhance the customer experience." – Gary Plotkin, Principal, CIO Advisory, KPMG in the US

Defining innovation

Although insurers have always known the importance of customers, they now see the need to improve the client experience holistically. This task is made more complicated by the fact that customer expectations are changing every day, as they deal with other companies in other sectors that redefine what good means. As a result, customer demands are dynamic, and insurers must continuously gather and analyse the latest customer insights to keep up with these expectations.

This requires insurers to act with agility. Globally, there has been an increase in the number of CEOs who believe that acting with agility is critical to the success of their business. Locally we saw the opposite – significantly fewer (18 percent) of New Zealand CEOs believe this in 2019, compared to 2018.

Our view is that New Zealand CEOs need to think differently about what agility and innovation mean in their business. It's really important to define what innovation means in the context of a particular organisation. Innovation should be considered a daily occurrence and doesn't have to be a formal programme requiring significant investment.

To compete and succeed, organisations must respond to their customers' changing expectations and requirements quickly. Creating a culture where people are empowered and view innovation as something that happens every minute of the day is critical – it's in everyone's hands.

This leads to the concept of fail fast. Over 50 percent of New Zealand CEOs feel confident their organisation accepts and celebrates a culture of fail fast. But when it comes to CEOs wanting employees to feel empowered to attempt innovation, even if it fails, New Zealand lags behind its global counterparts (62 percent vs. 84 percent).

"So what's behind this hesitation?" Simon Moutter, Former Managing Director of Spark New Zealand, thinks New Zealand businesses, and New Zealanders as a whole, are not fully comfortable with failure in general – "Fear of failure is embedded in our DNA".

Simon contrasts this with his experience offshore where stakeholders are more comfortable talking about success and failure in the same sentence, and failures can be seen as a real strength for the future.

Perhaps the concept of 'learn fast' is more helpful in a New Zealand context than 'fail fast?

Creating workforce 4.0

Disrupting themselves and the marketplace is top of mind among global insurance CEOs, while they strive to instil organisation-wide innovation and cyber controls and make the most effective technology and workforce investments.

These leaders feel the need to upgrade their own skills as they try to overcome an internal 'innovation disconnect,' forge strong external partnerships, and embed the agility and resiliency to develop holistic, flexible strategies for new opportunities and threats in an uncertain future.

Our survey shows that CEOs across the board recognise the need to transform their core executive teams to enhance their resilience (78 percent of New Zealand CEOs and 77 percent of global CEOs). New Zealand CEOs' attention to leadership transformation is on a par with that of global CEOs at 78 percent.

But we can't afford to be complacent; our ability to respond to critical changes in the local and global markets relies heavily on the capabilities of our people. Our survey shows that compared to our global peers, New Zealand CEOs have significantly less confidence in the availability of critical skills in digital transformation (40 percent), sustainability (36 percent) and cyber security (24 percent).

Our survey respondents made it clear that they plan to create a "Workforce 4.0", by upgrading the skills of their employee base. In fact, almost half of global CEOs (48 percent) say they plan to upskill more than half of their entire workforce, particularly in digital capabilities like advanced data visualisation and coding, within the next 3 years. This challenge is amplified by the fact that, not only is the work changing, but there is also a premium on the skills required by insurers across many industries.

As a result, companies must consider a diversified, 'build, buy and save' approach to develop their workforce. It is crucial that insurers save and retain their current workforce, in addition to actively hiring the next generation. This can be done in part by creating a value proposition and employee experience that goes beyond pay and benefits to a culture and environment where they can thrive and do their best work.

To create workforce 4.0, insurers must learn to manage their people in a new way, which includes defining people by what they can do versus specific job codes.

"With rapidly changing business needs, companies must rethink the currency of human capital and move away from the 20th century concept of workforce planning to a more fluid view of skills versus jobs and learn how to practice workforce shaping." – Evan Metter, Principal, People and Change, KPMG in the US

This new approach means that insurers must ask themselves, 'What competencies will we need?' instead of only asking, 'How many actuaries do I need?' They must then begin investing in their people so these capabilities are ready for deployment when the work demands. Although this change in approach is a 'heavy lift' for large insurers with traditional HR functions, these firms also have a huge advantage as they have a bigger talent pool to shape and considerable internal HR expertise and data to guide their efforts.

Technology over people investments?

It's interesting to note that, when CEOs were asked about their specific investment priorities to improve organisational resilience, a majority (68 percent) are emphasising capital investment in technology rather than on developing workforce skills (32 percent).

This is not necessarily a contradiction since it is natural that companies see the need to invest in the technology first before they flesh-out the staffing requirements to maintain these systems. That said, it's also important for leaders to understand that technology is not the silver bullet to their challenges, and technology is only half the story.

They must carefully balance investments in building their people skills, change management and training. Formal change management practices are essential to support the evolving human/technology mix. Such programs must extend beyond the usual 'communication and training' and incorporate disciplined methodology delivered by a professional change management function. By doing so, the necessary change management activities can begin early and the necessary continuity will be achieved to ensure they are executed effectively.

The right kind of leadership is also essential.

"There is a big difference between great generalist, operational and technology leaders versus a true change leader, in terms of their characteristics and behaviours." – Evan Metter, Principal, People and Change, KPMG in the US

Organisations often look for leaders who can drive results, but they also need to put the right kind of leaders in place who can lead the organisation through change. That means elevating leaders who exhibit the right combination of empathy, curiosity, resilience and humility. These individuals also need to practice new tactics including pacing implementation, managing political dynamics, creating an enabling environment and activating networks to be effective change leaders. For example, a few of the critical skills of strong change leaders include their ability to communicate a compelling story, activate networks, manage political dynamics and create an enabling environment.

Top of the CEO agenda

In summary, the 2019 Global CEO Outlook highlights how today's insurance CEOs are well-attuned to the future they face. With customer needs changing and expectations rising, and the competitive landscape evolving, insurers understand that their legacy operating models will no longer be fit for purpose. The future of insurance lies in achieving a deeper understanding of the customer, operational excellence, intelligent automation and adapting to the industry's shifting talent needs.

These findings reflect the current efforts by the large insurers to become more agile. This challenge is often intensified by the need to balance dual priorities of both protecting their current business and short-term objectives while also investing in the future. Investing in the future requires considerable strategic planning, not just inserting innovations into current operations that respond to today's customer challenges, but also considering the future needs they will have. Insurers must increasingly consider what future platforms they build and develop transformation plans that extend across functions. Their success depends on being more responsive, faster at introducing products, and better at building effective partnerships.

> "In an increasingly turbulent world, it's more important than ever for New Zealand businesses to look to the future and to challenge ourselves to grow. A growth mind-set is essential. Without it, we don't create opportunities, embrace change and contribute to New Zealand's prosperity."
>
> **– Godfrey Boyce, KPMG New Zealand Chief Executive**

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CUSTOMER AND CONDUCT

Understanding customers' needs and outcomes is essential for an organisation to innovate and stay competitive…

Customer and conduct: Lessons, questions and future outlook

James Brownell Director, Insurance Conduct Lead, KPMG New Zealand

Following on from the Australian Royal Commission and subsequent New Zealand banking reviews, 2019 has been a year of intensive focus from the Financial Markets Authority (FMA) and the Reserve Bank of New Zealand (RBNZ) on culture and conduct in the insurance sector.

The FMA/RBNZ's review of life insurers in January led them to request both life and general insurers to undertake two specific activities:

1. An in-depth product review
2. A gap analysis against the Australian Royal Commission findings; has resulted in a significant programme of work across the insurance sector.

This work needs to be considered against the backdrop of substantial regulatory change relevant to culture and conduct. Amongst other reviews around insurance contract law and the role of appointed actuaries, two key changes include the introduction of a new advisory regime (Financial Services Legislation Amendment Act) and the Ministry of Business, Innovation and Employment (MBIE)'s review of the Conduct of Financial Institutions and the introduction of a new conduct regime. Under both of these changes, new licencing requirements for insurers and advisers will impact the way that the sector is regulated, introduce additional obligations for insurers and advisers and give the FMA more power to monitor and enforce against licencing obligations. This will put the regulatory regime here more in line with frameworks in Australia and the United Kingdom, and will have a significant impact on manufacturers' obligations both in terms of how products are designed and how customers are engaged.

In this article we will focus on the challenges and lessons learned so far from both the life and general insurance market, the questions that organisations should be asking to ensure they have done enough to address regulators concerns and the future outlook for the general insurance market, including how conduct and culture should be integrated into insurers' strategies going forward.

1 Lessons learned from the wider industry

Recognising there are distinct differences between life and general insurance operations in terms of both product complexity and distribution, there are nevertheless important lessons to be learned from the life sector given they have been subject to direct reviews by the regulators and have therefore had a four month head start.

Product review

New Zealand insurers have not been required to have formal or comprehensive product review processes, and some have relied on informal processes and discussion. As a result the amount of work the specific product review requirement has entailed has generally been underestimated by the market. Indeed, the RBNZ and FMA recently formally requested a large number of life insurers to re-submit their product reviews, because they were either incomplete or did not go deep enough in terms of identifying risks and issues, and/or investigating issues that had been identified. This will be most relevant for general insurers with a large number of products and distribution channels, and where products have rapidly evolved over the last five years, meaning substantial legacy books. Organisations without appropriate data management and governance have struggled to pull together consistent and meaningful analysis across their product portfolios.

Identification and remediation of issues

The regulators are realistic, and understand that organisations are not perfect; therefore, where no issues have been identified, they are likely to be sceptical that the process has been rigorous enough. Insurers need to be proactive in identifying potential issues. In some cases, executive teams may have overly positive or biased views; gaining independent feedback from front-line staff, mystery shopping and feedback through customer forums can be effective ways of demonstrating this. Where issues have been identified, insurers typically do not have formal investigation or resolution frameworks so calculating customer impact and identifying root causes is incomplete and unsurprisingly progress in terms of rectifying issues has been slow or absent. This is demonstrated through examples of insurers knowingly sending out incorrect information to customers. There are plenty of case studies outside of New Zealand which demonstrate the importance of investigating and remediating issues quickly and efficiently in order to limit the longer-term negative impacts.

Systems and controls

The majority of issues we identified through working with our clients have not originated from bad intentions, but point to potential cultural issues around allowing systems and operational risk issues to continue unabated. It is apparent that there has been some reluctance to invest in systems, to address known issues and a general lack of accountability for identifying and establishing controls to stop issues from continuing to occur. A lack of appropriate consideration for operational and conduct related risks, including putting formal tolerances in place so that they can be proactively monitored and mitigated has also exacerbated these problems.

"Insurers need to be proactive in identifying potential issues. In some cases, executive teams may have overly positive or biased views; gaining independent feedback from front-line staff, mystery shopping and feedback through customer forums can be effective ways of demonstrating this."

Oversight of intermediaries

Any conflicts of interests created by commissions need to be proactively monitored by insurers, as it is apparent that soft commissions are still being used and are considered by the FMA and RBNZ as high risk. In the general insurance market there are a wide variety of distribution channels and types of arrangements which has made investigation and oversight of these more challenging. The FMA and RBNZ have made it clear that the onus sits with the manufacturer to ensure customers are getting good outcomes from their products. Expectations are that insurers understand the outcomes being delivered to customers by intermediary channels. For agency relationships, where insurers only provide product design and pricing support and legacy arrangements, this has meant insurers have to take a different approach. Utilising data and analytics will help insurers to understand whether intermediaries are doing the right thing for their customers.

2 What are the key questions insurers need to answer?

Based on the work we have carried out in the insurance space, we have outlined the questions that insurers should be asking to understand whether they have done enough to change the way they are considering customer outcomes in their organisations:

3 Future outlook

Based on initial feedback to life insurers and the legislation for a new conduct regime that has been fast tracked for implementation, it is clear that the focus on conduct and culture is here to stay and is likely to intensify as we move into 2020.

Customer centric focus and measurement

Understanding customers' needs and customer outcomes is about more than culture and conduct, it is essential for an organisation to innovate and stay competitive in a rapidly changing environment. A more customer centric focus and an improved understanding of customers' circumstances and needs will ultimately result in higher retention and sales. Lack of investment in this is a double edged sword - in an increasingly more connected and open world, negative outcomes can have a significant impact on an insurer's reputation.

Appropriate measurement and reporting of customer outcomes is critical to enable strategic decision making; customers' needs and financial performance should be synonymous. Use of advanced techniques for data analysis allows insurers to gain insights where data is unstructured or to identify trends and relationships that would otherwise not be possible. New Zealand banks and now insurers are developing customer outcome measurement tools and dashboards which have tolerances built in and allow appropriate ongoing monitoring, allowing insurers to be at the cutting edge of product design.

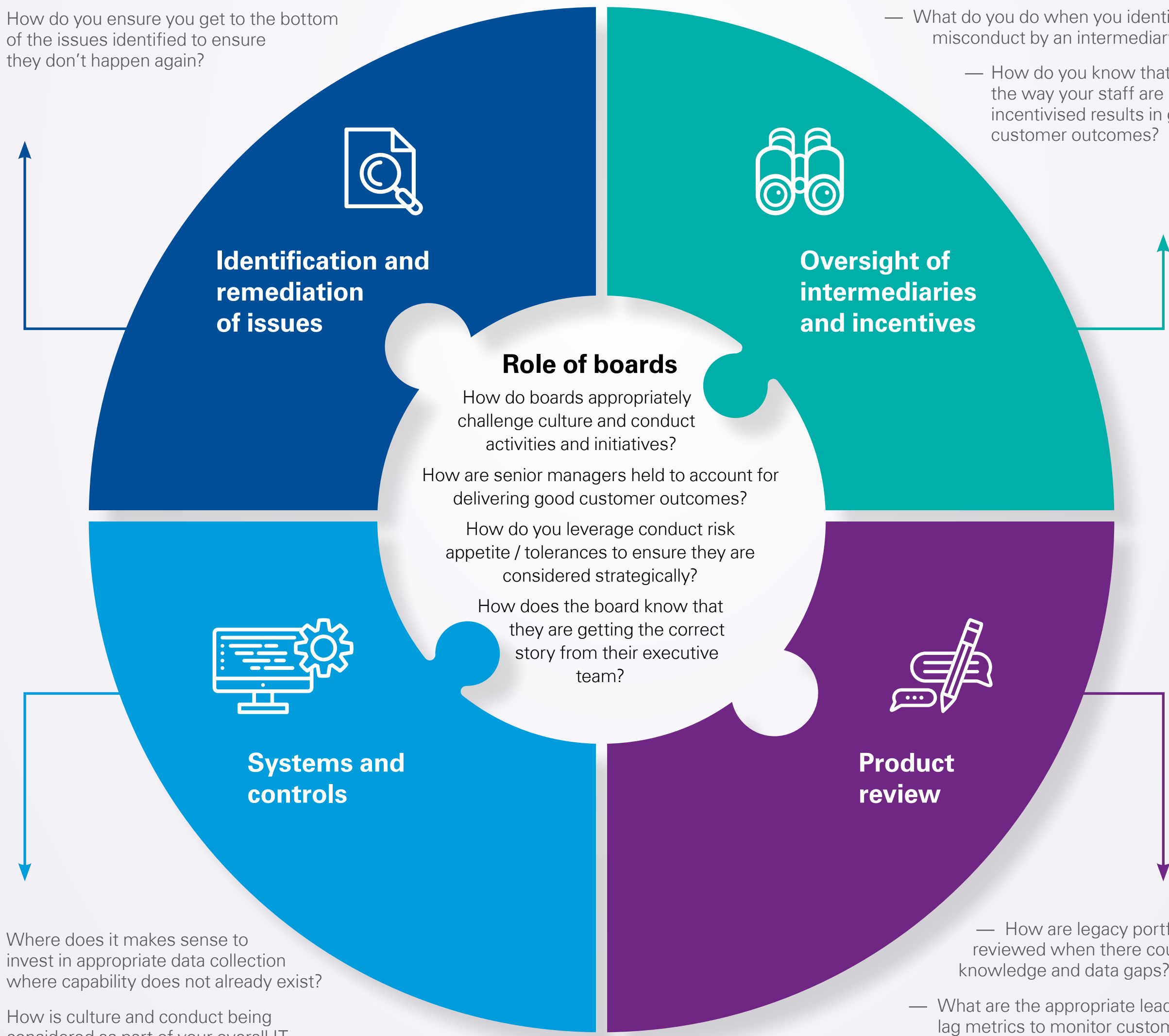
There will undoubtedly be challenges the insurance market need to face up to in the foreseeable future if insurers want to get ahead of the coming conduct regime and build culture and conduct into their strategic direction. Insurers who are treating their conduct and culture programmes as a conduit for change rather than a compliance box ticking exercise are those who will have a competitive advantage over their competitors.

> "Understanding customer experience and customer outcomes is about more than culture and conduct, it is essential for an organisation to innovate and stay competitive in a rapidly changing environment."

Areas of focus

- How do firms ensure that they have identified all the culture and conduct issues that exist within their business?
- How are issues investigated and remediated within your organisation, what frameworks are in place to ensure these are carried out effectively?
- How do you ensure you get to the bottom of the issues identified to ensure they don't happen again?

- How do you demonstrate that commissions across your portfolios are appropriate and do not drive poor customer outcomes?
- What kind of oversight is required / practical to ensure you know your products are being sold appropriately?
- What do you do when you identify misconduct by an intermediary?
- How do you know that the way your staff are incentivised results in good customer outcomes?



- Where does it makes sense to invest in appropriate data collection where capability does not already exist?
- How is culture and conduct being considered as part of your overall IT transformation?
- How do organisations gain comfort that data governance and quality in particular with legacy systems?
- How does the business manage its risks and ensure its control environment is operating effectively?

- How are legacy portfolios reviewed when there could be knowledge and data gaps?
- What are the appropriate lead and lag metrics to monitor customer outcomes?
- How can the product review process be leveraged on an ongoing basis to ensure changes are having the desired effect?

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LEGISLATIVE AND REGULATORY CHANGE

A new conduct regime. Revisions to key insurance legislation. No aspect of insurance will escape change. But how well co-ordinated will these changes be?

Legislative and regulatory change: An industry view

Tim Grafton Chief Executive, ICNZ

By any measure 2019 has seen unparalleled scrutiny of the financial sector with change now to come.

A new conduct regime will be before Parliament by Christmas. To be administered by the Financial Markets Authority (FMA), it will have powers to review and require changes to policies, processes, systems and controls.

A Bill to revise and consolidate New Zealand's insurance contract law will be fast on its heels. It will seek to redress a perceived imbalance in favour of the consumer.

A review of the Insurance Prudential Supervision Act (IPSA) will start shortly. Separate but related, the Reserve Bank of New Zealand (RBNZ) is steering away from light-handed regulation to more intrusive supervision. Its scope is shifting to financial stability being its primary purpose.

The sector awaits the Government's response to large premium increases in the Wellington commercial property market, felt most acutely by fixed income apartment dwellers.

No aspect of insurance will escape change. But how well co-ordinated will these changes be? Will they be proportionate to the problems identified? Will they align with the way product is distributed?

Conduct

General insurers are not sitting on their hands waiting for the law to change. They are amending systems, practices and incentives to align with expectations that customers' interests are understood and met.

The test will be to demonstrate how this has become part of an insurer's DNA. Accountability will rest with Boards to demonstrate how they re-set expectations and importantly monitor their implementation.

This will require changes to performance metrics and the introduction of lead indicators of how customers' interests are being met. It will mean offering customers products they understand, can easily compare and matching the expectations of service they are used to in other sectors.

Changes to The Insurance Council of New Zealand (ICNZ)'s Fair Insurance Code (FIC) which come into effect in April 2020 talk to developing, marketing and selling products responsibly and stress the need for plain English policies and clear communications. It beefs up reporting from members of complaints and breaches and reinforces a reasonable response to non-disclosure to an insurer of material information.

We have trademarked a logo which must be used on websites, claims and complaints material for consumers.

Last year, of 1.2 million claims from customers, there were 3,280 complaints of which 261 were referred to external dispute resolution schemes where 40 were partially or fully upheld.

A challenge for the sector is to apply changes across the value chain no matter the form of distribution. Brokers and underwriters will need to redefine their relationships to achieve this. The responsibilities of intermediaries and insurers need to be clearly and appropriately provided for compatible with other legislation, the common law and business practices.

Responsiveness to the customer at claims time is paramount. A future model for settling EQC claims when catastrophe strikes must have the customer at the centre. Having one accountable entity, their insurer, meets this need best.

Insurance law

Insurance law needs updating not least to reflect the digital age and more complex distribution arrangements. Insurance contracts are also fundamentally different from and should not be treated like other consumer products.

The limited terms and conditions deemed reasonably necessary to protect the legitimate interests of the insurer should remain part of any changes. Current prohibitions on unfair terms contract terms should still apply.

Even though ICNZ already requires a reasonable response to non-disclosure by consumers and SMEs, this too must be given effect in law though it's not clear whether that should apply to all businesses.

Any moves to promote comparison sites must avoid price-driven consumer behaviour at the cost of appropriate cover.

Future proofing is critical too. While maintaining a high level of consumer protection, the law and regulations should support flexibility to react, adapt and innovate, to improve products and services, and to meet shifting consumer expectations. It should be technology agnostic and not unduly interfere with competition and collaboration.

Prudential supervision

On the back of the CBL collapse, the initial priorities for the Insurance Prudential Supervision Act (IPSA) Review will be on escalating supervisory powers, solvency and the role of the appointed actuary where work is well underway. Given the focus on culture, governance is likely to be part of the mix too.

Shifting away from the light-handed approach of the past few years, we can expect the RBNZ not to take insurers' actuarial assessments at face value. Establishing a solvency buffer will bring those who fall within it into greater scrutiny. The question is whether this will de facto increase solvency requirements and therefore costs across the board.

As an aside, it is noteworthy that receivables from the Crown in the guise of funds owed to insurers by EQC from the Canterbury earthquakes can no longer be counted as capital in the solvency calculation.

Additional supervisory powers may include changing solvency factors as a condition of a license through to administrative fines and greater enforcement powers. Other measures, including requiring statutory funds to be kept onshore to protect policyholders in the event an offshore entity is distressed have been mooted before.

All measures need to carefully balance the cost to end consumers, maintaining the attractiveness of New Zealand to offshore capital and good regulation.

Insurance pricing

Misunderstanding surrounds 'risk-based' pricing. Insurers have always priced risk. If pricing becomes more granular reflecting better understanding of risk, the principles of pooling remain.

All house premiums still contribute to seismic or climate risks; some pay more while others pay less reflecting their risks.

Significant premium increases reflecting technical risk pricing should not attract market interventions unless there is market failure. Technical price is financially sustainable pricing and signals the need for resilience. If affordability is an issue, then address that without distorting the markets' signals.

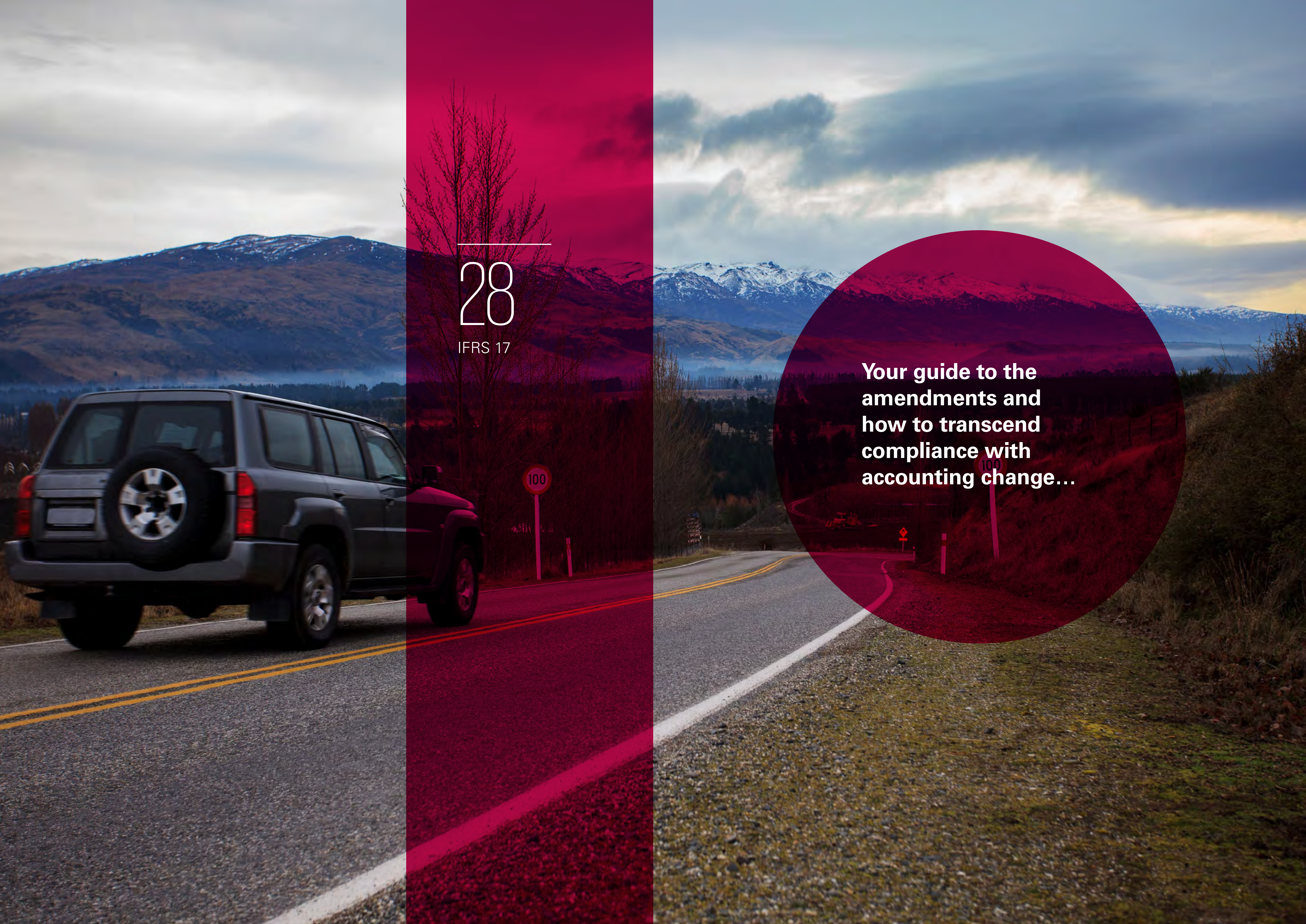
Resilience

Being able to understand what risks we face is at the centre of ICNZ's ambition to create a bespoke model of New Zealand's natural hazard risks, Rezealiance. Drawing on public funded science and applying insurance techniques to price all property risks benefits New Zealand Inc.

For climate change risks, it will inform changing risk exposure, investment, planning decisions to inform central and local government, and businesses and individuals.

Living in a risky country requires a balance between public and private interests, jointly working together to manage risks and being an attractive destination to share insured risks.

It is so important to regulate in a way that supports insurance to carry out its critical roles for society.



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IFRS 17

Your guide to the amendments and how to transcend compliance with accounting change…

IFRS 17: The new frontier

Ann Au Director, Insurance, KPMG New Zealand

"The amendments are helpful, but implementing IFRS 17 is still a complex and significant undertaking requiring substantial effort and new or upgraded data, systems, processes and controls. It's vital that insurers make good use of the extra year. Even with this, many insurers will need to step up the pace of their implementation efforts to reach the finish line with systems and processes tested and results understood by management and investors."

- Mary Trussell, KPMG's global lead, insurance accounting change

Ever-changing ever-flowing

Since the release of the new insurance accounting standard in May 2017, insurers experienced implementation challenges which prompted a change in IFRS 17.

With the aim of supporting the implementation, the International Accounting Standards Board (the Board) proposed amendments to address the challenges and concerns raised by insurers.

The Board also proposed to defer the effective date of IFRS 17 by one year to financial reporting periods beginning 1 January 2022.

The Board will consider comments on the proposed amendments and publish any resulting amendments to IFRS 17 in mid-2020.

Not a snooze button!

The additional time is not meant to be a snooze button for affected companies to wait for the exposure draft to be finalised in mid-2020.

Many insurers would have preferred a longer deferral, but the extra year affords an opportunity to step up the pace.

Some insurers are grabbing the opportunity to refine their implementation roadmap to generate an improved financial reporting capability, creating greater value from finance and managing future costs. More time means insurers can better understand the results and optimise the impact of IFRS 17.

Included in most implementation roadmaps is IT solution and selection. The deferral to 2022 provides insurers time to select an accounting system that suits best its business and financial reporting needs. This also gives insurers more time to ensure that processes and people (not just the tool) are ready for implementation.

In managing future costs, most insurers will design, test and implement new controls around the revised and new processes. Additional time means more time for test runs and parallel runs. Understanding results from these test runs and ensuring controls and processes are in good order will allow insurers to contain costs from work-around in the future.

Some insurers are using their time and effort more efficiently and effectively by leveraging the analysis derived from their five-year product review. Acknowledging that the focus of the review was to identify conduct and culture issues, the data extracted for this exercise can still be multi-purpose – it can also be used as a source information to help insurers map out and better understand the complexities of certain product features in its IFRS 17 impact assessment.

Due to challenges in extracting data either due to system limitation or to multiple manual interface, legacy products compared to contemporary products tend to require more time and effort for insurers to complete their impact assessment. This is possibly worsened by the inherent complex features and potential limited documentation retained on these legacy products. With recent focus by regulators on legacy and closed products, insurers are able to tap on the information gathered from the five-year product review for its IFRS 17 impact assessment.

Amendments in seven key areas

The proposed amendments focuses on the following seven areas in IFRS 17

» Scope changes for certain credit cards and loans that provide insurance coverage.

» Accounting for investment services in an insurance contract.

» Allocating acquisition cash flows that relate to future contract renewals.

» Mitigating the financial risk of direct participating contracts.

» Presentation of insurance contract assets and liabilities.

» Reinsurance of onerous contracts.

» Accounting for acquired claims liabilities on transition.

"Moving to IFRS 17 is a big task and this proposed package of targeted amendments will help insurers in their ongoing implementation of the new Standard."

- Hans Hoogervorst Chair of the International Accounting Standards Board

Out of the seven proposed amendments, there are three which are relevant to most general insurers:

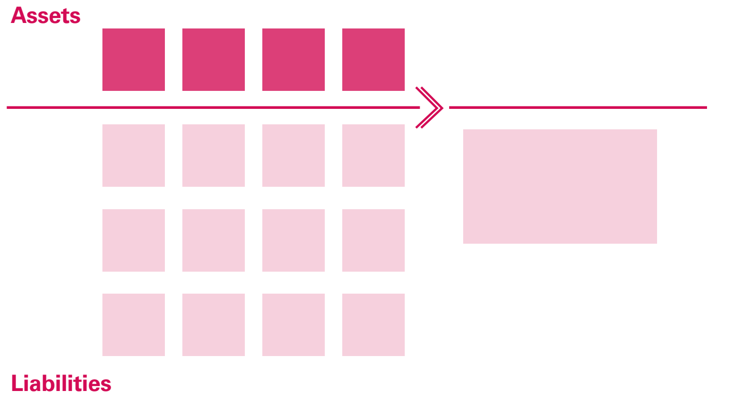
1 Presentation of insurance contract assets and liabilities

Allocating premium cash flows and the liability for incurred claims to carrying amounts at group level can be challenging for some insurers.

The Board proposed to present separately on the balance sheet – at portfolio level rather than group level – the carrying amounts of insurance contact assets and carrying amounts of insurance contract liabilities.

A group of insurance contracts is a lower level of aggregation than a portfolio of insurance contracts. Insurance contracts at a group level are based on profitability and dates of initial recognition. In contrast, contracts at portfolio level are based on contracts of similar risks which is at a higher level of aggregation.

This would provide practical relief to insurers who may find it time-consuming and costly to allocate cash flows at group level.



Many groups would be in a liability position, some could be in a assets position

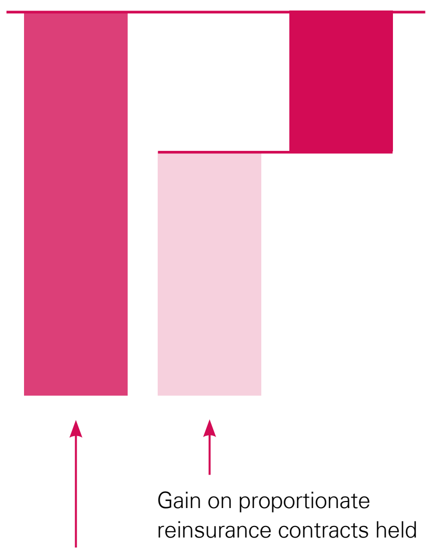
In most cases, the portfolio in aggregate will be in a liability position

2 Reinsurance of onerous contracts

IFRS 17 as initially issued requires an insurer to recognise losses in profit or loss when it issues onerous insurance contracts, with no corresponding gains recognised in profit or loss if the losses are covered by reinsurance contracts held. This can result in an accounting mismatch.

The Board proposed that if an insurer recognised a loss on underlying contracts that are onerous at initial recognition, then it would at the same time recognise a gain in profit or loss on reinsurance contracts held, to the extent that the underlying contracts are covered on a proportionate basis.

The Board decided to propose an amendment only for proportionate reinsurance. This is because the mismatch between the timing of the recognition of claims and the recognition of recoveries can be directly identified for proportionate reinsurance contracts.



Gain on proportionate reinsurance contracts held

Loss on onerous underlying insurance contracts

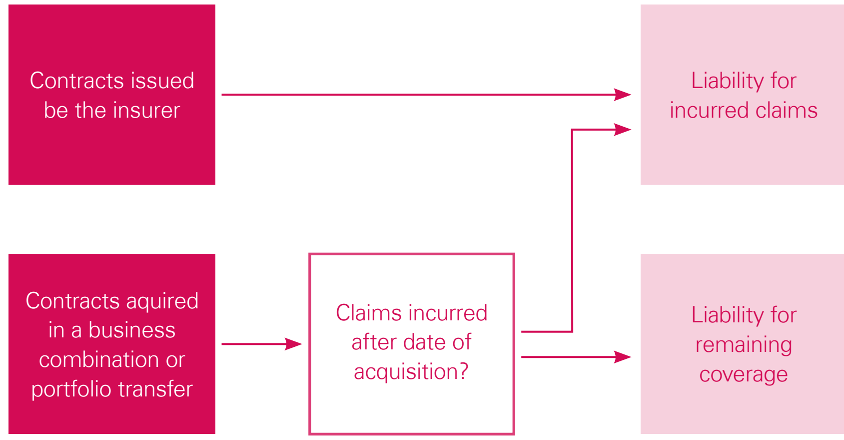
3 Accounting for acquired claims liabilities

Under the current IFRS 17, insurance contract liabilities are treated differently depending on whether the insurer:

- » issued the contracts; or
- » acquired them (either in a business combination or in a portfolio transfer)

The requirement to account for acquired claims liabilities for remaining coverage poses a challenge for some insurers on transition. If insurers use a single system to manage all claims liabilities, they may not be able to distinguish between claims liabilities arising from contracts that it issued and those that it acquired.

The Board proposed to amend the transition requirements for claims liabilities acquired by an entity, adding a specified modification to the modified retrospective approach. Under this specified modification, the insurer would be allowed to account for these liabilities as a liability for incurred claims. The insurer would be permitted to use the specified modification only to the extent that it does not have reasonable and supportable information to identify the acquired claims liabilities and account for them separately as a liability for remaining coverage.



Transcend IFRS 17

Front-runners in implementing IFRS 17 are taking IFRS 17 beyond solely an accounting change. They are taking a tactical approach – exploring how to reduce volatility, strategising how best to amend product features to achieve desired financial results and working out how to optimise systems and processes.

The requirement under IFRS 17 to recognise losses on groups of onerous contracts will potentially prompt important changes in product design and distribution strategy. Having a better understanding of the drivers of future financial results and potential source of volatility will also trigger changes in product mix. Insurers will need to regularly cross check these changes against its future strategy and good customer outcomes.

Some insurers' implementation plans include re-designing IT architectures and systems – taking the opportunity to transform and optimise business systems for a better, cheaper and faster end-to-end process.

Most insurers are currently exploring various potential scenarios under IFRS 17 and considering how these scenarios may impact solvency requirements. Early discussions with the regulators regarding these various impacts will prove beneficial in the long run.

Stakeholder management is also key. Some insurers are planning how to communicate the potential impacts on statutory, regulatory and management financial records with key stakeholders such as regulators, investors, brokers, reinsurers and employees. This step will help manage expectations and ensure the right story is being communicated. To offer more business-useful insights, feedback from these stakeholders will also help tailor not just financial record-keeping and reporting but also budgeting and forecasting of financial results.

With the recent conduct and culture review, the regulator is seeking for a change in performance metrics, and most insurers are currently revising their performance metrics to meet regulatory requirements. Insurers may need to plan ahead and look into any potential changes in systems and processes that would lead to future changes in data capture and data management for these metrics.

In summary, insurers can use the changes required by IFRS 17 to enhance their financial capability. Achieving this will require lots of preparation – insurers taking the opportunity to step up the pace during this extra year will reap the benefits in the future.

As insurers climb towards the precipice of this new frontier, they will not only be reminded of the rugged terrain and steep challenge but also the soaring heights of innovation and business transformation.

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RISK AND RESILIENCE

Physical risks from extreme climate events, which include storms, heavy rain, flooding, drought, heat waves and fires are broadly understood, but it is hard to predict...

Risk and resilience: Meeting the challenge of climate change

Niels Chlupka Manager, Sustainable Value, KPMG New Zealand

In 2018, California had the deadliest and most destructive wildfire season ever recorded. In 2019, tropical Cyclone Idai caused catastrophic damage and tragic loss of life in Mozambique, Zimbabwe and Malawi. Hot on its heels was a summer heat wave that set all-time high temperature records across much of Europe. This is what climate change looks like, and it is having serious consequences for people, economies and ecosystems.

Adding further urgency to the issue, in October 2018, the UN Intergovernmental Panel on Climate Change[1] stated we have at most, 12 years to make the drastic and unprecedented changes needed to avoid irreversible climate change. The World Economic Forum's Global Risks Report 2019[2] identified extreme weather events, failure on climate change mitigation and adaptation, and natural disasters as the three most likely risks of significant concern to society. No wonder climate change is rapidly rising up the public agenda.

It is also escalating up the insurance agenda: not just because natural disaster insurance claims are rising, but also because insurers are increasingly recognising that the mid- to long-term outlook on climate change carries massive risk. According to the 12th Annual Survey of Emerging Risks[3], actuaries ranked climate change as the top risk for 2019, beating out concerns over cyber damages, financial instability and terrorism.

Climate change risk

Mark Carney, the Governor of the Bank of England, used his speech[4] at the UN Climate Action Summit 2019 to implore insurers to use their money, deep risk management expertise and long-term perspective to ease the burden of climate change. Insurers are well aware that the physical impacts of climate change; in 2018 alone, extreme weather events across the globe caused insured losses of US$80 billion[5]. In New Zealand, insurers spent NZ$226 million helping customers recover from extreme weather.[6]

Physical risks

Physical risks from extreme climate events, which include storms, heavy rain, flooding, drought, heat waves and fires are broadly understood, but it is hard to predict the changing intensity, frequency and concentration of these events such as clusters of typhoons. Insurers are also finding it difficult to foresee the indirect risks such as disruption to economic value chains.

New Zealand has a very long coastline with numerous areas prone to flooding. Research from the National Institute of Water and Atmospheric Research (NIWA) shows that NZ$38 billion of our residential and commercial buildings may be at risk of flooding if sea levels rise one metre[7]. In May 2019, the Reserve Bank of New Zealand (RBNZ) warned that, as climate risks become more acute, insurance for properties susceptible to sea level rise and coastal inundation may become more expensive and difficult to obtain. This may profoundly reduce their value.[8]

Risks from extreme climate events are not only to physical property. Indeed, adverse health effects from increasing temperatures and higher humidity are also on the rise. Swiss Re has identified the impact of climate change on the life and health insurance sector as one of its top five emerging risks for 2019, noting it will extend the transmission season and geographical range for many infectious diseases, with millions of lives at risk.[9]

Transition risks

Transition risks occur as the economy moves towards a low-carbon future. Some sectors of the economy are facing big shifts in asset values or higher costs of doing business. The energy industry is a prime example: to avoid irreversible climate change, 62 percent of current fossil fuel reserves must be left in the ground.[10] This stark fact has resulted in a group of insurers and pension funds managing US$2.3 trillion in assets to commit to shifting their investment portfolios away from carbon-heavy industries.[11]

Liability risks

Liability risks arise from organisations not fully considering or responding to climate risk. In November 2018, the RBNZ noted that financial sector participants need to ensure climate risks are adequately reflected in their business. [12]Businesses who fail to respond to climate change put themselves at risk of litigation. As of July 2019, 1,328 climate change litigation cases have been filled in 28 countries, with 17 in New Zealand alone.[13]

So what can be done?

There are a number of actions that insurers can take to improve the way they assess and manage the impacts of climate change. Embedding climate risks into overall governance and risk management frameworks is critical. This includes sharpening financial risk modelling around climate impacts and measuring potential for liability claims.

The Task Force on Climate-related Financial Disclosures (TCFD) provides a comprehensive framework for action covering governance, strategy, and risk management, as well as metrics and targets.[14] Its uptake has been enormous, with 91 percent of 1,100 surveyed companies having decided to fully or partially implement the TCFD recommendations, and 75 percent of users of the information see a marked improvement in the quality of climate disclosures.[15]

Insurers should also ensure that their liabilities and investments are properly diversified to avoid excessive concentration of climate risk. This may include shifting investment portfolios away from carbon-heavy industries towards those that are climate resilient and best positioned to benefit from the transition to a low-carbon future.

Insurers have an important role to play in helping our society meet the profound challenge of climate change. Recognising and rewarding organisations that build climate resilience with lower insurance premiums is a powerful tool to drive the change we need.

[1] https://www.ipcc.ch/site/assets/uploads/sites/2/2019/05/SR15_SPM_version_report_HR.pdf
[2] http://www3.weforum.org/docs/WEF_Global_Risks_Report_2019.pdf
[3] https://www.soa.org/globalassets/assets/files/resources/research-report/2019/12th-emerging-risk-survey.pdf
[4] https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/remarks-given-during-the-un-secretary-generals-climate-actions-summit-2019-mark-carney.pdf?la=en&hash=C0D3A9F2C86647B04D88E7C0DC23264639D03BE2
[5] https://www.munichre.com/topics-online/en/climate-change-and-natural-disasters/natural-disasters/the-natural-disasters-of-2018-in-figures.html
[6] https://www.icnz.org.nz/media-resources/media-releases/single/item/insurers-pay-226m-to-support-recovery-from-extreme-weather/

[7] https://www.newsroom.co.nz/2018/11/20/329590/125000-buildings-worth-38bn-at-risk-from-first-1m-sea-level-rise-draft-report
[8] https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Financial%20stability%20reports/2019/fsr-may19.pdf?revision=47e0d60a-bdca-4fbb-bddc-2ad9f20a4b2d
[9] https://www.swissre.com/media/news-releases/nr-20190522-sonar2019.html
[10] http://www.climatecouncil.org.au/uploads/a904b54ce67740c4b4ee2753134154b0.pdf
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[12] https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Financial%20stability%20reports/2018/fsr-nov-2018.pdf?revision=d55c1f94-59ac-4903-a411-5642bf81c096
[13] http://www.lse.ac.uk/GranthamInstitute/wp-content/uploads/2019/07/GRI_Global-trends-in-climate-change-litigation-2019-snapshot-2.pdf
[14] https://www.fsb-tcfd.org/publications/final-recommendations-report/
[15] https://www.fsb.org/wp-content/uploads/P050619.pdf

Contributors

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Jamie is a financial services partner and leads the insurance practice at KPMG New Zealand. He has significant experience in the financial services sector working with New Zealand insurers, banks and other financial institutions. Jamie has relationships across the sector, with market participants, industry groups and local regulators. He also leads our Corporate Citizenship programme and is responsible for the work KPMG does in the community.

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Nick is a director in our financial services team with significant experience in the insurance sector, across both the general and life insurance markets. In addition to leading a number of our insurance audit engagements, Nick leverages his insurance expertise to support our clients across a range of insurance accounting and advisory projects.

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Ann is a director in our financial services team with experience in audit and accounting advisory work across the insurance sector. Ann has presented at a number of technical accounting updates, notably on IFRS 17 to the Reserve Bank of New Zealand, finance and actuarial teams, and board members of insurance entities.

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James is a director and head of insurance consulting at KPMG New Zealand. He specialises in conduct and operational risk management for insurance and financial services firms and has supported a number of NZ life and general insurers to develop their conduct and culture programmes. James has 12 years' experience in financial services consulting and a wide range of expertise across risk management, conduct, outsourcing and capital management.

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Niels is responsible for helping clients transition to the net-zero emissions, climate-resilient economy of New Zealand's future. He has a deep understanding of the regulatory landscape for achieving emission reductions in the EU, Australia and New Zealand, backed by practical experience developing emissions inventories, setting targets and the financial modelling of abatement options.

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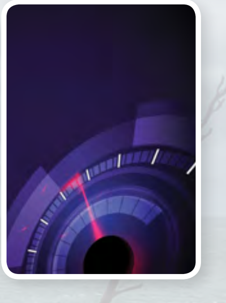
Tim Grafton CMInstD, is on the Global Federation of Insurance Associations' Executive, Chairs the Code Compliance Committee of the Fair Insurance Code and the Representative Users Group of the Deep South Science Challenge, and is on the New Zealand Advisory Board of ANZIIF and the Advisory Board of Victoria University's Chair in the Economics of Disasters.

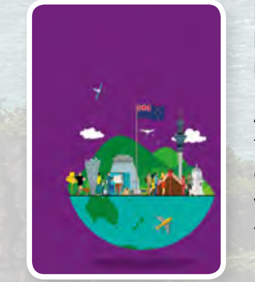
Our thought leadership

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



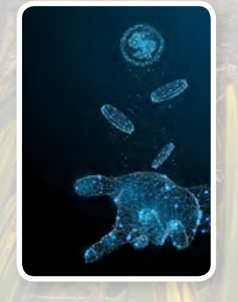
New Zealand CEO Outlook Report 2019

Discover our latest insights from 50 of New Zealand's leading CEOs, exploring how we can look to the future and challenge ourselves to grow.



New Zealand Customer Experience Excellence Report 2019

A showcase of New Zealand's top brands excelling in customer experience and insights revealing what consumers value most from their favourite brands.

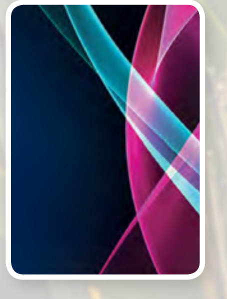


FIPS Quarterly: June 2019

Our latest FIPS Quarterly provides in-depth insights into the performance of New Zealand's financial services sector over the quarter ending June 2019.

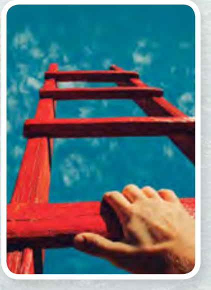
Partnering with insurtechs to face latest mobility twist

As driverless cars and MaaS threaten traditional auto insurance, insurers may turn to insurtechs to navigate mobility disruption.



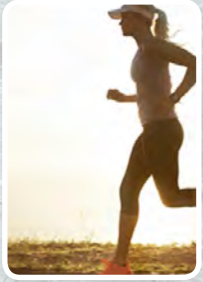
Global Insurance CEO Outlook 2019

Discover insights from global insurance CEOs, exploring the ability to be agile to build resilience and in turn support growth.



Flexibility for growth

What will it take to achieve operational excellence in today's insurance industry in a rapidly-changing and increasingly competitive market?

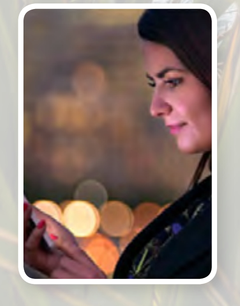


Product platforms reimagined

KPMG discuss reframing the approach to health insurance selection from the 'what-if' scenario to the 'why' during customer product selection.

Get the most out of your insurtech partnership

A look at organisational considerations on how insurers can get the most out of insurtech partnerships and how to prepare their organisation for success.



Bringing bancassurance into the digital era

With customers embracing digital channels, insurers must refine their partnerships to transform the way they serve their shared client base.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. 02663