KPMG
cutting through complexity

FINANCIAL SERVICES

The Intelligent Insurer: Creating value from opportunities in a changing world

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KPMG INTERNATIONAL

Contents

"A growing number of leaders recognize that there are important business opportunities to be secured through acting on sustainability issues from climate change to resource scarcity to deforestation, and significant risks associated with failing to do so."

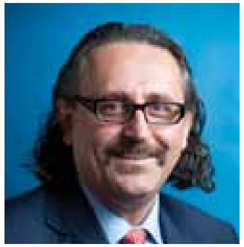
Yvo de Boer
Special Global Advisor
on Climate Change and Sustainability
KPMG International

As we develop our picture of the future we have drawn on the views of some of KPMG's most influential opinion formers.

Serena Brown, Global Citizenship, KPMG International. KPMG's Global Citizenship program brings together KPMG people from around the world to apply their skills, knowledge and resources to sustainable enterprises in pursuit of the United Nations Millennium Development Goals.

Yvo de Boer, Special Global Advisor on Climate Change and Sustainability at KPMG International and former Executive Secretary of the United Nations Framework Convention on Climate Change.

Bernard Salt is a Partner at KPMG in Australia. He has established a reputation as a trend forecaster for business and government.



Edge Zarrella, Partner, Clients and Innovation, KPMG in China. Edge's career spans more than 20 years in business and IT strategy working with clients in Australia, Asia Pacific and North America.

Foreword

Survival was the number one priority for many insurance firms during the depths of the global financial crisis. Since then European and North American insurers in particular have focused on addressing regulatory change, improving their understanding and modelling of risk and enhancing operational efficiency. Growth opportunities have largely been oriented towards the fast-growing insurance markets of South East Asia, Latin America and Africa. For insurers located in such high growth economies, the challenge has been to meet growing demand while addressing historically low interest rates and volatile equity markets.

Meanwhile, the world continues to change around us. From extended life expectancy to increasing urbanization, from more extreme weather events to greater use of social media, from an increasingly interconnected world where trust in global institutions has been significantly eroded, change is ever increasing. At KPMG we have distilled the themes we see emerging today into four over-arching mega-trends: the Environment, Technology, Demographics, and Social Values and Ethics.

Against a shifting macro-economic and political landscape, these forces create both opportunities and threats. The insurer of the future will adapt to these mega-trends in order to remain competitive, stay relevant for its customers, accountable to its stakeholders and create value for its investors. How it meets the challenges arising today will shape the role of insurance in society tomorrow.

To stimulate debate on these complex and far-reaching issues, we have grouped our thoughts to reflect four key components of the insurance business model:

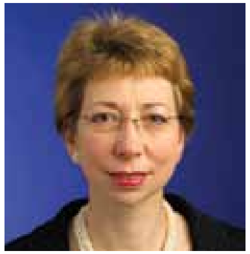
- Products and Markets
- Distribution and Operations
- Governance and People
- Regulation and Capital Management.

We invite you to engage with us in discussing the future implications for the insurance industry. In order to share views that are diverse and wide-ranging, we are opening up the conversation through social media and face-to-face discussions with industry players and experts.

Later in 2012, we will formulate a series of scenarios arising from these collective views, setting out the anticipated state of the global insurance industry in 2020, supported by in-depth analysis of the influencing and contributory factors.

We welcome your insights and opinions as we embark on this journey to develop a shared understanding of how the global insurance industry is rising to the challenge of creating sustainable, long-term value in a turbulent world.

Frank Ellenbürger
Global Head of
Insurance



Mary Trussell
Partner,
KPMG in the UK

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Executive summary

We have adopted the expression ‘global mega-trends’ to describe the four forces of the Environment, Technology, Demographics and Social Values and Ethics we see shaping the future for insurers. Our focus on these drivers is rooted in developments we are already observing as well as their impact on the outlook for the future. Some of these forces are already transforming the global political and economic outlook, while others have the potential to significantly influence the political and economic outlook in the coming decades.

To help make our analysis functional we have mapped the drivers of the global mega-trends onto key building blocks of the insurance business model: Products and Markets, Distribution and Operations, Regulation and Capital Management and Governance and People.

For each of these building blocks we have set out some of the key themes that we see emerging, and a selection of potential opportunities for growth and risks of inaction. Throughout, while we are looking into the future, we focus on change that can be actioned in the here and now. We hope you find this a useful tool as you explore the implications for your business.

Demographics

Growing populations and longer life expectancy create opportunities for insurers but pose important questions about how healthcare and retirement products are best structured and delivered. Meanwhile, continuing urbanization and changing generational attitudes towards insurance products pose challenges and opportunities of their own.

Technology

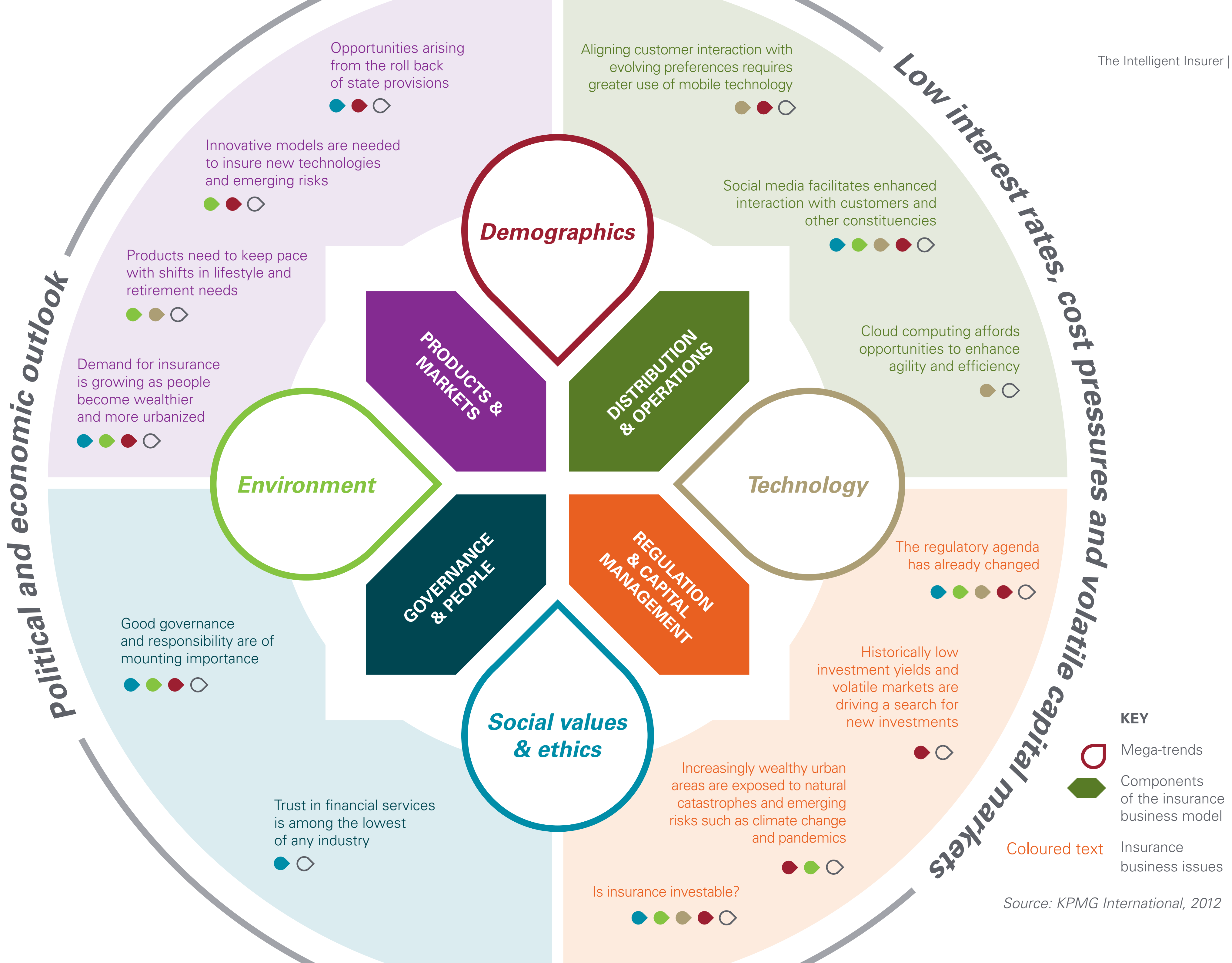
Greater connectivity and use of social media provide insurers with access to an unparalleled wealth of data. While cloud computing creates the potential to enhance flexibility and reduce costs, many insurers are constrained by legacy systems.

Environment

The combination of natural catastrophes, urbanization and growing wealth are changing the shape of risk for insurers. Economic expansion is driving more resource-intensive consumption and greater resource insecurity, while climate shifts add further challenges.

Social values and ethics

More effective engagement is needed to overcome the erosion of trust as expectations of good governance are changing dramatically. There is a significant opportunity to harness the power of social media to empower stakeholders as ambassadors for responsible business. However divergent social values and economic outcomes mean social unrest remains a threat.



Source: KPMG International, 2012

PRODUCTS AND MARKETS

The reality that people around the world are generally becoming wealthier and living longer means that in many countries saving for retirement must start sooner and last longer. Yet encouraging the public to save while interest rates remain at historical lows, especially in mature markets with ageing populations, is a significant challenge. Meanwhile, new technology brings shifting consumer preferences as well as new risks to be insured. The more we enter a knowledge economy the more important intangible assets become and the greater the challenge to insurers to innovate to protect what we value. With generational attitudes towards insurance changing, insurers need to attract consumers whose previous experience may have made them suspicious of insurance products and the way they are sold[1] as well as newer, younger customers.

Demand for insurance is growing as people become wealthier and more urbanized

S E D P

We see	For example
• Growing wealth, urbanization and expanding populations, most notably in high growth markets, increase demand for insurance as more people have assets to protect, and as economic migration causes fragmentation and dislocation of traditional family units.	• Global wealth due to rise by almost 50 percent by the end of 2016, led by increase in number of wealthy households in Latin America, Africa and Asia, driving consumption and investment.[2] • Urbanization and high population sizes and densities have a generally positive impact on demand for insurance products.
• Growing demand for income protection and retirement provision as families become smaller and women work outside the home.	

Powerful demographic and cultural changes underway

Source: CIA World Factbook

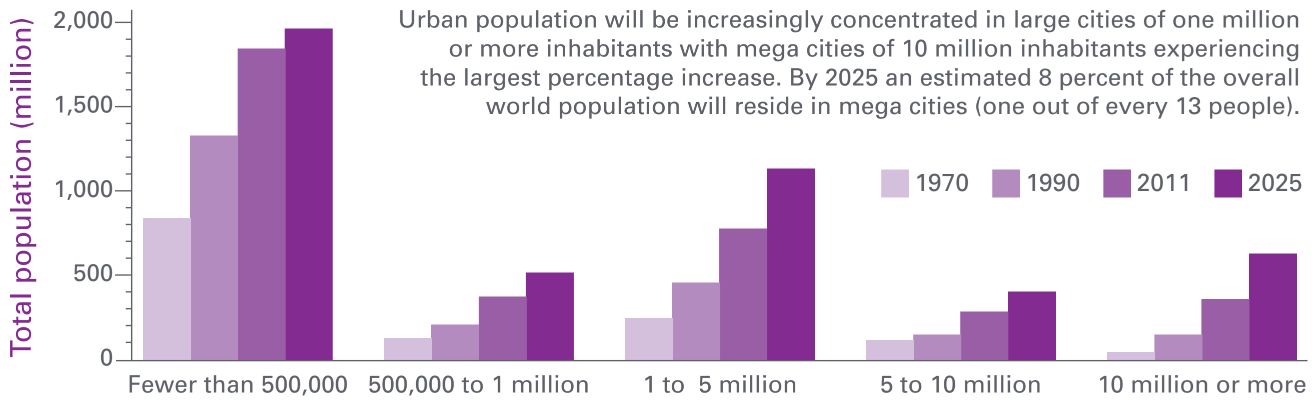
"Are insurers ready for shifts in generational preferences? From baby boomers focused on drawing down on their asset base to Generation Y's preferences for immediate response. The 20 years to 60 should be the reaping years, delivering peak income, position and power. The question is whether there is any slippage in these power years as the workforce ages. As baby boomers push beyond 60, they will retain some form of connection with the workplace – a reflection that many have not provisioned sufficiently for retirement."

Bernard Salt
Partner, KPMG in Australia

"Some insurers seem much more focused on products than on their customers. Have they got to grips with retirees' fluctuating needs throughout the various phases of retirement? Boomers and successive retirement groups are looking to protect quality of life rather than wealth accumulation. Maybe we need to think in terms of insurance in kind – a combination of housing, health and pensions rather than traditional insurance services."

Huub Arendse
Partner, KPMG in the Netherlands

Total population in millions by city size class, 1970, 1990, 2011 and 2025



Source: 'World urbanization prospects: The 2011 revision', United Nations, March 2012

Our working hypothesis includes

- The combination of growing wealth, urbanization and population growth, as well as emerging risks, are changing the 'shape of risk'.
- Declining birth rates mean increased demand for tax-efficient wealth transfer between generations in countries where saving is still a habit, such as China.

Opportunities for growth	Risks of inaction
• Erosion of traditional family networks due to migration increases demand for insurance in urban centers. • Partner with Non-Governmental Organizations (NGOs) to provide entry-level micro-insurance, combined with innovative use of technology to support affordability. • Use of demographic data and predictive analytics to understand where your customers and markets will be in five or 10 years from now. • Harnessing the power of crowd sourcing to anticipate needs and refine products.	• Business model ages faster than customers' preferences. • Product offerings become commoditized and are only distinguished on price. • Return to community insurance: online insurance exchanges and mutuals, learning from peer-to-peer lending.

Products need to keep pace with shifts in lifestyles and retirement needs

We see	For example
• Retirement periods increasing as longevity rises faster than legal retirement ages, creating a need for increasingly flexible retirement products to fund recreational demands of new retirees and higher healthcare costs for the extreme elderly.	• "While they obviously benefit from living longer lives, individuals face the financial risk that they may run out of retirement resources."[4] • "One useful asset to include in retirement portfolios is Treasury Inflation-Protected Securities (TIPS) [which] increase with inflation and decrease with deflation."[5]
• With continuing low investment yields and generally increasing life expectancies, working lives may extend for 50-60 years as growing number of retirees supplement incomes through temporary or part-time work, requiring flexible retirement products. • Conventional employment patterns change with people becoming more akin to self-employed contractors, with different insurance needs.	• "Current and future generations will not be able to rely on the 'old fashioned' model of providing for retirement by saving during their working years, and must begin to think about new approaches to financing old age."[6] • "Some British actuaries now model survival to age 125 when pricing insurance contracts; in the US the figure is age 120 … One way to protect against inadequate retirement savings is to work past age 70 and beyond."[7] • "We need to rethink – what if someone is half-retired? ... In the coming years, a lot of people are going to be 'semi-retired', like working three days a week for 60 percent of their incomes. We need to redefine pension systems and economic systems."[8]

Our working hypothesis includes

- Dramatically changing lifestyles and preferences are changing the demand for insurance. Smaller, older, better educated and urbanized households have very different insurance requirements from traditionally larger, younger, more rural populations.
- In future, many people will be unable to afford the cost of a guaranteed income in retirement. As a result, many will be unable to afford to fully retire, instead planning for periodic sabbaticals during their 'retirement' period.
- Having accumulated the largest build up of wealth the world has ever seen, and trying hard to consume it, baby boomers are still likely to have significant assets to transfer to their children. Will this create a successor generation who are unexpectedly well off, with distinctive savings preferences?

Opportunities for growth

- Develop flexible 'in retirement' products catering to evolving needs: from new retirees to extreme elderly and for retirees returning to work on a part-time or full-time basis.
- Innovate wealth transfer products for the newly mass-affluent.
- Develop alternative ways of transferring mortality risk e.g. longevity bonds.
- Educate customers to find new ways to save – supporting younger customers with accumulation and income protection, and baby boomers with decumulation.

Risks of inaction

- Anti-selection and declining customer loyalty if competitors offer more attractive products.
- Overlooking retirees' needs risks ignoring the fastest growing section of the population.
- Lower demand for life and health insurance unless it is made more appealing or costs and benefits become more transparent.
- Investment products outpaced by increasing retirement periods.

Innovative models are needed to insure new technologies and emerging risks

E D P

We see	For example
• Continued innovation by insurers, such as non-damage business interruption insurance against losses caused by intangible events such as supplier failure, product recall, cyber attack, loss of patents – or breach of data protection regulations by cloud service provider.	• Technologies such as cloud computing bring new and often uncertain risks into the scope of insurance coverage.
• Micro-insurance is an increasingly successful and growing opportunity, especially in high growth markets facilitated by innovative use of mobile technology.	• Kenyan Kilimo Salama ('safe agriculture') scheme provides crop insurance to smallholder farmers, enabled through mobile phone technology. Twelve thousand farmers enrolled as of late 2011.[9]
• Innovative insurance models being developed by the World Bank, such as crop insurance in Turkey and hurricane insurance in the Caribbean.	• "Typical crop insurance ... is hard for poor farmers to come by in Sub-Saharan Africa ... Index insurance, on the other hand, utilizes an index or scale based on local yields and a specific weather event … This reduces cost for the insurer, making them more likely to [serve] a 'risky' client such as a smallholder farmer."[10]
• Technological developments in screening could make some risks uninsurable unless insurers are prepared to innovate.	• Association of British Insurers (ABI) extended until 2017 the Concordat and Moratorium on Genetics, meaning that the results of a predictive genetic test will not affect a consumer's ability to take out any type of insurance other then life insurance in excess of 500,000 British pounds.[11]

"If weather conditions deteriorate, a panel of experts uses an index system to determine if crops will no longer be viable. At that point payouts are made directly to the handsets of farmers in the affected areas … With no field surveys, no paperwork and no middlemen, transaction costs are minimal."

Crop insurance provided by UAP Insurance of Kenya and Safaricom, from *'Security for shillings: Insuring crops with a mobile phone'*, The Economist, 2010

"Private spending on average accounts for 28 percent of total health spending for OECD countries … [but] can be expected to increase in coming years as governments look to individuals to pick up a greater share of health costs."

Health Funds Association of New Zealand, January 2012

Our working hypothesis includes

- Greater use of multiple trigger insurance policies may develop, providing protection against an accumulation of uncorrelated events, including climate risks.
- Insurers will need to think hard about how they use their ability to monitor an individual's location, activities and lifestyle. Does this threaten a business model based on uncertainty and create ethical issues about privacy?
- Interesting opportunities from the development of additive manufacturing (3D printing). Will this increasingly replace large scale manufacturing, changing the nature and demand for insurance in the manufacturing, transport and logistics sectors. Although presently expensive while in its infancy[12], will it eventually reduce the cost of claims as losses may be easier to replace?

Opportunities for growth	Risks of inaction
• Share data and insights with competitors, governments, NGOs, inter-governmental bodies and others to help further debate and feed innovation and research. • Collaborate with non-traditional partners such as property developers to achieve higher property standards and to advise on flood risk and security. • Reputational benefit by demonstrating the role of insurance in loss prevention. • Rethink products to enable the uninsured to become insurable, such as the ABI Concordat and Moratorium on the use of predictive genetic screening.	• Reliance on traditional insurance models creates exposure to changing risk profiles. • Lack of engagement may result in adverse social pressure. • Unaffordable premiums or unprofitable policies if models fail to keep up with developments such as growing frequency and severity of extreme weather events. • Over-dependence on markets that are more susceptible to natural catastrophes.

Opportunities from the rollback of state provision

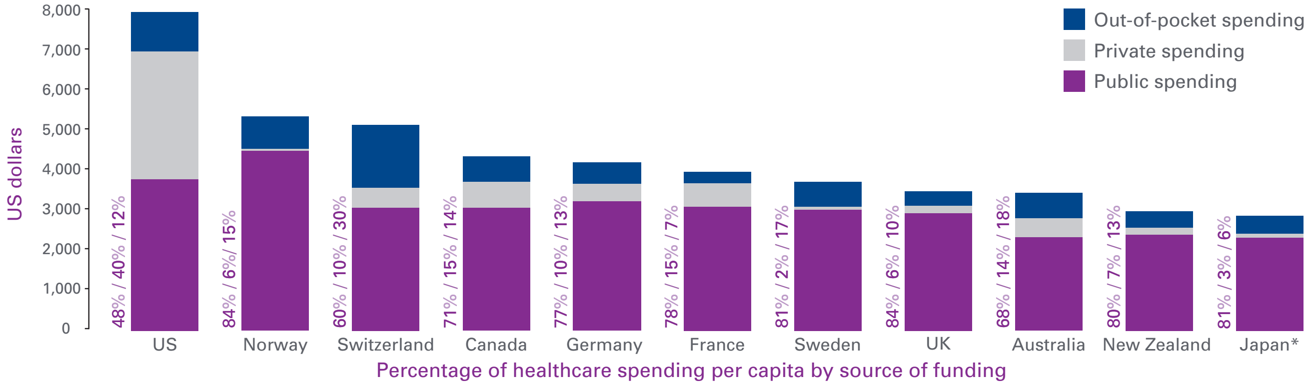
S D P

We see

For example

- Extremely diverse levels of private versus state healthcare provision around the world, including significant divergence in health spending per capita.

Healthcare spending per capita by source of funding, 2009



*Source: OECD Health Data 2011 (June) * 2008*

- Greater compulsion to self-fund for those who can afford to do so.

- Over recent years, Abu Dhabi, France, the Netherlands and parts of Switzerland, among others, have introduced mandatory insurance for their entire populations or for expatriate communities.[13]
- Nigeria's health minister has called for legislation to make health insurance mandatory, making access to healthcare more affordable.[14]

- Insurers investing in healthcare provision and other infrastructure assets.

- Investment in infrastructure is suited to long-term investors such as insurers and pension funds, but tends to be unattractive due to construction and operational risks.[15]

We see

- As healthcare costs continue to increase faster than consumer price indicates, greater focus is needed on health and wellness, including mental health.
- Could capping healthcare insurance premium increases provide an incentive to quit smoking, get active and eat healthily?

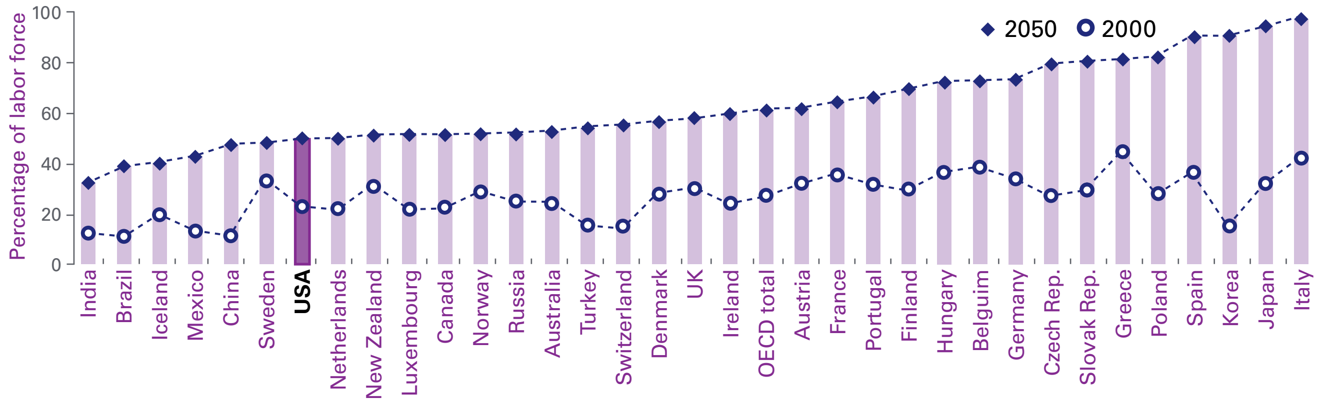
For example

- The rise in the cost of health insurance in the US exceeded wage growth in 2011, growing by 9 percent over the previous year.[16]
- In Australia, the average increase in health insurance premiums is determined annually by the health minister.[17]
- In the Netherlands, universal medical care coverage has been provided through an insurance market greatly reformed in 2006, where the government acts as regulator.[18]
- Anxiety disorders and depression are the fastest growing mental health problems in the world.[19]

Our working hypothesis includes

- As populations in mature markets age and the taxpayer base shrinks, stretched public finances will be unable to match increasing expectations. Those who can afford to self-fund healthcare, income protection and retirement will need to become more self-reliant, creating opportunities for insurers, although markets may be tightly regulated.
- Will we see more tax incentives on health insurance premiums or even as an incentive for healthy eating and taking more exercise become more prevalent, monitored online or via mobile devices?
- Advancements in medical technology may see mental health become the final remaining barrier to a fully active life. In future will it be acceptable for insurers to exclude claims that relate to mental health conditions?[20]

Ratio of inactive elderly population (>65 years) to the labor force (percentage)
Populations are ageing at dramatically different rates.



Source: OECD Factbook 2009: Economic, Environmental and Social Statistics

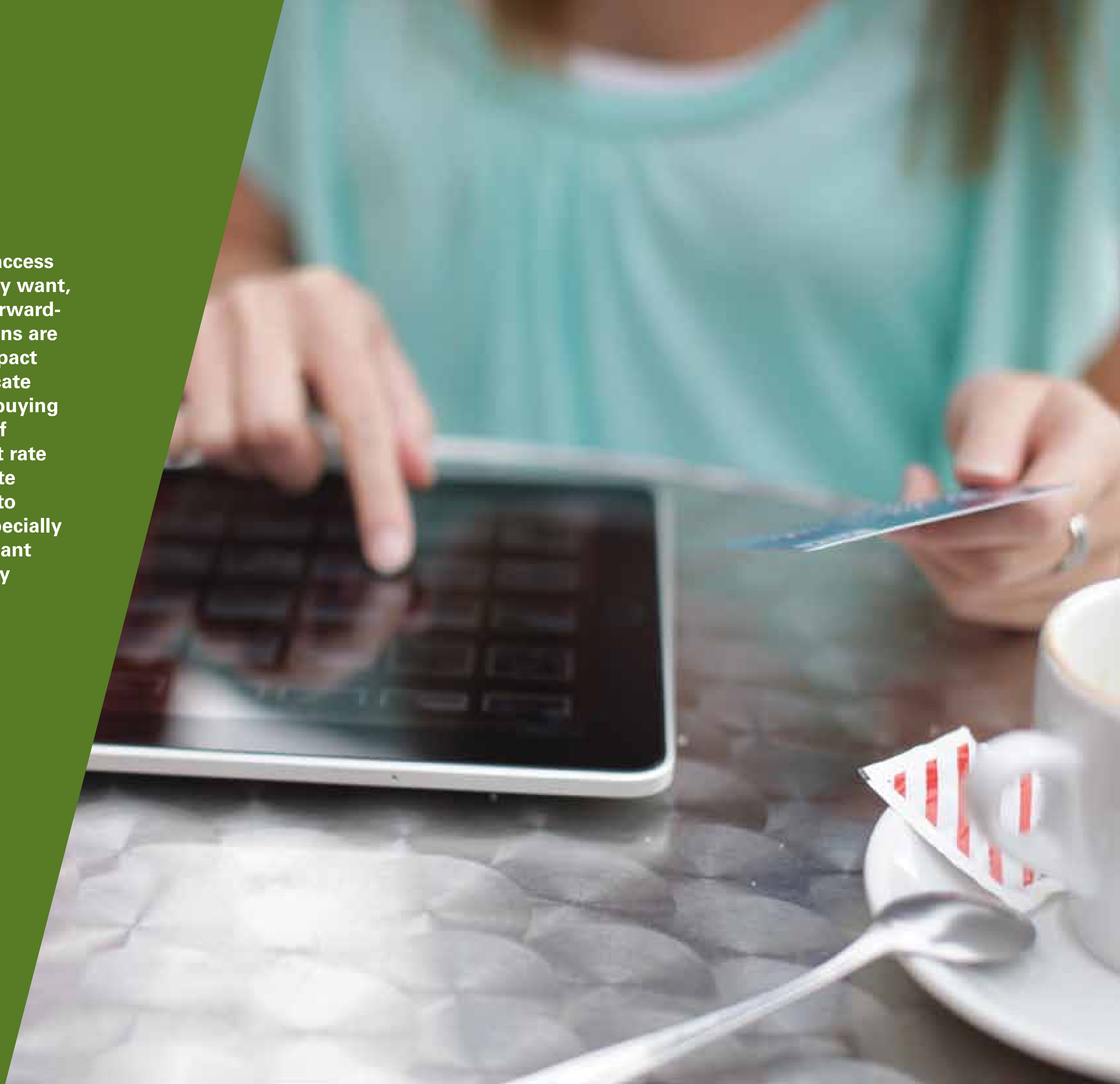
Opportunities for growth	Risks of inaction
• Better supplier management, perhaps through investment by insurers in private healthcare provision, to help manage the cost of claims. • Could less buy more – would insurers invest in their customers' well-being if this reduces the cost of claims? • Explore markets such as China where healthcare is traditionally financed from savings and there is a severe lack of state nursing homes. • Efforts to control government expenditure increase the potential market for private health insurance. • Active discussion with governments regarding their healthcare and spending policies to better understand upcoming needs.	• More buys less – rising medical costs makes health insurance less affordable, particularly as consumer expectations increase. • Risk equalization inhibits profitability and competition. • Social backlash on ethical grounds against ever-greater health screening.

"16% of employees believe social security benefits will be available for Generation Y retirees compared to today's retirees."

MetLife study in the US, March 2012

DISTRIBUTION AND OPERATIONS

Customers increasingly expect to access services where, when and how they want, using smartphones and tablets. Forward-looking financial services institutions are starting to explore the growing impact of using social media to communicate with customers, cater to evolving buying behaviors and mine a rich source of customer insights. In a low interest rate environment where insurers operate on tighter margins and must seek to acquire customers at less cost (especially in relatively slow-growing or stagnant economies), cloud computing is key to achieving greater flexibility and lowering unit costs.



Aligning customer interaction with evolving preferences requires greater use of mobile technology

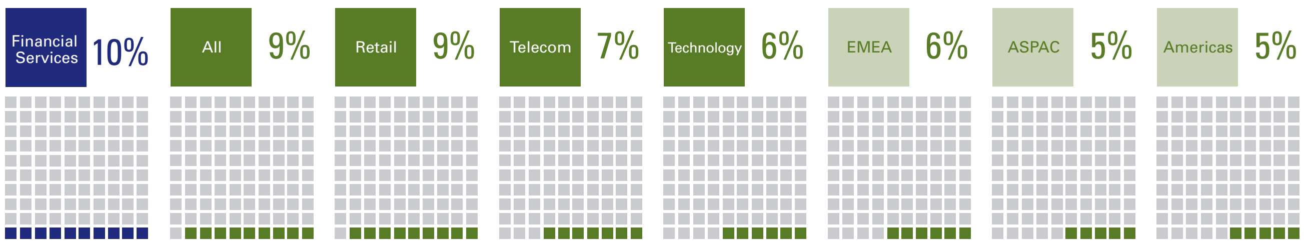
We see	For example
• Rapid growth in use of smartphones, tablets and GPS, as convenience, facilities, speed of service and ability to compare products are increasingly highly valued.	• In 2011, 17 percent of respondents preferred to transact banking and personal finance (mortgage, stocks etc.) through phones, tablets and other devices at the expense of using a PC.[21]
• Mobile payments gaining traction across Asia, Africa and Europe, with corporate customers adding their voices to calls for more advanced mobile payments solutions. • Security of personal data remains a concern. • Biometrics and microchips embedded under the skin may be in use by 2020.	• Mobile payments are expected to grow globally by 97 percent per annum over the 3 years to 2015, driven by customers' desires to shop in environments that are 'always on, always fast and always accessible.'[22] • "Some respondents believe that, by 2012, point-of-sale transactions will take place using biometrics."[23]

Our working hypothesis includes

- Insurers that go mobile have the potential to win two battles: to win the customer and to cut costs – a significant advantage at a time of low investment returns.

Mainstream mobile payments today

Base: 860 global companies (values may not sum 100% due to rounding)



Source: KPMG 2011 Mobile Payments Global Survey

"Customers want more mobile interaction. We see the tech-savvy Asian consumer leading the way in this space. Mobile payment volumes in Asia exceed western countries, and I see this continuing to grow exponentially. The use of social media is a major influence. Insurers must recognize that in future Asian consumers will expect more than their western counterparts. The world has changed. Insurers have got to face up to this."

Edge Zarrella
Partner, Clients and Innovation,
KPMG in China

"For consumers, speed and security of payment will be the mark of success … the winners will be the companies that can provide the richest consumer experience with the greatest convenience."

'Smartphone and tablet popularity brings maturity to mobile payment marketplace', KPMG in the UK, April 2012

Opportunities for growth	Risks of inaction
• Develop smartphone applications to deepen customer engagement and promote customer retention (e.g. access to claims specialists through apps). • Tailor the customer service experience to reflect different customer preferences, such as enabling mobile payments and payments through PayPal™. • Use mobile applications to promote social inclusion by increasing access to entry-level financial services. • Develop flexible solutions capable of adapting to upcoming regulatory changes such as the Insurance Mediation Directive 2 (IMD2) and Packaged Retail Investment Products (PRIPs).	• Relationships with customers become increasingly transactional and commoditized. • Inconsistent market presence if mobile channels not integrated into seamless and coordinated multi-channel distribution and customer servicing. • Re-purposing of web assets for mobile platform instead of rethinking approach to mobile technology may result in lost or sub-optimal opportunities. • Migration to mobile may erode existing customer base.

Social media facilitates enhanced interaction with customers and other constituencies

S E T D P

We see	For example
• Corporate use of social media increasing rapidly but varies significantly by country and may be constrained by regulatory considerations. Consumer use of social media expected to remain greater for some time.	• Seventy four percent of finance, insurance, business services and communications firms around the world are active on social media. Regulatory constraints in how financial services firms use 'new media' channels to communicate financial promotions to customers exist in the UK, among other countries.[24]
• While the payback period may be unclear, companies that have invested in greater use of social media say it is worthwhile.	• Exponential increase in the use of social media by financial services firms, for instance using Twitter as a customer service channel.[25]

Our working hypothesis includes

- Why would insurers not want to increase communication with their customers?
- Dramatic rise in crowd sourcing required over the coming years to drive innovation and enhance the customer experience.

"Under-investment in technology by insurers has not served them well. They need to streamline and innovate distribution while reinvigorating brands on better technological platforms.

One positive for insurers is that new technologies can be developed quickly and at low cost."

Edge Zarrella
Partner, Clients and Innovation
KPMG in China

Opportunities for growth	Risks of inaction
• Greater use of external data and data warehouses permits more targeted data mining and analytics to achieve greater consistency across channels and reduce lost business. • Crowd sourcing to drive product and service innovation. • Establish a win-back campaign to re-engage customers who have exited and decrease attrition. • Greater use of telemetry and smartphone GPS features to price travel insurance on a 'pay to play' basis. • Capture synergies and enhance brand presence through multi-channel convergence supported by closer collaboration between marketing, sales and product development teams. • Greater use of social media in fraud prevention and detection. • Bundle products into complementary offerings to create the opportunity to compete on attributes other than price including convenience, quality and customization.	• Insufficient internal data mining capacity and capability resulting in missed opportunity to interact with customers. • Customer dissatisfaction and mishandling complaints going viral, damaging brand and reputation. • Lack of preparedness for a hostile social media campaign. • Anti-selection, mis-pricing and increased capital requirements relative to peers. • 'Wait and learn' from others' mistakes risks falling too far behind competitors. • Could social media be used to create a mutual online 'crowd insurer'?

Cloud computing affords opportunities to enhance agility and efficiency

T P

We see	For example
• Cloud computing can enhance flexibility and scalability.	• "[Cloud provides] potential gains in areas such as speed to solution and widespread accessibility as well as flexibility, scalability, security and advanced technology."[26]
• Potential benefits include: – direct cost savings – reducing the inputs needed to generate the same output – productivity improvements – increased output per unit of cost – increased ability to innovate through greater flexibility.	• "Adoption of cloud services across 75 percent relevant ICT information, communication and technology spending, achieving opex [operating expenditure] and capex [capital expenditure] savings of 25 percent and 50 percent respectively."[27]

Our working hypothesis includes

- Heavily regulated industries such as insurance are more likely to adopt a private cloud to address regulators' concerns over data security.
- Many operational and some customer-facing applications are being moved onto cloud. The cloud is now reality.

Opportunities for growth	Risks of inaction
• Use public cloud to help achieve cost-effective penetration of under-insured markets, e.g. to facilitate micro-insurance. • Enhance revenue potential through becoming service provider through SaaS or IaaS model, servicing independent insurance agents or other insurers. • Use of a single repository for customer-related activities increases awareness of all customer touch points and decreases redundant or inappropriate customer communications – saving money and increasing customer satisfaction.	• Leapfrogged by new entrants and leading practice peers. • Cumbersome and expensive legacy systems, requiring considerable capital and maintenance expenditure. • Impairment of assets if infrastructure becomes obsolete. • Greater risk of regulatory intervention if data privacy and control not addressed voluntarily.

"Cloud computing – the hype has become reality. One of the next big challenges is catching up with banks regarding mobile and other forms of more convenient payments."

Salim Tharani
Partner, KPMG in the UK

GOVERNANCE AND PEOPLE

Financial institutions are increasingly subject to public scrutiny, with greater expectations of good governance since the global financial crisis. Against a backdrop of diminished trust in 'big business' and financial services in particular, there is a clear opportunity to enhance transparency and communication. Trust is shifting from being earned through customer engagement to being dispensed via social media, and the penalty for breaching trust is immediate and severe, with companies potentially being 'defriended' for life. Successfully building trust creates value, especially as intangibles are increasingly recognized on corporate balance sheets.

Good governance and responsibility is of mounting importance

S E D P

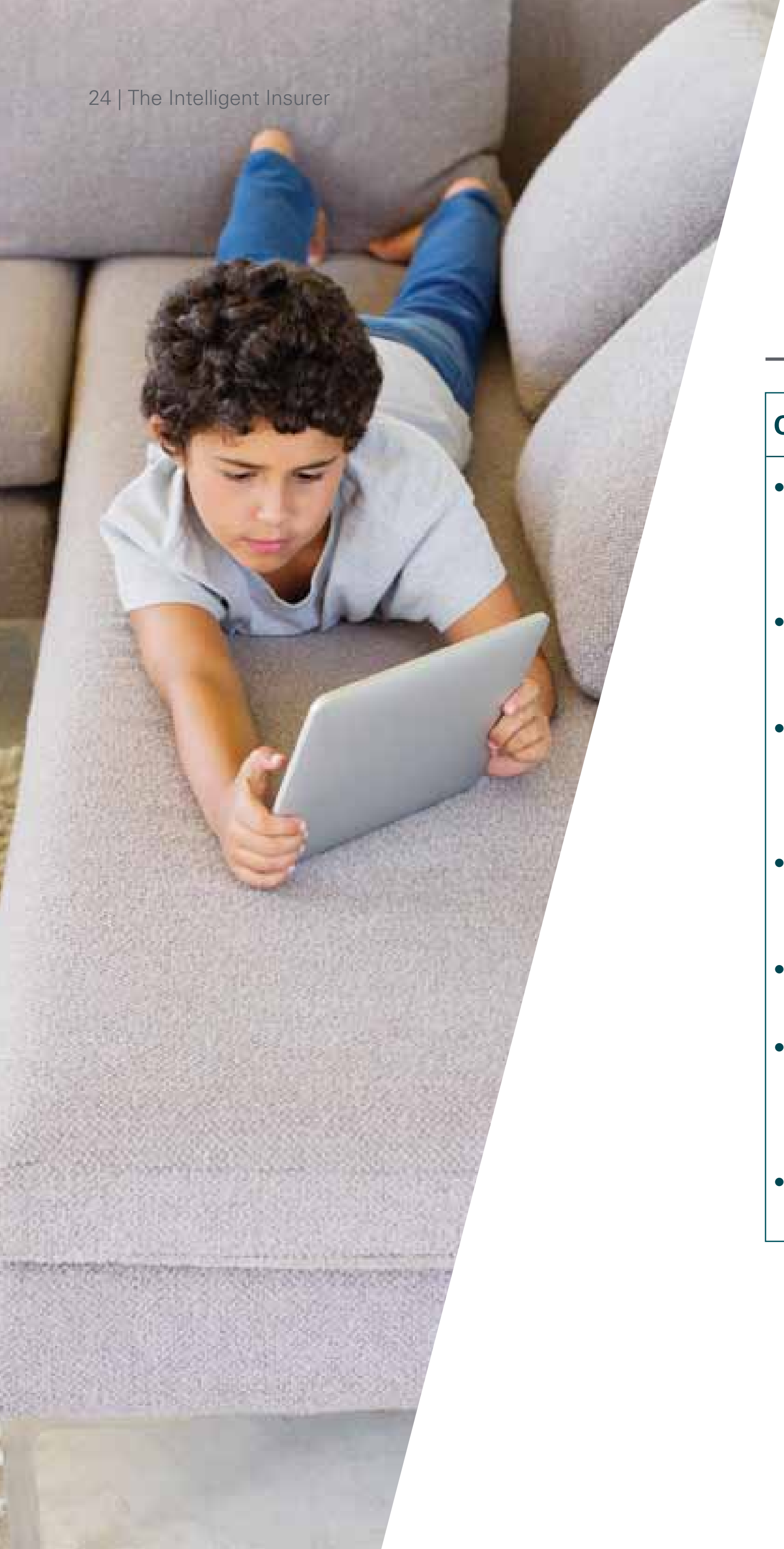
We see	For example
• Continuing pressure for responsible capitalism and sustainable and responsible investment.	• "Of course, no one was ever in favor of irresponsible capitalism, but there is a perception that capitalism has not performed as well as it should in recent years … There are essentially two ways to make capitalism more responsible. The first is government intervention … But to real free marketeers there is an alternative: greater competition."[28]
• Generation Y places greater value on challenge, self-improvement, enjoyment and values-driven employers.	• Young professionals "want to have a career where they are challenged and can grow with the challenges. Rather than being bored, they prefer jobs which stretch them and if they are no longer challenged they would consider moving on ..." [29]
• Executive remuneration will remain under scrutiny. 'Say on pay' is here to stay.	• "Recent and current executive compensation practices ... present incentives for executives to take actions to increase short-term shareholder value at the expense of other stakeholders ... redefining the corporate objective and designing executive compensation to take account of the interests of a broader group of stakeholders may help address the current ethical problems with executive compensation."[30]

Our working hypothesis includes

- Good governance and responsibility is valued by customers, employees and investors – its importance should not be underestimated.
- Integrated reporting that focuses on the essentials and cuts through clutter is an important means of rebuilding trust.

"The prominence of Responsible Capitalism on this year's [World Economic Forum] Davos agenda is symbolic of the groundswell of public opinion towards strengthened values and ethics in business and long-term responsible business strategies. With its long-term profile and actuarial insights into global risks, the insurance industry is uniquely placed to play a leading role in forging a model of capitalism that contributes to a more prosperous, sustainable and equitable world."

Serena Brown
Global Citizenship,
KPMG International



Opportunities for growth	Risks of inaction
• Actively utilize corporate responsibility agenda to compete for talent and to embed values throughout the organization, employing diverse workforce to realize opportunities in increasingly diverse markets. • Signing up to UN Global Compact and developing statements on human rights and other relevant issues helps to demonstrate a 'caring' organization. • Integrate governance, risk and compliance issues with financial management and reporting to generate transparency and confidence, including an approach to anti-corruption. • Link executive remuneration to long-term performance and operational risk management, to engender confidence and trust. • Strengthen relationships and reputation through community engagement. • Lead in sustainable and responsible investing, screening existing and prospective investments for ethical considerations. Use investment muscle to press for sustainable behavior by investees and stakeholders. • Easily understandable and transparent policy terms and conditions to attract customers.	• Failure to 'live' corporate responsibility values risks alienating the best talent and socially and environmentally aware customers. • Damage to brand if viewed as being unethical or an uncaring business. • Risk of shareholder dissent and associated adverse media coverage on executive remuneration.[31] • Accusations of greenwashing. • Social or governmental pressure if payouts lag peers and evolving expectations.

Trust in financial services is among the lowest of any industry

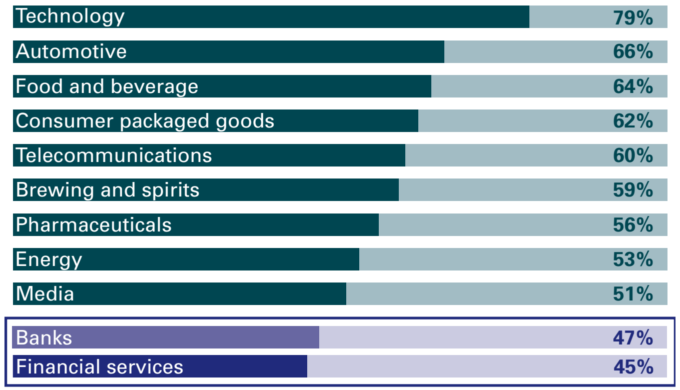
S P

We see

- Trust in financial services organizations is extremely low.

For example

Public trust in selection of industry sectors 2012



Source: Edelman Trust Barometer 2012

We see

- Social media is increasingly key to transparency and communications.

For example

- Facebook has 845 million active users – an increase of 39 percent in a year – with the mission to make the world more open and connected.[32]
- According to CorporateRegister.com, more than 5,500 companies around the world issued sustainability reports in 2011, up from about 800 a decade ago.[33]
- Finnish insurance company 'If' connects potential customers with 852 existing customers "to gain insight into the happiness or dissatisfaction of current policyholders, along with reasons why".[34]

"Insurers need innovative technologies to engage with the young and vibrant in emerging markets. This varied environment will require different governance skills, managing both older legacy systems, and new technologies. Insurers have struggled to deal with the more innovative technologies and unfortunately many struggle to attract newer skills."

Edge Zarrella
Partner, Clients and Innovation,
KPMG in China

"Trust in financial services by both consumers and investors is at an all-time low. Insurers are one of the guardians of our future – required to honor a promise made today many decades in the future. Engagement and transparency are vital means of reversing that trend, but a concerted and genuine effort is vital."

Mary Trussell
Partner, KPMG in the UK

Opportunities for growth	Risks of inaction
• Enhance communications to build stronger relationships with stakeholders, gauging and responding to their priorities and preferences. • Incentivize and deeply embed ethical behavior in your organization, rather than treating it as 'compliance.' • Actively monitor and build upon evidence showing levels of stakeholder trust in your firm. • View social media as an opportunity to engage and reach new customers, rather than as a damage limitation tool. • Develop shared interest groups built on peer-to-peer recommendations and cooperation through, for instance, social media sites. • Develop new or revised models of mutuality – were mutual insurers an early application of 'crowd funding.' • Improve brand recognition, reduce customer churn and employee turnover.	• Dissatisfaction or bad experience swiftly goes viral. • Increased recruitment costs from higher employee turnover. • Loss of trust translates into loss of customers.

REGULATION AND CAPITAL MANAGEMENT

The world is becoming more tightly coupled, with financial risk and insurance risk more closely interconnected. As a result, current approaches to capital management and risk modelling will need rethinking. A more developed understanding of interconnectivity, particularly of tail risks, may lead to better understanding of exposures and enable more accurate pricing and more effective loss prevention. This greater transparency, however, is accompanied by further risk if customers are not prepared to pay for the economic cost of the protection they seek.

Is insurance investable?

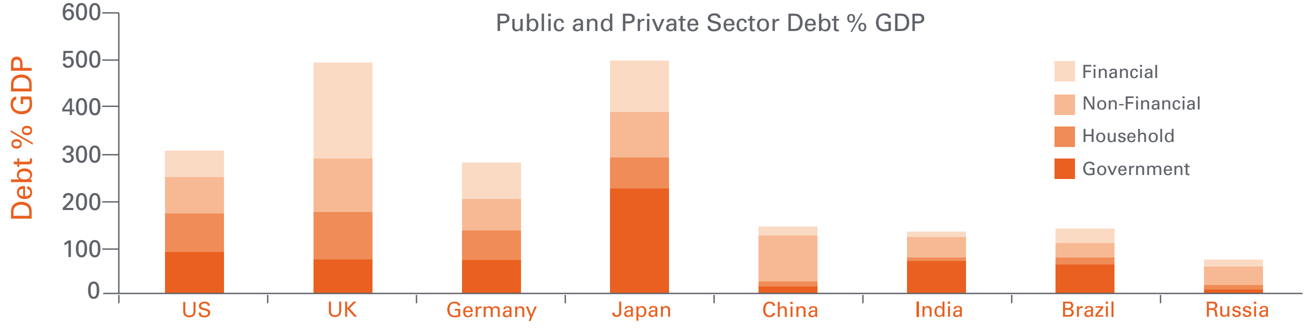
S E T D P

We see	For example
• Investor appetite for the insurance sector in mature markets is low – and declining.	• "Prospects for the insurance sector appear less promising than they were in 2001, when we expected baby boomers to accumulate retirement funds with attractive margins for life insurers ... the growth has been lower and the margins much less."[35]
• Many investors mistrust insurers, asking both what happens inside the black box and why it costs so much. This is compounded because insurance accounting conventions, particularly for life insurance, are difficult for the outside world to understand.	• "European life insurers need to get much better at telling us how they make money ... the dependence on investment margins is still too high in our view, and life insurers' cost bases still have significant room for improvement."[36] • Colin Devine, Managing Director of Citi Investment Research, noted "I want companies that I think have predictable liabilities ... the liabilities, unfortunately, are within that actuarial black box. That's the mistake I'm going to have to live with. That's what can trigger reserve adds and hold down ROE [Return on Equity]."[37]
• A greater appetite for insurance earnings from non–life insurance and protection products – as long as unpleasant surprises are avoided.	• JP Morgan Cazenove notes only one European stock in their coverage universe is trading above its value in 2000, which "reflects the interest of investors for business models which are little correlated with markets and which are focused on underwriting profits."[38]

"With its long-term profile and actuarial insights into global risks, the insurance industry is uniquely placed to play a leading role in forging a model of capitalism that contributes to a more prosperous, sustainable and equitable world."

Serena Brown
Global Citizenship,
KPMG International

Emerging Markets' Debt Lower



Source: Government debt and 2010 GDP estimates from the IMF, as of October 2010. Private sector data for Japan, China, India, Brazil and Russia from Haver Analytics, estimates for 2009 actual, as of April 2010. Private sector data for US, UK and Germany from IMF, as of October 2010

Our working hypothesis includes

- Regulation is driving capital up. In order to remain investable insurers need to service their capital. With lower investment yields, this means pressure to increase operating returns by either cutting costs or by increasing prices, or probably both.
- To attract investment, insurers will need to provide perceived value to their customers and transparency to their investors, as well as adequate returns.
- In the new world some of today's insurers may choose to become facilitators of insurance to social groups rather than risk carriers.

Opportunities for growth

- Attract investors by clearly explaining how profits are made and presenting risk-adjusted returns and measures understood by generalist investors such as cash generation and dividends.
- Re-engineer the business to permanently reduce costs – including costs of acquisition – and scale costs to the changing size of the business.
- Develop a business model that clearly articulates sources of earnings, with a focus on growing insurance earnings.

Risks of inaction

- Higher cost of capital.
- Some investors to perceive insurers as even riskier than banks.
- New, untainted market entrants seize competitive advantage.

Increasingly wealthy urban areas are exposed to natural catastrophes and emerging risks such as climate change and pandemics

E D P

We see	For example
• Growing urbanization resulting in an increasing proportion of the world's population living in Low Elevation Coastal Zones, which are susceptible to sea level rises and other natural catastrophes.	• "Growth of cities often comes with higher levels of income, production, accumulation and consumption, all of which contribute to environmental stress … Despite covering just 1 percent of the world's surface, cities are claimed to … account for 75 percent of global greenhouse emissions."[39] • "Settlements in coastal lowlands are especially vulnerable to risks resulting from climate change, yet these lowlands are densely settled and growing rapidly. In some countries (most notably China), urbanization is driving a movement in population towards the coast."[40]
• Agricultural yields in equatorial climates will fall with global warming, increasing risks to health and economic development.	

Predicted impact of temperature rise on food production

Temperature rise (°C)	Impact on food
1°C	Modest increase in cereal yields in temperate regions
2°C	Sharp declines in crop yields in tropical regions (5-10% in Africa)
3°C	Agricultural yields in higher latitudes likely to peak
4°C	Agricultural yields decline by 15-35% in Africa, and entire regions out of production (e.g. Australia)
5°C	Continuous increase in ocean acidity seriously disrupting marine ecosystems and possibly fish stocks

Source: Adapted from Stern (2007) p.v.

"There is a genuine appetite on the part of the business community to understand how environmental and climate change policies will affect them, coupled with a recognition that measures taken by governments to combat a warming planet simply cannot be seen as an imposition. Companies are keen to act responsibly and do what they do in the best possible way."

Yvo do Boer
Special Global Advisor on Climate Change and Sustainability, KPMG International

"We are already seeing the more forward-looking insurers starting to adjust their investment profiles and risk models. Low interest rates may constrain those who have not already done so."

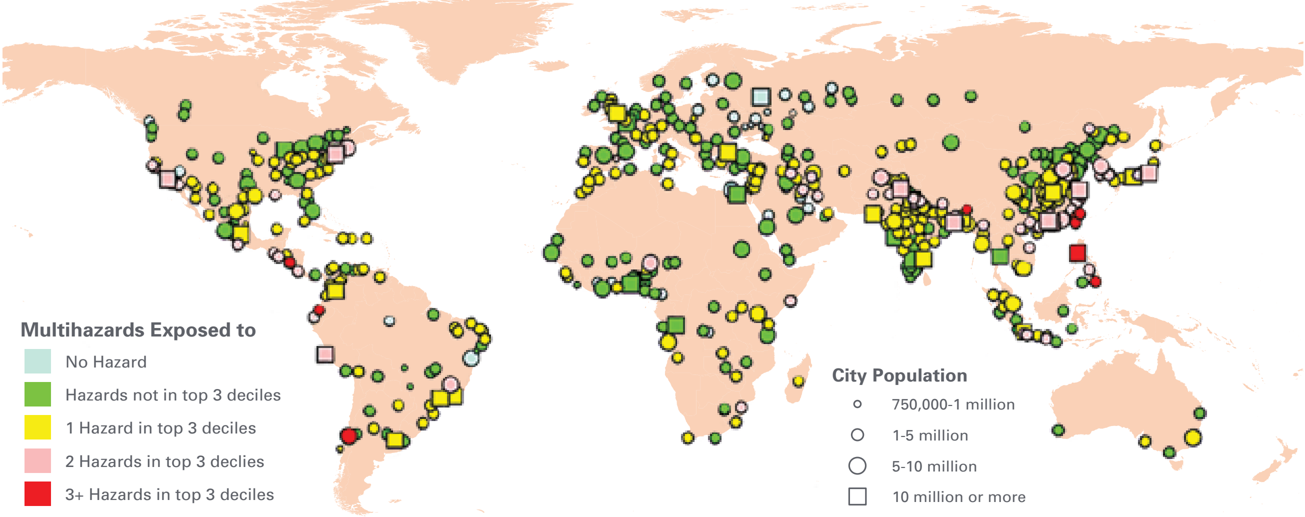
Francesca Short
Partner, KPMG in the UK

We see	For example
• Growing water scarcity impacts business operations and development of population centers.	• "We're already seeing decreases in companies' water allotments, more stringent regulations, higher costs for water, growing community opposition and increased public scrutiny of corporate water practices."[41]
• Greater connectivity and more complex supply chains exacerbate the risks arising from climate change.	• "For many companies, the most important climate change risks and opportunities may lie outside of their owned operations … [Kraft] is addressing growing climate and other risks to high-value tropical crops like coffee and cocoa by working with organizations such as the Rainforest Alliance … to support its suppliers and encourage sustainable production."[42]

Our working hypothesis includes

- The combined effect of growing urbanization, increasing insurance penetration, rising asset values in Low Elevation Coastal Zones and unforeseen perils will make the interaction of tail events even more challenging to understand and price.
- Smaller businesses will be more susceptible to larger losses, lacking scope to geographically diversify their supply chains.
- More scenario modelling is needed to help price the cost of unexpected but plausible losses rather than waiting for actual losses to occur.

Urban agglomerations by size class and potential risk of multiple natural disasters, 2025



Source: United Nations Department of Economic and Social Affairs, 2011

Opportunities for growth	Risks of inaction
• Innovative models to cater for future trends and preserve capital, such as engagement with World Bank's development of models on endangered crop yields and hurricane exposures. • Rising demand for health, property and business interruption insurance as wealth increases and risks are better understood. • Greater consideration of climate-related impacts on investment risks, including at due diligence phase – better understanding of risk profile, possible impaired investment values and impact of asset liability management on business in the longer term. • Data sharing with NGOs, governments, inter-governmental bodies and other businesses to enable better modelling, pricing and underwriting of risks and improved capital allocation.	• Missed opportunity to innovate to demonstrate future relevance of insurance to manage emerging risks. • Anti-selection as other insurers improve their pricing and underwriting and better understand risk concentrations and tail risk. • Unplanned changes in risk exposure, including to customers' supply chains. Investors seek to disinvest due to lack of understanding of your exposure to climate-related risks.

"Just as climate change may substantially increase insured losses, it also threatens the performance of the vast investment portfolios insurers rely on to meet their liabilities."

Climate Risk Disclosure by Insurers: Evaluating Insurer Responses to the NAIC Climate Disclosure Survey, CERES, September 2011

Historically low investment yields and volatile markets are driving a search for innovative long-term investments

We see	For example
• Investment returns are at historical lows even in high growth countries with structural surpluses.	• "Amid the latest panic over Europe we're seeing the lowest level of US interest rates since the aftermath of World War II, as investors bid up the prices of US government debt."[43]
• In the US and the UK, challenges are exacerbated by quantitative easing and other measures designed to boost money supply through large-scale asset purchases and incentivize economic regeneration.	• The 2009 and 2010 program of quantitative easing in the UK "reduced long-maturity gilt yields by up to 95 basis points on the long run."[44] • "Let's twist, but not like we did last year. One unintended consequence of Operation Twist is that the cost to banks and insurance companies could be substantial."[45]
• In high growth markets where government funding operates at a surplus the lack of long-dated government debt makes matching long-duration insurance liabilities a challenge.	• "High savings in several emerging market economies tend to reflect caution. Households save – probably more than they need – because they cannot rely on social safety nets, such as healthcare and unemployment insurance. Governments in Asia also save too much for a similar reason; by building up their international reserves, they create a large cushion against possible international shocks …"[46]
• Regulatory capital requirements can inadvertently distort markets and may curtail the products insurers offer to customers.	• "Overall, it seems likely that capital requirements under Solvency II will, in aggregate, lead to a risk reduction in the asset allocation of the insurance sector as a whole. This may to some extent be regarded as an intended consequence and legitimate goal of regulation, but one that has implications for financial markets and sectoral funding."[47]

Our working hypothesis includes

- Moves towards fiscal transparency favor mutual funds and mean more opaque insurance products may only sell if they contain tax advantages. As a result, insurers providing saving products risk losing out to wealth managers unless they can demonstrate sustainable and superior risk-adjusted performance.
- Infrastructure development offers interesting long-term opportunities for yield enhancement, if structured to mitigate capital add-ons, perhaps through innovative partnerships with governments.
- Successful insurers will permanently take cost out of their operations.

Opportunities for growth

- Greater focus on protection products and insurance earnings that are less correlated with market risk.
- Innovative search for yield pick up at reasonable risk, such as investment in long-term infrastructure development if suitable credit enhancement can be provided to mitigate capital add-ons.[48]
- Adjust investment allocation where possible within the constraints of risk appetite to include assets with higher yields.

Risks of inaction

- Doubt over long-term sustainability of current business models if insurers cannot find long-term investment instruments offering adequate returns and security.
- Insurers risk losing out to wealth managers unless they can demonstrate sustainable and superior risk-adjusted performance.
- Insurers who make a substantial element of their returns from investment spreads will need to demonstrate a long-term track record of risk-adjusted out-performance.

The regulatory agenda has already changed

We see	For example
• The political fall out arising from the global financial crisis has meant zero appetite for future government support. Regulators are themselves experiencing unprecedented reform, implementing additional measures to protect policyholders and seek better outcomes for consumers.	• The G20 and Financial Stability Board (FSB) are important new stakeholders on the insurance regulatory scene.[49] • Failure to understand these important developments and undertake reform could prove costly – both in terms of the prudential and conduct agendas.
• Old relationships with home country supervisors will no longer be enough in a new regulatory environment comprising supervisory colleges and multi-lateral oversight arrangements.	• This will require new relationships to be formed across borders, reporting information that facilitates and enhances dialogue for all concerned stakeholders. Supervisors are acutely aware that they cannot afford to go unsighted and are forcing insurers to be more open and transparent than ever before.
• Financial institutions may effectively become tax collection agencies and sources of taxpayer data for tax authorities clamping down on cross-border tax avoidance, increasing the compliance burden.	• Tax regimes will generally become more intrusive as authorities look to raise tax revenues from domestic and cross-border sources, including more aggressive transfer pricing approach and taxing offshore gains derived from onshore assets.
• The fair treatment of customers is no longer a national or even a regional issue. Consumer protection is moving much higher up the political agenda – managing different regimes in different countries is increasingly a key competence for global insurance groups. • G20 finance ministers have expressed concern that without the restoration of consumer trust and confidence in financial services the basis of global economic recovery may be limited.	• In February 2011, the G20 requested the OECD to develop guidelines for advancing consumer protection through informed choices including disclosure; transparency and education; protection from fraud, abuse and errors, along with recourse and advocacy. • Policy terms and conditions will be increasingly subject to regulatory focus.[50] • For example, in future we can see Own Risk and Solvency Assessments (ORSA) being required to contain specific material relating to consumer protection.

Our working hypothesis includes

- Increased political pressure on insurance supervisors to adopt unified requirements on capital, risk and governance – leading to a common framework for the supervision of Internationally Active Insurance Groups (IAIGs) (ComFrame) within 10-15 years.
- ComFrame replacing Solvency II for European Internationally Active Insurance Groups within 15 years, with all insurers required to undertake reverse stress testing as part of their ORSA analysis, outlining how they could be resolved in the event of a crisis within five years. We do not see a Solvency III.
- European groups being supervised centrally by the European Insurance and Occupational Pensions Authority (EIOPA) rather than by country supervisors within five to 10 years.

Opportunities for growth

- Openness and transparency is rewarded with the benefit of a supervisory dividend.
- Greater focus on consumer protection and transparency offers the opportunity of distinctive market positioning as well as supervisory benefits.
- An integrated approach to managing multiple regulatory relationships is a key competence for global insurers – and reduces the costs of compliance.

Risks of inaction

- Increased supervisory oversight and challenge to boards and management teams on strategy, pricing and risk management with additional oversight of internal systems and controls, processes and procedures.
- Increased capital requirements if insurers cannot adequately communicate the complexities of their business to supervisors.
- Competitive disadvantage of not embracing the change agenda – business units not able to effect changes in strategy and process will underperform.
- Sub-optimal risk and capital positions if unable to determine the best products for a given customer profile.
- Supervisors wanting to break up complex groups to help them better manage the risks to their own objectives.

Join the debate

We sincerely believe that insurance is a vital social and economic lubricant – and its role is becoming more important, not less. This role and the forces shaping its future must be clearly understood by governments, regulators, inter-governmental agencies, NGOs – and consumers.

Your views on these and other issues shaping the insurance industry of the future would be very welcome. You can join the conversation at:

Twitter: @kpmgglobal

LinkedIn: www.kpmg.com/socialmedia

Web: kpmg.com/intelligentinsurer

"It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is the most adaptable to change."

Clarence Darrow

To get the debate started we would like to hear your views on the following

- What mega-trends do you see affecting the industry during the next decade?
- What are the key challenges the industry needs to overcome?

Products and Markets

- Do you believe insurers make sufficient use of demographic data and predictive analytics to understand where customers and markets will be in 5 years?
- What innovative insurance products do you see becoming mainstream in the next 5 years?

Distribution and Operations

- How do you see distribution channels evolving in order to leverage advances in technology to enhance the customer experience?
- With operating models under increasing pressure in mature markets, what activities should insurers undertake today to prepare for the future?

Governance and People

- Do you see insurers taking a more proactive role in leveraging the corporate responsibility agenda to better compete for top talent?
- How do you see the evolution of social networks helping to build trust in financial services and to better engage with customers and other stakeholders?

Regulation and Capital Management

- Do you feel policymakers and regulators have a good grasp of the industry – and the vital social and economic role played by insurance?
- What innovative models do you see adapting to a low interest rate environment?

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