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KPMG IN RUSSIA AND THE CIS

Ongoing change: the Russian insurance market survey

June 2015

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Introduction

KPMG is proud to present this sixth annual survey of the Russian insurance market. You are invited to come with us as we explore the key directions in which the Russian insurance market is moving, and to look at the trends – as seen by the chief executives of insurance companies – that will determine short-term market development.

2014 was a difficult and complicated year, full of events that heavily impacted all firms operating in the Russian insurance market. The economic aftershocks continue to echo across the insurance industry, causing market growth to progressively slow. Against this backdrop of unstable foreign exchange rates, CMTPL insurance legislative reforms caused a market redistribution between the large and medium companies. Our survey's participants forecast that smaller market players will, like the Top-11 to Top-20 companies, see decreases in sales. This is due to the unstable macroeconomic environment, the limited resources that smaller players can call upon, and the greater hurdles they face in raising additional capital.

The expected loss ratios for Casco, CMTPL and VMI have increased when compared with last year's estimates. However, cost-cutting activities scheduled by insurers at the beginning of 2014 were effective, having prevented decreases in expected profitability for all lines of business, except Casco. We can thus conclude that the preventive measures taken to maintain the profitability of Casco are likely to have been insufficient.

Changes made by the regulator to compulsory insurance have intensified regulatory pressure on companies in all market segments. Regulation can affect any player, irrespective of size, as recent insurance market events show. Nevertheless, our survey participants continue to believe that areas such as capital adequacy and insurance fraud still require regulatory control.

We invite you to explore the findings of our survey and hope that this information will be enlightening for you. We would also like to take this opportunity to thank our colleagues and partners who contributed to this survey, and extend our gratitude to all the respondents, without whom this survey would not have been possible.

Best regards,

Adrian Quinton
Partner, CIS Head of Insurance and Actuarial Services

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Main findings

Despite the gross written premium of top firms increasing, total market growth is slowing down

Companies in the Top-11 to Top-20 range appear to be the main reason why insurance market growth decelerated in 2014. These companies, as would be expected, focus on providing motor insurance and VMI. They therefore suffered from the political and economic events that occurred last year more than others, seeing their aggregate portfolios curtailed by 4%. The insurance CEOs who took part in this survey believe that this decline will spread to the smaller market players, bringing the entire market closer to stagnation.

The main negative influences on the insurance market are coming from three sources: the economic situation in the country, purchasing power, and bank lending. However, our survey respondents expected CMTPL premiums to increase following a revision of rates, and this could become one of the few drivers of insurance market growth. Our respondents did not arrive at a definite conclusion as to how the life insurance market will develop, despite it showing double-digit growth over the last few years. Over half of our respondents are optimists, expecting the market to grow; while the remainder are more conservative, envisaging a decrease in gross written premium.

Aiming to maintain the profitability of their businesses, top managers keep on cutting costs

The economic shocks that have hit Russia in the last two years have complicated the tasks faced by chief executives in the insurance industry. The number one objective for an insurance company, as for any business in any other sector, is to increase profitability. In 2015, as previously, cost cutting is one of the principal ways that this goal can be achieved. However, practical methods to achieve this goal has changed. Now they include optimisation of tariff rate scales, taking into account currency market movements.

Insurance companies have shifted focus to concentrate on retaining clients. Increased consumer loyalty leads to lower acquisition costs, as well as to the securing of current revenue levels. Insurers are trying to increase their appeal to loyal customers in different ways. Product line expansion enables existing customers' interest to be aroused, stimulating them to purchase connected products. More detailed underwriting could lead to optimisation of the rates being offered in connection with popular products, making them cheaper for some consumers by allowing discounts to be awarded to loyal clients.

Combined loss ratios for all lines of business, except Casco, will remain at 2014 levels

The Casco loss ratio is more vulnerable to macroeconomic influences. Survey respondents expect the profitability of Casco insurance to decline in response to volatility on the currency markets. The expected profitability of CMTPL insurance will stay at previous years' levels, most probably due to the activities of the regulator concerning this line of business. Regulatory control is likely to tighten.

According to the predictions of our respondents, the combined loss ratios for other lines of business will not significantly differ from those ratios of previous years. The implementation in 2014 of cost optimisation measures is likely the most probable reason behind the maintenance of profitability.

Decreasing or canceling salary indexations, rather than reducing the headcount, is assumed to be the chosen route to further cutting personnel costs. However, the threat of 'brain drain' is likely to be critical for insurance companies, which will struggle to try and keep their existing human resources in the current economic environment.

Studying the way in which relationships with intermediaries and partners can be optimised is a practical route to cutting administrative and acquisition costs. Renewing rent contracts using fixed Rouble exchange rates would appear to be the most effective way to cut costs. Top managers are also optimising the organisational structures in their companies and developing less costly sales channels.

Insurers intend to reduce inflationary pressure on the profitability of motor insurance

In order to fight against inflationary pressures on motor insurance, insurance chiefs are intending to hedge their exchange rate risks and increase their tariffs on foreign-made cars.

Inflationary pressure affects CMTPL to a lesser extent following implementation of the "unified methodology to determine recovery expenses". Nevertheless, a majority of survey respondents find current CMTPL rates to be insufficient. They believe that on average rates should be scaled-up by 15%.

Insurance companies could be underestimating the impact of fraud on their performance

Survey respondents reported that the process of settling motor claims is subject to a far greater degree of insurance fraud. In the day when insurers can no longer maintain profitability by calling on the usual policy levers, it is likely to be those insurance executives who pay attention to fraud levels who find additional room for manoeuver and increase profitability.

The impact of internal fraud on company revenues is estimated by our survey participants as insignificant, though they singled out procurement, underwriting, commission payments, and abandons disposal as possible internal fraud vulnerabilities. It might be that insurers are concentrating so much on external fraud, that in so doing they are potentially underestimating problems with their own internal fraud.

CEOs of both large and small insurance companies note strengthening regulatory pressure

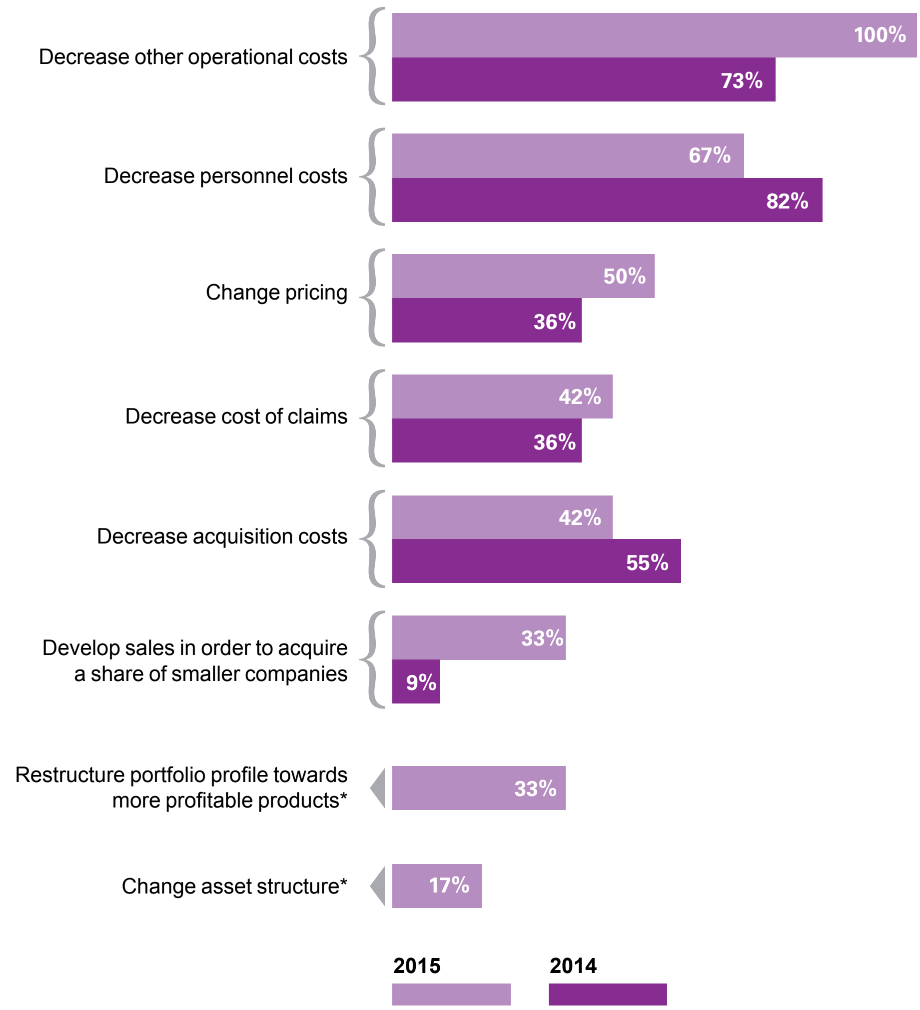
The regulator monitors the activities of market players irrespective of their size, a fact verified by recent insurance market news. However, a quarter of survey respondents consider that the market still has areas where regulation needs significant improvements. One such area identified by our survey participants is capital adequacy. Some respondents consider the current capital requirements as economically groundless, and suggest transitioning to foreign practices.

Survey respondents expect consolidation of the insurance market to speed-up

Stronger regulatory pressure has resulted in an altogether tougher insurance market environment, bringing many companies closer to bankruptcy or to the point at which their licences may be revoked. The smaller the company, the greater the effect from the economic woes: smaller companies will be writing less premium, enabling larger firms to enlarge their market share.

Market development strategies and options

Measures which are likely to be taken by insurers given the macroeconomic situation in the country



** This option was first presented in the 2015 questionnaire.*

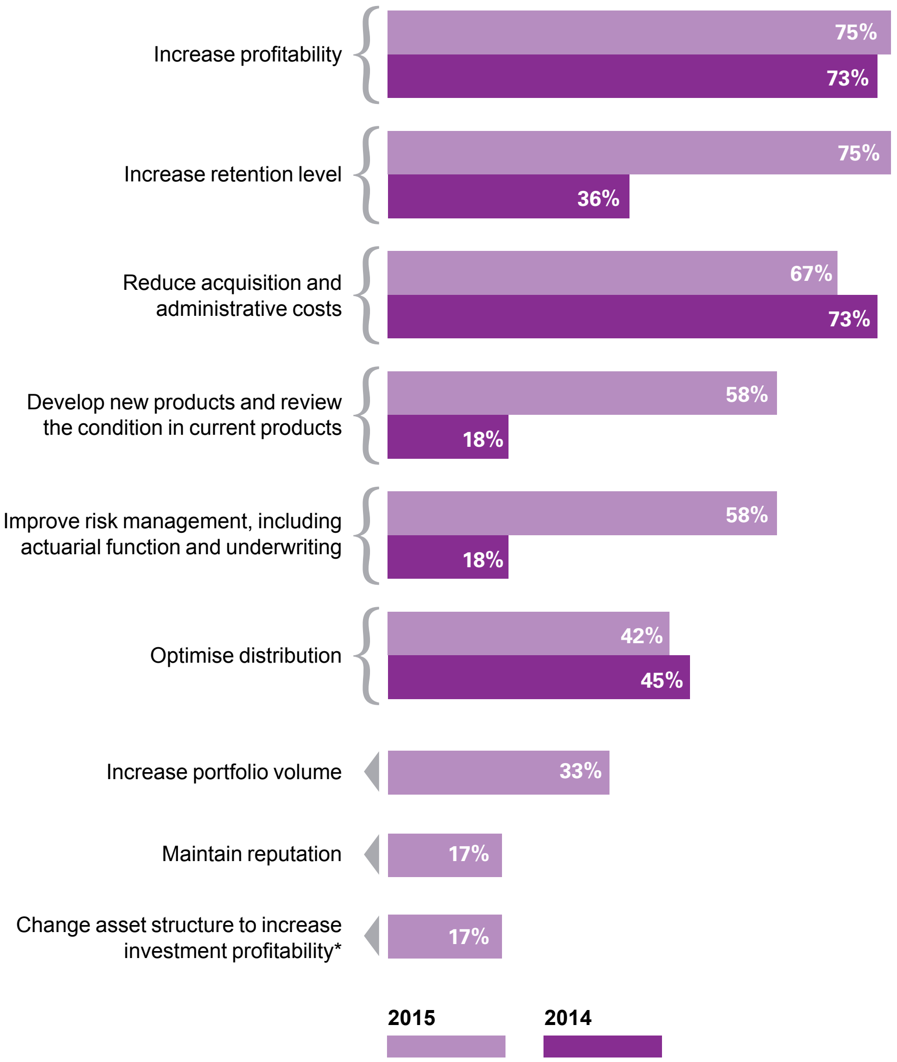
Source: KPMG analysis.

To maintain the profitability of their businesses in the current macroeconomic climate, insurance executives are going to continue cutting costs.

Rebounding from the political and economic events that took place in 2014, the Russian insurance market continues to change shape. Last year the majority of survey respondents singled out cuts to personnel costs as a number one target; now they are more focused on reducing operational expenses. Most insurance executives are going to continue cutting personnel costs, though to a lesser extent than previously. This might be as a result of actions in some companies to optimise employee benefits. Cutting wages simply carries the risk of prompting a 'brain drain' of a firm's staff, while high inflation has led to the price of consumer goods increasing. Paying staff a wage insufficient to pay for consumer goods will simply lead to staff leaving.

Exchange rate fluctuations have forced insurance companies to consider tariff revisions, particularly if their business is exposed to currency market volatility. Half of our respondents believe that it is time to implement rational tariff changes to enable them to retain their current market position and keep their financial stability.

Priority areas of development



** This option was first presented in the 2015 questionnaire.*

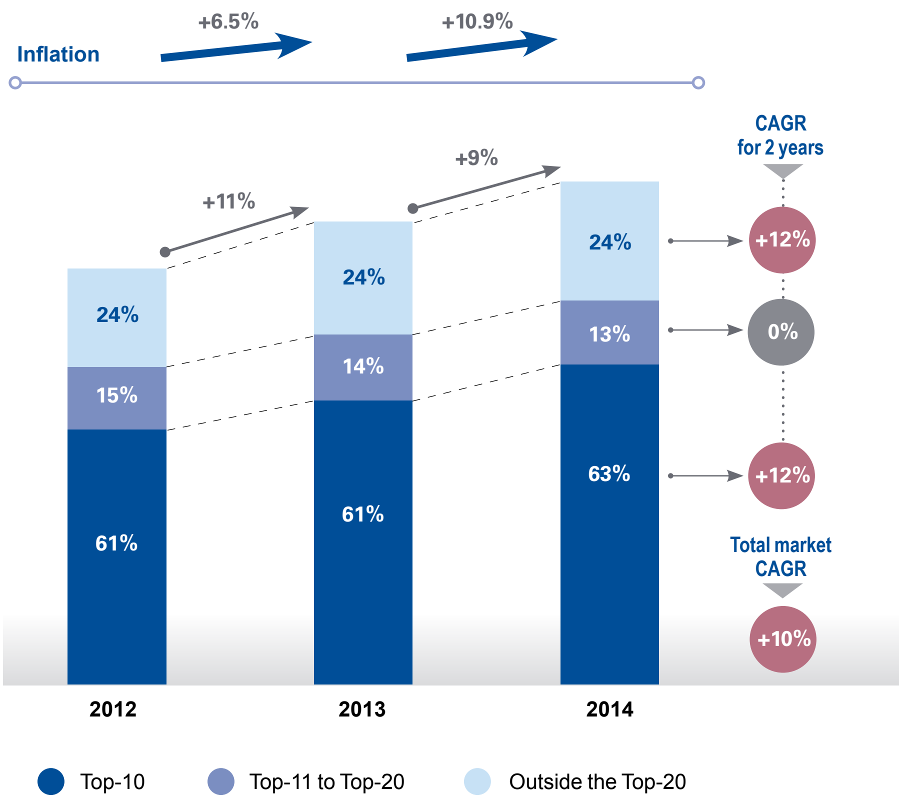
Source: KPMG analysis.

As always, the key priority for insurers is to increase profitability, though the ways to achieving this goal have slightly changed. For 2015, our respondents, together with cutting acquisition and administration costs, have highlighted other objectives such as increasing customer retention levels by diversifying the products they offer, and optimising underwriting strategies. Insurers are seeking every opportunity to raise the effectiveness of their business.

As identified in our 2014 survey, the majority of insurance firms keep focusing on retaining their current position and holding market share rather than increasing their portfolio.

Revenue growth

Gross written premium dynamics per market segment



Note: Percentages may not add up to 100% due to rounding.

Source: Central Bank of Russia.

The economic and political events of the last two years have had a negative influence on the insurance market, causing a slowdown in its expansion. In 2013, the growth rate decreased by half[1], while in 2014 the macroeconomic environment affected the market to a much lesser degree, causing a slowdown of only 2%. In fact, in 2014 the market increased 9%, much higher than the 5.5% growth rate expected at the beginning of the year, but lower than inflation.

[1] *"New reality: the Russian insurance market survey", KPMG 2014*

The leaders on the insurance market are growing faster than the market's average rate of growth, indicating that the market is continuing to consolidate.

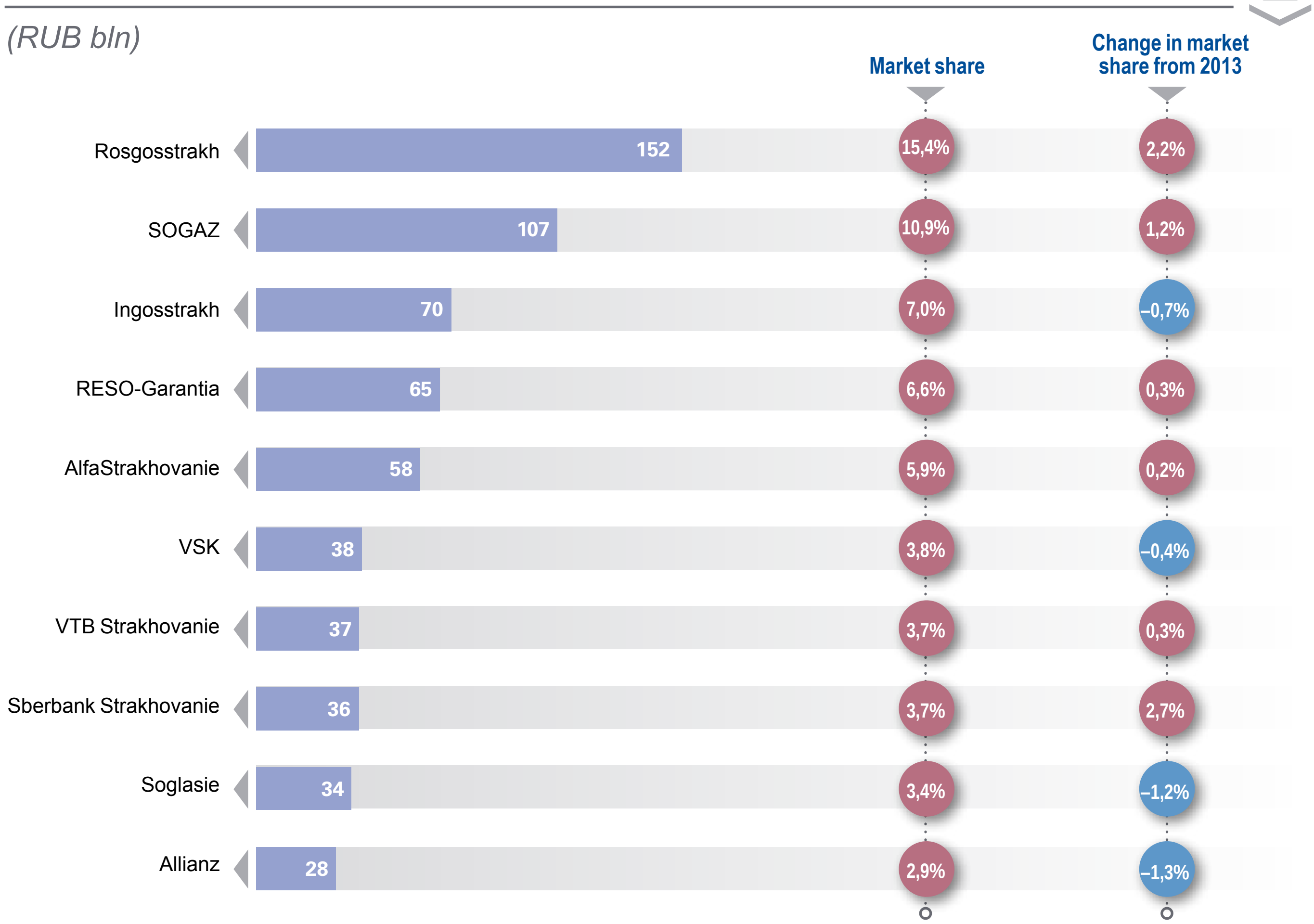
Insurers had expected steady growth for the large and medium players, but in fact the Top-11 to Top-20 companies decreased the amount of gross premium written in their segment. The smaller market players maintained a consistent year-on-year market share. The reason for the redistribution between the large and medium companies was probably the 8% decrease in CMTPL sales experienced by the Top-11 to Top-20 players, which are mainly specialised in providing motor insurance in the regions. The reduction in CMTPL sales in this segment was mainly caused by the following:

- "MSK" ceasing to sell in regions where it was making a loss[2];
- "GUTA-Strakhovanie" curtailed its business for the period of sanation[3].

Despite the crisis, smaller companies were able to keep their market share. This was most probably due to the structure of their portfolios, mostly oriented at life insurance and property insurance, both of which showed double-digit growth in 2014. Smaller companies usually offer cheaper insurance, which is attractive for customers in difficult economic times.

Top-10 Russian insurers by gross written premium in 2014

(RUB bln)



Source: Central Bank of Russia.

[2] Source: *http://www.insur-info.ru/press/105389/*
[3] Source: *http://www.gutains.ru/company/news/6033/*

The following events stand out in 2014 as affecting the structure of Russia's Top-10 insurance companies:

- the rapid increase in "Sberbank-Strakhovanie's" market share, placing it among the leaders;
- the decrease in market share belonging to "Allianz", due to "Allianz" curtailing its retail business in Russia.

Despite forecasts for premium growth from last year for the Top-11 to Top-20 segment which did not materialise in 2014, in the short-term insurers are still not anticipating any decreases in revenue in this segment.

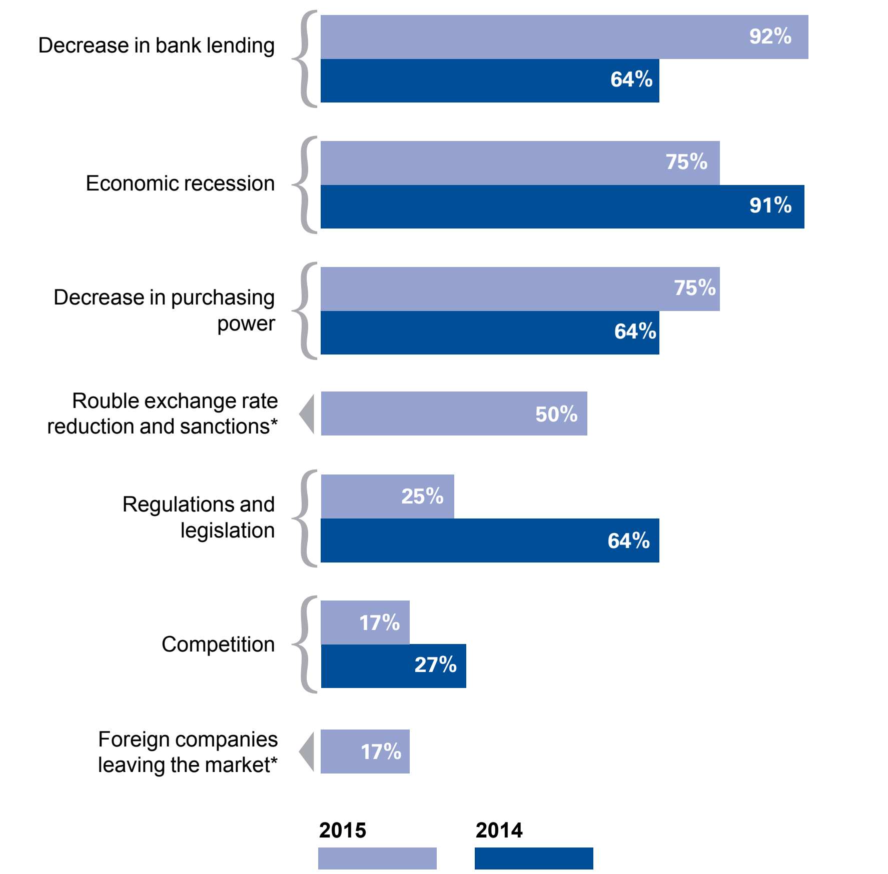
Our respondents believe that the market leaders will increase their share of gross written premium at the expense of smaller companies.

Expected increase in gross written premium in 2015 per market segment

Note: Percentages may not add up to 100% due to rounding.

Source: KPMG analysis.

Non-life insurance market drivers

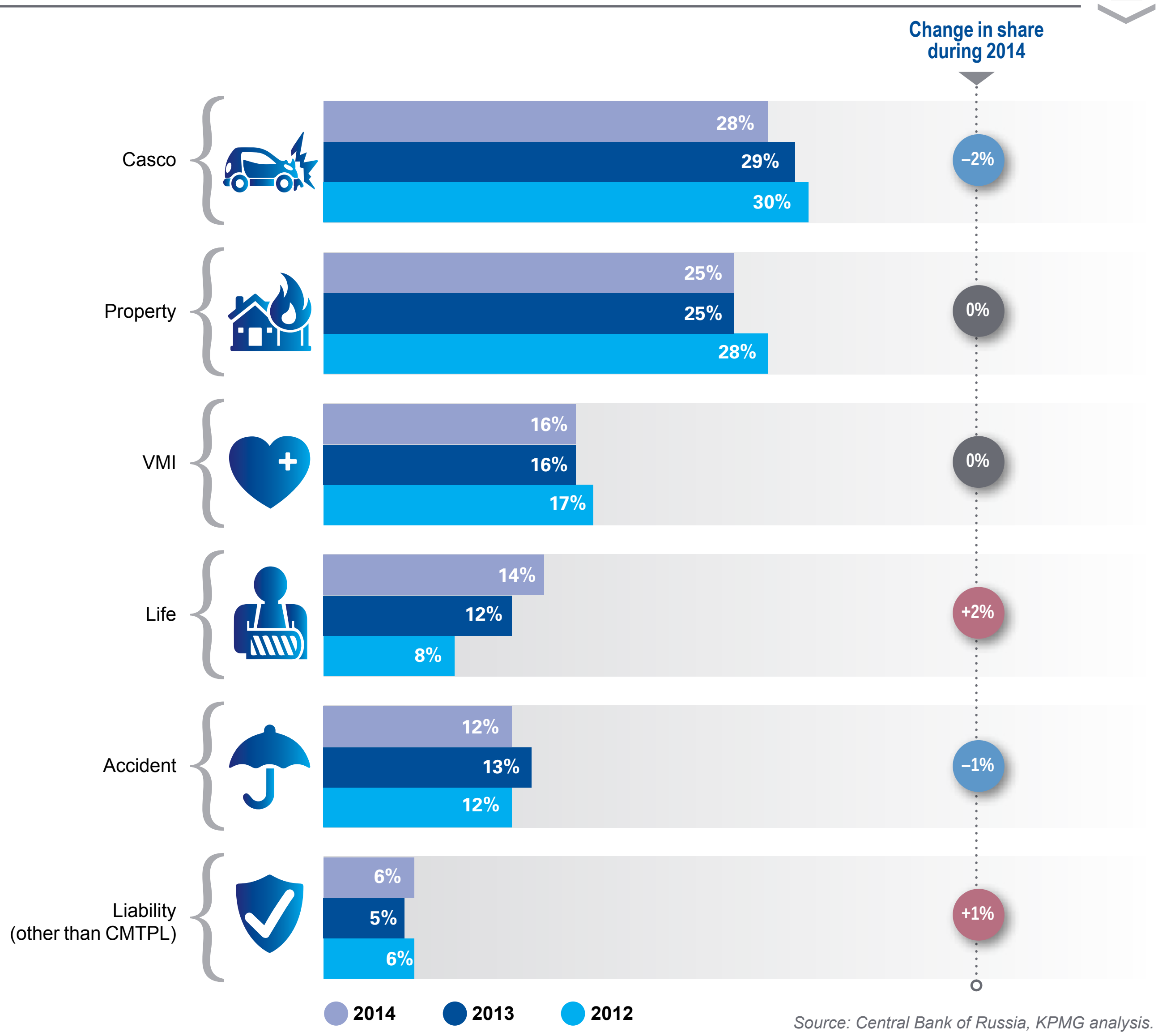


This option was first presented in the 2015 questionnaire.

Source: KPMG analysis.

The economic recession and subsequent decrease in purchasing power continue to be the key factor shaping the non-life insurance market. However, insurers have also highlighted decreases in bank lending as an extremely influential factor, pushing legislative changes into the background.

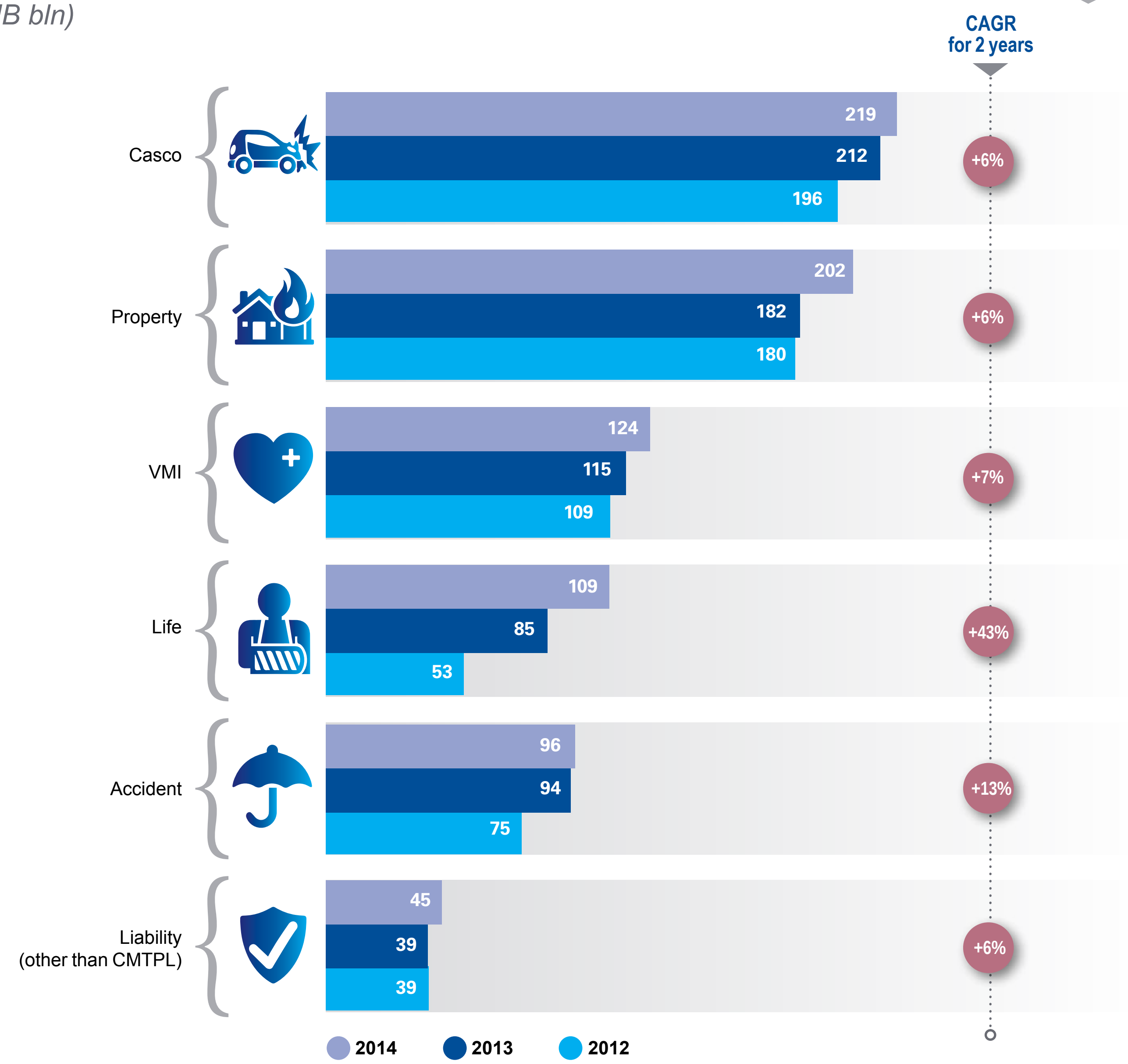
Premium share dynamics in 2012–2014 by key insurance market segments



Source: Central Bank of Russia, KPMG analysis.

Gross written premium growth dynamics per line

(RUB bln)



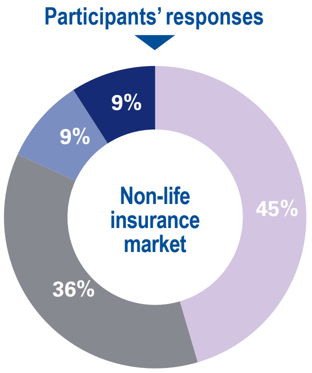
Source: Central Bank of Russia, KPMG analysis.

The growth rate for Casco premium insurance appeared to decrease more significantly than expected, with growth in 2014 limited to 3%. This slowdown is attributed to a general decrease in purchasing power, causing a 10%[4] fall in car sales in 2014. In 2015, the decrease in car sales is expected to continue, with the Association of European Business estimating that it could reach 24%[5].

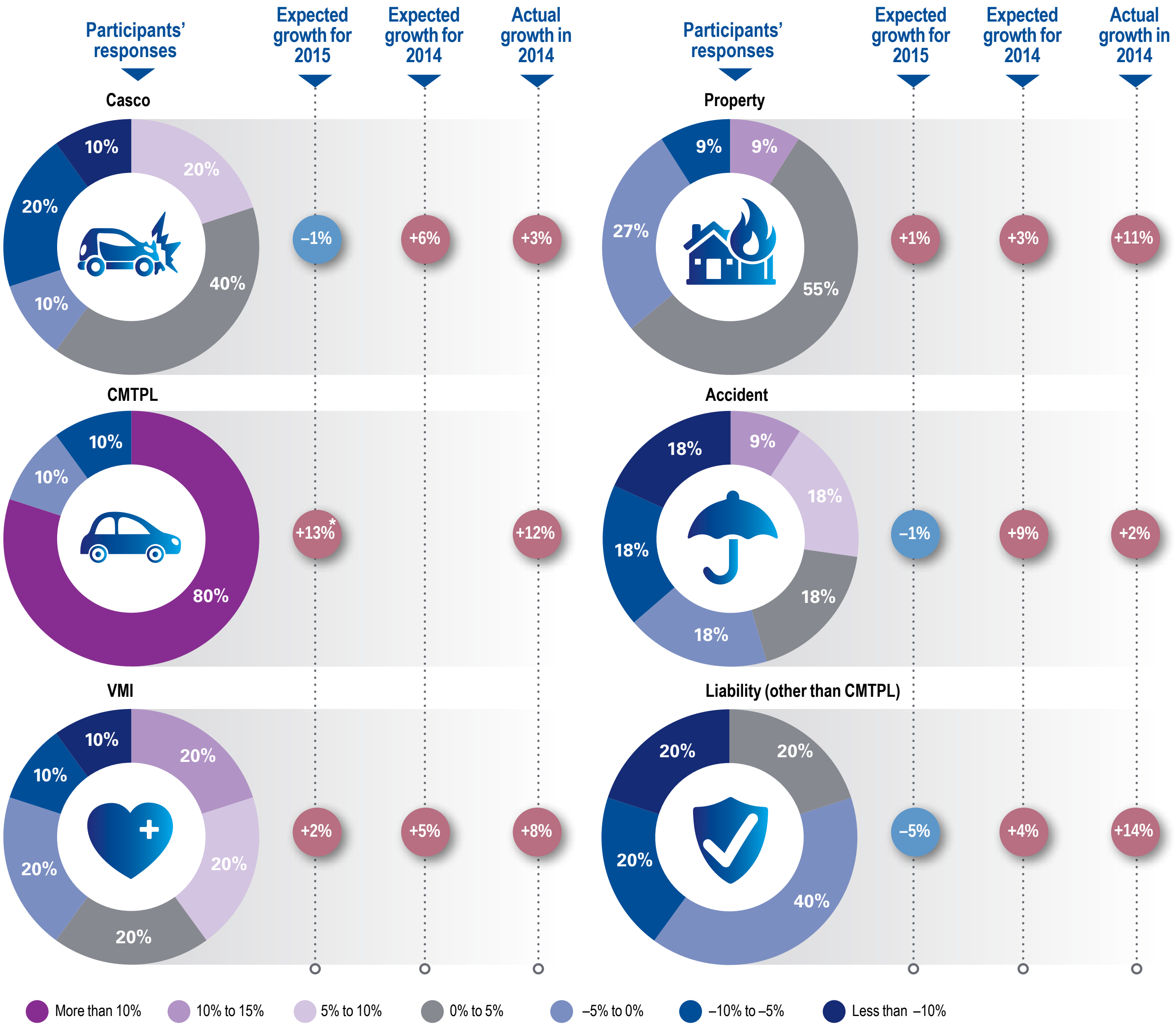
In 2015, insurers forecast a 1% decrease in Casco gross written premium.

[4,5] *Source: Association of European Business http://www.aebrus.ru/en/news/?ELEMENT_ID=1675881&sphrase_id=19264*

Expected premium growth in 2015 per segment



Insurers are anticipating further slowdown in non-life market growth from 7% to 4% in the short-run.



Note: Percentages may not add up to 100% due to rounding.

** While calculating the average expected growth rate we used the average rate of 17.5% for the interval "More than 15%". However, the majority of respondents answered "More than 15%", thus, the actual growth rate in respect of this line of business could appear to be higher.*

Source: KPMG analysis.

Revenue is still expected to grow, primarily originating in CMTPL sales. CMTPL sales could increase to 13% (refer to * on the graph on page 21), as predicted by our survey respondents. The reason for this growth is believed to be the revision of tariff rates that took place in 2014–2015.

The insurance executives surveyed forecast that growth in accident insurance would slow down in 2014 faster than the market's general rate of growth. This resulted in the share of accident insurance decreasing; something which happened for the first time since 2010. This was most likely caused by consumers reducing their insurance expenses – a common consumer reaction – as well as a 2% decrease in bank lending[6]. The insurance trend for accident insurance likely indicates market saturation, something predicted by our survey participants at the beginning of 2014[7]. Now our respondents anticipate a 1% decrease in accident insurance premiums in 2015.

Liability insurance and VMI both saw premium growth exceed the expectations expressed at the beginning of 2014.

Property insurance is another 'in demand' line of business in the crisis.

In 2014, premiums from property insurance grew 11%, leading to its market share increasing to 26%, approaching the level of Casco's market share. The main reason for this growth was the effective purchase by some large companies of property insurance policies. In addition to this, some smaller companies have expanded into writing premiums to cover agricultural insurance.

However, our respondents do not foresee any long-term rise in property insurance and expect premium growth to slow to 1% in the coming years.

Despite significant growth in the liability insurance sector throughout 2014, our survey participants predict that the number of premiums being written will decrease by up to 5% in the near future. One of the possible reasons for this could be that insurance expenses have been excluded from the budgets of government construction and infrastructure projects, as part of government cost cutting programmes.

[6] *Source: Central Bank of Russia*

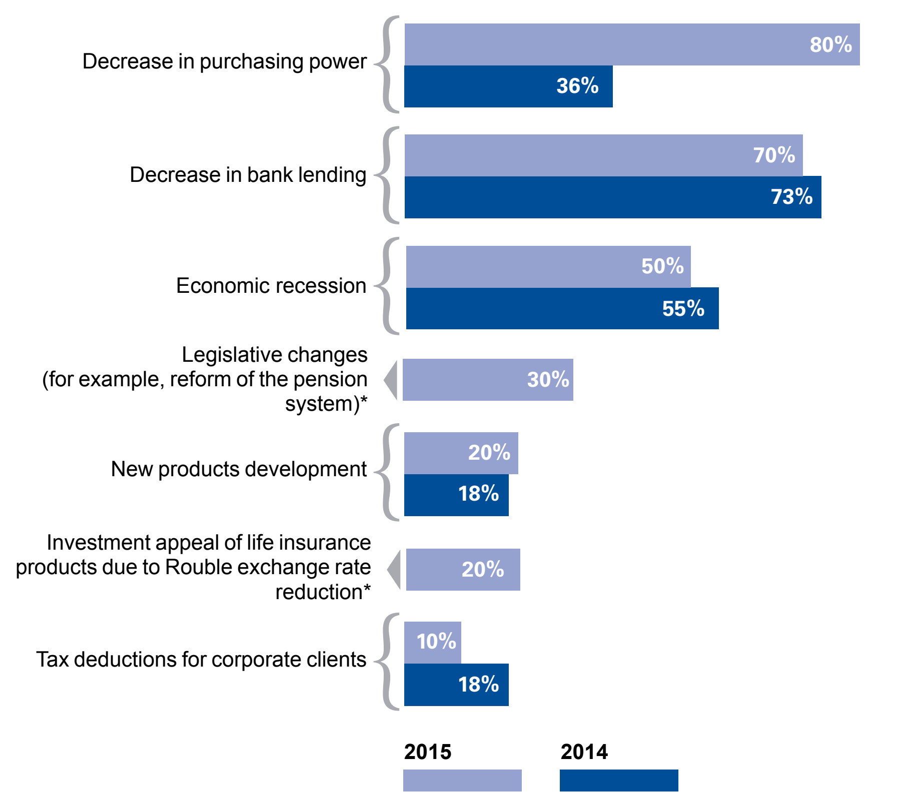
[7] *"New reality: the Russian insurance market survey", KPMG 2014*

In contrast to previous years, the life insurance market has slowed down twice as fast in terms of the amount of premium written; however, growth is still double-digit.

There is no doubt that one of the key reasons for this growth is the dramatic increase in "Sberbank Strakhovanie" sales. The long-term nature of revenue flows in respect of this line of business should also be taken into account, as it grades the volatility of premiums according to annual fluctuations in the number of policies sold.

As before, a key factor shaping the life insurance market is the decreasing amount of bank lending. The decrease in purchasing power has intensified its influence on the market, showing the prevalence of credit life insurance products on the Russian market. Our respondents additionally highlighted that reforming the pensions system could also shape the life insurance market.

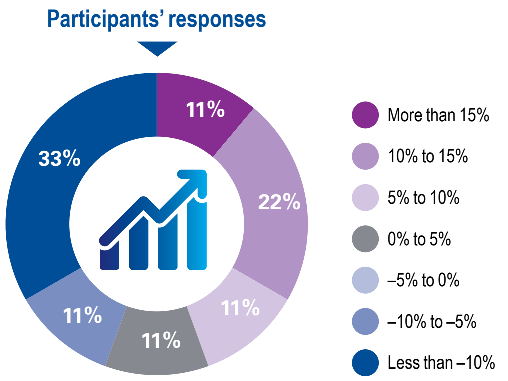
Life insurance market drivers



** This option was first presented in the 2015 questionnaire.*

Source: KPMG analysis.

Outlook for the life insurance market growth in the short term perspective



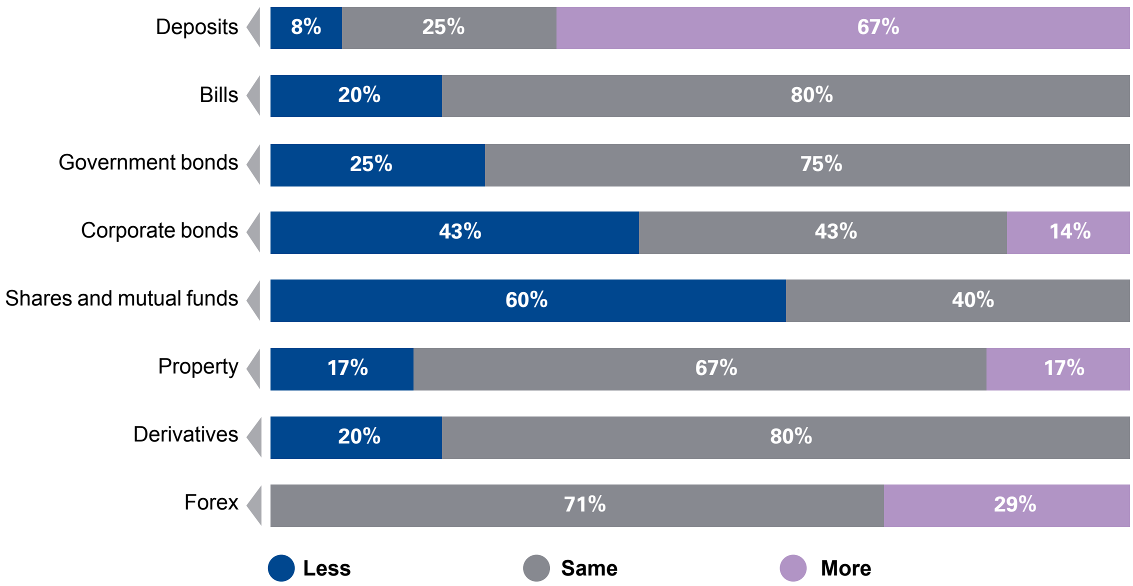
Note: Percentages may not add up to 100% due to rounding.

Source: KPMG analysis.

The contradictory forces in the developing life insurance market, such as decreasing bank lending on the one hand and continuous double-digit growth on the other, could lead to different development scenarios emerging in the near-term future.

The majority of survey participants forecast that the rate of growth in the life insurance market would fall by more than two-times. However, 44% of respondents predicted a 5% decrease in the amount of premium written, while the other 56% of respondents are more optimistic, expecting market growth of about 6%.

Preferred investment policies in 2015



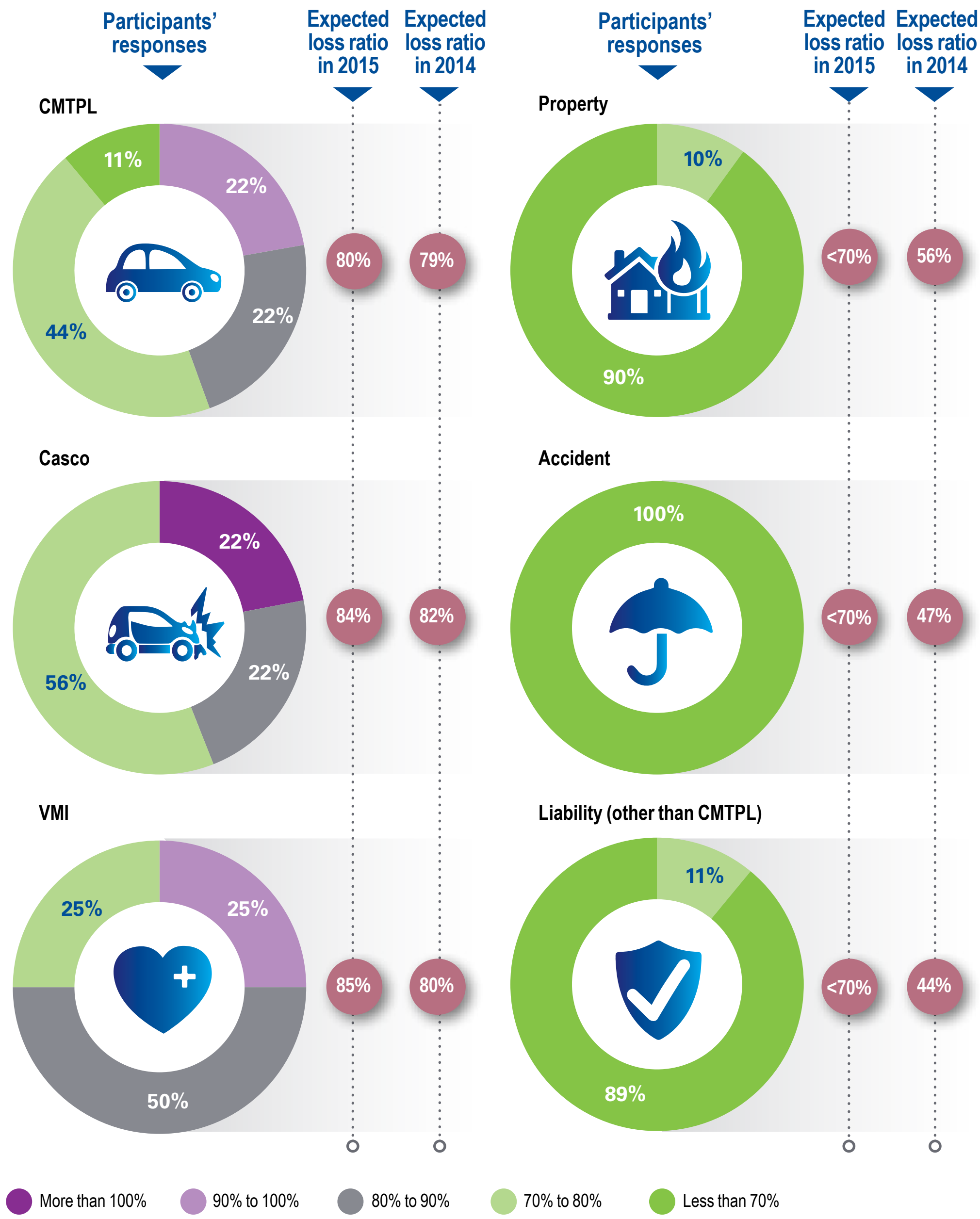
Note: Percentages may not add up to 100% due to rounding.

Source: KPMG analysis.

The unstable economic situation, combined with increased market and currency risk, are leading insurers to focus their investment policies away from shares and corporate bonds and towards deposits. For other securities, insurance firms are holding on to their current investment strategies.

Cost optimisation

Average expected loss ratios in 2015



Note: Percentages may not add up to 100% due to rounding.

Source: KPMG analysis.

Casco, CMTPL and VMI loss ratios may increase when compared with the expectations of previous survey participants.

In 2015, the motor insurance market is again expected to be difficult. Our survey indicates that voluntary motor insurance is vulnerable to foreign exchange market fluctuations. Our respondents agreed that Casco is likely to be affected by volatile currency exchange rates more than other lines of business, and thus an increase in the loss ratio in voluntary motor insurance is expected.

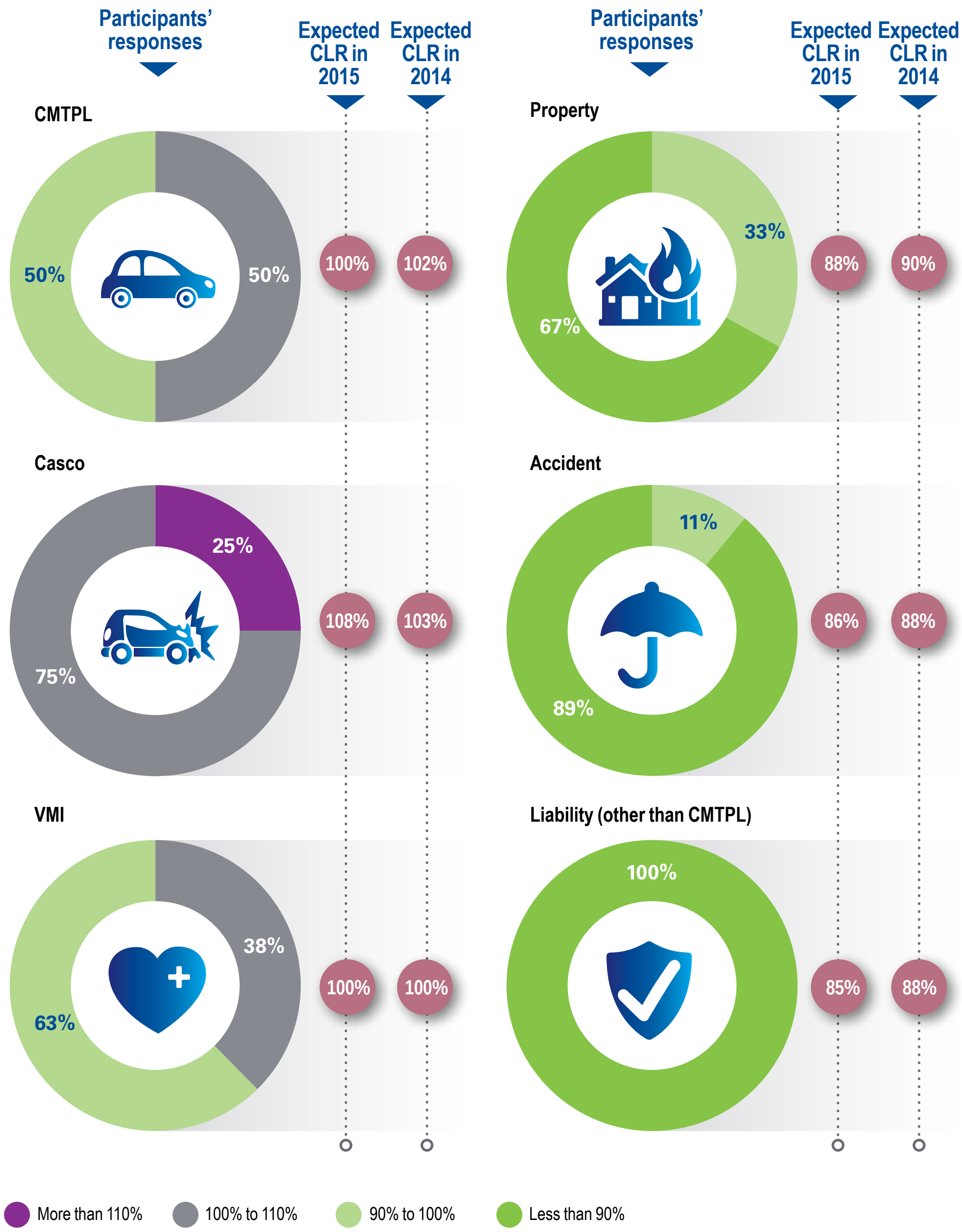
Despite CMTPL continuing to be one of the least profitable lines of business, there are no predictions for a significant increase in loss ratios. The average expected loss ratio for compulsory motor insurance is expected to remain at 2014 levels. This is most likely attributable to insurance rates being revised, the implementation of the "unified methodology to determine recovery expenses" (hereinafter, the "unified methodology"), and the compulsory requirement for prior notice to be given to insurance companies. The actions listed above were issued by the regulator and intend to improve the position of insurers operating in this line of business. It is crucial to understand that innovation is inevitably followed by stronger regulatory control, and insurance companies are likely to be unable to optimise their geographical structures, but instead be forced to include undesirable and potentially unprofitable regions and segments in their portfolios. If they do not meet the regulator's requirements, their licences could be restricted. 75% of our survey respondents believe that the steps taken by the regulator are insufficient to prevent the impact of currency market volatility affecting compulsory motor insurance, making this market vulnerable to the influence of exchange rate fluctuations.

The worsening of expected VMI losses is in line with macroeconomic trends in Russia. Statistics show that, during crises, people often turn more frequently to medical facilities, causing an increase in the number of VMI claims. Moreover, the value of medical consumables is highly exposed to the rate of inflation and exchange rate fluctuations. Both of these factors negatively influence the VMI loss ratio. This corresponds with the expectations of our survey respondents: a quarter consider that the VMI loss ratio will exceed 90%; previously, no one believed it would reach this level.

Property insurance and accident insurance remain the best lines of business in terms of combined loss ratios. Yet despite there being untapped potential in these areas to increase profitability, most insurers have no plans to increase their business activities in them.

The loss ratio forecast for liability insurance worsened: 11% of respondents anticipate loss ratios to exceed 70%, whereas last year no one expected it would be possible to reach this level. In 2014, most survey participants foresaw the loss ratio as being lower than 50%.

Average expected combined loss ratio in 2015



Note: Percentages may not add up to 100% due to rounding.

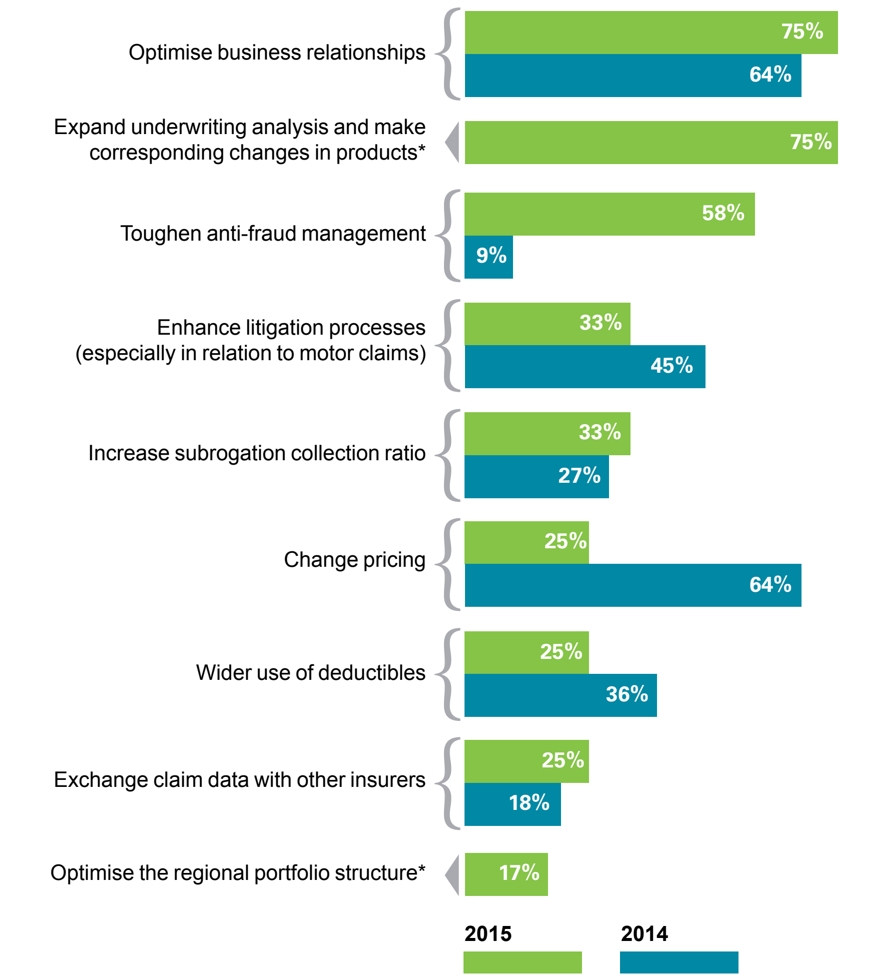
Source: KPMG analysis.

Despite increases in the CMTPL and VMI loss ratios, the combined loss ratios for these lines of business remained at the same level as in 2014.

The expected combined loss ratios for all lines of business, except Casco, have not changed significantly when compared to the previous year's forecast. This suggests that the cost cutting programmes rolled out by insurers at the beginning of 2014 were effective.

The profitability of Casco insurance is likely to decrease to a greater degree when compared with other lines of business. This is attributed to the overall macroeconomic situation and the influence of exchange rate fluctuations. These factors mean that nothing could have held combined loss ratio for voluntary motor insurance at the previous level – neither regular revision of rates nor the extensive use of cost cutting procedures carried out by the majority of insurers in 2014. The results of this survey suggest that a quarter of respondents consider that the combined loss ratio for Casco may exceed 110%.

Preferred methods to reduce claim costs



** This option was first presented in the 2015 questionnaire.*

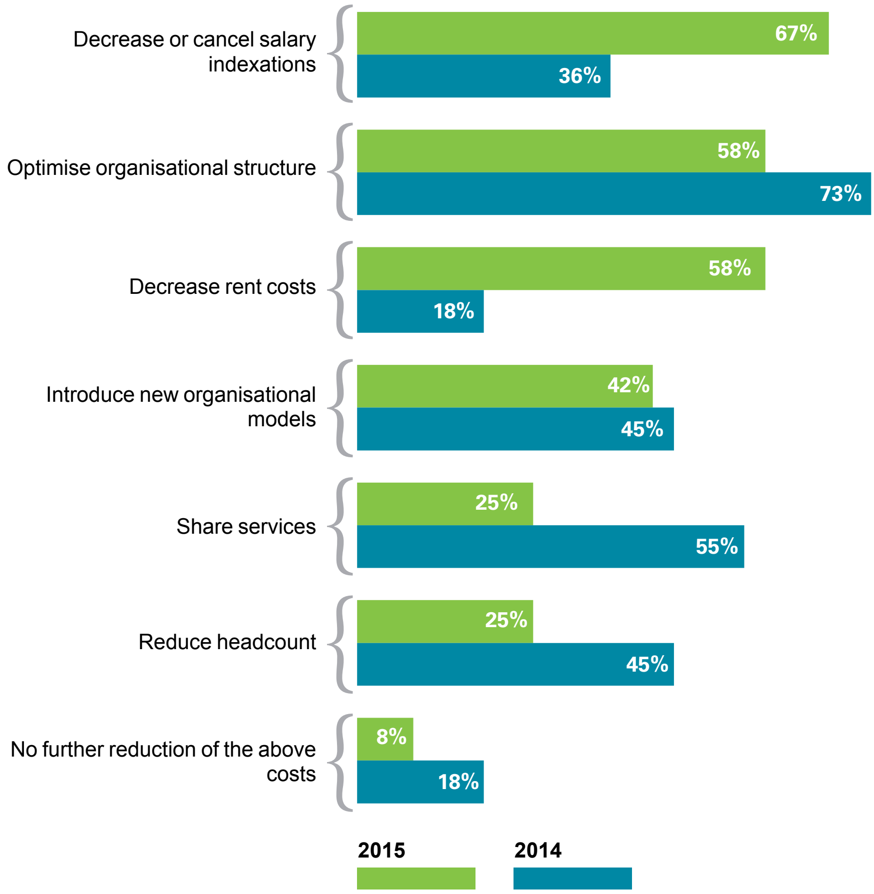
Source: KPMG analysis.

Optimisation of business relationships remains key to reducing claim costs.

In order to keep their businesses profitable, insurance executives are looking at improving their business relationships, increasing the strength of their underwriting analysis via the inclusion of additional risk factors, and revising the conditions attached to existing products to adapt them to the current market.

In contrast to 2014's plans, insurers are not planning to adjust loss ratios on their portfolios by increasing rates. The current levels are likely to reach their "ceiling", with further raises in tariffs deemed inefficient.

Preferred methods to cut administrative costs



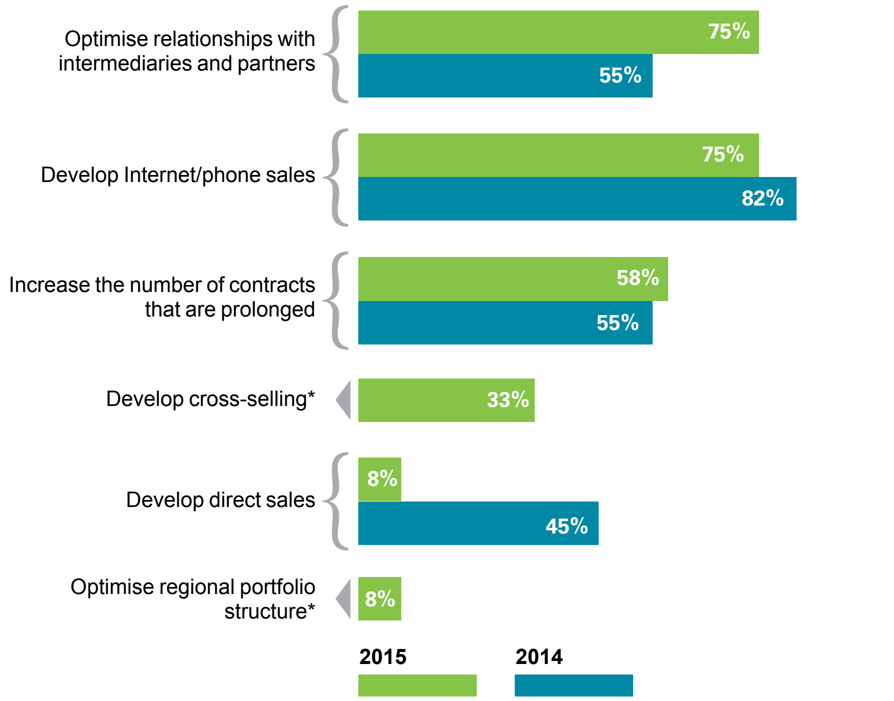
Source: KPMG analysis.

Insurance executives are seeking to cut administration costs mainly by cancelling or decreasing salary indexations.

In addition to this, more than half of respondents singled out the renewing of rent contracts under fixed Rouble exchange rates and optimising internal organisational structures as the preferred methods to cut administrative costs.

Insurers no longer consider headcount reductions as the only way to reduce administrative expenses. In 2015 they are going to focus on protecting the resources they have, including human ones.

Preferred methods to cut acquisition costs



* *This option was first presented in the 2015 questionnaire.*

Source: KPMG analysis.

Most survey respondents aim to continue optimising relationships with intermediaries and partners in order to lessen the burden of acquisition costs.

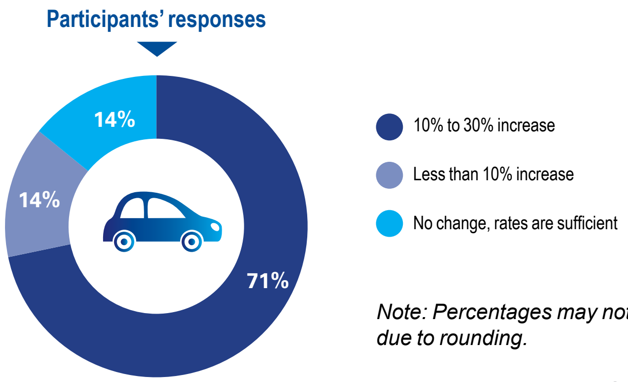
As last year, insurance chief executives have great expectations that, via the development of internet sales, initial sale costs can be practically reduced.

Motor insurance

The main external factors affecting the motor insurance market are:

- **Changes to the laws governing CMTPL insurance**
- **The introduction of a "unified methodology" to estimate CMTPL losses**
- **The decrease in the Rouble exchange rate**

Expected increases in CMTPL rates in order to correspond to the loss ratio



Note: Percentages may not add up to 100% due to rounding.

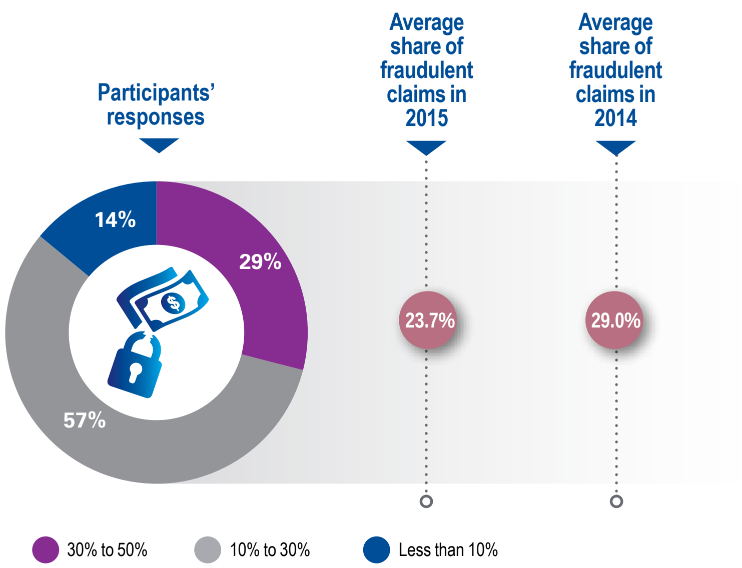
Source: KPMG analysis.

The following changes to obligatory motor insurance legislation were recently implemented: increase in tariffs (to 23% in October 2014, and further to 40% in April 2015); rise in coverage limits (from RUB120,000 to RUB400,000 for property, and from RUB160,000 to RUB500,000 for health and life); extended acceptable tariff ranges (from 5% to 20%). The market leaders are setting prices at the maximum end of the scale in order to cope better with the high loss ratios associated with this line of business. However, more than 70% of our respondents believe that CMTPL rates are still not high enough to be able to cover expected insurance payouts, and suggest an additional increase of 10%–30%. Moreover, taking into consideration recent events, insurers are expecting more oversight of policy sales in Russia's regions. In the opinion of our respondents, this could lead to loss ratios increasing further, making the current tariff rates insufficient. Moreover, the coverage limit for Euro-protocol claims was increased in the Moscow and Saint Petersburg regions (along with general coverage, it was increased to RUB400,000). It can be concluded that 40% of our respondents are expecting a significant increase in fraudulent claims in these regions.

Insurers are paying additional attention to the financial result of CMTPL direct claim settlements. The Belgian system applied at the beginning of 2014 prevents insurance companies from "selecting claims".

67% of our respondents confirmed that the financial result of the direct claims settlement is close to zero (meaning that the company's payouts are virtually the same as the reimbursements it has received from the special account in Russian Union of Motor Insurers). However, 17% of those surveyed declared that their payouts are higher than the reimbursements they receive, and that loss adjustment expenses are not the only reason for this mismatch. About 60% of respondents think that the direct settling of claims has done nothing to really help overcome fraud, stating that 30% of the claims reported are still illegal.

The share of fraudulent claims in those settled under the Consumer Protection Law since the prior notice to the insurance company condition was introduced



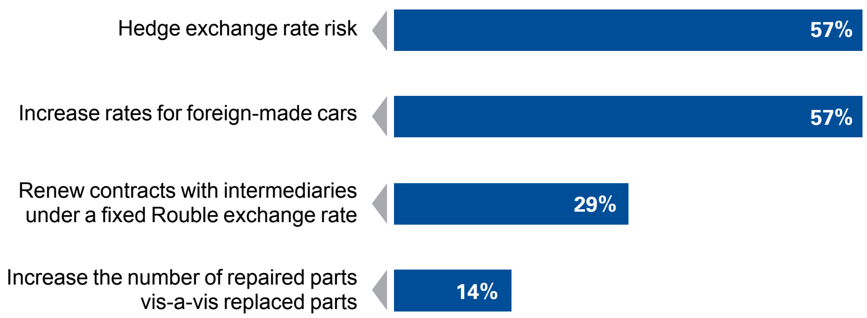
Source: KPMG analysis.

In December 2014, insurance companies started estimating CMTPL claims via use of the new methodology demanded in law. Before this law, there was no unified methodological system and companies estimated claim amounts based on the opinions of experts.

Insurers have been positive about these changes; however, more recently, some car owners have experienced problems (luxury foreign car owners in particular) because the cost of standard hours and spare parts calculated under the "unified methodology" is lower than the actual recovery expenses estimated on the basis of the real prices of official motor dealerships.

However, the insurance companies believe that this system, used to estimate CMTPL claims, will soon be stabilised (prices will be revised twice a year), meaning that actual expenses will be in line with those provided by the "unified methodology".

Possible measures to decrease the burden of inflation on motor insurance caused by the fall in Rouble exchange rate



Source: KPMG analysis.

At the end of 2014, the problem of currency exchange rate fluctuations was being widely discussed by insurance market analysts. Spare part prices and lacquer car paint coatings for foreign-made cars are highly influenced by exchange rate fluctuations. As such, this influences motor insurance loss ratios.

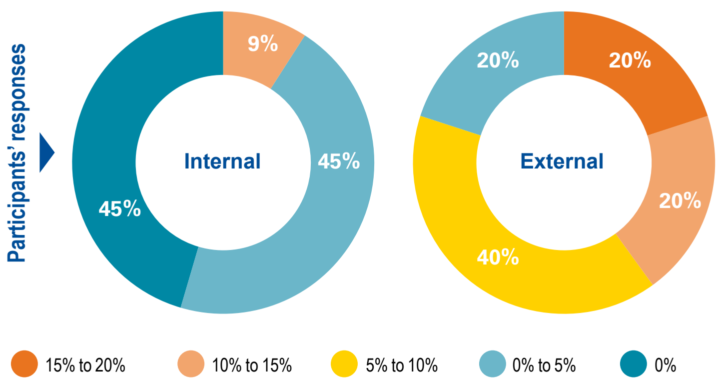
Insurance executives consider hedging against currency risks and adjusting rates for foreign-made cars are both equally important measures in the fight to help insurers compensate inflationary pressure.

In addition to the above, writing specific conditions (such as fixed currency exchange rates and discounts) into contracts with service stations may help hold repair expenses at previous levels.

{Insurance fraud}

The influence of fraud on the performance of insurance companies remains significant. When all the other methods used to improve profitability have been exhausted, it will be the insurance executive who pays attention to fraud levels who discovers potential to increase profitability in this area.

The share of internal and external fraud in a company's gross written premium



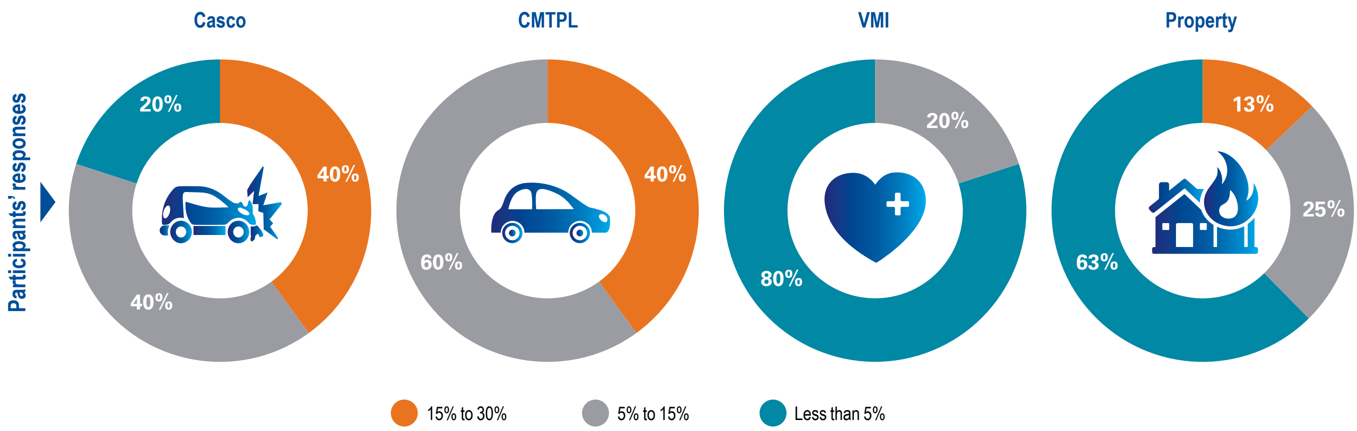
Note: Percentages may not add up to 100% due to rounding.

Source: KPMG analysis.

Insurance companies could be underestimating the impact of fraud on their performance results.

All of the respondents noted the effect of fraud on the financial indicators of their insurance companies. However, only half of survey participants had given consideration to the thought that fraud might not only be caused by external forces, but could also by caused by internal corporate malpractice (an insurance companies' own staff cheating).

The share of fraudulent claims in each market segment



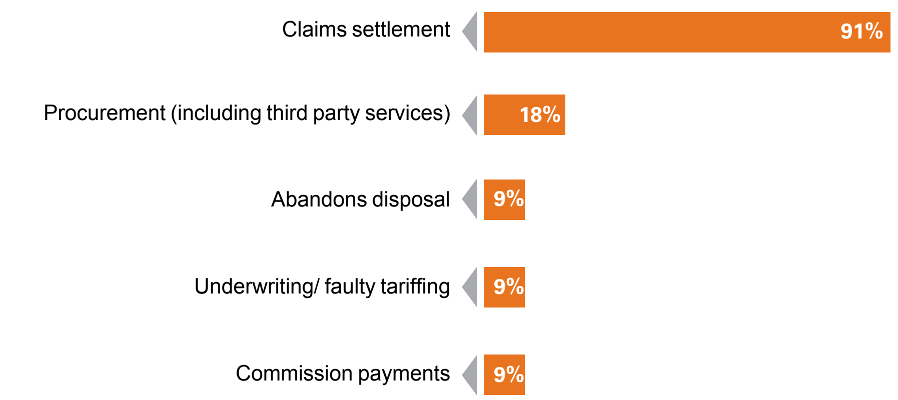
Note: Percentages may not add up to 100% due to rounding.

Source: KPMG analysis.

Our survey respondents' estimate of the percentage of claims that are fraudulent is slightly lower than similar estimates from leading Western markets[8]. The results of this survey suggest there is a belief that, even in lines of business such as VMI and Casco – which are notoriously liable to fraud – the number of fraudulent claims being made is rather low. Respondents expressed the opinion that the share of fraudulent claims in VMI is not above 5%, while the average amount of fraudulent claims for Casco is 13.5%, with the corresponding property insurance amount being 7%.

[8] *Insurance information institute http://www.iii.org/issue-update/insurance-fraud, Association of Certified Fraud Examiners http://www.acfe.com/article.aspx?id=4294974475, Global Health Care Anti-Fraud Network http://www.ghcan.org/newsroom.html*

Areas that are primary fraud targets



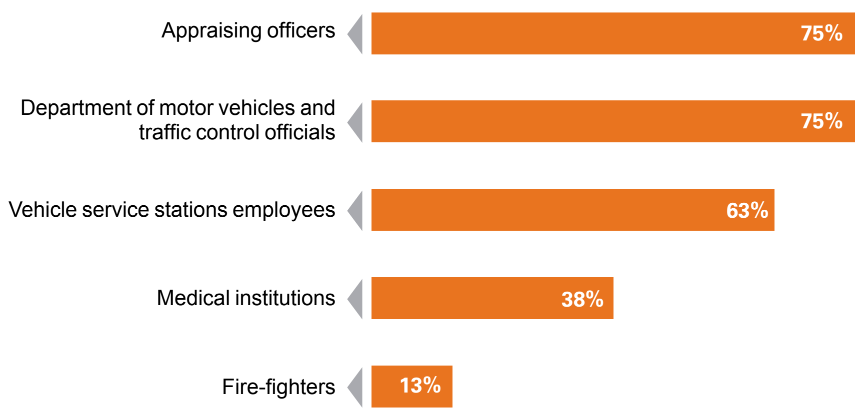
Source: KPMG analysis.

The majority of respondents highlighted the settling of claims as the area most exposed to fraud in the performance of their insurance company.

Among the other problem areas our survey respondents highlighted were procurement, underwriting, commission payments, and abandons disposal. However, the possibility for third parties to swindle the companies out of money in these spheres is still significantly lower than when settling claims. Interestingly, insurance executives share the view that fraud in these areas does not significantly influence the profitability of their companies, affecting only on average about 2% of a company's revenue.

It is no surprise, given that our respondents consider motor insurance as the line of business most liable to fraud, and the settling of claims as the area of performance most affected by the work of fraudsters, that the department of motor vehicles / traffic control officials, appraising officers, and vehicle service station employees were those identified as being most connected with corruption.

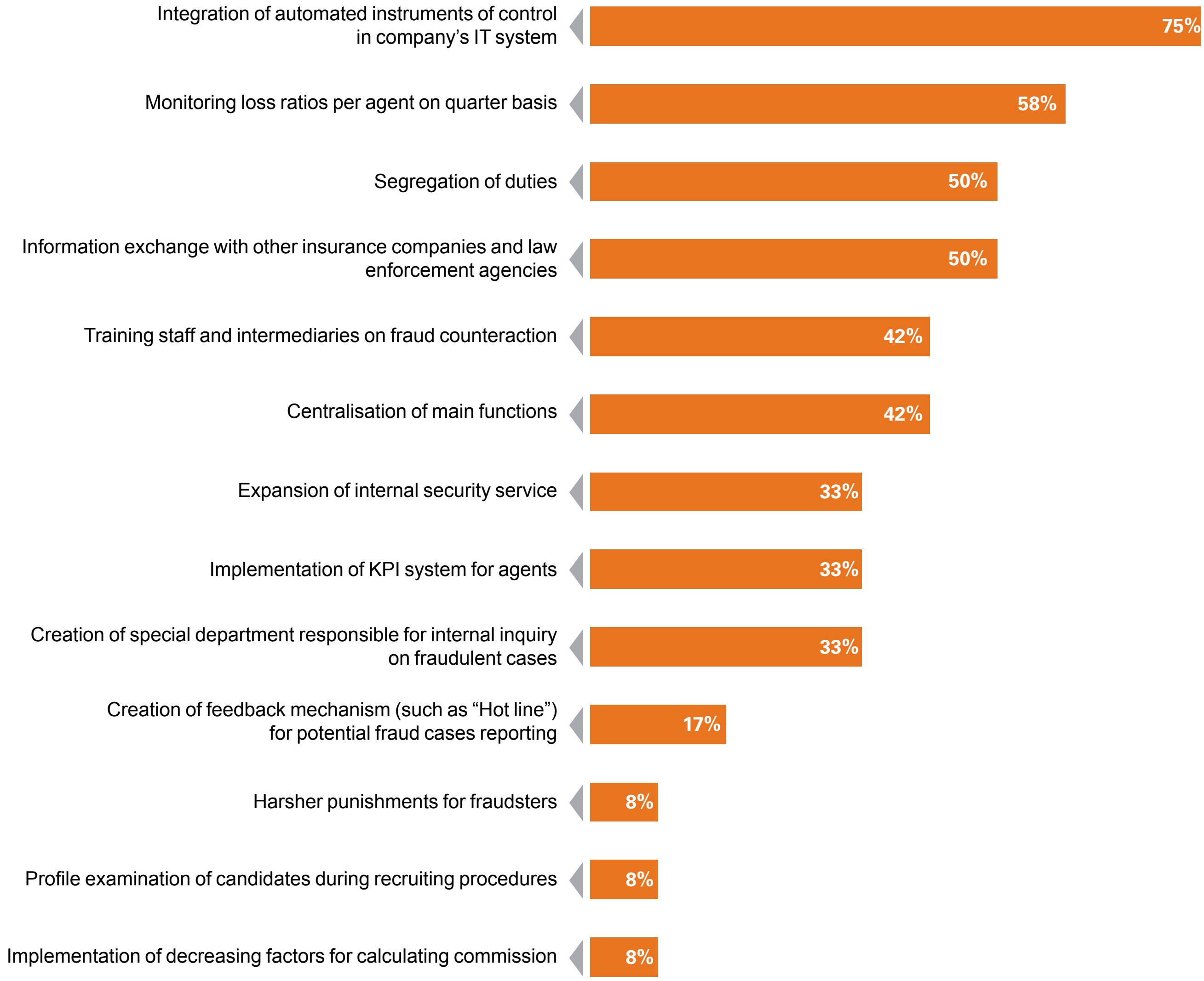
Third parties often involved in insurance fraud



Source: KPMG analysis.

Insurers may be concentrating only on external fraud while underestimating their own internal corporate fraud.

Preferred measures to decrease fraud



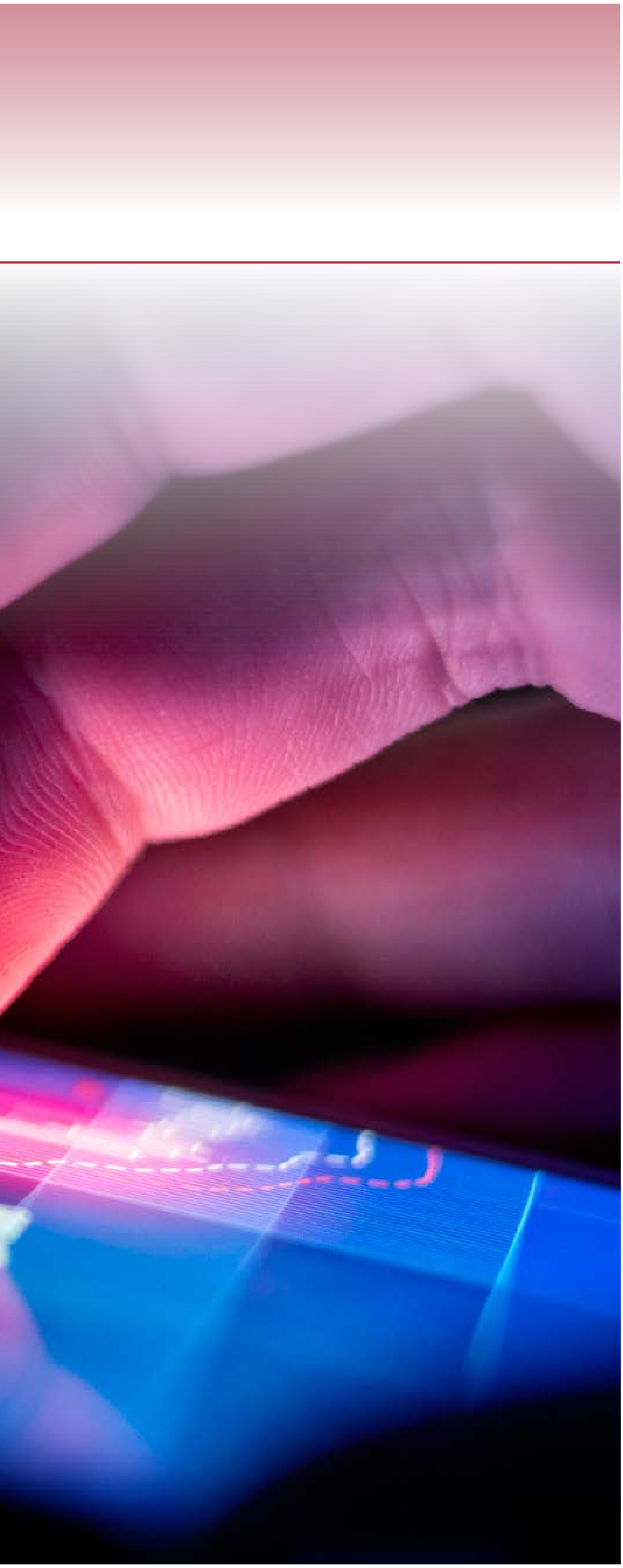
Source: KPMG analysis.

Survey respondents considered feedback mechanisms (hot lines) as one of the least effective way to fight fraud.

One of the best methods preferred in the struggle against fraud is the integration of automated control instruments and quarterly monitoring of loss ratios per agent. Creating feedback mechanisms (hot lines) is seen as the least effective way to reduce fraud. However, this is precisely the method highlighted by the Association of Certified Fraud Examiners[9] as the most effective instrument in revealing internal corporate fraud.

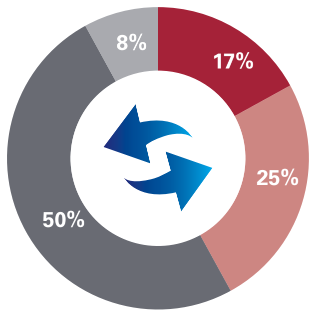
[9] *Source: http://www.acfe.com/article.aspx?id=4294974475*

Market regulation



The effect of in-force and forthcoming changes to the insurance market

Participants' responses



- Changes are insufficient and inefficient
- Changes are effective; however, there are still areas needing improvement
- Changes significantly increased regulatory pressure
- Difficult to say

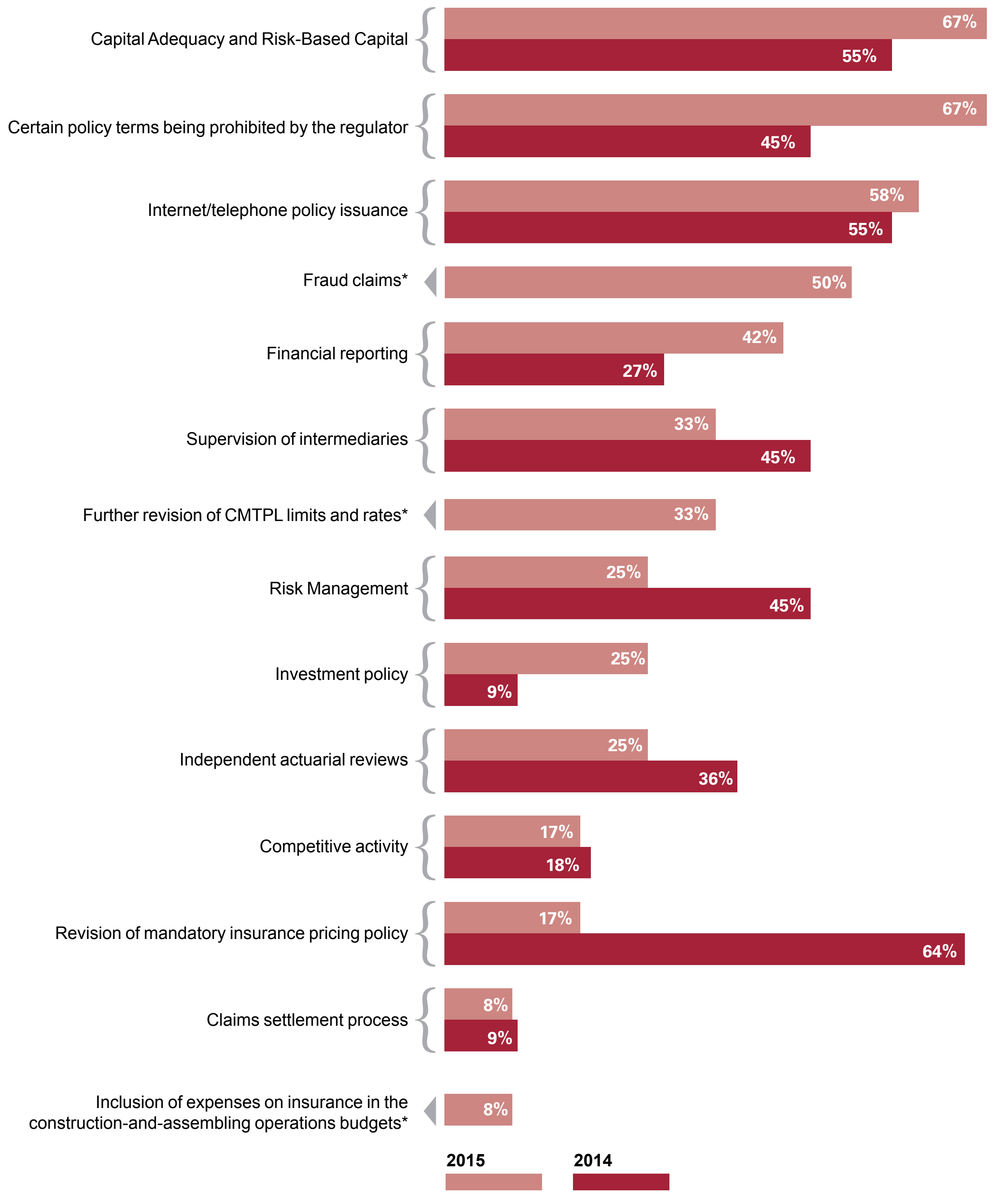
Note: Percentages may not add up to 100% due to rounding.

Source: KPMG analysis.

Half of our survey participants consider that regulatory changes have led to a strengthening of regulatory pressure on the insurance business, as recent insurance market news has confirmed.

The recently-introduced regulatory changes were intended for CMTPL. Yet 25% of our respondents consider that the insurance market still has some areas in need of effective supervisory control, the other 17% consider that in-force changes are insufficient and inefficient.

Areas requiring progressive regulatory change



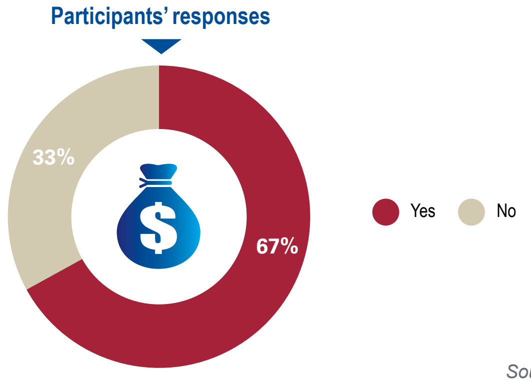
** This option was first presented in the 2015 questionnaire.*

Source: KPMG analysis.

Last year our respondents highlighted three areas that required attention form the regulator: CMTPL rates, the issuance and purchasing of policies via the internet, and capital adequacy. Two of these were subject to progressive changes in 2014. In 2015, regulatory action should be expected in the areas now being brought to attention – capital adequacy and the prohibition of certain policy terms by the regulator.

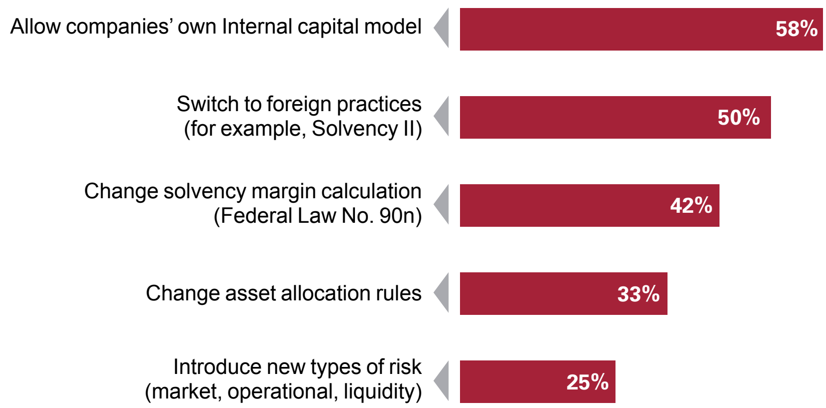
A third of our respondents consider the current capital requirements to be economically ungrounded.

Economical validity of the current capital requirements



Source: KPMG analysis.

Possible changes that could have a positive influence on the capital requirement level



Source: KPMG analysis.

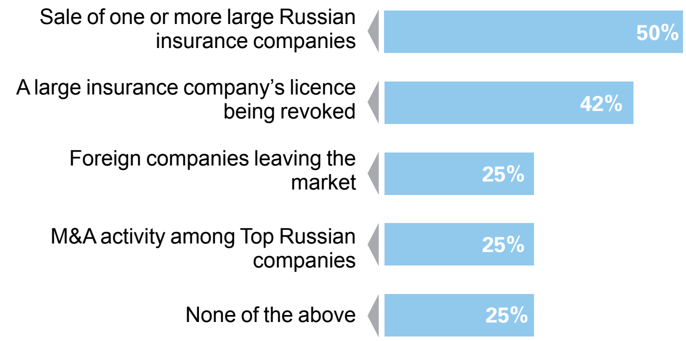
Insurers see three possible solutions to this problem: change solvency margin calculations; allow for companies to have their own internal capital models; or switch over to foreign practices, such as Solvency II.

When dealing with morle specific problems, the tendency is to cut personnel costs and reduce commission, actions which correspond with the desire expressed by insurers to further develop their online sales. Most respondents (about 60%) are waiting for the final amendments to the law "On the organisation of the insurance business in the Russian Federation", which would enable compulsory insurance policies to be sold via the internet (currently only voluntary insurance policies are sold online). Direct sales would permit insurance companies to cut agent and broker costs. The option of buying CMTPL policies online should be possible in 2016, according to the Central Bank of Russia. However, insurers will need time to adapt to this sales channel, as 60% of respondents fear that the online sale of CMTPL policies could lead to incorrect information being submitted, which in turn could lead to loss ratios for this line of business being negatively affected. Nevertheless, our respondents believe that internet sales will enable them to cut acquisition costs, once they have learned to manage the sales. As such, this is a priority area for them.

Problems such as fraud and fighting claims in court, are expected to remain crucial for insurance companies in 2015. 50% of our respondents highlighted this as an area requiring supervision and control from the mega-regulator.

M&A activity

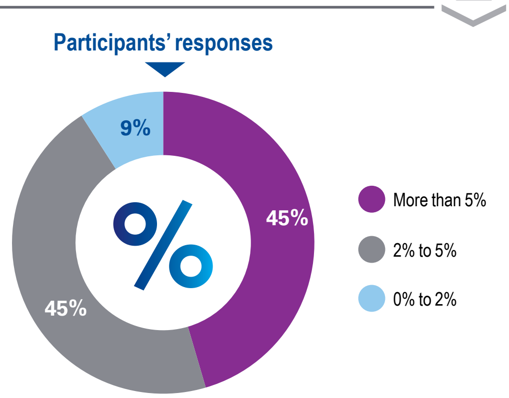
Likely M&A activity in 2015–2016



Source: KPMG analysis.

According to our respondents, in 2015 market consolidation could accelerate due to a large insurance company being sold or licences being revoked.

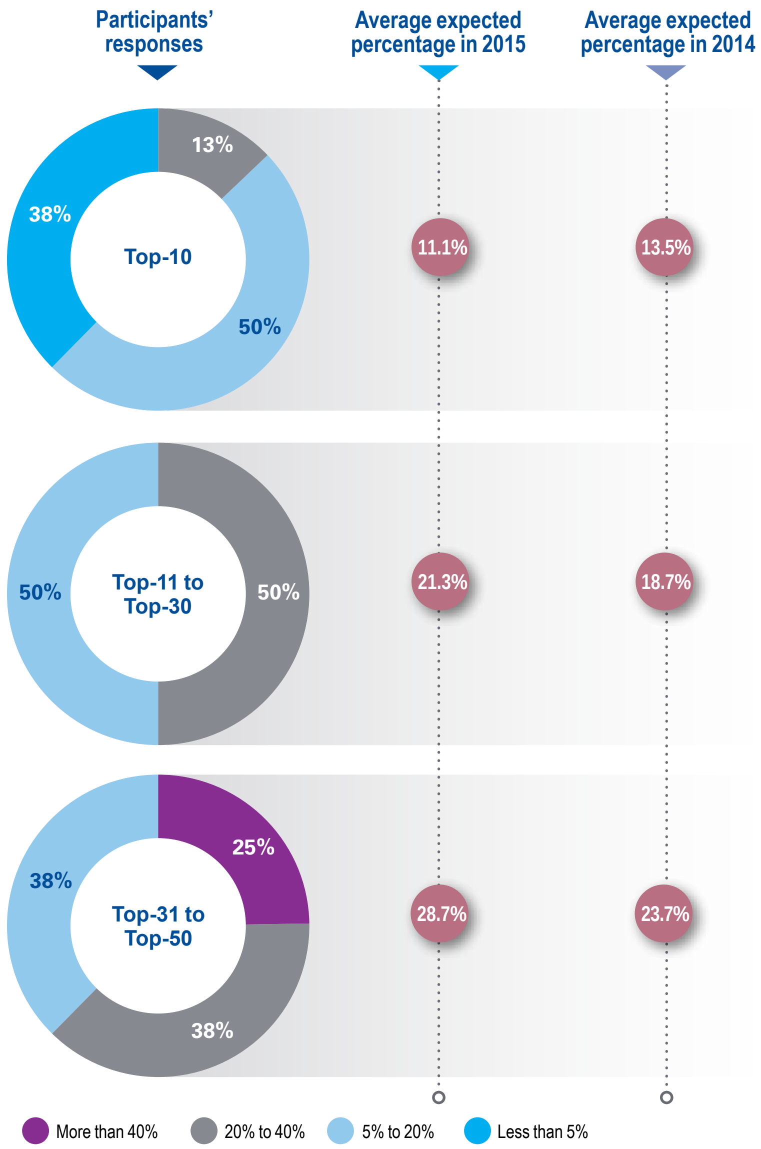
Increase in the Top-10's market share in 2015



Note: Percentages may not add up to 100% due to rounding.

Source: KPMG analysis.

The percentage of insurance companies close to bankruptcy/licence revocation per segment



Note: Percentages may not add up to 100% due to rounding.

Source: KPMG analysis.

Our respondents expect that the percentage of companies close to bankruptcy or having their licences revoked will increase for each market segment. This can be attributed to a number of factors, such as the general macroeconomic environment in Russia, the fall in the Rouble exchange rate, sanctions, the strengthening of regulatory pressure, and the stock market fall at the end of 2014.

Macroeconomic difficulties affect smaller market players more than larger ones, as they do not have enough resources to maintain their own financial stability and survive the difficult times without additional capital inflows. This means that the leaders have the opportunity to strengthen their market position and capture additional market segments. Our respondents expect this: 45% anticipate that the market share of the Top-10 will increase more than 5%.

The leaders could also expand their portfolios as a consequence of foreign companies curtailing their retail businesses and leaving the market.

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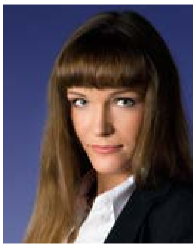

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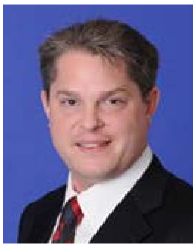

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