KPMG

General Insurance Update 2015

Opportunity through innovation

November 2015

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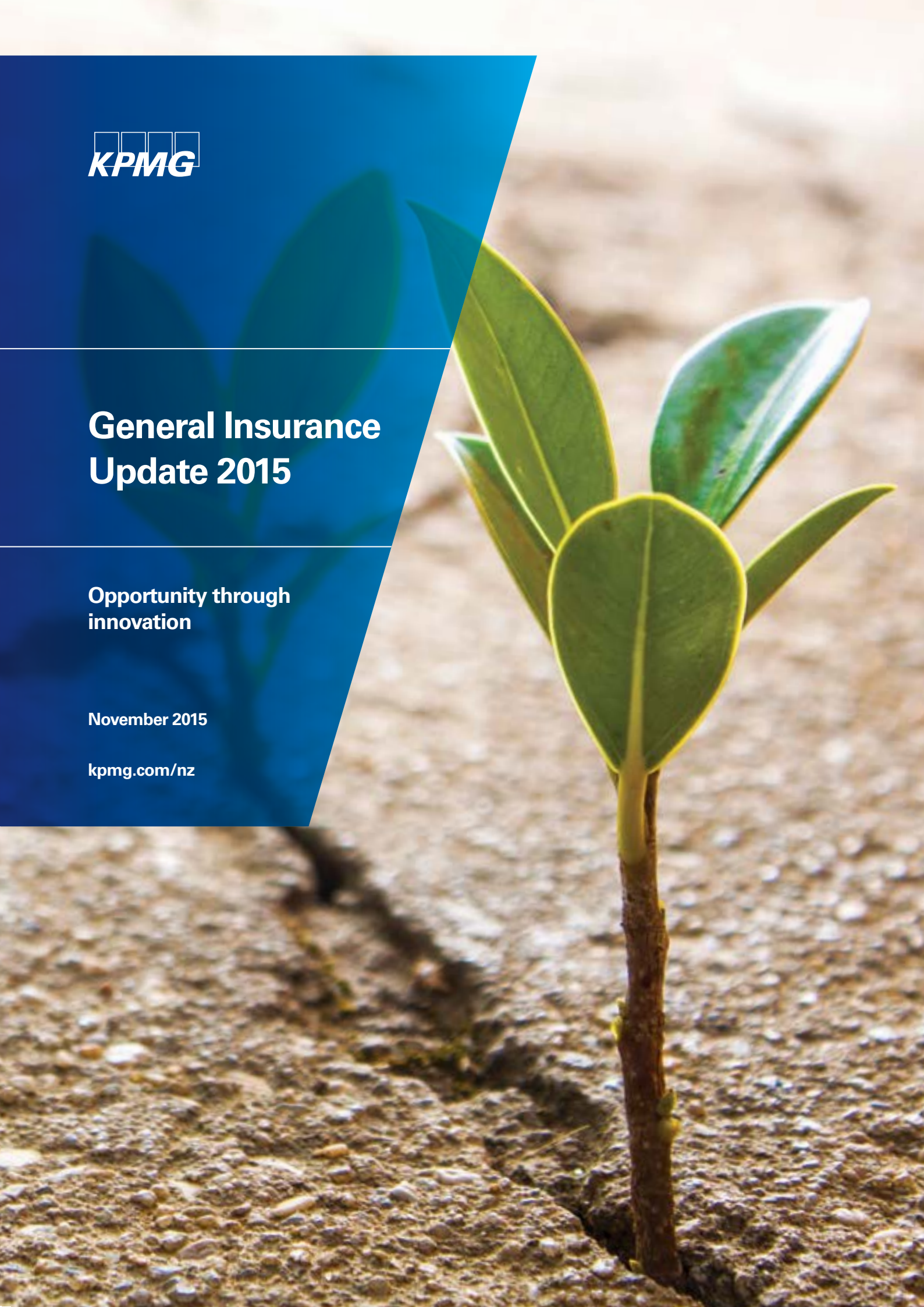

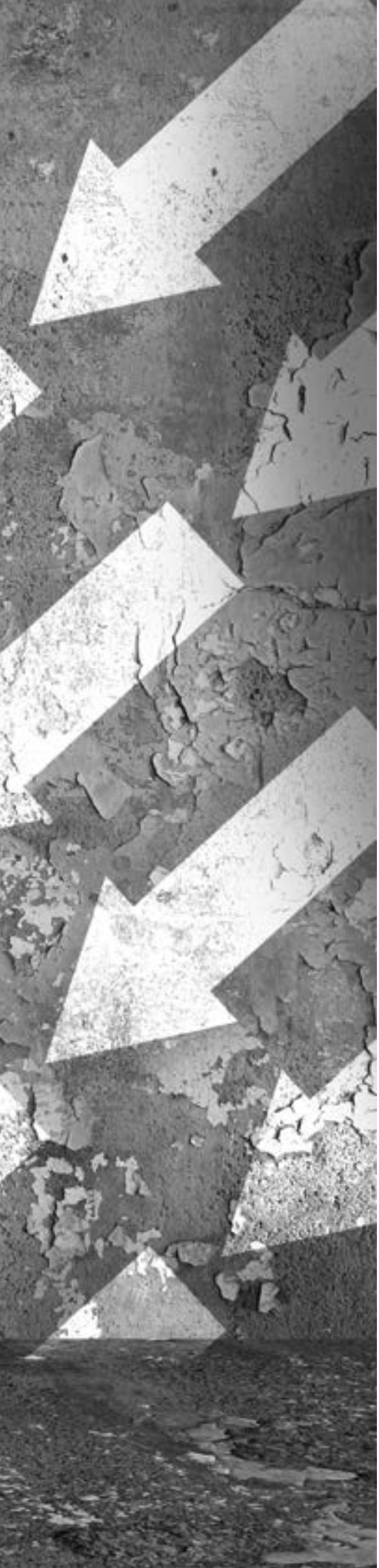

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The innovation imperative

Kay Baldock – Partner – Head of Insurance

Welcome to this bumper edition of our 2015 General Insurance Update.

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

In this publication, we look to the future, focusing on the innovation imperative.

For the second year running, we are pleased to include articles co-authored by our KPMG Global Insurance Leadership Team. The first of these articles on page 4 explores themes emerging from our recent KPMG International publication *'A New World of Opportunity: The Insurance Innovation Imperative'*, which examines survey data from senior insurance executives around the world. The innovation imperative is not a simple equation. There is no silver bullet to create a more innovative organisation; no off-the-shelf package that drives new ideas. Instead, insurers and intermediaries will need to navigate their own path through this new world of opportunity. They will need to develop new business and operating models, and new partnerships, in order to out-compete and out-innovate their peers and bold new entrants.

In our article titled *'What's being discussed in your war room?'* on page 10, we examine the results of the Lloyds City Risk Index 2015 to 2025 for both Auckland and Wellington. The analysis highlights that whilst natural catastrophes such as earthquake and flood threats are significant, they are far outweighed by man-made threats; such as market crash and oil price shocks, and emerging threats such as human pandemic and cyber-attack threats.

On the topic of earthquake risk, our article on page 14 examines the long-awaited discussion document on the future of New Zealand's Natural Disaster Insurance Scheme, which was released by Treasury in July 2015. Accompanying this article, on page 16, we are delighted to include an article from Tim Grafton, CEO of the Insurance Council of New Zealand (the "ICNZ"). Tim presents a summary of the ICNZ submission on the discussion document, made on behalf of the general insurance industry. We support the industry's views as expressed in the ICNZ submission. While acknowledging the merits of our current Earthquake Commission Scheme, it highlights the importance of making sure any scheme going forward is fit-for-purpose.

In the second of our co-authored articles we analyse the merits, and indeed, the need for insurers to adapt their business models to be customer-centric, and the importance of such an approach in unlocking future value.

Our article on page 24 focuses on the importance of conduct risk. It demonstrates what can happen when conduct risk goes wrong, as well as reviewing the International Association of Insurance Supervisors views on this topic. And on the self-regulation front, our article on page 28 considers the Fair Insurance Code 2016. We explore whether self-regulation goes far enough, whether it creates an uneven playing field, and how the Code will be monitored and enforced.

In our article on page 32, we review the growing trend across Asian insurers to increase their investment allocation to alternative investments such as real estate, and consider the attractiveness of real estate assets from a New Zealand perspective.

On the tax front, we discuss the recently announced proposals to impose GST on services provided by non-resident insurers to customers who are tax resident in New Zealand.

Our final article on cyber risk picks up from our publication last year, in which we highlighted the top five common cyber security risks. This year, we outline what organisations can do to get it right, emphasising the importance of a strong risk governance process.

On behalf of KPMG, we hope you enjoy the read.

Please do not hesitate to contact KPMG to assist your organisation in addressing any of the matters raised in this publication.

Opportunity through innovation

Gary Reader – Global Head of Insurance KPMG International & **Jamie Munro** – Audit Partner

On the face of it, the insurance industry has already travelled some distance in its embrace of technology-led innovation. Certainly, customer demand for self-service and online account management is catered for, particularly in the consumer-facing market.

Today's innovation culture goes beyond just digital. Disrupters with nimble, cost-effective business models and customer-centric offerings are snapping at the heels of the big players. Their innovations are customer- focused and technology-led.

Consumer expectations have never been higher. Across all industrial and commercial sectors, retail and business customers see digital technology as a catalyst for a better and more personalised service; providing access to a greater range of providers and products.

In the insurance industry, the imperative is to deliver better and faster decision making, and products tailored and priced for individuals and corporate insurance buyers. This presents a real challenge for the industry – not least because a burgeoning worldwide FinTech industry is throwing up new players that bring fresh-thinking and cutting-edge technologies to the marketplace. Without a commitment to innovation, incumbent insurers will sacrifice market share to more agile competitors.

"New technologies are reducing losses and costs while saving lives and increasing customer satisfaction, increasing risks and driving new business models and consolidation within the industry. New advances such as driverless cars, machine learning, home sensors, and 'robo-agents' empowered with artificial intelligence offer a world of opportunity for insurers."

Gary Reader, Global Head of Insurance, KPMG International.

Awareness into action

Research by KPMG International indicates that insurance industry leaders are acutely aware of the need to innovate. Earlier this year we polled senior executives from 280 insurance companies worldwide for our latest insurance report, *'A New World of Opportunity: The Insurance Innovation Imperative'*. Perhaps unsurprisingly, a significant majority agreed that the future success of their businesses was tied to their ability to innovate.

It was a viewpoint driven, at least in part, by growing evidence of fundamental change within the industry. Almost half said their own business models were already being disrupted by more nimble competitors and expected further disruption over the next five years. But as the report found, a broad awareness of disruption within the industry – and the associated risks – has not necessarily been matched by positive action. Fewer than half of companies questioned had an overarching strategy for innovation. Most watched (and ultimately followed) what others were doing, rather than aiming for first-mover advantage. Many organisations believe that improved use of technology will help drive greater innovation and growth.

Feeling the heat from disruption

Disruption is bringing heightened levels of competition for the local insurance sector. New entrants such as Youi and Countdown Insurance underline a period of market disruption. While New Zealand is behind other markets in adoption of online platforms; new technologies and new digital business models are emerging. Insurers need to focus on both short-term and longer-term opportunities, scanning the horizon for potential risks and disruptions while focusing on innovation to deliver long-term value. Some perceived disruptors, however, may actually be partners for insurance organisations seeking to innovate.

"Our leadership has its eyes wide open about what is at stake here. But we firmly believe that – if somebody's going to disrupt our industry – it might as well be us," noted John Geyer, Senior Vice President of MetLife's Innovation Programme.

The road ahead

To dwell on the negatives is to ignore the opportunities. The growing sophistication of big data – when coupled with analytics – dovetails neatly with customer demand for more personalised, faster and better-informed decision making. To take an example, a combination of customer and market data drawn from a broad range of sources can allow far more effective pricing of risk.

What are your organisation's biggest opportunities in the next two years?

60%

Improving operational processes and the use of technology

26%

Better use of capital and management of risk

6%

Wearables and 'the internet of things', including telematics

48%

Customer data analytics to improve underwriting, pricing and marketing

18%

Mergers & Acquisitions to improve market position and economies of scale

52%

Digital technology and integration into business objectives

26%

Cost reduction initiatives

3%

Biometrics for claims management and/or biosecurity

44%

Strengthening customer loyalty

18%

Changing consumer needs

Source: KPMG International 2015

What are your organisation's three greatest internal innovation challenges?

Innovation inhibitors

There are understandable reasons why major insurance groups might adopt a cautious, or measured, approach to innovation; rather than pressing ahead with new innovative business models or technology-powered operations. While perhaps the biggest factor is regulation, businesses also face issues such as a lack of core skills and insufficient funds for innovation projects. There are also structural problems. Big insurers tend to work in silos; dividing up not only functions – marketing, accounts management, etc – but also classes of work. Effective use of big data and analytics, almost by definition, means taking a holistic, group-wide approach. Equally important, organisations must create future-ready services and business models while managing their businesses in the present.

79%

#1
WE ARE RUNNING TO KEEP UP WITH WHAT WE DO ALREADY

74%

#2
LACK OF INTERNAL CORE SKILLS NEEDED TO DRIVE INNOVATION

71%

#3
LACK OF INVESTMENT AND COST PRESSURES

Answering the innovation imperative

The industry is at an inflexion point. Bold action is needed to seize opportunities and answer the innovation imperative.

WE BELIEVE THERE ARE 10 KEY CATALYSTS OF INNOVATION THAT MANAGEMENT CAN USE IN ORDER TO THRIVE IN A CHANGING WORLD.

1 APPLY AGILE AND DEDICATED LEADERSHIP

Strong, agile and dedicated executive leadership and accountability for innovation is a defining factor for success – innovation must be on the leadership agenda. Leadership training, development and incentivisation will be key.

2 ENCOURAGE CHANGE THROUGH CULTURAL TRANSFORMATION

For many insurers, cultivating innovation will require cultural change. Breaking down internal silos is a key success factor to create a more agile, collaborative and flexible organisation. Incentivising employees and creating structures that prioritise the success of customers – not products – will help drive cultural change and new ways of thinking.

3 CULTIVATE HIGH-PERFORMING HUMAN TALENT

The people dimension is the most important part of making innovation happen, and there is a lot to balance and optimise. Identify and develop individuals within your current talent pool with the reputation for shaping new ideas, simplifying processes, driving change and looking to the future. When hiring, be clear on the new skills and capabilities required – and create a more diverse workforce that reflects the culture you hope to achieve. Focus on encouraging different ways of working; through reward, the culture of the organisation, and performance management.

4 UNDERSTAND WHY YOU ARE INVESTING

Innovation requires discipline and governance, with portfolios risk and time balanced. Money flows and metrics matter – with teams rewarded for their input. Winning organisations budget for innovation and own it as a business.

5 DECIDE HOW YOUR ORGANISATION WILL THRIVE AS THE INSURANCE INDUSTRY TRANSFORMS

Once the need to act is clearly understood, companies must decide what to do. This commonly involves updating competitive strategies and realigning models. A refreshed understanding of where your company stands versus competitors informs how it must compete and win in future.

6 LEARN FROM OTHERS

Disintermediation in the insurance industry means partnerships will be critical to future success – but will need the right structures, models and infrastructure in order to create value. Large organisations need to learn to partner, and all organisations need to learn to partner effectively. Consider alliances with partners outside of insurance to accelerate customer benefits and expand the value chain.

7 DEVELOP YOUR OWN VIEW OF WHEN AND HOW ADVANCES IN TECHNOLOGY WILL IMPACT YOUR ORGANISATION

The immensity of the current changes – together with reliance on past success, and lack of confidence about the ability to adapt – have caused many insurers to resist change. This is a potentially fatal mistake. It is critical to keep refreshing your views.

8 LEVERAGE NEW TECHNOLOGIES INTO YOUR CURRENT BUSINESS

While upgrading core technology infrastructure such as policy administration and claims systems to support new customer centric business models and address cyber-risks is important, doing so assuming the status quo is a missed opportunity to pivot to meet new challenges.

9 MITIGATE RISK BY INVESTING AND EXPERIMENTING

The best companies have discovered ways to link their investments to the expected frequency and severity of risks, to ensure they are appropriately matching investment to risk. They are not afraid to experiment with new business models. Depending on your team's assessment of the viability of your current business model, and the role of technology in your competitive strategy, you might also explore new business models and businesses as the profile of risk changes.

10 BE WILLING TO DISRUPT EXISTING BUSINESS MODELS

Decide what role your company will play in industry consolidation and change. Scale is no defence to 'bystanders' that find themselves out-competed by organisations that are able to innovate smarter. We believe the greatest returns will accrue to those organisations that are able to 'join the dots' and actively participate in the change, consolidation and disruption ahead.

What next?

Good work is already being done.

The significant disruption of the New Zealand general insurance market following the Canterbury earthquakes, has resulted in a number of insurers transforming their businesses to succeed in the new market environment, developing new products and models.

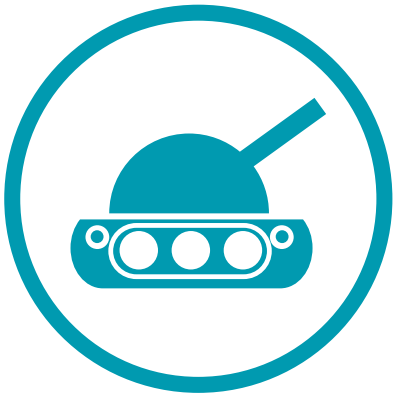
New technologies are being implemented to improve pricing and decision making. However, in a traditionally risk-averse industry, real change can be slow, not least because the lack of a clear strategy can hamper progress by focusing on incremental changes to certain aspects of the business, rather than taking a more strategic view. The incremental approach may seem safe but in the longer term it creates a risk that market share will be lost.

There is no single, generalised route map for business redefining innovation. Each company must make its own way, depending on its objectives, business model, market positioning and customer base. But all insurers should focus on innovation in the here and now. The market is moving too quickly for any business to do otherwise.

What's being discussed in your war room?

Nicholas Moss – Audit Senior Manager

War room – conceptually, a source of leadership and guidance to ensure that service and order is maintained. Its tasks are achieved by monitoring the environment and reacting to events, from the relatively harmless to a major crisis, using predefined procedures.



The Lloyds City Risk Index 2015 to 2025 was released in early September 2015. The Index provides an interesting analysis of potential threats to economic output over the next 10 years in 301 major cities. The Index should stimulate discussion by governments, communities and businesses on topics ranging from potential threats to a country's economic output, and disaster recovery in the event of a crisis, to scenario analysis in continually-evolving risk management plans. From an insurance perspective, the Index has the added benefit of informing potential market gaps and in de-risking emerging threats.

The methodology used to develop the Index is based on research by the Cambridge Centre for Risk Studies at the University of Cambridge Judge Business School. A summary is as follows:

- Cities are at risk from multiple threats. The Index considered 18 of them. Each threat has a range of events of differing magnitudes (simplified to 'small', 'moderate' or 'severe') that could affect each city in the future.
- An estimate was made of the likelihood of each city being affected by events of differing magnitudes. Likelihoods vary from city to city, depending on their location and risk characteristics. However, it is worth noting that all of the events are rare, and the probability of a city being impacted by any particular event scenario in the 10-year period may be only a few percent.
- Total GDP@Risk for each city from all threats was calculated by summing all of the expected losses from the different threats and their representative scenarios.
- GDP@Risk represents the loss of economic output, relative to the economic output that would have been expected had the catastrophic events not occurred.

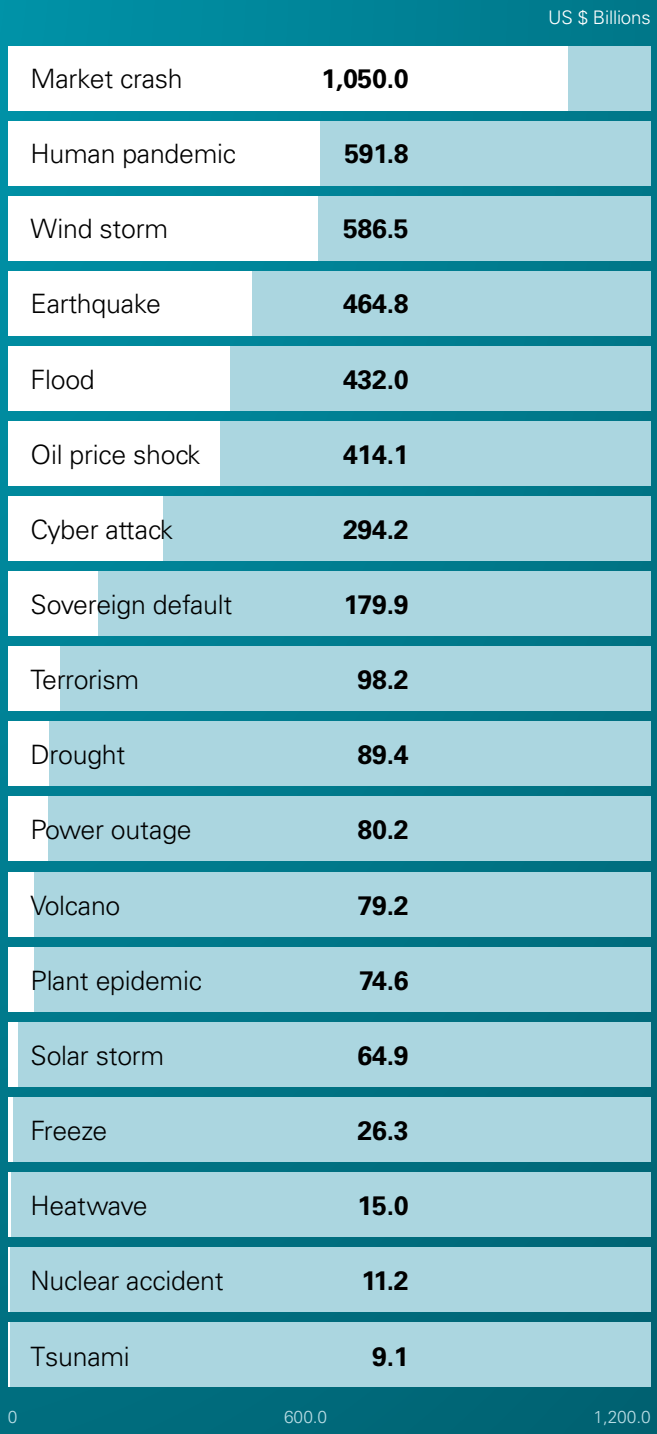
What were the results?

The Index shows Total GDP@Risk between 2015 and 2025 across all 301 cities is US$4.6 trillion. Included in the Index are Auckland and Wellington, with US$6.3 billion and US$1.2 billion GDP@Risk respectively.

While the numbers are significant, to a certain extent they are more relevant in the context of understanding trends identified by the Index. So what are the trends?

Let's start with Total GDP@Risk across all 301 major cities.

- New or emerging threats are having a growing impact and account for US$1.0 trillion Total GDP@Risk. These include plant epidemic at US$74.6 billion, solar storm at US$64.9 billion, cyber-attack at US$294.2 billion, and human pandemic at US$591.8 billion.
- Man-made threats are becoming increasingly significant and account for US$2.1 trillion Total GDP@Risk. These include market crash at US$1.1 trillion, oil price shock at US$414.1 billion, cyber-attack at US$294.2 billion, sovereign default at US$179.9 billion, terrorism at US$98.2 billion, power outage at US$80.2 billion, and nuclear accident US$11.2 billion.
- Emerging economies have the most to lose with US$3.3 trillion GDP@Risk. These include Jakarta at US$48.2 billion, Guangzhou at US$43.7 billion, Delhi at US$44.0 billion, and Lagos at US$16.7 billion.



Looking closer to home, the key trends for Auckland and Wellington are not out of line with those identified at a Total GDP@Risk level.

The Index identified US$6.31 billion GDP@Risk in Auckland.

- Man-made threats such as market crash and oil price shock are significant for Auckland, and account for US$3.56 billion and US$580.0 million, respectively.
- Emerging threats such as human pandemic and cyber-attack are noticeable threats in Auckland, and account for US$370.0 million and US$120.0 million GDP@Risk, respectively.

The Index identified US$1.21 billion GDP@Risk in Wellington.

- GDP@Risk in Wellington is relatively small compared to Auckland. However, man-made threats such as market crash and oil price shock are significant for Wellington, and account for US$600.0 million and US$100.0 million, respectively.

US $6.31 billion

GDP@RISK IN AUCKLAND

WHAT IS INTERESTING FOR BOTH AUCKLAND AND WELLINGTON IS THAT WHILE NATURAL CATASTROPHES SUCH AS EARTHQUAKE AND FLOOD THREATS ARE SIGNIFICANT, THEY ARE FAR OUTWEIGHED BY MAN-MADE AND EMERGING THREATS SUCH AS MARKET CRASH AND OIL PRICE SHOCK.

In fact, natural threats account for only 27% of the GDP@Risk in New Zealand.

In light of the Canterbury earthquakes, natural catastrophes are understandably well-considered threats in New Zealand. However, we should be mindful that there is a human tendency to be more optimistic about potential threats which have either not occurred in our lifetime or at least not in our recent past. This does not mean the threat is any less likely to occur.

The world is changing faster than at any time in human history. This change means threats are evolving – to governments, to communities, to businesses. Our preparation for potential catastrophes needs to continually evolve as well.

Governments should continue to assess evolving threats to a country's economic output and update their risk mitigation strategies and resource deployment accordingly.

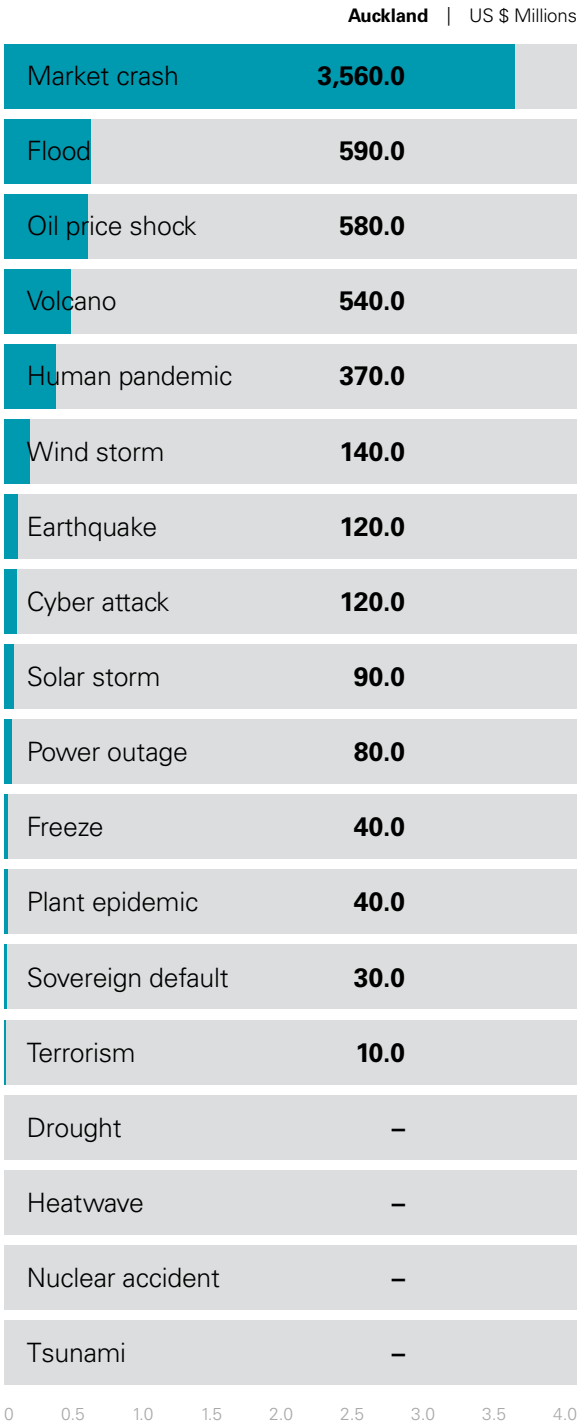
Similarly, businesses should continue to assess evolving threats to their balance sheets and, in doing so, should also consider that multiple threats could potentially come together at the same time. Too often, our analysis only considers impact from one potential threat at a time.

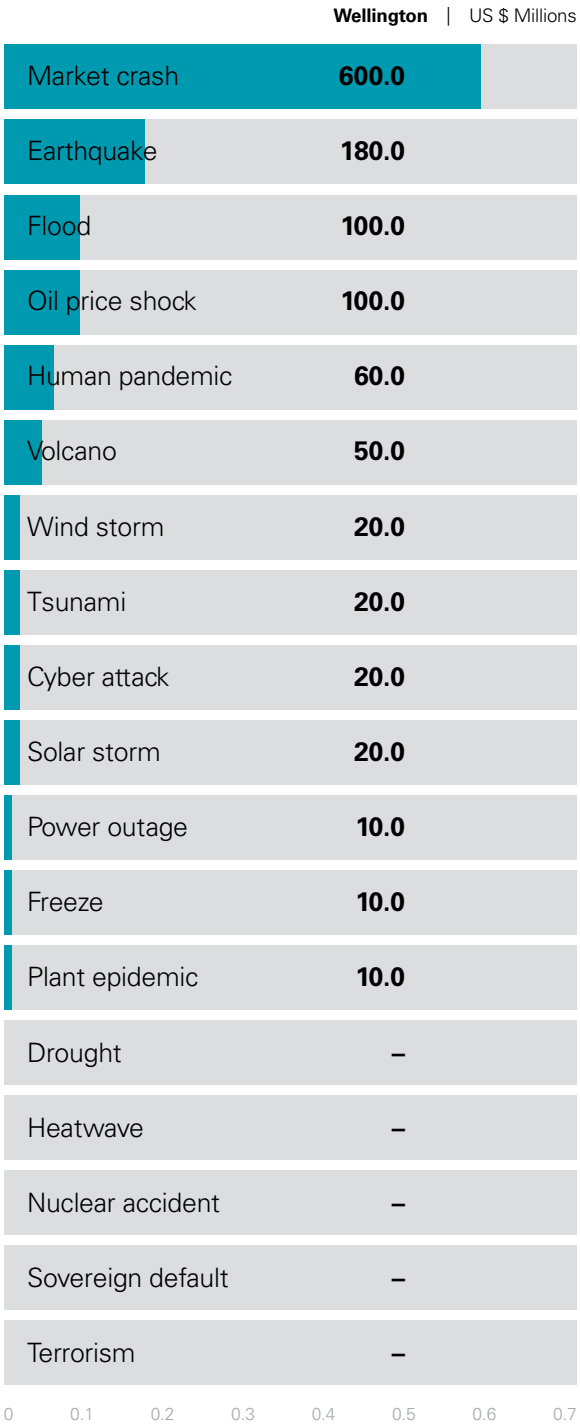
While not a focus of the Lloyds City Risk Index, consideration of multiple threats coming together should be applied to macroeconomic factors as well. In New Zealand, we are currently seeing continued low inflation, a weakening New Zealand dollar, falling interest rates and continued pressure on global commodity prices. However, these are current trends and multiple future scenarios are possible.

After potential scenarios have been considered, insurance can be a key part of the solution. Insurance de-risks governments, businesses and communities. A separate Lloyds study showed that a 1% increase in insurance penetration translates into a 13% reduction in uninsured losses and a 22% reduction in taxpayers' contributions following a disaster.[1] This Index may help insurers identify potential market gaps arising from emerging threats and may help inform market development.

More information on the Lloyds City Risk Index can be found at **http://www.lloyds.com/cityriskindex/**

1 Lloyds and How Insurance Fuels Sustainable Growth in Indian Economy Report





EQC Reform: KPMG's view

Nicholas Moss – Audit Senior Manager

Recently the Government published a discussion document which sets out potential changes to the Earthquake Commission Act 1993 (the "Act"). The Act legislates the role and mandate of the Earthquake Commission (the "EQC").

Perhaps unsurprisingly, the Minister's Foreword at the beginning of the discussion document starts with a purpose statement – "An EQC scheme that helps keep home insurance affordable and supports recovery after natural disasters."

This statement is not out of line with the role taken by the EQC in the Canterbury earthquakes. However, it is a significant shift from its role as currently defined by the Act – which is to administer insurance, manage the National Disaster Fund, and to research and educate about matters relevant to natural disasters.

An EQC scheme that helps keep home insurance affordable

The Canterbury earthquakes have demonstrated both the value of an independent entity dedicated to reducing the impact of natural disasters, and the need to revisit how best the EQC can form part of the collective response in the event of a natural disaster.

The first part of the purpose statement is "An EQC scheme that helps keep insurance affordable". One of the obvious benefits of the EQC scheme is insurance coverage – far higher in respect of the Canterbury earthquake losses than in other major earthquake events internationally. Taking a combined view of the Canterbury earthquakes, insurance coverage was around 71%. This in stark contrast to insurance coverage in the Japan earthquake of 2011 (19%); the 2010 Chile earthquake/tsunami (27%); the 1995 Japan earthquake (3%); and the Californian earthquake of 1994 (35%).

An EQC scheme that supports recovery after natural disasters

The financial benefit of the EQC scheme is unquestionable when you consider the insurance coverage rates of the Canterbury earthquakes. However, there are a number of other aspects of the EQC scheme which need to be re-visited; and amending the Act can only be part of the solution.

More importantly, amending the Act in the absence of understanding the extent to which the EQC should support recovery after natural disasters may prove to be only a distraction from addressing more fundamental issues.

There is no doubt there was confusion over whether policyholders should contact their private insurer or the EQC. There is no doubt there was confusion over the type of cover provided by the EQC (particularly land cover). Both these aspects of the EQC scheme are considered in the Government's discussion document. However, while these kinds of issues certainly need to be addressed, they appear to be low hanging fruit. They are not the root cause of more fundamental issues seen in the recovery and rebuild following the Canterbury earthquakes.

The second part of the purpose statement is "An EQC scheme that… supports recovery after natural disasters." How this might work in practice is not addressed in the discussion document, and it remains unclear to what extent the EQC will or should support recovery.

The EQC's own planning for large-scale natural disasters was inadequate prior to the Canterbury earthquakes – both in terms of their expected role (per the existing Act), and in terms of their extended role (as directed by the Minister for Canterbury Earthquake Recovery following the September 2010 earthquake).

The EQC anticipated that a large scale natural disaster could result in about 150,000 claims and settlements of at least $6.8 billion . This falls a long way short of actual experience to date from the Canterbury earthquakes. At the end of August 2015, the EQC website reported 167,481 building claims, 187,106 contents claims, and 150,735 land exposures. In dollar terms, this amounted to settled claims totalling $8.8 billion.

THE EQC WEBSITE REPORTED 167,481 BUILDING CLAIMS, 187,106 CONTENTS CLAIMS AND 150,735 LAND EXPOSURES, WITH SETTLED CLAIMS TOTALLING

$8.8 billion

The EQC's plan and business model for responding to such an event was also inadequate. The EQC's plan was to outsource the services it would require if it was to settle claims in cash. Whilst cash was the EQC's preferred settlement method prior to the Canterbury earthquakes, it is not a settlement method which supports a more hands-on role in reconstruction activities. In hindsight, nor did it support the EQC's extended role of project managing a significant proportion of the residential repair and rebuild.

The EQC's business model was also not able to support its plan. The EQC consisted of 22 staff prior to the Canterbury earthquakes, and the business model was to scale up staffing and rely heavily on outsourcing arrangements in the event of a natural disaster. However, the hub of this model was not strong enough to coordinate and manage the extent, and specialised nature, of the outsourced work. Nor did it contemplate a natural disaster the scale of the Canterbury earthquakes, which meant almost overnight there was a shortage of loss assessors/adjustors across the industry.

In order to adequately plan for disaster recovery, an organisation's role in supporting that recovery needs to be clear.

Where to next?

The discussion document acknowledges that it only addresses issues and sources of difficulty that can be traced to the Act. There are also a number of other Acts that influence the response to and recovery from natural disasters. These include the Civil Defence Emergency Act 2002, the Resource Management Act 1991, and the Building Act 2004.

Addressing potential issues and sources of difficulty that can be traced to the Act is certainly important. However, a more fundamental issue is first to clarify the extent to which the EQC should support the response to and recovery from a natural disaster. In understanding this, there needs to be consultation with industry groups critical to recovery from a natural disaster – the insurance industry and construction industry, to name just two. This currently appears lacking.

Amending the Act in the absence of clarifying the role of the EQC may prove to be only a distraction from addressing more fundamental issues and learnings from the Canterbury earthquakes.

On page 16, Tim Grafton, CEO of the Insurance Council of New Zealand ("ICNZ"), provides an overview of the ICNZ submission on the discussion document on behalf of the general insurance industry. KPMG concurs with the conclusions reached.

EQC Reform: Industry view

Tim Grafton – Chief Executive, Insurance Council of New Zealand

During their trips to New Zealand, a number of reinsurers have called into the Insurance Council (ICNZ) office in Wellington to discuss progress on the Canterbury earthquake claims.

Some reinsurers have mentioned that the earthquake recovery is right up there among the most complex natural disaster insurance recoveries ever. There are many reasons for this, but prominent among them is the existing Earthquake Commission Act 1993 ("EQC Act"). It provides that EQC covers land damage and the first $100,000 plus GST of building damage, and $20,000 plus GST of contents damage for each event.

The current Act caused problems of duplication and inefficient use of resources in Canterbury as well as contributing to delays. The fact that EQC cover reinstates after each event requires the complex calculation of damage to be apportioned for each of the major earthquakes for each claim. Issues with privacy slowed down the sharing of EQC data with insurers, and differences between the cover under private insurers' policies and the EQC Act caused inconsistencies in repair strategies. EQC also had difficulty in quickly determining whether some properties were over cap. From 2014 to June 2015, private insurers have received over 2,500 over cap properties from EQC, between three and a half to four and a half years after the first earthquake. In the last quarter ending 30 September 2015, 467 properties were handed over to insurers as over cap.

The EQC Act needs to be amended in light of the lessons learned from the extreme stress testing brought by the Canterbury earthquakes.

Treasury EQC Act Review

In July 2015, Treasury published a discussion document seeking submissions on how EQC should be structured in the future. The discussion document sought stakeholder input on how EQC should operate and outlined a number of scenarios for comment.

The ICNZ gathered together a group of experts from throughout the industry – from the fields of underwriting, claims, legal, and reinsurance – to examine the Treasury suggestions and bring together the industry response.

Principles for an Efficient Recovery from Natural Disaster

The ICNZ submission adopted a principles-based approach. At its heart, it sought to ensure as far as possible that anyone who has insured a residential dwelling can be re-housed after a natural catastrophe. Consistent with that, it also sought a scheme that keeps natural catastrophe cover affordable and available to all who choose to insure their residential dwelling.

The submission outlined a large number of recommendations for efficient recovery from natural disaster. The aim was to eliminate factors that led to duplication of effort, inefficiencies, additional costs and delays with the residential recovery.

The principle recommendations that would make the most immediate difference following a natural disaster, include:

» **Lodgement and Assessment of Claims**

ICNZ strongly supported the discussion document proposal to legislate that all EQC claims should be lodged with property owners' private insurers. However, this does not go far enough. To address the problems of duplication of resources, and the long tail of claims being transferred to insurers years after a disaster, legislation should also require claims to be assessed by insurers. ICNZ also advocates for all under cap as well as over cap claims to be managed by insurers to the point of settlement or reinstatement. This would be managed under a commercial arrangement between insurers and EQC. Claims would be audited by EQC and their re-insurers. This change in the claims process would remove duplication of costs, confusion for the insured, provide one point of contact for the insured and a faster recovery process. An important point in the ICNZ submission was that insurers have significantly more qualified resources and better systems in place to respond to a major disaster vis-a-vis EQC.

TO ADDRESS THE PROBLEMS OF DUPLICATION OF RESOURCES, AND THE LONG TAIL OF CLAIMS BEING TRANSFERRED TO INSURERS YEARS AFTER A DISASTER, LEGISLATION SHOULD ALSO REQUIRE CLAIMS TO BE ASSESSED BY INSURERS.

» **Land Cover**

ICNZ's submission did not support the discussion paper's proposal to combine site-works into a single building cap. This was because of the significant risk of under-insurance and the potential reduction of insurance coverage rates. Land repairs are notoriously difficult to price; and in the current fixed sum insured environment, a large proportion of the sum insured amount could be eaten up with additional land -foundation repair costs over and above what would be required to build or repair the house today. This would leave insufficient funds to repair the building.

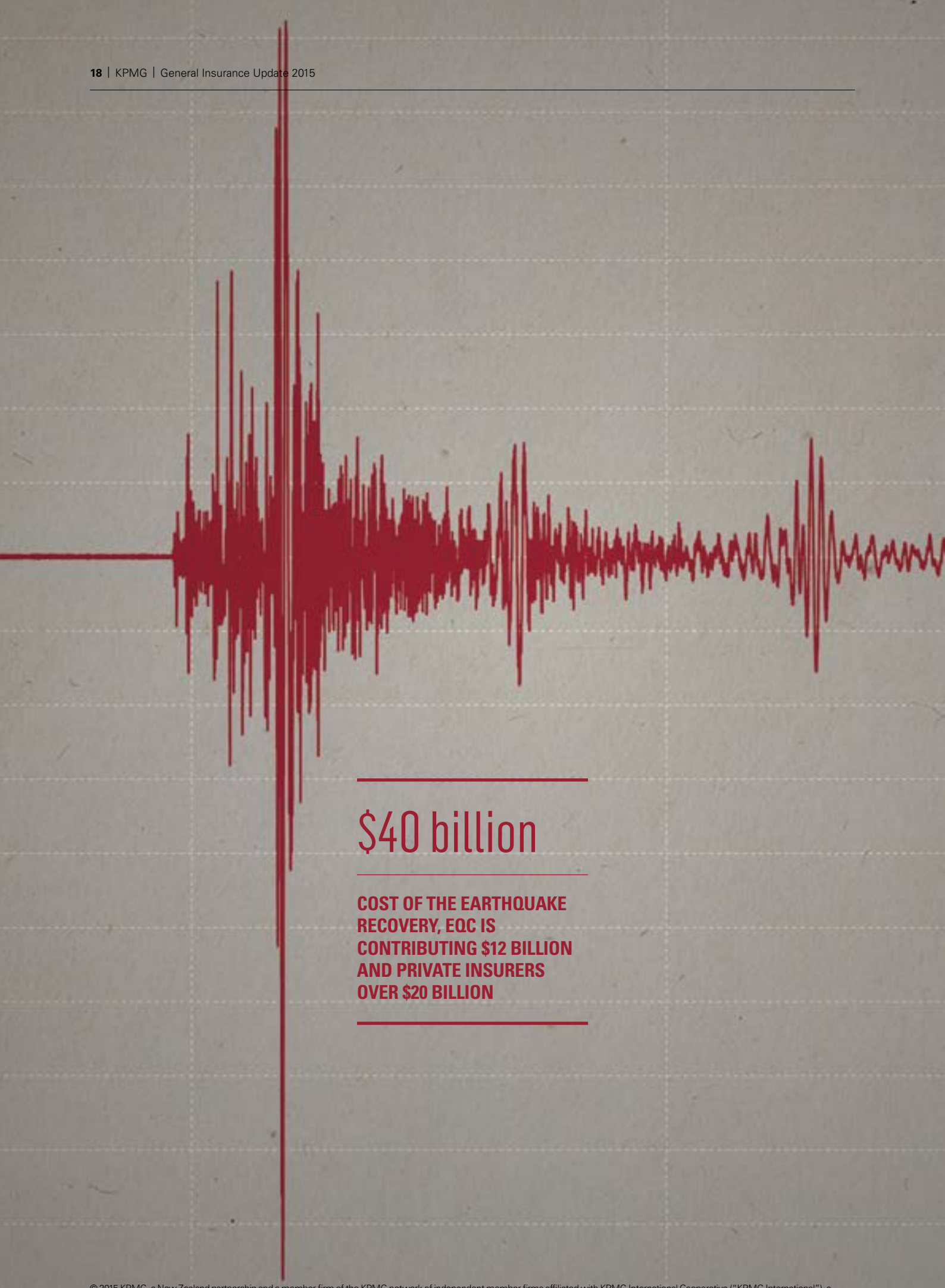
ICNZ proposed that the discussion document's combining of site-works into a single building cap be disbanded and replaced with two separate covers: land works and building cover. Land works would cover all land and enhanced foundation work required to create a building platform. This would include the additional foundations/ land works needed above the standard foundation costs of the house were rebuilt to today's, pre-quake building requirements – due to land damage from an earthquake or other natural peril – in order to provide a building platform to rehouse people. Building cover would be the costs for building repair or replacement, up to the EQC cap.

» **EQC Cap Cover**

ICNZ proposed that the building cap be set at $150,000 rather than $200,000 because of the cost allocated to land works. The current cap for contents of $20,000 plus GST should be removed, leaving private insurers to manage all contents claims. This removes another source of duplication of resources and associated inefficiency issues that contributed to delays in the Canterbury earthquake recovery.

» **Reinstatement of EQC Cover**

ICNZ's submission proposed a different cover by EQC; where EQC's cover would only fully reinstate, once the cap was reached, following the completion of repairs during the period of insurance. For example, if earthquake damage to a property was $250,000, EQC would pay up to its cap, say $150,000 and the private insurer, $100,000. If a further $50,000 damage was caused by a subsequent event before repairs were completed, these additional costs would be met by the private insurer. EQC has no further liability once their cap is reached until the repairs are completed. This is an important change in approach which significantly reduces EQC's exposure and avoids the major problem of EQC and insurers having to apportion losses between events. It also preserves the principle of indemnity, encourages repairs to be undertaken in a timely fashion, and removes incentives to under-insure for catastrophic events.



$40 billion

COST OF THE EARTHQUAKE RECOVERY, EQC IS CONTRIBUTING $12 BILLION AND PRIVATE INSURERS OVER $20 BILLION

» **Standard of Cover**

ICNZ submitted that EQC building cover should follow that of the insurer, so all assessments and repair standards would be based on the home owner's private insurance policy. This eliminates any bias in assessments, whether the losses are under or over the EQC cap. and policyholders get the standard of reinstatement they purchased from the ground up.

» **Need for Flexibility**

The current EQC Act and other legislation like the Privacy Act are too restrictive to enable catastrophe situations to be dealt with efficiently and effectively. ICNZ's submission sought greater flexibility around sharing of information and the ability for EQC to deal directly with third party interests like those of insurers.

» **Transition**

ICNZ advocated in the submission that at least 18 months needs to be allocated to phase in the new scheme. Apart from changes to policy wordings, systems changes and the need to develop the commercial contracts with EQC, annual reinsurance arrangements will need to transition through to new covers during the 12 months following enactment.

Conclusion

The Canterbury earthquake experience has shown that New Zealand is very fortunate to have such a comprehensive natural disaster support structure as the Earthquake Commission. Of the $40 billion cost of the earthquake recovery, EQC is contributing $12 billion and private insurers over $20 billion. Without this, the New Zealand economy would have been severely affected at a time when the world was in the grip of a global financial crisis.

The Canterbury experience has shown that the EQC Act was not designed with such a major catastrophe in mind; and many of the well-publicised problems of the earthquake recovery stem directly from the shortcomings of the EQC Act.

The Treasury review of the EQC Act gives an opportunity for the shortcomings to be put right. The ICNZ submission and recommendations on the Treasury discussion paper is based on its insights from the front-line work it has undertaken with private insurers and EQC. It recognises the need for the future shape of EQC to be affordable for government, as well as the costs of the scheme being affordable for consumers. If the ICNZ recommendations are adopted, we will have a more economic and efficient natural disaster scheme – one that promotes the world-leading levels of insurance penetration that New Zealand currently enjoys.

Putting the customer first: the competitive advantage

Mary Trussell – Insurance Innovation and High Growth Markets Global Lead Partner, KPMG International &
Kay Baldock – Head of Insurance, KPMG NZ

The objective of innovation should be to drive growth by delighting customers – either through improved efficiency, more customer-centric products and services, or through new channels and approaches.

In this article we explore what it means to be "customer-centric", and the importance of this concept to insurers in unlocking future value.

In an industry where products are traditionally sold rather than bought, can insurance companies be truly customer-centric? Do insurers need to be? KPMG certainly believes so. In fact, more than that, we believe that customer-centricity lies at the heart of innovation.

The KPMG International publication '*A New World of Opportunity: The Insurance Innovation Imperative' (KPMG 2015 report)*, released September 2015, explores the drivers of change facing the industry. Put simply, we believe that evolving customer needs – fuelled and empowered by technology – will continue to shift the demands customers make of insurers. Those customers that are not quickly satisfied will simply change to a more agile competitor who is willing and able to customise their offering and simplify the experience. We have seen this in many industries already. Insurance is not immune, and insurers recognise the fact.

CEO and Co-founder of Bought by Many[1], Steven Mendel notes: "*Customers no longer want to go meet with brokers and they no longer want generic products. What they want is a tailored experience and product offerings that reflect a deep understanding of their needs and risks.*"

Another example is Spanish-based global insurer, MAPFRE, who were the pioneers in Spain in developing an insurance-based customer service model. They routinely launched products for new needs – such as pet insurance that covers both animal health and owner civil liability, or new channels such as vending machines and department stores. Antonio Huertas, Chairman and CEO of the MAPFRE Group says, *"We have always known that our future lies in service."*[2]

So while insurance providers increasingly recognise the need to be customer-centric, what does this mean in practice?

Type the words "customer-centric" into Wikipedia and you are redirected to "customer satisfaction". Customer satisfaction is defined as "the number of customers, or percentage of total customers, whose reported experience with a firm, its products, or its services (ratings) exceeds specified satisfaction goals."[3] According to Wikipedia, customer satisfaction decreases when a company has increased bargaining power. They cite an example of companies which operate in an oligopoly, noting that the lack of choice means companies can exert power over customers resulting in terms and conditions that customers would otherwise find unacceptable, which ultimately leads to low customer satisfaction. Set against that of a more competitive industry where customers can easily switch service providers to find a customised solution tailored to their needs.

1 Bought by Many is a free members-only service that leverages social media to help consumers find insurance for niche and specialised risks

2 *A New World of Opportunity: The Insurance Innovation Imperative* – kpmg.com

As at October, 2015, there are currently 96 licensed insurers in New Zealand[4], and per our analysis, 72 of the 96 insurers engage in general insurance activities. Based on these statistics, customers purchasing general insurance products clearly have a range of insurers and products to choose from. How, then, do insurers not only retain existing business but also compete for new business?

Here's what our KPMG subject matter experts have to say:

Put the customer at the centre

Julio Hernandez, KPMG's Global Head of Customer Centre of Excellence[2]

"First, insurers need to understand what it is that customers want. In part, this is about listening to feedback from current customers, following social media and scanning the competitive environment. It's also about listening to what your customers are telling you about other people and what prospective customers are looking for.

At the same time, insurers need to avoid looking only to their current customers and competitors for best practices and potential disruptors. The fact is people transfer their expectations from one experience to another, regardless of industry.

If your airline can tell you exactly where your bag is throughout a series of overseas transfers, it stands to reason that your insurance company should be able to tell you where your claim is if your house has been flooded. And if you can communicate with your bank over Facebook, you will also likely expect to be able to talk to an insurer through the same channel.

But let me be clear: just because customers demand something doesn't mean they should always get it. In all cases, organisations need to start by deciding whether or not they are capable of delivering what the customer wants in an effective, safe, reliable way – it needs to make economic sense. And they need to decide if delivering on the customer expectation makes sense in their specific context.

In many cases, insurers may also want to consider whether a particular innovation is right for all their customers. An insurer may, for example, decide that claims from customers with lower risk ratings follow an automated claims handling process; whereas a notification from a high-risk customer with multiple prior claims should follow a more involved, high touch, process. Once again, however, this will require insurers to truly understand their customers and their behaviours to properly segment what level of service each customer commands."

The Retail sector

Mark Larson, Global Head of Retail, KPMG International[2]

"While – 30 years ago – nobody would have suggested the retail sector was 'innovative', today's leading retailers have embraced innovation and are using it to drive significant competitive advantage. In my experience, insurers could learn a lot from them.

One of the biggest transformations has been what retailers call the 'omni-channel' approach. This means providing a seamless experience for individual customers across multiple different 'touch points' – the store-front, the web store, the mobile app and the social experience (or, for insurers, the broker, the web portal, the customer service channels and the claims hotline).

What retailers have quickly realised is that delivery of a true 'omni-channel' experience starts with a clear view of the customer and their unique needs, preferences and demands. The better the retailer knows their customer, the more individualised (and, hopefully, profitable) the offering can be and the better the experience for the consumer.

3 https://en.wikipedia.org

4 http://www.rbnz.govt.nz/regulation_and_supervision/insurers/register/

The good news is that developing a single view of the customer from mountains of siloed data is no longer all that difficult; the past few years have seen technology solutions that can be used to integrate data from across the organisation and from outside sources – to help build a single, unified picture of the customer.

The bigger challenge comes in interpreting that data and turning those insights into tangible business decisions. That requires talent, strong leadership and a culture of innovation and collaboration – things that both retailers and insurers should continue to focus on for future success."

New players in the insurance arena – those focused on giving customers what they want – have demonstrated considerable success. Notable is the story of Beagle Street, a privately-owned UK company established in 2012, which has already captured over 8% of the UK life insurance market. So what's the secret to the company's success? Here's what their CEO had to say:

5 Beyond Price: The Rise of Customer Centric Marketing in Insurance

Giving customers what they want

By Matthew Gledhill, CEO of Beagle Street[2]

"At Beagle Street, we don't just want to disrupt the life insurance industry, we want to utterly transform it. The fact is that today's traditional life insurance process is fat, poorly-aligned to customer needs and overly-complicated."

So we put our entire focus into giving today's consumers what they want by delivering simple, affordable and more accessible life insurance. Our strategy is clearly working; we've only been around since 2012 and we already have more than 8% of the UK life insurance market; The Times named us #1 for Life Insurance in the UK. And – more importantly – our customer reviews say we are 'excellent', awarding us a 9.3 out of 10 for customer service.

How did we become so successful so quickly? Simple: by focusing on the customer. And delivering on what customers want – simplicity, accessibility and value. That's why our products can be bought online within 10 minutes, usually at prices 30% lower than traditional players, and with a basket of value-added services included free-of-charge.

Our customers rave about us because – unlike other insurers – we make an emotional connection with our policy holders rather than a rational connection. Ultimately, we know that buying life insurance is an act of love, not an act of fear. And so we design our products and our value-added services to reflect that altruistic motive.

For example, we offer free will writing services and family counselling services to our policy holders and their families. We email policy holders' benefactors to make sure they have the right cover details, just in case something should happen. We even conduct regular searches on official death registries to ensure that loved ones receive their pay-outs even if they haven't got the right details to submit a claim.

In part, our success is the result of our people's deep commitment to the customer. In fact, when we receive a serious complaint from a policy holder, we often bring them (first class) to our offices to sit down with the individuals who design and manage those products so that can we learn – first hand – how to improve and redesign that product to better meet customer needs in the future.

The larger part of our success, however, comes down to our single-minded focus on innovation. We recognised early on that major change was coming in the way life insurance was being distributed, and so we focused our attention onto innovating at the distribution level and investing heavily into improving the way that life insurance is sold.

Obviously, our goal isn't to amass the largest profits. Our goal is to provide the best service and the best proposition to the customer. And our experience shows that – if you get that right – "profits will quickly follow."

While the Beagle Street example is based on the life insurance industry, their approach highlights the merits of a customer-centric focus.

The concept of shifting from a product-centric to customer-centric focus is not new. In a 2013 report by McKinsey[5], the company compared marketing spend in the U.S. auto-insurance market versus premium growth, and considered why insurance advertising was not more effective. While this report was aimed at Auto Insurance Marketers, the conclusion is relevant to the product-centric versus customer-centric debate. The report concluded that in order to maximise returns, insurers needed to develop a sophisticated understanding of customer segments.

So what's changed? In short, it's the need to innovate. As discussed in our article on page 4, "Opportunity through innovation", in our recent KPMG survey[2], eight of ten insurance executives surveyed believe their organisation's future success to be closely tied to their ability to innovate ahead of competitors. The potent combination of data and digital is driving the need for digital solutions and end-to-end customer experiences. Now more than ever, insurers need to move away from traditional product solutions to tailored customised solutions.

In a market such as the New Zealand General Insurance market, which is viewed by many as mature and often described as saturated, it is clear that insurers need to respond to changing customer needs to not only maintain their current market position but also to grow.

According to Peter Fader of The Wharton School, University of Pennsylvania, and author of *"Customer Centricity"*, a requirement for customer-centricity is the ability for organisations to understand customers at a granular level; as well as the ability, both operational and organisational, to deliver different products and services to different types of customers i.e. offer tailored customised solutions.

In the New Zealand market over the last 12 months, we have continued to see examples of insurers offering tailored product solutions. For example, the tag line of new market entry Youi is: "We get to know you better it could save you lots". Insurers such as AA Insurance, AMI and STATE have enhanced their digital offerings – providing quotes and accepting initial claims notifications online, and allowing customers access anywhere, anytime. This shows insurers are increasingly recognising the need to be customer-centric rather than product-centric. Customers do not come to insurers to purchase a specific product. Rather they need help in managing risks – they need a solution provider.

Unlike most other industries, insurers have access to a wealth of customer data. This gives them the ability to customise solutions to help customers manage unique risks. Not responding to this shifting paradigm is not an option. Insurers need to respond now if they hope to stay relevant and grow new business opportunities. Those insurers who manage to unlock the value embedded in their data sets, and use this to offer tailored customer solutions, will not only increase through customer satisfaction, but through increased retention they will create a customer-for-life philosophy that ultimately leads to future financial gain.

Conduct risk: A new regulatory and risk management mantra

Neil Kerr – Advisory Associate Director, KPMG Sydney & **Adele Wallace** – Advisory Associate Director, KPMG Sydney

In the period immediately following the financial crisis, regulators across the globe focused on strengthening the resilience of insurers by seeking to apply higher solvency standards and enforcing greater oversight from the risk management functions at general insurers.

Regulators sought to do this both as a mechanism to ensure that financial institutions were more robust and resilient to future stresses; and ultimately, to ensure that consumers were protected from the risks of failure of the institutions that manufacture and distribute their insurance products. In New Zealand, local reforms from the Financial Markets Authority (the "FMA") have focussed on broader risk management, governance and culture; and the implementation of the Financial Markets Conduct Act.

Notwithstanding these regulatory changes and interventions in the form of fines and actions from regulators, customers continue to feel a sense of mistrust in the financial institutions they interact with. Examples of customer detriment continue to emerge, in spite of the regulatory changes that have taken place at a global and local level.

So how has customer detriment arisen historically? The drivers are many and are often deeply embedded into an organisation's culture and procedures. In brief, poor customer outcomes are a result of 'information asymmetry' in sales and communications, culture and product design.

Information asymmetry exists in sales of financial products whereby the provider of a product often has a detailed and in-depth understanding of a product, while a consumer is generally less well informed. Retail customers place a degree of trust and reliance upon the sales person to provide personalised advice based on their best interests, and to provide them with adequate and clear disclosure regarding the product or service. Global regulators have criticised the sales process and clarity of customer communications as a driver of poor customer outcomes; which can leave customers with products which do not perform as they were led to expect.

"Poor culture and poor or misaligned incentive arrangements can drive a range of risks, including financial product mis-selling and the design and sale of products that disadvantage investors and consumers."
FMA Strategic Risk Outlook 2015

Insurers have often relied on their 'product disclosures' to overcome complexity in product design. Financial products (and particularly general insurance products where the propensity to claim and therefore see a benefit is low) are often intangible with difficult to define or hard to understand benefits. Sales-focused incentive schemes and high value commission arrangements – that drive behaviours which deprioritise customer needs – have been identified as another key driver of poor customer outcomes. This results in regulatory attention on a firm's culture and 'tone from the top'.

Regulators have traditionally sought to address these imbalances by providing prescriptive requirements for disclosure, and setting professional standards for sales advisers in an attempt to rebalance the information asymmetry that exists. Yet issues continue to arise. In the last few years, a new regulatory and risk management mantra has emerged: conduct risk.

The roots of regulatory intervention and action in relation to conduct risk can be traced to the UK, where a series of widely publicised mis-selling scandals and the associated impact upon consumers and the industry drove the regulator to take a more interventionist and forward-looking approach. Approximately £20 billion has now been paid to customers in the form of redress in relation to payment protection insurance – which demonstrates the widespread financial impact upon firms and the scale of the impact upon consumers. In the UK, our experience has shown that for every £1 spent on up front compliance, up to £16 has been spent on remediation.

Locally, there is further evidence of greater intervention, with the FMA beginning to take a similar interventionist approach in New Zealand. In the first half of 2015 alone, three banks have been fined $24 million for the misleading conduct in the marketing, promotion and sale of complex derivative products to unsophisticated customers for a period dating back to 2005.

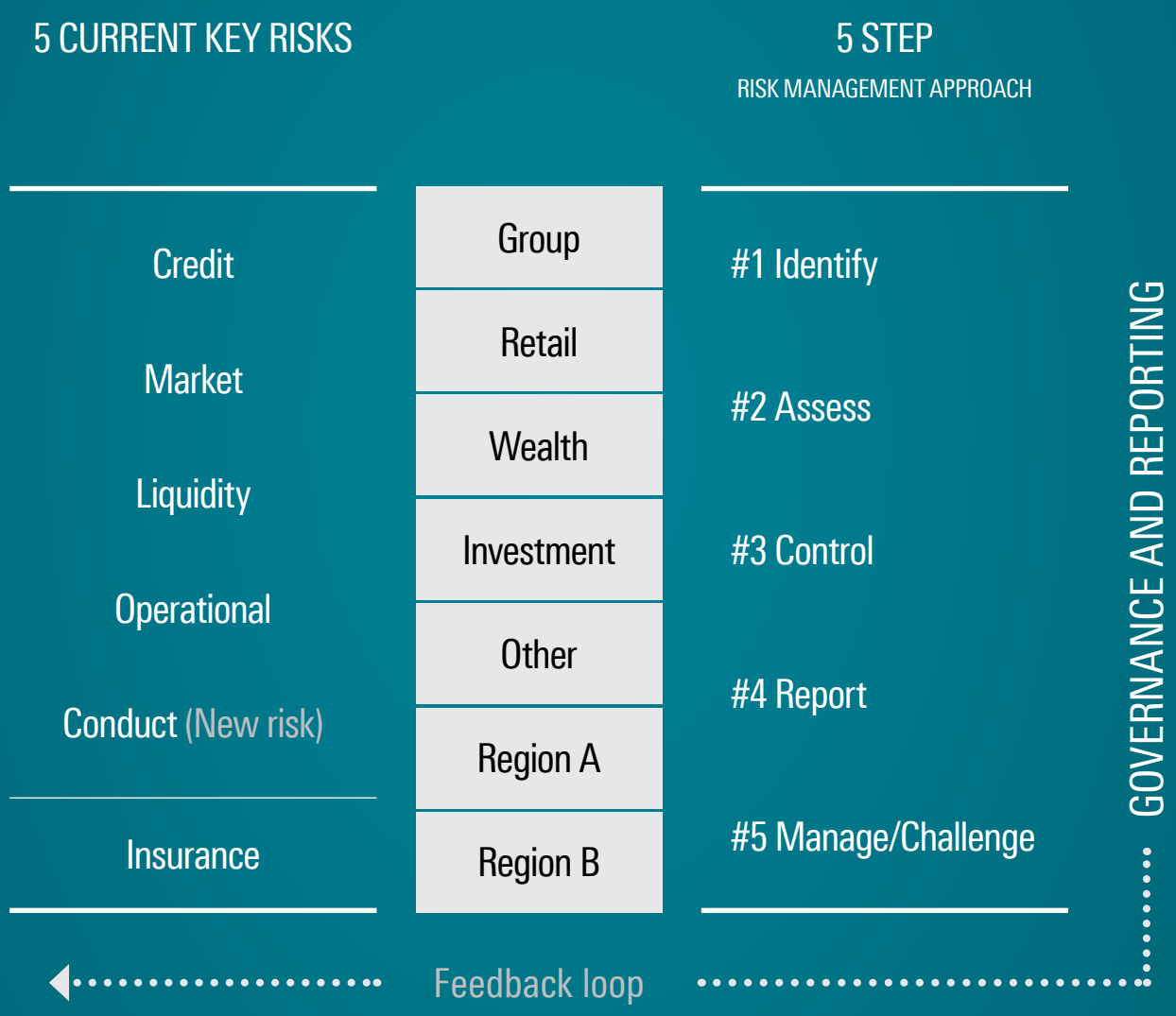
Internationally, the supervisory approach to conduct risk varies greatly. The focus on enhancing solvency standards in response to the global financial crisis has resulted in limited harmonisation of supervisory approaches, with local regulators seeking country-specific solutions. However conduct risk is now beginning to form part of the international regulatory agenda, with recent developments from the International Association of Insurance Supervisors (the "IAIS"). The IAIS has initially focussed on understanding the supervisory role in relation to conduct risk, including a 2014 paper entitled '*Approaches to Conduct of Business Supervision*'. Furthermore, the IAIS recently published an issues paper entitled '*Conduct of Business Risk and its Management*'. The IAIS is currently reviewing the comments received and considering next steps. This paper explores some of the sources of conduct risk, and considers its place within risk management frameworks, which we explore further below.

Regulators and policy setters in New Zealand are already looking to adopt some of the principles and approaches from the IAIS, and from early adopters of conduct supervisory tools such as the UK. Examples of tools being considered in New Zealand include:

- reviews of key customer processes such as sales and marketing;
- seeking insurers to improve their standard of product design with a particular focus on considering customer needs;
- understanding leadership accountabilities in relation to customers and culture;
- monitoring complaints, root cause analysis and complaints handling procedures to identify issues at specific insurers;
- seeking to understand how insurers detect specific customer vulnerabilities in their processes; and
- considering the impact of behavioural economics by seeking to understand how insurers understand and act upon behavioural biases.

In their recent paper, the IAIS explores the subtle difference between prudential risks and conduct risks. Prudential risks are largely focussed on the financial soundness of the insurer while conduct risks are focused on customer impacts. This subtle difference means that at a practical level, when monitoring conduct risks, firms need to look beyond the profit, growth, cost and claims ratios that have traditionally populated management dashboards for monitoring prudential risks. Conduct risk measurement typically start with the customer, by considering key indicators such as levels and types of complaints and claims (including underlying patterns and ratios). Yet there is also an important interplay between conduct and prudential risk monitoring in relation to financial metrics as indicators. For example, high profit or excessive returns may be positive in a prudential sense but could potentially be indicators of poor value for a customer.

In the UK, many firms have sought to address the balance of prudential risk management and conduct risk management by developing a more formal conduct risk framework, and incorporating conduct risk as a principal risk in their enterprise risk management framework. This includes developing the relevant supporting processes, procedures, measures and controls in place to identify and monitor conduct risks in an effort to demonstrate greater customer protection. This is shown in the diagram below.



Source: KPMG International – Evolving Insurance Regulation, April 2015

Conduct risk within the enterprise risk management framework

Insurers should continue to monitor local developments closely (i.e. enhancements to product governance and consideration of customer needs), as local regulators are already progressing quickly towards formally requiring insurers to consider conduct as part of their risk management programme. Whether this approach materially reduces the impact on customers remains to be seen, but establishing a mechanism to consider customer risk and financial risk can only support better outcomes for consumers.

Case study: Add-on insurance in the UK

The Financial Conduct Authority (the "FCA") in the UK launched a market study in relation to general insurance add-ons to consider the effect of the add-on mechanism on customer outcomes in the general insurance market. The FCA was concerned that selling products as an add-on has an adverse impact upon customer decision making, and abuses the innate sales bias (as the provider can utilise the point of sale advantage that they have, including choice and competition).

As a result, the study concluded that customers often receive poor value for money and estimated that this costs consumers approximately £108 million. The review focussed on five products: Guaranteed Asset Protection ("GAP") insurance, home emergency insurance, travel insurance, gadget insurance, and personal accident insurance.

The FCA sought to understand the inherent conduct risks of add-on products by reviewing and analysing product literature, pricing, management information, profitability and claims data; as well as undertaking consumer research.

To address the issues above, the FCA has proposed a four-pronged approach which includes:

- Imposing a deferred opt-in period in GAP sales and requiring insurers to provide additional information to aid comparison and shopping around.
- Introducing an opt-out sales ban.
- Requiring insurers to improve the information provided to customers in relation to general insurance add-ons.
- The FCA is now considering going even further by introducing a formal measure for value for money in general insurance add-on products. This is based upon factors such as claims ratios, frequencies, acceptance rates and average claims payouts.

This approach goes further than requiring insurers to develop their own oversight mechanisms and metrics in relation to conduct risk, and may even result in the requirement to report specific factors to the regulator.

What's changing in self-regulation

Ceri Horwill – Advisory Partner

There is a wave of change on the horizon for financial institutions in New Zealand, including insurers, with a focus on consumer protection and conduct risk. The New Zealand insurance industry is one of the most lightly regulated in the world, so this change is likely to eventually have a significant impact on the industry. Our article on page 24 discusses conduct risk issues relevant to insurance, but how does self-regulation fit into the mix?

The Insurance Council of New Zealand (the "ICNZ") have completed their review of their industry Code of conduct, and published the revised Fair Insurance Code 2016 (the "Code") in June 2015. The Code in itself isn't new, but is required to be reviewed every three years. The new Code applies from 1 January 2016, and is currently being trialled by members from 1 June 2015.

There are three key components to achieving "fair" insurance in New Zealand:

1. **Legislation**: In New Zealand this is principally the Insurance Law Reform Act 1977, as well as the contractual terms attaching to individual insurance policies.
2. **Disputes scheme**: Insurers must join a dispute resolution scheme under the Financial Service Providers Act.
3. **Self-regulation**: Insurers apply self-regulation through industry bodies and associations. Certain insurers form a representative body and, through that body, impose self-regulation to uphold standards amongst their members.

These three components together should lead the industry to the right consumer outcomes and higher standards of practice and service to customers, but there are some underlying challenges remaining. Insurance law in New Zealand is both old and hard to understand for consumers. The introduction of dispute resolution schemes has been a step forward, but in effect, those schemes can only investigate and uphold complaints within their membership rules and the current law. Self-regulation has its benefits, but it is also not without its limitations.

In our view, self-regulation does have an important role to play in achieving the right outcomes for customers. The new Code is a refreshing update to its 2011 predecessor and addresses important issues such as the lessons learned from the Canterbury earthquakes.

Supporters of self-regulation cite that regulation developed by the industry, for the industry, will result in regulation that works in practice and anticipates and addresses challenging issues head on. Self-regulation allows the industry to provide some flexibility in how regulation is implemented, recognising that one size doesn't fit all and allowing businesses to tailor their approach to what works for their business. Self-regulation also in theory has more buy-in, as it is not imposed on the industry but instils good behaviour from the bottom up. But that only works where there is a real understanding and balance of stakeholders' interests in developing the regulation.

However self-regulation also has its critics. Critics would argue that effective regulation cannot be developed by those being regulated, as it would be too weak and wouldn't regulate far enough. They would say that it only applies to those it has been developed for; and that those businesses ultimately have their own interests at heart, and couldn't effectively monitor and enforce themselves. We will discuss three of these challenges and how they apply to our insurance Code in more. We ask the questions: does self-regulation go far enough in the Code? Does it create an uneven playing field? How will the Code be monitored and enforced?

Does self-regulation go far enough: focus on non-disclosure

When reading the Code it is important to understand the context for some of the areas of change. Alongside the Code the ICNZ have published a set of frequently asked questions ("FAQs") which provide some useful colour on the key areas of debate, such as the thinking around non-disclosure.

In the FAQs, the ICNZ acknowledges critics who say it's all very well to improve the Code, but what is needed is change to underlying legislation, particularly around non-disclosure. This leads into a brief but interesting discussion on the different approaches that have been taken internationally to one of the areas of greatest risk from a consumer perspective. This is the risk that a piece of information is not disclosed or not asked for which is relevant to the insurer when it comes to making a claim possible, leading to the claim being declined or avoided.

The ICNZ cite two different approaches to non-disclosure. Firstly the approach where the insurer is made to list all key information that policyholders should declare. In the ICNZ's view, it is virtually impossible for an insurer to list all the things that might be relevant to each individual policy or a claim. They note that this approach has been taken in Australia and is leading to "all sorts of problems".

The Australian Securities & Investments Commissions (ASIC) has taken a prescriptive approach in Australia to setting out what should be included in a product disclosure statement. However insurers are lobbying for change as in their view the current approach doesn't always result in the customer fully understanding the product, particularly as they often don't read all of the disclosure. This is highlighted in the recent review of home insurance sales that ASIC undertook in 2014 which acknowledged that most firms meet the prescriptive rules for disclosure, but nevertheless ASIC made the following observations:

- An online survey found that only 20% of customers that took out new home insurance or considered switching read the PDS;
- Customer relied upon verbal disclosures made by insurers; and
- Customers' experience "cogitative overload" which affects their ability to process the disclosed information.

The ICNZ therefore make a case for an alternative solution to non-disclosure. Acknowledging that the ICNZ can't change the law itself, they view the best approach is for the Code to limit the ability of insurers to avoid contracts altogether and require them to "respond reasonably to non-disclosure". This is the approach included in the new 2015 Code.

Does "responding reasonably" go far enough? Critics say that the changes should go further than this and that a change in the underlying law is required. The current law in this area requires a consumer to disclose to an insurer all information that would be considered important to a "prudent underwriter" under the Insurance Law Reform Act 1977 sections 5 and 6. Compare this, for example, to the UK law where under the Consumer Insurance (Disclosure and Representations) Act 2012 the consumer must "take reasonable care not to make a misrepresentation". The concepts of "reasonable care" and "misrepresentation" have therefore become the focus areas in the UK. Guidance has been developed around how to approach this, and a history of case law is building up. Around the concept of "reasonable care", the focus is on the type of policy and the documentation provided, how clear the questions asked by the insurer were, and whether there was an agent involved. Around the concept of "misrepresentation" the focus is on the definition of a misrepresentation; whether it was deliberate or careless, and whether it was important enough to influence the decision of the insurer about whether or how to give the applicant cover.

In New Zealand, self-regulation and responding reasonably to non-disclosure is a step in the right direction. However, the underlying law needs to be reviewed to make it more understandable by both the industry and consumers, and to place the responsibility for obtaining the appropriate information firmly on both the industry and the applicant.

Uneven playing field?

The Code covers all general insurance products except health insurance and life insurance. It makes sense that the ICNZ can only impose a Code of conduct on their members, and therefore the Code is limited in its application. Yet even within their members, the Code only applies to policyholder individuals and entities with fewer than 19 employees. This is one of the major limitations of Codes of conduct or best practice generally; they create a standard for best practice but that standard is not always applicable pan industry. This can create confusion for consumers and an uneven playing field for industry participants.

Again the FAQs shed some light on why commercial customers were excluded. They state that while they appreciate that higher service standards should apply to all, large commercial claims tend to be drawn out over long periods and these claims typically arise from larger companies. They say that by their very nature, these claims take a long time to settle; and they do not want to dilute the time service commitments for consumers by trying to accommodate these businesses.

Generally, in terms of levels of sophistication of insurance applicants, consumers are the ones most at risk when it comes to their understanding of financial products, getting the product that is right for them, and ensuring they get the protection that they have paid for. Where an insurance business states publically that it has signed up to a Code, they have to live and breathe that Code internally to ensure they manage their reputational risk. Therefore stating publically under the 2015 Code that they are going to work on improving standards and service can only be a good thing for New Zealand consumers.

How will the Code be monitored/enforced?

The real test of any self-regulation regime is how it is upheld, monitored and enforced. The Code itself, in the interests of being clear and succinct, does not get into detail on how members will implement the day-to-day practicalities of compliance monitoring. However it is very clear that, where an insurer hasn't been able to resolve a complaint through its internal dispute resolution process, a policyholder can make a complaint to the insurer's independent external dispute resolution scheme. That scheme can consider breaches of the Code and, if they determine that an insurer has significantly breached the Code, then the insurer must report that to the ICNZ. The ICNZ can in turn reprimand, fine or expel a member for significant breaches of the Code.

These sanctions and this ability to enforce the Code represent a substantial increase to the old Code. The FAQs go even further and explain that a Code Compliance Committee ("CCC") will be set up. This will be made up of independent experts, who have the skills and experience to pass a public credibility test, and will comprise a majority of independents to counter public perception of bias.

All of the above sound like a good start. The real tests will be in getting the detail right over the next few months as the Code is implemented. For insurance businesses, it will be all about internal buy-in to the Code, training of staff, and giving the Code an appropriate level of standing within the business. It will also require self-monitoring, cultural change within the insurer where needed, and good management information to ensure what has been said is actually happening.

For the ICNZ and for the CCC, it will be about ensuring that the Code is being implemented and that members are taking it seriously, and that underlying root causes of complaints are identified and changed. It will also mean ensuring breaches are actually getting reported through to the CCC, and ensuring that the enforcement action is commensurate and appropriate to the breach.

The absence of a Code of conduct or standard for better practice doesn't mean in itself that insurers are not meeting high standards or behaving badly. However the opposite is also true. While having a Code doesn't necessarily mean that overall practices are better, in our view, self-regulation does encourage entities in the right direction and does set a useful benchmark for members to meet. But it can't work on its own. ICNZ members are heading in the right direction in terms of their aspirations and commitments; now the underlying legislation needs to be modernised to complete the picture. A complementary set of regulatory tools can all work together to achieve the right outcomes for customers and the industry.

Insurers' investment trend towards Real Estate assets

Ian Thursfield – Deal Advisory Partner

There has been a recent trend amongst large insurance companies to increase investment allocation to alternative investments, such as real estate or the infrastructure sector, in an attempt to increase yield and diversification.

The trend has been particularly prevalent for large Asian insurers. This is supported by major Asian economies such as China, Taiwan and South Korea permitting overseas investment, along with allocating higher funds towards the sector and a simplified approval process.

According to a global real estate consultant CBRE, the total asset size of Asia's insurance sector has increased by about 13% between 2008 and 2013. They also predict investment assets will grow from US$130 billion in 2013 to US$205 billion in 2018 because of the increasing asset size as well as decreasing regulatory restrictions.

Chinese insurers are one of the more active investor groups in overseas real estate investments. Factors driving the investment include:

- lack of domestic opportunities;
- need to diversify investments; and
- low yield levels of their prime core assets in domestic market.

China Insurance Regulatory Commission (CIRC) has also liberalised its regulations on insurance companies which now cap insurers' real estate assets at 30% of their total assets, compared to 15% in 2012. This led to investments of US$2.5 billion in foreign property in 2015 so far by Chinese insurers.

Increased activity by Asian insurers in the overseas real estate market is expected to continue, with US and European assets being attractive to investors due to:

- recent turmoil in the Chinese domestic stock market, discouraging pan-Asian investment;
- the US is perceived to offer a stable environment and companies are also comfortable with its economic recovery; and
- in Europe, relatively high property yields along with a continuing low interest rate environment in the Eurozone attract the interest of insurers to invest in alternative assets.

It is interesting to view this trend from a New Zealand perspective. While commercial Real Estate assets continue to offer a high yield relative to other international locations, there are perception issues (particularly in relation to earthquake and volcanic risk and currency volatility) that may limit the enthusiasm for insurers to commit large investment amounts to the New Zealand real estate market. That said, as part of a portfolio approach, the higher yields may still be attractive. Particularly as New Zealand scores highly on other determinants of international investment, such as capital mobility and legal and political stability.

Source: KPMG analysis; "Asian Insurers to Invest US $75 Billion in Global Real Estate" via World Property Journal (Link), July 2015; "China's overseas property investment to reach US $20 billion in 2015-study" via Reuters (Link), January 2015; "Boston Project Draws Chinese Insurance Firms' First U.S. Investments" via The Wall Street Journal (Link), April 2015; "M&G and ING push insurance cash into real estate investment" via Financial Times (Link), May 2014; "Insurers to target infrastructure to boost investment yields" via Financial Times (Link), September 2014

Recent real estate deals by Insurers

Insurer	Country of parent insurer	Deal value (US$ mn)	Assets
Fosun International Ltd.	China	90	73 Miller Street, Sydney
Anbang Insurance Group Co., Ltd	China	400-500	Office building on New York's Fifth avenue
China Life Insurance Company and Ping An Insurance Company (co-investors)	China	500	13-story office building and a nine-story condominium tower in Boston's Seaport District
Ping An Insurance Group	China	490	Office building in London
Sunshine Insurance Group Corporation	China	230	Baccarat hotel, New York
Fubon Life Insurance Company	Taiwan	540	London site of the Madame Tussauds waxworks museum
Manulife and Allianz (co-invest)	Canada; Germany	1,000	Office properties in the US gateway cities
Allianz Real Estate	Germany	672	Vesteda towers – residential (Netherlands)
AXA Real Estate	France	345	Bank branches in Spain
AXA Real Estate	France	233	Office spaces. Three assets in London, Espoo and Madrid
Prudential Real Estate	US	Undisclosed	Office property in Chicago

Note: 1 AUD = US$ 0.77; 1 EUR = US$ 1.12

Source: KPMG analysis; "Waldorf Astoria Buyer Picks Up 2nd NYC Building For Over US $400m" via Forbes (Link), February 2015; other press articles

GST proposed for offshore general insurance providers

Peter Scott – Tax Partner

The New Zealand Government has recently announced proposals to impose Goods and Services Tax ("GST") on services provided by offshore suppliers to New Zealand residents. The proposals are intended to align the GST treatment for both New Zealand resident suppliers and offshore suppliers selling to local consumers. The proposals will affect non-resident insurers that provide general (i.e. non-life) insurance to customers who are tax resident in New Zealand.

The proposals may require non-resident insurers to register for New Zealand GST, and charge GST on general insurance services provided to New Zealand resident customers. This could see an increase in the cost of insurance for New Zealand customers who are insured by offshore insurers.

While feedback is being sought, business-to-business supplies are expected to be excluded from the proposed rules. This is because a New Zealand GST-registered business can claim the GST paid, so there is little point in GST being charged. However, business-to-consumer suppliers are clearly targeted. The expected approach is that suppliers will be assumed to be business-to-consumer suppliers unless shown otherwise to Inland Revenue.

The Organisation for Economic Co-operation and Development ("OECD") has been focused on the taxation of cross-border services, particularly digital services, as part of its work on base erosion and profit shifting. The objective of this work is to give countries the tools they need to ensure that profits are taxed where economic activities generating the profits are performed, and where value is created; while at the same time give business greater certainty by reducing disputes over the application of international tax rules, and standardising requirements. The New Zealand Government's proposal is broadly consistent with the OECD's approach for taxing cross-border services. Australia announced similar changes earlier this year to tax offshore suppliers of services. New Zealand is simply following the global trend in this respect.

The Government will need to work through the rules on how a supplier will be able to identify whether a customer is a New Zealand tax resident. Options that have been proposed are to use a proxy, such as a billing or home address or bank details.

Tax policy officials are considering submissions on the Government discussion document, which were due by the end of September. At this stage, it is likely that legislation to apply GST on imported services will be introduced in Parliament in November this year.

A positive approach to managing cyber risk

Philip Whitmore – Advisory Partner

Over the last 12 months, cyber security risk has gained increased air-time around boardroom tables. In our 2014 General Insurance Update, we explored the five most common cyber security mistakes. In this article, we explore the 5 steps that organisations should consider in order to get it right.

1. UNDERSTANDING THE LANDSCAPE

The digital environment presents opportunities for insurers that want to seek out new markets and are prepared to invest in transformational change. The last ten years have seen a rapid emergence of new technology, greater connectivity for organisations and individuals, and a 24/7 approach to global commerce. However, this has left many organisations behind the curve – in struggling to achieve their business aspirations without feeling exposed to cyber security risk.

Every day we hear of new vulnerabilities, attacks and incidents. The constantly evolving threat landscape means that cyber risk is an everyday business consideration. This undoubtedly presents a feeling of vulnerability, which has been leveraged by some to increase budget and to sell products. We have often found that this results in significant sums of investment on ineffective programmes with poor alignment to risk and business imperatives. Cyber security is not a quick technical fix; nor is it a matter solely for the IT department. We see all too often that these behaviours leave leadership wondering what they really need to do, how much is really enough, and who they can trust to help them get it right.

By turning traditional thinking on its head and adopting a positive approach to managing cyber risk, the aim is to set insurers free to achieve their business aspirations.

2. ESTABLISHING THE CORRECT FOUNDATIONS

Scaremongering is an easy tactic, but staying on top of the evolving threat landscape and how it impacts you can remove fear, uncertainty and doubt.

Understanding the external threats from hacktivists, organised criminals, industrial espionage and (increasingly) nation states is important. However, it is all too easy to ignore the insider threats posed by careless, disgruntled or malicious employees. Attackers are frequently gaining access to employee's accounts through phishing emails and other socially engineered attacks. Bribery and intimidation is also still commonplace in most parts of the world, though thankfully not in New Zealand. Managing the external and internal threats together, rather than separately, creates an integrated approach that removes the fear and uncertainty of attack sources.

Many attackers are simply using different means to achieve a very old objective; be that theft, subversion, sabotage or espionage. Drawing parallels between security in the real and virtual worlds can remove fear of the unknown.

Building in agility, with the expectation of change and disruption, enables you to architect an environment that is secure by design.

Putting the correct foundations in place around governance, risk and compliance is the place to start. You can then achieve a balance of technical security, internal capability and the appropriate usage of technology and outsourced services.

Successful organisations are ones that integrate cyber risk management into all their activities. Those that practice sound transformational principles rather than succumbing to knee-jerk reactive solutions can create a comprehensive approach that focuses on what they can do – not what they can't.

3. COLLABORATION

Boards need to challenge management to gain answers to the right questions, before they themselves are challenged by stakeholders on their capability and control. Being able to identify, prioritise and protect the information life-cycle helps you to move confidently, safely and securely.

Having a robust strategy and architecture in place will enable you to access clear and actionable management information to give you strength in your decision making. It will also give you access to timely threat insights; trusted information-sharing networks; and credible benchmarks against peers and competitors. Information sources need to be impartial and independent of specific vendor agendas. Accessing sources you can trust allows you to test and examine the right mix of technology, service providers and internal capability to create a blend of control and visibility.

This is where collaboration and knowledge will differentiate to deliver business advantage. By leveraging the collective experience of those you trust, you will have confidence to execute new ideas, approaches and solutions to respond to current and future security issues.

4. CONFIDENCE

With each aspect of emerging technology, new considerations arise. Examples include the adoption of cloud technologies, the proliferation of social media, to remote working. These are all potential high growth investment options when managed effectively.

Similarly, the rise of mobile technology and its applications is relevant to all sectors and business models. Insurers need to make choices around these new technologies – and understand the cyber security issues up front – to strike the right balance between risk and opportunity.

Investing in a proactive approach to cyber risk management delivers wider commercial benefits. It is about having the confidence that as your business increasingly moves into a digital world, it is able to grow in an informed and agile manner.

5. ACCEPTANCE AND PROACTIVITY

Currently many insurers only act if and when a serious breach or failure occurs. Yet taking a proactive security stance can slow the attacker's progress and identify their actions early. Developing an adaptive approach can prevent downtime, avoid expensive disruptive responses to incidents, and maintain business operations. Thinking through the cyber attack scenarios and the changing threat landscape will help you understand how your business might be targeted and how to configure your defences.

By focusing on building solid foundations, you can underpin your security operations with leadership, sponsorship and governance. This helps set the conditions for the right culture where everyone recognises that security is the responsibility of all, and each individual understands the part that they can and must play.

Having the confidence to transform in this way integrates strategy, policy, governance, organisation, process, skills and technology.

Insurers who accept cyber attacks as an inevitable part of today's business landscape, and who build in proactive safeguards and responses, will secure the future of their business.

Our thought leadership

A new world of opportunity

In this report, we have gathered survey data from senior executives in the insurance industry from around the world, insights from interviews with some of the world's forward-thinking insurers, reinsurers, intermediaries, start-ups and disruptors. Combined with insights from our own network of professionals, this report offers pragmatic advice for those seeking to make the most of this new world of opportunity.

General Insurance Industry Review 2015

In the 12 months to June 2015, Australia's general insurers faced tough conditions – a mix of natural disasters, strong competition and a volatile economy. While not every year is marked by cyclones, without doubt the competition, both at home and abroad, is here to stay and will continue to create havoc on insurers' premiums if they don't successfully adapt their business strategies.

Insurers increasingly navigate uncertainty

Alternative investments are steadily accounting for a larger portion of overall investments – and with that, more focus is being placed on insurers' investment management processes and practices. In this report we look at why alternative investments gain a higher profile in a low-interest-rate environment.

Automobile insurance in the era of autonomous vehicles

KPMG remains at the forefront of the autonomous vehicle conversation. Our automotive team has issued a series of leading research reports focused on the emerging technology, the potential for consumer adoption, and the promise of an ultra-connected age. Our analysis has made increasingly clear that the automobile landscape is poised for radical change.

Big data competitive advantage

By now, most insurers understand the potential value that big data could deliver to their organisations. But our experience suggests that few insurers today are ready to take full advantage of the many opportunities that could be captured with greater data insights. Thankfully, there are a number of ways that insurers could start improving their data and analytics capabilities immediately.

Evolving insurance regulation

This report provides insights based on discussions with our clients, our assessment of key regulatory developments and through our links with policy bodies across the globe. 2015 is seeing international developments dominate regulatory change in the insurance industry. By being proactive and engaged in these fast-moving and important developments, insurers can meet the challenges and stay ahead of the game.

Global CEO outlook 2015

With so much change in the global economy, it is valuable to know what the leaders of today's global companies are anticipating for the years ahead. This year, KPMG have surveyed 1,200 Chief Executives from many of the world's largest and most complex companies, and obtained in-depth perspectives from a number of them on the major issues facing the global economy over the next three years.

Going beyond the data

Going beyond the data: turning data from insights into value delves into the challenges and opportunities today's organisations face as they strive to create value through D&A. In this summary report, we explore the top line results of KPMG International's recent survey of more than 800 Senior Executives to identify key themes influencing D&A's value proposition around the world.

Transforming the insurance sector: How machines will change the game for insurers

Will the next round of competition in the insurance industry be fought – and won – by machine learning? It would seem so, with a handful of your peers already starting to arm themselves with the skills, capabilities and technologies to start winning the early battles. Are you ready to compete in this new environment?

Tapping into insurance FinTech

Activity in the Financial Technology sector (better known as FinTech) has exploded with insurers actively competing head-on with banks, private equity firms and global technology companies to secure some of the latest technologies.

Trends driving the insurance M&A landscape in 2015

The world's largest corporates are expected to show an increased appetite for M&A deals and will likely had more capacity to find prospective transactions in 2015. In this years 'Trends' report, we have grouped our predictions for M&A activity under the following drivers:

1. Importance of high growth markets
2. Impact of regulation
3. Efficiency and focus
4. Consolidation

If you'd like to receive a copy of any of these publications, please email kbaldock@kpmg.co.nz. Alternatively, you can download these and many more publications from kpmg.com/nz

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Kay is a Financial Services Audit Partner and Head of our Insurance Practice. Prior to joining KPMG New Zealand in 2006, Kay worked for KPMG in Bermuda where she gained insights into the Global Reinsurance market. For the last 16 years she has focused primarily on the insurance industry. She is an Associate in Reinsurance of the American Institute for Chartered Property Casualty Underwriters. Kay assists her clients in navigating accounting standards, regulatory requirements and providing insights into best practice.

Mary Trussell

Partner – Insurance Innovation & High Growth Markets Global Lead Partner, KPMG International

A global insurance industry expert, Mary's 30 years of experience covers the entire range of insurance markets, from life and health and personal lines to commercial lines and reinsurance, across Asia Pacific, Europe and North America. A member of KPMG's Global Insurance Leadership team with particular responsibility for Innovation and High Growth Markets, Mary leads development of KPMG's thought leadership focused on those with an interest in the insurance sector.

Nicholas Moss

Senior Manager – Audit, KPMG NZ

Nick is a Senior Manager in our Financial Services Audit team. He has worked with the insurance industry for nearly 10 years. Nick has been involved on Solvency II implementation projects in Ireland and has worked with the industry in Mongolia to develop insurance knowledge. Nick was a member of the Risk Working Group of Mongolia, helping raise awareness of the importance of risk management.

Gary Reader

Partner – Global Head of Insurance, KPMG International

Gary has been with KPMG for over 30 years – 27 of those focusing on the insurance sector, with the last 2 years as the Global Head. Gary has worked across Audit, Consulting and Advisory. His background includes the Global Advisory leader for the insurance sector and a member of the European and Global Insurance leadership teams. He has played a big role in supporting all efforts to maximize KPMG's presence in the European and Global insurance marketplace.

Jamie Munro

Partner – Audit, KPMG NZ

Jamie is an Audit Partner with KPMG in Auckland, specialising in the financial services sector. Jamie has significant experience in the insurance industry, working with a number of New Zealand's licensed general insurers. Jamie firmly believes that a strong insurance industry is one of the keys to the prosperity of New Zealand and is proud to be working with this country's top financial organisations.

Tim Grafton

Chief Executive, Insurance Council of New Zealand

Tim was appointed Chief Executive of the Insurance Council of New Zealand in November 2012. Over the past 30 years he has had extensive experience in the media, government, public relations and market research sectors.

Prior to his appointment at ICNZ, Tim was Executive Director at leading market research company UMR Research where he led a number of key research projects. He has been a senior adviser to former Prime Minister Rt Hon Dame Jenny Shipley, the current Finance Minister Hon Bill English and former Finance Minister Rt Hon Sir William Birch.

Ceri Horwill

Partner – Advisory, KPMG NZ

Ceri leads KPMG's Financial and Regulatory Risk Management practice, specialising in banking advisory, financial instrument accounting, financial services regulation, financial risk and capital management. She provides regulatory, risk, accounting and compliance advice for a wide range of financial services clients which has given her an excellent understanding of financial products and insights into financial service businesses. Ceri joined KPMG in 1998.

Peter Scott

Partner – Tax, KPMG NZ

Peter is a Tax Partner and leads KPMG's Indirect Tax team in New Zealand. Peter has 18 years' experience advising on tax and has provided GST advice across a range of industries. This has included advising clients on the GST implications of property transactions, capital raising, compensation and settlement payments and GST issues relevant to financial institutions and fund managers.

Adele Wallace

Associate Director – Advisory, KPMG UK

Adele is an Associate Director from the UK regulatory practice and is currently on secondment to the New Zealand and Australian firm. Adele specialises in Conduct Risk and brings with her valuable insight and a rich range of experience in banking and particularly general insurance though her work at KPMG and her previous roles in industry.

Ian Thursfield

Partner – Deal Advisory, KPMG NZ

Ian Thursfield leads KPMG's Deal Advisory practice. He is responsible for the operations and strategic focus of the New Zealand Deal Advisory team including management of people, interaction with the wider firm and delivery of the New Zealand KPMG vision for Deal Advisory. He is also responsible for the delivery of financial due diligence and other related services to both domestic and offshore clients for private and capital market transactions.

Philip Whitmore

Partner – Advisory, KPMG NZ

Philip leads KPMG's Security Advisory Services, Technology Risk and Data Analytics practices in New Zealand. He has over 20 years' practical experience in the provision of information security, information systems controls assurance, IT risk management, data analytics and privacy risk management, and has worked extensively with insurers to help them manage their IT-related risks.

Neil Kerr

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Neil is currently on a secondment to the Insurance Risk team in our Sydney office. Neil specialises in conduct risk having previously worked as part of KPMG's Regulatory Practice in London. Neil provides conduct risk advice to life and general insurance clients and has a broad understanding of firm and regulatory expectations in relation to product governance, sales controls, claims and complaints procedures and the broader aspects of conduct such as assisting firms to develop their conduct risk frameworks.

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