KPMG

General Insurance Industry Review 2019

With the top 10 trends impacting the sector

Organisational Flex

December 2019

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The *KPMG General Insurance Insights Dashboard* which accompanies this report contains a range of interactive charts and graphs presenting the key industry metrics for the past 5 years. The interactive dashboard enables the data to be filtered to view the metrics for a particular year or insurer. It also enables comparison of metrics for an individual insurer to others in the market.

The dashboard can be accessed via our website at:
www.kpmg.com/au/insurancereview

Foreword

KPMG's General Insurance Industry Review 2019 includes the financial results up to 30 June 2019 of all Australian general insurers.

The format, content and presentation of the 2019 General Insurance Industry Review comprises three segments:

1. **The year in review** — a concise but insightful analysis of how the general insurance sector performed throughout the 2018/2019 financial year utilising Australian Prudential Regulation Authority (APRA) quarterly data statistics. This year we have incorporated customer insights and analysis from Google regarding the types and quantum of queries and searches performed through Google and YouTube search functions relevant for general insurance products.

2. **Top 10 emerging trends** — KPMG's views on the top 10 trends that will shape and influence the industry in 2020 and beyond. In this section we reflect on the implications of these current and emerging themes, which may require Australia's general insurers to significantly adapt the way they do business. We provide a short insight into each emerging trend and will follow these up with a more in-depth article on each topic as we enter 2020.

3. **KPMG General Insurance Insights Dashboard** — this interactive dashboard contains a range of interactive charts and graphs presenting key industry metrics for the past five years. The interactive dashboard allows the data to be filtered via year or insurer. It also allows for comparison between an individual insurer against others in the market.

As always, we appreciate the insurer and author contributions to the report.

David Kells
Partner,
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The highlights

The positives

- Gross written premium
- Net earned premium
- Expense ratio

The negatives

- Underwriting result
- Insurance profit
- Insurance margin
- Capital ratio
- Combined ratio
- Loss ratio

2019 results snapshot

Gross written premium

$44,829m	2018/19
$42,744m	2017/18
$42,971m	2016/17

Insurance profit

$4,399m	2018/19
$5,020m	2017/18
$4,835m	2016/17

Loss ratio

68.0%	2018/19
63.0%	2017/18
63.5%	2016/17

Expense ratio

24.0%	2018/19
25.0%	2017/18
24.8%	2016/17

Capital ratio

x1.79	2018/19
x1.83	2017/18
x1.85	2016/17

Results and analysis

At a glance

		Total 2018/19	Total 2017/18	Total 2016/17
Gross written premium $m	↑	44,829	42,744	42,971
Net earned premium $m	↑	32,231	30,833	30,139
Underwriting result $m	↓	2,401	3,923	3,536
Insurance profit $m	↓	4,399	5,020	4,835
Loss ratio	↑	68.0%	63.0%	63.5%
Expense ratio	↓	24.0%	25.0%	24.8%
Combined ratio	↑	92.0%	88.0%	88.3%
Insurance margin	↓	13.6%	16.3%	16.0%
Capital ratio	↓	1.79	1.83	1.85

Source: APRA Quarterly General Insurance Performance Statistics June 2019 (Direct Insurers only) and KPMG analysis

Year in review

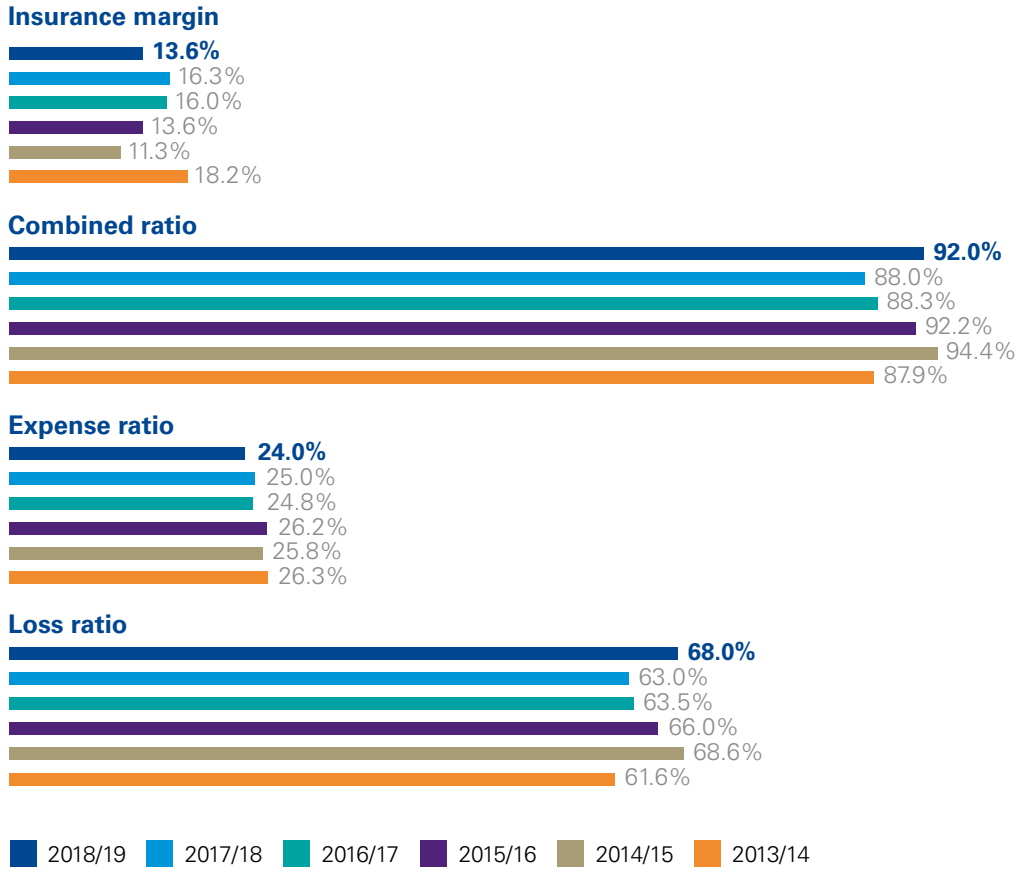
Insurance profit for the year ended 30 June 2019 was down 12 percent to $4,399 million, a significant reduction on the previous two year's annual results. Unfavourable claims experience – primarily from natural hazards and lower reserve releases – contributed to this result.

Gross written premiums (GWP) increased by five percent to $44,829 million. This growth in GWP was largely rate driven as the industry continues with re-pricing for claims cost inflation.

GWP growth was however offset by lower CTP GWP due to ongoing impacts from scheme reforms in NSW and QLD. This overall increase in GWP shows the market is continuing to harden with future price increases expected to occur again in the year ahead.

Net earned premiums increased by five percent reflecting continuing premium rate increases passed through in 2018 and 2019.

Key ratios



Source: APRA Quarterly General Insurance Performance Statistics June 2019 issued 23 August 2019 (Direct Insurers only) and KPMG analysis.

The loss ratio (claims cost) has become worse in 2018/19 at 68 percent (up five percent). The increase in the loss ratio is primarily on account of the higher natural catastrophe costs and lower prior period reserve releases out of CTP portfolios. Natural hazard costs were driven up by significant weather events including the hailstorms across Sydney, Central Coast and South-East Queensland in December 2018 and the Townsville floods in January/February 2019. These claims have been largely offset by higher reinsurance recoveries and ongoing reserve releases (albeit lower than past years releases).

The cost discipline of insurers is continuing with a further one percent decrease in the expense ratio, decreasing from 25 percent to 24 percent. This improvement comes despite all of the increased regulatory and compliance costs and demonstrates the realised net benefits from optimisation programs through automation and more 'cost effective' distribution channels. During FY19, Suncorp reported net benefits for their Insurance function of $235 million from its Business Improvement Program. Suncorp's program focused on digitalising the customer experience, optimising sales and service channels, enhanced end-to-end insurance renewal direct debit SMS notifications and re-designing claims supply chain processes to drive efficiencies. IAG's optimisation program (which is due to be complete by FY20) reported a net reduction in gross operating costs (excluding commission and levies) of around $90 million through the consolidation of all their claims onto a single claim platform and the transition of partnering activities to BAU. Whilst we understand other insurers are undertaking similar optimisation programs, no public disclosure is currently available.

These factors contributed to a lower industry insurance result of $4,399 million (prior year $5,020 million) and an insurance margin of 13.6 percent. The 'key ratios' graph shows the trend in insurance margins over the past five years.

Investment income allocated to insurance funds was $2,019 million up from $1,116 million in 2017/18 due to the market impact of unrealised gains as a result of the decrease in risk-free rates and narrowing credit spreads. With the ongoing low returns present in the current interest rate environment and conservative investment portfolios previously held, some insurers have looked to diversify investment portfolios.

The industry's capital coverage at 30 June 2019 for direct insurers is still very strong at 1.79 times the APRA prescribed capital amount. This compares to 1.83 times at 30 June 2018.

Market outlook

The average GWP quarterly increase for 2018/19 was 1.2 percent (refer to the gross written premium – rolling 12 months YOY growth graph). This growth reflects the hardening of the market as we have seen since 2015/16 which is largely rate driven (excluding the impact of regulatory changes in NSW CTP). These rate rises are expected to continue into 2019/20 across both personal and commercial classes.

This hardening market is in line with our predictions over the past two years, and while it has contributed to an improved result this year, we continue to see the industry achieving returns below the results achieved in 2012, 2013 and 2014.

Looking ahead, insurers are expected to finalise their optimisation programs with further improvements from initiatives expected to be realised in FY20. The majority of these programs focus on enhancing digital capabilities and automating businesses, but also to improve product offerings and enhance the customer experience. It is therefore not surprising that five of our top 10 trends continue to relate to technology and the customer.

Efficiencies gained will, to an extent, be offset by higher regulatory and compliance costs as insurers continue to embed operational changes in response to the Royal Commission's recommendations released in February 2019. The continued focus on the implementation of the global accounting standard, IFRS 17 Insurance Contracts will also impact any efficiencies.

Gross written premium (rolling 12 months)

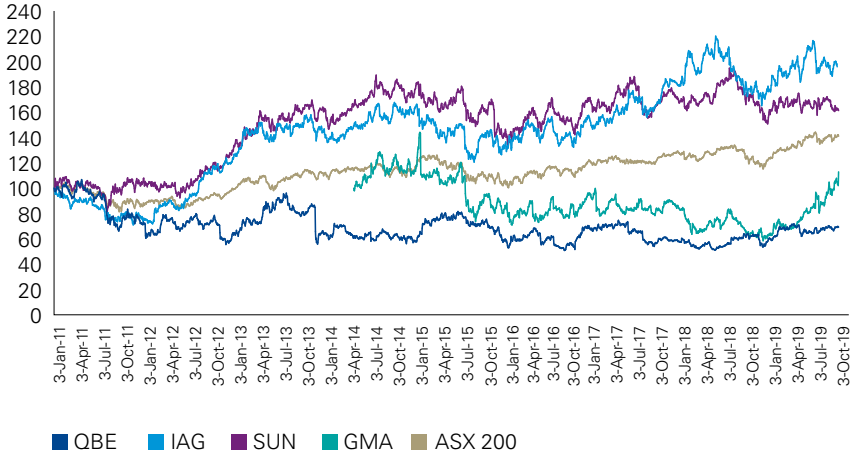
Source: APRA Quarterly General Insurance Performance Statistics June 2019 (Direct Insurers only).

Share price performance

The 'Insurance companies share price performance since January 2011' graph depicts the share price performance of the four listed Australian General Insurers – IAG, QBE, Suncorp (SUN) and Genworth (GMA) – and their performance against the Australian Stock Exchange (ASX) 200 Index for the period from January 2011 to October 2019.

The share price performance of the Australian listed insurers continues to be varied this year. A decline in share price was experienced in the year to 30 June 2019 by IAG and Suncorp. IAG was down 5.5 percent and Suncorp by 7.7 percent, whereas QBE and Genworth saw an increase in share price of 21.5 percent and 9.3 percent respectively, exceeding the ASX 200 index increase of 6.8 percent.

Insurance companies performance since January 2011



Source: KPMG analysis.

Customer insights

As optimisation programs continue to focus on digitising the customer experience – insights from Google show that retail general insurance products make up 70 percent of Google searches for insurance products in Australia (2017: 65 percent).

Customers are increasingly less likely to sit down at a desktop to research and select an insurance product in a single sitting. The research, select and sign-up for insurance products journey has become more and more fragmented, and is conducted across multiple devices. Google search queries for general insurance products on mobile devices continues to outgrow queries on other devices (see table below).

Google search engine data highlights that customers are also increasingly turning to online search in order to narrow down what has become an overwhelming amount of options and information. Queries for best insurance products (e.g. 'best car insurance') have steadily increased over the past three years (FY16-FY19):

32% increase for **'best car insurance'**

29% increase for **'best home insurance'**

23% increase for **'best travel insurance'**

Google searches by Insurance product

Insurance product	% of Google searches 2019
Car	**35%**
Travel	**22%**
Health	**20%**
Home	**8%**
Pet	**5%**
Life	**5%**
Business	**2%**
Income	**2%**
Funeral	**1%**

Search growth (mobile only)

	Car insurance	Home insurance	Travel insurance
FY19	**11%**	24%	24%
FY17	**26%**	26%	28%

Source: Google Data, AU, Finance, Jul 17 – Jun 18 vs Jul 18 – Jun 19

Today a customer might research 'best home insurance products' on their phone while on the train to work, get a quote on their laptop during a lunch break, then sign-up on their tablet at home in the evening. In order to capture this demand, general insurers need to adopt:

- An 'always-on' approach to digital marketing that ensures they are present during each of those critical moments.
- Simple, informative websites, with device responsive design, that are easy to navigate.
- Personalised, relevant interactions with consumers by leveraging available data/signals.

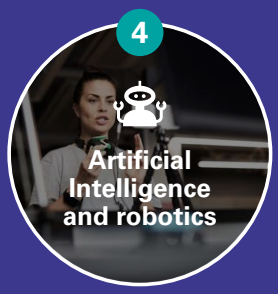
Customers are now increasingly expanding their search queries and turning to YouTube videos as a means to research financial services products. These videos include educational content (e.g. how to manage personal finances) as well as reviews and tutorials that help consumers compare and select products.

Insurers have an opportunity to increase brand awareness and consideration by advertising in this space and creating their own video content (e.g. 'how much insurance protection do I need?').

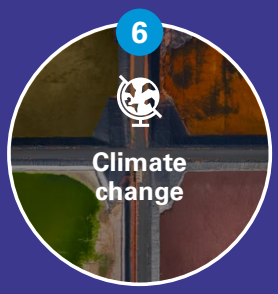
Top 10 industry trends

Here we identify 10 emerging trends in the global general insurance sector, and consider the implications for Australian general insurers.

Technology



Regulatory/Products/Trends



Technology

Digital

The first wave of digital transformation is over and now it's time to get ready for the next. C-level executives of general insurers have made digital transformation part of their strategies and have accelerated investments in foundational capabilities such as seamless interaction between channels, data and analytics, mobile apps, cloud and agile ways of working. This has set their organisations up for easier interactions, more personalised products and experiences, and greater operating efficiencies.

To become truly customer centric, general insurers need to take a more holistic view on transforming their business to become a connected enterprise through joining their front, middle and back offices digitally. Simply putting in place a new 'digital front-end' is not enough and might put desired outcomes at risk. Going forward we expect general insurers will be broadening their perspective from digital initiatives in functional silos to end-to-end digital customer journeys and value chains. In doing so, their strategies and transformation roadmaps might need to be revised to realise the full potential of digital.

General insurance leaders will need to work out how to:

- Navigate the limitations of legacy platforms and significant programmes of regulatory change and remediation while transitioning to digital-first infrastructure.
- Orchestrate more future-facing digital capabilities including blockchain, AI and IoT into value driving services spanning prevention, protection and response.
- Develop partnerships with start-ups, InsurTechs and other sectors to drive networked value through digital ecosystems and extend digital capabilities.
- Create future-fit operating models for a digital-first world.

2 InsurTech

New start-up ventures targeting various aspects of the insurance industry have rapidly emerged. They take advantage of a range of trends including: new technologies and changing customer needs, the slow response by incumbents, availability of plentiful investment funds, supportive regulators and accelerators/incubators/hackathon innovation hubs that are all transforming the industry.

Most began with ambitions to disrupt, but their enthusiasm has been tempered by the reality of investments, regulations, capital requirements and the risks and challenges of offering something new to cautious customers.

InsurTechs have therefore largely recast themselves as enablers of innovation – collaborating and partnering with incumbents to bring their ideas to market. Their focus has shifted from customer facing to behind the scenes, offering personalisation, client engagement and data analytics. They are exploring how technology can help improve claims, fraud and other core functions to be performed at lower cost and as-a-service.

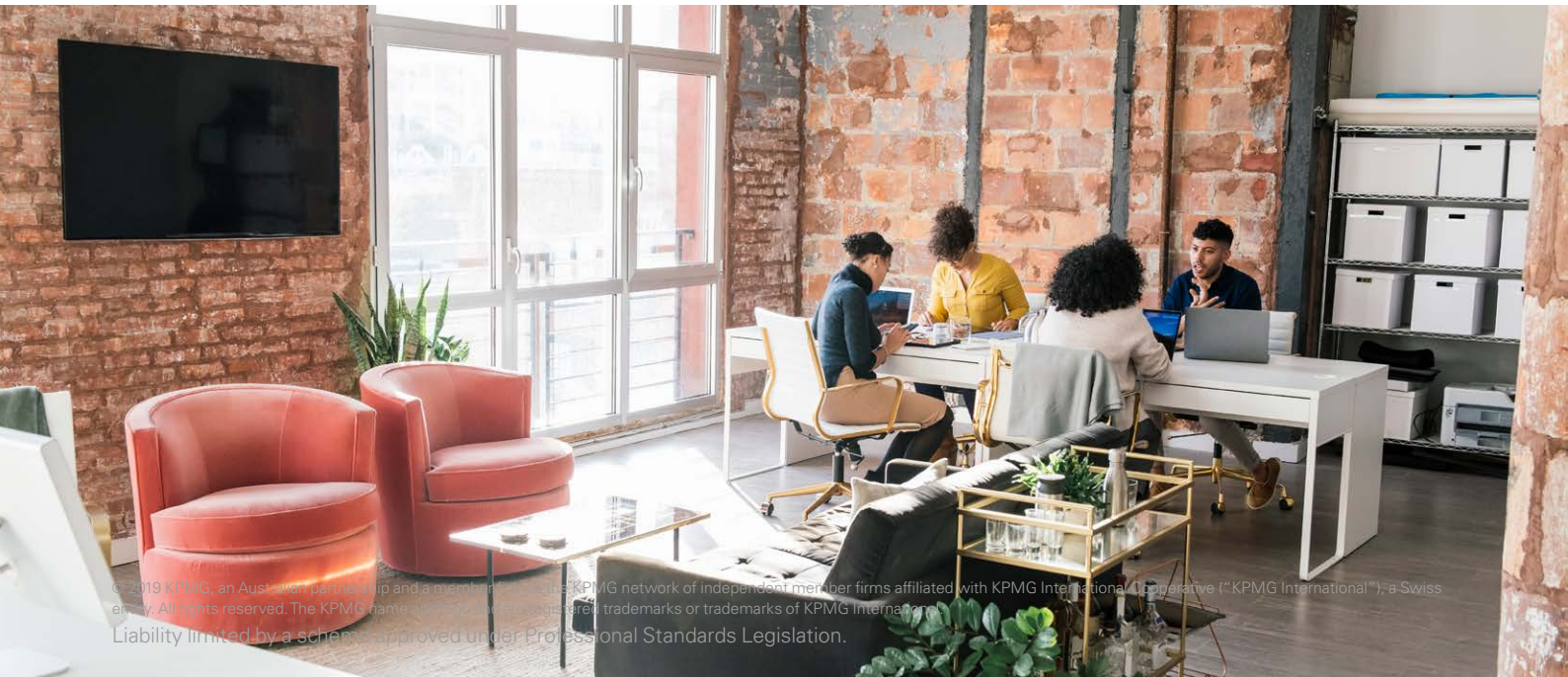
The increased collaboration between incumbents and InsurTech is positive. The incumbents gain innovation, new products/services and new/enhanced core capabilities. The InsurTechs get revenue and access to a broader market, customers and credibility.

Data is however central to InsurTech. Data is used to generate insights to customer behaviours, facilitate better underwriting and drive risk pricing and improved user customer engagement. Some Australian InsurTech start-ups focus on the defensive data play while others focus on the offensive side.

A defensive data play includes improving data quality and helping incumbent insurers extract data from legacy systems. Codafication is an Australian-based InsurTech which uses smart APIs to pull data out of legacy systems to improve existing offerings and enable further innovation.

An offensive data play focuses on using data-driving, algorithmic approach to price risk in real time. A QBE partner – Precision Autonomy, offers insurance for commercial drones by processing vast amounts of valuable sensor and performance data.

Big data is transformational in the insurance industry but also continues to cause concerns related to security and privacy. The move towards individual risk-based pricing also raises interesting challenges to the pooling of risk concept that underlies insurance.



3 Blockchain

Blockchain continues to offer transformative potential of immutable, reconcilable and auditable records to the insurance industry. Over the past several years, Blockchain projects in financial services and insurance sectors have delivered numerous proof of concepts and pilots across the whole value chain.

We expect blockchain developments in the insurance sector to evolve along the following three trajectories:

- Moving beyond the proof of concept – past two years focussed on exploring and proving the technology and 2020 will see numerous projects across claims management, reinsurance, know your customer and marketplaces move into production and start to extract benefits derived from blockchain (e.g. IBM and Marsh, B3i Products).
- IoT-enabled automation – smart contracts allow execution of pre-defined actions based on a trusted and shared view of data. With IoT-enabled sensors and new real-time monitoring technologies maturing we will see greater use of blockchain-based automation to update, validate, trigger and alert when insurance-related events may occur.
- Insurers as blockchain ecosystem participants – with trade finance and supply chain traceability use cases for blockchain ahead of the curve, we will see greater opportunity for insurance providers to join those ecosystems and derive value from real-time trusted data (e.g. Marco Polo, Voltron, eTradeConnect). This will further enable programmatic insurance products as well as improve visibility for internal risk modelling.

4 Artificial Intelligence and robotics

The 'Art of the Possible' has never been a truer statement since Artificial Intelligence (AI) and robotic's coming of age. AI matched human performance in several areas including speech recognition and computer vision in 2017. At this point, it became a viable substitute for far more human capabilities. This has enabled insurers to drive new capabilities.

Increased digitisation of business – technology was only a substitute for rules-based activity and digital information. Today, AI and robotics allow for technology to perceive their environments, mimic human cognition to make decisions and replicate human actions at scale and with precision. This is enabling InsurTech disruptors to operate with less than 20 percent of the workforce of traditional insurers.

Tilt to proactivity, risk prevention and management rather than simply assessment and payout – an element of AI is machine learning which has provided a massive increase in abilities to analyse data and forecast outcomes. This has allowed insurers to get ahead of insured risks to help actively prevent and manage. This has ranged from improving an individual's health and wellness to optimising preventative maintenance schedules using a combination of drone based inspections, digital twin simulations and machine learning algorithms assessing potential outcomes. This has increased the profitability on some covers by >25 percent.

Ability to play to personalise to segments of one – the cost of sensors and the ability for AI to ingest and interpret all the source data that can be generated is transforming the industry. Previously, insurers used historical data and self-declared information to price risk. Now, customer's actual behaviours and situation can be taken into account in real time, providing insurance-as-a-service. Your behaviour will be rewarded (or penalised). For example, tracking where and how a truck is being driven and the sort of load that it is carrying can all be taken into account to provide insurance-as-a-service.

The challenge now is for insurance leadership to stretch their thinking to encompass all that today's AI and robotics capabilities offer.

Customer centricity

Many companies want to be more customer-focused but struggle to create a culture and supporting infrastructure to realise this ambition. Being customer centric is not just about market research and smart marketing.

Every function and interaction is required to be tailored towards the customer experience and these interactions cut across a multitude of channels, including:

- brokers/agents and call centres;
- online via emails or websites;
- regular mail; and
- visits to physical offices/stores.

Today, insurers are fighting for relevance with customers that have high demands. Customers now expect insurers to understand their values, preferences, situation and lifestyle. They demand immediate, global, one-click, 24/7 access to a personalised, contextualised, empathetic experience. They want a rapid, seamless journey integrated into their overall engagement with the insurer through purchasing a policy and throughout the claims experience.

Generic insurance products that renew each year are losing their appeal.

Insurers need to continue to enhance the customer experience. Customers will continue to be even more informed and in control of the relationship with their insurer. They are firmly in-charge, creating buyer's markets eagerly sought after by insurers. Power shifts and success will be driven by those insurers who lead the customer interface and engage in continuous customer interactions.

Providing a customer with the flexibility to adjust their level of 'excess' and then consider the corresponding increase/decrease in the cost of their policy is an example where the customer feels they have the power and flexibility to tailor their own product. This is achieved through no real cost to the insurer and creates a win/win for all parties involved.

Further, the introduction of the Consumer Data Right (CDR) Bill will have wide ranging implications across many different sectors of the Australian economy. Open Banking is the first reform to launch in Australia on 1 February 2020 and other sectors which will include insurance will follow. The CDR means consumers will have greatly improved access to, and control over, their own data. It mandates a greater transparency of service and value that will facilitate better informed consumer choice. Insurance providers will benefit from the CDR by gaining customer insights through enriched data to improve customer experience, personalise offerings, retain and gain customers and improve customer stickiness which they should utilise to enhance the future customer experience.

Regulatory/Products/Trends

6 Climate change

Climate-related insurance losses across the world in 2018 were the fourth highest on record at US$76 billion, as reported by Munich Re's annual natural catastrophe report. While 2018 was a far cry from the highest ever losses from 2017, it acts as a clear signal to the insurance industry – this is the new normal.

In previous years, climate-related insurance losses were tied to a small number of large natural events which caused massive destruction, such as Hurricanes Harvey, Irma and Maria in 2017. A higher frequency of severe localised events causing high levels of damage was observed in 2018, with 29 events each resulting in an economic loss of US$1 billion or more.

In 2018 there was also a closing of the gap between overall economic loss and insured loss from natural catastrophes. The total loss from natural catastrophes in 2018 was estimated to be US$146 billion, with 48 percent of this covered by insurance. This result is far higher than the 10 and 30 year averages of 32 percent and 31 percent respectively. Insurance coverage is critical to the on-going functioning of the whole financial sector, both through the direct assistance provided to affected communities post catastrophe but also through enabling the provision of other critical financial services to the community, businesses and projects such as loans and investment.

Proactive insurers are increasingly focused on driving the climate resilience of the entire economy through:

- considering climate risk in their investment portfolios;
- including climate science within risk models;
- demanding better climate modelling to further improve risk practices; and
- sharing analysis and learnings with customers.

While insurers continue to play a critical role in helping communities recover from catastrophic events, there will be increasing economic and social pressure on the industry to work with communities and customers to improve climate resilience from increasingly severe events.

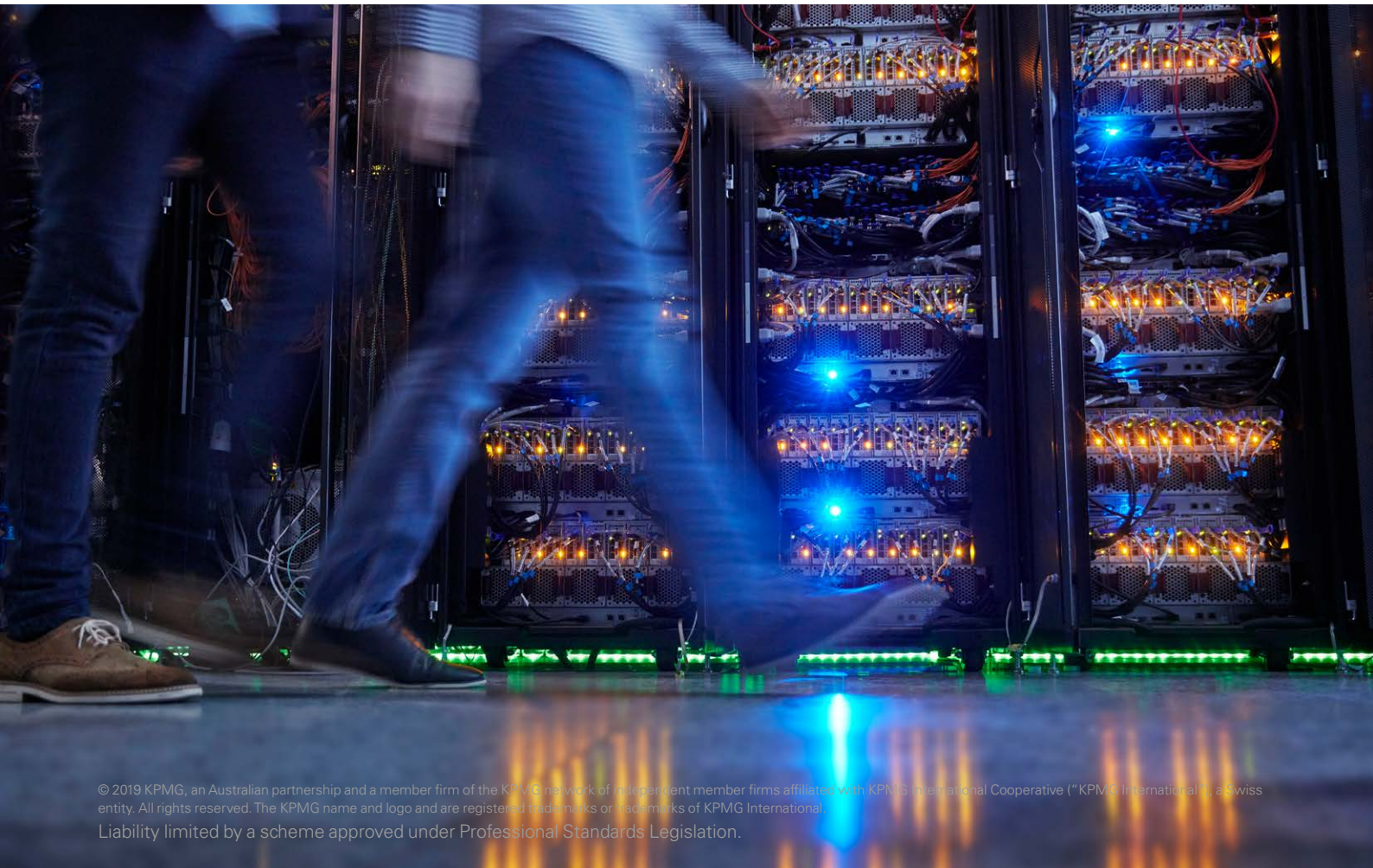
7 Cyber security

The ever evolving cyber threat landscape continues to present challenges in all industry sectors, with the introduction of Australia's Mandatory Data Breach legislation in February 2018, closely followed by the EU's broad reaching General Data Protection Regulation (GDPR) in May 2018.

The penalties for serious or repeated non-compliance with Australian mandatory notification requirements includes fines up to $360,000 for individuals and $1.8 million for organisations. The GDPR states that serious infringements of its requirements may be punished by a fine of whichever is greater – four percent of annual worldwide turnover, or €20 million.

Regulatory fines are only one of many costs associated with a data breach. Other costs are often far reaching and include legal and litigation fees, business interruption, remediation, public relations, customer compensation and notification costs – each of which can be risk transferred through the use of an appropriate cyber insurance policy.

As attackers shift their focus to target the weakest link – the human element – through the use of social engineering and people-focused attacks, insurers continue to shift focus in how cyber policies are written, placing increased emphasis on an organisation's resilience, ability to identify and respond quickly to cyber threats, cyber training programs, data management, and executive oversight of how cyber risks are managed.



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IFRS 17

The road to implementation of IFRS 17 *Insurance Contracts* continues to extend as proposed changes to the Standard have been exposed and subsequently commented on and redeliberations by the International Accounting Standards Board (IASB) over certain areas are expected over the next few months.

This brings both opportunities and potential costs which insurers should seize and manage.

The proposed extra year before the standard becomes effective gives insurers the opportunity to:

- further develop and strengthen implementation plans;
- consider the option of parallel runs;
- engage with stakeholders on the expected impacts of the standard;
- identify opportunities to make further process changes, particularly in finance and actuarial areas; and
- use the change as an opportunity to enhance current financial reporting processes and infrastructure.

Importantly, insurers shouldn't see this as an opportunity to delay their implementation projects. While there are still a number of areas being considered for amendment in a revised standard, much is now decided, and practical application and interpretation should be underway. The level of detailed regulatory engagement has also increased with insurers getting a much clearer idea of how regulatory reporting might be influenced by IFRS 17.

It's critical that momentum is maintained and that insurers don't lose sight of the ultimate goal of having a global standard that aids comparability and transparency of reporting for insurers.

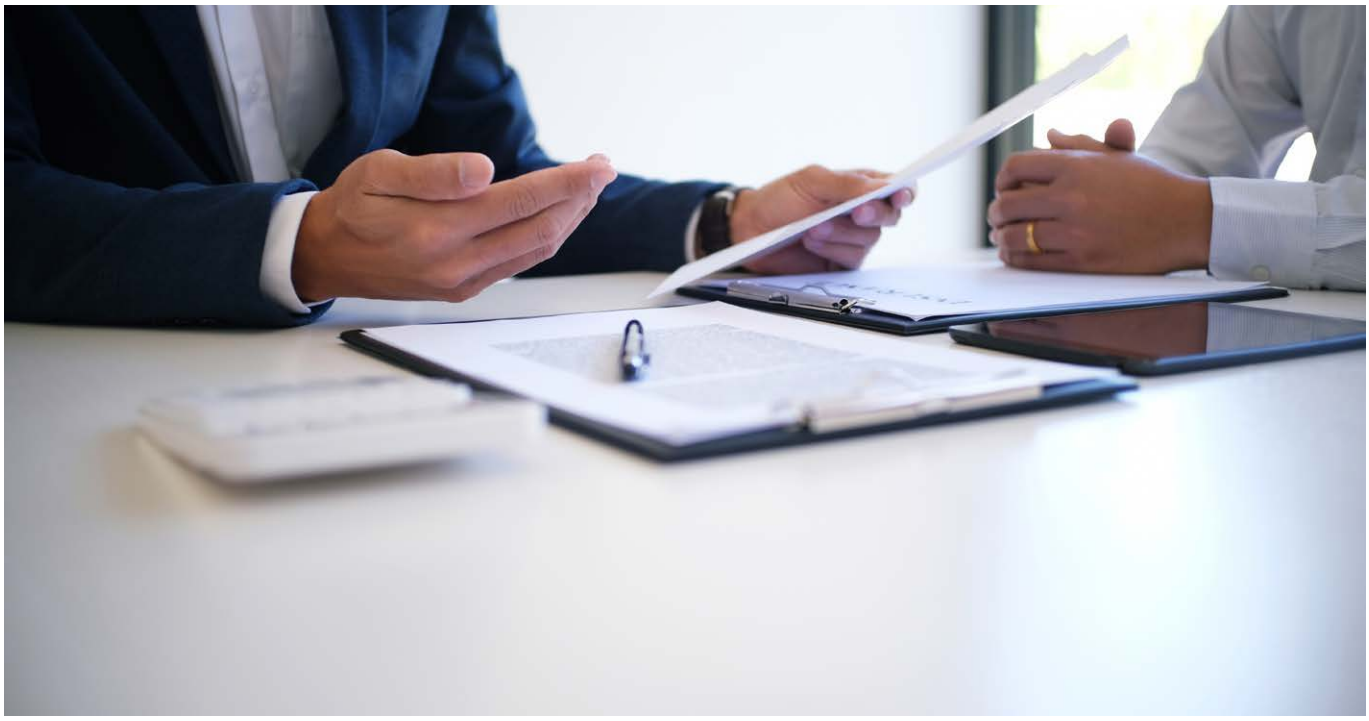
9 Regulatory agenda

The final report on the Royal Commission into Misconduct and Banking, Superannuation and Financial Services Industry (FSRC) included 15 recommendations that are relevant to core areas of insurance. Soon after the final report was released, the government announced its commitment to implement each of the FSRC's recommendations, setting up an ambitious regulatory agenda for the industry.

With a heavy focus on addressing consumer harms identified by the FSRC, this regulatory agenda affects nearly every aspect of the relationship between consumers and their insurers, including selling and distribution practices, pre-contractual disclosures, the handling of claims and the fairness of insurance contract terms. The regulatory agenda will also have an impact on how insurers manage their own businesses (with the commitment to bring the industry within the remit of Banking Executive Accountability Regime) and how the industry regulates itself (with the plan to make voluntary industry codes legally enforceable).

Compounding these changes, ASIC have been given new powers to intervene against financial and insurance products that cause potential detriment to consumers.

In this changing environment, there are clear competitive advantages for those industry players that are able to embrace change, and in particular re-imagine the practices that guide their interactions with consumers. These new practices will not only allow organisations to regain consumer trust, but also minimise the risk of enforcement action by a newly emboldened regulator. A comprehensive, co-ordinated response to these changes will be critical in ensuring that insurers emerge from this period of change with sustainable and robust systems and processes.



10 Investment returns - low interest rates

Since 2011, interest rates in Australia fell steadily by more than 80 percent. The official cash rate has fallen from a high of 4.75 percent to a low of 0.75 percent in 2019. Similar reductions have been observed across the yield curve.

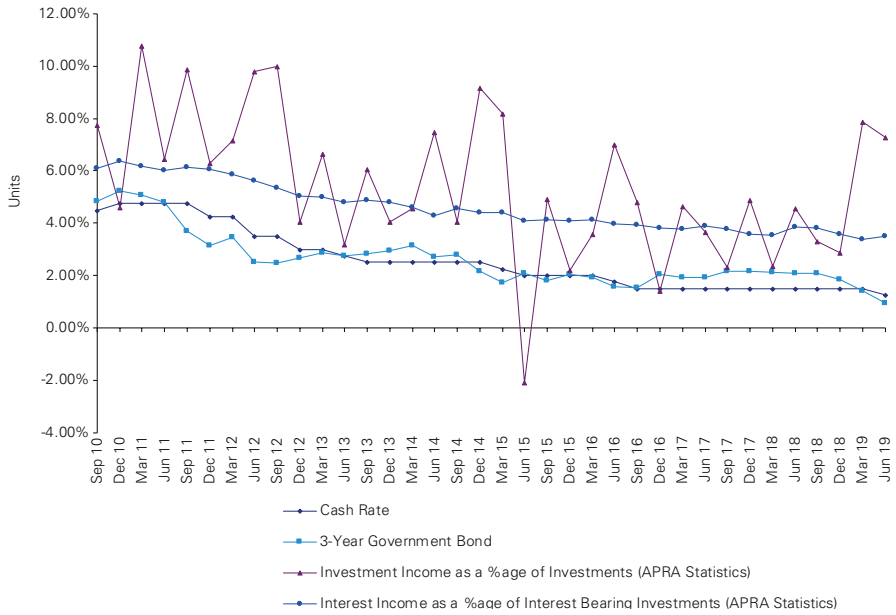
Investment income for the insurance industry includes capital gains and income on all asset classes and so has not followed the downward trend in the official cash rate. Specifically, interest income on interest bearing assets has also experienced more stable reductions over time (currently at approximately 3.5 percent but not to the levels observed through reductions in the official cash rate and yield curve). This is because it takes time for assets to mature and then be reinvested, leading to a lower interest income once new money is reinvested.

Given this, we expect income from fixed interest securities to continue to reduce over the next two to three years to below two percent if this low yield world continues.

Other implications of the lower interest rate environment are:

- premium rates have increased,
- increase focus on underwriting profitability,
- Capital Adequacy has reduced slightly; and
- some insurers have started considering alternative investment assets.

Interest rates (cash and 3 year government) vs investment return (total and interest bearing)



Source: KPMG analysis.

In summary, while the low interest rate environment will increase the focus of management on other levers and may change the dynamic in the way that the business is run. At the same time, the interest rate reduction does not have an immediate impact as might be expected and lags the actual interest rate changes observed.

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Organisational Flex

In today's ever-changing world, agility and flexibility are essential to growth that's sustainable.

Whatever challenges your organisation is facing, we can help maximise opportunity, while minimising risk, both today and for the future.

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