Reinventing insurance, one step at a time

A New Zealand perspective on how the change management imperative will redefine the industry

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The times they are a-changing…

It's been almost 700 years since the first insurance contract was issued, and yet it's only been in the last few years that insurers have faced fundamental changes in the way their industry operates.

In our biennial publication, part of the global *Insurance Banana Skins* series published with the Centre for the Study of Financial Innovation, we saw that these changes are front and centre of the risks New Zealand insurers are experiencing.

Transformation is leading the risks New Zealand insurers are facing, with change management and technology two of the most pressing risks here in New Zealand and across the globe.

Driving both is a need for insurers to transform their core operations and build a customer-centric value proposition. It's a positive that insurers are aware of this risk across New Zealand. The next challenge is to convert that awareness into successful organisational transformation.

While change management and technology were the two highest-ranked risks the sector faces, it's the intersection of the two that will provide many of the biggest challenges for insurers. The transition to a digital business model, upgrades to core IT infrastructure and new services enabled by emerging technology like AI all exist in this collision point between the two biggest risks for New Zealand insurers.

What are the biggest risks insurers are facing?

	New Zealand	Global	Australia
Change management	1	1	4
Technology	2	3	5
Competition	3	8	11
Cyber risk	4	2	1
Reputation	5	17	3
Regulation	6	6	9
Human Talent	7	9	12
Investment performance	8	5	8
Social Change	9	16	7
Cost reduction	10	13	17

On the side-lines are FinTech start-ups, specifically those in the InsurTech sub-sector and new emerging "RegTech". The growth in the number of these start-ups is astonishing. Some recent examples of start-ups are shown in the diagram.

InsurTech start-ups, along with innovation within insurers, are bringing new technologies to the market that aren't inhibited by legacy systems. This lowers the cost to serve customers and, as a result, it's no surprise that competition has ranked so highly in New Zealand (the third-greatest risk in New Zealand and up five places on 2015).

New technologies and business models, via new InsurTech players or innovation by incumbents, is threatening all parts of the insurance value chain. It therefore has the potential to disaggregate the current value proposition to clients.

As one of our respondents stated: "disruption from new digital technologies [is] enabling new entrants to enter [the] market place, rendering existing distribution models obsolete". It's this threat to distribution models that holds some of the greatest risks to established insurers.

Source: PwC June 2017

Robotics and cyber security: How technology is reshaping the industry

In the race to create better insurance products, robotics has now come to the fore. Robotic Process Automation (RPA) in particular, is an area where cognitive technologies are being used to replace many of the clerical tasks that insurers have to manage.

It's these back-end processes where the greatest opportunities lie for insurers to improve their operations. However, as we're seeing in our survey data, it's technologies like RPA that are also seen as significant risks by our respondents.

Globally, we've identified five key risks that come with RPA implementation in the insurance sector:

1. Executive (Have the right people bought in?)
2. Functional (Who designs the controls?)
3. Technical (How will you test the robot? How much access will it have to your data?)
4. Operational (How will you stay compliant?)
5. Change management (Who's managing the implementation?)

The rise of RPA won't spell the end for human involvement in the insurance industry.

Each of these risks requires insurers to seriously consider how their current risk profile is evolving as a result of RPA, and how they will control these processes. To do this, you need a process that identifies viable projects for RPA, determines how robots will be configured and share with one another, consider the cyber security implications and have a back-up plan in case there are any disruptions to your automated processes.

Interestingly, the rise of RPA won't spell the end for human involvement in the insurance industry. Although further down the list in seventh place, human talent is still a key risk here in New Zealand, higher than the rest of the world. It's a sign that the skills an insurance company needs are changing. Application Programming Interface (API) development skills, for example, are allowing insurers to combine new technologies like RPA with legacy systems that would otherwise have to be replaced completely. As robots replace autonomous tasks, the war for talent that can build, maintain and integrate robots is only going to increase in the insurance sector.

This demand for talent has other implications for RPA implementations and broader transformation efforts. If you have a manual process to handle a robotic failure, who understands this process? And what would happen if they left? Here, RPA is a case study in the much broader talent risks that come with organisational transformation, but it's far from the only example that insurers will have to manage.

"Pretty high risk here, especially given some of the FinTech needs and ability to source talent here in NZ. The industry does not sell itself well as employer of first choice when it could so easily be that."

"[I'm] less optimistic here because Fintech threats (and opportunities) come from all quarters and not just within the traditional insurers."

While cyber security is a key risk for RPA implementation, it's also one that's shared across a company's entire digital footprint. With these new technologies, systems and processes also comes new risks, which helps to explain why cyber security ranks so highly in our survey (fourth for the second survey in a row).

Insurers now have access to ever-increasing quantities of policyholder data, the need to protect this data and recover in the event of a breach is only going to increase. For an industry that runs on trust, the need to develop and deepen the relationship with both current and future customers has never been greater.

This year, we've already seen the impact of cyber attacks on businesses around the world – especially with the WannaCry ransomware attack earlier this year that infected over 300,000 computers worldwide. The ransomware affected a range of public institutions and corporations around the world, highlighting the potential risks cyber attacks pose, both to insurers themselves and cyber insurance policyholders.

Over-investing in basic cyber security controls could leave insurers at risk

As we saw in our *2017 Global State of Information Security Survey*, the key cyber security challenge for New Zealand businesses, particularly insurers, isn't just keeping up with their expanding digital footprints, it's also about making sure they're investing in the right controls and cyber security measures. Over-investing in basic controls, at the expense of more advanced solutions, could well leave insurers at risk from advanced cyber security attacks. As the sector's technology footprint becomes larger, more sophisticated and even more central to the service offering for customers, the need for strong cyber security controls will only grow.

Even though cyber security is now established as a key risk for insurers, its fourth placing is behind both the global average and Australia (second and first respectively). One reason for this may be that New Zealand hasn't seen a major attack on the same scale as WannaCry, which exploited a weakness in older versions of Windows and saw most infections in Eastern Europe and Asia.

Ultimately, the cyber security challenge isn't going anywhere, and in a landscape where successful transformation and change management projects will be key to insurers' competitiveness in the coming years. This pressure means effective cyber security isn't just a compliance issue – it's going to be a key competitive advantage as insurers expand their digital footprint.

"Many insurance companies run off legacy systems that limit access to new markets and provide inherent inefficiencies to business models."

"New Zealand has a robust macro setting, but a housing market collapse is a possibility and global dynamics remain uncertain."

Financial risks have seen the biggest increase

We have been in a 'lower for longer' interest rate environment for some time now. This has continued to impact investment performance with lower interest rates leading to greater insurance liabilities.

This means insurers can no longer rely on generating good investment returns to achieve their profit targets. Shareholders will be still be demanding similar returns on capital and this has to be delivered by improving underwriting profits. Winning and retaining more business with better margins is the new norm.

While investment performance and interest rates have seen the biggest increase in perceived risks since 2015, their ranks are still below the global averages. This is not surprising given the yields in European countries are *negative* for up to 5 years in duration. Investment performance has therefore been poor and political disruption has not changed this outlook.

Why is concern about regulatory risk increasing?

To those in the industry, there is no surprise that regulatory risk is perceived to be a greater threat now compared to 2015. The high-risk initiatives affecting the industry include the implementation of *IFRS 17 - Insurance Contracts*, the review of the Financial Advisers Act, and the proposed changes to the EQC Act.

These three initiatives alone could drive significant changes in the way insurers' performance is measured, the distribution models they use and the cross-subsidies built into the pricing of their products.

However, these are not the only regulatory initiatives planned or underway. On top of this, we have increases to EQC levies, increases to Fire Service levies (and changes to the way emergency services are funded), a Privacy Act review in development and a review of the Insurance (Prudential Supervision) Act 2010.

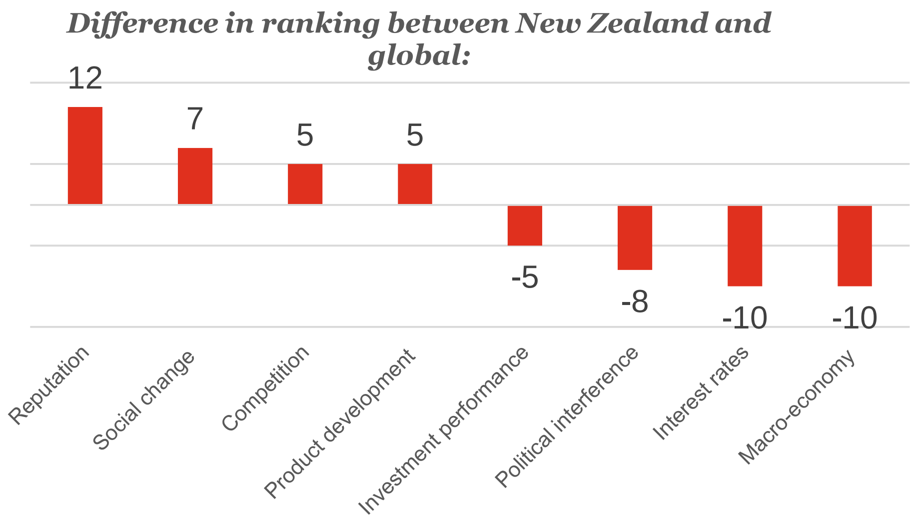
All of these changes take time and effort to respond to, from scoping to implementation, which helps to explain why regulatory risk is increasing.

One of the real standouts from our Australian findings was the increase in the risk of political interference in the insurance sector. This jumped nine places in Australia to be the second-highest risk overall, after cyber security. New Zealand insurers do not share the same concern, thanks to our stable political system. Although political interference has risen three places, it remains firmly in the lower half of the perceived risks here in New Zealand.

How have risk perceptions changed since 2015?

New Zealand ranking		Change
1	Change management	+1
2	Technology	New
3	Competition	New
4	Cyber risk	No Change
5	Reputation	No Change
6	Regulation	+6
7	Human talent	-1
8	Investment performance	+13
9	Social change	+1
10	Cost reduction	New
11	Quality of management	+3
12	Interest rates	+8
13	Product development	-6
14	Business practices	-3
15	Quality of risk management	-6
16	Political interference	+3
17	Macro-economy	+1
18	Capital availability	+4
19	Corporate governance	-2
20	Guaranteed products	+1
21	Brexit	New
22	Complex instruments	+3

How does New Zealand compare globally?



Reputational risk and social change are perceived to be far greater in New Zealand compared to the rest of the world. This is perhaps no surprise with unfavourable media coverage of the industry in recent years after the industry's response to the Canterbury earthquakes and the dual EQC/private insurer model, questionable adviser sales practices and falling investment returns. Reputation and customer trust are critical to staying competitive in the sector, so they need to remain front of mind.

The risks that are more pressing overseas than locally are those related to the general business environment. While we saw increases in the perceived risk of interest rates and investment performance in the New Zealand results, the overall ranking of these concerns and macro-economic and political interference all rank low relative to the global results. Again, this likely reflects the more stable macro-economic environment New Zealand insurers are operating in.

How prepared are New Zealand's insurers for these risks?

Clearly change management, technology and new sources of competition are transforming the industry, but this doesn't explain how the insurance sector is responding. To understand this, we asked a further question: How prepared is the industry to manage them in the future?

The results were interesting as they showed that New Zealand ranks around the bottom quartile of countries surveyed in terms of preparedness. This is naturally below the global average and many of our Asia-Pacific neighbours, with Australia, Japan and China all ranking much closer to the global average in terms of preparedness.

However, in terms of preparedness, we also share the space with much of the English-speaking world. Canada, the United States and South Africa all had similar levels of preparedness to New Zealand, while our local insurers felt more prepared than their counterparts in the United Kingdom and Hong Kong.

Although New Zealand insurers may feel less prepared to navigate the risks ahead than the global average, that could well be a sign that they're more realistic about the transformation challenge ahead of them than their more colleagues overseas.

However, one thing is very clear: change management is absolutely crucial in a fast-moving, digital world underpinned by fast-moving changes in customer expectations and regulation. Change favours the prepared mind, so what is your business doing to prepare itself?

Get in touch

Karl Deutschle
Partner, Insurance Sector Leader
T: +64 9 355 8067
E: karl.p.deutschle@nz.pwc.com

Andy Symons
Partner, Financial Services Sector Leader
T: +64 9 355 8535
E: andy.d.symons@nz.pwc.com

David Lamb
Partner
T: +64 9 355 8419
E: david.lamb@nz.pwc.com

Ben Coulter
Director
T: +64 9 355 8620
E: ben.a.coulter@nz.pwc.com

About this report

This report is New Zealand's biennial supplement to *the PwC Banana Skins* series, a global report that measures risk in financial services.

PwC conducts this survey in partnership with the Centre for the Study of Financial Innovation (CSFI), a US-based, non-profit think tank.

Twenty-two insurance industry professionals contributed to this New Zealand report, completing an online survey between January and March 2017. Globally, the CSFI and PwC gathered 836 responses, making this the largest sample we've recorded since we started the Insurance Banana Skins publication.

Thank you to all those who took part in this year's survey. Your contribution has been invaluable to us and has given us an unparalleled insight into the state of the insurance industry here in New Zealand.

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