



INSURANCE

A glimmer of hope

Growth prospects in the global insurance industry
and the escalation of risk and capital management

June 2009

FINANCIAL SERVICES

Acknowledgements

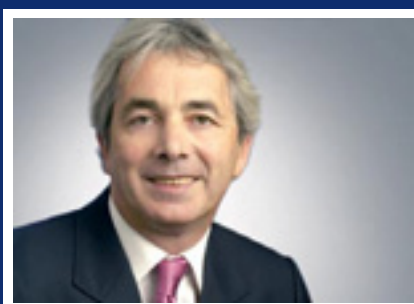
This initial survey report is the first of a two-part series which KPMG International has commissioned from the Economist Intelligence Unit. It examines how the financial crisis is changing the attitude of the global insurance industry to risk and capital management, highlighting some of the key issues that these institutions should address in response. These include preventing further losses and positioning their businesses for future growth. The survey's findings reflect the sentiment of the 315 senior insurance executives across 49 countries who answered the survey. Our sincere thanks are expressed to these individuals.

Our second and larger survey will track further anticipated changes in attitudes and responses to risk management, along with other pressing issues. The results will be published later this year.

We would like to thank members of the Editorial Board and other colleagues around the world who have helped us in carrying out this research, in particular Liz White, Nina Mülders, Freddie Hospedales and Sam Baxter from KPMG in the UK, and Rob Mitchell from the Economist Intelligence Unit.



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Respondents by geography:

31%

Based in Europe

28%

Based in Asia Pacific

28%

Based in North America

13%

Based in the Middle East and Africa

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About the survey

In March and April 2009, the Economist Intelligence Unit surveyed, on behalf of KPMG International, 315 executives from insurance companies around the world. The survey asked them about their prospects for the coming year, along with their priorities for risk and capital management. Respondents were spread globally, with 31 percent from Europe, 28 percent each from Asia Pacific and North America and 13 percent from the Middle East and Africa. Approximately 68 percent of respondents represent businesses with annual revenue of more than US\$500m. More than 50 percent of respondents were C-level, or board-level executives, and the vast majority had responsibilities for finance, risk or general management. Respondents were split among life insurance (42 percent), non-life insurance (49 percent) and reinsurance (9 percent) companies or divisions.

42%

Life insurance

49%

Non-life insurance

9%

Reinsurance

Introduction

Aside from a handful of high-profile casualties, the global insurance industry seems, so far, to have escaped the worst ravages of the financial crisis. Mainstream business operations are holding up well. Problems have only arisen from exposures to risky financial instruments, such as credit default swaps (CDS) and collateralized debt obligations (CDO) or losses on investment portfolios. Profitability is more likely to have been impacted than underlying solvency.

Although the insurance industry has been more resilient than the banking sector over the past 18 months, capital markets have not always drawn the same conclusion. Share prices at most of the world's major insurers have tumbled, while spreads on credit default swaps have widened considerably, indicating fears of future debt default. Whether the markets are accurate in their pricing of insurance assets remains to be seen, but insurers do seem to have been affected by the general market downturn.

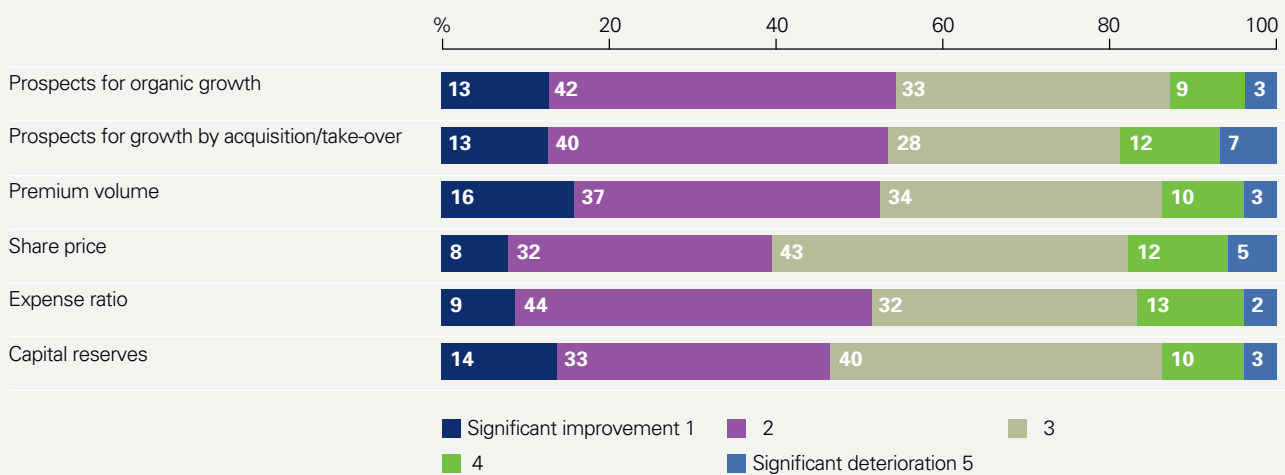
Faced with troubled capital markets, falling ratings and share prices, many insurers are rethinking their risk and capital management strategies. As insurers do not borrow short and lend long – indeed they tend to do the opposite – it is also true that, historically, they have had a very different approach to risk management. While banks have been happy to securitize their assets then sell them off using an originate-to-distribute model, insurers typically retain a stake in their underwriting business, which requires them to be more disciplined in their risk management.

In this global survey, we reflect upon insurers' prospects for the future and expectations for growth over the next 12 months, as well as their opportunities resulting from the financial crisis and its impact on their approach to risk and capital management.

Summary of findings

Insurers are cautiously optimistic about their prospects for the next 12 months. Asked how they thought their business would perform across a number of key measures over the next year, insurers expressed cautious optimism. More than half of the respondents thought that their prospects for organic growth were positive, and a similar proportion believed that their prospects for growth by acquisition / take-over were also positive. They were also fairly confident that premium volumes would increase over the coming year.

Figure 1. Answers from all respondents to the question: Looking ahead to the next 12 months, how would you rate the prospects for your business across the following measures? Please rate on a scale of 1 to 5, where 1 = Significant improvement and 5 = Significant deterioration



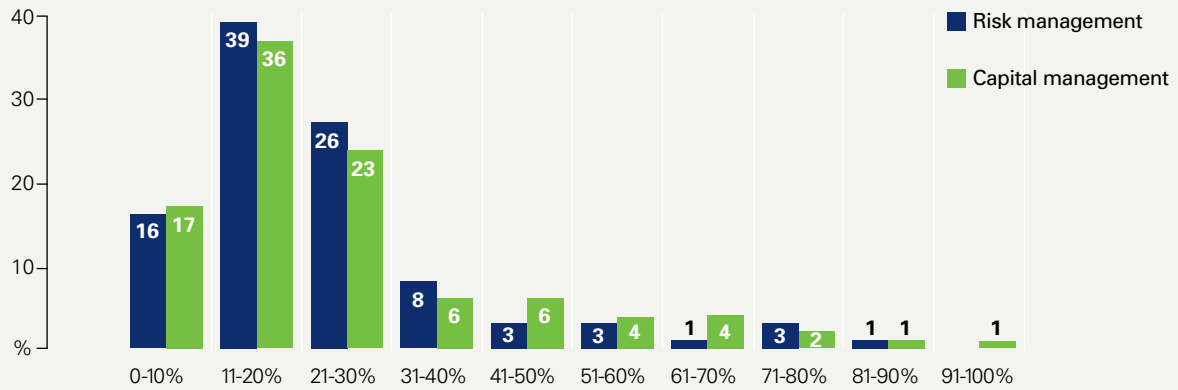
Source: Economist Intelligence Unit survey, March 2009

While there are some minor differences between the responses of the life and non-life insurers across the regions who participated in the survey, overall there is a striking consistency in their optimism as to their prospects.

Despite this overall optimism in a highly challenging environment, respondents in general were less sanguine about their prospects in the financial markets. Less than 4 in 10 respondents said that they expected an improvement in their share price over the next 12 months, perhaps reflecting a sentiment that the market has failed to see beyond the high-profile difficulties experienced by the likes of AIG.

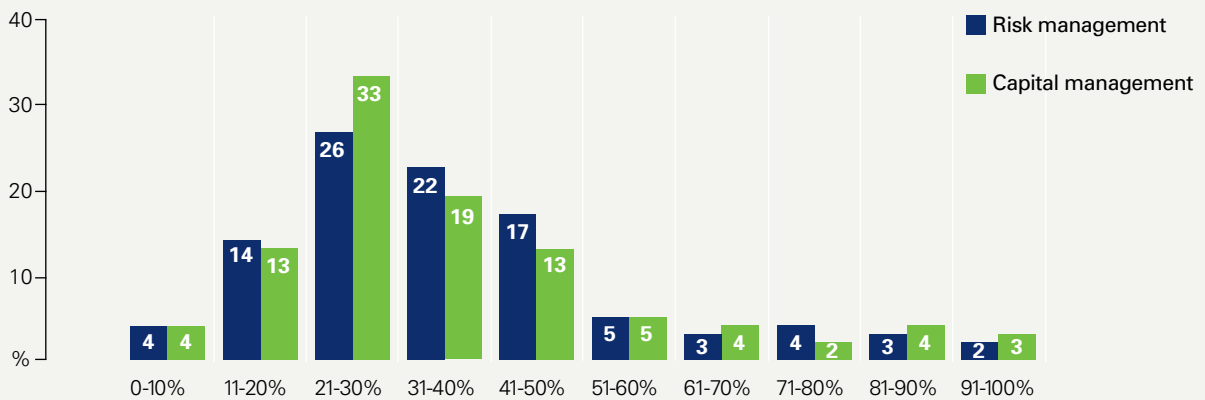
The current environment has sharpened the focus of insurers on risk management. Although risk management is historically a more central activity for insurers than for banks, the survey paints a clear picture of a significantly increased and broader focus on it over the past year. At board level, the proportion of time spent on both risk management and capital management has increased substantially. Figures 2 and 3 to the right indicate that the estimated average has moved from 23 percent to 36 percent.

Figure 2. Answers from all respondents to the question: What proportion of time did your board spend on risk and capital management activities 12 months ago?



Source: Economist Intelligence Unit survey, March 2009

Figure 3. Answers from all respondents to the question: What proportion of time does your board spend on risk and capital management activities now?

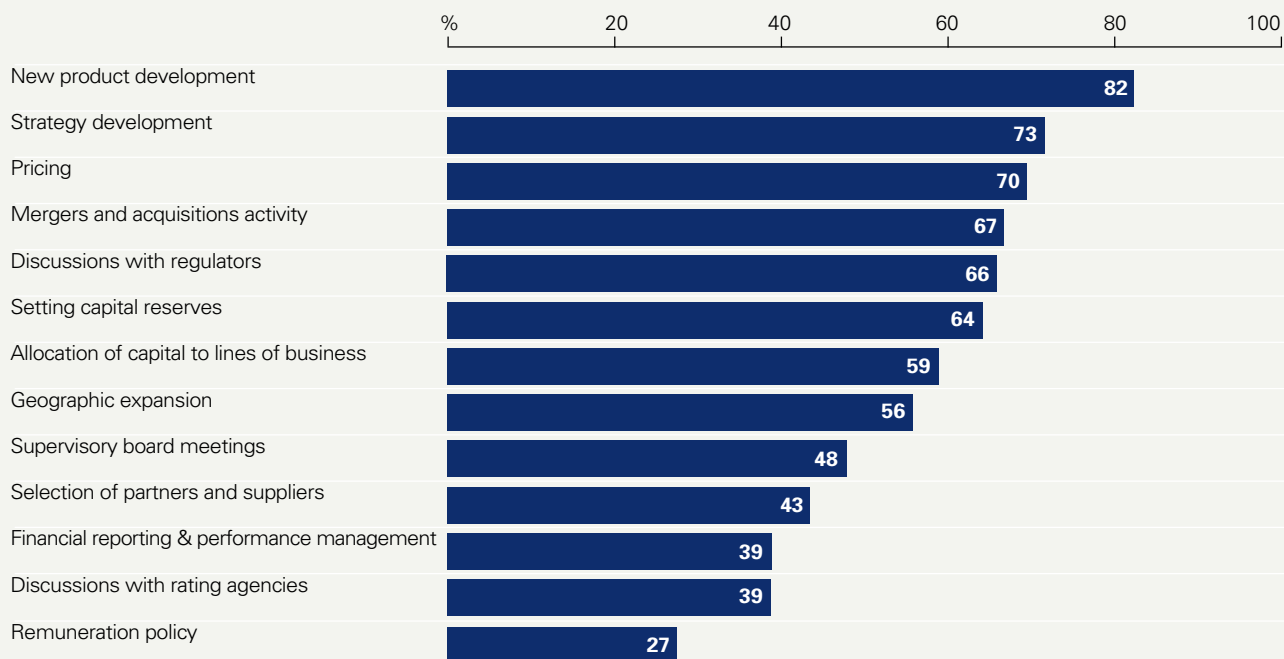


Source: Economist Intelligence Unit survey, March 2009

Specific risk activities are also gaining a higher degree of focus. For example, more than 8 in 10 respondents have increased the attention paid to market risk, while more than 70 percent are heightening the priority given to credit risk and the aggregation of risk at a firm-wide level. Another clear risk management trend seems to be the formation of Risk Committees (sometimes supplemented with external expertise). Their role is primarily to oversee and challenge the risk strategies adhered to by the business and monitored by the internal risk management function. Almost two-thirds of the survey respondents say they have appointed – or are in the process of doing so – board-level risk committees in addition to the longer-established audit committees.

The role and the responsibilities of the Chief Risk Officer are far-reaching and usually embrace strategic activities within the organization. Supporting the survey results that conversations around risk have become more prevalent throughout the business, so has the importance of the Chief Risk Officer's role. Respondents were able to select more than one activity which they saw the risk management function active in and in the majority of respondent companies it is clear that their remit is considerably broader than the traditional "risk" activities and they are increasingly being involved in new product development, M&A activity and strategy development. Less than a third, however, are involved in setting remuneration policy, while over one-third participate in discussions with rating agencies, the selection of partners and suppliers, or financial reporting and performance management. This breadth of activity reflects the observation that the Chief Risk Officers will have a different view on many business issues than that offered by their C-level peers and will join them in the board room to work through a solution.

Figure 4. Answers from all respondents to the question: In which of the following activities does the risk management function play an active role in your organization? Please select all that apply. *

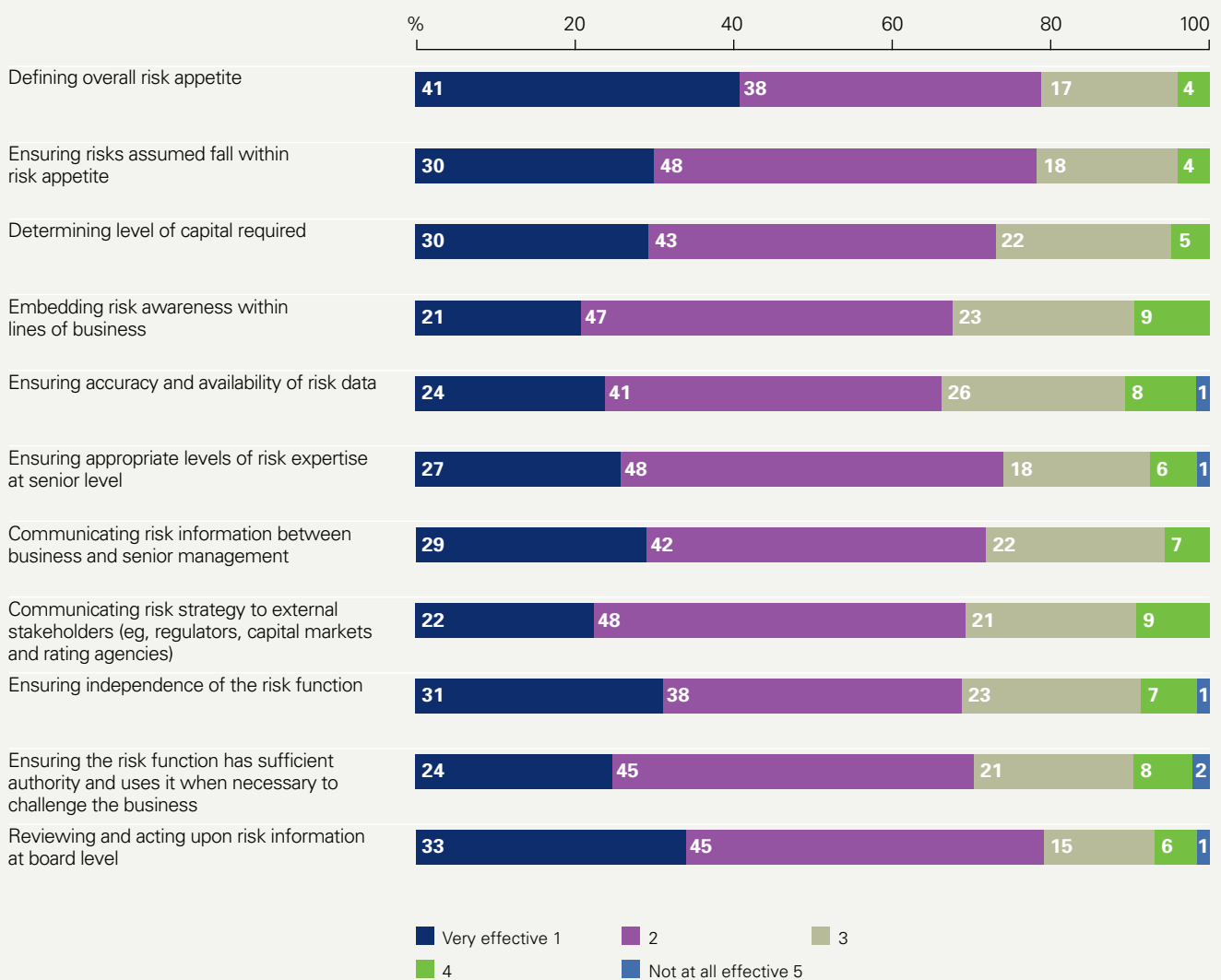


Source: Economist Intelligence Unit survey, March 2009

*Note that respondents had the opportunity to identify more than one activity.

Despite their increased risk focus, insurers rate themselves highly on most aspects of risk management. Insurers questioned for this survey express high levels of confidence in their ability to perform well across most aspects of risk management. For example, more than three-quarters of respondents rate themselves as effective or very effective at defining risk appetite, while a similar proportion rate themselves as effective at ensuring that assumed risks fall within their risk appetite. Indeed, there is no risk-related activity within the survey at which less than 6 in 10 respondents believe themselves to be effective. It is clearly evident from the results below that risk-related activities underpin many business operations.

Figure 5. Answers from all respondents to the question: How would you rate the effectiveness of your organization with the following risk related activities? Please rate on a scale of 1 to 5, where 1 = Very effective and 5 = Not at all effective.



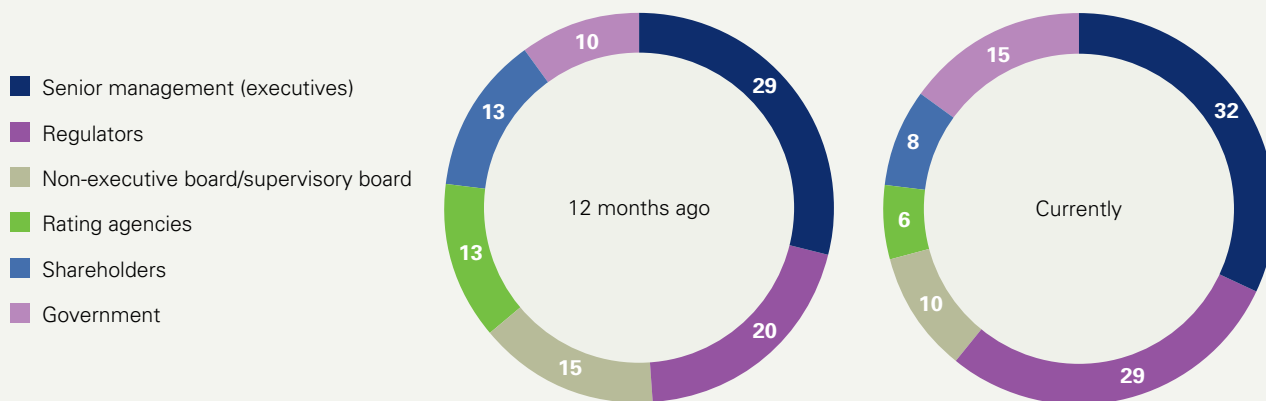
Source: Economist Intelligence Unit survey, March 2009

Respondents also express widespread confidence that their institutions and the industry in general, is well-capitalized. An impressive 85 percent agree that they are well-capitalized relative to their risks, and most believe that the industry as a whole has sufficient capital reserves. On the other hand it is interesting that more than half of companies say that they will need to increase their capital reserves over the next 12 months.

The influence of regulators on risk management is growing.

Asked about the stakeholders who exerted greatest influence over risk management in their organization a year ago, respondents state that senior management (executives) held the greatest sway by some margin, followed by regulators. But asked about sources of influence at the present time, there is a noticeable change, with regulators seen as exerting almost as much influence as senior management.

Figure 6. Answers from all respondents to the question: Which of the following stakeholders in your organization had greatest influence over risk management policy and execution 12 months ago (before the credit crisis), and which have greatest influence now (due to the credit crisis)? Please select up to three for each column. *

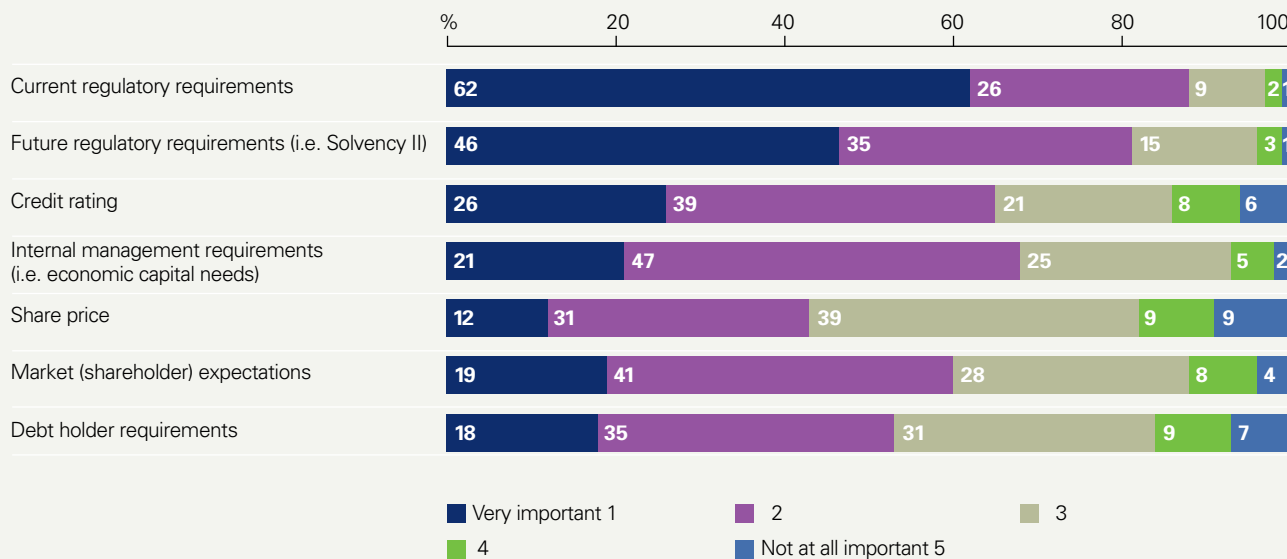


Source: Economist Intelligence Unit survey, March 2009

*Note that respondents had the opportunity to identify more than one stakeholder.

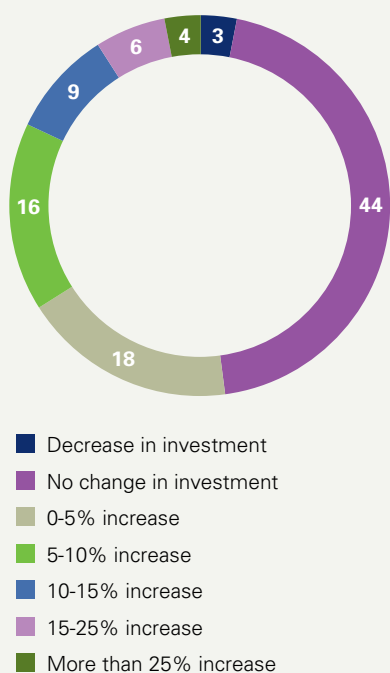
Regulation – both current and future – is by far the biggest driver of capital requirements. There is a clear consensus among respondents that regulators are playing a greater role in capital management. Regulatory regimes, including current criteria and the forthcoming European Solvency II, are by far the most important drivers of capital requirements in the insurance industry. Other external factors, such as share price, market expectations or debt-holder requirements, are perceived as considerably less important from a capital requirement perspective.

Figure 7. Answers from all respondents to the question: How important are the following issues as drivers of capital requirements in your business? Please rate on a scale of 1 to 5, where 1 = Very important and 5 = Not at all important.



Source: Economist Intelligence Unit survey, March 2009

Figure 8. Answers from all respondents to the question: What change in levels of investment budget in risk management related resources (ie, people, technology and data) does your institution expect to make over the next year?



Source: Economist Intelligence Unit survey, March 2009

The expectation of stronger risk management and capital management performance in insurance is not always met with greater investment.

Although the survey points to a strong consensus that, in future, there will be a much greater focus on risk management and capital management, respondents are split as to whether they will invest more or allocate increased resources to these activities. Around half of respondents expect to make a greater investment, but that still leaves a substantial proportion of around 47 percent of respondents who expect to achieve stronger performance with the same resources in both risk and capital management as before.

In terms of specific areas of investment, there are slight differences between risk management and capital management. With risk management, the most widespread area of future investment is training, followed by processes and policies. However, only around one-third of respondents expect to increase resources or expenditure in those areas. This suggests that investments made will be incremental, and designed to improve existing resources rather than bring in new ones.

In the case of capital management, the most likely area for increased investment is around processes and policies, followed by information technology. People-related investments are seen as less likely, with less than one-quarter of respondents planning to spend more on training or recruitment.

Conclusion

The insurance industry has weathered the financial crisis far better than the banking sector, thanks in part to its more long-term perspective and its stronger focus on risk management. Although capital markets have marked down insurance assets considerably, insurers themselves are reasonably optimistic about the future, with a small majority expecting an improvement in prospects for growth by organic means and acquisition over the next year.

While believing themselves to be well-capitalized, and rating themselves highly in terms of effectiveness across most risk management activities, there is a clear sense among respondents that a greater focus on both capital management and risk management would be warranted given the current global challenges. Boards are spending more time discussing risk issues, and insurers in general seem to be aware that regulators can be expected to play a stronger role in setting risk management requirements. Yet despite this acknowledgement that a greater focus is required, not all companies appear to be prepared to commit greater resources to achieve improvements in risk management. Many, it seems, want to achieve better results, but without incremental levels of investment.

KPMG comment

There can be no doubt that the current financial crisis has impacted large sectors of the insurance industry, if only in terms of the loss of value and increased risk around most financial assets. Perhaps surprisingly there is a distinct air of optimism that the industry has seen the worst and has the attributes to prepare itself for a more favorable environment. Less surprising is the increased focus on risk and capital management from the board level down and the significant increase in the perceived influence of the regulator in both these areas. Interestingly, despite this,

- a significant majority of respondents regard themselves as effective in risk related activities, and
- there is limited appetite for incremental spend, with almost half the respondents expecting to improve performance without increasing resources.

The findings also reveal a similar apparent contradiction around capital, where most respondents believe they are well-capitalized but more than half nonetheless believe they will need to strengthen their capital, which is more in line with messages we are getting from the marketplace.

We look forward to exploring these issues and anomalies in the next stage of the survey.

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