Addressing top-of-mind insurance issues

Contents

Generative AI in insurance: Use cases and adoption 03

Generative AI in the Workplace: Vital need for people strategy 04

Generative AI regulatory challenges: Navigating risk and compliance 05

ESG 06

Risk and regulatory 07

Digital transformation 08

Cost optimization 09

Cyber 10

Mergers & acquisitions 11

Generative AI in insurance: Use cases and adoption

Across industries, **business leaders are racing to determine how generative AI can be used.** For financial services companies, including insurers, generative AI offers great promise in everything from compliance to robo-advisory services. But many financial services companies also face significant obstacles including regulation, legacy IT systems, siloed data sets, and limited cloud deployment. However, these obstacles are not reasons to avoid or delay implementing generative AI in an organization as the **industry is rapidly identifying use cases and, in some cases, already using it across the organization to drive value and reduce costs**. While use is rapidly expanding, some **trends in use cases have emerged**.

The following are some areas where insurers are exploring (or already using) generative AI technology on its own or in combination with technology solutions:

- **Marketing and distribution:** Market research and analysis, lead generation, sales campaign management, account and contract management
- **Product development and pricing:** Product design, testing, pricing, configuration, and launch; change and maintenance
- **Underwriting and issuance:** Risk analysis and appetite, risk monitoring, policy quotes and validation, forms management, quality control
- **Policyholder services:** Policy changes and endorsement processing, customer service interactions (call centers, self-service), next best product actions, complaints handling
- **Claims:** Intake, assessments, and initial reviews; validation, adjudication and settlement; fraud detection and management
- **Reinsurance:** Acquisition, claims management and reserving, settlement

Artificial intelligence is materially changing how insurance executes key activities and the degree of adoption is primarily driven by proven use cases, scalability, and organizational buy-in, including changing behavior to enable adoption.

Thought leadership:

- The generative AI advantage in financial services
- Generative AI: From buzz to business value
- Responsible AI and the change of AI Risk

Generative AI in the workplace: Vital need for people strategy

Executives are already convinced of how transformative generative AI will be, but many questions remain, including how do we use generative AI now that we have it and how does it impact the workforce? Change management has never been more crucial for C-suite leaders. As we work on leveraging generative AI for business transformation, **it's imperative to redesign our talent plan today as even with generative AI, success in the future will still hinge on having the best people and capable team.** Addressing the impact of generative AI on the workforce is crucial for executives to ensure a smooth transition and to optimize the benefits of this technology.

Strategies executives can employ:

1. **Invest in workforce training and reskilling:** Allocate resources for training and upskilling employees to work alongside generative AI. Focus on developing skills, such as prompt writing.
2. **Communication and change management:** Open and transparent communication about generative AI's role and impact on the workforce is essential. Create a change management plan that involves employees in the process and addresses their concerns.
3. **Job redesign:** Rethink job roles and responsibilities to incorporate generative AI. Identify tasks that can be automated and evolve job descriptions to emphasize tasks that require human judgment, empathy, and creativity.
4. **Flexibility and adaptability:** Foster a culture of adaptability and continuous learning. Encourage employees to embrace change and be open to new technologies and ways of working.
5. **Ethical considerations:** Develop guidelines and policies for the ethical use of generative AI.
6. **Data security and privacy:** Invest in robust data security and privacy measures to protect sensitive information. Employees should feel confident that AI systems are secure and respect privacy.
7. **Job transition assistance:** Provide support for employees whose roles may be significantly impacted by AI, including options for reassignment or retraining.

Thought leadership:

- Generative AI for HR and workforce
- Generative AI in the modern workplace
- Two-minute video reminder of why generative AI is the opportunity—and the imperative—of our lifetime

Generative AI regulatory challenges: Navigating risk and compliance

Businesses are asking key questions on where the regulations are and where they may go. How do we as an organization design our risk governance and risk management so that we take advantage of the automation advances while mitigating the risks?

As AI, including generative AI is more widely adopted, **the role of risk will be critical to innovating while maintaining trust.** In the absence of formal legislation or regulation (and even when such may come), companies must proactively set appropriate risk and compliance guardrails and "speedbumps."

Entities should anticipate that regulatory approaches to AI and/or the areas of regulatory and supervisory focus **will undergo transformation**, potentially varying among state, federal, and global jurisdictions, which increases the complexity of AI compliance. Similarly, regulatory expectations in other evolving areas that touch on system inputs and outputs as well as customer impact (such as fairness, privacy, and cybersecurity) may overlap with AI expectations, increasing regulatory scrutiny and adding to complexity.

Key areas to watch – AI regulatory themes:

- **Risk management** and governance around the design, use, and deployment of AI
- **Fairness/Consumer harm** under existing regulations
- **Purpose limitation** and **data minimization** (privacy)

Thought leadership:

- Where will AI/generative AI regulations go
- 2023 KPMG Chief Ethics & Compliance Officer Survey – Anticipating more scrutiny

ESG

In July 2023, the Securities and Exchange Commission (SEC) finalized its cybersecurity disclosure rules. Effective September 5, 2023, **public companies are now required to disclose material cybersecurity events** on Form 8-K and disclose on Form 10-K an entity's process to assess, identify, and manage material risks from cybersecurity threats, including board oversight. The SEC's final climate disclosure rule and proposed human capital management disclosures are expected as early as October. The SEC's proposed corporate board diversity disclosure rules are expected in April 2024.

In July 2023, the European Commission published the final text of the first 12 European Sustainability Reporting Standards (ESRSs). For years beginning January 1, 2024, **certain companies will need to apply the ESRSs**, which require the disclosure of comprehensive information on an entity's performance regarding sustainability topics and how they are managed. US companies may be subject to certain reporting requirements if listed on any EU exchange or if have substantial activity and a presence in the EU.

The NAIC sent their annual **Climate Risk Disclosure Survey** out in July 2023 to US insurers with responses due August 31, 2023. The survey **questions were based on the adopted TCFD-aligned disclosure framework**. This shift toward TCFD-aligned disclosures for US insurers will further push organizations to address ESG as an important part of their strategy. The response rate of this survey from 2022 was 80 percent of the entire US insurance market (source: California Department of Insurance).

Steps being taken by insurers and recent ESG focus:

- The impact of extreme weather events is causing disruption and changes in strategy for insurers. **Insurance companies are shifting focus to offer prevention services to mitigate impacts from extreme weather.**
  - Natural catastrophes are estimated to have cost the insurance industry approximately $43 billion in the first half of 2023. *Source: Munich Re, NatCatSERVICE (July 2023)*
- Life insurers should invest in ESG product alignment as policyholders are continuing to look for insurance products that will have a positive effect on global ESG factors, such as offering sustainable investment opportunities.

Thought leadership with recent ESG impacts to the insurance market:

- Insights from the 2023 COSO ICIF report: Takeaways and ways to build an effective ESG-reporting architecture
- It's getting hot in here! Climate risk scenarios for insurers in an ESG world
- KPMG guest post in ESG Today: Climate change, extreme weather driving insurance urgency
- Internal audit's role in ESG for insurance organizations

Risk and regulatory

Regulators are pursuing what they perceive to be "weak links" within risk programs and coverage. The following key regulatory challenges will continue to be a focus in the last part of 2023:

- Scrutiny and divergence
- Climate and sustainability
- Transparency and reporting
- Data and cybersecurity
- Technology and resiliency
- Credit and capital
- Fairness and inclusion
- Fraud and financial crime
- Payments and crypto
- Risk and governance

(Source: Ten Key Regulatory Challenges of 2023)

NAIC regulatory updates – Guidance effective for 2023:

- **Definition of a liability (SSAP No. 5R)** incorporates updates from FASB conceptual framework such as removing the term "probable" and the phrase "in the future as a result of past transactions or events" in the definition of a liability
- **Negative interest maintenance reserve (IMR) (SSAP No. 7)** provides optional temporary guidance for admitting negative IMR

SEC final rules:

- **Compensation clawback rules** effective date is October 2, 2023, and issuers must adopt a compliant recovery policy within 60 days of the effective date of the relevant exchange's listing standards (i.e., issuers adopt no later than December 1, 2023)
- Final **Cybersecurity disclosure rules** issued.

Thought leadership:

- Risk and governance: 2023 Regulatory challenges
- Insurance: September 2023 SAPWG call

Digital transformation

Digital transformation is crucial for insurance companies to thrive amid disruptive threats and evolving customer expectations. **This transformation goes beyond technology, impacting the entire enterprise from strategy to culture.** By fortifying foundations and building integrated ecosystems, insurers can deliver consistent customer experiences and streamline processes.

Insurers must **modernize their core operations, digitizing processes such as policy administration and claims** to drive digital transformation. By leveraging advanced technologies, such as cloud computing and AI, banks can innovate, accelerate processes, and enable real-time processing. This modernization is essential for banks to stay competitive, improve efficiency, and meet the demands of today's digital-first customers.

Successful digital transformation requires more than technology. It necessitates a **focus on governance, culture, and change management**. Leaders must demonstrate value, align organizational structures with new technologies, and ensure adoption.

Potential actions to consider:

- Prioritize **strengthening their foundational elements**, including strategy, people, and culture.
- Focus on **establishing an integrated ecosystem** that fosters collaboration and delivers consistent experiences across channels.
- Embark on core modernization efforts, **digitizing operations such as policy administration and claims.** This modernization is crucial for insurers to stay competitive, enhance efficiency, and meet the ever-evolving demands of a digital-first marketplace.

Thought leadership:

- Corporate controller and CAO hot topics: Digital transformation spotlight
- Opportunity is knocking. Are you answering? How companies can collaborate with service providers to open the door to sustained digital transformation

Cost optimization

As the market stabilizes and a full-blown recession appears less likely, the emphasis on reducing costs and improving efficiency is growing stronger.

We see three layers of cost-related initiatives in the industry: (1) near-term, **"low-hanging fruit" takeout** to drive in-year earnings improvement; (2) **investment in digitization, automation, and cloud migration,** and development of digital-first business models to enhance efficiency and scalability; and (3) development of metrics, reporting, incentives, and cultural change programs to support the transition from a periodic low-hanging fruit mindset to a **"continuous performance improvement" mindset.**

Common themes in cost reduction efforts include **continued digitization and automation of complex processes** (e.g., onboarding and underwriting); **outsourcing of high variable volume processes** (KYC, AML monitoring, and investigations); locational strategies (e.g., offshoring of select corporate functions and analytics centers, and domestic hybrid work location strategies); and **strategic business reconfiguration** (servicing channel migration strategies, self-service portal development, account service-level realignment, and branch network optimization).

Potential actions to take include:

- **Reassess capacity needs and levels –** Even after recent "spans and layers" reviews to account for changing business conditions and expectations.
- **Optimize funding costs –** Invest in deposit analytics, pricing tools, and value propositions to optimize funding costs during high- or volatile-rate environments, as inexpensive deposit funding is no longer widely available.
- **Examine procured cost bases –** Explore alternative vendors, contract renegotiation, and demand management.
- **Develop core transformation strategy –** Leverage the new and advancing technologies—cloud, digital, and generative AI.
- **Transform underlying cost drivers –** Simplify enterprise and product architecture, account service-level realignment, transformation of "institutional metabolism," and decision-making pace.

Thought leadership:

- Cost optimization: Drive profitability and efficiency

Cyber

The **SEC** approved a new rule related to cybersecurity risk management and disclosure requirements for public companies. Meeting these regulations requires action and input from multiple groups within the organization. Registrants are required to report material cybersecurity incidents on **new Item 1.05 of Form 8-K** within four business days after the registrant determines that the incident is material.

These new rules will significantly expand registrants' annual disclosures and provide more standardized and specific details regarding material cybersecurity incidents. Organizations need to begin scrutinizing their existing systems, processes, and controls to meet these **new requirements coming in December** of this year.

Additionally, financial institutions are continuing to rapidly adopt **AI** for cybersecurity. Organizations have been utilizing AI-powered solutions to accelerate threat detection, expedite responses, and protect personally identifiable information.

Key focus areas for CISOs include:

- **Proactive compliance with SEC requirements –** Organizations should prioritize and proactively respond to regulatory requirements by involving all relevant teams in order to ensure compliance with the upcoming response requirements from the SEC. This collaborative approach will aid in meeting deadlines and maintaining transparency when addressing cybersecurity concerns.
- **Scrutinize current processes to leverage automation –** Financial institutions should assess their existing processes and pinpoint problem areas to determine where automation and AI can be employed to more effectively allocate limited cyber resources.
- **Establish guardrails to maximize the benefits of AI –** To ensure the effective and responsible use of AI in combating cybersecurity threats and addressing regulatory requirements, establish expectations, define internal processes beforehand, and implement controls throughout the development of these tools.

Thought leadership:

- SEC finalizes cybersecurity rules
- AI security framework design
- Building trust in AI is a shared responsibility

Mergers & acquisitions

This fall 2023 update covers general trends and how insurance related mergers and acquisitions (M&A) activity has progressed in 2023.

2023 at a glance:

Based on the first half of 2023, M&A deal volume continued its descent. Compared to H1'22, deal value plunged 83.5 percent to $4.2 billion from $25.5 billion, while volume fell 25.3 percent to 491 deals from 657.

The two largest transactions in the quarter were strategic divestments by American International Group, which continues to focus on its core operations. AIG sold some of its reinsurance holding to Renaissance Re for $3 billion and its crop risk business to American Financial Group for $240 million.

MGA/MGU broker demand trend:

Forecasts for the US economy in the second half of 2023 remain uncertain. The industry continues to face concerns around recession fears, rising interest rates, and cooling labor markets. Despite the ongoing concerns, the MGAs/MGUs have been able to stay attractive to carrier and investors. MGAs and MGUs continue to invest in their operation capabilities through investing in technology advancements and data analytics, which result in lower-cost platforms and the flexibility to participate in sectors that can drive profits and diversification.

Hardening of rates in reinsurance and P&C commercial lines:

Reuters reported that the July 1 renewal period saw that the US property catastrophe reinsurance rates increased by approximately 50 percent. In the current reinsurance market, some experts are observing that reinsurers are focusing on improving profitability by increasing rates to grow and meet shareholder expectations. This is driving the recent significant insurance deals from the American Financial Group and Crop Risk Services transaction as well as the Renaissance Re Holdings and Validus transaction. Per the publicly disclosed press releases for both transactions, the presidents and CEOs stated that their reasoning for acquiring these targets was to strengthen their position as leading global property and casualty reinsurers while providing additional greater economies of scale. If the reinsurance market continues to increase its rates, we can anticipate a sustained increase in deal activity in the second half of 2023.

Sources: Reuters, "U.S. property catastrophe reinsurance rates rise up to 50% on July 1, report says" (July 2023); RenaissanceRE, "RenaissanceRe Holdings LTD. advances strategy with $2.985 billion acquisition of Validus Re" (May 2023)

Thought leadership with recent M&A impacts to the insurance market:

- Financial services M&A activity turned positive in Q2

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