CFO Survey
February 2019

Insurance in Indonesia

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2018 represented a mixed year for the insurance market in Indonesia. Economic growth rates stayed buoyant at above 5% but there were difficulties with market confidence as the Rupiah suffered depreciation, largely dragged down by other global emerging currencies. Especially relevant to the insurance industry, 2018 was the worst year in over a decade for natural disasters, with fatal disasters in Lombok, Sulawesi and Java, as well as marine and aviation tragedies with catastrophic loss of life. These have acted as a stark reminder of the vital role that insurance can play in rebuilding communities.

The coming years represent a period of change and development for the insurance industry. There are expected to be enhancements to regulations both from the perspective of the OJK and the tax authorities. In addition, the introduction of IFRS17 as a global standard in reporting is presenting both a welcome opportunity and a challenge. Meanwhile, there is a continuing inflow of capital.

There are initial steps being taken in the industry to enact greater innovation in the design of products and the methods of distribution. These changes are being undertaken to enhance penetration and better meet the protection and savings needs of an agile, wealthier and growing population. Along with all these changes comes the need for the finance function to modernise and remain relevant. Finance and the CFO clearly play a major role in responding to regulatory and accounting change, but the need for enhanced skills in areas such as analytics, as well as the need for cutting edge systems and processes to respond to the developments in front-line capabilities is just as important. We have started to see initial investment being made by our clients in Robotic Process Automation (RPA), Data Analytics and Digital Dashboards to enhance their finance function so that it is not seen merely a support function but can actually give valuable insights on the business.

Our survey of the insurance market has highlighted the priorities of the CFO and the finance function as we move into this period of development. Responses, which came from all parts of the Indonesian insurance market, highlighted a number of key themes which are highlighted throughout this report.

We would like to take this opportunity to thank all of the respondents for sharing their valuable insights. We hope that you find this survey useful and thought provoking.

PwC Indonesia, February 2019

PwC's View

Insurers are desperate to unlock profitability, but are struggling to get the tools or resources to do so

- The focus of the market is moving towards profitability rather than simply top-line growth.
- CFOs point at economic uncertainty as the main barrier to profitability, but we believe that there are significant restrictions in the market's agility to meet the changing demands of Indonesian consumers.
- Insurers struggle to attract bright and talented people to help them innovate and unlock profitability.

IFRS17: Time is running out for insurers to get their programme running

- CFOs are aware of the looming challenge of IFRS17 implementation; however, time is running out. Most insurers are now well into their programme of implementation.
- Insurers who are not already looking at the initial impact assessment may be poorly positioned to keep pace with the competition.

Insurance has fallen a long way behind other industries in innovation and needs to invest to keep up with rapid technology change

- The massive growth in availability of digital and data-based tools which can help the industry grow is not being taken up as quickly as in other industries.
- CFOs declare a high level of confidence in the back office functions, yet the processes are heavily manual and causing delays and errors.
- Despite the shortage of talent, there is remarkably little investment in robotic processing and data analytics in finance processes compared to other industries.

About this survey

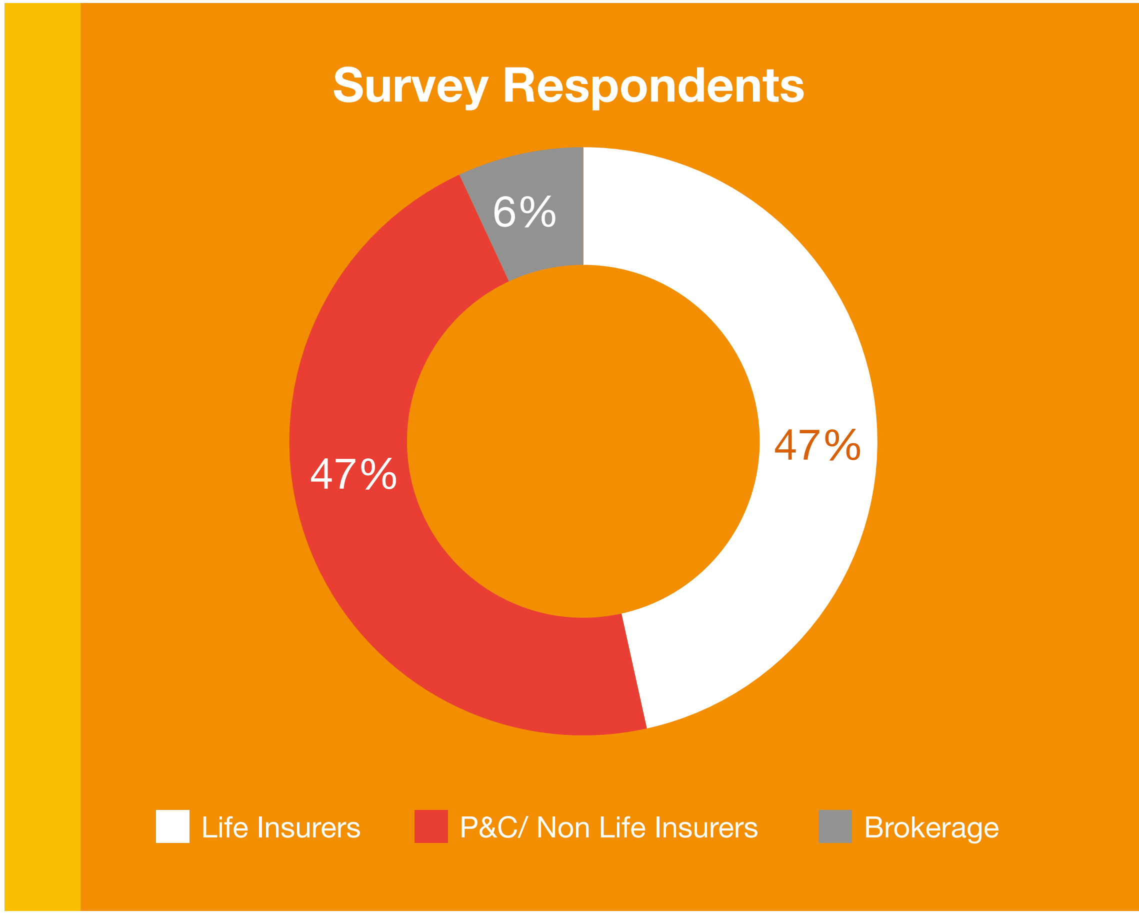
Our 2019 Insurance in Indonesia CFO survey includes 24 questions with the focus on:

- The expectations for Indonesia's insurance market
- Regulations and insurers' readiness to embrace these
- The finance function's ability to support growth

Replies are confidential and only aggregate data is presented in this report.

Our respondents represent more than a third of the total assets of the top 35 insurers in Indonesia (based on Info Bank data from mid 2018). Therefore we believe that survey responses reasonably represent the actual views of insurers in Indonesia.

The aim of this report is to give an overview to Indonesia's insurers of the general consensus of where we are at the moment, the key priorities for the future and the readiness to embrace the challenges in the industry.



Survey Responses

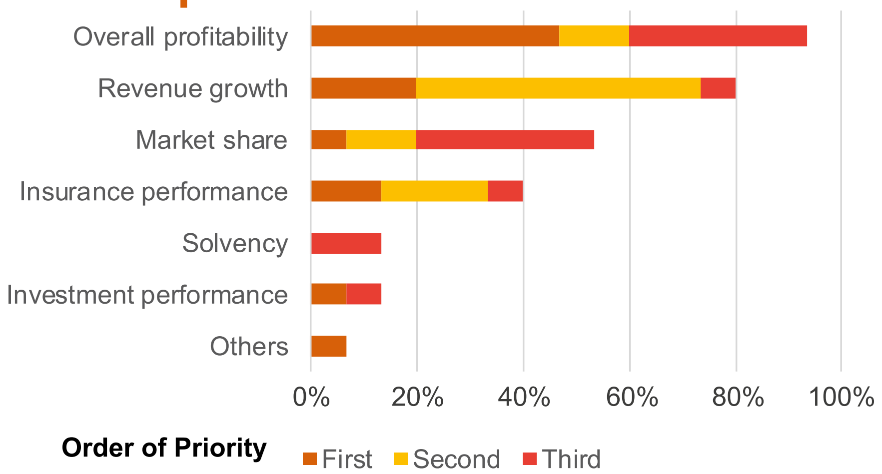
1. There is a positive outlook in the market

The majority of the respondents expect an improving outlook over the coming years, but it was not a unanimous view. Life insurers are the most optimistic. This outlook has swung slightly compared to our 2016 survey where the majority believed that the outlook will remain the same.

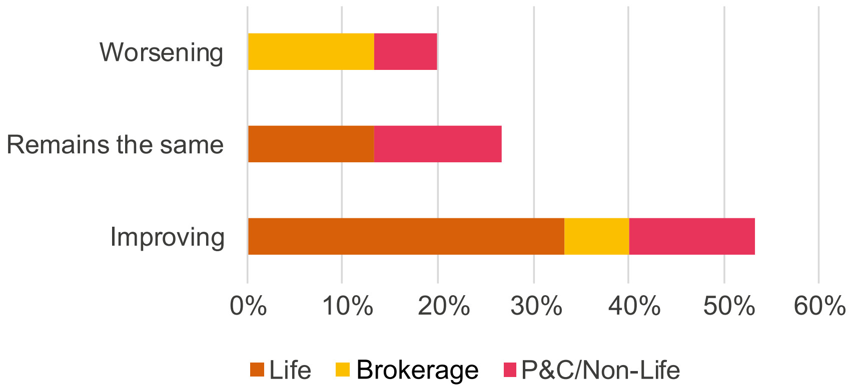
This balanced optimism is not surprising given that insurers are expected to benefit from steady economic growth and rising household incomes, combined with increasing market penetration. The innovation in both product and distribution strategies in the market are likely to help the industry to capitalise on the growth potential.

M&A activity has been strong over the past year, suggesting that global players reflect this optimism in the Indonesian outlook for insurance.

Future priorities



Market expectations for the future



2. With focus shifting to profitability

Increasing profitability has become the principal focus of CFOs. Nearly half of respondents had profitability as their top priority and almost all had it in their top three. This reflects the maturity journey of the market which is shifting its attention away from simply top-line growth as shareholders are looking for return on capital.

There is increasing pressure on returns as market results in 2017 came under scrutiny. For life insurers, the increasing competitiveness of products in the eyes of consumers has constrained profitability.

This indicates also that cost management has become a main differentiating factor to remain competitive in the market, with general insurers suffering particularly from high operating costs.

Over the coming years we expect product and distribution strategies to increasingly balance growth priorities with profitability.

3. Macroeconomic conditions are seen as the biggest challenge to achieving the strategy

Despite the optimistic view, insurers perceive Indonesia's macroeconomic conditions as a significant threat in executing their strategy and this is consistent among life and general insurers. Potential political instability as a result of the presidential election in 2019 and a volatile Rupiah during 2018 have increased this risk that the ultimate impact will be felt on portfolio performance.

Other than macroeconomics, we note that more than half of life insurers believe that lack of qualified resources and challenges in the distribution channels will also impair their ability to compete. Although the agency model is still the primary distribution model in the market, bancassurance is gaining more interest for its ability to provide wider access to the potential customer base.

It is important to carefully assess and choose the right partners, with the key focus on the transparency of data being used and the information exchange.

On the other hand, pricing is seen as a bigger challenge for general insurers. This is understandable as there is a higher need to tailor the types of products offered in order to meet market demands in various sectors.

We have also noted that general insurers are mostly concerned with regulation. It may be that fixed pricing is behind this concern. This highlights the need to have a robust process to ensure that there is synergy between the variety of products offered and the applicable regulations.

Interestingly, none of the respondents included solvency or liquidity amongst their key concerns, indicating market confidence to absorb more risks to support business growth. This is especially surprising given there have been some high profile liquidity-based challenges in the market over the last 18 months. It is important that, whilst firms are confident to accommodate the target growth, they maintain a robust yet flexible risk management framework.

Top 3 future challenges:

Life Insurers

1. Macroeconomic conditions
2. Availability of talent
3. Limitations in the distribution network

General Insurers

1. Macroeconomic conditions
2. Price competition
3. Regulatory and legal limitations

4. Exposure to investment performance is mainly driven by the insurance products and applicable regulations

All of our respondents believe that their businesses will be highly or moderately affected by poor investment performance in 2019. This is not to say that insurers expect poor performance but is likely more a reflection on the reasonably high reliance on investment performance to contribute to insurers' bottom line results, particularly in the life insurance sector. The government is encouraging investment in infrastructure as one opportunity to diversify portfolios, although this might come with some additional risks.

The recent trend shows the increase in consumer interest for unit-linked products, as this shows promising growth. However, with the highly volatile movements in the stock market it will be interesting to see if consumer preference shifts to more traditional products.

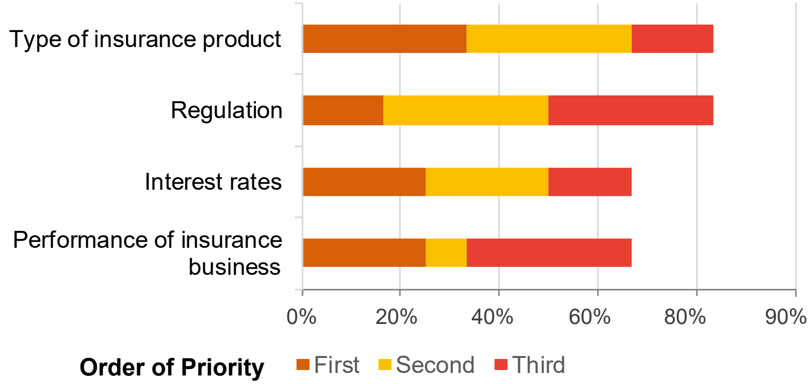
Having effective asset liability management that is in line with the risks absorbed will be the key factor in improving investment returns and ensuring that future liabilities can be met.

The Otoritas Jasa Keuangan (OJK) has put policies in place that require insurers to have a minimum investment in Surat Berharga Negara (SBN) of 30% and 20% of total assets for life and general insurers, respectively. While this may stabilise the portfolio, it could also limit insurers' ability to determine the make up of their asset portfolio.

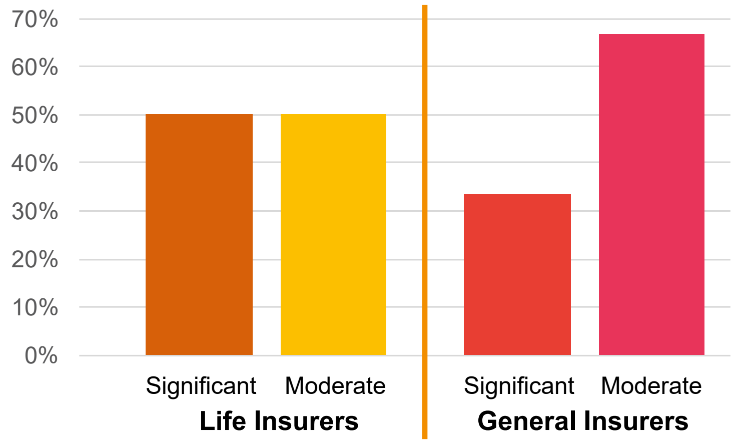
It is important to have effective investment policies which are being reviewed and updated regularly according to regulatory changes.

Various upcoming updates from the OJK, and the expectation of highly fluctuating investment performance, will mean that insurers need to shift their focus to monitoring and assessing the impacts on their portfolio. This requires good information systems and strong data analytics capabilities.

Factors influencing investment decisions in 2019



Exposure to poor investment performance in 2019



5. Government regulations and pricing pressures are seen as the biggest risks

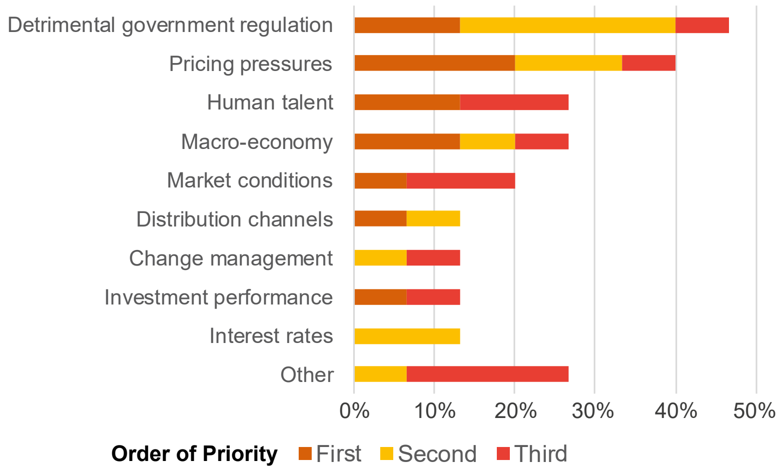
Consistent with our previous survey, regulation is still viewed as the key risk in the industry, with more respondents placing it in their top three risks than any other risk factor. We are expecting to see new regulations to come related to 'Insurtech', the Policyholder Protection Fund and reassessment of primary party. In the longer term, there is likely to also be significant development in the Risk-Based Capital (RBC) framework.

Interestingly, pricing pressure was the risk factor which the largest number of respondents selected as their number one risk. Competition amongst insurers therefore remains a key area of focus.

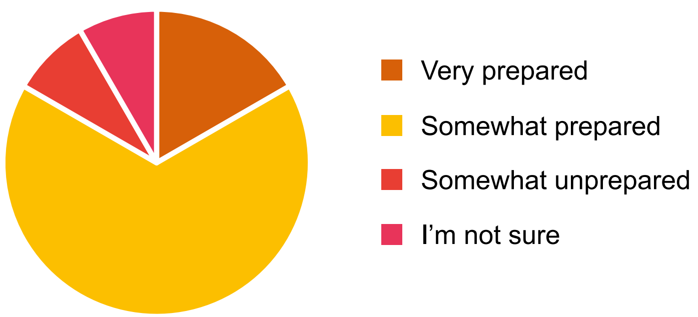
To remain relevant, insurers need to keep being innovative. Globally, we have observed significant disruptions in the industry in the form of digital transformation and usage of big data, resulting in a shift in the type of products to being less traditional with numerous new ways to penetrate the market.

None of the respondents included Cyber Risk as a key risk despite the rise in global exposure and losses. We would expect this to become an area of focus in the near term.

Risks in the insurance industry



Back office functions' preparedness in addressing the concerns?



6. There is a high level of confidence in back-office functions

The majority of our respondents believe that they have sufficient support from their back-office departments to address the concerns and risks above. In the past few years, sizable investments have been made to finance and compliance functions to respond to developing requirements. However, this confidence may be misplaced as we have noted that reliance on manual processes is still causing delays and errors in processing. We are expecting an even bigger disruption in the market as companies will try to be more innovative in the forms of new products offered or the changes in distribution strategy, not to mention the more challenging regulatory requirements.

Failure to have reliable and efficient back-office support and to invest in a stronger process and system could deter the ability to compete and grow.

7. IFRS 17 and OJK regulations are deemed to be favourable for the insurance industry, with tax regulation being seen as unclear

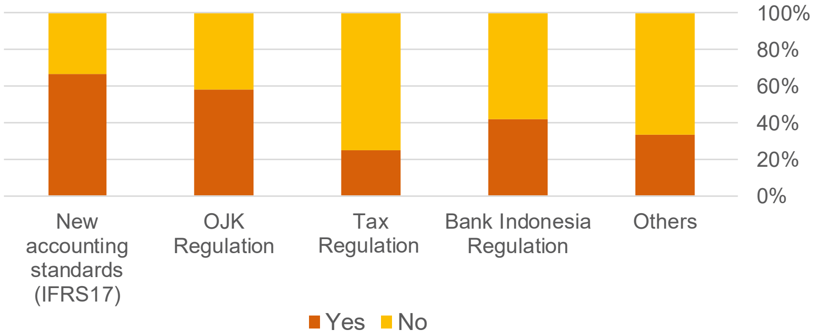
Unsurprisingly, our survey shows that tax regulation is seen as the least favourable regulation in the insurance industry, largely due to its lack of clarity which often leads to confusion in application. For instance, the treatment of reserves for unit link products according to circular letter No. SE-97/PJ/2011 and deductibility of claims expenses has caused a fair amount of confusion. Objections to these disputes can take around six to ten years to finally resolve. Furthermore, tax regulation is often perceived as not properly reflecting actual industry circumstances. We believe that this uncertainty could hinder the insurance industry's attractiveness in Indonesia.

On the other hand, refreshingly, the majority agree that the new accounting standard, IFRS 17, is helpful for the industry as a whole as it will increase comparability and transparency of the financial statements, as well as increase management's attention to risk management; however, there are concerns that the implementation will require significant investment and might disrupt business as usual.

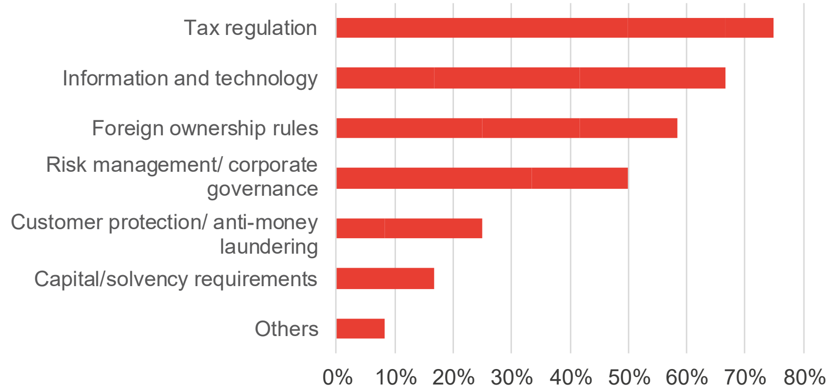
The OJK provides regular updates on regulations. More than half of respondents believe that it would be helpful to have more clarity on how to develop good corporate governance and provide more prudency in running the business. Some respondents commented that the regulation related to minimum investment levels in SBN could limit insurers' ability to manage their portfolios.

General insurers also expressed a desire in the industry for more regulatory guidance on engineering fees charged by brokers to ensure that the market is operating optimally.

Favourability of Indonesia's regulations



Where could regulations benefit from greater clarity



8. More work is required in IFRS17 implementation

Although viewed as favourable, insurers still feel that the implementation of IFRS 17 is going to be a significant challenge, particularly where system upgrades are required. This view is more prevalent for life insurers due to the higher level of complexity of the valuation methodology for life products. The lack of technical capabilities and resources are seen as the biggest difficulties in implementation. Firms are likely to need stronger actuarial functions, increasing demand in a market which is already stretched for actuarial skills.

The other main challenge is the inadequacy of current systems in interfacing actuarial to reporting processes and the lack of ability in capturing the more granular policy data needed.

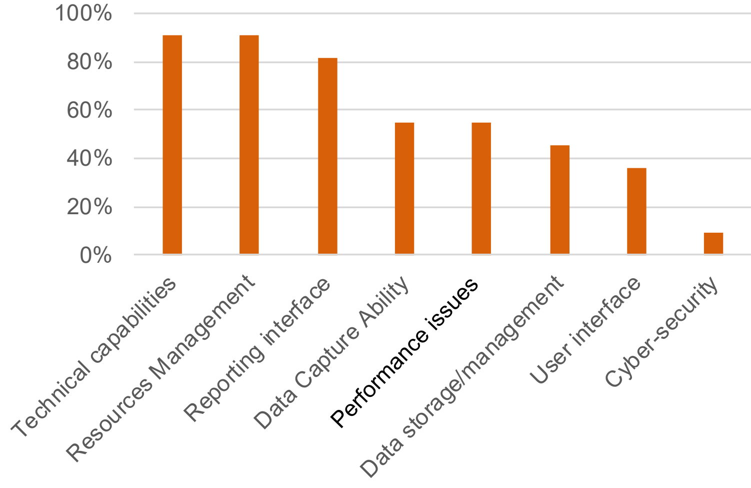
In PwC's experience, this view is reflected globally by insurers as they face the implementation of the new standard. If insurers in Indonesia are not already looking at initial impact assessment, they may be poorly positioned to keep pace with the competition.

Many insurers are considering IFRS17 as an opportunity to re-evaluate the adequacy of their finance function and to re-assess their end-to-end system architecture.

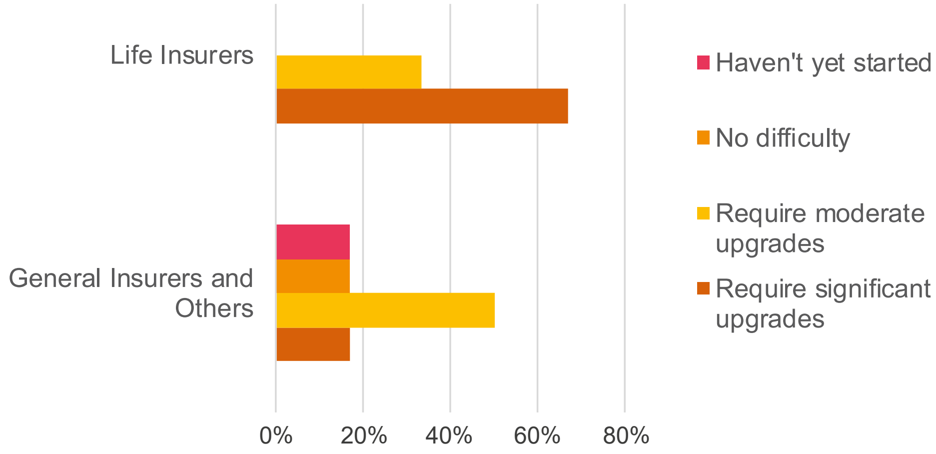
The implementation can be driven by either the actuarial function or finance function by leveraging existing data and systems and buildingpp necessary additional models.

We believe that the most effective approach will be by approaching implementation as a combined team across the finance and actuarial functions.

Challenges in IFRS 17 implementation



System readiness for IFRS 17



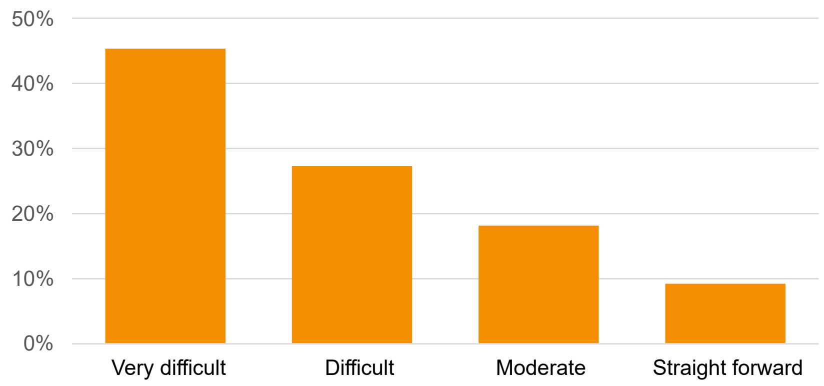
9. Lack of talent is the number one challenge in finance functions

Currently, finance functions are reasonably lean and focussed primarily on reporting. Finance functions also largely lack the tools to make informed decisions on cost and being fit-for-growth. There is a will to develop the finance function into something which is more analytical and can be involved more in supporting business decisions, but the majority of insurers agree that securing and retaining finance talent is the biggest inhibitor to this.

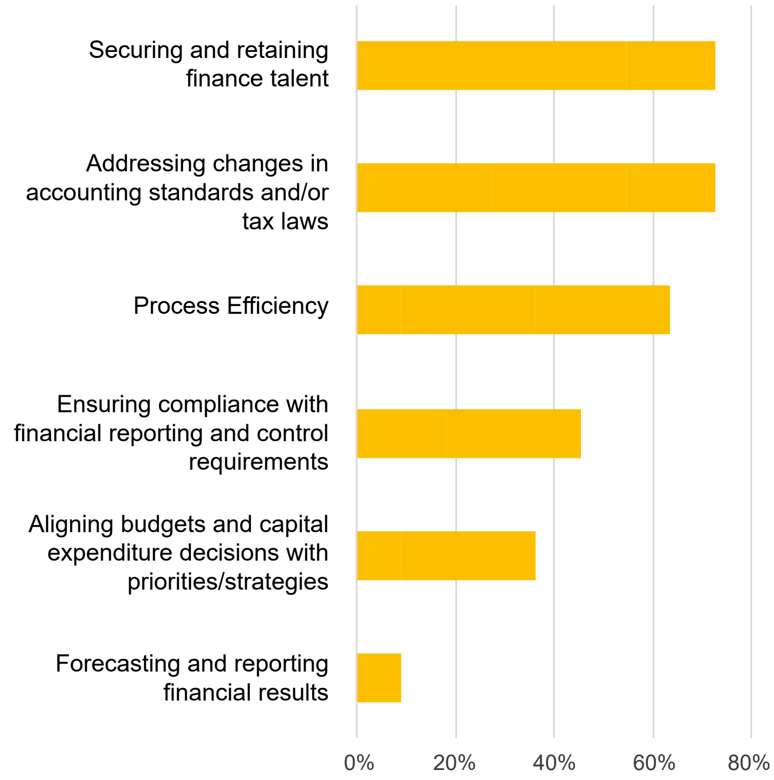
The growing complexity of business processes, as well as the additions of various regulations and IFRS implementation will require insurers to keep improving their finance function to support the business. The war for talent is a significant challenge; attractive remuneration packages and development opportunities will be a key deciding factor in winning this.

Alternatively, areas like RPA offer significant opportunities to reduce cost and improve accuracy, and to address the shortage of talent in the back office. However, such initiatives must be done carefully, with a Center of Excellence concept that considers all of the implications, including HR, regulatory, cost, communication, and labour unions.

Future difficulty in attracting and retaining talent



Challenges in the finance function



10. There is a need to upgrade the current finance system

The current finance systems being used by most insurers are viewed as moderately complex, with some levels of interface between systems.

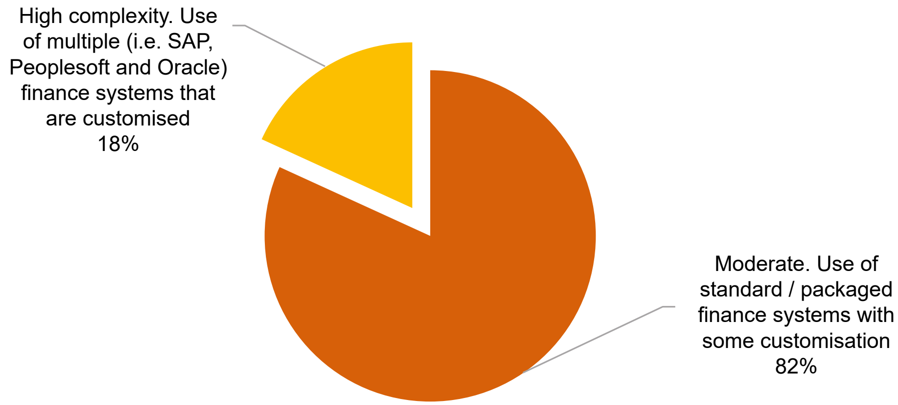
With the growing complexity of reporting requirements to be applied and products being offered, we expect that standard finance systems will be unable to catch up with the process.

Moreover, extensive manual input into the systems, rather than using an automatic interface, will result in a delay in the reporting process, not to mention the risk of inaccurate information due to human error.

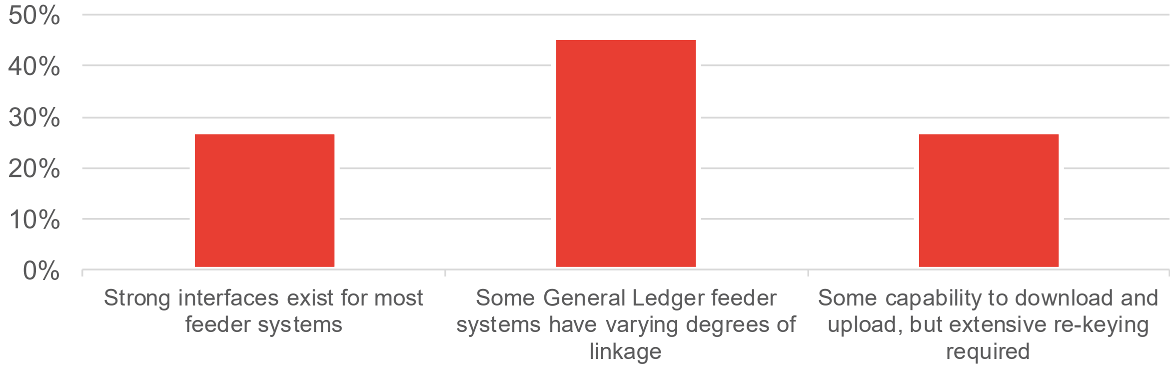
As part of IFRS17, it is expected that the systems need to be highly connected, especially in the actuarial and finance functions, i.e. feeding massive data to each other's systems continuously. There is a need to purchase or build customised systems to enable this process, ensuring a smooth reporting process.

However, management needs to assess carefully the business needs, as having an unnecessarily complex systems might provide no value or even disrupt the process.

Complexity of finance system



Level of interface in finance system



11. System issues and inefficient processes have become the main reasons for the delay in the closing process

In this fast-paced environment, senior management in the finance function has a role to play as a business partner, spending time in thinking strategically and minimising time spent on administrative tasks such as the closing process.

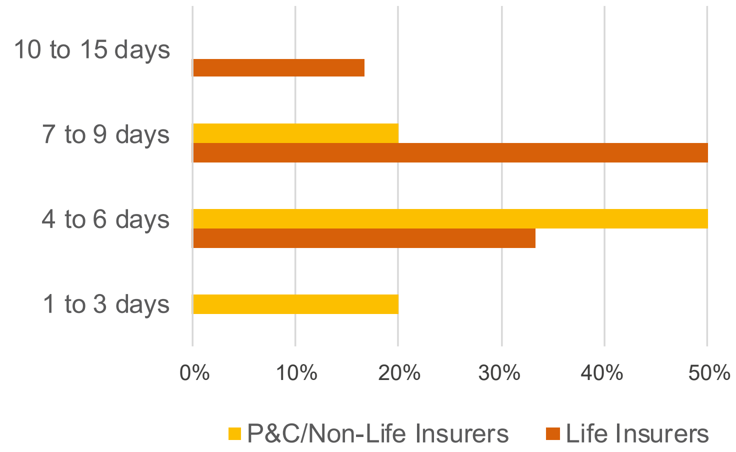
The majority of surveyed insurers experience quite significant delays in the closing process, with some extreme cases where the process can take 10-15 days. The reporting process has been shown to be challenging, mainly due to errors found in the current system, as well as the high involvement of manual processes. This somewhat contradicts the relatively high confidence in the back-office function. Clearly it indicates that the “somewhat prepared” felt by most insurers may reflect overconfidence.

This highlights the needs to invest in a better system and process in order to support future growth. For instance, some firms have started to implement a “Fast Close” methodology in order that the finance function can spend more time focussing on issues and less on the reporting process. Having a reliable system and process, moreover if combined with the latest technology, will enable insurers to give relevant information to management, and and could also help in giving new perspectives by utilising big data and extracting insights that can be used to read the market better.

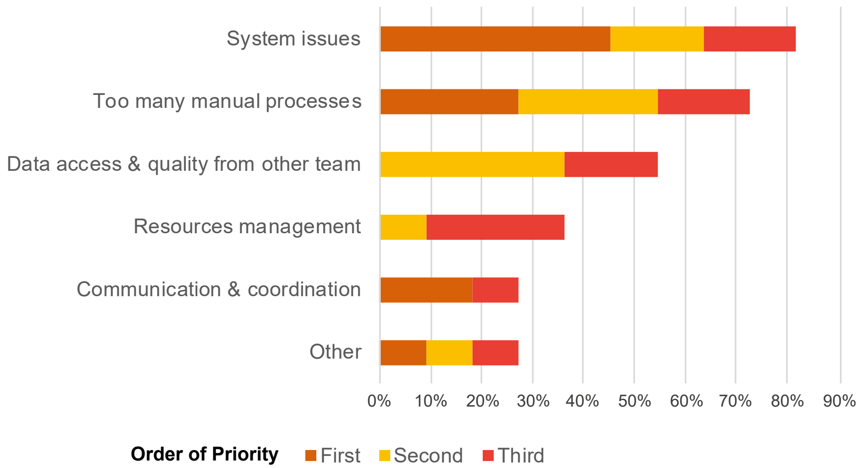
The appearance of InsureTech is also expected to disrupt how traditional insurance business processes are being run, all the way from the way the market is penetrated to the settlement to customer process. The opportunity to use the latest technology to cope with the rise in demands, for example, by using RPA and digital dashboards, will drive efficiency in the process.

It is crucial to review the key priorities, perform a robust gap analysis and lay out detailed plans to address the issues in the finance function and smoothen the process. This could become a competitive advantage for those who act now.

Period of monthly closing



Challenges in closing process



Suggested CFO priorities for 2019 and 2020

Based on the survey, we suggest several priorities that need to be on the agenda of CFOs :

- Exploring the possibility of using the latest technology, for instance RPA or digital dashboards, in order to improve efficiency and controls.
- Being aware of market developments and needs to ensure that products offered can meet the demands of the growing population via the most effective distribution channels.
- Sufficient investments in the systems and finance functions are key in addressing the growing complexity of regulations and new products.
- Carrying out regular reviews of the investment and asset liability management policies to ensure their relevance to the strategy.
- Formulating clear human resource strategies and attractive remuneration packages are key in securing and retaining qualified finance and actuarial talent as well as innovative individuals who can help realise growth and profit-making opportunities.
- The growing amount of personal information being kept and used in running the business will require investment in improving cyber security.
- Efficient structuring and pricing of new products will help insurers to remain competitive and improve profitability.

PwC Indonesia's Insurance, Risk and Actuarial Practice

PwC is the leading professional services firm serving the insurance industry in Indonesia.

Our Insurance, Risk and Actuarial Practice is made up of 15 highly skilled and experienced professionals including accountants, actuaries and data analysts alongside regulation and operating model specialists.

We also work closely with other PwC functions to provide specialist solutions to insurance clients across a number of different disciplines. Our services are broken down into four key areas aligned to where our clients sit on their growth journey in the Indonesian market:

- Governance, Risk & Compliance
- Growing the business
- Building resilience
- Actuarial services

Our Asia-wide insurance practice

In Asia, our presence in the insurance market has been rapidly expanding as the industry has grown. We understand the particular challenges faced across Asian economies with respect to distribution, business practices and regulation.

Our Indonesian insurance team all have international experience and work with a number of global clients. This means that we can bring the best of our global business to you. We also have specific specialists in various areas of the insurance business in South East Asia, including Claims, Agency distribution, Underwriting and Settlement processes.

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