LOCATION STUDY FOR THE SWISS INSURANCE INDUSTRY

Executive summary

A study commissioned by the
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Thanks
To a great extent, this study is based on a publication by the Business and Economic Development Division of the Office for Economy and Labour of the Canton of Zurich and the Zurich Office for Urban Development („Finanzplatz Zürich 2012/13 – Monitoring, Prognosen, Standortanalyse Versicherungen" - no English version so far) . We would like to thank these institutions for their gracious permission to use and quote this valuable study.

Executive summary

Since the onset of the financial crisis in 2008, the financial sector has been in the focus of public interest and widely covered in the media. At first glance, the situation of insurance companies would appear to be similar to that of banks: Switzerland is among the most important insurance markets worldwide and is home to two of the world's largest insurance companies, both of which have the potential to be classified as "too big too fail". And yet, media reports focus largely on the banking and investment fund industries. A second, closer look at the situation explains this apparent discrepancy.

On behalf of the Swiss Insurance Association (SIA), BAKBASEL investigated how Switzerland has positioned itself as an insurance hub and how it will develop in future. In this study we present detailed quantitative figures on the structure, significance and performance of the industry, provide an outlook on potential future developments, and evaluate the industry-specific features of the location. The industry-specific challenges, opportunities and risks are then derived from these results.

Economic importance of the Swiss insurance industry

Some 210 private insurers are active in Switzerland. In 2011, these companies posted premium income of CHF 166 billion worldwide and CHF 56 billion in Swiss direct business. That makes Switzerland one of the biggest insurance markets globally. In no other country is more spent per person on insuring domestic risks.

With gross value added of just under CHF 20 billion, a share of around 4 percent in the economy as a whole and some 60,000 employees, the insurance industry is a key pillar of the Swiss economy. The insurance industry is of considerable importance within the financial sector as well, playing a decisive role in enhancing diversification and exerting a stabilising influence on Switzerland as a financial centre.

Depending on how it is defined and where you draw the lines, the insurance industry exerts even greater influence than the above-mentioned figures for gross value added would suggest. For statistical reasons, risk transfer is not recorded, while insurance benefits – the payments made for claims – are not assigned to the insurance industry, but to the those industries that rectify the damage.

In addition to their function as providers of services and as employers of large numbers of people, the insurance companies indirectly have positive effects through their business activities – for example on IT service providers and other supplier industries (such as auditors / auditing companies and brokers) or on local trade and commerce (through the consumer spending of insurance industry employees).

What is more, the insurance industry performs an array of important economic functions. In addition to key functions such as risk transformation and capital accumulation, these include what is known as the "pioneering effect". This refers to the unlocking of entrepreneurial potential through the ability to insure risks and the attendant increase in society's overall level of risk tolerance.

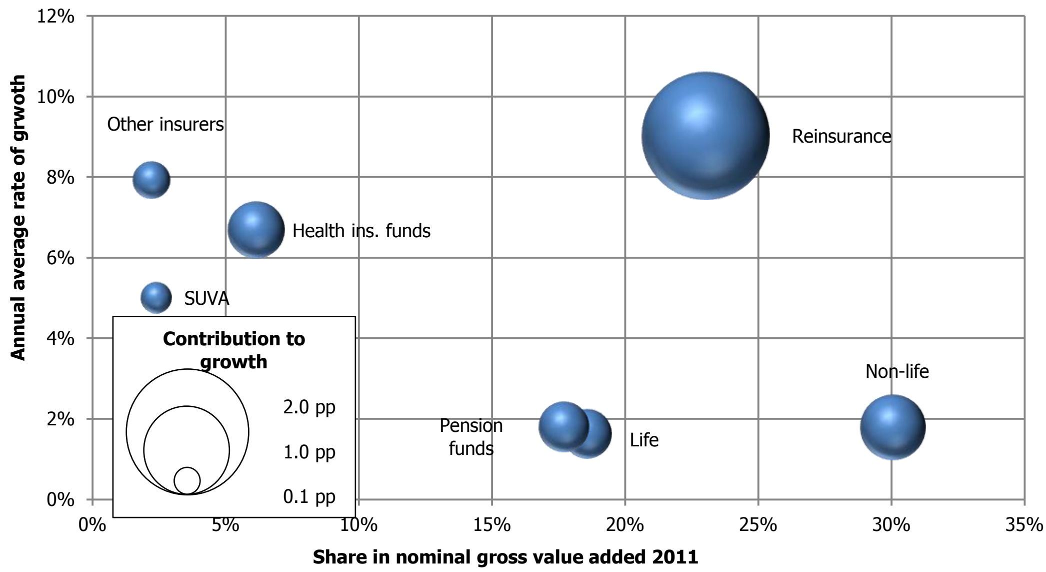
Structural transformation

The recent history of the Swiss insurance industry has been marked by several turning points, which have altered its fate in the long term. The period of change began in the 1990s with the break-up of insurance cartels and the rapid progress made in information and communication technology.

The transformed market environment led to consolidation, productivity gains and the outsourcing of individual steps in the production chain to external providers – a process that has often been described as the "industrialisation" of the industry.

Gung-ho trends became evident in the insurance industry with the rise in importance of non-technical (finance and investment) business – at the expense of the real business of technical underwriting – under the sway of booming stock exchanges and the bancassurance strategy in the 1990s. This trend experienced a massive correction through the first financial crisis of the new millennium, and the industry was compelled to make additional efficiency and productivity gains. The return to its core business helped the insurance industry to steer a much more stable course during the most recent financial crisis (starting 2008) than banks and other providers of financial services.

Fig. 0-1 Contributions to growth by classes of insurance, 1995–2011



Percentage share in nominal gross value added by the insurance industry 2011; average real gross value added 1995–2011; contribution of classes of insurance to growth in gross value added by the insurance industry, in percentage points (pp)
Source: BAKBASEL

Performance

The structural transformation described above heralded a golden decade for the insurance industry, featuring substantial productivity gains and growth in gross value added, even when compared with other markets worldwide.

On the other hand, the structural transformation resulted in a drop in the insurance workforce. Many jobs were outsourced to other sectors, such as to insurance support services and the IT industry. The insurance industry thus already has a considerable share of its structural transformation and efficiency gains behind it, whereas this process is only just beginning for the banks.

The story of the reinsurance industry, which has a cluster of international significance in Zurich, has been a slightly different one. Quite apart from historical reasons, the formation of the cluster of reinsurance companies in Zurich was essentially due to the excellent conditions prevailing at the location. The boom of the 1990s was decisive in attracting numerous reinsurance companies to Zurich.

Outlook

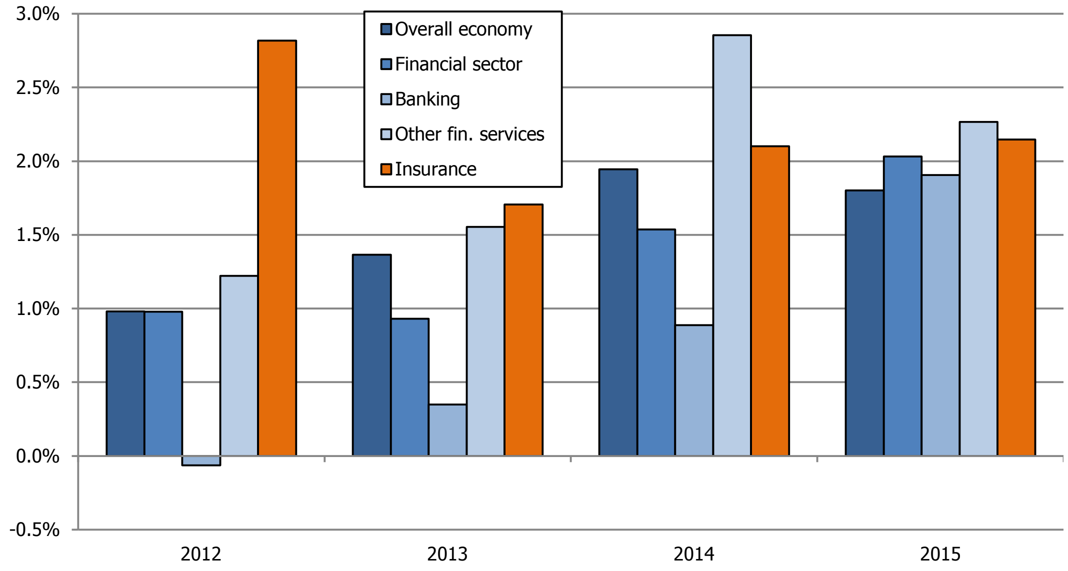
The insurance industry delivered excellent performance in 2012 despite record-low interest rates and rather sluggish overall economic growth. BAKBASEL is optimistic that, going forward, the insurance industry will continue to reap the benefits of improved cost efficiency and gradually rising premium rates.

What is more, as the economy begins to pick up it will buoy the insurance industry as well through rising demand and positive potential in the financial markets. The insurance industry is leading the way for the financial sector, and establishing itself as one of the fastest-growing industries in Switzerland.

In the long term, the main drivers of growth in the insurance industry will be the positive trend in population growth and the rising incomes of private individuals as a result of overall economic growth.

In addition, the reinsurance industry is expected to gain in importance in Switzerland as it is the sector that stands to profit most from the rapid growth in emerging markets.

Fig. 0-2 Growth in gross value added by the insurance industry compared with other industries, 2012–2015



Growth in real gross value added, in %, 2012–2015
Source: BAKBASEL

The attraction of Switzerland for the insurance industry

The challenges facing the Swiss insurance industry are closely linked to the prevailing location factors. Switzerland is a highly attractive location for insurance companies.

With its concentrated competition-relevant know-how and the availability of specialised upstream services, the Zurich financial cluster in particular can boast significant location advantages that are hard to copy.

Further, the reliability of the overall regulatory environment and the economic and political stability of Switzerland guarantee companies excellent parameters for their business activities as well as certainty for their long-term planning. Switzerland's outstanding accessibility and infrastructure also contribute towards its high level of attractiveness as a business location.

The current situation in respect of insurance regulation, however, is less gratifying. The continual legislative revisions provoke uncertainty, and the differences between Swiss insurance regulations and those prevailing abroad could potentially jeopardise the competitiveness of local companies.

Challenges

The challenges the insurance industry faces are exceptionally varied and depend to a large extent on company-specific characteristics, such as business areas, geographical focus and company size.

Reinsurance companies: Growth in emerging markets and the consequent expansion in demand is opening up substantial opportunities. In addition to the challenges it poses in terms of adapting or renewing risk models, climate change will stoke demand for insurance cover for peak risks.

Life insurance companies: The specific challenges encountered by life insurance companies include the current environment of low interest rates and, more importantly, demographic change. The focus here is on finding ways to finance the pensions of people as life expectancy increases and on exploiting the opportunities for new or expanded fields of enterprise.

Non-life insurance companies: The central challenge for non-life insurers is the fierce competition prevailing as a result of the largely saturated local market. The main opportunities in this class of business are presented by product innovation and ongoing immigration to Switzerland.

Regulatory environment: Regulatory issues are one of the key challenges facing the insurance industry. Switzerland is one of the first countries to have introduced a flexible, risk-oriented regulatory instrument – the Swiss solvency test (SST) – one that can serve as a model for other countries with their predominantly rule-based systems. While this pioneering role offers the insurance industry the chance to gain a first-mover advantage, the fact that the SST tends to be stricter than other regimes does not exactly make for a level playing field between Swiss companies and their foreign competitors. In conjunction with investment regulations, the SST heightens the danger of systemic risks in the insurance industry as all insurance companies pursue similar investment strategies in an effort to achieve compliance. What is more, the industry is concerned about developments in the area of consumer protection. However, as the Financial Services Act (FIDLEG) and the revisions of other rules and regulations are still in an early phase, we can only speculate on their potential impact on the industry.

The battle for talent: The globalized economy and ever fiercer competition heighten the need for highly qualified specialists. Thanks to its excellent system of education and training and its unparalleled quality of life, Switzerland is still in a position to meet its needs in this respect. But we need to stay on the ball, maintain the attractiveness of the country for private individuals, and meet the demand for highly qualified workers by investing more in specific (further) training of local personnel. The falling number of insurance industry trainees in recent years is a trend that must be reversed. If immigration policy becomes more restrictive, the importance of insurance-specific training in Switzerland will only increase.

Ongoing spread of technology: Rapid technological progress poses a major challenge and is bringing about radical change in the Swiss insurance industry. The technical options available also provide customers with new information tools and, in turn, with the ability to organise their interests more easily. Both these trends are producing a shift in power toward the customer, and thus toward more intense competition. Fiercer competition (through market liberalisation) was one of the reasons for the rise of insurance companies in the 1990s and will continue to provide impulses for future growth and productivity gains.

Summary

Switzerland is among the 20 largest insurance markets in the world. In no other country is such a large amount spent on insurance for domestic risks as in Switzerland. With gross value added of just under CHF 20 billion, the equivalent of around 4 percent of the national total, the insurance industry is a key pillar of the Swiss economy. It is also of considerable importance within the financial sector, playing a decisive role in enhancing diversification.

Several turning points that brought about major structural change are discernible in the recent history of the Swiss insurance industry. The breaking up of insurance cartels, the spread of technology, the reworking of business models after the failure of the bancassurance strategy and the formation of a reinsurance cluster in Zurich are all signs of this structural transformation. On the whole, the insurance industry has successfully survived this structural transformation – success that finds expression in notable efficiency and productivity gains.

In terms of growth, insurance was among the leading industries in the Swiss economy last year. As the economy begins to pick up again as from mid-2013, demand for insurance services will grow, as will potential for financial investments. BAKBASEL expects the insurance industry to continue posting above-average rates of growth. If conditions remain attractive in Switzerland, we also expect the reinsurance cluster in Zurich to continue gaining in strength.

Switzerland's attractiveness as a business hub is one of the key prerequisites for many of the positive effects and future opportunities of the insurance industry. The fact that numerous leading companies in the insurance and finance industries choose to set up shop in Switzerland is one indication of that attractiveness. Key elements in the country's popularity as a business location are the reliability of its general regulatory environment, its political and economic stability, top-flight infrastructure and accessibility as well as competitive taxation system and sound public finances.

The availability of qualified workers is another key factor for companies when choosing a business location. Thanks to its excellent system of education and training and its unparalleled quality of life, Switzerland is still in a position to meet this need. However, as a growing scarcity of insurance specialists is becoming apparent worldwide, the county must ramp up its efforts in this area. In addition to keeping the location attractive for private individuals, more targeted (further) training of local personnel is another means of countering this trend.

The industry is monitoring trends in insurance-specific regulation with concern. Depending on the ultimate design of Solvency II – the European counterpart to the Swiss solvency test (SST) – it is conceivable that Switzerland may be placed at a big disadvantage compared with other locations. Major opportunities are offered by the ongoing spread of technology throughout the industry, by climate change and by the tapping of new markets. Over and above emerging markets (for reinsurers), new opportunities could arise for the industry from a treaty on freedom of services with the EU. However, market deregulation of this kind not only offers opportunities, but – at least in the short term – also poses risks in the shape of a trend towards consolidation.