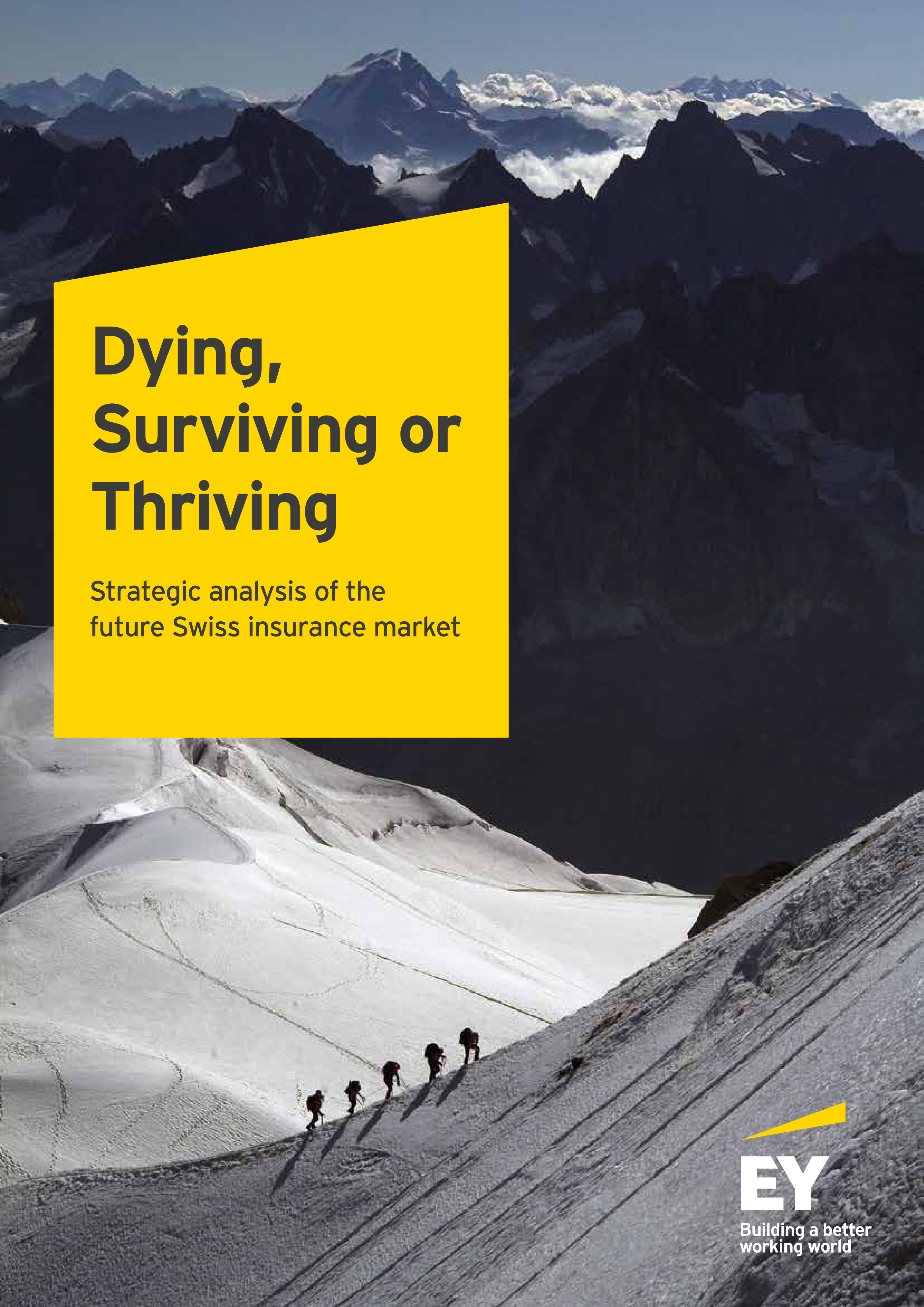


Dying, Surviving or Thriving

Strategic analysis of the future Swiss insurance market

EY
Building a better working world

Content

Editorial		**3**
1	**Executive summary**	**4**
2	**Study design**	**6**
3	**Illusion and painful reality**	**8**
3.1	Illusion – unrealistic growth targets	9
3.2	Painful reality limited growth opportunities	10
3.3	Partial conclusion: At least 30 percent of insurers at risk	15
4	**A threat to business models**	**16**
4.1	New technologies	17
4.2	InsurTechs	20
4.3	Competition from outside the industry	22
4.4	Lower entry barriers	23
4.5	Partial conclusion: far-reaching disruption	23
5	**New opportunities**	**24**
5.1	New insurance segments	25
5.2	New services	25
5.3	Partial conclusion: Focus	25
6	**Scenarios**	**26**
6.1	Scenario 1: consolidation	30
6.2	Scenario 2: partial disruption	32
6.3	Scenario 3: complete disruption	34
7	**Conclusions**	**37**
8	**Authors**	**38**
9	**References**	**39**

Editorial

The Swiss insurance market has grown steadily over the last several years and decades, with cash flow and returns developing favorably. The sector managed to ride out the financial crisis without major setbacks. That would explain the unwavering optimism. This very same confidence can be seen in the current growth forecasts of insurers, which by far exceed expected market trends.

But this stands in sharp contrast with reality: The market environment is deteriorating, just as new competitors prepare to make their entry. The sector faces turbulent times. Specifically, we expect 45 percent of Swiss insurers to be squeezed out of the market by 2030 in the most likely scenario.

In view of the disconnect between ambition and reality, we set out to conduct an in-depth analysis of the insurance market, and identify looming threats along with opportunities. In contrast to prior years, when we directly surveyed market participants, this year, we brought together our sector experts in a joint effort to analyze extensive domestic and international data and distill the key trends. This allowed us to capture the market dynamics and establish a basis from which we can challenge our clients' strategies.

Life and non-life insurers are confronted with other problems than health insurers. Nevertheless, we decided not to differentiate by segment in this study. Instead, we focused on the changes and threats that all insurers have to tackle. That provides us a basis from which we can systematically address specific challenges in individual areas in a next step, i.e., in forthcoming publications.

With this study, we would like to encourage insurers to challenge their strategies. We indicate risks and clarify why success hinges on focused action based on sound concepts. Dying, surviving or thriving: Companies have the choice. For more analyses, visit www.ey.com/ch/insurancereports.

We hope you enjoy reading our take on the subject and look forward to discussing it with you.

Achim Bauer
Insurance Sector Leader Switzerland

Yamin Gröninger
Insurance Sector Director Switzerland

1 Executive Summary

The Swiss market is stagnating, individual segments are already shrinking. Undeterred, however, most major insurers have their sights fixed on growth, as the latest annual reports show. But the mobile phone industry provides an example of what a stagnating industry can expect: painful consolidation combined with the entry of new attackers. In the most likely scenario, 45 percent of Swiss insurers will be squeezed out of the market by 2030. If the disruptive trends continue and accelerate, as many as 70 percent of today's insurers will be pushed out of the market.

Dying, surviving or thriving
Companies have three strategic options:

1) They can sit back, wait – and die.
2) They can evolve their business models, seek out alliances – and survive.
3) They can revolutionize their business models, prevail over disruptive companies – and thrive.

The painful reality
Insurers are struggling for market share in an increasingly challenging environment.

- **Unfavorable macroeconomic outlook:** Switzerland's gross domestic product is stagnating and household wealth is in decline, stifling demand for insurance products.
- **Stricter political and regulatory environment:** An array of interventions is pushing up costs and weakening the position of the Swiss financial services market, negatively impacting insurable assets.
- **Demographic change:** The increase in Switzerland's resident population, an important growth driver thus far, is tapering off; rigorous implementation of the mass immigration initiative ("Masseneinwanderungsinitiative") could reinforce this trend. Attempts to simultaneously serve multiple customer segments (digital natives, baby boomers and retirees) are driving up costs.
- **Environmental awareness:** A growing awareness of environmental issues is likewise changing the insurance business. Increased use of car sharing programs lowers demand for car insurance. Climate change augments the risk of natural disasters, deteriorating insurers' loss ratio.
- **Market saturation and overinsurance:** Luxembourg is the only country in the world with higher per capita spending on insurance than Switzerland. Consumers are trying to optimize their insurance products, lowering the volume of premiums. Increasing price transparency only serves to intensify this process.

New attackers are entering the market

Companies and consumers are exchanging roles: In the past, the business-to-consumer model allowed companies to offer products that suited them. In today's prevalent consumer-to-business model, it is the companies that serve customer needs best and fastest that are gaining the upper hand. That creates opportunities for new players:

- **InsurTechs:** Numerous disruptive providers are challenging the traditional business model and breaking up the value chain. Three elements are being redefined: customer experience, process innovation and new business models. However, the focus of InsurTechs also limits their impact on the insurance market structure. Strategies based around forging alliances with start-ups look promising.
- **Industry outsiders:** In almost every business segment there is at least one provider who knows customers better than the insurers do. Big corporations are entering the insurance market: Volkswagen and Alibaba have already launched relevant products. One of the biggest risks for insurers is the prospect of major players like Google collaborating with start-ups to build up entirely new companies and business models.

Now is the time to act

Swiss insurers need to take action now. They need to scale up and increase efficiency to push others out of the market. Or they can break with the past and fight the disruptive attackers. Both strategies require a sharpened focus on core strengths. The former strategy entails companies undergoing a steady evolution, while the latter requires a business model revolution.

Innovation is the core element in this context. However, insurers cannot harness the potential of digitization alone. Instead, they need to forge alliances with new providers. Ultimately, the industry is called upon to make Switzerland a center of innovation for the insurance business and attract new insurance start-ups.

2 Study design

Our study is based on extensive hypothesis-driven research conducted by EY analysts and industry experts. Volumes of data, from macroeconomic and demographic data to the annual reports and investor presentations of insurance companies, were analyzed, and complemented with our own models, knowledge and insights obtained from numerous domestic and international engagements on behalf of insurance companies.

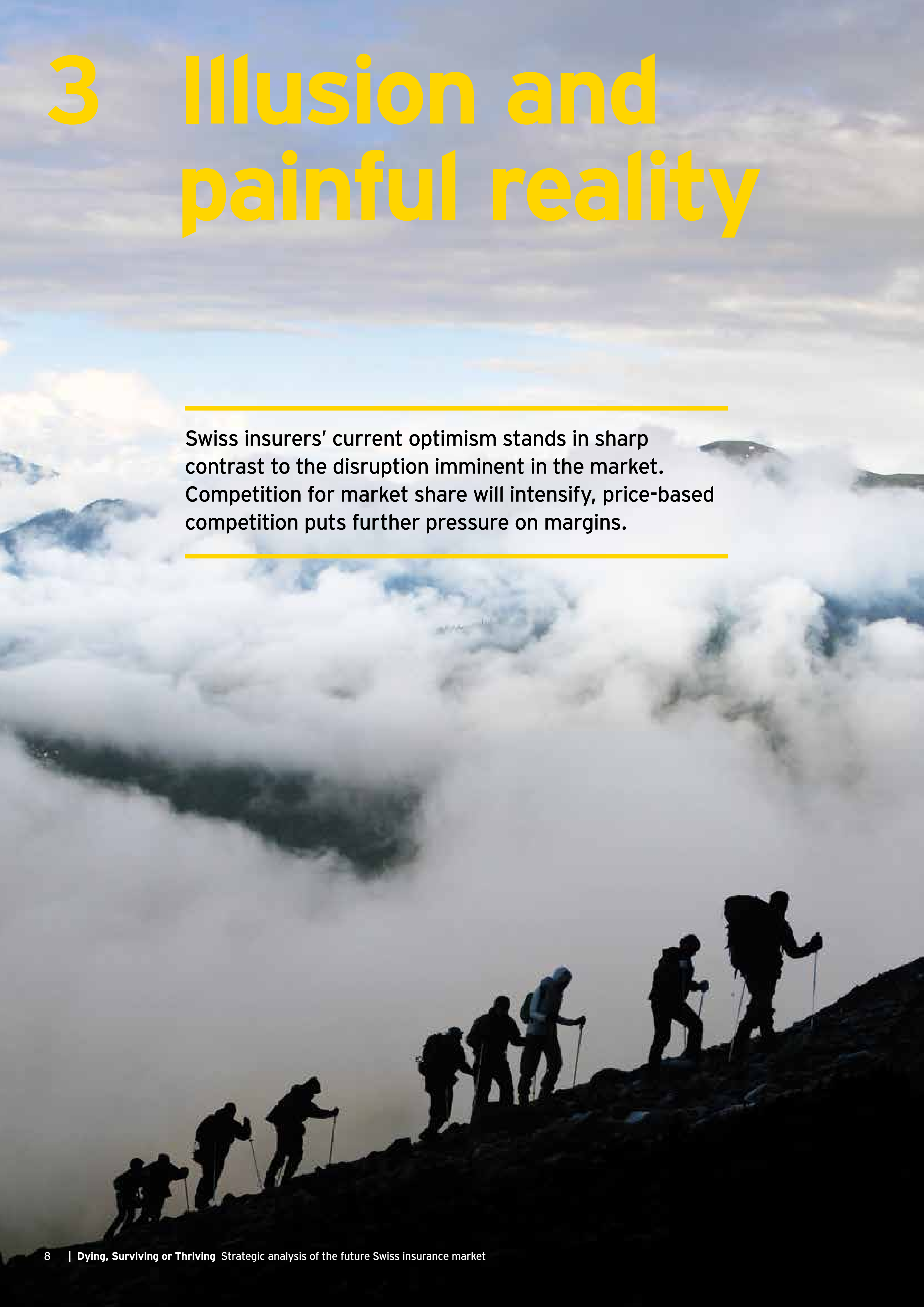
The study thus consciously takes a different approach compared with the last two editions: Rather than surveying the subjective opinions of market participants, here, we have endeavored to unearth developments and implications as objectively as possible. This allows the study to go a step further, providing a critical view of insurers' current position.

The study covers the segments life, non-life and health insurance; reinsurers are not included in the scope. We do not provide segment-by-segment analyses. Instead, the research focuses on those changes and threats that all insurers have to face. We intend to provide segment-specific analyses and to detail the options available to insurers in a future series of studies.

In chapter 3, we contrast the optimistic estimates of market participants against the industry's suboptimal reality and limited growth opportunities. In chapter 4, we indicate how new technologies and new providers challenge the market position of Swiss insurers. Chapter 5 outlines opportunities emerging in the current environment, while chapter 6 provides examples in order to sketch out scenarios and potential strategies with which companies can overcome present threats. Our conclusions in chapter 7 underscore why insurers need to act now!

3 Illusion and painful reality

Swiss insurers' current optimism stands in sharp contrast to the disruption imminent in the market. Competition for market share will intensify, price-based competition puts further pressure on margins.

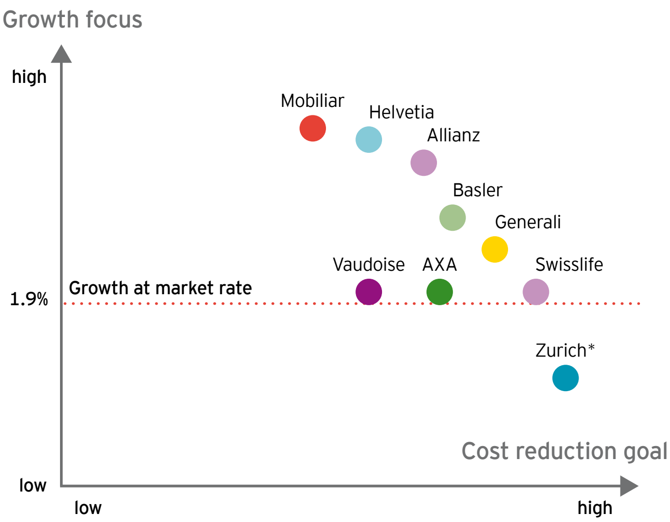


3.1 Illusion – unrealistic growth targets

Optimism still reigns in the Swiss insurance market. According to current forecasts by BAK Basel , premiums are expected to grow 1.9 percent annually by 2025. That is significantly above the growth rates seen in prior years (2004–2014), when gross premiums edged up 0.55 percent annually adjusted for inflation.

The major Swiss insurers are even more ambitious: An EY analysis of annual reports shows that five of the largest nine firms have ambitions to outpace the market and grow by 5 percent annually on average. They likewise have enthusiastic targets for profits and cash flow that cannot be reached with cost savings alone. These nine insurers make up 85 percent of the non-life and 96 percent of the life segments.

Growth and cost targets of Swiss insurers



*Restructuring plan

Source: BAK Basel[1], annual reports and investor presentations, AXA, Zurich and Generali based on global forecasts

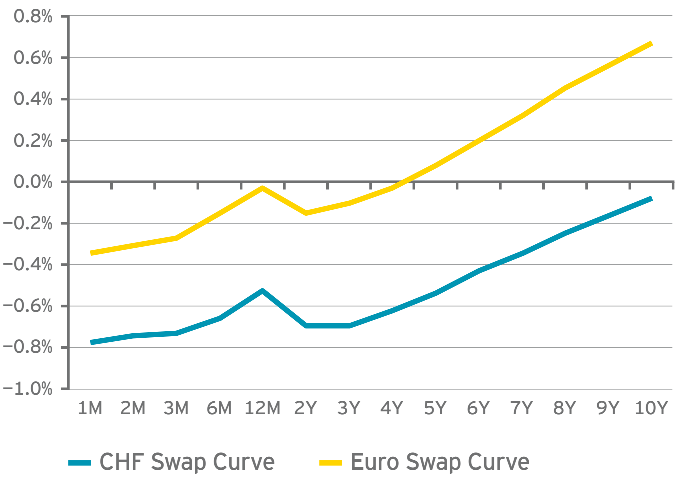
3.2 Painful reality – limited growth opportunities

The Swiss insurance market is growing too slowly to accommodate the targets set by companies. At the same time, insurers face the challenge of tapping new business segments and good risks. In the following, we discuss the factors that hinder the market's development.

Low interest rates and macroeconomic environment

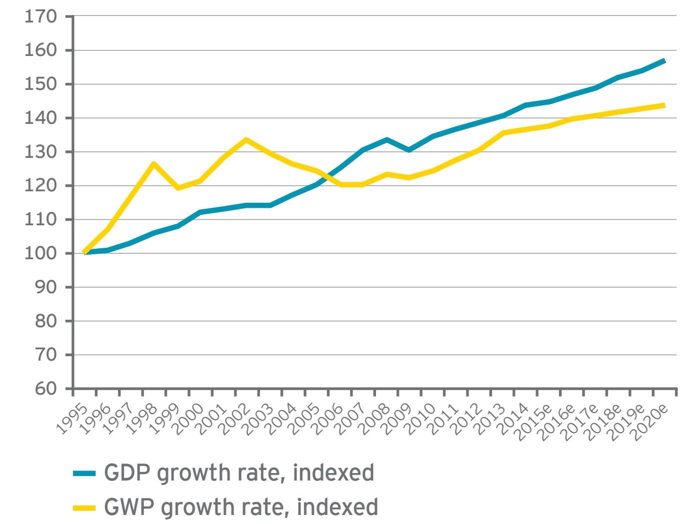
The unremittingly low interest rates pose a serious threat to life insurers in particular. Some portfolios are still profitable thanks to earlier investments. But when the time comes to renew fixed-income investments, the lower returns will put the screws on earnings. Negative interest rates will persist: Swiss franc swaps have negative rates for terms up to ten years, euro swaps up to four years. That makes it increasingly difficult to reach the returns guaranteed to customers.

Swiss franc and euro swap rates
(percent)



Source: Yourmoney.ch[2]

Correlation between economic growth and development of premiums

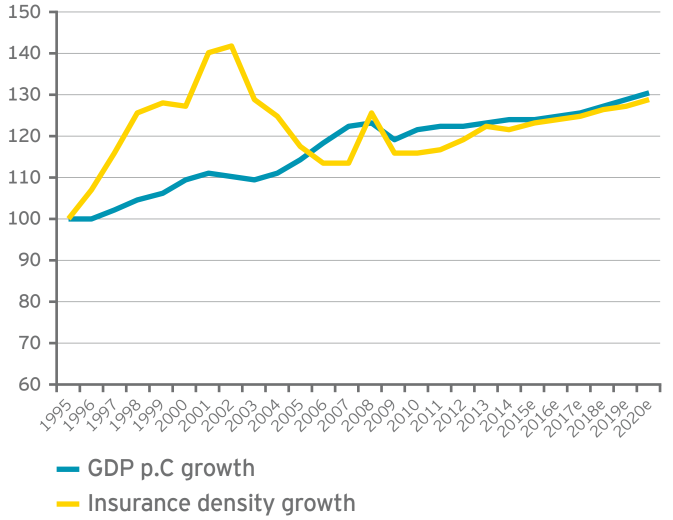


Source: IMF[3] *, BFS*[4] *, BAK and EY analyses*

The macroeconomic environment remains challenging. The strong franc hinders a swift recovery of economic growth; between 2008 and 2014, per capita gross domestic product edged up a meager 0.17 percent. This is of relevance for insurers, given the correlation between premiums and economic growth.

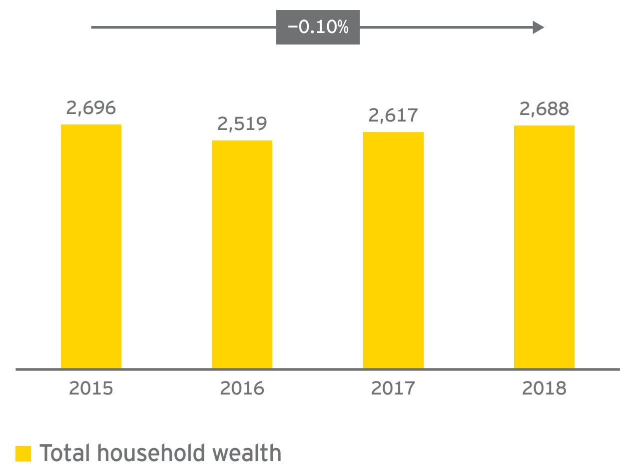
At the same time, household wealth in Switzerland is slightly in decline. An EY projection estimates that financial and nonfinancial assets will drop 0.1 percent respectively by 2018. The consequence is stagnating demand for life and non-life insurance products.

Correlation between economic growth and insurance density growth



Source: IMF[3] , BFS[4] , BAK and EY analyses

Development of Swiss household assets
(USD billion)



Source: EY Wealth and Asset Sizing Model 2015

Stricter political and regulatory environment
Government and regulatory intervention infringe on Swiss insurers' parameters. On the one hand, intervention like the mass immigration initiative ("Masseneinwanderungsinitiative"), or the Retirement System 2020 reform ("Altersvorsorge 2020") stalls the market's development and could dry up revenue streams. On the other hand, regulation such as Solvency II, Swiss Solvency Test and the Common Reporting Standard drive up costs, frustrating efforts by companies to reduce their costs. Moreover, once it is finished with banks, the US Department of Justice might increasingly train its sights on insurers as it checks compliance with the Foreign Account Tax Compliance Act (FATCA). The penalties imposed on Swiss banks in the region of three- to four-digit millions, shows that it's not just reputation that's at stake, but also hefty financial damages.

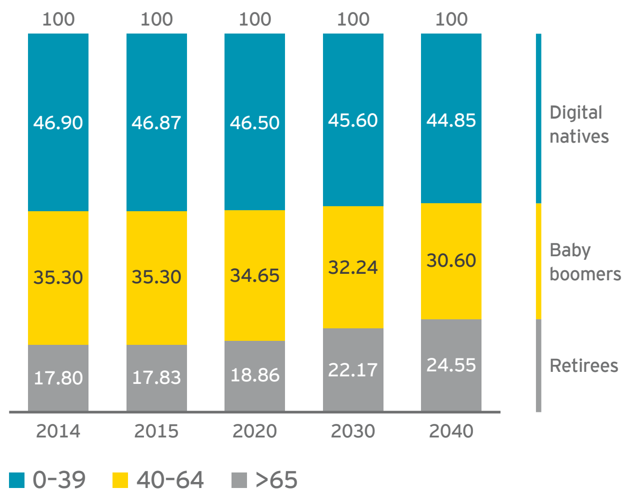
Combined, these developments erode the earnings and profit prospects of Swiss insurers.

Demographic change
In recent years, insurers have seen a reliable source of growth in the increase in Switzerland's resident population, which was mainly driven by immigration. But the trend is losing momentum. After revising its forecast downward, the OECD now anticipates an increase of 0.61 percent over the next five years, compared with its original projection of 0.76 percent. Population growth could slow further if immigration is effectively restrained by implementation of the mass immigration initiative, along with additional government intervention. In such a scenario, insurers will see demand contract further.

Demographic change poses another challenge for insurers. Customer segments roughly split into digital natives, baby boomers and retirees – are shifting. As a result, the cost of sales and distribution is increasing.

While retirees continue to seek one-to-one contact when buying policies, baby boomers have more exacting expectations: They get their information online, but buy their policies from customer

Development of resident population by age group
(percent)



Source: BFS[6]

advisors – in contrast to digital natives, who exclusively opt for electronic channels and want speed and convenience. Companies have to serve these different channels simultaneously. Building up know-how and infrastructure for the various customer groups entails substantial added costs and intensifies pressure on margins.

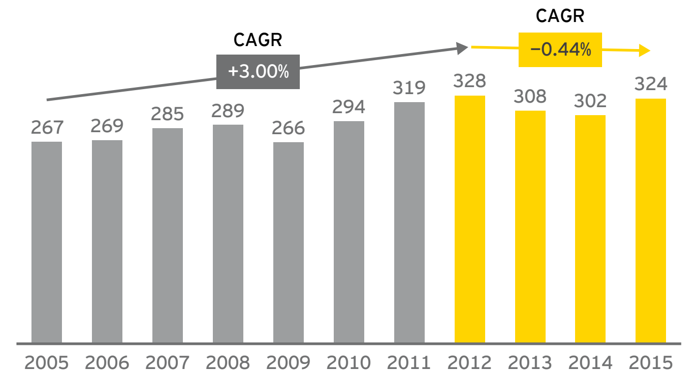
Increasing life expectancy is driving demographic change. This creates additional demand for individual products, such as car insurance, as people continue to drive later in life. But it also increases costs in health insurance and, through rising technical provisions, in life insurance too.

Environmental awareness
The insurance business is increasingly impacted by a growing environmental awareness and the ramifications of climate change. The number of motor vehicle registrations in Switzerland is indicative of this development: After steady growth of 3 percent in prior years, the market has shrunk since 2012. The emergence of the sharing economy has not only weakened the dominance of the car, but of other expendable consumer goods as well.

Add to this the repercussions of climate change for insurers in the form of a greater threat of natural disasters. With climate change comes an increase in the frequency and severity of insured events, deteriorating the loss ratio of insurers.

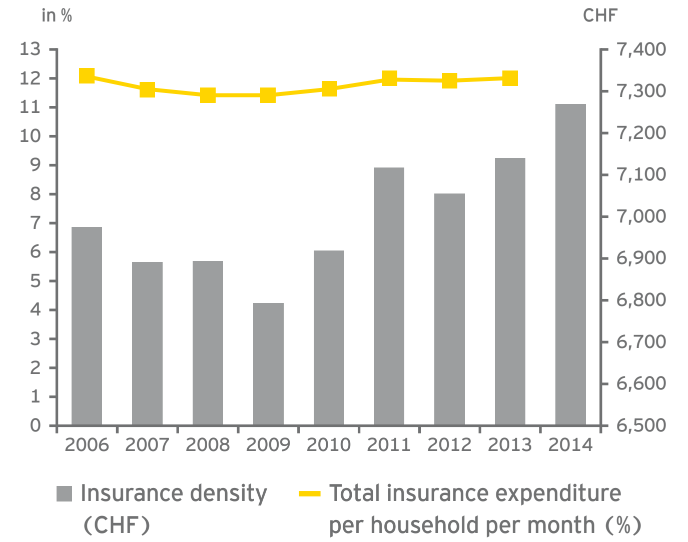
Overinsurance and market saturation
In 2014, per capita spending on insurance in Switzerland came to CHF 7,267, or approximately 12 percent of income. Only Luxembourg has higher per capita spending. One thing is clear from the figures: The Swiss insurance market is saturated, many consumers are overinsured. Most of the money spent goes to mandatory insurance like health or car insurance. This spending decreases in tough economic times as consumers optimize their insurance products, as was evident between 2006 and 2009, for instance. Insurance brokers like Knip benefit from the growing price sensitivity; premiums are already in decline as a result.

New motor vehicle registrations in Switzerland (1,000 vehicles)



Source: Statista[6]

Swiss insurance density (in CHF)**, average household spending for insurance in Switzerland** (in %)



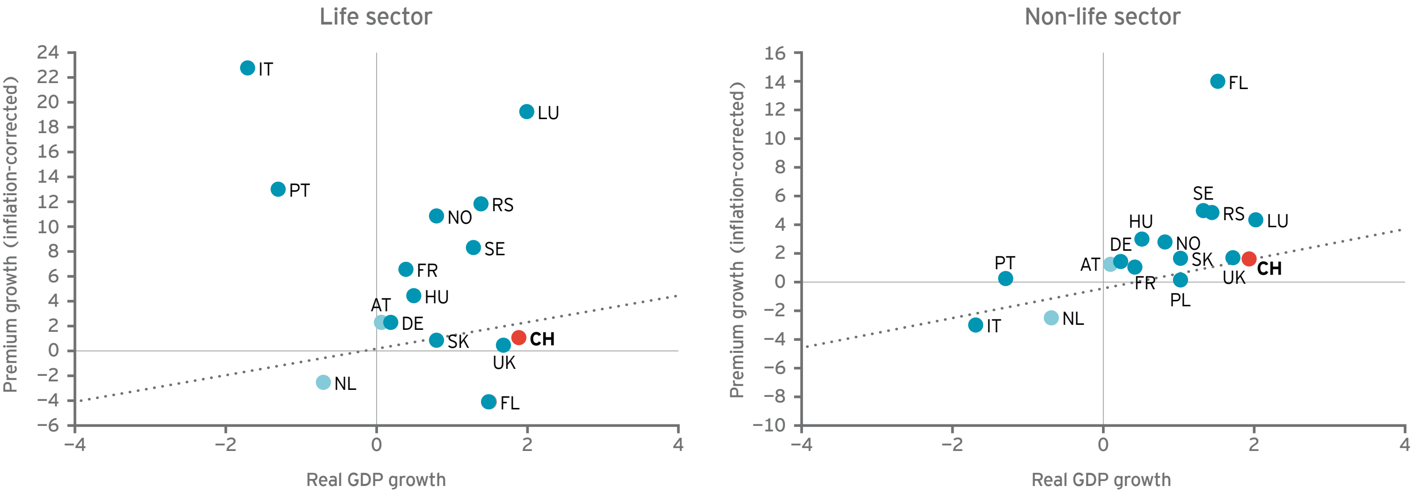
Source: Swiss Re Sigma series[7], BFS[8]

A comparison with other European countries confirms that the Swiss market is saturated: While premium growth outpaces gross domestic product in countries like Sweden or Luxembourg, premium growth in life and non-life lags clearly behind economic growth in Switzerland.

Tougher competition

Combined, the aforementioned changes will fuel competition in the coming five to ten years. Key determinants of growth like economic development or population trends are losing momentum. Although the major Swiss insurers are lowering their costs and increasing their efficiency, tighter regulatory requirements and adjustments to IT infrastructure are driving up expenditures. To have any chance of growing profitably in a saturated market, companies will have to do more than saving. Acquisitions or price cuts are unavoidable in order to win market share. Such moves are already visible. In 2014, the Helvetia Group substantially increased its market share with the acquisition of Nationale Suisse, while Allianz Suisse and Generali gradually pursue an aggressive pricing policy in car insurance.

Europe-wide comparison of development of premiums and economic growth



Legend: Netherlands (NL), Austria (AT), Germany (DE), France (FR), Hungary (HU), Norway (NO), Slovakia (SK), Poland (PL), Sweden (SE), Serbia (RS), Liechtenstein (FL), United Kingdom (UK), Luxembourg (FL), Italy (IT), Portugal (PT)

Source: SwissRe Sigma[9]

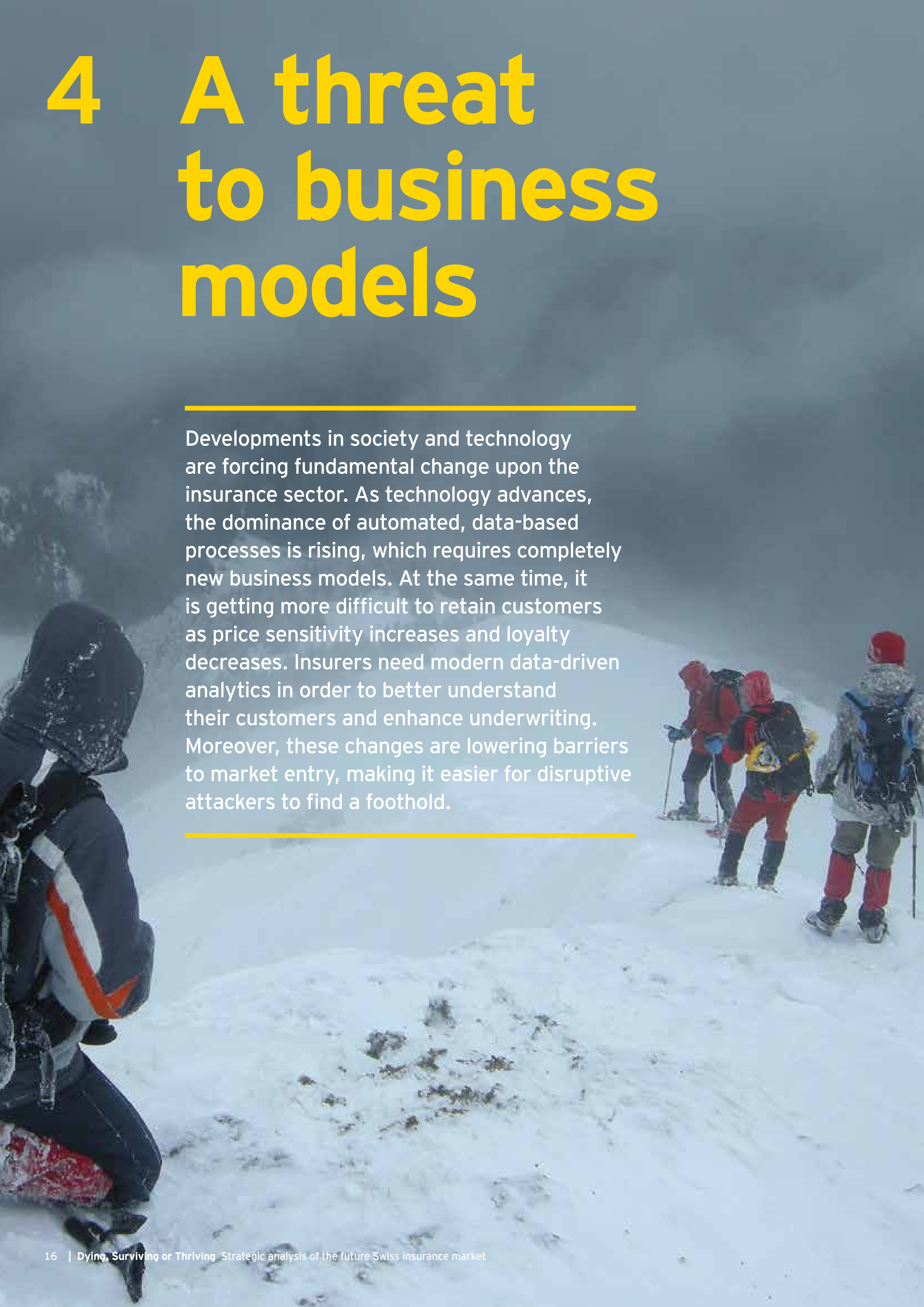
3.3 Partial conclusion: At least 30 percent of insurers at risk

Growth opportunities in the insurance market are limited, with a contraction in volume conceivable. The mismatch between the market's development and companies' objectives will culminate in a far-reaching shake-up. Not all insurers will be able to hit their targets. To grow profitably, they will need to either partner with competitors or squeeze them out of the market. If we aggregate the aforementioned growth objectives and set them in relation to the saturated market, **30 percent of Swiss insurers would have to go out of business by 2030**. If new attackers penetrate the market, up to 70 percent of the established companies will disappear. And such a scenario is certainly likely.

Other industries provide a reminder of what happens when revenue stagnates: markets get hit by painful disruption in the form of takeovers between incumbents and new competitors entering the market. An emphatic example is provided by the mobile phone market, from which all of the previously leading manufacturers had to withdraw (see "New game in the mobile phone industry"). Or take the travel industry: In 1996, Microsoft established Expedia, the first online booking site. Travel agencies, hotels, and airlines ignored the new service. Today, Expedia is the world's largest travel company; traditional travel agencies have been pushed out of the market. Comparable changes await the insurance market.

New game in the mobile phone industry

Mobile phone companies illustrate how a stagnating market can be turned on its head overnight. For years, the big three manufacturers Nokia, Ericsson and Motorola had dominated the market. In 2007, the market weakened sharply, and the price war intensified. That is precisely when Apple launched its first iPhone. In contrast to established providers that focused on in-house innovations, Apple centered its attention on the needs and expectations of consumers. The computer manufacturer's pitch that it had reinvented the telephone proved true: Equipped with a camera and an audio player, the device featured intuitive touchscreen operation. Consumers' expectations changed rapidly. The major manufacturers continued to cling on to the old telephone operating system for years and lost market share, while new providers like Samsung were quick to understand how they could secure a foothold in the smartphone business alongside Apple. By the time the former market leaders made the switch to the new software, it was too late. With dramatic consequences: In 2012, Ericsson was taken over by Sony; that same year, Motorola sold its mobile phone business to Google; and in 2014, Nokia had to sell its mobile business to Microsoft.



4 A threat to business models

Developments in society and technology are forcing fundamental change upon the insurance sector. As technology advances, the dominance of automated, data-based processes is rising, which requires completely new business models. At the same time, it is getting more difficult to retain customers as price sensitivity increases and loyalty decreases. Insurers need modern data-driven analytics in order to better understand their customers and enhance underwriting. Moreover, these changes are lowering barriers to market entry, making it easier for disruptive attackers to find a foothold.

4.1 New technologies

New technologies allow greater efficiency, accelerate processes in claim management and streamline communication. But such changes are also threatening fundamental aspects of the insurance market. New technologies make the world a safer place. For instance, the number of traffic casualties has been decreasing for years, and fire insurance claims are in decline. Such positive changes in society mean less business for insurers: The better people get at controlling risks, the lower their demand for insurance protection.

Digitization also has a critical part to play. However, most insurers still lack a clear strategy: New services or platforms were developed, however, mostly not aligned to the strength of existing business. As a result, capital expenditure often fails to produce the desired success.

Omni-channel sales

With smartphones, consumers are increasingly making decisions online. Although brokers are still the first point of contact for most insurance policies sold, the importance of digital channels is on the rise. Digital natives, already the biggest demographic group today, communicate with their insurers using smartphones and tablets. Some insurers have already taken action in a bid to tap the potential of new sales channels and customer experiences. For instance, two years ago, AXA announced a strategic alliance with Facebook to collaborate on digital social marketing and drive forward digitization (see AXA innovation ecosystem).

AXA innovation ecosystem

AXA is driving digitization forward. The insurance group has built what are referred to as innovation labs in eight countries, including major cities like London, Paris, San Francisco or Shanghai, but also at its Swiss headquarters in Winterthur. The innovation ecosystem stands on three pillars: firstly, AXA Labs forge close ties with high-techs like Facebook and LinkedIn; secondly, Data Innovation Labs exploit the potential of big data; and thirdly, AXA promotes strategic alliances with start-ups, an initiative that has already seen the emergence of numerous InsurTechs, including Medlanes, Climate-Secure or Policy Genius. The AXA example underscores how corporations can actively shape the transformation of the insurance sector. That requires strict alignment of the strategy toward digitization, coupled with early detection and use of emerging opportunities.

New technologies have massively improved the position of consumers, with noticeable consequences: Price consciousness is increasing, loyalty decreasing. The Swiss company Comparis shows that this is a process that takes time. The comparison service has enabled benchmarking of policies and premiums for years, but only now are consumers increasingly switching policies. Technology makes it easier, as the online portal Knip demonstrates (see section 4.2). With increasing digitization, customer centricity is becoming a core competence for insurers. Those who lose touch with the trend will find themselves in serious difficulty.

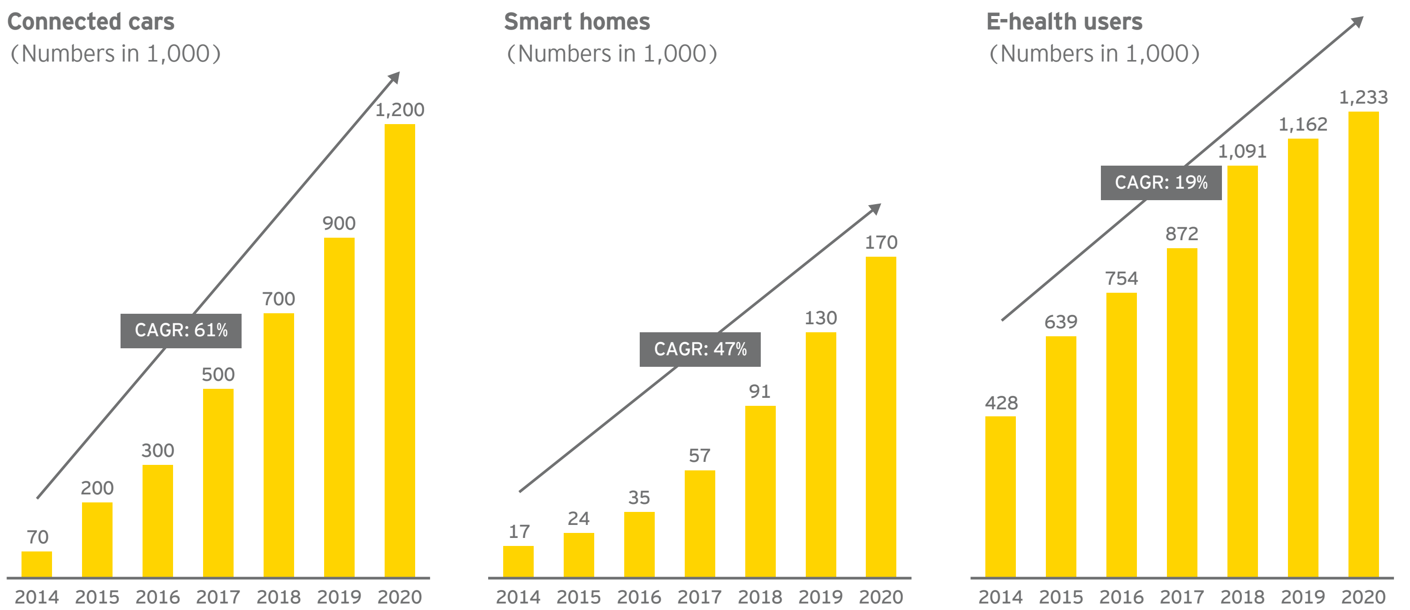
Technological innovations

Numerous innovations in technology affect key business segments of insurers. Notable examples include self-driving cars, smart homes and big data. Not only does this rein in demand for insurance, it also weakens the standing of insurers in the ecosystem. Product manufacturers leading such innovations beat insurers with relevant customer data in real time.

Connected cars: Propelled by the intensive work of corporations like Google, Volvo or Mercedes, the pace of development in the field of self-driving cars is breathtaking. It's no longer a question of whether computers will drive cars in the future, but when. There is no shortage of indicia that this will soon be the case. For one thing, the technology has already advanced far, plus it allows a substantial reduction in the risk of accidents. Today, human error at the wheel is by far the most frequent cause of accidents, making up 93 percent of all claims in the United States. Demand for insurance can be expected to decrease if self-driving cars gain traction.

Smart homes: Internet-of-things technology is changing how we live. Worldwide, the market for smart home technology is trending upward 17 percent per year. Innovative security and alarm systems effectively prevent damage and break-ins. Take the example of the intelligent LED lights that the Swiss start-up comfylight.com has come up with: The system registers the movement patterns of household members for later simulation when they are away from home. Other innovations include surveillance cameras that record any break-ins and directly call the police.

Spread of new technologies in Switzerland



Source: Statista[10]

Big data: Big volumes of data can be analyzed quicker and more effectively. That allows insurers to gain key insights into customer needs and pricing. Some Swiss insurers like AXA Winterthur are already investing sizable sums into platforms that will allow a better understanding of the decisive aspects of customer relationships and more personalized prices.

That entails new challenges for companies given that it also makes risks more transparent for customers. The better people understand their individual risks thanks to new devices, the more they will limit their insurance coverage to those areas in which they are most likely to incur losses. The looming adverse selection of risk will mean that insurers will increasingly have to deal with bad risks. That makes it more difficult to offer affordable insurance protection. Wearables like Apple Watch, which record information on sports activities, are a good example. People who commit to a healthy lifestyle will lower their health insurance to a minimum. It follows that only those who lead unhealthy lifestyles will be interested in additional coverage.

Consumer-to-business (C2B)

With digitization, companies and consumers are exchanging roles. Consumer-to-business (C2B) is the name given to the new model under which consumers dictate how much of which products they demand when and where. Technological innovations are increasing the negotiating power of consumers: They are aware of their risks and decide what information they pass on to insurers. Companies have to actively work on building the closest possible ties with customers. Those who successfully leverage social media, Internet-of-things or other technology to strengthen customer interaction will reinforce their market position.

4.2 InsurTechs

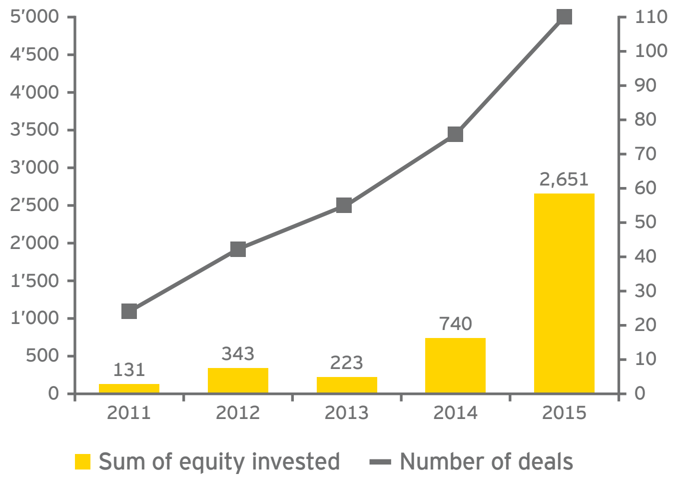
Digitization has taken the insurance market by storm. New, disruptive business models are proliferating, numerous start-ups have gone into operation. Both factors challenge established business models and break up the value chain. Alone in 2015, venture capital of over USD 2.6 billion was injected into InsurTechs worldwide, more than a threefold increase on the prior year.

So far, the InsurTechs have only conquered small segments of the market. Their potential to fundamentally change the fabric of the insurance market is therefore still limited. Having said that, InsurTechs clearly bring greater competition and lower prices. Three elements are being redefined by InsurTechs: customer experience, process innovation and new business models.

Movement on customer experience
InsurTechs are simplifying sales and offer a better customer experience, as illustrated by the following examples:

- **Knip und FinanceFox:** The two Swiss start-ups act as pure insurance brokers. That allows customers to conveniently compare and adjust their policies. Although this does not replace the business models of established insurers, it does lead to a strong increase in competition.
- **Oscar und Vitality:** The US InsurTechs demonstrate how customer experience can be enhanced. Both are active in health insurance and use an incentive system to motivate their customers to lead healthy lifestyles. The connection between insurance and lifestyle provides the companies close contact with their customers.

InsurTechs: venture capital and transactions worldwide
(USD million and number of transactions)



Source: CB Insight[11]

Process innovations

A second group of InsurTechs is focused on providing insurers with platforms, services and analytical tools. As a result, IT expenditure can be lowered, more efficient processes designed and risks identified with greater precision. The following US companies illustrate the possibilities:

- **Vlocity:** Assumes cloud-based handling of business processes, including product and policy management. Insurers benefit from efficient processes, without having to tie up money building them up.
- **RiskMatch:** Provides platform for insurance brokers. Its web-based solutions include services such as portfolio management or placements.
- **QuanTemplate:** Offers insurers data analytics. The software is tailored to industry-specific needs and allows fast and comprehensive analysis and visualization of risks.

New business models

InsurTechs' third segment complements the established insurance market: The companies operate with new business models and offer new services.

- **Elliptic:** Based in London, the company offers insurance for bitcoins. The service provides coverage against the loss or theft of investments in the digital currency.
- **Friendsurance:** German insurance platform that combines the solidarity principle of insurance with modern social networks. If no or few claims have to be settled, customers are refunded part of their insurance premiums.
- **Uvamo:** Chicago start-up offering a variant on peer-to-peer lending. The company brings insurance customers and investors together: Customers get insurance against risks online, while investors buy a stake in the premium pool in exchange for a share of the premiums.

4.3 Competition from outside the industry

It's not just innovative start-ups that threaten the market position of insurance companies, major players from outside the industry also have their sights on customers. The fact is that in almost every business segment there is at least one provider who knows customers better than the insurers do.

Car insurance provides a good example of how insurers can lose access to their customers. Carmakers know customers' needs much better. Volkswagen Financial Services already sells third-party liability insurance and other car insurance policies. The automotive group's subsidiary has set itself the target of selling a VW insurance product to every second new customer. Since 2011, Volkswagen Financial Services has more than doubled its revenue from premiums.

With Apple Care, Apple has been offering its own insurance for iPhones, iPads and notebooks for five years now. Manufacturers' proximity to customers generally allows them to offer insurance immediately when a product is bought. Hospitals and manufacturers of medical technology are also making the most of this advantage, as Crystal Run demonstrates: Last year, the manufacturer of diagnostic devices began to sell health insurance as well.

The same applies to companies like Google, Facebook or Twitter. It is easy to imagine these corporations taking on the role of insurance brokers in the future. Alibaba's successful entry into the insurance sector illustrates the potential speed of such a move: In just one year, the online group, through its digital insurance arm, Zhong An, has won 150 million customers and sold 630 million policies. That corresponds to roughly one-fifth of China's current insurance market. The alliance between AXA and Facebook in digital marketing (see section 4.1.) also emphasizes this development.

4.4 Lower entry barriers

Many experts still consider the Swiss insurance market to be sheltered. But these natural barriers are losing significance. Six changes should be noted:

Attracting capital: The insurance business is capital-intensive, posing a challenge for InsurTechs. But major corporations, like Google, that are equipped with a solid capital basis have no difficulty attracting funds in capital markets.

Talents: With digitization, know-how is less decisive for success; it's technology that counts. New providers are benefiting as consumers increasingly buy their policies online. Any competencies they might need, they can source directly from external suppliers.

IT and technology: InsurTechs are breaking up the value chain. That allows new providers to directly source software solutions for sales, claim settlement or risk management. It is no longer necessary to build up expensive infrastructure.

Reinsurance: New providers benefit from the fact that reinsurers are increasingly offering their services to companies outside the traditional market. Take for example Munich Re, which announced that it would insure the business of the start-up Lemonade.

Regulatory requirements: Legal requirements on insurers will continue to tighten. That opens up new opportunities for new providers that do not have to shoulder legacy burdens.

Branding: Trust is at the core of the insurance business, making a strong brand a basic precondition. That is exactly what big players from outside the industry such as Google or Facebook have, a strength they could exploit in a bid to penetrate the market.

4.5 Partial conclusion: far-reaching disruption

The Swiss insurance market offers new, disruptive players and industry outsiders good opportunities. Low growth combined with intense competition between incumbents, weakens the position of major insurance companies (see section 3.2.). In addition, technological innovation is transforming the insurance market into a consumer-to-business model. Customer proximity and detailed knowledge of needs are becoming core competencies. Moreover, Switzerland is still perceived as a profitable and appealing market for insurance services, augmenting incentives for new competitors to enter the market.

Innovative, agile start-ups with new business models and without concerns about legacy burdens can benefit from this change. Industry outsiders with a keen understanding of customer behavior are also at an advantage. That increases the likelihood of new providers taking over central elements of the value chain in the long run. In such a scenario, the biggest risk for insurers is the prospect of major players like Google collaborating with start-ups to build up entirely new business models. A fusion between the capital and scale of a major corporation and the innovation power of a start-up would pose a going concern risk for traditional insurance companies. **Unless effective action is taken, up to 70 percent of established Swiss insurers will be squeezed out of the market.**

5 New opportunities

But the profound changes also create opportunities for Swiss insurers. In view of the market's dynamics, however, providers have no time to lose with their response. We see the options with greatest promise in two dimensions: New insurance segments and new services.

5.1 New insurance segments

Changes in society and technology are creating new risks that need coverage. Examples include cybercrime or reputational risk. The sharing economy can also give rise to new insurance needs. People renting their apartment on Airbnb or offering a taxi service on Uber will want to hedge their risks. User of such P2P (person-to-person) services will likewise want short-term insurance that can be booked on mobile devices. Although insurance companies still have trouble accurately pricing coverage for such risks, the potential inherent in the new market segments is undisputed. To increase the precision of forecasts to the extent possible, some companies are already relying on predictive modeling.

New opportunities are also emerging for insurers against the backdrop of climate change and anticipated countermeasures such as in connection with the introduction of emissions prices. The agreement reached at the climate summit in Paris last December makes restrictions on CO2 emissions more likely, and some companies will have a hard time complying with the new standards. Such risks are insurable. Protection against weather anomalies also opens up new market segments for companies.

The UK company Animal Friends exemplifies how social change can create new insurance needs. The company has specialized in offering dog, cat and horse owners insurance against veterinary costs due to illness or accident. That shows how creative companies can benefit from trends in society and offer novel insurance policies.

5.2 New services

While customers increasingly exert more exacting demands on insurers' services, their willingness to pay for standard products is diminishing. This trend challenges companies, but also affords them new opportunities. New technologies enable closer customer relationships. Automated claim settlement in car insurance provides a good example. Whenever a claim is filed, not only does the insurer settle the claim, but also arranges an appointment to have the vehicle repaired. Although building up such services involves an upfront investment, there is a greater willingness to pay, and customer loyalty improves in the process.

5.3 Partial conclusion: focus

The market environment allows insurers to move into new market segments and expand their portfolio of services. However, in order to make the most of the opportunities, companies have to focus on specific segments, products or geographies. That is essential in order to prevail against new attackers. Without a clear orientation, insurers risk their customers failing to see the value added of their offering and switching to companies that have already rigorously aligned toward customer needs.

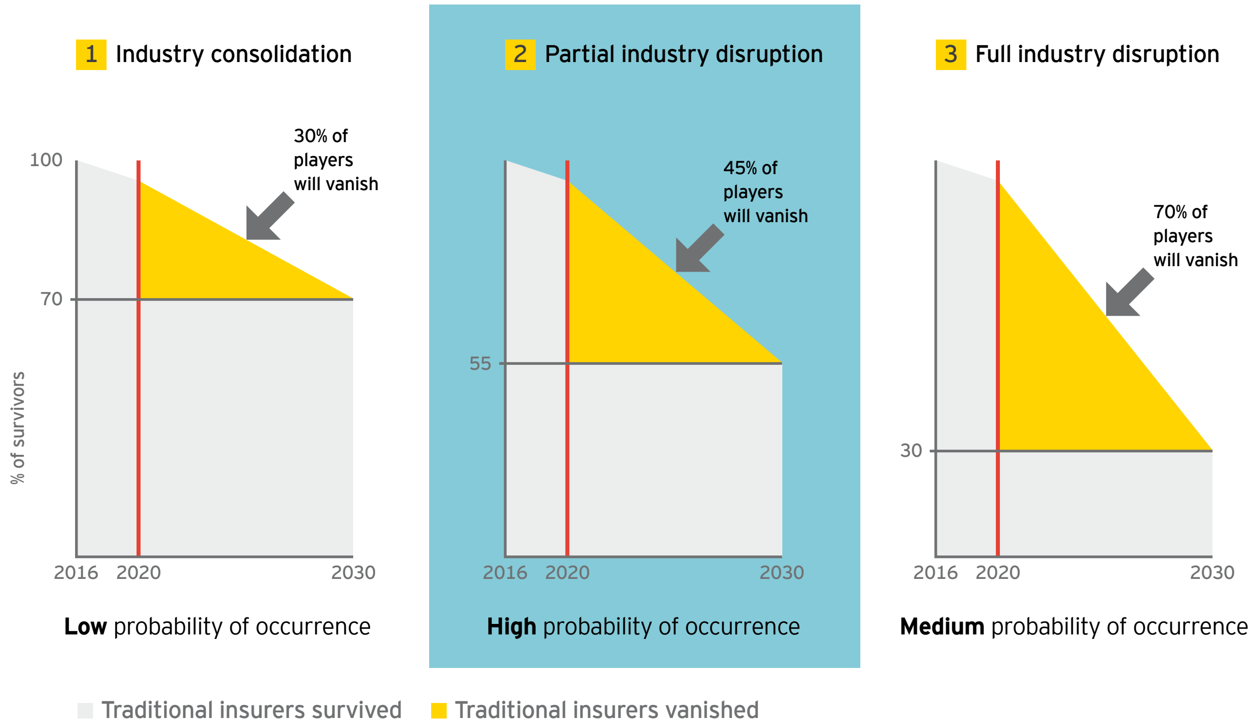
6 Scenarios

It is not possible to predict the Swiss insurance market's exact trajectory. A scenario analysis provides a better means of highlighting potential repercussions of market changes. In the following, we look at three scenarios: Firstly consolidation, secondly partial disruption and thirdly complete disruption.

- The three scenarios differ in terms of the dynamics of change, with three underlying factors: The impact of new technologies, the emergence of disruptive start-ups and the entry of corporations from outside the industry.

- A more challenging environment ensues across all three scenarios. The same external factors underpin the scenarios, including the macroeconomic fundamentals, government policy and regulation, environmental change, demographics and customer behavior (see section 3.2).

Major changes by 2030



Source: EY

Companies' growth targets are far above forecasted market growth of 1.9 percent per annum. In scenario 1, companies cling on to the targeted growth of 5 percent up to 2030, while in scenarios 2 and 3 they gradually settle for more moderate targets over time. Depending on the dynamics that sweep through the market, new providers emerge, with profound implications for insurers.

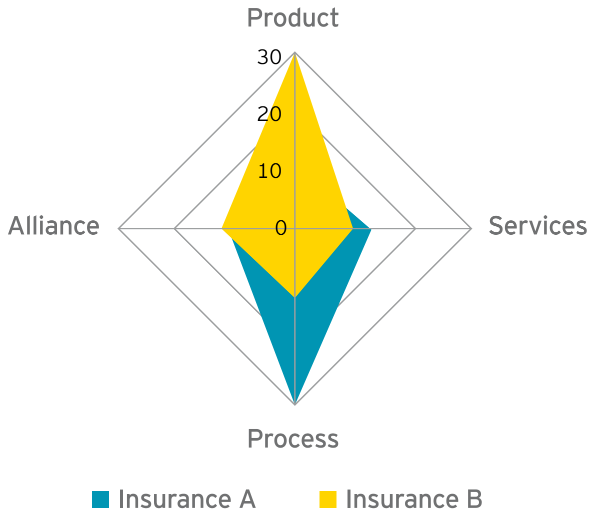
- In scenario 1 (consolidation), companies can only reach their average 5-percent-growth targets if they take over or squeeze out peers. No new providers enter the market. Competitive forces push 30 percent of companies out of the market.
- In scenario 2 (partial disruption), InsurTechs enter the market. We assume that, by 2020, five new providers will secure a foothold in the Swiss market, jointly attracting 300,000 customers per year. By 2030, they will have secured a market share of 36 percent. At the same time, traditional insurers are intent on outpacing the market and grow by 5 percent up to 2020, by 3 percent up to 2025 and by 1.9 percent from then on. As a result, 45 percent of the established insurers will be squeezed out of the market by 2030.
- In scenario 3 (complete disruption), additional major players from outside the industry establish operations in the market. Given their financial clout and digital alignment, we assume that the new players can win all digital natives and 40 percent of customers aged over 40 by 2030. They are able to gain a substantial market share much faster than InsurTechs. On aggregate, the new attackers will conquer two-thirds of the market by 2030. Given that incumbents, as described in scenario 2, intend to outpace the market up to 2025, 70 percent of them will be squeezed out.

From a current perspective, it is difficult to grasp the magnitude of the anticipated losses. However, these forecasts are certainly realistic, as evidenced by the disruption that followed the entry of major technology corporations into the travel or mobile phone industries (see section 3.3).

In light of the outlined developments, insurers have to rethink their strategies and sharpen their focus. A two-stage adjustment process promises success: In a first step, companies have to clarify their strengths; all activities have to be centered on these core competencies. In a second step, they have to decide whether they intend to continuously evolve their business model or revolutionize it. Under the first approach, companies aim to take market leadership in a field; under the second, they take a completely different avenue and try to keep pace with the disrupters.

Insurers' specific options can be illustrated by taking the example of two companies that have positioned themselves differently within the four dimensions of products, services, processes and alliances: Insurer A focuses on processes in order to generate price advantages. In contrast, Insurer B centers on innovative products that are as easy to understand as possible. In addition, the two insurers have different cultures: A has an "optimization culture," while B is marked by an "innovation culture". These dimensions represent the organization's fundamental focus. Depending on the given scenario, an additional focus is needed in the alliances or services dimensions. In the following, we outline promising trajectories for the two companies in our example across the different scenarios.

Strategic positioning – Examples



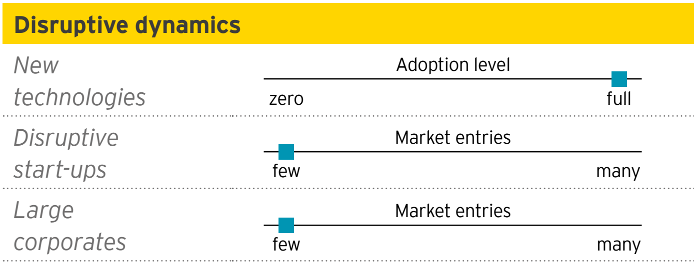
Source: EY

6.1 Scenario 1: consolidation

Insurers are confronted with tougher competition. The market environment is getting considerably more challenging, driven by the macroeconomic fundamentals, government policy, regulation and demographic development. Environmental aspects are gaining in importance, while new technologies lead to greater transparency and price consciousness. A price war erupts among providers, accompanied by eroding margins.

But the dynamics are low, given that only a few disruptive providers enter the market, and the value chain remains intact. In order to survive in this climate, insurers need to center wholly on customers' needs. Those who fail are either taken over by competitors or squeezed out of the market.

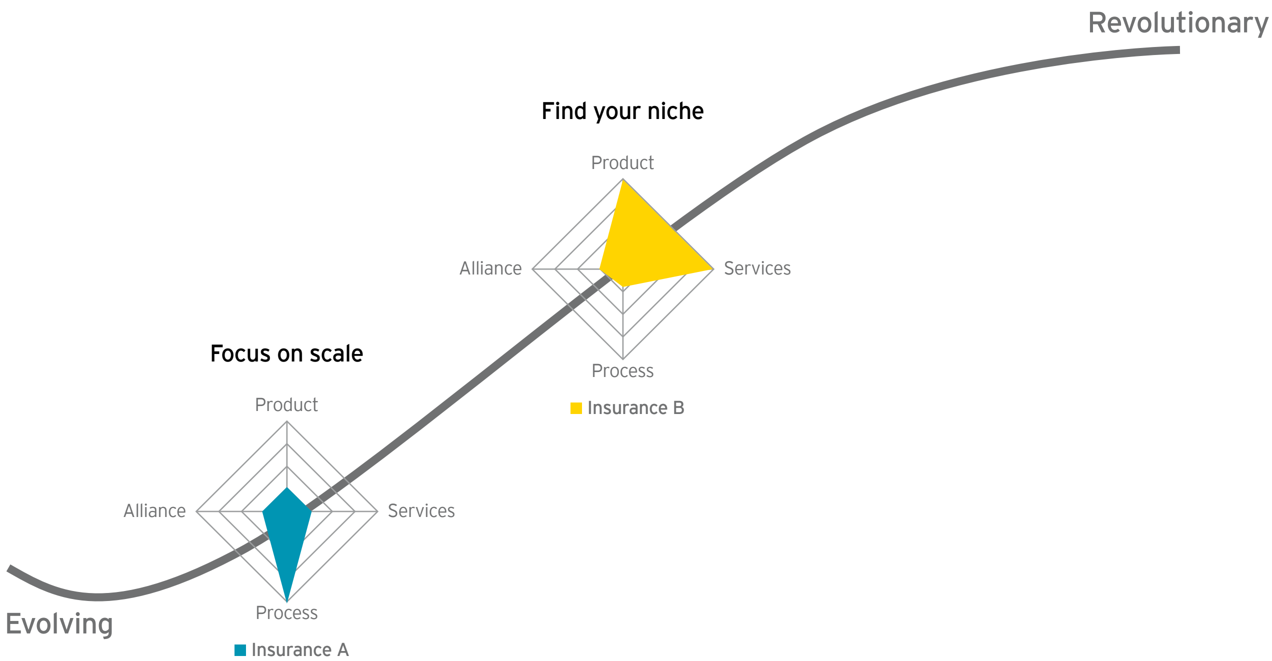
Scenario 1: Low dynamics



Source: EY

In this environment, insurers have two options: Company A enhances the efficiency of processes and drives up growth, company B focuses on a niche and additionally reinforces its service offering.

Consolidation: Growth or niche strategy



Source: EY

Focus on scale

By scaling-up, companies can dominate their competitors. Economies of scale is the decisive advantage in price competition. From this position it is possible to take over weaker players. However, companies need substantial financial resources to succeed. Process enhancements are key, due to the limited ability to draw on technological innovation or realign the business model. Take for instance aggressive pricing strategies designed to weaken direct competitors, a development already evident among car insurers.

Find your niche

Niche strategies are needed for a more far-reaching transformation of the business model. In this context, the task of companies is to surpass all major providers with innovative insurance products and services. In addition to the focus on products, it is also important to offer innovative services that add value. In the following we present some examples.

- **Quicker and more convenient claim settlement:** That entails mobile apps or the automated settlement of receivables, e.g., by automatically arranging appointments with local mechanics.
- **Focus on new insurance services:** Cybercrime or the introduction of emissions prices open up new possibilities. The spread of robotics raises new questions that insurers can adequately address.
- **Data-based health insurance:** Wearables and smartphones lead to a massive increase in data volumes. This in turn increases the importance of evidence-based medicine, while making it easier to create individual risk profiles. As a result, a completely new basis is created for calculating premiums. The speed and extent of change hinges critically on regulation.
- **Telematics in car insurance:** New technologies enable continuous monitoring of driving habits and vehicle data, enabling more efficient pricing. This is an area in which some Swiss insurers are lagging behind the possibilities that technology affords.

6.2 Scenario 2: partial disruption

The market environment deteriorates further as InsurTechs enter the market and break up the value chain. This stokes up already intense competition among insurers.

Disruptive providers concentrate on selected segments, such as sales channels or claim settlement. That forces insurers to either boost their innovative power and increase their efficiency or partner with InsurTechs. If they are to prevail, companies have to capture genuine synergies from their collaborative arrangements and improve processes along the value chain end to end. Those capable of taking over new providers are likewise at an advantage.

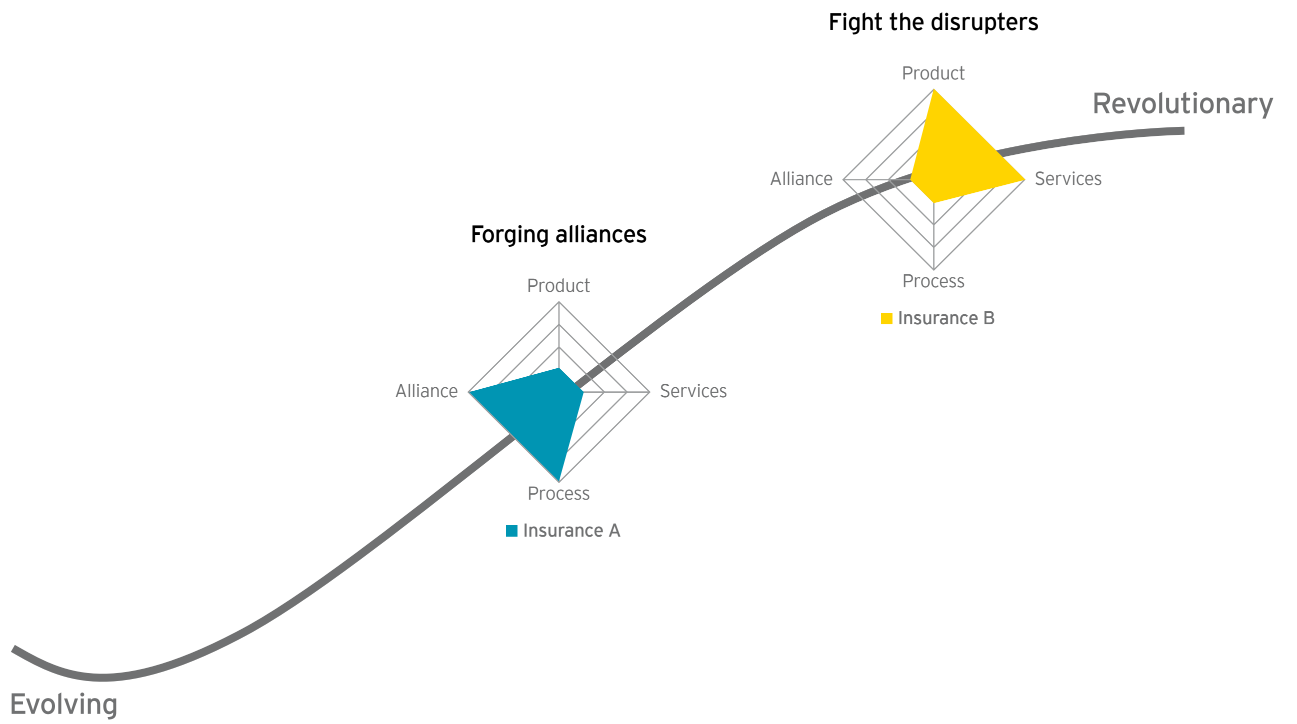
Scenario 2: Greater dynamics

Disruptive dynamics			
New technologies	Adoption level	zero	full
Disruptive start-ups	Market entries	few	many
Large corporates	Market entries	few	many

Source: EY

Insurers can take two alternative approaches in response to the new providers: They can either systematically partner with them (company A) or they can fight back (company B).

Partial disruption: Forging alliances or squeeze-out strategy



Source: EY

Forging alliances

If InsurTechs manage to gain a foothold in the Swiss insurance market, incumbents will be at risk. At the same time, there's an opportunity to enter into collaborative arrangements with disruptive start-ups and benefit from their innovation potential. That enables the development of new services or, more importantly, outsourcing of individual processes in order to streamline the value chain and capture additional efficiency gains. Collaboration with InsurTechs is therefore a good idea for organizations focused on processes. What follows are specific examples:

- Companies can use the platforms of insurance brokers like Knip and outsource sales and distribution.
- Insurers can use online platforms to drive forward marketing of their products. One recent example is the investment of the insurance company Mobiliar in the online marketplace for cars and real estate Scout24.
- Alliances in e-health afford opportunities. Take for example CSS, which partnered with dacadoo, a company specialized in digital healthcare solutions: Together, they are developing health insurance solutions that allow insured customers to monitor their health.

Fight the disrupters

Insurers can take a stand against the new competitors and launch new disruptive products and services themselves. Thanks to their financial resources, they have the edge over start-ups. Capital doesn't just help in the development but also in the implementation of new business models. To this extent, insurers have to keep a very close eye on the new providers and quickly respond to first moves. An in-house innovation lab is one means of tracking the activities of InsurTechs. Apart from a pronounced alignment toward products, this strategy also requires a focus on highly innovative services. Potential examples include the following:

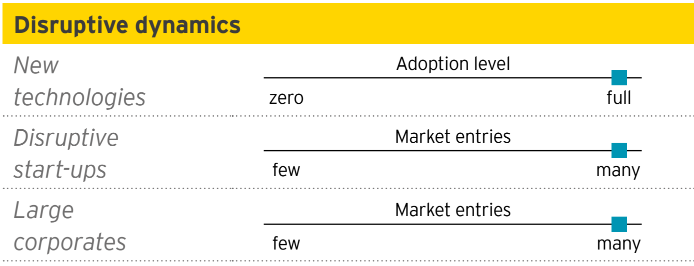
- Instead of solely analyzing customer data for pricing purposes, a health insurer could begin to actively monitor its customers' health, warn them of any risks and thereby encourage prevention.
- At the end of 2014, Sanitas launched an app that digitizes health insurance policies and makes them available on mobile devices. Users can access information at any time as well as scan and submit physicians' bills. They can also use the app to search for medication and physicians nearby. With this step, Sanitas is going into direct competition with insurance brokers for digital touch points with customers. Knip thus loses decisive advantages, such as the digitization of the insurance policy or the convenient submission of insurance claims.

6.3 Scenario 3: complete disruption

In our third scenario, insurers face the greatest challenges. Apart from the difficult market environment and the entry of InsurTechs, major players from other industries enter the market. This steps up the intensity of competition further. Corporations like Facebook or Google are able to develop entirely new business models and achieve the greatest possible customer centricity in the process.

The industry outsiders are not only equipped with massive financial funds, they also dominate customer touch points. Volkswagen's sale of insurance policies is a case in point. Confronted with such market power, insurers risk being pushed out of the market. The value chain disintegrates entirely and established insurers are no longer able to serve customers end to end. Instead, they are forced to focus on isolated aspects and outsource the rest to partners. Apart from these collaborative arrangements, it is important to drive forward innovation and seek ways of recovering customer touch points.

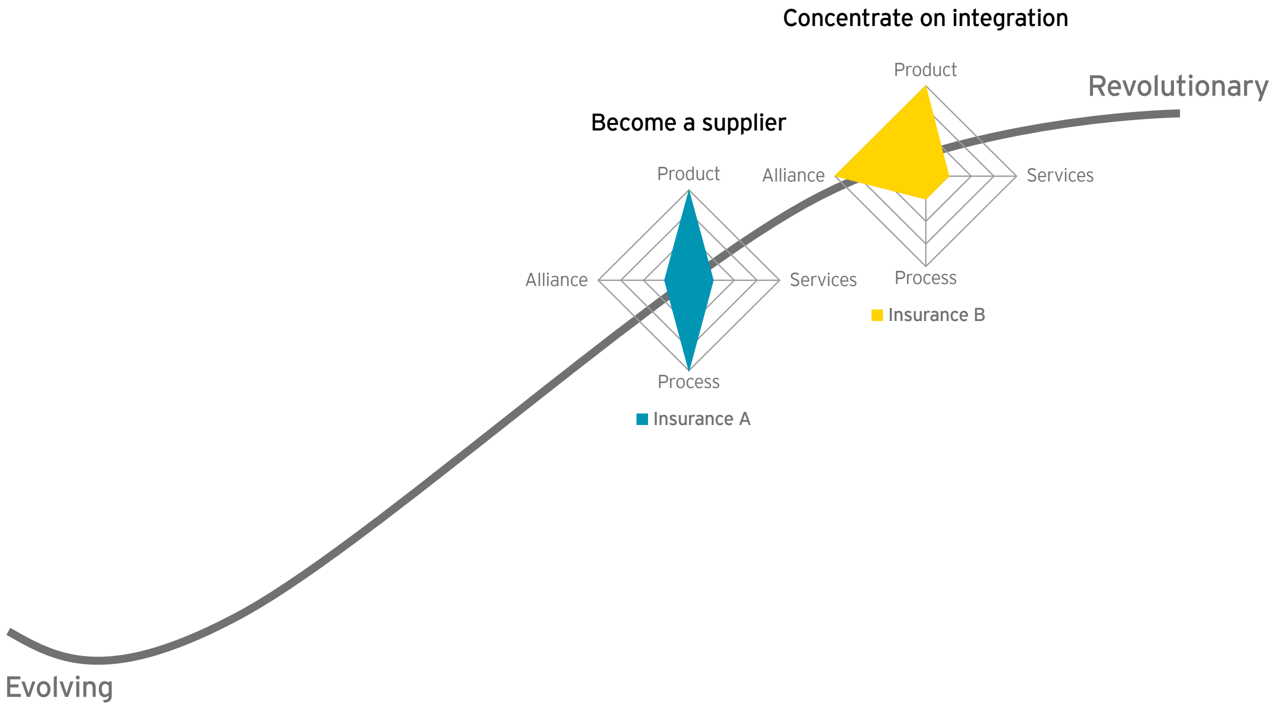
Scenario 3: Powerful dynamics



Source: EY

The powerful dynamics force insurers to completely realign their business model. They are faced with a choice between taking on the role of supplier (insurer A) or concentrating on integration (insurer B).

Complete disruption: Supplier or integration



Source: EY

Become a supplier

Insurers that accept the role of a supplier can deploy their know-how systematically at the process level. In addition, it is necessary to focus on standardized products in order to prevail in the business-to-business market. Cost-intensive competition with new attackers is averted. Just two examples:

- In several European countries, Allianz sells and manages car insurance for BMW. The insurer uses BMW dealerships as a sales channel and concentrates on products and processes in a bid to consciously align these to customers' needs.
- Reinsurers are considering offering insurance coverage for private customers and corporates, thus effectively removing the division of labor between reinsurers and insurers. That would make today's insurers into sales channels. Thanks to the aggregation of risks, reinsurers can offer better-priced premiums.

Concentrate on integration

By partnering with an industry outsider it is possible to systematically improve customer touch points, while avoiding direct competition. As a result, it is possible to benefit from the in-house product competence along with the partner's innovative services. By forging alliances with the most dangerous competitors, companies can reinvent the insurance business. That means that, in addition to an alignment toward products, it is important for organization B to focus on value-adding alliances with key companies. Specific examples:

- The insurance group Sompo Japan Nipponkoa offers for China's largest Internet-based travel company Tu Niu integrated insurance products for overseas trips. The travel insurance also covers the cost of medical treatment or hospital referrals. Thanks to the alliance, the insurance company obtains access to millions of Chinese customers.
- The company eBaoTech provides an example of how insurers can collaborate with automotive groups. The Chinese company has developed a cloud platform that carmakers can use to sell insurance directly to customers.

7 Conclusions

Turbulent times are brewing for the Swiss insurance sector. We consider it likely that the market will develop in line with scenario 2, and that InsurTechs will gain a foothold. Even if many of the new providers are still in the process of setting up their operations, companies like Friendsurance show just how big the disruptive potential is. Technological innovation is accelerating the trend, and the demographic development is raising the importance of digital offerings further. We think it less likely that industry outsiders will enter the Swiss insurance market as described in scenario 3. But at the same time, we consider mere consolidation as described in scenario 1, in which no new providers enter the fray, unlikely.

If InsurTechs gain traction in the market, roughly 45 percent of established insurers will find themselves exposed to a going concern risk by 2030. This is a threat that requires immediate action. Companies have to identify their core competence so that they can systematically build it up. Given its importance as a unique selling proposition for customers, clear specialization is essential in times of fierce competition for market share. It is also necessary to evaluate in-house innovation capabilities as well as one's willingness to innovate. Any business model realignment inevitably has implications for a company's organization, which means that it has to be attuned to the corporate culture and employees. A systematic market analysis is needed to identify potential partners for forming alliances. There are in fact already numerous active InsurTechs with sizable market potential. How are new attackers managing to rapidly win new clients? What makes them better? Where do their strengths coincide with our weaknesses? And where do we have strengths that compensate for the weaknesses of InsurTechs? These questions need to be answered quickly.

In actual fact, these heterogeneous players complement each other well. A limited offering is the main weakness of InsurTechs: They typically concentrate on solving a specific problem, which is what makes them creative and agile. In contrast, traditional insurers are able to offer integrated solution packages, albeit with limited agility. So both can benefit from collaboration.

Innovation is the core element in this context. However, insurers cannot capture the potential of digitization alone. What they need is new forms of collaboration: They have to build up incubators for start-ups or inject capital into them. This is an area in which insurers lag behind banks. The key is for companies to avoid competing with the new players, and to support them instead. That will allow them to harness their innovations profitably in the next step. Looking beyond individual companies, the industry is called upon to make Switzerland a center of innovation for the insurance business and attract new start-ups. Take for example Kickstart Accelerator, a Swiss start-up program in which EY is active as global partner. This development can be supported with suitable political initiatives, such as tax relief for fledgling companies or flexible regulation.

There are already a number of indications of a stalling market. This study has analyzed some of these in greater depth. Most insurance companies continue to turn a blind eye to the unpleasant reality. Steady growth and good returns have blinkered them into overlooking the risk that the insurance business as they know it will disappear.

Only those who challenge their business models and strategically realign them will overcome the increasingly daunting trials ahead. The outlined strategies show possible avenues that can be taken. Selecting a strategy tailored to the organization is one thing, its rigorous implementation quite another. The sooner that companies act, the better the chances of success.

As the philosopher Lao-Tse famously noted: **"Do the difficult things while they are easy! Do the great things while they are small!"**

8 Authors

Authors

Achim Bauer
Insurance Sector Leader Switzerland

Phone: +41 58 286 34 12
achim.bauer@ch.ey.com

Yamin Gröninger
Insurance Sector Director Switzerland

Phone: +41 58 286 39 01
yamin.groeninger@ch.ey.com

Julius Scheidt
Consultant

Phone: +41 58 286 43 95
julius.scheidt@ch.ey.com

Ricardo Garcia
Consultant

Phone: +41 58 286 43 11
ricardo.garcia@ch.ey.com

Edvin Rimpo
Consultant

Phone: +41 58 286 44 30
edvin.rimpo@ch.ey.com

Experts

Alex Lacher
Senior Manager

Phone: +41 58 286 43 12
alexander.lacher@ch.ey.com

Matt Charlesworth
Senior Manager

Phone: 41 52 286 35 20
matthew.charlesworth@ch.ey.com

René Wettstein
Manager

Phone: +41 58 286 33 86
rene.wettstein@ch.ey.com

Michael Vellat
Manager

Phone: +41 58 286 38 64
michael.vellat@ch.ey.com

Michal Suchan
Manager

Phone: +41 58 286 36 43
michal.suchan@ch.ey.com

9 References

1 BAK Basel. Macroeconomic importance of the Swiss financial sector. http://www.bakbasel.ch/fileadmin/documents/reports/BAKBASEL_Die_volkswirtschaftliche_Bedeutung_Finanzsektor_Schweiz_2015.pdf

2 Yourmoney. www.yourmoney.ch/yourmoney/interestsSwap.html [By 25.4.2016]

3 IMF. World Economic Outlook Database 2015. http://www.imf.org/external/pubs/ft/weo/2015/02/weodata/index.aspx

4 Swiss Federal Statistical Office. Direct Swiss Business – Gross Written Premium http://www.bfs.admin.ch/bfs/portal/de/index/themen/12/05/blank/kennzahlen/01/praemien.html

5 Swiss Federal Statistical Office. http://www.bfs.admin.ch/bfs/portal/de/index/themen/01/22/lexi.html

6 Statista. New car registrations Switzerland. https://de.statista.com/statistik/daten/studie/448455/umfrage/pkw-neuzulassungen-in-der-schweiz/

7 Swiss Re Sigma. Insurance Research Database. http://www.swissre.com/sigma/

8 Swiss Federal Statistical Office. Income, Consumption and Wealth. http://www.bfs.admin.ch/bfs/portal/de/index/themen/20/02/blank/key/einkommen0/niveau.html

9 Swiss Re Sigma. Globale Assekuranz 2014: Zum „Leben“ erwacht. http://www.swissre.com/sigma/?year=2015#

10 Statista. Digital Market Outlook.
https://de.statista.com/outlook/320/155/connected-car/schweiz#/
https://de.statista.com/outlook/279/155/smart-home/schweiz#market-smarthomes
https://de.statista.com/outlook/312/155/ehealth/schweiz#market-revenue

11 CB Insight. Insurance Tech Insights. https://www.cbinsights.com/blog/insurance-tech-startup-funding-2015/

EY | Assurance | Tax | Transactions | Advisory

About the global EY organization
The global EY organization is a leader in assurance, tax, transaction and advisory services. We leverage our experience, knowledge and services to help build trust and confidence in the capital markets and in economies all over the world. We are ideally equipped for this task – with well trained employees, strong teams, excellent services and outstanding client relations. Our global purpose is to drive progress and make a difference by building a better working world – for our people, for our clients and for our communities.

The global EY organization refers to all member firms of Ernst & Young Global Limited (EYG). Each EYG member firm is a separate legal entity and has no liability for another such entity's acts or omissions. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information, please visit www.ey.com.

EY's organization is represented in Switzerland by Ernst & Young Ltd, Basel, with ten offices across Switzerland, and in Liechtenstein by Ernst & Young AG, Vaduz. In this publication, "EY" and "we" refer to Ernst & Young Ltd, Basel, a member firm of Ernst & Young Global Limited.

ED None

ey.com/ch