Dying, Surviving or Thriving

Are you ready for disruption in the Swiss insurance market?

June 2016

Building a better working world

While the majority of insurance companies still target growth in Switzerland, the market is stagnating

Illusion

I Growth targets

Majority of Swiss market players explicitly target ambitious growth rates (significantly) above market average

II Market perception

Equity analysts also believe in growth and profitability of Swiss insurers, advising investors to hold or buy stocks

The gap

- Aggregated growth targets of individual market players are significantly above Swiss market's realistic growth potential
- Swiss insurers have realized that Swiss market is heavily saturated and have started asking themselves what their options are

Reality

I Market forecasts

According to our research, Swiss insurance market growth measured by GWP is forecast at 1.9% p.a., which is way too optimistic considering that GWP growth in the past 8 years was around 1.1% p.a. (adjusted for inflation)

II Growth drivers

All major growth drivers of the Swiss insurance market show signals of stagnation or even slight decline

- The Swiss market is turning into a red ocean* with limited sources of growth

*Red ocean refers to industries marked by saturation and high competition, where all players try to outperform their rivals and grab greater shares of existing demand.

Source: BAK Basel

Historically, industries that lacked growth potential have witnessed painful disruption – mobile phone industry is an example

1 Executive summary

Comparison of mobile phone industry with insurance market

Mobile phone industry	Period	Insurance market	Period
I Market concentration After years of very high growth in the mid 90s, the mobile phone market saw a big rise in concentration	1995-2005	**I Market concentration** Over the last 10 years, Swiss insurance market has been concentrated among roughly 10 key players	2004-2014
II Market stagnation During the financial crisis (2007 to 2009), the mobile phone market started to stagnate	2007-2009	**II Market stagnation** During the last 8 years, GWP in Swiss insurance market grew 1.1% p.a. even below real GDP growth, which is a clear indicator of stagnation	2006-2014
III New entrants At the same time, Apple began to introduce the first smartphones and new competitors emerged	2007-2009	**III New entrants** Since 2013, investment in InsurTech has been increasing exponentially. Big players from other industries have started considering whether to enter the insurance market	2013-2016
IV Market disruption All major mobile phone producers (Nokia, Motorola, etc.) were squeezed out of the market by smartphone producers Today's market leaders (Samsung, Apple, Huawei) were not among the early mobile phone manufactures	2009-2016	**IV Market disruption ?** **Will traditional insurance products be reinvented?** **Will traditional insurers be squeezed out of the market?**	2016 - ?

- ► We expect competitive dynamics to increase substantially
- ► Is history about to repeat itself in the insurance market?

EY

Profitable growth has become an illusion under current market circumstances, mainly driven by external factors

1 Executive summary

External drivers: overview

1 Macroeconomic outlook

Suboptimal macroeconomic outlook for Switzerland **puts limitations on growth potential** for the Swiss insurance market – various indicators show signs of stagnation and market decline

2 Population growth

Tightening **political environment, e.g**. mass immigration initiative (“**Masseneinwanderungsinitiative**”), constrains insurable population, which is a key driver of the insurance business

3 Complexity of customer demand

Shifting demographic landscape increases complexity of customer demand and behavior across generations

4 Lifestyle change

Emerging **green trends** entail significant **lifestyle** changes (e.g. sharing economy) and reduce insurable risks

5 Price sensitivity

Insurance spending per household in Switzerland is among highest worldwide – there are early indications of **customers optimizing their insurance portfolios** and **reducing insurance spending**, driven by changing customer behavior **(less loyal, more price-sensitive)** and technology-enabled transparent information

► Competitive dynamics are going to increase substantially in the Swiss insurance market – first indicators of price wars and industry consolidation are already visible

The traditional insurance business model is endangered by disruptive dynamics

1 Executive summary

Disruptive dynamics: overview

1 Customer-centricity

Digital waves across entire economy transformed market from **“business-to-customer” (B2C) to “customer-to-business” (C2B).** Instead of being pushed with products, customers are pulling products and services, whenever and wherever they want. Companies who know customers best will eventually thrive

2 Disruptive start-ups

Insurtech players start attacking different **elements** of the traditional insurance **value chain** with new technology (e.g. Blockchain, P2P), however, without changing the entire value chain

3 Big players

Big players from other industries (e.g. automotive, technology, retail), who have data about insurance customers and know their needs, **represent a more serious threat** for traditional insurers – first movers are already entering insurance market (Walmart, VW) – the question is not if, but when scale-up will come

4 Lower entry barriers

Entry barriers for the Swiss insurance market **are declining** substantially due to developments in six dimensions – access to capital, talents, IT & technology, reinsurance protection, regulatory requirements, branding – entering the insurance market is becoming much easier

- In a stagnating, low-growth market environment, a new market entrant can make a big impact and expand fast
- There are already early indications of a realistic scenario in which large corporations from other industries enter the Swiss insurance market in cooperation with small disruptive start-ups

We see 3 possible scenarios for future development – insurers need to prepare now

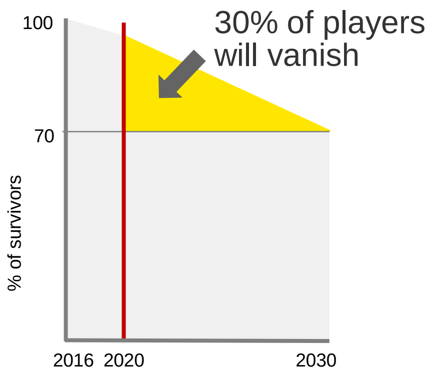
Scenarios: overview

Scenario	Description
1 **Industry consolidation**	► In our base case scenario, **competition increases** among incumbents due to the **challenging market environment,** mainly driven by **external drivers** ► However, new entrants do not reach a critical scale and the insurance industry's **value chain remains integrated** ► Emerging **technology gets adopted**, but **does not disrupt** the entire insurance business model ► Underperforming players are acquired or squeezed out in a price war
2 **Partial industry disruption**	► In this scenario, insurers **compete against InsurTech** companies on part of the value chain ► **InsurTech** reaches a **maturity level** for **different elements** (e.g. client acquisition, distribution, claims, etc.) – however, **core elements** of the insurance value chain (e.g. underwriting) **remain unchanged** ► Underperforming players lose customers to InsurTech and innovative peers, and are thus squeezed out of the market
3 **Full industry disruption**	► In this scenario, **big players** from **other industries** enter the insurance market to provide **entire insurance solutions** tailored to customers ► These are typically **big tech players** or other **large corporates** who know the insurance customers better and have **better access** to them than insurers ► The industry's business model is redefined in this scenario; to survive, most players need strategic partnerships in an ecosystem around customers (comparable with the mobile phone industry)

If no action is taken, 30%, 45% and 70% of Swiss insurers will vanish by 2030 in each of the 3 respective scenarios

Scenarios: details

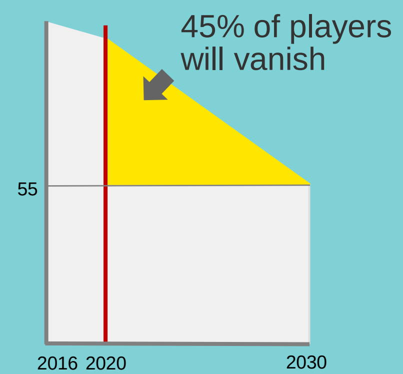
1 Industry consolidation



Low probability of occurrence

In scenario 1 (consolidation), companies can only reach their 5-percent-growth targets if they take over or squeeze out 30% peers given the market growth potential.

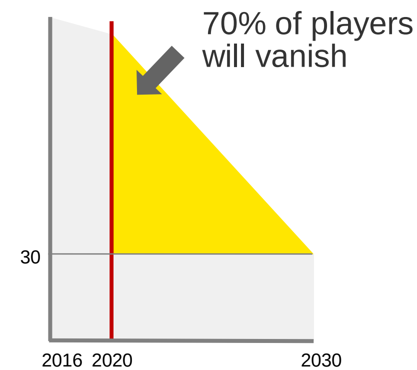
2 Partial industry disruption



High probability of occurrence

In scenario 2 (partial disruption), on top of the competition among existing players as in scenario 1, we assume that in 2020 five new InsurTech providers will secure a foothold in the Swiss market, jointly attracting 300,000 customers per year (Friendsurance has acquired 60'000 customers a year in Germany). On aggregate roughly 45% of companies will be squeezed out of the market.

3 Full industry disruption



Medium probability of occurrence

In scenario 3 (complete disruption), additional majors from outside the industry establish operations in the market. Given their financial clout and digital alignment, we assume that the new players can win 100% of digital natives aged under 40 and 40% of customers aged over 40 by 2030. They are able to gain a substantial market share much faster than InsurTechs. On aggregate, 70% of traditional players will be squeezed out.

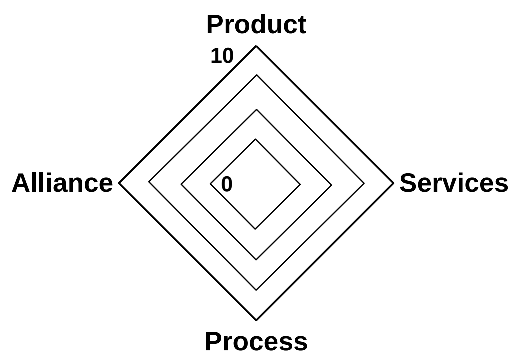
Traditional insurers survived | Traditional insurers vanished

Source: Team analysis based on examples of insurance industry in other countries

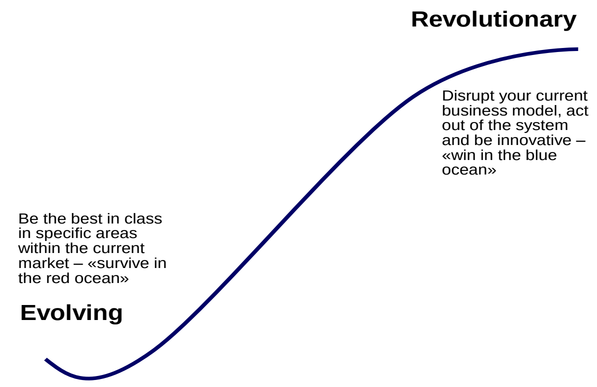
We suggest a two-step approach to address future strategic challenges and reposition in new environment

Our framework: overview

Step 1: Define your areas of focus



Step 2: Define level of change



Possible dimensions of focus

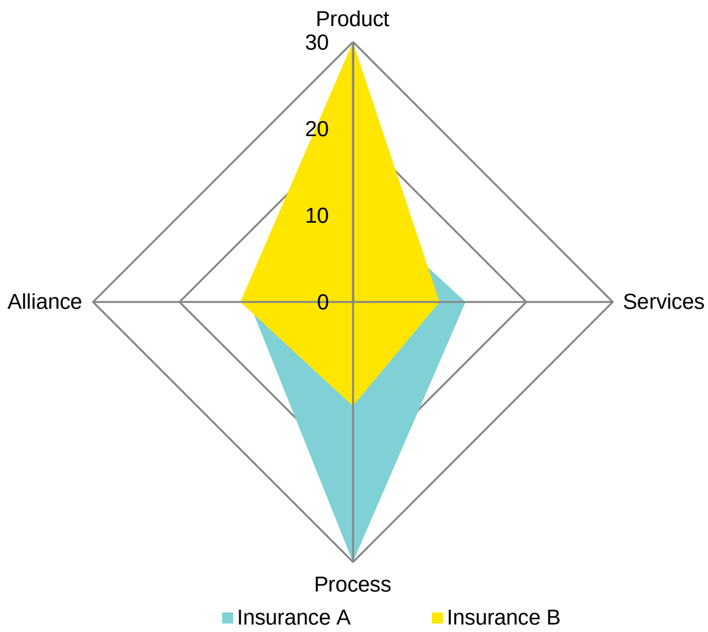
- **Product:** Simple & coherent, innovative, cheap, etc.
- **Alliance:** Working with partners in channels (e.g. brokers), with disruptive start-ups or with industry players (e.g. car manufacturer) and tech giants (e.g. Google)
- **Services:** Fast claim management, sophisticated life insurance advisory, automation, etc.
- **Process:** lean and integrated processes enable cost benefits and organizational agility

Possible intensity of change

- After choosing their field of play, market players need to decide, whether they want to stay in current market or explore new markets
- Extent to which market players can and need to take evolutionary or revolutionary approach in their strategies strongly depends on given scenario
- Some scenarios are too dynamic for evolving strategies and require a business model revolution
- **Evolving:** gain scale in current market, standardize products in current market, simplify processes, etc.
- **Revolutionary:** Enter new market segments and offer new and innovative products, form new, disruptive alliances with new market players, create NewCos with new business models, etc.

In the future, focus will be key – market players need to analyze their strengths and decide on which areas to focus

Strategic positioning: Specialization spider diagram



Insurance A:

- Is a leader in operational excellence and thus is able to provide lowest price for similar products
- Has a «optimizing» culture

Insurance B:

- Is a leader in understandable, innovative products
- Has a «creative / innovative» culture

Comments

- Our framework has 4 dimensions
- Market players need to analyze their current capabilities and decide in which dimensions they want to be future leader
- It will not be possible to be an all-round player with a fully integrated value chain similar to current insurance model, which means that specialization is key

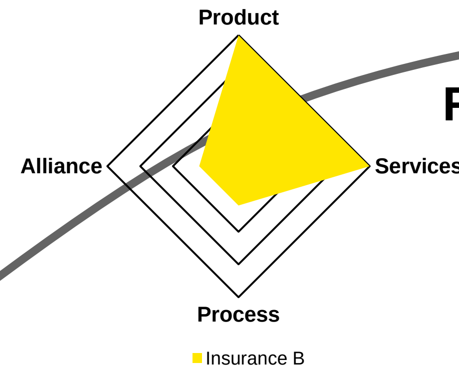
In our most likely scenario, 2 possible strategic directions are looking for partners or fighting the disrupters

Scenario analysis: Most likely scenario

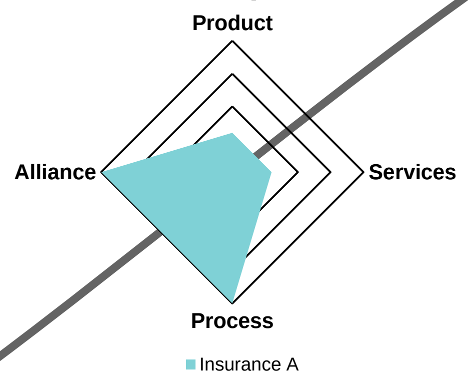
Look for partners

- Use new disruptive start-ups as an opportunity to make your value chain more efficient
- Partner up with new disruptive market players and outsource specific elements of your value chain to make your processes leaner so you can compete based on prices and jointly squeeze other disrupters out of market
- Mobiliar acquired Scout24, an online market place for automotive and real estate. Through this alliance, Mobiliar is able to integrate underwriting of related property and liability risks into the real estate and car purchases

Revolutionary



Look for partners



Fight the disrupters

Fight the disrupters

- Focus on providing very disruptive & innovative insurance services better than all disruptive market players to directly compete with them (e.g. through a NewCo)
- E.g. health insurer provides health monitoring and support
  - Health insurer not only uses data of insurers transmitted by a wearable to calculate their premium, but also to help them monitor their health
  - Health insurer constantly analyzes data and alerts insured when they detect dangerous patterns
- Win in market by disrupting the disrupters
- Sanitas launched a mobile app, which digitalizes policies and help to find a doctor nearby

Evolving

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