Swiss Insurers Gain Strength From Diversification And Cost Control

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Swiss insurers' 2017 results display continued strength, in S&P Global Ratings' view. We believe the solid performance, in particular for the property/casualty (P/C) segment, stems from the insurers' commitment to underwriting discipline and cost efficiency. For their part, life insurers benefitted from further back book management such as portfolio shifting from traditional to capital-light products, and cost reduction, supported by fee income from unit-linked business and asset management business. What's more, Swiss insurers started to transform their business models several years ago, increasing their resilience to a tough operating environment of limited organic growth opportunities, low and even negative interest rates, and a stringent solvency regime.

Key Takeaways

- The Swiss insurers we rate delivered strong results in 2017, with key credit metrics in line with, or exceeding, our expectations.
- These companies are well positioned to cope with low interest rates as per our base case. We expect they will further shift their portfolios to capital-light products, continue to improve profitability and capitalization of the life segments, and comply with the stringent regulatory regime.
- The P/C segment is a solid profit contributor with favorable combined ratios, which are some of the lowest in Europe.

We rate six Switzerland-based primary insurance groups, namely AXA Versicherungen, Allianz Suisse, Baloise, Helvetia, Swiss Life and Zurich, most of which are composite insurers and two of which are Swiss entities of international insurance groups. The average financial strength rating is in the upper 'A' range for these six insurers, which compares well with the 'A' average for insurers we rate in Western Europe. The average rating may be trending upward because two companies--Baloise and Swiss Life--have a positive outlook.

Table 1

Swiss Insurers: Peer Comparison

	Swiss Life group	Helvetia group	Zurich group	Baloise group	Allianz Suisse group	AXA Versicherungen
IICRA	Low Risk	Low Risk	Intermediate Risk	Low Risk	N/A	N/A
Competitive position	Strong	Strong	Extremely Strong	Strong	N/A	N/A
Business risk profile	Strong	Strong	Very Strong	Strong	N/A	N/A
Capital and earnings	Very Strong	Strong	Very Strong	Very Strong	N/A	N/A
Risk position	Moderate Risk	Intermediate Risk	Intermediate Risk	Intermediate Risk	N/A	N/A
Financial flexibility	Adequate	Adequate	Strong	Adequate	N/A	N/A
Financial risk profile	Strong	Strong	Very Strong	Very Strong	N/A	N/A
Anchor	a-	a	aa-	a+	N/A	N/A
Management and governance	Satisfactory	Satisfactory	Satisfactory	Satisfactory	N/A	N/A
ERM	Strong	Adq, Strong Risk Controls	Very Strong	Strong	N/A	N/A
SACP/GCP final adjustment	0	0	0	(1)	N/A	N/A
Indicative SACP/GCP	a	a	aa-	a	N/A	N/A
Liquidity	Exceptional	Exceptional	Exceptional	Exceptional	N/A	N/A
SACP/GCP	a	a	aa-	a	N/A	N/A
GRE status	No	No	No	No	N/A	N/A
Group status	N/A	N/A	N/A	N/A	Core	Core
FSR/GCP	A	A	AA-	A	AA-	AA-
Outlook	Positive	Stable	Stable	Positive	Stable	Watch Negative

IICRA--Insurance industry country risk assessment. ERM--Enterprise risk management. SACP--Stand-alone credit profile. GCP--Group credit profile. FSR--Financial strength ratings. N/A--Not applicable.

A Nontraditional Product And Underwriting Strategy Pays Off

In 2017, rated Swiss insurers' results, both from underwriting and investments, were generally in line with, or above, our base-case expectations (see table 2). This was despite a shrinking market in the life business where prolonged low or even negative interest rates limit sales of traditional new business. We believe the insurers' success is the result of an earlier shift in product portfolios toward nontraditional products and fee business, which are less sensitive to interest rates.

Table 2

Key Metrics: Rated Insurers Outperformed Our Forecasts In 2017

Full-year 2017 and 2016 performance versus S&P Global Ratings' expectations for 2017 and 2018

	2018f	2017f	2017	2016
Baloise group				
GPW (mil. CHF)	About 6,500-6,700	About 6,600-6,800	6,741	6,712
Net income (mil. CHF)	>500	>500	532	534
Return on shareholders' equity (%)	8-12	8-12	8.9	9.5
P/C net combined ratio (%)	93-95	93-95	92.3	93.2
Net investment yield (%)	>2.0	>2.1	2.5	2.2
S&P capital adequacy	At least very strong	Extremely strong	Extremely strong*	Extremely strong
Fixed-charge coverage (x)	~20	~20	~20*	20
Financial leverage (%)	~20	~20	~20*	18
Helvetia group				
GPW (mil. CHF)	8,700-8,800	8,500-8,600	8,478	8,403
Net income (mil. CHF)	400-450	400-450	403	377
Return on shareholders' equity (%)	>8	>8	9.8	8.0
P/C net combined ratio (%)	<95	<95	91.8	92.6
Net investment yield (%)	>2%	>2%	2.1	2.1
S&P capital adequacy	Strong	Strong	Strong*	Strong
Fixed charge coverage	>10	>10	11*	16
Financial leverage (%)	<30	<30	28*	23
Swiss Life group				
GPW (mil. CHF)	~13,000	13,652	12,946	13,384
Net income (mil. CHF)	~1,000	900-950	1,013	926
Return on shareholders' equity (%)	6-8	~7	6.9	7.1
Life new business margin (%)	2-3	>1.5	2.5	2.1
Net investment yield (%)	~3.0	~3.0	2.6	2.7
S&P capital adequacy	Extremely strong	Extremely strong	Extremely strong*	Extremely strong
Fixed charge coverage	9-11	>9	10	10
Financial leverage	>20	>20	16	21
Zurich group				
GPW (mil. CHF)	~51,000-52,000	~51,000-52,000	48,346	50,615
Net income (mil. CHF)	>3,000	>1,900	3,257	3,478
Return on shareholders equity (%)	>9	>6	9.8	10.6
P/C net combined ratio (%)	~96-98	~100-105	103.4	98.8

Table 2

Key Metrics: Rated Insurers Outperformed Our Forecasts In 2017 (cont.)

Full-year 2017 and 2016 performance versus S&P Global Ratings' expectations for 2017 and 2018

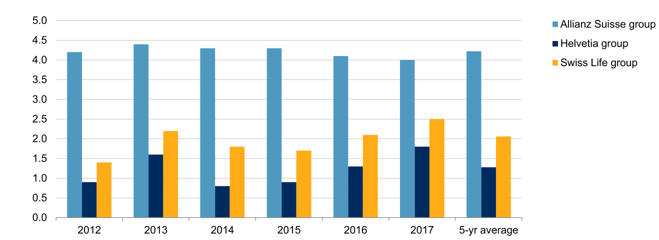
	2018f	2017f	2017	2016
Net investment yield (%)	>2.4	>2.4	2.7	2.9
S&P capital adequacy	Very Strong	Very Strong	Very Strong*	Very Strong
Financial leverage (%)	<30	<30	~30*	25

GPW--Gross premiums written. Sources: S&P Global Ratings' publications and insurers' own published results. We do not have company specific assumptions for Allianz Suisse and AXA Versicherungen as they are core to their respective groups. *Expected capital adequacy, fixed charge coverage and financial leverage ratios for 2017.

The profitability of Swiss insurers remains respectable. The P/C segments of insurance groups are solid profit contributors, based on favorable underwriting results, with one of the lowest combined (loss and expense) ratios in Europe, similar to the combined ratio in Nordic markets. The P/C segment grew by more than 1.5% in 2017, we estimate, and is very resilient because of the relatively long-term nature of the dominating business lines, such as motor, which are based on multiyear contracts.

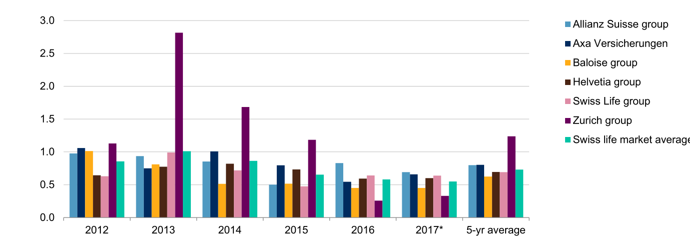
Swiss life insurance is dominated by group life insurance business, where the top-three major players wrote 70% of premiums in 2016. Despite the low-interest-rate environment, profitability and new business margins of the market leaders have improved at least over the last three years (see chart 1). In 2017, Swiss Life, which is the market leader in Switzerland, improved its new business margin (based on the present value of new business premiums) to 2.5%, from 2.1% the year before. This was mainly driven by an improved portfolio mix rather than the yield uptick. The legal allowance for adjusting guarantee rates of the back book in the Swiss mandatory group life business smooths operating pressure for the local life insurers (see "European Life Insurers Are Playing The Long Game With Product Shifts," published Feb. 22, 2018). This can also be seen in a solid return on assets (see chart 2).

Chart 1



Source: Company published annual reports. *No published results for Axa Switzerland; Baloise and Zurich results not included because they are based on Annual Premium equivalent.

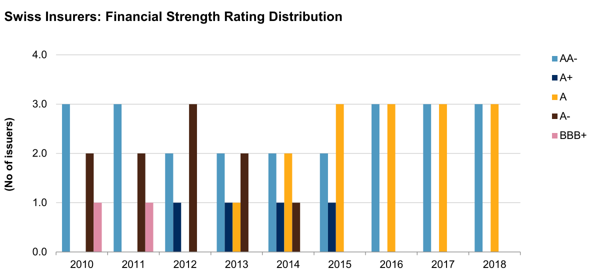
Chart 2



*S&P Global Ratings' estimates for Baloise, Hevetia, and Zurich. Source: Company published annual reports; market average based on Finma report.

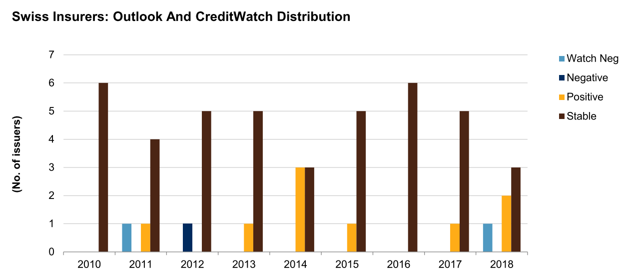
Swiss insurers' resilience against low interest rates is evident in their consolidated or improved capital positions, which in turn backed ratings stability. Several years of low and even negative interest rates have reduced coupons from fixed-income investment and heightened reinvestment risk for those life insurers whose back books contain policies with guaranteed returns. Yet our ratings on Swiss insurers have stayed largely stable and in fact we see a positive trend (reflected in the positive outlooks on Baloise and Swiss Life) because companies have managed to diversify their businesses while they consolidate or improve their capital positions (see charts 3 and 4). This showcases the measures companies have taken to mitigate lower yields. For example, life insurers have been moving toward capital-light products, such as unit-linked products or products with lower or no guarantees. They have also diversified their earnings through fee business or have completely switched the product portfolio to semi-autonomous products in the group life segment. The switch to these products might be a reaction to the maintenance of the conversion rate at 6.8% for mandatory group life products, following the rejected pensions reform referendum in September 2017. Against that background, AXA Versicherungen's exit from the full cover group life business didn't come as a surprise. In addition, diverse assets and liabilities supported by advanced risk management, and also driven by a stringent regulatory regime, stabilize risk capital.

Chart 3



Ratings at year-end, except 2018 which is on May 22, 2018.

Chart 4



Outlooks at year-end, except 2018 which is at May 22, 2018.

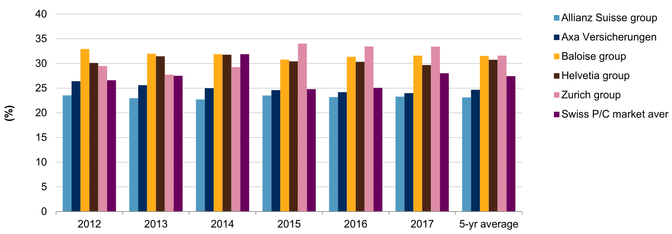
High Efficiency In A Saturated Market

We don't expect the operating environment for Swiss insurance companies will change much over the coming two to three years, because organic growth opportunities are limited and barriers for market entrants are high. The life market is already concentrated, with 85% of gross written premiums stemming from the top-five insurers (and 70% from the top three, Swiss Life, Axa Leben, and Helvetia). Domestic non-organic growth and even bolt-on acquisitions are an exception rather than standard, such as the takeover of Nationale Suisse by Helvetia in 2014. In addition, the Swiss insurers we rate are generally well established, with well-known brands and long-standing distribution networks.

Underwriting results in Swiss P/C are some of the strongest in Europe, with combined ratios of below 90% for the domestic market (company-specific results differ because of inclusion of foreign markets). There are three reasons for this strong underwriting result in our view. Firstly, contracts of more than one year such as in motor liability and to some extent less fierce price competition than in other markets. Secondly, natural catastrophe risks are ceded to a large extent. Finally, the ultralow interest rate environment adds further discipline to expense ratios (see charts 5 and 6). We believe this focus on cost-efficiency will continue.

Chart 5

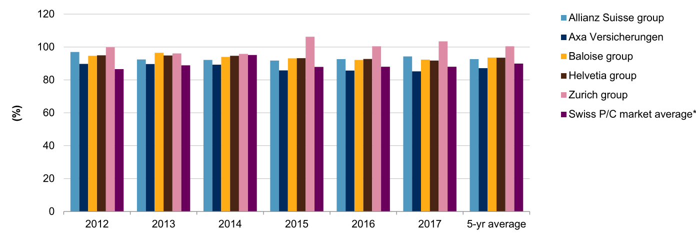
Swiss Insurers: Company-Specific Property/Casualty Expense Ratios



*S&P Global Ratings' estimate for 2017. Source: Company published annual reports; market average based on Finma report.

Chart 6

Swiss Insurers: Property/Casualty Net Combined Ratios



*S&P Global Ratings' estimate for 2017. Source: Company published annual reports; market average based on Finma report.

One element of improving cost-efficiency is companies' investment in digitalization, which so far has made its way into areas such as claims handling, invoicing, digital health declarations, and robotics. Nevertheless, we believe that digitalization efforts still lag behind those in the Nordic markets, where insurers are able to turn technology trends to their advantage (see "Nordic Insurers: Digitalization Is A Key To Operational Efficiency," published May 2, 2018, on RatingsDirect). We think Swiss insurers will continue to invest in digitalization in the coming years, to maintain efficiency and customer service.

In addition, Swiss insurers are putting great efforts into business development and diversification beyond the primary insurance space. Examples are Baloise's property-related services for customers as well as selected banking activities, and Helvetia's activities in specialty business including reinsurance. All these businesses add value and diversification to the companies' established platforms.

Healthy Capitalization Showcases Stringent Regulation

The already high level of capitalization of rated insurance groups in Switzerland will remain stable or become slightly stronger, in our view. With a stringent regulatory regime already in place for some years, rated insurers have continuously strengthened their capital position.

Swiss insurers have well-diversified asset portfolios by geography, and in general focus on asset classes that are less interest-sensitive, particularly property. Fixed-income securities make up around a half of most portfolios, which will remain a stable anchor. A specific Swiss sector feature is its high exposure in property, often held for decades. This stems from an attractive risk reward profile, with a high quality local regulated rental residential market and attractive returns above many other asset classes. It is also noteworthy that with exposure in the range of 2%-3%, Swiss insurers are less prominent equity investors in relative terms than other markets like the Nordic countries. Swiss insurers also hold fixed-asset investments outside Switzerland to match the diversified insurance liabilities from their operations outside Switzerland with higher average coupons. Investments in foreign currency are nearly fully hedged. Asset-liability mismatch risk exists but is quite low. For instance, market leader Swiss life reported a mismatch below one year over the last five years.

Local solvency ratios are well above the regulator's intervention threshold of 100%. Financial condition reports, which companies published for the first time in April 2018, show results comfortably within a range of 170%-262% for rated Switzerland-based groups as of Jan. 1, 2018 (151%-214% as of Jan. 1, 2017). In particular, nonlife players are holding around twice the capital required by the regulator. This moves in parallel with the results of the S&P capital adequacy model, where rated insurers show results in the 'AA' or 'AAA' range with a positive trend (table 3).

Table 3

Swiss Solvency Test (SST) Results Versus S&P Capital Adequacy

(%)	2017	2016
Allianz Suisse Group		
SST ratio (Allianz Leben)	181	180
SST ratio (Allianz Sach)	232	202
Axa Versicherungen		
SST ratio	177	151
Baloise Group		
SST ratio	262	214
S&P Global Ratings' capital adequacy	Extremely strong*	Extremely strong
Helvetia Group		
SST ratio	212	165
S&P Global Ratings' capital adequacy	Strong*	Strong
Swiss Life		
SST ratio	170	161
S&P Global Ratings' capital adequacy	Extremely strong	Extremely strong
Zurich Group		
SST ratio	216	204
S&P Global Ratings' capital adequacy	Very strong*	Very strong

Sources: S&P Global Ratings' publications and insurers' own published results. We do not publish company specific capital adequacy for Allianz Suisse and AXA Versicherungen as they are core to their respective groups. *Expected capital adequacy.

Related Criteria

- Insurers: Rating Methodology, May 7, 2013

Related Research

- Nordic Insurers: Digitalization Is A Key To Operational Efficiency, May 2, 2018
- Insurance Industry And Country Risk Assessment: Switzerland Life, March 1, 2018
- Insurance Industry And Country Risk Assessment: Switzerland Property/Casualty, March 1, 2018
- European Life Insurers Are Playing The Long Game With Product Shifts, Feb. 22, 2018
- Swiss Life, May15, 2018
- Helvetia Insurance Group, Dec. 4, 2017
- Baloise Group, Nov. 30, 2017

- Zurich Insurance Co. Ltd., Nov. 7, 2017

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