

Current situation

Over the past decades, interest rates have decreased to historic lows (see figure 1). Despite the recent increase of the federal funds rate in the US, insurance companies and regulators will likely have to deal with low interest rates for years to come. According to the latest CFO Survey¹ conducted by Deloitte in Switzerland, the majority of Swiss CFOs still do not expect Swiss interest rates to rise until 2018 at the earliest (see figure 2).

Figure 1. How interest rates have developed over the past decades (overnight rates from central banks are displayed)

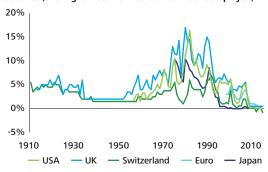
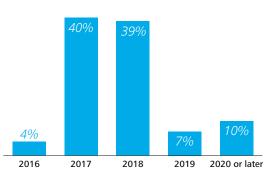


Figure 2. When Swiss CFOs expect the base rate of Swiss interest rates to rise



This situation of continued ultra-low interest rates significantly impacts clients, insurance companies and regulatory bodies.



Customers adapt to the low interest rate environment. The fraction of real estate owners has increased disproportionately over the last decade. Additionally, alternative investment options have become more popular: The share of "Buy to Let" mortgages has doubled and Credit Suisse mortgages in 2015².



FINMA has reduced the maximum guaranteed interest rates that life insurances may offer to their customers from 1.25% to

 $^\prime\!O$ (0.5% for single premium policies). The Swiss Government reduced the minimum guaranteed rate of interest credit for the mandatory part of pension savings from 1.75% in 2015 to 1.25%in 2016. Under Solvency II the ultimate forward rate (UFR) was introduced which artificially lowers the economic weight of long-term liabilities.

Impact on the Industry

Pension Funds

Swiss pension funds require an average minimum return O to keep their funding ratios stable. To keep the current level of benefits, pension funds will either have to bear significant investment risks to achieve this minimum return or they face the risk of a deteriorating funding ratio.

General Insurance

Low interest rates have stimulated a hunt for yield, which lead to additional capital flows into the insurance market. The market of Non-Life Insurance linked securities increased by

O compared to 2008. The higher supply of funds diminishes the premium rates due to fierce competition.

Life Insurance

their solvency capital.

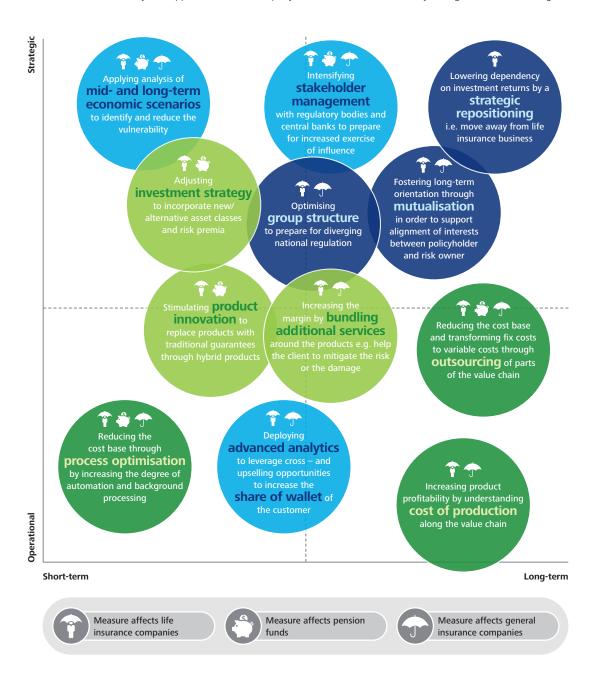
Due to the low interest rate environment, in 2014 Swiss life insurance companies had to use 50% of the total operating result to strengthen





Strategies for insurance companies

Different strategies can be applied to cope with the low interest rate environment. A selection of specific measures is presented below. We differentiate measures on the strategic vs operational level (vertical axis) and measures with short-term vs long-term effect (horizontal axis). A thorough analysis of the strategic positioning and the operating model can reveal the vulnerability and opportunities of a company and form the basis to identify the right mixture of strategies.



Insurance companies in Switzerland will have to prepare for a continuation of ultra-low interest rates and increased activity of regulatory bodies. A special focus should lie on the **alignment of products with capital market instruments**, the adjustment of the **investment strategy**, and a **review of the group structure** with intra-group liquidity management.

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References

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- 2. Immobilienmarkt 2015 Strukturen und Perspektiven. Credit Suisse Economic Research, March 2015 and www.ubs.com

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