Product innovation in a low-interest rate environment – Experience of an international insurance group

Lukas Junker

ZURICH

V Congreso Internacional
Dependencia y Calidad de Vida
El reto de la cronicidad

Organizadores

Patrocinador

medirest
Una marca de Compass Group

Colaboradores

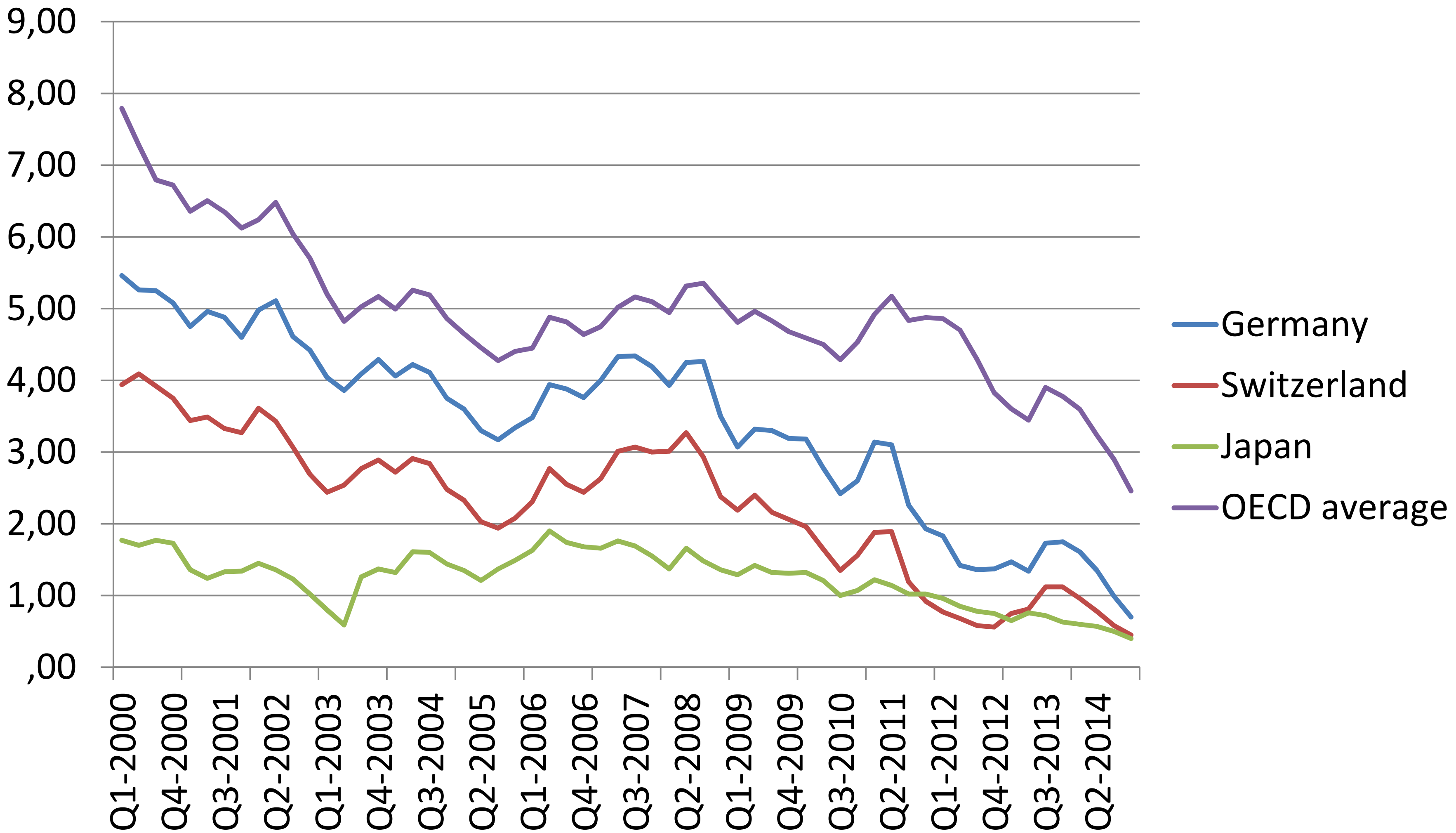
Madrid, 10-11 de marzo de 2015
Palacete Duques de Pastrana

Agenda

- **Context – general implications of low interest rates for life insurers**
- Evolution of product offering in countries affected by low rates
- Outlook

Countries most affected by low interest rates have been Japan, Switzerland, and Germany

Long-term interest rates, Percent



Source: OECD

Low interest rates affect Life insurance companies in 3 ways

Pressure on new business volumes

- Overall savings rate decreases (although only relatively mildly)
- Less willingness to save long-term
  - Shift towards short-terms savings vehicles (wait-and-see approach)
  - Shift towards real estate

Challenges to value proposition

- Traditional guaranteed products return less than zero to the customer after cost…
- … but customers still want guarantees

Squeeze to in-force economics

- Reinvestment at lower rates results in compressed spreads
- Challenges to profitability as well as financial stability – “train running slowly into the wall, but the doors are closed”

Insurance companies have reacted in different ways – 2 "camps"

Strategic shift

Incremental optimization

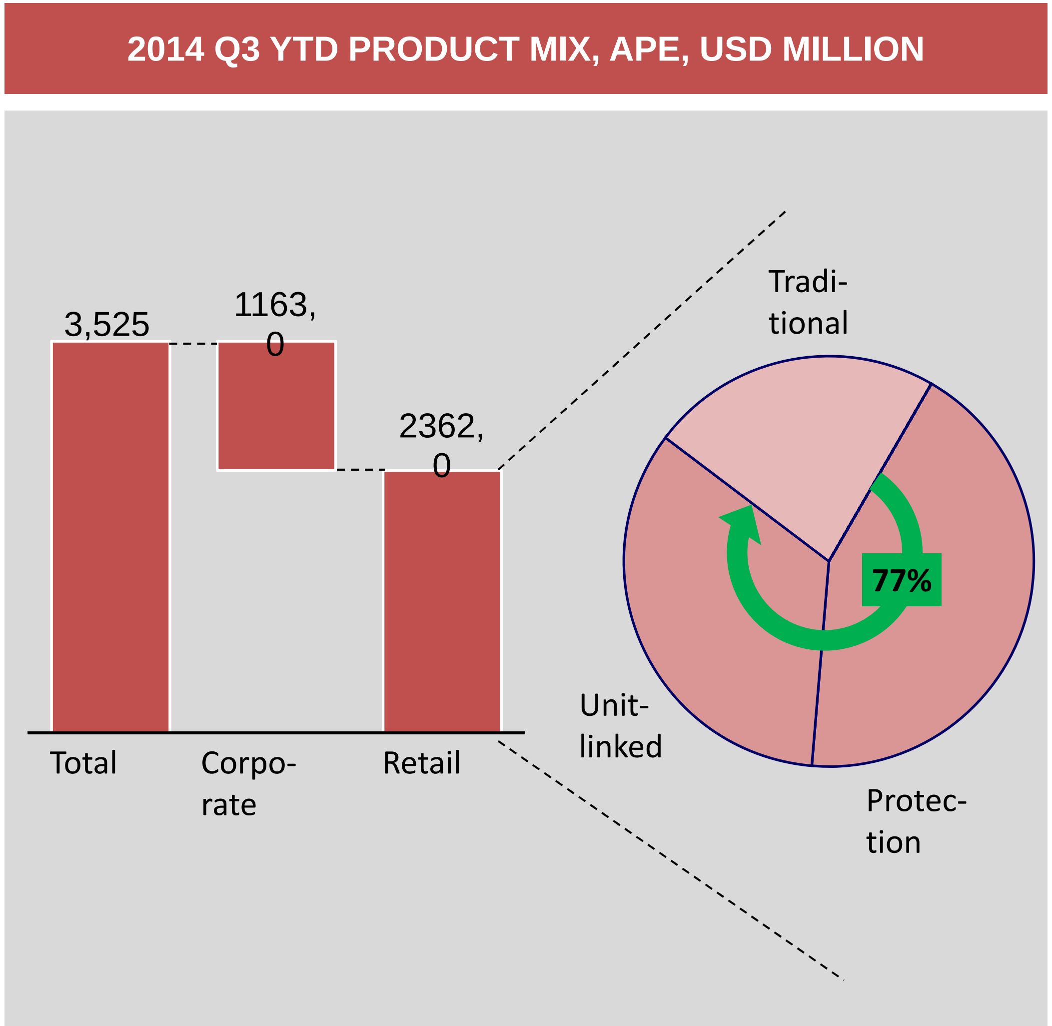
- Market perspective
  - Long-term guarantees are a fundamental part of the life insurance value proposition
  - Low-interest rates are a temporary phenomenon
- Actions
  - Continue to provide guaranteed products, optimized to reduce capital intensity
  - Cut distribution and admin costs
  - … and hope that interest rates go up again

- Market perspective
  - Insurance companies are not rewarded for taking investment risk
  - Low-interest rates are potentially long-lived
- Actions
  - Move away from products with interest rate risk
  - Focus new business on protection and unit-linked products
  - Some companies: build asset management capabilities in order to capture part of margin

- Most continental European insurance groups

- UK and Nordic insurance groups

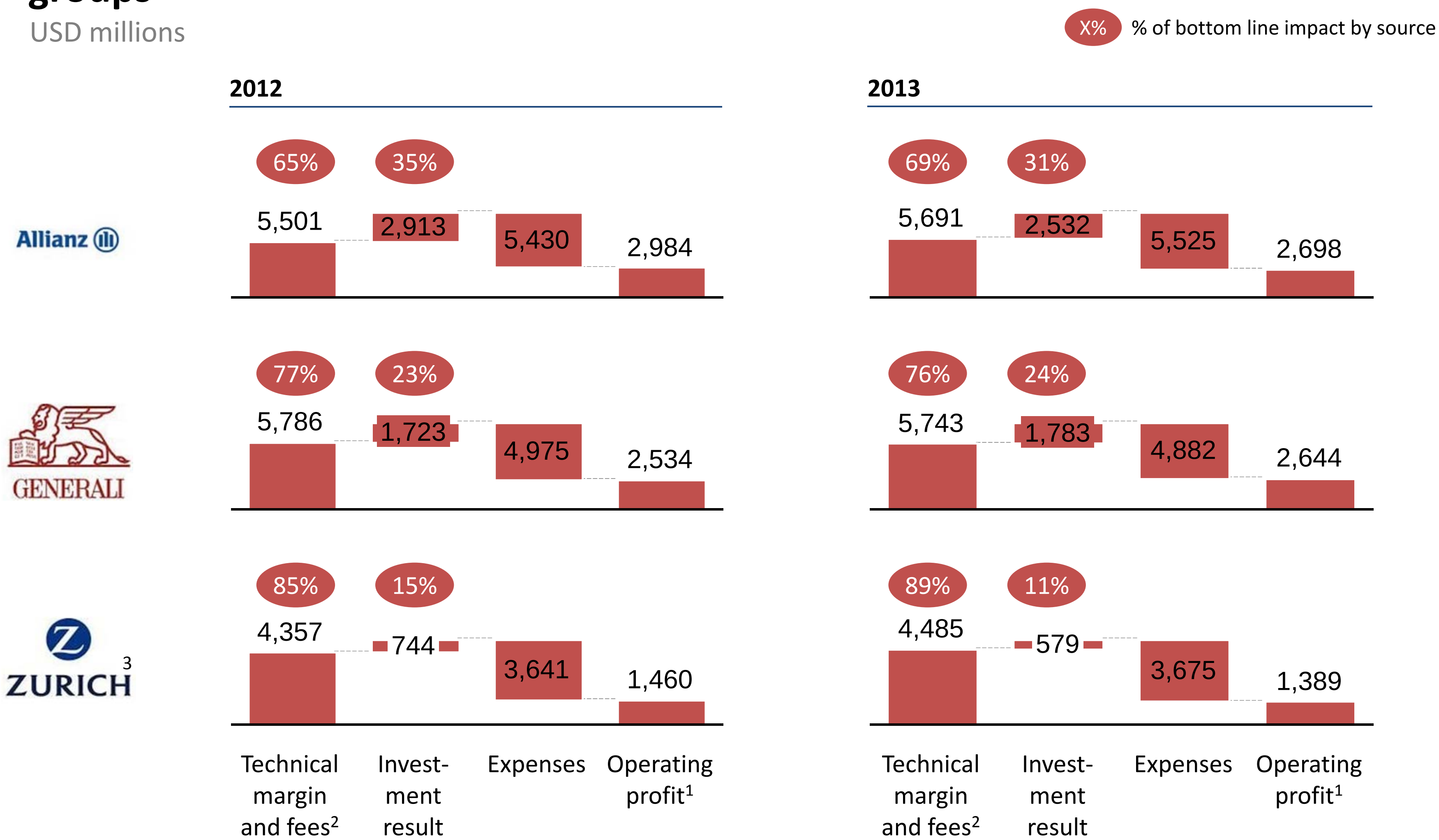
Our experience at Zurich – strategic shift + product innovation



- Clearly defined global strategic priorities – corporate, unit-linked, protection
- Traditional business actively de-emphasized
- Product innovation in different guarantee concepts (e.g., CPPI)

As a result, lowest exposure to investment result among large insurance groups

USD millions

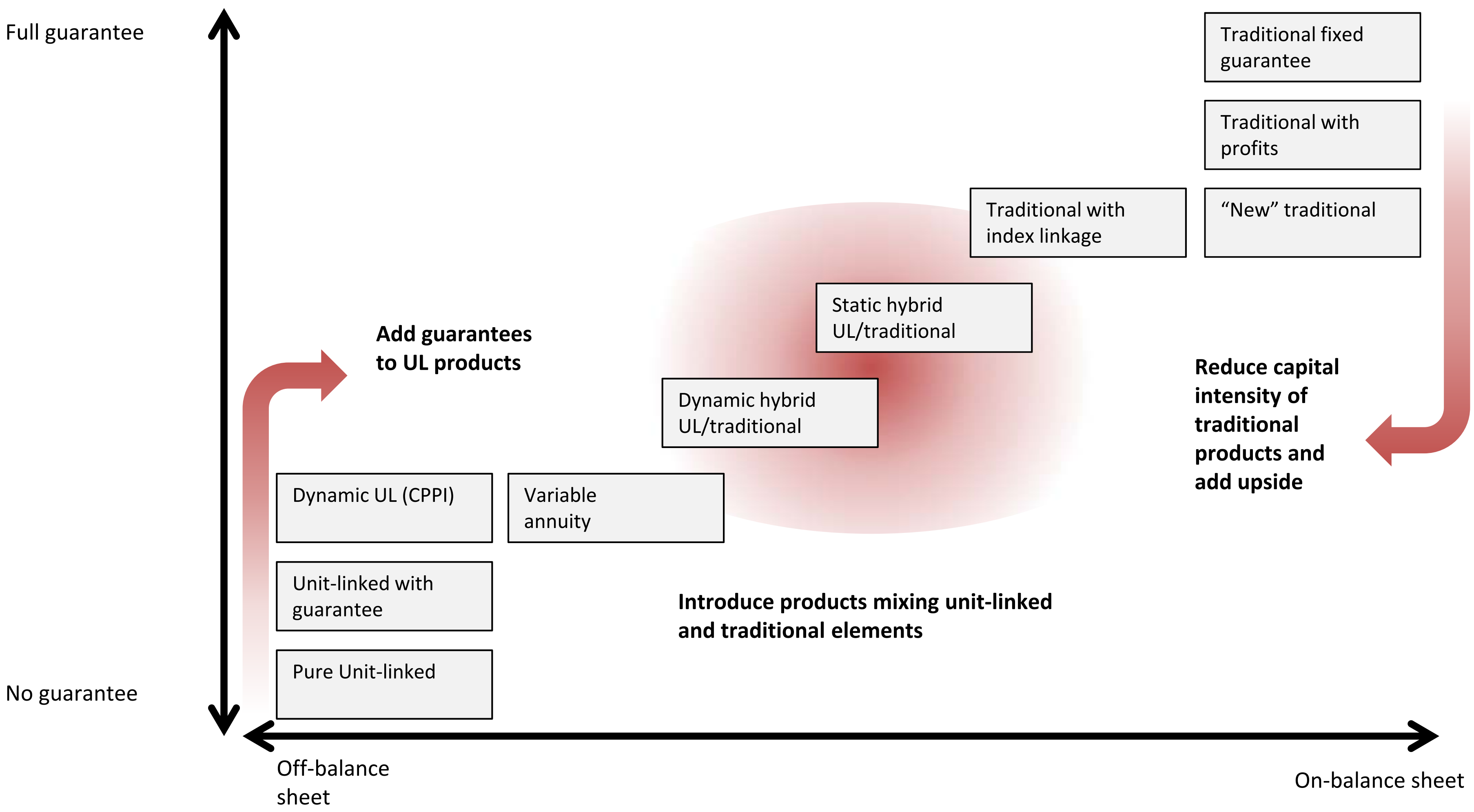


1 Before deferrals
2 Fees, loadings, risk margin
3 Includes Zurich Santander net result, primarily risk margin net of expenses (USD 105m/182m 2012/2013)

Agenda

- Context – general implications of low interest rates for life insurers
- **Evolution of product offering in countries affected by low rates**
- Outlook

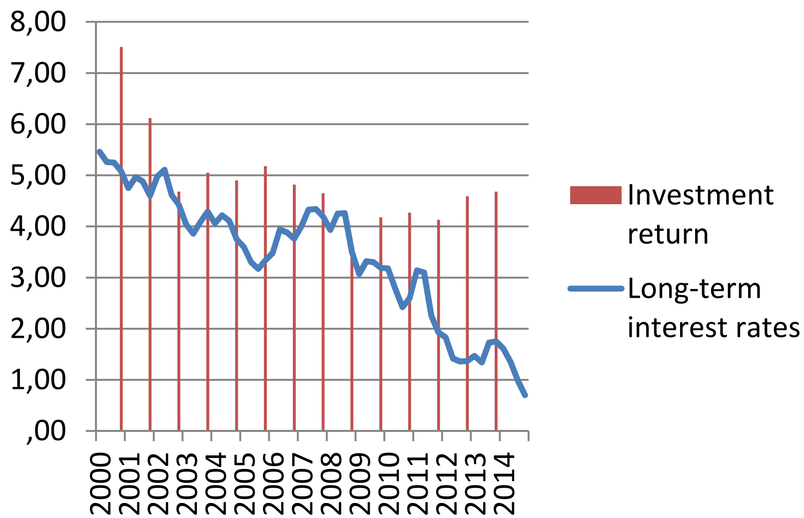
Substantial innovation activity – many different competing concepts



Example German market

Market characteristics

- Customer demand for guarantees remain strong – hardly a market for pure unit-linked products without guarantees
- Long-duration investment strategy has so far buffered impact of low interest rates – credited rates remain relatively high
- Product innovation has been mainly targeted at
  - Bringing more upside into traditional products
  - Reducing capital intensity of traditional products



Product innovation activity (examples)

Traditionals with index linkage

- Traditional with profits product with lower guarantee
- Bonus invested into certificate linked to index

Hybrids

- Combination of traditional and unit-linked product
- Static or dynamic allocation two 2 or 3 baskets

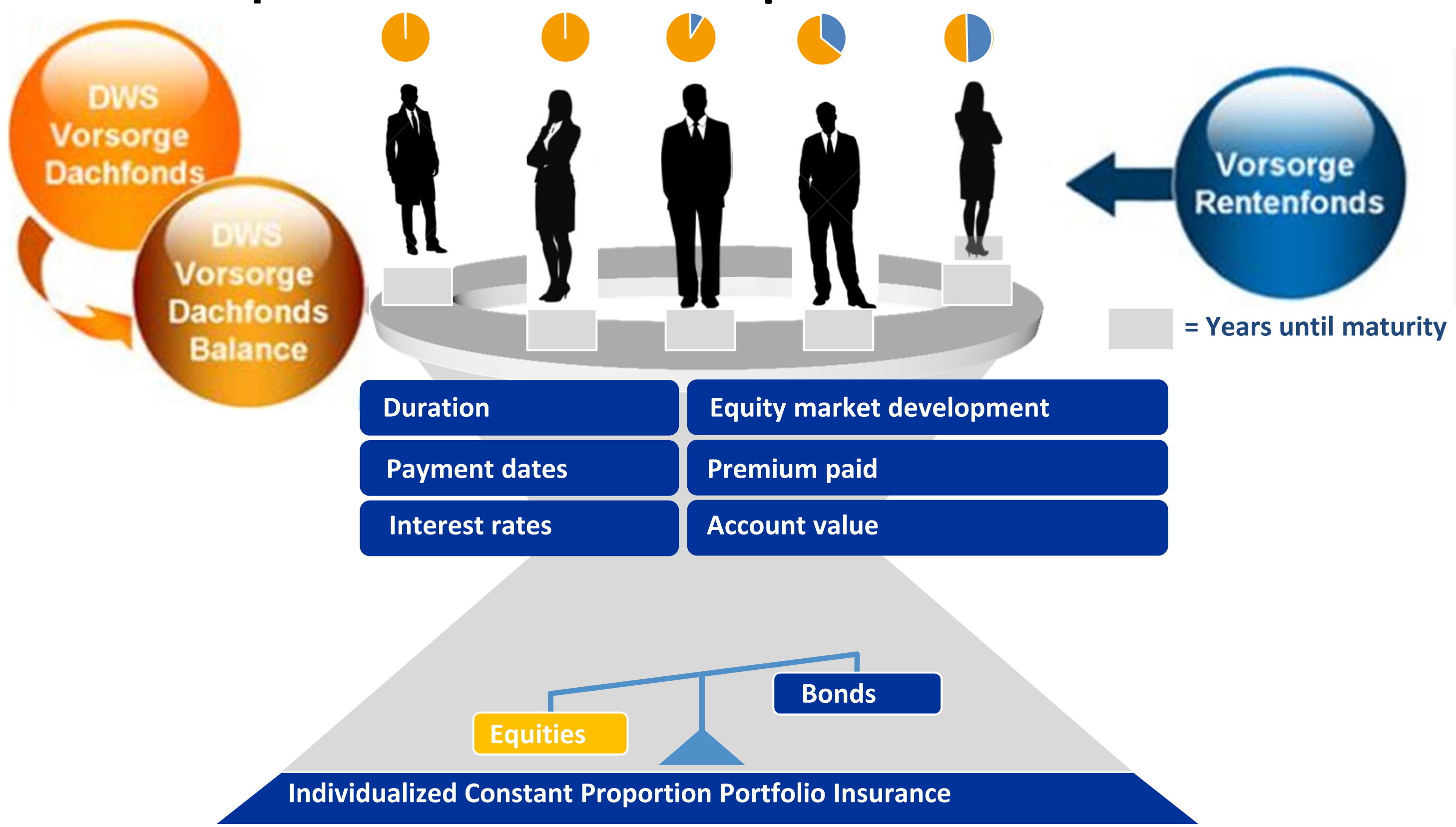
Variable annuities

- Unit-linked product with guarantee
- Guarantee is hedged or reinsured
- Has remained niche so far

UL iCPPI

- Unit-linked product with dynamic asset allocation
- Guarantee given by 3rd party

Product example – Zurich DWS iCPPI product



- Dynamic reallocation between equity and bond funds based on CPPI algorithm
- Return of premium guarantee at maturity, given by 3rd party (DWS)
- Lock-in of maximum value after 5 years
- Optional adjustment to more conservative asset allocation when approaching maturity
- Optional protection riders available (e.g., disability)

Example Swiss market

Market characteristics

- Extensive Pillar 2 coverage with
  - Mandatory employer contribution + optional top-up payments by employees
  - Attractive annuity factors
- Pillar 3 savings largely discretionary – relatively high risk appetite and receptiveness to unit-linked products
- Early onset of low interest rates has spurred product innovation
- Most activity in the area of structured products

Product innovation activity

New traditionals

- Traditional products with reduced guarantees in return for higher upside
- Reduced guarantees can be e.g., in form of lower guaranteed rate (0%) only)

AXA winterthur

Traditionals with index linkage

- Traditional with profits product with bonus invested into certificate linked to index
- Usage of levered certificates in order to increase exposure level

ZURICH

helvetia

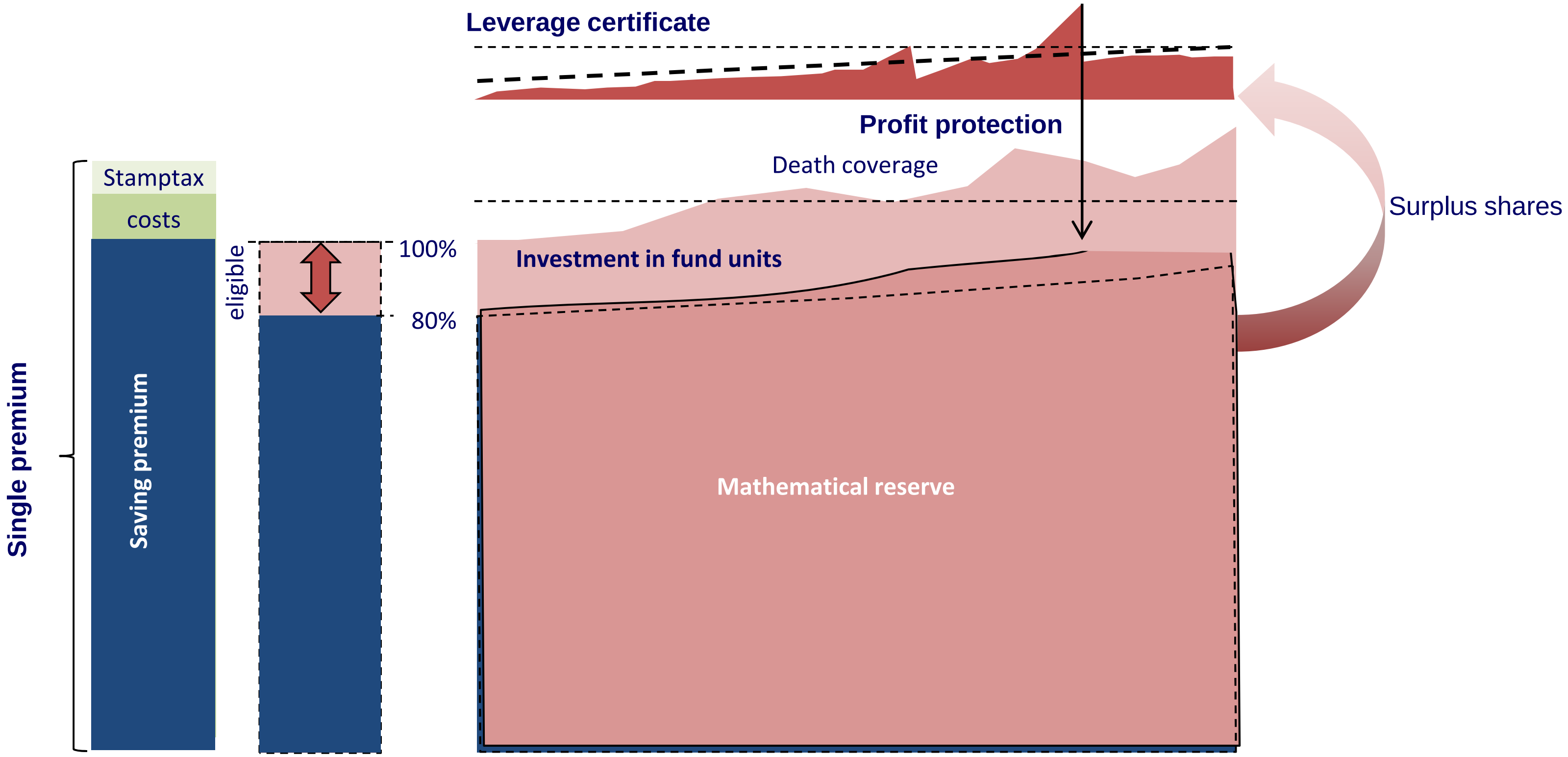
Variable annuities

- Unit-linked product with guarantee
- Guarantee is hedged or reinsured
- Has remained niche so far

Basler Versicherungen

SwissLife

Product example – Zurich VorsorgePremium certificate product with index linkage



- Product responds to challenge to static hybrid products: if a guaranteed is supposed to be given, investment into equity part and hence equity exposure will be very low
- In this product, the premium is invested into segregated account and protected equity fund, and surplus is invested into leveraged certificate
- Certificate is levered (3x) in order to generate stronger exposure
- Profit protection through shifting back into segregated account in case of strong performance

Agenda

- Context – general implications of low interest rates for life insurers
- Evolution of product offering in countries affected by low rates
- **Outlook**

Possible scenarios for the future

	Expected customer demand	Appropriate actions
Prolonged low rate scenario	• Generally lower appetite for long-term savings • Search for higher-yield investment options	• Offer shorter-duration product options • Build out offering of unit-linked propositions
Gradual rate increase	• Gradually increasing demand for traditional products	• Offer products with flexible investment options/ guarantees allowing to profit from interest rate upturn
Sudden rate increase	• Strong tendency to lapse low-guarantee traditional products	• Take action to protect in-force book against mass lapses and adverse bond price developments

- Customer demand and hence optimal product strategy differs by macroeconomic scenario
- Given substantial product development lead times, positive rate scenarios will require actions that seem counterintuitive from today's point of view

Need for multi-product portfolio that works under different capital market conditions