

June 2014

The time has finally come to face the facts

Interview with Walter B. Kielholz, Chairman of the Board of Directors Swiss Re

elipsLife echo: After a disaster, reinsurers' stock prices invariably drop. If there are no disasters, premiums fall and stock prices also fall. Is it so difficult for reinsurance companies to teach investors about the mechanisms of the reinsurance business?

Walter B. Kielholz: As a rule, stock prices rise in the wake of a disaster. Although they may fall in the short term, the drop never lasts. Just take the attack on the World Trade Center in September 2001 as an example. Stock prices collapsed for a short while, but then rose dramatically again. On balance, major losses have a positive effect on the market capitalisation of reinsurance companies. This has always been the case and is also understood as such by most investors. In the past few years we had incredibly good margins in the property and specialty business. It is only because of the low interest rates that valuations are not higher. But this is a very complex business, certainly much more complex than just calculating the price for bananas. The reinsurance business is a business for specialists, also from the point of view of the investors.

The process of global consolidation in the direct insurance sector is continuing apace. Is this an opportunity or a risk for Swiss Re?

It rather seems to me that the consolidation has come to a halt for now. For two reasons: firstly, regulators no longer like large financial institutions, and secondly, the insurance sector



in Europe in particular has recently finished a major phase of consolidation in preparation for the single European financial market. Traditional distribution channels are also under severe pressure, as a result of which insurance business is moving away from the large companies. Globally speaking, we are seeing astonishingly little consolidation at the moment.

Regarding the financial industry in Switzerland: what are the consequences of the abolition of banking secrecy for Switzerland as a financial centre?

Banking secrecy allowed the private banks to apply a simple business model. Business has become more challenging with the abolition of banking secrecy, as private clients now have to be won over with performance, good services and low costs. Asset managers who relied solely on banking secrecy are going through a difficult time, but those who used international business models to position themselves are seeing an uninterrupted influx of client funds. The business will be divided between institutions with clever business models focusing on performance, costs and international exposure – and institutions that cannot cope with these concepts.

That sounds positive.

I believe that Switzerland will move smoothly into this new phase. Because the private client business was so easy, Switzerland neglected the institutional asset management business and left it to other financial centres such as

Luxembourg and London. But there is no objective reason why London should have such a dominant position in the institutional asset management segment.

... and the consequences of the yes vote for the mass immigration initiative?

First we must see what this means exactly. However, if this should mean the end of the bilateral agreements with the EU, the industrial sector would have an enormous problem. This would be a serious setback for Switzerland as a business location. But as I said, we must first wait and see how the decision is implemented. What is much more serious for me is the fact that we have to expect further slip-ups. The important question is why the country's political and economic leaders can no longer reach the people.

Do you agree with the argument that a gap has developed between the business sector and the people?

It is mainly a divide between the political elite and the people. Previously, voters mostly followed the Federal Council's recommendations for referendums, but nowadays this is only true to a limited extent. This is happening because certain groups have been systematically bad-mouthing the country's political elite for the past 20 years. The classe politique in Berne is constantly reviled, and only the politicians in Brussels are worse. This is irresponsible. It is bad if the people holding the political reins are constantly disparaged.



The gap between the elite of the business world and the people on the street has to do with the recession, wage transparency and the size of salaries. This gulf has been there for a long time, but is becoming more visible now. The business elite is in a much better position financially and partly also takes a global view, which clashes with the local or national view of many people.

Why has it come to this?

As said before, the systematic disparagement of the classe politique intensified by the opportunities for slander afforded by the new social media, combined with the global economic recession and the tension between the local and global views have caused this divide.

Do you see any way to improve this situation?

I expect that we will have to wait until enough harm has been done before we can return to normal. Many proposals and initiatives severely test the limits of our system of direct democracy, such as the deportation initiative, the minaret initiative and the paedophile initiative. In the current climate it is possible to find majority support for many things.

You are considered to be one of the big captains of industry in Switzerland. What do you think are the ingredients for entrepreneurial success?

Quite often, successful entrepreneurs quickly earn a halo, but success is mostly a factor of the environment and its framework conditions. Success demands a good education and investment capital, and these conditions are met in Switzerland. What we find difficult, however, is coping with failure.

While Americans interpret failure as a lesson learnt, we see it as a disgrace. And this is wrong, because being an entrepreneur also means that a business idea may not be successful.

Swiss Re's pension fund is considered to be one of the best in the country. But even this pension fund has lost some of its allure: rejection of the defined benefits principle, increase in the retirement age, reduction of the conversion rate. Has it become too expensive for Swiss Re to maintain the pension fund at its former level?

Yes, it has. We should not forget that Swiss Re's pension fund was established before the First World War, when circumstances and life expectancy were still very different. The defined benefits principle mirrored the rather employer-dominated understanding of employee-employer relationships that prevailed at this time. The current defined contribution principle is more flexible and better suited to the needs of employees who do not wish to work for the same employer all their lives. At the same time it allows the company to account correctly for the financial consequences. But when I look at the current benefits, they are still excellent.

Many pension funds of large companies run the risk of a seriously distorted ratio of active insured to pension recipients. How do you rate this risk?

Large industrial or distribution companies that have gone through a massive restructuring phase actually do have a problem. Pensioners are also growing older and interest rates are low. In the long run this presents a problem. For the past ten years or so, the central banks have followed a policy that favours people who accumulate debt rather than those who save their money. Monetary policy is nothing more than the fixing of interest rates. Interest rates are either high, which is good for those who save, or they are low, which is good for those who take up loans. As the government is usually a debtor, this means that everywhere in the world the government as



the debtor systematically collects the money deposited by savers. I recently told Federal Councillor Berset that it will be impossible to revise the BVG until this fact is recognised. The interest rates applied in Switzerland are wrong, because the BVG is unfortunately based on nominal interest rates rather than real interest rates. Pension funds are confronted by a difficult environment that is very different from the beginning of the 1980s when mandatory BVG benefits were introduced. In those days, both inflation and interest rates were considerably higher.

What is your personal assessment of the standard of the employee benefits insurance in Switzerland?

Generally speaking, the standard is excellent. When I was young, old people were often poor, but this is no longer true today. However, the current challenges are considerable, and the upcoming BVG revision might break more than it fixes. Federal Councillor Berset's vision means that the active generation will have to carry a greater burden on behalf of the pensioners. The reason is simple: together with the pensioners and those who will soon retire, government employees and Social Democrats have the majority in the country. As increasing the retirement age or even reducing pensions would be political off-limits, everything has to be financed with a higher value added tax. This hits the working, active middle class the hardest. To me, this one-sided shifting of the burden to the active generation is unreasonable and cannot be sustained in the long run.

Pension funds find themselves in stormy waters, particularly in the face of demographic trends, low pension reserves and low interest rates. Will the pension funds - and therefore all of us - become victims of unfulfillable benefit promises?

I believe that too many pension funds promise benefits that may suit the needs of the average, but not the individual. People have very different needs. Some people have three children, while others have none. Many want to retire early, others want to work longer in order to enjoy a high standard of living. Some have assets, others do not. But the BVG defines benefits that apply to everybody, instead of making a distinction, for example through incentives to encourage people to save more during the savings phase. Nowadays we definitely need tailor-made solutions that take account of individual circumstances for the benefits phase, i.e. when pensions are being drawn. I am in favour of solutions that give the employees a choice. These days we apply the defined contribution principle. When someone retires, he should have the right to choose the solution and pension fund that best suit his needs.

What developments in the employee benefits insurance do you expect in the next three to five years?

The time has finally come to face the facts. We can continue to uphold a totally unrealistic conversion rate to the detriment of the active population, but the current practice where pensions are cross-subsidised by those who are still working is disturbing. Who then should finance the future pensions of those who are actively working today?

Personal information

Walter B. Kielholz, born in 1951, Swiss citizen, started his career in 1976 with General Reinsurance Corporation in Zurich. In 1986 he moved to Credit Suisse, where he was responsible for customer relationships with the large insurance companies. Walter B. Kielholz joined Swiss Re in 1989. He was elected to the Executive Committee in 1993, which he chaired from 1997 to 2002. Before he was appointed Chairman of the Board of Directors in 2009, he served as the Executive Vice-Chairman of the Board of Directors of Swiss Re. Walter B. Kielholz was a member of the Board of Directors of Credit Suisse Group AG from 1999 to 2014, and served as its Chairman from 2003 to 2009. Walter B. Kielholz is active in many international associations and institutions. He studied business administration at the University of St. Gallen and earned his degree in financial management and accounting.

