

Creating value, finding focus: Global Insurance Report 2022

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Where to play: Focusing the portfolio

Creating value, finding focus

Welcome to the first edition of McKinsey's Global Insurance Report, focused on challenges and opportunities for carriers in the global insurance industry. In this report, we look back at the past year's developments and ahead to the ways that the industry is evolving.

The global pandemic is resurgent with yet another wave of rising case numbers and pressure on healthcare systems. Its effects on business are no less significant. Over the past two years, COVID-19 has accelerated some trends that look certain to reshape the way insurance is underwritten, distributed, and managed. At the same time, some of the problems that have challenged the industry over the past decade have not gone away, and the complexity of the macroeconomic environment has increased. Revenue growth is limited in most regions; intermediaries are capturing more value; scale economies are proving elusive; and productivity is quite stagnant. As a result, economic profit—that is, profit after cost of capital—in the insurance industry is practically at a standstill.

The industry's problems are not lost on capital markets. As public investors mark down companies' shares, private investors swoop in to acquire closed books, and some insurers reconsider their geographical footprints, the fundamental structure of the industry is coming into question. Insurers now face several fundamental strategic questions: How can they

create more value for shareholders? Can they unlock latent demand and improve the customer experience? How can they regain momentum on the long-running quest to improve productivity? Also, what about talent? How can they reimagine the employee proposition to attract and retain the brightest and best after the pandemic? Finally, how can insurers, individually and collectively, reframe the role and purpose of insurance in society?

To address these questions, we believe the leadership teams of insurance carriers need to capitalize on nine value levers:

1. Make environmental, social, and governance (ESG) considerations a core feature of the business model.
2. Regain relevance through product innovation and coverage of new risks.
3. Enhance and personalize customer engagement and experience.
4. Engage with ecosystems and insurtechs.
5. Develop new businesses for the digital age.
6. Scale impact from data and analytics.
7. Modernize core technology platforms.
8. Address the productivity imperative.
9. Reimagine culture, diversity, and ways of working to attract and retain talent.

Addressing these nine imperatives will help carriers answer strategic questions about “how to play.” But the challenges and recent trends facing the industry will force some insurers also to think about “where to play,” to rebalance their portfolios of businesses, and to review their capital allocation accordingly, in particular through M&A and asset disposals. At the end of this report, we focus on this pressing question: Where should insurers be active (in terms of geography, lines of business, and position in the value chain) to renew value creation and themselves? The recent wave of sales of noncore businesses to buyers with different business models suggests that a secular change may be in the works. We might be witnessing a period when the quest for economies of scale

and breadth of footprint, a common strategic thrust of the past decades for many insurers, yields to a more rigorous search for a company’s true source of competitive advantage.

To form a strategy that addresses the challenges of this period of intense flux, carriers will need to put focus and local scale at center stage. Insurers that can develop a tightly defined business model and take advantage of the trends and currents unleashed by the global pandemic can restart growth, expand performance on multiple dimensions, and renew themselves through value creation, securing an industry-leading position in the years to come.

Where should insurers be active to renew value creation and themselves?

A scenic landscape featuring rolling green hills and a winding road. The sun is low on the horizon, creating a bright, hazy sky with soft rays of light. The road curves through the valleys, and the hills are covered in lush green vegetation. The overall atmosphere is peaceful and hopeful.

In coming years, the global insurance industry will be profoundly shaped by some megatrends that have emerged and accelerated since February 2020.



1

Welcome to a new world

The past two years may have been the most peculiar recession and recovery in living memory. In 2020, the human tragedy of the COVID-19 pandemic triggered a global economic downturn that was initially sharper than the Great Depression. As government support programs took shape, the recession rapidly bottomed out, leading to a strong economic recovery in 2021. Global financial markets took a roller-coaster ride as well.

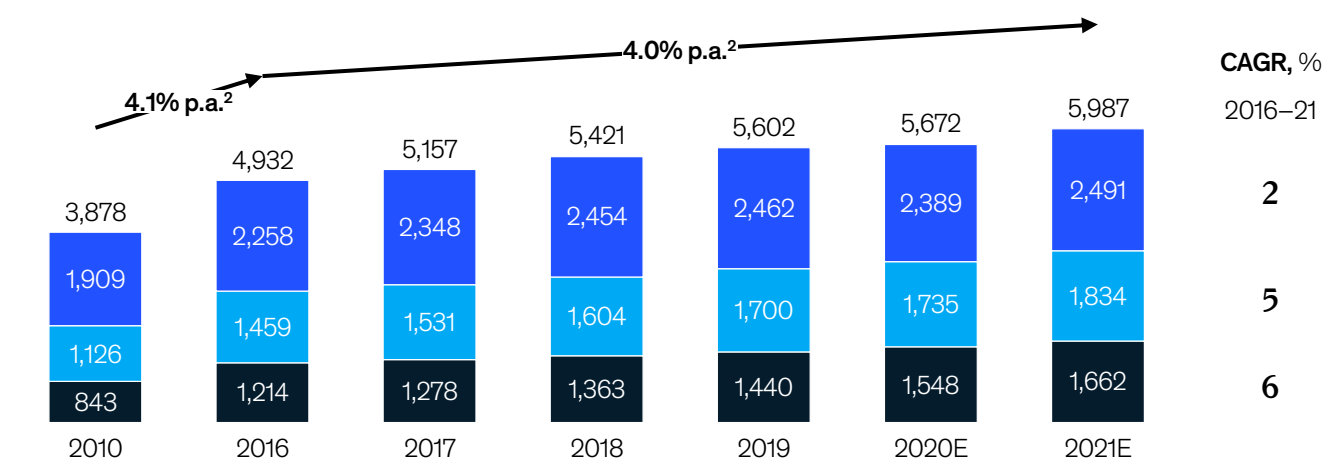
The impact on the insurance industry was noticeable: in 2020, premium growth slowed to approximately 1.2 percent (compared with more than 4 percent per year between 2010 and 2020). Profits fell by about 15 percent from 2019. The decline was sharpest in Asia-Pacific (down 36 percent) and was particularly driven by falling profits in life (Exhibits 1 and 2).

Preliminary data suggest that premium growth and profits rebounded in 2021, especially in regions where strong vaccine rollouts have made many activities possible again, at least periodically.

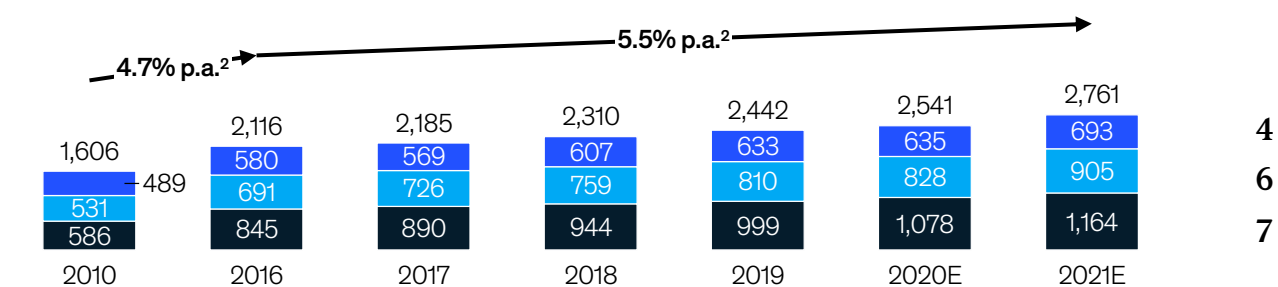
Premium growth rebounded in 2021 after slowing in 2020.

Global insurance gross premiums written, \$ billions¹

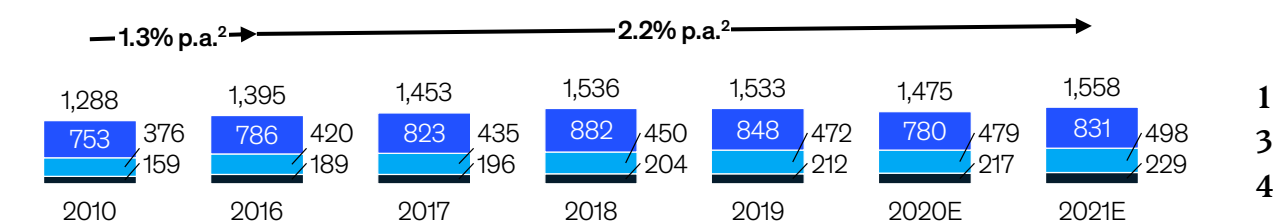
Health P&C Life



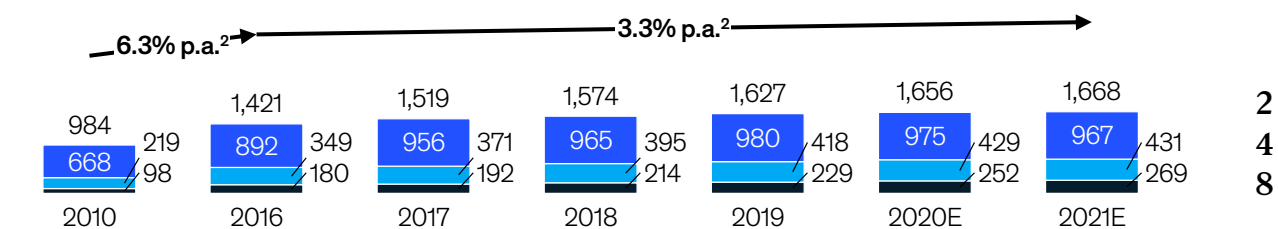
Americas



Europe, Middle East, and Africa



Asia-Pacific



Note: Figures may not sum, because of rounding.

¹ Based on 2020 average fixed exchange rate.

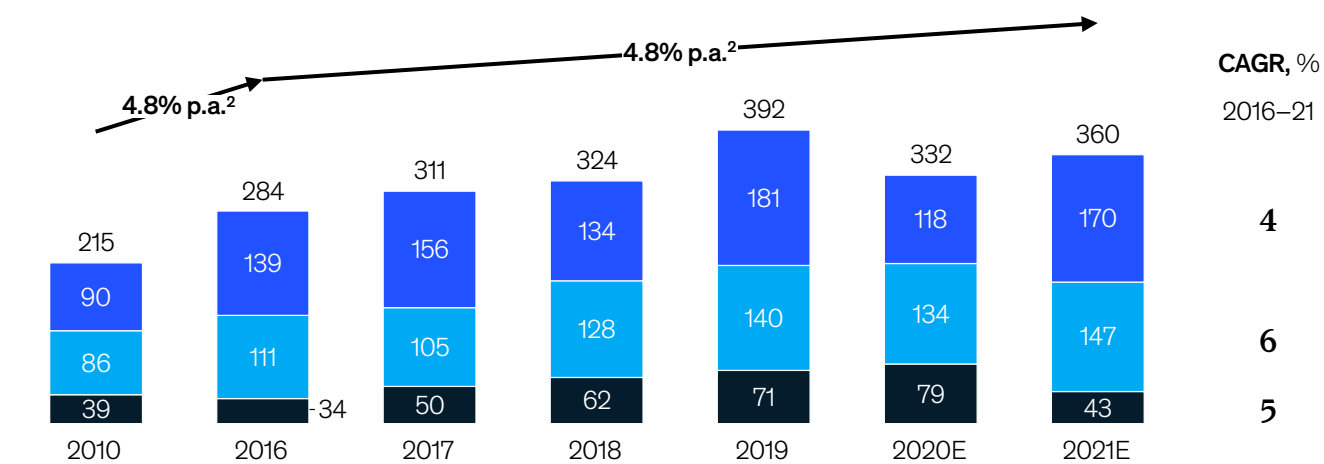
² Per annum.

Source: McKinsey Global Insurance Pools

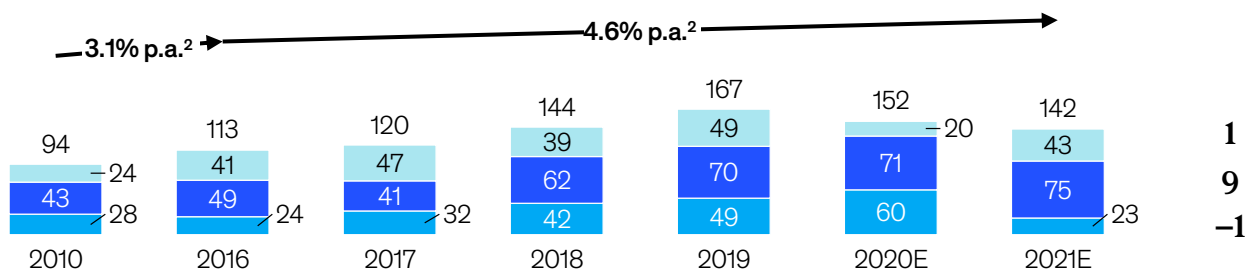
Industry profits increased in 2021 after a dip in 2020.

Global insurance after-tax profits, \$ billions¹

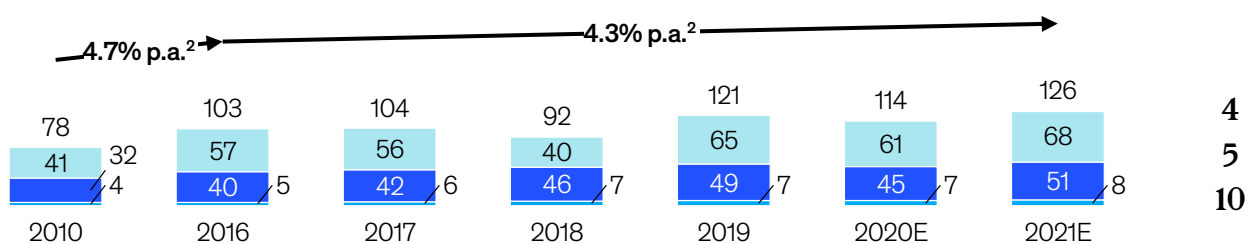
Health P&C Life



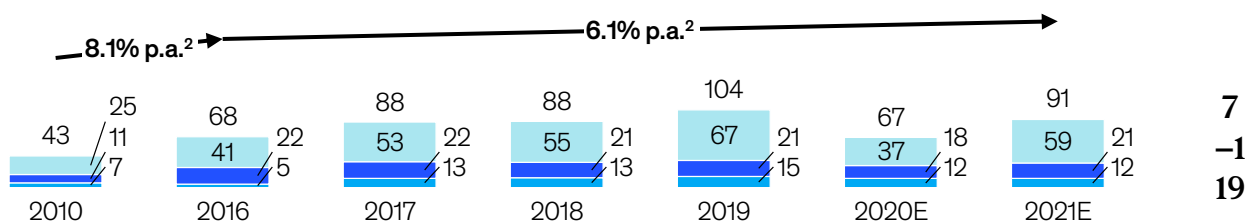
Americas



Europe, Middle East, and Africa



Asia-Pacific



Note: Figures may not sum, because of rounding.

¹ Based on 2020 average fixed exchange rate.

² Per annum.

Source: McKinsey Global Insurance Pools

Megatrends in the post-COVID-19 world

In coming years, the global insurance industry will be profoundly shaped by some megatrends that have emerged and accelerated since February 2020. Some are shifts in the macroeconomy; others are changes in competitive dynamics. The most dramatic may be changes in customer and employer behaviors. While most of these trends are not completely new, they have accelerated during the pandemic. In aggregate, they are shaping a new operating environment for insurers that is hugely disruptive and that challenges traditional ways of value creation. These trends, in brief, include the following:

- **A decoupling of macroeconomic environments among Asia, Europe, and North America, whether through elevated geopolitical and trade tensions or different interest rate trends between regions.** (For example, while the situation remains highly ambiguous, the United States may be exiting the “low for long” rate environment on the back of a noticeable though perhaps transitory spike in inflation). In areas where low rates continue to prevail, this could put even more pressure on life insurers to revamp their business models accordingly.
- **A dichotomy between ‘winners’ and ‘losers,’ reinforced by the crisis.** The economic impact of the COVID-19 pandemic has varied considerably by geography (for example, Asia, Europe, and North America are recovering at different speeds); by sector (for example, travel and hospitality suffered a deep recession, whereas e-commerce companies soared); and within each sector (resulting in intense M&A activity). The past two years have thus reinforced the superstar phenomenon¹—the growing concentration of economic success—that we have observed not just among companies but also in cities, economic sectors such as insurance, and other aspects of the global economy. Among the world’s largest companies, economic profit is distributed unequally along a “power curve,” with the top 10 percent of firms capturing 80 percent of

it. The insurance industry has not escaped this trend, moving from a moderately value-creating industry to one that destroys value—and the trend is even stronger at the company level. Half of insurers globally are not earning their cost of capital, and half are trading below book value.

- **A potential anchoring of remote-interaction models with customers.** The pandemic saw a “decade in days” acceleration in digital uptake—for example, e-commerce sales in the United States grew as much in the first half of 2020 as in the previous ten years.² Tech players’ platforms strengthened their position as go-to places for customers. The frequency of interactions and the level of personalization have dramatically changed, and insurers need to ensure they stay relevant and can craft truly personal, needs-based contextual experiences. This situation will probably provide tailwinds for insurtechs and other digital attackers, raising the risk of disruption for incumbents. To fend off the threat, insurers will need to make additional IT investments to digitalize and automate their processes; if the trend persists, they might even need to significantly modify their distribution models by repositioning the roles of agencies, brokers, and digital sales channels.
- **An increased awareness of sustainability, climate change, and issues of diversity, equity, and inclusion (DE&I).** Corporates and customers alike have become attuned to a broader range of environmental and energy issues, as well as situations of social, racial, and generational injustice. This will have an immediate impact on insurers, particularly in their investment and underwriting portfolios, as governments set target dates to reach net-zero emissions. In addition, natural catastrophes abounded in 2020 and 2021, leaving insurers wondering whether these patterns represent extraordinary activity or the new normal—in which case, they will need to examine whether their pricing models adequately account for these events.

¹ For more, see “What every CEO needs to know about ‘superstar’ companies,” McKinsey Global Institute, April 2, 2019.

² Arun Arora, Hamza Khan, Sajal Kohli, and Caroline Tufft, “DTC e-commerce: How consumer brands can get it right,” McKinsey, November 30, 2020.

Several megatrends are shaping a new operating environment for insurers that is hugely disruptive and that challenges traditional ways of value creation.

- **New challenges to the purpose and relevance of insurers.** Just as the financial crisis of 2007–09 put the spotlight on the banking industry, the pandemic and its associated insurance issues have put the spotlight on the insurance industry. This might prompt insurers to rethink their societal purpose and relevance in the economy as a risk-taking industry. There is a perception that the industry has lost this characteristic in the past ten years by limiting the types of risks or clients it covers (as seen in Europe, where life insurance has moved sharply toward unit-linked products).
- **A renewed focus on health and well-being and a greater interest in home nesting.** The ongoing health crisis could leave a mark on consumers' psyches for a generation and could inspire insurers to actively participate in health and protection ecosystems.⁶ At the same time, consumers are now hooked on "home nesting," or leisure activities at home (such as cooking, DIY projects, meditation, and streaming entertainment). According to the McKinsey Global Institute, home nesting is one of the new behaviors most likely to endure after the pandemic.⁷ In response, insurers might invest in smart-home⁸ services and offerings such as discounts on homes equipped with devices that can detect fire, flood, or unwanted visitors.
- **The dawn of new ways of working.** Almost all companies are trying to figure out new hybrid working models⁹; so are many professions that have close contact with customers. This will have a huge impact on the insurance industry. Carriers will have to identify the skills required to manage remote and hybrid teams¹⁰ and review their real estate needs—both to adjust to a changing workforce and to match clients' new geographical footprints (for example, as people move to midsize cities, suburbs, and exurbs).

³ Lennart Andersson, Andreas Gläufke, Timo Möller, and Tobias Schneiderbauer, "Why shared mobility is poised to make a comeback after the crisis," McKinsey, July 15, 2020.

⁴ Kersten Heineke, Benedikt Kloss, and Darius Scurtu, "The future of micromobility: Ridership and revenue after a crisis," McKinsey, July 16, 2020.

⁵ *Insurance insights that matter*, "A view from the Pacific Insurance Conference: How to create a successful insurance ecosystem," blog entry by Bernhard Kotanko, McKinsey, January 8, 2020.

⁶ "Digital health ecosystems: A payer perspective," McKinsey, August 2, 2019.

⁷ For more, see "The consumer demand recovery and lasting effects of COVID-19," McKinsey Global Institute, March 17, 2021.

⁸ "Digital ecosystems for insurers: Opportunities through the Internet of Things," McKinsey, February 4, 2019.

⁹ Aaron De Smet, Bonnie Dowling, Mihir Mysore, and Angelika Reich, "It's time for leaders to get real about hybrid," *McKinsey Quarterly*, July 9, 2021.

¹⁰ *Insurance insights that matter*, "Why insurers should embrace remote work," blog post by Julie Goran and Tom Welchman, McKinsey, April 21, 2021.



Insurance barely earns
its cost of capital, making
investors skeptical.



2

State of the industry

Old challenges still loom

Even before 2020, the insurance industry faced challenges. Now, those issues have taken on even greater urgency:

- **Headwinds on revenue growth.** Three structural factors are challenging industry growth (Exhibits 3 and 4): persistent low interest rates, which pressure spread-based businesses such as life insurance; pricing pressures driven by fee transparency, digital attackers, and lower-cost options—pressures that in some markets are aggravated by price comparison websites; and organic demand that is growing only slowly in mature markets. The latter is particularly worrying, because growth in developed economies is coming mostly from price increases rather than from volume or new risks covered, highlighting a risk that the industry might lose its relevance over time.

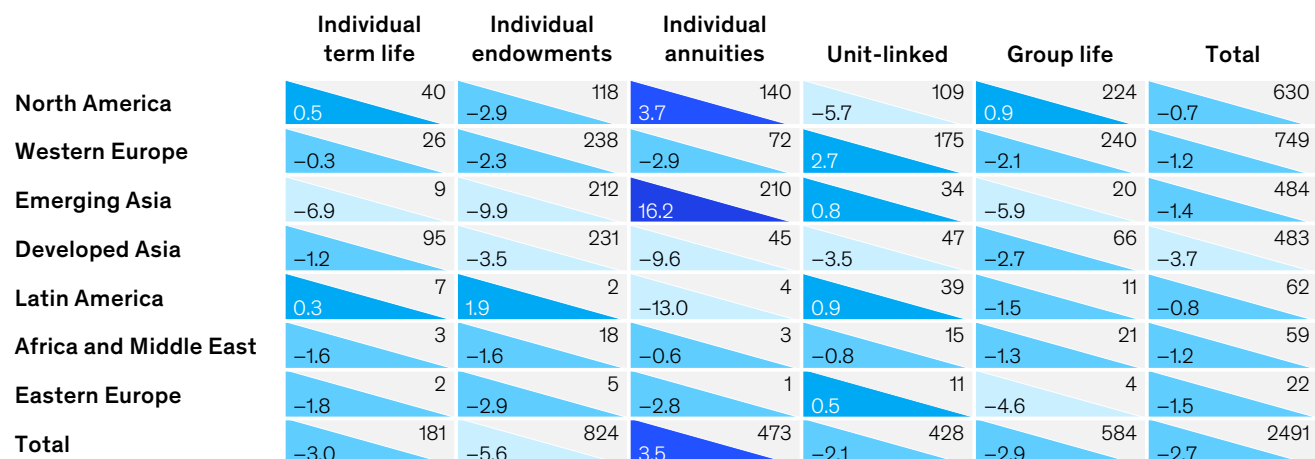
Exhibit 3

In life, revenue growth in much of the world is subdued.

Global revenues by life insurance product and region, 2021E

Gross direct domestic premiums written (GDDPW), \$ billions¹

Difference between premiums and GDP growth,² ppt³



Note: Figures may not sum, because of rounding.

¹ Based on average fixed exchange rate.

² Growth in nominal premiums and GDP, 2016–21.

³ Percentage points.

Source: McKinsey Global Institute; McKinsey Global Insurance Pools

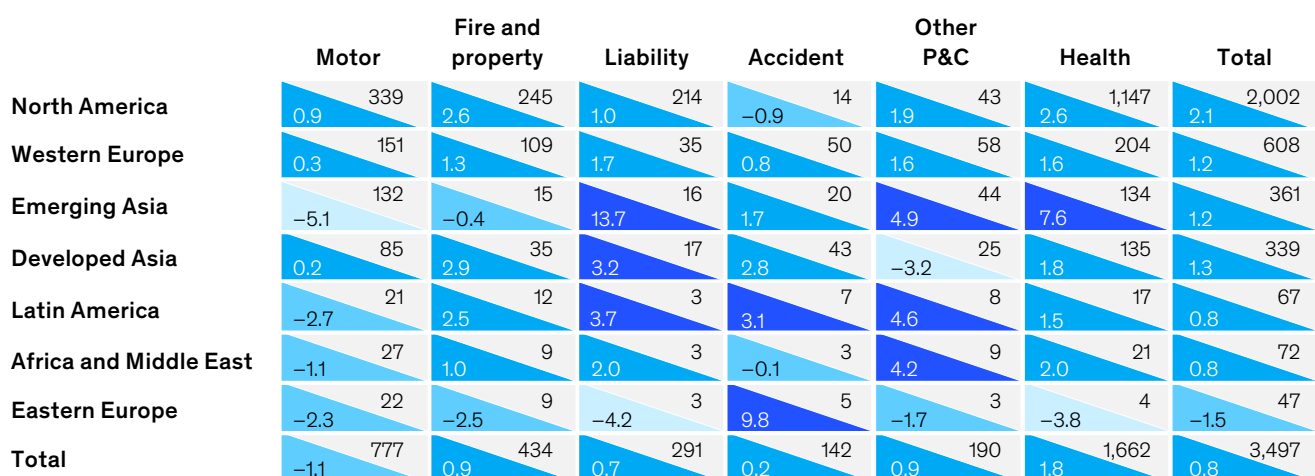
Exhibit 4

In nonlife, North America has been the highest-growth region compared to GDP in recent years.

Global revenues by nonlife insurance product and region, 2021E

Gross direct domestic premiums written (GDDPW), \$ billions¹

Difference between premiums and GDP growth,² ppt³



Note: Figures may not sum, because of rounding.

¹ Based on average fixed exchange rate.

² Growth in nominal premiums and GDP, 2016–21.

³ Percentage points.

Source: McKinsey Global Institute; McKinsey Global Insurance Pools

— **An ongoing ‘fight for the customer.’**

Insurtechs are driving digital innovation and disruption in the industry,¹¹ with investments in insurtechs worldwide growing from \$1 billion in 2004 to \$7.2 billion in 2019 to \$14.6 billion in 2021. More than 40 percent of insurtechs are focused on the marketing and distribution segments of the insurance value chain (Exhibit 5), enabling them to solve customer pain points through a digitally enhanced client experience that could pose a competitive threat to incumbents. And while some of these players have seen their share price tumble since their IPOs, we believe that a distinctive digital customer experience—from attackers or incumbents—will be a prerequisite for industry-beating growth. And beyond distribution, superior technology and healthy margins in insurance service businesses will challenge the traditional approach of many insurers to own the whole value chain—they will be forced to form partnerships or make outsize investments to keep up.

— **A value shift toward intermediaries.** Over the past five to ten years, brokers have emerged as the clear winners of the industry, with both public and private investors recognizing their position of strength in the insurance value chain (Exhibit 6). Total shareholder returns are much higher for brokers than for other industry segments, and private-equity firms are investing.¹² In 2019, for example, CVC Capital Partners invested in April, and GTCR invested in AssuredPartners. PE-backed brokerage deals completed in the United States accounted for roughly three-quarters of all insurance transactions from 2016 to 2019. Because insurers do not control their distribution channels as tightly as other financial sectors (though it depends on the region and line of business, as illustrated in Exhibit 7), they might run an even greater risk of becoming pure balance-sheet providers, while intermediaries keep an asset-light client relationship model. The shift toward digital is perhaps the last chance for insurers to regain the upper hand in this “fight for the customer.”

Exhibit 5

Insurtechs are concentrated in marketing and distribution.

Insurtechs by product and business activity, % of database total¹

■ <5% ■ 5–10% ■ >10%

		Products			
					
		P&C: Motor	P&C: Other ²	Health	Life
Value chain	Product development	2	5	2	2
	Marketing and distribution	8	21	7	7
	Pricing and underwriting	3	6	2	2
	Policy management	2	5	2	2
	Claims	3	6	2	1
	Other ³	1	4	2	2

Note: Overlaps exist because some insurtechs provide solutions for multiple P&C subproducts and operate across multiple value chain components.

¹ Insurtech database includes ~2,000 profiles as of 2020.

² Including accident, fire and property, liability, and other P&C insurance.

³ Includes IT, HR, finance, and other support functions.

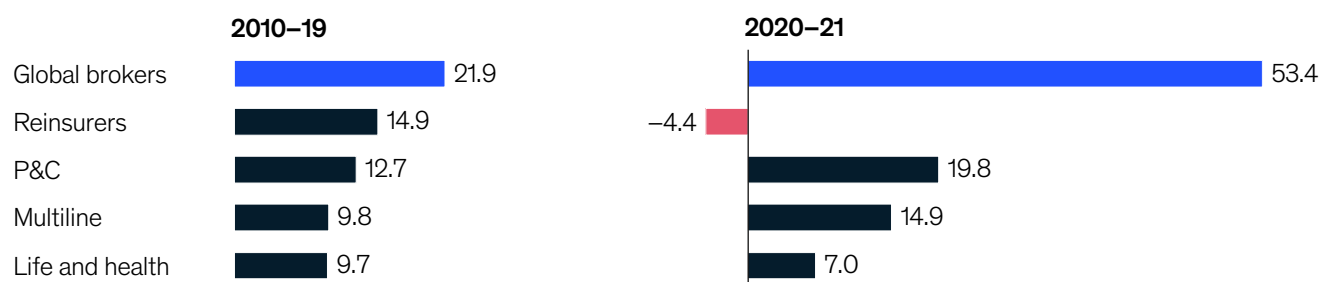
Source: McKinsey Global Insurance Pools; McKinsey insurtech database

¹¹ Tanguy Catlin, Simon Kaesler, Alex Kimura, and Pradip Patiath, “Global perspectives on insurtechs,” McKinsey, September 30, 2021.

¹² Ramnath Balasubramanian, Grier Tumas Dienstag, Katka Smolarova, and Ruxandra Tentis, “The insurance trends private-equity investors should understand in 2021,” McKinsey, August 20, 2021.

Brokers and North American insurers produced the best returns in the past decade.

Annualized TSR by line of business, %



Annualized TSR by geography, %



Note: The following sectoral indexes have been considered: Refinitiv Global Reinsurance Index, S&P Global 1200 Insurance Brokers TR Index, S&P Global 1200 Life & Health Insurance TR Index, S&P Global 1200 Multiline Insurance TR Index, S&P Global 1200 Property & Casualty Insurance TR Index, STOXX Europe 600 Insurance Index, STOXX Asia/Pacific 600 Insurance Index, STOXX North America 600 Insurance Net Return Index.

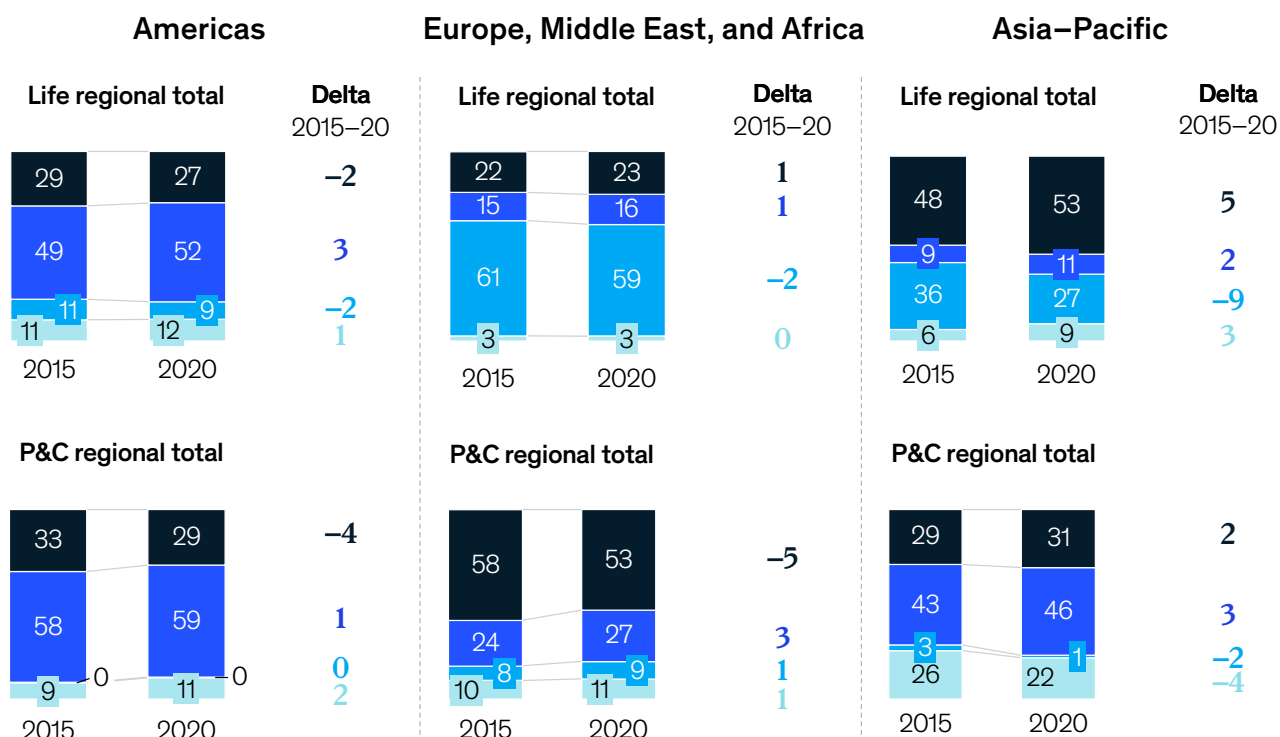
Source: Bloomberg; Capital IQ; Refinitiv Eikon

Distribution channels differ by geography and line of business.

Gross premiums written by distribution channel, 2015–20, %

Dominant distribution channel

- Tied agents and branches
- Brokers
- Bancassurance
- Direct and other



Note: Figures may not sum to 100%, because of rounding.

Source: McKinsey Global Insurance Pools

- **Elusive economies of scale.** Many segments of the insurance industry have been seeking scale in recent years. In North America, for example, increased scale was a primary goal for 60 percent of recent acquisitions.¹³ The results have been meager: globally, scale does not seem to be producing higher ROE (Exhibit 8). It turns out that trying to achieve scale on a global level has been a recipe for becoming average.

Importantly, this does not hold true for local or national scale effects; on these levels, scale is correlated with profitability (Exhibit 9).

The fragmentation of the industry in several countries (Exhibit 10), coupled with this scale effect at the local level, could present

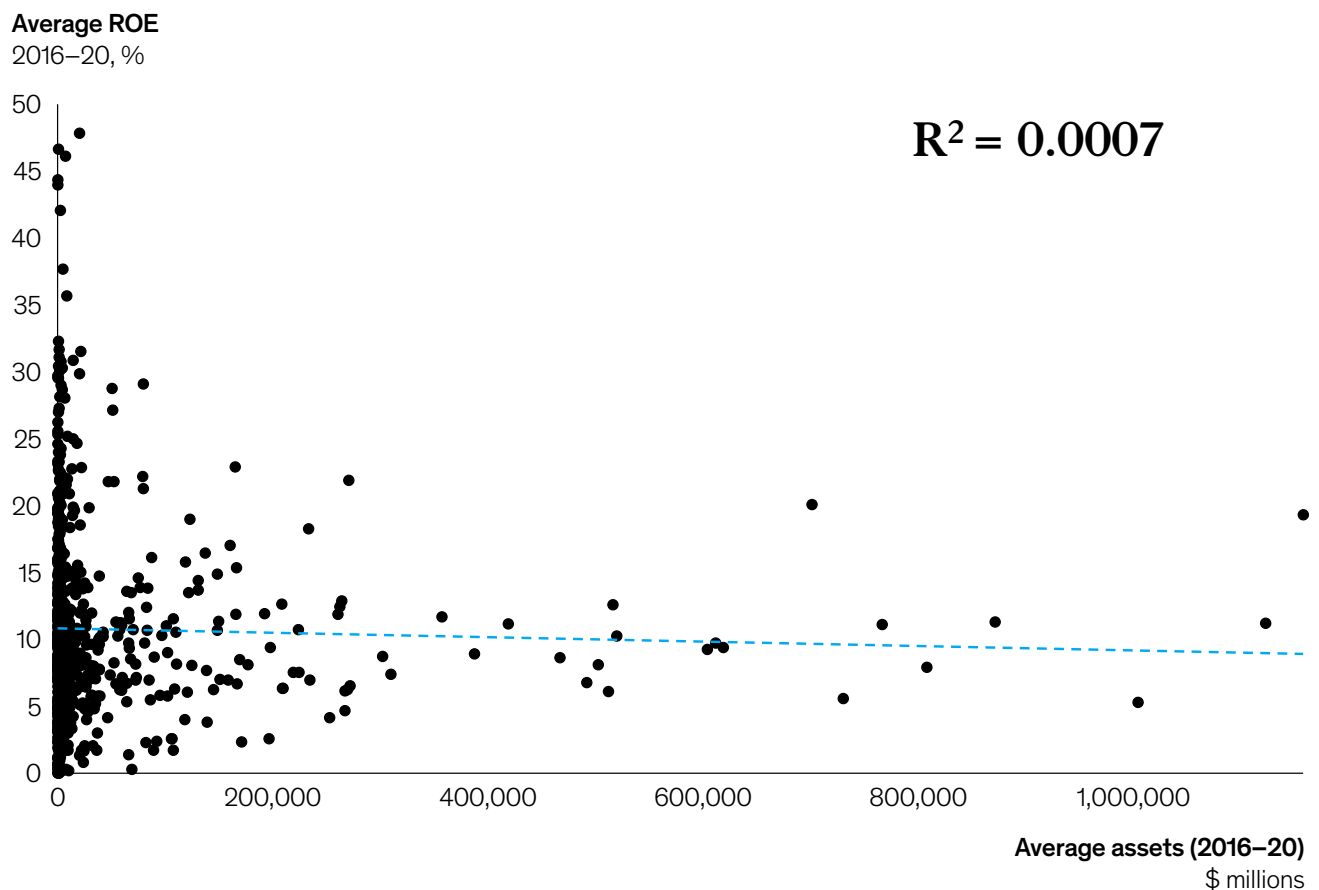
an opportunity for a value-creating wave of local consolidation in the industry.

- **Limited productivity improvement.** Though many insurers have undertaken cost savings programs, the aggregate results have not been fruitful. Industry-wide, productivity improvements have been limited.¹⁴ Exhibit 11 offers an illustration: between 2014 and 2019, expense ratios fell for only 45 percent of global P&C carriers (with important variations across regions). For many, ratios did not budge or actually rose. That's a disappointing outcome for an industry that has communicated so much on the need for productivity improvements.

Exhibit 8

There is little evidence of global scale effects.

Return on equity and assets for listed and nonlisted insurers, 2016–20, n = 630 insurers worldwide



Source: Capital IQ; Company annual reports; SNL Financial

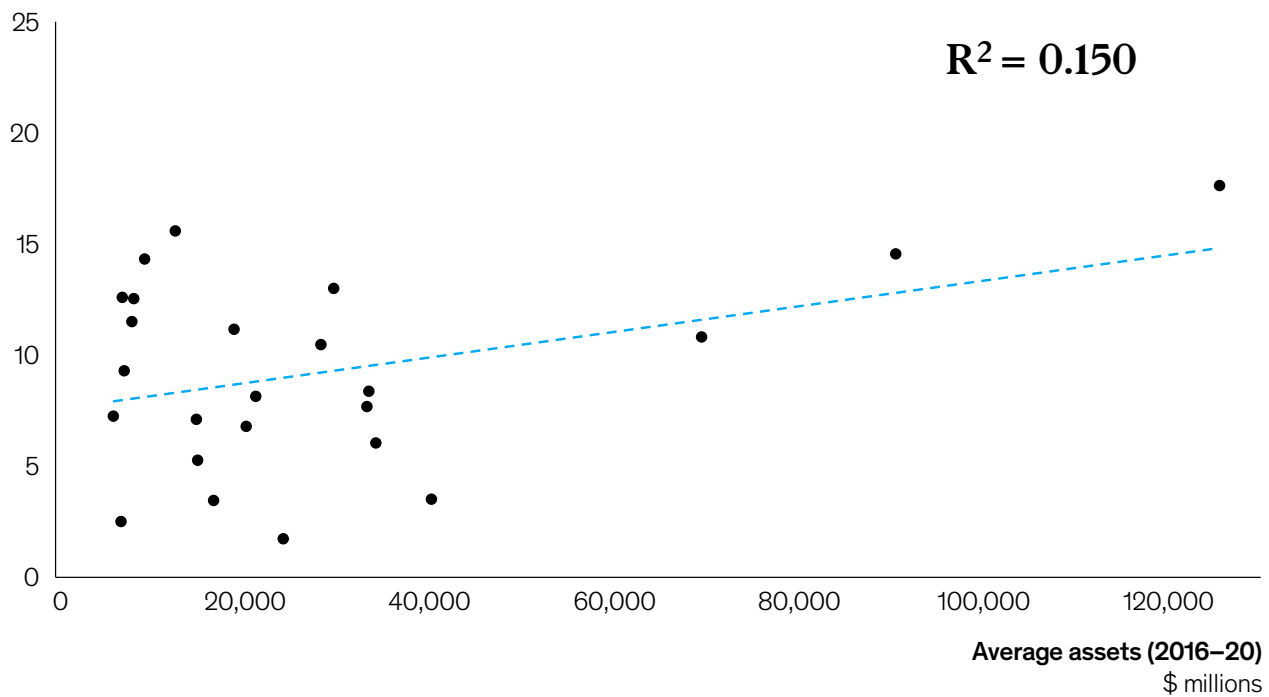
¹³ "A better approach to M&A in North American insurance," McKinsey, March 9, 2021.

¹⁴ "The productivity imperative in insurance," McKinsey, August 14, 2019.

Scale effects can occur within local and national markets.

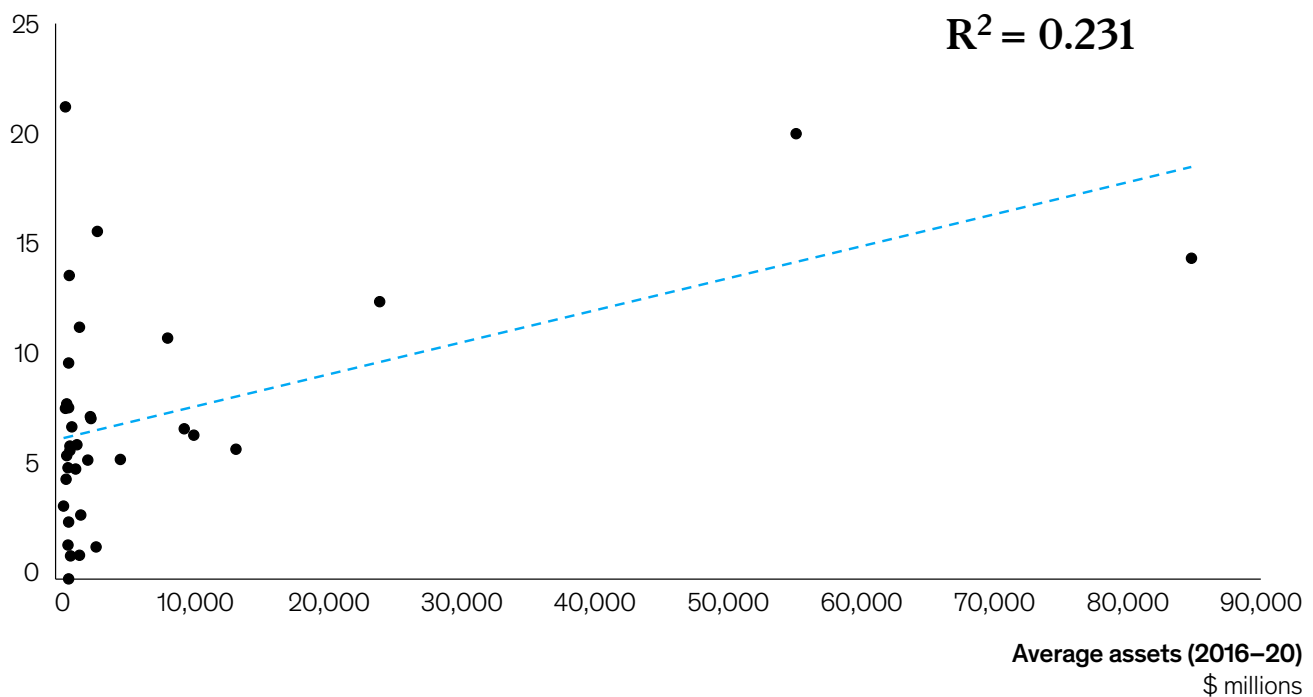
Return on equity and assets for life insurers in Italy, 2016–20, n = 24 insurers

Average ROE
2016–20, %



Return on equity and assets for P&C insurers in China, 2016–20, n = 35 insurers

Average ROE
2016–20, %



Source: McKinsey Global Insurance Pools

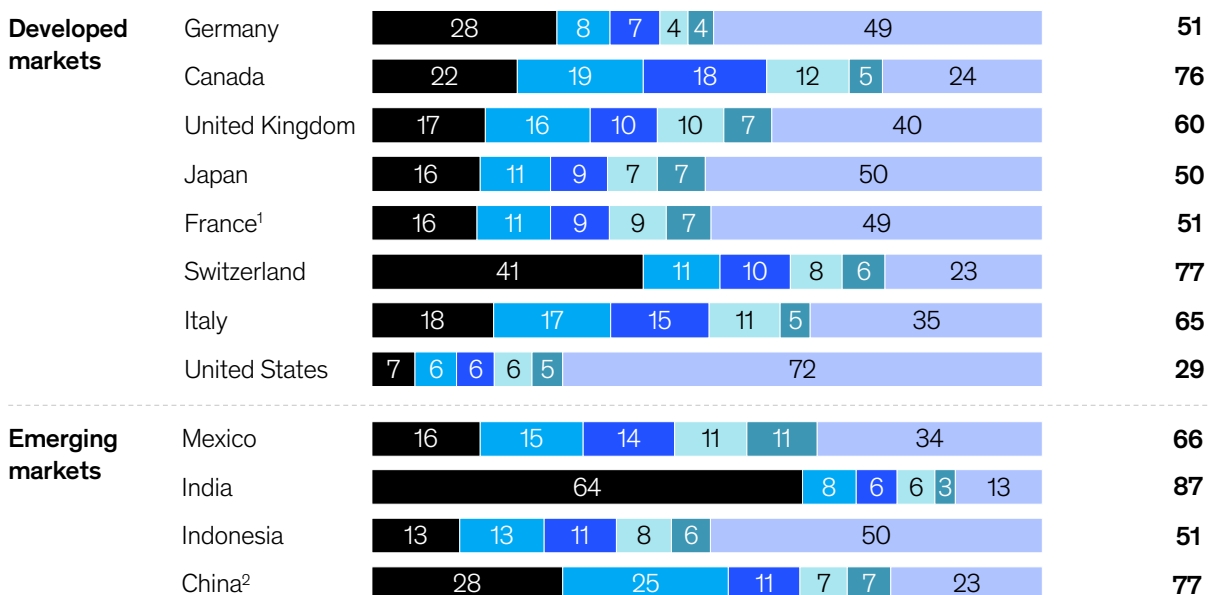
Market share is highly fragmented in several countries.

Domestic business of all players in markets

Largest
 2nd largest
 3rd largest
 4th largest
 5th largest
 Other

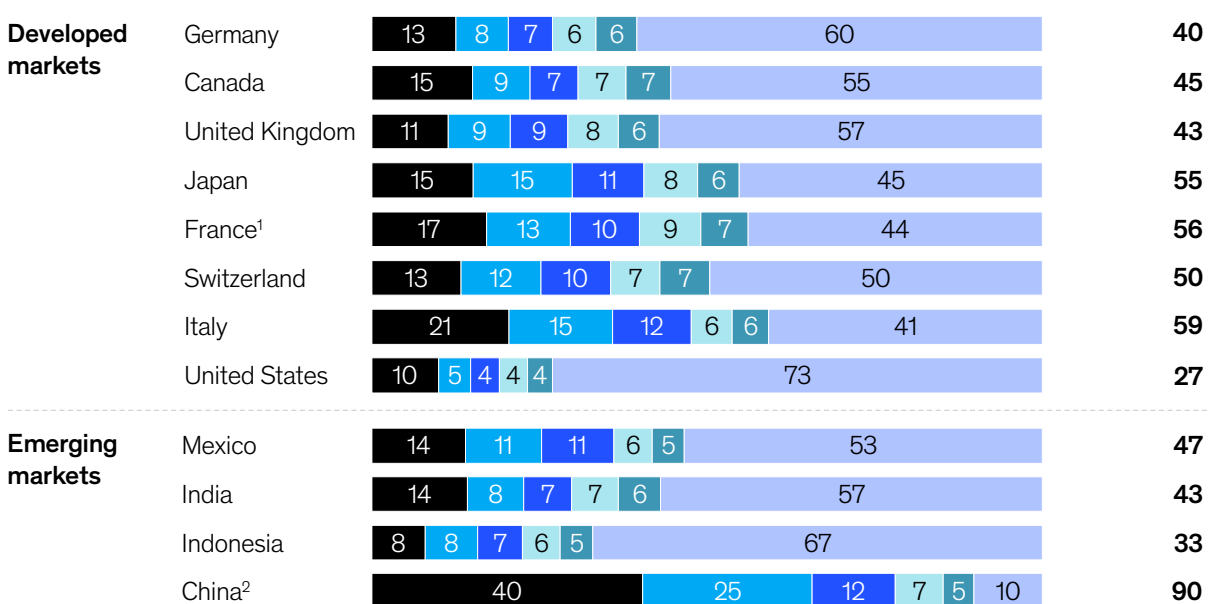
Life insurance market share of top 5 insurers by premiums, 2020, %

Top 5 market share, life, 2020, %



Nonlife insurance market share of top 5 insurers by premiums, 2020, %

Top 5 market share, nonlife, 2020, %



Note: Figures may not sum to 100%, because of rounding.

¹ France life comprises life insurance and capitalization; nonlife comprises P&C excluding accident.

² Based on 2019 data.

Source: McKinsey Global Insurance Pools

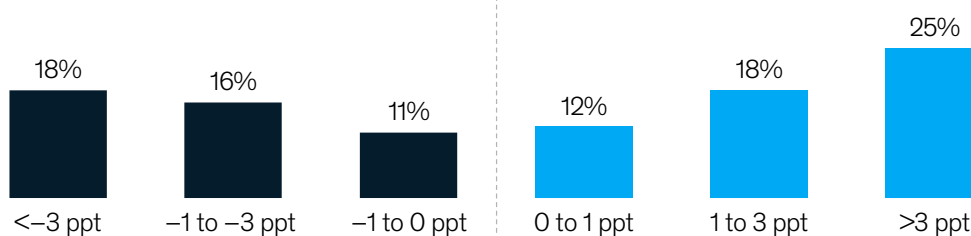
Many P&C insurers have struggled to reduce costs.

Distribution of changes in P&C insurance expense ratio 2014–19,¹ %

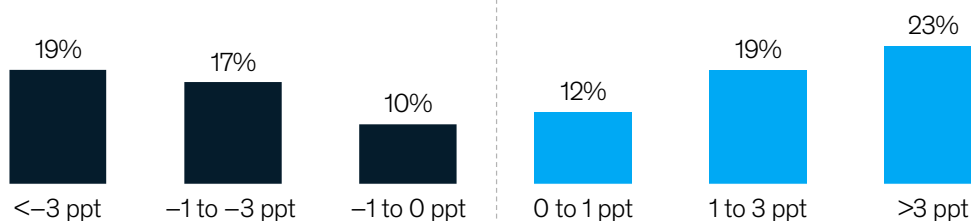
Global, n = 858

Reduced ratio

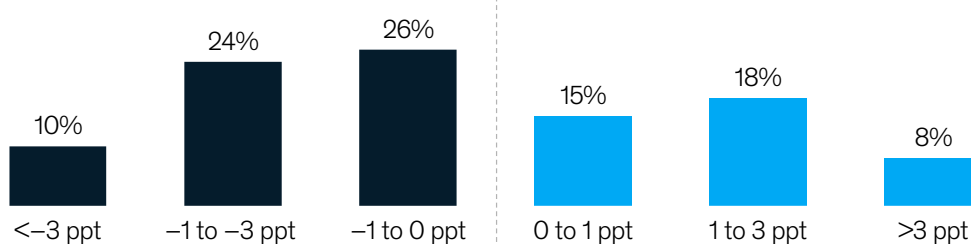
Increased ratio



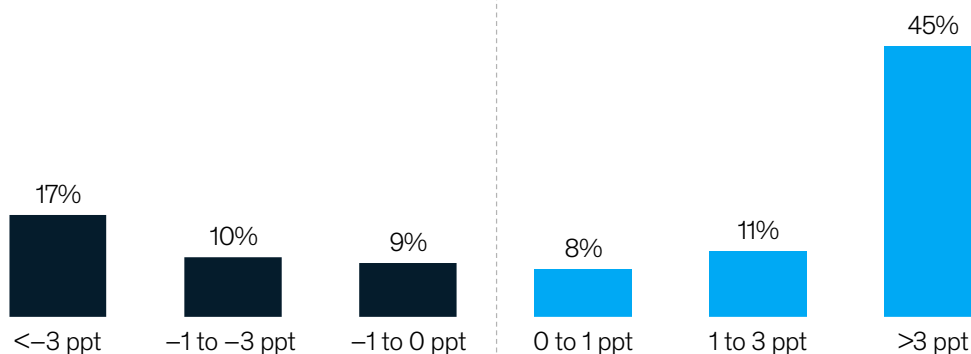
Americas, n = 672



Europe, Middle East, and Africa, n = 62



Asia-Pacific, n = 124



¹ Changes in expense ratios are expressed as percentage point (ppt) difference, 2014–19.

Source: McKinsey Global Insurance Pools

After decades of stable returns, insurance is now a value-destroying industry in which half the players do not earn their cost of equity.

Insurance barely earns its cost of capital, making investors skeptical

Together, these elements explain the industry's limited value creation recently. Exhibit 12 shows the "power curve" distribution¹⁵ of economic profit of every sector in the economy. Not only has the overall insurance industry destroyed value in the past years, but its positioning has eroded from 2005–09 to 2015–19 (with insurance brokers as the exception).

Looked at another way, industry average ROEs have remained at or slightly below the cost of equity over the past years, notably in North America and Western Europe (Exhibit 13).

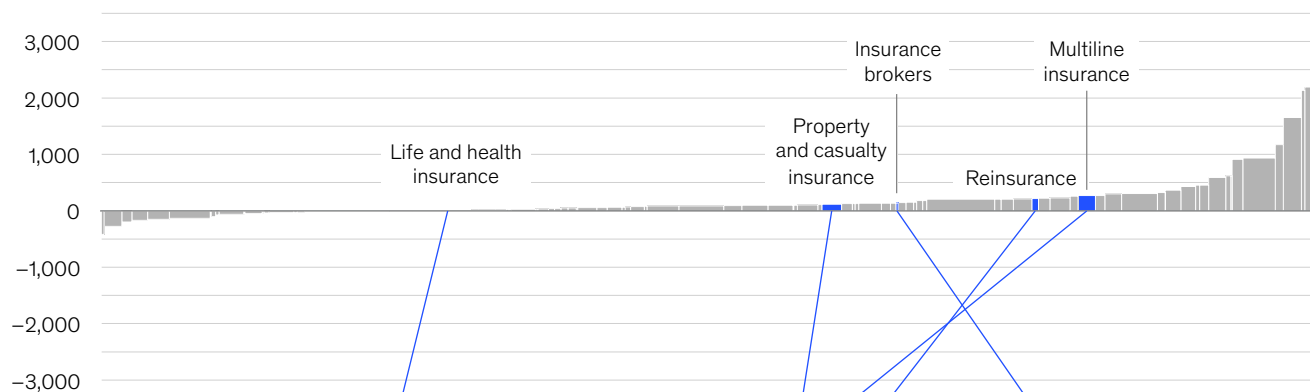
¹⁵ Alex D'Amico, Mei Dong, Kurt Strovink, and Zane Williams, "How to win in insurance: Climbing the power curve," McKinsey, June 18, 2019.

Exhibit 12

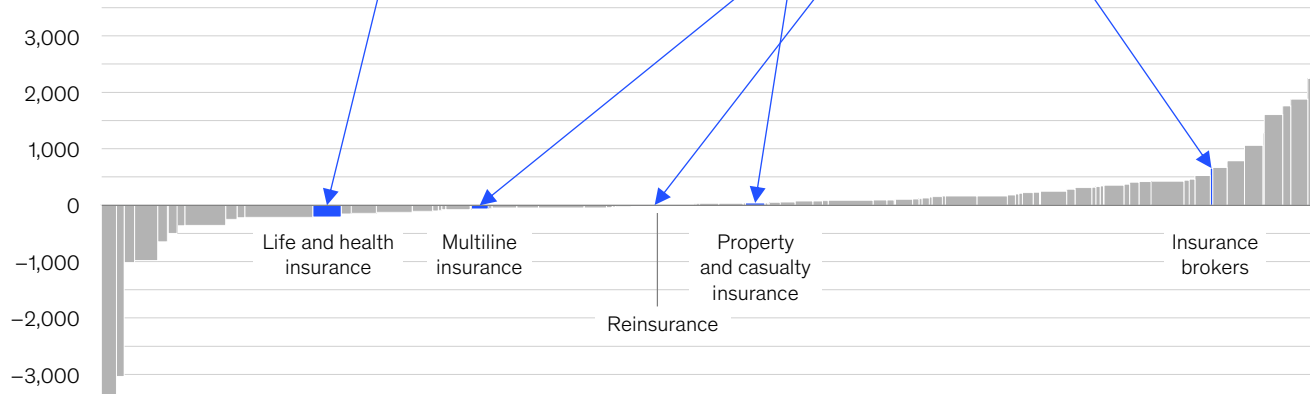
Insurance has had negative economic profit in recent years.

Economic profit earned by an average company in 96 industries,¹ \$ millions

2005–09



2015–19

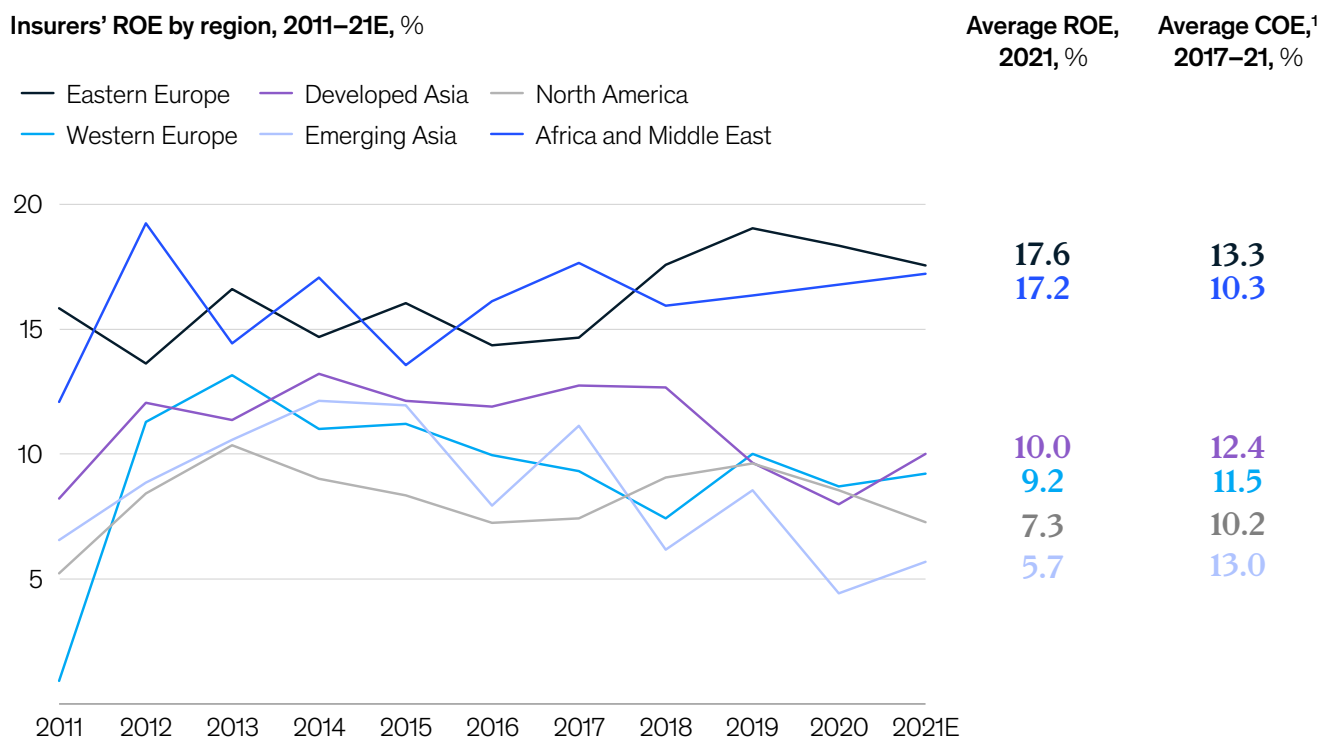


¹ Based on the 2,689 largest companies globally where sufficient data are available; including financial institutions and private companies; excluding real estate and real estate investment trusts.

Source: S&CF Insights; S&P Global; McKinsey Corporate Performance Analytics

Economic profitability has slumped in several regions.

Insurers' ROE by region, 2011–21E, %



¹ Cost of equity.

Source: Bloomberg; McKinsey Global Insurance Pools

This is not a problem caused by a few underperformers. Rather, it is industry-wide: 54 percent of listed insurers, representing 52 percent of the global industry's equity, had an ROE below their cost of equity over the past five years (Exhibit 14), raising questions about the long-term economic viability of their business model.

Not surprisingly, investors in the public markets have taken note. Worldwide, about 50 percent (depending on region and lines-of-business focus) of listed insurance companies have consistently traded below their book value over the past five years (Exhibit 15). This is clearly a vote of no confidence in the industry and raises questions about the long-term future of several players as stand-alone entities—particularly in multiline, where about 60 percent of players are trading below book value.

In summary, after decades of stable returns, insurance is now a value-destroying industry in

which half the players do not earn their cost of equity. What can insurers do to beat the odds and emerge from the current environment as winners? Our research¹⁶ across insurance and other sectors has found that five bold moves, pursued persistently, can propel players up the power curve: dynamically reallocate capital among businesses; reinvest a substantial share of capital into organic growth and innovation; pursue thematic and programmatic M&A (but not megadeals); enhance underwriting margins; and make game-changing improvements to achieve top-quartile productivity. All of this has to be done in a very different and rapidly changing environment, and starting points vary greatly among geographies and lines of business.

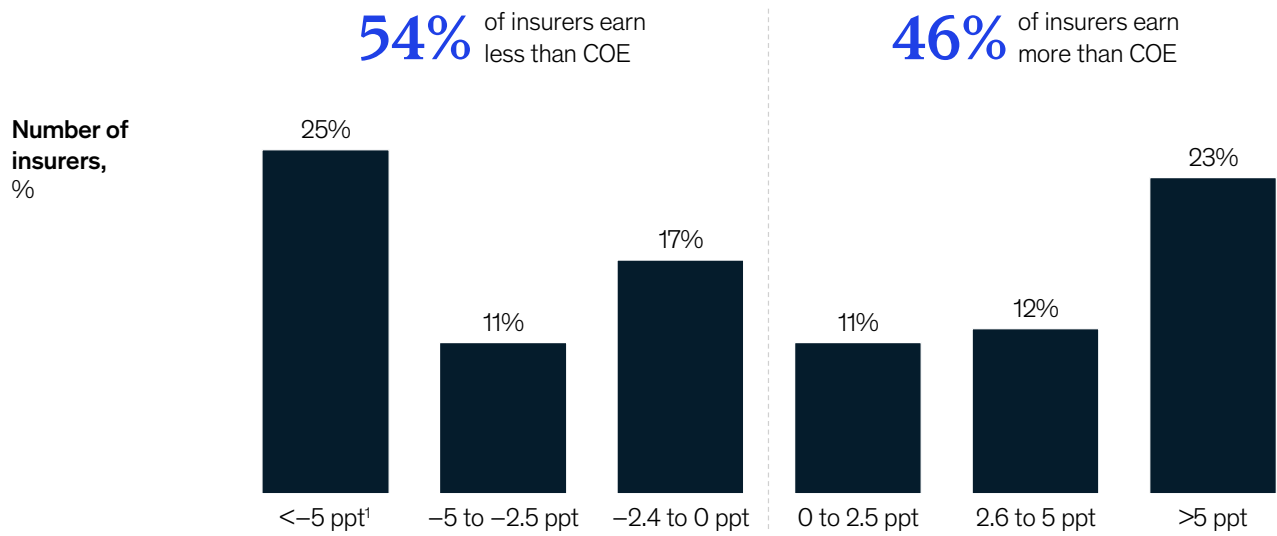
To acknowledge these differences and capitalize on the tailwinds of change outlined above, we have identified nine levers that insurers can pull to improve value creation.

¹⁶ Chris Bradley, Martin Hirt, and Sven Smit, "Strategy to beat the odds," *McKinsey Quarterly*, February 13, 2018.

More than half of insurers globally do not earn their cost of equity.

Distribution of average ROE minus average cost of equity (COE), 2017–21, %

Listed players, n = 299



Note: Figures may not sum to 100%, because of rounding.

¹ Percentage points.

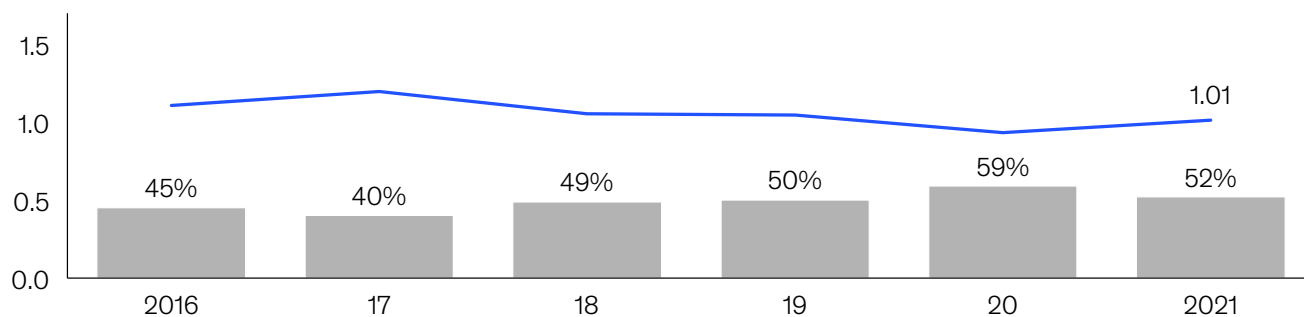
Source: McKinsey Global Insurance Pools

More than half of insurers have been trading below book value.

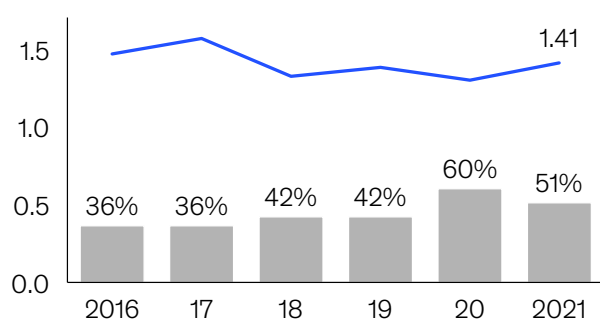
Insurers' price-to-book (P/B) ratio and proportion trading below book value, 2016–21, %

— Insurance P/B ■ Percentage of insurers trading below book value

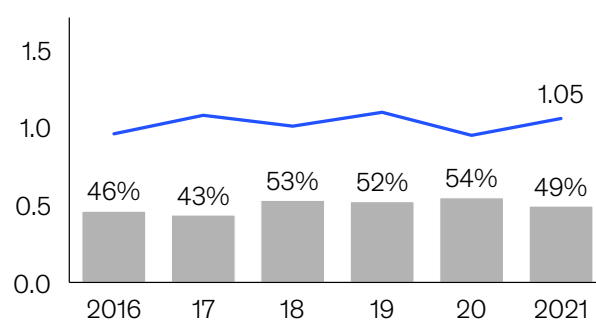
World (n = 251)



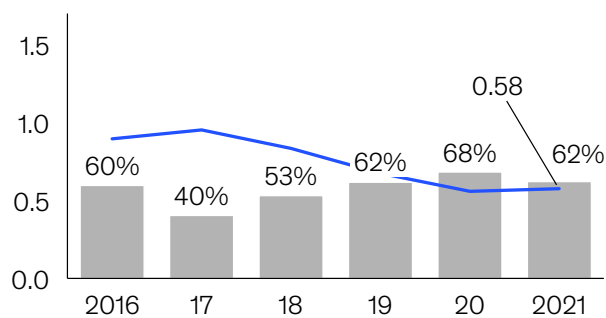
Americas (n = 88)



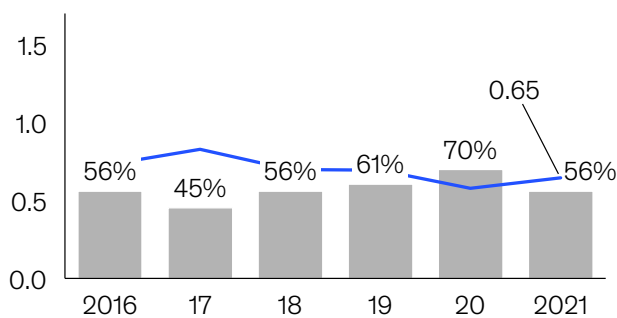
Europe, Middle East, and Africa (n = 116)



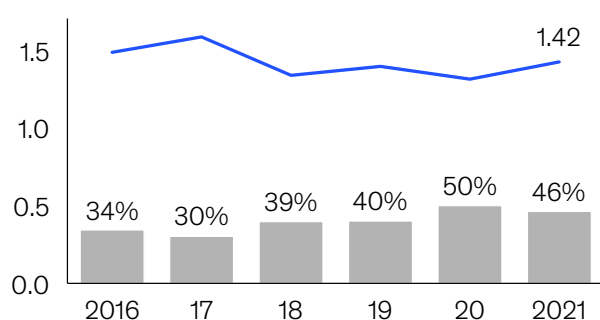
Asia-Pacific (n = 47)



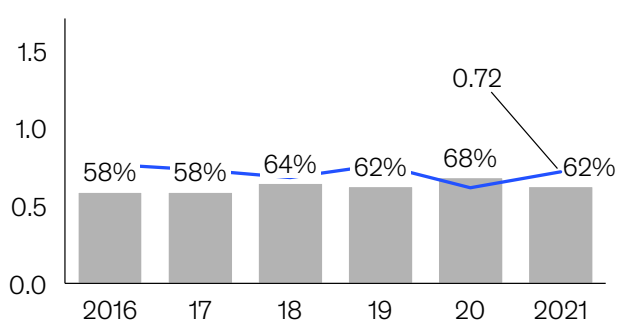
Life (n = 66)



P&C (n = 132)



Multiline (n = 53)



Source: Bloomberg; Capital IQ





**What can insurers do
to beat the odds and
emerge from the current
environment as winners?**



3

Strategic imperatives for insurers

So far we have sketched the trends and challenges buffeting the industry. Their effects run so deep that insurers now face some fundamental strategic questions:

- How can we improve shareholder value creation?
- How can we unlock latent demand and improve customer experience?
- How can we overcome stagnating productivity?
- How can we reimagine the employee proposition to attract and retain talent post-COVID-19?
- How can we frame the industry's wider purpose and role in society?

Answering these questions is an urgent and broadly transformational task. In our view, it can be best accomplished by taking action on the following nine imperatives:

- **Make environmental, social, and governance (ESG) considerations a core feature of the business model.** ESG issues increasingly affect how all companies do business. More and more companies and their investors are recognizing ESG as a strategic priority that involves significant business risks and opportunities. In interactions with many stakeholders, including at annual general meetings of publicly listed insurers, ESG has become a major theme.

But ESG is often used as a catchall term covering many topics; for any given company, just a handful of those topics will be of supreme importance. As an illustration, consider climate risk, an area in which evidence is mounting that P&C insurers will soon need to revisit their business models.¹⁷ However, while many insurers have begun to incorporate climate-risk considerations in their investment processes, new-product launches and underwriting processes are mostly unchanged. With climate risk mounting, insurers have an opportunity to broaden the relevance of the industry's traditional risk transfer to explicitly address risk mitigation. Five simultaneous actions can make this happen: stress-test total exposure against projected climate hazards; build resilience and rebalance portfolios; help organizations mitigate climate risk; create innovative products to address climate-related risk; and revise investment strategies.

- **Regain relevance through product innovation and coverage of new risks.** While the insurance industry has improved its resilience and solvency in recent years, some substantial risks have been left uninsured. A fast-changing world is creating many new and evolving risks—cyberrisks, climate change, pandemics, intangible assets—that remain underinsured, while other risks have been gradually transferred to governments to handle.

Risks are rapidly evolving. In P&C commercial lines, for instance, data and cybersecurity risk and machine-learning liability are coming to the fore. New risks call for new products and a reallocation of priorities, and they represent significant opportunities for P&C and life insurers that are willing to innovate. Such firms are taking three steps: making their products modular, reallocating capital between personal and commercial lines, and moving quickly to establish strong market positions in the new risks.

As noted, climate risk will require product innovation. But even more innovation is necessary as the insurability of entire regions may come into question.¹⁸ As our colleagues have written, “The P&C industry can address this issue by forming an industry-wide coalition and collaborating more closely with governments and regulators.”¹⁹ At the very least, requiring customers to opt out of protection, rather than the current model of opting in, could substantially increase insurance penetration, as behavioral science has shown. This raises the issue of affordability; on that front, rather than artificially suppressing risk-based rates, governments and insurers might need stronger public–private partnerships, including government insurance voucher programs to address affordability issues without losing the highly valuable pricing mechanism that signals risks back to the insured (for example, to prevent building in areas with high flood risk).

- **Enhance and personalize customer engagement and experience.** New customer behaviors require a shift in distribution. Consumers are embracing digital channels and have become used to delightful experiences with leading tech companies. They expect the same when buying insurance both online and offline. A seamless, consistent “multi-access” experience²⁰ in every channel is now the gold standard for insurers. At the same time, most customers still expect some form of advice on most products. Addressing customer needs and improving customer experience thus does not necessarily mean going direct. It might mean supporting distributors with

¹⁷ “Climate change and P&C insurance: The threat and opportunity,” McKinsey, November 19, 2020.

¹⁸ Sylvain Johansson, Andy Luo, Erwann Michel-Kerjan, and Leda Zaharieva, “State of property and casualty insurance 2020,” McKinsey, April 22, 2020.

¹⁹ Ibid.

²⁰ Simon Kaesler, Michael Krause, and Johannes-Tobias Lorenz, “The multi-access (r)evolution in insurance sales,” McKinsey, April 1, 2020.

seamless, digital customer journeys that let customers decide which topics they can access digitally themselves and on which topics they value personal advice (for example, before buying a complex and low-frequency product or in the case of a severe claim).

Major European and US carriers have not moved as quickly as some players in Asia that have seamlessly linked their digital platforms and tied agent channels and invested in customer personalization and engagement. Carriers willing to launch this journey could follow different approaches based on their strengths and organizational capabilities. Many insurers that traditionally rely on agents start by providing digital tools to agents. Insurers that depend on direct distribution are typically far down the road of digitalization; they can augment direct channels with tools to connect customers with people. Carriers that rely on both an agent network and direct channels can build a true multi-access model that fully integrates both agent and direct channels.

— **Engage with ecosystems and insurtechs.**

The ongoing drive toward digitalization has also put the insurance industry on the verge of a paradigm shift: as traditional industry borders fall away, ecosystems will greatly influence the future of insurers, with insurtechs aiming to play a role in this recomposition of the value chain. Our research suggests that ecosystems could encompass \$60 trillion in revenue by 2030.²¹

Many insurance executives are looking at ways to engage with emerging ecosystems in areas such as mobility, healthcare, and the connected home. While only the very largest insurers will be able to create or orchestrate their own ecosystems, the ability to connect with ecosystems will be a prerequisite for growth for all carriers as these systems gain in scale and customers come to expect insurance products as part of the offering.

Carriers will need to take a close look at their relationships with end customers in the context of purchasing journeys—such as buying a car, going on vacation, and buying a home—and decide how to embed solutions and services alongside insurance coverage. To succeed, insurers need to build the technological

and organizational foundations as well as the necessary partnerships to generate value from their ecosystem approaches. Our conversations with insurance executives around the world suggest that leading carriers take a three-stage approach²² to participating in or forming an ecosystem: strategize, enable, and generate value. These stages can help insurers implement ecosystems in manageable, focused phases.

— **Develop new businesses for the digital age.**

Private investors have spotted the potential for improvement and the not-too-distant prospect of attractive returns in insurance. They are investing heavily in insurtechs, whose attractive talent pools can rapidly create and scale new businesses.

In this context, incumbent carriers must reinvent their business models to fulfill the imperative to grow and, ultimately, to deliver stakeholder value. As our colleagues wrote recently, “New-business building is emerging as a crucial strategic priority to drive reinvention and innovation for the industry. Part of the reason is speed: what used to take years must now be done in months or weeks to meet changing demands of the market. Insurance executives must shift how they lead their institutions—from a methodical pace of change to the decisive reinvention of their businesses. Many established companies have tried and failed to build new businesses from scratch. The ones that succeed combine the speed of a start-up with the scale and resources of the core business.”²³

Organizations that repeatedly build successful new businesses exhibit six characteristics: strong commitment from senior management, obsession with value over ideas, a test-and-learn culture, “open architecture” capabilities, balance between organizational freedom and corporate support, and dynamic performance management and measurement. To get started on new-business building, insurers can look for opportunities that simultaneously meet customer demands, square with the organization’s strengths, and are sizable enough to create real value.

— **Scale impact from data and analytics.** Most insurance executives would agree that data and analytics capabilities are becoming table

²¹ Miklos Dietz, Hamza Khan, and Istvan Rab, “How do companies create value from digital ecosystems?,” McKinsey, August 7, 2020.

²² “Ecosystems and platforms: How insurers can turn vision into reality,” McKinsey, March 12, 2020.

²³ Ari Libarikian and Kurt Strovink, “CEO brief: The future of business building in insurance,” McKinsey, June 2, 2021.

stakes in the P&C and life sectors in Europe, North America, and Asia.²⁴ Leaders see enormous potential in best-in-class data and analytics capabilities across the value chain, even for the highest-performing companies. For example, even the leading P&C insurers can see loss ratios improve three to five points, new business premiums increase 10 to 15 percent, and retention in profitable segments jump 5 to 10 percent. However, after years of investing and experimenting, most insurers have not yet seen the return on their investments at the enterprise level. While individual pilots are successful, they realize the real challenge is in scaling the impact to the whole organization. We call this the pilot trap; to escape it, insurers need to move analytics from experiments to the mainstream.

This move requires a combination of distinctive analytics, tools, frontline and management routines, and investments in talent and capability building. The ideal mix of these elements will vary by line of business. Based on our experience with similar efforts, getting a few things right often determines whether companies achieve their full potential. One principle is to start small to learn and build conviction—for example, by picking two lines of business, one with strong performance and another that is performing less well, to prove impact. “Big bang” efforts made without examples of the potential outcome often fail to drive change. Another guideline: keep the effort anchored in the C-suite; delegating down can dilute long-term aspirations. Carriers should also focus on the pace of execution: in other words, speed is a strategy, especially in the next 18 to 24 months, given evolving market conditions. Fourth, carriers should engage the front line throughout the effort to help ensure lasting change; adoption by users is the foundation for success. Finally, it’s a good idea to link capital allocation decisions to the latest market intelligence and insights (at a high enough frequency to ensure you can react to market shifts).

At the same time, technology is evolving quickly. The next level will be to leverage

even more advanced technologies to enhance decision making and productivity, lower costs, and optimize the customer experience: as AI becomes more deeply integrated²⁵ in the industry, carriers need to understand the potential for AI to reshape claims, underwriting, pricing, and distribution. With this understanding, they can build the skills and create the culture needed for an AI-powered future.

— **Modernize core technology platforms.**

From 2012 to 2020, technology’s average share of operating costs rose by 36 percent for P&C and 10 percent for life. The key driver is increasing digitalization—at both the front end, where technology enhances the customer experience, and the back end, where digital drives productivity gains and operational performance. Digitalization is straining legacy systems, some of which are decades old, and many insurers are considering a replacement of core systems with tech platforms that support the requirements of the digital age. The challenge is that such projects can take five to ten years, and they often last longer and cost more than expected. Insurers need to clearly pinpoint the real business requirements, quantify the effects, and then identify the tech changes required to achieve them. A wholesale change of all core systems is not always the right answer, and the long timeline of such a change can prevent carriers from adjusting to rapidly changing market conditions.

To reach the next normal of core technology,²⁶ carriers will need to take three bold actions: reimagine the relationship between the IT group and other business functions, reinvent the ways that IT delivers products and services to internal customers, and anticipate the future requirements of technology systems to provide the organization with essential capabilities (but without necessarily undertaking a complete change of the IT stack).

— **Address the productivity imperative.** In the current conditions, addressing structural expenses²⁷ has become an even more important source of value—especially given

²⁴ Kia Javanmardian, Sirus Ramezani, Ashish Srivastava, and Cameron Talischi, “How data and analytics are redefining excellence in P&C underwriting,” McKinsey, September 24, 2021.

²⁵ Ramnath Balasubramanian, Ari Libarikian, and Doug McElhaney, “Insurance 2030—The impact of AI on the future of insurance,” McKinsey, March 12, 2021.

²⁶ Krish Krishnakanthan, Ani Majumder, Björn Münstermann, and Peter Braad Olesen, “Reaching the next normal of insurance core technology,” McKinsey, July 2, 2020.

²⁷ Alex D’Amico, Kweilin Ellingrud, Daniel Garza, and Nancy Szmolyan, “The productivity imperative for US life and annuities carriers,” McKinsey, March 16, 2021.

the limited progress to date. Total expenses relative to total revenues (including investment income) increased by 20 percent from 2003 to 2019 for the life and annuities industry and by 6 percent for P&C insurance carriers. During these same years, automakers and telecoms companies successfully reduced their total expense ratios by 15 percent or more.²⁸

Insurers need more than mere piecemeal attempts at improvements. Only a transformative approach²⁹ will allow an insurer to survive and thrive in a post-COVID-19 world. Each carrier is unique, but any company can begin the process to improve productivity by establishing the trajectory and full performance potential of the business across the value chain—including sales and distribution, product development, operations, technology, and corporate functions.

With a clear vision, insurers can write a comprehensive and detailed plan with clear, measurable goals and assign responsibility to specific executives. Financial, operational, and customer-experience targets are all in scope. Examples include straight-through processing rates and all-digital policy application and issuance rates in underwriting. Without both clear goals and accountability, transformations often deliver poor results.

To do the work, insurers should build a team to continually and logically sequence all the improvement initiatives so that every part of the organization knows what to do and when to do it in a harmonized way. A senior executive should lead the team, holding people accountable for their actions and their results. The keys to success of such a productivity transformation are top-management conviction, leadership to challenge prevailing orthodoxies and drive step-change performance improvements, and a rigorous execution machine that ensures delivery (and, where required, adaptation) of initiatives.

— **Reimagine culture, diversity, and ways of working to attract and retain talent.** Our

colleagues summed it up recently: “Once in a generation (if that), we have the opportunity to reimagine how we work. In the 1800s, the Industrial Revolution moved many in Europe and the United States from fields to factories. In the 1940s, World War II brought women into the workforce (if not the C-suite) at unprecedented rates. In the 1990s, the explosion of PCs and email drove a rapid increase in productivity and the speed of decision making, ushering in the digital age as we know it today. And in 2020, the COVID-19 pandemic drove employees out of offices to work from home. ... The return to the workplace is a chance to create a new, more effective operating model that works for companies and people navigating a world of increasing uncertainty. There is, however, one big catch: employers must confront the broadening disconnect between how they and their employees see the future.”³⁰ Because of this disconnect, a record number of employees are quitting or thinking about doing so (the so-called Great Resignation).³¹

Many companies don't really understand why their employees are leaving. Without knowing the true causes of attrition, companies sometimes offer pay raises and bonuses that fall flat. Rather than sensing appreciation, employees sense a transaction. Leaders need to start from scratch, question everything, and make changes to the working model based on the evidence.

There is no road map or playbook for this unprecedented time. Experimentation will be key. Carriers can try different working models and norms, physical-space layouts, and tools in service of a future that balances productivity with creativity, personal flexibility with team collaboration, and the office with the home. That means experimenting and piloting as individuals, teams, business units, offices, and organizations. Letting experiments play out is not easy for many leaders. A clear solution may not be immediately apparent—the big answers may not emerge for years.

²⁸ Ibid.

²⁹ Alexander Erk, Pradip Patiath, Jonathan Pedde, and Jasper van Ouwkerk, “Insurance productivity 2030: Reimagining the insurer for the future,” McKinsey, October 8, 2020.

³⁰ “It’s time for leaders to get real about hybrid,” July 9, 2021.

³¹ Aaron De Smet, Bonnie Dowling, Marino Mugayar-Baldocchi, and Bill Schaninger, “‘Great Attrition’ or ‘Great Attraction’? The choice is yours,” *McKinsey Quarterly*, September 8, 2021.

An aerial photograph of a dense forest. A road, appearing as a dark, winding line, cuts through the green canopy. The road has a Y-junction or intersection. The trees are mostly green, with some showing yellow and orange hues, suggesting autumn. The perspective is from directly above, looking down on the forest and road.

Where should companies
play—in terms of geography,
lines of business, and
position in the value chain—
to renew themselves?



4

Where to play: Focusing the portfolio

Above, we outlined nine essential actions for leaders to renew their companies and rejuvenate value creation. While addressing these imperatives would enable carriers to answer the “how to play” question, we believe a related question is equally pressing: Where should companies play—in terms of geography, lines of business, and position in the value chain—to renew themselves?

The pandemic years seem to herald a new phase for the insurance industry. Several players are already changing and refocusing their footprint and business model—in effect, rebalancing their portfolio of activities and reviewing their capital allocation particularly through M&A and asset disposals. Indeed, a new premise for industry transformation may be emerging as carriers realize that the changes unleashed by the COVID-19 crisis will raise the stakes of competition

while also complicating the macroeconomic environment, especially through inflation and interest-rate evolution. Carriers have to invest quickly and massively in technology, data and analytics capabilities, digital skills, the customer experience, and compliance capabilities just to keep pace in the changing environment. Those investments won't be easy to fund in an industry with some disappointed shareholders. And they carry an opportunity cost: as carriers with diversified portfolios have many mouths to feed, some areas will be shortchanged.

Insurers are realizing that the costs of complexity (whether in the product portfolio, client experience, geographical footprint, lines of business, or position in the value chain) are simply too high. More carriers are concluding that it is better to simplify their operating model, cede some benefits of diversification, and invest the proceeds to gain scale where they intend to operate. Thus, many carriers (though not all; some are still pursuing global scale) are shedding subscale, noncore businesses; seeking profitability in their core activities and markets; and gaining the ability to make bolder, more focused investments. Many carriers believe they will be able to renew value creation by offloading legacy liabilities to owners better positioned to manage them and by refocusing their business model.

Consider a flurry of recent deals, each with focus and local scale as the core strategic rationale. Voya Financial recently sold its annuities, life, and wealth businesses and doubled down on retirement, asset management, and group insurance. MassMutual, meanwhile, divested its US direct-contribution business, OppenheimerFunds, and its businesses in Asia. Concurrently, it doubled the size of its captive channel through an acquisition and then acquired American Financial Group's annuities business to secure product scale in its core insurance business.

Financial buyers have also entered the arena. Private equity firms are rolling up insurance and annuities assets³²—typically sold by public carriers—to secure permanent capital for their investment arms. Recent deals include Apollo's acquisition of Athene, KKR's deal for Global Atlantic, Generali's sale of its Generali Leben book

to Viridium, and Athora's acquisition of VIVAT life and asset management from Anbang. And some global insurers have rethought their geographical footprint; for example, AXA has sold its activities in Central and Eastern Europe, Greece, the Gulf region, Malaysia, and Singapore; Aviva has sold most of its international businesses, including operations in France, Italy, Poland, Singapore, and Turkey; and Aegon has divested its businesses in Central Europe and Turkey.

The next phase of M&A

The overall pace of M&A activity among insurers and investors is likely to increase, though we anticipate more activity among life insurers than P&C. For life insurers, industry consolidation is largely the result of macro challenges, including sustained low interest rates and others that make it difficult to achieve an attractive, sustainable ROE. P&C insurers also face headwinds from low interest rates—although less so than their life insurance counterparts—as well as an overabundance of carriers in many businesses, resulting in downward pressure on ROE.

As the industry continues to restructure, making a series of small deals could be a bridge to a programmatic approach to acquisitions for P&C and life insurers.³³ Our research over the past 20 years has consistently shown that a programmatic approach increases carriers' odds of success as well as their potential for long-term independence—if they can resist the allure of very large acquisitions. Across industries, programmatic M&A has worked best when companies build dedicated teams and carefully design processes based on best practices across all stages of the M&A process, from strategy and sourcing to due diligence and integration planning. Today's deal pace is strong; as that continues, leading carriers can adopt those best practices to fulfill their growth needs.

Both life and P&C insurers could focus on M&A in existing businesses, and they could also increase their presence in truly adjacent areas, as long as they do not wander too far afield. For example, life insurers could expand in businesses related to asset and wealth management; P&C carriers could move into service-provider functions in personal, commercial, or specialty lines.

³² "Running up on runoff: Strategic options for life closed books," McKinsey, February 10, 2021.

³³ "A better approach to M&A in North American insurance," McKinsey, March 9, 2021.

Embracing a strategy of focus and local scale will require a hard look at global insurers' portfolios of activities, as well as some tough decisions.

How to (re)focus portfolios of activities

Over the past several years, most global insurers' strategies have centered on four areas: productivity, economies of scale and scope, greater exposure to higher growth markets, and the benefits of diversification (including the impact of Solvency II). As previously mentioned, these moves have not yet been sufficiently radical to trigger higher valuations. One could even argue that investors now see insurers as a "value" play, with no surprises and no volatility, a view that removes growth and risk taking from the equation (with a corresponding impact on market multiples).

Global insurers (those with a monoline presence in several countries as well as multiline in a few) thus face one pressing question: How should they revisit their business model and portfolio of activities to improve shareholder value creation? For global insurers, the question of where to play (and the related question of the "right to play" of several carriers) may well be an existential one: the next phase of the industry could deliver a structure in which insurance liabilities are reallocated toward their natural owners³⁴—that is, the companies whose distinctive characteristics enable them to create more value in a given business than other potential owners could. In

a worst-case scenario, global insurers could become irrelevant, with an industry slowly moving toward a structure in which retail P&C transfers to mutuals, bancassurance, and direct players; commercial P&C goes to reinsurers and specialists; life insurance goes to wealth, asset management, and private-equity firms; and health insurance becomes further entwined with public healthcare systems. Considering the role global insurers could play in addressing global issues such as climate and pandemic risks, maintaining their relevance becomes an urgent priority, for them and for society at large.

Embracing a strategy of focus and local scale will require a hard look at global insurers' portfolios of activities, as well as some tough decisions. We believe they can renew value creation by moving from a diversified, generalist, end-to-end business model toward a sharper, (multi)specialist business model. Many different flavors of focus will exist, all potentially sound bases for natural ownership: portfolios could be centered on a geography, a line of business (potentially through disposals and acquisitions), a distinctive value proposition along the value chain, or the differentiating advantages of private ownership.

For leaders who find the prospect enticing and are excited to start such a transformation journey, we

³⁴ Richard Dobbs, Bill Huyett, and Tim Koller, "Are you still the best owner of your assets?," *McKinsey Quarterly*, November 1, 2009.

suggest developing a rigorous understanding of their starting point and then testing their strategy against the following markers:

Geographical lens

1. Aside from your home market, where do you have the position to achieve local scale and generate profitability above cost of capital, justifying investments?
2. How should you tackle high-growth markets (such as Africa, emerging Asia, Latin America, and the Middle East) that might be the future of the industry but where you might have a subscale business? Is there an alternative path between divesting and scaling investments without end (for example, by spinning off the entity and keeping a minority stake)?
3. Could you swap assets with other players in the same situation as yours to find a new equilibrium across multiple countries in one go?

Lines of business lens

4. Taking a fine-grained approach to growth,³⁵ in which lines of business should you focus your efforts and investments? How can you divest the ones where you cannot create value?
5. Where you decide to compete, how can you promote innovation and cover new types of risks or client segments to increase your relevance in the market?

6. Where you decide to compete, how can you develop adjacencies or new services (for example, generating tech-based revenues such as BlackRock earns from Aladdin, its risk management system)?

Value chain lens

7. Are you the natural owner of the main building blocks of the insurance value chain (distribution, technology, administration, balance sheets and underwriting, investments)?
8. Where you are not the natural owner, could you outsource part of your value chain to other players—even competitors—so that you can focus your investments on the distinctive elements of your value proposition (for example, Wakam and iptiQ acting as B2B2C providers without proprietary distribution networks)?
9. Where you are the natural owner, could you insource activities from other players (for example, acting as a utility for other subscale insurers)?

COVID-19 has reset the playing field for the global insurance industry. To stake out a profitable, fast-growing position, many companies will need to pull back on visions of global scale and instead find their key source of competitive advantage—one that makes them the best owner of their assets.

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³⁵ Mehrdad Baghai, Sven Smit, and S. Patrick Viguier, "The granularity of growth," *McKinsey Quarterly*, May 1, 2007.



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