

Global reinsurance: Fit for the future?

September 2017



Global reinsurance: Fit for the future?

By volume, reinsurance markets are about one-tenth of primary insurance markets globally, but reinsurance plays a pivotal role in supporting the solvency and capital efficiency of insurance risk transfer. Reinsurance has faced the same competitive pressures as primary markets, including excess supply and softening demand. Looking forward, there are many opportunities for the industry to maintain and increase its relevance, as new risks grow in importance and global macroeconomic conditions become more complex – and therefore riskier.

This paper explores the recent performance of the reinsurance sector (outperforming primary insurance in total return to shareholders but lagging in valuation), the importance of scale and diversification (globally diversified reinsurers sustaining margins better), and finally considers the outlook for property and casualty, life, and health reinsurance. Key themes common to all reinsurance segments are highlighted (e.g., cost imperative, leadership in digital innovation, analytics support, growth in emerging markets) as well as segment-specific development opportunities, whether emerging risks in property and casualty, longevity challenges in life, or supplemental health insurance gaps in developed markets.

History and recent industry performance

Reinsurance has played a critical role in the industry for more than 150 years. It is believed to have started with Cologne Re, which wrote the first reinsurance treaties in 1852, one decade after the Great Fire of Hamburg. Cologne Re has since merged and became part of Gen Re (a subsidiary of Berkshire Hathaway) in the 1990s. Swiss Re and Munich Re were established in the 1860s to 1880s, and continue to be the top two global reinsurers in today's market.

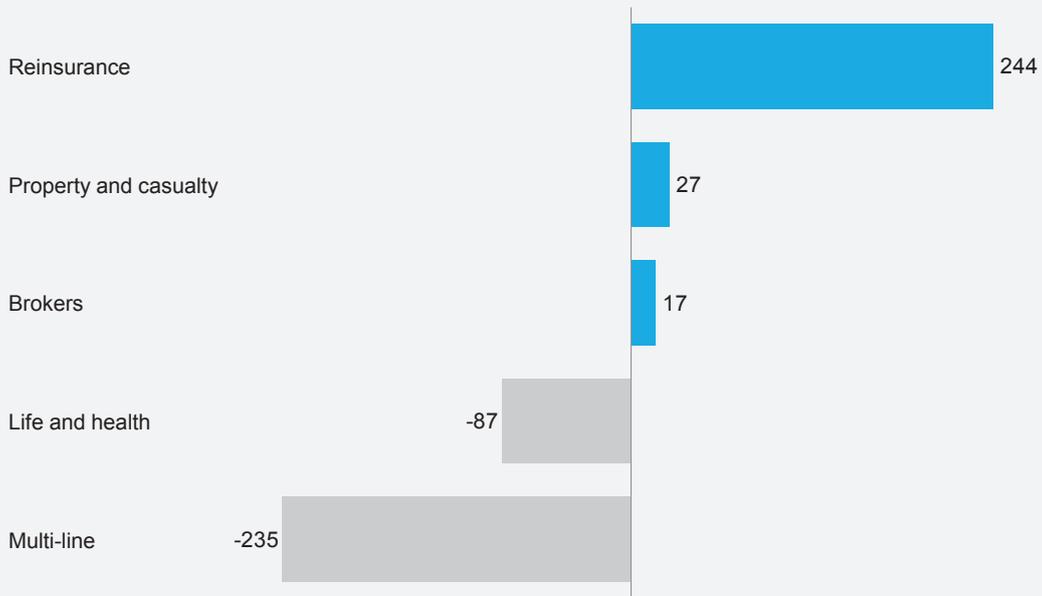
Reinsurance was one of the earliest global industries. In the early 1900s in the US, reinsurance was offered within the divisions of US-based primary insurers, but was also provided by several Russian companies, as well as Munich Re, Cologne Re, and Swiss Re. Today, global reinsurance companies often pay the lion's share for catastrophic claims globally, including tail events like the terrorist attacks of September 11 or Hurricane Katrina. Annual payouts by reinsurers have on average exceeded USD 110 billion annually over the last decade. Aside from catastrophic events, the industry – across P&C, life, and health reinsurance – plays a critical role in supporting primary companies in many ways, including transferring complex risks, reducing capital requirements and capping volatility, filling in capability gaps, smoothing earnings fluctuations, enabling growth with more capacity, and improving solvency.

In McKinsey's power curve analysis, which measures economic value creation across companies, we found that reinsurance has been the highest-performing part of the insurance industry in recent years; see *Exhibit 1*. Also, looking back at the last five and a half years (January 1, 2012 to June 30, 2017), reinsurers have generated a total return to shareholders of close to 20%, outperforming the insurance industry (13%) as well as the stock market overall. However, this overperformance (particularly in non-life reinsurance) has been driven, at least partially, by a recent period of limited insured catastrophic events (compared to historical averages), as well as reserve releases. For these reasons, as well as the growth prospects, which investors view as flat in real terms, valuations for reinsurance companies lag behind those of primary companies; see *Exhibit 2*.

Exhibit 1

Reinsurance has been the highest-performing part of the industry

Economic profit by segment, average for 2011 - 15¹
USD millions



¹ Economic profit measured as returns in excess of cost of capital
SOURCE: McKinsey Strategy Practice and Corporate Performance Analytics™

Exhibit 2

Reinsurers have outperformed the overall insurance industry in the past years – yet valuations remain moderate

Total annual return to shareholders, January 1, 2012 to June 30, 2017
CAGR¹ in percent



Price-to-book ratio 2016 as of June 30, 2017
Multiple



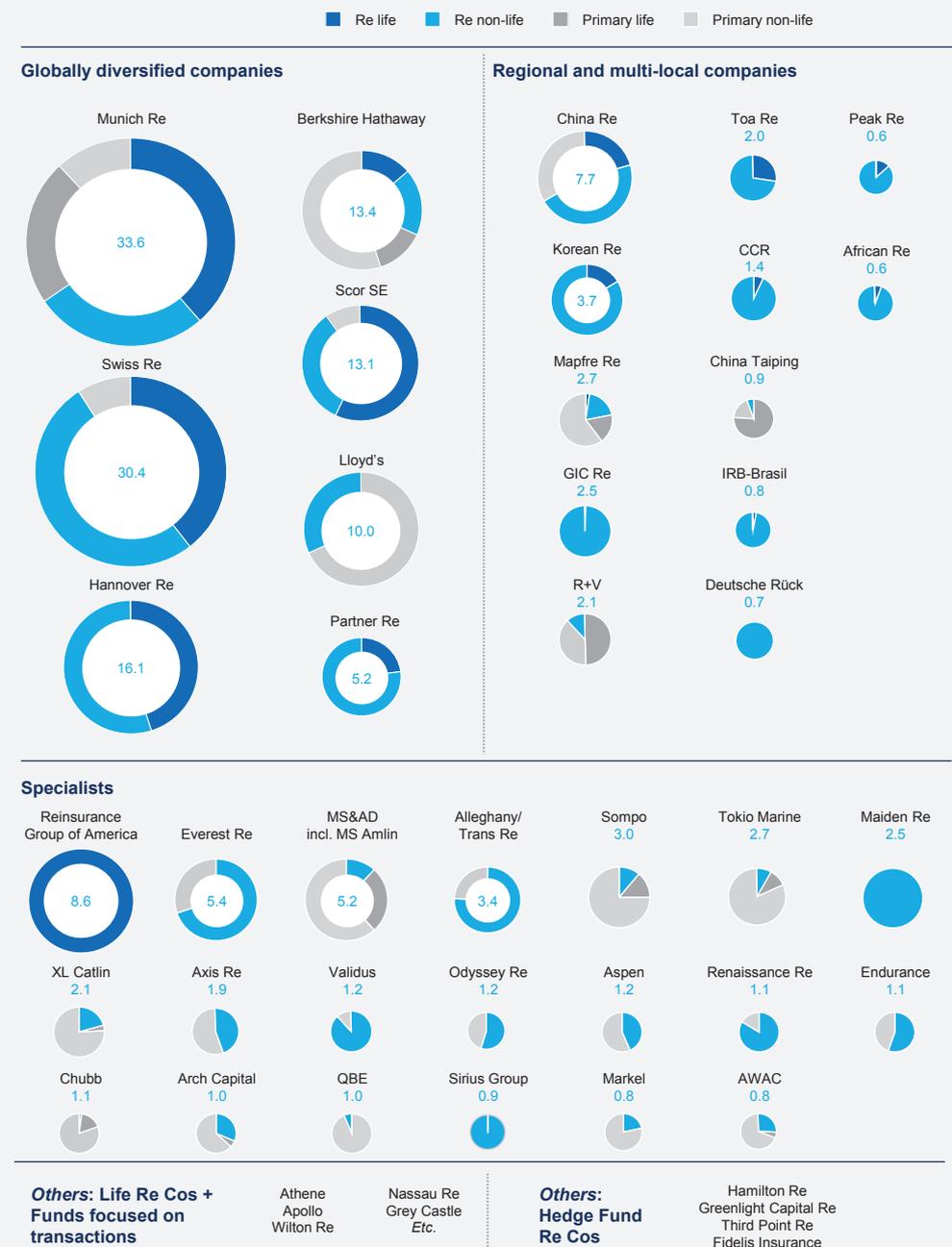
¹ Compound annual growth rate
² Synthetic capitalization-weighted index of the largest traded companies with significant proportion of reinsurance in portfolio: Munich Re, Swiss Re, Hannover Re, SCOR, RGA, PartnerRe (until de-listing in Feb 2016), Everest Re, Korean Re, AWAC, Renaissance Re, Alleghany Corporation (parent of Transatlantic Re) and Validus Holdings
³ Global S&P 1200 Insurance sub-index
SOURCE: Capital IQ; McKinsey calculations

Reinsurance, much like primary markets, faces an oversupply of capital. Nearly all of the global reinsurance companies have been expanding their footprint – looking to do more business in Asia and Latin America – while “local” and regional companies have also been looking to grow globally, beyond local markets.

Exhibit 3

Three “types” of reinsurance players have emerged; very few “pure play” reinsurers remain

Top reinsurance companies (total net written premiums in USD billions) by size¹



¹ Size of the pie represents to reinsurance NWP based on S&P Global Reinsurance Highlights 2016; shares of different segments based on annual reports

Additionally, over the last decade, the lines have blurred between primary insurance and reinsurance, with most companies offering both. Today, only a very few “pure play” reinsurance companies remain across both non-life and life/health. See *Exhibit 3* for an overview of the reinsurance landscape.

The oversupply of capital is exacerbated in P&C, compared to life, by shared-and-layered placements – especially for property risks, which can be highly syndicated and include dozens of different reinsurance companies participating in the risk-transfer transaction. On the one hand, this creates stability and diversification across the industry. On the other hand, this complexity – and the intermediation required to structure it – increases the ultimate cost of risk transfer for the insured. As a result, some primary insurance companies have been seeking to consolidate their reinsurance panels as a way to increase efficiency and gain negotiating leverage to reduce costs.

Importance of scale and diversification

In recent years, the reinsurance industry has continued to consolidate and diversify. The leading global, diversified companies – such as Munich Re, Swiss Re, SCOR, Hannover Re, and Partner Re – have maintained their market share, and have also sustained their profitability better than others in the industry; see *Exhibit 4*.

Exhibit 4

Although not the most profitable in selected years, globally diversified players sustained their margins better, also in the recent soft market



¹ Only reinsurers included with information available over the last 10 years, excl. Lloyds. Sample consists of Munich Re, Swiss Re, Hannover Re, SCOR, RGA, Everest Re, PartnerRe, Odyssey Re, Endurance, QBE, Korean Re, Transatlantic Re, R+V, Toa Re, CCR, Deutsche Rück, Mapfre Re, General Ins. Corp of India
² Incl. income of primary insurance business

SOURCE: Global Reinsurance Highlights 2007 and 2016; AM Best; SNL; annual reports; own analysis

Among mid-sized companies, there has been some consolidation – including, for instance, Montpelier-Endurance, Platinum-RenRe, and XL-Catlin.

At the same time, overall market capacity continues to increase as a result of the inflow of capital from both traditional rated carriers as well as alternative capital. So far, alternative capital, also known as insurance-linked securities (ILS), has been deployed mostly with short-tail property catastrophe markets. Other parts of the market have had limited penetration from new capital.

In a market with overcapacity, scale and diversification become more important. For instance:

- Larger companies have more capacity to assume larger blocks, and capacity – coupled with strong balance sheets – also allows more risk taking, and potentially higher profitability.
- Larger, more diversified companies enjoy superior diversification benefits (especially in a Solvency II-like environment). One of the top five global carriers has reported a capital diversification benefit of nearly 30%, due to the non-correlating combination of P&C and life within its portfolio
- Larger companies may have greater options to optimize their own balance sheets, particularly with retrocession placements and risk transfer to capital markets
- Greater diversification allows greater ability to rebalance the portfolio by dynamically increasing or decreasing the line size across products and markets, as local conditions continuously change.
- Larger, more diversified companies can also offer a “one-stop shop” to primary clients with diverse needs, providing multi-year programs and also single limits which span across different geographies and products. This means more convenience and sometimes coverage or cost benefits for the primary client and, when done right, it can create stickiness and greater profitability for the reinsurance company.
- More recently, we have also witnessed that scale has allowed more resources to be invested in innovation (e.g., emerging risks, big data, technology) and in the critical blocking-and-tackling which makes the industry successful (e.g., relationship and client management).

Despite this, scale and diversification are not a panacea. Several leading reinsurance companies have reached efficient scale across the lines of business within their risk appetite. And, to state the obvious, the reinsurance industry is hardly a “winner takes it all” game, since cedents still have to diversify across several reinsurance partners to ensure stability and promote a healthy, competitive dynamic.

P&C reinsurance (non-life): Ability to support new risks?

Non-life reinsurance remains strongly capitalized. Even in the case of a 1-in-250-year loss event, industry capitalization is unlikely to deteriorate below the “A” level versus the current “AAA” capital adequacy. This, in combination with the ongoing inflow of capital in the continued low-interest rate environment, makes the current soft market likely to persist – at least in the near term, and in the absence of a series of above-average catastrophic losses. It is still unclear if Hurricane Harvey, the first major hurricane to make landfall in the US since Wilma in 2005, will reverse price softening.

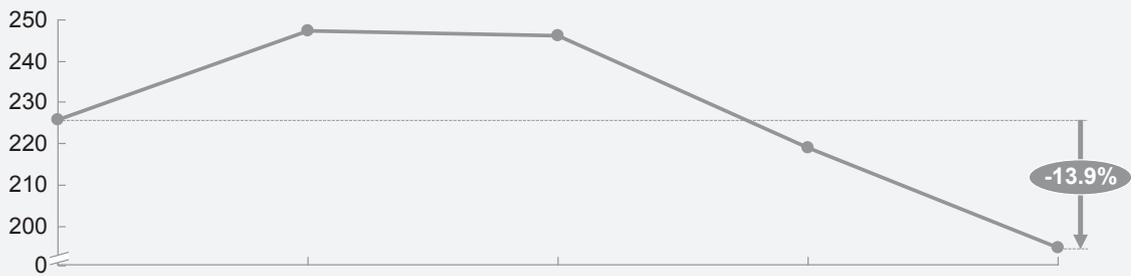
Industry pricing has been declining in most lines of business, with rate-on-line declining by 15% to 20% over the last five years. Pricing deterioration has been worse in some lines – notably, property catastrophe – where pricing has come down by 50% or more. Exposure growth over the same period has not offset the price declines and decreasing cessions, so real industry growth has been slow (less than 1% globally in the period 2013 to 2015). And while in 2016 soft pricing has started to lead to higher cession rates in some markets and/or by selected large carriers, there is a clear longer-term trend towards lower cession rates. Global cession rates have decreased from approximately 12% in 2009 to approximately 9% in 2015. These factors (lower pricing, lower cession rates), and others – like higher commissions – have also led to a higher expense ratios; see *Exhibit 5*.

Exhibit 5

Pressure is mounting: reinsurance total expense ratio has increased by 4 percentage points over the last 5 years, partly driven by the softer market

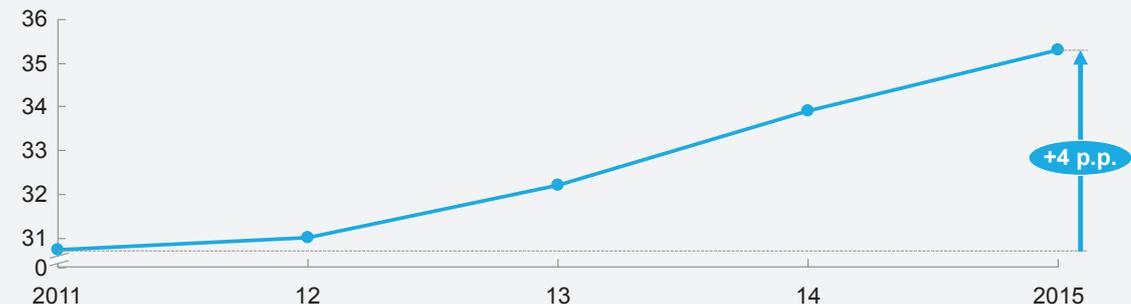
Global property cat rate-on-line (RoL) index¹

Index, 1990 = 100



Yearly average net expense ratio (commissions and operating expense)

Percent



¹ Represents an index of RoL in the global P&C property cat reinsurance markets, i.e., percentage derived by dividing reinsurance premium by reinsurance limit

SOURCE: S&P Global Ratings, Global Reinsurance Highlights, 2016 Edition; Guy Carpenter Capital Ideas

Alternative capital remains abundant in the industry, representing an estimated quarter of overall P&C reinsurance capacity. Many believe that alternative capital has reached its peak. Significant inflows into property catastrophe markets can be explained by high margins, which have come down by half in the last five years. Also, most inflows of “off-balance sheet” capital are now channeled into affiliate funds (i.e. reinsurance companies establishing sidecars or captive funds) rather than independents (e.g., funds structured as non-rated insurance balance sheets). This asset class, with margin compression, has become less attractive.

Finally, brokers have been consolidating and also attempting to increase their impact as an intermediary. Over the last decade, the top three reinsurance brokers (Aon Benfield, Guy Carpenter, and Willis Re) have slightly increased their market share, which now exceeds threequarters of the brokered channel. Brokers have also experimented with several types of “facilities” for more standard types of reinsurance coverage. While the jury is still out as to the ultimate success of such mechanisms, they are likely to continue causing margin pressure for some of the current placements in the market.

Despite these headwinds, the long-term demand outlook is strong for several reasons:

- The impact of changing climate patterns, combined with the fast-growing concentration of population and assets in hazard-prone areas
- The rise of the middle class in emerging economies, coupled with rapid urbanization
- The uncertain consequences of technological disruption, particularly the perils posed by cyber
- The continued growth of primary insurance in emerging markets.

In light of the above, the key for P&C reinsurance companies will be to increase agility and speed in establishing differentiated, hard-to-replicate value in an industry which is becoming increasingly commoditized. The following seven questions are worth considering:

- 1. Can the industry substantively support emerging niche risks?** There are many emerging risk classes (particularly cyber), as well as other parts of the industry facing a major change: autonomous automobiles, the internet of things, robotics in manufacturing, artificial intelligence, etc. Though primary companies typically incubate new forms of coverage, reinsurance companies can play a substantial role in supporting this new product development. However, they must overcome two challenges: first, how to underwrite white-space risks without a critical mass of loss experience. Second, how to sustainably monetize investments in building “new” expertise, since in an efficient and competitive market, other companies will eventually begin to “follow the leader” and offer competing capacity, even if they did not make the same level of initial investment.
- 2. Can the industry monetize expertise and value-added services beyond the first few years of quota share?** Reinsurers commonly provide advice/insight to their cedent partners, although this advice is often included as part of the risk transfer transaction. Is there a way to expand and monetize this consultative risk capability? This could include

providing assistance to primary insurance companies' clients in scaling up their own risk analytics capabilities, or interacting more with the risk managers of the underlying insureds.

- 3. Is there an opportunity to expand third-party capital beyond property cat?** Reinsurance companies could provide privileged access to tranches of risk within their portfolio. This may, for example, be done through a broad appetite for multi-line transactions with selective retro (e.g., for large reinsurers with the necessary underwriting breadth and capital base) or distinctive underwriting expertise in new risks “naturally” attracting an over-proportional amount of submissions (e.g., for specialist reinsurers). This would allow investors access to new, uncorrelated asset classes, while giving reinsurers more ability to generate returns by replacing balance sheet risk profits with fee income.
- 4. Is there an opportunity for more multi-year, cross-product pricing?** The larger, global companies (e.g., Munich Re, Swiss Re) are known to provide more complex, cross-product structures. This is also the convention in some emerging markets, particularly most of Latin America. There are some pitfalls to this approach (e.g., locking in insufficient pricing and underperforming business), but also other benefits (e.g., customer stickiness, lower administrative costs). Much of the industry continues to underwrite at the product level, and more whole-account, multi-year underwriting may be a way to change the fundamental approach to underwriting.
- 5. Does a more efficient, digital-based operating platform provide an upside?** Reinsurance is a talent-intensive business, and many mid-sized reinsurance companies already see themselves as being relatively lean and cost efficient. Reinsurance companies also recognize that underwriting performance, much more than cost, is the key underlying driver of success. This mindset, however, has also been a double-edged sword, resulting in low impetus to modernize. The industry has lots of brick-and-mortar and low-grade technology (e.g., Excel-based models hosted on local desktops, prevalence of case-by-case underwriting, including for small-ticket items). There may be an upside from building a more efficient, digitally enabled, analytically driven operating platform. Aside from the obvious cost benefits, such a platform might also provide the tools to support more mobile, data-driven, technology-based underwriting, which could improve results even further and have the cultural benefit of attracting new, younger talent. Finally, reinsurers may have a role to play in supporting digital innovation by partnering with “disruptors” and potentially enabling new risk transfer models.
- 6. Who will capture the emerging markets opportunity?** Emerging markets continue to provide the most underlying growth in the industry, and large multinational reinsurance companies already have a well-established international footprint. Going forward, there will be fierce competition with local or multi-local companies, who are “catching up” and building the same level of skills/talent to rival the global companies, but with the benefit of being local. Irrespective of which companies prevail, reinsurance – both risk transfer and the expertise which accompanies it – will continue to support the fast growth of primary insurance in emerging markets.
- 7. What potential is there for more public-private partnerships as governments continue to “privatize” their exposures?** Many governments have historically provided

a “back stop” to the (re-)insurance industry, stepping in for peak risks like terrorism and natural disasters, and also have strong participation in some lines of business that are viewed as politically sensitive (particularly flood insurance and agriculture insurance). Yet, given the higher public debt levels in many OECD and non-OECD countries, there is political pressure for governments to reduce their risk exposure. Over the past seven years, the OECD Council has also developed several recommendations supported by its 35 member countries to increase the role played by the private insurance industry in disaster financing.

In the US, for example, since the Terrorism Risk Insurance Act became law in 2002, this federal program has transferred more risks to the private sector every time it has been renewed, most recently in 2015 (until 2020). Flood risk also constitutes a significant market opportunity for insurers and reinsurers. The federally run National Flood Insurance Program (NFIP) purchased USD 1 billion of reinsurance earlier this year for the first time since its creation in 1968. Twenty-five reinsurers participated in the transaction. Another example is the setup of Flood Re in the UK.

Even more, outside of the US and other developed markets – where many catastrophic events are uninsured – there is a major opportunity for reinsurance companies and governments to collaborate, and build structures where the reinsurance industry provides expertise and insight in constructing innovative solutions.

Life reinsurance: Ability to meet unmet needs?

Life reinsurance has higher barriers to entry and is a significantly more consolidated market than P&C reinsurance. The top five life reinsurance companies account for more than 75% of the revenues globally, compared to 40% in non-life reinsurance.

“Traditional” life reinsurance faces similar pressures to those described in P&C reinsurance, including slow or declining growth in the primary sector, continued commoditization and price compression for biometric risks, decreasing cession rates in some large markets (especially the US), and of course low interest rates – which, given the longer tail in life business, have a stark impact. Globally, real growth in life reinsurance markets has been soft, averaging approximately 1% in the period 2013 to 2015, with Asia being one of the few bright spots thanks to its solid economic development and the emergence of the “saving middle class.”

Life reinsurance cession rates, particularly for developed markets, vary by market, ranging from 30% in the US to more than 80% in some other markets (like the UK). Rates in several markets have also been declining. In the US, for instance, in the mid-1990s to 2000s, cession rates rose to nearly 60%, given the uncertainty in the industry – starting with the unknown HIV epidemic, and then from the scale-up of “preferred” underwriting. Since then, as primary carriers in the life insurance industry became more comfortable with underwriting these risks, cession rates fell to under 30% in 2015 to 2016. There have been some industry tailwinds over this time period – for instance, “Regulation XXX” and “Regulation AXXX” in the early 2000s, creating capital requirements that meant reinsurance companies were uniquely able to provide capital relief. More recently, principle-based reserving (PBR) may also provide

similar opportunities for capital relief. Nevertheless, the regulatory and risk landscape in the US has been relatively stable and benign over the last two decades – therefore the need for traditional life reinsurance has been declining.

Yet, there are many opportunities for future growth. As with P&C, the big theme is to establish some differentiation in service or product, beyond cost and capacity, which helps to mitigate commoditization. Many of the opportunities described above for P&C also apply to life reinsurance: i.e., monetizing consultative support and value-added services; increasing access to third-party capital; building the next-generation, digitally driven operating model. Other themes (e.g., whole-account pricing) may be less significant, given the oligopolistic (i.e., higher concentration, more stable) industry structure.

Beyond those described in P&C, additional opportunities for life reinsurance to consider include:

1. What role can life reinsurance play in innovation, be it channel expansion, streamlined underwriting, or beyond? Most of the global reinsurance companies have invested significantly in digital distribution in both developed and developing markets. While distribution has obviously been the domain of primary companies, life reinsurers may have a competitive advantage when building new direct/digital channels, given the lack of legacy intermediary relationships. Other advantages may be broader risk experience (typical of any reinsurance company compared to a primary), as well as an ability to move at a faster pace.

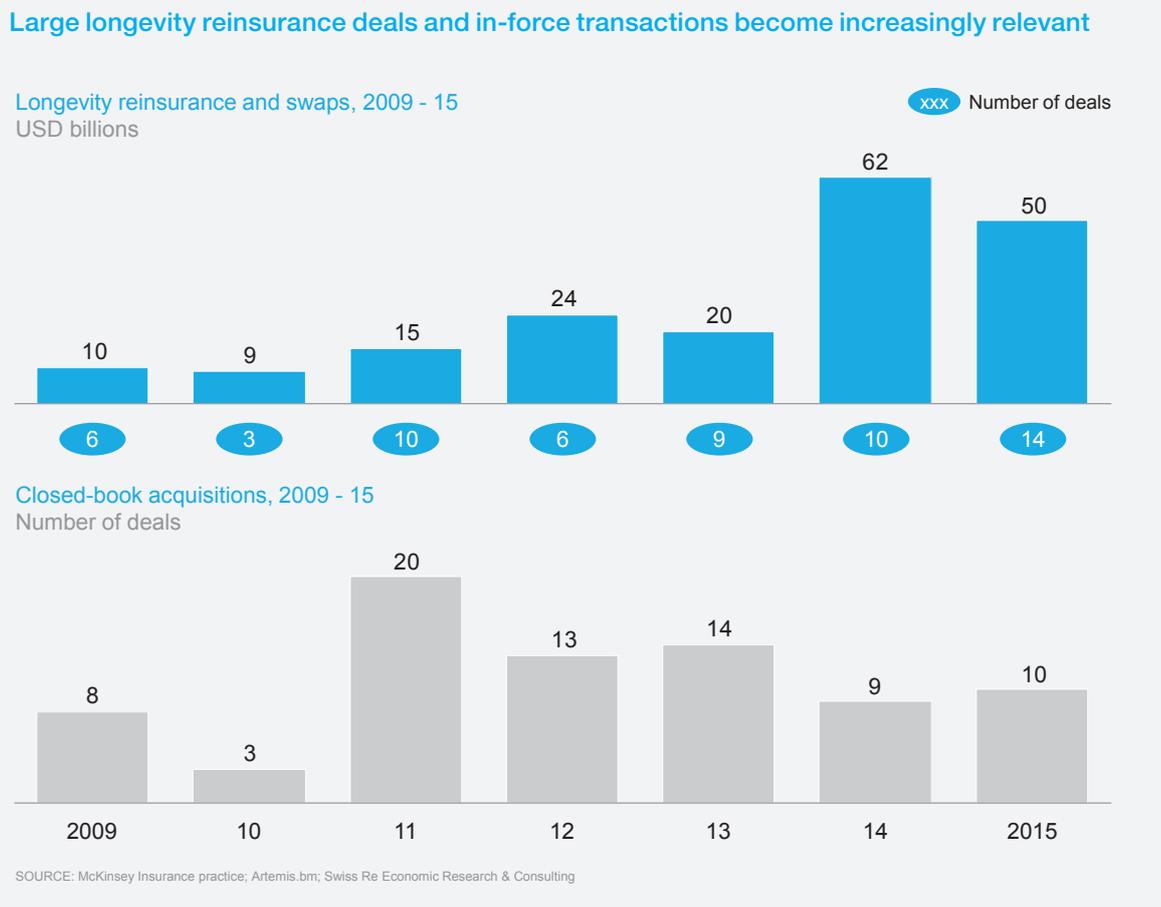
The industry is investing heavily to apply data/analytics to underwriting, which practically means higher face-value policies with more simplified issuance and less medical underwriting. This concept is not new, and fast-movers over the last few years have faced some tough growing pains – but, the analytics are improving and the industry is making progress. This is an area in which reinsurers are uniquely positioned to lead.

Beyond distribution and underwriting, there is also an emerging theme of wellness and value-based care, where reinsurance companies may also play a leadership role. Medicine is at a tipping point, with the emergence of personalized medicine, genomics, and more consumer interest in the “quantified self.” There may be opportunities for life reinsurance companies to partner with leading genomics/wellness companies, as well as global pharma and healthcare companies, to provide hybrid insurance and medical solutions.

2. Can life reinsurers rise to meet the longevity challenge? Life spans have been gradually increasing for decades, but the pace at which this will continue to increase – particularly with advances in medical technology – remains unknown. Over the last few years, the value of longevity reinsurance transfers/swaps increased from USD 9 billion to USD 10 billion p.a. in 2009/10 to USD 50 billion to USD 60 billion p.a.; see *Exhibit 6*.

More broadly, there is demand for corporates and pension funds – as well as potentially governments – to reduce pension/longevity exposures. Reinsurance companies have been supporting these transactions, as have new entrants and primary insurers. Having the ability to access these significant risk pools, with the requisite expertise and sufficient capacity, could be differentiating in the industry.

Exhibit 6



3. Can life reinsurance support the incubation of supplemental morbidity products?

Globally, the most common morbidity products include long-term care (LTC), disability, and critical illness. These markets are slow-moving, and, in some countries, have been the bane of the industry – as an example, LTC in the US has been among the lowest-performing products in the last few decades. Still, there is major market need for these products. Longevity is increasing globally, but morbidity is increasing at a faster pace – people are living longer, but also unhealthier. The reinsurance industry may play a greater role in supporting primary companies to innovate the product and delivery/channel to help incubate and expand these solutions in the market.

4. Can life reinsurance companies support the pivot within the primary industry to capital-light revenues?

In the current interest rate and regulatory environment, helping primary insurance with the in-force business is an increasing need. While the number of closed-book acquisitions has remained stable since the financial crisis, at an average of 13 per year in 2011 to 2015, geographically they are now spreading beyond the US/UK.

Strategically, many primary companies are attempting to shift to capital-lighter business, particularly in wealth and retirement. They face the pivotal strategic decision to pull back or divest traditional life business, or maintain these businesses with lower costs and less capital. This presents an opportunity for reinsurers to play a greater role in off-loading capital-intensive risks from primary carriers. Aside from the business itself,

reinsurers may play a broader, more integrated role by also doing the processing and policy administration – which are currently offered by third-party administrators and systems vendors.

5. What is the opportunity to support regulatory change – Solvency II, SIFI, among others? The industry has not (yet) seen a major uptick in life reinsurance from global regulatory change. However, many of the global regulatory changes are relatively recent and, in the case of SIFI (Systemically Important Financial Institution), still in flux. Specifically for Solvency II in Europe, regulators are currently being educated about the benefits/feasibility of innovative reinsurance solutions, as are primary companies. As primary companies and regulators become more aware of reinsurance within the broader arsenal of capital relief interventions, an increased deal flow may emerge.

6. Could pandemics (or other “new risks”) impact the life industry, as hurricanes have impacted P&C? The mortality risk landscape in life is, in many respects, more stable than P&C (which can experience large and sudden shocks that can affect many reinsurers at once). HIV/AIDS has caused over 40 million deaths since the global pandemic began, though the disease is now partially treatable, and has a low impact on mortality rates in today’s developed markets. Aside from HIV, there have not been any other notable pandemic events that have materially impacted mortality tables. There have been some “scares” – like the deadly SARS crisis, then the H1N1 crisis in the 2000s, and the recent Ebola epidemic in 2014/15. But again, these risks passed and had negligible impact on mortality experience in developed markets.

Looking ahead, the “super bug” (e.g., antibiotic-resistant bacteria) is believed to be more widespread, and faster spreading, than previously realized. As of 2016, there are an estimated 20,000+ deaths each year in the US from multidrug-resistant infections, with an estimated 700,000 deaths globally. If this threat accelerates and impacts mortality in a significant and/or unexpected way, then reinsurance companies – assuming they can develop some quantitative view of this emerging risk – may play a critical role in risk transfer/mitigation and also in threat-level monitoring.

Practically, with the recent Zika and Ebola crises, there has been an increasing interest by global government organizations, as well as NGOs and private foundations, in establishing coordinated pandemic solutions. As with public-private partnerships in P&C, life reinsurance companies have unique experience and expertise to offer as new, innovative solutions are developed.

Health reinsurance: Reinsurance, or primary play?

More so than P&C and life reinsurance, health reinsurance is a multi-niche, multi-local market, with significant local differences, and also supporting markets where reinsurance is less frequent. The reasons for this include large and strong balance sheets for primary companies (notably in the US); the non-cumulating nature of the risks (pandemics and extreme mortality are usually covered in life reinsurance); and, the shorter-tail nature of the health risks, notably with more flexibility to calibrate pricing annually based on experience.

Overall, global health reinsurance cession rates have consistently been less than 2%, although they are higher in some emerging markets. Most of the global health reinsurance market has been in the US (65% of global premiums; mostly focused on stop-loss coverage), with the next largest market being China (at 10% of global premiums). There are several areas of opportunity in health reinsurance, looking ahead:

- 1. In the US, will the risk landscape continue to shift to care providers?** Most of the US health reinsurance market is employer stop-loss (approximately USD 14 billion), as well as payor capital management solutions (USD 5 billion). These solutions are provided by an amalgam of companies, including global life reinsurance companies, primary P&C companies, primary life/retirement companies, as well as divisions with major US payors. The emerging trend in the US is the shifting of risk from payors to providers, who then require an excess of loss solutions to cap risk. This market is currently small (less than USD 300 million), but is expected to continue to grow over time as providers assume more risk.
- 2. In Europe and developed Asia, could health reinsurers play a more important role in closing the gap in supplemental health?** Health insurance in most developed markets (outside of the US) is heavily government supported, whether through public taxation or compulsory social insurance. There may be a role for reinsurance companies to become more involved in supporting or incubating primary supplemental health solutions.
- 3. What new solutions can health reinsurers support in emerging markets?** New health solutions are required for the rapidly rising middle class, especially in Asia. These markets, aside from lacking mature health insurance markets, also lack the underlying health delivery infrastructure to provide care. Most countries have public hospital networks, but the care is often sub-par compared to that which is commonplace in more developed economics. Insurers and reinsurers globally are investing to address this gap. In China, for instance, Swiss Re partnered with the healthcare group Roche in 2012, with a hybrid, bundled solution of insurance and cancer treatment pharmaceuticals. Reinsurers may play a leadership role in providing actuarial/pricing expertise, while convening partnerships with providers to rapidly develop and deploy provision of care. Reinsurers may also partner with governments to provide support to local primary carriers on health coverages so as to stimulate an increase in insurance penetration.

As reinsurance companies evaluate health markets, they must consider what unique skills and capabilities they can bring to bear. Here, the lines blur between reinsurance and insurance companies. Some have argued that health solutions would be best left to local, primary

insurance companies who have the established experience and infrastructure to provide hands-on care, rather than reinsurance companies. However, if reinsurers can couple their speed, innovation, and superior risk insight, with the practical ability to provide care (with local healthcare experts or other partners), this could be a winning combination.

Another challenge in health markets is the ability to scale expertise across regions. Healthcare is often described as a multi-local market, with differences across regions even more pronounced than those in the P&C and life reinsurance, and cross-market synergies are less obvious. Yet, some leading companies (such as Munich Re, which owns one of the world's largest medical third-party administrators, MedNet) have been seeking global scale and leverage.



In closing, innovation matters, as does speed. Despite tough conditions and lagging price-to-book values, reinsurance provides many opportunities to help protect against tomorrow's risks in developed countries, while also addressing the growing needs of emerging markets. Looking forward, the relevance of reinsurance will continue to be felt as risks evolve and take new forms, and as global regulations continue to change and establish new, tougher standards. Reinsurance may also play a critical role in solving global challenges – including financial protection against natural and man-made disasters, longevity, and morbidity – which are becoming more pronounced across both developed and emerging markets.

There is no crystal ball, but the importance of the industry may become more starkly apparent if there is a sudden, unanticipated risk which materializes. If history is any guidepost, one can expect this. Nobody knows when this will happen, or what forms new risks will take. But, if – and when – new risks come online, the winners will be those reinsurance companies who have speed and agility – across underwriting, analytics, and capital deployment – to support the primary companies in navigating uncharted territories.

For more information, please contact:

Sylvain Johansson

Partner, Geneva

+41 (22) 744-2073

Sylvain_Johansson@mckinsey.com

Ari Chester

Partner, Pittsburgh

+1 (412) 804-2813

Ari_Chester@mckinsey.com

Erwann Michel-Kerjan

Partner, New York

+1 (267) 761-2705

Erwann_Michel-Kerjan@mckinsey.com

Oleksiy Rachok

Associate Partner, Zurich

+41 (44) 876-8158

Oleksiy_Rachok@mckinsey.com

Mei Dong

Associate Partner, Toronto

+1 (416) 313-3878

Mei_Dong@mckinsey.com

September 2017

Copyright © McKinsey & Company

Design contact: Visual Media Europe

www.mckinsey.com