

McKinsey
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Executive summary

State of property & casualty insurance 2020

The reinvention imperative

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Foreword

The insurance industry is often perceived as complicated and slow moving. Yet insurance is one of the largest global industries, generating more than \$5 trillion in annual revenue. It plays a critical role in today's economies, offering financial protection and risk mitigation to individuals, small businesses, large corporations, nonprofit organizations, and even governments. As a whole, property and casualty (P&C) insurance represents \$1.6 trillion in premiums (about one-third of the insurance industry) and remains one of the few industries that has yet to be disrupted.

The three Rs: Resilience, relevance, and reinvention

As a notable achievement in the financial-services world, the insurance industry has grown economically stronger in the past two decades after sustaining \$45 billion (2020 prices) in insured losses from the terrorist attacks of September 11, 2001—then the costliest event in the history of insurance globally. And in the past few years, natural disasters have led insurers and reinsurers to pay hundreds of billions of dollars in claims, an unprecedented amount of losses. Despite these claims payments, the most recent natural disasters have been earning events for insurers, not solvency ones—perhaps a testament to the industry's resilience. But this resilience will be tested in the years to come through the changing severity and frequency of disasters coupled with limited flexibility to balance market-driven price responses in the changing risk level, continued low interest rates, and changes to the traditional business model.

In fact, as innovation and technology significantly transform entire industries, P&C overall has largely been running in place. Industry growth relative to GDP is flat or even negative in several developed markets, valuations in the sector are often lower compared with adjacent financial-services sectors such as banking and asset management, and new talent acquisition isn't prioritized, despite more than one-quarter of its most experienced professionals soon retiring in key geographies. Furthermore, despite improvements in labor productivity, overall cost performance has not improved in the past 15 years. The P&C industry is being outpaced on total productivity by sectors from automotive to telecommunications to banking. In the face of current and emerging advances in fintech and digital distribution, the P&C industry's existing operating model faces challenges and risks losing economic relevance.

Moreover, the fast-changing risk landscape is creating many new and evolving risks—cyber, climate change, pandemic, intangible assets—that remain underinsured, while others have slowly been transferred to governments to handle. This shift creates significant insurance gaps. However, it also presents substantial opportunities for P&C insurers that can innovate,

serve clients more comprehensively, and capture value across an increasingly sophisticated traditional value chain that is being reshaped by factors such as B2B2C, alternative capital, and direct sales. Insurers must also be proactive in setting (perhaps even shaping) a clear agenda on environmental, social, and governance (ESG) issues.

As this report goes to press, the entire world is facing the deadly spread of COVID-19. The unfolding human tragedy will have massive short and long-term social, economic, and geopolitical implications. While it is too early to assess the full spectrum of its impact on the insurance industry, we will be monitoring the situation as it evolves. For more, see the P&C memo by the same authors, “Coronavirus response: Short- and long-term actions for P&C insurers.”

Given the fragmented nature of the industry, new models of collaboration—including with governments and regulators—will need to be tested to help carriers transition to this future state, as no single insurer can efficiently and repeatedly absorb first-mover costs as change accelerates. The industry must reinvent itself.

A call to action

This report paints a nuanced picture and provides a call to action. On the one hand, some geographies are winning over others, and leading CEOs are inspiring their organization to be true market shapers (those in the top quintile by measure of economic profit) by making the necessary bold moves and executing them relentlessly. Those carriers are success stories. On the other hand, a number of insurers have created limited economic value, if any at all. In this report, we provide a global view of the P&C industry using proprietary McKinsey data sources, including our Global Insurance Pools database, power curve analysis, and Insurance 360 cost benchmarks. We examine key market structure elements, including growth and profitability, M&A, and distribution. We analyze what market shapers have done differently as a source of inspiration for CEOs. We also explore six key forces that are shaping—and will continue to influence—the evolution of P&C insurance. And finally, our analysis shows how P&C carriers can find a path to higher profitability and sustainable growth once again.

Our research and experience reinforce that succeeding requires bold moves of considerable scale and investment. Now is an exciting moment for the industry, but leaders must act with speed and conviction. We anticipate that the gap between carriers that act swiftly and deftly and those that do not will increase: the former has proportionally more to invest in deploying new capabilities, as they capture most of the industry profits. This dynamic will further increase the gap between winners and laggards in subsequent years.

CEOs, working with the board, have a unique role to play in this context: they must decide what kind of organization they will steward and lead in the next five years, which clients they will serve and focus on, and how they will do so with distinction and relevance.



Executive summary

This report provides a close study of a complex industry. Some developing markets are poised to surpass developed markets by measure of growth, the M&A space is active, and distribution is under attack. And while insurance as an industry may be slow to change, its risk environment is not. The increased occurrence of extreme threats (whether relating to climate or terror), the proliferation of technology and innovation, and the growth of ecosystems, for example, all provide ample opportunity—and risk—for insurers.

Some carriers are flourishing in this landscape. Market shapers have achieved growth, yes—but they have also figured out how to do things differently, achieving sustainability and setting themselves apart from their peers.

So what are insurers to make of the state of the industry? And how can they adapt? This report provides an overview of the P&C industry, what market shapers are doing differently to capture value, and how CEOs can make their organization the next success story.

Variations across markets

The global P&C industry contributes significantly to the global economy: it generated \$1.6 trillion in premiums in 2018. For a mature industry, it now faces a rapidly changing risk landscape caused by factors such as intangible assets, man-made emerging risks, changing climate patterns combined with growing exposure in high-risk areas, pandemics, the growth of the cyber world, changing customer expectations, and the use of advanced analytics tools, among others.

Given P&C's focus on risk management and financial protection, one might expect the industry to reinvent itself more profoundly to meet the shifting demand and to move the insurability frontier forward.

But the industry as a whole accounted for 2.1 percent of global GDP in 2018, the same share as in 2008.¹ These top-line numbers obscure significant variations in performance and growth across geographies, product lines, and stakeholders along the value chain. Developed countries still dominate by total gross premiums written (80 percent). However, Western European markets, and to some extent the US market, grew slower than GDP, while developing markets in Latin America, the Middle East, and Africa not only grew much faster (at annual growth rates of 11 to 16 percent from 2012 to 2018) but also achieved higher profitability. We expect the fast growth in the developing Asia–Pacific market to possibly surpass Western Europe this decade as the world’s second-largest P&C market.

By comparing market dynamics, we found that P&C overwhelmingly remains a local game in many countries. Domestic carriers regularly dominate their markets, maintaining a higher market share and better profitability compared with multinational players. Executives should carefully review the trade-offs between international expansion and a focus on core markets and reflect on the importance of mastering local distribution and market access.

In addition, the global P&C industry has seen robust levels of M&A activity. The largest deals in the past few years were completed by European and North American carriers aiming to increase scale, smaller companies accessing new digital and advanced analytics capabilities, Asian firms investing more capital into Europe and North America to establish a presence beyond their home markets, and active private-equity and hybrid investors diversifying their portfolio.

Despite this M&A activity, which we expect to continue for the next five years, the industry remains fragmented. This is true even with the personal lines market undergoing consolidation: a few auto insurers in large markets have led the charge as digital attackers and have captured a growing portion of a customer base with changing expectations.

Last, in distribution, intermediaries have significantly increased their clout, especially given the consolidation of global alpha brokers in commercial lines that generated significant value to their shareholders in the past decade. Furthermore, new models such as ecosystems threaten to further divide the industry. We estimate that more than 30 percent of personal lines P&C premiums will be distributed through ecosystem models by 2030. Thus, P&C industry market shapers will have to win on that front. In the future, increasing the value transfer of cheaper distribution to the customers will be key. Our market analysis reveals that today, insurers can spend a multiple in distribution costs as their products generate in profit; in the United Kingdom, for instance, P&C insurers spend three times more in distribution (as percentage of their total revenues) than what they generate in profits; by comparison, the mortgage industry spends half in distribution what it generates in profit.

What market shapers do differently

To gain a detailed view of the reasons for success beyond decisions on where to operate, we assessed more than 200 insurers around the world. [Our power curve analysis](#) found that from 2013 to 2017, the industry generated an average of \$37 million in economic profit per company (generally accepted accounting principles view).² This figure falls short of the \$500 million to \$2 billion generated by industries in the top quintile of our global distribution, such as beverages, automobiles, pharmaceuticals, technology, and biotech.

¹ Overall, P&C growth written premiums (GWP) over GDP decreased globally by 2 percent from 2008 to 2018.

² For a more complete discussion of the power curve see Alex D’Amico, Mei Dong, Kurt Strovink, and Zane Williams, “How to win in insurance: Climbing the power curve,” July 2019, McKinsey.com.

That said, insurance market shapers (those in the top quintile) have already made bold moves in recent years that helped them create significantly more economic value than their peers: on average, these insurers have created more than \$750 million in economic profit—nearly twentyfold the industry average. Market shapers can then reinvest this revenue into new capabilities needed to win in today’s environment, further widening the gap with competitors.

Interestingly, carriers that have made the most progress in creating economic profit have pursued five bold moves:

- *Dynamically shift resources between businesses.* Reallocate at least 60 percent of surplus generated over a decade.
- *Reinvest a substantial share of capital in organic growth opportunities.* Be in the top 20 percent of the industry by strategic reinvestment relative to new business premiums. Typically, that means spending 1.7 times the industry median.
- *Pursue thematic and programmatic M&A.* No individual deal is larger than 30 percent of the market cap, but the total value of deals over a ten-year period is greater than 30 percent of the market cap.
- *Make game-changing improvements in productivity.* Reduce costs in line with the top 30 percent of the insurance industry.
- *Positively increase underwriting margins.* Improve underwriting capabilities to be in the top 30 percent of the industry by gross underwriting margin.

Navigating an evolving risk landscape: Six shaping forces

We also analyzed six forces that will shape the industry in the years ahead, each with significant implications for insurers (exhibit). Taken altogether, they indicate that if P&C is to significantly increase its relevance over the next decade, carriers must be prepared to reinvent themselves across the value chain.

1. *A rapidly evolving insurable mass calls for product innovation and a reallocation of portfolio priorities.* In response, P&C insurers will need to adapt their go-to market strategies, embrace modularity in their product offerings, reallocate capital between personal and commercial lines, and compete to insure new types of risks. On commercial lines, for instance, data and cybersecurity (perhaps the new directors and officers insurance), intangibles, and machine-learning liability are examples of new types of risks that need new product offerings. Terrorism risk also remains a real threat to the industry, with many countries having developed their own protection programs.
2. *Uninsured natural catastrophes are creating new market opportunities.* While the insurance industry has become more resilient financially, it has also let a significant portion of risk go uninsured. The evolution of natural disasters and changing climate calls for increasingly sophisticated catastrophe models and pricing approaches. Increasing climate risk will quickly intensify and challenge the insurability of entire regions: the P&C insurance industry can address this issue by forming an industry-wide coalition and collaborating more closely with governments and regulators. And CEOs should be prepared to address how climate change may affect their organization and how they plan on reducing the downside and capturing the upside.

Our culture of preparedness must change significantly to make financial protection and the adoption of risk-reduction measures at scale a priority. Carriers will need to overcome deep behavioral biases in risk selection and pricing that currently constrain adequate protection. In high-risk areas, insurance may

Six forces will shape the industry in the years ahead.



need to become mandatory, as it is in several countries, to significantly increase financial protection. At the very least, an opt-out option rather than the current opt-in would significantly increase insurance penetration, as behavioral science has shown. Rather than artificially suppressing risk-based rates, governments and insurers will need stronger public–private partnerships (PPPs), including government insurance voucher programs to address affordability issues.

3. ***Evolving data and analytics capabilities are changing the game in acquisition, risk selection, and underwriting and pricing.*** The rise of Internet of Things (IoT) sensors and telematics are providing insurers with more information to improve underwriting. Making thoughtful investments in data and analytics at scale will also be a differentiator in P&C. However, to capture value from their data carriers will need to crack the code on how to efficiently harness their data and shift their talent mix—from a large workforce that prioritizes transactional policy and claims activities toward one focused on higher-value activities enabled by technology.
4. ***A shift to solutions and service as well as the growth of ecosystems is reshaping distribution.*** As insurance purchases become less à la carte and more integrated into customer buying and experience journeys, business as usual may no longer suffice. Carriers will need to take a close look at their relationship with end customers in the context of purchasing journeys (for instance, buying a car, going on vacation, buying a home) and decide how to embed solutions and services alongside insurance coverages. Insurers must sharpen their value propositions and reconsider their cost structure and capital allocation.

Sometimes being a low-cost provider will be the winning model, while in other situations providing the best customer experience will be the differentiator. In ecosystem-oriented models, successful carriers will also need to become better at getting value from the enormous pool of data they have (or can get) access to in order to stay relevant. Insurers could also add more value to services. Similarly, embedding services into the offering will become more important for carriers to provide value to clients beyond the core underwriting function.

5. ***Unchanging cost improvements have made productivity an industry imperative.*** To keep pace with attackers, address the widening gaps between leaders and laggards, and invest in modernizing legacy technology, the industry needs to reset its operational efficiency. In recent years, while labor productivity has risen, overall industry expense ratios have also increased because of upticks in spending on distribution, marketing, and technology. Small to medium-size carriers must explore more innovative, structural changes, including strategic alliances or partnerships, to stay competitive.
6. ***Solving the talent equation should be a much higher priority than it is today.*** Reshaping the workforce for the emerging era of technology-led business models must be at the top of the agenda for any insurance CEO. Leaders will need to focus on building the talent and expertise needed to integrate technology into operations and support customer engagement. Insurers must enhance their value proposition to replenish their workforce and attract the next generation of employees.

Increasing the relevance of insurance in this new risk landscape will likely require carriers to reimagine new ways to collaborate and cocreate with governments and other stakeholders. Indeed, one carrier alone cannot absorb the first-mover cost as the pace of data, technology, training, and customer expectations continues to evolve rapidly. Public–private collaboration can clarify what is insurable and not, by whom and under which conditions, and who will pay for future losses. As risk experts, insurers and reinsurers can help shape the insurability of known and emerging risks. When price reflects risk, insurance can be a powerful market signal for the level of risk that individuals and organizations face. And creating incentives for good behavior can effectively reduce the cost of risk. But when the market can no longer be that signal, as we've seen in several geographies, then it creates a false sense of safety. More generally, insurers and governments need to work together to improve risk awareness and financial protection.

The evolving market structure and six shaping forces present a range of opportunities for P&C insurers that are prepared to respond with bold moves, execute them extremely well, and do so consistently.

As this report goes to press, we wanted to share our initial assessment of the likely impact of the COVID-19 crisis on the industry. Insurance is closely linked to the broader economy and this pandemic is likely to affect the industry operating model in several ways, with implications for both growth and profitability. While the impact will differ significantly on a line-by-line basis, we expect some decline in premium revenue as a result of the expected economic downturn. The drop may be especially apparent in commercial insurance, which is more vulnerable to economic conditions compared with personal lines. The cumulative losses that the industry might sustain are not yet clear; to date, losses have been concentrated in travel and event cancellation.

The biggest unknown factor is how the industry resolves coverage for business interruption. This will be a true test of the relevance and resilience of the industry. In addition, the crisis poses challenges to industry operating models and may act as a catalyst for changes in them across the entire value chain. It is also likely to reinforce the need to accelerate product innovation and digital transformation, efforts that were already underway at many companies. Lastly, the COVID-19 crisis highlights the potential for public–private partnerships. Because pandemics affect so many people and businesses at the same time, they are typically considered uninsurable by the market alone. This opens the possibility for insurers and governments to collaborate further on improved pandemic risk assessment, risk communication, and financial protection.

What type of organization do you want to lead as CEO?

The traditional insurance business model and value chain is evolving. This progression will create opportunities and risks for carriers, agents, and brokers to take on new roles, cede some existing ones, and adjust relationships with customers. Today's vertically integrated business model is fracturing as reinsurers connect with distribution, primary carriers build direct distribution models, and brokers move into underwriting. The evolving market structure and six shaping forces present a range of opportunities for P&C insurers that are prepared to respond with bold moves, execute them extremely well, and do so consistently.

To succeed, CEOs have an important role of calibration to play. They will need to objectively assess where they can win and then make targeted investments across technology, finance, and talent. Four archetypes—value player, capacity provider, core reinventor, and ecosystem partner—can guide executives where to play and what capabilities to focus on (for instance, [world-class underwriting](#) or launching new products and services). Pursuing one of these archetypes could profoundly transform the organization. This is an even more pressing CEO agenda in the current COVID-19 crisis environment and will continue to be in its aftermath.