

# Global Insurance Insights

A detailed analysis of trends  
that shape the industry

McKinsey Global Insurance Pools – fifth edition, 2015



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# Foreword

We are pleased to present “Global Insurance Insights,” the fifth edition of McKinsey’s annual in-depth analysis of the global insurance industry, based on our proprietary Global Insurance Pools (GIP) database. We hope it will interest those who make decisions about allocating resources globally and those looking to deepen their understanding of the drivers of insurance growth and profitability in all regions.

The report begins by summarizing the most important developments of 2013 and 2014. These two years were very eventful ones for the industry, marked by strong growth in Life and Health, steady development in P&C, and increased profitability in Life and P&C.

The report then provides a perspective on the industry’s three lines of business: Life, P&C, and Health. What is driving the rebound in growth and profitability in Life and will this continue? Which product categories and geographies are still growing in P&C, and how have new risk categories had an impact? How attractive is Health and what are the prospects for this segment in emerging markets?

We conclude our paper by providing a perspective on competitive dynamics, drawing on the global and local insurer databases that we recently added to our GIP Markets Database.

Some notes on our approach: In general, our detailed analysis focuses on data through 2013. We have selective data available for 2014 based on preliminary reports. The forecasting tools developed as part of McKinsey’s GIP service line were used to assess how the insurance industry might respond over the next decade to global macroeconomic shifts. Our “consensus scenario” assumes a recovery of GDP growth in coming years in addition to steadily increasing interest rates. The results reported in this report reflect the output of this model.

We hope you find this report useful and thought-provoking. Please contact us if you would like to discuss any of the topics it raises.

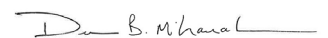
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# Executive summary

In 2014, the insurance industry staged an impressive recovery, with anticipated global growth of 6.3 percent - far exceeding the 2.8 percent reported in 2013 - and total premiums reaching EUR 3.8 trillion. Growth in 2014 was also notable because it was higher than nominal GDP growth for the first time in five years.

What factors help explain the industry's strong performance? Preliminary reports suggest that Health showed the highest growth, while Life demonstrated a strong recovery in growth of gross written premiums (GWP) from 2013 to 2014. Growth in P&C insurance remained relatively stable, at a decent 5 percent. Early reports also show that emerging markets grew significantly more than mature markets (12 percent vs. 5 percent), mainly because of their lower penetration levels and higher nominal GDP growth. The only two regions experiencing double-digit growth were Emerging Asia and Latin America.

As in previous years, the penetration rate for mature markets (8 percent) far exceeds that of emerging markets (3 percent). This pattern will continue, since the growth seen in emerging markets is not yet strong enough to largely surpass nominal GDP growth and thus to increase penetration.

At the product level, preliminary reports revealed some important trends:

- **Life.** Most regions saw positive Life growth in 2014, but the amount of the increase, as well as the factors responsible, varied by region. In a marked departure from 2013, the US, Japan and Mature Asia demonstrated the strongest gains. Of all Life products, endowments experienced the most growth, primarily because of a resurgence in sales at Italian banks, but unit-linked products also performed well. Life Return on Equity (RoE) rose from 11.5 percent in 2012 to 12.7 percent in 2013 as equity markets were strong.
- **P&C.** Growth in the P&C market held steady in 2014, coming in at 5 percent. The main growth drivers were Motor in emerging markets and Fire and Property in mature markets. At the regional level, growth was stable, except for a significant slowdown in Eastern Europe. As in 2013, Emerging Asia and Latin America are driving most of the P&C growth. For profitability, P&C RoE increased in almost all regions in 2013, reaching 11.5 percent globally.
- **Health.** The Health segment grew 8 percent in 2014, up from 5 percent annually in the two previous years. Emerging markets are rapidly gaining share and should account for about 8 percent of global premiums in 2014 (up from 5 percent in 2008). Emerging Asia and Latin America achieved the most growth, at 31 percent and 23 percent, respectively. The US is also expected to contribute strongly to growth as the Affordable Care Act is raising the number of insured. Globally, the net combined ratio for Health has been under 100 percent, on average, for the last decade, with emerging markets generally reporting higher numbers than mature markets.

We describe major trends for all product lines using final data for 2013 and earlier years, as well as preliminary reports for 2014 (H1 or Q3). In general, our most detailed analyses focus on the final data through 2013.

### Competitive dynamics

US and European insurers, which once ruled the global ranks, have been steadily losing ground to Asian companies as emerging markets grow and mature markets slow down. Although both US and European companies have expanded into emerging markets, they have faced many challenges and still depend on the slow-growing mature markets for most of their business. Their struggle will likely continue, since local insurers are becoming more competitive.

Most insurers have managed to improve their RoE in recent years, but the largest insurers are not necessarily capturing a disproportionate share of profits in Life and Non-Life in all countries, as our analysis in this paper will show. Mergers and acquisitions (M&A) have been declining across all regions, mostly because companies lack available free capital. A reversal of the downward trend is not observed yet, as several challenges to consolidation still need to be addressed, however, there are some fundamental factors in place that could help increase M&A activity over the long term.

## About McKinsey's Global Insurance Pools (GIP)

GIP features a proprietary Markets Database containing over 150,000 data points covering the largest 64 countries worldwide and 99 percent of global insurance premiums. It includes key financial indicators for every market, from 2000 to the present, and projections to 2020.

The forecasts in this paper are based on a consensus macroeconomic scenario provided by Oxford Economics, and the informed judgment of McKinsey's experts. The Oxford forecast assumes average global nominal GDP growth of 6.3 percent for 2014 through 2020 (compared to 5.4 percent for the previous decade) and a gradual increase in interest rates (which some would consider an optimistic view). The scenario does not include potential macroeconomic and regulatory threats. For further methodological details, please refer to the Appendix.

## New additions to GIP

GIP recently expanded to include information on individual insurers. It now provides integrated data on selected global and local insurers and information on performance benchmarking.

Individual insurer databases. These include:

- **Local Insurers Database**, including key financial indicators for the top 15 largest local insurers in 11 individual insurance markets, as well as premium data for the 10 largest insurers in more than 50 countries globally
- **Global Insurers Database**, including key financial statement information for over 100 major global insurers, including their split for Life and Non-Life.

Note: the GIP Markets Database leverages data published by local regulators, which often follow local accounting standards. The Global Insurers Database leverages annual reports, which mostly follow standards of the International Financial Reporting Systems. This means that the Markets Database reports an RoE on average ~2 points higher than that in the Global Insurers Database, since local accounting standards allow for more favorable valuation of assets and liabilities. The 2013 RoE data in this paper is from the Markets Database.

**Performance benchmarking.** GIP's tailored performance benchmarking allow insurance companies to compare themselves to their peers. This in-depth analysis covers capital markets performance; financial performance for total business, Life, and Non-Life; and country-level performance.

More detailed information on the GIP initiative can be found in the Appendix.

## How GIP supports our clients

McKinsey's Global Insurance Pools can help insurers along several dimensions. A "Granularity of Growth" analysis can identify a company's specific drivers of growth; our databases can also help to benchmark the company's growth and profitability against market performance and competitors and identify the impact of different macro-economic scenarios on growth and future market shares.

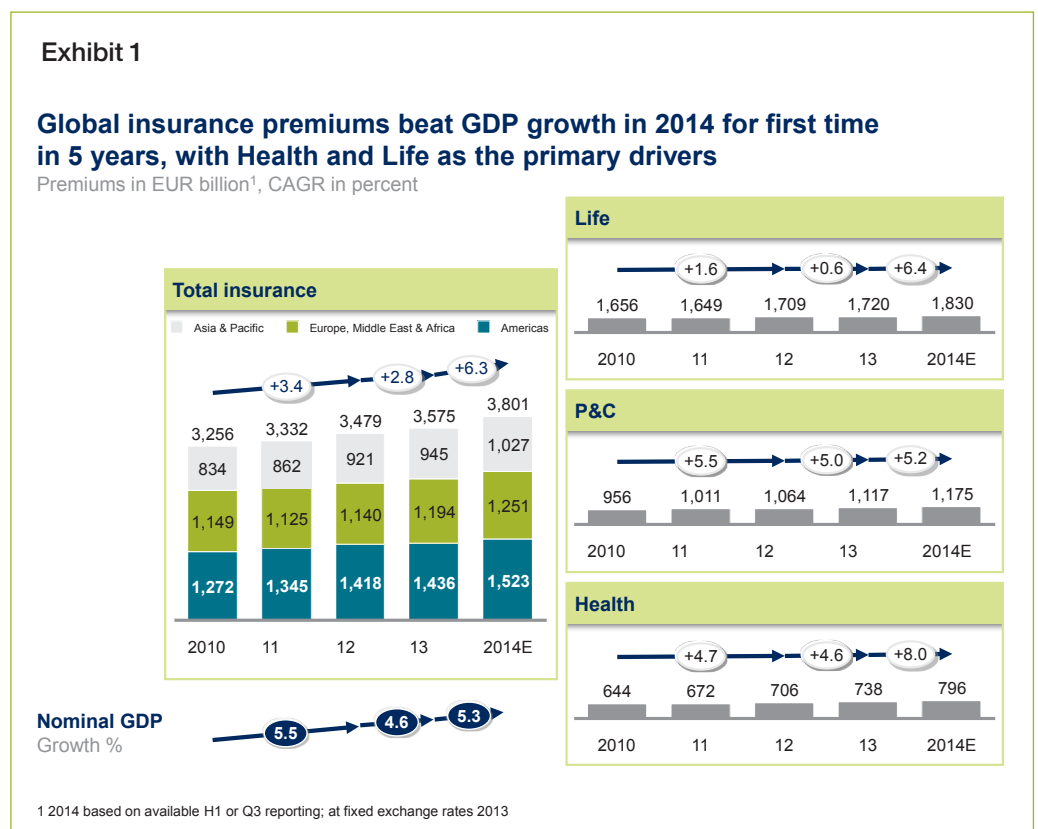
McKinsey offers a subscription to the database giving unlimited access to all data points.



# Recent developments in the global insurance industry

The year 2014 should provide welcome relief for the insurance industry, with early data suggesting that premiums have grown 6.3 percent worldwide, reaching EUR 3.8 trillion<sup>1</sup>. This premium growth is well above the 2.8 percent reported in 2013 and also exceeds GDP growth for the first time in five years.

The industry's strong performance primarily stems from improvement in Life (EUR 1.8 trillion in premiums), which is expected to have experienced 6.4 percent growth in 2014, compared to 0.6 percent in 2013. Health premiums are also expected to see greater growth in 2014 at 8.0 percent, reaching EUR 0.8 trillion, while P&C premium growth should remain stable at a decent 5 percent, reaching 1.2 trillion. (Exhibit 1)



## Regional growth patterns

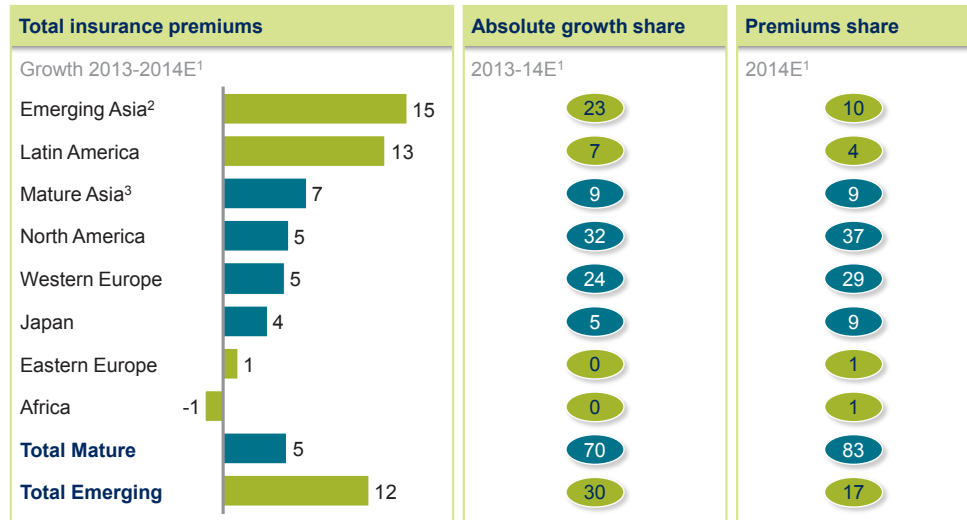
Only two regions saw double-digit growth in 2014: Emerging Asia (15 percent) and Latin America (13 percent). These results helped give emerging markets an overall growth rate of 12 percent. Growth in mature markets, although solid, is lower at 5 percent. Unlike the past few years, mature markets should see the greatest share of absolute growth (70 percent) in 2014. (Exhibit 2)

<sup>1</sup> All 2014 numbers are based on H1 or Q3 data.

## Exhibit 2

### Emerging Asia and Latin America continue to outperform, while mature markets represent largest share of growth in 2014

Percent



<sup>1</sup> 2014 figures based on available H1 or Q3 reporting

<sup>2</sup> Emerging Asia includes: China, India, Indonesia, Malaysia, Philippines, Thailand, Vietnam, Middle East

<sup>3</sup> Mature Asia includes: Australia, Hong Kong, New Zealand, Singapore, South Korea, Taiwan

## Penetration rates

As in previous years, the 2014 industry penetration rate (premiums / nominal GDP) for mature markets (8 percent) still largely exceeds that of emerging markets (3 percent).

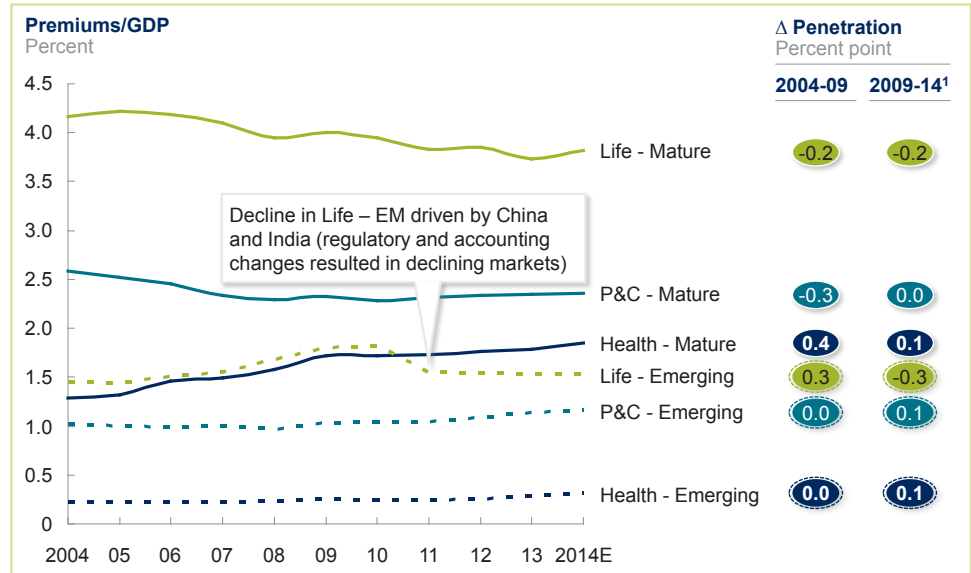
When looking at growth patterns, we found that industry penetration rates in mature markets have been fairly stable over the last decade, with an increase in Health compensating for declines in Life and P&C. (Exhibit 3) In emerging markets, the industry penetration rate generally rose over the same period, with approximately equal growth reported in all three product lines. There was, however, a somewhat significant drop in Life in emerging markets in 2011, when accounting and regulatory changes in India and China pushed sales down. Although Life penetration has not yet returned to its pre-2011 peak, it has been relatively stable and expected to return to growth in the coming years.

Penetration rates in mature markets remain higher than those in emerging markets. This limited convergence, however, does not show the full picture in emerging markets, where a more detailed analysis - for instance, one based on socioeconomic class or geographic location - would reveal that certain subsegments are experiencing rapid growth. As one example, urban areas are experiencing greater increases in penetration rates than rural areas.

### Exhibit 3

## Penetration rates vary by product line and region

Penetration (Premiums/GDP)



<sup>1</sup> 2014 based on available H1 or Q3 reporting; at fixed exchange rates 2013

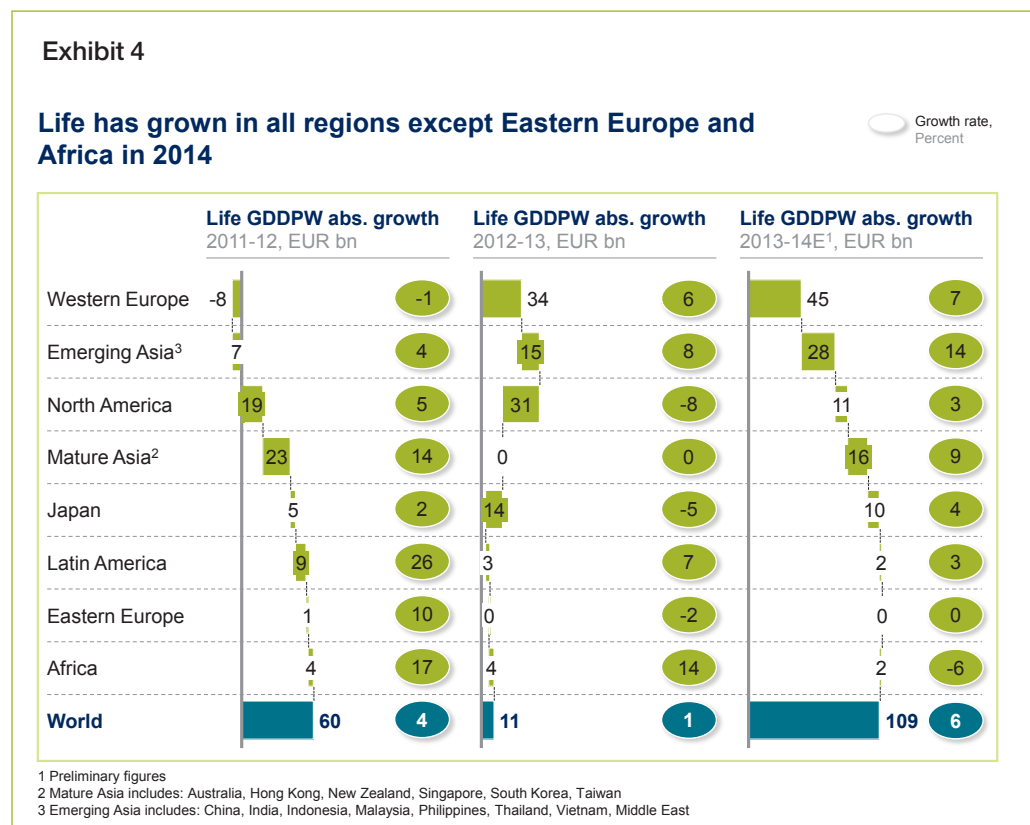
# A perspective on Life insurance

The Life industry has staged a strong recovery in 2014, with worldwide premium growth (6 percent) exceeding GDP growth for the first time in years. The 2014 growth rate is also significantly higher than the 1 percent reported in 2013, when large declines in the US and Japan drove the entire market down.

## Regional growth

Our 2014 reports suggest that Life saw growth in all major markets for the first time in years. (Exhibit 4) Some regions, however, fared better than others because of market-specific factors. An examination of regional trends revealed the following:

- Western Europe's** growth of 7 percent surpassed the 6 percent reported in 2013 largely because of the strongly rebounding Italian market. In 2011 and 2012, Italian banks were suffering from a liquidity crisis and focused on selling deposits and other banking products, rather than Life, to increase their own funding. In 2013, as funding needs diminished and interest rates decreased, they again began selling more Life products, and this trend intensified in 2014. Consumer demand for Life has been strong because lower interest rates have renewed interest in managed products.
- Eastern Europe** saw the market decline 2 percent in 2013, while in 2014, there was 0 percent growth. A double-digit decline in Poland was largely responsible for the market's poor performance. (The sharp decrease there mainly resulted from the government's attempt to discontinue a specific short-term product that is exempt from capital gains tax).

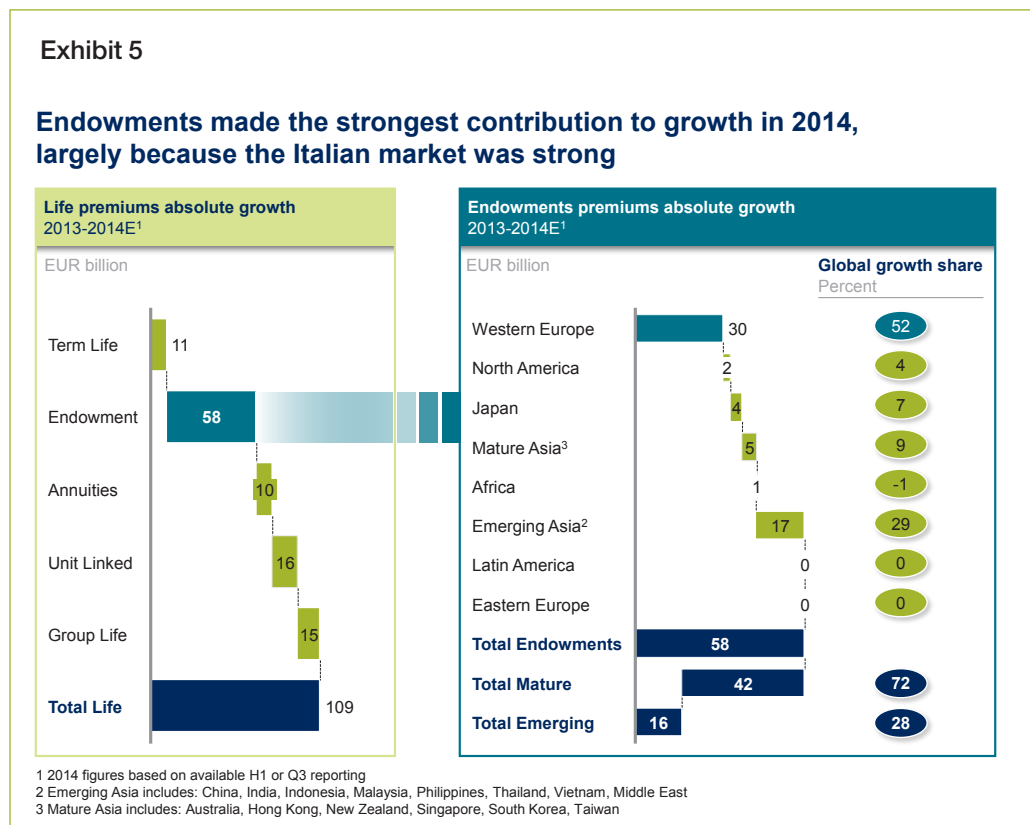


- **Growth in North America** came in at 3 percent in 2014. This is significantly up from the 8 percent decline reported in 2013, when the industry had to deal with two factors: a restructuring of the variable annuity business of local insurers and a normalization effect in Group Life. (In 2012, two large pension plans transferred to insurers, resulting in a one-off premium jump in 2012, followed by a drop in 2013). The return to growth in 2014 was also driven by an improving economy, combined with growing consumer demand.
  
- **Japan's** Life sector has been volatile in recent years. Growth declined in 2013 after a reduction in the guaranteed rate and a decline in the sales of lump-sum premium payment policies, but recovered strongly in 2014 because of two developments. First, capital markets were strong in Japan, generating high demand for investment products. Second, the devaluation of the yen triggered more interest in products denominated in foreign currency.
  
- **Other Mature Asia (including Oceania)** also saw a recovery in 2014, with an anticipated 9 percent growth (up from 0 percent in 2013). The strong returns were mainly driven by three markets:
  - Australia benefitted from higher inflows into group superannuation. This was largely driven by one player almost quadrupling its single-premium sales, but all players experienced double-digit growth in Group Life as underwriting pressure increased prices.
  - In South Korea, growth returned to normal after a decline in 2013 that partly resulted from new regulations eliminating tax benefits for immediate annuities. South Korea's 2013 growth was also low because of stagnant growth of savings products due to an ongoing low interest rate environment.
  - In Taiwan, growth temporarily increased because the government instituted new criteria for Life policies, particularly premium-rate flexible annuities, in August 2014. Since consumers expected the new policies would be more expensive or offer fewer benefits, GWP jumped early in the year.
  
- **Emerging Asia's** 2014 growth of 14 percent comes after several years of low or negative growth in a few large markets. China is the largest source of the growth, with premiums increasing about 17 percent. China's resurgence is linked to the government's promotion of traditional protection products and the rebound of the tied agent channel. India also witnessed double-digit growth in 2014, which comes after few years of low or negative growth that largely resulted from poor sales of unit-linked products. A recent restructuring of these products, however, made them more popular again, which resulted in a return to growth in 2014.
  
- **Latin America** was one of the strongest regions in Life for several years, but growth decreased from 7 percent in 2013 to 3 percent in 2014. This poor showing primarily occurred because unit-linked sales in Brazil (~70 percent of total Life market) fell by about 8 percent between 2012 and 2014 in response to capital-market volatility and regulatory changes. Other Life products, however, continued to grow, and Brazil's long-term prospects look strong.

- Africa** is expected to show a decline in Life in 2014, after years of robust but volatile growth, because of slow economic growth, high unemployment, and an unstable labor market. While these factors have been an issue for several years, their impact was less significant during 2012 and 2013 because the affluent segment was relatively unaffected by the economy during that time. Furthermore, unit-linked products were in strong demand in Africa in 2013 because of favorable equity markets. At this point, however, the economic problems are so severe that they are significantly decreasing sales in the affluent market as well as the mass market.

### Product growth

Of all Life products, endowments saw most growth in absolute terms in 2014. (Exhibit 5) Their gains mostly resulted from the resurgence in Life sales at Italian banks, which serve as the primary distribution channel for endowments in that country.



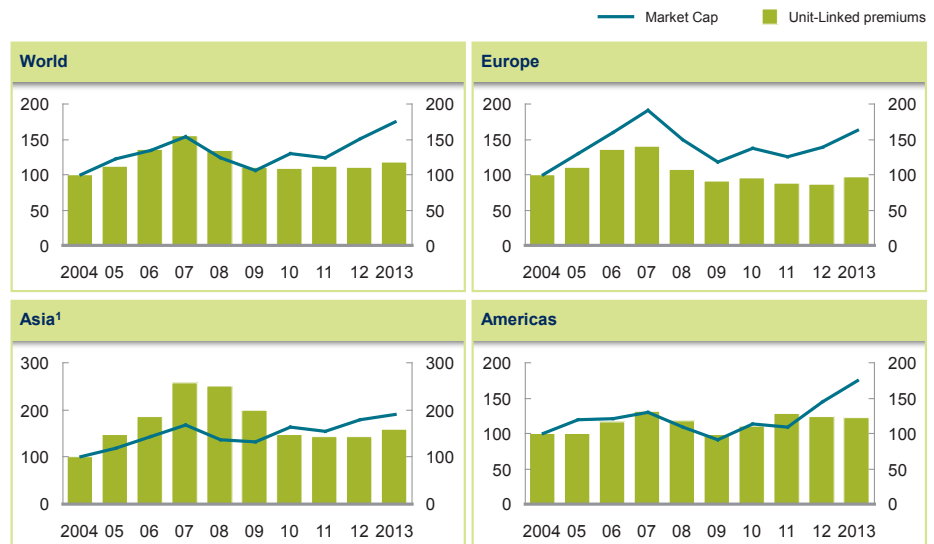
Unit-linked products also made a strong contribution to growth in 2014 because strong worldwide equity markets increased demand. It should be noted, however, that the market effect is somewhat more muted in recent years than it was from 2004 through 2007, when stocks were also performing well. (Exhibit 6) Several factors could be limiting the recent growth of unit-linked products. First, consumers need to regain trust in these products in the aftermath of the capital-market crash, especially given the prolonged unstable economic and financial climate. Second, several country-specific trends may have posed obstacles:

- In the **US**, players have been restructuring or discontinuing their variable-annuity business in recent years because of market volatility and low interest rates. **Japan**

## Exhibit 6

### The correlation between Unit-linked growth and the equity markets performance has weakened since the 2008 economic crisis

Unit Linked premiums; indexed at 2004; Market Cap: indexed at 2004



<sup>1</sup> Asia including Middle East

has experienced market changes similar to those in the US, with unit-linked premiums dropping 70 percent between 2007 and 2013.

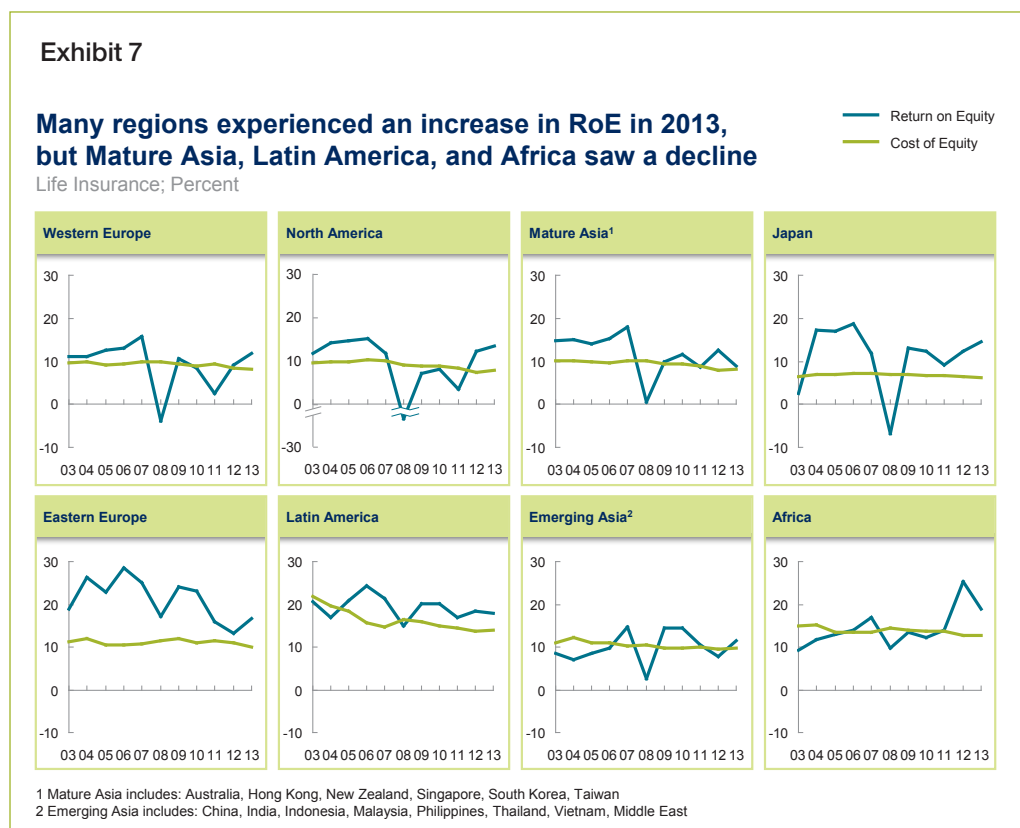
- In **India**, more stringent regulations on sale of unit-linked products has resulted in a continued decline in premiums since 2009.
- Although some **European markets**, such as France, still aggressively push unit-linked products, others have shifted their focus to new guarantee concepts, including unit-linked with guarantees. And, although not very pronounced, Solvency 2 seems to have pushed unit-linked growth somewhat in Europe.

Protection products (Term Life) continued to perform well, showing the highest growth rate over the last 2 years (7 to 8 percent annually). Protection is one of the few remaining Life products with limited competition from non-insurance players and generally has a higher margin.

#### Profitability

RoE for Life was 12.7 percent in 2013, up from 11.5 percent in 2012. The strong equity market, which experienced a 20 percent global TRS (Total Return to Shareholders) in 2013, was the primary driver behind this increase. For 2014, RoE should come in 1 to 2 percent lower, although the capital markets are still performing well, with double digit TRS (over 17 percent). This is in line with the trend seen in the 2014 published results from the top 40 global players.

Almost all regions contributed to the strong returns. (Exhibit 7) Mature Asia, however, saw profits decline to the level of cost of equity (CoE), largely because Taiwan experienced a one-time valuation adjustment resulting from a change in accounting methods. Africa and Latin America also saw RoE decline, although it remained above CoE. In Western Europe, RoE increased for the second consecutive year, since equity markets are strong and Solvency 2 regulation does not yet have its full effect.



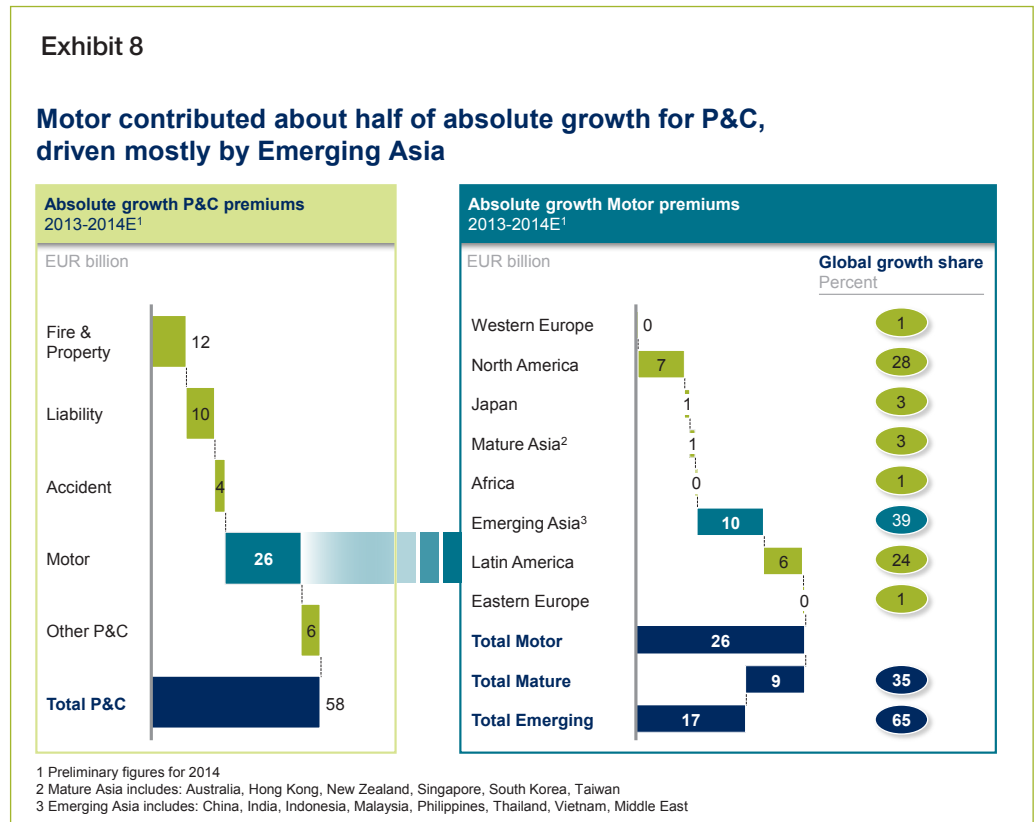
### Growth forecast

Life is not expected to continue the strong growth seen in 2014. Penetration levels are decreasing in mature markets, and Emerging Asia is the only region where they are rising. Overall, mature markets should see annual growth rates of 3 percent between 2014 and 2020, while emerging markets will see growth of about 12 percent annually. Given the relatively small share of emerging markets - they only represented 17 percent of global Life premiums in 2014 - their growth will not compensate for the slowdown in mature markets.



# A perspective on P&C insurance

Growth in the global P&C market continued to be very steady. It was 5 percent in 2013 and came in about the same in 2014. At the product level, Motor showed the most growth, driven mostly by Emerging Asia. (Exhibit 8)



## Regional growth

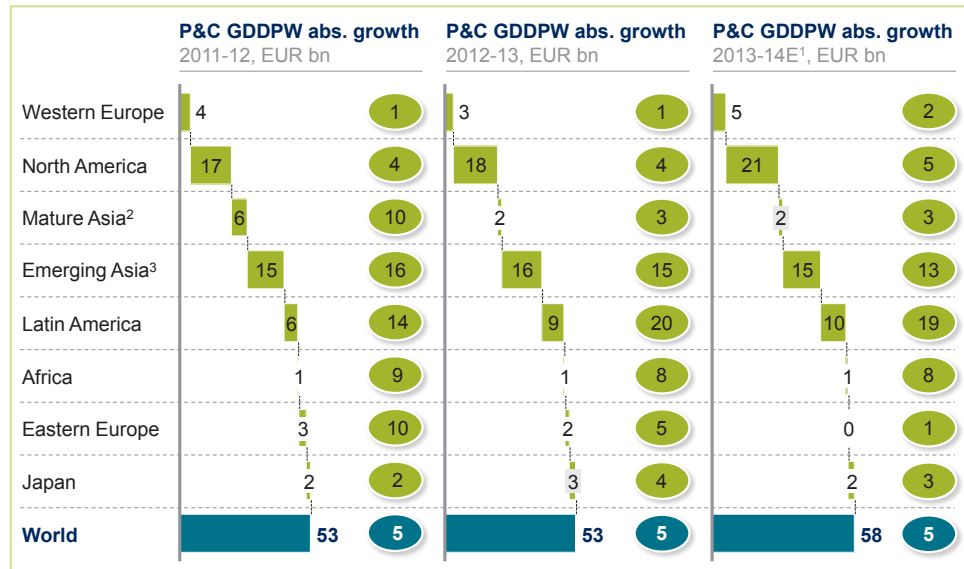
At the regional level, growth has generally been stable for the past three years in **Western Europe, Africa, North America and Japan**. (Exhibit 9) Other regions, however, saw more dramatic changes:

- In **Eastern Europe** P&C growth was significantly lower in 2013 because the region's economy was suffering. The same trend is seen in 2014. In Poland, for instance, motor premiums fell 5 percent in 2013 and continued to fall by 3 percent in 2014.
- Growth significantly dropped in **Other Mature Asia (including Oceania)** from 2012 to 2013, but that reflects normalization in the wake of earlier price increases related to bad weather. From 2013 to 2014, growth has stabilized.
- **Emerging Asia and Latin America** experienced the strongest growth in 2013 and continued to do so in 2014. Growth is mostly driven by Motor, which still represents ~60 percent of the total P&C market in these regions.

## Exhibit 9

### P&C growth has generally been stable at the regional level over the past 3 years

 Growth rate, Percent



<sup>1</sup> Preliminary figures

<sup>2</sup> Mature Asia includes: Australia, Hong Kong, New Zealand, Singapore, South Korea, Taiwan

<sup>3</sup> Emerging Asia includes: China, India, Indonesia, Malaysia, Philippines, Thailand, Vietnam, Middle East

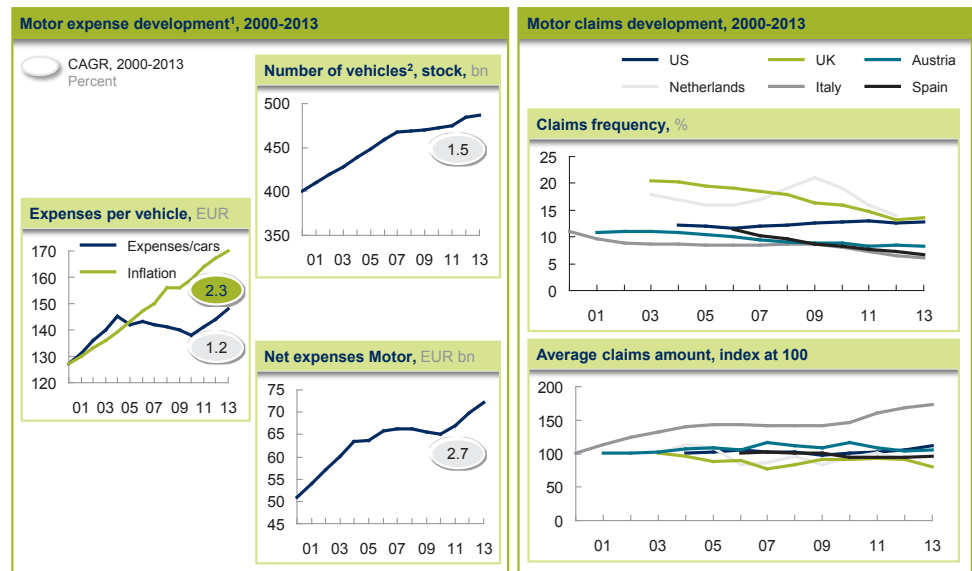
### Product growth

Motor, which represented over 40 percent of global P&C premiums in 2013, remains the largest product line in P&C. This segment also saw highest absolute growth in 2013 – a trend that continued in 2014. In emerging markets, Motor was responsible for 60 percent of absolute growth from 2008 through 2013, making it by far the largest growth driver. In mature markets, Motor was only responsible for 30 percent of absolute growth over the same period, with Fire and Property making a much greater contribution.

Although Motor is still the most significant product in mature markets, its share of premiums fell from 45 percent in 2000 to 39 percent in 2013, and this trend is expected to continue. Two factors can help to explain this trend. Motor expenses have continued to grow, mostly driven by inflation and an increasing number of vehicles on the road. However, the increase in expenses per vehicle has remained well below inflation because of operational efficiency and the rise of the direct channel in many countries. Secondly, claims frequency and severity differs by country. However, there has been a general trend toward a reduction in frequency, and this should continue as technological advances, such as automatic-braking systems, lane-change assistance, and ultimately self-driving cars, reduce the accident rate. (Exhibit 10) The full impact of these improvements is still very uncertain and will depend on a number of factors, including the replacement rate for cars and regulations for self-driving cars, which can vary greatly between countries.

## Exhibit 10

### Expenses per vehicle are increasing less than inflation; claims frequency is falling



1 Based on: US, UK, France, Italy, Netherlands, Sweden, Spain, Portugal, Ireland  
 2 Total number of vehicles

Several new P&C risk categories have been developed recently, but they are still at very early stages. For instance, cyber risk only accounted for 0.04 percent of European P&C premiums in 2013 (excluding the UK). Although the category is projected to grow 30 to 40 percent annually until 2018, it will still only represent 0.2 percent of premiums by that year. The situation is similar in the US, where cyber risk only accounted for 0.3 percent of P&C premiums in 2013. Given the low market share of new risk categories, we do not expect these products to fully compensate for the limited growth of Motor in mature markets.

### Profitability

P&C RoE increased in all regions except Africa, reaching 11.5 percent globally in 2013. (Exhibit 11) The increase was mostly driven by a favorable capital-market environment, since some regions witnessed an increase in net combined ratio in 2013. In the US, RoE was finally able to rise above CoE in 2013, driven by improved underwriting results, a low incidence of natural disasters or other catastrophes, and higher investment returns.

### Growth forecast

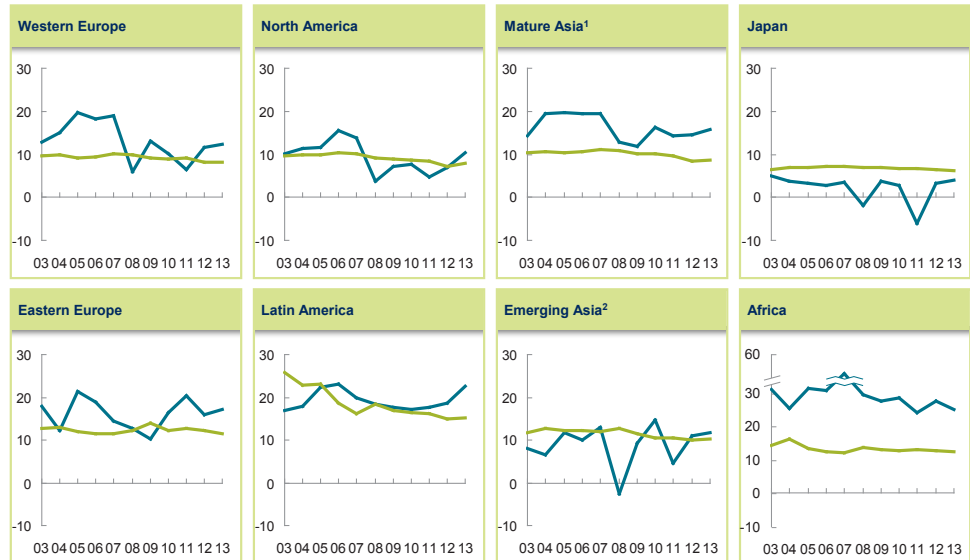
P&C growth is expected to remain stable, at about 5 percent annually until 2020. Emerging markets will show the highest growth, around 13 percent annually, while mature markets will only show growth of about 3 percent. Penetration rates in emerging markets are not likely to converge to the current levels in mature markets, but rather increase modestly, while mature markets will see penetration rates slowly decrease.

## Exhibit 11

### RoE continued to increase in 2013

P&C Insurance; Percent

— Return on Equity  
— Cost of Equity



<sup>1</sup> Mature Asia includes: Australia, Hong Kong, New Zealand, Singapore, South Korea, Taiwan

<sup>2</sup> Emerging Asia includes: China, India, Indonesia, Malaysia, Philippines, Thailand, Vietnam, Middle East

# A perspective on Health insurance

The Health segment has shown steady growth in recent years, increasing by about 5 percent in both 2012 and 2013 (a figure in line with nominal GDP growth). In 2014, we anticipate 8 percent growth.

## Regional growth

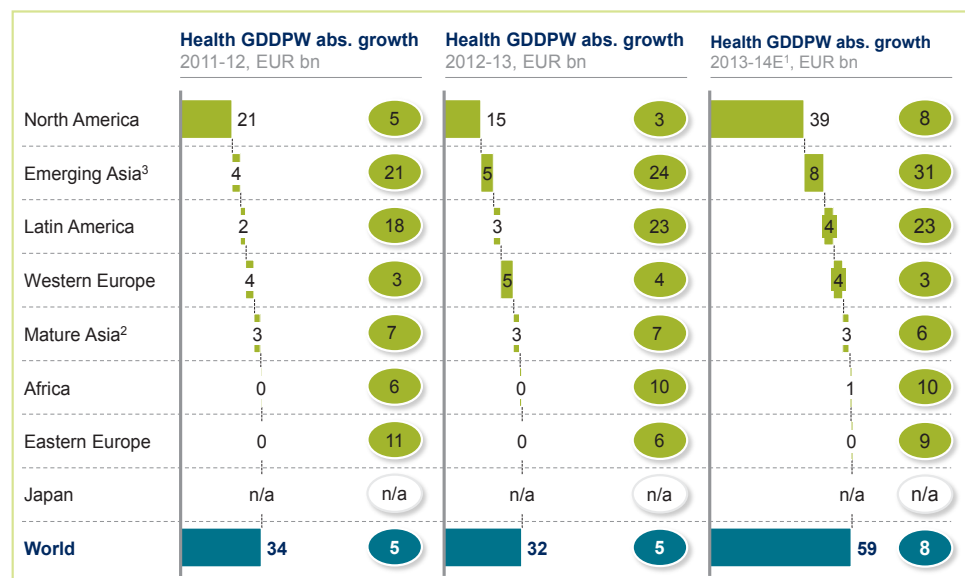
Emerging markets are rapidly gaining share in the Health sector. In 2014, they accounted for about 8 percent of global premiums, up from about 5 percent in 2008. Growth in **Mature Asia and Africa** was fairly stable in 2014. (Exhibit 12) For the other regions, consider the following:

- The **US** market saw a sharp increase in growth from 3 percent in 2013 to an anticipated 8 percent in 2014. The main drivers behind the increase are the launch of the Affordable Care Act, which is raising the number of individuals with private health insurance, and premium inflation. Since the US accounts for two thirds of global Health premiums, it serves as the primary growth driver for the global Health sector.

Exhibit 12

### Emerging Asia and Latin America show highest growth; US is largest contributor to growth

Growth rate, Percent



<sup>1</sup> Preliminary figures

<sup>2</sup> Mature Asia includes: Australia, Hong Kong, New Zealand, Singapore, South Korea, Taiwan

<sup>3</sup> Emerging Asia includes: China, India, Indonesia, Malaysia, Philippines, Thailand, Vietnam, Middle East

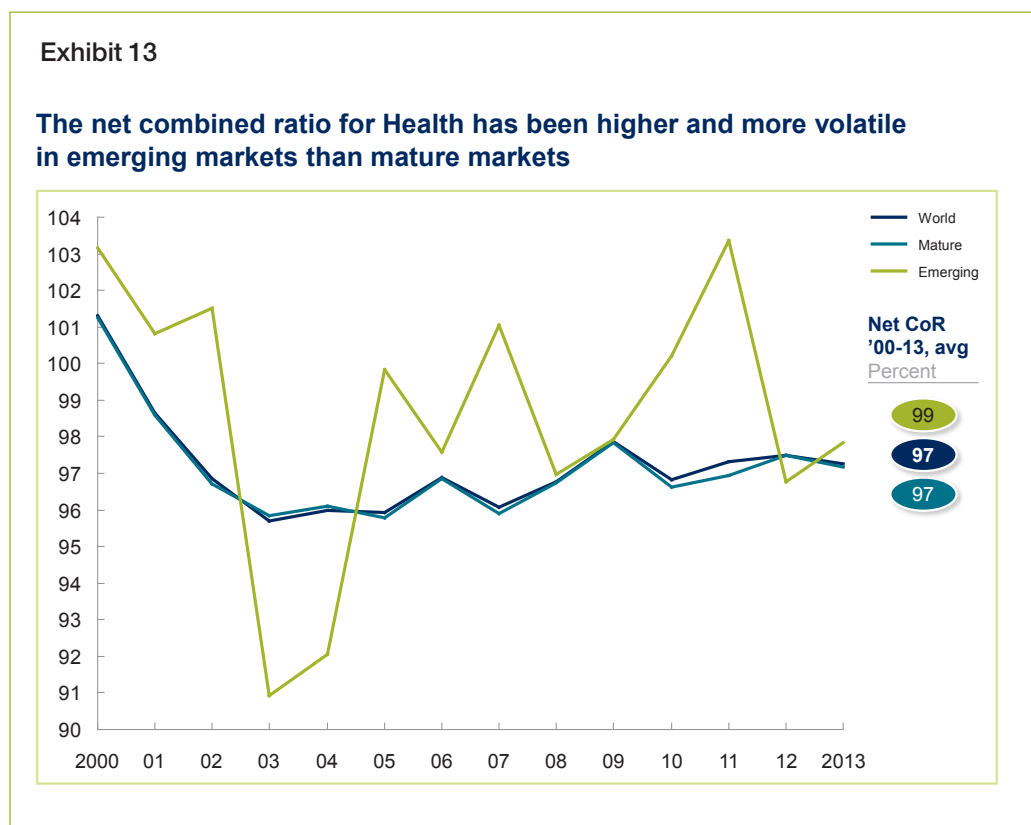
- The markets experiencing the most growth in 2014 are **Emerging Asia** (31 percent) and **Latin America** (23 percent). These markets also experienced the most growth in 2012 and 2013.
- **Western Europe's** growth fell from 4 percent in 2013 to 3 percent in 2014. In this region, three countries—the Netherlands, France, and Germany—represent over 75 percent of the market, and some developments there are constraining growth. For instance, the Dutch market is expected to have grown 2 percent in 2014 (versus 4% in 2013) because

of new regulations capping health expenditures, as well as an increase in co-payments. Similarly, German growth will fall because of new regulations that strictly limit eligibility for private health insurance.

- **Eastern Europe** showed strong growth, going from 6 percent in 2013 to 9 percent in 2014, but the market remains very small.

### Profitability

Globally, the net combined ratio for the Health sector has been under 100 percent, on average, for the last decade. (Exhibit 13) There are major geographic variations, however, with emerging markets experiencing much greater volatility than mature markets and typically reporting a higher net combined ratio. This pattern is the opposite of that in P&C, where the combined ratio is about 4 percent lower in emerging markets than mature markets. The difference in volatility may occur because regulations typically cap or prescribe profitability in Health in mature markets, but not in P&C. In addition, the Health segment is still in its early stages in emerging markets, and there will be much volatility as all stakeholders, including regulators, insurers, and consumers, adjust to the new environment.



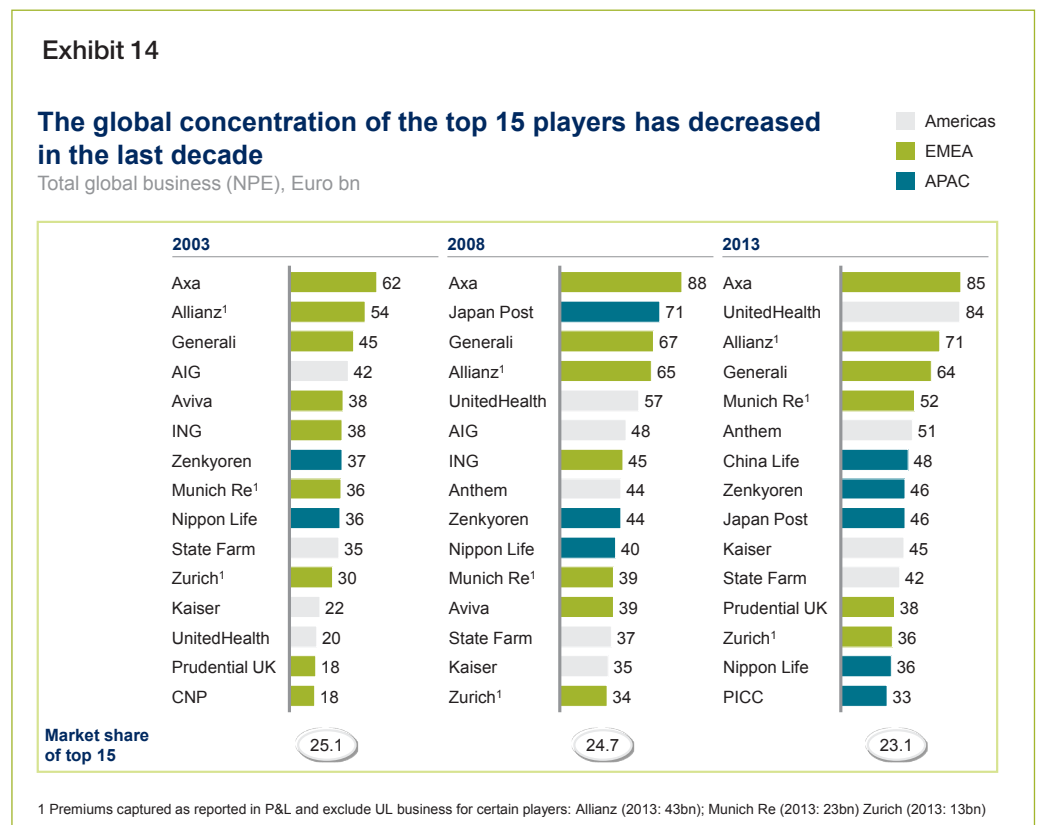
### Growth forecast

Following the pattern of the last few years, emerging markets will continue to gain share in the Health market, increasing to about 17 percent by 2020. Two trends are responsible for this rise: the ongoing efforts of mature markets to control healthcare expenditures and increased attempts by emerging markets to capture opportunities related to private health insurance.

# Competitive dynamics

The new additions to the GIP database provide insights about individual insurers, both within countries and at the group level. They allowed us to examine company-specific trends for the first time in 2014, as well as to aggregate data and draw conclusions about insurers at a global and local level.

The growth of emerging markets, combined with the relative slowdown in mature markets, has had a major effect on company performance. US and European insurers, have been very slowly but steadily losing ground to Asian companies. (Exhibit 14) In keeping with this trend, Asia accounted for 5 companies in the top 15 in 2013, up from three in 2008 and two in 2003. In a related development the global market share of the top 15 groups declined from 25 percent in 2003 to 23 percent in 2013. This trend is also apparent at the national level, with the market share of top companies declining in various countries.



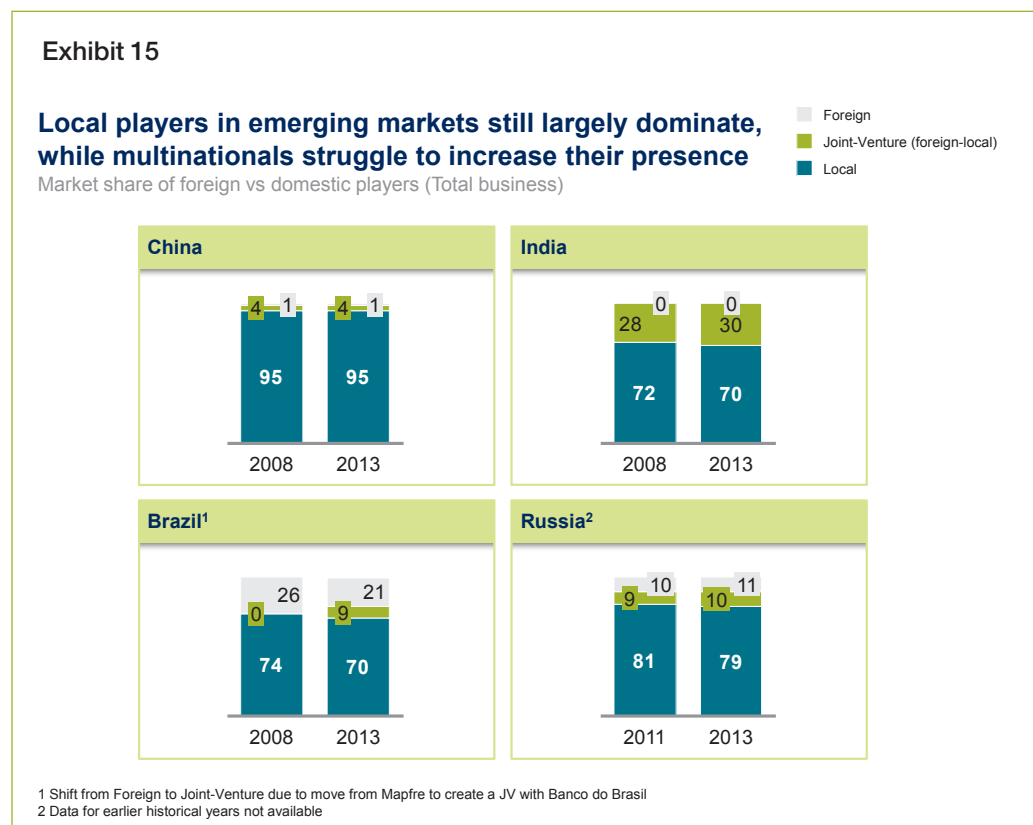
## Challenges facing foreign players in emerging markets

Although European and US insurers have expanded into emerging markets, they have faced many challenges and still depend on the slower-growing mature markets for most of their business. Those European and US players that have established a solid presence in emerging markets are still facing intense competition from local companies, and many have difficulty capturing a larger share of the market (with a number of exceptions, obviously). (Exhibit 15)

Many challenges that foreign insurers face relate to local regulations. For instance, the market share for foreign companies in the Chinese P&C market has been under 1 percent since 2008, partly because of a regulation stating that foreign companies can only sell P&C

insurance in a limited number of provinces, making it difficult to capture a share of China's motor insurance business. This policy is enforced by making companies purchase licenses (maximum of one each year). Some positive changes are occurring, however. For instance, foreign insurers have been allowed to sell Motor TPL (Third Party Liability) since 2012, and M&A activity has increased recently.

Local regulations are also a challenge in India, another rapidly growing market, where the law historically stipulated that foreign partners could only have a 26 percent ownership share in local companies. Since 2008, there was a plan to increase this to 49 percent and foreign players entered the market at that time with the assumption that this increase would soon be announced. However, it took 6 years for this change to occur, and it was only implemented recently. (Regulations still stipulate, however, that ultimate control of the company needs to remain with the Indian partner).



### Profitability

Most insurers have managed to improve their RoE in recent years, but the largest insurers are not capturing a disproportionate share of profits in Life and Non-Life in all countries. In fact, insurers that ranked among the top five had an above average RoE for total business in 7 out of the 11 countries we investigated, and in four countries, they underperformed. Product mix does not seem to be a performance differentiator for profitability, since the results were roughly similar for Life and Non-Life. (Exhibit 16)

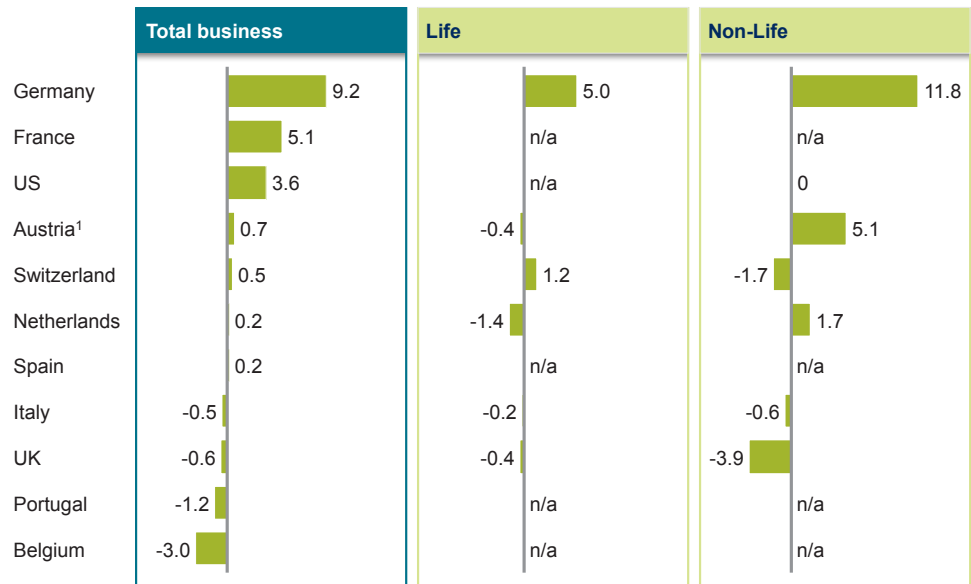
In Life (and to a certain extent in P&C), scale may convey limited benefits because each insurer has many local entities that operate somewhat independently (often driven by



## Exhibit 16

### A top 5 position can help outperform the market, but is not a guarantee

RoE outperformance of top 5 players vs. the market, Average 2010-13, Percent



<sup>1</sup> In Austria, RoE has been calculated based on pre-tax profits

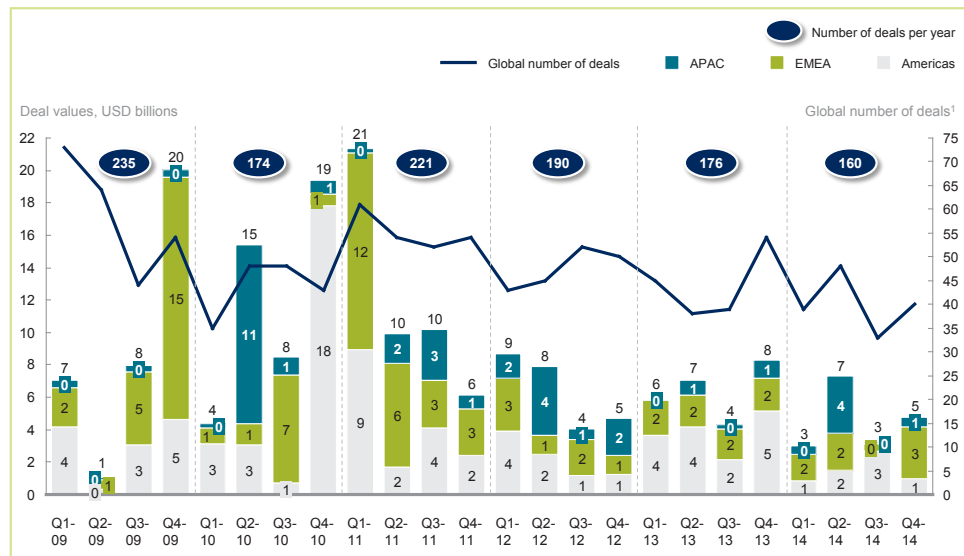
country-specific regulations). But even at the country level, scale benefits are confined to certain areas. For instance, scale may reduce administrative expenses but it has no effect on commissions. Given the limitations of scale, other factors are more likely to affect profitability, such as the amount of legacy, product mix, and channel mix.

### M&A: recent trends and predictions

A review of the last six years shows that the number of mergers and acquisitions was highest in 2009 (235 deals) and 2011 (221 deals). Beginning in 2012, M&A activity has shown a steady decline across all regions, reaching a low point in 2014. (Exhibit 17) The main factor behind the decrease is the scarcity of capital in the industry, and limited appetite from investors to allocate more capital. A reversal of the downward trend is not observed yet, as several challenges to consolidation still need to be addressed, such as limited cross-border synergies, local ownership structures, new regulations (such as Solvency 2) and a tough macro-economic environment. However, there are some fundamental factors in place that could help increase M&A activity over the long term, including the low concentration levels in certain markets, a rise in capital buffers seen at several insurers already, and interest from emerging markets.

## Exhibit 17

### M&A in the insurance sector has declined over the past few years



1 Including deals for which deal values are not available

\* \* \*

The insurance industry performed impressively in 2014 in terms of volumes and profitability. Life witnessed a strong recovery in growth, while Health showed the highest growth rate. From a geographic perspective, the emerging markets of Latin America and Emerging Asia continue to be the highest growth areas. Despite these recent gains, the industry cannot be complacent; there are many uncertainties and challenges ahead for which it needs to prepare and multiple questions to answer. What is the right product strategy for Life insurers, as Solvency 2 approaches, competition increases, and a prolonged low-interest rate environment is becoming a new reality? What will be the speed and magnitude of the introduction of new car technologies and how will this impact the Motor insurance market? What growth strategies are best and what is the potential role of M&A in these?

To answer these questions and maintain a competitive edge, insurers need an in-depth understanding of current and future trends, such as those provided by our GIP analyses, so they can re-examine their product mix, geographic focus, and capabilities. Those companies that identify new developments, prepare for change and adapt to the rapidly evolving landscape may emerge as the winners.

# Appendix

## McKinsey's Global Insurance Pools

McKinsey's GIP initiative uses a bottom-up approach to size insurance markets. The GIP **Markets Database** comprises the 64 largest insurance markets, covering more than 99 percent of total global premiums.

The level of detail in our GIP Markets Database varies from market to market. For the less advanced markets, the data might include gross premiums written, technical reserves, and profits. For the more advanced markets, it includes complete sets of financial indicators for each product line, including the mix of distribution channels. Historical data covers the period 2000–2013, with estimates for 2014 based on H1 or Q3 reporting, and our forecasts run until 2020. Historical data are available in local currency as well as in EUR and USD (and other currencies). In the present report, we express the historical data and forecasts in EUR using 2013 fixed exchange rates.

GIP distinguishes five product groups in Life, based on European terminology: Term Life, Endowments, Annuities, Unit-linked, and Group Life (see below for detailed descriptions). P&C includes five product groups: Motor, Fire & Property, Liability, Accident, and Other (such as Travel). Health is considered a separate line and includes all Health premiums underwritten by pure Health insurers and Life or P&C insurers, based on data extracted either from the Life data or P&C records (depending on the regulatory treatment).

The distribution mix is available for the largest 35 countries. The channel categories include tied agents, brokers/IFAs, bancassurance, branches, remote, and other (such as retailers and car dealers).

The GIP model was built on a country-by-country basis by collecting and analyzing public data (such as national insurance regulators' data and/or industry association publications) and drawing on the insights of our global network of local experts. We mapped the local product types and distribution channels to the standard globally accepted definitions.

In addition to the Markets Database, GIP now also offers integrated data on selected global and local insurers.

The **Local Insurers Database** includes key financial indicators for the top 15 largest local insurers in 11 individual markets for the years 2005-2013. In addition, the database includes premiums data (for Total, Life and Non-Life) for the top 10 insurance groups in 52 countries for the period 2000-2013.

The **Global Insurers Database** includes key financial statement information for 105 global insurers including their split for Life and Non-Life for the period 2005-2014.

## Life product definitions

*Term Life:* all types of protection products with purely biometric risk coverage.

*Endowments:* all individual life-savings products (both single and regular premium) that provide a guaranteed credited-rate component and a lump-sum payout. Under US terminology, this would include Universal Life and Whole Life.

*Annuities:* individual life-savings products (both single and regular premium) that provide a guaranteed credited-rate component and a payout in the form of an annuity (in other words, regular monthly payment streams either for a fixed duration or for life). Under US terminology, this would include Fixed Annuities.

*Unit-linked:* individual life-savings products (both single and regular premium) for which the policyholder bears the investment risk and that provide a lump-sum payout. Under US terminology, this would include Variable Life, Variable Universal Life, and Variable Annuities.

*Group Life:* includes Group Protection, Group Unit-linked, and Group Annuities; the largest segment is Corporate Pensions.

### Forecasting methodology

Our volumes-forecasting model is based on a series of historical multivariate regression models that use both macroeconomic drivers and momentum as explanatory variables for premium growth.

We run panel regressions with random effects at both country and product-category levels. For Life, P&C, and Health, we split countries into 2 or 3 subgroups, based primarily on each country's level of maturity. We then run separate regressions for the subgroups at the country and product-category levels, with particular equation specifications for each product.

The macro-drivers we considered include GDP growth (nominal and real), long-term and short-term interest rates, penetration, and equity market returns.

For our profit-forecasting model we also developed separate methodologies for Life, P&C, and Health.

For P&C and Health, we take a driver-based approach in which we forecast separately all of the components of profit (claims, costs, and investment income). For each profit component, we test various specifications, combining macroeconomic variables (such as GDP growth, interest rates, and inflation) and time-series variables (such as momentum effects and mean-reversion effects). The approach for Life was similar. That said, since Life profits are highly sensitive to capital market and regulatory conditions, any profit forecast is only valid under the assumption of stability on both these fronts.

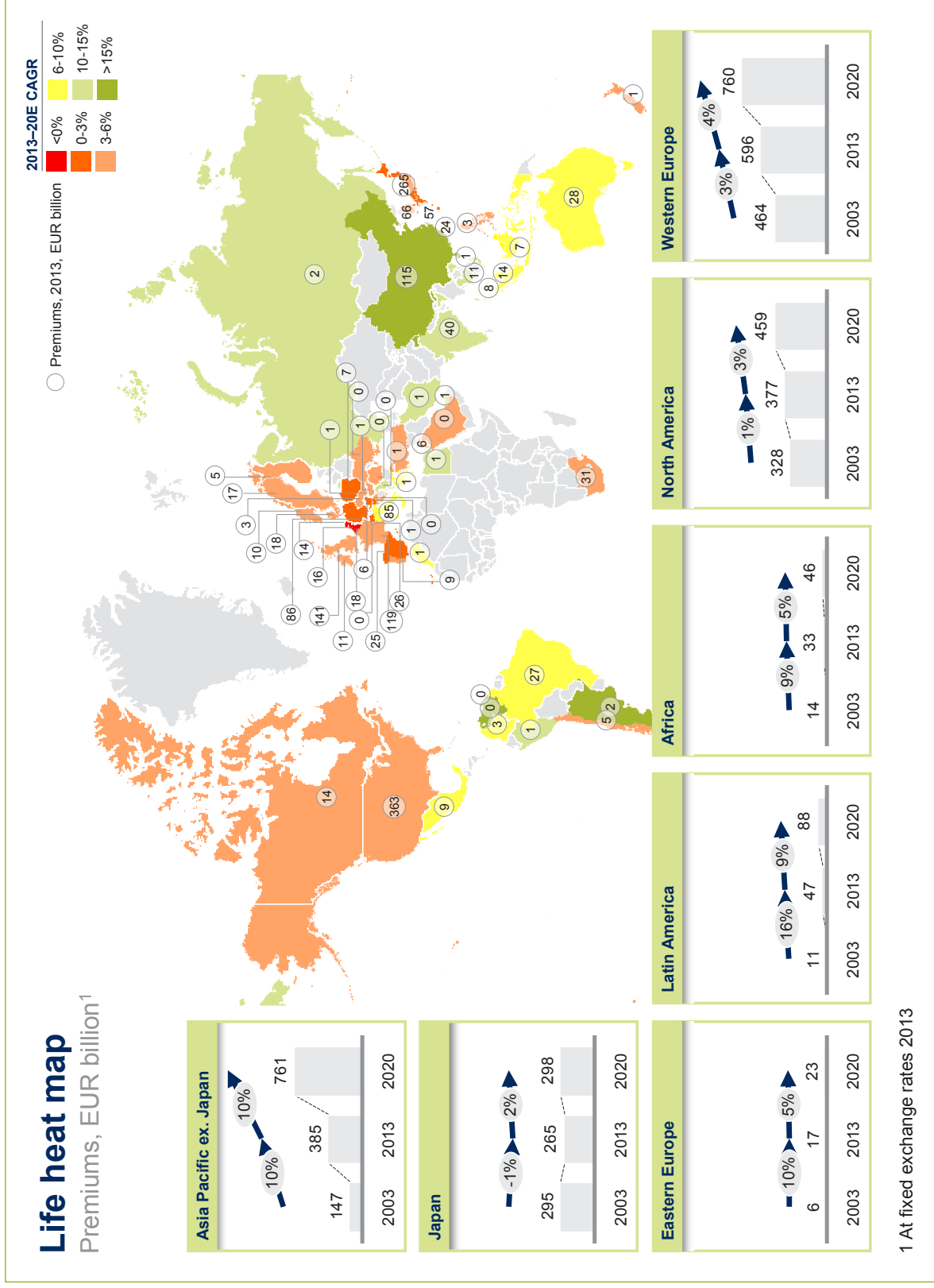
For both P&C and Life, we ran panel regressions grouping similar countries. Overall, the regressions have generated superior results, with strong  $R^2$  values, good stability, and reasonable back-testing behavior.

All our models employ economic forecasts from Oxford Economics. Our global network of local experts reviews the forecasts produced by our regression models to adjust for any specificities in local markets (upcoming regulatory changes, demographic shifts, pension or healthcare system reforms, etc.).

### **Use of fixed exchange rates to reduce the impact of currency fluctuations**

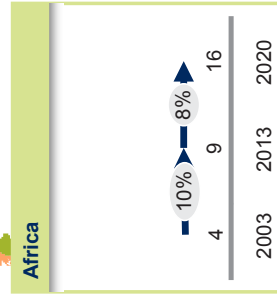
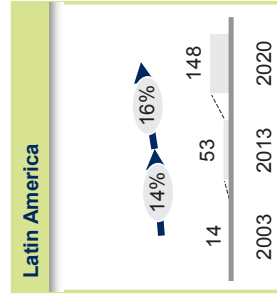
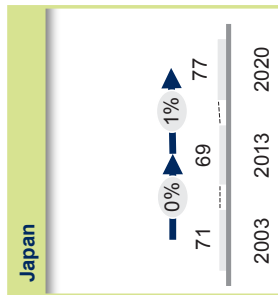
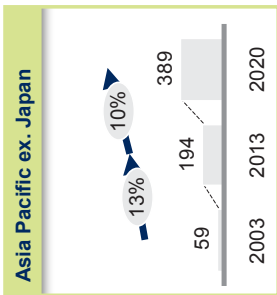
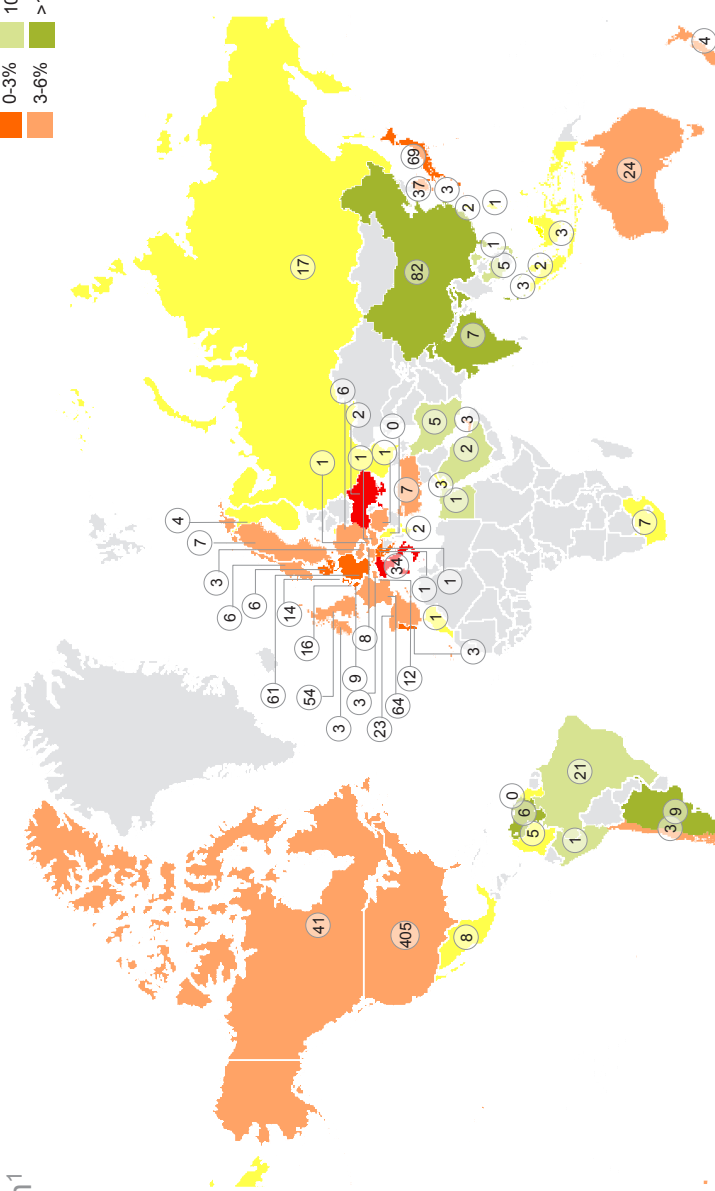
Our analysis generally uses nominal figures based on 2013 fixed exchange rates. This approach allows us to compare local growth rates without the interference of sometimes highly pronounced currency fluctuations. One drawback of our method, however, is that it does not account for differing inflation rates across countries. In consequence, estimates of growth in markets with high inflation (such as some countries in Latin America) may show an upward bias that can significantly distort comparisons among countries over the long term. In some cases, there are striking differences in the results, depending upon what method we use. For instance, an analysis using nominal figures based on fixed exchange rates showed that growth in emerging markets was six times higher than growth in mature markets from 2011 through 2013 (12 percent versus 2 percent). When we used yearly exchange rates, growth in emerging markets was only three times as high (9 percent versus 3 percent).

# Global insurance heat maps



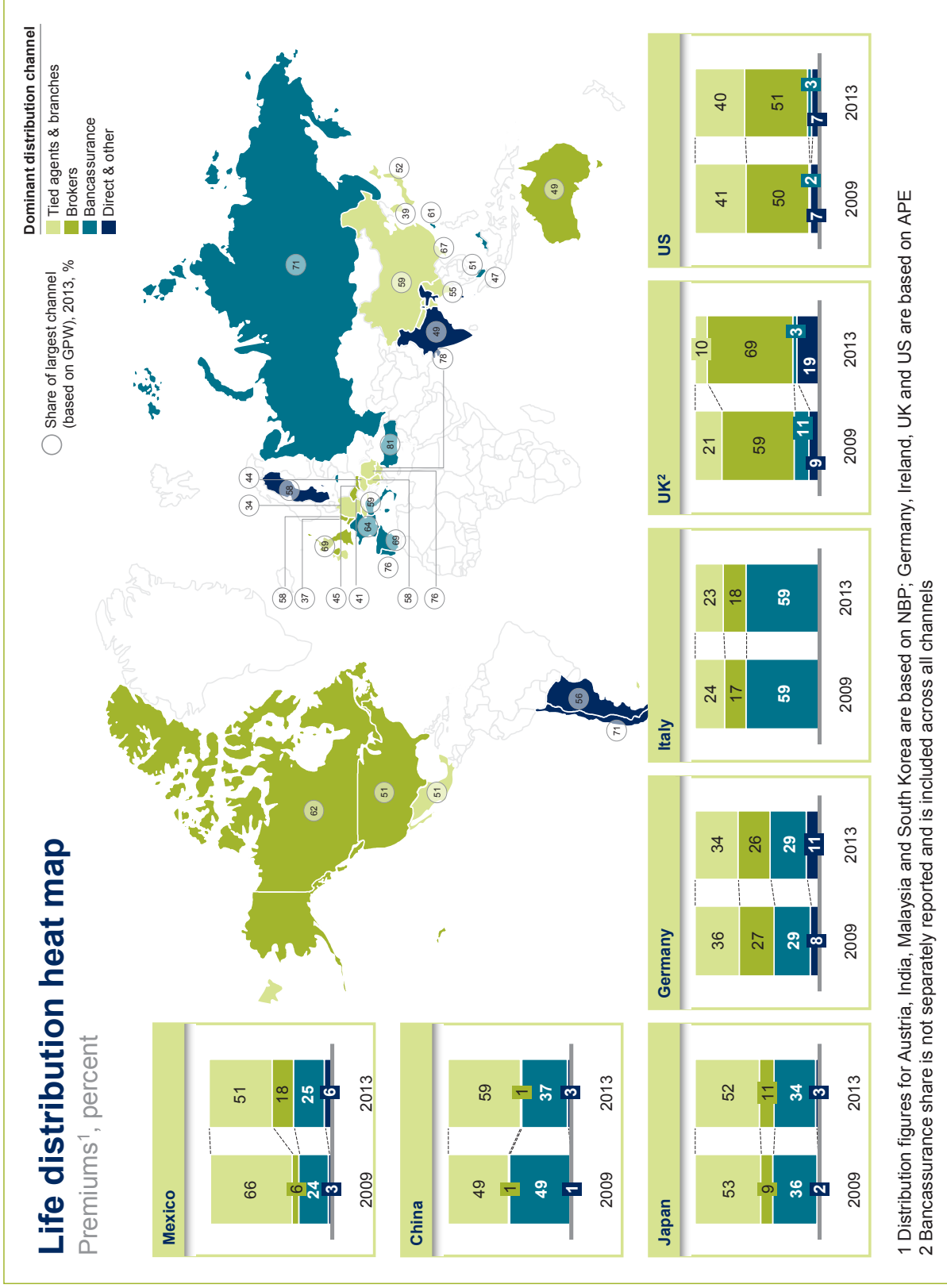
# P&C heat map

Premiums, EUR billion<sup>1</sup>



<sup>1</sup> At fixed exchange rates 2013

# Global distribution heat maps





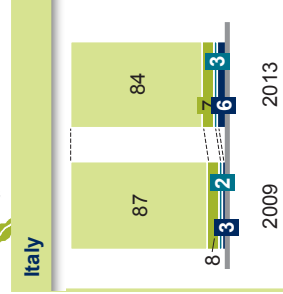
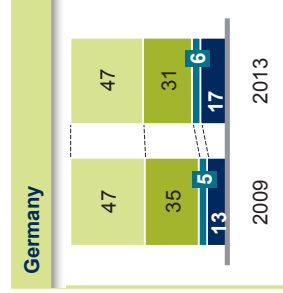
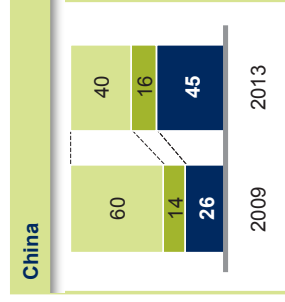
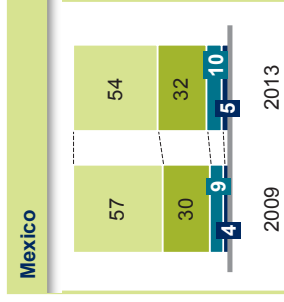
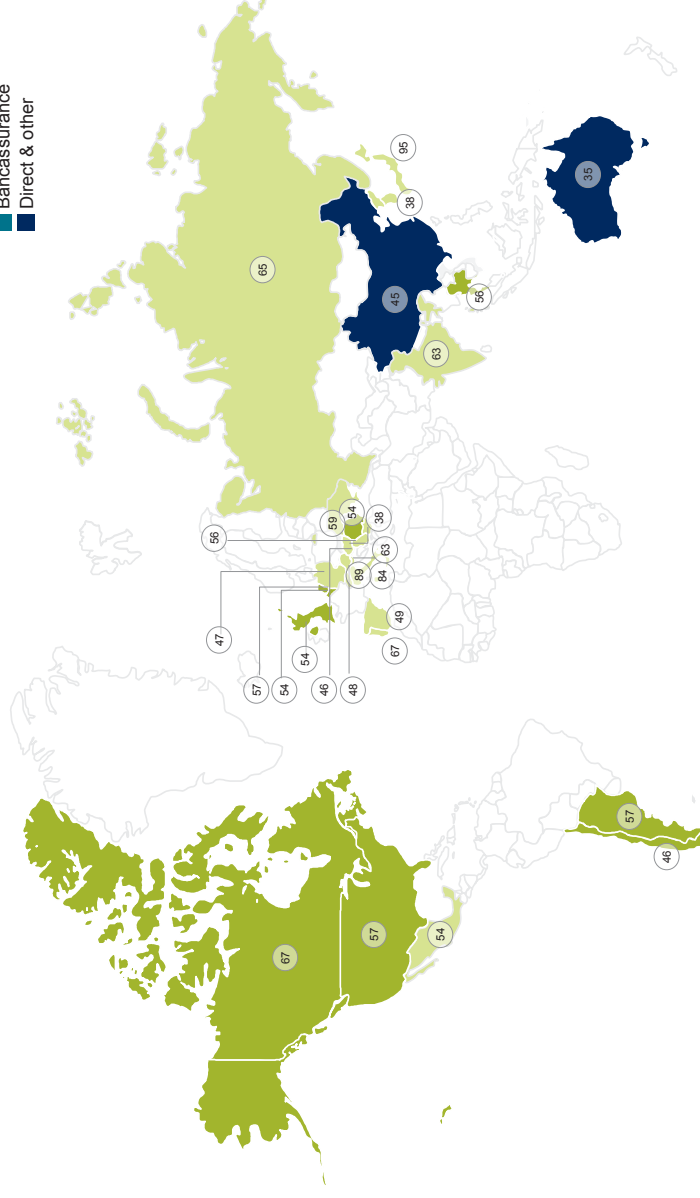
# P&C distribution heat map

Premiums<sup>1</sup>, percent

## Dominant distribution channel

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

○ Share of largest channel (based on GPW), 2013, %



<sup>1</sup> Germany, China, United Kingdom, Luxembourg, South Korea, France, Chile, Slovenia, Hungary and Japan are for Non-Life



### **Authors and contributors**

This report is the product of many authors and contributors. Roderick Jorna, Marlous Jutte and Samuel Gerssen led the overall effort. A special thank you to the Global Insurance Pools team (Ankit Goel, Abhishek Gupta and Anantdeep Singh) for their contributions.

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