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McKinsey Global Insurance Pools, fifth edition, 2015

Global Insurance Industry Insights

A detailed analysis of trends that shape the industry

North America edition

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. 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 marked by strong growth in life insurance, steady development in property-casualty insurance, and increased profitability in both life and property-casualty.

The report then provides a perspective on the industry's two primary lines of business: life insurance and property-casualty insurance.[1] Questions addressed in the report include the following: What is driving the rebound in growth and profitability in life insurance, and will this continue? Which product categories and geographies are still growing in property-casualty, and how have new risk categories had an impact?

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

A note 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 initiative 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 the coming years in addition to steadily increasing interest rates. The results detailed 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.

Devin McGranahan
Insurance leader, Americas

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1 The global version of this report includes data and perspectives on health insurance markets. This version, prepared for a North American readership, does not include health insurance, as it is largely a separate market with a different set of competitors

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Contents

Executive summary

In 2014, the insurance industry staged an impressive recovery, with anticipated global growth of 5.9 percent—far exceeding the 2.4 percent reported in 2013—and total premiums reaching almost $4 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? Life insurance demonstrated a strong recovery in the growth of gross written premiums (GWP) from 2013 to 2014. Growth in property-casualty insurance remained relatively stable, at 5 percent. Early reports also show that emerging markets grew significantly more than mature markets (11 percent versus 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[2] and Latin America.

As in previous years, the penetration rate for mature markets (6 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 surpass nominal GDP growth to a significant degree and increase penetration.

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

- **Life insurance.** Most regions saw life insurance growth in 2014, but the amount of the growth, as well as the factors responsible, varied. In a marked departure from 2013, the U.S., Japan and Mature Asia[3] demonstrated the strongest gains. Of all life insurance products, permanent products experienced the most growth, primarily because of a resurgence in sales at Italian banks, but variable products also performed well. Life insurance return on equity (ROE) rose from 11.5 percent in 2012 to 12.7 percent in 2013 as equity markets were strong.

- **Property-casualty insurance.** Growth in the property-casualty market held steady in 2014 at 5 percent. The main growth drivers were auto insurance in emerging markets and property insurance 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 property-casualty growth. Property-casualty ROE increased in almost all regions in 2013, reaching 11.5 percent globally.

Major trends for all product lines are based on final data for 2013 and earlier years, as well as preliminary reports for 2014 (1H or 3Q). In general, the most detailed analyses focus on the final data through 2013.

Competitive dynamics

U.S., which, along with European firms, once ruled the global ranks, have been steadily losing ground in terms of global premiums to Asian companies as emerging

2 China, India, Indonesia, Malaysia, Philippines, Thailand, Vietnam and the Middle East.
3 Australia, Hong Kong, New Zealand, Singapore, South Korea and Taiwan.

markets grow and mature markets slow down. Although both U.S. and European carriers 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, because local insurers are becoming more competitive.

Most insurers have improved their ROE in recent years, but the largest insurers are not necessarily capturing a disproportionate share of profits in life insurance and property-casualty insurance in all countries. Mergers and acquisitions (M&A) have been declining across all regions, mostly due to lack of available free capital. Several challenges are reigning in consolidation; however, there are some fundamental factors in place that could help increase M&A activity over the long term.

Why this matters for North American carriers

Over the longer term, the insurance industry has become more global. In the mid-1950s, the 40 largest global property-casualty carriers drew 95 percent of revenues from their home country; in 2013 domestic revenues for the top 40 decreased to 64 percent. Carriers with a diverse global mix have also been shown to perform better: between 2004 and 2012, the combined ratio of the largest carriers with a more global footprint was three points lower than that of the largest carriers with a less global footprint. Global insurers benefit from diversification, increased staff mobility, more leverage with distribution partners and other advantages.

Most of the globalization of the 40 largest property-casualty insurers has been driven by European carriers, with some exceptions. Most U.S. property-casualty carriers remain primarily focused on domestic markets. This is understandable, as the U.S. property-casualty market is still five times larger than the next-largest markets (China, Japan). And, while other developing markets and emerging markets today comprise the majority of global premiums, this was not the case from the 1960s to the 1980s, when the U.S. accounted for 75 percent of global property-casualty premiums. These same patterns apply broadly to life insurance, where only a few U.S. carriers have made significant forays into international markets.

In both property-casualty and life insurance, markets outside of the U.S. continue to gain share, due in particular to fast growth in emerging markets. This trend, combined with the fact that the U.S. insurance market remains among the world's most mature and competitive, suggests that it is only a matter of time before more U.S. carriers seek a larger presence outside their borders.

About McKinsey's Global Insurance Pool database

McKinsey's 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 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 include:

- **Local Insurers Database**, including key financial indicators for the 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 split for life insurance and property-casualty insurance.

Note: The GIP Markets Database leverages data published by local regulators, which often follow local accounting standards. The Global Insurers Database uses 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 allows insurance companies to compare themselves to their peers. This in-depth analysis covers capital markets performance; financial performance for total business, life insurance and property-casualty insurance; and country-level performance.

Recent developments in the global insurance industry

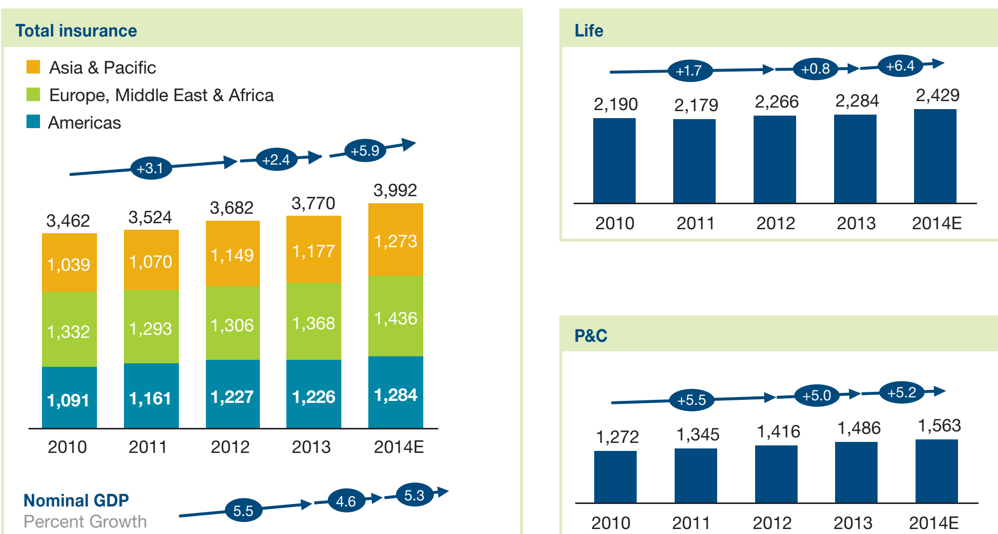
The year 2014 should provide welcome relief for the insurance industry, with early data suggesting that premiums have grown 5.9 percent worldwide, reaching almost $4 trillion.[4] This premium growth is well above the 2.4 percent reported in 2013 and also exceeds GDP growth for the first time in five years.

The industry's strong performance primarily stems from improvement in life insurance ($2.4 trillion in premiums), which is expected to reach 6.4 percent growth in 2014, compared to 0.8 percent in 2013. Property-casualty premium growth should remain stable at 5 percent, reaching $1.6 trillion (Exhibit 1).

Exhibit 1

Growth in global insurance premiums beat GDP growth in 2014 for the first time in 5 years

Premiums, $ billion,[1] CAGR in percent



1 2014 based on available H1 or Q3 reporting; at fixed exchange rates 2013
SOURCE: McKinsey Global Insurance Pools

Regional growth patterns

Only two regions saw double-digit growth in 2014: Emerging Asia (14 percent) and Latin America (12 percent). These results helped give emerging markets an overall growth rate of 11 percent. Growth in mature markets was 5 percent. Unlike the past few years, mature markets are expected to see the greatest share of absolute growth (68 percent) in 2014 (Exhibit 2, page 6).

4 All 2014 numbers are based on 1H or 3Q data.

Exhibit 2

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

Percent

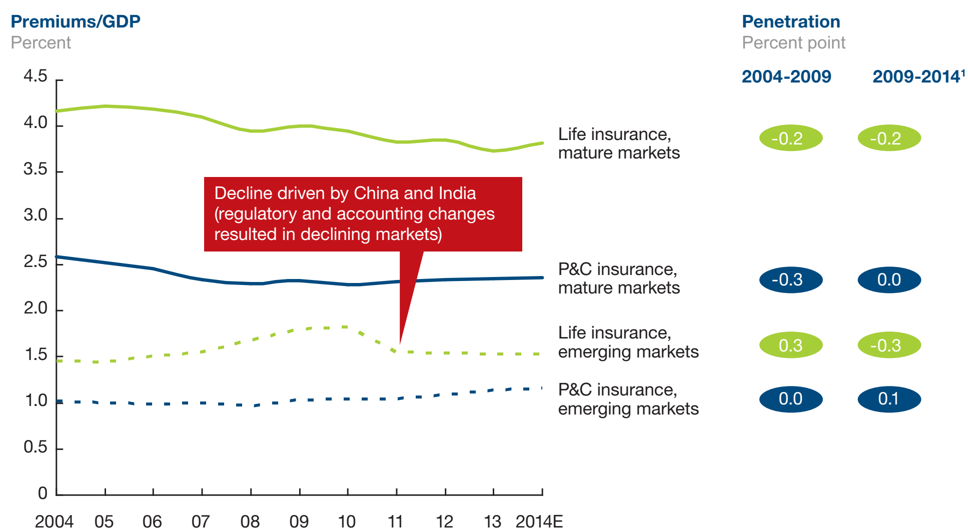
	Total insurance premiums: Growth 2013-2014E[1]	Absolute growth share: 2013-2014E[1]	Premium share: 2014E[1]
Emerging Asia[2]	14	26	12
Latin America	12	7	4
Mature Asia[3]	7	11	9
Western Europe	5	30	32
North America	4	19	28
Japan	4	7	12
Eastern Europe	1	0	2
Africa	-3	-1	1
Total Mature	5	68	81
Total Emerging	11	32	19

1 2014 figures based on available 1H or 3Q reporting.
2 Includes China, India, Indonesia, Malaysia, Philippines, Thailand, Vietnam and the Middle East.
3 Includes Australia, Hong Kong, New Zealand, Singapore, South Korea, Taiwan and Japan.
SOURCE: McKinsey Global Insurance Pools

Exhibit 3

Penetration rates vary by product line and region

Penetration (Premiums/GDP)



1 2014 based on available 1H or 3Q reporting; at fixed exchange rates 2013
SOURCE: McKinsey Global Insurance Pools; Oxford Economics

Penetration rates

As in previous years, the industry penetration rate in 2014 (premiums/nominal GDP) for mature markets (6 percent) exceeds that of emerging markets (3 percent).

Industry penetration rates in mature markets have been fairly stable over the last decade (Exhibit 3). In emerging markets, the industry penetration rate generally rose over the same period. There was a significant drop in life insurance growth in emerging markets in 2011, when accounting and regulatory changes in India and China pushed sales down. While life penetration has not yet returned to its pre-2011 peak, it has been relatively stable and is 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. A more detailed analysis—for instance, one based on socioeconomic class or location—would reveal that certain emerging market subsegments are experiencing rapid growth. As one example, urban areas are experiencing greater increases in penetration rates than rural areas.

A perspective on life insurance

The life industry 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 U.S. and Japan drove the global market down.

Regional growth

Our 2014 data suggest that life insurance grew 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:

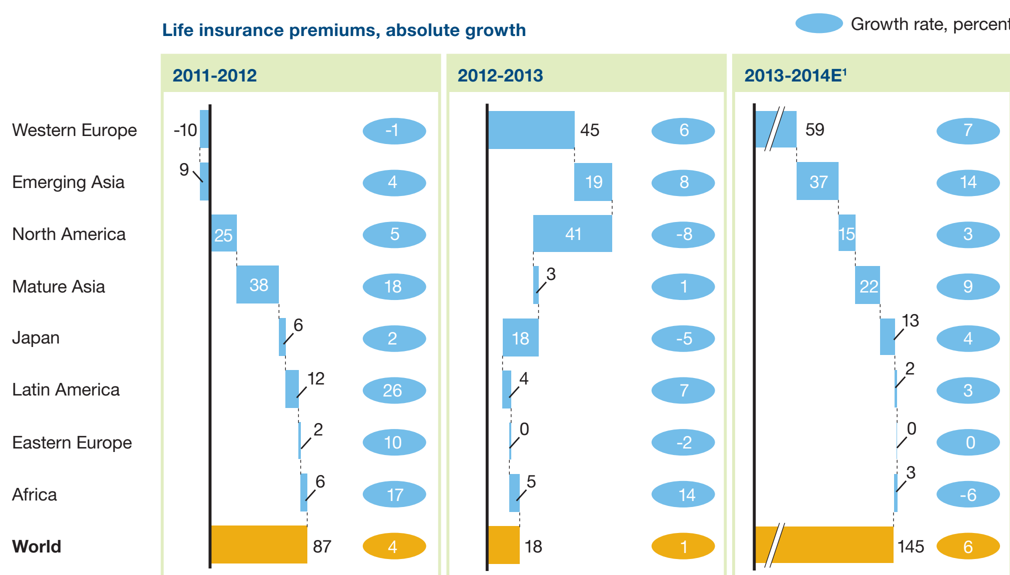
- **Western Europe's growth** of 7 percent surpassed the 6 percent reported in 2013 largely because of the strongly rebounding Italian market. In 2011 and 2012, Italian banks were suffering from a liquidity crisis and focused on selling deposits and other banking products, rather than life insurance, to increase their own funding. In 2013, as funding needs diminished and interest rates decreased, they resumed selling life insurance products, and this trend intensified in 2014. Consumer demand for life insurance has been strong because lower interest rates have renewed interest in managed products.

- **Eastern Europe's life insurance** market declined 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 re-

Exhibit 4

Life insurance grew in all regions except Eastern Europe and Africa in 2014

Absolute growth of life premiums, $ billion



1 Preliminary figures

SOURCE: McKinsey Global Insurance Pools

sulted from the government's attempt to discontinue a specific short-term product that is exempt from capital gains tax.

- Life insurance growth in **North America** came in at 3 percent in 2014. This is a significant improvement over 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 insurance 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 as a result of two developments: first, capital markets were strong in Japan, generating high demand for investment products; second, the devaluation of the yen trigged 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 1 percent in 2013). The strong returns were mainly driven by three markets:

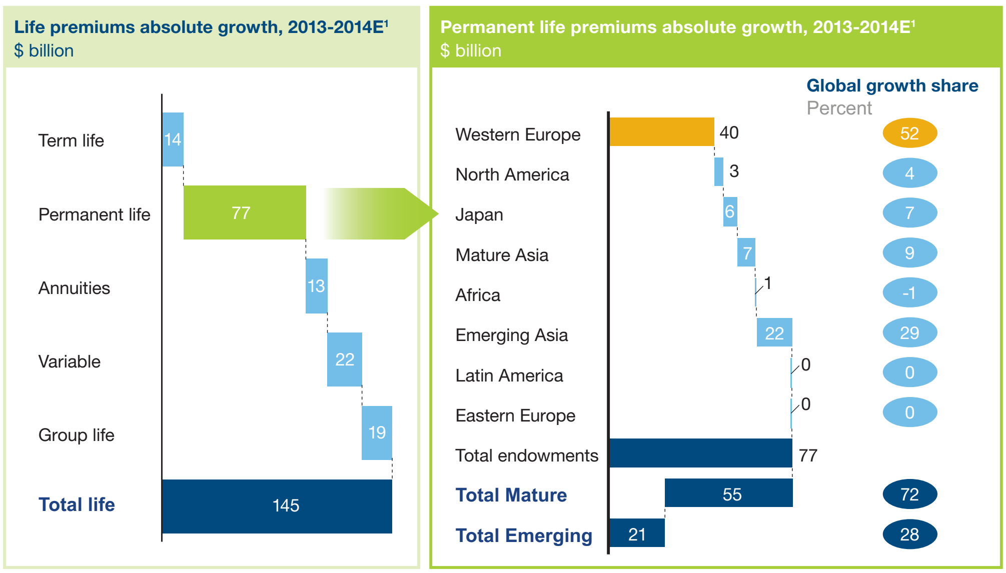
  - Australia benefitted from higher inflows into group superannuation. This was largely driven by one insurer that almost quadrupled its single-premium sales. However, all insurers experienced double-digit growth in group life insurance as underwriting pressure increased prices.
  - In South Korea, growth 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 as a result of government criteria for life insurance policies, particularly premium-rate flexible annuities, instituted 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** 14 percent life insurance growth in 2014 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, after a few years of low or negative growth that largely resulted from poor sales of variable products. A recent restructuring of these products, however, made them more popular again.

- **Latin America** has been a growth engine for life insurance for several years, but growth decreased from 7 percent in 2013 to 3 percent in 2014. This poor showing primarily occurred because variable sales in Brazil (~70 percent of total life insurance market) fell by about 8 percent between 2012 and 2014, in response to capital markets volatility and regulatory changes. Other life products, however, continued to grow, and Brazil's long-term prospects look strong.

Exhibit 5

Permanent life made the strongest contribution to growth in 2014, largely because of a strong Italian market



1 2014 figures based on available H1 or Q3 reporting.
SOURCE: McKinsey Global Insurance Pools

Exhibit 6

The correlation between variable growth and equity markets performance has weakened since the 2008 financial crisis

Variable premiums and market capitalization indexed at 2004

1 Includes the Middle East
SOURCE: McKinsey Global Insurance Pools; Bloomberg

- **Africa** is expected to show a decline in life insurance 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; the affluent segment continued buying insurance products despite worsening economic conditions. Furthermore, variable products were in strong demand in Africa in 2013 because of favorable equity markets. At this point, however, Africa's economic problems are so severe that they are causing significant decreases in sales in the affluent market as well as the mass market.

Product growth

Of all life insurance products, permanent life saw the most growth in absolute terms in 2014 (Exhibit 5). These gains were driven primarily by the resurgence in life insurance sales at Italian banks, which serve as the primary distribution channel for permanent products in that country.

Variable products also made a strong contribution to growth in 2014, as robust 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 variable products. First, consumers need to regain trust in these products in the aftermath of the capital markets crash, especially given the prolonged unstable economic and financial climate. Second, several country-specific trends may have posed obstacles:

- In the **U.S.,** insurers have been restructuring or discontinuing their variable annuity business in recent years because of market volatility and low interest rates. Japan has experienced market changes similar to those in the U.S., with variable premiums dropping 70 percent between 2007 and 2013.

- In **India**, more stringent regulations on the sale of variable products has resulted in a continued decline in premiums since 2009.

- Although insurers in some **European markets**, such as France, still aggressively push variable products, insurers in other markets have shifted their focus to new guarantee concepts, including "unit-linked with guarantees." And, although the effect has not been very pronounced, Solvency 2 seems to have pushed variable growth in Europe.

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

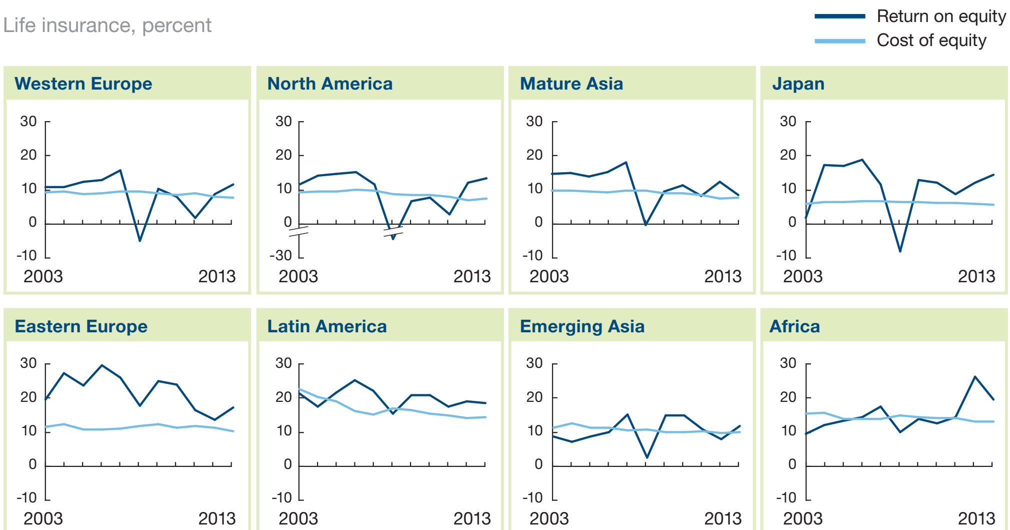
Profitability

Global ROE for life insurance was 12.7 percent in 2013, up from 11.5 percent in 2012. The strong equity market, which experienced a 20 percent global total return to shareholders (TRS) in 2013, was the primary driver behind this increase. For 2014,

Exhibit 7

Mature Asia, Latin America and Africa were the only regions to see declines in life insurance ROE

Life insurance, percent



SOURCE: McKinsey Global Insurance Pools; Oxford Economics

ROE is expected to be 1 to 2 percent lower, although the capital markets are still performing well, with TRS of over 17 percent. This is in line with the trend seen in the 2014 published results from the top 40 global carriers.

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 experienced ROE declines, although ROE remained above COE in both regions. In Western Europe, ROE increased for the second consecutive year, due to strong equity markets and the fact that Solvency 2 regulation has not yet had its full effect.

Growth forecast

Life insurance 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 these levels 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 life insurance share of emerging markets—17 percent of global life premiums in 2014—their growth will not compensate for the slowdown in mature markets.

A perspective on property-casualty insurance

Growth in the global property-casualty market continued to be very steady: 5 percent in 2013 and about the same in 2014. At the product level, auto insurance 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, page 14). Other regions saw more dramatic changes:

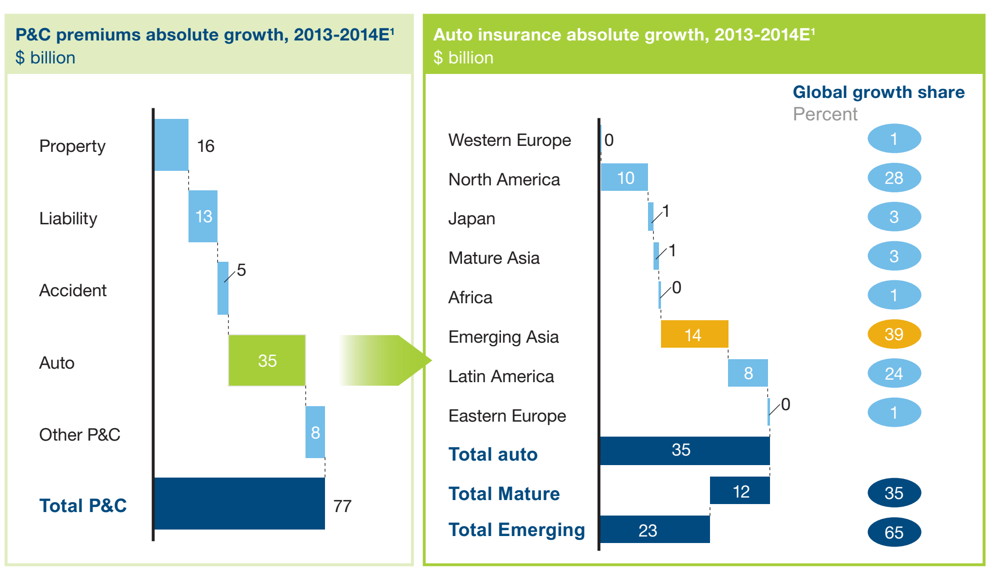
- In **Eastern Europe**, property-casualty growth was significantly lower in 2013 because the region's economy was suffering. The same trend is seen in 2014. In Poland, for instance, auto insurance premiums fell 5 percent in 2013 and by another 3 percent in 2014.

- Growth slowed significantly in **Other Mature Asia (including Oceania)** from 2012 to 2013; however, this decline reflects normalization in the wake of earlier price increases related to bad weather. From 2013 to 2014, growth stabilized.

- **Emerging Asia and Latin America** experienced the strongest growth in 2013 and 2014, mostly driven by auto insurance, which represents approximately 60 percent of the total property-casualty market in these regions.

Exhibit 8

Auto insurance contributed about half of absolute growth in P&C, driven mostly by Emerging Asia

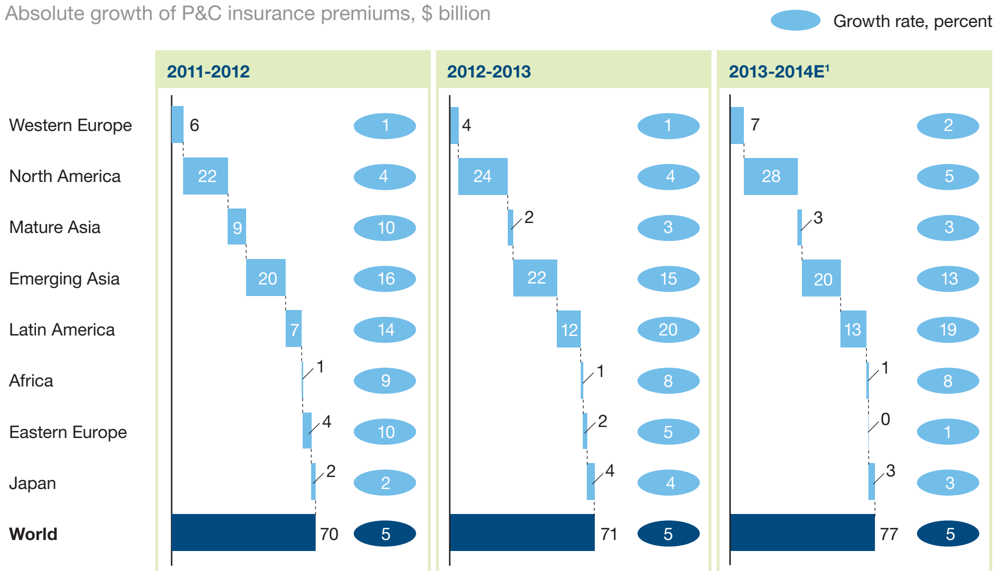


1 2014 figures based on available H1 or Q3 reporting.
SOURCE: McKinsey Global Insurance Pools

Exhibit 9

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

Absolute growth of P&C insurance premiums, $ billion



1 Preliminary figures

SOURCE: McKinsey Global Insurance Pools

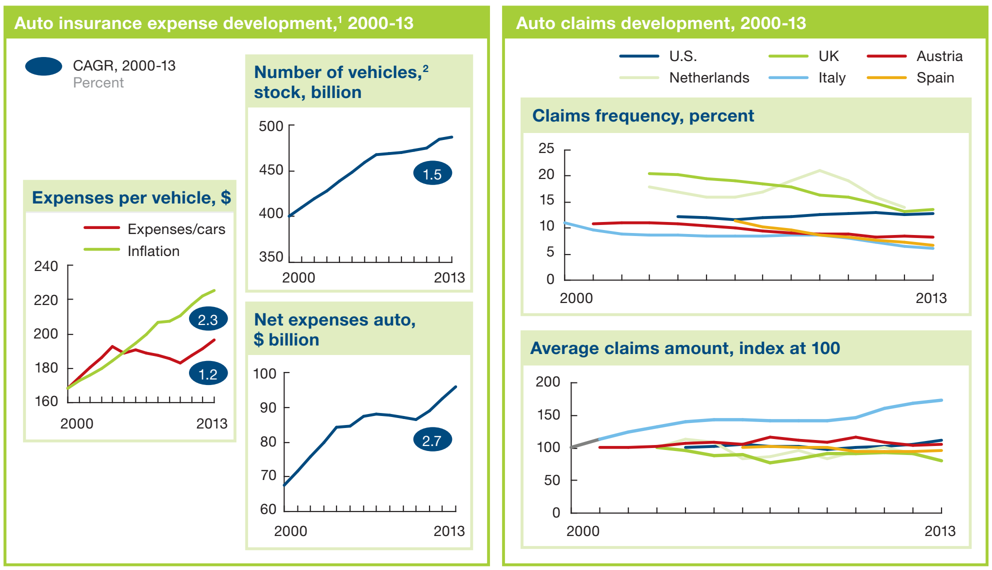
Product growth

Auto insurance, which represented over 40 percent of global property-casualty premiums in 2013, remains the largest product line in property-casualty. This segment also saw highest absolute growth in 2013 and in 2014. In emerging markets, auto insurance was responsible for 60 percent of absolute growth from 2008 through 2013, making it by far the largest growth driver. In mature markets, auto was only responsible for 30 percent of absolute growth over the same period, with property making a much greater contribution.

Although auto insurance 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 are at work: First, auto insurance 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 are likely to vary greatly between countries.

Exhibit 10

In auto insurance, expenses per vehicle are increasing less than inflation; claims frequency is falling



1 Based on: U.S., UK, France, Italy, Netherlands, Sweden, Spain, Portugal, Ireland
2 Total number of vehicles
SOURCE: McKinsey Global Insurance Pools

Several new property-casualty risk categories have been developed recently, but they are still at very early stages. For instance, cyberrisk only accounted for 0.04 percent of European property-casualty 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 U.S., where cyberrisk only accounted for 0.3 percent of property-casualty premiums in 2013. Given the low market share of new risk categories, McKinsey does not expect these products to fully compensate for the limited growth of auto insurance in mature markets.

Profitability

Property-casualty ROE increased in all regions except Africa, reaching 11.5 percent globally in 2013 (Exhibit 11, page 16). The increase was mostly driven by a favorable capital markets environment, as some regions witnessed an increase in net combined ratio in 2013. In the U.S., ROE finally rose above COE in 2013, driven by improved underwriting results, a low incidence of natural disasters or other catastrophes, and higher investment returns.

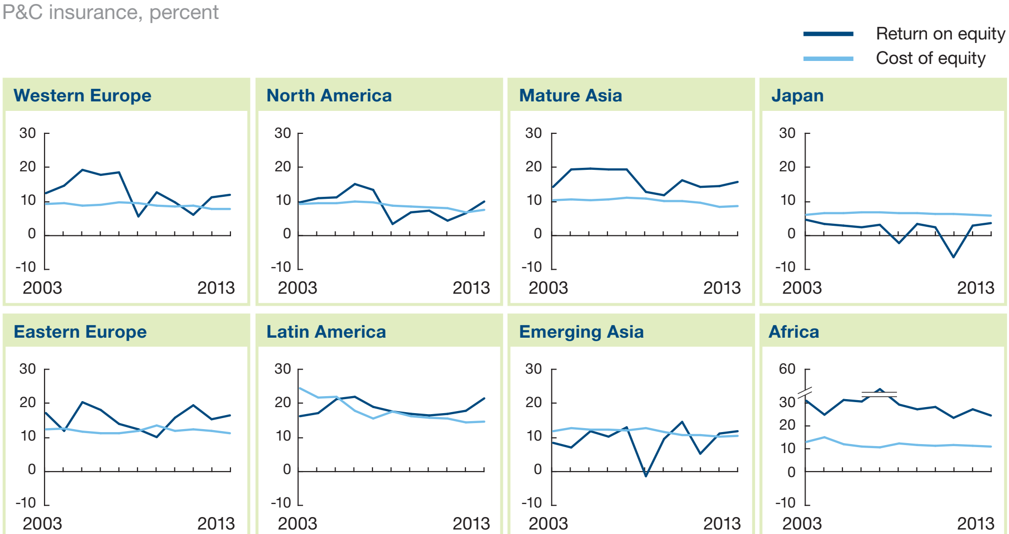
Growth forecast

Property-casualty growth is expected to remain stable, at about 5 percent annually, until 2020. Emerging markets will show the highest growth, around 13 percent an-

Exhibit 11

P&C ROE continued to increase in 2013

P&C insurance, percent



SOURCE: McKinsey Global Insurance Pools; Oxford Economics

nually, while mature markets will 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.

Competitive dynamics

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

The growth of insurance in emerging markets, combined with the relative slowdown in mature markets, has had a significant effect on company performance. U.S. and European insurers have been very slowly but steadily losing ground to Asian carriers (Exhibit 12). In keeping with this trend, Asia accounted for eight of the top 15 global insurers in 2013, up from five in 2008 and two in 2003. In a related development, the global market share of the top 15 insurers declined from 24 percent in 2003 to 21 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 carriers in emerging markets

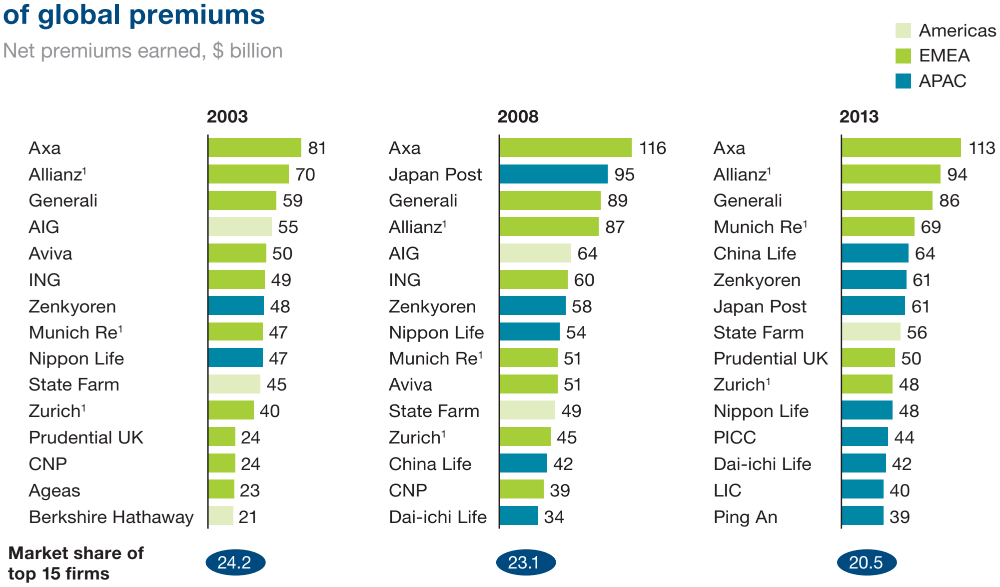
Although European and U.S. insurers have expanded into emerging markets, they have faced many challenges and still depend on the slower-growing mature markets for most of their business. European and U.S. insurers that have established a solid presence in emerging markets are facing intense competition from local carriers, and many have struggled to capture a significant share of the market—there are, of course, exceptions (Exhibit 13, page 18).

Many challenges that foreign insurers face relate to local regulations. For instance, the market share for foreign carriers in the Chinese property-casualty market has been

Exhibit 12

Asian insurers have been gaining ground against U.S. insurers in terms of global premiums

Net premiums earned, $ billion



1 Premiums captured as reported in P&L and exclude UL business for certain players: Allianz (2013: $43 billion); Munich Re (2013: $23 billion); Zurich (2013: $13 billion).

SOURCE: McKinsey Global Insurance Pools

Exhibit 13

Local players in emerging markets still dominate, while multinationals struggle to increase their presence

Market share of foreign versus domestic players (total business)

1 Shift from foreign to joint venture due to Mapfre's JV with Banco do Brasil.

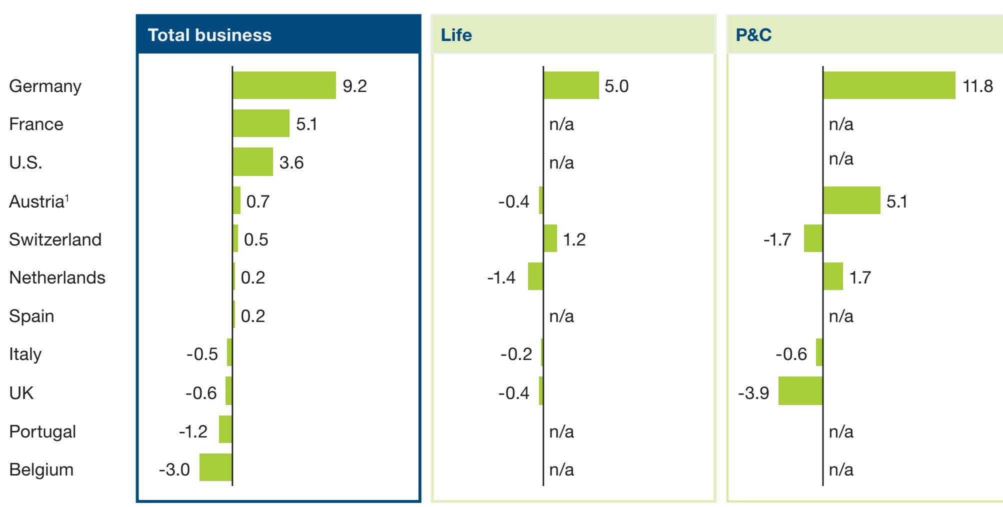
2 Data for earlier historical years not available

SOURCE: McKinsey Global Insurance Pools; Oxford Economics

Exhibit 14

A top 5 position does not guarantee market outperformance

ROE outperformance of top 5 players versus the market, average 2010-13, percent



1 In Austria, ROE was calculated based on pre-tax profits.

SOURCE: McKinsey Global Insurance Pools; Oxford Economics under 1 percent since 2008, partly because of a regulation stating that foreign companies can sell property-casualty insurance in a limited number of provinces. This policy is enforced by a rule requiring foreign insurers to purchase licenses (maximum of one each year). There have been some positive shifts; for example, foreign insurers have been allowed to sell auto insurance 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 have a maximum 26 percent ownership share in local companies. Starting in 2008, there were plans to increase this to 49 percent, and foreign insurers entered the market on the assumption that this increase would be announced. However, it took six years for this change to take effect, and it was only implemented recently. Regulations still stipulate that ultimate control of the company needs to remain with the domestic partner.

Profitability

Most insurers have improved their ROE in recent years, but the largest insurers are not capturing a disproportionate share of profits in life insurance and property-casualty in all countries. In fact, insurers that ranked among the top five had an above average ROE for total business in 7 of the 11 countries analyzed. Product mix does not seem to be a performance differentiator for profitability, since the results were roughly similar for life insurance and property-casualty (Exhibit 14).

In life insurance and, to a certain extent, property-casualty, scale may convey limited benefits because each insurer has many local entities that operate with a degree of independence (often driven by 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 business, product mix and channel mix.

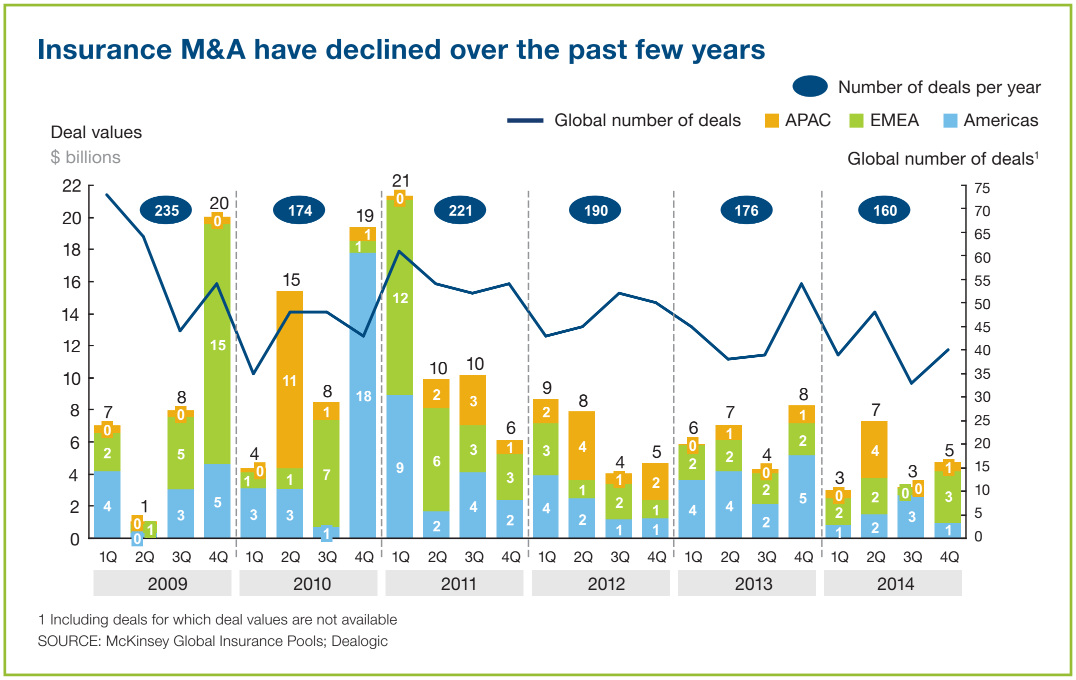
M&A: Recent trends and predictions

A review of the last six years shows that the number of insurance mergers and acquisitions was highest in 2009 (235 deals) and 2011 (221 deals). Beginning in 2012, M&A activity declined steadily across all regions, reaching a low in 2014 (Exhibit 15, page 20). The main factor behind the decrease is the scarcity of capital in the industry, and limited appetite from investors to allocate more capital. Several challenges to consolidation remain, such as limited cross-border synergies, local ownership structures, new regulations (e.g., Solvency 2) and a tough macro-economic environment. However, there are some fundamental factors that could help increase M&A activity over the long term, including low market share concentration levels in certain markets, a rise in capital buffers seen at several insurers already, and interest from emerging markets.

■ ■ ■

The insurance industry performed impressively in 2014 in terms of volumes and profitability. Life insurance in particular witnessed a strong recovery in growth. From a geographic perspective, the emerging markets of Latin America and Emerging Asia

Exhibit 15



continue to be the highest growth areas. Despite recent gains, however, the insurance industry cannot be complacent; there are many uncertainties and challenges ahead and many questions that senior executives will need to address: 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? How quickly will new technologies take hold in auto insurance, and how big will the resulting changes be? 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, 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 will increase their chances of emerging 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 1H or 3Q reporting, and 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 U.S. dollars using 2013 fixed exchange rates.

GIP distinguishes five product groups in life insurance: term-life, permanent, annuities, variable, and group life (see below for detailed descriptions). Property-casualty includes five product groups: auto, property, liability, accident, and other (such as travel).

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.

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; the databases can also help a company benchmark their growth and profitability against market performance and competitors and identify the impact of different macro-economic scenarios on growth and future market shares.

GIPs is available by subscription.

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Life product definitions

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

Permanent life: individual life-savings products (both single and regular premium) that provide a guaranteed credited-rate component and a lump-sum payout. This would include universal life and whole life insurance.

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). This includes fixed annuities.

Variable: individual life-savings products (both single and regular premium) for which the policyholder bears the investment risk and that provide a lump-sum payout. Includes variable life, variable universal life and variable annuities.

Group life: includes group protection, group variable, 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 insurance and property-casualty insurance, countries were split into two or three 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 insurance and property-casualty insurance.

For property-casualty, 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 insurance was similar. That said, since life profits are highly sensitive to capital markets and regulatory conditions, any profit forecast is only valid under the assumption of stability on both these fronts.

For both property-casualty and life insurance, 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 (e.g., upcoming regulatory changes, demographic shifts, pension or healthcare system reforms).

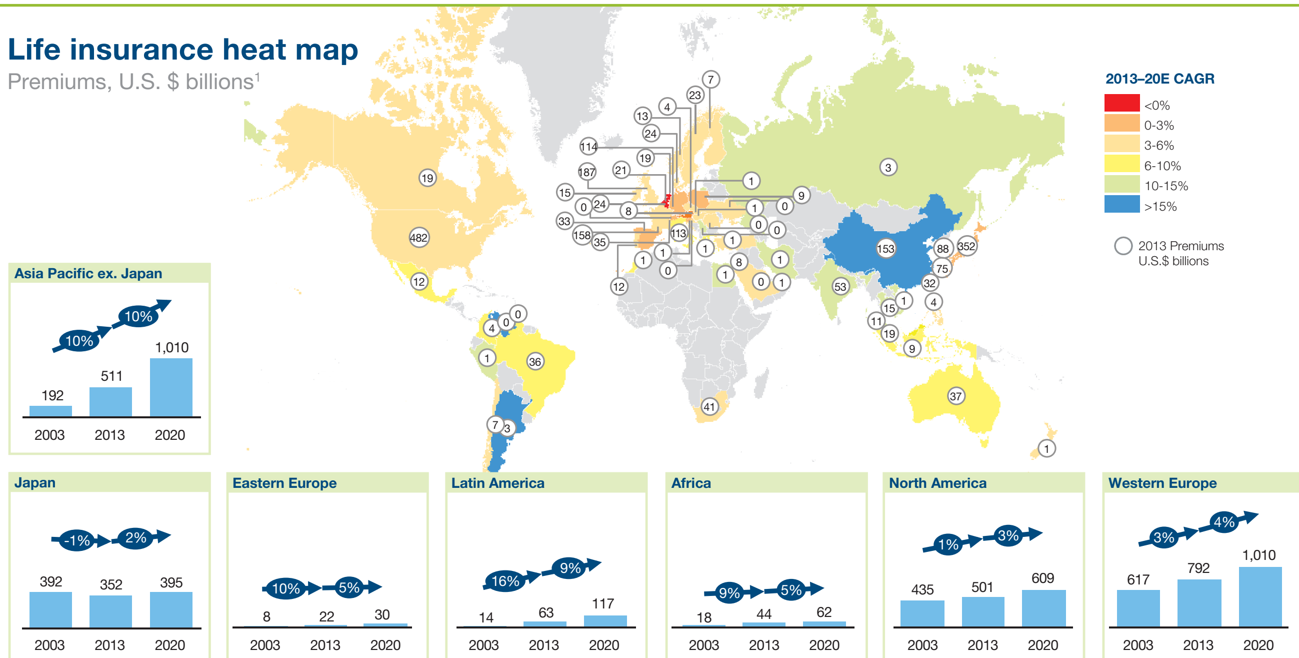
Use of fixed exchange rates to reduce the impact of currency fluctuations

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 heat maps

Life insurance heat map

Premiums, U.S. $ billions[1]

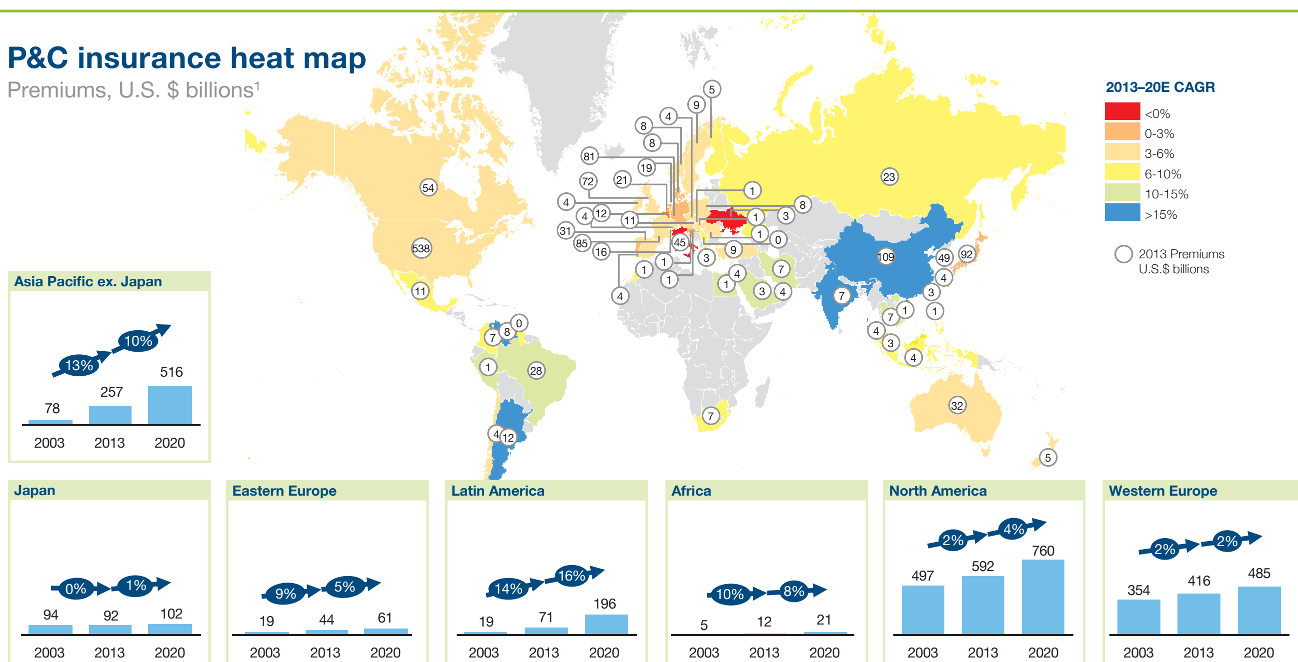


1 At fixed exchange rates 2013

SOURCE: McKinsey Global Insurance Pools, IHS Global Insight –August 2011

P&C insurance heat map

Premiums, U.S. $ billions[1]

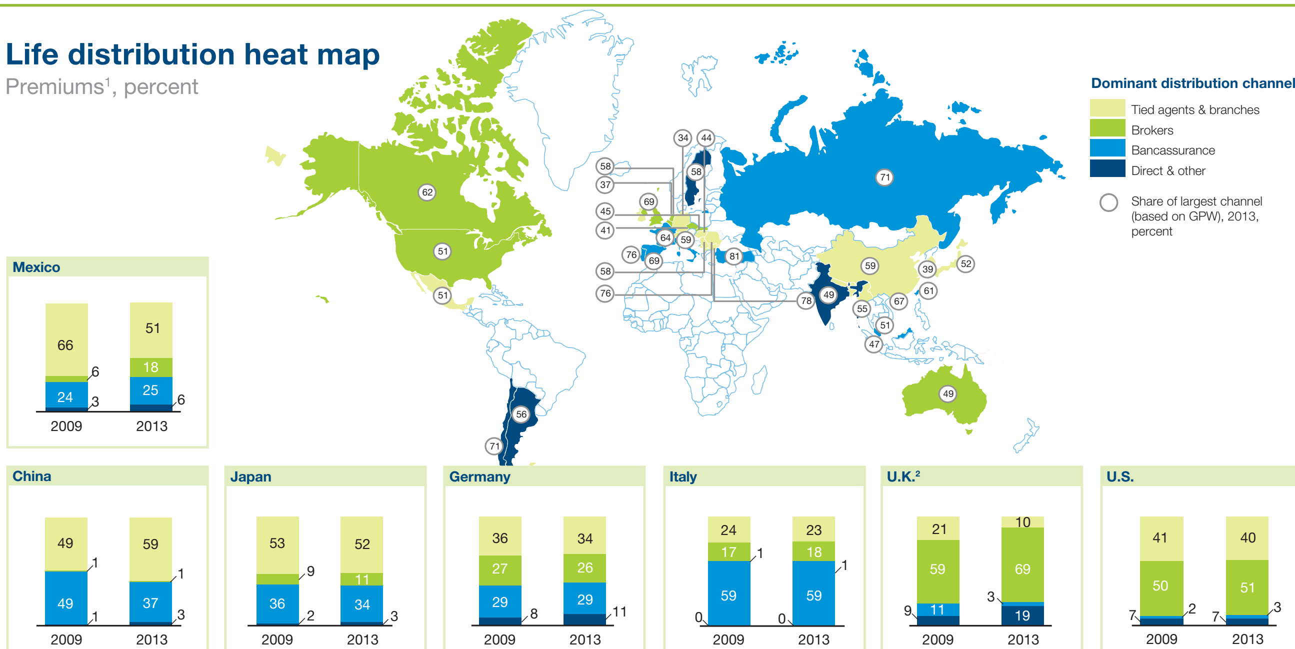


1 At fixed exchange rates 2013

SOURCE: McKinsey Global Insurance Pools, IHS Global Insight –August 2011

Life distribution heat map

Premiums[1], percent



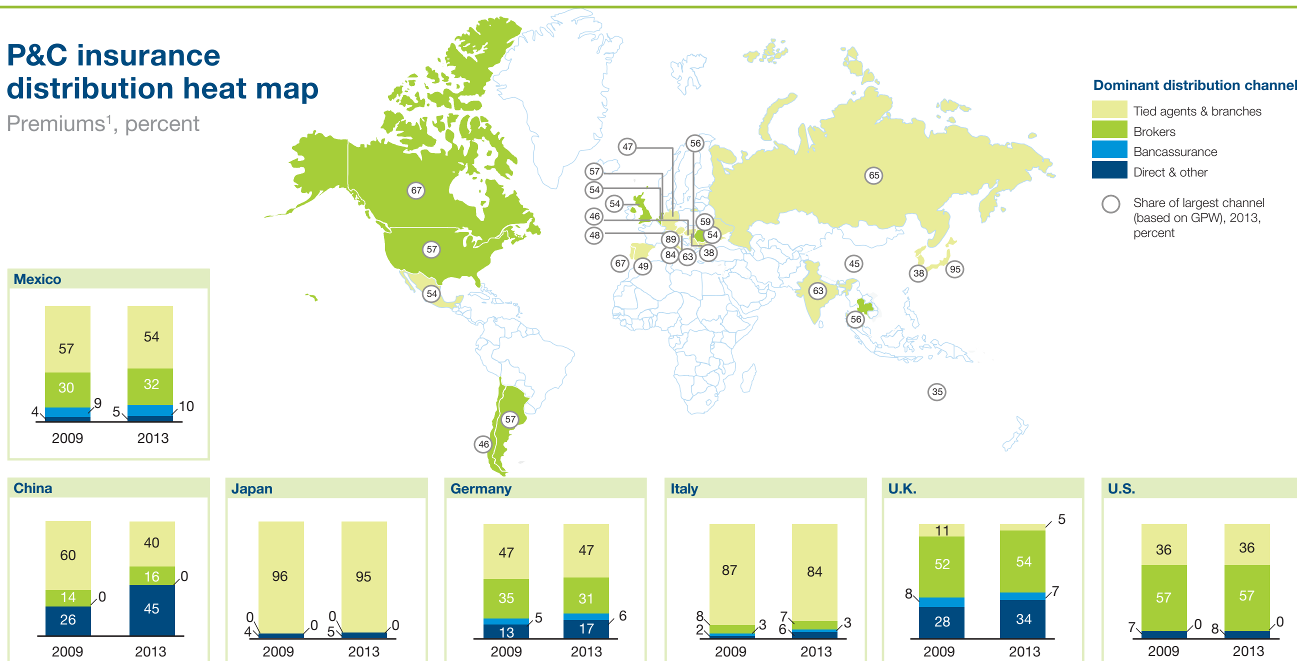
1 Distribution figures for Austria, India, Malaysia and South Korea are based on new business premiums (NBP); Germany, Ireland, UK and U.S. are based on annualized premiums equivalent (APE)

2 Bancassurance share is not separately reported and is included across all channels

SOURCE: McKinsey Global Insurance Pools

P&C insurance distribution heat map

Premiums[1], percent



1 Germany, China, United Kingdom, Luxembourg. South Korea, France, Chile, Slovenia, Hungary and Japan are for non-life

SOURCE: McKinsey Global Insurance Pools

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