Life insurance industry outlook 2023: What model fits your business?

Volatile forces will shape the global life insurance industry in the coming months and years. How will life insurers' business models need to adapt?

by Henri de Combles de Nayves

Over the past decade, the life insurance industry has experienced increasing instability. How are insurers adapting? What business models are most viable today? In this short article, we provide an overview of the current life insurance industry, the forces it's reckoning with, and the opportunities that will emerge going forward.

Four trends to watch

With a recession looming in many parts of the world, life insurance leaders should keep an eye on four paramount forces that will create opportunities and obstacles for the industry in the coming decade:

- **Increasing awareness of personal risk.** Coming out of the pandemic, consumers are more concerned than ever with prioritizing their personal health and financial security.
- **Elevated nominal interest rates.** In the past six months, interest rates have risen by more than 300 basis points across several markets and countries. As central banks look to get inflation under control, the industry will contend with a completely different market than what we have seen over the past two decades—which have largely consisted of quantitative easing and ultralow nominal rates.
- **The undeniable role of technology.** Efficient life insurers—those in the top quartile of total costs to gross premiums written—have increased their IT spend from 2 percent of gross premiums to 3 percent (a 50 percent jump) within the past four years. A new era of data, analytics, and digital customer engagement is dawning as insurers look for more efficient ways to operate.
- **The rise of Asian economies and the return of geopolitics.** The middle-class population in China, India, and Southeast Asia is projected to grow to 1.2 billion people by 2030 and make up nearly 14 percent of the total global population.[1]

An industry at the crossroads

The industry saw weak productivity, and nominal GDP growth far outpaced premium growth over the past two decades—leaving life insurers struggling to generate returns in excess of the cost of capital. In addition, insurance carriers have still not structurally addressed their cost base; since 2003, costs as a share of revenues have increased by 23 percent for life insurers—compared with a 5 percent increase for P&C insurers—while other industries, including asset management, have been able to address costs.

[1] Augusto de la Torre and Jamele Rigolini, "MIC Forum: The rise of the middle class," The World Bank, 2011.

Meanwhile, life insurers' relevance in capital markets has declined. This trend is most apparent in the United States, where the largest life insurers' share of market capitalization relative to other financial-services peers has decreased over the past 35 years—from 40 percent in 1985 to 17 percent in 2005 to only 9 percent in 2020, according to McKinsey analysis of data on the top 20 publicly traded life insurers, banks, and asset management and securities brokers in the United States.

Entrants and new sources of capital are disrupting and pushing the evolution of the sector. The past decade has seen a continuous rise of private capital–backed platforms that are typically fully or partially owned by alternative asset managers. They see the industry as a source of "permanent" capital, enabling them to generate more predictable fee-based earnings streams while reducing the overall fundraising burden. There's also been a structural shift toward more independent, third-party distribution: pure-play distributors, such as brokerages, independent marketing organizations, and field marketing organizations, have generated 2.6 times the TSR of life insurance companies since 2010 and currently trade at nearly 2.8 times the price-to-earnings multiple of their life insurance counterparts.

So where should life insurers be focused? What strategic strengths can insurers depend on to generate growth in the coming turbulence?

On the horizon: Fundamental reimagination of the life insurance business model

Traditionally, insurers have achieved profit and growth by identifying attractive products and markets, such as individual protection and annuities, and structured their end-to-end value chain to support these products and markets.

Today, products that meet the needs of the same customer segments—such as retirement and wealth and asset management services or group and retail sales—are converging, which is pushing insurers into new territory. Some insurers will even go so far as to branch into the health and protection ecosystems if there is demand from their customers.[2] Insurers are also expanding and evolving their product shelves, shifting the mix away from traditional and balance sheet–heavy products to capital-light products and combining distribution points to create a simpler, more integrated customer experience.

Looking ahead, insurers will increasingly "unbundle" their value chain and focus on sources of distinctive value creation[3] while seeking partnerships or leaving other parts of the value chain to those who are advantaged. Four leading business models could take center stage during this change:

- **Distribution specialists.** Insurers that pursue this model will have distinctive distribution capabilities and privileged customer access and insights. They will focus on advice and the distribution of a broad range of insurance, wealth management, and other financial products taking a client-centric, technology-enabled approach. They will have a capital-light model with little to no product manufacturing and work with a broad range of partners for access to products. This model will be attractive to

[2] For more, see Mathew Lee, Arielle Pensler, Neha Sahgal, and Matthew Scally, "US workplace benefits: Connecting health, wealth, and wellness," McKinsey, October 3, 2022.

[3] For more, see Ramnath Balasubramanian, Rajiv Dattani, Asheet Mehta, and Andrew Reich, "Unbundling value: How leading insurers identify competitive advantage," McKinsey, June 9, 2022.

public and privately owned insurers given the capital-light and fee-income-based earnings streams, which are typically more highly valued by investors.

- **Product manufacturing and origination specialists.** Insurers that pursue this model will have privileged distribution access (proprietary or third-party), strong product development driven by customer insights, and distinctive underwriting capabilities. While they may develop several products of varying capital efficiency, they will retain only the most capital-efficient products, such as simple protection, on their own balance sheets. Pursuing this model will help convert earnings streams that are more capital intensive to recurring fee-income earnings streams that are more capital efficient.

- **Balance sheet specialists.** Insurers that pursue this business model will have distinctive risk assessment capabilities and will marry this expertise with their strong balance sheet capacity to absorb various risk types. They will have the leading investment management talent in the insurance industry, with distinctive asset origination capabilities—either in-house or via relationships with specialist asset managers, at times even acquiring stakes in such managers as well. This model will largely be relevant for privately held insurers (for example, mutual insurers or private capital–backed platforms) with access to long-dated, permanent capital sources.

- **Full-service, integrated insurers.** Insurers pursuing this model will be few and far between; they will represent the high-water mark in terms of distinctive capabilities across the insurance value chain. They may be characterized by strong capital positions, either through scale or through structural capital advantages, and have select sources of distinctiveness across investment management and distribution—though they may still look to unbundle operations and technology. Many insurers that have the capabilities to be full-service and integrated might consider evaluating each of their business units independently and identifying the models most appropriate for some of their businesses while retaining a full-service or integrated model for others.

Life insurers have responded to broader trends and industry shifts by reevaluating their traditional business models. The industry will face persistent challenges in the coming years. Ultimately, a changing industry landscape can allow insurers to overcome current performance challenges by transforming both where and how they generate value.

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