Global Insurance Report 2023: Expanding commercial P&C’s market relevance

The nature of risk is evolving faster than ever. Commercial carriers must step up to fulfill the societal desire for resilience in a volatile world by closing protection gaps—or risk losing relevance.

This article is a collaborative effort by Susanne Ebert, Robin Huettemann, Kia Javanmardian, James Polyblank, Sirus Ramezani, Shannon Varney, and Leda Zaharieva, representing views from McKinsey’s Insurance Practice.
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Build the capabilities and talent to manage the shift from art to science
Introduction

Global commercial property and casualty (P&C) lines have delivered strong financial performance in recent years following the soft market of 2013 to 2018, despite widespread disruption in the wake of the COVID-19 pandemic, the war in Ukraine, and the resulting supply chain disruptions. Premiums have been propelled by extensive year-on-year risk-adjusted rate hardening: the annual premium growth rate for commercial P&C lines has hovered at 6 to 8 percent since 2018, and combined ratios have been improving (Exhibit 1).

However, commercial carriers find themselves at an inflection point as they face a continuing cycle of economic uncertainties, including inflation, geopolitical headwinds, environmental challenges, and capital constraints. This gradual acceleration of macroeconomic trends across multiple events that are pressuring the insurance industry is different from previous shocks. In combination with the structural changes in the nature of risks, commercial carriers today need to address four critical challenges.

First, in the current environment, rates in some lines are starting to soften as capacity returns, while hardening continues in other lines—in some cases further supported by maintaining limits, despite inflation. Rising claims inflation and growing competition from distributors are squeezing profits. But opportunities exist as well. Some commercial carriers are expecting meaningful investment returns due to the increase in interest rates. The race to decarbonize underwriting portfolios—with nuances depending on geographies—is challenging and calls for new capabilities but also offers opportunities for growth.

Second, the nature of risks is evolving faster than ever, especially when it comes to natural catastrophes (NatCats), the net-zero transition, and supply chain and cyber risks. Rather than stepping back and reducing their exposure, commercial carriers find themselves at an inflection point as they face a continuing cycle of economic uncertainties.
Despite recent macroeconomic turbulence, global premiums for commercial lines continue to be propelled by rate hardening.

Global commercial property and casualty (P&C) insurance premiums, $ billions

<table>
<thead>
<tr>
<th>Year</th>
<th>Motor</th>
<th>Others</th>
<th>Property</th>
<th>Casualty</th>
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<td>2012</td>
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<tr>
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<tr>
<td>2022</td>
<td>922</td>
<td>155</td>
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Net combined ratio, %

<table>
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<th>Hard cycle</th>
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<tbody>
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<tr>
<td>2022</td>
<td>102</td>
<td>95</td>
</tr>
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Commercial carriers will need to invest and take decisive action in response to each of these four challenges. First, commercial carriers must define a clear source of distinctiveness to protect their margins by competing beyond rates. Second, they can expand relevance by closing protection gaps through product innovation, more sophisticated pricing, and risk prevention and mitigation solutions. Third, commercial carriers will need to secure capacity by innovating the use of alternative capital and addressing investor concerns about long-term profitability. Finally, commercial carriers must reinvent their employee value proposition and develop the capabilities to shift from art to science to address the risks of the future.
The most successful commercial carriers have defined a clear source of distinctiveness that allows them to compete beyond prices.
Define a clear source of distinctiveness to compete beyond rates

Commercial carriers are facing four competing pressures: rate volatility; rising inflation and price adequacy uncertainty; the expansion of distributors up the value chain; and pressure to decarbonize underwriting portfolios.

Deceleration in rate growth. Global rate growth has slowed for the past seven consecutive quarters—from 20 percent in the third quarter of 2020 to 6 percent in the third quarter of 2022. In real terms (adjusting for inflation), rates declined (softened) in the third quarter of 2022 for the first time since 2019. However, this trend varies across lines. For example, financial and professional liability lines experienced the most significant rate deceleration, from 40 percent in the third quarter of 2020 to −1 percent in the third quarter of 2022. By contrast, rate increases in NatCat and reinsurance lines are accelerating across both loss- and non-loss-affected policies.

1 Based on data from the Marsh Global Insurance Market Index; McKinsey Global Institute analysis of data from IHS Markit.
Global property catastrophe reinsurance rates increased by 37 percent in January 2023 renewals—representing the largest increase since 1992, with implications for primary rates to follow. Inflation (measured by the consumer price index, or CPI) may have peaked in 2022, but for certain lines, the market is continuing to harden in 2023 with both rate increases and flat limits even as asset values increase.

**Rising inflation and price adequacy uncertainty.**

Most major economies are experiencing decades-high inflation. In the fourth quarter of 2022, year-on-year inflation was 12 percent in Europe, 7 percent in the United States, and 4 percent in Asia. Inflation adds pressure to the top line as clients review their coverages and retain more risks to reduce costs. At the same time, loss costs and reserve requirements grow, negatively affecting the bottom line, which resulted in $8 billion in estimated incremental inflation across US commercial lines loss costs in 2021. On the positive side, as interest rates rise for the first time in years, commercial carriers may see an increase in investment returns—with effects varying across commercial carriers depending on investment portfolio exposure. Thus, long-tail lines in particular experience price adequacy uncertainty in the current cycle, given that their pricing economics are especially sensitive to inflation and interest rates, as well as to the challenges of modeling the evolving frequency and severity of catastrophe events and cyber risks.

**Pressure from distributors.**

Distribution partners are faring well in the race for talent and capital, with stronger returns, greater proximity to customers, and more capital-light business models than commercial carriers. Thus, brokers delivered an average annual TSR of 20 percent in 2019–22 versus 9 percent delivered by commercial carriers. Furthermore, emerging managing general agents (MGAs) have successfully recruited respected underwriting veterans to join them. Based on this position, they are even moving up the value chain; the rise of MGAs reflects this trend. In the United States, MGAs grew at 10 percent per annum between 2012 and 2021—more than twice the rate of industry premiums. However, these channels can bring significant benefits for commercial carriers if they are leveraged effectively.

**Scrubtivity of underwriting portfolio emissions.**

Commercial carriers play a major role in decarbonizing the “real economy” by 2050 because economic activities are driven, in part by, the availability of insurance coverages. With the goal of increasing accountability, the Net Zero Insurance Alliance (NZIA) has committed to disclosing underwriting portfolio-enabled CO₂ emissions and defining near-term reduction targets for 2030 by July 2023, in addition to annual progress reporting. Initial estimates show that to achieve net-zero emissions by 2050, underwriting portfolio-enabled emissions need to be reduced by 43 percent by 2030. Over time, commercial carriers will likely move capacity toward industries with a lower emissions intensity, faster decarbonization pathways, and net-zero supporting technologies. This trend will affect rates in these evolving industries and in those with a higher emissions intensity. To successfully compete, commercial carriers will need to develop new capabilities in underwriting portfolio management and underwriting functions.

Progress in decarbonizing underwritten emissions still varies across geographies, with European commercial carriers and NZIA members leading the way.

**Compete on distinctive proposition rather than price**

The most successful commercial carriers have defined a clear source of distinctiveness that allows them to compete beyond prices—and have doubled down their investment in these areas. By focusing on certain lines of business, specialist commercial carriers have almost consistently outperformed their more diversified peers (as measured by premium growth and profitability)

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1 The great realignment, Howden, January 1, 2023.
2 McKinsey Global Institute analysis of data from IHS Markit.
3 Ibid.
5 S&P Capital IQ; based on five global brokers and 16 commercial (re)insurance carriers and weighted by shareholder equity.
7 Including the emission-reduction target category, engagement target category, or reinsuring the transition targets.
8 Over 50 percent with no or limited overshoot.
9 The financial services industry, related to the Task Force for Nature-related Financial Disclosures (TFND), is working to steer financial flows from nature-negative outcomes toward nature-positive outcomes, such as biodiversity.

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in both hard and soft markets between 2016 and 2021 (Exhibit 2). During the same period, the more specialized US excess and surplus (E&S) market grew at 16 percent annually—more than three times the rate of the US admitted market. Their historical resilience suggests that specialist commercial carriers are better equipped to thrive amid ongoing economic uncertainty.

Exhibit 2

Specialists have displayed improved underwriting profitability and premium growth versus diversified commercial and large-risk-focused carriers.

Comparison of growth vs underwriting profitability for commercial carriers, by archetype

<table>
<thead>
<tr>
<th>Gross written premium (GWP), $ billions</th>
<th>+14% p.a.</th>
<th>+12% p.a.</th>
<th>+20% p.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Specialists</td>
<td>32</td>
<td>37</td>
<td>42</td>
</tr>
<tr>
<td>Diversified</td>
<td>83</td>
<td>89</td>
<td>97</td>
</tr>
<tr>
<td>Large-risk-focused</td>
<td>70</td>
<td>66</td>
<td>71</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Net combined ratio (CoR), %</th>
<th>+9% p.a.</th>
<th>+5% p.a.</th>
<th>+12% p.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Specialists</td>
<td>89</td>
<td>105</td>
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<tr>
<td>Diversified</td>
<td>86</td>
<td>102</td>
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</tr>
<tr>
<td>Large-risk-focused</td>
<td>105</td>
<td>117</td>
<td>107</td>
</tr>
</tbody>
</table>

1Insurance carriers that are more focused on certain commercial lines of businesses. 2Insurance carriers offering a diversified set of commercial lines, including both standard and specialty lines, potentially across small to large commercial segments. 3Globally diversified players that provide insurance for large risks. 4For certain insurers, GWP is estimated using GWP/NWP (gross written premium/net written premium) or GWP/NEP (gross written premium/net earned premium) industry average ratios. 5Average net CoR for each category; excludes certain large-risk-focused insurers, given reporting available is only for gross CoR. 6Per annum. 7Commercial GWP and net CoR for certain players have been estimated for 2016 and 2017 because dedicated commercial business units were formed after 2017.

Source: A.M. Best; company annual reports; McKinsey analysis

McKinsey & Company
Nonetheless, all commercial carriers—including diversified and large-risk-focused commercial carriers—can act on four imperatives to compete on proposition rather than price.

**Be clear on where to compete**
Offering distinctive expertise, products, and services that are connected not only to risk transfer but also risk prevention and mitigation deepens carriers’ value proposition to clients. This allows commercial carriers to avoid competing on price alone and becoming commoditized capacity providers. More-specialized commercial carriers have been able to focus their investment to create these propositions, but even diversified and large-risk commercial carriers can prioritize their resources with a clear view of where they want to be distinctive (across specific lines and value chain steps).

**Focus on technical excellence to address inflation**
Commercial carriers will need to double down on technical excellence to manage rates effectively by keeping them ahead of loss cost trends in response to inflation. Pricing models and renewal underwriting will need to reflect a forward-looking view of inflation across various components (such as goods, wages, and social inflation), combined with strong underwriting risk discipline for softening lines. The most sophisticated commercial carriers leverage inflation scenario models to frequently rebalance their portfolio mix exposures across lines with larger and smaller gaps between the market price and technical price once accounting for inflation.

**Implement targeted distribution strategy**
Commercial carriers should develop a targeted distribution strategy across lines of business, regions, industry verticals, and client segments, depending on their own source of distinctiveness and the areas in which they develop underwriting excellence. For example, some commercial carriers can go directly to clients with a digital proposition in an area where they are clearly distinct; this is especially true for small and medium-size enterprises (SMEs) with more-standard risks. In other areas, commercial carriers may instead choose to underwrite more opportunistically or operate as a pure capacity provider alongside a lead insurer or through MGAs. Being targeted and transparent about their distribution strategy allows commercial carriers to avoid channel conflict, understand what it takes to be brokers’ preferred commercial carrier, and build strategic distribution relationships.

**Capture the underwriting portfolio decarbonization opportunity**
As commercial carriers think about their source of distinctiveness, they should reflect on how this relates to decarbonization targets. To build a proposition related to the decarbonization of the “real economy,” carriers could follow four steps: First, create transparency for underwriting portfolio–enabled emissions, which may require identifying and closing existing data gaps. Second, develop a forward-looking view on sector-level emission intensity and revenue implications to define individual underwriting portfolio decarbonization pathways, targeting a portfolio mix that reflects the growth opportunities in sectors that support the net-zero transition. Third, integrate the emissions perspective across business processes—especially underwriting, pricing, and portfolio management. Finally, act when the underwriting portfolio deviates from the defined decarbonization pathway (for example, by rebalancing the portfolio within and across sectors or by engaging clients).
The declining relevance of commercial lines is the most critical challenge that the insurance industry is facing today.
Expand relevance in the face of the structurally changing nature of risk

Commercial carriers have not always kept pace with structural changes in the nature of risk, which are accelerating more rapidly than ever. While premiums for commercial lines have been growing over the past three years at approximately 7 percent per year, rate hardening has driven most of this growth. After adjusting for rate growth, global premiums lagged significantly behind real global GDP growth during this same period, indicating a decline in the relevance of commercial lines (Exhibit 3).
This is the most critical challenge that the insurance industry is facing today. Commercial carriers must take action to expand their relevance by reducing protection gaps to fulfill the societal desire for resilience in a changing environment. Three trends in particular are driving increased protection gaps: the increasing frequency and severity of NatCat risks, the transition toward a net-zero economy, and the evolution of cyber risks. These demonstrate the most pressing coverage gaps for commercial carriers. In addition, evolving supply chains and the evolution of trade and commerce will affect lines such as marine and business interruption.

**NatCats.** Extreme weather events, sometimes very localized, have increased in frequency and severity, leading to ever-higher levels of loss and damages and affecting a growing number of geographies. Executives frequently use the phrase, “1-in-200 events are no longer 1-in-200,” and the facts support it. Since 2017, the United States has experienced an average of 15 NatCats per year with damages exceeding $1 billion—up from fewer than ten per year in the previous decade and fewer than six in the decade prior to 2007 (Exhibit 4)—due to the increased frequency and severity of NatCats. For the same reason, year-on-year NatCat prices went up in 2022. For example, Florida property catastrophe reinsurance rate-on-line increased by 25 percent in midyear 2022 renewals. Meanwhile, the global NatCat protection gap was estimated at $130 billion to $140 billion in 2021, with more than 60 percent of that concentrated in North America and Europe.¹³

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¹³ Reinsurance: A tipping point, Howden, September 14, 2022.

¹⁴ McKinsey analysis based on Swiss Reinsurance Company, excluding supply chain distribution and net-zero transition investment opportunities. Most of the gap is attributable to commercial lines.
Net-zero transition. According to our previous analysis, the transition to a net-zero economy could account for more than $800 billion in annual global capital expenditures in renewable energies and decarbonization technologies by 2030. These new technologies will create new forms of risk requiring protection, and the resulting insurance value pool could be worth up to $15 billion, concentrated in property as well as energy and construction specialty lines. However, the renewable energy line of business has not been particularly profitable for carriers in recent years, resulting in their reduced appetite to provide capacity. But as commercial carriers analyze past claims patterns and collect additional third-party data, they can innovate on insurance coverage and underwriting practices—and enable better risk-engineering practices to accompany clients on their way to net-zero emissions.

Cyber. Cyberthreats pose a significant accumulation risk—for example, when targeted at critical infrastructures, such as water or energy—with potential implications across the entire insurance and reinsurance portfolio. The occurrence is unpredictable, and the risk characteristic is constantly evolving. As a result, commercial carriers are struggling to properly quantify risk exposure and adjust terms and conditions, as well as wordings—also, to consequently win the conviction of reinsurance capacity. This is rapidly evolving, however, as new frameworks to define cyber catastrophes are emerging from multiple commercial carriers. For instance, 2023 saw the placement of the first
As widespread technological shifts have permeated nearly every aspect of work, especially with the rise of remote work environments, cyber risk has become ubiquitous. As a result, commercial carriers have recently enacted rate increases, reduced coverages, and added exclusions, such as on state-sponsored acts. Already, cyber economic losses in 2020 totaled $945 billion—a more than one hundred times the total premium market ($9 billion in 2021) indicating a massive protection gap. Even if only a fraction of these losses is insurable, it could translate to a more than $100 billion growth opportunity for the global commercial-insurance industry.

Commercial carriers can take four actions to expand their relevance by turning the evolving risk nature into new growth opportunities while closing protection gaps and helping individual clients and whole economies become more resilient.

**Upgrade and innovate on product and policy design for risk transfer solutions**

To provide coverage for net-zero transition risks—which are not sufficiently covered by existing insurance today—commercial carriers must build the capabilities to underwrite prototype-like risks, such as for decarbonization technologies, including carbon capture and energy storage. While initial insurance products exist, they are not widely available due to the lack of historical data when underwriting these risks for the first time. Commercial carriers can also support the adoption of carbon markets by offering alternative risk-transfer solutions, including coverages for buyers (for example, to insure a carbon offset becoming invalid) and sellers (for example, to cover nature-based loss from a pest infestation).

Parametric (or index-based) solutions—in which payouts are linked to defined and objective indexes or trigger points, such as flood levels or the strength of an earthquake—can improve the efficiency of NatCat coverages for both clients and commercial carriers. Risks become more transparent, while payouts are instantaneous and are less exposed to long litigations, reducing the tail of the risk.

Products can also be tailored to certain segments. For example, SMEs within a specific industry often face similar types of risks and share the desire to be protected against them but would prefer to take a more hands-off approach to their insurance coverages. Here, commercial carriers can

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18 Eugenia Lostri and Zhanna Malekos Smith, The hidden costs of cybercrime, McAfee, December 2020; most of the gap is attributable to commercial lines.
innovate by structuring product bundles across lines of business for traditional SME industries (for example bakeries and carpentries) as “tailor made” coverages to address their respective risk exposures while applying simplified wordings.

Adjust pricing to reflect the true cost of risk
Commercial carriers need to evolve their pricing models to be more nuanced in relation to changing risks and leverage more advanced modeling techniques and internal and external data. For example, the industry tends to react to individual weather events, which can make coverage unaffordable the following year. Pricing models should take a longer-term view of changing weather patterns with a through-cycle approach to risks. This shift requires that commercial carriers apply advanced modeling to catastrophic events to determine whether a one-off weather event is a true anomaly or indicative of an emerging pattern.

Data and advanced analytics will be critical for commercial carriers to overcome the challenge of limited loss data history, especially for emerging risks. Commercial carriers may need to partner with asset owners or other third parties, for example, to gain access to data and knowledge of new trends. In the short term, commercial carriers can leverage the underwriting expertise of the most advanced MGAs while they build out their own talent and capabilities over the long term.

Invest in risk prevention and mitigation services
Commercial carriers must expand their offerings beyond risk transfer to services that mitigate or prevent risks. For example, in cyber, the most engaged commercial carriers help clients reduce cyberthreats and improve risk selection by providing threat intelligence, data center diversification, consulting, and employee training. Many commercial carriers also partner with cybersecurity firms to offer end-point protection or multifactor authentication. Insurtechs, in particular, can leverage this opportunity to offer cyber protection products as a “vaccine” against risks—in other words, the more that individual companies protect against cyber risks, the lower the risk exposure for the industry as a whole. For example, commercial carriers can encourage customers to include cyber-monitoring services as part of their policy by offering premium discounts for preventative cyber risk actions. This will require commercial carriers to maneuver within the ecosystem of pre- and post-breach service providers.

Similar mitigation and prevention solutions can help clients become more resilient to NatCat risks. For example, leading commercial carriers have been working with governments and regulators to ensure that building codes are fit for purpose and adequately address local catastrophe risks. In addition, commercial carriers can help manage clients’ exposure by providing extreme weather warnings (such as for floods or hail) or by advising large fleet owners (such as marine and aviation clients) to relocate their fleets based on upcoming extreme weather events. Commercial carriers can also leverage their expertise to help clients develop supply chain resilience or navigate the jungle of environmental, social, and governance (ESG) and enterprise risk management (ERM) frameworks, as well as supplier certificates.

Educate stakeholders, and raise awareness of risks
In many cases, clients are not fully aware of the severity of risks or the availability of coverages. For example, a McKinsey survey of more than 400 SMEs without cyber insurance coverage found that 80 percent were either unaware of available insurance products or unaware of their exposure to cyber risks in the first place. However, a McAfee survey suggests that two-thirds of companies reported some kind of cyberincident in 2019. As part of the solution for cyber and beyond, carriers can proactively engage clients, distributors, regulators, and governments to educate stakeholders and support their risk prevention and mitigation efforts to increase institutional resilience with a proactive approach toward risks.

21 “New McAfee report estimates global cybercrime losses to exceed $1 trillion,” McAfee, December 7, 2020.
Commercial carriers need to evolve their pricing models to be more nuanced in relation to changing risks and leverage more advanced modeling techniques and internal and external data.
3

Access capacity through alternative capital and public–private partnerships to compete in a tight capital cycle

Closing even a portion of the protection gaps highlighted above would require hundreds of billions of dollars of capital. At the same time, dedicated reinsurance balance sheet capital dropped by 16 percent in 2022; reinsurance renewals have been one of the hardest in January 2023, especially for NatCat coverage; and reinsurers have announced plans to tighten

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22 Based on a current premium-to-surplus ratio of about 100 percent (including reinsurance).
23 The great realignment, January 1, 2023.
capacity even further. These developments are driven by increasing NatCat activity since 2017 (which was mainly absorbed by reinsurers), decades-high inflation requiring higher limits, mark-to-market losses of financial instruments (devaluation on books due to higher interest rates), and the strengthening of the dollar (for non-US commercial carriers because capital is mainly traded in dollars). As a result, the commercial industry’s premium-to-surplus ratio has surpassed its ten-year average. This combination of increasing demand and decreasing supply of reinsurance capital needs to be solved in the current cycle.

The alternative capital market—including insurance-linked securities (ILS), collateralized reinsurance, and sidecars—followed a similar arc to reinsurance capacity in the current cycle. For example, the public ILS market has underperformed since 2018 because nearly 85 percent of it is tied to catastrophe Cat bonds. Investors suffered the brunt of losses linked to the increased frequency of NatCat events. Furthermore, for bonds without parametric payout triggers, investors have been discouraged by cedents trapping capital, which increases the duration of the risk exposure. As a result, public ILS Cat bond issuance fell by 81 percent in the third quarter of 2022 to the lowest third-quarter level in the last decade.

It appears the industry has tried to address some of these investor frustrations. Already in 2022 renewals—but even more predominately in 2023—terms and conditions tightened and prices went up, in line and driven by the increased attachment points for reinsurance. This supported the performance of the 2022 public ILS market, in which even the impact of Hurricane Ian was mitigated—a major event for the industry. However, this is because public ILS bonds tend to focus on higher risk tranches. Other forms of reinsurance capital have seen worse performance because they are in lower tranches, closer to the risk itself. They are likely to see continued rate correction.

Some commercial carriers are successfully raising additional capital already. Nevertheless, to accelerate and make significant headway in closing protection gaps, alternative sources of capital will be critical.

**Innovate on the use of alternative capital and prove long-term profitability**

Despite recent headwinds, alternative capital markets and private investors continue to be an important source of capital for both reinsurers and primary commercial carriers. As commercial carriers themselves hit risk and capacity limits and traditional reinsurance capital is constrained,
alternative capital is especially relevant in the current cycle.

Although alternative reinsurance capital grew to account for 15 percent of the total reinsurance capital allocation in 2021—up from 6 percent in 2011—28 it remains a largely untapped pool of capital, with alternative reinsurance capital representing less than 1 percent of the global alternative assets under management (AUM).29 Especially in recent years, total alternative AUM grew by 12 percent per year between 2018 and 2021 while total alternative reinsurance capital stayed flat. This represents an opportunity to increase the allocation toward alternative reinsurance capital by demonstrating its value in an alternative portfolio (Exhibit 5).

Exhibit 5

Total alternative asset-under-management (AUM) growth has significantly outpaced alternative reinsurance capital since 2018.

Global alternative markets AUM, 1 $ billions

<table>
<thead>
<tr>
<th>Year</th>
<th>AUM</th>
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<td>2019</td>
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<td>2020</td>
<td>94</td>
</tr>
<tr>
<td>2021</td>
<td>97</td>
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Alternative reinsurance capital, 2 $ billions

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<th>Capital</th>
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<td>19,000</td>
</tr>
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<td>2021</td>
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</table>

Share of total reinsurance capital, 3 %

<table>
<thead>
<tr>
<th>Year</th>
<th>Share</th>
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<td>2020</td>
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</tr>
<tr>
<td>2021</td>
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</tbody>
</table>

1 Assets under management. Includes commodity funds, hedge funds, infrastructure funds, real estate funds, structured product, private debt funds, and private equity funds.
2 Includes collateralized reinsurance, insurance-linked securities (ILS), industry loss warranties, ILS catastrophe bonds, and sidecars; private market is excluded given limited transparency; 2021 value based on the first half of 2021.
3 Source: ILS annual report 2021; alternative capital: Continuing growth momentum, Aon, 2021; McKinsey Performance Lens Global Growth Cube database

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To capitalize on this opportunity, however, and to win back investors on a broader scale, commercial carriers need to prove their ability to price and model catastrophe events and to deliver consistent returns above cost of capital over the long term. Therefore, reinsurers and primary commercial carriers should actively engage alternative capital markets and can appeal to investors by focusing on three themes.

**Tailor proposition to different types of investor appetite.** To cater to the risk appetites of different private investors, commercial carriers can consider pooling risks across multiple lines to diversify and tailor the overall risk profile of funds. This is a departure from the current model, in which risk transfer is focused on NatCat coverages, leading to a higher risk concentration. Other mechanisms to attract a broader range of investors include the use of parametric triggered payouts, which can reduce the duration or tail of the risk exposure for investors and thereby address one of their major concerns. Additionally, parametric trigger points objectivize the loss payout and facilitate accurate modeling. Furthermore, alternative capital, especially when linked to NatCats, can contribute to investors’ broader ESG agendas, given that tranches can be structured to align with specific ESG themes.

**Rethink alternative capital products.** The complexity of alternative capital vehicles may discourage some potential investors. To attract these investors, commercial carriers can innovate by simplifying alternative capital products through the standardization of structures and contract language to evolve alternative capital into a more widely suitable product. In addition, to regain investors’ confidence, commercial carriers need to improve their modeling of catastrophe events, particularly by embedding climate change factors. Last, primary commercial-lines carriers can increase their participation in the alternative capital market by issuing bonds directly rather than relying on reinsurers or third-party providers.

**Venture into new markets.** Closing the protection gaps in markets beyond the core NatCat market requires commercial carriers to increase their capacity. However, investors are still cautious about the limited historical data, untested models, and high volatility associated with cyber risks. Commercial carriers must therefore improve their ability to price and model the impact of catastrophic events. Recent developments that enable carriers to monitor exposures in their cyber portfolio are a sign that the industry is improving its transparency. Thus, we have seen progress (albeit still small) in ILS being deployed to cyber—such as the first launch of a cyber Cat bond.

**Reestablish public–private partnerships**

In addition to the ILS markets, commercial carriers can leverage public–private partnerships to access capacity for risks that the private sector cannot absorb alone. While such partnerships are well established, commercial carriers can significantly expand their use of them to close the protection gaps associated with systemic or societal risks—for instance, those related to critical infrastructure.

Recent examples suggest that public institutions are ready to embrace such partnerships: the Swiss Influenza Pandemic Plan is in place to address commercial risks stemming from company-wide lockdowns, and the US government is currently considering a public–private partnership to address growing cyber risks. Even on a global scale, governments are willing to take on some of the risks: multiple nations agreed at COP27 to establish a loss and damage fund, an arrangement in which wealthier countries pay out to poorer countries when they are hit by climate-related disasters.

However, as commercial carriers shape their partnerships with public institutions, it is key to agree on which risks should be borne by corporations or by commercial-lines carriers in private markets, which should be pooled across the industry, and which should be borne by the public sector.

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30 Swiss Influenza Pandemic Plan, Swiss Federal Department of Finance, 2018.
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Successful underwriting requires a comprehensive set of quantitative capabilities and qualitative skills.
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Build the capabilities and talent to manage the shift from art to science

Many commercial carriers are investing heavily in advanced analytics, workbenches, and external data sources to help put data at the fingertips of underwriters and claims handlers to address the changing nature of risks. To keep up with the speed of change, commercial carriers must attract and retain the necessary talent, as well as develop the capabilities of experienced employees. This will necessitate a cultural shift because many underwriters and claims handlers still prefer to rely solely on their extensive experience rather than data-driven approaches and advanced technologies.

At the same time, commercial carriers must contend with the aging of the experienced workforce as the baby boomer generation reaches retirement age. For example, in 2020–21, roughly one in four employees of carriers in the United States was 54 years or older; and one in four

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in the United Kingdom was 50 years or older.\textsuperscript{34} An average effective labor market exit age is between 64 and 65.\textsuperscript{35} This means that 25 percent of commercial carriers’ workforce will retire in the next ten years. Meanwhile, the lack of in-office interactions in the aftermath of the COVID-19 pandemic has limited the space for knowledge sharing, and a tight labor market threatens commercial carriers’ ability to attract and retain the talent they need. Indeed, the demand for expert underwriters, claims handlers, and data and analytics talent is fast outpacing supply. MGAs, insurtechs, and other industries (such as consumer and tech) are all competing for a limited pool of talent—and commercial carriers are not consistently the top employer of choice.

Leverage the commercial-lines business model to build a unique talent value proposition

Commercial carriers can attract the necessary talent by refining their employee value proposition. Given their often global and cross-industry underwriting portfolios, commercial carriers can emphasize their ability to offer a unique opportunity to gain exposure to a diverse set of roles, industries, geographies, and functional areas by allowing for cross-functional career paths. This is especially relevant as commercial carriers are shifting toward cross-functional teams (including claims, risk engineering, sales, and portfolio managers) to address the evolving risk landscape. Commercial carriers also need to expand their talent pools beyond the insurance industry to target nontraditional profiles, such as those with deep technology expertise or a cyberscience background.

With the move toward more analytics-driven, semiautonomous underwriting, commercial carriers can further empower underwriters to shift from pure risk underwriting toward data-driven portfolio management. Doing so will require strong change management and capability-building initiatives—such as the codification of knowledge, mentorship and coaching from senior underwriters, and skills training on new tools and capabilities.

As insurance companies seek to modernize their underwriting function, they must carefully balance the productive tensions between art and science, automation, and judgment-based experience, as well as autonomy and workflow-based approaches. Successful underwriting has evolved beyond risk selection and pricing; it requires a comprehensive set of quantitative capabilities and qualitative skills across coverage lines and technologies.

Commercial P&C carriers are at a crossroads. Persistent challenges lie ahead, including high inflation, rate volatility, the net-zero transition, the changing nature of risks, tightening capacity, and a shrinking labor market. Yet there is significant opportunity open to those who can carve out a distinctive value proposition for their clients, investors, and talent and innovate risk transfer and prevention solutions to stay ahead of the evolving risk landscape.

By taking bold and decisive action, commercial carriers can expand their relevance and advance their purpose to create a safer and more resilient society.

\textsuperscript{34} “Fact base 2022,” London Market Group, 2022.
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