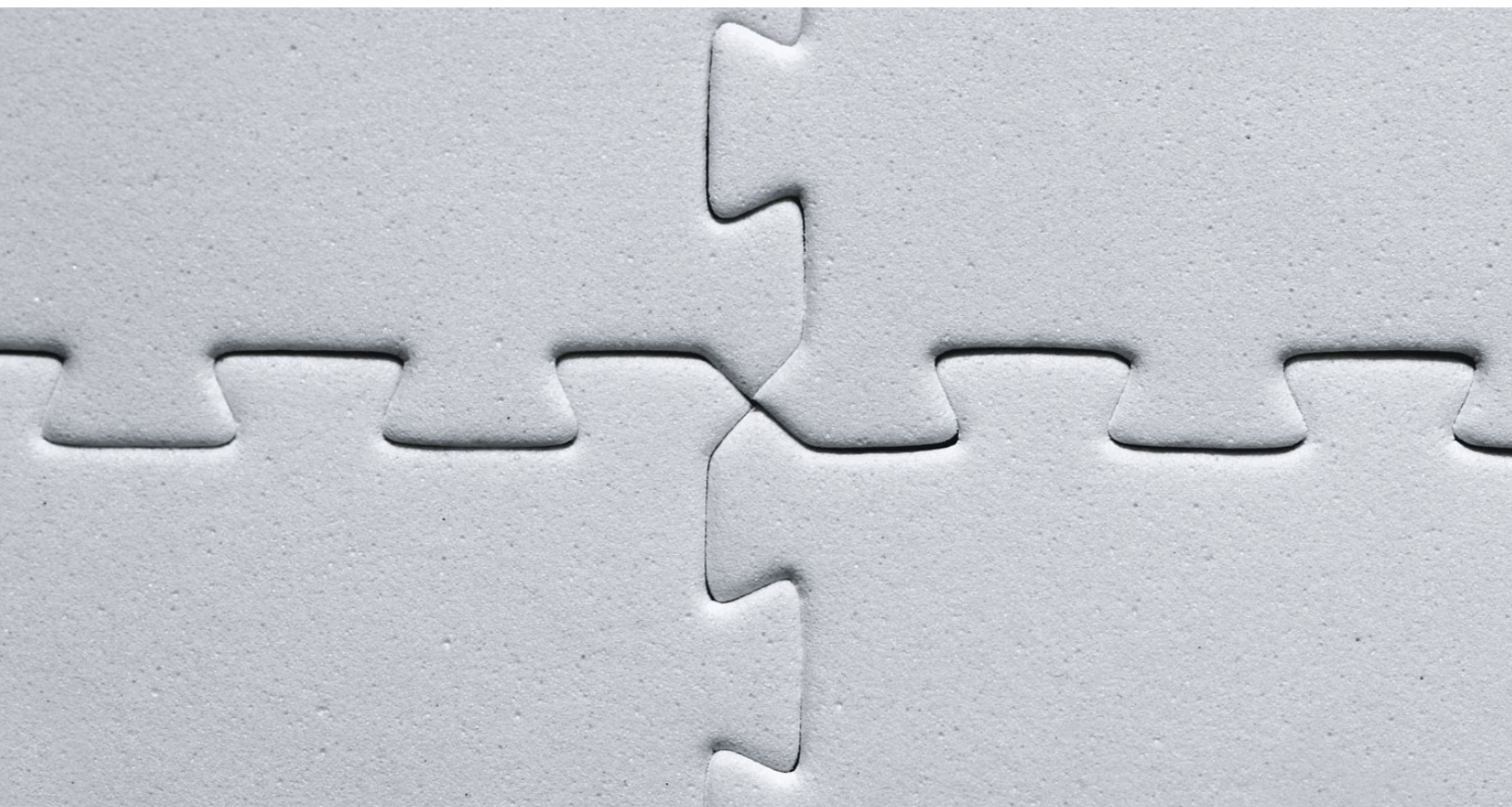


Insurance and Private Equity Practices

# The insurance trends private-equity investors should understand in 2021

The uncertainty that plagued the industry in 2020 is clearing. Here's where performance is trending—and how private-equity investors can double down.

*by Ramnath Balasubramanian, Grier Tumas Dienstag, Katka Smolarova, and Ruxandra Tentis*



**As the contours** of a postpandemic economy begin to take shape, the implications for private-equity (PE) investors in the insurance sector are also coming into focus. When we last published our perspective on this space, in November 2020, insurance-industry M&A activity was on the rise, insurtech IPOs and special-purpose acquisition companies (SPACs) were taking off, and uncertainty around the timing of COVID-19 vaccines and the “next normal” loomed large.<sup>1</sup> Today, many players in US and European markets are applying insights from their 2020 performance to emerge stronger amid increased consolidation, digitization, and specialization, as well as persistently low interest rates.

These trends also light the way for PE investors, who continue to look for ways to deploy large amounts of capital—leading to what some in the industry see as outsize valuations, especially in public markets. While PE’s total insurance investment was lower in 2020 than in 2019, it remained above 2017 levels, primarily driven by distribution and balance-sheet transactions.<sup>2</sup> Insurance accounts for more than half of all PE deals in financial services. This is partially driven by an increased appetite for balance-sheet investments, which investors view as a significant source of permanent capital, as well as by continued opportunities for value creation in an industry that

has historically been slower to adopt new business models. In this article, we offer an update on the industry’s outlook and highlight several areas for investors to consider as they search for value in insurance services, distribution, technology, and balance-sheet plays.

### **Insurance investment priorities in 2021**

The uncertainty of 2020 caused industry-wide disruption. The SNL US Life Insurance Index closed the year more than 20 percent below the S&P 500 Index, and property and casualty (P&C) insurers, while slightly higher on a year-over-year basis, also closed significantly below the S&P 500. But the first half of 2021 showed notable improvement (Exhibit 1). Insurance stocks recovered, with life insurers and software providers leading the way. And while pre-IPO and pre-SPAC insurtech valuations remained high, publicly traded insurtech companies were a notable outlier in the first half of 2021, as investors reevaluated their appetite in this space because of increased concerns about long-term profitability.

Several tailwinds—consolidation, digitization, and specialization—will play a key role in informing investors’ decisions and value-creation priorities in a postpandemic environment. Persistent low interest rates can also create a tailwind for investors

---

<sup>1</sup> Ramnath Balasubramanian, Matthew Scally, Ruxandra Tentis, and Grier Tumas Dienstag, “Creating value in US insurance investing,” November 10, 2020, McKinsey.com.

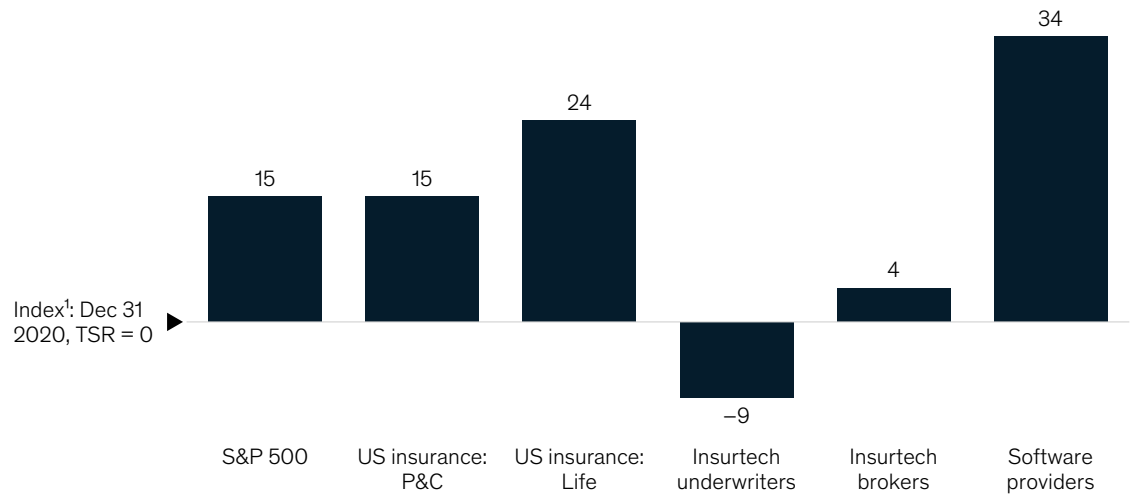
<sup>2</sup> McKinsey analysis of Pitchbook and Preqin 2020 insurance transactions.

**Several tailwinds—consolidation, digitization, and specialization—will play a key role in informing investors’ decisions and value-creation priorities in a postpandemic environment.**

Exhibit 1

## In the first half of 2021, total shareholder returns for US insurance businesses trended upward.

Total shareholder returns (TSR), Jan 1–June 30, 2021, %



<sup>1</sup>Market-cap-weighted index includes underwriters Lemonade, Metromile, and Root; brokers Goosehead and SelectQuote; and software providers CorVel, Crawford, Duck Creek, Ebix, Guidewire, and Sapiens.  
Source: S&P Global Market Intelligence

when existing balance-sheet asset owners look to offload risks.

### Consolidation shifts focus to less trodden paths of opportunity and continued need for value creation

Despite vigorous deal making among brokerage and claims services and third-party administrators, these industry segments remain fragmented. In personal P&C, for example, new independent agencies have emerged nearly as quickly as existing ones have merged. While the number of agencies declined an estimated 20 percent from 1996 to 2006 because of agency roll-ups, the decline was less than 5 percent over the following decade.<sup>3</sup> Two major factors are propelling agents to open their own independent agencies: the 68 percent increase in M&A activity over the past five years<sup>4</sup> has led an

increasing number of unsatisfied individual agents in M&A situations to strike out on their own. And in personal lines, insurers have decreased their use of agents who sell their products exclusively in favor of independent agents who sell multiple brands.

This activity has attracted the attention of investors, who have invested heavily in distribution compared with services, technology, and balance-sheet transactions (Exhibit 2). We expect acquisitions to continue as both distribution and services players benefit from scale.<sup>5</sup> Larger distributors can negotiate higher compensation as a percentage of premium than smaller agencies can, and larger services players can provide a wider breadth of offerings to clients, from servicing more lines to covering more steps in the claims value chain. Indeed, small insurers tend to consolidate

<sup>3</sup> 2018 agency universe study, Independent Insurance Agents & Brokers of America (IIABA), 2018, independentagent.com.

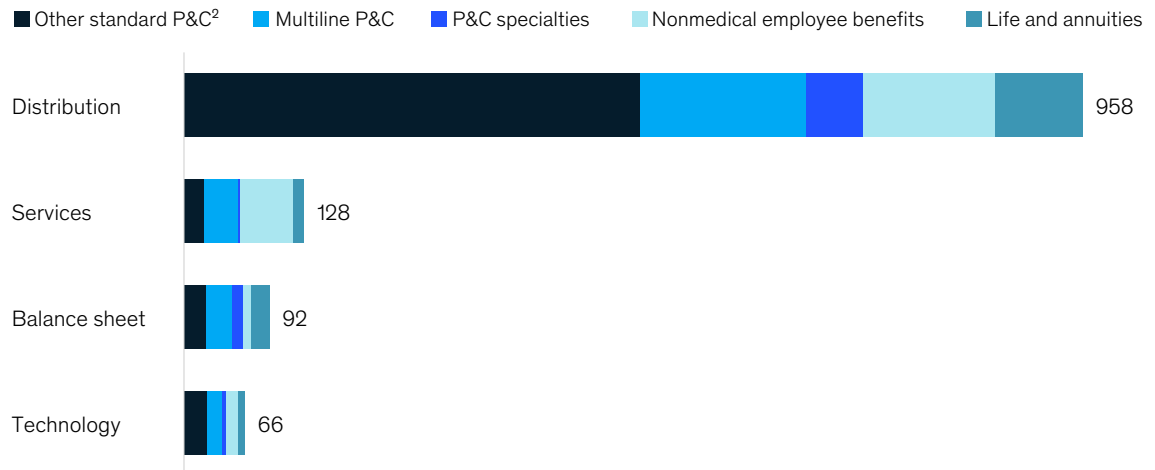
<sup>4</sup> Daniel Menzer, *Agent & broker 2020 year-end merger & acquisition report*, Optis Partners, January 2021, optisins.com.

<sup>5</sup> For more on how insurance players can fully harness the benefits of scale, see Nagendra Bommadevara, Björn Münstermann, Sanaya Nagpal, and Ulrike Vogelgesang, "Scale matters ... to an extent: Playing the scale game in insurance," March 2, 2021, McKinsey.com.

## Exhibit 2

### Distribution has been a core investment across lines since 2016.

#### Number of private-equity deals in insurance by area of investment, 2016–20<sup>1</sup>



<sup>1</sup>Excludes health insurance; includes select deals not classified under Insurance by Pitchbook.

<sup>2</sup>Property and casualty.

Source: Pitchbook; Preqin for technology deals; McKinsey analysis

outsourcing into just a few players that can handle most of their needs, while large insurers tend to stitch together “best-in-breed” claims solutions. Together, these tendencies will continue to influence the growth of claims agencies that develop capabilities across lines, geographies, and elements of the claims value chain.

Given higher multiples, investors entering the insurance brokerage space are targeting what have been traditionally considered adjacent or riskier asset classes, such as nonstandard auto agencies or MGAs focused on cyber insurance. In 2020, around 70 percent of acquired brokerages had standard P&C lines, according to McKinsey analysis of Capital IQ transaction data. Going forward, investors can look to riskier, specialized niches and models to find platforms for growth. Investors also have to consider the acquisition pipeline and diversification challenges of specialized brokerage targets. Given that niche areas naturally offer fewer opportunities for M&A, operational levers—such as commission optimization, targeted geographic

expansion, and cross-selling—are more important to achieving organic growth.

The same principles for targeting adjacent and riskier spaces hold true for claims businesses. One claims-services provider, for example, has made more than a dozen acquisitions to deepen its expertise in one service adjacent to claims services, while also broadening its geographical reach and covered insurance lines to round out its portfolio. This approach has elevated the prominence and value of services providers because large customers appreciate their depth in specific services and small to midsize customers turn to them to consolidate outsourcing.

#### Accelerated digitization encourages investments

The capital markets are increasingly rewarding intermediaries and insurers that use technology to create value, often by augmenting their internal IT capabilities through third-party vendors. IT or data-and-analytics vendors can support insurers on a specific part of the process or value chain,

from underwriting increasingly granular packets of risk (including liabilities previously aggregated with larger segments or seen as unfavorable) to gathering data and adjudicating claims without a human adjuster. Traditional brokers also seek out tech to support their growth and maximize agent time spent on value-added activities. For example, they are increasingly leveraging customer relationship management in conjunction with intelligent lead matching or dashboards and streamlining the digital experience for agents in small commercial lines. In our experience, this can lead to a reduction of up to five hours a week in the work required for submissions, freeing up valuable time for agents.

Adding to the fray are the increasing numbers of digital-native distributors that build their own technology. These distributors use their homegrown tech as a point of differentiation and a faster route to online channels in some lines. Because they often struggle to manage costs—for customer acquisition, for example—digital distributors are also adding products and acquiring balance-sheet capabilities to expand their presence along the value chain. Once a digital-native distributor gains traction with a specific customer segment—business owners who want pay-as-you-go workers' compensation, for example, or millennial renters—it can offer additional products. However, even the most mature distributors that have gone public have yet to prove this strategy leads to long-term profitability—their loss ratios hover above 100 percent compared with a more typical ratio of approximately 70 percent for established insurers.

Likewise, the increasingly granular segmentation and data usage enabled by technology providers will continue to gain traction in the marketplace. Both digital-native and traditional insurers are becoming more adept at identifying niche customer segments and using data and analytics to serve them well. Instead of attempting to sell homeowner's insurance to everyone, for instance, distributors and insurers are using data and technology to analyze specific

cohorts—such as coastal homes in specific zip codes—to better understand properties, market directly to homeowners, and underwrite risk. This model enables rapid growth from homes that less tech-advanced insurers might charge higher rates, serve at a higher combined ratio, or decline to serve at all.

### **Specialty insurance opens new doors**

Specialty insurance, which covers unique risks or special circumstances, and reinsurance have continued to attract investor interest in the face of ongoing market hardening.

On the carrier side, multiple de novo and scale-up platforms raised a total of more than \$8 billion during 2020 to bolster their balance sheets and take advantage of the hardening.<sup>6</sup> However, in the past decade, growth of alternative capital has increased supply in the specialty market, making the class of 2020 different from prior classes in several ways:

- A sole focus on reinsurance has become more difficult for start-ups given a global oversupply of capital; almost all de novo carriers are building new businesses in both primary and reinsurance.
- With growing availability of technology and data sources, insurers are looking to differentiate beyond capacity to take on insurance risk. Some are deploying capital more efficiently to boost ROE, while others are using digital and analytics to innovate underwriting, even partnering with leading tech companies that are newer to insurance.
- While London and Bermuda remain the main incubation locations for start-up carriers, competition in the specialty market has gone global; for example, 17 of the top 20 Lloyd's syndicates now belong to a global insurance group.<sup>7</sup> As a result, new and growing insurers are increasingly looking for partners with global reach and expertise beyond capital.

<sup>6</sup> "Will new capital be the difference between a hardening and hard market in 2021?," *The Insurer*, February 2, 2021, theinsurer.com.

<sup>7</sup> "Top 20 Lloyd's syndicates in 2020," *Atlas Magazine*, May 17, 2021, atlas-mag.net.



On the distribution side, major mergers increase market consolidation in the long term, but they have also provided an opportunity for smaller brokers to retain key talents and assets during the transition. As a result, the competitive landscape for specialty brokers is becoming more dynamic and fragmented, with a strong tier of up-and-coming brokers likely to pursue aggressive growth in the next few years, particularly in London. Recent major transactions highlighted investors' continued interest in the distribution space. In addition, the number of managing general agents (MGAs) and the players that support them, such as fronting carriers, continues to grow. Those with scale and sophisticated capabilities in operations and analytics look for opportunities to "go upstream" and attract capital to co-invest in balance-sheet risk-taking—for instance, by setting up their own Lloyd's syndicate. In the long run, this new model of pairing distributors' data-and-analytics insights with high-quality alternative capital could disrupt a significant portion of the specialty market focused on lower-premium, higher-volume products.

While investing in specialty carriers and brokers in the hard market has become a proven model for value creation, investors can now also look beyond that for two new types of opportunities. First, data and insights are playing a more important role in underwriting specialty insurance and reinsurance. Investing in data and service vendors focused on complex emerging perils—including cyber, political, renewable, and environmental—could unlock new sources of value. Second, new business models that match capital more efficiently with risks—including exchanges, MGA platforms, and syndicated structures—will continue to gain traction in the market in the long term.

#### **Capture-divestiture moves amid prolonged low interest rates**

With recent moves to take insurers private, sophisticated PE investors are buying blocks of

policies and assuming those risks—and billions in assets often come with that risk. In the United States in 2020, entities affiliated with general partners (GPs) acquired more than \$100 billion in general account liabilities from traditional insurers' balance sheets.<sup>8</sup> If the current low-interest-rate environment persists, growing pressure could make acquisition candidates of another \$2 trillion in liabilities, further accelerating growth in GP insurance capital.

As insurers are under pressure to divest assets and liabilities that were underwritten at much higher rates, GPs have both the investment capabilities to manage the assets and the culture and skills to build the operational capabilities to handle the policies.<sup>9</sup> Specifically, investors that combine operating capabilities with skill in managing investments and maximizing returns have a clear value proposition, making management teams more comfortable in taking over their blocks and customers.

Meanwhile, PE investors see significant value in long-term capital with a life cycle beyond that of a typical fund, reducing the fundraising burden on GPs and increasing through-cycle investment flexibility. Purchasing divested blocks also provides income diversification and a predictable, captive stream of fee income. For example, after a long track record in insurance vehicles, one investment management firm reported that nearly half of its assets under management were in insurance, amounting to half of all management fees earned.

### **How PE investors can make the most of these trends**

Structural changes in the US insurance industry—such as heightened risk for directors and officers and ongoing risks related to the pandemic and climate change—will continue into the foreseeable future. Savvy investors playing the long game in insurance can seek pockets of opportunity among

<sup>8</sup> Steve Evans, "KKR's acquisition of Global Atlantic shows PE's attraction to float & sidecars," *Artemis*, August 12, 2020, [artemis.bm](https://artemis.bm); Romessa Nadeem, "Prudential PLC to sell 11% stake in US arm to Athene as part of reinsurance deal," *S&P Global Market Intelligence*, June 18, 2020, [spglobal.com](https://spglobal.com); Allison Bell, "Venerable agrees to reinsure \$12B Equitable Holdings annuity block," *ThinkAdvisor*, October 28, 2020, [thinkadvisor.com](https://thinkadvisor.com).

<sup>9</sup> For more on life insurers' options amid enduring low interest rates, see Ramnath Balasubramanian, Alexander D'Amico, Aditi Jain, Nick Milinkovich, and Karthi Purushothaman, "Maximizing the value of in-force insurance amid enduring low returns," April 20, 2020, [McKinsey.com](https://mckinsey.com).

these challenges by, for instance, investing in specialty insurers writing small-business cyber risk for which there is increased need, and partnering with ecosystem players using superior climate data to price risk at a granular level.

Consolidation will continue across sectors, but accessible targets that are both mature and profitable are becoming increasingly sparse. Many available nonpublic entities are either very small or very large, especially in the technology space, and PE investors face increasing competition from other forms of capital. According to McKinsey analysis of Dealroom data, planned or completed insurtech IPOs raised nearly \$2 billion in public capital in 2020 and the first quarter of 2021, exceeding prior years' activity.<sup>10</sup> SPAC deal momentum also increased the competition, with several multibillion-dollar announcements since the third quarter of 2020. Strategic investors (namely, insurance carriers and distribution players) are closing similarly sized deals in 2021, including the sale of annuity units to mutual insurers or other offshore insurers that are not subject to the disclosure requirements facing US publicly traded entities, as well as the purchase of multiple independent distribution networks and platforms. PE investors will need to become more creative in sourcing deals—for example, by creating earlier-stage and growth-equity funds, co-investing

with venture capitalists or insurers, taking public companies private, or aggregating smaller targets to achieve scale beyond classic broker and third-party administrator roll-ups.

Finally, implementing operational improvements continues to increase in importance relative to capturing structural differences in valuation multiples. While consolidation opportunities remain, in a competitive market a business-as-usual approach is increasingly insufficient to acquire attractive targets and achieve multiples arbitrage. Across sectors, investors need a differentiated value-creation thesis to succeed—for example, by vertically integrating, automating claims processes and services, improving agent productivity, and monetizing data-and-analytics use cases across the value chain.

---

While much lies ahead on the road to postpandemic normalization, some of last year's uncertainty has abated, and opportunities abound for the prepared investor. Those who take bold, targeted action in both M&A and value creation within their portfolio companies will lead the way as the industry marches through the Roaring 2020s.

---

<sup>10</sup> For more on trends in insurtech investments and partnerships, see *Insurance insights that matter*, "Insurtechs are increasingly ripe for insurer investments and partnerships," blog entry by Shitij Gupta, Varun John Jacob, and Shalija Raheja, July 16, 2021, McKinsey.com.

**Ramnath Balasubramanian** is a senior partner in McKinsey's New York office; **Grier Tumas Dienstag** and **Katka Smolarova** are associate partners in the Boston office, where **Ruxandra Tentis** is a partner.

The authors wish to thank Rajiv Dattani, Benjamin Niedner, Andrew Reich, Matthew Scally, and Josue Ulate Chinchilla, as well as the McKinsey Global Insurance Pools team, for their contributions to this article.

Copyright © 2021 McKinsey & Company. All rights reserved.

## Contact

To connect with someone on this topic, please contact:

### **Ramnath Balasubramanian**

Senior partner, New York

Ramnath\_Balasubramanian@McKinsey.com

### **Katka Smolarova**

Associate partner, Boston

Katka\_Smolarova@McKinsey.com

### **Grier Tumas Dienstag**

Associate partner, Boston

Grier\_Tumas\_Dienstag@McKinsey.com

### **Ruxandra Tentis**

Partner, Boston

Ruxandra\_Tentis@McKinsey.com

### **Matthew Scally**

Partner, New York

Matthew\_Scally@McKinsey.com

### **Leda Zaharieva**

Partner, London

Leda\_Zaharieva@McKinsey.com

## Further reading

Our recent articles include the following:



[Creating value in US insurance investing](#)



[McKinsey's Private Markets Annual Review](#)



[Building new digital businesses in insurance](#)



[Purpose for asset owners: Climbing a taller mountain](#)