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How financial institutions can help fill European retirement needs

Western Europe's nonpublic retirement market is growing rapidly. To capture the business opportunity, insurers and asset managers should take on three approaches.

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More than 40 years of declining mortality rates in Europe combined with an aging population means the European retirement system is providing for more people for more years. In fact, in 2050, about 40 percent of the population is expected to be over the age of 55, compared with about 33 percent today.[1] Moreover, the current deflationary market, exacerbated by the ongoing interventions to support the economy amid the COVID-19 pandemic, is propelling an increase in demand for investments with guaranteed returns and alternative solutions that provide liquidity and in-kind benefits.

Concurrently, changing European initiatives such as the Pan-European personal pension product (PEPP) have the potential to open markets for the cross-border distribution of pension products. Even so, specific local factors could make it challenging for insurers and European asset managers that offer retirement plans and products to expand their market shares into private retirement products. Uncertainty about local reforms to public pension systems and varied fiscal initiatives of countries could obstruct changes to a national retirement market.

The question is no longer whether new nonpublic retirement products are needed—development of these offerings is already underway. Rather, the focus is on how insurers and asset managers can tap into expanding value pools and provide retirement offerings and products across and within otherwise fragmented European markets. This will also be important as more nontraditional players enter the market with innovative products and value propositions, such as single- or multiple-product platforms for direct online distribution.

To secure the business opportunity, traditional retirement players should pursue innovative, flexible product offerings, improve digitization to cost-effectively reach and engage with a larger customer base, and achieve product integration into the broader ecosystem to boost sales via cross-selling.[2] Doing so will help them fill a gap in the European retirement market and compete with nontraditional players.

Nonpublic retirement market outlook

Even though COVID-19 may have affected paths to retirement reform, the shift from public to private pensions is already underway in Europe and likely to continue. Thus, private pension products are needed to fill in the retirement gap. (For background on the European retirement product landscape, see sidebar, “The current state of European retirement.”)

To help insurers and asset managers get a clearer picture of the current retirement landscape and where the most promising value pools are, we conducted an analysis of Western European retirement markets as of 2018 and projections through 2023, which include the

The current state of European retirement

The current retirement market encompasses a wide spectrum of solutions falling within either public, state-funded plans (pillar I) or nonpublic solutions, which can be sponsored by either employers or individuals (pillar II or III). Nonpublic retirement solutions include both pure retirement products and some life products dedicated to retirement purposes. Pillar II in particular includes open and closed pension funds with defined-benefit, defined-contribution, and hybrid funds as well as group life policies meant for retirement. Pillar III includes individual life solutions (life annuities, endowments, and unit-linked solutions) as well as individual retirement accounts.

[1] “Population (demography, migration, and projections),” Eurostat database, https://ec.europa.eu/eurostat/web/population-demography-migration-projections/population-projections-/database.
[2] Tanguy Catlin, Ulrike Deetjen, Johannes-Tobias Lorenz, Jahnavi Nandan, and Shirish Sharma, “Ecosystems and platforms: How insurers can turn vision into reality,” March 2020, McKinsey.com.

impact of COVID-19. The analysis showed that, in general, Western Europe represents a promising opportunity for retirement players, the United Kingdom and Germany in particular. The findings are based on an assessment of several factors, including current and projected replacement rates (how much the public pension system satisfies retirement needs), the current level of market development (penetration of retirement-dedicated savings) and expected room for further growth, and existing tax incentives for nonpublic retirement.

Combined, these elements provide the expected growth rates for the nonpublic retirement market and inform our evaluation of the opportunities at both the regional and country levels.

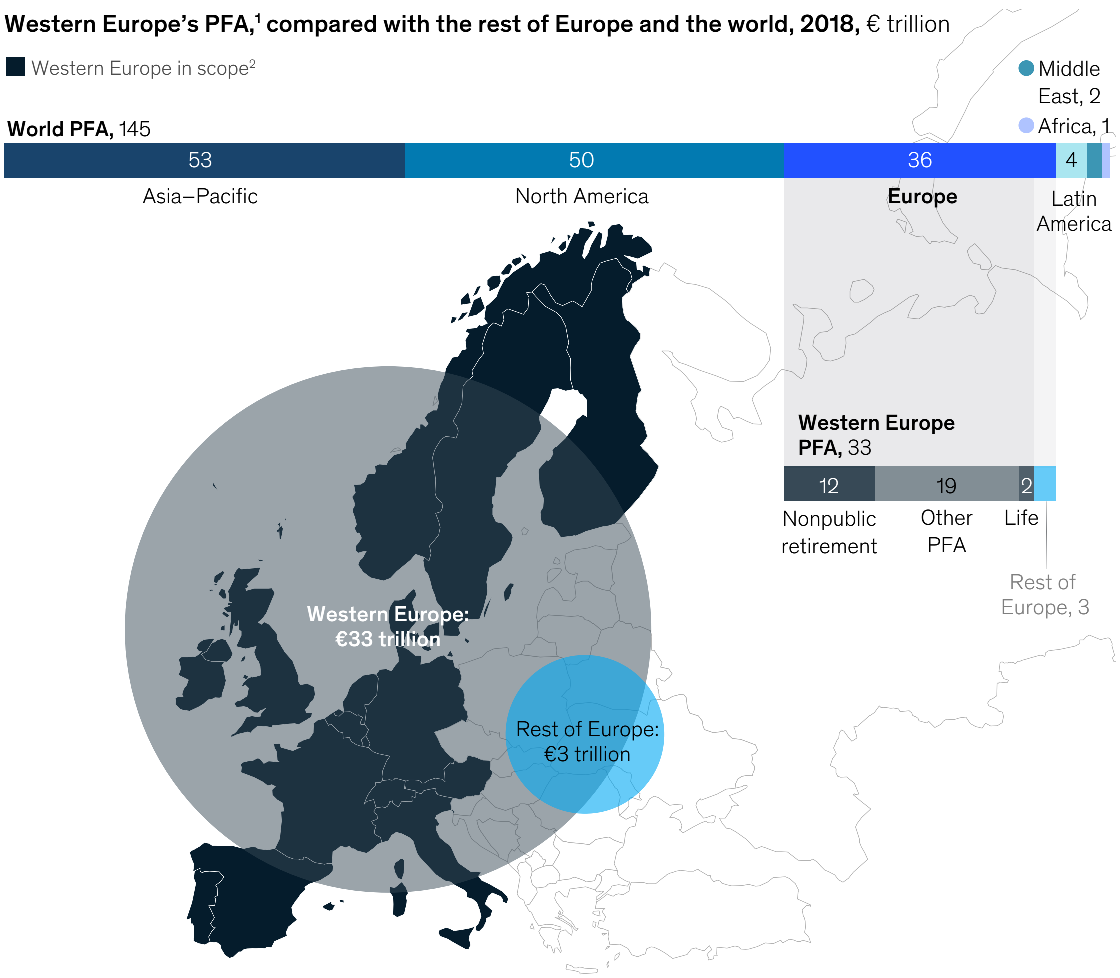
Western European market outlook

As of 2018, nonpublic retirement solutions for Western Europe represented 36 percent of total personal financial assets in the region, or about €12 trillion (Exhibit 1).

Exhibit 1

Western European nonpublic retirement markets amount to approximately 36 percent (€12 trillion) of total personal financial assets in the region.

Western Europe's PFA,[1] compared with the rest of Europe and the world, 2018, € trillion



Note: The boundaries and names shown on this map do not imply official endorsement or acceptance by McKinsey & Company; numbers may not sum to totals due to rounding.
[1] Personal financial assets; total includes cash, liquidity management, deposits (retail), investments (retail), insurance, and pension distribution (retail).
[2] The scope of the research focused on Western European countries, and the ones highlighted in the map are those considered in scope for that geographic grouping.
Source: McKinsey Global Banking Pools; McKinsey/United Nations (disputed boundaries), McKinsey analysis

Of that, 50 percent of retirement assets under management (AUM) were concentrated in pension funds, which includes defined-benefit, defined-contribution, and hybrid funds. The remaining 50 percent consisted of group life and individual life solutions (such as annuities, endowments, and unit-linked solutions) and retirement accounts. Importantly, retirement AUM in Western Europe are expected to have a compound annual growth rate (CAGR) of 3.6 percent by 2023. More specifically, defined-contribution and hybrid pension funds show the strongest growth potential, at a CAGR of over 5 percent, while individual life solutions and retirement accounts show the smallest, yet still healthy, growth projections, remaining at 2.5 percent (Exhibit 2).

Along the entire value chain—which includes asset management, insurance, and distribution—nonpublic retirement AUM generated about €73 billion in revenue in 2018. Currently, asset management takes the largest slice of the nonpublic retirement pie, capturing about 45 percent of the total revenue (Exhibit 3), followed by insurance, at about 32 percent, and distribution, seizing the remaining value. (Some insurers participate in both insurance and distribution value pools.)

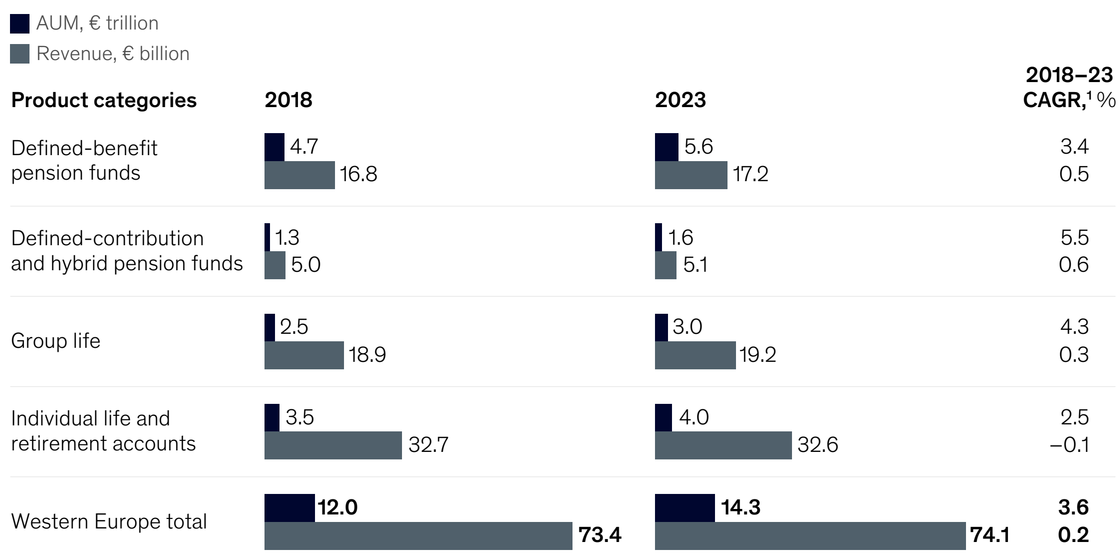
Across all product categories and geographies, margins are expected to decline. Multiple dynamics, such as the transition toward passively managed retirement savings, an increase in competition to acquire retirement assets, and a decrease in performance-based fees in a deflationary market, will contribute to the margin decline. However, revenue is expected to fully recover to 2018 levels by 2023, despite the decreasing margins, as citizens increasingly turn to private options. From 2020 to 2023, revenue growth is expected to accelerate, reaching a CAGR of about 3 percent.

Country outlook

Based on our analysis, some countries, such as the United Kingdom and Germany, present attractive

Exhibit 2

The Western European market is expected to grow to about €14 trillion in assets under management (AUM) by 2023, generating about €74 billion in total revenues.

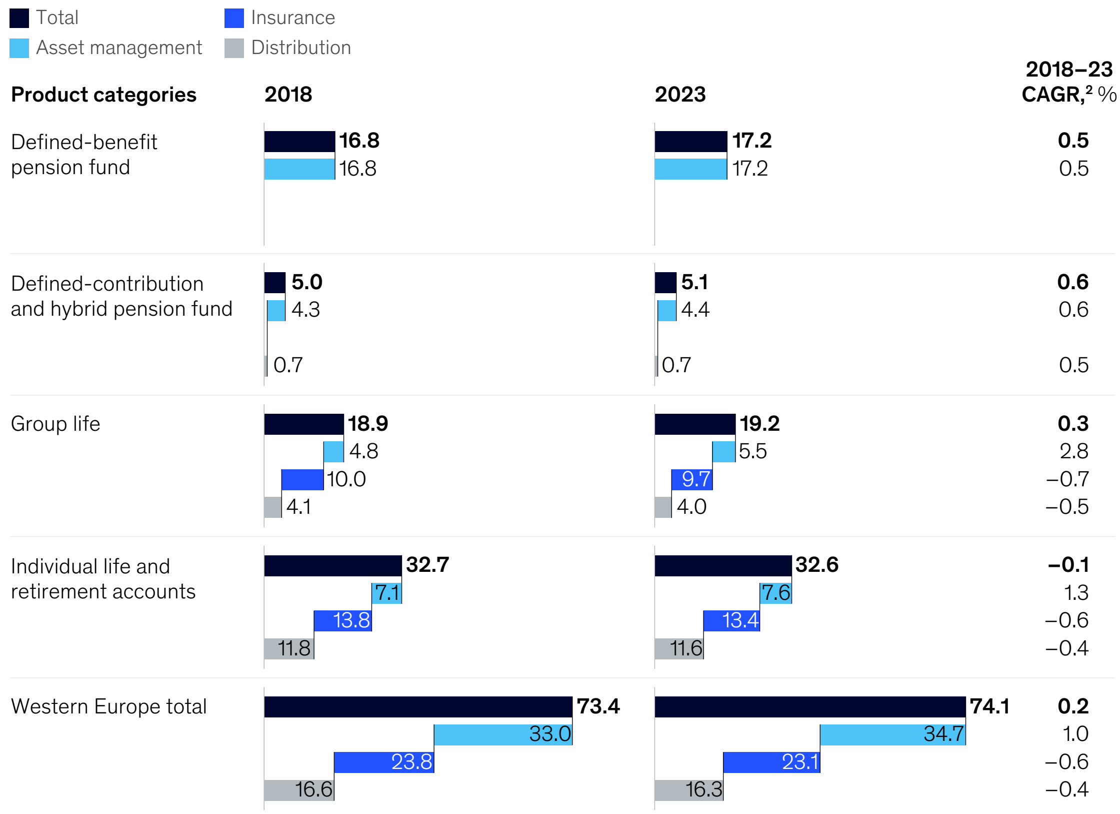


Note: Numbers may not sum to total due to rounding.
[1] Compound annual growth rate.
Source: McKinsey Global Insurance Pools; McKinsey Growth Cube

Exhibit 3

Asset management leads the Western European nonpublic retirement market.

Revenue pool allocations by overall product margins,[1] € billion (2018–23)



Note: Numbers may not sum to totals because of rounding.
[1] Revenue generated by integrated players are split according to relative asset management vs insurance vs distribution margins.
[2] Compound annual growth rate.
Source: McKinsey Global Insurance Pools; McKinsey Growth Cube; McKinsey analysis

prospects for nonpublic retirement. Indeed, the best outlook is for the United Kingdom, with a personal-financial-asset penetration ratio of about 50 percent, which is forecasted to increase significantly from 2018 to 2023, driven by a consistent increase in demand for all product categories. This increase in penetration will, in turn, lead to future revenue growth of almost 4 percent CAGR (Exhibit 4).

Germany also shows promise for asset managers and insurers, given its low retirement AUM penetration compared with, for instance, the Netherlands, and a strongly declining replacement rate.

Three imperatives to win in the European retirement market

The need for retirement solutions provided by the private sector will only increase. This boost will probably come with an enlarged customer base that consists of individuals in different phases of preretirement who have different needs, willingness to invest, and retirement goals. For retirement players to meet these varied

Exhibit 4

As of 2018, Western Europe has been particularly attractive for nonpublic retirement.

2018 nonpublic retirement market, by country

	United Kingdom	Netherlands	Germany	France	Switzerland	Italy
Market AUM,[1] € trillion	3.7	1.8	1.6	1.5	0.7	0.6
Tax incentives	Medium	Medium	Low	High	High	Medium
Personal-financial assets penetration,[2] %	50	70	30	40	20	20
Replacement rate,[3] %	86 Strongly declining	102 Stable	56 Strongly declining	76 Strongly declining	N/A	79 Declining
2020–23 revenue CAGR,[4] %	3.9	3.0	2.7	1.8	1.6	1.4
Market accessibility	High	Medium	Medium	Medium-low	Medium	Medium

[1] Assets under management.
[2] Retirement assets under management over total personal financial assets as of 2018.
[3] Ratio of pension income from mandatory or widespread schemes in the first year of retirement, divided by work income in the last year before retirement.
[4] Compound annual growth rate.
Source: Eurostat; McKinsey Growth Cube; McKinsey Global Insurance Pools; McKinsey Performance Lens

needs and customer types, they will need to pursue product innovation, improve digitization, and identify opportunities for cross-selling in the ecosystem. As they do so, however, players should be aware of specific local factors, such as fiscal incentives, which will inform what is feasible and what is not.

Pursue product innovation and flexibility

Whereas traditional product propositions have standardized setting options (such as an annual contribution amount) and predetermined investment strategies, including allocation development overtime, flexible product offerings give customers more freedom. Today, flexibility is a common trait when it comes to setting (defining the payment structure and retirement age) and payout options (annuity or lump sum). Tailor-made investment strategies and withdrawal flexibility are also important, with the latter being pivotal in the retirement-decumulation phase, when pension assets are converted to income.

Some retirement players are already advancing multiple solutions to offer flexibility and customized features. These range from recommendations for customized investment solutions with automatic portfolio adjustments to solutions with multiple setting and payout options and optional add-ons, such as a critical-illness premium waiver. Moreover, some players are moving toward solutions that allow subscribers to withdraw money for free, like a bank account. To guide decision making related to product flexibility, companies should decide who exactly they are targeting and then structure their product offerings with this audience in mind.

One German multinational embraced flexibility for its retirement product by offering flexible payment schemes. Customers could make either one-off payments or recurring monthly payments with no minimum payment amount and no long-term obligations. Payment plans were built using a preselected retirement age (there was a wide range to choose from) as a guide. In addition, the company provided three payout options—a lump sum, recurring income, or a combination of both. Customers could enjoy additional flexibility via the withdrawal of money at no expense. In the end, this flexibility allowed the company to serve a broader customer base, which enables growth—especially as demand for retirement products grows.

Improve digitization

While financial institutions have invested heavily in digital, retirement solutions often are still sold and serviced via nondigital channels. As the pandemic continues, however, insurers and asset managers must accelerate their digitization of processes and functions, as remote and digital channels will become part of the next normal.

Digitization provides retirement players with benefits on both the front end and back end of their organizations. On the front end, they can use flexible digital platforms, such as dashboards, to help keep customers up to date on their pension funds and activity. And direct-engagement channels can offer subscribers guidance about retirement investment solutions as well as facilitate the direct online sale of retirement products. These platforms provide an omnichannel customer experience, unleashing substantial growth opportunities. Digitization can also help sales forces provide better advisory services on complex products. Particularly, digital platforms and collaboration tools can improve client relationships by enabling agents to connect with clients at the moment they are in need. Solutions such as robo-adviser platforms can support the sales force by automatically generating proposals based on a client's specific needs.

On the back end, digitization via artificial intelligence and machine learning–based applications can help retirement players reduce clearance, administrative, and fraud costs. Other productivity and cost-efficiency improvements include using sophisticated technology to enhance decision-making promptness, improve risk selection, and predict customer behaviors. To enhance back-office functions, companies should identify any potential synergies with other business units as well as opportunities to automate and streamline existing processes.

To design a compelling end-to-end customer journey, organizations should identify the

Digitization provides retirement players with benefits on both the front end and back end of their organizations.

key milestones for retirement planning and decide how to use digitization to improve direct engagement and customer awareness. One German insurer digitized its front- and back-end processes, which made it easier for customers to access their information, make changes, and automate deposits. For instance, an online portal and dashboard allowed subscribers to see their account values in real time and even to check historical premium payments, make regular deposits, and update account details. Another multinational insurer created an online platform that allowed customers to engage more deeply with their retirement planning—for example, by using digital planning calculators and an online tool that let them see whether they were on track for retirement. A dedicated employer platform that serves as a go-between for the insurer or asset manager and the employer can help streamline processes, save time, and reduce costs.

Achieve cross-selling via ecosystems

Health, wealth, and retirement can become more closely linked and constitute a single ecosystem when an insurer identifies the roles it can fill and the partnerships it can leverage. Once part of an ecosystem, a player can also boost its cross-selling opportunities. To do so, however, insurers must find their positioning within the ecosystem through opportunities that include dedicated partnerships or acquisitions. For instance, a firm offering retirement savings products could partner with a senior-living provider to offer customers in-kind benefits instead of (or in combination with) a monthly retirement payout. Customers could save for retirement and then, upon retiring, receive a monthly income and access to senior-living housing.

One Chinese insurer was able to do just that: it offered a package of insurance products (including annuity, medical, and life) to high-net-worth individuals alongside the chance to live at a retirement home where they would receive healthcare and medical rehabilitation services.

Ecosystem development is also a business necessity for retirement players to cope with the unprecedented competition from digital providers.[3] The market provides several different opportunities, such as exploring adjacencies in financial services and developing partnerships with distributors; these approaches can provide advisory services a 360-degree view of customer needs. In practice, this means a customer could go to the same channel for investment and retirement advice. Many banks already include retirement, alongside wealth structuring and tax advisory services, as part of their comprehensive advisory offerings.

As the dynamics of the European retirement market continue to change, the need for insurers and asset managers to offer retirement products will only increase. Indeed, declining net pension replacement rates and an aging population are straining the public pension systems in all European countries. Retirement players must step up and provide the right products, services, and digital customer experiences to help European citizens assuage concerns that they will miss out on the retirement they have been planning for.

[3] Catlin, Deetjen, Lorenz, Nandan, and Sharma, "Ecosystems and platforms."

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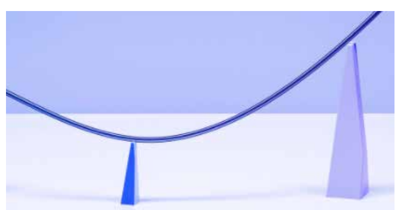

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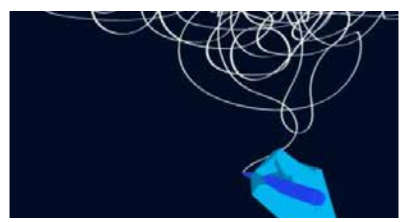

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