Property/Casualty Insurance Results: Nine-Months 2015

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Private U.S. property/casualty insurers' net income after taxes grew to $44.0 billion in the first nine months of 2015 from $37.8 billion in the first nine months of 2014. Insurers' overall profitability as measured by their annualized rate of return on average policyholders' surplus grew to 8.8 percent in nine-months 2015 from 7.6 percent in nine-months 2014, according to ISO, a Verisk Analytics (Nasdaq: VRSK) business, and the Property Casualty Insurers Association of America (PCI).[1]

Insurers' combined ratio[2] improved to 96.9 percent for nine-months 2015 from 97.7 percent for nine-months 2014, and their net underwriting gains[3] increased to $7.1 billion from $4.2 billion. Net written premium growth increased to 4.1 percent for nine-months 2015 from 4.0 percent for nine-months 2014.

Insurers' net investment income increased to $34.8 billion in the first nine months of 2015 from $34.5 billion a year earlier, and insurers' realized capital gains increased slightly to $8.9 billion from $8.8 billion, resulting in $43.7 billion in net investment gains[4] for nine-months 2015. The nine-months 2015 net investment gains were the highest since 2007, when they were $47.8 billion, and the second-highest since the beginning of ISO's quarterly records in 1986.

Net investment gains through nine months are the highest since 2007.

Improvements in underwriting results and elevated investment gains pushed insurers' annualized overall rate of return for nine-months 2015 to 8.8 percent from 7.6 percent for nine-months 2014. However, the nine-months 2015 rate is just 0.5 percentage points above the 30-year average annualized rate of return for nine-months results and 0.4 percentage points below the 9.2 percent annualized rate of return for first-half 2015.

Net income reached its highest nine-month level since the $49.6 billion recorded for nine-months 2007.

Despite insurers' $44.0 billion in net income after taxes in 2015, the industry's surplus[5] declined to $663.9 billion as of September 30, 2015, from $675.2 billion as of year-end 2014, mostly because of $26.0 billion in dividends to stockholders and $22.7 billion in unrealized capital losses.

Underwriting Results

The improvement in underwriting results is mainly due to the growth in earned premiums in excess of the growth in losses and loss adjustment expenses (LLAE). In nine-months 2015, earned premiums grew 3.9 percent to $376.8 billion, while LLAE rose just 2.7 percent to $260.0 billion, other underwriting expenses grew 4.3 percent to $108.4 billion, and policyholders' dividends rose 6.5 percent to $1.3 billion. As a result, net underwriting gains increased to $7.1 billion from $4.2 billion in nine-months 2014.

Net written premiums climbed $15.4 billion, or 4.1 percent, to $392.7 billion in nine-months 2015 from $377.3 billion in nine-months 2014. The net written premium growth rate of 4.1 percent is slightly above the 4.0 percent for nine-months 2014 and just slightly below the 4.2 percent growth rate for full-year 2014. The growth rate in net earned premiums slowed to 3.9 percent in nine-months 2015 from 4.2 percent in nine-months 2014 and 4.4 percent for full-year 2014. However, the decrease in earned premium growth, as well as in the overall volume of underwriting activity in 2015, was partly the result of the sale of a large book of Canadian personal lines business that took effect on January 1, 2015.[6]

1. This study defines the U.S. property/casualty insurance industry as all private property/casualty insurers domiciled in the United States, including excess and surplus insurers and domestic insurers owned by foreign parents but excluding state funds for workers compensation and other residual market carriers. The figures are consolidated estimates based on reports accounting for at least 96 percent of all business written by U.S. property/casualty insurers. All figures are net of reinsurance unless otherwise noted and occasionally may not balance due to rounding.
2. Combined ratio, defined as a sum of loss ratio, expense ratio, and dividend ratio, is a key measure of losses and other underwriting expenses per dollar of premium. The loss ratio is the ratio of losses and loss adjustment expenses (LLAE) to earned premiums; the expense ratio is the ratio of other underwriting expenses to written premiums; and the dividend ratio is the ratio of policyholders' dividends to earned premiums.
3. Underwriting gains (or losses) equal earned premiums minus LLAE, other underwriting expenses, and dividends to policyholders.
4. Net investment gains equal the sum of net investment income and realized capital gains (or losses) on investments.
5. Policyholders' surplus is insurers' net worth measured according to Statutory Accounting Principles.
6. This business is now written by Canadian insurers and no longer flows through financial reports of U.S.-domiciled insurers.

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The 2.7 percent increase in LLAE in nine-months 2015 compares favorably to the 7.5 percent increase a year earlier. A decline in catastrophe losses slowed down the rise in overall LLAE by almost a percentage point. Private U.S. insurers' net LLAE from catastrophes declined $1.7 billion to $14.2 billion for nine-months 2015 from $15.9 billion a year ago. Net LLAE for losses other than catastrophes rose $8.5 billion, or 3.6 percent, to $245.9 billion in nine-months 2015 from $237.4 billion in nine-months 2014.

Private U.S. insurers' net LLAE includes both their domestic and foreign catastrophic losses.[7] However, U.S. insurers' $14.2 billion in net LLAE from catastrophes in nine-months 2015 is primarily attributable to catastrophes that struck the United States. Though estimating U.S. insurers' LLAE from catastrophes elsewhere around the globe is difficult, the available information suggests that U.S. insurers' net LLAE arising from such events was not large in both nine-months 2015 and nine-months 2014.

Direct insured property losses from catastrophes striking the United States totaled $13.0 billion in nine-months 2015, down $1.7 billion from $14.8 billion in nine-months 2014 and $1.9 billion below the $14.9 billion average for the past ten years.[8]

Reflecting the differences between premium growth and the growth in LLAE and other costs of providing insurance, the combined ratio improved by 0.8 percentage points to 96.9 percent in nine-months 2015 from 97.7 percent in nine-months 2014.

Underwriting results benefited from $9.3 billion in favorable development of LLAE reserves in nine-months 2015, based on new information and updated estimates for the ultimate cost of claims from prior accident years. The $9.3 billion of favorable reserve development in nine-months 2015 followed $8.9 billion of favorable development in nine-months 2014 and resulted in comparable favorable reserve development effects on underwriting gains and on loss ratios in 2015 and 2014.

Excluding development of LLAE reserves, net LLAE grew $7.2 billion, or 2.8 percent, to $269.4 billion in nine-months 2015 from $262.1 billion in nine-months 2014.

The $7.1 billion in net gains on underwriting in nine-months 2015 amounted to 1.9 percent of the $376.8 billion in net premiums earned during the period. The $4.2 billion in net gains on underwriting in nine-months 2014 amounted to 1.2 percent of the $362.5 billion in net premiums earned during that period.

While overall net written premium growth in nine-months 2015 rose slightly to 4.1 percent from 4.0 percent a year earlier, the dynamics varied across industry segments.

Net written premium growth for insurers writing mostly personal lines slowed 0.1 percentage point to 5.5 percent in nine-months 2015 but remained more robust than for other segments. Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines slowed 0.4 percentage points to 2.3 percent in nine-months 2015, while premium growth for insurers writing more balanced books of business accelerated 0.9 percentage points to 4.7 percent.

Underwriting profitability as measured by combined ratio deteriorated for personal lines insurers and improved for other major sectors of the industry. Excluding mortgage and financial guaranty insurers, commercial lines insurers' combined ratio decreased 1.2 percentage points in nine-months 2015 to 93.8 percent. Balanced insurers' combined ratio fell 3.0 percentage points to 98.7 percent from 101.7 percent for nine-months 2014, while personal lines insurers' combined ratio deteriorated 0.8 percentage points to 99.6 percent.

Investment Results

Insurers' net investment income—primarily dividends from stocks and interest on bonds—grew 1.1 percent to $34.8 billion in nine-months 2015 from $34.5 billion in nine-months 2014. Insurers' realized capital gains on investments rose 0.6 percent to $8.9 billion in nine-months 2015 from $8.8 billion a year earlier. Combining net investment income and realized capital gains, overall net investment gains grew $0.4 billion, or 1.0 percent, to $43.7 billion for nine-months 2015 from $43.3 billion for nine-months 2014.

Insurers' $8.9 billion in realized capital gains in nine-months 2015 was the net result of $1.9 billion in realized losses on impaired investments and $10.8 billion in realized gains on other investments, with realized losses on impaired investments increasing in nine-months 2015 from $1.4 billion for nine-months 2014.

The 1.1 percent increase in net investment income was driven by a 1.4 percent increase in average cash and invested assets for nine-months 2015 compared with nine-months 2014. The annualized yield on insurers' investments in nine-months 2015 was 3.1 percent—virtually unchanged from nine-months 2014, just slightly below the 3.2 percent investment yield for full-year 2014, and significantly below the 3.8 percent average annualized quarterly yield for the last ten years. Long-term annual data shows that insurers' investment yield last fell as low as 3.1 percent in 1965. From 1960 to 2014, insurers' annual investment yield averaged 5.1 percent but ranged from as low as 2.8 percent in 1961 to as high as 8.2 percent in 1984 and 1985.

Combining the $8.9 billion in realized capital gains in nine-months 2015 with the $22.7 billion in unrealized capital losses during the same period, insurers posted $13.8 billion in overall capital losses for nine-months 2015—a $29.7 billion swing from the $15.8 billion in overall capital gains for nine-months 2014.[9] Over the past 30 years, insurers' total capital gains have averaged $2.5 billion per quarter but have ranged from as high as $26.8 billion in fourth-quarter 1998 to as low as negative $31.9 billion in fourth-quarter 2008 during the financial crisis.

Pretax Operating Income

Pretax operating income[10] increased $6.3 billion to $43.1 billion for nine-months 2015 from $36.8 billion for nine-months 2014.

7. Net LLAE from catastrophes also includes revisions to LLAE from catastrophes that occurred during prior periods but excludes LLAE covered by the National Flood Insurance Program, residual market insurers, and foreign insurers and reinsurers.
8. Estimates are from Verisk's Property Claim Services® (PCS®), based on information available as of January 25, 2016. Direct losses are before reinsurance recoveries and exclude loss adjustment expenses. These figures are for all types of insurers, including residual market insurers, foreign insurers, and reinsurers, but exclude ocean marine losses and losses covered by the National Flood Insurance Program.
9. Unrealized capital gains or losses contribute directly to surplus change, but they do not impact net income.
10. Pretax operating income is the sum of net gains or losses on underwriting, net investment income, and miscellaneous other income.

The $6.3 billion increase in operating income was due to the $3.0 billion increase in net gains on underwriting, the $2.9 billion increase in mis- cellaneous other income, and the $0.4 billion increase in net investment income. The total other income increase reflects a special transaction in the third quarter of 2014 when a loss portfolio transfer resulted in an accounting loss of about $3.0 billion.

Net Income after Taxes

Combining operating income, realized capital gains (losses), and federal and foreign income taxes, the insurance industry's net income after taxes increased $6.2 billion to $44.0 billion for nine-months 2015 from $37.8 billion for nine-months 2014. That is the highest nine-months net income since the $49.6 billion in nine-months 2007. The growth in net income was primarily the result of the $6.3 billion increase in operating income.

Policyholders' Surplus

Policyholders' surplus declined $11.4 billion to $663.9 billion as of September 30, 2015, from a record high of $675.2 billion at year-end 2014. Still, policyholders' surplus for nine-months 2015 remained above any pre-2014 values. Additions to surplus in nine-months 2015 included $44.0 billion in net income after taxes and $5.5 billion in new funds. The deductions from surplus consisted of $22.7 billion in unrealized capital losses on investments (not included in net income), $26.0 billion in dividends to shareholders, and $12.2 billion in miscellaneous charges against surplus.

The $22.7 billion in unrealized capital losses in nine-months 2015 represents a $29.7 billion swing from the $7.0 billion in unrealized capital gains for nine-months 2014.

New funds paid in increased to $5.5 billion in nine-months 2015 from $4.3 billion in nine-months 2014. Dividends to shareholders grew $2.1 billion, or 9.0 percent, to $26.0 billion in nine-months 2015 from $23.9 billion in nine-months 2014. Miscellaneous charges against surplus grew to $12.2 billion in nine-months 2015 from $4.2 billion in nine-months 2014. A large portion of the increase in miscellaneous charges against surplus is attributable to a special transaction. In the second quarter of 2015, one insurer invested at least $5.0 billion in a noninsurance asset that is classified as "nonadmitted" per statutory accounting rules and does not count toward the insurer's surplus.

Premium-to-surplus ratio is only about half the average for the 56 years ending 2014.

Using 12-month trailing premiums, the premium-to-surplus ratio rose to 0.77 as of September 30, 2015, from 0.73 as of September 30, 2014. At the same time, the ratio of loss and loss adjustment expense reserves to surplus rose to 0.88 as of September 30, 2015, from 0.86 a year earlier. The 0.77 premium-to-surplus ratio is only about half the 1.44 average premium-to-surplus ratio based on annual data for the 56 years from 1959 to 2014. Similarly, the 0.88 LLAE-reserves-to-surplus ratio as of the end of nine-months 2015 is far below the 1.38 average for the 56 years ending 2014.

Third-Quarter Results

The property/casualty insurance industry's consolidated net income after taxes rose to $13.1 billion in third-quarter 2015 from $11.8 billion in third-quarter 2014. Property/casualty insurers' annualized rate of return on average surplus increased to 7.8 percent in third-quarter 2015 from 7.0 percent a year earlier.

The $13.1 billion in net income after taxes for the insurance industry in third-quarter 2015 was a result of $15.6 billion in pretax operating income, $0.7 billion in realized capital gains on investments, and $3.2 billion in federal and foreign income taxes.

The industry's $15.6 billion in pretax operating income for third-quarter 2015 was up $2.7 billion from the $12.9 billion for third-quarter 2014. The industry's third-quarter 2015 pretax operating income was the net result of $3.8 billion in net gains on underwriting, $11.5 billion in net investment income, and $0.4 billion in miscellaneous other income.

Net gains on underwriting declined $0.2 billion to $3.8 billion in third-quarter 2015 from $3.9 billion in third-quarter 2014.

Net LLAE from catastrophes included in private U.S. insurers' financial results in third-quarter 2015 was $3.0 billion, a nominal increase from $2.9 billion for third-quarter 2014.[11] The contribution of catastrophe LLAE to the third-quarter combined ratio remained virtually unchanged from a year earlier.

Direct insured losses from catastrophes striking the United States in third-quarter 2015 totaled $2.4 billion, up $0.2 billion from third-quarter 2014.[12]

Third-quarter 2015 net gains on underwriting amounted to 2.9 percent of the $129.3 billion in premiums earned during the period, a deterioration compared with third-quarter 2014 net gains on underwriting, which were 3.2 percent of the $124.5 billion in premiums earned during that period. The industry's combined ratio worsened to 95.7 percent in third-quarter 2015 from 95.5 percent in third-quarter 2014. Over the last 30 years, the third-quarter combined ratio averaged 105.0 percent but reached as high as 122.8 percent in 1992 and as low as 90.6 percent in 2006.

Net written premiums rose $5.3 billion, or 4.1 percent, to $136.0 billion in third-quarter 2015 from $130.7 billion in third-quarter 2014. That was the twenty-second consecutive quarter of growth in written premiums, beginning in the second quarter of 2010 and following 12 quarters of declines.

11. Net LLAE from catastrophes also includes revisions to LLAE from catastrophes that occurred during prior periods but excludes LLAE covered by the federal flood insurance program, residual market insurers, and foreign insurers and reinsurers.
12. Estimates are from Verisk's Property Claim Services (PCS) based on information available as of January 25, 2016. Direct losses are before reinsurance recoveries and exclude loss adjustment expenses. These figures are for all types of insurers, including residual market insurers, foreign insurers, and reinsurers, but exclude ocean marine losses and losses covered by the National Flood Insurance Program.

Net earned premiums grew $4.8 billion, or 3.8 percent, to $129.3 billion in third-quarter 2015 from $124.5 billion in third-quarter 2014. LLAE grew 4.3 percent to $88.7 billion in third-quarter 2015 from $85.0 billion in third-quarter 2014. Noncatastrophe LLAE rose 4.3 percent to $85.7 billion from $82.2 billion in third-quarter 2014.

The $11.5 billion in net investment income for the industry overall in third-quarter 2015 was virtually unchanged from third-quarter 2014. Miscellaneous other income jumped to $0.4 billion in third-quarter 2015 from negative $2.5 billion in third-quarter 2014, with the amount for 2014 driven by a special transaction mentioned earlier in the section on nine-month results.

Realized capital gains on investments declined to $0.7 billion in third-quarter 2015 from $1.6 billion in third-quarter 2014. Combining net investment income and realized capital gains, net investment gains declined $0.9 billion, or 7.0 percent, to $12.1 billion in third-quarter 2015 from $13.0 billion a year earlier.

Insurers posted $13.9 billion in unrealized capital losses on investments in third-quarter 2015—a $13.1 billion drop from the $0.8 billion in unrealized capital losses on investments in third-quarter 2014. Combining realized and unrealized amounts, the insurance industry posted $13.2 billion in overall capital losses in third-quarter 2015—a $14.1 billion drop from the $0.8 billion in overall capital gains on investments in third-quarter 2014.

Insurers' $0.7 billion in realized capital gains in third-quarter 2015 was the net result of $1.1 billion in realized losses on impaired investments and $1.8 billion in realized gains on other investments, with realized losses on impaired investments increasing from $0.9 billion in third-quarter 2014. The $0.7 billion is the lowest quarterly realized gains amount since $3.2 billion in realized capital losses in the second quarter of 2009.

The key operating results for the industry are summarized in the table on page 5.

NINE-MONTHS 2015: **BY THE NUMBERS**

$44.0 billion
Nine-months net income highest since 2007

22
Consecutive quarters of growth in written premiums

3.1%
Annualized percent yield on investments for nine-months 2015

5.1%
Average annualized percent yield on investments for nine-months 1960 to 2014

$13.0 billion
Direct insured property losses from U.S. catastrophes for nine-months 2015

Beth Fitzgerald is president of ISO Solutions. The unit develops ISO's core products and services, such as advisory prospective loss costs (projections of future claims), policy forms, underwriting rules, and related information products that most insurers use to write one or more lines of commercial or personal business. Ms. Fitzgerald's area is instrumental in the development of ISO's various predictive analytical products for underwriting personal and commercial insurance. Under her direction, ISO also collects and compiles data from insurers, acts as statistical agent for all U.S. insurance regulators, supplies actuarial and data management consulting services, and conducts cutting-edge research on various issues in property/casualty insurance.

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Operating Results for 2015 and 2014 ($ millions)

Nine Months	2015	2014
Net Written Premiums	$392,681	$377,315
Percent Change (%)	4.1	4.0
Net Earned Premiums	376,804	362,498
Percent Change (%)	3.9	4.2
Incurred Losses & Loss Adjustment Expenses	260,028	253,270
Percent Change (%)	2.7	7.5
Statutory Underwriting Gains (Losses)	8,393	5,359
Policyholders' Dividends	1,251	1,175
Net Underwriting Gains (Losses)	7,141	4,184
Pretax Operating Income	43,117	36,819
Net Investment Income Earned	34,849	34,453
Net Realized Capital Gains (Losses)	8,867	8,815
Net Investment Gains	43,716	43,268
Net Income (Loss) after Taxes	44,034	37,812
Percent Change (%)	16.5	-11.5
Surplus (Consolidated)	663,868	674,448
Loss & Loss Adjustment Expense Reserves	580,978	579,274
Combined Ratio, Post-Dividends (%)	96.9	97.7

Third Quarter	2015	2014
Net Written Premiums	$135,994	$130,684
Percent Change (%)	4.1	3.7
Net Earned Premiums	129,302	124,523
Percent Change (%)	3.8	4.0
Incurred Losses & Loss Adjustment Expenses	88,701	85,041
Percent Change (%)	4.3	9.6
Statutory Underwriting Gains (Losses)	4,021	4,202
Policyholders' Dividends	271	256
Net Underwriting Gains (Losses)	3,750	3,946
Pretax Operating Income	15,592	12,881
Net Investment Income Earned	11,457	11,438
Net Realized Capital Gains (Losses)	680	1,607
Net Investment Gains	12,137	13,045
Net Income (Loss) after Taxes	13,062	11,823
Percent Change (%)	10.5	-35.4
Surplus (Consolidated)	663,868	674,448
Loss & Loss Adjustment Expense Reserves	580,978	579,274
Combined Ratio, Post-Dividends (%)	95.7	95.5

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