Property/Casualty Insurance Results: First-Quarter 2016

By Beth Fitzgerald, President, ISO Solutions,
and Robert Gordon, Senior Vice President, Policy Development and Research, PCI

Private U.S. property/casualty insurers' net income after taxes dropped to $13.3 billion in first-quarter 2016 from $18.1 billion in first-quarter 2015. Insurers' overall profitability as measured by their annualized rate of return on average policyholders' surplus dropped to 7.9 percent from 10.8 percent a year earlier, according to ISO, a Verisk Analytics (Nasdaq:VRSK) business, and the Property Casualty Insurers Association of America (PCI).[1]

Insurers' combined ratio[2] deteriorated to 97.5 percent for first-quarter 2016 from 95.7 percent for first-quarter 2015, and their net underwriting gains[3] decreased to $2.2 billion from $4.1 billion. Net written premium growth slowed to 3.2 percent for first-quarter 2016 from 3.8 percent for first-quarter 2015.

Insurers' net investment income dropped to $10.9 billion in first-quarter 2016 from $11.7 billion a year earlier, and insurers' realized capital gains decreased to $2.3 billion from $4.7 billion, resulting in $13.2 billion in net investment gains[4] for first-quarter 2016, down $3.2 billion from $16.3 billion for first-quarter 2015.

Net written and earned premium growth slowed, partially due to special transactions.

The 26.6 percent decrease in net income after taxes drove insurers' annualized rate of return on average surplus to 7.9 percent—2.9 percentage points below the 10.8 percent value for first-quarter 2015 and 0.5 percentage points below the 8.4 percent long-term average quarterly rate of return.

The industry's surplus[5] reached a new all-time high value of $676.3 billion as of March 31, 2016, increasing $2.6 billion from $673.7 billion as of December 31, 2015, and inching over the $675.2 billion surplus as of December 31, 2014.

Underwriting Results

In the first quarter of 2016, earned premiums grew 3.5 percent to $126.4 billion, while LLAE rose 6.3 percent to $87.1 billion, other underwriting expenses grew 2.9 percent to $36.4 billion, and policyholders' dividends remained essentially unchanged at $0.8 billion. As a result, net underwriting gains decreased to $2.2 billion from $4.1 billion.

Net written premiums climbed $4.0 billion to $130.1 billion in first-quarter 2016 from $126.1 billion in first-quarter 2015. Net written premium growth slowed to 3.2 percent from 3.8 percent for first-quarter 2015. The growth rate in net earned premiums also slowed, to 3.5 percent in 2016 from 3.7 percent for first-quarter 2015.

The 6.3 percent increase in LLAE in first-quarter 2016 exceeds premium growth and compares unfavorably to the 1.7 percent increase a year earlier. LLAE growth in 2016 was accelerated by an increase in catastrophe losses. Private U.S. insurers' net LLAE from catastrophes grew $1.5 billion to $4.9 billion for first-quarter 2016 from $3.4 billion a year earlier. Net LLAE for losses other than catastrophes rose $3.7 billion, or 4.7 percent, to $82.2 billion in first-quarter 2016 from $78.5 billion in first-quarter 2015.

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 the 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.

ISO
Verisk Insurance Solutions

PCI
Property Casualty Insurers
Association of America

Private U.S. insurers' net LLAE includes both their domestic and foreign catastrophic losses.[6] However, U.S. insurers' $4.9 billion in net LLAE from catastrophes in first-quarter 2016 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 either 2016 or 2015.

Both net investment income and realized capital gains dropped in 2016.

Direct insured property losses from catastrophes striking the United States totaled $4.8 billion in first-quarter 2016, up $1.2 billion from $3.6 billion in first-quarter 2015 and $1.7 billion above the $3.1 billion average first-quarter direct catastrophe losses for the past ten years.[7] Moreover, from 1950 through 2015, first-quarter direct catastrophe losses exceeded $4.0 billion only in 1994, and that was due to the $12.5 billion Northridge earthquake.

Reflecting the differences between premium growth and the growth in LLAE and other costs of providing insurance, the combined ratio deteriorated by 1.7 percentage points to 97.5 percent in first-quarter 2016 from 95.7 percent in first-quarter 2015.

Underwriting results benefited from $4.4 billion in favorable development of LLAE reserves in first-quarter 2016, based on new information and updated estimates for the ultimate cost of claims from prior accident years. The $4.4 billion of favorable reserve development in first-quarter 2016 followed $5.7 billion of favorable development in first-quarter 2015. Favorable development reduced the combined ratio by 3.5 percentage points in first-quarter 2016 and by 4.7 percentage points in first-quarter 2015.

Excluding development of LLAE reserves, net LLAE grew $3.8 billion, or 4.3 percent, to $91.5 billion in first-quarter 2016 from $87.6 billion in first-quarter 2015. Excluding development of LLAE reserves, net non-catastrophe LLAE grew only $2.4 billion, or 2.8 percent, to $86.6 billion in first-quarter 2016 from $84.2 billion a year earlier. The combined ratio deteriorated 1.7 percentage points in first-quarter 2016, but if the catastrophe LLAE and LLAE reserve development in first-quarter 2016 had been at the same level as in first-quarter 2015, the combined ratio would have improved 0.6 percentage points.

The $2.2 billion in net gains on underwriting in first-quarter 2016 amounted to 1.7 percent of the $126.4 billion in net premiums earned during the period. The $4.1 billion in net gains on underwriting in first-quarter 2015 amounted to 3.3 percent of the $122.0 billion in net premiums earned during that period.

While overall net written premium growth in first-quarter 2016 declined to 3.2 percent from 3.8 percent a year earlier, the dynamics varied across industry segments.

Net written premium growth for insurers writing mostly personal lines accelerated 2.6 percentage points to 7.3 percent in first-quarter 2016, significantly exceeding the growth for other segments. Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines dropped 3.1 percentage points to negative 1.3 percent in first-quarter 2016, while premium growth for insurers writing more balanced books of business slowed 0.8 percentage points to 4.3 percent. The negative growth for commercial lines insurers is attributable to two special transactions of U.S. insurers with their foreign affiliates in first-quarter 2016.

Underwriting profitability as measured by the combined ratio improved for balanced insurers and deteriorated for other major segments. Excluding mortgage and financial guaranty insurers, commercial lines insurers' combined ratio increased 0.4 percentage points to 94.3 percent in first-quarter 2016. Personal lines insurers' combined ratio deteriorated 3.2 percentage points to 100.8 percent, while balanced insurers' combined ratio improved 0.3 percentage points to 96.3 percent in 2016 from 96.6 percent in 2015.

Investment Results

Insurers' net investment income—primarily dividends from stocks and interest on bonds—declined 6.6 percent to $10.9 billion in first-quarter 2016 from $11.7 billion in first-quarter 2015. This is the lowest quarterly investment income since the $9.9 billion in third-quarter 2004. Insurers' realized capital gains on investments fell 51.3 percent to $2.3 billion in first-quarter 2016 from $4.7 billion a year earlier. Combining net investment income and realized capital gains, overall net investment gains dropped 19.4 percent to $13.2 billion in first-quarter 2016 from $16.3 billion a year earlier.

Insurers' $2.3 billion in realized capital gains in first-quarter 2016 resulted from $3.0 billion in net realized gains on asset sales partially offset by $0.7 billion in realized losses on asset impairments. The realized losses on impairments in 2016 increased $0.3 billion from $0.4 billion for first-quarter 2015, while the net realized gains on asset sales decreased $2.1 billion.

Policyholder surplus reached a new record level.

Insurers' net investment income decreased 6.6 percent despite a 0.3 percent increase in average cash and invested assets for first-quarter 2016 compared with first-quarter 2015. The annualized yield on insurers' investments in first-quarter 2016 dropped to 2.9 percent—the lowest annualized quarterly yield since at least 2001—from 3.1 percent a year earlier. Both yields are significantly

6. 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.
7. Estimates are from Verisk's Property Claim Services® (PCS®) based on information available as of June 15, 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.

below the 3.8 percent average annualized quarterly yield for the last ten years. On a full-year basis, insurers' annual investment yield last fell to 2.9 percent in 1962. From 1960 to 2015, insurers' 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 $2.3 billion in realized capital gains in first-quarter 2016 with the $2.1 billion in unrealized capital losses[8] during the same period, insurers posted $0.2 billion in overall capital gains for first-quarter 2016—a $1.7 billion improvement from first-quarter 2015. 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.

The loss ratio deteriorated due to higher catastrophe losses and less favorable reserve development.

Pretax Operating Income

Pretax operating income[9] declined $2.1 billion to $13.5 billion for first-quarter 2016 from $15.6 billion for first-quarter 2015. The $2.1 billion decline in operating income was the net result of the $1.9 billion decrease in net gains on underwriting, the $0.6 billion increase in total other income, and the $0.8 billion decrease in net investment income.

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 fell $4.8 billion to $13.3 billion for first-quarter 2016 from $18.1 billion for first-quarter 2015. Despite the decline, first-quarter 2016 net income after taxes is still above the $10.6 billion average quarterly income for the last ten years.

Policyholders' Surplus

Policyholders' surplus increased $2.6 billion to a new record-high $676.3 billion as of March 31, 2016, from $673.7 billion as of December 31, 2015. It surpassed the prior record—$675.2 billion at year-end 2014—by $1.0 billion. Additions to surplus in first-quarter 2016 included $13.3 billion in net income after taxes and $0.2 billion in new funds. The deductions from surplus consisted of $2.1 billion in unrealized capital losses on investments (not included in net income), $7.0 billion in dividends to shareholders, and $1.9 billion in miscellaneous charges against surplus.

Unrealized capital losses declined to $2.1 billion in first-quarter 2016 from $6.2 billion a year earlier. Net new funds paid in decreased by $0.3 billion to $0.2 billion in first-quarter 2016 from $0.5 billion in first-quarter 2015. Dividends to shareholders dropped $5.6 billion, or 44.4 percent, to $7.0 billion in first-quarter 2016 from $12.5 billion in first-quarter 2015. Miscellaneous charges against surplus decreased to $1.9 billion in first-quarter 2016 from $3.2 billion in first-quarter 2015.

Using 12-month trailing premiums, the premium-to-surplus ratio rose to 0.77 as of March 31, 2016, from 0.75 as of March 31, 2015. At the same time, the ratio of loss and loss adjustment expense reserves to surplus rose to 0.87 as of March 31, 2016, from 0.86 a year earlier. The 0.77 premium-to-surplus ratio is only about half of the 1.42 average premium-to-surplus ratio based on annual data for the 57 years from 1959 to 2015. Similarly, the 0.87 LLAE-reserves-to-surplus ratio as of March 31, 2016, is far below the 1.38 average for the 57 years ending 2015.

The key operating results for the industry are summarized in the table on page 4.

First-Quarter 2016: BY THE NUMBERS

$676.3 billion
Industry surplus, compared with $673.7 billion at year-end 2015 and $675.2 billion at year-end 2014

$13.3 billion
Net income after taxes, a 26.6% drop from $18.1 billion for first-quarter 2015

3.2%
Net written premium growth, after 3.8% in first-quarter 2015

97.5
Combined ratio, after 95.7 in first-quarter 2015

2.9%
Annualized quarterly investment yield, the lowest so far in this century

$4.8 billion
Direct catastrophe losses—the highest first-quarter catastrophe losses since the 1994 Northridge earthquake

8. Unrealized capital gains or losses contribute directly to surplus change, but they do not affect net income.
9. Pretax operating income is the sum of net gains or losses on underwriting, net investment income, and miscellaneous other income.

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.

Robert Gordon is senior vice president of policy development and research for PCI. He is responsible for working with PCI members to develop and frame public policy positions on the opportunities and challenges facing the property/casualty insurance industry at the state, federal, and international levels. Mr. Gordon also coordinates policy support for PCI's extensive state and federal advocacy efforts, media outreach, and information products.

Operating Results for 2016 and 2015 ($ Millions)

First Quarter	**2016**	**2015**
Net Written Premiums	$130,075	$126,101
Percent Change (%)	3.2	3.8
Net Earned Premiums	126,372	122,047
Percent Change (%)	3.5	3.7
Incurred Losses & Loss Adjustment Expenses	87,090	81,928
Percent Change (%)	6.3	1.7
Statutory Underwriting Gains (Losses)	2,917	4,787
Policyholders' Dividends	753	723
Net Underwriting Gains (Losses)	2,164	4,065
Pretax Operating Income	13,475	15,560
Net Investment Income Earned	10,893	11,658
Net Realized Capital Gains (Losses)	2,284	4,687
Net Investment Gains	13,177	16,344
Net Income (Loss) after Taxes	13,313	18,138
Percent Change (%)	-26.6	30.9
Surplus (Consolidated)	676,256	671,900
Loss & Loss Adjustment Expense Reserves	586,036	575,577
Combined Ratio, Post-Dividends (%)	97.5	95.7

ISO
545 Washington Boulevard
Jersey City, NJ 07310-1686
1-800-888-4476 • www.iso.com

PCI
8700 West Bryn Mawr Avenue, Suite 1200S
Chicago, IL 60631-3512
847-297-7800 • www.pciaa.net

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Property Casualty Insurers Association of America
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