Property/Casualty Insurance Results: First-Half 2016

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Private U.S. property/casualty insurers' net income after taxes dropped to $21.7 billion in first-half 2016 from $31.0 billion in first-half 2015. Insurers' overall profitability as measured by their annualized rate of return on average policyholders' surplus declined to 6.4 percent from 9.2 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 99.8 percent for first-half 2016 from 97.6 percent for first-half 2015, and their $1.5 billion in net underwriting losses[3] in first-half 2016 compares to a $3.5 billion gain a year earlier. Net written premium growth slowed to 3.0 percent for first-half 2016 from 4.1 percent for first-half 2015.

Insurers' net investment income declined to $22.1 billion in first-half 2016 from $23.4 billion a year earlier, and insurers' realized capital gains dropped to $4.4 billion from $8.2 billion, resulting in $26.5 billion in net investment gains[4] for first-half 2016, down $5.1 billion from $31.6 billion for first-half 2015.

The first-half 2016 underwriting loss ended the longest-ever streak of underwriting gains. The industry has reported net year-to-date underwriting gains 13 times in a row, beginning with three-months 2013 through three-months 2016.

The 30.2 percent decrease in net income after taxes drove insurers' annualized rate of return on average surplus to 6.4 percent—2.8 percentage points below the 9.2 percent value for first-half 2015 and 2.6 percentage points below the 30-year average first-half rate of return for 1986–2015.

The industry's surplus[5] reached a new all-time-high value of $680.6 billion as of June 30, 2016, surpassing not only $674.2 billion as of December 31, 2015, but also the $676.3 billion record as of March 31, 2016.

Underwriting Results

In the first half of 2016, earned premiums grew 3.8 percent to $257.1 billion, while LLAE rose 7.2 percent to $183.7 billion, other underwriting expenses grew 2.8 percent to $73.8 billion, and policyholders' dividends remained essentially unchanged at $1.0 billion. As a result, the industry reported a $1.5 billion net underwriting loss, which compares to the $3.5 billion gain for first-half 2015.

Net written premiums climbed $7.8 billion to $264.7 billion in first-half 2016 from $256.8 billion in first-half 2015. Net written premium growth slowed to 3.0 percent from 4.1 percent for first-half 2015. The growth rate in net earned premiums also slowed, to 3.8 percent in 2016 from 4.1 percent for first-half 2015.

The 7.2 percent increase in LLAE in first-half 2016 exceeds premium growth and compares unfavorably to the 1.9 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 $3.5 billion to $14.5 billion for first-half 2016 from $11.0 billion a year earlier. Net LLAE

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

for losses other than catastrophes rose $8.8 billion, or 5.5 percent, to $169.2 billion in first-half 2016 from $160.4 billion in first-half 2015.

Private U.S. insurers' net LLAE includes both their domestic and foreign catastrophic losses.[6] However, U.S. insurers' $14.5 billion in net LLAE from catastrophes in first-half 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.

Net written and earned premium growth slowed.

Direct insured property losses from catastrophes striking the United States totaled $13.5 billion in first-half 2016, up from $10.7 billion in first-half 2015 and $1.9 billion above the $11.6 billion average first-half direct catastrophe losses for the past ten years.[7]

Reflecting the differences between premium growth and the growth in LLAE and other costs of providing insurance, the combined ratio deteriorated by 2.2 percentage points to 99.8 percent in first-half 2016 from 97.6 percent in first-half 2015.

Underwriting results benefited from $5.9 billion in favorable development of LLAE reserves in first-half 2016, based on new information and updated estimates for the ultimate cost of claims from prior accident years. The $5.9 billion of favorable reserve development in first-half 2016 followed $7.8 billion of favorable development in first-half 2015. Favorable development reduced the combined ratio by 2.3 percentage points in first-half 2016 and by 3.2 percentage points in first-half 2015.

Excluding development of LLAE reserves, net LLAE grew $10.3 billion, or 5.8 percent, to $189.6 billion in first-half 2016 from $179.3 billion in first-half 2015. Excluding development of LLAE reserves, net non-catastrophe LLAE grew $6.9 billion, or 4.1 percent, to $175.1 billion in first-half 2016 from $168.2 billion a year earlier. In sum, the changes in LLAE attributable to catastrophes and reserve development account for 2.1 percentage points out of the 2.3-percentage-point deterioration reported for the loss ratio in first-half 2016.

The $1.5 billion net loss on underwriting in first-half 2016 amounted to 0.6 percent of the $257.1 billion in net premiums earned during the period. The $3.5 billion in net gains on underwriting in first-half 2015 amounted to 1.4 percent of the $247.7 billion in net premiums earned during that period.

While overall net written premium growth in first-half 2016 declined to 3.0 percent from 4.1 percent a year earlier, the dynamics varied across industry segments.

Net written premium growth for insurers writing mostly personal lines accelerated 0.7 percentage points to 6.0 percent in first-half 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 3.2 percentage points to negative 0.9 percent in first-half 2016, while premium growth for insurers writing more balanced books of business slowed 0.8 percentage points to 3.7 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 deteriorated across all major segments. Excluding mortgage and financial guaranty insurers, commercial lines insurers' combined ratio increased 1.3 percentage points to 96.0 percent in first-half 2016. Personal lines insurers' combined ratio deteriorated 3.2 percentage points to 103.1 percent, and balanced insurers' combined ratio deteriorated 1.5 percentage points to 99.6 percent in 2016 from 98.1 percent in 2015.

Investment Results

Insurers' net investment income—primarily dividends from stocks and interest on bonds—declined 5.7 percent to $22.1 billion in first-half 2016 from $23.4 billion in first-half 2015. This is the lowest first-half investment income since the $19.1 billion in 2004. Insurers' realized capital gains on investments fell 45.6 percent to $4.4 billion in first-half 2016 from $8.2 billion a year earlier. Combining net investment income and realized capital gains, overall net investment gains dropped 16.0 percent to $26.5 billion in first-half 2016 from $31.6 billion a year earlier.

Insurers' $4.4 billion in realized capital gains in first-half 2016 resulted from $5.6 billion in net realized gains on asset sales partially offset by $1.2 billion in realized losses on asset impairments. The realized losses on impairments in 2016 increased $0.4 billion from $0.8 billion for first-half 2015, while the net realized gains on asset sales decreased $3.3 billion.

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

Insurers' net investment income decreased 5.7 percent despite a 1.3 percent increase in average cash and invested assets for first-half 2016 compared with first-half 2015. The annualized yield on insurers' investments in first-half 2016 dropped to 3.0 percent from 3.1 percent a year earlier. Both yields are significantly below the 3.7 percent average annualized quarterly yield for the last ten years.

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 September 9, 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.

On a full-year basis, insurers' annual investment yield last fell to 3.0 percent in 1964. 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 $4.4 billion in realized capital gains in first-half 2016 with the $1.4 billion in unrealized capital losses[8] during the same period, insurers posted $3.1 billion in overall capital gains for first-half 2016—a $3.6 billion improvement from first-half 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.

Pretax Operating Income

Pretax operating income[9] declined $6.3 billion to $21.4 billion for first-half 2016 from $27.7 billion for first-half 2015. The $6.3 billion decline in operating income is mostly due to the $5.0 billion decrease in net gains on underwriting and the $1.3 billion decrease in net investment income.

Policyholder surplus reached a new record level.

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 $9.4 billion to $21.7 billion for first-half 2016 from $31.0 billion for first-half 2015. Despite the decline, first-half 2016 net income after taxes is still above the $19.5 billion average first-half income for the last ten years.

Policyholders' Surplus

Policyholders' surplus increased $6.5 billion to a new record-high $680.6 billion as of June 30, 2016, from $674.2 billion as of December 31, 2015. Additions to surplus in first-half 2016 included $21.7 billion in net income after taxes and $0.7 billion in new funds. The deductions from surplus consisted of $1.4 billion in unrealized capital losses on investments (not included in net income), $13.0 billion in dividends to shareholders, and $1.6 billion in miscellaneous charges against surplus.

Unrealized capital losses declined to $1.4 billion in first-half 2016 from $8.7 billion a year earlier. Net new funds paid in decreased by $4.3 billion to $0.7 billion in first-half 2016 from $5.0 billion in first-half 2015. Dividends to shareholders dropped $7.1 billion, or 35.5 percent, to $13.0 billion in first-half 2016 from $20.1 billion in first-half 2015. Miscellaneous charges against surplus decreased to $1.6 billion in first-half 2016 from $9.3 billion in first-half 2015.

Using 12-month trailing premiums, the premium-to-surplus ratio rose to 0.77 as of June 30, 2016, from 0.75 as of June 30, 2015. At the same time, the ratio of loss and loss adjustment expense reserves to surplus rose to 0.87 as of June 30, 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 June 30, 2016, is far below the 1.38 average for the 57 years ending 2015.

Second-Quarter Results

The property/casualty insurance industry's consolidated net income after taxes fell to $8.3 billion in second-quarter 2016 from $12.9 billion in second-quarter 2015. Property/casualty insurers' annualized rate of return on average surplus dropped to 4.9 percent in second-quarter 2016 from 7.7 percent a year earlier.

The $8.3 billion in net income after taxes for the insurance industry in second-quarter 2016 was a result of $7.8 billion in pretax operating income, $2.2 billion in realized capital gains on investments, and $1.7 billion in federal and foreign income taxes.

The industry's $7.8 billion in pretax operating income for second-quarter 2016 was down $4.3 billion from the $12.1 billion for second-quarter 2015. The industry's second-quarter 2016 pretax operating income was the net result of $3.8 billion in net losses on underwriting, $11.2 billion in net investment income, and $0.4 billion in miscellaneous other income.

Higher catastrophe losses and less favorable reserve development pushed up the combined ratio and generated net underwriting losses for insurers.

Net losses on underwriting worsened $3.1 billion to $3.8 billion in second-quarter 2016 from $0.6 billion in second-quarter 2015.

Net LLAE from catastrophes included in private U.S. insurers' financial results in second-quarter 2016 increased to $9.6 billion from $7.6 billion in second-quarter 2015.[10] The contribution of catastrophe LLAE to the second-quarter combined ratio increased to 7.3 percentage points in 2016 from 6.1 percentage points in 2015.

Direct insured losses from catastrophes striking the United States in second-quarter 2016 totaled $8.5 billion, up from the $7.1 billion in direct insured losses caused by catastrophes that struck the United States in second-quarter 2015.[11]

Second-quarter 2016 net losses on underwriting amounted to 2.9 percent of the $130.7 billion in premiums earned during the period, a deterioration compared with second-quarter 2015 net losses on underwriting, which were 0.5 percent of the $125.5 billion in premiums

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.
10. 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.
11. Estimates are from Verisk's Property Claim Services (PCS) based on information available as of September 9, 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.

earned during that period. The industry's combined ratio rose to 102.1 percent in second-quarter 2016 from 99.4 percent in second-quarter 2015. Over the last 30 years, the second-quarter combined ratio averaged 104.3 percent but reached as high as 117.5 percent in 2011 and as low as 92.8 percent in 2006.

Net written premiums rose $3.8 billion, or 2.9 percent, to $134.5 billion in second-quarter 2016 from $130.7 billion in second-quarter 2015. That was the 25th consecutive quarter of growth in written premiums, beginning in the second quarter of 2010 and following 12 quarters of declines.

Net earned premiums grew 4.1 percent to $130.7 billion in second-quarter 2016 from $125.5 billion in second-quarter 2015. LLAE grew 8.1 percent to $96.7 billion in second-quarter 2016 from $89.4 billion in second-quarter 2015. Noncatastrophe LLAE rose 6.4 percent to $87.1 billion from $81.8 billion in second-quarter 2015.

Net investment income for the industry declined $0.6 billion to $11.2 billion in second-quarter 2016 from $11.7 billion in second-quarter 2015. Miscellaneous other income declined to $0.4 billion in second-quarter 2016 from $1.0 billion in second-quarter 2015.

Realized capital gains on investments declined to $2.2 billion in second-quarter 2016 from $3.5 billion in second-quarter 2015. Combining net investment income and realized capital gains, net investment gains declined $1.9 billion, or 12.4 percent, to $13.3 billion in second-quarter 2016 from $15.2 billion a year earlier.

Insurers posted $0.8 billion in unrealized capital gains on investments in second-quarter 2016, a $3.3 billion improvement from $2.5 billion in unrealized capital losses a year earlier. Combining realized and unrealized amounts, the insurance industry posted $2.9 billion in overall capital gains in second-quarter 2016, a $1.9 billion improvement from the $1.0 billion in overall capital gains on investments in second-quarter 2015.

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

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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First-Half 2016: BY THE NUMBERS

$680.6 billion
Industry surplus, compared with $676.3 billion last quarter and $674.2 billion at year-end 2015

$21.7 billion
Net income after taxes, a 30.2% drop from $31.0 billion for first-half 2015

3.0%
Net written premium growth, after 4.1% in first-half 2015

99.8%
Combined ratio, after 97.6% for first-half 2015

$1.5 billion
Net underwriting loss, after $3.5 billion underwriting gain for first-half 2015

3.0%
Annualized investment yield—0.7 percentage points below the 3.6% average value for the last ten first halves

$13.5 billion
Direct catastrophe losses—a $2.9 billion increase from first-half 2015 and $1.9 billion above the ten-year average

Operating Results for 2016 and 2015 ($ Millions)

First Half	2016	2015
Net Written Premiums	$264,656	$256,836
Percent Change (%)	3.0	4.1
Net Earned Premiums	257,066	247,661
Percent Change (%)	3.8	4.1
Incurred Losses & Loss Adjustment Expenses	183,735	171,404
Percent Change (%)	7.2	1.9
Statutory Underwriting Gains (Losses)	(475)	4,451
Policyholders' Dividends	1,021	985
Net Underwriting Gains (Losses)	(1,496)	3,466
Pretax Operating Income	21,363	27,666
Net Investment Income Earned	22,067	23,400
Net Realized Capital Gains (Losses)	4,438	8,164
Net Investment Gains	26,505	31,564
Net Income (Loss) after Taxes	21,685	31,047
Percent Change (%)	-30.2	19.5
Surplus (Consolidated)	680,638	673,174
Loss & Loss Adjustment Expense Reserves	589,713	579,175
Combined Ratio, Post-Dividends (%)	99.8	97.6

Second Quarter	2016	2015
Net Written Premiums	$134,498	$130,662
Percent Change (%)	2.9	4.5
Net Earned Premiums	130,672	125,535
Percent Change (%)	4.1	4.3
Incurred Losses & Loss Adjustment Expenses	96,684	89,439
Percent Change (%)	8.1	2.0
Statutory Underwriting Gains (Losses)	(3,486)	(379)
Policyholders' Dividends	265	259
Net Underwriting Gains (Losses)	(3,751)	(638)
Pretax Operating Income	7,802	12,058
Net Investment Income Earned	11,179	11,738
Net Realized Capital Gains (Losses)	2,156	3,491
Net Investment Gains	13,334	15,229
Net Income (Loss) after Taxes	8,304	12,895
Percent Change (%)	-35.6	6.3
Surplus (Consolidated)	680,638	673,174
Loss & Loss Adjustment Expense Reserves	589,713	579,175
Combined Ratio, Post-Dividends (%)	102.1	99.4

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