Property/Casualty Insurance Results: Nine-Months 2016

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Private U.S. property/casualty insurers' net income after taxes dropped to $31.8 billion in nine-months 2016 from $44.1 billion in nine-months 2015. Insurers' overall profitability as measured by their annualized rate of return on average policyholders' surplus declined to 6.2 percent from 8.8 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 99.5 percent for nine-months 2016 from 96.9 percent for nine-months 2015, and their $1.7 billion in net underwriting losses[3] in nine-months 2016 compares to a $7.3 billion gain a year earlier. Net written premium growth slowed to 2.8 percent for nine-months 2016 from 4.1 percent for nine-months 2015.

Insurers' net investment income declined to $33.0 billion in nine-months 2016 from $34.9 billion a year earlier, and insurers' realized capital gains dropped to $5.6 billion from $8.8 billion, resulting in $38.6 billion in net investment gains[4] for nine-months 2016, down $5.1 billion from $43.7 billion for nine-months 2015.

Insurers experienced a drop in net income after taxes to $31.8 billion from $44.1 billion a year earlier.

The 27.9 percent decrease in net income after taxes drove insurers' annualized rate of return on average surplus to 6.2 percent—2.6 percentage points below the 8.8 percent value for nine-months 2015 and 2.1 percentage points below the 30-year average nine-month rate of return for 1986–2015.

The industry's surplus[5] reached a new all-time-high value of $688.3 billion as of September 30, 2016, surpassing $674.2 billion as of December 31, 2015, $676.3 billion as of March 31, 2016, and $680.6 billion as of June 30, 2016.

Underwriting Results

In the first nine months of 2016, earned premiums grew 3.6 percent to $390.7 billion, LLAE rose 7.6 percent to $279.9 billion, other underwriting expenses grew 2.6 percent to $111.2 billion, and policyholders' dividends remained essentially unchanged at $1.3 billion. As a result, the industry reported a $1.7 billion net underwriting loss, in contrast to the $7.3 billion gain for nine-months 2015.

Net written premiums climbed $10.9 billion to $403.8 billion in nine-months 2016 from $392.9 billion in nine-months 2015. Net written premium growth slowed to 2.8 percent from 4.1 percent for nine-months 2015. The growth rate in net earned premiums also slowed, to 3.6 percent in 2016 from 4.0 percent for nine-months 2015.

The 7.6 percent increase in LLAE in nine-months 2016 exceeds premium growth and compares unfavorably to the 2.7 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 $4.8 billion to $18.8 billion for nine-months 2016 from $14.0 billion a year earlier. Net LLAE for losses other than catastrophes rose $14.9 billion, or 6.1 percent, to $261.1 billion in nine-months 2016 from $246.2 billion in nine-months 2015. Private

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

U.S. insurers' net LLAE includes both their domestic and foreign catastrophic losses.[6] However, U.S. insurers' $18.8 billion in net LLAE from catastrophes in nine-months 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 2015 or 2016.

Direct insured property losses from catastrophes striking the United States totaled $17.4 billion in nine-months 2016, up from $13.1 billion in nine-months 2015 and $1.5 billion above the $15.9 billion average nine-months direct catastrophe losses for the past ten years.[7]

Higher catastrophe losses and less favorable reserve development pushed the combined ratio up to 99.5 percent and generated net underwriting losses.

Reflecting the differences between premium growth and the growth in LLAE and other costs of providing insurance, the combined ratio deteriorated by 2.6 percentage points to 99.5 percent in nine-months 2016 from 96.9 percent in nine-months 2015.

Underwriting results benefited from $6.5 billion in favorable development of LLAE reserves in nine-months 2016, based on new information and updated estimates for the ultimate cost of claims from prior accident years. The $6.5 billion of favorable reserve development in nine-months 2016 followed $9.3 billion of favorable development in nine-months 2015. Favorable development reduced the combined ratio by 1.7 percentage points in nine-months 2016 and by 2.5 percentage points in nine-months 2015.

Excluding development of LLAE reserves, net LLAE grew $16.9 billion, or 6.3 percent, to $286.4 billion in nine-months 2016 from $269.5 billion in nine-months 2015. Excluding development of LLAE reserves, net noncatastrophe LLAE grew $12.2 billion, or 4.8 percent, to $267.7 billion in nine-months 2016 from $255.5 billion a year earlier. In sum, the changes in LLAE attributable to catastrophes and reserve development account for 1.9 percentage points out of the 2.6-percentage-point deterioration of the loss ratio in nine-months 2016.

The $1.7 billion in net losses on underwriting in nine-months 2016 amounted to 0.4 percent of the $390.7 billion in net premiums earned during the period. The $7.3 billion in net gains on underwriting in nine-months 2015 amounted to 1.9 percent of the $377.0 billion in net premiums earned during that period.

While overall net written premium growth in nine-months 2016 declined to 2.8 percent from 4.1 percent a year earlier, the dynamics varied across industry segments.

Net written premium growth in nine-months 2016 was the strongest for insurers writing mostly personal lines. At 5.7 percent, it continued to grow at the same rate as in nine-months 2015. Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines dropped 3.8 percentage points to negative 1.3 percent in nine-months 2016, while premium growth for insurers writing more balanced books of business slowed slightly to 3.7 percent from 3.8 percent in nine-months 2015. 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.

Growth in net written premiums slowed to 2.8 percent

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 1.8 percentage points to 96.0 percent in nine-months 2016. Personal lines insurers' combined ratio deteriorated 3.3 percentage points to 102.9 percent, and balanced insurers' combined ratio deteriorated 2.2 percentage points to 99.2 percent in 2016 from 97.0 percent in 2015.

Investment Results

Insurers' net investment income—primarily dividends from stocks and interest on bonds—declined 5.2 percent to $33.0 billion in nine-months 2016 from $34.9 billion in nine-months 2015. This is the lowest nine-month investment income since the $29.0 billion in 2004. Insurers' realized capital gains on investments fell 36.5 percent to $5.6 billion in nine-months 2016 from $8.8 billion a year earlier. Combining net investment income and realized capital gains, overall net investment gains dropped 11.6 percent to $38.6 billion in nine-months 2016 from $43.7 billion a year earlier.

Insurers' $5.6 billion in realized capital gains in nine-months 2016 resulted from $7.2 billion in net realized gains on asset sales partially offset by $1.6 billion in realized losses on asset impairments. The net realized gains on asset sales decreased $3.6 billion in 2016 from $10.8 billion for nine-months 2015, and the realized losses on impairments decreased $0.4 billion.

Insurers' net investment income decreased 5.2 percent despite a 1.5 percent increase in average cash and invested assets for nine-months

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 December 20, 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.

2016 compared with nine-months 2015. The annualized yield on insurers' investments in nine-months 2016 dropped to 2.9 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. 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 $5.6 billion in realized capital gains in nine-months 2016 with the $2.4 billion in unrealized capital gains[8] during the same period, insurers posted $8.0 billion in overall capital gains for nine-months 2016—a $21.7 billion improvement from $13.7 billion in overall capital losses for nine-months 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 $10.9 billion to $32.5 billion for nine-months 2016 from $43.3 billion for nine-months 2015. The decline in operating income is mostly due to the $9.0 billion decrease in net gains on underwriting and the $1.8 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 $12.3 billion to $31.8 billion for nine-months 2016 from $44.1 billion for nine-months 2015. Despite the decline, nine-months 2016 net income after taxes is still above the $29.0 billion average nine-months income for the last ten years.

Policyholders' Surplus

Policyholders' surplus increased $14.1 billion to a new record-high $688.3 billion as of September 30, 2016, from $674.2 billion as of December 31, 2015. Additions to surplus in nine-months 2016 included $31.8 billion in net income after taxes, $2.4 billion in unrealized capital gains on investments (not included in net income), and $1.4 billion in new funds. The deductions from surplus consisted of $18.8 billion in dividends to shareholders and $2.6 billion in miscellaneous charges against surplus.

Policyholders' surplus continued to grow, reaching a new record high of $688.3 billion.

Unrealized capital gains increased to $2.4 billion in nine months 2016 from $22.5 billion in losses a year earlier. Net new funds paid in decreased to $1.4 billion in nine-months 2016 from $5.7 billion in nine-months 2015. Dividends to shareholders dropped 27.8 percent to $18.8 billion in nine-months 2016 from $26.1 billion in nine-months 2015. Miscellaneous charges against surplus decreased to $2.6 billion in nine-months 2016 from $11.9 billion in nine-months 2015.

Using 12-month trailing premiums, the premium-to-surplus ratio declined to 0.76 as of September 30, 2016, from 0.77 as of September 30, 2015. At the same time, the ratio of loss and loss adjustment expense reserves to surplus declined to 0.86 as of September 30, 2016, from 0.87 a year earlier. The 0.76 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 0.86 LLAE-reserves-to-surplus ratio as of September 30, 2016, is far below the 1.38 average for the 57 years ending 2015.

Third-Quarter Results

The property/casualty insurance industry's consolidated net income after taxes fell to $10.1 billion in third-quarter 2016 from $13.1 billion in third-quarter 2015. Property/casualty insurers' annualized rate of return on average surplus dropped to 5.9 percent in third-quarter 2016 from 7.8 percent a year earlier.

The $10.1 billion in net income after taxes for the insurance industry in third-quarter 2016 was the result of $11.1 billion in pretax operating income, $1.2 billion in realized capital gains on investments, and $2.2 billion in federal and foreign income taxes.

The industry's $11.1 billion in pretax operating income for third-quarter 2016 was down $4.6 billion from the $15.7 billion for third-quarter 2015. The industry's third-quarter 2016 pretax operating income was the net result of $0.2 billion in net losses on underwriting, $11.0 billion in net investment income, and $0.4 billion in miscellaneous other income.

Underwriting results deteriorated to $0.2 billion of net underwriting losses in third-quarter 2016 from $3.8 billion of net underwriting gains in third-quarter 2015.

Net LLAE from catastrophes included in private U.S. insurers' financial results in third-quarter 2016 increased to $4.2 billion from $3.0 billion in third-quarter 2015.[10] The contribution of catastrophe LLAE to the third-quarter combined ratio increased to 3.1 percentage points in 2016 from 2.3 percentage points in 2015.

Direct insured losses from catastrophes striking the United States in third-quarter 2016 totaled $3.6 billion, up from the $2.5 billion in direct insured losses caused by catastrophes that struck the United States in third-quarter 2015.[11]

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 December 20, 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.

Third-quarter 2016 net losses on underwriting amounted to 0.2 percent of the $133.6 billion in premiums earned during the period, a deterioration compared with third-quarter 2015 net gains on underwriting, which were 2.9 percent of the $129.4 billion in premiums earned during that period. The industry's combined ratio rose to 99.0 percent in third-quarter 2016 from 95.7 percent in third-quarter 2015. Over the last 30 years, the third-quarter combined ratio averaged 104.8 percent but reached as high as 122.8 percent in 1992 and as low as 90.6 percent in 2006.

Net written premiums rose $3.1 billion, or 2.3 percent, to $139.2 billion in third-quarter 2016 from $136.1 billion in third-quarter 2015. This was the 26th consecutive quarter of growth in written premiums, starting in the second quarter of 2010 after 12 quarters of declines.

Net earned premiums grew 3.3 percent to $133.6 billion in third-quarter 2016 from $129.4 billion in third-quarter 2015. LLAE grew 8.3 percent to $96.1 billion in third-quarter 2016 from $88.7 billion in third-quarter 2015. Noncatastrophe LLAE rose 7.3 percent to $92.0 billion from $85.8 billion in third-quarter 2015.

Net investment income for the industry declined $0.5 billion to $11.0 billion in third-quarter 2016 from $11.5 billion in third-quarter 2015. Third-quarter miscellaneous other income stayed mostly unchanged at $0.4 billion.

Realized capital gains on investments increased to $1.2 billion in third-quarter 2016 from $0.7 billion in third-quarter 2015. Combining net investment income and realized capital gains, third-quarter 2016 net investment gains were $12.1 billion, essentially at the same level as a year earlier.

Insurers posted $3.8 billion in unrealized capital gains on investments in third-quarter 2016, a $17.6 billion improvement from $13.8 billion in unrealized capital losses a year earlier. Combining realized and unrealized amounts, the insurance industry posted $4.9 billion in overall capital gains in third-quarter 2016—an $18.1 billion improvement from the $13.1 billion in overall capital losses on investments in third-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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Nine-Months 2016: BY THE NUMBERS

$688.3 billion
Industry surplus, compared with $680.6 billion last quarter and $674.2 billion at year-end 2015

$31.8 billion
Net income after taxes, a 27.9% drop from $44.1 billion for nine-months 2015

2.8%
Net written premium growth, after 4.1% for nine-months 2015

99.5%
Combined ratio, after 96.9% for nine-months 2015

$1.7 billion
Net underwriting loss, after $7.3 billion underwriting gain for nine-months 2015

2.9%
Annualized investment yield, 0.7 percentage points below the 3.6% average value for the last ten nine-month periods

$17.4 billion
Direct catastrophe losses—a $4.3 billion increase from nine-months 2015 and $1.5 billion above the ten-year average

Operating Results for 2016 and 2015 ($ Millions)

Nine Months	**2016**	**2015**
Net Written Premiums	$403,819	$392,909
Percent Change (%)	2.8	4.1
Net Earned Premiums	390,697	377,047
Percent Change (%)	3.6	4.0
Incurred Losses & Loss Adjustment Expenses	279,878	260,146
Percent Change (%)	7.6	2.7
Statutory Underwriting Gains (Losses)	(414)	8,513
Policyholders' Dividends	1,300	1,257
Net Underwriting Gains (Losses)	(1,715)	7,256
Pretax Operating Income	32,471	43,329
Net Investment Income Earned	33,035	34,862
Net Realized Capital Gains (Losses)	5,614	8,843
Net Investment Gains	38,649	43,705
Net Income (Loss) after Taxes	31,819	44,149
Percent Change (%)	-27.9	16.8
Surplus (Consolidated)	688,278	664,592
Loss & Loss Adjustment Expense Reserves	594,680	581,054
Combined Ratio, Post-Dividends (%)	99.5	96.9

Third Quarter	**2016**	**2015**
Net Written Premiums	$139,163	$136,073
Percent Change (%)	2.3	4.1
Net Earned Premiums	133,631	129,386
Percent Change (%)	3.3	3.9
Incurred Losses & Loss Adjustment Expenses	96,143	88,741
Percent Change (%)	8.3	4.4
Statutory Underwriting Gains (Losses)	61	4,062
Policyholders' Dividends	279	272
Net Underwriting Gains (Losses)	(218)	3,790
Pretax Operating Income	11,109	15,663
Net Investment Income Earned	10,968	11,462
Net Realized Capital Gains (Losses)	1,176	679
Net Investment Gains	12,144	12,141
Net Income (Loss) after Taxes	10,134	13,102
Percent Change (%)	-22.7	10.8
Surplus (Consolidated)	688,278	664,592
Loss & Loss Adjustment Expense Reserves	594,680	581,054
Combined Ratio, Post-Dividends (%)	99.0	95.7

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