Property/Casualty Insurance Results: First-Quarter 2017

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Private U.S. property/casualty insurers' net income after taxes dropped to $7.7 billion in first-quarter 2017 from $13.4 billion in first-quarter 2016. Insurers' overall profitability as measured by their annualized rate of return on average policyholders' surplus dropped to 4.4 percent from 7.9 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 99.6 percent for first-quarter 2017 from 97.4 percent for first-quarter 2016, and their $0.7 billion in net underwriting losses[3] compares to a $2.3 billion gain a year earlier. Net written premium growth accelerated to 4.0 percent for first-quarter 2017 from 3.2 percent for first-quarter 2016.

Insurers' net investment income increased to $11.8 billion in first-quarter 2017 from $10.9 billion a year earlier, and insurers' realized capital gains increased to $2.6 billion from $2.3 billion, resulting in $14.4 billion in net investment gains[4] for first-quarter 2017, up $1.2 billion from $13.2 billion for first-quarter 2016.

Net written premium growth accelerated.

The 42.2 percent decrease in net income after taxes drove insurers' annualized rate of return on average surplus to 4.4 percent—3.5 percentage points below the 7.9 percent value for first-quarter 2016 and 3.7 percentage points below the 8.1 percent average quarterly rate of return for 1987 through 2016.

The industry's surplus[5] reached a new all-time high value of $709.0 billion as of March 31, 2017, increasing $8.1 billion from $700.9 billion as of December 31, 2016.

Underwriting Results

In the first quarter of 2017, earned premiums grew 3.5 percent to $130.8 billion, while LLAE rose 7.4 percent to $93.5 billion, other underwriting expenses grew 2.8 percent to $37.4 billion, and policyholders' dividends remained essentially unchanged at $0.7 billion. As a result, the industry reported a $0.7 billion net underwriting loss, which compares to the $2.3 billion gain for first-quarter 2016.

Net written premiums climbed $5.2 billion to $135.4 billion in first-quarter 2017 from $130.2 billion in first-quarter 2016, a 4.0 percent growth, comparing favorably to 3.2 percent growth for first-quarter 2016. The growth rate in net earned premiums remained unchanged, at 3.5 percent.

The 7.4 percent increase in LLAE in first-quarter 2017 exceeds premium growth and compares unfavorably to the 6.2 percent increase a year earlier. LLAE growth in 2017 was accelerated by an increase in catastrophe losses. Private U.S. insurers' net LLAE from catastrophes grew $2.7 billion to $7.6 billion for first-quarter 2017 from $4.9 billion a year earlier. Net LLAE for losses other than catastrophes rose $3.7 billion, or 4.5 percent, to $85.8 billion in first-quarter 2017 from $82.1 billion in first-quarter 2016.

Private U.S. insurers' net LLAE includes both their domestic and foreign catastrophic losses.[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 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.
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.

ISO
Verisk Insurance Solutions
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Property Casualty Insurers
Association of America

However, U.S. insurers' $7.6 billion in net LLAE from catastrophes in first-quarter 2017 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 2017 or 2016.

Direct insured property losses from catastrophes striking the United States totaled $7.3 billion in first-quarter 2017, up $2.3 billion from $5.0 billion in first-quarter 2016 and $3.6 billion above the average first-quarter direct catastrophe losses for the past ten years.[7] Moreover, from 1950 through 2017, first-quarter direct catastrophe losses exceeded $4.0 billion only in 1994, 2016, and 2017, with the $14.5 billion record set in 1994 due to the $12.5 billion Northridge earthquake. The first-quarter 2017 catastrophes losses are attributed to 13 events; the three largest of these events, all including hail and tornadoes, account for $4.4 billion in direct losses.

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 99.6 percent in first-quarter 2017 from 97.4 percent in first-quarter 2016.

Underwriting results benefited from $5.5 billion in favorable development of LLAE reserves in first-quarter 2017, based on new information and updated estimates for the ultimate cost of claims from prior accident years. The $5.5 billion of favorable reserve development in first-quarter 2017 followed $4.4 billion of favorable development in first-quarter 2016. Favorable development reduced the combined ratio by 4.2 percentage points in first-quarter 2017 and by 3.4 percentage points in first-quarter 2016.

Excluding development of LLAE reserves, net LLAE grew $7.6 billion, or 8.3 percent, to $99.0 billion in first-quarter 2017 from $91.4 billion in first-quarter 2016. Excluding development of LLAE reserves, net noncatastrophe LLAE grew $5.1 billion, or 5.8 percent, to $91.6 billion in first-quarter 2017 from $86.5 billion a year earlier. The industry first-quarter loss ratio deteriorated 2.6 percentage points in 2017, and even if the catastrophe LLAE and LLAE reserve development in first-quarter 2017 had been at the same level as in first-quarter 2016, the loss ratio would still have deteriorated by 1.5 percentage points.

The $0.7 billion in net underwriting losses in first-quarter 2017 amounted to 0.6 percent of the $130.8 billion in net premiums earned during the period. The $2.3 billion in net gains on underwriting in first-quarter 2016 amounted to 1.8 percent of the $126.4 billion in net premiums earned during that period.

The loss ratio deteriorated: partially due to higher catastrophe losses and despite more favorable reserve development.

While overall net written premium growth in first-quarter 2017 accelerated to 4.0 percent from 3.2 percent a year earlier, the dynamics varied across industry segments.

Net written premium growth for insurers writing mostly personal lines slowed 1.6 percentage points to 5.7 percent in first-quarter 2017, still exceeding the growth for other segments. Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines recovered to 2.9 percent in first-quarter 2017 from negative 2.2 percent in first-quarter 2016, while premium growth for insurers writing more balanced books of business slowed 1.2 percentage points to 3.2 percent. Two special transactions of U.S. commercial lines insurers with their foreign affiliates in first-quarter 2016 suppressed the segment's premiums for that period, decreasing the growth reported for first-quarter 2016 and increasing the growth reported for first-quarter 2017.

Underwriting profitability as measured by the combined ratio deteriorated for all major segments. Excluding mortgage and financial guaranty insurers, commercial lines insurers' combined ratio worsened 1.3 percentage points to 95.6 percent in first-quarter 2017. Personal lines insurers' combined ratio deteriorated 0.8 percentage points to 101.4 percent, and balanced insurers' combined ratio deteriorated 5.4 percentage points to 101.3 percent in first-quarter 2017 from 95.9 percent in first-quarter 2016.

Investment Results

Insurers' net investment income—primarily dividends from stocks and interest on bonds—increased 8.4 percent to $11.8 billion in first-quarter 2017 from $10.9 billion in first-quarter 2016. First-quarter 2016 investment income was the lowest quarterly investment income since the $9.9 billion in third-quarter 2004. Insurers' realized capital gains on investments increased to $2.6 billion in first-quarter 2017 from $2.3 billion a year earlier. Combining net investment income and realized capital gains, overall net investment gains grew 9.1 percent to $14.4 billion in first-quarter 2017 from $13.2 billion a year earlier.

Insurers' $2.6 billion in realized capital gains in first-quarter 2017 resulted from $2.8 billion in net realized gains on asset sales partially offset by $0.2 billion in realized losses on asset impairments. The realized losses on impairments in 2017 decreased $0.5 billion from $0.7 billion for first-quarter 2016, while the net realized gains on asset sales decreased $0.2 billion.

Insurers' net investment income increased 8.4 percent, while average cash and invested assets for first-quarter 2017 grew 4.3 percent compared

7. Estimates are from Verisk's Property Claim Services® (PCS®) based on information available as of June 19, 2017. 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.

with first-quarter 2016. The annualized yield on insurers' investments in first-quarter 2017 rose to 3.0 percent from 2.9 percent for first-quarter 2016, which was the lowest annualized quarterly yield since at least 2001. These yields are significantly below the 3.6 percent average annualized quarterly yield for the last ten years. From 1960 to 2016, insurers' annual investment yield averaged 5.0 percent but ranged from as low as 2.8 percent in 1961 to as high as 8.2 percent in 1984 and 1985.

Both net investment income and realized capital gains rose in 2017.

Combining the $2.6 billion in realized capital gains in first-quarter 2017 with the $6.5 billion in unrealized capital gains[8] during the same period, insurers posted $9.1 billion in overall capital gains for first-quarter 2017—an $8.9 billion improvement from first-quarter 2016. Over the past 30 years, insurers' total capital gains have averaged $2.6 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 $8.2 billion to $5.4 billion for first-quarter 2017 from $13.6 billion for first-quarter 2016. The decline in operating income was the net result of the $3.0 billion decrease in net gains on underwriting, the $6.1 billion decrease in total other income, and the $0.9 billion increase in net investment income. The decrease in total other income is driven by the $6.3 billion accounting loss recorded by a major insurer on a retroactive reinsurance transaction that closed in first-quarter 2017.

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 $5.6 billion to $7.7 billion for first-quarter 2017 from $13.4 billion for first-quarter 2016. First-quarter 2017 net income after taxes is below the $9.9 billion average quarterly income for the last ten years and the lowest since fourth-quarter 2012, when net income after taxes was $7.3 billion.

Policyholders' Surplus

Policyholders' surplus increased $8.1 billion to a new record-high $709.0 billion as of March 31, 2017, from $700.9 billion as of December 31, 2016. Additions to surplus in first-quarter 2017 included $7.7 billion in net income after taxes, $6.5 billion in unrealized capital gains on investments (not included in net income), and $0.2 billion in miscellaneous additions to surplus. The deductions from surplus consisted of $5.4 billion in dividends to shareholders and $0.9 billion in net capital returned to parent companies.

Unrealized capital gains increased $8.7 billion to $6.5 billion in first-quarter 2017 from $2.1 billion in losses a year earlier. The net $0.9 billion of capital returned to insurers' parents in first-quarter 2017 compares to $0.2 billion of capital inflow a year earlier. The outflow in 2017 is predominantly due to one major insurer returning to its parent a noninsurance subsidiary with a net worth of $1.3 billion. Dividends to shareholders dropped 21.9 percent, to $5.4 billion in first-quarter 2017 from $7.0 billion in first-quarter 2016. The miscellaneous surplus changes added $0.2 billion to industry surplus in first-quarter 2017—an improvement from a net $2.4 billion charge against surplus in first-quarter 2016.

Policyholder surplus reached a new record level.

Using 12-month trailing premiums, the premium-to-surplus ratio declined to 0.75 as of March 31, 2017, from 0.77 as of March 31, 2016. Similarly, the ratio of loss and loss adjustment expense reserves to surplus declined to 0.84 as of March 31, 2017, from 0.87 a year earlier. These ratios remain low compared with their historical levels, due to surplus growing more rapidly than premiums or reserves. For example, over the 20 years ending 2016, the average premium-to-surplus ratio was 0.90 and the LLAE-reserves-to-surplus ratio was 1.08.

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

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.

Operating Results for Q1 2017 and Q1 2016 ($ Millions)

First Quarter	2017	2016
Net Written Premiums	$135,379	$130,158
Percent Change (%)	4.0	3.2
Net Earned Premiums	130,819	126,394
Percent Change (%)	3.5	3.5
Incurred Losses & Loss Adjustment Expenses	93,462	87,051
Percent Change (%)	7.4	6.2
Statutory Underwriting Gains (Losses)	(4)	3,010
Policyholders' Dividends	725	756
Net Underwriting Gains (Losses)	(728)	2,254
Pretax Operating Income	5,409	13,560
Net Investment Income Earned	11,805	10,888
Net Realized Capital Gains (Losses)	2,558	2,282
Net Investment Gains	14,363	13,170
Net Income (Loss) after Taxes	7,733	13,381
Percent Change (%)	-42.2	-26.3
Surplus (Consolidated)	709,034	676,305
Loss & Loss Adjustment Expense Reserves	592,798	585,825
Combined Ratio, Post-Dividends (%)	99.6	97.4

Beth Fitzgerald is senior vice president, industry engagement, ISO. Ms. Fitzgerald helps represent ISO to the global property/casualty insurance industry, participating in meetings with organizations both in the United States and around the world. Ms. Fitzgerald uses her broad experience and knowledge of insurance to engage with a wide range of stakeholders, including insurers, regulators, agents/brokers, and actuaries. Before her current role, Ms. Fitzgerald served as president of ISO Solutions, where she oversaw the development of ISO's core products and services, including 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.

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First-Quarter 2017: BY THE NUMBERS

$709.0 billion

Industry surplus, compared with $700.9 billion at year-end 2016

$7.7 billion

Net income after taxes, a 42.2% drop from $13.4 billion for first-quarter 2016

4.0%

Net written premium growth, after 3.2% in first-quarter 2016

99.6%

Combined ratio, after 97.4% in first-quarter 2016

3.0%

Annualized quarterly investment yield, compared to 3.6% average annualized quarterly yield for the last 10 years

$7.3 billion

Direct catastrophe losses—the highest first-quarter catastrophe losses since the 1994 Northridge earthquake and $2.3 billion above the direct catastrophe losses for first-quarter 2016

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