

Property/Casualty Insurance Results: First-Quarter 2018

By Neil Spector, President, ISO, and Robert Gordon, Senior Vice President, Policy, Research and International, PCI

Private U.S. property/casualty insurers' net income after taxes rose to \$17.1 billion in first-quarter 2018 from \$7.9 billion in firstquarter 2017. Insurers' overall profitability as measured by their annualized rate of return on average policyholders' surplus rose to 9.1 percent from 4.5 percent a year earlier, according to ISO, a Verisk (Nasdaq: VRSK) business, and the Property Casualty Insurers Association of America (PCI).¹

Insurers' combined ratio² improved to 94.6 percent for first-quarter 2018 from 99.5 percent for first-quarter 2017, and their \$4.2 billion in net underwriting gains³ compare to a \$0.6 billion loss a year earlier. Net written premium growth accelerated to 15.7 percent for first-quarter 2018 from 4.0 percent for first-quarter 2017.

Insurers' net investment income in firstquarter 2018 was \$11.8 billion, essentially the same as in first-quarter 2017, while insurers' realized capital gains increased to \$3.6 billion from \$2.6 billion, resulting in \$15.4 billion in net investment gains⁴ for first-quarter 2018, up \$1.0 billion from \$14.4 billion for first-quarter 2017. The industry finally attained underwriting gains, after reporting underwriting losses for seven quarters in a row.

The increase in net income after taxes drove insurers' annualized rate of return on average surplus to 9.1 percent—more than double the 4.5 percent for first-quarter 2017 and 1.3 percentage points above the 7.8 percent average annualized quarterly rate of return for 1988 to 2017.

The industry's surplus⁵ as of March 31, 2018, was \$749.3 billion, down \$3.2 billion from \$752.5 billion as of December 31, 2017.

Underwriting Results

In the first quarter of 2018, earned premiums grew 9.4 percent to \$143.1 billion, while LLAE rose 3.0 percent to \$96.2 billion, other underwriting expenses grew 12.3 percent to \$41.9 billion, and policyholders' dividends increased to \$0.8 billion from \$0.7 billion a year earlier. As a result, the industry reported a \$4.2 billion net underwriting gain, which compares to the \$0.6 billion loss for firstquarter 2017. Before 2018, insurers had not seen quarterly underwriting gains since first-quarter 2016, when the industry had \$2.3 billion in underwriting gains.

Net written premiums climbed \$21.2 billion to \$156.6 billion in first-quarter 2018 from \$135.4 billion in first-quarter 2017. Net written premium growth accelerated to 15.7 percent from 4.0 percent for first-quarter 2017. Net earned premium growth also accelerated, to 9.4 percent in first-quarter 2018 from 3.5 percent in first-quarter 2017.

The sharp acceleration of premium growth is largely due to changes in reinsurance utilization, apparently prompted by the recent U.S. tax reform. Many insurers chose to significantly reduce the portion of premiums ceded to their non-U.S. affiliates because of the concerns about possible tax implications under the new law. The effective dates of these reinsurance changes were close to the January 1, 2018 effective date of the tax reform. As a result, the first-quarter 2018 premium

 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.



growth is a compound effect of several developments, with the main drivers being organic growth in underlying direct written premiums; multiple insurers ceding less premiums to their non-U.S. affiliates in 2018; and, in some cases, one-time increases in written premiums associated with the returns of previously ceded unearned premium reserves.

The economy also helped increase premiums. From its subdued growth of 2016, U.S. economic activity has continued to strengthen over the past several quarters. In the first quarter of 2018, nominal GDP reached \$19.960 trillion or 4.735 percent above its year-earlier pace.⁶ This resurgent growth in economic activity and incomes is helping to bolster demand for insurance, and in turn, actual growth in written premiums—in both personal and commercial lines.

To assess the underlying direct premium growth, ISO had compiled premiums for a large cohort of insurers whose first-quarter data was available both for 2017 and 2018, which represents more than 95 percent of the total net written premiums for the industry. Aggregated net written premiums for these insurers grew 15.2 percent in the first-quarter 2018, while the direct written premiums grew approximately 6.0 percent; that is, changes in reinsurance contributed about 9.0 percentage points to the net premiums growth rate in first-quarter 2018. Still, direct written premium growth in first-quarter 2018 has also accelerated compared with preceding years, as annual written premium growth did not exceed 5.0 percent on both a direct and net basis for more than ten years.

The 3.0 percent increase in LLAE in firstquarter 2018 lags earned premium growth and compares favorably to the 7.2 percent increase a year earlier. LLAE growth in 2018 was mitigated by a decline in catastrophe losses. Private U.S. insurers' net LLAE from catastrophes in first-quarter 2018 dropped to \$5.0 billion for first-quarter 2018 from \$7.7 billion a year earlier. Net LLAE for losses other than catastrophes rose \$5.6 billion, or 6.6 percent, to \$91.2 billion in first-quarter 2018 from \$85.6 billion in first-quarter 2017. Net written premium growth is mostly due to changes in reinsurance arrangements, but the underlying direct written premiums also grew at a healthy rate.

Private U.S. insurers' net LLAE includes both their domestic and foreign catastrophe losses.⁷ However, U.S. insurers' \$5.0 billion in net LLAE from catastrophes in first-quarter 2018 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 2018 or 2017.

Reflecting the differences between premium growth and the growth in LLAE and other costs of providing insurance, the combined ratio improved by 4.9 percentage points to 94.6 percent in first-quarter 2018 from 99.5 percent in first-quarter 2017.

Underwriting results benefited from \$7.4 billion in favorable development of LLAE reserves in first-quarter 2018, based on new information and updated estimates for the ultimate cost of claims from prior accident years. The \$7.4 billion of favorable reserve development in first-quarter 2018 compares to \$5.5 billion of favorable development in first-quarter 2017. Favorable development reduced the combined ratio by 5.2 percentage points in first-quarter 2018 and by 4.2 percentage points in firstquarter 2017.

Excluding development of LLAE reserves, net LLAE grew \$4.7 billion, or 4.7 percent, to \$103.6 billion in first-quarter 2018 from \$98.9 billion in first-quarter 2017. Excluding both LLAE from the catastrophes and the development of LLAE reserves, net LLAE grew \$7.7 billion, or 8.4 percent, to \$99.1 billion in first-quarter 2018 from \$91.3 billion a year earlier. The combined ratio improved 4.9 percentage points in first-quarter 2018, but if catastrophe LLAE and LLAE reserve development in first-quarter 2018 had been at the same level as in first-quarter 2017, the combined ratio would have improved only 1.4 percentage points.

The \$4.2 billion in net underwriting gains in first-quarter 2018 amounted to 2.9 percent of the \$143.1 billion in net premiums earned during the period. The \$0.6 billion in net losses on underwriting in first-quarter 2017 amounted to 0.5 percent of the \$130.8 billion in net premiums earned during that period.

While overall net written premium growth in first-quarter 2018 accelerated to 15.7 percent from 4.0 percent a year earlier, the growth, as well as the embedded effects of reinsurance changes, varied significantly across industry segments.

Net written premium growth for insurers writing mostly personal lines accelerated to 8.2 percent in first-quarter 2018 from 5.7 percent a year earlier. Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines jumped to 34.7 percent in first-quarter 2018 from 2.5 percent in first-quarter 2017. The bulk of the changes in reinsurance utilization was concentrated in this segment. Premium growth for insurers writing more balanced books of business doubled from 2.4 percent in first-quarter 2017 to 4.8 percent in firstquarter 2018. Estimated direct premium growth was approximately 8.0 percent for insurers writing predominately personal lines, approximately 3.5 percent for insurers with balanced books of business, and approximately 5.0 percent for insurers writing mostly commercial lines. In aggregate, all-lines direct premiums for these insurers grew 5.9 percent, with 8.6 percent growth in automobile premiums partially offset by weaker growth in most non-automobile commercial lines of business and 4.1 percent growth in homeowners' premiums. Direct premium growth was estimated using a consistent set

^{6.} U.S. Commerce Department's National Income and Product Accounts, as detailed in Survey of Current Business (June 2018).

^{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.

of insurers representing over 95 percent of commercial insurers and close to 100 percent of remaining segments.

Underwriting profitability as measured by the combined ratio improved across all segments. Excluding mortgage and financial guaranty insurers, commercial lines insurers' combined ratio improved 1.4 percentage points to 94.0 percent in first-quarter 2018. Personal lines insurers' combined ratio improved 7.1 percentage points to 94.2 percent, while balanced insurers' combined ratio improved 4.5 percentage points to 97.2 percent in 2018 from 101.7 percent in 2017.

Investment Results

Insurers' net investment income-primarily dividends from stocks and interest on bondswas \$11.8 billion in first-quarter 2018, essentially unchanged from a year earlier. Insurers' realized capital gains on investments increased to \$3.6 billion in first-quarter 2018 from \$2.6 billion a year earlier. Combining net investment income and realized capital gains, overall net investment gains grew 6.7 percent to \$15.4 billion in first-quarter 2018 from \$14.4 billion a year earlier.

Insurers' net investment income remained unchanged at \$11.8 billion, while average cash and invested assets for first-quarter 2018 grew 5.8 percent compared with firstquarter 2017. The annualized yield on insurers' investments in first-quarter 2018 declined to 2.9 percent from 3.0 percent for first-quarter 2017. Both yields were significantly below the 3.5 percent average annualized quarterly yield for the last ten years. Moreover, the 2.9 percent yields for the first quarter of 2018, the first and third quarters of 2016, and the second quarter of 2017 were the lowest annualized quarterly yields since at least 2001. From 1960 to 2017, 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. In recent years, investment yields have trended downward, and annual yields have not exceeded 4.0 percent since 4.2 percent for 2008. On a full-year basis, insurers' annual investment yield steadily declined from 4.6 percent for 2005 to 3.2 percent

for both 2014 and 2015 and to 3.1 percent in 2017. Recent increases in the federal funds rate are expected to eventually push up the yields on insurers' investments, even though it might take some time.

The annualized investment yield of 2.9 percent remains at an historically low level

Combining the \$3.6 billion in realized capital gains in first-quarter 2018 with the \$12.1 billion in unrealized capital losses8 during the same period, insurers posted \$8.5 billion in overall capital losses for first-quarter 2018-a \$17.6 billion reduction from first-quarter 2017. Over the past 30 years, insurers' total capital gains have averaged \$3.1 billion per quarter but have ranged from as high as \$45.8 billion in fourth-quarter 2017 to as low as negative \$31.9 billion in fourth-quarter 2008 during the financial crisis.

Pretax Operating Income

Pretax operating income⁹ increased \$10.6 billion to \$16.2 billion for first-quarter 2018 from \$5.6 billion for first-quarter 2017. The \$10.6 billion increase in operating income was the combined result of the \$4.8 billion increase in net gains on underwriting and the \$5.9 billion increase in total other income, while investment income remained unchanged. Total other income in first-quarter 2017 was suppressed by the \$6.3 billion accounting loss recorded by a major insurer on a retroactive reinsurance transaction that closed in firstquarter 2017. As a result, the return of total other income to a more typical level in firstquarter 2018 represented a \$5.9 billion increase from a year earlier.

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 rose \$9.3 billion to \$17.1 billion for first-quarter 2018, more than double the \$7.9 billion for first-quarter 2017. First-quarter 2018 net income after taxes is well above the \$9.6 billion average quarterly income for the last ten years and is the highest since \$18.2 billion for first-quarter 2015.

Policyholders' Surplus

Policyholders' surplus declined \$3.2 billion to \$749.3 billion as of March 31, 2018, from \$752.5 billion as of December 31, 2017. Additions to surplus in first-quarter 2018 included \$17.1 billion in net income after taxes and \$2.4 billion in net additional capital provided to insurers. Deductions from surplus consisted of \$12.1 billion in unrealized capital losses on investments (not included in net income), \$10.1 billion in dividends to shareholders, and \$0.6 billion in miscellaneous net charges against surplus.

Insurers had \$12.1 billion in unrealized capital losses in first-quarter 2018, an \$18.6 billion swing from \$6.5 billion in unrealized capital gains a year earlier. The net \$2.4 billion of capital inflow in first-quarter 2018 compares to \$0.9 billion of outflow a year earlier. Dividends to shareholders rose to \$10.1 billion in firstquarter 2018 from \$5.4 billion in first-quarter 2017. The net result of aggregated miscellaneous credits to surplus and charges against surplus was a \$0.6 billion charge in first-quarter 2018 and a \$0.1 billion credit in first-quarter 2017.

Using 12-month trailing premiums, the premium-to-surplus ratio rose to 0.77 as of March 31, 2018, from 0.75 as of March 31, 2017. In contrast, the ratio of loss and loss adjustment expense reserves to surplus declined to 0.82 as of March 31, 2018, from 0.84 a year earlier. These ratios remain low compared with their historical levels, due to surplus generally growing more rapidly than premiums or reserves. For example, over the 20 years ending 2017, the average premiumto-surplus ratio was 0.89 and the LLAEreserves-to-surplus ratio was 1.06.

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

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

Operating Results for 2018 and 2017 (\$ Millions)		
First Quarter	2018	2017
Net Written Premiums	\$156,578	\$135,363
Percent Change (%)	15.7	4.0
Net Earned Premiums	143,094	130,780
Percent Change (%)	9.4	3.5
Incurred Losses & Loss Adjustment Expenses	96,159	93,318
Percent Change (%)	3.0	7.2
Statutory Underwriting Gains (Losses)	4,985	119
Policyholders' Dividends	815	726
Net Underwriting Gains (Losses)	4,170	(606)
Pretax Operating Income	16,160	5,563
Net Investment Income Earned	11,795	11,836
Net Realized Capital Gains (Losses)	3,559	2,557
Net Investment Gains	15,354	14,393
Net Income (Loss) after Taxes	17,131	7,879
Percent Change (%)	117.4	-41.4
Surplus (Consolidated)	749,281	709,016
Loss & Loss Adjustment Expense Reserves	611,852	592,253
Combined Ratio, Post-Dividends (%)	94.6	99.5



Neil Spector is president of ISO, helping property/casualty insurers manage and improve underwriting and rating performance throughout the policy life cycle. In the United States, Europe, and around the world, Mr. Spector is responsible for the personal and commercial lines underwriting and rating organization, including product management, strategy, sales, and operations, as well as application development, business development, government relations, and finance.



Robert Gordon is senior vice president for policy, research and international, 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.

First-Quarter 2018: **BY THE NUMBERS**

749.3 billion Industry surplus, down from \$752.5 billion at year-end 2017 billion Net income after taxes, more than twice the \$7.9 billion

in first-quarter 2017

Net written premium growth, after 4.0% in first-quarter 2017

Combined ratio, after 99.5% in first-quarter 2017

billion Net underwriting gain, after a \$0.6 billion underwriting loss in first-quarter 2017

> Annualized quarterly investment yield

P A Verisk Business

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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