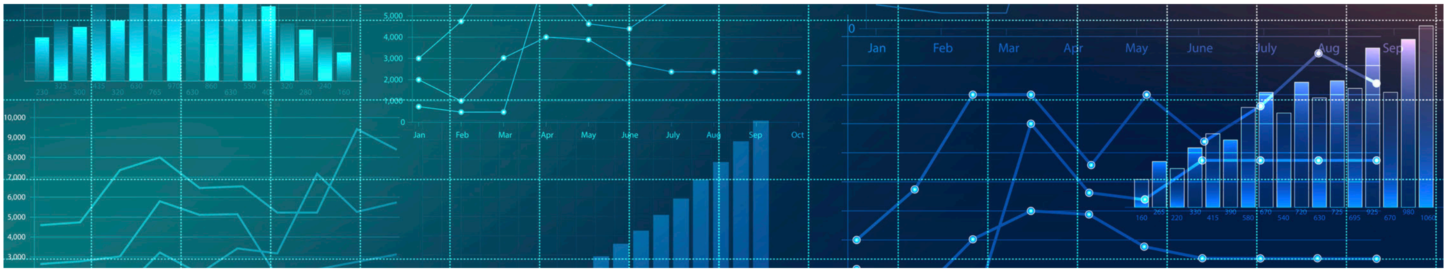


Property/Casualty Insurance Results: First-Half 2018

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 $34.0 billion in first-half 2018 from $15.5 billion in first-half 2017. Insurers' overall profitability as measured by their annualized rate of return on average policyholders' surplus increased to 9.0 percent from 4.4 percent a year earlier, according to ISO, a Verisk (Nasdaq:VRSK) business, and the Property Casualty Insurers Association of America (PCI).[1]

Insurers' combined ratio[2] improved to 96.2 percent for first-half 2018 from 100.7 percent for first-half 2017, and their $6.0 billion in net underwriting gains[3] in first-half 2018 compare with $4.6 billion in losses a year earlier. Net written premium growth accelerated to 13.3 percent for first-half 2018 from 4.1 percent for first-half 2017.

Insurers' net investment income increased to $26.8 billion in first-half 2018 from $23.4 billion a year earlier, and insurers' realized capital gains increased to $5.4 billion from $3.6 billion, resulting in $32.2 billion in net investment gains[4] for first-half 2018, up $5.2 billion from $27.0 billion for first-half 2017.

> The industry attained underwriting gains both in the first and second quarters of 2018.

The increase in net income after taxes drove insurers' annualized rate of return on average surplus to 9.0 percent—more than double the 4.4 percent for first-half 2017 and 0.7 percentage points above the average annualized first-half rate of return for 1988–2017.

The industry's surplus[5] continued to grow, reaching a new all-time-high value of $761.1 billion as of June 30, 2018, after $750.7 billion as of December 31, 2017, and $747.8 billion as of March 31, 2018.

Underwriting Results

In the first half of 2018, earned premiums grew 10.2 percent to $292.9 billion, while loss and loss adjustment expenses (LLAE) rose 3.6 percent to $201.3 billion, other underwriting expenses grew 12.7 percent to $84.5 billion, and policyholders' dividends grew 11.6 percent to $1.1 billion. As a result, the industry reported a $6.0 billion net underwriting gain, rebounding from the $4.6 billion net underwriting loss for first-half 2017. The $6.0 billion underwriting gain for 2018 comprises a $4.1 billion gain for the first quarter and a $1.9 billion gain for the second quarter, while the $4.6 billion underwriting loss for first-half 2017 comprises a $0.6 billion loss for the first quarter and a $3.9 billion loss for the second quarter.

Net written premiums climbed $36.6 billion to $312.2 billion in first-half 2018 from $275.6 billion in first-half 2017. Net written premium growth accelerated to 13.3 percent from 4.1 percent for first-half 2017. Net earned premium growth also accelerated, to 10.2 percent in first-half 2018 from 3.4 percent for first-half 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 concerns about possible tax implications under the new law. The effective dates of these reinsurance changes

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 A Verisk Business

PCI Property Casualty Insurers Association of America were close to the January 1, 2018, effective date of the tax reform. As a result, first-half 2018 premium 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.

To assess the underlying direct premium growth, ISO compiled premiums for a large cohort of insurers whose first-half data was available both for 2017 and 2018, which represents more than 95 percent of total net written premium for the industry. Aggregated net written premium for these insurers grew 13.2 percent in first-half 2018, while direct written premium grew approximately 6.0 percent; that is, changes in reinsurance contributed about 7.0 percentage points to the net premium growth rate in first-half 2018. Still, direct written premium growth in first-half 2018 also accelerated compared with preceding years, as annual written premium growth has not exceeded 5.0 percent on both a direct and net basis for more than ten years.

The 3.6 percent increase in LLAE in first-half 2018 compares favorably with the 5.8 percent increase a year earlier. LLAE growth in 2018 was suppressed by a decrease in catastrophe losses. Private U.S. insurers' net LLAE from catastrophes declined $3.3 billion to $14.6 billion for first-half 2018 from $18.0 billion a year earlier. Net LLAE for losses other than catastrophes rose $10.2 billion, or 5.8 percent, to $186.6 billion in first-half 2018 from $176.4 billion in first-half 2017.

Private U.S. insurers' net LLAE includes both their domestic and foreign catastrophic losses.[6] However, U.S. insurers' $14.6 billion in net LLAE from catastrophes in first-half 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 the first half of 2018 or the first half of 2017.

Net premium grew mostly due to reinsurance changes, but direct premium also grew at a healthy rate.

Reflecting the differences between premium growth and the growth in LLAE and other costs of providing insurance, the combined ratio improved by 4.6 percentage points to 96.2 percent in first-half 2018 from 100.7 percent in first-half 2017.

Underwriting results benefited from $9.6 billion in favorable development of LLAE reserves in first-half 2018, based on new information and updated estimates for the ultimate cost of claims from prior accident years, including catastrophe losses. The $9.6 billion of favorable reserve development in first-half 2018 compares with $6.9 billion of favorable development in first-half 2017. Favorable development reduced the combined ratio by 3.3 percentage points in first-half 2018 and by 2.6 percentage points in first-half 2017.

Excluding development of LLAE reserves, net LLAE grew $9.6 billion, or 4.7 percent, to $210.9 billion in first-half 2018 from $201.3 billion in first-half 2017. Excluding catastrophes and the development of LLAE reserves, net LLAE grew $13.9 billion, or 7.6 percent, to $197.5 billion in first-half 2018 from $183.5 billion a year earlier. The combined ratio improved 4.6 percentage points in first-half 2018, but if catastrophe LLAE and LLAE reserve development in first-half 2018 had been at the same level as in first-half 2017, the combined ratio would have improved only 1.8 percentage points.

The $6.0 billion net gain on underwriting in first-half 2018 amounted to 2.1 percent of the $292.9 billion in net premiums earned during the period. The $4.6 billion net loss on underwriting in first-half 2017 amounted to 1.7 percent of the $265.8 billion in net premiums earned during that period.

While overall net written premium growth in first-half 2018 increased to 13.3 percent from 4.1 percent a year earlier and the combined ratio improved to 96.2 percent from 100.7 percent, the dynamics varied across industry segments.

Net written premium growth for insurers writing mostly personal lines accelerated to 7.6 percent in first-half 2018 from 6.1 percent a year earlier. Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines jumped to 25.6 percent in first-half 2018 from 2.6 percent in first-half 2017. The bulk of the changes in reinsurance utilization was concentrated in this segment. Premium growth for insurers writing more balanced books of business more than doubled from 2.6 percent in first-half 2017 to 5.6 percent in first-half 2018.

Underwriting profitability as measured by the combined ratio improved across all segments. Excluding mortgage and financial guaranty insurers, commercial lines insurers' combined ratio improved 1.0 percentage points to 95.4 percent in first-half 2018. Personal lines insurers' combined ratio improved 7.2 percentage points to 95.8 percent, while balanced insurers' combined ratio improved 3.6 percentage points to 99.4 percent in 2018 from 102.9 percent in 2017.

Investment Results

Insurers' net investment income—primarily dividends from stocks and interest on bonds—increased 14.6 percent to $26.8 billion in first-half 2018 from $23.4 billion in first-half 2017. Insurers' realized capital gains on investments increased 49.2 percent to $5.4 billion in first-half 2018 from $3.6 billion a year earlier. Combining net investment income and realized capital gains, overall net investment gains increased 19.2 percent to $32.2 billion in first-half 2018 from $27.0 billion a year earlier.

Net investment income growth in first-half 2018 was significantly affected by the timing and magnitude of dividends from insurers' subsidiaries outside the U.S. property/casualty universe. Such dividends can include the earnings accumulated within subsidiaries

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.

over a long time. Three insurers were most notable for large changes in their investment income from such "external" subsidiaries, with two posting elevated investment income in first-half 2018 and the other in first-half 2017. Excluding these three insurers, net investment income grew 2.1 percent.

Both realized capital gains and net investment income rose, but investment yields remain low.

Insurers' net investment income increased 14.6 percent, while average cash and invested assets for first-half 2018 grew 5.9 percent compared with first-half 2017. That brought the annualized yield on insurers' investments in first-half 2018 to 3.2 percent, an increase of 0.2 percentage points from a year earlier, but below the 3.5 percent average annualized quarterly yield for the last ten years. 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 3.1 percent for both 2016 and 2017. Recent increases in the federal funds rate are expected eventually to push up the yields on insurers' investments, although it might take some time. The 0.2-percentage-point increase in yield in first-half 2018 was fully attributable to the timing and magnitude of dividends from insurers' "external" subsidiaries. Excluding the three insurers most affected by such dividends, annualized investment yield was 2.9 percent for both periods.

Combining the $5.4 billion in realized capital gains in first-half 2018 with the $8.0 billion in unrealized capital losses[7] during the same period, insurers posted $2.6 billion in overall capital losses for first-half 2018—a $19.2 billion drop from first-half 2017. Over the past 30 years, insurers' total capital gains have averaged $3.2 billion per quarter but have ranged from as high as $45.7 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 income[8] increased $19.6 billion to $33.6 billion for first-half 2018 from $14.0 billion for first-half 2017. The increase in operating income was the combined result of the $10.6 billion increase in net gains on underwriting, the $5.6 billion increase in miscellaneous other income, and the $3.4 billion increase in net investment income. Total other income in first-half 2017 was suppressed by the $6.3 billion accounting loss recorded by a major insurer on a retroactive reinsurance transaction that closed in first-quarter 2017. As a result, the return of total other income to a more typical level in first-half 2018 represented a $5.6 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 $18.5 billion to $34.0 billion for first-half 2018 from $15.5 billion for first-half 2017. First-half 2018 net income after taxes is considerably above the $19.8 billion average first-half income for the last ten years and is the highest first-half income in history in nominal dollars. When adjusted to 2012 dollars[9] to account for inflation, first-half 2018 net income after taxes was $30.9 billion and ranked fourth, after $35.8 billion for first-half 2005, $35.5 billion for first-half 2007, and $32.8 billion for first-half 2006.

Policyholders' Surplus

Policyholders' surplus increased $10.4 billion to a new record-high $761.1 billion as of June 30, 2018, from $750.7 billion as of December 31, 2017. Additions to surplus in first-half 2018 included $34.0 billion in net income after taxes and $3.2 billion in net additional capital provided to insurers. Deductions from surplus consisted of $8.0 billion in unrealized capital losses on investments (not included in net income), $17.4 billion in dividends to shareholders, and $1.4 billion in miscellaneous charges against surplus.

Insurers had $8.0 billion in unrealized capital losses in first-half 2018, a $21.0 billion swing from $13.0 billion in unrealized capital gains a year earlier. The net $3.2 billion of capital inflow in first-half 2018 compares with $0.2 billion of capital outflow a year earlier. Dividends to shareholders rose to $17.4 billion in first-half 2018 from $11.3 billion in first-half 2017. Miscellaneous charges against surplus decreased to $1.4 billion in first-half 2018 from $2.6 billion in first-half 2017.

Using 12-month trailing premiums, the premium-to-surplus ratio increased to 0.77 as of June 30, 2018, from 0.75 as of June 30, 2017. In contrast, the ratio of loss and loss adjustment expense reserves to surplus declined to 0.81 as of June 30, 2018, from 0.84 a year earlier. These ratios remain low compared with their historical levels because surplus grew more rapidly than premiums or reserves. For example, over the 20 years ending 2017, the average premium-to-surplus ratio was 0.89 and the LLAE-reserves-to-surplus ratio was 1.06.

Net income after taxes soared, pushing policyholder surplus to a new record level.

Second-Quarter Results

The property/casualty insurance industry's consolidated net income after taxes rose to $16.9 billion in second-quarter 2018 from $7.5 billion in second-quarter 2017. Property/casualty insurers' annualized rate of return on average surplus more than doubled to 9.0 percent in second-quarter 2018 from 4.2 percent a year earlier.

The $16.9 billion in net income after taxes for the insurance industry in second-quarter 2018 was the net result of $17.5 billion in pretax

7. Unrealized capital gains or losses contribute directly to surplus change, but they do not affect net income.
8. Pretax operating income is the sum of net gains or losses on underwriting, net investment income, and miscellaneous other income.
9. Using GDP deflator as published by the U.S. Bureau of Economic Analysis in August 2018.

operating income, $1.9 billion in realized capital gains on investments, and $2.4 billion in federal and foreign income taxes.

The industry's $17.5 billion in pretax operating income for second-quarter 2018 was up $9.1 billion from $8.4 billion for second-quarter 2017. The industry's second-quarter 2018 pretax operating income was the sum of $1.9 billion in net underwriting gains, $15.0 billion in net investment income, and $0.5 billion in miscellaneous other income.

Net underwriting results improved $5.8 billion to $1.9 billion in gains for second-quarter 2018 from $3.9 billion in losses for second-quarter 2017.

Net LLAE from catastrophes included in private U.S. insurers' financial results in second-quarter 2018 declined to $9.7 billion from $10.3 billion in second-quarter 2017.[10] The contribution of catastrophe LLAE to the second-quarter combined ratio decreased to 6.5 percentage points in 2018 from 7.6 percentage points in 2017.

Second-quarter 2018 net gains on underwriting amounted to 1.3 percent of the $149.8 billion in premiums earned during the period, whereas in second-quarter 2017 net losses on underwriting amounted to 2.9 percent of the $135.0 billion in premiums earned during the period. The industry's combined ratio improved to 97.7 percent in second-quarter 2018 from the 101.9 percent in second-quarter 2017. Over the last 30 years, the second-quarter combined ratio averaged 104.0 percent but reached as high as 117.5 percent in 2011 and as low as 92.8 percent in 2006.

The second-quarter combined ratio improved to 97.7% from 101.9% a year earlier.

Net written premiums rose $15.3 billion, or 10.9 percent, to $155.6 billion in second-quarter 2018 from $140.2 billion in second-quarter 2017. That was the 33rd consecutive quarter of growth in written premiums, beginning in the second quarter of 2010 and following 12 quarters of declines. Similar to the premiums for first-half 2018, written premium growth in second-quarter 2018 was bolstered by changes in reinsurance utilization.

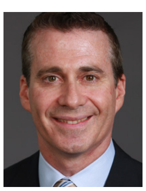
Net earned premiums grew 11.0 percent to $149.8 billion in second-quarter 2018 from $135.0 billion in second-quarter 2017. LLAE grew 4.0 percent to $105.1 billion in second-quarter 2018 from $101.0 billion in second-quarter 2017. Noncatastrophe LLAE rose 5.1 percent to $95.4 billion from $90.8 billion in second-quarter 2017.

Net investment income for the industry increased to $15.0 billion in second-quarter 2018 from $11.6 billion in second-quarter 2017, with the bulk of the increase attributable to the variations in magnitude and timing of dividends from subsidiaries outside the U.S. property/casualty insurance universe. Miscellaneous other income dropped to $0.5 billion in second-quarter 2018 from $0.7 billion in second-quarter 2017.

Realized capital gains on investments increased to $1.9 billion in second-quarter 2018 from $1.1 billion in second-quarter 2017. Combining net investment income and realized capital gains, net investment gains increased $4.2 billion, or 33.5 percent, to $16.9 billion in second-quarter 2018 from $12.7 billion a year earlier.

Insurers posted $4.0 billion in unrealized capital gains on investments in second-quarter 2018, a $2.5 billion drop from $6.5 billion of unrealized capital gains a year earlier. Combining realized and unrealized amounts, the insurance industry posted $5.9 billion in overall capital gains in second-quarter 2018—a $1.7 billion decline from the $7.5 billion in overall capital gains on investments in second-quarter 2017.

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



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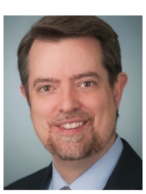

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10. Net LLAE from catastrophes also includes revisions to LLAE from catastrophes that occurred during prior periods but excludes LLAE covered by the National Flood Insurance Program, residual market insurers, and foreign insurers and reinsurers.

Operating Results for 2018 and 2017 ($ Millions)

First Half	**2018**	**2017**
Net Written Premiums	$312,187	$275,610
Percent Change (%)	13.3	4.1
Net Earned Premiums	292,947	265,816
Percent Change (%)	10.2	3.4
Incurred Losses & Loss Adjustment Expenses	201,281	194,377
Percent Change (%)	3.6	5.8
Statutory Underwriting Gains (Losses)	7,174	(3,540)
Policyholders' Dividends	1,130	1,013
Net Underwriting Gains (Losses)	6,044	(4,553)
Pretax Operating Income	33,606	14,010
Net Investment Income Earned	26,828	23,415
Net Realized Capital Gains (Losses)	5,414	3,629
Net Investment Gains	32,242	27,044
Net Income (Loss) after Taxes	34,026	15,495
Percent Change (%)	119.6	-29.1
Surplus (Consolidated)	761,121	715,247
Loss & Loss Adjustment Expense Reserves	618,872	598,448
Combined Ratio, Post-Dividends (%)	96.2	100.7

Second Quarter	**2018**	**2017**
Net Written Premiums	$155,579	$140,231
Percent Change (%)	10.9	4.2
Net Earned Premiums	149,848	135,036
Percent Change (%)	11.0	3.3
Incurred Losses & Loss Adjustment Expenses	105,094	101,020
Percent Change (%)	4.0	4.5
Statutory Underwriting Gains (Losses)	2,214	(3,633)
Policyholders' Dividends	313	288
Net Underwriting Gains (Losses)	1,901	(3,920)
Pretax Operating Income	17,488	8,363
Net Investment Income Earned	15,048	11,595
Net Realized Capital Gains (Losses)	1,856	1,065
Net Investment Gains	16,903	12,659
Net Income (Loss) after Taxes	16,933	7,528
Percent Change (%)	124.9	-10.3
Surplus (Consolidated)	761,121	715,247
Loss & Loss Adjustment Expense Reserves	618,872	598,448
Combined Ratio, Post-Dividends (%)	97.7	101.9

First-Half 2018: BY THE NUMBERS

$761.1 billion

Industry surplus, up from $747.8 billion last quarter and from $750.7 billion at year-end 2017

$34.0 billion

Net income after taxes, more than twice the $15.5 billion in first-half 2017

13.3%

Net written premium growth, after 4.1% in first-half 2017

96.2%

Combined ratio, after 100.7% for first-half 2017

$6.0 billion

Net underwriting gain, after a $4.6 billion underwriting loss in first-half 2017

3.2%

Annualized investment yield, up from 3.0% a year earlier but below the 3.4% average for the last 10 first halves.

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