Property/Casualty Insurance Results: Nine-Months 2018

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Private U.S. property/casualty insurers' net income after taxes more than doubled to $49.5 billion in nine-months 2018 from $22.4 billion in nine-months 2017. Insurers' overall profitability as measured by their annualized rate of return on average policyholders' surplus rose to 8.6 percent from 4.2 percent a year earlier, according to ISO, a Verisk (Nasdaq:VRSK) business, and the American Property Casualty Insurance Association (APCI).[1]

Insurers' combined ratio[2] improved to 97.3 percent for nine-months 2018 from 104.1 percent for nine-months 2017, and their $4.7 billion in net underwriting gains[3] in nine-months 2018 compare with $21.0 billion in net underwriting losses a year earlier. Net written premium growth accelerated to 11.4 percent for nine-months 2018 from 4.1 percent for nine-months 2017.

Insurers' net investment income grew to $40.9 billion in nine-months 2018 from $35.4 billion a year earlier, while insurers' realized capital gains decreased to $9.3 billion from $13.5 billion, resulting in $50.2 billion in net investment gains[4] for nine-months 2018, a $1.4 billion increase from $48.8 billion for nine-months 2017.

The industry held on to underwriting gains through nine-months 2018 despite underwriting losses in the third quarter.

The increase in net income after taxes drove insurers' annualized rate of return on average surplus to 8.6 percent—more than double the 4.2 percent for nine-months 2017 and 0.9 percentage points above the average annualized nine-month rate of return for 1988–2017.

The industry's surplus[5] continued to grow, reaching a new all-time-high value of $781.5 billion as of September 30, 2018, after $761.1 billion as of June 30, 2018, and $750.7 billion as of December 31, 2017.

Underwriting Results

In the first nine months of 2018, earned premiums grew 9.3 percent to $442.8 billion, while LLAE fell 0.5 percent to $310.2 billion, other underwriting expenses grew 12.1 percent to $126.4 billion, and policyholders' dividends increased to $1.5 billion from $1.4 billion a year earlier. As a result, the industry reported a $4.7 billion net underwriting gain, a sharp turnaround from the $21.0 billion net underwriting loss for nine-months 2017.

Net written premiums climbed $48.1 billion to $468.8 billion in nine-months 2018 from $420.6 billion in nine-months 2017. Net written premium growth accelerated to 11.4 percent from 4.1 percent for nine-months 2017. Net earned premium growth was 9.3 percent in nine-months 2018, accelerating from 3.6 percent for nine-months 2017.

The sharp acceleration of premium growth is partially 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 were close to the January 1, 2018, effective date of the tax reform. As a result, nine-months 2018 premium growth is a compound effect of several developments,

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.

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 nine-month data was available for both 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 11.4 percent in nine-months 2018, while direct written premium grew approximately 5.8 percent; that is, changes in reinsurance generated almost half of the net premium growth in nine-months 2018. Still, direct written premium growth in nine-months 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 0.5 percent decrease in LLAE in nine-months 2018 compares favorably with the 11.4 percent increase a year earlier. The prior time overall LLAE decreased was in 2013, in the wake of the losses from Superstorm Sandy in 2012. The decline in LLAE in 2018 was largely driven by a decrease in catastrophe losses. Private U.S. insurers' net LLAE from catastrophes declined $13.1 billion to $25.9 billion for nine-months 2018 from $38.9 billion a year earlier. Net LLAE for losses other than catastrophes rose $11.6 billion, or 4.2 percent, to $284.3 billion in nine-months 2018 from $272.8 billion in nine-months 2017.

Private U.S. insurers' net LLAE includes both their domestic and foreign catastrophic losses.[6] The $25.9 billion in net LLAE from catastrophes in nine-months 2018 is primarily attributable to catastrophes that struck the United States, even though some U.S. insurers incurred nontrivial losses from Typhoon Jebi, which hit Japan in August 2018, and from other non-U.S. events.

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 6.8 percentage points to 97.3 percent in nine-months 2018 from 104.1 percent in nine-months 2017.

Underwriting results benefited from $11.3 billion in favorable development of LLAE reserves in nine-months 2018, based on new information and updated estimates for the ultimate cost of claims from prior accident years. The $11.3 billion of favorable reserve development in nine-months 2018 followed $6.7 billion of favorable development in nine-months 2017. Favorable development reduced the combined ratio by 2.5 percentage points in nine-months 2018 and by 1.6 percentage points in nine-months 2017.

Excluding development of LLAE reserves, net LLAE grew $3.1 billion, or 1.0 percent, to $321.5 billion in nine-months 2018 from $318.4 billion in nine-months 2017. Excluding catastrophes and the development of LLAE reserves, net LLAE grew $17.8 billion, or 6.4 percent, to $297.4 billion in nine-months 2018 from $279.6 billion a year earlier. Combined, the changes in LLAE attributable to catastrophes and reserve development account for 5.0 percentage points out of the 6.9-percentage-point improvement reported for the loss ratio in nine-months 2018.

The $4.7 billion net gain on underwriting in nine-months 2018 amounted to 1.1 percent of the $442.8 billion in net premiums earned during the period. The $21.0 billion net loss on underwriting in nine-months 2017 amounted to 5.2 percent of the $404.9 billion in net premiums earned during that period.

While overall net written premium growth rate in nine-months 2018 increased to 11.4 percent from 4.1 percent a year earlier and the combined ratio improved to 97.3 percent from 104.1 percent, the dynamics varied across industry segments.

Net written premium growth for insurers writing mostly personal lines accelerated to 6.8 percent in nine-months 2018 from 6.7 percent a year earlier. Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines jumped to 21.2 percent in nine-months 2018 from 1.9 percent in nine-months 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 nine-months 2017 to 5.8 percent in nine-months 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 7.5 percentage points to 98.2 percent in nine-months 2018. Personal lines insurers' combined ratio improved 6.7 percentage points to 96.2 percent, while balanced insurers' combined ratio improved 4.9 percentage points to 99.6 percent in 2018 from 104.4 percent in 2017.

Investment Results

Insurers' net investment income—primarily dividends from stocks and interest on bonds—increased 15.7 percent to $40.9 billion in nine-months 2018 from $35.4 billion in nine-months 2017. Insurers' realized capital gains on investments declined to $9.3 billion in nine-months 2018 from the record-high $13.5 billion for nine-months 2017. Combining net investment income and realized capital gains, overall net investment gains increased $1.4 billion, or 2.8 percent, to $50.2 billion in nine-months 2018 from $48.8 billion a year earlier.

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.

Net investment income growth in nine-months 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 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 nine-months 2018 and the other in nine-months 2017. Excluding these three insurers, net investment income grew 5.1 percent.

Investment income rose, but the investment yields remained at historic lows.

Insurers' net investment income increased 15.7 percent, while average cash and invested assets for nine-months 2018 grew 6.1 percent compared with nine-months 2017. The annualized yield on insurers' investments in nine-months 2018 was 3.3 percent, an increase of 0.3 percentage points from a year earlier but still below the 3.4 percent average annualized nine-months 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 this may take some time. The 0.3-percentage point increase in yield in nine-months 2018 was largely 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 3.0 percent in nine-months 2018, less than a 0.1-percentage point increase from a year earlier.

Combining the $9.3 billion in realized capital gains in nine-months 2018 with the $4.7 billion in unrealized capital gains[7] during the same period, insurers posted $14.0 billion in overall capital gains for nine-months 2018—a 50.5 percent drop from the $28.2 billion for nine-months 2017. Over the past 30 years, insurers' total capital gains have averaged $3.3 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] jumped $36.1 billion to $46.4 billion for nine-months 2018 from $10.3 billion for nine-months 2017. The increase in operating income was the combined result of the $25.7 billion increase in net gains on underwriting, the $4.9 billion increase in miscellaneous other income, and the $5.5 billion increase in net investment income. Total other income in nine-months 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 nine-months 2018 represented a significant 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 $27.1 billion to $49.5 billion for nine-months 2018 from $22.4 billion for nine-months 2017. Nine-months 2018 net income after taxes is considerably above the $30.8 billion average nine-month income for the last ten years and the highest nine-month income since $49.6 billion in 2007.

Policyholders' Surplus

Policyholders' surplus increased $30.8 billion to a new record-high $781.5 billion as of September 30, 2018, from $750.7 billion as of December 31, 2017. Additions to surplus in nine-months 2018 included $49.5 billion in net income after taxes, $4.7 billion in unrealized capital gains on investments (not included in net income), and $3.3 billion in net additional capital provided to insurers. Deductions from surplus consisted of $23.9 billion in dividends to shareholders and $2.8 billion in miscellaneous charges against surplus.

Unrealized capital gains decreased to $4.7 billion in nine-months 2018 from $14.7 billion a year earlier. The net $3.3 billion of capital inflow in nine-months 2018 compares with $0.3 billion a year earlier. Dividends to shareholders rose $8.7 billion, or 57.0 percent, to $23.9 billion in nine-months 2018 from $15.2 billion in nine-months 2017. Miscellaneous charges against surplus decreased to $2.8 billion in nine-months 2018 from $5.3 billion in nine-months 2017.

Net income after taxes soared to a near-record level.

Using 12-month trailing premiums, the premium-to-surplus ratio increased to 0.77 as of September 30, 2018, from 0.76 as of September 30, 2017. In contrast, the ratio of loss and loss adjustment expense reserves to surplus declined to 0.80 as of September 30, 2018, 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 2017, the average premium-to-surplus ratio was 0.89 and the LLAE-reserves-to-surplus ratio was 1.06.

Third-Quarter Results

The property/casualty insurance industry's consolidated net income after taxes rose to $15.5 billion in third-quarter 2018 from $6.9 billion in third-quarter 2017. Property/casualty insurers' annualized rate of return on average surplus more than doubled to 8.0 percent in third-quarter 2018 from 3.8 percent a year earlier.

The $15.5 billion in net income after taxes for the insurance industry in third-quarter 2018

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.

was a net result of $12.8 billion in pretax operating gains, $3.9 billion in realized capital gains on investments, and $1.2 billion in federal and foreign income taxes.

The industry's $12.8 billion in pretax operating gains for third-quarter 2018 was a $16.5 billion swing from $3.7 billion in operating losses a year earlier. The industry's third-quarter 2018 pretax operating income was the net result of $1.3 billion in net losses on underwriting, $14.1 billion in net investment income, and $0.1 billion in miscellaneous other income. The $1.3 billion in net underwriting losses in the third quarter of 2018 contrasts with underwriting gains in the first two quarters of the year but represents a significant improvement from the $16.4 billion in third-quarter 2017.

Net LLAE from catastrophes included in private U.S. insurers' financial results in third-quarter 2018 declined to $11.2 billion from $21.0 billion in third-quarter 2017.[9] The contribution of catastrophe LLAE to the third-quarter combined ratio decreased to 7.4 percentage points in 2018 from 15.1 percentage points in 2017.

Third-quarter 2018 net losses on underwriting amounted to 0.9 percent of the $149.8 billion in premiums earned during the period, and the third-quarter 2017 ratio of net losses on underwriting to earned premiums was 11.8 percent. The industry's combined ratio improved to 99.7 percent in third-quarter 2018 from 110.7 percent in third-quarter 2017. 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.

The third-quarter underwriting results improved compared to 2017, helped by the decline in catastrophe losses.

Net written premiums rose $11.5 billion, or 8.0 percent, to $156.6 billion in third-quarter 2018 from $145.0 billion in third-quarter 2017. That was the 34th 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 nine-months 2018, written premium growth in third-quarter 2018 was bolstered by changes in reinsurance utilization.

Net earned premiums grew 7.7 percent to $149.8 billion in third-quarter 2018 from $139.1 billion in third-quarter 2017. LLAE declined 7.2 percent to $108.9 billion in third-quarter 2018 from $117.3 billion in third-quarter 2017. Noncatastrophe LLAE rose 1.4 percent to $97.8 billion from $96.4 billion in third-quarter 2017. The reported results for third-quarter 2018 also benefited from $1.7 billion in favorable LLAE reserve development, compared with the $0.3 billion of unfavorable LLAE reserve development in third-quarter 2017.

Net investment income for the industry increased to $14.1 billion in third-quarter 2018 from $11.9 billion in third-quarter 2017. Miscellaneous other income decreased to $0.1 billion in third-quarter 2018 from $0.8 billion in third-quarter 2017.

Realized capital gains on investments decreased to $3.9 billion in third-quarter 2018 from $9.8 billion in third-quarter 2017. Combining net investment income and realized capital gains, net investment gains decreased $3.8 billion, or 17.6 percent, to $17.9 billion in third-quarter 2018 from $21.8 billion a year earlier.

Insurers posted $12.7 billion in unrealized capital gains on investments in third-quarter 2018, an $11.0 billion increase from $1.7 billion of unrealized capital gains a year earlier. Combining realized and unrealized amounts, the insurance industry posted $16.6 billion in overall capital gains in third-quarter 2018, a $5.0 billion improvement from the $11.6 billion in overall capital gains on investments in third-quarter 2017.

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

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9. 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)

Nine Months	2018	2017
Net Written Premiums	$468,753	$420,633
Percent Change (%)	11.4	4.1
Net Earned Premiums	442,785	404,934
Percent Change (%)	9.3	3.6
Incurred Losses & Loss Adjustment Expenses	310,205	311,717
Percent Change (%)	-0.5	11.4
Statutory Underwriting Gains (Losses)	6,196	(19,548)
Policyholders' Dividends	1,462	1,428
Net Underwriting Gains (Losses)	4,734	(20,976)
Pretax Operating Income	46,440	10,340
Net Investment Income Earned	40,894	35,358
Net Realized Capital Gains (Losses)	9,298	13,466
Net Investment Gains	50,192	48,824
Net Income (Loss) after Taxes	49,505	22,359
Percent Change (%)	121.4	-30.2
Surplus (Consolidated)	781,479	717,699
Loss & Loss Adjustment Expense Reserves	628,052	621,825
Combined Ratio, Post-Dividends (%)	97.3	104.1

Third Quarter	2018	2017
Net Written Premiums	$156,566	$145,023
Percent Change (%)	8.0	4.2
Net Earned Premiums	149,837	139,118
Percent Change (%)	7.7	4.1
Incurred Losses & Loss Adjustment Expenses	108,924	117,340
Percent Change (%)	-7.2	22.0
Statutory Underwriting Gains (Losses)	(978)	(16,008)
Policyholders' Dividends	331	416
Net Underwriting Gains (Losses)	(1,309)	(16,424)
Pretax Operating Income	12,834	(3,671)
Net Investment Income Earned	14,066	11,943
Net Realized Capital Gains (Losses)	3,883	9,837
Net Investment Gains	17,949	21,780
Net Income (Loss) after Taxes	15,479	6,865
Percent Change (%)	125.5	-32.8
Surplus (Consolidated)	781,479	717,699
Loss & Loss Adjustment Expense Reserves	628,052	621,825
Combined Ratio, Post-Dividends (%)	99.7	110.7

Nine-months 2018: BY THE NUMBERS

$781.5 billion

Industry surplus, up from $761.1 billion last quarter and from $750.7 billion at year-end 2017

$49.5 billion

Net income after taxes, more than twice the $22.4 billion for nine-months 2017

11.4%

Net written premium growth, after 4.1% in nine-months 2017

97.3%

Combined ratio, after 104.1% for nine-months 2017

$4.7 billion

Net underwriting gain, after a $21.0 billion underwriting loss for nine-months 2017

3.3%

Annualized investment yield, up from 3.0% a year earlier but below the 3.5% average annualized quarterly yield for the last ten years

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