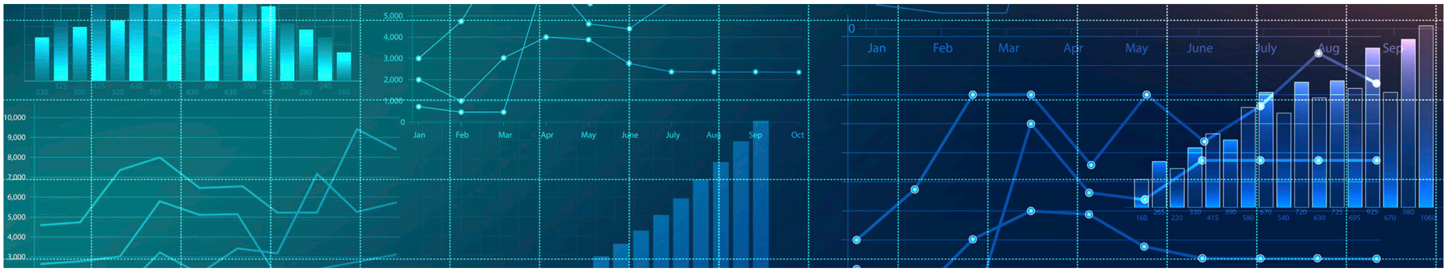


Property/Casualty Insurance Results: Nine-Months 2019

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

Private U.S. property/casualty insurers' net income after taxes declined to $48.1 billion in nine-months 2019 from $49.4 billion in nine-months 2018. Insurers' overall profitability as measured by their annualized rate of return on average policyholders' surplus fell to 8.2% from 8.6% a year earlier, according to ISO, a Verisk (Nasdaq:VRSK) business, and the American Property Casualty Insurance Association (APCIA).[1]

Insurers' combined ratio[2] deteriorated to 97.8% for nine-months 2019 from 97.4% for nine-months 2018, despite net underwriting gains[3] increasing to $5.4 billion in nine-months 2019 from $4.7 billion a year earlier. Net written premium growth slowed to 2.7% for nine-months 2019 from 11.4% for nine-months 2018.

Insurers' net investment income declined to $40.4 billion in nine-months 2019 from $40.9 billion a year earlier, and insurers' realized capital gains fell to $7.5 billion from $9.3 billion, resulting in $47.8 billion in net investment gains[4] for nine-months 2019, a $2.3 billion decrease from $50.1 billion for nine-months 2018.

> Nine-months 2019 delivered solid underwriting gains and brought the industry surplus to a new record.

The industry's surplus[5] grew in every quarter of 2019 so far, reaching a new all-time-high value of $812.2 billion as of September 30, 2019, after $802.2 billion as of June 30, 2019, and $742.1 billion as of December 31, 2018.

The decrease in net income after taxes combined with surplus growth lowered insurers' annualized rate of return on average surplus to 8.2%—down from the 8.6% for nine-months 2018 but 0.7 percentage points above the average annualized nine-month rate of return for 1989 to 2018.

Underwriting Results

In the first nine months of 2019, earned premiums grew 4.7% to $463.2 billion, while LLAE grew 5.5% to $327.1 billion; other underwriting expenses grew 2.3% to $129.2 billion; and policyholders' dividends increased to $1.6 billion from $1.5 billion a year earlier. As a result, the industry reported a $5.4 billion net underwriting gain, up from the $4.7 billion net underwriting gain for nine-months 2018.

Net written premiums rose $12.8 billion to $481.3 billion in nine-months 2019 from $468.4 billion in nine-months 2018. Net written premium growth slowed to 2.7% from 11.4% for nine-months 2018. Net earned premium growth was 4.7% in nine-months 2019, slowing from 9.3% for nine-months 2018.

The unusually low written premium growth for nine-months 2019 is mainly due to the unusually high comparison base. Following changes to the U.S. tax code effective on January 1, 2018, many insurers restructured reinsurance programs which had the effect of significantly reducing the portion of premiums ceded to non-U.S. affiliates. As a result, nine-months 2018 premium growth was a compound effect of several developments, with the main drivers being organic growth in underlying direct written premiums,

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% 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

American Property Casualty Insurance Association
INSURING AMERICA apci.org

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. Notably, the 2018 increases in earned premiums were less pronounced than the increases in written premiums, mostly due to the absence of one-time increases and partially due to the time it takes for increased written premiums to be earned.

Net written premium growth seems small when compared against the unusually high nine-months 2018 level, but the two-year average growth rate is the strongest in years.

With 2018 values unusually high, it's worth comparing 2019 premiums with the values for 2017. Average annual growth over the two-year period from nine-months 2017 to nine-months 2019 was 7.0% both for net written premiums and for earned premiums, and that significantly exceeds the rates observed in the preceding years. During the 14 years from 2004 until 2017, the net written premium growth rate averaged 2.3% and never exceeded 5.1%.

To assess the underlying direct premium growth, ISO compiled premiums for a large cohort of insurers whose nine-months data was available for 2017, 2018, and 2019, which represents more than 95% of total net written premium for the industry. Aggregated net written premium for these insurers grew 11.5% in nine-months 2018 and then grew only 2.6% in nine-months 2019, while direct written premium grew approximately 5.8% in nine-months 2018 and then grew 4.8% in nine-months 2019. The changes in direct written premiums are consistent with continued growth in the economy and relative stability in insurance markets.

The 5.5% increase in LLAE in nine-months 2019 outpaces earned premium growth and compares with the 0.5% decline a year earlier. Private U.S. insurers' LLAE from catastrophes declined $4.5 billion to $21.5 billion for nine-months 2019 from $26.0 billion a year earlier. LLAE for losses other than catastrophes rose $21.5 billion, or 7.6%, to $305.6 billion in nine-months 2019 from $284.0 billion in nine-months 2018.

Private U.S. insurers' LLAE includes both their domestic and foreign catastrophic losses.[6] However, U.S. insurers' $21.5 billion in LLAE from catastrophes in nine-months 2019 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' LLAE arising from such events was not large compared with domestic catastrophe losses. The most notable foreign catastrophes generating losses for some U.S. insurers were Typhoon Faxai, which made landfall in Japan in September 2019, and Typhoon Jebi, which hit Japan in August 2018.

Reflecting the differences between written premium growth, earned premium growth, and the growth in LLAE and other costs of providing insurance, the combined ratio deteriorated by 0.4 percentage points to 97.8% in nine-months 2019 from 97.4% in nine-months 2018, despite an increase in underwriting gains.

Underwriting results benefited from $6.7 billion in favorable development of LLAE reserves in nine-months 2019, based on new information and updated estimates for the ultimate cost of claims from prior accident years. The $6.7 billion of favorable reserve development in nine-months 2019 followed $11.3 billion of favorable development in nine-months 2018. Favorable development reduced the combined ratio by 1.4 percentage points in nine-months 2019 and by 2.5 percentage points in nine-months 2018.

Excluding development of LLAE reserves, LLAE grew $12.4 billion, or 3.9%, to $333.7 billion in nine-months 2019 from $321.3 billion in nine-months 2018. Excluding catastrophes and the development of LLAE reserves, LLAE grew $15.9 billion, or 5.3%, to $313.0 billion in nine-months 2019 from $297.1 billion a year earlier. While the industry incurred $4.5 billion less in catastrophe LLAE in nine-months 2019 than in nine-months 2018, the industry also recorded less benefit from favorable development of LLAE reserves in nine-months 2019 than in nine-months 2018. The combined ratio deteriorated 0.4 percentage points in nine-months 2019. If catastrophe LLAE and LLAE reserve development in nine-months 2019 would have been at the same level as in nine-months 2018, the combined ratio would have deteriorated by 0.3 percentage points.

The $5.4 billion net gain on underwriting in nine-months 2019 amounted to 1.2% of the $463.2 billion in net premiums earned during the period. The $4.7 billion net gain on underwriting in nine-months 2018 amounted to 1.1% of the $442.5 billion in net premiums earned during that period.

While the overall net written premium growth rate in nine-months 2019 slowed to 2.7% from 11.4% a year earlier and the combined ratio deteriorated to 97.8% from 97.4%, the dynamics varied across industry segments.

Net written premium growth for insurers writing mostly personal lines slowed to 4.2% in nine-months 2019 from 6.8% a year earlier. Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines dropped to just 1.3% in nine-months 2019 from 21.4% in nine-months 2018. The bulk of the changes in reinsurance utilization was concentrated in this segment. Premium growth for insurers writing more balanced books of business declined to 2.5% in nine-months 2019 from 5.6% in nine-months 2018.

Estimated direct premium growth was approximately 4.2% for insurers writing predominately personal lines, approximately 4.4% for insurers with balanced books of business, and approximately 5.9% for insurers writing mostly commercial lines, excluding mortgage and financial guaranty insurers. Direct premium growth was estimated using a consistent set of insurers representing more

6. 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.

than 95% of commercial insurers and close to 100% of remaining segments.

Excluding mortgage and financial guaranty insurers, commercial lines insurers' combined ratio improved 1.0 percentage points to 97.0% in nine-months 2019. Personal lines insurers' combined ratio deteriorated 1.1 percentage points to 97.5%, and balanced insurers' combined ratio deteriorated 1.3 percentage points to 101.3% in nine-months 2019 from 100.0% in nine-months 2018.

Investment Results

Insurers' net investment income—primarily dividends from stocks and interest on bonds—declined 1.2% to $40.4 billion in nine-months 2019 from $40.9 billion in nine-months 2018. Insurers' realized capital gains on investments declined to $7.5 billion in nine-months 2019 from $9.3 billion for nine-months 2018. Combining net investment income and realized capital gains, overall net investment gains decreased $2.3 billion, or 4.5%, to $47.8 billion in nine-months 2019 from $50.1 billion a year earlier.

The decline in net investment income in nine-months 2019 is largely due to an unusually high comparison base. 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. Excluding one insurer that posted elevated investment income in nine-months 2018 due to investment income from such "external" subsidiaries, nine-months net investment income grew 4.0% in 2019.

Insurers' net investment income declined 1.2%, while average cash and invested assets for nine-months 2019 grew 2.5% compared with nine-months 2018. Annualized yield on insurers' investments in nine-months 2019 was 3.1%, down from 3.3% a year earlier and below the 3.4% average annualized quarterly yield for the last ten years. From 1960 to 2018, insurers' annual investment yield averaged 5.0% but ranged from as low as 2.8% in 1961 to as high as 8.2% in 1984 and 1985. In recent years, investment yields have trended downward, and annual yields have not exceeded 4.0% since 4.2% for 2008. On a full-year basis, insurers' annual investment yield steadily declined from 4.6% for 2005 to 3.2% for both 2014 and 2015 and to 3.1% in 2016 and 2017. In 2018, investment yield rose to 3.4%, but the bulk of the increase was due to one-time money transfers from subsidiaries outside the U.S. property/casualty universe, rather than from sustainable increases in investment profitability.

Insurers reported record nine-month capital gains as stock markets recovered from the year-end 2018 decline.

Combining the $7.5 billion in realized capital gains in nine-months 2019 with the $50.8 billion in unrealized capital gains[7] during the same period, insurers posted $58.3 billion in overall capital gains for nine-months 2019—a $44.4 billion improvement from nine-months 2018. 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 $44.6 billion in fourth-quarter 2018.

Pretax Operating Income

Pretax operating income[8] rose $0.7 billion to $47.1 billion for nine-months 2019 from $46.4 billion for nine-months 2018. The increase in operating income was the net result of the $0.7 billion increase in net gains on underwriting, the $0.5 billion increase in miscellaneous other income, and the $0.5 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 $1.3 billion to $48.1 billion for nine-months 2019 from $49.4 billion for nine-months 2018. Nine-months 2019 net income after taxes is considerably above the $34.0 billion average nine-month income for the last ten years.

Policyholders' Surplus

Policyholders' surplus surged $70.1 billion to a new record-high $812.2 billion as of September 30, 2019, from $742.1 billion as of December 31, 2018. Additions to surplus in nine-months 2019 included $48.1 billion in net income after taxes and $50.8 billion in unrealized capital gains on investments (not included in net income). Deductions from surplus consisted of $23.6 billion in dividends to shareholders, $2.0 billion in net capital outflow, and $3.3 billion in miscellaneous charges against surplus.

The $70.1 billion increase in surplus for nine-months 2019 followed immediately after the $39.5 billion drop in surplus in fourth-quarter 2018. Both events were driven by a significant downturn in the stock market at the end of 2018 and the subsequent recovery in 2019. With insurers' investments in publicly traded common stocks mostly valued according to their market price, stock market ups and downs usually generate unrealized capital gains and losses for the industry, respectively. The $50.8 billion in unrealized capital gains in nine-months 2019 more than fully offset the $45.7 billion in unrealized capital losses in fourth-quarter 2018.

Unrealized capital gains surged to $50.8 billion in nine-months 2019 from $4.7 billion a year earlier. The net $2.0 billion of capital outflow in nine-months 2019 compares with $3.4 billion of capital inflow a year earlier. Dividends to shareholders declined $0.3 billion, or 1.3%, to $23.6 billion in nine-months 2019 from $23.9 billion in nine-months 2018. Miscellaneous charges against surplus increased to $3.3 billion in nine-months 2019 from $2.7 billion in nine-months 2018.

Using 12-month trailing premiums, the premium-to-surplus ratio remained at 0.77 both as of September 30, 2019, and as of September 30, 2018. The ratio of loss and loss adjustment expense reserves to surplus

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.

remained at 0.80 both as of September 30, 2019, and 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 2018, the average premium-to-surplus ratio was 0.89, and the LLAE-reserves-to-surplus ratio was 1.05.

Third-Quarter Results

The property/casualty insurance industry's consolidated net income after taxes declined to $15.3 billion in third-quarter 2019 from $15.4 billion in third-quarter 2018. Property/casualty insurers' annualized rate of return on average surplus declined to 7.6% in third-quarter 2019 from 8.0% a year earlier.

The $15.3 billion in net income after taxes for the insurance industry in third-quarter 2019 was the net result of $14.0 billion in pretax operating income, $3.2 billion in realized capital gains on investments, and $1.8 billion in federal and foreign income taxes.

The industry's $14.0 billion in pretax operating income for third-quarter 2019 increased $1.1 billion from $12.8 billion a year earlier. The industry's third-quarter 2019 pretax operating income was the net result of $13.5 billion in net investment income and $0.5 billion in miscellaneous other income. The contribution of underwriting activities was essentially zero; that is, underwriting had break-even results in third-quarter 2019, which contrasts with a $1.3 billion net underwriting loss in third-quarter 2018.

LLAE from catastrophes included in private U.S. insurers' financial results in third-quarter 2019 declined to $7.7 billion from $11.3 billion in third-quarter 2018. The contribution of catastrophe LLAE to the third-quarter combined ratio decreased to 4.8 percentage points in 2019 from 7.5 percentage points in 2018.

> Third-quarter underwriting results improved in 2019, partially due to lower catastrophe losses.

Third-quarter 2019 net gains on underwriting amounted to 0.0% of the $159.2 billion in premiums earned during the period, and the third-quarter 2018 ratio of net losses on underwriting to earned premiums was 0.9%. The industry's combined ratio improved to 98.8% in third-quarter 2019 from 99.7% in third-quarter 2018. Over the last 30 years, the third-quarter combined ratio averaged 104.4% but reached as high as 122.8% in 1992 and as low as 90.6% in 2006.

Net written premiums rose $9.8 billion, or 6.2%, to $166.2 billion in third-quarter 2019 from $156.5 billion in third-quarter 2018. The overall trend has been for quarterly written premiums to rise, and indeed there have been increases in 37 of the past 38 quarters. The only decline after the Great Recession occurred in first-quarter 2019 and was due to an unusually high comparison base, with premiums in 2018 affected by changes in reinsurance utilization.

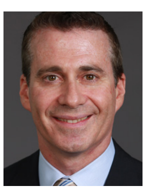
Net earned premiums grew 6.3% to $159.2 billion in third-quarter 2019 from $149.7 billion in third-quarter 2018. LLAE increased 5.2% to $114.5 billion in third-quarter 2019 from $108.9 billion in third-quarter 2018. Noncatastrophe LLAE rose 9.5% to $106.8 billion from $97.6 billion in third-quarter 2018. The reported results for third-quarter 2019 benefited from $0.9 billion in favorable LLAE reserve development, compared with $1.7 billion of favorable LLAE reserve development in third-quarter 2018.

Net investment income for the industry declined to $13.5 billion in third-quarter 2019 from $14.1 billion in third-quarter 2018. Miscellaneous other income increased to $0.5 billion in third-quarter 2019 from $0.1 billion in third-quarter 2018.

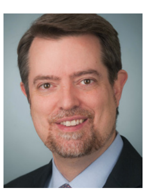
Realized capital gains on investments decreased to $3.2 billion in third-quarter 2019 from $3.9 billion in third-quarter 2018. Combining net investment income and realized capital gains, net investment gains decreased $1.3 billion, or 7.1%, to $16.6 billion in third-quarter 2019 from $17.9 billion a year earlier.

Insurers posted $9.2 billion in unrealized capital gains on investments in third-quarter 2019, a $3.5 billion decline from $12.7 billion of unrealized capital gains a year earlier. Combining realized and unrealized amounts, the insurance industry posted $12.4 billion in overall capital gains in third-quarter 2019, a $4.2 billion decline from the $16.6 billion in overall capital gains on investments in third-quarter 2018.

The key operating results for the industry are summarized in the table on page 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, APCIA. He is responsible for working with APCIA 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 APCIA's extensive state and federal advocacy efforts, media outreach, and information products.

Operating Results for 2019 and 2018 ($ Millions)

Nine-months	2019	2018
Net Written Premiums	$481,287	$468,445
Percent Change (%)	2.7	11.4
Net Earned Premiums	463,190	442,473
Percent Change (%)	4.7	9.3
Incurred Losses & Loss Adjustment Expenses	327,059	310,021
Percent Change (%)	5.5	-0.5
Statutory Underwriting Gains (Losses)	6,911	6,146
Policyholders' Dividends	1,555	1,459
Net Underwriting Gains (Losses)	5,356	4,687
Pretax Operating Income	47,104	46,410
Net Investment Income Earned	40,378	40,860
Net Realized Capital Gains (Losses)	7,457	9,253
Net Investment Gains	47,835	50,113
Net Income (Loss) after Taxes	48,075	49,408
Percent Change (%)	-2.7	121.0
Surplus (Consolidated)	812,177	781,559
Loss & Loss Adjustment Expense Reserves	649,456	628,152
Combined Ratio, Post-Dividends (%)	97.8	97.4

Third Quarter	2019	2018
Net Written Premiums	$166,219	$156,463
Percent Change (%)	6.2	7.9
Net Earned Premiums	159,184	149,732
Percent Change (%)	6.3	7.6
Incurred Losses & Loss Adjustment Expenses	114,505	108,859
Percent Change (%)	5.2	-7.2
Statutory Underwriting Gains (Losses)	463	(993)
Policyholders' Dividends	469	331
Net Underwriting Gains (Losses)	(6)	(1,324)
Pretax Operating Income	13,957	12,813
Net Investment Income Earned	13,487	14,054
Net Realized Capital Gains (Losses)	3,153	3,865
Net Investment Gains	16,641	17,919
Net Income (Loss) after Taxes	15,288	15,435
Percent Change (%)	-0.9	124.8
Surplus (Consolidated)	812,177	781,559
Loss & Loss Adjustment Expense Reserves	649,456	628,152
Combined Ratio, Post-Dividends (%)	98.8	99.7

Nine-Months 2019: BY THE NUMBERS

$812.2 billion

Industry surplus, up from $802.2 billion on June 30, 2019, and from $742.1 billion at year-end 2018

$48.1 billion

Net income after taxes, down from $49.4 billion in nine-months 2018

$481.3 billion

Net written premium, after $468.4 billion in nine-months 2018 and $420.6 billion in nine-months 2017

97.8%

Combined ratio, after 97.4% for nine-months 2018

$5.4 billion

Net underwriting gain, after $4.7 billion underwriting gain in nine-months 2018

3.1%

Annualized investment yield, down from 3.3% a year earlier

$58.3 billion

Total capital gains, compared with $13.9 billion in nine-months 2018

ISO
A Verisk Business

ISO
545 Washington Boulevard
Jersey City, NJ 07310-1686
1-800-888-4476 • www.iso.com

APCIA
8700 West Bryn Mawr Avenue, Suite 1200S
Chicago, IL 60631-3512
847-297-7800 • www.pciaa.net

American Property Casualty Insurance Association℠
INSURING AMERICA apci.org

is20010 (1/20)