Property/Casualty Insurance Results: Nine-Months 2017

***By Beth Fitzgerald, Senior Vice President, Industry Engagement, ISO,
and Robert Gordon, Senior Vice President for Policy, Research and International, PCI***

Private U.S. property/casualty insurers' net income after taxes dropped to $22.4 billion in nine-months 2017 from $32.1 billion in nine-months 2016. Insurers' overall profitability as measured by their annualized rate of return on average policyholders' surplus declined to 4.2 percent from 6.3 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] deteriorated to 104.1 percent for nine-months 2017 from 99.5 percent for nine-months 2016, and their net underwriting losses[3] jumped to $20.9 billion in nine-months 2017 from $1.7 billion a year earlier. Net written premium growth rebounded to 4.1 percent for nine-months 2017 (same as for nine-months 2015) from 2.8 percent for nine-months 2016.

Insurers' net investment income grew to $35.4 billion in nine-months 2017 from $33.2 billion a year earlier, and insurers' realized capital gains increased to $13.4 billion from $5.6 billion, resulting in $48.8 billion in net investment gains[4] for nine-months 2017, a $10.0 billion increase from $38.8 billion for nine-months 2016.

The 30.3 percent decrease in net income after taxes drove insurers' annualized rate of return on average surplus to 4.2 percent—2.1 percentage points below the value for nine-months 2016 and close to half of the 8.0 percent average annualized nine-month rate of return for 1987–2016.

The industry's surplus[5] continued to grow, reaching a new all-time-high value of $719.4 billion as of September 30, 2017, after $717.0 billion as of June 30, 2017, and $700.8 billion as of December 31, 2016.

Underwriting Results

In the first nine months of 2017, earned premiums grew 3.6 percent to $404.9 billion, while LLAE rose 11.3 percent to $311.6 billion, other underwriting expenses grew 1.4 percent to $112.8 billion, and policyholders' dividends increased to $1.4 billion from $1.3 billion a year earlier. As a result, the industry reported a $20.9 billion net underwriting loss, dwarfing the $1.7 billion net underwriting loss for nine-months 2016.

Net written premiums climbed $16.7 billion to $420.6 billion in nine-months 2017 from $403.9 billion in nine-months 2016. Net written premium growth recovered to 4.1 percent (similar to the growth rates for nine-months 2014 and nine-months 2015) from 2.8 percent for nine-months 2016. The net earned premium growth of 3.6 percent in nine-months 2017 is the same as for nine-months 2016.

Insurers' net income dropped and combined ratio deteriorated when major hurricanes returned to the United States.

The 11.3 percent increase in LLAE in nine-months 2017 significantly exceeds the 7.6 percent increase a year earlier. LLAE growth in 2017 was driven by catastrophe losses, as three major hurricanes made landfall in the United States in the third quarter, and that was after already above-average catastrophes for the first six months of 2017. At this point, the estimates of the insured losses from hurricanes Harvey, Irma, and Maria are far from being

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.

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final; and many claims, especially those for business interruption, will take a long time to settle. ISO estimates that private U.S. insurers' net underwriting losses from catastrophes as reflected in their statutory statements for nine-months 2017 were between $36 billion and $40 billion. As the portion of these losses attributable to reinstatement premiums and underwriting expenses cannot be reasonably determined but is believed to be relatively small, the analysis below treats all catastrophe-related underwriting losses as LLAE. Using a $37.8 billion point estimate near the middle of the range, ISO estimates that catastrophe LLAE grew $19.0 billion from $18.8 billion a year earlier. Net LLAE for losses other than catastrophes rose $12.7 billion, or 4.9 percent, to $273.7 billion in nine-months 2017 from $261.1 billion in nine-months 2016.

Private U.S. insurers' net LLAE includes both their domestic and foreign catastrophic losses.[6] However, U.S. insurers' LLAE from catastrophes in nine-months 2017 is primarily attributable to catastrophes that struck the United States.

Reflecting the differences between premium growth and the growth in LLAE and other costs of providing insurance, the combined ratio deteriorated by 4.6 percentage points to 104.1 percent in nine-months 2017 from 99.5 percent in nine-months 2016.

Underwriting results benefited from $6.7 billion in favorable development of LLAE reserves in nine-months 2017 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 2017 followed $6.5 billion of favorable development in nine-months 2016. Favorable development reduced the combined ratio by 1.6 percentage points in nine-months 2017 and by 1.7 percentage points in nine-months 2016.

Excluding development of LLAE reserves, net LLAE grew $31.8 billion, or 11.1 percent, to $318.2 billion in nine-months 2017 from $286.4 billion in nine-months 2016. Excluding development of LLAE reserves, net non-catastrophe LLAE grew $12.9 billion, or 4.8 percent, to $280.6 billion in nine-months 2017 from $267.7 billion a year earlier. In sum, the changes in LLAE attributable to catastrophes and reserve development account for 4.5 percentage points out of the 5.3-percentage-point deterioration reported for the loss ratio in nine-months 2017.

The $20.9 billion net loss on underwriting in nine-months 2017 amounted to 5.2 percent of the $404.9 billion in net premiums earned during the period. The $1.7 billion net loss on underwriting in nine-months 2016 amounted to 0.4 percent of the $390.7 billion in net premiums earned during that period.

While overall net written premium growth rate in nine-months 2017 increased to 4.1 percent from 2.8 percent a year earlier and the combined ratio deteriorated to 104.1 percent from 99.5 percent, the dynamics varied across industry segments.

The combined ratio for insurers writing mostly commercial lines deteriorated 10.3 percentage points.

For insurers writing mostly personal lines, net written premium increased 6.6 percent in nine-months 2017. That is even higher than the 5.9 percent growth rate in nine-months 2016 and significantly exceeds premium growth for other segments. The segment's combined ratio improved, albeit just by 0.2, to 102.8 percent and became the lowest across the segments due to the deterioration of results for other insurers.

Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines was 1.8 percent, recovering from the negative 1.2 percent for nine-months 2016. 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 nine-months 2016 and increasing the growth reported for nine-months 2017. Excluding mortgage and financial guaranty insurers, commercial lines insurers' combined ratio worsened 10.3 percentage points to 106.2 percent in nine-months 2017 and became the highest across segments.

Net premium growth for insurers writing more balanced books of business slowed to 2.7 percent from 3.4 percent a year earlier. Their combined ratio deteriorated 4.7 percentage points to 104.0 percent in nine-months 2017 from 99.3 percent a year earlier.

Investment Results

Insurers' net investment income—primarily dividends from stocks and interest on bonds—increased 6.6 percent to $35.4 billion in nine-months 2017 from $33.2 billion in nine-months 2016. Insurers' realized capital gains on investments more than doubled to $13.4 billion in nine-months 2017 from $5.6 billion a year earlier. Combining net investment income and realized capital gains, overall net investment gains increased $10.0 billion, or 25.7 percent, to $48.8 billion in nine months 2017 from $38.8 billion a year earlier.

Insurers' $13.4 billion in realized capital gains in nine-months 2017 resulted from $14.4 billion in net realized gains on asset sales partially offset by $0.9 billion in realized losses on asset impairments. Realized losses on impairments in 2017 decreased $0.6 billion from $1.6 billion for nine-months 2016, while net realized gains on asset sales increased $7.2 billion. However, the increase in realized capital gains is fully attributable to a single transaction in third-quarter 2017 that generated $9.1 billion of realized capital gains.

Insurers' net investment income increased 6.6 percent, while average cash and invested assets for nine-months 2017 grew 4.9 percent compared with nine-months 2016. The annualized yield on insurers' investments in nine-

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.

months 2017 was 3.0 percent, a slight improvement from 2.9 percent a year earlier and below the 3.5 percent average of the last ten similarly calculated annualized investment yields for nine-month periods. In recent years, investment yields have trended downward, and annualized yields have not exceeded 4 percent since first-quarter 2009. 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.

Combining the $13.4 billion in realized capital gains in nine-months 2017 with the $14.7 billion in unrealized capital gains[7] during the same period, insurers posted $28.2 billion in overall capital gains for nine-months 2017—a $20.1 billion improvement from nine-months 2016. Over the past 30 years, insurers' total capital gains have averaged $2.8 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[8] declined $22.5 billion to $10.3 billion for nine-months 2017 from $32.8 billion for nine-months 2016. The decline in operating income was the net result of the $19.2 billion increase in net losses on underwriting, the $5.5 billion decrease in miscellaneous other income, and the $2.2 billion increase in net investment income. The decrease in total other income was 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 $9.7 billion to $22.4 billion for nine-months 2017 from $32.1 billion for nine-months 2016. Nine-months 2017 net income after taxes was below the $26.3 billion average nine-month income for the last ten years and the lowest nine-month income since $8.4 billion in 2011.

Policyholders' Surplus

Policyholders' surplus increased $18.6 billion to a new record-high $719.4 billion as of September 30, 2017, from $700.8 billion as of December 31, 2016. Additions to surplus in nine-months 2017 included $22.4 billion in net income after taxes, $14.7 billion in unrealized capital gains on investments (not included in net income), and $0.1 billion in net additional capital provided to insurers. The deductions from surplus consisted of $15.1 billion in dividends to shareholders and $3.4 billion in miscellaneous charges against surplus.

Policyholders' surplus continued to grow despite the catastrophes.

Unrealized capital gains increased to $14.7 billion in nine-months 2017 from $2.5 billion a year earlier. The net $0.1 billion of additional capital provided to insurers in nine-months 2017 compares with $1.5 billion a year earlier. Dividends to shareholders dropped $3.7 billion, or 19.7 percent, to $15.1 billion in nine-months 2017 from $18.8 billion in nine-months 2016. Miscellaneous charges against surplus increased to $3.4 billion in nine-months 2017 from $3.2 billion in nine-months 2016.

As of September 30, 2017, the premium-to-surplus ratio (using 12-month trailing premiums) was 0.76, and the ratio of loss and loss adjustment expense reserves to surplus was 0.86. Both values were the same as of September 30, 2016, and 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.

Third-Quarter Results

The property/casualty insurance industry's consolidated net income after taxes fell to $6.9 billion in third-quarter 2017 from $10.2 billion in third-quarter 2016. Property/casualty insurers' annualized rate of return on average surplus dropped to 3.8 percent in third-quarter 2017 from 6.0 percent a year earlier. If not for a single transaction that generated $9.1 billion in realized capital gains for one insurer, the third quarter would have reported an after-tax loss.

The $6.9 billion in net income after taxes for the insurance industry in third-quarter 2017 was a net result of $3.6 billion in pretax operating losses, $9.8 billion in realized capital gains on investments, and negative $0.7 billion in federal and foreign income taxes.

The industry's $3.6 billion in pretax operating losses for third-quarter 2017 compares with $11.2 billion in operating gains a year earlier. The industry's third-quarter 2017 pretax operating loss was the net result of $16.4 billion in net losses on underwriting, $12.0 billion in net investment income, and $0.8 billion in miscellaneous other income. Net losses on underwriting worsened to $16.4 billion in third-quarter 2017 from $0.2 billion in third-quarter 2016.

ISO estimates that net LLAE from catastrophes included in private U.S. insurers' financial results in third-quarter 2017 increased to $19.9 billion from $4.2 billion in third-quarter 2016.[9] The contribution of catastrophe LLAE to the third-quarter combined ratio increased to 14.3 percentage points in 2017 from 3.1 percentage points in 2016.

Underwriting losses for third-quarter 2017 were $16.4 billion, and the combined ratio for the quarter was 110.7 percent.

Third-quarter 2017 net losses on underwriting amounted to 11.8 percent of the $139.1 billion in premiums earned during the period, and the third-quarter 2016 ratio of net losses on under-

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. 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.

writing to earned premiums was 0.2 percent. The industry's combined ratio deteriorated to 110.7 percent in third-quarter 2017 from the 99.0 percent in third-quarter 2016. Over the last 30 years, the third-quarter combined ratio averaged 105.0 percent but reached as high as 122.8 percent in 1992 and as low as 90.6 percent in 2006.

Net written premiums rose $5.8 billion, or 4.2 percent, to $145.0 billion in third-quarter 2017 from $139.2 billion in third-quarter 2016. That was the 30th consecutive quarter of growth in written premiums, beginning in the second quarter of 2010 and following 12 quarters of declines.

Net earned premiums grew 4.1 percent to $139.1 billion in third-quarter 2017 from $133.6 billion in third-quarter 2016. LLAE grew 22.0 percent to $117.3 billion in third-quarter 2017 from $96.1 billion in third-quarter 2016. Non-catastrophe LLAE rose 5.9 percent to $97.4 billion from $92.0 billion in third-quarter 2016. The reported results for third-quarter 2017 were also affected by $0.3 billion in unfavorable LLAE reserve development, compared with the $0.7 billion of favorable LLAE reserve development in third-quarter 2016. Excluding catastrophes and reserve development, third-quarter LLAE rose 4.9 percent.

Net investment income for the industry increased to $12.0 billion in third-quarter 2017 from $11.0 billion in third-quarter 2016. Miscellaneous other income increased to $0.8 billion in third-quarter 2017 from $0.4 billion in third-quarter 2016.

Realized capital gains on investments increased to $9.8 billion in third-quarter 2017 from $1.2 billion in third-quarter 2016. Combining net investment income and realized capital gains, net investment gains increased $9.6 billion to $21.8 billion in third-quarter 2017 from $12.2 billion a year earlier. However, this increase is mostly attributable to realized gains from a single transaction.

Insurers posted $1.7 billion in unrealized capital gains on investments in third-quarter 2017, a $2.2 billion decline from $3.9 billion of unrealized capital gains a year earlier. Combining realized and unrealized amounts, the insurance industry posted $11.5 billion in overall capital gains in third-quarter 2017, a $6.4 billion improvement from the $5.1 billion in overall capital gains on investments in third-quarter 2016.

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

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.

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.

Nine-Months 2017: BY THE NUMBERS

$719.4 billion
Industry surplus, compared with $717.0 billion last quarter and $700.8 billion at year-end 2016

$22.4 billion
Net income after taxes, a 30.3% drop from $32.1 billion for nine-months 2016

4.1%
Net written premium growth, rebounding to the 2015 level after 2.8% in nine-months 2016

104.1%
Combined ratio, after 99.5% for nine-months 2016

$20.9 billion
Net underwriting loss, after $1.7 billion underwriting loss for nine-months 2016

3.0%
Annualized investment yield, compares with the 2.9% for nine-months 2016

$13.4 billion
Realized capital gains, more than double the $5.6 billion for nine-months 2016

Operating Results for 2017 and 2016 ($ Millions)

Nine Months	2017	2016
Net Written Premiums	$420,584	$403,916
Percent Change (%)	4.1	2.8
Net Earned Premiums	404,936	390,731
Percent Change (%)	3.6	3.6
Incurred Losses & Loss Adjustment Expenses	311,588	279,878
Percent Change (%)	11.3	7.6
Statutory Underwriting Gains (Losses)	(19,453)	(383)
Policyholders' Dividends	1,430	1,301
Net Underwriting Gains (Losses)	(20,884)	(1,685)
Pretax Operating Income	10,321	32,789
Net Investment Income Earned	35,406	33,220
Net Realized Capital Gains (Losses)	13,428	5,614
Net Investment Gains	48,834	38,834
Net Income (Loss) after Taxes	22,352	32,053
Percent Change (%)	-30.3	-27.4
Surplus (Consolidated)	719,428	688,181
Loss & Loss Adjustment Expense Reserves	622,050	594,458
Combined Ratio, Post-Dividends (%)	104.1	99.5

Third Quarter	2017	2016
Net Written Premiums	$145,006	$139,196
Percent Change (%)	4.2	2.3
Net Earned Premiums	139,119	133,642
Percent Change (%)	4.1	3.3
Incurred Losses & Loss Adjustment Expenses	117,291	96,143
Percent Change (%)	22.0	8.3
Statutory Underwriting Gains (Losses)	(15,970)	72
Policyholders' Dividends	416	279
Net Underwriting Gains (Losses)	(16,387)	(208)
Pretax Operating Income	(3,635)	11,213
Net Investment Income Earned	11,959	11,030
Net Realized Capital Gains (Losses)	9,809	1,176
Net Investment Gains	21,768	12,206
Net Income (Loss) after Taxes	6,885	10,209
Percent Change (%)	-32.6	-22.1
Surplus (Consolidated)	719,428	688,181
Loss & Loss Adjustment Expense Reserves	622,050	594,458
Combined Ratio, Post-Dividends (%)	110.7	99.0

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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

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