Property/Casualty Insurance Results: 2017

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Private U.S. property/casualty insurers' net income after taxes dropped to $36.1 billion in 2017 from $42.9 billion in 2016. Insurers' overall profitability as measured by their rate of return on average policyholders' surplus declined to 5.0 percent from 6.2 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 103.7 percent for 2017 from 100.6 percent for 2016, and their net underwriting losses[3] jumped to $23.2 billion in 2017 from $4.7 billion a year earlier. Net written premium growth rebounded to 4.6 percent for 2017 from 2.7 percent for 2016.

Insurers' net investment income grew to $49.0 billion in 2017 from $46.6 billion a year earlier, and insurers' realized capital gains increased to $15.1 billion from $7.3 billion, resulting in $64.1 billion in net investment gains[4] for 2017, a $10.1 billion increase from $53.9 billion for 2016.

The 15.8 percent decrease in net income after taxes drove insurers' rate of return on average surplus to 5.0 percent, down 1.2 percentage points from 2016 and well below the 8.1 percent average rate of return for 1987 to 2016.

The industry's surplus[5] grew 7.4 percent and reached a new all-time-high value of $752.5 billion as of December 31, 2017.

Insurers' net income dropped and combined ratio deteriorated after major hurricanes and devastating wildfires.

Underwriting Results

In 2017, earned premiums grew 3.3 percent to $540.6 billion, while losses and loss adjustment expenses (LLAE) rose 8.4 percent to $410.1 billion, other underwriting expenses grew 2.3 percent to $151.1 billion, and policyholders' dividends increased to $2.6 billion from $2.3 billion a year earlier. As a result, the industry reported a $23.2 billion net underwriting loss, dwarfing the $4.7 billion net underwriting loss for 2016.

Net written premiums climbed $24.2 billion to $552.6 billion in 2017 from $528.3 billion in 2016. Net written premium growth recovered to 4.6 percent (the highest written premium growth rate since 4.9 percent in 2004) from 2.7 percent for 2016. Net earned premium growth was 3.3 percent in 2017, down from 3.5 percent for 2016.

The 8.4 percent increase in LLAE in 2017 significantly exceeds the 3.3 percent earned premium growth. LLAE growth in 2017 was driven by catastrophe losses, as three major hurricanes—Harvey, Irma, and Maria—made landfall in the United States in the third quarter, followed by devastating California wildfires in the fourth. At this point, the estimates of the insured losses from these events are not yet final; and many claims, especially those for business interruption, 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 2017 were between $51 billion and $56 billion. As the portion of these losses attributable to reinstatement premiums and underwriting expenses cannot be reasonably determined, but is believed to

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 available as of April 15, 2018. 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

PCI Property Casualty Insurers Association of America

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be relatively small, the analysis below treats all catastrophe-related underwriting losses as LLAE. Using a $53.3 billion point estimate near the middle of the range, ISO estimates that catastrophe LLAE grew $30.0 billion from $23.3 billion a year earlier. Net LLAE for losses other than catastrophes rose $1.8 billion, or 0.5 percent, to $356.8 billion in 2017 from $355.0 billion in 2016.

Private U.S. insurers' net LLAE includes both their domestic and foreign catastrophe losses.[6] However, U.S. insurers' LLAE from catastrophes in 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 to 103.7 percent in 2017 from 100.6 percent in 2016.

Underwriting results benefited from $8.8 billion in favorable development of LLAE reserves in 2017, based on new information and updated estimates for the ultimate cost of claims from prior accident years. In recent years, the industry has consistently reported favorable reserve development. In addition to the better-than-expected claims experience on long- and medium-tail lines, significant favorable reserve development is also reported on short-tail lines due to salvage and subrogation not reflected in the original LLAE estimates. The $8.8 billion of favorable reserve development in 2017 is slightly below the $9.5 billion average for the last five years but is more than twice the unusually low $3.8 billion of favorable development in 2016. Favorable development reduced the combined ratio by 1.6 percentage points in 2017 and by 0.7 percentage points in 2016.

Excluding development of LLAE reserves, net LLAE grew $36.9 billion, or 9.7 percent, to $418.9 billion in 2017 from $382.0 billion in 2016. Excluding development of LLAE reserves, net noncatastrophe LLAE grew $7.0 billion, or just 1.9 percent, to $365.8 billion in 2017 from $358.8 billion a year earlier. The changes in reserve development somewhat mitigated the increase in catastrophes. The increase in LLAE attributable to catastrophes added 5.4 percentage points to the change in the loss ratio, while the combined impact of catastrophes and changes in reserve development added 4.5 percentage points to the change in the loss ratio in 2017.

The $23.2 billion net loss on underwriting in 2017 amounted to 4.3 percent of the $540.6 billion in net premiums earned during the period. The $4.7 billion net loss on underwriting in 2016 amounted to 0.9 percent of the $523.5 billion in net premiums earned during that period.

While the overall net written premium growth rate in 2017 increased to 4.6 percent from 2.7 percent a year earlier and the combined ratio deteriorated to 103.7 percent from 100.6 percent, the dynamics varied across industry segments.

For insurers writing mostly personal lines, net written premium increased 6.7 percent in 2017. That is even higher than the 6.0 percent growth rate in 2016 and significantly exceeds premium growth for other segments. The segment's combined ratio improved by 0.7 percentage points to 102.4 percent. That improvement, combined with the deterioration of results for other insurers, made insurers writing mostly personal lines the best-performing segment in 2017.

The combined ratio for insurers writing mostly commercial lines deteriorated 5.3 percentage points.

Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines was 3.3 percent, recovering from the negative 1.5 percent for 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 2016 and increasing the growth reported for 2017. Excluding mortgage and financial guaranty insurers, commercial lines insurers' combined ratio worsened 5.3 percentage points to 104.5 percent in 2017 from 99.3 percent a year earlier.

Net premium growth for insurers writing more balanced books of business slowed to 2.6 percent from 3.2 percent a year earlier. Their combined ratio deteriorated 5.9 percentage points to 105.4 percent in 2017 from 99.5 percent a year earlier, becoming the highest combined ratio in 2017 across segments.

Investment Results

Insurers' net investment income—primarily dividends from stocks and interest on bonds—increased 5.1 percent to $49.0 billion in 2017 from $46.6 billion in 2016. Insurers' realized capital gains on investments more than doubled to $15.1 billion in 2017 from $7.3 billion a year earlier. Combining net investment income and realized capital gains, overall net investment gains increased $10.1 billion, or 18.8 percent, to $64.1 billion in 2017 from $53.9 billion a year earlier.

Insurers' $15.1 billion in realized capital gains in 2017 resulted from $16.5 billion in net realized gains on asset sales partially offset by $1.4 billion in realized losses on asset impairments. Realized losses on impairments in 2017 decreased $1.3 billion from $2.7 billion for 2016, and net realized gains on asset sales increased $6.5 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 5.1 percent, while average cash and invested assets for 2017 grew 5.3 percent compared with 2016. The yield on insurers' investments in 2017 was 3.1 percent, the same as that of a year earlier. Both yields are significantly below the 3.5 percent average investment yield for the last ten years. In recent years,

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.

investment yields have trended downward, and annual yields have not exceeded 4.0 percent since 4.2 percent for 2008. 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.

Combining the $15.1 billion in realized capital gains in 2017 with the $58.9 billion in unrealized capital gains[7] during the same period, insurers posted $74.0 billion in overall capital gains for 2017, a $51.6 billion increase from 2016 and a new record. Over the preceding 30 years, from 1987 to 2016, insurers' total capital gains have averaged $10.5 billion per year, ranging from as low as negative $72.7 billion in 2008, due to the financial crisis, to the prior record-high of $47.6 billion in 2013. However, as a ratio to prior year-end cash and invested assets, total capital gains for 2017 were 4.8 percent, significantly above the 1.4 percent average for 1987 to 2016, but second to the 5.7 percent ratio for 1997.

Pretax Operating Income

Pretax operating income[8] declined $22.7 billion to $20.3 billion for 2017 from $43.0 billion for 2016. The decline in operating income was the net result of the $18.5 billion increase in net losses on underwriting, the $6.6 billion decrease in miscellaneous other income, and the $2.4 billion increase in net investment income. The decrease in total other income is driven by the $8.1 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 $6.8 billion to $36.1 billion for 2017 from $42.9 billion for 2016. The net income after taxes for 2017 is below the $37.7 billion average annual income for the last ten years and is the lowest annual income since $35.1 billion in 2012.

Policyholders' Surplus

Policyholders' surplus increased $51.7 billion to a new record-high $752.5 billion as of December 31, 2017, from $700.8 billion as of December 31, 2016. Additions to surplus in 2017 included $36.1 billion in net income after taxes, $58.9 billion in unrealized capital gains on investments (not included in net income), and $2.1 billion in net additional capital provided to insurers. The deductions from surplus consisted of $23.7 billion in dividends to shareholders and $21.8 billion in miscellaneous charges against surplus.

Unrealized capital gains increased to $58.9 billion in 2017 from $15.0 billion in unrealized capital gains a year earlier. The net $2.1 billion of additional capital provided to insurers in 2017 compares with $0.5 billion provided in 2016. Dividends to shareholders dropped $3.8 billion, or 13.7 percent, to $23.7 billion in 2017 from $27.5 billion in 2016. Miscellaneous charges against surplus increased to $21.8 billion in 2017 from $4.3 billion in 2016.

Even though the new tax rates were not yet in effect until 2018, they already had affected tax-related assets and liabilities of insurers as of December 31, 2017.

The record unrealized capital gains reported in 2017 are partially due to the changes in U.S. tax laws. Even though the new tax rates were not in effect until 2018, they already had affected insurers' tax-related assets and liabilities as of December 31, 2017. The economy and insurers' investment strategies drove increases in the value of insurers' assets during 2017, and because of the lower tax rate in 2018, the portion of these increases reported as unrealized capital gains was larger than it would have been in prior years.[9] However, insurers' benefits associated with the lower tax rate used in calculating future tax liabilities were offset by other effects of the new law. The value of insurers' deferred tax assets associated with past underwriting losses declined in proportion to the tax rate, triggering the negative changes in deferred taxes included in the $21.8 billion of miscellaneous charges against surplus mentioned above.

As of December 31, 2017, the premium-to-surplus ratio (using 12-month trailing premiums) declined to 0.73 from 0.75 as of December 31, 2016. At the same time, the ratio of loss and loss adjustment expense reserves to surplus declined to 0.82 as of December 31, 2017, from 0.85 a year earlier. These ratios remain low when compared with their historical levels, due to surplus growing more rapidly than premiums or reserves. For example, during the 20 years ending 2016, the average premium-to-surplus ratio was 0.90 and the LLAE-reserves-to-surplus ratio was 1.08.

Fourth-Quarter Results

The property/casualty insurance industry's consolidated net income after taxes rose to $13.8 billion in fourth-quarter 2017 from $10.9 billion in fourth-quarter 2016. Property/casualty insurers' annualized rate of return on average surplus rose to 7.5 percent in fourth-quarter 2017 from 6.3 percent a year earlier.

The $13.8 billion in net income after taxes for the insurance industry in fourth-quarter 2017 was a net result of $10.0 billion in pretax operating income, $1.7 billion in realized capital gains on investments, and negative $2.1 billion in federal and foreign income taxes.

The industry's $10.0 billion in pretax operating income for fourth-quarter 2017 compares with $10.2 billion in operating income a year earlier. The industry's fourth-quarter 2017 pretax operating gain was the net result of $2.3 billion in net losses on underwriting, $13.6 billion in net investment income, and negative $1.2 billion in miscellaneous other income.

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. Statutory accounting generally requires insurers to subtract future taxes when reporting unrealized capital gains; specifically, insurers' income statements show unrealized capital gains or losses net of the associated changes in deferred tax liabilities.

Underwriting losses for fourth-quarter 2017 were $2.3 billion, and the combined ratio for the quarter was 102.5 percent.

Net losses on underwriting improved to $2.3 billion in fourth-quarter 2017 from $3.0 billion in fourth-quarter 2016.

Net LLAE from catastrophes included in private U.S. insurers' financial results in fourth-quarter 2017 increased to $15.4 billion from $4.4 billion in fourth-quarter 2016.[10] The contribution of catastrophe LLAE to the fourth-quarter combined ratio increased to 11.3 percentage points in 2017 from 3.3 percentage points in 2016.

Fourth-quarter 2017 net losses on underwriting amounted to 1.7 percent of the $135.7 billion in premiums earned during the period, and the fourth-quarter 2016 ratio of net losses on underwriting to earned premiums was 2.3 percent. The industry's combined ratio improved to 102.5 percent in fourth-quarter 2017 from 104.1 percent in fourth-quarter 2016. Over the last 30 years, the fourth-quarter combined ratio averaged 106.1 percent but reached as high as 123.3 percent in 1992 and as low as 94.9 percent in 2014.

Net written premiums rose $7.6 billion, or 6.1 percent, to $132.0 billion in fourth-quarter 2017 from $124.4 billion in fourth-quarter 2016. That was the 31st consecutive quarter of growth in written premiums, beginning in the second quarter of 2010 and following 12 quarters of declines.

Net earned premiums grew 2.2 percent to $135.7 billion in fourth-quarter 2017 from $132.8 billion in fourth-quarter 2016.

LLAE grew 0.1 percent to $98.5 billion in fourth-quarter 2017 from $98.4 billion in fourth-quarter 2016. Noncatastrophe LLAE dropped 11.5 percent to $83.1 billion from $94.0 billion in fourth-quarter 2016. The reported results for fourth-quarter 2017 were also affected by $2.1 billion in favorable LLAE reserve development, compared with the $2.8 billion of unfavorable LLAE reserve development in fourth-quarter 2016. Excluding catastrophes and reserve development, fourth-quarter LLAE declined 6.5 percent.

Net investment income for the industry increased to $13.6 billion in fourth-quarter 2017 from $13.4 billion in fourth-quarter 2016. Miscellaneous other income fell to negative $1.2 billion in fourth-quarter 2017 from negative $0.1 billion in fourth-quarter 2016.

Realized capital gains on investments remained at $1.7 billion in fourth-quarter 2017, the same as in fourth-quarter 2016. Combining net investment income and realized capital gains, net investment gains increased to $15.2 billion in fourth-quarter 2017 from $15.1 billion a year earlier.

Insurers posted $44.1 billion in unrealized capital gains on investments in fourth-quarter 2017, a $31.6 billion increase from $12.6 billion of unrealized capital gains a year earlier. Driven by a combination of developments in the U.S. economy and the effects of tax law changes on insurers' balance sheets, the $44.1 billion amount was more than twice the prior quarterly unrealized capital gains record of $20.8 billion set in fourth-quarter 1998. Combining realized and unrealized amounts, the insurance industry posted $45.8 billion in overall capital gains in fourth-quarter 2017, a $31.5 billion improvement from the $14.3 billion in overall capital gains on investments in fourth-quarter 2016.

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

2017: BY THE NUMBERS

$752.5 billion
Industry surplus, compared with $719.4 billion three months earlier and $700.8 billion at year-end 2016

$36.1 billion
Net income after taxes, a 15.8% drop from $42.9 billion for 2016

4.6%
Net written premium growth, rebounding after 2.7% in 2016

103.7%
Combined ratio, after 100.6% for 2016

$23.2 billion
Net underwriting loss, after $4.7 billion underwriting loss for 2016

3.1%
Investment yield, 0.4 percentage points below the 3.5% average value for the last ten years

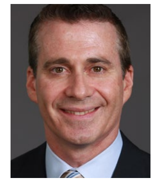
$15.1 billion
Realized capital gains, more than double the $7.3 billion for 2016

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 2017 and 2016 ($ Millions)

Full Year	2017	2016
Net Written Premiums	$552,566	$528,347
Percent Change (%)	4.6	2.7
Net Earned Premiums	540,611	523,514
Percent Change (%)	3.3	3.5
Incurred Losses & Loss Adjustment Expenses	410,123	378,276
Percent Change (%)	8.4	8.0
Statutory Underwriting Gains (Losses)	(20,609)	(2,404)
Policyholders' Dividends	2,609	2,305
Net Underwriting Gains (Losses)	(23,218)	(4,708)
Pretax Operating Income	20,332	43,031
Net Investment Income Earned	48,972	46,600
Net Realized Capital Gains (Losses)	15,083	7,314
Net Investment Gains	64,055	53,914
Net Income (Loss) after Taxes	36,123	42,924
Percent Change (%)	-15.8	-24.5
Surplus (Consolidated)	752,508	700,834
Loss & Loss Adjustment Expense Reserves	619,225	596,952
Combined Ratio, Post-Dividends (%)	103.7	100.6

Fourth Quarter	2017	2016
Net Written Premiums	$131,982	$124,432
Percent Change (%)	6.1	2.4
Net Earned Premiums	135,675	132,783
Percent Change (%)	2.2	3.0
Incurred Losses & Loss Adjustment Expenses	98,534	98,398
Percent Change (%)	0.1	9.2
Statutory Underwriting Gains (Losses)	(1,155)	(2,021)
Policyholders' Dividends	1,179	1,003
Net Underwriting Gains (Losses)	(2,334)	(3,024)
Pretax Operating Income	10,011	10,242
Net Investment Income Earned	13,566	13,380
Net Realized Capital Gains (Losses)	1,655	1,700
Net Investment Gains	15,221	15,080
Net Income (Loss) after Taxes	13,771	10,872
Percent Change (%)	26.7	-14.2
Surplus (Consolidated)	752,508	700,834
Loss & Loss Adjustment Expense Reserves	619,225	596,952
Combined Ratio, Post-Dividends (%)	102.5	104.1



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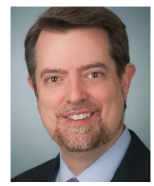

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is18016 (5/18)