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First-Quarter 2009 Results Show P/C Industry Well Capitalized Despite Net Loss After Taxes and Decline in Surplus

JERSEY CITY, N.J. — First-quarter 2009 financial results show that private U.S. property/casualty insurers had $437.1 billion in policyholders' surplus (or statutory net worth) at March 31, 2009. Insurers also had $554.4 billion in loss and loss adjustment expense reserves to cover the cost of settling claims that had already occurred and another $201.5 billion in unearned premium reserves set aside to cover losses arising during the remaining term of policies in effect on March 31, bringing the total funds available to cover losses and other contingencies to just under $1.2 trillion. Key leverage ratios, such as the premium-to-surplus ratio, show that the property/casualty insurance industry remained well capitalized, though policyholders' surplus fell $19 billion, or 4.2 percent, from $456.1 billion at year-end 2008.

Contributing to the decline in policyholders' surplus in first-quarter 2009, insurers suffered a $1.3 billion net loss after taxes and $16.4 billion in unrealized capital losses on investments (not included in net income after taxes). Other deductions from surplus in first-quarter 2009 included $2.1 billion in dividends paid to stockholders and $0.1 billion in miscellaneous other surplus changes. Partially offsetting the deductions from surplus, insurers raised $0.9 billion in new funds paid in (new capital).

The property/casualty insurance industry's $1.3 billion net loss after taxes for first-quarter 2009 constitutes a $9.8 billion adverse swing from the industry's $8.5 billion in net income after taxes in first-quarter 2008. And reflecting the swing to a net loss after taxes, the insurance industry's annualized overall rate of return on average policyholders' surplus dropped to negative 1.2 percent in first-quarter 2009 from positive 6.6 percent in first-quarter 2008.

Insurers' net loss after taxes for the first three months of 2009 resulted from a combination of losses on underwriting and deterioration in investment results. In first-quarter 2009, insurers withstood $2.5 billion in net losses on underwriting — more than four times the $0.6 billion in net losses on underwriting in first-quarter 2008. The combined ratio — a key measure of losses and other underwriting expenses per dollar of premium — worsened to 102.2 percent in the first three months of this year from 99.9 percent in the first three months of 2008, according to ISO and the Property Casualty Insurers Association of America (PCI).

Insurers' net investment gains — the sum of net investment income and realized capital gains (or losses) on investments — fell 69.9 percent to $3.7 billion in first-quarter 2009 from $12.4 billion a year earlier.

Partially offsetting the deterioration in underwriting and investment results, insurers' miscellaneous other income rose to $0.4 billion in the first three months of 2009 from $0.2 billion in the corresponding portion of 2008, and insurers' federal income taxes declined to $2.9 billion from $3.6 billion.

The figures are consolidated estimates for all private U.S. property/casualty insurers based on reports accounting for at least 96 percent of all business written by such insurers.

"Property/casualty insurers absorbed a pounding in first-quarter 2009, as the recession deepened and stock markets tumbled. Based on quarterly data extending back to 1986, insurers' $1.3 billion net loss after taxes for the first three months of this year is the worst first-quarter result on record," said Michael R. Murray, ISO's assistant vice president for financial analysis. "The perfect storm that beset the insurance industry in 2008 continued unabated in first-quarter 2009. Yet, aside from some problems in the mortgage and financial guaranty sector, the property/casualty insurance industry emerged intact."

"With so many once iconic banks, Wall Street institutions, and industrial giants having been done in by the recession and the crisis that swept through the financial system, property/casualty insurers' policyholders can be secure in the knowledge that property/casualty insurers have the financial resources to fulfill their obligations," said David Sampson, PCI president and chief executive officer. "Even as other financial service providers succumbed to the recession and financial crisis, property/casualty insurers' conservative investment strategies and prudent risk management enabled them to continue quietly going about their business — underwriting policies, paying claims, providing millions of jobs, and buying the state and municipal bonds that finance critical projects all across the nation — and all without burdening taxpayers."

The recession and credit crisis took a disproportionate toll on results for mortgage and other financial guaranty insurers. As economic conditions deteriorated and foreclosure and default rates rose, ISO estimates that mortgage and financial guaranty insurers' annualized rate of return fell to negative 149.3 percent in first-quarter 2009 from negative 89 percent in first-quarter 2008. Excluding mortgage and financial guaranty insurers, the insurance industry's rate of return declined to 2.2 percent for the first three months of 2009 from 9.5 percent for the first three months of last year, as the industry's net income fell 80.1 percent to $2.4 billion from $11.9 billion.

Underwriting Results

The factors leading to net losses on underwriting included weakness in premiums and increases in loss and loss adjustment expenses.

Net written premiums dropped $4 billion, or 3.6 percent, to $106.4 billion in the first three months of 2009 from $110.4 billion in the first three months of 2008. Net earned premiums declined $2.3 billion, or 2.2 percent, to $105.6 billion in first-quarter 2009 from $107.9 billion in first-quarter 2008.

"At negative 3.6 percent for first-quarter 2009, net written premium growth was the weakest for any first-quarter since the start of ISO's quarterly data for the property/casualty industry. Prior to this year, the record low for first-quarter premium growth was the negative 0.8 percent for first-quarter 2008, with first-quarter premium growth ranging as high as 13.5 percent in 1987," said Murray. "Market surveys and U.S. government data indicate that declining demand and declines in the price of commercial insurance cut into premiums. According to the Council of Insurance Agents and Brokers' first-quarter 2009 market survey, commercial premium rates declined 5.1 percent on average for all sizes of accounts. And as net written premiums fell in first-quarter 2009, the nation's current-dollar gross domestic product [GDP], which takes into account both inflation and real growth, dropped 0.4 percent."

As premiums declined, overall net loss and loss adjustment expenses (after reinsurance recoveries) rose $0.9 billion, or 1.1 percent, to $78.7 billion in first-quarter 2009 from $77.8 billion a year earlier. But ISO estimates that the net catastrophe losses included in insurers' financial results fell to $3.1 billion — down $0.5 billion, or 13.6 percent, compared with the net catastrophe losses included in insurers' net financial results for first-quarter 2008. Excluding estimated net catastrophe losses, loss and loss adjustment expenses increased $1.4 billion, or 1.8 percent, to $75.7 billion in first-quarter 2009 from $74.3 billion a year earlier.

According to ISO's Property Claim Services® (PCS®) unit, catastrophes occurring in first-quarter 2009 caused $2.9 billion in direct insured losses to property (before reinsurance recoveries) — down 17.1 percent from $3.5 billion in first-quarter 2008. Nonetheless, the $2.9 billion in direct catastrophe losses in first-quarter 2009 is more than one and half times the $1.7 billion average for all first quarters during the ten years from 2000 to 2009.

Other underwriting expenses — primarily acquisition expenses, expenses associated with underwriting, pricing and servicing insurance policies, and premium taxes — dropped 3.9 percent to $29.1 billion through three-months 2009 from $30.3 billion through three-months 2008.

Dividends to policyholders also declined, falling $0.1 billion, or 14.9 percent, to $0.3 billion in the first quarter of this year from $0.4 billion in the first quarter of 2008.

The $2.5 billion net loss on underwriting for three-months 2009 amounts to 2.4 percent of the $105.6 billion in net premiums earned during the period, whereas the $0.6 billion net loss on underwriting for three-months 2008 amounted to 0.5 percent of the $107.9 billion in net premiums earned during the first quarter of last year.

The 102.2 percent combined ratio for first-quarter 2009 is the worst first-quarter underwriting result since first-quarter 2002, when the combined ratio also equaled 102.2 percent. But the combined ratio for first-quarter 2009 is 0.8 percentage points better than the 103 percent average first-quarter combined ratio since the start of ISO's quarterly data in 1986.

"With catastrophe losses having declined and with the experts forecasting a more moderate hurricane season, we now face a genuine risk of complacency that could have disastrous consequences," said Sampson. "The hurricane season has just started, and it just takes one storm like Hurricane Ike or Hurricane Katrina or Hurricane Andrew to disrupt millions of lives and cause tens of billions of dollars in damage. Now is the time for all of us — insurers, regulators, legislators, businesses, and consumers — to take the steps that need to be taken to make sure we'll be prepared when the next big storm hits."

"Though natural catastrophes didn't have a big impact on insurers' results for first-quarter 2009, the recession and the crisis sweeping through the financial system certainly took a toll on underwriting results for the period, with foreclosures and other credit problems contributing to disproportionate deterioration in results for mortgage and financial guaranty insurers," said Murray. "As mortgage and financial guaranty insurers' net written premiums fell 28 percent to $1.5 billion in the first three months of this year from $2.1 billion in the first three months of 2008, their loss and loss adjustment expenses jumped 18.1 percent to $5.7 billion from $4.8 billion. As a result, their combined ratio jumped to 299.6 percent in first-quarter 2009 from 268.2 percent in first-quarter 2008. Excluding mortgage and financial guaranty insurers, industry net written premiums fell 3.1 percent, loss and loss adjustment expenses were essentially unchanged at $73.1 billion, and the combined ratio increased to 98.4 percent in first-quarter 2009 from 96.8 percent in first-quarter 2008."

Investment Results

The industry's net investment income — primarily dividends from stocks and interest on bonds — fell $1.1 billion, or 8.7 percent, to $11.7 billion through three-months 2009 from $12.9 billion through three-months 2008. Realized capital losses on investments (not included in net investment income) in first-quarter 2009 totaled $8 billion — $7.6 billion more than the $0.4 billion in realized capital losses in first-quarter 2008. Combining net investment income and realized capital losses, overall net investment gains fell $8.7 billion to $3.7 billion for the first three months of 2009 from $12.4 billion a year earlier.

Combining the $8 billion in realized capital losses in first-quarter 2009 with $16.4 billion in unrealized capital losses during the period, insurers' overall capital losses totaled $24.4 billion through three-months 2009 — $13.7 billion more than their $10.6 billion in overall capital losses through three-months 2008.

"Conceptually, insurers' investment income is a result of two things — the yield on cash and invested assets, and the amount of cash and invested assets held by insurers," said Sampson. "The 8.7 percent decline in investment income in first-quarter 2009 was driven by a 7.5 percent decline in insurers' average holdings of cash and invested assets to $1.2 trillion in first-quarter 2009 from $1.3 trillion in first-quarter 2008. But the annualized yield on insurers' cash and invested assets also declined, receding to 4 percent in the first three months of this year from 4.1 percent in the first three months of last year."

"Insurers' overall capital losses through three-months 2009 reflect both developments in financial markets and insurers' need to write-down investments that became impaired as a result of the recession, foreclosures, and the crisis in the financial system," said Murray. "In first-quarter 2009, stock prices as measured by the S&P 500 dropped 11.7 percent, with the New York Stock Exchange composite index falling 13.5 percent. In addition, ISO estimates that insurers suffered $7.8 billion in pretax capital losses on impaired investments in first-quarter 2009 — up from $1.3 billion in first-quarter 2008. In more ordinary times, the fact that the S&P 500 rose 12.9 percent from the end of first-quarter 2009 through June 24 would be reason to be optimistic about the outlook for capital gains. But in today's environment, any optimism has to be tempered by the possibility that some additional investments will become impaired as a result of the recession."

Pretax Operating Income

Pretax operating income — the sum of net gains or losses on underwriting, net investment income, and miscellaneous other income — fell 23.9 percent to $9.5 billion in first-quarter 2009 from $12.5 billion in first-quarter 2008. The $3 billion decline in operating income is the net result of the $2 billion increase in net losses on underwriting, the $1.1 billion decline in net investment income, and the $0.1 billion increase in miscellaneous other income.

Net Income after Taxes

The insurance industry's net income after taxes fell $9.8 billion to negative $1.3 billion through three-months 2009 from positive $8.5 billion through three-months 2008. Net income would have fallen more if not for a $0.8 billion decline in federal income taxes to $2.9 billion, which partially offset the $3 billion decline in operating income and the $7.6 billion increase in realized capital losses on investments.

Policyholders' Surplus and Financial Leverage

Policyholders' surplus — insurers' net worth measured according to Statutory Accounting Principles — dropped $19 billion to $437.1 billion at March 31, 2009, from $456.1 billion at year-end 2008. Despite the decline in policyholders' surplus, leverage ratios suggest that insurers remained strongly capitalized.

Leverage ratios, such as the ratio of premiums to surplus and the ratio of loss and loss adjustment expense reserves to surplus, provide simple measures of the amount of risk supported by each dollar of policyholders' surplus. All else being equal, the lower the leverage ratios, the more likely an insurer has enough policyholders' surplus to withstand future losses and other contingencies.

As of March 31, 2009, the ratio of 12-month premiums to surplus stood at 0.98, with the ratio of annual premiums to year-end surplus averaging 1.52 during the 50 years from 1959 to 2008 and ranging from a low of 0.84 at year-end 1998 to a high of 2.75 at year-end 1974. Similarly, as of March 31, 2009, the ratio of loss and loss adjustment expense reserves to surplus was 1.27, with that ratio averaging 1.43 based on annual data for the 50 years ending 2008 and ranging from a low of 0.59 at year-end 1961 to a high of 2.13 at year-end 1974.

Deductions from surplus in first-quarter 2009 included insurers' $1.3 billion in net losses after taxes, $16.4 billion in unrealized capital losses on investments (not included in net income), $2.1 billion in dividends paid to stockholders, and $0.1 billion in miscellaneous other surplus changes. Those deductions were partially offset by $0.9 billion in new funds paid in (new capital raised by insurers).

The $16.4 billion in unrealized capital losses on investments in first-quarter 2009 is $6.1 billion, or 60.1 percent, more than the $10.2 in unrealized capital losses in first-quarter 2008.

The $2.1 billion in dividends to shareholders through first-quarter 2009 is down $4.1 billion, or 65.9 percent, from $6.2 billion in first-quarter 2008.

The $0.1 billion in miscellaneous charges against surplus in first-quarter 2009 constitutes a $0.6 billion swing from the $0.5 billion in miscellaneous additions to surplus in first-quarter 2008.

The $0.9 billion in new funds paid in through three-months 2009 is down 75.7 percent from $3.8 billion through three-months 2008.

OPERATING RESULTS FOR 2009 and 2008 ($ Millions)

FIRST QUARTER	**2009**	**2008**
NET WRITTEN PREMIUMS	106,383	110,386
NET EARNED PREMIUMS	105,577	107,925

INCURRED LOSS & LOSS ADJUSTMENT EXPENSES	78,722	77,833
STATUTORY UNDERWRITING GAINS (LOSSES)	(2,216)	(167)
POLICYHOLDERS' DIVIDENDS	329	387
NET UNDERWRITING GAINS (LOSSES)	(2,545)	(553)
PRETAX OPERATING INCOME	9,541	12,540
NET INVESTMENT INCOME EARNED	11,731	12,850
NET REALIZED CAPITAL GAINS (LOSSES)	(7,987)	(412)
NET INVESTMENT GAINS	3,744	12,438
NET INCOME (LOSS) AFTER TAXES	(1,309)	8,493
SURPLUS (CONSOLIDATED)	437,097	514,210
LOSS & LOSS ADJUSTMENT EXPENSE RESERVES	554,413	536,887
COMBINED RATIO, POST-DIVIDENDS (%)	102.2	99.9

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