Property/Casualty Insurance Results 2014

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Private U.S. property/casualty insurers' net income after taxes fell to $55.5 billion in 2014 from $63.4 billion in 2013, with insurers' overall profitability as measured by their rate of return on average policyholders' surplus dropping to 8.4 percent from 10.2 percent, according to ISO, a Verisk Analytics business (Nasdaq:VRSK), and the Property Casualty Insurers Association of America (PCI).[1]

Insurers' combined ratio[2] deteriorated from 96.2 percent in 2013 to 97.0 percent in 2014. Net written premium growth slowed slightly from 4.4 percent in 2013 to 4.1 percent in 2014. Policyholders' surplus increased by $21.3 billion in 2014 to $674.7 billion.

Insurers' net investment income dropped to $46.2 billion last year from $47.3 billion in 2013. The drop in investment income is a result of historically low investment yields as the economy slowly recovers from the financial crisis and its aftermath.

Premium Growth

Growth in overall net written premiums slowed to 4.1 percent in 2014, down from 4.4 percent in 2013 but above the 1.6 percent average of the last ten years.

Net gains on underwriting decreased from $15.2 billion in 2013 to $12.3 billion in 2014, a change mainly attributable to the growth in net losses and loss adjustment expenses (LLAE).

Net written premiums climbed 4.1 percent in 2014 to $496.6 billion, and net earned premiums grew 4.3 percent to $487.6 billion. However, net LLAE grew 6.2 percent in 2014 to $334.7 billion. The 2.6 percent growth of underwriting expenses also diminished net gains on underwriting, while the dividends to policyholders remained essentially unchanged.

Insurers earned net gains on underwriting in just 13 of the 56 years from the start of ISO's data in 1959 to 2014, with insurers posting cumulative net losses on underwriting amounting to $473.9 billion during that period.

Investment Gains and Other Income

Insurers' overall results for 2014 also reflect a $2.5 billion decrease in net investment gains,[3] which fell to $56.2 billion in 2014 from $58.7 billion in 2013.

Insurers' miscellaneous other income fell $4.3 billion to negative $2.8 billion in 2014 from $1.5 billion in 2013. Reflecting and partially offsetting their pretax losses, insurers' federal and foreign income taxes fell $1.8 billion to $10.2 billion from $12.0 billion.

The unusual change in miscellaneous other income is due to retroactive reinsurance. Statutory accounting requires the gains and losses on retroactive reinsurance to be reported as miscellaneous income, rather than premiums and losses. The industry's reported

Insurers have enjoyed nearly five years of uninterrupted growth in written premiums after three years of declines.

net losses in 2014 are driven by the combined effect of a statutory loss recorded on a new contract by a major reinsurer and unfavorable reserve development on another contract of the same reinsurer.

Underwriting Results

Net gains on underwriting shrank to $12.3 billion in 2014 from $15.2 billion in 2013 as the LLAE growth exceeded premium growth.[4]

Net written premiums rose $19.5 billion, or 4.1 percent, to $496.6 billion for 2014 from $477.0 billion for 2013.

Net earned premiums rose $20.1 billion, or 4.3 percent, to $487.6 billion from $467.4 billion.

Net LLAE (after reinsurance recoveries) grew $19.7 billion, or 6.2 percent, to $334.7 billion in 2014 from $315.1 billion in 2013.

Other underwriting expenses also increased $3.5 billion, or 2.6 percent, to $138.1 billion in 2014 from $134.6 billion in 2013. That increase lagged behind premium growth,

1. The figures are consolidated estimates for all private property/casualty insurers based on reports accounting for at least 96 percent of all business written by private U.S. property/casualty insurers.
2. Combined ratio, defined as a sum of loss ratio, expense ratio, and dividend ratio, is a key measure of losses and other underwriting expenses per dollar of premium.
3. Net investment gains equal the sum of net investment income and realized capital gains (or losses) on investments.
4. Underwriting gains (or losses) equal earned premiums minus LLAE, other underwriting expenses, and dividends to policyholders.

Property Casualty Insurers
Association of America

while dividends to policyholders remained flat at $2.5 billion.

The increase in overall LLAE is predominantly due to the increase in LLAE other than catastrophe losses. Private insurers' net LLAE from catastrophes grew $2.8 billion to $16.8 billion in 2014, while other net LLAE rose $16.9 billion, or 5.6 percent, to $317.9 billion in 2014 from $301.0 billion in 2013.

U.S. insurers' $16.8 billion in net LLAE from catastrophes in 2014 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' net LLAE from catastrophes overseas were immaterial in both 2014 and 2013.

Direct insured property losses[5] from catastrophes striking the United States grew $2.6 billion to $15.5 billion in 2014 from $12.9 billion in 2013.[6] At $15.5 billion, direct catastrophe losses were $7.2 billion below the $22.7 billion average for direct catastrophe losses during the past ten years.

The industry's combined ratio, excluding M&FG insurers and LLAE reserve development, remained rather stable, hovering at 99.4 percent — just better than break-even.

Driven by the growth in LLAE, the combined ratio deteriorated by 0.8 percentage points to 97.0 percent in 2014 from 96.2 percent in 2013. The loss ratio[7] increased by 1.3 percentage points last year, while the expense ratio decreased by 0.4 percentage points and the dividend ratio remained unchanged.

Underwriting results for 2014 benefited from $11.2 billion in favorable development of LLAE reserves based on new information and updated estimates for the ultimate cost of old claims from prior accident years. The $11.2 billion of favorable reserve development in 2014 follows $15.6 billion of favorable development in 2013, with a significant portion of the change attributable to mortgage and financial guaranty (M&FG) insurers.

M&FG insurers continue to be significantly affected by the mortgages and mortgage-backed securities issued before the real estate crisis. In addition to the volatility brought about by large-scale litigation with the issuers of those mortgages and securities, insurers' financial results reflect major regulatory interventions, with regulators sometimes prescribing significant deviations from standard accounting and operating procedures.

The $11.2 billion of favorable reserve development for the industry overall in 2014 resulted from $0.3 billion of favorable reserve development for M&FG insurers and $10.9 billion of favorable reserve development for other insurers. Favorable development for M&FG insurers dropped from $3.5 billion in 2013 to $0.3 billion in 2014, while favorable development for other insurers dropped from $12.0 billion in 2013 to $10.9 billion in 2014.

Excluding development of LLAE reserves, total industry net LLAE grew $15.3 billion, or 4.6 percent, to $345.9 billion in 2014 from $330.6 billion in 2013, and the combined ratio improved by 0.2 percentage points to 99.3 percent from 99.5 percent. Excluding both the contribution of M&FG insurers and the development of LLAE reserves, net LLAE grew $17.6 billion, or 5.4 percent, and the combined ratio remained unchanged at 99.4 percent.

The $12.3 billion in net gains on underwriting in 2014 amounted to 2.5 percent of the $487.6 billion in net premiums earned during the period, whereas the $15.2 billion in net gains on underwriting in 2013 amounted to 3.3 percent of the $467.4 billion in net premiums earned during that period.

M&FG insurers' combined ratio grew 34.9 percentage points to 78.6 percent for 2014 from 43.7 percent for 2013. Their combined ratio for 2014 was 18.5 percentage points better than the 97.2 percent combined ratio for the industry excluding mortgage and financial guaranty insurers.

M&FG insurers' net written premiums fell 9.2 percent to $4.6 billion for 2014 from $5.1 billion for 2013, and their net earned premiums fell 9.0 percent to $5.2 billion from $5.7 billion. Their LLAE increased to $2.3 billion in 2014 from $1.3 billion in 2013, and other underwriting expenses grew to $1.6 billion from $1.1 billion.

Excluding M&FG insurers, industry net written premiums rose 4.2 percent in 2014 to $491.9 billion, net earned premiums increased 4.5 percent to $482.3 billion, LLAE grew 6.0 percent to $332.5 billion, other underwriting expenses increased 2.2 percent to $136.4 billion, and dividends to policyholders remained flat at $2.5 billion. As a result, the combined ratio for the industry excluding M&FG insurers rose to 97.2 percent for 2014 from 96.8 percent for 2013.

Growth varied significantly by sector. Excluding M&FG insurers, net written premium growth for insurers writing predominantly commercial lines slowed to 3.0 percent in 2014 from 4.0 percent in 2013 as premium growth for insurers writing more balanced books of business slipped to 3.3 percent from 4.1 percent. Conversely, net written premium growth for insurers writing mostly personal lines accelerated to 5.8 percent in 2014 from 5.3 percent in 2013.

Loss and loss adjustment expense ratios deteriorated for all major sectors of the industry, reflecting the growth in LLAE in excess of premium growth, but that was partially offset by improvements in expense ratios. Excluding M&FG insurers, commercial lines insurers' combined ratio worsened 0.6 percentage points in 2014 to 95.1 percent as balanced insurers' combined ratio improved by 0.4 percentage points to 98.2 percent and personal lines insurers' combined ratio worsened 0.7 percentage points to 98.2 percent.

Investment Results

Insurers' net investment income fell 2.5 percent to $46.2 billion in 2014 from $47.3

5. The losses are estimates from Verisk's Property Claim Services® (PCS®) based on information available as of May 7, 2015.
6. Direct losses are before reinsurance recoveries and exclude loss adjustment expenses. These figures are for all insurers, including residual market insurers, foreign insurers, and reinsurers, but exclude ocean marine losses and losses covered by the National Flood Insurance Program.
7. The loss ratio is the ratio of LLAE to earned premiums.

billion in 2013. In addition, insurers' realized capital gains on investments fell $1.3 billion to $10.1 billion in 2014 from $11.4 billion a year earlier. The 2014 decline in realized capital gains is partially attributable to an increase in realized losses on impaired investments, which grew $0.6 billion to $2.3 billion in 2014 from $1.7 billion in 2013. Combining net investment income and realized capital gains, overall net investment gains fell $2.5 billion, or 4.3 percent, to $56.2 billion for 2014 from $58.7 billion for 2013.

The decline in insurers' investment income reflects declines in market yields, with the yield on insurers' investments falling to 3.2 percent in 2014 from 3.4 percent in 2013. Insurers' average holdings of cash and invested assets[8] rose 5.1 percent in 2014 compared with their average holdings a year earlier. Based on annual data, insurers' investment yield last fell this low in 1965, when it was 3.1 percent. From 1960 to 2014, insurers' investment yield averaged 5.1 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 $10.1 billion in realized capital gains in 2014 with $11.5 billion in unrealized capital gains during the same period, insurers posted $21.6 billion in overall capital gains for 2014 — down $26.0 billion from the record $47.6 billion in overall capital gains for 2013. From the start of ISO's data in 1959 to 2014, insurers' total capital gains have ranged from as high as $47.6 billion in 2013 to as low as negative $72.7 billion in 2008 during the financial crisis. Insurers' overall capital gains declined in 2014 but remained positive, consistent with the developments in financial markets. In 2014, the major stock indices rose, but those increases are small compared with the increases in 2013.[9]

Pretax Operating Income and Net Income After Taxes

Pretax operating income[10] dropped $8.4 billion to $55.6 billion for 2014 from $64.1 billion for 2013. The $8.4 billion decrease in operating income reflects the $3.0 billion decrease in net gains on underwriting, the $1.2 billion decline in net investment income, and the $4.3 billion drop in miscellaneous other income. Excluding M&FG insurers, the insurance industry's operating income fell $7.1 billion to $52.7 billion for 2014 from $59.8 billion for 2013.

The insurance industry's net income after taxes[11] decreased $7.9 billion to $55.5 billion for 2014 from $63.4 billion for 2013. The decrease in net income resulted from an $8.4 billion decrease in operating income and the $1.3 billion decrease in realized capital gains. The decline in income would have been greater but for a $1.8 billion decrease in federal and foreign income taxes. Excluding M&FG insurers, the insurance industry's net income after taxes fell $6.1 billion to $53.1 billion in 2014 from $59.2 billion in 2013.

Policyholders' Surplus

Policyholders' surplus climbed $21.3 billion to a record-high $674.7 billion as of December 31, 2014, from $653.4 billion at year-end 2013. Additions to surplus in 2014 included insurers' $55.5 billion in net income after taxes and $11.5 billion in unrealized capital gains on investments (not included in net income).

Those additions were partially offset by $32.7 billion in dividends to shareholders, $11.8 billion in miscellaneous charges against surplus, and net $1.2 billion in capital that insurers returned to parent companies.

Unrealized capital gains on investments fell $24.7 billion to $11.5 billion in 2014 from $36.2 billion in 2013. Dividends to shareholders grew $4.3 billion, or 15.2 percent, to $32.7 billion in 2014 from $28.4 billion in 2013. Miscellaneous charges against surplus climbed to $11.8 billion in 2014 from $8.8 billion in 2013, with insurers' additions to pension and benefits liabilities being the main reason for the increase. The net $1.2 billion of capital returned to insurers' parents in 2014 is the first net outflow of capital since at least 1959 and a reverse of the net $3.9 billion capital inflow in 2013. However, this outflow is predominantly due to one major insurer returning to its parent several noninsurance subsidiaries with combined net worth of $7.1 billion.

Excluding M&FG insurers, industry surplus rose $20.6 billion to $658.3 billion as of December 31 last year from $637.7 billion as of December 31, 2013.

As of year-end 2014, the premium-to-surplus ratio was 0.74 — up from 0.73 at year-end 2013. The 0.74 ratio was about half the 1.44 average premium-to-surplus ratio for the 56 years from 1959 to 2014. The ratio of loss and loss adjustment expense reserves to surplus as of year-end 2014 was 0.85 — down from 0.88 a year earlier and below the 1.38 average LLAE-reserves-to-surplus ratio for the past 56 years.

Fourth-Quarter Results

The property/casualty insurance industry's consolidated net income after taxes fell to $17.8 billion in fourth-quarter 2014, down $2.9 billion from $20.7 billion in fourth-quarter 2013. Property/casualty insurers' annualized rate of return on average surplus fell to 10.6 percent in fourth-quarter 2014 from 13.0 percent a year earlier. Excluding M&FG insurers, the insurance industry's annualized rate of return fell to 10.5 percent in fourth-quarter 2014 from 12.8 percent in fourth-quarter 2013 as net income after taxes dropped to $17.2 billion from $19.9 billion.

The $17.8 billion in net income after taxes for the entire insurance industry in fourth-quarter 2014 was a result of $19.0 billion in pretax operating income, $1.3 billion in realized capital gains on investments, and $2.5 billion in federal and foreign income taxes.

Investment yields were 3.2 percent in 2014, lower than any time since 1965. The paltry yields have caused overall 2014 insurer investment income to drop 2.5 percent despite the continued growth in cash and invested assets.

8. Invested assets are the assets on which insurers earn investment income.
9. In 2014, the New York Stock Exchange Composite rose 4.2 percent, the Dow Jones Industrial Average increased 7.5 percent, the S&P 500 rose 11.4 percent, and the NASDAQ Composite climbed 13.4 percent. In 2013, the New York Stock Exchange Composite rose 23.2 percent, the Dow Jones Industrial Average increased 26.5 percent, the S&P 500 rose 29.6 percent, and the NASDAQ Composite climbed 38.3 percent.
10. Pretax operating income is the sum of net gains or losses on underwriting, net investment income, and miscellaneous other income.
11. Net income after taxes combines operating income, realized capital gains (losses), and federal and foreign income taxes.

The industry's $19.0 billion in pretax operating income for fourth-quarter 2014 was up $0.4 billion from $18.6 billion for fourth-quarter 2013. The industry's fourth-quarter 2014 pretax operating income was the net result of $8.0 billion in net gains on underwriting, $11.9 billion in net investment income, and negative $0.9 billion in miscellaneous other income. Excluding M&FG insurers, pretax operating income for fourth-quarter 2014 amounted to $18.1 billion — a $0.2 billion increase from $17.9 billion in pretax operating income for the industry excluding M&FG insurers in fourth-quarter 2013.

The $8.0 billion in net gains on underwriting for the entire industry in fourth-quarter 2014 constitutes a $3.1 billion increase from the $5.0 billion in net gains on underwriting in fourth-quarter 2013.

The net LLAE from catastrophes included in private U.S. insurers' financial results dropped to $1.0 billion in fourth-quarter 2014 from $1.3 billion a year earlier.

Excluding loss adjustment expenses, direct insured losses from catastrophes striking the United States in fourth-quarter 2014 totaled $0.7 billion — down $0.3 billion from the $1.0 billion in direct insured losses caused by catastrophes that struck the United States in fourth-quarter 2013.[12]

Fourth-quarter 2014 net gains on underwriting improved to 6.4 percent of the $125.3 billion in premiums earned during the period compared with fourth-quarter 2013 net gains on underwriting, which were 4.2 percent of the $119.5 billion in premiums earned during that period. The industry's combined ratio improved to 94.9 percent in fourth-quarter 2014 from 97.2 percent in fourth-quarter 2013.

At 94.9 percent, the combined ratio for fourth-quarter 2014 was the lowest recorded in nearly three decades. The fourth-quarter combined ratio has averaged 106.5 percent since 1986 but has reached as high as 123.3 percent in 1992.

In fourth-quarter 2014, the industry achieved its nineteenth successive quarter of growth in written premiums, following 12 quarters of declines. Net written premiums rose $5.5 billion, or 4.8 percent, to $119.6 billion in fourth-quarter 2014 from $114.1 billion in fourth-quarter 2013.

Net earned premiums grew $5.8 billion, or 4.8 percent, to $125.3 billion in fourth-quarter 2014 from $119.5 billion in fourth-quarter 2013. LLAE grew 2.7 percent to $81.6 billion in the last quarter of 2014 from $79.5 billion in the last quarter of 2013 despite the decline in LLAE from catastrophes. Noncatastrophe LLAE rose 3.1 percent to $80.6 billion in fourth-quarter 2014 from $78.2 billion a year earlier.

Insurers' surplus continued to grow to record levels, while the premium-to-surplus ratio remained at nearly half the historical average. This strong capitalization despite the financial crisis and major catastrophes over the past two decades suggests that insurers are well positioned to respond to marketplace needs.

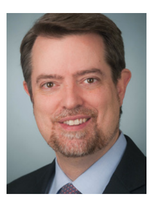
Excluding M&FG insurers, net written premiums rose 4.9 percent in fourth-quarter 2014, net earned premiums rose 4.9 percent, LLAE grew 3.6 percent, and the combined ratio improved to 95.2 percent from 97.4 percent in fourth-quarter 2013.

The $11.9 billion in net investment income in fourth-quarter 2014 was down 9.2 percent compared with the $13.1 billion in net investment income in fourth-quarter 2013. Miscellaneous other income fell to negative $0.9 billion in fourth-quarter 2014 from positive $0.6 billion in fourth-quarter 2013.

Realized capital gains on investments fell to $1.3 billion in fourth-quarter 2014 from $5.4 billion in fourth-quarter 2013. Combining net investment income and realized capital gains, net investment gains fell $5.3 billion, or 28.6 percent, to $13.2 billion in fourth-quarter 2014 from $18.4 billion a year earlier.

Insurers posted $4.4 billion in unrealized capital gains on investments in fourth-quarter 2014 — down $11.5 billion from insurers' $16.0 billion in unrealized capital gains in fourth-quarter 2013. Combining realized and unrealized amounts, the insurance industry posted $5.7 billion in overall capital gains in fourth-quarter 2014 — down $15.6 billion from the $21.3 billion in overall capital gains on investments in fourth-quarter 2013.

The $5.7 billion in overall capital gains for fourth-quarter 2014 is after $0.9 billion in realized losses on impaired investments, with the amount of realized losses on impaired investments growing from $0.5 billion in fourth-quarter 2013.



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Beth Fitzgerald is president of ISO Insurance Programs and Analytic Services. The unit develops ISO's core products and services, such as 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. Ms. Fitzgerald's area is instrumental in the development of ISO's various predictive analytical products for underwriting personal and commercial insurance. Under her direction, ISO also collects and compiles data from insurers, acts as statistical agent for all U.S. insurance regulators, supplies actuarial and data management consulting services, and conducts cutting-edge research on various issues in property/casualty insurance.

12. The losses are estimates from Verisk's Property Claim Services® (PCS®) based on information available as of May 7, 2015.

Operating Results for 2014 and 2013 ($ Millions)

Twelve Months	2014	2013
Net Written Premiums	$496,581	$477,042
Percent Change (%)	4.1	4.4
Net Earned Premiums	487,553	467,430
Percent Change (%)	4.3	4.1
Incurred Losses & Loss Adjustment Expenses	334,721	315,053
Percent Change (%)	6.2	(5.5)
Statutory Underwriting Gains (Losses)	14,747	17,761
Policyholders' Dividends	2,462	2,514
Net Underwriting Gains (Losses)	12,285	15,247
Pretax Operating Income	55,639	64,076
Net Investment Income Earned	46,152	47,342
Net Realized Capital Gains (Losses)	10,063	11,369
Net Investment Gains	56,215	58,711
Net Income (Loss) After Taxes	55,501	63,427
Percent Change (%)	(12.5)	80.8
Surplus (Consolidated)	674,714	653,380
Loss & Loss Adjustment Expense Reserves	575,607	573,406
Combined Ratio, Post-Dividends (%)	97.0	96.2
Fourth Quarter	**2014**	**2013**
Net Written Premiums	$119,603	$114,090
Percent Change (%)	4.8	5.6
Net Earned Premiums	125,281	119,503
Percent Change (%)	4.8	4.7
Incurred Losses & Loss Adjustment Expenses	81,628	79,475
Percent Change (%)	2.7	(12.0)
Statutory Underwriting Gains (Losses)	9,294	6,212
Policyholders' Dividends	1,264	1,252
Net Underwriting Gains (Losses)	8,030	4,960
Pretax Operating Income	19,017	18,599
Net Investment Income Earned	11,861	13,060
Net Realized Capital Gains (Losses)	1,301	5,363
Net Investment Gains	13,162	18,423
Net Income (Loss) After Taxes	17,849	20,704
Percent Change (%)	(13.8)	185.5
Surplus (Consolidated)	674,714	653,380
Loss & Loss Adjustment Expense Reserves	575,607	573,406
Combined Ratio, Post-Dividends (%)	94.9	97.2

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