Property/Casualty Insurance Results: First-Quarter 2015

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Private U.S. property/casualty insurers' net income after taxes grew to $18.2 billion in first-quarter 2015 from $13.9 billion in first-quarter 2014, with insurers' overall profitability as measured by their annualized rate of return on average policyholders' surplus growing to 10.8 percent from 8.4 percent, according to ISO, a Verisk Analytics business (Nasdaq:VRSK), and the Property Casualty Insurers Association of America (PCI).[1]

Insurers' combined ratio[2] improved to 95.7 percent for first-quarter 2015 from 97.1 percent for first-quarter 2014, and their net underwriting gains[3] increased to $4.1 billion from $2.4 billion. Net written premium growth remained unchanged at 3.7 percent for the first quarters of 2014 and 2015.

Insurers' net investment income increased to $11.7 billion in the first quarter of 2015 from $11.2 billion a year earlier, and insurers' realized capital gains jumped to $4.7 billion from $2.9 billion, resulting in $16.4 billion in net investment gains for first-quarter 2015. Both the realized capital gains and the net investment gains[4] were the highest they've been in the first quarter since the beginning of ISO's quarterly records in 1986.

In the first quarter of 2015, the industry continued to see strong underwriting results, attaining underwriting gains for a third quarter in a row. Over the past 30 years, insurers posted net gains on underwriting in only one out of every five quarters. Insurers' 95.7 percent combined ratio for first-quarter 2015 was 8.9 percentage points better than the average quarterly combined ratio. The strong underwriting results and elevated investment gains also pushed up overall profitability, with insurers' annualized overall rate of return for first-quarter 2015 reaching 10.8 percent, 2.4 percentage points higher than the 8.4 percent long-term average quarterly rate of return.

Net income reached its highest first-quarter level since ISO began keeping quarterly records in 1986.

Despite insurers' $18.2 billion in net income after taxes in 2015, the industry's surplus[5] declined to $671.7 billion as of March 31, 2015, from $674.7 billion as of year-end 2014, mostly because of $12.5 billion in dividends to stockholders and $6.2 billion in unrealized capital losses.

Underwriting Results

The improvement in underwriting results is mainly due to the growth in earned premiums in excess of the growth in losses and loss adjustment expenses (LLAE). In first-quarter 2015, earned premiums grew 3.7 percent to $121.9 billion, while LLAE rose just 1.7 percent to $81.9 billion, other underwriting expenses grew 3.5 percent to $35.3 billion, and policyholders' dividends were essentially unchanged at $0.7 billion. As a result, net underwriting gains increased to $4.1 billion from $2.4 billion.

Net written premiums climbed $4.4 billion, or 3.7 percent, to $125.9 billion in first-quarter 2015 from $121.4 billion in first-quarter 2014. The net written premium growth rate of 3.7 percent is unchanged from first-quarter 2014 but below the 4.3 percent average for the last 12 quarters and the 4.1 percent growth rate for full-year 2014. The growth rate in net earned premiums slowed to 3.7 percent in first-quarter 2015 from 4.2 percent in first-quarter 2014 and 4.3 percent for full-year 2014. However, the decrease in earned premium growth was partly the result of the sale of a large book of Canadian personal lines business that took effect on January 1, 2015.[6]

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 a 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.
6. This business is now written by Canadian insurers and no longer flows through financial reports of U.S.-domiciled insurers.

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The 1.7 percent increase in LLAE in first-quarter 2015 compares to the 8.2 percent surge in first-quarter 2014. Both catastrophe and noncatastrophe losses contributed to the rise in overall LLAE. Private U.S. insurers' net LLAE from catastrophes increased to $3.4 billion for first-quarter 2015 from $3.2 billion a year ago. Net LLAE for losses other than catastrophes rose $1.1 billion, or 1.4 percent, to $78.5 billion in first-quarter 2015 from $77.3 billion in first-quarter 2014.

Private U.S. insurers' net LLAE includes both their domestic and foreign catastrophic losses.[7] However, U.S. insurers' $3.4 billion in net LLAE from catastrophes in first-quarter 2015 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 elsewhere around the globe was immaterial in both first-quarter 2015 and first-quarter 2014.

Net investment income increased because of growth in average cash and invested assets. But insurers' investment yield remained at historically low levels.

Direct insured property losses from catastrophes striking the United States totaled $3.3 billion in first-quarter 2015, up $0.3 billion from $3.0 billion in first-quarter 2014 and $0.6 billion above the $2.7 billion first-quarter average for the past ten years.[8]

Reflecting the differences between premium growth and the growth in LLAE and other costs of providing insurance, the combined ratio improved by 1.3 percentage points to 95.7 percent in first-quarter 2015 from 97.1 percent in first-quarter 2014.

Underwriting results benefited from $5.7 billion in favorable development of LLAE reserves in first-quarter 2015 based on new information and updated estimates for the ultimate cost of claims from prior accident years. The $5.7 billion of favorable reserve development in first-quarter 2015 follows $5.4 billion of favorable development in first-quarter 2014, and the effects of favorable reserve development on underwriting gains and on loss ratios in 2015 and 2014 are comparable.

Excluding development of LLAE reserves, net LLAE grew $1.7 billion, or 1.9 percent, to $87.6 billion in first-quarter 2015 from $85.9 billion in first-quarter 2014.

The $4.1 billion in net gains on underwriting in first-quarter 2015 amounted to 3.3 percent of the $121.9 billion in net premiums earned during the period. The $2.4 billion in net gains on underwriting in first-quarter 2014 amounted to 2.0 percent of the $117.6 billion in net premiums earned during that period.

While overall net written premium growth in first-quarter 2015 remained unchanged from a year earlier at 3.7 percent, the dynamics varied across segments.

Net written premium growth for insurers writing mostly personal lines dropped 0.9 percentage points to 4.6 percent in first-quarter 2015. Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines remained unchanged at 2.4 percent in first-quarter 2015 as premium growth for insurers writing more balanced books of business slipped 0.1 percentage points to 3.2 percent.

Reflecting the growth in premiums in excess of LLAE, underwriting profitability improved for all major sectors of the industry. Excluding mortgage and financial guaranty insurers, commercial lines insurers' combined ratio decreased 0.3 percentage points in first-quarter 2015 to 94.8 percent as balanced insurers' combined ratio fell 2.9 percentage points to 95.1 percent and personal lines insurers' combined ratio declined 1.0 percentage point to 97.4 percent.

Investment Results

Insurers' net investment income — primarily dividends from stocks and interest on bonds — grew 4.6 percent to $11.7 billion in first-quarter 2015 from $11.2 billion in first-quarter 2014. Insurers' realized capital gains on investments rose approximately $1.7 billion to $4.7 billion in first-quarter 2015 from $2.9 billion a year earlier. Combining net investment income and realized capital gains, overall net investment gains grew $2.3 billion, or 16.0 percent, to $16.4 billion for first-quarter 2015 from $14.1 billion for first-quarter 2014.

Insurers' $4.7 billion in realized capital gains in first-quarter 2015 was the net result of $0.3 billion in realized losses on impaired investments and $5.0 billion in realized gains on other investments, with realized losses on impaired investments unchanged at $0.3 billion for both first-quarter 2015 and first-quarter 2014.

The 4.6 percent increase in net investment income is attributable to both the 2.9 percent increase in average cash and invested assets for first-quarter 2015 compared with first-quarter 2014 and to the amount and timing of dividends from affiliated investments. The annualized yield on insurers' investments in first-quarter 2015 is 3.1 percent — unchanged from first-quarter 2014, slightly below the 3.2 percent investment yield for 2014, and significantly below the 3.9 percent average annualized quarterly yield for the last ten years. Long-term annual data shows that insurers' investment yield last fell as low as 3.1 percent in 1965. From 1960 to 2014, insurers' annual 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 $4.7 billion in realized capital gains in first-quarter 2015 with the $6.2 billion in unrealized capital losses during the same period, insurers posted $1.6 billion in overall

7. Net LLAE from catastrophes also includes revisions to LLAE from catastrophes that occurred during prior periods but excludes LLAE covered by the federal flood insurance program, residual market insurers, and foreign insurers and reinsurers.
8. Estimates are from Verisk's Property Claim Services® (PCS®) based on information available as of June 11, 2015. Direct losses are before reinsurance recoveries and exclude loss adjustment expenses. These figures are for all types of insurers, including residual market insurers, foreign insurers, and reinsurers, but exclude ocean marine losses and losses covered by the National Flood Insurance Program.

capital losses for first-quarter 2015 — a $5.8 billion drop from the $4.3 billion in overall capital gains for first-quarter 2014.[9] Over the past 30 years, insurers' total capital gains have averaged $2.7 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[10] increased $1.8 billion to $15.6 billion for first-quarter 2015 from $13.8 billion for first-quarter 2014. The $1.8 billion increase in operating income reflects the $1.7 billion increase in net gains on underwriting and the $0.5 billion increase in net investment income, with those developments partially offset by the $0.4 billion decrease in miscellaneous other 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 increased $4.3 billion to $18.2 billion for first-quarter 2015 from $13.9 billion for first-quarter 2014. This is the highest first-quarter net income in 30 years. The growth in net income was the result of the $1.8 billion increase in operating income, the $1.7 billion increase in realized capital gains, and the $0.7 billion decrease in federal and foreign income taxes.

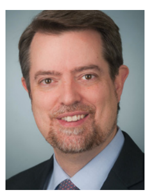
Policyholders' Surplus

Policyholders' surplus declined $3.0 billion to $671.7 billion as of March 31, 2015, from a record high of $674.7 billion at year-end 2014. Still, policyholders' surplus for first-quarter 2015 remained above any pre-2014 values. Additions to surplus in first-quarter 2015 included insurers' $18.2 billion in net income after taxes and $0.5 billion in new funds. The deductions from surplus consisted of $6.2 billion in unrealized capital losses on investments (not included in net income), $12.5 billion in dividends to shareholders, and $2.9 billion in miscellaneous charges against surplus.

The $6.2 billion in unrealized capital losses in first-quarter 2015 represents a $7.5 billion swing from the $1.3 billion in unrealized capital gains for first-quarter 2014.

New funds paid in fell to $0.5 billion in first-quarter 2015 from $1.8 billion in first-quarter 2014. Dividends to shareholders grew $5.1 billion, or 69.1 percent, to $12.5 billion in first-quarter 2015 from $7.4 billion in first-quarter 2014. Miscellaneous charges against surplus grew to $2.9 billion in first-quarter 2015 from $1.3 billion in first-quarter 2014.

Using 12-month trailing premiums, the premium-to-surplus ratio rose to 0.75 as of March 31, 2015, from 0.73 as of March 31, 2014. At the same time, the ratio of loss and loss adjustment expense reserves to surplus declined to 0.86 as of March 31 this year from 0.87 a year earlier. The 0.75 premium-to-surplus ratio is only about half of the 1.44 average premium-to-surplus ratio based on annual data for the 56 years from 1959 to 2014. Similarly, the 0.86 LLAE-reserves-to-surplus ratio as of the end of first-quarter 2015 is far below the 1.38 average for the 56 years ending 2014.



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9. Unrealized capital gains or losses contribute directly to surplus change, but they do not count toward net income.
10. Pretax operating income is the sum of net gains or losses on underwriting, net investment income, and miscellaneous other income.

Operating Results for Q1 2015 and Q1 2014 ($ Millions)

First Quarter	2015	2014
Net Written Premiums	125,863	121,427
Percent Change (%)	3.7	3.7
Net Earned Premiums	121,944	117,599
Percent Change (%)	3.7	4.2
Incurred Losses & Loss Adjustment Expenses	81,865	80,507
Percent Change (%)	1.7	8.2
Statutory Underwriting Gains (Losses)	4,822	3,022
Policyholders' Dividends	738	668
Net Underwriting Gains (Losses)	4,085	2,354
Pretax Operating Income	15,608	13,775
Net Investment Income Earned	11,685	11,168
Net Realized Capital Gains (Losses)	4,674	2,936
Net Investment Gains	16,359	14,103
Net Income (Loss) after Taxes	18,172	13,856
Percent Change (%)	31.1	(3.0)
Surplus (Consolidated)	671,726	661,601
Loss & Loss Adjustment Expense Reserves	575,256	573,725
Combined Ratio, Post-Dividends (%)	95.7	97.1

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