Property/Casualty Insurance Results: 2018

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Private U.S. property/casualty insurers' net income after taxes rose to $60.0 billion in 2018 from $36.1 billion in 2017. Insurers' overall profitability as measured by their rate of return on average policyholders' surplus rose to 8.0 percent from 5.0 percent a year earlier, according to ISO, a Verisk (Nasdaq:VRSK) business, and the American Property Casualty Insurance Association (APCIA).[1]

Insurers' combined ratio[2] improved to 99.2 percent for 2018 from 103.7 percent for 2017, and their net underwriting losses[3] improved to $0.1 billion in 2018 from $23.3 billion a year earlier. Net written premium growth accelerated to 10.8 percent for 2018 from 4.6 percent for 2017.

Insurers' net investment income grew to $55.3 billion in 2018 from $48.9 billion a year earlier, while insurers' realized capital gains decreased to $10.4 billion from $15.1 billion, resulting in $65.8 billion in net investment gains[4] for 2018, a $1.7 billion increase from $64.0 billion for 2017.

The increase in net income after taxes drove insurers' rate of return on average surplus to 8.0 percent, up 3.1 percentage points from 2017 and 0.2 percentage points above the 7.8 percent average rate of return for 1988 to 2017.

Insurers' underwriting results and returns improved in 2018, as catastrophe losses receded from the extremes reached in 2017.

The industry's surplus[5] was $742.2 billion as of December 31, 2018, an $8.5 billion decline from $750.7 billion a year earlier and a $39.3 billion decline from the all-time-high value of $781.5 billion as of September 30, 2018.

Underwriting Results

In 2018, earned premiums grew 9.9 percent to $594.1 billion, while losses and loss adjustment expenses (LLAE) rose 3.4 percent to $424.2 billion, other underwriting expenses grew 10.6 percent to $167.0 billion, and policyholders' dividends increased to $3.0 billion from $2.6 billion a year earlier. As a result, the industry reported a $0.1 billion net underwriting loss, a significant improvement from the $23.3 billion net underwriting loss for 2017.

Net written premiums climbed $60.0 billion to $612.6 billion in 2018 from $552.6 billion in 2017. Net written premium growth accelerated to 10.8 percent from 4.6 percent for 2017. Net earned premium growth was 9.9 percent in 2018, triple the 3.3 percent for 2017. Written premium growth was the strongest since 14.3 percent in 2002, and earned premium growth was the strongest since 10.9 percent in 2003.

The sharp acceleration of premium growth is partially due to changes in reinsurance utilization, apparently prompted by the recent U.S. tax reform. Many insurers chose to significantly reduce the portion of premiums ceded to their non-U.S. affiliates because of concerns about possible tax implications under the new law. The effective dates of these reinsurance changes were close to the January 1, 2018, effective date of the tax reform. As a result, 2018 premium growth is a compound effect of several developments, with the main drivers being organic growth in underlying direct written premiums, multiple insurers ceding less premiums to their non-U.S. affiliates in 2018, and, in some cases, one-time increases in written premiums associated with the returns of previously ceded unearned premium reserves.

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.

ISO
A Verisk Business

American Property Casualty Insurance Association
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To assess the underlying direct premium growth, ISO compiled premiums for a large cohort of insurers whose annual data was available for both 2017 and 2018. This cohort represents more than 95 percent of total net written premium for the industry. Aggregated net written premium for these insurers grew 10.8 percent in 2018, while direct written premium grew approximately 5.6 percent; that is, changes in reinsurance generated almost half of the net premium growth in 2018. Still, direct written premium growth in 2018 has also accelerated. For comparison, written premium growth has remained below 5.0 percent both on a direct and net basis every year from 2004 through 2017.

The 3.4 percent LLAE increase in 2018 is the lowest annual LLAE change rate since the 5.5 percent decline in 2013, which took place in the wake of the losses from Superstorm Sandy in 2012. Similar to the decline in 2013, the slowdown in 2018 was largely driven by a decrease in catastrophe losses. Private U.S. insurers' net LLAE from catastrophes declined $6.2 billion to $43.3 billion in 2018 from $49.5 billion a year earlier. Net LLAE for losses other than catastrophes rose 5.6 percent, to $380.8 billion in 2018 from $360.8 billion in 2017.

Private U.S. insurers' net LLAE includes both their domestic and foreign catastrophe losses.[6] The $43.3 billion in net LLAE from catastrophes in 2018 is primarily attributable to catastrophes that struck the United States, even though some U.S. insurers incurred nontrivial losses from Typhoon Jebi, which hit Japan in August 2018, and from other non-U.S. events.

Reflecting the differences between premium growth and the growth in LLAE and other costs of providing insurance, the combined ratio improved to 99.2 percent in 2018 from 103.7 percent in 2017.

Underwriting results benefited from $13.0 billion in favorable development of LLAE reserves in 2018, 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 $13.0 billion of favorable reserve development in 2018 exceeds the amounts reported in each of the four prior years but is still below $15.6 billion of favorable development in 2013. Favorable development reduced the combined ratio by 2.2 percentage points in 2018 and by 1.6 percentage points in 2017.

Net premium growth accelerated, helped by changes in reinsurance agreements.

Excluding development of LLAE reserves, net LLAE grew $18.1 billion, or 4.3 percent, to $437.2 billion in 2018 from $419.1 billion in 2017. Excluding development of LLAE reserves, net noncatastrophe LLAE grew $26.1 billion, or 7.1 percent, to $395.9 billion in 2018 from $369.8 billion a year earlier. The decrease in LLAE attributable to catastrophes subtracted 1.9 percentage points from the change in the loss ratio, while the combined impact of catastrophes and changes in reserve development subtracted 2.7 percentage points from the change in the loss ratio in 2018.

The $0.1 billion net loss on underwriting in 2018 was negligible compared to the $594.1 billion in net premiums earned during the period. The $23.3 billion net loss on underwriting in 2017 amounted to 4.3 percent of the $540.6 billion in net premiums earned during that period.

While the overall net written premium growth rate in 2018 increased to 10.8 percent from 4.6 percent a year earlier and the combined ratio improved to 99.2 percent from 103.7 percent, the dynamics varied across industry segments.

Net written premium growth for insurers writing mostly personal lines accelerated to 6.7 percent in 2018 from 6.3 percent a year earlier. Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines jumped to 19.3 percent in 2018 from 4.2 percent in 2017. The bulk of the changes in reinsurance utilization was concentrated in this segment. Premium growth for insurers writing more balanced books of business more than tripled from 1.9 percent in 2017 to 6.3 percent in 2018.

Underwriting profitability as measured by the combined ratio improved across all segments. Excluding mortgage and financial guaranty insurers, commercial lines insurers' combined ratio improved 2.9 percentage points to 101.4 percent in 2018. Personal lines insurers' combined ratio improved 5.5 percentage points to 96.9 percent, and balanced insurers' combined ratio improved 4.0 percentage points to 101.7 percent in 2018 from 105.8 percent in 2017.

Investment Results

Insurers' net investment income—primarily dividends from stocks and interest on bonds—increased 13.2 percent to $55.3 billion in 2018 from $48.9 billion in 2017. Insurers' realized capital gains on investments decreased to $10.4 billion in 2018 from $15.1 billion a year earlier. Combining net investment income and realized capital gains, overall net investment gains increased $1.7 billion, or 2.7 percent, to $65.8 billion in 2018 from $64.0 billion a year earlier.

Net investment income growth in 2018 was significantly affected by the timing and magnitude of dividends from insurers' subsidiaries outside the U.S. property/casualty universe. Such dividends can include the earnings accumulated within subsidiaries over a long time. Excluding two insurers most notable for large changes in their investment income from such "external" subsidiaries, net investment income grew 4.7 percent.

Insurers' net investment income increased 13.2 percent, while average cash and invested assets for 2018 grew 3.6 percent compared

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.

with 2017. The yield on insurers' investments in 2018 was 3.4 percent, an increase of 0.3 percentage points from a year earlier and the same as the average annual yield for the last ten years. 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. In recent years, investment yields have trended downward, and annual yields have not exceeded 4.0 percent since 4.2 percent for 2008. On a full-year basis, insurers' annual investment yield steadily declined from 4.6 percent for 2005 to 3.1 percent for both 2016 and 2017. Recent increases in the federal funds rate are expected to eventually push up yields on insurers' investments, and 2018 results seem to indicate a turn in investment performance. However, the 0.3-percentage-point increase in yield in 2018 was largely attributable to the timing and magnitude of dividends from insurers' "external" subsidiaries. Excluding the two insurers most affected by such dividends, the investment yield actually increased less than 0.1 percentage point in 2018, remaining at the historically low level.

> Investment returns remained low, even though investment income increased 13.2 percent.

Combining the $10.4 billion in realized capital gains in 2018 with the $41.4 billion in unrealized capital losses[7] during the same period, insurers posted $30.9 billion in overall capital losses for 2018, a $104.9 billion decrease from 2017. Unrealized capital losses in 2018 are the second-largest ever, exceeded only by $52.9 billion in 2008. In both 2008 and 2018, insurers' massive unrealized capital losses were driven by steep declines in the stock market suppressing the value of securities on the balance sheets of insurers. Over the 30 years from 1989 to 2018, insurers' total capital gains have averaged $11.8 billion per year, ranging from as low as negative $72.7 billion in 2008, due to the financial crisis, to as high as $73.9 billion in 2017.

Pretax Operating Income

Pretax operating income[8] soared $36.3 billion to $56.6 billion for 2018 from $20.3 billion for 2017. The rise in operating income was the combined result of the $23.2 billion improvement in net underwriting results, the $6.6 billion increase in miscellaneous other income, and the $6.4 billion increase in net investment income. Total other income in 2017 was suppressed by the $6.3 billion accounting loss recorded by a major insurer on a retroactive reinsurance transaction that closed in first-quarter 2017. As a result, the return of total other income to a more typical level in 2018 represented a significant increase from a year earlier.

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 rose $23.9 billion to $60.0 billion for 2018 from $36.1 billion for 2017. The net income after taxes for 2018 is well above the $43.4 billion average annual income for the last ten years and is the highest annual income since $63.4 billion in 2013.

Policyholders' Surplus

Policyholders' surplus decreased $8.5 billion to $742.2 billion as of December 31, 2018, from $750.7 billion as of December 31, 2017. Additions to surplus in 2018 included $60.0 billion in net income after taxes and $8.3 billion in net additional capital provided to insurers. The deductions from surplus consisted of $31.7 billion in dividends to shareholders, $41.4 billion in unrealized capital losses on investments (not included in net income), and $3.8 billion in miscellaneous charges against surplus.

The $41.4 billion in unrealized capital losses on investments contrasts with $58.8 billion in unrealized capital gains a year earlier. The net $8.3 billion of additional capital provided to insurers in 2018 compares with $2.6 billion provided in 2017. Dividends to shareholders increased $7.8 billion, or 32.6 percent, to $31.7 billion in 2018 from $23.9 billion in 2017. Miscellaneous charges against surplus decreased to $3.8 billion in 2018 from $23.8 billion in 2017.

As of December 31, 2018, the premium-to-surplus ratio (using 12-month trailing premiums) increased to 0.83 from 0.74 as of December 31, 2017. At the same time, the ratio of loss and loss adjustment expense reserves to surplus increased to 0.85 as of December 31, 2018, from 0.82 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 2017, the average premium-to-surplus ratio was 0.89 and the LLAE-reserves-to-surplus ratio was 1.06.

> Policyholder surplus at year-end 2018 was the second highest year-end surplus ever

Fourth-Quarter Results

The property/casualty insurance industry's consolidated net income after taxes fell to $10.5 billion in fourth-quarter 2018 from $13.7 billion in fourth-quarter 2017. Property/casualty insurers' annualized rate of return on average surplus fell to 5.5 percent in fourth-quarter 2018 from 7.5 percent a year earlier.

The $10.5 billion in net income after taxes for the insurance industry in fourth-quarter 2018 was the net result of $10.1 billion in pretax operating income, $1.1 billion in realized capital gains on investments, and $0.8 billion in federal and foreign income taxes.

The industry's $10.1 billion in pretax operating income for fourth-quarter 2018 compares with $10.0 billion in operating income a year earlier. The industry's fourth-quarter 2018 pretax operating gain was the net result of $4.8 billion in net losses on underwriting, $14.5 billion in net investment income, and $0.5 billion in miscellaneous other income. Net underwriting losses doubled to $4.8 billion in fourth-quarter 2018 from $2.4 billion in fourth-quarter 2017.

Net LLAE from catastrophes included in private U.S. insurers' financial results in

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

fourth-quarter 2018 increased to $17.3 billion from $10.6 billion in fourth-quarter 2017.[9] The contribution of catastrophe LLAE to the fourth-quarter combined ratio increased to 11.5 percentage points in 2018 from 7.8 percentage points in 2017.

Fourth-quarter 2018 net underwriting losses amounted to 3.2 percent of the $151.3 billion in premiums earned during the period, and the fourth-quarter 2017 ratio of net underwriting losses to earned premiums was 1.7 percent. The industry's combined ratio deteriorated to 104.6 percent in fourth-quarter 2018 from 102.5 percent in fourth-quarter 2017. Over the last 30 years, the fourth-quarter combined ratio averaged 106.0 percent but reached as high as 123.3 percent in 1992 and as low as 94.9 percent in 2014.

Net written premiums rose $11.8 billion, or 9.0 percent, to $143.8 billion in fourth-quarter 2018 from $132.0 billion in fourth-quarter 2017. That was the 35th consecutive quarter of growth in written premiums, beginning in the second quarter of 2010 and following 12 quarters of declines. Similar to the premium growth for the entire year 2018, written premium growth in fourth-quarter 2018 was bolstered by changes in reinsurance utilization.

Net earned premiums grew 11.5 percent to $151.3 billion in fourth-quarter 2018 from $135.7 billion in fourth-quarter 2017. LLAE grew 15.6 percent to $114.0 billion in fourth-quarter 2018 from $98.6 billion in fourth-quarter 2017. Noncatastrophe LLAE increased 9.8 percent to $96.6 billion from $88.0 billion in fourth-quarter 2017. The reported results for fourth-quarter 2018 were also affected by $1.7 billion in favorable LLAE reserve development, compared with $2.1 billion of favorable LLAE reserve development in fourth-quarter 2017. Excluding catastrophes and reserve development, fourth-quarter LLAE grew 9.4 percent, lagging earned premium growth. The fourth-quarter loss ratio, adjusted to remove catastrophes and reported reserve development, improved to 65.2 percent in 2018 from 66.4 percent in 2017.

> Total capital losses of $44.9 billion in fourth-quarter 2018 are the highest quarterly losses on the record.

Net investment income for the industry increased to $14.5 billion in fourth-quarter 2018 from $13.5 billion in fourth-quarter 2017. Miscellaneous other income rose to $0.5 billion in fourth-quarter 2018 from negative $1.2 billion in fourth-quarter 2017.

Realized capital gains on investments fell to $1.1 billion in fourth-quarter 2018 from $1.7 billion in fourth-quarter 2017. Combining net investment income and realized capital gains, net investment gains increased to $15.6 billion in fourth-quarter 2018 from $15.2 billion a year earlier.

Insurers posted $46.0 billion in unrealized capital losses on investments in fourth-quarter 2018, a stunning $90.1 billion reversal from $44.1 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 for fourth-quarter 2017 was more than twice the prior quarterly unrealized capital gains record of $20.8 billion set in fourth-quarter 1998. The $46.0 billion in unrealized capital losses in fourth-quarter 2018, closely related to the stock market downturn, are the worst quarterly losses ever. The fourth-quarter 2018 amount significantly exceeds the $21.8 billion in unrealized capital losses in fourth-quarter 2008 and the prior all-time record of $26.8 billion in unrealized capital losses in third-quarter 1998. Combining realized and unrealized amounts, the insurance industry posted $44.9 billion in overall capital losses in fourth-quarter 2018, also an all-time quarterly record and a $90.6 billion deterioration from the $45.7 billion in overall capital gains on investments in fourth-quarter 2017.

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

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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.

Operating Results for 2018 and 2017 ($ Millions)

	2018	2017
Net Written Premiums	$612,589	$552,630
Percent Change (%)	10.8	4.6
Net Earned Premiums	594,066	540,608
Percent Change (%)	9.9	3.3
Incurred Losses & Loss Adjustment Expenses	424,175	410,292
Percent Change (%)	3.4	8.5
Statutory Underwriting Gains (Losses)	2,900	(20,732)
Policyholders' Dividends	3,008	2,605
Net Underwriting Gains (Losses)	(108)	(23,338)
Pretax Operating Income	56,590	20,332
Net Investment Income Earned	55,347	48,906
Net Realized Capital Gains (Losses)	10,414	15,126
Net Investment Gains	65,761	64,032
Net Income (Loss) after Taxes	59,994	36,080
Percent Change (%)	66.3	-15.9
Surplus (Consolidated)	742,163	750,700
Loss & Loss Adjustment Expense Reserves	633,317	619,000
Combined Ratio, Post-Dividends (%)	99.2	103.7

Fourth Quarter	**2018**	**2017**
Net Written Premiums	$143,836	$131,997
Percent Change (%)	9.0	6.1
Net Earned Premiums	151,281	135,675
Percent Change (%)	11.5	2.2
Incurred Losses & Loss Adjustment Expenses	113,970	98,575
Percent Change (%)	15.6	0.2
Statutory Underwriting Gains (Losses)	(3,296)	(1,184)
Policyholders' Dividends	1,547	1,177
Net Underwriting Gains (Losses)	(4,843)	(2,361)
Pretax Operating Income	10,150	9,992
Net Investment Income Earned	14,453	13,548
Net Realized Capital Gains (Losses)	1,116	1,660
Net Investment Gains	15,569	15,208
Net Income (Loss) after Taxes	10,489	13,720
Percent Change (%)	-23.5	26.2
Surplus (Consolidated)	742,163	750,700
Loss & Loss Adjustment Expense Reserves	633,317	619,000
Combined Ratio, Post-Dividends (%)	104.6	102.5

2018: BY THE NUMBERS

$742.2 billion

Industry surplus, an $8.5 billion decline from $750.7 billion at year-end 2017 and a $39.3 billion decline from $781.5 billion as of September 30, 2018

$60.0 billion

Net income after taxes, a 66.3% increase from $36.1 billion for 2017

10.8%

Net written premium growth, after 4.6% in 2017

99.2%

Combined ratio, after 103.7% for 2017

$0.1 billion

Net underwriting loss, after $23.3 billion for 2017

3.4%

Investment yield, an increase from 3.1% for 2016 and 2017

$30.9 billion

Total capital losses, after record $73.9 billion in total capital gains for 2017

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