U.S. Property and Casualty Insurance Industry

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Industry Overview

Net profit in the U.S. property and casualty insurance industry fell 20% to $18 billion for the first half of 2017 compared to $22 billion for the first half of 2016. The decline was primarily attributed to a net underwriting loss of $3.2 billion that was due, in large part, to the following:

- **Higher Catastrophe Losses—**$14 billion in catastrophe losses versus $11 billion for the prior year period
- **Prevailing Soft Market**—average commercial rates fell for the 11th straight quarter
- **Auto Continues to Underperform**—Personal & Commercial Auto Liability PDLR of 70% and 66%, respectively

Offsetting the decrease in profit margins, unrealized capital gains of $19 billion was the highest amount recorded over the last ten mid-years. As a result, **capital and surplus reached a record high of $749 billion**.

Table 1 - Property/Casualty Insurance Industry Results (in billions, except for percent)

		For the six months ended June 30,									
	Chg.	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Direct Premiums Written	4.7%	$321.3	$306.9	$295.5	$282.8	$269.1	$259.9	$249.0	$242.8	$242.6	$251.1
Net Premiums Written	4.3%	$280.4	$268.8	$261.1	$251.4	$241.4	$231.6	$223.0	$217.0	$217.4	$228.3
Net Premiums Earned	3.3%	$270.4	$261.7	$252.5	$243.0	$232.9	$223.4	$216.8	$211.9	$216.6	$224.3
Net Loss & LAE Incurred	5.6%	$197.4	$186.9	$175.0	$171.8	$159.5	$163.8	$177.7	$155.8	$158.6	$167.4
Underwriting Expenses	1.7%	$75.7	$74.5	$72.4	$69.3	$67.6	$65.6	$62.6	$61.1	$60.6	$62.1
Underwriting Gain (Loss)	(1,660.0%)	($3.2)	($0.2)	$4.7	$1.5	$5.8	($5.9)	($23.7)	($4.7)	($1.8)	($4.9)
Net Loss Ratio	1.6 pts	73.0%	71.4%	69.3%	70.7%	68.5%	73.3%	82.0%	73.5%	73.2%	74.6%
Expense Ratio	(0.7) pts	27.0%	27.7%	27.7%	27.6%	28.0%	28.3%	28.1%	28.1%	27.9%	27.2%
Dividend Ratio	(0.0) pts	0.54%	0.55%	0.53%	0.57%	0.54%	0.48%	0.53%	0.50%	0.46%	0.54%
Combined Ratio	0.9 pts	100.6%	99.7%	97.6%	98.8%	97.0%	102.2%	110.6%	102.1%	101.5%	102.4%
Investment Inc. Earned	5.7%	$25.6	$24.2	$24.7	$25.2	$27.0	$25.4	$27.1	$27.8	$25.6	$29.0
Realized Gains (Losses)	(19.3%)	$3.9	$4.8	$8.5	$7.6	$11.1	$4.1	$3.9	$4.4	($11.5)	($0.6)
Investment Gain (Loss)	1.6%	$29.5	$29.0	$33.2	$32.8	$38.1	$29.5	$31.0	$32.1	$14.2	$28.4
Investment Yield (a)	0.05-pts	3.29%	3.24%	3.32%	3.48%	3.96%	3.85%	4.09%	4.42%	4.30%	4.54%
Net Income	(20.4%)	$17.7	$22.2	$32.7	$28.5	$35.7	$20.1	$6.6	$22.2	$6.9	$17.1
Return on Revenue	(1.7) pts	5.9%	7.6%	11.4%	10.3%	13.2%	8.0%	2.6%	9.1%	3.0%	6.8%
		June 30,	December 31, 2008-2016								
	Chg.	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Capital & Surplus (b)	2.4%	$748.9	$731.3	$705.9	$706.7	$686.3	$615.9	$578.4	$587.6	$541.1	$480.0
Return on Surplus (c)	(3.4) pts	2.4%	5.8%	4.1%	7.9%	14.2%	6.7%	0.9%	8.7%	9.7%	(13.6%)

(a) annualized, (b) adjusted to removed stacked entities, (c) prior years are based on full-year results

Summary of Market Conditions

A soft market cycle continues to grip the U.S. property and casualty insurance industry, particularly in the commercial market. According to The Council of Insurance Agents & Brokers, the Q2 2017 Commercial Property and Casualty Survey results showed that commercial rates decreased across all account sizes, with an **overall average decrease of 2.8% in second quarter, the eleventh consecutive quarter of declining rates.** The commercial lines with the greatest decrease in rates were Commercial Property -3.6%, Workers' Compensation -2.7%, and General Liability -2.7%. **Commercial Auto Liability rates increased for the 24th consecutive quarter** with a 6.2% increase in Q2 2017, which followed a 5.4% and 4.4% increase in the previous two quarters.

Despite a soft market cycle since 2007, the industry has been able to produce profits for each of the last ten years and again in the first half of 2017. This is due, in large part, to the following two factors: 1) below average catastrophe losses and 2) reserve takedowns that have benefited underwriting results.

As a result of sustained profits, capital and surplus increased by 56% since the 2008 economic crisis to $749 billion at June 30, 2017. At the same time, growth in net writings has occurred at a more moderate rate of 23%. As a result, the capacity for insurers to write more business increased to 73% for the current trailing twelve month period compared to 93% in 2008 (**Fig. 1**). The increased capacity has led to intense competition in the marketplace as many insurers look to gain market share. Several companies have accomplished this through mergers and acquisitions (M&A). M&A activity has been particularly active during this period of strong capitalization, which has been a primary factor for the steady decline in the number insurers (**Fig. 2**).

Net Writings Leverage

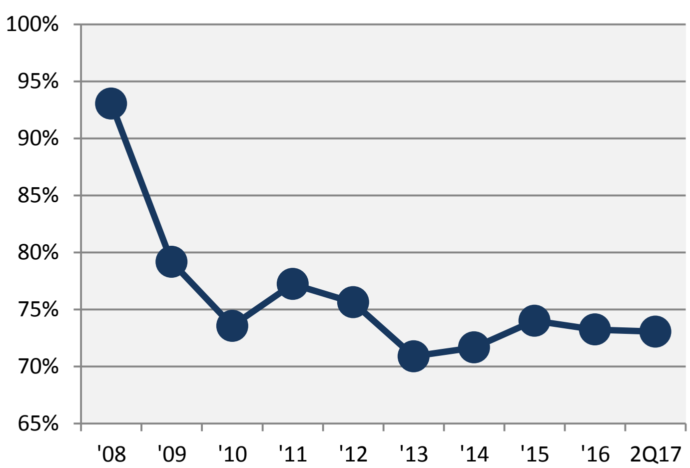

Fig. 1

No. of Property and Casualty Filers

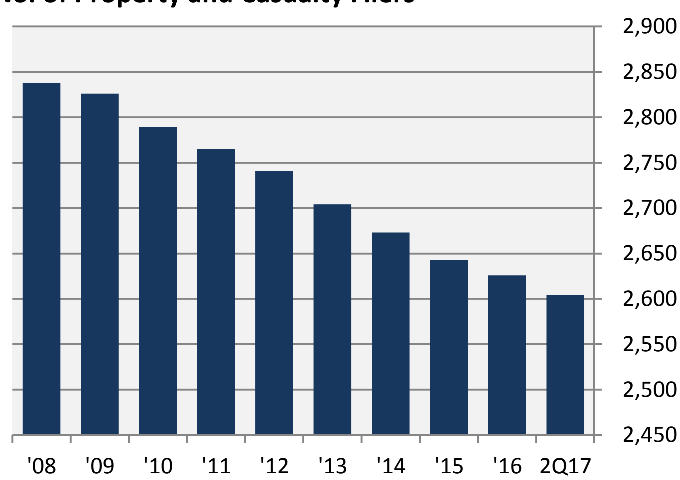

Fig. 2

Writings

Direct premiums written (DPW) increased 4.7% to $321 billion in the first half of 2017 compared to $307 billion for the same period in 2016. Sequentially, direct writings have increased for 29 consecutive quarters over the same prior year quarters with an average 3.8% growth rate during this period. All three markets, Personal, Commercial, and Combined Lines experienced growth in direct writings in the current period.

DPW in the **Personal Lines Market** increased 6.5%, or $10.1 billion to $165 billion (51% of total DPW).

- Private Passenger Auto Liability: +8.5%, or $5.4 billion to $69 billion
- Auto Physical Damage: +7.5%, or $3.5 billion to $50 billion
- Homeowners Multiple Peril: +2.7%, or $1.2 billion to $46 billion

In the **Commercial Lines Market**, despite declining rates, direct writings increased 3.0%, or $3.5 billion to $118 billion (37% of total DPW). **Table 2** on the following page highlights the largest commercial lines increases/decreases.

Table 2—Commercial Lines with Largest Increases/Decreases in DPW

Increases				Decreases			
Line of Business	% Chg from PYTD	$ Chg from PYTD	CYTD DPW	Line of Business	% Chg from PYTD	$ Chg from PYTD	CYTD DPW
Other Liability	4.0%	$1.2 B	$32.4B	Ocean Marine	(1.9%)	($38M)	$1.9B
Commercial Auto Liability	8.6%	$1.1B	$14.0B	Boiler & Machinery	(3.9%)	($34M)	$845M
Excess Workers' Compensation	199.7%	$322.6M	$484.2M	Aircraft (all perils)	(2.2%)	($16M)	$698M
Group A&H	8.6%	$195M	$2.5B	Fidelity	(1.9%)	($11M)	$590M

With respect to **Combined Lines**, overall DPW increased 3.2%, or $1.2 billion to $38 billion (12% of total DPW). The increase was primarily attributed to the following lines of business:

- Allied Lines: +5.9%, or $750 million to $13.5 billion
- Inland Marine: +5.3%, or $573 million to $11.3 billion
- Other A&H: +11.6%, or $99 million to $955 million

DPW by State, Territories

All states and territories except for Alaska experienced DPW growth compared to the prior year-to-date. On a percentage basis, the Northern Mariana Islands and American Samoa experienced the largest growth, both with double-digit increases, but from a dollar basis, California, New York, and Florida were among the premium growth leaders. **Fig. 3** below, shows the percent change in DPW by state for the current period compared to the prior year period.

Net Premiums Written

On a net basis, writings increased 4.3% to $280 billion, marking the seventh consecutive mid-year of growth.

Change in DPW by State (CYTD to PYTD)

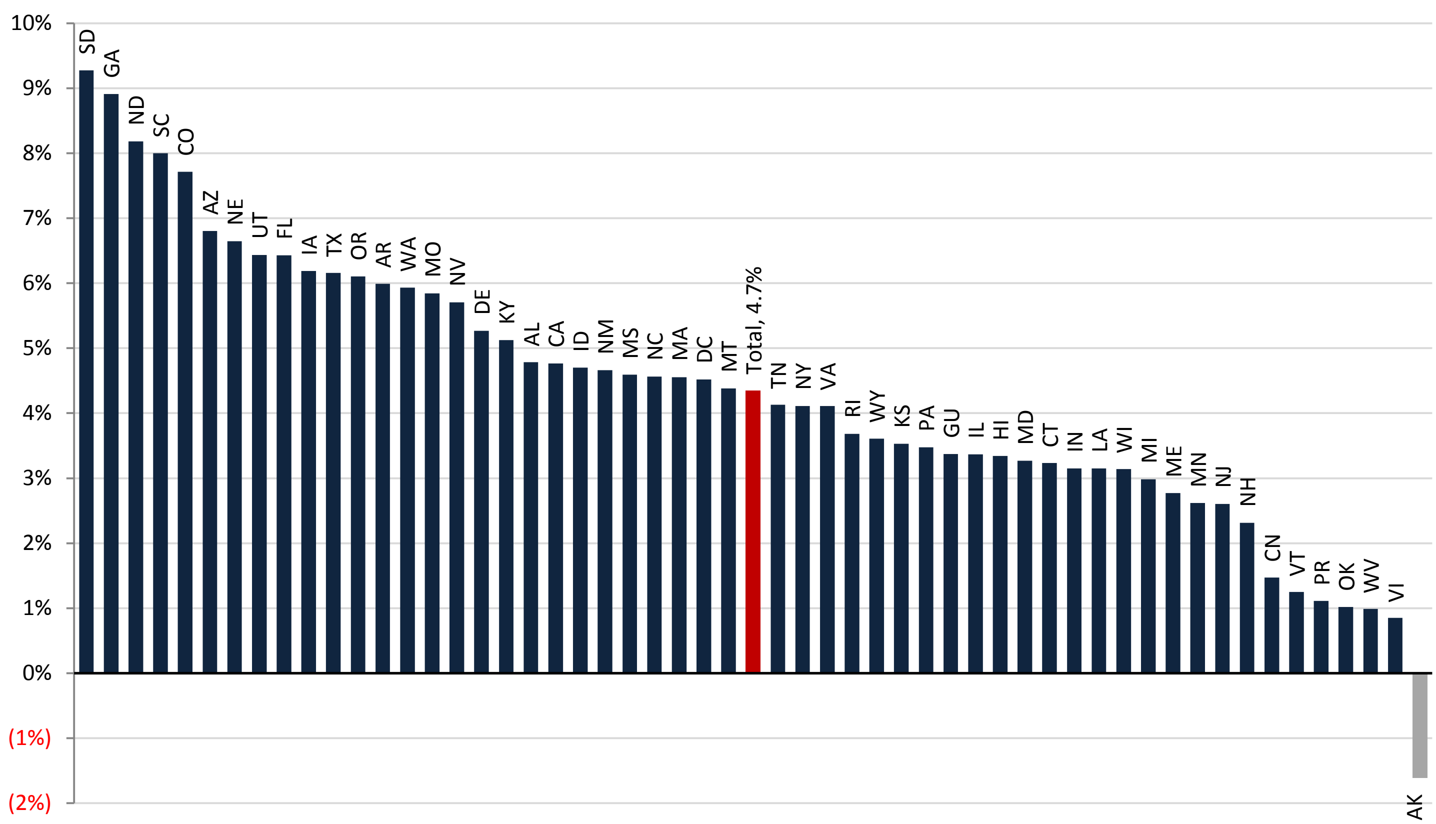

Fig. 3

Underwriting Operations

The U.S. property and casualty insurance industry recorded a net underwriting loss for the second consecutive mid-year period with an underwriting loss of $3.2 billion versus a $182 million loss a year ago. This loss for the current period was primarily due to higher catastrophe losses and the continued underperformance in auto liability, partly offset by favorable reserve development. Net premiums earned increased by 3.3% to $270 billion while aggregated net losses, LAE, and other underwriting expenses incurred increased 4.5% to $273 billion. **The combined ratio (Fig. 4) pierced the 100% threshold for the first time since 2012 at 100.6%**—represented by a 73.0% net loss ratio, a 27.0% expense ratio, and a 0.54% dividend ratio.

Underwriting Income (through June 30)

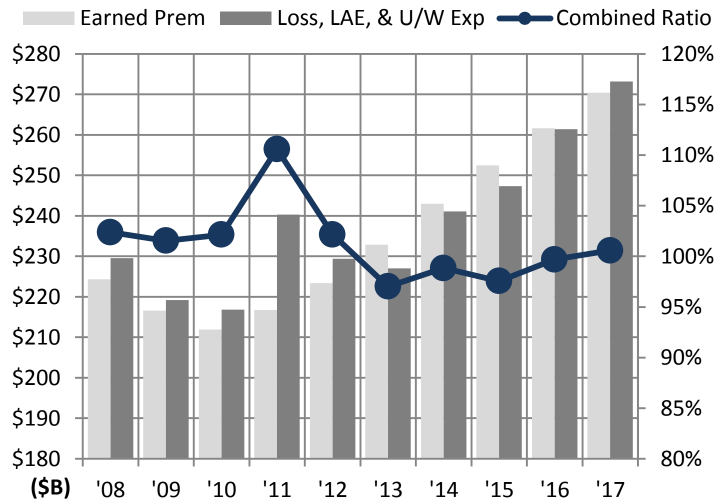

Fig. 4

Pure Direct Loss Ratio

On a direct basis, the industry's overall pure direct loss ratio (PDLR) was slightly worse compared to a year ago, with a 1.3-percentage point deterioration to 60.5% as direct losses incurred increased 6.3% to $186 billion while direct premiums earned increased 4.0% to $307 billion. Below are the PDLRs by market and by lines of business (**Table 3**).

- **Personal Lines**—PDLR of 66.9%, +1.0-pts
- **Commercial Lines**—PDLR of 55.6%, +2.8-pts
- **Combined Lines**—PDLR of 46.6%, -3.4-pts

Table 3—PDLR by Lines of Business

Improvement				Deterioration			
Line of Business	Pt. Chg from PYTD	PDLR (CYTD)	PDLR (PYTD)	Line of Business	Pt. Chg from PYTD	PDLR (CYTD)	PDLR (PYTD)
Aggregate Write-ins	(62.3)-pts	(16.4%)	45.9%	Financial Guaranty	208.6-pts	237.5%	28.9%
Other A&H	(15.9)-pts	129.2%	145.1%	International	54.0-pts	71.2%	17.1%
Excess Workers' Comp	(9.7)-pts	66.3%	75.9%	Farmowners Multi Peril	23.9-pts	78.1%	54.2%
Mortgage Guaranty	(9.3)-pts	11.1%	20.4%	Products Liability	19.4-pts	48.4%	29.0%
Burglary & Theft	(7.0)-pts	10.8%	17.8%	Boiler & Machinery	10.5-pts	50.5%	40.0%
Allied Lines	(5.1)-pts	55.6%	60.7%	Fidelity	10.2-pts	45.2%	35.0%
Group A&H	(4.7)-pts	62.3%	67.0%	Aircraft (all perils)	9.0-pts	61.8%	52.8%
Surety	(4.3)-pts	13.6%	17.9%	Homeowners MP	8.0-pts	64.0%	56.0%
Prvt Psgr Auto Liability	(2.1)-pts	70.2%	72.3%	Credit	5.0-pts	52.1%	47.1%
Auto Physical Damage	(2.0)-pts	65.3%	67.3%	Earthquake	2.6-pts	2.8%	0.2%
Ocean Marine	(1.5)-pts	48.6%	50.1%	Commercial Auto Liab.	2.0-pts	66.4%	64.4%
Fire	(0.9)-pts	45.7%	46.6%	Commercial Multi Peril	1.9-pts	53.1%	51.2%
Med. Professional Liab.	(0.7)-pts	50.0%	50.7%	Other Liability	1.6-pts	54.8%	53.1%
Warranty	(0.5)-pts	54.6%	55.1%	Credit A&H	0.9-pts	16.9%	16.0%
Workers' Compensation	(0.04)-pts	54.2%	54.2%	Inland Marine	0.8-pts	48.3%	47.4%

Investment Operations

Industry investment profits totaled $30 billion for the first half of 2017, up 1.6% from a year earlier (**Fig. 5**). The increase resulted from a 5.7% increase in net investment income earned to $26 billion, partially offset by a 19% decline in net realized gains to $3.9 billion. Investment yield (annualized) edged slightly higher to 3.29% versus 3.24% for the prior year period. The first mid-year improvement in yield since 2010 that can be attributed to recent rate hikes by the Federal Reserve (Fed).

In June, 2017, the Fed made a quarter-point rate hike, its fourth since December 2015. The Fed's decision to increase rates was primarily due to the low unemployment rate of 4.3% and the inflation rate of 1.9% that was in line with the Fed's target. The Fed unanimously declined to increase rates at its July meeting however, it said that it expects to begin winding down its $4.5 trillion balance sheet relatively soon. At the September meeting, the Fed decided to maintain rates in order to support strengthening in the job market and returning the inflation rate closer to its 2% objective. The Fed expects economic growth to be held down in the third quarter due to the destruction caused by hurricanes Harvey, Irma, and Maria.

Fig. 6 shows the industry's cash and invested assets allocation. Bonds comprised the majority of cash and invested assets totaling $994 billion, which equated to 54% of total cash and invested assets, followed by unaffiliated common stocks of $283 billion (15.6% of total cash and invested assets), and $261 billion affiliated common stocks (14.2% of total cash and invested assets).

Net Income

The $3.2 billion underwriting loss plus total other losses of $5.0 billion were offset by net investment income of $29.5 billion to result in a net profit $17.7 billion for the year (**Fig. 7**).

Return on revenue worsened 1.7-percentage points to 5.9% compared to 7.6% for the prior year period.

Investment Income (through June 30)

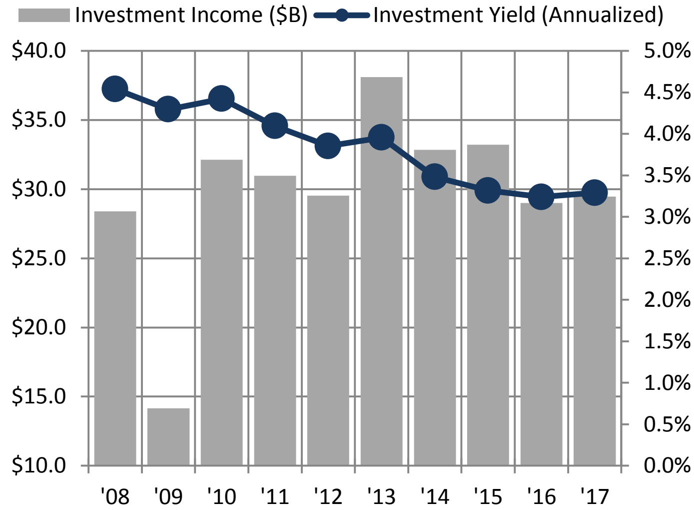

Fig. 5

Cash & Invested Assets

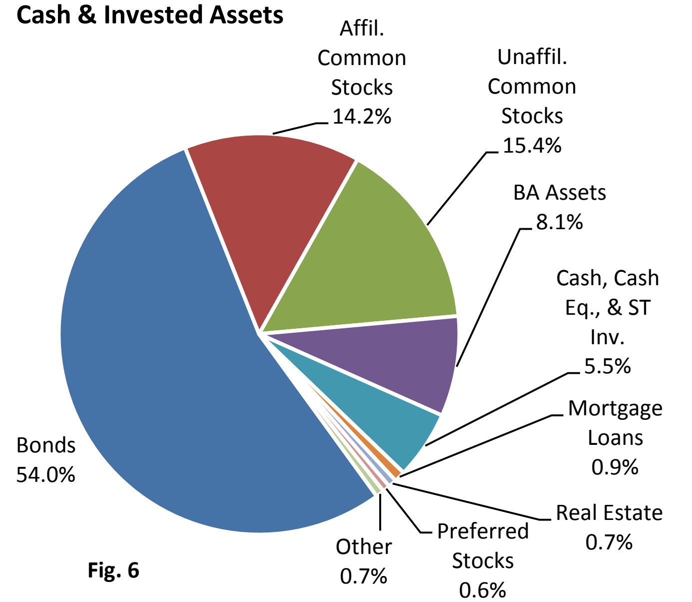

Fig. 6

Net Income (through June 30)

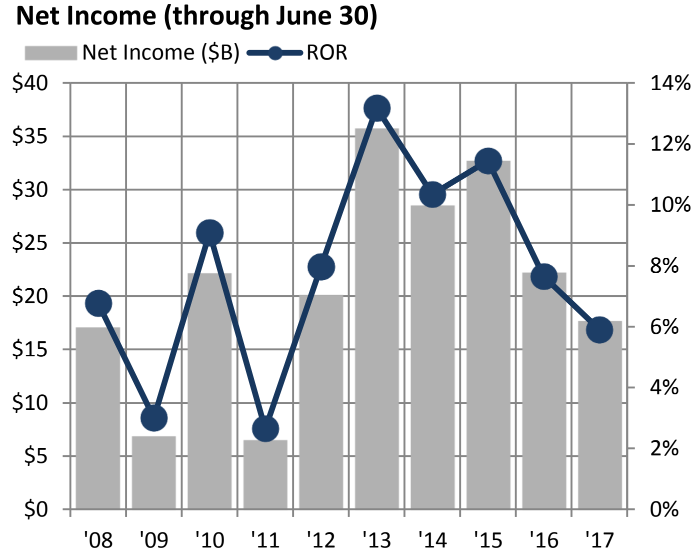

Fig. 7

Cash & Liquidity

Net cash provided by operating activities totaled $16 billion for the first six months of 2017 compared to $26 billion for the same period in 2016 (**Fig. 8**). The deterioration was attributed to:

- A **6.9% increase in cash outflows** stemming from a 10.3% increase in benefit and loss related payments and a 4.2% increase in commissions and expenses paid
- Partially offset by a **2.8% increase in cash inflows** as higher net premiums earned led to a 1.8% increase in premiums collected

Liquidity was nearly flat with a 0.5-percentage point increase, but remained strong at 79.7% at June 30, 2017 as liquid assets totaled $1.4 trillion and adjusted liabilities totaled $1.1 trillion.

Capital & Surplus

Industry aggregated policyholders' surplus (adjusted for affiliated investments) increased 2.4% since the prior year-end to a new high of $749 billion at June 30, 2017 (**Fig. 9**). The increase was mostly attributable to:

- Net income of $18 billion
- Unrealized capital gains of $19 billion
- Partially offset by $13 billion in stockholder dividends

Return on surplus was 2.4%, down 3.4-points compared to 5.8% for the prior year.

Loss & LAE Reserves

Loss and LAE reserves decreased 0.5%, or $3.2 billion since the prior year-end to $636 billion at June 30, 2017, whereby $524 billion comprised of unpaid losses and $111 billion unpaid LAE (**Fig. 10**). Reserve leverage edged higher, but remained relatively low at 85% compared to 83% at year-end 2016.

The trend in net favorable loss reserve development continued with an overall redundancy of $6.9 billion through mid-year, which consisted of a $44 billion deficiency in prior year known case loss and LAE reserves, offset by a $51 billion redundancy in prior year IBNR loss and LAE reserves.

Cash from Operations (through June 30)

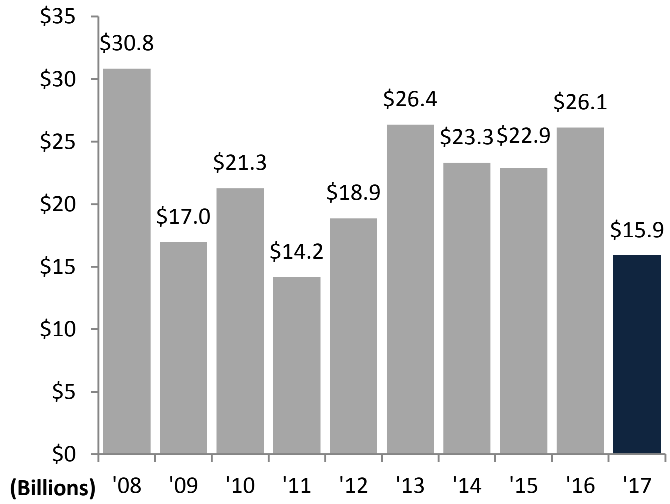

Fig. 8

Capital & Surplus ($B)

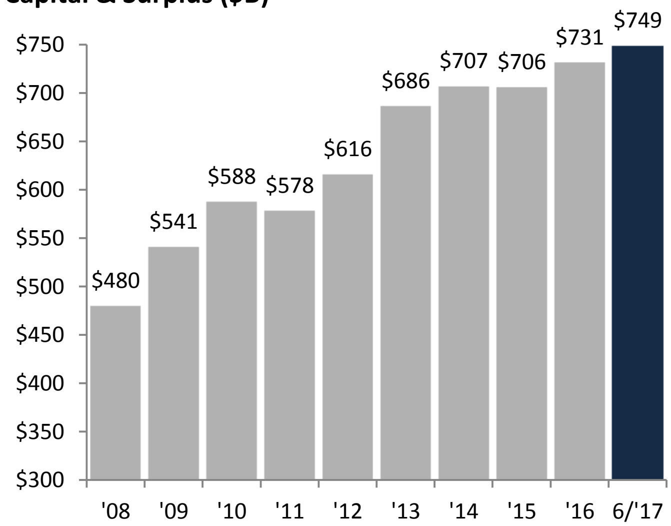

Fig. 9

Loss & LAE Reserves ($B)

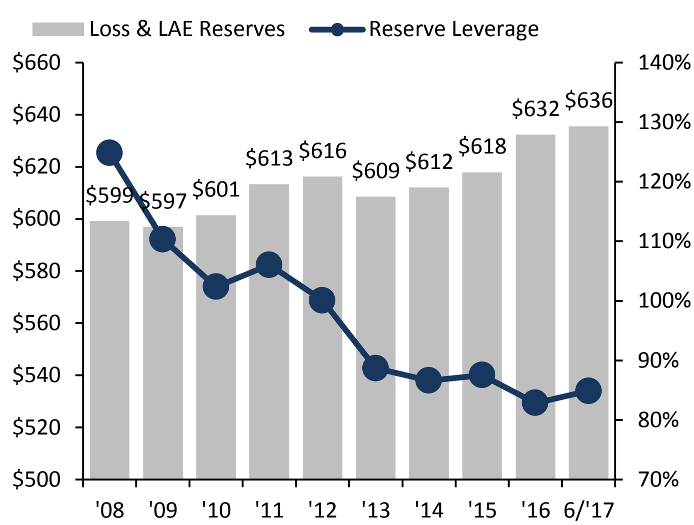

Fig. 10