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ISO RELEASE: P/C Insurers? Profits and Profitability Slipped In First-Quarter 2014 As Gains On Underwriting Shrank

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P/C Insurers? Profits and Profitability Slipped In First-Quarter 2014 As Gains On Underwriting Shrank

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JERSEY CITY, N.J., July 3, 2014 ? Private U.S. property/casualty insurers? net income after taxes fell to $13.8 billion in first-quarter 2014 from $14.3 billion in first-quarter 2013, with insurers? overall profitability as measured by their annualized rate of return on average policyholders? surplus falling to 8.4 percent from 9.6 percent.

Insurers? pretax operating income ? the sum of net gains or losses on underwriting, net investment income, and miscellaneous other income ? fell to $13.7 billion in first-quarter 2014 from $15.8 billion in first-quarter 2013.

Deterioration in underwriting results prompted the decreases in insurers? pretax operating income, net income after taxes, and overall rate of return, with net gains on underwriting falling $2.3 billion to $2.2 billion in first-quarter 2014 from $4.5 billion in first-quarter 2013. The combined ratio ? a key measure of losses and other underwriting expenses per dollar of premium ? deteriorated to 97.3 percent for first-quarter 2014 from 94.9 percent for first-quarter 2013, according to ISO, a Verisk Analytics company (Nasdaq:VRSK), and the Property Casualty Insurers Association of America (PCI).

Net gains on underwriting dropped as premium growth slowed and net loss and loss adjustment expenses (LLAE) surged upward, with quarterly LLAE rising for the first time since Superstorm Sandy struck in fourth-quarter 2012.

The deterioration in underwriting results in first-quarter 2014 also reflects increases in underwriting expenses and dividends to policyholders, which both rose compared with their levels in first-quarter 2013.

Partially offsetting the decline in net gains on underwriting, insurers? net investment gains ? the sum of net investment income and realized capital gains (or losses) on investments ? rose $1.3 billion to $14.1 billion in first-quarter 2014 from $12.8 billion in first-quarter 2013. Insurers? results for first-quarter 2014 also benefited from a $0.4 billion increase in miscellaneous other income to $0.2 billion in first-quarter 2014 from negative $0.1 billion in first-quarter 2013. Insurers? federal and foreign income taxes for first-quarter 2014 amounted to $2.8 billion, virtually unchanged from their level a year earlier.

Policyholders? surplus ? insurers? net worth measured according to Statutory Accounting Principles ? grew $8.7 billion to a record $662.0 billion at March 31, 2014, from $653.3 billion at year-end 2013.

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.

?Policyholders? surplus ? the funds available to cover new claims ? rose $8.7 billion in first-quarter 2014 to a record-high $662.0 billion, leaving no doubt that insurers are strong, well capitalized, and well prepared to pay future claims. Policyholders can rely on insurers to fulfill their obligations and help finance economic recovery even if we?re struck this hurricane season by a storm more devastating than Superstorm Sandy or Hurricane Katrina,? said Robert Gordon, PCI?s senior vice president for policy development and research. ?The experts are predicting the hurricane season this year will be relatively calm, but it only takes one powerful storm to disrupt millions of lives and cause tens of billions of dollars in damage. Moreover, millions of Americans live with the ever-present threat of a catastrophic earthquake or terrorist attack that could cause vast devastation and loss of life, while others of us live in locations at risk of being struck by wildfires, tornadoes, inland flooding, or other natural disasters. This means that all of us ? insurers, homeowners, businesses, and officials at all levels of government ? must continue to focus on risk management, disaster readiness, and mitigation aimed at minimizing the human tragedy caused by future catastrophes. Many businesses and individual consumers could also benefit from reviewing whether they have adequate insurance including flood and earthquake coverage.?

?Though insurers? net gains on underwriting in first-quarter 2014 were down from the levels experienced a year earlier, underwriting results remained unusually strong. Insurers posted net gains on underwriting for only 21 of the 113 quarters since the start of ISO?s quarterly data, and insurers? 97.3 percent combined ratio for first-quarter 2014 was 7.7 percentage points better than the average since first-quarter 1986,? said Michael R. Murray, ISO?s assistant vice president for financial analysis. ?Better-than-average underwriting profitability offset weakness in investment income, with insurers? 8.4 percent annualized overall rate of return for first-quarter 2014 equaling the average rate of return since the beginning of 1986. But with premium growth slowing and loss and loss adjustment expenses surging upward in first-quarter 2014, there is some risk that net gains on underwriting will slip further as the year progresses. Further slippage in underwriting results could lead to downward pressure on insurers? overall profitability, as current investment yields make offsetting increases in investment income rather unlikely. In fact, insurers? net investment income ? primarily interest on bonds and dividends from stocks ? peaked at $15.4 billion in fourth-quarter 2007 but totaled just $11.2 billion in

first-quarter 2014 as a result of low investment yields brought about by the Great Recession, the financial crisis, and residual weakness in the economy.?

The property/casualty industry?s 8.4 percent annualized rate of return for first-quarter 2014 was the net result of double-digit rates of return for mortgage and financial guaranty (M&FG) insurers and single-digit rates of return for other insurers. ISO estimates that M&FG insurers? annualized rate of return on average surplus improved to 16.5 percent for first-quarter 2014 from 8.3 percent for first-quarter 2013. Excluding M&FG insurers, the industry?s annualized rate of return fell to 8.2 percent in first-quarter 2014 from 9.6 percent in first-quarter 2013.

Underwriting Results

Underwriting gains (or losses) equal earned premiums minus LLAE, other underwriting expenses, and dividends to policyholders. Though premiums rose in first-quarter 2014, net gains on underwriting fell to $2.2 billion during the period from $4.5 billion in first-quarter 2013 as LLAE surged upward.

Net written premiums climbed $4.2 billion, or 3.6 percent, to $121.4 billion in first-quarter 2014 from $117.2 billion in first-quarter 2013. At 3.6 percent, quarterly net written premium growth had slowed from 4.3 percent in first-quarter 2013 to its slowest pace since first-quarter 2012, when written premiums rose 3.0 percent.

Similarly, net earned premiums grew $4.9 billion to $117.9 billion in first-quarter 2014 from $113.0 billion in first-quarter 2013, with growth in net earned premiums receding to 4.3 percent in first-quarter 2014 from 4.6 percent in first-quarter 2013.

Outpacing the growth in premiums, LLAE rose $6.4 billion, or 8.6 percent, to $80.8 billion in first-quarter 2014 from $74.4 billion in first-quarter 2013. The 8.6 percent increase in LLAE in first-quarter 2014 contrasts with a 1.5 percent decline in first-quarter 2013.

Other underwriting expenses increased $0.7 billion, or 2.0 percent, to $34.2 billion in first-quarter 2014 from $33.5 billion in first-quarter 2013 as dividends to policyholders grew $0.1 billion to $0.7 billion from $0.6 billion.

Increases in both catastrophe and noncatastrophe losses contributed to the upward surge in overall LLAE. ISO estimates that private U.S. insurers? net LLAE from catastrophes increased to $3.2 billion for first-quarter 2014 from $2.5 billion a year ago. Other net LLAE rose $5.7 billion, or 8.0 percent, to $77.6 billion in first-quarter 2014 from $71.9 billion in first-quarter 2013.

Private U.S. insurers? net LLAE from catastrophe includes their losses from all catastrophes, whether they struck the United Sates or elsewhere around the globe. 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.

U.S. insurers? $3.2 billion in net LLAE from catastrophes in first-quarter 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 elsewhere around the globe was immaterial in both first-quarter 2014 and first-quarter 2013.

Direct insured property losses from catastrophes striking the United States totaled $3.0 billion in first-quarter 2014, up $0.2 billion from $2.8 billion in first-quarter 2013 and $0.4 billion above the $2.6 billion first-quarter average for the past ten years, according to ISO?s Property Claim Services® (PCS®) based on the information available through July 2, 2014. Direct catastrophe losses are before reinsurance recoveries and exclude loss adjustment expenses. These figures include losses covered by residual market insurers, foreign insurers, and reinsurers but exclude ocean marine losses and losses covered by the National Flood Insurance Program.

Reflecting the imbalance between growth in premiums and growth in LLAE and the other costs of providing insurance, the combined ratio deteriorated by 2.3 percentage points to 97.3 percent in first-quarter 2014 from 94.9 percent in first-quarter 2013.

?The increase in net LLAE more than accounts for the deterioration in underwriting results in first-quarter 2014,? said Gordon. ?If LLAE had been flat instead of increasing 8.6 percent, the combined ratio would have improved 3.1 percentage points to 91.8 percent instead of rising 2.3 percentage points to 97.3 percent.?

Underwriting results would have deteriorated more in first-quarter 2014 if not for $5.5 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 $5.5 billion of favorable reserve development in first-quarter 2014 follows $5.6 billion of favorable development in first-quarter 2013.

The $5.5 billion of favorable reserve development for the industry overall in first-quarter 2014 reflects $0.2 billion of favorable reserve development for M&FG insurers and $5.3 billion of favorable reserve development for other insurers.

M&FG insurers? $0.2 billion of favorable reserve development in first-quarter 2014 is $0.1 billion less than their $0.3 billion of favorable reserve development in first-quarter 2013.

The amount of favorable reserve development for the industry excluding M&FG insurers remained essentially unchanged at $5.3 billion.

Excluding development of LLAE reserves, total industry net LLAE grew $6.3 billion, or 7.8 percent, to $86.3 billion in first-quarter 2014 from $80.0 billion in first-quarter 2013, and the combined ratio rose by 2.0 percentage points to 101.9 percent from 99.9 percent.

The $2.2 billion in net gains on underwriting in first-quarter 2014 amounted to 1.9 percent of the $117.9 billion in net premiums earned during the period, whereas the $4.5 billion in net gains on underwriting in first-quarter 2013 amounted to 4.0 percent of the $113.0 billion in net premiums earned during that period.

?Mortgage and financial guaranty insurers? superior underwriting results contributed to their superior overall rate of return,? said Murray. ?Mortgage and financial guaranty insurers? combined ratio dropped 13.2 percentage points to 81.5 percent for first-quarter 2014 from 94.7 percent for first-quarter 2013, and their combined ratio for first-quarter 2014 was 15.9 percentage points better than the 97.4 percent combined ratio for the industry excluding mortgage and financial guaranty insurers. Reflecting the difference in combined ratios, M&FG insurers? 16.5 percent annualized overall rate of return for first-quarter 2014 was more than twice the 8.2 percent annualized rate of return for the industry excluding M&FG insurers.?

M&FG insurers? net written premiums fell 15.2 percent to $1.0 billion for first-quarter 2014 from $1.2 billion for first-quarter 2013, and their net earned premiums fell 18.6 percent to $1.2 billion from $1.4 billion. M&FG insurers? net LLAE fell even more sharply, declining 42.0 percent to $0.5 billion from $0.9 billion last year. M&FG insurers? underwriting expenses were unchanged at $0.4 billion for both first-quarter 2014 and first-quarter 2013.

Excluding M&FG insurers, industry net written premiums rose 3.8 percent in first-quarter 2014 to $120.4 billion, net earned premiums increased 4.6 percent to $116.7 billion, LLAE grew 9.2 percent to $80.3 billion, other underwriting expenses increased 2.0 percent to $33.8 billion, and dividends to policyholders increased 21.2 percent to $0.7 billion. As a result, the combined ratio for the industry excluding M&FG insurers climbed to 97.4 percent for first-quarter 2014 from 94.9 percent for first-quarter 2013.

?Reflecting changes in the economy and developments in insurance markets, overall net written premium growth slowed to 3.6 percent in first-quarter 2014 from 4.3 percent in first-quarter 2013, with premium growth for commercial lines insurers being particularly weak,? said Gordon. ?Excluding mortgage and financial guaranty insurers, net written premium growth for insurers writing predominantly commercial lines slid 0.8 percentage points to 2.0 percent in first-quarter 2014 as

premium growth for insurers writing more balanced books of business slipped 0.7 percentage points to 3.4 percent. In contrast, premium growth for insurers writing mostly personal lines receded just 0.1 percentage point to 5.4 percent in first-quarter 2014.?

?Reflecting the slowdown in premium growth and the upward surge in LLAE, underwriting profitability deteriorated for all major sectors of the industry,? said Murray. ?Excluding mortgage and financial guaranty insurers, commercial lines insurers? combined ratio rose 4.1 percentage points in first-quarter 2014 to 95.5 percent as balanced insurers? combined ratio increased 0.6 percentage points to 98.2 percent and personal lines insurers? combined ratio climbed 2.3 percentage points to 98.5 percent.?

Investment Results

Insurers? net investment income ? primarily dividends from stocks and interest on bonds ? fell 2.0 percent to $11.2 billion in first-quarter 2014 from $11.4 billion in first-quarter 2013. But insurers? realized capital gains on investments rose $1.5 billion to $2.9 billion in first-quarter 2014 from $1.4 billion a year earlier. Combining net investment income and realized capital gains, overall net investment gains grew $1.3 billion, or 10.3 percent, to $14.1 billion for first-quarter 2014 from $12.8 billion for first-quarter 2013.

Insurers? $2.9 billion in realized capital gains in first-quarter 2014 was the net result of $0.3 billion in realized losses on impaired investments and $3.2 billion in realized gains on other investments, with realized losses on impaired investments falling $0.1 billion to $0.3 billion in first-quarter 2014 from $0.4 billion in first-quarter 2013.

?The decline in insurers? investment income reflects low market yields, with the annualized yield on insurers? investments dropping to 3.1 percent in first-quarter 2014 from 3.3 percent in first-quarter 2013. Insurers? average holdings of cash and invested assets ? the assets on which insurers earn investment income ? actually rose 6.0 percent in first-quarter 2014 compared with their average holdings a year earlier,? said Gordon. ?Long-term annual data show that insurers? investment yield last fell as low as 3.1 percent in 1965. From 1960 to 2013, 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 $2.9 billion in realized capital gains in first-quarter 2014 with $1.3 billion in unrealized capital gains during the same period, insurers posted $4.2 billion in overall capital gains for first-quarter 2014 ? down $10.3 billion from the $14.5 billion in overall capital gains for first-quarter 2013. Since the start of ISO?s quarterly data in 1986, insurers? total capital gains have averaged $2.6 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.

?The decline in insurers? overall capital gains on investments from $14.5 billion in first-quarter 2013 to $4.2 billion in first-quarter 2014 reflects developments in financial markets,? said Murray. ?The S&P 500 rose 10.0 percent in first-quarter 2013 but just 1.3 percent in first-quarter 2014. Similarly, the NASDAQ Composite increased 8.2 percent in first-quarter 2013 but just 0.5 percent in first-quarter 2014.?

Pretax Operating Income

Pretax operating income ? the sum of net gains or losses on underwriting, net investment income, and miscellaneous other income ? declined $2.1 billion to $13.7 billion for first-quarter 2014 from $15.8 billion for first-quarter 2013. The $2.1 billion decrease in operating income reflects the $2.3 billion

decrease in net gains on underwriting and the $0.2 billion decline in net investment income, with those developments partially offset by the $0.4 billion increase in miscellaneous other income.

?The $2.1 billion first-quarter 2014 decline in operating income was the first since fourth-quarter 2012, when operating income tumbled $8.1 billion largely as a result of Superstorm Sandy,? said Gordon. ?But the first-quarter 2014 decline in operating income wasn?t driven by a spike in catastrophe losses. Rather, it was largely driven by the $5.7 billion increase in noncatastrophe LLAE.?

M&FG insurers? operating income increased to $0.7 billion in first-quarter 2014 from $0.3 billion in first-quarter 2013. Excluding M&FG insurers, the insurance industry?s operating income dropped $2.5 billion to $12.9 billion for first-quarter 2014 from $15.5 billion for first-quarter 2013.

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 decreased $0.6 billion to $13.8 billion for first-quarter 2014 from $14.3 billion for first-quarter 2013. The decline in net income was the net result of the $2.1 billion decrease in operating income and the $1.5 billion increase in realized capital gains.

M&FG insurers? net income after taxes rose to $0.7 billion in first-quarter 2014 from $0.3 billion in first-quarter 2013. Excluding M&FG insurers, the insurance industry?s net income after taxes fell $1.0 billion to $13.1 billion in first-quarter 2014 from $14.1 billion in first-quarter 2013.

Policyholders? Surplus

Policyholders? surplus climbed $8.7 billion to a record-high $662.0 billion as of March 31, 2014, from $653.3 billion at year-end 2013. Additions to surplus in first-quarter 2014 included insurers? $13.8 billion in net income after taxes, $1.3 billion in unrealized capital gains on investments (not included in net income), and $1.8 billion in new funds paid in. Those additions were partially offset by $7.4 billion in dividends to shareholders and $0.7 billion in miscellaneous charges against surplus.

Unrealized capital gains on investments fell $11.8 billion to $1.3 billion in first-quarter 2014 from $13.1 billion in first-quarter 2013.

New funds paid in grew to $1.8 billion in first-quarter 2014 from $1.4 billion in first-quarter 2013.

Dividends to shareholders grew $2.5 billion, or 50.3 percent, to $7.4 billion in first-quarter 2014 from $5.0 billion in first-quarter 2013.

Miscellaneous charges against surplus fell to $0.7 billion in first-quarter 2014 from $1.2 billion in first-quarter 2013.

M&FG insurers? surplus rose to $16.1 billion as of March 31, 2014, from $15.7 billion at year-end 2013. Excluding M&FG insurers, industry surplus rose $8.2 billion to $645.9 billion as of March 31 this year from $637.7 billion as of December 31, 2013.

?Using 12-month trailing premiums, the premium-to-surplus ratio dropped to 0.73 as of March 31, 2014, from 0.76 as of March 31, 2013. And the ratio of loss and loss adjustment expense reserves to surplus fell to 0.87 as of March 31 this year from 0.95 a year earlier,? said Murray. ?To the extent that these leverage ratios shed light on the amount of risk supported by each dollar of surplus, insurers are extremely well capitalized at this point and have ample capacity to meet increasing demand for

coverage as the economy grows. The 0.73 premium-to-surplus ratio as of March 31 is only about half of the 1.45 average premium-to-surplus ratio based on annual data for the 55 years from 1959 to 2013. Similarly, the 0.87 LLAE-reserves-to-surplus ratio as of the end of first-quarter 2014 is far below the 1.39 average for the 55 years ending 2013.?

About ISO

Since 1971, ISO has been a leading source of information about property/casualty insurance risk. For a broad spectrum of commercial and personal lines of insurance, the company provides statistical, actuarial, underwriting, and claims information; policy language; information about specific locations; fraud identification tools; and technical services. ISO serves insurers, reinsurers, agents and brokers, insurance regulators, risk managers, and other participants in the property/casualty insurance marketplace. ISO is a member of the Verisk Insurance Solutions group at Verisk Analytics (Nasdaq:VRSK). For more information, visit www.iso.com [1] and www.verisk.com [2].

About PCI

PCI is composed of more than 1,000 member companies, representing the broadest cross section of insurers of any national trade association. PCI members write over $195 billion in annual premium, 39 percent of the nation?s property casualty insurance. Member companies write 46 percent of the U.S. automobile insurance market, 32 percent of the homeowners market, 37 percent of the commercial property and liability market, and 41 percent of the private workers compensation market. For more information, visit www.pciaa.net [3].

OPERATING RESULTS FOR 2014 AND 2013

($ millions)

FIRST QUARTER	2014	2013
NET WRITTEN PREMIUMS		121,421
PERCENT CHANGE (%)		3.6
NET EARNED PREMIUMS		117,880
PERCENT CHANGE (%)		4.3
INCURRED LOSSES & LOSS ADJUSTMENT EXPENSES		80,789
PERCENT CHANGE (%)		8.6
STATUTORY UNDERWRITING GAINS (LOSSES)		2,908
POLICYHOLDERS? DIVIDENDS		673
NET UNDERWRITING GAINS (LOSSES)		2,235
PRETAX OPERATING INCOME		13,654
NET INVESTMENT INCOME EARNED		11,180
NET REALIZED CAPITAL GAINS (LOSSES)		2,933
NET INVESTMENT GAINS		14,113
NET INCOME (LOSS) AFTER TAXES		13,754
PERCENT CHANGE (%)		-4
SURPLUS (CONSOLIDATED)		662,013
LOSS & LOSS ADJUSTMENT EXPENSE RESERVES		574,648
COMBINED RATIO, POST-DIVIDENDS (%)		97.3

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