Triple-I Financial Analysis of P/C Insurer Performance in 2019

Insurance Industry

May 7, 2020

IN THIS ARTICLE

DOWNLOAD TO PDF

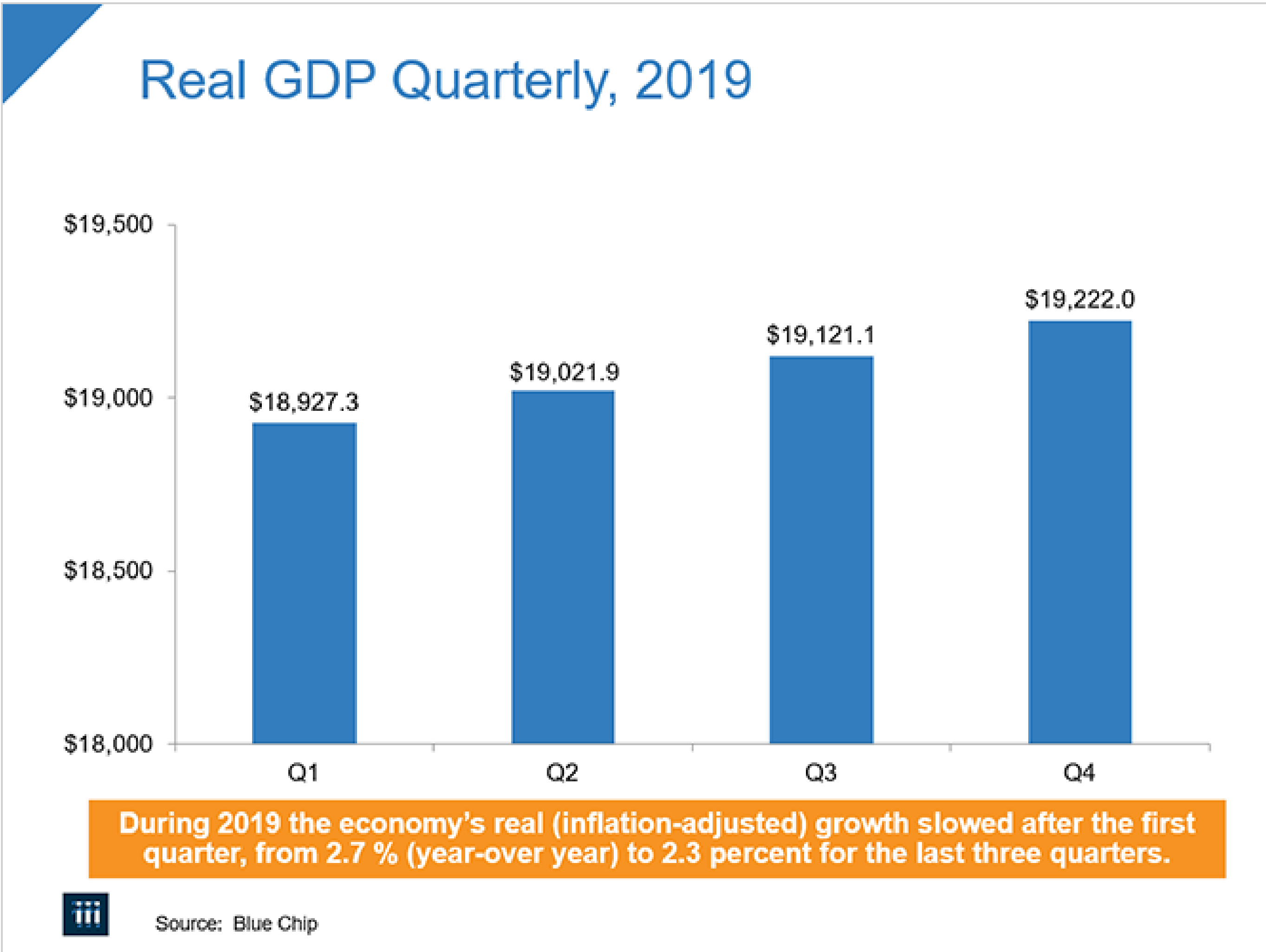
2019 was a solid, profitable year for the property/casualty (P/C) industry, with contributions to profit from both insurance and investment operations. Net income after taxes was $61.4 billion. The combined ratio for 2019 was 98.9, slightly better than the 99.2 in 2018. At the end of 2019, industry surplus attained its highest-ever level—$847.8 billion. This was driven largely by unrealized capital gains from a soaring stock market in the second, third, and fourth quarters of the year and declining interest rates.

The Economic Context

SHARE

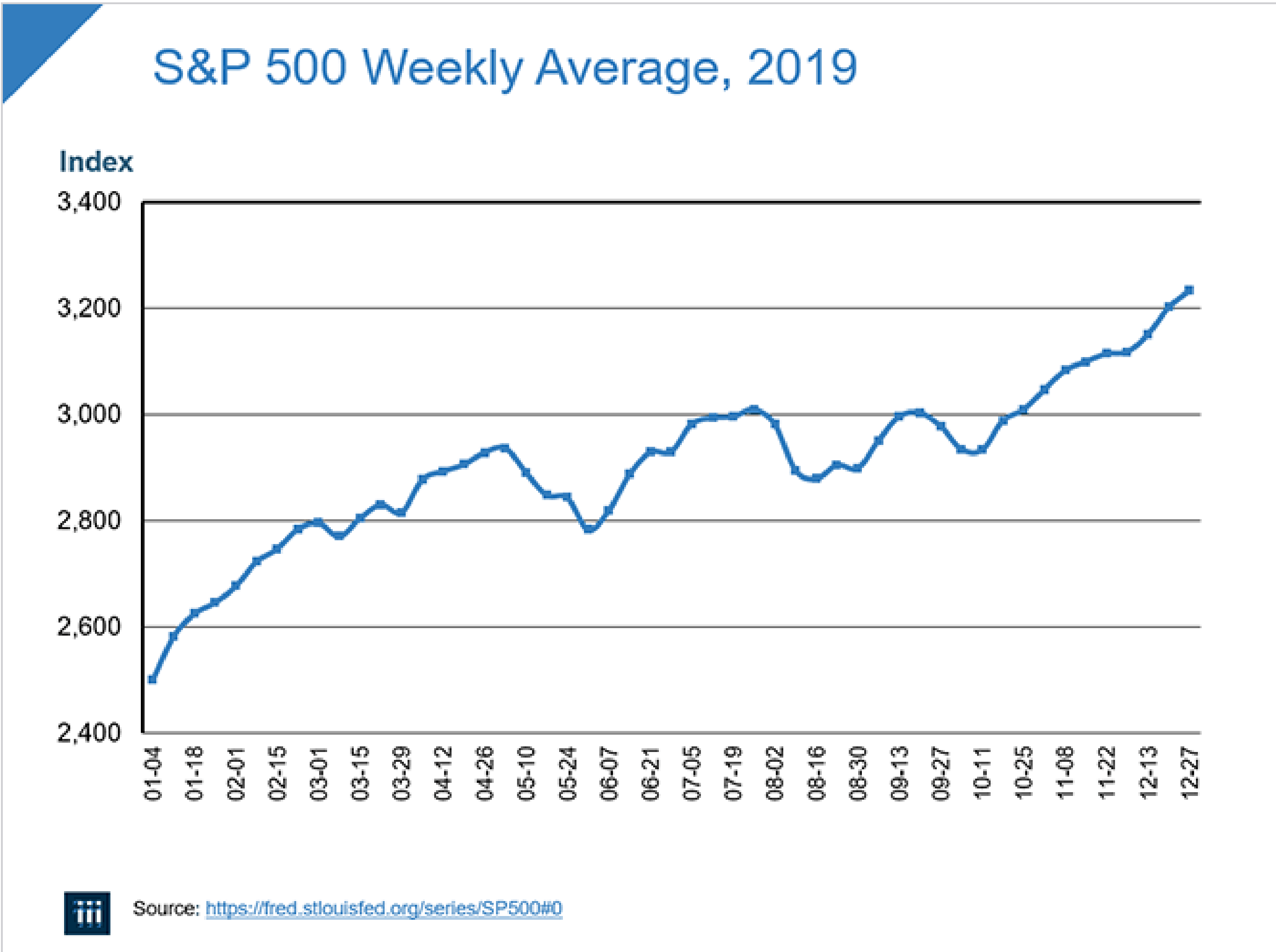
By most economic standards, 2019 was a good year. The expansion that began in July 2009 that followed the Great Recession of 2007-to-2009, passed the 120-month mark as the longest business-cycle recovery from a recession in U.S. history, and kept going through the end of the year (*Figure 1*).

Figure 1



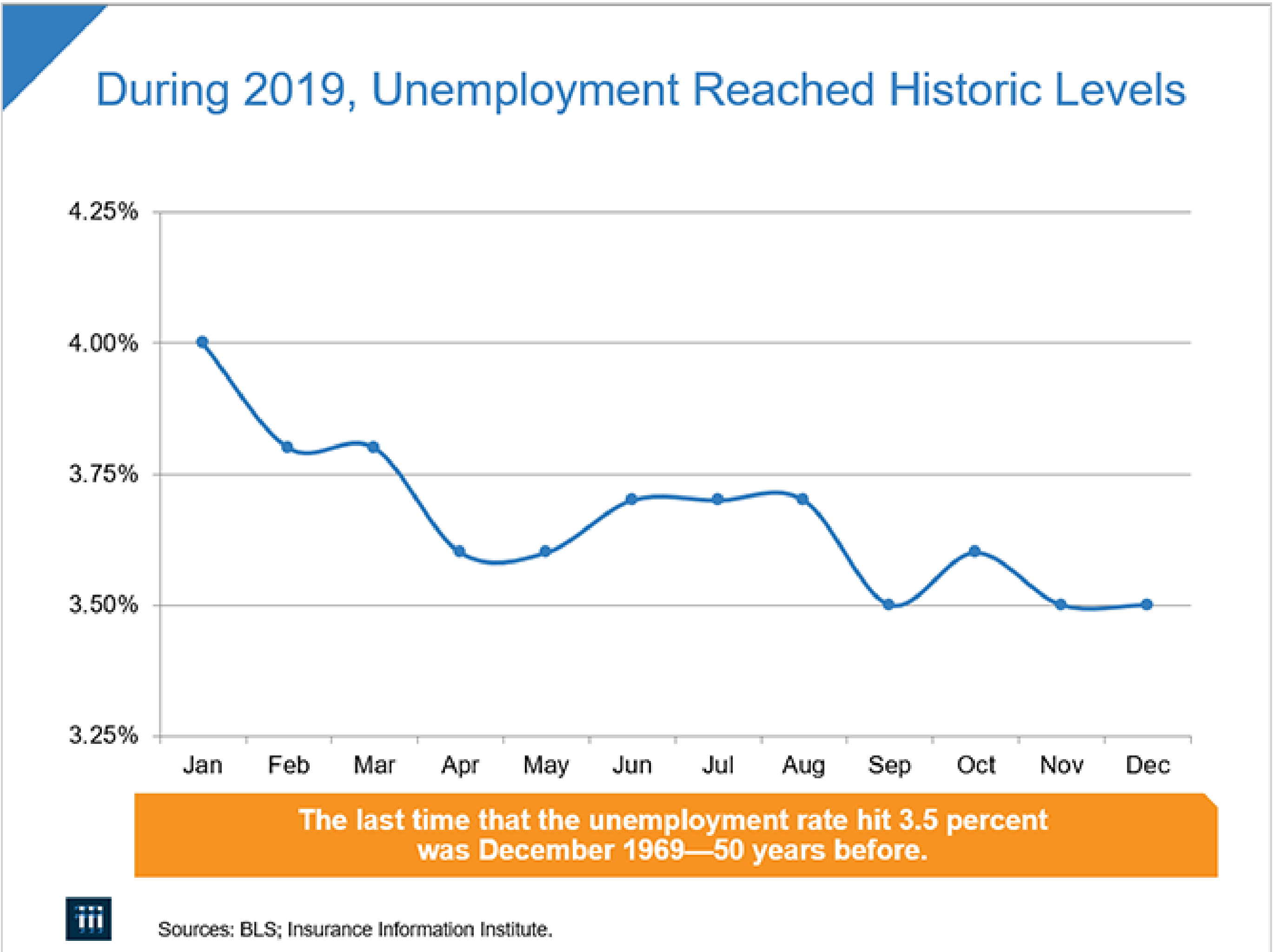
The stock market reflected this growth (*Figure 2*).

Figure 2



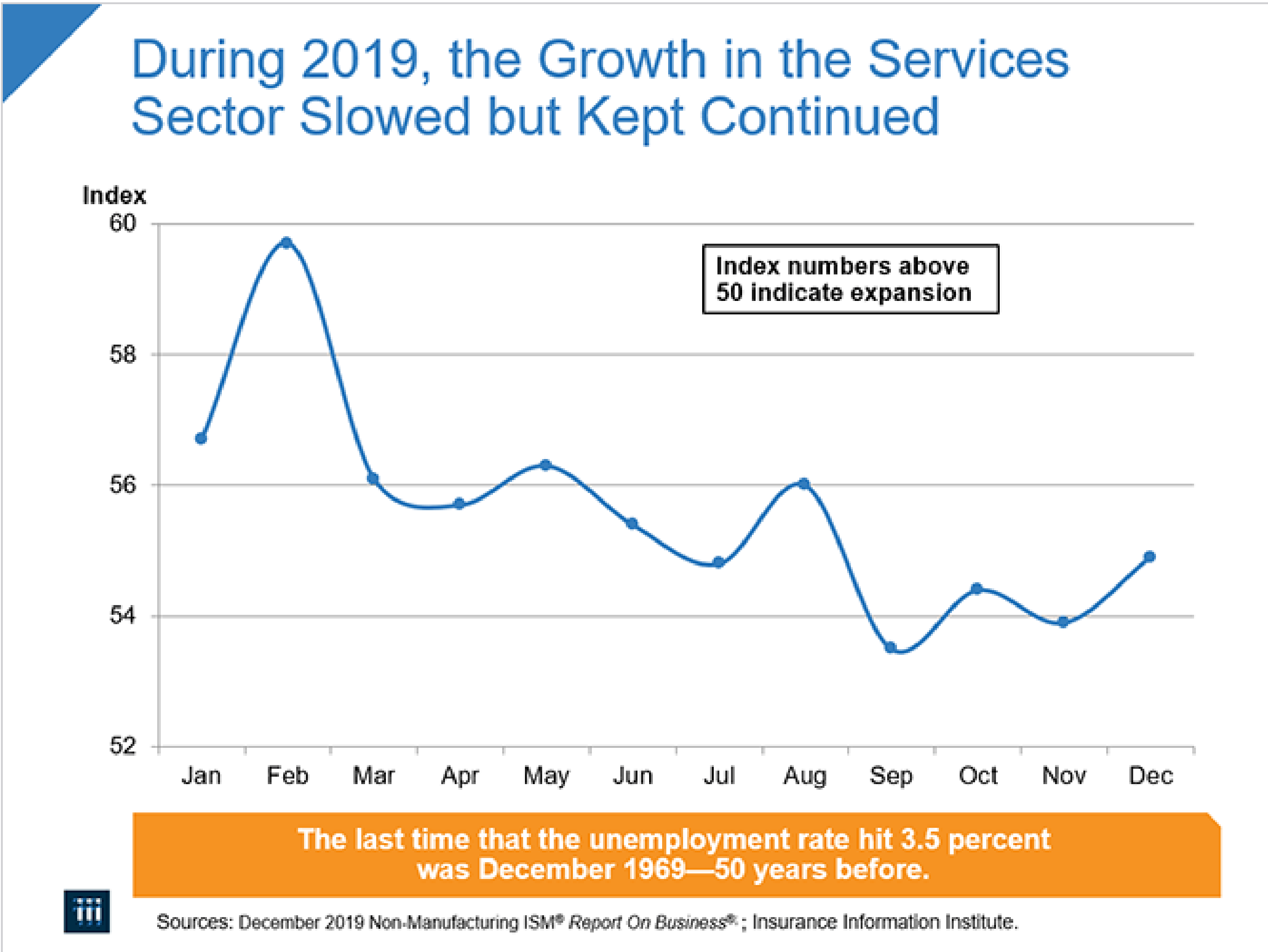
Nationally, unemployment hit and remained at a 66-year low (*Figure 3*).

Figure 3



The services sector of the economy—constituting roughly four-fifths of the production of goods and services—continued growing (as indicated by the ISM index above 50 percent throughout 2019, in *Figure 4*).

Figure 4



Source: https://www.instituteforsupplymanagement.org/files/ISMReport/ROB201912NMI.pdf

P/C Industry Performance

SHARE

Underwriting Performance

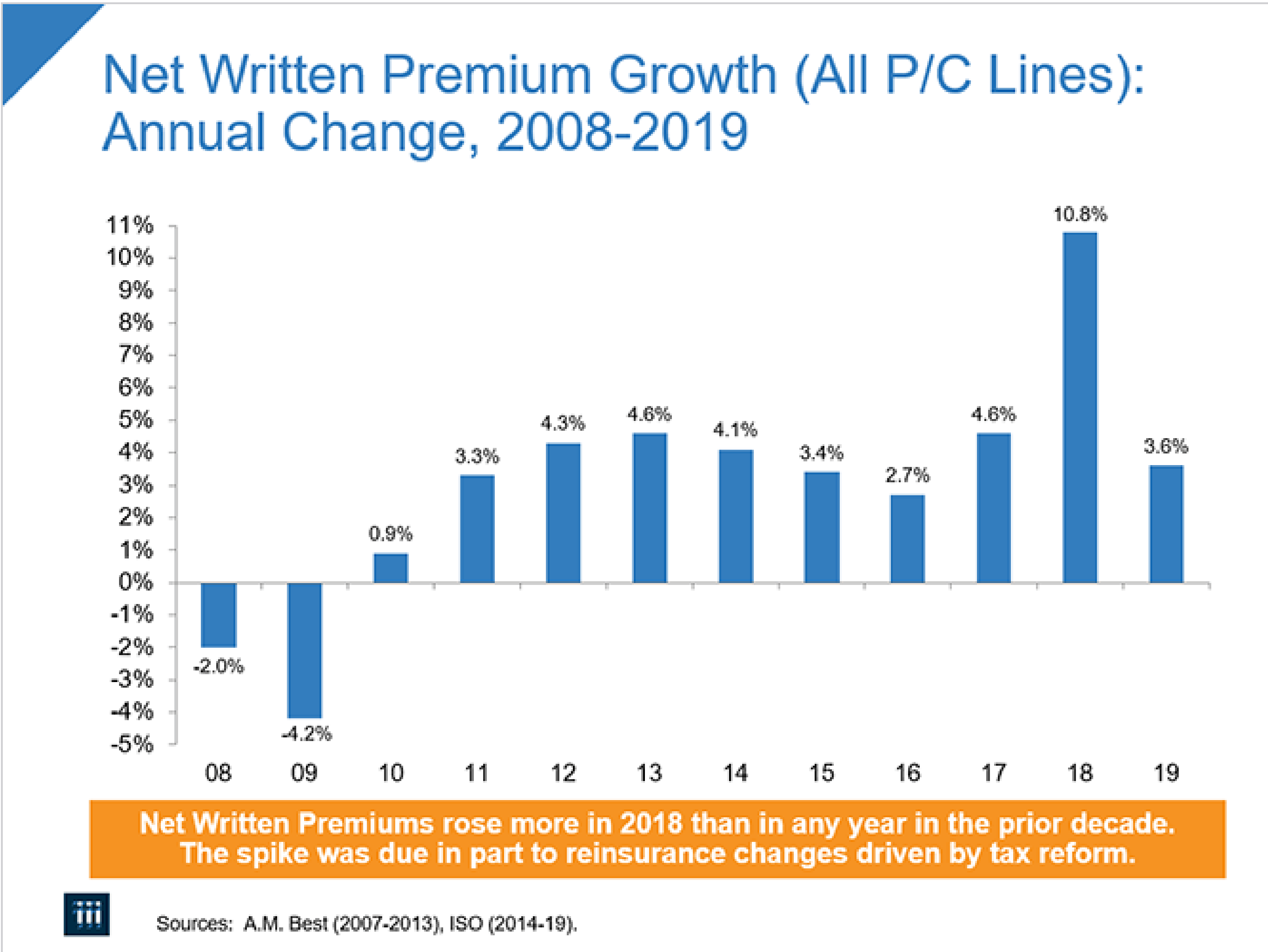
Premiums. The industry measures premium income in three different ways. Direct premiums written (DPW) are what policyholders pay for coverage and are analogous to retail prices for services. Net Premiums Written (NPW) are direct premiums after subtracting the cost of reinsurance; they are a measure of the risk that insurers accept after accounting for the portion of risk passed along to reinsurers. Both DPW and NPW are prospective in nature; they measure insurance yet to be provided. In contrast, Net Premiums Earned (NPE) is retrospective; it measures insurance protection that was provided.

ISO research determined that P/C industry DPW grew by 5.6 percent in 2018 and by 5.2 percent in 2019. This means that direct premiums grew at roughly the same rate as the U.S. economy in 2018 (5.4 percent in current dollars) and at a faster rate than the economy in 2019, which grew by 4.1 percent.

Premium comparisons of NPW and NPE growth in 2019 vs. 2018 are distorted by changes in reinsurance practices in early 2018 that are attributable to the major tax legislation adopted in December 2017. The effect of these changes was to raise calculated NPW and NPE growth rates for 2018 and, by comparing to an inflated base year, lessen the growth rates for 2019. To overcome this, ISO calculated the average annual growth rates for 2017-19.

NPW in 2019 was $634.0 billion, representing growth from 2017 to 2019 at an average annual rate of 7.1 percent (*Figure 5*). The comparable average annual growth rate for NPE in from 2017 to 2019 was 7.3 percent. In historical context, these are remarkable growth rates for these measures. Except for the hard market in 2001-to-2003, in the last two decades growth rates for NPW and NPE never exceeded 5.0 percent.

Figure 5

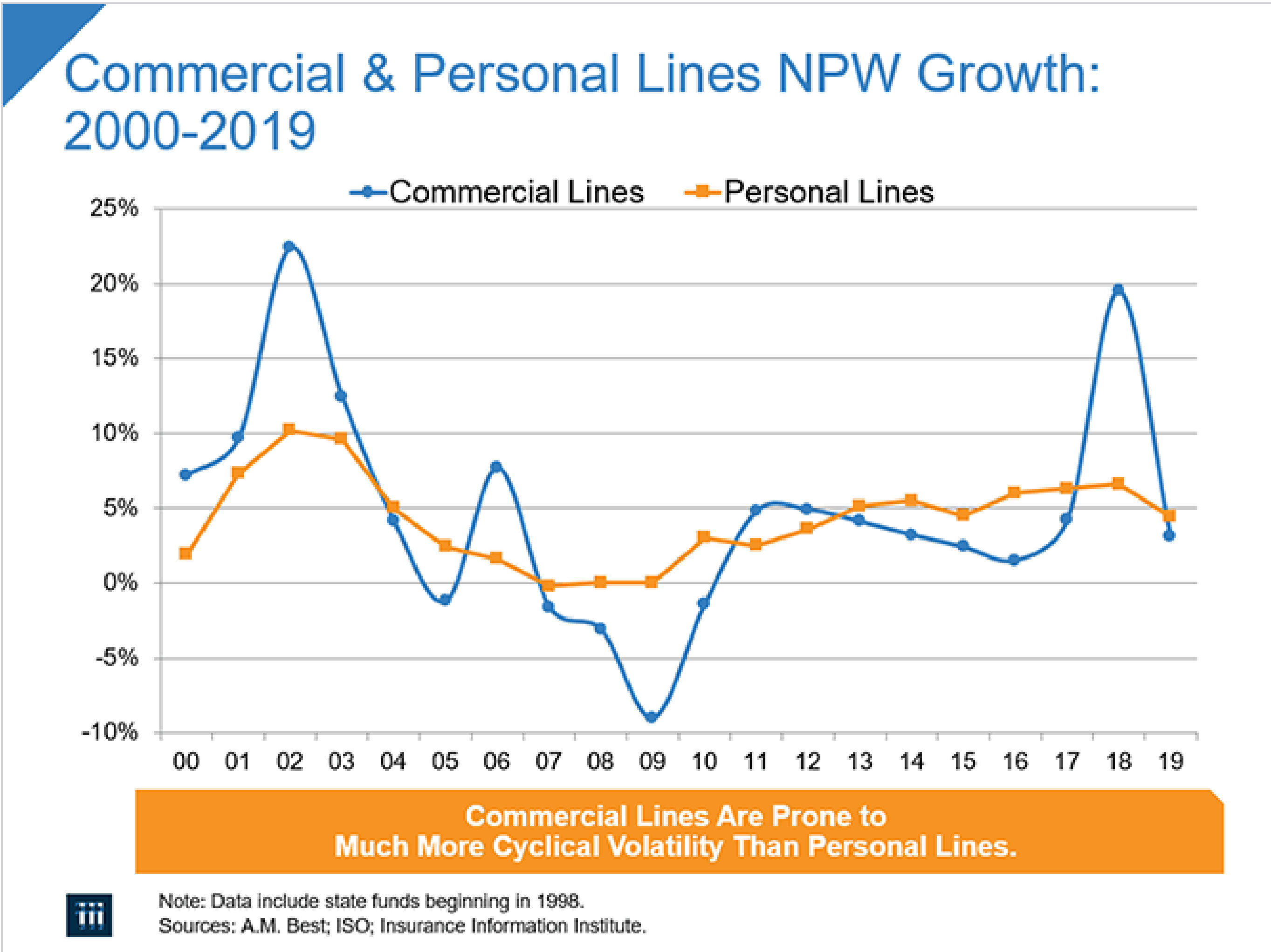


Premium flows differ between the major P/C markets. In 2019, NPW for insurers writing mainly personal lines (auto and homeowners) rise by 4.4 percent. In contrast, NPW for insurers writing mainly commercial lines rose only 3.1 percent. *Figure 6* shows this contrast over the prior two decades.

Claims. Overall, claims (more formally, Losses and Loss Adjustment Expenses, or LLAE) in 2019 were $442.1 billion, compared to $423.9 billion in 2018 (up $18.2 billion, or 4.3 percent). But this result is the product of several components moving in opposite directions. To see these components, we separate LLAE into three parts—LLAE for claims arising from catastrophes, LLAE arising from other events, and changes in LLAE reserves *Figure 7*).

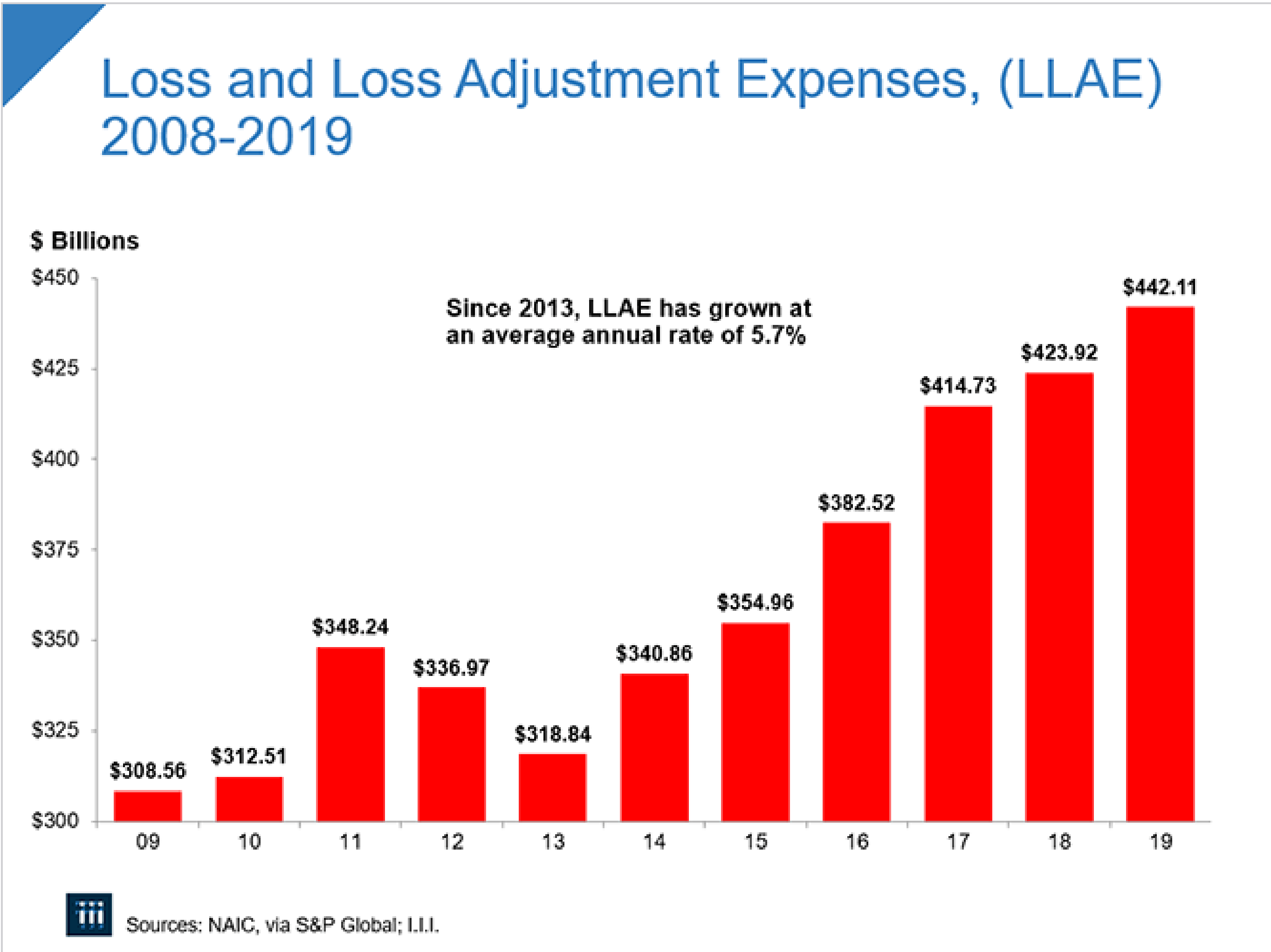
2019 was a comparatively benign year for claims arising from natural catastrophes. Such claims in 2019 totaled $28.4 billion—a sizeable drop from 2018's $43.3 billion (down 34.4 percent). In contrast, LLAE not arising from catastrophes in 2019 rose significantly to $413.7 billion (up by $33.1 billion, or 8.7 percent). Of course, in 2019 the industry took on more risk (as noted previously, NPE was 4.8 percent higher), but the rest of the rise in non-catastrophe LLAE came from an increase in the amount of such claims per dollar of risk, which went from $0.666 to $0.678—up 1.8 percent.

Figure 6



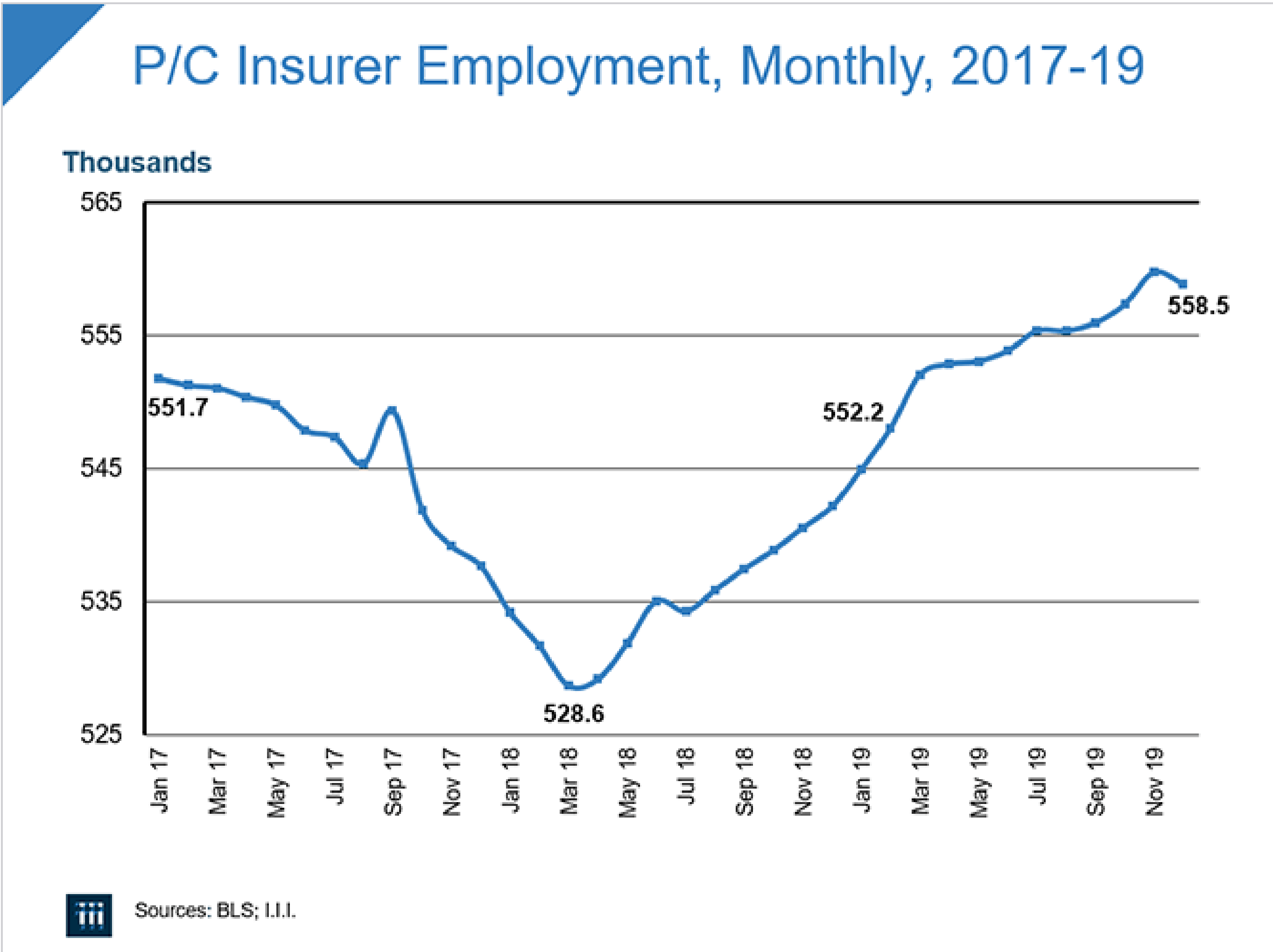
LLAE reserves are set aside for future payments of past- and current-year claims. Each year each insurer re-evaluates the adequacy of the reserve, and changes in the current year affect the overall LLAE. In 2019 P/C insurers released $7.2 billion in LLAE reserves, reducing the overall LLAE by that amount. Total LLAE reserves at year-end 2019 were $654.2 billion. With inflation continuing to be unexpectedly low, LLAE reserves have been released each year for the last several. The release at the end of 2018 was even larger—$13.0 billion.

Figure 7



Underwriting and other Operational Expenses. In 2019, P/C insurers incurred $172.3 billion in underwriting, agent commissions, and other operational expenses. Employment by P/C insurers rose in 2019 from 542,100 to 558,500—a 3.0 percent increase. But this essentially restored employment to the level it had been three years earlier—and then surpassed it—as *Figure 8* shows.

Figure 8

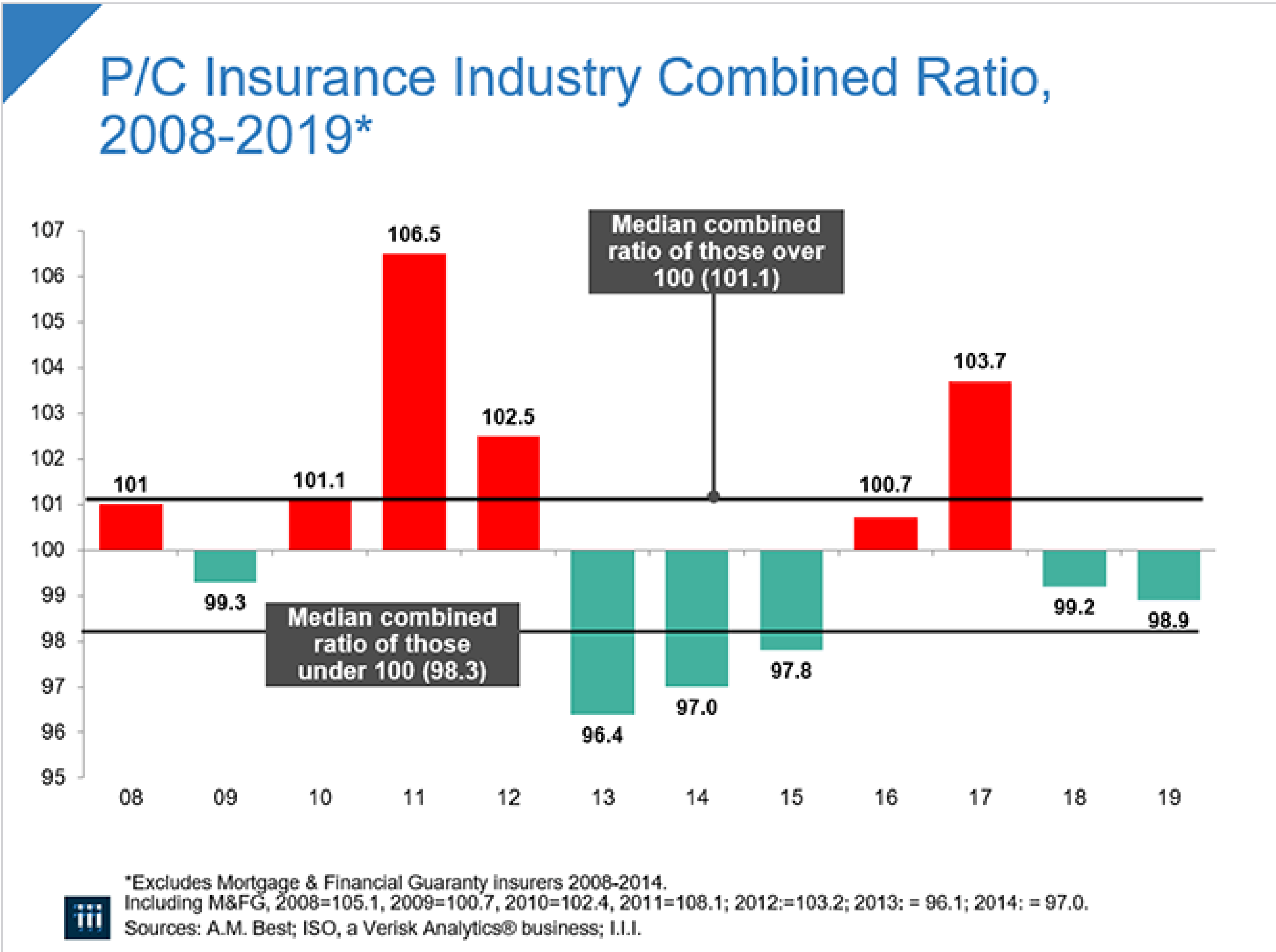


For the past decade, and again in 2019, overall expenses have grown at an average annual rate of 2.4 percent—very close to the rate of increase in general inflation as measured by the consumer price index.

Overall Underwriting Performance. Overall underwriting performance is the result of combining insurance activity and expense performance. In 2019, P/C insurers' earned premiums were more than they incurred in outgo, posting a $3.65 billion underwriting profit, using statutory accounting methods. Underwriting profit in the P/C industry is uncertain; it occurred in only half of the years of the past decade, and it tends to arise in years in which catastrophe-related claims are relatively low, as was the case in 2019.

Another common measure of overall underwriting performance is the combined ratio. This ratio is calculated by the sum of dividing net (of reserve changes) LLAE by net earned premiums and expenses by net written premiums. In 2019 the combined ratio was 98.9, a slight improvement over 2018, when the combined ratio was 99.2 (*Figure 9*).

Figure 9



Investment Performance

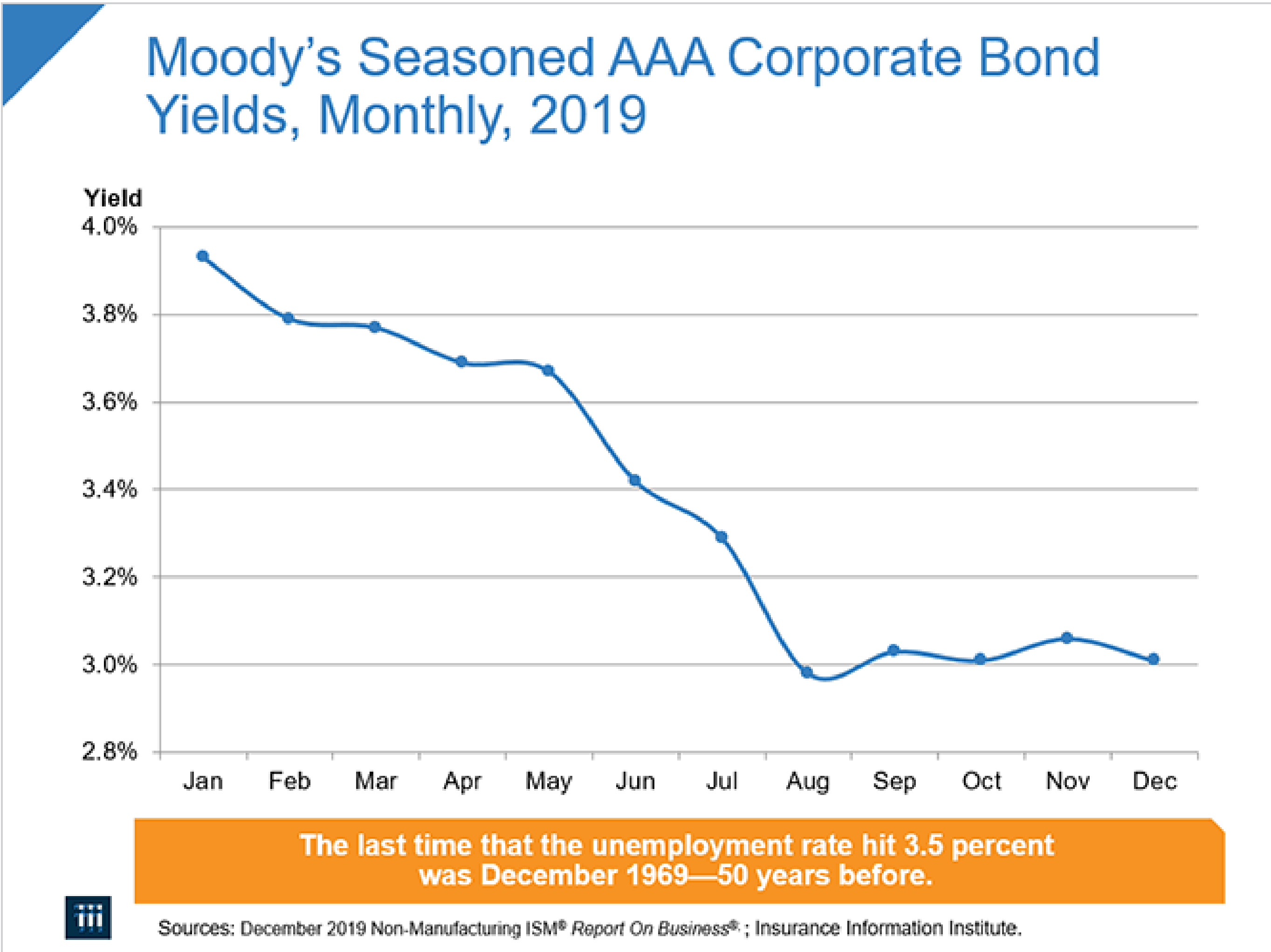
SHARE

Investment performance consists of net investment income and realized capital gains. Under statutory accounting, unrealized capital gains do not affect the income statement but do affect the balance sheet—especially the surplus account.

Net investment income. Net investment income in 2019 was $54.4 billion, down slightly from $55.3 billion in 2018.

In 2019, bonds made up about 64 percent of the investment holdings of P/C insurers and so were thus the major source of investment income. Within the bond portfolio, at the start of 2019 86 percent of the portfolio was in bonds that matured in over one year, so that their yield would have been unaffected by any changes in prevailing interest rates. But rates (as measured by Moody's seasoned AAA corporate bond yields) did come down a full percentage point during the first eight months of 2019 and stay there the rest of the year, as *Figure 10* indicates.

Figure 10



P/C insurers also received investment income from stock dividends; common and preferred stocks made up 24.2 percent of invested assets as of year-end 2019. Net dividends from stocks (to all stockholders) rose only 2.2 percent in 2019 over 2018.

Realized Capital Gains. In 2019, P/C insurers realized $10.44 billion in capital gains, virtually the same amount as in 2018 ($10.34 billion). They could have realized more, since they finished the year with $86.9 billion in unrealized capital gains. ISO noted that this is the largest-ever unrealized capital gain by far; the next highest total was $58.8 billion in 2017.

Capacity; Profit

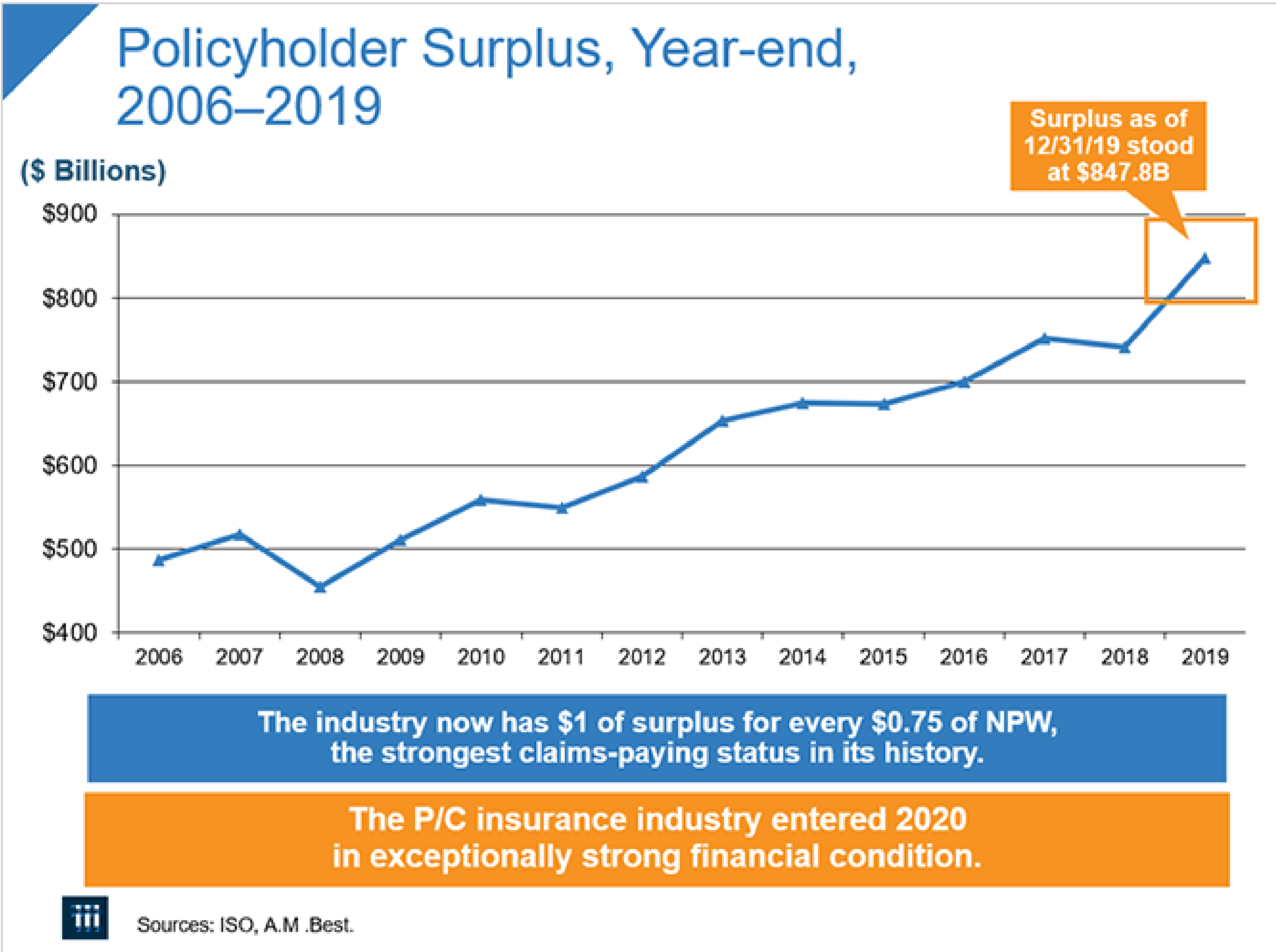
SHARE

Capacity. An insurer's excess of assets over liabilities is its capital "cushion," which provides the wherewithal to pay claims and expenses beyond what was contemplated in premiums.

As noted above, under insurance company statutory accounting, unrealized capital gains and losses are not considered income but affect the capital position of insurers as reflected in the Policyholders' Surplus account. As of December 31, 2019, surplus stood at $847.8 billion, up $105.5 billion (14.2 percent) vs. year-end 2018 (*Figure 11*). This is historically the highest dollar measure of policyholders' surplus. Moreover, even with the stock market's sharp and sudden fall at the end of the first quarter of 2020, the industry is, and will remain, extremely well capitalized and financially prepared to pay very large-scale losses in 2020 and beyond.

As a rough rule of thumb, one commonly-used indicator of capital adequacy is the ratio of net premiums written to surplus. For many years, a ratio of 1:1 was taken as quite strong. But recently surplus growth has far outpaced premium growth, resulting in ratios that are even stronger than 1:1. At year-end 2019 the ratio of new premiums written to surplus stood at 0.75-to-1.0 (lower numbers are stronger).

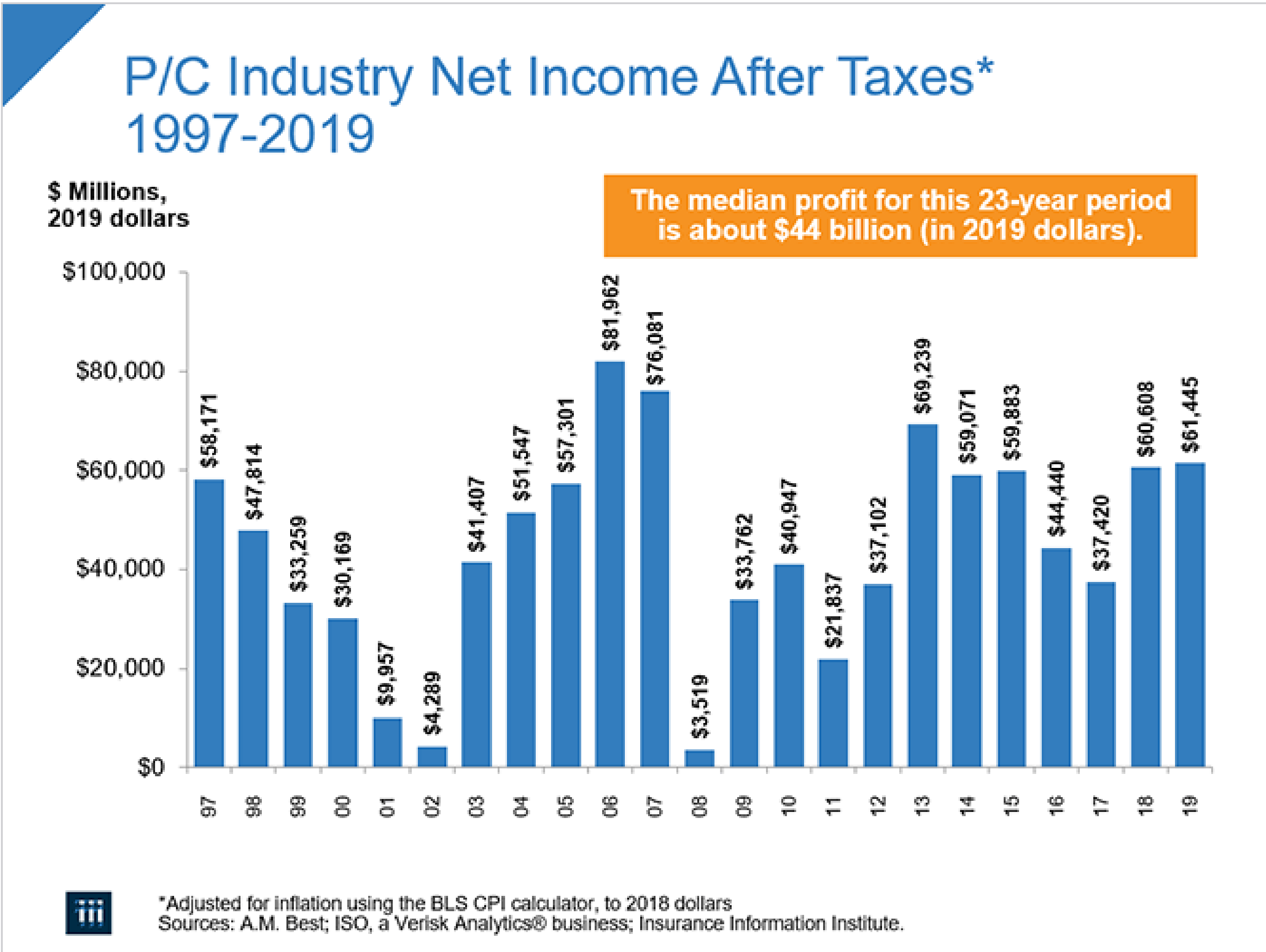
Figure 11



Profit. The industry's 2019 profit—net income after taxes--rose slightly (in current dollar terms) to $61.4 billion from $59.6 billion in 2018. However, inflation can distort these year-to-year comparisons. So for a clearer view *Figure 12* shows profit over the last two decades in constant 2019 dollars. From this chart, it is evident that 2019 was the second-most profitable year for the industry out of the last 10.

Aside from dollar measures, profit is also measured by net rates of return on average surplus. In 2019 that was 7.7 percent, down from 8.0 percent in 2018. The fall in return was not driven by smaller dollar profit; as just shown, that increased in 2019. Instead, it resulted from the historically large rise in surplus (the denominator in this measure), as also noted above.

Figure 12



To view the full report from ISO and APCIA, click here.

Full-Year 2019 Financial Results

SHARE

	$ Billions
Net Premiums Earned	$621.88
LLAE	442.11
Expenses	172.32
Policyholder Dividends	3.84
Net Underwriting Gains	3.65
Investment Income	54.43
Other Items	-1.42
Pre-tax Operating Income	59.5
Realized Capital Gains	10.44
Pre-tax Income	69.94
Taxes	8.49

	$ Billions
Net After-tax Income	61.45
Surplus	847.81
Combined Ratio	98.90%

Back to top