I.I.I. quarterly P/C industry snapshot: First quarter 2018

Information and analysis provided by the
Insurance Information Institute

2018-2020 Overview: The insurance industry and the economy

P/C insurance markets

- Ample (excess?) capital continues to spur competition.
- Rates are firming in most markets, except auto, where loss costs continue to force rates higher.
- 2018 Combined Ratio will vary by line of business but will likely be close to 100, except Personal Auto & Commercial Auto (108) and Workers Comp (95).
- Exposures will grow with the economy.

Financial markets

- Interest rates are finally rising. Projections for rate increases have gotten more modest.
- By most measures, annual inflation remains below 2 percent; the bond market suggests that could continue for five or more years.
- Carriers are giving alternative investments – ETFs, equities, real estate – a close look.

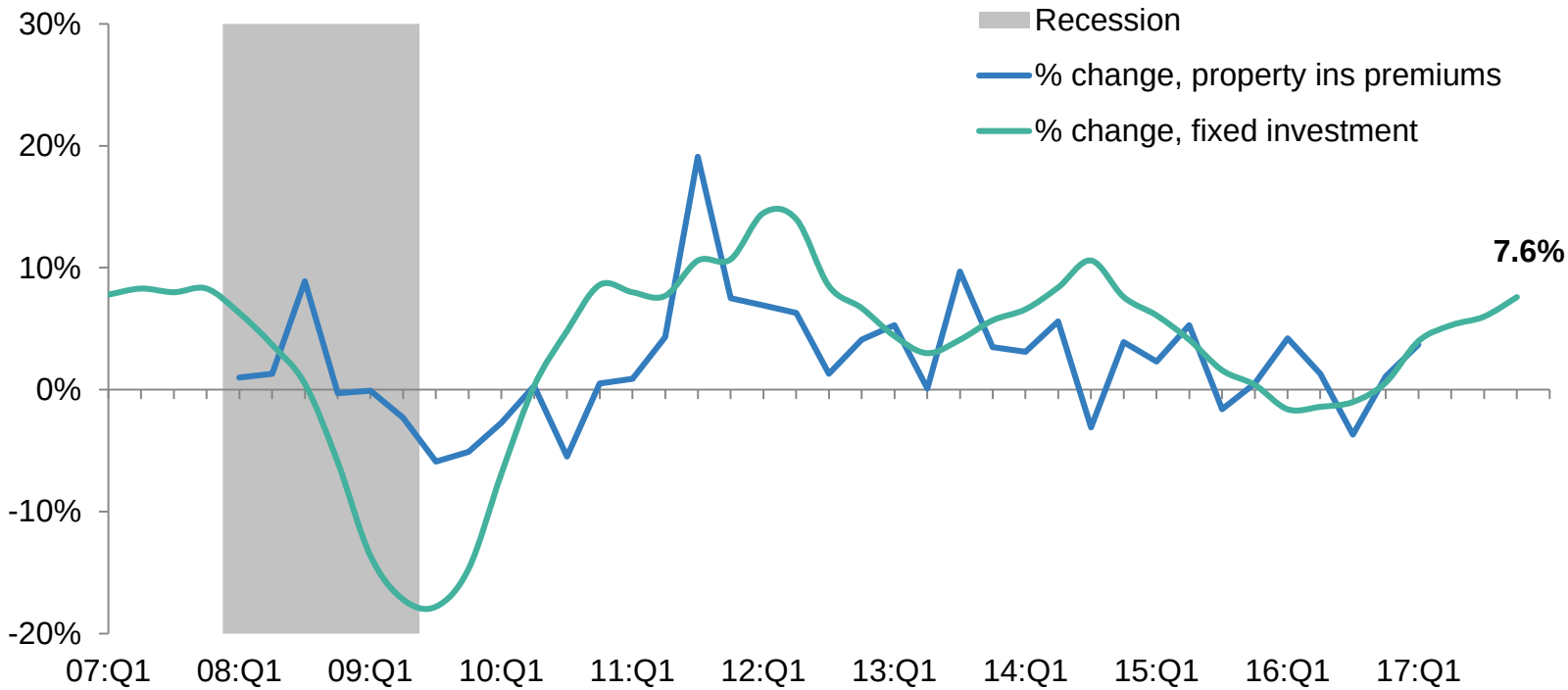
The U.S. economy

- Real GDP growth has shown unexpected strength in recent calendar quarters, but doubts persist that it can continue at a 3 percent real rate.
- Unemployment rates suggest we are near full employment but other measures indicate some slack remains.
- This is the second longest expansion since WWII, but there are no signs of a future recession.

Commercial lines trends: 2018:Q1

Business investments predict commercial property premium growth

% change from same quarter, prior year



- **Investment in structures, equipment, and software is expected to grow at least partly due to the provisions of the Tax Cuts and Jobs Act.**

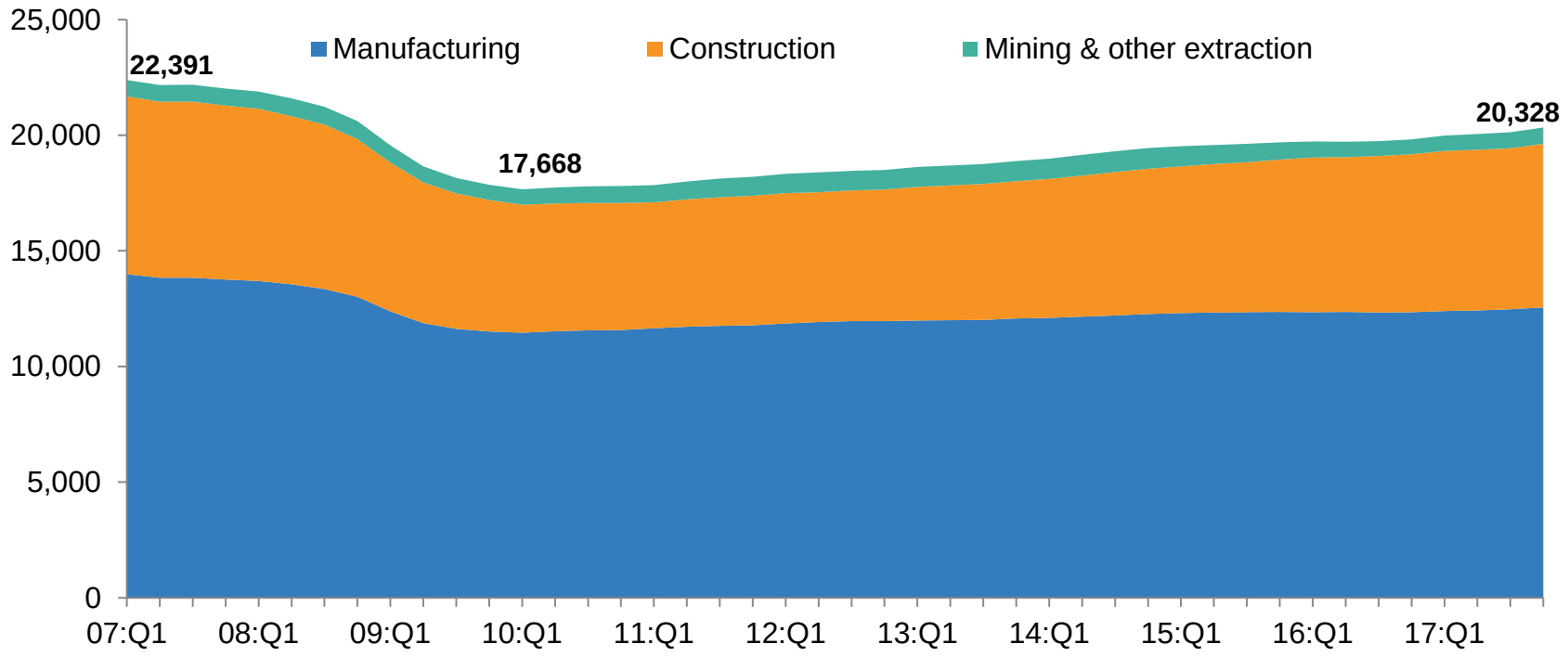
*Commercial property direct premiums written (fire, allied lines, CMP, inland marine, burglary and theft); business fixed investment (structures, equipment, and software).

Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.

Sources: https://fred.stlouisfed.org/series/PNFI#0; National Bureau of Economic Research (recession dates); Insurance Information Institute.

As hiring goes, exposures follow

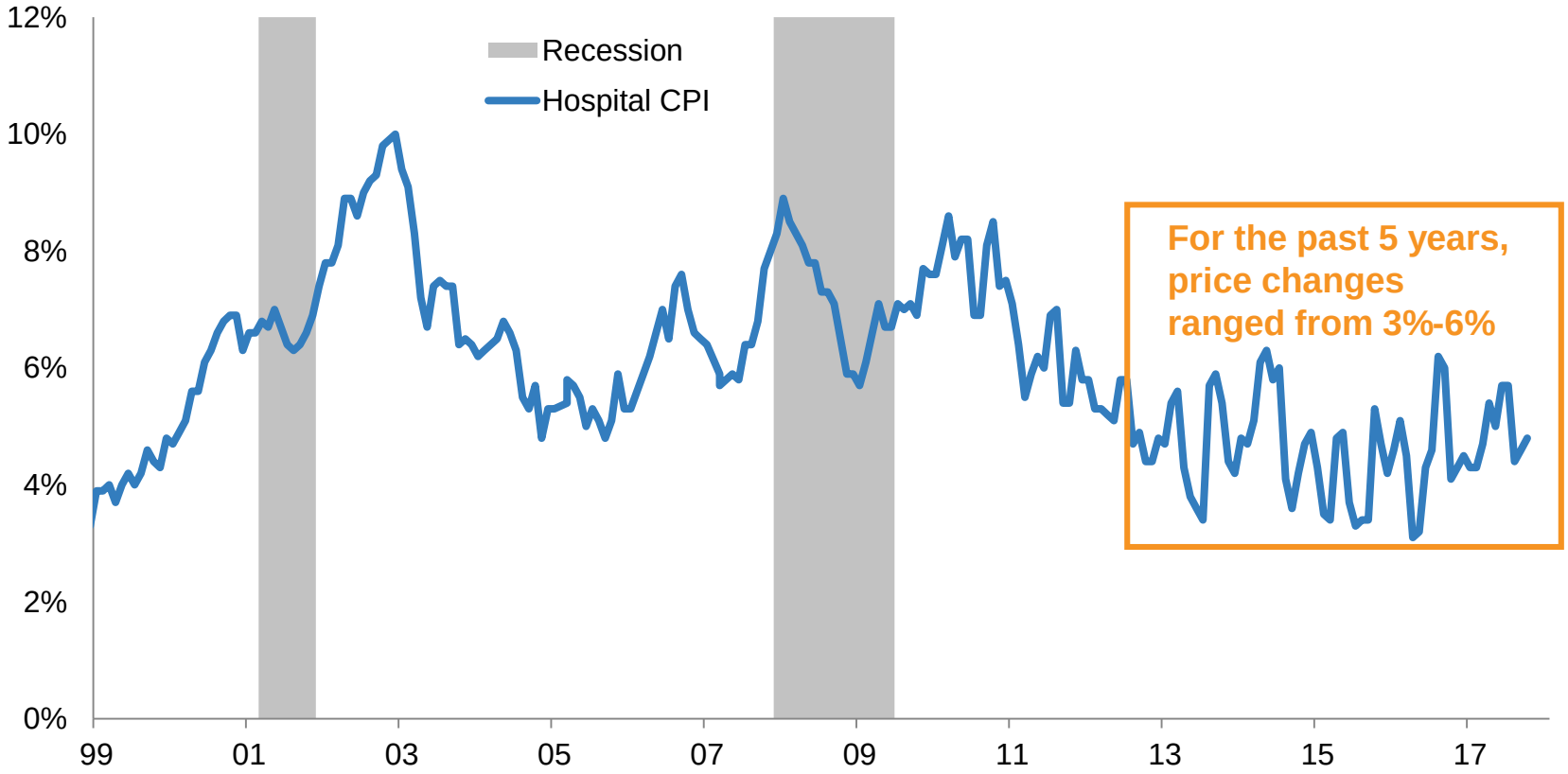
000 at quarter-end



- **At the end of 2017, employment in the three industries that are the heart of workers composition exposure was not quite back yet to the level reached before the Great Recession.**

Sources: US Bureau of Labor Statistics; Insurance Information Institute.

Price changes* for hospital care affect claims for many lines of business

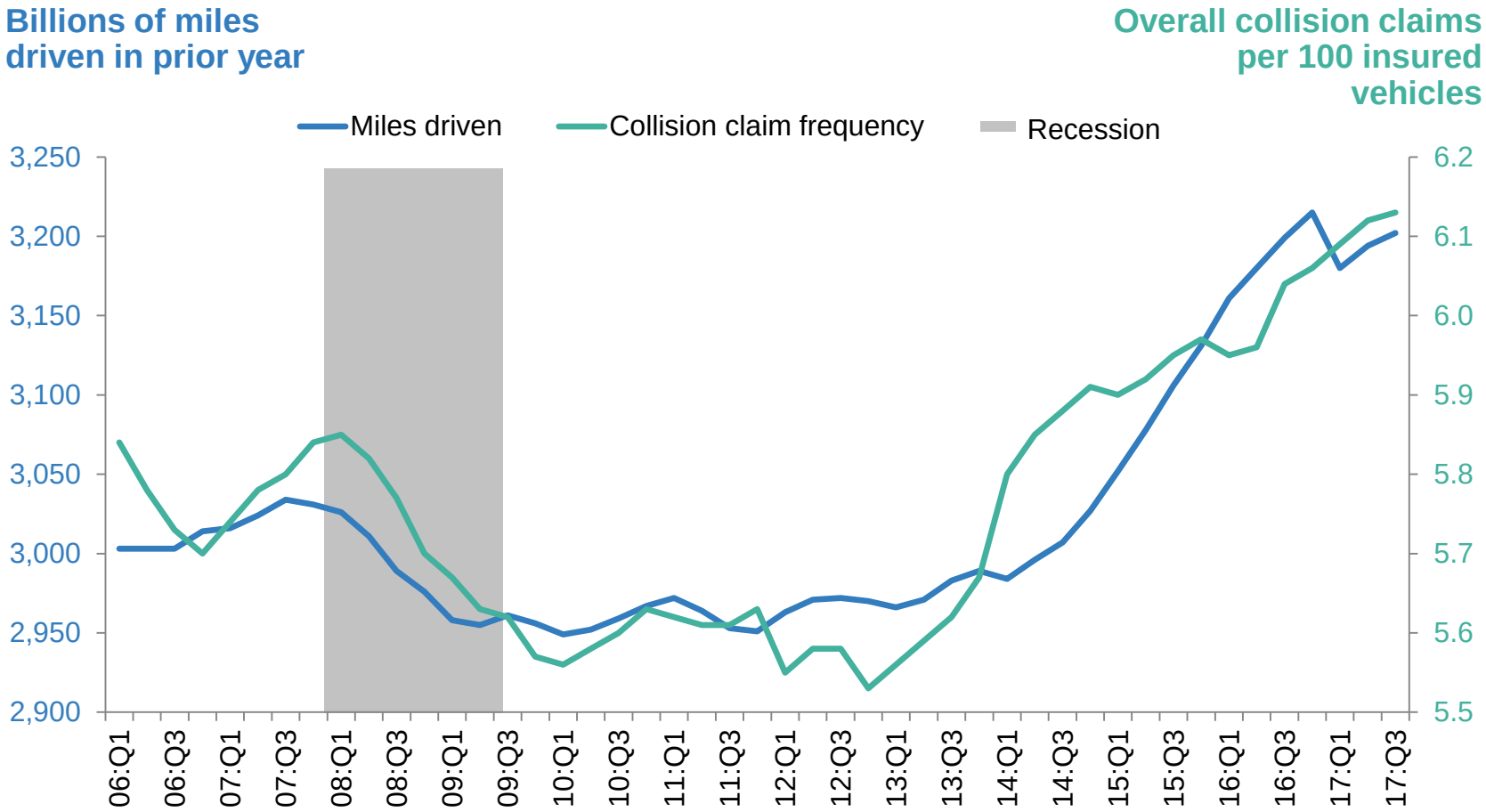


- **Over the last two decades, prices for hospital care rose, on average, several percentage points faster than inflation generally.**

*Percentage change from same month in prior year; through February 2018; seasonally adjusted.
Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Personal lines trends: 2018:Q1

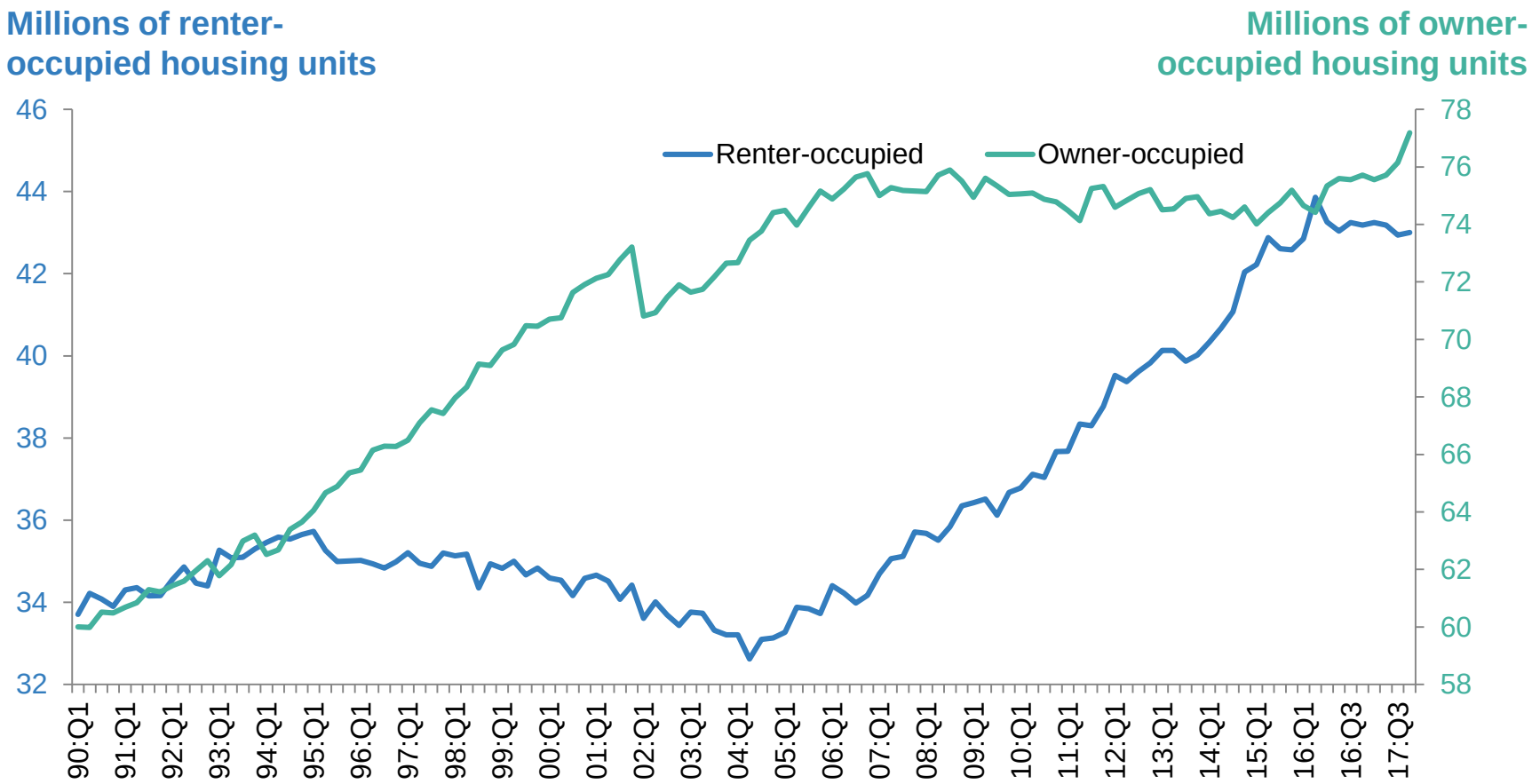
Driving patterns predict claim frequency



- **The only force that could derail this relationship would be a sharp and persistent rise in the cost of gasoline.**

Sources: Federal Highway Administration; Rolling four-quarter average frequency from Fast Track Monitoring System; Insurance Institute for Highway Safety; Insurance Information Institute.

To rent or to buy?



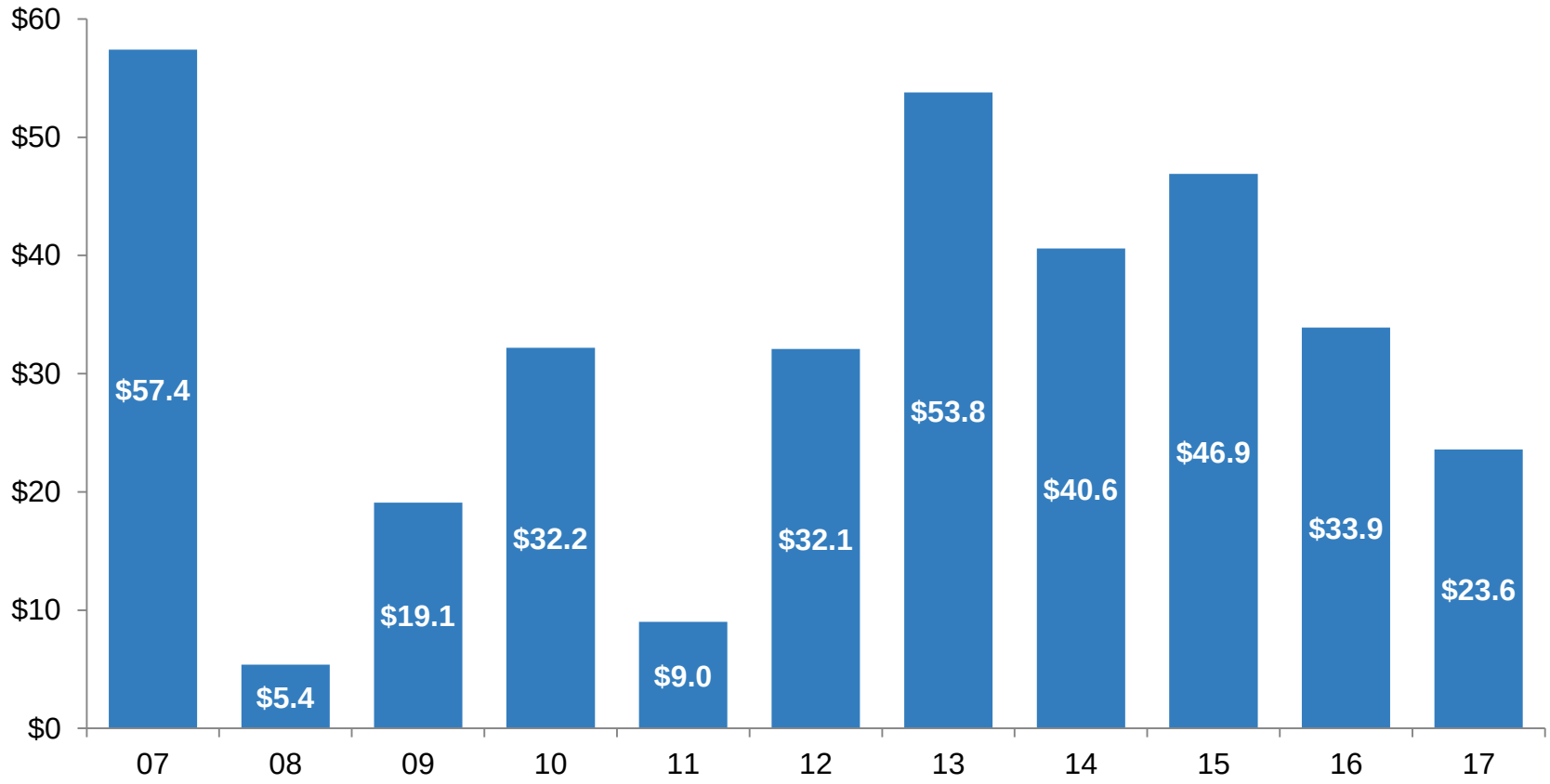
- **Since 2004 the number of renter-occupied housing units has grown by about 10.5 million units (+34%), but there has been no growth in the number of owner-occupied housing units in 12 years. Did this streak end in 2017?**

Sources: U.S. Census Bureau at http://www.census.gov/housing/hvs/data/histtabs.html, Table 8; Insurance Information Institute.

Economic and financial trends: 2018:Q1

P/C industry net income after taxes*

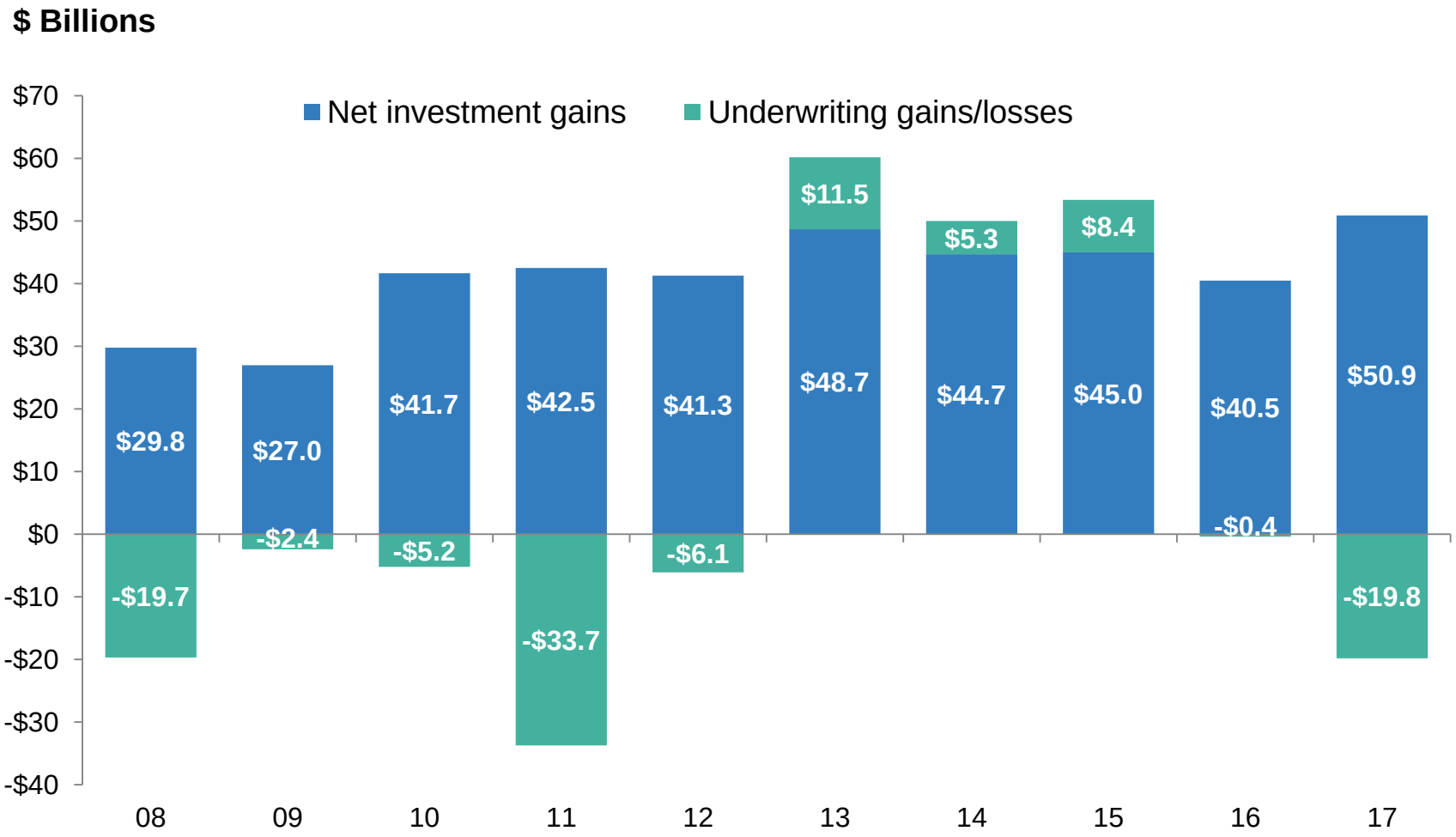
Billions, 2017 dollars



- **In the first three quarters of the year, net income varied. 2017 was the fourth lowest profit in the last 11 years.**

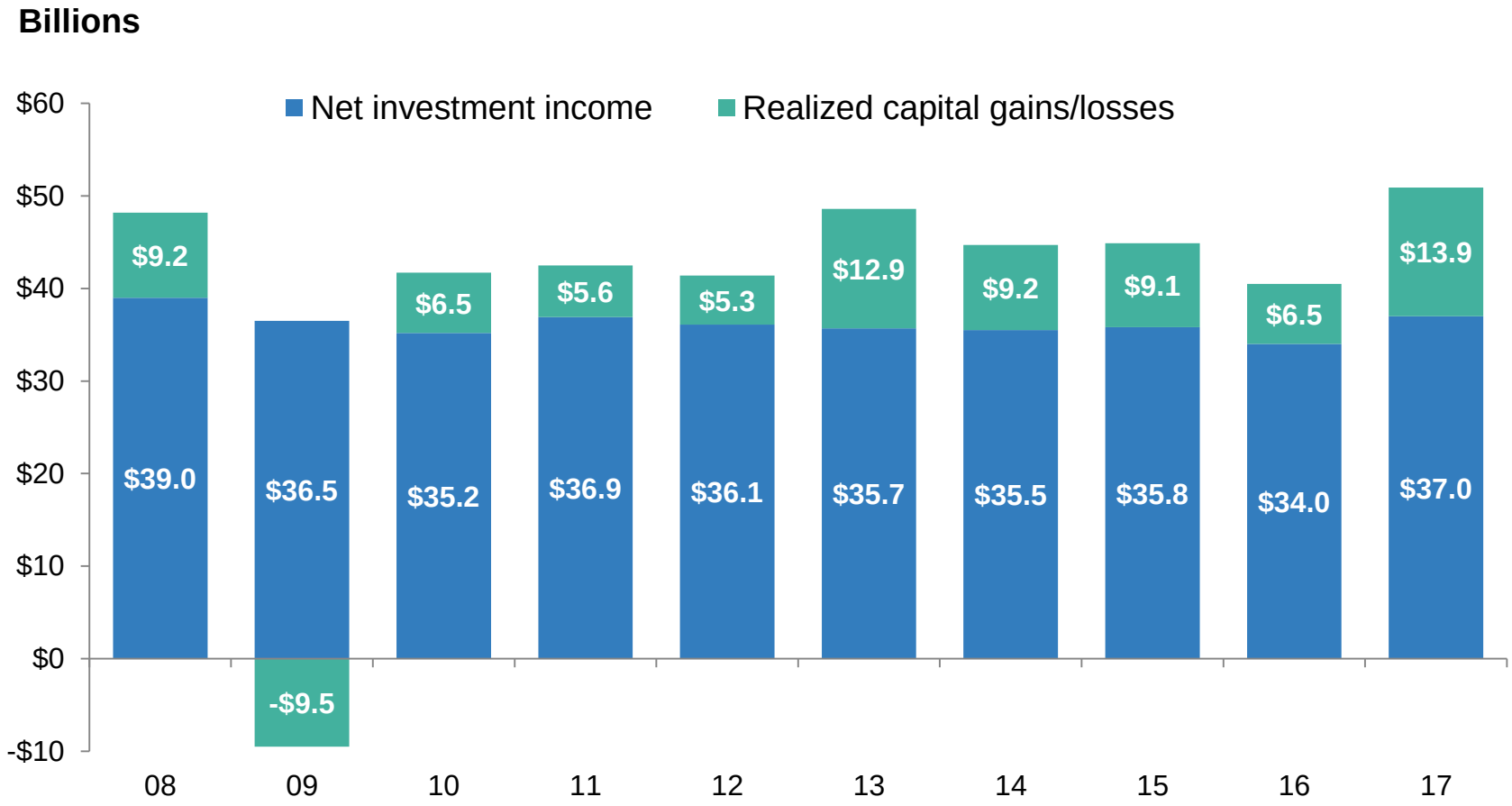
*Through third quarter. Adjusted for inflation using the BLS CPI calculator, to 2017 dollars.
Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

Key sources of P/C insurer profits



Data are before taxes and exclude extraordinary items.
Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

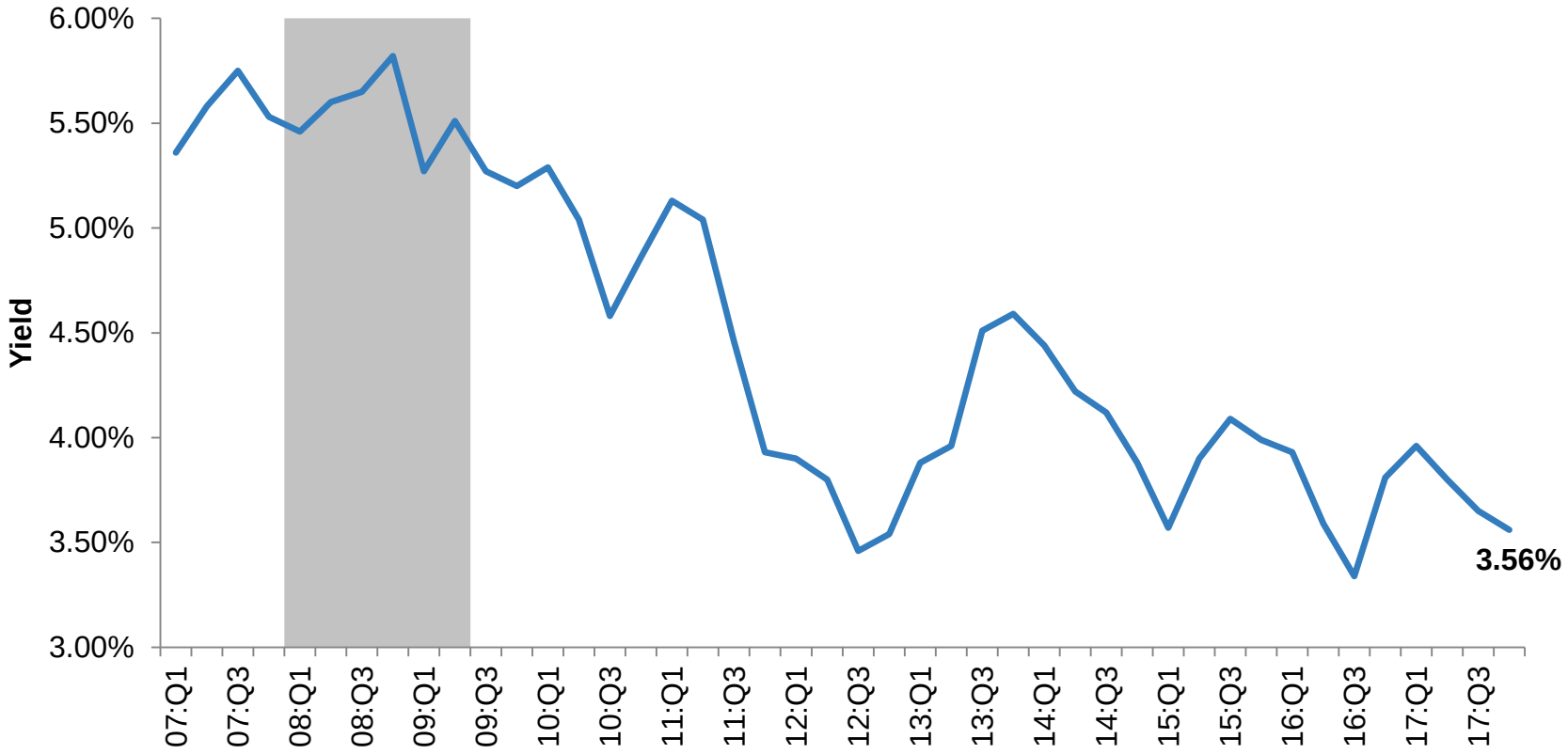
Sources of investment gains



Net investment income has been steady, but realized capital gains/losses have been quite variable.

Through third quarter.
Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.

Bond yields

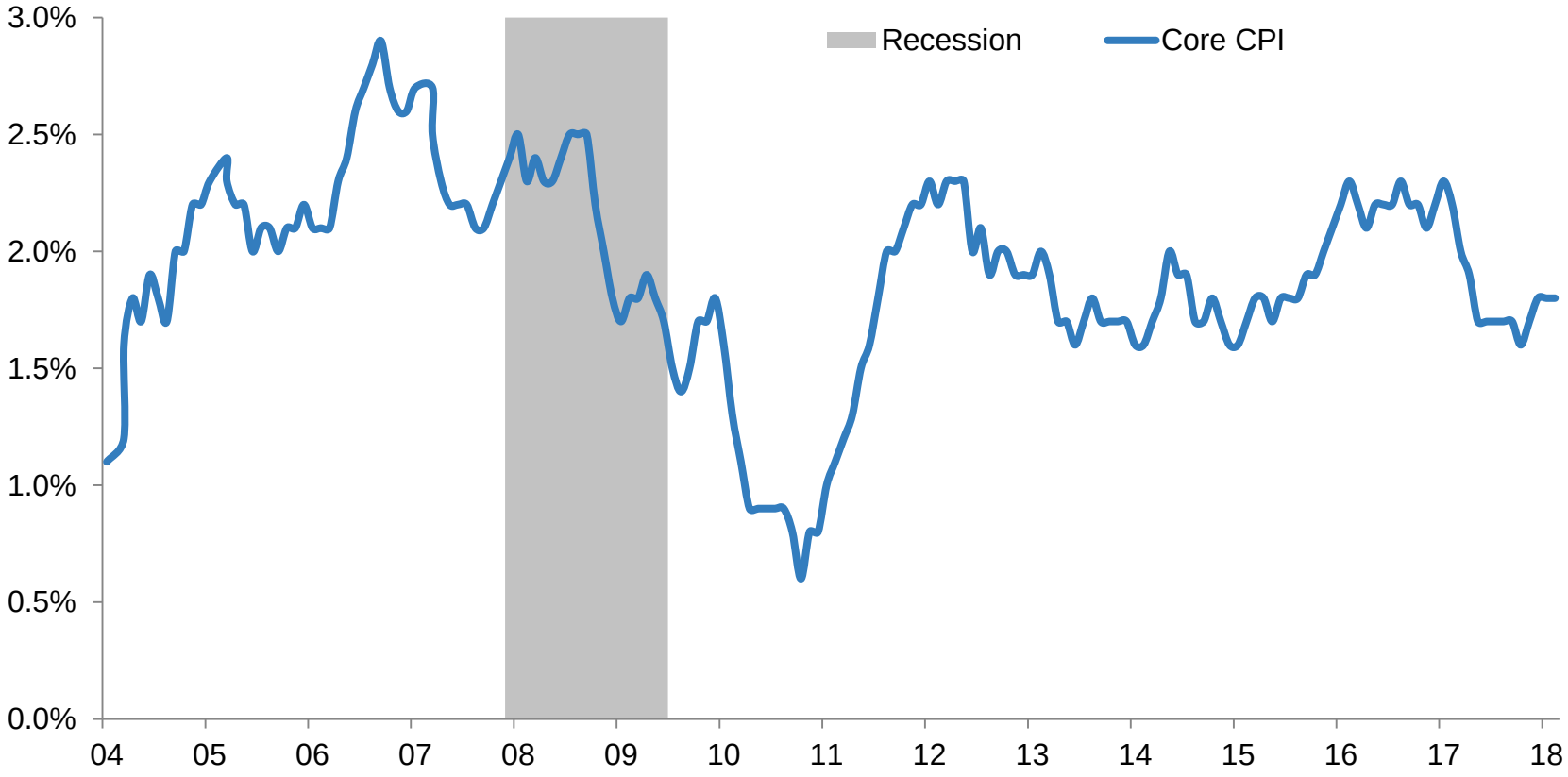


- **Top investment-grade bond yields have ranged from 3.8% to 4.0% for the last 3 years. 2017:Q3 was 3.65%. These yields probably won't rise much above 4.5% through 2018.**

Note: Recession indicated by gray shaded column.

Sources: https://fred.stlouisfed.org/series/AAA#0 ; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Change* in the core** Consumer Price Index



- **Over the last decade, prices tracked by the Core CPI have generally risen about 2% per year.**

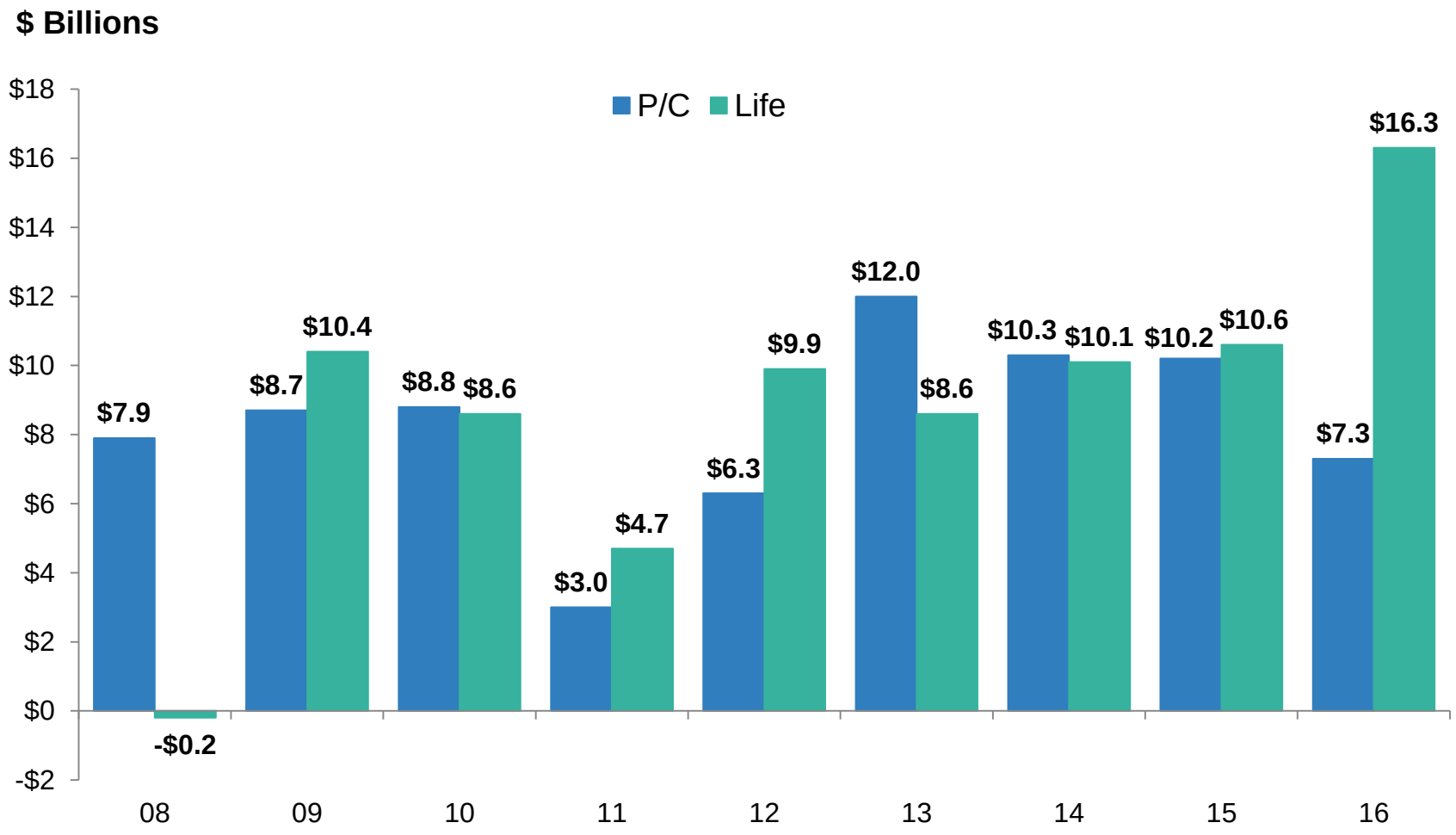
*Monthly, year-over-year, through February 2018. Seasonally adjusted. **CPI less food and energy.
Sources: US Bureau of Labor Statistics; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Quarterly Industry Snapshot

Federal Tax Cuts and the Insurance Industry

How Much Does the Industry Pay?

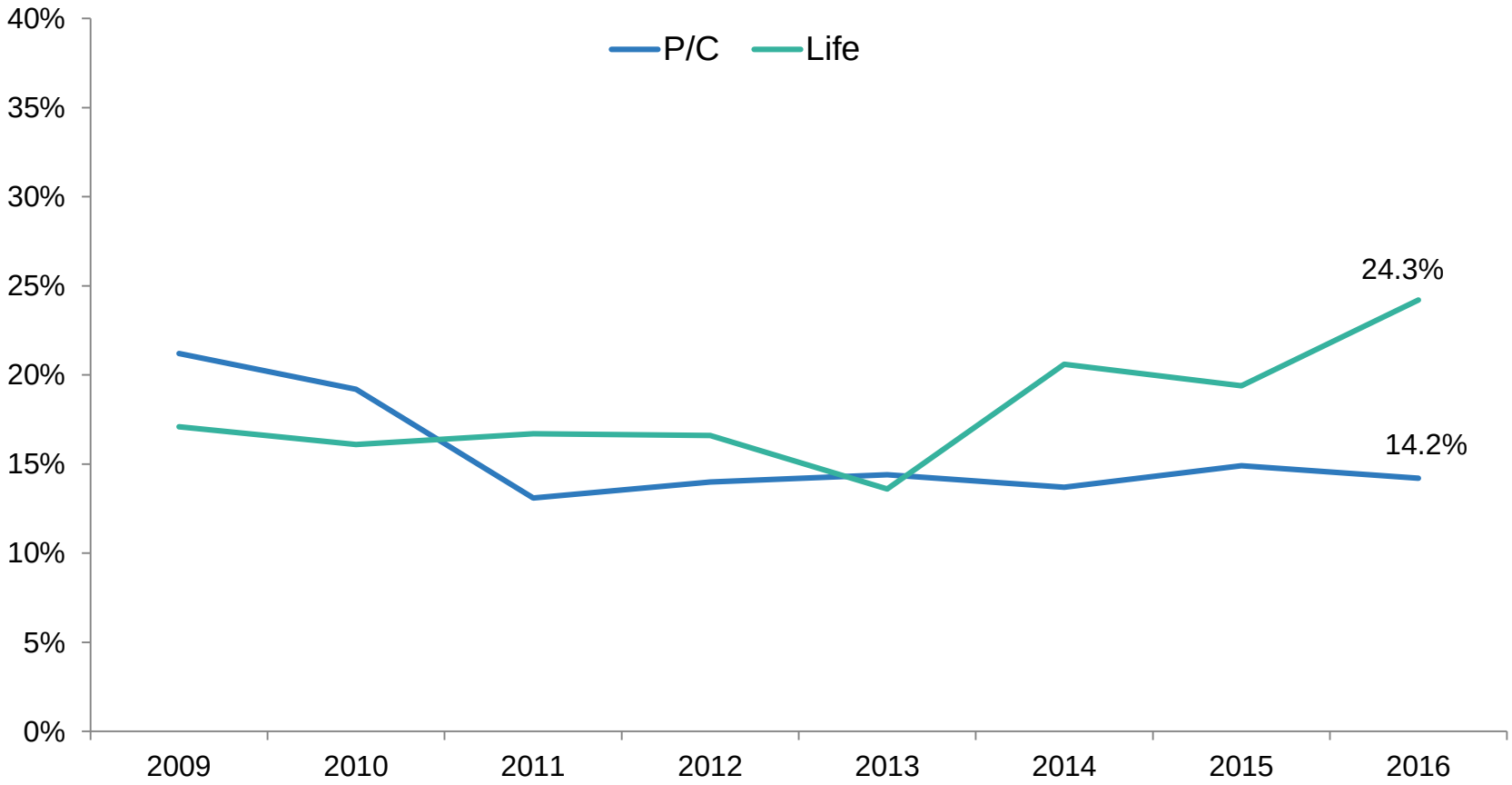
(Federal and Foreign Income Tax, Excluding Capital Gains)



Sources: NAIC data, sourced from S&P Global market Intelligence; I.I.I. Calculations.

What Rate Has the Industry Paid?

(Effective Federal and Foreign Income Tax Rates, Excluding Capital Gains)*



*Income taxes as a percent of net income after dividends to policyholders and after capital gains taxes.
Sources: NAIC data, sourced from S&P Global market Intelligence.

Tax Reform's Effects: Across All Corporations

Green numbers indicate tax reductions for taxpayers;
Red numbers indicate tax increases

Affecting Corporations Generally	2018-2027 ($ Billions)	As a % of a Decade of Profits*	Comments
21% corporate tax rate (down from 35%)	**$1,348.5**	**6.1%**	This could enable insurers to use tax savings for increased capacity.
Repeal of corporate Alternative Minimum Tax (AMT)	**$40.3**	**0.2%**	Likely few insurers will benefit from this change.
Deduction for dividends received by domestic corporations from certain foreign corporations	**$223.6**	**1.0%**	This is part of the transition to a territorial system of taxation.
Treatment of deferred foreign income upon transition to territorial tax system	**$338.8**	**1.5%**	This new provision will affect only companies with offshore operations. Insurers with only domestic operations will not be affected.
Current-year inclusion of global intangible low-taxed income (GILTI)	**$112.4**	**0.5%**	The tax applies to global insurance income, net of income from "tangible" sources
Base erosion and anti-abuse tax (BEAT)	**$149.6**	**0.7%**	This new provision will affect only companies with affiliated offshore operations (might apply to US parents with offshore subsidiaries).

*Projected cumulative profits for 2018-2027 = $22,273.6 billion. Projection = average profits for 2007-2016, growing by assumed nominal GDP growth of 5% per year.
Source of amount of forecast tax changes: Joint Committee on Taxation, JCX-67-17, published December 18, 2017.

Tax Reform's Effects: Property/Casualty Insurers

Green numbers indicate tax reductions for taxpayers;
Red numbers indicate tax increases

Affecting P/C Insurers	2018-2027 ($ Billions)	As a % of a Decade of Profits*	Comments
Modification of discounting rules for loss reserves	**$13.2**	**2.2%**	This provision likely increases taxable income by adopting a discount rate for loss reserves that is expected to be higher than rates used previously. Also significantly lengthens the discount period for loss reserves for long-tailed lines (from 10 to 24 years).
Modification of proration rules	**$2.1**	**0.4%**	This will reduce deductions for some tax-exempt income and some dividends-received income, thereby increasing taxable income. Could affect investment allocation decisions.

*Projected cumulative profits for 2018-2027 = $602.3 billion. Projection = average profits for 2007-2016, growing by assumed nominal GDP growth of 5% per year.
Source of amount of forecast tax changes: Joint Committee on Taxation, JCX-67-17, published December 18, 2017.

Tax Reform's Effects: Life Insurers

Green numbers indicate tax reductions for taxpayers;
Red numbers indicate tax increases

Affecting Life Insurers	2018-2027 ($ Billions)	As a % of a Decade of Profits*	Comments
Computation of life insurance reserves	**$15.2**	**4.5%**	Calculation simplified; expected to affect reserves for term and universal life to a greater extent than whole life or annuities
Capitalization of certain policy acquisition expenses	**$7.2**	**2.1%**	This increases both the capitalization of acquisition expenses and requires amortizing them over a longer period. This reduces deductions and raises taxable income.
Changes in a company's basis for computing reserves	**$1.2**	**0.4%**	Shortens the period of amortization of effect of change in method of calculating reserves.
Modification of proration rules affecting investment income that is channeled to policyholders	**$0.6**	**0.2%**	Simplifies calculation of the Dividends-Received and tax-exempt-interest deduction. Might affect investment allocation decisions.

*Projected cumulative profits for 2018-2027 = $337.1 billion. Projection = average profits for 2007-2016, growing by assumed nominal GDP growth of 5% per year.
Source of amount of forecast tax changes: Joint Committee on Taxation, JCX-67-17, published December 18, 2017.

Quarterly industry snapshot

For more information, contact:

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