The P/C Insurance Industry: Financial Update & Outlook

2016: OK, But A Little Worse Than 2015
2017 Could Be Better

Steven Weisbart, Ph.D., CLU
I.I.I. Senior Vice President & Chief Economist
P/C Industry Net Income After Taxes, First Three Quarters of Each Year, 2007-2016

The 2016 result is below the 2012-16 average of $36.8 billion

Highest 9-month total since 2007

Sources: A.M. Best; ISO, a Verisk Analytics company; Insurance Information Institute.

*ROE figures are GAAP; \(^1\)Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields a 8.2% ROAS in 2014, 9.8% ROAS in 2013, 6.2% ROAS in 2012, 4.7% ROAS for 2011, 7.6% for 2010 and 7.4% for 2009

Sources: A.M. Best; ISO, a Verisk Analytics company; Insurance Information Institute.
Profitability Peaks & Troughs in the P/C Insurance Industry, 1975-2016

If historical patterns hold, next ROE peak could be in 2017.

*Profitability = P/C insurer ROEs. 2011-16 figures are estimates based on ROAS data. Note: Data for 2008-2014 exclude mortgage and financial guaranty insurers. Sources: Insurance Information Institute; Natl. Assoc. of Insurance Comm.; ISO, a Verisk Analytics company; A.M. Best, Conning.
Policyholder Surplus, Quarterly, 2006:Q4–2016:Q3

($ Billions)

2007:Q3 Pre-Crisis Peak

Drop due to near-record 2011 CAT losses

Surplus as of 9/30/16 stood at $688.3B

Surplus has grown by only 2.5% over the last 9 quarters

The industry now has $1 of surplus for every $0.77 of NPW, close to the strongest claims-paying status in its history.

2010:Q1 data includes $22.5B of paid-in capital from a holding company parent for one insurer’s investment in a non-insurance business.

The P/C insurance industry entered 2017 in very strong financial condition.

Sources: ISO, A.M. Best.
Underwriting Performance
Commercial Lines is Prone to Much More Cyclical Volatility Than Personal Lines.

Note: Data include state funds beginning in 1998. 16E is first three quarters.
Sources: A.M. Best; Insurance Information Institute.
Net Written Premium Growth (All P/C Lines): First Three Quarters, 2006-2016

Total Net Written Premiums for the first nine months rose more slowly in 2016 than in any year since 2010.


Net Written Premiums Fell 0.7% in 2007 (First Decline Since 1943) by 2.0% in 2008, and 4.2% in 2009, the First 3-Year Decline Since 1930–33.

Net Written Premiums rose more slowly in each of the last three years vs. the year before, despite strong increases in personal lines premiums.

Shaded areas denote “hard market” periods. *2016 is first nine months.
Net Underwriting Gains & Losses, First Three Quarters, 2007-2016

2013/14/15 Were Welcome Respites from 2011/12, Which Were Among the Costliest Years for Insured Disaster Losses in U.S. History. Longer-term Trend is for More – Not Fewer – Costly Events.

*Estimates through 12/31/15 in 2015 dollars.

Note: 2001 figure includes $20.3B for 9/11 losses reported through 12/31/01 ($25.9B 2011 dollars). Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = $12.2B ($15.6B in 2011 dollars).

Sources: Property Claims Service, a Verisk Analytics business; Insurance Information Institute.
P/C Insurance Industry Combined Ratio, 2001-2016*

*Excludes Mortgage & Financial Guaranty insurers 2008-2014. 2016 is first nine months
Sources: A.M. Best; ISO, a Verisk Analytics company; 2010-2015E is from A.M. Best P&C Review and Preview, February 16, 2016.
2013/14/15 Were Welcome Respites from 2011/12, Which Were Among the Costliest Years for Insured Disaster Losses in U.S. History. Longer-term Trend is for More – Not Fewer – Costly Events.

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Sources: Property Claims Service, a Verisk Analytics business; Insurance Information Institute.
Investments

Investment Performance is a Key Driver of Profitability
Depressed Yields Will Necessarily Influence Underwriting & Pricing

Yields on 10-Year US Treasury Notes have been below 3% for over 5 years: 10-year bonds bought in 2007 at 5% will be reinvested at 2.5% for 10 more years.

Since nearly 50% of P/C bond/cash investments are in 5-year or longer maturities, most P/C insurer portfolios will have low-yielding bonds for years to come.

*Monthly, constant maturity, nominal rates, through February 2017.
Sources: Federal Reserve Bank at [http://www.federalreserve.gov/releases/h15/data.htm](http://www.federalreserve.gov/releases/h15/data.htm); National Bureau of Economic Research (recession dates); Insurance Information Institute.
P/C Insurer Portfolio Yields, 2002-2015

Even as Prevailing Rates Rise in the Next Few Years, Portfolio Yields Are Unlikely to Rise Quickly, Since Low Yields of Recent Years Are “Baked In” to Future Returns.

Sources: NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.
Investment gains consist primarily of interest, stock dividends and realized capital gains and losses.

*2005 figure includes special one-time dividend of $3.2B   **2016 is first nine months, annualized

Total Investment Gains through the first nine months of 2016 were down due to lower results in both investment income and realized capital gains.

1Investment gains consist primarily of interest, stock dividends and realized capital gains and losses.

*2005 figure includes special one-time dividend of $3.2B   **2016 is first nine months, annualized

Sources: ISO, a Verisk Analytics company; NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.
The ($5.1B) 11.6% drop in 2016 vs. 2015 reversed a small upward trend from 2012-2015. The drop was due to lower results in both investment income and realized capital gains.

Investment gains consist primarily of bond interest, stock dividends and realized capital gains and losses.

*Sources: ISO, a Verisk Analytics company; NAIC data, sourced from S&P Global Market Intelligence; Insurance Information Institute.


Sources: Blue Chip Economic Indicators (3/17); Insurance Information Institute
The Economic Environment for the U.S. P/C Insurance Business

The Strength of the Economy Will Affect the Exposure Base Across Most Lines
Since the Great Recession ended, the economy (as measured by real GDP) grew faster than 3% (at an annual rate) in a calendar quarter only 8 times in 31 quarters. Only once in the last 10.

Yearly U.S. Real GDP Growth: Range of Forecasts, 2017-2021

All Forecasts Expect U.S. Growth to be Fairly Steady in 2019-21; The Main Difference Among Them is the Level of Economic Activity.

Sources: Blue Chip Economic Indicators, March 2017 issue; Insurance Information Institute.
The Economy Drives the P/C Insurance Industry:

Except for the three “hard markets” in this 45-year period, Net Written Premiums track Nominal GDP—not year by year but fairly well.

Does the Economy Drive Business Property Insurance Premiums?

Direct Written Premium Growth (CMP Non-Liability) vs. Year-Earlier Change in Nominal GDP

Direct Written Premiums for the Non-Liability portion of Commercial Multiple Peril Insurance track one-year-earlier Nominal GDP—not year by year but fairly well.

Sources: A.M. Best 2016 Aggregates & Averages, p. 568; U.S. Commerce Dept, Bureau of Economic Analysis; I.I.I.
Near-term growth forecasts vary widely by state. Strongest growth = blue (over 4.5%); dark green (1.5%-4.5%); then light green; then gray; weakest = yellow
The manufacturing sector expanded in 67 of the 70 months from January 2010 through October 2015. It contracted in November 2015 through February 2016 and again in August 2015 but is expanding again.

Sources: Institute for Supply Management; Insurance Information Institute.


(Thousands of filings)

Business bankruptcies in 2014-16 were below both the Great Recession levels and the 2003:Q3-2005:Q1 period (the best five-quarter stretch in the last 20 years). Bankruptcies restrict exposure growth in all commercial lines.

The Labor Market

Key Driver of Profitability
The Fed’s Labor Market Conditions Index Combines 19 Labor Market Indicators

Since 1976, we’ve had a recession whenever the Index drops below -20.

Source: https://fred.stlouisfed.org/series/FRBLMCI#0
Nonfarm Employment, Quarterly Change, 2011 – 2017*

Thousands

After a strong 2014-15, the pace of job growth has slowed somewhat.

*Seasonally adjusted; 2017:Q1 is January + February x 3/2 and is preliminary
Sources: US Bureau of Labor Statistics; Insurance Information Institute
The Great Recession shifted employment from full-time to part-time. Full-time employment is finally above its pre-recession peak, but part-time hasn’t receded.

Opposite Trends for Components of Part-time Employment, 1990-2017

Both lines are now moving in good directions. People who work part-time “for economic reasons” would prefer full-time work. People who work part-time “for non-economic reasons” want (or need) part-time work.

Data are seasonally adjusted. Red-outlined box shows the Great Recession.
Sources: [https://fred.stlouisfed.org/series/LNS12032197](https://fred.stlouisfed.org/series/LNS12032197) and [https://fred.stlouisfed.org/series/LNS12032200](https://fred.stlouisfed.org/series/LNS12032200)
Opposite Trends for Components of Part-time Employment, 1990-2017

Both lines are moving in good directions. People who work part-time “for economic reasons” would prefer full-time work. People who work part-time “for non-economic reasons” want (or need) part-time work.

Data are seasonally adjusted. Red-outlined boxes are recessions.
Sources: [https://fred.stlouisfed.org/series/LNS12032197](https://fred.stlouisfed.org/series/LNS12032197) and [https://fred.stlouisfed.org/series/LNS12032200](https://fred.stlouisfed.org/series/LNS12032200)

In recent good times, the number of discouraged workers ranged from 200,000-400,000 (1995-2000) or from 300,000-500,000 (2002-2007).

A “discouraged worker” in a month did not actively look for work in the prior month for reasons such as
--thinks no work available,
--could not find work,
--lacks schooling or training,
--thinks employer thinks too young or old, and other types of discrimination.

Notes: Recessions indicated by gray shaded columns. Data are seasonally adjusted.
Unemployment and Underemployment Rates: Back to Normal?

January 2000 through February 2017, Seasonally Adjusted (%)

"Headline" Unemployment Rate U-3

Unemployment + Underemployment Rate U-6

For U-6, 8.0% to 9.5% is “normal.”

U-6 went from 8.0% in March 2007 to 17.5% in October 2009

U-6 was 9.2% in Feb. 2017.

“Headline” unemployment was 4.7% in Feb. 2017. 4.5% to 5.5% is “normal.”

Based on the latest readings, it appears that the job market is now back to “normal”

Nonfarm Payroll (Wages and Salaries): Quarterly, 2005–2016:Q4

Prior Peak was 2008:Q3 at $6.54 trillion

Recent trough (2009:Q1) was $6.23 trillion, down 5.3% from prior peak

Latest (2016:Q4) was $8.34 trillion, a new peak--$2.11T above 2009 trough

Y-o-Y Growth rates
- 2011:Q3 over 2010:Q3: 4.1%
- 2012:Q3 over 2011:Q3: 3.2%
- 2013:Q3 over 2012:Q3: 3.5%
- 2014:Q3 over 2013:Q3: 5.2%
- 2015:Q3 over 2014:Q3: 5.0%
- 2016:Q3 over 2015:Q3: 4.5%

Note: Recession indicated by gray shaded column. Data are seasonally adjusted annual rates.
Sources: http://research.stlouisfed.org/fred2/series/WASCUR; National Bureau of Economic Research (recession dates); Insurance Information Institute.
Since 2012-13, Wages Have Grown Faster Than Inflation,* 2007-2016

*Seasonally adjusted; year-over-year; Shaded area indicates recession.
The Housing Market

Key Driver of Profitability
Private Housing Starts, 1990-2021F


Job Growth, Low Inventories of Existing Homes, Still-low Mortgage Rates and Demographics, Should Continue to Stimulate Housing Unit Construction for Several More Years.

Insurers Continue to See Exposure Growth Associated with Home Construction: Construction Risk Exposure, Surety, Commercial Auto. It is Also a Potent Driver of Workers Comp Exposure.

Sources: U.S. Department of Commerce; Blue Chip Economic Indicators (3/17); Insurance Information Institute.
Since 2004 the number of renter-occupied housing units has grown by about 11 million units (+34.5%), but there has been no growth in the number of owner-occupied housing units in 12 years. When will this end?

Sources: US Census Bureau at [http://www.census.gov/housing/hvs/data/histtabs.html](http://www.census.gov/housing/hvs/data/histtabs.html), Table 8; Insurance Information Institute.
Rental-occupied Housing Units as % of Total Occupied Units, Quarterly, 1990:Q1-2016:Q4

Since the Great Recession Ended in June 2009, Renters Occupied 5.7 Million More Units (+15.6%).

Sources: U.S. Census Bureau, Residential Vacancies & Home Ownership in the Fourth Quarter of 2016 (released Jan 31, 2017) and earlier issues; Insurance Information Institute.
Rental Vacancy Rates, Quarterly, 1990-2016:Q4

Before the 2001 recession, rental vacancy rates were 7.0-7.5%. We’re below those levels now. => More multi-unit construction?

Sources: US Census Bureau, [http://www.census.gov/housing/hvs/data/histtabs.html](http://www.census.gov/housing/hvs/data/histtabs.html) Table 1; Insurance Information Institute.
US: Pct. Of Private Housing Unit Starts In Projects of 5+ Units, 1990-2017*

A NEW NORMAL? In 7 of the last 9 years, over 30% of housing unit starts were in 5+-unit projects

For the U.S. as a whole, the trend toward multi-unit housing projects (vs. single-unit homes) is recent. Commercial insurers with Workers Comp, Construction risk exposure, and Surety benefit.

*2017 is January and February, annualized; preliminary. Based on seasonally-adjusted data. Sources: U.S. Census Bureau; Insurance Information Institute calculations.
Auto Insurance

Lately: Adverse Loss Trends
In the last few years, sharp growth in miles driven. The more people drive, the more often their cars crash.

*2000-2016: Moving 12-month total vs. prior year.
Sources: Federal Highway Administration; National Bureau of Economic Research (recession dates); Insurance Information Institute.

Billions of Miles Driven in Prior Year

Recession

Miles Driven (left axis)

# Employed (right axis)

People Drive to and from Work and Drive to Entertainment. Out of Work, They Curtail Their Movement.

Note: miles driven for 2016 is through Q3 (latest available as of 1/12/2017)

Sources: Federal Highway Administration; Seasonally Adjusted Employed from Bureau of Labor Statistics (Series ID CES0000000025); Insurance Information Institute.

When people are out of work, they drive less. When they get jobs, they drive to work, helping drive claim frequency higher.

There are not only more accidents, but accidents per 100 insured vehicles is up too. This is what matters to insurers.

Sources: Seasonally Adjusted Employed from Bureau of Labor Statistics; Rolling Four-Qtr Avg. Frequency from Insurance Services Office; Insurance Information Institute.
The increase in frequency and severity of claims is driving up insurer payouts relative to premiums.

Private Passenger Auto net combined ratios have been rising every year for a decade.

Sources: National Association of Insurance Commissioners data, sourced from S&P Global Market Intelligence; Insurance Information Institute.
Return on Net Worth: Personal Auto, 2005-2015*

Rising claim costs has been a factor in keeping auto insurer ROEs quite low.

Auto Insurance Profitability Remains Well Below Pre-Crisis Levels (12% vs. ~4%)

*2015 Personal Auto figure is estimated.
SOURCE: National Association of Insurance Commissioners.
Commercial Lines

Key Driver of Growth & Profitability
Continued Growth in Industrial Production Will Lead to a Modest Rise in Commercial Exposures

Corporate tax reform could have a large impact on these forecasts.

Industrial production growth depends on aggregate demand, which can rise or fall depending on the value of the U.S. dollar (which affects the price of manufactures for export) and consumer purchasing power.

Sources: Blue Chip Economic Indicators, 3/2017; Insurance Information Institute.
Continued Business Investment Will Spur Modest Commercial Exposure Growth

Business investment was a major drag on the economy in 2016 and adversely affected commercial property and liability insurance exposures. Growth should begin a modest recovery in 2017.

The level and direction of interest rates and tax policy are likely to affect these growth rates.

Sources: Blue Chip Economic Indicators, 3/2017; Insurance Information Institute.
Total (Public+Private) Infrastructure* Spending, Monthly, 2003-2017**: Is a Big Increase Coming in 2017? 

Spending on infrastructure construction can rise dramatically, as it did from 2003-2008, but it hasn’t risen much since the Great Recession.

Infrastructure spending went from $170B in 2003 to $275B in 2008. Will infrastructure spending cross the $300B mark in 2017?

Sources: U.S. Department of Commerce, Census Bureau; Insurance Information Institute.
Just like Private Passenger Auto, Net Combined Ratios Have Been Rising Virtually Every Year for a Decade.
Questions?
Thank You!