

ISO Release: Investment Gains Propelled Improvement in P/C Insurers' Overall Financial Results for 2010 as Underwriting Results Deteriorated

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JERSEY CITY, N.J., April 20, 2011 — Private U.S. property/casualty insurers' net income after taxes rose to \$34.7 billion in 2010 from \$28.7 billion the year before, with insurers' rate of return on average policyholders' surplus — a key measure of overall profitability — increasing to 6.5 percent from 5.9 percent.

Reflecting insurers' \$34.7 billion in net income and other developments in 2010, policyholders' surplus — insurers' net worth measured according to Statutory Accounting Principles — rose \$45.5 billion, or 8.9 percent, to \$556.9 billion at December 31, 2010, from \$511.4 billion at December 31, 2009.

Contributing to the increases in the insurance industry's net income, overall rate of return, and surplus, insurers' net investment gains — the sum of net investment income and realized capital gains (or losses) on investments — grew \$13.8 billion to \$52.9 billion in 2010 from \$39.2 billion in 2009.

Partially offsetting the growth in investment gains, insurers' net losses on underwriting grew to \$10.4 billion in 2010 from \$3 billion in 2009. The combined ratio — a key measure of losses and other underwriting expenses per dollar of premium — deteriorated to 102.4 percent in 2010 from 101 percent in 2009, according to ISO and the Property Casualty Insurers Association of America (PCI).

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.

“Property/casualty insurers' positive results for 2010 show that insurers are well positioned to meet the needs of consumers and business owners as the economy recovers from the Great Recession. Combining insurers' \$556.9 billion in policyholders' surplus as of December 31, 2010, their \$557.7 billion in loss and loss adjustment expense reserves, and their \$199 billion in unearned premium reserves, insurers had \$1.3 trillion to pay claims and meet other contingencies,” said David Sampson, PCI's president and CEO. “Nonetheless, weather experts are forecasting an unusually active hurricane season this year, and the tragic events in Japan are a vivid reminder of the need for vigilance in preparing for natural catastrophes. Though major natural disasters seem to be striking our country more frequently, recent growth in policyholders'

surplus will help the insurance industry maintain its exemplary track record protecting consumers.”

“The economic recovery, growing confidence that we’ve put the financial crisis behind us, and investor expectations that the economy will continue improving certainly contributed to positive developments in financial markets and the increase in investment gains that benefited insurers’ overall financial results last year,” said Michael R. Murray, ISO’s assistant vice president for financial analysis. “But insurers continue to face substantial headwinds in their core business — underwriting — with prices yet to firm in many commercial insurance markets despite rising loss and loss adjustment expenses. Near term, economic growth may spur increases in the frequency of claims. And as the economy inches closer to full employment, inflation in the severity of claims may accelerate. But economic growth may also spur increases in demand for insurance that absorb excess capacity faster than investment gains create it. If it does, insurers can look forward to an end to the soft market, accelerating premium growth, and improvement in underwriting results. Wild cards that could hasten the turn in commercial insurance markets include catastrophes and reversals in financial markets that erase substantial amounts of insurers’ excess capacity.”

The property/casualty insurance industry’s 6.5 percent rate of return for 2010 was the net result of negative rates of return for mortgage and financial guaranty insurers and single-digit rates of return for other insurers. ISO estimates that mortgage and financial guaranty insurers’ rate of return on average surplus for 2010 was negative 36.6 percent, up from negative 51.7 percent for 2009. Excluding mortgage and financial guaranty insurers, the industry’s rate of return edged up to 7.5 percent for 2010 from 7.4 percent for 2009.

“Despite the increases in insurers’ net income and overall rate of return in 2010, insurers’ results remained subpar,” said Sampson. “Insurers’ 6.5 percent rate of return for 2010 was 0.4 percentage points less than their 6.9 percent average rate of return for the past 10 years and 2.6 percentage points less than their 9.1 percent average rate of return for the 52 years from 1959 to 2010. Moreover, insurers’ rate of return remained far below benchmarks like the 13.9 percent long-term average rate of return for the Fortune 500.”

Underwriting Results

With underwriting gains (or losses) equaling earned premiums minus net loss and loss adjustment expenses (LLAE), other underwriting expenses, and dividends to policyholders, net losses on underwriting grew \$7.4 billion to \$10.4 billion in 2010 as earned premiums fell and LLAE, underwriting expenses, and dividends to policyholders all rose.

Net written premiums rose \$3.7 billion, or 0.9 percent, to \$422.1 billion for 2010 from \$418.4 billion for 2009. But net earned premiums fell \$1.8 billion, or 0.4 percent, to \$420.5 billion from \$422.3 billion as a result of previous declines in written premiums.

Net LLAE (after reinsurance recoveries) rose \$2.8 billion, or 0.9 percent, to \$309.1 billion in 2010 from \$306.3 billion in 2009, largely as a result of higher catastrophe LLAE.

Other underwriting expenses — primarily acquisition expenses; expenses associated with underwriting, pricing, and servicing insurance policies; and premium taxes — rose \$2.5 billion, or 2.2 percent, to \$119.6 billion in 2010 from \$117 billion in 2009, while dividends to policyholders increased \$0.3 billion, or 14.4 percent, to \$2.3 billion from \$2 billion.

ISO estimates that private insurers’ net LLAE from catastrophes striking the United States rose \$2.7 billion to \$14.3 billion for 2010 from \$11.6 billion for 2009, with the \$11.6 billion for 2009 including some late-emerging losses from Hurricane Ike in 2008.

According to ISO's Property Claim Services (PCS) unit, catastrophes striking the United States in 2010 caused \$13.8 billion in direct insured losses (before reinsurance recoveries) for all insurers (including residual-market insurers and foreign insurers) — up \$3.2 billion from \$10.6 billion in 2009 but \$6.5 billion less than the \$20.2 billion average for the ten years ending 2010.

Noncatastrophe net LLAE rose \$0.1 billion to \$294.8 billion for 2010 from \$294.7 billion for 2009.

Total net LLAE for both 2010 and 2009 was reduced by downward revisions to the estimated ultimate cost of claims incurred in prior years and consequent releases of LLAE reserves. Such downward revisions and releases dropped to \$9.7 billion in 2010 from \$11 billion in 2009. Excluding those amounts, net LLAE rose \$1.5 billion, or 0.5 percent, to \$318.8 billion last year from \$317.3 billion in 2009.

“The 0.9 percent increase in total industry net written premiums in 2010 is certainly welcome news following three consecutive years of declines. Moreover — and possibly sending a signal about the nature of things to come — year-to-year comparisons improved for each of the three major subsectors of the industry tracked by ISO,” said Murray. “Net written premium growth for insurers writing predominantly personal lines accelerated to positive 3.3 percent in 2010 from negative 0.5 percent in 2009, with premium growth for insurers writing more balanced books of business increasing to positive 2.1 percent from negative 3.6 percent. Premium growth for insurers writing predominantly commercial lines rose to negative 2.7 percent from negative 7.5 percent. Excluding mortgage and financial guaranty insurers, commercial lines insurers' net written premiums dropped just 2.2 percent last year, after falling 6.5 percent in 2009.”

“The deterioration in underwriting profitability as measured by the combined ratio is a particular cause for concern, because today's low investment yields together with the long-term decline in investment leverage that helped insulate insurers from the ravages of the financial crisis and the Great Recession mean insurers need better underwriting results just to be as profitable as they once were,” said Sampson. “In 1986, insurers achieved a 15.1 percent rate of return with a combined ratio of 108.1 percent. Even though insurers' combined ratio for 2010 was 5.7 percentage points better, their rate of return was only 6.5 percent — 8.6 percentage points lower than in 1986 — because of declines in investment yields and investment leverage.”

The \$10.4 billion net loss on underwriting for 2010 amounted to 2.5 percent of the \$420.5 billion in net premiums earned during the period, whereas the \$3 billion net loss on underwriting for 2009 amounted to 0.7 percent of the \$422.3 billion in net premiums earned during that period.

“Reflecting the residual weakness in the economy and foreclosure rates, mortgage and financial guaranty insurers continued to suffer disproportionate losses on underwriting,” said Murray. “Mortgage and financial guaranty insurers' net written premiums declined 12.6 percent to \$5.8 billion for 2010, and their net earned premiums dropped 10.9 percent to \$6.8 billion. Reflecting these declines in premiums and an increase in underwriting expenses, mortgage and financial guaranty insurers' combined ratio deteriorated to 194.4 percent for 2010 from 191.8 percent for 2009, even though their loss and loss adjustment expenses dropped 14.8 percent to \$11.7 billion. Excluding mortgage and financial guaranty insurers, industry net written premiums rose 1.1 percent, earned premiums dropped 0.2 percent, loss and loss adjustment expenses increased 1.7 percent, and the combined ratio rose to 100.8 percent for 2010 from 99.3 percent a year earlier.”

Investment Results

Insurers' net investment income — primarily dividends from stocks and interest on bonds — increased by \$0.2 billion to \$47.2 billion in 2010 from \$47.1 billion in 2009. And insurers' \$5.7 billion in realized capital gains on investments in 2010 constituted a \$13.6 billion swing from insurers' \$7.9 billion in realized capital losses on investments in 2009. Combining net investment

income and realized capital gains, overall net investment gains rose 35.2 percent to \$52.9 billion in 2010 from \$39.2 billion in 2009.

Combining the \$5.7 billion in realized capital gains in 2010 with \$15.6 billion in unrealized capital gains during the period, insurers posted \$21.3 billion in overall capital gains in 2010 — a \$6.1 billion increase compared with insurers' \$15.2 billion in overall capital gains on investments in 2009.

“Unfortunately, insurers' net investment income in 2010 was even more anemic than it appears. The \$0.2 billion increase reflects \$1.3 billion that one insurer received from a newly acquired affiliate outside the insurance space,” said Sampson. “Absent the investment income generated by that acquisition and the new funds raised to finance it, insurers' investment income would have declined in 2010. Prospectively, there is still some risk that insurers' investment income will decline as they replace maturing bonds paying relatively high yields with new bonds paying lower yields.”

“Insurers' overall capital gains for 2010 reflect developments in financial markets. The New York Stock Exchange composite rose 10.8 percent last year, with the Dow Jones Industrial Average, the S&P 500, and the NASDAQ composite climbing 11 percent, 12.8 percent, and 16.9 percent, respectively,” said Murray. “Insurers' investment results also benefited from a decline in realized capital losses on impaired investments, which dropped to \$5.9 billion in 2010 from \$16.1 billion in 2009.”

Pretax Operating Income

Pretax operating income — the sum of net gains or losses on underwriting, net investment income, and miscellaneous other income — fell \$7.1 billion, or 15.9 percent, to \$37.8 billion for 2010 from \$45 billion for 2009. The \$7.1 billion decrease in operating income was the net result of the \$7.4 billion increase in net losses on underwriting, the \$0.2 billion increase in net investment income, and a \$0.1 billion increase in miscellaneous other income to \$1 billion for 2010 from \$0.9 billion for 2009.

Mortgage and financial guaranty insurers' operating income rose to negative \$4 billion last year from negative \$4.6 billion in 2009. Excluding mortgage and financial guaranty insurers, the insurance industry's operating income fell \$7.7 billion, or 15.5 percent, to \$41.9 billion in 2010 from \$49.6 billion in 2009.

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 for 2010 totaled \$34.7 billion, up from \$28.7 billion for 2009. The \$6 billion increase in net income was the net result of the \$7.1 billion decrease in operating income, the \$13.6 billion swing to \$5.7 billion in realized capital gains from \$7.9 billion in realized capital losses, and a \$0.4 billion increase in federal and foreign income taxes to \$8.9 billion for 2010 from \$8.4 billion a year earlier.

Mortgage and financial guaranty insurers' net income after taxes rose to negative \$4.4 billion for 2010 from negative \$6.2 billion for 2009. Excluding mortgage and financial guaranty insurers, the insurance industry's net income after taxes increased \$4.2 billion to \$39 billion for 2010 from \$34.8 billion for 2009.

Policyholders' Surplus

Policyholders' surplus increased \$45.5 billion to \$556.9 billion at year-end 2010 from \$511.4 billion at year-end 2009. Additions to surplus in 2010 included insurers' \$34.7 billion in net income after taxes, \$15.6 billion in unrealized capital gains on investments (not included in net income), and \$27.4 billion in new funds paid in (new capital raised by insurers). Those additions

were partially offset by \$31 billion in dividends to shareholders and \$1.2 billion in miscellaneous charges against surplus.

The \$27.4 billion in new funds paid in during 2010 was up from \$6.6 billion in 2009 and is the largest amount of new funds any year since the start of ISO's data in 1959. The record-high \$27.4 billion in 2010 included \$22.5 billion contributed to one insurer by its parent, as the insurer absorbed a major acquisition outside the insurance space. The previous record high for new funds was \$18.8 billion in 2002.

Insurers' unrealized capital gains on investments dropped to \$15.6 billion in 2010 from \$23.1 billion in 2009.

The \$31 billion in dividends to shareholders in 2010 was up \$14.1 billion, or 83.6 percent, from the \$16.9 billion in 2009.

The \$1.2 billion in miscellaneous charges against surplus in 2010 compared with \$12.6 billion in miscellaneous additions to surplus in 2009.

Mortgage and financial guaranty insurers' surplus rose to \$12.3 billion at year-end 2010 from \$11.6 billion at year-end 2009. Excluding mortgage and financial guaranty insurers, industry surplus rose \$44.7 billion to \$544.5 billion as of December 31 last year from \$499.8 billion as of December 31, 2009.

"The premium-to-surplus ratio as of December 31, 2010, was 0.76 — less than it was any year from 1959 to 2009 and only about half the 1.49 average premium-to-surplus ratio for the 52 years ending 2010. Similarly, the ratio of loss and loss adjustment expense reserves to surplus as of December 31, 2010, was 1.00 — the lowest it's been since the 0.97 for 1968 and far below the 1.42 average LLAE-reserves-to-surplus ratio for the past 52 years," said Murray. "With leverage ratios such as these providing simple measures of the amount of risk supported by each dollar of surplus, insurers appear to be exceptionally well capitalized at this point. But to the extent that these same leverage ratios provide insight into insurers' capacity utilization and the potential supply of insurance, they help explain why some insurance markets have remained so soft for so long."

Fourth-Quarter Results

The property/casualty insurance industry's consolidated net income after taxes fell 34.6 percent to \$8 billion for fourth-quarter 2010 from \$12.2 billion for fourth-quarter 2009. Reflecting the decline in net income, the industry's annualized rate of return on average surplus fell to 5.8 percent in the fourth quarter of 2010 from 9.8 percent in the fourth quarter of 2009.

Mortgage and financial guaranty insurers' annualized rate of return rose to negative 40.7 percent in fourth-quarter 2010 from negative 66.6 percent in fourth-quarter 2009 as their net income after taxes rose to negative \$1.2 billion from negative \$1.9 billion. Excluding mortgage and financial guaranty insurers, the industry's annualized rate of return receded to 6.8 percent in fourth-quarter 2010 from 11.5 percent a year earlier as its net income dropped 34.6 percent.

Fourth-quarter 2010 net income for the entire industry consisted of \$8.7 billion in pretax operating income and \$1.3 billion in realized capital gains on investments, less \$1.9 billion in federal and foreign income taxes.

The industry's fourth-quarter pretax operating income of \$8.7 billion was down 21.4 percent from \$11 billion in fourth-quarter 2009. Fourth-quarter 2010 operating income consisted of \$4.2 billion in net losses on underwriting, \$12.2 billion in net investment income, and \$0.6 billion in miscellaneous other income. Excluding mortgage and financial guaranty insurers, operating

income fell \$3.4 billion, or 25.3 percent, to \$9.9 billion in fourth-quarter 2010 from \$13.3 billion in fourth-quarter 2009.

The \$4.2 billion in net losses on underwriting in fourth-quarter 2010 compared with \$0.2 billion in net gains on underwriting in fourth-quarter 2009.

Fourth-quarter 2010 net losses on underwriting amounted to 3.9 percent of the \$106.1 billion in premiums earned during the period compared with fourth-quarter 2009 net gains on underwriting amounting to 0.2 percent of the \$105 billion in premiums earned during that period.

The industry's combined ratio deteriorated to 105.9 percent in fourth-quarter 2010 from 101.9 percent in fourth-quarter 2009.

The \$4.2 billion in net losses on underwriting for fourth-quarter 2010 was after deducting \$1.2 billion in premiums returned to policyholders as dividends, with dividends to policyholders up 15.3 percent from \$1 billion in fourth-quarter 2009.

Loss and loss adjustment expenses rose \$4.8 billion, or 6.4 percent, to \$79.7 billion in fourth-quarter 2010 from \$74.9 billion in fourth-quarter 2009.

"Excluding adjustments to LLAE reserves for claims that occurred in prior years, net LLAE still rose 3 percent to \$77.9 billion in fourth-quarter 2010 from \$75.6 billion in fourth-quarter 2009, the combined ratio rose 1.7 percentage points to 104.3 percent from 102.6 percent, and net losses on underwriting rose to 2.3 percent of earned premium from 0.6 percent," Sampson said.

LLAE for fourth-quarter 2010 included an estimated \$2.9 billion in net LLAE (after reinsurance recoveries) attributable to catastrophes striking the United States, with estimated net catastrophe LLAE increasing \$2.7 billion from \$0.2 billion in fourth-quarter 2009.

Excluding loss adjustment expenses, direct insured losses from catastrophes during fourth-quarter 2010 totaled \$2.8 billion, up \$2.6 billion from the direct insured losses from catastrophes during fourth-quarter 2009, according to ISO's PCS unit.

Written premiums rose \$1.3 billion, or 1.3 percent, to \$98.9 billion in fourth-quarter 2010 from \$97.6 billion in fourth-quarter 2009. The 1.3 percent increase in fourth-quarter 2010 followed a 2.3 percent increase in third-quarter 2010 and a 1.3 percent increase in second-quarter 2010. These increases in quarterly written premiums were the first since first-quarter 2007, when written premiums rose 0.8 percent compared with their level a year earlier.

Reflecting recent increases in written premiums, earned premiums rose \$1.1 billion, or 1 percent, to \$106.1 billion in fourth-quarter 2010 from \$105 billion in fourth-quarter 2009. The 1 percent increase in quarterly earned premium followed a 1.1 percent increase in third-quarter 2010. These increases were the first since third-quarter 2008, when earned premiums rose 1.3 percent.

OPERATING RESULTS FOR 2010 AND 2009
(\$ MILLIONS)

ISO 2010 OPERATING RESULTS

TWELVE MONTHS	2010	2009
NET WRITTEN PREMIUMS	422,065	418,365

TWELVE MONTHS	2010	2009
PERCENT CHANGE (%)	0.9	-3.8
NET EARNED PREMIUMS	420,506	422,302
PERCENT CHANGE (%)	-0.4	-3.7
INCURRED LOSS & LOSS ADJUSTMENT EXPENSES	309,109	306,286
PERCENT CHANGE (%)	0.9	-9.4
STATUTORY UNDERWRITING GAINS (LOSSES)	-8,160	-998
POLICYHOLDERS' DIVIDENDS	2,270	1,984
NET UNDERWRITING GAINS (LOSSES)	-10,430	-2,981
PRETAX OPERATING INCOME	37,834	44,983
NET INVESTMENT INCOME EARNED	47,246	47,057
NET REALIZED CAPITAL GAINS (LOSSES)	5,688	-7,904
NET INVESTMENT GAINS	52,935	39,154
NET INCOME (LOSS) AFTER TAXES	34,670	28,672
PERCENT CHANGE (%)	20.9	842.3
SURPLUS (CONSOLIDATED)	556,852	511,397
LOSS & LOSS ADJUSTMENT EXPENSE RESERVES	557,710	551,572
COMBINED RATIO, POST-DIVIDENDS (%)	102.4	101
FOURTH QUARTER	2010	2009
NET WRITTEN PREMIUMS	98,918	97,641
PERCENT CHANGE (%)	1.3	-1
NET EARNED PREMIUMS	106,063	104,964
PERCENT CHANGE (%)	1	-2.6
INCURRED LOSS & LOSS ADJUSTMENT EXPENSES	79,655	74,861
PERCENT CHANGE (%)	6.4	-6.1
STATUTORY UNDERWRITING GAINS (LOSSES)	-3,020	1,194
POLICYHOLDERS' DIVIDENDS	1,162	1,008
NET UNDERWRITING GAINS (LOSSES)	-4,182	187
PRETAX OPERATING INCOME	8,678	11,043
NET INVESTMENT INCOME EARNED	12,221	11,146
NET REALIZED CAPITAL GAINS (LOSSES)	1,254	1,672
NET INVESTMENT GAINS	13,475	12,818
NET INCOME (LOSS) AFTER TAXES	7,993	12,229
PERCENT CHANGE (%)	-34.6	NM*
SURPLUS (CONSOLIDATED)	556,852	511,397
LOSS & LOSS ADJUSTMENT EXPENSE RESERVES	557,710	551,572
COMBINED RATIO, POST-DIVIDENDS (%)	105.9	101.9

*NM = not meaningful.

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