

Insurance Executive Review

Market Commentary on Current Developments within the P&C Insurance Industry

9 Month Financials not as Good as Advertised .. Taking a Closer Look at the Numbers!

On December 22 the Insurance Services Office released the nine month financial result for the Private Property Casualty Insurance Industry under the headline "...Net Income Makes Dramatic Turnaround". It suggested that a significant improvement was made in 2009 over reported results in 2008. While the commentary noted the negative impact that the mortgage and financial guaranty markets have had on the overall industry numbers, it failed to demonstrate just how significant that market segment and catastrophe losses have had on these published reports. In the exhibits below we will try to bring more clarity to what the numbers may be telling us.

The Numbers as Reported

In Exhibit A below we show the "as reported" financial return for the P&C industry at nine months over the last 5 years (2005-2009). In looking at the recent 2 year period the stated improvement in underwriting moved from a \$19 Billion loss in 2008 to only a \$3 Billion loss in 2009, primarily aided by a lack of catastrophe losses that in 2009 were only half of the \$21 Billion in 2008.

EXHIBIT A

PROPERTY CASUALTY INDUSTRY RESULTS

2005 to 2008 NET INCOME

NINE MONTHS

(Millions of Dollars)

	2009	2008	2007	2006	2005
PREMIUM REVENUE					
Net Written Premium(NWP)	\$321,191	\$336,321	\$337,394	\$337,556	\$321,322
Net Earned Premium(NEP)	\$317,776	\$330,560	\$329,157	\$325,146	\$310,528
UNDERWRITING OPERATIONS					
Underwriting Expense	\$88,324	\$91,137	\$89,297	\$87,481	\$81,487
Incurred Claims and Loss Adj. Exp.	\$231,722	\$258,252	\$219,157	\$212,266	\$230,027
Policyholder Dividends	\$979	\$1,013	\$1,174	\$1,092	\$749
Total Underwriting Expense	\$321,025	\$350,402	\$309,628	\$300,839	\$312,263
Net Underwriting Gain (Loss)	-\$3,249	-\$19,842	\$19,529	\$24,307	-\$1,735
INVESTMENT OPERATIONS					
Net Investment Income	\$35,843	\$38,258	\$39,620	\$37,493	\$36,598
Other Income	\$1,107	\$735	-\$2,196	\$214	\$6
Pre-Tax Operating Income	\$33,701	\$19,151	\$56,953	\$62,014	\$34,869
Net Realized Capital Gains	-\$9,639	-\$9,726	\$8,157	\$1,474	\$4,299
Pre-Tax Income	\$24,062	\$9,425	\$65,110	\$63,488	\$39,168
Federal Tax	-\$7,898	-\$5,075	-\$15,510	-\$17,359	-\$9,423
Net After Tax Income	\$16,164	\$4,350	\$49,600	\$46,129	\$29,745
Consolidated Industry Surplus	\$490,800	\$480,096	\$521,791	\$466,739	\$471,198
Loss and LAE Reserves	\$552,414	\$564,096	\$527,615	\$511,218	\$497,924
Combined Ratio	100.7%	105.5%	93.8%	91.5%	99.9%
Net Industry Catastrophe Losses*	\$10.9	\$21.1	\$4.8	\$7.8	\$26.5

Source: Insurance Services Office (ISO)

*after reinsurance recoveries from foreign reinsurers

On the Net After Tax Income, a dramatic turnaround from \$4.3 Billion in 2008 to \$16.1 Billion in 2009 is certainly significant.....or is it?

Taking a Closer Look at the Numbers

In our previous newsletters we have taken issue with the mortgage and financial guaranty number skewing the industry results making them misrepresent what was actually taking place in the core property casualty business. In Exhibit B (taken from our Newsletter #14 last year) we have extracted the impact of those market segments and the "above average" catastrophe losses to look at core business results.

EXHIBIT B					
PROPERTY CASUALTY INDUSTRY RESULTS					
2007 vs. 2008 NET INCOME					
NINE MONTHS					
(Millions of Dollars)					
	2008	Mortgage Guaranty	Excess Catastrophe*	Adjusted 2008	2007
PREMIUM REVENUE					
Net Written Premium(NWP)	\$336,321	\$ 6,400		\$329,921	\$337,394
Net Earned Premium(NEP)	\$330,560	\$ 6,320		\$324,240	\$329,157
UNDERWRITING OPERATIONS					
Underwriting Expense	\$91,137	\$ 1,224		\$89,913	\$89,297
Incurred Claims and Loss Adj. Exp.	\$258,252	\$ 17,900	\$ 9,300	\$231,052	\$219,157
Policyholder Dividends	\$1,013	\$ -		\$1,013	\$1,174
Total Underwriting Expense	\$350,402	\$ 19,124	\$ 9,300	\$321,978	\$309,628
Net Underwriting Gain (Loss)	-\$19,842			\$2,262	\$19,529
INVESTMENT OPERATIONS					
Net Investment Income	\$38,258	\$ 303		\$37,955	\$39,620
Other Income	\$735			\$735	-\$2,196
Pre-Tax Operating Income	\$19,151			\$40,952	\$56,953
Net Realized Capital Gains	-\$9,726			-\$9,726	\$8,157
Pre-Tax Income	\$9,425			\$31,226	\$65,110
Federal Tax	-\$5,075	\$ (3,500)	\$ (1,100)	-\$9,675	-\$15,510
Net After Tax Income	\$4,350			\$21,551	\$49,600

Source: Insurance Services Office (ISO)

*excess above historical average and after reinsurance recoveries

In Exhibit C below we performed the same extraction of mortgage and financial segments for 2009.

EXHIBIT C				
PROPERTY CASUALTY INDUSTRY RESULTS				
2009 vs. 2008 NET INCOME				
NINE MONTHS				
(Millions of Dollars)				
	Unadjusted 2009	Mortgage Guaranty	Adjusted 2009	Unadjusted 2008
PREMIUM REVENUE				
Net Written Premium(NWP)	\$321,191	\$ 4,900	\$316,291	\$336,321
Net Earned Premium(NEP)	\$317,776	\$ 4,458	\$313,318	\$330,560
UNDERWRITING OPERATIONS				
Underwriting Expense	\$88,324	\$ 1,133	\$87,191	\$91,137
Incurred Claims and Loss Adj. Exp.	\$231,722	\$ 9,300	\$222,422	\$258,252
Policyholder Dividends	\$979	\$ -	\$979	\$1,013
Total Underwriting Expense	\$321,025	\$ 10,433	\$310,592	\$350,402
Net Underwriting Gain (Loss)	-\$3,249	\$ (5,975)	\$2,726	-\$19,842
INVESTMENT OPERATIONS				
Net Investment Income	\$35,843	\$ 303	\$35,540	\$38,258
Other Income	\$1,107		\$1,107	\$735
Pre-Tax Operating Income	\$33,701	\$ (5,672)	\$39,373	\$19,151
Net Realized Capital Gains	-\$9,639		-\$9,639	-\$9,726
Pre-Tax Income	\$24,062		\$29,734	\$9,425
Federal Tax	-\$7,898	\$ (2,125)	-\$10,023	-\$5,075
Net After Tax Income	\$16,164		\$19,711	\$4,350

Source: Insurance Services Office (ISO)

Summary

If we look at Underwriting performance and Net After Tax Income taking the above analysis into account, we find the difference between 2008 and 2009 nine month industry results to be less than a “dramatic turnaround”.

Exhibit D	Property Casualty Industry Data Nine Months Select Financials		
	2009	% Change	2008
<i>Nine Months data as reported</i>			
Underwriting Profit (Loss)	(\$3,249)	-83.6%	(\$19,842)
Net Income after tax	\$16,164	271.6%	\$4,350
<i>Nine Months data as adjusted*</i>			
Underwriting Profit (Loss)	\$2,726	20.5%	\$2,262
Net Income after tax	\$19,711	-8.5%	\$21,551

*adjusted per Exhibits B and C

What we see after our adjustment for outlier data is that 2008 and 2009 shows a much more narrow improvement in underwriting than the aggregate industry data would suggest. The inclusion of outlier data for relatively small or specialty segments when they can skew total industry results will lead to misunderstanding market dynamics. Furthermore, the industry is still operating with an improved underwriting profit in its core business suggesting that although declines in insurance demand is forcing down premium income, the soft market rates are still sufficient to produce positive returns. We do view these underwriting results with some suspicion in that they contain further releases of prior year claim reserves that may be weakening the balance sheet for the sake of current earnings reports. This would not be the first instance when excessive claim reserve draw-downs put some carriers into financial distress.

Total market premiums have now declined for 10 successive quarters versus prior year starting in mid 2007 and when combined with the subsequent economic downturn has carriers chasing a smaller market for insurance products. Unless economic activity picks up, we see further premium declines into 2010 with competition forcing effective market rates lower thereby moving core business into an underwriting loss cycle that could last for 10 quarters on the other side of any recovery.



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