The property and casualty (P&C) insurance industry continues to face economic and market-based challenges. New risks demand coverage; catastrophes are surfacing in unexpected ways and experience shifts are driving casualty lines’ capital needs. In this current environment of disruption and dynamic innovation, managers must analyze all factors in order to adapt to changing opportunities. The understanding of insurance risk requires review of many cyclical drivers, some of which affect costs, while others affect revenue. An understanding of the investment environment is also crucial. In this article, we will explore the P&C industry’s operating performance, historical balance sheet and capitalization to provide insight into industry trends for strategic decision making.

RECENT OPERATING PERFORMANCE IN THE P&C INDUSTRY

Over the span of the last 17 years, the industry’s operating performance contained two periods of consecutive underwriting gains: from 2006 to 2007 and from 2013 to 2015. The underwriting performance of 2016 put a halt on the most recent period of consecutive underwriting gains. In the early part of the millennium, the P&C industry’s underwriting results were trending downward. Adverse reserve development between 1999 and 2002 resulted from underpriced policies in a highly competitive market coupled with unexpected inflation in bodily injury costs. Ultimately, approximately 15 percent of statutory policyholder surplus was destroyed during this period. The events of September 11, 2001 further deepened a negative underwriting position, creating a rare occasion when investment income could not offset underwriting losses. The ensuing hard market improved underwriting results for several years, reaching peak performance in 2006. Even though 2005 witnessed record-setting hurricane events (notably Katrina, Rita and Wilma), it...
still generated a breakeven underwriting performance due to the strong cyclical hard market in casualty lines (before considering policyholder dividends).

The underwriting gains achieved in 2013-2015 ceased in 2016 due in part to significant auto underwriting losses, a slowing of reported benign loss reserve development and sluggish premium growth. While the catastrophe losses in 2016 did not top the cat loss amounts of 2011 and 2012, the amount of cat loss coupled with the other factors previously mentioned contributed to the deterioration in underwriting results.

INDUSTRY BALANCE SHEET

HISTORICAL BALANCE SHEET IN THE P&C INDUSTRY

Clearly, operating performance was an important driver of the industry’s surplus position, but unrealized capital gains/(losses) had a large impact. From 2000 to 2016, the industry’s surplus grew by over 100 percent. However, operating losses have been far more common than operating gains over this time period. Surplus decreased in only five of the 19 years. Reductions in surplus typically result from a combination of catastrophe events and stock market losses. Highlights of past losses are as follows:

- **2000**: While operating income was positive, the stock market saw its first annual decline in a decade. Unrealized capital losses and dividends more than offset a modest operating profit in 2000.
- **2001**: Losses from the terror events on September 11, adverse reserve development from previously mispriced business and a sagging stock market all contributed to the evaporation of nine percent of industry surplus – the largest decline in the last two decades.
- **2002**: The effect of three consecutive years of negative annual stock returns was mitigated by rate increases and re-underwriting. The industry experienced only a slight 1 percent loss to surplus.
- **2008**: Devastating stock market losses due to the credit crisis generated the worst annual returns since 1931. Approximately 20 percent of the industry’s invested asset portfolio was allocated to equities before the crisis. These asset losses and above-average property catastrophe losses depleted surplus by 12 percent, the largest amount across this history. In 2008, six named hurricanes made landfall and high tornado activity occurred in the United States.
- **2011**: Catastrophes wreaked havoc in 2011 across multiple geographic regions. Tornadoes across the United States, wildfires in the Southwest, winter storms in the Midwest and Hurricane Irene landfalls in North Carolina and New Jersey contributed to losses. In 2013, the industry enjoyed both strong underwriting and investment results, producing a return on surplus that was among the best in two decades. The strong underwriting results carried into 2014, but growth in surplus slowed due to lower stock returns. In 2015, the industry surplus position stayed flat, as capital returned to shareholders offset modest underwriting profits and investment income.

From 2008 to 2016, the loss and LAE reserve balance for the industry increased by only 10 percent, even as net earned premium increased by over 25 percent – coinciding with a period of consistent prior period reserve releases. The increase of 3 percent in 2015 was the largest increase since 2008.

On the asset side of the balance sheet, the industry’s fixed-income holdings steadily increased at a rate of 1 percent to 3 percent from 2009 to 2016, while stocks and other invested assets (including Schedule BA assets) experienced significantly more volatility.
HISTORICAL BALANCE SHEET IN THE P&C INDUSTRY

Historical Balance Sheet - All Companies - All LOBs

Operating Performance - Top 25 Companies Versus All Other Companies

Source: Guy Carpenter
The P&C industry experienced 5 percent growth in policyholders surplus in 2016, which was significantly larger than growth in 2015, largely driven by a positive 3.7 percent return in realized/unrealized capital gains. Following three consecutive years of underwriting gains for the P&C industry, 2016 marked negative underwriting performance (-0.4 percent).

Source: Guy Carpenter

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