National Association of Insurance Commissioners & The Center for Insurance Policy and Research

U.S. Property and Casualty Insurance Industry

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Industry Overview

The U.S. property and casualty insurance industry produced a net profit of $24.1 billion in the first half of 2016 compared to a profit of $32.7 for the same period in 2015. Contributing factors to the YoY decline was twofold: underwriting operations deteriorated to a loss of $180 million for the current period compared to a $4.7 billion gain for the prior year period, and investment income decreased 12.7% to $29.0 billion—the lowest amount recorded at mid-year since 2009. With respect to underwriting performance, a second quarter loss of $3.4 billion, impacted by severe storms in April that caused significant flooding and hail damage, offset the first quarter gain of $3.2 billion. Despite the first half underwriting loss, to some degree underwriting performance continued to be efficient considering a combined ratio of 99.7%—the fourth consecutive year it has fallen below the 100% benchmark, notwithstanding the second quarter results that produced a combined ratio of 102.1%. Regarding the decline in investment profits, low interest rates continue to suppress investment income; however, the main cause for the YoY decline was a 43.7% drop in net realized gains to $4.8 billion. Overall, return on revenue dipped to 8.3% versus double-digit returns experienced the previous three periods. In spite of these first half obstacles, robust growth in policyholders' surplus continued with surplus increasing to a new high of $711.6 billion. Capital adequacy—in terms of net writings as a percentage of surplus—remained strong at 74.5% for the trailing twelve month period. A pattern of prior year loss reserve releases continued, but may soon run its course as noted from the tapering-off that has occurred over the last few years.

Table 1. U.S. Property and Casualty Insurance Industry Results (in millions, except for percent data)

Six Months Ended June 30,	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Net Premiums Written	268,815	261,149	251,373	241,363	231,591	222,968	217,003	217,447	228,258	229,509
Net Premiums Earned	261,635	252,506	242,994	232,854	223,377	216,767	211,920	216,623	224,331	223,370
Net Losses Incurred	156,171	145,596	143,152	131,841	136,889	150,267	129,850	132,037	141,082	121,121
Loss Expenses Incurred	30,713	29,378	28,632	27,631	26,904	27,450	25,924	26,521	26,333	26,404
Underwriting Expenses	74,508	72,404	69,304	67,569	65,638	62,613	61,056	60,630	62,115	61,106
Underwrting Gain (Loss)	(180)	4,727	1,517	5,792	(5,887)	(23,686)	(4,681)	(1,822)	(4,892)	14,536
Investment Inc. Earned	24,190	24,664	25,238	27,049	25,440	27,052	27,766	25,623	29,014	29,224
Realized Gains (Losses)	4,815	8,550	7,603	11,051	4,099	3,912	4,355	(11,462)	(616)	3,815
Investment Gain (Loss)	29,005	33,214	32,842	38,101	29,539	30,964	32,122	14,160	28,398	33,039
Total Other Income	803	910	693	(1,637)	1,379	599	631	894	238	(1,425)
Net Income	24,060	32,706	28,521	35,720	20,149	6,553	22,176	6,921	17,092	34,412
Net Loss Ratio	71.4%	69.3%	70.7%	68.5%	73.3%	82.0%	73.5%	73.2%	74.6%	66.0%
Expense Ratio	27.7%	27.7%	27.6%	28.0%	28.3%	28.1%	28.1%	27.9%	27.2%	26.6%
Combined Ratio	99.7%	97.6%	98.8%	97.0%	102.2%	110.6%	102.1%	101.5%	102.4%	93.1%
Return on Revenue	8.3%	11.4%	10.3%	13.2%	8.0%	2.6%	9.1%	3.0%	6.8%	13.4%

	June 30,	December 31, 2007-2015								
	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Policyholders' Surplus	711,596	705,947	706,741	686,316	615,942	578,353	587,644	541,069	480,018	547,420
Return on Surplus	3.4%	8.1%	8.1%	10.7%	6.1%	3.1%	6.4%	5.9%	0.3%	11.9%

Summary of Market Conditions

Soft market conditions continue to be a concern in the U.S. property and casualty insurance industry, particularly the commercial market. According to The Council of Insurance Agents & Brokers, the Q2 2016 Commercial Property and Casualty Survey results showed that commercial rates once again decreased across all account sizes, with an overall average decrease of 3.9% in second quarter, following average declines of 3.7% in first quarter, 2.8% in fourth quarter 2015, and 3.1% in third quarter 2015. Further, results indicated that Commercial Property rates saw the greatest decrease in second quarter at 6%, followed by Workers' Compensation at 4.3% and General Liability at 3.6%. Commercial Auto and Employment Practices rates were the only lines that experienced rate increases in second quarter, by an average of 2.4% and 0.8%, respectively.

The decline in premium rates, while profit levels have been strong and sustainable, reflects the resilience of the U.S. property and casualty industry. This is largely due to the lack of large-scale loss events and the release of prior year reserves for several consecutive years and for which has aided the industry's bottom line. Ultimately, the higher profit margins have largely been retained on the balance sheets of insurers in order to fund future growth expectations. Since the 2008 economic crisis, policyholders' surplus has increased by 48.2% in aggregate to $711.6 billion at June 30, 2016. At the same time, growth in net writings has occurred at a more moderate rate of 17.8%. As a result of these changes, the overall capacity for insurers to take on more business strengthened to 74.5% for the trailing twelve month period compared to 93.0% in 2008, and significantly greater than the 133.2% recorded in 2002 (**Fig. 1**). In some respects, insurers are attempting to increase market share through mergers and acquisitions (M&A). M&A activity has been particularly strong during this period of strong capitalization, which has been a primary factor for the steady decline in filers (**Fig. 2**). The downward trajectory continued so far in 2016 with a net decline of 22 filers since the prior year-end, of which 13 were due to M&A.

Net Writings Leverage

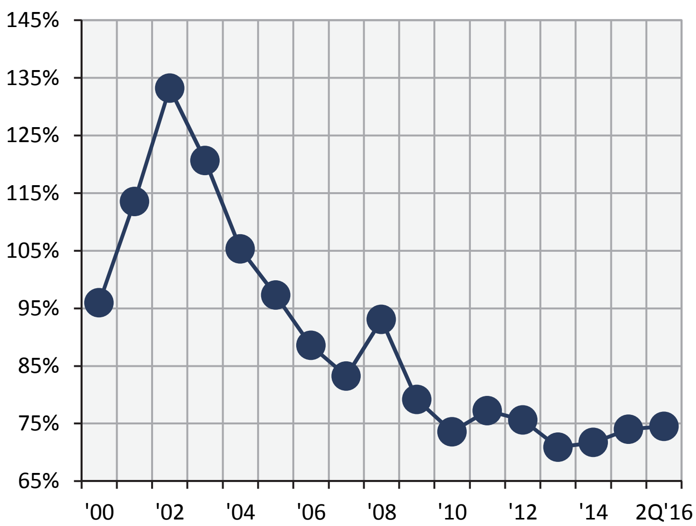

Fig. 1

No. of Property and Casualty Filers

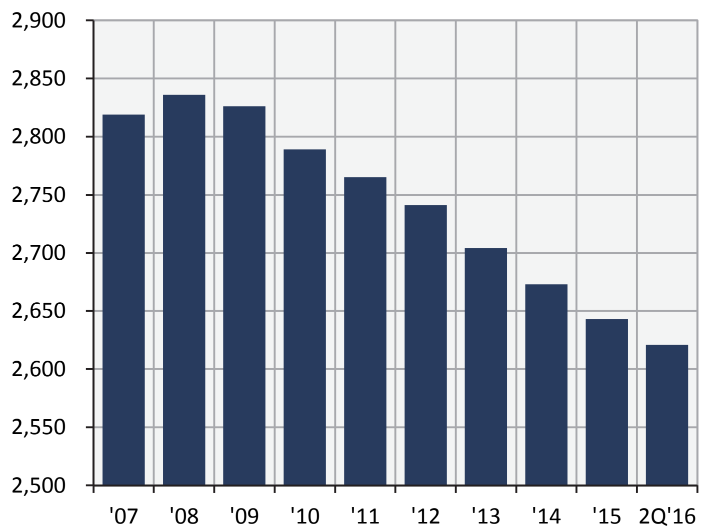

Fig. 2

Writings

Direct premiums written increased 3.9% to $306.9 billion in the first half of 2016 from $295.5 billion for the same period in 2015. Sequentially, direct writings have increased for 25 consecutive quarters over the same prior year quarters, with an overall average 3.7% growth rate during this period. All three markets, Personal, Commercial, and Combined Lines experienced direct premium growth in the current period.

Personal Lines

The Personal Lines Market experienced a 5.5%, or $8.1 billion increase in direct writings to $154.9 billion (50.5% of total direct writings). This was led by a 6.3%, or $3.8 billion increase in the Private Passenger Auto Liability line to $63.3

billion, followed by a 7.5%, or $3.3 billion increase in the Auto Physical Damage line to $46.8 billion, and a 2.6%, or $1.1 billion gain in Homeowners Multiple Peril line to $44.7 billion. On a sequential basis, Personal Lines direct writings have increased for 30 consecutive quarters, largely due to sustained growth in the Homeowners' line, whereby premiums have increased every quarter over prior year quarter since the first quarter of 2004 (50 consecutive periods).

Commercial Lines

In the Commercial Market, despite declining rates, direct writings increased 2.0%, or $2.2 billion YoY to $115.0 billion (37.5% of total direct writings). The increase primarily occurred in the top four lines: Other Liability—2.7%, Workers' Compensation—2.3%, Commercial Multiple Peril—0.7%, and Commercial Auto Liability—4.5%. Collectively these four lines comprised 82.5% of the Commercial Market premiums. On the other end of the spectrum, Ocean Marine premiums decreased for the fourth consecutive year, falling 15.6% to $2.0 billion from $2.3 billion prior year-to-date. The slide in Medical Professional Liability premiums may have bottomed at $4.9 billion, a 0.1% YoY gain, putting an end to nine consecutive declines at mid-year.

Combined Lines

The Combined Lines Market experienced a 3.0%, or $1.1 billion increase in direct writings to $37.0 billion (12.1% of total direct writings). Accounting for the majority of the increase were Allied Lines and Inland Marine, increasing 5.4% and 5.1%, respectively. Direct writings for Fire coverage fell 3.1% to $6.7 billion. Collectively, these three lines comprised 81.6% of the Combined Lines Market.

Geographic

Shown in **Table 2**, all but a few states and territories experienced YoY direct premium growth. On a percentage basis, the U.S. Virgin Islands, North Dakota, Montana and South Dakota all experienced double-digit increases, but from a dollar amount basis California, New York, and Florida were among the premium growth leaders. Texas topped all states in terms of direct losses paid—impacted by the severe storms in second quarter.

Net Writings

After cessions totaling $269.5 billion, net writings were 2.9% higher at $268.8 billion compared to $261.1 billion for the prior year-to-date.

Table 2. Direct Business by State, Territory

State/Territory	No. of Domestics	Total DPW	Market Share	Chg. in DPW	Direct Paid Loss
Alabama	16	4,098	0.7%	3.5%	2,066
Alaska	5	798	0.1%	(9.4%)	359
Arizona	51	5,060	0.8%	4.6%	2,745
Arkansas	11	2,436	0.4%	4.7%	1,597
California	99	36,115	5.9%	5.7%	18,670
Colorado	13	5,588	0.9%	6.3%	2,981
Connecticut	67	4,208	0.7%	2.8%	2,120
Delaware	101	1,143	0.2%	8.8%	530
Dist. of Columbia	42	883	0.1%	5.7%	334
Florida	128	24,307	4.0%	3.4%	11,448
Georgia	32	9,102	1.5%	6.8%	5,083
Hawaii	33	1,192	0.2%	3.5%	467
Idaho	9	1,306	0.2%	8.0%	617
Illinois	193	12,140	2.0%	(0.1%)	6,481
Indiana	67	5,379	0.9%	1.5%	2,859
Iowa	70	3,111	0.5%	3.2%	1,358
Kansas	25	3,077	0.5%	3.6%	1,399
Kentucky	10	3,555	0.6%	3.9%	1,998
Louisiana	29	5,641	0.9%	1.7%	3,189
Maine	9	1,079	0.2%	4.3%	471
Maryland	29	5,581	0.9%	6.7%	3,082
Massachusetts	44	7,099	1.2%	4.1%	3,527
Michigan	72	9,218	1.5%	2.1%	4,700
Minnesota	38	5,784	0.9%	5.5%	2,589
Mississippi	14	2,480	0.4%	2.8%	1,348
Missouri	48	5,404	0.9%	4.8%	3,046
Montana	15	1,108	0.2%	11.8%	667
Nebraska	32	2,282	0.4%	6.8%	1,250
Nevada	25	2,368	0.4%	6.6%	1,308
New Hampshire	48	1,166	0.2%	3.3%	521
New Jersey	67	10,436	1.7%	3.2%	5,928
New Mexico	13	1,560	0.3%	1.6%	933
New York	169	22,697	3.7%	3.8%	10,967
North Carolina	51	7,457	1.2%	5.6%	3,734
North Dakota	13	1,250	0.2%	12.1%	394
Ohio	132	7,878	1.3%	2.9%	3,716
Oklahoma	31	3,863	0.6%	(0.8%)	2,072
Oregon	18	3,166	0.5%	5.6%	1,622
Pennsylvania	162	11,731	1.9%	3.2%	7,296
Rhode Island	20	1,150	0.2%	3.5%	681
South Carolina	51	4,481	0.7%	6.0%	2,517
South Dakota	14	1,097	0.2%	10.5%	410
Tennessee	24	5,411	0.9%	3.9%	2,725
Texas	176	25,687	4.2%	3.3%	18,691
Utah	8	2,172	0.4%	5.8%	1,118
Vermont	105	782	0.1%	5.2%	281
Virginia	18	6,489	1.1%	4.0%	3,408
Washington	9	5,547	0.9%	4.8%	3,031
West Virginia	15	1,407	0.2%	(1.2%)	738
Wisconsin	115	5,315	0.9%	5.0%	2,313
Wyoming	2	537	<0.0%	(2.1%)	213
American Samoa	-	<1	<0.0%	(60.7%)	<1
Guam	8	156	<0.0%	(8.0%)	129
Puerto Rico	21	874	0.1%	(0.4%)	373
U.S. Virgin Islands	4	75	<0.0%	62.7%	19
N. Mariana Islands	-	8	<0.0%	7.0%	4

(in millions, except for percent data)

Underwriting Operations

The U.S. property and casualty insurance industry failed to maintain its three year trend of favorable mid-year underwriting results as a net underwriting loss of $180 million was recorded for the first six months of 2016 compared to an underwriting gain of $4.7 billion for the prior year period. Net premiums earned were higher by 3.6%, or $9.1 billion to $261.6 billion while aggregated net losses, LAE, and other underwriting expenses incurred increased at a higher rate of 5.7%, or $14.0 billion to $261.4 billion. The effect on the industry combined ratio was a 2.1-percentage point increase to 99.7%, represented by a 71.4% net loss ratio, 27.7% expense ratio and a 0.6% policyholders' dividend ratio. **Fig. 3** illustrates the industry underwriting performance for the last ten comparable periods.

As depicted in **Fig. 4**, the industry's current period underwriting results were negatively impacted by increased catastrophe losses. Insured losses from natural catastrophes totaled more than $11 billion for the first half of 2016 compared to the $8 billion reported mid-year 2015 (Source: Munich Re). The bulk of the losses ($8.8 billion) came from a series of storms in Texas and neighboring states that produced extensive hail and flood damage. According to the Federal Emergency Management Agency, a total of 12 events were declared major disasters throughout the United States during the first half of 2016, impacting the states shown in **Fig. 5**. There were 20 declared major disasters during the first half of 2015.

From a direct basis, the industry's overall pure direct loss ratio (PDLR) was slightly worse than a year ago, with a 1.8-percentage point deterioration to 59.2%. Direct premiums earned increased 4.1%, or $11.7 billion to $295.1, however it was surpassed by a 7.5%, or $12.2 billion rise in direct losses incurred to $174.8 billion. **Table 3** on the following page provides the breakout of the PDLR by line of business.

Personal Lines experienced a PDLR of 66.0%, a 3.1-percentage point increase over the prior mid-year period. The deterioration resulted from a 5.2% rise in direct premiums earned to $151.2 billion (50.7% of the total) that was exceeded by a 10.3% increase in direct losses incurred to $99.8 billion (55.6% of the total). All three Personal Lines PDLRs were worse than the prior year period, led by a 4.1-percentage point increase in the Private Passenger Auto Liability PDLR to 72.3%, fol-

Underwriting Income (through June 30)

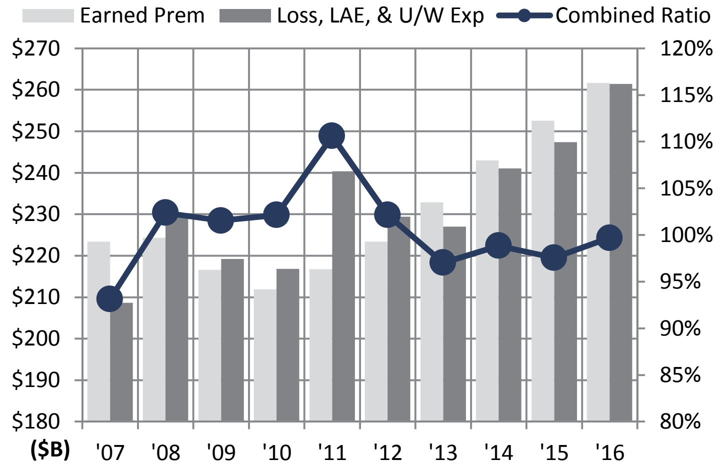

Fig. 3

Catastrophe Impact (through June 30)

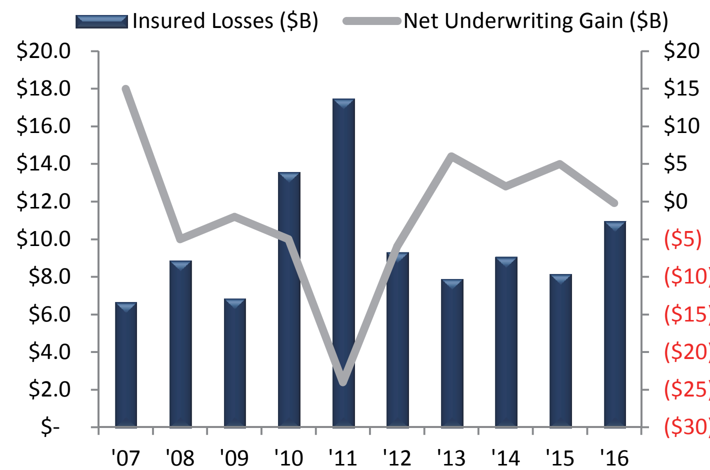

Fig. 4

Major Disaster Events (through June 30)
(Source: FEMA)

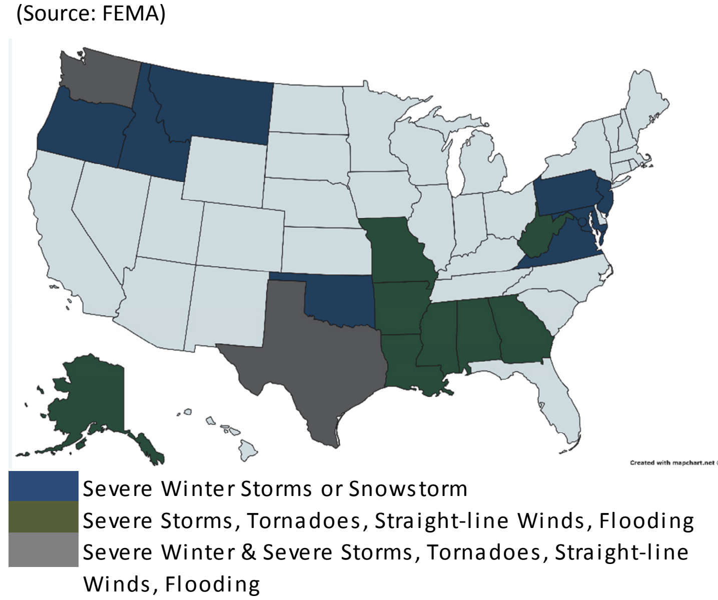

Fig. 5

lowed by a 3.2-percentage point rise in the Auto Physical Damage PDLR to 67.3% and a 1.3-percentage point increase to the Homeowners' Multiple Peril PDLR to 56.0%.

The Commercial Lines PDLR was nominally higher at 52.8% for the first half of 2016 compared to 52.6% for the first half of 2015. PDLRs for the top Commercial Lines included Workers' Compensation—54.2%, Other Liability—53.1%, Commercial Multiple Peril—51.2%, Commercial Auto Liability—64.4% and Medical Professional Liability—50.7%.

The PDLR for the Combined Lines Market rose 1.2-percentage points to 50.0% as a 5.5%, or $0.9 billion increase in direct losses incurred to $16.8 billion was met by a 3.0%, or $1.0 billion increase in direct premiums earned to $33.6 million. The top three Combined Lines: Allied Lines, Inland Marine and Fire accounted for 82.0% of total direct earned premiums within the Combined Lines. Allied Lines and Inland Marine recorded PDLR increases of 5.6– and 1.2-percentage points to 60.7% and 47.4%, respectively, while Fire coverage saw

Investment Income (through June 30)

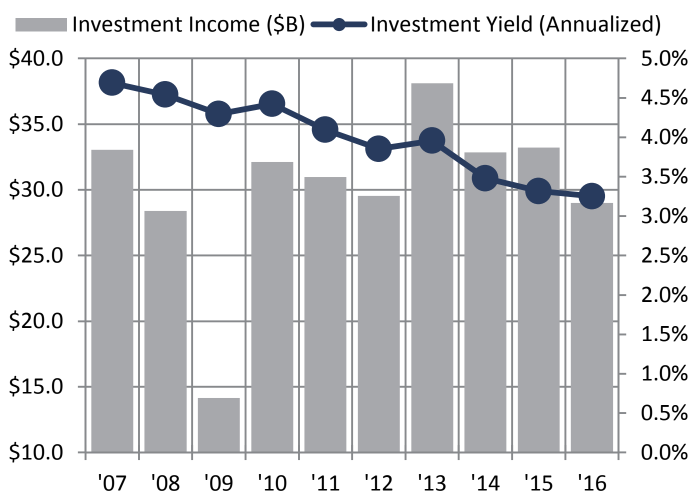

Fig. 6

Investment Operations

Industry investment profits totaled $29.0 billion for the first half of 2016, down 12.7% from a year earlier. The decline resulted from a 43.7% drop in realized capital gains to $4.8 billion and a 1.9% decline in net investment income earned to $24.2 billion. It was noted that this was the lowest mid-year investment income earned reported since 2004. The industry investment yield remained at a 10-year low of 3.3% (annualized).

Table 3. Pure Direct Loss Ratio by Line of Business

Market	Pt. Chg.	2Q16	2Q15	2Q14
Personal Lines	3.1-pts	66.0%	62.9%	62.9%
Commercial Lines	0.2-pts	52.8%	52.6%	54.2%
Combined Lines	1.2-pts	50.0%	48.8%	48.7%
Total	**1.8-pts**	**59.2%**	**57.4%**	**58.0%**

Personal Lines	Pt. Chg.	2Q16	2Q15	2Q14
Prvt Psgr Auto Liability	4.1-pts	72.3%	68.2%	64.7%
Homeowners MP	1.3-pts	56.0%	54.7%	57.9%
Auto Physical Damage	3.2-pts	67.3%	64.1%	65.5%

Commercial Lines	Pt. Chg.	2Q16	2Q15	2Q14
Workers' Compensation	(4.7)-pts	54.2%	58.9%	59.1%
Other Liability	2.1-pts	53.1%	51.1%	50.9%
Commercial Multiple Peril	2.9-pts	51.2%	48.3%	54.0%
Commercial Auto Liability	2.6-pts	64.4%	61.8%	62.4%
Medical Prof Liab	3.0-pts	50.7%	47.7%	49.3%
Ocean Marine	12.6-pts	50.1%	37.5%	36.5%
Surety	(0.2)-pts	17.9%	18.2%	17.2%
Group A&H	3.7-pts	67.0%	63.3%	65.7%
Farmowners Multiple Peril	0.5-pts	54.2%	53.7%	77.0%
Products Liability	(23.8)-pts	29.0%	52.8%	48.9%
Credit	14.2-pts	47.1%	32.9%	24.5%
Aircraft (all perils)	(3.0)-pts	52.8%	55.9%	57.0%
Boiler & Machinery	11.8-pts	40.0%	28.2%	34.7%
Fidelity	(12.7)-pts	35.0%	47.7%	46.7%
Excess Workers' Comp	(36.1)-pts	75.9%	112.1%	78.2%
Financial Guaranty	(0.5)-pts	28.9%	29.4%	79.3%
Burglary & Theft	(4.0)-pts	17.8%	21.8%	7.3%

Combined Lines	Pt. Chg.	2Q16	2Q15	2Q14
Allied Lines	5.6-pts	60.7%	55.1%	55.1%
Inland Marine	1.2-pts	47.4%	46.3%	45.0%
Fire	(3.3)-pts	46.6%	49.9%	47.7%
Mortgage Guaranty	(8.5)-pts	20.4%	28.9%	38.3%
Other A&H	8.6-pts	145.1%	136.5%	106.3%
Warranty	(4.3)-pts	55.1%	59.4%	67.7%
Earthquake	(0.5)-pts	0.2%	0.7%	1.7%
Aggregate Write-Ins	6.9-pts	45.9%	39.0%	42.7%
Credit A&H	2.5-pts	16.0%	13.5%	10.9%
International	66.4-pts	17.1%	(49.3%)	72.6%

In December 2015, the U.S. Federal Reserve (Fed) made its first rate increase in nearly a decade and hinted at the possibility of up to an additional 4 increases over the next two years. The projected rate hikes are intended to gradually increase investment returns and trigger an upward trend in industry yields. As of its September 2016 meeting, the Fed is still waiting for the right moment to approve the next increase. Policymakers commented that while the case for a rate increase has strengthened as the labor market continues to improve and economic activity is strengthened, further evidence is needed to support movement in inflation toward the Committee's 2 percent objective. It was noted the decision to hold the federal funds rate was not an unanimous decision, 3 out of 10 Committee members did vote for a rate increase, which leads investment strategists to suggest an imminent rate hike in December, barring any major changes to market conditions.

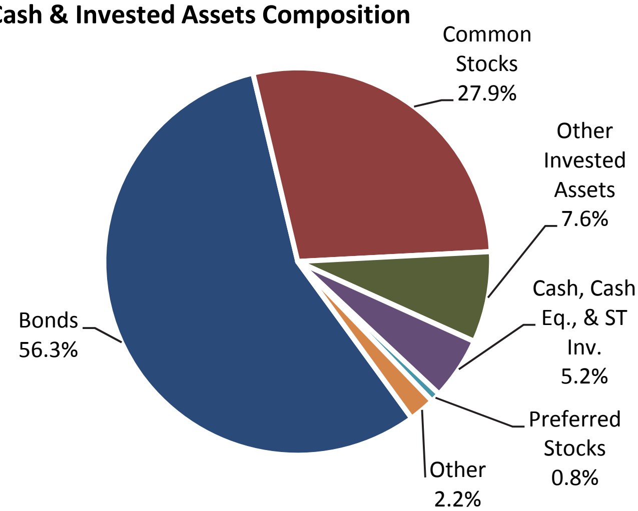

Fig. 7

Fig. 7, shows the industry's cash and invested assets allocation. As seen, bonds comprised the majority of cash and invested assets totaling $984.7 billion, which equated to 56.3% of total cash and invested assets. This was followed by common stocks of $488.1 billion (27.9% of total cash and invested assets), of which $248.3 billion or 50.9% was comprised of affiliated common stocks.

Net Income

Ultimately, the turnaround in underwriting performance and suppressed investment income led to a 26.4% or $8.6 billion decline in the industry's net profit to $24.1 billion. Return on revenue—a measure of net income to net premiums earned, net investment income earned, and realized capital gains (losses)— worsened 3.2-percentage points over the prior mid-year period to 8.3% and was slightly below the 10-year average of 8.6%.

Policyholders' Surplus

Industry aggregated policyholders' surplus (adjusted for affiliated investments) increased 0.8% since the prior year-end to a new all time high of $711.6 billion at June 30, 2016 (**Fig. 8**). The increase was mostly attributable to net income of $24.1 billion, unrealized capital gains of $1.9 billion, and $1.3 billion in paid-in surplus, which was partially offset by $14.8 billion in stockholder dividends. Return on surplus—a measure of net income and unrealized capital gains (losses), to average policyholders' surplus—was 3.4% through the first six months of 2016.

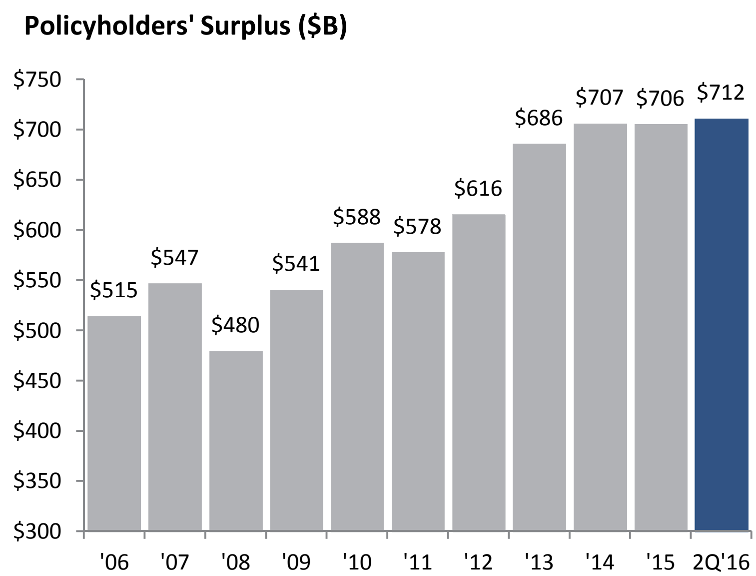

Fig. 8

Cash & Liquidity

Net cash provided by operating activities totaled $26.6 billion for the first six months of 2016 compared to $22.9 billion for the same period in 2015

(**Fig. 9**). The improvement was ascribed to higher net premiums earned that translated into an increase in premiums collected, which in turn led to 3.6% rise in cash inflows to $290.4 billion. Cash outflows increased at a lesser rate of 2.5% to $263.8 billion as rising benefit and loss related payments and commissions and expenses paid were partly offset by a decline in income taxes paid. Net cash used by investing activities totaled $13.3 billion and net cash used by financing and miscellaneous sources was $13.4 billion. Ultimately, cash and short-term investments decreased $61.8 million through mid-year.

Liquidity worsened 1.2-percentage points, however remained very strong at 80.0% at June 30, 2016 as liquid assets totaled $1.3 trillion and adjusted liabilities totaled $1.1 trillion.

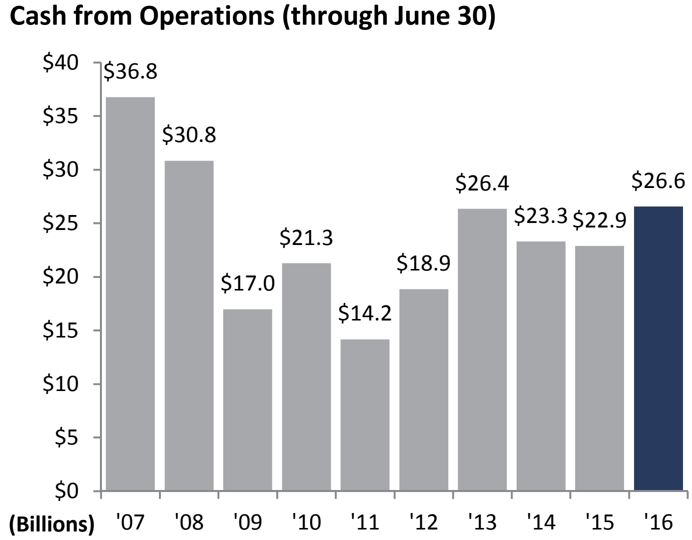

Fig. 9

Loss & LAE Reserves

Loss and LAE reserves decreased 1.4%, or $8.8 billion since the prior year-end to $626.7 billion at June 30, 2016, whereby $515.2 billion were unpaid losses and $111.5 billion unpaid LAE (**Fig. 10**). Reserve leverage edged higher, but remained relatively low at 88.1% compared to 87.5% at year-end 2015.

Fig. 11, shows the one-year and two-year loss reserve development from 2007 through 2015 and the net loss reserve development through June 2016. As shown, the trend in net favorable loss reserve development continued with an overall redundancy of $6.9 billion through mid-year, which consisted of a $25.0 billion deficiency in prior year known case loss and LAE reserves, that was offset by a $31.9 billion redundancy in prior year IBNR loss and LAE reserves. There were 1,105 insurers that experienced net favorable loss reserve development in the first half of 2016, down from 1,237 insurers reporting favorable development for the same period last year. With respect to net unfavorable loss reserve development, 779 insurers experienced deficiencies in the first half of 2016 compared to 674 insurers this time last year.

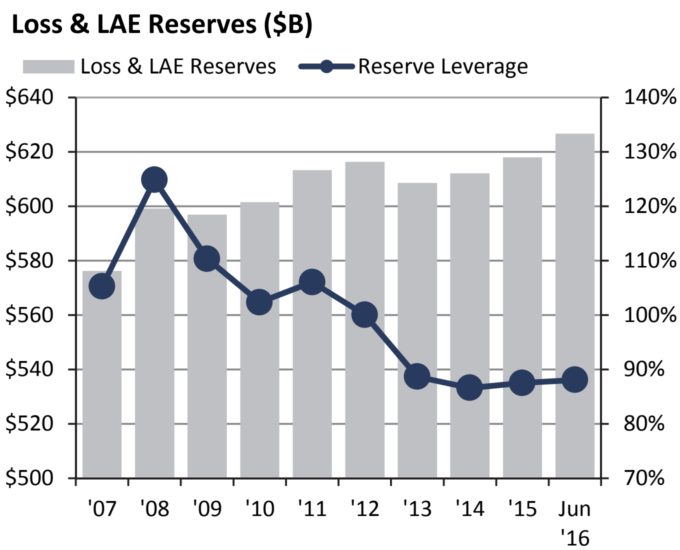

Fig. 10

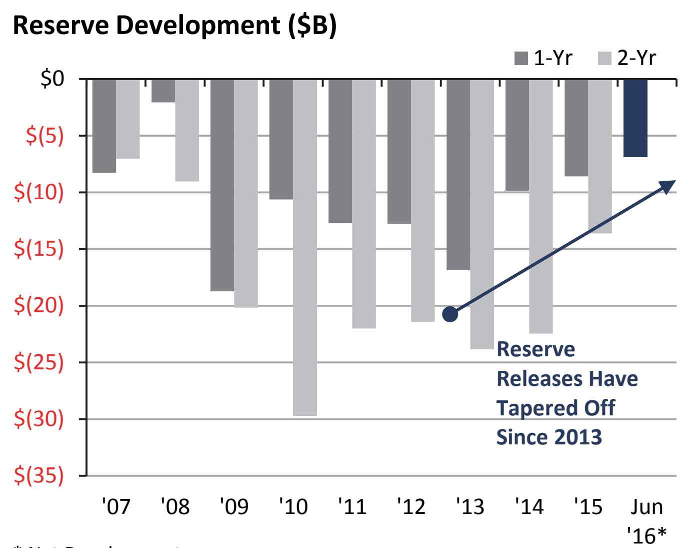

Fig. 11

DISCLAIMER: The NAIC 2016 Mid-Year U.S. Property and Casualty Insurance Industry Report is a limited scope analysis based on the aggregated information filed to the NAIC's Financial Data Repository as of June 30, 2016, and written by the Financial Regulatory Services Department staff. This report does not constitute the official opinion or views of the NAIC membership or any particular state insurance department.