

***Insurance Times***: A year to forget for P&C  
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The property/casualty insurance industry officially recorded its first-ever net loss after taxes in 2001, stemming from sharply higher underwriting losses and substantial deterioration in investment results, according to the industry's Insurance Services Office (ISO).

ISO reported that the industry lost \$7.9 billion in 2001, after earning \$20.6 billion in 2000. The industry's GAAP rate of return on average net worth fell to negative 1.4 percent in 2001 from 5.9 percent the year before.

Reflecting the net loss after taxes and unrealized capital losses on investments, the industry's surplus declined 8.7 percent to \$289.6 billion at year-end 2001 from \$317.4 billion at year-end 2000. The 8.7 percent decline in surplus in 2001 followed a 5.1 percent decline in 2000. The back-to-back declines in surplus were the first since 1984, when surplus declined 3.1 percent, and the largest since 1974, when surplus declined 23.9 percent.

The industry's net loss on underwriting after dividends to policyholders ballooned 69.7 percent to a record \$53 billion in 2001 from \$31.2 billion the year before. The industry's statutory combined ratio — a key measure of losses and expenses per dollar of premium — worsened by 5.9 percentage points to 116 percent last year from 110.1 percent in 2000. The combined ratio for 2001 was the third worst on record.

Compounding the effects of sharply higher underwriting losses, the industry's net investment income dropped a record 8.9 percent last year to \$37.1 billion. Insurers' realized capital gains on investments fell 57.5 percent to \$6.9 billion. In addition, insurers suffered \$17.7 billion in unrealized capital losses not included in income. Combining realized capital gains and unrealized capital losses, insurers' overall capital losses in 2001 amounted to \$10.8 billion — nearly five times the \$2.3 billion in capital losses in 2000.

The sharp increase in the industry's net loss on underwriting occurred as overall loss and loss-adjustment expenses (LLAE) rose 15.6 percent to \$276.1 billion in 2001 from \$238.8 billion the year before.

Combining an estimated \$9 billion in LLAE from the attack on September 11 with \$7.5 billion in other catastrophe losses, insurers incurred \$16.5 billion in catastrophe losses in 2001 — nearly four times the \$4.6 billion in catastrophe losses in 2000.

Estimates of the ultimate cost of the terrorist attack on September 11, 2001, range from \$30 billion to \$70 billion.

"Using the midpoint of that range, \$50 billion, and excluding losses covered by foreign insurers, U.S. insurers may ultimately face \$25 billion in net underwriting losses from the attack," said John J. Kollar, ISO's vice president for consulting and research.

"But ISO's analysis of statutory financial statements indicates that U.S. insurers included only about \$10 billion of net underwriting losses from the attack in their results through year-end 2001. This means U.S. insurers may be hit with another \$15 billion in losses from the terrorist attack on September 11," added Kollar.

ISO noted that insured catastrophe losses, including those from the September 11 terrorist attack, were responsible for only part of the deterioration in underwriting results. Other contributing factors included a 10.9 percent increase in noncatastrophe loss and loss-adjustment expenses. An increase in environmental and asbestos (E&A) losses and strengthening of the industry's reserves for losses other than E&A contributed to the growth in loss-adjustment expenses.

ISO's preliminary analysis of LLAE reserves as of year-end 2001 suggests that the insurance industry strengthened its reserves for losses other than E&A by between \$1 billion and \$7 billion in 2001. But even with that strengthening, ISO estimates that the industry's reserves for losses other than E&A were deficient by between \$25 billion and \$45 billion as of year-end 2001, excluding any deficiency or redundancy in reserves for losses from the terrorist attack on September 11.

The record 8.9 percent decrease in net investment income is the result of two developments. The yield on insurers' cash and invested assets fell to 4.7 percent in 2001 from 5.1 percent in 2000, as interest rates declined. Also, insurers' average holdings of cash-invested assets declined 0.9 percent to \$786.7 billion.

The industry's \$10.8 billion in overall capital losses on investment in 2001 reflects the weakness in stock markets during the year. Insurers' holdings of common stocks depreciated 8.2 percent in 2001, as the S&P 500 declined 13 percent.

"In recent years, swings in catastrophe losses, E&A losses and possible changes in the adequacy of reserves for other losses have all had a significant effect on insurers' reported financial results," observed Kollar.

When data are adjusted for catastrophes, E&A losses and changes in reserve adequacy, the industry's recent financial results appear notably better. The industry's adjusted combined ratio improves to 109.9 percent in 2001 from 114.4 percent in 2000, as the combined ratio based on reported results rose to 116.0 percent from 110.1 percent.

Kollar observed another bright spot in the industry's otherwise bleak performance. Premium growth accelerated to 8.1 percent in 2001 from 5.3 percent in 2000, 1.9 percent in 1999, and a record-low 1.8 percent in 1998.

ISO data on rates of renewals indicate that broad-based firming in commercial insurance markets has contributed to the acceleration in premium growth. Commercial markets began to firm in mid-1999 and increases in rates on renewals have gathered momentum ever since, Kollar said. In particular, rates on renewals for commercial lines fell an average of 2.3 percent in 1998, but then rose an average of 0.1 percent in 1999, 5.2 percent in 2000, and 8.9 percent in 2001, Kollar said.

Kollar also pointed out that these countrywide numbers mask significant differences by line, location and class of business. Also, commercial lines premium growth over the past five years varied widely by standard industrial classification. For example, from 1997 to 2001, commercial lines premiums for the SIC codes representing a range of "old economy" industries, such as textile mill products, coal mining and forestry, decreased between 2.1 percent and 7.8 percent per year.

Despite the acceleration in premium growth, surplus declined \$27.7 billion in 2001. Deductions from surplus last year included the \$7.9 billion net loss after taxes, \$17.7 billion in unrealized capital losses, \$10.9 billion in dividends to shareholders, and \$2.8 billion in miscellaneous charges against surplus. Those deductions were only partially offset by a record \$11.6 billion in new funds paid in. p