

Perspectives

NOVEMBER 2019

OUR VIEW ON INSURANCE CAPITAL MANAGEMENT TOPICS

IN THIS ISSUE ►

Underwriting Market Leaders
[Page 2](#)

Investment Market Leaders
[Page 3](#)

For more information on this topic,
 contact the author:



Jim Bachman

Head of Enterprise Capital
 Return & Risk Management
jim.bachman@neamgroup.com

neamgroup.com

Don't Uncork the Champagne: 2018 P&C (Investment) Results

This year's P&C *Perspectives* highlights 2018 industry financial performance, an update to *Underwriting Leaders'* insurance outcomes and an introduction to *Investment Leaders'* metrics and results.

A cursory view of industry results presents a picture of improvement:

- The largest increase in net premiums (10.7%) in 16 years
- A reduction in the combined ratio to better than breakeven (99.3%)
- Investment income growth at its highest level (14.7%) in the recent past
- A continued high level of policyholder surplus

A more thorough review reveals:

- A sharp reduction in ceded premiums masking a nominal 5% increase in direct premiums
- The combined ratio improvement due to a halving of insured catastrophe losses and aided by continued favorable prior year reserve development¹
- Growth in earned investment income primarily due to affiliated asset returns and record operating cash flow
- Improved book yields that were illusory, a false positive, driven by maturities and sales of lower yielding securities
- Industry return on average statutory capital remaining near its longer-term (low) average

Underwriting and investment results show continued wide variation among insurers with industry market leaders recording resilient results.

FINANCIAL HIGHLIGHTS

Recent History and Trends

Net premiums written increased over 10%, but in large part due to a significant reduction in ceded reinsurance premiums from the prior year. Return on equity (ROE) increased due to improved underwriting results, led by a reduction in the combined ratio and an uptick in investment earnings largely attributable to affiliated investments. Regardless of the sources of the investment earnings, the increase is welcome albeit the current level barely eclipses pre-crisis levels when the asset base was 70% of 2018 levels.

Although industry ROE increased, it remains in the mid-single digits. Capital and surplus growth faltered due to the Q4 2018 equity market sell-off. Operating leverage (premium-to-capital ratio) reversed a 35-year decline, but for the wrong reasons: an aberrant increase in net written premiums and a decline in equity markets. Shareholder dividends and other net capital withdrawals and contributions remained in line with the last 10 years' levels. Chart 1 summarizes the results.

Chart 1. Reported Industry Financial Results

Metrics (\$B)	2003	2007	2012	2017	2018
Direct Premiums Written	\$447.7	\$510.9	\$523.9	\$642.5	\$677.9
Ceded Reinsurance Premiums	-43.4	-64.0	-62.8	-84.1	-59.9
Net Premiums Written	404.3	446.9	461.2	558.4	618.0
Combined Ratio %	100.2	95.6	103.2	103.9	99.3
Insured Catastrophe Losses	12.9	6.7	35.0	101.9	47.5
Investment Earnings	39.7	56.5	50.3	49.7	56.9
Net Income	30.0	63.6	38.4	40.6	60.9
Return on Average Equity %	9.5	12.4	6.6	5.5	8.0
Cash From Operations	69.4	71.5	40.0	52.4	84.3
Total Cash and Investments	959.6	1287.7	1389.4	1691.4	1698.3
Affiliated Investments	62.5	108.6	148.0	202.2	191.6
Capital and Surplus	355.2	529.1	595.2	765.4	752.9
Net Capital Withdrawals	-9.1	-33.5	-28.6	-29.6	-30.3
Leverage					
Premium/Capital	1.14	0.84	0.77	0.73	0.82
Invested Assets/Capital	2.70	2.43	2.33	2.21	2.26

Source: NEAM, S&P Global Market Intelligence

Underwriting Market Leaders

Despite the vagaries of catastrophe losses and insurance market cycles, there are underwriting leaders that consistently outperform industry metrics (see Chart 2). These companies are a mixture of large, publicly-traded and often global companies and small regional domestic mutuals². They were deemed to have achieved superior results by outperforming industry median results for each of the following three key criteria in each of three most recent periods: three, five and 20 years.

- Premium growth
- Combined ratio
- Combined ratio volatility

Chart 2. Industry Market Leaders in Underwriting Performance

Company/Group	2018 NWP (\$B)	Company/Group	2018 NWP (\$B)
1. Berkshire	50.25	10. West Bend Mutl	1.17
2. Progressive	32.61	11. Navigators	1.09
3. Auto-Owners	7.80	12. SECURA Mutl	0.62
4. Tokio Marine	6.44	13. Vermont Mutl	0.45
5. W.R. Berkley	5.72	14. Ocean Harbor	0.29
6. Cincinnati Cos.	5.03	15. Ohio Mutl	0.25
7. Markel	3.12	16. Nodak Mutl	0.23
8. Selective	2.51	17. Pioneer State Mutl	0.23
9. ACUITY Mutl	1.47	18. Jewelers Mutl	0.22

Source: NEAM, S&P Global Market Intelligence

Chart 3 contrasts market leaders' underwriting performance to industry outcomes. The results are impressive, displaying stark differences in all categories: premium growth, reported combined ratio, and combined ratio volatility.

Chart 3. Industry Underwriting Market Leaders Group Average Compared to Industry Aggregates

Cohort	Premium Growth			Combined Ratio Reported			Combined Ratio Volatility		
	20-Year	10-Year	5-Year	20-Year	10-Year	5-Year	20-Year	10-Year	5-Year
Leaders Average	7.6%	6.7%	7.4%	95.4	94.8	92.9	6.4	4.4	2.3
Industry Median	5.1%	4.2%	4.5%	100.2	99.7	98.7	10.4	8.4	5.8
Industry Average	5.3%	5.9%	4.7%	100.5	99.6	98.6	20.0	15.5	11.2
Industry Composite	4.3%	4.8%	6.1%	100.9	100.1	99.2	9.3	6.1	4.6

Source: NEAM, S&P Global Market Intelligence

Investment Market Leaders

The initial approach to determine investment leadership focused on total return and volatility across all publicly-held securities within our industry-wide company level cusip database for the most recent three, five, 10 and 14 years. The analysis proved too difficult due to data limitations, the diversity of investment objectives and changing asset allocations: it netted only one company.

Accordingly, we opted for another approach, one addressing only fixed income and focusing on after-tax book yield and market risk defined as option adjusted credit duration. The leadership board is shown in Chart 4 below.

Chart 4. Industry (Fixed Income) Investment Market Leaders

Company/Group	Fixed Income (\$B)	Company/Group	Fixed Income (\$B)
1. USAA	19.59	11. Alaska National	0.68
2. Auto Owners	14.15	12. Builders Mutual	0.59
3. Employers	2.42	13. SFM Mutual	0.50
4. Argo	2.29	14. Farmers Mutl (NE)	0.48
5. ICW	2.23	15. Germania	0.41
6. FCCI	1.46	16. Ohio Mutual	0.36
7. Texas Farm Bureau	1.30	17. Phil. Contributionship	0.17
8. AMERISAFE	1.09	18. American Access	0.15
9. SECURA	0.81	19. New London County	0.12
10. Medical Mutual (MD)	0.72	20. Atlantic Charter	0.11

Source: NEAM, S&P Global Market Intelligence

There are 20 companies surpassing the industry median company performance benchmark. The group is less diverse than the underwriting leaders group. The companies tend to be small to medium size with a nearly exclusive U.S. focus - mostly mutual and reciprocals with either a targeted customer demographic and/or specialty or monoline products. As shown in Chart 5, they soundly outperform industry and average returns, and all industry categories for risk metrics.

Chart 5. Industry Investment Market Leaders Group Average compared to Industry Aggregates

Cohort	After-tax Book Yield				Risk (Option Adjusted Credit Duration)			
	14-Yr	10-Yr	5-Yr	3-Yr	14-Yr	10-Yr	5-Yr	3-Yr
Leader Average	3.02	2.83	2.54	2.49	3.60	3.77	3.75	3.79
Industry Average	2.76	2.50	2.26	2.28	3.88	4.13	4.30	4.33
Industry Median	2.75	2.51	2.22	2.23	3.82	4.08	4.26	4.26
Industry Composite	3.07	2.83	2.55	2.54	4.14	4.32	4.47	4.53

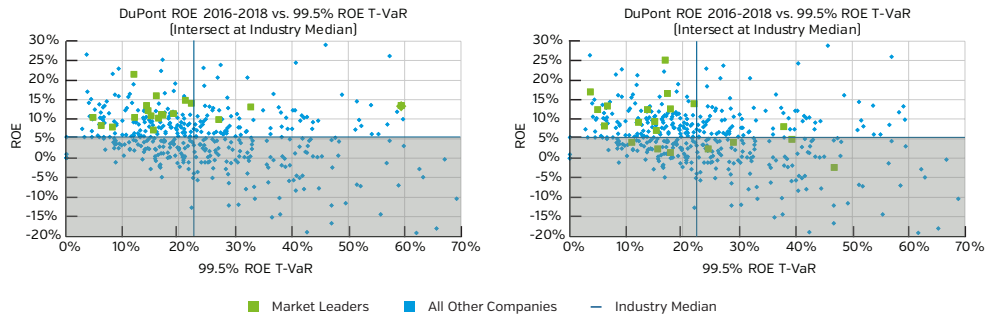
Source: NEAM, S&P Global Market Intelligence

As shown in Chart 6 below, industry *underwriting* leaders are well-positioned with their superior underwriting results to *most often* drive the most favorable enterprise ROE performance to support favorable AM Best ratings. All but three leaders cluster in the northwest quadrant of the left-hand chart and all exceed industry median ROE estimates.³

Charts 6. and 7. ROE and Estimated ROE T-VaR (% of Capital)

Underwriting Leaders - Very Favorable ROE Impact

Investment Leaders - “The Little Engine That Couldn’t”



Source: NEAM, S&P Global Market Intelligence

Industry investment leaders have a less direct impact on a favorable ROE as shown in the right-hand chart above, wherein several companies' estimated ROE is below the industry median [suggesting less favorable underwriting results]. However, the clustering in the northwest corner of the chart indicates a very favorable contribution for some companies.

WHAT'S NEXT?

This lead *Perspectives* highlights variations among insurers underwriting and investment results and the impact on historic return on equity. Visit www.neamgroup.com/insights/2018highlights to access the full report of 2018 investment results and read evolving trends in industry investment practices, which might impact your assessment of your investment outcomes.

ENDNOTES

¹ 2018 insured U.S. catastrophe losses reported by Insurance Information Institute (I.I.I.) totaled \$48B down from 2017 estimated loss of \$102B, yet double the 10-year average excluding 2017 all-time high amount.

² Results reflect only U.S. Statutory Statement reported results.

³ The Green dots represent the 480 largest P&C entities accounting for over 97% of industry assets. The Blue dots are industry leaders.



neamgroup.com

Connecticut | California | Dublin | London

© 2019 New England Asset Management, Inc.

All rights reserved. This publication has been prepared solely for general informational purposes and does not constitute investment advice or a recommendation with respect to any particular security, investment product or strategy. Nothing contained herein constitutes an offer to provide investment or money management services, nor is it an offer to buy or sell any security or financial instrument. While every effort has been made to ensure the accuracy of the information contained herein, neither New England Asset Management, Inc. ("NEAM, Inc.") nor New England Asset Management Limited (together, "NEAM") guarantee the completeness, accuracy or timeliness of this publication and any opinions contained herein are subject to change without notice. This publication may not be reproduced or disseminated in any form without express written permission. NEAM, Inc. is an SEC registered Investment Advisor located in Farmington, CT. This designation does not imply a certain level of skill or training. In the EU this publication is presented by New England Asset Management Limited, a wholly owned subsidiary of NEAM, Inc. with offices located in Dublin, Ireland and London, UK. New England Asset Management Limited is regulated by the Central Bank of Ireland. New England Asset Management Limited is authorised by the Central Bank of Ireland and subject to limited regulation by the Financial Conduct Authority. Details about the extent of our regulation by the Financial Conduct Authority are available from us on request. This is not an offer to conduct business in any jurisdiction in which New England Asset Management, Inc. and New England Asset Management Limited are not registered or authorized to conduct business.