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P/C INSURERS' NET INCOME AND SURPLUS ROSE THROUGH NINE-MONTHS 2007 AS UNDERWRITING GAINS DROPPED AND OVERALL PROFITABILITY SLIPPED

JERSEY CITY, N.J., Dec. 19, 2007 — The U.S. property/casualty insurance industry's net income after taxes rose 7.1 percent to $49.4 billion through nine-months 2007 from $46.1 billion through nine-months 2006. Fueled by the industry's net income, policyholders' surplus — insurers' net worth measured according to Statutory Accounting Principles — increased $35.6 billion to $521.8 billion at September 30, 2007, from $486.2 billion at year-end 2006.

But the insurance industry's overall profitability as measured by its annualized rate of return on average policyholders' surplus slipped to 13.1 percent in the first nine months of 2007 from 13.8 percent in the first nine months of 2006 as underwriting results deteriorated. Net gains on underwriting fell 25.3 percent to $18.1 billion through nine-months 2007 from $24.3 billion through nine-months 2006. The combined ratio — a key measure of losses and other underwriting expenses per dollar of premium — worsened to 93.8 percent in the first three quarters of 2007 from 91.5 percent in the first three quarters of 2006, according to ISO and the Property Casualty Insurers Association of America (PCI).

The figures are consolidated estimates for all private property/casualty insurers based on reports accounting for at least 96 percent of all business written by private U.S. property/casualty insurers.

Underwriting Results

"Despite the deterioration in underwriting results, the 93.8 percent combined ratio for nine-months 2007 is the second best for the first nine months of any year since 1986, when ISO's quarterly records begin. Even so, underwriting results weren't good enough for insurers to achieve the rate of return typically earned by firms in other industries," said Michael R. Murray, ISO assistant vice president for financial analysis. "With nine-month 2007 investment results, financial leverage, and tax rates, ISO estimates that the combined ratio would have had to be more than a full percentage point better — 92.6 percent — in order for insurers to have earned the 13.9 percent long-term average rate of return for the Fortune 500. Moreover, with today's low interest rates and investment yields, insurers must now post significantly better underwriting results just to be as profitable as they once were. For example, insurers' 93.8 percent combined ratio for nine-months 2007 was 14.2 percentage points better than their combined ratio for nine-months 1986. But even with that much improvement in underwriting results, insurers' 13.1 percent annualized rate of return for nine-months 2007 was 1.8 percentage points below insurers' annualized rate of return for nine-months 1986."

The deterioration in underwriting reflects weakness in written premiums as a result of escalating competition in insurance markets. Net written premiums were essentially unchanged at $337.6 billion in both nine-months 2007 and nine-months 2006, with written premium growth dropping to zero percent in the first nine months of 2007 from 5.1 percent in the first nine months of 2006.

Net earned premiums rose $4.1 billion to $329.3 billion in nine-months 2007 from $325.1 billion in nine-months 2006, but earned premium growth slowed to 1.3 percent in nine-months 2007 from 4.7 percent in nine-months 2006.

“Based on data extending back two decades, the zero percent increase in written premiums in nine-months 2007 would have been a record low if one insurer had not ceded $6 billion in premiums to its foreign parent back in nine-months 2005,” said Genio Staranczak, PCI chief economist. “And even with that special transaction depressing premiums for nine-months 2005, written premium growth through nine-months 2007 exceeded that through nine-months 2005 by only 0.2 percentage points.”

“Despite ongoing problems in some coastal property insurance markets, government data suggests that escalating competition is cutting into premium growth,” noted Murray. “All else being equal, one would expect premiums to rise as the economy grows and inflation increases the amount of insurance people need. But written premiums through nine-months 2007 were the same as written premiums through nine-months 2006, even though the nation’s gross domestic product [GDP] increased 4.8 percent. Moreover, in November 2007, the consumer price index [CPI] for tenants’ and household insurance fell 1.1 percent compared with its level a year earlier, as the CPI for all items increased 4.3 percent and the CPI for repair of household items climbed 4.5 percent. The CPI for motor vehicle insurance did increase 0.2 percent in November 2007, but the CPI for motor vehicle repairs rose 3.5 percent and the CPI for medical care rose 5 percent.”

Though net written premiums were flat, overall net loss and loss adjustment expenses (after reinsurance recoveries) increased $7.3 billion, or 3.4 percent, to $219.6 billion through nine-months 2007 from $212.3 billion through nine-months 2006. Excluding catastrophe losses, ISO estimates that net loss and loss adjustment expenses increased $12.5 billion, or 6.2 percent, to $214.5 billion in the first nine months of 2007 from $202 billion in the first nine months of 2006.

Overall loss and loss adjustment expenses rose despite a decline in catastrophe losses. According to ISO’s Property Claim Services (PCS) unit, catastrophes occurring in the first nine months of 2007 caused $4.8 billion in direct insured losses to property (before reinsurance recoveries) — down from the $7.8 billion in direct insured losses to property caused by catastrophes occurring in the first nine months of 2006. Including additional development of losses from the catastrophic hurricanes of 2005, ISO estimates that the net catastrophe losses included in insurers’ financial results through nine months fell to $5 billion in 2007 from $10.3 billion in 2006.

Premium growth also failed to keep pace with growth in other underwriting expenses — primarily acquisition expenses, expenses associated with underwriting, pricing and servicing insurance policies, and premium taxes — and dividends to policyholders. Other underwriting expenses rose $2.9 billion, or 3.4 percent, to $90.4 billion in nine-months 2007 from $87.5 billion in nine-months 2006. Dividends to policyholders grew $0.1 billion, or 6.9 percent, to $1.2 billion in nine-months 2007 from $1.1 billion in nine-months 2006.

The $18.1 billion net gain on underwriting through nine-months 2007 amounts to 5.5 percent of the $329.3 billion in net premiums earned during the period, whereas the $24.3 billion net gain on underwriting through nine-months 2006 amounted to 7.5 percent of the $325.1 billion in net premiums earned during that period.

Investment Results

The industry’s net investment income — primarily dividends from stocks and interest on bonds — grew $2 billion, or 5.4 percent, to $39.5 billion in nine-months 2007 from $37.5 billion in nine-months 2006. Realized capital gains on investments (not included in net investment income) more than quadrupled, rising to $8.2 billion in nine-months 2007 from $1.5 billion in nine-months 2006. Combining net investment income and realized capital gains, overall net investment gains climbed 22.5 percent to $47.7 billion in nine-months 2007 from $39 billion in nine-months 2006.

Combining the $8.2 billion in realized capital gains in nine-months 2007 with $6.2 billion in unrealized capital gains during the period, insurers posted $14.4 billion in overall capital gains in the first nine months of 2007 — up $1 billion, or 7.2 percent, from the $13.5 billion in overall capital gains in the first nine months of 2006.

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"The 5.4 percent increase in property/casualty insurers' net investment income in nine-months 2007 is the result of two partially offsetting developments," said Staranczak. "Insurers' average holding of cash and invested assets rose 7.9 percent. But the annualized yield on insurers' cash and invested assets fell to 4.24 percent in nine-months 2007 from 4.34 percent in nine-months 2006, as the average yield on ten-year Treasury notes dropped to 4.75 percent from 4.85 percent. Prospectively, we may see slowing in the growth of investment income as softening prices in insurance markets cut into premiums and the cash available to fund new investments. In addition, the Federal Reserve has cut its target for a key benchmark interest rate — the federal funds rate — three times since September 18, with the most recent cut coming on December 11. Together, the three cuts reduced the federal funds rate from 5.25 percent to 4.25 percent. If continuing problems in subprime credit markets and weakness in the economy lead to further cuts in interest rates, lower yields will likely take a bite out of insurers' investment earnings."

"The 7.2 percent increase in insurers' total capital gains in nine-months 2007 reflects developments in financial markets," said Murray. "Stock prices as measured by the S&P 500 increased 7.6 percent in the first nine months of 2007, with the rate of increase in the S&P 500 climbing from 7 percent in the first nine months of 2006. Going forward, the S&P 500 fell 5.3 percent from September 30 through December 17, and other major stock indexes — such as the New York Stock Exchange and NASDAQ composites and the Dow Jones Industrial Average — also fell during the period. This suggests insurers' results for fourth-quarter 2007 won't benefit from capital gains on stocks. But insurers' investments in bonds far exceed their investments in stocks, and bond prices rose as the yield on ten-year Treasury notes fell to 4.24 percent on December 14 from 4.59 percent at the end of third-quarter 2007. If insurers elect to realize gains on bonds in the fourth quarter, they may post overall capital gains for the period. Beyond this, any forecast for insurers' capital gains is only as good as the underlying forecasts for stock prices and interest rates."

Pretax Operating Income
Pretax operating income — the sum of net gains or losses on underwriting, net investment income, and miscellaneous other income — fell 8.7 percent to $56.6 billion in nine-months 2007 from $62 billion in nine-months 2006. The $5.4 billion decline in operating income is the net result of the $6.2 billion decline in net gains on underwriting, the $2 billion increase in net investment income, and a $1.2 billion decline in miscellaneous other income to negative $1 billion in nine-months 2007 from positive $0.2 billion in nine-months 2006. The decline in miscellaneous other income reflects a special transaction in which one U.S. insurer assumed $9.3 billion in liabilities from a foreign entity in exchange for considerations valued at $7.1 billion, some tax benefits, and the opportunity to earn investment income on the funds held to pay down the liabilities.

Net Income after Taxes
The insurance industry's net income after taxes rose $3.3 billion to $49.4 billion in nine-months 2007 from $46.1 billion in nine-months 2006, as a $6.7 billion increase in realized capital gains on investments more than offset the $5.4 billion decline in pretax operating income. The industry's net income after taxes also benefited from a decline in income taxes. Federal and foreign income taxes declined $1.9 billion, or 11 percent, to $15.4 billion in nine-months 2007 from $17.4 billion in nine-months 2006.

Policyholders' Surplus
Fueled by the industry's net income, policyholders' surplus increased 7.3 percent to $521.8 billion at September 30, 2007, from $486.2 billion at year-end 2006. Other additions to surplus in nine-months 2007 included $6.2 billion in unrealized capital gains on investments (not included in net income) and $1.9 billion in new funds paid in (new capital raised by insurers). These additions were partially offset by deductions from surplus, including $18.3 billion in dividends to shareholders and $3.6 billion in miscellaneous charges against surplus.

The $6.2 billion in unrealized capital gains in nine-months 2007 is down $5.8 billion, or 48.1 percent, from $12 billion in nine-months 2006.

The $1.9 billion in new funds paid in during the first nine months of 2007 is down $1.1 billion, or 36.4 percent, from $2.9 billion in the first nine months of 2006.

The $18.3 billion in dividends to shareholders in nine-months 2007 is up $1.8 billion, or 11 percent, from $16.5 billion in nine-months 2006.

The $3.6 billion in miscellaneous charges against surplus in nine-months 2007 compares with $3.5 billion in miscellaneous charges against surplus in nine-months 2006.

"Insurers' positive results through nine-months 2007 reflect not only the actions insurers have taken in the wake of 2005's record catastrophe losses but also an unusually large dose of good luck," said Staranczak. "Just as there are years when insurers and consumers suffer horrific losses at the hands of Mother Nature, there are other years when she is unusually benign. In 2007, despite dire predictions from all the experts, the U.S. was struck by just one hurricane — Hurricane Humberto — and it caused relatively little damage when it hit. But our good luck in 2007 doesn't mean insurers, regulators, legislators, and consumers can relax. It is just a matter of time. Someday, we'll be walloped by a storm that causes twice the damage done by Hurricane Katrina or more, and that means we all need to work on loss mitigation and risk management."

Third-Quarter Results

The industry's consolidated net income after taxes for third-quarter 2007 amounted to $16.8 billion, up 0.7 percent from the $16.7 billion in net income for third-quarter 2006. The industry's net income for third-quarter 2007 consisted of $17.6 billion in pretax operating income and $4 billion in realized capital gains on investments, less $4.8 billion in federal and foreign income taxes.

The industry's third-quarter 2007 pretax operating income of $17.6 billion was down 21.3 percent from $22.3 billion in third-quarter 2006. Third-quarter 2007 operating income consisted of $3.7 billion in net gains on underwriting, $13.4 billion in net investment income, and $0.4 billion in miscellaneous other income.

The $3.7 billion in net gains on underwriting in third-quarter 2007 was down 59.7 percent from $9.3 billion in third-quarter 2006. The decline in net gains on underwriting reflects weakness in premiums and increases in the cost of providing insurance.

Written premiums fell $0.3 billion to $114.2 billion in third-quarter 2007 from $114.4 billion in third-quarter 2006, with third-quarter written premium growth dropping to negative 0.2 percent in 2007 from 9.6 percent in 2006 (4.3 percent adjusted for nonrecurring special developments affecting the data) and a cyclical peak of 16.8 percent in third-quarter 2002.

Earned premiums rose $1 billion to $111.4 billion in third-quarter 2007 from $110.3 billion in third-quarter 2006, but third-quarter earned premium growth slowed to 0.9 percent in 2007 from 9 percent in 2006 (3.6 percent adjusted for special developments affecting the data) and a cyclical peak of 13.7 percent in 2002.

Direct insured losses from catastrophes were essentially unchanged at $1.3 billion in both third-quarter 2007 and third-quarter 2006, according to ISO's PCS unit. Yet overall loss and loss adjustment expenses climbed $5.8 billion, or 8.1 percent, to $76.6 billion in third-quarter 2007 from $70.9 billion in third-quarter 2006.

Growth in other underwriting expenses also outpaced growth in premiums. Other underwriting expenses increased $0.8 billion, or 2.6 percent, to $30.4 billion in third-quarter 2007 from $29.7 billion in third-quarter 2006.

At $0.5 billion in third-quarter 2007, dividends to policyholders were essentially unchanged from their level in third-quarter 2006.

Net gains on underwriting dropped to 3.4 percent of the $111.4 billion in premiums earned during third-quarter 2007, down from 8.4 percent of the $110.3 billion in premiums earned during third-quarter 2006. The industry's combined ratio deteriorated to 96 percent in third-quarter 2007 from 90.6 percent in third-quarter 2006. Nonetheless, the industry's combined ratio for third-quarter 2007 was the second best for any third quarter since 1986, when ISO's quarterly data begins.

The $13.4 billion of net investment income is up $0.4 billion, or 3.1 percent, compared with investment income in third-quarter 2006.

The $0.4 billion in miscellaneous other income is up from $0.1 billion in third-quarter 2006.

The $4 billion in realized capital gains is up $3.4 billion from $0.6 billion in third-quarter 2006.

Combining net investment income and realized capital gains, the industry posted $17.4 billion in net investment gains in third-quarter 2007, up 28.3 percent from $13.6 billion a year earlier.

The $0.1 billion in unrealized capital losses in third-quarter 2007 contrasts with the $7.4 billion in unrealized capital gains on investments in third-quarter 2006. Combining realized capital gains and unrealized capital losses, the insurance industry posted $3.9 billion in overall capital gains in third-quarter 2007 — down $4.1 billion, or 50.9 percent, from $8 billion in third-quarter 2006.

“With net written premiums declining 0.2 percent versus year-ago levels in third-quarter 2007 and 0.6 percent in second-quarter 2007, this is the first time in at least 20 years that written premiums have declined for two consecutive quarters,” noted Staranczak.

“Because of the mechanics of insurance accounting, the declines in net written premiums will affect insurers’ profitability going forward,” said Murray. “Less written premium now translates into less earned premium later, because written premium is the amount charged when a policy is sold, but that premium is earned over the term of the policy as coverage is provided. And less earned premium later translates into smaller profits down the road, because the underwriting gain for a period equals the earned premium for the period minus the cost of providing insurance during the same period.”

OPERATING RESULTS FOR 2007 and 2006 ($ Millions)

NINE MONTHS	**2007**	**2006**
NET WRITTEN PREMIUMS	337,572	337,556
NET EARNED PREMIUMS	329,288	325,146
INCURRED LOSS & LOSS ADJUSTMENT EXPENSES	219,556	212,266
STATUTORY UNDERWRITING GAINS (LOSSES)	19,314	25,398
POLICYHOLDERS' DIVIDENDS	1,167	1,092
NET UNDERWRITING GAINS (LOSSES)	18,146	24,307
PRE-TAX OPERATING INCOME	56,639	62,014
NET INVESTMENT INCOME EARNED	39,515	37,493
NET REALIZED CAPITAL GAINS (LOSSES)	8,204	1,474
NET INVESTMENT GAINS	47,718	38,967
NET INCOME (LOSS) AFTER TAXES	49,399	46,129
SURPLUS (CONSOLIDATED)	521,791	466,739
LOSS & LOSS ADJUSTMENT EXPENSE RESERVES	527,615	511,218
COMBINED RATIO, POST-DIVIDENDS (%)	93.8	91.5

THIRD QUARTER	**2007**	**2006**
NET WRITTEN PREMIUMS	114,186	114,449
NET EARNED PREMIUMS	111,364	110,322
INCURRED LOSS & LOSS ADJUSTMENT EXPENSES	76,642	70,890
STATUTORY UNDERWRITING GAINS (LOSSES)	4,292	9,763
POLICYHOLDERS' DIVIDENDS	547	476
NET UNDERWRITING GAINS (LOSSES)	3,744	9,286
PRE-TAX OPERATING INCOME	17,570	22,328
NET INVESTMENT INCOME EARNED	13,387	12,980
NET REALIZED CAPITAL GAINS (LOSSES)	4,030	593
NET INVESTMENT GAINS	17,417	13,573
NET INCOME (LOSS) AFTER TAXES	16,803	16,694
SURPLUS (CONSOLIDATED)	521,791	466,739
LOSS & LOSS ADJUSTMENT EXPENSE RESERVES	527,615	511,218
COMBINED RATIO, POST-DIVIDENDS (%)	96.0	90.6

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