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MID-YEAR FINANCIAL UPDATE: P&C AND LIFE SECTORS

By Imran Makda

While the U.S. economy has been generally healthy, the first half of 2017 brought a variety of challenges for life, health and property & casualty insurers. The following article highlights the bright spots and challenges for each sector.

PROPERTY-CASUALTY

Direct written premiums and policyholders' surplus were bright spots for growth during the first half of 2017. Direct written premiums hit $317 billion, up 4.4 percent year-over-year. This marks the 29th consecutive quarter for premium growth; the upward trajectory started in the second quarter of 2010 when the economy was just pulling out of the Great Recession. U.S. GDP growth has also increased roughly four percent annually since mid-2010. Healthy macro-economic conditions have helped to increase the industry's exposure growth, fueled by a continuing drop in the unemployment rate, as well as strength in construction sector and in automobile sales.

Projections for GDP growth to rise between 3.9 to 5.2 percent by the end of 2018 would typically have a positive effect on premiums, but significant losses weighed down the sector. Underwriting losses totaled $3.7 billion during the first six months of 2017, a dramatic drop from roughly $6 million in losses during the same period in 2016. A series of severe thunderstorms that hit the U.S. in the first few months of the year produced heavy losses.

Unfortunately, more difficult times lie ahead. The impact from the series of disastrous hurricanes that hit the U.S. in August and September 2017 is only beginning to unfold. As of mid-September, RMS estimated insured losses from Hurricane Irma associated with wind, storm surge and inland flood losses would total between $35 to $55 billion; Hurricane Harvey is expected to generate an additional $25 to $35 billion in losses. Higher catastrophe (CAT) claims will lead to higher losses and affect the combined ratio, which will likely result in a profit slump. On a positive note, experts believe the industry is well-positioned and well-capitalized to withstand a $100 billion insured event

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thanks to continuing inflows in catastrophe bonds and other alternative sources of industry capital in recent years. Prior to 2017, the industry enjoyed relatively mild hurricane seasons and low catastrophic losses for several years. As a result, the direct underwriters and reinsurers were able to further strengthen their balance sheets and surplus positions.

The annualized return on average equity (ROE) was 4.5 percent for the first half of the year, down from 6.5 percent in 2016. This drop was a direct result of increases in loss ratios (1.6 percent) and combined ratios (0.9 percent) during the first half of 2017. Policyholders' surplus increased slightly since the end of 2016 from $712.1 billion to $723 billion.

LIFE INSURANCE

Direct premiums and annuity considerations grew a mere 0.3 percent during the first half of 2017, standing in stark contrast to the 2.7 percent growth during the same period last year. In July, S&P Global Market Intelligence projected that direct premiums and considerations would decline 1.2 percent on a full-year basis in 2017, compared with 0.1 percent growth for the year in 2016.

A deeper look reveals strength in group annuity, group accident and health and group life business, while ordinary individual annuity and other accident and health products showed considerable weakness. Group annuity considerations were up 6.4 percent, offering one area of strength for the sector. Meanwhile, ordinary individual annuity considerations were a weak point, dropping 7.7 percent, the largest decline the industry experienced during a second quarter in the last five years.

The Trump administration's intentions for the Department of Labor's Fiduciary Rule contributed to weak sales for certain types of annuities this year and is expected to continue to decline for the remainder of the year. Millennials' interest in ordinary and term life insurance has been low and premiums continue to decline year-over-year.

Low bond yields have been one of the biggest problems affecting life insurers for the past several years. With the sector's profitability highly sensitive to interest rate changes, an increase in bond yields would provide much-needed relief to insurers struggling to maintain margins.

Despite these challenges, the life insurance sector showed dramatic improvement in net income year-over-year, totaling $22.1 billion for the first six months, compared with $1 billion in 2016. ROE was 11.5 percent, compared with 0.6 percent last year. Results were heavily influenced by a low increase in reserves and transfers.

HEALTHCARE

The first half of 2017 brought healthy top-line and bottom-line growth to the healthcare insurance sector. Direct written premiums increased 5.7 percent over the same period last year, and total members increased by 8.1 million. The expense ratio dropped during the first six months of the year, while the claims ratio remained steady, resulting in a net income increase of $11 billion year-over-year.

The big five for-profit insurers—Aetna, Anthem, Cigna, Humana and UnitedHealth Group—traditionally generate the lion's share of profits, collecting $8.4 billion in net earnings during the six-month period, the largest amount since the Affordable Care Act (ACA) exchanges went live in 2014. Most of the larger carriers had previously announced their decision to pull out of the ACA market. As such, the continuing regulatory and financial woes affecting the ACA market did not significantly impact their earnings. The suspension of the ACA's health insurance industry fee for 2017 also created a temporary windfall for the industry.

One highlight for the sector: Medicare Advantage underwriting profitability soared 279 percent in 2016. Insurers are benefiting from younger, healthier retirees, improvements in managing enrollees' health and securing more favorable contracts with providers. Medicaid, on the other hand, has been more challenging primarily because new Medicaid expansion enrollees have had more health issues. The picture is expected to improve as consumers gain more consistent access to better care.

Uncertainty around the ACA and threats to stop the cost-sharing reduction payments that help cover low-income enrollees are projected to drive up premiums in the coming year. **Kaiser Family Foundation** reported that healthcare insurers in 15 of 21 major U.S. cities where ACA plan rate filings are publicly available for so-called silver plans expect to hike their premiums by double digits in 2018.

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