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STUDENT OF THE INDUSTRY PARTING SHOT

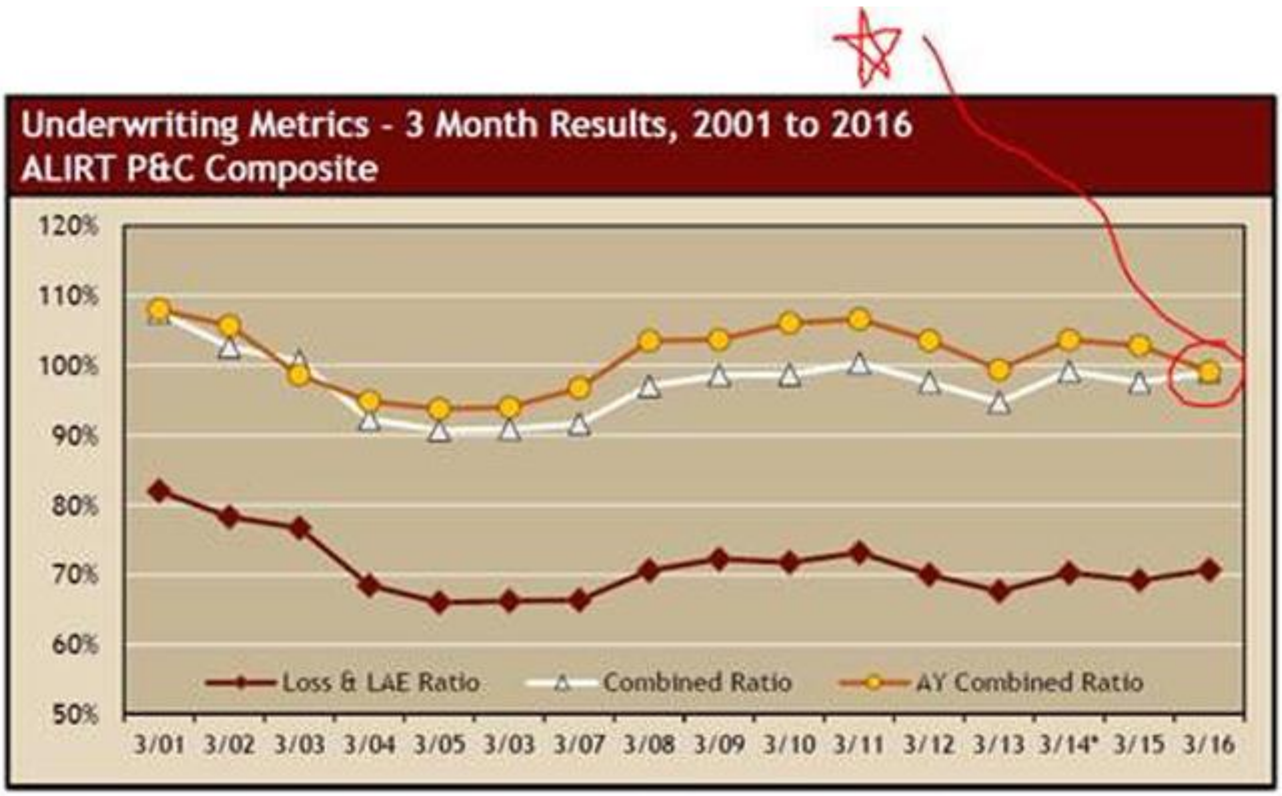
Industry Loss Ratios: An Inflection Point?

By Paul Buse, President of Big I Advantage®

I noted the results from 3 months of data for 2016 that ALIRT Insurance Research showed that both calendar-year and accident loss ratios were nearly identical so far in 2016. That is, the estimated loss costs for accidents and fires and the like actually taking place in January-March of 2016 and those the industry reports after considering changes on prior year loss estimates from 2015 and before are almost the same number.

Below is the graph from the ALIRT write-up of the calendar-year (white line) and the accident-year combined ratios (yellow-ish line). These lines represent industry loss ratios after about 27% of underwriting expenses are added. As underwriting expenses on a calendar- and accident-year basis are about the same, they are a good picture of trends in loss ratios as well. As you can see they converge in the first three months of 2016. In the write-up of results, ALIRT makes the point the industry may be at a "inflection point in a decade-long trend of reported underwriting results benefitting from reserve releases."

Inflection Point: What's going on here? That is a great question and the "inflection point" observation is an apt one. That is, an inflection point is **NOT** at the top of a curve or the bottom, it's more subtle. It's the point where you change from trending one way to trending the opposite. Visually, if you were riding your bike in a driveway trying to get exercise, you would probably ride in "figure 8s." In each figure 8, the inflection point occurs twice at the very middle/center of your driveway. It's the point where you go from leaning left around the major curve at one end of the driveway to leaning to the right in anticipation of curving right at the other end (and vice versa). ALIRT's message is that since both accident-year and calendar-year loss ratios appear to be essentially identical, the industry might be at that point of "leaning the other way" with respect to loss estimates (aka "reserves"). This would be because when accident and calendar year loss ratios are the same, changes on prior year reserves are essentially zero. You see for about 10 years the industry has reported annual results with help from reserve take-downs on prior years. That lowers the current year reported loss ratios in published results. If that practice is at the end of its tenure, we may be at the point where prior year reserves are less available to prop up 2016 results as we go or, worse, prior year reserves will prove inadequate and 2016 will see loss ratios increase even if losses actually happening in 2016 remain flat.



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Source: ALIRT Industry Research, "U.S. P&C Insurance Industry Review 3 Months 2016."