Low for Longer:
The Effect of Low Interest Rates
On the U.S. P&C Industry

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Return On Equity: P&C Insurance vs. Fortune 500

*GAAP basis.
Sources: ISO, Fortune; Insurance Information Institute.
P&C Insurance Industry Combined Ratio*


Sources: A.M. Best, ISO (2014-2015); Figure for 2010-2013 is from A.M. Best P&C Review and Preview, Feb. 18, 2016.
In the 10 year period ended 7/31/2016, pre-tax yields have declined by 380 bps

Source: Bank of America Merrill Lynch 5-7 Year AA US Corporate Index
Industry Profitability

• The 380 bps decline in new money yield equates to an ultimate 7.5 point decline in ROE
  • Assumes 2.5x investment leverage and ~20% tax rate

• In practicality, lower new money yields impact investment portfolios over time as existing bonds mature and new cash flow is invested

A.M. Best projects a **99% combined ratio** and **6% ROE** for the P&C industry in 2016*

*A.M. Best Review & Preview (February 18, 2016)
For purposes of this presentation, the Reinsurance sector was not included*
Return on Equity Attribution – 2006 vs. 2016

2006 – Attribution @ 99% Combined Ratio

Investments: 9%
Underwriting: 1%
Other: -1%
Total: 9%

2016 – Attribution @ 99% Combined Ratio

Investments: 6%
Underwriting: 1%
Other: -1%
Total: 6%
At 1:1 NPW/Surplus, the industry requires a 91% combined ratio which, all else being equal, would require a ~11% price increase.
Reduction in C/R to Offset 1% Decline in Investment Yield for Constant ROE by Line*

Lower Investment Earnings Place a Greater Burden on Underwriting and Pricing Discipline

*Based on 2008 Invested Assets and Earned Premiums
Source: A.M. Best; Insurance Information Institute.
Underwriting:
With Net Premiums Written to Policyholder’s Surplus of 1:1;
1.5 points of combined ratio = 1 point of ROE

Investments:
With Invested Assets to Equity (Policyholder’s Surplus) of $2.50
and an Investment Tax Rate of ~ 20%;
50 bps of pre-tax yield (40 bps of after-tax yield) = 1 point of ROE

Conclusion:
To offset a 50 bps decline in yield, the industry must improve the combined ratio by 1.5 points; this requires a 2% price increase above the level of expected claim inflation (which is currently running at about 2.5%)

*A.M. Best Review & Preview (February 18, 2016) Report used to calculate industry leverage
For purposes of this presentation, the Reinsurance sector was not included