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Fact Sheet for the Chairman, House Committee on Ways and Means

April 1986

TAX POLICY

Financial Cycles in the Property/Casualty Industry

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT DIVISION

April 9, 1986

B-220675

The Honorable Dan Rostenkowski
Chairman, Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

During our testimony on insurance taxation before the House Committee on Ways and Means, Congressman Richard T. Schulze asked that we provide information about past financial cycles in the property/casualty (p/c) insurance industry. The enclosed four figures illustrate the financial cycles that p/c insurance companies experienced over the past several decades.

To identify past cyclicity, we plotted the p/c insurance industry's underwriting gains or losses over time. Basically, underwriting gains or losses are the differences between the amount of a company's premiums received and the amount of its claims, expenses, and policyholder dividends paid. For our purposes, we expressed underwriting gains or losses in two ways: (1) a ratio of the claims, expenses, and policyholder dividends paid to the premium income (combined ratio) and (2) the difference (plus or minus) between the amount of premium income and the amount of claims, expenses, and policyholder dividends. The enclosed figures illustrate the cyclicity in the p/c industry expressed in these terms.

The data we used to develop these figures came entirely from publicly available information contained in Best's Aggregates and Averages published by the A.M. Best Company. Data on the overall p/c insurance industry was available for the period 1967 through 1985; data on the stock company segment of the industry was available for a longer period, 1945 through 1984.

As arranged with your office, we are making this information available to Congressman Schulze and other interested parties. We trust that you will find this information useful. If you have questions, please contact Mr. Natwar Gandhi of my staff on 376-0023.

Sincerely yours,

Johnny C. Finch

Johnny C. Finch
Senior Associate Director

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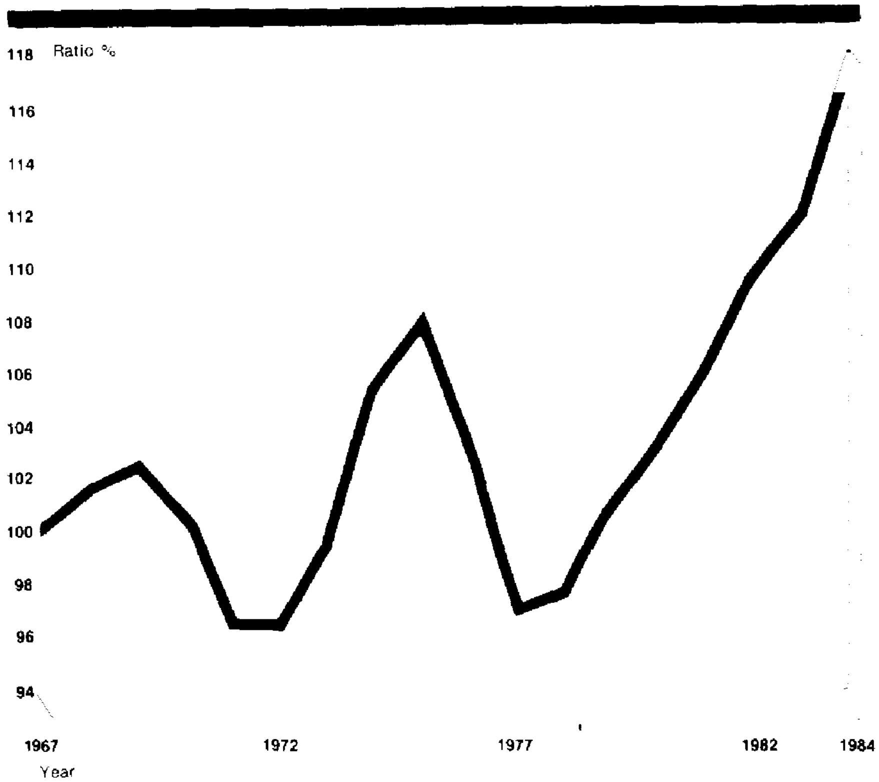
Figure 1 illustrates the cycles derived by plotting the annual combined ratios (the ratio of claims, expenses, and policyholder dividends paid to the premium income) of the p/c industry for the period 1967 through 1984. From 1969 through 1977 the cycles (the periods between peaks or troughs) appear to span 5 to 6 years in duration. This, however, has not been the case since 1977. The continuation of the upward cycle that began in 1977 has been due in large part to the industry's use of a technique known as "cash flow underwriting." Using this technique, companies undercharge for premiums in order to encourage sales and obtain funds. Premium proceeds are then used to take advantage of investment opportunities. Thus, the companies can afford to have ratios in excess of 100 percent (which represent an underwriting loss) if such losses are offset by investment earnings. The majority of the industry's investment earnings come from tax-exempt investments.

Figure 1: Combined Underwriting Ratios of the Property/ Casualty Industry For the Years 1967-84[a]

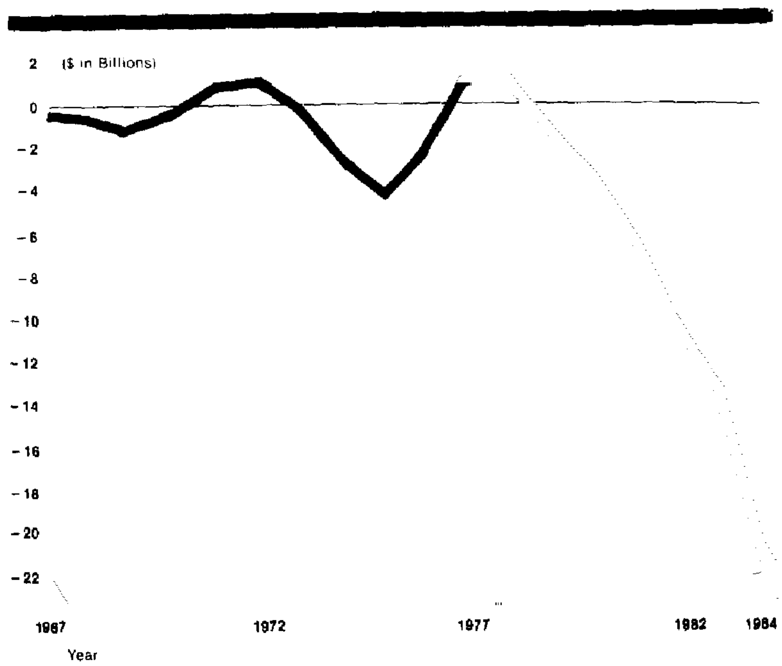


Year	Ratio%
1967	100.2
1968	101.5
1969	102.5
1970	100.1
1971	96.4
1972	96.2
1973	99.2
1974	105.4
1975	107.9
1976	102.4
1977	97.2
1978	97.5
1979	100.6
1980	103.1
1981	106.0
1982	109.6
1983	112.0
1984	118.0

[a]Ratios below 100 represent underwriting gains and those above 100 represent losses.

Figure 2 shows the cycles of the underwriting gains and losses in billions of dollars for the p/c insurance industry between 1967 and 1984. These gains and losses represent the difference between the industry's claims, expenses, and policyholder dividends paid and the premiums it collected. These figures show the same cyclical trend as Figure 1 showed for the combined ratios.

Figure 2: Underwriting Gains or Losses For the Property/ Casualty Industry For the Years 1967-84 (in billions)

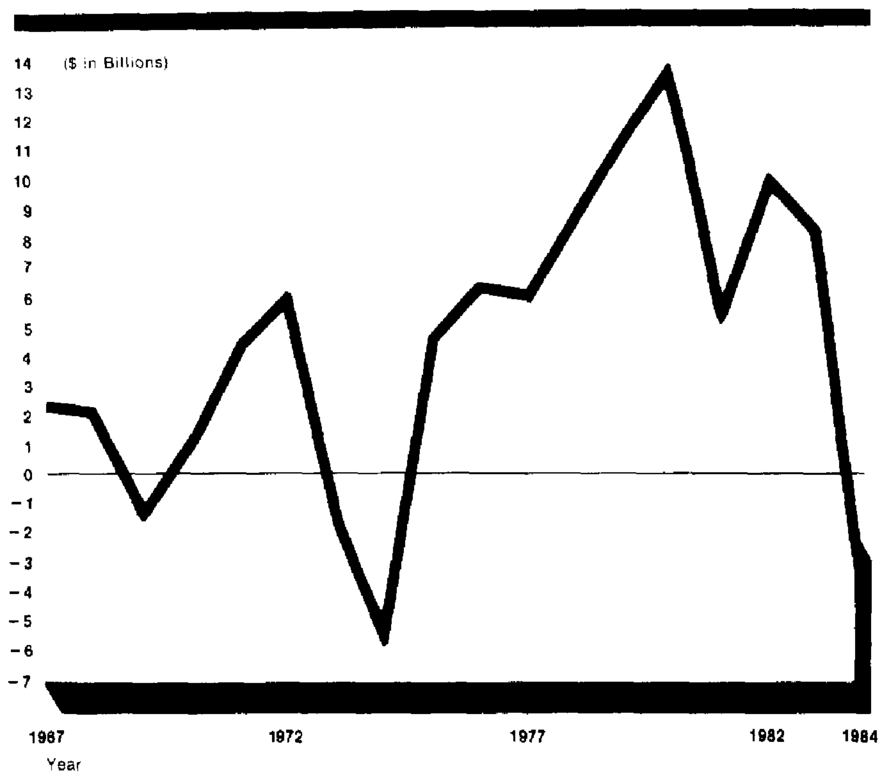


Year	Total
1967	$ -0.3
1968	-0.6
1969	-1.0
1970	-0.4
1971	0.8
1972	1.1
1973	0.0
1974	-2.6
1975	-4.2
1976	-2.2
1977	1.1
1978	1.3
1979	-1.3
1980	-3.3
1981	-6.3
1982	-10.3
1983	-13.3
1984	-21.5

While Figures 1 and 2 illustrate the underwriting portion of the p/c insurance industry operations, Figure 3 shows how the cyclical nature of the industry has been affected when companies' investment income is added to their underwriting gains and losses. With both revenue sources combined, the p/c industry has usually shown a positive net income after taxes.

Figure 3: Combined Underwriting and Investment Gains or Losses For the Property/Casualty Industry For the Years 1967-84[a]

(in billions)



Year	Total	Year	Total
1967	$ 2.3	1976	$ 6.4
1968	2.1	1977	6.0
1969	-1.4	1978	8.9
1970	1.2	1979	11.6
1971	4.4	1980	13.7
1972	6.0	1981	5.3
1973	-1.7	1982	10.0
1974	-5.6	1983	8.3
1975	4.6	1984	-2.4

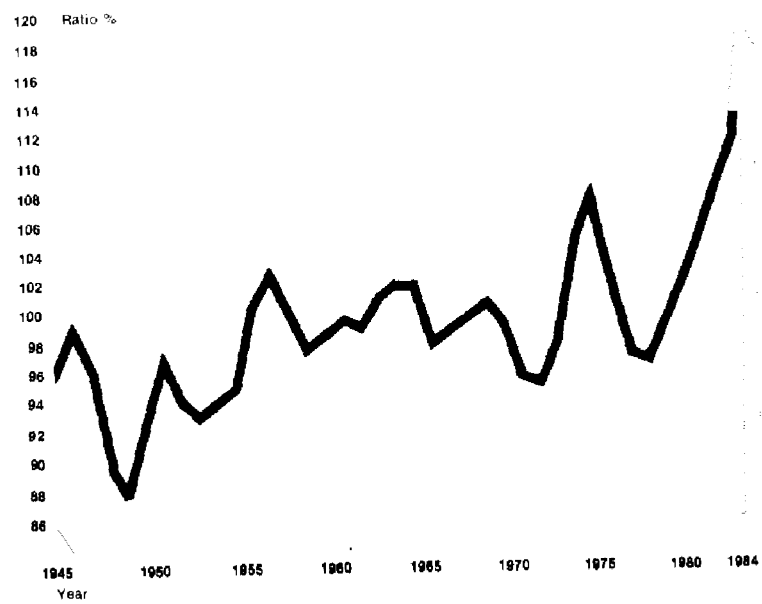
[a]These figures are aggregate stock and mutual company totals. We used aggregate totals because annual consolidated totals for the p/c industry, while available for some years, are not available for the entire period shown. Consolidated totals are usually lower since they do not include intercompany transactions. For the period 1975 through 1984, the aggregate stock and mutual totals shown above amounted to $72.4 billion while the corresponding consolidated totals amounted to $62.6 billion.

 APPENDIX

Figure 4 shows the cycles of the combined ratios for the industry's stock companies for the years 1945 through 1984. Except for the latest upswing beginning in 1978, Figure 4 shows that 5- to 6-year cycles were generally maintained throughout this period. This exception, as we noted in our explanation of figure 1, is in large part due to the effects of "cash flow underwriting."

APPENDIX

Figure 4: Combined Underwriting Ratios For Property/Casualty Stock Companies For the Years 1945-84[a]



Year	Ratio %	Year	Ratio %
1945	95.8	1965	101.9
1946	98.8	1966	98.1
1947	96.3	1967	98.9
1948	91.2	1968	100.0
1949	87.6	1969	100.6
1950	93.0	1970	99.3
1951	97.1	1971	95.8
1952	94.4	1972	95.4
1953	93.1	1973	98.2
1954	93.6	1974	105.0
1955	94.9	1975	107.5
1956	100.5	1976	102.0
1957	102.9	1977	97.0
1958	100.0	1978	96.6
1959	97.8	1979	99.6
1960	98.4	1980	102.4
1961	99.4	1981	104.9
1962	99.0	1982	108.7
1963	101.0	1983	111.8
1964	101.9	1984	119.0

[a]Ratios below 100 represent underwriting gains and those above 100 represent losses.

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