Homeowners: Improving Outlook, Growing Opportunities

Aon Benfield Analytics’ annual review of homeowners rate changes and industry reported financial results finds that the country’s largest homeowners insurers are showing positive rate momentum, coupled with advancements in ratemaking methodology associated with capturing the cost of catastrophe risk. Recovering the cost of capital required to support retained catastrophe risk has seen widespread acceptance by state regulators and by-peril rating is becoming more widespread.

Our prospective after-tax ROE estimate for the homeowners line of insurance is now 4.6 percent. This prospective ROE is based on estimated capital requirements sufficient for a countrywide, diversified personal lines insurer with an A.M. Best “A” rating, net of expected reinsurance benefit estimated by Aon Benfield. While the countrywide outlook is essentially flat relative to last year’s 4.7 percent estimate, at the state level, positive rate momentum is improving the outlook for many states. Excluding Florida, the industry’s prospective ROE is 8 percent, with 36 states having prospective ROE outlooks better than this average, and 28 states with prospective ROE outlooks 12 percent or greater. Although rate adequacy still remains elusive in the gulf and south-eastern states, positive rate and underwriting actions have put the outlook of rate adequacy within reach for states outside these regions.

Furthermore, in an industry desperate for growth as auto premium volumes have stagnated, homeowners continues to be a growth opportunity for personal lines carriers. Homeowners cumulative growth over the last three years has been 15 percent, compared to 6.5 percent for auto, a differential that grows even more when extended to five or ten year timeframes.

In order to maximize the growth opportunities available from the homeowners line of business, more granular pricing of catastrophe costs beyond state level indications is a necessity. Accurate segmentation of reinsurance and capital costs at the territory level and refining territory definitions more granularly to better match rates to cost variations is essential to achieving overall rate adequacy without jeopardizing an insurer’s ability to grow in areas that will diversify its catastrophe risk.

Aon Benfield Analytics provides information to clients regarding their own unique cost of catastrophe risk, including expected losses, reinsurance and cost of capital. This information may be integrated into rate filings and also into underwriting and pricing management at all levels of detail including product line, state, territory and individual risk.
Rate Adequacy within Reach for Non-Coastal States

August 2013 Prospective ROE at Current Rates

Countrywide ROE Estimate: 4.6%

Five-Year Historical Direct Combined Ratio

Countrywide Combined Ratio: 103%

ROE Study Methodology

Prospective ROEs are based on an analysis of state and aggregate statutory filing information for the industry’s reported direct losses and LAE, expense ratios, payout pattern, and investment yields. Actual historical catastrophe losses as measured by PCS are replaced with a multi-model view of expected cat loss. The rate filings of the top 20 insurance company groups by state are incorporated in estimates of on-level premium, and combined with an analysis of capital requirements and cost of reinsurance for a countrywide personal lines company with an A.M. Best “A” rating. Capital requirements by state are related to retained catastrophe risk by state in addition to premium and reserve risk.

The diversification available to a nationwide personal lines insurer impacts ROE calculation. For instance, homeowners business in California diversifies Gulf and East Coast hurricane exposure for a nationwide insurer. A California standalone would incur higher capital and reinsurance costs than the California portion of a nationwide insurer with similar premium volume in the state. Furthermore, Shake related earthquake loss is covered separately by the earthquake endorsement and is recorded on a separate statutory line of business and is not included in these estimates.
The combined ratios shown consider five years of actual direct premiums and expenses paid. Actual direct incurred losses and LAE are adjusted to remove cat loss, as measured by PCS, and include expected cat loss using multiple models; expected cat loss includes costs of assessments from state sponsored insurers. In many states, e.g. Florida, this adjustment clarifies the lack of expected profitability despite favorable historical combined ratios over the past five years.

Adjusting combined ratios for expected versus historical cat loss is an important step to distinguish bad weather results from inadequately priced business (and favorable weather results from appropriately priced business). Historical catastrophes can distort measures of results since homeowners volatility is primarily catastrophe loss related. Modeled catastrophe losses are nearly half of the industry total expected losses on a countrywide basis but over the past five years actual catastrophe losses are 24 percent below modeled expectations.

The percentages show the target combined ratios necessary to fund allocated capital for retained risk by state, including catastrophe risk. The targets are for a sample countrywide company only, and will vary among individual companies because of state distribution of premiums, capital adequacy standards, target return on capital, allocation methodologies, reinsurance and other considerations.
Homeowners Average Approved Rate Change

The map shows average rate changes approved for the top 20 homeowners insurance groups in each state between January 1, 2012 and July 1, 2013. The countrywide rate change for these insurers is 7.7 percent. Gulf states, where rate is most needed, show approved rate increases above the countrywide average; more activity is still needed in these states to achieve ROE targets.

Direct Written Premium Growth, 2009 to 2012

Industry premium change from 2009 to 2012 shows strong growth for the homeowners line. When compared to Auto growth over the same period the picture is clear: growth opportunities in personal lines start with “getting home right”. Flat home values in the 2009 to 2012 period indicate much of the premium growth is from rate activity; this is another positive indicator of the direction the homeowners line is moving. Midwestern states showed the largest premium increases with many exceeding 20 percent. Nevada is the only state to show a premium decrease over the past three years.

Industry - Homeowners

Direct Written Premium Growth
About Aon Benfield

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