Despite Underwriting Losses, RRGs Remain Financially Stable

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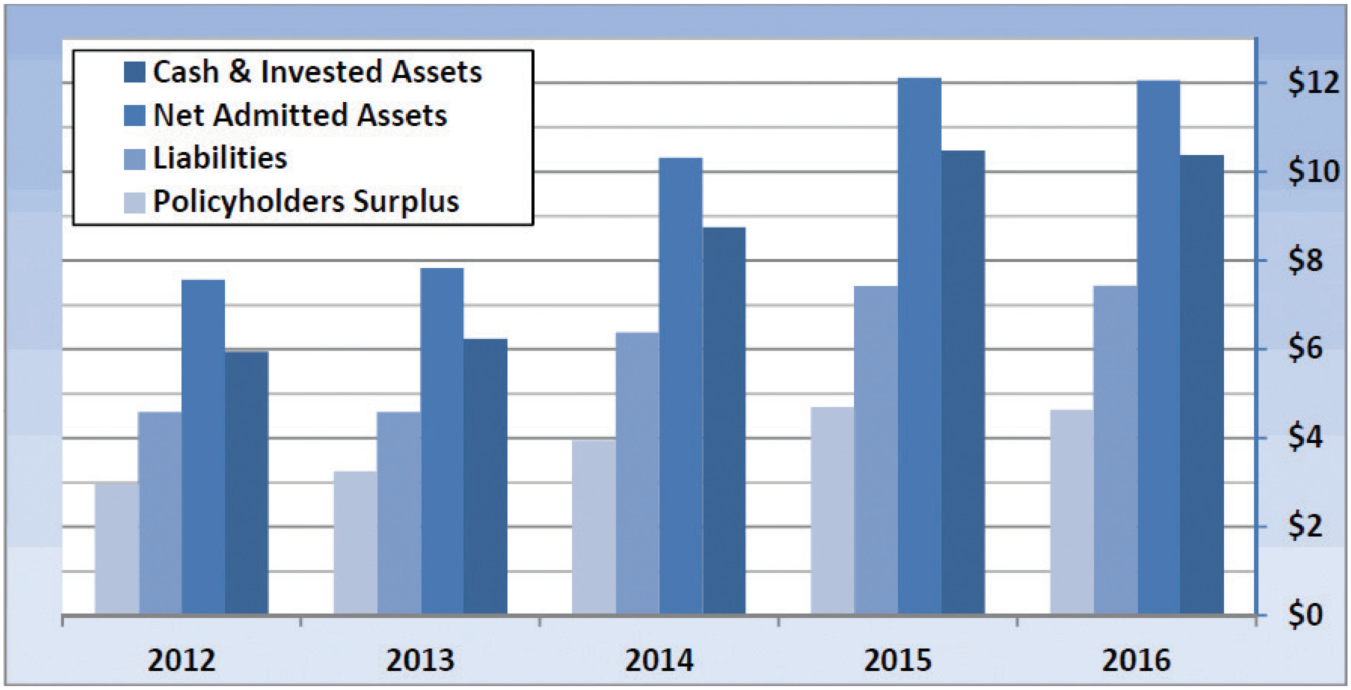
A review of the reported financial results of risk retention groups (RRGs) reveals insurers that continue to collectively provide specialized coverage to their insureds while remaining financially stable. Based on reported financial information, RRGs have a great deal of financial stability and remain committed to maintaining adequate capital to handle losses. It is important to note that ownership of RRGs is restricted to the policyholders of the RRG. This unique ownership structure required of RRGs may be a driving force in their strengthened capital position.

Balance Sheet Analysis

During the last five years, cash and invested assets have increased at a faster rate than total liabilities. Also, the level of policyholders' surplus becomes increasingly important in times of difficult economic conditions by allowing an insurer to remain solvent when facing uncertain economic conditions.

Since first quarter 2012, cash and invested assets increased 74.6% and total admitted assets increased 59.5%. More importantly, over a five year period from first quarter 2012 through first quarter 2016, RRGs collectively increased

Written by Douglas A Powell,
Sr. Financial Analyst, Demotech, Inc.



policyholders' surplus 56.1%. This increase represents the addition of over $1.6 billion to policyholders' surplus. During this same time period, liabilities have increased 61.8%. These reported results indicate that RRGs are adequately capitalized in aggregate and able to remain solvent if faced with adverse economic conditions or increased losses.

Liquidity, as measured by liabilities to cash and invested assets, for first quarter 2016 was 71.5%. A value less than 100% is considered favorable as it indicates that there was more than a dollar of net liquid assets for each dollar of total liabilities. This also indicates an increase for RRGs collectively as liquidity was reported at 70.8% at first quarter 2015.

Loss and loss adjustment expense (LAE) reserves represent the total reserves for unpaid losses and LAE. This includes reserves for any incurred but not reported losses as well as supplemental reserves established by the company. The cash and invested assets to loss and LAE reserves ratio measures liquidity in terms of the carried reserves. The cash and invested assets to loss and LAE reserves ratio for first quarter 2016 was 212.7% and indicates a decrease over first quarter 2015, as this ratio was 222.9%. These results indicate that RRGs remain conservative in terms of liquidity.

In evaluating individual RRGs, Demotech, Inc. prefers companies to report leverage of less than 300%. Leverage for all RRGs combined, as measured by total liabilities to policyholders' surplus, for first quarter 2016 was 160.1% and indicates an increase compared to first quarter 2015, as this ratio was 157.9%.

The loss and LAE reserves to policyholders' surplus ratio for first quarter 2016 was 105.3% and indicates an increase compared to first quarter 2015, as this ratio was 100.1%. The higher the ratio of loss reserves to surplus, the more an insurer's stability is dependent on having and maintaining reserve adequacy.

Regarding RRGs collectively, the ratios pertaining to the balance sheet appear to be appropriate and conservative.

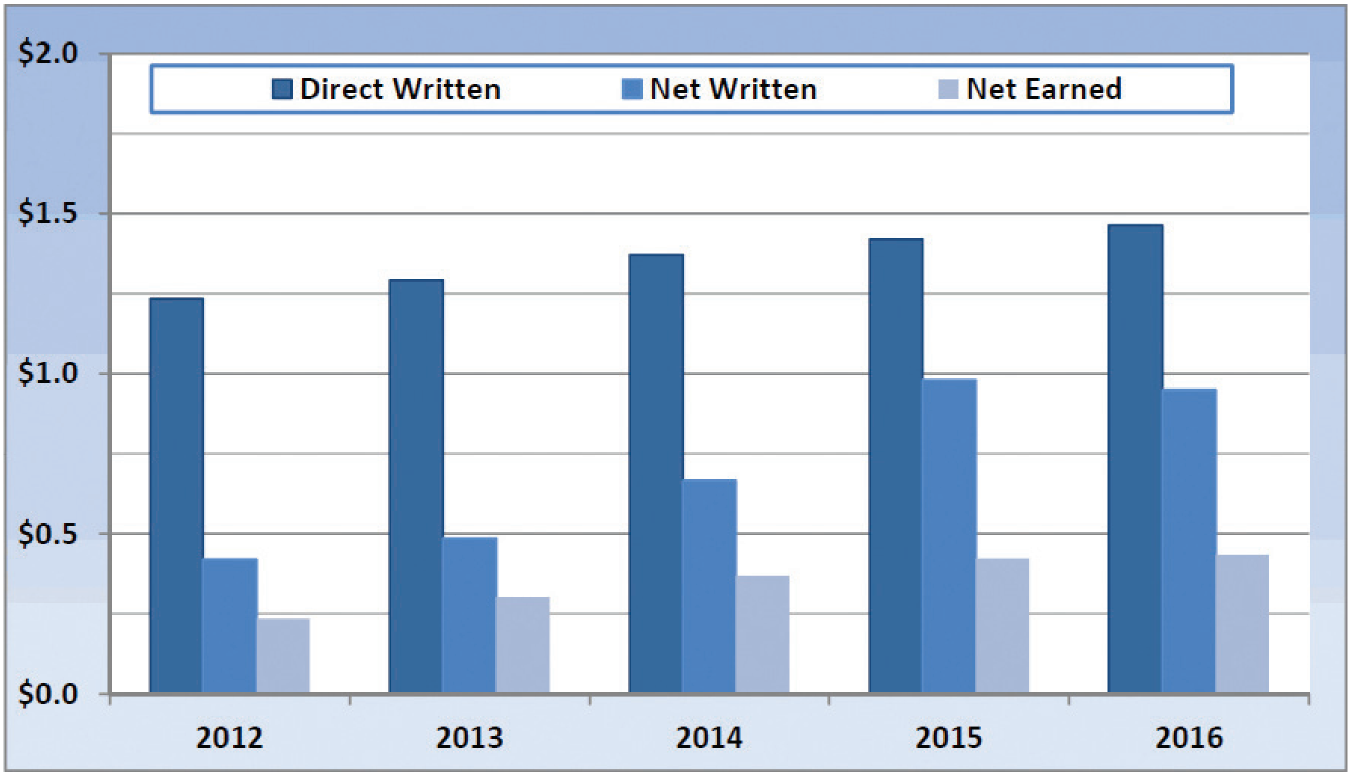
Premium Written Analysis

Since RRGs are restricted to liability coverage, they tend to insure medical providers, product manufacturers, law enforcement officials and contractors, as well as other professional industries.

RRGs collectively reported over $1.4 billion of direct premium written (DPW) through first quarter 2016, an increase of 3% over first quarter 2015. RRGs reported nearly $950 million of net premium written (NPW) through first quarter 2016, a decrease of 3.1% over first quarter 2015.

The DPW to policyholders' surplus ratio for RRGs collectively through first quarter 2016 was 126.3%, up from 120.9% at first quarter 2015. The NPW to policyholders' surplus ratio for RRGs through first quarter 2016 was 81.9% and indicates a decrease over first quarter 2015, as this ratio was 83.4%. Please note that these ratios have been adjusted to reflect projected annual DPW and NPW based on first quarter results.

An insurer's DPW to surplus



ratio is indicative of its policyholders' surplus leverage on a direct basis, without consideration for the effect of reinsurance. An insurer's NPW to surplus ratio is indicative of its policyholders' surplus leverage on a net basis. An insurer relying heavily on reinsurance will have a large disparity in these two ratios.

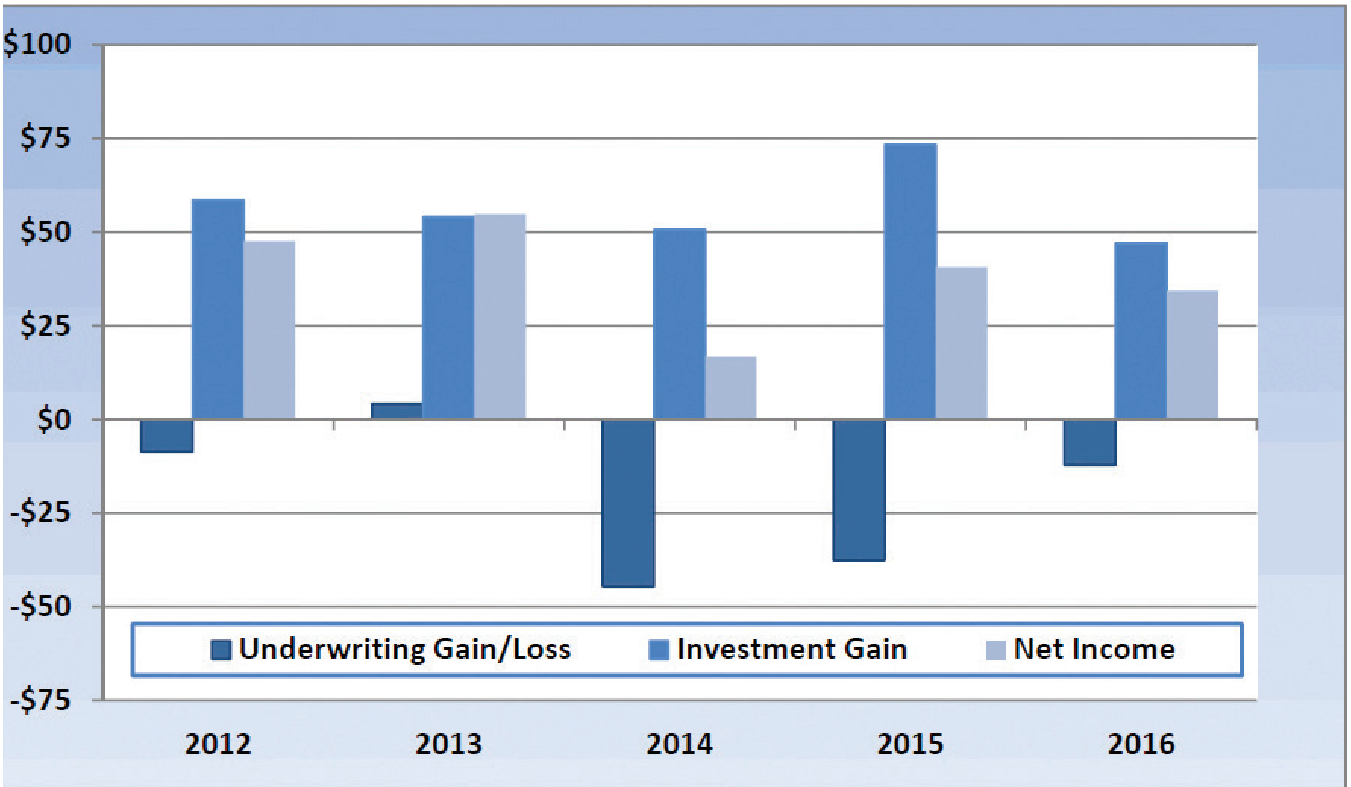
A DPW to surplus ratio in excess of 600% would subject an individual RRG to greater scrutiny during the financial review process. Likewise, a NPW to surplus ratio greater than 300% would subject an individual RRG to greater scrutiny. In certain cases, premium to surplus ratios in excess of those listed would be deemed appropriate if the RRG had demonstrated that a contributing factor to the higher ratio is relative improvement in rate adequacy.

In regards to RRGs collectively, the ratios pertaining to premium written appear to be conservative.

Income Statement Analysis

In regards underwriting gains and losses, RRGs collectively were not profitable through first quarter 2016 as RRGs reported an aggregate underwriting loss of $12.2 million. The collective underwriting losses were offset by strong investment gains and other sources of income. RRGs reported a net investment gain of $47 million and a net income of $34.3 million. RRGs have collectively reported a net income at each year-end since 1996.

The loss ratio for RRGs collectively, as measured by losses and loss adjustment expenses incurred to net premiums earned, through first quarter 2016 was 77.3%, a decrease over first quarter 2015, as the loss ratio was 82.3%. This ratio is a measure of an insurer's underlying profitability on its book of business.



The expense ratio, as measured by other underwriting expenses incurred to net premiums written, through first quarter 2016 was 12% and indicates an increase compared to first quarter 2015, as the expense ratio was reported at 11.4%. This ratio measures an insurer's operational efficiency in underwriting its book of business.

The combined ratio, loss ratio plus expense ratio, through first quarter 2016 was 89.2% and indicates a decrease compared to first quarter 2015, as the combined ratio was reported at 93.6%. This ratio measures an insurer's overall underwriting profitability. A combined ratio of less than 100% indicates an underwriting profit.

Regarding RRGs collectively, the ratios pertaining to income statement analysis appear to be appropriate. Moreover, these ratios have remained within a profitable range.

Conclusions Based on First Quarter 2016 Results

Despite political and economic uncertainty, RRGs remain financially stable and continue to provide specialized coverage to their insureds. The financial ratios calculated based on the reported results of RRGs appear to be reasonable, keeping in mind that it is typical and expected that insurers' financial ratios tend to fluctuate over time.

The results of RRGs indicate that these specialty insurers continue to exhibit financial stability. It is important to note again that while RRGs have reported net income, they have also continued to maintain adequate loss reserves while increasing premium written year over year. RRGs continue to exhibit a great deal of financial stability. ■

Douglas A Powell is a Senior Financial Analyst at Demotech, Inc. Mr. Powell supports the formulation and assignment of Financial Stability Ratings® by providing analysis of statutory financial statements and business information. He also performs financial and operational and peer group analyses, as well as benchmark studies for client companies. Email your questions or comments to dpowell@demotech.com.