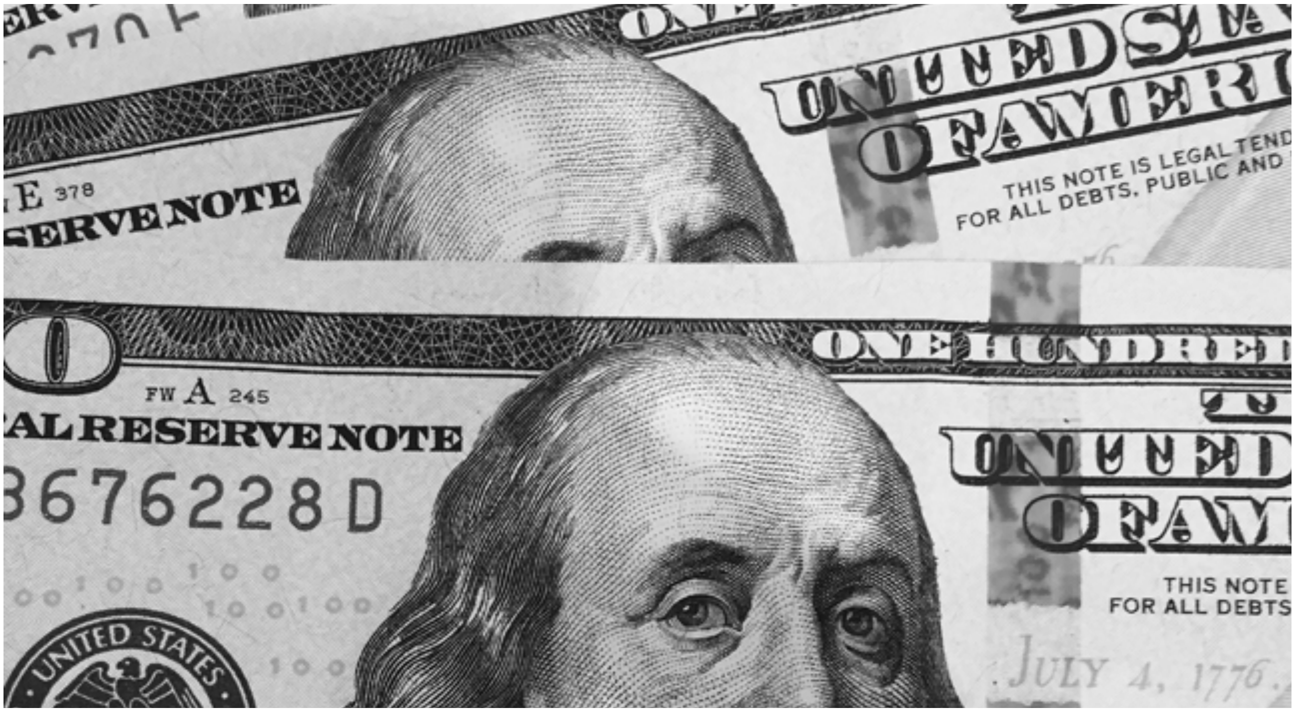

RRGs Report Net Income in Third Quarter 2017

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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

Since third quarter 2016, cash and invested assets (2 percent), total admitted assets (2.5 percent), and policyholders' surplus (2.5 percent) have increased modestly while liabilities increased 2.5 percent. These reported results indicate that RRGs remain adequately capitalized in aggregate and are able to remain solvent if faced with adverse economic conditions or increased losses. 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.

Liquidity, as measured by liabilities to cash and invested assets, for third quarter 2017 was 68.4 percent. A value less than 100 percent is considered favorable as it indicates that there was more than a dollar of net liquid assets for each dollar of total liabilities.

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 third quarter 2017 was 213.5 percent. 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 percent. Leverage for all RRGs combined, as measured by total liabilities to policyholders' surplus, for third quarter 2017 was 151 percent. The loss and LAE reserves to policyholders' surplus ratio for third quarter 2017 was 103.4 percent. 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 nearly $2.8 billion of direct premium written (DPW) through third quarter 2017, an increase of 3.5 percent over third quarter 2016. RRGs reported nearly $1.7 billion of net premium written (NPW) through third quarter 2017, an increase of approximately 1 percent over third quarter 2016.

The DPW to policyholders' surplus ratio for RRGs collectively through third quarter 2017 was 76.2 percent. The NPW to policyholders' surplus ratio for RRGs through third quarter 2017 was 45.6 percent. Please note that these ratios have been adjusted to reflect projected annual DPW and NPW based on third 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 percent would subject an individual RRG to greater scrutiny during the financial review process. Likewise, a NPW to surplus ratio greater than 300 percent 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

RRGs collectively reported a $9.8 million underwriting loss through third quarter 2017. However, RRGs collectively reported a net investment gain of nearly $210 million and a net income of $173.5 million. Also of note, 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 third quarter 2017 was 74.7 percent. 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 third quarter 2017 was 19.9 percent. This ratio measures an insurer's operational efficiency in underwriting its book of business.

The combined ratio, loss ratio plus expense ratio, through third quarter 2017 was 94.6 percent. This ratio measures an insurer's overall underwriting profitability. A combined ratio of less than 100 percent typically 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 Third Quarter 2017 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. ■

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