THE MUTUAL FACTOR: 5 YEARS LATER 2022

How Performance, Structure, and Focus Set Mutual Insurance Companies Apart

NAMIC® NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES | AON

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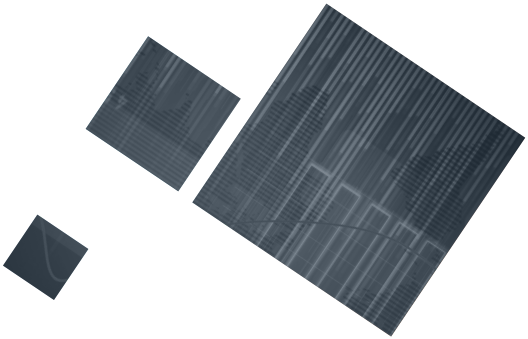
About NAMIC

The National Association of Mutual Insurance Companies consists of more than 1,500 member companies, including seven of the top 10 property/casualty insurers in the United States. The association supports local and regional mutual insurance companies on main streets across America as well as many of the country's largest national insurers. NAMIC member companies write $357 billion in annual premiums and represent 69 percent of homeowners, 56 percent of automobile, and 31 percent of the business insurance markets.



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FOREWORD

The year 2022 marks the fifth anniversary of publication of NAMIC's Mutual Factor report, the first-of-its-kind performance analysis of the mutual property/casualty insurance industry. This unprecedented publication resulted from the desire to gain an objective overview of the mutual sector and its unique structure over time, particularly in relation to other, differently structured insurance companies.

The original Mutual Factor, published in 2018, began as a data-driven overview of the key performance metrics of the mutual insurance industry in comparison to other insurance companies and served as a benchmark for standard metrics. That first report generally showed that while mutuals do things differently than other insurance companies, that difference provides a distinct strength focused on policyholders above all else.

Subsequent reports followed in 2019, 2020, and 2021 but with an important distinction. Each of those reports was published by NAMIC in partnership with Aon to enhance and expand the report by adding critically important details on how mutual companies fared under the updated AM Best Credit Rating Methodology framework released in 2017. All four previous reports also included additional research among key stakeholder groups – general insurance consumers, commercial insurance buyers, independent agents, and in 2020, a unique survey among mutual industry thought leaders to gain perspective on the COVID-19 pandemic and its impact on the industry.

This year NAMIC is proud to publish the fifth iteration – the 2022 Mutual Factor – again comparing performance metrics over the past 12 months and over a five-year time frame, along with AM Best credit ratings impact and new emerging issues. And in similar fashion to our 2020 thought leadership survey, the 2022 report is taking a deeper dive into attitudes and perceptions among reinsurers as a key stakeholder group. The stakeholder analysis features the results from in-depth interviews with leaders representing the reinsurance sector to gain insights into what reinsurers see on the horizon, and on how mutuals are viewed in comparison to other insurance companies.

After five years, the annual Mutual Factor report has come of age, providing an in-depth analysis of the mutual insurance sector along with insights and perspective into how the mutual structure has survived, and more importantly, thrived over its more than 250 years of existence. NAMIC is proud to bring you this fifth anniversary edition of the report, and we hope the data and insights contained within the 2022 Mutual Factor will further support all NAMIC members as they continue to adapt, innovate, and succeed in the years ahead.

EXECUTIVE SUMMARY OF FINDINGS

The property/casualty insurance industry is a massive and extremely competitive business. With more than $715 billion in premiums written in 2021, there are dozens and sometimes hundreds of insurers competing for policyholders and premium dollars in some markets. Competition breeds diversity in approach to the assessing of pricing, and financing of risk. It is that diversity that is one of the insurance industry's greatest assets and a key driver of the industry's enduring strength in the face of often unforeseeable adversity and innumerable challenges.

The roots of modern insurance originate indisputably with mutual insurers – entities organized for the sole benefit of their members. The understanding that mutual risks could be pooled to benefit all members of the pool is a simple and intuitive concept dating back to ancient times and remains just as relevant today. Mutual insurers today compete with other insurers, particularly stock insurers that operate for the benefit of their investors. In recent years, capital markets have sought to play a larger role, particularly in reinsurance.

The different organizational structures within the insurance industry naturally give rise to somewhat different approaches to the management and pricing of risk as well as investment strategies that, in turn, result in differences in operating performance.

The 2022 Mutual Factor report provides evidence of the overall financial strength and stability of the mutual insurance segment as it relates to market performance. The report looks at some distinctions in the key measures of operating performance between mutual and stock insurers and the industry overall through June 2022, during 2021, and over a five-year period. In addition, the report analyzes the impact of ratings agency criteria on mutuals and looks at how the mutual industry is perceived by key stakeholders. Nearly 30 metrics are compared across the mutual, stock, and "other" insurer categories. Some of the key findings are as follows:

MARKET PERFORMANCE

In Q2 2022, the policyholder dividend ratio for mutual insurers was normalized to pre-pandemic levels at around 1%. Stock insurers dividend ratios remained flat through the pandemic as they returned money to insureds through premium credits.

Mutual insurers ran at an underwriting loss as a result of the challenging quarter for the industry. The combined ratio for mutual insurers for Q2 2022 was 113.8% compared to 97.0% for stock companies, which operated at an underwriting profit, aligning with their focus on returns.

For 2021, the industry reported an increase in losses and loss adjustments (LAE), the growth in net earned premium did not offset these losses and, therefore, resulted in a higher loss and LAE ratio (72.5%) compared to 2020 (70.2%) for the industry. Mutual insurers recorded LAE expenses of 74.7% of premium for 2021 compared to 70.3% for 2019, and stock companies came in slightly lower at 70.9% for 2021 compared to 70.1% in 2020.

Expense ratios remained fairly consistent YOY across all segments of the insurance industry, with stock companies reporting an improvement in 2021 (25.9%) compared to 2020 (27.4%) while mutuals reported a consistent 27.4% for 2021 and 2020. The expense ratio is similar for mutuals and stocks on a five-year basis as well.

In 2021, the industry hit a record $1.053 trillion in capital and surplus, growing 13.3% from 2020. Mutual insurers grew by 10.1%, while stock companies grew by 15.8%. The growth in surplus was mainly attributed to increase in unrealized capital gains and insurer income from the soaring stock market. Mutuals' five-year compound average growth of rate is 7.4%, while stock companies' five-year surplus growth rate of 9.1% has been bumped up by strong 2021 results.

The pace of increase in capital and surplus was slightly slower than that of premium growth in 2021, therefore increasing leverage industrywide – and thereby decreasing the amount of capital standing behind each dollar of premium written. Mutual insurers were slightly less leveraged than their stock counterparts in 2021, with $1.49 in policyholder surplus backing up each dollar in net premiums written compared to $1.45 for stock insurers.

Decreasing and low interest rates remained a challenge for the insurance industry in 2021, with yields on invested assets remaining under 3.0% for mutual and stock companies alike, at or close to their lowest levels since the beginning of the financial crisis in 2008. Yields are slightly lower for mutual insurers, suggesting a fixed income portfolio that is somewhat more conservative and of shorter duration.

The return on average surplus for the mutual segment was 3.5% compared to 8.5% for stock insurers. Mutual insurers typically operate with lower returns on surplus, i.e., equity, because policyholders, not external shareholders, are the owners of the company and benefit in other ways from their relationship with insurers, e.g., policyholder dividends and lower pricing.

MUTUAL AM BEST RATINGS

The 2022 Mutual Factor report includes a study on how mutual companies compare to stock companies under AM Best's Credit Rating Methodology (BCRM). The study includes all rating components throughout the BCRM and, similar to last year's report, shows that mutual insurer ratings compare favorably to ratings of stock insurers.

Specific highlights include:

- For the first half of 2022, AM Best has taken rating action on more than 300 companies. Of the mutuals, 93% of companies had their rating affirmed, with 7% receiving a change in rating. This compares to 83% of stock companies that had their rating affirmed, with 15% receiving a change in rating. Mutual companies are well capitalized with median Best's Capital Adequacy Ratio at the VaR 99.6 of 62%, 8 points higher than stock companies at 54%. Ninety-one percent of mutual companies also have the "Strongest" or "Very Strong" balance sheet strength, compared to 81% for stock companies.

- Although 87% of both mutual and stock companies have an "Adequate" or better operating performance assessment, stock companies show 26% higher standard deviation when looking at five-year combined ratio volatility.

- Forty-seven percent of mutual companies have a "Neutral" or better business profile, compared to 39% of stock companies. Mutual companies also compare better than stock companies in Enterprise Risk Management with 97% scoring "Appropriate" or better and 92% of stock companies scoring the same.

REINSURANCE INDUSTRY THOUGHT LEADERSHIP STUDY

The 2022 Mutual Factor provided yet another opportunity to explore the perspectives and insights of a stakeholder group that is critically important to the mutual insurance industry. This year's report focuses on in-depth interviews with 24 executives of the reinsurance industry to learn how they perceive the challenges facing their own industry, as well as the challenges and opportunities facing mutual insurers. Reinsurance thought leaders also shared insights into the value they place on their relationships with the mutual industry.

Specific highlights include:

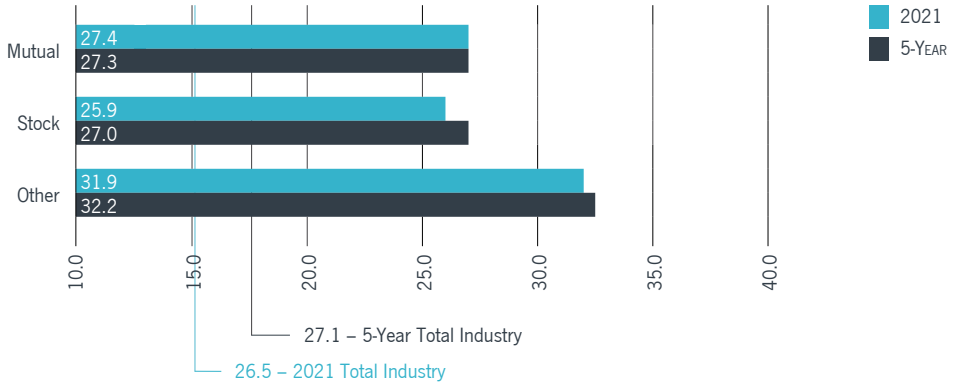
- Most reinsurers believe that extreme weather events are becoming more frequent and more severe. Many of these events (e.g., derechos, wildfires) are unmodeled and the true extent of risk may be unknown. These events have had a negative impact on reinsurers' earnings in recent years.
- Economic inflation is expected to be short-lived, but social inflation is a looming concern and considered a more insidious problem by reinsurers.
- Reinsurers see mutuals as a desirable and a stable part of their portfolios.
- Growth is not a key criterion used by reinsurers in assessing the financial health of mutual insurers. In fact, rapid growth is a red flag, unless there is a solid strategy behind it. In general, reinsurers look at ratings agencies, key ratios, and management as the most important factors.

The Thought Leadership Study of reinsurance industry executives is the fifth survey among key industry stakeholders by NAMIC as part of the Mutual Factor report since 2018. Previous customer surveys focused on personal home and auto insurance customers, commercial insurance purchasers, mutual industry thought leaders during the pandemic, and independent insurance agents.

THE STATE OF MUTUALS

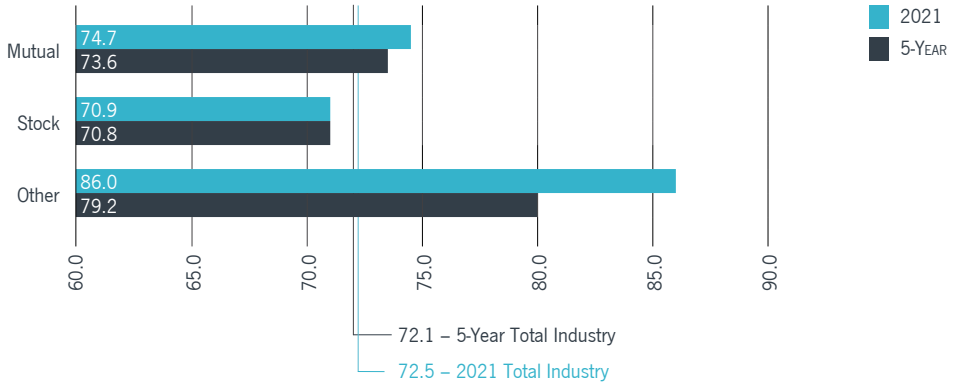
EXPENSE RATIO (%)

The expense ratio of mutual insurers is 27.4%, which is higher than the expense ratio of 25.9% for stock insurers in 2021. However, on a five-year basis the expense ratio for mutuals and stocks is closer at 27.3% compared to 27.0% for stock insurers. This suggests that the expense load for mutuals is competitive with that of stock insurers and the market overall.



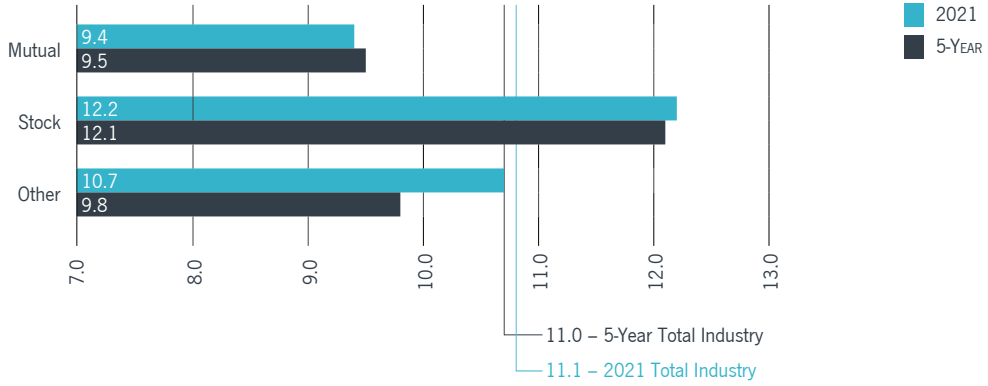
LOSS & LAE RATIO (%)

Mutual insurers typically pay out a higher share of each premium dollar in claims and claim-related expenses, known as loss adjustment expenses, or LAE, than stock insurers. In 2021, mutual insurers paid out 74.7% of each premium dollar for claims and claim-related expenses compared to 70.9% for stock insurers. Results are consistent when evaluated on a five-year basis with the Loss & LAE ratio for mutuals at 73.6% and stocks at 70.8%. The higher five-year Loss & LAE ratio for Other reflects elevated losses from workers' compensation state funds.



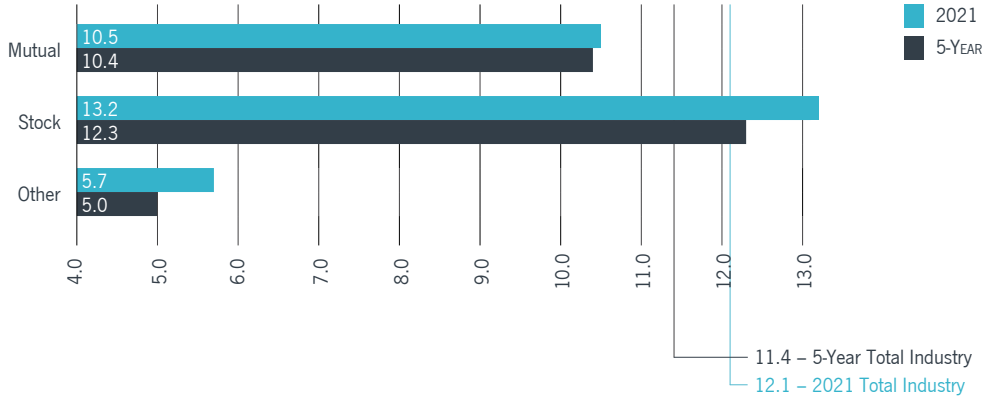
NET COMMISSION RATIO (%)

The commission expense ratio of mutual insurers (9.4%) is 3 points better than stocks (12.2%) for 2021, reflecting the benefit that business mix and type of distribution has on the commission structure for large mutual insurers. Mutual and stocks results are similar on a five-year basis at 9.5% and 12.1% respectively.



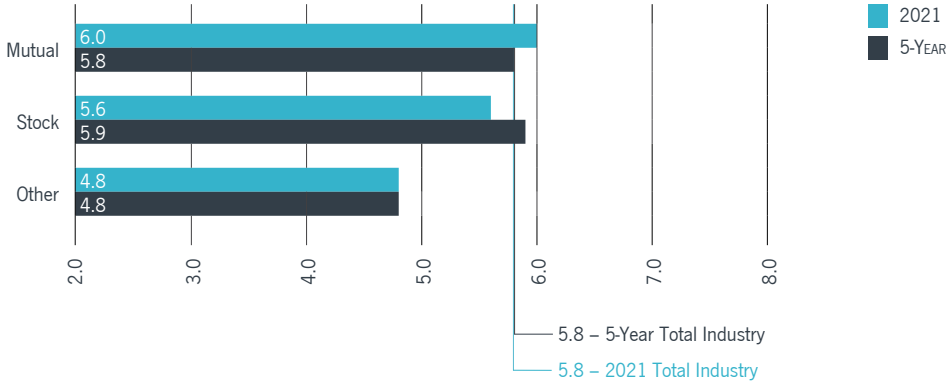
DIRECT COMMISSION & BROKERAGE EXPENSE RATIO (%)

The direct commission and brokerage expense ratio of mutual insurers (10.5%) is 3 points better than stocks (13.2%) for 2021, reflecting the benefit that business mix and type of distribution has on the commission structure for large mutual insurers. Five-year results are similar to 2021, with mutuals at 10.4% and stocks at 12.3%.



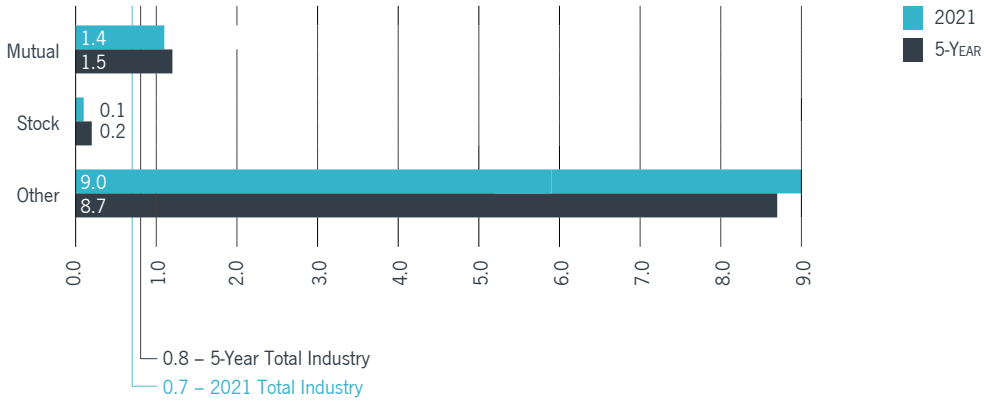
DIRECT GENERAL EXPENSE RATIO (%)

General expenses reflect the cost to the insurer of underwriting and servicing policies. Expressed as a ratio to direct premiums written, this ratio in 2021 was 6.0% for mutual insurers and 5.6% for stock insurers. On a five-year basis, the result for mutuals and stocks is similar to 2021 at 5.8% and 5.9%, respectively.



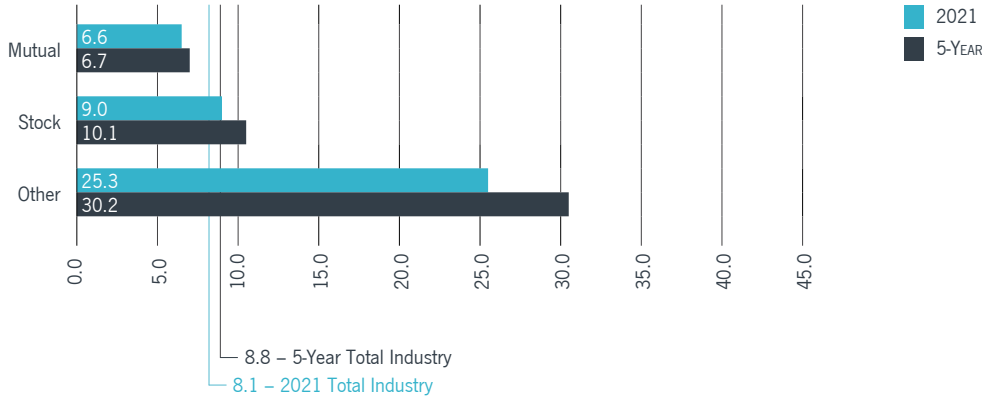
DIVIDEND RATIO (%)

Paying dividends to policyholders is much more common among mutuals than stock companies, reinforcing the fact that mutual policyholders are also the companies' owners. In 2021, mutual insurers paid dividends to policyholders equal to 1.4% of net premiums compared to 0.1% for stock companies, with the total industry falling within the median at 0.7% for the year. Mutual companies reported about 1% less in their dividend ratio from the high in 2020 due to elevated dividends during the initial COVID-19 lockdown. Dividend payments remain consistent for mutuals and stocks over five years. Policyholder dividends are an important customer retention tool for some mutuals and can also represent a reward and incentive for policyholders who file few, if any, claims.



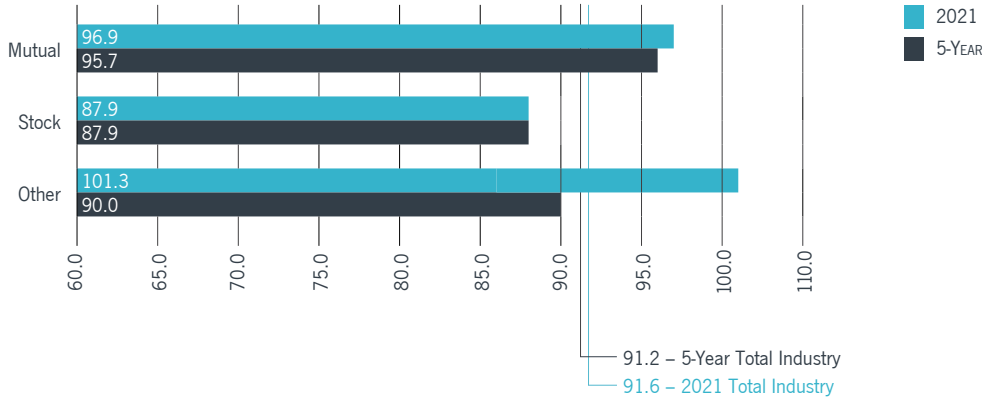
NET INVESTMENT INCOME RATIO (%)

The net investment income ratio for mutual insurers in 2021 stood at 6.6%, below the 9.0% recorded for stock insurers. The same trend can be identified on a five-year average, where the net investment income ratio for mutuals is 6.7%, which is lower than the stocks' 10.1%. The lower figure reflects, in part, the mutual segment's more conservative approach to investing and lower asset leverage. The high net investment ratio for Other is a result of state funds and higher asset leverage to back long-tailed reserves.



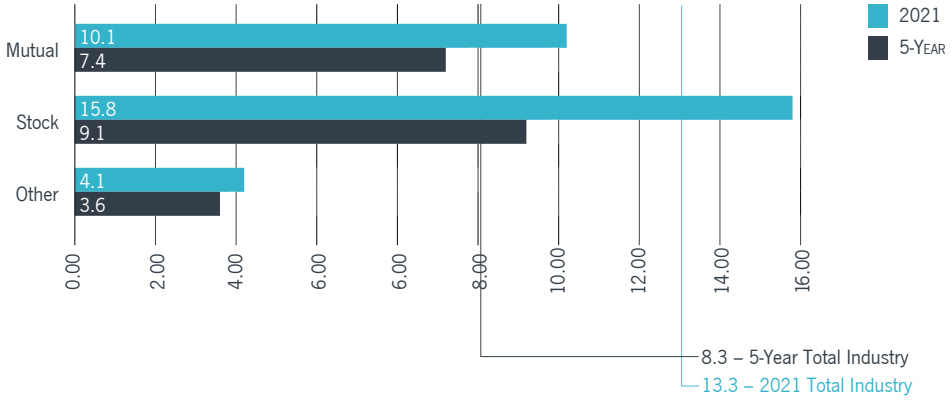
OPERATING RATIO (%)

The operating ratio for mutual insurers in 2021 was approximately 9 points higher than for stock insurers. Over the last five years mutual insurers were almost 8 points higher than stock insurers. This emphasizes the combined effects of higher loss ratios and a lower investment income ratio. An operating ratio slightly below 100% aligns with Mutuals' pricing approach versus stocks who need to target sub-90 operating ratios to meet investor needs.



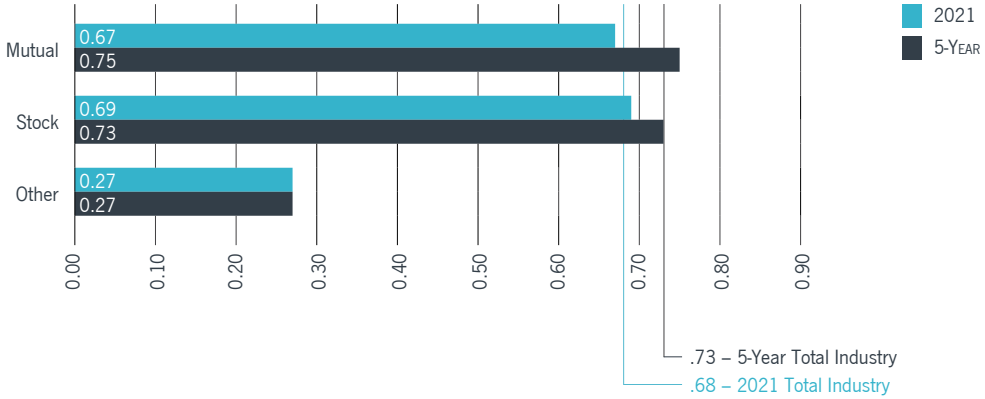
CAPITAL AND SURPLUS GROWTH (%)

Despite increased catastrophe activity through 2021, capital and surplus growth for the entire industry was 13.3%, compared to a 7.3% increase from last year. The mutual segment grew by 10.1% in 2021 and stock companies grew by 15.8%. The last five years showed positive surplus growth for mutuals (7.4%) and stocks (9.1%). This overall growth was very strong by historical standards and occurred despite heavy catastrophe losses.



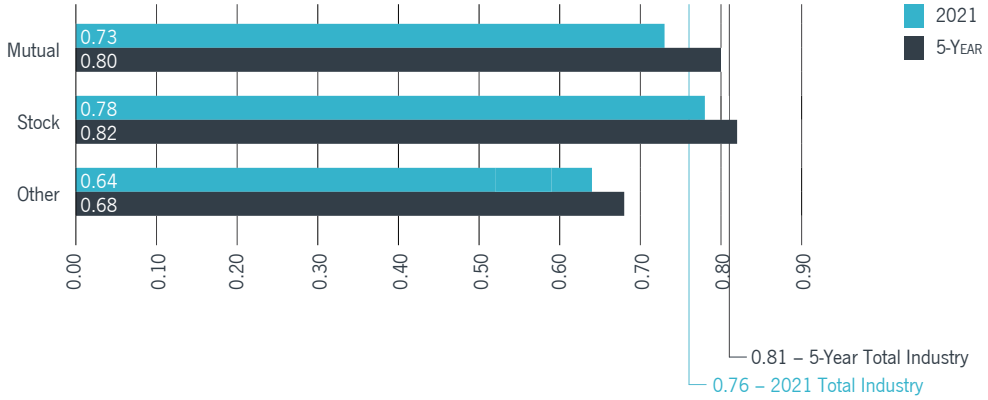
NET WRITTEN PREMIUM TO SURPLUS RATIO (%)

Historically, mutual insurers operate with slightly less leverage than stock insurers. This means that mutual insurers carry more surplus, i.e., claims paying capital, per dollar of net written premium. In 2021, mutual insurers had a net written premium to surplus ratio of 0.67, which means they held $1.49 in surplus for every $1 in net written premium received while stock insurers held $1.45. These both compare similarly to the total industry, in which the industry holds $1.47 in surplus for every $1 in net written premiums. This suggests that mutuals and stocks carry adequate surplus.



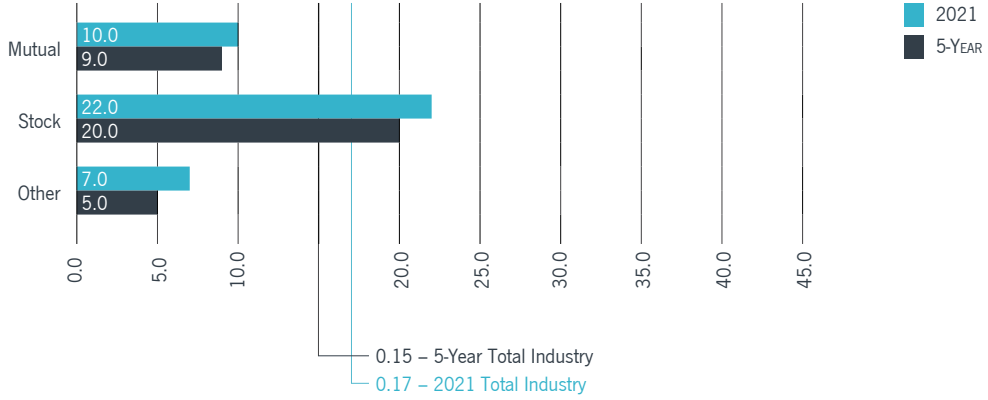
DIRECT WRITTEN PREMIUM TO SURPLUS (%)

Over a five year basis, stock insurers had a direct premium to surplus ratio of 0.82, which means they held $1.22 in surplus per $1 in direct written premium, compared to $1.25 for mutual insurers. Historical trends continued in 2021, with mutual insurers operating less leveraged as they held $1.37 per $1 in direct written premium compared to $1.28 per $1 in direct written premium for stock insurers.



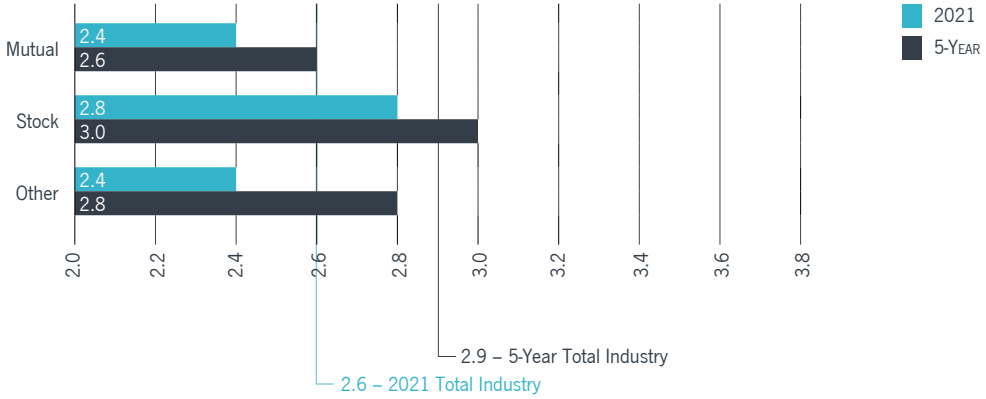
CEDED-TO-DIRECT WRITTEN PREMIUM RATIO (%)

Ceded-to-direct written premium shows how much reinsurance is purchased relative to a company's direct writings. Mutual insurers are ceding about 10% of their direct writings, while stock companies are ceding about 22% for 2021 and 20% on a five-year basis.



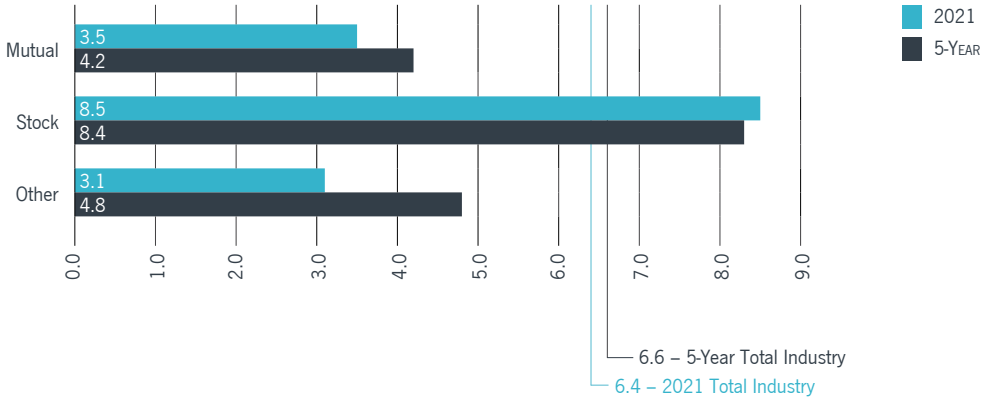
NET YIELD ON INVESTED ASSETS (%)

Persistently low interest rates remain a challenge throughout the insurance industry through 2021, with yields on invested assets in the 2.5% to 3.0% range compared to more than 4.5% prior to the onset of the financial crisis in 2008. Net yield on invested asset for mutual insurers in 2021 is 2.4%, compared to their five-year average of 2.6%.



RETURN ON AVERAGE EQUITY (%)

Profitability across the entire property/casualty insurance industry decreased in 2021 in large part due to increased catastrophe losses. Return on Average Equity (Capital & Surplus) is lower within the mutual segment due primarily to the fact that mutuals paid out a higher share of each premium dollar in claims and claim-related expenses and because they tend to invest more conservatively.



Aggregate Underwriting Ratios				
	Segment			
	Mutual	Stock	Other	Total
Net Written Premium ($)	286,187,255	426,474,503	3,351,624	716,013,382
Net Earned Premium ($)	279,302,252	407,607,889	3,238,442	690,148,583
Expense Ratio (%)	27.4	25.9	31.9	26.5
Loss & LAE Ratio (%)	74.7	70.9	86.0	72.5
Dividend Ratio (%)	1.4	0.1	8.8	0.7
Combined Ratio (%)	103.5	96.9	126.6	99.7
Net Investment Income Ratio (%)	6.6	9.0	25.3	8.1
Operating Ratio (%)	96.9	87.9	101.3	91.6

Additional Aggregate Metrics				
	Segment			
	Mutual	Stock	Other	Total
Net Written Premium ($)	286,187,255	426,474,503	3,351,624	716,013,382
Direct Written Premium ($)	311,651,304	477,826,848	7,969,203	797,447,355
Dir. Commission & Brokerage Exp. ($)	32,692,345	63,032,893	456,700	96,181,938
Ceded Reins: Premiums Ceded ($)	32,030,769	104,446,990	545,250	137,023,009
Gross Written Premiums ($)	319,098,860	546,767,753	8,165,132	874,031,745
Surplus, 2021 ($)	425,243,097	615,223,565	12,438,098	1,052,904,760
Net Total Assets ($)	930,222,640	1,651,293,068	35,432,895	2,616,948,603
Net-to-Direct Written Premium Ratio	0.92	0.89	0.42	0.90
Ceded-to-Direct Written Premium Ratio	0.10	0.22	0.07	0.17
Ceded-to-Gross Written Premium Ratio	0.10	0.19	0.07	0.16
Net Commission Ratio (%)	9.4	12.2	10.7	11.1
Dir. Com. & Brokerage Exp. Ratio (%)	10.5	13.2	5.7	12.1
Direct General Expense Ratio (%)	6.0	5.6	4.8	5.8
Capital & Surplus Growth (%)	10.1	15.8	4.1	13.3
Net Written Premium to Surplus Ratio	0.67	0.69	0.27	0.68
Dir. Written Premium to Surplus Ratio	0.73	0.78	0.64	0.76
Pretax Return on Revenue (%)	2.7	11.6	-2.5	7.9
Return on Average Equity (C&S) (%)	3.5	8.5	3.1	6.4
Return on Average Assets (%)	1.6	3.1	1.1	2.6
Net Yield on Invested Assets (%)	2.4	2.8	2.4	2.6

Source: S&P Global Market Intelligence

FIVE-YEAR RAW DATA*

Aggregate Underwriting Ratios				
	Segment			
	Mutual	Stock	Other	Total
Net Written Premium ($)	270,029,885	363,880,452	3,113,886	637,024,223
Net Earned Premium ($)	265,333,332	352,280,914	3,081,354	620,695,600
Expense Ratio (%)	27.3	27.0	32.2	27.1
Loss & LAE Ratio (%)	73.6	70.8	79.2	72.1
Dividend Ratio (%)	1.5	0.2	8.7	0.8
Combined Ratio (%)	102.5	98.0	120.1	100.0
Net Investment Income Ratio (%)	6.7	10.1	30.2	8.8
Operating Ratio (%)	95.7	87.9	90.0	91.2

Additional Aggregate Metrics				
	Segment			
	Mutual	Stock	Other	Total
Net Written Premium ($)	270,029,885	363,880,452	3,113,886	637,024,223
Direct Written Premium ($)	289,970,426	412,871,164	7,924,458	710,766,048
Dir. Commission & Brokerage Exp. ($)	30,158,310	50,750,667	395,682	81,304,659
Ceded Reins: Premiums Ceded ($)	26,192,401	83,088,139	404,157	109,684,697
Gross Written Premiums ($)	296,118,336	467,152,963	8,037,584	771,308,883
Surplus, Five-Year Average ($)	361,068,381	501,375,422	11,598,503	874,042,306
Net Total Assets ($)	811,209,484	1,393,135,653	34,736,872	2,239,082,009
Net-to-Direct Written Premium Ratio	0.93	0.88	0.39	0.90
Ceded-to-Direct Written Premium Ratio	0.09	0.20	0.05	0.15
Ceded-to-Gross Written Premium Ratio	0.09	0.18	0.05	0.14
Net Commission Ratio (%)	9.5	12.1	9.8	11.0
Dir. Com. & Brokerage Exp. Ratio (%)	10.4	12.3	5.0	11.4
Direct General Expense Ratio (%)	5.8	5.9	4.8	5.8
Capital & Surplus Growth (%)	7.4	9.1	3.6	8.3
Net Written Premium to Surplus Ratio	0.75	0.73	0.27	0.73
Dir. Written Premium to Surplus Ratio	0.80	0.82	0.68	0.81
Pretax Return on Revenue (%)	4.1	11.2	8.2	8.1
Return on Average Equity (C&S) (%)	4.2	8.4	4.8	6.6
Return on Average Assets (%)	1.9	3.0	1.6	2.6
Net Yield on Invested Assets (%)	2.6	3.0	2.8	2.9

*Five-year data represents data from 2017 through 2021

TOP TEN MUTUAL WRITERS								
Rank			Group/Company	Direct Written Premium ($000)	Overall Rank			Market Share
2021	2020				2021	2020		
1	1	▶	State Farm	$70,311,695	1	1	▶	8.8
2	2	▶	Liberty Mutual	$41,473,558	4	5	▲	5.2
3	3	▶	USAA	$25,257,974	8	7	▼	3.2
4	4	▶	Farmers Insurance	$25,009,069	9	9	▶	3.1
5	5	▶	Nationwide	$19,435,641	10	10	▶	2.4
6	6	▶	American Family Insurance	$12,579,932	15	15	▶	1.6
7	7	▶	Auto-Owners Insurance	$9,689,588	17	17	▶	1.2
8	8	▶	Erie Insurance	$7,868,311	21	19	▼	1.0
9	9	▶	FM Global	$5,602,979	28	27	▼	0.7
10	10	▶	Auto Club Exchange	$4,662,813	35	35	▲	0.6

Source: S&P Global Market Intelligence

TOP TEN MUTUAL WRITERS OF PERSONAL AUTO								
Rank			Group/Company	Direct Written Premium ($000)	Overall Rank			Market Share
2021	2020				2021	2020		
1	1	▶	State Farm	$41,665,754	1	1	▶	15.9
2	2	▶	USAA	$15,738,749	5	5	▶	6.0
3	3	▶	Liberty Mutual	$13,257,306	6	6	▶	5.1
4	4	▶	Farmers Insurance	$12,441,182	7	7	▶	4.8
5	5	▶	Nationwide	$5,565,737	8	8	▶	2.1
6	6	▶	American Family Insurance	$5,488,677	9	9	▶	2.1
7	7	▶	Auto Club Exchange	$3,724,620	12	12	▶	1.4
8	8	▶	Erie Insurance	$3,384,616	13	13	▶	1.3
9	9	▶	Auto-Owners Insurance	$3,225,410	14	14	▶	1.2
10	10	▶	CSAA Insurance Exchange	$2,905,119	15	15	▶	1.1

Lines of business for this table include: 19.1 Pvt Pass Auto No-Fault, 19.2 Oth Pvt Pass Auto Liab, and 21.1 Pvt Pass Auto Phys Damage | Source: S&P Global Market Intelligence

TOP TEN MUTUAL WRITERS OF COMMERCIAL AUTO								
Rank			Group/Company	Direct Written Premium ($000)	Overall Rank			Market Share
2021	2020				2021	2020		
1	1	▶	Liberty Mutual	$2,055,875	3	3	▶	3.8
2	2	▶	Nationwide	$1,683,255	5	5	▶	3.1
3	3	▶	Auto-Owners Insurance	$1,412,449	8	8	▶	2.6
4	5	▲	State Farm	$834,351	15	18	▲	1.5
5	9	▲	Farmers Insurance	$806,104	18	26	▲	1.5
6	6	▶	Sentry	$785,448	20	20	▶	1.5
7	4	▼	Erie Insurance	$726,314	21	17	▼	1.3
8	7	▼	Acuity A Mutual Insurance Co.	$680,830	24	23	▼	1.3
9	8	▼	Federated Insurance	$598,132	26	25	▼	1.1
10	10	▶	EMC Insurance	$567,524	27	27	▶	1.1

Lines of business for this table include: 19.3 Comm'l Auto No-Fault, 19.4 Oth Comm'l Auto Liab, and 21.2 Comm'l Auto Phys
Source: S&P Global Market Intelligence

TOP TEN MUTUAL WRITERS OF COMMERCIAL PROPERTY AND LIABILITY								
Rank			Group/Company	Direct Written Premium ($000)	Overall Rank			Market Share
2021	2020				2021	2020		
1	1	▶	Liberty Mutual	$15,508,935	2	2	▶	5.1
2	2	▶	Nationwide	$8,300,815	8	8	▶	2.8
3	3	▶	FM Global	$5,600,790	16	15	▼	1.9
4	4	▶	State Farm	$4,467,134	21	20	▼	1.5
5	5	▶	Farmers Insurance	$3,831,960	23	21	▼	1.3
6	6	▶	Auto-Owners Insurance	$2,955,246	26	26	▶	1.0
7	8	▲	American Family Insurance	$1,696,115	38	39	▲	0.6
8	7	▼	USAA	$1,530,774	39	38	▼	0.5
9	9	▶	Erie Insurance	$1,347,059	41	40	▼	0.4
10	10	▶	The Doctors Co.	$1,272,249	42	43	▲	0.4

Lines of business for this table include: 2.1 Allied Lines (Sub), 2.2 Multiple Peril Crop, 2.3 Federal Flood, 2.4 Private Crop, 2.5 Private Flood, 3 Farmowners MP, 5.1 Comm'l Multi Prl (Non-Liab), 5.2 Comm'l Multi Prl (Liab), 6 Mrtg Guaranty, 8 Ocean Marine, 9 Inland Marine, 10 Financial Guaranty, 11 Med Prof Liab, 12 Earthquake, 17.1 Oth Liab (Occurrence), 17.2 Oth Liab (Claims), 18 Product Liability, 22 Aircraft, 23 Fidelity, 24 Surety, 26 Burglary & Theft, 27 Boiler & Machinery, 28 Credit, 30 Warranty, 34 Oth P&C (State) | Source: S&P Global Market Intelligence

TOP TEN MUTUAL WRITERS OF WORKERS' COMPENSATION								
Rank			Group/Company	Direct Written Premium ($000)	Overall Rank			Market Share
2021	2020				2021	2020		
1	1	▶	Liberty Mutual	$2,166,895	6	5	▼	4.1
2	2	▶	Texas Mutual Insurance Co.	$923,449	16	17	▲	1.7
3	4	▲	Pinnacol Assurance	$539,424	24	24	▶	1.0
4	3	▼	CopperPoint Insurance Companies	$478,237	26	23	▼	0.9
5	6	▲	Encova Insurance	$467,321	28	29	▲	0.9
6	5	▼	Erie Insurance	$454,139	29	27	▼	0.9
7	7	▶	Sentry	$431,024	30	30	▶	0.8
8	8	▶	MEMIC	$385,857	33	31	▼	0.7
9	11	▲	Federated Insurance	$356,173	35	38	▲	0.7
10	10	▶	Nationwide	$345,373	37	37	▶	0.6

Lines of business for this table include: 16 Workers' Comp and 17.3 Excess Workers' Comp
Source: S&P Global Market Intelligence

TOP TEN MUTUAL WRITERS OF ACCIDENT AND HEALTH								
Rank			Group/Company	Direct Written Premium ($000)	Overall Rank			Market Share
2021	2020				2021	2020		
1	1	▶	State Farm	$1,063,470	1	1	▶	14.4
2	2	▶	Liberty Mutual	$101,865	18	13	▼	1.4
3	3	▶	Farmers Insurance	$74,330	22	25	▲	1.0
4	4	▶	American Family Insurance	$22,283	39	37	▼	0.3
5	5	▶	Nationwide	$18,066	42	46	▲	0.2
6	26	▲	Physicians Insurance	$18,043	43	610	▲	0.2
7	6	▼	Sentry	$5,658	49	51	▲	0.1
8	9	▲	Coverys	$1,307	53	60	▲	0.0
9	7	▼	Texas Farm Bureau Insurance	$781	56	58	▲	0.0
10	8	▼	Rural Mutual Insurance Co.	$737	57	59	▲	0.0

Lines of business for this table include: 13 Group A&H, 14 Credit A&H (Grp & Ind), 15.1 Cllct Rnbl A&H, 15.2 Non-Cancelable A&H, 15.3 Grted Renewable A&H, 15.4 NonRnwbl Stated Only, 15.5 Oth Accident Only, 15.6 Medicare Title XVIII Tax Exempt, 15.7 Oth A&H (State), and 15.8 Fed Emp Health Ben | Source: S&P Global Market Intelligence

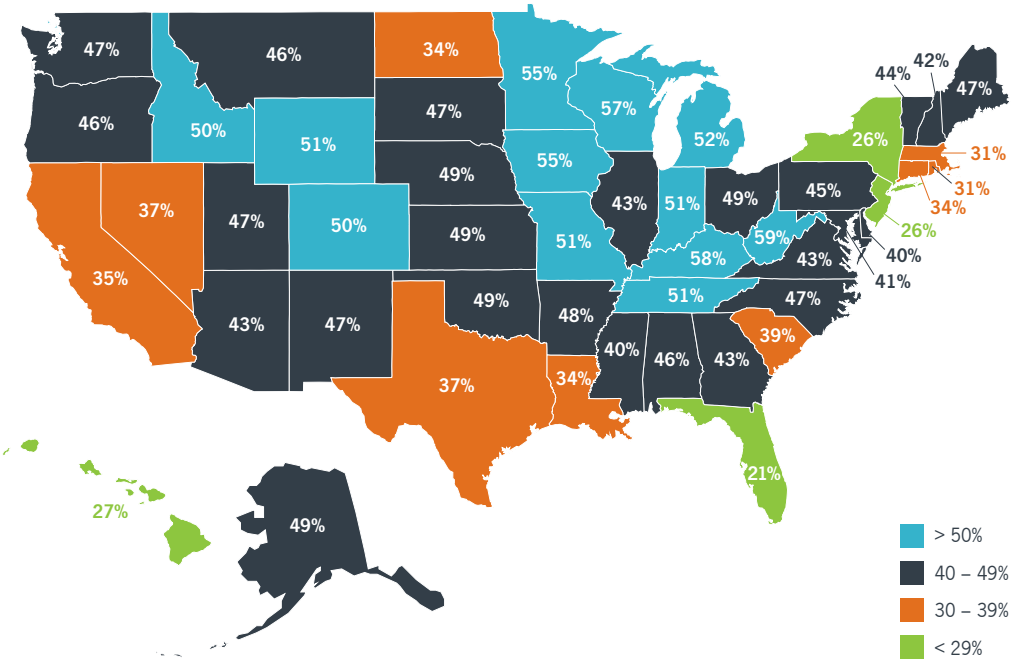
TOP TEN MUTUAL WRITERS OF HOMEOWNERS								
Rank			Group/Company	Direct Written Premium ($000)	Overall Rank			Market Share
2021	2020				2021	2020		
1	1	▶	State Farm	$22,046,155	1	1	▶	18.4
2	2	▶	Liberty Mutual	$8,382,682	3	3	▶	7.0
3	3	▶	USAA	$7,988,445	4	4	▶	6.7
4	4	▶	Farmers Insurance	$7,608,035	5	5	▶	6.4
5	5	▶	American Family Insurance	$5,003,013	7	7	▶	4.2
6	6	▶	Nationwide	$3,522,394	8	8	▶	2.9
7	7	▶	Erie Insurance	$1,956,184	11	11	▶	1.6
8	8	▶	Auto-Owners Insurance	$1,845,560	12	12	▶	1.5
9	9	▶	CSAA Insurance Exchange	$1,053,685	17	15	▼	0.9
10	10	▶	Amica	$964,274	18	16	▼	0.8

Lines of business for this table include: 4 Homeowners MP | Source: S&P Global Market Intelligence

MUTUAL STATE MARKET SHARE (%)

In 2021, mutuals owned 39% of the property/casualty insurance market in the United States, where the stock and other segments had 60% and 1%, respectively. Stock companies make up most of the property/casualty insurance market nationally, which in part is driven by mutual companies de-mutualizing to stock companies in recent years after legislation to permit this process was passed in many states.

Although the mutual segment has a smaller share of the market compared to the stock segment, the mutual segment has a consistent market share presence throughout the United States. Mutuals have the majority of the market share in 12 states and at least 40% market share in another 25 states. The states with more mutual company presence are in the Midwest region of the country. In the four states, plus District of Columbia, where the mutual segment's market share is less than 30%, premiums are typically written by larger stock insurers such as Allstate, Travelers, Zurich, The Hartford, and Progressive.



THE DIFFERENCE BETWEEN MUTUAL & STOCK COMPANY COMBINED RATIOS

Mutual insurers have historically operated with combined ratios that are several points above stock insurers. From 2017 through 2021, the average combined ratio of the mutual segment was 102.5 compared to 98.0 for stocks companies. This was true in 2021 as well, with mutual insurers running a combined ratio of 103.5 compared to 96.9 for stock insurers. There are several reasons for this, discussed in turn below.

POLICYHOLDER DIVIDENDS

The overwhelming majority of policyholder dividends are paid by mutual insurers to their policyholders in recognition of their ownership stake in the company. Stock companies pay dividends as well, but generally to their shareholder owners, and they are not included in the combined ratio. The dividend ratio for mutual insurers in 2021 was 1.4% (which is back to normalized levels after the 2.5% recorded in 2020 due to COVID-19) compared to 0.1% for stock insurers.

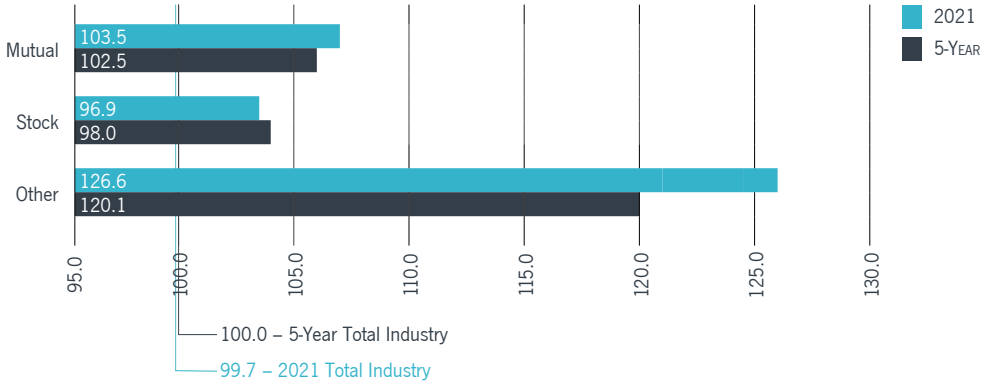
PRICING STRATEGY

Policyholders of mutual companies may also benefit from differences in pricing strategies. Some mutuals tend to temper the pace of rate increases rather than or in addition to paying dividends to policyholders. This translates into greater price stability and lower relative premiums for policyholders. At the same time, a slower pace of rate increase for mutuals will generally lead to loss ratios and ultimately combined ratios that are higher than those of stock companies. Stock insurers tend to operate in this manner because of their responsibility to maximize returns for shareholders. Mutual insurers over the long run must operate profitably, of course, but with their primary objective being growth of surplus. Consequently, mutual insurers do not generally face the same degree of immediacy with respect to the need to increase rates that in turn benefits policyholders as the mutual insurer will pay out a higher share of each premium dollar collected from customers.

Note that this does not mean the average cost per claim, i.e., claim severity, is higher for mutuals. It simply means that mutual insurers on average absorb proportionately more losses than stock companies.

COMBINED RATIO (%)

Mutual insurers saw an uptick in their combined ratios because of increased natural catastrophes in 2021, mainly Winter Storm Uri and an active hurricane season. Mutuals' combined ratio for year-end 2021 is 103.5, which is about 3 points higher than what they experienced the year prior. Despite the recent high catastrophe years, mutuals' combined ratio on a five-year basis is at 102.5. In contrast, the stocks' combined ratio is much lower at 96.9 for 2021 and 98.0 on a five-year average. Stocks compare favorably to the industry combined ratio of 2021 (99.7%), whereas mutuals exceed the industry average.

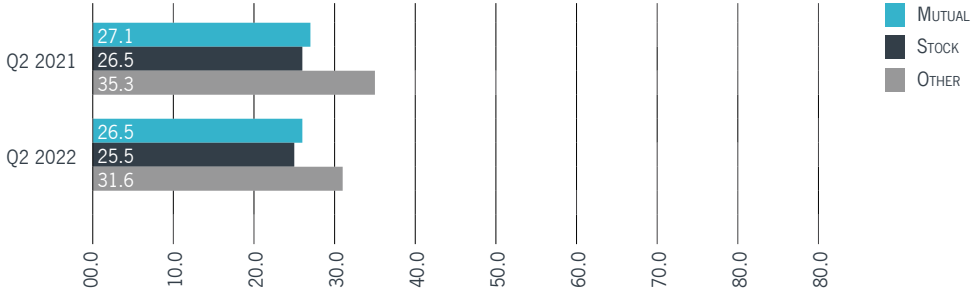


2022 YTD PERFORMANCE THROUGH JUNE

In this section, we review preliminary results from June 2022 statutory financials. While there remains some compilation of group results at the time of this report, about 93% of companies and premium are represented in the analysis below.

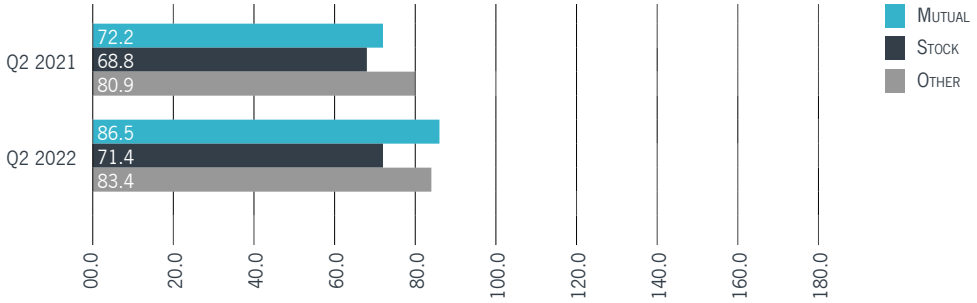
EXPENSE RATIO (%)

Mutual and stock companies both were able to lower their expense ratio by 1 point respectively in Q2 2022 compared to Q2 2021. The Other segment saw even more expense ratio improvement, with a nearly 4 point reduction in Q2 2022.



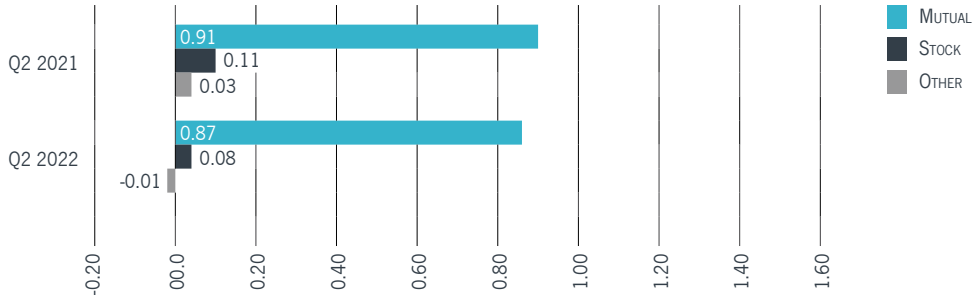
LOSS & LAE RATIO (%)

Loss & LAE ratio in Q2 2022 has deteriorated from Q2 2021 for all segments. Q2 2022 has been a challenging quarter for the industry as whole, and specifically for the mutual segment as they experienced increased loss activity. The increased severe convective storm and derecho activity sprawled across much of the Midwest, which is the region where mutual companies hold most of their market share.



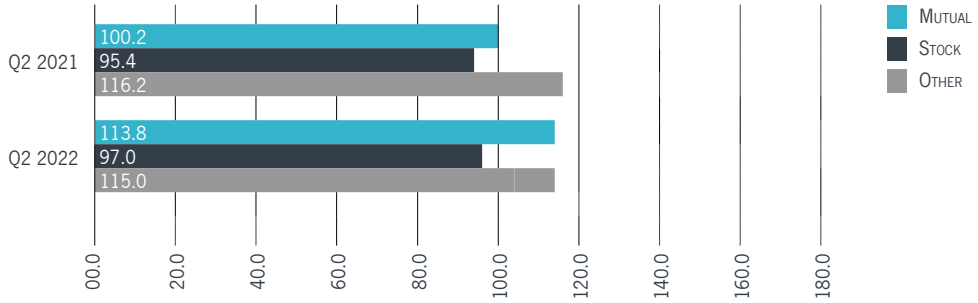
POLICYHOLDER DIVIDEND RATIO (%)

The policyholder dividend ratio has returned to normal trends for both mutuals and stock companies since the spike reported in Q2 2020 due to COVID. Mutual companies continue to use dividends to return value to their policyholders.



COMBINED RATIO (%)

Both mutuals and stock insurers saw combined ratio rise from Q2 2021 to Q2 2022. The increased losses are driving this increase as the expense ratio for mutuals and stock companies saw improvement YOY. The large expense improvement the Other segment reported for Q2 2022 was able to offset their loss ratio increase, allowing combined ratio results to improve by one point YOY.



BENCHMARK STUDY FOR AM BEST RATINGS

OVERVIEW

AM Best continues to be a recognized source of information and commentary on global insurance trends and issues. This rating agency demonstrates expertise, high standards, and sole focus on the insurance industry. As a result, AM Best has emerged as the preeminent rating agency for U.S. insurance companies. Best's Credit Rating Methodology provides a comprehensive explanation of AM Best Rating Services' rating process.

Best's Credit Ratings (BCR) includes Best's Financial Strength Ratings (FSR), Issuer Credit Ratings (ICR) and Issue Credit Ratings (IR). AM Best uses an array of both quantitative and qualitative measures to analyze rated organizations.

The credit rating process is a continuous dialogue with the rated company's management, which is facilitated by a rating analyst. The rating analyst monitors the rating unit's financial and non-financial results, in addition to any significant developments for each rated entity or issue in their portfolio.

Our benchmark study is based upon 622 U.S. property/casualty insurance companies that have been rated by AM Best under the Best's Credit Rating Methodology (BCRM) framework. The findings consist of groups and unaffiliated single companies. With a total count of 622 U.S. property/casualty insurance companies, 53% are represented as stock companies and 47% as mutuals. Stock companies that are part of mutual group ratings were counted as a single mutual company. Reciprocal exchanges, Risk Retention Groups, Cooperatives, and Lloyds were counted as mutual companies. The study is a result of Aon's ability to track how mutual companies are rated under the AM Best criteria. This is based upon ratings as of July 3, 2022.

KEY FINDINGS

The BCRM Benchmark study provides deep insight and conclusions regarding how mutuals are rated under the AM Best criteria.

It was found that **87%** of mutual companies are rated "A-"or higher and **94%** have "positive" or "stable" outlook.

The median VaR 99.6 BCAR score for mutual companies is **62%**, 8 points higher than stock companies at **54%**.

91% of mutuals have "Strongest" or "Very Strong" balance sheet strength, compared to **81%** of stock companies.

87%

Mutual and stock companies have similar operating performance assessment distribution with **87%** "Adequate" or better assessments.

26%

The median five-year combined ratio volatility highlights that stock companies exhibit **26%** higher standard deviation than mutual companies.

47% of mutual companies have "Neutral" or better business profile versus **39%** for stock companies.

97% of mutuals have "Appropriate" or better ERM assessment compared to **92%** of stock companies.

Only **4%** of mutuals receive a rating lift from parent affiliation while **21%** of stock companies depend on this lift.

U.S. PROPERTY/CASUALTY COMPANIES RATING DISTRIBUTION

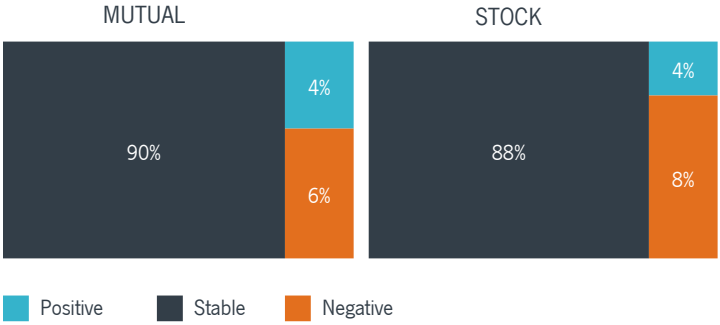
Out of the 622 U.S. property/casualty insurance companies, the majority are either rated "A" or "A-." Slightly fewer mutuals are rated "A++"/ "A+," with 9% receiving the highest rating, compared to 11% of stock companies. However, more mutuals received an "A" rating than stock companies. Forty-five percent of mutuals received an "A" for 2022, compared to 31% of stock companies. It is important to note that 10% of stock companies received a "B+" or lower. This compares to only 3% of mutuals that received a "B+" or lower.

Current Rating

Count: Mutual – 295, Stock – 327

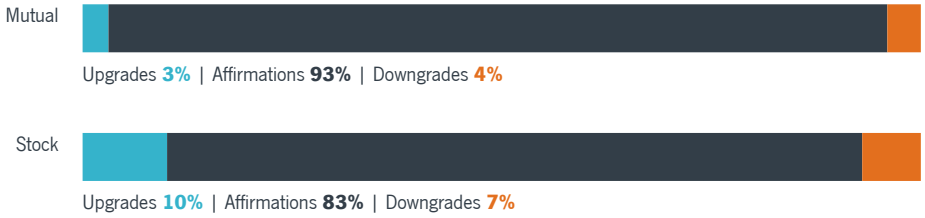
Current Rating Outlook

The majority of companies have a stable rating outlook for the following year, with mutual and stock companies having a stable outlook of 90% and 88%, respectively. Four percent of both stock and mutual companies are on positive outlook. Additionally, more stock companies have a negative outlook than mutual companies. Six percent of mutual companies have a negative outlook. However, when compared to stock companies, a larger amount (8%) are on negative outlook. Having a positive or negative outlook does not guarantee rating action.



Rating Action

For the first half of 2022, AM Best has taken rating action on more than 300 companies. Of the mutuals, 93% of companies had their rating affirmed, with 7% receiving a change in rating. This compares to 83% of stock companies that had their rating affirmed, with 15% receiving a change in rating. This suggests mutuals' ratings are more stable than their stock counterparts over time.

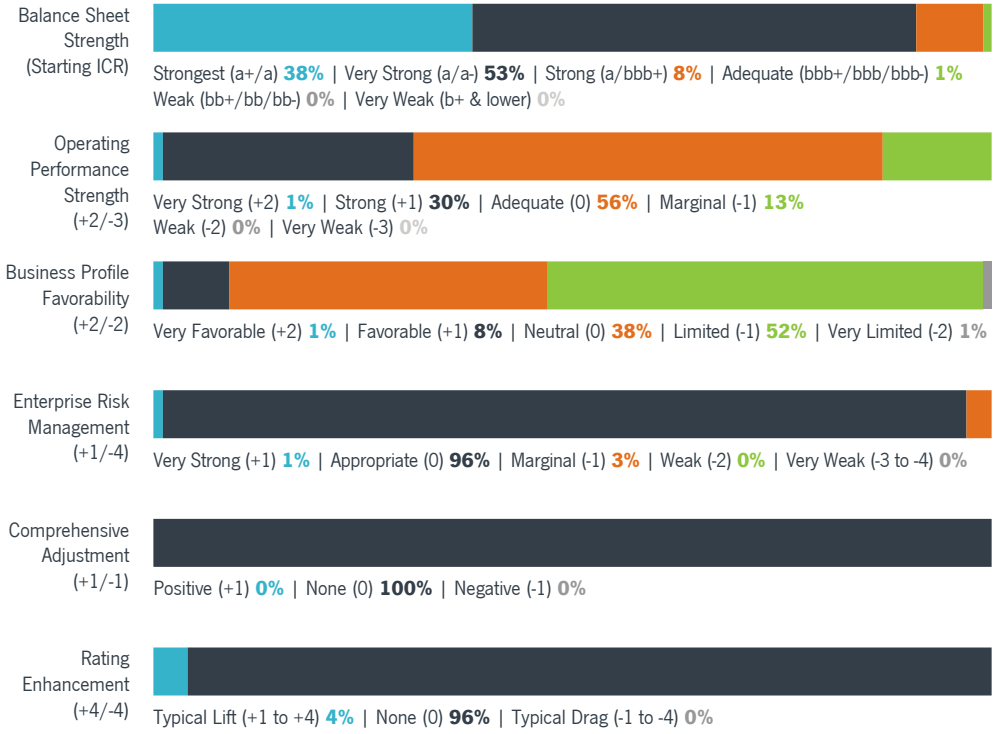


Total: Upgrades – 19, Downgrades – 18

BCRM BUILDING BLOCK ASSESSMENTS

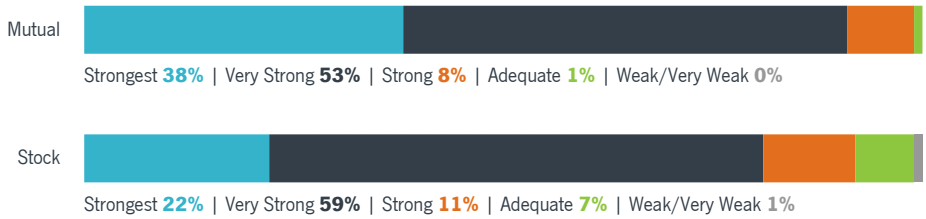
AM Best follows a building block rating approach, which assesses individual components and applies positive or negative notching. Balance Sheet strength sets a base ICR based on the company's BCAR score and other key financial metrics. AM Best will then assess Operating Performance, Business Profile, and Enterprise Risk Management (ERM). After these building blocks, AM Best may apply a comprehensive adjustment if there is something unique not captured in the first four categories. Lastly, AM Best may apply a rating enhancement depending on the parent company before determining the ICR. A company's financial strength rating is a direct function of its ICR.

Referencing the U.S. property/casualty insurance Mutual Distribution Building Block Assessment, 53% of mutuals have a "Very Strong" Balance Sheet Strength. This results in an initial ICR of "a/a-." The majority of mutuals receive an "Adequate" Operating Performance. Fifty-two percent of mutuals receive a "Limited" Business Profile. Ninety-six percent of mutuals have "Appropriate" ERM, given their risk profile. Not one mutual has received a comprehensive adjustment. Despite some mutuals having parental affiliation, 96% of mutuals do not receive a rating enhancement. This notching approach would result in a final ICR for mutuals of "A-," with an FSR of "A-."



BALANCE SHEET STRENGTH

Balance Sheet Strength is the first building block in the BCRM. Companies receive a "Strongest," "Very Strong," "Strong," "Adequate," "Weak" or "Very Weak" assessment depending on their BCAR score and other key financial metrics (Leverage, Reserve Development, Reinsurance, etc.). The balance sheet assessment provides a range of starting ICRs for the analyst to select. Ninety-one percent of mutual companies receive a "Strongest" or "Very Strong" assessment, which simultaneously results in 91% of mutuals starting with an "a+," "a," or "a-" ICR. Additionally, no mutuals are considered to have "Weak" or "Very Weak" Balance Sheet Strength.

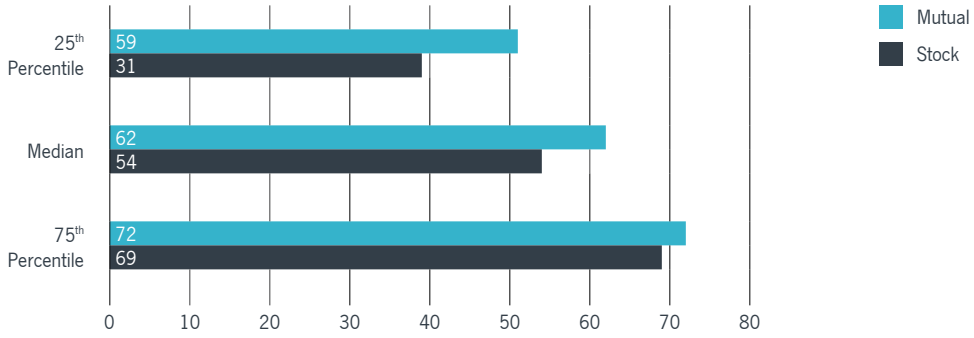


Published BCAR Scores

The primary quantitative tool used to evaluate a company's capitalization is BCAR. AM Best will calculate BCAR at five different confidence intervals (C.I.) VaR 95, 99, 99.5, 99.6, and 99.8 with each C.I. using different capital factors that reflect 20-, 100-, 200-, 250-, and 500-year events, respectively. AM Best will run a baseline calculation as well as a stressed, but only the baseline scores at the VaR 95, 99, 99.5, 99.6 C.I. will be published. The scores provide a starting point for the Balance Sheet Strength assessment.

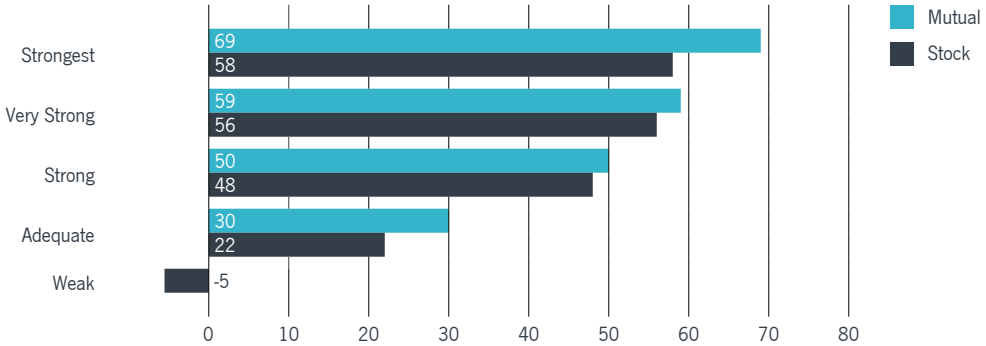
BCAR at VaR 99.6 Percentiles

The most relevant C.I. in the published BCAR output is the VaR 99.6. A company must maintain a BCAR ratio above 10% or 25% to receive a "Very Strong" or "Strongest" balance sheet assessment, respectively. While meeting the BCAR requirement does not guarantee those assessments, most companies manage to be well above the 10% and 25% thresholds. Mutuals at all percentiles maintain a significant higher capitalization compared to stock companies. The numbers below reflect all possible Balance Sheet Strength assessments.



Median BCAR at VaR 99.6 by Balance Sheet Strength Assessment

The median BCAR score for both mutuals and stock companies at each Balance Sheet Strength assessment follow a trend that illustrates the two are correlated. Companies with higher BCAR scores tend to receive more favorable assessments. The median BCAR score for stock companies is less than mutuals as stock companies benefit from having more financial flexibility. It is important to note that BCAR is just one component of the Balance Sheet Strength. This leads to a wide range of assessments, even with most BCAR scores above the 10% and 25% thresholds.

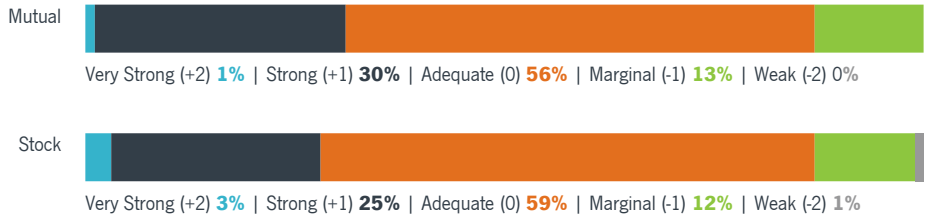


OPERATING PERFORMANCE

Following the Balance Sheet Strength assessment, a company's starting ICR can receive positive, negative, or neutral notching reflective of their Operating Performance. This assessment examines Combined Ratio, Operating Ratio, Net Income, Surplus Growth, and other performance metrics to determine "Very Strong" (+2), "Strong" (+1), "Adequate" (0), "Marginal" (-1), "Weak" (-2), or "Very Weak" (-3) notching.

Operating Performance Strength

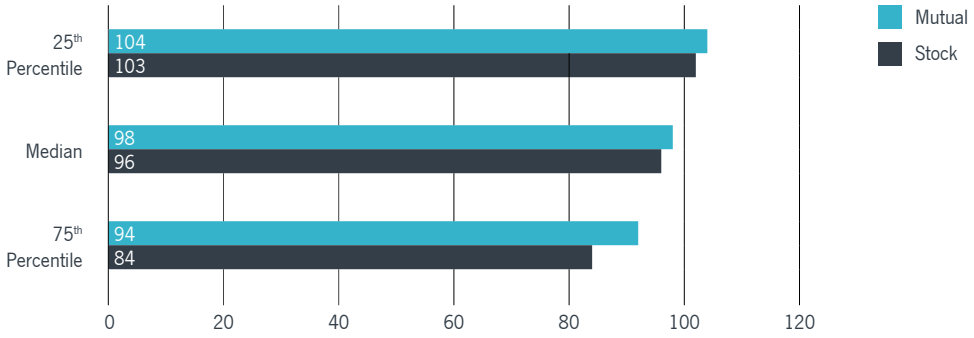
Overall, mutual and stock companies receive similar assessment distributions for the Operating Performance building block. Eighty-seven percent of mutual and stock companies do not receive negative notching.



Combined Ratio and Combined Ratio Volatility Five-Year Percentiles

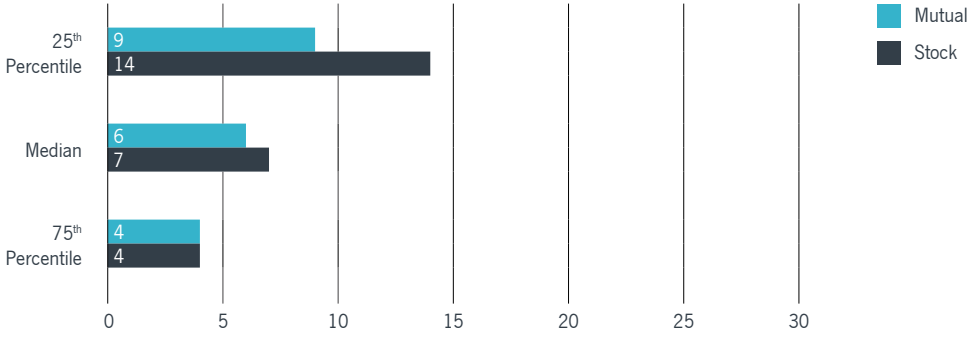
The five-year combined ratio for mutuals and stock companies are similar but separate toward the higher percentile. However, mutual companies experience less volatility when examined through all percentiles. The results below reflect all possible Operating Performance assessments.

Five-Year Combined Ratio



Count: Mutual – 295, Stock – 327

Five-Year Combined Ratio Volatility



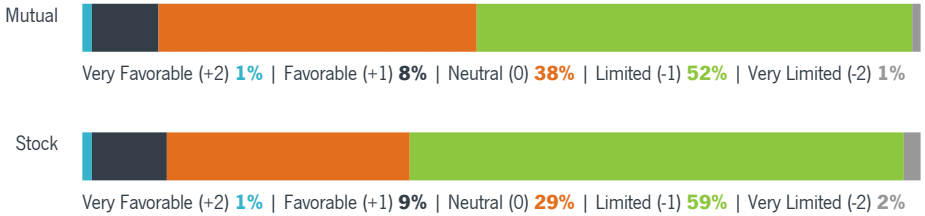
Count: Mutual – 295, Stock – 327

BUSINESS PROFILE ASSESSMENT

After concluding the operating performance review, rating analysts assess the rating unit's business profile. Business Profile factors include the following characteristics: Market Position, Pricing Sophistication, Management Quality, Data Quality, Regulatory & Market Risk, Product Risk, Distribution Channels, Degree of Competition, Product/ Geographic Concentration, and Innovation.

Business Profile Favorability

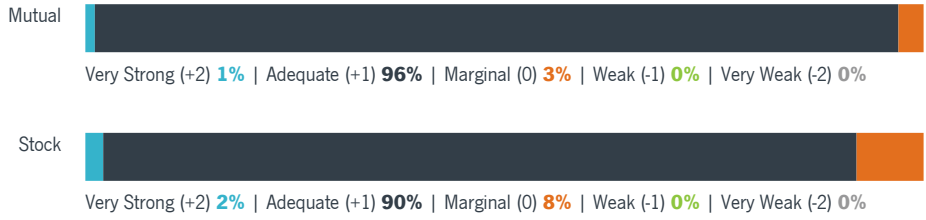
The business profile assessment can result in an increase, decrease, or no change in the respective rating. Forty-seven percent of mutual companies have "Neutral" or better business profile compared to only 39% of stock companies. Stock companies are slightly more likely to receive a "Limited" assessment at 59% compared to mutuals at 52%.



Count: Mutual – 295, Stock – 327

ENTERPRISE RISK MANAGEMENT

Enterprise Risk Management (ERM) has become a more prominent factor in AM Best Rating Methodology. AM Best evaluates ERM on three major fronts: risk management framework, risk management capabilities considering risk profile, and overall strength of ERM. The analysis of ERM can result in either an increase, decrease, or no change in the respective rating. Ninety-seven percent of mutual companies have "Appropriate" or better ERM assessment compared to 92% of stock companies. It is important to note that none of the U.S. property/casualty insurance companies have received "Weak" or "Very Weak" assessment.

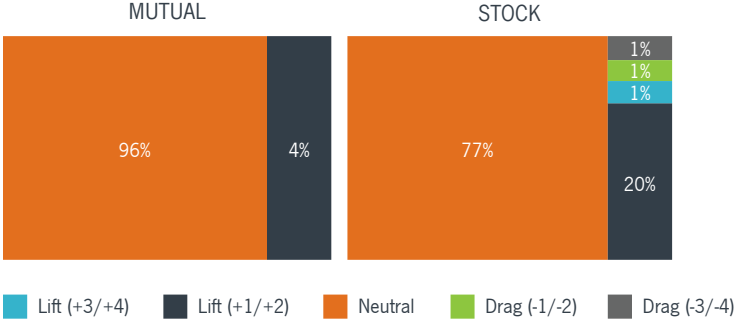


Rating Enhancement

Non-lead rating units that are well integrated within the organization may receive a notching lift based on implicit/explicit support of the broader organization. Conversely, a non-lead rating unit may be penalized for its association with a weaker holding company and receive a drag. In addition to the Rating Lift/Drag building block, there is also a building block for a Comprehensive Adjustment. Not one company globally in all insurance sectors has received a Comprehensive Adjustment.

Drag/Lift Percentages

Only 4% of mutual companies receive a rating lift from parent affiliation while 21% of stock companies depend on this lift. The rating adjustment can be anywhere from +4 notches to -4 notches. While no mutual companies have receive +3 or more lift, not one mutual has received a drag.



RATING AGENCY HOT TOPICS

The industry's future contains both challenges and opportunities. Pricing and inflation, catastrophe losses, ESG, reserve adequacy, investment market volatility, and criteria changes could have an impact on individual ratings and on how rating agencies view the insurance industry overall.

Pricing and Inflation

Pricing conditions have strengthened in recent years, with strong commercial pricing momentum continuing through 2022 and insurers garnering improved terms and conditions. Personal auto premiums are also returning to pre-pandemic levels. Rising reinsurance costs are also a contributing factor to the current rate environment, with a harder market expected for January 1 renewals. The consumer price index has reached the highest year-over-year change in nearly 40 years, although many experts have predicted that this has reached its peak.

Catastrophe Losses

The U.S. industry losses for YE 2021 totaled $134 billion, which is the second highest of the decade. Insured cat losses have breached more than $100 billion in four out of the last five years. Many of these losses are due to previously considered "secondary perils." This has brought model performance, pricing, and reinsurance cost/needs to the forefront of rating agencies. Insurers and rating agencies have begun to revisit management's "View of Risk" to ensure the models they are relying on reflect the actual exposure the company has.

Environmental, Social and Governance

Prominent among current ratings issues is Environmental, Social and Governance (ESG), a requirement of growing importance to central banks, rating agencies, regulators, and shareholders alike. ESG risks for insurers include climate change; stress test failures; liability risks such as product liability, social inflation, data privacy and corporate governance; and the consideration of ESG factors alongside financial factors in the investment and underwriting decision-making processes.

A key and very broad ESG-related challenge is climate change risk that was a main focus across the re/insurance sector at midyear renewals. About 46% of public companies tracked for Aon's Cat Risk Tolerance Study include a climate change financial disclosure as of YE 2021.

Reserve Adequacy

Social inflation is impacting current year's losses and prior year's reserves as courts re-open and exposure levels return to pre-pandemic levels. Moreover, this trend has raised concerns for the adequacy of loss reserves for commercial segments due to the long-tailed nature of these lines. Favorable prior-year loss reserve development is having a waning effect on current calendar-year results for more insurers. This has created substantial capacity for LPTs, allowing for new capital solutions in the market.

Investment Markets

The first half of 2022 has been marked by one of the most volatile periods in financial market performance. Rising interest rates, widening of credit spreads, and volatile equity markets are challenging insurers balance sheets. A confluence of events, for example declining asset values combined with significant catastrophe losses, profitability pressures from social inflation, or rising capital requirements due to business growth would lead to pressure on insurers' rating positions.

Criteria Changes

In December 2021, S&P issued a request for comment regarding an overhaul to its insurance capital model. A portion of the updated criteria was withdrawn, with a new request for comment expected to be issued no earlier than Q4 2022. Key themes of the update include increased risk factors on premiums and reserves, offset partially by increased diversification benefit. In February 2022, AM Best formally published a new Delegated Underwriting Authority Enterprise criteria, which lays out the framework for assessing Managing General Agents performance and their value to an insurance carrier.

THOUGHT LEADERSHIP STUDY – THE REINSURANCE PERSPECTIVE

An important element of NAMIC's annual Mutual Factor report beyond the metrics of the industry's performance has been the inclusion of key perspectives from a variety of stakeholders. Over the past four years, NAMIC has gathered insights from consumers of both personal and commercial lines, as well as from independent agents, and during the 2020 pandemic, from leaders within the mutual industry. As key partners of mutual insurers, the reinsurance industry represents another critically important stakeholder group, so in 2022 NAMIC conducted yet another qualitative research project designed to learn how reinsurers perceive market challenges they currently face, along with their view of the mutual insurance sector and the challenges facing mutual companies.

Specifically, this research project consisted of a series of in-depth video and telephone interviews – conducted by an outside research firm, John Gilfeather and Associates – with a total of 24 executives from reinsurance companies in the U.S., Bermuda, Germany, and the United Kingdom. Care was taken to ensure that the reinsurance companies reflected a mix based on size, lines of business, geography, and ownership. Interviewees were limited to CEOs or other senior executives for each company.

The objectives of the Reinsurance Thought Leadership Study were threefold:

1) To define the challenges the reinsurance industry is facing over the next several years;
2) To explore the value mutual insurance companies provide to reinsurers; and
3) To assess what reinsurance industry thought leaders see as opportunities for and threats to the mutual insurance industry.

The list of reinsurance industry thought leaders was developed jointly by NAMIC and Aon. Interviews were open-ended with multiple topics addressed and conducted over the period of July 5, 2022, through August 12, 2022. Outlined on the following pages are some of the highlights from each major category referenced above. The full report on the Reinsurance Thought Leadership Study is available on NAMIC.org.

REINSURANCE EXECUTIVE PERSPECTIVES – CHALLENGES FACING REINSURERS

Based on the interviews conducted, reinsurance industry thought leaders are in broad general agreement that the two most significant issues facing the reinsurance industry are more frequent/more severe extreme weather events and inflation, seen as both economic inflation and social inflation.

Extreme Weather Events

Most reinsurers believe that extreme weather events are becoming more frequent and more severe. Many of these events, such as derechos and wildfires, are unmodeled and, as a result, the true extent of risk may be unknown. Reinsurers mentioned the increase in extreme weather events more than any other issue. Many believe these events are putting a strain on the entire insurance system because many events that used to be known as secondary perils – such as severe convective storms, wildfires, and derechos – are now happening with increasing frequency, but existing models do not adequately account for them.

> *"Some of the natural perils, like North Atlantic hurricanes, are pretty-well understood. There are other perils that are changing and don't lend themselves to modeling that we have as much confidence in, like the wildfires out West or the severe convective storms that are problematic in the central part of the country. Reinsurers don't want to provide structures for a risk that is hard to model and to understand. How much overall risk-bearing capacity can be deployed to those nonmodeled perils?"*

Reinsurance thought leaders see extreme weather as exacerbating or being the root cause of other issues occurring in the reinsurance industry. Specifically, reinsurance leaders view inflation as making it more expensive to repair buildings damaged by extreme weather because materials and labor costs are rising. They see extreme weather as causing some reinsurers to shorten the time horizon they use when underwriting and pricing reinsurance – some believe that the historical data on weather events dating back 20 or even 10 years is not predictive as data for the past five to seven years.

> *"Time horizons are shrinking because of what we're observing, particularly on the natural catastrophe side. It's more realistic for us to look at a shorter period of experience, say the last five to ten years, as opposed to the last twenty years, which are probably not nearly as informative in terms of our underwriting appetite."*

"Anyone who runs an insurance company that has property exposure anywhere in the world needs to step back and really think about what historical data they're using and what that looks like going forward and what those tail events are that you thought were unlikely."

Inflation

Economic inflation and social inflation are mentioned as key issues facing the reinsurance industry – sometimes in almost the same breath.

Economic inflation is viewed by reinsurance industry thought leaders as a global issue that has far-reaching impacts and affects insurers in many ways, including the pricing of insurance policies and the increased cost of materials and labor to rebuild properties damaged by storms. While reinsurance leaders believe inflation will abate starting in 2023, they also acknowledge they are not economists. Most believe there will be a short, painful time before inflation returns to levels that the country has been accustomed to in recent years, with energy availability and supply chain corrections key to this recovery.

"We now have this problem with inflation that is really hitting the property side. It's a combination of both economic inflation and disconnects between supply chain disruptions and what you have availability for of raw materials and labor for reconstruction or repair. It's just a constant multiplication across almost every part of the property space that is creating a huge stress on the system."

"We're going to continue at an elevated level of inflation, but I think we're witnessing the peak at this point. I don't expect it to get much worse than it is, but we're going to see this elevated level through the duration of the next two years."

While reinsurers see economic inflation as short-lived, they view social inflation as a more insidious and looming concern. Among the impacts reinsurers mentioned are property repair demands that go far beyond the limits of policies as written; business interruption verdicts that exceed the limits of policies as written; nuclear verdicts in liability cases; and the potential for an accelerated pace of lawsuits as the result of hedge funds providing litigation financing.

"We talk about large verdicts. We talk about social inflation. We talk about the social aspects of people trying to use insurance for a purpose for which it is not designed, in effect, a spreader of financial resources as opposed to, what it was originally intended for, which is as a way to indemnify people and corporations for losses so that the insurance will get them back to their original position."

"The most severe thing that I worry about, I'd say a tangent to this, is where we see things like litigation financing. Where hedge funds are basically going in and financing plaintiff's attorneys to go out and sue corporations and insurance companies. This is a cancer on our industry, and frankly our society."

Other key issues mentioned by reinsurance industry thought leaders as having an impact on their business include profitability, Environmental, Social, and Governance, and third-party capital. On the issue of capital, while most leaders agree capital continues to grow in the reinsurance industry, there is some disagreement. Some express a view that as interest rates continue to climb, people are going to turn to other investments that provide more growth potential. Several leaders reflect a belief that the trend over the past few years is toward a flattening of capital growth.

REINSURANCE EXECUTIVE PERSPECTIVES – THE MUTUAL INDUSTRY AS SEEN THROUGH THE REINSURANCE LENS

The mutual insurance sector is regarded as very important to reinsurers. Some reinsurers are mutuals themselves, and others see mutuals as a desirable and stable part of their portfolios. Reinsurers believe that mutual insurance companies' focus on their policyholders is an advantage because it allows companies to take a long-term perspective to pricing and relationships, an approach that is highly valued by reinsurers. Reinsurers value mutuals as customers because of their stability, longevity, risk profile, knowledge of their customers/markets, and accessibility of top management.

"The relationship reinsurance has with the mutual companies is kind of different to the ones we have with the big nationals and the big stock companies. They can be very much a building block of our portfolio. You talk to a regional company and their buyers, and they know what a hailstorm looks like. They live there. They know the demographic. They know the occupancy. They know the building codes. They know the meticulous nature of them. They know the legal environment because they live amongst it."

"Mutuals have a distinct advantage of being able to have a mid- to long-term view of some of the challenges that face our industry and be able to set strategy and execute on that strategy over that much longer horizon than publicly traded companies that have the inherent problem of having much shorter quarterly earnings or annual earnings, objectives, targets, and pressures."

While reinsurance thought leaders believe that mutual insurance companies have many advantages in markets they serve, they also note that mutuals face many of the same key issues and challenges as reinsurers. Those include risks from extreme weather events, inflation, and several other issues.

Some highlights related to key issues perceived by reinsurers as impacting mutuals are below:

Extreme Weather Risk: Reinsurance thought leaders acknowledge that as the result of mutuals' small marketing footprints, many of them know their customers, their territory, and their risks. But reinsurers also note that this leaves mutuals exposed because they cannot diversify their risks over larger, more diverse geographic areas. Among those interviewed, many reinsurers believe extreme weather events affect smaller, local, and regional companies more than larger, national companies. Larger companies have the luxury of being able to spread risk across broader geographic areas so localized extreme weather conditions will not have an outsized impact on the total portfolio. That said, smaller or regional mutuals experiencing shock losses due to extreme weather events can expect reinsurers to stand by them.

> *"Because mutual companies tend to be more localized, when these events occur they have a much larger impact on the mutual insurer because their insured base is not spread out or diversified. These events are happening, not only more frequently, but they are becoming more severe. So, over the last five years, we've seen the severity really impact the mutual insurer base. The events are just becoming bigger and tougher to handle."*

> *"We think about not how that company has performed last year or how it will perform next year but how we expect it to perform over a long period of time. One of the advantages with mutual companies is that they don't necessarily change a lot. If we have that long-term perspective, it's easier to project out the loss experience over a longer time frame. One year of shock losses is not going to necessarily scare us away."*

> *"It behooves reinsurers to have those deep relationships with the smaller mutual companies so they can understand the underlying portfolio and not have a knee-jerk response to a blip in the loss experience due to a shock loss. But if we consistently – six times out of ten years – are seeing these shock losses happen, it's no longer a shock loss. It's the new norm."*

Inflation: Reinsurers generally do not think mutual companies have an advantage over other insurance companies when it comes to coping with inflation. Among reinsurers that do perceive mutuals as having an advantage in dealing with inflation, it is a narrow call based on mutuals' having larger surpluses, inflation guard roll-ups, being nimble, and not being in high-cost areas.

"Most of the mutual companies have a much higher surplus ratio to the premiums they write than the publicly traded companies do. They have this bigger shock absorber on how to deal with inflation or any other curve ball that's thrown their way."

Reinsurers that believe mutual companies do not have an advantage in dealing with inflation today cite mutuals' more difficulty in raising rates, the deeper pockets of larger companies, and the fact that inflation affects everyone.

"Mutuals are probably more challenged because of the relationship they have with their insured base. There's a little more reservation to push valuation changes and rate increases in the mutual base versus a national or stock company because of that relationship."

Investment Potential: Reinsurers have mixed opinions on small and mid-sized mutual companies' ability to invest in technology, talent, and innovation. Some believe mutuals are doing a good job of investing in these areas, especially in recent years. Other reinsurers feel that these investments depend on the will of the companies to do so, rather than strictly size or mutuality. Still others interviewed believe mutuals are falling behind on these investments. Overall, because of difficulties in investing in the future and succession issues, most reinsurers believe there could be an uptick in the pace of consolidation among smaller mutual companies – but this will be tempered by the difficulties of the actual merger process.

"I have to say, unfortunately, yes, there will be much more pressure on the very small mutual companies because size does matter. Extremely small mutual carriers will have a really tough time because of regulatory pressures, reporting pressures, ESG reporting, and all these kinds of things. So, I assume we will see an increased level of consolidation within the mutual space. The positive thing though is that because of the mutual structure, we're going to have like-minded companies looking to merge so the mindset will still stay the same."

Independent Agents: Reinsurers believe that mutual companies' commitment to the independent agent channel is a key strength of the industry, despite potential disruptions. While direct writing is seen as a threat in simpler personal lines and among younger customers, there is a sense that, as customers age and have more and more complex assets, the value of agents' advice will prevail. Some reinsurers see consolidation of insurance agencies as a concern for the mutual industry, questioning whether the mutual company/agent relationship dynamic may change or whether consolidated agencies will want to deal with smaller mutuals.

Insurtech entrants are not seen as a significant threat. They are struggling to establish themselves and show positive financial results. In fact, some reinsurers believe insurtech companies are potential technology partners for mutuals.

Financial Health Assessment: Reinsurers closely evaluate the financial health of mutual companies, beginning with a look at ratings from AM Best primarily and S&P. Reinsurers follow that with a thorough review of the company balance sheet looking for overall strengths and at key ratios, along with assessments of top management. In general, reinsurers do not view growth as a fundamental aspect of financial strength. In fact, many cited too rapid growth as a red flag if it is not underpinned with a solid strategy.

> *"We start with the AM Best rating for U.S. companies. We look at their results over the last five years. How well have they done? How do they buy their reinsurance? Are they extremely leveraged? Are they a conservative company?"*
>
> *"Growth is great; however, it needs to be profitable growth. Growth just for the sake of inflating the top line will not help anybody. Growth can also stall for a little bit. That's perfectly okay if it is for the right reason where you are developing new distribution to certain segments and/or revamping your product offering or whatever. There needs to be a good story around growth or the lack of growth."*
>
> *"We don't consider growth to be a positive or a negative. We are looking more at just improving underlying performance over time and ideally a growth in surplus over time, but not necessarily a growth in premium."*

MARKET ANALYSIS METHODOLOGY & TECHNICAL NOTES

GENERAL

Insurance companies were assigned to one of three segments based on an internal review conducted by NAMIC and Aon, classifying each insurer as a policyholder-owned "mutual," a shareholder-owned "stock," or "other."[1]

Using financial data for groups and unaffiliated singles as provided by S&P Global's Market Intelligence and NAMIC, two types of aggregate metrics were calculated for each segment and the three segments as a group: sums for dollar-denominated fields such as premiums and cumulative metrics for ratios such as the net commission expense ratio.

For example, in calculating the cumulative dividend ratio for the mutual segment, the sum of all mutual earned premium was divided by the sum of all mutuals' dividends to policyholders, where no special weighting was given based on size of a company. This approach allows for a more holistic view of each respective segment.

FURTHER COMMENTS ON NAMIC AND AON'S INTERNAL REVIEW OF COMPANY CLASSIFICATION

Previously, the Benchmark Study for AM Best Rating's section included an "others" segment; however, due to a limited number of insurers classifying as "other" within AM Best's database, NAMIC and Aon carefully reviewed each company and reclassified these companies as either "mutual" or "stock" based on the company's history and operations.

OTHER NOTES

Aggregate combined ratios are the sums of aggregate expense ratios, aggregate loss and loss adjustment expense ratios, and aggregate dividend ratios, rather than weighted averages. Similarly, aggregate operating ratios are the sums of aggregate combined ratios and aggregate investment ratios.

Quarterly data is as of August 31, 2022, and data may later change or be incomplete due to late filers, consolidation issues, amended financials, etc.

Five-year data is representative of all companies operating in 2021. This data will not include any companies that were removed from S&P Global's Market Intelligence database. For example, American Capital Assurance Corp. will not be included in any of the five-year data even though it operated up until 2021.

[1]LLCs, U.S. branch of alien insurers, insurance pool of trusts, and syndicates.

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