Trend Review
September 22, 2016

Mutual P/C Insurers Managing Market Challenges

Mutual carriers are expanding into more of the small commercial market to stay competitive.

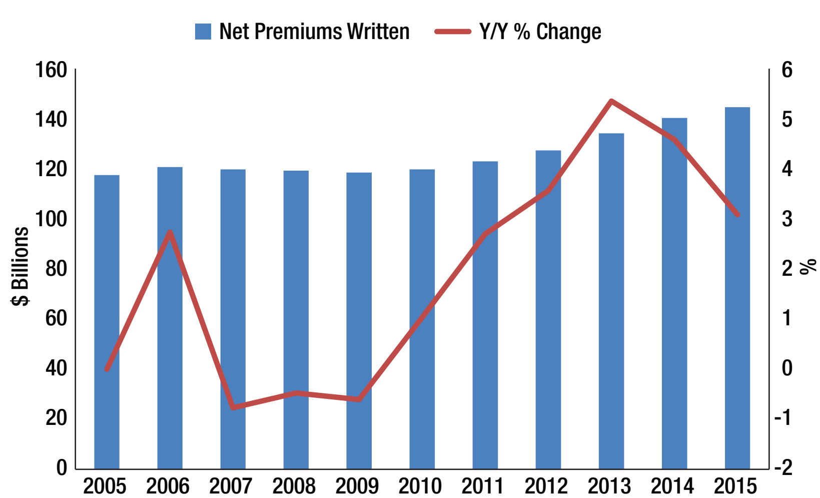
All mutual companies operate with a common goal to serve their policyholders, which allows management to focus on the long-term goal of financial stability. In the mutual company organization structure, policyholders maintain a defined set of rights with ownership interests. While it's true that mutuals are customer-focused, there is also heavy emphasis on preserving and steadily increasing surplus levels, which is evidenced by strong pretax return measures. Despite some limited financial flexibility, mutuals benefit from surplus notes, Federal Home Loan Banks, and other sources to aid liquidity. In addition, mutuals have been actively participating in affiliations over the years, expanding product and geographic diversification efforts. A.M. Best understands the mutual organization and is cognizant of the operating philosophy that drives performance metrics. Regardless of the structure, all insurers must have a clearly defined strategic position and solid enterprise risk management capabilities in order to be successful in today's highly competitive and dynamic operating environment. Balance sheet strength, operating performance, business profile and enterprise risk management influence the success of all companies.

When evaluating a company's balance sheet strength and long-term financial credit-worthiness, business profile plays an important role. It is A.M. Best's opinion that a strong business profile drives favorable and sustained operating performance. This can be influenced by a rating unit's mix of business, both geographically as well as business line concentration. A fairly significant percentage of the rated mutual companies are geographically concentrated, with over 40% writing in one state in 2015, while 12% wrote only one line of business. While concentration could lead to qualitative competitive advantages such as niche market penetration, enhanced customer service, and greater expertise in their respective markets, this can also pose greater potential risk from extreme weather-related events. Despite these challenges, mutual companies maintain comprehensive reinsurance structures to mitigate catastrophic weather events through smaller retentions, quota shares, and additional unique coverages.

Premium Production, Including Geographic and Line of Business Concentrations

Net premiums written (NPW) throughout the P/C Mutuals market grew at a moderate pace of 3.1% in 2015 (**Exhibit 1**) and has grown every year since 2010 at a compound average rate of 3.4%. NPW

Exhibit 1
P/C Mutuals – NPW YoY % Change



Source: BESTLINK – *Best's Statement File - P/C, US*

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growth over the last five years can be attributed to rate actions, as dominant players in the mutual space maintain a considerable market share. The ten largest mutual insurers in this population represented over 70% of the NPW in 2015 (**Exhibit 2**). While this population is diverse, State Farm Group dominates in terms of market share with 41% of the market, and Nationwide Group follows at 13.1%. Those two groups were the only ones with a market share greater than 10.0%. As in the case with the overall property/casualty market, competition in the mutual space continues to remain heightened.

The premium increase attributable to several lines of coverage outpaced the overall 3.1% NPW increase for rated mutuals in 2015 (**Exhibit 3**), particularly Other & Products Liability, Auto Physical Damage, Commercial Auto Liability, Inland Marine, and Commercial Multi-Peril. Not surprisingly, the premium increases in those lines, with the exception of Commercial Auto Liability and Inland Marine, from 2014 to 2015 translate to decreased incurred loss ratios, indicative of profitable growth in those segments (**Exhibit 4**). Over the last five years, A.M. Best has seen many of the mutual carriers expanding into more of the small commercial market to stay competitive and shift away from personal lines challenges. Since 2011, commercial lines' NPW has grown by a total of 28% while personal lines' NPW has grown by 15% (**Exhibit 5**), with personal lines now representing 66% of the total NPW, versus 68% five years ago. Gradually shifting away from personal lines goes hand in hand with the product line diversification that has been demonstrated with the rated mutual companies.

Exhibit 2
Top 25 P/C Mutuals (Ranked by NPW)
($ Millions)

AMB#	Company Name	Net Premiums Written	Market Share (% of Total)
000088	State Farm Group (G)	59,348	41.0
005987	Nationwide Group (G)	19,000	13.1
000124	American Family Insurance Group (G)	7,308	5.1
004354	Auto-Owners Insurance Group (G)	5,805	4.0
018502	FM Global Group (G)	3,268	2.3
004029	State Insurance Fund WC Fund	2,437	1.7
000302	COUNTRY Financial Property Casualty Grp (G)	2,199	1.5
000856	State Auto Insurance Companies (G)	1,959	1.4
018522	Amica Mutual Group (G)	1,943	1.3
000086	Sentry Insurance Group (G)	1,880	1.3
000730	Westfield Group (G)	1,769	1.2
000346	EMC Insurance Companies (G)	1,646	1.1
004028	State Compensation Insurance Fund of CA	1,625	1.1
000598	Shelter Insurance Companies (G)	1,555	1.1
004284	Federated Mutual Group (G)	1,446	1.0
000468	ACUITY A Mutual Insurance Company	1,270	0.9
003917	Grange Mutual Casualty Pool (G)	1,222	0.8
018154	Tennessee Farmers Insurance Companies (G)	1,175	0.8
000106	Alfa Insurance Group (G)	1,138	0.8
011453	Texas Mutual Insurance Company	1,133	0.8
000964	West Bend Mutual Insurance Company	961	0.7
003281	Kentucky Farm Bureau Group (G)	878	0.6
004202	Utica National Insurance Group (G)	821	0.6
018220	Arbella Insurance Group (G)	810	0.6
004071	Amerisure Companies (G)	776	0.5
Top 25 Mutuals		**123,372**	**85.3**
Total - P/C Mutuals		**144,643**	**100.0**

Source: A.M. Best data and research

Exhibit 3
P/C Mutuals – NPW by Line of Business
($ Millions)

	2014	2015	YoY % Change
Private Passenger Auto Liability	37,055	37,752	1.9
Homeowners/Farmowners Multi Peril	33,467	34,406	2.8
Auto Physical Damage	25,869	27,494	6.3
Commercial Multi Peril	10,452	10,859	3.9
Workers' Compensation*	8,831	9,132	3.4
Other & Products Liability**	5,511	5,861	6.4
Fire & Allied Lines***	5,911	5,473	-7.4
Commercial Auto Liability	4,538	4,809	6.0
Inland Marine	2,863	3,014	5.3
Accident & Health	1,566	1,606	2.6
Medical Professional Liability	1,624	1,557	-4.1
All Other Lines****	2,624	2,678	2.1
Total - P/C Mutuals	**140,314**	**144,643**	**3.1**

* Workers' Compensation includes Excess Workers' Compensation
** Other Liability includes professional liability, D&O, excess casualty/umbrella, environmental/pollution, general liability, and EPLI.
*** Fire & Allied Lines includes earthquake, multiple peril crop and federal flood coverage
**** All Other Lines includes mortgage guaranty, financial guaranty, ocean marine, aircraft, fidelity, burglary & theft, boiler & machinery, credit, international, excess of loss reinsurance, warranty and aggregate write-ins
Source: A.M. Best data and research

Exhibit 6 displays the direct premiums written (DPW) in the top ten states, which account for almost 50% of the DPW for all the P/C Mutual companies, while also showing the corresponding direct incurred loss ratio for the last five years. Overall, the direct incurred loss ratio was relatively flat over the last three years through 2015, with the exception of Texas and California, which saw an increase to the direct incurred loss ratio in 2015. The main contributors to the increase were the Valley and Butte fires (Best's News Service, Sept. 23, 2015), which raged across California for much of September, as well as statewide wildfires in Texas in October (Best News Service, Oct. 19, 2015). Other states such as Michigan saw substantial decreases to the direct incurred loss ratio due to ongoing rate activity and stabilized weather patterns, which helped offset California's and Texas's increases.

Operating Performance and the Contribution to Surplus Growth

Rated mutual companies reported another solid year of underwriting performance, as demonstrated with a stable loss ratio in recent years (**Exhibit 7**). Weather conditions in the last three years have been somewhat milder as compared to earlier years such as 2011 and 2012. Improvement from 2011 to 2015 is most notably from a decrease in catastrophic weather-related events, with Hurricane Irene in 2011 and Hurricane Sandy in 2012 contributing heavily to the combined ratios. Despite the stable loss ratios in recent years, an elevated underwriting expense ratio continues to marginally compress underwriting measures. As compared to the

Exhibit 4
P/C Mutuals – NPW and Incurred Loss Ratios by Line of Business
($ Millions)

	2014		2015	
	Net Premiums Written	Incurred Loss Ratio (%)	Net Premiums Written	Incurred Loss Ratio (%)
Private Passenger Auto Liability	37,055	63.1	37,752	67.5
Homeowners/Farmowners Multi Peril	33,467	55.6	34,406	52.6
Auto Physical Damage	25,869	67.8	27,494	55.9
Commercial Multi Peril	10,452	56.0	10,859	50.5
Workers' Compensation*	8,831	56.1	9,132	49.8
Other & Products Liability**	5,511	49.5	5,861	46.3
Fire & Allied Lines***	5,911	52.3	5,473	51.4
Commercial Auto Liability	4,538	65.9	4,809	68.8
Inland Marine	2,863	37.0	3,014	45.9
Accident & Health	1,566	78.0	1,606	84.9
Medical Professional Liability	1,624	34.9	1,557	36.1
All Other Lines****	2,624	51.1	2,678	48.1

* Workers' Compensation includes Excess Workers' Compensation
** Other Liability includes professional liability, D&O, excess casualty/umbrella, environmental/pollution,
general liability, and EPLI.
*** Fire & Allied Lines includes earthquake, multiple peril crop and federal flood coverage
**** All Other Lines includes mortgage guaranty, financial guaranty, ocean marine, aircraft, fidelity, burglary & theft, boiler & machinery, credit, international, excess of loss reinsurance, warranty and aggregate write-ins
Source: A.M. Best data and research

Exhibit 5
P/C Mutuals – Commercial vs Personal Lines NPW
($ Millions)

	2011	2012	2013	2014	2015
Commercial NPW	31,717	34,222	36,922	39,225	40,564
Commercial Lines % of Total	25.8%	26.9%	27.5%	28.0%	28.0%
Personal Lines NPW	83,015	84,433	88,353	92,259	95,289
Personal Lines % of Total	67.6%	66.4%	65.9%	65.8%	65.9%
Total NPW	122,733	127,186	134,098	140,312	144,643

Total NPW total includes Combined, Reinsurance and Other premium totals
Source: A.M. Best data and research

Exhibit 6
P/C Mutuals – Top 10 States Ranked by DPW
($ Millions)

			Direct Incurred Loss Ratio (%)				
State	2015 DPW	% of Total U.S. DPW	2011	2012	2013	2014	2015
Texas	9,988	6.7	67.8	60.0	58.1	57.5	60.4
California	9,463	6.3	56.5	58.4	56.4	57.5	64.6
Illinois	8,011	5.4	70.1	73.0	64.8	63.6	62.6
New York	6,654	4.4	72.3	81.7	61.9	62.2	64.4
Michigan	6,541	4.4	130.5	93.7	90.5	75.3	68.5
Ohio	6,281	4.2	69.2	66.5	53.4	55.5	52.4
Florida	6,145	4.1	60.6	56.6	58.2	66.1	68.6
Pennsylvania	5,839	3.9	69.8	61.6	56.1	67.8	62.4
Georgia	5,583	3.7	72.8	59.5	70.7	67.9	68.9
North Carolina	5,060	3.4	86.9	60.0	52.2	53.2	53.4
Top 10 States	**69,565**	**46.5**	**75.7**	**67.1**	**62.2**	**62.7**	**62.6**
Total U.S. Mutual DPW	**149,669**	**100.0**					

Source: A.M. Best data and research

rest of the P/C Industry, mutual companies have a slightly elevated commission expense (**Exhibit 8**) driving the expense ratio. This measure increased modestly in 2015 from 2014 for rated mutuals as it did for the P/C Industry as well. Commission increases are reflective of the profitability of the books of business and are typical for companies that utilize independent agents, such as mutuals. Overall, the commission ratio has been relatively constant over the past five years for rated mutuals and the total industry, differing by approximately 1.6 points year over year.

Loss ratios continue to improve and stabilize from various rate actions, improved pricing sophistication, and milder weather patterns over the last three years, while evolving enterprise risk management programs, including technological investments and higher commission expenses, coincide with the increased premium growth and address the uptick in the expense ratio. The combined ratio of rated mutuals in 2015 was 100.3%, which increased marginally from 2014 yet has been relatively comparable over the last three years. The small increase was driven solely by the higher underwriting expense ratio. The policyholder dividend portion of the combined ratio has been virtually unchanged in the last five years, and contributed 0.7 points, or approximately $1.0 billion in 2015.

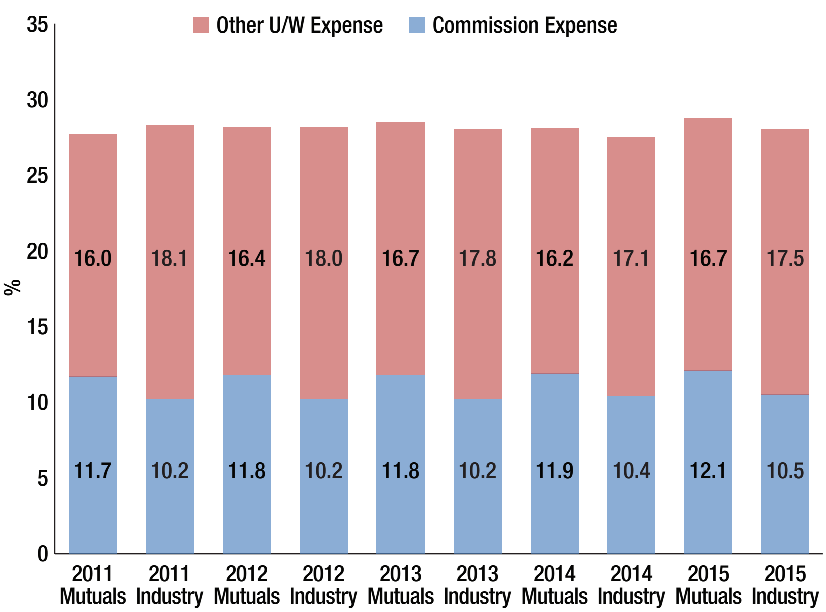
Overall, rated mutuals' PHS increased 4.0% by year-end 2015, driven by a 16.2% increase in net income from 2014 (**Exhibit 9**). While other carriers may be focused on different return measures, the cornerstone of all mutual companies is capital preservation. Unrealized capital losses in 2015 of $5.9 million hampered additional

Exhibit 7
P/C Mutuals – Combined Ratio Components
($ Millions)

	2011	2012	2013	2014	2015
Net Premiums Written	122,733	127,186	134,098	140,312	144,643
Net Premiums Earned (NPE)	121,429	124,919	131,057	137,438	142,560
Pure Loss Ratio (%)	70.0	61.1	57.3	58.7	58.6
Loss-Adjustment Expense (LAE) Ratio (%)	12.0	12.5	12.1	12.3	12.2
Loss & LAE Ratio (%)	82.0	73.6	69.4	71.0	70.8
Underwriting Expense Ratio (%)	27.7	28.6	28.5	28.1	28.8
Policyholder Dividend/NPE	0.6	0.6	0.8	0.7	0.7
Combined Ratio (%)	110.3	102.8	98.7	99.8	100.3

Source: A.M. Best data and research

Exhibit 8
P/C Mutuals vs Total P/C Industry – 5-Year Underwriting Expense Component Trends



Source: BESTLINK – *Best's Statement File - P/C, US*

Exhibit 9
P/C Mutuals – Change in PHS
($ Billions)

	2014	2015	YoY % Change
Beginning PHS at Prior Year End	178.6	188.4	5.5
Net Income	10.5	12.2	16.2
Unrealized Capital Gains/(Losses)	4.1	-5.9	NM
Contributed Capital	0.0	0.1	NM
Other Changes	-4.6	1.2	NM
Ending PHS	188.4	195.9	4.0
Change in PHS from Prior Year End ($)	9.8	7.5	-23.5
After Tax Return on PHS (ROE) (%)	8.0	3.3	

Note: Figures may not add due to rounding.
Source: A.M. Best data and research

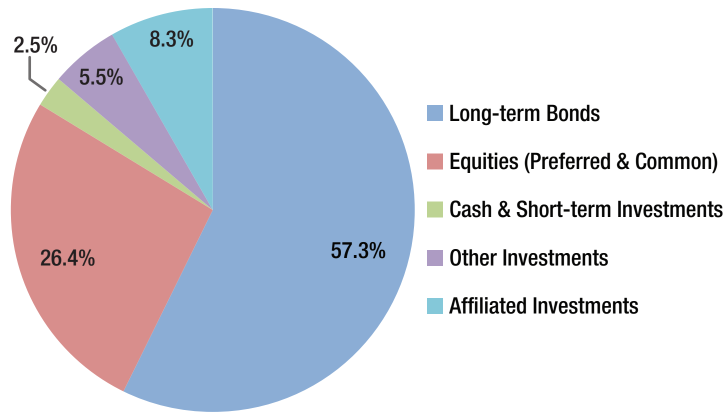
surplus growth. This, combined with increased net underwriting losses and decreased net investment income, generated a 6.9% decrease in pre-tax operating income for the mutual rating units. Offsetting this decline, however, was a 68% increase in realized capital gains. Despite the increase to surplus and net income in 2015, the after tax return on surplus (ROE) was only 3.3% for 2015 versus 8.1% in 2014.

Exhibit 10
P/C Mutuals – Common Stock Leverage
($ Millions)

	2011	2012	2013	2014	2015
Total Common Stock Holdings	78,193	85,108	101,914	110,054	104,756
Policyholder's Surplus (PHS)	147,599	157,605	178,619	188,396	195,869
Common Stock as a % of PHS	53.0%	54.0%	57.1%	58.4%	53.5%

Source: A.M. Best data and research

Exhibit 11
P/C Mutuals – Invested Assets (2015)



Source: A.M. Best data and research

Investment Performance and Allocation

As has been the case for the broader P/C market, investment market conditions have been challenging for rated mutual companies as reflected by declining investment yields. However, the overall strength of the equity market, despite some volatility, and the opportunity to generate higher returns have driven mutual companies to increase allocations to common stocks, mutual funds, and ETFs in recent years. Although growth in common stock holdings started to diminish in 2015, overall investment leverage (**Exhibit 10**) remained high over the last five years, at an average of 55%.

Invested assets for rated mutual companies are mostly comprised of long-term bonds (57.3%) while equities accounted for 26.4% of the investment portfolio (**Exhibit 11**) in 2015. Net investment yields are expected to remain fairly low in the near-term due to the lower interest rate environment and net investment income in 2015 decreased 2% from the previous year (**Exhibit 12**).

Mutual Company Ratings

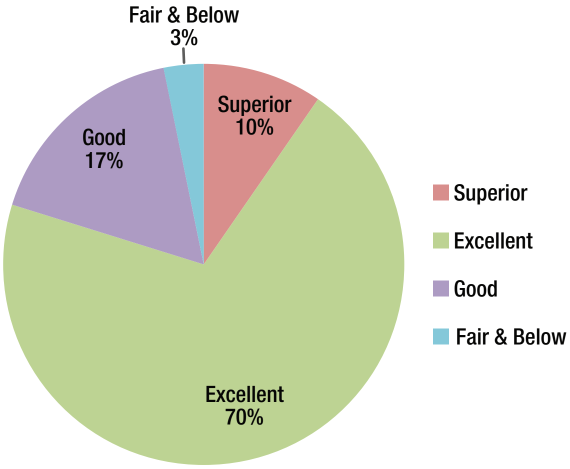
Over the latest three years, rated mutuals have demonstrated stable loss ratios, increased premium trends, and moderate surplus growth, which have all aided the financial strength of the companies. Of all of the rated mutuals referenced in the report, 70% have issuer credit ratings (ICRs) in the Excellent (a+, a, a-) category, followed by 17% Good (bbb+, bbb, bbb-), 10% Superior (aa+, aa, aa-), and only 3% at Fair and Below (bb+ to c)

Exhibit 12
P/C Mutuals – Financial Indicators
($ Billions)

	2014	2015	YoY % Change
Net Premiums Written	140.3	144.6	3.1
Net Premiums Earned	137.4	142.6	3.8
Pure Losses Incurred	80.7	83.5	3.5
Loss Adjustment Expenses (LAE)	17.0	17.4	2.4
Losses & LAE	97.7	100.9	3.3
Underwriting Expenses	39.6	42.0	6.1
Policyholder Dividends	1.0	1.0	0.0
Underwriting Income (Loss)	-0.9	-1.3	NM
Net Investment Income	10.1	9.9	-2.0
Other Income/(Loss)	0.4	0.4	0.0
Pretax Operating Income	9.7	9.0	-6.9
Realized Capital Gains/(Losses)	2.5	4.2	68.0
Federal Income Taxes	-1.7	-1.1	NM
Net Income	10.4	12.1	16.3

Note: Figures may not add due to rounding
Source: A.M. Best data and research

Exhibit 13
P/C Mutuals – Issuer Credit Rating Distribution



Source: BESTLINK – *Best's Statement File - P/C, US*
The ICR rating distribution is as of August 31, 2016

Exhibit 14
P/C Mutuals – Issuer Credit Rating Outlooks

	2016	%
Stable	169	77.5
Positive	24	11.0
Negative	24	11.0
Under Review	1	0.5
Grand Total	**218**	**100.0**

Source: A.M. Best data and research
The rating outlooks shown are as of August 31, 2016

(**Exhibit 13**). Noteworthy is that nearly 80% of all rated mutual companies have a stable outlook, with the remainder split evenly between positive and negative outlooks (**Exhibit 14**).

Conclusion

By focusing on capital preservation coupled with controlled growth, mutual companies exhibit consistent financial stability to benefit policyholders. Despite market challenges and above average expense ratios, steady loss ratios and net investment income in recent years have aided profitability while product diversification has helped to alleviate concentration risk. In today's challenging operating environment, A.M. Best believes well managed companies stand out regardless of organizational structure.

Methodology: The property/casualty mutual insurance companies discussed in this report contain 218 U.S.-domiciled rating units as of December 31, 2015 with net premiums written above $1 million and exclude risk retention groups. A rating unit, described as either an individual insurer or a consolidation of companies, is the basis upon which rating evaluations are performed. The (G) listed after certain companies reflects a group consolidation. In general, the financial results of rating units represent the way insurance groups operate and manage their business. The charts and displays for exhibits 1-12 utilize annual statutory data as filed with the NAIC.

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