



The Shifting Investment Strategies Helping Address The P&C Insurance Crisis: Implications For Investment Risk Oversight

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Synopsis: Certain sectors of the property & casualty insurance market are facing significant challenges, if not in a state of crisis, struggling to meet commercial objectives, with regulators attempting to revise guidelines to achieve societal needs for insurance. Climate hazards and other emerging risks have driven increases in loss frequency and severity, while high post-pandemic inflation has driven up the cost of claims, resulting in headlines warning of a [*Possible Collapse of the U.S. Home Insurance System*](#) with policies and the regulatory framework not calibrated to today's realities. An often-overlooked factor is the income generated from investments, particularly the significant shifts in investment strategies toward common stock, as well as illiquid, higher-yielding, and complex credit. As Warren Buffet describes, the collect-premiums-now, pay-claims-later model leaves property & casualty companies holding large sums of cash *float*. Policies generating underwriting losses can, depending on the magnitude of the loss, be part of a viable business model if the float can generate sufficient yield. Sufficient yield limits the degree to which insurers must raise premiums or withdraw from loss-generating lines and markets. The extended period of low yields in the wake of the Global Financial Crisis had downstream implications for loss-generating underwriting blocks and the degree to which they can fit into a viable business model.

We estimate that shifting investment strategies have generated additional income, equating to roughly 40% of industry net income in 2023, benefiting insurers and policyholders.

However, these shifting strategies compound the complexities as the industry navigates the uncharted waters of underwriting and policy pricing in the face of climate hazards and other emerging risks, all of which introduce balance sheet and liquidity risks specifically. Meanwhile, regulators must assess the degree to which current guidelines are appropriate for the new landscape, dovetailing with the National Association of Insurance Commissioners (NAIC) formative efforts to modernize its [*Investment Risk Oversight Framework*](#), which we support wholeheartedly. This report analyzes the role of investment income in sustaining the industry and explores the significant shifts in investment strategies employed by property & casualty insurers.

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It is consistent with our goal of bringing value to our community

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1 Executive Summary—*Who said insurance is a boring business, managing through actuarially predictable cycles?*

Certain sectors of the property & casualty insurance market are facing significant challenges, if not in a state of crisis, struggling to meet commercial objectives, with regulators attempting to revise guidelines to achieve societal needs for insurance. Climate hazards and other emerging risks have driven increases in loss frequency and severity, while high post-pandemic inflation has driven up the cost of claims, resulting in headlines warning of a [*Possible Collapse of the U.S. Home Insurance System*](#) with policies and the regulatory framework not calibrated to today's realities. An often-overlooked factor is the income generated from investments and the significant shifts in investment strategies toward common stock, as well as illiquid, higher-yielding, and complex credit, which have sustained the industry until now.

We estimate these shifting strategies have generated additional income equating to roughly 40% of the industry's net income in 2023, benefiting insurers and policyholders.

However, these shifting strategies compound the complexities as the industry navigates the uncharted waters of underwriting and policy pricing in the face of climate hazards and other emerging risks, all of which introduce additional balance sheet and liquidity risks specifically. Meanwhile, regulators must assess the degree to which current guidelines are appropriate for the new landscape, dovetailing with the National Association of Insurance Commissioners (NAIC) formative efforts to modernize its [*Investment Risk Oversight Framework*](#), which we support wholeheartedly.

This report analyzes the role of investment income in sustaining the industry and explores the significant shifts in investment strategies employed by property & casualty insurers. We do not view the shift in investment strategy as a practice that should de facto be restricted. Instead, our goal is to provide insurers and regulators with a perspective on the critical role shifting investment strategies have played in supporting affordable policies over the last two decades while acknowledging the significant changes to investment risk that require possible revisions to investment oversight.

The rest of this report is organized as follows:

- Section 2 explores the critical role investment income plays in the property & casualty business model.
- Section 3 explores the significant shifts in investment strategies and implications for income.
- Section 4 discusses the implications of the simultaneous increase in investment risk and the change in the sources of underwriting risk for investment oversight, and our optimism for the future.

2 A Critical Reliance on Investment Income — *Warren Buffet is still right.*

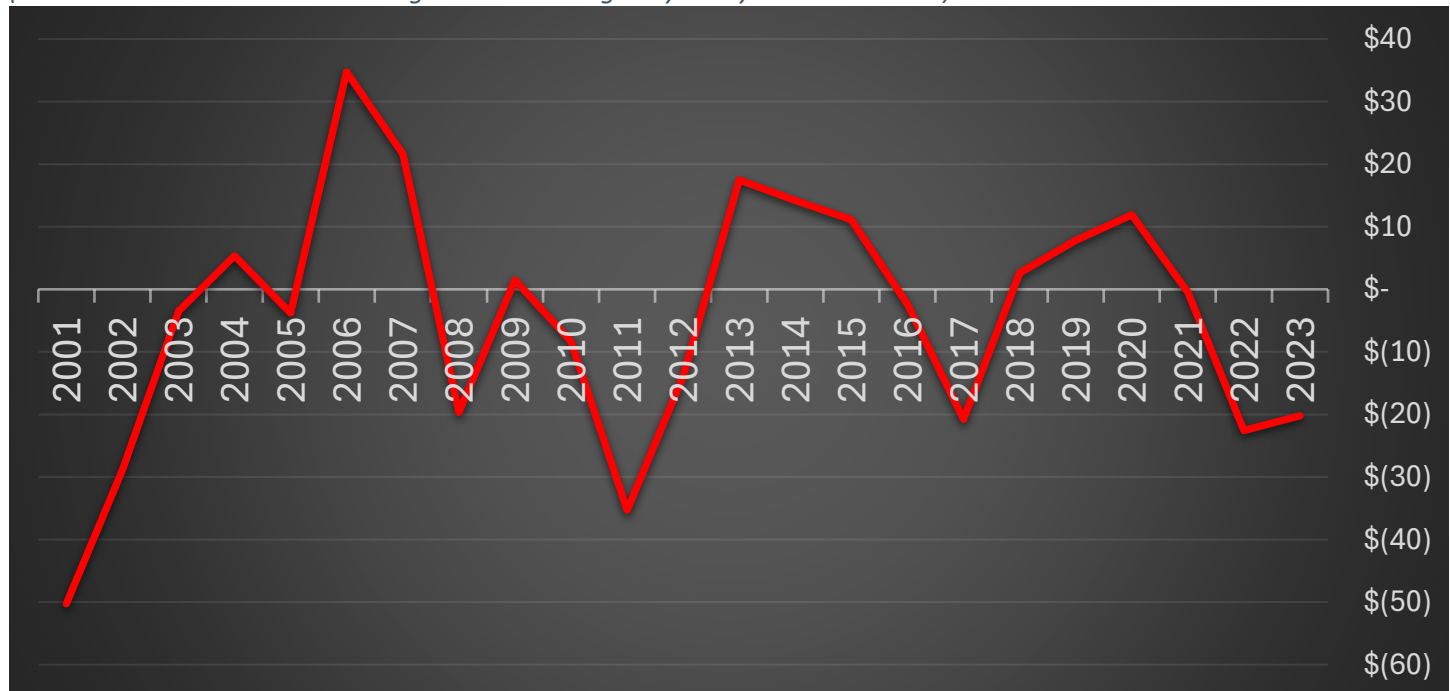
As Warren Buffet describes, the collect-premiums-now, pay-claims-later model leaves property & casualty companies holding large sums of cash *float*. Policies generating underwriting losses can, depending on the magnitude of the loss, be part of a viable business model. Sufficient yield limits the degree to which insurers would withdraw from loss-generating lines and markets. While this is nothing new to the industry, the extended period of low yields in the wake of the Global Financial Crisis (GFC) was coupled with significant shifts in property & casualty investment strategies toward common stock, as well as higher yielding and complex credit.

The shifting investment landscape has downstream implications for loss-generating underwriting blocks and the degree to which they can fit into a viable business model. This is particularly relevant in the context of insurers confronting increasing loss frequency and severity from hazards and other emerging risks that have not been fully priced into policies. Climate-driven losses (e.g., inland and coastal floods, invasive storms, hurricanes, wildfires) are being realized at scale in previously untouched regions, creating a new world for risk assessment, underwriting, claims, and recovery. In a seeming confluence of headwinds, many existing liability lines are now the focus of third-party investors in litigation finance, escalating social

inflation claims. At the same time, emerging risks in cyber and terrorism have presented an entirely new set of exposures to the industry. These developments translate into significant structural challenges in risk management, further complicated by a sea of changes in technological innovation. Who said insurance was a boring business of managing through actuarially predictable cycles?

As the industry works through underwriting, pricing, risk mitigation, and other core business strategies, a less publicized aspect of the business, investment strategy, has been a critical pillar in keeping the industry afloat and helping limit the need to increase policy rates further. A quick look at headline numbers in *Figure 1* highlights relying on Net Underwriting Income (in red) alone is not sustainable.

Figure 1: Property & Casualty Statutory Net Underwriting Income (Billion)
 (Source: S&P Global Market Intelligence* and Bridgeway Analytics Calculations)



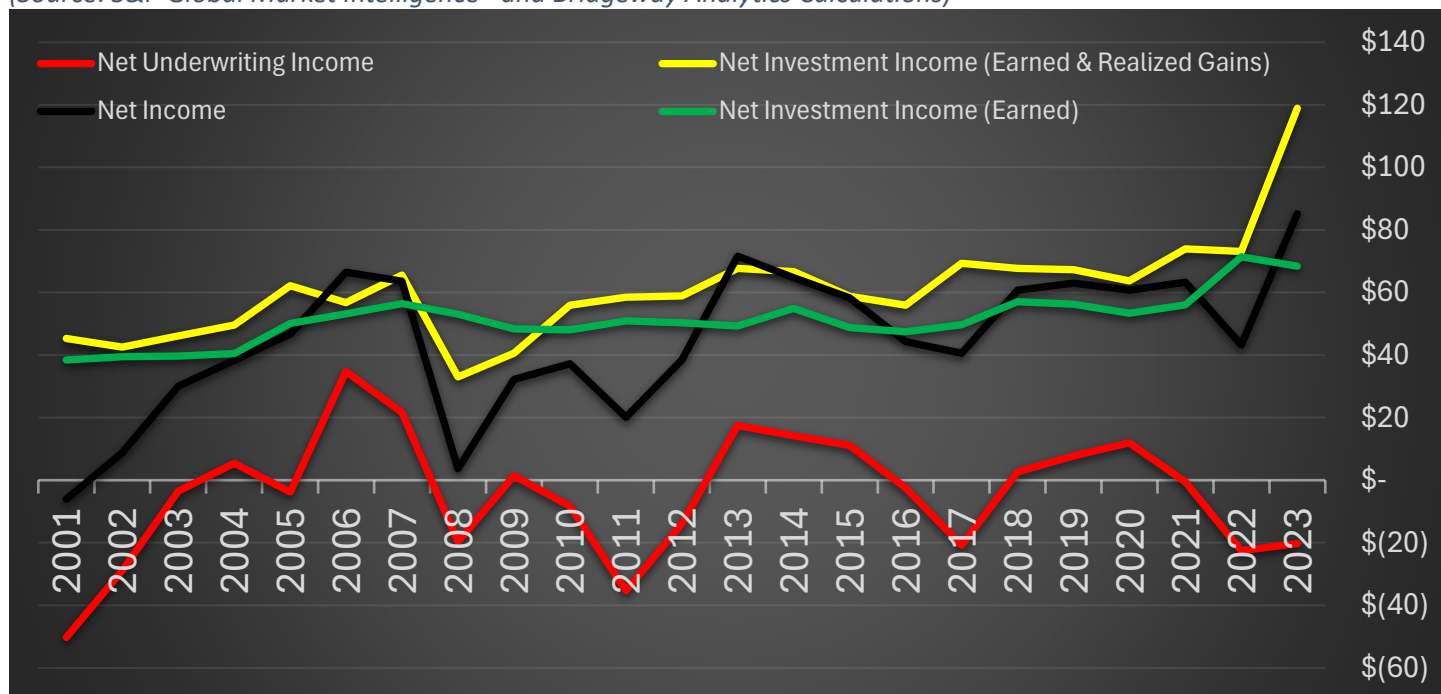
Understandably and appropriately, headlines such as [Soaring Insurance Costs Could 'End' Affordable Housing](#) focus on the most visible aspects of these events as they impact policyholders: The societal crisis of preventable loss of life or financial security. Insurance coverage in specific markets is unaffordable or not available. Trade industry reporting has covered the progression through:

- (1) The first line of defense by regulated (re)insurers: Premium increases, lower limits, reduced capacity,
- (2) Growth in excess and surplus lines, and
- (3) Greater use of alternative risk transfer mechanisms.

Regulators have attempted to mitigate the problem by reining in litigation and policy claim abuse while providing rate relief. Nevertheless, insolvencies have occurred, and companies have withdrawn from certain jurisdictions, requiring coverage by government entities and the assumption of liabilities by state guaranty pools.

The significant role of Statutory Net Investment Income (Earned & Realized Gains) (in yellow) in keeping industry Net Income (in black) positive can be seen in *Figure 2*. We included Net Investment Income (Earned) (in green) to provide a sense of the stability of earned income (e.g., income from coupons) compared to realized gains and losses (e.g., capital gains on common stock), which are more volatile but still an important source of income and included in Net Income (in black).

Figure 2: Property & Casualty Statutory Net Income Decomposition (\$Billion)
(Source: S&P Global Market Intelligence* and Bridgeway Analytics Calculations)



3 Has The Industry Shifted Investment Strategies Materially? **Yes.**

When governed prudently, higher-yielding investment strategies can benefit insurers and policyholders. Notably, life insurers' investment strategies have also shifted significantly since the advent of the extended low-yield post-GFC era. That segment has received significant attention from rulemaking bodies globally, possibly because life investment strategies have been coupled with private equity affiliates and offshore reinsurance. The property & casualty investment strategy shift has received much less attention from rule makers and the broader community. Investment strategy is core to the property & casualty business model, highlighting the need for a deliberate understanding of the composition of new risk exposures.

3.1 Has the shift in asset allocation introduced more risk? **Yes.**

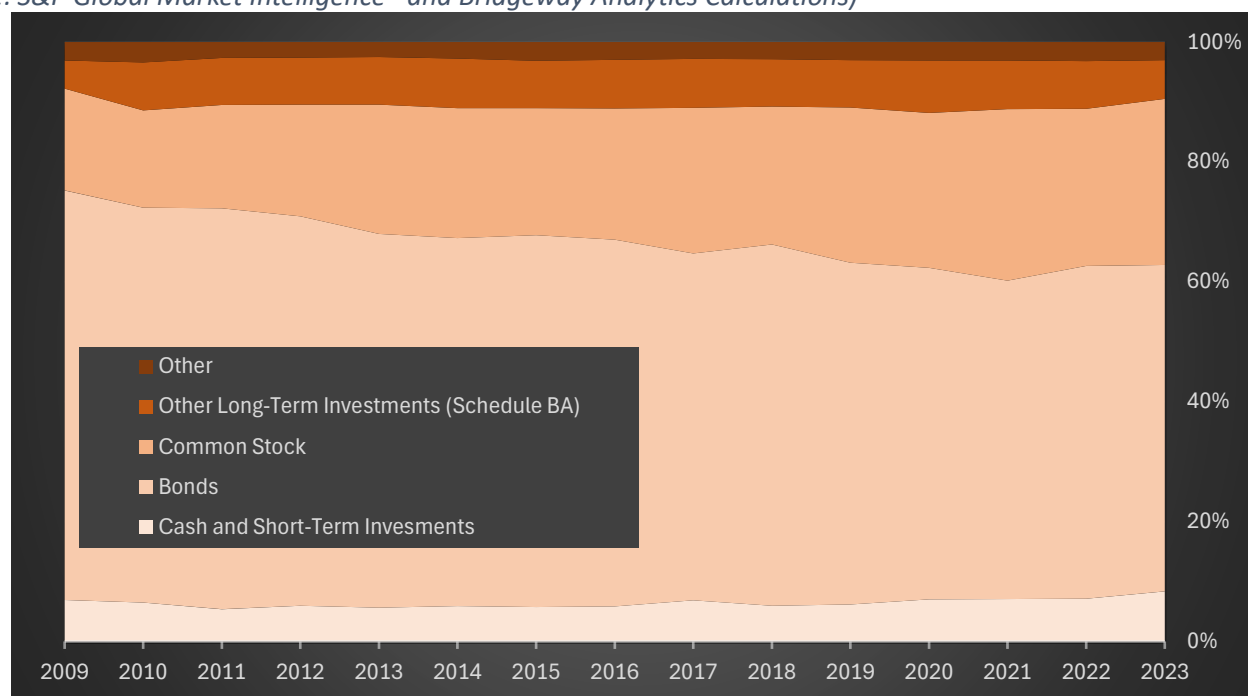
The composition of cash and invested assets (\$1.2 trillion in 2009 and \$2.32 trillion in 2023) highlights a shift toward equity (17% in 2009 to 28% in 2023) and away from bonds, as seen in *Figure 3*.^{1,2} Statistics are reported net of intergroup holdings to avoid double counting crossholdings; property & casualty intergroup holdings are a significant ~10% in 2023. Relating this trend with the reliance on investment income when navigating underwriting and policy pricing in the face of the frequency and severity of emerging risks leads to the natural question of what levels of common stock are prudent. While common stock investments are generally more liquid than other holdings, value is generally more volatile than fixed-income holdings.

¹ Bond here references Schedule D debt, which includes loans, debt of structured assets, and other credit securities, as defined in SSAP No. 26. Bonds are eligible for Designations that differentiate capital, which is generally more favorable.

² It is noteworthy that two of the largest companies, Berkshire Hathaway and State Farm, are among the insurers having a larger allocation to common stock. Although their size accentuated the trend in the aggregate data, the conclusion would not have been different. Specifically, if they are excluded from the analysis, the total investment in common stock and Schedule BA investments in 2023 was 18%, peaking at 20% in 2021, which is 7% (6%) higher than the 13% (14%) allocation in 2008 (2009). This compares to an increase of 12%, from a 22% allocation in 2009 to 34% in 2023 if the two are included.

From an RBC perspective, the 15% unaffiliated common stock R-1 charge was set based on studies that estimated a 95% loss ranging from 10% to 12%, and the higher factor reflects the increased risk when testing a period in excess of 1 year.³ We'll revisit this when exploring the relative treatment of bonds.

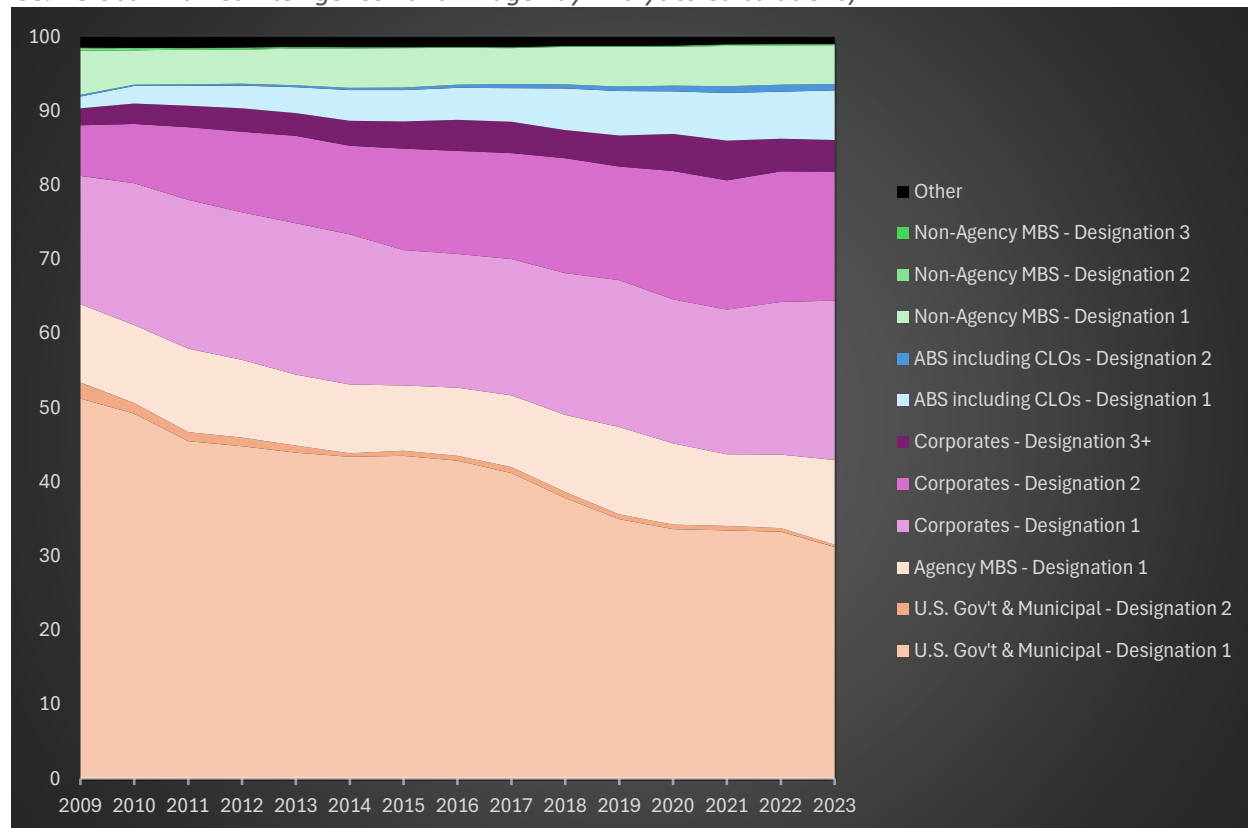
Figure 3: P&C Investments-percent of Cash & Invested Assets
(Source: S&P Global Market Intelligence* and Bridgeway Analytics Calculations)



We now explore Schedule D bond holdings, which comprise roughly 50% of property & casualty cash and invested assets. The nature of Schedule D bonds allows for a more direct assessment of issuer characteristics (e.g., U.S. Government or debt of an asset-backed security (ABS)) and credit risk (i.e., Designations). Over the last 15 years, there has been a significant rotation away from U.S. Government, Municipal, and Agency-MBS Securities Designated 1 (roughly Moody's Rating Aaa-A3) and toward Non-Agency MBS, ABS, and CLOs can be seen in *Figure 4*. In addition, a notable rotation toward lower-quality corporate bonds Designated 2 (roughly Moody's Rating Baa1-Baa3) and 3 (roughly Moody's Rating Ba1-Ba3). The rotation into bonds Designated 3 is striking because property & casualty companies generally carry those bonds at the lower of amortized cost or fair value, which can introduce significant balance sheet volatility compared to those with Designated 1 or 2, which are generally carried at amortized cost. It suggests that the added yield from investing in Designation 3 assets more than offset the added capital requirements and unfavorable accounting treatment.

³ RBC Property & Casualty Forecasting & Instructions.

Figure 4: Property & Casualty Schedule D Bold Holdings (% of Carrying Value)
(Source: S&P Global Market Intelligence* and Bridgeway Analytics Calculations)



In 2021, the RBC R-1 bond factors were updated along granular Designations; Designation 1A-1G roughly maps to Moody's Ratings Aaa to A3, which vary significantly in risks.

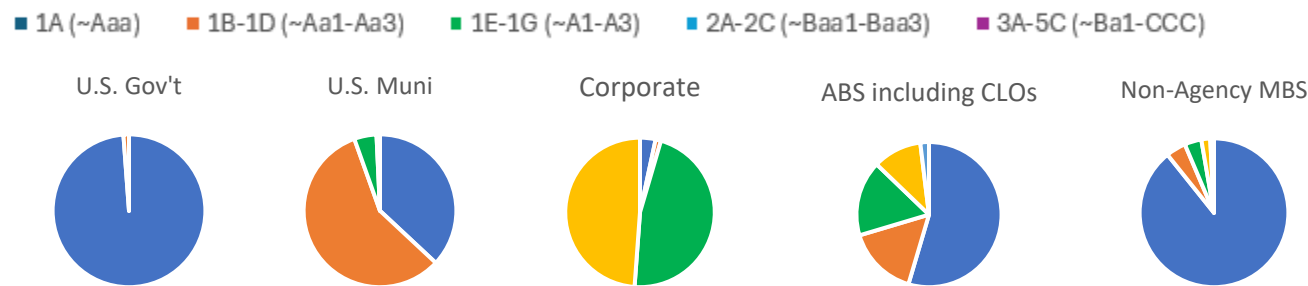
Did you know a 10-year A3 cumulative Idealized Default Rate is 180 times that of Aaa, which Moody's Ratings uses as a benchmark when rating structured products?

The more granular reporting allows us to get a more accurate reflection of the shifts in credit risks resulting from the rotation from U.S. government and municipal investments, which by and large receive Designations 1A-1D (~Aaa and Aa), to corporate debt Designated 1E-2C (~A and BBB), and ABS and CLOs, and non-agency MBS primarily Designated 1A-1D (~Aaa and Aa), with some 1E-2C (~A and BBB), warrants further exploration (see Figure 5). However, we caution readers not to overinterpret our analysis since Designations are only one dimension of risk, and many questions have been raised over the comparability of Designations across asset classes. In addition, Designations do not consider portfolio diversification benefits, concentration risks, or balance sheet interactions with policies.

From an RBC perspective, the R-1 factors range from 20 bps for Designation 1A (roughly Moody's Rating Aaa) to 130 bps for 1F (roughly Moody's Rating A2) to 600 bps for 3B (roughly Moody's Rating Ba2). U.S. Government securities are exempt. The R-1 bond factors for NAIC Designation Category 1A – 2C were estimated by simulating portfolio defaults and cash flows over a 5-year horizon. The factors for NAIC Designation Category 3A to 6 are estimated to align with lower of amortized

cost or fair value accounting.⁴ The approach departs from the roughly 1-year horizon used for common stock. It raises the question of the degree to which the factors are comparable in measuring risks.

Figure 5: Property & Casualty 2023 Year-End Holdings: Composition of Designations
(Source: S&P Global Market Intelligence* and Bridgeway Analytics Calculations)



3.2 Has the shift materially impacted insurers’ income? **Yes.**

We now assess the impact of shifting investment strategies on property & casualty industry income. Our back-of-the-envelope approach (1) estimates the income generated by each of the significant investment segments and (2) compares the income that would be generated by the portfolio under the 2009 composition with the income generated under the 2023 composition.

For bonds on Schedule D, we use effective yields to proxy for income. Acknowledging limitations with available data, we point to imprecisions that include the treatment of impairment, the floating or fixed rate nature of the coupon, abstracting from differences in duration across asset classes, and measuring yields at origination for 2023 property & casualty holdings. The annualized return on the S&P 500 was roughly 12.5% over the last 15 years.

Table 1 This chart presents the change in investment composition between 2009 and 2023 as a percent of cash and investments for the asset classes that changed most significantly, along with our estimates for the additional annual income those asset classes produce above U.S. government, U.S. agency and municipal debt. Municipal debt is included since it was likely lower yielding, with ratings in the range of Aaa and Aa in 2009 as in 2023. Notice that corporate bonds Designated 1 as a percent of cash and invested assets have remained roughly flat, while their proportion of Schedule D bonds has grown, which we discussed above. The 147 bps of additional income, on the \$2.32 trillion of cash and invested assets, translates to \$34 billion, roughly 40% of net income in 2023.

*Shifting investment strategies generated roughly \$34 billion of additional income,
roughly 40% of net income in 2023.*

⁴ RBC Property & Casualty Forecasting & Instructions.

Table 1: Additional portfolio income from shifting investment strategies
(Source: S&P Global Market Intelligence* and Bridgeway Analytics Calculations)

	Percent of cash and investments (2009)	Percent of cash and investments (2023)	Change from 2009 to 2023	Estimated additional annual income above government, agency, and municipal debt	Additional portfolio income from shifting investment strategies
U.S. government, U.S. agency, and municipal debt	34.8%	17.0%	-17.2%	0%	0 bps
ABS including CLOs	1.1%	4.1%	3%	4%	12 bps
Corporate Bonds Designation 1	11.8%	11.6%	-0.2%	2%	0 bps
Corporate Bonds Designation 2	4.6%	9.4%	4.8%	4%	19 bps
Common stock	17.2%	27.8%	10.6%	11%	116 bps
Other			-1.0%	0%	0 bps
Total					147 bps

4 What Does the Simultaneous Increase in Investment Risk & Change in Underwriting Risk Mean? *This is a Critical Moment for Governance, and we are Optimistic.*

We've highlighted why this is a critical time to update financial governance to maintain the high industry standards in place. The evolving landscape, including the post-GFC extended low-yield era, has had property & casualty investment strategies change significantly alongside capital markets. The joint formation and evolution of demand and supply for investment products has had asset managers and other capital market participants expand the opportunity set. These have been positive developments for insurers and policyholders from a return standpoint. However, regulations and enterprise risk management need to be assessed and possibly evolve to enable the prudent application of these new strategies in ways that can support the balance sheet in its capacity to assume the increase in investment risk while also addressing changes to the source of underwriting risks. Limitations in current methodologies exacerbate this combination, with examples discussed above, including:

- The lack of comparability in the RBC treatment of common stock, measured over a 1+ year horizon, and bonds measured over a 5-year horizon.
- The lack of differentiation in the treatment across debt classes, with corporate, municipal, and ABS debt receiving the same treatment but generally acknowledged to exhibit significantly different risks.

While we are encouraged by ongoing efforts to revise the life insurance investment framework, which faces similar limitations, the property & casualty have received much less attention. This is understandable, considering the significant level of risk historically observed in underwriting income compared to investment income, which we saw in *Figure 2*. It is also natural to focus on the acceleration of risk in core businesses and the more immediate and damaging consequences of underwriting risk in the everyday lives of people and the operations of institutions. The simultaneous changes in property & casualty underwriting losses and consequential pressure to take on more investment risks should motivate more intense efforts surrounding the governance of these newer investment strategies, with considerations for liquidity and asset-liability risks, especially for long-tail lines. While some companies have made impressive progress, similar frameworks should become the industry standard. In addition, valuable improvements to the life oversight framework, including features of AG 53 and Liquidity Stress Testing, can be leveraged.

The NAIC's formative initiative to modernize *Investment Risk Oversight* sets a path to address these critical issues. We look forward to further progress and participation as these programs focus greater attention on the property & casualty insurance sector.

5 Appendix: S&P Global Market Intelligence Data Use Disclaimer

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