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P&C Insurers: Moving Up in Credit Quality

INSIGHTS

While P&C insurers are seeking more conservative strategies and risk reduction in select asset classes, they're also increasing exposure to illiquid assets—which provide the potential for yield enhancement.

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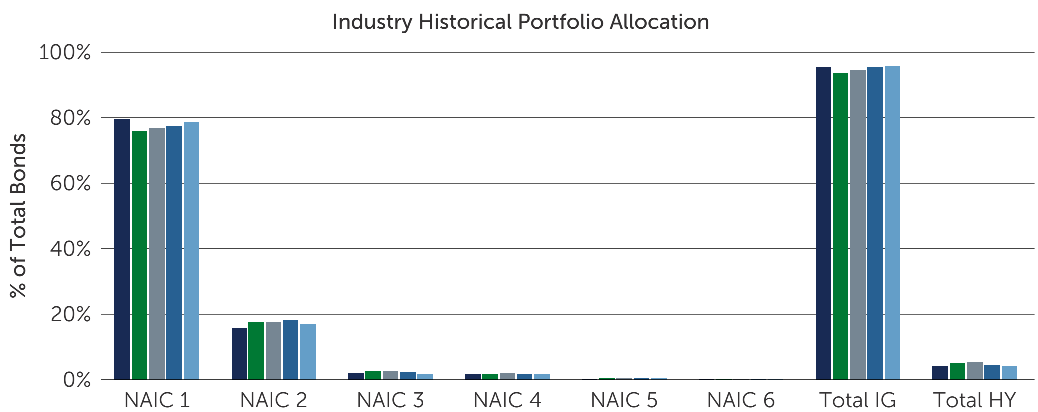
Against the shifting market backdrop, asset allocations in property & casualty (P&C) insurers' portfolios continue to evolve—particularly given their focus on risk reduction and yield enhancement. With the release of 2023 statutory filings, we review the key themes emerging in asset allocations for P&C insurers.

1. Shift Away from High Yield Toward Higher Ratings

Allocations to the highest rated NAIC 1 class (A- and higher) have continued climbing since 2020, growing to 2.6% of total bonds **(Figure 1)**. Within NAIC 1, AAA-rated growth has been strong, with decreases seen mainly in the AA and A-rated categories. This credit improvement has also drawn from NAIC 2 (BBB+/-), which saw a reduction of 0.9% over the past year—the first reduction since 2019. High yield allocations have declined since hitting a peak in 2021.

Figure 1: Moving Up in Credit Quality



	NAIC 1	NAIC 2	NAIC 3	NAIC 4	NAIC 5	NAIC 6	Total IG	Total HY
2019	79.8%	15.8%	2.1%	1.7%	0.4%	0.2%	95.6%	4.4%
2020	76.1%	17.6%	2.6%	1.9%	0.5%	0.1%	93.7%	5.1%
2021	76.8%	17.8%	2.7%	2.1%	0.4%	0.1%	94.6%	5.4%
2022	77.5%	18.1%	2.2%	1.7%	0.4%	0.1%	95.5%	4.5%
2023	78.6%	17.2%	2.0%	1.6%	0.5%	0.1%	95.8%	4.2%

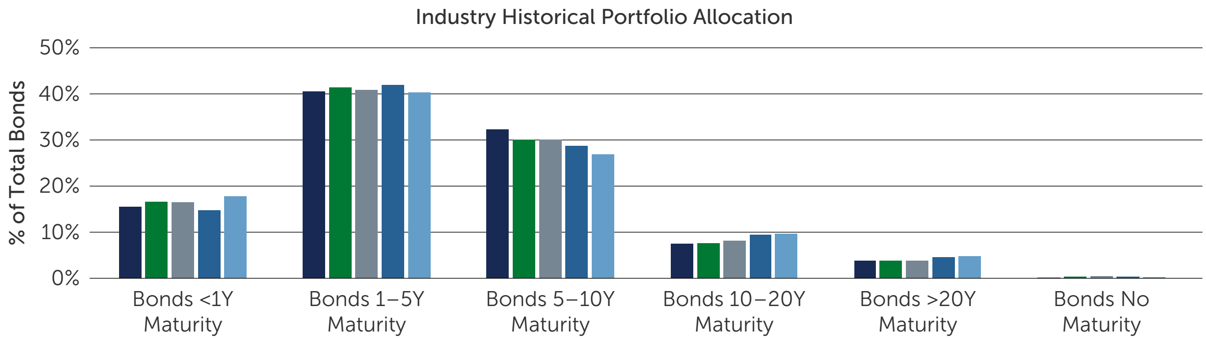
Source: S&P Global. As of December 31, 2023.

2. Allocations Across Maturities Become More Barbelled

Looking across portfolios, allocations to bond maturities have become increasingly barbelled. Insurers who wish to take advantage of the inverted yield curve can benefit by investing in short maturities under one year while balancing with longer maturities (greater than 10 years), which offers the potential for capital appreciation if interest rates fall. Industry giant Berkshire Hathaway, accounting for 22% of P&C assets, weighs heavily on the industry allocation to short maturities, with 96% of their bonds allocated to those with less than one year to maturity, up from 85% in 2022.[1] Ex-Berkshire, the industry still increased allocations to the shortest bucket **(Figure 2)**.

1. Source: S&P Global. As of December 31, 2023.

Figure 2: Allocations Rise in Both Short and Longer Maturities



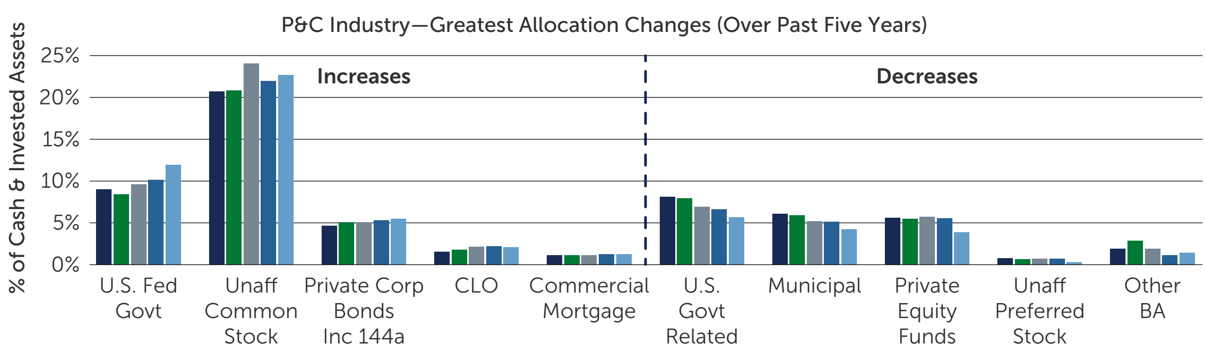
	Bonds <1Y Maturity	Bonds 1–5Y Maturity	Bonds 5–10Y Maturity	Bonds 10–20Y Maturity	Bonds >20Y Maturity	Bonds No Maturity
2019	15.6%	40.6%	32.3%	7.5%	3.8%	0.2%
2020	16.7%	41.4%	30.1%	7.6%	3.9%	0.4%
2021	16.6%	40.9%	30.1%	8.1%	3.8%	0.5%
2022	14.7%	42.0%	28.8%	9.5%	4.6%	0.4%
2023	17.8%	40.4%	26.9%	9.7%	4.8%	0.4%

Source: S&P Global. As of December 31, 2023.

3. Demand for U.S. Treasuries & Equities Rises

Consistent with the improved credit profile within P&C portfolios, U.S. Treasury allocations have grown significantly over the past several years while government-related and municipal bond allocations have slipped **(Figure 3)**. Common stock allocations have also increased, reflecting the strong equity market returns in 2023. Meanwhile, private equity (PE) allocations have fallen. This was led mainly by Berkshire Hathaway, which saw a massive reduction of nearly 8% in their PE allocation last year to 3.9%. Private corporate bonds and commercial mortgage loans have maintained a steady increase, while collateralized loan obligations (CLO) allocations fell last year, breaking a six-year string of rises.

Figure 3: CLO Allocations Fall, Breaking Six-year Streak



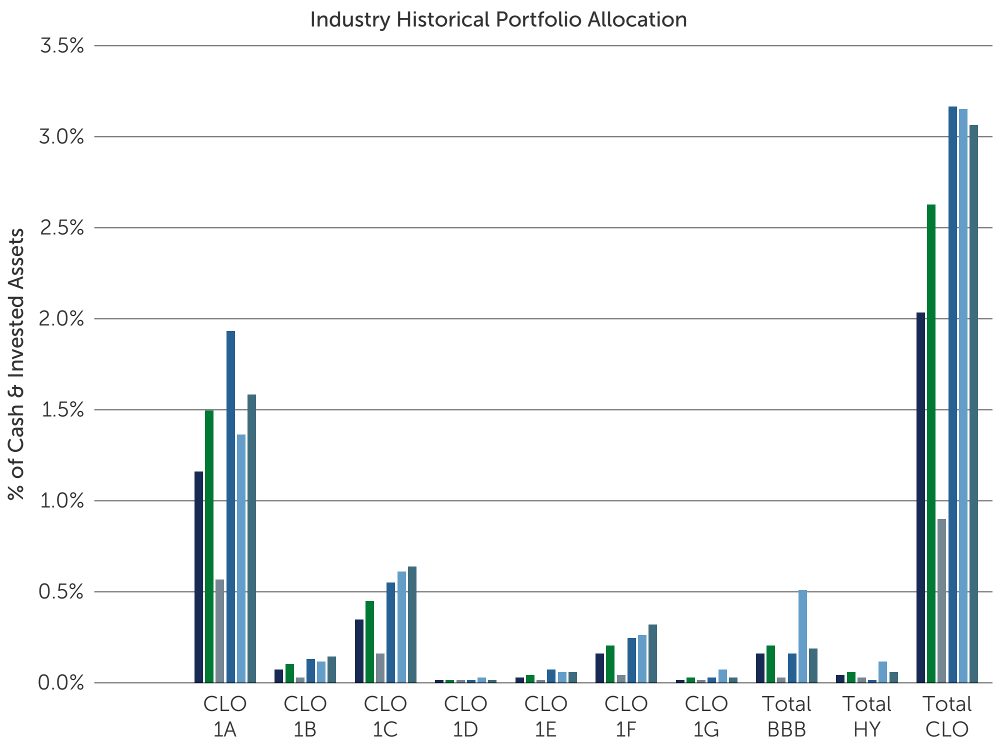
	U.S. Fed Govt	Unaff Common Stock	Private Corp Bonds Inc 144a	CLO	Commercial Mortgage	U.S. Govt Related	Municipal	Private Equity Funds	Unaff Preferred Stock	Other BA
2019	9.0%	20.7%	4.6%	1.5%	1.1%	8.1%	6.1%	5.6%	0.7%	1.9%
2020	8.4%	20.9%	5.0%	1.8%	1.1%	8.0%	5.9%	5.4%	0.6%	2.9%
2021	9.6%	24.1%	5.0%	2.1%	1.1%	6.9%	5.2%	5.7%	0.7%	2.0%
2022	10.2%	22.0%	5.4%	2.2%	1.2%	6.7%	5.1%	5.6%	0.7%	1.1%
2023	11.9%	22.8%	5.5%	2.0%	1.2%	5.6%	4.2%	3.9%	0.3%	1.4%

Source: S&P Global. As of December 31, 2023.

4. CLO Allocations Slip Across All Rating Buckets

Within the CLO asset class, allocations vary across business types, with commercial lines having the largest allocations **(Figure 4)**. Personal lines are skewed lower given Berkshire Hathaway's heavy weight and near zero allocation to CLOs. Slight reductions in CLOs were seen with near uniformity across all ratings, and the total CLO allocation is well below that of the life industry where it is the fastest growing asset class (2.0% versus 4.1%).

Figure 4: Commercial Lines Dominate CLO Allocations



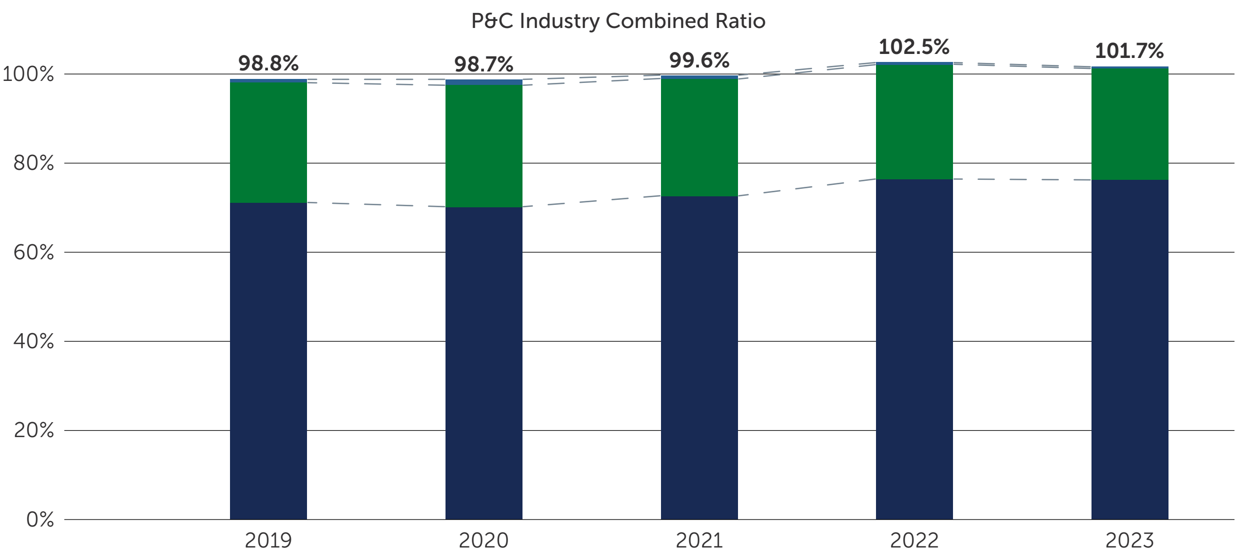
	CLO 1A	CLO 1B	CLO 1C	CLO 1D	CLO 1E	CLO 1F	CLO 1G	Total BBB	Total HY	Total CLO
P&C Industry	1.2%	0.1%	0.4%	0.0%	0.0%	0.2%	0.0%	0.2%	0.0%	2.0%
P&C Industry ex-Berkshire	1.5%	0.1%	0.5%	0.0%	0.0%	0.2%	0.0%	0.2%	0.1%	2.6%
Personal Lines Subindustry	0.6%	0.0%	0.2%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.9%
Commercial Lines Subindustry	1.9%	0.1%	0.6%	0.0%	0.1%	0.2%	0.0%	0.2%	0.0%	3.2%
Commercial Property Subindustry	1.4%	0.1%	0.6%	0.0%	0.1%	0.3%	0.1%	0.5%	0.1%	3.2%
Commercial Workers Comp Subindustry	1.6%	0.1%	0.6%	0.0%	0.1%	0.3%	0.0%	0.2%	0.1%	3.1%
Berkshire Hathaway Inc. (SNL P&C Group)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Source: S&P Global. As of December 31, 2023.

Key Takeaway

P&C insurers are balancing their investment objectives with operating performance. While expense management has helped, loss ratios and combined ratios have trended higher over recent years, which may be leading to more conservative investment strategies and risk reduction in select asset classes **(Figure 5)**. While liquidity remains key for P&C insurers, there has been modest growth within illiquid classes such as private corporate bonds and mortgage loans—which can offer a potential opportunity for yield enhancement.

Figure 5: Rising Loss & Combined Ratios Lead to Conservation Strategies



	2019	2020	2021	2022	2023
Loss & Loss Adjusted Expense Ratio	71.0%	70.1%	72.6%	76.4%	76.3%
Expense Ratio	27.0%	27.4%	26.4%	25.7%	24.9%
Policy Dividend Ratio	0.8%	1.2%	0.7%	0.4%	0.4%

Source: S&P Global. As of December 31, 2023.

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