Financial Review
July 22, 2013

U.S. P/C Industry Once Again Shows Profitable First-Quarter Results

The industry's combined ratio improved to 94.7 in the first quarter of 2013.

Driven by continued increases in premiums and modest declines in pure losses, the U.S property/casualty (P/C) industry posted a second consecutive first-quarter underwriting profit in 2013, as results improved compared with 2012 (see **Exhibit 1**). The industry's pretax operating and net income showed strong increases on the improved underwriting results, while the level of investment income remained steady. The industry's combined ratio improved to 94.7 in the first quarter of 2013, compared with 97.4 in the first quarter of 2012 (see **Exhibit 2**). Consequently, policyholders' surplus (PHS) – $618.3 billion at March 31, 2013 – increased by 6.0% to reach a new record amount (see **Exhibit 3**).

For the purposes of this report, data of companies in A.M. Best's mortgage guaranty and financial guaranty composites are excluded.

Financial Performance

Underwriting results for the first quarter of 2013 marked a second consecutive profitable first quarter for the industry. Losses from catastrophe events were modest and generally below expectations for the quarter. Year-on-year price increases also have boosted underwriting results as the industry's pricing environment continues to strengthen. For some insurers, 2013 will mark a third round of pricing improvement in certain lines that were particularly impacted by the soft market conditions that prevailed in earlier years.

Pricing in personal lines remains strong, with the homeowners and personal automobile liability lines both showing solid increases in direct premiums written (DPW) (see **Exhibit 13**). Several commercial lines showed strong increases in DPW, notably workers' compensation (11.1%), general and products liability (8.3%), commercial multiperil (7.8%) and commercial auto liability (7.6%). Continued rate increases and exposure growth – for example, increased employee counts and miles driven – have contributed to the growth in premium for commercial lines. Premium audits, which were driving substantial levels of return premium as recently as 2011 now have either a neutral or positive impact on premiums.

Exhibit 1
U.S. Property/Casualty – 1st Quarter Financial Indicators (2012-2013)
Excludes mortgage and financial guaranty segments.
($ Billions)

	1st Qtr 2012	1st Qtr 2013	Year/Year % Change
Net Premiums Written	$113.2	$118.4	4.6
Net Premiums Earned	108.4	113.5	4.7
Pure Losses Incurred	61.6	61.4	-0.4
Loss-Adjustment Expenses	12.7	13.3	5.2
Losses & LAE	74.3	74.7	0.6
Underwriting Expenses	32.1	33.6	4.5
Policyholder Dividends	0.5	0.6	5.9
Underwriting Income/(Loss)	1.5	4.6	208.5
Net Investment Income	12.0	12.0	0.3
Other Income	0.4	0.1	-81.4
Pretax Operating Income/(Loss)	13.9	16.7	20.5
Realized Capital Gains/(Losses)	2.7	8.1	195.7
Federal Income Taxes	2.5	2.8	14.4
Net Income	14.2	22.0	55.4

Note: Figures may not add due to rounding.
Population reported as of June 19, 2013.
Source: A.M. Best data & research

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Exhibit 2

U.S. Property/Casualty – 1st Quarter Combined Ratio Components (2012-2013)

Excludes mortgage and financial guaranty segments.

	1st Qtr 2012	1st Qtr 2013
Pure Loss Ratio	56.8	54.1
Loss-Adjustment Expense (LAE) Ratio	11.7	11.7
Loss & LAE Ratio	68.5	65.8
Underwriting Expense Ratio	28.4	28.4
Policyholder Dividend Ratio	0.5	0.5
Combined Ratio (Reported)	97.4	94.7

Population reported as of June 19, 2013.
Source: A.M. Best data & research

Exhibit 3

U.S. Property/Casualty – 1st Quarter Change in Policyholders' Surplus (2012-2013)

Excludes mortgage and financial guaranty segments.
($ Billions)

	1st Qtr 2012	1st Qtr 2013	Year/Year % Change
Beginning Policyholders' Surplus (PHS) at Prior Year End	$567.3	$598.4	5.5
Net Income	14.1	22.0	55.7
Unrealized Capital Gains/(Losses)	-0.5	15.9	n/m*
Contributed Capital	1.6	-4.3	n/m*
Stockholder Dividends	-8.4	-10.4	24.0
Other Changes	9.3	-3.3	n/m*
Ending Policyholders' Surplus	583.4	618.3	6.0
Change in PHS from Prior Year End ($)	$16.1	$19.9	
Change in PHS from Prior Year End (%)	2.8%	3.3%	
After-Tax Return on Surplus (ROE)	2.5%	3.6%	

*n/m = not meaningful
Note: Figures may not add due to rounding.
Population reported as of June 19, 2013.
Source: A.M. Best data & research

Among the major lines of insurance, only two – medical professional liability and accident and health (A&H) – showed declines in DPW in the first quarter of 2013. These lines have been consistently profitable in recent years and continue to attract competition, resulting in ongoing downward pressure on rates despite increases elsewhere in the industry.

First-quarter losses resulting from catastrophe events declined in 2013, a second consecutive drop in first-quarter catastrophe losses. Catastrophes accounted for 2.0 points of the combined ratio in the first quarter of 2013 versus 3.2 points in the first quarter of 2012. Generally mild weather patterns produced modest losses during the first quarter of 2013. However, this quarter typically produces lower catastrophe losses compared with those of the second or third quarters. Several episodes of severe weather will drive higher catastrophe losses in the second quarter of 2013 compared with the first quarter.

While the industry's pure loss ratio reflects the benefit of increased net premiums earned, the expense ratio was unchanged in the first quarter of 2013 compared with the first quarter of 2012 (see **Exhibit 2**). Although insurers continue to press for improved operating efficiencies, as net premiums written (NPW) increase, so do commission costs.

Movement of reserves for prior accident years was typically modest in the first quarter, with the industry recognizing 2.0 points of favorable development. In addition, the industry's reserves for asbestos and environmental-related losses developed favorably by 0.2 points in the quarter. The industry's reported accident-year combined ratio of 92.5 for the first quarter of 2013 improved by 1.4 points from 93.9 in the first quarter of 2012, reflecting the current year's rate increases and lower natural catastrophes losses (see **Exhibit 12**).

The level of favorable development recognized by the industry in the quarter was similar to that in the first quarter of 2012. Despite the continuing favorable development, A.M. Best believes the industry has recognized most of the benefit from reduction of prior accident years' reserves for the more recent accident years. Consequently, the benefit of favorable development on the industry's combined ratio is expected to decline in future periods.

The persistent low interest rate environment continues to pressure the industry's net investment income, which includes primarily interest payments from bonds and dividends on equities. The industry's net investment income grew by 0.3% year over year, despite a 3.6% increase in cash and invested assets. While there have been no large shifts in asset classes to improve yields, companies have continued to reduce the term of fixed-income holdings, add to equity positions and invest more in non-traditional assets for the P/C industry – such as hedge funds, limited partnerships and direct mortgages. As in prior years, however, investment income contributes the majority of the industry's pretax operating profits, which improved substantially in the first quarter of 2013, increasing by 20.5% to $16.7 billion from $13.9 billion in the first quarter of 2012.

The industry realized more than $8.1 billion in capital gains in the first quarter of 2013, primarily on strong equity markets, but also as gains on limited partnerships, hedge funds and other nontraditional investments were recognized. This was a $5.4 billion increase over 2012's first-quarter realized gains. Income taxes increased in the quarter, reflecting the improved profitability. As a result of improved pretax operating results, increased realized gains and slightly higher income-tax provisions, the industry's net income increased more than 55%, to $22 billion, compared with $14.1 billion in the first quarter of last year (see **Exhibit 3**).

Policyholders' Surplus

As a result of the strong level of net income, the industry's PHS increased by 3.3% from year-end 2012 in the first quarter, to a record $618.3 billion. First-quarter 2013 growth in surplus was stronger than in the first quarter of 2012, when surplus grew by 2.8%. Growth in surplus for the quarter also was boosted by $15.9 billion in unrealized capital gains, a $16.4 billion swing from $0.5 billion in unrealized losses at the end of the first quarter of 2012. As with the industry's realized gains in the first quarter of 2013, the increase in unrealized gains was driven primarily by strengthening equity markets during the quarter. The improvement in net income and the increased unrealized gains more than offset a $2 billion increase in stockholder dividends to $10.4 billion from $8.4 billion in the first quarter of 2012.

Given the industry's relatively strong levels of capital and the improvement in underwriting results, the pace of rate increases may slow somewhat in 2013 after consecutive increases. However, future profitability will continue to depend on the industry holding firm on pricing and underwriting practices, given the expectation that:

• Investment income will continue to be pressured by lower yields on reinvestment;

• Underwriting income will have less benefit from recognition of prior accident years' loss reserves; and

• Volatility in investment markets can cause rapid and sharp changes in the industry's surplus through changes in its unrealized gain position.

Personal Lines Segment

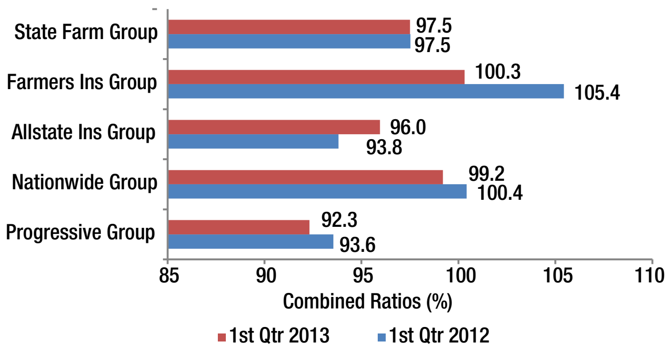
Earnings for the personal lines segment for the first quarter of 2013 improved over the first quarter of 2012. After-tax net income was $5.3 billion for the three months ended March 31, 2013, compared with approximately $4.9 billion for the first three months of 2012 (see **Exhibit 4**). The improvement was attributed primarily to higher pretax operating income and higher realized capital gains, partially offset by higher income taxes.

Exhibit 4
U.S. Property/Casualty – Personal Lines Segment 1st Quarter Key Figures (2012-2013)

	1st Qtr 2012	1st Qtr 2013	Year/Year % Change
Net Premiums Written	$59.0	$62.1	5.3
Underwriting Gain/(Loss)	1.6	2.2	36.3
Net Income	4.9	5.3	7.9
Policyholders' Surplus	226.2	236.6	4.6
After-Tax Return on Surplus (%)	2.2	2.3	

*n/m = not meaningful
Population reported as of June 19, 2013.
Source: A.M. Best research

Exhibit 5
U.S. Property/Casualty – Personal Lines Segment 1st Quarter Combined Ratios (2012-2013)
Top 5 groups ranked by first-quarter 2013 gross premiums written.



Source: A.M.Best data & research

Pretax operating income of $5.9 billion was up nearly 8.1% for the first quarter of 2013, compared with approximately $5.4 billion for the first quarter of 2012. This increase was driven mainly by higher levels of underwriting income, partially offset by a slight decrease in net investment income (NII).

Underwriting income for the first quarter of 2013 was $2.2 billion, compared with $1.6 billion for the same period in 2012 (see **Exhibit 4**). Net premiums earned (NPE) increased by $2.4 billion, or 4.1%, to $60.7 billion, while net loss and loss-adjustment expenses incurred increased by nearly $1.1 billion, or 2.6%, to $41.7 billion. Other underwriting expenses incurred of $16.5 billion were also $0.7 billion or 4.6% higher for the first quarter of 2013 compared with the first quarter of 2012.

The increase in NPE was attributed primarily to rate increases, mainly on the homeowners line of business, and to a lesser extent on the private passenger auto liability line. Rates for homeowners multiperil coverages have been increasing to help offset a higher rate of incurred claims countrywide due to more frequent and severe weather-related events over the past few years. Private passenger auto liability rates also have moved upward to mitigate higher severity of claims due to medical cost inflation.

The personal lines segment reported a favorable calendar-year combined ratio of 95.7 through the first three months of 2013, compared with a combined ratio of 96.9 through the first three months of 2012 (see **Exhibit 12**). The pure loss ratio was 57.1 for the first quarter of 2013, compared with 58.5 during the same period in 2012. Both the homeowners and private passenger auto liability lines showed improvement. The loss ratio on the homeowners line was 47.5 for the first quarter of 2013, compared with 55.1 for the prior year's first quarter. The loss ratio on private passenger auto liability was 63.2 for the first quarter of 2013, compared with 64.4 for the first quarter of 2012. The underwriting expense ratio of 26.5 for the segment was down slightly year on year from 26.7 in 2012.

Included in the first-quarter 2013 underwriting results was nearly $3.3 billion of prior accident-year favorable reserve development, which contributed to reducing the calendar-year combined ratio by 5.4 points. This produced an accident-year combined ratio of 101.1 for the first quarter of 2013, compared with an accident-year combined ratio of 103.6 through the first quarter of 2012 (see **Exhibit 12**). Favorable reserve development was approximately $3.9 billion for the first quarter of 2012, reducing the 2012 calendar-year combined ratio by 6.7 points. Furthermore, there were fewer catastrophe losses in the first quarter of 2013 compared with the first quarter of 2012. Catastrophe losses net of reinsurance totaled nearly $1.6 billion, or 2.6 points of the year-to-date combined ratio, compared with more than $2.1 billion and 3.7 points to the first-quarter 2012 combined ratio. Excluding catastrophes and prior-year reserve development, the normalized combined ratio for the first quarter of 2013 was 93.1, which is comparable to the normalized combined ratio of 93.2 for the first quarter of 2012.

NII of $3.1 billion for the first quarter of 2013 was down 5.8% compared with the prior year's first quarter. The decrease was attributed mainly to lower yields, partially offset by an increase in cash and invested assets. Yields were down primarily through reinvestment of maturing bonds at lower interest rates, which have been at historical lows. The preponderance of the segment's invested assets is in fixed-income securities. However, realized capital gains increased to $668.9 million from $489.2 million. This reflected improved equity valuations from strengthening financial markets.

PHS for the segment was $236.6 billion at March 31, 2013, an increase of $7.4 billion or 3.2% from Dec. 31, 2012. The increase was largely due to after-tax net income of $5.3 billion and unrealized capital gains of $4.1 billion, partially offset by stockholders dividends of nearly $1.0 billion and other surplus reductions of approximately $1.1 billion. Other reductions to surplus included adjustments due to changes in accounting principles as a result of adoption of Statement of Statutory Accounting Principles (SSAP) #92, Accounting for Post-retirement Benefits Other Than Pensions and SSAP 102, Accounting for Pensions, which took effect Jan. 1, 2013.

Companies continue to take underwriting actions to improve earnings and reduce exposure to catastrophic loss. Homeowners writers continue to raise rates and deductibles, increase home and roof inspections, and implement catastrophe risk management initiatives. Greater segmentation and sophistication in pricing continue to be used on auto lines, and insurers are increasing attention to risks that are more susceptible to tornado/hail storms, as well as extremely hot and dry conditions that may lead to wildfires.

Although the personal lines segment remains competitive, it continues to exhibit strong capitalization and generally positive operating performance. In addition, actions the industry is taking to strengthen enterprise risk management (ERM) practices and tighten underwriting standards have benefited the personal lines segment.

Exhibit 6

U.S. Property/Casualty – Commercial Lines Segment 1st Quarter Key Figures (2012-2013)

Excludes mortgage and financial guaranty segments.

($ Billions)

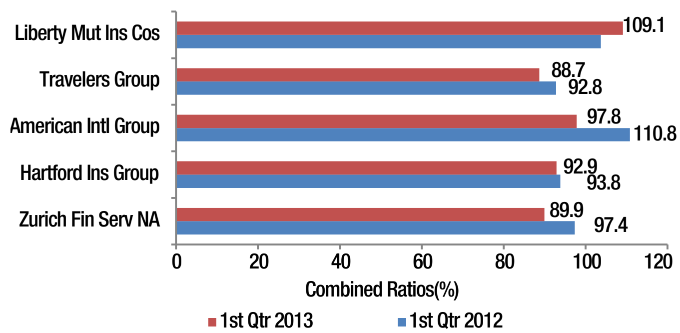
	1st Qtr 2012	1st Qtr 2013	Year/Year % Change
Net Premiums Written	$46.6	$47.2	1.2
Underwriting Gain/(Loss)	(0.2)	1.1	n/m
Net Income	7.4	12.8	71.5
Policyholders' Surplus	226.9	237.1	4.5
After-Tax Return on Surplus (%)	3.3%	5.5%	

Population reported as of June 19, 2013.
Source: A.M. Best data & research

Exhibit 7

U.S. Property/Casualty – Commercial Lines Segment First-Quarter Combined Ratios (2012-2013)

Top 5 groups ranked by first-quarter 2013 gross premiums written



Source: A.M. Best research

Exhibit 8

U.S. Property/Casualty – U.S. Reinsurance Segment 1st Quarter Key Figures (2012-2013)[1]

($ Billions)

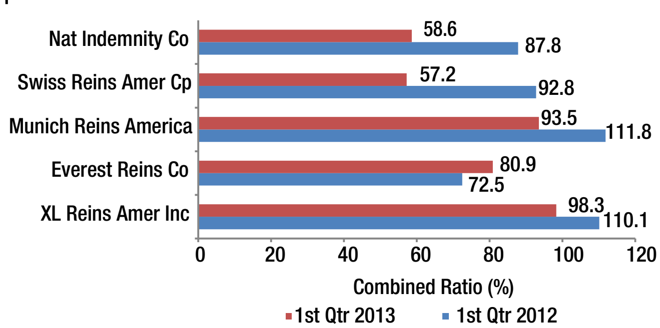
	1st Qtr 2012	1st Qtr 2013	Year/Year % Change
Gross Premiums Written	$11.3	$13.5	19.8
Underwriting Gain/(Loss)	0.0	1.3	n/m[2]
Net Income	1.8	4.0	121.3
Policyholders' Surplus	130.3	144.5	10.9
After-Tax Return on Surplus (%)	1.4%	2.8%	

[1] First-quarter 2013 data reflect a change in an internal reinsurance contract that will not be repeated in future quarters.
[2] n/m = not meaningful
Population reported as of June 19, 2013.
Source: A.M. Best data & research

Exhibit 9

U.S. Property/Casualty – U.S. Reinsurers First-Quarter Combined Ratios (2012-2013)

Top 5 groups ranked by first-quarter 2013 gross premiums written.



Source: A.M.Best research

Commercial Lines Segment

Improving pricing conditions have sustained growth in premium volume, which is based on results reported through March 31, 2013. This is shown by the commercial lines segment's 1.2% increase in NPW to approximately $47.2 billion, up from approximately $46.6 billion during the same prior-year period. The sustained growth in premium reflects ongoing recovery in the exposure base given an improving economic environment, combined with ongoing rate firming as market conditions improve. As in recent quarters, growth in premium volume within the commercial lines segment has been driven primarily by the workers' compensation line, which has reported both rate increases and an expanding payroll (exposure) base as economic conditions improve after the recession.

Excluding losses arising from natural catastrophes, the commercial lines segment's underwriting performance improved through March 31, 2013, reflecting more adequate rates. The segment further benefited from lower catastrophe-related losses than in the prior year. Results in the commercial lines segment were impacted by approximately 1.5 points of natural catastrophe-related losses in the first quarter of 2013, down from approximately 2.7 points reported during the same prior-year period. Including the benefit of lower catastrophe losses during the quarter, the reported combined ratio improved incrementally to 96.3, compared with the 98.5 reported for the first quarter of 2012 (see **Exhibit 12**).

In addition to lower catastrophe losses, the improving loss and LAE ratio reflects the ongoing improvement in pricing. Despite an increasing premium base that reflects an improved pricing environment, the commercial lines segment's underwriting expense ratio in the first quarter of 2013 increased 1.2 points over the same prior-year period. Policyholder dividend ratios remained unchanged.

As has been the trend of late, the improving loss ratio reflects the benefit of favorable development on prior accident-year loss reserves, although the level of recognized favorable development has declined modestly in recent years. Specifically, the combined ratio benefit during the quarter ended March 31, 2013, was approximately 2.9 points, down from the 3.1 points reported during the same prior-year period. Core loss reserves – excluding asbestos and environmental (A&E) – developed less favorably through March 31, 2013, with a benefit to the combined ratio of 3.4 points, compared with the 3.6 points reported during the first quarter of 2012. The earnings drag associated with the impact of A&E resulted in approximately 0.4 points of adverse development through March 31, 2013, slightly less than the 0.5 points reported during the same period of 2012.

As previously stated, A.M. Best remains concerned with the industry's loss-reserve position given the extended soft market cycle, which eroded pricing adequacy and reduced the available loss-reserve cushion. As a result, the level of recognized reserve redundancies has declined in recent years and does not provide the same support to current calendar-year results as in prior years.

Despite ongoing improvement in pricing, the commercial lines segment's return on pretax operating income (POI/NPE) declined incrementally during the quarter ended March 31, 2013, compared with the same prior-year period. On an absolute dollar basis, the segment reported higher pretax operating income given the factors previously mentioned – such as improved rates and lower catastrophe losses – although the improvement in pretax income was slightly outpaced by growth in earned premium, which reduced the measure. The segment's net income/NPE return measures improved considerably through March 31, 2013, compared with the same prior-year period, driven by an approximate 200% increase in realized capital gains.

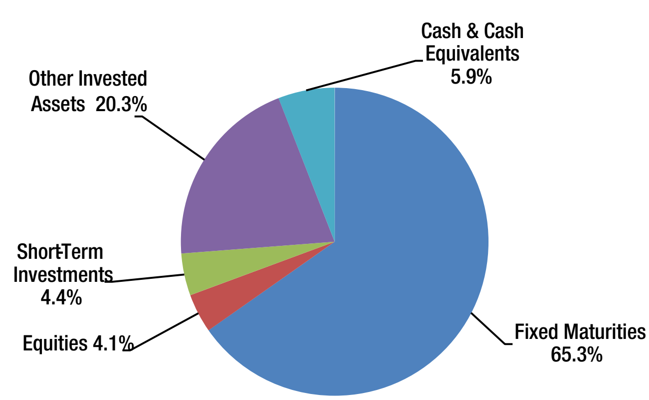
Collectively, the segment realized approximately $7.5 billion in capital gains through March 31, 2013, compared with approximately $2.5 billion during the first quarter of 2012. Concurrently, the segment improved from an unrealized capital loss of approximately $7.8 billion at March 31, 2012, to an unrealized capital gain of $8.2 billion through March 31, 2013. Due in part to the decreasing investment yields, a decline in NII tempered the increase in pretax operating income of 2.4%. Considering the aforementioned increase in realized capital gains, net income increased approximately 72% through March 31, 2013, to $12.8 billion from $7.4 billion during same prior-year period. While improved net income drove an increase of 4.5% in PHS for the commercial lines segment during the first quarter of 2013 – to $237.1 billion from $226.9 billion at March 31, 2012 – growth in PHS was somewhat constrained by ongoing stockholder dividends, which increased relative to the same prior-year period.

Exhibit 10
U.S. Reinsurance & Bermuda Market – Financial Highlights (1st Quarter 2013)
($ Billions)

Net Premiums Written (P/C only)	$18.2
Net Premiums Earned (P/C only)	13.8
Net Investment Income	1.7
Realized Investment Losses	0.7
Total Revenue	**$17.1**
Net Income	**$3.9**
Shareholders' Equity	102.8
Shareholders' Equity (2011 End of Year)	101.7
Loss Ratio	52.4
Expense Ratio	31.0
Combined Ratio	83.4
Favorable Loss Reserve Development	-5.8
Return on Equity (annualized)	15.2%
Return on Revenue (annualized)	22.7%

Source: A.M. Best data & research

Exhibit 11
U.S. & Bermuda Reinsurance Segments – Investment Allocation (1st Qtr 2012)



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

Reinsurance Segment

The reinsurance industry finished the first quarter of 2013 in profitable territory, producing a solid underwriting gain of $1.3 billion, which is a significant increase from $9.5 million for the same period in 2012 (see **Exhibit 8**). The reinsurance segment's combined ratio of 76.6 is a considerable improvement over the 93.4 recorded in the first quarter of 2012 (see **Exhibit 12**). This reflects the continuation of strong operating performance as the result of relatively benign catastrophe losses.

The investment market remains challenging, although, NII increased in the first quarter, and there was a small increase in invested assets compared with the same period last year. With investment yields remaining weak, companies are investing more in highly rated corporate bonds, and there has been a noticeable increase in the allocation to other invested assets compared with the first quarter of 2012. Companies continue to hold approximately the same amount of cash and short-term investments as in prior quarters as they seek to maintain flexibility and the ability to reinvest at higher yields once more favorable interest rates return.

Management teams continue to invest cautiously amid global economic uncertainty, the potential for inflation and overall volatile markets. The risk of rising inflation has prompted many companies to maintain shorter durations in their fixed-income investment portfolios. The $3.9 billion in NII for the first quarter of 2013 is significantly higher than the $2.4 billion reported for the same period in 2012. NII continued to sustain the segment's overall net profit of approximately $4.0 billion in the first quarter.

The U.S. reinsurance segment reported a positive 5.3% total return on equity for the first quarter of 2013, which is slightly lower than the 5.5% recorded for the same period in 2012. PHS increased to 3.6%, an improvement from the 3.4% produced in the first quarter of 2012. Unrealized capital gains of approximately $3.6 billion largely contributed to the increase in PHS.

Exhibit 12
U.S. Property/Casualty – 1st Quarter Segment Underwriting Trends (2012-2013)
Excludes mortgage and financial guaranty segments.

	Personal Lines Segment		Commercial Lines Segment		U.S. Reinsurance Segment[2]		Total U.S. P/C Industry	
	1st Qtr 2012	1st Qtr 2013	1st Qtr 2012	1st Qtr 2013	1st Qtr 2012	1st Qtr 2013	1st Qtr 2012	1st Qtr 2013
Change in Net Premiums Written (Yr/Yr %)	2.6	5.3	4.1	1.2	1.1	20.0	3.1	4.6
Change in Net Premiums Earned (Yr/Yr %)	2.6	4.1	3.3	3.4	4.1	18.4	2.8	4.7
Pure Loss Ratio	58.5	57.1	54.9	51.5	55.4	45.3	56.8	54.1
Loss-Adjustment Expense (LAE) Ratio	11.2	11.5	12.9	12.9	8.0	6.1	11.7	11.7
Loss & LAE Ratio	69.6	68.6	67.8	64.4	63.4	51.4	68.5	65.8
Underwriting Expense Ratio	26.7	26.5	30.3	31.5	30.0	25.2	28.4	28.4
Policyholder Dividend Ratio	0.6	0.6	0.4	0.4	0.0	0.0	0.5	0.5
Combined Ratio (Reported)	96.9	95.7	98.5	96.3	93.4	76.6	97.4	94.7
Less: Accident-Year Cat Losses (Points)[1]	3.7	2.6	2.7	1.5	2.4	0.0	3.2	2.0
Less: Asbestos & Env Losses (Points)	0.0	0.0	0.5	0.4	0.3	0.5	0.2	0.2
Combined Ratio (Normalized)	93.2	93.1	95.3	94.3	90.7	76.1	93.9	92.5
Accident-Year Combined Ratio (Reported)	103.6	101.1	101.6	99.2	92.4	87.0	102.2	99.4

Note: Figures may not add due to rounding.
[1] A catastrophe generally is defined as an industry event that causes $25 million or more in insured property losses. For U.S. reinsurers, catastrophe losses include losses outside of the United States.
[2] First-quarter 2013 data reflects a change in an internal reinsurance contract that will not be repeated in future quarters.
Population reported as of June 19, 2013.
Source: A.M. Best data & research

For the first quarter of 2013, the U.S. reinsurance segment's statutory gross premiums written (GPW) increased by 19.8% to $13.5 billion, compared with $11.3 billion for the same period in 2012. The growth in the statutory GPW is distorted, however, by an intercompany pooling agreement that took effect with one of the large companies within the composite. Excluding the effects of this intercompany agreement, the annualized growth in GPW is in the high single-digit range. Reinsurance pricing is flat to down, and reinsurers are finding better opportunities for growth in the insurance market through their primary operations.

The January and April renewals came in as expected, with rates remaining stable overall. However, the June and July renewal seasons exhibited negative pressure on pricing due to the increase in capacity and declining demand for reinsurance protection.

On a GAAP basis – which excludes Berkshire Hathaway – the U.S. reinsurance and Bermuda market reported a combined ratio of 83.4 in the first quarter of 2013 (see **Exhibit 10**), a minor improvement over the reported 88.8% combined ratio for the same period in 2012. These positive results are attributable to the relatively benign catastrophe activity experienced during the first quarter of 2013, which has helped to strengthen reinsurers' capital positions. Reinsurers have reconsidered catastrophe limits, terms and conditions, and they have reduced exposures in areas where pricing adequacy remains questionable.

For the first quarter of 2013, NII was $1.7 billion and added to the underwriting profit to generate net income of $3.9 billion. However, this is a slight decrease from the same period in 2012, which recorded NII of $1.9 billion. The U.S. reinsurance and Bermuda market reported annualized returns on equity and revenue for the first quarter of 2013 of 15.2% and 22.7%, respectively. The profitable performance speaks to the flexibility of the reinsurance segment, considering the weak global economy, continuing low-yield investment environment, competitive pricing and increased primary retentions.

In an attempt to manage future returns and shareholder expectations, companies continue to use a variety of capital management strategies. With management teams satisfied with

Exhibit 13

U.S. Property/Casualty Industry – 1st Quarter Direct Premiums Written (2012-2013)

($ Thousands)

Lines of Business	1st Qtr 2012	1st Qtr 2013	Year/Year % Change
Private Passenger Auto Liability	$27,272,302	$28,371,323	4.0
Homeowners & Farmowners Multiple Peril	17,479,391	18,578,280	6.3
Auto Physical Damage	18,400,507	19,275,975	4.8
Other & Products Liability (Occurrence & Claims Made)	12,721,212	13,773,877	8.3
Workers' Comp (Includes Excess Workers' Comp)	12,566,681	13,962,811	11.1
Fire & Allied Lines	7,805,628	7,874,428	0.9
Commercial Multiple Peril	8,670,709	9,349,227	7.8
Ocean and Inland Marine	5,339,003	5,527,499	3.5
Other*	4,917,860	4,846,283	-1.5
Commercial Auto Liability	4,953,823	5,331,055	7.6
Medical Professional Liability (Occurrence & Claims Made)	3,255,633	3,150,182	-3.2
Accident & Health	2,090,444	2,072,475	-0.9
Total DPW	$125,473,193	$132,113,415	5.3

* Other includes Aircraft, Boiler & Machinery, Burglary & Theft, Credit, Earthquake, Fidelity, Financial Guaranty, International, Mortgage Guaranty, Surety, Warranty and Aggregate Write-Ins.
Population reported as of June 19, 2013.
Source: A.M. Best data & research

their capital positions and share prices remaining below book value, share repurchases are continuing to gain momentum and appear to be the favored capital management strategy. Companies also have taken advantage of the low interest rate environment to refinance existing debt and preferred securities with lower cost alternatives.

As companies continue to search for alternative market opportunities, numerous new sidecars have been formed alongside traditional reinsurers. This third-party capital allows for additional financial and operational flexibility. Third-party capital also provides additional underwriting capacity and complements the traditional balance sheet and risk appetite. Managed capital allows the reinsurer greater flexibility with their own capital resources and provides a source of low-risk income in the form of management fees and profit-sharing income.

The trend of further syndication of lines and risks, aimed at reducing counterparty credit risk, continues to create opportunities for some smaller reinsurers at the expense of some of the larger, global organizations. Furthermore, primary companies' retentions remain high relative to historical levels, as primary companies continued to struggle to grow underwriting revenues given the weak economic conditions and poorer prospects for a quick recovery. However, with the potential for more volatility in assets and the model changes, primary companies' perception of risk appears to be changing, which ultimately should benefit the reinsurers. Inflationary pressures also are looming, but companies remain vigilant to this threat, especially those taking on longer-tailed exposures.

The current market continues to be challenging, but reinsurance companies remain well capitalized and continue to maintain pricing integrity and underwriting discipline, while capitalizing on existing opportunities. In this challenging market environment, prudent and effective cycle management remains the most important factor to long-term success.

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