Review & Preview
March 6, 2024

US Property/Casualty: Weather, Reinsurance, and Inflation Drive Results – Again

Given the change in weather patterns of late, secondary perils have become more intense, resulting in larger losses for primary insurers due to higher retentions

Principal Takeaways

- Climate change and secondary perils played an even larger role in 2023, resulting in the US experiencing more billion-dollar catastrophe events than in any year on record.
- Commercial lines insurers continued to reap the benefits of up-pricing and effective risk selection, but overall results were overshadowed by weather and further deterioration in personal lines.
- A fundamental shift in reinsurance behavior and risk appetites has placed more of the risk burden on primary carriers via higher attachment points and increased reinsurance pricing.
- Sizable underwriting losses in 2023 were masked by higher investment yields and record-high net investment income.
- AM Best expects improved underwriting and operating results in 2024, owing to the commercial lines' continued profitability, coupled with improvements in personal lines and in investment returns owing to higher yields, as well as strong cash flow.

2023 Review

The year 2023 started with many US P/C companies hoping for some respite from the difficulties of 2022, in terms of both underwriting and investments. Just as P/C companies managed their way through the COVID-19 pandemic, they were preparing to sharpen their risk management protocols by closely examining how to best manage their investment portfolios in the wake of continued interest rate hikes, the risk of recession, and early signs of a bear market. The need to understand and devise new strategies to address the growing frequency of severe convective storms was another challenge, especially for insurers whose geographic profiles were not historically viewed as catastrophe-prone. This challenge was further exacerbated by favorable reinsurance pricing, leading to an over-reliance on reinsurance availability, which quickly dissipated at the beginning of the year, reflecting changes in reinsurers' risk appetites and return hurdles.

In addition to these headwinds, lingering challenges such as litigation financing and social inflation have yet to be resolved. Insurers also faced persistent inflationary pressures and were in dire need of rate relief to offset elevated loss costs, supply chain disruptions, and rising commodity and labor costs. Regarding social inflation, insurers were still trying to contend with savvy plaintiff attorney tactics, more sympathetic juries, and rising jury awards, which have dampened commercial lines' underwriting results, particularly in lines such as general, products, and professional liability.

Furthermore, the 2023 Vesttoo scandal highlighted the critical importance of companies' enterprise risk management (ERM) practices in assessing the quality of reinsurance collateral,

Analytical Contacts:
Daniel Ryan, Oldwick
+1 (908) 882-2290
Daniel.Ryan@ambest.com

Sharon Marks, Oldwick
+1 (908) 882-2092
Sharon.Marks@ambest.com

David Blades, Oldwick
+1 (908) 882-1659
David.Blades@ambest.com

Contributors listed on page 27

2024-016

Copyright © 2024 A.M. Best Company, Inc. and/or its affiliates. ALL RIGHTS RESERVED. No portion of the content may be reproduced, distributed, or stored in a database or retrieval system, or transmitted, or uploaded into any external applications, bots or websites, including those using artificial intelligence technologies such as large language models and generative AI in any form or by any means without the prior written permission of AM Best. AM Best does not warrant the accuracy, completeness, or timeliness of the AM Best content. While the content was obtained from sources believed to be reliable, its accuracy is not guaranteed. You specifically acknowledge that neither AM Best nor the content gives any investment, financial, tax, insurance, or legal advice. You are solely responsible for seeking competent professional advice before making any investment, financial, tax or insurance decision. For additional details, refer to our Terms of Use available at the AM Best website: www.ambest.com/terms.

particularly in fronting arrangements. Fortunately for the industry, only a handful of carriers were impacted by the scandal.

On a positive note, commercial lines insurers continued to reap the benefits of rate increases and effective risk selection, achieving a net underwriting profit in 2023. However, advances in commercial lines were overshadowed by the deterioration in the personal lines segment, in both the homeowners and private passenger automobile lines. Since early 2022, personal lines insurers have been aggressively pursuing rate increases to more accurately reflect calculated rate needs, in the quest for an underwriting turnaround. However, regulatory constraints, inflationary pressures, and more frequent and severe weather-related events were tough hurdles to overcome.

Including above average losses from natural catastrophes and increased reinsurance costs, the industry reported a net underwriting loss of approximately $38 billion—its largest underwriting loss in over a decade. Nevertheless, the P/C industry was able to post a sizable pretax operating profit in 2023, thanks to higher investment yields and a corresponding increase in net investment income. In addition, insurers' balance sheets were bolstered by gains in the equity markets, as the industry was able to reverse some of its 2022 unrealized loss positions courtesy of the bull market during the second half of 2023.

AM Best expects a solid rebound for the P/C industry in 2024, including improved underwriting and operating results, owing to the commercial lines' continued profitability, coupled with improvements in personal lines and stronger investment returns from higher yields, as well as strong cash flow.

Catastrophe Losses—Are Secondary Perils Really "Secondary"?

Insured losses from weather-related events continue to take a toll on P/C insurers and to trend above the long-term averages, as the frequency and intensity levels of storms worsen. What has been particularly troublesome for insurers in the past three years is the degree to which losses from so-called secondary perils are growing.

In 2023, the US experienced more billion-dollar catastrophe events than any other year on record. According to the National Oceanic and Atmosphere Administration (NOAA), which has tracked climate in the US for 129 years, 2023 was the fifth-warmest year on record. Insurers are trying to better understand the rising frequency and intensity of secondary peril events and how to accurately assess the level of risk in their property portfolios while developing strategies to lessen the possibility of increased insured losses affecting their results.

For years, the insurance industry has traditionally referred to these events as "secondary perils," since they are typically far less severe than primary perils such as hurricanes and tropical storms. Over the last few years, however, the growth in both the frequency and severity of secondary perils has become problematic for many insurers. AM Best's estimate for catastrophe losses impacting the US P/C industry in 2023 is approximately $65 billion. With only one hurricane making landfall in the US, the vast majority of catastrophe losses in 2023 were attributable to secondary perils.

Unlike hurricane events, secondary perils are not limited to coastal states and are far more widespread geographically. Given the change in weather patterns in recent years, secondary perils have become more frequent and intense, resulting in higher losses for primary insurers due to higher retentions. Some industry experts put the average annual losses from secondary perils at approximately $35 billion a year. To put that in perspective, insured losses from secondary perils in 2023 were almost double the average annual loss amount. Among the more notable secondary peril weather-related

events that occurred in 2023 were the Lahaina wildfires, the drought/heat wave across the South and Midwest, the winter freeze in the Northeast, and the heavy rainfall and subsequent flooding in California's Bay Area.

Aon estimates global insured catastrophe losses at $118 billion in 2023, a fourth year of losses amounting to more than $100 billion. Severe convective storms were one of the primary drivers of global insured losses in 2023. Aon estimated that US catastrophes resulted in insured losses of roughly $80 billion in 2023, versus $99 billion in 2022. AM Best's loss estimate is lower than Aon's, because it reflects the net catastrophe losses retained by US insurers and reinsurers.

Despite having the fourth most active hurricane season since 1950, 2023 was a relatively benign year, with only one hurricane making landfall in the US—Hurricane Idalia, which hit the Big Bend region of northern Florida in August 2023. Fortunately for insurers, the remoteness of the areas that bore the brunt of Idalia helped minimize the impact, as insured losses from the hurricane came to less than $2 billion.

With catastrophic events becoming more frequent, more varied by type, and more intense, they have become an even greater challenge for primary insurers to manage. As secondary perils become more common, reinsurers have also been feeling the wrath of these storms and, as a consequence, have been raising reinsurance rates, increasing retentions, and introducing tighter terms and conditions. Many believe these changes in reinsurers' behavior will be longer-lasting than in the past, which will put even more of the onus and financial responsibility on primary insurers. Changes in weather patterns are likely to perpetuate this, as insurers and reinsurers reflect the realities of more recent events and lessen their confident in historical claims patterns and data. In addition, third-party modeling firms also are racing to keep up with adjusting their models for a rise in these formerly infrequent events.

AM Best estimates that net catastrophe losses added roughly 7.8 points to the P/C industry's combined ratio in 2023 (**Exhibit 1**), versus our initial CAT load estimate of 6.3 points, up from 5.7

Exhibit 1

US Property/Casualty – Financial Indicators[1]

Excludes mortgage and financial guaranty segments

	Actual					Estimated/ Projected	
	2018	2019	2020	2021	2022	2023E	2024P
Change in Net Premiums Written (%)	10.7	3.4	2.5	9.4	8.1	11.4	9.0
Change in Surplus (%)	-0.7	14.4	7.2	12.9	-6.9	2.5	3.8
Combined Ratio (Reported)	99.6	99.2	98.8	100.0	103.1	103.7	100.7
Less: U.S. Catastrophe Losses1	5.7	4.1	7.7	7.5	6.7	7.8	6.8
Less: A&E Losses	0.5	0.3	0.3	0.2	0.2	0.2	0.2
Combined Ratio (Normalized)	93.4	94.9	90.8	92.3	96.2	95.6	93.8
Accident Year Combined Ratio (Normalized)[2]	95.7	96.1	92.3	93.4	96.9	96.3	94.2
Change in Net Investment Income (%)	14.0	0.4	-7.1	5.4	27.5 [3]	6.2	14.5
Net Investment Yield (%)	3.4	3.2	2.7	2.7	3.2	3.4	3.6
Pre-tax Return on Net Premiums Earned (ROR) (%)	9.3	9.6	9.1	7.6	5.7	4.7	8.1
After-tax Return on Surplus (ROE) (%)	7.7	7.1	6.6	5.8	4.0	8.8	6.0
Net-Premiums-Written-to-Surplus-Ratio	0.8	0.7	0.7	0.7	0.8	0.9	0.9

E=Estimated, P=Projected

[1] 2018-2022 catastrophe losses based on AM Best data; 2023-2024 are AM Best estimates/projections.

[2] Normalized accident-year combined ratio adjusted to exclude prior-year core reserve development, which excludes asbestos and environmental losses.

[3] Includes $10.8 billion intercompany distribution by large reinsurer that flowed through NII.

Source: AM Best data and research

points in previous years. In 2024, AM Best increased its CAT loss estimate to 6.8 points to reflect this recent phenomenon and its potential impact on the P/C industry, considering the changes in weather patterns and their increased severity and frequency. Although the revision to the CAT load in 2024 seems modest, the increase in insured loss dollars is more significant, as this load is relative to a larger premium base. AM Best may revisit the CAT load again next year based on the actual level of catastrophe loss activity in 2024. How primary insurers are able to absorb these losses in light of higher retentions will be crucial for capital preservation and their overall financial strength.

An Unyielding Reinsurance Market

As catastrophe losses and elevated property and car values continued to plague primary insurers, reinsurers were steadfast in their attempts to improve underwriting performance in the property market, by tightening terms and conditions, drastically increasing attachment points, and adjusting rates on line.

Some casualty reinsurers became increasingly concerned about social inflation and litigation funding, leading them to pay closer attention to primary insurers experiencing a higher degree of adverse reserve development—a sign that the impact of these factors may not have been adequately accounted for in existing reserves. Some reinsurers began to reduce their capacity in these lines, particularly in the public D&O (directors and officers) and excess casualty segments. Development patterns affected by pandemic-related court closings have also caused challenges for reinsurers.

These conditions have led to a fundamental shift in the reinsurance market, which is having a pronounced effect on primary companies, large and small. Over the years, many insurers have used their reinsurance relationships to manage earnings in addition to preserving capital, which included the use of lower-level catastrophe covers and aggregate reinsurance. Primary insurers have become increasingly reliant on their reinsurance partners to help them manage their portfolios in good times and bad. Many of these same insurers can no longer rely on these strategies, as reinsurance capacity has become more discriminate in its use due to higher hurdle rates and stakeholder demands.

In 2023, US reinsurers reported net premium growth of nearly 18% and improved underwriting results across the board. The improvement was driven primarily by better property results, while concerns about casualty reserve development were prevalent. Also impacting the US reinsurance segment's underwriting results in 2023 was a large intercompany assumed loss portfolio transfer (LPT), which added $6.8 billion to both incurred losses and premiums.

Catastrophe losses did not impact US reinsurers as much as they did primary insurers in 2023, due mainly to the use of higher attachment points and the elimination of aggregate covers. Reinsurers' results also benefited greatly from considerable risk-adjusted rate increases in the property reinsurance market at 2023 renewals. Reinsurers generated robust results in 2023, but this followed a multi-year period in which reinsurers' returns lagged their required costs of capital. As a result, we do not expect that reinsurance underwriting conditions will ease significantly through 2024.

Private Passenger Auto Results—Worst Three-Year Stretch in Recent Memory

The private passenger auto segment has posted net underwriting losses for three straight years. This line has long been the leading line of business of the P/C industry, accounting for a third of all business written and more than two thirds of all personal lines premiums written. Therefore, P/C results are typically skewed by the results of the private passenger auto line.

Results for the private passenger auto line, coming off its pandemic-affected best year in 2020, now reflect a return to pre-pandemic traffic patterns. In fact, travel on US roads in 2023 set a new yearly record based on miles driven, according to the National Highway Traffic Safety Administration. This, combined with the impact of inflation and rising loss costs, continues to impact all auto lines—commercial and private passenger. Riskier and more aggressive driving habits, including speeding during rush hours, and distracted driving also have contributed to the deterioration in auto results. To counter these trends and address worsening results, auto insurers have sought rate increases for the better part of two years. The justification for the rate increases has been the same, including increased fatalities; rising costs for auto repairs; higher used car prices; supply chain and labor market challenges, and ever-increasing medical costs.

However, given the magnitude of the proposed rate increases, some state regulators have resisted granting approvals, leaving insurers with increases that fall short of the rate need detailed in proposed rate filings and necessitating a delay before being able to file again. As a result, many auto insurers are still in catch-up mode and have yet to obtain the rate increases needed to achieve true rate adequacy.

Pricing Momentum in 2024

AM Best projects an increase of 9.0% in net premiums written (NPW) for the P/C industry (**Exhibit 2**) in 2024, following an estimated 11.4% increase in 2023.

AM Best also estimates that personal lines premium increased by more than 12% in 2023, with the same level of growth split evenly among homeowners and private passenger auto. AM Best projects an increase of 10% for personal lines insurers in 2024, with insurers expressing greater determination in dealing with regulators to achieve the rate increases necessary to address their calculated rate needs, while also being willing to withdraw from a given state entirely if necessary increases are not approved. On a positive note, in late 2023 and early 2024, several states that have generally been viewed as more challenging, such as California and Washington, have given way to higher and much needed rate increases.

Because of resistance by regulators in 2023, some of the large personal lines insurers were able to leverage their position in a state by either threatening to exit the state entirely or stop writing new business. AM Best believes other insurers will do the same. There has been a concerted push throughout the industry for rate increases. In 2023, personal auto and homeowners results ended the year with a combined ratio estimated at 110, while commercial lines posted another strong year at 97.1. Despite insurers' best efforts to fight through regulatory hurdles to achieve needed rate increases,

Exhibit 2

US Property/Casualty – Combined Ratio Components

Excludes mortgage and financial guaranty segments

($ billions)

	Net Premiums Written	NPW Growth (%)	Loss Ratio	LAE Ratio	Under-writing Expense Ratio	Dividend Ratio	Combined Ratio
2018	617.4	10.7	61.2	10.8	27.1	0.6	99.6
2019	638.2	3.4	60.4	11.0	27.0	0.8	99.2
2020	654.2	2.5	59.4	10.8	27.3	1.2	98.8
2021	715.5	9.4	62.8	10.2	26.3	0.7	100.0
2022	773.7	8.1	66.9	10.1	25.7	0.5	103.1
2023E	862.1	11.4	67.6	10.0	25.5	0.5	103.7
2024P	939.5	9.0	64.2	10.0	25.9	0.6	100.7

E=Estimated, P=Projected

Source: AM Best data and research

Cyber Insurance—Prices Moderate in Wake of Rising Ransomware Attacks

Pricing seems to have leveled off in 2023, but the appetite and take-up rate for cyber insurance remains stable, making cyber insurance one of the fastest growing lines of business in the P/C industry the past eight years, outpacing the overall industry since the NAIC began collecting data on the line in 2015. Cyber premiums account for a mere 0.8% of premiums written by P/C insurers but the line has grown exponentially since the pandemic because of the widespread increase in employees' working from home. Cyber is still viewed as having the greatest potential for growth in the P/C industry, with direct premiums written (DPW) estimated to reach $15 billion by 2025. But with this growth comes a great deal of risk and uncertainty.

In 2023, the number of ransomware attacks rose sharply, with some industry experts suggesting increases ranging from 50% to 75% over 2022. Still, the leveling off of cyber pricing and self-insured retentions still mostly unchanged or declining are a strong indication that we could be at the beginning of a soft market for cyber insurers.

Once again, much of the growth was in surplus lines insurers, which now account for the majority of cyber premium written in the US. And much of this growth came from small and middle-market accounts, with the bulk coming from standalone policies, which accounted for roughly 70% of all the cyber business written in 2022.

Both loss frequency and severity are on the rise given the spike in ransomware attacks in 2023. Also troubling was the two-fold nature of the ransom demands, as threat actors sought not only ransom to get the target's operations back on line, but also a second ransom to not release the data captured; otherwise, companies would run the risk of the data leaking into the black market. In line with these dual demands, threat actors began moving their focus back to larger targets, seeking out companies that can afford larger ransom payments.

In July 2023, the SEC adopted rules requiring companies to disclose material cyber security incidents within four days. Threat actors have since found ways to use the new disclosure requirement to their advantage, by filing whistleblower claims on their own attacks with claims that the incident was not disclosed or that the disclosure was inaccurate. Threat actors were also exploiting the four-day requirement by attacking on a Friday, making it more difficult for the targets to publicly release their disclosures in time.

Despite being a property dispute stemming from the NotPetya attack in 2017, the case between Merck & Co. and Ace American Insurance Co. was finally settled in 2023, which sets the precedent on the use of war exclusions and how they apply to cyber policies in the future. The Merck case highlights why the definition of "war" is so important on cyber policies—cyber attacks can easily spread beyond their intended targets without geographical or political limitations. A clear definition of "war" with associated exclusions and clear coverage is still ongoing.

Catastrophe bonds have been part of the overall reinsurance market for some time, bringing additional capacity to cover extreme events. The first cyber catastrophe bonds came to the market in 2023, a sign that investors are willing to support the risks because of improved modeling. Three private bonds and four public bonds were issued in 2023, and issuance momentum is growing. Swiss Re even brought forth the first industry loss warranty (ILW) catastrophe bond providing $50M of retrocession protection. Improved clarity with regard to systemic risks, such as war and state-sponsored attacks, will likely bring with it more ILS (insurance-linked securities) capacity to the cyber market, which is greatly needed to support the growth of cyber risk exposures.

AM Best expects the line to post underwriting losses again in 2024, although they may moderate, as carriers work to get ahead of severity trends.

Pricing momentum for most of the commercial lines continued in 2023, as net premiums rose by 8.2%. Economic inflation and social inflation were key influences on industry losses and pricing changes that year. According to Swiss Re, liability costs in the US have risen an average 16% in the past five-year period, four times higher than the average economic inflation rate, revealing the impact of loss factors beyond that of inflation on indemnity payments. Social inflation has been particularly disruptive for liability insurance lines because it is difficult to measure or predict and can disproportionately affect longer-tail lines of coverage. In addition, CAT losses, rising property replacement values and higher repair costs (for labor and materials) continue to pressure commercial property rates and reinsurance pricing upward. The combined ratios of the commercial automobile and commercial multi-peril lines were above 100, but despite the lines' results, the operating performance of the commercial segment was still far better than that of the personal lines segment.

Although highly fragmented across many lines of business, commercial lines continued to benefit from solid overall premium growth and a continuation of business being written in the excess and surplus lines market. And, although rate increases in the professional liability, cyber, and workers' compensation lines have been moderating, in most other lines the increases have been healthy. Price increases in personal lines seem to have accelerated and outpaced those of its commercial lines peers in 2023.

Rising loss costs drove combined ratios higher in 2023. Underwriting expenses were down a fraction but the ratio was relatively flat, as acquisition costs were little changed and any impact from streamlining costs and efficiencies has yet to be recognized. For 2023, policyholder dividends remained at 0.5%, which matches 2022 but is low relative to historical norms. The distortion in 2020 was due largely to the dividends paid to auto policyholders whose vehicles were unused during the first year of the pandemic.

Industry Underwriting Results—A Mixed Bag

Overall, the PC industry is expected to post a combined ratio of 103.7 for 2023, as **Exhibit 1** showed. The estimated normalized accident year combined ratio, adjusted to exclude CATs and any impact from prior year loss reserve development, came in at 96.3, down slightly from 96.9 in 2022. As the 2023 rate increases continue supporting net earned premium, the estimated normalized accident year combined ratio for the P/C industry is expected to improve further, to 94.2, given the anticipated overall rate increases in 2024.

Historically, personal lines and commercial lines are equally influential in determining the P/C industry's overall underwriting results. The personal lines segment is dominated by 10 insurers, which account for roughly 72% of annual DPW. These leading writers also have some of the most robust balance sheets in the industry but are heavy users of reinsurance due to potential catastrophes.

The longer-tailed commercial lines segment is much more fragmented, with the top 10 writers accounting for only 34% of all commercial lines premium. These lines comprise multiple lines of business—both claims-made and loss occurrence policies, which are often subject to their own market cycles and competition. The commercial lines are also split among admitted and non-admitted markets, which tend to move based on changes in risk appetites and competitive behavior. Over the past several years, a greater share of commercial business has moved to the excess and surplus lines (E&S) market, which suggests more pricing discipline than previously. The E&S market accounts for an estimated 22% of all commercial lines premium, up from 11% just 10 years ago. Some of the

PFAS—The Next Asbestos?

Commercial lines have seen the emergence of new risks and latent liabilities, such as per- and poly-fluoroalkyl substances (PFAS). PFAS have been used in a variety of consumer products since their origin in 1947 but have recently been found to increase the risk of cancer. They are also called “forever chemicals,” because they cannot be broken down in the environment or in the body. Previous lawsuits against PFAS manufacturers focused on production facilities and their harm to the environment; new scientific research into toxicity is leading to consumer personal injury claims.

There are reportedly thousands of PFAS-related lawsuits pending nationwide. Policyholders—and hence insurers—could be on the hook for potential damages from these compounds. The exposure to PFAS chemicals and the resulting litigation have elicited heightened attention and focus from the plaintiff’s bar, which likely views these forever chemicals as a fertile source of lawsuits and large recoveries. Whether PFAS-related liabilities will result in insurance industry losses approaching asbestos-related liabilities is uncertain at this point, but insurers are preparing for numerous claims and large losses.

The increase in PFAS regulations and litigation could result in massive settlements and payouts, which is causing policyholders to look to insurance carriers for coverage. PFAS litigation is typically covered by general liability insurance policies and claims generally involve actions occurring over an extended period and many locations, implicating multiple policy periods and insurers. Pollution exclusions were added to most general liability policies in the late 1980s and early 1990s—decades after the widespread use of PFAS had begun—and there could be coverage under those old policies.

For newer policies written after those general liability or product liability exclusions were added, there may still be partial or full coverage for PFAS liabilities, depending on the language of the specific exclusion. Jurisdictions interpret various pollution exclusions differently, such as the applicability of the “hazardous materials” exclusion and the “sudden and accidental” exception to the pollution exclusion.

In 2023 alone, major chemical companies such as 3M, DuPont, and Chemours settled over $14 billion in cases related to water contamination. In December 2023, the city of Wausau (Wisconsin) filed suits against 15 manufacturers and more than 60 insurance companies. Some industry experts believe these recent product liability and personal injury cases are only beginning and that payouts could become the next asbestos litigation threat for all insurance carriers.

growth in commercial lines could also be attributable to the increased use of fronting companies over the past few years and the growing interest in cyber liability insurance since 2021.

Fronting companies have made good advancements in recent years but not without some growing pains, such as the Vesttoo scandal in 2023 and the use of fraudulent letters of credit, highlighting the importance of due diligence of reinsurance counterparty risk and collateralized arrangements. Thankfully, the impact of the Vesttoo scandal was not widespread, affecting a small number of fronting insurers and the ways in which letters of credit (LOCs) are now vetted. In late 2023, Lloyd’s revised its guidance on the use of LOCs, which now require verification every six months by its members or they will be subject to a discount of the value of the LOC until confirmation is received.

Results have been steadier the last two years for a significant number of commercial lines of business, with few exceptions. With investment margins at their lowest levels in 40 years, underwriting results had to improve for insurers to meet minimum return hurdles, which prompted the compounding

effect of rate increases year over year. Although pricing may moderate in 2024, the focus on rate adequacy is a positive for commercial lines insurers as well as the industry itself.

In 2023, the personal lines segment incurred a net underwriting loss of $48 billion, up from $40 billion in 2022, as above-average catastrophe losses contributed 10 points to the segment's combined ratio of 110.0 (**Exhibit 3**). Rate increases in 2022 contributed to the improvement in the combined ratio for personal auto, which went from 112.2 to 109.5 in 2023, while that of the homeowners line went from 104.6 to 111.0 due to weather-related losses and higher net retentions (**Exhibit 4**).

In September 2022, AM Best changed the outlook for the personal lines segment to Negative, citing the increase in catastrophes, rise in reinsurance costs and net retentions, and the troubled personal automobile line as the main reasons. The Negative outlook was the first for the segment since AM Best started issuing industry/ratings outlooks over 20 years ago.

Net Investment Income Rebounds

In an effort to fight inflation, the Federal Reserve raised the federal funds rate 525 basis points in 2022 and 2023, which caused bond prices to fall below their carried values. However, this drop had a negligible effect on insurers, which traditionally carry these at amortized cost and hold nearly all these investments to maturity. Stock market volatility and a waning economy and weaker GDP forecasts led to concerns about once resilient balance sheets, liquidity, and the cost of capital. Recession concerns abated in the second half of 2023, as the Fed began to pause its tightening efforts—a relief to investors, as the equity markets rallied, and the possibility of a soft(ish) landing looked more promising.

Exhibit 5 shows that the industry's estimated net investment income grew significantly in 2022 and held fairly steady in 2023, at $75.9 billion. However, net investment income in 2022 was skewed by a $10.8 billion intercompany distribution at one very large reinsurer, which flowed through net investment income. Adjusted for this one-time transaction, the growth in the industry's net investment income in 2023 would be significantly higher than the 6.2% shown in **Exhibit 1**. With rate cuts not expected until mid-year 2024, AM Best estimates that insurers will continue to reap the benefits of appreciably higher investment yields and projects, and that 2024 net investment income will exceed $85 billion in 2024.

Exhibit 3

US Property/Casualty – Segment Indicators

Excludes mortgage and financial guaranty segments

	US Personal Lines			US Commercial Lines			US Reinsurance		
	2022	2023E	2024P	2022	2023E	2024P	2022	2023E	2024P
Change in Net Premiums Written (%)	7.6	12.4	10.0	10.8	8.2	6.5	2.3	17.8 [2]	11.8
Change in Policyholders' Surplus (%)	-11.5	-0.9	2.1	-0.5	5.9	5.2	-7.6	3.1	4.7
Combined Ratio (Reported)	109.2	110.0	104.7	95.4	97.1	97.9	99.5	94.4	90.8
Less: Catastrophe Losses	7.6	10.0	8.5	3.4	5.0	4.5	14.2	6.5	6.0
Less: A&E Losses	0.1	0.1	0.1	0.4	0.4	0.3	0.2	0.3	0.2
Combined Ratio (Normalized)	101.5	99.9	96.1	91.6	91.7	93.1	85.0	87.6	84.6
Accident Year Combined Ratio (Normalized)[1]	100.3	100.6 [2]	95.9	94.1	93.6 [2]	94.1	89.6	83.8 [2]	86.7
Change in Net Investment Income (%)	-4.8	37.6	16.4	6.8	30.4	11.4	137.6 [3]	-43.2	18.1
Investment Yield (%)	2.4	3.3	3.5	2.9	3.5	3.7	5.6 [3]	3.0	3.2
After-Tax Return on Surplus (ROE) (%)	-3.7	-3.2	1.6	8.0	8.7	8.2	11.5	29.8	10.1
NPW/PHS (Reported)	1.0	1.1	1.2	0.8	0.8	0.8	0.4	0.4	0.4

E=Estimated, P=Projected

[1] Normalized accident-year combined ratio adjusted to exclude prior-year core reserve development, which excludes A&E losses.

[2] Includes impact of large intercompany assumed LPT.

[3] Includes $10.8 billion intercompany distribution by large reinsurer that flowed through NII.

Source: AM Best data and research

Although investment returns in 2022 and 2023 benefited from improved longer-term yields, total returns were also subject to swings in the equity markets. The US equity markets rebounded nicely in 2023 thanks to a strong US economy and consumer resilience. AM Best expects that, absent capital market volatility, investment returns in 2024 should generate yields and returns much stronger than in 2020 and 2021.

As the equity markets rebounded in 2023, the resulting unrealized gains reversed a fair portion of the unrealized losses reported in 2022. This led to stronger overall balance sheets, as policyholders' surplus rose 2.5% to just over $1.0 trillion (**Exhibit 4**). However, some lingering effects from changes in bond

Exhibit 4

US Property/Casualty – Product Line Underwriting Trends

	NPW 2023		Combined Ratios						
Product Line[1]	**Share (%)**	**Growth (%)**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023E**	**2024P**
Private Passenger Auto	34.8	12.5	97.7	98.8	92.5	101.4	112.2	109.5	103.1
Homeowners & Farmowners Multi-peril	15.7	12.0	103.6	98.5	107.3	103.4	104.6	111.0	106.1
Other & Products Liability[2]	12.4	9.5	101.1	105.6	105.0	97.1	96.2	96.5	97.5
Fire & Allied Lines[3]	6.9	22.0	107.7	97.6	103.2	98.9	95.6	96.0	97.0
Commercial Auto	6.5	10.0	108.0	109.4	101.8	98.8	105.4	107.0	103.5
Commercial Multi-peril	6.4	15.0	106.5	105.1	109.8	106.2	105.5	107.0	104.5
Workers' Compensation	6.0	3.0	87.0	88.3	91.1	92.2	87.8	90.5	91.5
Inland Marine	2.6	8.0	86.4	86.5	98.0	86.9	86.1	84.0	86.0
Medical Professional Liability	1.3	5.0	104.0	112.2	113.6	107.9	102.5	105.8	106.4
All Other Lines[4]	7.4	8.0	97.7	94.3	95.3	95.4	88.5	89.5	90.5
Total All Lines[5]	**100.0**	**11.4**	**99.6**	**99.2**	**98.8**	**100.0**	**103.1**	**103.7**	**100.7**

E=Estimated, P=Projected

[1] Source: Best's Statement File Supplement — Insurance Expense Exhibit (IEE) — P/C, US (2018-2022)

[2] Other Liability includes cyber liability, professional liability, D&O, excess casualty/umbrella, environmental/pollution, general liability, and EPLI.

[3] Fire & Allied Lines includes earthquake, multi-peril crop, private flood, and federal flood.

[4] All Other Lines includes accident & health lines, mortgage guaranty, financial guaranty, ocean marine, aircraft, fidelity, surety, burglary & theft, boiler & machinery, credit, international, excess of loss reinsurance, warranty, and miscellaneous.

[5] Source: AM Best data and research

Exhibit 5

US Property/Casualty – Surplus Recap

Excludes mortgage and financial guaranty segments

($ billions)

	Actual					Estimates	
	2018	**2019**	**2020**	**2021**	**2022**	**2023E**	**2024P**
Beginning Policyholders' Surplus	770.7	765.3	875.6	938.8	1,060.2	987.0	1,011.4
Net Underwriting Income	-2.9	1.4	4.3	-7.2	-30.8	-38.4	-15.3
Net Investment Income	57.0	57.3	53.2	56.1	71.5 [1]	75.9	86.9
Other Income/(Expense)	1.2	1.2	1.1	3.5	1.7	1.7	1.8
Pretax Operating Income	55.4	59.9	58.6	52.4	42.3	39.2	73.4
Realized Capital Gains/Losses	10.7	10.5	11.5	17.7	2.2	55.5 [2]	0.0
Federal Income Taxes	6.9	8.2	8.5	8.7	5.5	6.2	10.0
Net Income	59.2	62.1	61.6	61.5	39.0	88.6	63.4
Unrealized Capital Gains/Losses	-41.4	85.8	39.4	91.0	-103.3	29.3	0.0
Contributed Capital	10.7	4.3	9.4	7.8	13.9	8.4	8.4
Stockholder Dividends	-32.9	-35.0	-45.6	-32.1	-36.5	-104.4 [3]	-38.7
Other Changes	-1.0	-7.0	-1.6	-6.9	13.7	2.6	5.6
Ending Policyholders' Surplus	765.3	875.6	938.8	1,060.2	987.0	1,011.4	1,050.1
Total Changes in Surplus ($)	-5.4	110.3	63.2	121.3	-73.2	24.4	38.7
Change in Surplus from Prior Year (%)	-0.7	14.4	7.2	12.9	-6.9	2.5	3.8

Notes: Figures may not add up due to rounding. E=Estimated, P=Projected

[1] Includes $10.8 billion intercompany distribution by large reinsurer that flowed through NII.

[2] Includes $50 billion realized gains from large reinsurer.

[3] Includes $82 billion dividend paid out by large reinsurer.

Source: AM Best data and research

Artificial Intelligence & Insurance

AI has the potential to transform the entire insurance industry, including underwriting and claims processing. Insurers have been very active adopting AI for customer service via conversational AI, which is based on natural language processing and allows the customer and the insurer to interact through chatbots and voice assistants. AM Best expects to see more advanced and specialized conversational AI developed over the near term to handle more complex situations.

Claims handling is another area in which AI tools can play a role, by assisting claims adjusters with image recognition and extracting information from medical records. By analyzing large amounts of historical data, AI can be used to make plausibility assessments, ensure quality and uniformity in the adjusting process, and help adjustors summarize data and generate a preliminary report.

AI can also be used to analyze large amounts of data to spot unusual patterns as an indication of fraud. Furthermore, it may detect manipulated images or patterns of behavior, which could lead to further investigation.

Insurers can use AI to customize policies for each of their customers' needs, for more tailored policies with potentially lower premiums and greater flexibility in coverage limits. AI could also help cut costs and generate savings for customers. And by being able to analyze large volumes of data in a short period, AI could provide real-time risk assessments and make for faster decision-making, allowing companies to respond quickly to market changes and offer pricing that is commensurate with the underlying risk.

This is already happening in cyber insurance, in which insurers are using advanced technology to scan customers' IT systems to evaluate their vulnerabilities and appropriately incorporate them into their decision-making, rather than rely on surveys and subjective decision-making, which normally take weeks. Using AI to replace human interaction in the underwriting process can be another way for insurers to take advantage of building intelligence into the process to allow underwriters to use their time more effectively in allowing the system to take on many of the light tasks while keeping human attention dedicated to the most complex tasks in the final decision process.

By leveraging large data sets, AI can detect potential problems and minimize human errors before they become more significant. For example, AI can help reduce the administrative costs associated with the underwriting process. AI-driven systems can automatically process customer applications and identify key risk indicators that may be overlooked in a manual process. This reduces time and errors associated with traditional underwriting methods, allowing companies to increase efficiency and focus resources on other business areas.

Better customer understanding can also lead to more effective cross-selling opportunities, enhancing both new business and retention levels.

The industry has always leveraged technology and AI in its analysis, so the use of machine learning is nothing new. What is new is the speed of development of AI and its associated capabilities, so keeping abreast of these developments will be critical in the years ahead. Further improvements in AI, including advancements in generative AI, could eventually change the way the world does business. For insurers, however, AI could pose challenges related to regulatory constraints and privacy laws and the prohibited use of certain data in the underwriting process, as well as technical challenges related to insurer legacy systems and the large investment of time, money, and experience required.

valuations are not recognized in companies' statutory filings. In its rating analysis, AM Best considers the strong starting capital of most insurers, positive cash flows, additional sources of liquidity, sound risk management, and the ability to hold fixed-income assets to maturity. Despite unrealized losses and healthy 8.8% NPW growth, the ratio of net writings to surplus increased to an estimated 0.8 at year-end 2022, highlighting the industry's solid capital position.

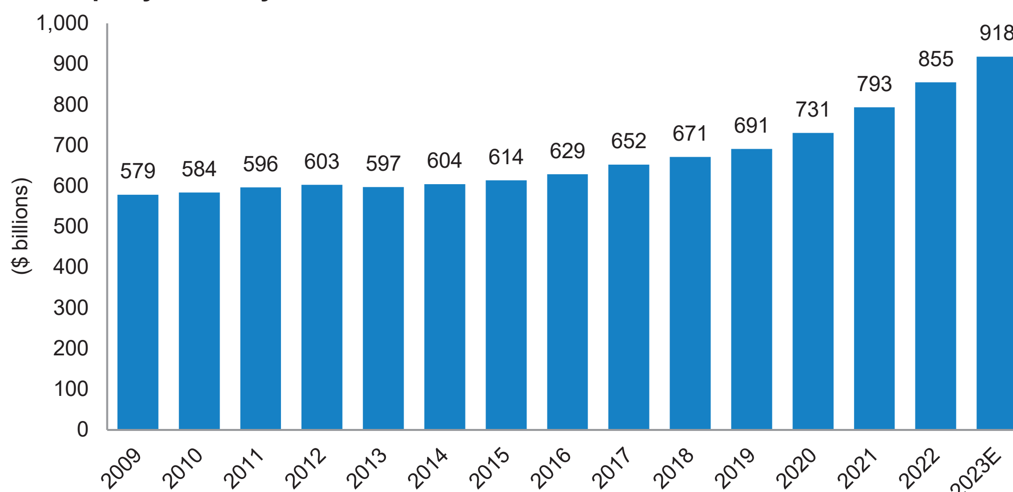
Loss & LAE Reserves—Bigger and Stronger

Adverse reserve development is a leading cause of insurer insolvency. As a result, reserve adequacy remains a critical rating issue for AM Best. Loss and loss adjustment expense (LAE) reserves are typically the largest liability on a P/C insurer's balance sheet. Underestimating these liabilities could have a significant, negative impact on an insurer's reported surplus, potentially resulting in adverse rating actions. Unexpected or larger-than-anticipated changes in an insurer's reserve position could materially affect the assessment of the company's balance sheet strength and ERM.

Despite being another year further removed from the pandemic, the US P/C industry continues to struggle with many lingering effects of COVID-19, such as economic inflation and court backlogs. At the same time, the industry is dealing with issues unrelated to the pandemic, such as social inflation, litigation financing, and extreme weather-related events. With a limited amount of post-pandemic data to work with, insurers are trying to determine what the insurance environment will look like and what the impact will be on the severities, frequencies, reporting patterns, and closing rates of claims. For the property and physical damage lines of business, the impact of economic inflation on parts and labor required that insurers increase their estimated ultimate loss and LAE and the corresponding loss and LAE reserves. For liability lines of business, delays in claims closing rates, an increase in the frequency of litigated claims, and higher claims settlements due to social inflation have required casualty insurers to increase their estimates for ultimate losses and LAE and corresponding reserves. Overall, the US P/C industry loss and LAE reserves have grown dramatically the last several years (**Exhibit 6**), with the largest increases occurring in the last three years (**Exhibit** 7).

A review of industry paid and case incurred loss, defense and cost containment expense (DCC) development data by Schedule P line of business at year-end 2022 indicates that loss and DCC development was rising for many lines of business well beyond their pre-pandemic levels. AM Best

Exhibit 6
US Property/Casualty – Total Loss & LAE Reserves*



* Excludes mortgage guaranty & financial guaranty composites.
E=Estimated

Exhibit 7

US Property/Casualty – Total Loss & LAE Reserves*

Calendar Year End	Total Loss & LAE Reserves ($ billions)	Change ($ billions)	Change (%)
2009	578.6	-0.7	-0.1
2010	583.7	5.1	0.9
2011	596.4	12.7	2.2
2012	602.9	6.5	1.1
2013	597.3	-5.7	-0.9
2014	604.5	7.2	1.2
2015	613.9	9.4	1.6
2016	628.7	14.9	2.4
2017	652.3	23.6	3.8
2018	671.1	18.7	2.9
2019	691.4	20.3	3.0
2020	730.8	39.4	5.7
2021	793.4	62.6	8.6
2022	854.9	61.5	7.8
2023E	918.3	63.3	7.4

* Excludes mortgage guaranty and financial guaranty composites.

E=Estimated

Source: AM Best data and research

Exhibit 8

US Property/Casualty– Estimated Year End Loss & DCC Reserve Deficiencies, 2023*

($ billions)

Product Line	Excluding Discount	Statutory Discount	Total Deficiency
Workers' Compensation	-8.6	15.0	6.4
Commercial Auto Liability	3.5	0.2	3.7
Personal Auto Liability	1.1	0.2	1.3
Reinsurance - Nonprop Assumed	-1.3	0.8	-0.5
Commercial Mult-peril	-1.6	0.0	-1.6
Homeowners	-3.1	0.0	-3.1
Medical Professional Liability	-4.3	0.6	-3.7
Other/Products Liability	-8.2	1.1	-7.1
All Other Lines	-13.0	0.7	-12.3
Total Core Reserves	**-35.5**	**18.6**	**-16.9**
Asbestos & Environmental	5.9	0.0	5.9
Total	**-29.6**	**18.6**	**-11.0**

* Excludes mortgage guaranty and financial guaranty composites.

Source: AM Best data and research

Exhibit 9

US Property/Casualty – Loss & DCC Reserve Adequacy By Line of Business*

Including statutory discount

($ billions)

Product Line	Estimated Reserve Deficiency @ 12/22	Estimated Reserve Deficiency @ 12/23	Change Stronger/ (Weaker)
Workers' Compensation	1.6	6.4	-4.8
Commercial Auto Liability	4.7	3.7	1.0
Personal Auto Liability	2.9	1.3	1.6
Reinsurance – Nonprop Assumed	-1.0	-0.5	-0.5
Commercial Multi-peril	-0.8	-1.6	0.8
Homeowners	-2.1	-3.1	1.0
Medical Professional Liability	-2.8	-3.7	0.9
Other/Products Liability	-3.1	-7.1	4.0
All Other Lines	-11.6	-12.3	0.7
Total Core Reserves	**-12.2**	**-16.9**	**4.7**
Asbestos & Environmental	7.5	5.9	1.6
Total	**-4.7**	**-11.0**	**6.3**

* Excludes mortgage guaranty and financial guaranty composites.

Source: AM Best data and research

believes that, even as insurers continued to wrestle with the impact of issues mentioned above, the overall industry loss and LAE reserves were further strengthened in 2023, after already strengthening in 2022. We estimate that the P/C industry's net loss and LAE reserves as of year-end 2023 are redundant by $11.0 billion, consisting of a $16.9 billion redundancy on core reserves and a $5.9 billion reserve deficiency on asbestos and environmental (A&E) reserves. Overall reserves are estimated to be redundant despite $18.6 billion of statutory discounting, which AM Best considers a deficiency from full-valued reserves. This implies that the undiscounted reserves are $29.6 billion redundant (**Exhibit 8**).

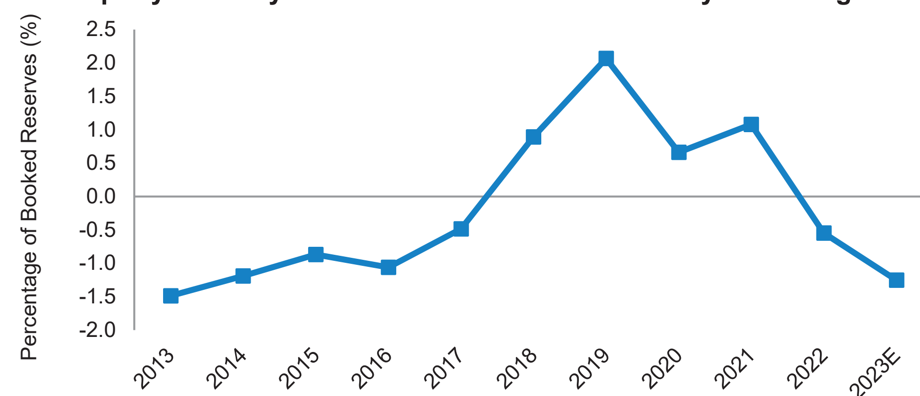
The estimated reserve positions vary widely by line of business, with workers' compensation, commercial auto liability, and personal auto liability showing deficiencies, and non-proportional reinsurance assumed, commercial multi-peril, homeowners, medical professional liability, other/products liability, and "all other" lines showing redundancies. The estimated reserve deficiencies are based on industry statutory Schedule P cumulative paid and case incurred loss and DCC development, using AM Best's internal loss reserve model. Industry data was adjusted to remove the distorting effects of large transactions such as commutations, loss portfolio transfers, adverse development covers, and accounting treatment of retroactive reinsurance.

Overall industry reserves as of year-end 2023 are estimated to be $6.3 billion stronger than overall reserves reported as of year-end 2022, with the majority of the strengthening occurring in other/ products liability and the majority of the weakening, in workers' compensation (**Exhibit 9**). A&E reserves are expected to strengthen by $1.6 billion in 2023, and total core reserves, by $4.7 billion. When year-end 2023 total redundancy is stated as a percentage of year-end booked reserves overall, total redundancy is approximately 1.3% of overall reserves—an improvement from the 2.1% deficiency at year-end 2019 (**Exhibit 10**).

On a calendar year basis, the industry continued to report favorable one-year reserve development overall but by a dramatically lower amount (**Exhibit 11**). The industry reported a 17th calendar year of favorable prior year reserve development, although the $3.6 billion of favorable development reported in 2022 was $7.1 billion lower than in 2021. The favorable development in 2022 was primarily in the workers' compensation line of business, which reported $6.6 billion of favorable development, and the "all other" lines, which reported $7.1 billion. This favorable development was countered by $5.0 billion of adverse development in the personal auto liability line, $3.9 billion of adverse development in the other/products liability line, and $2.1 billion of adverse development in

Exhibit 10

US Property/Casualty – Loss & LAE Reserve Deficiency Percentage



Notes: Positive values indicate deficiencies, Negative values indicate redundancies. E=Estimated.
Source: AM Best data and research

Exhibit 11

US Property/Casualty – Incurred Loss & DCC Development

One year development for calendar years, accident years as of Dec. 31, 2022
($ billions)

Accident Year	One-Year Reserve Development * 2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Accident Year Development Through 2022
Prior	-11.6	-6.2	-1.3	-0.2	-2.2	-4.2	-2.6	-0.5	0.7	0.3	-27.8
2013		-4.0	-1.2	-0.5	-1.4	-1.2	-0.9	-0.8	-0.6	-0.2	-10.7
2014			-3.2	0.1	-1.6	-1.3	-1.1	-1.1	-0.6	-0.6	-9.2
2015				-0.1	-1.3	-0.6	-0.7	-0.8	-0.6	-0.3	-4.4
2016					-1.7	-0.3	-0.1	-0.4	-0.2	0.2	-2.5
2017						-3.6	-0.4	-2.3	-0.3	0.9	-5.6
2018							-1.7	-1.5	-0.9	1.3	-2.8
2019								-1.5	-0.7	1.7	-0.5
2020									-7.6	-4.1	-11.8
2021										-2.7	-2.7
Total in Calendar Yr	**-11.6**	**-10.2**	**-5.6**	**-0.7**	**-8.1**	**-11.2**	**-7.4**	**-8.8**	**-10.7**	**-3.6**	

* Excludes mortgage guaranty and financial guaranty composites.

* Positive values indicate adverse development; negative values are favorable.

Source: AM Best data and research

the commercial auto liability line. AM Best expects the industry to report another year of overall favorable reserve development in calendar year 2023, at a level similar to the amount reported in the 2022 calendar year (excluding any distortions due to LPTs, adverse development cover [ADC], commutations, etc.).

AM Best's Major Segment Outlooks

US Personal Lines

AM Best's outlook for the US personal lines segment remains at Negative. The outlook for the segment had been revised to Negative in September 2022, along with that for personal auto. In 2023, the outlook for the homeowners line was also revised to Negative. The outlooks reflect ongoing deterioration in reported results for both lines amid rising loss cost severity, rate adequacy challenges, heightened weather activity, and elevated reinsurance costs. A return to underwriting profitability for the segment over the near term appears highly unlikely.

Exhibit 12

US Property/Casualty – US Personal Lines Segment Key Financials

($ billions)

	2022	2023E	2024P
Net Premiums Written	407.4	457.7	503.7
Underwriting Gain/Loss	-39.5	-48.0	-26.8
Net Income	-15.1	-12.8	6.6
Policyholders' Surplus	408.2	404.6	413.0
After-Tax Return on Surplus (%)	-3.7	-3.2	1.6

E=Estimated, P=Projected

Source: AM Best data and research

Insurers ahead of the curve on rate adequacy and pricing sophistication maintain a competitive advantage. Many segment carriers continue to pursue rate adequacy in response to rising loss cost severity but staying ahead of current trends has been challenging. The increase in loss severity for auto has been driven by rises in fatality rates, repair costs for newer vehicles, and used car prices, as well as supply chain and labor market disruptions, and higher medical costs, not to mention the overall inflationary environment.

The timeliness and effectiveness of insurers' pursuit of rate increases have varied, but efforts to address rate adequacy are neither simple to execute nor accomplished expediently. The process to obtain approvals for rate increases is vital to the segment's operating performance. When reviewing rate change proposals, state insurance departments must strike a balance between ensuring affordable coverage for policyholders and the long-term financial stability of insurance companies. Furthermore, 12-month policies for the homeowners line adds to the difficulty of effectively responding to quickly escalating loss cost trends. On a positive note, significant rate increases have been approved in several jurisdictions, including those that have historically been viewed as more challenging.

Driving the need for rate increases has been the substantial catastrophic loss activity of recent years, which continued in 2023. Hurricane Idalia, the Lahaina wildfire disaster in Hawaii, California flooding, freezing winter weather in the Northeast, and severe convective storms (including wind, hail, and tornadoes, particularly in the Midwest and South) have resulted in significant losses. Furthermore, due to climate and demographic changes, secondary perils have become just as problematic as hurricanes and earthquakes. In response, some market leaders have curtailed new business in CAT-exposed areas, citing escalating construction costs, heightened CAT risk exposure, and elevated reinsurance costs. In some cases, particularly for those lacking scale, carriers have exited markets completely. Continued refinement in underlying risk portfolios and appetites is expected.

The recent challenges in the reinsurance market have driven higher retentions and levels of co-participation for many primary carriers. The ability to absorb multiple events (primary and secondary perils), both financially and operationally, in a relatively short period is increasingly important. Some

have attempted to structure their reinsurance programs to capture and mitigate aggregate risks more effectively. However, given reinsurance market conditions, this has proven a challenge, which has exposed weakness in some insurers' ERM.

Despite indications that mid-year 2023 and January 2024 reinsurance placements were less chaotic than in prior periods, pricing remains a headwind for the personal lines segment. Reinsurance costs have risen owing to several years of poor performance driven by natural catastrophes, growing secondary peril activity, and elevated claims costs attributable to the rising cost of construction materials and labor. As a result, reinsurers have generally started to realign their risk profiles with a greater focus on generating underwriting profits—hence, the price increases. As reinsurers raise rates, limit capacity, and tighten terms and conditions, the challenge for primary insurers in CAT-prone states will continue to grow as they take on more net exposures, which will unfavorably impact results, particularly given the growing activity associated with secondary perils.

Even with revised reinsurance programs for primary carriers and performance challenges, risk-adjusted capital remains solid for most. These generally favorable positions provide some leeway for managing future challenges, further supported by sufficient liquidity and positive cash flows. Nonetheless, the risk-adjusted capital of some of the companies that have historically reported excess capitalization has declined materially, owing to a combination of underwriting losses, changes in reinsurance structures, and reserve increases amid the inflationary environment, which eroded the prior period's capital cushion. The spike in loss costs in recent years has also prompted adverse reserve development for some carriers, as actual claims costs were higher than initially projected. In some cases, investment market volatility has further pressured overall capitalization. On the bright side, with the rise in interest rates, companies can generate higher yields, which helps offset challenging underwriting results, benefitting operating performance metrics. Given that the segment's primary lines are relatively short-tailed, the impact of the rise in rates may be somewhat limited.

In recent years, the best-performing auto and homeowners insurers have invested significant resources in technology to improve their underwriting and pricing tools. Advances in predictive modeling and pricing analytics, as well as the use of third-party data, have provided carriers more tools to manage profitability pressures. The ability to quickly pivot to enhance pricing and underwriting in policy administration systems is critical. Initiatives escalated during the pandemic, as insurers quickly moved to meet both their own business requirements and customer demands.

The use of insurtech in both the auto and homeowners markets will continue to grow, as insurers focus on more effective and efficient ways to reach customers. Mobile applications for submitting claims, video chats for claims reviews, aerial imagery from drones, and artificial intelligence to support online text and voice chats when generating quotes and servicing claims became a lifeline for many policyholders during the pandemic. By leveraging propriety underwriting models and more user-friendly technology platforms, leading carriers have been able to customize coverage and better match price to risk. Additionally, there is a significant push to leverage technology to ensure that the total insured value for all policies is accurate, given the macroeconomic factors at play. We expect the pace of adopting technology to continue to accelerate.

AM Best's market segment outlook takes into account the impact of current trends on companies operating in a particular segment over the next 12 months. The Negative outlook for the personal lines segment indicates that AM Best expects market trends to have a negative impact on the companies in the segment, but that doesn't mean that all the segment companies also have a Negative outlook.

Carriers that are slow to address the risk-adjusted capital and performance challenges ahead or do not have the means, expertise, or technological capabilities to keep pace with changes in the segment, will likely face ratings pressure.

US Commercial Lines

AM Best's outlook on the overall US commercial lines segment remains at Stable. This is based on our expectation that the segment will be profitable and resilient in the face of near- and longer-term challenges and that risk-adjusted capital for the vast majority of carriers will remain sound.

Exhibit 13

US Property/Casualty – US Commercial Lines Segment Key Financials

($ billions)

	2022	2023E	2024P
Net Premiums Written	284.3	307.7	327.7
Underwriting Gain/Loss	8.9	4.8	2.2
Net Income	28.3	32.6	32.4
Policyholders' Surplus	354.9	376.0	395.5
After-Tax Return on Surplus (%)	8.0	8.7	8.2

E=Estimated, P=Projected

Source: AM Best data and research

Underlying our outlook are our Stable outlooks for the core commercial property and workers' compensation lines, as well as a Positive outlook for the excess and surplus market. However, that same level of optimism does not apply to most of the US casualty segment—particularly commercial auto liability (given its persistent underwriting losses) and general liability (primarily reflecting adverse claim, exposure and litigation trends). The same can be said for non-medical professional liability, which includes management liability lines such as public institution D&O and employment practices liability, as well as cyber liability. Near-term concerns include stubbornly high economic, medical, and social inflation, the latter including jury awards and litigation costs, which continue to rise. Property insurers have faced sharply higher costs in recent years from supply-chain disruptions, higher costs of raw materials and labor, and rising technology-related costs, while casualty reinsurers are voicing concerns about social inflation and rate adequacy, which could lead to higher reinsurance costs and tighter terms and conditions on casualty covers.

Commercial lines insurers, unlike their personal lines peers, reported robust underwriting results through 2023 and are expected to continue to do so, driven by strong net premiums earned following prior year rate increases for most of the major commercial lines of business. This has occurred despite some recent weakening in pricing gains, as well as growth in net premiums written, due to the US economy's continued expansion.

According to the Council of Insurance Agents and Brokers (CIAB), commercial lines premiums overall rose approximately 8% through the first three quarters of 2023, generally consistent with prior quarters, which comes on the heels of positive rate change trends since 2020.

AM Best estimates that commercial lines net premiums were up 8.2% in 2023, versus 10.8% in 2022, primarily reflecting continued price declines in workers' compensation and certain specialty casualty lines. Our expectation for 2024 is for a similar decline in growth—but still over 6%. Overall underwriting performance is expected to remain favorable despite modest weakening, with a calendar year combined ratio forecast for 2023 at 97.1, up from 95.4 in 2022 as a result of higher catastrophe losses (at 5.0 vs. 3.4). In contrast, we expect the accident year combined ratio to have improved slightly, to 93.6 from 94.1 in 2022, given a continuation of favorable overall reserve development, despite a diminution of favorable development in workers' compensation and continuing adverse development in most casualty lines. Our forecast for 2024 is for ongoing but modest weakening in overall underwriting performance, reflecting a continuation of current pricing trends and slightly lower normalized catastrophe loss activity.

Investment returns are expected to continue to improve in 2024, to 3.7%, as they did in 2023 (to 3.5% vs. 2.9% in 2022), with the continued rollover of fixed-income portfolios into sharply higher new-money rates. And the overall return on surplus (capital) for commercial lines insurers is expected to remain just above the 8% mark—close to 2023 and 2022 results—partly reflecting weakened underwriting and strengthened investment performance.

Overall underwriting performance for the commercial lines segment will likely continue to highlight ongoing underwriting losses in the commercial auto and multi-peril lines (comprising primarily the highly commoditized small business/package policies that include both catastrophe-exposed property and liability coverages), with the 2023 combined ratios estimated at about 107, as well as in medical professional liability (105.8). In contrast, workers' compensation and general and specialty liability (the latter including D&O and other management liability coverages, as well as virtually all non-medical professional liability lines) are expected to remain profitable for 2023 and into 2024, albeit with modestly narrower margins, reflecting the ongoing downward pressure on workers' compensation premium rates and sustained adverse claims and reserve trends in casualty lines. (For a more detailed discussion of the underlying lines of business, see the line-of-business summary starting on page 19.)

The most notable challenge for the US commercial insurers, and the economy overall, has been persistent inflationary pressure, which is affecting just the property lines segment. The general rise in claims demands, settlements, and judgments (social inflation) is enormously relevant for casualty lines (if more difficult to measure and anticipate than the costs of goods and services), because these trends not only impact future claims, but also require continual re-evaluation of existing claims reserves. With the exception of commercial auto liability, these lines benefited from material favorable loss reserve development most of the last decade. Over time, however, the extent of favorable development has diminished, due in part to the rise in claims costs—particularly in the general liability and management liability segments (the latter largely comprising non-medical professional liability), both of which have seen adverse development in more recent years.

In addition to well-established areas of litigation, the emergence of new types of liability is ever-present for commercial casualty insurers, particularly in light of evolving legal and social attitudes toward dietary and other substances, the development of new chemical and materials technologies, genetic engineering research, and other trends. Additional concern appears warranted with respect to potential long-term liability costs related to (1) herbicides and pesticides in use over the course of multiple decades, (2) "nutraceuticals" such as dietary supplements, and (3) "forever chemicals" in commercial household products and industrial production facilities that could lead to bodily harm or impair real property asset values or affect drinking water. All of these issues may prove to be fertile ground for mass tort litigation in the years ahead.

Commercial insurers face additional challenges with regard to assessing the nature and scope of exposures relating to climate risk. The variability in these insurers' reported results in recent years is largely a reflection of the variability in catastrophe losses each year.

Also worthy of note is the evolution of litigation financing, in which third-party investor groups (often private equity firms or hedge funds) provide up-front financing to plaintiff attorneys involved in personal injury and liability litigation in return for a share in the ultimate jury award or settlement. Litigation financing appears to be here to stay and has become a significant factor in mass tort litigation and can be a major contributor to the lengthening of claims settlement periods and costly verdicts.

Delegated Underwriting Authority Enterprises

AM Best's outlook for the global delegated underwriting authority enterprises (DUAE) segment remains at Positive, due to sustained growth and performance globally, the ability to address underserved and emerging risks, and the role of technology and talent in driving innovation in the segment. The growing number of DUAEs collaborating with insurers to write specialty business is driving the increase in US P/C premium generated by DUAEs overall. In a review of data in Note 19 of insurance companies' 2022 NAIC (National Association of Insurance Commissioners) statements, AM Best identified 654 managing general agents (MGAs) that generated more than $65 billion in DPW.

Recent growth in the segment has been attributable to the role DUAEs play in insurance distribution in Europe and Asia-Pacific, underpinned by underwriting expertise, technology, and a broader range of capacity providers. The UK, including the London market, is Europe's biggest and most sophisticated DUAE market. Established DUAE players in the US and UK are looking to extend their operations, by growing and diversifying into other countries.

One of the core value propositions of DUAEs is the ability to bring their specialized underwriting skills and market expertise to emerging and evolving risks. The growth of volatile risks, including exposures to more frequent and severe US weather-related events such as wildfires and severe convective storms, has supported sizable premium generated by DUAEs the last couple of years. Challenges due to secondary perils allow DUAEs to play a vital role in matching these risks and surplus lines insurers. The DUAE model allows them to move faster, exploit niche markets, show creativity in coverages, and target opportunities moving from the admitted to E&S market.

Significant investments in technology allow DUAEs to better analyze data in volatile markets and attract talent from the tech industry. Capital and capacity providers are still dedicated to the DUAE model despite broader market conditions because of DUAEs' ability to use data and technology for good risk selection, as well as the ability to adapt quickly. DUAEs have also proven attractive to technology professionals such as data scientists and engineers. Competition for talent from the traditional market and beyond is expected to remain tight, as the segment continues to attract diverse sources of capital.

Finally, DUAEs have strengthened the value of fronting companies. Considering the issues of the past year in the fronting space, monitoring and managing credit risk through robust ERM practices will need to be demonstrated to showcase their value. Fronting companies have provided access for more reinsurance participation as reinsurers' appetite for DUAE business remains firm.

AM Best's Individual Segment Outlooks

US Homeowners Insurance

AM Best's outlook for the US homeowners segment remains at Negative, driven primarily by the ongoing deterioration in overall underwriting performance in 2023 owing to heightened catastrophic loss volatility and increased secondary perils. Results have been further challenged by rising loss cost severity driven by inflationary pressures and elevated reinsurance costs, as well as tightened terms and conditions. Reinsurance pricing will likely remain a headwind for the homeowners segment. As reinsurers continue to raise rates and capacity remains tight, the challenge for primary insurers in CAT-prone states will escalate as they take on more exposures.

As a result, loss ratios will be pressured for these carriers—overall results will be negatively impacted, particularly given the growth of secondary perils. The rise in loss costs has been compounded by restrictive regulatory environments in several large, CAT-prone states. In some cases, particularly

for those lacking scale, carriers have exited markets completely, citing escalating construction costs, heightened CAT risk exposure, and elevated reinsurance costs.

Factors offsetting these negative pressures include solid risk-adjusted capital for most insurers, with sufficient liquidity despite an eroding capital cushion for some. Accelerated technological adoption is still a key long-term differentiator, as catastrophe risk management remains one of the more significant challenges for segment carriers. However, in light of persistently high loss costs, as well as higher net retentions for CAT-exposed carriers, a return to underwriting profitability for the segment over the near term appears highly unlikely.

US Personal Auto Insurance

The outlook for the US personal auto segment remains at Negative due to continued operating performance challenges driven by rising claims costs and rate adequacy. Even as insurers pursue significant premium increases, overall segment results continued to deteriorate through 2023. Unfavorable trends have affected both the liability and physical damage components of the US private passenger auto line. Economic inflation, supply chain disruptions, and technological advances in vehicles have all led to increased claims costs. Coupled with increased accident frequency, loss costs have outpaced rate increases, creating rate adequacy challenges for insurers.

Despite these operating performance challenges, risk-adjusted capital continues to support the underlying risks for most of the US personal auto carriers. Owing to a rebound in the equity markets in 2023, many segment carriers were able to absorb these underwriting pressures while maintaining their balance sheet strength.

The segment relies on risk management capabilities, including the continued use of newer technology and data analytics to supplement underwriting, claims handling, and rate making, which AM Best expects will continue. Fostering innovation in all operational phases and in risk management will continue to benefit the personal auto writers as they focus on maintaining adequate rate levels even in such a highly competitive segment.

Historically, the personal auto line has been a leader in adopting technology, facilitated by the inherent nature of the product. For many years, there has been a push toward leveraging technology throughout entire organizations, including claims, underwriting, and distribution. In addition, many companies have updated or are updating their legacy systems, in an effort to remain competitive. Innovation has led to greater efficiencies and enhanced the customer experience. As the use of technology expands across the broader financial services landscape, companies are likely to continue to look for ways to meet higher customer expectations, particularly the ease of doing business. Some companies develop their technological capabilities internally. Others use third-party partners as the preferred route. In any case, companies that can't meet customer demands will be at a competitive disadvantage.

US Commercial Auto Insurance

AM Best's outlook for the US commercial auto insurance segment remains at Negative, primarily reflecting expectations of continued unprofitable underwriting results due to persistently worsening severity driven by inflation as well as rising medical costs. Commercial auto writers benefited from a decline in frequency in 2020 and 2021 due to the pandemic, with 2021 marking the segment's best year in a decade, with a combined ratio below 100. However, performance in 2022 and 2023 was more typical of pre-pandemic results, as frequency levels rebounded, severity worsened, and the segment was once again unprofitable.

The increase in commercial auto loss severity has been driven by several factors, including high inflation (albeit at no longer record-high rates), rising replacement costs, and increased labor costs. Challenges plaguing the industry include social inflation, combined with the rise of third-party litigation, nuclear verdicts, widespread labor shortages (such as ongoing shortages of licensed commercial drivers), inexperienced drivers, and distracted driving, which are having a significant impact on the line's profitability.

Moderate pricing increases are expected to continue through 2024, as insurers try to keep up with rising loss costs and inflation. Despite aggressive rate actions and targeted underwriting initiatives in recent years, insurers continue to struggle to achieve price adequacy. With economic inflation, social inflation, and rising nuclear verdicts, the segment is unlikely attain rate adequacy in the near term. As a result, AM Best expects segment results to remain unprofitable in 2024.

US Commercial Property Insurance

AM Best's outlook for the US commercial property segment remains at Stable, reflecting strong risk-adjusted capital and overall liquidity, the highest reported rate increases and continued underwriting diligence, capacity deployment, risk selection, and tightened terms and conditions. However, the ongoing impact of catastrophes, specifically secondary perils, rising reinsurance costs, tightened reinsurance capacity, and persistent inflation pressures remain general concerns.

Carriers remain focused not only on rate adequacy but also underwriting discipline, which has led to improved risk selection. Additionally, with economic inflation still affecting the costs of construction material and labor, underwriters have been diligent and focused on properly calculating insurance to value, which has helped them implement corrective actions to address macroeconomic trends. Moreover, even with sufficient underwriting capacity, carriers remain careful about deploying capacity and continue to tighten terms and conditions for high loss experience or high exposure accounts. Supply chain disruptions and inflation pressures, along with the growing frequency and severity of weather-related catastrophe events, underscore the need for constant discipline with respect to risk selection, pricing adequacy, and underwriting controls.

Natural catastrophe activity was relentless in 2023 and several years prior. In calendar year 2023, the US experienced 28 separate weather-related disasters, each over $1 billion in damages—a historic year—and total insured losses near $93 billion. The frequency and severity of convective storms such as tornados and hail continue to grow, as has the severity of losses due to macroeconomic pressures. Storms accounted for nearly 70% of US insured natural catastrophe losses in 2023. To combat this, many carriers have increased named-storm and wind and hail deductibles, while limits remain more restrictive.

Reinsurance programs are costly for carriers with renewals, adding higher costs and more exposure to carriers' balance sheets. Underwriting diligence remains a key aspect of pricing adequacy, and despite declines in the pace of material and labor increases, carriers will continue to take rate actions. Although pricing increases are expected to continue in 2024, AM Best also expects rate increases to decelerate.

US Directors & Officers Liability Insurance

AM Best has assigned a Negative outlook for the D&O liability insurance segment, due to a variety of market dynamics. D&O liability risks have expanded in recent years, as the business environment has

become increasingly more complex and interconnected. Additionally, the recent rise of generative artificial intelligence (AI) opens up a whole new avenue for the plaintiffs' bar. Furthermore, as new entrants enter the market, capacity has been increasing, driving down pricing just as exposures are growing.

The rising cost of litigation owing to societal trends such as broad interpretations of liability contracts, legal advertising, and more plaintiff-friendly juries continues to drive increases in both loss frequency and severity. Large, public-facing companies are particularly vulnerable. As the cost of litigation continues to rise, companies are becoming more likely to explore settlement opportunities even when the facts may be on their side. According to Woodruff Sawyer, settlement dollars during the first half of 2023 were up slightly more than 29% year over year, with settlements over $20 million up about 33% from the same period in 2022. These trends were apparent in D&O and casualty insurers' and reinsurers' underwriting results at year-end 2023.

If interest rates remain high and inflation persists, access to credit markets will become increasingly difficult, as companies struggle to balance the need for profits with prudent debt management. Additionally, the risk of insolvencies is elevated, which can lead to increased litigation.

US Excess and Surplus Lines Insurance

On November 6, 2023, AM Best revised the outlook for the excess and surplus lines insurance segment to Positive from Stable owing to the efficient use of E&S lines capacity as a safety valve for declining capacity in the commercial lines and some of the personal lines markets. Further supporting the Positive outlook are the segment's strong underwriting results, which has driven favorable operating performance and strengthened capital positions, as well as market conditions that have supported the entrance of new participants, along with incumbent carriers' pursuit of E&S lines participation. Finally, the integration of new, complex technologies across various industries makes it likely that specifically tailored surplus lines coverage solutions will remain in high demand.

Admitted carriers continue to tighten their underwriting criteria, leading accounts to seek coverage in the E&S market. These accounts are written on their merits, with customized policy conditions and rates commensurate with the risk—the core competencies of surplus lines carriers. This places E&S market participants in a position to take advantage of prevailing market opportunities, given the steady volume of submissions of recent years. Among the lines being cast off by admitted carriers and finding their way to the E&S carriers are commercial auto and D&O liability. Cyber liability and the expanding legal cannabis industry also continue to look toward E&S carriers.

Surplus lines carriers' financial results reflect the advanced underwriting acumen required to effectively underwrite accounts with moderate to high hazard risks—and to do so while generating underwriting profits. E&S participants are posting more favorable underwriting results and greater top-line growth than those in the broader P/C industry. Although surplus lines carriers are not immune from general insurance industry headwinds such as social inflation and reinsurance capacity, the impact of these factors is moderated through surplus lines carriers' core competencies of risk selection, price, and policy terms.

New entrants to the E&S market—both start-ups and new affiliates of established commercial carriers—have entered the market to serve niche, distressed, and new risks. To date, the approach of the new entrants has been measured and judicious. Given the current market conditions, as well as the historical viability of E&S providers, especially in light of their financial impairment rates (which are much lower than those of admitted insurers), opportunities for new participants abound.

AM Best believes that, given the overall dynamics of the insurance industry, tailwind conditions for US E&S lines carriers will remain in place beyond the short term.

US General Liability Insurance

AM Best's outlook for the US general liability insurance segment remains at Negative, owing primarily to inflationary trends affecting claims costs, as well as the potential for adverse loss frequency and severity due to third-party litigation financing and emerging litigation exposures with the potential for large-scale class action lawsuits. Offsetting factors include a modest improvement in the segment's underwriting performance due to consistent rate increases, tightening underwriting standards, and high interest rates, which will favorably influence profitability in this medium- to long-tailed and occurrence-based line.

Expanded litigiousness in the US is resulting in a growing number of lawsuits with greater penalties that fall under general liability insurance. Changing jury attitudes, advertising by plaintiff lawyers, distrust in institutions, expanding legal concepts, and third-party litigation have all contributed to the increase in litigation. Social inflation is becoming the new normal and continues to significantly affect the general liability line, as seen in the increase in the number of claims with attorney representation across virtually all casualty lines and in nuclear verdicts, in which juries award increasingly large sums. Medical costs associated with third-party injuries are among the costliest protections covered by general liability insurance. Litigation financing plays a significant role in mass tort litigation and often results in costly verdicts. Third-party investor groups (often private equity firms, hedge funds, and some college endowment funds) provide up-front support to plaintiff attorneys involved in personal injury and liability litigation.

The emergence of new potential exposures is especially critical for general liability insurers. Claims related to PFAS (per-and poly-fluoroalkyl substances) are growing quickly because they are in so many products. Additionally, in light of the opioid epidemic, entities that manufacture, sell, and distribute opioid pharmaceutical products have turned to their general liability insurance for coverage. Finally, many states have legalized the possession and use of cannabis for medical and recreational purposes, but the disparity between federal and state laws raises issues about criminal liability. Marijuana laws and regulations are not always administered uniformly from one community to another, which may pose further risk for insurers.

Despite noteworthy headwinds, insurers' risk-adjusted capital strength remains a key offsetting factor. Rate increases over the past few years are still up on average but not nearly as high as they were in prior years. Insurers are also expected to maintain well-defined risk appetites and prudent underwriting practices, including tightened terms and conditions and higher deductibles and coverage exclusions. Such efforts should help improve results, as will more restrictive capacity deployment. Additionally, investment income will rise due to the high interest rate environment, which will help strengthen the overall performance of the general liability line.

US Medical Professional Liability Insurance

On November 9, 2023, AM Best revised its outlook for the US medical professional liability (MPL) segment from Negative to Stable, owing primarily to improved rate adequacy; the diminishing impact of pandemic-related exposures; persistently redundant loss reserves; higher reinvestment rates and improved overall returns; and robust balance sheets supported by strong levels of risk-adjusted capital.

The outlook also considers the segment's overall resilience and ability to adapt to various market cycles, despite tort reform challenges (including MICRA [California's Medical Injury Compensation

Reform Act]), the shrinking pool of solo practitioners, persistent economic uncertainty, volatility in the equity markets, rising reinsurance costs, higher claims severity, and social inflation.

Given the segment's generally robust balance sheets, investment income remains a key driver, generating overall returns on revenue that exceed industry averages. This should play an even larger role if interest rates remain higher for longer. Further appropriate pricing adjustments should also drive additional momentum in 2024.

What remains to be seen is the potential impact of rising loss frequency, as well as escalating burnout rates, staffing shortages, and further growth of alternative care providers. The potential for these trends to negatively impact frequency while severity continues to rise could impede the progress the segment has made the past several years. Nevertheless, the Stable outlook incorporates AM Best's expectation that MPL carriers will continue to work through these issues and remain diligent in their efforts to maintain price adequacy amid competitive pressures and uncertain economic times. The outlook also considers headwinds from rising severity and social inflation, which place a greater onus on prudent reserving.

US Private Mortgage Insurance

AM Best's outlook for the US private mortgage insurance segment remains at Stable, due to somewhat favorable macroeconomic conditions; strong home price growth in the years since the pandemic, driven by very limited housing supply; stable premium levels; robust operating performance; and continued strength in the capital position of the private mortgage insurers.

The unemployment rate remains very low, despite a slight rise the past year. Core PCE (personal consumption expenditures) inflation is declining despite remaining above the Fed's target, which is likely to pause further interest rate hikes.

Supply and demand dynamics in the US housing market will probably stop the bottom from dropping out on home prices. The large cohort of Millennials entering their prime homebuying age in the coming years will keep housing demand afloat. Housing supply has been low because of under-building since the mid-2000s and, more recently, the rate lock effect, whereby homeowners with mortgage rates close to 3%-4% are unwilling to sell their homes, thus greatly reducing the supply of existing homes for sale.

The operating performance and capitalization of the private mortgage insurers remain bright spots. Underwriting income is still robust since higher persistency has more than compensated for the significant decline in new insurance written. Risk-adjusted capital remains favorable, as the private mortgage insurers continue to protect their surplus using traditional reinsurance and mortgage insurance-linked securities.

US Surety Insurance

AM Best's outlook on the US surety segment remains at Stable owing to the segment's strong profitability and the ongoing strength of the US construction industry. US construction spending continues to grow, led by both private and public sectors. Healthy demand for construction projects should support surety premium growth, as construction spending drives much of the demand for surety bonds, particularly performance and payment bonds. Although skilled labor shortages and raw materials cost pressures remain hurdles for planning and executing construction projects, a decline in price volatility due to easing inflation and the healing of supply chains should benefit contractors and the surety market.

The market should also continue to benefit from the US government's long-term commitment to infrastructure investment through the Infrastructure Investment and Jobs Act (IIJA) of 2021 and the Inflation Reduction Act (IRA) of 2022. As more projects under these bills are approved and commenced, the significant amount of public funds dedicated to restoring or upgrading aging infrastructure in the US, as well as investments in new projects, is providing a significant tailwind for the surety market. In addition, private construction spending has been resilient, driven by increases in several categories of non-residential construction, while residential construction has also grown modestly.

The macroeconomic factors that have affected the residential construction market, including tightened monetary policy, may ease as mortgage rates fall over the near term. The shortage of existing homes available for sale continues to support housing market fundamentals. As interest rates decline, home builders are likely to add more housing supply to meet demand, spurring residential investment and benefiting the surety market.

The profitability of surety writers will likely remain strong, bolstered by a resilient construction industry. The segment's profitability will result in ample capacity, as well as persistently soft market conditions. Given the significant excess capacity available, AM Best expects the environment for the surety segment to remain highly competitive.

US Title Insurance

AM Best's outlook on the US title segment remains at Negative despite some easing in mortgage rates of late and the hopes of further easing in 2024. The outlook also takes into consideration the record-high drop in home sales in 2023, which could be a prelude of what to expect in 2024. High mortgage rates continue to dampen real estate transactions and title insurers alike in 2024. Despite expectations for a gradual improvement later in the year, much depends on the number of interest rate cuts the Federal Reserve ultimately decides to make, the timing of these cuts, and the amount. More meaningful rate cuts earlier in the year could prompt an increase in home purchases and accelerate the process and create some positive momentum for title insurers. However, interest rates could remain higher for longer, so a turnaround for title insurers may not come until 2025. Other drivers of the Negative outlook are home price inflation, affordability, and slow to non-existent refinance activity.

Despite these challenges, the US title industry will likely remain profitable, although at lower than historical averages due to the decline in home sales and a corresponding decline in title insurance transactions based on the key drivers highlighted above.

US Workers' Compensation Insurance

AM Best' outlook for the US workers' compensation segment—the third-largest component of the commercial lines market, lagging only other and products liability and commercial auto—remains at Stable. The Stable outlook reflects the sustained performance, despite long-term rate decreases, of the workers' compensation segment, which has been more profitable than any other line of business, personal or commercial, since 2015.

The segment maintains sound levels of risk-adjusted capital, as evidenced by the increase in the redundant loss reserve position, which has improved annually since 2018. Underwriting results have benefited from consistent loss ratios, which, combined with reduced fraud and lower defense costs, have driven consistently profitable underwriting results. Although indemnity losses for lost time have increased somewhat in recent years, medical losses have been relatively flat, which narrows the gap between medical and indemnity severity.

Despite lingering concerns, the impact of the pandemic on insurers' balance sheets and operating performance has been somewhat muted. Top-line growth had been affected by the spike in unemployment in 2020, as well as downward pressure on rates. However, the economic recovery that began with the reopening of businesses in 2021 allowed many workers to return to full-time employment. Demand for labor continues, as evidenced by the 3.7% unemployment rate in January 2024. These indicators suggest an ongoing rise in workers' comp premiums, although growth will depend on other economic factors and whether a recession occurs.

Operating performance should benefit from an improvement in net investment income due to higher interest rates on maturing or new-money investments, as proceeds will be reinvested at the higher rates. As with other long-tailed lines, workers' comp remains susceptible to inflationary pressures. Although the impact of inflationary pressures on medical claims has been somewhat muted given the long-term decline in the frequency of lost-time claims and the improvement in workplace safety, rising wages have driven higher indemnity costs, resulting in an increase in claims severity.

The spike in unemployment in 2020 due to the pandemic negatively impacted top-line premium growth. Although premium levels have recovered as the pandemic moves further into the rearview mirror, claims latency and the potential long-term health effects of the virus could still have a lingering effect on results. Written premiums have rebounded from the pandemic-driven decline that cut payrolls and premiums. Wage growth, combined with strong job creation, has driven payroll growth, and with it, premiums to pre-pandemic levels.

Intensifying market competition remains a concern, which may lead some carriers to loosen underwriting standards to attract or retain business. Although performance should remain solid overall, persistent downward pressure on rates and pricing due to ongoing competition will likely narrow profit margins and somewhat dampen the segment's profitability over the near term.

Contributors:

Richard Attanasio, Oldwick
Kourtnie Beckwith, Oldwick
Elizabeth Blamble, Oldwick
Joni Cerbone, Oldwick
Chris Draghi, Oldwick
Christopher Graham, Oldwick
Michael Lagomarsino, Oldwick
Gordon McLean, Oldwick
Anthony Molinaro, Oldwick
Billiah Moturi, Oldwick
Thomas Mount, Oldwick
Alan Murray, Oldwick
Josie Novak, Oldwick
Riley Parnham, Oldwick
Vicky Riggs, Oldwick
Wai Tang, Oldwick
Kenneth Tappen, Oldwick
Maurice Thomas, Oldwick
Robert Valenta, Oldwick
Greg Williams, Oldwick

Published by AM Best

BEST'S MARKET SEGMENT REPORT

A.M. Best Company, Inc.
Oldwick, NJ
CHAIRMAN, PRESIDENT & CEO **Arthur Snyder III**
SENIOR VICE PRESIDENT & TREASURER **Cynthia Young**
SENIOR VICE PRESIDENT **Lee McDonald**

A.M. Best Rating Services, Inc.
Oldwick, NJ
PRESIDENT & CEO **Matthew C. Mosher**
EXECUTIVE VICE PRESIDENT & COO **James Gillard**
EXECUTIVE VICE PRESIDENT & CSO **Andrea Keenan**
SENIOR MANAGING DIRECTORS **Edward H. Easop, Stefan W. Holzberger, James F. Snee**

AMERICAS
WORLD HEADQUARTERS
A.M. Best Company, Inc.
A.M. Best Rating Services, Inc.
1 Ambest Road, Oldwick, NJ 08858
Phone: +1 908 439 2200

MEXICO CITY
A.M. Best América Latina, S.A. de C.V.
Av. Paseo de la Reforma 412, Piso 23,
Col. Juárez, Alcadía Cuauhtémoc, C.P. 06600, México, D.F.
Phone: +52 55 1102 2720

EUROPE, MIDDLE EAST & AFRICA (EMEA)
LONDON
A.M. Best Europe - Information Services Ltd.
A.M. Best Europe - Rating Services Ltd.
12 Arthur Street, 8th Floor, London, UK EC4R 9AB
Phone: +44 20 7626 6264

AMSTERDAM
A.M. Best (EU) Rating Services B.V.
NoMA House, Gustav Mahlerlaan 1212, 1081 LA Amsterdam, Netherlands
Phone: +31 20 308 5420

DUBAI*
A.M. Best Europe - Rating Services Ltd. - DIFC Branch*
Office 102, Tower 2, Currency House, DIFC
P.O. Box 506617, Dubai, UAE
Phone: +971 4375 2780
*Regulated by the DFSA as a Credit Rating Agency

ASIA-PACIFIC
HONG KONG
A.M. Best Asia-Pacific Ltd
Unit 4004 Central Plaza, 18 Harbour Road, Wanchai, Hong Kong
Phone: +852 2827 3400

SINGAPORE
A.M. Best Asia-Pacific (Singapore) Pte. Ltd
6 Battery Road, #39-04, Singapore
Phone: +65 6303 5000

Best's Financial Strength Rating (FSR): an independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations. An FSR is not assigned to specific insurance policies or contracts.

Best's Issuer Credit Rating (ICR): an independent opinion of an entity's ability to meet its ongoing financial obligations and can be issued on either a long- or short-term basis.

Best's Issue Credit Rating (IR): an independent opinion of credit quality assigned to issues that gauges the ability to meet the terms of the obligation and can be issued on a long- or short-term basis (obligations with original maturities generally less than one year).

Best's National Scale Rating (NSR): a relative measure of creditworthiness in a specific local jurisdiction that is issued on a long-term basis and derived exclusively by mapping the NSR from a corresponding global ICR using a transition chart.

Rating Disclosure: Use and Limitations
A Best's Credit Rating (BCR) is a forward-looking independent and objective opinion regarding an insurer's, issuer's or financial obligation's relative creditworthiness. The opinion represents a comprehensive analysis consisting of a quantitative and qualitative evaluation of balance sheet strength, operating performance, business profile, and enterprise risk management or, where appropriate, the specific nature and details of a security. Because a BCR is a forward-looking opinion as of the date it is released, it cannot be considered as a fact or guarantee of future credit quality and therefore cannot be described as accurate or inaccurate. A BCR is a relative measure of risk that implies credit quality and is assigned using a scale with a defined population of categories and notches. Entities or obligations assigned the same BCR symbol developed using the same scale, should not be viewed as completely identical in terms of credit quality. Alternatively, they are alike in category (or notches within a category), but given there is a prescribed progression of categories (and notches) used in assigning the ratings of a much larger population of entities or obligations, the categories (notches) cannot mirror the precise subtleties of risk that are inherent within similarly rated entities or obligations. While a BCR reflects the opinion of A.M. Best Rating Services, Inc. (AM Best) of relative creditworthiness, it is not an indicator or predictor of defined impairment or default probability with respect to any specific insurer, issuer or financial obligation. A BCR is not investment advice, nor should it be construed as a consulting or advisory service, as such; it is not intended to be utilized as a recommendation to purchase, hold or terminate any insurance policy, contract, security or any other financial obligation, nor does it address the suitability of any particular policy or contract for a specific purpose or purchaser. Users of a BCR should not rely on it in making any investment decision; however, if used, the BCR must be considered as only one factor. Users must make their own evaluation of each investment decision. A BCR opinion is provided on an "as is" basis without any expressed or implied warranty. In addition, a BCR may be changed, suspended or withdrawn at any time for any reason at the sole discretion of AM Best.

Version 011624