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Market Segment Outlook: US Personal Lines

The outlook for the personal lines segment remains Negative amid deteriorating personal auto and homeowners results

AM Best's outlook for the US personal lines segment remains at Negative. The outlook for the segment was revised to Negative in September 2022, along with the outlook for personal auto. A year later, the outlook for the homeowners line was also revised to Negative. The outlooks reflect the following factors:

- Ongoing deterioration in reported results for both the personal auto and homeowners lines
- Rising loss cost severity, driven by inflationary pressures
- Challenges maintaining rate adequacy
- Elevated reinsurance costs and tightened terms and conditions
- Heightened catastrophic loss volatility; increased secondary peril activity
- Higher overall retentions and co-participation on property lines, driving higher net losses
- Restrictive regulatory environment in various states

Factors offsetting these negative pressures include the following:

- Solid risk-adjusted capitalization with sufficient liquidity, despite an eroding capital cushion for some insurers
- Improving investment yields owing to the rising interest rate environment
- An aggressive push for rate adequacy across the segment, with some easing of regulatory hurdles
- Accelerated technology adoption
- Improving catastrophe risk management practices

Loss Cost Pressures & Rate Adequacy Challenges

The Negative outlook on the personal lines segment is due to the continued deterioration in reported results for both the homeowners and personal auto lines of business, with auto liability and physical damage accounting for approximately two thirds of the segment's results. Given the persistently high loss costs, as well as increased levels of net retention for homeowners carriers, a return to underwriting profitability for the segment over the near term appears highly unlikely.

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 higher fatality rates, increased repair costs for newer vehicles, higher used car prices, supply chain and labor market disruptions, and rising medical costs, not to mention the overall inflationary environment. A return to more normalized frequency levels after the COVID-19 pandemic lockdowns ended also pressured profitability, with more drivers back on the road. Insurers have pursued rate increases in response to these trends, but the timeliness and effectiveness have varied. The process is complex and varies by regulatory jurisdiction. However, carriers ahead of the curve in terms of rate adequacy and pricing sophistication maintain a competitive advantage.

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Distracted driving will likely remain an industry issue contributing to loss trends for the automobile lines. Newer vehicles with enhanced safety features account for a growing percentage of vehicles on the road, which may ultimately favorably impact frequency, but their repair costs are higher. With limited access to needed parts and shortages of qualified labor, the time for repairs has lengthened considerably, resulting in additional loss cost pressures. This dynamic also increases car rental reimbursements as allowed by policy coverages.

Eventually, the growing use of telematics and usage-based insurance may help address loss frequency, as insurers can assess driving behavior in real time or implement additional product innovations such as per-mile insurance. However, this is unlikely to have a meaningful impact over the near term, as carriers are focused on stabilizing their existing products.

Heightened Catastrophic Loss Volatility; Increased Impact of Secondary Perils

The substantial catastrophic loss activity of recent years has 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) resulted in significant losses. Due to climate and demographic changes, these secondary perils have become just as problematic as more high-profile events such as hurricanes and earthquakes. Depending on the structure and pricing of reinsurance programs, losses associated with these events often fall within companies' net retentions. The recent challenges in the reinsurance market have driven higher retentions and levels of co-participation for many primary carriers. In some cases, this has severely impacted results, particularly for those insurers with geographic or product concentrations. The ability to absorb multiple events, both financially and operationally, in a relatively short time frame is increasingly important. Personal lines insurers continue their exposure management efforts, as well as strategic agency management initiatives. In addition, some have attempted to structure their reinsurance programs to more effectively capture and mitigate aggregate risks. However this has proven a challenge, given reinsurance market conditions. In some cases, the challenging environment has exposed weakness in insurers' enterprise risk management.

Given the ongoing market challenges, many carriers have addressed pricing needs through both rate increases and inflation adjustment factors. Although rate momentum started accelerating in late 2020 and has continued in 2023, achieving and maintaining rate adequacy remain challenging. Furthermore, 12-month policies for the homeowners line adds to the difficulty of effectively responding to escalating loss cost trends. 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.

Reinsurance Costs Remain Elevated

Reinsurance pricing will likely remain 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 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. As these companies increase retentions and the level of co-participation in their programs, overall results will be negatively impacted, particularly given the growing activity associated with secondary perils. Despite indications that mid-year 2023 reinsurance placements were less chaotic than the January 2023 renewals, with a similar trend expected for the 2024 renewal season, pricing

remains a challenge. Reinsurers have generally started to realign their risk profiles with a greater focus on generating underwriting profits.

Restrictive Regulatory Environment

Efforts to address rate adequacy are neither simple to execute nor accomplished expediently. The process for state insurance departments to approve carrier rate increase requests 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. On a positive note, recent significant rate increases have been approved in a number of jurisdictions.

Before the heightened inflationary pressures, carriers were generally able to address rate needs with modest rate increases. Accordingly, the regulatory response to rate adequacy needs had not been a significant barrier to generating adequate operating results. However, as the magnitude of increases grew, in line with trends in the broader economy, companies accelerated both the frequency and the degree of rate filings.

Solid Risk-Adjusted Capitalization and Sufficient Liquidity

Risk-adjusted capitalization remains solid for most carriers despite performance challenges. These generally favorable positions provide some leeway in managing future challenges, further supported by sufficient liquidity and positive cash flows.

The capital cushion of some companies, however, has eroded due to persistent underwriting losses. Accordingly, the risk-adjusted capital of some of the companies that have historically reported "excess" capitalization has declined materially through a combination of underwriting losses, changes in reinsurance structures, and reserve increases amid the inflationary environment. The spike in loss costs in recent years has 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. The compounding effects of both capital and operating performance deterioration may continue to lead to negative rating pressure for some carriers.

On the bright side, with interest rates rising, companies can generate higher yields, which helps offset challenging underwriting results, benefitting operating performance metrics. As the segment's primary lines are relatively short-tailed, the impact may be somewhat limited. These ongoing challenges may lead to an increase in mergers, acquisitions, affiliations, or book rolls, as companies refine their risk appetite in managing these market dynamics.

Accelerated Technology Adoption

In recent years, the best-performing auto and homeowners insurers have invested significant resources in current 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 opportunities to manage profitability pressures. The ability to quickly pivot to enhance pricing and underwriting in policy administration systems has proven important.

These initiatives escalated during the COVID-19 pandemic, as insurers quickly moved to meet both their own business requirements and customer demands. Because of the lockdowns, remote access was critical for claims, underwriting, and loss control, as well as policy issuance, whether direct or through agency distribution. Companies that were further along upgrading their systems were better positioned to quickly transition while continuing to focus on data analytics.

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. In addition to rate increases, insurers continue to seek ways to address ongoing performance challenges through more robust and integrated risk management. For example, insurers are reviewing risk appetites and the underwriting rules embedded in their platforms to identify areas that may be more problematic or indicators of loss trends. There is a significant push to ensure that the total insured value for all issued policies is accurate, given the macroeconomic factors at play. We expect this accelerated pace of technology adoption to continue.

Ratings Pressure

AM Best's market segment outlook contemplates the impact of current trends on companies operating in a particular segment over the next 12 months. Our ratings consider how companies manage these factors and trends. The Negative outlook for the personal lines segment indicates that AM Best expects market trends to have a negative impact on companies operating in the segment, but that does not mean that all companies operating in the segment also have a Negative outlook. Carriers that are slow to address the 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.

GUIDE TO BEST'S MARKET SEGMENT OUTLOOKS

Our market segment outlooks examine the impact of current trends on companies operating in particular segments of the insurance industry over the next 12 months. Typical factors we would consider include current and forecast economic conditions; the regulatory environment and potential changes; emerging product developments; and competitive issues that could impact the success of these companies.

A Best's Market Segment Outlook can be Positive, Negative, or Stable.

Best's Market Segment Outlook	
Positive	A Positive market segment outlook indicates that AM Best expects market trends to have a positive influence on companies operating in the market over the next 12 months. However, a Positive outlook for a particular market segment does not mean that the outlook for all the companies operating in that market segment will be Positive.
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We update our market segment outlooks annually but may revisit them at any time during the year if regulatory, financial, or market conditions warrant.

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