AM Best
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Best's 2024 Market Segment Outlooks

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Market Segment Outlook: Global Reinsurance

The outlook for the segment remains at Stable in light of rate improvements and growing demand, countered by concerns about underlying risks

AM Best is maintaining its outlook for the global reinsurance industry at Stable. Key factors supporting the outlook include the following:

- Substantial rate improvement, primarily in property lines, with higher average attachment points expected to result in widening profit margins
- Increased demand for coverage due to heightened catastrophic loss activity as well as general economic uncertainty
- Rising investment income, as new money yields on fixed-income investments have more than doubled
- Strong demand for life and annuity reinsurance from US-domiciled insurers, as well as continued strong flow of capital to support new L/A reinsurance entrants

Factors countering these positives include the following:

- Persistent, growing uncertainty about underlying risks, including frequency and severity of weather-related activities and evolving risk profiles
- Cautious new capital, despite improved market conditions
- Concerns about economic and social inflation
- Higher post-COVID-19 mortality in certain markets

Weather and Loss Trends Persist, While Reinsurers Benefit from Hardening Market

The insurance market was off to another fast start in terms of catastrophic loss activity in 2023. Consistent with recent history, insurers have been plagued by elevated weather-related losses, including secondary perils. Rising sea surface temperatures and elevated coastal property values continue to adversely impact modeled loss projections. These factors have caused many reinsurers to retract significant amounts of capacity in the property reinsurance market. The remaining reinsurers have benefitted from the reduced supply via drastically higher attachment points and higher risk-adjusted rates on line. Despite some disparity between primary insurers' and reinsurers' underwriting returns through the year, AM Best believes reinsurers won't be relaxing their stance for some time. The market is currently working in favor of reinsurers, but investors' appetites had already been stressed for an extended period before the market shift.

Some casualty reinsurers have reported pockets of adverse reserve development, triggered mainly by social inflation in the US. Some larger players reduced their exposures, particularly in public D&O (directors and officers) and excess casualty. Reinsurers will need to maintain prudent loss reserving methodologies to account for the impact of social inflation, as well as general inflation, in the years to come.

Although the global life reinsurers have reported an improvement in mortality since the height of the pandemic, non-COVID mortality experience generally remains higher than expected—life

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reinsurers have noted an uptick in deaths related to liver disease, drug use, and diabetes—and whether mortality will revert to pre-COVID levels remains to be seen. In addition, questions remain about the near and long-term impacts of pandemic-related mortality experience on assumptions and future pricing.

Re-Redefining the Function of Reinsurance

Reinsurance was originally created with one goal in mind: capital preservation. Over time, that goal has shifted, as new players entered and exited and business strategies evolved. In more recent history, many primary insurers have used reinsurance to manage earnings in addition to preserving capital, including the use of lower-level catastrophe covers and aggregate reinsurance. As the soft market in reinsurance persisted, primary insurers became reliant on this coverage and priced/managed their portfolios on the expectation of this coverage being provided. Recently, these types of products have essentially disappeared from the market, leaving many primary insurers with a substantial mismatch between their risk tolerances and current portfolios.

Nowadays, reinsurance is again being viewed as a capital preservation product, but some might question if reinsurance could once again be used for earnings management. There remains demand for it, and innovators look to create products where demand exists. However, (re)insurers have created issues in the past and, more recently, by providing insurance for sub-optimal exposures. Whether the market eventually sees lower level/aggregate covers again remains to be seen, as it may take a few years before the market is comfortable enough to even consider these options.

Insurability Being Challenged

One of the less emphasized issues in the current insurance market is insurability and the adverse trends surrounding it. Particularly in the US, coastal property values continue to rise as more and more property owners flock to catastrophe-exposed areas. Government- and state-sponsored entities/programs providing coverage of last resort, as well as price regulation, have created perverse incentives, counteracting the market risk signals that should have prevented continued property development on flood plains and other adverse terrains. Similar issues are affecting wildfire-exposed regions. Insurers see themselves challenged between prudent risk management and the desire to retain market share.

Different Rates, Different Problems

The rise in interest rates has caused some stir, particularly with regard to unrealized investment losses. However, the mark-to-market losses many reinsurers experienced were not substantial enough to result in a strategic shift in business to reduce capital burdens. Property/casualty reinsurers retained adequate liquidity and were able to recoup much of their losses as their fixed-income investments matured. Moreover, despite lingering unrealized losses, many reinsurers anticipate recouping these losses rather soon, given an average portfolio duration of three to five years. As older instruments mature, insurers are re-investing in new, higher-yielding issuances, typically with yields that are double, or even triple, the prior issuances.

The rise in new money yields improves overall operating returns substantially via higher net investment income. However, the rise in risk-free rates also results in a materially higher cost of capital for reinsurers. Some of the established franchises have still been able to raise capital to support new business, while others have had some difficulty.

The long-duration liabilities of global life reinsurers require investing in assets of similar duration to prevent a mismatch. As a result, life reinsurers reported much larger unrealized losses, given that these long-duration assets are more sensitive to changes in interest rates. These assets also take longer

to reinvest into higher-yielding securities without having to realize significant losses due to the large unrealized loss positions.

Nonetheless, life reinsurers have experienced rising investment yields over the past year because of the rising interest rate environment. In addition, reinsurers in the US life segment have reduced credit risk in their investment portfolios by increasing their allocation to NAIC-1 bonds, as higher rates have made the corporate bond market more attractive. However, many Bermuda- and Cayman Island-based reinsurers continue to take on additional investment risk through private credit and other structured securities that provide an illiquidity premium. In many cases, these securities are sourced from the parent company that specializes in these types of investments. AM Best will continue to monitor the generally higher level of investment risk in offshore-domiciled life reinsurers.

Established Capital Remains Supportive, New Capital Remains Cautious

An important distinction must be made between "available" and "deployed" capital, as all "available" capital does not translate automatically into "deployed" capital. Despite all the noise around unrealized investment losses and elevated catastrophe losses, the segment maintains sufficient capital to support its current ratings. Some reinsurers have reported temporary reductions in capital buffers, although this is likely to revert in the near term as assets backing reserves and investments begin to benefit from higher fixed-income rates. Moreover, some reinsurers have chosen to divert capital from property reinsurance and deploy it into primary/specialty lines of business, effectively reducing the total deployed capital. Furthermore, reinsurers continue to partner with third-party capital providers to optimize risk limits on their balance sheet.

At year-end 2022, reinsurance capital had declined roughly 8.6% from 2021, most of which we expect will be recouped throughout 2023. Through the first half of 2023, prior year unrealized losses had eroded significantly. The S&P 500 was up 16.9%, while fixed-income values continued to benefit from bond issues pulling to par as they approached maturity dates. Shareholders' equity was up 10% on average among global reinsurers at mid-year 2023, with some up over 30% after raising capital earlier in the year. Net investment income for the segment is already approaching—and in some cases has even exceeded—the prior year's total. Additionally, reinsurers have reported improved underwriting results across the board. Although the third quarter is typically the loss-making quarter for reinsurers in the US market, many primary insurers have reported substantial catastrophe activity at mid-year 2023 that hasn't impacted reinsurers.

Some of those that remain in the reinsurance market have looked to fill the gap created by those that have exited the market. However, raising capital in the current economic environment has proven difficult for some. Established, high-quality, and diversified organizations have been able to raise capital to support expansion efforts through the hard cycle. New entrants, despite varying business plans and strong management teams supporting them, have had more difficulty obtaining funding. Although new entrants could eventually obtain funding, they are unlikely to obtain enough to move the market in a meaningful way.

New capital continues to flow into the life reinsurance market, as demand remains strong thanks to a record level of annuity sales in the US and the continued divestment of large blocks of capital-intensive and interest rate-sensitive business by the large publicly traded companies in the US and Canada. Private-equity and asset managers have been the primary source of capital for new entrants in both the annuity and block reinsurance markets in the US, Bermuda, and Cayman Islands. The surge of new entrants in recent years has resulted in greater competition for block annuity deals. As a result, more L/A reinsurers have been seeking flow reinsurance deals, as well as looking to diversify their

business profile by entering the retail L/A market. Several Bermuda-domiciled reinsurers have also entered into deals in international markets such as Japan, where regulatory changes and low interest rates have increased the demand for reinsurance.

Opportunity and Risk Balance

The current global reinsurance market has been referred to as a “generational” opportunity for reinsurers. Pricing trends and restrictions in terms and conditions are at all-time highs. However, uncertainty continues to mount. Aside from the convergence of social inflation, climate change, and lack of insurability, reinsurers need to adapt to a high inflationary environment, something many of their actuaries and underwriters have never experienced. Uncertainty surrounding the market’s ability to quickly adapt to these new market dynamics and capitalize on pricing remains elevated as well.

December 5, 2023

Market Segment Outlook: US Commercial Lines

The segment's outlook remains at Stable, owing partly to strong underwriting performance and disciplined risk selection, notwithstanding a number of near-term concerns

AM Best is maintaining its outlook for the US property/casualty commercial lines segment at Stable, supported by the following key factors:

- Underwriting performance during and after the global pandemic and amidst substantial economic and capital markets volatility has been persistently strong.
- Admitted carriers in aggregate remain disciplined about risk selection, terms and conditions, and capacity deployment, as evidenced by the continuation of strong submission flow and growth in the non-admitted/excess and surplus lines (E&S) market.
- Sharply higher fixed-income re-investment rates have begun to significantly bolster operating profitability in virtually all lines, especially longer-tailed casualty.
- Though well past its peak, pricing momentum remains positive for most classes of business, with the notable exceptions of workers' compensation and certain management liability (such as public companies' directors and officers) lines.
- Reserve development from prior period exposures is expected to be favorable overall for commercial lines, although at lower levels than in the last few years. However, expected reserve development from prior period exposures will vary widely by line of business.

Near-term concerns include the following:

- Economic inflation remains stubbornly elevated, reflecting supply-chain disruptions and increased commodity and labor costs, primarily affecting loss costs in property lines.
- Social inflation, including jury awards and litigation costs, continues to rise, affecting loss costs in the casualty lines, with adverse implications for underwriting and reserve margins.
- Domestic and geopolitical risks (including congressional gridlock; rising tensions with China, the US's largest trading partner worldwide; seemingly indefinite indirect conflict with Russia over Ukraine; and a combustible situation in the Middle East) have the potential to sharply heighten commercial and economic risks relevant to the US P/C commercial lines segment.
- Property reinsurance costs have risen while coverage capacity has declined owing to storm and wildfire losses affecting most of the US in 2022 and 2023. Casualty treaty 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.

The Stable outlook reflects AM Best's expectation that the segment will remain profitable in aggregate and will be resilient in the face of near- and longer-term challenges. It also reflects that the risk-adjusted capital for the majority of segment carriers will remain sound. The outlook also reflects the Stable outlooks on the commercial property and workers' compensation lines, as well as the Positive outlook for the E&S market, the latter of which often diverges from other commercial segments in which it competes.

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Robust Underwriting Performance for Most Major Commercial & Specialty Lines

Commercial lines insurers, unlike their personal lines peers, reported robust underwriting results through the third quarter of 2023. They are expected to continue to do so, driven by strong net premiums earned on the heels of prior year rate increases for most of the major commercial lines of business (despite some recent weakening in pricing gains), as well as growth in net premiums written, due to the continued economic expansion in the US.

Segment earnings have also benefited from substantial underlying underwriting gains and net favorable prior year reserve development. Continued favorable overall prior year reserve development has been driven primarily by better-than-expected loss experience (mostly frequency-related) in workers' compensation, countered partly by pressures from social inflation.

The segment's normalized (eliminating the effect of catastrophe losses and loss reserve development) underwriting performance remained healthy in 2022. Thus far in 2023, the segment's operating ratio (which includes the benefit of earned investment income, an increasingly important consideration for commercial casualty insurers) has continued to rise. Sharply higher investment yields have begun to have a more meaningful impact on overall earnings, offsetting any decline in underwriting performance due to pricing softness in certain specialty casualty lines or adverse claims trends due to inflationary pressures.

Admitted carriers appear to be exercising caution in both property and liability lines, leading significant numbers of commercial insureds to seek coverage in the E&S market—which places E&S market participants in a sweet spot for current market opportunities, given the steady volume of submissions in recent years. Among the lines being side-stepped by admitted carriers and finding their way to E&S carriers are commercial auto, directors & officers liability, cyber, as well as catastrophe-exposed property and other high-volatility coverages.

Reserve development from prior period exposures is still expected to be favorable for the commercial lines overall, although at lower levels than in the last few years. In addition, due to the impact of issues such as economic inflation, social inflation, and slower claims closing rates due to court backlogs, expected reserve development from prior period exposures will vary widely by line of business, with favorable development in workers compensation and property offsetting adverse development in commercial auto and other liability (general liability, professional liability, products liability).

Commercial insurers face a diverse underwriting landscape, and managements are increasingly leveraging technology and innovative products to enhance underwriting and pricing decisions, with greater visibility into profitability at the account level. At the same time, a more direct focus on loss control and claims management is resulting in lower claims frequency and severity. Despite structural challenges that can materially affect performance, the segment continues to benefit from improved technical pricing and is well positioned to meet both short- and intermediate-term challenges.

Solid Capitalization and Liquidity

Segment carriers maintain strong levels of capitalization and liquidity that will enable them to navigate continued uncertainty about capital markets volatility, the growing frequency and severity of weather events, and ongoing inflationary pressures. Significant market volatility has affected both equity and fixed-income security valuations, as have higher reinsurance costs, increasing risk retentions, and pricing in several key segments tapering.

However, the US commercial P/C segment maintains solid risk-adjusted capitalization, reflecting generally conservative investment profiles and hold-to-maturity strategies with respect to fixed-

income securities. It also reflects segment insurers' moderate and generally well-reinsured catastrophe exposures, despite the smaller premium rate increases and the impact of persistently elevated inflationary pressures on both property and casualty lines.

Pricing Off Its Peak But Still Favorable for Most Major Commercial Lines

Following a multi-year peak in late 2020/early 2021, premium rates for most of the major commercial lines of business continued to rise in 2022, albeit at a slower pace than in prior years, with rate-on-rate pricing gains fueling commercial insurers' underwriting performance into 2023. A notable exception has been workers' compensation, whose multi-year underwriting performance has been the strongest of the segment and whose premium rates are also the most tightly regulated, resulting in ongoing premium rate decreases in 2022 and 2023. This is despite continued favorable margins reflecting higher payrolls and total pricing, as well as favorable reserve development from prior years, driven primarily by lower-than-historical claims frequency.

According to the Council of Insurance Agents and Brokers' (CIAB) third-quarter 2023 report, overall premiums increased by an average of 8.1% in the third quarter of 2023, in comparison to 8.9% in the second quarter. Commercial property rates have seen the highest increase, most recently at a pace of 18%, reflecting significant natural catastrophe loss activity, as well as rising property values, tighter reinsurance terms and conditions, and higher ceded rates on line. In contrast, workers' compensation premiums have continued to decline modestly, around 1% per quarter, reflecting a long-term trend. Commercial auto, a historically underperforming line due to its risk characteristics and sensitivity to qualified labor supply and demand, has seen consistent quarterly premium rate increases in the high single-digit percentage range. General liability has seen a more tepid, but still favorable, change in the 5% range, which AM Best views as reasonably close to current claims cost trends. Umbrella, a more leveraged line of business, continues to see premium rate changes in the high single-digit percentage range, albeit down sharply from prior highs.

Financial lines have seen a steeper decline, due primarily to sharp reductions in initial public offerings, SPACs (special purpose acquisition companies), and corporate M&A. Overall rates (excluding workers' compensation) have been up in the mid-single digits, while total pricing, which includes rates and exposures, has increased in the high single digits. Because of the decline in workers' compensation rates (which will be offset partly by rising wages) and sustained increases in nearly all other lines, direct premiums written for the overall commercial lines are expected to grow, in the mid- to high single digits. If not for inflationary pressures, as well as the prospect of sharply higher reinvestment rates on fixed-income securities portfolios, AM Best would expect further downward pressure on premium rates. However, early indications suggest that insurers remain wary of multiple risk factors—and a growing number of diverse economic and geopolitical headwinds—and that pricing may strengthen in response to rising costs across the board and to the impact of heightened market volatility on capitalization and the rising costs of reinsurance protection.

Inflation Cutting into Margins and Pricing Increases in Property & Liability Lines

The most notable adverse trend facing US commercial insurers, and the economy overall, has been the persistent inflationary pressure for both goods and services, as wage growth has lifted employment costs. Headline inflation rose 3.2% YoY in October 2023, compared with an average inflation rate of 8% for 2022. Despite US Treasury efforts to combat inflation with rising rates, insurers' loss costs are likely to continue to rise, albeit at a more moderate pace. Ongoing congressional gridlock and worsening geopolitical tensions (which were already high in 2022), along with the Federal Reserve's aggressive anti-inflation monetary policy, offer the potential for greater tail risk for commercial insurers, potentially reviving and exacerbating supply chain issues. Labor shortages continue to push up prices for a variety

of consumer goods and materials, as well as repairs or replacement of damaged property. Rising cost estimates will also be reflected in a reduction in the benefit of further reserve releases on business written in prior years, as those reserves were likely established under more benign assumptions.

Inflationary pressures are affecting not only the property lines. 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), as these trends not only impact future claims but also require continual re-evaluation of existing claims reserves. These lines (with the exception of commercial auto liability) benefited from material favorable loss reserve development during 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.

According to Swiss Re, US liability claims costs have risen an average 16% annually the last five years, well above the 4% average rate of economic inflation. The gap indicates that social inflation is a persistent challenge for commercial casualty insurers, which will need to remain intensely focused on underwriting discipline. But social inflation is not a new phenomenon. The US liability crisis of the mid-1980s was the first episode of runaway social inflation, in part a response to corporates and their insurers being retroactively held liable for environmental damage, as well as huge asbestos-related claims. Another episode of social inflation, in the early 2000s, was driven by an expansion of mass torts. The current wave is characterized by a rising frequency of large, single-claimant events, often based on ballooning non-economic damages. At the same time, the number of claimants in multi-district litigation cases has risen to a historic high.

Commercial insurers with long- and short-tailed lines of business will need to remain vigilant about inflation, for pricing and reserving. AM Best views the market as being reasonably disciplined. However, given loss cost inflation and a potential slowdown in growth in exposures owing to uncertain economic conditions, casualty rates in most classes will need to rise at an accelerated rate, or the industry will fail to keep pace.

Capital Markets Volatility Impacts Balance Sheets, but Higher Interest Rates To Fuel Returns

Inflationary pressures have affected commercial insurers' underwriting and reserving margins, but the sharp increase in capital markets volatility and in interest rates in 2022 significantly eroded the market values of their equity and fixed-income securities portfolios. Nevertheless, US commercial insurers' securities portfolios remain overwhelmingly invested in investment-grade, fixed-income securities generally held to maturity (significantly mitigating the likelihood of realized investment losses).

A notable tailwind for commercial insurers, however, is the significant strengthening of yield for insurers' fixed-income securities portfolios (which had supported overall operating performance), as free cash flows and maturing fixed-income portfolios continue to roll over into sharply higher interest-rate bearing bonds. Over the past decade, insurers have had to generate more substantial underwriting profits to offset the impact of persistently low interest rates. Insurers' challenges in the next year or two will be to avoid sacrificing underwriting pricing adequacy and to maintain adequate risk-adjusted returns.

Emerging Classes of Potential Litigation Merit Continued Vigilance by Casualty Insurers

With the post-pandemic return of court dockets to full productivity, the key drivers of claims trends have largely returned to historical levels, although the "new normal" incorporates a higher level of embedded risk and claims cost trends, in AM Best's view.

Emerging Materials & Technology

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 implementation 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. The emergence of 5G technology has already prompted significant concern with regard to digital/national security, as well as aviation with respect to flight safety, an area of potentially incalculable exposure.

Climate-Related Exposures

Commercial insurers also face challenges assessing the nature and scope of exposures relating to climate risk. The variability in the commercial lines' reported results in recent years is largely a reflection of the variability in catastrophe losses each year. The segment has been subject to an increase in the frequency of more severe events, driven not just by climate risk but also by demographics and rising costs to repair and replace damaged property. The effects of these factors on the segment are material and will persist over the long term. To be successful, companies have adopted innovative technology and product design, as well as firm underwriting objectives, and incorporated assessments of these risks in their enterprise risk strategies. The segment's ongoing core underwriting and overall operating profitability, which contribute to steady risk-adjusted capital strength, reflect the resilience of the companies in the market.

Litigation Financing

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 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.

Commercial Lines Insurers Remain Strongly Capitalized To Absorb Impact of Headwinds

Despite growing headwinds brought on by rising inflationary pressures, increasingly volatile capital markets, and some attrition in the segment's pricing power, the US commercial lines segment remains solidly capitalized on a risk-adjusted basis. This view considers the segment's generally conservative investment profile and hold-to-maturity strategy with respect to its predominantly investment-grade fixed-income securities portfolios and limited equity exposures, as well as its consistently sound aggregate reserve position and enhanced risk management discipline across underwriting, claims, and actuarial areas, which are essential to navigating a highly dynamic market environment. Finally, the reinvestment of new cash flows at sharply higher rates than current portfolio yields should provide a strong tailwind for both long- and short-tail commercial lines.

December 4, 2023

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.

November 30, 2023

Market Segment Outlook: US Life/Annuity

The Stable outlook is based on the segment's persistently strong capital and liquidity positions, as annuity sales drive premium growth

AM Best is maintaining its Stable outlook for the US life/annuity segment. Key factors include the following:

- Strong liquidity and capital positions
- Robust annuity sales
- Slightly improved new money yields in a benign credit environment

Factors offsetting these tailwinds include the following:

- Market volatility and increased uncertainty
- Asset classes, such as structured credit and commercial real estate, that remain a concern
- Legacy liabilities

The Stable outlook for the US life/annuity segment is supported by the industry's absolute level of capital, as well as solid levels of risk-adjusted capitalization. Although required capital may be higher due to growth, both capitalization metrics are expected to remain favorable. Strong capital buffers and the ability to maintain excess capital allow the industry to absorb financial market risks and potential changes in asset and liability valuations, which is likely to be bolstered as new capital is injected into the industry. Given the long-term nature of the L/A insurance business, insurers continue to demonstrate good liquidity management to meet their short-term liquidity needs.

The industry had endured decades of a low interest rate environment. The dynamics shifted recently and rates have risen, negatively impacting the value of bondholdings, leading to unrealized losses on fixed maturities that directly affect capital levels. However, more favorable rates allow insurers to extend asset durations, with bonds maturing in the near term being reinvested at more attractive interest rates, and new money being deployed in the current environment.

Despite very strong levels of risk-adjusted capital, there are additional headwinds. Inflation may continue to hamper profitability. Credit losses in commercial mortgages and collateralized loan obligations may also pose some risk, although we have not yet seen a material increase in impairments or defaults.

Record Annuity Sales Growth

The L/A industry has recorded 10 straight quarters of year-over-year individual annuity premium growth, attributable mainly to ongoing equity market declines and rising interest rates, which has led to solid growth for fixed-rate deferred annuity sales and fixed-indexed annuity sales. Growth in the annuity market has heightened competition, as many new

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companies have entered the space, including several new private equity and asset management-backed insurers looking to capitalize on the difference between the cost of liabilities and potential favorable investment returns. These new market entrants have added much-needed capacity to the market, launching multi-year guaranteed annuities (MYGA) due to their attractive interest rate spreads.

US annuity sales have continued to grow in 2023. During the second quarter of 2023, sales increased 12% YoY, to $88.6 billion, the highest quarterly figures ever recorded by LIMRA. The growth was due mainly to ongoing equity market declines, coupled with rising interest rates, which has led to solid growth in registered index-linked annuity and fixed-indexed annuity products.

AM Best is concerned that annuity growth will be accompanied by an increase in surrender benefits. Although surrenders topped $100 billion in the second quarter of 2023, they remain low as a percentage of annuity premium growth. Companies are looking to mitigate the risk and disincentivize surrenders. In many cases, companies are attaching market value adjustments (MVAs) to surrender charges, so that if yields are higher at the time of withdrawal than when the contract was purchased, the surrender charge is higher.

Growth in the L/A segment is not limited to annuity sales, however. Although the COVID-19 pandemic dampened operating earnings due to higher mortality, it also renewed interest in life insurance. Many innovative companies have found ways to sell products through digital channels, driving double-digit premium growth and improving the industry's outlook. This sales growth has since moderated, as new annualized premium only increased 2% in the second quarter of 2023.

ERM Anchors Stability

L/A liabilities are backed by financial assets, so insurers must continuously manage significant market risk, carefully measuring credit, equity, liquidity, and interest rate risk. In the aftermath of the 2008-2009 financial crisis and the pandemic, the ability to execute on strong enterprise risk management strategies has provided insurers with added operational security and favorable outcomes for these risks.

The segment faces some fundamental risks: mortality, morbidity, longevity. Although COVID-19 impacted mortality, it was seen as mostly manageable, as companies updated assumptions for their impact on life products. However, greater uncertainty and risk are being introduced in the relatively newer and growing annuity product lines, where experience may not yet be fully developed. Examples include embedded risks related to future policyholder behaviors, annuitization rates, the impact of surrenders and lapses, and the longevity risk associated with growth in pension risk transfer deals. Risk managers and insurance executives continue to grapple with operational challenges such as cyber risk, as the industry improves its digitization capabilities.

Strong corporate governance structures contribute to better capital management outcomes, strengthening insurer resilience and bolstering an insurer's ability to adjust to changing market conditions. The market acknowledges that risk is not static. An integrated, dynamic ERM framework and continuous evaluation of risk components require ongoing improvement to keep up with changing risks. In addition, stress-testing and a strong corporate governance structure consisting of risk management committees have become integral to the operations of many insurers, which has helped them size the capital required to support the business. In addition, workplace challenges such as cyber risk and the war for talent remain top of mind for many insurance executives and operational risk managers.

Managing Legacy Liabilities

Although traditional L/A insurers are well capitalized, prudent asset-liability matching remains key to a successful ERM framework. Primary L/A insurers have generally enhanced their balance sheet strength through business diversification, but many are now looking toward third-party reinsurers to achieve the same results. Primary L/A writers are tapping the global reinsurance market more frequently to help mitigate long-term liability risk. Reinsurers can provide capacity for large one-off full or structured risk reinsurance transactions on in-force blocks, which helps the primary company more efficiently manage capital and improve the risk profiles for some of these blocks. Other primary writers look to the reinsurance market to access expertise and compete in new markets. They may seek guidance in working with distribution channels or refining underwriting methods.

Market Uncertainty

AM Best remains cautious about ongoing market uncertainty, which can alter the dynamics of industry profitability. This includes concerns about asset classes with higher risk and less liquidity, encompassing structured credit and commercial real estate investments. As we look to 2024, we will continue to monitor issues such as inflation, slowing economic growth, market-sensitive lapse rates, and asset credit risk, including commercial real estate impairments. However, we believe the challenges the segment faces will be manageable, given its sizable capital base and favorable liquidity measures.

These are the key factors determining our outlook at this time. AM Best reserves the right to revisit the outlook if any of these risks fall outside expectations.

November 27, 2023

Market Segment Outlook: Delegated Underwriting Authority Enterprises

AM Best is maintaining its outlook for the segment at Positive, owing to prospects for sustained growth, among other factors

AM Best is maintaining its outlook for the global delegated underwriting authority enterprises (DUAE) segment at Positive. Key factors that have led to the Positive outlook include the following:

- Sustained growth and performance globally
- Ability to address underserved and emerging risks
- Technology and talent, which continue to drive innovation

Factors countering these tailwinds include the following:

- Tight capacity for certain risks
- Uncertainty looming over fronting market
- Ongoing and evolving economic challenges

AM Best defines a DUAE as a third party appointed by a (re)insurer through contractual agreements, to perform underwriting, claims handling and other administrative functions on behalf of its partners. DUAEs comprise entities such as managing general agents, coverholders, program administrators, program underwriters, underwriting agencies, and appointed representatives.

Sustained Growth and Performance Globally

The DUAE segment is still burgeoning with opportunity despite capacity constraints, specifically in the property market. AM Best research shows that DUAEs are expanding their share of premium written across the broader insurance market, while new entrants keep growing in number. The rising number of DUAEs collaborating with insurers to write specialty business is driving the increase in US property/casualty 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's analysis indicates that managing general agents (MGAs) generated direct premiums written (DPW) of over USD 65 billion. Insurance carriers striving for organic growth find the direct access DUAEs provide to policyholders to be profitable.

An important element in a carrier-DUAE relationship is cementing a long-term partnership. Profit-sharing structures have grown notably, reinforcing the contractual alignment of interests and fostering long-term relationships and stable capacity. Significant growth has occurred with DUAEs forming captives to take part of the business they produce as capacity partners look for greater alignment. Captives provide DUAEs with a strategic advantage when negotiating renewals with their (re)insurers. Captives also allow DUAEs to participate in underwriting profits beyond earnings from a profit commission or sliding scale.

DUAEs are playing an important role in insurance growth and distribution in Europe and Asia-Pacific, given their underwriting expertise, technology, and a broader range of capacity providers.

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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. This has led to a number of new start-ups and acquisitions of existing businesses by DUAE groups based outside the US. AM Best expects this trend to continue and to drive further growth in global markets.

Ability to Address Underserved and Emerging Risks

One of the core value propositions of a DUAE is its ability to bring 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 the sizable growth of 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 insurers to move more quickly, exploit niche markets, show creativity in coverages, and target opportunities moving from the admitted to the excess and surplus lines (E&S) market. The hard market for most lines of business has offered opportunities for DUAEs to thrive and will allow them to capture more market share. Historically, under hard market conditions, carriers have tended to move away from the DUAE model, but the maturity in the DUAE space, coupled with opportunities that offer carriers access to certain lines of business, suggests value in the partnership.

Technology and Talent Driving Innovation

Significant investments in technology allow DUAEs to better analyze data in volatile markets and attract talent from the tech industry. The segment's ability to use data and technology for good risk selection, coupled with its nimbleness, means that capital and capacity providers are still dedicated to the DUAE model despite broader market conditions. The focus on quality technology is not only about data analysis and modeling—there is also need for continually streamlined technology that can identify untapped niche markets, increase touchpoints with clients, and improve the policyholder experience. Data is clearly now the key to strong partnerships. Data requires investment in technology that can be expensive, and the benefits must outweigh the costs to be seen as value creating.

Tech talent is drawn to DUAEs in a way that traditional insurers struggle to rival. In addition to the entrepreneurial opportunities that attract talent, DUAEs have proved 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.

Capacity Constraints

AM Best has not witnessed a sector-wide pullback of capacity for DUAE-sourced business in 2023 and does not expect one in 2024. Reinsurers were prudent in their deployment of overall capacity at year-end 2022 and again at mid-year renewals, and even more so regarding the underwriting of property risks. DUAEs active in reinsurance placement faced similar challenges to primary insurers: tightened terms and conditions, increased retentions, reduced limits, and lower ceding commissions.

DUAEs continue to play an integral role in the insurance distribution value chain, often sitting between intermediaries such as retail or wholesale brokers and insurance companies. The specialized nature of most DUAEs allows them to team up with insurance company partners to focus on specialized businesses and their unique risks. As such, DUAEs have strengthened the value of fronting companies. Given events of the past year (such as Vestoo, as well as funding pressures from private equity and venture capital firms), fronting carriers will need to demonstrate their ability to monitor

and manage credit risk through robust enterprise risk management (ERM) practices, to showcase their value. Fronting companies have provided access for more reinsurance participation as reinsurers' appetite for DUAE business remains solid. However, incidents in the fronting space have yet to completely play out, and these hiccups may have an impact on DUAE capacity.

Continued Economic Challenges

The segment is not immune to macroeconomic challenges. Although inflation tends to escalate premium volume, concerns about the impact on current and prior year expected losses are growing. Fraudulent claims may increase as economic conditions have hit the pockets of small businesses and individuals. For DUAEs directly, the inflationary environment remains an obstacle to meeting expense budgets and targets over the near term. Social inflation has challenged DUAEs, particularly in litigious states and certain lines of business.

Looking Ahead

DUAEs have become a relied-upon distribution channel for insurers of all types and under all market conditions. Despite capacity pressures and macroeconomic challenges, the DUAE segment continues to flourish. Talent and technology have played a vital role in adding value to the market, particularly in more difficult conditions. There are many opportunities for DUAEs to grow and expand into new areas and to develop new coverages and products to address the ever-changing risks faced around the world.

These are the key factors determining our outlooks at this time. AM Best reserves the right to revisit the outlook if any of these risks fall outside expectations.

December 1, 2023

Market Segment Outlook: US Health Insurance

The segment outlook remains at Stable, based on persistently favorable earnings, which have driven strong risk-adjusted capitalization, and on expected growth in the Medicare Advantage business

AM Best is maintaining its outlook for the US health insurance industry at Stable, based on the following factors:

- Continued favorable earnings
- Positive impact of investments and interest rates, and favorable liquidity
- Growth in Medicare Advantage (MA) business
- Strong levels of risk-adjusted capitalization

Counterbalancing factors include the following:

- Inflationary pressure on providers' costs and the impact on contracts
- Narrower margins on government business (MA and Medicaid managed care)

The US health insurance industry's underwriting income was flat through the first half of 2023, after generally increasing every year for several years. The MA market had achieved strong underwriting results the past few years, as many seniors—among the most vulnerable to COVID-19—delayed care, bolstering results. However, this trend has changed notably in 2023, as COVID spikes have lessened. Several health insurers have reported greater pent-up demand in the MA segment for certain types of procedures, although MA earnings have been profitable. The number of reported COVID cases has increased very slightly lately but nowhere near any of the previous spikes. As claims experience in 2023 tracks more toward pre-COVID volume, some carriers have reported an increase in the incidence and severity of medical conditions.

Despite challenges, the industry is well positioned to thrive in 2024. Margins are expected to narrow, as the profitability of government programs (Medicaid managed care and MA) is expected to return to more normal levels. Earnings in both government lines of business have been above normal the past few years, driving profitability for some insurers and for the industry as a whole. Health insurers continue to look for ways to lower overall health care spend, focusing on improving patient health outcomes through initiatives such as value-based care models, which pay providers based on patient outcomes and quality, as well as the use of advanced data analytics to better reach members and aid in population health and disease/care management.

Health insurers are prioritizing cost controls and directing care to high-quality/low-cost locations in an effort to bend the cost curve. To encourage plan adoption, insurers are introducing strong financial incentives while still allowing members to choose their preferred place of care, whether in the doctor's office, at home, or an alternate site. This approach is complementing the use of narrower networks to control costs. Insurers are seeing gradual positive results, which could have a pronounced impact on trend-related rate increases over time. The escalation in provider risk-sharing arrangements, including full capitation, withholds, and acceptance of up- and downside

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risk, is helping insurers lower costs and generate better outcomes and financial results. Advances in data analytics and personalized care, supported by targeted medical management, have also contributed to cost control efforts and better outcomes.

AM Best remains less optimistic about smaller, less diversified health carriers. Over the last year, several financially impaired or struggling companies have either gone out of business or exited markets such as individual ACA (Patient Protection and Affordable Care Act) products and select geographies, where there was too much pressure on operations and financial results were poor. Typically, these companies experienced difficulties due to rapid growth, a lack of underwriting discipline, government reimbursement lags and related cash flow management issues, pricing problems, and excessive claims, across the commercial and, in particular, government segments. These marketplace disruptions also affects the rest of the industry.

Industry Remains Well Capitalized

The strong earnings reported the past few years reflect the industry's capital strength, with a 9.8% five-year compound annual growth rate in capital and surplus despite the sizable realized and unrealized investment losses reported. Capitalization remains strong in 2023, with another year of favorable, albeit lower, capital expansion expected in 2024. However, AM Best expects more dividend payments to parent organizations in 2024, owing to a decline in capital-intensive Medicaid premiums as a result of Medicaid redeterminations. Organizations will not need to maintain the same level of absolute capital, given the drop in premium revenues in these regulated entities.

Investments and Liquidity

Health insurance claims are generally short-tailed. As such, the investment portfolios of most health insurers tend to be conservative, with higher percentages of fixed-income and cash and short-term investments. The higher interest rates have not only improved investment income, but insurers no longer need to increase credit risk to obtain higher yields. Through the first half of 2023, we have seen a slight increase in allocations to Class 1 bonds and slightly lower allocations to higher-risk investment classes. We expect this trend to continue into 2024.

Although interest rates caused a decline in net investment income (NII) for full-year 2022, rising interest rates have resulted in a sizable increase in net income through second-quarter 2023 and, for many, a reversal of unrealized losses. With realized losses decreasing and unrealized gains turning significantly positive, along with a growing asset base and more fixed-income and short-term investments, AM Best expects investment results to contribute to overall net income for year-end 2023 and into 2024.

As for liquidity, health insurers generate strong cash flows from operations, a trend we expect will continue. Additionally, many insurers have access to Federal Home Loan Bank borrowings or lines of credit for contingent liquidity needs.

Inflationary Pressure on Provider Costs Could Impact Health Insurers

Health insurers across the country are well prepared to deal with anticipated challenges in 2024, focusing on rising medical costs across all lines of business, by both higher utilization and costs, as well as the need for related rate increases. When the inflationary pressures hit the economy, health insurance was showing only modest signs of higher costs due to longer contracts and COVID-related declines in utilization. Health insurance for a long time led the way in annual price increases compared to the rest of the economy, only recently showing relatively modest inflation.

Health care providers are facing staffing shortages, salary pressures, and supply cost increases. Staffing challenges can limit the number of beds available for in-patient needs or require hospitals to pay overtime, incentivize nurses to take extra shifts, or hire more expensive traveling nurses. Although health insurance provider (hospital, physician, other provider) contracts are multi-year, many are facing higher pricing and longer negotiations at contract renewal time, given the recent challenges.

Overall, the industry has been balancing lower earnings in the commercial segment with steady profitability in government programs the last few years, including 2023. However, with costs on the rise, higher rate increases have been occurring. To maintain favorable earnings, carriers, especially in the commercial segment, have responded to the rise in medical costs with sizable rate increases in 2023, which will likely continue into 2024. In some geographies, combined rate increases for 2023 and new 2024 rates are exceeding 20%. However, more publicity on rate increases may generate more regulatory scrutiny. Pressure from employer groups and individuals, as well as media scrutiny of rate increases, is coming at a time when individuals and employer groups are seeing the impact of inflation on their own financial conditions and results. However, the rate increases are generally actuarially justified and go through extensive regulatory review.

Government Programs

MA and Medicaid managed care are typically narrow-margin, high-volume businesses. Earnings and margins for both have been outsized the past few years, which AM Best does not expect will continue into 2024 or beyond. The higher earnings have been driven partly by COVID-related issues, including the public health emergency (PHE) declared during the pandemic and its impact on Medicaid enrollment, as well as the decline in provider visits under MA given the vulnerability of this population to COVID. Earnings on both products are expected to remain profitable, as underwriting income returns to more typical, pre-COVID levels.

Medicare Advantage Growth Continues, but Potential Challenges Ahead

MA growth in recent years can be attributed to new age-ins (seniors reaching retirement age), individuals converting from traditional Medicare and Medicare supplements, and carriers' geographic and product expansion. Pricing in this market can be more challenging, presenting a barrier to entry for smaller and new carriers.

Whether the pent-up demand and rise in utilization in the senior segment in 2023 will continue into 2024 is uncertain. Additionally, the assumptions insurers used for the resumption of care/pent-up demand in MA pricing for 2024 filed in June 2023 are unclear. If the assumptions were not correct, the segment's underwriting income and margins could be pressured.

As in prior years, companies with higher STAR ratings and more appropriate risk-adjustment revenue payments will have an advantage absorbing a lower level of profitability. A number of carriers reported losing significant revenue bonuses through the declines in their STAR ratings. Carriers are working to improve their STAR ratings for the next year, although many have opted to absorb the price adjustment in the interim rather than increase rates and potentially lose membership. For these carriers, a miss in expected utilization patterns or trends could have a substantially greater impact.

Even with the potential pressure on the MA segment for 2024, earnings from the segment are expected to remain profitable, albeit lower than in with recent years.

Medicaid: Impact of Rising Costs and Redeterminations on Revenue & Earnings

The Medicaid managed care market has been more insulated from rising costs than the commercial

segment. The unique circumstances brought on by the COVID PHE led to much lower utilization and higher revenue in the Medicaid managed care line of business, with these trends persisting through mid-2023.

States were authorized to begin Medicaid redeterminations starting in April 2023, with a reduction in the additional Federal Medical Assistance Percentage (FMAP) phasing out by the end of 2023. Given the amount of work involved, states have 14 months to complete the Medicaid redeterminations. As such, Medicaid rolls have declined through the latter part of 2023. AM Best expects that most of the redeterminations will be completed in the first half of 2024 and could lead to a substantive decline in membership and revenues for health insurers with large blocks of Medicaid business. With states unable to disenroll members the past few years, Medicaid rolls and premiums continued to increase. Thus far in 2023, Medicaid redeterminations have been slower than projected owing to a lack of resources in many states to complete these reviews more quickly. Medicaid managed care revenue streams began to decline for many insurers in the third quarter of 2023, with a more precipitous drop expected for 2024, although the timing will vary by state. AM Best expects that carriers with larger blocks of Medicaid business will see declines in both revenue and earnings from this line of business in mid- to late 2024.

Some of the individuals who had been covered by Medicaid had other coverage and thus were not utilizing their Medicaid benefits, which resulted in higher profitability for the line. As these non-utilizing members are disenrolled, the risk pool will contain a greater number of members who do use their Medicaid benefits, resulting in lower profitability and deterioration in the risk pool. However, some of these lives could be picked up by carriers either on or off exchange through ACA individual health coverage, balancing out the overall risk pools for insurers. Since Medicaid rates are determined based on claims experience and trends, adjusting pricing may take time, but rates, which are set by the states, will eventually be raised. Additionally, some states are being proactive and implementing an acuity adjustment to Medicaid rates for 2024, to account for the change in the risk pool. Health insurers have been expecting Medicaid enrollment to decline for the past two years, but the public health emergency lasted longer than expected. Health insurers are prepared to absorb the impact and return to a more normal level of profitability in this line of business in 2024 and beyond.

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.
Negative	A Negative market segment outlook indicates that AM Best expects market trends to have a negative influence on companies operating in the market over the next 12 months. However, a Negative outlook for a particular market segment does not mean that the outlook for all the companies operating in that market segment will be Negative.
Stable	A Stable market segment outlook indicates that AM Best expects market trends to have a neutral influence on companies operating in that market segment over the next 12 months.

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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BEST'S MARKET SEGMENT REPORT

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