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Market Segment Outlook: US Personal Lines

The outlook for the segment remains at Negative, due primarily to the personal auto line's results, among other factors

AM Best's outlook for the US personal lines segment remains at Negative. The outlook had been Stable for a number of years until September 2022, when it was revised owing to the following factors:

- Deterioration in reported results for the personal auto line
- Rising loss cost severity, driven by inflationary pressures
- Challenges maintaining rate adequacy
- Restrictive regulatory environment
- Elevated reinsurance costs and potential reinsurance capacity constraints
- Heightened catastrophic loss volatility

Factors offsetting these negative pressures include the following:

- Robust risk-adjusted capitalization and sufficient liquidity
- Acceleration of digital transformation/technology adoption
- Fostering of innovation in operations and risk management

Inflationary Pressures & Rate Adequacy Challenges

The negative outlook on the personal lines segment outlook is due to the significant deterioration in reported results for the personal auto lines of business. Liability and physical damage account for approximately two thirds of the segment's results. AM Best estimates that, through the first nine months of 2022, the private passenger auto liability loss ratio deteriorated by nearly 11 points relative to the prior year period, while the auto physical damage loss ratio deteriorated by approximately 16 points. Given the persistently high loss costs, a return to underwriting profitability for the auto segment over the near term appears highly unlikely.

Many carriers continue to pursue rate adequacy in response to rising loss cost severity, but their ability to stay ahead of current trends has been a challenge. The increase in loss severity has been driven by several factors: the higher rate of fatalities, increases in the costs to repair newer vehicles, higher used car prices, supply chain and labor market challenges, and rising medical costs. The return to more normal frequency levels following the pandemic lockdowns has led to further profitability pressures. Many companies in the personal auto segment have pursued rate increases in response to these trends, but the timeliness and effectiveness have varied, as the process is complex and varies by regulatory jurisdiction. However, carriers ahead of the curve in terms of rate adequacy and pricing sophistication have likely built on existing competitive advantages.

Distracted driving continues to play a part in loss trends and will likely remain an industry issue. In addition, newer vehicles with enhanced safety features account for a growing percentage of vehicles on the road, which may ultimately impact frequency favorably, but

Analytical Contact:
Richard Attanasio, Oldwick
+1 (908) 439-2200 Ext. 5432
Richard.Attanasio@ambest.com

Contributors:
John Andre, Oldwick
David Blades, Oldwick

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their repair costs are higher. With access to needed parts and—just as important—qualified labor limited, the cycle time for repairs has lengthened considerably, resulting in additional loss cost pressures. According to the St. Louis Federal Reserve, cost increases for the auto industry are not limited to just microprocessors, given that automotive parts overall saw an increase of approximately 20% over the past year.

Eventually, the growing use of telematics and usage-based insurance may help address loss frequency, as insurers can measure 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.

Restrictive Regulatory Environment

The regulatory environment remains a key point of consideration when evaluating market conditions. 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, the magnitude of increases has grown, in line with challenging trends in the broader economy. Global supply chain issues and rising labor costs have resulted in stubbornly persistent inflation, which has led the Federal Reserve to raise the federal funds rate by 375 basis points to date, to a range of 3.75% to 4.0%—and may rise above 4% by the end of 2022. As a result, the ability to consistently generate adequate operating results has been challenged. Inflationary trends will eventually plateau, but how long this environment will continue remains highly uncertain.

Reinsurance Costs Remain Elevated

The reinsurance market has weathered significant volatility the past several years, dampened by cat losses and secondary perils, soft market pricing/terms and conditions, and higher demand for cat protection, as well as the unwillingness of traditional carriers to deploy substantially more capacity. Due to Hurricane Ian and the above average catastrophe activity throughout the US in recent years, reinsurers are further re-evaluating their portfolios and risk tolerance levels. Due in a large part to global economic issues, new market entrants and capital providers that have historically followed other large catastrophes are not expected after Hurricane Ian. The recent uptick in inflation, especially the rise in the cost of materials and labor, in addition to supply chain issues and shortages, is adding to the increase in reinsurance costs.

The personal lines segment is still being impacted by higher frequency and severity of storm activity throughout the country. Many primary companies have attempted to manage this trend by increasing their net retention levels while purchasing protection higher in the tower to protect balance sheets. Rising reinsurance costs can pressure both operating performance and balance sheet strength if lower levels of reinsurance protection result in higher net probable maximum losses or net retained losses significant enough to erode surplus. Primary carriers may struggle to pass these higher costs through to their customers due to regulatory hurdles in some states. AM Best and Guy Carpenter estimate that overall reinsurance capital will be down 8.4% in 2022, due largely to investment market performance. Expectations are for the property reinsurance market to continue to firm/harden at least into 2023.

Heightened Catastrophic Loss Volatility

After a number of relatively quiet years of named events, Hurricane Ian struck the west coast of Florida on September 30, with estimated losses ranging from $42 billion to $74 billion. Given the magnitude of Ian and the highly litigious Florida market, escalated loss development will contribute to ongoing pricing and capacity pressures for cedents. Due to climate and demographic changes,

secondary perils (tornadoes, wildfires, straight-line winds, and winter storms) 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, like the losses in the upper Midwest during the first half of 2022. In recent years, the severity and frequency of these secondary perils have increased substantially. The ability to absorb multiple events both financially and operationally is increasingly important. Insurers throughout the segment continue their efforts on exposure management, strategic agency management, and enhanced reinsurance programs that capture aggregate risks, with varying degrees of success.

Robust Risk-Adjusted Capitalization and Sufficient Liquidity

Economic growth has slowed in the US, going from 5.7% growth in 2021 to an anemic 0.2% projected by the end of 2022. Economic uncertainty has led to depressed consumer and business sentiment, as well as market volatility, creating uncertainty on the asset side of the balance sheet. Persistently high inflation has resulted in a more hawkish monetary policy, manifest through higher interest rates. Equity market downside risk has worsened quite a bit, and higher interest rates will pressure bond market values as well. Widening credit spreads also add to pressures for balance sheet values and investment income. Despite the challenges brought about by inflationary pressures and ongoing equity market volatility, overall risk-adjusted capitalization remains robust. These generally favorable positions provide some cushion to manage the challenges ahead, further supported with positive cash flows.

Accelerated Technology Adoption

In recent years, the best-performing auto and homeowners' insurers have invested significant resources into 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 pursue profitable growth or manage profitability pressures.

These initiatives escalated during the COVID-19 pandemic, as insurers pivoted quickly to meet both their own business requirements and customer demands. Because of lockdown conditions, 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 and service customers. Mobile applications for submitting claims, video chats for claim reviews, 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. We expect this accelerated pace of technology adoption to continue.

Looking Ahead....

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 it 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. Best's ratings take into account the manner in which companies manage these factors and trends.

A Best's Market Segment Outlook, like a Best's Credit Rating Outlook for a company, 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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A.M. Best Company, Inc.
Oldwick, NJ
CHAIRMAN, PRESIDENT & CEO **Arthur Snyder III**
SENIOR VICE PRESIDENTS **Alessandra L. Czarnecki, Thomas J. Plummer**
GROUP VICE PRESIDENT **Lee McDonald**

A.M. Best Rating Services, Inc.
Oldwick, NJ
PRESIDENT & CEO **Matthew C. Mosher**
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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 - MENA, South & Central Asia*
Office 102, Tower 2, Currency House, DIFC
P.O. Box 506617, Dubai, UAE
Phone: +971 4375 2780
*Regulated by the DFSA as a Representative Office

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

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