December 2, 2024

Market Segment Outlook: US Commercial Lines

The segment's outlook remains at Stable, owing to strong underwriting performance, improved investment returns, countered by social inflation and rising climate risk

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

- Persistently strong underwriting performance for the US commercial lines segment, despite substantial economic and capital market volatility
- Sustained risk-adjusted pricing strength for most classes of business and moderating inflation
- Improved investment returns, which have bolstered operating profitability, especially in longer-tailed casualty lines
- Adequate and stable reserves, although certain lines of businesses continue to develop adversely
- Discipline about risk selection, terms and conditions, and capacity deployment, as evidenced in part by the continuation of strong submission flow and sustained growth in the non-admitted/excess and surplus lines (E&S) market

Near-term concerns include the following:

- Elevated casualty claims, reflecting the multi-year impact of social inflation, with adverse implications for underwriting and reserve margins
- Relatively high property claims costs, despite significant moderation in inflationary pressures
- Escalating geo-political risks and near-term policy uncertainty following the US elections

The Stable outlook reflects AM Best's expectation that the US commercial Lines segment will remain profitable in aggregate and will be resilient in the face of near- and longer-term challenges. It also reflects AM Best's view that the risk-adjusted capital of the majority of segment carriers will remain sound, as well as the Stable outlooks on the commercial property and workers' compensation lines and the Positive outlook for the E&S market. These Stable and Positive sub-segment outlooks continue to counterbalance the Negative outlooks on a number of commercial casualty lines: general liability, commercial auto and directors & officers (D&O) insurance.

Robust Underwriting Performance and Sustained, If Moderated, Growth

US commercial lines insurers overall reported favorable underwriting results through the third quarter of 2024, as evidenced by combined ratios averaging in the mid-90s the past three years, and are expected to continue to do so, driven by moderate pricing gains in most lines of business, as well as growth in net premiums written due to the US economy. The notable exceptions to price increases are workers' comp and certain specialty casualty classes (e.g., D&O and cyber), although the profitability of the workers' comp line remains favorable.

Underwriting results have benefited from net favorable prior year reserve development. The ongoing favorable prior year reserve development overall has been driven primarily by better-than-expected loss experience (mostly frequency-related) in workers' comp, countered partly

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by pressures from social inflation affecting casualty lines, as well as further additions to reserves for asbestos, environmental, and other mass-tort prior year liabilities, although the impact of the latter on commercial casualty insurers is diminishing.

The commercial lines' normalized combined ratio (eliminating the effect of catastrophe losses and loss reserve development) and operating ratios (the latter of which includes the benefit of earned investment income, an increasingly important consideration for commercial casualty insurers) remained healthy in 2023. Thus far in 2024, the segment's overall performance has been maintained, in part reflecting higher investment portfolio yields, as well as a continuation of segment-wide underwriting trends.

Admitted carriers appear to be maintaining caution in both property and liability lines, leading significant numbers of commercial insureds to seek coverage in the E&S market, which continues to benefit from favorable deal flow. Among the lines often being offered to the E&S segment are commercial auto and D&O liability, as well as high-risk and catastrophe-exposed property, cyber, and other high-volatility coverages.

Commercial insurers continue to leverage 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.

A Tale of Three Segments: Property, Liability and Workers' Compensation

For the property markets, extremely tight property market conditions began to ease toward the end of 2023, and market competitiveness has intensified throughout 2024, as insurers (initially reluctant to support a flattening of renewal rates) were compelled to readjust their approach to this more competitive market, due to greater stabilization in reinsurance cost and capacity. Premium growth rates for commercial property have declined to the high single-digit percentages from the high teens in 2023, in large part reflecting stabilized reinsurance markets and renewals. The impact of Hurricanes Helene and Milton in the third and fourth quarters will likely ensure continued firmness in reinsurance renewal pricing and terms in 2025—but are unlikely to prompt the shock renewal adjustments of 2023. With property reinsurance expected to remain relatively stable in 2025, non-life reinsurers have diverted much of their focus to casualty renewals.

Inflationary pressures on replacement costs have eased substantially throughout 2024, as average building cost inflation trends have slowed to the low single digits. This is a welcome relief for insureds who should see improved premium rate stability. In contrast, the definition of natural catastrophe risk continues to expand from the traditional perils of earthquake, flood, and windstorm in high-hazard zones, to include the impact of secondary perils such as severe convective storms, wildfires, and winter freezes. Recent year insured losses have been driven primarily by secondary perils such as severe convective storms.

For the casualty segment, the most notable developments have been the impact of increased claims frequency and severity in recent years, which have driven up loss ratios, and subsequently premiums, while workers' comp results continue to mitigate the worsening results of other casualty lines. The marketplace is responding to rising inflation. Workers' comp remains the most profitable of all P/C lines and appears set to enter its second consecutive decade of uninterrupted underwriting gains. Although workers' comp remains a very healthy line of insurance for carriers and continues to offset the deterioration in general liability and auto liability programs, workers' comp rate reductions in

2025 will likely compress underwriting and operating margins. Commercial auto and product liability are facing a heightened risk of rising nuclear verdicts fueled by third-party litigation financing, and we expect rates to increase in these lines to keep up with this trends.

On the reinsurance side, casualty lines are clearly a point of emphasis for upcoming renewals. Many reinsurers have indicated diminished appetite in a number of general liability and auto lines. Concerns about social inflation trends in US casualty—and to some degree even globally—continue to rise. Reinsurers will likely become more selective with their casualty books, which may result in more hardening.

Pricing is Well Off Its Peak But Remains 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, albeit at a slower pace than in prior years, with rate-on-rate pricing gains fueling commercial insurers' underwriting performance into mid- to late 2024. A notable exception has been workers' comp, whose multi-year underwriting performance has been the strongest of the segment and whose premium rates are also the most tightly regulated, resulting in a continuous stream of rate decreases. Positive underwriting margins reflect 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) latest quarterly report, commercial lines premiums overall rose approximately 5% through the first three quarters of 2024, generally consistent with prior quarters, which comes on the heels of positive rate changes since 2020. Commercial property rates have grown the most, around 9% as of third-quarter 2024 but also registered the greatest year-over-year change (down from about 18%) owing largely to stabilized reinsurance market pricing and capacity. In contrast, workers' comp premiums have continued to decline modestly, by 1% to 2% 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 nevertheless 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, while 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,

Improved Investment Returns Bolster Operating Margins Despite Capital Markets Volatility

Inflationary pressures have affected commercial insurers' underwriting and reserving margins, but the rise in interest rates in 2022-2023, despite easing in 2024, provided a significant tailwind for commercial insurers. 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). This contrasts with the prior decade, in which insurers had to generate more substantial underwriting profits to offset the impact of persistently low interest rates. Insurers' challenge in the next year or two will be to avoid sacrificing underwriting pricing adequacy and to maintain adequate risk-adjusted returns.

Investments in Data and Risk Analytics To Enhance Risk-Adjusted Pricing and Selection

Commercial and specialty insurers are increasingly acquiring or making investments in innovative technologies, both to keep up with evolving market practices and to gain an edge over their competitors with respect to data access and risk selection. Speed of response is an essential

consideration in the highly commoditized small and medium-sized risk marketplace, where consistency and streamlined and frictionless processing are essential for both agents and insureds. Key areas of focus include predictive analytics (telematics and other behavioral-based data gathering and monitoring) to better match price with risk and to provide real-time individual risk-adjusted ratemaking, and the utilization of 'big data' and increasingly artificial intelligence—to discover and leverage more nuanced relationships between risk and return.

Firms that can bring value-added data solutions and the ability to combine data sets in ways that create real value for underwriters, claims adjusters, and actuarial analytics will benefit. One example is aerial imagery that can examine roof lines to see if a building has changed; another is in the world of IoT (Internet of Things) devices and data collection. Other areas of focus revolve around solutions related to operational efficiency or process automation and enhancing distribution reach, especially embedded insurance, which has seen significant growth. Startups are seeking to capture data in a behavior or usage-based format that allows them to design solutions. Insurers seem willing to pay for devices and insurtech solutions that offer the ability to mitigate risk and provide data for both customers and risk management solutions. Those two areas—insightful data sources and effective risk mitigation products—are where insurers will tend to find compelling value as these capabilities also improve both customer experience and insurers' operational performance.

Emerging Classes of Litigation Merit Ongoing 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 costs.

Emerging Materials & Technology

The emergence of new sources of liability is an ever-present exposure for commercial casualty insurers, particularly latent risks in emerging products and technologies, which could result in financial losses to insurers and insureds. Worsening litigation trends and skepticism against insurers and corporations could result in verdicts that could balloon to significant amounts, as demonstrated by asbestos losses. In addition, climate-related casualty litigation, mental health issues caused by technology, and forever chemicals (PFAS) could develop adversely for insurers. Much uncertainty remains, and AM Best is monitoring developments in these areas.

Litigation Financing

Another issue 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.

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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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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