Ratings Review
September 10, 2024

# Declining Balance Sheet Strength, Unfavorable Operating Performance Driving US Rating Downgrades

**More downgrades, fewer upgrades have been driven by personal lines over the past three years**

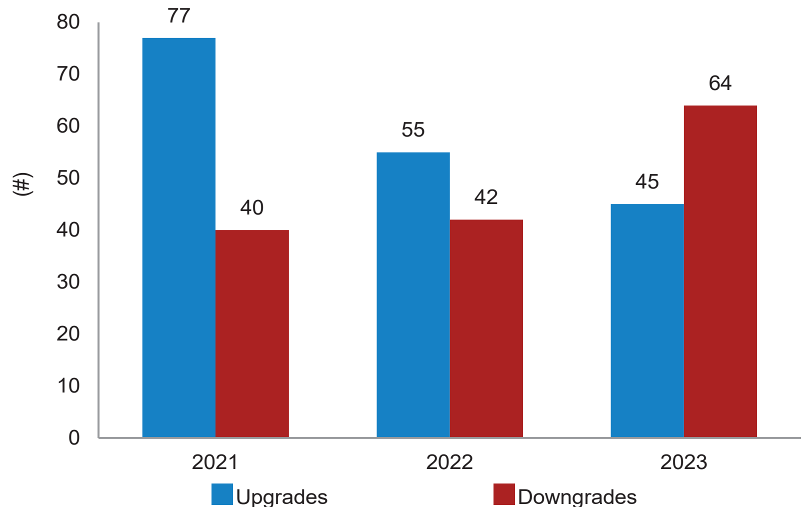
## Principal Takeaways

- Nearly half of all building block assessment changes over the last three years were due to balance sheet strength assessments.
- There were 63 downgrades versus 46 upgrades in the personal lines segment over the last three years. Notably, more than half of the 63 downgrades occurred in 2023.
- Companies domiciled in California, Florida, and Texas have accounted for more than a quarter (27%) of downgrades over the last three years, driven largely by personal lines carriers.
- P/C mutual organizations derive 62% of their premium from personal lines, compared to 39% for stock companies. Despite personal lines challenges, P/C mutual organizations still received more upgrades than downgrades over the last three years, reflective of strong balance sheets.

Recent years have seen a higher number of negative ratings actions on companies operating in US insurance markets. Rating upgrades and downgrades are dependent on the individual circumstances of each rated company; however, the wider trajectory of ratings movements can reflect marketplace dynamics. Some of the factors driving these rating actions are cyclical in nature, while others reflect a more permanent shift in operating conditions. In 2023, the number of ratings downgrades exceeded upgrades. There were 64 downgrades, up by of 22 since 2022, while the number of upgrades were 45, down from 55 in 2022 (**Exhibit 1**).

This deterioration reflects the conditions that US property/casualty insurers have faced in recent years, including worsening economic and social inflation, as well as rising operating and loss costs. The downgrades reflect deteriorating operating results particularly in the personal lines segment, which has had a Negative outlook from AM Best since September 2022 and

Exhibit 1
**US Property/Casualty and Life/Health ICR Rating Changes 2021-2023**




Source: AM Best data and research

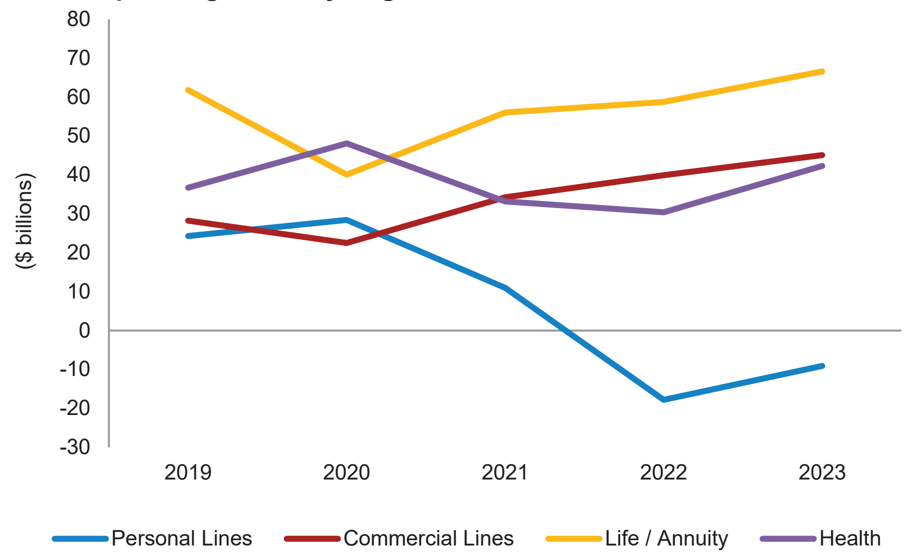
**Analytical Contact:**
David Lopes, Oldwick
+1 (908) 882-2071
David.Lopes@ambest.com

2024-094

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

has seen a growing number of downgrades in the last two years. Rising interest rates have increased investment income for all insurance segments; higher rates also helped bolster premium growth for life/annuity insurers due to attractive crediting rates. Health insurers have navigated reduced utilization through the pandemic and shifts in government mandates in response to the pandemic's impact on the economy, which has affected enrollment and mix.

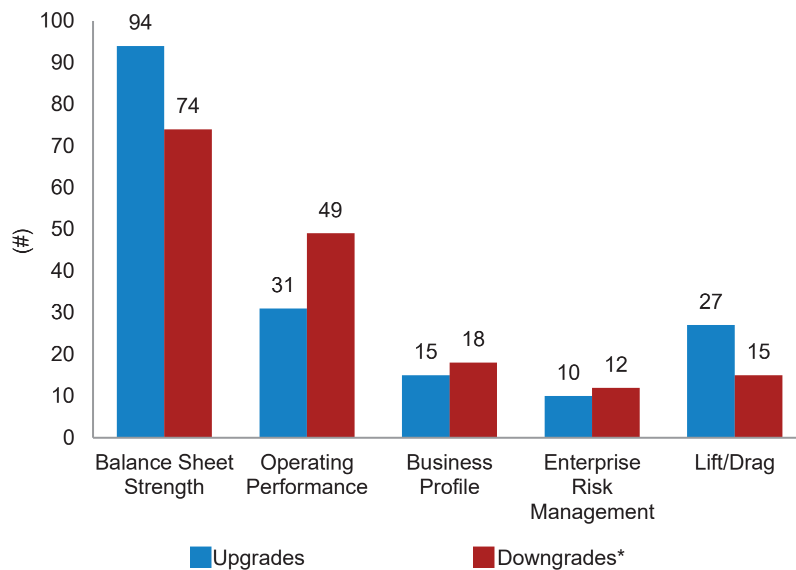
Exhibit 2
**Pretax Operating Gains by Segment**




Source: BESTLINK

The reinsurance market has experienced notable fluctuations the past two years as well, as the market faced challenges due mainly to a decline in investment capital. Reinsurers combatted this by seeking alternative capital. The demand for catastrophe bonds has grown among institutional investors seeking diversification and attractive yields. These bonds can be a more cost-effective way to secure reinsurance compared to traditional reinsurance contracts.

Exhibit 3
**Building Block Assessment Changes, 2021-2023**




* Some companies had multiple building block assessment changes.
Source: AM Best data and research

The L/A and commercial lines segments have seen growing pretax operating gains, while the health segment has seen favorable but variable results (**Exhibit 2**). The recovery and growth in the L/A and commercial segments indicate the positive impact of macroeconomic factors such as rising interest rates and effective risk management strategies, while the fluctuations in the health segment reflect the complex interplay of pandemic-related factors affecting profitability.

## Balance Sheet Strength Is Critical

Balance sheet strength is important regardless of insurance segment, business line, or varying state regulatory frameworks, especially for smaller insurance companies. Nearly half of all building block assessment changes over the last three years were to balance sheet strength assessments (**Exhibit 3**).

Overall, ICR downgrades were driven primarily by declines in capitalization and deteriorating operating performance. Upgrades were due primarily to balance sheet and operating performance improvements, insurers being added to different rating units, or related to lift from parent organizations. Roughly 44% of downgrades were also due to changes in multiple building blocks, 90% of which included balance sheet strength.

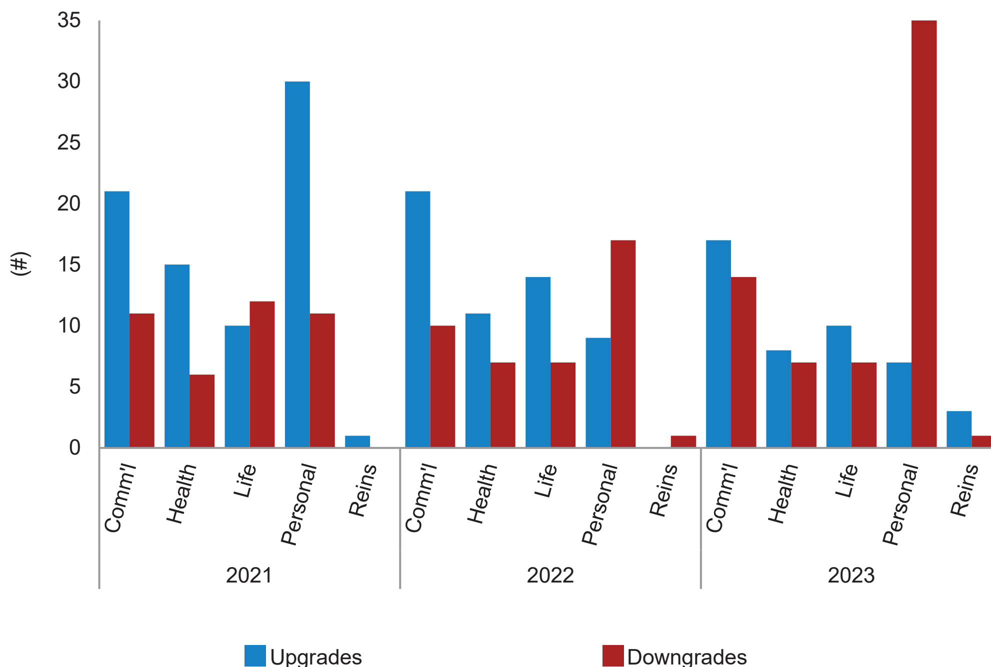
Business profile and enterprise risk management (ERM) are important but have not played as significant a role as balance sheet strength in recent rating actions. This underscores the paramount importance of maintaining robust capitalization and financial stability to navigate operational and market challenges. Lift/drag factored into more upgrades than downgrades, likely due to better balance sheet strength or capital support from a new relationship with the parent company.

### Personal Lines Drive Downgrades

Personal lines carriers have accounted for 43% of ICR downgrades over the last three years. The number of personal lines' ratings downgrades rose in 2023, as property insurers have navigated the perfect storm of elevated catastrophe losses, secondary perils, reinsurance pricing increases leading to greater business retention, inflation, and regulatory hurdles.

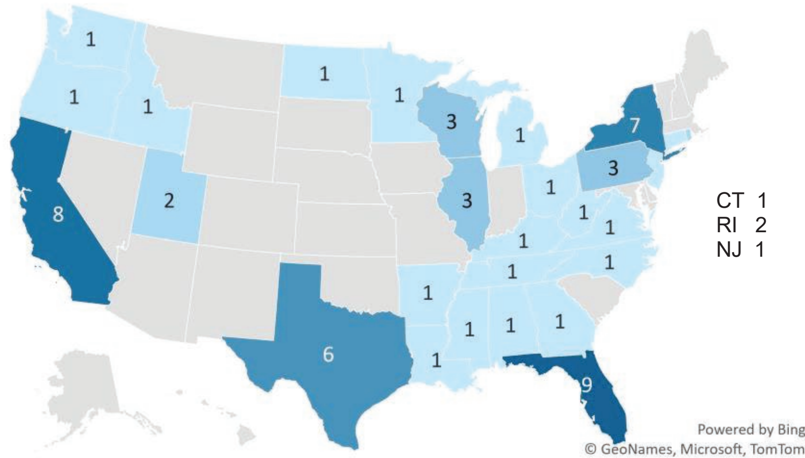
In 2021, personal lines ICR upgrades outnumbered downgrades by 19, however, the position reversed the following year, amid a doubling of downgrades. In 2023, there were 35 downgrades versus seven upgrades in the segment (**Exhibit 4**). With regulatory, risk-related, and macroeconomic challenges still prominent, a return to underwriting profitability for the personal lines segment over the near term is unlikely. Companies with a larger business mix of personal lines faced more challenges and headwinds, as well as a greater likelihood of underwriting result pressures, ultimately deteriorating balance sheets.

Exhibit 4
**ICR Changes Per Business Segment**




Source: AM Best data and research

Exhibit 5
**Personal Lines – Number of Downgrades by State of Domicile**



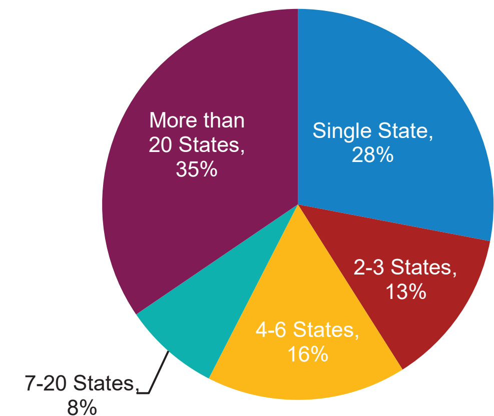

Source: AM Best data and research

## Commercial Lines Account for Largest Share of Upgrades

In the commercial lines segment, upgrades continued to outnumber downgrades. Despite volatility, the segment accounted for the largest share of upgrades over the last three years, although the number fell in 2023, while the number of downgrades rose.

However, commercial lines carriers also accounted for nearly a quarter of downgrades the last three years—commercial casualty companies accounted for half the downgrades in the commercial segment in 2023. Social inflation and litigation financing pose challenges for casualty insurers, which have responded by seeking rate increases while tightening terms and conditions.

Exhibit 6
**Downgrades by Geographic Concentration, 2021-2023**




Source: AM Best data and research

## Secondary Perils Shifting Geographic Risk, Impacting Regional Carriers

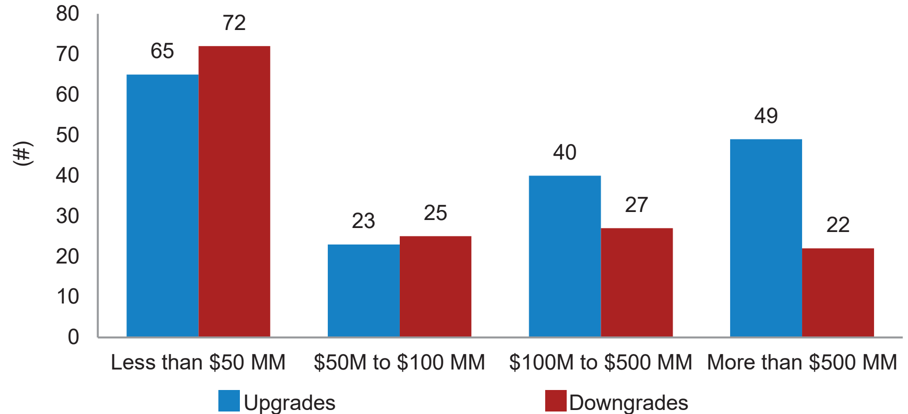
There has been an increased recalibration in geographical exposures among property insurers, as some companies have reduced activity, or even stopped writing business, in states prone to natural disasters, such as Florida, California, and Texas. Companies domiciled in these three states have accounted for more than a quarter (27%) of downgrades over the last three years, driven largely by personal lines carriers (**Exhibit 5**). Additionally, secondary perils such as wildfires, tornados, and severe thunderstorms have become more common in the West, South, Southeast, and the Great Lakes regions, with impacts on ratings.

Secondary perils are accounting for a larger share of the losses from catastrophes than even primary perils such as hurricanes, and in states that have not historically frequently experienced such perils or losses. Single state and multi-state regional companies are seeing greater risks in such areas. Single state companies accounted for over a 28% of the downgrades over the last three years, while companies writing business in six states or fewer accounted for 60% (**Exhibit 6**).

Many carriers continue to pursue rate adequacy in response to rising loss severity, but staying ahead of current trends has been challenging. However, some jurisdictions have been more accommodating of late. Carriers ahead of the curve in terms of rate adequacy and pricing sophistication maintain a competitive advantage. Catastrophe bonds (cat bonds) and reinsurance are valuable tools for insurers looking to manage catastrophe risk, improve capital efficiency, and diversify their risk portfolios. Despite some challenges, the benefits of liquidity, cost-efficiency, and risk transfer make cat bonds an attractive option in the evolving risk landscape.

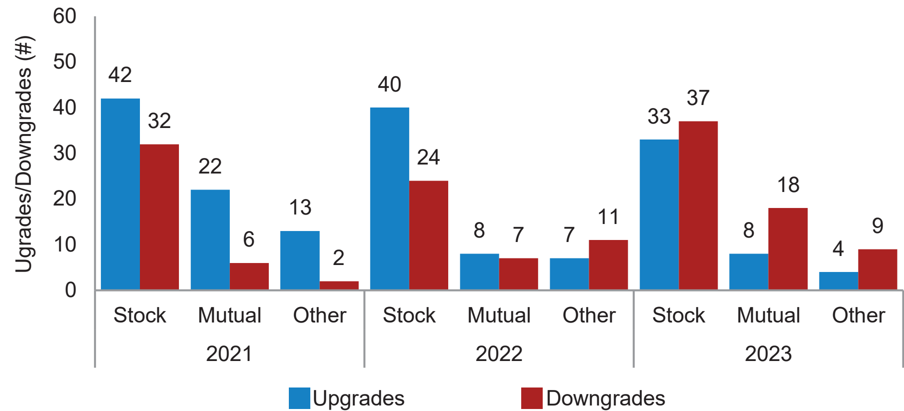
ICR changes have occurred to companies both large and small, regardless of capital size. However, companies with less than $100 million of capital and surplus experienced a higher number of downgrades than upgrades over the last three years (**Exhibit** 7). These companies tended to be regional commercial or personal lines writers.

Exhibit 7
**Rating Changes by Capital and Surplus, 2021-2023**



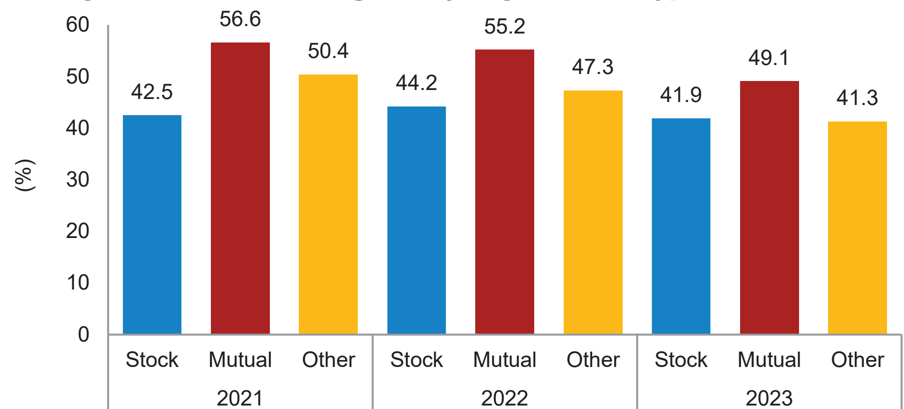

Source: AM Best data and research

Exhibit 8
**ICR Changes by Organization Type**




Source: AM Best data and research

Exhibit 9
**Average BCAR Score VaR @99.6 by Organization Type**




Source: AM Best data and research

## Mutuals' Business Mix Leans Toward Personal Lines

Business mix can intersect with organizational structure. P/C mutual organizations derive 62% of their premium from personal lines, notably higher than the 39% for stock companies. The larger concentration in personal lines has impacted underwriting results, and although mutual organizations still received more upgrades than downgrades over the last three years, reflective of strong balance sheets with higher Best's Capital Adequacy Ratio (BCAR) scores than stock companies, 2023 saw more downgrades than upgrades (**Exhibit 8**).

Mutual companies generally take a longer-term view with respect to operating performance, emphasizing the preservation of capital over time. Holding more capital—as the generally higher BCAR scores for mutuals attest—tends to suppress return measures but also serves to cushion against fluctuations in underwriting results (**Exhibit 9**).

Accumulating underwriting losses, however, can deplete capital. Many rated mutuals have faced challenges in recent years when renewing reinsurance programs. Reinsurers have demanded price increases, especially in catastrophe-affected states, as well as tighter terms and conditions.

Published by AM Best

BEST'S SPECIAL REPORT

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Version 011624**