

*Our Insight, Your Advantage®*Financial Review  
April 28, 2025

**Elevated  
catastrophe losses  
(P/C), rising medical  
and pharmaceutical  
costs (health), and  
higher interest  
rate environment  
(L/A) among key  
challenges insurers  
have overcome  
in recent years to  
meet cost of capital**

## Insurers Exceed Cost of Capital Across Segments

### Principal Takeaways

- P/C insurers generated high investment returns to exceed the cost of capital in 2024, despite high catastrophe losses.
- Health insurers continue to outpace their cost of capital amid rising medical costs.
- Life insurers were able to meet their increased cost of capital.

Whether or not the returns an insurer generates meet the cost of capital is a useful benchmark for that insurer's performance. The cost of capital is a measure of how much in returns investors can expect to be compensated for their investment. It considers the cost of debt and cost of equity, with weights relative to an individual company's dependence on each method of raising capital, as well as a risk factor based on the company's risk profile. Since investors have a wide array of options for the deployment of their capital, the cost of capital captures the opportunity costs to an investor associated with other foregone choices, along with the risks associated with the chosen investments. Higher-risk investments require higher returns to attract capital.

### Property/Casualty

During the past few years, P/C industry results have been negatively affected by elevated catastrophe losses and by the increase in both the frequency and severity of secondary perils. Two major hurricanes, severe convective storms, winter weather events, and wildfires in New Mexico led to significant insured property losses in 2024. Despite these catastrophe events, the US P/C market recorded an underwriting gain of approximately \$22.9 billion, a significant improvement over a \$21.3 billion underwriting loss in 2023. Improved performance in the personal lines segment, specifically private passenger automobile, is primarily responsible for the turnaround in underwriting. While insurers have experienced significant underwriting losses in recent years, investment income has been strong, and insurers have posted positive operating income despite underwriting losses. P/C insurers have been able to take advantage of a higher federal funds interest rate to reinvest bonds at a higher rate, and insurers' diversified equity portfolios also boosted investment income materially. The total P/C industry is estimated to have increased investment income by 15% in 2024.

P/C insurers' ability to navigate turbulent waters can be seen in the median return on capital employed (ROCE) surpassing the median weighted average cost of capital (WACC) for four of the past five years, while having the highest median ROCE in over a decade at 13.2% (**Exhibit 1a**). ROCE represents an insurer's ability to generate profits from its capital base, including both debt and equity. Cost of capital measures the return expected by investors for the equity provided, determined by the cost of debt, cost of equity, and the risk factor of the individual

#### Analytical Contact:

Helen Andersen, Oldwick  
+1 (908) 882-1629  
Helen.Andersen@ambest.com

#### Contributors:

David Blades, Oldwick  
Sridhar Manyem, Oldwick

2025-065

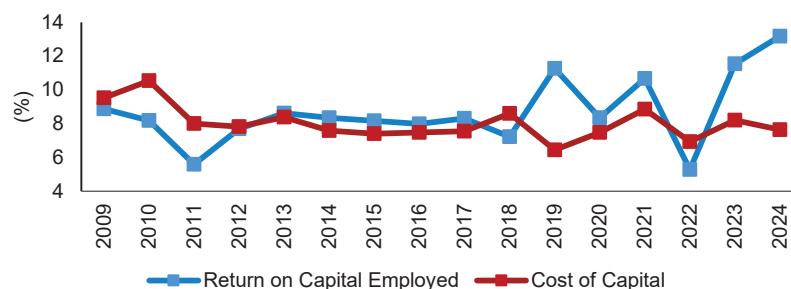
business. It reflects prudent investment strategies and effective risk management that P/C insurers have exceeded their cost of capital despite the prevalence of natural disasters in 2023 and 2024. WACC is calculated using a weighted average of cost of equity and cost of debt, based on the relative proportion of financing from each source.

Similarly, return on equity has also increased to 14.9%, a new high for more than a decade, exceeding the cost of equity at 8.1% (**Exhibit 1b**). Unlike ROCE, Return on Equity (ROE) does not include yields on any form of debt in its calculation. The robust performance of the equity market in 2024 drove a decrease in the cost of equity, which in turn lowered the overall cost of capital.

### Health

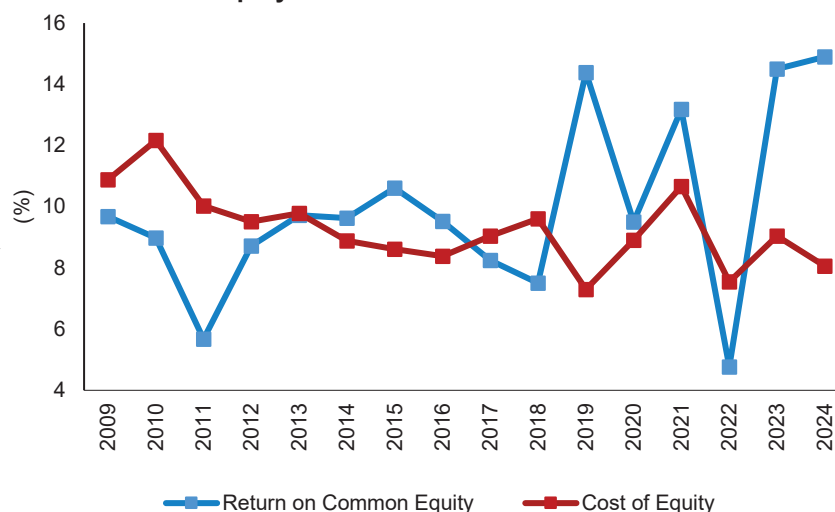
Health insurers have consistently exceeded their cost of capital over the past 15 years. The median ROCE has steadily decreased over the past four years but still surpassed the median WACC by about 2.5 percentage points (**Exhibit 2a**).

**Exhibit 1a**  
**P/C Insurers' Median Return on Capital Employed to Median Cost of Capital**



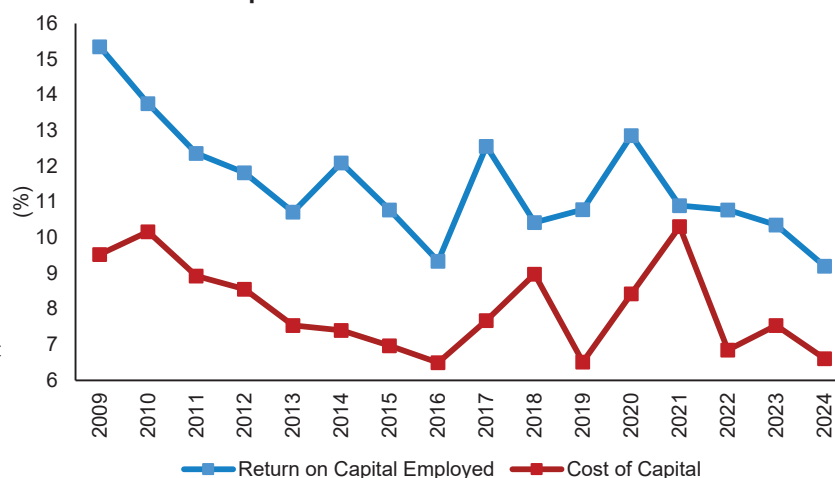
Source: Bloomberg

**Exhibit 1b**  
**P/C Insurers' Median Return on Common Equity to Median Cost of Equity**



Source: Bloomberg

**Exhibit 2a**  
**Health Insurers' Median Return on Capital Employed to Median Cost of Capital**



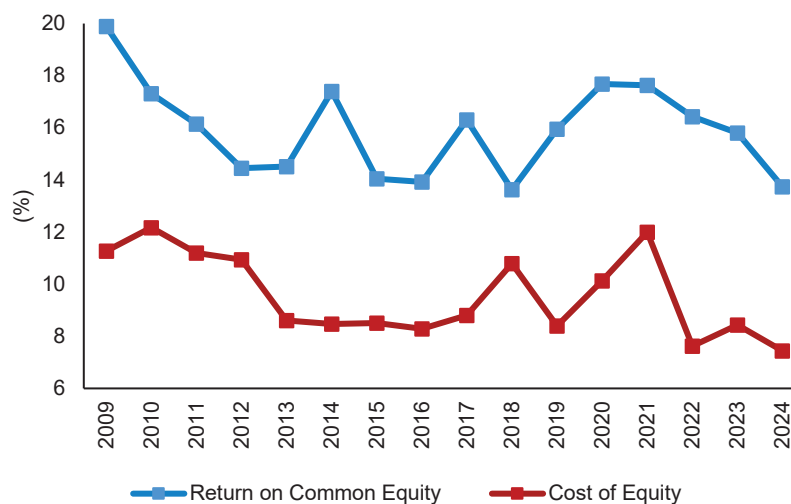
Source: Bloomberg

The decline in health insurers' returns has been driven by rising medical and pharmaceutical costs, in conjunction with higher claims. Health insurers experienced historically high earnings in 2020-2022, as the COVID-19 pandemic drove many people to delay non-urgent care, and redeterminations for Medicaid eligibility were postponed, leading to additional premiums and lower costs for government business.

In 2024, however, government business was pressured, with utilization returning to pre-pandemic levels, lower than expected reimbursements for Medicare Advantage, and higher acuity in Medicaid due to eligibility redeterminations disenrolling healthier members. Necessary rate increases have lagged, which has led to pressure on profit margins in government business. In the commercial segment, however, rate increases have kept pace with rising cost trends, and as a result drove a greater percentage of earnings.

Health insurers' net investment income remains strong. Health insurers' portfolios consist primarily of high-quality fixed-income securities, although 2024 saw a mild shift from bond holdings to equities. The median ROE for health insurers in 2024 was 13.7%, the lowest it has been since 2018, but still comfortably exceeded the median cost of equity by a margin of 6.3 percentage points (**Exhibit 2b**).

**Exhibit 2b**  
**Health Insurers' Median Return on Common Equity to Median Cost of Equity**

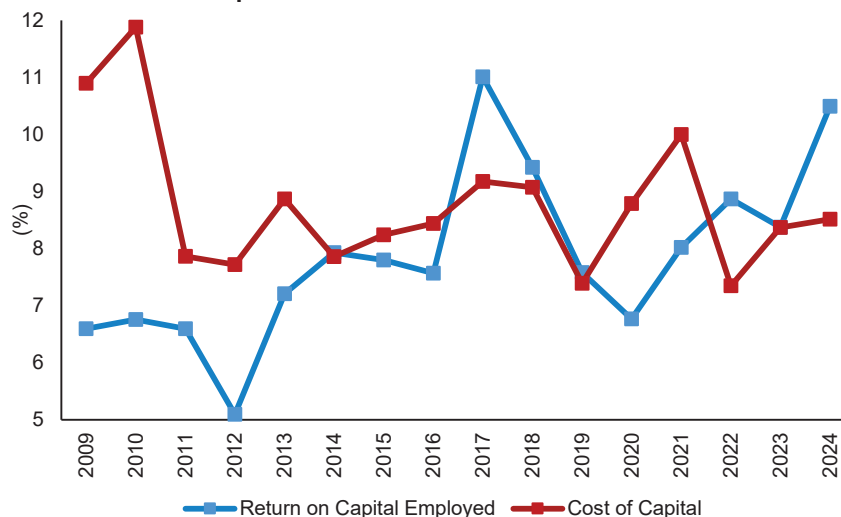


Source: Bloomberg

### Life/Annuity

As a very long-tailed line, the L/A segment is heavily reliant on investments to generate operating returns and is significantly impacted by interest rates. The higher interest rate environment of the past few years has allowed L/A insurers to grow premiums, especially in annuities, where better investment yields allow writers to provide more attractive crediting rates. Reinvested cash flows in higher-yielding assets to take advantage of higher

**Exhibit 3a**  
**Life Insurers' Median Return on Capital Employed to Median Cost of Capital**



Source: Bloomberg

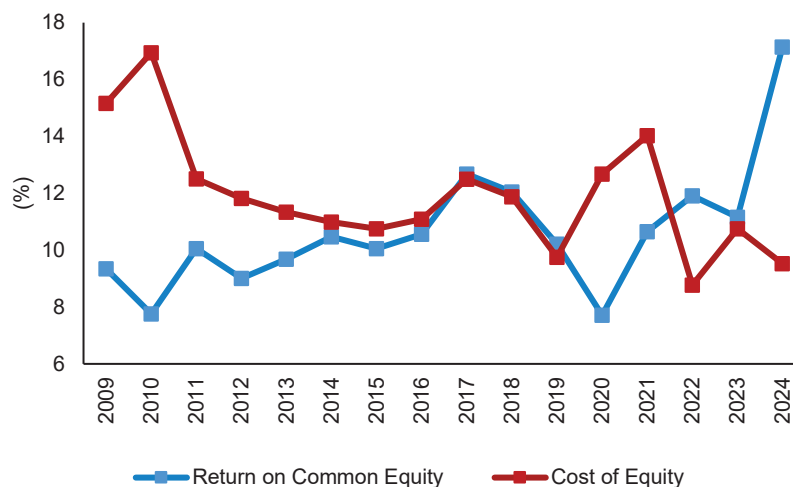
interest rates also led to an increase in investment income. Increased premiums, as well as an increase in invested assets, drove higher returns in 2024, and life insurers exceeded their cost of capital by about two basis points, 10.5% ROCE compared to 8.5% WACC (**Exhibit 3a**).

Unlike the health and P/C segments, the median WACC for L/A writers did not decline in 2024, despite a similar decrease in cost of equity (**Exhibit 3b**). The L/A segment's return on equity outperformed its cost of equity capital by close to 800 bps, the strongest outperformance over the past fifteen years, driven by rising interest rates, as US consumers

were attracted to the rates offered by annuity products. Insurers with such strong performance and robust capital positions have an implied reduced risk of default, potentially driving down the cost of debt and making equity financing less expensive. In general, life insurers are more asset-intensive so their cost of equity is more correlated with equity market volatility. After the financial crisis of 2008-2009, life insurers consistently underperformed due to low interest rates, creating pressure on spread income and making annuity products relatively unattractive. This changed in the recent past as the Fed rate hikes since 2022 have boosted annuity sales and provided more spread.

Median return on equity increased significantly for public life insurers in 2024. ROEs were significantly lower for mutual life insurers, who typically hold more capital and pay higher dividends and benefits, as well as life insurers owned by private equity.

**Exhibit 3b**  
**Life Insurers' Median Return on Common Equity to Median Cost of Equity**



Source: Bloomberg

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 James Gillard**  
**EXECUTIVE VICE PRESIDENT & COO Stefan W. Holzberger**  
**EXECUTIVE VICE PRESIDENT & CSO Andrea Keenan**  
**EXECUTIVE VICE PRESIDENT & CIO James F. Snee**  
**SENIOR MANAGING DIRECTOR & CHIEF RATING OFFICER Kenneth Johnson**  
**SENIOR MANAGING DIRECTOR Edward H. Easop**

**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, Alcaldía 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 credit-worthiness 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.