September 18, 2023

Market Segment Outlook: US Homeowners

The outlook is moving to Negative from Stable owing to deteriorating underwriting performance

AM Best has revised its outlook for the US homeowners segment to Negative from Stable, based on the following factors:

- Net underwriting results deteriorated owing to elevated natural catastrophes and secondary perils.
- Rising loss costs, inflation, and supply chain disruptions are pressuring earnings, making it difficult to maintain rate adequacy.
- Reinsurance market conditions remain firm, with material changes in pricing, terms and conditions, and attachment points.
- Several market leaders have curtailed new business in catastrophe-exposed states.

Factors offsetting these negative pressures include the following:

- Risk-adjusted capitalization remains solid for most insurers with sufficient liquidity, but the capital cushion for some insurers has started to erode.
- Technology adoption is accelerating, accompanied by improved catastrophe risk management practices.

The revised outlook for the homeowners segment reflects several ongoing challenges that have dampened results in recent years. Carriers that were already contending with headwinds such as above average catastrophe activity, inflationary pressures, and elevated reinsurance costs are being further challenged by more frequent secondary weather perils and higher retentions and co-participation given reinsurance pricing trends. In 2022, the segment incurred a net underwriting loss for a third consecutive year, with inflation causing underwriting expenses and loss adjustment expenses to rise to five-year highs. Above-average cat losses in the first half of 2023 from severe convective storms and secondary perils will likely pressure year-end 2023 underwriting results. Homeowners carriers will find it difficult to absorb these underwriting pressures while strengthening their balance sheets. A return to underwriting profitability over the near term appears highly unlikely.

Heightened Catastrophic Loss Volatility

Calendar year 2023 has already been active, highlighted by losses from Hurricane Idalia, the Lahaina wildfire disaster in Hawaii, atmospheric rivers in California, severe convective storms across several southern US states, and flooding rains in the northeastern US. Catastrophe losses and secondary perils are expected to remain above normal for the rest of 2023 Atlantic hurricane season, according to the National Oceanic and Atmospheric Administration (NOAA).

Hurricane Idalia made landfall as a Category 3 storm in Florida's Big Bend area along the Gulf Coast, the strongest storm to hit that part of the state in 125 years. As we indicated in *Florida*

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Losses from Hurricane Idalia Are Unlikely To Match Hurricane Ian's (September 1, 2023), the storm will most likely be an earnings event for the industry. According to BMS, estimated insured losses are expected to be in the range of $3 billion to $5 billion.

Inflationary Pressures and Rate Adequacy Challenges

With inflationary pressure still prominent in the third quarter of 2023, loss costs continue to rise. Supply chain and labor shortage issues have further contributed to the rise in loss costs and challenged reserving practices for many carriers. These factors are having an adverse impact on the operating performance of the segment.

In response to the ongoing market challenges, many carriers have generally addressed rate needs through both rate increases and inflation adjustment factors. Although rate momentum started accelerating in late 2020 and has continued into the third quarter of 2023, maintaining rate adequacy remains a significant challenge. Furthermore, 12-month policies add to the challenge of effectively responding to accelerating loss cost trends. As a result, the impact on reported results will be moderate over the near term.

In response to the rate adequacy trends, some market leaders have curtailed new business in cat-exposed areas, citing escalating construction costs, heightened cat risks, and elevated reinsurance costs. Three of California's top five homeowners insurers (State Farm, Allstate, and Farmers) have closed or limited access to new policyholders. Some carriers have placed a moratorium on new Florida homeowners business over the past 18 months. During that period, several companies not rated by AM Best have been declared insolvent.

Reinsurance Costs Remain Elevated

Reinsurance costs have risen owing to several years of poor performance, driven by natural catastrophes, growing secondary perils, and elevated claims costs attributable to the rising cost of construction materials. As reinsurers increase rates, limit capacity, and tighten terms and conditions, the challenge for primary insurers in cat-prone states will continue to grow.

Reports indicate that mid-year reinsurance placements were less chaotic than the January 2023 renewals but remain challenging from a pricing perspective. Although pricing was particularly strong in cat-exposed areas, reinsurers have generally started to realign their risk profiles with a greater focus on generating underwriting profits, which have been elusive for a number of years. AM Best believes that higher rates will persist over the near term.

Risk-Adjusted Capitalization Still Solid

Despite the operational challenges segment carriers face, overall risk-adjusted capitalization remains solid for most homeowners insurers due to their risk management best practices to protect their balance sheets. Companies remain vigilant in assessing their rate needs, pushing for increases where pricing is inadequate. However, the capital cushion of some companies, especially those in cat-exposed areas, has started to erode due to the persistent underwriting losses in recent years. With companies increasing their reinsurance retention and co-participation levels because of reinsurance market conditions, cat activity is having a larger negative impact on results. In some cases, this is driving increases in overall underwriting leverage, pressuring capital assessments.

Accelerated Technology Adoption and Catastrophe Risk Management

In light of the evolving risk environment, insurers have accelerated their shift to digital technology and intensified their focus on product innovation. Because the homeowners line deals with large homogeneous risks, initiatives can be scaled and replicated relatively easily. Pricing sophistication has helped carriers in their pursuit of rate adequacy. By leveraging proprietary underwriting models and technology platforms, top performers have been able to customize coverage for the right price. New technologies can strengthen risk selection and mitigation, enhance claims processing, lower expense and service costs, and improve product offerings. As distribution channels transition from being product-focused to customer-oriented, improving the customer experience has been a top priority for leading segment carriers. The homeowners segment continues to face various challenges, but the focus on technology and catastrophe risk management may provide a path going forward.

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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