AM Best
December 2024

Best's 2025 Market Segment Outlooks

Table of Contents

November 20, 2024

Market Segment Outlook: Global Reinsurance

The outlook for the segment remains at Positive, owing to strong underwriting profit margins, stable property rates and terms, and solid capitalization

AM Best is maintaining its outlook for the global reinsurance segment at Positive, driven primarily by the following factors:

- Underwriting profit margins remain robust, despite second half 2024 losses from Hurricanes Milton and Helene. Full year 2024 is anticipated to be another solid year for the reinsurance industry.
- Property rates and terms have been relatively stable and are unlikely to soften over the near term, owing to hurricane activity in 2024.
- The segment remains well capitalized, with no new players expected to disrupt current market discipline. Consolidations and flights to quality are more likely.
- Demand for coverage remains strong, and possibly even growing, due to heightened natural catastrophe loss activity and general economic and political uncertainty.
- Higher interest rate yields are beginning to earn out, increasing investment income and bolstering total returns.
- Concerns about adverse reserve development in US casualty reserves have become a prominent discussion point for 2025 renewals, with continued adverse development causing many reinsurers to re-evaluate their positions.
- The global life/annuity and health reinsurance segments remain well capitalized and positioned for robust growth.

Technical Margins Remain Resilient Despite More Severe CAT Losses

Reinsurers' underwriting margins have improved steadily since 2021, with substantial improvement to rates and terms following the market dislocation in 2023. In 2023, the global reinsurance segment generated one of its best years in recent history, with several large reinsurers reporting combined ratios below 90.0 and returns on equity exceeding 20%. Much of the improvement came by way of improved property reinsurance results, aided by higher attachment points, which limited frequency of losses. Through the first nine months of 2024, global reinsurers continue to benefit from improved underwriting margins. AM Best's large European reinsurer and US & Bermuda reinsurer composites reported first-half 2024 combined ratios of 82.3 (IFRS 17) and 85.8 (GAAP). However, some minor deterioration is likely as a result of Hurricanes Helene and Milton in the second half of the year, although full-year results are still expected to be generally favorable.

The US 2024 hurricane season was forecast to be an active one and has been thus far. Both the frequency and magnitude of hurricane events have been above average. However, the market has been fortunate to some extent, as many of the events' paths altered right before landfall, redirecting them to less populated areas. Additionally, much of the loss due to Hurricane Helene were related to flood and storm surge, which is typically not covered by commercial insurers. Nevertheless, reinsurers expect to bear some losses from both Helene and Milton. We expect the

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2024-138

two will have an impact on third- and fourth-quarter earnings, but reinsurers should generally still report profitable full-year results for 2024.

The hurricane losses in the third and fourth quarter are unlikely to result in further hardening in the reinsurance market. Although reinsurers will participate in these losses, they are not out of the scope of what reinsurers are pricing for. Reinsurers expect they will need to occasionally fund losses for traditional CAT events such as hurricanes, if they are able to avoid losses related to secondary perils that are not priced within the coverage. These hurricanes should ease some of the tensions that have built up in recent years among cedents and reinsurers about the inequality of loss assumptions following a rise in more frequent and less severe events. Although pricing is not expected to increase, we do believe that reinsurers will be able to avoid any softening in property reinsurance rates for at least the next year or two. With property reinsurance expected to remain relatively stable in 2025, non-life reinsurers have diverted much of their focus to casualty renewals.

Casualty Business in the Cross Hairs

AM Best's positive outlook for the global reinsurance segment has been driven largely by the tailwind in property reinsurance, with the only major headwind being some uncertainty about casualty business—specifically, US casualty social inflation trends. Despite generally strong operating results in 2023, several reinsurers reported adverse casualty reserve development at year-end. This development was driven by accident years 2019 and prior, with the indication being that accident year 2020 showed significant improvement as a result of market shifts in underwriting that year. Additionally, much of the adverse development in casualty was offset by redundant reserving in property lines.

As Monte Carlo concluded in 2024, casualty lines were a point of emphasis for the upcoming renewals. Many reinsurers have indicated diminished appetite in various 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.

The issue with casualty is that changes have a slower impact than they do in shorter-tailed lines such as property. Through the first nine months of 2024, a few large reinsurers had already reported substantial amounts of prior year development in their casualty books. Others have publicly announced increases in their loss picks in casualty as well, pointing to an overall deterioration in casualty underwriting margins. The most concerning aspect of these actions is that development has now extended into years such as 2020 and 2021. Additionally, we have witnessed historic material reserve actions in line with annual reviews, so there remains further risk of material development in the market for 2024. This will likely cause some reinsurers to re-evaluate their casualty positions during the January renewal cycle and could constrict capacity for primary companies.

Life Re Is Steady

Life insurance remains a good source of diversification for the large global reinsurers. The global L/A and health reinsurance segments continue to remain well capitalized and positioned for robust growth. Claims from elevated mortality impacts have been manageable, but pinpointing direct causes and future directions has been difficult, although claims have recently leveled off. In the meantime, reinsurers continue to evaluate underwriting practices, including premium rate increases to help mitigate the impact of higher claims. Reinsurers are also looking at emerging trends such as artificial intelligence and digitization to see what kind of role they will play in the future of the industry.

Higher Rates Earn Through

One of the motivating factors for the initial shift to the Positive outlook for global reinsurance was the sustained higher interest rate environment. Not only has the higher cost of capital translated into stricter underwriting discipline, but as new money has been invested in higher interest rate fixed-income instruments, reinsurers have gradually improved their investment income streams. Although rates have declined, they remain higher than the rates on most of the older maturing bond issuances in reinsurers' portfolios. Some reinsurers lengthened durations as rates rose, although non-life portfolio durations generally remain within three to five years. With rising geopolitical tensions, the recent US elections, and general economic uncertainty, future interest rate trends are far from clear. However, reinsurers will collect relatively higher levels of dividend and interest income for at least the next three to five years.

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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2024-144

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.

December 2, 2024

Market Segment Outlook: US Personal Lines

The outlook for the personal lines segment improves to Stable owing to improved rate and pricing conditions, particularly in the auto space, as well as solid risk-adjusted capitalization, among other factors

AM Best's outlook for the US personal lines segment has been revised to Stable from Negative, in line with a corresponding change in the personal auto outlook to Stable from Negative. In March 2024, the outlook for the homeowners line remained at Negative. The revised outlook reflects the following factors:

- An aggressive push for rate and improved pricing segmentation has led to improved underwriting performance, particularly for personal auto writers
- More accommodating regulatory treatment of rate requests
- Solid risk-adjusted capitalization with sufficient liquidity
- Rising investment yields as lower-yielding bonds mature and are reinvested at higher rates
- Accelerated technology adoption
- Improving catastrophe risk management practices

Factors counterbalancing these positives include the following;

- Ongoing volatility in reported results, particularly for the homeowners line of business
- Elevated loss cost severity owing to inflation and more expensive parts in newer vehicles
- Heightened severe weather activity
- Elevated reinsurance costs and tightened terms and conditions, including higher overall retentions and co-participation on property lines, driving higher net losses

Rate and Refined Underwriting Gain Traction

The Stable outlook on the personal lines segment follows a similar change in the personal auto outlook as the subsegment reflects over half of the premium in the personal lines space. Personal lines carriers were met with multiple challenges after the onset of the COVID-19 pandemic in 2020 significantly increasing loss costs. Factors contributing to higher costs include the economic impact of inflation in various areas (repair parts, labor, medical costs), supply chain disruptions, higher incidence of fatalities/severe injuries, more advanced technology in newer vehicles, and elevated jury awards in litigated claims. Although post-pandemic repair times remain somewhat elevated, pressures have eased as inventory rebounded moderately. The availability of qualified labor, however, remains an area to monitor. Nonetheless, carriers recognized the need to respond by aggressively pushing for higher rates to better account for these more volatile trends.

Large rate increases have been achieved over the last two years, appearing to get to a more adequate position particularly within personal auto. Given the different state regulations across the US, rate increase approvals have varied. Most state governments have understood the need for large rate increases given the macro-economic influences carriers have had to contend with. As a result, many large rate increases have been implemented across portfolios with some jurisdictions becoming more accommodating, to both reflect current conditions and, in part,

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2024-146

protect availability of coverage within their states. The process was often lengthy as regulatory bodies reviewed an influx of requests prior to approval, creating a backlog. Material rate increases have become more the norm as carriers opted for the quickest path to adequacy, a change from prior years, where reducing market disruption and stair stepping rates was more of a focus. On the homeowners side, in addition to base rate changes, several carriers have increased inflation guard factors and made a concerted effort to correct insurance-to-values for current standards.

Carriers refined underwriting practices to not only better match rate to risk on a more granular basis but to also hone risk appetites and cull books of risks that sat outside of established risk-tolerance levels. Greater focus on risk segmentation and tiering has translated into more sophisticated rating algorithms. Carriers recognized the need to evaluate credit risk, age of drivers, limits and coverages purchased, miles driven, specific vehicle characteristics, and many other qualities on a more detailed basis to more effectively capture expected loss costs and exposure. A by-product of re-underwriting is that several carriers stopped writing new business, did not renew portions of their portfolios, or pulled out of certain areas and lines entirely. This was more apparent in the homeowners segment. As a result of deep dives into nationwide portfolios leading to non-renewals and more limited capacity, coupled with large rate increases, insureds began to shop for coverage more often. The behavioral shift created a need for primary carriers to protect portfolios through more advanced and rigorous vetting processes to protect against adverse selection. More robust controls during the quote and binding process were implemented to ensure efforts to refine active books of business and diligently manage the trajectory of growth (or strategic shrinking) were not undone by volatile new business.

Collectively, actions have led to meaningful improvement in the direct loss ratios for both personal auto liability and physical damage. Conversely, homeowners carriers remain challenged by elevated severe weather activity, adjustments to reinsurance pricing and programs, and the negative impact of inflation on loss costs, driving a higher level of loss experience compared to prior years. In many cases, personal auto policies benefit from six-month terms, which allows carriers to implement rate changes more quickly than for a 12-month policy commonly issued in the homeowners space.

Adjusting to a New Normal

Over the past few years, US personal lines carriers have dealt with considerable disruption, from elevated severe weather activity to increased reinsurance costs to the compounding impact of inflation. Throughout this turbulent period, many carriers persevered despite escalating losses. Carriers remained nimble as they implemented corrective actions. While not all fared well, with a number of ratings downgrades occurring and weaknesses for some exposed, the segment overall maintained solid risk-adjusted capitalization. Still, the capital cushion for some companies eroded materially due to sizable operating losses, elevated reserves related to inflationary factors, changes to reinsurance protections, or a combination of all three. However, not all economic changes created headwinds for carriers. One particularly favorable change was the rise in interest rates. Traditionally, carriers's investment portfolios focused on fixed-income securities, which have historically offered low returns in a low interest rate environment. The economic shift to higher interest rates as a means to combat inflation favorably influenced the interest rates offered on bonds, increasing net investment income for many carriers as they invested cash. Higher investment income helped offset underwriting volatility, improving bottom-line results. With carriers locking in higher rates for longer terms, the benefit should continue.

The ability for carriers to absorb the financial impact of severe weather events while keeping balance sheets intact remains critical. Many carriers have re-evaluated geographic and product concentrations to more adequately manage capital. Actions taken include de-risking areas of high geographic concentration or those risks that have a disproportionate impact on modeled losses, strategic agency management, new business moratoriums, greater review of bound risks through inspections, and rate changes.

Technology: A Double-Edged Sword

Management teams adopted sophisticated technological and data capture capabilities to enhance risk exposure analyses. Technology has paved the way for more advanced data analysis, particularly surrounding risk accumulations and identification, enabling more proficient portfolio management decisions. Personal auto has achieved success as many carriers had already implemented systems upgrades, allowing rates to be quickly adjusted to appropriate levels.

Carriers are deploying data analytics to refine risk portfolios and avoid premium leakage. They are including a greater number of risk characteristics into rating algorithms, leveraging data automation to populate and verify critical information and placing greater emphasis on those indicators that are driving loss. Telematics and usage-based insurance show promise in measuring real-time driving behavior and miles driven. On the personal property side, the advent of aerial imagery from drones has given carriers greater ability to review properties and identify roof damage or nearby hazards.

Successful carriers have implemented technology to support rate revisions, re-underwriting, and, when necessary, de-risking. The personal auto space has benefited in the past from leveraging technology, particularly in the underwriting process, allowing the segment to more nimbly react. Updating legacy systems has long been an action item for many carriers. Those with an established system were better-positioned to capitalize on the competitive advantage and more quickly course correct.

Technology, however, is a double-edged sword, offering ways to improve operations and risk selection while simultaneously making risks costlier. More advanced safety features help reduce accidents and injuries, but also increase repair costs through more expensive parts.

Severe Weather Continues To Impact Property Losses

The story remains relatively the same for weather-related loss activity, as the cost and frequency continues to be a significant issue for primary carriers, particularly in the homeowners space. In 2023, the US experienced more billion-dollar events than in any other year on record, and activity has remained elevated throughout 2024. In addition to Hurricanes Milton, Helene, Debby, and Beryl, US losses have also been significantly influenced by severe convective storms. The greater frequency of impactful weather events is influenced by a number of factors: buildup of infrastructure and populations in areas prone to severe weather, the inflationary impact on materials and labor, and shifting weather patterns. Of note, tornado alley in the US has been shifting beyond the Great Plains area, expanding to include the Midwestern and Southeastern US. The distinction between primary catastrophe perils (hurricanes and earthquakes) versus secondary perils (severe convective storms and wildfires) has become less important, with secondary peril activity rising and accounting for a greater share of losses than in past years. A company's enterprise risk management and catastrophe mitigation plans now need to account for smaller storms that generate large losses, equalizing the importance of secondary peril exposure to their primary counterparts.

Reinsurance Reimagined

Greater weather-related losses led to reinsurers taking on above average losses compared to historic norms, translating into a hardened reinsurance market as reinsurers refreshed their appetite and pricing to account for a changing environment. The ability to procure reinsurance protection dramatically shifted, with rates rising considerably the past few years. While the cost of reinsurance appears to be stabilizing, the new price tag created an imbalance in the economics of the personal lines carriers. Carriers altered programs to maximize the benefit while addressing increased costs, along with passing on the higher cost to insureds through rate increases. These adjusted programs often come with higher levels of retention and co-participation, leading to primary carriers taking on more losses and potentially exposing balance sheets to greater shock losses.

The personal auto space is comparatively less impacted by severe weather events and does not generate the same level of need for reinsurance protection as the homeowners line of business, nor the same level of required capital. Reinsurance pricing more profoundly impacts the rate adequacy of property policies, prompting a greater level of attention to property risk accumulations. The cat load of a risk, and its associated cost, has become a more prevalent factor when making underwriting decisions as it will directly influence modeled losses and the amount of reinsurance protection required to appropriately protect surplus positions.

Looking Forward

AM Best's market segment outlook takes into account the impact of current trends on companies operating in a particular segment over the next 12 months, and how companies manage these factors and trends. The Stable outlook for the personal lines segment indicates that AM Best expects market trends to have a neutral impact on companies operating in the segment, but it does not mean that all companies operating in the segment also have a Stable outlook. Carriers that have been slow to address the challenges or do not have the means, expertise, or technological capabilities to keep pace with changes will likely face ratings pressure while those that have been able to capitalize on past efforts to modernize and stay ahead of trend may benefit from effective management.

December 3, 2024

Market Segment Outlook: US Life/Annuity Insurance

AM Best is maintaining its Stable outlook owing to strong capitalization industry-wide, top-line growth in most core lines, and consistent profitability

AM Best is maintaining its Stable outlook for the life/annuity segment, supported by the following key factors:

- Strong capitalization across the industry
- Top-line growth in most core lines of business
- Consistent profitability

Factors offsetting these tailwinds include the following:

- Increased allocations to higher risk assets
- Potential for further lowering of rates
- Ongoing drag of legacy liabilities

The Stable outlook for the US L/A segment is supported by strong capitalization across the industry, robust top line growth in core lines of business, and consistent profitability. As in 2023, the overall L/A segment is strongly capitalized, with most companies maintaining more than adequate risk-adjusted capitalization. Top-line trends continue to be bolstered by favorable interest rates, resulting in record-high sales of individual annuities, which includes fixed index annuity products and strong registered indexed-linked annuities (RILAs) sales. Many L/A insurers have demonstrated innovative and value-added product design, introducing products to gain or maintain market share. Innovation provides a competitive advantage across the L/A marketplace and serves as a key differentiator. Growing market demand is further supported by the needs of the overall aging population.

The L/A segment has benefited from favorable interest rates in recent years, after an extended period of low rates in which companies were forced to invest premiums in somewhat riskier, higher yielding assets, to meet policyholder guarantees. Further rate cutting could place some pressure on sales of fixed products. In a declining interest rate environment, customers are not likely to surrender policies, which would benefit a company's persistency and assets under management. Also, with advances in digitalization, expenses are likely to moderately increase as companies seek to implement various initiatives. However, efficiencies would likely improve after the implementation phase. Prudently pricing their products while balancing customers' preferences and claim costs may challenge some carriers. There remains a need for some L/A insurers to reinsure legacy liabilities, taking advantage of third-party expertise to more efficiently manage capital. A material uptick in reinsurance activity has occurred in recent years to strengthen capital and manage reserves. AM Best continues to monitor companies with large blocks of legacy business, as well as those that are ceding material blocks.

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2024-142

Profitability

Profitability of the L/A segment for 2025 is expected to be mixed. Strong sales of individual annuities should continue into 2025, driven by the aging population, the potential for lower interest rates, and concerns about market volatility. However, products will need to continue to modernize. Although life product sales surged during the COVID-19 pandemic, life insurance sales have since moderated down and are expected to return to moderate growth levels in 2025. In addition, the industry is becoming more competitive as more players continue to enter the market and offer innovative products and services. Overall, the L/A segment is expected to experience a period of both consolidation and growth in 2025. Although there are challenges to address, the long-term outlook for the industry remains favorable, driven by the aging population and its need for financial security.

The L/A market has experienced notable shifts in profitability trends, primarily influenced by changes in interest rates and demographic factors. The increased demand for guaranteed income products, driven by a growing aging population seeking financial security in retirement, has bolstered profitability. Traditional life insurance and fixed annuity products rely heavily on fixed income investments. When interest rates rise, insurers see improved margins on new business as higher yields on bonds enhance returns on investment portfolios. However, the potential for falling interest rates will pressure the profitability of life insurance products. Regulatory changes could also have a negative impact on the industry.

Top-Line Trends

Challenges remain as companies navigate a competitive landscape and evolving consumer preferences. The ongoing pressure to innovate and offer more flexible, personalized products can increase operational costs. Additionally, regulatory changes and market volatility can impact profitability margins. Insurers are increasingly leveraging technology and innovation to streamline operations and improve customer engagement, which may help offset some of these challenges. Overall, while the L/A market shows promise in profitability, firms must remain flexible.

AM Best expects the popularity of hybrid annuities, combining life insurance and annuity features, to continue. Variable annuities with guaranteed minimum income benefits (GMIBs) may remain popular due to their potential for growth and income.

Most consumers prioritize income security and longevity risk protection. L/A insurers are developing tailored annuity solutions to meet these needs. Intense competition among annuity providers may lead to pricing pressures and product differentiation. Addressing misconceptions and improving consumer understanding of annuities will be crucial.

Private equity and asset manager (PE/AM)-backed insurers are playing a pivotal role in funding segment growth by investing in innovative technology, expanding distribution channels, and enhancing operational efficiencies. As companies in this segment adapt to changing consumer preferences and regulatory landscapes, PE/AM firms provide both capital and strategic expertise, enabling L/A providers to develop more personalized products, leverage data analytics for better risk assessment, and improve customer engagement through digital platforms. Additionally, PE/AM firms are increasingly pursuing mergers and acquisitions to consolidate their positions in a competitive market, ultimately driving innovation and growth.

Innovation

Insurers have been modernizing their operations to more effectively compete in the marketplace. Systems upgrades and customer-facing applications make the business process better for all parties involved. As another period of declining interest rates potentially approaches, insurers may look for other ways to boost efficiency. Many companies have been outsourcing services (including billing, policy administration, investment, and claims management) to third parties to reduce overhead costs and manage profitable, scalable growth.

Companies that are behind in digitization are at a competitive disadvantage. The speed of doing business is an absolute differentiator, particularly for insurers with large numbers of younger customers. AM Best continues to have regular discussions with company leadership on innovation capabilities and plans. The increased adoption of generative AI across the insurance industry may help companies operate more efficiently in the future. However, with the increased utilization of automation and generative AI also comes greater risk of cyber attacks. Risk management capabilities must strengthen and align with the innovations companies are implementing. Insurers will need to ensure that they have the appropriate talent to develop and incorporate generative AI for their future needs.

While companies may face challenges in the near term, there may be advantages for companies that have proven themselves nimble. As 2025 approaches, there is potential uncertainty in a variety of areas. Given the strength of the L/A segment's risk-adjusted capital position as well as its overall liquidity, AM Best believes that these challenges will remain manageable. AM Best maintains the right to revisit the outlook if any of the risks become elevated outside of expectations.

November 21, 2024

Market Segment Outlook: Delegated Underwriting Authority Enterprises

The outlook for the global DUAE segment remains at Positive, owing to sustained growth and niche expertise, despite potential capacity challenges

AM Best is maintaining its Positive outlook for the global delegated underwriting authority enterprises (DUAE) segment, owing to the following key factors:

- DUAE distribution channel's sustained growth and resilience globally
- Niche expertise and tailored solutions for specialty lines and emerging risks
- Continued investment in talent and technology, which supports versatility

Factors countering these positives include the following:

- Capacity challenges
- Additional scrutiny of DUAEs by market participants

DUAE Distribution Channel's Sustained Growth and Resilience Globally

DUAEs have established themselves as an important distribution channel for insurers over the business cycle. The channel continues to increase its market share, supported by strong and sustained premium growth globally. Accompanying the segment's robust premium growth is the rising number of DUAEs, as the market continues to attract new entrants. Capacity for the DUAE segment benefits from ongoing material growth in the excess and surplus (E&S) market, as elevated catastrophe activity and the regulatory environment continue to direct more premiums into surplus line businesses. AM Best expects growth drivers—strong capacity, diverse capital sources, growing niche expertise, and continued investment in talent and technology—for the DUAE segment to remain largely consistent.

General optimism among insurers and reinsurers about DUAEs persists, with more strategic partnerships being formed between carriers and DUAEs. These strategic partnerships are generally longer-term and allow capacity support across lines of business, industries, and geographies, instead of simply by program. Supported by integrated structures of profit commissions and loss corridors, strategic collaborations demonstrate long-term commitment from both sides in creating mutually beneficial risk management solutions. The alignment of interests is further complemented by profit-sharing models, whereby DUAEs establish captives to assume risks alongside their carrier partners.

Niche Expertise and Tailored Solutions for Specialty Lines and Emerging Risks

DUAEs are increasingly proving their value in the E&S and specialty marketplace. The niche underwriting expertise offered by DUAEs, bolstered by proprietary technology and databases, allows them to develop tailored and creative solutions for hard-to-place risks. In addition to participating in traditional insurance markets globally, DUAEs find themselves in non-traditional spaces such as partnerships with fronting and hybrid fronting companies as well as start-up specialty commercial carriers. Non-traditional solutions such as collateralized reinsurance and

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2024-145

insurance-linked securities are used to supplement more traditional binding programs, effectively optimizing DUAEs' and their carrier partners' capital efficiency. The DUAE model allows carriers to reach niche markets without full exposure to market volatility—DUAEs extend their agility to their partners by offering carriers a cost-effective way to enter and exit new markets and take on different risks (or not). The specialized product, industry, and market knowledge that DUAEs bring to the table further strengthen their strategic value to their partners.

The segment's growing niche expertise is aligned with the insurance industry's growing demand for specialty products. As technological advancements and evolving market conditions give rise to more complex risks, DUAEs that can differentiate themselves through innovation and expertise will be better equipped to address these challenging and emerging risks. With the E&S market maintaining its growth momentum, conditions are ripe for the continued expansion of DUAEs. By developing programs that effectively link supply to demand in various specialty lines, DUAEs can capitalize on profitable opportunities overlooked by the traditional market. This leads to a reinforcing feedback loop that can generate favorable trends in both the E&S and DUAE segments over the near term.

Continued Investment in Talent and Technology Supports Versatility

Underpinning the DUAE segment's niche and versatility is its substantial and continued investment in technology. Free from legacy systems, DUAEs leverage data and analytics to promote better risk selection, build differentiated programs, streamline operations, drive product development, and nimbly scale up and down in response to market changes. Many DUAEs operate on proprietary digital platforms and use data-driven placement strategies to drive underwriting and distribution efficiency, while equipping their partners with value-adding, cutting-edge risk assessment tools. The segment's commitment to technological innovation has consistently attracted talent, funding, and strategic capacity.

Talent is drawn to DUAEs in a way that traditional insurers struggle to replicate. The industry's entrepreneurial culture appeals to professionals seeking a dynamic and flexible working environment, as well as ownership and growth opportunities. The heavy investment in technology attracts fresh talent from the tech industry. In addition, as demand for underwriters, especially those with niche expertise, remains strong, the DUAE model's low overhead costs (compared with insurers) allow DUAEs to offer competitive compensation packages that continue to lure specialized talent.

Capacity Challenges

The segment's strengthening ties to the E&S and fronting sectors can serve as a double-edged sword. As DUAEs increasingly become major players in these markets—which receive significant capacity support from reinsurers—they face a greater dependence on reinsurance. Given elevated catastrophe losses, reinsurance renewals may have higher costs as well as tighter terms and conditions. Reinsurance capacity constraints can negatively affect the DUAE market in the form of capacity tightening, compressed commission income, and narrowing underwriting margins, as well as weakened bottom-line performance. As collateralized reinsurers have become another important source of capacity for DUAEs, any reduction in their availability due to loss development, additional reserving requirements, or credit issues will negatively impact the DUAE market. Additionally, more stringent underwriting conditions in the Lloyd's market are suppressing growth in its delegated authority businesses, which is also pressuring capacity. Lloyd's remains the largest capacity provider for DUAE business, particularly in the US.

Additional Scrutiny of DUAEs by Market Participants

Internal governance and controls as part of risk management are critical to keeping pace with the DUAE segment's rapid growth. The fronting market's considerable expansion, execution risks for DUAE startup operations and fronting carriers, and the complexity of non-traditional instruments all warrant ongoing monitoring and scrutiny. Private equities' funding of DUAEs also calls for proper due diligence of DUAEs' sources of capital. In the UK, Lloyd's management has expressed concerns about the quality of its delegated businesses and called for caution in risk selection. Meanwhile, questions are being raised about regulatory compliance when it comes to UK DUAEs using overseas capacity providers that are not authorized to write business in the country.

DUAEs are subject to less stringent regulatory guidelines than insurance companies are, so upholding discipline in underwriting and reserving practices, building sound internal governance and enterprise risk management systems, conducting appropriate due diligence in their partnerships, and ensuring long-term alignment of interest are all the more important for market participants.

Moreover, there is less data transparency in the DUAE segment than in the traditional market. The need for prudence amid rapid growth can allow individual players to balance growth with stability of revenue, profitability, partnerships, and talent retention. It will also help enhance efficiency in the insurance marketplace as DUAEs remain a vital part of the ecosystem.

These are the key factors determining our outlooks at this time. AM Best reserves the right to revisit its outlook if any of the risks stated fall outside expectations.

November 26, 2024*

Market Segment Outlook: US Health Insurance

The outlook for the segment remains at Stable, owing to good capitalization and liquidity, favorable net investment income, and profitability, despite declining underwriting results

AM Best is maintaining its outlook for the US health insurance industry at Stable based on the following factors:

- Good capitalization and liquidity
- Solid commercial segment underwriting and earnings
- Moderating rate pressures at provider contract renewals
- Continued favorable net investment income, albeit at lower levels

Overall operating results remains favorable despite the following headwinds:

- Pressured Medicare Advantage and Medicaid managed care earnings
- Ongoing growth in the use of specialty medications and GLP-1s

In 2023, the US health insurance industry reported favorable overall earnings supplemented by positive net investment income, positioning plans to navigate the headwinds and narrowing profits margins in certain product lines. This trend continued through the first half of 2024, although declines in underwriting income were offset by a rise in net investment income and realized capital gains. We expect to see similar earnings trends in 2025, with a decline in overall underwriting income driven by lower results in Medicare Advantage (MA) and Medicaid managed care and by favorable earnings in the commercial segment. AM Best expects the US health industry to remain profitable overall in 2024 and 2025, although net income is expected to decline. Premium generation will continue to be supported by business expansion, the ongoing ageing-in of seniors into MA and premium rate increases, countered partly by a decline in Medicaid managed care due to a drop in enrollments.

Industry Remains Well Capitalized

Persistently favorable earnings have allowed the industry to accumulate capital, bolstered by the five-year compounded annual growth rate in 2023 for capital, which outpaced net premium, further improving risk-adjusted capitalization. However, we expect this trend to reverse for full-year 2024 and 2025.

Growth in MA membership and premiums, a more capital-intensive product, as well as growth in the individual ACA (the Patient Protection and Affordable Care Act) product, is expected to continue. This premium growth will be partly counterbalanced by a decline in Medicaid managed care due to lower enrollment. Additionally, earnings are expected to fall. These factors will likely result in premium growth outpacing capital growth and cause a slight drop in risk-adjusted capitalization in 2024 and 2025. However, AM Best expects the industry to remain well capitalized overall.

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2024-140-112624

Solid Commercial Segment Results

Underwriting results reported in 2023 for the commercial segment were the highest in three years, driven by fewer COVID claims and higher rate increases to reflect greater medical cost trends. Furthermore, growth in the individual ACA segment has helped improve the segment's results. We expect profitability to remain stable as rate increases are likely to keep pace with medical trend. Favorable results have been supported by administrative expense management, pharmacy rebates, and medical care management.

Although health insurers have reported volatile revenue development over the past few years, growth in the commercial segment accelerated in 2023 and overall premium expansion has been reported through 2024. This is the result of enrollment growth, premium rate increases, and solid retention rates, trends we expect will continue in 2025.

The group segment has not experienced substantial enrollment gains, the individual segment experienced enrollment growth due to a shift in members from Medicaid, for which some individuals are no longer eligible because of redeterminations. Furthermore, individual membership has benefited from increased subsidies for the individual ACA product, which led to coverage becoming more affordable for some. The increased subsidies will continue through 2025.

AM Best remains concerned about some regional, smaller, and less diversified health plans. Historically, these plans have been challenged by industry headwinds, pricing pressures, a lack of underwriting discipline, and a reimbursement lag. These plans may lack the financial wherewithal or support of a financially strong parent to provide capital support for the challenges that they may face.

Investment Income Supplements Underwriting

The industry's investment income grew substantially in 2023 due to solid growth in invested assets. Liquidity and cash flow from operations has been solid, which we expect will continue into 2025. Higher interest rates helped bolster investment income, as health insurer's reinvested new money at higher rates through 2023. Furthermore, the industry took actions to de-risk its investment portfolios, with a slight improvement in the credit quality of bond portfolios the past few years.

Given the short-tailed nature of claims, health insurers generally hold conservative asset allocations in support of their insurance liabilities, mainly investment-grade fixed income and cash and short-term investments. Strong performance in investment-grade fixed income and equities drove favorable returns. Investment income remains a favorable contributor to overall net income in 2024 and is expected to supplement earnings in 2025.

Moderating Rate Pressures at Provider Contract Renewals

With provider contracts being multiyear, many contracts have been renewed and renegotiated the past few years to reflect inflationary pressures, which pushed rates higher. The recent decline in inflation has led to moderating rate pressure at contract renewals. However, industry providers continue to face headwinds, including supply cost increases and staffing shortages in certain specialties, which is expected to continue into 2025.

Strained Medicare Advantage and Medicaid Managed Care Earnings

The MA and Medicaid managed care lines of business account for a substantial portion of health insurers enrollment/revenues, and these segments have been quite profitable the past few years. These segments accounted for over half of new premiums written and major medical enrollment in 2023. However, both segments are facing pressures that will negatively impact operating performance in the near term. Historically, these segments are high-volume with narrower margins. Recent trends suggest the outsized profitability of recent years is declining and could fall to levels below historical norms. AM Best still expects overall profitability for these segments, but margins are expected to narrow, and profitability may be difficult for some carriers. Still, health insurers in these segments have been challenged before and have demonstrated their ability to withstand difficult operating conditions.

Pharmaceutical and Specialty Medications Create Cost Pressures

Innovative new specialty drugs and GLP-1s are unlocking new possibilities for patients but are resulting in cost pressures for health insurers. The various use cases of GLP-1s, including highly prevalent patient medical conditions such as diabetes and obesity, have expanded usage, especially in the US, which accounts for a large percentage of global utilization of GLP-1s. Furthermore, the lack of competitive alternatives to many of these drugs has allowed prices to remain elevated; generic alternatives to GLP-1s are not expected until at least 2026.

Additionally, insurers are seeing cost pressures from gene therapies and other specialty drugs, which can be very expensive and required for lifetime treatment. The increased usage of high-cost specialty pharmaceuticals to treat a growing number of medical conditions is also elevating pharmaceutical spend. The introduction of biosimilars for drugs such as Humira may provide a lower-cost alternative. As more biosimilars are introduced and gain acceptance, insurers may see some cost reprieve. However, with the continued introduction of new high-cost drugs, including specialty drugs and gene therapy, the health insurance industry will continue to face pharmaceutical cost pressures.

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.

Published by AM Best

BEST'S MARKET SEGMENT REPORT

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Version 011624

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