Best's Market Segment Report

February 25, 2021

P/C Industry Maintains Strong Capital in the Face of 2020 Challenges

A rebound in loss experience is likely to pressure 2021 results

The year 2020 may be remembered as the year in which the US property/casualty industry put its enterprise risk management skills to the test: a pandemic, above average losses from natural catastrophes, investment market volatility—events that highlighted the socio-political challenges the country faces. But buoyed by solid risk-adjusted capital, continued underwriting and pricing discipline, and a decline in loss frequency in several of its largest lines, the P/C industry performed remarkably well. When the books for the year are closed, we expect to see the industry generating a modest underwriting gain, with a decline in investment income and a slight increase in surplus.

The skills the industry brought to bear in facing the challenges 2020 threw at it will be needed again in 2021. Ongoing uncertainties surrounding COVID-19, an expected increase in loss activity more in line with pre-pandemic levels, elevated catastrophe activity and heightened pricing challenges, inclusive of reinsurance spikes, will remain headwinds in 2021.

Setting the Stage for 2020

The US P/C industry began 2020 with expectations of a challenging year. Despite a reprieve from elevated catastrophe losses in 2019, the industry had experienced a noteworthy increase in catastrophe activity over the previous several years. These losses were driven by "secondary" perils such as wildfires and convective storms, which are more difficult to model and thus more difficult to address with underwriting and pricing actions. As a result of the increase in catastrophe activity, reinsurance prices were generally expected to move up, further squeezing the industry's profits.

In addition, the casualty lines were seeing legal and social factors—"social inflation"—combining to drive claims costs higher. Even as insurers moved to bring pricing for current years in line with changes in loss costs, prior accident years' reserves were generating less favorable development as the number of claims with attorney involvement increased, initial settlement demands grew, well-publicized nuclear jury awards became more frequent, and third party litigation financing became more common. Large jury awards are perceived by some as a solution for correcting societal inequities, not just resolving the issues associated with a particular claim or class action.

At the same time, however, there was reason for optimism. The personal lines insurers were generally achieving rate increases that kept up with rising claims costs, and the pricing of most commercial lines was seeing substantial improvement. The US economy was performing solidly, and expectations were that interest rates were poised to begin moving up, which would help improve investment returns. Although the performance of the US equity markets had displayed some variability in recent years, market indices were near record-highs, further boosting the industry's capital, with most companies maintaining risk-adjusted capitalization assessed as Strongest or Very Strong as measured by Best's Capital Adequacy Ratio (BCAR). Companies benefitted from actions taken in prior years to improve underwriting performance. The use of increasingly sophisticated tools to analyze data to inform underwriting, pricing, and claims decisions resulted in favorable underwriting results for a number of years.

Analytical Contacts:
Michelle Baurkot, Oldwick
+1 (908) 439-2200 Ext.
Michelle.Baurkot@ambest.com

Daniel Mangano, Oldwick
+1 (908) 439-2200 Ext.
Daniel.Mangano@ambest.com

Jennifer Marshall, Oldwick
+1 (908) 439-2200 Ext. 5327
Jennifer.Marshall
@ambest.com

Contributors:
Kourtnie Beckwith
David Blades
Elizabeth Blamble
Joni Cerbone
Jacqalene Lentz
Thomas Mount
Josie Novak
Robert Raber
Vicky Riggs
Wai Tang
Maurice Thomas
Robert Valenta
Michael Venezia

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Catastrophe Losses Rise Again in 2020

Mother Nature never ceases to amaze us, and in 2020, she took it to a new level in both the number of storms and the level of intensity, following a relatively benign catastrophe year in 2019. Hurricanes, wildfires, and even a record-setting derecho hit the US, pressuring the results of the property lines of business.

One of the most destructive 2020 events was Hurricane Laura, a Category 4 Storm that made landfall in Louisiana and caused substantial wind and storm surge damage, generating approximately $10 billion in insured losses. Twelve named storms, including Laura and five other hurricanes, made landfall in the US—five hurricanes in Louisiana alone. Total insured losses from hurricanes for the year are estimated at $25 billion.

Hurricanes weren't the only storms that made records in the US in 2020. Insured losses from severe convective storms reached a record high of $30 billion, exceeding total insured losses from hurricanes. The derecho that roared through the Midwest in early August, damaging buildings and flattening crops—and wreaking significant damage in Cedar Rapids, Iowa—is estimated to be the costliest convective storm on record, with insured losses of approximately $5 billion.

Wildfires also remained active in 2020, with record-setting fires (in terms of area burned) in both California and Oregon causing over $11 billion in insured losses. Drought conditions, particularly across northern California and the Pacific Northwest, helped fuel dozens of large fires. Overall, catastrophe activity increased substantially, to 7.5 combined ratio points for the industry in 2020 from 4.1 points in 2019. As a result, performance for property lines deteriorated significantly in 2020.

COVID Pandemic Presents New Challenges

Before the industry had to deal with the familiar challenge of elevated catastrophe losses, it was presented with a new one: the COVID-19 pandemic. Although the insurance industry has always considered the potential impact of a pandemic on its operations and results, 2020 provided a practical test of those considerations. Over a weekend in mid-March, most companies in the industry shifted to operating on a full-remote basis. In response to government stay-at-home orders for non-essential workers, traffic on roads nearly disappeared, as many businesses began operating with, at most, skeleton crews. When it became clear that what was expected to be a temporary suspension of normal activity for several weeks would last much longer, the industry was presented with a new set of questions and challenges:

- Premium refunds to reflect lower miles driven
- Changes in payroll and sales assumptions for commercial lines products
- Changes in loss frequency and severity
- Uncertainty about coverage triggers and exclusions, particularly for business interruption losses

In some cases, regulators and legislators quickly made their expectations of the industry clear, particularly for personal automobile. Many insurers provided premium adjustments to cover the months during which the most severe restrictions were in place. Higher commercial lines rates were somewhat offset by lower payrolls and sales. As a result, AM Best expects that net premiums written for the industry will increase just 1.8% for 2020, the slowest growth in the past five years (**Exhibit 1**).

Exhibit 1
US P/C – Financial Indicators, 2015-2021P
Excludes mortgage and financial guaranty segments

	2015	2016	2017	2018	2019	2020E	2021P
Change in Net Premiums Written (%)	3.3	2.8	4.5	10.7	3.4	1.8	4.6
Change in Surplus (%)	-0.2	4.3	7.2	-0.8	14.4	2.6	1.2
Combined Ratio (Reported)	98.3	100.9	104.0	99.6	99.2	99.3	99.8
Less: US Catastrophe Losses[1]	3.5	4.8	9.8	5.7	4.1	7.5	6.1
Less: A&E Losses	0.5	0.4	0.4	0.4	0.3	0.4	0.3
Combined Ratio (Normalized)	94.2	95.7	93.7	93.5	94.9	91.5	93.4
Accident Year Combined Ratio (Normalized)[2]	95.9	96.8	96.0	95.7	96.1	93.0	94.8
Change in Net Investment Income (%)	-11.4	-2.0	7.2	14.0	0.4	-9.3	10.3
Net Investment Yield (%)	3.1	3.0	3.1	3.4	3.2	2.7	2.8
Pre-tax Return on Net Premiums Earned (ROR) (%)	10.9	7.8	3.4	9.3	9.6	8.0	8.0
After-tax Return on Surplus (ROE) (%)	8.1	5.9	4.5	7.7	7.1	5.4	4.8
Net Premiums Written to Surplus Ratio	0.8	0.7	0.7	0.8	0.7	0.7	0.7

E=Estimated, P=Projected
[1] 2015-2019 catastrophe losses based on AM Best data.
[2] Normalized accident year combined ratio adjusted to exclude prior year core reserve development, which excludes A&E losses.
Source: AM Best data and research

Exhibit 2
US P/C – Combined Ratio Components, 2015-2021P
Excludes mortgage and financial guaranty segments
($ billions)

	Net Premiums Written	Net Premiums Written Growth (%)	Loss Ratio (%)	Loss-Adjustment Expense Ratio	Under-writing Expense Ratio	Dividend Ratio	Combined Ratio
2015	519.5	3.3	57.9	11.9	27.8	0.7	98.3
2016	533.8	2.8	61.0	11.7	27.7	0.6	100.9
2017	557.9	4.5	64.4	11.9	27.1	0.7	104.0
2018	617.4	10.7	61.2	10.8	27.1	0.6	99.6
2019	638.2	3.4	60.4	11.0	27.0	0.8	99.2
2020E	649.7	1.8	59.8	10.9	27.4	1.2	99.3
2021P	679.7	4.6	60.8	11.1	27.2	0.7	99.8

E=Estimated, P=Projected
Source: AM Best data and research

Combined Ratio Remains Profitable Despite Cats and COVID

Despite the above average catastrophe experience in 2020, we expect the industry's combined ratio to increase only slightly, to 99.3 (**Exhibit 2**). Under ordinary circumstances, a 3.4 point increase in catastrophe losses would be expected to drive a similar increase in the combined ratio. But several other factors were able to offset most of the effect of higher catastrophes:

- Loss frequency declined significantly in personal auto and, to a lesser degree, in commercial auto. The drop in mileage as a result of government-mandated stay-at-home orders and the move of many employees to remote work drove significant reductions in accident frequency, particularly in the early months of the pandemic. Although the lower losses were somewhat counterbalanced by required premium refunds and increased dividends, as well as higher repair costs, the decline in frequency was so great that it improved the auto lines' combined ratios.

- Most commercial lines experienced solid price improvement, the pace of which accelerated throughout the year. Workers' compensation, which has experienced several years of compounded rate decreases, saw pricing stabilize somewhat, even as claims frequency declined owing to an increase in both unemployment and remote work. The decline in economic activity saw payrolls and receipts—which are the premium basis for many commercial lines classes—drop as well, but these were generally offset by rate increases.

On balance, the improved performance of personal and commercial auto and workers' compensation, which together account for greater than half the industry's net written premiums, more than offset the effect of higher catastrophe losses. As such, the industry's loss ratio for 2020 is projected to be 59.8, continuing the decline since 2017. The loss adjustment expense (LAE) ratio benefitted from the declines in claims frequency for the personal and commercial auto and the workers' compensation lines. Underwriting expenses grew more slowly than in some prior years, reflecting the drops in shopping behavior and expenses associated with travel and business entertainment. However, the underwriting expense ratio is projected to increase modestly, influenced partially by carriers, particularly in personal lines, that reported refunds during the pandemic as expenses.

An increase in policyholder dividends is also likely to decrease the industry's underwriting gains in 2020. Regulators provided insurers latitude to determine how to account for premium refunds, both mandated and voluntary. Many insurers accounted for the refunds as returned premiums or expenses, but several large companies paid these refunds in the form of policyholder dividends. As a result, the dividend ratio is expected to increase 50%, to 1.2 combined ratio points in 2020, from 0.8 points in 2019. A return to a more normal policyholder dividend payout is included in the 2021 projections.

Uncertain Underwriting Conditions for 2021

We expect many of the same factors insurers encountered in 2020 to continue to impact results in 2021. Although the number of miles driven has not returned to pre-pandemic levels, there was a steady increase in vehicles on the road throughout 2020 that is expected to continue into 2021. Catastrophes are projected to remain at a level modestly higher than historical averages, in part because of greater frequency of secondary peril events, such as the major freeze event in Texas in mid-February 2021. The personal lines segment is expected to have 6.5 points of catastrophe losses and commercial lines 5.5 points in 2021. We expect the commercial lines pricing environment to remain firm, with even workers' compensation seeing some minor increases. An increase in economic activity is also expected, which will boost net premiums written for the commercial lines segment and the industry as a whole.

For most lines of business in 2021, a rebound in accident frequency and severity is likely to offset the benefit of favorable pricing and lower catastrophe losses from 2020. We thus expect the industry's combined ratio to increase to 99.8 for 2021. Should pricing activity be stronger than expected, or losses remain suppressed due to continued adverse economic conditions or a more protracted recovery from COVID, the combined ratio may be better than expected.

Investment Returns to Remain Near Historical Lows

Investment yields are expected to remain more or less in line with 2020 levels, with a very modest improvement to 2.8%, from 2.7% in 2020. The 2020 mark reflects the drop in bond rates early in the year, as COVID emerged globally. As a result, the industry's net investment income is likely to decline by 9%, to $52 billion, from $57.3 in 2019. The modest improvement in yield projected for 2021, combined with an increase in invested assets, is expected to return net investment income to about $57 billion in 2021.

Exhibit 3

US P/C – Surplus Recap, 2015-2021P

Excludes mortgage and financial guaranty segments
($ billions)

	2015	2016	2017	2018	2019	2020E	2021P
Beginning Policyholders' Surplus	**691.5**	**690.1**	**719.9**	**771.7**	**765.3**	**875.6**	**898.5**
Net Underwriting Income	6.2	-6.5	-25.3	-2.9	1.4	0.7	-3.0
Net Investment Income	47.6	46.7	50.0	57.0	57.3	52.0	57.3
Other Income/Expense	1.6	1.0	-6.0	1.2	1.2	-1.6	-0.9
Pretax Operating Income	55.4	41.1	18.7	55.4	59.9	51.1	53.4
Realized Capital Gains/Losses	9.8	8.1	15.6	10.7	10.5	5.7	0.0
Federal Income Taxes	9.7	7.0	-0.8	6.9	8.2	8.1	9.4
Net Income	**55.6**	**42.2**	**35.1**	**59.2**	**62.1**	**48.8**	**44.0**
Unrealized Capital Gains/Losses	-20.9	15.75	60.0	-41.4	85.8	-1.7	0.0
Contributed Capital	11.3	2.8	3.0	10.7	4.3	3.7	4.9
Stockholder Dividends	-38.0	-27.6	-29.2	-32.9	-35.0	-28.4	-31.9
Other Changes	-9.3	-3.4	-17.1	-2.0	-7.0	0.5	-6.7
Ending Policyholders' Surplus	**690.1**	**719.9**	**771.7**	**765.3**	**875.6**	**898.5**	**908.9**
Total Changes in Surplus ($)	-1.4	29.8	51.8	-6.4	110.3	22.9	10.4
Change in Surplus from Prior Year (%)	-0.2	4.3	7.2	-0.8	14.4	2.6	1.2

E=Estimated, P=Projected
Figures may not add due to rounding.
Source: AM Best data and research

A sharp decline in the equity markets in March led to the industry posting substantial unrealized losses for the first quarter, but the rebound experienced through the rest of the year will likely erase most of that deficit. An unrealized capital loss of $1.7 billion is projected to be offset by $5.7 billion in realized gains on the sale of investments. AM Best does not project realized or unrealized capital gains/losses for 2021, which suppresses the net income, surplus growth, and return metrics.

Returns and Surplus Growth Expected to Slow

Because of the deterioration in underwriting and investment performance in 2020, pre-tax operating and net income are both projected to decline from their 2019 levels. We expect surplus to increase 2.6% in 2020, up approximately $23 billion (**Exhibit 3**). The industry's after-tax return on equity is anticipated to decline to 5.4% for the year, down from its recent high of 7.7% in 2018, as **Exhibit 1** showed.

In 2021, a modest deterioration in underwriting results and a slight improvement in investment results are likely to generate marginally higher pre-tax operating income. As AM Best does not project the impact of realized and unrealized capital gains for 2021, net income and surplus show modest declines. The ultimate change in these items will be influenced by capital gains and losses that occur throughout the year.

Loss & LAE Reserves – Beginning the Decade with Greater Reserve Uncertainty

Adverse reserve development is a leading cause of insurer insolvency. As a result, reserve adequacy remains a critical rating issue for AM Best. Loss and LAE reserves are typically the largest liability on a P/C insurer's balance sheet. Underestimating those liabilities may have a material negative effect on an insurer's reported surplus, potentially resulting in adverse rating action. Unexpected or larger than anticipated changes in an insurer's reserve position may materially affect the assessment of the company's balance sheet strength and enterprise risk management.

Exhibit 4

US Property/Casualty – Estimated Year-End Loss & DCC Reserve Deficiencies, 2020

($ billions)

Product Line	Excluding Discount	Statutory Discount	Total Deficiency
Workers' Compensation	-1.9	15.0	13.1
Other/Products Liability	9.2	1.4	10.6
Commercial Auto Liability	2.5	0.3	2.8
Reinsurance - Nonprop Assumed	1.3	0.9	2.2
Commercial Multiperil	0.3	0.0	0.3
Homeowners	-0.4	0.0	-0.4
Personal Auto Liability	-1.2	0.2	-1.0
Medical Professional Liability	-2.6	0.5	-2.1
All Other Lines	-3.8	0.8	-3.0
Total Core Reserves	**3.4**	**19.1**	**22.5**
Asbestos & Environmental	10.4	0.0	10.4
Total	**13.8**	**19.1**	**32.9**

* Excludes Mortgage Guaranty and Financial Guaranty.

Source: AM Best data and research

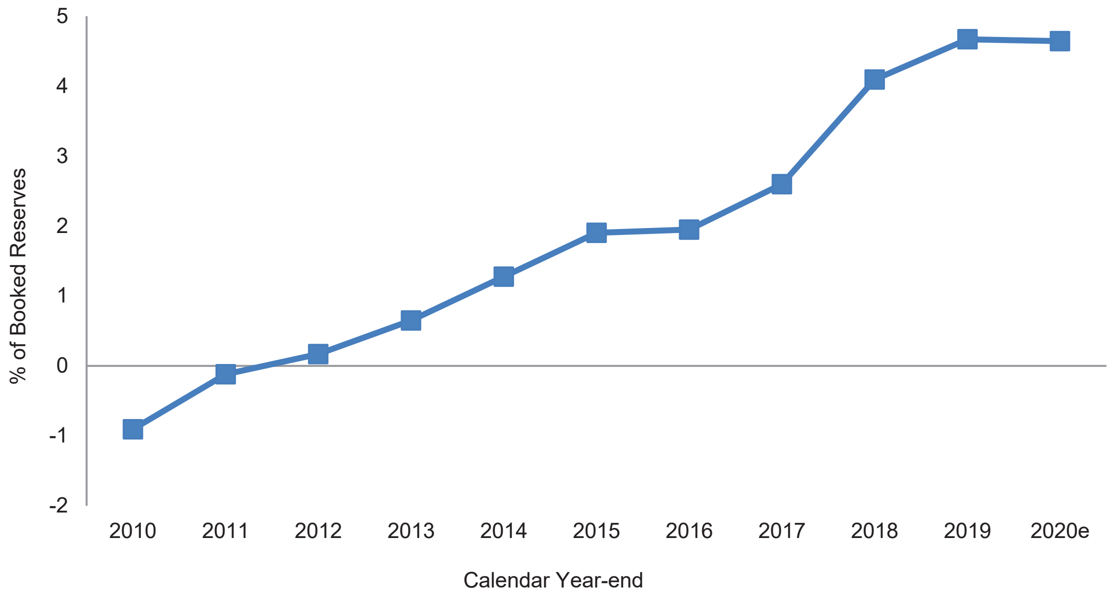
The reserve setting process for US P/C insurers has enough uncertainty during stable environments, but when social unrest, social inflation, extreme climate-related events, cyber attacks, and an extended shutdown of the global economy due to a pandemic are introduced into the selection of estimated ultimate liabilities, the reserves shown on many insurers' balance sheets will likely contain more uncertainty than observed over the last two decades. Many of the underlying assumptions used in the reserve setting process will be impacted by this drastically changing environment and will need to be re-evaluated. Changes in exposures, frequency, severity, claims reporting, claims settlement, loss development, and expected loss ratios are examples of assumptions that will be impacted either adversely or favorably depending on the line of business, the type of coverage, and even the individual risk.

Despite the challenges the industry faces in setting reserves for year-end 2020, AM Best believes the industry's overall reserve position is largely unchanged from its year-end 2019 estimate. We estimate the P/C total net loss and LAE reserve deficiency at $32.9 billion, consisting of a $22.5 billion deficiency on core reserves and a $10.4 billion reserve deficiency on A&E reserves. Of the total $32.9 billion deficiency, $19.1 billion is due to statutory discounting, which AM Best considers a deficiency from full-valued reserves. The estimated reserve positions vary widely by line of business, with workers' compensation and other/products liability showing the largest overall deficiencies, and the medical professional liability, personal auto liability, and "all other" lines showing the largest redundancies (**Exhibit 4**). The estimated reserve deficiencies are based on industry statutory Schedule P cumulative paid and case incurred loss and expense development, using AM Best's internal loss-reserve model. Industry data was adjusted to remove the distorting effects of large transactions such as commutations, loss portfolio transfers, adverse development covers, and prospective accounting treatment of retroactive reinsurance.

Overall industry reserves as of year-end 2020 are estimated to be only $0.6 billion weaker than the reserves reported as of year-end 2019. However, when the year-end 2020 deficiency is stated as a percentage of the year-end booked reserve, it is actually slightly lower than the percentage estimated for year-end 2019 (**Exhibit 5**). A&E reserves are expected to strengthen $2.2 billion in 2020 and total core reserves are expected to weaken $2.8 billion. Greater movement in reserve positions is expected by line in core reserves as workers' compensation, reinsurance assumed, and "all other" lines are expected to weaken in 2020, but that weakening should be partially offset by strengthening in other liability, commercial auto liability, commercial multi-peril, medical professional liability, personal auto liability, and homeowners.

Exhibit 5

US P/C Industry – Loss & LAE Reserve Deficiency Percentage



Source: AM Best data and Research

Exhibit 6

US Property/Casualty – Incurred Loss & DCC Development, 2010-2019

One year development for calendar years, accident years as of Dec. 31, 2019

Excludes Mortgage Guaranty and Financial Guaranty Segments

($ billions)

Accident Year	One-Year Reserve Development *										Total AY Development Through 2019
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	
Prior	-9.4	-10.2	-4.2	-4.1	-1.8	0.5	1.4	0.7	-2.2	-1.1	-30.6
2010		-3.6	-2.2	-1.4	-1.1	-0.5	-0.5	-0.8	-0.5	-0.4	-11.0
2011			-4.8	-1.3	-1.0	-0.7	-0.9	-0.6	-0.6	-0.4	-10.3
2012				-4.6	-2.1	-0.7	-0.6	-0.8	-0.9	-0.6	-10.3
2013					-4.0	-1.2	-0.5	-1.3	-1.2	-0.9	-9.1
2014						-3.1	-0.1	-1.4	-1.2	-1.1	-6.9
2015							-0.2	-1.1	-0.6	-0.2	-2.1
2016								-1.7	-0.3	-0.1	-2.1
2017									-3.6	-0.5	-4.2
2018										-1.4	-1.4
Total in Calendar Year	**-9.4**	**-13.8**	**-11.2**	**-11.4**	**-10.1**	**-5.7**	**-1.5**	**-6.9**	**-11.2**	**-6.7**	

* Positive values indicate adverse development; negative values indicate favorable development.

Source: AM Best data and research

The industry reported $6.7 billion of favorable reserve development in calendar year 2019 and consequently reported its 14th consecutive year of favorable prior year development (**Exhibit 6**). The favorable development in 2019 was primarily from the workers' compensation line of business, which reported $8.1 billion of favorable development, and the "all other" lines, which reported $4.1 billion of favorable development. This favorable development was offset by $3.2 billion of adverse development in the other liability line and $2.5 billion of adverse development in the commercial auto liability line. AM Best expects the industry to report another year of favorable reserve development in calendar year 2020, at a level similar to the amount reported in 2019 calendar year.

US Personal Lines

In 2020, the US personal lines segment faced challenges from increased catastrophe activity and COVID-19 (**Exhibit 7**). The effect on the main lines of business (homeowners and personal auto), however, were nearly completely different (**Exhibit 8**). Higher catastrophe

Exhibit 7

US P/C – Segment Indicators, 2019-2021P

Excludes mortgage and financial guaranty segments

	Personal Lines			Commercial Lines			US Reinsurance		
	2019	2020E	2021P	2019	2020E	2021P	2019	2020E	2021P
Change in Net Premiums Written (%)	4.8	1.4	4.2	2.6	3.6	4.8	-2.4	-2.6	6.9
Change in Policyholders' Surplus (%)	15.1	3.9	3.3	6.5	0.3	-1.1	29.7	3.8	0.2
Combined Ratio (Reported)	98.9	98.1	98.6	99.3	101.2	101.8	100.6	99.0	99.9
Less: Catastrophe Losses	5.0	8.0	6.5	2.5	6.5	5.5	3.9	8.0	6.0
Less: A&E Losses	0.1	0.1	0.1	0.5	0.7	0.6	0.5	0.7	0.6
Combined Ratio (Normalized)	93.7	90.0	92.0	96.3	94.1	95.7	96.3	90.3	93.3
Accident Year Combined Ratio (Normalized)[1]	94.0	90.4	92.3	99.1	97.1	98.5	98.1	92.8	95.4
Change in Net Investment Income (%)	-2.8	-9.7	12.9	1.3	-7.1	6.6	4.2	-13.0	14.1
Investment Yield (%)	2.8	2.3	2.5	3.3	2.9	3.1	3.8	2.9	3.0
After-Tax Return on Surplus (ROE) (%)	6.0	5.4	5.0	8.4	5.6	4.8	7.3	5.2	4.6
NPW/PHS (Reported)	0.9	0.9	0.9	0.7	0.7	0.8	0.3	0.3	0.3

E=Estimated, P=Projected

[1] Normalized accident-year combined ratio adjusted to exclude prior-year core reserve development, which excludes A&E losses.

Source: AM Best data and research

Exhibit 8

US P/C – Product Line Underwriting Trends, 2015-2021P

	Net Premiums Written 2020E		Combined Ratios						
Product Line[1]	**Share (%)**	**Growth (%)**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020E**	**2021P**
Private Passenger Auto	36.6	-2.0	104.6	106.3	102.6	97.7	98.8	94.4	98.0
Homeowners & Farmowners Multi Peril	15.9	6.5	91.8	93.1	107.1	103.6	98.5	109.1	102.8
Workers Compensation	7.0	-9.0	95.8	95.6	92.5	87.0	88.3	86.2	88.4
Commercial Auto	6.9	3.0	108.8	110.5	111.1	108.0	109.4	105.1	108.1
Commercial Multi Peril	6.3	5.0	94.7	101.8	107.9	106.5	105.1	106.0	104.0
Fire & Allied Lines[2]	5.4	7.0	85.6	89.7	123.9	107.7	97.6	106.9	96.0
Inland Marine	2.4	-1.0	83.8	84.0	89.9	86.4	86.5	98.5	89.1
Medical Professional Liability	1.4	2.9	102.3	106.5	101.7	104.0	112.2	116.3	117.5
Other & Products Liability[3]	10.6	8.5	103.4	111.1	101.0	101.1	105.6	104.9	107.1
All Other Lines[4]	7.4	8.0	84.0	87.2	103.6	97.7	94.3	87.0	93.7
Total All Lines[5]	**100.0**	**1.8**	**98.3**	**100.9**	**104.0**	**99.6**	**99.2**	**99.3**	**99.8**

E=Estimated, P=Projected

[1] Source: Best's Statement File Supplement - Insurance Expense Exhibit (IEE) - P/C, US, 2015-2019

[2] Fire & Allied Lines includes earthquake, multiple peril crop, and federal flood.

[3] Other Liability includes professional liability, D&O, excess casualty/umbrella, environmental/pollution, general liability, and EPLI.

[4] All Other Lines includes accident & health lines, mortgage guaranty, financial guaranty, ocean marine, aircraft, fidelity, surety, burglary & theft, boiler & machinery, credit, international, excess of loss reinsurance, and miscellaneous.

[5] Source: AM Best data and research

activity added approximately eight points to the combined ratio for the homeowners segment, which was further pressured by increased reinsurance costs expected to remain at higher levels in 2021. Losses from hurricanes, wildfires, and windstorms plagued much of the country. Non-catastrophe losses, including water and fire losses, also remained prominent in 2020, although companies in this segment have become more sophisticated at managing and pricing for these risks. Proactive underwriting actions, including improved pricing segmentation, ongoing exposure management, and diversified reinsurance programs, significantly diminished the adverse impact of these losses.

Exhibit 9
US P/C – Personal Lines, Key Figures 2019-2021P
($ billions)

	2019	2020E	2021P
Net Premiums Written	357.8	362.9	377.9
Underwriting Gain/Loss	2.2	5.1	3.6
Net Income	23.4	21.9	20.9
Policyholders' Surplus	391.0	406.2	419.5
After-Tax Return on Surplus (%)	6.0	5.4	5.0

E=Estimated, P=Projected
Source: AM Best data and research

Exhibit 10
US P/C – Commercial Lines, Key Figures 2019-2021P
($ billions)

	2019	2020E	2021P
Net Premiums Written	222.6	230.6	241.6
Underwriting Gain/Loss	-0.1	-4.5	-6.3
Net Income	26.1	17.5	14.9
Policyholders' Surplus	310.4	311.4	308.1
After-Tax Return on Surplus (%)	8.4	5.6	4.8

E=Estimated, P=Projected
Source: AM Best data and research

In contrast, positive underwriting performance in the private passenger auto segment further benefited from the decline in the frequency of losses, as the pandemic restricted drivers on the road. Increased rates in earlier years and reduced frequency from improved safety features in newer vehicles somewhat negated the ongoing severity pressures associated with medical costs and pricey repairs. The drop in drivers on the road will likely continue as the pandemic persists and employers extend flexible work arrangements, further diminishing frequency trends. Growth in net premiums written for 2020 is projected at a low 1.4%, partly resulting from nearly $4 billion of premium refunds associated with the pandemic, but this is more of a one-time impact rather than a trend, with 2021 growth returning to a more normal 4.2%. The after-tax return on surplus was impacted only marginally by the challenges of 2020, with the personal lines segment expected to report a return of 5.4%, down from 6.0% in 2019.

Overall, the personal lines segment maintains sufficient capital to withstand significant market impacts as experienced in 2020 (**Exhibit 9**). Despite the above average catastrophe events, we are projecting an increase in policyholders' surplus of 3.9% in 2020, driven by underwriting and investment income, as well as realized capital gains. We expect the combined ratio to decline 0.8 points to 98.1 in 2020, from 98.9 in 2019, even with three extra points of catastrophe losses. Given the recent uptick in the frequency and severity of catastrophe events, AM Best expects that cat losses will remain elevated, with an allocation of 6.5 points in 2021 for the personal lines segment. Advancements in technology and data analytics, the lower levels of catastrophe activity anticipated in 2021, and innovation initiatives in all operational areas should continue to benefit underwriting performance and contribute to further surplus growth. Although the pandemic has not had a materially adverse impact on the personal lines segment, ongoing economic pressures and the prevailing low interest rate environment will remain headwinds throughout 2021.

US Commercial Lines

Results for the commercial segment are expected to deteriorate in 2020, as the impact of lower losses in workers' compensation and commercial auto owing primarily to COVID-19 is more than counterbalanced by an increase in catastrophe losses (**Exhibit 10**). Catastrophe losses, projected to reach 6.5 points for 2020, up four points from 2019, are most prominent in the commercial property lines, including fire and allied lines and commercial multiperil. Losses were driven by wildfires out West, hurricanes in the Southeast, and the derecho that hit the Midwest in August, causing severe damage in several states. AM Best expects that catastrophe losses for the commercial segment will return to 5.5 points for 2021, slightly elevated from the historical average.

The commercial property lines of business also experienced an increase in LAE, related primarily to business interruption claims owing to business closures because of the pandemic. Even though insurers generally denied claims for pandemic-related business interruption, the costs associated with defending those claim decisions drove LAE up for the year. Litigation related to business interruption claims in the United States has generally favored insurers, but there have been recent cases that, if broadly applied, could result in greater actual loss payments in 2021. AM Best's forecast for 2021 does not presume any significant increase in business interruption payments related to the pandemic, although LAE is expected to remain above historical levels as these cases proceed through the court system.

For 2020, we expect that the combined ratio for several large casualty lines, including workers' compensation and other (general) liability will decline, somewhat offsetting the increase in losses in property. Workers' compensation premiums declined due primarily to the decline in payrolls resulting from layoffs and business closures. Workers' comp losses are expected to fall on an absolute basis, reflecting lower loss frequency because of both layoffs and the conversion of many to work-from-home status. COVID-related claims experience has not been significant to date, with most claimants requiring minimal medical care. Even in states that adopted rebuttable presumption requirements, the majority of claims consist of lost wages while infected employees quarantine until receiving clearance to return to work.

With premiums down as a result of both declining payrolls and the impact of prior years' rate declines, the workers' comp loss ratio will likely increase modestly in 2020. However, both LAE and underwriting expenses are expected to drop, reflecting lower claims frequency and a reduction in new business. Consequently, the combined ratio for the workers' comp line in 2020 is expected to improve modestly. As the employment situation returns to a more normal level, particularly in the second half of 2021, we expect these trends to reverse, with a rise in both premiums and losses, driving up the combined ratio.

Losses in general (other) liability are anticipated to see some relief from the upward pressure of recent years for 2020. Insurers have been reporting a strong pricing environment for other liability, driven by D&O and E&O but also impacting general liability coverages. The loss and LAE ratio for other and product liability is expected to remain relatively flat in 2020 despite strong premium growth, as claims activity, particularly for smaller claims, was somewhat muted because of the business closures and lower traffic at businesses that remained open. Underwriting expenses are expected to fall modestly, reflecting a lower level of shopping behavior among insured. As with workers' comp, a return to more normal market conditions is expected in 2021, which will adversely affect the line's results.

As noted, we anticipate that catastrophe losses will decline from their high in 2020 but remain modestly elevated from historical levels. Uncertainties related to the COVID pandemic—

including the continued economic impact of business restrictions and the ultimate resolution of COVID-related business interruption claims—will continue to affect the segment into 2021.

AM Best believes that the trends affecting the results of the commercial lines before the pandemic are likely to remain headwinds in 2021. Among the issues the industry faces is the ongoing growth in social inflation, driven by emerging social trends and an increase in third-party litigation financing; rising reinsurance costs; and challenges associated with secondary catastrophe events, such as wildfires and convective storms. Additionally, with favorable pricing conditions expected to continue, companies without legacy concerns may have an opportunity to take advantage of those positive trends, increasing competition, and potentially short-circuiting price recovery. The current investment market is also a potential drag on operating performance, but it does drive a greater commitment to maintaining underwriting and pricing discipline to achieve desired total returns.

We also expect that the combined ratio for commercial auto will be higher in 2021. In 2020, the line benefitted from a decline in traffic that drove lower accident frequency, although increased traffic speed did contribute to higher severity. However, with driving patterns returning to more normal levels in 2021, we expect frequency to follow suit. As the upward pressure on settlement demands seems unlikely to abate, losses for the auto line are likely to increase. In commercial multiperil, the continued pressure on casualty claims costs will offset the benefit of lower expected catastrophe losses. Although we anticipate that the current favorable pricing environment will continue through 2021, those benefits will not be fully reflected in performance until 2022.

In addition to the favorable insurance market environment and the expected lower level of catastrophe losses, several other factors will help offset the headwinds the segment faces. Chief among these is the solid level of risk-adjusted capital, with capital remaining steady or increasing in 2020 for most companies. Continued favorable, albeit declining, development of prior years' loss reserves also supports the strength of the segment's balance sheet. Finally, 2020 has demonstrated the segment's ability to operate effectively in an environment with a significant level of remote work. Even if only some of the changes in the business environment become permanent, they could provide material expense savings over the long term.

AM Best's Sub-Segment Market Outlooks

US Homeowners Insurance

AM Best is maintaining its Stable outlook on the US homeowners segment, owing to the following key drivers:

- Strong risk-adjusted capitalization
- Core business remaining profitable
- Continued investment in technology and risk management tools

Surplus levels continue to support the underlying risks for most US homeowners' carriers despite the adverse effects of more frequent catastrophes, the COVID-19 pandemic, and ongoing volatility in investments. Owing to the rebound in the equity markets throughout 2020, a vast majority of homeowners carriers were able to absorb the downturn with favorable risk-adjusted capitalization maintained. Additionally, core results remain profitable despite increased non-CAT weather losses and the higher frequency of fire and water losses, owing to proactive underwriting actions, including improved pricing sophistication, ongoing exposure management, and diversified reinsurance programs. Advances in predictive modeling and pricing analytics, as well as third-party data, have provided opportunities for homeowners' carriers to pursue profitable growth.

Key countervailing factors include elevated catastrophe activity, the rise in reinsurance pricing, and the ongoing economic impact of COVID-19. US catastrophe losses trended well above normal levels in 2020, and are likely to remain moderately elevated, which will further fuel the rise in reinsurance pricing expected for 2021. Although the pandemic is not expected to materially affect the US homeowners segment, ongoing depressed economic conditions and the inherent risk of price inflation for construction supplies and contractors may further increase the cost of adjusting claims, transporting goods, and labor.

US Personal Auto Insurance

AM Best is maintaining its Stable outlook for the US personal auto segment, owing to the following key drivers:

- Solid risk-adjusted capitalization of most writers in the segment
- Underwriting profitability reported in recent years
- Continued utilization of newer technology and data analytics
- Innovation in all operational phases and risk management

Most personal auto writers maintain a consistently favorable capital position built upon ongoing use of newer technology and data analytics to supplement underwriting, claims handling, and ratemaking. AM Best believes that the private passenger auto industry's favorable overall operating performance in recent years will continue throughout the remainder of 2021, owing to the improvement in auto claims frequency that has somewhat negated ongoing severity pressures. Frequency will continue to benefit from fewer drivers on the road for the foreseeable future, as the pandemic persists and employers extend work-from-home operations or support hybrid work environments. Innovation in all operational phases and in risk management will also continue to benefit personal auto writers as they maintain their focus on pricing adequacy and auto repair management in order to remain competitive.

The main counterbalancing factors include the near- and medium-term economic fallout and market disruption arising from the pandemic, regulatory uncertainty, as well as the prevailing low interest rate environment, which will continue to pressure overall investment returns in 2021. However, given the compulsory nature of personal auto insurance, the effects of the pandemic on the segment appear to be more muted than on some of the commercial lines.

US Commercial Auto Insurance

AM Best is maintaining a Negative outlook on the commercial auto line of business, due to the following key factors:

- Continuation of a decade-long trend of unprofitable underwriting results—the segment has not generated a combined ratio under 100 since 2010 despite several years of consecutive rate increases
- The growing impact of social inflation on the segment, along with nuclear verdicts and litigation financing significantly impacting profitability
- Ongoing adverse development of loss reserves and increases in current accident year loss costs, as companies continue to adjust to the new trends in claims

Although price increases and corrective underwriting actions are expected to continue through 2021, the long-term economic effects of COVID-19 remain uncertain. AM Best expects a modest decline in the segment's profitability in 2021 and expects another year of unprofitable underwriting as the line returns to more historically normal frequency levels.

US Commercial Property Insurance

AM Best's outlook for the commercial property segment remains Negative, owing primarily to the following factors:

- Uncertainty about the duration of the pandemic and its impact on business interruption coverage
- The long-term growth in CAT losses stemming from secondary perils (convective storms, wildfires, flooding), where modeling capabilities continue to evolve
- The rising cost of reinsurance, with tighter terms and conditions

Key offsetting factors that may benefit results for commercial property in 2021 include the possibility that litigation related to COVID-19 will continue to be resolved primarily in the industry's favor, although litigation expenses related to denied claims are expected to increase. The rate environment for property is likely to remain firm through 2021.

US Excess & Surplus Lines Insurance

In February, AM Best revised the outlook for the excess and surplus lines to Stable from Negative. The key drivers of the stable outlook include the following:

- The limited impact of the pandemic on the E&S market, which resulted in part from bespoke terms and conditions that helped insulate the segment from pandemic-related claims
- Current market conditions, as prices continue to firm and terms and conditions tighten
- Increased level of new entrants, further indication of expectation that market conditions will remain favorable, and that capacity should remain stable

US General Liability Insurance

AM Best's outlook for general liability insurance remains at Negative, given the expectation that unfavorable secular trends related to social inflation and third-party litigation financing will continue to adversely impact the line's loss costs. Near-term concerns about macroeconomic conditions in the US and the potential ongoing drag on pandemic-related exposures raises concerns about premium growth and increased claims activity. The rising cost of reinsurance and the prospect of diminished investment returns also weigh on the outlook for this market segment.

Companies' solid risk-adjusted capital is a key offsetting factor. Rate increases over the past two years, which accelerated through 2020, should help improve results, although the rate increases may not have caught up to loss cost trends. Given the negative pressures the segment faces, insurers are expected to maintain more prudent underwriting, including tighter policy terms and conditions, greater diligence in deploying capacity and better defined risk appetites.

US Medical Professional Liability Insurance

AM Best is maintaining its Negative outlook on the medical professional liability (MPL) segment for 2021, due to the following key reasons:

- Ongoing pressures of depressed demand
- Rate adequacy concerns
- Rising loss costs and social inflation diminishing reserve redundancies
- The potential for additional claims frequency owing to the COVID-19 pandemic.

Given the extent of these challenges, the MPL market could be facing one of its most difficult periods in a decade. Despite rate actions, operating and underwriting results are likely to remain pressured through 2021, as the segment continues to work through its broad set of challenges, as well as the potential impact from the pandemic. These concerns are magnified by the decline in favorable prior year reserve redundancies, the emergence of nuclear verdicts, social inflation, and the erosion of tort reform in states across the country.

MPL carriers, for the most part, have significant capital to help them weather the storm. Rising claims severity, social inflation, and the increased frequency of high severity losses took a pause in 2020, following the onset of the pandemic and the closure of the courts. Claims frequency declined significantly following a drop in non-pandemic-related healthcare utilization, as non-essential procedures were either delayed or never performed. However, whether those trends re-emerge as the pandemic recedes and courts re-open remains uncertain. The pandemic-related "halo effect" surrounding healthcare workers may benefit the outcomes of some cases, at least in the near term.

US Private Mortgage Insurance

AM Best is maintaining its Negative outlook for the private mortgage insurance (PMI) market, owing to ongoing uncertainty about COVID-19, deteriorating US macroeconomic conditions, elevated unemployment, increased loss reserves, and declining earnings. The PMI industry faces the risk of a macroeconomic slowdown as the pandemic continues, but a number of factors have helped moderate the adverse conditions, including the following:

- Strong mortgage underwriting standards, coupled with the better risk-adjusted capital position of the private mortgage insurers
- Federal government stimulus programs
- Forbearance programs offered by Fannie Mae, Freddie Mac, and the Federal Housing Administration
- Lower-than-expected delinquencies
- A rebounding mortgage insurance-linked securities (MILS) market

US Professional Liability Insurance

AM Best is maintaining its Negative outlook for the professional liability market segment, due to the effects of market dynamics on the lines that comprise the segment, including employment practices liability (EPL), cyber, and non-medical professional liability. The COVID-19 outbreak and the stock market decline have the potential to bring about more opportunities for lawsuits, which would result in a rise in claim defense costs regardless of the outcome of the lawsuits. Directors and officers liability (D&O) risks have expanded over the past few years, as the business environment has become increasingly complex and interconnected. Some of the reasons for the Negative outlook follow:

- The expected re-emergence of social inflation trends as courts re-open in 2021, with claims related to diversity; environmental, social, and governance (ESG); and other social justice issues anticipated to grow
- Increases in securities and privacy litigation; heightened exposures to cyber claims, particularly related to the expansion of the remote work environment
- Event-driven exposures from man-made and environmental disasters and product issues, which often result in significant securities or derivative claims from shareholders

Overall, the segment maintains ample capital, which should support companies through these challenges. Despite a more judicious deployment of capital and increasingly stringent underwriting and pricing standards, AM Best expects profitability to remain challenged in 2021.

US Surety Insurance

AM Best is maintaining its Negative outlook on the surety segment due to the impact of COVID-19 on the construction industry and current economic uncertainty. The pandemic is adversely affecting the construction process, including the potential for disruptions in the supply chain, which affects the availability and cost of construction materials, and government restrictions on labor, resulting in significant adverse effects on the performance of construction contracts and related costs.

The impact on construction projects has varied significantly by jurisdiction, based on the severity of the pandemic and shutdown orders in a particular area. Safety protocols such as social distancing have caused delays or the cancellation of projects and have reduced capacity and productivity in some locations. Although most construction projects have been allowed to continue, contractors face continued COVID-19-related restrictions, and we expect that project delays, an inability to complete certain projects, and lower levels of new construction in certain segments severely affected by COVID-19 could place stress on contractor backlogs and resources.

After the pandemic subsides, governments may look to infrastructure spending to reduce unemployment and address investments in the transportation and energy sectors, and may invest in ESG programs to promote environmental or social objectives. Over the longer term, a comprehensive infrastructure spending bill would bolster infrastructure projects and result in more business opportunities for the surety companies.

US Title Insurance

AM Best's outlook for the title segment was recently revised to Stable from Negative, as the title industry has proven far more resilient than anticipated in the wake of the sudden economic slowdown and lockdowns brought about by the pandemic. Title was the most profitable P/C market segment in 2020, despite the pandemic's impact on the homebuying process and the US economy.

The Stable outlook also takes into account decisions made by the Federal Reserve in 2020 to cut the federal funds rate by 150 basis points, effectively bringing the rate to zero, and to purchase assets in the open markets, including mortgage-backed securities. These two actions helped lower interest rates and brought the 30-year fixed mortgage rates near historical lows—which should fuel continued real estate sales and refinancing activity in the real estate markets and further the business activities of title insurers in 2021.

US Workers Compensation Insurance

AM Best's outlook for the workers' compensation segment remains Negative, owing to continued uncertainty about the COVID-19 pandemic, from both an economic and a regulatory perspective. Premium audit adjustments, which account for adjustments in payroll, could have a significant impact on insurers' top line as the pandemic continues. Given the decline in premium, we are expecting expense ratios to rise, causing a deterioration in the segment's combined ratio. State regulatory actions on rebuttable presumptive legislation for COVID-19 are another issue. Moreover, the segment was already under pressure before the pandemic, as many states continued to experience rate decreases, putting pressure on the direct loss ratio.

Offsetting factors include the solid risk-adjusted capitalization and redundant reserves (exclusive of statutory discounts) the segment has experienced in recent years. Lost-time claims frequency has been declining, and loss experience has benefitted from workplace safety initiatives, which have supported underwriting performance.

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A.M. Best Company, Inc.
Oldwick, NJ
CHAIRMAN, PRESIDENT & CEO **Arthur Snyder III**
SENIOR VICE PRESIDENTS **Alessandra L. Czarnecki, Thomas J. Plummer**
GROUP VICE PRESIDENT **Lee McDonald**

A.M. Best Rating Services, Inc.
Oldwick, NJ
PRESIDENT & CEO **Matthew C. Mosher**
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EXECUTIVE VICE PRESIDENT & CSO **Andrea Keenan**
SENIOR MANAGING DIRECTORS **Edward H. Easop, Stefan W. Holzberger**
SENIOR VICE PRESIDENT **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.
Paseo de la Reforma 412, Piso 23, Mexico City, Mexico
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, 6th 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 - MENA, South & Central Asia*
Office 102, Tower 2, Currency House, DIFC
P.O. Box 506617, Dubai, UAE
Phone: +971 4375 2780
*Regulated by the DFSA as a Representative Office

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