

# BEST's MARKET SEGMENT REPORT

April 7, 2020

## Market Segment Outlook: US Commercial Lines

We are  
changing our  
outlook to  
Negative on  
concerns about  
the impact of  
COVID-19 and  
the ensuing  
economic  
slowdown

AM Best is revising its outlook for the commercial lines segment to Negative from Stable, reflecting concerns about the macroeconomic fallout of the physical distancing guidelines that have been initiated to slow the spread of COVID-19. Other than in the event cancellation and travel insurance lines, AM Best does not expect significant claims activity in commercial lines owing directly to the pandemic itself. However, the rapid deterioration of the economy, with unemployment claims skyrocketing and more than 90% of the nation's population under "stay at home" orders as of this writing, will be felt throughout the commercial insurance segment.

Among key reasons for the change in the outlook are the following:

- Expectation of lower premiums because of slowing economic conditions, resulting in lower earnings
- Reduced surplus/equity as a result of lower asset values
- The prospect of interest rates remaining lower than expected for longer than expected

Despite the change to Negative, insurers that can maintain pricing and underwriting discipline while sustaining lower premium income may achieve a stronger market position when economic conditions improve.

The main offsetting factor is the industry's solid risk-adjusted capitalization, which AM Best believes will withstand the effects of the pandemic on the commercial segment. In addition, the decline in economic activity will likely lead to a decline in losses in most commercial lines, with the trade credit line having the greatest potential for increased losses as a result of the economic fallout.

### Premium Revenues to Decline

Declines in receipts, payrolls, and miles driven, as well as other factors, will reduce premium revenues and incoming cash flows. Most insurers indicate that they will continue to implement rate increases where needed to bring rates in line with loss trends, but whether the market will bear these increases is unclear. The unprecedented circumstances that have resulted in the economic slowdown make it difficult to anticipate the speed at which the economy will recover as stay-at-home orders are lifted—or even how long they will have to remain in place. Adding to the challenge is the as yet unclear effect of government stimulus efforts intended to help businesses offset the impact of the shutdown.

Once the immediate crisis is past, the longer-term potential for the economy may still be in doubt, despite hopes for a recovery whose velocity matches that of the decline. AM Best expects that both unemployment and GDP will remain challenged through 2020. A number of major industry sectors, including construction, retail, hospitality and transportation, will face difficult conditions into the second quarter, at a minimum. A certain percentage of small businesses, which make up the majority of commercial lines insureds (although not of premium), will be unable to reopen. Changes in consumer behavior may alter the demand for certain products and services, at least in the near term. The effect on energy

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### AM Best's Market Segment Outlooks

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related businesses of the drop in oil prices may have some longer-lasting effects on insurance companies that focus on this segment.

### Reduced Loss Potential

Although the short-term expectations for commercial lines' premium are negative, the claims side may offer some potential benefits to underwriting results in a number of lines, other than trade credit, as noted above. Reduced exposures to losses—as a result of workers who are laid off or are working from home, fewer patrons in stores, restaurants and bars, and fewer miles driven in many segments of the commercial auto line—may bring losses down in line with the decline in premium, allowing underwriting results to remain balanced. One factor that could drive an increase in losses is a rise in vacant properties, which are historically more prone to loss than occupied premises are.

### Potential Business Interruption Losses

Another area that AM Best continues to monitor is the potential for government intervention in establishing causes of loss for business interruption (BI), despite a lack of coverage-triggering events or specific exclusions that would preclude policies from responding to these claims. Legislators in several states have drafted legislation that would require insurers to cover business interruption losses related to physical distancing guidelines or government-mandated closures of non-essential businesses.

AM Best believes that, if any of this legislation were to be enacted, the courts would determine whether the legislation is enforceable or constitutional. The immediate impulse to spread the cost of pandemic-related economic losses to the insurance industry may be understandable. However, we believe that legislative remedies will be tempered by an

appreciation of the effect they would have on the availability and affordability of commercial insurance products.

### **Deterioration in Underwriting Results**

Beyond the impact on losses, AM Best does expect an adverse effect on companies' underwriting results, as expenses are unlikely to decline as rapidly as premiums. Many companies have moved to remote work environments for the majority of staff members, but there have been a few reports of significant layoffs or furloughs in the industry. The longer the economic slowdown continues, the greater the potential for such actions as a way to cut expenses. But, at least for 2020, we do not expect substantial reductions in expenses. Underwriting earnings on a statutory basis, measured against lower than expected net premiums written, are expected to deteriorate. On a GAAP basis, the effect may lag into 2021, as earned premiums will remain relatively solid based on business written in 2019 and early 2020.

Key equity averages remain sharply below their year-end 2019 levels as of this writing. The US Federal Reserve pledge to provide unlimited quantitative easing seems to have soothed bond markets, but concerns about deteriorating credit quality and an associated increase in impairments remain. As a result of declining asset values, surplus and risk-adjusted capital levels are expected to decline.

### **Solid Risk-Adjusted Capitalization and Liquidity**

The industry has built a solid level of risk-adjusted capitalization to support its various premium, reserve, and asset risks, among others. Risk-adjusted capital levels are being assessed to gauge the impact of the pandemic on individual companies, but AM Best believes that most companies have sufficient capital to support their current ratings, even with the investment volatility that marked much of March.

As we expect losses will be lower, more or less in line with premiums, we do not anticipate significant liquidity concerns at the industry level. However, regulatory or legislative requirements to allow insureds to extend payment terms could result in temporary issues, as cash flows from premiums would be disrupted in advance of the offsetting reduction in claims payments. Given that most insurers plan to fund loss payments out of incoming premiums rather than by liquidating assets or using the proceeds of maturing investments, a slowdown in premium receipts could have unintended consequences. Companies without sufficient cash on hand or access to back-up funding sources might be forced to liquidate assets to meet claims over the short term.

A return to a Stable outlook will depend in large part on the extent and length of the economic downturn and conditions; progress on the development of effective treatments and methods to identify individuals who may have an immunity to the virus; and a clearer sense of the impact of any government actions to offset some of the economic fallout of the shutdown. Expectations now are that the economy is more likely to have a relatively flat and lengthy recovery, and AM Best will continue to monitor the situation and provide updates as appropriate.



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## Market Segment Outlook: US Commercial Auto

**Commercial  
auto outlook  
remains  
Negative amid  
changing  
claims  
environment  
despite signs of  
improvement**

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

- Despite several years of consecutive rate increases, year-end 2019 filings are likely to show that the line's underwriting performance deteriorated from its 2018 levels.
- Adverse development of loss reserves and increases in current accident year loss costs continue, as companies attempt to adjust to the changing claims environment.

Price increases and underwriting actions are expected to continue through 2020, although the economic effects of COVID-19 may increase pushback. As a result, AM Best expects a modest improvement despite expectations of another year of unprofitable underwriting for the line.

### Numerous Challenges

The commercial auto line's loss severity and frequency continue to increase, although the decrease in traffic due to "stay at home" orders may result in a decline in frequency, even if only temporarily. Severity is being driven by rising costs associated with both property damage (first- and third-party) and higher average claims seeking damages for bodily injury. Despite new technology that helps keep drivers alert and focused on safe driving habits, distracted driving remains a major concern and is affecting frequency. The effect of social inflation, which has caused an increase in the number of claims with claimant attorney representation, as well as higher settlements and jury awards, has added substantially to current accident year loss trends.

### Limited Impact of COVID-19

The COVID-19 pandemic is not likely to have a substantial net effect on the commercial auto line. Accident frequency may decline as commercial vehicles encounter less traffic owing to stay-at-home orders, particularly in areas with high population density. Some of this benefit may be nullified by lower premiums for policies with usage-sensitive premium bases, such as miles driven. The extent of the impact will depend on how long social distancing practices are in effect and the severity and length of the associated economic slowdown.

### Potential Improvement in Underwriting Results

AM Best's expectation for an improvement in underwriting results in 2020 reflects the impact of compounded rate increases in recent years, with some carriers implementing consecutive double-digit rate hikes, and underwriting actions being taken to improve the overall quality of the insured population. Companies continue to work with insureds to implement technology that helps better monitor driving habits and provide information that can be useful in adjusting and settling claims.

Some companies, particularly those with a specialty focus in the commercial auto segment, have seen their results improve recently. However, the persistently challenging legal environment makes it likely that this line will remain a drag on the industry's profitability.

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## Market Segment Outlook: US Excess & Surplus Lines

**The outlook for E&S is moving to Negative, owing to the disruption caused by the COVID-19 outbreak and the ensuing contraction in the US economy**

AM Best is revising the outlook for the excess and surplus lines segment to Negative from Stable. The disruption stemming from the COVID-19 outbreak has resulted in a contraction in the US economy. For several years, this segment had benefitted from strong growth, coinciding with the expanding and strengthening economy. A direct link has been established between a healthy US and worldwide economy and the need for surplus lines products, particularly servicing new or emerging markets and industries for which the segment's innovative coverage solutions and products are specifically vital. The pulse of a healthy surplus lines market has been measured by the increased activity of stamping offices processing the business.

The contraction in economic activity has already had an acute, overwhelming impact on small businesses throughout the country, and US economic indicators show that a majority of US businesses have experienced declines. Further deterioration at the pace economists are predicting will reduce the need for insurance for the traditional surplus lines markets of unique, specialized risks. Markets in which many surplus lines carriers participate—contractors, commercial business, manufacturing, construction, to name just a few—may experience significant declines in demand. A contraction in exposures does offer some benefits, but decreased underwriting cash flow, potential increases in claims frequency and severity, and challenging investment market conditions will leave many companies swimming against the current. Surplus lines carriers are also likely to be subject to the coverage creep issue that state legislatures are already attempting to undertake for business interruption losses.

Despite numerous challenges, the proven, long-term expertise and commitment to core competencies that have allowed the seasoned surplus lines organizations to flourish historically will be even more critical now, if these companies are to navigate the current unprecedented conditions. These insurers have previously overcome the traumatic impact of weather, economic, social, and political factors, proactively managing their risk-adjusted capitalization and preserving policyholders' surplus. AM Best believes the surplus lines segment has the fundamental strengths that will help them endure and overcome the tremendous challenges they must face as the country deals with the myriad levels of disruption caused by COVID-19.

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## Market Segment Outlook: US Homeowners

**Homeowners  
outlook  
remains Stable  
as CAT losses  
subside from  
2017 and  
2018; impact  
of COVID-19  
remains to be  
seen**

AM Best is maintaining its Stable outlook on the US homeowners segment. The key drivers for this outlook are:

- Significant decline in catastrophe activity
- Generally profitable underwriting performance
- Strong risk-adjusted capitalization

Potential offsetting factors include:

- Increased reinsurance pricing in catastrophe-exposed areas
- Uptick in non-weather-related water losses
- Greater than expected impact from COVID-19

### Significant decline in catastrophe activity

Following recordbreaking CAT activity in 2017 and above average storm losses in 2018, the homeowners segment experienced reduced CAT losses in 2019 despite being one of the wettest years on record for the US. The most notable activity included wildfires affecting multiple areas in California and Alaska, two tropical cyclones (Dorian and Imelda), three inland floods (affecting the Missouri, Arkansas, and Mississippi Rivers), and eight severe storms. In 2019, the US saw 14 weather and climate disasters with losses over \$1 billion each, at a total estimated cost of \$45 billion, with floods accounting for \$20 billion of this total, compared to over \$100 billion in 2018. In 2019, segment companies also experienced some loss creep from Hurricane Michael, with current insured loss estimates over \$7 billion, largely due to social inflation, increased litigation, and ongoing assignment of benefits issues in Florida.

After two active years of California wildfires, with 2018 accounting for more than \$10 billion in insured losses, homeowners insurers have been taking numerous re-underwriting measures, filing rounds of rate hike requests and exiting fire-prone areas where not restricted by recent legislative changes. Given the "new normal" trend in wildfires, many segment companies have re-evaluated their wildfire underwriting strategies and enhanced their reinsurance programs to limit exposure concentrations. Enhanced data analytics on the wildfire peril, including CAT models and risk scoring, can help companies better manage this risk.

### Generally profitable underwriting performance

Premium growth in the US homeowners segment benefited from pricing activity in loss-affected areas, reflecting carriers' increased emphasis on rate adequacy in recent years. Operating performance in 2019 for the segment profited from below average CAT activity and other underwriting actions taken by management. Savvy homeowners companies have been able to manage volatility through improved pricing sophistication, continued exposure management, and enhanced reinsurance programs that take advantage of both traditional and non-traditional reinsurance capacity.

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Top performing homeowners insurers have also invested a significant amount of resources into technology to improve their underwriting and pricing tools. Advances in predictive modeling and pricing analytics, as well as the use of third party data, have provided homeowners carriers greater opportunities to pursue profitable growth.

### Strong risk-adjusted capitalization

Many homeowners carriers' surplus levels benefited from the quick rebound in the equity markets in the first quarter of 2019 following the significant downturn in December 2018. Carriers that had sufficient liquidity to hold firm despite above-average catastrophe losses in 2018 were able to strengthen their capital position. A significant increase in unrealized capital gains, combined with underwriting profitability and favorable investment returns, has allowed surplus to reach record levels in 2019. While 2020 has proven to reverse most of the prior year's capital gains in response to COVID-19, most carriers have been able to absorb the downturn to date.

### Increased reinsurance pricing in catastrophe-exposed areas

A long-term trend of favorable reinsurance pricing leading into the catastrophe events of 2017 and 2018 benefited the homeowners segment. While the abundance of capacity had delayed the upward tide of reinsurance pricing, there is now more demand from reinsurers in terms of price increases and tighter terms and conditions in CAT-exposed areas, as they look to better manage their risk appetites. Rising reinsurance costs have the potential to pressure operating performance and balance sheet strength of the homeowners segment, particularly those in loss-affected areas with a high dependence on reinsurance.

**Uptick in non-weather-related water losses**

Non-weather-related water damage claims have increased significantly over the past several years and are a leading cause for homeowners claims. Issues including frozen pipe leaks, faulty plumbing, sewer backups, and broken appliance water lines have become more prominent with relatively high loss costs for these water damage losses. Insurtech in the homeowners segment has gained increased attention and insurers have been promoting the use of in-home, tech-enabled water detection tools to alert the policyholder of potential issues or shut off the water system completely. While these types of tools may prove effective in limiting losses, homeowners carriers are still evaluating how to distribute and appropriately reflect the use of these tools in their pricing algorithms.

**Greater than expected impact from COVID-19**

Currently, the COVID-19 virus is not anticipated to have a material adverse impact on the US homeowners segment. Most carriers have implemented work-from-home solutions to comply with state-mandated rules, and call centers have remained operational to service policyholders. AM Best anticipates carriers will benefit from continued remote underwriting and claims process through enhanced technology and increased use of mobile apps. While recessionary economic conditions and elevated unemployment rates raise concerns over the ability of insureds to support mortgages and pay for insurance, many insurance companies in this segment are offering extended grace periods and payment options to their customers to ease the financial strain. Additionally, some mortgage lenders are utilizing forbearance options whereby a lender temporarily reduces or suspends mortgage payments until the homeowner's financial condition has stabilized. In the face of this uncertainty, many companies in this segment are also increasing liquidity levels.

The most notable and immediate financial impact for the US homeowners segment has been attributed to fluctuations in capital levels for companies with large common stock holdings, given the market downturn in recent weeks associated with economic concerns following social distancing and stay-at-home mandates. While many companies in this segment maintain robust balance sheets, those that have weaker risk-adjusted capitalization may not be able to withstand the erosion in capital and, accordingly, could face ratings pressure.

AM Best's Stable outlook assumes that companies in the US homeowners segment will continue to respond appropriately to market challenges, including the current pandemic and elevated level of uncertainty. The focus on data analytics, pricing segmentation, exposure management, and ongoing leveraging of technology and innovation has positioned this segment to withstand these market challenges. Should risks fall materially outside of current expectations or the pandemic impacts materialize more profoundly for this segment, however, the outlook would be revised.



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# BEST'S MARKET SEGMENT REPORT

April 7, 2020

## Market Segment Outlook: US Medical Professional Liability

**Key drivers of  
our Negative  
outlook for  
the segment  
are depressed  
demand and  
diminishing  
reserve  
redundancies,  
as well as  
COVID-19**

AM Best is maintaining its Negative outlook on the medical professional liability (MPL) segment for 2020, owing to the following factors:

- Depressed demand
- Diminishing reserve redundancies
- Concerns regarding rate adequacy amid rising loss cost trends and social inflation
- The impact of the COVID-19 pandemic

### COVID-19 Throwing a Wrench in the Works

The number of confirmed diagnosed COVID-19 cases continues to grow. The healthcare community is doing its best to manage this unprecedented pandemic, but inadequate supplies, staffing, and hospital space all present major difficulties that could result in additional risk and numerous liability concerns to all of those professionals and facilities involved, including the medical professional liability insurers who insure them.

As this situation worsens, healthcare systems are becoming more strained, which could lead to non-standard care practices. Physicians and healthcare professionals who have not been professionally trained in infectious disease but are volunteering to assist hospitals and physicians could also find themselves caught in a web of liability. Most experts agree that the case numbers will grow exponentially as more diagnostic tests are rolled out, which, in turn, could lead to a greater number of less experienced professionals involved. The rise in cases also means more hospital overcrowding, higher patient per medical, and a greater risk for delayed procedures and hospital infections—further burdening an already constrained healthcare system, which could result in additional potential liability.

The areas most effected by the virus are the more densely populated cities, some of which— unfortunately for medical professional liability insurers—are the least desirable as far as litigation venues are concerned. Further exacerbating the situation is the shortage of medical equipment and supplies and hospital beds, all of which could lead to more unfavorable medical outcomes and lawsuits.

On the brighter side, potential litigation will depend on whether a bill providing federal liability immunity to medical professionals courageous enough to risk their own lives for the sake of others will garner bipartisan support. Until such an act is passed, Good Samaritan laws would still apply and would be the mechanism states can use to provide much needed liability protection for those on the front lines. However, delays in non-pandemic-related medical treatments and elective surgeries, as well as the expanded use of telemedicine, could result in negligence, including “failure to diagnose”—an area that has always posed some of the greatest challenges when it comes to potential liability exposure. These issues, along with existing headwinds to the segment, further dim profitability prospects for the segment.

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### Operating and Underwriting Income Under Pressure

The number of independent physicians has shrunk due to consolidation in the healthcare industry and the employment of physicians by hospitals that often have their own captive or self-insurance mechanisms. As the population of those aged 65 and over in the US continues to grow, Medicare reimbursements and outcome-based medicine will likely fuel yet more consolidation.

To combat a dwindling insured base, many MPL insurers have implemented alternative strategies. Some carriers have leveraged their expertise to expand or diversify into new markets and enhance product offerings. Others have looked to improve efficiencies through innovation, such as intelligent automation and data analytics. And some are looking to partner with other MPL carriers in an effort to reach outside their geographic boundaries through reinsurance arrangements or joint ventures.

Nevertheless, profitability has been unfavorable in recent years. The impacts of social inflation and the rising frequency of high severity claims have minimized the impact of rate increases. The segment's excess capital and capacity continue to provide a buffer for escalating loss costs but have had a minimal effect on improving performance or revenues. Operating and underwriting results are likely to remain pressured through 2020, as the segment continues to work through these challenges as well as the impacts of the pandemic on loss costs and carriers' ability to implement planned rate increases, during a challenging time for healthcare providers. These concerns are magnified by the reduction in favorable prior year reserve redundancies and the erosion of tort reforms in states across the country.



### Carriers Facing Other Challenges

MPL carriers will continue to face hurdles from other market dynamics as well, such as the evolution of healthcare delivery systems; the digitization of healthcare and medical records as it relates to patient privacy and the heightened activity of cyber events; the rapid pace of innovation in the healthcare industry; and the potential impact of the opioid crisis and litigation financing. The segment's long-term survivors will be those able to effectively use innovation to identify and appropriately price existing and emerging underwriting risks; find new ways to bring new value-added products and services to the market; improve efficiencies and reduce expenses; and maintain—and even gain—competitive advantages.

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# BEST'S MARKET SEGMENT REPORT

April 7, 2020

## Market Segment Outlook: US Professional Liability

**Our outlook on the segment has gone to Negative from Stable owing to difficult market dynamics**

AM Best has revised its outlook for the professional liability market segment from Stable to Negative, owing to the effects of a variety of market dynamics on the lines that comprise the professional liability insurance market, including employment practices liability (EPL), errors and omissions, cyber, and non-medical professional liability (lawyers, accountants, architects, etc.). In addition, the COVID-19 outbreak in the US and the accompanying stock market decline could bring about more opportunities for lawsuits, which at the very least would result in a rise in claim defense costs. The largest line in the segment is Directors & Officers Liability (D&O), for which the risk exposures have expanded exponentially over the past few years, amid an increasingly complex and interconnected business environment. Among the specific reasons for the change in outlook are the following:

- Social inflation—specifically, the rising cost of litigation from societal trends such as more plaintiff-friendly juries, broader interpretations of liability contracts, and negative attitudes toward larger businesses and corporations—is driving the rise in both loss frequency and loss severity.
- Significantly more capital is being invested in litigation financing, and heightened regulatory issues are also placing more pressure on the segment.
- New event-driven exposures from man-made and environmental disasters and product issues have emerged, often resulting in significant securities or derivative claims from shareholders.
- A record number of class action lawsuits and cyber issues/new data protection laws are further pressuring corporate boards to disclose information on a timely basis.

These issues have put the onus squarely on the industry's underwriters to properly assess and underwrite these evolving risks.

### D&O Profitability Deteriorating

For years, the ongoing profitability of D&O coverage made it extremely attractive, drawing capacity while causing rates to drop precipitously. The push by a number of D&O underwriters for higher pricing only began to take hold midway through 2018 and has not yet stemmed the tide of recently deteriorating underwriting results for both public and private company D&O.

Whether the higher rates and tighter terms and conditions can keep up with the constantly evolving risks is in doubt. A case in point: The \$240 million Wells Fargo derivative suit settlement in the spring of 2019 has been described as the largest ever insurer-funded cash component of any shareholder derivative settlement. The Side A portion of D&O, which covers derivative suits, had long been considered a more benign exposure. Public D&O underwriters have to consider the ramifications of this settlement in their underwriting, given the potential rise in actions from the plaintiff bar.

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### Potential for Increased Third-Party Liability Claims Owing to COVID-19

COVID-19-related third-party liability claims filed against companies and their boards may be higher than they were in previous coronavirus outbreaks such as Middle East respiratory





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syndrome (MERS) and severe acute respiratory syndrome (SARS). We expect that claims will be in the form of securities class actions and shareholder derivative claims related to affirmative acts of mismanagement or the failure to act/disclose by officers and directors in response to the outbreak. Two securities class actions related to the pharmaceutical and cruise industries were filed in March. Uncertainty about the duration of both the virus and its impact creates the potential for even more volatility for insurers to contend with.

### Cyber and Privacy Exposures Growing

Cyber risk and privacy liability are exposures with increasingly complex risk characteristics, presenting numerous challenges for professional liability underwriters. Cyber and data breaches are becoming ever more pervasive in all different business sectors, particularly for businesses that rely on personal data. At the same time, new data protection laws and related requirements have added to the minefield companies must navigate to protect against potential litigation. The COVID-19 situation could lead to more claims, as companies' security systems may be overwhelmed by the vast number of employees working remotely.

### Employment Practices Liability

The EPL segment has seen a notable increase in the number of harassment lawsuits over the last couple of years, as the #MeToo movement has prompted societal changes that are likely to be lasting. Laws in some states have made it somewhat easier for individuals to file suits alleging harassment and discrimination for events that may have taken place years earlier, resulting in very complex and costly workplace dispute cases for insurers to defend or settle. Also of note is the growth in age discrimination lawsuits.



### Capacity Ample but More Focused

Capacity for professional liability remains ample, given that these products allow large national and international multi-line companies to round out their product offerings. However, this capacity is far from naïve, with judicious selection for high-profile risks such as general healthcare, technology, and life sciences, as well as non-profits with exposures to preschools, camps, and other youth activities. Insurers will need to better assess and adequately price for the ever-changing risk exposures while effectively focusing on new and evolving regulatory requirements.

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Version 010320



# BEST'S MARKET SEGMENT REPORT

April 7, 2020

## Market Segment Outlook: US Workers' Compensation

The main offsetting factor is the segment's solid level of risk-adjusted capitalization, which AM Best believes will withstand the effects of the pandemic on the workers' compensation segment.

AM Best is revising the outlook for the workers' compensation segment, the largest component of the commercial lines market, from Stable to Negative.

This action reflects AM Best's concerns that the unprecedented coronavirus (COVID-19) pandemic will significantly impact economic conditions over the upcoming year, with businesses of all sizes impacted. Exceptionally high unemployment and a sharp decline in GDP are projected. Additionally, balance sheets will be pressured by the increased market volatility as evidenced to date by the large drop in the Dow Jones Industrial Average (DJIA) since year-end 2019. The prospect of interest rates staying lower than expected for longer than expected will also lead to reduced investment returns.

The main offsetting factor is the segment's solid level of risk-adjusted capitalization, which AM Best believes will withstand the effects of the pandemic on the workers' compensation segment. While there may also be some upside to the workers compensation sector as a result of the event (less fraud, fewer workplace accidents, lower defense costs), these are outweighed by the aforementioned economic and financial market concerns. Furthermore, workers' compensation premiums are generally based on payroll, and a decline in payroll when workers are laid off will drive a reduction in revenue to the insurers. Over the near term, the net effect of lower losses may shield insurers' underwriting income from the full impact of the drop-off in premiums, although expenses will likely go up relative to premium, causing some deterioration in the combined ratio.

Prior to the event, the segment had already been under pressure as many states were continuing to experience rate decreases, with this compression putting pressure on the direct loss ratio. The line had continued to perform well in recent years, owing to a decline in lost-time claims frequency and a concerted effort to improve workplace safety.

AM Best will continue to monitor the situation and provide updates as appropriate.

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**AM 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. Best's ratings take into account the manner in which companies manage these factors and trends.

A Best's Market Segment Outlook, like a Best's Credit Rating Outlook for a company, can be Positive, Negative, or Stable.

- 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.
- A Negative market segment outlook indicates that AM Best expects market trends to have a negative influence on companies operating in the market over the next 12 months. However, a Negative outlook for a particular market segment does *not* mean that the outlook for all the companies operating in that market segment will be Negative.
- A Stable market segment outlook indicates that AM Best expects market trends to have a neutral influence on companies operating in that market segment over the next 12 months.

We update our market segment outlooks annually, but may revisit them at any time during the year if regulatory, financial, or market conditions warrant.



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