Homeowners Return on Equity Outlook

October 2022

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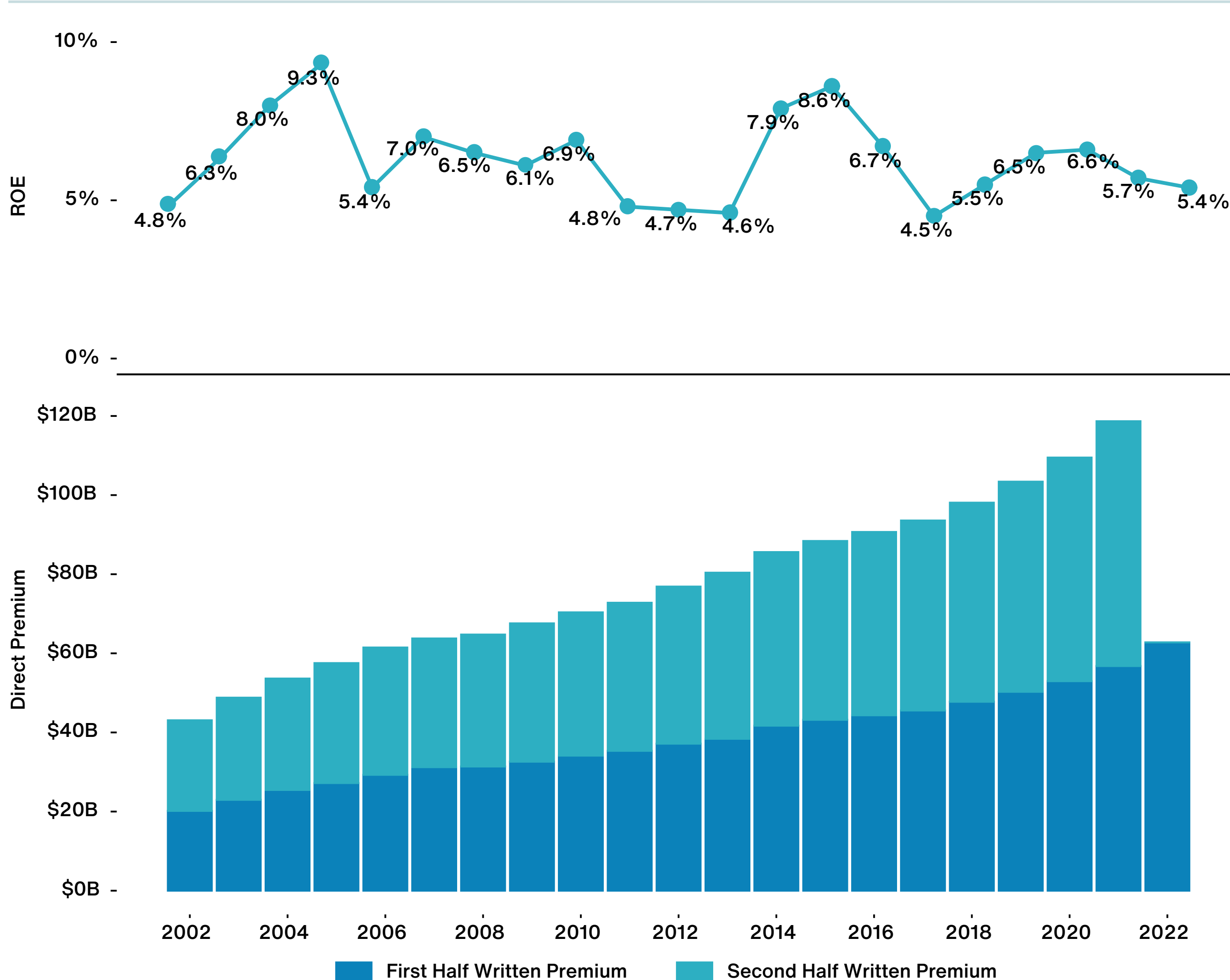
Return on Equity Study Methodology

The basis of the prospective Return on Equity (ROE) estimate is state and aggregate statutory filing data including reported direct losses, expenses, payout pattern, and investment yields. We replace actual historical catastrophe losses as measured by Property Claims Services with a modeled view of expected catastrophe loss. On-leveling of direct premiums to current rates uses rate filing data from both SERFF and data vendors. Finally, estimated capital requirements and reinsurance costs consider a capitalization level consistent with an AM Best "A" rating for all states except for Florida Specialists where capitalization level is determined by Demotech rating. The ROE estimates exclude earthquake shake losses as the premium and losses for that coverage are recorded on a separate statutory line of business.

Twenty Years of Benchmarking Homeowners Returns

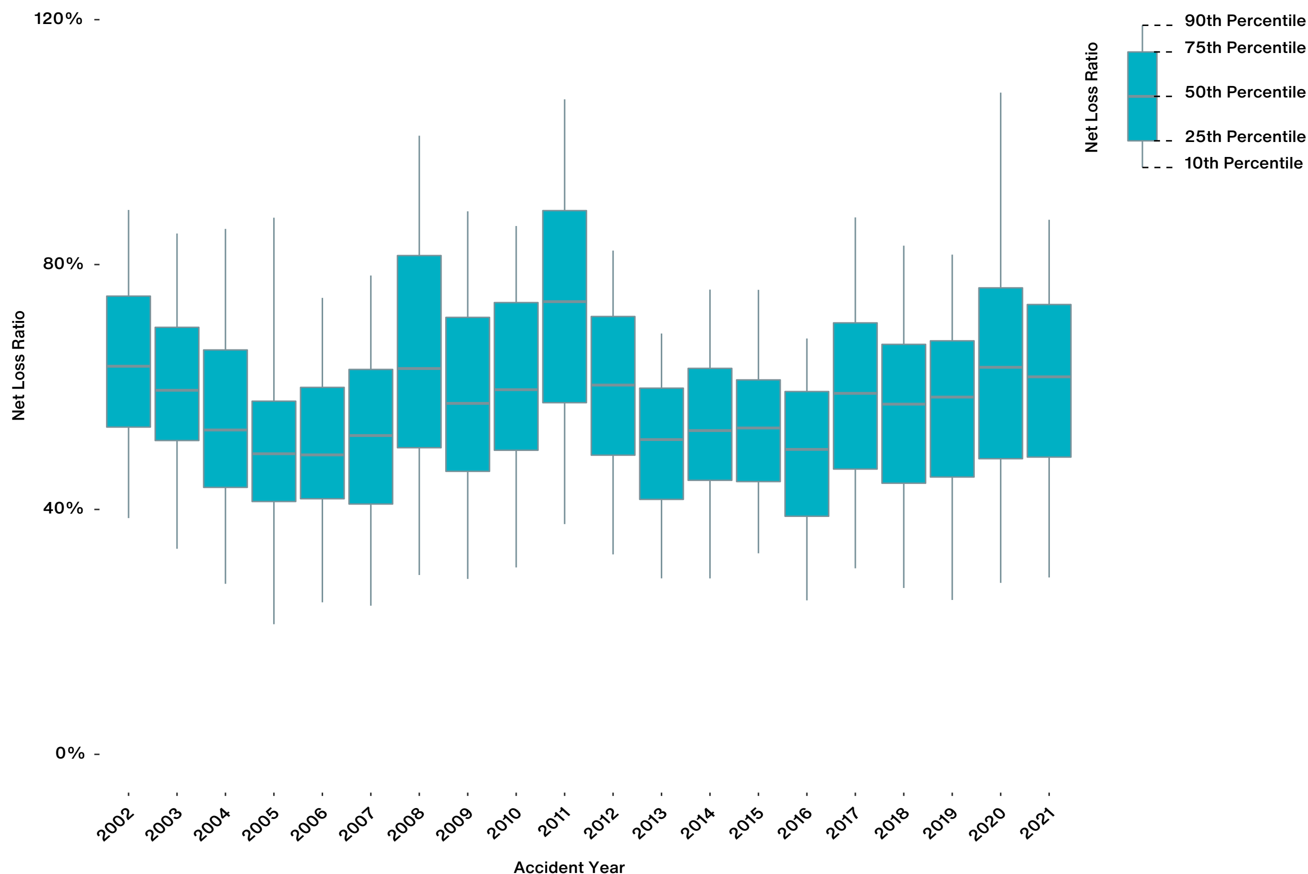
This 2022 edition of Aon's Homeowners Return on Equity (ROE) report begins our third decade of measuring and reporting on the health of this important line of business. Aon's first Homeowners ROE report was released in 2002. A lot has happened in those twenty years with one constant: the Homeowners line has never, on a prospective actuarial basis, hit our benchmark hurdle rate for return on capital (even after we moved the hurdle down to 10 percent from 15 percent in the original study). This year we find the prospective ROE for our National cohort to be 5.4 percent, and the full history of both premium volume and measured ROEs is below:

Exhibit 1: Prospective ROEs and Written Premium Through Time



The chart belies changes in methodology and data inputs; the study has changed significantly over the course of its publication history. Nonetheless, the comparisons through time are apt as we've always sought to measure the prospective ROE through a pricing actuary's lens. Exhibit 1 also demonstrates the immense volume the line achieved; by year end 2021 Direct Premiums Written (DPW) hit $119B which represents 15 percent of the $798B total P&C DPW in the United States. Given rate activity in 2022 and first half premium volume, we are likely to hit $130B by 2022 year end.

Exhibit 2: Loss Ratio Distribution for Insurers Through Time



One of the challenges of measuring profitability for Homeowners is separating signal from noise in historical results. The significant exposure to weather events and natural catastrophes exacerbates this difficulty. Exhibit 2 demonstrates both the year-to-year volatility for the line and the range of outcomes between insurers. Oversimplifying, the historical difference between median and top-quartile performance is approximately 10 loss ratio points. Adjusting our prospective ROE to top-quartile loss ratio results yields 12.5 percent. Most insurer outperformance is explained by regional companies sitting outside the catastrophe bull's eye for a season or two. Our target direct combined ratio for the national cohort to hit the 10 percent ROE hurdle is 92.6; on a ten-year basis, three of the eight (~39th empirical percentile) insurers in our national cohort met that target.

While it is possible (through outperforming 75 percent of the industry) to achieve our 10 percent ROE benchmark, there are important factors to consider regarding the general future of this line that holds significant importance for the financial security of over 80 million U.S. homeowners. Long term concerns can be summarized as climate trends, demographic trends, and regulatory trends. In the pages that follow, we'll provide the following: a review of short-term forces affecting insurers now, commentary on climate, demographic, and regulatory trends and the exhibits and benchmarks for our national and specialist cohorts that became a staple of the report with the last three editions.

What's Happening Right Now?

Macroeconomics, and specifically inflation, was the headline in last year's edition. It is in this year's also. The macroeconomic picture continues to exude turmoil with negative impacts to Homeowners insurers. The picture has a few components: First, as of print time, the S&P 500 is down 19 percent since December 31, 2021. In the 10 years leading up to December 31, 2021 our national cohort increased their equity holdings from 20 percent to 27 percent of surplus and their alternative investments from 6 percent to 8 percent of surplus because the historically low fixed income yields and limited underwriting profitability pushed them into higher volatility assets in search of returns (admitted bonds fell from 68 percent to 60 percent over the same period). A notable follow on: we've kept the ROE hurdle at 10 percent for this year's edition as the industry is still contemplating the possibility of a higher cost of capital going forward (versus treating the current interest environment as temporary). It is reasonable to suppose a 12 percent or higher ROE hurdle will be appropriate for insurers trying to attract capital in a higher yield environment than what we experienced in the 2010-2020 window.

Second, also as of print time, the Vanguard total bond market index (VBMFX) is down 13 percent. Insurers are savers and, over the long term, benefit from higher interest rates. Nonetheless, rate shocks and abrupt migration to higher interest rates depress the value of the large amounts of fixed income AAA and Treasury instruments property insurers like to hold in significant quantities. **The net consequence of these changes is that aggregate total surplus for our national cohort is down from $282B at December 31, 2021 to $255B at July 1, 2022** (this policyholder surplus supports all lines written by the cohort insurers). At the same time, first half 2022 direct written premiums grew to $37B from first half 2021 premiums of $33B. We estimate the aggregate impact to the AM Best capital adequacy ratio for the cohort at a fourteen-point reduction combining effects including increased premiums and reduced policyholder surplus. The good news is these insurers started in extremely strong capital positions and have been able to absorb the increased risk levels while continuing to maintain adequate capitalization. Further, if the insurers can avoid any liquidity calls, they should be able to carry the bonds to expiry and redeem them at par value; in other words, unrealized losses on the bond portfolio could shake out as a timing blip with a little luck. Similarly, the stock market may bounce back over the course of the cycle further helping bolster capital adequacy.

One other form of good news is inflation; more specifically, **insurers succeeded in keeping up with inflation**. Last year we reported on potential impacts to the ROE if insurers fell 300 or 1,000 basis points behind on inflation. A year later we can confidently say that that inflation guard features on policies worked as designed. There is still a half year earning lag as policies automatically renew at new, increased coverage values. And on a case-by-case basis some insurers benchmarked their coverages better than others. Members of our national cohort generally achieved double digit coverage value increases via their inflation guard mechanisms, and this flows one-to-one into increases in premium volume with no required change in rates (as indicated above that 2022 H1 premiums are 12.6 percent higher than 2021 H1 premiums for the national cohort).

We should make the following clear about inflation guard: **if you're benchmarking to Consumer Price Index (CPI) or Producer Price Index (PPI), you're falling behind.** Industry normative practice is benchmarking directly to a building cost valuation vendor in the policy system. The industry leaders are using multiple external and internal data sources to implement geographically specific inflation indices. And it is working.

The inflationary environment also impacted reinsurance market capacity and utilization. Inflation adjusted values and claims payments drove both modeled and actual losses into excess reinsurance layers; the market responded with hardening prices and risk appetite adjustments. Homeowners insurers faced these headwinds throughout 2022 and will continue to do so into 2023. We quantify the potential impact of current-market reinsurance costs to the cohorts in the benchmark analysis sections of this report. Like primary results, reinsurance outcomes vary significantly by insurer for many reasons; this report focuses on aggregated and averaged results.

Climate Trends

Recently, so called "non-peak" or "secondary" perils have been driving increases in insured losses in the U.S. Since 1990, increases in losses by non-tropical cyclone perils outpaced the increase in tropical cyclone losses. When we compare our modeled severe thunderstorm and wildfire expected loss to recent catastrophe experience, aggregate three-year experienced loss ratios are five and two points higher for these two perils, respectively. That combined five loss ratio points of activity above modeled expectation is why we estimate 2019-2021 actual ROEs for Homeowners insurers below 2 percent; when your expected ROE is less than 6 percent, there's very little cushion to absorb adverse weather outcomes. 2022 has continued that trend, with a noticeable uptick in losses through the first half of the year, particularly in the upper Midwest where tornadoes, hail and derecho events have pummeled insureds and left many insurers evaluating if they are just unlucky or if there is something more to the story.

Climate scientists are becoming more confident in attributing relative risk to areas that are expected to change due to anthropogenic impacts on climate in the future, and we're already beginning to observe changes for the few perils where the link between climate change and risk is clearer. For instance, researchers suggest that favorable conditions for wildfire activity have increased over the last twenty years and will continue to do so with future warming through increases in vapor pressure deficits as shown in Exhibit 3. This is correlated well with increased fire sizes and is reflected in recent experience; nine out of the top ten wildfires that caused over $1B in insured loss occurred from 2017 to 2021. Additionally, scientists have observed increases in extreme precipitation over the last 20 years (as in Exhibit 4), driven by a warming planet enabling weather systems to hold more moisture. While correlations between atmospheric moisture content and severe weather are not well established to date by the scientific community, there is the possibility that a warmer planet could potentially have more thunderstorm activity. This could be influencing recent observed weather trends; Property Claims Services (PCS) events from 2011-2020 produced an average loss ratio that is four points higher than 2001–2010 for states driven by severe thunderstorm.

Exhibit 3: Twenty Year State Averaged Trend in Vapor Pressure Deficit

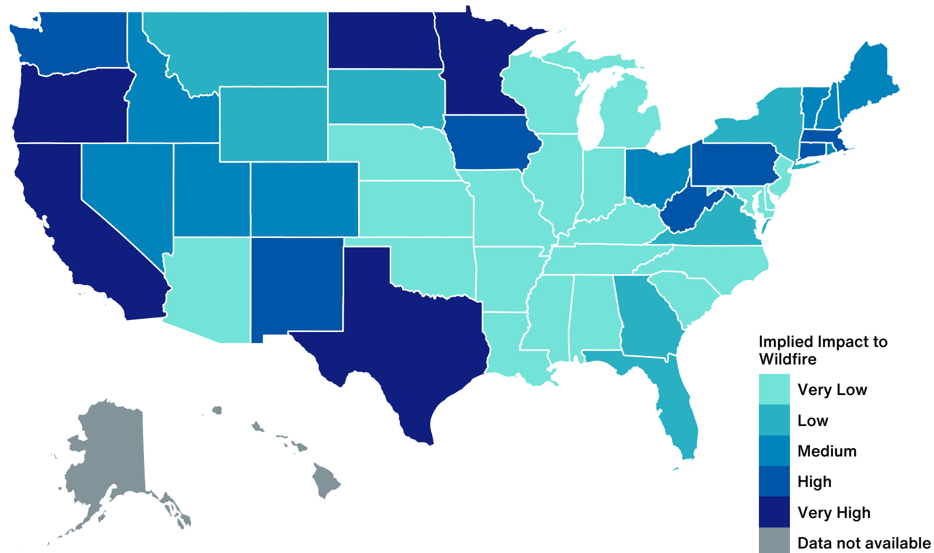
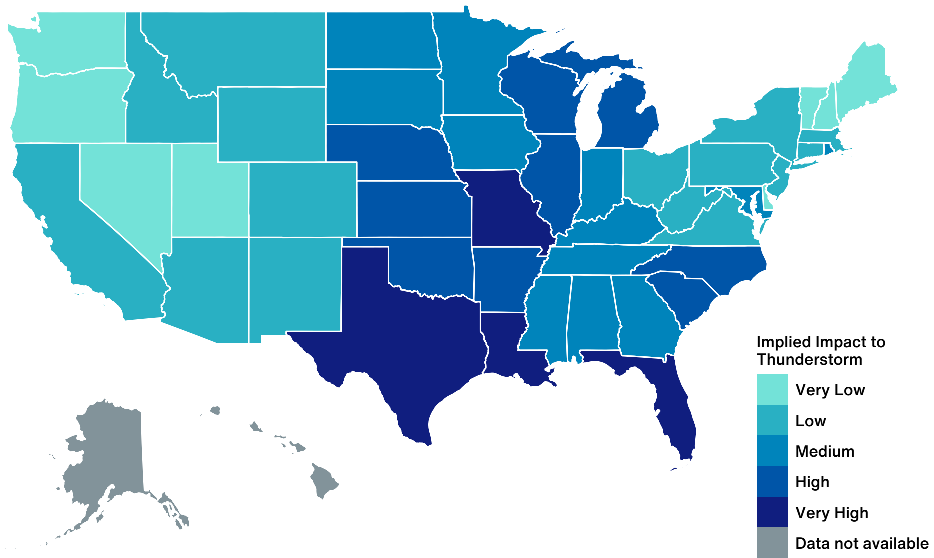


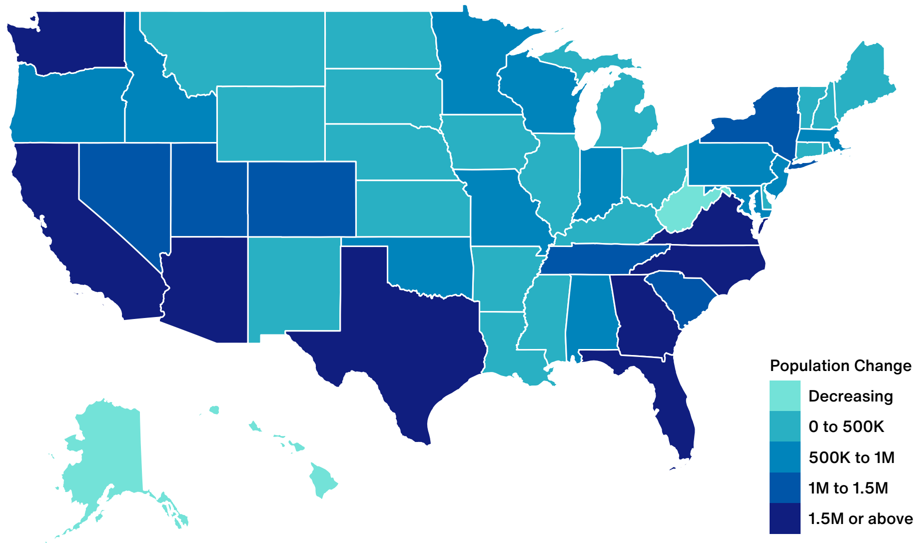
Exhibit 4: Twenty Year State Averaged Trend in Single-Day Extreme Precipitation



Demographic Trends

An additional trend challenging insurers is a changing population footprint. People are migrating into riskier zones even before you layer on additional potential impacts from climate change. Over the past 20 years, we saw population growth exceeding 1.5M people in states like California, Florida and Texas, all states which are prone to some combination of catastrophic wildfires, severe thunderstorms or hurricanes.

Exhibit 5: Twenty Year State Change in Population

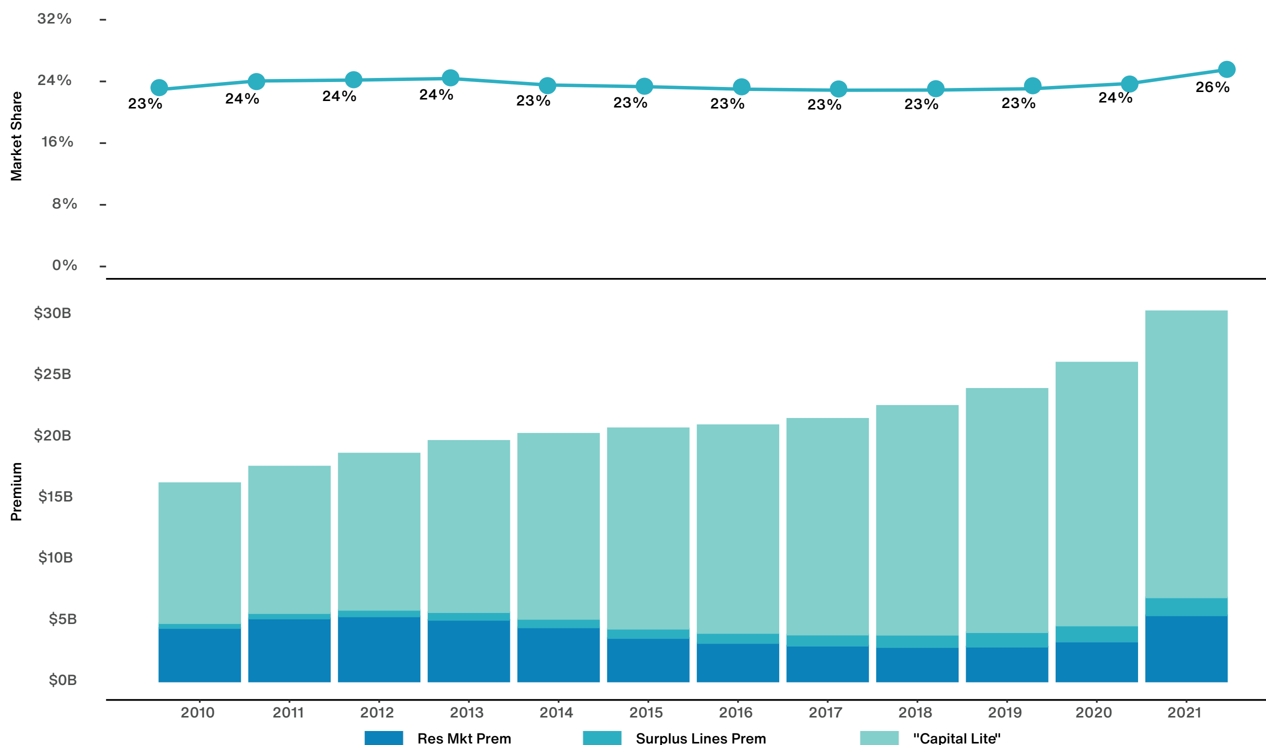


Further, social inflation and expansion of challenging judicial domains are leading to measurable increases in defense and cost containment expenses (DCC) for insurers in select jurisdictions. It costs up to 20 points on the loss to adjust and settle a claim for insurers in high-litigation jurisdictions; up to a quarter of that cost could be eliminated if insurers were forced into adversarial claims situations less often. The largest dollar impacts of social inflation likely manifest as "nuclear verdicts" in liability lines; from that perspective the Homeowners line may escape the worst of it. So, while it is true that inflation guard has kept Homeowners insurers roughly up-to-date with the macroeconomic environment, social trends towards higher utilization of insurance (i.e. more propensity to file a claim, litigate a claim, and expect a claim to settle at or above policy limits) will require rate action to address if they don't abate.

Regulatory Trends

The demographic trends highlighted that homeowners are migrating into higher cost geographies more prone to natural catastrophes that drive volatile financial results. Higher volatility requires higher profit margins to attract the necessary capital to provide high quality insurance coverage. These higher risk zones also tend to be more heavily regulated. If regulators focus too heavily on affordability, resulting rate and regulatory actions can reduce the ability for insurers to achieve sufficient returns to attract and retain capital to the homeowners line as the population migrates to the heavily regulated jurisdictions. This can be seen in the expansion of residual markets, surplus lines insurers, and “capital-lite” approaches, all of which represent a different strategy to cope with an inability for the private admitted insurance market to charge an actuarially sound premium.

Exhibit 6: Premium and Market Share Growth for Non-Traditional Insurers



The residual market is a mechanism for monitoring the most aggressive approach to frustration with rate regulation: private insurers simply reduce their underwriting appetite to exclude the classes of business most likely to be unprofitable.

Surplus lines (or “E&S” lines) describes an alternative private market strategy that provides freedom of rate and form to the insurer, but often at the cost of higher expense structures. Surplus lines insurers spend up to 43 cents of expense on each premium dollar (including claims adjusting) vs. the industry average of 35 cents. Highly customized insurance products tend to be more expensive to acquire and administer and surplus lines insurers often cover niche business. Surplus lines insurers may be required to work through wholesaler distribution platforms that must confirm (e.g. with three declinations) the inability of the policyholder to purchase a policy in the admitted market. Also, surplus lines policies deny the policyholder access to the state’s guarantee fund in the event of insurer insolvency.

The third strategy for coping with frustrating rate regulation is the “capital lite” business model. Capital lite business plans seek to achieve hurdle ROEs by sizing the capital denominator of the ROE equation to fit with the dollars of profit regulators are allowing. Our rate indices later in this study show that insurers are accelerating their rate increases relative to last year. That is good news, but insufficient to move the market above the hurdle 10 percent ROE. And that hurdle likely is not high enough to attract truly novel capital sources to the industry to back startup insurers. With the collapse of insurtech valuations and the slow growth of direct distribution into the Homeowners product, the ability to attract capital is limited. In the last 24 months of new company formations where Aon participated, the interest in Homeowners was either from surplus lines business plans or capital lite strategies including reciprocal exchanges.

Residual markets, surplus lines policies, and capital-lite strategies all have their place within a well-functioning marketplace that both offers consumers considerable

choice and ensures a "last resort" mechanism for anyone to get at least minimal coverage. And policyholders continue to benefit from choice of insurance provider. The top ten national Homeowners insurers represented only 63 percent of 2021 premium volume. It takes 61 companies on a national basis to accumulate 90 percent of the Homeowners market premium.

Since 2021 there have been at least ten Homeowners insurer insolvencies. One was a company rated A- by AM Best, and the insurer was dropped to a C rating on negative outlook a few months before becoming insolvent. The other nine did not meet the standard of an AM Best A rating, the capital measurement benchmark in this study, during the years prior to insolvency. These insurers represented an aggregate of $1.2B direct written premium across Florida, Louisiana, Texas, North and South Carolina, and Alabama. Regulation is critical in the Homeowners line of business and care should be taken to avoid encouraging growth in less well-capitalized business plans or policies that lack a guarantee fund backstop as that does not benefit the policyholder long term. Insurance regulatory bodies were commissioned to make sure insurers charged enough. An insurance policy is a promise that insurers failing to charge fair and actuarially sound rates will not be able to fulfill.

How To Cope and Differentiate

The short-and long-term challenges of 2022 have no easy solutions, but Aon is positioned to help insurance providers navigate the dynamic reality of today's market. Successful carriers will:

1. **Be tactical with rate at the policy level, accounting for all losses and expenses as well as adjustments for inflation, model miss, and other trends impacting the industry.**
2. **Be aware of segments where rate adequacy will be challenging given regulatory oversight, competition and distribution network dynamics.**
3. **Be efficient in claims settlement including identifying and focusing attention on claims most likely to be problematic. We include in claims settlement the ability to mitigate abusive litigation in litigious jurisdictions.**
4. **Take the long-term view on investments.**
5. **Understand and maintain capital based on internal and external metrics to achieve returns equal to or greater than target ROE.**

Insurers greatly benefit from owning their own view of catastrophe risk. Learning and understanding how the models fit into underwriting strategies and customizing model outputs to fit their experience and expectations all produce measurably better results for carriers and is something that rating agencies are encouraging. Aon's in-house team of model experts, risk engineers and scientists have helped multiple clients review and customize their view of risk using Aon's Impact Forecasting open platform as well as other proprietary vendor models. This can also facilitate a better view on underwriting as the catastrophe risk will be better quantified for each policy.

Aon is engaged in numerous partnerships with academic institutions to understand and implement the latest science and peril-specific impacts to the Homeowners ROE. At Aon, we continue to enhance our understanding of the potential impacts of climate change on secondary perils, such as severe convective storm activity with the University of Illinois Urbana Champaign and Central Michigan University and the impacts to wildfires with the University of California, Merced and University of California, Los Angeles. Despite the rising losses from these secondary perils, tropical cyclone continues to be of importance due to the potential for widespread industry losses in a single event. Aon invests in understanding the potential impacts from climate change on hurricane frequency and severity through a multi-year, multi-phase partnership with Columbia University. Knowing how the risk landscape is changing is key to underwriting success and can build better outcomes for insurers.

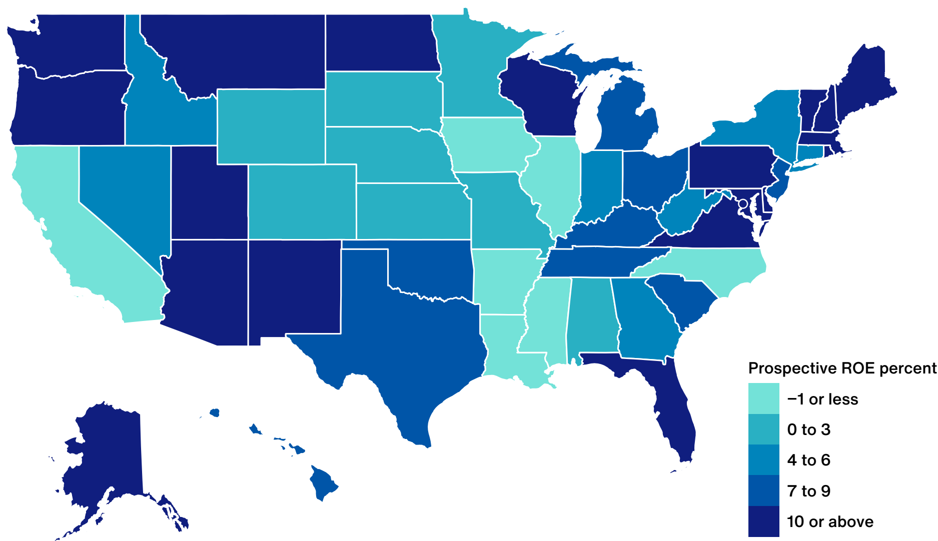
We've talked about the importance of claims management in past editions of the report; the trends and loss activity of 2022 again demonstrate the value to best-in-class claims operations. Aon's Claims Signal™ platform helps clients accelerate the claims review process, potentially saving up to 4 loss ratio points on claims leakage across automobile property damage, liability and property lines through early detection. Aon also provides services and functional expertise in raising capital and has practice groups with dedicated experts in E&S, MGA, InsurTech and other relevant business trends.

We are here to help our clients and partners navigate a complex and highly competitive marketplace to make better business decisions.

Benchmarking Prospective ROE: National Multiline Carriers

The National carriers' greatest competitive attribute is scale. Generally, they are recognizable household names backed by massive marketing reach, multi-channel distribution strategies, and voluminous data and operational complexity. That said, no two national carriers are the same; their strategies are as diverses as their organizational structures (which include mutual, stock, and reciprocal exchange).

Exhibit 7: September 2022 prospective ROE at current rates



The national cohort considers aggregate financial and market positions of the top eight U.S. Homeowners carriers based on 2021 direct written premium. These insurers write in all fifty states without a large proportion of premium in a single state and aren't exclusively targeting specialty niche markets such as high value homes. Three characteristics emerge when modeling this group:

1. **Financial diversification, even more than geographic diversification, provides ROE lift to the Homeowners line.**
2. **Conservative risk taking that limits the highest severity locations such as coastal tier 1 counties.**
3. **Large net positions with high reinsurance limits backed by a large balance sheet.**

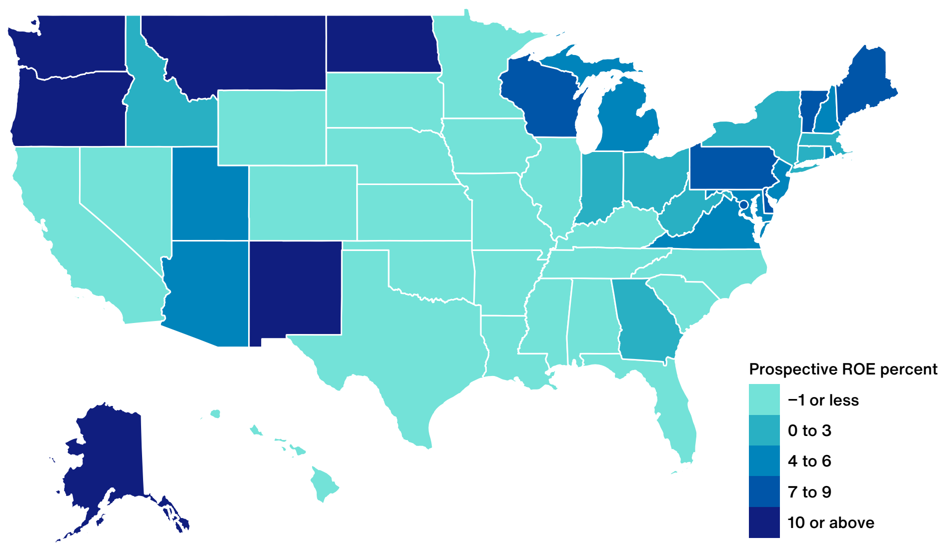
The national cohort produces a model-adjusted 97 percent combined ratio (assuming expected catastrophe activity) and those three points of underwriting profit, combined with investment income, produce a 5.4 percent ROE versus a 5.7 percent last year. Recent macroeconomic trends alongside rising reinsurance costs continued to put pressure on the ROE this year which is offset by material improvements in rate action taken by the national carriers over the past 18 months. Additionally, the scale of this cohort's balance sheet and investment portfolio, even with recent challenges in the financial markets, provide a tremendous diversification benefit to the Homeowners line. This year's cohort modeled at a 1.3:1 premium to surplus ratio while exceeding capital requirements for an A rating.

In total, 36 states with 65 percent of the cohort's premium volume post a modeled combined ratio below 100 percent. 19 states representing 22 percent of the cohort's premium volume meet or exceed our 10 percent ROE hurdle

Benchmarking ROE: Single-State Monoline Specialist Carriers

Regional and specialty insurers turn focus to competitive advantage. These carriers often thrive on deep, local relationships with their markets, including independent agents, policyholders and domiciliary regulators.

Exhibit 8: September 2022 prospective ROE at current rates



Single-state carriers who only write Homeowners are a rare breed outside a few key markets like Florida. That said, to show the opposite end of the spectrum from the large nationals, our synthetic specialty carriers are comprised of industry average financial and market characteristics of insurers whose primary business is Homeowners. We dampened noise in the study by reflecting average expense loads in each state and modeled the lack of diversification benefit in our catastrophe and capital benchmarks. Three characteristics emerge when modeling this group:

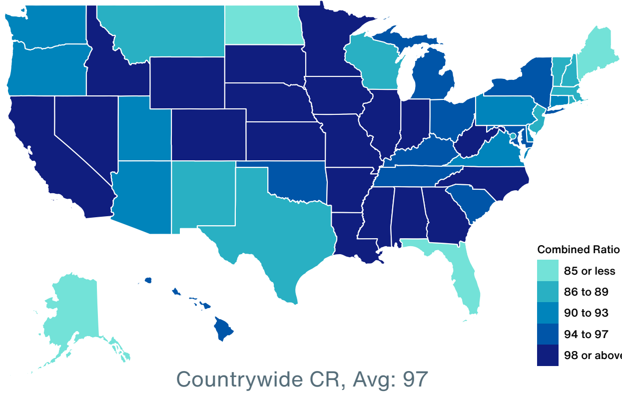
1. **Unsurprisingly, there are various strategies employed that are heavily specific to the local environment.**
2. **Specialty carriers often fill risk-taking positions between the national carriers and wind pools or fair plans, relying on local risk selection expertise.**
3. **Reinsurance creates a significant diversification benefit that can put the specialists in a competitive position with the nationals on a net basis. The net target combined ratios on the following pages allow a comparison on a state-by-state basis.**

One of the major headwinds this cohort continues to face is the lack of diversification; single state carriers are susceptible to extreme weather shocks that can make writing profitable business a challenge The specialists model to a 0.8: 1 premium to surplus ratio in total with significant variance state-to-state. Additionally, reinsurance costs are rising faster for this cohort due to their concentrations in higher risk geographies and put 140 basis points of pressure on the aggregate Specialist ROEs, which is roughly double the impact reinsurance costs had on ROEs for the national carriers in this year's study.

Florida has been a rapidly evolving story over the past year. A reinsurance capacity crunch resulted in the state providing additional coverage through the Reinsurance Assistance Program (RAP). Ratings pressure from Demotech on carriers which have struggled with operational losses in the state, especially since Hurricane Irma, led to a handful of insurers reducing exposures or shuttering operations in Florida. We've updated the study to reflect these changes using current Demotech capital and reinsurance requirements and modeling the RAP coverage in addition to the traditional private reinsurance and public FHCF capacity.

Benchmarking Target and Prospective Combined Ratios: National Multiline Carriers

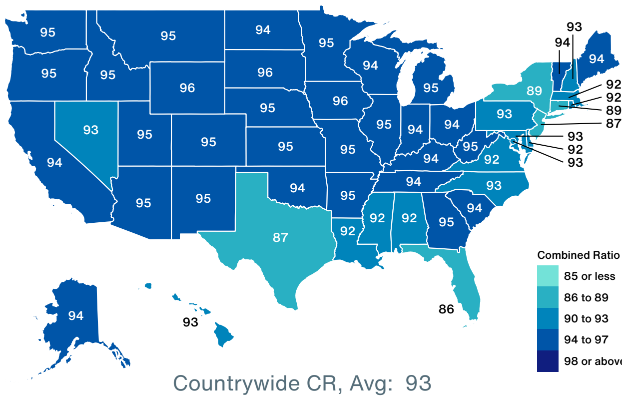
Exhibit 9: Model adjusted prospective combined ratio



The prospective combined ratio calculation illustrated in the left map (and next page, right for specialist cohorts) substitutes catastrophe experience with a custom model view of loss, on-levels historical premiums to prospective levels, and incorporates expense levels consistent with annual statement reports.

The national cohort appears to struggle with states with significant thunderstorm or wildfire exposure.

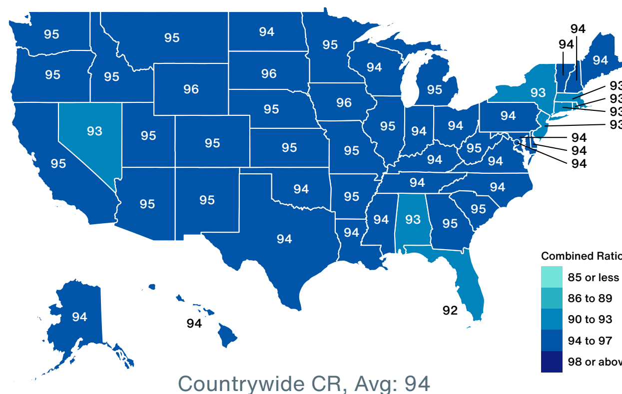
Exhibit 10: Direct combined ratio to achieve a 10 percent return on allocated capital



The percentages in the left map (and next page, right for specialist cohorts) show the direct target combined ratios necessary to fund reinsurance costs and allocated capital for retained risk by state, including catastrophe and non-catastrophe risk. The risk-taking habits of the national cohort also comes out in this modeling. The cohort is generally underweight in Florida relative to its market share in the rest of the U.S. This creates a dual peak catastrophe risk footprint with the primary peak in Texas and secondary in New York.

For a diversified national insurer, the target combined ratios fall into three main categories: (1) Peak (TX/NY), (2) other hurricane-exposed states and (3) states not materially exposed to hurricanes.

Exhibit 11: Net combined ratio to achieve a 10 percent return on allocated capital

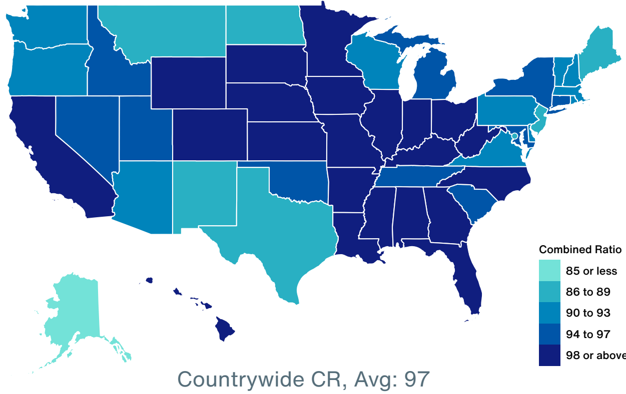


The percentages in the left map (and next page, right for specialist cohorts) show the net target combined ratios necessary to fund allocated capital for retained risk by state, including catastrophe and non-catastrophe risk.

The net target combined ratios for the national cohort demonstrate the benefit of reinsurance even to large national writers with significant diversification within their own footprint. After reinsurance, the peak risk areas are effectively mitigated. Texas, New York, and states heavily correlated with those two peaks achieve targets similar to non-peak areas.

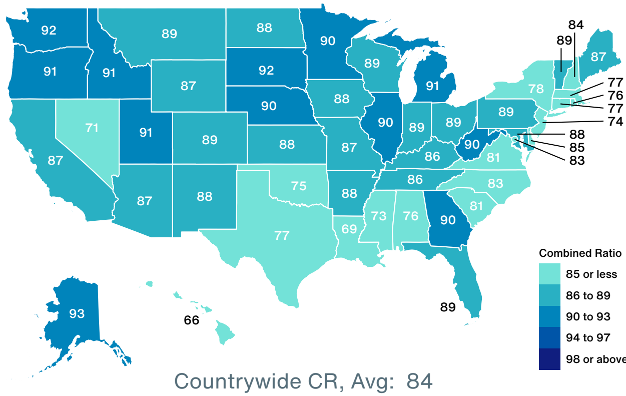
Benchmarking Target and Prospective Combined Ratios: Single-State Monoline Specialist Carriers

Exhibit 12: Model adjusted prospective combined ratio



As expected, the model-adjusted combined ratios for the specialists show more variability between states than the national cohort. States with severe thunderstorm and wildfire exposure seem to pose the greatest challenge to pricing actuaries, regardless of the size and scale of the carrier.

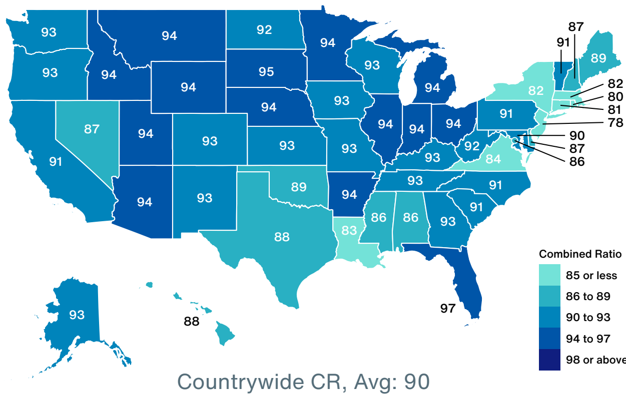
Exhibit 13: Direct combined ratio to achieve a 10 percent return on allocated capital



We've illustrated target combined ratios for our synthetic specialist cohort, but actual targets will vary significantly among individual companies due to state premiums distribution, capital adequacy standards, target return on capital, allocation methods, reinsurance, and other considerations.

Monoline specialists have larger capital requirements in AM Best's capital framework, which necessitates lower direct target combined ratios than competitors with more diversified insurance footprints or lines of business as seen in the national cohort.

Exhibit 14: Net combined ratio to achieve a 10 percent return on allocated capital

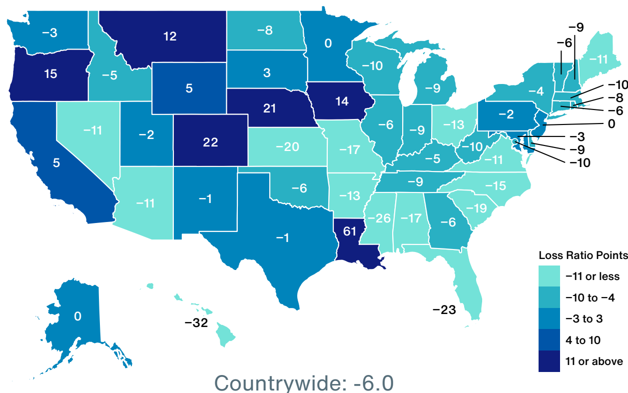


Reinsurance provides a significant benefit to specialist target combined ratios. Specialists can tap into the balance sheet of their global reinsurance partners to provide an alternative form of risk diversification.

Reinsurance buying habits vary significantly amongst the specialists depending on their geographic footprint. For example: Midwest insurers buy limits to higher return periods than Northeast insurers because of the tradeoff between modeled tail loss (Northeast hurricane is riskier than Midwest thunderstorm) and the pricing levels in the reinsurance market (Midwest thunderstorm tends to be priced lower as a diversifying peril).

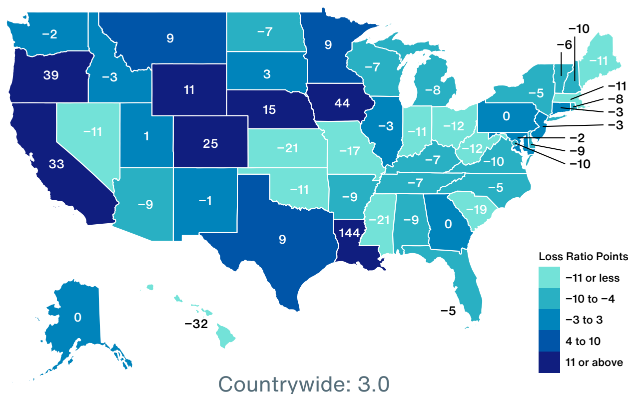
Total Industry Aggregate Catastrophe Results

Exhibit 15: Ten year Property Claims Services loss experience vs. modeled average annual loss



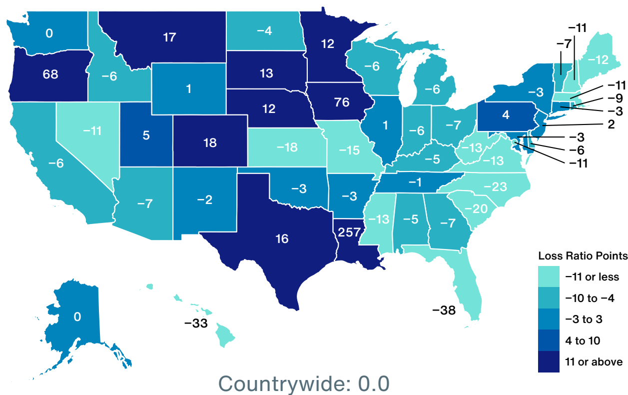
The maps left and below show, in loss ratio points, the amount that catastrophe experience varies from model average annual loss. Adjusting combined ratios for expected versus historical catastrophe loss is an important step to distinguish weather-related randomness from inadequately priced business. Historical catastrophes can distort measures of results at a state level, causing the noise to overwhelm the signal. While state level adjustments can be significant, the ten-year nationwide experience catastrophe loss ratio of 22 points is meaningfully lower than the modeled expected catastrophe loss ratio of 28 percent.

Exhibit 16: Five year Property Claims Services loss experience vs. modeled average annual loss



On a five-year basis (2017-2021), heavy cat activity, including wildfires, wind, and severe thunderstorm activity resulted in a deterioration of results across many states. Louisiana stands out as the clear leader in combined ratio drag because of multiple landfalling tropical cyclones in 2020.

Exhibit 17: Three year Property Claims Services loss experience vs. modeled average annual loss

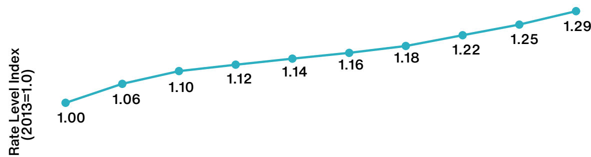


The three-year perspective shows the most variation on a state-by-state basis between favorable and adverse loss results. This is expected given the catastrophe exposure inherent in the Homeowners line; longer time horizons generally help smooth results. The effects of the 2020 Derecho and both 2020 and 2021 hurricane seasons produces large loss differences between expected on a three-year basis. The first half of 2022 has already seen elevated severe thunderstorm activity, which may put further pressure on the line for this year.

Rate Activity Indices

Direct written premiums continue to grow through 2021 as rate activity has increased in the recent period. Both the national carriers and all other carriers are pushing increased rate changes through 2022 to combat inflationary pressures and increased losses.

Exhibit 18: Rate activity index; National multiline carriers



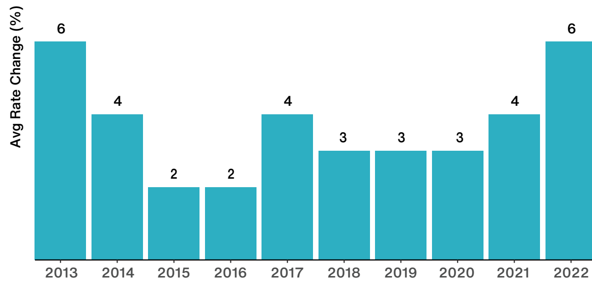
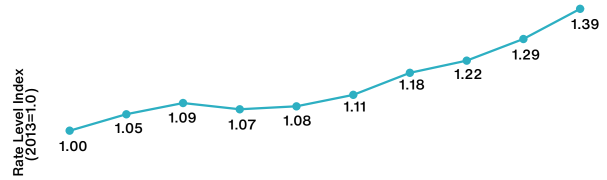
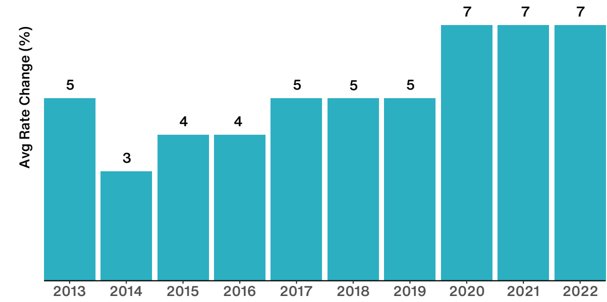


Exhibit 19: Rate activity index; Single-state monoline carriers

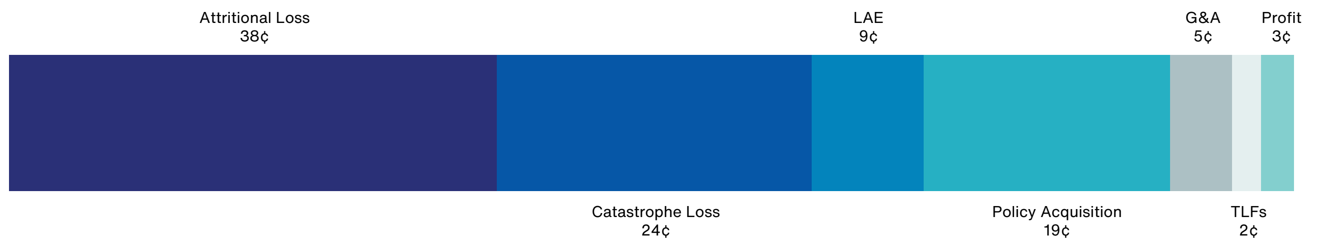




One dollar of homeowners premium

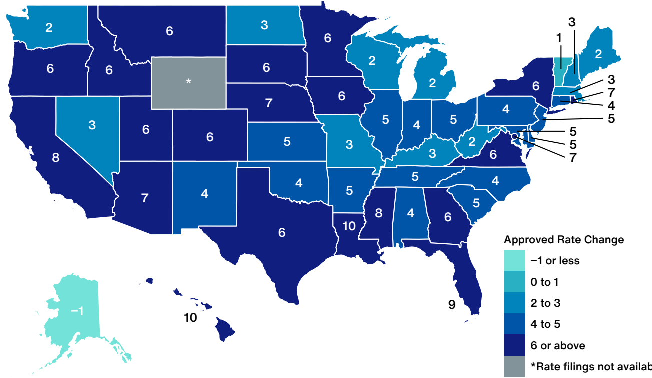
Aon's study suggests that, at prospective 2022 rates and before income taxes, Homeowners insurers keep about three cents of profit for every premium dollar they earn. That direct profit must be shared between the primary carrier, reinsurance partners, and the U.S. Treasury.

Exhibit 20: Dollar of premium breakdown for the industry aggregate homeowners insurance carriers



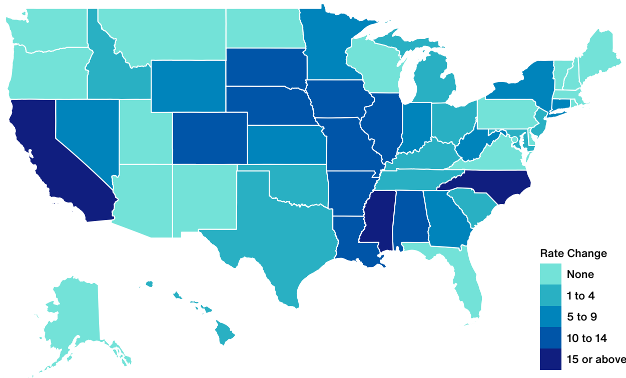
Total Industry Aggregate Growth and Rate Activity

Exhibit 21: Homeowners average approved rate change



The map on the left shows the average approved rate changes filed between January 2021 and September 2022 for all carriers that filed in the period. Positive rate activity is at 6 percent for all carriers in the U.S., up from last year's reported 5 percent at time of publication.

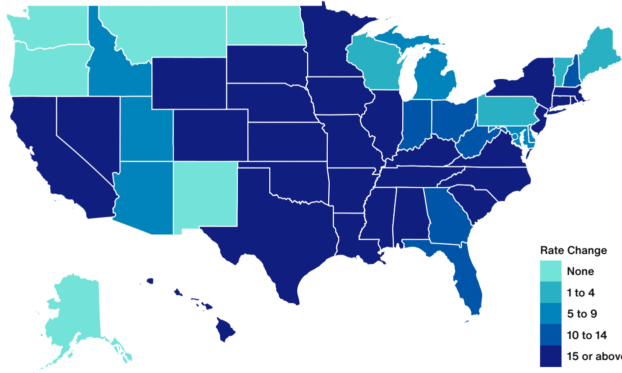
Exhibit 22: National carriers rate need to achieve 10 percent ROE



The left map and map on following page show the rate needed for the national and specialist cohorts to achieve a 10 percent ROE on a direct basis. These are indications based on Aon's study including aggregation of financial data to construct our synthetic carrier cohorts. The actual rate and return needs of any individual carrier will vary depending on portfolio distribution, competitive and strategic decisions, risk appetite and the demands of policyholders, owners, and other stakeholders.

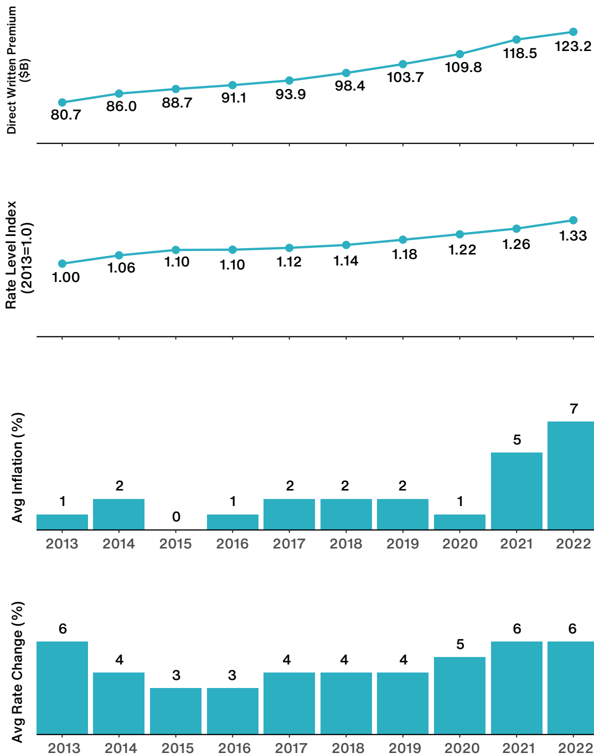
The national cohort's diversification benefits continue to be reflected in this map with 19 states already achieving a 10 percent ROE. However, wildfire and severe thunderstorm prone states stand out as areas needing further rate action in addition to current rate progress for inflationary pressures.

Exhibit 23: Specialist carriers rate need to achieve 10 percent ROE



On a direct basis, specialist carriers require more rate to reach 10 percent ROE due to their focus in catastrophe prone states, less diversification, and larger surplus requirements by the rating agencies but can offset this by leveraging their reinsurance partners to reduce volatility.

Exhibit 24: Premium growth and rate change, 2021 to 2022*



Direct written premiums increased from $81B in 2013 to $119B in 2021 with a projected $123B for 2022 given prospective rate activity (and assuming no further growth). Policyholders changing insurers will prevent the industry from realizing the full aggregate benefit of the individual carriers' rate actions.

Rate activity has accelerated in 2021 and 2022. The acceleration is due to claims trend through and since the pandemic that may be indicators of social inflation or increased insurance utilization on the part of policyholders. Statements from the Treasury department and Futures markets suggest we are at or past peak inflation as of the publication of this report; insurers will want to continue monitoring trends relative to inflation protection features in their policies to ensure they are taking enough rate to keep pace.

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