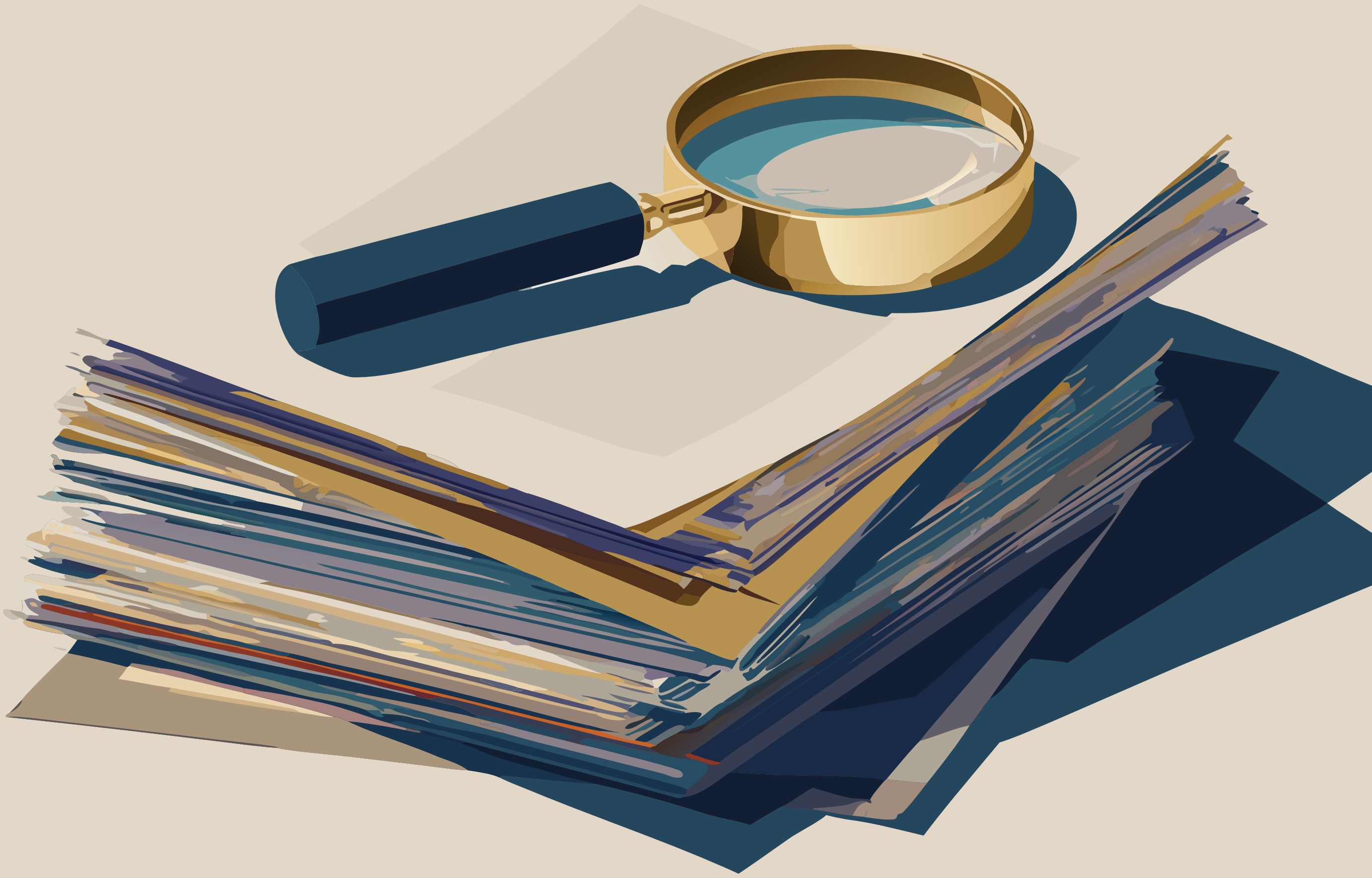
Insurance Policy 2026 Preview

# Continued Pressure

## Why the Insurance Industry Will Continue to Face Scrutiny



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Capstone believes the National Association of Insurance Commissioners (NAIC) will continue its multi-year effort to tighten its scrutiny of the investment strategies of insurers, and of their use of artificial intelligence (AI) and big data. We expect state policymakers to continue weighing targeted reforms to promote insurance affordability as heightened catastrophe risks shape the nation's largest property and casualty (P&C) markets.

## THE BOTTOM LINE

## Outlook at a Glance

- NAIC SCRUTINY OF INSURER INVESTMENT STRATEGIES SET TO CONTINUE IN 2026, WITH INITIATIVES TO EXAMINE RISK-BASED CAPITAL AND CREDIT RATINGS TAKING FULLER SHAPE
- AUTO INSURANCE REFORM ON THE TABLE IN 2026 AS STATES GRAPPLE WITH RISING PREMIUMS
- HOMEOWNERS INSURANCE SET TO REMAIN A HOT REFORM ENVIRONMENT IN 2026 AMID BURGEONING CATASTROPHE RISK AND AFFORDABILITY CHALLENGES
- NAIC WILL CONTINUE SCRUTINIZING INSURER USE OF AI AND BIG DATA IN 2026, WITH FORMAL REGULATORY FRAMEWORK PROPOSALS ON THE DOCKET

# NAIC Scrutiny of Insurer Investment Strategies Set to Continue in 2026, with Initiatives to Examine Risk-Based Capital and Credit Ratings Taking Fuller Shape

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|---|---|
| **Winners** | N/A |
| **Losers** | Life insurance companies, small er credit rating providers |

Capstone expects NAIC scrutiny of insurer investment strategies to continue in 2026, with particular focus on the sufficiency of existing risk-based capital (RBC) requirements and the credit ratings informing them. Building on 2025, we expect the association, comprised of state insurance regulators, to develop and implement frameworks to better assess investment risk across alternative and complex asset classes, including structured securities and private credit, which have seen greater insurer uptake in recent years.

The initiatives, which should be understood as an effort to mature the NAIC's prudential oversight, are likely to be slow-moving. However, NAIC's decisions, at least to the extent they enhance RBC requirements on certain asset classes, could make it less desirable for insurers to invest in higher-yielding, complex assets, with associated impacts on investment income. This could lead to less demand for the services of credit ratings providers (CRPs) that rate such securities.

## RBC REVIEW TO GAIN STEAM IN 2026; GUIDING PRINCIPLES CREATE ROADMAP FOR POTENTIAL ENHANCEMENT

During the NAIC Summer 2025 National Meeting, NAIC President Jon Godfread highlighted the work of the RBC Model Governance Task Force as "one of the NAIC's most significant initiatives of the year in light of growing [insurer] interest in alternative assets."

The RBC Task Force, formed in February 2025, was tasked with developing guiding principles to provide a strategic foundation for potential revisions to the existing RBC framework. Following several months of discussions between regulators and industry, the Task Force voted to adopt the revised principles for RBC requirements at the NAIC Fall National Meetings in December.

The new guidelines center on nine principles that encourage updates to RBC requirements only when insurer solvency risk changes and require that any potential changes account for emerging risks before they materialize. Any updates that would tighten RBC requirements on insurers are likely to reduce insurer demand for the asset classes to which they apply.

## THIRD-PARTY CRPS FACE HEIGHTENED SCRUTINY, WITH NEW FRAMEWORK EXPECTED IN 2026

Relatedly, we expect NAIC to push toward more closely scrutinizing third-party credit ratings of complex securities held by insurers in 2026, including by implementing its "discretion" process and refining its CRP due diligence initiative.

Third-party credit ratings are a key input in determining underlying RBC requirements for life insurers, particularly for complex securities and/or bonds that include private credit and other alternative asset classes. Amid burgeoning insurer investment in such asset classes and perceptions that NAIC relies blindly on third-party credit ratings of the complex securities that insurers hold, the NAIC adopted a "discretion amendment." This amendment enables the Securities Valuation Office (SVO) to challenge credit ratings that are "materially higher" than SVO designations, subject to procedural protections. That process is scheduled to begin January 1, 2026, though we anticipate potential delays in implementation as the NAIC stands up the process.

Additionally, the NAIC is developing a due diligence framework for CRPs that we expect will take shape in the coming year. It is currently a relativelyan amorphous initiative intended to establish gating criteria for NAIC acceptance of a CRP rating for insurer investments. While there are currently no criteria for becoming a CRP for NAIC purposes beyond registration with the Securities and Exchange Commission (SEC) as a Nationally Recognized Statistical Ratings Organization (NRSRO), we believe the effort is driven by NAIC's concern that third-party CRPs, particularly smaller firms, may provide favorable credit ratings that do not properly account for underlying investment and credit risk, thereby reducing RBC requirements for insurers.

The NAIC's efforts to tighten its due diligence process to evaluate the approval of new CRPs to rate insurer investments could impact a key channel of demand for CRP services. In our view, the ongoing initiatives will increase NAIC oversight over credit ratings, with implications for smaller CRPs, including A.M. Best, Morningstar Credit Ratings, and Egan Jones, among others.

# Homeowners Insurance Set to Remain a Hot Reform Environment in 2026 amid Burgeoning Catastrophe Risk and Affordability Challenges

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|---|---|
| **Winners** | Homeowners insurance companies |
| **Losers** | Reciprocal exchanges |

Capstone expects P&C insurance reforms to remain an important focus in 2026, as policymakers and regulators navigate the tension between ensuring that insurance is affordable and that the private insurance market remains competitive and profitable. We expect reform efforts to focus on personal lines, particularly homeowners and auto insurance.

## HOMEOWNERS INSURANCE AT A CROSSROADS IN CATASTROPHE-PRONE STATES WITH ACTION LIKELY IN 2026

Rising extreme-weather events, such as hurricanes, floods, and wildfires—totaling $101.4 billion in claims in 2025—continue to raise pressure on insurers as they navigate complex, state-by-state regulatory frameworks. Homeowners insurance specifically has been a constant subject of reform efforts for policymakers as rates on home policies have risen by an average of 58% since 2018.

Catastrophe-prone areas, including California, Florida, and Texas, which make up some of the nation's largest P&C markets and are also the regions most exposed to catastrophes, have adopted administrative and legislative measures to encourage more underwriting by home insurers and improve affordability amid rising premiums. We expect that to remain the case in 2026.

### Insurers Set to Take Advantage of California Reforms in 2026 as Ballot Measure Threats Abate

Specific to wildfire-exposed California, rate adequacy reforms were finalized in December 2024 through the Sustainable Insurance Strategy (SIS), a suite of four major reforms to the state's insurance regulatory regime established under Proposition 103. The reforms sought to expedite the rate approval process, enable insurers to utilize forward-looking catastrophe models, factor reinsurance costs when setting rates, and beef up the solvency of the state insurer of last resort. Additionally, a suite of bills proposed in the aftermath of the Los Angeles wildfires earlier this year was signed by Governor Gavin Newsom (D), as lawmakers continued their effort to encourage more underwriting in the nation's largest P&C market.

In 2025, home insurers appear set to gradually increase underwriting in the state in 2026, contingent on underlying balance sheet exposure and wildfire risk dynamics. To date, at least five separate insurers have filed for rate increases incorporating SIS reforms, including Mercury General Corp. (MCY), Farmers Insurance - a subsidiary of Zurich Insurance Group (ZURN on the Swiss exchange), Pacific Specialty, USAA, and CSAA. On November 21st, 2025, Farmers Insurance said it was eliminating the 9,500 cap on the number of new home insurance policies it writes each month in California. Farmers, the state's second-largest homeowners' insurer, credited the decision to the "spreading adoption of Insurance Commissioner Ricardo Lara's Sustainable Insurance Strategy" as it looks to expand underwriting to approximately 300,000 consumers in distressed areas in early 2026.

As debates over insurance availability and affordability intensify between consumer advocates, policymakers, and industry participants, two separate ballot initiatives were filed in 2025, one by an independent insurance agent and the other by Consumer Watchdog (CWD), a notable consumer advocacy group. Both initiatives seek to overhaul key provisions of Proposition 103, though in opposite directions, including the public-intervenor system, the prior rate approval system, and heightened guardrails on non-renewal issuances. Despite broad policy support for homeowners' insurance reform in California, both 2026 ballot measures were mutually withdrawn on December 2nd. Despite their withdrawal, the ballot measures suggest the fight over consumer protection, insurance affordability, and underwriting for conditions is set to continue in 2026, with meaningful stakes for carriers operating in the large, disaster-prone market.

**Stability Likely to Drive More Entrants in Florida in 2026, with Reciprocals as Favored Model**

We expect Florida to remain a hot market for new entrants in 2026 as market stability improves, recent reforms keep costs down, and the state continues its depopulation initiative to push more policies into the private market. That said, reciprocal insurance exchanges (RIEs), the favored model among new entrants in 2025, attracted increased scrutiny from regulators this year, and we expect that to continue in 2026 as the model proliferates.

In 2023, Florida enacted comprehensive tort reforms through HB 837, eliminating one-way attorney's fees and restricting bad-faith claims, among other tactical reforms to reduce significant legal costs borne by insurers (and ultimately consumers in the form of rate increases). These reforms have helped stabilize the market, including by supporting the entry of 17 new insurers, primarily reciprocal insurance exchanges (RIEs), in Florida as of September 2025, signaling a softening and competitive market. At the same time, the state's efforts to depopulate the insurer of last resort, Citizens Property Insurance Corporation, have largely succeeded. As of June 2025, 568,914 policies were in force, down from more than 1.2 million in 2023, as private entrants to the market took advantage of the opportunity to grab market share.

Reciprocals have become more common in CAT-prone states and among private investors because they have lower capital requirements than traditional insurance carriers and greater balance sheet insulation. RIEs are a form of insurance company in which policyholders (that is, subscribers) mutually insure each other, with fees used to pay for an attorney-in-fact (AIF) who oversees the day-to-day operations of the exchange. One benefit of the model is it reduces balance sheet risk, assuming sufficient surplus capital in the underlying exchange, and the opportunity for investors in the AIF to generate fee-based revenues established under subscription agreements.

From 2017 to 2024, 27 new reciprocal entities opened for business, including 14 in Florida, four in Texas, and two in Louisiana. In 2024, RIEs collectively wrote $15 billion in premiums (a 55% increase from 2019), accounting for 5% of total US P&C premiums. The rapid proliferation of the model in catastrophe-prone regions (for example, in Florida, Louisiana, and Texas) has drawn scrutiny from regulators, which we expect to continue in 2026.

Specifically in 2025, regulators began more closely examining the structure. During the Spring 2025 NAIC meeting, the Financial Condition (E) Committee announced the formation of the new

Reciprocal Exchanges (E) Working Group tasked with modifying applicable NAIC model laws (which must be adopted by states to take effect) to clarify that fees charged to reciprocal exchanges by their AIFs should be "fair and reasonable" and subject to regulator approval.

Private investors have historically derived substantial fee income through AIFs, typically earning fees of 25%-30% of gross premiums. On November 5th, 2025, the Financial Condition Committee approved the Working Group's 2026 proposed charge to clarify that fees charged to AIFs must be "fair and reasonable" and should not exceed a "reasonable profit." While the Working Group has not yet met, we expect to get additional color on its initiative in 2026. Capstone views NAIC scrutiny of management fees as raising the risk of potential downward pressure on RIE-AIF fees.

### Texas' Rising Homeowners Premiums Likely to Draw Further Legislative Scrutiny in 2026

Texas, the nation's second-largest P&C market, continues to grapple with skyrocketing premiums, which are among the highest in the US. Home insurance premiums in Texas have climbed at a 49% compounded annual growth rate (CAGR) since 2020, leading to growing scrutiny in 2025, which we expect to continue in 2026.
Texas, while vulnerable to fire, hail, wind, floods, tornadoes, and storms, promotes market competition among insurers through its "file and use" system, which allows insurers to use rates without prior approval of the Texas Department of Insurance (TDI). This approach enables insurers to set actuarially-justified rates without potential compression driven by regulatory review. Costly disasters in recent years have led insurers to implement significant rate changes, notably in 2023 when the state's annual loss ratio reached 105.1%. As a result, insurers in Texas raised premiums an average 21.1% for homeowners' policies in 2023 (the highest in the last decade), 19% in 2024 and and estimates of continued high single-digit increases for full year 2025.

In 2025, lawmakers introduced SB 1643, aiming to require the Insurance Commissioner's approval for rate increases/decreases exceeding 10%. While the bill failed to progress in the House Committee, it would mark a significant shift in Texas's approach to insurance regulation and is consistent with growing scrutiny of rapidly rising premiums in recent years. We view its potential reintroduction as likely in 2027, given Texas's biennial legislative cycle, as legislative scrutiny of homeowners' premiums persists. However, we expect the regulatory environment in Texas to remain generally favorable for P&C carriers in 2026.

# Auto Insurance Reform On the Table in 2026 as States Grapple with Rising Premiums

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| **Winners** | Auto insurance companies |
| **Losers** | Plaintiffs bar; third-party litigation finance investors |

## STATES TO GRAPPLE WITH AUTO INSURANCE AFFORDABILITY WITH TORT REFORM AS KEY LEVER

Auto insurance affordability remains a key issue nationwide, with the Bureau of Labor Statistics estimating that premiums have increased by an average of 55% since 2020. Legislators have applied various approaches to address the cost crisis, most notably tort reforms, which benefit auto insurers by reducing legal costs. Other recent efforts, including in Michigan, to establish tighter price controls, will likely continue to be explored if rates continue to climb.

Additionally, we believe that alternative measures will also be pursued, including tort reforms, as seen in Florida and, more recently, in Georgia and Louisiana. Florida Insurance Commissioner Mike Yaworsky argued "the data is undeniable and the evidence is clear" that tort reform has been a success. In a sign of the growing strength of the Florida market, Florida Office of Insurance Regulation (FLOIR) announced that the state's top five auto insurers by direct premiums written reduced their rates by an average of 6.5%, which the FLOIR attributed to the reforms.

The dynamics signal a softening of the auto insurance market following tort reform initiatives in 2023. Drawing on the success of Florida's reforms, we believe that other Southern states, such as South Carolina and Missouri, are primed to potentially pass tort reform in 2026. With tort reform remaining a major legislative priority for Governor Henry McMaster (R-SC), we view South Carolina as likely to move on the issue in the near term. Additionally, Missouri saw 36 tort reform bills proposed in the latest session alone, potentially introducing risks to plaintiff's lawyers.

Earlier this year, Michigan lawmakers proposed SB 328, which would require insurers to charge consumers 10% less than government-approved rates. While the bill failed to advance, Capstone believes that proposed price controls on auto insurance rates could gain support in 2026 if rates continue to climb at a brisk pace. Enacting such measures would be negative for auto carriers.

## NO FAULT AND AT FAULT LIABILITY REGIMES LIKELY TO REMAIN A SUBJECT OF DEBATE IN 2026

As auto insurance rate premium increases nationwide, we expect more debate of at-fault and no-fault liability regimes in 2026.

Today, 38 states operate under an "at-fault" auto insurance system, where the party that causes the accident is responsible for the other party's injuries and damages. However, the remaining 12 states operate under a no-fault insurance regime, where insurance companies pay for their policyholders' injuries and damages regardless of who caused the accident.

In Florida's 2025 legislative session, elected officials proposed HB 1181/SB 1256, which aimed to transform the state's no-fault regime to an at-fault system to lower auto insurance rates. Specifically, the bills sought to replace the mandatory $10,000 Personal Injury Protection (PIP) coverage requirement with compulsory bodily injury liability coverage of $25,000 per person and $50,000 per incident, plus $10,000 in property liability coverage. The bills failed to advance.

Other states, such as New Jersey, also saw similar legislation introduced in 2025. While we refrain from assessing prospects for passage of any such reforms, continued increases in auto premiums would constitute a key catalyst supporting reform in 2026.

# NAIC Will Continue Scrutinizing Insurer Use of AI and Big Data in 2026, with Formal Regulatory Framework Proposals on the Docket

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| **Winners** | N/A |
| **Losers** | Insurtech companies, advanced analytics and data vendors with exposure to insurance end markets |

## NAIC PROPOSALS TO FURTHER REGULATE INSURERS' USE OF AI EXPECTED IN 2026 AS STATES MATURE APPROACH

Capstone anticipates that the NAIC will continue to make preliminary proposals to further regulate insurers' use of Artificial intelligence (AI) as companies look to integrate AI into their operations.

In recent years, the NAIC has become increasingly active in issuing guidance about the use of AI by insurers: the NAIC Executive Committee adopted the NAIC's Principles of Artificial Intelligence in

2020, and in 2023, the NAIC adopted an AI Model Bulletin, which set standards for AI use, emphasizing the need for models to comply with both state and federal consumer protection laws. So far, 24 states have adopted the Bulletin, including New Jersey, Delaware, and Wisconsin in 2025. While many states adopted these guidelines in 2024, Capstone expects a handful will likely seek to adopt the bulletin in 2026.

## NAIC AI FRAMEWORKS SET TO ADVANCE IN 2026; OVERSIGHT TO GROW ON DATA/MODEL VENDORS, INSURTECHS

We expect the NAIC, and various states, on an intermittent basis, to adopt AI-related proposals in 2026 following the groundwork laid by the Big Data and AI Working Group in 2025. The proposals will enable regulators to more closely scrutinize how insurers use AI.

In 2025, the working group created a draft AI systems evaluation tool that aims to standardize how regulators assessinsurers' AI use that state regulators can collect during financial and market conduct examinations. The tool would simplify data collection for regulators evaluating insurance risks across AI governance, testing protocols, high-risk models, data sources, and financial implications. If adopted at scale, the tool would give state regulators increased insight into Insurers' AI practices and expose possible violations of consumer protection laws. A final version of the tool is still several months away from being adopted, and at the December 2025 NAIC National Meeting, the working group discussed feedback and revisions to the tool, acknowledging that a third draft will likely be necessary before the pilot program is rolled out. The pilot version is expected to be adopted by 10 states for use in early 2026.

Exhibit C of the current draft is intended to aggregate information about "high risk" models, such as those which could "cause adverse consumer, financial, or financial reports impacts." Regulators using this exhibit may be more likely to examine insurers' use of AI in business practices that pose the highest risks to consumers, such as policy underwriting and claims denials. If adopted by state insurance regulators at scale, the NAIC's AI evaluation tool is likely to increase scrutiny of insurtech companies and carriers that have incorporated AI into their claims management and risk modeling processes. Companies that contract with insurers to use AI for claims management and risk modelling would similarly be subject to greater oversight.

Additionally, in May 2025, the Big Data and AI Working Group put forward a request for information (RFI) regarding a potential model law that would govern insurers' use of AI. Working Group Commissioner Mike Humphreys said that the RFI, which received 33 comment letters, is only a preliminary inquiry into a model law to bridge the gap between existing AI guidance and the need for further regulation. While it is in the early stages, Capstone anticipates that the working group will continue to explore developing a model law in 2026.

Even in the absence of a standardized model, at least 17 states proposed bills regarding regulating AI use in various aspects of business this year. In Colorado, Governor Jared Polis (D) signed SB 24-205 into law, which established broad consumer protections to prevent "algorithmic discrimination" in consequential business decisions, including claims denials made by insurers. On November 24, 2025, Florida State Representative Hillary Cassel (R) introduced HB 527, which would require that humans review all claims denial decisions before they are finalized.

Capstone expects that in 2026, states will continue to weigh and potentially adopt consumer protections that increase AI compliance requirements for insurers. Carriers that have heavily integrated AI into the claims management process are likely to face more stringent compliance requirements if reform efforts gain sufficient momentum to pass.

# ENHANCED REGULATION OF DATA USES ANTICIPATED IN 2026 AS CONSUMER PRIVACY REMAINS IN FOCUS

Insurer use of third-party consumer data will remain in focus in 2026, as the NAIC and states continue to explore consumer data privacy protections.

At NAIC's December meetings, the Third-Party Data and Models Working Group unveiled the first draft of a Risk-Based Regulatory Framework for Third-Party Data and Model vendors. The draft framework, which is currently in a 60-day public comment period that ends on February 6, 2026, requires data and model vendors to register with state insurance regulators before their models can be used in situations with "direct consumer impact." This definition includes pricing, underwriting, and claims management, among other functions. While significant revisions are expected, Capstone views the ultimate framework as likely to increase compliance burdens for smaller Insurtech and data/model vendors that serve the insurance end market. Incumbent players are likely better equipped to absorb any associated cost burdens.

In recent years, state officials have also expressed increased interest in insurers' use of third-party consumer data. In 2021, Colorado passed SB 21-169, which increased restrictions around insurers' use of external consumer data and information sources (ECDIS). In 2024, New York adopted Insurance Circular Letter No. 7, which provided similar guidance on data use. More states could be set to follow their lead in the coming year.

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