

# Surplus Lines Market Report 2013

## NAPSLO helps wholesalers adapt and respond to evolving marketplace and regulatory landscape

The National Association of Professional Surplus Lines Offices (NAPSLO) is a membership organization of insurance brokers, agents, underwriters and associates

### NAPSLO

who are committed to the surplus lines industry and the wholesale distribution system. With headquarters in Kansas City, Mo., NAPSLO has more than 700 member firms from 1,500 offices. Its membership is made up of approximately 62% wholesale brokers and 21% companies/underwriters; the remaining members are associates. Founded in 1975, NAPSLO provides a variety of valuable services to its members.

#### What challenges and opportunities does the excess and surplus lines market face in the coming year?

Challenges for our industry include adapting to the devastating effects of catastrophes like Superstorm Sandy in 2012 and generating stable investment returns in a recovering economy. Recent analysis, including A.M. Best Co.'s upcoming 2013 Special Report on U.S. Surplus Lines, will show that the health of the surplus lines market is stable with no financially impaired surplus lines companies in the last nine years.

Another challenge for the surplus lines industry and those working in the sector is to adapt to the pace of change. The marketplace is constantly evolving, and E&S professionals also have to evolve to continually provide the best, most innovative solutions. Fortunately, that commitment to innovation also creates opportunity. With projections of continued growth for the surplus lines market in the coming year, our

opportunity is to showcase our value in solving complex insurance problems.

#### What benefit does a wholesaler provide to the retail market?

Wholesalers are technical experts that work in a very unique segment of the insurance industry and offer retail agents access to stable market capacity in the nonadmitted market. Retail agents – and their customers – look to wholesalers to be specialists for complex risks where retail agents might not have expertise. That results in cost-effective solutions for clients that are not “one size fits all,” but instead are skillfully tailored to meet specific needs for nonstandard risks.

Wholesale brokers also streamline the process for retail agents. The relationship between wholesalers and retailers is important because, in order to maintain ongoing client relationships, retail agents must be able to meet their customers' needs quickly and knowledgeably. The customer wants assurance that the agent can provide a solution and trusts that it will be handled with integrity. That's where wholesalers add value to the equation. They routinely deal in business that is

With the highest level of integrity and professionalism, NAPSLO members offer expertise, specialization and access in niche markets, and are dedicated to providing innovative and cost-effective insurance solutions that don't fit in the standard market.

#### What is NAPSLO's focus for the future?

NAPSLO remains focused on providing outstanding member networking opportunities, career development and education, and regulatory and legislative advocacy. The association will welcome a record number of attendees to its 2013 annual convention and continually works to increase the value and relevance of its networking events, and to expand its professional development offerings.

NAPSLO's legislative advocacy will continue to focus on the Nonadmitted and Reinsurance Reform Act (NRRA). The NRRA created a national framework for uniformity and efficiency in surplus lines regulation and taxation. Key reforms intended by the NRRA are: fixing the regulation and taxation of surplus lines transactions in one state, the “home state” of the insured;



insured; one state regulates and taxes the transaction, producing tremendous efficiencies. NAPSLO's work continues to advocate for the complete and uniform implementation of all reforms intended by the NRRA, including home state taxation, where surplus lines taxes are calculated at the home state's tax rate on 100% of the premium and retained 100% by the home state.

#### What other federal legislative issues are on the horizon for the industry?

##### NARAB II

The U.S. House passed legislation earlier this month for the National Association of Registered Agents and Brokers, more commonly known as NARAB II. The Senate previously introduced the same bill, but has not yet voted. NARAB II will establish a national clearinghouse as a one-stop licensing system for agents and brokers operating outside of their home state. Agents and brokers will apply for membership to the association, agreeing to strict standards and ethical requirements. NARAB II will be governed by a nonprofit board of state insurance commissioners and industry representatives with a goal of applying licensing, continuing education and non-resident insurance producer standards on a multistate basis while preserving the laws of individual states.

NAPSLO and its members have put significant effort into advancing this legislation because we believe it will greatly increase the efficiency and compliance in the licensing process for members licensed in multiple states. It supports a more competitive insurance

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complex and nuanced, and they efficiently discern not only what needs to be covered in a policy but also what is of highest importance to the client. The wholesaler is not just an aggregator, but is an innovator and a solutions-oriented problem solver.

#### What key attributes differentiate a NAPSLO member in the surplus lines marketplace?

Integrity and professionalism form the foundation cornerstones of both the association and its membership and represent the core values clients can expect from a NAPSLO member firm. NAPSLO members, who must meet specific criteria and adhere to a detailed code of ethics, are guided by the association's founding promise to conduct business in utmost good faith.

establishing national uniform eligibility standards for U.S.-based insurers writing surplus lines insurance; prohibiting a state from preventing a licensed surplus lines broker from procuring insurance from non-U.S.-based insurers included on the NAIC Quarterly Listing of Alien Insurers; and establishing a nationwide definition of an exempt commercial purchaser for whom a broker can access the surplus lines market.

In the three years since its passage, the NRRA's establishment of home state regulation and taxation is greatly improving and streamlining the compliance process for our industry. Rather than requirements for brokers and carriers to make multiple filings, and broker requirements to pay taxes in multiple states for one transaction, surplus lines transactions are now governed by the home states of the



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market and improves state insurance regulation to the benefit of consumers.

#### **National Flood Insurance Program (NFIP)**

Last April, NAPSLO's team met with a number of members of Congress regarding the NFIP and the potential for NAPSLO members to provide private flood coverage options in accordance with the Biggert-Waters Flood Insurance Reform Act. The surplus lines industry plays an important role in offering flood coverage, both in placing primary and

excess policies, and it is important for insureds, banks and banking regulators to understand nonadmitted carriers are not prohibited from providing flood coverage on a primary or excess basis. In fact, the nonadmitted market can provide broader coverage for flood insurance beyond the offerings of the current federalized program. NAPSLO will continue its advocacy on this to ensure NAPSLO members are able to provide coverage as allowed by law.

#### **Terrorism Risk Insurance Act**

#### **Reauthorization (TRIA)**

TRIA is up for reauthorization on Dec. 31, 2014, and is becoming a focus of debate on the Hill this congressional session. In general, we believe private-market solutions should be exhausted before government-sponsored programs or residual markets are considered, and governments should not provide coverage options the private or open market is able to address.

However, we believe the existing program has been successful primarily because it's a tool for insurers to better

manage the risk of terrorism events and provides some certainty to the industry in offering private capital and solutions to policyholders.

We support a thoughtful and thorough review of TRIA with the goal of maintaining or increasing opportunities for capacity and solutions in the private market. We also believe it's important for Congress to take action sooner rather than later since insurers are already issuing policies with coverage periods beyond the 2014 reauthorization date.

## Executive Insights: Specialty Risks

### Views on demand, market issues and tort costs

**Q:** In what areas or lines of business are you seeing the strongest demand for specialty insurance solutions? And what might be the next area of demand for specialty solutions?



**W. Todd Evans**  
Executive Vice President  
Engle Martin &  
Associates, Inc.

We are seeing an increased demand for both property and general liability coverage in the contractors, builders risk and inland marine markets. As

construction begins to pick up with the uptick in the economy, it affects a number of other industries such as manufacturing, transportation and a large number of labor trades.

As we become more dependent on technology, there are large risks, both financial and reputational, associated with the information that is exposed. These cyber exposures, including identity theft and data breaches, are creating a major need for specialty insurance products for those engaged in the collection, management, and protection of huge amounts of personal data.



**Mac Wesson**  
President & Chief  
Operating Officer  
U.S. Risk Insurance  
Group Inc.

With the overall commercial P&C market continuing to show signs

of firming, we believe the demand for specialty insurance products will strengthen in many industry sectors. We have a significant presence

in the health care, energy, entertainment, staffing and financial institution sectors, and we think they will continue to grow. But we also see emerging and growing demand for solutions to cyber-related exposures, catastrophe-exposed property risks and alternative energy production.

In addition to cyber-related exposures, we believe the growing dependence on international suppliers and distributors on the part of many commercial insureds gives rise to a need for more comprehensive global insurance protection. While that exists today, it tends to be more fragmented than it should be. We also believe insurance coverage designed to protect the environment will strengthen as the world becomes less tolerant of events that endanger our planet.

**Q:** What issue do you expect will have the greatest impact on the specialty lines insurance marketplace in the next 12 to 18 months?

**W. Todd Evans, Engle Martin & Associates Inc.:**

There are a number of issues that could impact the specialty lines insurance marketplace over the next 12 to 18 months. First, the direction of the global economy can have a large impact on demand for specialty insurance products. Many major global economies are still in states of crisis. As these economies improve or get worse, that can impact capacity and demand for insurance products. Second, the extent of catastrophic events over the next 12 to 18 months will no doubt impact the specialty lines insurance marketplace. Third, the ever-increasing regulatory environment of various insurance marketplaces will affect how specialty products are developed, delivered and priced. The increased regulation can stifle creativity in the marketplace, leading to more homogenous insurance products. Finally, we continue to see increased capacity from non-traditional markets.

For example, the Chinese insurance market is now participating more in quota shares on large property accounts.

**Mac Wesson, U.S. Risk Insurance Group Inc.:**

As businesses become more creative and diverse in the products and services they provide for an ever-changing world, the exposures to loss that accompany that diversity are often unique and require specialized treatment. Specialty insurance solutions are will be developed in the future to keep pace. We believe this trend will fuel growth in the specialty lines insurance marketplace for the next 12 to 18 months and beyond.

**Q:** Tort costs in dollar terms have remained relatively stable since the mid-2000s, after rising steadily for decades. Do you expect that stability to continue?

**W. Todd Evans, Engle Martin & Associates Inc.:**

Tort costs are likely to increase because insurance carriers have been aggressive in managing expenses of litigation in recent years, which has offset some of the overall cost. However, now the carriers have driven expenses down as far as they can, so we would expect overall tort costs to increase.

**Mac Wesson, U.S. Risk Insurance Group Inc.:**

In a word, yes. In the health care sector, particularly, tort reform has made a significant impact on keeping tort costs in check. As the political and regulatory winds of change come and go as they always do, certain elements of our society may become plaintiffs' targets, but overall tort costs look to remain fairly stable in the near and long term.