

Segment Review  
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## Surplus Lines Continue to Overcome Market Pressures

**Adhering to underwriting discipline and creating products to meet market demand will be critical for future success**

For a second year, underwriters of surplus lines business generated only modest growth in direct premium, about 2.8% in 2016, constrained by sluggish growth in industry sectors that affected exposure bases, and by increasing competitive pressure, including admitted companies venturing into the surplus lines area. Surplus lines writers also posted an underwriting loss for a second straight year, but were still able to generate both pretax and net profits and maintain solid balance sheet strength.

A.M. Best believes the surplus lines market is financially sound and should remain so for the foreseeable future. However, competitive market pressures appear to be escalating, making it more difficult for companies that lack the necessary scale, diversification, or brand recognition to excel, especially with interest rates remaining relatively low and other economic factors presenting a challenge. Adhering to proven underwriting fundamentals and discipline, creating products to address new or emerging risks, and maintaining solid balance sheet strength will be keys to future success for surplus lines insurers.

Consolidation among surplus lines insurers continues to impact market competition, and a similar phenomenon has been occurring with wholesale brokers and intermediaries. Acquiring insurers continue to use M&A as part of their strategies to carve out a bigger piece of the market. Larger wholesalers have been growing in scale and expanding their profiles through the acquisition of smaller brokers and intermediaries. The steady push to consolidate has led to a situation in which retailers are doing business with fewer wholesalers, and wholesalers are doing business with fewer insurance companies. Whether this momentum slows down at all by the end of 2017 remains to be seen.

The surplus lines market has had no impairments for 13 years. To maintain their solid footing amid current market dynamics, surplus lines companies must resist the competitive lure of relaxing risk selection standards and lowering rates to at least maintain, if not grow, top line revenue.

As surplus lines writers look to the future, they remain focused in large part on providing a broad array of products across different states and territories, enhancing data analytics capabilities, and investing in new technology to better serve both broker/agency partners and insured clients. Developing ways to recruit and retain younger talent to proactively manage the expected loss of intellectual capital of an aging workforce will also be critical. Companies that effectively develop plans to counter these issues will likely prosper over the coming market cycles.

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**Contents**

I. State of the Market . . . . .	3	VI. Surplus Lines Fundamentals . . . . .	45
II. Financial Performance and Rating Distribution . . . . .	17	Appendices . . . . .	49
III. Regulation and Legislation . . . . .	26		
IV. Current Distribution Trends . . . . .	34		
V. Impairment Trends . . . . .	40		

