The Risk Takers

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Learning Objectives

To Understand:

1. Distinctions between surplus lines and admitted markets
2. The key elements of surplus lines
3. Why surplus lines exists and its role
4. Types of surplus lines organizations
5. The risk taking process
Reliable or Renegade
Image or Reality
Key Elements of Surplus Lines

- Freedom of rate and form
- It’s cyclical and responsive to market needs
- It’s a safety valve market of last resort
- It adds value through innovation, stabilization of economy, and risk taking
- It attracts certain types of risks
- It adds capacity when needed to the market
Why Freedom of Rate & Form?

• It’s the basic foundation of E&S
• Varying risks and limited data = Need for freedom of rate and form
• Risk considerations:
  – New
  – Unique
  – Distressed
  – High Capacity Requirements
  – Less Seasoned
DPW Total P&C and Surplus Lines
A comparison over the past two decades of the growth in the surplus lines industry with that of P&C as a whole.
Total Property & Casualty Market 2015

$591.2 Billion DWP

Standard Market  93%
• Carriers highly regulated in each licensed state
• Stringent R.R. & F guidelines
• Lower hazard risks.
• 75% A.M. Best A- or better

Surplus Lines  7%
• Carriers highly regulated in domicile state
• Freedom from R. R. & F. in authorized states
• Surplus lines types of risks
• 95.5% A.M. Best A- or better
• Brokers licensed entities in carrier non-domiciled states
Historic Direct P/C Combined Ratio


* Domestic Professional Surplus Lines
Source: A.M. Best data and research

Source: A.M. Best 2015 Special Report U.S. Surplus Lines
Organization & Structure
A.M. Best Segmentation (2015 Market Share)

- Domestic Surplus Lines: 72%
- Regulated Alien: 7%
- Lloyd's: 21%

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Organization & Structure

Domestic Surplus Lines Cos.

- One state domicile and license
- Capital requirements
- Better operating performance
- Highly concentrated – 77% in top 25 groups
- Higher A. M. Best Ratings
Organization & Structure

Lloyd’s

- Market rather than company
- Admitted in IL & KY
- Coverholders and Lloyd’s brokers
- Lines of business beyond surplus lines
Organization & Structure

Alien Companies

• Non admitted in all states
• Trust funds required
• Regulated by IID (NAIC division)
• Variety of business models
A.M. Best Financial Impairment Trends
All P/C Companies 1977-2015

• Slightly lower surplus lines industry impairment trends
• No surplus lines impairment since 2004
• Top impairment reasons:

- Deficient Loss Reserves / Inadequate: 47%
- Alleged Fraud: 12%
- affiliate Problems: 8%
- Rapid Growth: 7%
- Catastrophes: 7%
Examples of Underwriting Methods & Resources

Let’s discuss examples of methods & tools for:

• Buying Rationale
• Exposure analysis
• Loss analysis
• Pricing
• Coverage
Examples of Underwriting Methods & Resources

Exposure analysis

• Drives selection, pricing and coverage
• Where to look:
  – Other accounts, classes & sub-classes
  – A.M. Best loss control reports
  – Previous account history
  – Google Scholar
  – Wikipedia & other online open sources
  – Other information sources?
Examples of Underwriting Methods & Resources

Loss analysis

- Claims department input. An U/W’s best partner
- Book analysis
- Industry data
- Jurisdictional data (Labor law, judicial hell holes, etc.)
- Loss trending, frequency/severity models
Examples of Underwriting Methods & Resources

Pricing

• A result of adjusting for coverage grants or exclusions
• What to consider:
  – ISO loss costs plus LCM’s
  – Self developed loss costs or full rates
  – Comparative pricing on similar accounts
  – Payback rationale
Examples of Underwriting Methods & Resources

Coverage

• ISO as a foundation? It depends
• Build from coverage grants and exclusions
• Tailor to contractual needs (MSA’s, AI’s etc.)
  – Too often too broad or narrow
• Trigger determination (claims made or occurrence) based on multiple or cumulative exposures
Six Sequential Risk Taking Questions

Surplus Lines Risk?

Questions to Ask

A Good or Bad Write?

Placement Story?

Terms & Conditions?

Loss Exposures & Parties?

Coverage Grants & Exclusions?
Let’s Review Three Risks!
Case Study #1
The Medical Device Manufacturer

- The Insured has developed a system (hardware and software) that allows a hospital to monitor patients’ vital signs through a centralized nursing station. Examples are EKG’s, EEG’s, Pulse Oximeters and other monitoring devices.
- The Insured is ready to launch a records management software package that will include private patient data.
- This system decreases hospital expense and provides for real time monitoring of multiple patients.
- Let’s look at the exposures and coverages.
Case Study #2
The DIC Exposed Distributor

- The Insured owns four large distribution warehouses that supply owned discount stores throughout the U.S. These are located at port of entry locations in Savannah, New Orleans, Long Beach and Seattle.

- Goods are imported from many foreign countries, including Japan, New Zealand and Chile.

- Let’s look at the property exposure and coverage.
Case Study #3
The E-Cigarette Distributor

• The Insured sells privately branded E-Cigarettes through both online and physical locations.
• Components are bought from manufacturers in China, Malaysia and three European countries.
• All E-Cigarettes include nicotine and a variety of flavors.
• A 1 year warranty assures the “vaping” experience.
• Let’s look at the liability and other exposures and coverages.
Case Studies- Questions

• Is this a surplus lines type of risk? Why?
• What are the key exposures to loss?
• What parties may be exposed to damages in the event of a loss? Think broadly.
• What exposures may require customized coverages beyond a typical GL or Property standard market placement?
• What would be important underwriting and pricing factors to consider beyond exposure base?
• Would you write this risk?
Key Takeaways

• Freedom of rate and form is our foundation
• Surplus lines is cyclical and a safety valve
• Surplus lines carriers are admitted and licensed in at least one state
• Surplus lines regulation is primarily broker-based
Key Takeaways (Cont.)

- Every surplus lines risk has a story. Know it!
- Surplus lines companies typically have better operating performance
- Surplus lines underwriting and broking is trust based
- Surplus lines underwriters have numerous underwriting tools to use with seemingly ambiguous risks
The Risk Takers

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