Update: Surplus Lines Execs See Bright Prospects Amid Rising Competition

OLDWICK, N.J. - (Corrects information in the second, fourth and 13th paragraphs.) Surplus lines insurers have had two years of aggregate underwriting profit following three straight years of losses, and the market's outlook remains stable as rising economic activity and good legislative prospects keep competitive pressure in check, according to industry executives speaking during an A.M. Best webinar.

Brady Kelley, executive director of the National Association of Surplus Lines Offices, said the market is seeing record levels of growth and premiums. "We're optimistic about current underwriting discipline and good market conditions," he said. "Slowly but surely, new businesses are emerging, construction projects are happening and commercial lending is up."

In a newly released Best's Special Report, "Surplus Lines Profit From Underwriting Discipline and Core Competencies," A.M. Best said 2014 underwriting profits for surplus lines insurers were driven by a combination of product diversification, underwriting discipline and advantageous market conditions. "The report added surplus lines companies "continue to outperform the overall property/casualty industry and recorded a second straight year of underwriting profitability following three years of underwriting losses."

Jacqueline Schaendorf, president and chief operations officer with Insurescape House, said in seven of the past 10 years, the excess and surplus lines market has seen growth, and a good sign of that growth has been the emergence of competitors. "We're seeing that in private equity, and with other equity coming into the marketplace," she said.

According to Schaendorf, even with the adequate capitalization in the overall property/casualty market, surplus lines is still attracting competition due to the past decade's overall profitability. Inevitably, pressure on pricing is cropping up in certain segments of the market in the wake of the profitability and increased competition.

In commercial property, Manga Propis, head of distribution management at Lexington Insurance, said there are two main segments. One is the traditional excess and surplus catastrophe property market with clients who have a lot of technical risk. "We're seeing a lot of competition, both in terms of the players and the pressure on rates," in that segment, she said.

Some insurers are reporting adverse loss development, along with the negative effects of low interest rates, said Propis.

The other, so-called "differentiated" segment involves tailored solutions for hard-to-place risks in commercial property. Propis said that segment is seeing some "dynamic" developments.

Propis added there is increasing interest in multiyear deals for custom solutions in commercial property.

Robert Sargent, president and chief executive officer of Tennant Risk Services, added there is "a healthy level of strong competition" in professional liability lines right now. He added the competition is "evolutionary rather than revolutionary" as the competition is still tempered by strong underwriting.

"The market tends to be fragmented, so it really depends on which area you're talking about," he said.

Propis and Kelley both said legislative developments are a key issue in the development of the surplus lines market. Propis noted proposed updates to the federal Dodd-Frank Act and the Nonadmitted and Reinsurance Reform Act should help both admitted and nonadmitted insurers to better develop client relationships.

Kelley added the NARARules recently adopted by Kansas, North Dakota and Louisiana should go further toward creating nationwide uniformity in surplus lines market practices (Best's News Service, July 29, 2015).

A.M. Best said in its report its outlook on the surplus lines insurance market remains stable. "In addition, the overall macroeconomic environment has continued to increase merger and acquisition activity," the report said. "We have seen over the past five years that surplus lines, as well as specialty admitted carriers, have been the target of M&A. Targeted companies provide acquirers an opportunity either to establish a new surplus lines platform, or to supplement an existing one."

The A.M. Best report said the greatest challenge to an individual surplus lines carrier "may be retaining its market
share." Because a fair portion of this business comes from brokers, surplus lines business is generally shopped each year to some extent, resulting in lower policyholder retention. As a group, surplus lines carriers have focused on improving retention via technology, better broker relationships and enhancing their underwriting analytical capability. This leads to a consistently competitive environment for retention. As one carrier tightens its risk appetite and deems certain types of exposures to be outside of its preferred risk profile, another may reach the conclusion it has the expertise and capability for that same risk.

In an effort to retain market share, some surplus lines organizations have enhanced their network through acquiring renewal rights or establishing new MGAs. Another area of concern for traditional surplus lines carriers is the fact that new entrants and new parents of existing players are likely to create even more competition. Additionally, reinsurers have made moves to "drop down" into primary layers. Also, new start-up companies, often financed by private equity looking for investment opportunities, can threaten the market share of established surplus lines insurers. The diversification and expanded capacity in the market is expected to continue to drive investment by current incumbent market leaders in their own systems, capabilities, and core competencies in order to retain their positions in this market.

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