

Segment Review
September 19, 2016

Surplus Lines Financially Sound Despite Market Pressures and Economic Challenges

Proven underwriting discipline, product creation, diversification, and considerable balance sheet strength expected to drive future success.

For 2015, underwriters of surplus lines generated growth in direct premium of 2.5%, the smallest increase of the last five years, attributable to competitive market conditions and sluggish growth in some industry sectors that impacted exposure bases. Despite the lower growth and the inability to sustain what had been two straight years of underwriting gains entering 2015, surplus lines underwriters still notably generated both pretax and net profits.

A.M. Best believes the surplus lines market is financially sound and should remain solid for the foreseeable future despite competitive market pressures and challenging economic factors. Future success for the market is expected to be driven by proven underwriting fundamentals and discipline, product creation and diversification, and considerable balance sheet strength, particularly true for the leading writers of surplus lines business.

The zero trend of surplus lines impairments for the past decade extended through 2015; however, an impairment was recorded in late July 2016. Absent any specific drivers of surplus lines impairments, persisting sluggish economic conditions and a prolonged soft market could tighten profit margins. With interest rates remaining low, combined with the volatility experienced in U.S. and global financial markets, surplus lines companies must resist relaxing risk selection standards and lowering rates for the lure of premium growth and maintaining market share.

On May 2, 2016, the Nonadmitted Insurance Multistate Agreement (NIMA) was dissolved after its two largest members, Florida and Louisiana, withdrew from the tax-sharing system. NIMA's wind-down plan anticipates conclusion of the agreement by December 2017. On or after that effective date, no new multistate renewal or reinstatement transactions will be accepted through the Surplus Lines Clearinghouse (SLC) multistate reporting platform.

As surplus lines intermediaries navigate through the current market and look into the future, they remain focused 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. Finding ways to recruit and retain younger talent to effectively deal with the demographic challenge of an aging workforce will also be critical, particularly considering that many experienced workers may lack some skills needed to meet the challenges involved with utilizing data and technology. In addition, consolidation of both surplus lines carriers and brokerages is expected to remain prevalent, with the potential adverse impact on existing relationships and response time being chief among the concerns of surplus lines intermediaries.

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