National Association of Professional Surplus Lines Offices, Ltd.

Analysis of Non-Loss Costs
by Conning Insurance Research
September 2016

One Financial Plaza Hartford, CT 06103 | www.conning.com

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Purpose of Report

National Association of Professional Surplus Lines Offices, Ltd. (“NAPSLO”) retained Conning Inc.'s Insurance Research Division (“Conning”) to conduct an analysis of the relative non-loss costs of commercial insurance policies distributed through wholesale brokerage channels as compared to retail brokerage channels.

Executive Summary

Conning measured all non-loss costs relative to premium from 2010 to 2015 for individual insurance companies that predominantly write commercial insurance.

Two composites were defined and analyzed: a Wholesale Composite, which included 83 individual companies with $19 billion in premium, and a Retail Composite, which included 266 companies with $61 billion in premium.

When comparing the two composites, Conning found:

- The total median non-loss cost ratio for the wholesale composite was lower than the retail composite by 0.9 percentage point.
- Retail non-loss cost ratios were lower than wholesale in 2010 and 2011; however, wholesale ratios were lower for 2012 through 2015.
- The wholesale composite's commission ratio is consistently 3 to 4 points higher than the retail composite, but is offset by the wholesale composite's non-commission cost ratios that average nearly 4 points lower than the retail composite.
- Except for 2010, in each of the six years measured, the annual growth rate in direct premium written for insurers in the wholesale composite exceeded the annual growth rate in direct premium written for insurers in the retail composite.

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METHODOLOGY

Summary Methodology

Measurement

- Conning measured total non-loss costs (commissions; taxes, licenses, and fees; other acquisition expenses; and general expenses) relative to premiums for individual insurance companies.
- Premiums and expenses were measured on a direct basis, excluding the effects of reinsurance or pooling.

Data Employed

- Annual statutory-based financial information for the six years ended 2015.
- Analysis included ten lines of business, for insurers that predominantly write commercial insurance. The ten lines (“Selected Lines”) include other liability, commercial multiperil, commercial auto, allied lines, fire, inland marine, products liability, medical professional liability, earthquake, and ocean marine.

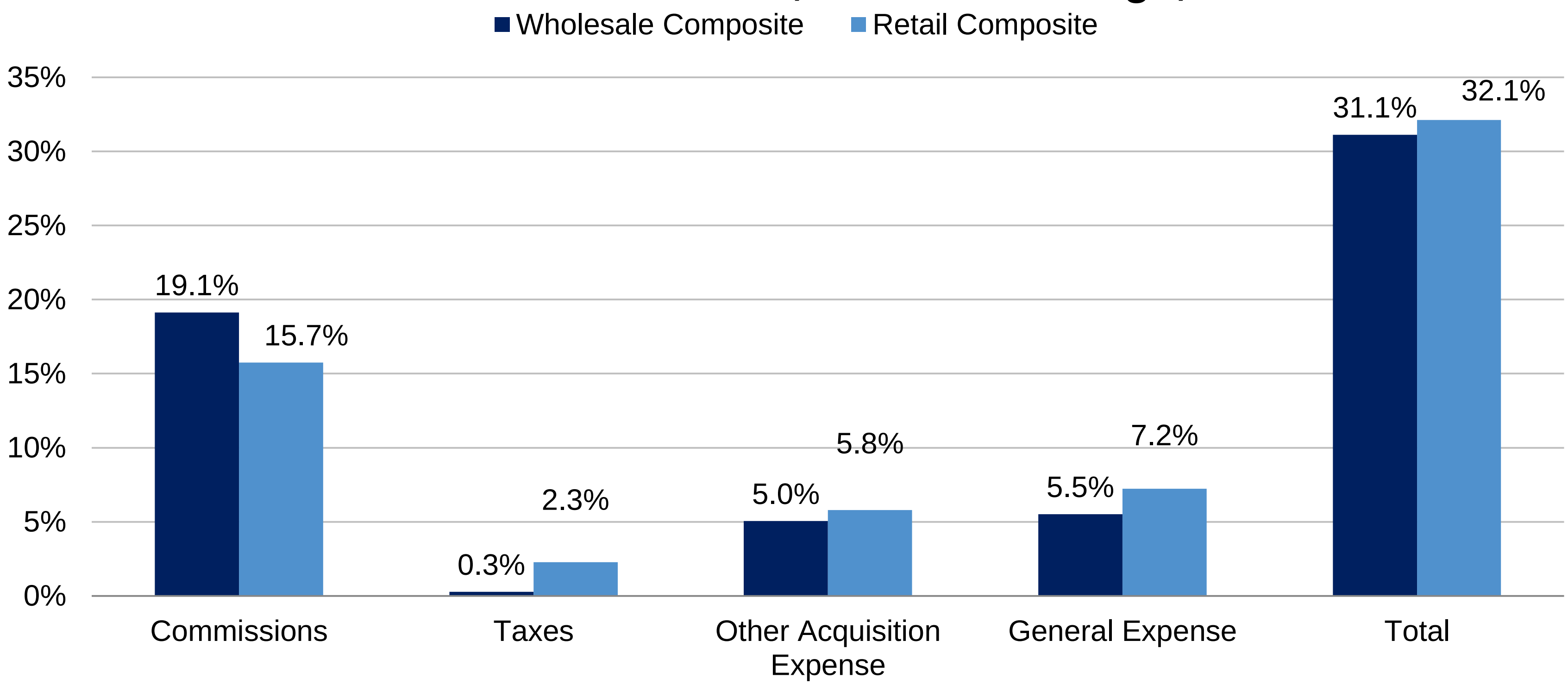
Development of Wholesale and Retail Composites

- Two composite groups of companies were formed as a proxy for retail and wholesale distribution.
- Companies were placed into each composite based on a combination of A.M. Best's distribution identification tag as well as through NAPSLO's company-by-company review, based on NAPSLO's collective knowledge of commercial insurance distribution.
- The selection process resulted in 83 companies representing $19 billion in premium for the Wholesale Composite and 266 companies representing $61 billion in premium for the Retail Composite.
- See the Appendix for a more detailed description of the report methodology.

ANALYSIS OF NON-LOSS COST EXPENSES

Wholesale Non-Loss Cost Ratios Less Than Retail Ratios

Median Annual Non-Loss Cost Ratios, Six-Year Average, Selected Lines



Total non-loss cost ratio for wholesale composite was lower than the retail composite by 100 basis points.

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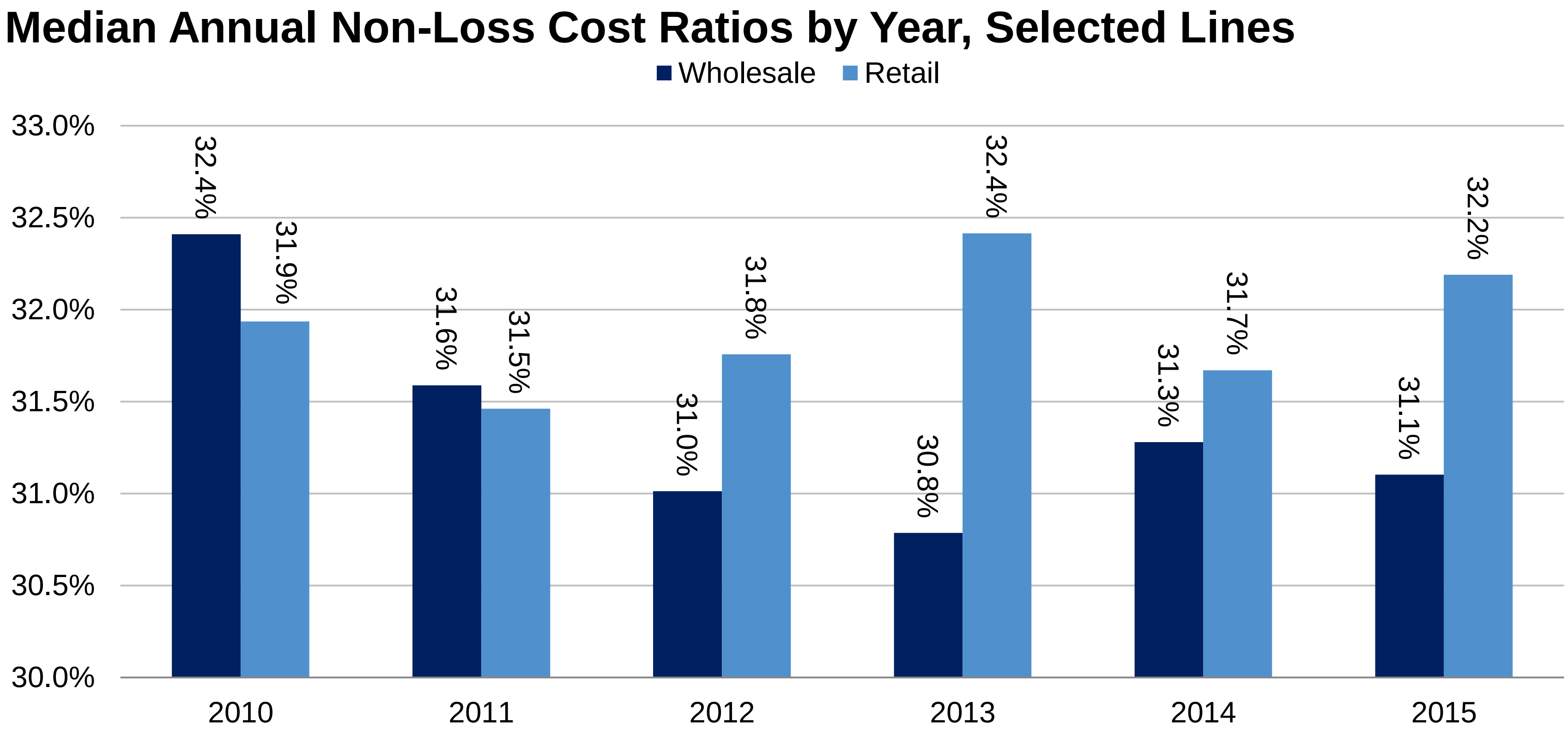
Non-Loss Costs Fluctuate by Year, but in a Narrow Range



Retail non-loss cost ratios were lower than wholesale in 2010 and 2011; however, wholesale ratios were lower for 2012 through 2015.

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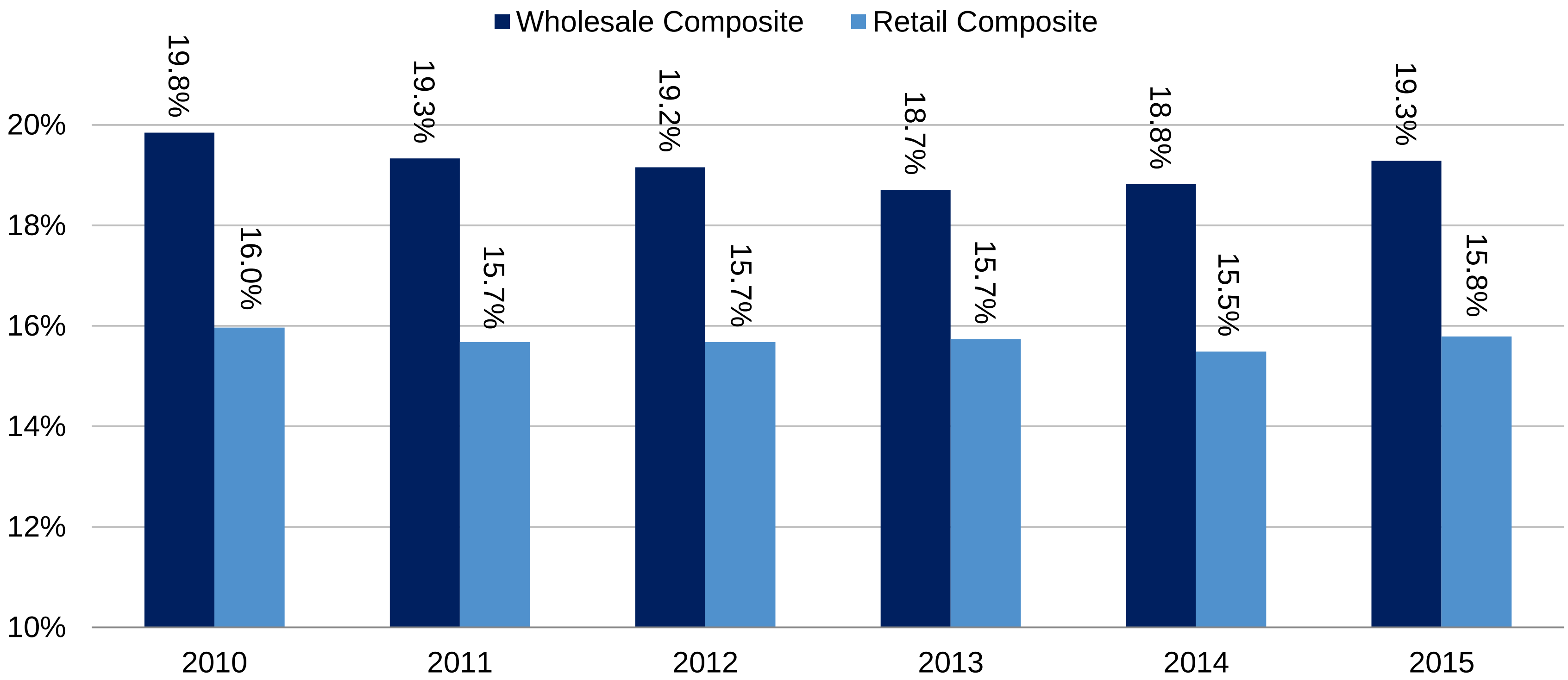
Wholesale Commission Ratio Higher Than Retail

Median Annual Commission Cost Ratio, Selected Lines



The wholesale commission ratio is consistently 3 to 4 points higher than retail.

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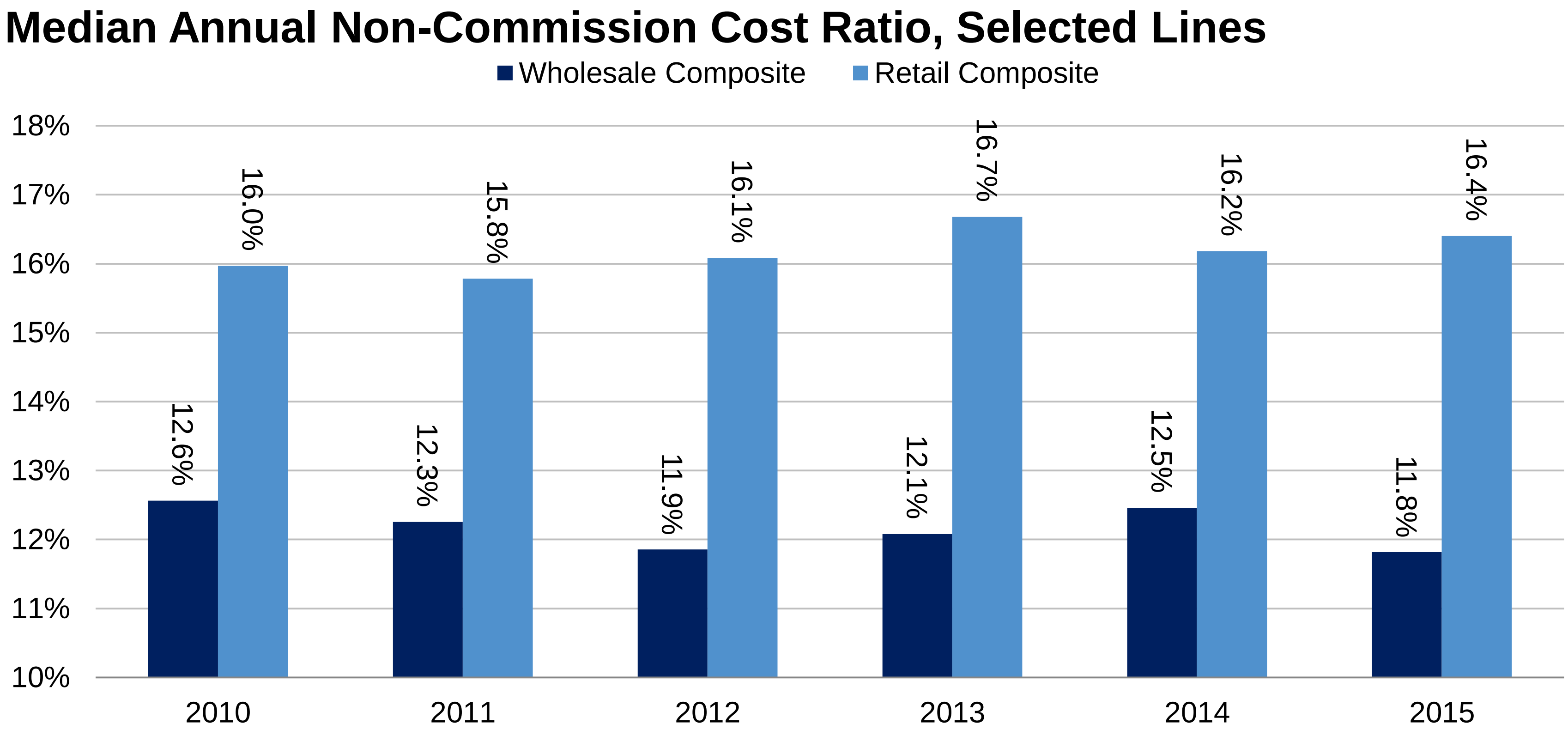
Yet Wholesale Non-Commission Ratios Are Much Lower than Retail



Wholesale non-commission cost ratios average nearly 4 points lower than retail.

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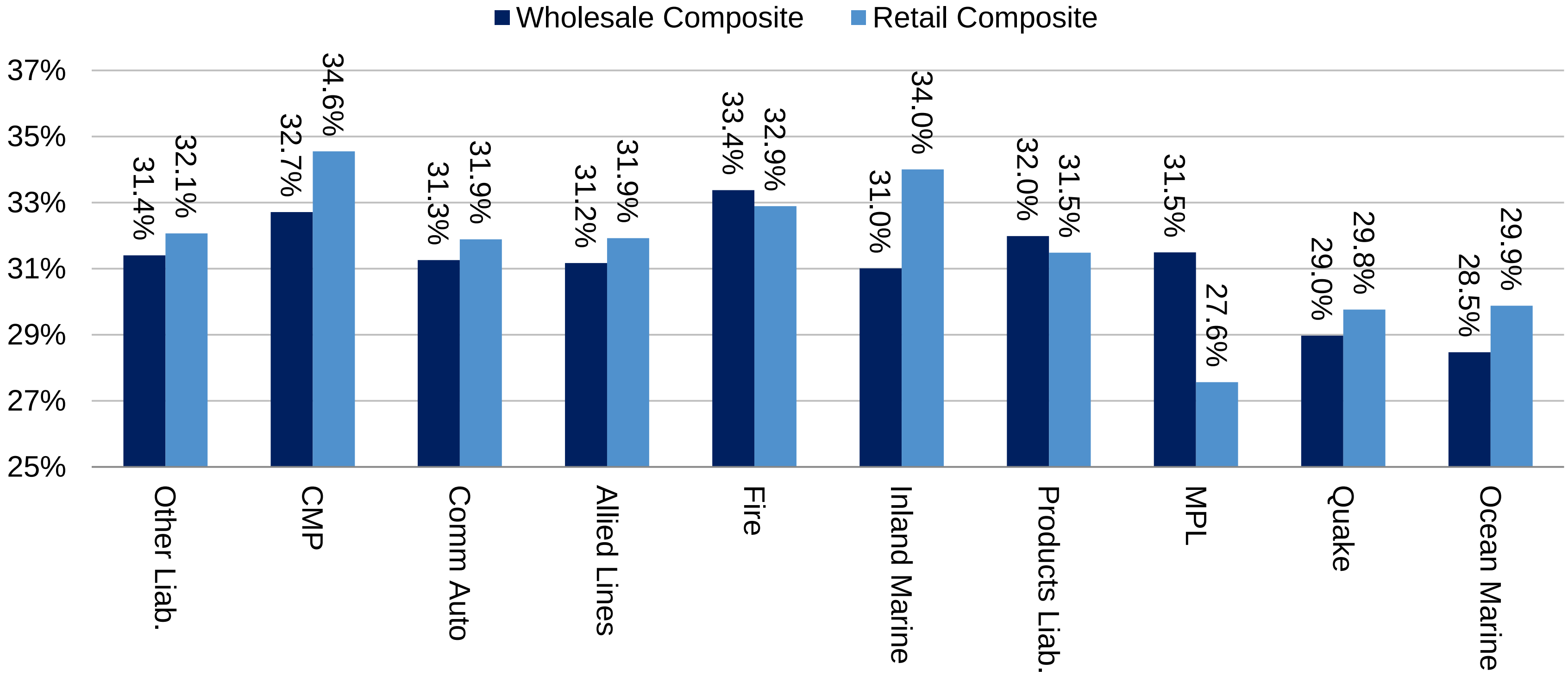
Results by Line Are Mixed

Median Annual Non-Loss Cost Ratios by Line, Six-Year Average



The lines of business with the greatest differential were: Inland marine: 3.0 points, MPL: 3.9 points, CMP: 1.9 points.
Only the MPL, fire, and products liability lines had higher non-loss cost ratios for wholesale than for retail.

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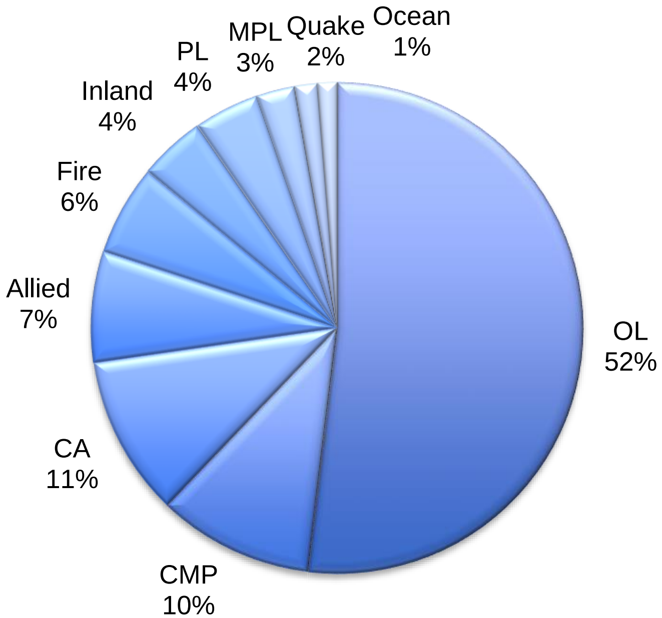
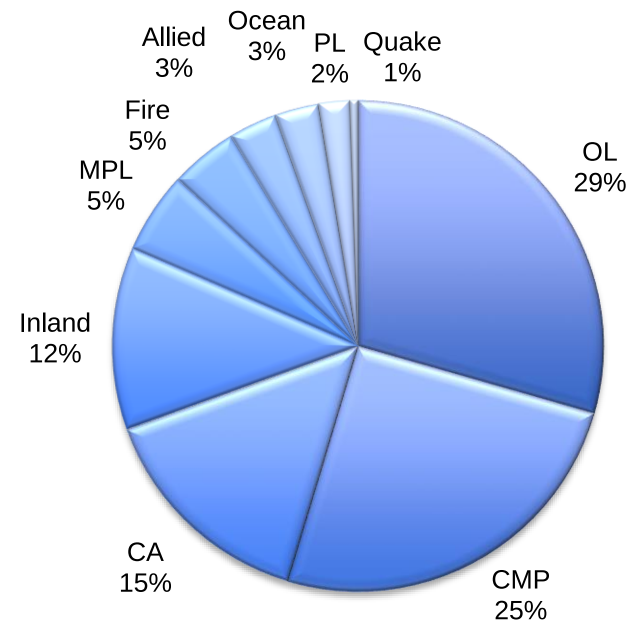
PROFILE OF COMPOSITES

Business Mix

Wholesale Composite



Retail Composite



In each composite, the top 3 lines account for about 70% of aggregate DPW, and were the same in each composite (other liability, commercial multiperil, commercial automobile).

Other liability dominates wholesale, accounting for greater than 50% of DPW, versus 29% for retail. Conversely, commercial multiperil's 25% weighting in retail is more than double the 10% weighting in wholesale.

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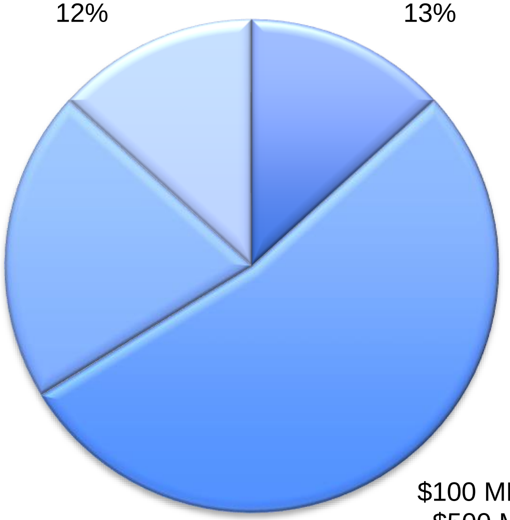
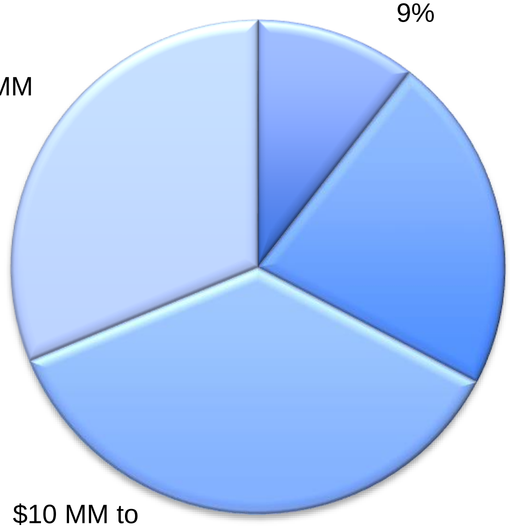
Company Size

Wholesale Composite



Retail Composite



In general, larger companies populate wholesale and small companies populate retail, with twice as many companies with $100 MM or more in DPW in wholesale.

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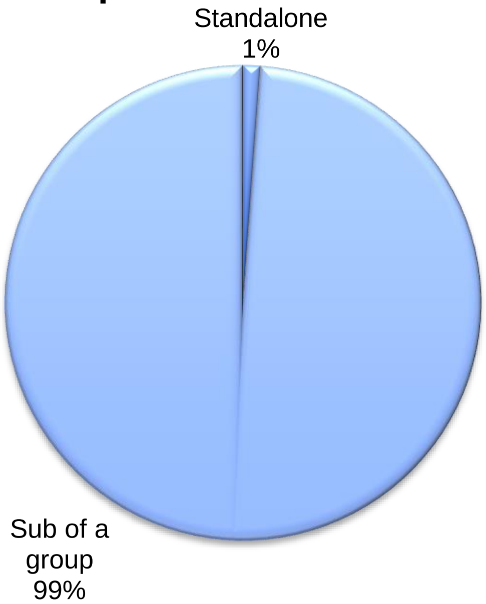
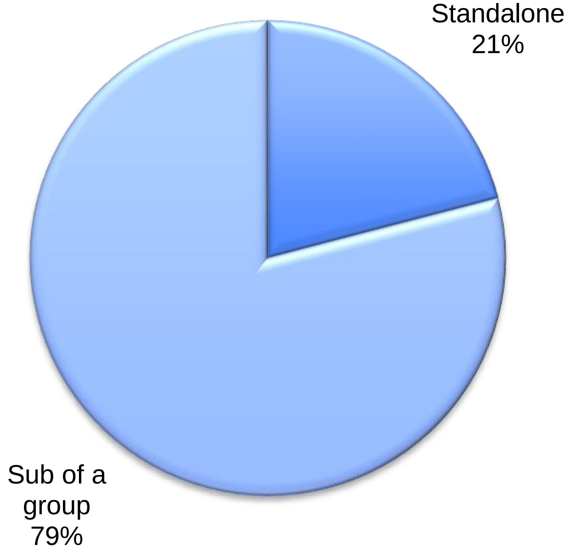
Company Affiliation

Wholesale Composite



Retail Composite



Virtually none of the insurers in wholesale are standalone entities, while standalone entities accounted for 21% of the total number of companies in retail.

Based on DPW, entities affiliated with larger groups represented more than 96% of the premium in each composite.

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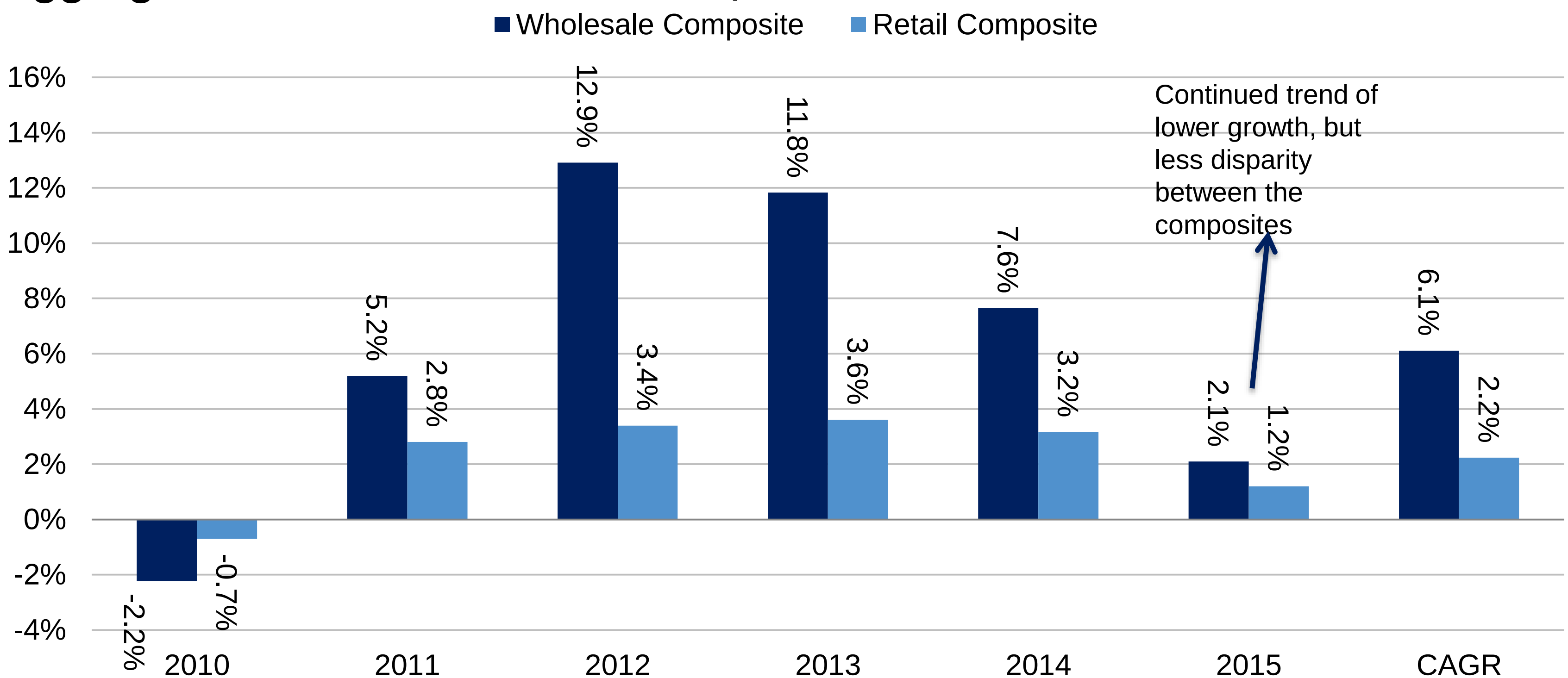
Premium Growth

Aggregate Direct Premium Growth, All Commercial Lines



Except for 2010, in each of the six years measured, the annual growth rate in DPW for insurers in wholesale exceeded the annual growth rate in DPW for insurers in retail.

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APPENDIX

Measurement and Data Employed

Measurement

For the analysis, Conning measured total non-loss costs of insurance companies ("Non-Loss Costs"), by select lines of business, that predominantly write commercial insurance.

Data Employed

In its analysis, Conning used statutory financial information for the six years ended 2015.

I. Premiums and other data were measured on a direct basis.

II. Companies were analyzed on an individual basis (not on a group basis).

III. The initial universe of companies included 3,061 individual P&C insurers (the "3,061 Company Universe") that report statutory financial data to A.M. Best and Company ("A.M. Best").

IV. No minimum premium size was required for a P&C insurer to be included in the analysis.

V. Included insurers that had at least 70% of total DPW (direct premiums written) in commercial P&C lines of business.

VI. Ten individual commercial lines were examined ("selected lines"). Only companies with an aggregate of at least 70% of DPW within these selected lines were included.

VII. Selected Commercial Lines:

Allied Lines	Commercial Automobile	Commercial Multiperil	Earthquake
Fire	Inland Marine	Medical Professional Liability	
Ocean Marine	Other Liability	Products Liability	

Appendix: Building the Composites

From the 3,061 Company Universe, a total of 349 eligible insurance companies were placed in either the Final Wholesale Composite or the Final Retail Composite.

A. The Final Wholesale Composite was composed of 83 companies with aggregate 2014 DPW of $19.1 billion.
B. The Final Retail Composite was composed of 266 companies with aggregate 2014 DPW of $60.6 billion.

Companies Excluded by Conning from the 3,061 Universe

Number of Companies Excluded	Reason for Exclusion
1,605	Companies with less than 70% of DPW in commercial lines
157	Companies with less than 70% of DPW in selected lines
227	Workers' compensation & excess workers' compensation insurers (greater than 50% DPW in this line)
206	Risk retention groups
127	Insurers employing direct response distribution as their predominant or exclusive distribution
59	Monoline surety writers (greater than 50% DPW in this line)
25	Insurers with zero or negative DPW in 2014
20	Workers' compensation state funds and other state facilities
18	Mortgage guaranty insurers (greater than 50% DPW in this line)
13	Financial guaranty insurers (greater than 50% DPW in this line)
14	Crop insurers (greater than 50% DPW in this line)
11	Insurers with outlier expense ratios (above 100%, less than 5%)
6	Captive insurers
4	Companies in liquidation or run-off
3	Two student travel & accident insurers and one trade credit insurer
2,495	**Total companies excluded prior to NAPSLO's review (removal of 217 companies with < 2/3 of business either wholesale or retail)**

Data source: ©A.M. Best Company—used by permission, Conning analysis

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Data Analyzed

Summary of Data Components Analyzed

For each of the companies in the Final Wholesale and Final Retail Composite, Conning analyzed the following financial measures:

I. DPW

II. Non-Loss Costs (underwriting expenses)

Included in the components of Non-Loss Costs are the following individual expenses:

I. Commissions

II. Taxes, Licenses, and Fees

III. Other Acquisition Expenses

IV. General Expenses

Conning used a median measurement of Non-Loss Cost ratios for each Composite.

I. A median measurement was used as the most representative of the Select Commercial Lines.

II. Use of an average or weighted average would have favored larger companies rather than weighting equally all companies in their respective Composites.

About Conning®

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