

Segment Review
August 27, 2015

Surplus Lines Profit from Underwriting Discipline and Core Competencies

Product diversification, underwriting discipline and market conditions drive profitable 2014 surplus lines results.

Underwriters of surplus lines continued to report profitable results in 2014 including profits from favorable reserve development. Results were driven by a combination of product diversification, underwriting discipline, and advantageous market conditions. As a result, 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.

A. M. Best's outlook on the surplus lines insurance market remains stable. In addition, the overall macroeconomic environment has been conducive to increased merger and acquisition (M&A) activity. 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.

Surplus lines insurers also have kept pace with Enterprise Risk Management tools and processes due to increased oversight by regulators and rating agencies. Management at these firms have taken a closer look at their operations from an enterprise standpoint and have either better formalized existing programs or made the necessary adjustments to be more in-line with peers.

The persistent low interest rate environment continues and investment portfolio returns suffer as carriers struggle to replace maturing, and higher yielding, securities with suitable replacements without adding to credit and liquidity risk.

In January 2015, NARAB II was signed into law by President Obama as part of the Terrorism Risk Insurance Program Reauthorization Act of 2015. The market view is that NARAB II will make it easier for agents and brokers to conduct business and make the licensing process more streamlined. Productivity is expected to improve and the cost of business and compliance to decrease.

One of the hallmarks of the surplus lines insurance market is the development of new insurance solutions to address new or emerging risks, or to provide improved coverage for known risks. The core competencies of the successful surplus lines carriers remain the same, focused on effective strategic analysis, product diversification and underwriting discipline. These companies typically concentrate more on bottom-line profits than top-line organic growth, utilizing the segment's freedom of rate and form, while providing coverage for the varied, nonstandard risks that they underwrite. This focus gives these insurers the best chance to withstand adverse market circumstances and succeed over the long term.

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