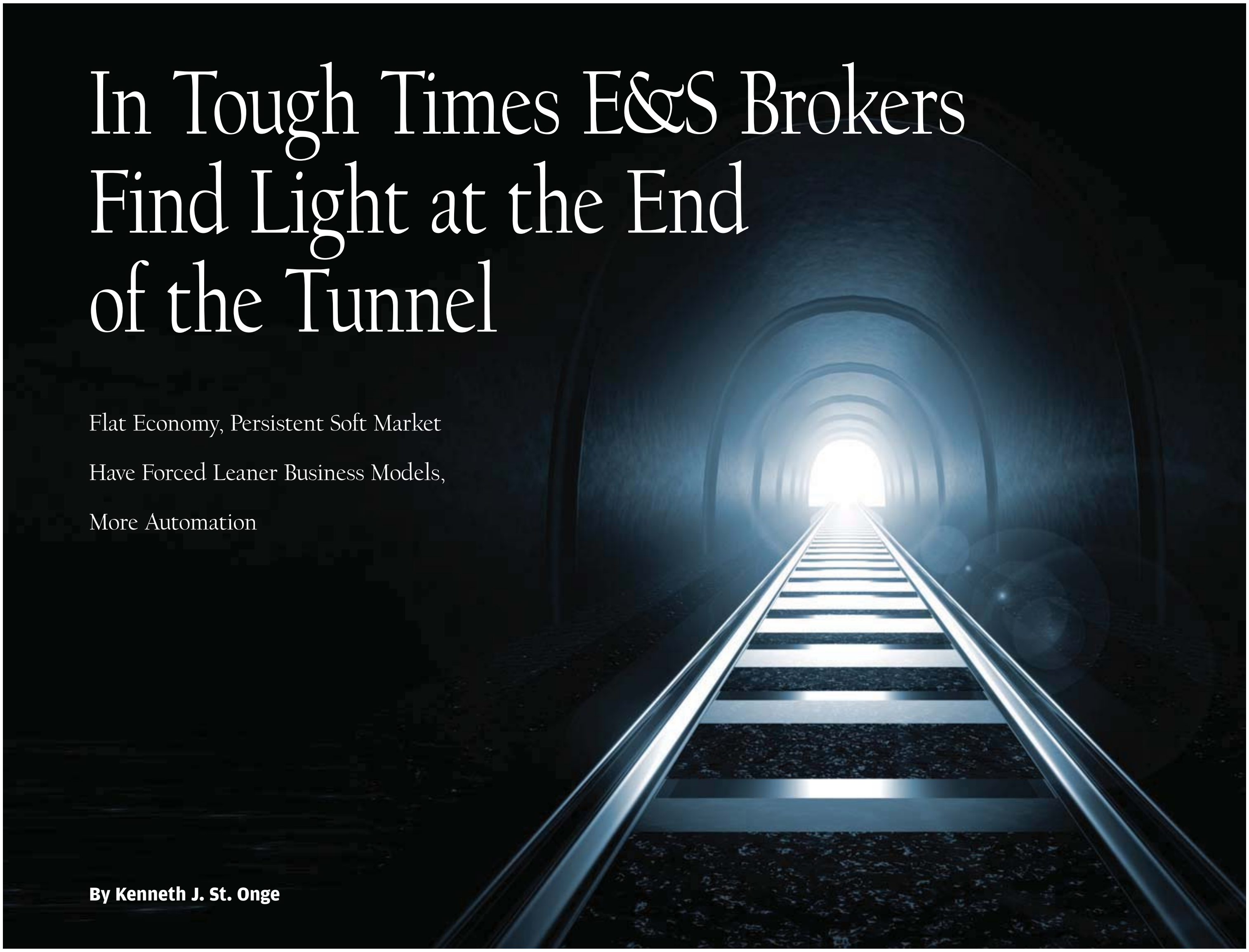
In Tough Times E&S Brokers Find Light at the End of the Tunnel



Flat Economy, Persistent Soft Market Have Forced Leaner Business Models, More Automation

By Kenneth J. St. Onge

A poor economy, natural catastrophes and an extended soft market have all combined to nip growth in the excess and surplus lines (E&S) insurance market over the last year.

Although there are a few bright spots at the moment — specific markets and regions that have seen growth — many brokers interviewed by *Insurance Journal* maintain that it's a difficult time to be in the E&S business. But even they see a light at the end of the tunnel and predict a rebound within 18 to 24 months, driven largely by an upswing in the insurance cycle and overall expansion of the economy.

There are signs even now. In the property realm, indicators point to some hardening in the surplus lines market because of catastrophes last year and the capital impairment of property/casualty insurers, said Marla Donovan, vice president of Burns & Wilcox, in a June webinar by the National Association of Surplus Lines Offices (NAPSLO) and the A.M. Best Co. This trend, Donovan said, has been weighed down by slow or negative growth in non-property lines, eliminating the perfect storm of potential for rate increases.

The majority of wholesale brokers and E&S carriers have not seen a decline in capacity or a tightening of terms; all have remained essentially flat. But NAPSLO members reported in a June 2009 survey that a major catastrophic event or changes in the economy could have a significant impact on capacity in the near future.

Paul Springman, president and CEO of Markel Corp., called the state of the market a "mixed bag." The E&S industry is seeing some hardening in pricing but not relative to loss experience, Springman said in the June webinar. "On non-catastrophe business in middle America right now, it's still very competitive with lots of players and lots of choices." Springman anticipates an uptick in claims frequency as a result of the economic conditions, which will lead to an uptick in pricing and a hardening market.

If so, it's behind schedule, according to Donovan, who believes the surplus lines industry should already be in a harder market but demand for coverage remains soft because of the economy. "As the economy starts to rebound, we will start to see demand for the conventional products — general liability, workers' compensation — increase," as well as for some specialty lines for exposures linked to serving aging baby boomers, products like health spas, she said. She also thinks demand for environmental products and employment practices liability insurance will grow, too.

On Competition: 'It's as bad as it's ever been here right now.' — Bart Koch, Tejas American General Agency, Cedar Park, Texas

Although brokers have faith in an eventual turnaround, they remain vexed by the "when?" Dick Bouhan, executive director of NAPSLO said that brokers for the most part agree the market is and will remain stable to soft for the near term future. In many cases it's prompted "some retrenchment in personnel that is reflective of the contracting marketplace and premium."

In other words, there has been a subtle reordering of the industry's operational landscape. Regardless of where they're based, E&S brokers say these economic and industry forces are reshaping the way they do business, ushering in new modes of competition, leaner businesses and increased automation. The industry-wide impact of these changes will emerge over the next several years as the insurance marketplace returns to normalcy and the new fault lines in the E&S market emerge.

Competitive Standards

Renewed competition from standard market carriers is one of the major forces shaping the current E&S market, and brokers say much of that is being driven by the soft market and standard insurers' need to bring in new premium dollars.

"It's as bad as it's ever been here right now," said Bart Koch, a partner with Tejas American General Agency in Cedar Park, Texas. "I'd say across the board, and especially on an account of any size, standard markets are becoming a lot more aggressive. They'll look at classes that have traditionally been surplus lines," he said, particularly "if it's of some size."

Many E&S brokers report the same trend: Traditional surplus lines markets are under increased competition from the standard market. Although it's happening across a number of product lines, a lot of brokers along the East Coast say it's getting far more competitive for coastal property.

"The coastal property market is getting more aggressive," said Greg Provenzo, senior vice president at the Richmond, Va., office of Atlantic Specialty Lines Inc. "A lot of standard market carriers are under-pricing it and then using wind deductibles that are, in my opinion, often less than they should be." It's not just coastal property either; in the Mid-Atlantic region of the country, Provenzo said that the standard market is getting aggressive in writing some manufacturing risks that have traditionally been placed in the E&S market.

On Opportunities: 'Professional liability has been holding up fairly well for us, so we are trying to expand there.' — David Wilson, JM Wilson, Portage, Mich.

Even on the other side of the country brokers say the standard market is encroaching into the E&S market.

Deb Neville, director of brokerage operations at Pacific Coast E&S Insurance Services in Oceanside, Calif., said that almost across the board, there is increased competition from admitted markets.

"Everybody is aggressive," she said. "Is there one particular market? No. They want new business. They're writing the tough stuff that they would never normally want, coverage for things like roofers and nutraceuticals. They want a piece of the pie."

Soft Opportunities

Some E&S brokers say they have found opportunities within the soft market that have at least allowed them to continue in niches they've previously occupied. But overall, flattened rates and a difficult economy have made business more challenging.

"Professional liability has been holding up fairly well for us, so we are trying to expand there," said David Wilson, president of JM Wilson managing general agency that writes mostly in the Midwest, but is expanding its Southeast presence. On the whole, Wilson said he has been surprised by the persistence of the soft market. "We know carriers aren't making money on investments. They couldn't possibly be making money overall on their insurance products. It just continues to soften. The reason is because of the economy. There are really fewer insureds out there so we are all fighting over fewer insureds. It's supply and demand."

Brokers say the persistence of the soft market is forcing insurers to re-examine the scope of their policies and in many cases offer enhancements.

"A lot of companies are offering broader coverages than they typically have in the past, such as ordinance of law or equipment coverage," said Atlantic's Provenzo. "E&S carriers are seeing the demand and packaging in what they didn't before. For instance, many nightclub policies would not include assault and battery coverage, whereas they do now."

Wind coverage continues to be a spot where brokers say growth opportunities exist, although finding the right market and the right price is still a challenge.

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Given the current storm season, many predict wind rates will continue to grow and outpace the rest of the insurance marketplace.

"Wind (prices), right now, are growing slightly, because we are in the throes of wind season — especially on coastal property," said Atlantic's Provenzo. "I wouldn't necessarily use the term 'hardening' but certainly premiums are trending up."

Lester Edelman, principal of AFG Partners, a nine-person wholesale brokerage based in New York, agreed. "In general there is a rate hardening with respect to wind," he said. "The hardening comes more in the form of higher deductibles and higher rates. Or both."

Challenging Economics

The economic crisis has taken its toll. Many E&S brokerages have had to reduce staff in order to remain competitive, although in many cases, that downsizing has led to productivity gains and a rethinking of business models.

"We had 72 employees 18 months ago, and currently we have about 42 employees," said Jim Yates owner and president of Yates & Associates Insurance Services, in Tustin, Calif. "We are strictly a wholesaler doing small commercial and that has been the hardest hit in this recession. We lost a lot of business through nonrenewal or going out of business."

That led to an operational overhaul, Yates said. "Now we have underwriters to handle new business specifically, so we can give better service to the independent agent now. We are starting to hire back new underwriters that can serve agents. We have done some outsourcing for rating, and all policy issuance and endorsement rating, quote rating, new and renewal, that's actually being done when we are asleep. We feel with the way we have changed our model of doing business — it was a necessity. Now we will be more efficient, effective and can run a more economical operation."

On Changes: '[T]he way we have changed our model of doing business – it was a necessity. Now we will be more efficient, effective and can run a more economical operation.'
– Jim Yates, Yates & Associates Insurance Services, Tustin, Calif.

It's a scenario witnessed in brokerages across the country, from the West Coast, to the Midwest to the East Coast: E&S brokers are trimming and reorganizing to save money and streamline their operations.

"We have reduced staff about 5 percent, but it hasn't affected our turnaround time as far as quotes and policies," said Wilson of JM Wilson. "Being located in Michigan isn't exactly the place to be today right now from an economic standpoint. Although we are in the transportation business and we have seen some pretty big fleets go under, it hasn't really affected us because we didn't write any of those fleets. But it sure doesn't help." Wilson has actually added several branches over the same time period, which he attributes to gains in productivity.

"We have downsized," said Jim Roe of Arlington/Roe & Co. based in Indianapolis, Ind. "We were up to about 135 people. But we had a couple of acquisitions over the last four or five years and found out that we just don't need the same number of people … We are actually doing more business with about 15 fewer people."

Roe says as a result of the changes the firm has "become more efficient. We've gone paperless in the last few years. But, we have, unfortunately had to, let some people go, and close a couple of our offices; it was the hardest thing I've ever done. But, we have to take a look at the big picture and make sure that we're taking care of the people who brought us to the dance."

Automation Nation

The E&S business for the last decade has witnessed a massive uptick in the use of automation to quote and deliver policies. That use of technology has become far more pronounced over the last several years and in many cases, it has resulted in significant productivity gains during the current economic climate.

"It's huge in our business," said Atlantic's Provenzo. "When we started 15 years ago, I would type a policy and have to wait at least a day for it to be delivered. Now we deliver the policy in 24 hours to our retailers."

That boost was driven largely by new capital investment, Provenzo said. "Two years ago, we spent $250,000 on building an imaging system and installing paperless technology to make the business more efficient. It's put us ahead of the curve."

It's not just in binding and quoting. The technology has helped many brokers increase operational efficiencies of which retail agents might not be aware. AFG's Edleman, for instance, said his brokerage's investment in automation technology has helped streamline how it pays surplus lines taxes in various states.

Despite its expense, some brokers say that the economic crisis has likely brought more automation, not less, as brokers continue to search for efficiency gains.

"We have been a paperless operation for around four years … (and) it's more important now, from an economic standpoint, than when we first went into it," said Yates. "These times will force many to get more into technology than they had in the past. It plays a big part."

Some would say even too big.

"It's completely taken over," said Marcus Jensvold, president of M.D. Jensvold & Co., a nine-person specialty lines brokerage in Houston. "It just dominates your operations. I get together with my fellow old timers now (and) we get nostalgic about the old days in offices when people talked to each other. Now all you hear is the soft click of the keyboard. … In that respect it's sort of changed the culture."

Most brokers interviewed by *Insurance*

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Surplus Lines Premium Down 9% Mid-Year 2009

The volume of surplus lines premium is down nationally by an average of a little more than 9 percent and indications show the trend is not likely to change anytime soon, according Phil Ballinger, executive director of the Surplus Lines Stamping Office of Texas (SLSOT).

While surplus lines premium for the first six months of the year has increased compared with the first half of 2008 by more than 12 percent in Texas (see table), Ballinger said Texas is an "anomaly" compared with the other 13 states that have stamping offices.

The increase in Texas appears due to heightened interest in writing property accounts, even some coastal property accounts, Ballinger said. As in other states, casualty lines are generally down in Texas.

For the first time in his 17 years at SLSOT, Ballinger said, California is no longer the leading state in terms of reported premium volume for the first half of 2009. "California was always number one in premium volume by a big margin," he said. Florida now has taken the top spot.

Ballinger explained that because every state has its method of categorizing individual filings, the figures under the "6 Mos Items" columns in the accompanying table can be somewhat misleading.

"Items are really just an individual filing," Ballinger said. "It may not be directly comparable from state to state because some states only take money filings, like a policy or an endorsement. [Texas] will take some that are not money filings, like name changes, things like that."

Florida, however, will count as two "items" a filed policy that has two insurers listed on it. "That's why their numbers are so high on item counts," he said. "Generally for most states [the item count is] going to be policies."

He noted that Montana shows a significant increase in surplus lines activity so far this year, percentage wise, but that's because they are such a small state in terms of overall premium volume. "It's so small, that a dollar increase will translate into a big percent increase," Ballinger said.

Montana also is closing its stamping office this year and shifting those responsibilities to the insurance department. Minnesota, on the other hand, has "kind of bucked the trend," Ballinger said and opened a stamping office in 2009. IJ

Stephanie K. Jones

Production Statistics From U.S. Stamping Offices, Mid-Year 2009

State	Rates		6 Mos Premium (mill.)			6 Mos Items		% Chg	Comments
	St. Fee	SL Tax	2009	2008	% Chg	2009	2008		
AZ	0.20%	3.00%	$205.2	$249.3	-17.7%	34,055	36,059	-5.6%	
CA	0.225%	3.00%	$2,252.9	$3,116.8	-27.7%	217,842	232,638	-6.4%	New stamping fee rate Jan. 1, 2009
FL	0.10%	5.00%	$2,351.4	$2,585.8	-9.1%	550,116	586,476	-6.2%	
ID	0.25%	1.50%	$29.2	$38.9	-24.9%	6,784	7,386	-8.2%	
IL	0.10%	3.50%	$526.5	$608.4	-13.5%	57,816	51,854	11.5%	
MN	0.25%	3.00%	$114.0	XXX	XXX	11,507	XXX	XXX	New stamping office Jan. 1, 2009
MS	0.25%	4.00%	$171.2	$156.9	9.1%	46,586	40,857	14.0%	
MT	1.00%	2.75%	$34.6	$24.0	44.2%	7,130	5,412	31.7%	Stamping office ceased operation July 1, 2009
NV	0.40%	3.50%	$116.5	$160.0	-27.2%	13,212	14,686	-10.0%	
NY	0.20%	3.60%	$1,811.3	$1,841.0	-1.6%	102,059	110,305	-7.5%	Additional fee of $25 applies for late/ erroneous filing
OR	$15.00	2.00%	$105.1	$148.5	-29.2%	18,230	19,553	-6.8%	New flat stamping fee June 1, 2009 (no fee on endts) Additional 1% tax on "fire" premium
PA	$25.00	3.00%	$453.5	$504.2	-10.1%	86,231	88,894	-3.0%	Additional fee of $25 applies for late filing
TX	0.06%	4.85%	$1,770.9	$1,577.8	12.2%	420,852	426,494	-1.3%	
UT	0.15%	4.25%	$90.6	$88.2	2.7%	10,023	9,479	5.7%	New stamping fee rate Jan. 1, 2009
WA	0.25%	2.00%	$267.1	$274.0	-2.5%	42,710	43,360	-1.5%	
TOTAL			$10,300.0	$11,373.8	-9.4%	1,625,153	1,673,453	-2.9%	

NY data is gross premium; 2009 net premium = $891.8 million. Items include certain non-premium filings in IL, NV, & TX. Data for FL includes $288.9 million / 6,408 policies in IP insurance. Data for TX excludes $253.3 million in "other state" and $77.8 million in "tax exempt" premium. Stamping fee rates are at July 1, 2009.
Source: Surplus Lines Stamping Office of Texas

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Journal said the move to automation is inevitable. "I don't think any of us has a choice," said Wilson. "You don't want to spend the money but on the other hand you are kind of shooting yourself in the foot."

Another reason? A thinning pool of agents. Some brokers interviewed by *Insurance Journal* said agents in many parts of the country are reducing the number of wholesalers they use. Of course, not all feel pressured by that trend.

"Yes we have seen this," said Atlantic's Provenzo." It's mainly the larger retailers that want to consolidate their wholesale-brokered business. It's not necessarily concerning. Our business is about relationships. I think we really stand on our own."

On Technology: 'Automation has helped incredibly in streamlining how we pay surplus lines taxes in various states.' — Lester Edelman, AFG Partners, New York, N.Y.

Looking Forward

Despite the difficulties brokers have faced over the last two years, many believe that a turnaround is not far down the road, and it will be driven by growth in the economy.

"The word on the street overall is the economy is getting better," said Roe of Arlington/Roe & Co. "We are starting to see the press say the economy is starting to grow, the stock market has been growing, so I think as people who are real nervous right now, are starting to see some growth that they might start, might get a little bit more aggressive in spending. … Eventually, I think, some of that will start getting in, and that should help all of us."

In some places, the bright spots are already visible for E&S brokers.

David Parker, president of Hanover Excess in Wilmington, N.C., said that a new state law has created an opportunity for him to sell gap coverage for coastal homes. A reform package just signed into law caps the property and contents limits that the state-backed Beach Plan can offer at half of their previous maximum. The result is surging demand for excess coverage.

Parker also thinks his state's economy shows signs of renewal. Although he's still writing new, vacant property accounts, he's also seen a rise in new construction startups, perhaps by unemployed workers deciding to venture out on their own. IJ

This story was reported by St. Onge, Andrea Ortega-Wells, Stephanie K. Jones and Andrew G. Simpson.