BEST'S MARKET SEGMENT REPORT

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Surplus Lines Push Through Various Headwinds for Higher Growth

The surplus lines market continues to grow, generating both pretax and net profits and maintaining strong balance sheets in 2017

In a year of higher losses driven primarily by an increase in catastrophes and persistent competitive market conditions that impacted most lines of business, surplus lines and specialty market insurers continued to demonstrate the resilience that has long been one of their defining characteristics. The surplus lines market grew 5.8% in 2017, up notably from just under 3% in each of the two preceding years. Growth was constrained somewhat by competitive pressures, including pressure stemming from traditional surplus lines business being written by admitted companies. Although weather-related losses led surplus lines writers to post an underwriting loss for the third year running, the domestic professional surplus lines composite (as defined in this report) was still able to generate both pretax and net profits and maintain strong balance sheets.

The ability to operate profitably despite tough market conditions and other challenges leads A.M. Best to maintain its view that the surplus lines market is financially sound and should remain so for the foreseeable future. For most types of business—other than property catastrophe and automobile/transportation—competitive market pressures spurred by a wealth of available capacity appear to be escalating, not diminishing. The task of competing at the highest level in the surplus lines and specialty market will likely become more difficult for companies that lack the necessary scale, diversification, value proposition, or brand recognition to excel, as well as for those that do not leverage available innovations such as predictive analytics as effectively as other competitors do. With interest rates still relatively low and other economic factors presenting operational challenges, the ability to compete effectively is especially crucial. Developing ways to enhance operational or analytical strong points, exercising the proper discipline despite pressure from competitors, and creating products to address new or emerging risks will help separate the best from the rest among the surplus lines and specialty companies. Such success will result in the ability to maintain solid balance sheet strength, which is integral to any chance at future success.

Consolidation among surplus lines insurers continued to impact market competition in 2017. With a number of mergers involving prominent surplus lines and specialty market organizations expected to close in 2018, consolidation will continue to re-shape the market, including wholesale intermediaries. Acquiring insurers continue to use M&A as part of their strategies to carve out a bigger piece of the market. On the distribution side, the larger wholesalers have been growing in scale and expanding their profiles by acquiring smaller brokers and intermediaries. The push to consolidate has led to retailers often doing business with fewer wholesalers, and wholesalers in some cases doing business with fewer insurance companies. A.M. Best does not believe that M&A momentum will slow down over the near term.

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