Surplus success

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Matthew Power's assessment of the Surplus Lines market exemplifies the type of results the mainstream Property & Casualty market has coveted for years.

"The Surplus Lines market grew almost 6% in direct premium in 2017, growth in E&S has been quite strong over the past several years and I expect that growth trajectory to accelerate over the coming year into 2020," says Power, head of wholesale, alternative distribution operations at Risk Strategies, a privately held national insurance brokerage and risk management firm.

The Surplus Lines industry reached a historic $44.9bn in direct written premium in 2017, a 5.8% increase over the prior year, adds Joel Cavaness, president of Risk Placement Services Inc. The 15 states with stamping offices reported $31.4 billion in surplus premium collection in those states during 2018 – an 11.3% increase over 2017, he notes.

Power, who served at AIG for nearly 30 years, believes that there are two underlying causes driving growth in this space.

"There are two forces at play," he explains. "It is the traditional cyclicality of moving from admitted to non-admitted, and that's always been the Yin and Yang of our industry. Some of that growth is due to traditional market cyclicality; underwriters continue to give back market share where they simply cannot achieve risk appropriate rates and terms. But today there is greater value placed on Excess and Surplus lines because of our freedom of rate and form, and our ability to customise and meet the changing demand of customers.

"But there is another dynamic playing in the sector, and that's the need for the highly customised insurance offerings that are being generated from the sheer volume of new emerging technological advancements and the underlying business models of customers," he continues. "Things like biotech and genomics, manufacturing and robotics mean that there is an absolute need for customisation, and that's where E&S underwriters come in."

Cavaness was in agreement that new technologies are spurring growth in the surplus lines space. "New and emerging technologies often bring with them complex risks for which there are not existing, standard solutions," he tells *Reactions*. E&S professionals are innovators, and possess knowledge and access to specialty markets that result in customised solutions for retail agents and their clients, he adds: "Often, the E&S market is an 'incubator' where coverages are created and requested when other markets will not consider them."

Cyber insurance is one such marketplace in which E&S players can shine, as the traditional market continues to grapple with how exactly to cover its myriad perils – which often intersect with other types of coverage. Cavaness says, "Like many new products, the E&S segment has been critical to the development of cyber insurance. These emerging markets continue to present opportunities for the industry."

"Cyber is constantly evolving, so the underwriter needs to be nimble with a deep understanding of the peril," says Power. "The E&S sector is better able to shift and create bespoke solutions and respond to a broader shift to non-admitted cyber."

While the standard market is offering robust cyber products, "E&S brokers still offer customised expertise, market access and unique cyber solutions that aren't yet available in the standard market," adds Cavaness. "As technology continues to evolve, cyber coverage evolves and grow in all segments of the marketplace. There are many standard cyber solutions today that didn't exist a decade ago; however, the more innovative and flexible solutions to evolving cyber risks will continue to incubate in the wholesale, specialty and Surplus Lines market."

Additionally, private flood cover is another space in which the E&S sector can really shine as reforms to the National Flood Insurance Program (NFIP) continue to point toward increased private market participation. It is an area in which the Wholesale & Specialty Insurance Association (WSIA) continues to leverage its legislative and educational efforts in Washington.

"Growth in private-market flood solutions continue to garner interest. We anticipate that the next round of legislation will see rates moving upward as the programme begins to assess properties individually on an actuarial basis," says Power. "E&S lines have been making a market for private flood coverage, which didn't exist four years ago."

Consumers whose risks don't fit within the terms and limits of the NFIP, or whose risks are declined by the standard market, look to surplus lines for solutions, says Cavaness: "We believe it is essential for consumers in those situations to have alternatives." These include situations where the property exposure exceeds the $250,000 residential property limit or the $500,000 commercial property limit offered by the NFIP, or when homeowners or businesses desire cover for replacement cost rather than the actual cash value of their property, or when they reside in communities or zones not eligible for NFIP coverage, he explains.

Other lines of business in which the E&S sector has flourished include the recreational boating and energy sectors, following extensive hurricane and wildfire losses in recent years.

In recreational boating, Power says, “Underwriters both domestically and in London have become extremely cautious in terms of where and to who they allocate capacity; this is a product of the 2017 storm season and recent past years’ experience. Brokers and MGAs who have to deliver consistency are no longer in a position to provide solutions in the space, so you see more and more of this business bleeding into the E&S sector,” he explains.

In the energy sector, utilities are facing upward rate momentum post-2018 wildfires, so coverage for transmission lines and cell towers are increasingly difficult to obtain in cat prone areas of the country, Power notes.

Alternative capital is also having a material impact on the E&S space, much the same as it has had on the mainstream P&C market.

“Certainly, it has had an impact in the E&S business but not in a bad way. Alternative capital in our industry is here to stay, at least while the providers feel they can get the proper return on the capital allocated to the risk they are assuming,” says Cavaness.

“We all seek solutions for our collective clients and with capital and risk-taking alternatives it keeps the market competitive and efficient,” he continues. “The alternative market has allowed many to bundle up certain types of business and look at portfolios that can be modelled to match the appetites of this capital.”

Still, as is often the case in traditional lines, pricing for certain E&S risks is not always where it should be, Cavaness says. There are several lines or subsets of lines that are currently experiencing pricing and underwriting adjustments, he points out: assisted living facilities, excess trucking liability, primary trucking, California homeowners and some classes of property to just name a few.

“Several of these have just seen adverse court judgments or attritional loss experience where the underwriting community has decided that they need more rate or shorter limits,” he notes. “Sometimes in our business, we only have a rear-view mirror to gauge the success of the decisions that we make even when we feel we have all of the adequate information up front to make these same decisions.”

