Testimony of Patrick Small
President of DUAL Special Flood
On behalf of the Wholesale & Specialty Insurance Association

Before the
Subcommittee on Housing and Insurance
Committee on Financial Services
United States House of Representatives
"How Do We Encourage Greater Flood Insurance in America?"

March 10, 2023

I. Introduction

Good morning, Chairman Davidson, Ranking Member Cleaver, and members of the Subcommittee. My name is Patrick Small and I am the President of DUAL Special Flood. My firm is a member of the Wholesale & Specialty Insurance Association, and we thank you for inviting me here today to testify about my perspective and experience as a professional in the private flood insurance market.

II. About DUAL Special Flood and WSIA

DUAL North America operates as a managing general underwriter and is a leading program administrator in the US offering specialized financial lines, property and casualty insurance products. We place coverage in all 50 states on a surplus lines basis working directly with retail agents and brokers, wholesale brokers and insurance carriers. In 2022, DUAL NA placed $1.5 billion in gross written premium amongst all of our product lines with over 30 carrier partners and 30 plus underwriting programs across seven operating subsidiaries. DUAL's Specialty Flood division focuses on both primary private and excess flood for commercial and residential consumers and places $65 million in annual premium or about 5% of DUAL's annual premium production.

DUAL is a member of the Wholesale & Specialty Insurance Association (WSIA), which is our member services organization and professional trade association representing the entirety of the wholesale, specialty and surplus lines industry. WSIA membership consists of approximately 725 member firms, including U.S. Wholesale, U.S. Insurance Market, Associate and Service members, representing tens of thousands of individual brokers, insurance company professionals, underwriters and other insurance professionals worldwide conducting business in the U.S. surplus lines market. WSIA was formed in 2017 through the merger of the National Association of Professional Surplus Lines Offices (NAPSLO) and American Association of Managing General Agents (AAMGA). Additional information about the surplus lines market can be reviewed in **Attachment A**.

III. <u>Flood Insurance</u>

In 1968, Congress established the National Flood Insurance Program (NFIP) to make up for a lack of available flood insurance from the private insurance market. The program has enabled property owners in participating communities to purchase insurance protection from the federal government; however, in 2012 with the Biggert-Water Flood Insurance Reform Act (BW12), Congress recognized the need and opportunity to encourage a more active participation by the private insurance market as a means to encourage more Americans to purchase flood coverage. WSIA supported these actions and continues to. Since 2012, the private market has been able provide coverage in partnership with or as an alternative to the NFIP to enhance flood insurance coverage across the nation. However, there is room and certainly a need for growth in these coverages with a strong NFIP and a regulatory atmosphere that educates consumers and enables the private insurance market.

A. <u>Current State of Surplus Lines Flood Market</u>

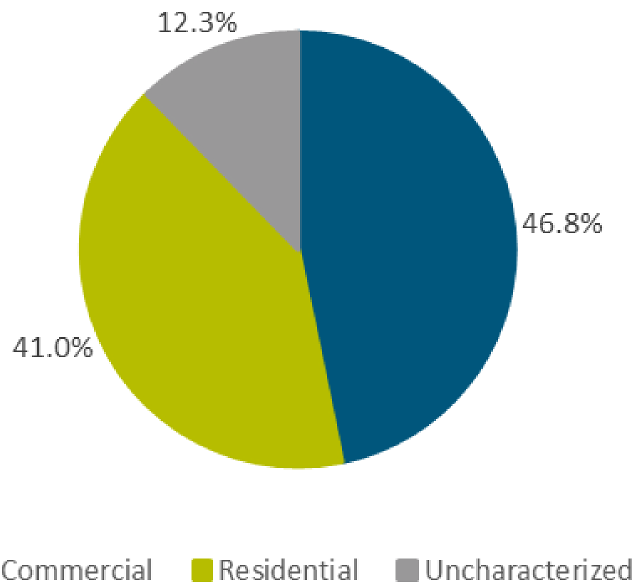
Generally speaking, consumers whose risks do not fit within the terms and limits of the NFIP or whose risks are declined by the standard market will have agents and brokers looking to the surplus lines market for solutions. Consumers will and do need alternatives to the NFIP when: (1) they need higher limits than the $250,000 residential, and $500,000 commercial limits offered by the NFIP; or (2) they need enhanced coverage beyond that offered by the NFIP.

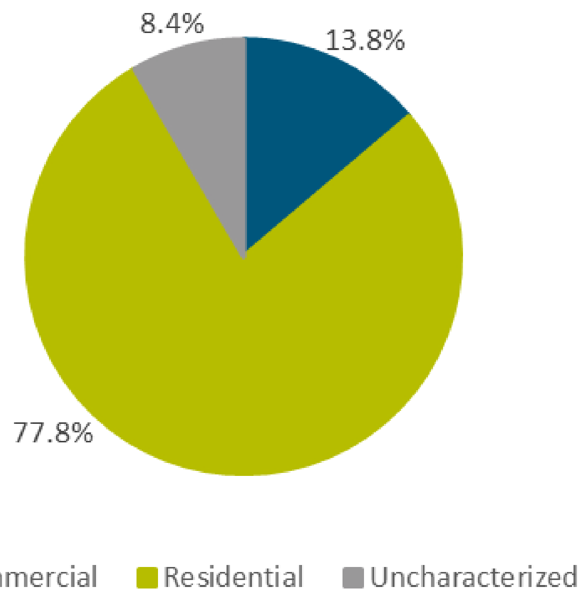
Utilizing data from states with surplus lines stamping offices, which exist in 15 states to assist regulators in the oversight of insurers and producers transacting business in a given state's surplus lines market, we have seen a steady increase in flood insurance coverages written by the private market. In 2022, 10 of the 15 states with surplus lines stamping offices collected specific flood insurance policy data (California, Florida, Illinois, Mississippi, New York, North Carolina, Pennsylvania, Texas, Utah and Washington), including four of our largest surplus lines states (California, Florida, New York and Texas).

These 10 states reported $552 million in flood premium in 2022 compared to the $58.8 billion in total surplus lines premium written in these states – only .94% of their total surplus lines premium is for flood risks. The states with stamping offices are fairly representative of the entire U.S. market because they comprised 65.8% of the $82.7 billion in U.S. surplus lines premium written in 2021. If we extrapolate their proportion of flood insurance premium nationwide, we estimate roughly $840 million in flood insurance premium written by the surplus lines market across the country.

Of the $552 million in flood insurance premium:

- $267 million or 46.8% covers commercial property;
- $234 million or 41.0% covers residential property; and
- $70 million or 12.3% is not specifically characterized as either commercial or residential property.





Although flood coverage represents a relatively small proportion of the surplus lines market, it represents a market for consumers that would otherwise have no solution. For consumers who seek private market alternatives to the NFIP, the standard market serves as the primary solution for risks that fit within the standard pricing and underwriting criteria of standard insurance

carriers. While the standard market is developing for flood insurance, it takes time for the standard market to develop the experience and data to support standard pricing and underwriting criteria. The surplus lines market has been developing primary flood solutions for decades, but both markets are still very young in their development. It is important to note the surplus lines market has been a solution for decades for flood insurance risks that do not qualify for the NFIP and for coverages that exceed the limits and terms of the NFIP.

B. Modernization of Regulatory Requirements has had a Positive Impact on Flood Insurance

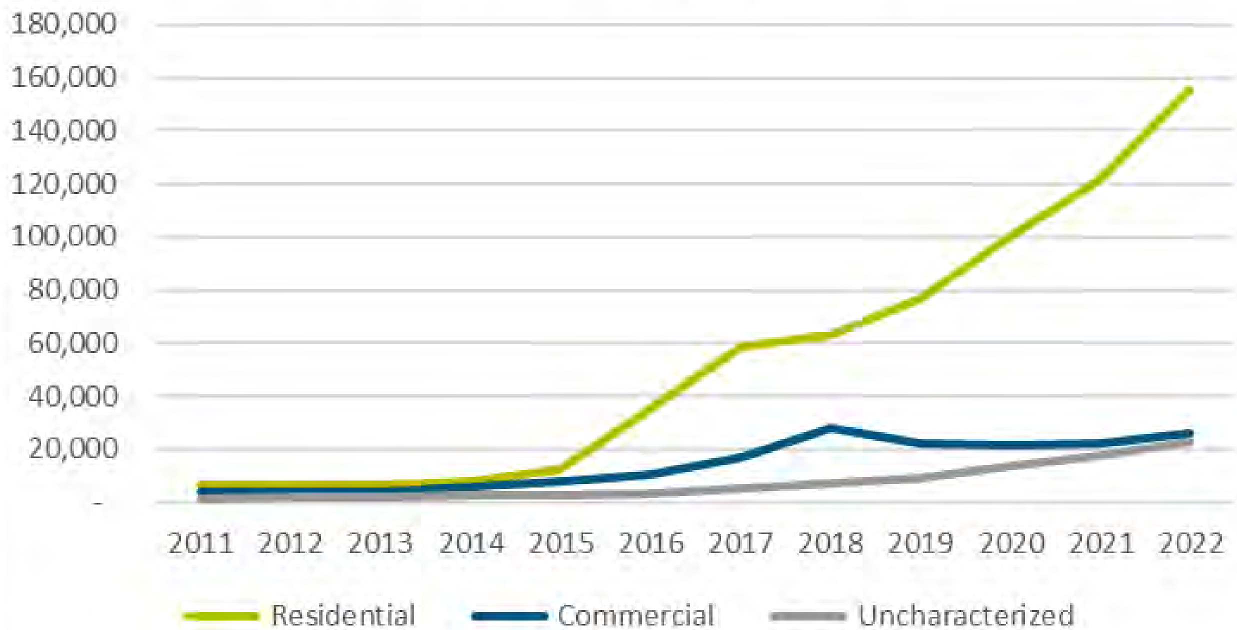
While WSIA and other industry members were supportive of BW12, it took time to see its reforms facilitate growth in the private market. The Final Rule for Loans in Areas Having Special Flood Hazards[1], issued in 2019 by five federal agencies overseeing lenders (FDIC, OCC, Federal Reserve, NCUA and FCA), was instrumental in the surplus lines market's development. This Rule brought much needed clarification to lenders on the acceptance of private flood insurance policies from surplus lines insurers, and we have experienced growth in surplus lines flood coverages and new market entrants as a result. The FHA issued a similar rule in 2022, which will further assist those mandatory purchasers with FHA backed loans. In particular, individuals with FHA loans are clearly allowed to secure surplus lines policies in lieu of NFIP policies, providing these property owners with significantly more options to choose from than before when they were limited to the NFIP.WSIA provided comments on both of these rules during the rule making process as part of a coalition of interested trades, detailing the importance of the clarifications the rules could provide (**Attachment B and Attachment C**). Our industry is particularly appreciative of the improved regulatory environment from these rules.

Our analysis of surplus lines flood insurance data from the stamping office states over time illustrates that there is a positive correlation between surplus lines premium and the improved regulatory environment. Many of the stamping office states only recently began reporting flood data; however, the four largest states, California, Florida, Texas and New York, which collectively account for nearly 50% of the U.S. surplus lines insurance market, have been collecting and reporting data since at least 2011. In these four states, surplus lines flood insurance premium has grown from $119 million in 2011 to $437 million in 2022, an average of 14% per year.

The number of policies written in these states during that time has increased even faster. In 2011, there were only 11,653 surplus lines flood policies written in these four states but, in 2022, over 204,000 policies were written, an average increase of 33% per year. Most of those new policies were written on residential risks, giving more options to consumers, just as BW12 intended. Clearly the reforms of BW12 and subsequent regulatory clarifications have enabled growth in surplus lines flood insurance solutions, which benefits the NFIP and consumers.

[1] 12 CFR Parts 22 and 172

E&S Flood Premium, Top 4 States
200,000,000
180,000,000
160,000,000
140,000,000
120,000,000
100,000,000
80,000,000
60,000,000
40,000,000
20,000,000
-
2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022
Residential
Commercial
Uncharacterized


E&S Flood Policies, Top 4 States
180,000
160,000
140,000
120,000
100,000
80,000
60,000
40,000
20,000
-
2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022
Residential
Commercial
Uncharacterized

While we have illustrated how federal measures such as BW12 and the Final Rule positively correlate in the data from the state stamping offices specifically for surplus lines, recent data from the National Association of Insurance Commissioners (NAIC) Flood Data Call provides a compelling overview of developments in the overall private market flood insurance in the states since 2018.[2] The information is compiled from data collected through the NAIC Financial Annual Statement, which is required of all insurance carriers domiciled in the United States. The NAIC also administers the Quarterly Listing of Alien Insurers though the International Insurance Department (IID), which requires non-U.S. insurers doing business in the states to provide certain information on an annual basis. The IID began collecting flood insurance policy data in late 2019. The NAIC's data illustrates increasing private market participation in flood insurance. In its April 28, 2020 *Report on Private Flood Insurance Data*, the NAIC noted that, from 2016 to 2019, the number of companies reporting flood data increased from 50 to 140.[3]

At the state level, we see the advantages that regulatory modernization has on the insurance market in general, but in particular with flood. We appreciate the efforts state insurance regulators are making to address gaps in flood insurance coverage which they undertake with the goal of increasing consumer options. The NAIC and its members regularly work with federal regulators, state legislators, and the industry to improve the regulatory environment to the extent it benefits their consumers. A number of states have taken specific actions related to surplus lines coverages that allow a consumer to more quickly assess their flood insurance options by providing exemptions for diligent searches in a variety of manners, including:

- Louisiana, Mississippi, Virginia, and Wisconsin generally eliminated diligent searches for all risks.

- Florida generally eliminated diligent searches for commercial risks, except commercial residential; however, in compliment to its commercial flood exemption, Florida also eliminated diligent search for any residential flood risk.

- Alaska, Arizona, Connecticut, Idaho, Iowa, New Jersey, Oklahoma, Pennsylvania, and Rhode Island exempt all flood risks from diligent search requirements, either by legislative or regulatory actions.

- Six states provide diligent search exemptions with certain stipulations, including:
  - California – excess coverage only
  - Maryland – excess coverage only unless the NFIP is unavailable
  - Michigan – excess coverage only
  - Nevada – forced place coverage only
  - New Mexico – excess coverage only
  - New York – excess coverage only unless the NFIP is unavailable

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[2] See NAIC Private Flood Insurance Data Call webpage data call results under "Important Links."

[3] See NAIC Property & Casualty Committee webpage and review "2020 Private Flood Memo" under documents tab.

Two states have exempted flood insurance from premium tax (Oklahoma) or state filing fees (Mississippi), allowing the consumer some relief from additional expenditures related to these coverages. These types of measures ultimately help consumers find the coverage that they need through an easier process.

IV. Next Steps Toward Developing a More Robust Private Flood Market

We believe there are a number of other legislative and regulatory changes that would further improve flood insurance coverage options for consumers and impact their purchasing decisions.

A. Allowing Consumers to Move Freely between the NFIP and Private Market

Currently, if a policyholder leaves the NFIP, they cannot return under the same rating standard at which they left because their property will not be considered to have been "continuously covered" by mandatory flood insurance. This is intended to incent the policyholder to continuously maintain coverage and not let their policy lapse. However, what it does not contemplate is a consumer who wants to move back and forth between the NFIP and the private market, which unintentionally serves as a disincentive for consumers – whether it is staying with or returning to the NFIP.

In most insurance transactions or other consumer purchases, a consumer has the ability to regularly compare the products they purchase and make a choice as to what best fits their needs – and finances – at the time. However, in the case of flood insurance, if a consumer has an NFIP policy and considers moving to the private market, they are hesitant because they know they cannot return under the same rating standard should conditions in the private market change. We strongly believe consumers should be considered to be "continuously covered" if they maintain either NFIP or private market coverage. This reform to current law would improve consumer choice and competition within the market, which directly benefits the consumer. This issue was highlighted as a barrier to progress by the Congressional Research Service in its most recent *Private Flood Insurance and the National Flood Insurance Program* report[4].

As a solution to this barrier, we strongly support H.R. 900, the *Continuous Coverage for Flood Insurance Act*, introduced by Reps. Luetkemeyer and Castor. This legislation allows consumers that leave the NFIP for the private market to be considered to have had continuous coverage for purposes of fulfilling their mandatory purchase requirement. Implementation of this legislation is a critical step to improving options for consumers and the overall flood insurance market.

B. Allowing Unearned Premium to be Returned to Consumers that Leave the NFIP Mid-Term

Currently, if a NFIP policyholder leaves the NFIP after their policy has been bound or renewed, the unearned premium for that policy is nonrefundable from the NFIP if the policy is cancelled mid-term. In most private market insurance policies, a portion of the premium is considered "unearned" and is returned to the policyholder when a policy is cancelled before its expiration

[4] See Congressional Research Service Private Flood Insurance and the National Flood Insurance Program report updated January 9, 2023

date. This issue is detailed in a joint insurance trades comment letter to FEMA dated February 4, 2019 (**Attachment D**). It is our understanding that FEMA determined that our request must be corrected by legislative rather than regulatory actions.

We believe the inability to receive a refund of unearned premium from the NFIP serves as a disincentive for the consumer to consider the private market. There are two key scenarios within which this occurs. When an NFIP policy is automatically renewed, force-placed by a lender or similar situation where the policyholder did not intentionally plan to accept the renewal. Once the NFIP policy has been renewed, the policyholder must pay the entirety of the next policy year's premium with no opportunity for a refund if cancelled mid-term. Similarly, if a policyholder finds an alternative solution that better fits their needs and budget, they cannot cancel their policy mid-term without leaving that unearned premium on the table. Both situations make it very difficult for a consumer to have true choice in purchasing their flood insurance. We strongly support legislative proposals that would allow for any unearned premium to be refunded by the NFIP to the consumer.

C. Technical Changes to the Definitions of Private Flood Insurance

The impact of the regulatory rules has been significant. They have brought about many of the clarifications that we sought in our support of the Flood Insurance Modernization and Market Parity Act, first introduced in the 114th Congress as H.R. 2901 and in the 115th Congress as H.R. 1422. Both of these bills unanimously passed the House and would have revised the definition of private flood insurance to make clear that lending institutions could accept private flood insurance policies, including surplus lines policies, in lieu of an NFIP policy to fulfill a property owner's mandatory purchase requirement.

While we believe the agency rules have provided specific clarification that private flood policies are acceptable, especially surplus lines, we believe there continues to be important provisions in that legislation that will help improve the ability to provide private policies as proof of coverage. Specifically, the language used to reference surplus lines policies in the underlying definition of private flood insurance needs to mirror the language of the Nonadmitted & Reinsurance Reform Act of 2010 (NRRA)[5]. Although the current definition of private flood insurance was adopted in 2012, it used outdated language with respect to surplus lines regulation and is inconsistent with the changes Congress made two years prior in the NRRA. We believe that updating the definition to use terms consistent with the NRRA, such as "eligible insurer" and "home state" are technical changes that should be noncontroversial. Maintaining the outdated language leads to confusion when a lender looks to the state law to confirm certain elements of the regulation of that policy, but the terms are inconsistent between the federal definition and those of the state, causing unnecessary confusion and sometimes delay. We encourage Congress to consider this technical change and ensure the consistent and accurate use of the language they adopted for our industry in 2010 is reflected in the definition of private flood insurance. WSIA outlined our proposed changes to effectuate this revision in comments to Congress in 2021 (**Attachment E**).

[5] 15 U.S.C. §8201

D. Long-term Reauthorization of the NFIP

A strong, financially sound NFIP is critical to a vibrant flood insurance program in the United States. We appreciate that the program has not had a long-term lapse in several years, but we believe that having a long-term extension of the program provides greater comfort in the stability and continuity of NFIP coverages. When property owners are working to close on their loans, and they are required to provide proof of flood insurance coverage, if they plan to provide an NFIP policy and the Program is nearing expiration, or part of a very short extension, it creates uncertainty as to whether that closing will be able to proceed. Additionally, if the NFIP lapses or it is unclear if it will be extended and the property owner has secured their private coverage as an excess policy, it puts their secondary coverage in limbo as well since they many not actually have the underlying primary coverage that their private policy is based on when it is issued. Leading up to the 2021 reauthorization, WSIA outlined our priorities for a long term reauthorization of the program (**Attachment F**) and joined other insurance trade associations in urging Congress to ensure the program was extended for these similar reasons (**Attachment G**). Our industry continues to believe and support these comments.

E. Technology, Modeling, Modernization

Flooding is certainly not a new natural catastrophe, but the mitigation and underwriting of flood risks continues to evolve. Technology, in particular modeling, has significantly improved in recent times. In order to continue to make flood insurance affordable for those that are required to have it and appealing to those that need it but do not purchase it because it is not mandatory, modernization of the tools used to underwrite the risk must be used and continue to evolve. The private market has dedicated resources to these models and the more they are invested in and used, the better the benefit is for the consumer.

While wind and surge has been widely studied for coastal geographies, the inland pluvial and fluvial modeling is relatively new to the predictive process of determining the likelihood of a flood event. Risk Rating 2.0 is certainly a step in the right direction putting emphasis on the inland models as well as emphasis on the valuation of the property, which is a key component for underwriting accuracy and rate development on any type of property insurance. Rate adequacy is crucial for the insurance mechanism to actually work and fund claims. Equally important is to maintain a premium base that is sustainable for the longer term and to rely less and less on taxpayer contributions. As the NFIP continues to evolve, Risk Rating 2.0 and presumably the subsequent updates and releases should aid in developing the desired outcome of a financially stable insurance program.

V. Conclusion

We appreciate the opportunity to provide our perspective on the current flood insurance market. In the decade since BW 12 passed, it is clear that we are seeing the evolution of Congress' intent to improve the options available in the national flood insurance market and the opportunities for American families and business owners. Like Congress, we want this trend to continue and lead to increased coverage and protections to those impacted by flooding. We have offered a

brief overview of our market and some of the trends we are experiencing and provided our thoughts on some ways to continue to improve the opportunities for consumers and we look forward to continuing to work towards and support solutions in public-private partnerships that bolster these goals.

About the Surplus Lines Market

The surplus lines market, also known as the E&S market or nonadmitted market, plays an important role in providing insurance for nonstandard and/or complex risks, including flood insurance. Often called the “safety valve” of the insurance industry, surplus lines insurers fill the need for coverage in the marketplace by providing capacity in catastrophe-prone regions and coverage for risks that are declined by the underwriting and rating processes of standard insurance carriers. In 2021, total U.S. surplus lines premium of $82.7 billion represented 10.4% of total U.S. property and casualty premium.

Surplus lines insurance is used to cover risks that are difficult to place because they have characteristics that fall outside of the coverage the standard market is either capable of or willing to underwrite. A few examples include coastal properties exposed to catastrophic storms, emerging technologies, small business start-ups, and risks with poor credit, lack of loss history, or in high-risk locations of the country. Both surplus lines insurers and their distribution partners are specialists who create innovative and cost-effective solutions to meet the insurance consumer’s specific needs. It is important to note that, in most cases, the surplus lines market can only be accessed upon demonstration that the standard market is unable or unwilling to underwrite the risk.

With the ability to customize coverages to accommodate a wide variety of risks, the surplus lines market acts as an effective supplement to the standard market, giving consumers insurance options for nonstandard and/or complex risks, as highlighted in catastrophe-prone areas of the country. States such as California, Florida, Louisiana, New Jersey, New York, Pennsylvania, and Texas are good examples of how the surplus lines industry has acted as an effective market in responding to catastrophic events, where consumers may otherwise have been left without coverage for their commercial risks and/or personal assets.

All states with a history of dealing with catastrophic storms have been impacted by the normal, downward shift in the standard market’s appetite for providing coverage in the wake of catastrophic losses. The surplus lines industry has served as an effective supplement in such cases, offering consumers options that may no longer exist in the standard market. Such events result in an ebb and flow of business and risk appetite between the standard and surplus lines markets – a market cycle that has been demonstrated to be quite effective for decades.

A. Types of Risks Typically Written in the Surplus Lines Market

While the surplus lines market is not the primary market for most insurance coverages, it is a critical market as supply and demand for insurance ebbs and flows. The surplus lines market allows innovation to occur much more quickly and efficiently for risks that the standard market cannot accommodate.

The surplus lines industry generally serves as the innovator for new and emerging risks and related insurance products, such as vacant properties, nursing homes, builder’s risk, environmental risks and older or high-value homes. For example, a new business venture with a new innovative product may not be able to find insurance in the standard market, because of the lack of experience, loss history and approved underwriting processes or rates for emerging

risks. Other examples of coverage innovations in surplus lines that now have evolved to the standard market include sharing economy, employment practices liability, directors and officers liability, medical malpractice, cyber risk, among many others.

B. Regulation of Surplus Lines Insurance

To secure a surplus lines insurance policy, an insured does not go directly to the surplus lines market for coverage. In most instances, the risk must first be "declined" after a "diligent search" of the standard market. Once it has been determined that the standard market cannot or will not underwrite the level of risk, the surplus lines market may provide the coverage. This is why the surplus lines market is considered the "safety valve" for insureds unable to find coverage in the standard market.

The financial and market regulation of a surplus lines insurer, like admitted insurers, is the purview of the surplus lines insurer's domiciliary state. In addition, the regulation and taxation of individual surplus lines transactions is also through the licensed surplus lines broker. Surplus lines brokers work directly with retail agents and brokers representing those insureds who are unable to obtain insurance through the standard market. The licensed surplus lines broker is responsible for (1) selecting an eligible surplus lines insurer; (2) reporting the surplus lines transaction to insurance regulators; (3) remitting the premium tax due on the transaction to state tax authorities; and (4) assuring compliance with all surplus lines regulations.

Although the surplus lines market is regulated differently than the admitted market, in order to provide the flexibility necessary to innovate and customize insurance coverages, it is important to understand that it is indeed subject to diligent regulation. Each U.S. based surplus lines company is licensed in at least one of the 50 states or other U.S. jurisdictions and must fulfill the solvency and market regulatory requirements of that state or jurisdiction. Like standard insurers, the surplus lines insurer's state of domicile is the regulator of that insurer's solvency and market practices, and the surplus lines insurer submits to all the same rigorous rules and regulations as a standard insurer. Where the markets differ is that surplus lines policies are not subject to the rate and forms requirements applied to the standard market, allowing the surplus lines market the flexibility to innovate and underwrite customized solutions for unique risks in an actuarially sound fashion.

Surplus lines insurance companies have a tremendous solvency record. AM Best reports that in 2021 the industry reported no financially impaired surplus lines companies (**Attachment H**). By comparison, there were 14 disclosed impairments in the standard market in 2021. Since 2003, AM Best has reported just one surplus lines company impairment, in contrast to 274 impairments in the standard market. Surplus lines insurers continue to maintain a higher proportion of secure ratings than the overall property/casualty industry. Through August 2, 2022, 100% of surplus lines companies maintained secure AM Best ratings compared to 97% for the total property/casualty industry, with surplus lines carriers having much higher proportions in the Exceptional, Superior and Excellent rating categories. This exceptionally strong record of solvency speaks to the financial strength, quality of underwriting, and security offered by the surplus lines market.

December 21, 2018

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable J. Mark McWatters
Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

The Honorable Joseph Otting
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

The Honorable Dallas Tonsager
Chairman and CEO
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102

The Honorable Randal Quarles
Vice Chairman for Supervision
Board of Governors of the Federal Reserve System
Eccles Board Building
20th and C Street, NW
Washington, DC 20219

Dear Chairman McWilliams, Comptroller Otting, Vice Chairman Quarles, Chairman McWatters, and Chairman Tonsager:

We write you today regarding your agencies' long-running efforts to finalize the corresponding regulations implementing section 100239 of the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters). Based on the testimony of Chairman McWilliams and Comptroller Otting during an October 2, 2018 hearing before the Senate Committee on Banking, Housing, and Urban Affairs[1] and the notice published in the Unified Agenda[2], we understand that your respective agencies have set a target completion date for this work of February 2019.

The delay in promulgating a final rule, and the inconsistencies between the two proposed rules[3], have exacerbated some of the very uncertainties and barriers that prevented growth in the private flood insurance market prior to Biggert-Waters. Because of this, your goal of completing this work early next year is welcome news for the cross-industry stakeholders that we represent. However, we wish to reaffirm the concerns that have been raised regarding the most recent joint proposed rule that was

[1] *Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act: Hearing before the Committee on Banking, Housing, and Urban Affairs, Senate, 115th Congress (2018)*

[2] https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201810&RIN=1557-AD67

[3] Loans in Areas Having Special Flood Hazards, *78 FR 65107* (2013 Proposed Rule); *and,* Loans in Areas Having Special Flood Hazards – Private Flood Insurance, *81 FR 78063* (2016 Proposed Rule)

published in 2016 in an effort to ensure that any final rule enacted by your agencies is consistent with both the statutory language as well as the intent of Congress. Without significant changes to the 2016 Proposed Rule, we fear what was intended to be an effort to promote the private flood insurance market could effectively constrict the already limited market.

Each of our organizations submitted comments on the 2016 Proposed Rule that outlined the concerns of our respective industries (i.e. lenders, insurers, agents, reinsurers) and the members that we represent. While many of our concerns with the proposed rule were similar, they were expressed from the perspective of our specific industry sectors and the remedies we proposed at that time might have appeared to diverge or conflict for that reason.

Since submitting those comments to the 2016 Proposed Rule, we all have spent substantial time discussing this issue and working together to craft a consensus perspective which addresses the concerns of each of the involved industries in a unified way while ensuring the objectives of the regulators are achieved. The efforts undertaken by this stakeholder group were extensive and required significant give and take by all of the participants. While we all stand by this approach as the best possible way to achieve a final rule that is both workable and consistent with both the letter and spirit of the current statute, we do recognize that additional legislative amendments are likely needed.

Background

As you all are aware, the Flood Disaster Protection Act of 1973 (1973 Act) prohibits federally regulated lenders from issuing loans secured by properties located in a special flood hazard area (SFHA) unless the property is covered by flood insurance. Today, the National Flood Insurance Program (NFIP) has largely been responsible for fulfilling this “mandatory purchase” requirement.

In addition to requiring the federal government to offer NFIP policies at actuarially unsound rates, the 1973 Act significantly limits the ability of the NFIP to offer individual or tailored coverage to its customers. While this one-policy-fits-all approach has worked for some customers, it does limit the ability and options of some to protect their homes and businesses against the unique flooding risks associated with their properties. It is for these properties, as well as for consumers who would like more choices in their coverage options and terms, that the private flood insurance market can play a significant role.

While there has been a small continual private flood insurance marketplace, Biggert-Waters contained much-needed reforms to the NFIP that allowed the private residential flood insurance market to grow and offer consumers more coverage options to choose from. Included in the reforms in Biggert-Waters, Congress made a direct effort in Section 100239 to incentivize growth in the private flood insurance market by requiring lenders to accept private flood insurance policies that meet certain conditions to satisfy the mandatory purchase requirement.

It is important to note, however, that while Biggert-Waters requires lenders to accept certain private flood insurance policies, it purposely did not alter lenders' discretionary ability to accept non-NFIP policies that do not align precisely to the statutory requirements for mandatory acceptance. Prior to the enactment of Biggert-Waters, and continued through today, lenders have had the ability to review non-NFIP policies on an individual basis to determine if the policy provides the protection required both under the 1973 Act and general safety and soundness principles. It has historically been through lenders' discretionary acceptance that the current private flood insurance market has been able to exist and provide financial protection in areas that the NFIP cannot.

The existence of this discretion by lenders was known to Congress prior to enactment of Biggert-Waters. Therefore, it must be assumed that Congress not only did not intend to limit current authority but rather support such authority.

Definition of "Private Flood Insurance"

Section 100239 of Biggert-Waters provides a statutory definition of "private flood insurance" as it relates to private policies that lenders are required to accept as satisfaction of the mandatory purchase requirement. This statutory definition for "private flood insurance" is divided into three sections: (1) qualifying issuers who may offer a policy that is required to be accepted by the lender; (2) mandatory coverage terms that must be included to ensure that the policy offers coverage that is "at least as broad as" the coverage offered by an NFIP policy; and (3) required contractual provisions that align with those of an NFIP policy.[4]

Qualifying Issuers

In order for a policy to be required to be accepted by a lender, the statute states that it must be issued by an insurance company that is: "(1) licensed, admitted, or otherwise approved to engage in the business of insurance in the state or jurisdiction in which the insured building is located, by the insurance regulator of that state or jurisdiction; or (2) in the case of a policy of difference in conditions, multiple peril, all risk, or other blanket coverage insuring nonresidential commercial property, recognized or not disapproved as a surplus lines insurer."[5]

While not explicitly mentioned in the statute, Congress intended to include surplus lines insurers as writers of residential as well as commercial private flood insurance policies that could qualify for mandatory acceptance under Section 100239. The legislative history, which includes a colloquy between the Chairman of the relevant Senate Committee and the lead Senate sponsor of the provision, makes clear the Congressional intent.[6] Unfortunately, the 2016 Proposed Rule did not take this Congressional

[4] 42 U.S.C. 4012a(b)(7)

[5] Id.

[6] 158 Cong. Rec. S6051 (daily ed. Sept. 10, 2012)

intent into account. In addition to not clearly identifying surplus lines insurers as eligible issuers, the 2016 Proposed Rule failed to recognize that Congress, under Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)[7], expressly limited the regulation of the placement of nonadmitted insurance to the state in which the insured resided.

Therefore, Congressional intent was to both authorize surplus lines insurers for both residential and commercial policies as well as align the definition of "surplus lines insurers" with the provisions of Dodd-Frank, which was enacted by Congress prior to Biggert-Waters. As such, we believe your agencies should use their authority to promulgate the rule in a way that the drafters intended; by identifying surplus lines insurers in the regulations and defining these insurers in a way that complies with Dodd-Frank. Such a clarification would not be a substantive change to the statutory definition, but rather a confirmation that the rule is consistent with both Biggert-Waters and Dodd-Frank.

> ***RECOMMENDATION #1:*** *Surplus Lines Clarification. The final rule should specify that private flood insurance issued by surplus lines insurers can qualify for mandatory acceptance as within the definition of "private flood insurance," and that surplus lines insurers should be defined as an insurer that has been recognized, or not disapproved, as a surplus lines insurer by the insurance regulator of the state or jurisdiction in which the insured is located, including surplus lines eligibility established in accordance with sections 521 through 527 of the Dodd-Frank Wall Street Reform and Consumer Protection Act 10 (15 U.S.C. 8201 through 8206).*

Mandatory Coverage Terms

The statutory definition requires that "private flood insurance" provide flood insurance coverage which is "at least as broad as" the coverage provided under an NFIP policy.[8] However, the statute defers to the regulators to determine what constitutes "at least as broad," including when considering "deductibles, exclusions, and conditions offered by the insurer."[9]

In the 2016 Proposed Rule, your agencies identified six minimum coverage terms that a private policy must include to be considered "at least as broad" as an NFIP policy. While four of these requirements directly relate to the protection of the safety and soundness of the lending institution, two of the requirements go beyond the role of the regulations of lenders and wade into the regulation of the business of insurance itself.

[7] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 stat. 1376, 1590 (2010)

[8] 42 U.S.C. 4012a(b)(7)

[9] Biggert-Waters Flood Insurance Reform Act of 2012, Pub. L. No. 112-141, 126 Stat. 960 (2012)

Congress has expressly and repeatedly deferred to the states for the regulation of the business of insurance, and for that reason, we believe that the final rule should limit the requirements for "as broad as" coverage to those that are within the purview of the prudential regulators.

> ***RECOMMENDATION #2:*** *"At least as broad as." The final rule should provide that a policy is at least as broad as the coverage under a standard flood insurance policy if, at a minimum, the policy defines the term "flood" to include the events defined as a "flood" in a standard flood insurance policy; covers both the mortgagor(s) and the mortgagee(s) as loss payees; contains deductibles no higher than the maximum deductible allowed under a similar standard flood insurance policy or the maximum deductible allowed under Federal National Mortgage Association and Federal Home Loan Mortgage Corporation regulations related to windstorm coverage, whichever is higher; and does not contain conditions that narrow the coverage provided in a standard flood insurance policy.*

Required Contractual Provisions

Finally, the statute requires that "private flood insurance" subject to mandatory acceptance include several contractual provisions that are in line with those included in an NFIP policy. Included in these required provisions are: (1) a requirement for the insurer to give 45 days' written notice of cancellation or non-renewal of flood insurance coverage; and (2) a provision requiring an insured to file suit not later than one year after the date of a written denial of all or part of a claim under the policy.

Each state, through their general regulation of the business of insurance, has requirements related to the time limitations for both cancellation notices and statutes of limitation. These laws are put in place to protect consumers and vary state-to-state. Unfortunately, as Biggert-Waters does not preempt state insurance laws, the statute effectively prohibits "private flood insurance" as it relates to mandatory acceptance in states whose requirements contradict the statutory definition. However, it is important to note that many states have enacted cancellation notice and statute of limitation requirements that provide protection to consumers beyond those outlined in Biggert-Waters. For example, a state may require 60 days' notice to consumers of cancellation or non-renewal; as opposed to the only 45 days' notice required under Biggert-Waters.

Because of this, we believe any final rule should make clear that these statutory limitations are the minimum periods for both requirements, and that policies written in states where the consumer has more time to act remain eligible for mandatory acceptance.

> ***RECOMMENDATION #3:*** *State Law Clarification. The final rule should specify that policies meeting the private flood insurance definition must include cancellation notice provisions requiring the insurer to give written notice of 45 days, or longer when consistent with State law. Similarly, the final rule should specify that policies meeting the private flood insurance definition must include a provision requiring the insured to file suit not later than 1 year, or longer when consistent with State law, after a written denial of a claim.*

Mandatory Acceptance

Section 100239 requires lenders to accept "private flood insurance" policies that meet the definition outlined in the statute. It does not, however, include any process, standard, or mechanism for lenders, who are often not insurance experts, to determine whether a policy meets the definition. This unfortunately places many lenders in a difficult position of having to evaluate whether a policy meets the definition while being subject to civil money penalties if their insurance interpretation is deemed incorrect.

Compliance Aid Provision

The 2016 Proposed Rule tried to correct this omission with the inclusion of a "compliance aid provision." While we and other stakeholders support the notion of a compliance aid provision, it was made clear that the specific mechanism proposed in 2016 was unworkable. However, we have identified two potential compliance aid provisions that not only ensure compliance with the statute and regulation but are already common practice in today's insurance market.

Currently, in most states, private insurers offering flood insurance policies outside of the NFIP have been authorized by state insurance regulators to include in their policies what is known as a conforming conditions clause or endorsement. These clauses state that if a provision of the private policy limits the coverage to coverage that is not at least as broad as that available under the Standard Flood Insurance Policy Dwelling Form (SFIP), the private policy would be amended to conform to the SFIP. The inclusion of this language ensures that if there is any disagreement that a private policy is not "at least as broad as the coverage provided under a standard flood insurance policy,"[10] that the policy would be enforced as if compliant with the SFIP.

Additionally, certain states have enacted laws that allow their respective State insurance commissioners to review private flood insurance policies to determine whether the policy complies with federal regulation related to mandatory acceptance. While this requires significant resources by the State insurance commissioners, it allows the primary functional regulators to assist lenders in understanding the terms of coverage in a private flood insurance policy and the applicability of the federal mandatory acceptance requirements. Unfortunately, due to the required resources, not every state will be able to implement these practices.

As both of these compliance aids ensure that a policy, in effect, meets the requirements under the statute; any final rule should provide for automatic acceptance of private flood policies that include a conforming condition clause/endorsement, or that demonstrates that the state insurance commissioner in the state where the property is located has confirmed that the policy is "at least as broad as" the SFIP.

[10] Biggert-Waters Flood Insurance Reform Act of 2012, Pub. L. No. 112-141, 126 Stat. 960 (2012)

Additionally, it is important to recognize that some lending institutions have, or have the means of creating, an internal compliance process beyond the use of a conforming conditions provision or state insurance commissioner certification to review individual and unique private insurance policies in terms of the applicability of mandatory acceptance requirements. At the same time, many lenders do not have the personnel or resources to examine unique private flood policies on an individual basis, and therefore should be permitted to reject policies without a compliance aid, provided the institution considered the policy in a manner consistent with its consideration of other forms of hazard insurance.

> ***RECOMMENDATION #4:*** *Compliance Aid for Mandatory Acceptance. The final rule should provide that a flood insurance policy shall be deemed to meet the definition of private flood insurance under the rule if the insurance policy declarations page(s) attests that the policy includes a conforming conditions clause or endorsement that would amend the private flood insurance policy to provide coverage terms at least as broad as the coverage terms of the Standard Flood Insurance Policy if such terms are not as broad under the private flood insurance policy; or, alternatively, if the State insurance commissioner of the state in which the insured property is located certifies or confirms that the private flood insurance policy is "at least as broad" as the Standard Flood Insurance Policy.*
>
> *Furthermore, the final rule should provide that institutions may develop appropriate means of confirming that flood insurance policy meets the definition of private flood insurance in the rule, provided that if a policy includes a compliance aid mechanism in accordance with the rule, the policy shall be deemed to meet this definition without further consideration. For purposes of the rule, if an institution determines that a policy does not meet the definition of private flood insurance, and such policy does not include a compliance aid mechanism in accordance with the rule, such determination will be presumed correct, provided that the institution considered the policy in a manner consistent with its consideration of other forms of hazard insurance for the building or property securing the loan.*

Salability of Associated Loans

In addition to providing lenders a standardized means to determine if a policy meets the definition of private flood insurance as it relates to mandatory acceptance, it is important that a lender's requirement to accept a private flood insurance policy under Section 100239 does not impede the ability to securitize the loan. Specifically, in addition to the requirements that your agencies ultimately include in any final rule, a lender would likely be beholden to the requirements of the Government Sponsored Enterprises (GSEs) related to the financial rating of the insurer.[11]

Therefore, it is possible that a lender could be required to accept a private flood insurance policy that would result in the lender having to hold the loan on their books until maturity. As the requirement of a

[11] *See* Part B7-3-01: Property Insurance Requirements for Insurers, of the Fannie Mae Selling Guide; *and* Chapter 8202.1: General property insurance requirements, of the Freddie Mac Single-Family Seller/Servicer Guide

lender to hold these loans on their books for extended periods of time could negatively affect the safety and soundness for the institutions you regulate, your agencies are well within their authority to include a clarifying limitation as it relates to a prudential issue well within your agencies' general regulatory authority.

To ensure that the mandatory purchase requirement under Section 100239 does not have unintended ramifications to a lender, any final rule should include a limitation on the mandatory acceptance requirement to policies offered by insurers the meet the minimum financial rating requirements under the GSEs.

> ***RECOMMENDATION #5***: *Mandatory Acceptance. The final rule should provide that lenders must accept private flood insurance, as defined, as satisfaction of the flood insurance coverage requirement, provided that coverage under the flood insurance policy is in the required amount, and that the private insurer meets the applicable minimum financial rating requirements specified by a government sponsored enterprise governing the acceptability of property insurance on loan security.*

Discretionary Acceptance

In certain cases, it may be appropriate for a property owner (both residential and commercial) to obtain coverage with terms that are not the same as the coverage offered under an SFIP. Because of the nature of the individual needs and means of certain property owners, it is important to allow private insurers (in compliance with state insurance laws and regulations) to tailor coverage offered in certain circumstances. That is why under current regulations (and consistent with the policy that your agencies stated in the 2013 rule)[12] lending institutions have the discretion to examine and accept private insurance policies that are compliant to their general requirements to protect the collateralized property used to secure a loan. This is similar to how lenders evaluate other hazard insurance policies, such as homeowners' insurance, when determining if the policy is compliant with safety and soundness principles required by your agencies.

While Section 100239 requires lenders to accept private flood insurance for policies that meet the definition of "private flood insurance," it was never the intent of Congress to alter or eliminate the status quo that authorized lenders, on a discretionary basis, to accept flood insurance outside of a standard flood insurance policy of the NFIP in satisfaction of the mandatory purchase requirement in 12 CFR § 339.3.

Unfortunately, the 2016 Proposed Rule would have altered the current authority of lenders to accept private policies that do not conform to the SFIP on a discretionary basis by imposing burdensome and unnecessary requirements. While it may be justified that lending institutions only accept policies that

[12] 78 Fed. Reg. 210, 65114 (October 30, 2013)

properly secure the collateral used in obtaining a loan, the requirements included in the 2016 Proposed Rule would expand beyond safety and soundness concerns and impede on the role and authorities of State insurance commissioners in the regulation of private insurance and relevant consumer protection. These requirements would directly counter the clear congressional intent of expanding the private flood insurance marketplace by constricting the current marketplace, particularly on commercial lending.

> ***RECOMMENDATION #6:*** *Discretionary Acceptance. The final rule should provide that lenders may accept, or reject, a flood insurance policy issued by a private insurer that is not issued under the NFIP and does not meet the statutory definition of private flood insurance in satisfaction of the flood insurance purchase requirement, if the flood insurance policy is in the proper amount required, and provided the policy covers both the mortgagor(s) and the mortgagee(s) as loss payees (with the exception of a Residential Condominium Building Association Policy), and in the reasonable judgement of the lender, the policy provides sufficient protection of the loan secured by the property located in a special flood hazard area, consistent with the standards and practices used by the lender regarding other property hazard insurance.*

We thank you all for your continued work on this very important issue and would be happy to provide any additional information that you may need as you work to finalize this much anticipated rule.

Sincerely,

American Bankers Association

American Insurance Association

Council of Insurance Agents and Brokers

Independent Community Bankers of America

Independent Insurance Agents and Brokers of America

National Association of REALTORS®

Property and Casualty Insurers Association of America

Reinsurance Association of America

Wholesale & Specialty Insurance Association

Attachment C

May 17, 2021

VIA ELECTRONIC FILING – www.regulations.gov

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Re: Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Private Flood Insurance

To Whom It May Concern:

The Council of Insurance Agents & Brokers ("The Council") and the Wholesale & Specialty Insurance Association (WSIA) appreciate this opportunity to comment on the proposed supplement to the Interagency Questions and Answers ("Q&A") Regarding Flood Insurance issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the National Credit Union Administration (collectively "the Agencies").[1]

By way of background, The Council represents the largest and most successful employee benefits and property/casualty agencies and brokerage firms. Council member firms annually place more than $300 billion in commercial insurance business in the United States and abroad. In fact, they place 90 percent of all U.S. insurance products and services, and they administer billions of dollars in employee benefits. Council members conduct business in some 30,000 locations and employ upward of 350,000 people worldwide, specializing in a wide range of insurance products and risk management services for business, industry, government, and the public.

[1] Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Private Flood Insurance, 86 Fed. Reg. 14696 (Mar. 18, 2021), https://www.govinfo.gov/content/pkg/FR-2021-03-18/pdf/2021-05314.pdf.

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The Wholesale & Specialty Insurance Association is a world-class member service organization representing the entirety of the wholesale, specialty and surplus lines industry. The Wholesale & Specialty Insurance Association was formed in 2017 through the merger of the American Association of Managing General Agents (AAMGA) and the National Association of Professional Surplus Lines Offices (NAPSLO). WSIA's membership consists of approximately 735 member firms, including U.S. Wholesale, U.S. Insurance Market, Associate and Service members, representing tens of thousands of individual brokers, insurance company professionals, underwriters and other insurance professionals worldwide conducting business in the U.S. surplus lines market.

As a general matter, members of The Council and WSIA have seen firsthand how the Agencies' regulatory actions have effectively expanded the private flood insurance market to date.[2] Where growth of the private market was previously hindered by a complex and highly technical statutory framework, the Agencies' implementation of the mandatory acceptance provisions and the widespread use of compliance aid assurance clauses have allowed the private flood insurance market to thrive. The mandatory acceptance provisions facilitate private policy placements, ensure that consumers have access to affordable flood coverage, and provide security to lenders seeking to fulfill their compliance obligation (thereby encouraging lender acceptance of private flood insurance policies).

Having experienced the growth and success of the mandatory acceptance framework, The Council and WSIA support the Agencies' work thus far to interpret the Biggert-Waters Act's (the "Act") private flood provisions and issue comprehensive guidance. The proposed Q&A builds on these efforts and will provide greater certainty to the industry participants working to further develop the private flood insurance market. There are, however, a few details that we believe could be clarified. For instance, while not directly addressed in the Q&A, the proposal could incorporate language that clarifies that digital transmission (e.g., use of fillable PDFs, electronic signatures, etc.) of relevant flood coverage documents—as well as physical transmission or use of paper images—is permissible. Below, we have included some more specific suggestions on how these proposed Q&As could be strengthened.

1. *The Agencies should clarify the scope of Q&A Mandatory 7 to clearly define the exact elements that lenders must review beyond the compliance aid assurance clause.*

Q&A Mandatory 7 describes additional reviews a lender <u>must</u> conduct under the mandatory acceptance framework when a flood insurance policy is issued by a private insurer. Specifically, it provides that—beyond relying on the compliance aid assurance clause—the lender must:

- Ensure that the coverage is at least equal to the lesser of the outstanding principal balance of the designated loan;
- Determine the maximum limit of coverage available for the particular type of property under the Act; and
- Ensure that <u>other key aspects of the policy</u> are accurate, such as the borrower's name and property address.

[2] Final Rule, Loans in Areas Having Special Flood Hazards, 84 Fed. Reg. 4953 (Feb. 20, 2019), https://www.federalregister.gov/documents/2019/02/20/2019-02650/loans-in-areas-having-special-flood-hazards.

The Council and WSIA understand that lenders must undertake this additional analysis with respect to deductibles, coverage limits, and the accuracy of consumer/property information. But we believe that the reference to "other key aspects of the policy" should be narrowed to only apply in circumstances when there are unique loan-related issues (rather than permit a broad interpretation which could inject a discretionary analysis in an otherwise mandatory framework).

As drafted, outside of the borrower's name and property address, it is unclear what additional aspects of a policy that a lender should affirmatively review on every private flood insurance policy. We understand, however, that there are complex arrangements for which there may be additional policy provisions that warrant further review (e.g., schedules associated with single policies that cover multiple commercial properties).

To account for these arrangements, the Agencies should narrow the application of the catch-all language to focus solely on the lenders' potential need to review "key aspects" related to non-standard flood insurance policies, such as the supplemental documents that may be required when a single policy covers multiple commercial properties.

2. *The Agencies should clarify that Q&A Private Flood Compliance 6 applies to conventional multiple-peril policies and policies that have a flood-related endorsement.*

Q&A Private Flood Compliance 6 provides clear guidance on a lender's ability to accept multiple-peril policies that cover flood hazards.

The Council and WSIA appreciate the Agencies' efforts to provide clarity on this issue, but—to ensure that the guidance offered is comprehensive—it should explain that lenders are permitted to accept both standalone multiple-peril policies that address flood risks and scenarios in which the flood coverage is endorsed onto another policy that insures against other perils (e.g., via an endorsement to a homeowners policy), as long as the mandatory or discretionary acceptance provisions are otherwise satisfied.

3. *The Agencies should consider removing or redrafting Q&A Private Flood Compliance 10 and 11 because, as drafted, they suggest that lenders have an independent obligation to verify the eligibility of surplus lines insurers seeking to write flood coverage.*

The Council and WSIA acknowledge the Agencies' ongoing efforts to ensure that surplus lines insurers can write flood coverage for residential and nonresidential properties.[3] To that end, the Agencies offer several Q&As addressing the role that surplus lines insurers play in the private flood insurance market (e.g., Q&A Private Flood Compliance 9-11). In reviewing these questions, however, we think it is important that the Agencies clarify that the surplus line broker (not the lender) is responsible for determining whether a carrier is eligible to write a given policy and affirm that policies written by surplus lines insurers that contain the compliance aid assurance clause are eligible for mandatory acceptance (without an independent analysis by the lender).

[3] *E.g.,* 12 C.F.R. § 22.2(k)(1)(i); 12 C.F.R. § 208.25(b)(9)(i)(A); 12 C.F.R. § 339.2; 12 C.F.R. § 614.4925; 12 C.F.R. § 760.2 (defining "private flood insurance" to mean an insurance policy that is issued by an insurance company that is "licensed, admitted, or otherwise approved to engage in the business of insurance by the insurance regulator of the State or jurisdiction in which the property to be insured is located") (emphasis added).

Attachment C

Q&A Private Flood Compliance 10, which seeks to clarify lenders' ability to accept flood policies issued by surplus lines insurers for noncommercial properties, contains language suggesting that lenders may only accept such policies if "the surplus lines insurer is eligible or not disapproved to place insurance in the State or jurisdiction in which the property to be insured is located."

As written, the response implies that the lender has an obligation to determine whether the insurer is "eligible" in a given state. This duty, however, is already addressed under state law, which requires the insurance broker who is placing the policy to only place that coverage with an insurer that satisfies the state's eligibility requirements. The suggestion in this response that the lender has a separate, independent obligation to undertake an eligibility determination unnecessarily complicates the current requirements under state law and creates a regulatory hurdle that does not exist today.

Similarly, Q&A Private Flood Compliance 11 seeks to clarify that lenders can accept a private flood policy that includes a compliance aid assurance clause and a disclaimer that the "insurer is not licensed in the State or jurisdiction in which the property is located." These questions seem to be an effort to explain that, if a private flood policy

- Is written by a surplus lines insurer on residential/noncommercial property;
- Contains the compliance aid assurance clause; and
- Meets all other necessary requirements (e.g., maximum coverage limit),

then the policy will be eligible for mandatory acceptance by a lender. As drafted, however, the response offered in Q&A Private Flood Compliance 11 implies a level of discretion (i.e., outlines several circumstances under which lenders *may* accept the policies) and suggests that lenders have an independent obligation to verify the contents of a policy procured from a surplus lines insurer. As with Q&A Private Flood Compliance 10, the response provided seems to only risk further confusion and impose additional verification obligations on lenders (in what would otherwise fall within the mandatory acceptance framework).

The Council and WSIA appreciate the Agencies' work thus far to expand access to private flood insurance policies, inject additional clarity into the existing regulatory framework, and encourage and facilitate greater involvement in the private flood insurance market. With these largely technical changes, we believe that these Q&As will provide a coat of certainty and consistency to industry participants.

Thank you for your consideration of these important issues.

Respectfully submitted,

Ken A. Crerar
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Executive Director

Attachment C

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February 4, 2019

David I. Maurstad
Deputy Associate Administrator for Mitigation and Insurance
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Dear Deputy Associate Administrator Maurstad:

The undersigned organizations are writing to respectfully request clarification related to Cancellation Reason Code 26 ("Code 26"), and to further request FEMA consider appropriate action to ensure that consumers are not harmed by any unclear guidance related to Code 26. As you know, Code 26 was put in to place on October 1, 2018 and deals with duplicate flood insurance coverage from a source other than the National Flood Insurance Program (NFIP). However, since then there has been some confusion as to how to properly apply this code to cancel an NFIP policy.

The implementation of Code 26 was announced in March 2018 when FEMA issued a bulletin regarding the October 1, 2018 program changes which highlighted among other things Cancellation Reason Code 26 for duplicate coverage. In relevant part the March bulletin states: "Beginning October 1, 2018, FEMA will establish Cancellation Reason Code 26 to allow cancellation of an NFIP policy when a policyholder has obtained a duplicate policy from sources other than the NFIP. . . ."[1] Between March and October, the purpose of the new cancellation code was generally explained to stakeholders--including Write-Your-Own (WYO) companies, insurance agents and brokers, NFIP policyholders, and members of Congress—as allowing for refunds on unearned premiums for the mid-term cancellation of NFIP policies if a consumer elected to purchase a policy from the private flood insurance market.

However, when the October flood insurance manual came out it stated in relevant part: "To cancel an NFIP policy when the insured obtained a duplicate policy from sources other than the NFIP and the insured did not intend to renew or purchase the NFIP policy."[2] The addition of the intentional language in the October manual is resulting in a lack of clarity in the way that Code 26 is being interpreted by WYOs, agents, and FEMA staff, and is stifling the intent of Code 26 because it is unclear how it should be interpreted. Additionally, one possible interpretation is that if a policyholder has an NFIP policy in force, then buys a private flood policy intending to cancel the NFIP policy, that intentional act means it cannot be cancelled. Effectively meaning that cancellation can only occur if a private policy is obtained during an accidental renewal of an NFIP policy.

This inconsistency and subsequent differing interpretations are creating legal and reputational risks for the agents, brokers, and WYO companies that sell NFIP policies. It is also causing harm to consumers as policyholders are receiving inconsistent answers on their ability to receive refunds for unearned premiums on NFIP polices when they choose to purchase a private flood insurance policy. As such, clarification is

[1] See, Bulletin W-18008, "October 1, 2018, Program Changes," (March 27, 2018) available at: https://bsa.nfipstat.fema.gov/wyobull/2018/w-18008.pdf.
[2] See, October 1, 2018 NFIP Flood Insurance Manual, Chapter 6, Page 18, available at: https://www.fema.gov/media-library/assets/documents/171681.

needed to ensure that refunds for unearned premiums for a mid-term cancellation in favor of a private policy are permitted under Code 26 as was intended and communicated by FEMA in the Spring.

Allowing for refunds on unearned premiums is something that has broad support among NFIP stakeholders. Such refunds are generally permitted in other lines of insurance and are consumer-friendly, as they allow consumers to receive pro-rated refunds when cancelling an insurance policy. In fact, a recent report by the University of Pennsylvania identified NFIP regulations that only allowed policyholders to switch insurance providers at the time of their annual renewal and not mid-term as a significant point of frustration for consumers and a barrier to more affordable policies for some consumers. The report issued in November 2018 (after the October bulletin) also notes that FEMA now allows such cancellations.[3] Refunds for mid-term cancellations is also something that has found support in Congress. Section 205 of H.R. 2874, "the 21st Century Flood Reform Act" that passed the U.S. House of Representatives in 2017 would have required FEMA to allow refunds of unearned premiums upon cancellation of an NFIP policy in favor of a private flood insurance policy.

Additionally, in the past FEMA allowed mid-term cancellation for unearned premiums if the consumer purchased a private flood insurance policy under Cancellation Reason Code 16. However, that reason code was later rescinded. Previously, FEMA allowed refunds for mid-term cancellations, then reversed course, and then sought to allow them again resulting in the current confusion. In addition to seeking clarity on how Code 26 is to be applied now we ask that FEMA also consider other options for ensuring that mid-term cancellation refunds are available consistently to consumers who purchase private flood insurance, such as issuing formal regulations. The undersigned organizations believe that this would be supported by stakeholders, would be beneficial to consumers, and would be consistent with ongoing efforts by FEMA to ensure that more Americans maintain insurance for the peril of flood.

Finally, the undersigned organizations appreciate all the work that FEMA staff has done and continues to do to improve the consumer experience for NFIP policyholders; and we specifically appreciate the time and effort that has gone into addressing issues related to mid-term cancellations. We thank you in advance for considering our request and are ready to work with FEMA to address these issues so that we can best serve NFIP policyholders.

Sincerely,

American Property Casualty Insurance Association
Council of Insurance Agents and Brokers
Independent Insurance Agents and Brokers of America
National Association of Mutual Insurance Companies
Reinsurance Association of America
Wholesale & Specialty Insurance Association

[3] *See*, "Local solutions to Flood Insurance Affordability: Portland's Flood Insurance Savings Program," by Jacob Sherman and Carolyn Kousky Wharton Risk Management and Decision Processes Center, University of Pennsylvania, at page 7.

Attachment E

Wholesale & Specialty Insurance Association (WSIA)
Statement for the Record to the hearing,
"Reauthorization of the National Flood Insurance Program, Part I"
Before the
U.S. Senate Banking, Housing & Urban Affairs Committee

May 18, 2021

Overview

Chairman Brown, Ranking Member Toomey, thank you for the opportunity to provide our thoughts and comments in response to the Senate Banking Committee's hearing entitled, "Reauthorization of the National Flood Insurance Program, Part I." On behalf of the Wholesale & Specialty Insurance Association (WSIA), we appreciate the Committee's attention to the National Flood Insurance Program and the importance of enacting a long-term reauthorization for the stability of the program.

WSIA represents the entirety of the wholesale, specialty and surplus lines industry. Our organization's membership consists of approximately 735 member firms, including U.S. Wholesale, U.S. Insurance Market, Associate and Service members, representing tens of thousands of individual brokers, insurance company professionals, underwriters and other insurance professionals worldwide conducting business in the U.S. surplus lines market.

Often called the "safety valve" of the insurance industry, surplus lines insurers fill the need for coverage in the marketplace by insuring those risk that are declined by the standard underwriting and pricing processes of admitted insurance carriers. With the ability to accommodate a wide variety of risks, the wholesale, specialty and surplus lines market acts as an effective supplement to the admitted market.

NFIP Reauthorization

WSIA supports Congressional efforts to enact a long-term reauthorization of the NFIP. Since 2014, WSIA has worked with legislators and staff in their efforts to help develop a private flood insurance market for flood insurance. During that time our focus has been on ensuring flood insurance customers have the tools they need to choose between a NFIP policy and a private flood policy; and clarifying the definition of private flood insurance so that it aligns with how Congress has defined our industry previously, through the *Nonadmitted & Reinsurance Reform Act* that was passed as part of the *Dodd-Frank Wall Street Reform Act* (Pub.L. 111–203.)

WSIA believes that in order to foster a robust private flood market, consumers need the confidence to know that they can return to the NFIP should they move to a private flood insurance policy. The ability to freely move back and forth between the NFIP and private market is a critical component to a robust, sustainable flood program and public policy to protect business and homeowners during catastrophic events. This crucial piece of that policy is currently missing and that is why we were pleased to support bi-partisan legislation (H.R. 1666) introduced by Reps. Castor (D-FIL) and Luetkemeyer (R-MO) that would enable policyholders to move between NFIP and private flood insurance policies to meet requirement to have continuous coverage in order to return to NFIP without penalty. We were pleased to see these provisions included in long-term reauthorization legislation moved out of the House Financial Services Committee (H.R. 3167) during the last Congress. WSIA would encourage the inclusion of such language in any effort undertaken by the U.S. Senate as well.

An additional component to ensure the greatest success for both the public and private options, is another provision previously included in the House package to allow a consumer with an NFIP policy to cancel their policy mid-term to go to the private market and see their unused premium returned. If a consumer has the option to obtain a better price and possibly better coverage for their property, they should be able to do so without penalty. Unfortunately as the law is written now, this is not possible and the consumer either must maintain their NFIP policy or cancel without return of premium. We believe allowing for mid-term cancellations is another important component to improving the flood coverage market overall.

WSIA continues to believe that the definition of private flood insurance should be updated to address discrepancies in various terminology used in the law that conflict with terminology and definitions previously established in the *Nonadmitted & Reinsurance Reform Act*, which passed as part of the Dodd-Frank Wall Street Reform Act of 2010, Pub. L. 111-203 (Dodd-Frank). That law simplified and streamlined the state regulatory processes and requirements for surplus lines insurance transactions. Two critical areas that the NRRA addresses was defining the insured's 'Home State' to be the regulator of the transaction and that a surplus lines insurer is 'eligible' rather than approved to place business in that transaction in the home state of the insured. Unfortunately, the language included as part of Biggert-Waters maintained pre-NRRA references conflicting with both state and federal laws which have continued to cause confusion during the acceptance of the policies under the mandatory purchase requirement.

WSIA acknowledges that this issue around surplus lines eligibility has improved since the implementation of the 2019 Final Rule, nonetheless it is an area that we believe can be resolved by Congress through technical changes to simply align the language of the prevailing law with the underlying definition of private flood insurance. WSIA would be happy to work with staff further on this technical correction.

WSIA would like to reiterate its pledge to be a resource for the Committee, its Members and staff as you continue to work to improve and reauthorize the NFIP. Thank you again for the opportunity to provide our initial comments.

Sincerely,

Keri Kish	Brady R. Kelley
Director of Government Relations	Executive Director

Attachment F

August 4, 2021

The Honorable Maxine Waters
Chairwoman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Patrick McHenry
Ranking Member
House Committee on Financial Services
4340 O'Neill House Office Building
Washington, D.C. 20024

Chairwoman Waters & Ranking Member McHenry,

On behalf of the Wholesale & Specialty Insurance Association (WSIA), we appreciate your continued commitment to enacting a long-term reauthorization of the National Flood Insurance Program (NFIP). WSIA shares this commitment and stands ready to work with you and your staff to achieve that goal. To that end, please find below an overview of our perspectives on the program and our thoughts on improvements that can be made to the program.

WSIA represents the entirety of the wholesale, specialty and surplus lines industry. Our organization's membership consists of approximately 735 member firms, including U.S. Wholesale, U.S. Insurance Market, Associate and Service members, representing tens of thousands of individual brokers, insurance company professionals, underwriters and other insurance professionals worldwide conducting business in the U.S. surplus lines market.

Often called the "safety valve" of the insurance industry, surplus lines insurers fill the need for coverage in the marketplace by insuring those risk that are declined by the standard underwriting and pricing processes of admitted insurance carriers. With the ability to accommodate a wide variety of risks, the wholesale, specialty and surplus lines market acts as an effective supplement to the admitted market.

Since 2014, WSIA has worked with legislators and staff in their efforts to help continue to develop a private flood insurance market for flood insurance. During that time our focus has been on ensuring flood insurance customers have the tools they need to choose between a NFIP policy and a private flood policy; and clarifying the definition of private flood insurance so that it aligns with how Congress has defined our industry previously, through the *Nonadmitted & Reinsurance Reform Act* (NRRA) that was passed as part of the *Dodd-Frank Wall Street Reform Act* (Pub.L. 111–203.)

Private Flood Insurance

WSIA continues to believe that the definition of private flood insurance should be updated to address discrepancies in various terminology used in the law that conflict with terminology and definitions previously established in the NRRA. That law simplified and streamlined the state regulatory processes and requirements for surplus lines insurance transactions.

Two critical areas that the NRRA addresses is defining the insured's "Home State" to be the regulator for the transaction and that a surplus lines insurer is "eligible" rather than approved to place business in that transaction in the home state of the insured. Unfortunately, the language included as part of Biggert-Waters maintained pre-NRRA references which have continued to cause confusion during the acceptance of the policies under the mandatory purchase requirement.

One of the confusions in the differences in terminology can be seen in the questions posed by the lending Agencies charged with promulgating regulations and guidance around the acceptance of private flood insurance. The NRRA defines the "home state" of the insured (the policyholder) to be "***the state in which an insured maintains its principal place of business*** or, in the case of an individual, ***the individual's principal place of residence***." However, the Biggert-Waters Flood Insurance Reform Act of 2012 focused the definition of "Private Flood" to include an insurance policy that (among other factors), "is **recognized, or not disapproved**, as a surplus lines insurer by the insurance regulator of the State or jurisdiction ***where the property to be insured is located."*** Further confusion develops from this statement by the use of the terms "recognized or not disapproved." As noted previously, the appropriate regulatory procedure is to refer to an insurer being "eligible" to write the type and kind of policy being issued in the home state of the insured. The NRRA defines the process and requirements for establishing insurer eligibility, which does not include "recognized" or "not disapproved." While we understand the Agencies cannot ignore the language associated with the current definition of private flood insurance, we believe it demonstrates the need to ensure consistency in the language defining these terms.

WSIA acknowledges that this issue around surplus lines eligibility has improved since the implementation of the 2019 Final Rule, nonetheless it is an area that we believe can be resolved by Congress through technical changes to simply align the language of the prevailing law with the underlying definition of private flood insurance. WSIA would be happy to work with staff further on this technical correction.

Improving Consumer Confidence

WSIA believes that in order to foster a robust private flood market, consumers need the confidence to know that they can return to the NFIP should they move to a private flood insurance policy. The ability to freely move back and forth between the NFIP and private market is a critical component to a robust, sustainable flood program and public policy to protect business and homeowners during catastrophic events. This crucial piece of that policy is currently missing and that is why we are pleased to support bi-partisan legislation (H.R. 4699) introduced by Reps. Castor (D-FL) and Luetkemeyer (R-MO) that would enable policyholders to move between NFIP and private flood insurance policies to meet the requirement to have continuous coverage in order to return to NFIP without penalty. We were pleased to see these provisions included in long-term reauthorization legislation moved out of the House Financial Services Committee during the last Congress. WSIA would encourage the inclusion of such language in any effort undertaken by the U.S. Senate as well.

An additional component to ensure the greatest success for both the public and private options, is another provision previously included in the House package to allow a consumer with an NFIP policy to cancel their policy mid-term to go to the private market and see their unused premium returned. If a consumer has the option to obtain a better price and possibly better coverage for their property, they should be able to do so without penalty. Unfortunately, as the law is written now, this is not possible and the consumer either must maintain their NFIP policy or cancel without return of premium. We believe allowing for mid-term cancellations is another important component to improving the flood coverage market overall.

WSIA would like to reiterate its pledge to be a resource for the Committee, its Members and staff as you continue to work to improve and reauthorize the NFIP. Thank you again for the opportunity to provide our initial comments.

Sincerely,

Keri Kish	Brady R. Kelley
Director of Government Relations	Executive Director

September 14, 2021

The Honorable Nancy Pelosi
Speaker
United States House of Representatives
Washington, DC 20515

The Honorable Charles Schumer
Majority Leader
United States Senate
Washington, DC 20510

The Honorable Kevin McCarthy
Minority Leader
United States House of Representatives
Washington, DC 20515

The Honorable Mitch McConnell
Minority Leader
United States Senate
Washington, DC 20510

Dear Speaker Pelosi and Leaders Schumer, McConnell, and McCarthy:

The undersigned organizations write to ask you to ensure that millions of Americans will continue to have access to flood insurance coverage through the National Flood Insurance Program (NFIP).

As you know, the NFIP is currently set to expire on September 30, 2021. We commend past bipartisan efforts to enact long-overdue and significant reforms designed to create long-term stability for policyholders, including reforms designed to improve the accuracy of flood maps, increase mitigation, and address affordability.

Although there is widespread agreement that a long-term reauthorization of a reformed NFIP is needed, allowing the program to lapse would be devastating to the policyholders across the nation who are still being impacted by COVID-19 and are facing an increasing number of severe flooding events. With a lapse in the program's authorization, policyholders would not be able to obtain coverage, or buy or sell properties of all kinds.

Therefore, in the absence of any agreement to reform the program, we are calling on you to extend the program before September 30 in order to provide some continuity and certainty to the millions of policyholders who rely on a functioning NFIP. This would also give Congress the time needed in order to build consensus around substantive program reforms.

We greatly appreciate your work over the years to ensure the continuity of the NFIP. As Americans across the nation continue to recover from the devastating effects of recent catastrophic flooding, the importance of the program has never been more evident. We thank you for your continued work on this vital issue.

Sincerely,

National Association of Mutual Insurance Companies
Council of Insurance Agents and Brokers
Independent Insurance Agents and Brokers of America
Reinsurance Association of America
Wholesale & Specialty Insurance Association
American Property Casualty Insurance Association
National Multifamily Housing Council

Independent Community Bankers of America
National Apartment Association
National Leased Housing Association
National Affordable Housing Management Association
National Association of REALTORS®
National Association of Home Builders
American Bankers Association
American Land Title Association
The Council for Affordable and Rural Housing
Manufactured Housing Institute
Mortgage Bankers Association

Attachment H

AM Best
September 6, 2022
Best's Market Segment Report

Record-High Direct Premiums Written for the US Surplus Lines Segment in 2021

BEST'S MARKET SEGMENT REPORT

Our Insight, Your Advantage™

September 6, 2022

Record-High Direct Premiums Written for US Surplus Lines Segment in 2021

US surplus lines companies reported vastly improved underwriting and operating results, as well as the largest year-over-year premium growth since 2003

Principal Takeaways

- Total US surplus lines direct premiums written rose to a record $82 billion-plus in 2021, with the largest year-over-year premium growth since 2003.
- Surplus lines coverage solutions have been even more in demand to cover higher hazard, evolving risks such as cyber liability, certain professional liability classes, energy, and environmental liability, as well as property risks in areas susceptible to wildfires.
- Start-up companies among both insurers and surplus lines intermediaries are having a sizable impact on the market.
- In aggregate, surplus lines insurers reported vastly improved underwriting and operating results in 2021.
- Consolidation among surplus lines intermediaries will continue to reshape the competitive landscape for surplus lines distributors.

From the first quarter of 2020 through mid-2022, the US property/casualty (P/C) companies have dealt with myriad challenges, some of them unprecedented. Insurers and their distribution partners are navigating the wide-ranging effects of a pandemic, including a supply chain crisis and rising inflation, while withstanding above average losses from natural catastrophes and substantial investment market volatility. As a result, loss costs continue to rise and price adequacy remains a serious concern for several lines of coverage.

Despite these challenges, the P/C industry has been able to limit underwriting losses and generate surplus growth. In particular, nonadmitted or surplus lines companies have been able to generate net underwriting and operating gains. Surplus lines insurers have been especially critical to the market, providing solutions for unique exposures with higher risk profiles endemic to manufacturing, engineering, and construction businesses, along with new technological advancements. As businesses in all industries adapt to new ways of operating, these insurers have been even more important post-pandemic, due to technological advancements.

Consolidation of specialty insurance market distributors (wholesale insurance brokers and managing general agents or MGAs) continues to reshape the market. M&A has helped new and surviving entities provide a wider array of products and services, better positioning them to deal with the transformation in retail agents' buying trends. Acquisitions of small brokers and intermediaries are expanding the operations of some of the largest wholesale brokers. AM Best believes competitive market conditions will continue to lead to strategic acquisitions of both specialty niche insurers and insurers with a well-established market presence or advanced technological capabilities.

The dearth of surplus lines impairments (only one since the beginning of 2004) further highlights the resilience of the surplus lines and specialty market companies. Market dislocation—due to the short- and long-term effects of the pandemic, including economic upheaval—offers many opportunities for surplus lines companies, operating as the safety valve for the admitted or standard market.

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AM Best's Annual Surplus Lines Market Report

In 1991, we published *Best's Insolvency Study: Property/Casualty Insurers 1969-1990,* in an effort to bring clarity to debates about insurers' solvency. In 1994, the Derek Hughes/NAPSLO Educational Foundation—now the WSIA Education Foundation—commissioned a similar study on the solvency record of the domestic surplus lines industry. Although the segment was poorly understood at the time, data showed that its financial stability and solvency were at least on par with that of the overall P/C industry.

Since then, AM Best has published an annual report on the surplus lines market (commissioned by the foundation), documenting the following:

- The market's role in developing products to cover new or emerging risks, distressed risks, high-capacity risks, and other unique risks that cannot be insured in the standard P/C market
- The importance of surplus lines insurers' freedom of rate and form, which has allowed for creative insurance solutions to meet very complex or unique coverage needs
- The critical and still growing role of wholesalers in developing products and forging relationships with insurers that facilitate the placement of business in this market

Throughout its history, the surplus lines market has faced significant obstacles and intense competition—including periods of aggressive pricing during which standard market carriers seeking organic growth offered broader coverage—as well as the growing appeal of the alternative risk transfer market as another means of covering surplus lines risks. Throughout, surplus lines industry representatives have maintained an active presence in the states and in Washington, DC, tracking and addressing critical regulatory issues affecting the industry and helping advance key pieces of legislation.

Despite numerous economic, regulatory, legislative, and market challenges, the surplus lines insurers' market share has more than doubled over the last 20 years, from 4.3% of total P/C direct premiums written (DPW) in 2001, to 10.1% at the end of 2021. The surplus lines insurers' share of the commercial lines' DPW grew from 8.3% at the end of 2001 to 20.4% at the end of 2021, further demonstrating the segment's importance. As of mid-year 2022, 97% of surplus lines insurers had AM Best long-term Issuer Credit Ratings (ICRs) of "a-" or higher, compared with 83% for the total P/C industry.

The surplus lines market functions as a strong, viable safety valve for the insurance industry, as economic turmoil, emerging issues and developing exposures continue to drive the demand for new, creative, and comprehensive insurance solutions. AM Best believes that, given the surplus lines market's proven ability to effectively assess new exposures and its flexibility to tailor terms and limits to meet coverage demands, the market's critical role and value to the P/C insurance marketplace will continue to grow.

Overall, AM Best expects surplus lines insurers will continue to benefit from underwriting results, organic capital generation, and intelligent management of balance sheet factors, as they have throughout the pandemic. Volatility in the investment markets, however, could constrain overall operating earnings and capital. Proficient excess and surplus lines insurers with talented personnel typically fare well during cycles when market conditions stress standard market insurers. The P/C industry faces numerous challenges, among them, rising claims costs, social inflation, high jury verdicts, and severe weather events. The contraction in capacity owing to changing admitted company risk appetites, along with rate increases—even smaller ones—still in store for many commercial lines of business, creates an environment in which the hallmarks of the surplus lines insurers—creative market and product-oriented solutions—are especially valued.

Section I – State of the Market

Abundant Opportunities Yielding Significant Growth

In 2021, year-over-year premium growth in the surplus lines market was exceptional. Submission flow has boomed the past few years. An increase in opportunities, along with market hardening for some of the lines of coverage, led to 30% YoY growth for the DPSL writers in 2021 (**Exhibit 1**). The DPSL's growth was the largest contributor to the 25% increase for the entire surplus lines market in 2021, which includes the premium attributable to Lloyd's syndicates, premium written by non-Lloyd's alien insurers, and premium written by domestic specialty insurers that do not focus on surplus lines but write some nonadmitted premium (less than 50% of their total direct premium volume). Coverage lines that have generated unfavorable results for several years—such as commercial general liability, umbrella and excess liability, cyber, professional liability, and catastrophe-exposed property—led the way.

Exhibit 1

US Surplus Lines – Direct Premiums Written by Segment, 1988-2021

($ millions)

	Total P/C Industry		Total Surplus Lines		Domestic Professionals				Lloyd's			Regulated Aliens (Excluding Lloyd's)				Domestic Specialty			
Year	DPW	YoY % Chg	DPW	YoY % Chg	DPW	YoY % Chg	Surplus Lines Mkt Share	# of Cos.	DPW	YoY % Chg	Surplus Lines Mkt Share	DPW	YoY % Chg	Surplus Lines Mkt Share	# of Cos.	DPW	YoY % Chg	Surplus Lines Mkt Share	# of Cos.
1988	211,270	4.2	6,281	-4.3	3,704	-10.4	59.0	86	1,237	-7.5	19.7	1,012	31.3	16.1	104	328	2.2	5.2	128
1989	220,620	4.4	6,123	-2.5	3,530	-4.7	57.7	88	1,182	-4.4	19.3	1,050	3.8	17.1	101	361	10.1	5.9	123
1990	230,757	4.6	6,532	6.7	3,882	10.0	59.4	117	1,241	5.0	19.0	1,013	-3.5	15.5	85	396	9.7	6.1	149
1991	235,627	2.1	6,924	6.0	4,081	5.1	58.9	117	1,322	6.5	19.1	1,111	9.7	16.0	85	410	3.5	5.9	151
1992	240,410	2.0	7,549	9.0	4,491	10.0	59.5	120	1,388	5.0	18.4	1,220	9.8	16.2	74	450	9.8	6.0	151
1993	253,847	5.6	8,540	13.1	5,270	17.3	61.7	123	1,631	17.5	19.1	1,183	-3.0	13.9	70	456	1.3	5.3	138
1994	263,653	3.9	8,786	2.9	6,089	15.5	69.3	115	1,196	-26.7	13.6	992	-16.1	11.3	64	509	11.6	5.8	141
1995	273,929	3.9	9,245	5.2	6,511	6.9	70.4	112	1,300	8.7	14.1	1,022	3.0	11.1	57	412	-19.1	4.5	144
1996	279,990	2.2	9,205	-0.4	6,668	2.4	72.4	108	1,354	4.2	14.7	818	-20.0	8.9	57	365	-11.4	4.0	125
1997	287,196	2.6	9,419	2.3	6,569	-1.5	69.7	106	1,609	18.8	17.1	802	-2.0	8.5	59	439	20.2	4.7	114
1998	300,309	4.6	9,861	4.7	6,763	3.0	68.6	107	1,574	-2.2	16.0	1,196	49.1	12.1	58	328	-25.3	3.3	113
1999	308,671	2.8	10,615	7.6	7,265	7.4	68.4	105	1,912	21.5	18.0	1,140	-4.7	10.7	55	298	-9.1	2.8	116
2000	327,286	6.0	11,656	9.8	7,884	8.5	67.6	98	2,499	30.7	21.4	941	-17.5	8.1	46	332	11.4	2.8	106
2001	367,798	12.4	15,813	35.7	10,773	36.6	68.1	104	3,368	34.8	21.3	1,362	44.7	8.6	44	310	-6.6	2.0	91
2002	422,703	14.9	25,565	61.7	19,572	81.7	76.6	108	4,082	21.2	16.0	1,600	17.5	6.3	46	311	0.3	1.2	76
2003	463,033	9.5	32,799	28.3	25,662	31.1	78.2	115	4,492	10.0	13.7	2,400	50.0	7.3	45	245	-21.2	0.7	63
2004	481,588	4.0	33,012	0.6	25,744	0.3	78.0	115	4,596	2.3	13.9	2,400	0.0	7.3	53	272	11.0	0.8	59
2005	491,429	2.0	33,301	0.8	25,968	0.9	78.0	111	4,675	1.7	14.0	2,400	0.0	7.2	50	238	-12.5	0.7	57
2006	503,894	2.5	38,698	16.3	29,410	13.3	76.0	117	5,989	28.1	15.5	3,100	29.2	8.0	55	199	-16.4	0.5	54
2007	506,180	0.5	36,637	-3.5	27,675	-5.9	74.1	120	6,360	6.2	17.0	3,100	0.0	8.3	55	202	1.5	0.5	56
2008	492,881	-2.6	34,365	-6.2	24,612	-11.1	71.6	130	6,062	-4.7	17.6	3,403	9.8	9.9	53	288	42.6	0.8	70
2009	481,410	-2.3	32,952	-4.1	22,830	-7.2	69.3	139	6,090	0.5	18.5	3,735	9.8	11.3	55	297	3.1	0.9	69
2010	481,120	-0.1	31,716	-3.8	21,882	-4.2	69.0	143	5,789	-4.9	18.3	3,758	0.6	11.8	56	287	-3.4	0.9	66
2011	501,555	4.2	31,140	-1.8	22,582	3.2	72.5	146	5,790	0.0	18.6	2,537	-32.5	8.1	53	231	-19.5	0.7	60
2012	523,360	4.3	34,808	11.8	25,490	12.9	73.2	142	6,270	8.3	18.0	2,747	8.3	7.9	61	301	30.3	0.9	53
2013	545,760	4.3	37,719	8.4	26,818	5.2	71.1	140	7,099	13.2	18.8	3,362	22.4	8.9	59	440	46.2	1.2	49
2014	570,187	4.5	40,243	6.7	28,274	5.4	70.3	135	8,157	14.9	20.3	3,311	-1.5	8.2	60	501	13.9	1.2	58
2015	591,186	3.7	41,259	2.5	29,333	3.7	71.1	139	8,645	6.0	21.0	2,974	-10.2	7.2	58	307	-38.7	0.7	53
2016	612,906	3.7	42,425	2.8	29,112	-0.8	68.6	139	9,607	11.1	22.6	3,057	2.8	7.2	61	649	111.4	1.5	59
2017	642,127	4.8	44,879	5.8	30,594	5.1	68.2	138	10,325	7.5	23.0	3,289	7.6	7.3	59	671	3.4	1.5	58
2018	678,029	5.6	49,890	11.2	34,054	11.3	68.7	148	11,755	13.8	23.2	3,543	7.7	7.0	62	537	-20.0	1.1	61
2019	712,194	5.0	56,279	11.2	39,060	14.7	70.4	154	12,477	6.1	22.5	4,337	22.4	6.3	62	405	-24.6	0.7	60
2020	728,866	2.3	66,102	17.5	46,948	20.2	71.0	161	12,821	2.8	19.4	5,847	34.8	8.8	74	486	20.0	0.7	65
2021	798,246	9.5	82,653	25.0	61,200	30.3	74.0	169	13,872	8.2	16.8	6,864	17.4	8.3	75	717	47.5	0.9	69

Domestic professional surplus lines and domestic specialty surplus lines 2021 DPW totals are aggregated as of June 24, 2022.

Source: AM Best data and research

AM Best's Domestic Professional Surplus Lines Composite

The domestic professional surplus lines (DPSL) composite consists of some of the leading companies in the surplus lines segment. We believe that it provides an accurate picture of the overall segment's financial performance.

We break down the surplus lines companies into four categories:

- **Domestic professional** companies (the largest segment) are US-domiciled insurers that write 50% or more of their total premium on a nonadmitted or surplus lines basis.
- **Domestic specialty** companies are US-domiciled insurers that operate on a nonadmitted basis to some extent, but whose direct nonadmitted premium writings amount to less than 50% of their total direct premiums written.
- **Regulated alien insurers** and **Lloyd's syndicates** are non-US-domiciled insurers that must file financial statements and auditors' reports, the names of their US attorneys or other representatives, as well as information on their US trust accounts, with the International Insurers Department (IID) of the National Association of Insurance Commissioners (NAIC). Regulated aliens must also meet IID criteria relating to capital and surplus, as well as underwriting and claims practices, and have a reputation of financial integrity. The NAIC publishes a Quarterly Listing of Alien Insurers that meet its criteria. In this report, we separate the premium written by the non-Lloyd's alien insurers and the Lloyd's syndicates.

Note: Lloyd's is not an individual insurer but a market of many risk bearers. According to the IID, 90 Lloyd's syndicates were transacting surplus lines business in 2021. Premium totals for the Lloyd's market reflect the activities of the 90 syndicates and should not be compared to the premium of any one surplus lines group or company referenced in this report.

Opportunities to compete for business came as admitted carriers have refined their risk appetite and culled what they deemed difficult or higher risk commercial exposures from their portfolios, leaving more of the moderate- to higher-hazard business for surplus lines insurers. Despite the contraction in the wholesale brokerage marketplace owing to M&A, the expanded reach of these entities has led to their surplus lines insurance partners getting more and better opportunities to grow their portfolios.

Drivers of adverse loss trends such as social inflation, nuclear jury verdicts, natural catastrophes, and cyber ransomware attacks led surplus lines carriers to push for and achieve higher rates for liability coverage lines, including umbrella and excess coverage. Insurers have been circumspect in deploying capacity to cyber risks because of the growing number of ransomware attacks as hackers try to exploit remote work environments. With admitted companies more wary about cyber exposures, surplus lines insurers have filled in the coverage gaps, and with more defined coverage terms. This approach has helped generate premium growth for loss-leading risks for general and professional liability insurance as well.

These factors, in addition to exposure growth following the initial impact of the pandemic, have helped drive higher average premium levels for surplus lines accounts. Although pricing increases were largely expected to level off at the start of the year (except for accounts that have consistently generated underwriting losses), premium growth through mid-2022 in the surplus lines market has maintained the strong upward momentum from the end of 2021.

Higher retention levels and the steady appetites of established surplus lines insurers have also contributed to the substantial YoY rise in direct premium. Additionally, accounts presenting newer risk factors because of growing levels of specialization in their operations have sought wholesale insurance brokers to help find the best insurance coverage solutions. Overall, AM Best expects

businesses with emerging risk characteristics to continue finding their best coverage options in the surplus lines market.

The Lloyd's market, in aggregate, is still generating a considerable share of the total surplus lines market's annual premium, almost 17%, although its growth in the last couple of years has lagged that of the DPSL. Lloyd's still has excellent brand recognition in the specialty P/C insurance market and the reinsurance market, both of which are experiencing improving pricing conditions. The Lloyd's business mix is well diversified but still has some geographical bias toward North America and product bias toward moderate- to high-risk commercial specialty lines, making it a mainstay in the US market.

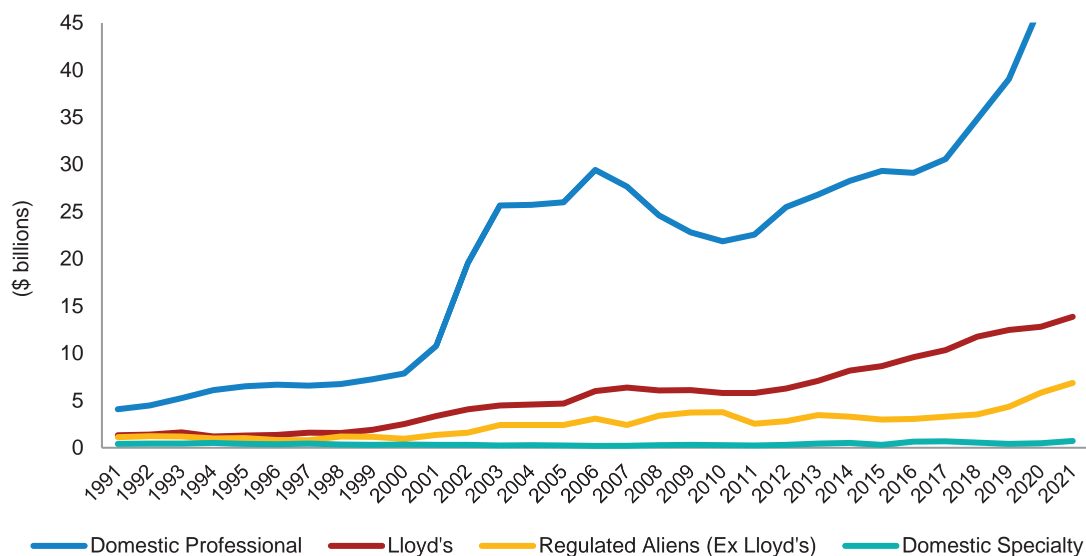
New entrants and incremental capital raises have had an impact on the edges of the market, but pricing momentum is likely to continue, as a multitude of factors—such as investment market volatility due to inflation, rising interest rates, social inflation, and elevated natural catastrophe activity—are likely to influence pricing through 2022 and into 2023.

Substantial Top-Line Growth Despite Extraordinary Challenges

In addition to the 30% YoY premium growth for DPSL companies and the more moderate 8% growth generated by the Lloyd's market, non-Lloyd's regulated alien insurers also experienced substantial DPW growth in 2021, of 17% (**Exhibit 2**). Growth has consistently been bolstered by market interest from outside the US—from both Lloyd's syndicates and non-Lloyd's alien insurers. These critical segments of the market have buoyed the upswing of the last few years.

Surplus lines market shares for domestic professionals and non-Lloyd's alien insurers continued to grow (**Exhibit 3**). Because domestic specialty companies are less dedicated to surplus lines business, they have typically experienced greater YoY premium volatility than dedicated DPSL insurers. True surplus lines insurers tend to flourish during turbulent times, similar to the last 18 to 24 months, given the pandemic, the resulting economic tumult, and changing climate/weather conditions. These conditions lead to greater market demand for products that can help cover businesses dealing with expanding or emerging risks, which favors surplus lines carriers.

Exhibit 2
US Surplus Lines – DPW by Segment, 1991-2021



Source: AM Best data and research

Service Offices Premium Reach New Highs in 2021 and 2022

According to the January 25, 2022, annual report of the US Surplus Lines Service and Stamping Offices, which captures insurance data from surplus lines stamping and service offices in 15 states, surplus lines premium in 2021 increased by 22% to $51.0 billion from $41.7 billion in 2020, after increasing by 14.9% in 2020. The number of surplus lines transactions filed—new and renewal business and endorsements including premium audits—increased by 6.6% YoY, after declining by 1.9% in 2020. These increases represented record levels of both premiums written and number of transactions (5.3 million). The premium recorded by the stamping offices was 61% of the surplus lines premium ($82.7 billion) aggregated by AM Best in this report. The increase in the reported number of filings, which provides a rough estimate of the flow of business into and out of the surplus lines market, was less than one third the YoY premium increase, which makes the premium growth all the more impressive. Of the 15 states reporting, each (with the exception of Idaho) reported a YoY premium increase greater than the increase in items filed. In most cases, premium rose two to three times more than transactions did.

All 15 states reported double-digit premium growth, with 10 reporting growth above 20%. The largest premium growth was reported by Illinois (40.1%), Arizona (37.6%), and North Carolina (34.7%). Three states that generate the most surplus lines premium annually also generated double-digit growth: California ($13.2 billion, up 18.4%), Texas ($9.1 billion, up 14.9%, the lowest growth percentage of any of the reporting states), and Florida ($9.5 billion, up 25.9%). New York, the fourth-highest state by annual surplus lines premium, saw an increase of 25.8%, up to $6.3 billion, after modest growth of 3.9% in 2020.

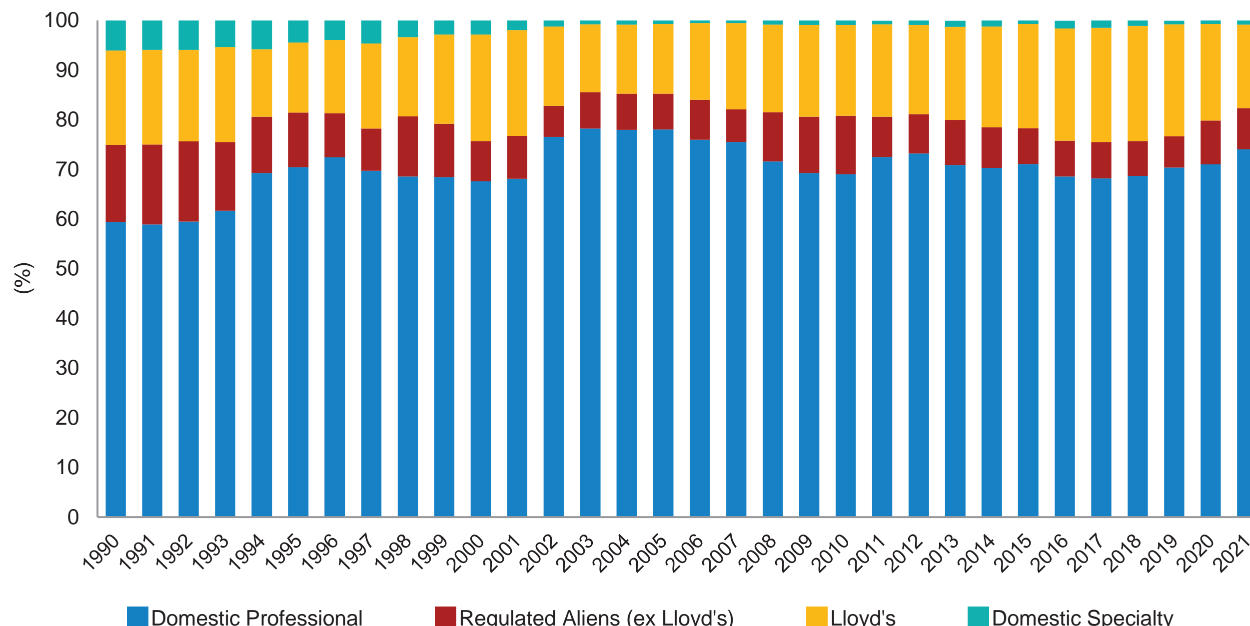
The results capture growth in premium per transaction, not just premium growth. In 2020, the overall decline in transactions from 2019 reflected the impact of COVID-19. However, the record-high premium volume and number of transactions demonstrated the importance and stability of surplus lines carriers as a component of the P/C market. Commercial general and excess liability, cyber, property, and employment practices liability were coverage lines most responsible for the YoY premium. California's Surplus Lines Association noted that cyber, property, and commercial auto saw significant increases in item count and average premium, coinciding with reports of increased activity in data breaches, ransomware attacks, and wildfires, as well as higher auto loss severity and emerging social and cost inflation.

According to the 2022 mid-year report from the US Surplus Lines Service and Stamping Offices, surplus lines premium exceeded $31 billion, up from $24 billion from the first half of 2021, and premium-bearing transaction filings almost reached 2.8 billion, up from 2.6 billion transactions. The 2022 first-half premium amounts to more than 61% of the record $51.0 annual premium reported by the service offices for 2021, while the number of transactions constitute almost 54% of the record-level transactions.

The 15 stamping offices reported premium increases through mid-year 2022, and all but Oregon and Pennsylvania reported double-digit increases. With increases reported in some states specifically in the construction and property areas, inflationary pressures increasing the prices for construction materials unquestionably had some impact on the surplus lines premium growth. Some states are still seeing pricing increases for professional liability business, a sector that has definitely hardened over the last few years although many market observers anticipated competitive market pressures to ease some of that upward pressure on renewal premiums in 2022.

Only two states reported declines in the number of transactions during the first half, both of which were minimal—Idaho, down by 1.0%, and Oregon, by 0.3%. Eight of the 15 offices reported double-digit increases in transactions during the first half, led by Arizona (23.1%), Mississippi (19.1%), and North Carolina (18.3%). An increase in the number of surplus lines startup companies that might be expected to produce discernible downward pressure on rates has not yet had that effect, at least not through the first half of 2022.

Exhibit 3
US Surplus Lines – Market Share by Segment, 1989-2021



Source: AM Best data and research

The market for property risks is still hardening, especially for accounts that have suffered large losses or multiple weather-related catastrophe losses. Billion-dollar weather and climate-related events continue to occur with greater frequency in the US. Wildfires have been a concern in a growing number of states, including Colorado, New Mexico, and New Jersey, which have not been accustomed to significant or frequent wildfire activity. All of these factors have propelled premiums for surplus lines carriers. The commercial auto market, particularly for trucking risks, also remains quite firm because of poor underwriting results, which have been consistently substandard, its poor performance extending back for a longer period than property results.

The substantial growth in the surplus lines segment has led to the market breaching the 10% mark in P/C industry direct premiums written for the first time (**Exhibit 4**). Surplus lines written premium remains far more weighted toward commercial than personal lines. Surplus lines DPW as a percentage of commercial lines DPW ranged from 13% to 15% from 2003 through 2017, before rising to 18.3% in 2020 and eclipsing the 20% mark for the first time (20.4%) in 2021 (**Exhibit 5**). Since 2000, the P/C industry's commercial DPW has grown by 248%, while the surplus lines DPW has grown by 617%, owing to higher rates and more conservative pricing (especially in recent years), as well as the shift of risks from the admitted market to the nonadmitted market. The surplus lines segment should continue growing in line with overall commercial lines market growth.

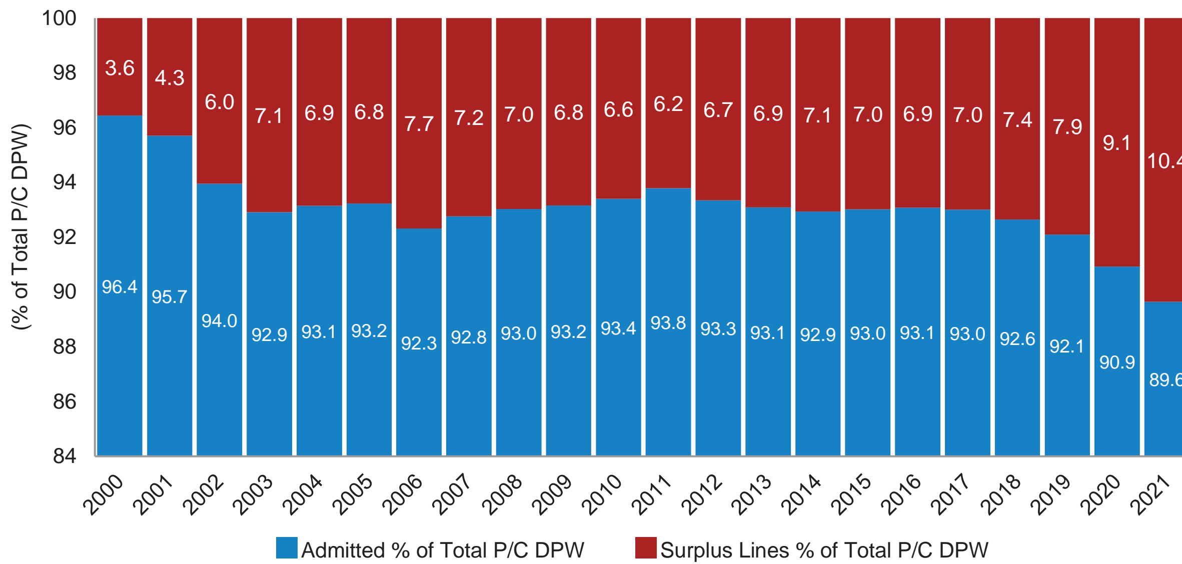
Greater Diversification Among the Top Groups

In 2021, 25 groups and the Lloyd's market generated about 71% of surplus lines DPW, as **Exhibit 6** shows; excluding Lloyd's market, these 25 groups account for around 54% of the total surplus lines market premium, down about one percentage point from a year ago. For nearly 30 years, the 25 groups and the Lloyd's market have accounted for more than 70% of market premium. Ten or so years ago, that percentage was closer to 75%, but the market has become slightly more diversified of late.

Lloyd's syndicates grew their premium by approximately 8%, much lower than the total surplus lines market growth of more than 25%. Lloyd's appetite for US surplus lines and the specialty commercial business remains strong, but the carrier also continues to diversify into the Asian, European, South American, and overall reinsurance markets.

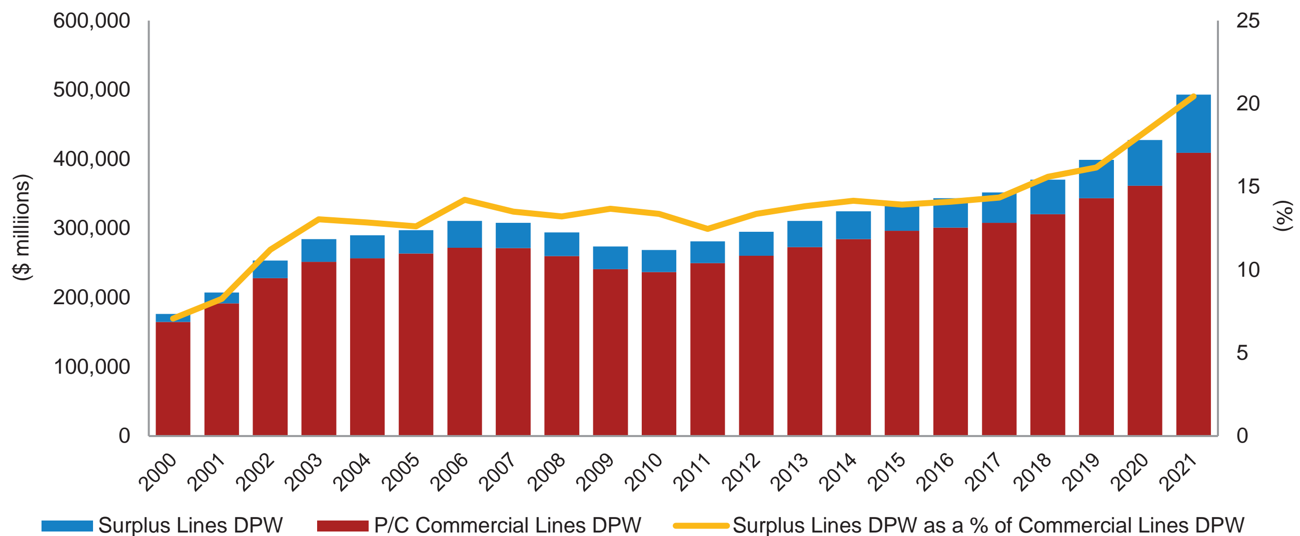
AIG's premium grew 17.7% with the benefit of a strategic restructuring and a renewed focus to improve underwriting results. Berkshire Hathaway Insurance Group, having supplanted AIG as the leading surplus group in 2020, retained its top spot, with annual DPW growth of 18.4% in 2021. Its surplus lines writings were dominated by DPW growth at its main surplus lines insurer/reinsurer, National Fire & Marine Insurance Company. Berkshire Hathaway and AIG together make up 10% of the US surplus lines market.

Exhibit 4
US P/C Industry – Admitted vs Surplus Lines, Proportion of DPW, 2000-2021



Source: AM Best data and research

Exhibit 5
Surplus Lines DPW as a % of P/C Industry Commercial Lines DPW, 1999-2021



Source: AM Best data and research

Exhibit 6

US Surplus Lines – Lloyd's and Top 25 Groups, 2021

Ranked by Direct Premiums Witten

Rank	AMB #	Group Name	Surplus Lines DPW ($ thousands)	YoY DPW % Change	Surplus Lines Market Share (%)
	85202	**Lloyd's**	**13,871,953**	**8.2**	**16.6**
1	00811	Berkshire Hathaway Ins Grp	4,212,256	18.4	**5.0**
2	18540	American International Grp	4,177,807	17.7	**5.0**
3	18468	Markel Corporation Grp[1]	3,530,213	26.5	**4.2**
4	03116	Fairfax Financial (USA) Grp	2,997,286	37.9	**3.6**
5	18252	W. R. Berkley Insurance Group	2,820,382	24.7	**3.4**
6	05987	Nationwide Group	2,611,335	16.3	**3.1**
7	18498	Chubb INA Grp	2,442,535	25.9	**2.9**
8	00060	Liberty Mutual Insurance Cos	2,208,819	29.4	**2.6**
9	18557	XL Reinsurance America Grp	1,906,397	14.5	**2.3**
10	18640	Alleghany Insurance Holdings Grp	1,660,032	29.2	**2.0**
11	18878	Sompo Holdings US Grp	1,624,567	36.8	**1.9**
12	18756	Starr International Grp	1,440,373	33.2	**1.7**
13	05658	QBE North America Insurance Grp	1,284,541	33.9	**1.5**
14	18733	Tokio Marine US PC Grp	1,258,541	34.0	**1.5**
15	18777	AXIS US Operations	1,243,936	33.5	**1.5**
16	18549	Zurich Ins US PC Group	1,195,708	6.9	**1.4**
17	05696	Everest Re US Grp	1,063,466	49.4	**1.3**
18	04019	Argo Group	1,061,974	4.6	**1.3**
19	18313	CNA Insurance Cos	1,029,061	39.9	**1.2**
20	04835	Great American P&C Group	984,303	29.2	**1.2**
21	18484	Arch Insurance Grp	963,358	37.6	**1.2**
22	00048	Hartford Insurance Group	947,578	26.0	**1.1**
23	18674	Travelers Group	906,111	32.8	**1.1**
24	18753	Munich-American Companies	875,991	71.0	**1.0**
25	18626	James River Group	870,944	18.3	**1.0**
		Subtotal of Top 25 Surplus Lines Groups	**45,317,514**	**25.2**	**54.2**
		Subtotal of the Top 25 Groups and Lloyd's	**59,189,467**	**20.7**	**70.8**
		Total US Surplus Lines Market	**83,553,739**	**26.4**	**100.0**

[1] Includes State National Group companies.

Source: AM Best data and research

Markel Corporation Group was the third-largest writer in 2021 and the only other group whose market share exceeded 4%, which includes almost $1.5 billion in surplus lines premium written by subsidiary State National Group. This represented a rebound of sorts after only a 1.6% rise in 2020, when the lead insurer of State National's program services operation, United Specialty Insurance Company, saw a $200 million decline in DPW owing to the cessation of two large programs during the year. State National is not a core surplus lines insurer on a net basis, because it writes the majority of its surplus lines premium via fronting arrangements with other carriers and maintains very little of that nonadmitted premium on its books, net of reinsurance.

Of the top 25 surplus lines groups, 23 achieved double-digit premium growth in 2021, and 19 generated $1.0 billion or more in nonadmitted premium. Zurich and Argo Group were the only two of the 25 to grow at a single-digit pace. The top ten surplus lines groups by DPW were the same as in 2020 and 2019, although the third through tenth spots order shifted around slightly. Of the remaining seven companies in the top 10, Fairfax Financial saw the largest YoY premium growth, at approximately 38%, propelling it to the #4 spot.

New distribution partnerships, including some that delegate authority to managing general agents or similar delegated underwriting authority enterprises (DUAEs), have helped fuel the growth of surplus lines entities. New distribution platforms and geographic or product line diversification have played an integral role allowing these groups to defend their leading positions.

Exhibit 7

US Surplus Lines, Top 25 Companies, 2021

Ranked by direct premiums written.

Rank	AMB #	Company	Surplus Lines DPW ($ thousands)	Surplus Lines Market Share (%)
1	02428	National Fire & Marine Ins Co	3,406,774	4.1
2	03292	Scottsdale Insurance Company	2,544,315	3.0
3	02350	Lexington Insurance Company	2,350,906	2.8
4	03759	Evanston Insurance Company	2,056,584	2.5
5	11340	Indian Harbor Insurance Co	1,905,074	2.3
6	13033	Endurance American Spec Ins Co	1,624,566	1.9
7	13977	Starr Surplus Lines Ins Co	1,440,373	1.7
8	03535	AIG Specialty Insurance Co	1,435,246	1.7
9	04433	Westchester Surplus Lines Ins	1,390,371	1.7
10	12562	QBE Specialty Insurance Co	1,284,541	1.5
11	13105	United Specialty Insurance Co	1,257,729	1.5
12	13866	Ironshore Specialty Ins Co	1,244,541	1.5
13	12515	AXIS Surplus Insurance Company	1,243,936	1.5
14	03557	Steadfast Insurance Company	1,193,788	1.4
15	12619	Landmark American Ins Co	1,138,386	1.4
16	12096	Everest Indemnity Insurance Co	1,063,466	1.3
17	11123	Crum & Forster Specialty Ins	1,039,513	1.2
18	03538	Columbia Casualty Company	1,029,061	1.2
19	12078	Liberty Surplus Ins Corp	964,279	1.2
20	12523	Arch Specialty Insurance Co	963,358	1.2
21	12118	Gemini Insurance Company	878,534	1.1
22	03510	Illinois Union Insurance Co	826,206	1.0
23	12604	James River Insurance Co	820,501	1.0
24	03286	Houston Casualty Company	799,995	1.0
25	03837	Great American E & S Ins Co	789,037	0.9
		Top 25 – Subtotal	**34,691,080**	**42.0**
		Total US Surplus Lines Market	**82,652,576**	**100.0**

Source: AM Best data and research

The Lloyd's market and the top surplus lines group have historically accounted for 30% or more of the market's annual direct premium—just ten years ago, AIG and Lloyd's accounted for just under 33% of the segment's premium. In 2021, Lloyd's and the leading surplus lines group, Berkshire Hathaway, accounted for approximately 21.6% of the segment's premium, down from approximately 25%, due largely to the decline in the Lloyd's market share.

Leading Companies Dominating, but Newly Rated Fronting Carriers Gaining Prominence

AIG's main surplus lines insurer, Lexington Insurance Company, held the position as the largest single US surplus lines company by DPW from 1994 through 2019. As **Exhibit 7** shows, in the last two years, two companies, Berkshire Hathaway's National Fire & Marine and Nationwide's Scottsdale Insurance Company, moved past Lexington, comfortably in the case of National Fire & Marine, to become the leading single companies writing US surplus lines business. Along with Lexington, these three companies accounted for approximately 10% of the total US surplus lines DPW for the year. National Fire & Marine's 4.1% share led the way although it was down slightly from 4.4% YoY growth in 2020.

Although fronting companies generate premium on a nonadmitted basis, they are different from core surplus lines insurers whose operating performance relies on how effective they are at selecting, underwriting, pricing, and settling claims. Instead, fronting companies use surplus lines to meet coverage needs and grow top-line premium while retaining moderate to minimal risk on a net basis. Their bottom-line profitability depends on the ceding fees they receive as compensation for the direct business that they write and cede to companies interested in retaining the risk on a net basis.

Over the last several years, a number of companies have been formed aiming to use the fronting model and a surplus lines structure to take advantage of favorable insurance market conditions and build up top-line premium. Many of these entities are pursuing a strategy very similar to the one State National Group has very successfully used for almost four decades. These companies look to grow organically, using strong relationships with distribution partners (often MGAs) and select reinsurance partners, leveraging existing opportunities in the market for fronting paper—often pure fronting paper—but also on a participatory basis. Fronting companies reinsure a significant portion, if not all, of their DPW, which limits their underwriting risk, making credit risk the critical risk they need to effectively manage.

Exhibit 8
US Surplus Lines (Fronting) Companies Rated by AM Best in the Last Five Years, by DPW
($ thousands)

AMB #	Company Name	2022 Surplus Lines DPW	Best's FSR
18944	Trisura US Insurance Group	751,222	A-
18931	Transverse Insurance Group	165,134	A-
18954	Palomar Holdings US Group	145,656	A-
18956	Obsidian Insurance Group	102,913	A-
18965	Accelerant US Holdings Group	93,118	A-
18449	Ambac Financial Group	13,037	A-
18947	Sutton National Group	8,777	A-
	All Companies	**1,279,857**	

Source: AM Best data and research

Exhibit 8 shows the new fronting companies that have received AM Best ratings during the last five years and their 2021 DPW, which amount to just under $1.3 billion in 2021. Trisura US Group, with its lead surplus lines insurer Trisura Specialty Insurance Company, has generated the largest amount of premium from these fronting operations, with just over $750 million in surplus lines premium in 2021, enough to qualify as the 28th largest surplus lines group by DPW. The exhibit does not include Clear Blue Insurance Group, which was the first of the new companies using the fronting model to receive an AM Best rating, in December 2015. Now a fully established company, Clear Blue generated over $480 million in nonadmitted premium in 2021. These fronting operations rely on experienced professionals to assess new accounts; most have experienced management teams with extensive knowledge of specialty commercial and surplus lines risks that assess individual accounts, using proprietary tools to assess a broad range of risks, including underwriting, credit, contractual, and collateral.

Current Opportunities

Cannabis

As of May 2022, 19 states, two territories, and the District of Columbia had enacted measures to regulate cannabis for adult non-medical, or recreational use. As of February 3, 2022, 37 states, three territories, and the District of Columbia allowed the medical use of cannabis products. In November 2020, voters in Mississippi passed a ballot initiative to allow for medical use, but it was subsequently overturned by the state supreme court on May 14, 2021. The legislature then passed new legislation, which was signed by the governor on February 2, 2022.

The cannabis industry has very complex requirements. Many financial institutions refuse to serve the multibillion-dollar industry because of the regulatory uncertainty created by divergent state and federal cannabis laws. Nevertheless, the market continues to expand, with cultivators, processors, wholesalers, and retail dispensaries commencing operations and employing a growing number of people. With the expansion comes greater demand for insurance coverage. The main impediment to a fully viable cannabis market is the wariness of insurers about entering a market for a product that remains classified as a Schedule I drug under US federal law.

In mid-July, the US House of Representatives passed the National Defense Authorization Act (NDAA), which has as an attached amendment, the Secure and Fair Enforcement (SAFE) Banking Act, that gives banks and insurance companies legal protection for doing business with firms in

the legal cannabis industry. The amendment specifically allows banks to open their doors to the cannabis industry through a provision that provides officers, directors, and employees of an insurer with protection from liability under any federal law or regulation. The protection exists solely for insurance for a company in a state that allows the production, sale, transportation, and distribution of cannabis. It also covers the investment of any income derived from the business.

Insurers may be interested in covering the growing cannabis industry, but most remain reluctant to get involved while marijuana remains a Schedule I drug. Cannabis-related operations have not held much attraction for a majority of the more heavily regulated admitted carriers; however, a growing number of surplus lines carriers have stepped up to provide coverage solutions for these businesses. Passage by the Senate of the NDAA along with the SAFE Act would likely result in a more active market for cannabis coverage. Most of the insurers currently providing coverage for cannabis businesses in the US are surplus lines insurers able to use their freedom of rate and form to address the risks, wherever cannabis operations are legal in the United States. Developing coverage solutions for the businesses that grow, produce, and sell cannabis products fits with the type of creativity that has long been a hallmark of the surplus lines companies.

Growing Cyber Security Concerns Need Surplus Lines Solutions

High-profile cyber crimes, primarily ransomware attacks, continue to garner significant headlines. Threat actors are pivoting and deploying new strategies for attacks, with an unfortunate level of success. The victims of cyber attacks are becoming more varied every year, with victims encompassing educational institutions, hospitals, municipalities, meat suppliers and insurance companies. Cyber attacks on insurance companies—and ransomware attacks in particular—have been increasing in size and scale.

Cyber insurance started mainly as third-party coverage to protect against cyber criminals stealing and selling client data; however, first-party ransomware claims are growing, both in number and in the percentage of cyber claims. Initially, ransomware claims involved encrypting victims' files, requiring a key to unencrypt them. The victim of the attack would have to pay a ransom to obtain the encryption key. Ransomware claims have evolved and often involve extortion whereby cyber criminals threaten to release or sell sensitive data after collecting the ransomware payment. The growth in crypto-currencies (which are difficult to trace), the immediacy of payments, and the lack of buyers for previously compromised data make ransomware much more attractive for hackers.

These attacks underscore the urgency of proactively addressing cyber threats. Such efforts require brokers, underwriters, managing general agents/underwriters, and customers working together, in conjunction with governmental and regulatory bodies—which has become even more imperative, given the potentially heightened impact of cyber owing to the pandemic. Companies and organizations allowing remote working environments face the prospect of cyber threat actors exploiting any inherent data security weaknesses in a company's virtual environment.

Surplus lines insurance represents an alternative marketplace for cyber risk. New surplus lines policies can serve as testing grounds for product innovation. The greater number of products sold offers more opportunities for the interpretation of contract language. Should those interpretations prove favorable to a company in court proceedings, the policies may become more common. Surplus lines companies use their freedom from insurance form regulations to develop coverage with tighter language that stands a better chance of avoiding unfavorable court rulings than standard contract wording does.

In recent years, many cyber MGAs and MGUs have created their own captive or specialty insurers, which allows them to retain a share of each risk they underwrite and fuels additional growth—and

which demonstrates a long-term commitment to underwriting a profitable and sustainable book on a global scale. MGAs and MGUs benefit from working closely with their policyholders and (surplus lines) insurance brokers to create customized coverage. Domestic and regulated alien surplus lines insurers are playing an increasingly important role in providing needed standalone and packaged coverage options in the dynamic cyber market. Other potential growth areas for surplus lines insurers include renewable energy, construction, healthcare, professional liability, and environmental liability.

Potential Macroeconomic Headwinds

- The inflation rate was 8.5% in July 2022 after reaching 9.1% in June, the highest rate since November 1981 (9.6%). Inflation is driving up the cost of first-party coverage due to rapid increases in demand for goods, materials, and labor. Price hikes in construction materials, rental vehicles, and auto parts are impairing the risk profile of contracting/construction and commercial trucking. These are two troubled risk classes in which insureds are more and more in need of creative surplus lines solutions to cover expanding loss exposures.
- Social inflation remains a significant issue. Third-party claims costs have not slowed down to any notable degree thus far in 2022. Claims are being heard in a more plaintiff-friendly environment overall. Umbrella and excess liability markets have been hit the hardest by skyrocketing judgments, driving excess premiums up drastically. Surplus lines insurers with larger balance sheets that are able to participate in towers for some of these more difficult risks need to remain judicious in deploying capacity.
- Economic inflation will continue to pressure pricing, as carriers consider the reserves needed to pay for future claims. With inflation still on the rise, the risk of past reserve levels proving inadequate is also growing, especially for general liability and professional liability risks, where surplus lines insurers have found greater opportunities as admitted insurers avoid risks that they deem difficult or that no longer fit their risk appetite.
- Supply chain issues persist, and both labor and material costs have increased. Claims are remaining open longer, as required components, materials, and labor are more costly and difficult to obtain.
- Additional headwinds include the following:
    - Higher medical costs as healthcare providers remain constrained by staff and capacity shortages
    - Exposure to long-tail reserve weakening, where surplus lines carriers will not benefit from favorable trends in workers compensation (where reserve development has been favorable), because workers' compensation business represents only a small proportion of total surplus lines premium volume

Influx of Startups Potentially Tempering the Impact of Tough Economic Conditions

A slowing economy, high inflation, and rising interest rates held sway as the second half of 2022 commenced. The risk management, operational, and coverage that allowed the industry to address the heightened challenges of 2020 and 2021 will remain critical as the end of 2022 approaches and business plans for 2023 are solidified. Escalating losses from severe convective storms across the central, eastern, and southern US, historic flooding in Montana (that forced a rare closing of Yellowstone National Park), and sweltering temperatures leading to wildfires in Arizona, New Mexico, California, and even Alaska are complicating the property insurance market for both standard and surplus lines insurers.

Margin compression on the personal lines business should remain constant through the end of this year and into the next, with the benefits of rising personal lines premiums partially nullified by natural catastrophe losses still trending higher than historical norms and the supply chain crisis pressuring claims costs. After years of targeted rate and price hikes on underperforming lines of coverage, commercial lines premium increases are likely to moderate somewhat. Although

underwriting results for AM Best's DPSL have outperformed the broader P/C industry's, surplus lines carriers will need to marshal the same skills and standards used to generate those results to contend with the economic and risk-oriented challenges of 2022 and 2023.

Interest in the surplus lines market, however, remains high, manifested in the form of a number of start-up companies, new affiliates in established insurance organizations, companies seeking strategic alignments with fronting companies, and distribution entities, including insurtech-focused MGAs. Startup insurance companies usually include established surplus lines professionals taking advantage of market demand to venture out on their own, with the backing of capital providers. These enterprises generally seek to quickly capitalize on perceived market opportunities, although they are well aware of the need to build a scalable infrastructure. Furthermore, technology-driven startups (insurtechs), which have traditionally been focused on personal-lines products, have in recent years shifted to chasing opportunities in the small, specialty commercial and surplus lines space. These startups use technology to streamline their time to market with what they consider innovative product offerings.

Abundant Opportunities Despite Challenging Times

Inflation and its effects on the fertile surplus lines/specialty market sectors like construction and property continue to push renewal prices up. Some market observers expect further new external capacity to enter the market, leading to market stabilization as the capacity is deployed and greater supply tempers the recent pressure on pricing on many coverage lines. Continued upward premium momentum through the first half of 2022 does not suggest that moderating price increases are constraining top-line premium volume for the surplus lines market. As long as the competitive pressures that accompany additional market capacity do not lead to a loosening of underwriting terms and conditions, results for the surplus lines insurers should remain favorable over the near term.

Section II: Financial Performance and Ratings Distribution

This section examines the financial performance of AM Best's Domestic Professional Surplus Lines (DPSL) composite, which is composed of some of the leading companies in the surplus lines segment. We believe that the composite provides an accurate picture of the overall segment's financial performance. This section also discusses AM Best's ratings on the DPSL composite companies in comparison to the overall P/C industry.

In calendar year 2021, the companies in the composite generated $34.6 billion in DPW, accounting for approximately 41.4% of the total US surplus lines market and about 55.7% of the entire domestic professional surplus lines market as defined in this report. The composite's DPW grew by 25%, falling just shy of the 26.4% year-over-year growth for the entire surplus lines market, including Lloyd's syndicates and other regulated alien insurers, and almost tripling the 9.5% growth of the total P/C industry.

AM Best's DPSL Composite

The analysis in Section II is based on the statutory financial data of the 68 US-based DPSL companies, although not all of the companies identified in Appendix B as domestic professional surplus lines companies are included in the composite. Composite members are surplus lines companies that wrote more than 50% of their business on a nonadmitted basis in 2021. When creating the composite, AM Best excluded any surplus lines companies that (1) are members of intercompany pools writing predominantly admitted business as opposed to surplus lines business; (2) reinsure all of their business with an affiliate; or (3) write a relatively small amount of premium. The composite does include companies that may be part of an intercompany pool but still write surplus lines business on a predominantly direct basis and retain a meaningful portion of it.

Overall, US P/C insurers—including surplus lines insurers—began 2021 with a fair amount of wariness owing to pandemic and resulting economic upheaval, in addition to a spate of natural catastrophes and social unrest throughout pockets of the US. There was some optimism, though, about the potential breakthrough vaccine to combat the pandemic.

For the surplus lines market in particular, the unsettling events of 2020 and resulting uncertainty led to more conservatism among admitted carriers, which generally leads to optimism and opportunities for surplus lines insurers. Early in 2021, however, that optimism was met with an atypical, destructive ice storm (Winter Storm Uri) that caused a prolonged freeze and power outages in Texas during the first quarter, a time when the industry is generally insulated from catastrophes. That served as a harbinger of things to come for the remainder of the year—an above-average season of activity for Atlantic tropical cyclones, numerous wildfires throughout the western and southwestern states, and tornadoes wreaking havoc in Tennessee and Kentucky, along with wildfires in Colorado, at the end of the year. Coupled with rising inflation and investment market volatility, both 2021 and the first half of 2022 have presented rough waters for insurers to navigate, including the companies that comprise the DPSL composite.

Despite macroeconomic and natural catastrophe-related pressures, the DPSL composite more than met the challenge in 2021, generating notably enhanced underwriting and operating results while increasing its aggregate policyholders' surplus by 16%. Much of the increase was driven by an increase of more than 25% in DPW, while related increases in losses and loss adjustment expenses incurred were only 14%. The key factors boosting the segment's premium growth included hardening market conditions that resulted in not only tighter coverage terms and conditions, but also rate and pricing increases, particularly in some of the key lines written by surplus lines insurers.

Submission Flow Still Fueling Strong Premium Growth

On the heels of YoY DPW growth of 13.6% in 2018, 11.8% in 2019, and 15.5% in 2020, the DPSL composite's 25% growth from $27.6 billion to $34.6 billion in 2021 was significant and the largest annual jump in several years. The premium growth reflected the segment's elevated submission flow and the market conditions affecting some of the lead lines of coverage for surplus lines writers. With many admitted carriers refining plans aimed at improving underwriting profitability, the premium growth led to some higher risk hazard, as more complex accounts settled into the nonadmitted market.

Net retention of gross written premiums (GPW) (the sum of direct and assumed premiums written) for the composite was fairly steady from year to year (58.2% in 2021 compared to 59.6% in 2020), so its net premiums written growth in 2021 of 24.9% was commensurate with its top-line DPW growth, as **Exhibit 9** shows. That net retention remained static YoY indicates that surplus lines carriers were bullish on the profit potential of the new and renewal business written during 2021 and sought to retain the business on a net basis. Surplus lines insurers with profitable books likely also benefited from flat pricing on their reinsurance program renewals A good portion of the

Exhibit 9

US DPSL Composite – Premiums, 2017-2021

($ millions)

	Direct Premiums Written	Assumed Premiums Written	Gross Premiums Written	Ceded Premiums Written	Net Premiums Written
2017	18.8	10.1	28.9	16.8	12.1
2018	21.4	11.0	32.4	18.0	14.3
2019	23.9	11.9	35.8	20.2	15.6
2020	27.6	12.1	39.7	22.8	16.9
2021	34.6	14.1	48.6	27.5	21.1
2020/2021 Growth (%)	**25.2**	**16.5**	**22.6**	**20.8**	**24.9**

Values may not add up due to rounding.

Source: AM Best data and research

Exhibit 10

US DPSL Composite – Top 5 Product Lines by DPW, 2021 vs 2020

Rank	Product Line	2021 Surplus Lines DPW ($ thousands)	2021 DPSL Peer Composite Market Share (%)	2020 Surplus Lines DPW ($ thousands)	2020 DPSL Peer Composite Market Share (%)	2021/2020 DPW Change (%)
1	Other Liability	17,781,070	51.4	13,569,724	47.6	31.0
2	Allied Lines	4,208,666	12.2	3,595,674	12.5	17.0
3	Fire	3,983,966	11.5	3,047,950	9.7	30.7
4	Medical Prof. Liability	1,317,179	3.8	1,086,096	5.2	21.3
5	Commercial Multiple Peril	1,306,234	3.8	1,193,652	4.7	9.4
	Top 5 – Subtotal	**28,597,115**	**82.7**	**22,493,096**	**79.7**	**27.1**
	Total DPSL Composite	**34,566,653**	**100.0**	**23,553,513**	**100.0**	**46.8**

Note: All 2020 and 2021 figures are for the companies comprising the DPSL composite as of December 31, 2021.

Source: AM Best data and research

growth in top-line premium was due to pricing increases on renewals, particularly on accounts that have suffered losses that have made them unprofitable over the recent term.

DPSL Premium More Concentrated Among Lead Coverage Lines

As **Exhibit 10** shows, general liability business (coded as Other Liability – Occurrence or Other Liability – Claims-Made for NAIC statutory reporting) continues to generate the largest share of the composite's DPW at greater than 50%. The claims made line of business consists largely of professional liability coverages, covering a wide variety of professionals and businesses from claims of negligence from customers or clients. The general liability and fire lines of coverage grew 30% YoY, and allied lines, 17%. The changes to everyday life and daily business activities due to the pandemic affected the type and level of specialization needed to adequately cover the property and liability exposures of more complex business operations. This fundamental need for coverage solutions often favored DPSL composite carriers.

Catastrophe-exposed property was one of the P/C risk classes that has experienced consistent pricing increases. The higher prices are aimed at keeping up with rising loss severity from wildfires and windstorms the past several years and have boosted the DPSL composite insurers in terms of more adequate premium at the individual account level. Standard market carriers have been re-assessing their exposures in different states, whether coastal or inland properties that appear more in danger of potential wildfire losses as drought conditions spread to more areas within an escalating number of states. The allied lines business, consisting of property coverage usually purchased in conjunction with a fire policy and covering perils such as water, windstorm, sprinkler leakage, and vandalism, continued to grow, by 17%—the business accounted for more than 12% of composite premium in 2021. The almost 31% growth in fire DPW exceeded that of allied lines and reflected changing loss frequency and loss severity trends for property risk. The level of growth in the composite's five leading lines reflected a growing concentration in the market, with those lines accounting for about 83% of the composite's direct premium, up several percentage points in just the last two to three years.

Marked Enhancement in Underwriting

Despite challenging economic factors, rising loss costs and the ever growing wildfire and convective storm activity, the DPSL composite's net underwriting and operating results improved in 2021. The significant growth in top-line premium spurred a dramatic improvement in loss and underwriting expense ratios. The growth of 20% in NPW and 25% in net premiums earned (NPE) in 2021 far outpaced the 14% growth in net incurred loss and loss adjustment expenses (LAE) incurred, yielding a three percentage point improvement in the composite's net loss & LAE ratio, to 67.7 from 71.0 (**Exhibit 11**). In contrast, the P/C industry's net loss and LAE ratio deteriorated by 2.5 percentage points, rising to 72.5.

For the composite, the pure net loss ratio (focusing on incurred losses excluding, any allocated loss adjustment expenses) was the primary source of the improvement. Efforts to charge adequate premiums for the moderate to high hazard surplus lines risks, along with improved risk selection on individual accounts, most likely drove the improvement. Results for the DPSL composite's lead general liability line of coverage improved slightly, contributing to the improvement in the overall loss ratio. Property results improved more noticeably, despite elevated weather-related catastrophe losses, driving the dramatic turnaround from an underwriting loss of $194 million in 2020 to an underwriting gain of $643 million in 2021. In contrast, the total P/C industry's 2020 underwriting gain of $5.3 billion was followed by an almost $4.1 billion loss in 2021.

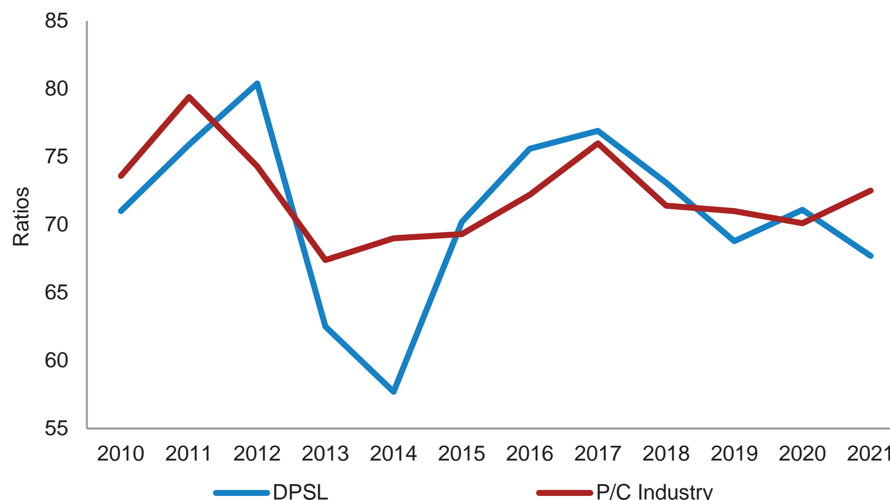
The DPSL composite posted a 94.1 overall combined ratio, a full five points lower than the P/C industry's 99.7 (**Exhibit 12**). The net loss and LAE ratios were primarily responsible for the difference in combined ratios, since the other underwriting expense ratio (the other key component of the combined ratio) was the same for both, at 26.5. This is noteworthy because average direct and net commission expense ratios, which account for the majority of underwriting expenses outside of loss adjustment expenses, have traditionally been slightly higher for the DPSL composite than for the P/C industry. The higher ratios have been due to the multi-layered distribution of surplus lines products, including expenses attributable to retail producers, wholesale brokers or managing general agents, and program managers.

Over the last ten years, the composite and the total P/C industry have generated similar combined ratios, on average—99.8 for the composite compared to 99.5 for the total industry—despite the greater level of volatility in the underwriting results of the DPSL composite, specifically attributable to the riskier catastrophe-exposed property risks written by the composite's insurers. Historically, surplus lines underwriters have demonstrated their expertise in selecting and pricing more complex, riskier accounts than those insured by standard market insurers.

On an accident year basis (removing the benefit—or lack thereof—from prior year loss reserve development), the composite's combined ratio improved markedly, dropping to 94.0 from 99.5, reflecting the effectiveness of underwriting, pricing, and claim management strategies amid the myriad factors that made the task very difficult. The adverse prior year development in the

Exhibit 11

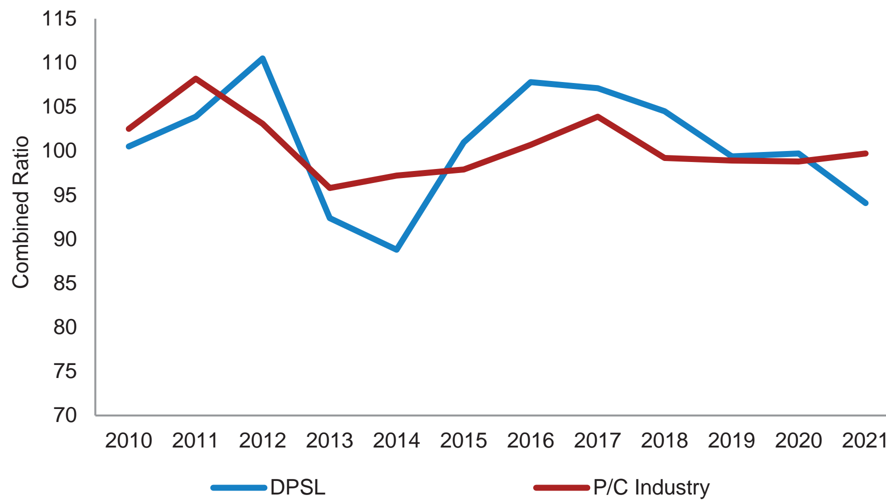
US DPSL Composite vs US P/C Industry – Net Loss and LAE Ratio, 2010-2021



Source: AM Best data and research

Exhibit 12

US DPSL Composite vs US P/C Industry – Net Combined Ratio, 2010-2021



Source: AM Best data and research

composite's lead general liability line of coverage, on both per occurrence and claims-made general liability coverage, does not factor into accident year combined ratio results, which benefitted the composite. The P/C industry posted a 2.7 point increase in its accident year reported combined ratio. The performance of the private passenger and commercial auto lines of coverage, in particular, helped drive the deterioration in the industry's bottom-line accident year combined ratio. The deterioration represented somewhat of a return to more normalized results, since 2020 auto results, both personal and commercial, reflected a decline in vehicle traffic on state and interstate roadways due to the pandemic.

Improvement in Operating Results

The DPSL composite's operating results in 2021 were stimulated by the improvement in underwriting performance. An improvement of more than $800 million in the composite's net underwriting profit was the primary reason for the $1.0 billion increase in pretax operating earnings (**Exhibit 13**). Net investment also improved but only by a modest 4.2%, far short of the improvement in underwriting profitability. On the other hand, because of its decidedly worse underwriting performance, the overall P/C industry generated a pretax gain 8.1% lower in 2021 than in 2020, going from a $5.3 billion underwriting profit to a $4.1 billion loss.

An increase of almost 25% in net premium volume for surplus lines insurers, in a year when many of the coverage lines its insurers write were under upward pricing pressure, provided DPSL insurers with a distinct benefit. The premium growth for surplus lines insurers the past two years despite the pandemic was due to a couple of key factors: (1) opportunities attributable to market dislocation that diminished the supply for the prevailing market demand for nonadmitted and specialty commercial exposures, and (2) insurers fighting hard to achieve greater rate adequacy per risk. In some cases, standard market incumbent carriers looking to avoid certain risk classes gave DPSL insurers the chance to write more accounts whose premium and coverage term specifics met their standards.

Despite the relatively modest benefit from net investment income in 2021, the composite's pretax and net operating results have traditionally reaped solid returns from invested assets. In some years, net investment income has been more than enough to offset modest underwriting losses.

Volatility in the investment markets has made it tougher for all P/C carriers, whether standard market or surplus lines companies, to find investment opportunities that generate higher income or investment yields. Nevertheless, net income for both the DPSL composite and the total P/C industry benefitted from higher realized capital gains in 2021.

Exhibit 13
US DPSL Composite – 12-Month Financial Indicators, 2020-2021
($ billions)

	DPSL Composite			P/C Industry		
	2020	2021	YoY % Change	2020	2021	YoY % Change
Net Premiums Written	16.9	21.1	24.9	659.1	720.2	9.3
Net Premiums Earned	16.0	19.2	19.9	646.1	693.9	7.4
Pure Losses Incurred	9.4	10.7	13.7	383.3	432.9	12.9
Loss Adjustment Expense	1.9	2.3	23.3	69.7	70.5	1.0
Losses & LAE	11.2	13.0	16.2	453.1	503.3	11.1
Underwriting Expenses	4.8	5.6	15.8	180.8	190.7	5.5
Policyholder Dividends	0.0	0.1	81.3	7.9	5.0	-36.7
Underwriting Income/Loss	-0.2	0.6	NM	5.3	-4.1	NM
Net Investment Income	1.6	1.6	4.2	54.4	56.6	4.1
Other Income/Loss	0.1	0.0	-98.5	1.1	3.5	214.4
Pretax Operating Income	1.3	2.3	74.1	60.0	55.1	-8.1
Realized Capital Gains/Losses	0.1	0.7	497.1	10.9	18.2	66.0
Federal Income Taxes	0.3	0.4	40.9	8.7	9.1	4.0
Net Income	1.1	2.5	131.9	62.1	64.2	3.3

NM = Not meaningful.
Source: AM Best data and research

The balance sheets of the DPSL companies remain formidable relative to risks insured—a hallmark of the surplus lines companies in general. Policyholders' surplus grew by $4.6 billion (more than 16%), primarily because net income more than doubled, to more than $2.5 billion, in addition to unrealized capital gains of more than $3.6 billion. These increases helped offset the $1.6 billion in shareholder dividends paid to DPSL members' parent companies.

Exhibit 14
US DPSL Composite vs PC Industry – Investment Performance, 2020-2021
($ millions)

	DPSL			P/C Industry		
	2020	2021	YoY % Change	2020	2021	YoY % Change
Net Investment Income	1,573	1,639	4.2	54,401	56,620	4.1
Realized Capital Gains/Losses	117	657	463.1	10,937	18,154	66.0
Net Investment Gain/Loss	1,689	2,296	35.9	65,338	74,774	14.4
Unrealized Capital Gains/Losses	1,083	3,645	236.6	40,361	91,943	127.8
Total Investment Return	2,772	5,940	114.3	105,699	166,717	57.7

Source: AM Best data and research

Even in years with extensive claims from weather-related and natural catastrophes, the impact on the surplus lines market—where coverage for property risks more exposed to these perils is often written—is generally tempered by the distribution of the composite's risks, which is heavily weighted towards liability exposures. This weighting allows the rated surplus lines carriers to maintain solid risk-adjusted capitalization despite weather-related losses, even in years of extraordinary activity.

Unrealized Gains Lead to Surge in Overall Investment Gains

As **Exhibit 14** shows, net investment income for both the DPSL composite and the P/C industry rose modestly in 2021. Investment returns in 2021 were affected by COVID-19 and its impact on global bond rates, although 2021 did benefit from stronger equity markets. The P/C industry's net income benefitted from a 66% increase in realized capital gains, although that pales in comparison to 435% increase in the DPSL's net investment income. Likewise, operating returns for both the broad industry and the DPSL composite were boosted by unrealized gains, but the boost for the DPSL was greater. The increase in both realized and unrealized gains for the composite were driven by appreciation of its common and preferred shareholdings. The DPSL composite's balance sheet strength remains solid, although that could change, given the stock market's posting its worst

loss since 1970 during the first half of 2022 and the S&P 500's closing the half down by 20.6%. The stock market began trending upward at the start of the third quarter of 2022

The composition of invested assets has been relatively stable for both the DPSL composite and the P/C industry. P/C insurers have historically maintained conservative investment strategies while remaining open to exploring alternatives in their search for yield. Common stock leverage (common stocks/policyholders' surplus) for the DPSL composite dropped substantially early in 2020 owing to the pandemic and ended that year down. However, common stock leverage returned to 2019 levels by the end of 2021. The P/C industry also experienced an increase of several percentage points in common stock leverage.

For the DPSL composite, returns on revenue and equity rose markedly, owing to the significant increases in pretax and net income. The composite's total returns (including realized and unrealized gains or losses) were more outsized and exceeded both five and ten-year averages, while pretax returns were slightly elevated from a historical standpoint but slightly less so than total returns. Because of the decline in pretax earnings, the P/C industry's pretax returns declined as well, but overall, because of realized capital gains, its total returns on both revenue and equity rose considerably in 2021 as well and were noticeably above the five and ten-year averages.

Loss Reserve Development Trends Still Favorable

Development of prior accident year loss reserves for the DPSL composite was modestly unfavorable in 2021, following two years when its favorable reserve development diminished. The overall reserve deficiency was attributable to the composite's other liability reserves, both on a per occurrence basis and on a claims-made basis, with per occurrence reserves trending more adversely. Commercial automobile liability and medical professional liability reserves also contributed to the unfavorable prior year development. For the composite, the adverse reserve development of these lines countered the favorable development on prior years' workers' compensation and homeowners/farmowners reserves. For the P/C industry, prior year reserve development has trended a little less favorably each year for several years into 2021. The less favorable development reflects a diminishing reserve cushion for the industry overall. The P/C industry's reserves reflected 1.0 percentage point of favorable development in 2021, compared to 1.1 in 2020. Nevertheless, prior year reserves for only a few lines of coverage—in particular, other liability (occurrence), and commercial auto liability to a lesser extent—needed strengthening.

The overall story for loss reserves for both the DPSL composite and the P/C industry remains the same, with the previously considerable level of favorable accident year reserve development diminishing little by little each year. Many industry observers surmise that companies may not be able to count on the benefits of prior year reserve redundancies augmenting their calendar year results for much longer. In 2021, the DPSL composite reached the point where prior year redundancies could no longer yield that benefit, and the broader industry inched a little closer. Improved pricing could help reserve development, but ongoing challenges due to the impacts of inflation on claims costs and of social inflation will likely continue to significantly pressure admitted and nonadmitted insurers to assess reserves conservatively, to limit future reserve redundancies.

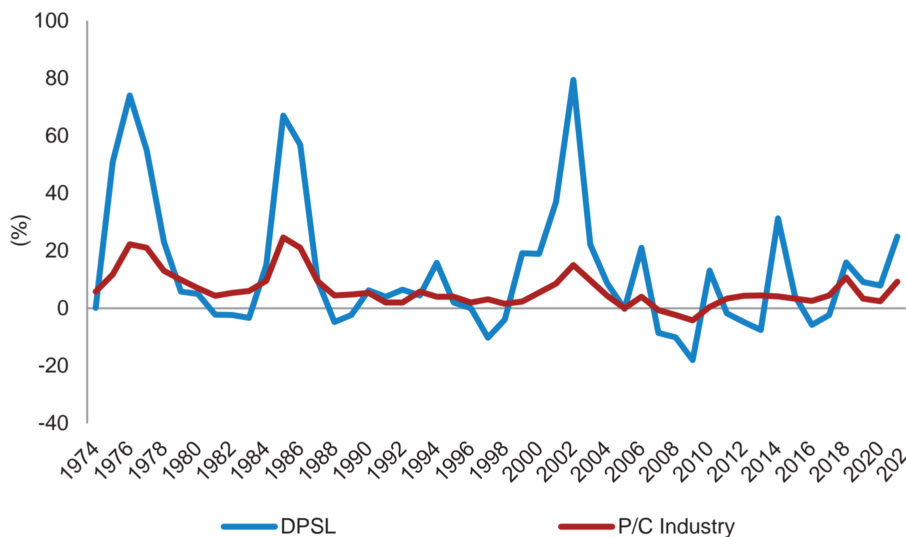
Net Earnings and Unrealized Gains Boosting Balance Sheet Strength

Higher DPW for the DPSL the last five years has driven the increase in NPW, as average pricing for many of the composite's core lines of coverage and risk classes has increased. Net premiums for the P/C industry have also risen but as a result of growth in both direct and assumed premiums written with companies that brought back onshore premium that had been ceded to offshore affiliates after the passage of the Tax Cuts and Jobs Act (TCJA) in 2017. This increase in premium retention, particularly by companies with offshore affiliates, also contributed to the increase in

the DPSL's NPW, which has outpaced the P/C industry's each of the last four years (**Exhibit 15**). However, direct premium volume, which is not affected by reinsurance or pooling agreements, provides a more accurate measure of insurer growth. The DPSL composite's direct premium volume has grown 94% the last five years, while the broad P/C industry's has grown more modestly, 23%, and in the low to mid-single digits in more recent years.

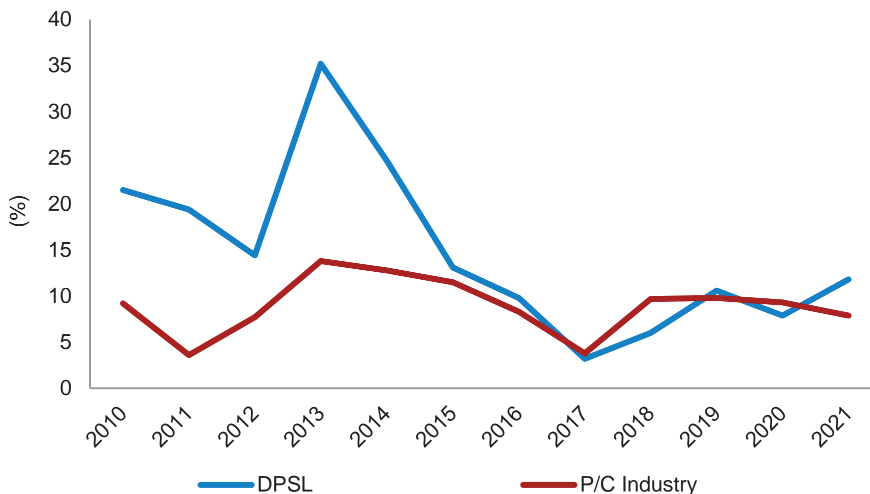
As **Exhibit 16** shows, pretax operating returns on revenue for the DPSL composite had been relatively modest and somewhat volatile the five years before 2021. On average, the returns were in line with those of the P/C industry's. After operating earnings lagged in 2020 because neither net underwriting income nor net investment income were as favorable as in 2019 (due to the pandemic), the DPSL's pretax return on revenue was slightly better than the overall industry's. Over the long term, the DPSL composite's pretax returns on revenue have generally been better

Exhibit 15
US DPSL Composite vs P/C Industry – NPW Growth, 1974-2021



Source: AM Best data and research

Exhibit 16
US DPSL Composite vs P/C Industry – Pretax Returns on Revenue (Net Premiums Earned), 2010-2021



Source: AM Best data and research

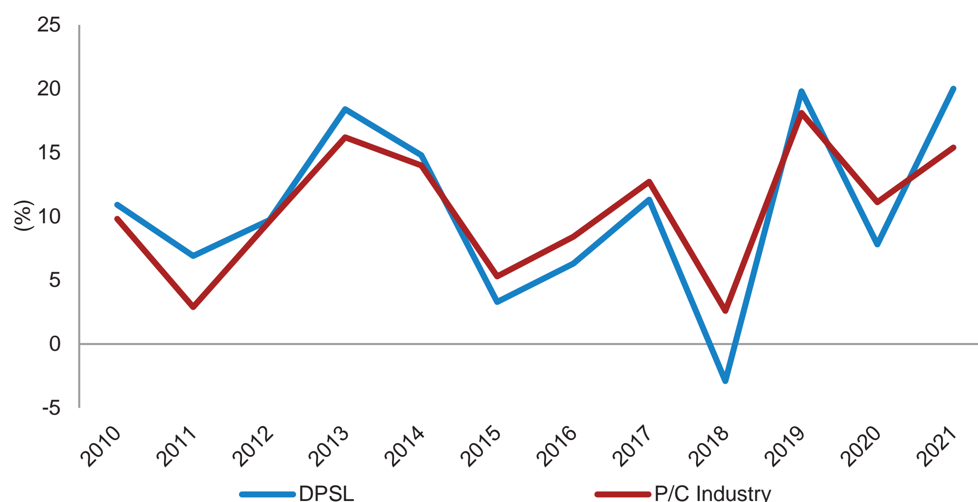
than those of the P/C industry—its return on equity (ROE) has been either modestly higher or lower than the P/C industry's aggregate returns, often reflecting differences in unrealized gains and, to some extent, stockholder dividends (**Exhibit 17**).

Dividend payouts have been significant, approximately $8.2 billion over the past five years, although companies appear to be managing dividends responsibly—the DPSL composite maintains sufficient policyholders' surplus to support its business risks. In general, dividends have generally reflected companies' overall net profitability, with payouts rising in years of higher profits for both the composite and the overall industry (**Exhibit 18**).

Historically, the DPSL's net underwriting leverage ratios have been either in line with or slightly lower than the P/C industry's. Net premium growth in recent years (driven by higher average rates) and a corresponding increase in net liabilities has caused a slight uptick in the DPSL's leverage. The composite's ceded premium leverage, however, has generally been a little higher than the P/C industry's.

Exhibit 17

US DPSL Composite vs P/C Industry – Total Returns on Surplus, 2010-2021



Source: AM Best data and research

Exhibit 18

US DPSL Composite vs P/C Industry – Investment Performance, 2020-2021

($ billions)

	DPSL			P/C Industry		
	2020	2021	YoY % Change	2020	2021	YoY % Change
Policyholders' Surplus at Prior Year End	27.3	28.5	4.5	887.4	952.7	7.4
Net Income	1.1	2.2	102.7	62.1	64.2	3.4
Unrealized Capital Gains/Losses	1.1	3.6	236.6	40.4	91.9	127.8
Contributed Capital	1.3	0.2	-85.2	9.9	6.2	-37.3
Stockholder Dividends	-2.4	1.6	NM	-46.4	-34.0	-26.8
Other Changes	0.2	-0.1	-153.9	0.7	-7.1	NM
Ending Policyholders' Surplus	28.5	33.1	16.3	952.7	1,073.9	12.7
Change in PHS from Prior Year End ($)	1.2	4.6	276.2	65.3	121.3	85.8
After Tax Return on Surplus (ROE) (%)	7.8	20.0	156.4	11.1	15.4	38.7

NM = Not meaningful.

Note: Figures may not add due to rounding.

Source: AM Best data and research

Ratings Distribution

As **Exhibit 19** shows, DPSL insurers have a higher proportion of issuer credit ratings (ICRs) in the "Exceptional," "Superior," "Excellent," and "Good" categories than the overall P/C industry. As of August 2, 2022, 100% of the ratings on the AM Best-rated DPSL rating units were in these categories, compared to 97.2% for the P/C industry.

Exhibit 19

US DPSL vs. US P/C Industry – AM Best Ratings by Rating Unit

Category	Rating Level	DPSL Rating Units	DPSL %	Total P/C Industry Rating Units	Total P/C Industry %
Exceptional	aaa	1	1.2	3	0.4
	Subtotal	**1**	**1.2**	**3**	**0.4**
Superior	aa+	8	9.4	15	2.2
	aa	7	8.2	14	2.0
	aa-	16	18.8	45	6.6
	Subtotal	**31**	**36.5**	**74**	**10.8**
Excellent	a+	14	16.5	95	13.8
	a	18	21.2	169	24.6
	a-	20	23.5	234	34.1
	Subtotal	**52**	**61.1**	**498**	**72.6**
Good	bbb+	0	0.0	39	5.7
	bbb	0	0.0	29	4.2
	bbb-	1	1.2	24	3.5
	Subtotal	**1**	**1.2**	**92**	**13.4**
Fair	bb+, bb, bb-	0	0.0	13	1.9
Marginal	b+, b, b-	0	0.0	4	0.6
Weak/Very Weak	ccc+, ccc ,ccc-, cc	0	0.0	2	0.3
Poor	c	0	0.0	0	0.0
	Subtotal	**0**	**0.0**	**19**	**2.8**
Total Issuer Credit Ratings		**85**	**100.0**	**686**	**100.0**

Domestic professional surplus lines ratings are as of August 2, 2022. US P/C industry ratings distribution data is as of June 30, 2022. Source: AM Best data and research

The percentage of DPSL insurers in the top-tier rating categories of Excellent to Exceptional remains very high—84 out of 85 rating units, or 99%. In recent years, the number of DPSL rating units has declined, owing primarily to consolidations and M&A, in addition to new reinsurance pooling agreements, which have resulted in multiple rating units merging into single rating units. However, in 2022, the total number of surplus lines rating units increased by two. Newer start-up companies have helped offset the impact of the consolidation on the overall population of surplus lines companies.

For the P/C industry overall, the number of rating units in the Excellent to Exceptional categories remains very good, at 83.8%, up from 78.1 at mid-2021. The DPSL composite's rating median remains higher, having risen in recent years to "a+," compared to the median ICR of "a-" for the P/C industry's. Only one DPSL insurer has an ICR lower than "bbb," while 43 P/C rating units have ICRs of "bbb-" or lower.

Section III – Regulation & Legislation

National Association of Registered Agents & Brokers

Despite the efforts of the WSIA and a coalition of interested industry trade partners, directors for the National Association of Registered Agents and Brokers (NARAB) have still not been appointed. NARAB was chartered in January 2015 and was designed to act as a national clearinghouse, allowing insurance producers to sell, solicit, or negotiate in states other than their resident state. The legislation directed the president to appoint 13 board members (eight regulators and five industry members), with the advice and consent of the US Senate, 90 days after January 12, 2015. The WSIA and other industry partners continue to urge the administration to send nominees' names to the Senate Banking Committee for approval and make NARAB operational. The coalition has indicated to both the White House and the NAIC that the five industry members previously nominated remain willing to serve. In addition, the WSIA has stated that it will be ready to provide additional nominees for consideration when asked.

Not all states accept resident surplus lines licenses from other states for a nonresident license in their own state. For example, obtaining nonresident surplus lines licenses in Florida by insurers domiciled in New York, and vice versa, has been particularly difficult, because the licenses are not considered reciprocal. An operational NARAB would be able to address this issue, which is critical to more uniform and efficient licensing (including surplus lines brokers) on a national level. The clearinghouse would simplify and streamline how nonresident insurance agents and brokers operate, while states maintain their authority over them. It would also eliminate burdensome multi-state requirements without eroding regulatory authority or consumer protection. Developing the system and national rules and implementing the underlying law requires a board of directors. WSIA believes there is an urgent need for NARAB to become operational.

Cannabis-Related Legislation

Thirty-seven states and Washington, DC, allow medical marijuana use; 18 states and DC also allow adult recreational use. The legal businesses in all of these jurisdictions must have viable and affordable insurance options, just like all businesses. However, there remains a disconnect between state and federal laws that continues to reduce the comfort level of financial services providers in supporting those businesses, especially because of limitations and prohibitions in the federal banking system.

On February 4, the House passed H.R. 1996, the Secure and Fair Enforcement Banking Act (SAFE) as part of the United States Innovation and Competition Act of 2021 (H.R. 4521). It was the sixth time the House passed the bill, which provides a safe harbor for entities and individuals providing legitimate financial services to cannabis related businesses in states having legalized the activity. SAFE is strongly supported by the national insurance trades as well as state insurance regulators and many other industries' trade associations.

WSIA and the coalition of interested trade partners believe SAFE is the best step forward to enable more insurance options for businesses in states with legal cannabis operations. The bill has strong bipartisan support in the House but continues to stall in the Senate as part of negotiations on broader cannabis-related social reforms. The NAIC's Cannabis (C) Working Group is working to identify state-specific activities to expand protections and offer alternative solutions in the absence of federal actions to increase coverage opportunities and options.

On April 1, 2022, the US House of Representatives again passed the Marijuana Opportunity Reinvestment and Expungement Act (MORE), legislation that would remove cannabis as a scheduled drug from the federal list of controlled substances under the Controlled Substances Act. If passed by the Senate, the legislation would implement reforms related to cannabis, including expunging the record of individuals convicted of certain marijuana-related offenses and reducing sentences for other offenses. The bill also prohibits the denial of any federal public benefit based on an individual's cannabis use or possession and bars some federally funded programs from declining to provide services to an otherwise eligible small business operating in the cannabis industry. Additionally, a tax on sales would fund services in communities most impacted by prohibition and provide support for a more diverse and inclusive market. Although current bans in other states would not be changed, full passage of the MORE Act would send a powerful signal about the importance of building on the wave of reforms that have resulted in 18 states allowing legal access to marijuana for adult recreational use in recent years.

National Flood Insurance Program (NFIP)

On March 11, the NFIP's statutory authority, including its authority to sell and renew flood policies, was extended until September 30, 2022. Since the NFIP's last multi-year reauthorization (when it expired on September 30, 2017), the NFIP has been extended 21 times, with three brief lapses.

Members of both major political parties have expressed a desire to consider deeper reforms to the programs, particularly after the 2021 changes by the Federal Emergency Management Agency (FEMA) on pricing for the NFIP (Risk Rating 2.0). However, the consensus is that we will continue to see short-term extensions for some time.

After the November mid-term elections, we may see greater reforms and a long-term reauthorization. WSIA and other industry participants advocate reform and reauthorization efforts that would support a robust and healthy private flood insurance market. A key aspect of legislative reform would be allowing consumers to freely move between the NFIP and private market in securing coverage, while still being deemed to have continuous coverage. Maintaining continuous coverage is a critical element for mandatory coverage for some federally backed mortgages and to maintain a grandfathered rating in the NFIP. Another provision that would significantly benefit consumers is one that would allow the NFIP to return premium to a consumer who leaves mid-term for the private market. Long-term reauthorization of the NFIP with such provisions would benefit both the NFIP and private market while also encouraging greater voluntary take-up of flood insurance.

Evolution of Cyber Legislation

Because of the ever-growing complexity of cyber risk, cyber insurance is becoming a critical element of businesses' risk management strategies. As an important part of the ecosystem, insurers need to develop and frequently re-assess their appetites and guidelines for cyber risk. Companies making risk management decisions also need to place acceptable limits on the types of accounts they are targeting, by industry, geography, size of the insured, etc. Underwriting practices need to clearly identify risk controls, for example using multi-factor authentication (MFA), securing open ports, patching policies, accessing controls, training, etc. In some cases, MFA has become a minimum necessity for obtaining cyber coverage.

Regulations such as California Consumer Privacy Act (CCPA), the California Privacy Rights Act (CPRA), Europe's General Data Protection Regulations (GDPR), and many other rules hold organizations to specific standards as they collect store, process, and transfer consumer data. In some cases, non-compliance can lead to regulatory investigations, lawsuits, fines, and settlements, and may provide plaintiffs a path to pursue private rights of action.

The CCPA was signed into law in 2018, creating new privacy rights for Californians, along with significant new data protection obligations for businesses. The law went into effect on January 1, 2020, with enforcement authority held by California's Office of the Attorney General. The CCPA differs from Europe's GDPR in that it lack's some of the latter's more onerous requirements (such as the 72-hour window in which a company must report a breach), but in some ways takes a broader view of what constitutes private data.

The CCPA provides a non-exhaustive list of categories for personal information that include the following:

- Any identifying information, including real name, postal address, unique personal identifier, online identifier, email address, social security number, driver's license number, passport number, or similar identifier
- Commercial information, including records of personal property, products, or services purchased
- Biometric information
- Internet or other network activity information, such as browsing history, search history, and information about a consumer's interaction with a website, application, or advertisement
- Geolocation data
- Professional or employment-related information
- Education information

The CPRA expanded the definition of "personal information" to include a category for "sensitive personal information." This includes a consumer's account log in, financial account, debit card, or credit card numbers in addition to their social security, driver's license, state identification card, and passport number.

Consumers retain certain critical rights over their personal information under the CCPA/CPRA, among them:

- Notice at Cancellation: A business that collects a consumer's personal information must disclose at or before the point of collection the categories of information it will collect and how it will use that information.
- Privacy Policy: Covered businesses must provide, in an online privacy policy or on an internet website, an explanation of consumers' rights under the CCPA and how they may exercise those rights.
- Right to Know: The CCPA grants consumers the right to request information from businesses about the following:
    - Personal information the business collects about them
    - Sources from which the information was collected
    - The business or commercial purposes for which the information was collected or sold
    - The categories of third parties to whom personal information was disclosed
    - The "specific pieces" of information collected, in addition to various other rights
- Deletion: With some exceptions, consumers have the right to request that covered businesses and their service providers, contractors and third parties, as applicable, delete personal information collected about them.
- Correction of Inaccurate Information: The CPRA expanded consumers rights with respect to request that a business correct inaccurate personal information.
- Opt Out: Under the CCPA, consumers can opt out of the "sale" of their personal information

Through the beginning of July 2022, at least 40 states and Puerto Rico introduced or considered more than 250 bills or resolutions deal significantly with cyber security, according to the National Conference of State Legislatures; 23 states have enacted at least 40 bills so far. The most common legislative provisions are the following:

- Requiring that government agencies
    - Implement cyber security training
    - Set up and follow formal security policies, standards and practices
    - Have incident response plans in place
    - Provide mandatory training for employees
    - Report security incidents, including ransomware attacks
- Providing funding for cyber security programs and practices in state agencies, local governments, and schools
- Mandating security practices relating to elections
- Establishing or supporting programs or incentives for cyber security workforce training and education programs

In 2017, New York was the first state to implement a comprehensive insurance industry cyber security regulation; soon thereafter, the NAIC introduced its Insurance Data Security Model Law. Twenty-one states have implemented the NAIC's model; others are working to advance legislation in their states.

Select State-Specific Surplus Lines Legislation

Alaska

The Alaska Surplus Lines Placement List was reissued in Order R22-01 on January 19, 2022 with the addition of "professional media liability" and "construction weather parametric" to the placement list.

Arizona

HB 2612 removes certain arbitrary criteria listed as necessary to achieve certain occupational licensing, including being "trustworthy" to be eligible for a surplus lines broker license. The bill passed and is expected to become effective September 24, 2022.

California

The California Department of Insurance (CDI) issued a Notice on March 14 strongly urging all insurance companies that transact business in California to act promptly by reviewing their financial holdings and taking immediate steps to identify and divest from any direct investments in Russian assets or property that have could provide revenue or other financial support for Russia. The notice is directed at both admitted and nonadmitted insurance companies.

The CDI issued a Notice on March 11 on the FAIR Plan, the property insurer of last resort, and whether a diligent search of the "normal insurance market" should be conducted before a licensed producer may place insurance with the plan. The notice addresses a document issued by the FAIR plan on November 23, 2021, which mandates that risks should be submitted to the FAIR Plan for coverage after making a diligent search of the normal insurance market (defined as both the admitted insurers and licensed surplus lines brokers). The notice served as a reminder that a diligent search is mandated under California Insurance Code section 10093(a). However, the clarifying CDI notice states that even though brokers submitting FAIR Plan applications may have to certify that a diligent search of the normal insurance market was conducted, "it is the view of the Department that brokers are not statutorily required to prove to the FAIR Plan that their search was 'diligent.'" Similarly, the notice asserts that brokers do not have to prove that insurance in the normal market was "unavailable."

Colorado

HB 22-1111 requires that insurers provide additional time and flexibility in rebuilding or replacing an insured residence and its contents, as well as additional living expense coverage, costs of additional building code upgrades, and a way to contact the insurer directly. The bill would apply to homeowners' policies in the event of a total loss in a wildfire declared disaster area; it does not specify its applicability to surplus lines policies.

Florida

SB 1728 and HB 1307 would have established whether an eligible surplus lines insurer may participate in the depopulation program of the Citizens Property Insurance Corporation in the same manner and on the same terms as an authorized insurer under elevated capital and surplus requirements, additional filing requirements, and other requirements. Both bills contained several other property insurance provisions, all of which failed to pass.

SB 1402 and HB 951 would have established eligibility requirements for US surplus lines insurers (DSLI). HB 951 was a more traditional DSLI bill that would have permitted a surplus lines insurer to write surplus lines insurance in its domiciliary state of Florida, whereas SB 1402 would have permitted a domestic admitted insurer to become eligible as a DSLI without a prohibition on continuing to write admitted business in the state. Both bills were subjected to numerous amendments, but neither was passed before the end of the legislative session.

SB 156 would provide technical amendments to 2020 legislation, requiring the provision of loss run statements to personal lines insureds within a specific period, including insureds covered by surplus lines policies. Amendments specify that the surplus lines licensee on behalf of the insurer could provide the loss run statements. The bill became effective on June 24 by signature of the governor.

Georgia

The Georgia Office of Commissioner of Insurance and Safety Fire (OCI) issued Directive 22-EX-3 warning that entities must be licensed before selling, soliciting, or negotiating insurance in Georgia. The directive mandates implementation of a tiered fine schedule on July 1, 2022, for any person or entity selling, soliciting, or negotiating insurance in Georgia without a license.

On January 21, the OCI issued Directive 22-EX-1, requesting data from nonadmitted insurance companies to assist with the reconciliation of premium written by nonadmitted companies with premium reported by tax filers. Data should be submitted through SLIP 90 days after the end of the quarter for foreign insurers and annually by June 30 for alien insurers.

The OCI issued Bulletin 22-EX-2, urging all licensed insurance companies to review their financial holdings and operations to begin the process of identifying and divesting from any investments or operations in Russian assets or operations that may provide financial support for Russia.

Illinois

SB 1571 amends the Foreign Fire Insurance License Fee Act and shifts the administration of the fee from the Illinois Municipal League to a foreign fire insurance board. The Illinois Municipal League has long provided an exemption from the fee for nonadmitted policies; however, whether such an exemption will remain when the administration of the fee shifts to the independent board is unclear. The bill was signed by the governor in May and will take effect January 1, 2023.

HB 2739, which was approved in early May with a January 1, 2023, effective date, will facilitate the placement of private flood insurance and exempt surplus lines flood placement from the diligent search requirement. Prior to its approval, the bill was amended to remove the diligent search relief but contains a provision that requires the producer, surplus lines broker, or insurer inform the insured of the existence of the NFIP prior to placing the private flood insurance.

Kentucky

The Department of Insurance issued draft amendments to Section 806 Kentucky Administrative Regulations 10:030 that modify surplus lines affidavit filings. Currently, affidavits must be filed within the 15 days after the transaction's invoice date or effective date; the draft amendments would require filing the affidavit within 15 days after the effective date, eliminating the invoice date option. The regulation would also reinstate quarterly zero-premium reports for all licensed brokers. Both provisions had been negotiated by WSIA with department staff when the regulation was reviewed in 2019. WSIA submitted comments and worked with local stakeholders to encourage flexibility and, in January 2022, the Department of Insurance indicated it was withdrawing the regulation until the end of the legislative session when it would schedule a call with the industry to find a mutual solution.

Louisiana

SB 162 would have prohibited cancellation and non-renewal of any admitted or nonadmitted insurance policy in a declared disaster area until 90 days after the property is repaired. The law would have been applicable to both personal and commercial lines of insurance in an area subject to a declared state of emergency that had been damaged by a named storm or windstorm. A structure subject to the law would have been considered repaired only after it was insurable under a similar property policy offered by another insurer operating in Louisiana, except for the Louisiana Citizens Property Insurance Corporation, the residual property market in Louisiana.

The bill ultimately failed after it was referred for a summer study. Industry was highly concerned with the bill's language and the potentially negative unintended consequences and worked

together to help the legislature understand these concerns. In particular, they were concerned the bill could have a significant impact on the insurance capacity in Louisiana, which is already experiencing loss and reductions in capacity. WSIA collaborated with the Louisiana Surplus Lines Association to advocate for exemptions and carve-outs or other significant amendments to SB 162.

SB 21 requires that nonadmitted insurers comply with statutory contact information requirements to enable their placement on the approved unauthorized insurer list. It was signed by the governor and becomes effective January 1, 2023.

SB 105 required that an insurer writing property, casualty, and liability policies mail or deliver to the insured at the mailing address on the policy, a notice of renewal, rate increase, change in deductibles, reduction in limits, or change in coverage at least 30 days before the policy's expiration date. It also provided that if an insurer failed to provide the 30-day notice, the expiring policy and its rates, terms, and conditions would remain in effect until the insurer gave notice or until the insured obtained replacement coverage, whichever occurs first. The bill did not pass.

SB 134 clarifies that prohibited use coverage shall be triggered when a civil authority issues either a formal evacuation order or another public safety announcement that the area should be evacuated because of a covered peril. The bill passed the Senate and is still under consideration in the House.

SB 198 requires that if after a third adjuster is assigned during a catastrophe, the insurer must have a summary of the claim disposition up to that point, with information such as the undisputed amount to be covered and a list of issues that remain in dispute. The bill passed and became effective on August 1, 2022.

HB 280 pertains to a catastrophe response plan or a plan that describes how an insurer will respond to a catastrophe affecting its policyholders. Such a plan must be maintained by the following entities: every insurer writing any form of commercial, residential property, automobile, marine, or inland marine insurance coverage; insurers writing life or accident and health insurance; health maintenance organizations; managing general agents; and third-party administrators. The bill did not pass.

On January 24, the Louisiana Department of Insurance (LDI) issued Directive 219, directing all authorized and surplus lines insurers of their obligation to comply with La. R.S. 22: 1704(E)(2), which grants insureds the right to hire a public adjuster to help them meet the requirements of their insurance policies. Insurers, as defined in La. R.S. 22:46(10), include every person engaged in the business of making insurance contracts.

Maryland

WSIA was heavily involved in the introduction of HB 563 and SB 572 in an effort to modernize the existing cap of $100 on personal lines and $250 on commercial lines surplus lines policies. In 2021, conversations held with various stakeholders indicated an openness to reasonable changes to the existing policy fee caps. An agreement was reached on legislation that would raise the personal lines cap from $100 to $200 and the commercial fee cap, from $250 to $500 or 7%, whichever is greater. It would also codify no fee caps for surplus lines policies sold to exempt commercial purchasers. WSIA initially sought to remove the fee caps entirely but eventually agreed upon the outlined compromise. The bill is set to take effect on October 1, 2022.

Because of the legislation, the Maryland Insurance Administration has indicated that it will begin requiring brokers to specify their policy fees when filing policy information. Maryland law already specifies that the policy fee charged and retained by the surplus lines broker must be reasonably related to the cost of underwriting, issuing, processing, and servicing the policy, regardless of the statutory fee cap.

Massachusetts

SB 303 and H 1082 eliminates the requirement for an affidavit for any insurance or coverage under an insurance policy procured by a special insurance broker if the special insurance broker has previously completed one, or if the policy is renewed, continued, or extended by the same insurance company.

H 1050 would exempt several admitted commercial risks from rate and filing requirements. WSIA and the NESLA submitted testimony offering an amendment to the bill that would also exempt the same risks from diligent search requirements when placed in the nonadmitted market. This bill was passed by the Joint Committee on Financial Services.

SB 720 and H 1133 facilitates the placement of private flood insurance and would allow a surplus lines broker to place flood insurance without making a diligent search of the admitted market.

Michigan

SB 461 provides for the licensing and regulation of medical marijuana growers, processors, provisioning centers, secure transporters, and safety compliance facilities. It mandates that financial security requirements be provided by a licensed insurance company or licensed captive insurance company. However, the marijuana regulatory agency cited in the bill has indicated that it would accept nonadmitted policies if marijuana licensees are unable to secure insurance in the admitted market. The bill became effective March 30, 2022.

Minnesota

HF 4245 clarifies a licensing statute that an eligible surplus lines insurer has not assumed a risk if premium for the risk has never been transmitted to the surplus lines insurer. The bill also clarifies that surplus lines insurers and brokers are exempt from the statute regarding agent appointments.

Mississippi

HB 451 would re-allocate funds derived from the 3% nonadmitted policy fee. Between July 1, 2022, and July 1, 2026, annual revenue of $8 million would be remitted to the Mississippi Windstorm Underwriting Association and the remainder to the state general fund. The bill would also allow the association to use excess funds to purchase reinsurance in an amount that may exceed the total premiums collected from policyholders. The bill became effective July 1, 2022.

Montana

HB 63 makes technical changes to the surplus lines insurers' eligibility statute, renaming the NAIC "Non-Admitted Insurers Quarterly Listing" as "Quarterly Listing of Alien Insurers." The bill became effective July 1, 2021.

New York

S 8128 and A 9117 permit a waiver of the diligent effort requirement in limited circumstances for certain insurance coverage to be placed by licensed excess line brokers with unauthorized insurers, if a retail insurance broker seeks to procure or place commercial lines insurance through an unaffiliated wholesale excess line insurance broker. WSIA supports both bills, each proposed at the request of the Excess Line Association of New York.

S 8127 and A 9088 would simplify the affidavit requirements for excess line insurance placement by reducing the number of data points required on the affidavit. The WSIA supports these bills, both of which have been proposed at the request of the Excess Line Association of New York.

S 3079 and A 7488 prohibit the exclusion of coverage for losses or damages caused by exposure to lead-based paint. It provides that no insurer licensed or permitted by the superintendent to provide liability coverage to rental property owners can exclude coverage for losses or damages caused by exposure to lead-based paint. Whether the legislation as drafted would apply to surplus lines policies is unclear.

North Carolina

SB 496 is an omnibus insurance bill that includes provisions related to disaster declarations. Premium collections and cancellations for property and casualty companies would not be eligible to resume until 15 days after the expiration of a disaster emergency, and deferral provisions would apply to surplus lines policies. The bill contains similar provisions for public health emergencies. The underlying law, which had already laid out requirements for proof of loss statements and premium deferrals in the event of a disaster, was previously interpreted to apply to surplus lines policies. The bill was signed, with most provisions becoming effective by October 1, 2022.

Ohio

SB 256 regulates travel insurance and specifies that surplus lines taxes associated with travel insurance must be paid in accordance with ORC 3905.30 to 3905.38 (the revised surplus lines code). The bill became effective July 21, 2022.

Oklahoma

HB 3275 makes changes to the Oklahoma Market Assistance Association and requires that surplus lines carriers offering homeowners' or homeowners' liability coverage in the state be members of the association. Association members are required to quote, at a minimum, one out of every five applications referred to them within 10 working days. Assessments of participating insurers fund the operations of the association. WSIA worked with the Oklahoma Insurance Department to amend the bill, eliminating surplus lines insurers from mandatory participation. The bill did not pass.

SB 1592 creates an Educators' Professional Liability Insurance Program for full- and part-time personnel employed by a public school district and a public charter school. The program will provide employees liability coverage of up to $1 million in coverage per occurrence. The Office of Management and Enterprise Services will administer the program and may contract liability insurance from a licensed insurer, create a self-insured risk pool, or use a combination of both. The bill did not pass.

Rhode Island

HB 7752 would make a clarification to a surplus lines licensing law that would permit surplus lines brokers to place certain accident and health policies. The bill became effective on June 30, 2022.

South Carolina

S 432 states that a liability insurer owing a duty to defend an insured against a claim, suit, or other action, has a right of contribution for defense costs against any other liability insurer owing a duty to defend the insured against the same claim, suit, or other action. This holds true, provided contributions are not sought from any liability insurer for defense costs that are incurred before the liability insurer receives notice of the claim, suit, or other action. The bill is applicable to all liability policies issued in South Carolina including those issued by surplus lines insurers.

Utah

The Department of Insurance is amending Rule R590 with technical changes, in addition to codifying a $10 late fee for late stamping office filings.

Section IV – Current Distribution Trends

Wholesale insurance brokers and managing general agents (MGAs) remain essential to the insurance distribution model, facilitating transactions involving specialized nonadmitted insurance products and services. Along with a hardening insurance market (except for a few lines of coverage such as workers' compensation), COVID-19 has greatly increased demand for the expertise and services of insurance intermediaries.

Among the key issues and trends currently shaping the surplus lines intermediaries industry are the following:

- Consolidation among insurance brokerages and other intermediaries
- Hard market conditions
- The changing role of insurance brokers
- Recruiting and developing talent amid a changing work environment
- Data security

Competition from Ongoing Market Consolidation

Interest in insurance brokerage targets remained high in 2021, especially for MGAs and managing general underwriters (MGUs), following a record-setting year for deals in 2020. Since the onset of the pandemic, the insurance broker segment has been very profitable and—most importantly—adaptable. Brokers' agility dealing with new operating and work environments for themselves and for their clients, while maintaining a high level of attentiveness and service, has impressed potential acquirers.

As a result, insurance brokerage has been driving insurance-related M&A, further increasing distributor consolidation. Well-capitalized acquirers, particularly private equity firms, have created steady competition for available insurance assets. This interest has resulted in high multiples for insurance brokerage targets, with momentum continuing into 2022. However, inflation concerns, the struggling private equity market, and the impact of rising interest rates on the bond market could pose difficulties for insurers struggling to generate desired investment returns. Companies that are able to rebalance their portfolios and generate sustained earnings will be more appealing for acquisition.

Hardening market conditions and rate/pricing increases in many lines of P/C insurance, particularly in specialty commercial segments, have resulted in a rise in brokerage valuations. Since rate increases generally equate to greater commissions, they also serve as a tailwind for the brokerage segment. Rising interest rates may dampen valuations, although this may be countered by more interest from private equity and other investors.

Disruptions in the market owing to climate/weather events are causing companies to re-think their retentions for different risk classes. Lower retentions lead to the need for more coverage. Rate increases and greater uptake on insurance coverage provide additional opportunities for brokerages to grow revenues.

Mega-deals involving insurance distributors have come under growing regulatory scrutiny, however, especially in the US. The Aon and Willis Towers Watson merger ultimately collapsed under the weight of scrutiny from the US Department of Justice during the summer of 2021. However, Willis was still able to sell its Willis Re operations to Arthur J. Gallagher in December

Production Sources

During the second and third quarters of 2022, AM Best sent surveys to the insurers writing the majority of surplus lines business to obtain information about the most common production sources generating surplus lines premiums in 2020 and 2021. We received responses from companies accounting for approximately 36% of all US surplus lines premium. Many of the global or national insurance groups that collect data on premiums written by their various companies on an overall or group basis, and therefore do not track their surplus lines premiums separately from their admitted market premiums, did not provide data.

Survey results for 2020 and 2021 were similar (**Exhibit 20**), with some variances. In 2021, wholesale brokers without binding authority remained the primary surplus lines distribution channel for the survey respondents, accounting for approximately 57% of surplus lines premium, on par with 2020. Wholesale brokers with binding authority accounted for about 20% of premium, down from almost 25% in 2020. Premium generated by program managers rose slightly, to 10.0% from 8.7% in 2020, and by retail agents/brokers, to 12.6% from 9.1%. Program managers remain a valuable source of niche surplus lines business. For insurers, they are additional distributors that control books of business and are ideal partners with which companies can partner to develop the kind of specialized coverage for which surplus lines insurers are known.

Exhibit 20
US Surplus Lines – Leading Production Sources by DPW
(%)

Production Source	2020 % of Total	2021 % of Total
Wholesale Agent/Broker Without Binding Authority	57.2	56.8
Wholesale Agent/Broker with Binding Authority	24.5	19.8
Program Manager – Retail or Wholesale Agent/Broker	8.7	10.0
Retail Agent/Broker	9.1	12.6
Direct Procurement	0.2	0.2
Other	0.3	0.5
Total	**100.0**	**100.0**

Note: Figures may not add up to 100 due to rounding
Source: AM Best data and research

2021. The big four insurance brokerages—Aon, Marsh, Willis, and Gallagher—continue to grow via acquisitions, but consolidations involving smaller and mid-tier brokerages also bear watching. Additionally, the number of active buyers diminishes significantly once a certain valuation threshold is crossed (probably in the neighborhood of $10 billion).

According to data from Optis Partners LLC, M&A among insurance brokerages increased over the last nine months of 2021 after dipping in the first quarter, to cap off a record-setting year. Optis reported 384 fourth-quarter transactions involving US and Canadian brokerages, third-party administrators, and MGA operations, a 26% increase over fourth quarter 2020. For full year 2021, the number of deals came to 1,034, up 30% from 795 in 2020. Additionally, private equity-backed transactions accounted for 76% of the deals, up from 70% in 2020. Over the last few years, private equity has been responsible for most of the growth in transactions. Of the 14 buyers involved in acquisitions in 2021, all but one (Gallagher) were private equity/hybrid firms. The top 10 organizations or brokers by revenue accounted for more than half the deals that took place in 2021: 592.

Consolidation throughout the entire distribution chain—wholesalers, retailers, underwriting managers, and MGAs—remains among the foremost concerns of surplus lines intermediaries. Sellers approaching retirement age are concerned about the perpetuation of their businesses. The need to consolidate reflects the difficulty of attracting new generations to the field. More expansive efforts throughout the distribution chain have been made to bridge this gap.

Other factors spurring M&A in the segment include the following:

- Consolidation expands scale, which can lead to greater specialization and can enhance efficiency and make a company more competitive.
- The cost of accessing new technologies to improve digitization can be prohibitive for smaller

and medium-sized brokers, making a merger more advantageous.
- Adapting to growing and more complex regulatory requirements can bring investing into new digital technologies into play
- Larger brokers may seek more specialization to enrich their product offerings, which can lead to more growth.

Given the amount consolidation in the insurance industry the last several years—especially the pace of specialty distributor acquisitions—this issue will remain an important one over the near to medium term. Deals involving larger, publicly traded firms make the headlines, but consolidations at the local level by retail and wholesale agents and brokers are just as meaningful to the surplus lines market and could help drive a higher number of transactions in 2022.

Challenges Owing to Hard Market Conditions

Premium for most personal and commercial product lines is growing, although the growth is likely to moderate somewhat by the end of the year. Supply and demand dynamics remain the reason for the rise in pricing, as fewer insurers compete for business in risk classes that have generated above-average losses or troubled lines of coverage in different states/territories. Some insurers, particularly incumbents, insist that premium increases are still needed to compensate for losses on accounts/lines of coverage that have generated unfavorable results over a prolonged period. In the commercial segment, rate increases for higher-hazard risks are still above average in comparison to the broad market.

The cyber market continues to see substantial rate increases and narrower coverage terms and conditions due to deteriorating loss experience, driven in large part by pandemic-inspired remote work environments. Renewal rate hikes of 25% were commonplace at the start of 2022 owing to unfavorable claims experience. Through June, admitted market rates were up by 4% to 8% on average, while excess and surplus lines rates rose 10% to 20%, and property rates rose by 15% to 35%, according to independent broker Brown & Brown. These events add to the challenge brokers face finding adequate coverage for their clients at premiums they find reasonable for continually evolving cyber risks.

Economic and social inflation are also creating challenges for insurance distributors—social inflation has manifested in larger compensation amounts in liability cases. One critical element for distributors is managing policyholders' expectations about the cost of insurance coverage and the factors involved in claims. Adverse judgments have also resulted from an expansion of the definition of tort liability that is not normally contemplated in pricing, which can then lead to companies charging higher premiums because of higher claims costs.

Financially, insurance distributors tend to benefit from hard markets, as higher premiums mean higher commissions and income. A hard market also gives brokers and MGAs a chance to differentiate themselves from their competitors. During soft markets, many clients may stay with their agents because of their satisfaction and low prices. During a hard market, the level of service provided becomes the primary differentiator among companies. Demonstrating expert services and having clients invest in those services can help distributors flourish despite tougher market conditions. Good retention practices—meeting a client's needs via account rounding and taking advantage of new opportunities presented by policyholders unhappy with their current brokers—will help distributors come through hard market conditions in good shape.

Changing Role of Insurers

The role of the insurance broker has changed over the years, from simply brokering transactions, to providing risk management strategies, serving as valued advisors, and helping clients understand the insurance market to better manage expectations. Brokers now strive to educate consumers,

which doesn't always coincide with getting the best price. Instead, the aim is to help business owners engage their employees and enhance the overall quality of their operations, which will make them more attractive to insurance carriers.

Insurance brokers and MGAs are also identifying new and more inventive ways to help their clients. As brokers engage with clients on a deeper level, they will be better able to explain to insurance companies how their insureds differ from others in their risk class and why they are a better-than-average risk—skills that are particularly useful during a hard market. Although average renewal rates are rising because of market conditions, they will rise less for clients able to demonstrate that they are a better risk for the insurance companies.

Attracting New Talent in the Remote Work Environment

As more work environments evolve into hybrid, if not largely virtual, workplaces, insurance companies and distributors will need to continue enhancing their digital capabilities. People in all types of industries can now work from home and maintain a high standard of quality. Workplaces that try to return to the traditional office model may find attracting the best and brightest difficult.

For insurance intermediaries, the transformation to a flexible/hybrid workforce requires adept planning and the realignment of resources, policies, and infrastructure to accommodate employees, even as companies maintain their primary function of serving clients, as well as partnering with insurers. Different job functions require different levels of flexibility, depending on the tasks involved. Focusing on people, not jobs, is important to cultivating the agility and adaptability likely to be needed as business operations continue to evolve. In the insurance market, this may call for a considerable shift in recruiting and managing talent. Companies that offer the flexibility employees want will be more successful attracting top-level talent. A focus on recruiting efforts for the skills necessary in the new world will be paramount.

As we head towards 2023, intermediaries that have already found ways to take advantage of the virtual environment (by investing in specialized equipment for next-level remote work, for example), are enhancing their capabilities for real-time collaboration. Brokers with strong call center operations and robust technology platforms have fared well compared with brokers that rely more on feet-on-the-street models. Many MGAs and MGUs have been able to develop advanced work distribution frameworks with flexible working schedules because they have been transparent with their staffs about work expectations and deadlines. Effective communication is a critical element for successful hybrid operations. More and more customers of all ages—not just Millennials or Generation Z—are shopping for all types of products online, insurance included. Agents and brokers that are adept at reaching existing customers and prospects via online platforms will most likely reap positive results.

Growing Threat from Cyber

Every business that maintains electronic data or systems is at risk of a cyber attack or data breach that could significantly cripple its operations and cause substantial harm to its reputation. Cyber risk is still a relatively new peril, so insurers lack a deep trove of historical data about the likelihood and cost of cyber events, which makes underwriting and pricing coverage more difficult. It also makes the job of insurance intermediaries tougher as they are looked upon to provide advice on risk assessment, management, and mitigation. Despite numerous technological advents to provide protection, there is still a tremendous amount of uncertainty about how companies in different industries can protect themselves against cyber breaches.

Insurance brokers, retail agents, and insurance companies are coordinating efforts to deal with growing buyer demand in the wake of the highly publicized cyber breaches of the last few years.

These efforts include educating policyholders on risk management measures to proactively address the constantly evolving threat. As remote work grows, so will the cost of a data breach—and those data breaches will take longer to detect and identify.

MGAs' Value in a Hardening Market

Cyber attacks, climate-related concerns, and inflation are just a few of the volatile factors fueling demand for more specialized coverage, which underscores the premium growth prospects for the overall MGA segment. MGAs and other intermediaries that are delegated with binding authority—DUAEs, or delegated underwriting authority enterprises[1]—have long been an important part of the insurance value chain, helping insurers find accounts that fit their risk appetite and product offerings, in addition to contributing to bottom-line profits. MGAs and other DUAEs have been used to drive some of the transformation in the industry, enhancing the value offered to individual customers and businesses as it moves away from more traditional functions and typical ways of conducting business.

AM Best estimates that premium written through the MGA market in the United States reached $60 billion in 2021, up from $51 billion in 2020. This followed the economic growth story in 2021, as lockdowns lifted and monetary policies eased, which contributed to real GDP growth of 5.7%. As businesses reopened, commerce resumed and the insurance industry experienced premium growth of 9.5%, attributable to the hardening of market conditions and pricing.

AM Best also estimates that premiums that move through the MGA market have doubled over the past decade. Acquisitions and consolidations of insurance distributors have led to a decline in the number of brokers, while the number of MGAs has risen. Specialized brokers have moved to MGA operations, providing insurers with a more cost-effective conduit to new markets. Some MGAs used established relationships with affinity groups and their ability to bundle risks, to provide insurers access to niche business opportunities. Among these niche opportunity areas is cyber insurance; another is providing coverage solutions relative to the increase in frequency and severity of weather-related events in recent periods, along with the impact and challenges arising from secondary perils. Inflation also has caused an increase in asset values—corporations, consumers and their agents are increasingly facing an insurance market with very cautious risk appetites. MGAs can play a vital role in matching these risks and insurers. A number of new players have entered markets such as directors & officers and cyber, as these lines have attracted capital and talent.

Given the competitive market conditions in the specialty commercial and surplus lines markets, insurers have achieved premium growth by acquiring quality books of business, expanding their portfolio offerings, and enhancing their distribution networks. Premium revenue generated through MGAs in the US has doubled in the past decade, but the number of brokers still far outweighs the number of MGAs and other DUAEs. However, the number of brokers has declined steadily (in part through acquisitions and consolidation) over the past decade, while the number of MGAs has increased, due to specialized brokers shifting to MGA operations and taking their specialty business with them.

MGAs striving for success will need to be leaner, more cost-effective, and tech-enabled. They will also need to provide expertise unique to the entity. Product innovation, actuarial capabilities, and full confidence and authority in claims handling will also be integral to their success. Discerning insurers will demand philosophical alignment with these partners as they seek to adapt to emerging market challenges.

[1]AM Best includes MGAs in the category of delegated underwriting authority enterprises (DUAEs), which groups together managing general underwriters, coverholders, program administrators, program underwriters, underwriting agencies, direct authorizations and appointed representatives.

The DUAE Market

AM Best defines a *DUAE* as a third party appointed by a (re)insurer, through contractual agreements, to perform underwriting, claims handling, and other administrative functions on behalf of its partners. DUAEs include MGAs, MGUs, coverholders, program administrators, underwriting agencies, direct authorizations, and appointed representatives. MGAs are the most common form of DUAE in the US market. Insurers typically enter relationships with DUAEs to generate growth, provide specialized market expertise, and handle administrative functions related to the business produced.

Another important distinction is whether an MGA is affiliated or unaffiliated with the insurer. An affiliated MGA is one that is 100% owned by an insurer. An unaffiliated or nonaffiliated MGA is a third party that can do business with multiple insurers. An exclusive contract with an insurer does not mean the MGA is an affiliate of the insurer.

Our analysis of the US DUAE market is based on information that insurers provide in Note 19 of the annual financial statements they file with the National Association of Insurance Commissioners (NAIC). Note 19 identifies the MGA through which an insurer has written direct premiums and provides the MGA's federal employee identification number. It also identifies whether the contract between the two parties is exclusive, as well as the type of business written, type of authority granted, and the total direct premium written by the MGA. NAIC reporting regulations for Note 19 require that companies disclose individual MGA premium data only for MGAs whose premium constitutes more than 5% of the risk-bearing entity's policyholders' surplus. Premium data and associated information for MGAs that do not reach the 5% threshold do not need to be reported on Note 19.

Section V – Impairment Trends

Financial impairments in the P/C industry rose slightly in 2021, in line with the modest volatility the industry has experience the last few years, after a prolonged period of declines. The number of impairments in 2021 was still significantly lower than the 21.2 average of impairments from 2000 through 2021. As **Exhibit 21** shows, industry impairment rates the past several years have been more in line with those in the very early 1980s. Notably, since the end of 2003, only one surplus lines company—a monoline insurer writing surety bonds for private student loans—has become impaired (in 2018).

However, AM Best believes the financial impairment frequency (FIF) is a more accurate indicator of industry impairments than a simple count. The FIF is calculated by dividing the number of companies that become impaired in a given year, by the number of companies operating in the insurance market that year. The P/C industry's 2021 FIF was 0.47, which was higher than the 0.23 FIF in 2020, but still far below the historical average of 0.82 since 1980. The FIF reached its highest point, 1.06, in 2011, which reflected the impact of soft market conditions during 2007-2010 and the Great Recession in 2007-2009.

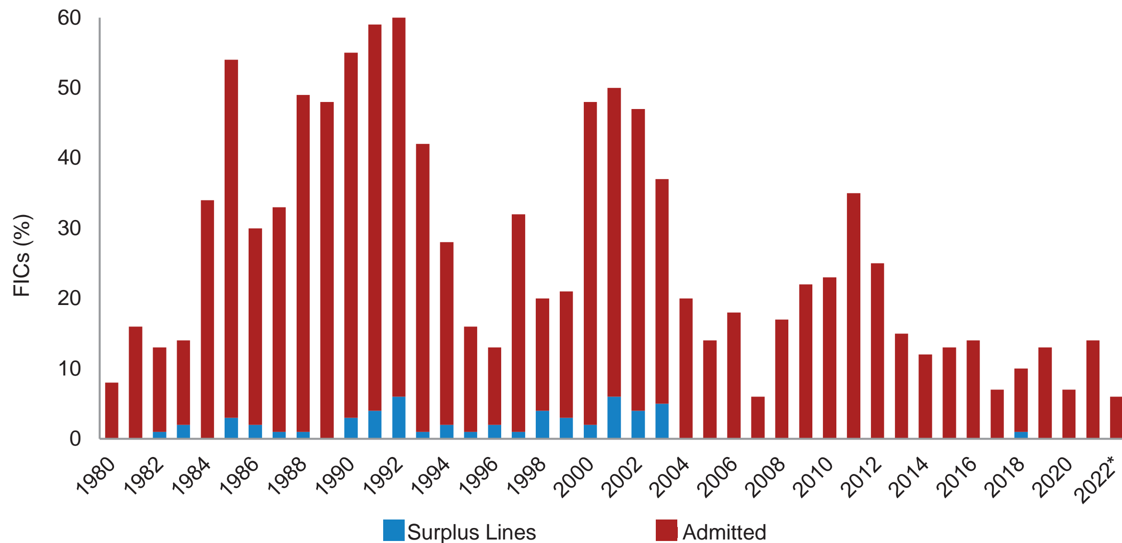
Negative operating periods for the industry tend to spark a rise in the FIF. Events such as global pandemics, stock market declines, economic recessions, or extraordinarily large catastrophe losses that typically force the end of soft markets have historically led to higher FIFs, as evidenced by a review of FIF rates in 1988-1993 and 2000-2003. The high FIF rates in 2000-2003 took place during the five-year period (2000-2005) of the highest number of impairments in the last 20-plus years. Workers' compensation and personal lines companies accounted for about half of those impairments.

The growing use of confidential actions by state insurance regulators reluctant to disclose impairments until all avenues for rehabilitation, or all efforts to find buyers for troubled insurers are exhausted, can obscure the number of recorded impairments. A reporting lag engendered

Attachment H

Exhibit 21

US P/C Annual # of Impairments, Admitted Companies vs Surplus Lines Companies, 1980-2021



FIC = Financially impaired companies.
* 2021 data is as of June 22, 2022
Source: AM Best data and research

by confidential actions could lead to a rise in the number of impairments over time. Generally, there is a lag of about 18 months on average between a confidential regulatory action and public disclosure of the impairment, usually the time between supervision and liquidation—assuming the confidential action ever becomes public at all.

Surplus Lines Impairment Trend Remains Favorable

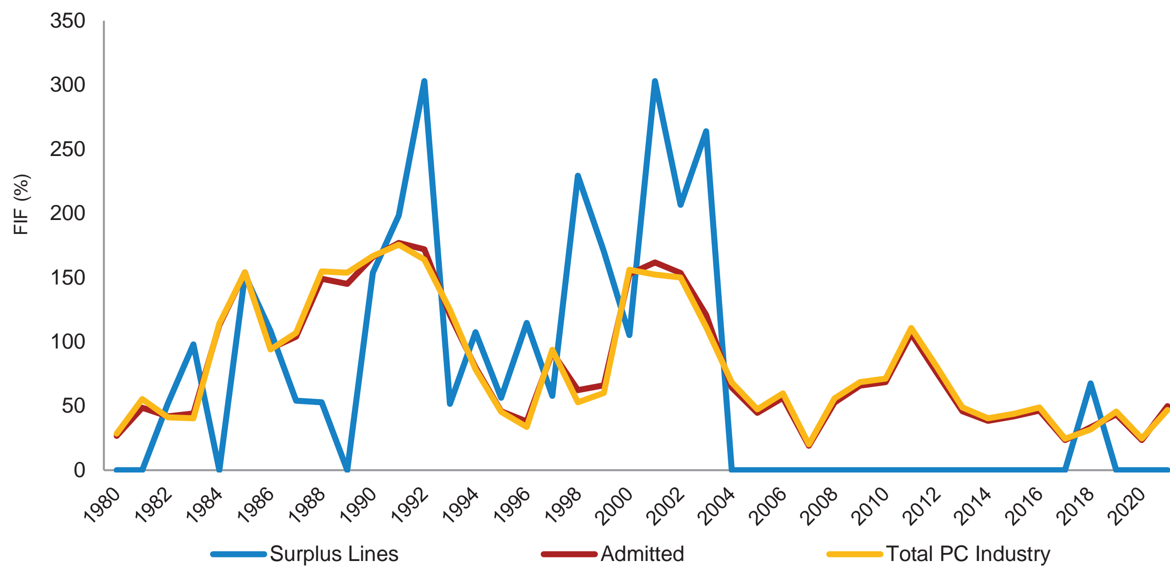
Very few surplus lines companies have become impaired over the last 20 years, although the segment's average FIF of 0.71 from 1980 to 2021 is only slightly lower than the admitted companies' 0.82 average for the period. The closeness of these impairment numbers reflects the significantly higher impairment frequencies for surplus lines at certain times—particularly in 1992, 1998, 1999, and 2001-2003 as **Exhibits 22 and 23** show.

Financial Impaired Companies (FICs) Defined

Over the past few decades, AM Best's method of identifying impaired or insolvent insurance companies has evolved. AM Best currently defines financial impairments as a situation in which an insurer has been placed, via court order, into conservation, rehabilitation, or insolvent liquidation, as of the date of the earliest court action. Supervisory actions taken by state insurance department regulators without court order are not considered impairments, unless there are clear indications that policyholder payments may be delayed or otherwise limited in some manner through the regulatory oversight process.

A number of regulatory oversight actions may be taken with respect to troubled insurers for which court orders are not sought, such as requiring company action plans, implementing a variety of forms and levels of supervision, or taking licensure actions. Companies may be subject to insurance department orders and actions on multiple occasions, particularly in certain jurisdictions. Although regulatory actions may suggest difficulties and impose constraints, they do not necessarily mean that an insurer is unable to meet its ongoing policy and contract obligations until such time as either clear direction is given by the regulator with regard to delaying or limiting policy or contract payments, or a court order is sought to place the company into conservation, rehabilitation, or insolvent liquidation.

Exhibit 22
US P/C Financial Impairment Frequency, Admitted vs Surplus Lines Companies, 1980-2021



FIF: Financial impairment frequency.
Source: AM Best data and research

Between 2004 and 2017, 241 admitted companies became impaired; however, none of them were identified as a predominantly surplus lines company. Nevertheless, surplus lines companies posted an average annual FIF only slightly lower than that of the P/C industry. In the nearly 30 years we have been publishing this annual report, AM Best has highlighted the segment's strengths, such as their underwriting discipline and the nimbleness to develop new products in real time to satisfy emerging risks. The discipline exhibited by surplus lines insures is underpinned by adherence to long-held underwriting standards and the application of judicious risk selection principles, even as varying factors have caused changes in the profiles of different risks classes. Critically, segment insurers have not succumbed to competitive market pressures during softer markets, which can manifest in rampant underpricing and questionable risk selection. This has been a hallmark of many surplus lines companies, particularly the ones generating consistently good results. More importantly, the discipline and favorable operating performance have resulted in solid balance sheet strength overall, which has helped surplus lines companies avert impairments during difficult operating periods.

Greater financial and strategic resources dedicated to improving enterprise risk management (ERM) have also had a positive impact on the ability of surplus lines companies to maintain excellent capital strength and ward off impairments. Effective underwriting has buttressed the strong overall risk-adjusted capitalization of the segment's companies, better insulating them from the occasional periods of market hyper-competitiveness—particularly when surplus lines carriers and opportunistic admitted carriers compete for high quality specialty business. Improved utilization of data analytics and other emerging technologies, along with better management reporting and more vigorous oversight, has also contributed to the decline in impairments.

Over the last ten years, the DPSL composite's underwriting profitability has varied more than that of the P/C industry, as **Exhibits 24 and 25** show. This unevenness has been driven mainly by market competition and by results in years when outsized weather-related and natural catastrophe losses have had an overriding impact on results, particularly the property-related coverage lines. Nevertheless, the aggregate surplus lines market remains profitable from an operating perspective. Both underwriting and operating performance in 2021 improved over 2020. The surplus lines

Exhibit 23

US P/C Industry vs Surplus Lines – # and Frequency of Financially Impaired Companies, 1980-2021

	Financially Impaired Companies (FICs)			Financial Impairment Frequency (FIF)[2]		
	PC Industry	Surplus Lines	Admitted Cos.[1]	PC Industry	Surplus Lines	Admitted Cos.
1980	8	0	8	0.27	0.00	0.28
1981	16	0	16	0.49	0.00	0.55
1982	13	1	12	0.42	0.52	0.41
1983	14	2	12	0.44	0.98	0.40
1984	34	0	34	1.13	0.00	1.14
1985	54	3	51	1.54	1.52	1.54
1986	30	2	28	0.95	1.08	0.94
1987	33	1	32	1.04	0.54	1.07
1988	49	1	48	1.49	0.53	1.55
1989	48	0[3]	48	1.45	0.00	1.54
1990	55	3	52	1.66	1.54	1.67
1991	59	4	55	1.77	1.99	1.76
1992	60	6	54	1.72	3.03	1.64
1993	42	1	41	1.21	0.52	1.25
1994	28	2	26	0.80	1.08	0.79
1995	16	1	15	0.46	0.56	0.45
1996	13	2	11	0.38	1.15	0.34
1997	32	1	31	0.92	0.58	0.94
1998	20	4	16	0.62	2.29	0.53
1999	21	3	18	0.66	1.70	0.60
2000	48	2	46	1.53	1.05	1.56
2001	50	6	44	1.62	3.03	1.52
2002	47	4	43	1.54	2.07	1.50
2003	37	5	32	1.21	2.64	1.11
2004	20	0	20	0.64	0.00	0.68
2005	14	0	14	0.45	0.00	0.47
2006	18	0	18	0.56	0.00	0.60
2007	6	0	6	0.19	0.00	0.20
2008	17	0	17	0.53	0.00	0.56
2009	22	0	22	0.66	0.00	0.69
2010	23	0	23	0.68	0.00	0.71
2011	35	0	35	1.06	0.00	1.11
2012	25	0	25	0.76	0.00	0.81
2013	15	0	15	0.46	0.00	0.49
2014	12	0	12	0.39	0.00	0.40
2015	13	0	13	0.42	0.00	0.44
2016	3	0	3	0.47	0.00	0.49
2017	7	0	7	0.23	0.00	0.24
2018	10	1	9	0.33	0.68	0.32
2019	13	0	13	0.43	0.00	0.46
2020	7	0	7	0.23	0.00	0.25
2021	14	0	14	0.50	0.00	0.47

[1] Includes alternative markets.

[2] Failure frequencies are annualized.

[3] 1989 figures have been revised from prior reports to eliminate seven UK-domiciled companies.

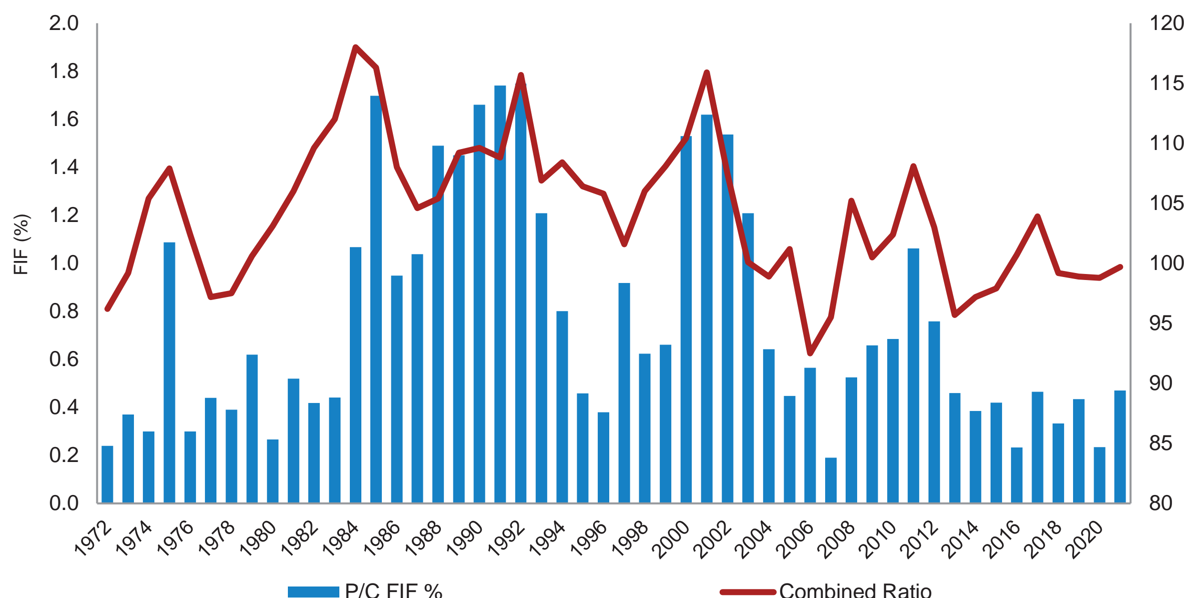
Source: AM Best data and research.

segment has consistently generated operating profits despite years when net underwriting results have suffered somewhat.

Prolonged market competitiveness and the resulting margin compression have not resulted in additional surplus lines impairments. The lack of impairments from 2004 through 2017 is

Exhibit 24

US P/C Industry – Financial Impairment Frequency vs Combined Ratio, 1980-2021



Notes: Combined ratios are after policyholder dividends. A combined ratio below 100 indicates an underwriting profit; above 100, an underwriting loss.
Source: AM Best data and research

attributable primarily to companies' overall capital strength. The segment continues to generate operating profits that have led to surplus growth, which has supported its strong risk-adjusted capitalization.

Characteristics of P/C Financial Impairments

Historically, most P/C impairments have fallen into the category of general business failure owing to some combination of poor strategic direction, weak operations, internal control weaknesses, or underpricing/under-reserving of the business. This was true for both the surplus lines segment and the admitted market.

From 2000 to 2021, more than 400 P/C insurers became impaired. AM Best was able to identify the line of business for the lion's share of those impairments. Workers' compensation led the group, accounting for about a quarter of the impairments, while personal lines insurers accounted for around 30%, split between private passenger auto and homeowners. The private passenger auto impairments were about evenly split between standard and non-standard auto insurers. Commercial lines insurers accounted for a little over 20%, split between other liability/commercial multi-peril and commercial auto. The remaining percentage of impairments were split among specialty lines.

AM Best was able to identify specific causes for about a quarter of the impairments: fraud or alleged fraud, problems with affiliates, and catastrophe losses. Investment losses were also a significant factor for some impairments.

Exhibit 25

US DPSL Composite – Financial Impairment Frequency vs Combined Ratio, 1997-2021

	DPSL FIF (%)	Combined Ratio
1997	0.58	93.8
1998	1.72	98.5
1999	1.70	99.8
2000	1.05	105.0
2001	3.54	105.3
2002	2.07	93.0
2003	2.64	92.2
2004	0.00	93.5
2005	0.00	93.2
2006	0.00	79.4
2007	0.00	76.1
2008	0.00	93.6
2009	0.00	93.1
2010	0.00	100.5
2011	0.00	105.1
2012	0.00	110.5
2013	0.00	92.4
2014	0.00	88.0
2015	0.00	100.5
2016	0.00	107.3
2017	0.00	107.1
2018	0.68	104.5
2019	0.00	99.4
2020	0.00	99.7
2021	0.00	94.1

Source: AM Best data and research

From 2021 through mid-August 2022, 12 insurers became impaired—six in Florida and six in Louisiana. These impairments were related to weather-related catastrophes and involving homeowners and commercial property risks. Florida insurers have shed policies and sought hefty rate increases because of financial losses in the state, forcing agents to find new carriers for thousands of customers. Overall, the property market in Florida has been particularly difficult, not only because of catastrophe losses but also because of roof replacement fraud and a high degree of claims litigation. Customers in the thousands have been seeking coverage from the state-backed Citizens Property Insurance Corporation (created as an insurer of last resort), because Florida carriers have either gone out of business or have drastically curtailed the types of properties they write.

AM Best remains guardedly optimistic about surplus lines impairments. Thus far, COVID-19 has not led to surplus lines impairments. Nevertheless, factors such as rising interest rates and inflationary pressures, the potential for long-term stock market volatility, and any weakening in economic conditions that negatively affect GDP growth, could be pressure points for insurance companies' combined ratios, although these factors would not impair surplus lines companies alone—at worst, they could result in erosion of insurer policyholder's surplus.

Section VI: Surplus Lines Fundamentals

This section is a primer for readers who are not familiar with the wholesale, specialty, and surplus lines market. Below, we discuss the market and the types of risks insured, industry participants, the distribution system, licensing and compliance, and market cycles.

The Surplus Lines Market

The surplus lines, or nonadmitted, market functions as a supplemental market insuring risks that are not acceptable to the standard, or admitted, insurance market. The majority of the surplus lines business consists of commercial lines insurance but can also include personal lines such as homeowners insurance in catastrophe-prone areas. Businesses unable to obtain insurance coverage from admitted insurers also have the option of self-insuring or seeking solutions in the alternative risk transfer (ART) market.

The surplus lines market has historically been an innovator of new kinds of insurance designed to meet emerging risks. For example, surplus lines insurers were the first to provide cyber insurance, environmental impairment liability insurance, and employment practices liability insurance. These and other types of policies that originated in the surplus lines market can now be obtained in either the admitted insurance market or the surplus lines market, depending on the characteristics of the particular risk.

When the insurance market or capacity becomes restricted and market conditions harden, the appetite of the admitted market carriers for some risks or lines of insurance tends to diminish, and business flows into the surplus lines market. Even in normal or soft markets, there will still be many risks that require surplus lines treatment. By fulfilling the role of insuring risks that the admitted market cannot or will not insure, the surplus lines market operates as a safety valve for the insurance marketplace.

Risks insured in the surplus lines market can be divided into four categories:

- New or emerging risks, which require special underwriting expertise and the flexibility that the surplus lines market affords—for example, the risks associated with technological innovations such as transportation network platforms and the nonmilitary use of unmanned aircraft systems (drones)

- Distressed risks, which are characterized by unfavorable attributes, such as a history of frequent losses or the potential for catastrophic losses, making them unacceptable to admitted insurers—for example, a vacant building in an area that experiences frequent crime losses; a shopping mall with frequent liability claims; or a manufacturer of explosives
- Unique risks, which are so specialized or unusual that admitted insurers are unwilling or unprepared to insure them—for example, a medical device manufacturer that needs products liability coverage for a new product in clinical trials
- High-capacity risks, which require high insurance limits that may exceed the capacity of the admitted market—for example, a chemical plant that could become legally liable for hundreds of millions of dollars in damages if a toxic chemical were to leak in large quantities

Surplus Lines Insurers

Surplus lines insurers are referred to as nonadmitted insurers because they are not licensed, or "admitted," in the state of the insured's principal place of business or principal residence (for an individual). By federal law, the insured's "home state" is responsible for overseeing and regulating surplus lines transactions. Every US jurisdiction has a surplus lines law that permits specially licensed intermediaries (also referred to as surplus lines brokers or licensees) to "export" risks that cannot be placed in the admitted market to eligible surplus lines insurers.

Although not a licensed insurer in the insured's home state, a surplus lines insurer must be licensed in its state or country of domicile and be regulated for solvency by that jurisdiction—the same way that the state-based insurance regulatory system in the US ensures the financial stability of licensed or admitted insurers.

Historically, a surplus lines insurer could not write surplus lines insurance in its state of domicile. However, numerous states have changed their laws to allow an insurer recognized as a Domestic Surplus Lines Insurer (DSLI) to issue policies on risks located in the insurer's state of domicile.

Unlike admitted carriers, surplus lines insurers are not subject to the rate or form regulations of an insured's home state; a surplus lines insurer and its policyholder are free to use whatever policy forms and rates they agree upon. This approach ensures that the surplus lines market provides an open and flexible marketplace for insureds who are unable to fulfill their insurance requirements in the state's admitted market.

A state's minimum capitalization requirement for surplus lines insurers is generally higher than for admitted insurers. The enhanced capital requirement allows for greater protection for policyholders insured by surplus lines companies, given that the state guaranty fund protection provided to policyholders of admitted insurers that become insolvent is generally unavailable to surplus lines insureds.

Regulated aliens (including Lloyd's) are non-US domiciled insurers that must file financial statements and auditors' reports, the names of their US attorneys or other representatives, as well as information on their US trust accounts, with the International Insurers Department (IID) of the National Association of Insurance Commissioners (NAIC). Regulated aliens must also meet IID criteria relating to capital and surplus, as well as underwriting and claims practices, and have a reputation of financial integrity. The NAIC publishes a Quarterly Listing of Alien Insurers naming the alien insurers that meet its criteria.

As a result of the Nonadmitted and Reinsurance Reform Act (NRRA) of 2010, which was enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, a state may not prohibit

a surplus lines broker from placing nonadmitted (surplus lines) insurance with or procuring such insurance from a nonadmitted insurer listed on the NAIC Quarterly Listing of Alien Insurers.

The Distribution System

For this report, the entities in the surplus lines distribution system are defined as follows:

- Retail producers, which can be either agents who represent the insurer or brokers who represent the insured
- Surplus lines intermediaries, which can operate as wholesale brokers, managing general agents (MGAs), underwriting managers, or Lloyd's coverholders or open market correspondents (OMCs)
- Program managers, which manage specialty or niche insurance products and market to retailers and wholesalers

These three types of organizations are the primary distributors for surplus lines insurers and play an important role in helping consumers obtain coverage that is unavailable in the admitted market.

Surplus lines intermediaries are licensed in the states where the insured or risk is located and act as intermediaries between retail producers and surplus lines insurers. Typically, a surplus lines intermediary provides the retail producer and the insured access to the surplus lines market when the admitted market cannot provide coverage or the risk qualifies for export.

The basic difference between wholesale brokers and MGAs is that MGAs are authorized to underwrite and bind coverage on behalf of the surplus lines insurer through binding authority agreements. Wholesale brokers are authorized only to submit business to surplus lines insurers; the insurers then underwrite, quote, and bind the risk if they deem it acceptable. Some MGAs also have claims-handling responsibilities and may be involved in placing reinsurance.

A Lloyd's coverholder is a firm that has been authorized to bind coverage on behalf of underwriting syndicates at Lloyd's; a Lloyd's open market correspondent is a firm that has been approved to generate business for a Lloyd's broker for placement at Lloyd's on an open market basis.

Before a risk can be exported, surplus lines laws generally require a "diligent search" of the admitted market, to allow the admitted market the opportunity to insure the risk first. In general, three declines from admitted insurers are required before the risk can be placed in the surplus lines market.

In some states, specific types of risks can be placed in the surplus lines market without the diligent search. These states have "export lists" of risks for which the insurance commissioner has determined there is little or no coverage available in the state's admitted market; the types of risks listed can be exported to an eligible surplus lines insurer without having to conduct a diligent search. In a few states, commercial lines deregulation laws allow for "automatic export" waivers, giving qualifying commercial buyers and their brokers or intermediaries immediate access to both the surplus lines market and a deregulated admitted market without a diligent search.

In a surplus lines transaction, the surplus lines intermediary is generally responsible for the following:

- Filing an affidavit affirming that a diligent search has been conducted, if required
- Maintaining the records relating to the transaction
- Collecting and remitting premium taxes to the insured's home state

In addition, the surplus lines intermediary must have the following, among other things:

- The technical expertise about the risk to be insured

- Extensive insurance product and market knowledge
- The ability to respond quickly to changing market conditions
- Access to eligible surplus lines insurers

Licensing and Compliance

In a surplus lines transaction, the insured's home state has the greatest degree of regulatory oversight, and the onus of compliance is on the surplus lines intermediary—the regulated entity in the transaction. In addition to being a licensed (resident or nonresident) agent or broker, a surplus lines broker or licensee must:

- In many states, pass a written surplus lines examination to secure a resident license
- Pay an annual licensing fee
- Determine whether the risk meets all the requirements for placement with a surplus lines insurer
- Collect and remit the state's surplus lines premium taxes

Furthermore, the surplus lines intermediary is responsible for determining whether the nonadmitted insurer insuring the risk meets the insured's home state eligibility requirements. A surplus lines intermediary may be held liable for payment of claims when a risk is placed with a surplus lines insurer not authorized to receive the risk or with one that is financially unsound when the risk is bound. However, depending on state law, there may be no cause of action against a broker who exercises due diligence or care in selecting the insurer, even if the insurer were to become insolvent sometime after.

Surplus lines policies must disclose that a nonadmitted insurer is providing coverage and that guaranty fund protection will not be available if the insurer becomes insolvent.

Market Cycles

In general, the same market conditions that affect admitted insurance will also affect surplus lines insurance, sometimes significantly. When conditions in the admitted market harden, or become more difficult, a sizable amount of business will flow from it to the surplus lines market. In a hard market, underwriters tend to become more conservative and restrictive, scrutinizing loss exposures more carefully, to determine how they can write a particular risk at a profit. In these circumstances, admitted carriers tend to insure only those risks they are most comfortable assuming and to avoid risks that are more complex or with which they have little or no experience.

As the market cycle progresses, competition heats up and market conditions in the admitted market soften, with producers and insurers trying to maintain market share by lowering rates, expanding coverage, and offering additional services at the expense of profit margins. During this soft market phase, consumers' bargaining power increases significantly, causing a drop in rates and relaxation of coverage limitations or exclusions, at which point business begins to return to the admitted market.

Over time, as margins deteriorate to unprofitable levels, competitive pricing pressures erode the admitted market's capacity, which again leads to a hardening of the market, and the cycle continues.

Appendix A

US Surplus Lines – Top 50 Groups and Lloyds

Ranked by 2021 nonadmitted direct premiums written; ratings are as of August 15, 2022.

($ thousands)

Rank	AMB #	Company	Type	Surplus Lines DPW	YoY % Change in DPW	Best's FSR	Best's FSR Implication/ Outlook	Rating Effective Date
	85202	**Lloyd's**		**13,871,593**	**8.2**	**A**	**Stable**	**15-Jul-22**
1	**00811**	**Berkshire Hathaway Ins Group**		**4,212,256**	**18.4**			
1	20650	AZGUARD Insurance Company	PROF	12,774		A+ p		22-Jun-22
1	00308	Cypress Insurance Company	MISC	1,667		A++ g		6-Jan-22
1	03806	General Star Indemnity Co	PROF	573,724		A++ g		7-Apr-22
1	02540	Mount Vernon Fire Ins Co	PROF	147,725		A++ g		17-Aug-21
1	18657	Mount Vernon Specialty Ins Co	PROF	9,970		A++ g		17-Aug-21
1	02428	National Fire & Marine Ins Co	PROF	3,406,774		A++ g		6-Jan-22
1	04406	National Indem Co of Mid-Amer	MISC	-93		A++ g		6-Jan-22
1	01824	National Indem Co of the South	MISC	3,051		A++ g		6-Jan-22
1	22320	Radnor Specialty Insurance Co	PROF	11,226		A++ g		17-Aug-21
1	03736	U.S. Underwriters Insurance Co	PROF	32,877		A++ g		17-Aug-21
1	02541	United States Liability Ins Co	MISC	12,561		A++		17-Aug-21
2	**18540**	**American International Group**		**4,177,807**	**17.7**			
2	03535	AIG Specialty Insurance Co	PROF	1,435,246		A r	Stable	7-Oct-21
2	02350	Lexington Insurance Company	PROF	2,350,906		A p	Stable	7-Oct-21
2	02598	Tudor Insurance Company	PROF	2,203		A g	Stable	7-Oct-21
2	03132	Western World Insurance Co	PROF	389,452		A g	Stable	7-Oct-21
3	**18468**	**Markel Corporation Group**		**3,530,213**	**26.5**			
3	03759	Evanston Insurance Company	PROF	2,056,584		A g	Stable	15-Sep-21
3	20566	Independent Specialty Ins Co	PROF	200,646		A p	Stable	15-Sep-21
3	00524	Superior Specialty Ins Co	PROF	15,255		A p	Stable	15-Sep-21
3	13105	United Specialty Insurance Co	PROF	1,257,729		A p	Stable	15-Sep-21
4	**03116**	**Fairfax Financial (USA) Group**		**2,997,286**	**37.9**			
4	12525	Allied World Asr Co (US) Inc	PROF	496,688		A g	Stable	25-May-22
4	12526	Allied World National Assur Co	MISC	212,511		A g	Stable	25-May-22
4	11719	Allied World Surplus Lines Ins	PROF	520,744		A g	Stable	25-May-22
4	11123	Crum & Forster Specialty Ins	PROF	1,039,513		A r	Stable	14-Jul-22
4	11883	First Mercury Insurance Co	PROF	10,033		A r	Stable	14-Jul-22
4	12631	Hilltop Specialty Insurance Co	PROF	72,895		A g	Stable	23-Jun-22
4	14995	Hudson Excess Insurance Co	PROF	538,294		A g	Stable	23-Jun-22
4	12258	Seneca Specialty Ins Co	PROF	106,608		A r	Stable	14-Jul-22
5	**18252**	**W. R. Berkley Insurance Group**		**2,820,382**	**24.7**			
5	03026	Admiral Insurance Company	PROF	772,133		A+ r	Stable	8-Jun-22
5	14158	Berkley Assurance Company	PROF	288,516		A+ r	Stable	8-Jun-22
5	11296	Berkley Specialty Insurance Co	PROF	145,219		A+ r	Stable	8-Jun-22
5	12118	Gemini Insurance Company	PROF	878,534		A+ r	Stable	8-Jun-22
5	11231	Great Divide Insurance Co	MISC	6,542		A+ r	Stable	8-Jun-22
5	01990	Nautilus Insurance Company	PROF	729,438		A+ r	Stable	8-Jun-22
6	**05987**	**Nationwide Group**		**2,611,335**	**16.3**			
6	01931	Scottsdale Indemnity Company	MISC	34,106		A+ r	Stable	22-Dec-21
6	03292	Scottsdale Insurance Company	PROF	2,544,315		A+ r	Stable	22-Dec-21
6	12121	Scottsdale Surplus Lines Ins	PROF	32,914		A+ r	Stable	22-Dec-21
7	**18498**	**Chubb INA Group**		**2,442,535**	**25.9**			
7	02713	Chubb Custom Insurance Co	PROF	225,781		A++ g	Stable	10-Dec-21
7	03761	Executive Risk Indemnity Inc.	MISC	27		A++ g	Stable	10-Dec-21
7	11251	Executive Risk Specialty Ins	PROF	100		A++ g	Stable	10-Dec-21
7	02084	Federal Insurance Company	MISC	51		A++	Stable	10-Dec-21
7	03510	Illinois Union Insurance Co	PROF	826,206		A++ g	Stable	10-Dec-21
7	04433	Westchester Surplus Lines Ins	PROF	1,390,371		A++ g	Stable	10-Dec-21

Appendix A (Cont'd.)

US Surplus Lines – Top 50 Groups and Lloyds

Ranked by 2021 nonadmitted direct premiums written; ratings are as of August 15, 2022.

($ thousands)

Rank	AMB #	Company	Type	Surplus Lines DPW	YoY % Change in DPW	Best's FSR	Best's FSR Implication/ Outlook	Rating Effective Date
8	**00060**	**Liberty Mutual Insurance Cos**		**2,208,819**	**29.4**			
8	13866	Ironshore Specialty Ins Co	PROF	1,244,541		A r	Stable	27-Jul-22
8	12078	Liberty Surplus Ins Corp	PROF	964,279		A r	Stable	27-Jul-22
9	**18557**	**XL Reinsurance America Group**		**1,906,397**	**14.5**			
9	11340	Indian Harbor Insurance Co	PROF	1,905,074		A+ g	Stable	17-Aug-21
9	00789	T.H.E. Insurance Company	MISC	1,324		A+ g	Stable	17-Sep-21
10	**18640**	**Alleghany Corporation Group**		**1,660,032**	**29.2**			
10	01960	Capitol Specialty Ins Corp	PROF	344,493		A g	Stable	17-Nov-21
10	13859	Covington Specialty Ins Co	PROF	144,260		A+ r	Stable	17-Nov-21
10	22013	Fair American Select Ins Co	PROF	32,893		A+ r	Stable	17-Nov-21
10	12619	Landmark American Ins Co	PROF	1,138,386		A+ r	Stable	17-Nov-21
11	**18878**	**Sompo Holdings US Group**		**1,624,567**	**36.8**			
11	13033	Endurance American Spec Ins Co	PROF	1,624,566		A+ g	Stable	2-Sep-21
11	00743	Lexon Insurance Company	MISC	2		A+ r	Stable	2-Sep-21
12	**18756**	**Starr International Group**		**1,440,373**	**33.2**			
12	13977	Starr Surplus Lines Ins Co	PROF	1,440,373		A g	Stable	5-Nov-21
13	**05658**	**QBE North America Ins Group**		**1,284,541**	**33.9**			
13	12562	QBE Specialty Insurance Co	PROF	1,284,541		A p	Stable	7-Apr-22
14	**18733**	**Tokio Marine US PC Group**		**1,258,091**	**34.0**			
14	03286	Houston Casualty Company	PROF	799,995		A++ g	Stable	9-Dec-21
14	22607	Safety Specialty Insurance Co	PROF	197,984		A++ g	Stable	17-Nov-21
14	00763	Tokio Marine Specialty Ins Co	PROF	260,112		A++ p	Stable	9-Dec-21
15	**18777**	**AXIS US Operations**		**1,243,936**	**33.5**			
15	12515	AXIS Surplus Insurance Company	PROF	1,243,936		A g	Stable	12-Aug-22
16	**18549**	**Zurich Ins US PC Group**		**1,195,708**	**6.9**			
16	02147	Empire Fire and Marine Ins Co	MISC	1,104		A+ g	Stable	1-Oct-21
16	02148	Empire Indemnity Ins Co	MISC	528		A+ g	Stable	1-Oct-21
16	03557	Steadfast Insurance Company	PROF	1,193,788		A+ g	Stable	1-Oct-21
16	03565	Zurich Amer Ins Co of Illinois	MISC	288		A+ g	Stable	1-Oct-21
17	**05696**	**Everest Re U.S. Group**		**1,063,466**	**49.4**			
17	12096	Everest Indemnity Insurance Co	PROF	1,063,466		A+ g	Stable	15-Jun-22
18	**04019**	**Argo Group**		**1,061,974**	**4.6**			
18	03283	Colony Insurance Company	PROF	717,147		A- g	Stable	13-Apr-22
18	02619	Colony Specialty Insurance Co	MISC	10,597		A- g	Stable	13-Apr-22
18	11035	Peleus Insurance Company	PROF	334,230		A- g	Stable	13-Apr-22
19	**18313**	**CNA Insurance Companies**		**1,029,061**	**39.9**			
19	03538	Columbia Casualty Company	PROF	1,029,061		A g	Stable	4-Aug-22
20	**04835**	**Great American P & C Ins Group**		**984,303**	**29.2**			
20	03735	American Empire Surplus Lines	PROF	142,310		A+ r	Stable	3-Dec-21
20	03837	Great American E & S Ins Co	PROF	789,037		A+ r	Stable	3-Dec-21
20	03293	Great American Fidelity Ins Co	PROF	49,970		A+ r	Stable	3-Dec-21
20	14150	Mid-Continent E&S Ins Co	PROF	2,986		A+ r	Stable	3-Dec-21
21	**18484**	**Arch Insurance Group**		**963,358**	**37.6**			
21	12523	Arch Specialty Insurance Co	PROF	963,358		A+ g	Stable	10-Dec-21
22	**00048**	**Hartford Insurance Group**		**947,578**	**26.0**			
22	02611	Hartford Ins Co of Illinois	MISC	2,453		A+ p	Stable	29-Jul-21
22	12563	Maxum Indemnity Company	PROF	88,433		A+ r	Stable	29-Jul-21
22	10761	Navigators Specialty Ins Co	PROF	765,833		A+ r	Stable	29-Jul-21
22	02706	Nutmeg Insurance Company	MISC	350		A+ p	Stable	29-Jul-21
22	11654	Pacific Insurance Company, Ltd	PROF	90,509		A+ p	Stable	29-Jul-21

Appendix A (Cont'd.)

US Surplus Lines – Top 50 Groups and Lloyds

Ranked by 2021 nonadmitted direct premiums written; ratings are as of August 15, 2022.

($ thousands)

Rank	AMB #	Company	Type	Surplus Lines DPW	YoY % Change in DPW	Best's FSR	Best's FSR Implication/ Outlook	Rating Effective Date
23	**18674**	**Travelers Group**		**906,111**	**32.8**			
23	04869	Northfield Insurance Co	PROF	292,177		A++ g	Stable	29-Jul-22
23	04025	Northland Casualty Company	MISC	894		A++ g	Stable	29-Jul-22
23	03592	St. Paul Surplus Lines Ins Co	PROF	15,394		A++ g	Stable	29-Jul-22
23	00241	Travelers Excess & Surp Lines	PROF	597,645		A++ g	Stable	29-Jul-22
24	**18753**	**Munich-American Hldg Corp Cos**		**875,991**	**71.0**			
24	02666	American Modern Select Ins Co	MISC	250		A+ g	Stable	27-Jul-22
24	03763	American Western Home Ins Co	MISC	-35		A+ g	Stable	27-Jul-22
24	20791	Bridgeway Insurance Company	PROF	74,343		A+ g	Stable	27-Jul-22
24	14838	HSB Specialty Insurance Co	PROF	116,720		A++ r	Stable	29-Jul-22
24	12170	Princeton E&S Lines Ins Co	PROF	684,713		A+ g	Stable	27-Jul-22
25	**18626**	**James River Group**		**870,944**	**18.3**			
25	22509	Falls Lake Fire & Casualty Co	MISC	28,456		A- g	Stable	30-Sep-21
25	14313	Falls Lake National Ins Co	MISC	22,352		A- g	Stable	30-Sep-21
25	13985	James River Casualty Company	PROF	-366		A- g	Stable	30-Sep-21
25	12604	James River Insurance Co	PROF	820,501		A- g	Stable	30-Sep-21
26	**03262**	**Swiss Reinsurance Group**		**784,487**	**41.6**			
26	10783	First Specialty Ins Corp	PROF	187,794		A+ g	Stable	22-Jul-21
26	11135	North American Capacity Ins Co	PROF	596,692		A+ g	Stable	22-Jul-21
27	**14027**	**Kinsale Insurance Company**		**764,373**	**38.3**			
27	14027	Kinsale Insurance Company	PROF	764,373		A	Stable	23-Jun-22
28	**18944**	**Trisura US Insurance Group**		**751,222**	**59.4**			
28	20575	Trisura Specialty Insurance Co	PROF	751,222		A- g	Stable	2-Dec-21
29	**18783**	**Aspen US Insurance Group**		**746,697**	**24.2**			
29	12630	Aspen Specialty Insurance Co	PROF	746,697		A g	Stable	26-May-22
30	**18533**	**AmTrust Group**		**683,962**	**39.3**			
30	11693	Associated Industries Ins Co	PROF	517,434		A- r	Stable	26-Aug-21
30	04070	Republic-Vanguard Ins Co	PROF	128,009		A- r	Stable	26-Aug-21
30	02522	Security National Ins Co	MISC	38,518		A- p	Stable	26-Aug-21
31	**18429**	**Allianz US PC Insurance Cos**		**639,961**	**-10.5**			
31	02618	Allianz Underwriters Ins Co	PROF	44,609		A+ g	Stable	2-Jun-22
31	02267	Interstate Fire & Casualty Co	PROF	595,352		A+ g	Stable	2-Jun-22
32	**18975**	**Core Specialty Insurance Group**		**623,486**	**263.4**			
32	11432	StarStone Specialty Ins Co	PROF	623,486		A- g	Positive	4-Aug-22
33	**03873**	**SCOR US Group**		**617,323**	**38.5**			
33	02837	General Security Indem Co AZ	PROF	617,323		A+ g	Stable	22-Sep-21
34	**18868**	**Clear Blue Insurance Group**		**480,972**	**101.7**			
34	22327	Clear Blue Insurance Company	MISC	3,153		A- g	Stable	21-Apr-22
34	22328	Clear Blue Specialty Ins Co	PROF	447,803		A-	Stable	21-Apr-22
34	20920	Highlander Specialty Ins Co	PROF	30,016		A- g	Stable	21-Apr-22
35	**04294**	**The Cincinnati Insurance Cos**		**479,213**	**29.1**			
35	13843	Cincinnati Specialty Undrs Ins	PROF	479,213		A+ g	Stable	2-Apr-22
36	**03883**	**RLI Group**		**469,512**	**20.9**			
36	02591	Mt. Hawley Insurance Company	PROF	469,512		A+ g	Stable	30-Nov-21
37	**00780**	**Progressive Insurance Group**		**439,806**	**523.1**			
37	22322	Blue Hill Specialty Ins Co	PROF	439,524		A+ g	Stable	13-Jan-22
37	13918	Protective Specialty Ins Co	PROF	280		A g	Stable	13-Jan-22
37	01840	Sagamore Insurance Company	MISC	2		A g	Stable	13-Jan-22
38	**03918**	**GuideOne Insurance Companies**		**428,005**	**59.6**			
38	14334	GuideOne National Insurance Co	PROF	428,005		A- r	Stable	14-Jun-22

Appendix A (Cont'd.)

US Surplus Lines – Top 50 Groups and Lloyds

Ranked by 2021 nonadmitted direct premiums written; ratings are as of August 15, 2022.

($ thousands)

Rank	AMB #	Company	Type	Surplus Lines DPW	YoY % Change in DPW	Best's FSR	Best's FSR Implication/ Outlook	Rating Effective Date
39	**18669**	**Global Indemnity Group**		**373,678**	**17.4**			
39	03674	Penn-America Insurance Company	PROF	92,548		A g	Stable	19-May-22
39	11460	Penn-Patriot Insurance Company	PROF	10,495		A g	Stable	19-May-22
39	12050	Penn-Star Insurance Company	PROF	97,019		A g	Stable	19-May-22
39	03128	United National Insurance Co	PROF	173,615		A g	Stable	19-May-22
40	**18605**	**Hallmark Insurance Group**		**368,598**	**8.0**			
40	14154	Hallmark National Insurance Co	PROF	9,287		A- p	Negative	16-Nov-22
40	10838	Hallmark Specialty Ins Co	PROF	359,310		A- p	Negative	16-Nov-22
41	**18717**	**Skyward Specialty Ins Group**		**361,842**	**5.9**			
41	13825	Houston Specialty Insurance Co	PROF	361,827		A- g	Stable	19-Aug-21
41	14363	Oklahoma Specialty Ins Co	PROF	15		A- r	Stable	19-Aug-21
42	**00897**	**IFG Companies**		**348,626**	**20.2**			
42	00709	Burlington Insurance Company	PROF	348,626		A g	Stable	4-Oct-21
43	**18132**	**AmeriTrust Group**		**316,003**	**18.9**			
43	12011	Ameritrust Insurance Corp	MISC	3,253		A- u p	Positive	13-Apr-22
43	03780	Century Surety Company	PROF	310,042		A- u p	Positive	13-Apr-22
43	02180	ProCentury Insurance Company	MISC	2,709		A- u p	Positive	13-Apr-22
44	**03926**	**Selective Insurance Group**		**308,070**	**23.6**			
44	13842	Mesa Underwriters Spec Ins Co	PROF	308,070		A+ p	Stable	10-Nov-21
45	**04354**	**Auto-Owners Insurance Group**		**301,424**	**37.4**			
45	01780	Atlantic Casualty Insurance Co	PROF	301,424		A+	Stable	9-Dec-21
46	**18680**	**AF Group**		**268,229**	**0.1**			
46	13044	Accident Fund General Ins Co	MISC	10,925		A r	Stable	17-Oct-21
46	11876	Third Coast Insurance Company	PROF	257,304		A r	Stable	17-Oct-21
47	**18458**	**Intact US Insurance Group**		**261,439**	**44.9**			
47	14398	Homeland Ins Co of Delaware	PROF	21,780		A+ r	Stable	2-May-22
47	10604	Homeland Ins Co of New York	PROF	239,659		A+ r	Stable	2-May-22
48	**00008**	**Allstate Insurance Group**		**254,933**	**220.1**			
48	11866	Agent Alliance Insurance Co	PROF	61,982		A+ r	Stable	11-Aug-22
48	13069	National General Premier Ins	MISC	2,277		A+ r	Stable	11-Aug-22
48	13927	North Light Specialty Ins Co	PROF	190,675		A+ g	Stable	11-Aug-22
49	**20603**	**Ategrity Specialty Ins Co**		**252,713**	**21.3**			
49	20603	Ategrity Specialty Ins Co	PROF	252,713		A- g	Negative	11-Nov-21
50	**18915**	**Ascot Insurance U.S. Group**		**247,655**	**177.0**			
50	20561	Ascot Insurance Company	MISC	734		A g	Stable	17-Sep-21
50	11545	Ascot Specialty Insurance Co	PROF	246,921		A g	Stable	17-Sep-21

Affiliation codes: g = group rating; p = pooled rating; r = reinsured rating.

Source: AM Best data and research

Appendix B

DPSL Composite Companies, 2017-2021

X denotes domestic professional surplus lines companies (those whose surplus lines business generates more than 50% of their total premium).

Company	2017	2018	2019	2020	2021
Accelerant Specialty Ins Co					X
Acceptance Casualty Insurance Co	X	X	X	X	X
Acceptance Indemnity Insurance Co	X	X	X	X	X
Accredited Specialty Ins Co					X
Admiral Insurance Co	X	X	X	X	X
Adriatic Insurance Co	X	X	X	X	X
Agent Alliance Insurance Co	X	X	X	X	X
AIG Specialty Insurance Co	X	X	X	X	X
AIX Specialty Insurance Co	X	X	X	X	X
Allianz Underwriters Insurance Co	X	X	X	X	X
Allied World Asr Co (US) Inc			X	X	X
Allied World Surplus Lines Ins	X	X	X	X	X
American Empire Surplus Lines	X	X	X	X	X
American Modern Surpl Lines Ins Co	X	X			
American Mutual Share Ins Corp	X	X	X	X	X
American Natl Lloyds Ins Co					X
American Safety Insurance Co	X	X	X	X	X
Appalachian Insurance Co	X	X			
Arch Specialty Insurance Co	X	X	X	X	
Ascot Specialty Ins Co					X
Aspen Specialty Insurance Co	X	X	X	X	X
Associated Industries Insurance Co		X	X	X	X
Atain Insurance Co	X	X	X		
Atain Specialty Insurance Co	X	X	X	X	X
Ategrity Specialty Ins Co			X	X	X
Atlantic Casualty Insurance Co	X	X	X	X	X
AXIS Surplus Insurance Co	X	X	X	X	X
AZGUARD Insurance Co					X
Berkley Assurance Co	X	X	X	X	X
Berkley Specialty Ins Co	X	X	X	X	X
Blackboard Specialty Insurance Co	X	X	X	X	
Blue Hill Specialty Ins Co					X
Bridgeway Insurance Co					X
Burlington Insurance Co	X	X	X	X	X
Canal Indemnity Co	X	X	X		
Canopius US Insurance, Inc.	X	X	X	X	X
Capitol Specialty Insurance Corp	X	X	X	X	X
Catlin Specialty Insurance Co	X	X	X		
Centerline Prop and Cas Ins Co					X
Century Surety Co	X	X	X	X	X
Chubb Custom Insurance Co	X	X	X	X	X
Cincinnati Specialty Undrs Ins	X	X	X	X	X
Clear Blue Specialty Ins Co	X	X	X	X	X
CM Vantage Specialty Ins Co	X	X	X	X	X
Colony Insurance Co	X	X	X	X	X
Columbia Casualty Co	X	X	X	X	X
Concord Specialty Insurance Co					X
Conifer Insurance Co	X		X	X	X
Coverys Specialty Insurance Co	X	X	X	X	X
Covington Specialty Ins Co	X	X	X	X	X
Crum & Forster Specialty Ins	X	X	X	X	X
CUMIS Specialty Ins Co Inc	X	X	X	X	X
Dorchester Insurance Co, Ltd					X
Dover Bay Specialty Ins Co	X	X	X	X	X
Empire Indemnity Insurance Co	X	X	X	X	
Endurance American Spec Ins Co	X	X	X	X	X
Evanston Insurance Co	X	X	X	X	X
Everest Indemnity Insurance Co	X	X	X	X	X
Everspan Indemnity Ins Co					X
Executive Risk Specialty Insurance	X	X	X		X
Fair American Select Ins Co	X	X	X	X	X
First Mercury Insurance Co	X	X	X	X	X
First Specialty Insurance Corp	X	X	X	X	X
Frontline Ins Unlimited Co			X	X	X
Gemini Insurance Co	X	X	X	X	X
General Security Indem Co AZ	X	X	X	X	X
General Star Indemnity Co	X	X	X	X	X
GeoVera Specialty Insurance Co	X	X	X	X	X
GNY Custom Insurance Co	X	X	X	X	X
Gotham Insurance Co	X	X	X	X	X
Gray Surplus Lines Ins Co					X
Great American E&S Insurance Co	X	X	X	X	X
Great American Fidelity Insurance Co	X	X	X	X	X
GuideOne National Insurance Co	X	X	X	X	X
Guilford Insurance Co	X	X	X	X	
Hallmark National Ins Co	X	X	X	X	X
Hallmark Specialty Insurance Co	X	X	X	X	X
HCC Specialty Insurance Co	X				
Homeland Insurance Co of DE	X	X	X	X	X
Homeland Insurance Co NY	X	X	X	X	X
Housing Specialty Insurance Co Inc.	X	X	X	X	X
Houston Casualty Co	X	X	X	X	X
Houston Specialty Insurance Co	X	X	X	X	X
HSB Specialty insurance Co	X	X	X	X	X
Hudson Excess Insurance Co	X	X	X	X	X
Hudson Specialty Insurance Co	X	X	X	X	
Illinois Union Insurance Co	X	X	X	X	X
Independent Specialty Ins Co			X	X	X
Indian Harbor Insurance Co	X	X	X	X	X
Insurors Indemnity Select Ins					X
Interstate Fire & Casualty Co	X	X	X	X	X
Ironshore Specialty Insurance Co	X	X	X	X	X
ISMIE Indemnity Company					X
James River Casualty Co	X	X	X	X	X
James River Insurance Co	X	X	X	X	X
Kinsale Insurance Co	X	X	X	X	X
Knight Specialty Insurance Co	X	X	X	X	X
KW Specialty Insurance Company					X
Landmark American Ins Co	X	X	X	X	X
Lexington Insurance Co	X	X	X	X	X
Liberty Surplus Ins Corp	X	X	X	X	X
Maxum Indemnity Co	X	X	X	X	X
Medical Security Insurance Co	X	X	X	X	X
Mercer Insurance Co		X	X	X	X
Merchants National Ins Co	X	X	X	X	X
Mesa Underwriters Spec Ins Co	X	X	X	X	X
Mid-Continent Excess & Surplus	X	X	X	X	X
Mobilitas Insurance Co of Arizona					X
Mobilitas Insurance Company					X
MSA Insurance Co	X	X	X	X	X
MSIG Specialty Ins USA Inc.			X	X	X
Mt Hawley Insurance Co	X	X	X	X	X

Appendix B (Cont'd.)

DPSL Composite Companies, 2017-2021

X denotes domestic professional surplus lines companies (those whose surplus lines business generates more than 50% of their total premium).

Company	2017	2018	2019	2020	2021
Mt Vernon Fire Insurance Co	X	X	X	X	X
Mt. Vernon Specialty Ins Co	X	X	X	X	X
NAMIC Insurance Co, Inc	X	X	X	X	X
National Fire & Marine Ins Co	X	X	X	X	X
National Guaranty Ins Co of Vermont	X	X	X	X	X
Nautilus Insurance Co	X	.X	X	X	X
Navigators Specialty Ins Co	X	X	X	X	X
NORCAL Specialty Insurance Co					X
Noetic Specialty Insurance Co	X	X	X	X	
North American Capacity Ins Co	X	X	X	X	X
North Light Specialty Insurance Co	X	X	X	X	X
Northfield Insurance Co	X	X	X	X	X
Obsidian Specialty Ins Co					X
Oklahoma Specialty Ins Co	X	X	X	X	X
Old Republic Union Ins Co	X	X	X	X	X
Pacific Insurance Co, Ltd	X	X	X	X	X
Palomar Excess and Surplus Ins					X
Peleus Insurance Co	X	X	X	X	X
Penn-America Insurance Co	X	X	X	X	X
Penn-Patriot Insurance Co	X	X	X	X	X
Penn-Star Insurance Co	X	X	X	X	X
Prime Insurance Co	X	X	X	X	X
Princeton Excess & Surp Lines	X	X	X	X	X
ProAssurance Specialty Ins Co	X	X	X	X	X
Professional Security Ins Co	X	X	X	X	X
Protective Specialty Ins Co	X	X	X	X	X
QBE Specialty Insurance Co	X	X	X	X	X
Radnor Specialty Insurance Co	X	X	X	X	X
Rainier Insurance Company					X
Republic-Vanguard Ins Co	X	X	X	X	X

Company	2017	2018	2019	2020	2021
Rockhill Insurance Co	X	X	X	X	
Safety Specialty Insurance Co	X	X	X	X	X
Savers Property and Cas Ins Co		X			
Scottsdale Insurance Co	X	X	X	X	X
Scottsdale Surplus Lines Ins	X	X	X	X	X
Seneca Specialty Ins Co	X	X	X	X	X
Southwest Marine & General	X	X	X	X	X
St. Paul Surplus Lines Ins Co	X	X	X	X	X
Starr Surplus Lines Ins Co	X	X	X	X	X
StarStone Specialty Ins Co		X	X	X	X
Steadfast Insurance Co		X	X	X	X
TDC National Assurance Co		X	X	X	
TDC Specialty Insurance Co		X	X	X	X
TM Specialty Insurance Co			X		
Tokio Marine GRV Re, Inc.		X	X		
Tokio Marine Specialty Ins Co		X	X	X	X
Travelers Excess & Surp Lines		X	X	X	X
Trisura Specialty Ins Co		X	X	X	X
Tudor Insurance Co		X	X	X	X
United National Insurance Co		X	X	X	X
United National Specialty Ins Co		X	X	X	
United Specialty Insurance Co		X	X	X	X
US Underwriters Insurance Co		X	X	X	X
VerTerra Insurance Co		X			
Voyager Indemnity Ins Co		X	X	X	X
Watford Specialty Insurance Co		X	X	X	X
Westchester Surplus Lines Ins		X	X	X	X
Western World Insurance Co		X	X	X	X
Wishire Insurance Co		X	X	X	X

Source: AM Best data and research

Appendix C

State Survey – Capital & Surplus Requirements for Surplus Lines Companies

	Domestic Company Minimum Surplus	Alien Company Minimum Surplus	Alien Companies Required to Maintain a Trust Fund	Pending Revisions
Alabama	$15,000,000	(1)	No	No
Alaska	$15,000,000	(1)	Yes, $2,500,000	No
Arizona	$15,000,000	(1)	Yes, $2,500,000	No
Arkansas	$15,000,000	(1)	No	No
California	$45,000,000	(1)	No	No
Colorado	$15,000,000	(1)	No	No
Connecticut	$15,000,000	(1)	No	No
Delaware	$15,000,000	(1)	No	No
Dist of Columbia	$15,000,000	(1)	No	No
Florida	$15,000,000	$15,000,000	Yes, $5,400,000	No
Georgia	$15,000,000	(1)	No	No
Hawaii	$15,000,000	(1), (2)	Yes, $5,400,000	No
Idaho	15,000,000	(1)	No	No
Illinois	$15,000,000	(1)	No	No
Indiana	(3)	(1)	No	No
Iowa	$15,000,000	(1)	No	No
Kansas	$4,500,000	(1)	No	No
Kentucky	$15,000,000	(1)	No	No
Louisiana	$15,000,000	(1), (2)	Yes, $5,400,000	No
Maine	$15,000,000	(1)	No	No
Maryland	$15,000,000	(1)	No	No
Massachusetts	$15,000,000	(1)	No	No
Michigan	$15,000,000	(1)	No	No
Minnesota	$15,000,000	(1)	(4)	No
Mississippi	$15,000,000	(1)	Yes, $5,400,000 (2)	No
Missouri	$15,000,000	(1)	No	No
Montana	$15,000,000	(1)	Yes, $5,400,000 (2)	No
Nebraska	$15,000,000	(1)	No	No
Nevada	$15,000,000	(5)	No	No
New Hampshire	$15,000,000	(1)	No	No
New Jersey	$15,000,000	(1)	No	No
New Mexico	$15,000,000	(1)	No	No
New York	$47,000,000	(1)	No	No
North Carolina	$15,000,000	(1)	No	No
North Dakota	$15,000,000	(1)	No	No
Ohio	$15,000,000	(1)	No	No
Oklahoma	$15,000,000	(1)	No	No
Oregon	$15,000,000	(1)	Yes, $5,400,000 (2)	No
Pennsylvania	$15,000,000	(1), (6)	No	No
Puerto Rico	$15,000,000	(7)	No	No
Rhode Island	15,000,000	(1)	No	No
South Carolina	$15,000,000	(1)	No	No
South Dakota	$15,000,000; (8)	(1)	No	No
Tennessee	$15,000,000	(1)	No	No
Texas	$15,000,000	(1)	No	No
Utah	$15,000,000 (9)	(1)	No	No
Vermont	$15,000,000	(1)	No	No
US Virgin Islands	$15,000,000	(1)	No	No
Virginia	$15,000,000	(1)	No	No
Washington	$15,000,000	(1)	No	No
West Virginia	$15,000,000	(1)	No	No
Wisconsin	$15,000,000	(1)	No	No
Wyoming	$15,000,000	(1)	No	No

Notes:
(1) Surplus lines brokers may do business with nonadmitted insurers domiciled outside the US (including Lloyd's syndicates) that appear on the Quarterly Listing of Alien Insurers maintained by the International Insurers Department (IID) of the NAIC and comply with minimum capital requirements in the state (generally $15,000,000; $45,000,000 in California).
(2) Approved alien insurers are required to maintain a trust fund in the US designed to reasonably protect all policyholders, with a minimum amount set by state law. In Florida, Hawaii, Louisiana, Mississippi, and Oregon, the stipulated minimum is $5.4 million.
(3) Indiana does not impose formal eligibility requirements other than requiring a sponsoring broker for foreign surplus lines insurers. A licensed surplus lines producer must request by letter or email that a foreign (US) surplus lines insurer be added to the state's eligibility list.
(4) Trust of a minimum of $1,500,000 must be maintained under Minnesota 60A. 206, Subd. 5.
(5) The Nevada Division of Insurance no longer has the authority to maintain a list of eligible insurers, and there are no requirements that a foreign or alien insurer must meet other than the objective eligibility criteria specified in the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA) and reaffirmed in Chapter 685A of NRS, as amended by Senate Bill 289.
(6) If the company is listed on the Quarterly List of Alien Insurers maintained by the IID, a written request for surplus lines eligibility must include documentation evidencing its listing by the NAIC.
(7) Puerto Rico no longer imposes a fee or financial premium; nor does it require other information from a foreign or alien insurer for surplus lines eligibility purposes, aside from the eligibility requirements set forth in the NRRA.
(8) South Dakota requirements for a surplus lines insurer remain the same as before, aside from the requirements under the NRRA. Surplus lines insurers will be required to file the Unauthorized Insurer Business Written & Premium Tax Report, along with the Schedule T & State Page for foreign companies. Alien surplus lines companies will be required to file the Unauthorized Insurer Business Written & Premium Tax Report.
(9) As of July 21, 2011, Utah cannot prohibit placement of surplus lines insurance with a nonadmitted insurer domiciled outside the US if the insurer is listed on the Quarterly Listing of Alien insurers maintained by the International Insurers Department of the NAIC.
Source: AM Best data and research

Appendix D

State Survey – Surplus Lines Stamping Offices and Premium Taxes

State	Stamping Office	Premium Tax (%)	Stamping Fee (%)	State	Stamping Office	Premium Tax (%)	Stamping Fee (%)
Alabama	No	6.00	No	Nebraska	No	3.00	No
Alaska	No	2.70	1.00	Nevada	Yes	3.50	0.40
Arizona	Yes	3.00	0.20	New Hampshire	No	3.00	No
Arkansas	No	4.00	No	New Jersey	No	5.00	No
California	Yes	3.00	0.25 [1]	New Mexico	No	3.003	No
Colorado	No	3.00	No	New York	Yes	3.60	0.17
Connecticut	No	4.00	No	North Carolina	Yes	5.00	0.40
Delaware	No	3.00	No	North Dakota	No	1.75	No
Dist of Columbia	No	2.00	No	Ohio	No	5.00	No
Florida	Yes	4.94 [2]	0.06	Oklahoma	No	6.00	No
Georgia	No	4.00	No	Oregon	Yes	2.30 [6]	$10
Hawaii	No	4.68	No	Pennsylvania	Yes	3.00	$20 [7]
Idaho	Yes	1.50	0.50	Puerto Rico	No	9.00	No
Illinois	Yes	3.50	0.075	Rhode Island	No	4.00	No
Indiana	No	2.50	No	South Carolina	No	6.00	No
Iowa	No	1.00	No	South Dakota	No	2.5-3.0	No
Kansas	No	6.00	No	Tennessee	No	5.00	No
Kentucky	No	3.00 [3]	No	Texas	Yes	4.85	0.075
Louisiana	No	4.85	No	Utah	Yes	4.25	0.18
Maine	No	3.00	No	Vermont	No	3.00	No
Maryland	No	3.00	No	US Virgin Islands	No	5.00	No
Massachusetts	No	4.00	No	Virginia	No	2.25	No
Michigan [4]	No	2.00	No	Washington	Yes	2.00	0.10
Minnesota	Yes	3.00	0.04	West Virginia	No	4.55	No
Mississippi	Yes	4.00	0.25	Wisconsin	No	3.00	No
Missouri	No	5.00	No	Wyoming	No	3.00 [8]	No
Montana	No	2.75 [5]	0.25				

[1] Stamping fee will change to 0.18% on January 1, 2023.
[2] Stamping fee lowered to 0.06% as of 4/1/20. Tax rate reduced from 5% to 4.94% for policies issued/renewed on or after 7/1/20.
[3] Surplus lines tax is 3%, plus a 1.8% surcharge payable by the broker.
[4] In Michigan, a 0.5% regulatory fee applies in addition to the premium tax.
[5] An additional 2.5% tax is applied to fire portions of surplus lines payments (annually), payable by the agent.
[6] This amount includes 0.3% collected for Oregon Fire Marshalls' office payable by the broker.
[7] Additional stamping fee of $25 applies to a late filing; an additional $50 fee applies to a filing with a missing producer affadavit.
[8] In Wyoming, the surplus lines tax is 3.00% plus 0.175% SLAS Clearinghouse transaction fee.
Source: AM Best data and research

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