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Insights for an Evolving Market

U.S. Excess and Surplus Market:

Unlocking Growth with Strategy & Execution

Personal lines continue to drive high growth in the U.S. P&C market, while underwriting profitability continues to be an issue amidst natural catastrophe losses and regulatory scrutiny around rate changes in key states.

With almost 10%[1] growth rate in 2023 and through the first half of 2024, the $950+ billion U.S. P&C insurance market has been showing solid premium growth. Personal lines, constituting around half of the total P&C market, are expected to continue to drive P&C market growth with the ongoing momentum coming from personal auto and property lines: Both personal auto and homeowners' premiums have been growing with double-digit rates. On the commercial side, growth rates are lower with the commercial property market showing signs of softening and rates decreasing for certain liability lines.

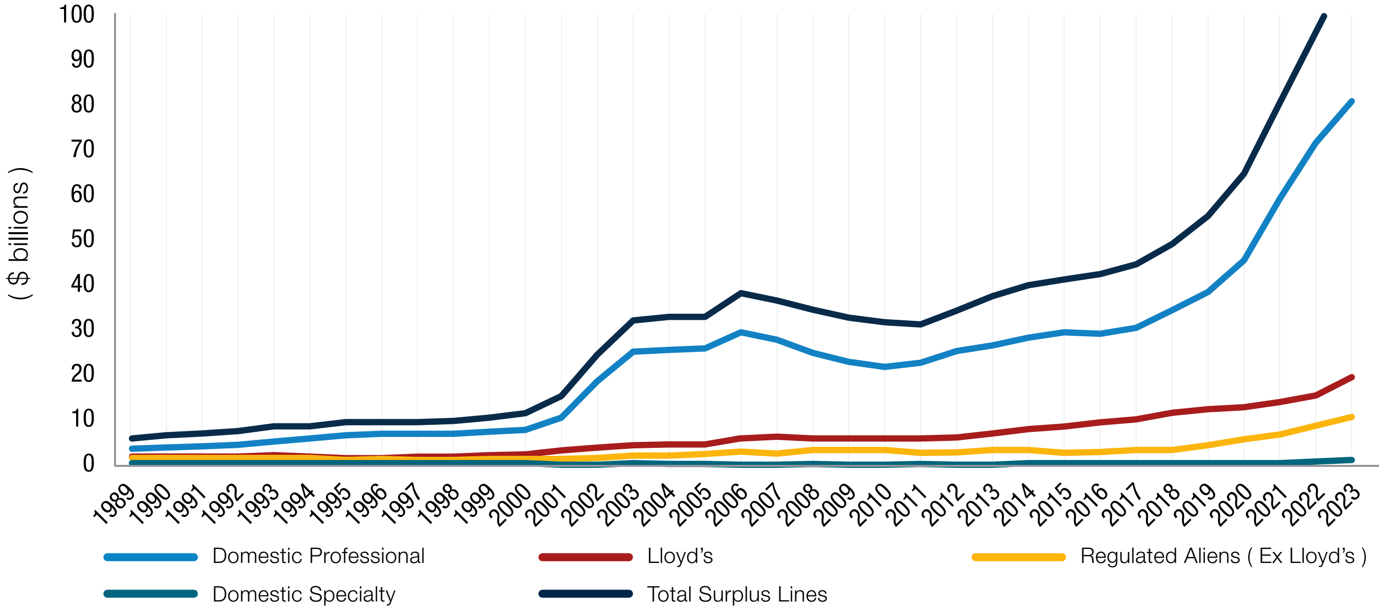
Meanwhile, challenges around underwriting profitability in personal lines in 2023 are not expected to disappear. Personal lines loss ratios were 68% in the first half of 2024 - 14 percentage points higher than the loss ratio of commercial lines[2]. Despite the (expected) loss ratio improvement in auto physical damage and homeowners' lines in the first half of 2024, difficulties around managing catastrophic exposures as well as social inflation impacting liability lines continue to drive loss ratios up and challenge the insurers operating in the admitted market.

Difficulties that admitted carriers face in rate approval process due to regulatory landscape in key states such as California (the largest P&C market in the U.S.) make it harder to resolve the profitability issues quickly. Numerous top insurers offering homeowners insurance in California have paused or restricted new business in 2023, and ultimately started to drop policies altogether in early 2024, due to regulatory scrutiny and long processing times (this can take longer than 6 months) on rate increase approvals. California Department of Insurance (CDI) has been working to execute on a 'Sustainable Insurance Strategy' announced in September 2023 to address the fundamental issues with the archaic regulatory landscape and incentivize the admitted carriers back into the state. However, material impacts of executing this strategy have not yet been observed and insurance companies are skeptical about whether the announced changes in 2023 will streamline the process and durations for rate change applications.

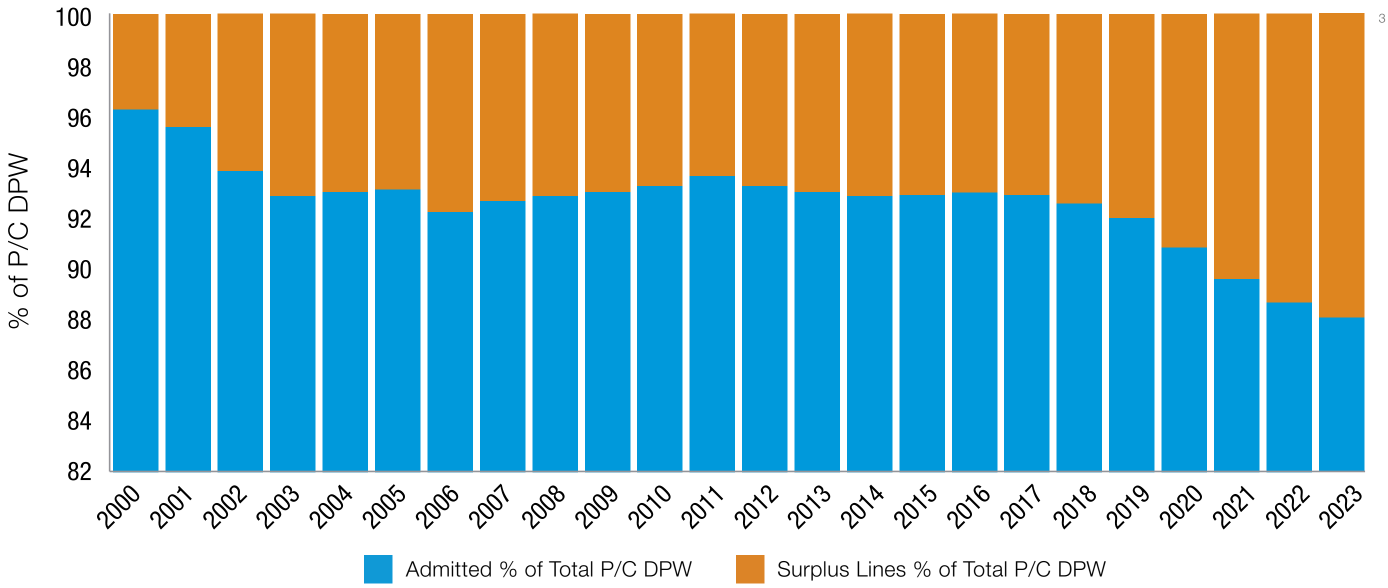
In this landscape, the excess and surplus (E&S) market seems promising with its double-digit growth rates, improving underwriting results and further penetration potential into personal lines.

Over the last 5 years, U.S. E&S insurance market growth has been outperforming overall P&C market growth: In 2023, surplus lines direct premiums written totaled $115 billion, with a five-year CAGR of 18%, increasing its share in the U.S. P&C Market from 7% in 2018 to 12% in 2023. The E&S market is heavily penetrated into commercial lines with around 24% share, whereas personal lines is still there, implying further growth and penetration potential for E&S players.

US Surplus Lines – DPW by Segment



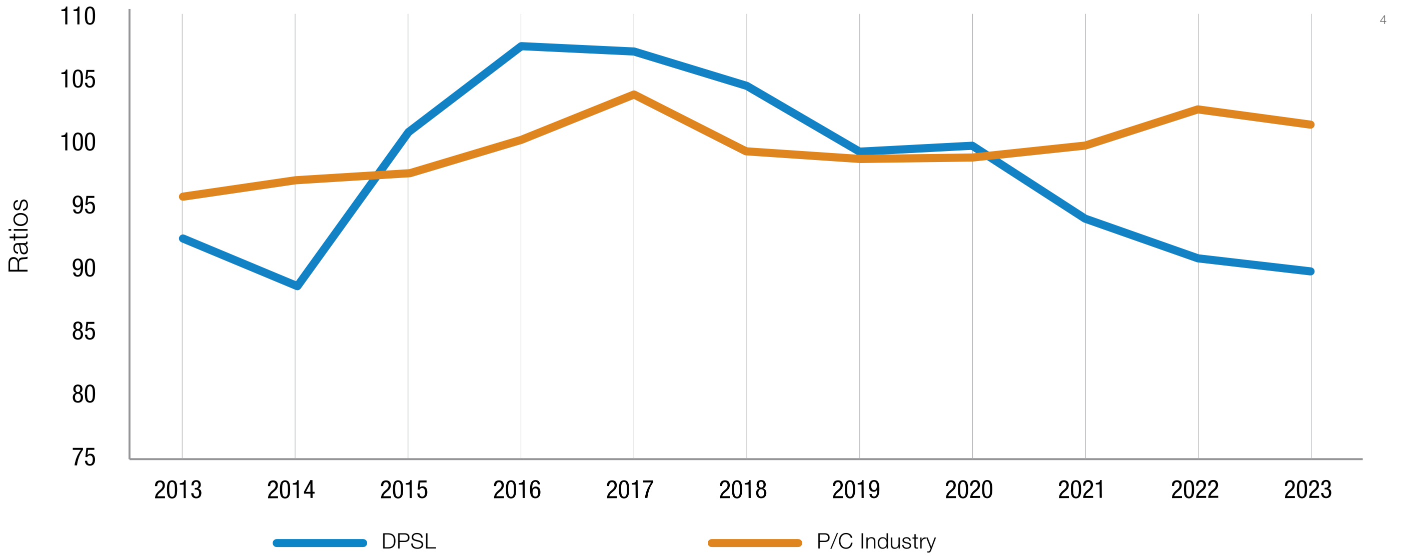
US P/C Industry - Admitted vs. Surplus Lines, Proportion of DPW



E&S market growth in the last five years has been driven by both casualty (two-thirds of the total E&S market) and property lines (one-third of the total E&S market). The market has grown at double-digit rates per annum, as admitted carriers shed more business falling outside of their risk appetite to the E&S market where rate increases are not limited by regulation. Furthermore, elevating weather-related catastrophic risks, increase in claims with rising construction costs, and social inflation are enabling surplus lines writers to get a larger share of the total P&C market.

Amidst such a solid growth performance, underwriting results of the E&S market materially improved between 2020 and 2023: According to AM Best, Domestic Professional Surplus Lines Composite Net Combined Ratio improved to 90% in 2023 – 11 points lower than P&C industry's 101.5%, as hard pricing in most lines of business was able to keep pace with loss costs.

US DPSL Composite vs. US P/C Industry - Net Combined Ration

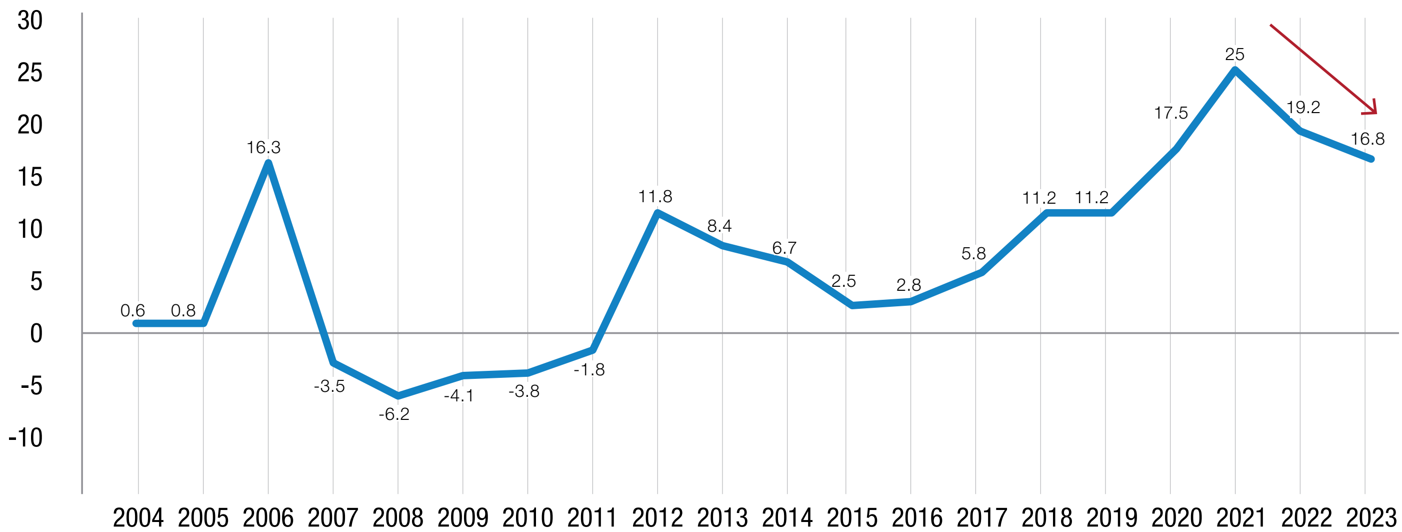


Meanwhile, there are challenges in the E&S market for incumbents and potential new entrants.

Despite all these positive developments in the E&S market, there are challenges that still remain. Entering this high-growth space may turn out to be a short-term play for some insurers given the trends listed below:

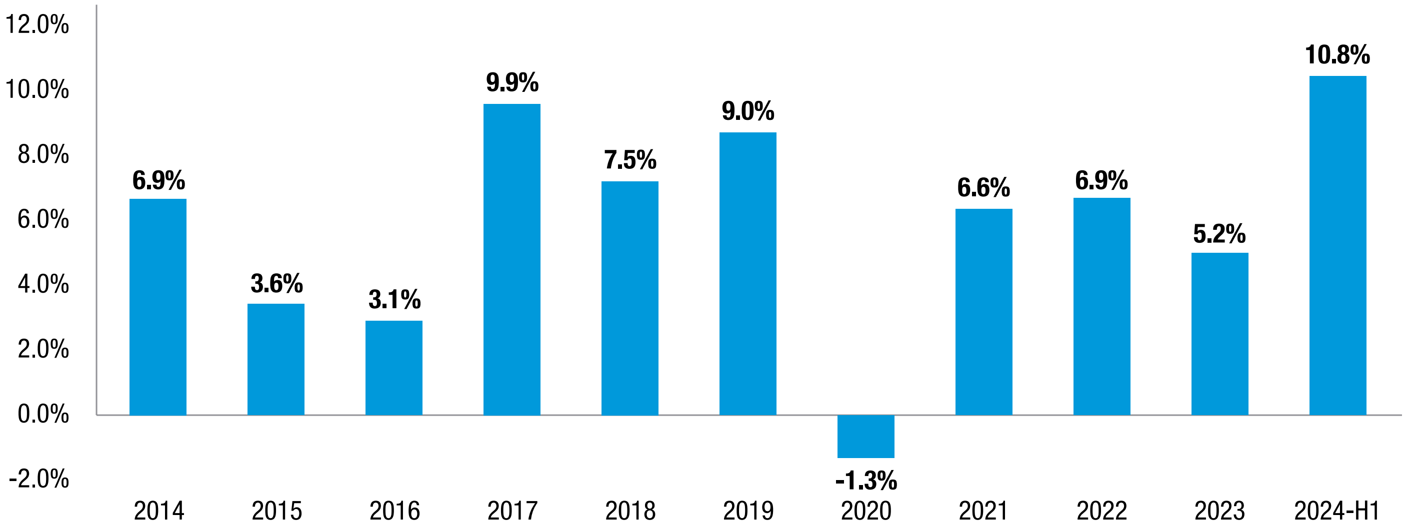
Growth slowed down in 2023 though it is bouncing back in 2024: While keeping its double-digit performance, the E&S market's annual growth slowed down between 2021 and 2023, reaching its lowest nominal growth rate since 2019. Nevertheless, transaction data from stamping offices in 15 states (to help oversee surplus lines transactions that constitute roughly two-thirds of total E&S market premiums) report transaction volume growth of 10.8% in the first half of 2024 – the highest real growth rate in the last decade. Hence, real growth seems to have bounced back in 2024, with the longer-term trend remaining to be seen.

E&S Market Growth Rate Evolution (%)



Source: Exhibit 1 in A.M.Best September 18, 2024 Market Segment Report [5]

E&S Market Growth Rate Evolution (%)



Source: Wholesale & Specialty Insurance Association Stamping Office Line of Business Reports [6]

Catastrophe (CAT) exposure and volatility in property: Losses and loss expectations are rising in CAT prone states due to both loss frequency and severity increase amidst more volatile weather-related flooding and fires. Besides, exposure of carriers in CAT prone states such as (California and Florida) has risen due to increased home building of higher-value properties near wilderness areas and coastal regions. On the other hand, admitted carriers lack adequate rate increases due to regulatory scrutiny in these areas. Hence, admitted carriers have been reconsidering their exposure levels in CAT prone states. Although this remains as an opportunity for E&S carriers to grow their portfolios in CAT prone areas with the right pricing, property is still a volatile line given its catastrophe exposure and this is not an easy risk to manage even for E&S carriers.

Intensifying competition in casualty amidst the loss cost drivers: Since 2019/20, there has been an influx of new entrants to the casualty lines (two-thirds of the E&S market). New players have brought fresh capacity, attracted experienced talent away from established carriers, and put inevitable pressure on rates. Meanwhile, revitalizing court activity post Covid-19, rising nuclear jury verdicts and growing litigation funding trend increase potential losses, especially for established carriers that carry big legacy claim portfolios and create an additional need for rate increases which cannot be quickly pursued amidst the competitive landscape.

Distribution: The distribution channel mix comprises of wholesaler brokers and agents, retail agents and brokers, program managers and managing general agents (MGAs). Amongst these, wholesaler brokers have a dominant presence since they placed almost 95% of E&S premiums over the last 5 years[7]. For new entrants and smaller players that lack established wholesaler relationships, the E&S market is hard to place and grow share.

What should existing players and potential entrants consider?

Despite the high growth rates in the last few years and lucrative profitability compared to the overall P&C market, challenges in the E&S market are there given the CAT-related volatile nature of property lines and competitive landscape amidst the cost pressure in casualty lines.

In this context, being a successful carrier in the promising E&S market requires full clarity in strategy and risk appetite as well as relentless execution. New entrants and high growth players should plan to achieve an optimal portfolio mix consistent with their longer-term profitable growth objectives. While doing this, pros and cons of each line of business need to be taken into account together with the competitive strengths of the player. For example, a carrier that targets to grow more in the relatively underpenetrated E&S homeowners' insurance market in CAT prone areas should be ready to manage the inherent volatility through setting the right levels of reserves as well as reinsurance protection mechanisms. On the other hand, a carrier that targets to grow more in the casualty space should be ready to push for reaching enough scale amidst the intense competition, while taking the loss control measures given the cost pressures. In both ways, having advanced predictive analytics capabilities is essential to create and sustain competitive advantage through better margin management.

Having full clarity in the desired portfolio mix is crucial from a distribution channel and underwriting talent management perspective as well. Carriers should be clear in communicating their desired growth areas in the well-established wholesaler distribution network in the E&S market and set appropriate distribution channel incentivization/disincentivization mechanisms for certain sub-lines. Investing in the distribution channel relationship and a qualified underwriting team to support in a consistent way is key, as organic growth through relationship development with the main E&S channels will take time.

Actively targeting inorganic growth opportunities is another way for faster growth. Some of the new market entrants in the last three years may inevitably fail and become acquisition targets for established players. Acquiring a target that has some degree of fit with the acquirer's desired portfolio mix and shaping the target's line of business and distribution channel mix post-acquisition is a challenging but quick way to achieve the desired scale. Other acquisition (or partnership) targets for potential entrants could be successful MGAs in the E&S space - with the support of smart technology and special knowledge that they developed in specific niches, MGAs help carriers enter profitable niches that are otherwise very hard to penetrate.

How A&M can help

With our experienced team of industry executives, former regulators, and data analytics experts, A&M's Insurance and Risk Advisory Team is ready to support carriers targeting to enter/grow into the E&S market in multiple ways:

Strategy & Operations:
A&M is ready to provide strategic advice, and operations support to help companies' sustainable profitable growth endeavors in the following:

- Market entry/growth strategy and evaluation of growth options
- Product line and/or territorial expansion strategy
- Regulatory & compliance support amidst the challenges of complying with additional regulations while growing in new lines/territories
- Interim management support for effective growth strategy execution
- Distribution effectiveness
- Program/project management office support
- Staff augmentation

Mergers & Acquisitions:
A&M professionals combine first-hand performance and financial improvement and regulatory experience with deep technical knowledge to help ensure critical transactional metrics are achieved. A&M teams support insurance clients throughout the acquisition, merger integration and divestiture lifecycle via the following services:

- Acquisition /merger strategy and planning
- Full-scope integrated due diligence and valuation
- Regulatory review and approval
- Integration planning, synergy development/tracking and transition to business as usual

Data Analytics Support:
A&M's advanced analytical techniques draw insights from data, predict outcomes, measure performance, and reduce risk. We improve profitability and support companies' margin strategies across all operational areas — distribution channel management; rate quoting, underwriting and sales; policy management and renewal; claims management; reserve analysis and optimization as well as reporting processes.

Resource links

[1] Premium growth remained elevated at around 10% in 1H24, also driven by personal lines, but competition is building as more carriers reach rate adequacy.: US Property & Casualty outlook: strong winds, smoother sailing | Swiss Re

[1] While net premiums written grew 10.0%, policyholders' surplus grew at a lesser rate of 6.2%: 2023-annual-property-and-casualty-insurance-industries-analysis-report.pdf

[2] See Table 2: Premium growth and loss ratios by lies of business, YTD, 1H24: US Property & Casualty outlook: strong winds, smoother sailing | Swiss Re

[3] See Exhibits 2 and 4 in this AM Best report: improved-underwriting-and-operating-results-sustain-us-surplus-lines-market-momentum.pdf

[4] See Exhibit 13 in this AM Best report: improved-underwriting-and-operating-results-sustain-us-surplus-lines-market-momentum.pdf

[5] See 'Surplus lines YoY % Chg column in Exhibit 1 in this AM Best report: improved-underwriting-and-operating-results-sustain-us-surplus-lines-market-momentum.pdf

[6] See % growth in 'Items in the tables presented in each of the WSIA reports here. Each number of the graph is obtained from the respective period's report: Stamping Offices & SLAs

[7] Wholesale brokers placed 93% to 94% of E&S premiums over the past five years: A Deep Dive Into the E&S Insurance Market | Insurance Thought Leadership

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