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Texas Surplus Lines Insurer Financial Update

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Annually the Surplus Lines Stamping Office of Texas (Stamping Office) prepares a Composite Financial Summary of the insurers operating on a surplus lines basis in Texas. The purpose of this composite is to display a snapshot of the relative size and strength of the insurers comprising the surplus lines market in Texas over the most recent five-year span. These composites are a product of the insurer evaluation function of the Stamping Office. We have been evaluating insurers for 23 years, with the primary work product an evaluation report delivered to the Texas Department Insurance (TDI) for its use in deciding on insurer eligibility. The year 2011 is a year of significant change for the Stamping Office Financial Analysis function because of the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act bill that included the Nonadmitted and Reinsurance Reform Act (NRRA). The NRRA created new federal standards for insurer eligibility and set in place preemptions of state insurer eligibility laws. The federal requirements are far less extensive than the existing state laws and regulations. The criteria under NRRA as it relates to eligibility of U.S. domiciled insurers are only twofold: licensure and minimum capital and surplus of $15 million, unless the state has a higher minimum. For non-U.S. insurers, no agent could be prohibited from using an insurer appearing on the NAIC International Insurers Department list (the IID List). Prior to July 21, 2011 (the effective date of the NRRA) and under our Plan of Operation the Stamping Office evaluated each insurer that is eligible (listed on the Surplus Lines Insurers List) as well as those seeking eligibility and recommend to TDI whether an insurer possesses the financial characteristics to be eligible. As no changes were made to the Insurance Code or our Plan of Operation, the Stamping Office will continue to thoroughly evaluate insurers and publish a five-year financial summary for each insurer on our website (slsot.org) as a pdf file. A potential issue exists if non-U.S. insurers elect not to provide financial information to evaluate because they are IID-listed. Even though state eligibility law is preempted in many ways, there is no change to the laws or regulations with which a Texas licensed surplus lines agent must comply. Surplus lines agents have a statutory "duty of reasonable effort … to ascertain the financial condition … of surplus lines insurers", "to make a reasonable inquiry into the financial condition of the insurer" and a "continuous duty to stay informed of the insurer's solvency and financial strength."

Published SLSOT insurer financial summaries are important for interested parties needing this information and also help agents meet their legal obligations. Each Friday during the year, the Stamping Office publishes the five-year summaries for those insurers that have been evaluated during that week, making the summaries some of the most current financial data available. The Exhibit on page 2 is the result of compiling significant data elements from each insurer's evaluation. This exhibit compares various annual

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aggregate financial data and ratios for eligible surplus lines insurers operating in Texas.

The year 2010 can, in some respects, be considered a year of "rolling backward" after 2009 was a year of "recovery." Aggregate net income after tax was $5.755 billion, 31% lower than 2009, although 89% of the insurers recorded net income compared to 83% in 2009. The return on policyholder's surplus grew to 7.9 % compared to 7.2% in 2009. Underwriting gain fell to $608 million, a decline of $1.918 billion (-76%) with 61% of the insurers recording underwriting gains in 2010 compared to 68% in 2009. Evidence and insurer comments in their Management's Discussion and Analysis of Operations (MD&A) suggest that underwriting discipline, fewer catastrophic events and release of redundant loss reserves were not enough to offset the soft market pricing, excess capacity and poor economy. The other significant driver of net income, net investment gain (before tax), fell to $4.990 billion compared to $7.416 billion in 2009. The combined ratio in 2010 for these surplus lines insurers deteriorated to 94% compared to 91% in 2009.

Capital and surplus (C&S) in aggregate for 2010 declined $21.9 billion or 19% after an 18% increase in 2009. This aggregate decline was due primarily to the departure of one surplus lines insurer with C&S of $14.7 billion, as well as dividends paid, increases in nonadmitted assets and changes in other surplus components such as deferred income tax, reinsurance reserve penalties and unrealized capital gains and losses. Average C&S was $483 million in 2010 compared to $593 million in 2009.

The 2010 year saw both gross premium and net premium decline. Nearly every company's MD&A or Director's report identified soft rates, lower insured

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Texas Surplus Lines Insurer Composite Financial Information

Calendar Year 2010-2006 and Comprised of Currently Eligible Insurers *

	2010	2009	2008	2007	2006
Capital & Surplus	93,768,544,643	115,689,479,798	97,879,840,420	102,692,104,822	96,255,165,279
Average	483,343,014	593,279,384	496,699,698	546,234,600	556,388,239
Median	100,031,960	94,401,947	83,750,500	92,426,439	86,819,000
Underwriting Gain (Loss)	607,753,468	2,525,510,498	253,624,543	4,006,155,437	3,571,040,220
Average	3,181,955	13,222,568	1,424,857	21,538,470	20,883,276
Median	172,771	960,152	1,034,000	1,969,636	1,835,687
Net Income After Tax	5,754,866,769	8,351,650,025	4,067,005,775	10,146,951,413	6,294,992,030
Average	30,288,772	43,049,742	20,750,029	54,261,772	36,812,819
Median	4,387,745	4,863,624	2,358,436	5,697,642	5,877,948
Return on Policyholder Surplus	7.9%	7.2%	4.1%	13.0%	10.5%
Gross Premium	73,155,036,957	85,514,361,135	87,958,091,414	72,764,196,877	81,066,459,165
Average	381,015,817	443,079,591	451,067,135	395,457,592	479,683,190
Net Premium	35,138,452,035	47,004,141,691	50,067,687,310	51,322,190,259	41,542,047,622
Average	183,012,771	242,289,390	259,418,069	278,924,947	245,810,933
Gross Premium to Surplus Ratio	78%	74%	90%	71%	84%
Net Premium to Surplus Ratio	37%	41%	51%	50%	55%
SLSOT Premium Processed**	2,708,948,357	3,274,335,562	3,222,601,195	3,724,220,192	2,998,384,870
Average	16,930,927	18,499,071	18,104,510	21,527,284	20,536,883
Combined Ratio	94%	91%	96%	92%	88%
	Number of Insurers				
Insurers Included	194	195	190	187	173
Foreign (U.S.)	146	146	143	139	130
Alien (Non-U.S.)	48	49	47	47	44
Underwriters at Lloyd's (Syndicates)	75	74	76	70	63
Eligible Insurers Owned by a Top 50 Global Reinsurance Group	45 (23%)	44 (23%)	40 (21%)		
Premium / % of total	$1.3 B / 38%	$1.3 B / 37%	$1.1 B / 33%		
New Submissions for Eligibility	4	5	14	12	8
Priority Rating Changes Upgrades	28 / 14%	20 / 10%	23 / 12%	17 / 9%	27 / 16%
Priority Rating Changes Downgrades	6 / 3%	19 / 10%	22 / 11%	14 / 7%	7 / 4%
Increased capital & surplus	149 / 77%	150 / 77%	100 / 51%	143 / 76%	157 / 91%
Underwriting gains	119 / 61%	132 / 68%	107 / 60%	136 / 72%	124 / 72%
Net income	175 / 89%	162 / 83%	139 / 71%	164 / 88%	151 / 87%
Positive Op. Cash (U.S. insurers)	112 / 75%	107 / 73%	111 / 77%	112 / 79%	110 / 86%

* Exclusive of Underwriters @ Lloyd's ** Will not equal total premium processed by the SLSOT

(Insurer, continued from page 2)

exposures due to the world-wide economic downturn, competition and excess insurer capital as causes for the decline in premium. Gross premium for these 194 eligible insurers was $73.155 billion, a decline of 14.5% over the prior year. Net premium declined 25.2% in aggregate, $11.866 billion. The gross premium to surplus ratio increased to 78% in 2010 from 74% in the prior year, with the net premium to surplus ratio declining to 37% from 41%. These two ratios are indicators of leverage and excess capital remaining in the market.

There are three distinct risk-bearing entities in the Texas surplus lines market. As of October 1, 2011 foreign (U.S.) insurers make up 75% of eligible insurers [146], Alien (Non-U.S.) insurers are 25% of eligible insurers [48] plus Underwriters at Lloyd's, London [75 Syndicates]. Of the 48 Non-U.S. insurers, 46 are IID-listed. Premium produced by licensed surplus lines agents and processed by the Stamping Office for these entities in 2010 was as follows: Foreign insurers $2.415 billion, 73%; Alien insurers $245.4 million, 7% and Lloyd's $649.6 million, 20%. As of September 30, 2011 the total processed premium of $2.406 billion was down year-to-date 3.7% compared to the same period in 2010. The three types of entities maintained the same market share in 2011 as in 2010. The top ten individual insurers (including Lloyd's) reported 51% of the total premium processed by the Stamping Office in 2010, with this percent declining to 48% as of September 30, 2011. All of the individual top ten premium insurers are members of insurance groups. When compiling premium for insurers belonging to an insurance group, the top ten groups wrote 57% of the premium processed by the Stamping Office in 2010, a decline of 6% compared to 2009's total.

Data in the lower section of the Exhibit reflect the number and percent of surplus lines insurers that had increases in C&S, underwriting gains, net income and positive operating cash flow. C&S increased for 149 insurers (77%), underwriting gains were recorded by 119 insurers (61%). Income was earned by 175 insurers (89%) and operating cash flow was positive for 75% of the U.S. Insurers. Even in the soft market Texas had four new submissions for eligibility.

2010 was the third consecutive year gross premium declined for eligible Texas surplus lines insurers and the fourth year net premium declined. Along with lower gross and net premium, underwriting gains were significantly lower in 2010. The lower underwriting gains were partially offset by improved investment income, resulting in a 7.9% return on policyholder surplus. The soft market persists, but some commentators see a stabilization and potential market turn. Arguing for a market turn is that insurers have generally used up reserve redundancies and investment rates of return are still historically low, plus the number of catastrophes and higher reinsurance costs should require underwriting discipline and rate increases. Other commentators argue that the status quo will prevail due to an overcapitalized market, aggressive standard lines carriers in the S/L market and few positive signs the overall economy is improving. Insurers operating on a surplus lines basis in Texas are financially sound with healthy balance sheets, although less so than in 2009. Texas eligible surplus lines insurers continue to outperform the P&C market and commercial insurance markets as a whole. ★

SLSOT Seminars

The SLSOT hosted two seminars in October , *"2011 Texas Surplus Lines Insurance Regulation".* If you missed the seminar in Houston or Arlington, we have uploaded the SLSOT, Texas Comptroller, and Texas Department of Insurance speaker handouts on our website at www.slsot.org. Please visit the seminar link under the "*Publications & Education"* menu. ★

EFS Quick Tips

Electronic Policy Filing

- Call the EFS Help Desk (800) 681-5848 for assistance in using the new policy id "tie back" for corrections that may appear as late filings.

- EFS entries must be made from information shown on the policy, binder, endorsement, etc. They should never be made from information shown on an invoice or email or because you will be renewing a policy. An invoice or email is not a legally binding part of the policy. ★

Helpful Hints

Paper Policy Filing

- Reconcile your batch edits and monthly reports as soon as they are received. Notify us of any errors as quickly as possible. If the information isn't reconciled in a timely manner, it may be too late to have corrections made which may result in an item being listed on the Late Filers Report.

- Be sure to notify TDI when you have a change of address. It's not enough to call or email the Stamping Office with this information. ★

11th Annual Salsa & Queso Contest

After a long, hot, and extremely dry summer, we are finally enjoying some cooler temperatures in Texas. To kick off the fall season the Stamping Office held its 11th annual Salsa & Queso Contest on Halloween. This year Angelica Perez, Help Desk Specialist, was the winner for Best Salsa. This is her 3rd win overall in this category. Toby Pick, Data Entry Analyst, enjoyed his 1st win with Best Queso. The winners received $25 cash prizes in addition to bragging rights and custody of the famous sombreros. ★

Comparison of SLSOT Premium Processed by Line of Business

Annual Statement Line of Business	Premium through 10/31/2011	Premium through 10/31/2010	Percent Change
1 Fire (including allied lines)	$749,854,879	$774,416,928	-3.17%
2 Allied lines	$47,361,653	$35,624,817	32.95%
3 Farmowners multiple peril	$812,198	$985,068	-17.55%
4 Homeowners multiple peril	$88,802,273	$83,145,576	6.80%
5 Commercial multiple peril	$186,319,135	$153,177,764	21.64%
8 Ocean marine	$15,131,504	$13,538,256	11.77%
9 Inland marine	$43,833,313	$50,494,041	-13.19%
11 Medical malpractice	$47,329,545	$47,196,378	0.28%
12 Earthquake	$73,972	($21,472)	444.50%
13 Group accident & health	$54,903,228	$66,047,114	-16.87%
15 All other A&H	$5,306,943	$4,230,083	25.46%
17 Other liability	$1,140,348,074	$1,136,099,909	0.37%
18 Products liability	$18,797,427	$16,330,240	15.11%
19.2 Other private passenger auto liability	$0	$3,112	-100.00%
19.4 Other commercial auto liability	$65,827,306	$56,583,444	16.34%
21.1 Private passenger auto physical	$2,212,297	$1,965,066	12.58%
21.2 Commercial auto physical damage	$36,681,384	$53,754,330	-31.76%
22 Aircraft (all perils)	$4,075,498	$4,903,957	-16.89%
23 Fidelity	$1,514,615	$2,552,890	-40.67%
24 Surety	$656,744	$833,505	-21.21%
26 Burglary & theft	$4,117,358	$2,731,991	50.71%
27 Boiler & machinery	$115,031	($1,247,116)	109.22%
28 Credit	$155,044,765	$253,002,043	-38.72%
31 Aggregate/other business	$212,150	$454,465	-53.32%
TOTAL	$2,669,331,292	$2,756,802,389	-3.17%

Note: Due to rounding figures may not total

Texas market data reports are updated monthly and available to view and print on our website at www.slsot.org under the link Texas Market Data.

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The "Lone Star Lines" newsletter is published quarterly by the Surplus Lines Stamping Office of Texas for surplus lines agents, companies, and others involved in the surplus lines industry.

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We invite readers to suggest topics for articles that may be of interest to others.