PEOPLEFIRST
Property & Casualty Services

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TERMS TO KNOW

The Specialty Lines Market - What is It?

The specialty lines insurance market is the segment of the insurance industry where the more difficult or unusual risks are written. Because specialty lines insureds tend to be more unusual or higher risk, much of the specialty lines market is characterized by a high degree of specialization. Insurers participating in this market have specialized expertise and experience in underwriting and rating insurance for a wide range of risks. These insurers usually work with brokers who are experienced in specialty lines insurance. Much of the product development comes from the broker community in their quest to protect the insureds.

The specialty lines insurance market focuses on two types of products: unusual or difficult insurance and higher risk accounts. An example of an unusual or difficult product is professional liability, and an example of a higher risk account would be a manufacturer of explosives. The professional liability line is included in the specialty lines market because the underwriting, rating and claims functions require a high degree of expertise and experience. The explosives manufacturer would be included because of the unique products liability exposures presented.

Insurance in the specialty lines market is provided on an admitted (licensed) basis or a “surplus lines” (non-admitted) basis..

General Liability Insurance

General Liability insurance will protect an organization in the event the insured causes bodily injury or property damage to others and becomes legally obligated to pay damages. Liability for Bodily Injury can occur when a physical injury to a person is caused by third party. Liability for Property Damage can occur when a third party causes direct or indirect damage (such as loss of use of property) to another person's property.

General liability insurance is standardized and relatively easy to obtain. It is often provided in a package policy with other coverages, sometimes called a business office package policy. Most general liability policies issued to professional organizations contain exclusions for professional liability claims.

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The Surplus Lines Market

The surplus lines insurance market exists due to a regulatory distinction and provides an alternative for unusual or higher risk insurance unavailable to purchasers from licensed insurers. Coverage may be unavailable from licensed insurers due to the exposures presented by the particular account or the terms and conditions in the coverage provided. For insureds unable to secure insurance coverage from licensed companies, the surplus lines market provides an alternative market with flexibility, additional capacity and innovative underwriting.

The surplus lines market goes by a variety of names, including the following:

- Excess and Surplus Lines Market
- E&S Market
- Non-admitted Market

The licensed market goes by a complementary set of names, including:

- Licensed Market
- Standard Market
- Admitted Market

Insurers operating in the surplus lines market are generally small, specialty insurers or specialized divisions of larger insurance organizations. In either case, the participants have significant experience and expertise with segments of the unusual coverages and businesses found in the surplus lines market.

The excess and surplus lines market is among the least understood and most misinterpreted segments in the property/casualty industry. An illustration of this is the common fallacy that surplus lines insurance transactions are unregulated. In fact, most states have detailed insurance laws governing the activities of their surplus lines constituents, and there is the possibility that some form of federal regulation could be enacted.

Surplus lines insurers are not "licensed" in the state where insured or risk is located, although they must be "licensed" in their state (or country) of domicile. However, all surplus lines insurers are subject to solvency and other insurance department regulation, and must be "approved" in each state they operate in. All U.S. jurisdictions have surplus lines laws that protect insurance consumers by controlling the eligibility standards of surplus carriers and requiring specially trained brokers and agents to assist consumers.

The specially trained brokers are called surplus lines brokers, and must be licensed in their state of residency to transact surplus lines business. Surplus lines brokers are generally wholesale brokers. Some, more specialized surplus lines brokers also have authority to underwrite on behalf of insurers. These brokers are called managing general agents (MGAs), program administrators or underwriting managers. Tennant Risk Services is an Underwriting Manager.

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State regulation of licensed insurers includes the approval of all policy forms and rates. Licensed insurers will not normally file policy forms, underwriting guidelines and rates for approval with state insurance departments for coverages or classes of business that are unusual (and therefore present small markets) or higher risk due to the complexity, time and high cost of filing. Therefore, these types of risks are better served in the surplus lines market, which is not subject to rate and form filing requirements. This alternative approach allows for customized coverages and innovative underwriting.

To the unsophisticated insurance buyer, state review of rates and forms ensures fairness in pricing and adequacy of coverage. A difficulty experienced by insurers and consumers when these regulations exist, however, is that the approval process can be slow and stifle creativity. The nature of much of the specialty lines insurance market dictates a flexible market in order to meet the specialty lines buyer's needs. The rate and form flexibility of the surplus lines market provides for a more creative and responsive market.

For an account to be placed in the surplus lines market it must be declined by the standard market. If a retail insurance agent or broker cannot find coverage for a unique or higher risk account they may turn to the surplus lines market to purchase appropriate coverage. The insured's agent or broker contacts a surplus lines broker for placement with specialty insurers operating in the surplus lines market. The exact mechanics of the process may vary in each state, but the intent in most states is that an account must be declined by the standard (licensed) market in order for it to be written in the surplus lines market.

Premiums received for risks placed in the surplus lines market are subject to a surplus lines tax in every state. In most states this surplus lines tax is approximately the same as the premium tax imposed upon licensed domestic and foreign carriers. The tax for licensed insurers is included in the premium, while the surplus lines tax is in addition to the premium. Also, many states have fees and additional paperwork required for state tax purposes in addition to the surplus lines tax.

Insureds with coverage from licensed insurers have some protection from insurer insolvency from state guarantee funds. State guarantee funds that provide claims payment protection to the insured in the event of insurer default do not apply to surplus lines coverage (except in New Jersey). Note that some state guarantee funds have low limits of recovery that apply to commercial insureds.

Most surplus lines business is commercial, although some unusual or higher risk personal lines coverage is placed in the surplus lines market. An example of personal lines coverage in the surplus lines market is catastrophe-prone homeowners insurance.

The surplus lines market is also a proving ground for new products and underwriting concepts. Recent examples of new products beginning in the surplus lines market are employment practices liability coverage and products to respond to hacker exposures. Other types of risks may be written by either the surplus lines market or in the licensed market, depending upon the exposures presented by the specific account, include directors and officers coverage and umbrella coverage.

Since 1994 the A.M Best Company has performed an annual survey of the excess and surplus lines market and has found that its solvency record is as good, if not better, than the overall industry.

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Claims Made Vs Occurrence Policies

There are two primary forms of liability insurance policies - claims-made and occurrence policies. Most professional liability insurance, including directors and officers and employment practices liability insurance, is written on a claims-made basis.

An occurrence policy obligates the insurance company to pay for claims arising out of occurrences during the policy period regardless of when the claim is reported. The policyholder is covered for any incident that occurs during the term of the policy regardless of when the claim arising from the incident is reported to the company. In some situations the claim might be made many years after the incident occurred. This leads to uncertainty for both the insured and the insurer.

A claims-made policy protects an insured against claims or incidents that are reported while the policy is in force. Normally, a claims made policy provides coverage for acts occurring prior to the claims-made policy period. Coverage for acts occurring prior to the policy period is called "prior acts coverage," and the period prior to the policy period for which claims are covered is called the prior acts period. Prior acts coverage is usually only provided when a claims-made policy has been in force immediately prior to the current claims-made policy on a basis consistent with the prior policy. Prior acts coverage is defined as "full prior acts", covering acts occurring at any time prior to the current policy period, or is defined by a "retroactive date." When a retroactive date is used, prior acts coverage is provided from the retroactive date to the current policy period.

"Tail coverage," also called an "extended reporting period," provides protection for claims that are filed after a claims-made policy has been non-renewed or canceled. This coverage is optional, and the need can arise if the professional organization is acquired or goes out of business, or a decision is made not to purchase insurance. The terms and pricing for tail coverage vary greatly and are usually defined in the policy