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TO THE HOUSE COMMITTEES ON CONSUMER PROTECTION AND COMMERCE AND JUDICIARY

TWENTY-EIGHTH LEGISLATURE
Regular Session of 2016

Wednesday, March 23, 2016
2:10 p.m.

TESTIMONY ON SENATE BILL NO. 2684, S.D. 1, H.D. 1 – RELATING TO MOTOR VEHICLE INSURANCE.

TO THE HONORABLE ANGUS L.K. MCKELVEY AND KARL RHOADS, CHAIRS, AND MEMBERS OF THE COMMITTEES:

My name is Gordon Ito, State Insurance Commissioner, testifying on behalf of the Department of Commerce and Consumer Affairs ("Department"). The Department provides the following comments.

The Department requests language be inserted in proposed section 431:10C-D, Hawaii Revised Statutes ("HRS"), that an insurer must submit policies covering transportation network company ("TNC") activity to the Insurance Division for review and approval prior to the initial offer to TNCs or TNC drivers, with a provision that a mandatory delay period be in place prior to the TNC policy becoming effective. Proposed language for the Committee's consideration could be inserted as a new subsection in section 2, proposed section 431:10C-D, HRS, as follows:

"All policies shall comply with chapter 431."

We thank the Committees for the opportunity to present testimony on this matter.

TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
TWENTY-EIGHTH LEGISLATURE, 2016

ON THE FOLLOWING MEASURE:
S.B. NO. 2684, S.D. 1, H.D. 1, RELATING TO MOTOR VEHICLE INSURANCE.

BEFORE THE:
HOUSE COMMITTEES ON CONSUMER PROTECTION & COMMERCE AND ON JUDICIARY

DATE: Wednesday, March 23, 2016 **TIME:** 2:10 p.m.

LOCATION: State Capitol, Room 325

TESTIFIER(S): Douglas S. Chin, Attorney General, or
Rodney I. Kimura, Deputy Attorney General

Chairs McKelvey and Rhoads and Members of the Committees:

The Department of the Attorney General submits comments on legal issues posed by this bill.

The purposes of this bill are to establish motor vehicle insurance requirements for transportation network companies and transportation network company drivers, and to expressly authorize the counties to regulate transportation network companies, transportation network activities, and transportation network drivers.

The first legal issue is a subject-title problem stemming from section 3 on pages 13-14. The title of this bill is "Relating to the Motor Vehicle Insurance." Section 3 of the bill authorizes the counties to regulate transportation network companies, transportation network activities, and transportation network drivers. Article III, section 14, of the Hawaii State Constitution provides in pertinent part that "Each law shall embrace but one subject, which shall be expressed in its title." County regulation of transportation network companies, transportation network activities, and transportation network drivers is not related to motor vehicle insurance. Accordingly, the provisions in section 3 of the bill on page 13, line 10, continuing to page 14, line 7, should be deleted.

The second legal issue relates to proposed section 431:10C-D(k) on page 11, lines 9 to 12, of the bill. The provision requires that the insurance carrier for the transportation network company "be licensed to do business as a motor vehicle insurance company in the State."

If enacted, proposed subsection (k) will have the effect of prohibiting nonadmitted insurance. Such a prohibition could pose a risk of preemption of the subsection. Currently, federal law provides that "the placement of nonadmitted insurance shall be subject to the statutory and regulatory requirements solely of the insured's home State." 15 U.S.C. § 8202(a). This federal law has a broad preemption provision that preempts "[With respect to subsection (a) of this section,] any law . . . of any State that applies or purports to apply to nonadmitted insurance sold to, solicited by, or negotiated with an insured whose home State is another State. . . ." 15 U.S.C. § 8202(c).

We add that the prohibition stemming from proposed subsection (k) will conflict with section 431:8-301(a), Hawaii Revised Statutes (HRS), which permits insurance to be procured from an unauthorized insurer under certain circumstances specified in subsection (a).

To minimize the risk of preemption and to harmonize proposed subsection (k) with section 431:8-301(a), HRS, we recommend that lines 9 to 12 on page 11 be revised to provide as follows:

> [~~The~~] <u>Unless otherwise required by federal law, the</u> transportation network company insurance carrier shall be licensed to do business as a motor vehicle insurance company in the State, <u>notwithstanding section 431:8-301.</u>

Thank you for the opportunity to testify on this measure.

U B E R

TESTIMONY OF BRIAN HUGHES ON BEHALF OF UBER TECHNOLOGIES IN OPPOSITION TO SB 2684 SD1 HD1

March 23, 2016

Thank you Chair McKelvey, Chair Rhoads, and members of the Committee for the opportunity to provide testimony on SB 2684. As the General Manager of Uber Hawaii, I am testifying in opposition to the proposed draft of SB 2684.

This Bill is a significant deviation from legislation that has passed in 30 states, including several states with insurance and regulatory landscapes that are similar to Hawaii. Substantial changes would need to be made to allow Uber to operate and there are a number of items within the Bill that prevent us from supporting it.

There are several definition changes necessary in this Bill. Many of the definitions used are out of date, carried over from bills predating passed legislation in other states. The definitions in Section 431:10C-A of Transportation Network Companies and Transportation Network Company Driver would need to be updated to reflect current legislation that provides a more holistic solution. We would also suggest the addition of a definition for “Personal Vehicle” as well as“Prearranged Ride.” Both are critical concepts in distinguishing TNCs. We would recommend striking the “Transportation Network Company Activity” term and definition in favor of a term and definition of “Prearranged Ride.”

> "*Personal Vehicle*" means a vehicle that is:
> (a) Used by a Transportation Network Company Driver to provide a prearranged ride;
> (b) Owned, leased or otherwise authorized for use by the Transportation Network Company Driver; and
> (c) Not a taxicab, limousine, or other for-hire vehicle.
> "*Prearranged Ride*" means the provision of transportation by a TNC Driver to a rider:
> (a) Beginning when a TNC Driver accepts a rider’s request for a ride through a Digital Network controlled by a Transportation Network Company;
> (b) Continuing while the TNC Driver transports the requesting rider, and
> (c) Ending when the last requesting rider departs from the Personal Vehicle.
>
> The term ”prearranged ride” does not include transportation provided through any of the following:
> (a) A ridesharing arrangement as defined by HRS § 279G-1;
> (b) Use of a taxicab, limousine, or other for-hire vehicle;
> (c) A regional transportation provider.

The insurance language used in Section 431:10C-C and 431:10C-D should be updated to reflect two periods of activity to reflect the distinct levels of risk from when a driver is on a prearranged ride and when a driver is simply logged into the app with only one person in the vehicle with no need to drive to find demand and no immediate ability to engage in commercial activity. We would advocate for the following update:

> **431:10C-C. FINANCIAL RESPONSIBILITY OF TRANSPORTATION NETWORK COMPANIES.** On or before July 1, 2016 and thereafter, a Transportation

Network Company Driver or Transportation Network Company on the TNC Driver's behalf shall maintain primary automobile insurance that:

(a) Recognizes that the TNC Driver is a Transportation Network Company Driver or otherwise uses a vehicle to transport passengers for compensation and covers the TNC Driver:

(1) while the TNC Driver is logged on to the Transportation Network Company's Digital Network; or

(2) while the TNC Driver is engaged in a Prearranged Ride.

(b) The following automobile insurance requirements shall apply while a participating Transportation Network Company Driver is logged on to the Transportation Network Company's Digital Network and is available to receive transportation requests but is not engaged in a Prearranged Ride:

(1) Primary automobile liability insurance in the amount of at least $50,000 for death and bodily injury per person, $100,000 for death and bodily injury per incident, and $25,000 for property damage.

(2) Personal injury protection coverage that meets the minimum coverage amounts where required by HRS § 431:10C–103.5.

(3) The coverage requirements of this subsection (b) may be satisfied by any of the following:

(A) Automobile insurance maintained by the Transportation Network Company Driver; or

(B) Automobile insurance maintained by the Transportation Network Company; or

(C) Any combination of subparagraphs (A) and (B).

(c) The following automobile insurance requirements shall apply while a Transportation Network Company Driver is engaged in a Prearranged Ride:

(1) Primary automobile liability insurance that provides at least $1,000,000 for death, bodily injury and property damage;

(2) Personal injury protection coverage that meets the minimum coverage amounts where required by HRS § 431:10C–103.5.

(3) The coverage requirements of this subsection (c) may be satisfied by any of the following:

(A) Automobile insurance maintained by the Transportation Network Company Driver; or

(B) Automobile insurance maintained by the Transportation Network Company; or

(C) Any combination of subparagraphs (A) and (B).

(d) If insurance maintained by TNC Driver in subsections (b) or (c) has lapsed or does not provide the required coverage, insurance maintained by a Transportation Network Company shall provide the coverage required by Section 3 beginning with the first dollar of a claim and have the duty to defend such claim.

(e) Coverage under an automobile insurance policy maintained by the Transportation Network Company shall not be dependent on a personal automobile insurer first denying a claim nor shall a personal automobile insurance policy be required to first deny a claim.

(f) Insurance required by this Section 3 may be placed with an insurer licensed under HRS § 431:3-203 or with a surplus lines insurer eligible under HRS § 431:8-301 that has a credit rating of no less than "A-" from A.M. Best or "A" from Demotech or similar rating from another rating agency recognized by the department of insurance.

(g) Insurance satisfying the requirements of this Section 3 shall be deemed to satisfy the financial responsibility requirement for a motor vehicle under the Motor Vehicle Safety Responsibility Act, Chapter 287 of the Motor Vehicle Code.

(h) A Transportation Network Company Driver shall carry proof of coverage satisfying sections 3(b) and 3(c) with him or her at all times during his or her use of a vehicle in connection with a Transportation Network Company's Digital Network. In the event of an accident, a Transportation Network Company Driver shall provide this insurance coverage information to the directly interested parties, automobile insurers and investigating police officers, upon request pursuant to HRS § 291C-137. Upon such request, a Transportation Network Company Driver shall also disclose to directly interested parties, automobile insurers, and investigating police officers, whether he or she was logged on to the Transportation Network Company's Digital Network or on a Prearranged Ride at the time of an accident.

We also recommend striking the following language, and instead advocate for the ability for insurance policies to expressly exclude specific types of activity:

During transportation network company activity, and notwithstanding any other law to the contrary, the following shall apply:

(1) The transportation network company driver's or the vehicle owner's personal motor vehicle insurance policy shall not be required to provide any coverage to any person or entity unless the policy expressly provides for that coverage during transportation network company activity, with or without a separate charge, or the policy contains an amendment or endorsement to provide coverage for transportation network company activity, for which a separately stated premium is charged; and

(2) The transportation network company driver's or the vehicle owner's personal motor vehicle insurance policy shall not be required to provide a duty to defend or indemnify for the driver's activities in connection with the transportation network company, unless the policy expressly provides otherwise for transportation network company activity, with or without a separate charge, or the policy contains an amendment or endorsement to provide coverage for transportation network company activity, for which a separately stated premium is charged.

The above language explicitly creates a gap in coverage and creates a condition outside the four corners of the insurance contract between two parties.

Additionally, Section 431:10C-F is an unnecessary addition as it attempts to go beyond the scope of insurance - addressing terms of use of the app unrelated to motor vehicle insurance.

We would also recommend striking the amendments to Section 46-16.5, as it will likely create a patchwork of regulation across counties that creates further burden on the business.

To date, 30 states across the country have passed TNC legislation, and while there is some variation amongst those states, if passed SB 2684 would be out of step with the rest of country. For example, SB 2684 currently requires one limit of insurance at all times. By requiring only one insurance limit, the insurance provisions of SB 2684 do not consider the fact that a transportation network company vehicle is fundamentally a personal vehicle with two distinct timeframes of activity ("Period One" and "Period Two") that occur when the Uber app is in use.

Period One is when a transportation network company (TNC) driver is logged on to the app and is available to receive transportation requests from potential riders, but has not been matched to a rider. Period Two begins when a TNC driver has accepted a ride request and continues until the last rider has exited the vehicle. Drivers are able to easily distinguish between the two periods as one is simply “app on” and the other is “on trip”.

During Period One, the vehicle’s use remains personal, as the driver is not transporting any passengers and has not accepted a ride for pick up. TNC drivers and riders are matched via GPS based on a TNC driver’s proximity to a potential rider, rather than through a traditional street hail. It is, therefore, unnecessary for a TNC driver to drive around during Period One in search of a rider. In fact, by pushing demand to the closest TNC driver, a driver is incentivized to avoid driving around, as it would waste gasoline and add mileage to his or her vehicle. Less miles driven during this period amount to a lower risk; thus, the limits of $50K/$100K/$25K appropriately address this risk.

Last year, the Colorado Commissioner of Insurance conducted a study of Period One and found no actuarial justification for increasing the insurance limits from similar amounts in Colorado ($50k/$100k/$30k) during the Period One timeframe. Moreover, these limits are 2.5 times the limits required of private passenger vehicles under Hawaii law ($20K/$40K/$10K).

During Period Two, when a rider is matched with a driver, Uber supports primary coverage with a liability limit of $1 million; an amount five times the limit required in SB 2684 and consistent with the coverage Uber now provides to TNC drivers in Hawaii and throughout the country.

The model insurance legislation developed by the National Conference of Insurance Legislators (NCOIL) encompasses these principles and accounts for the unique nature of the Uber app, and we urge the Committee to adopt this model. Not only do the liability limits in the NCOIL model more appropriately address the risk presented, but the NCOIL model requires that all other compulsory coverages required by state law also be included. In Hawaii, this means that personal injury protection benefits -- $10K per person -- will be required coverage from the time the app is turned on, to the time the app is turned off.

To date, of the 30 states that have passed TNC legislation, nearly every state’s language reflects the principles expressed in the NCOIL model. Several of those states require personal injury protection benefits, such as Minnesota, Kansas, and Maryland. The NCOIL model language, therefore, can and does take those important public protections into account. SB 2684 in its current form, would be a significant departure from the NCOIL model.

An additional benefit of the NCOIL model language is that it provides consumers with the opportunity to purchase additional coverage if they so choose, and thus, encourages the private insurance marketplace to innovate. Following the adoption of insurance regulations throughout the country, several large and well known insurance companies have developed insurance products for transportation network company drivers. As of today, at least 11 insurance companies have developed insurance products in some 23 states. These products provide coverage above and beyond what is required by statute, should a TNC driver wish to obtain additional coverage. One of the benefits of adopting the NCOIL model is that we expect that these products will become available in the Hawaii market and present another option for Hawaii residents.

Further, where a TNC driver chooses not to buy such coverage -- or where a TNC driver buys such coverage that lapses -- the TNC always has the obligation to provide primary insurance coverage. This ensures that there will never be a gap in coverage, and that personal injury protection benefits will always be available to injured persons.

The language in the Bill following §431:10C-F is unnecessary and seeks to go beyond the scope of insurance, and we believe it should be excluded from the Bill. We do support the language following §431:10C-G, which achieves the goal to ensure insurance coverage will not be undermined by any other contract. Uber Technologies, Inc. rider terms of service state very explicitly that they “Do not purport to limit liability or alter your rights as a consumer that cannot be excluded under applicable law.” This can be found in Section 5. This is stating our Terms of Service do not supercede or attempt to supercede any law to be passed, requiring insurance coverage or otherwise. It is not the intention of the terms of service to negate or override any law.

These terms are very similar to what is found in a host of other industries, particularly companies that similarly put individuals in touch with third parties who provide a service or product. For example, online marketplaces or auction houses generally disclaim liability for the conduct of third-party providers that deliver food or packages. This type of language used is standard in Hawaii from businesses across many industries--and is even used by the State itself.

Apps and websites that connect people with other people or services generally have very similar Terms of Service. Terms of Service from everything from dating apps to travel booking sites to even the State of Hawaii’s own site, include very similar language. This may help provide better context to what is a very commonplace industry practice - and one that does not undermine the efforts of the Legislature to ensure every trip is insured from end to end.

Thank you for the opportunity to provide testimony on this matter, and we look forward to working closely with the committee.

Testimony of
Gary M. Slovin / Mihoko E. Ito
on behalf of
USAA

DATE: March 22, 2016

TO: Representative Angus McKelvey
Chair, Committee on Consumer Protection and Commerce

Representative Karl Rhoads
Chair, Committee on Judiciary

Submitted Via CPCtestimony@capitol.hawaii.gov

RE: **S.B. 2684, S.D.1, H.D.1 – Relating to Motor Vehicle Insurance**
Hearing Date: Wednesday, March 23, 2016, at 2:10 p.m.
Conference Room: 325

Dear Chair McKelvey, Chair Rhoads and Members of the Joint Committee:

We submit this testimony on behalf of USAA, a diversified financial services company. USAA is the leading provider of competitively priced financial planning, insurance, investments, and banking products to members of the U.S. military and their families. USAA has over 82,000 members in Hawaii, the vast majority of which are military-based members.

USAA **supports the intent** of S.B. 2684, S.D.1, H.D.1, which establishes motor vehicle insurance requirements for transportation network companies and persons who operate or serve as drivers for transportation network companies ("TNCs").

This measure contains insurance requirements which reflect key principles that should regulate TNCs, including: 1) requiring TNCs to have primary insurance coverage that specifically covers TNC activity, 2) providing clear guidelines for TNC activity and 3) requiring claims cooperation by TNCs.

USAA supports this bill's efforts to institute responsible insurance requirements on the TNC industry. We have indicated our support as well for the NCOIL model, which was adopted with input from many of the stakeholders.

Gary M. Slovin
Mihoko E. Ito
C. Mike Kido
Tiffany N. Yajima

999 Bishop Street, Suite 1400
Honolulu, HI 96813
(808) 539-0840

With respect to the language of the current bill, S.B. 2684, S.D.1, H.D.1, we would respectfully request that the Committee consider amending or removing the following provision in the bill at page 13, lines 4-9:

> **§431:10C-G Limitations and exclusion inapplicable.** Nothing in this part shall limit or affect any motor vehicle insurance policy applicable to a passenger, pedestrian, or person other than a transportation network company driver while the driver is engaged in transportation network company activity.

We understand that this section was intended to clarify the application of uninsured and underinsured motor vehicle coverages. However, we believe that this paragraph creates an ambiguity around the overall purpose of the bill to establish insurance requirements for TNCs while excluding the personal auto policy. We also note that existing Hawaii law already makes it clear that UM/UIM will apply, and therefore, this paragraph might not be necessary.

Thank you very much for the opportunity to submit testimony on this measure.

National Association of Professional Surplus Lines Offices, Ltd.

4131 N. Mulberry Dr., Ste. 200
Kansas City, MO 64116
816.741.3910
F 816.741.5409

March 16, 2016

Hawaii State Legislature
415 South Beretania Street
Honolulu, HI 96813

Dear Sirs and Madams:

On behalf of the National Association of Professional Surplus Lines Offices (NAPSLO)[1], we appreciate the opportunity to provide comments in opposition to Senate Bill 2684. We do not oppose the basic fundamentals of the bill, however; we strongly oppose the provision in §431:10C-D(k) which would require a transportation network company (TNC) to obtain its insurance from a "licensed" insurance carrier. This provision may seem reasonable, but due to the non-standard and high capacity nature of TNC umbrella insurance, this provision will likely prevent a TNC from acquiring the necessary coverage with the policy terms that are appropriate for a TNC.

Surplus lines, or nonadmitted insurance, exists to ensure precisely the new and unique type of risk posed by a TNC. In order for the risk to be insured by the surplus lines market, it must be unavailable or declined by the "licensed" or admitted market. In the event no "licensed" carrier is willing or able to write coverage for the TNC, this bill will block the TNC from operating. All other states that have passed TNC bills have allowed the surplus lines market to provide coverage in the event the standard market is unavailable or declines to write the risk. For these reasons we urge you to oppose SB 2684 in its current form.

The surplus lines market has a superb solvency record and is appropriately regulated. The market serves an important role as a "safety valve" and supplement to the standard market, allowing consumers that may go without insurance a highly-respected, sound coverage.

[1] NAPSLO is the professional trade association representing the surplus lines industry and the wholesale insurance distribution system. Comprised of approximately 400 wholesale broker member firms, 100 surplus lines insurance companies, and 200 associates and services providers to the surplus lines market, our membership operates in over 1,500 offices representing tens of thousands of individual brokers, insurance company professionals, underwriters and other insurance professionals worldwide.

Financial Strength of the Surplus Lines Market

The attached report, A.M. Best's *2015 Special Report U.S. Surplus Lines—Market Review,* provides an overview of the strength and importance of the surplus lines insurance industry. We hope you will review it to better understand our industry and the important role we play in the insurance marketplace as you discuss surplus lines insurance.

A.M. Best is a premier ratings agency for the insurance market. They offer unbiased and in-depth reviews of insurers in order to help the public better understand an insurer's financial strength in the overall marketplace. The attached report highlights the superior financial strength of the overall surplus lines marketplace. According to A.M. Best, 2014 surplus lines premium volume exceeded $40.2b billion and represents a vast majority of insureds who, without the surplus lines market, would have a difficult time obtaining insurance. For the 11th year in a row, the surplus lines industry reported no financially impaired companies in 2014, in contrast to the admitted property/casualty industry's 207 disclosed financial impairments over the same period. Domestic professional surplus lines insurers continue to maintain a higher proportion of secure ratings than the overall property/casualty industry.

A.M. Best also indicates surplus lines insurers continue to demonstrate resiliency by remaining well capitalized despite significant market challenges and unprecedented natural catastrophes in recent years. Due to the huge impact of Superstorm Sandy, 2012 was a tough year for underwriting in property and casualty policies, yet surplus lines insurers remained strong.

Accessing the Surplus Lines Insurance Marketplace

The surplus lines marketplace is an essential part of the national insurance market. Just like the standard or admitted marketplace, it operates successfully in the state-based regulatory system where business is exported from one state to another.

Generally, when an insured is unable to secure needed insurance through licensed insurers, also known as admitted insurers, the insured may secure coverage through the nonadmitted market. However, an insured cannot go directly to the nonadmitted market to seek coverage. While the admitted market is accessed by a retail broker, the nonadmitted market is accessed by a wholesale broker. Retail brokers are typically prohibited from placing a risk with a nonadmitted company and must rely on the wholesale broker to place the risk on behalf of the retail broker's client. In most states, in order to place a risk with the nonadmitted market the admitted market must "decline" the risk. Once the nonadmitted market accepts the risk, it is considered to be "exported" to the nonadmitted market. In most cases without the nonadmitted market, the insured may not be able to secure required or desired insurance at all.

Surplus Lines Insurance Marketplace—How it works

The surplus lines market plays an important role in providing insurance for hard-to-place, unique or high capacity (i.e., high limit) risks. Often called the "safety valve" of the insurance industry, surplus lines insurers fill the need for coverage in the marketplace by insuring those risks 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 surplus lines market acts as an effective supplement to the admitted market.

Surplus lines insurers are able to cover unique and hard-to-place risks because, as nonadmitted insurers, they are able to react to market changes and accommodate the unique needs of insureds that are unable to obtain coverage from admitted carriers. This results in cost-effective solutions for consumers that are not "one size fits all," but are instead skillfully-tailored to meet specific needs for non-standard risks.

Risks typically written in the surplus lines market fall into three basic categories: (1) non-standard risks, which have unusual underwriting characteristics; (2) unique risks for which admitted carriers do not offer a filed policy form or rate; and (3) capacity risks where an insured seeks a higher level of coverage than most insurers are willing to provide.

Examples of the types of risks commonly insured by the surplus lines market include:
- Coastal property coverage;
- A developer re-building homes and businesses in hurricane-prone areas;
- A sports celebrity that wants to insure their legs or hands;
- A school district building a new high school;
- A non-profit association that seeks to provide food, medical care and education to the Third World;
- A research lab working on a promising, yet unproven new drug;
- A law firm specializing in intellectual property work;
- Earthquake coverage; and
- High layer casualty coverage, among many others.

The surplus lines market is particularly important in introducing new products to the market efficiently. New and innovative products, and processes and procedures for which there is no loss history are difficult, if not impossible, to price or rate for insurance purposes. Surplus lines insurers are uniquely qualified to cover these emerging risks because they have developed this expertise through decades of experience.

The Regulation of a Surplus Lines Transaction

While the surplus lines market is regulated differently than the admitted market in order to provide the flexibility necessary to cover the hard-to-place risks, it is important to understand that it is subject to diligent regulation. Each U.S. based (domestic) surplus lines company is licensed (admitted) in at least one of the 50 states or other U.S. jurisdiction and must fulfill the solvency requirements of that state or jurisdiction. Like admitted insurers, the surplus lines insurer's state of domicile is the financial solvency regulator of that insurer.

Nonadmitted insurance companies are domesticated in their home state. In general, they cannot write surplus lines business in their domestic state. A nonadmitted insurer is regulated by the insurance department in their domestic state, submitting to all the same rigorous rules and regulations as an admitted insurer. However, nonadmitted insurers are not required to adhere to the rate and forms requirements of the admitted market, allowing the nonadmitted market the flexibility to underwrite unique risks in an actuarially sound fashion. In addition to the solvency regulation of the surplus lines insurer's domiciliary state or country, the surplus lines insurer must meet eligibility standards in order to insure risks in any state through a licensed surplus lines broker.

Although solvency regulation is the purview of the surplus lines insurer's domiciliary state, the actual surplus lines transaction is regulated through a licensed surplus lines broker. Surplus lines brokers do not generally work directly with consumers. Rather, they work directly with retail agents and brokers representing the insured that was unable to secure insurance through the admitted 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 the requirements of the surplus lines codes.

One of the most significant regulatory requirements imposed by state surplus lines laws is that a surplus lines broker must complete a diligent search of the admitted markets. A diligent search represents the attempt to find the coverage from admitted insurers before a policy is placed in the surplus lines market. The standard to fulfill the diligent search requirement can vary from state to state, but generally, three companies licensed to write the kind and type of insurance must decline a risk before it can be placed in the surplus lines market.

The licensed surplus lines broker in each state is also responsible for providing the insured with a written statutory notice regarding a surplus lines transaction. Every state requires a notification to the insured party in a surplus lines transaction that discloses: (1) the surplus lines policy is not covered by the state guaranty fund; and (2) the insurance is placed with a surplus lines company that is not subject to many of the state's regulations. As the sole regulated entity in a surplus lines placement, the surplus lines broker must hold a surplus lines license, which is required in every state.

Conclusion
The surplus lines market is a financially stable segment of the insurance industry and plays a vital role in insuring difficult to place risks in a way that is tailored to each specific insurance need when the risk is one that cannot be placed in the standard market. Though regulated differently than the admitted market, surplus lines transactions and professionals are regulated, and our industry plays a vital role in helping bring new products, technology and services to market every day. SB 2684 would prohibit that vital service for a TNC and for that reason we would ask you to NOT recommend the bill for passage.

If you have any questions regarding the surplus lines market, please do not hesitate to reach out to us.

Sincerely,

Keri A. Kish

John Meetz

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BEST'S SPECIAL REPORT
Our Insight, Your Advantage.

U.S. Surplus Lines
Record Levels Reached

August 2015

Founded in 1899, A.M. Best Company is the world's oldest and most authoritative insurance rating and information source. For more information, visit *www.ambest.com.*

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Segment Review
August 27, 2015

Surplus Lines Profit from Underwriting Discipline and Core Competencies

Product diversification, underwriting discipline and market conditions drive profitable 2014 surplus lines results.

Underwriters of surplus lines continued to report profitable results in 2014 including profits from favorable reserve development. Results were driven by a combination of product diversification, underwriting discipline, and advantageous market conditions. As a result, surplus lines companies continue to outperform the overall property/casualty industry and recorded a second straight year of underwriting profitability following three years of underwriting losses.

A. M. Best's outlook on the surplus lines insurance market remains stable. In addition, the overall macroeconomic environment has been conducive to increased merger and acquisition (M&A) activity. We have seen over the past five years that surplus lines, as well as specialty admitted carriers, have been the target of M&A. Targeted companies provide acquirers an opportunity either to establish a new surplus lines platform, or to supplement an existing one.

Surplus lines insurers also have kept pace with Enterprise Risk Management tools and processes due to increased oversight by regulators and rating agencies. Management at these firms have taken a closer look at their operations from an enterprise standpoint and have either better formalized existing programs or made the necessary adjustments to be more in-line with peers.

The persistent low interest rate environment continues and investment portfolio returns suffer as carriers struggle to replace maturing, and higher yielding, securities with suitable replacements without adding to credit and liquidity risk.

In January 2015, NARAB II was signed into law by President Obama as part of the Terrorism Risk Insurance Program Reauthorization Act of 2015. The market view is that NARAB II will make it easier for agents and brokers to conduct business and make the licensing process more streamlined. Productivity is expected to improve and the cost of business and compliance to decrease.

One of the hallmarks of the surplus lines insurance market is the development of new insurance solutions to address new or emerging risks, or to provide improved coverage for known risks. The core competencies of the successful surplus lines carriers remain the same, focused on effective strategic analysis, product diversification and underwriting discipline. These companies typically concentrate more on bottom-line profits than top-line organic growth, utilizing the segment's freedom of rate and form, while providing coverage for the varied, nonstandard risks that they underwrite. This focus gives these insurers the best chance to withstand adverse market circumstances and succeed over the long term.

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SR-2015-117

Contents

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A.M. Best Surplus Lines Market Report - A Retrospective

More than two decades ago, A.M. Best published *Best's Insolvency Study: Property/Casualty Insurers 1969-1990*, in an effort to inform then-active debates over insurers' solvency. Sparked by interest in this topic, the Derek Hughes/NAPSLO Educational Foundation commissioned a similar study in 1994, on the solvency record of the domestic surplus lines industry. The segment was poorly understood by many at the time, but the data showed that, conventional wisdom aside, the surplus lines market's financial stability and solvency were at least on par with the overall property/casualty (P/C) industry.

Over the ensuing years, A.M. Best has published annually a special report on the surplus lines market, commissioned by the Foundation that has documented:

- The market's role in covering new or emerging risks, distressed risks, high-capacity risks, and 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 specific or unique coverage needs.
- The role of surplus lines distributors, including wholesalers and managing general agents (MGAs), which have played a critical and still growing part in developing products and forging relationships with insureds that facilitate the placement of business in this market.

Throughout its history, the surplus lines market has faced significant obstacles and intense competition. This includes aggressive pricing and liberal coverage from standard market carriers seeking organic growth, and the alternative risk transfer market's appeal as another means of covering potential surplus lines risk. Meanwhile, surplus lines industry representatives have been active in Washington D.C. and individual states on critical regulatory issues affecting the industry, advancing key pieces of legislation. Among these were the National Association of Registered Agents and Brokers (NARAB) provision of the 1999 Gramm-Leach-Bliley Act, which led to nonresident surplus lines agent and broker licenses and a new landscape in wholesale and MGA distribution. More recent actions include passage of the Nonadmitted and Reinsurance Reform Act in 2010, passage of NARAB II, along with the Terrorism Risk Insurance Program Reauthorization Act of 2015 and the introduction of new federal Flood legislation (see section III of this report).

Despite the challenges, the surplus lines market more than doubled from 3.3% of total P/C direct premiums written (DPW) in 1994 to approximately 7.1% by the end of 2014. As a percentage of commercial lines DPW, surplus lines insurers grew from a 6.1% share to 13.9%, hence further demonstrating the undeniable importance of the sector within the overall P/C industry.

Surplus lines companies in 1994 held a higher median A.M. Best financial strength rating (FSR) than the total P/C industry; 85.4% of surplus lines companies had secure ratings (defined as an A.M. Best rating from B+ to A++), compared to 74.2% for the industry. Through mid-year 2015, 100% of surplus lines companies maintained secure ratings versus 95.4% for the P/C industry. Most noteworthy is that 99% of surplus lines insurers have A.M. Best ratings of A- or higher, compared with 78% for the total P/C industry – further corroborating the health of the surplus lines sector today.

The surplus lines market clearly is a safety valve for the insurance industry, especially in hard markets. As emerging issues and exposures drive more demand for creative, comprehensive insurance solutions, A.M. Best believes the surplus lines market will continue to gain in prominence.

Section I – State of the Market

Continuing the momentum established in 2012 and 2013, the surplus lines sector ended the 2014 year in strong form. Leading the parade for this sector was nearly $1 billion of net underwriting profit which included over $525 million of net accident year underwriting profit, plus $376 million of additional profits taken from prior years in the form of favorable reserve development.

During the year, price momentum continued as direct premiums in this sector grew 6.7% (see **Exhibit 1**) despite competitive pressures domestically and abroad, robust balance sheets in need of putting capital to work, as well as new entrants. There is no doubt that insurers and underwriters have resigned themselves to the reality of today's low interest rate environment and the fact that we are likely to remain in this malaise for some time.

Exhibit 1

U.S. Surplus Lines – Direct Premiums Written (DPW) by Segment (1988-2014)

(USD millions)

	Total P/C Industry		Total Surplus Lines		DOMESTIC PROFESSIONALS				LLOYD'S			REGULATED ALIENS (excluding Lloyd's)				DOMESTIC SPECIALTY			
Year	DPW	Annual % Chg	DPW	Annual % Chg	DPW	Annual % Chg	Surplus Lines Market Share	No. of Cos.	DPW	Annual % Chg	Surplus Lines Market Share	DPW	Annual % Chg	Surplus Lines Market Share	No. of Cos.	DPW	Annual % Chg	Surplus Lines Market Share	No. 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%	40,234	6.7%	28,274	5.4%	70.3%	135	8,157	14.9%	20.3%	3,302	-1.8%	8.2%	60	501	13.9%	1.2%	58

The total DPW for Regulated Alien Insurance Companies represents those companies that had filed annual 2014 financial statements with the NAIC as of July 22, 2015.
Source: BESTLINK – *Best's Statement File - P/C*, US, A.M. Best data and research

In general, the market position of surplus lines insurers continues to be described in favorable terms such as profitable, stable, well-capitalized and consistent performers. These attributes are the result of effective strategic analysis, product diversification, underwriting discipline, advantageous market conditions, and an environment conducive to opportunistic mergers and acquisitions. With a business profile that industry members traditionally refer to as "counter-cyclical", these carriers are extending their trends of favorable overall profitable results. Though some carriers have encountered difficulties, in general the surplus lines carriers remain strong performers and in control of their circumstances.

In our 2015 review of the state of the surplus lines market, A.M. Best will discuss many points, including:

- Market share of the leading members of this line of business
- Factors contributing to financial performance
- Merger and acquisition activity impacting these carriers
- A.M. Best's views on the near-term market cycle.

One advantage to surplus lines insurers is their ability to obtain new business declined by standard carriers at a price deemed supportive of the risk profile. The results for these companies are growth in premium levels, improvement in cash flow, and expansion of the invested asset base. These factors and others led to the surplus lines market recording a second straight year of underwriting profitability following three years of net underwriting losses. It is worth noting that there were no large scale weather events in either 2013 or 2014. A complete review of the aggregate financial results is provided in Section II of this report.

Over the past five years, surplus lines as well as specialty admitted insurers have been the target of mergers and acquisitions (M&A). This is also true of existing insurers who have formed new surplus lines platforms and those that decide to build out their existing platforms. In most cases, M&A activity features strong performing companies targeting other strong performers. This is highlighted by the June 10, 2015 announcement of Tokio Marine & Nichido Fire Insurance Co., Ltd., already active in the U.S. surplus lines market, acquiring HCC Insurance Holdings, Inc. (a key participant in the surplus lines market). HCC, in turn, had recently acquired ProAg Insurance. Additional M&A activity over the past year includes Global Indemnity's purchase of American Reliable and Fosun Group's acquisition of Meadowbrook Insurance. These actions merely mirror similar activity across the insurance industry.

While the latest two years have produced strong profitability, results in earlier years were impacted by weather related losses including Superstorm Sandy in 2012. That event was significant by any measure, and for many surplus lines carriers, it pushed incurred losses to record levels producing results that were outside historical trends and resulted in combined ratios for the Domestic Professional Surplus Lines (DPSL) that exceeded the ratios for the overall property/casualty industry for the first time in more than a decade. In the aftermath, many insurers revisited their books of business in terms of insured exposures and policy terms and conditions.

Enterprise risk management (ERM) programs continue to grow in prominence within organizations, with regulators and rating agencies alike looking to management teams to incorporate or revisit risk appetite and tolerance statements within their ERM structures. In order to adhere to these guidelines, most companies have worked proactively to be compliant while others are trying to keep pace revisiting risk management frameworks, processes and procedures, exposure aggregations, and risk mitigation tactics.

The continuing investment market challenges such as low return rates and headline making defaults (Detroit, Harrisburg, and Puerto Rico) apply negative pressure to portfolios. Carriers with strong balance sheets featuring available capital are under pressure to improve return on equity rates. These conditions are leading standard market carriers to exert greater pricing discipline and minimize risk, while leading surplus lines carriers to exhibit more conservative rate management in concert with obtaining premium levels in-line with loss costs. The end result has been improved performance outcomes across both markets.

The total surplus lines direct written premium is distributed across a variety of corporate structures and company domiciles. **Exhibit 5** consolidates the distribution of premium by segment, representing the increases across the line and by segment. A.M. Best believes this reflects an expanding appetite for appropriately underwritten surplus lines business, including business written through Lloyd's syndicates.

Exhibit 2
Surplus Lines Specialists – Operating Performance (2014)
(%)

Group Name	Change in DPW	Loss/LAE Ratio	Combined Ratio	Pre-Tax ROR (%)	Pre-Tax ROE (%)
Alleghany Insurance Holdings	3.3	54.7	89.1	23.0	14.4
Arch Insurance Group	18.7	64.7	96.1	8.0	6.6
Argo Group	3.8	62.1	97.3	13.3	7.6
AXIS Insurance Group	-0.4	73.4	109.8	-2.2	-1.3
Catlin U.S. Pool	17.6	76.3	97.8	4.1	2.7
Global Indemnity Group	-8.6	62.1	104.1	2.2	1.8
HCC Insurance Group	3.1	47.1	77.5	35.1	14.0
IFG Companies	-11.1	56.4	98.3	11.5	4.6
James River Insurance Company	44.6	56.4	88.7	33.3	10.8
Markel Corporation Group	4.7	57.0	95.8	10.6	8.8
RLI Group	2.2	43.2	84.0	25.3	20.4
W. R. Berkley Group	10.3	59.3	91.7	20.6	19.3
Western World Insurance Group	17.8	23.8	57.8	50.4	35.3
Average - Surplus Lines Specialsts	**8.2**	**56.7**	**91.4**	**18.1**	**11.2**
Total P/C Industry	**4.5**	**69.0**	**97.2**	**12.8**	**9.2**

Source: BESTLINK – A.M. Best Co.'s AMB Credit Report - Insurance Professional

Surplus lines specialists provide wide ranging product diversification to cover the varied exposures that require critical insurance solutions in the market. These specialists, as shown in **Exhibit 2** and **Exhibit 3** generate a significant amount of operating profits, solid returns and favorable reserve development. Surplus lines specialists are U.S. domiciled insurers that primarily write surplus and / or specialty admitted business. These specialists largely exclude companies or groups that are part of a much larger, global multiline insurance operation, but include some specialty groups with Bermuda-based parents.

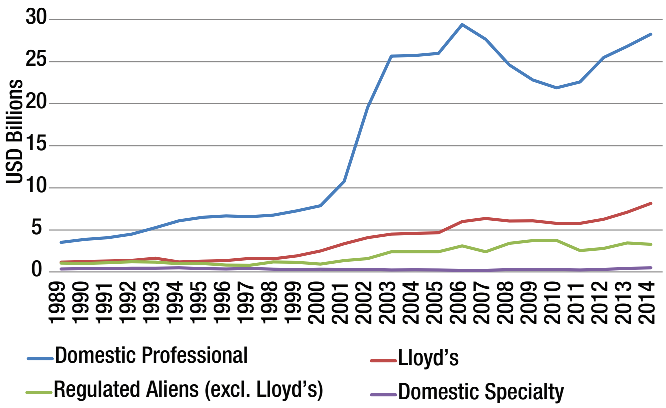
Reserve adequacy is a material component of A.M. Best's assessment of overall capital adequacy and the ongoing trend of favorable though tightening reserve development for the surplus lines market has been recognized. A.M. Best continues to expect this ability to benefit from favorable reserve development to dissipate. The point at which the industry as a whole is unable to sustain consolidated favorable reserve development may be nearer than before. However, surplus lines carriers that are able to maintain conservative loss reserve selections and support strong balance sheet positions will likely

Exhibit 3
Top Surplus Lines Specialists – Loss Reserve Development (2014 Calendar Year)
(USD thousands)

Group Name	One-Year Loss Reserve Development Through 2014 (000)	One-Year Development to Original 2013 Reserves (%)
Alleghany Insurance Holdings	-$218,284	-2.2%
Arch Insurance Group	-$31,754	-2.2%
Argo Group	$2,175	2.0%
AXIS Insurance Group	-$99,596	-5.5%
Catlin U.S. Pool	$13,189	9.9%
Global Indemnity Group	$5,920	2.2%
HCC Insurance Holdings	-$70,546	-4.0%
IFG Companies	-$13,434	-3.5%
James River Insurance Company	-$15,604	-13.3%
Markel Corporation Group	-$164,276	-5.6%
RLI Group	-$66,967	-9.2%
W. R. Berkley Group	-$155,527	-1.8%
Western World Insurance Group	-$178,449	-30.0%
Average - Surplus Lines Specialsts	**-$76,396**	**-4.9%**
Total P/C Industry	**-$6,740,000**	**-1.6%**

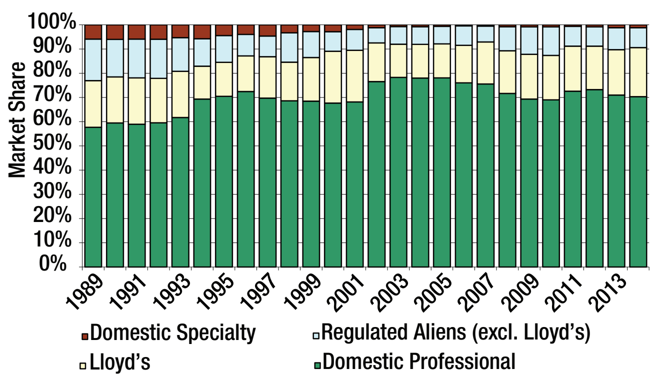
Source: A.M. Best data and research

Exhibit 4
U.S. Surplus Lines - DPW by Segment
(1989-2014)



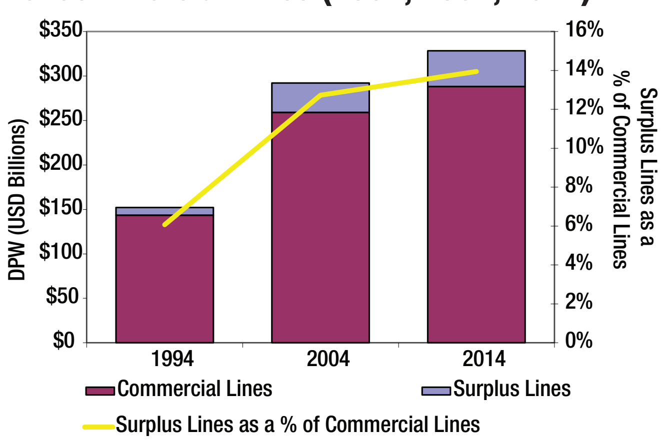
Source: A.M. Best data and research

Exhibit 5
U.S. Surplus Lines – Market Share by Segment
(1989-2014)



Source: A.M. Best data and research

Exhibit 6
U.S. Surplus Lines – Direct Premiums Written vs. Commercial Lines (1994, 2004, 2014)



Source: A.M. Best data and research

have the ability to benefit in forthcoming years and be able to absorb the inevitable fluctuations in loss frequency and severity.

Surplus lines insurers have traditionally applied specialized underwriting to each risk and utilized their freedom of rate and form to serve as a market of last resort. However, A.M. Best has observed an increase of traditional standard market carriers expanding their capacity to write non-standard business with a subsidiary or affiliate structured and designed to operate as a surplus lines company. While none of these companies have enough size to reach the status of a Top 25 surplus lines company (**Exhibit 8**) in terms of direct premiums written many are within striking distance and may reach this level in the coming years as they continue to grow. A handful of these companies are expanding their appetite for nonadmitted business to retain membership within the group or as a diversification play.

For the fourth straight year, domestic professional surplus lines (DPSL) carriers, those writing >50% of their business on a nonadmitted basis, saw their direct premium levels grow. Growth also was seen across other channels when comparing 2014 to 2013 (**Exhibit 4**), notably non-Lloyd's alien companies (this premium is tracked by the National Association of Insurance Commissioners).

Exhibit 6 shows the path surplus lines premium has taken over the last 20 years. Over time, surplus lines premium as a percentage of total commercial lines premium has increased steadily. The proportion seen in 2014 is the highest recorded since first measuring this split.

Further in-depth analysis of surplus lines financial results and measures will be explored in Section II – Financial Condition and Ratings Distribution.

Leading Surplus Lines Companies and Groups

Exhibit 7 encompasses the leading surplus lines organizations, measured on the basis of 2014 direct premiums written. We have already noted that the top position among surplus lines groups in terms of DPW has most recently been held by Lloyd's. The growth in premium written by Lloyd's and the increase in the Lloyd's share of the surplus lines market is a trend that began many years ago. Lloyd's provides a unique platform for partnering with MGAs or for primary insurers looking for reinsurance participants on their surplus lines programs.

Among domestic groups, the largest writer of surplus lines DPW remains AIG, primarily through Lexington Insurance Company. Its direct written premium levels remain near $5.0 billion, a consistent amount over the last five years and reflective of its strengths in the market. AIG has shifted some of its premium production offshore, from Lexington to AIG Europe Limited, a licensed non-Lloyds alien insurance company. This has constrained the total premium captured in the group rankings for the organization, but it is still more than double the surplus lines DPW of the next domestic group. The consolidation of the DPW generated by these two leading groups continues to remain near 30% of the measured surplus lines market.

Most of the composition of the top ten groups remains the same as last year, notably Nationwide Group (through the Scottsdale Insurance Company subsidiary), W.R. Berkley, Zurich Financial, and Markel. These organizations have consistently been among the leaders in surplus lines with long standing relationships and recognizable brand names. There is some shifting among the top groups for 2014 with Ironshore Insurance Group and Berkshire Hathaway accumulating significant gains in premium to reach a top ten position in the market. While Berkshire is making an aggressive run in this space, Ironshore was one of the companies that expected to be acquired by Fosun in 2015.

Exhibit 7
U.S. Surplus Lines – Top 25 Groups (2014)
Ranked by direct premiums written.
(USD Thousands)

Rank	AMB No.	Group Name	Surplus Lines DPW	Total Surplus Lines Market Share (%)
1	85202	Lloyd's	8,157,000	20.3
2	18540	American International Group	4,679,470	11.6
3	05987	Nationwide Group	1,780,987	4.4
4	18252	W.R. Berkley Group	1,485,813	3.7
5	18549	Zurich Financial Svcs NA Group	1,204,753	3.0
6	18468	Markel Corporation Group	1,191,418	3.0
7	18498	ACE INA Group	1,032,388	2.6
8	18728	Ironshore Insurance Group	894,986	2.2
9	00811	Berkshire Hathaway	835,316	2.1
10	03116	Fairfax Financial (USA) Group	793,974	2.0
11	18640	Alleghany Insurance Holdings	780,702	1.9
12	18313	CNA Insurance Companies	745,886	1.9
13	18130	XL America Group	726,916	1.8
14	18603	AXIS Insurance Group	591,135	1.5
15	00012	Chubb Group of Insurance Companies	574,425	1.4
16	18484	Arch Insurance Group	548,931	1.4
17	04019	Argo Group	526,338	1.3
18	18713	QBE Americas Group	522,550	1.3
19	18591	Allied World Group	517,559	1.3
20	04835	Great American P&C Group	472,564	1.2
21	18720	Catlin U.S. Pool	443,724	1.1
22	18604	State National Group	434,505	1.1
23	18783	Aspen US Insurance Group	425,002	1.1
24	18756	Starr International Group	396,987	1.0
25	03262	Swiss Reinsurance Group	378,134	0.9
		Subtotal of Top 25	**$30,141,363**	**74.9**
		Total U.S. Surplus Lines Market	**$40,233,826**	**100.0**

Source: A.M. Best data and research

Exhibit 8

U.S. Surplus Lines – Top 25 Companies (2014)

Ranked by direct premiums written.
(USD Thousands)

Rank	AMB No.	Company Name	Group Name	Surplus Lines DPW	Total Surplus Lines Share (%)
1	02350	Lexington Insurance Company	American International Group	3,780,213	9.4%
2	03292	Scottsdale Insurance Company	Nationwide Group	1,559,064	3.9%
3	03557	Steadfast Insurance Company	Zurich Financial Svcs NA Group	1,051,685	2.6%
4	03535	AIG Specialty Insurance Co	American International Group	899,194	2.2%
5	13866	Ironshore Specialty Ins Co	Ironshore Insurance Group	880,700	2.2%
6	03538	Columbia Casualty Company	CNA Insurance Companies	745,886	1.9%
7	11340	Indian Harbor Insurance Co	XL America Group	726,883	1.8%
8	12515	AXIS Surplus Insurance Company	AXIS Insurance Group	591,135	1.5%
9	04433	Westchester Surplus Lines Ins	ACE INA Group	575,138	1.4%
10	12523	Arch Specialty Insurance Co	Arch Insurance Group	548,931	1.4%
11	02428	National Fire and Marine	Berkshire Hathaway Group	540,747	1.3%
12	12619	Landmark American Ins Co	Alleghany Insurance Holdings	532,764	1.3%
13	02713	Chubb Custom Insurance Co	Chubb Group of Insurance Cos	526,899	1.3%
14	12562	QBE Specialty Insurance Co	QBE Americas Group	522,550	1.3%
15	03283	Colony Insurance Company	Argo Group	522,240	1.3%
16	01990	Nautilus Insurance Company	W. R. Berkley Insurance Group	506,983	1.3%
17	03759	Evanston Insurance Company	Markel Corporation Group	484,732	1.2%
18	02732	Essex Insurance Company	Markel Corporation Group	472,335	1.2%
19	12118	Gemini Insurance Company	W. R. Berkley Insurance Group	467,658	1.2%
20	03510	Illinois Union Insurance Co	ACE INA Group	457,250	1.1%
21	10092	Catlin Specialty Insurance Co	Catlin U.S. Pool	443,724	1.1%
22	03026	Admiral Insurance Company	W. R. Berkley Insurance Group	443,067	1.1%
23	13105	United Specialty Insurance	State National Group	434,505	1.1%
24	12630	Aspen Specialty Insurance Co	Aspen US Insurance Group	425,002	1.1%
25	13977	Starr Surplus Lines Company	Starr International Group	396,987	1.0%
		Subtotal		**$18,536,272**	**46.1%**
		Total U.S. Surplus Lines Market		**$40,233,826**	**100.0%**

Source: A.M. Best data and research

Greater variability is seen further down the top 25 list with a few organizations moving five or more spots up or down. Most member companies experience growth or contraction in direct premium levels as they move into or out of selected lines of business. As always, the counter cyclical nature of the surplus lines market relative to the standard insurance industry leads to a resolute expanding/contracting rhythm for their direct premium. This may launch a group into the top 25, only to see it drop off in later years. A continued trend is the expanded diversity of the market as the population of the top 25 companies shifts. (See **Exhibit 8**.) One ongoing driver is interest from investors for creating new entrants in this market as an investment opportunity is perceived. Another ongoing trend is the advancement of total direct premium, as many of the top 25 group members experienced overall growth in direct premium during 2014. This is a condition of the surroundings as the top surplus lines markets effectively exerted their market influence.

Given the historical trends, it would be a real challenge for any observer to predict how the list of leading companies would look in the near-term future. Although a fair portion of the rankings remain the same from ten years prior (see **Exhibit 9**), constant merger and acquisition activity, start-up companies, and poor operating performance can be expected to add companies to, or subtract them from, the surplus lines market. Even with this dynamic, A.M. Best believes that the top-tier surplus lines insurers, those with a proven track record of favorable operating results, strong balance sheet positions, and supportive market profiles, will retain their position through a combination of disciplined underwriting and product innovation.

Current Challenges

The ability to generate favorable underwriting results is the mainstay of profitability of any insurance company. A.M. Best actively monitors all conditions that impact markets, and as we will note here, certain factors created specific challenges for the surplus lines market participants. Even despite the last two years of strong underwriting profitability, surplus lines companies have been facing tighter operating conditions in order to be able to generate income. These companies continued to serve as a "market of last resort" for the higher hazard classes not served by traditional markets, and that is not expected to change any time soon.

Exhibit 9

U.S. Surplus Lines – Top 25 Groups (2005)

Ranked by direct premiums written.

(USD Thousands)

Rank	Company Name	Surplus Lines DPW	Total Surplus Lines Market Share (%)
1	American Inernational Group	6,977,070	21.0%
2	Lloyd's	4,675,000	14.0%
3	Zurich/Farmers	1,739,701	5.2%
4	ACE INA Group	1,497,092	4.5%
5	Nationwide Group	1,405,160	4.2%
6	W. R. Berkley Group	1,327,155	4.0%
7	Markel Corporation	1,276,579	3.8%
8	Berkshire Hathaway	886,294	2.7%
9	CNA Insurance Companies	814,094	2.4%
10	Arch Capital Group	796,143	2.4%
11	AXIS Insurance Group	630,238	1.9%
12	St. Paul Traveles Companies	599,185	1.8%
13	Argonaut Insurance Group	520,141	1.6%
14	Chubb Group	459,080	1.4%
15	United America Indemnity Group	437,025	1.3%
16	XL America Group	422,740	1.3%
17	RLI Group	390,213	1.2%
18	Great American P&C	367,955	1.1%
19	IFG Companies	361,291	1.1%
20	Hartford Insurance Group	355,823	1.1%
21	HCC Insurance Holdings Group	349,238	1.0%
22	Fairfax Financial (USA) Group	325,082	1.0%
23	HDI U.S. Group	306,218	0.9%
24	Western World Insurance Group	275,104	0.8%
25	Allianz of America	256,797	0.8%
	Subtotal	**27,450,418**	**82.5%**
	Total U.S. Surplus Lines Market	**33,280,702**	**100.0**

Source: A.M. Best Co. Report *Annual Review of the Excess & Surplus Lines Industry*, September 2006

As more companies enter the arena, either as start-ups, reinsurers dropping down to working layers, or standard carriers expanding their appetite and tolerance, competition will likely increase on price, distribution, risk management, and client services. Even with the surplus lines market's freedom of rate and form, a portion of the market's capacity is restricted by price sensitivity and unable to advance price corrections without a loss of market share, or for various reasons, still have operations conducted on an admitted basis. The discussion of the investment environment and the adverse impact it is having on the insurance industry has become repetitive. Almost every company across the industry has been forced to evaluate their portfolios and make tough choices to allocations, strategies, and risk / return tolerances. The surplus lines carriers are in this same boat and making the same choices. One area on which A.M. Best has already commented in separate special reports and webinars is diversification within investment portfolios focused on Schedule BA assets, hedge funds, private placements, and 144A holdings. Best has observed an increase in these assets in investment portfolios of surplus lines carriers to a level similar with the overall industry.

Concerns of where to invest "new money" and expectations of depressed future treasury yields are factors cited by insurance executives when discussing investment allocation decisions away from traditional assets. The analysis of investment risk will always have a comprehensive review of portfolio risk. Nonetheless, A.M. Best is alert to the modifications in investment risk tolerances and will take a deeper dive when necessary. Furthermore, in Best's Capital Adequacy Ratio (BCAR) analyses, more emphasis will be placed on understanding the risk parameters of these vehicles and significantly higher capital risk factors may be applied on the amounts allocated to these investments.

The surplus lines market typically receives credit for being ahead of the curve on innovation. As noted in prior special reports on this market, exposures such as technological advancements, environmental liability, and cyber risks are areas where surplus lines carriers have been able to meet the needs and demands of the markets. Underwriting discipline and sophisticated pricing models allow carriers to design and develop products providing appropriate coverage. The ability to advance these differentiating products continues to benefit this niche as the next generation of new exposures develops.

The greatest challenge to an individual surplus lines carrier may be retaining its market share. Since a fair portion of this business comes from brokers, surplus lines business is generally shopped each year to some extent, resulting in lower policyholder retention. As a group, surplus lines carriers have focused on improving retention via technology, better broker relationships and enhancing their underwriting analytical capability. This leads to a consistently competitive environment for retention. As one carrier tightens its risk appetite and deems certain types of exposures to be outside of its preferred risk profile, another may reach the conclusion it has the expertise and capability for that same risk.

In an effort to retain market share, some surplus lines organizations have enhanced their network through acquiring renewal rights or establishing new MGAs. Another area of concern for traditional surplus lines carriers is the fact that new entrants and new parents of existing players are likely to create even more competition. Additionally, reinsurers have made moves to "drop-down" into primary layers. Also, new start-up companies, often financed by private equity looking for investment opportunities, can threaten the market share of established surplus lines insurers. The diversification and expanded capacity in the market is expected to continue to drive investment by current incumbent market leaders in their own systems, capabilities, and core competencies in order to retain their positions in this market.

The Lloyd's Market

Lloyd's has been active in the United States since the late 1800s. As the top writer of nonadmitted business from 2010 through 2014, it plays an extremely important role in the surplus lines market. The United States continues to be Lloyd's biggest market, with surplus lines and reinsurance activities generating the majority of Lloyd's U.S. sourced revenues. Risks underwritten by Lloyd's vary considerably, encompassing both property and liability loss exposures. With roughly $8.2 billion in DPW in 2014, Lloyd's represents approximately 20.3% of the surplus lines market.

Over the past decade, Lloyd's surplus lines premium volume has grown from increased marketing activity, new agency appointments, risk-bearing affiliates of syndicates, and the enhanced awareness of Lloyd's security ratings among buyers and producers. Lloyd's surplus lines premium continues to exceed the combined premium levels of its U.S. reinsurance and direct business. Overall, A.M. Best believes Lloyd's will continue to maintain its substantial participation in the U.S. surplus lines market, despite the volatile earnings inherent in surplus lines business.

Mergers & Acquisitions

The insurance industry appetite for mergers and acquisitions continues to make news headlines. Surplus lines carriers may not be the primary source of this news, but they are making waves. One such extremely noteworthy item is the continuing narrative of AXIS Capital Holdings Ltd., the ultimate parent of AXIS Surplus Insurance Company, which as of 2014, was the 14th largest surplus lines carrier. A transaction that would combine AXIS Capital with PartnerRe Ltd. was initially announced January 25, 2015. Subsequent involvement in the bidding for PartnerRe by Exor S.p.A. led to ongoing negotiations, court activity, and a delay in the initial merger proceedings moving forward. On August 3, it was announced that Exor had won the bid to acquire PartnerRe for $6.9 billion of $140.50 per share. A.M. Best will continue to monitor developments relative to this announced purchase.

Likewise, on July 1, 2015, it was announced that Ace Ltd. will acquire Chubb Corporation in a transaction valued $28.3 billion. Both of these organizations derive significant levels of their direct premium from the surplus lines market.

Activity that has already reached completion in 2015 included XL Group plc closing its deal to take ownership of Catlin Group Limited. This acquisition was announced January 1, 2015, and subsequently closed May 1, 2015. This consolidation of two members of the top 25 U.S. surplus lines groups has had an impact on the market, including narrowing the field and dispersing talent.

HCC Insurance Holdings, Inc. (HCC) announced in October 2014 and closed on January 1, 2015 their acquisition of Producers Ag Insurance Group from CUNA Mutual Group. Though crop insurance is not written on a surplus lines basis, many large insurers and reinsurers have been interested in crop insurance due to its product specialization, technology and the benefits afforded through government support and subsidies. The Producers Ag acquisition further strengthened HCC's product and earnings diversification. In a transaction announced June 10, 2015, Tokio Marine Holdings, Inc., through its subsidiary Tokio Marine & Nichido Fire Insurance Co., Ltd., is acquiring HCC for a total of $7.5 billion. Tokio Marine's purchase of a U.S. based property casualty insurer marks its second big splash since acquiring Philadelphia Consolidated Holding Corp for $4.7 billion in late 2008.

Another transaction first announced late in 2014, after the publication of the 2014 surplus lines report, involved Meadowbrook Insurance Group (Meadowbrook). In July 2015, Meadowbrook was acquired by Shanghai based investment group, Fosun International Ltd. In a separate deal announced in May 2015, Fosun announced its plans to acquire the remaining interest in

Stamping Offices Report Growth in Surplus Lines Premium

According to information compiled by the Surplus Lines Stamping Office of Texas, the 14 states maintaining stamping offices reported a 7.6% increase in premium volume during 2014, compared with a 16.0% increase in premium volume in 2013. However, part of the large increase in 2013 reflected a constriction of growth in 2012 due to a large amount of prior years' return premium transactions processed in New York.

Likewise, the stamping offices reported a 6.9% increase in the number of documents filed: 3.4 million in 2014, compared with 3.2 million in 2013. The document count indicates the number of policies and endorsements handled by the various stamping offices. A change in document count provides a rough estimate of the flow of business into and out of the surplus lines market.

The stamping offices only report on 14 states, and the results are influenced heavily by four states — California, Florida, New York and Texas. California generated the highest premium volume of these states, consistent with its ranking in 2013. California recorded the second highest increase in premium during 2014 versus 2013. Only Utah recorded a higher increase at 18.8%. By document count, the leading states continue to be Florida and Texas.

Through the first six months of 2015, the reported document count reveals an increase of 5.3%, compared with an increase of 9.5% in the same period of 2014. Premium growth during the first six months of 2015 was 9.5%, up from the 4.8% increase in 2014. California showed the strongest growth and highest premium volume.

The increase in premium by state exceeding the increase in the number of items processed reflects the underwriting discipline and adherence to adequate pricing in the surplus lines market, which A.M. Best believes will continue at least through the end of 2015.

Ironshore Inc., for $1.84 billion. These transactions further enhance Fosun's plans to build out its insurance business globally.

In a relatively minor transaction, Assurant Inc., one of the smaller surplus lines market participants, streamlined its organization with the sale of American Reliable Insurance Company to Global Indemnity. This transaction will allow Global Indemnity to expand into complementary surplus lines of business and achieve certain economies of scale.

Shortly after the publication of this special report last year, the acquisition of Western World by Validus was completed. This acquisition represented another clear example of a recognized reinsurer making a bold move into the U.S. surplus lines arena.

The next transaction cannot be predicted; however, it is almost a certainty that there will be additional mergers or acquisitions within the surplus lines market in the near term. Capital needs to be allocated where it will create favorable returns for appropriate risks. Across the industry, the option for entering or strengthening a position within a business line is moving into a more prominent position in the market, especially for those with a strong balance sheet position. Add to this the challenge of depressed returns on investments and the result is a continuing appetite for merger and acquisition activity.

A.M. Best's View of the Surplus Lines Market

The state of the surplus lines market through the remainder of 2015 is viewed to be stable. This view takes into consideration continued modest economic improvement, GDP growth of approximately 3%, moderate loss cost inflation between 2 to 4% and an incremental rise in interest rates in the range of 250 to 350 basis points by year end 2015. Equally important, this view assumes some degree of price discipline on the part of surplus lines insurers and to some extent, similar behavior from standard market insurers. A.M. Best believes that today's prevailing low interest rate environment will help to keep aggressive pricing on the sideline. This perspective also anticipates a continuation of favorable prior year reserve releases albeit at a lesser pace.

Using an average return on investment of 5%, A.M. Best believes that surplus lines insurers in the aggregate should be able to sustain a rate of return on equity at or greater than 10% in 2015. This assumes a combined ratio of 90% to 95%, attritional loss ratio between 60% to 65% and non-attritional losses of 5% including storm activity. This also assumes the continued benefit of favorable prior year reserve development.

A.M. Best views the surplus lines market as stable from a ratings perspective and expects that the vast majority of surplus lines insurers will have their ratings affirmed. While this is our general view of the market, many conditions, such as underwriting profitability, competition, new products, investment returns, and reserve development, will affect our analysis of each company operating in this line.

Over the last ten years, the surplus lines sector recorded seven years of underwriting profit, with the exception being three consecutive years from 2010 through 2012. A.M. Best expects 2015 to be another fruitful year of underwriting profitability for this niche.

We have observed that despite all of the challenges, carriers in general are maintaining pricing discipline. Our perspective for an upbeat 2015 also contemplates three points of catastrophe losses in the year – a point impact similar to the assumption used in our forecast for commercial lines insurers. It should be noted that surplus lines carriers, by nature of the specialized business and risk appetite, will remain exposed to large losses such as natural catastrophes and terrorism events. Weather-wise, the hazard comes from a variety of events (hurricanes, tornadoes, polar vortex), but the prudent carriers remain forefront as they monitor the risks. Terrorism exposures also continue to be a primary concern. Advances in risk assessment, use of standard reinsurance, and passage of TRIPRA 2015 (discussed in detail later in this report) partially mitigate this concern. Regardless of the extent that the impact of these events on a book of business can be minimized, their occurrence patterns may be less predictable than ever. That noted, models, TVAR calculations, and PML accumulation monitoring are necessities for day-to-day decisions.

Another key element in surplus lines carrier operations is the extensive commitment to develop and implement more sophisticated technology. These measures already are proving valuable in interfacing with producers in an efficient manner, parsing volumes of data to identify desirable risks versus problematic ones, tracking underwriter and producer success, and actively monitoring risk accumulations on a highly defined level. It is getting to the point that if an insurer is not taking effective advantage of these capabilities, it likely will be fighting an uphill battle for relevance and viability in the surplus lines markets.

Successful surplus lines carriers are those whose boards and management teams have been able to apply strategic options to turn threats into opportunities. Application of underwriting capability to reverse poor experience in a highly specialized line is just one example of turning the tables on perceived weaknesses in a business profile. One way to assess this is implementation of a risk appetite and tolerance statement. A.M. Best began requesting these from all insurance carriers through the 2014 Supplemental Rating Questionnaire distributed during the first quarter of 2015. Organizations that have the ability to clearly and succinctly state and implement these measures will be in a better position to retain or enhance their positions in the surplus lines market. Even with all of these items, the expectation of surplus lines carriers and their long term success remains grounded in key factors: freedom of rate and form, ability to maintain price integrity, a focus on bottom line stability, balanced risk / reward tolerance levels, strong investment returns, and enterprise risk management capability exceeding risk profiles.

Conclusion

Through the first half of 2015, overall market conditions remain comparable with 2014, demonstrating ongoing competition, low interest rates and limited weather related events. With persistently low interest rates providing only marginal investment returns, underwriting performance remains as the leading driver of operating performance. Total investment income from both traditional and higher yielding asset classes are needed to provide additional support to income and surplus.

The core competencies of the successful surplus lines carriers remain the same, focused on effective strategic analysis, product diversification and underwriting discipline. Advantageous market conditions and an environment conducive to opportunistic mergers and acquisitions only further benefit the strong carriers. Competition continues to expand in this market either through affiliated companies, new entrants or M&A activity. Even with the best ability to focus on their own performance, surplus lines carriers remain exposed to external factors, such as economic conditions and judicial or regulatory concerns that can and will interfere with daily operations and financial success.

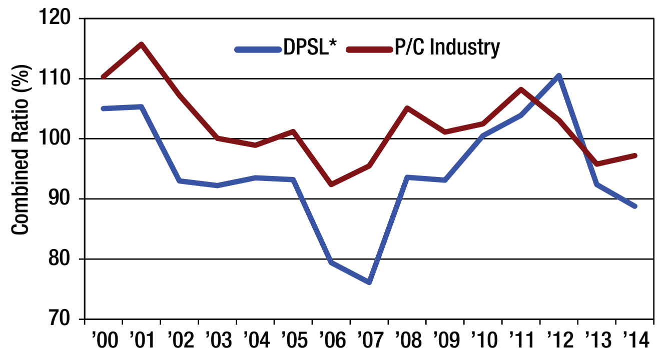
Historically, the best surplus lines insurers have focused on maintaining the underwriting and pricing integrity that have been the hallmark of this market segment. These companies typically focus more on bottom-line profits than top-line organic growth, utilizing the segment's freedom of rate and form, while providing coverage for the varied, nonstandard risks that they underwrite. This focus gives these insurers the best chance to withstand adverse market circumstances and succeed over the long term. A.M. Best expects surplus lines insurers to concentrate on using proven fundamentals to overcome the execution risk presented by current and future underwriting and investment market conditions.

Section II – Financial Condition and Rating Distribution

In the past, A.M. Best was able to report with near certainty the surplus lines premium volume written by the 73 companies that make up the Domestic Professional Surplus Lines (DPSL) composite. (See sidebar, *A.M. Best's DPSL Peer Composite Defined*.) However, as the industry advances, multiple admitted and non-admitted specialty carriers have been established within the same group. With these, risk-sharing tools such as pooling agreements and internal reinsurance programs have been employed, blurring the statutory reporting lines between the segments and their related data.

For example, on January 1, 2014, Lexington Insurance Company expanded their pooling agreement with more entities from across numerous AIG segments, mixing standard and surplus lines business into a homogenous pool shared among the participants. Though this strategy is not unprecedented, the magnitude of the agreement has led to an extraordinarily substantial impact on the surplus lines premium data for 2014. In particular, during 2013, Lexington Insurance Company assumed $1.6 billion in premium. With its new pooling agreement, the amount of the company's assumed premium increased almost 550%, to $10.2 billion. As Lexington is a component of the DPSL composite, those results also were impacted with an increase in assumed premium from $4.9 billion in 2013 to $12.6 billion in 2014. Though partially offset by the sharp increase in ceded premiums ($11.2 billion in 2014 from $8.5 billion in 2013), the effect on the composite's net written premium was still substantial, increasing 20% to $10.6 billion from $8.8 billion in 2013.

Exhibit 10
U.S. DPSL* – Combined Ratios vs. U.S. P/C Industry



* Domestic Professional Surplus Lines
Source: A.M. Best data and research

A.M. Best's DPSL Peer Composite Defined

The analysis in this section is based on the statutory financial data of the 73 U.S.-based domestic professional surplus lines (DPSL) companies. The DPSL composite produced approximately $15.9 billion in direct premiums written (DPW) in calendar year 2014, representing approximately 39.5% of the total U.S. DPSL market as defined in this report.

DPSL companies are identified as those that write at least half of their business on a nonadmitted basis. These organizations historically have accounted for approximately two-thirds to three-quarters of the total surplus lines market.

To determine the population of true DPSL companies for the purpose of this section and the comparisons herein, A.M. Best excludes surplus lines companies that are members of intercompany pools that predominantly write admitted business as opposed to surplus lines business; those companies that reinsure all of their business with an affiliate, and companies that write a relatively small amount of premium. The DPSL composite, however, does include companies that may be part of an intercompany pool, but still write surplus lines business predominantly on a direct basis and retain a substantial portion of this business.

As the lines between classes of business become less clear, operational and strategic changes made by the larger players in the industry will inevitably alter the juxtaposition of data between periods.

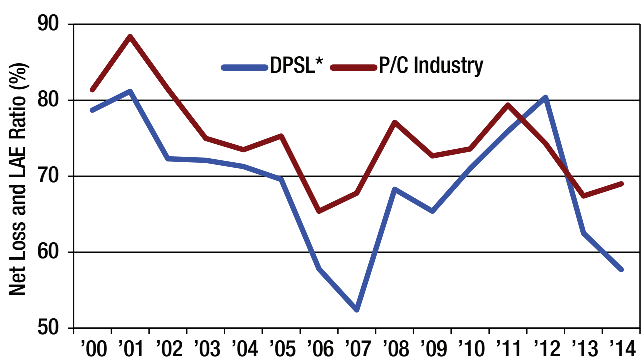
DPSL Peer Composite Overview

A.M. Best's domestic professional surplus lines (DPSL) composite is a consolidation of 73 U.S.-based DPSL companies committed to the surplus lines space and provides a good indication as to the health of the surplus lines sector. In 2013 and 2014, direct written premium for this composite grew at 3.5% and 3.3%, respectively. As for net written premiums, growth in 2014 was 19.9%

Similar to the segment's performance in 2013, the DPSL composite continued to outpace the operating and underwriting results posted by the P/C industry in 2014. Benefiting from another benign catastrophe year in 2014, the composite posted loss ratios below the prior year in most lines of business, which helped achieve the lowest overall loss and LAE ratio since 2007. (See **Exhibit 11**.) Also helping to sustain underwriting profits in 2014, was the steady increase in direct premium writings, supported by exposure and rate growth.

Notwithstanding the companies' consistently profitable performance, the composite still struggled in 2014, with low investment yields and continued excess capacity. The sharp decline in investment yields was the result of an increased asset base but with a decrease in investment income, driven by the low interest rate environment. This occurred despite an increase in common stock allocations that provided an opportunity for diversification.

Exhibit 11
U.S. DPSL* - Net Loss & Loss Adjustment Expense Ratios vs. U.S. P/C Industry



* Domestic Professional Surplus Lines
Source: A.M. Best data and research

Operating Performance

The DPSL composite continues to clearly outpace the underwriting and operating results of the total P/C industry, as evident in the composite's 99.0 and 99.3 five- and ten-year combined ratios, compared with 101.2 and 101.1, respectively, for the total P/C industry. (See **Exhibit 10**.) It's important to note, also, that the composite's combined ratios in 2013 and 2014, at 92.4 and 88.8, respectively, were well below their five- and ten-year averages and the total P/C industry's combined ratio in those years. Furthermore, the DPSL composite posted lower combined ratios than the total P/C industry in nine out of the last ten years, though the difference between the two has narrowed.

The impact on surplus lines insurers' underwriting profitability from prior years' weather-related losses has lessened, since the segment's innate exposure to catastrophe-prone risks hasn't been taxed since the storms of 2012. The lack of significant weather-related events in 2014 boosted the underwriting performance by tempering the composite's pure loss ratio to 44.7, its lowest level in over five years. This compares very favorably to the total P/C industry's 2014 loss ratio of 57.2. The underwriting controls and pricing discipline exhibited throughout the surplus lines market ensures the continuity of secure capitalization levels moving forward.

The DPSL composite's operating ratio still compared favorably to that of the total P/C industry in 2014, at 72.3% compared to 86.1%, though the gap between the two narrowed from 2013

(13.8 pts. vs. 19.8 pts.). This reduced spread is attributed to the composite's diminished net investment ratio of 16.5% compared to 26.8% in 2013, with both an increased premium base and a 26% decline in investment income driving this trend. Nonetheless, 2014 marked the composite's second best operating performance since 2007 (2013 was the best), which is a testament to the strength and consistency of the surplus lines segment.

Posting the second-straight year of underwriting profitability, the composite was well-positioned to offset the decline in investment income with underwriting performance. Pretax operating profits in 2014 rank well historically, as higher operating profits were only seen in four of the last ten years, one of which was 2013. The step back from 2013 levels was caused by the decline in investment income. Mirroring the operating profitability, the composite's net income remained strong at $2.8 billion, a moderate 17% decline from 2013's near-record level.

Though net income through the composite was strong in 2014, essentially none was passed through to policyholder surplus, as surplus levels dropped 1.7%. The stockholder dividends paid out more than offset the favorable net profitability, which indicates strong capitalization and optimism throughout the segment. This dip in surplus levels contrasts with the total P/C industry's 3.4% increase.

Despite this disparity in surplus growth, the DPSL composite's pretax returns outperformed the total P/C industry by a strong margin. (See **Exhibit 14**.) Reflecting the prior ten years, the 2014 DPSL composite exceeded the total P/C industry's total return on revenue at 32.3% and 14.0%, respectively, and total return on equity at 14.8% and 10.1%, respectively. This favorable trend has persisted throughout even the high catastrophe event years, evident of the surplus lines segments emphasis on strong underwriting controls, superior capital position, risk selection and diversification, as well as operating efficiency.

Net Investment Gains

The DPSL's net investment income again reversed course in 2014, falling 26.1% after increasing by 11.0% in 2013. (See **Exhibit 12**.) However, the overall P/C Industry recognized the opposite result, increasing 11.5% in 2014 and falling 1.1% in the previous year. For the fourth straight year, the DPSL composite increased its total stock allocation, now approaching $10.9 billion, whereas the bond allocation has declined since 2011, and now stands at $31.1 billion. The increase in stock allocation is also supported by a diminishing cash and short-term investment allocation, now a mere 5.7% of total admitted assets throughout the composite. Generally, the trend of increasing stock allocation is also evident in the total P/C industry, although to a slightly lesser degree. Of course, this increase in "stock allocation" was driven, in part, by the appreciation in the market value of these assets over the last few years.

Exhibit 12
U.S. DPSL* Composite – Investment Performance vs. P/C Industry
(USD Billions)

	DPSL * 2013	DPSL* 2014	Year/Year Change (%)	Total P/C Industry 2013	Total P/C Industry 2014	Year/Year Change (%)
Net Investment Income	2,357	1,741	-26.1	49,501	55,179	11.5
Realized Capital Gains or (Losses)	554	843	52.2	12,141	12,086	-0.5
Net Investment Gain	2,911	2,584	-11.2	61,642	67,265	9.1
Unrealized Capital Gains or (Losses)	865	563	-34.9	38,611	4,215	-89.1
Total Investment Return	3,776	3,147	-16.7	100,253	71,480	-28.7

*Domestic Professional Surplus Lines
Source: A.M. Best data and research

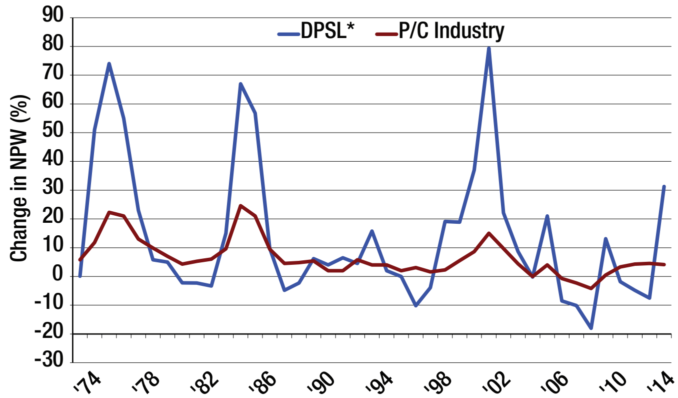
In 2014, the composite's realized gains of $843 million and unrealized gains of nearly $563 million on investments softened the decline in total investment return to 8.5% when compared to 2013. The P/C industry experienced a more pronounced (approximately 29%) decline in its total investment return, which was driven by below-average unrealized capital gains.

Favorable Loss-Reserve Development

Throughout the past few years, favorable prior-year loss-reserve development has boosted the overall P/C industry's underwriting profitability. Likewise, favorable reserve development reduced the DPSL composite's loss ratio by 3.6 points in 2014, though less than the 8.5 points in 2013. Mirroring the DPSL composite, the overall P/C industry recognized a 1.9 and 3.6 point reduction in 2014 and 2013, respectively.

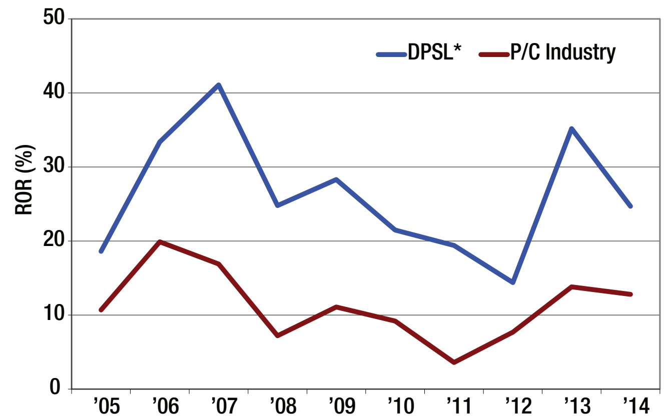
These findings are consistent with A.M. Best's perspective that although the favorable reserve development is supporting underwriting profitability, the magnitude of the support is declining and will continue to dissipate. Commercial auto insurers are already realizing rapidly rising adverse reserve development throughout the P/C industry, while the DPSL composite companies are seeing adverse development across several lines. One main driver of this trend is the ongoing reserve margin tightening amongst surplus lines insurers, reflective of patterns within the overall industry. Insurers that have reserved conservatively will continue to benefit from reserve redundancies and will be better positioned to take advantage of market opportunities through the cycle as others are forced to recognize reserve redundancies, leading to eroding underwriting results and surplus positions.

Exhibit 13
U.S. DPSL* Composite vs. P/C Industry – NPW Growth (1974-2014)



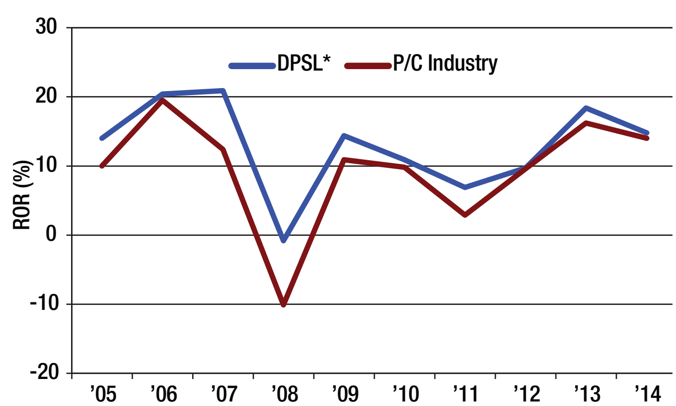
* Domestic Professional Surplus Lines
Source: A.M. Best data and research

Exhibit 14
U.S. DPSL* - Pretax Returns on Net Premiums Earned (NPE) vs. U.S. P/C Industry



* Domestic Professional Surplus Lines
Source: A.M. Best data and research

Exhibit 15
U.S. DPSL* – Total Returns on Surplus vs. P/C Industry



* Domestic Professional Surplus Lines
Source: A.M. Best data and research

DPSL's Growth Rate Less Than Total P/C Industry's

As mentioned earlier, much of the net growth experienced in the DPSL composite in 2014 is connected to the new pooling arrangement of Lexington Insurance Company and AIG. (See **Exhibit 13**.) However, the direct premium writings were unaffected by this arrangement and may serve as the best metric to determine growth throughout the sector. In 2014, the DPSL composite saw direct premium writings increase 3.3%, slightly trailing the overall P/C industry growth of 4.5%. This is the fourth straight year of DPW growth.

Net premium written for the DPSL composite grew 31.3%, compared to the more modest 4.1% growth in the P/C industry. Without the support of Lexington's new pooling arrangement, A.M. Best estimates that NPW growth in the DPSL composite would have been flat, if not slightly negative. The evidence supporting this estimate is the higher growth rate of ceded premiums (12.3% CAGR) compared to gross premiums (9.2% CAGR) over the past five years. As companies take advantage of less expensive reinsurance and continue to optimize their reinsurance placements, this trend likely will continue. It is important to note, however, that a similar trend is occurring throughout the entire P/C industry (3.6% and 3.9% five-year CAGR for gross and ceded premiums, respectively), though to a lesser degree.

Balance Sheet Strength

Given the uniquely hazardous risks that surplus lines companies insure, it is particularly important for these companies to maintain very strong balance sheets. Historically, these insurers have generally

Exhibit 16
U.S. DPSL* - Best's Rating Distribution by Rating Unit vs. U.S. P/C Industry

Best's Financial Strength Rating (FSR)		Domestic Professional Surplus Lines		Total P/C Industry	
Level	**Category**	**# of Rating Units**	**Percentage**	**# of Rating Units**	**Percentage**
RATINGS					
A++	Superior	8	8.79	24	2.75
A+	Superior	21	23.08	81	9.28
	Subtotal	**29**	**31.87**	**105**	**12.03**
A	Excellent	43	47.25	290	33.22
A-	Excellent	18	19.78	285	32.65
	Subtotal	**61**	**67.03**	**575**	**65.86**
B++	Good	1	1.10	94	10.77
B+	Good	0	-	59	6.76
	Subtotal	**1**	**1.10**	**153**	**17.53**
Total Ratings		**91**	**100.00**	**833**	**95.42**
FAIR & BELOW RATINGS					
B	Fair	0	-	25	2.86
B-	Fair	0	-	7	0.80
	Subtotal	**0**	**-**	**32**	**3.67**
C++	Marginal	0	-	1	0.11
C+	Marginal	0	-	3	0.34
	Subtotal	**0**	**-**	**4**	**0.46**
C	Weak	0	-	3	0.34
C-	Weak	0	-	1	0.11
	Subtotal	**0**	**-**	**4**	**0.46**
D	Poor	0	-	0	-
E	Under Regulatory Supervision	0	-	0	-
F	In Liquidation	0	-	0	-
	Subtotal	0	-	0	-
Total Fair & Below Ratings		**0**	**-**	**40**	**4.58**
Total Rating Opinions		**91**	**100.00**	**873**	**100.00**
Total NR Ratings		**4**		**970**	
Total Reported Rating Units		**95**		**1,843**	

*Domestic Professional Surplus Lines
1 Domestic professional surplus lines ratings are as of August 11, 2015
2 Total industry ratings distribution data is as of June 26, 2015
Source: A.M. Best data and research

remained very well capitalized and have continued to maintain this strength through 2014, providing flexibility in the quickly-evolving surplus lines sector.

In 2014, the DPSL composite's policyholder surplus declined by 1.7%, despite generating $2.8 billion in net income. Though reinforced by unrealized capital gains, bringing the composite's total return to $3.4 billion, these earnings were more than offset by $3.2 billion in dividends to holding companies to support stockholder dividends and share buybacks.

By comparison, in 2013 the P/C industry and DPSL composite both experienced turnaround years, generating a 68.7% and 120.4% increase in net income, respectively. Despite this immense growth in the DPSL composite, policyholder's surplus declined 1.2%. A.M. Best believes this speaks to the segment's balance sheet strength, as these companies have capitalized themselves well enough to pay dividends on their earnings.

Exhibit 17
DPSL Peer Composite – Top 5 Product Lines (2014)
Ranked by direct premiums written.
(USD Thousands)

Rank	Product Line	Surplus Lines DPW	DPSL Peer Composite Market Share (%)
1	Other Liability	7,333,953	46.1
2	Fire	1,844,219	11.6
3	Allied Lines	1,565,946	9.8
4	Commercial MultiPeril	1,016,829	6.4
5	Inland Marine	948,412	6.0
	Subtotal of Top 5	**12,709,359**	**79.9**
	Total DPSL Peer Composite	**15,909,089**	**100.0**

Note: "Other Liability" consists primarily of commercial occurrence and claims made general liability policies.
Source: A.M. Best data and research

The DPSL composite continues to maintain generally lower leverage than the total P/C industry, with the exception of ceded leverage, which is slightly higher than the P/C industry average. Despite the marginal difference in ceded leverage, the use of affiliated reinsurers by the composite and total P/C industry are comparable at 86.2% and 85.0% of premiums, respectively. The composite's net leverage of 2.0 times surplus registers a shade below the total industry average of 2.3 times surplus. Because of the DPSL composite's slightly higher ceded leverage of .8 times surplus compared to the industry average of .5 times surplus, the two have equivalent gross leverage of 2.8 times surplus.

Further supporting the composite's strong risk-adjusted capitalization is its conservative investment portfolio, with U.S. government and NAIC Class 1 bonds still constituting the vast majority of the portfolios. Likewise, durations consciously are being kept short in anticipation of an eventual rise in interest rates.

Section III: Regulation and Legislation

One of the first acts of the 114th Congress was the passage of the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA) to reinstate the federal Terrorism Risk Insurance Program, which expired December 31, 2014. (See **Exhibit 18.**) President Obama signed TRIPRA into law on January 12, 2015, extending the federal terrorism program until December 31, 2020. Key revisions to prior provisions included:

- Federal share reduces from 85% to 80% (1% per year)
- Program trigger increases from USD 100 million to USD 200 million (USD 20 million per year)
- Industry's aggregate retention increases from current USD 27.5 billion to USD 37.5 billion (USD 2 billion per year) and Treasury's recoupment rate increases from 133% to 140%.

Exhibit 18
Federal Terrorism Backstop

Terms	TRIPRA (Previous Program)	TRIPRA Reauthorization Act of 2015 (H.R.26, Current Program)
Status		Enacted into law
Extension	NA	5 years to December 31, 2020.
Co-Participation	15%	Beginning on January 1, 2016, Co-Participation will increase 1% annually to 20%
Deductible	$27.5 billion	$27.5 billion, increasing annually by $2 billion to $37.5 billion in the year 2020.
Trigger	$100 million	$100 million, rising by $20 million to $200 million by 2020.
Recoupment	133%	Increase from 133% to 140%
Timeline for Certification	Not Specified	5 years

Source: A.M. Best research
Terrorism Risk Insurance
Program Reauthorization Act (TRIPRA) of 2015 and the Flood Insurance Reform Act, are measures that would reauthorize and modify existing federal programs.

The TRIPRA extension also included the long-anticipated adoption of the National Association of Registered Agents and Brokers (NARAB II). The insurance industry lobbied many years for NARAB in an effort to streamline the licensing process for agents and brokers nationwide and eliminate burdensome multistate requirements while preserving important state regulatory authority and consumer protections in nonresident licensing. NARAB will not become operational until the President appoints a Board, which must be confirmed by the Senate. The Board will consist of eight regulators and five industry members, with three of the industry members representing the P&C industry. After establishing the Board, it is expected to be one to two years before NARAB issues its first national license as the Board is tasked with adopting rules and requirements for internal operations and licensing. Although this is a federally created Board, the states maintain their regulatory and disciplinary authority.

The chart below summarizes recent federal and state legislative and regulatory proposals that could affect the surplus lines industry.

2014-2015 Federal Legislation/ Regulation

Bill/Sponsor	Key Provisions & Actions
Terrorism Risk Insurance Program Reauthorization Act (TRIPRA)	Before September 11, 2001, insurance coverage for losses as a result of a terrorist attack was included in general insurance. After the attacks, such coverage became very expensive, if offered at all. Congress responded to this disruption by passing the Terrorism Risk Insurance Act of 2002, providing a government reinsurance backstop so commercial insurers would offer terrorism coverage. The lack of available insurance caused fears of a major impact on the economy, as companies would remain idle due to uncertainty. The act – extended and amended in 2005 and 2007 and now known as the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) – expired on December 31, 2014.
H.R. 26 TRIP Reauthorization Act of 2015 (Current Program)	On January 12, 2015, President Obama signed into law the Terrorism Risk Insurance Program Reauthorization Act of 2015, which extends TRIP to December 31, 2020 and revises several features of the previous program. Beginning January 1, 2016,The federal share of payments will be reduced by 1% annually to 80% of insured losses from acts of terrorism. The Aggregate industry insured loss trigger will increase stepwise from $100 million in 2015 to $200 million for 2020 and requirements for mandatory recoupment from insurers receiving federal financial assistance will be revised; the recoupment threshold increases $2 billion annually, up to $37.5 billion, and then by a specified formula, while the terrorism loss risk-spreading premium increases from 133% to 140%. Finally, a recoupment in case uncompensated losses surpass aggregate market retention totals is now mandatory. Improvements to the program under this act include the requirement of both the Secretary of the Treasury and the Secretary of Homeland Security to certify an “act of Terrorism”, tasking the Secretary of the Treasury to study and issue final rules governing the process for certifying an act of terrorism, and assignment of the GAO to study federal assessment and collection of upfront premiums and the creation of a capital reserve fund to house prepaid capital. The Act calls for the appointment of at least one member to the Board of Governors of the Federal Reserve, experienced with community banks having less than $10 billion in assets, the appointment of an advisory committee to facilitate the creation of non-governmental risk-sharing mechanisms to support private market reinsurance capacity, specific congressional information and reporting requirements for participating insurers, as well as biennial study on the competitive challenges facing small participating insurers.
H.R. 26, Title II National Association of Registered Agents and Brokers Reform Act of 2015 (NARAB II)	The National Association of Registered Agents and Brokers (NARAB) Reform Act of 2015 was enacted on January 12, 2015 as part of the Terrorism Risk Insurance Program Reauthorization Act of 2015. NARAB will streamline agent and broker licensing for those operating on a multi-state basis. It creates a nonprofit board governed by a panel of state insurance regulators and industry representatives to create rigorous standards and ethical requirements with a goal of applying licensing, continuing education and nonresident insurance producer standards on a multi-state basis. With a focus on nonresident licensing, agents or brokers applying for a national license through NARAB will first be required to hold a current license in their home state, pass a national criminal background check and meet the criteria established by the Board, which shall include standards for personal qualifications, educational training and professional experience. The President, with the advice and consent of the U.S. Senate, will appoint the 13 Board members (8 regulators and 5 industry members). Before becoming operational, the board must first establish the rules, requirements and procedures, as well as a national licensing clearinghouse. NARAB is not expected to become operational for a while, with most observers believing it will most likely happen in about two years. • Title II establishes NARAB without contingencies, prohibits NARAB from merging or operating as an insurer/producer, establishes presidential oversight of the NARAB, precludes Federal Funding of NARAB, and also establishes criteria for the board of directors, as well as operational parameters. The Act maintains NARAB’s state regulatory jurisdiction regarding consumer protection, market conduct, and state disciplinary authority. • Title II grants NARAB disciplinary enforcement powers, and requires NARAB to establish procedures for multi state qualifications and oversight of non-NARAB insurance producers. • Title II directs NARAB to establish fairness and eligibility criteria and standards to join and maintain membership with NARAB, including criminal history record checks.

	• Title II prescribes procedures for authorized and required information sharing for both NARAB and its members, establishes authorized business practices based on NARAB membership, equivalent to a nonresident insurance producer license, establishes continuing education requirements for members by sources other than NARAB, as well as consumer complaint management. • Finally, Title II authorizes civil action by aggrieved individuals resulting from a NARAB decision or action, and minimally preempts state laws that regulate insurance producers.

Bill/Sponsor	**Key Provisions & Actions**
Flood Insurance Reform Act of 2012	The Biggert-Waters Flood Insurance Reform Act of 2012 was passed by Congress and signed by the President in 2012. It extended the National Flood Insurance Program (NFIP) for five years, while requiring significant program reform.
The following bills were introduced in the 113th Congress in:	Concern about increased premium rates resulting from Biggert-Waters caused Congress to reconsider its implementation. The House and Senate ultimately both passed bills to reverse some of the changes brought about by Biggert-Waters.
October 2013:	
H.R. 3370, by Rep. Michael Grimm (R-NY)	H.R. 3370, the Homeowner Flood Insurance Affordability Act of 2014, required the NFIP to consult with "Write Your Own" companies on rate tables, capped the annual increase for the chargeable risk premium rate for flood insurance to 18% (with some exclusions), and required an increase in the chargeable flood insurance risk premium rates for certain properties. It directed FEMA to minimize the number of policies with annual premiums exceeding 1% of the total policy coverage, imposed an annual premium surcharge, beyond existing assessments and surcharges, on new or renewed policies, and draft a framework that addresses flood insurance affordability, via programmatic and regulatory change. This legislation was signed into law in March 2014. Finally, H.R. 3370 required a review of the NFIP flood mapping program to ensure accurate flood hazard data.
March 2014:	
H.R. 4313, by David Jolly (R-FL)	H.R.4313, the Flood Insurance Premium Parity Act of 2014, amended the National Flood Insurance Act of 1968 (NFIA) to prohibit the Administrator FEMA from estimating reduced (subsidized) risk premium rates for flood insurance for residential property that is neither the primary residence of an individual (as under current law) nor the secondary residence of the property owner. It also directed FEMA to establish standards for a residential property to qualify as a secondary residence eligible for subsidized risk flood insurance premium rates that require the owner to occupy the property for an appropriate minimum period of time each year, and limit subsidized risk premium rates to but a single property of the owner. H.R. 4313 sought to repeal the prohibition against estimating subsidized risk premium rates for business property (thus qualifying business property for such rates) and directed FEMA to refund directly to insureds any flood insurance premiums collected in excess of the rates required under this Act. This legislation was not enacted.
May 2014:	
H.R.4558 and S.2381, by Rep. Dennis Ross (R-FL) and Rep. Patrick Murphy (D-FL) and Sen. Dean Heller (R-NV) and Sen. Jon Tester (D-MT).	H.R.4558 and S. 2381, the Flood Insurance Market Parity and Modernization Act, introduced in May 2014, would ensure that surplus lines insurers are eligible to offer private market solutions and alternatives to consumers needing coverage of unique and complex flood risks. This legislation was not enacted but has been filed again in 2015.
June 2015:	
H.R 2901/S. 1679, by Rep. Dennis Ross (R-FL), Rep. Patrick Murphy (D-FL) and Sen. Dean Heller (R-NV) and Sen. Jon Tester (D-MT)	H.R.2901/S. 1679, the Flood Insurance Market Parity and Modernization Act will provide clarity to lenders that they may accept private flood insurance solutions from the surplus lines market, just as they had prior to the Biggert-Waters Act of 2012.

2014/2015 State Level Legislation/Regulation

State Legislation	The following are bills proposed or enacted at the state level regarding surplus lines:
Kansas	HB 2352 (formerly SB 155) has been signed by the Governor on June 5, 2015. This critical legislation eliminates the requirement to tax multistate risks at other states' rates. Effective January 1, 2016, all surplus lines premium where Kansas is the home state of the insured shall be taxed 100% at Kansas's rate of 6%. Kansas was one of seven states that continued to tax multistate risks at multiple states' rates, although they retained 100% of the tax. Kansas now joins the majority of states that have fully implemented the home state tax approach as envisioned under the NRRA. The legislation also rescinded Kansas's participation in the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT). Having failed to reach the required ten member states, SLIMPACT never became operational.

Louisiana	HB 259, passed by the Louisiana legislature on June 12, 2015 and signed into law by the governor on July 1, 2015, removes the requirement for the state to participate in the Nonadmitted Insurance Multistate Agreement (NIMA), allowing the Commissioner to withdraw effective October 1. The new law will also reduce the surplus lines premium tax from 5% to 4.85% and, when Louisiana is the home state, taxes 100% of the premium regardless of where the risk is located. Additionally, the law revises the required "zero premium" report from a quarterly to an annual filing.
North Dakota	HB 1146, signed by the Governor on March 20, 2015, eliminates the requirement to tax multistate risks at other states' rates. Effective June 1, 2015, all surplus lines premium where North Dakota is the home state of the insured shall be taxed 100% at North Dakota's rate of 1.75%. North Dakota was one of seven states that continued to tax multistate risks at multiple states' rates, although they retained 100% of the tax. North Dakota now joins the majority of states that have fully implemented the home state tax approach as envisioned under the NRRA. The legislation also rescinded North Dakota's participation in the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT). Having failed to reach the required ten member states, SLIMPACT never became operational. SB 2187, signed by the Governor on March 26, 2015, standardized the date for tax filings and payments. Prior law required taxes to be filed before May 1 and annual tax statements to be filed on or before April 1. Effective June 1, 2015, both taxes and the annual tax statement will be filed by March 1.
Utah	SB 212 was enacted on March 26, 2015 and repeals HB 129, which passed in March 2014, and required surplus lines insurers to initiate an audit within six months of expiration of the policy and prohibited surplus lines insurers from counting as earned premium an amount in excess of 50% of the initial premium.
State Reporting Changes	**The following states issued bulletins or legislative changes regarding surplus lines taxes:**
Arizona	HB 2342 was passed to clarify the role and voting procedures of the Surplus Line Association. It originally included language to clarify that for group insurance contracts, the home state is the state of incorporation or organization of the group, however, this provision was removed before passage.
California	SB 585 will require insurers, including nonadmitted, to notify the Department of Child Support Services if a claim is owed to any person owing a duty of child, spouse of family support. The Department of Insurance is charged with creating a system and regulatory guidance for use by insurers. The legislation is currently awaiting hearing in the Assembly Insurance Committee.
Colorado	Bulletin No. B-2.10: This bulletin was issued to clarify standards for taxation based upon changes that were made to the Colorado statute in 2012 to implement the NRRA.
Connecticut	HB 6865 was passed on June 2, 2015 and required nonadmitted insurance policies to include the definition of depreciation per C.S.A §38a-307 when a coinsurance clause is issued. The surplus lines industry opposed the legislation with significant concerns that it imposed form requirements on nonadmitted policies as well as limiting application to the nonadmitted market. The legislation narrowly passed both chambers and a number of industry members requested the Governor veto the measure, which he did on June 30. HB 6771 permits nonadmitted insurers to establish an office in Connecticut for the lawful transaction of surplus lines insurance. The legislation takes effect October 1, 2015.
Delaware	HB 40 was signed by the Governor on June 4, 2015 to remove the notarization requirement for diligent search broker affidavits. The documents are now considered written statements to be retained in the broker's files.
Florida	HB 252 provided that the absence of a countersignature on a policy does not affect the validity of a surplus lines policy and became effective July 1, 2015. SB 1094 revised the existing statute to specifically require agents placing coverage outside of the National Flood Insurance Program (NFIP), including surplus lines polices, to obtain acknowledgement from the applicant that if the applicant discontinues coverage under the NFIP that is provided at a subsidized rate, the full risk rate for flood insurance may apply to the property if the applicant later seeks to reinstate coverage under the program. The legislation also became effective July 1, 2015. It should be noted that the underlying statute allows a surplus lines agent to export flood coverage to an eligible surplus lines insurer without making a diligent effort. This exemption is set to expire on July 1, 2017.
Illinois	SB 1573 would repeal provisions of 2014's SB 3324, which deleted language for the industrial insured exemption; however, the bill is still pending and it is considered unlikely to pass. The Department of Insurance issued a bulletin regarding the definition of industrial insured on June 18, 2015.

Kansas	SB 145 was the only legislative activity regarding insurer eligibility during this legislative session, but failed to be adopted. This bill would have revised the definition of eligible insurer to conform to the definition and intention of the NRRA and would have removed the requirement of appearing on an eligibility list, but would have allowed the commissioner to maintain a voluntary list. The Department has indicated it is willing to discuss the industry's concern with the current eligibility listing requirements in the near term.
Louisiana	Bulletin 2015-06: On July 15, 2015 the Department of Insurance issued Bulletin 2015-06, also effective October 1, 2015, to provide guidance to the industry on how to report and file taxes under the both prior to and after the state withdraws from NIMA and the revised tax mechanism becomes effective. HB 214 creates a domestic surplus lines insurer (DSLI). This law becomes effective on August 1, 2015.
Maryland	Bulletin 15-12: A request for Maryland surplus lines brokers to provide the data regarding claims relating to the Baltimore City Civil Unrest pursuant to Maryland Insurance Code §§2-206(1) and 3-322. Data shall be submitted for each surplus lines company the surplus lines broker represents, by line of business, for the City of Baltimore using the link to the Severe Event Data Collector. SB 868 was signed by the Governor on May 12. This legislation addressed requirements for Transportation Network Companies (TNC) operating in the state. The legislation originally proposed specific rate and form approval for surplus lines insurers, which industry members strongly opposed. Work with the Department of Insurance and legislature successfully resulted in alternative language so that surplus lines insurers are not required to file TNC policies with the Department; rather, the Public Utilities Commission may request a copy of the policy for review prior to approving the TNC's license to operate in the state. HB 565 is enacted legislation that authorizes the use of surplus lines insurance for disability insurance coverage under specified circumstances and provides that the procurement of specified disability insurance through surplus lines insurance is subject to specified requirements. The law will take effect October 1, 2015.
Massachusetts	SB 479 would establish hybrid personal injury protection policies as an option to fulfill required coverage in Massachusetts. The bill contemplates that nonadmitted insurers may also file such a form. The legislation is still pending.
Michigan	HB 4532 was filed on April 28, 2015 in Michigan to revise some statutes related to NRRA. The legislation remains pending.
Minnesota	HB 177 takes effect on August 1, 2015 and will regulate self-service storage facilities and require them to obtain insurance that may be obtained through a surplus lines company. In May, the Minnesota Joint Underwriting Association attempted to assess surplus lines companies as part of their guaranty assessment but issued a stay after discussions with surplus lines industry trade associations.
Mississippi	SB 2254 exempts from premium taxes the surplus lines policies procured by the Mississippi Department of Administration. The bill became effective July 1, 2015.
Montana	HB 94 was enacted on February 24th to allow natural disaster multi-peril insurance to be sold as surplus lines insurance; HB 240 was enacted on April 10th to remove prohibition of surplus lines policy fees, but limits the fee to $50 for personal lines and $100 for commercial lines.
New Jersey	The New Jersey Department responded to comments that interested parties submitted last August on changes to Regulation 11:19-3.1 through 3.5 that were adopted April 21. The Regulation became effective May 18 and pertains to requirements of the new electronic filing system for surplus lines transactions. The Department declined to make many changes based on the comments they received and the final regulation remains similar to the original proposal.
New York	Insurance Reg. 41 (11 NYCRR Part 27): Titled the Proposed 14th Amendment to Insurance Regulation 41, this amendment applies to the excess line placements governing standards to conform to the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA). On October 8, 2014, the New York Department of Financial Services (DFS) adopted their proposed amendments to Regulation 41. This regulation details the state's standards governing surplus lines placement in New York. The amendments incorporate changes in the standards related to the NRRA. AB 9590 was signed by the Governor on January 29, 2015 and prevents third parties from demanding the issuance of a Certificate of Insurance (COI) that goes beyond simply demonstrating proof that insurance coverage has been placed. AB 4616 was signed by the Governor on March 13 and requires Certificates of Insurance on policies for Personal Injury Liability or Property Damage Liability to be issued on a form promulgated by the insurer or a form approved by the Department.

Nevada	AB 486 removes statutory fees for surplus lines companies ($1,300 annually) and removes mandatory $15 Insurance Recovery Account fee for surplus lines brokers and replaces it with an assessment of $10 to be imposed by the Commissioner only after the Insurance Recovery Account falls below $40,000. The bill became effective July 1, 2015.
North Carolina	HB 262 authorized the creation of the North Carolina Stamping Office, making it the 15th stamping office in the nation. The legislation is expected to take effect within 60 days of adjournment, which is projected to be around July 26, 2015.
Oklahoma	SB 487 became effective April 10 and removes diligent search effort requirements in the procurement of flood insurance through surplus lines insurers.
Oregon	SB 935 became effective on June 18 and exempts wet marine and transportation insurance from the requirement to obtain certificate of authority. The Division adopted O.A.R. 836-010-0026 in March which prohibits the use of discretionary clause language in insurance contracts for all lines of insurance.
Pennsylvania	SB 736, if passed, will regulate self-service storage facilities and will allow the required insurance to be obtained through a surplus lines insurer.
South Dakota	HB 1088 became effective February 24th and amends prior law to allow surplus lines insurers to provide excess disability insurance.
Tennessee	SB 82 becomes effective January 1, 2016 and requires broker affidavits to be filed within 30 days of issuing a policy. Prior to enactment of the law, affidavits were to be issued at the end of each month. Additionally, effective February 16, the Department began using OPTins for electronic payments for surplus lines premium tax
Texas	HB 409 would have required liquor licensees to carry liquor liability insurance. This type of insurance is not currently required. The bill would have allowed the coverage to be provided from an admitted or eligible surplus lines insurer but failed to pass out of the House. HB 686 related to insurance agents' ownership and use of information related to the expiration of property and casualty insurance policies. The proposed bill would have allowed an agent the exclusive ownership and use of an "expiration" directly related to an insurance application submitted by or an insurance policy written through that agent for the purpose of soliciting, selling or negotiating the renewal or sale of the coverage. The bill failed to pass out of committee. HB 2947 was sought to revise diligent search requirements. The bill was proposed as a compromise based on indications from the Department on their intent to revise regulations regarding the requirements. Ultimately the Department decided not to change the current procedure and the legislation was allowed to die.
Virginia	HB 1745 became effective July 1, 2015, and increases the maximum assessment of fire insurance companies, including surplus lines policies, for the Fire Programs Fund from .01 to .025%.
Washington	HB 1308 clarified that the portion of a risk located outside of the U.S. is exempt from surplus lines premium tax. The law has been signed by the Governor and became effective July 24, 2015.
Wisconsin	OCI Bulletin 05-14: This bulletin informs surplus lines insurers of changes to filing requirements, effective July 1, 2014. This is the result of the Wisconsin Office of the Commissioner of Insurance (OCI) declining to join the Nonadmitted Insurance Multi-State Agreement, Inc. (NIMA) as a full member.

Sources: Library of Congress, National Association of Professional Surplus Lines Offices, Ltd. (NAPSLO) and individual states' legislative websites.

Update on the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA)

The NRRA was passed as a provision of the Dodd-Frank Wall Street Reform Act of 2010 (DFA). Some leaders, and other members of the 114th U.S. Congress, have stated that revisions and repeals of provisions of the DFA are a high priority, but the NRRA has not been identified as a specific target in these discussions.

Similar to what was reported in the 2014 segment review, as of 2015, all states except Michigan, as well as the District of Columbia, have adopted specific NRRA implementation language. Both of those jurisdictions, however, follow the NRRA in practice and continue to comply with the NRRA's home state tax approach. The NRRA, which was passed by Congress in July 2010 and took effect one year later, resulted in the following reforms related to surplus lines/nonadmitted insurance:

- Limited the regulation and taxation of surplus lines/nonadmitted transactions to only one state – the home state of the insured, meaning the state where a commercial insured's principal place of business is located, or if the insured is an individual, the individual's state of residence.

- Established uniform, nationwide eligibility standards based on two sections of the National Association of insurance Commissioners' Nonadmitted Model Act for U.S.-domiciled nonadmitted insurers. The model act defines an eligible surplus line insurer as being authorized in its state of domicile to write the coverage being offered on a nonadmitted basis and meeting specified capital and surplus standards. The NRRA also requires states to allow licensed surplus lines brokers to place or procure insurance from any alien (non-U.S.-based nonadmitted insurer) that is on the NAIC Quarterly Listing of Alien Insurers.

- Created a nationwide definition of an exempt commercial purchaser (ECP), applicable in each state, for which a broker can access the surplus lines market without the need of a diligent search being performed.

The simplification of the regulation and taxation of the surplus lines insurance transaction is the key focus, and many feel, the greatest success of the NRRA. The law called on each state to adopt nationwide, uniform requirements, forms and procedures for the reporting, payment, collection and allocation of surplus lines premium taxes and recognized that states may form compacts or other mechanisms to share surplus lines premium taxes paid to an insurer's home state. The home state provision has produced significant benefits for the surplus lines industry by reducing the need for brokers and insurers to comply with differing sets of rules, disclosures and requirements. Effective October 1, 2015, 47 jurisdictions[1], representing 86% of the nationwide surplus lines premium, will retain 100% of the taxes they collect, and effective January 1, 2016, 41 of those jurisdictions will tax 100% of any multistate risk in accordance with the home state's tax rates and rules.

Also effective October 1, 2015, Louisiana will withdraw from the Non-Admitted Insurance Multi-State Agreement (NIMA). In addition to retaining 100% of the taxes collected at their own premium tax rate, they will now also tax 100% of the surplus lines risk, regardless of where it resides. HB 259 was passed during the 2015 legislative session to effectuate these changes. In addition to the above-noted changes, the surplus lines premium tax rate will decrease from 5% to 4.85%.

Only five jurisdictions – Florida, Puerto Rico, South Dakota, Utah and Wyoming – remain in NIMA and continue to share taxes as part of their membership. Tennessee currently participates as an associate member of NIMA and, as a result, requires surplus lines brokers

[1] AK, AL, AR, AZ, CA, CO, CT, DC, DE, GA, HI, IA, ID, IL, IN, KS, KY, LA, MA, MD, ME, MI, MN, MO, MS, MT, NC, ND, NE, NH, NJ, NM, NV, NY, OH, OK, OR, PA, RI, SC, TN, TX, VA, VT, WA, WI, WV

to provide multistate allocation information to NIMA's Surplus Lines Clearinghouse (SLC). Tennessee's associate membership expires on October 1, 2015, and the state will need to decide if it wishes to join NIMA as a full member. Wisconsin participated in the one-year associate membership but on June 25, 2015, declined to join as a full member.

There are five non-NIMA jurisdictions that continue to tax multistate risks at multiple jurisdictions' rates, although they retain 100% of the tax. These jurisdictions include Hawaii, Massachusetts, Nebraska, New Hampshire and Vermont. Prior to the 2015 legislative session, Kansas and North Dakota also required brokers to collect surplus lines premium taxes based on an allocation of risk and at other jurisdictions' rates; however, as of June 1, 2015, North Dakota eliminated this requirement and implemented the 100% home state approach such that when North Dakota is the home state, taxes are calculated and remitted based on its 1.75% tax rate. Kansas passed similar legislation but it does not become effective until January 1, 2016 so brokers must continue, until that time, to calculate the tax based on the premium tax rate where the risk resides.

Along with NIMA, the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT) was the other tax-sharing model put forth by various jurisdictions in response to the NRRA. Nine jurisdictions initially adopted SLIMPACT; however, it failed to become operational as it never secured the required tenth member. Three states have withdrawn from SLIMPACT, including Kansas, North Dakota and Tennessee, leaving only six states in the non-operation agreement (Alabama, Indiana, Kentucky, New Mexico, Rhode Island and Vermont). No SLIMPACT states are pushing to make the compact operational and it is believed more states will eventually eliminate the law from their statutes and simply continue to follow the home state approach they already use.

The NRRA also addressed insurer eligibility and provided clear criteria for determining an insurer's eligibility to provide surplus lines insurance in each state. While some states have eliminated many pre-NRRA eligibility requirements such as "white lists," a number of states continue to impose eligibility requirements beyond those outlined in the NRRA. Since the 2014 report, no states have taken legislative or regulatory action to eliminate these additional requirements.

The NAIC's International Insurers Department Quarterly Listing of Alien Insurers has become the accepted regulatory source for establishing eligibility for alien (non-U.S.) insurers that appear on the list as required by the NRRA. The list is maintained by the National Association of Insurance Commissioners (NAIC), and provides brokers, exempt commercial purchasers, and insureds with assurance concerning the eligibility of non-U.S. insurers being utilized to quote or place excess and surplus lines insurance business.

On January 1, 2015, the criteria used to qualify as an ECP were required by the NRRA to be adjusted based on the Consumer Price Index (CPI). The NAIC subsequently recommended to states that the ECP criteria be adjusted as follows:

Criteria	Pre-2015	Post-2015
Net Worth	USD 20,000,000	USD 22,040,000
Annual Revenues	USD 50,000,000	USD 55,100,000
Annual Budgeted Expenditures	USD 30,000,000	USD 33,060,000

It was not the intent of the NRRA to have any effect on prices or the availability of coverage. Based on the information in the 2014 Government Accountability Office report on the effects of the NRRA, market participants have stated that the NRRA has indeed had little, if any, effect on the prices or availability of coverage. According to the surplus lines insurers contacted by the GAO, the NRRA has caused little noticeable shifting in coverage between the admitted and surplus lines markets, which, again, was not the intent of the legislation.

Federal Flood Insurance Legislation

In June of 2015, lawmakers introduced a bipartisan measure, the Flood Insurance Market Parity and Modernization Act, designed to clarify provisions of the National Flood Insurance Program (NFIP) to ensure private market flood insurance solutions are accepted by lenders. The law would clarify that lenders may accept coverage either alternatively or in addition to that made available through the NFIP in order to meet the mandatory purchase requirements of the National Flood Insurance Act in 42 U.S.C.A §4012a. This legislation is important to surplus lines insurers in order to preserve the coverages they historically provided, as well as to modernize the definition of private flood insurance to reflect the “eligible insurer” and “home state” terminology adopted in federal law through the NRRA.

The bipartisan bill was introduced by Representatives Dennis Ross (R-FL) and Patrick Murphy (D-FL) and Senators Jon Tester (D-MT) and Dean Heller (R-NV). A similar bill was introduced last year, but failed to pass.

Section IV – Current Distribution Trends

Surplus lines coverage solutions emerge when the standard market cannot provide needed coverages. As new exposures arise, the surplus lines market often provides the best, or sometimes the only, solution for retail producers and insureds seeking coverage for these exposures. It was only a few years ago that drones, 3-D printers, and cyber risks were not on anyone's radar screen. In 2015, they are at the forefront of people's minds, including surplus lines professionals. Sharing technologies, such as Uber, and driverless cars can be added to the list of newly emerging risks as well.

Opportunities

With new technologies come new risks, which present an opportunity to provide coverage for those who are looking to protect themselves against these risks. The planned usage of small unmanned aerial vehicles or drones is an example of technology presenting new and unique risks. Drones are being used for property inspections and inspections by insurance claim adjusters, imaging and surveillance applications in law enforcement, search and rescue attempts, and catastrophe response efforts, often obtaining detailed photographs of terrain, homes and people. Risks posed by the use of commercial drones include population safety, property damage, and both security and privacy concerns. It is still to be determined whether the benefits of increased commercial usage of drones are worth the associated risks. Another obvious problem is the already crowded U.S. airspace. From an insurance perspective, surplus lines companies may contribute positively to the resolution of issues related to drones by evaluating the risks and offering solutions to those looking to implement drone technology.

The dawn of 3-D printing is another area that presents opportunities, as well as potential pitfalls. For example, prosthetics can be developed using this technology, and can do wonders for so many people but there also is the risk that they will not work as intended. Who should bear that risk and how should coverage be implemented? In the case of using this technology to develop weapons, specifically non-metallic weapons, there are risks associated with the ability to get non-metallic weapons past metal detectors, creating considerable safety concerns. How such risks are protected against and who bears that risk are issues and questions that still require deep consideration and possibly a few lawsuits to provide clarity.

Cyber threats are a growing loss exposure as well. With mobile devices, information is now at our fingertips 24/7. This may include personal information, medical data, store purchases, bank account information and other confidential material, all of which are enticing targets for cyber criminals. There have been numerous reports of personal data being compromised and this drives up the cost of doing business. Many companies that have previously chosen not to purchase cyber risk insurance are now weighing its importance. Through 2014, approximately 20% of large enterprises carried cyber risk coverage, with an even lower adoption rate among medium- and small-sized enterprises. Cybersecurity threats show no signs of abating; if anything, the opposite is true. Protection against cyber threats is likely to be an increased area of focus, resulting in a significant opportunity that, in terms of insurance, could only be met by surplus lines insurers given the rapidly changing nature and scope of cyber exposures and the state form filing process that admitted insurers are encumbered with. Surplus lines insurers can meet the needs of insureds where standard coverage is insufficient or nonexistent.

Challenges

Competition, consolidation, and pricing are among the primary concerns of producers in the surplus lines space. Surplus lines intermediaries find that some producers are placing traditionally surplus lines risks in the admitted market. Not surprisingly, current market pricing generally is considered soft to weak due to overcapacity.

NARAB II

The National Association of Registered Agents and Brokers Reform Act of 2015 (NARAB II) was signed into law by President Obama in January 2015 as part of the Terrorism Risk Insurance Program Reauthorization Act of 2015. While it will take a number of years for this to be implemented, the market view is that NARAB II will make it easier for agents and brokers to conduct business and make the licensing process more streamlined. Productivity is expected to improve and the cost of business and compliance to decrease. NARAB II also aims to make it easier for insurers doing business in multiple states.

Business Trends

It's a mixed bag as far as whether surplus lines business is growing or not. Some companies are experiencing slight, more deliberate growth. Other entities report opportunities for across-the-board growth through varied lines of business. Some surplus lines insurers report feeling squeezed as standard lines insurers write more business that was formerly written mainly in the surplus lines market. Still others see flat growth prospects over the near-term that they expect will remain as such, absent a major catastrophe.

Consolidation

The general feeling is that consolidation has only had a limited impact among surplus lines producers, but there is a bigger concern that consolidation will adversely impact existing relationships and response time. There also is concern that fewer alternatives will be available and that quality will give way to price in the decision-making process.

Technology

A major benefit of effective technology is that when well-implemented, it makes it easier for producers to focus on their main goals. Technology also allows for greater mining of data. Ideally, small businesses benefit from new technology by simplifying tasks while larger companies benefit from greater efficiency. It is very important for future success of surplus lines insurers that as technology changes, they are able to keep pace. Insureds will undoubtedly be using even more advanced technologies in the years ahead. Current employees also may need to be trained to use the tools newly available. Depending on the priorities of the insurer, there may be a significant learning curve involved in becoming an expert at using new tools and technologies effectively.

Investment in New Products

The development of new products and programs remains important to surplus lines insurers. One of the hallmarks of the surplus lines insurance market is the development of new insurance solutions to address new or emerging risks, or to provide improved coverage for known risks. New products and programs continue being developed and launched. Some insurers, however, value the importance of investing in one's core products and expanding into other areas in deliberate, circumspect fashion, as opportunities arise.

Section V – Impairment Trends

Following a drop in 2013 to the lowest levels since 2007, financial impairments in the U.S. admitted property/casualty (P/C) industry dropped a little further in 2014, falling to almost one-third of the 2012 impairment count. Year-over-year, the impairment count was down 20% in 2014 and 44% in 2013.

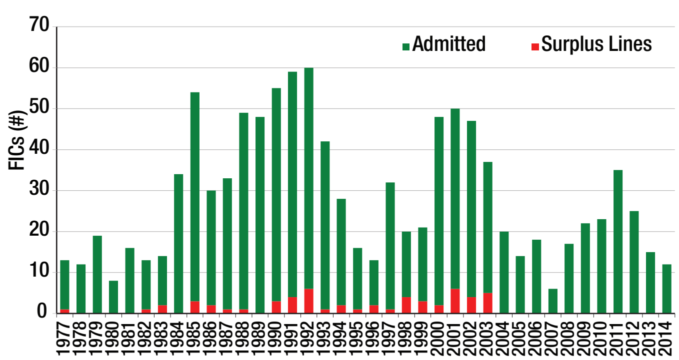
For the 11th consecutive year, the surplus lines industry recorded no financial impairments for the year.

P/C Industry Impairment Experience

The 12 known impairments in 2014 (see **Exhibit 19**), and 15 in 2013, compared with the 25 in 2012, have been more in line with figures seen consistently during the 1970's. A.M. Best assigned ratings to four and reported on seven of the 12 impairments in 2014. Of the companies that were rated, none carried a Secure rating in the year of impairment.

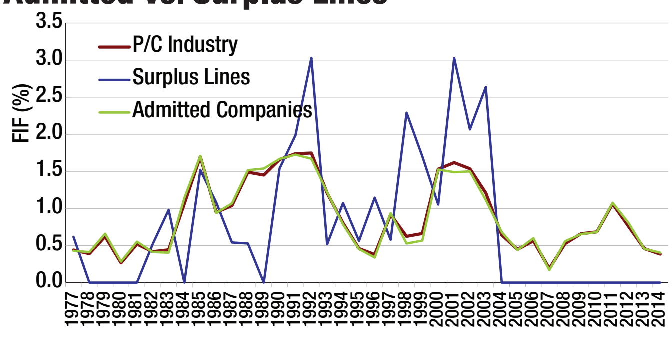
It is possible that additional financial impairments for 2014 and prior years could emerge. There could be a lag in the reporting of impairments due to the increasing use of confidential actions by insurance regulators, who are reluctant to publicly disclose impairments until all possible avenues to rehabilitate or find a buyer for troubled insurers have been exhausted. A.M. Best has found that there is an average 1.5-year lag between a confidential regulatory action and public disclosure of the impairment, usually the time between supervision and liquidation – if the confidential action ever becomes public at all.

Exhibit 19
U.S. Property/Casualty – Annual Impairment Count, Admitted Companies vs. Surplus Lines



Source: A.M. Best data and research.

Exhibit 20
U.S. Property/Casualty – Financial Impairment Frequency, Admitted vs. Surplus Lines



Source: A.M. Best data and research, BestLink Best's Statement File – P/C, U.S.

The financial impairment frequency (FIF) is calculated using the number of companies that become impaired in a given year, divided by the number of companies operating in the insurance market in that year. A.M. Best believes the FIF is a more accurate indicator of impairment trends than a simple count. The P/C industry's 2014 FIF was 0.39, below the industry's historical average of 0.91. Reviewing the most recent ten-year-term, the 2011 FIF of 1.06 seems to have marked the peak for impairment frequency, after the 2007-2010 soft-market trough and the 2007-2009 recession.

A.M. Best has found that, historically, increases in the insurance industry's FIF correlate strongly with preceding negative operating environments marked by events such as stock market booms and busts; economic recessions; and extraordinary catastrophe losses that typically force the end of soft markets (see **Exhibits 20 and 21**). Evidence of these trends resides in the increased FIF rates during the periods 1988 to 1993 and 2000 to 2003.

Surplus Lines Impairment Experience

Despite the absence of surplus lines financial impairments from 2004-2014, the industry's failure frequency rate of 0.86% from 1977 to 2014 remains close to the admitted company average of 0.91%. This reflects the surplus

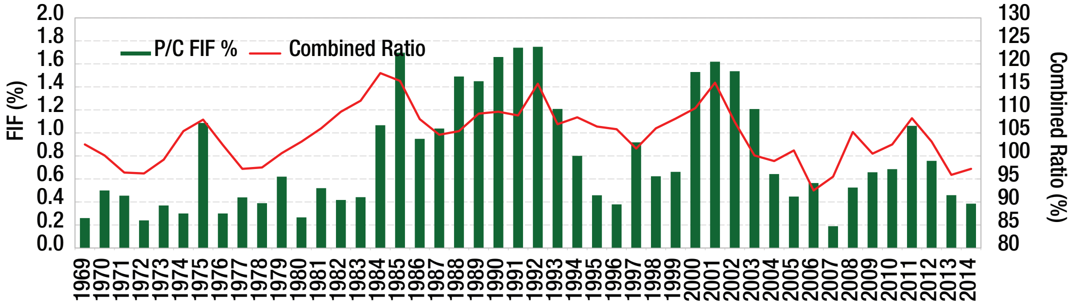
Exhibit 21
U.S. Property/Casualty – Financially Impaired Companies Count & Frequency Industry vs. Surplus Lines.

	Financially Impaired Companies (FIC)			Financial Impairment Frequency (FIF)[2]		
Year	P/C Industry	Surplus Lines	Admitted Cos.[1]	P/C Industry	Surplus Lines	Admitted Cos.[1]
1977	13	1	12	0.44	0.62	0.43
1978	12	0	12	0.39	0.00	0.41
1979	19	0	19	0.62	0.00	0.66
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
1977-2014	**1078**	**55**	**1023**	**0.88**	**0.79**	**0.88**

1 Includes alternative markets.
2 Failure frequencies are annualized rates.
3 1989 figures have been adjusted from previous reports to exclude 7 U.K.-domiciled companies.
Source: A.M. Best data and research

lines industry's significantly higher impairment frequencies during certain periods, in particular, 1992, 1998, 1999 and 2001-2003. (See **Exhibit 21.**) Since 2003, with each year that the surplus lines industry has experienced no financial impairments, the historical impairment frequencies for admitted and surplus lines companies have been steadily converging. The failure frequency rate is calculated using the number of companies that become insolvent in a given year, divided by the numberof companies operating in the insurance market in that year.

Exhibit 22
U.S. Property/Casualty – Financial Impairment Frequency vs. Industry Combined Ratio*



*Combined ratios are after policyholders' dividends. A combined ratio below 100 indicates an underwriting profit; above 100, an underwriting loss.
Source: A.M. Best data and research

The primary reason for the absence of surplus lines insurer failures in the mid-2000's related primarily to the surplus lines industry's improved underwriting performance, driven by demonstrated underwriting discipline and adequate pricing, overall. Investments in advanced technologies and improved systems, along with better management reporting and more robust oversight have also helped the impairments to trend positively for surplus lines insurers.

Beginning in 2007, however, underwriting profitability and operating performance began a period of deterioration that lasted through 2012, as indicated by a rise in the surplus lines industry's combined ratio (see **Exhibit 23**), before improvements were recorded in 2013 and again in 2014. For that reason, the absence of impairments in the late 2000's and early 2010's was initially more related to the overall capitalization of surplus lines companies than to underwriting performance. The improvement in profitability in the most recent years should also contribute to the likelihood that the recent impairment trend for surplus lines companies remains favorable.

A.M. Best remains optimistic, but guardedly so, about the low trend of surplus lines impairments with the offsetting factors specifically related to sluggish or, in some cases, weak economic conditions that have prolonged the soft market and contributed to pressure on combined ratios. The persistent low interest rate environment limits the ability of surplus lines (and admitted) companies to potentially withstand or offset any deficiencies in pricing or inadequate risk selection with investment returns and capital market gains.

Causes and Characteristics of Financial Impairments

The causes and characteristics of financial impairments have generally remained consistent for both the surplus lines and admitted P/C industries during the period that A.M. Best has examined impairment data, most recently updated in the special report, *U.S. Property/Casualty – Impairment Review* (August 2015).

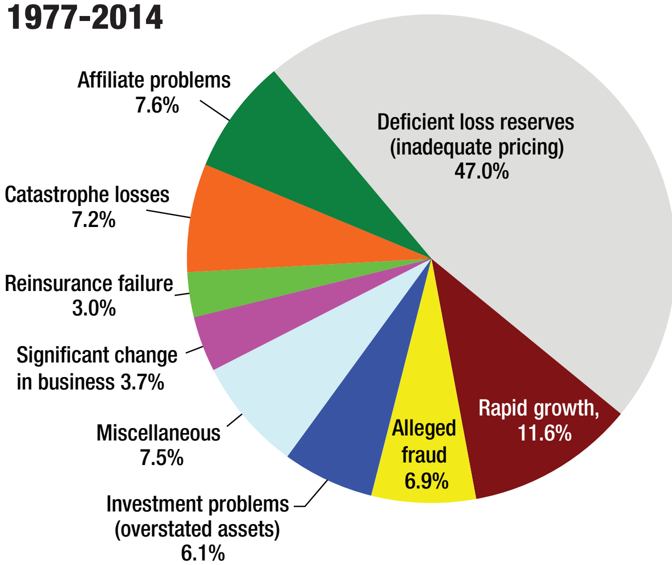
Deficient loss reserves/inadequate pricing and rapid growth have accounted for the largest portion of total impairment among surplus lines and admitted companies. (See **Exhibits 24 and 25.**) These two categories in combination

Exhibit 23
U.S. DPSL* Composite – Financial Impairment Frequency & Combined Ratio

Year	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	88.8

*Domestic Professional Surplus Lines
Source: A.M. Best data and research

Exhibit 24
U.S. Property/Casualty Admitted – Primary Causes of Financial Impairment, 1977-2014

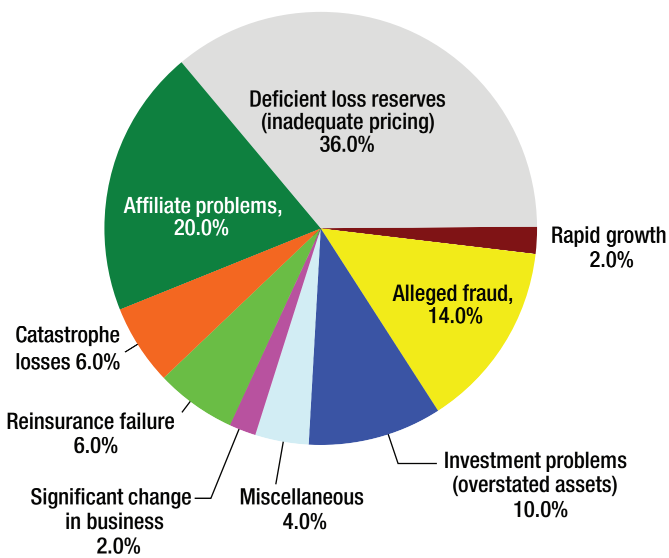


Note: Exhibit % based on companies where the cause of impairment was identified.
Source: A.M. Best data and research

accounted for 38.0% of surplus lines impairments and 58.6% of admitted P/C company impairments.

The second-highest cause of surplus lines impairments has been affiliate problems at 20%, vs. 7.6% for admitted P/C companies. Some surplus lines companies became impaired when their parent companies, which were engaged primarily in the admitted market, were declared insolvent. Some of these past instances of surplus lines failures highlight the extent to which poorly managed operations of a parent company can impact its surplus lines affiliates.

Exhibit 25
U.S. Surplus Lines – Primary Causes of Financial Impairment, 1977-2014



Note: Exhibit % based on companies where the cause of impairment was identified.
Source: A.M. Best data and research

Alleged fraud was the next highest cause of impairment among surplus lines companies at 14.0% vs. 6.9% for admitted companies. All other causes of impairment for surplus lines and admitted insurers accounted for 28% and 26.9%, respectively, of the identified impediments. A.M. Best believes that except for those insolvencies directly related to catastrophe losses, all insolvencies are related to some form of mismanagement. In many instances, companies that become impaired because of catastrophe losses tend to be those concentrated in a particular line of business or geographic area, and have been financially weakened by years of operating losses.

Looking at impairments by line of business, the "other liability" category – encompassing directors and officers (D&O), errors and omissions (E&O), general liability, contractual liability, and excess umbrella – accounted for the highest percentage of surplus lines impairments over the course of time that A.M. Best has studied P/C impairment trends. The workers' compensation and commercial automobile lines caused the second and third highest number of impairments, respectively. Workers' compensation is not a major line of coverage for surplus lines insurers but a surplus lines insurer's impairment could result from adverse workers' compensation experience of one or more admitted insurers within the same group of companies.

Conclusion

Over the span of time that A.M. Best has studied financial impairments, a strong correlation has been found between the insurance industry's financial impairment frequency and negative operating environments marked by events such as high catastrophe losses; severe downturns in the stock market; or economic recessions. Most often, the triggers for a marked increase in impairments have been sudden, major events that pushed companies already made vulnerable by negative operating performance or mismanagement beyond the brink, and into financial impairment.

Financially Impaired Companies Defined

A.M. Best designates an insurer as a Financially Impaired Company (FIC) as of the first official regulatory action taken by an insurance department, whereby the insurer's:

- Ability to conduct normal insurance operations is adversely affected;
- Capital and surplus have been deemed inadequate to meet legal requirements; and/or
- General financial condition has triggered regulatory concern.

State actions include supervision, rehabilitation, liquidation, receivership, conservatorship, cease-and-desist orders, suspension, license revocation and certain administrative orders. A.M. Best emphasizes that the FICs in this study might not technically have been declared insolvent.Note that the above definition of an FIC is broader than that of a Best's Rating of "E" (under regulatory supervision), which is assigned only when an insurer is "no longer allowed to conduct normal ongoing insurance operations." Thus, a company may be designated as financially impaired in this study but may not have been assigned an "E" Best's Rating. Further, a Best's Rating of "F" (in liquidation) can reflect aliquidation as part of the impairment process, or it can indicate a voluntary dissolution. Unless they occur under financial duress, voluntary dissolutions are not counted as impairments. Before 1992, a Best's Rating of "NA-10" was used to indicate that a company was under regulatory supervision and/or in liquidation.

Revisions

As a result of ongoing research efforts, A.M. Best's impairment database is updated continually to reflect the incorporation of new data or adjustments to existing data. The most common revision to the data is a company's initial year of impairment. If any change places a company outside of this study's parameters, the company is eliminated from the study.

Confidential Supervisions

In addition to the regulatory actions that are announced publicly, there also are actions that insurance regulators undertake on a confidential basis. When A.M. Best becomes aware of an active confidential regulatory action, the impairment is counted in the aggregate analysis, but is not reported on a company-specific basis to protect confidentiality. While the reporting of confidential actions likely is understated, A.M. Best believes a full accounting of these nonpublic actions would not change materially its impairment analysis.

Section VI – Fundamentals of The Surplus Lines Market

The U.S. surplus lines market (also called the nonadmitted market) functions as a supplemental market for insuring risks that are not acceptable to the standard insurance market (also called the admitted market).

The insurers in the surplus lines market are property/casualty companies that distribute their products to consumers through surplus lines producers. Consumers that are unable to secure insurance coverage from standard (admitted) insurers also have the option of self-insuring or seeking coverage in the alternative risk transfer (ART) market.

The risks insured in the surplus lines market are usually classified as one of the following:

- **Distressed risks** – characterized by unfavorable attributes, such as a history of frequent losses or the potential for catastrophic losses that make them unacceptable to admitted insurers. Examples of distressed risks include a vacant building located in an area that experiences frequent crime losses, a shopping mall with frequent liability claims or a manufacturer of explosives.
- **Unique risks** – so specialized or unusual that admitted insurers are unwilling or unprepared to insure them. An example of a unique risk is a medical device manufacturer that needs product liability coverage while a new product is in clinical trials.
- **High-capacity risks** – requiring high insurance limits that may exceed the capacity of the standard market. An example of a high-capacity risk is a chemical plant that could become legally liable for hundreds of millions of dollars in damages if a toxic chemical were to escape in large quantities.
- **New or emerging risks** – requiring special underwriting expertise and flexibility that the surplus lines market can provide. Examples of new or emerging risks that are in need of property and/or liability coverage include the nonmilitary use of unmanned aircraft systems (drones) and marijuana businesses in states that have legalized the medical or recreational use of marijuana.

The surplus lines market has historically been an innovator of new kinds of insurance coverage designed to meet emerging market needs. Examples of policies that were originated by surplus lines carriers include cyber risk, environmental impairment liability, employment practices liability, directors and officers liability, and excess and umbrella liability. These types of policies can now be obtained in either the standard (admitted) insurance market or the surplus lines market, depending on the characteristics of the particular risk.

The majority of surplus lines business consists of commercial lines insurance, although some personal lines coverage, such as homeowners insurance in catastrophe-prone areas, is also written on a nonadmitted basis..

Surplus lines insurers are referred to as nonadmitted insurers because they are not licensed (admitted) in the state where the insured's principal place of business is located or where the insured resides. This state is known as "the insured's home state" and is the state that is responsible by federal law for oversight and regulation of the surplus lines transaction. Every U.S. jurisdiction has a surplus lines law that permits specially licensed intermediaries (surplus lines brokers/licensees) to "export" risks that cannot be placed in the standard market to eligible surplus lines (nonadmitted) insurers.

Although not a licensed insurer in the "home state of the insured," each surplus lines insurer is licensed in its state or country of domicile and is regulated for solvency by that jurisdiction. This is the same approach used by the state-based insurance regulatory system in the United States to assure the financial stability of licensed or admitted insurers. As a nonadmitted carrier, a surplus lines insurer is not subject to the rate and form regulations of the insured's home state and is therefore free to use policy forms and rates that are appropriate for the risks it accepts. State regulation of licensed or admitted insurers, in contrast, includes the oversight of insurance policy rates and forms. The purpose of this special regulatory approach to surplus lines insurers is to ensure that the surplus lines market provides an open and flexible marketplace for insureds that are unable to fulfill their insurance requirements in the state's admitted or standard market.

When the insurance market or capacity becomes restricted and market conditions "harden," standard market carriers typically reduce their appetites for some risks or lines of insurance, and business flows into the surplus lines market. Even under normal market conditions or when the market is considered "soft," there are still many distressed, unique, high-capacity and new or emerging risks that require surplus lines treatment. In 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.

The minimum capitalization requirement for surplus lines insurers is generally higher in each state than it is for admitted insurers. This enhanced capital standard provides greater protection for policyholders insured by surplus lines companies, since state guaranty fund protection, provided to policyholders of admitted insurers that become insolvent, is not generally available to surplus lines insureds. (See Section II for current financial trends in the surplus lines market).

Market Cycles

In general, the condition of the admitted insurance market affects the state of the surplus lines market. (See Section I for the latest surplus lines market trends). This impact, on occasion, can be significant. When admitted market conditions harden or become more difficult, a sizable amount of business flows from the admitted market to the surplus lines market. During a hard market, underwriters tend to become more conservative and restrictive, examining loss exposures more carefully to determine how a particular risk under consideration can be written at a profit.

In these circumstances, standard market carriers only insure those risks that they are most comfortable in assuming and tend 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" as producers and insurers strive to maintain market share by reducing rates, expanding coverage and offering additional services at the expense of profit margins. During this soft market phase of the cycle, consumers' bargaining power increases significantly, causing rates to drop and coverage limitations or exclusions to be relaxed. When these circumstances occur, business begins to return to the admitted market.

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

Industry Participants

For the purposes of this report, A.M. Best has categorized surplus lines insurers into three broad segments:

- Domestic professional companies: This largest segment is represented by U.S.-domiciled insurers that write 50% or more of their total premium on a nonadmitted basis.
- Domestic specialty companies: U.S.-domiciled insurers that operate to some extent on a nonadmitted basis but whose direct nonadmitted premium writings amount to less than 50% of their total direct premiums written.

- Regulated aliens (including Lloyd's): To qualify as a regulated alien, insurers must file financial statements, copies of auditors' reports, the names of their U.S. attorneys or other representatives and details of their U.S. trust accounts with the International Insurers Department (IID) of the National Association of Insurance Commissioners (NAIC). Additionally, regulated aliens must fulfill criteria established by the IID concerning capital and/or surplus, reputation of financial integrity, and underwriting and claims practices. On a quarterly basis, the NAIC publishes its Quarterly Listing of Alien Insurers, which lists 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.

Distribution

Retail producers, surplus lines intermediaries and program managers are the primary distributors for surplus lines insurers. All of these entities play an important role in helping consumers find insurance coverage that is unavailable in the standard market. (See Section IV for a description of current surplus lines distribution issues).

For purposes of this special report, the types of organizations within the surplus lines distribution system are defined as follows:

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

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 with access to the surplus lines market when the admitted market cannot provide coverage or the risk otherwise 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 only have the authority to submit business to surplus lines insurers. The insurers then underwrite, quote and, if the risk is considered to be acceptable, bind the risk. In addition, some MGAs have claims-handling responsibilities and may be involved in the placement of reinsurance.

Lloyd's coverholders are authorized to bind coverage on behalf of underwriting syndicates at Lloyd's. OMCs are approved for placing coverage at Lloyd's either directly or through a Lloyd's broker.

Surplus lines laws generally require that a "diligent search" of the admitted market be performed before a risk can be exported to a surplus lines insurer. In general, the diligent-search requirement, which assures the admitted market the first opportunity to insure the risk, requires that three declinations from admitted insurers be obtained before the risk can be placed in the surplus lines market.

In certain states, specified types of risks can be placed in the surplus lines market without the diligent search requirement being fulfilled. Many states have created an "export list," which sets forth types of risks for which the insurance commissioner has determined there is little or no coverage available in the state's admitted market. A type of risk that appears on the export list can be exported, without a diligent search, to an eligible surplus lines insurer. Also, a few states have commercial lines deregulation laws that allow for "automatic export" waivers, giving qualifying commercial buyers and their brokers or intermediaries immediate access to the surplus lines market, as well as access to a deregulated admitted market, without a diligent search.

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

- Filing an affidavit affirming that a diligent search has been performed, when it is required;
- Maintaining the records relating to the transaction; and
- Collecting premium taxes and remitting them to the insured's home state.

In addition to facilitating the surplus lines placement, the surplus lines intermediary provides a number of services, which include:

- Technical expertise about the risk to be insured;
- Extensive insurance product and market knowledge;
- Ability to respond quickly to changing market conditions; and
- Access to eligible surplus lines insurers.

Licensing and Compliance

In a surplus lines transaction, the insured's home state exercises the greatest degree of regulatory oversight, and the onus of regulatory compliance is placed on the surplus lines broker or licensee, which is 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 do the following:

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

Further, the surplus lines broker or licensee is responsible for determining whether the nonadmitted insurer insuring the risk meets the insured's home state eligibility requirements. A broker or licensee 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, under a negligence standard, who exercises due diligence or care in selecting the insurer, even if the insurer becomes insolvent years later.

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.

Conclusion

This section on "Fundamentals" is a primer for readers who are not already familiar with the surplus lines market, to assist them in understanding this unique insurance marketplace and to put the other sections of this report into context. The fundamentals of the surplus lines market include the participants and their roles, the types of risks insured, the regulatory structure and the responsibilities imposed on the surplus lines broker/licensee and the dynamic role of market cycles.

Appendix A

U.S. Surplus Lines - Top 50 Groups, 2014

Ranked by direct premims written
(USD Thousands)

Rank	A.M. Best #	Group Name	Type of Company	Surplus Lines DPW	Year/Year Change in DPW	Total Group PHS	Best's Financial Strength Rating*	Financial Strength Rating Outlook / Implications	Rating Effective Date
1	085202	Lloyds		$8,157,000	14.9%		A	Positive	22-Jul-15
2	018540	American International Group		$4,679,470	-3.2%	$6,616,409			
2	003535	AIG Specialty Insurance Co	PROF	$899,194		$45,363	A	Stable	27-Feb-15
2	002361	Illinois National Insurance Co	MISC	$63		$36,972	A	Stable	27-Feb-15
2	002350	Lexington Insurance Company	PROF	$3,780,213		$6,534,074	A	Stable	27-Feb-15
3	005987	Nationwide Group		$1,780,987	7.1%	$956,234			
3	001931	Scottsdale Indemnity Company	MISC	$23,141		$37,232	A+	Stable	19-Mar-15
3	003292	Scottsdale Insurance Company	PROF	$1,559,064		$764,852	A+	Stable	19-Mar-15
3	012121	Scottsdale Surplus Lines Ins	PROF	$10,828		$46,666	A+	Stable	19-Mar-15
3	000601	Western Heritage Insurance Co	PROF	$187,954		$107,484	A+	Stable	19-Mar-15
4	018252	W. R. Berkley Insurance Group		$1,485,813	11.9%	$996,022			
4	003026	Admiral Insurance Company	PROF	$443,067		$615,642	A+	Stable	22-Jan-15
4	014158	Berkley Assurance Company	PROF	$42,926		$51,746	A+	Stable	22-Jan-15
4	011296	Berkley Regional Specialty Ins	PROF	$22,204		$52,934	A+	Stable	22-Jan-15
4	012118	Gemini Insurance Company	PROF	$467,658		$54,271	A+	Stable	22-Jan-15
4	011231	Great Divide Insurance Co	MISC	$2,975		$66,909	A+	Stable	22-Jan-15
4	001990	Nautilus Insurance Company	PROF	$506,983		$154,521	A+	Stable	22-Jan-15
5	018549	Zurich Financial Svcs NA Group		$1,204,753	-2.2%	$565,903			
5	002147	Empire Fire & Marine Ins Co	MISC	$285		$44,396	A+	Stable	26-Nov-14
5	002148	Empire Indemnity Ins Co	PROF	$151,349		$50,030	A+	Stable	26-Nov-14
5	003557	Steadfast Insurance Company	PROF	$1,051,685		$436,185	A+	Stable	26-Nov-14
5	003565	Zurich American Ins Co of IL	MISC	$1,433		$35,292	A+	Stable	26-Nov-14
6	018468	Markel Corporation Group		$1,191,418	3.8%	$1,319,262			
6	003677	Alterra Excess & Surplus Ins	PROF	$192,957		$158,321	A	Stable	15-May-15
6	004898	Associated International Ins	PROF	$41,394		$109,075	NR		
6	002732	Essex Insurance Company	PROF	$472,335		$416,532	A	Stable	15-May-15
6	003759	Evanston Insurance Company	PROF	$484,732		$635,334	A	Stable	15-May-15
7	018498	ACE INA Group		$1,032,388	5.7%	$329,338			
7	003510	Illinois Union Insurance Co	PROF	$457,250		$159,550	A++ u	Negative	2-Jul-15
7	004433	Westchester Surplus Lines Ins	PROF	$575,138		$169,787	A++ u	Negative	2-Jul-15
8	018728	Ironshore Insurance Group		$894,986	20.1%	$482,419			
8	013847	Ironshore Indemnity Inc.	MISC	$14,286		$156,603	A u	Negative	31-Jul-15
8	013866	Ironshore Specialty Ins Co	PROF	$880,700		$325,815	A u	Negative	31-Jul-15
9	000811	Berkshire Hathaway Ins Group		$835,316	48.0%	$7,649,707			
9	003806	General Star Indemnity Co	PROF	$156,426		$615,985	A++	Stable	17-Jun-14
9	002540	Mount Vernon Fire Ins Co	PROF	$98,329		$395,241	A++	Stable	12-Jun-15
9	002428	National Fire & Marine Ins Co	PROF	$540,747		$5,604,726	A++	Stable	21-May-14
9	001824	National Indem Co of the South	MISC	$1,280		$177,447	A++	Stable	21-May-14
9	004406	National Indem Co of Mid-Amer	MISC	$1,415		$170,269	A++	Stable	21-May-14
9	003736	U S Underwriters Insurance Co	PROF	$28,975		$122,718	A++	Stable	12-Jun-15
9	002541	United States Liability Ins Co	MISC	$8,144		$563,321	A++	Stable	12-Jun-15
10	003116	Fairfax Financial (USA) Group		$793,974	-5.2%	$525,347			
10	012347	American Safety Indemnity Co	PROF	$9,493		$128,147	NR		
10	011123	Crum & Forster Specialty Ins	PROF	$132,197		$47,313	A	Stable	4-Jun-15
10	011883	First Mercury Insurance Co	PROF	$319,461		$55,862	A	Stable	4-Jun-15
10	014995	Hudson Excess Insurance Co	PROF	$13,192		$58,847	A	Stable	5-May-15
10	012631	Hudson Specialty Ins Co	PROF	$209,371		$186,779	A	Stable	5-May-15
10	012258	Seneca Specialty Ins Co	PROF	$110,260		$48,400	A	Stable	4-Jun-15
11	018640	Alleghany Ins Holdings Group		$780,702	2.1%	$373,242			
11	001960	Capitol Specialty Ins Corp	PROF	$82,733		$53,485	A	Stable	24-Apr-15
11	013859	Covington Specialty Ins Co	PROF	$161,540		$48,515	A+	Stable	24-Apr-15
11	022013	Fair American Select Ins Co	PROF	$3,666		$46,887	A	Positive	24-Apr-15
11	012619	Landmark American Ins Co	PROF	$532,764		$224,355	A+	Stable	24-Apr-15
12	018313	CNA Insurance Companies		$745,886	-7.7%	$241,607			
12	003538	Columbia Casualty Company	PROF	$745,886		$241,607	A	Stable	16-Dec-14
13	018130	XL America Group		$726,916	17.2%	$97,731			

Appendix A

U.S. Surplus Lines - Top 50 Groups, 2014

Ranked by direct premims written

(USD Thousands)

Rank	A.M. Best #	Group Name	Type of Company	Surplus Lines DPW	Year/Year Change in DPW	Total Group PHS	Best's Financial Strength Rating*	Financial Strength Rating Outlook / Implications	Rating Effective Date
13	011340	Indian Harbor Insurance Co	PROF	$726,883		$46,171	A	Stable	1-May-15
13	002424	XL Select Insurance Company	PROF	$33		$51,560	A	Stable	1-May-15
14	018603	AXIS Insurance Group		$591,135	8.0%	$205,938			
14	012515	AXIS Surplus Insurance Company	PROF	$591,135		$205,938	A+	Stable	4-Aug-15
15	000012	Chubb Group of Insurance Cos		$574,425	36.1%	$1,599,066			
15	002713	Chubb Custom Insurance Co	PROF	$526,899		$187,382	A++ u	Negative	2-Jul-15
15	003761	Executive Risk Indemnity Inc	MISC	$549		$1,258,019	A++ u	Negative	2-Jul-15
15	011251	Executive Risk Specialty Ins	PROF	$46,976		$153,664	A++ u	Negative	2-Jul-15
16	018484	Arch Insurance Group		$548,931	0.3%	$292,438			
15	012523	Arch Specialty Insurance Co	PROF	$548,931		$292,438	A+	Stable	21-Aug-15
17	004019	Argo Group		$526,338	5.3%	$371,142			
17	003283	Colony Insurance Company	PROF	$522,240		$319,845	A	Stable	2-Oct-14
17	002619	Colony Specialty Insurance Co	MISC	$4,190		$19,989	A	Stable	2-Oct-14
17	011035	Peleus Insurance Company	PROF	-$93		$31,309	A	Stable	2-Oct-14
18	018713	QBE Americas Group		$522,550	-32.7%	$197,459			
18	012562	QBE Specialty Insurance Co	PROF	$522,550		$197,459	A	Stable	15-Jan-15
19	018591	Allied World Assurance Group		$517,559	10.9%	$361,815			
19	012525	Allied World Asr Co (US) Inc	PROF	$213,588		$139,608	A	Stable	16-Dec-14
19	012526	Allied World National Assur Co	MISC	$61,990		$129,657	A	Stable	16-Dec-14
19	011719	Allied World Surplus Lines Ins	PROF	$241,982		$92,550	A	Stable	16-Dec-14
20	004835	Great American P & C Ins Group		$472,564	20.0%	$243,487			
20	003735	American Empire Surplus Lines	PROF	$149,529		$108,414	A+	Stable	20-Mar-15
20	010937	Great Amer Protection Ins Co	PROF	$301		$26,038	A+	Stable	20-Mar-15
20	003837	Great American E&S Ins Co	PROF	$309,094		$45,955	A+	Stable	20-Mar-15
20	003293	Great American Fidelity Ins Co	PROF	$10,832		$45,981	A+	Stable	20-Mar-15
20	014150	Mid-Continent E&S Ins Co	PROF	$2,807		$17,099	A+	Stable	20-Mar-15
21	018720	Catlin US Pool		$443,724	15.3%	$204,276			
21	010092	Catlin Specialty Insurance Co	PROF	$443,724		$204,276	A	Stable	1-May-15
22	018604	State National Group		$434,505	84.4%	$74,980			
22	013105	United Specialty Insurance Co	PROF	$434,505		$74,980	A	Stable	9-Jun-15
23	018783	Aspen US Insurance Group		$425,002	36.6%	$131,940			
23	012630	Aspen Specialty Insurance Co	PROF	$425,002		$131,940	A	Stable	23-Oct-14
24	018756	Starr International Group		$396,987	30.4%	$97,237			
24	013977	Starr Surplus Lines Ins Co	PROF	$396,987		$97,237	A	Stable	20-Oct-14
25	003262	Swiss Reinsurance Group		$378,134	14.7%	$118,685			
25	010783	First Specialty Ins Corp	PROF	$222,710		$70,136	A+	Stable	6-Nov-14
25	011135	North American Capacity Ins Co	PROF	$155,424		$48,550	A+	Stable	6-Nov-14
26	018723	HCC Insurance Group		$375,470	6.3%	$1,908,061			
26	003286	Houston Casualty Company	PROF	$356,178		$1,891,871	A+	Stable	25-Sep-14
26	012531	HCC Specialty Ins Co	PROF	$19,292		$16,190	A+	Stable	25-Sep-14
27	018674	Travelers Group		$360,946	9.1%	$960,742			
27	004869	Northfield Insurance Co	PROF	$115,829		$126,184	A++	Stable	28-May-15
27	004025	Northland Casualty Company	MISC	$984		$35,409	A++	Stable	28-May-15
27	000712	Northland Insurance Company	MISC	$4,159		$538,940	A++	Stable	28-May-15
27	003592	St. Paul Surplus Lines Ins Co	PROF	$26,486		$194,869	A++	Stable	28-May-15
27	000241	Travelers Excess & Surp Lines	PROF	$213,488		$65,340	A++	Stable	28-May-15
28	000060	Liberty Mutual Insurance Cos		$350,326	-19.4%	$97,565			
28	012078	Liberty Surplus Ins Corp	PROF	$350,326		$97,565	A	Stable	24-Sep-14
29	018081	Navigators Insurance Group		$316,220	24.2%	$1,026,915			
29	001825	Navigators Insurance Company	MISC	$27		$893,946	A	Stable	3-Jun-15
29	010761	Navigators Specialty Ins Co	PROF	$316,194		$132,969	A	Stable	3-Jun-15
30	018523	Assurant P&C Group		$296,295	-3.4%	$220,002			
30	002050	Standard Guaranty Ins Co	MISC	$136,887		$160,733	A	Stable	21-Nov-14
30	002861	Voyager Indemnity Ins Co	PROF	$159,409		$59,270	A	Stable	21-Nov-14
31	018753	Munich-American Hldng Corp Cos		$296,040	6.9%	$242,655			
31	013062	Amer Modern Surpl Lines Ins Co	PROF	$31,834		$26,683	A+	Stable	13-Nov-14

Appendix A
U.S. Surplus Lines - Top 50 Groups, 2014
Ranked by direct premims written
(USD Thousands)

Rank	A.M. Best #	Group Name	Type of Company	Surplus Lines DPW	Year/Year Change in DPW	Total Group PHS	Best's Financial Strength Rating*	Financial Strength Rating Outlook / Implications	Rating Effective Date
31	002666	American Modern Select Ins Co	MISC	$844		$44,879	A+	Stable	13-Nov-14
31	003763	American Western Home Ins Co	PROF	$53,791		$63,228	A+	Stable	13-Nov-14
31	014838	HSB Specialty Insurance Co	PROF	$4,433		$49,794	A++	Stable	6-Feb-15
31	012170	Princeton Excess & Surp Lines	PROF	$205,138		$58,070	A+	Stable	13-Nov-14
32	002946	Western World Insurance Group		$277,071	13.4%	$624,510			
32	002598	Tudor Insurance Company	PROF	$62,313		$172,421	A	Stable	6-Nov-14
32	003132	Western World Insurance Co	PROF	$214,758		$452,089	A	Stable	6-Nov-14
33	018620	Endurance Specialty Group		$268,714	39.8%	$90,259			
33	013033	Endurance American Spec Ins Co	PROF	$268,714		$90,259	A	Stable	28-May-15
34	003883	RLI Group		$259,933	-0.2%	$461,140			
34	002591	Mt Hawley Insurance Company	PROF	$259,933		$461,140	A+	Stable	4-Jun-15
35	018626	James River Group		$252,707	31.3%	$174,119			
35	013985	James River Casualty Company	PROF	$5,971		$15,862	A-	Positive	26-Jun-15
35	012604	James River Insurance Co	PROF	$246,736		$158,257	A-	Positive	26-Jun-15
36	005696	Everest Re U.S. Group		$225,986	27.6%	$78,588			
36	012096	Everest Indemnity Insurance Co	PROF	$225,377		$57,548	A+	Stable	25-Jul-14
36	011197	Everest Security Insurance Co	MISC	$609		$21,040	A+	Stable	25-Jul-14
37	018490	White Mountains Insurance Grp		$225,063	1.5%	$162,199			
37	010604	Homeland Ins Co of NY	PROF	$200,571		$111,328	A	Stable	3-Oct-14
37	014398	Homeland Insurance Company DE	PROF	$24,492		$50,872	A	Stable	3-Oct-14
38	000856	State Auto Insurance Companies		$222,567	24.0%	$99,813			
38	013023	Rockhill Insurance Company	PROF	$222,567		$99,813	A-	Stable	28-Apr-15
39	000897	IFG Companies		$190,370	-16.3%	$455,048			
39	000709	Burlington Insurance Company	PROF	$187,960		$180,745	A	Stable	12-Jun-15
39	012242	Guilford Insurance Company	PROF	$2,410		$274,304	A	Stable	12-Jun-15
40	018717	HIIG Group		$182,997	11.0%	$280,336			
40	013825	Houston Specialty Insurance Co	PROF	$121,821		$263,641	A-	Stable	23-Jan-15
40	014363	Oklahoma Specialty Ins Co	PROF	$61,176		$16,695	A-	Stable	23-Jan-15
41	018669	Global Indemnity Group		$177,300	11.2%	$369,462			
41	003674	Penn-America Insurance Company	PROF	$69,751		$84,418	A	Stable	12-Jun-15
41	011460	Penn-Patriot Insurance Company	PROF	$1,985		$20,615	A	Stable	12-Jun-15
41	012050	Penn-Star Insurance Company	PROF	$44,648		$49,300	A	Stable	12-Jun-15
41	003128	United National Insurance Co	PROF	$58,497		$195,876	A	Stable	12-Jun-15
41	000447	United National Specialty Ins	MISC	$2,418		$19,254	A	Stable	12-Jun-15
42	003873	SCOR U S Group		$174,815	27.8%	$51,676			
42	002837	General Security Indem Co AZ	PROF	$174,815		$51,676	A	Stable	1-Oct-14
43	004294	The Cincinnati Insurance Cos		$162,412	19.1%	$265,556			
43	013843	Cincinnati Specialty Undrs Ins	PROF	$162,412		$265,556	A	Stable	12-Dec-14
44	018733	Philadelphia Ins/Tokio Mar Grp		$161,444	58.6%	$173,937			
44	000763	Tokio Marine Specialty Ins Co	PROF	$161,444		$173,937	A++	Stable	4-Jun-15
45	014027	Kinsale Insurance Company		$157,917	27.2%	$104,101			
45	014027	Kinsale Insurance Company	PROF	$157,917		$104,101	A-	Stable	9-Apr-15
46	018653	Maxum Specialty Insurance Grp		$151,425	5.1%	$109,724			
46	012563	Maxum Indemnity Company	PROF	$151,425		$109,724	A-	Negative	22-May-15
47	018567	IAT Insurance Group		$150,163	5.2%	$286,247			
47	011774	Acceptance Casualty Ins Co	PROF	$7,803		$49,427	A-	Stable	11-Jun-15
47	010611	Acceptance Indemnity Ins Co	PROF	$93,423		$129,182	A-	Stable	11-Jun-15
47	000975	Wilshire Insurance Company	MISC	$48,937		$107,639	A-	Stable	11-Jun-15
48	003926	Selective Insurance Group		$147,070	14.0%	$66,794			
48	013842	Mesa Underwriters Spec Ins Co	PROF	$147,070		$66,794	A	Stable	28-May-15
49	025045	GeoVera U.S. Insurance Group		$141,024	-4.9%	$22,359			
48	011678	GeoVera Specialty Insurance Co	PROF	$141,024		$22,359	A	Stable	5-Jun-15
50	018587	Atain Insurance Companies		$110,008	25.8%	$199,155			
50	012422	Atain Insurance Company	PROF	$4,857		$45,743	A	Stable	12-Jun-15
50	002842	Atain Specialty Insurance Co.	PROF	$105,152		$153,412	A	Stable	12-Jun-15

* Ratings are as of August 21, 2015
Source: A.M. Best data and research

Appendix B

U.S. Domestic Professional Surplus Lines – Entrances & Exits, 2010-2014

X denotes domestic professional surplus companies, defined as companies with direct premium from surplus lines business greater than 50% of total premium.

Company Name	2010	2011	2012	2013	2014
Acceptance Casualty Insurance Co			X	X	X
Acceptance Indemnity Insurance Co	X	X	X	X	X
Admiral Insurance Co	X	X	X	X	X
Adriatic 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
Alterra Excess & Surplus Ins	X	X	X	X	X
American Empire Surplus Lines	X		X	X	X
American Modern Surpl Lines Ins Co	X	X	X	X	X
American Mutual Share Ins Corp	X	X	X	X	X
American Safety Indemnity Co	X	X	X	X	X
American Safety Insurance Co	X	X	X	X	X
American Western Home Ins Co	X	X	X	X	X
Appalachian Insurance Co	X	X	X	X	X
Arch Excess & Surplus Co	X	X			
Arch Specialty Insurance Co	X	X	X	X	X
Aspen Specialty Insurance Co	X	X	X	X	X
Associated Industries Insurance Co			X	X	
Associated International Ins	X	X	X	X	X
Atain Insurance Co	X	X	X	X	X
Atain Specialty Insurance Co.	X	X	X	X	X
Atlantic Casualty Insurance Co	X	X	X	X	X
AXIS Specialty Insurance Co	X				
AXIS Surplus Insurance Co	X	X	X	X	X
Berkley Assurance Co		X	X	X	X
Berkley Regional Specialty Ins	X	X	X	X	X
Burlington Insurance Co	X	X	X	X	X
Canal Indemnity Co	X	X	X	X	X
Canopius US Insurance, Inc.			X	X	X
Capitol Specialty Insurance Corp	X	X	X	X	X
Catlin Specialty Insurance Co	X	X	X	X	X
Century Surety Co	X	X	X	X	X
Chubb Custom Insurance Co	X	X	X	X	
CIM Insurance Corporation	X	X	X	X	
Cincinnati Specialty Undrs Ins	X	X	X	X	X
Clarendon America Insurance Co	X	X			
Colony Insurance Co	X	X	X	X	X
Columbia Casualty Co	X	X	X	X	X
Companion Specialty Ins Co	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
Discover Specialty Insurance Co	X	X	X	X	
Empire Indemnity Insurance Co	X	X	X	X	X
Endurance American Spec Ins Co	X	X	X	X	X
Essex Insurance Co	X	X	X	X	X
Evanston Insurance Co	X	X	X	X	X
Everest Indemnity Insurance Co	X	X	X	X	X
Executive Risk Specialty Insurance	X	X	X	X	X
Fair American Select Ins Co					X
Fireman's Fund Ins Co of OH	X	X	X	X	X
First Financial Insurance Co	X	X	X	X	

Company Name	2010	2011	2012	2013	2014
First Mercury Insurance Co	X	X	X	X	X
First Specialty Insurance Corp	X	X	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
Genesis Indemnity Insurance Co	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
Great Amer Protection Insurance Co			X	X	X
Great American E&S Insurance Co	X	X	X	X	X
Great American Fidelity Insurance Co	X	X	X	X	X
GuideOneNational Insurance Co				X	X
Guilford Insurance Co	X	X	X	X	X
Gulf Underwriters Insurance Co	X		X		
Hallmark Specialty Insurance Co	X	X	X	X	X
HCC Specialty Insurance Co	X	X	X	X	X
Hermitage Insurance Co			X		
Homeland Insurance Co of NY	X	X	X	X	X
Homeland Insurance Company DE				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
Hudson Excess Insurance Co				X	X
Hudson Specialty Insurance Co	X	X	X	X	X
Illinois Union Insurance Co	X	X	X	X	X
Indian Harbor Insurance Co	X	X	X	X	X
Interstate Fire & Casualty Co	X	X	X	X	X
Ironshore Specialty Insurance Co	X	X	X	X	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
Landmark American Ins Co	X	X	X	X	X
Landmark Insurance Co	X	X			
Lexington Insurance Co	X	X	X	X	X
Liberty Surplus Ins Corp	X	X	X	X	X
Maiden Specialty Insurance Co	X	X	X	X	X
Maxum Indemnity Co	X	X	X	X	X
Medical Security Insurance Co				X	X
Merchants National Ins Co	X	X	X	X	X
Mesa Underwriters Spec Ins Co			X	X	X
Mid-Continent Excess & Surplus			X	X	X
Montpelier US Insurance Co	X				
MSA Insurance Co	X	X	X	X	X
MSI Preferred Insurance Co	X	X	X		
Mt Hawley Insurance Co	X	X	X	X	X
Mt Vernon Fire Insurance 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
Nevada Capital Insurance Co				X	
Newport Insurance Co			X		

Apendix B

U.S. Domestic Professional Surplus Lines – Entrances & Exits, 2010-2014

X denotes domestic professional surplus companies, defined as companies with direct premium from surplus lines business greater than 50% of total premium.

Company Name	2010	2011	2012	2013	2014
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
Nutmeg Insurance Co	X	X			X
Oklahoma Specialty Ins Co				X	X
Old Guard Insurance Co	X	X	X		
Old Republic Union Ins Co	X	X	X	X	X
Omega US Insurance Inc	X	X			
Pacific Insurance Co, Ltd	X	X	X	X	X
Peleus Insurance Company	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
Philadelphia Insurance Co	X	X			
Prime Insurance Co	X	X	X	X	X
Prime Insurance Syndicate Inc					
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
Professional Underwriters Liability	X	X	X		
Protective Specialty Ins Co		X	X	X	X
QBE Specialty Insurance Co	X	X	X	X	X
Rainier Insurance Co					
Republic-Vanguard Ins Co	X	X	X	X	X
Rockhill Insurance Co	X	X	X	X	X
SAFECO Surplus Lines Insurance Co	X	X			
Sagamore Insurance Co		X	X		
Savers Property & Casualty Ins Co			X		
Scottsdale Insurance Co	X	X	X	X	X

Company Name	2010	2011	2012	2013	2014
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
SPARTA Specialty Insurance Co			X	X	X
Specialty Surplus Insurance Co	X				
St. Paul Fire & Casualty Ins	X	X	X	X	
St. Paul Surplus Lines Ins Co	X	X	X	X	X
Standard Guaranty Ins Co	X	X	X		
Starr Surplus Lines Ins Co	X	X	X	X	X
Steadfast Insurance Co	X	X	X	X	X
TDC Specialty Insurance Co				X	X
TM Specialty Insurance Co	X	X	X		
Tokio Marine Specialty Ins Co			X	X	X
Torus Specialty Insurance Co	X	X	X	X	X
Traders & General Ins Co	X	X	X		
Travelers Excess & Surp Lines	X	X	X	X	X
TrustStar Insurance Co			X		
Tudor Insurance Co	X	X	X	X	X
United National Insurance Co	X	X	X	X	X
United Specialty Insurance Co	X	X	X	X	X
US Underwriters Insurance Co	X	X	X	X	X
Utica Specialty Risk Ins Co	X	X	X	X	
Valiant Specialty Insurance Co	X	X	X		
Voyager Indemnity Ins Co	X	X	X	X	X
Westchester Surplus Lines Ins	X	X	X	X	X
Western Heritage Insurance Co	X	X	X	X	X
Western World Insurance Co	X	X	X	X	X
Wilshire Insurance Co			X		
XL Select Insurance Co	X	X	X	X	X

Source: A.M. Best data and research

Appendix C
U.S. State Survey: Regulated & Unregulated Alien Lists

State	Regulated Alien List Maintained	Unregulated Alien List Maintained	Alien Insolvencies Tracked	Fraud Unit
Alabama^	No	No	No	Yes
Alaska^	Yes**	No	No	Yes
Arizona^	No**	No	No	No
Arkansas	Yes**	No	No	Yes
California	Yes****	No	No	Yes
Colorado^	Yes	No	No	Yes
Connecticut	No	No	No	Yes
Delaware	Yes**	No	No	No
Dist of Columbia	No	No	No	No
Florida	Yes (1)	Yes (2)	No (3)	Yes (4)
Georgia	Yes**	No	No	Yes
Hawaii^	Yes**	No	No	No
Idaho	Yes*	No	Yes	Yes
Illinois	No	Yes	No	Yes
Indiana	Yes*	No	No	No
Iowa^	Yes*	No	No	No
Kansas^	Yes*	No	No	Yes
Kentucky	Yes*	No	No	Yes
Louisiana^	Yes	No	No	Yes
Maine	Yes	No	No	No
Maryland^	Yes*	No	No	No
Massachusetts	Yes**	No	No	Yes
Michigan (5)	Yes	No	No	No
Minnesota	Yes	No	No	Yes
Mississippi^	Yes**	No	No	Yes
Missouri	Yes*	No	No	Yes
Montana^	No	Yes	No	Yes
Nebraska^	No	No	No	Yes
Nevada	Yes**	No	No	Yes
New Hampshire	Yes**	No	No	No
New Jersey^	No	No	No	No
New Mexico	Yes*	No	No	No
New York^	No	No	Yes	Yes
North Carolina^	Yes (6)	No (6)	No	Yes
North Dakota	Yes**	No	No	Yes
Ohio^	Yes**	Yes	No	No
Oklahoma^	Yes	No	No	No
Oregon	No	No	No	No
Pennsylvania	No***	No	Yes	Yes
Puerto Rico^	Yes	No	No	No
Rhode Island	Yes**	No	No	No
South Carolina	No	No	No	No
South Dakota	No	No	No	Yes
Tennessee	No	No	No	No
Texas	Yes**	No	No	Yes
Utah	Yes**	No	Yes	Yes
Vermont	No	No	No	No
Virginia^	No	No	No	No
Washington	No	No	No	Yes
West Virginia	Yes*	No	No	Yes
Wisconsin	No	No	No	No
Wyoming^	Yes**	No	No	No

^ Indicates state's response is as of August 2014. These states have not responded as of August 20, 2015.
* Uses the "white list" from the International Insurers Department of the National Association of Insurance Commissioners.
Source: A.M. Best Co., as of August 20, 2015.
** Uses the "Quarterly Listing of Alien Insurers" from the International Insurers Department of the NAIC to qualify aliens for the ADOI "List of Qualified Unauthorized Surplus Lines Insurers."
*** The Pennsylvania Insurance department maintains a listing of all eligible surplus lines insurers including alien insurers.
**** Uses the "Quarterly Listing of Alien Insurers" from the International Insurers Department of the NAIC
(1) The Florida Office of Insurance Regulation maintains a current listing of all surplus lines insurers including aliens.
(2) The Florida Office of Insurance regulation maintains a list of Federally Authorized Insurers that claim federal exemption (IID list)
(3) An alien insurer insolvency is not tracked once it has become insolvent or disappeared.
(4) There is a unit for unlicensed/unapproved entities that is operated out of the Market Conduct section of the Florida Office of Insurance Regulation. There is no routine monitoring of unregulated alien insurers.
(5) The Michigan Office of Financial and Insurance regulation maintains a current listing of all eligible unauthorized surplus lines including aliens.
(6) The North Carolina Department of Insurance maintains a current listing of all surplus lines carriers that have applied and been approved for regulation, including aliens.

Appendix D
State Survey: Capital & Surplus Requirements for Surplus Lines Companies

State	Domestic Company Minimum Surplus	Alien Company Minimum Surplus	Pending Revisions
Alabama^	$5,000,000	$2,500,000 (1) & $15,000,000	No
Alaska^	$15,000,000	$15,000,000 & 2,500,000 (1)	No
Arizona^	$15,000,000	$15,000,000(8)/ $5,400,000 (1)	No
Arkansas	$20,000,000	N/A	No
California	45,000,000 (2)	(8)	No
Colorado^	$15,000,000	$5,400,000	No
Connecticut	$15,000,000	$15,000,000 (10)	No
Delaware	$15,000,000	$15,000,000	No
Dist of Columbia	$300,000	$300,000	No
Florida	$15,000,000	$15,000,000 (3)	No
Georgia	$4,500,000	$10,000,000 / $10,000,000(1)	No
Hawaii^	$15,000,000	$5,400,000 (1)	No
Idaho	$2,000,000	$15,000,000	No
Illinois	$15,000,000	$15,000,000	No
Indiana	$15,000,000	$15,000,000	No
Iowa^	$15,000,000	N/A	
Kansas^	$4,500,000	$50,000,000	No
Kentucky	$6,000,000	$5,400,000 (3)	No
Louisiana^	$15,000,000	$15,000,000 (8)	No
Maine	$4,500,000	Listed with NAIC International Insurers Department (9)	No
Maryland^	$15,000,000	N/A	No
Massachusetts	$20,000,000	$20,000,000	Yes
Michigan	$7,500,000	$15,000,000 (10)	Yes
Minnesota	$15,000,000	$15,000,000	No
Mississippi^	$1,500,000	$15000000 & 5,400,000 (3)	No
Missouri	$15,000,000	$15,000,000	Yes
Montana^	$15,000,000	$15,000,000	Yes
Nebraska^	$15,000,000	(8)	No
Nevada	$15,000,000	$5,400,000 / 100,000,000 (4)	Yes
New Hampshire	$15,000,000	N/A	No
New Jersey^	$15,000,000	$15,000,000 (6)	N/A
New Mexico	15,000,000 (5)	$15,000,000 (5)	N/A
New York^	$45,000,000	$45,000,000 (9)	No
North Carolina^	$15,000,000	$15,000,000 (11)	No
North Dakota	$15,000,000	$15,000,000	No
Ohio^	$5,000,000	$15,000,000	No
Oklahoma^	$15,000,000	$15,000,000	No
Oregon	$5,000,000	15,000,000 / $5,400,000 (3)	No (6)
Pennsylvania	$15,000,000/ $4,500,000	(8)	No
Puerto Rico^	$300,000 / $1,000,000	$300,000 / $1,000,000	No
Rhode Island	$15,000,000	$15,000,000	No
South Carolina	$15,000,000	$15,000,000	No
South Dakota	$500,000	$500,000	No
Tennessee	$15,000,000	Listed with NAIC International Insurers Department	No
Texas	$15,000,000	(8)	No
Utah	$2,500,000 (1)	$15,000,000	No
Vermont	$15,000,000	$15,000,000	No
Virginia^	$1,000,000/ $3,000,000	Deemed Approval (7)	No
Washington	$15,000,000	(10)	No
West Virginia	$15,000,000	$15,000,000	No
Wisconsin	N/A	N/A	No
Wyoming	$15,000,000	$15,000,000	No

^ Indicates state's response is as of August 2014. These states have not responded as of August 20, 2015.
(1) Trust Fund
(2) Minimum surplus phase-in period for US-domiciled nonadmitted insurers currently on the California list of eligible surplus lines insurers that did not meet the $45 million minimum capital and surplus requirements as of Jan. 1, 2011; the insurer must have capital and surplus if $45 million by December 31, 2013.
(3) In addition, alien carriers required to maintain $5.4 million trust fund in the United States.
(4) Lloyd's
(5) Due to Dodd-Frank
(6) This law became effective January 1, 2012.
(7) Insurers appearing on the Quarterly Listing of Alien Insurers maintained by the International Insurers Department of the NAIC deemed approved in Virginia.
(8) Alien company must be listed on the Quarterly Listing of Alien Insurers maintained by the International Insurance Department of the NAIC.
(9) Due to Dodd-Frank; NAIC Quarterly Listing of Alien Insurers is used for verification purposes. As of January 1, 2013, new alien insurers require $45 million.
(10) Due to Dodd-Frank; NAIC Quarterly Listing of Alien Insurers is used for verification purposes.
(11) For those alien surplus lines carries that have applied and been approved for registration in North Carolina. Additionally, those insurers listed on the NAIC Quarterly Listing of Alien Insurers are deemed eligible in North Carolina.
Source: A.M. Best Co., as of July 17, 2015.

Appendix E
State Survey: Stamping Office & Multi State Taxation

State	Stamping Office	Premium Tax	Stamping Fee	Tax Allocated	Procurement Tax Applies	Procurement Monitored
Alabama^	No	6.00%	No	No	Yes	No
Alaska^	No	2.70%	1.00%	No	Yes	Insured Reports
Arizona^	Yes	3.00%	0.20%	No	No	No
Arkansas	No	4.00%	No	Yes	Yes	Yes
California	Yes	3.00%	0.20%	No	Yes (1)	Yes (1)
Colorado^	No	3.00%	No	Yes	Yes	Yes
Connecticut	No	4.00%	No	No	Yes	Yes
Delaware	No	3.00%	No	No	Yes	Insured Reports
Dist of Columbia	No	2.00%	No	Yes	Yes	No
Florida	Yes	5.00%	0.175%	Yes (3)	Yes	Yes
Georgia	No	4.00%	No	No	Yes	Insured Reports
Hawaii^	No	4.68%	No	Yes	No	No
Idaho	Yes	1.50%	0.25%	No	Yes	Insured Reports
Illinois	Yes	3.50%	0.20%	Yes	No	No
Indiana	No	2.50%	No	No	Yes	Yes
Iowa^	No	1.00%	No	No	Yes	No
Kansas^	No	6.00%	No	No	No	No
Kentucky	No	3.00%	No	Yes	No	Yes
Louisiana^	No	4.85%	No	Yes	Yes	Insured Reports
Maine	No	3.00%	No	No	Yes	Yes
Maryland^	No	3.00%	No	N/A	Yes	Insured Reports
Massachusetts	No	4.00%	No	Yes	No	No
Michigan*	No	2.00%	No	No	No	Yes-Insured Reports
Minnesota	Yes	3.00%	0.06%	No	Yes	Insured Reports
Mississippi^	Yes	4.00%	0.25%	Yes	Yes	Yes
Missouri	No	5.00%	No	No	Yes	Yes
Montana**^	No	2.75%	0.00%	Yes	No	No
Nebraska^	No	3% (9)	No	No (6)	No	No
Nevada	Yes	3.50%	0.40%	No	Yes	Yes
New Hampshire	No	3.00%	No	Yes	Yes	Yes
New Jersey^	No	5.00%	No	No*	Yes (1)	No
New Mexico	No	3.00%	N/A	N/A	No	No
New York^	Yes	3.60%	0.18%	No	Yes	Yes (2)
North Carolina^	No	5.00%	No	No	Yes	Insured Reports
North Dakota	No	1.75%	No	No	Yes	No
Ohio^	No	5.00%	No	No	Yes	No
Oklahoma^	No	6.00%	No	Yes	No	Insured Reports
Oregon	Yes	2.3% (4)	$15.00	No	Yes	No
Pennsylvania	Yes	3.00%	$25.00	No	Yes	Insured Reports
Puerto Rico^	No	9.00%	No	Yes	Yes	Yes
Rhode Island (7)	No	2.00%	No	No	No	No
South Carolina	No	4.00%	No	No	No	No
South Dakota	No	2.5% - 3.0%	No	Yes (8)	Yes	Yes
Tennessee	No	5.00%	No	No	No	No
Texas	Yes	4.85%	0.06%	No	Yes	Insured Reports
Utah	Yes	4.25%	0.25%	Yes	Yes	No
Vermont	No	3.00%	No	N/A	Yes	Yes
Virginia^	No	2.25%	No	No	No	No
Washington	Yes	2.00%	0.10%	No	Yes	Yes

Appendix E
State Survey: Stamping Office & Multi State Taxation

State	Stamping Office	Premium Tax	Stamping Fee	Tax Allocated	Procurement Tax Applies	Procurement Monitored
West Virginia	No	4.55%	No	No	No	No
Wisconsin	No	3.00%	No	No	Yes (5)	No
Wyoming	No	3.00%	No	Yes	Yes	Yes

^ Indicates response is as of August 2014. These states have not responded as of August 20, 2015.
(1) Not by DOI; handled by state franchise tax board.
(2) Not by DOI; handled by Department of Revenue Services/Taxation.
(3) Florida has joined the tax sharing agreement of NIMA. Since 7/1/12, all Florida home state policies get filed at the NIMA Clearinghouse and other NIMA participants will get their portion of the allocated premium. Non-participating state's premium will be retained by the home state.
(4) This amount includes .3% collected for Oregon Fire Marshalls' office.
(5) Tax now 3% on ocean marine business.
(6) Tax payable is the sum of 3% on portion of gross premiums allocated to Nebraska plus other state's applicable tax rates applicable on the portion of the premiums allocated to other states.
(7) Premium taxes are handled by the Division of Taxation.
(8) South Dakota joined the tax sharing agreement of NIMA as of 7/1/12. All of South Dakota's home state policies get filed at the NIMA Clearinghouse and premium is allocated with other participating NIMA states. Non-NIMA states' premium is retained by the home state of the insured.
* In Michigan, a 0.5% regulatory fee applies in addition to the premium tax.
** Assess a 1% stamping fee on paper filings and a 1/2% (0.005) stamping fee on electronically filed policies. No longer necessary for Montana. Effective 1/1/2012, Montana's stamping fee is 0.00% for electronically filed policies and endorsements and paper filings have a 0.25% stamping fee.
Source: A.M. Best Company, as of August 20, 2015.

Published by A.M. Best Company
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TESTIMONY OF MICHAEL ONOFRIETTI, ACAS, MAAA, CPCU

COMMITTEE ON CONSUMER PROTECTION & COMMERCE
Representative Angus L.K. McKelvey, Chair
Representative Justin H. Woodson, Vice Chair

COMMITTEE ON JUDICIARY
Representative Karl Rhoads, Chair
Representative Joy. A. San Buenaventura, Vice Chair

Wednesday, March 23, 2016
2:10 p.m.

SB 2684, SD 1, HD1

Chair McKelvey, Vice Chair Woodson, and members of the Committee on Consumer Protection & Commerce; and Chair Rhoads, Vice Chair San Buenaventura, and members of the Committee on Judiciary, my name is Michael Onofrietti, ACAS, MAAA, CPCU, Chairman of the Board of the Hawaii Insurers Council. Hawaii Insurers Council is a non-profit trade association of property and casualty insurance companies licensed to do business in Hawaii. Member companies underwrite approximately thirty-six percent of all property and casualty insurance premiums in the state.

Hawaii Insurers Council **supports** SB2684, SD1, HD1 as a fair, reasonable and workable solution to the insurance coverage issues presented by transportation network companies (TNCs) in Hawaii.

Insurance Issues

As Section 1 of the bill finds, “concerns have been raised about potential gaps in motor vehicle insurance coverage associated with transportation network companies.” Thus, by the end of 2015, at least 29 states had enacted legislation to establish insurance requirements. The purpose of SB2684, SD1, HD1 is to “close the insurance gaps associated with transportation network companies" in this State. Hawaii Insurers Council believes that SB2684, SD1, HD1 accomplishes its purpose.

The bill (§431:10C-D, paragraph (a)) requires TNCs to disclose in writing to transportation network company drivers (TNC drivers) the insurance coverage and limits applicable during TNC activity. The bill also requires written disclosure of the fact that the TNC driver's own personal motor vehicle insurance policy might not apply during TNC activity. These requirements keep the TNC drivers well informed and avoid potential confusion.

Importantly, the bill (§431:10C-D, paragraph (b)) mandates primary motor vehicle insurance covering a TNC driver while the driver is engaged in TNC activity. The primary liability insurance coverages are equal to those required of motor carriers by State regulation and those required of taxis by county ordinance. These limits are $100,000 per person/$200,000 per accident for Bodily Injury Liability and $50,000 per accident for Property Damage Liability. The bill also requires Uninsured and Underinsured Motorist coverages equal to the primary Bodily Injury Liability limits, but provides for written rejection and the option to "stack" in accordance with existing law. Consistent with existing law, the bill mandates Personal Injury Protection coverage and requires offers of other optional insurance coverages.

In addition, the bill (§431:10C-D, paragraph (g)) explicitly provides that personal motor vehicle insurance policies maintained by TNC drivers will not be required to provide primary or excess coverage during TNC activity. Thus, the bill appropriately and clearly places insurance coverage where it belongs, depending upon the activity in which the TNC driver is engaged. When the TNC driver is driving for purely personal reasons, the driver's personal motor vehicle insurance policy will still apply. But when the TNC driver is engaged in TNC activity, the motor vehicle insurance policy applicable to TNC activity will apply. This system makes common sense and draws a clear delineation: personal uses and activities would still be covered under the personal motor vehicle insurance policy, while TNC activities, which are commercial in nature, would be covered under the TNC policy.

At the same time, the bill does not stifle innovation opportunities for insurers. At its option, an insurer providing personal motor vehicle insurance coverage may elect to provide coverage during TNC activity.

The bill (§431:10C-G) also clarifies that it does not limit or affect the motor vehicle insurance coverage applicable to any pedestrian or passenger who may be injured during TNC activity. This provision protects the insurance coverages pedestrians and passengers choose to purchase on their own vehicles.

Hawaii Insurers Council believes that the insurance provisions in SB2684, SD1, HD1 (§431:10C-D) are reasonable, consistent and transparent; protects TNC drivers, their passengers and the public; and preserves the availability and affordability of personal motor vehicle insurance policies for all owners and drivers in the State.

Records

Hawaii Insurers Council Hawaii supports §431:10C-E of the bill, which would require TNCs to keep records for a period of five years and to turn over driver or other records within ten days of a written request. Hawaii is a Personal Injury Protection (PIP) state, so claims under PIP coverage must be paid within a prescribed period of time, and claims for Bodily Injury Liability, Uninsured Motorist, and Underinsured Motorist can be presented many years after an auto accident. Therefore, the recordkeeping and production requirements are necessary, fair and reasonable.

Disclaimers

The bill (§431:10C-F) expresses the State's public policy to invalidate any disclaimer of liability, pre-accident waiver, and indemnification or hold harmless "agreement" TNCs or TNC drivers seek to impose on their passengers. Hawaii Insurers Council supports this measure.

As always, Hawaii Insurers Council is committed to working with the Legislature and all interested parties on this bill.

Thank you for the opportunity to testify.

TESTIMONY OF HAWAII ASSOCIATION FOR JUSTICE (HAJ)
IN OPPOSITION TO S.B. NO. 2684, S.D. 1, H.D. 1

Wednesday, March 23, 2016
2:10 pm
Conf. Rm. 325

TO: Chairman Angus McKelvey and Karl Rhoads and Members of the House Committee on Consumer Protection & Commerce, and Committee on Judiciary:

This OPPOSITION is focused on the INSURANCE provisions of SB 2684, S.D.1, H.D.1, that exclude or permit exclusions of coverage in personal automobile insurance policies for Transportation Network Company (TNC) activities.

Counties Have Regulatory Jurisdiction

Hawaii Revised Statutes section 46-16.5 specifically confers jurisdiction over regulation of public passenger vehicles to the counties. Public passenger vehicles are "privately-operated, demand-responsive transportation services." Pursuant to this authority, counties currently regulate taxis and limousines, including applicable insurance requirements. The Revised Ordinances of Honolulu, section 12-1.23, for example, mandates the insurance requirements for taxis operating in the City and County of Honolulu.

Companies like UBER and LYFT certainly fall within the jurisdiction of county regulation as "privately-owned demand-responsive transportation services" pursuant to HRS section 46-16.5. The Honolulu City Council is currently working on promulgation of TNC regulations, including appropriate insurance requirements.

Honolulu has regulated insurance requirements for public passenger vehicles for decades without any problems. There is no reason to believe that continued county regulation of these insurance regulations is not appropriate. Because counties have been given the regulatory jurisdiction over the subject this attempt to circumvent county regulation should be deferred. If, it is found that Honolulu or any other county has inappropriately regulated TNC insurance requirements, the legislature can always consider whether state intervention is appropriate. However, the counties should be allowed, in the first instance, to fulfill the exercise of their statutory mandate to regulate public passenger vehicles.

Substantive Change to the Insurance Law

There are two ways to handle the addition of insurance requirements for special applications like TNCs. First, you can add the TNC coverage on top of existing auto insurance, specifying that the TNC policy is "primary" and applies first, while leaving auto insurance in place as a seamless safety net of "secondary" basic coverage to catch situations where the TNC coverage is cancelled, lapses, exhausts or is denied. The second alternative is to carve out a gap in auto insurance by excluding TNC activities and filling that gap with TNC coverage. This second approach is taken in this bill. The downside of this approach is that there is no safety net provided by secondary auto insurance in the event that the TNC policy is cancelled, lapses, is exhausted or coverage is denied – as there is in the first approach.

Both approaches can be used, however, Hawaii's legislature has used the first approach in the past. The rental car insurance situation, for example, is similar to the TNC situation addressed in this measure. Rental car coverage is addressed in section 431:10C-303.5 which provides that insurance on the rental car is PRIMARY (applies first), unless the driver/renter has their own motor vehicle insurance. If the driver/renter has applicable insurance then that insurance pays first (is PRIMARY) and the rental car's insurance applies second (is SECONDARY) for liability coverage. The statutory language is as follows:

> (a) U-drive motor vehicle insurance policy shall be <u>primary</u>; provided that its bodily injury and property damage liability coverages shall be <u>secondary</u> to the operator's or renter's motor vehicle insurance policy if:

The statute has no exclusions for either the rental car policy or the driver/renter's policy. Instead, the order in which they should apply (primary/secondary) is mandated by the statute to keep the secondary policy in place as a safety net should the primary policy be cancelled, lapses, is exhausted or coverage is denied. This approach is also used for motor carriers that have additional insurance requirements with no statutory exclusions.

Hawaii's motor vehicle insurance law currently provides a seamless safety net of basic benefits for persons injured in <u>all</u> accidents involving the lawful use of motor vehicles. There are <u>no exceptions</u> to the basic liability coverage. This measure would change that by mandating that a car's insurance policy exclude coverage from the time a driver logs on to a TNC network until a passenger exits the vehicle; thus creating a gap in auto insurance coverage.

There are no statutory exclusions for cars used for taxi cabs even though taxi and UBER drivers do virtually the same thing; nor are there exclusions for pizza delivery, sales persons, moving trucks and vans, newspaper delivery, or other commercial uses of motor vehicles. Coverage is based on whether the vehicle is being used lawfully or not (a car thief is not entitled to benefits from insurance on the car they are stealing), not on the type of use (personal, commercial or a combination of both).

This measure states that TNC insurance is "primary" when a TNC driver is engaged in TNC activity. However, the TNC coverage is actually exclusive, not primary, because there is no secondary auto insurance coverage which is excluded by this measure. That exclusion conflicts with the current structure of the insurance code to provide for Primary and Secondary coverage, and not allow exclusions from liability coverage.

Mandating the exclusion found in this measure would be bad public policy because it would create gaps in coverage where none currently exist. For example, if the TNC and driver fail to provide the required primary coverage (whether by oversight, deliberate nonpayment or denial of coverage) and if the policy on the car excludes coverage, there would be no insurance to cover the TNC car.

That is why auto insurance laws specify Primary and Secondary coverage, rather than permit exclusions – so there will always be protection available in the event that there is no coverage under one policy or the other. By keeping the TNC policy primary and the auto insurance on the car secondary the TNC policy would pay first, as contemplated in this measure, and auto insurance would pay secondarily if, and only if, the primary TNC policy has lapsed, been cancelled, exhausted or denied coverage. This way, there will be no gaps in coverage, and thereby preserve the comprehensive seamless safety net of coverage currently in place.

Practical Problems Created by this Measure

We think of Uber and Lyft, two multi-billion dollar operations, when think of Transportation Network Companies. UBER says there is nothing to worry about because it will provide the coverage. This may be true of UBER, but this statute applies generically to all TNCs whether existing now or to be created in the future. Enterprising individuals may start their own TNC operations – and fail. And who knows what will happen to Uber and Lyft five or ten years from now. Companies worth up to $100 billion perish (Tower Records, Lehman Brothers, ENRON, Blockbuster, Compaq, Saab, etc.). If Uber or Lyft are unable to pay their insurance premiums in the future, there could be an uninsured gap of many months before that is discovered. The prospect of failure (whether by UBER or a local startup) must be considered in the crafting of this measure; with the prudent course being to maintain auto insurance as a secondary coverage instead of excluding it entirely.

Anther situation where there may be no coverage is where the primary TNC insurer denies coverage. What would happen if, for example, if a TNC driver lets a friend drive you? The TNC insurer may deny coverage because you were not being driven by an authorized TNC driver. If the auto policy excludes coverage, as proposed in this measure, you would have no insurance benefits available from either policy.

There are other possibilities. TNC companies currently require annual inspections of cars and only those that pass are "authorized" for use in TNC activities. If a driver's authorized car broke and they borrowed a friend's car that car may not be covered by the TNC policy. What if the driver has their license revoked or suspended for DUI; but continues to drive without the TNC or insurance company's knowledge? What happens if there's a malfunction with the TNC network so it is not clear if a driver had picked up a ride through the network? The potential situations where there may be denials of primary TNC insurance are varied and unpredictable, therefore, prudence requires that auto insurance remain secondary and no exclusion be allowed in order to avoid having no insurance available in case of an accident.

Where there is no insurance applicable an injured passenger may apply to the Hawaii Joint Underwriting Plan Assigned Risks Program – the State's free insurance program. This program is not intended to provide free benefits in situations where there is an actual auto policy in effect on car (but excluded by this measure). Yet this is another unintended consequence of this measure.

TNC companies typically provide the insurance for drivers while they are engaged in TNC activities. Under this measure the TNC company is required to provide $100,000 per person/$200,000 per accident for accidental harm. Many drivers have higher limits on their cars because they also have umbrella policies which provide $1 million or more in additional benefits. The majority of umbrella policies used in Hawaii require at least $300,000 per person/$300,000 per accident. Under this measure, only the TNC policy will apply and the personal policy with the higher limit will be excluded. That will result in the (unintended) loss of umbrella policy protection for both the driver and those who may be injured because the TNC policy limits are lower than the minimum limits required for most umbrella policies.

A retiree who drives for UBER part-time may have a house and an umbrella policy for protection. Under this bill, the umbrella policy will no longer provide protection so the retiree is a risk of losing their house. That would not be the case if UBER's insurance was primary and other insurance was secondary to provide the added protection consumers think they have. Many people also buy higher liability limits to protect themselves – $300,000 is not uncommon in Hawaii. Under this bill, they will have only the $100,000 provided by the TNC policy. If they seriously hurt someone they will be personally liable. Insurance companies will say that the drive could purchase special additional TNC coverage from their insurance company. But let's be realistic, no ordinary consumer is even going to realize that these loopholes exist, let alone know what to do to plug them.

This measure also allows a TNC company to waive or reject uninsured and underinsured motorist coverage applicable to the driver. Drivers will lose the ability to protect themselves and their families from the financial consequences of serious injuries or death because the TNC company will have the right to waive or reject these benefits applicable to the drivers – even if drivers want those benefits.

TNC companies will also be allowed by this measure to decide whether the TNC policy will included collision and comprehensive coverages. This means that when a TNC company decides NOT to include these coverages the drivers will have no insurance to cover the cost of repairs or the total loss of their cars damaged in accidents. With many cars costing $25,000 to $50,000 or more today that is a loss that will inflict extreme hardship on drivers.

This measure also dictates that a TNC "does not own, control, operate or manage" the TNC cars. This is an issue that should be determined by the factual circumstances of each TNC operation. Indeed, there have been rulings on this issue against TNC operations on the mainland. This should be left to the appropriate regulatory agency or court to determine based on the way each TNC operates. The outcome can affect the rights of passengers against TNC companies for injuries or the entitlement of TNC drivers to the protection of state employment laws. This provision should be deleted.

Motor vehicle insurers want to exclude coverage when drivers are engaged in TNC related activities because they want TNC companies to provide the insurance for their operations. Viewed in isolation that is understandable. But in the context of the entire motor vehicle insurance system there are several factors that counsel against taking that approach. First, as discussed above, it would create gaps in coverage that currently do not exist in the insurance code. Second, it would shift costs to the State's free insurance program where the TNC policy has lapsed, been cancelled, exhausted or denied coverage.

Third, if there is any substantial increase in risk to personal auto insurance, as a result of providing secondary coverage, that is an underwriting factor that is best addressed by adjusting the premiums to reflect that increased risk. Insurance companies charge according to the risk associated with a vehicle's use. Application forms routinely ask about typical risk factors, such as whether the car will be used primarily for personal low-mileage driving, to and from work, business, high-mileage driving, the number of drivers and whether those drivers have moving violations or clean traffic records, whether you have caused any accidents (and if so, how many), which Island the car will be located (each Island has a different base rate), and whether it's a sports car, sedan or truck. TNC driving can be included as an underwriting factor, if it is significant enough, so any additional risk can be borne by that car.

Fourth, people use their cars for all kinds of business related activities, whether driving to see customers, delivering pizza or newspapers, giving their fellow employees a ride, picking up supplies for the office, using their truck for yard services, etc. There are no statutory exclusions permitted for these activities yet this has not made auto insurance unaffordable or unprofitable in Hawaii. Hawaii has been among the most profitable insurance markets in the nation – the most profitable in more years than any other state for the past 15 years. There is no reason to believe that TNC cars will alter the overall availability or profitability of Hawaii's insurance market to any significant extent, especially since TNC companies typically provide the primary insurance. If a need to re-visit this subject develops in the future it can be done at that time.

Fifth, this measure is attempting to pass legislation to provide limited insurance coverage on the one hand, while TNC apps contain waivers, exclusions and indemnity provisions in their terms and conditions on the other hand – with the interplay between the two left unaddressed by this measure and unclear.

Sixth, the impact of TNC driving is minimal. There were 1,312,445 registered vehicles in Hawaii in 2014 (the most current year for which data is available). Even if 1,000 people decided to use their cars for TNC rides this would represent less than .001 (one-tenth of one percent) of vehicles. Oahu has only 1,814 taxis, as of the July 2013 to June 2014 fiscal year, so it seems doubtful that demand could support an increase of more than a few thousand additional vehicles. Even if three thousand cars joined the TNC fleet those cars would still be less than three-tenths of one percent. Furthermore, many TNC drivers tend to work part-time or sporadically because they do not need to comply with stringent and costly taxi regulation. Therefore, there may be more TNC cars but they tend to be on the road much less than Taxi cabs which are more likely to be on the road full-time. Yet taxi cabs have not created a significant problem requiring the need for a taxi exclusion to the motor vehicle insurance code.

In addition, keep in mind that all of these TNC cars will have TNC policies so and TNC companies are required to provide the TNC coverage in the event that a policy is cancelled because a driver fails to pay premiums. So, the driver's policy will have to be cancelled or lapse, and a TNC's policy will have to be cancelled or lapse, before any personal policy will apply. The effect on the personal automobile insurance industry is negligible and simply not worth changing our entire system to accommodate.

Seventh, what would be the rationale for allowing exclusions for TNC activities but not other business activities? Lots of people use their cars for occasional business related activities. If you buy lunch for the office and send a worker to pick-up it up that is technically a business use for which there may be no coverage under a business use exclusion. If you use your car for part-time work, such as to deliver papers for an hour or two in the morning, that is technically a business use for which there would be no insurance coverage. If you let your teenager deliver pizza after school for a few hours that would also technically be a business use that would have no coverage. If your teenager injured someone there may be no insurance for the injured person and no insurance to protect you when you and your teenager are sued. If a grandmother pays her grandchild $20 to take her to the airport that is technically a ride for compensation. Once exclusions for this or that activity or business use are permitted the seamless comprehensive safety net of the current law will be riddled with gaps in coverage – an unintended but certainly foreseeable outcome.

We ask that all references to the exclusion of automobile coverage on the car be deleted and replaced by language requiring TNC policies to be Primary and personal motor vehicle policies to be Secondary.

Thank you for considering our testimony. Any questions can be directed to Bert Sakuda or Shawn Ching, attorney members of the Hawaii Association for Justice.

2300 Harrison Street
San Francisco, CA 94110

March 23, 2016

Chair McKelvey, Chair Rhoads and Members of the House Committee on Consumer Protection and Commerce and Committee on Judiciary:

My name is Robert Grant, Director of Government Relations for Lyft testifying in opposition to SB 2684 SD1 HD1. First, thank you to all of the legislators who have recognized the importance of ridesharing and who are seeking proactively to find solutions for the peer-to-peer ridesharing industry here in Hawaii.

SB 2684 SD1 HD1 proposes an “insurance only” solution that we believe does not go far enough in protecting our riders. As with any new innovation or variance from traditional and long-standing practice, questions regarding liability and risk exposure have come up regarding companies such as ours. To address this, in March, 2015, transportation network companies (“TNC’s”) and large national insurance companies reached a nationwide agreement on a comprehensive insurance regime that clarifies responsibility and protects TNC drivers and passengers throughout all stages of a pre-arranged ride.

The first stage of a ride, commonly referred to as “Period 1,” is the time during which the application is on and a driver is available to accept ride requests, but a ride has not been accepted. During this period, primary automobile liability insurance is required in the amount of at least $50,000 for death and bodily injury per person, $100,000 for death and bodily injury per incident, and $25,000 for property damage. The insurance requirements must be met by a policy held by the transportation network company, the TNC driver, or any combination of the two.

During Period 2, when a ride is accepted and the driver is en route to the passenger, and Period 3, when the passenger is in the vehicle, Lyft provides primary commercial liability coverage of $1 million per incident.

We urge this Committee to instead move more comprehensive legislation that includes the national compromise language, as 30 other states have already done. The national compromise language provides far more coverage than the primary insurance currently required by common carriers throughout Hawaii. The national policy, adopted by insurance and transportation network companies, is better for the general public while also permitting all Transportation Network Companies - regardless of size - to compete in Hawaii. We truly believe that implementing the insurance compromise framework as part of a larger regulatory solution will bring the state into the modern age of transportation and ensure that its citizens are not left behind.

Lyft wants to work with legislators and other stakeholders to craft strong comprehensive legislation that protects consumers and allows the ridesharing industry to serve all residents of Hawaii equally.

For these reasons Lyft cannot support SB 2684 SD1 HD1, as it is not the right legislative vehicle to deliver on that shared goal. Thank you for this opportunity to testify.

LATE TESTIMONY

PCI

Advocacy. Leadership. Results.

To: The Honorable Angus McKelvey, Chair
House Committee on Consumer Protection & Commerce

The Honorable Karl Rhoads, Chair
House Committee on Judiciary

From: Mark Sektnan, Vice President

Re: SB 2684 SD1 HD1 Relating to Motor Vehicle Insurance
PCI Position: Request for Amendments

Date: Wednesday, March 23, 2016; Conference room 325; 2:10 PM

Aloha Chairs McKelvey and Rhoads, and Members of the Committees:

The Property Casualty Insurers Association of America (PCI) supports the intent of **SB 2684 SD1 HD1** but would prefer if this bill is amended to reflect the model adopted by the National Conference of Insurance Legislators (NCOIL) which creates an insurance structure for the operation of transportation network companies (TNC), with Hawaii's mandated coverages. **In addition, we would like to request the following amendment on page 11, lines 9-12:**

> "[~~The~~] <u>Except where the transportation network company's insurance is procured in accordance with section 431:8-301, the</u> transportation network company insurance carrier shall be licensed to do business as a motor vehicle insurance company in the State."

This amendment addresses language currently in the HD1 which would restrict the insurance marketplace for the TNCs by limiting insurance to only those companies licensed and admitted to do business in Hawaii. This could have the unintended consequence of shutting down this new innovative market place because the TNCs would be unable to obtain insurance as it is not currently available in the "admitted" market. The surplus lines market operates as the "safety valve" for the insurance market. Due to greater flexibility, they write coverages for emerging markets like TNC's that are not being covered by admitted insurers.

In Hawaii, PCI member companies write approximately 42.7 percent of all property casualty insurance written in Hawaii. PCI member companies write 44 percent of all personal automobile insurance, 65.2 percent of all commercial automobile insurance and 75 percent of the workers' compensation insurance in Hawaii.

<u>PCI HAS SUPPORTED INNOVATION IN THE MARKET PLACE FOR TRANSPORTATION & INSURANCE IN THE 29 STATES THAT HAVE PASSED TNC LAWS</u>

PCI supports innovation in the market place, for transportation and insurance. We have been active nationally on insurance issues involving TNCs with both states and municipalities beginning with the passage of the seminal California law and continuing through today as Ohio recently becai 29th state to approve legislation closing the insurance coverage gaps associated with TNCs.

TNC INSURANCE ISSUES

In Hawaii, as in all other states, there is virtually no coverage under a private passenger auto insurance policy if you use your vehicle to provide rides to strangers for compensation.

There are three phases of TNC Activity: Period 1, when the driver has the app on, but is not matched with a rider; Period 2, when the driver and rider are matched via the app and the driver is going to pick the passenger up; Period 3, when the passenger is actually in the vehicle. Without statutes to clarify insurance coverage there may be coverage gaps for TNC drivers and passengers. TNC drivers are particularly at risk of coverage disputes while the app is on and they are available for hire, but do not yet have a passenger in their vehicle (Period 1). They may find there is no coverage for their injuries or getting their vehicle repaired if there was an accident.

Insurers are in the business of selling insurance. TNC drivers and passengers need insurance, but a regulatory and statutory framework is needed to protect not only drivers, but their passengers and the public by closing the insurance gaps that left drivers and the public vulnerable in an accident.

The NCOIL model act comports with the recommendations contained in the National Association of Insurance Commissioners (NAIC) Sharing Economy Working group white paper on TNC issues ("Transportation Network Company Insurance Principles for Legislators and Regulators").

CONCLUSION

PCI supports innovation that brings new products into the marketplace. The TNC laws and regulations that have been enacted in 29 states put an end to consumer confusion regarding insurance coverage, while also allowing for continued marketplace innovation. As new transportation ideas evolve to meet consumers' needs and demands, insurers are developing new products to cover those ideas and provide peace of mind.

The NCOIL model provides a framework for companies to use in delivering needed and innovative insurance products to cover the unique risks associated with TNC operations. In the states where such legislation has become law, an insurance marketplace catering to TNC risks has begun to levelop. This can happen in Hawaii, too, with the passage of appropriate legislation.

CI respectfully requests that the committee consider amending **SB 2684 SD1 HD1** to reflect the COIL model law with Hawaii's mandated coverages and the amendment to allow surplus lines urers.