



National Association of Professional Surplus Lines Offices, Ltd.

200 N.E. 54th Street • Suite 200 • Kansas City, MO 64118 • 816/741-3910 • Fax 816/741-5409

www.napslo.org

Brady R. Kelley
Executive Director

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Mr. Michael T. McRaith, Director
Federal Insurance Office
Room 1319 MT
Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Attention: Study on Natural Catastrophes and Insurance

On behalf of the National Association of Professional Surplus Lines Offices (NAPSLO), we appreciate the opportunity to provide our comments to the FIO on the current state of the market for natural catastrophe insurance in the United States.

NAPSLO is a national trade association representing the surplus lines industry and the wholesale insurance distribution system. NAPSLO members play an important role in the economy by insuring hard-to-place risks and creating new insurance products in response to the needs of an ever-changing social, business and insurance environment. The NAPSLO membership consists of approximately 400 wholesale brokerage member firms, 100 company member firms and 200 associate member firms. NAPSLO member firms operate over 1,500 offices representing approximately 15,000 to 20,000 individual brokers, insurance company professionals, underwriters and other insurance professionals in the 50 states and the District of Columbia.

Since our founding in 1975, NAPSLO has become the authoritative voice of the surplus lines industry. Acting as a source of information, NAPSLO directs significant resources to gathering and providing information for regulators, members, other segments of the insurance industry, the media and the public about the surplus lines industry. We are unique in that both surplus lines brokers and surplus lines companies are full members of the association; thus NAPSLO represents the full spectrum of the surplus lines wholesale marketplace.

We have reviewed FIO's request for its required study on natural catastrophes and insurance, and will confine our comments to those elements of the natural catastrophe market that are pertinent to the surplus lines market, as it is within this area that NAPSLO is uniquely qualified to offer insights and views.

The surplus lines market plays an important role in providing insurance for hard-to-place, unique or high capacity (i.e., high limit) risks. With the ability to accommodate a wide variety of risks, the surplus lines market acts as a supplement to the admitted market. Often called the "safety valve" of the insurance industry, surplus lines placements fill the need for coverage in the marketplace by insuring those risks that are declined by admitted insurance carriers.

Surplus lines companies are able to cover unique and hard-to place risks because, as nonadmitted or unlicensed insurers, they are not required to comply with rate and form filing regulations that apply to admitted insurance carriers. As a result of this flexibility, surplus lines insurers are able to react to market changes and accommodate the unique needs of the insureds that are unable to obtain coverage from admitted carriers. According to A.M. Best, the total surplus lines direct written premium volume in 2011 was slightly over \$31 billion and represents a vast number of insureds who, without the surplus lines market, would have a difficult time obtaining insurance, if they were able to secure it at all.

An area which the surplus lines market is uniquely designed to address encompasses those property risks whose underwriting profiles are challenged by the potential for catastrophic natural disasters. The surplus lines market currently insures many coastal properties where wind exposure is a significant factor. It also insures properties in earthquake prone areas and in districts where wildfires are an important underwriting consideration. Our members insure properties for flood risks as well. Although the surplus lines market is not the complete answer to the insurance problems in areas subject to natural catastrophes, it is a critical part of the overall insurance structure when it comes to protecting high-risk properties.

Several factors limit the ability of surplus lines insurers to play a more substantial role in insuring catastrophe risks. As a private, voluntary market whose purpose is to underwrite difficult to insure properties, surplus lines pricing must reflect the underwriting characteristics of the risk. For example, coastal and near coastal properties subject to hurricane exposures will be rated and priced accordingly. The same is true for determining the rate for earthquake or wildfire prone property; in all instances the premium is appropriate to the risk. While there are many competitive companies operating in the surplus lines marketplace, the market's greatest obstacle comes from government-run residual market insurance plans or pools created to provide insurance for high-risk properties. Often this insurance is offered at substantially subsidized rates that are lower than rates private markets can afford to provide and lower than are actuarially sound. Often these programs are structured to accept all applicants, which results in an unfriendly market environment for those insurers wishing to offer coverage but who need to offer sustainable, risk-oriented rates.

The request for comments for this study on flood insurance is of particular interest to our members. The nonadmitted industry plays an important role in offering flood coverage, both in placing primary and excess policies. In 2012, the Flood Insurance Reform Act was signed into law, extending the NFIP until September 30, 2017. NAPSLO was encouraged by certain improvements provided by the law, especially the provision requiring lenders to accept flood insurance from private insurers--both admitted and nonadmitted. Unfortunately, there remains some misunderstanding from lenders on this critical piece of the law. It is highly important for insureds and banks to understand nonadmitted carriers are **not** prohibited from providing flood coverage on a primary or excess basis—and should not be inappropriately denied the ability to place these coverages contemplated by the law. Consumers should not be restricted from accessing the existing private market.

While the nonadmitted market cannot commit to covering all risks, our market can provide broader coverage for flood insurance (and probably other catastrophe related coverages) beyond the offerings of the current federalized program and our market should be exhausted before the government steps into provide coverage. The private market is an existing competitive market with the ability to provide appropriate solutions.

While we do believe there is an appetite for this coverage to be in the private market, if the program were privatized, insurance premiums would likely need to increase. Both admitted and nonadmitted carriers

must analyze their capacity for coverage and rates above the current government program levels before committing to a fully privatized market.

We believe it is critical for Congress to more fully review and analyze the existing program, including important issues such as the flood maps and areas where coverage is required to better understand what the coverage needs for properties actually encompasses today. Further, and most importantly, Congress must balance the nature of the federal government's involvement in offering flood insurance when there is a private market solution available.

NAPSLO members are eager to play a larger role in flood insurance where they can. NAPSLO believes that in order to facilitate a greater role for voluntary players in the catastrophe risk market, government-run residual markets must be considered as a backstop to **both** the admitted **and** nonadmitted markets. We recognize that the surplus lines market does not have the capacity to take on all catastrophe risks immediately, but surplus lines carriers are willing to play a greater role by applying their expertise to insuring these unique risks. Again, we cannot emphasize enough the importance that state and federal governments must first exhaust the private market solutions available to consumers before stepping-in to provide alternative coverage or subsidized solutions.

NAPSLO stands ready to answer any questions regarding catastrophe risk and the surplus lines industry's traditional and future role in offering catastrophe protection, and is happy to assist the FIO in any way we can. To assist in your study of this issue, we are including two studies we feel will be helpful in your assessment of the private market. The first is a paper authored by NAPSLO, *Surplus Lines and Residual Markets: Maintaining the Public's Right to Freedom of Choice*, providing our perspective on the importance of the open market providing coverage before a residual market is established. The second study is AM Best's *2012 Special Report U.S. Surplus Lines—Market Review*, which will provide additional information on the stability and importance of the nonadmitted market in the private insurance market.

Again, on behalf of our members, we thank you again for the opportunity to provide comments on this important issue.

Sincerely,

Handwritten signatures of Brady R. Kelley and Keri A. Kish in blue ink.

Brady R. Kelley
Executive Director
brady@naplso.org
816-799-0860

Keri A. Kish
Director of Government Relations
keri@napslo.org
816-799-0855