Excess and Surplus: State of the Risk

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Making the most of emerging new risks and the declining capacity in admitted markets, the Excess and Surplus (E&S) segment has grown for five consecutive years by double-digit percentage rates. However, the trend of expansion appears to be slowing down a bit. Solid underwriting results continue to drive operating profitability, supporting an outlook for continued growth and development.

S&P Global Intelligence reports the 2023 growth rate of US direct premiums for E&S climbed only 14.5 percent down from the peak year-over-year increase of 32.3 percent in 2021 and 20. 1 percent in 2022. Total E&S premiums for 2023 reached $86.47 billion, up from $75.51 billion in 2022. The segment's share of U.S. total direct premiums written in 2023 grew to 9.2 percent, up from 5.2 percent in 2018.

Back in 2020, analysts had projected continued growth for the market, with estimates predicting total premiums would reach as high as $125.9 billion by 2027 but at 15.2 percent Compound Annual Growth Rate (CAGR). Does the sector currently have the right underpinnings for sustainable growth, or has it simply profited from pandemic-era issues? Success hinges upon several factors.

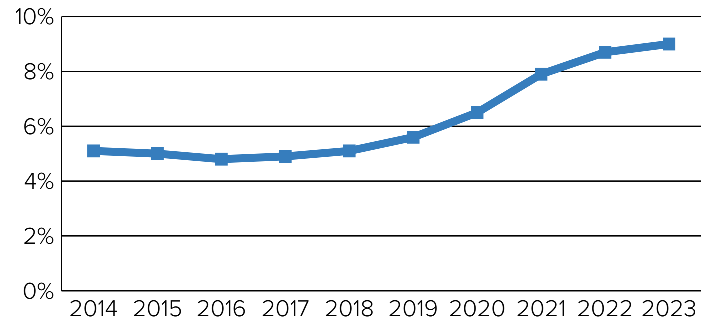
Trends to Watch

Future growth can depend on regulation that fosters flexibility. Contrary to myth, E&S is a regulated market. Much of the provisional framework applies to rules around placements, such as the stipulation that policies can only be placed via brokers licensed as a general property/casualy (P/C) broker and also licensed to place surplus lines. A surplus lines broker must complete a diligent search, a thorough attempt to find the coverage from admitted insurers before a policy is placed in the surplus lines market. However, some states maintain other rules, such as requiring surplus lines insurers to follow the same cancellation and nonrenewal requirements applicable to admitted insurers.

In any case, the main value proposition of the E&S market is its ability to customize a policy to fit the risk and the target customer, particularly when no other option for such bespoke coverage exists. Options can include higher limits, special terms and conditions, additional coverage, and other features. Therefore, insurers need room to master underwriting and pricing challenges to offer these custom-tailored solutions.

A study of differences across regulatory environments looked at the relationship between regulatory provisions and activity in surplus

U.S. Excess and Surplus Lines Share of P/C Industry Direct Premiums Written, 2014-2023*



*Excludes Lloyd's of London and territories.
Source: NAIC data, sourced from S&P Global Market Intelligence, Insurance Information Institute.

lines. For example, researchers observed a "positive correlation between premiums written and several regulatory measures, such as greater capital and surplus requirements, higher premium taxes and the existence of state surplus lines associations." Data on this and other noted correlations indicate that E&S may be sensitive to regulatory changes, a real possibility as the coming year may bring significant political changes for 85 of the 99 state legislative chambers in the U.S.

Outsized verdicts can bring opportunities or challenges for E&S. A report on large verdicts, awards of at least $10 million, from Marathon Strategies found that the median verdict against corporate defendants jumped from $21.5 million in 2020 to $41.1 million in 2022 – a 95 percent increase – while the number of verdicts doubled. Out of the 900 large verdicts spanning from 2009 to 2022, 63 percent came from only four states: Texas, Florida, California, and Pennsylvania. Two of these states, Florida and California, are grappling with a host of other formidable challenges to P/C affordability and availability.

The total sum of those 900 verdicts reached $18.3 billion in 2022, up from the cumulative sum of $4.9 billion in 2020 , when cases slowed amid court closures and public health measures associated with the COVID-19 pandemic. Since the pandemic, the largest verdict amounts have climbed from $1.1 billion in 2020 to $7.3 billion in 2022. Twenty verdicts for over $100 million were awarded that year, including four for over $1 billion. Rising frequency in large awards can also drive settlement values.

Commercial auto liability faces considerable exposure to these losses. S&P reports that growth rates for the commercial auto E&S market "slowed dramatically in 2023, "with growth rates at only 5 percent versus 30.6 percent in 2022 and 49.9 percent in 2021 ". Also, the 13 of the 15 largest U.S. E&S underwriters for commercial auto liability experienced a YoY increase in 2023 direct premiums written, whereas eight of the largest 15 underwriters of coverage for commercial auto physical damage experienced a decline. A 2023 report from the Insurance Information Institute notes how inflationary factors from legal costs burden this product line. Inflation – including social inflation – increased commercial auto losses from 2013 to 2022 by $35 billion to $44 billion.

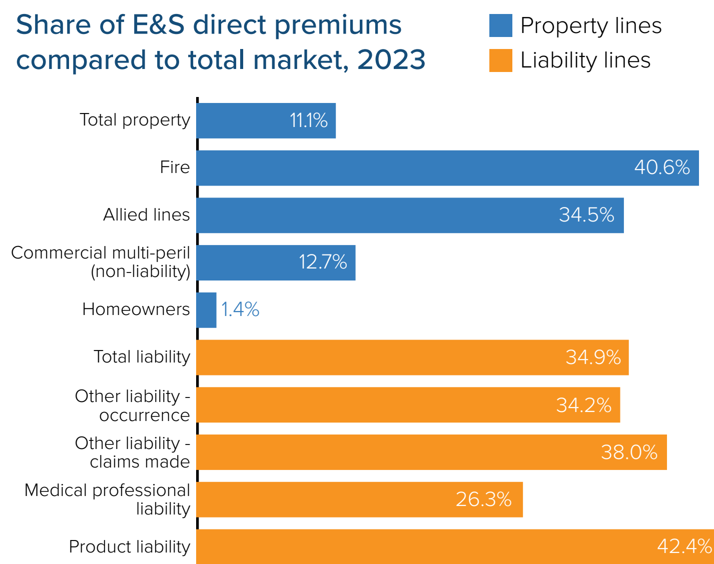
As cases from the early pandemic years still make their way through the court system, admitted and E&S insurers may struggle with risk prediction and mitigation. On the other hand, the increasingly volatile litigation environment could be driving growth in the E&S umbrella/excess casualty lines.

More climate disasters and catastrophes create hard-to-place risks.
Much of E&S growth can be seen in lines experiencing lower claim frequency but also higher claim severity, such as liability, fire, earthquake, flood, and ocean marine insurance. Since 2018, E&S's share of total property lines direct premiums written has grown in regions troubled with this perfect storm, including:

- Florida, 21.1 percent share (an increase of 7.1 percentage points)
- California, 14.2 percent (an increase of 8.8 percentage points)
- Louisiana, 22.7 percent (an increase of 8.3 percentage points)

Only one other state, South Carolina, has experienced growth by more than 8 points in E&S share against the total property segment since 2018. The price of capital allotted to catastrophic and similar risks can be expensive and subject to tougher underwriting and pricing models. Admitted insurers overburdened with this type of risk challenge may continue to strategically non-renew business or reduce their footprint in heavily troubled regions. Carriers that insure single-family residences are also turning to the E&S market for various risks, such as to fill the gaps in capacity and coverage for flood risk. These and similar trends related to climate and catastrophe liability can mean more risks for E&S to take on, including some that may be coming into this market for the first time.

Reinsurance outcomes may play a role, but capital positions remain strong.
The global reinsurance market experienced a 12 percent increase in capacity, reaching $729 billion in 2023, according to a report from Gallagher Re. However, analysts have noted that reinsurance "has entered a sustained hard market for property catastrophe rates (particularly excess of loss), a result of both an increase in ceded losses and disciplined decisions by reinsurers. Nonetheless, that market is driven by loss cost inflation, catastrophes, and investment market volatility and gains. If reinsurance becomes more expensive or harder to get, E&S insurers may be forced to increase prices as applicable.



Source: NAIC data, sourced from S&P Global Market Intelligence, Insurance Information Institute.

Fortunately, reports indicate that for 2024 "reinsurance buyers generally saw positive outcomes during the mid-year renewals, finding adequate capacity to meet cedents' increasing demand for protection — in both property and casualty." In the four-year run-up, capacity has been enough to bolster reinsurance, with reinsurer balance sheets expanding from the stellar results of 2023 and Q1 2024. However, E&S in the U.S. has been under "continued pressure for increases in excess of loss pricing of +1 percent to +5 percent for better performing programs and +2.5 percent to +10 percent for those that were loss impacted."

E&S drives innovation in the insurance industry and beyond

While analysts expect these dynamic (and, in some cases, volatile) market conditions to continue for the foreseeable future, other factors that may drive outcomes for the sector include talent, economic inflation, and supply chain issues. E&S policyholders also depend on its solid record of loss control provision and claims handling services.

The ever-evolving world calls upon the industry to grapple with unprecedented risk, from new businesses to new technology to new events. Ultimately, however, prospects for E&S hinge upon its capacity to support innovation in risk management, providing creative and customized solutions that aren't accessible on the admitted market – whether that involves finding new ways to price and underwrite long-standing risks or providing coverage of new risks for which loss records may be scarce or non-existent.

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