Arizona Department of Insurance
2013 Market Monitoring

Volume 11, Issue 4 | Other Liability Insurance | April, 2013

I. Rate System:

Arizona's "open competition" law, applicable to Other Liability ("OL") insurance, prohibits insurers from charging excessive, inadequate or unfairly discriminatory rates, or rates that will have the effect of destroying competition, or establishing a monopoly. By statute, the Department cannot find a rate to be excessive if "a reasonable degree of price competition" ("RDPC") exists at the consumer level. The law presumes a competitive market exists unless the Director, after a public hearing, determines that a RDPC does not exist in the market.

II. Market Monitoring Methodology:

The Department relies upon annual statements filed with the Department, insurers' responses to an annual Department survey, current trade press articles, and A.M. Best data to monitor the market.

The purpose of market monitoring is twofold: to assist the Director in determining whether competition exists; and to assist consumers with their questions and concerns about the availability of certain OL sublines of insurance.

III. Survey Responses:

Out of 162 surveys sent, 162 insurers with a combined total market share of approximately 92.00% responded to the Department's 2013 OL survey.

The survey targeted three OL sublines: Lawyers Professional ("LP"), Directors & Officers ("D&O"), and Architects & Engineers ("AE") Professional Liability. Of the 162 insurers that responded, 24 insurers write LP, 68 insurers write D&O, and 24 insurers write AE.

- **The majority of the subline insurers said:**
  - Competition is intense;
  - Coverage is available;
  - Underwriting stance is conservative;
  - Reinsurance is not problematic;
  - Market entry is easy;
  - New business is actively sought; and
  - Subprime/credit issues are ongoing.

IV. Major OL Subline Trends:

Trend #1: Markets are concentrated and insurers are actively seeking new business. The Top Five insurers for two of the market segments hold the majority of the market share. The Top Five LP insurers write 65.99% of the Arizona 2012 LP market, down from 67.40% in 2011. The Top Five D&O insurers hold 46.98% of Arizona's D&O market, up from 46.30% in 2011. The Top Five AE insurers control 65.18% of the AE market, down from 69.90% in 2011. Insurers in all three market segments are actively seeking new business.

Trend #2: Easy market entries and exits. Insurers indicated no difficulty in entering the Arizona market. The LP market remained the same with 24 insurers; 20 were existing insurers; four were new insurers and four insurers exited. The D&O market increased from 58 to 68 insurers; 56 were existing insurers; 12 were new insurers and two insurers exited. The AE market increased from 22 insurers to 24 insurers; 22 were existing insurers, two were new insurers and no insurer exited the market.

Trend #3: Coverage remains available.

Insurers from all three markets indicated they expect no change in coverage availability in 2013 compared to 2012 availability. An increase occurred in insurer participation in the D&O and AE lines while LP remained the same. The number of in-force policies written, except for LP, decreased. In the LP market, insurer participation remained the same and the in-force policy count increased 9.32%. In the D&O market, insurer participation increased 17.24% and the in-force policy count decreased 27.58%. In the AE market, insurer participation increased by 9.10% while the in-force policy count decreased by 9.53%. Fluctuation in the average premium size occurred in all three market segments.

Trend #4: <u>The majority of the insurers indicated they would continue their conservative underwriting stance in 2013</u>. None of the 24 LP insurers and 24 AE insurers indicated that they were changing their underwriting stance in 2013. One of the 68 D&O insurers indicated that they were tightening their underwriting approach in 2013 due to a national corporate decision.

Trend #5: <u>Changes in loss experience varied in the three market segments</u>. The LP incurred loss ratio ("ILR"), claims severity and frequency decreased. The ILR decreased (79.90%, 2011; 36.48%, 2012). Claim severity ($96,583, 2011; $80,192, 2012) and claims frequency (165, 2011; 114, 2012) both decreased.

The D&O market reflected an increase in severity ($147,990, 2011; $205,476, 2012) and in the ILR (61.93%, 2011; 75.95%, 2012) while claims frequency decreased (242, 2011; 185, 2012). Claims and lawsuits arising from the 2009 economic downturn and credit events will continue to impact the D&O and the LP subline markets for many more years.

The AE market shows the least impact of the three sublines by the economic downturn and credit events of 2009. Claims frequency decreased (113, 2011; 60, 2012) while claims severity increased ($49,012, 2011; $54,224, 2012). The overall ILR decreased from 70.31% in 2011 to 21.62% in 2012.

Trend #6: <u>Insurers in all three market segments were not expecting changes in their 2013 non-renewals</u>. The majority of the LP, D&O, and AE insurers indicated no change or increase in the number of nonrenewals is expected in 2013.

Trend #7: <u>Reinsurance is not problematic for any insurers.</u> One Hundred percent of the LP, D&O and AE insurers indicated no problems in obtaining reinsurance.

Trend #8: <u>Impact from the subprime/credit issues vary by market segment</u>. All LP and AE insurers indicated no impact due to subprime/credit issues. Seven D&O insurers (23.51% market share) indicate that the impact is substantial due to increases in claims and litigation. The full impact will not be known for years.

Trend #9: <u>Alternative markets increase the availability and affordability of commercial liability insurance</u>. Six Risk Retention Groups ("RRGs") are within the Top 162 insurers that wrote OL in 2012; however, only one RRG fell within the targeted sublines. This particular LP RRG's direct written premium ("DWP") is 35.86% of the total DWP in the admitted LP market subline. Only two insurers among the top 162 OL insurers that wrote D&O or AE policies believe there is increased competition from the Surplus Lines market.

V. Conclusions: While all of the sublines do not have a large number of insurers operating within their respective markets, coverage is available and affordable in all three sublines, entry and exit is easy, obtaining reinsurance is not problematic, insurers are actively competing for market share, and although no one yet knows the full impact of the subprime/ credit issues, we do know that claims, litigation and loss ratios are impacted by this issue.