United States Government Accountability Office

Report to Congressional Committees

January 2014

PROPERTY AND CASUALTY INSURANCE

Effects of the Nonadmitted and Reinsurance Reform Act of 2010

GAO-14-136

GAO Highlights

Highlights of GAO-14-136, a report to congressional committees

Why GAO Did This Study

Surplus lines insurers are critical to ensuring that businesses and individuals with difficult-to-insure risks can manage those risks. These insurers provide coverage for risks that the traditional, or admitted, insurance market is unwilling or unable to cover. Historically, insurance brokers who sell such coverage have found it to be time consuming and often difficult to allocate state taxes brokers collect and remit on insurance premiums on behalf of policyholders when the risks covered reside in multiple states. To help address this issue, Congress passed NRRA as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The act mandates GAO study changes in the surplus lines insurance market. This report (1) describes the size and condition of the surplus lines insurance market and (2) examines actions states have taken to implement NRRA's provisions and the effects of the act, if any, on the price and availability of coverage. To address these questions, GAO analyzed end-of-year financial data for 2008 through 2012 for insurers who sold surplus lines insurance in 2012 and interviewed insurance regulators from states with a large number of surplus lines insurers, industry associations representing interests in the surplus lines market, and large insurers and brokers. GAO also reviewed related studies and analyses.

In commenting on a draft of the report, the National Association of Insurance Commissioners provided technical comments, which GAO incorporated as appropriate.

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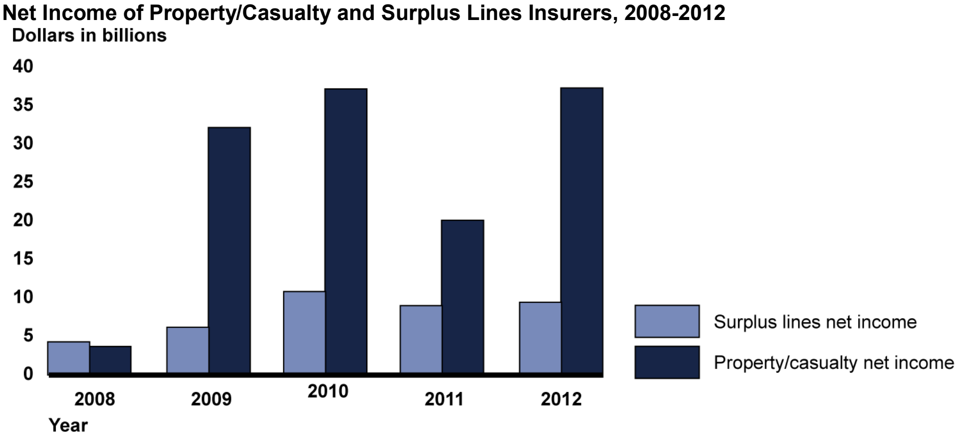
Effects of the Nonadmitted and Reinsurance Reform Act of 2010

What GAO Found

Surplus lines insurers' premiums written have increased modestly and the companies have generally remained profitable. From 2008 through 2012 premiums written by surplus lines insurers, who sell property/casualty insurance through brokers in states where they are not licensed, grew slightly from $24.8 billion to $25.2 billion and remained stable at around 5 percent of the property casualty market as a whole. Over this time, surplus lines insurers' premiums generally exceeded their claims and underwriting expenses and they remained profitable. Surplus lines insurers also saw capital gains over this period.

Net Income of Property/Casualty and Surplus Lines Insurers, 2008-2012



Source: GAO analysis of SNL Financial data.

Almost all states have modified their laws to implement at least portions of the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA). In 2010, Congress passed the act, which supporters argued would make it easier for surplus lines insurers and brokers conducting business across states. Under NRRA, only the "home state" of the insured—the state where the insured maintains its principal business or residence or, if the risk is 100 percent outside that state, the state to which the greatest percentage of the insured's taxable premium is allocated—may tax or regulate surplus lines insurance transactions. According to market participants GAO interviewed, the changes in states' laws have simplified compliance for multistate risks. While most home states are collecting and retaining 100 percent of premium taxes, a few states are participating in a tax-sharing agreement, as permitted under NRRA. According to industry associations, including those whom GAO interviewed, some states are making additional requests of surplus lines insurers beyond the requirements specified in NRRA. The National Association of Insurance Commissioners formed a subgroup to address this issue and in August 2013 issued options for improving compliance. Market participants said that NRRA has had little, if any, effect on the prices or availability of coverage, as this was not an intent of the act. The participants said that the insurance business cycles are primarily responsible for any changes in prices and availability. According to surplus lines insurers that GAO contacted, NRRA has caused little noticeable shifting in coverage between the admitted and surplus lines markets.

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Abbreviations

FIO	Federal Insurance Office
IID	International Insurers Department
NAIC	National Association of Insurance Commissioners
NAPSLO	National Association of Professional Surplus Lines Offices
NIMA	Nonadmitted Insurance Multi-State Agreement
NRRA	Nonadmitted and Reinsurance Reform Act of 2010
P/C	property/casualty
RRG	risk retention group
SLIMPACT	Surplus Lines Insurance Multi-State Compliance Compact

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

January 16, 2014

The Honorable Tim Johnson
Chair
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Mike Crapo
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Jeb Hensarling
Chair
Committee on Financial Services
House of Representatives

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
House of Representatives

The surplus lines insurance market is a critical component of the larger property/casualty (P/C) insurance market because it can provide insurance coverage for risks that traditional insurers, sometimes referred to as admitted insurers, are unwilling or unable to cover. In 2012, the premiums for such coverage totaled over $25 billion. The risks covered can include those with potentially catastrophic property damage and liability associated with high-hazard products, special events, environmental impairment, and employment practices, among others.[1] While admitted insurers must be licensed in the states where they sell insurance, surplus lines insurers must be licensed in only one state but may sell in others where they are not, provided they are authorized

[1] P/C insurance provides protection for physical items such as houses, cars, commercial buildings, and inventory (property) and protection against legal liability (casualty). Property insurance is coverage for losses related to a policyholder's own person/property. Casualty (or liability) insurance is coverage for a policyholder's legal obligations to compensate for losses caused to others.

according to the states' surplus lines laws.[2] In the surplus lines market, specialized insurance brokers typically seek coverage on behalf of clients. Unlike the insurers themselves, these brokers must be licensed to sell insurance in every state where they operate and must have a special license to operate in the surplus lines market.

In some cases, the risks that surplus lines insurers cover are spread across several states. Each of these states can tax premium income at a different rate, and historically it has often been difficult and time consuming for brokers to determine how to apportion premium taxes and determine which tax rates to apply.[3] Also, some states have had differing requirements for brokers with respect to providing important information to policyholders, determining that a risk could not be placed with a traditional insurer before allowing use of a surplus lines insurer, and determining which insurers were eligible as surplus lines insurers. Surplus lines brokers have cited these differences as challenges brokers face in complying with state surplus lines regulations. To address these issues, Congress passed the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA) as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[4] In enacting NRRA, Congress sought to streamline the process for taxing multistate risks, make it easier to access the surplus lines market, and create uniform standards for regulating surplus lines insurers.

[2]Surplus lines coverage is actually part of a larger "nonadmitted market" and is the largest component of that market. An insured can also access the nonadmitted market by purchasing insurance out of state from a carrier not licensed to sell insurance where the risk is located or through a broker not licensed by the jurisdiction where the risk is located.

[3]Insurers generally have two sources of income: premium revenue and investment income.

[4]Pub. L. No. 111-203, 124 Stat. 1376, 1589 (2010).

NRRA also mandates that GAO study the legislation's effect on the admitted and nonadmitted markets—specifically, surplus lines coverage.[5] This report (1) describes the size and condition of the surplus lines market and (2) examines actions states have taken to implement NRRA's provisions and describes the effects of the act, if any, on the price and availability of insurance coverage in the surplus lines market.

To address these objectives, we analyzed end-of-year financial and corporate data for 2008 through 2012 on all surplus lines insurers and the surplus lines and P/C industries obtained from SNL Financial, A.M. Best, National Association of Professional Surplus Lines Offices (NAPSLO), and National Association of Insurance Commissioners (NAIC).[6] We identified a population of 199 surplus lines insurers that operated in calendar year 2012 based on documentation from NAIC. These insurers were eligible or approved to sell surplus lines insurance in 2012 and actually did sell it in that year.[7] We did not include risk retention groups in our study population because the nonadmitted insurance reforms of NRRA specifically excluded these groups. We also obtained and examined states' lists of eligible surplus lines insurers from state departments of insurance, state surplus lines associations, and NAIC. We

[5]Although the nonadmitted market includes surplus lines insurers and other P/C insurers that provide surplus coverage, such as risk retention groups, our analysis includes only surplus lines insurers, because they are the focus of NRRA nonadmitted market reforms. A risk retention group (RRG) is a group of similar businesses with similar risk exposures, such as educational institutions or building contractors that create their own insurance company to self-insure their risks on a group basis. The specific definitional requirements for an RRG are set forth in 15 U.S.C. § 3901(a)(4).

[6]SNL Financial is a private financial database that contains publicly filed regulatory and financial reports. A.M. Best is a credit rating organization that serves the insurance industry and periodically conducts and publishes market-wide research. NAPSLO is an association that represents surplus lines insurers and brokers. NAIC is a voluntary association of the heads of insurance departments from the 50 states, District of Columbia, and five territories.

[7]According to SNL Financial data, the number of insurers, including risk retention groups, eligible to write surplus lines coverage was 2,858 in calendar year 2008 and had declined to 2,756 for calendar year 2012. While over 2,000 insurers were eligible to write surplus lines coverage in 2012, only 199 actually did sell such coverage in that year.

interviewed officials with NAIC and the Federal Insurance Office (FIO).[8] We also interviewed several market participants, including surplus lines insurers and their corporate parents; two large brokers; representatives of multiple industry associations representing brokers, insurers, underwriters, managing general agents, and actuaries; and state insurance regulators and stamping offices.[9] We selected these organizations for interviews based on each having a role in the surplus lines market. To assess issues related to data reliability, we reviewed related documentation, conducted interviews with knowledgeable officials, and reviewed previous related reliability assessments GAO had conducted of these data and determined that no material changes had been made in how the data were collected and tabulated. We determined that, for the purpose of describing the size and condition of the surplus lines insurance market, for this review, the data were sufficiently reliable. We also reviewed past GAO work and the work of others who have examined surplus lines and related insurance markets. Appendix I provides detailed information on the methodology.

We conducted this performance audit from April 2013 to January 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain

[8]FIO was established by the Dodd-Frank Act. It is not a regulator or supervisor but monitors all aspects of the insurance industry. For example, it identifies issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system. FIO also coordinates federal efforts and develops federal policy on international insurance matters. It represents the interests of the federal government in the International Association of Insurance Supervisors, while NAIC and the states represent the interests of state insurance regulators. The International Association of Insurance Supervisors represents insurance regulators and supervisors of more than 200 jurisdictions in nearly 140 countries. Its objectives are to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe, and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability.

[9]Stamping offices provide oversight, information, and assistance to brokers conducting surplus lines transactions. They were formed by surplus lines brokers as a form of self-regulation to facilitate compliance with the unique regulatory requirements applicable to surplus lines transactions. The offices are funded by a processing or "stamping" fee that they earn for reviewing surplus lines coverages. According to NAPSLO officials, in 2011 more than two-thirds of the national surplus lines premiums flowed through these stamping offices. Today, 14 states—Arizona, California, Florida, Idaho, Illinois, Minnesota, Mississippi, Nevada, New York, Oregon, Pennsylvania, Texas, Utah, and Washington—have surplus lines stamping offices.

sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The Admitted Insurance Market

Admitted insurers can be licensed to sell several lines or types of coverage to individuals or families, including personal lines—e.g., homeowners, renters, and automobile insurance—and commercial lines—e.g., general liability, commercial property, and product liability insurance. Admitted insurers can sell insurance in one or more states but must be licensed to operate in every state in which they sell coverage. Their activities are regulated primarily by the states, which make and enforce their own laws and regulations. State regulators license agents, review insurance products and premium rates, and examine insurers' financial solvency and market conduct. To help ensure adequacy and fairness in pricing and coverage, state regulators oversee the insurance rates and forms of admitted insurers.

Admitted P/C insurers have two primary sources of revenue: premiums from selling insurance and investment income. They collected $293.9 billion in premiums in 1998 and $523.9 billion in 2012.[10] Compared to the liabilities held by life insurers, their liabilities tend to be fairly short-term, so they generally invest in a mix of relatively low-risk, liquid, conservative instruments, such as government and municipal bonds, higher-grade corporate bonds, short-term securities, and cash. State regulators require admitted insurance companies to maintain specific levels of capital in order to continue to conduct business. To help ensure that policyholders continue to receive coverage if their insurer becomes insolvent or unable to meet its liabilities, states have guaranty funds (separate for life and P/C insurance), which are funded by assessments on insurers doing business

[10]In this report, we use the term "premiums written" to mean "direct premiums written," which is the number of insurance policy premiums written not including the policies given to reinsurers. These figures reflect the direct (gross) premiums written that are registered on the books of an insurer or a reinsurer at the time a policy is issued and paid for. See GAO, *Insurance Markets: Impacts of and Regulatory Response to the 2007-2009 Financial Crisis*, GAO-13-583 (Washington, D.C.: June 27, 2013).

in their state.[11] All states have laws that permit surplus lines insurers to sell coverage in their states, but do not cover their policies with state guaranty funds (which are funded by assessments on admitted insurers doing business in their state), leaving policyholders unprotected if their surplus lines insurer becomes insolvent.

The Nonadmitted Insurance Market and Surplus Lines Insurers

P/C insurers provide coverage for numerous property and casualty risks, but there are some risks that they will not cover—for instance, risks that are difficult to assess, occur too frequently to be acceptable to admitted insurers, are specialized or unusual, or require coverage that exceeds the capacity of admitted carriers. In these cases, potential insureds may turn to the nonadmitted market. This market functions as a safety valve, offering insurance products for risks that the admitted market will not cover.

Among the nonadmitted insurers are surplus lines insurers. These insurers provide coverage for general, management, and professional liabilities and commercial automobile, environmental, and property risks, among other things, and tailor their products to meet the needs of the

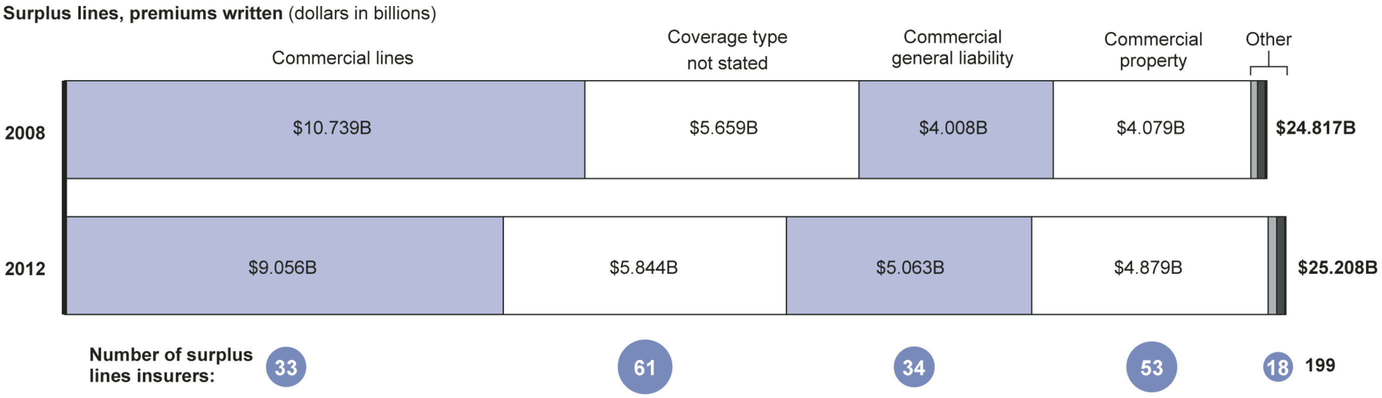
[11]Guaranty funds for life and P/C insurance are similar to the Federal Deposit Insurance Corporation for insured depository institutions. Guaranty funds pay covered claims within limits set by individual state laws and the insurance contract. For instance, the overall benefit "cap" in most states for an individual life or property casualty policy is $300,000, though some states have maximums that are higher. Certain products, such as some variable annuities, financial guaranty insurance, and mortgage guaranty insurance, are not covered by state guaranty funds.

insured.[12] For example, they may write policies to cover a research laboratory working on an unproven drug, special sporting or other events, or liabilities arising from environmental impairment. They may also write policies on new and innovative products that have little loss history—something admitted insurers would typically require in order to adequately price the risk. Some of the carriers also write coverage for personal lines, such as homeowners insurance in catastrophe-prone areas.[13] Figure 1 shows that over the 5-year period from 2008 through 2012, these insurers provided relatively larger amounts of coverage for commercial lines and property liabilities, with lesser amounts of coverage for reinsurance and personal lines. There was also a sizeable amount of coverage provided by companies writing less than $1 million in premiums where the liabilities covered were not clearly identified.

[12]General liability insurance covers an organization's responsibility for bodily injury and property damage arising because of the organization's premises, operations, and products, other than liabilities covered under other insurance policies. Management liability insurance covers loss exposures for directors and officers (e.g., to cover lawsuits against them), employment practices (e.g., employment-related discrimination claims), and fiduciary exposures (e.g., claims made by beneficiaries of an employee benefit plan against the plan's officials for breach of their fiduciary responsibilities). Professional liability insurance (also known as malpractice insurance or errors and omissions liability insurance) is coverage provided to professions requiring specialized education and knowledge and skills that are primarily intellectual (e.g., health care, finance, and law) rather than physical. Commercial auto insurance covers liabilities to organizations arising from the ownership, maintenance, or use of autos. Environmental insurance covers losses for bodily injury, property damage, and clean-up or remediation that exceeds coverage provided in general liability or commercial property policies. Commercial property insurance covers risks to buildings and other structures (e.g., vacant buildings) and personal property that are commonly not available in the admitted market.

[13]Arthur L. Flitner, and Jerome Trupin, *Surplus Lines Insurance Products* (Malvern, Pennsylvania: The Institutes, 2006).

Figure 1: Type of Coverage Provided by Surplus Line Insurers, by Premiums Written, 2008 and 2012



Source: GAO analysis of SNL Financial data.

Notes: The types of coverage are based on SNL Financial's "designated focus," which identifies the types of coverage or broad categories of lines of business provided by an insurer. A company is designated as having a "commercial lines" focus if it has very diversified operations within the commercial lines. The "Coverage type not stated" focus is for companies with less than $1 million in net premiums written, which, based on their size, SNL did not assign a designated focus. "Other" includes reinsurance, personal lines, commercial medical malpractice, commercial workers' compensation, commercial financial lines, and large reinsurance. See appendix I for an explanation of SNL's methodology for indentifying types of coverage.

Surplus lines insurers have more flexibility with respect to the terms and pricing of the coverage offered because, according to NAIC, unlike admitted insurers, they do not need state approval to modify policy exclusions and coverages. This flexibility to tailor the coverage provided and the price at which they provide it enables nonadmitted insurers to manage unique or large risks.

Surplus lines insurers can be domiciled—that is, headquartered—either in the United States or abroad. Those domiciled in the U.S and licensed in at least one U.S. state are known as "foreign" insurers in states other than their state of domicile, while those domiciled in a foreign country are known as "alien" insurers.[14] A foreign surplus lines insurer is regulated as an admitted insurer in the state in which it is domiciled, and that state is

[14]According to NAIC, alien insurers write about 25 percent of the U.S. surplus lines premiums annually, with Lloyd's of London writing approximately 70 percent of that business.

Categories and Examples of Common Surplus Lines Risks
Risks typically written in the surplus lines market fall into three categories: (1) nonstandard risks, which have unusual underwriting characteristics; (2) unique risks, which admitted carriers do not offer; and (3) capacity risks for which an insured seeks a higher level of coverage than admitted insurers are willing to provide. Examples of the types of risks commonly insured by the surplus lines market include:

- coastal properties;
- developers rebuilding homes and businesses in hurricane-prone areas;
- celebrities who want to insure certain features such as legs or hands;
- school districts building new schools; and
- nonprofit associations that provide food, medical care, and education to the Third World.

Source: National Association of Professional Surplus Lines Offices, Ltd.

its financial solvency regulator.[15] Alien insurers wishing to enter the U.S. surplus lines market must apply to NAIC's International Insurers Department (IID) for inclusion in the *Quarterly Listing of Alien Insurers*, which reviews their financial condition as part of the alien insurer application process. These insurers then become an eligible surplus lines insurer in all states. Alien insurers may also apply to an individual state to become authorized only in that jurisdiction. Table 3 in appendix II lists the alien insurers approved by NAIC from 2008 through 2012, and table 4 shows their location—mostly in England and Bermuda.

Surplus lines insurers must sell their insurance through a broker.[16] These brokers are licensed retail agents that represent insurance buyers and place coverage with surplus lines insurers.[17] They are 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 state regulations. To place coverage in the surplus lines market, brokers must follow state due diligence requirements. Although they vary from state to state, according to an association representing surplus lines insurers and brokers, these requirements generally call for brokers to establish that three admitted companies licensed to write the kind and type of insurance requested have declined to provide it before turning to a surplus lines insurer.

Historically, brokers and the surplus lines insurers have had to comply with a multitude of state laws and regulations dealing with taxation, oversight, and market access. For example, brokers have had to comply with differing rules across states for things like providing policyholders with important notices and determining which insurers were eligible for placing business. Brokers also have had to remit taxes on all surplus lines insurance transactions. Historically the revenue from surplus lines

[15]NRRA defines "state" to include the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Northern Mariana Islands, the Virgin Islands, and American Samoa.

[16]Such insurers are the focus of this report and do not include nonadmitted insurers (i.e., insurers not licensed to transact business in an insured's home state) who sell insurance directly to buyers.

[17]Brokers are licensed by the states.

transactions that took place outside the insurer's state of domicile had to be among all states where parts of the risks were located.

The Nonadmitted and Reinsurance Reform Act of 2010

NRRA, which generally took effect on July 21, 2011, contains provisions that are intended to address the various regulatory concerns discussed earlier and, in turn, streamline the brokers' placement of insurance coverage in the surplus lines market. The act creates a "home-state" system of taxation and regulation to resolve difficulties in determining how to tax and regulate surplus lines transactions. NRRA defines the home state as the state in which the insured maintains its principal place of business, or in the case of an individual, the individual's principal residence. If all the insured risk is outside this state, NRRA defines the home state as the state to which the greatest percentage of taxable premium taxed for that insurance contract is allocated. Under NRRA, the home state has sole and exclusive authority to tax and regulate a sale of surplus lines insurance. In addition, only the insured's home state may require a surplus lines broker to be licensed, even for transactions that involve multiple states. NRRA also permits but does not require states to form an interstate compact or otherwise establish procedures to allocate premium taxes collected by an insured's home state for transactions. These compacts, if instituted, are intended to help states adopt nationwide uniform requirements, forms, and procedures for reporting, paying, collecting, and allocating premium taxes.

NRRA further seeks to simplify and make more uniform the criteria states use to determine which insurers can be eligible to sell insurance on a surplus lines basis. Specifically, NRRA states that a state may not impose eligibility requirements on or establish eligibility criteria for surplus lines insurers domiciled in the United States that are authorized to write policies in their state of domicile. The act also states that the insurer generally must maintain minimum capital and surplus levels as required by NAIC's Non-Admitted Insurance Model Act, which is the greater of $15 million or the minimum capital and surplus requirements of the insured's home state, or in certain situations, less than the minimum capital and surplus when a state's insurance commissioner finds an insurer acceptable.[18] This model act, among other things, is intended to protect persons seeking insurance, assure such insurance is placed only with reputable and financially sound insurers, and establish state regulation of surplus lines insurance. NRRA also specifies that a state may not prohibit a broker from placing surplus lines insurance with an alien insurer listed on NAIC's *Quarterly Listing of Alien Insurers*. Under NRRA, Congress delegated to NAIC responsibility for reviewing and approving the financial information of alien surplus lines insurers. Finally, NRRA contains a provision specifying that, after July 21, 2012, a state may not collect any fees for licensing a surplus lines broker unless it participates in NAIC's national producer database or an equivalent.

Although NAIC does not regulate admitted or surplus lines insurers, according to NAIC officials it does provide services designed to make certain interactions between insurers and regulators more efficient. According to NAIC, these services include providing detailed insurance data to help regulators analyze insurance sales and practices; maintaining a range of databases useful to regulators; and coordinating regulatory efforts by providing guidance, model laws and regulations, and information-sharing tools.

Surplus Lines Insurers' Premiums Written Increased Modestly and Companies Have Generally Remained Profitable

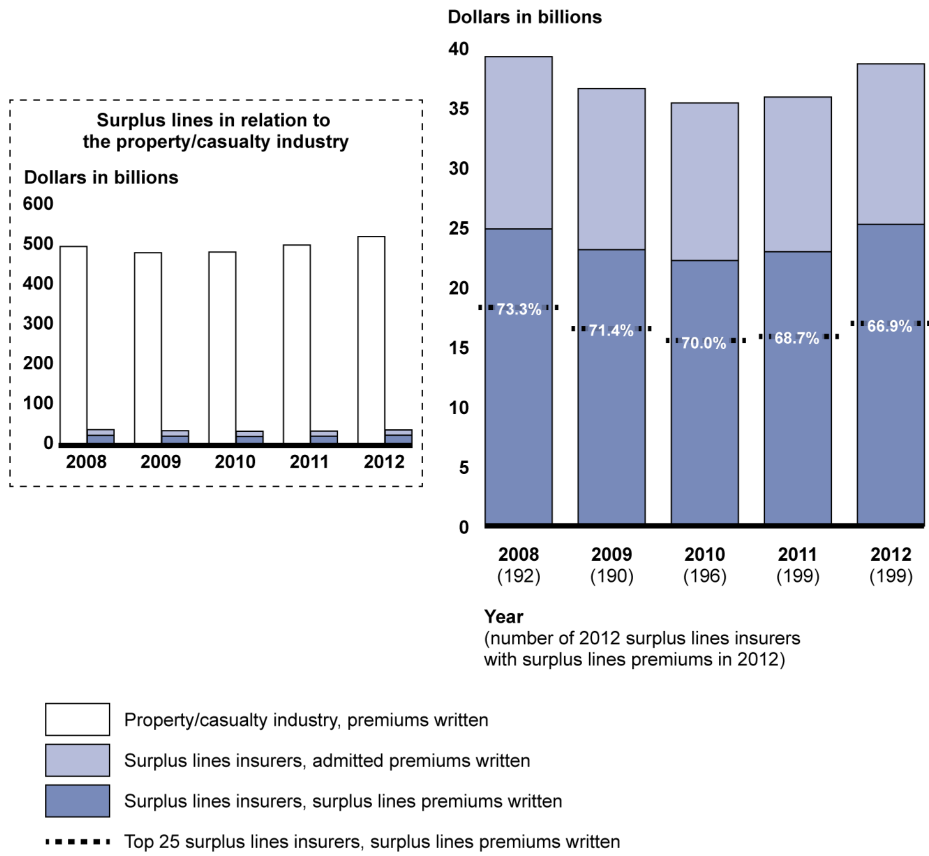
From 2008 to 2012 premiums written by surplus lines insurers grew by 1.6 percent (from $24.8 billion to $25.2 billion) and remained around 5 percent of the property casualty market as a whole. Over this time, even though insurers' claims and underwriting expenses generally exceeded premiums, their net investment income allowed them to remain profitable. As a result, surplus lines insurers also saw growth in capital holdings.

[18]By surplus we mean policyholder surplus, which is an important measure of an insurer's ability to pay claims and represents the extent to which an insurer's assets exceed its liabilities. Generally, a model act or law is meant as a guide for subsequent legislation. State legislatures may adopt model acts in whole or in part or modify them to fit their needs. Most states' surplus lines laws are very similar to those recommended in the model act, but actual requirements vary by state, ranging from a high of $45 million in California to $300,000 in the District of Columbia and $500,000 in South Dakota.

Premiums Written by Surplus Lines Insurers Have Increased Since 2008

From 2008 to 2012, premiums written by the population of surplus lines insurers that we examined rose modestly, mirroring trends in the overall P/C market. While the total amount of premiums written (the sum of premiums written by the surplus insurers on an admitted basis in their states of domicile and on a surplus lines basis) declined following the 2008 financial crisis in both markets, it began increasing in 2011 and continued to rise through 2012. In the surplus lines market, premiums written increased about 3.2 percent in 2011, rising from about $22.2 billion in 2010 to $22.9 billion in 2011, and rose another 10.0 percent to $25.2 billion in 2012. Premiums written in the overall P/C market rose from $498.6 billion in 2008 to $523.4 billion in 2012. Surplus lines premiums, which account for a small fraction of this overall P/C market, declined slightly as a share of total P/C premiums in 2009 and 2010 but began rising in 2011. In 2012, they accounted for 4.8 percent of the overall P/C market (see fig. 2).

Figure 2: Size of the Property/Casualty Market and Surplus Lines Market, Premiums Written, 2008–2012



Source: GAO analysis of SNL Financial data.

According to market analyses and surplus lines insurers and representatives of industry we interviewed, surplus lines premiums can fall for several reasons, including an overall slowdown in the economy and a “soft” insurance market, which tends to occur after losses have been relatively low. Economic slowdowns or downturns, such as the one during the 2007-2009 financial crisis, can result in fewer new business ventures of the type that would use surplus lines insurance. And in a softening insurance market, generally after losses have been relatively low, admitted insurers are often willing to write higher-risk coverage for lower prices—coverage that might at another time be written by surplus lines insurers. In contrast, during a “hard” insurance market, generally after losses have been higher, admitted insurers are often less willing to write high-risk coverage, and surplus lines insurers are more likely to step in to write such coverage. With the U.S. economy in recovery, pricing evidence suggests that since 2010 insurance markets have likely been hardening, creating a flow of business from the admitted market into the surplus lines market. Consistent with this trend, insurers that sell surplus lines coverage saw the proportion of their total premiums from surplus lines transactions increase slightly in 2011 and 2012, rising from 63.9 percent to 65.3 percent.

Most of the largest surplus lines insurers sell surplus lines coverage almost exclusively, while smaller insurers that sell this coverage write most of their premiums in the admitted market. Because U.S. surplus line insurers are licensed as admitted insurers in their states of domicile, they may sell some coverage on an admitted basis (see table 5 in app. III). Of the top 25 surplus lines insurers as measured by total premiums written (both admitted and surplus lines), 20 wrote over 98 percent of their premiums as surplus lines in 2012, on average. Only three wrote less than 95 percent. By comparison, the remaining smaller surplus lines insurers received on average 38.9 percent of their premiums from the surplus lines business during this period.

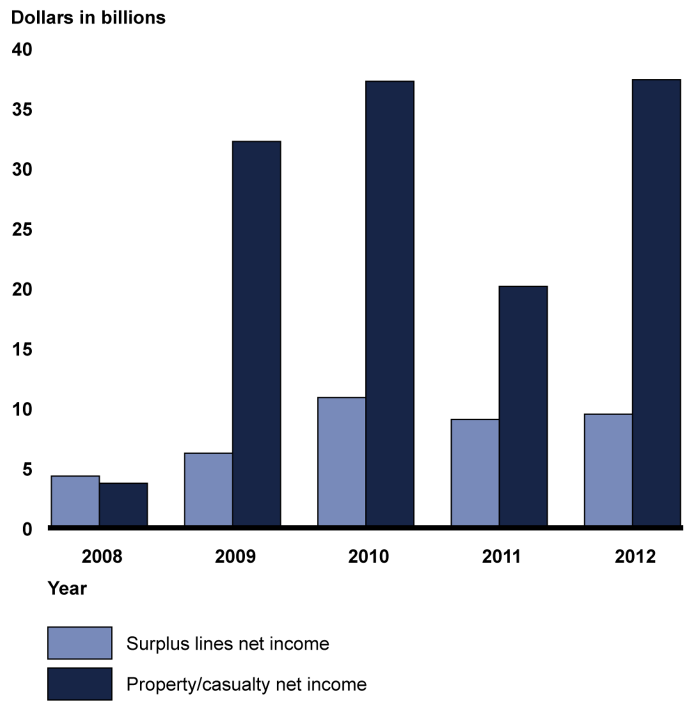
Since 2008, the list of top 25 surplus lines insurers has remained largely unchanged, and these insurers have sold the bulk of surplus lines coverage. Most of the top 25 insurers from 2012 were also among the top insurers from 2008 through 2011 and in 2012 wrote about $16.9 billion in surplus lines premiums, or about 66.9 percent of the market (see fig. 2). The largest five surplus lines insurers each wrote over $1 billion in premiums, with the largest U.S. based surplus lines insurer, Lexington Insurance, writing $4.2 billion in premiums in 2012. Lloyd's of London, which is licensed as an admitted carrier in Illinois, Kentucky, and the U.S. Virgin Islands, is the largest surplus lines insurer and wrote $6.3 billion in surplus lines premiums in 2012, or about 25 percent of the total 2012 premiums written for all U.S. based surplus lines insurers. Lloyd's surplus lines premiums are written primarily to cover property exposures, and in 2012 their share of the surplus lines market premium was largest in Texas (30 percent) and South Carolina (29 percent) and was at least 20 percent each in Florida, Georgia, Louisiana, Massachusetts, and North Carolina. Table 6 in appendix III includes detailed information about premiums written by the top 25 surplus lines insurers.

A majority of surplus lines premiums were written in a small number of states. For example, from 2010 through 2012 just under half of the surplus lines premiums written in the United States were written in 4 states, and almost two-thirds of the premiums were written in 10 states (see table 7 in app. III). For each of these years, the top four states with the most surplus lines premiums written were, respectively, California, Florida, Texas, and New York—the four states with the most P/C premiums written in the admitted market as well.

Surplus Lines Insurers' Net Income Has Generally Increased

Insurer's net income, which takes into account all aspects of the company's operations, including premiums written, losses, other costs, and investment income, is a measure of profitability. As shown in figure 3, the net income for P/C and surplus lines increased overall from 2008 to 2012. Net income for surplus lines insurers more than doubled over the period, from $4.3 billion to $9.5 billion, but for P/C insurers it increased nine-fold, from $3.7 billion to $37.3 billion, which is below the pre-crisis highs of $66.4 billion and $63.6 billion in 2006 and 2007, respectively, but has generally been trending upward.

Figure 3: Property/Casualty and Surplus Lines Insurers' Net Income, 2008-2012



Source: GAO analysis of SNL Financial data.

Surplus Lines Insurers' Net Investment Income Has Increased

Income from investments is important for surplus lines insurers because it can allow them to operate at an overall profit despite unprofitable underwriting operations. As we discussed earlier in this report, investments of the broader P/C industry, which include surplus lines insurers, were negatively affected by the 2008 financial crisis, and the net investment income decreased for both surplus lines insurers and the P/C industry from 2008 through 2012 (see table 1).[19] From 2008 through 2012, the surplus lines insurers that we examined saw their invested assets increase from $152.7 billion to $233.1 billion, respectively. These assets were held in a broad range of instruments, but the bulk was in bonds. An increasing percentage was invested in industrial bonds and decreasing percentages in government and other bonds. These insurers also held more in cash and other short-term investments from 2009 through 2012, but less so than in 2008. They have also tended to increase their investments in common stock, but that amount remains below 7 percent of total cash and investments (see table 8 in app. III).

Table 1: Comparison of Surplus Lines Insurers and Property/Casualty Market and Investment Performance, 2008–2012

Dollars in millions

	2008	2009	2010	2011	2012
Surplus Lines Insurers					
Net investment income[a]	$6,096.9	$7,386.8	$8,043.8	$10,032.3	$10,177.4
Capital gain/loss[b]	-13,101.7	9,345.3	9,556.8	847.3	8,708.1
P/C Industry					
Net investment income[a]	$53,132.9	$48,401.9	$48,099.5	$50,890.6	$50,109.2
Capital gain/loss[b]	-78,255.9	16,998.8	19,747.2	1,885.4	23,726.4

Source: GAO analysis of SNL Financial data.

[a]Net investment income earned includes investment income earned from all forms of investment, including interest and dividends, investment fees earned relating to uninsured accident and health plans, dividends from SCA entities, joint ventures, partnership, and limited liability companies: minus investment expenses, taxes (excluding federal income taxes), licenses, fees, depreciation on real

[19]Total investment return consists of net investment income and capital gain or loss. Net investment income includes all interest, dividends, and other earnings derived from an insurer's invested assets minus any associated investment expenses, taxes (excluding federal income taxes), licenses, fees, depreciation on real estate, and other invested assets. Capital gain or loss reflects increases or decreases in the value of an investment, and can be divided into realized and unrealized. Capital gains or losses are "realized" when assets are sold, and reflect the difference between sales price and purchase price, along with other adjustments. "Unrealized" capital gains or losses reflect changes in value of assets that have not yet been sold.

estate, and other invested assets. Also includes investment income credited to uninsured accident and health plans and interest on borrowed money. It excludes capital gains on investments and equity in undistributed income or loss of SCA entities, joint ventures, partnerships, and limited liability companies.

[b]Capital gain/loss includes realized capital gain/loss (the net realized capital gains less capital gains tax including realized investment related to foreign exchange for the current year) and unrealized capital gain/loss (the change in net unrealized capital gains less capital gains tax). Capital gains or losses are "realized" when assets are sold, and reflect the difference between sales price and purchase price, along with other adjustments. "Unrealized" capital gains or losses reflect changes in value of assets that have not yet been sold.

Our analysis of data on net investment income earned (income earned from all forms of investments) shows that from 2008 to 2012 the net investment income increased for surplus lines insurers and decreased slightly for the P/C market (see table 1). For surplus lines, this net investment income rose from $6.1 billion to $10.22 billion, while for P/C insurers it started the period at $53.1 billion and finished the period at $50.1 billion.

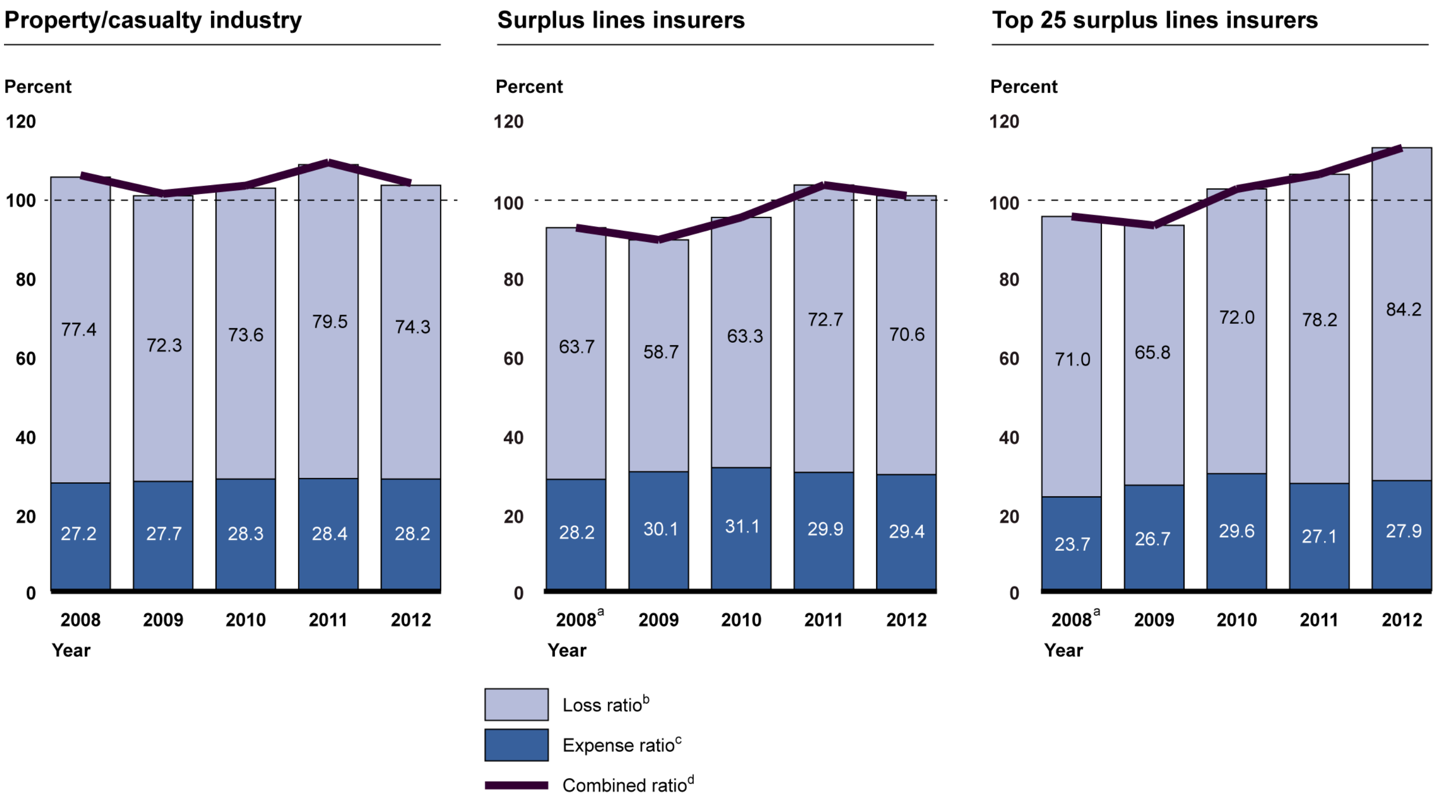
Over this 5-year period, surplus lines and P/C insurers saw an increase in their capital gains each year until 2011 when it dropped and then increased again in 2012. Surplus lines insurers had capital losses of $13.1 billion in 2008, rising to $9.6 billion in 2010, and dropping to $0.8 billion in 2011 because of a significant decrease in unrealized capital gains. Capital gains increased to $8.7 billion in 2012 due to a rebound in these capital gains. P/C insurers saw capital losses of $78.3 billion in 2008, but capital gains of $23.7 billion in 2012. According to an A.M. Best report, in 2008 and 2009, the P/C industry's assets were strained by write-downs of devalued assets, mortgage-backed securities, and other related assets, and the changes in 2010 and 2011 for both the P/C industry and surplus lines insurers are largely attributable to their increased investment in relatively short-term fixed income securities that carry low interest rates.

Surplus Lines Insurers' Generally Made Money on Their Underwriting Operations

From 2008 through 2012, surplus lines insurers generally have made money on their underwriting operations. Insurers' underwriting operations generally consist of the premiums it collects and the expenses it incurs related to insurance activities. Expenses can generally be divided into two categories: (1) underwriting expenses and (2) loss and loss adjustment expenses. Underwriting expenses are those incurred by an insurer as it obtains business, such as brokers' commissions, employee incentive programs, and marketing. Loss and loss adjustment expenses are losses insurers incur as they investigate and settle claims, including actual claim payments as well as legal fees. Expressed as a percentage of premiums written, these ratios are referred as the “expense” and “loss” ratios, respectively. The insurer’s underwriting profitability can be measured by summing the loss and the expense ratios. This sum, measured relative to premiums written is referred to as the “combined” ratio, where a value of less than 100 percent indicates that an insurer’s underwriting is profitable, and a value of more than 100 percent indicates an underwriting loss.

The expense ratio for the surplus lines industry as a whole was greater than the ratio for the broader P/C market (see fig. 4). In part, this could reflect the higher costs associated with assessing and pricing the more complex risks often covered by surplus lines insurers. The expense ratios for the surplus lines industry increased slightly over this period, rising from 28.2 percent in 2008 to 29.4 percent in 2012.

Figure 4: Expense and Loss Ratios, and Combined Ratios for the Property/Casualty Market and Surplus Line Insurers, 2008–2012



Source: GAO analysis of SNL Financial data.

[a]The 2008 ratios for one top 25 company was omitted because that outlier insurer reported a large negative expense ratio for that year.

[b]Expense ratio is the net underwriting expenses as a percentage of net premiums written.

[c]Loss ratio is the net loss and loss adjustment expense incurred as a percentage of net premiums written.

[d]Combined ratio is the loss and loss adjustment expense ratio plus expense ratio.

Since 2008, surplus lines insurers' loss ratios have increased but remained below those of the broader P/C market (see fig. 4). In 2012, these expenses for the surplus lines insurers in our analysis were 70.6 percent of premiums written. According to an A.M. Best report, the loss and loss adjustment cost percentage increased from 2010 to 2011 for both admitted and surplus lines insurers because of large losses from weather-related catastrophes and a weak economy. In 2012, surplus lines insurers experienced losses because of Superstorm Sandy.

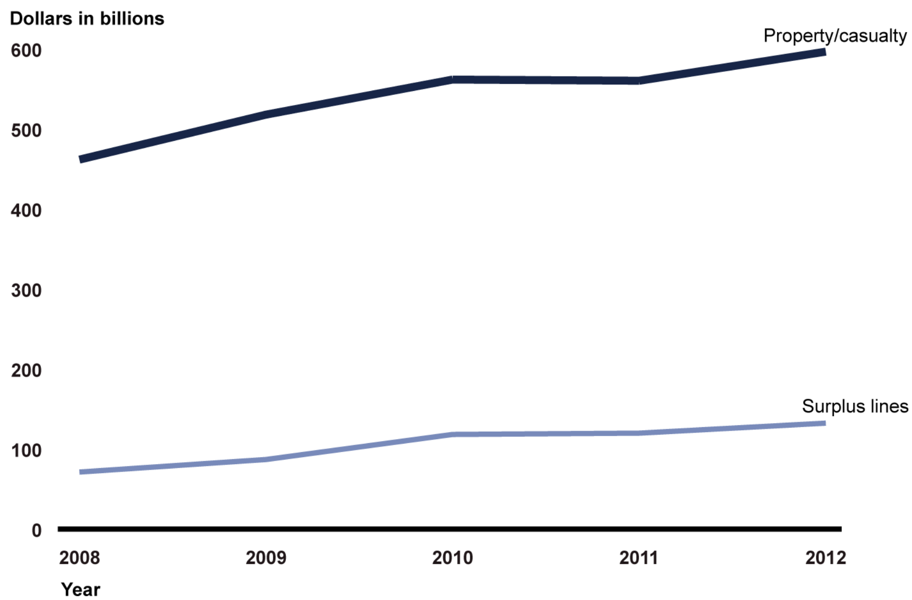
Figure 4 shows that from 2008 to 2012, the overall underwriting activity of surplus lines insurers in our analysis was profitable every year except in 2011 (the industry was profitable in 2012 because the unrounded combined ratio for 2012 was 99.94). In contrast, the 25 largest surplus lines insurers had underwriting profits in 2008 and 2009, with an average combined ratio of less than 100 percent in each of those years, but showed losses for the remaining 3 years. An A.M. Best report noted that the competitive insurance marketplace and the recent recession combined to weaken surplus lines insurers' underwriting performance in 2010 and 2011 and led to overall underwriting losses in the P/C market. And according to the *Insurance Journal*, catastrophic losses especially in New York and New Jersey, due to Superstorm Sandy in 2012, drove up surplus lines insurers' loss and combined ratios for 2012 to the point where they exceed those of the total P/C market.

Surplus Lines Insurers' Capital Has Been Increasing

Surplus lines insurers' capital has increased since 2008, adding to their bottom line. A key measure of their capital is "policyholders surplus."[20] A higher level of policyholder surplus means that an insurer has more capital available to pay claims. Figure 5 shows that the capital for surplus lines insurers has been increasing since 2008, similar to an increase also seen in the P/C market.

[20]We use the term "capital" to mean policyholders' surplus for P/C insurers. The measure generally refers to the excess of an insurance company's assets above its legal obligations to meet the benefits, or liabilities, payable to its policyholders.

Figure 5: Property/Casualty and Surplus Lines Insurers’ Capital, 2008-2012



Source: GAO analysis of SNL Financial data.

Note: We use the term “capital” to mean policyholders’ surplus for property/casualty insurers.

Table 2 shows that from 2008 to 2012 the surplus level for these insurers was $71.3 billion in 2008 and rose to $132.4 billion in 2012, and for the top 25 surplus lines insurers, their total policyholder surplus rose from $15.6 billion in 2008 to $17.6 billion in 2012.

Table 2: Surplus Lines Insurers, Policyholder Surplus, 2008–2012

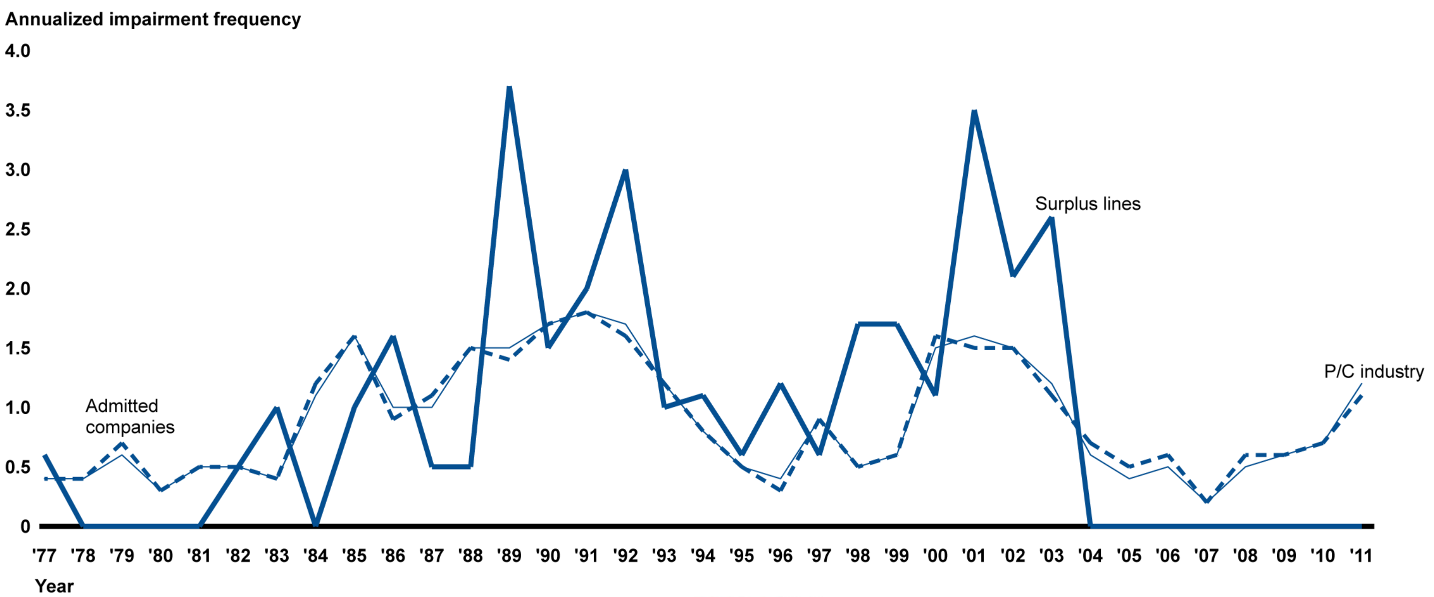
Dollars in millions

	2008	2009	2010	2011	2012
All National Association of Insurance Commissioners (NAIC)-listed surplus lines insurers	$71,292.0	$86,965.6	$118,286.3	$119,902.5	$132,406.2
Top 25 NAIC-listed surplus lines insurers	15,627.5	14,308.2	15,416.9	15,326.3	17,572.9

Source: GAO analysis of SNL Financial data.

Surplus lines insurers have also experienced few impairments of their capital (see fig. 6). Impairments occur when an insurer’s assets are too low in comparison to their liabilities. According to an A.M. Best report, accounting for the number of insurers in the industry, the surplus industry’s average rate of impairment from 1977 to 2011 was 0.99 percent, slightly higher than the impairment rate of 0.90 percent for P/C insurers. A.M. Best added that from 1998 to 2003, impairments occurred because of the increased failure rate of insurers that relied heavily on underwriting done by managing general agents and because some parents of surplus lines subsidiaries became insolvent.[21] A.M. Best added that more recently surplus lines insurers have not experienced any impairments since 2004, because of better underwriting performance, improved financial market conditions, and more favorable pricing.[22] Thus, the recent experience of surplus lines insurers compares favorably to that of admitted insurers, which experienced a higher percentage of impairments.

Figure 6: Percentage of Admitted and Surplus Line Insurers with Annual Impairments, 1997–2011



Source: A.M. Best research, BestLink — U.S. P/C Statement File, © 2013.

Note: Financial impairment refers to an insurer's assets being lower than its liabilities.

[21]A managing general agent is an insurance agent or broker that, unlike traditional agents/brokers, is vested with underwriting authority from an insurer.

[22]As reported by A.M. Best, which is a company that conducts financial analyses of insurance companies, including surplus lines insurers.

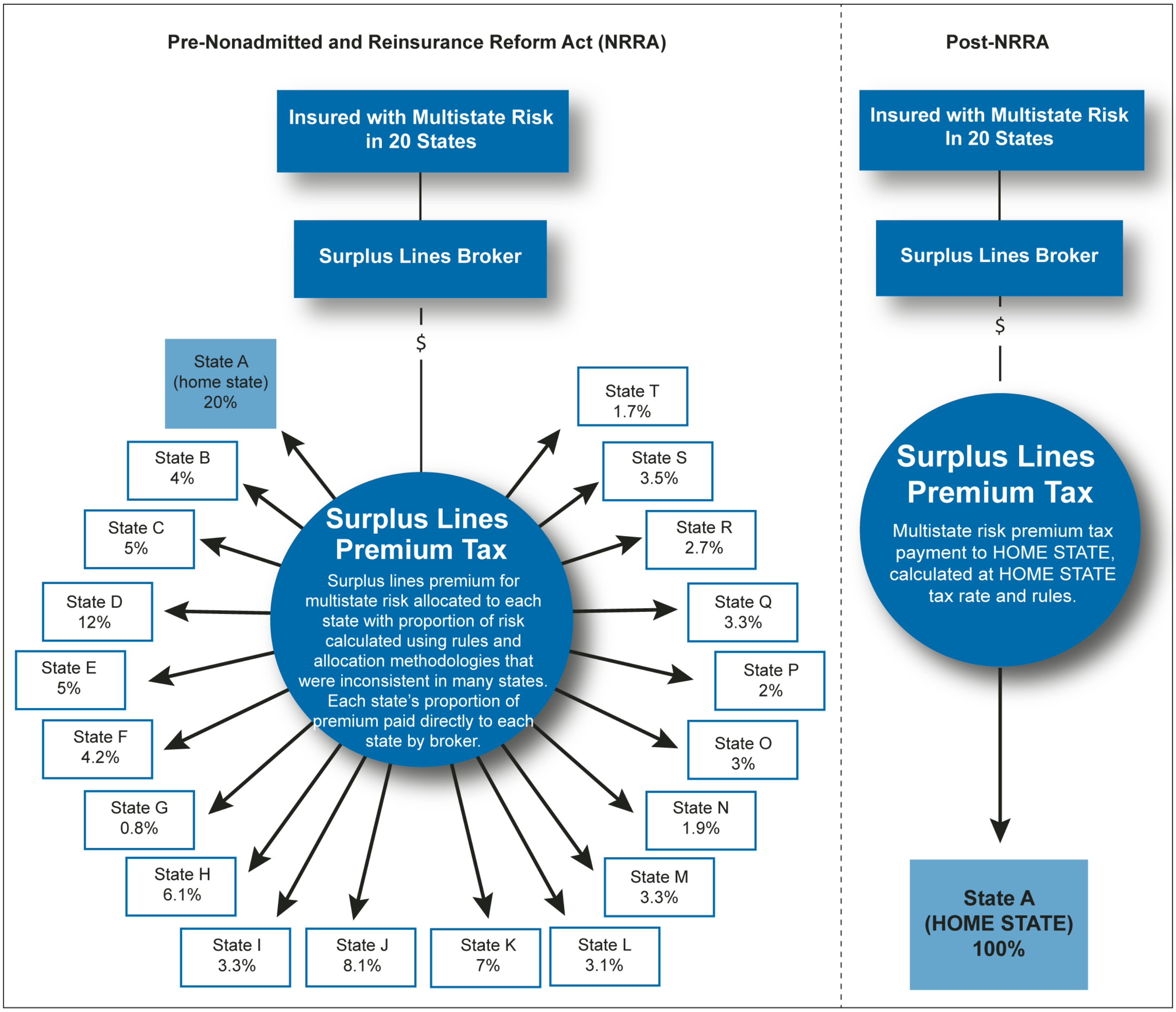
NRRA Implementation Has Begun in Most States and Appears to Have Had Little Effect on the Pricing and Availability of Coverage

Almost all states have begun to implement NRRA, which our review of the legislative history shows that Congress passed in 2010 to make it easier for surplus lines insurers and brokers conducting business across states. According to surplus lines insurers, brokers, and representatives of industry associations, the act has simplified the collection of premium taxes for multistate risks. Market participants we spoke with said that NRRA has had little, if any, effect on the prices or availability of coverage, as NRRA was not intended to affect these areas. The participants noted that any changes in price and availability would be due to the insurance cycle rather than NRRA.

Almost All States Have Modified Their Laws to Implement NRRA's Home State Definition

As noted, NRRA created a home state system for the regulation and taxation of surplus lines insurance. According to our review of state insurance laws in all 50 states, as of December 2013, all states except Michigan have amended their laws to address this provision, which regulators and market participants we spoke with consider to be the key provision of NRRA. We found that the states had largely adopted a definition of the home state that closely matched the term as defined in NRRA—that is, the state in which the insured maintains its principal place of business or residence or, if all the risk resides outside that state, the state to which the greatest percentage of taxable premium is allocated for that insurance contract. According to officials of an association representing surplus lines insurers and brokers, the home state provision has produced significant benefits for the surplus lines industry by reducing the need for insurers to comply with differing sets of rules, disclosures, and requirements. As shown in figure 7, the act has also simplified the payment of premium taxes for transactions involving a multistate risk. Most market participants we interviewed agreed that the home state provision has brought needed clarity to the market.

Figure 7: Illustration of Surplus Lines Premium Tax Payment Process Pre- and Post-NRRA



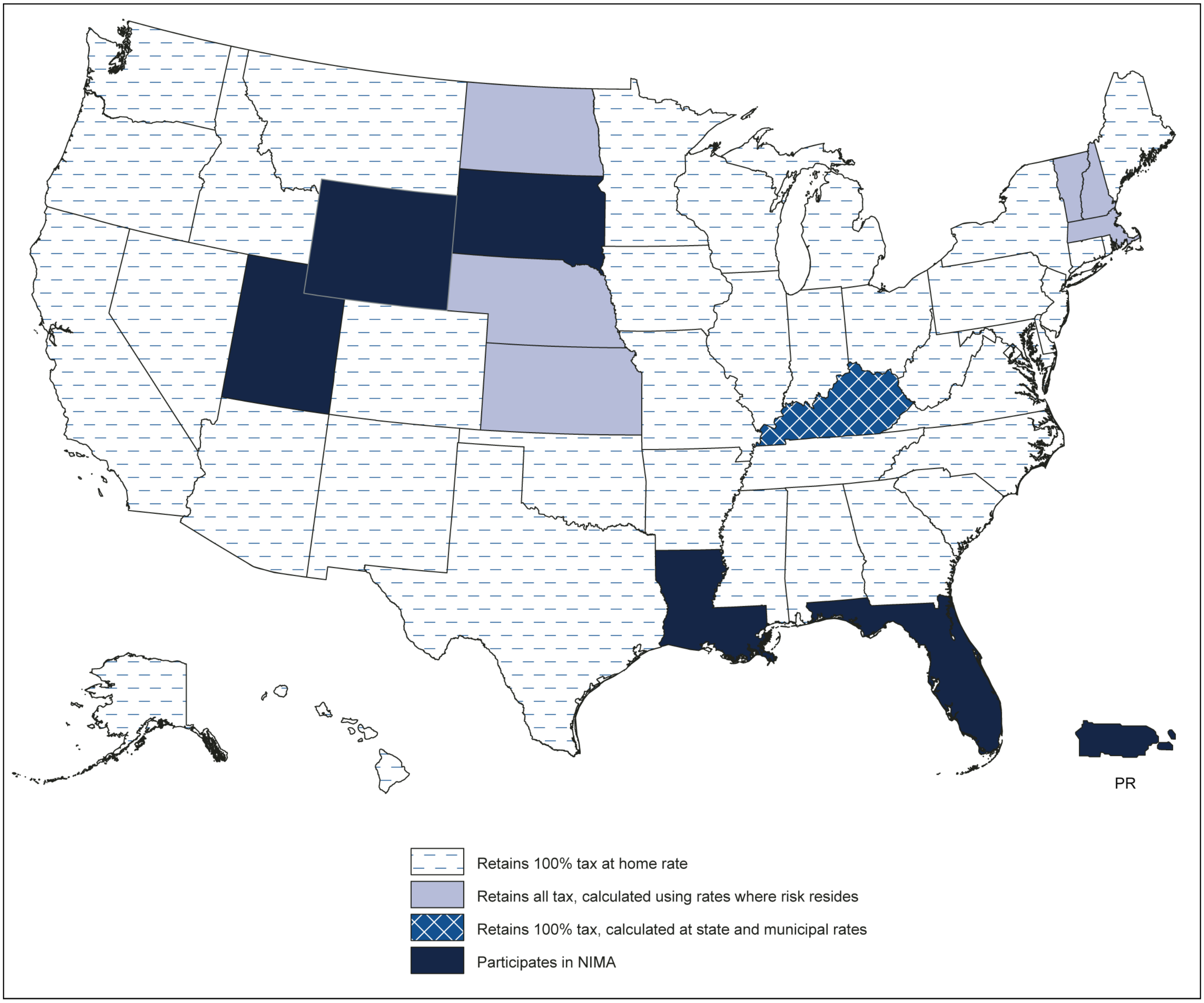
Source: National Association of Professional Surplus Lines Offices, Ltd.

Note: NRRA defines the home state as the state in which the insured maintains its principal place of business or residence or, if all the risk resides outside that state, the state with the greatest percentage of taxable premium for that transaction.

Under the home state system, as an option for collecting and allocating premium taxes, NRRA permitted but did not require states to form an interstate compact or otherwise establish procedures to allocate premium taxes paid to a home state.[23] These compacts, if instituted, were intended to help states adopt nationwide uniform requirements, forms, and procedures for reporting, paying, collecting, and allocating premium taxes for multistate risks. To date, only a few states have chosen to participate in an interstate compact. Two compacts exist, but only one was operational as of November 2013. The operational compact, called the Nonadmitted Insurance Multi-State Agreement (NIMA), includes five participating states—Florida, Louisiana, South Dakota, Utah, and Wyoming—and Puerto Rico (fig. 8). The other compact is the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT). It comprises nine states—Alabama, Indiana, Kansas, Kentucky, New Mexico, North Dakota, Rhode Island, Tennessee, and Vermont—but requires 10 states (or 40 percent of surplus lines premiums written), whichever comes first—to take effect. Having not reached the minimum threshold, SLIMPACT is not currently operational.

[23]An interstate compact is a legal agreement between two or more states to act cooperatively to address matters of interest to both states.

Figure 8: Types of Surplus Lines Premium Taxes as of November 2013



Source: GAO analysis of data from National Association of Professional Surplus Lines Offices, Ltd.; Map Resources (map).

Rather than joining an interstate compact, most states have opted to levy (at their own state tax rate) and then retain 100 percent of the premium tax when they are the home state of the insured (see fig. 8). Although data were unavailable to analyze the net effect on taxes of states adopting this approach, representatives from two industry associations we spoke with have expressed support for it because of its simplicity and view it as most consistent with the intent of NRRA.

Market participants, such as surplus lines insurers, and representatives of the industry associations we interviewed said that a state's decision of whether to join a compact depended largely on the amount of revenue involved. One analysis of the tax-sharing effect of NIMA, performed by an association representing surplus lines insurers and brokers, showed that a small amount of tax revenue, roughly $125,000 across the participating states, was eligible for sharing among NIMA's members. The largest states in terms of premium, such as California, New York, and Texas, are currently not members of an interstate compact. Rather, these states tax and retain 100 percent of premium when they are the home state of the insured, as discussed above. Market participants told us it is unlikely these large states would join an interstate compact because they stand to collect more revenue by using their current approach rather than by joining an interstate compact. In addition, states apply a range of tax rates to both single and multistate risks when they are the home state of the insured (see table 9 in app. IV). For example, some states will use the tax rate in their own state, while others will use the applicable tax rate from the respective states where each portion of the multistate risk resides.

In addition, according to NAIC, all states except for Washington are now participating in its national insurance producer database for licensing surplus lines brokers, which NRRA made a prerequisite for collecting fees for licensing an individual or entity as a surplus lines broker.[24] The database contains information on insurance producers' (agents' and brokers') name, address, state of license, and any regulatory actions taken, among other elements. According to NAIC, the database, which is updated daily, links state regulatory licensing systems into a single common system. NAIC officials told us that they are working with Washington on the implementation of the state's surplus lines for both initial licensing and renewals of surplus lines brokers and the state will be participating in the database in December 2013.

[24]States may also participate in any other equivalent uniform national database, for the licensure of surplus lines brokers and the renewal of such licenses.

To Assess Eligibility, Some States Are Making Additional Requests of Nonadmitted Insurers

Section 524 of NRRA establishes nationwide criteria for determining whether insurers are eligible to sell in states where they are not domiciled. In particular, the section discourages states from imposing eligibility requirements on these insurers if they are authorized to write coverage and meet minimum capital and surplus requirements in the insured's home state.[25] However, a range of industry associations we spoke with representing insurers, and insurance agents and brokers, among others, noted that some states were taking actions that they believed were inconsistent with Section 524. For example, the associations said that some states were requesting information—such as business plans, disaster plans, and policy forms—that the associations believe were not relevant to confirming the criteria set forth in Section 524. They said that some states were also asking for fees or other charges that are not specified in Section 524. According to the associations, in some cases, states are applying different standards for single and multistate risks, a particular issue for alien insurers. For example, according to the associations, one state may consider an alien insurer listed on NAIC's *Quarterly Listing of Alien Insurers* as eligible to sell coverage if the covered risk resides in more than one state; however, if the policy is a single state policy, then the same alien insurer must meet state-specific eligibility standards to write the policy. The associations say that these actions place an additional administrative burden on surplus lines insurers and result in a lack of consistency across states, which NRRA was intended to address.

To reduce the requesting of additional information by state insurance regulators, NAIC formed a subgroup that in August 2013 developed options for improving access to financial information by regulators, brokers, and the insured. These options, which received input from the surplus lines industry, include the following:

- NAIC will provide quarterly and annual summaries of insurer financial data (surplus lines total direct premium written and policyholders' surplus) to help states confirm an insurer's financial health,
- states will make greater use of NAIC's automated systems to verify insurer financial data, and
- states will provide a link to NAIC's *Quarterly Listing of Alien Insurers* on their insurance department websites.

[25] Insurers may also meet an equivalent requirement: the greater of $15 million or the minimum capital requirements of the insured's home state.

According to NAIC officials, they will continue to encourage states to implement these suggestions and in 2014, the association may consider a survey to gauge state implementation.

NRRA Appears to Have Had Little, If Any, Effect on Prices and Availability of Coverage

According to surplus lines insurers and brokers and representatives of the industry associations that we contacted, NRRA has had little, if any, effect on the price and availability of coverage in the admitted and surplus lines markets. Market participants noted that the changes under NRRA were intended to streamline and simplify the taxation and regulation of surplus lines insurance, and these changes would not likely affect the price or availability of coverage. Market participants noted that the insurance cycle of soft and hard markets (rising and falling premiums), as discussed in greater detail later, was the primary factor affecting the price and availability of coverage. They added that in their view it would be difficult to determine the precise effect, if any, of NRRA because it generally would be difficult to separate the effects of laws and regulations from the normal functioning of the insurance cycle.

While surplus lines insurers generally write tailored products, according to a market participant, in some instances the insured (individuals or groups covered by an insurance policy) may move from the surplus lines to the admitted market. Insureds may do so because an admitted insurer changed its underwriting and pricing standards to accept risks that it previously did not accept. For example, an admitted insurer that did not cover commercial apartment risks may decide to do so. According to a study of surplus lines insurance, whether this strategy succeeds depends on the admitted insurer's underwriting and pricing expertise and ability to comply with the state's form and rate filing regulations.[26] The study noted that insureds may also migrate from one market to another because of the insurance cycle, a concept noted by many of the market participants that we interviewed. As we have discussed, in a soft market, admitted insurers may lower their acceptability standards, broaden their coverage, and decrease prices to retain customers and attract new ones. In a hard market, by contrast, admitted insurers may raise their acceptability standards, restrict coverage, and raise prices, so insureds may not find the coverage they want in the admitted market and thus move to the surplus lines market.

[26]Flitner and Trupin, *Surplus Lines Insurance Products*, 1.19.

According to market participants, any changes in coverage would be due to the insurance cycle rather than NRRA and there has been little noticeable shifting in coverage between the admitted and surplus lines markets as a result of NRRA.

Agency Comments

We provided a draft report to NAIC for review and comment. NAIC provided technical comments, which we incorporated, as appropriate.

We are sending copies of this report to the appropriate congressional committees. In addition, the report is available at no charge on the GAO website at http://www.gao.gov.

If you have any questions about this report, please contact me at (202) 512-8678 or garciadiazd@gao.gov. Contact points our Offices of Congressional Relations and Public Affairs are listed on the last page of this report. GAO staff who made major contributions to this report are listed in appendix VI.

Daniel Garcia-Diaz
Director, Financial Markets
and Community Investment

Appendix I: Objectives, Scope, and Methodology

The objectives of this report were to (1) describe the size and condition of the surplus lines insurance market and (2) examine actions states have taken to implement the Nonadmitted and Reinsurance Reform Act's (NRRA) provisions and the effects of the act, if any, on the price and availability of surplus lines coverage.

To describe the size and condition of the surplus lines market, we obtained and analyzed, but did not independently verify, end-of-year financial and corporate data, from 2008 through 2013, on 199 surplus lines insurers from the following sources:

- SNL Financial,
- A.M. Best,
- National Association of Professional Surplus Lines Offices (NAPSLO), and
- National Association of Insurance Commissioners (NAIC).[1]

We identified surplus lines insurers as those that NAIC recognized as eligible or approved to sell surplus lines insurance in calendar year 2012 and actually did sell it in that year.[2] Specifically, we examined lists of eligible surplus lines insurers from state department of insurance websites, state surplus lines association websites, and NAIC's website. Several states published lists of insurers that are permitted to write surplus lines coverage in their state. The lists provided various types of information on each insurer but were not consistent in all cases. To address this inconsistency, we cross-checked the lists with insurer profiles from NAIC and SNL Financial and resolved any discrepancies.

[1]SNL Financial is a private financial database that contains publicly filed regulatory and financial reports. A.M. Best is a credit rating organization that serves the insurance industry. NAPSLO is an association that represents surplus lines insurers and brokers. NAIC is a voluntary association of the heads of insurance departments from the 50 states, District of Columbia, and five territories.

[2]Using SNL Financial data, the number of insurers, including risk retention groups, eligible to write surplus lines coverage was 2,858 in calendar year 2008 and declined to 2,756 for calendar year 2012.

We did not include risk retention groups, since the nonadmitted insurer provisions of NRRA specifically omitted these groups.[3]

Using the corporate and financial data described above, we analyzed data on these surplus lines insurers' financial characteristics, such as their premiums written, expense ratios, and capital.[4] We also examined the general focus of their activities, such as whether they are involved in commercial property, commercial general liability, personal lines, or commercial medical malpractice. We used the types of coverage identified in SNL Financial's "designated focus," which identifies the types of coverage or broad categories of business provided by the insurer. Specifically, if a company writes 60 percent or more of its overall P/C premiums in a specific category, it is given a corresponding SNL-designated focus. SNL uses the following methodology to assign a focus to a company: Companies with less than $1 million in net premium written are not given a line of business designated focus. Companies whose reinsurance business is greater than 64 percent (a figure determined by SNL Financial) of their premiums written are classified as reinsurers. Reinsurance companies with more than $1 billion in assets are designated as large reinsurers. All other insurers are designated as having a personal, commercial, or accident and health focus. A company is designated as having a commercial lines focus if it has very diversified operations within the commercial lines. Otherwise, SNL designates a company as focusing on one of the following commercial lines: commercial property (auto, multiperil, fire and allied, and inland and ocean marine), commercial medical malpractice, commercial workers' compensation, commercial financial lines (financial lines such as fidelity,

[3]A risk retention group (RRG) is a group of similar businesses with similar risk exposures, such as educational institutions or building contractors, which create their own insurance company to self-insure their risks on a group basis. The specific definitional requirements for an RRG are set forth in 15 U.S.C. § 3901(a)(4).Our analysis also does not include insurance captives. A captive insurance company is established by a single company or groups of companies that self-insure their own risks.

[4]We use the term "premiums written" to mean "direct premiums written," which is the amount of insurance policy premiums written not including the policies given to reinsurers. Expense ratios measure the level of underwriting and administrative expenses relative to net premiums written. Loss reserve is an insurer's estimate of the value of claims not yet paid or the liabilities for unpaid losses.

surety, and mortgage guaranty), and commercial general liability (other and general liability).

To provide a comparison of the surplus lines market to the admitted market, we drew upon a recent report we issued on the insurance markets and the impacts of and responses to the 2007-2009 financial crisis.[5] This recent report examined, among other things, admitted insurers' investments, underwriting performance, and premium revenues. To assess issues related to data reliability for the current report, we reviewed related documentation, conducted interviews with knowledgeable officials, and reviewed previous related reliability assessments and determined that no material changes had been made in how they collected and tabulated the data. We determined that, for the purpose of describing the size and condition of the surplus lines insurance market, for this review, the data were sufficiently reliable.

To examine actions taken by states to implement NRRA and the effect of the act, if any, on the price and availability of coverage, we reviewed and analyzed the insurance laws of the 50 states and the District of Columbia, focusing on each state's implementation of the "home state" provision of NRRA. We focused on this provision because regulators and market participants consider it to be the key provision of NRRA. To supplement our analysis, we consulted a law firm's law manual on the surplus lines laws in the United States.[6]

In addition, we interviewed staff from NAIC and the Federal Insurance Office within the U.S. Department of the Treasury. We also interviewed officials from two state departments of insurance (Delaware and Illinois), based on these states having a large number of surplus lines insurers domiciled in their state. We interviewed officials from two state surplus line associations (New York and California) for the same reason. Finally, we contacted relevant associations of the insurance industry, including:

- NAPSLO,
- Property Casualty Insurers Association of America,

[5] GAO, *Insurance Markets: Impacts of and Regulatory Response to the 2007-2009 Financial Crisis*, GAO-13-583 (Washington, D.C.: June 27, 2013).

[6] Edward Wildman Palmer LLP, *Excess and Surplus Lines in the United States Including Direct Procurement Laws and Industrial Insured Exemptions*, John P. Dearie, Jr., ed., (New York, NY: Revised January 2013).

- American Insurance Association,
- Council of Insurance Agents and Brokers,
- American Academy of Actuaries, and
- American Association of Managing General Agents.

We selected these associations for interviews because of their role in the surplus lines market; in representing the interests of insurers, underwriters, brokers, and others; or for their expertise. We also interviewed four insurer parent companies, whom we selected based on their large amounts of surplus lines premiums written and having subsidiaries that operate in both the admitted and surplus lines markets. To obtain the perspectives of those who serve as intermediaries between insurers and the insured, we interviewed two large brokers. In addition, we reviewed documents from NAIC including a compendium of state laws on surplus lines, a sample bulletin for states' implementation of NRRA, and records from recent national meetings. We also reviewed related industry reports and analyses of the surplus lines market.

NRRA mandated that we determine and analyze the extent to which there has been a change in the number of individuals who have nonadmitted insurance policies, the type of coverage provided under such policies, and whether such coverage is available in the admitted insurance market. We solicited these data from industry associations, surplus lines insurers, and a large insurance broker, but were told that insurers do not track such information. Representatives of industry associations and a few insurers told us that coverage for individuals represents only a small segment of the market, as the market largely focuses on coverage for businesses. These representatives also said that any change in the number of individuals with coverage before and after NRRA is likely to be small. They added that any change in coverage would be due to the insurance cycle rather than NRRA.

We conducted this performance audit from April 2013 to January 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: National Association of Insurance Commissioner’s Alien Insurers

Section 524 of the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA), as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), says that states may not prohibit a surplus lines broker from placing nonadmitted insurance with, or procuring nonadmitted insurance from, a nonadmitted insurer domiciled outside the United States (also called an alien insurer) that is listed in National Association of Insurance Commissioner’s (NAIC) International Insurers Department (IID) *Quarterly Listing of Alien Insurers*. This publication includes a list of alien insurers that have filed financial statements, copies of auditors’ reports, the name of their U.S. attorneys or other representative, and details of U.S. trust accounts with the NAIC IID and, based upon these documents and other information, appear to fulfill the criteria set forth in the International IID’s *Plan of Operation for Listing of Alien Nonadmitted Insurers*. According to NAIC, the listing provides brokers, exempt commercial purchasers, and insureds with assurance as to the eligibility of non-U.S. insurers with which excess and surplus lines insurance business is being quoted or placed. Alien insurers listed by NAIC must observe applicable state insurance laws and regulations, including those covering trust funds. NAIC cautions brokers that the appearance of an alien insurer’s name on this list is not an endorsement by NAIC.

In order to be considered for inclusion in the NAIC publication, an insurer must demonstrate that it meets IID’s standards on capital and surplus, U.S. trust accounts, and integrity. First, a company must continually maintain enough capital or surplus to meet its obligations. IID set the minimum amount for April 2012 at $30 million and increased it to $45 million as of January 2013. IID also considers the size of the company, the type of business underwritten by the company, and trends in the company’s capital and surplus. Second, the insurer must establish a U.S. trust account in a U.S. financial institution, consisting of cash deposited with the trustee, securities, or an acceptable letter of credit on behalf of U.S. policyholders. IID provides applicants details on the terms and conditions of such accounts. Third, an insurer is to have an established reputation of financial integrity and satisfactory underwriting and claims practices. According to A.M. Best, as of August 2012, 34 states maintained a list of regulated aliens, 11 states used IID’s “white list,” and

12 states used IID's *Quarterly Listing of Alien Insurers* to qualify aliens as surplus lines Insurers.[1]

From January 2010 through April 2013, 72 surplus lines insurers were listed in NAIC's *Quarterly Listing of Alien Insurers* (see table 3). This count combines the over 80 Lloyd's of London syndicates into one entry. Also over this time, several companies were added to the list while others were dropped, and some companies changed their name.

Table 3: Surplus Lines Insurers Listed in NAIC's *Quarterly Listing of Alien Insurers*, January 2010 through April 2013

Alien ID#	Insurer	Country
AA-1120810	ACE European Group Limited	England
AA-2730007	ACE Seguros, S.A.	Mexico
AA-1120841	AIG Europe Limited (Chartis Europe Limited in 2012)	England
AA-1120146	Alea London Limited	England
AA-1320065	Allianz Global Corporate & Specialty (France)	France
AA-1344102	Allianz Global Corporate & Specialty AG	Germany
AA-1780094	Alterra Europe plc	
AA-1780074	AmTrust International Underwriters, Ltd.	Ireland
AA-1120053	Arch Insurance Company (Europe) Limited	England
AA-3190873	Ariel Reinsurance Company, Ltd.	Bermuda
AA-1120337	Aspen Insurance UK Limited a/k/a Aspen Re	England
AA-3190004	Associated Electric & Gas Insurance Services Ltd (AEGIS)	Bermuda
AA-1420113	Assuranceforeningen SKULD (Gjensidig) a/k/a SKULD P&I Club	Norway
AA-1120375	Aviva International Insurance Limited	England
AA-1320012	AXA Corporate Solutions Assurance	France
AA-1784130	AXIS Specialty Europe Public Limited Company, AKA AXIS Specialty Europe SE, AKA AXIS Specialty Europe Limited	Ireland
AA-1120030	Berkshire Hathaway International Insurance Limited	England
AA-1120007	Britannia Steam Ship Insurance Association Limited, The	England
AA-1120290	British Aviation Insurance Company Limited, The	England
AA-1120146	Catalina London Limited	England
AA-1120049	Catlin Insurance Company (UK) Limited	England
AA-1121106	CNA Insurance Company Limited	England

[1]A white list is a list of the unauthorized insurers approved by a state to sell a surplus lines insurance policy.

Alien ID#	Insurer	Country
AA-1560210	Commonwealth Insurance Company	Canada
AA-3194130	Endurance Specialty Insurance Ltd	Bermuda
AA-3160013	Energy Insurance Mutual Limited	
AA-3194231	Gard Marine & Energy Limited	Bermuda
AA-3191188	Gard P.&I. (Bermuda) Ltd.	Bermuda
AA-1360015	GENERALI, Assicurazioni Generali, S.p.A. a/k/a Assicurazioni Generali Di Trieste a/k/a Assicurazioni Generali Di Trieste E Venezia	Italy
AA-3190600	Glencoe Insurance Ltd.	Bermuda
AA-1120697	Great Lakes Reinsurance (UK) PLC	England
AA-1120757	Heddington Insurance (U.K) Limited	England
AA-1460013	Infrassure Ltd.	Switzerland
AA-1120822	International Insurance Company of Hannover Limited	England
AA-1780104	Ironshore Europe Limited	Ireland
AA-3190917	Ironshore Insurance Ltd.	Bermuda
AA-1120066	Lancashire Insurance Company (UK) Limited	England
AA-3190871	Lancashire Insurance Company Limited	Bermuda
AA-3194157	Lantana Insurance Ltd.	Bermuda
AA-1120855	Liberty Mutual Insurance Europe Limited	England
	Lloyd's Syndicates (various)	England
AA-1120887	London & Edinburgh Insurance Company Limited	England
AA-1844116	Mapfre Global Risks, Compañia Internacional de Seguros y Reaseguros, S.A.	Spain
AA-1121276	Marine Insurance Company Limited, The	England
AA-1121425	Markel International Insurance Company Limited	England
AA-1121410	Mitsui Sumitomo Insurance Company (Europe) Limited	England
AA-1580085	Mitsui Sumitomo Insurance Company Limited	
AA-3194129	Montpelier Reinsurance Ltd.	Bermuda
AA-3194201	Newbury Insurance Company Limited	Bermuda
AA-1120006	North of England Protecting and Indemnity Association Limited, The	England
AA-1560210	Northbridge Indemnity Insurance Corporation	Canada
AA-1420012	Norwegian Hull Club	Norway
AA-1120377	Ocean Marine Insurance Company Limited, The	England
AA-1780096	PartnerRe Ireland Insurance Limited	Ireland
AA-1120481	QBE Insurance (Europe) Limited	England
AA-1120465	RiverStone Insurance (UK) Limited	England
AA-1120019	SCOR UK Company Limited	England
AA-1371003	Shipowners' Mutual Protection and Indemnity Association	Luxembourg
AA-1440076	Sirius International Insurance Corporation	Sweden

Alien ID#	Insurer	Country
AA-1121372	Standard Club Europe Ltd., The	
AA-1125000	Sunderland Marine Mutual Insurance Company Limited	England
AA-1121405	Swiss Re International SE	Luxembourg
AA-1120512	Swiss Re Specialty Insurance (UK) Limited	England
AA-3191044	Through Transport Mutual Insurance Association Limited	Bermuda
AA-1121445	Tokio Marine Europe Insurance Limited	England
AA-1120093	Torus Insurance (UK) Limited	England
AA-1124127	TT Club Mutual Insurance Limited	England
AA-1121480	Unionamerica Insurance Company Limited	England
AA-3191146	United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited, The a/k/a UK P&I Club	Bermuda
AA-1120138	United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited, The a/k/a UK P&I Club	England
AA-1124141	W. R. Berkley Insurance (Europe) Limited	England
AA-3194197	Wind River Reinsurance Company, Ltd.	Bermuda
AA-1120001	Zurich Specialties London Limited	England

Source: GAO analysis of NAIC data.

Note: This table combines numerous Lloyd's syndicates into one entry. Also, several companies were added, others were dropped, and still others changed names over this period. Where no country is listed, none was stated.

The NAIC-listed alien insurers are domiciled in several countries, but half of them were domiciled in England (see table 4). Another 14 were domiciled in Bermuda. The rest are domiciled in other countries, most of which are western European countries.

Table 4: Home Countries of NAIC-Approved Alien Insurers

Country	Number of alien insurers domiciled in country
England	36
Bermuda	14
Not stated	4
Ireland	4
Norway	2
Canada	2
France	2
Luxembourg	2
Sweden	1
Mexico	1
Switzerland	1
Germany	1
Spain	1
Italy	1
Total	**72**

Source: GAO analysis of NAIC data.

Note: This table combines numerous Lloyd's syndicates into one entry. Also, several companies were added, others were dropped, and still others changed names over this period.

Appendix III: Surplus Lines Insurers' Premiums Written and Investments

Table 5 shows that the largest surplus lines insurers write most of their premiums in the surplus lines market, while smaller surplus lines insurers write most of their premiums in the admitted market.[1]

Table 5: Premiums Written by Top 25 Foreign Surplus Lines Insurers, 2012

Dollars in thousands

	Premiums Written, 2012		
Surplus lines insurer	**Surplus lines**	**Total**	**Surplus lines premiums written as a percentage of total premiums written, 2012**
Lexington Ins. Co.	$4,231,217	$4,285,132	99%
Scottsdale Ins. Co.	1,253,252	1,270,469	99
Steadfast Insurance Co.	1,024,415	1,058,976	97
QBE Specialty Ins Co.	1,020,691	1,021,678	100
Chartis Specialty Ins Co.	810,365	809,854	100
Columbia Casualty Co.	777,851	782,097	100
Ironshore Specialty Ins Co.	665,099	708,699	94
Landmark American Ins. Co.	588,326	589,564	100
Nautilus Ins. Co.	487,032	489,903	99
AXIS Surplus Ins Co.	475,797	477,636	100
Indian Harbor Ins. Co.	455,130	455,768	100
Westchester Surplus Lines Ins Co.	452,322	454,599	100
Arch Specialty Ins. Co.	447,491	449,992	99
Illinois Union Ins. Co.	437,740	448,009	98
Evanston Ins. Co.	407,517	410,492	99
Colony Ins. Co.	404,675	404,898	100
First Mercury Ins. Co.	376,027	376,250	100
Essex Ins. Co.	371,637	371,709	100
Chubb Custom Ins. Co.	361,809	361,796	100
Liberty Surplus Ins. Corp.	353,284	355,862	99
Houston Casualty Co.	319,267	384,955	83
Admiral Ins Co.	305,896	306,031	100
Catlin Specialty Ins Co.	300,122	326,138	92

[1]We use the term "premiums written" to mean "direct premiums written," which is the amount of insurance policy premiums written not including the policies given to reinsurers.

Dollars in thousands

Surplus lines insurer	Premiums Written, 2012 Surplus lines	Total	Surplus lines premiums written as a percentage of total premiums written, 2012
Gemini Ins. Co.	280,117	280,308	100
Aspen Specialty Ins Co.	250,265	250,265	100
Total top 25 foreign surplus lines Insurers	**$16,857,343**	**$17,131,080**	**98.4%**
Total rest of foreign surplus lines insurers	**$8,350,492**	**$21,498,941**	**38.9%**
Total all foreign surplus line Insurers	**$25,207,836**	**$38,630,021**	**65.3%**

Source: GAO analysis of SNL Financial data.

Table 6 provides detail on the surplus lines premiums written from 2008 through 2012 by the top 25 surplus lines carriers in each of those years. The carriers are listed in order of descending surplus lines premiums written for 2012.

Table 6: Premiums Written by Lloyd's of London, the Top 25 Foreign Surplus Lines Insurers, and All Foreign Surplus Lines Insurers, 2008–2012

Dollars in thousands

	Surplus lines premiums written					
Surplus lines Insurer	**2008**	**2009**	**2010**	**2011**	**2012**	**Percentage change in surplus lines premiums written, 2008-2012**
Lloyd's of London	$6,062,359	$6,090,703	$5,789,151	$5,790,116	$6,269,517	3.42%
Lexington Ins. Co.	5,962,889	5,336,832	4,549,242	4,533,088	4,231,217	-29.0
Scottsdale Ins. Co.	1,074,324	1,030,400	1,004,024	1,086,995	1,253,252	16.7
Steadfast Insurance Co.	1,178,955	1,090,154	1,047,976	923,629	1,024,415	-13.1
QBE Specialty Ins Co.	150,378[a]	527,256	607,943	583,141	1,020,691	578.8
Chartis Specialty Ins Co.	1,198,963	788,229	783,893	798,444	810,365	-32.4
Columbia Casualty Co.	730,788	726,922	712,595	746,582	777,851	6.4
Ironshore Specialty Ins Co.	43,694[a]	312,095	512,587	601,266	665,099	1422.2
Landmark American Ins. Co.	587,463	569,963	508,418	531,960	588,326	0.1
Nautilus Ins. Co.	378,438	347,142	368,126	430,531	487,032	28.7
AXIS Surplus Ins Co.	538,252	512,046	501,762	463,840	475,797	-11.6
Indian Harbor Ins. Co.	403,603	357,412	333,705	349,972	455,130	12.8
Westchester Surplus Lines Ins Co.	516,845	454,912	412,548	407,986	452,322	-12.5
Arch Specialty Ins. Co.	466,162	441,551	402,245	411,999	447,491	-4.0
Illinois Union Ins. Co.	530,151	437,271	522,226	462,207	437,740	-17.4
Evanston Ins. Co.	613,577	517,929	468,112	408,230	407,517	-33.6

Dollars in thousands

	Surplus lines premiums written					Percentage change in surplus lines premiums written, 2008-2012
Surplus lines Insurer	**2008**	**2009**	**2010**	**2011**	**2012**	
Colony Ins. Co.	517,559	450,667	359,622	366,563	404,675	-21.8
First Mercury Ins. Co.	296,663	292,130	297,922	290,196	376,027	26.8
Essex Ins. Co.	359,132	285,305	293,257	320,938	371,637	3.5
Chubb Custom Ins. Co.	328,504	284,302	285,093	333,530	361,809	10.1
Liberty Surplus Ins. Corp.	217,382	209,126[a]	197,968[a]	275,117	353,284	62.5
Houston Casualty Co.	341,275	343,686	299,224	304,132	319,267	-6.4
Catlin Specialty Ins Co.	119,219[a]	187,227[a]	228,069	261,461	305,896	156.6
Admiral Ins Co.	413,608	331,104	282,416	284,168	300,122	-27.4
Gemini Ins. Co.	137,834[a]	134,540[a]	153,191[a]	230,991[a]	280,117	103.2
Aspen Specialty Ins Co.	1,655[a]	75,966[a]	157,904[a]	185,000[a]	250,265	15021.8
Alterra Excess & Surplus Ins Co.	181,176[a]	247,438	271,358	280,114	244,683[a]	35.1
Endurance American Specialty Ins Co.	187,048[a]	256,903	245,349	274,907	243,450[a]	30.2
Mt. Hawley Ins. Co.	313,365	251,065	226,937	212,272[a]	238,816[a]	-23.8
Empire Indemnity Ins. Co.	361,802	278,201	166,257[a]	136,151[a]	145,033[a]	-59.9
National Fire & Marine Ins. Co.	339,359	196,377[a]	127,113[a]	117,826[a]	127,742[a]	-62.4
Interstate Fire & Casualty Co.	331,045	246,106[a]	199,932[a]	181,072[a]	193,259[a]	-41.6
St. Paul Surplus Lines Ins. Co.	200,420	171,410[a]	154,436	67,989[a]	43,610[a]	-78.2
Total top 25 surplus lines insurers	**$18,200,527**	**$16,470,914**	**$15,524,649**	**$15,730,996**	**$16,857,343**	
Total all foreign surplus lines insurers	**$24,817,210**	**$23,080,805**	**$22,179,937**	**$22,912,788**	**$25,207,828**	

Source: GAO analysis of data from SNL Financial and Lloyd's of London.

[a]Not in top 25 surplus lines insurers by surplus line direct premiums written for that year.

Surplus lines premiums are concentrated in a few states (see table 7). About half of the surplus lines premiums are written in 4 states, and just under two-thirds of the premiums are written in 10 states. From 2010-2012, the 10 states with the most surplus lines premiums written in their states accounted for 62.8 percent, 63.3 percent, and 63.6 percent of the total premiums in 2010, 2011, and 2012, respectively.

Table 7: 10 States with the Largest Surplus Lines Premiums Written, 2010–2012

	Surplus lines premiums written in that state					
State	**2010**	**Rank**	**2011**	**Rank**	**2012**	**Rank**
California	$3,491,917,586	1	$3,548,577,214	1	$3,678,599,211	1
Florida	2,765,750,810	2	2,811,918,708	2	3,238,089,541	2
Texas	2,590,673,889	3	2,562,329,113	3	2,954,822,770	3
New York	1,644,281,742	4	1,658,896,733	4	1,897,085,405	4
Louisiana	929,742,945	5	917,166,358	6	965,426,258	6
Illinois	819,384,135	6	1,008,262,633	5	926,849,208	5
New Jersey	721,252,997	7	782,621,215	7	870,724,730	7
Pennsylvania	665,079,633	8	686,224,140	8	762,469,481	8
North Carolina	372,020,511	14	421,311,245	13	562,837,972	9
Georgia	470,564,662	10	514,675,060	10	555,913,202	10
Total top 10 states	$16,412,817,778		$14,982,830,528		$14,607,883,341	
Total all states	**$25,239,342,055**		**$22,884,248,654**		**$22,229,898,568**	

Source: GAO analysis of National Association of Insurance Commissioners data.

Note: "All states" includes the District of Columbia, Puerto Rico, U.S. Virgin Islands, Guam, American Samoa, and the Northern Mariana Islands.

From 2008 through 2012, the 199 SL insurers that we examined had cash and invested assets from $152.7 billion to $233.1 billion, respectively, in several asset classes, and are mostly invested in bonds. An increasing percentage was invested in industrial bonds and decreasing percentages in government and other bonds. These insurers also invested somewhat heavily in cash and other short-term investments, but less so than in 2008. They have also tended to increase their investments in common stock, but that amount remains under 7 percent of total cash and investments (see table 8).

Table 8: Surplus Lines Insurers' Investments, 2008–2012

Dollars in thousands

	2008	2009	2010	2011	2012
Total cash and investments	$152,656,888	$173,420,057	$211,242,459	$214,953,998	$233,088,686
Bonds	77.0%	79.9%	79.4%	77.8%	77.7%
U.S. Government bonds	28.3	28.2	28.5	26.5	25.9
Special revenue bonds	26.4	25.7	26.2	26.6	26.3
Industrial bonds	28.4	32.0	32.0	32.9	34.2
Other bonds[a]	16.9	14.1	13.2	13.9	13.6
Preferred stock[b]	0.8	0.9	0.9	0.9	0.9
Common stock[c]	3.9	4.1	4.9	5.8	6.6
Mortgage loans	0.0	0.0	0.0	0.0	0.1
Real estate	0.1	0.1	0.1	0.2	0.2
Contract loans	0.0	0.0	0.0	0.0	0.0
Cash & short term investments	17.3	14.1	13.6	14.5	13.5
Other investments	0.9	0.8	1.0	0.8	0.9

Source: GAO analysis of SNL Financial data.

[a]Other bonds includes foreign government bonds; states, territories, and possessions bonds; political subdivisions bonds; public utilities bonds; credit tenant loans; and affiliated bonds.

[b]Preferred stocks are equities with a class of ownership in a corporation, where preferred stockholders have a higher claim on the assets and earnings than do common shareholders. Preferred stock generally has a dividend that must be paid out before dividends to common stockholders and the shares usually do not have voting rights.

[c]Common stock is a security representing equity ownership of a company's assets. Voting rights are normally accorded to holders of common stock.

Appendix IV: States' Premium Tax Rates on Surplus Lines Sales

Table 9: States' Premium Tax Rates on Single State and MultiState Transactions

State	Member of interstate compact	Tax rate (when state is insured's home state)	
		Single state risks (percent)	Multistate risks (percent)
Alabama	SLIMPACT	6%	6%[a]
Alaska	no	2.7[e]	2.7
Arizona	no	3	3
Arkansas	no	4	4
California	no	3	3
Colorado	no	3	3[b]
Connecticut	no	4	4
Delaware	no	2	2
District of Columbia	no	2	2
Florida	NIMA	5[e]	5[b,c]
Georgia	no	4	4
Hawaii	no	4.68	[d]
Idaho	no	1.5	1.5
Illinois	no	3.5	3.5
Indiana	SLIMPACT	2.5	2.5[a]
Iowa	no	1	1
Kansas	SLIMPACT	6	[a,d]
Kentucky	SLIMPACT	3	3[a]
Louisiana	NIMA	5	5[b,c]
Maine	no	3	3
Maryland	no	3	3
Massachusetts	no	4	[d]
Michigan	no	2[e]	2.5
Minnesota	no	3	3
Mississippi	no	4	4
Missouri	no	5	5
Montana	no	2.75	2.75
Nebraska	no	3[e]	[d]
Nevada	no	3.5	3.5
New Hampshire	no	3	[d]
New Jersey	no	5	5
New Mexico	SLIMPACT	3.003	3.003[a]
New York	no	3.6	3.6

State	Member of interstate compact	Tax rate (when state is insured's home state) Single state risks (percent)	Multistate risks (percent)
N. Carolina	no	5	5
N. Dakota	SLIMPACT	1.75	[a,d]
Ohio	no	5	5
Oklahoma	no	6	6
Oregon	no	2.3	2.3
Pennsylvania	no	3	3
Puerto Rico	NIMA	9	9[b,c]
Rhode Island	SLIMPACT	4	4
S. Carolina	no	4[e]	6[b]
S. Dakota	NIMA	2.5[e]	2.5[b,c,d]
Tennessee	SLIMPACT	5	5[a]
Texas	no	4.85	4.85
Utah	NIMA	4.25	4.25[b,c]
Vermont	SLIMPACT	3	[a,b]
Virgin Islands	no	5	No provision
Virginia	no	2.25[e]	2.25
Washington	no	2	2
W. Virginia	no	4[e]	4.55
Wisconsin	no	3	3
Wyoming	NIMA	3	3[b,c]

Source: GAO analysis of National Association of Insurance Commissioners data.

Note: NIMA, the Nonadmitted Insurance Multi-State Agreement, is an interstate agreement that states may enter to report, collect, and distribute surplus lines taxes according to a uniform risk allocation formula in a manner intended to be consistent with NRRA. SLIMPACT, the Surplus Lines Insurance Multi-State Compliance Compact, is an alternative interstate compact that according to the Council of State Governments is also intended to implement the intent of NRRA, streamline surplus lines taxation and regulation, and reform insurance regulation.

[a]Rate may change if SLIMPACT becomes operational. Kentucky plans to implement an 11.8 percent rate if SLIMPACT becomes operational.

[b]Portion of surplus lines premiums representing risk and exposures in the state at the percentage stated.

[c]Portions allocated to other NIMA states will be taxed at a rate in state where risk is located and shared by agreement. In Florida, portions allocated to non-NIMA states are taxed and retained at a rate in state where risk is located. Portions allocated to non-NIMA states are not taxed by Louisiana. Portions allocated to non-NIMA states are taxed and retained at 9 percent (or 15 percent for independently procured coverage) by Puerto Rico. Portions allocated to non-NIMA states are taxed and retained by S. Dakota at 2.5 percent plus applicable fire tax. Portions allocated to non-NIMA states are not taxed by Utah. Portions allocated to non-NIMA states are taxed and retained at 3 percent in Wyoming.

[d]Tax rate of state where risk is located.

[e]In Alaska, add a 1 percent filing fee. In Florida add a 0.3 percent service fee. In Michigan, add a 0.5 percent regulatory fee. In Nebraska (percent not stated) and S. Dakota (0.5 percent) fire taxes apply. In S. Carolina, a 2 percent municipal tax may apply. In Virginia, a 0.1 percent assessment for Virginia Bureau of Insurance may apply. In W. Virginia, add a 0.55 percent surcharge.

Appendix V: Premiums Written of Parent Companies of Foreign Surplus Lines Insurers

The potential for business to shift between admitted and surplus lines insurance companies owned by a given parent company depends in part on the extent to which that parent's subsidiaries offer the same coverages on both an admitted and surplus lines basis, and in the same markets. While we could not determine if the admitted and surplus lines insurance subsidiaries owned by the parent companies listed in table 10 sold the same coverages or in the same markets, we did examine whether there was a change in the proportion of a parent's subsidiaries business that was done in the surplus lines market. We also examined the surplus lines companies whose parents did not have other property and casualty (P/C) subsidiaries.

Table 10: Total Admitted and Surplus Lines Premiums Written by Subsidiaries of Top 25 Parent Companies That Have a National Association of Insurance Commission-Listed Foreign Surplus Line Subsidiary, by 2012 Surplus Line Premiums Written, 2008 and 2012

Dollars in thousands

	Premiums Written				
SNL P/C group	Total surplus lines, 2008	Surplus lines as a percentage of total, 2008	Total, 2012	Total surplus lines, 2012	Surplus lines as a percentage of total, 2012
American International Group	$7,230,679	25.1%	$23,596,418	$5,041,939	21.4%
Nationwide Mutual Group	1,243,219	7.3	17,042,933	1,414,690	8.3
Zurich Insurance Group Ltd.	1,545,248	13.0	10,577,401	1,175,583	11.1
W. R. Berkley Corp.	951,547	26.5	4,028,480	1,113,018	27.6
Markel Corp.	1,185,201	64.0	2,073,810	1,064,527	51.3
QBE Insurance Group Ltd.	150,401	3.4	5,590,843	1,020,691	18.3
ACE Ltd.	1,046,996	12.2	9,277,091	890,062	9.6
CNA Financial Corp.	730,788	8.8	8,510,763	777,851	9.1
Ironshore Inc.	44,053	64.6	846,584	673,699	79.6
Alleghany Corp.	657,429	49.6	1,231,441	656,743	53.3
Fairfax Financial Holdings	578,481	22.6	2,854,235	650,596	22.8
AXIS Capital Holdings Ltd.	582,144	52.4	1,284,189	475,797	37.1
XL Group plc	406,141	13.4	2,474,034	455,897	18.4
Arch Capital Group Ltd.	468,017	26.1	1,890,693	447,491	23.7
Allied World Assurance Co.	341,717	65.8	990,115	426,742	43.1
Chubb Corp.	377,870	3.8	9,691,654	426,000	4.4
Argo Group International	614,361	51.7	934,866	409,909	43.8
Berkshire Hathaway Inc.	741,634	4.4	20,236,495	404,636	2.0
Liberty Mutual	256,009	1.0	28,297,511	353,284	1.2
HCC Insurance Holdings Inc.	362,818	31.3	1,138,794	335,056	29.4

Dollars in thousands

SNL P/C group	Premiums Written Total surplus lines, 2008	Surplus lines as a percentage of total, 2008	Total, 2012	Total surplus lines, 2012	Surplus lines as a percentage of total, 2012
Assurant Inc.	301,807	7.8	4,290,979	319,343	7.4
American Financial Group Inc.	247,773	5.8	4,015,280	314,165	7.8
Catlin Group Ltd	119,219	83.4	579,682	305,896	52.8
Munich-American Holding Corp.	340,405	18.4	2,170,996	303,142	14.0
Travelers Companies Inc.	445,366	2.0	22,695,958	285,008	1.3
Total, for all 93 SNL P&C Groups (average for percentages)	**$24,918,350**	**22.3%**	**$283,446,660**	**$24,945,357**	**22.4%**
Total for 11 surplus lines companies not in a SNL P&C Group (average for percentages)	**$114,163**	**46.4%**	**$402,885**	**$261,495**	**51.3%**

Source: GAO analysis of SNL data.

Note: By parent we mean SNL's P&C Group level, which excludes non-P&C subsidiaries.

As shown in table 10, SNL Financial, Inc. (SNL) P/C Groups (a proxy for parents, including only P/C insurers) with surplus lines insurer subsidiaries tend to have admitted subsidiaries whose premiums written exceed that of the surplus lines subsidiaries, often by a large percentage.[1] Of the 25 companies with the highest premiums written in 2012, 4 had over half of their premiums provided by their surplus lines business lines, and of those, 1 (Ironshore, Inc.) had a significant portion of its premiums (79.6 percent) provided by these business lines. American International Group, Inc., the largest surplus lines provider as measured by 2012 surplus lines premiums written, wrote $5 billion in surplus lines premiums in 2012, but that was 21.4 percent of its total premiums written. It shows that surplus lines insurers whose parents have no P/C subsidiaries wrote 51.3 percent of their total premiums written in the surplus lines business lines in 2012, which was more than double the 22.4 percent for parents with P/C subsidiaries (see table 10).

[1]We use the term "premiums written" to mean "direct premiums written," which is the number of insurance policy premiums written not including the policies given to reinsurers.

Appendix VI: GAO Contact and Staff Acknowledgments

GAO Contact

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Staff Acknowledgments

In addition to the contact named above, Patrick Ward (Assistant Director), Emily Chalmers, Pamela Davidson, John Forrester, Ronald Ito, Marc Molino, and Jessica Sandler made important contributions to this report.

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