

A Message from the Chairman

by William P. Teich, CPCU



■ **William P. Teich, CPCU**, is claim director for Horizon Management, a division of Hartford Financial Services, specializing in run-off claim management. He manages its assumed business and a surplus lines claim unit, leading teams in Hartford, Boston, and London. Teich entered the insurance industry in 1986, and has been with Hartford for his entire career. He has experience in direct, ceded, and assumed claims.

This is my second opportunity to write to you through our section newsletter *The Specialist* and luckily the timing is just following our Annual Meeting and Seminars in Los Angeles, which was a great success. The E/S/SL Section received the Bronze Award for the Circle of Excellence Recognition Program and we will be shooting for Silver, or better yet the Gold, for 2005. Our section's committee held its annual meeting and has laid out a plan that we believe will bring value to our membership. Although last year's meeting is over, we have our upcoming mid-year meeting in Phoenix in April and our Annual Meeting in Atlanta in October 2005, and our committee offers a warm welcome to

anyone that would like to participate. We are also interested in new members for our committee, so if you are interested please send me an e-mail at william.teich@thehartford.com.

We have some recent changes to our section committee. I would like to welcome **Priscilla L. Carroll, CPCU**, as co-editor of our newsletter with **W. Wesley Carroll, CPCU**. They did a great job with their first two publications and are always interested in ideas for articles as well as content for the newsletter. You can reach Wes and Priscilla at wcarroll@wes-carroll.com. I would also like to welcome **Jim Roe, CPCU**, president of Arlington/Roe & Company, to our section committee. Jim participated in our Annual Meeting and was extremely helpful in assisting the section committee in establishing our plan for 2005.

So what is on the agenda for 2005?

- Following our e-mail outreach program earlier this year to our membership, we heard that our section wants a closer relationship with other surplus lines organizations such as NAPSLO, PLUS, and AAMGA. As a result, we are working more closely with these groups to explore joint educational programs at their mid-year and annual meetings as well as at the CPCU Society's Annual Meeting and Seminars. We will keep you posted on our development and welcome any volunteers to help us with this important initiative.
- We are producing a seminar at this year's Annual Meeting and Seminars in Atlanta entitled "The Impact of SMART Act Legislation." This program is both timely and relevant to our section as well the Society membership as a whole. We will

be providing more details on the seminar in upcoming additions of our newsletter and on our web site. Please let me know if you have an interest in becoming involved for the 2005 Annual Meeting and Seminars or have additional ideas for new programs.

- We are continuing to develop our web site. If you have specific content or links that you find useful, or an interest in helping support and develop our web site, we would appreciate your contacting **Lynn D. Goodwin, CPCU, CIC**, at lgoodwin@ipsico.com.
- We continue to develop a turnkey program on the nature and purpose of the surplus lines market. We have a draft work product that we are working on and would welcome additional participants in this process. If you are interested, please contact **Elizabeth B. Buschemeyer, CPCU**, at bettyb72@msn.com.

In closing, thank you for your continued support of the E/S/SL Section. I look forward to our section's continued growth and to adding greater value to our section membership for 2005. ■

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Stamping Office Statistics

by Phil Ballinger, CPCU, ASLI

Editor's Note: The author of this article is Phil Ballinger, CPCU, ASLI, who is general manager of the Surplus Lines Stamping Office of Texas. He told us the following when he sent the statistical information:

"Every six months I poll my fellow stamping office managers to identify surplus lines trends in their states. I thought you might be interested in this data, as it is the closest to a "real-time" market measure I know of. The attached spreadsheet compares data from the first half of 2004 with the same period last year. The 15 stamping offices process surplus lines premium representing approximately 60 percent of total U.S. surplus lines premium." ■

	2004 Rates		6 Mos. Premium (mill.)				6 Mos. Items			First Half 2004/2003 Comparative Statistics
State	St. Fee	SL Tax	2004	2003	% Chg		2004	2003	% Chg	
AZ	0.25%	3.00%	\$226.3	\$173.7	30.3%		20,647	17,800	16.0%	New stamping fee rate effective July 1, 2004
CA	0.225%	3.00%	\$2,689.1	\$2,377.1	13.1%		214,353	179,737	19.3%	New stamping fee rate effective January 1, 2004
CO	0.10%	3.00%	\$238.2	\$220.3	8.1%		23,740	17,164	38.3%	New stamping fee rate effective January 1, 2004
FL	0.25%	5.00%	\$1,511.4	\$1,402.7	7.8%		587,478	661,959	-11.3%	New service fee rate effective April 1, 2004
ID	0.50%	2.75%	\$32.7	\$25.7	27.2%		5,964	5,227	14.1%	
IL	0.30%	3.50%	\$536.7	\$412.1	30.2%		55,979	43,247	29.4%	
MS	0.25%	4.00%	\$131.8	\$119.1	10.7%		23,501	32,217	-27.1%	
MT	1.00%	2.75%	\$20.9	\$17.7	18.1%		4,597	4,100	12.1%	
NV	0.50%	3.50%	\$182.4	\$99.8	82.8%		10,959	7,904	38.7%	Fee subject to \$25 minimum per item; no fee on endorsements
NY	0.30%	3.60%	\$1,503.6	\$1,187.1	26.7%		91,746	75,201	22.0%	New stamp. fee rate effective July 1, 2004; certain add'l fees apply
OR	0.35%	2.00%	\$110.7	\$111.0	-0.3%		14,598	15,134	-3.5%	Certain minimum fees apply for return premiums, etc.
PA	\$15.00	3.00%	\$363.7	\$353.6	2.9%		45,511	52,317	-13.0%	Flat stamping fee of \$15 per original filing
TX	0.10%	4.85%	\$1,674.0	\$1,352.2	23.8%		511,870	441,527	15.9%	
UT	0.25%	4.25%	\$75.9	\$60.5	25.5%		6,805	4,279	59.0%	
WA	0.40%	2.00%	\$342.0	\$309.3	10.6%		51,278	50,056	2.4%	
TOTAL			\$9,639.4	\$8,221.9	17.2%		1,669,026	1,607,869	3.8%	

Gross premium reported in NY.

Items include non-money filings in IL, NV, & TX.

TX data for 2004 excludes \$160.0 million in "other state" & \$93.5 million in "tax exempt" premium.

Data includes the following in 2004 IP insurance: CO - \$14.8 million

FL - \$200.7 million/4,048 policies

Prepared by the Surplus Lines Stamping Office of Texas

Trimming a Surplus

by Jack Roberts

Editor's Note: This article originally appeared in the January 2005 issue of *Risk & Insurance* and is reprinted here with permission.

Only companies with sound balance sheets can absorb the kinds of claims that result from unexpected losses, and that's going to mean consolidation in the not-too-distant future, says Kevin H. Kelley, CEO of Lexington Insurance Co., the world's largest excess and surplus carrier. Risk & Insurance interviewed Kelley in his Boston office.



■ Kevin H. Kelley, CEO of Lexington Insurance Co.

What is your assessment for the markets in terms of capacity and pricing, and where do you see the business going in 2005?

I'd say '05 is still pretty much undetermined. What we're seeing in the property side is a market that is in transition. Rates are continuing to move down in the fourth quarter but not by as much as they were dropping earlier in the year. I think that is a result of several things. One, the hurricanes that we had in the third quarter, and two, as a result of that, the catastrophe costs that are bound to go up for the property insurers. In addition to that, I think there continues to be a lot of uncertainty around the renewal of the Terrorism Risk Insurance Act and what that might do to geopolitical risk.

I was going to ask you about TRIA in terms of what you think will happen, and how that may play out in the markets as far as you're concerned?

I think it's a tough read on whether it's going to be renewed or not. I think that right now the insurance industry is not particularly popular in Washington and obviously customers of insurers are always much more popular. Given the recent issues that the industry's facing right now, I think TRIA renewal might be problematic. What we are noticing is an increase in the take-up rate at which policyholders are buying terrorism coverage, and so I think there's increased concern by the general policyholder about geopolitical risk.

You offer a product in that market that doesn't depend on TRIA. Does that give you any indication of how buyers are reacting to the TRIA program itself?

The people that buy our products are pretty unique in several ways in that they tend to have very large values. They tend to have mortgages on those properties and the lenders to that policyholder generally insist on some coverage.

One of the biggest interest groups that helped pass TRIA the last time was real estate groups where coverage is critical and essential to them, but they seem to have found a way to survive regardless of what has happened.

A lot of our policyholders are those real estate firms so they are buying coverage that is different than what TRIA would offer, and buying it from a commercial marketplace.

Do you think there's any chance that a federal regulatory proposal may pass in Congress, and how, if it were passed, would that have any impact on the excess markets?

The surplus lines industry is pretty much there because of the way insurance is regulated by the states. The fact that you have 50 different regulators of insurance creates the environment for a surplus lines company to be in the marketplace. It may have an impact on the surplus lines business, but I think the surplus lines industry has evolved well beyond where it was 50 years ago when it was really in its infancy.

The Bush Administration has been making noise about workers comp and health care reform. What do you think that would do to the excess and surplus market?

I think it all depends on what you pass. We've been a major advocate of the President's position regarding health care liability and malpractice reform. It is very, very clear, if you take a look at California, which has had a cap on noneconomic damage for a period of time, that the results there are very different versus the states where such a cap does not exist. The number-one recommendation is to impose a cap of some kind on noneconomic damages, and to do it in a way that would stand up to a constitutional test. Texas has done that. That gives underwriters some certainty in an environment that still has a ton of uncertainty associated with it because, as we all know, medication inflation is a big driver of tort liability costs.

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Trimming a Surplus

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How would you characterize the markets these days in terms of excess issues? Is it healthy?

If you believe in the underlying motto that you have to expect the unexpected, and the unexpected today results in big claims, then you must have a balance sheet that allows you to sustain that kind of catastrophe. Therefore, one would believe that you'd be seeing much more consolidation in the business than you are currently seeing. I believe that is only temporary. Intermediate-term I believe you'll see more consolidation in the surplus lines, specialty marketplace once balance sheets of companies have strengthened. Probably as a follow up to that point, what amazes me is how limits are determined, from a buyer's perspective, and how frequently they don't change in an environment that has substantially changed. That's what I really see occurring. I see a realization on the part of buyers that capacity demand is going to increase and that I see the market responding to meet that need. But in order to do that I think there's going to have to be some consolidation in order to do it in a way to create a balance sheet that can perform post major event.

It's interesting you say that. I recently talked with a REIT that did a new analysis of its CAT risk and found that it was about \$2 billion under what its real risk was but it was not aware of potential losses in certain location and the escalation of those losses.

I think that one of the big bogeys is that so many clients out there look at catastrophe from the standpoint of a first-party loss, which is the first place you're going to look. But I think there's a phenomenal exposure, a growing exposure, to third-party claims.

So, would you say they should look at it more like from asbestos loss, for example?

Well, if you put numbers on asbestos today, it's much bigger than any loss we've seen. It's a question of how much time do you get to pay. One of the things that constantly amazes us is we have major venues and you have an exposure to the public and there's an event of some kind that occurs. There's a major catastrophe both from a first-party standpoint and a third-party standpoint. Yet victims don't get a dime and there's serious injury, there's bad PR all over the place. And the solution to that problem is to try to find deep pockets somewhere and to try to find a judge who's going to reinvent the law to put the deep pockets/assets on the line. That is not a great way to solve that problem.

A sporting event or something like that?

A sporting event or really any event where there's a clustering of people if you had a hybrid liability contract that would pay on the nose to anybody that was injured for a specified injury. That goes a long way to part of the issue. But, I think trying to compensate victims allows them to move on with their lives, which is important. Now they still may sue, but at least they've got some collateral benefit here that hopefully a judge would consider in any kind of settlement.

Is it your belief that these events are not insured enough or insured in appropriate ways?

Probably the latter, in an appropriate way, because they all rely on some sort of tort liability trigger, which as we know, takes so long to get resolution. ■

Analyzing the Exotics

by Laura S. Danoff, CPCU



■ **Laura S. Danoff, CPCU**, is the principal of L.S. Danoff Educational Enterprises, a provider of continuing education in California, Washington, and Oregon, founded in 1999. An E&S broker for 22 years, Danoff is also a motivational speaker, and designs custom insurance classes for in-house programs. She received her CPCU designation in 1981 and has served on the Boards of the CPCU Society Golden Gate Chapter and Santa Clara Valley Chapter, as well as the Northern California Steering Committee of PLUS. This article was based on her seminar “Take it Apart Quickly: Analyzing the Exotics.” For details about that and other seminars, please go to www.LSDanoff.com.

Quick—what’s one of the best things about being in E&S? Right—being the first to offer new, revolutionary products.

Quick—what’s one of the worst things about being in E&S? Right—having to learn the new, revolutionary coverages.

This results in a few issues:

1. Knowing what’s in the form is critical for sales and for keeping yourself out of an E&O situation.
2. Finding the time to read the forms.
3. Figuring out where the coverages are in the forms.

This article will address all three, and by the time you reach the end, you’ll have some practical suggestions to finding where the coverage is in any policy form, especially new coverage forms, which I’ve nicknamed, the “*exotics*.”

Let’s begin with the issue of time. You know the drill: you receive the kit, you glance at it, and you put it on your credenza . . . on top of all of the other kits, knowing that you’ll get around to reading them at some nebulous time known as “sometime” (also known as The Twelfth of Never).

It doesn’t matter which side of the business you’re on, broker, underwriter, primary, excess—if there’s a new form, you just have to learn it. It’s critical. That’s why I’m here. When I left the world of wholesale broking after 22 years to start my own CE business in 1999, reading the policy forms to find the actual coverages became my job, and I looked forward to the task.

Okay, I didn’t exactly look *forward* to it. Okay, I had to do it if I wanted to make my mortgage company happy every month. Okay, I told myself that I’d analyze the first policy form right after I’d filed all of my provider documents with the Departments of Insurance and reorganized my spice cabinet alphabetically.

Okay, I really, truly dreaded it. But I had to do it, so I picked up a form, gritted my teeth, girded my loins (insert any other metaphor here), and began to read. “How hard can it be?” I told myself. “After all, it’s not rocket science.”

A digression. No, insurance is not “rocket science.” In fact, *nothing* you compare to rocket science can be rocket science. The only thing that actually can *be* rocket science is, well, rocket science.

But you know what? Insurance is harder. Why? Because the general public doesn’t have to understand rocket science, but we expect the general public to understand our products, and if they don’t, guess who they’ll blame?

Let’s face it—we’re *in* the industry and there are times we can’t understand our own products, especially the new ones. But because my mission was to make this easier for others, first I had to learn how to do it.

When I started reading policy forms, there were two challenges:

1. How many words I could read before dozing off.
2. They’re not linear.

You can’t start at the top of page one and read straight through to the end. You have to dart around from bolded words in the Insuring Agreements to Definitions, from Definitions to Exclusions to back to Insuring Agreements and so on. But I did devise a technique that can actually quickly locate the coverages and potential E&O areas if you’re not aware of them. So get out your highlighter and your policy form and we’ll get started.

In fact, that’s my first step with any unfamiliar form: make a copy of it and get a highlighter.

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Analyzing the Exotics

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Because we're in E&S, let's start with a brand new **exotic** coverage. The genesis of this coverage was a night of channel-surfing while eating too much junk food and drinking too much Diet Coke (to stay awake) alternating with too much Pinot Noir (because any article mentioning wine these days has to include reference to the movie *Sideways*).

The result: Reality TV Show Offense Liability Insurance (RTVSOLI).

What does it cover? One of my CPCU instructors always related liability insurance to what he called "The All-American Doctrine of Entitlement," roughly translated as "Something bad happened to me! I'm entitled to money! Where can I get it?"

I figured if anyone can sue a fast food company for making someone obese, I should be entitled to money for the brain cells lost by watching reality TV shows. Some of the worst offenders included "Who Wants to Marry My Retrocessionaire?" "America's Funniest Insurance Regulations," and "Fear Factor Deposition, Eating Your Words." Now that you know the reasons for the coverage, let's get to analyzing the form.

Any policy analysis begins with a roll of the "DICE," okay, actually the word is "DICED," but I couldn't find a metaphor for that. Every insurance policy can be divided into the following:

- Declarations: the who, what, when, where, how much
- Insuring Agreements: the *giveth*
- Conditions: who does what and when
- Exclusions: the *taketh* away—but not always
- Definitions: what the **bold words** really mean

Where do you start? Ignoring the Declarations as we're just looking for coverages, we boldly move on to the Insuring Agreements, or The Coverage, or What We Insure, Here's What We're

Gonna Cover, etc., as isn't that where you think the coverage would be? BZZZT! Nope. Let's look at the Insuring Agreement for RTVSOLI:

We will pay on **Your** behalf those sums in excess of the **Deductible and within the applicable Limit of Insurance** stated in Item 5 of the Declarations that **You** become legally obligated to pay as **Damages or Claim Expenses** because of Claims as a result of a **Wrongful Act**.

I highlighted "**You**" and "**Wrongful Act**." So tell me (rhetorically), at this point do you have any idea of what's being covered? No—the critical information, i.e., what constitutes that Wrongful Act, who's actually an Insured, what constitutes a claim, will be found in the Definitions. So you only get as far as one sentence and have to go running off to another section of the policy. But at least you do know what that section is. Why not just go to the Exclusions? Because first you have to know the Act that's being covered before you can fine-tune it into what isn't. Let's find out.

- **Wrongful Act** means production of a television program that results in a **Reality TV Show Offense**.

Oh, really helpful. Having fun yet? We now skip back from the W's to the R's and that's our first really important find, our first hint at what's really being covered.

- **Reality TV Show Offense** means any actual or alleged: headache, nausea, shock, gastric or emotional distress, feelings of self-hatred, annoyance, outrage, and drop in IQ, arising out of viewing a **Reality TV Show** produced by **You**, including but not limited to programs containing:
 - a. former child stars now in rehab
 - b. dysfunctional families
 - c. over-botoxed, collagenated or otherwise enhanced aging celebrities of any gender

- d. groups of unrelated persons thrown together in any controlled environment
- e. the consumption of any food that is still moving

As night follows day, that definition leads you to another, **Reality TV Show**, because even if you think you know what a "Reality TV Show" is, it doesn't matter what you think. In the event of a claim, it's the policy definition that will rule, not your thoughts. Here's this one:

- **Reality TV Show** is an unscripted television program in which contestants are competing or have submitted themselves to making a change in their lives. The following are not **Reality TV Shows**: news, political discussions, talent shows, game shows.

How do you like that? An Exclusion within a Definition. That's why it's my theory that the true coverage will generally be found somewhere between the Definitions and the Exclusions, and for any of the *exotics*, that's where I'd always begin.

So on to the Exclusions, which I'd called "the taketh away, *but not always*," because when you run into words and phrases such as: "but," "however," "does not apply to," etc., what follows those words (or sometimes it's just a semi-colon) may actually be a grant of coverage. Here's an example:

The insurer shall not be liable for loss arising from any **Claim** made against **YOU** alleging that someone else should have won; however, this exclusion shall not apply to (insert exception here).

Here are some key words and phrases to look for in the Definitions and Exclusions: “including but not limited to”—very broad, “shall also include,” “does not include,” “provided however,” “but only when,” “but this does not apply to,” all of which will allow you to hone in on the actual coverage.

With any E&S policy form there are always provisions you’ll want to check, including:

- Duty to Defend
- Extended Reporting
- Hammer Clause?

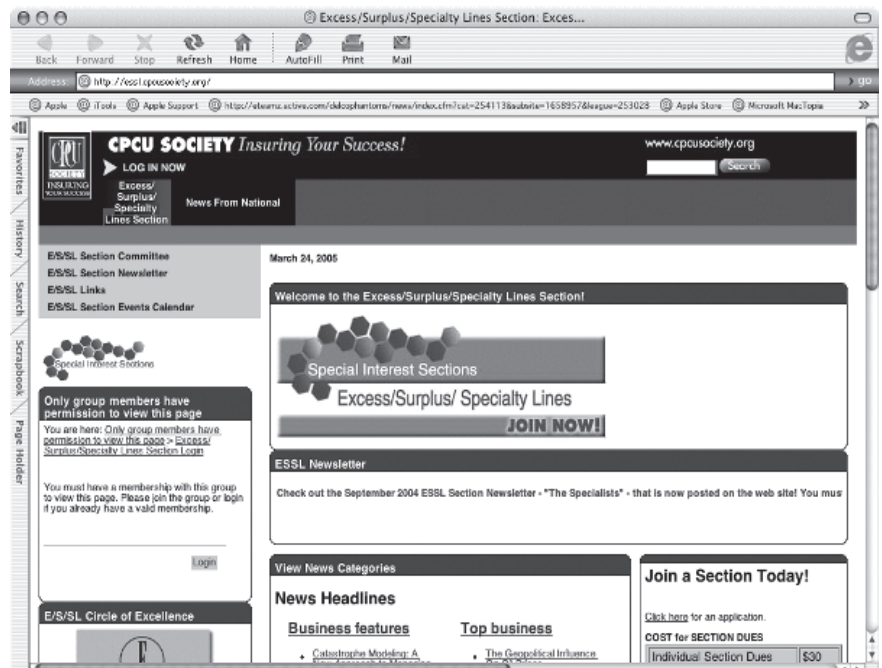
So while the prospect of reading through an entire E&S policy might seem daunting, the reality is that you can quickly locate the actual coverage of any exotic (or other) form, by locating:

- Covered Persons
- Covered Acts
- Key Definitions
- Key Exclusions
- Key Provisions

Or you could just guess and later find yourself appearing on “My Big Fat Obnoxious E&O Situation.”

And now, if you’ll excuse me, it’s time for “The Amazing Regulatory Race.” Tonight Paul vs. Virginia is going to square off against McCarran-Ferguson, and I can’t wait to see how it’ll turn out. ■

http://essl.cpcusociety.org



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