

EXCESS LINE ASSOCIATION OF NEW YORK

ANNUAL REPORT 2002



*E*ducation *E*&*S* Compliance *E*lectronic Transmission



Chairman's Report

MARGARET M. BEIRNE

Despite relatively few natural catastrophes in 2002, the insurance industry nevertheless was suffering from a catastrophe, to some degree, self created. Increased prices, reduced limits, tighter terms and conditions, reserve strengthening, as well as reduced reinsurance capacity, sent insureds and brokers running for cover—and coverage. The storm, however, has produced some positive developments.



After years of intense price competition, rising prices accelerated throughout most of the year as insurers focused on making an underwriting profit. The center of attention became risk selection and profitability. The excess and surplus lines market was the beneficiary of the hard market. Many risks found their way into the surplus lines market as admitted insurers abandoned “non-core” and underperforming lines of business and imposed more restrictive underwriting guidelines. The substantial increase is evident. ELANY processed more than 113,000 documents in 2002—an increase of 19% over the prior year. Moreover, while A.M. Best estimates a 14% increase in net written premium in 2002 industry wide, ELANY saw its processed premium increase by 93%. Several lines of business saw increases in excess of 100%.

Throughout the year, ELANY has continued to push for reforms that will simplify the filing and compliance processes and ease access to the surplus lines marketplace. Through the efforts of Dan Maher, ELANY's Executive Director, and several Board members, the New York Insurance Department

has agreed to permit ELANY to accept a legible facsimile copy of Part C; this should reduce the number of late filings, if it does not completely eliminate them.

- ELANY was successful in pursuing legislation which amended the definition of “hospitals” in the insurance law. Nursing homes and a narrow group of specialty medical care providers can now obtain medical malpractice in the surplus lines market.
- Last spring, the Board went to London for meetings with brokers, underwriters and representatives of Lloyd's, the IUA and various London companies to help broaden their knowledge of the workings of the surplus lines process. ELANY continues to provide education to brokers, carriers and elected officials about the operations of the surplus lines marketplace.
- ELANY's website was redesigned to provide greater content and easier access to information. I encourage everyone to visit it often.

The year 2003 will be another busy year. ELANY is currently undertaking a review of systems and vendors used by other stamping offices as we prepare to implement an electronic filing system. ELANY has presented a proposed expanded export list to the New York Insurance Department and is hopeful that the list will be expanded in 2003. Reciprocal licensing is very much at the forefront of ELANY's legislative agenda, and we are hopeful that New York will pass a reciprocal licensing bill this year.

I offer thanks to the staff at ELANY for their tireless efforts in making certain that the association operates in a timely and efficient manner. ELANY will continue to assist its members in transacting their business as efficiently as possible. We welcome your thoughts and suggestions. ❖

Increased prices, reduced limits, tighter terms and conditions, reserve strengthening, as well as reduced reinsurance capacity, sent insureds and brokers running for cover—and coverage. —Margaret M. Beirne

Executive Director's Report

DANIEL F. MAHER

2002 began and ended as a hard market in full bore. Excess line brokers and insurers struggled under the weight of new submissions which increased in multiples if not exponentially but were nevertheless, able to meet the challenge. In New York and many other states, E&S premiums doubled the record volume of 2001.



While no signs exist to suggest the hard market will abate anytime soon, there are some indications that the volume flowing to the E&S market is no longer accelerating at the pace set in 2002. Pricing on property risks appears to be flattening out and some new capacity and competition have been created in both the direct and reinsurance markets, largely due to new ventures headquartered in Bermuda.

The hard market creates an interesting quandary in the E&S world. Marginalized in the soft market, the E&S industry is often vilified in the hard market. It is a shame that the public, on one hand, can turn to this segment of the industry, utilize its services and acquire insurance when the need is the greatest yet complain about price, terms, and finally, offer the coup de grace: "and the product is nonadmitted," as if that is an incurable social disease.

While some progress has been made in conveying a true and clear picture of what a nonadmitted policy means to John Q. Public, contrary entrenched notions are sometimes bolstered for political expediency. For example, one insurance commissioner recently referred to surplus lines as a "necessary evil." The commissioner was not forced to characterize the industry that way. He could have said, that segment of the property and casualty industry known as the E&S industry, allows the insurance departments in the various states to hold rates down for 90% of the consuming public at level at which standard markets are willing to write and allows the more difficult risks to be placed nonadmitted, where freedom of rate and form are needed to entice the contract. Is protecting 90% of the public with some rate control and allowing a safety valve market greater freedom for the special risk or difficult risk not in the best interest of the entire public?

It appears the E&S industry will always need to protect itself from these types of mischaracterizations unless regulators,

ELANY unveiled its new website, which was reorganized to create simple navigation and succinct responses. . .

industry representatives and others can be persuaded to speak from an objective, informed point of view.

Now, putting away the soapbox for a few moments, a number of other interesting developments took place in 2002. ELANY unveiled its new website, which was reorganized to create simple navigation and succinct responses to specific questions often raised in the E&S marketplace. Take a look for yourselves at the ELANY Lexicon, where the website contains a great wealth of information for your benefit.

In 2002, ELANY also converted its bulletin and newsletter delivery system to email in order to provide advice and information in real time with greater efficiency. The combination of the email system and the new website provide immediate, substantial resources for members on questions unique to the E&S industry. These are part and parcel of our ongoing quest to create a fully electronic filing system.

The committee chairs and association chairwoman, Margaret Beirne, have some interesting recollections on ELANY's progress in 2002, so I need not reiterate their well-informed observations, but I do urge you to explore the rest of this Annual Report.

Finally, one of our board members heeded the call of Horace Greeley and went west. Les Ross, our beloved former Treasurer and his charming wife, Nancy, relocated to Tri City's west coast office in San Francisco. We'll miss his wit and wisdom but then again, I now have a place to stay for free in San Francisco. 🍷

While no signs exist to suggest the hard market will abate anytime soon, there are some indications that the volume flowing to the E&S market is no longer accelerating at the pace set in 2002.

—Daniel F. Maher



Committee Reports

INDUSTRY LIAISON LEGISLATION AND REGULATION COMMITTEE

Kurt Bingeman, Chairman



ELANY remained committed to industry affairs throughout 2002. Executive Director Dan Maher and I continued our efforts with other New York associations including IBANY, PIWA, IIAA and PIA, as well as nationally with NAPSLO, NAIC, NCOIL, RIMS and the other Stamping Offices.

We were successful in redefining the term "Hospital" in §2118 of the Insurance Law, which allows many additional New York clients requiring miscellaneous malpractice insurance (i.e. Nursing Homes) to access the E&S Market as an alternative. The October 31, 2002, excess line broker license renewal cycle went smoother because of the repeal of the bond requirement in New York and we continue to support similar repeals in every state to meet the Gramm Leach–Bliley Act requirements.

The Board's April trip to London served as a successful platform to provide current information on the state of business in New York, specifically communicating with Lloyd's, as well as company market brokers and underwriters, regarding

issues important to their writing business in New York. Meaningful discussions with several insurers on solvency matters were also held.

We increased our industry educational efforts participating in numerous sessions for the PIA, IIAA, Women's Insurance Network of Long Island and others.

We held a special education session in Albany for

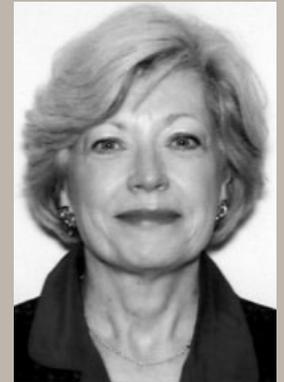
various state agencies, including The Department of Environmental Conservation, The New York State Thruway, The Department of Transportation, The Office of Parks, Recreation and Historical Preservation on the use and acceptance of E&S insurance, New York legislative and regulatory requirements, as well as

ELANY's oversight and solvency analysis. We believe the effort has resulted in greater willingness to accept proof of insurance from New York eligible nonadmitted insurers by these agencies. Our "Basics of E&S" seminars for IIAA and PIA are continuing statewide during 2003.

In the fall of 2002, we became involved in the debate on the issues surrounding Labor Laws §§240/241 and their impact on insurance for contractors in New York and expect this to carry into the 2003 legislative agenda. This has also spawned an effort by ELANY, with the help and support of other producer associations, to seek an expanded export list. Last but not least, ELANY reacted to the new federal Terrorism Risk Insurance Act (TRIA) and its impact on E&S buyers, brokers and insurers in New York. ➔

INFORMATION RESOURCES AND SECURITY COMMITTEE

Margaret M. Beirne, Chairman

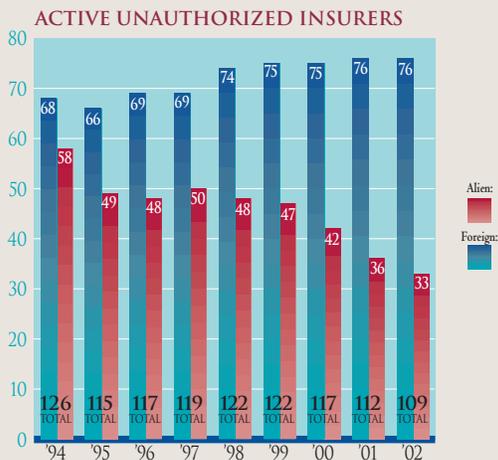


The Information Resource & Security Committee is responsible for screening all new applicants, in addition to monitoring the financial strength and viability of those companies currently on the Insurer Data File eligibility list. ELANY places great emphasis on this responsibility, as New York insureds covered under policies issued by surplus lines carriers do not have access to any guaranty fund protection.

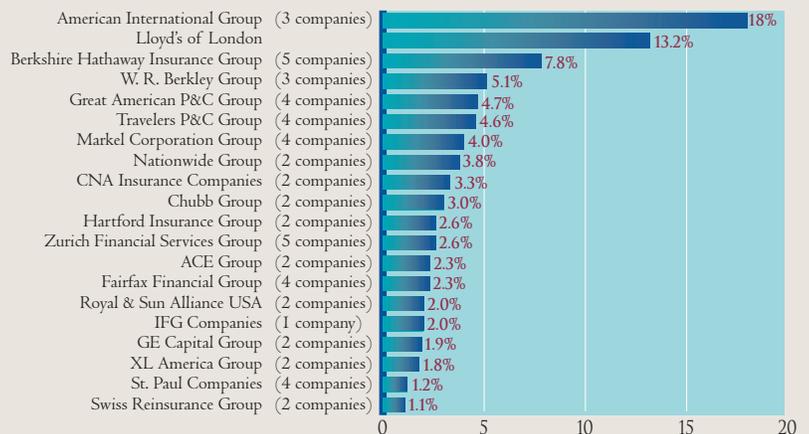
The Committee has been quite busy keeping track of the number of companies that have been sold, investigating new ownership, surplus deterioration and rating downgrades. Under-reserving, the re-emergence of asbestos, terrorism coverage, medical malpractice, tort reform, asset impairment and reinsurance recoverables are being closely monitored.

Reserve strengthening, particularly for asbestos, became the standard for most companies during the latter part of the year; however, reserves on several other lines of business have not been fully addressed. While the passage of the Terrorism Risk Insurance Act requires insurers to offer terrorism coverage, how to evaluate the risk and adequately price it remains unclear.

For the first time in many years, investment returns were



2002 NEW YORK PREMIUM BY INSURANCE GROUP



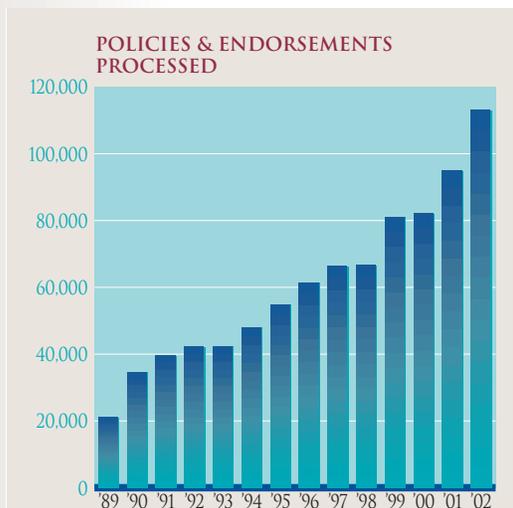
insufficient to cover growing underwriting losses. "Excess capital" is rapidly being diminished by underwriting losses, reserve development on prior accident years, and significantly reduced investment income. Reserve strengthening that occurred during the latter part of the year is continuing into 2003 as more companies announce that they are conducting in-depth reserve studies. Asbestos has been the frontrunner in this round of reserve strengthening but we are still waiting to hear about the adequacy of professional liability reserves, mold, and workers compensation. Recent lawsuits against auditing and actuarial firms have not been fully reserved and new corporate governance laws are forcing markets to be much more diligent in assessing reserve adequacy.

Unlike their European counterparts, property-casualty insurers in the United States generally hold a greater number of fixed-income assets over equities in their investment portfolios. This, however, has not insulated them against the declines in the equity market and has placed additional pressure on surplus. Many companies have taken asset write-downs in their investment portfolio. As part of ELANY's review of insurers on the eligibility list, we take a close look at the quality of the investment portfolio and reinsurance recoverables, as both these assets represent a significant portion of a company's asset base. There has been much said of late about the industry's reinsurance recoverables and we monitor the quality of the reinsurers and the recoverables very closely. One insolvent reinsurer can impact a great number of primary carriers as they participate in reinsurance programs across a wide range.

Rating agencies have become the de-facto regulators of the industry. As a result of recent accounting scandals, rating agencies are issuing rating changes and more drastic downgrades at a rapid pace. During the course of the past year, we have witnessed rating downgrades on a number of major carriers. Despite the improved pricing environment, 38 insurance companies were placed under regulatory supervision in 2002, compared with 30 in 2001. Inadequate reserves and inadequate pricing were the primary causes of financial impairment to these companies.

During the year, ELANY added one alien and two foreign companies to the eligibility list and removed three alien and two foreign companies. ELANY had 109 companies on the eligibility list at year-end 2002, compared with 112 companies in 2001. The breakdown is 76 foreign companies and 33 alien companies. Five companies have been downgraded by either A.M. Best or Standard & Poor's, yet the overwhelming majority of companies are still rated A- or better.

I would like to take this opportunity to welcome ELANY's new Financial Director, Richard Schlesinger. Rich joined ELANY at the end of October with a background from the regulatory, market and brokerage sides of the business. Rich will be happy to answer your questions on any of the markets on the eligibility list.



We wish him well in this position.

The Committee benefits from various resources, including the expertise of ELANY's staff members, who coordinate their efforts with the New York Insurance Department, and from feedback obtained from member brokers. While the work of the Committee continues to serve ELANY, its members and the State, it is important to note that this oversight process is intended as a complement, not a substitute, for the due care which each broker must exercise in selecting excess line insurers.



OPERATIONS AND PROCEDURES COMMITTEE

David Eisenberg, Chairman

ELANY was challenged in 2002 by a huge increase in the volume of business produced by its members. The challenge was met in a variety of ways.

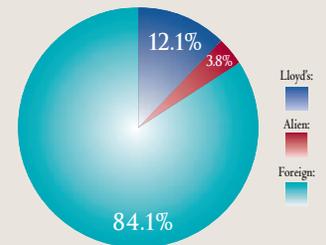
ELANY expanded its staff to maintain a prompt turnaround time in response to the accelerating volume of business. The insurance department graciously acceded to ELANY's request for permission to accept faxed copies of originally signed Part C affidavits. This change, though modest, will allow excess line brokers to file affidavits at or close to the time of placement. This can benefit excess line brokers by streamlining the documentation/filing process, as well as reducing the late filing rate to an acceptable level.

Our efforts to educate the insurance community at large accelerated in 2002. Informal training has been and continues to be available to members at ELANY headquarters and to some extent at the offices of members. ELANY hosted or co-hosted a number of programs qualified for continuing education credits in conjunction with the Professional Insurance Agents Association (PIA), Professional Insurance Wholesalers Association (PIWA), Women's Insurance Network of Long Island and the Independent Insurance Agents Association (IIAANY).

This year, in my dual roles as an ELANY board member and as President of PIA, I can personally attest to the benefits of these continuing education seminars. Numerous retail producers, many of whom ELANY reached through programs cosponsored by PIA, were venturing into the E&S market for the first time in years. The seminars offered these retailers a tremendous

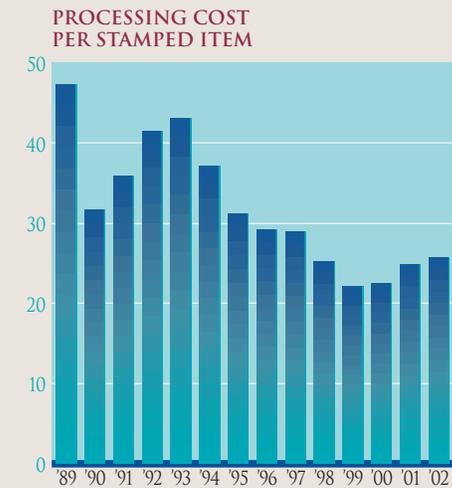
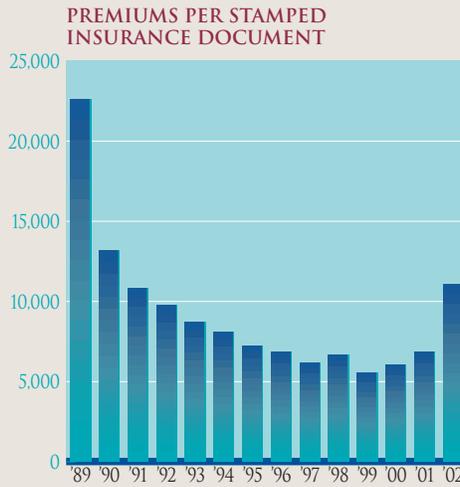
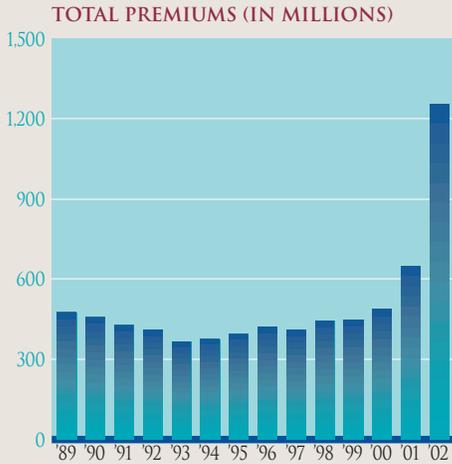
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PERCENTAGE OF YEAR 2002 PREMIUM DISTRIBUTION BY ELIGIBLE INSURERS*



**Figures are on a risk attaching basis.*





All figures and statistics are based on calendar year premium except where otherwise noted.

benefit in my view. For the retailers, whether they are accessing the E&S market directly or through wholesalers, the seminars offer information and direction on the procedures, rules and

other pertinent distinctions between the E&S market and the admitted market.

To the extent ELANY can better equip the marketplace with information and tools, the smoother the compliance and filing process will be for all. To this end, ELANY continues to dispense and train members and retailers on their point, click and comply software. Also, the website has been redesigned to provide a tremendous wealth of information.

The association continues to focus on the creation of an electronic filing system as it goes forward, with the ultimate goal to simplify the compliance process for the benefit of all members. 🐘

FINANCE COMMITTEE

Donald Privett, Chairman

In the history of insurance, 2002 will be remembered as a year in which the industry was disrupted beyond anything experienced in its past. The tragic events of September 11, 2001, the downward financial spiral and scandals occurring in the stock market, among other issues, forced premiums to increase.

The whole issue of terrorism insurance in New York City and the fact that a federal financial backstop was not put into effect until November 26, 2002, created great uncertainty

in many standard admitted companies, leaving them unsure of what to do. The industry had to determine an appropriate response to their clients' needs without creating additional risk concentration exposures that would further expose their weakened balance sheets. The answer came from the surplus lines community, which resulted in very significant increases in both premium and document flow to ELANY and a monumental increase in work.

Processed documents increased by 19.2%, which was in addition to a 17% increase from the year before. 113,018 documents were processed in 2002, which is an increase of

32,000 documents from two years ago.

Premium volume jumped 93.2% to annual volume of \$1,253,900,000.

The Board of Directors and our Executive Director, early on, recognized that there was a need to increase staff and a need to improve the association infrastructure to meet this unprecedented increase in work.

The challenges were successfully met with expenses only increasing by 23.5%. The increase in workload did not reflect a proportionate increase in expenses for which the staff deserves credit. This also reflects well planned and implemented improvements in data processing. The actual processing cost per document increased to \$25.74, up from \$24.84 the year before. The expense increase reflects numerous new initiatives relating to data processing, plus a substantial increase in use of temporary employees to handle the increased workflow.

Stamping fees increased 93.2% to \$5,015,710. The fund balance increased by \$2,466,528.

2002 REVENUES

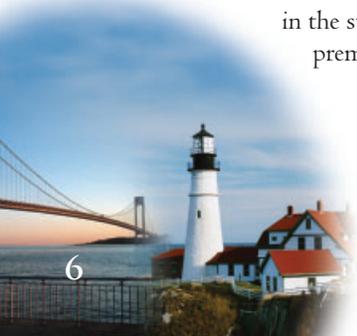
Stamping Fees	\$5,015,710
Investment & Miscellaneous Income	359,579
TOTAL	\$5,375,289

2002 EXPENSES

Payroll	1,154,385
Computer Charges	186,468
Rent & Utilities	229,946
Professional Fees	224,872
Postage/Printing/Stationery	117,666
All Other	995,422
TOTAL	\$2,908,759

FUND BALANCE \$4,906,100

The annual independent audit of the Association's books and records has been completed and copies are available at the ELANY offices for members to review. 🐘



2002 Statistics*

*The following statistics are on a year 2002 risk attaching basis.

TOP 10 INSURERS

Insurer	New York Premium	%
1. Lexington Insurance Company	\$ 207,165,357	16%
2. Lloyd's Underwriters	\$ 160,214,375	12%
3. Admiral Insurance Company	\$ 54,631,158	4%
4. American International Specialty Lines Insurance Company	\$ 49,310,064	4%
5. Scottsdale Insurance Company	\$ 48,470,471	4%
6. Great American E&S Insurance Co.	\$ 44,375,170	3%
7. U.S. Underwriters Insurance Company	\$ 44,042,963	3%
8. Columbia Casualty Company	\$ 42,219,115	3%
9. National Fire & Marine Insurance Co.	\$ 34,685,173	3%
10. Illinois Union Insurance Company	\$ 33,036,777	2%
SUBTOTAL	\$ 718,150,623	54%
All Others	\$ 606,157,391	46%
TOTAL	\$ 1,324,308,014	100%

The top 10 insurers accounted for 54.2% of total premiums written in 2002, compared to 60.5% in 2001, 62.9% in 2000, and 63.4% in 1999.

PURCHASING GROUP ACTIVITY

Of the \$1.324 billion in premiums written and reported to ELANY, \$27 million of written premium was attributable to purchasing groups. Past years' premiums attributable to purchasing groups were as follows:

2002 . . . \$27,301,283	1999 . . . \$ 7,289,724
2001 . . . \$10,992,045	1998 . . . \$ 6,886,396
2000 . . . \$10,024,822	

ELANY ACTIVE MEMBERS

ELANY had 384 active licensees submit business in 2002.

TOP 10 PERILS

PERIL	NEW YORK PREMIUM	2001 RANKING
1. General Liability	\$ 444,595,137	1
2. Errors and Omissions	\$ 221,245,046	2
3. All Risk	\$ 203,851,875	5
4. Umbrella Liability	\$ 122,317,008	7
5. Multiple Peril	\$ 96,595,512	3
6. Additional Property Coverage	\$ 53,692,672	—
7. Fire	\$ 38,944,915	10
8. Inland Marine	\$ 30,299,717	6
9. Miscellaneous Professional	\$ 26,596,950	—
10. Residual Value	\$ 26,379,654	4
SUBTOTAL	\$ 1,264,518,486	
All Others	\$ 59,789,528	
TOTAL	\$ 1,324,308,014	

E & S TAX

Total excess line taxes (based on a 3.6% rate) paid to the State on business placed through licensed excess line brokers are itemized below:

2002 . . . \$47,675,088	1999 . . . \$15,784,439
2001 . . . \$24,674,333	1998 . . . \$16,452,984
2000 . . . \$18,647,436	1997 . . . \$14,705,600

EXCESS LINE ASSOCIATION STAFF

Daniel F. Maher, *Executive Director*
 Nancy Born, *Office Manager*
 Theresa Hetherington, *Stamping Office Manager*
 James Hilton, *IT Manager*
 Richard Schlesinger, *Financial Director*
 Carmen Allende, *Examiner*
 Tiffani Britt, *Examiner*
 Lori Cangialosi, *Coder*
 Lorraine Chin, *Coder/Data Entry Operator*
 Joanna D'Amico, *Executive Secretary*
 Kaderrah Doyle, *Receptionist*
 Rosabel Garcia, *Examiner*
 Noreen Hansen, *Examiner*
 Jenny Kyi, *Coder/Data Entry Operator*
 Lillian Muniz, *Data Entry Operator*
 Rebecca Muniz, *Coder/Mail Clerk*
 Djenaba Nwoke, *Examiner*
 Carlos Padilla, *Examiner*
 Keizia Parks, *Examiner*
 Breanna Pay, *Examiner*
 Erna Perz, *Senior Coder*
 Beth Pfluger, *Stamping Office Supervisor*
 Dana Rathje, *Examiner*
 Marilyn Rosado, *Coder/Mail Clerk*
 Tiffany Sheppard, *Coder*
 Jacqueline Washington, *Data Entry*

Valeriy Berlyand, *IT Consultant*
 Marshall Pinnix, *Consulting Financial Analyst*





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Vice Chairman

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Marsh Advantage America

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Association Counsel

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