

If You Build It: The Role of Excess & Surplus Lines Coverage in New York State's Construction Insurance Market

A Market Segmentation Analysis

March, 2022



**NOVASTANCE
ANALYTICS**

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Forward

This study of New York’s construction industry insurance market was underwritten by the Excess Line Association of New York. It was initiated to determine if the excess line market competes with the admitted market for various construction industry insurance coverages in New York State. All analysis, findings and conclusions are solely those of NovaStance Analytics.

The study was conducted by NovaStance Analytics of Hartford, CT. Primarily responsible for the design, execution and writing of the study was Frederick O. Yohn, Jr. Dr. Yohn has 30 years of experience researching the property-casualty insurance industry, including positions at Aetna Life & Casualty, Conning & Co., MarketStance LLC and Insurance Services Office (ISO)/Verisk Analytics.

Dr. Yohn holds BS degrees in Engineering and Economics from the Massachusetts Institute of Technology and MA and PhD degrees in Economics from Princeton University. Prior to his career in the insurance industry, Dr. Yohn served as a Senior Economist at the Board of Governors of the Federal Reserve in Washington, D.C.

Executive Summary

Excess & Surplus line insurance (E&S) provides an important part of New York's market for construction industry coverages accounting for some \$1.3 billion in 2017 written premium. Two types of coverage account for the bulk of the coverage provided through E&S markets: general liability and excess liability.

Some 93% of the premium associated with these coverages is attributable to construction firms in New York City and the other five counties in its metro area. Construction firms in these metro New York counties are seen to be much more heavily dependent on the E&S market to meet their coverage needs than are Upstate New York firms. Much of this disparity is attributable to the significantly higher risk profile of construction in the metro area combined with other factors such as the state's scaffold law.

Almost 90% of construction industry liability coverages are on New York's Export List. Nevertheless, more than 80% of policies filed with the Excess Line Association of New York (ELANY) include declinations for similar coverage from admitted market carriers. This alone provides compelling evidence that the E&S market serves as a vital backstop for construction industry insurance coverages rather than competing against admitted market providers.

An analysis of risk profile, geographical locations of risks, the varying risk factors that are endemic to different locations and the prevalence of policy filings that contain declinations demonstrating a lack of admitted market appetite for these risks leads to the conclusion that the excess line market does not compete with the admitted market for construction risks. Instead, each market serves distinctly different insureds and risks. Indeed, the New York State Department of Financial Services' placement of these risks on its Export List is a regulatory recognition that the two markets do not compete in the construction insurance space.

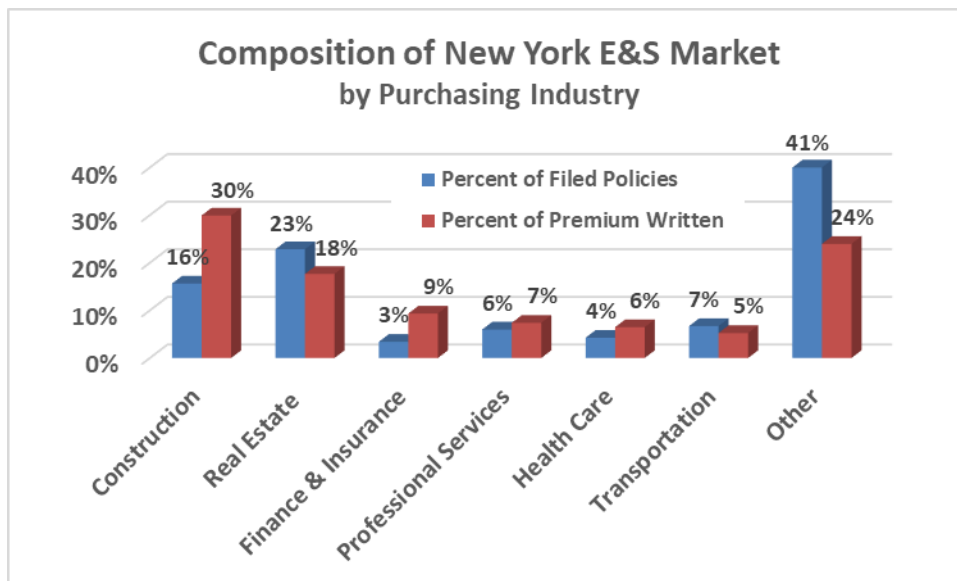
New York's E&S Market

This study is the second in a series of white papers on the Excess & Surplus line (E&S) market's role in New York's property-casualty insurance market.¹ In addition to exploring the size and dispersion of this market, the study examines evidence that the E&S market acts as a supplementary market for risks that are uninsurable in the admitted market and hence does not compete with this primary market.

Construction risks are the largest industry segment by premium in the New York E&S market, accounting for 30% of the total. The combination of general liability (GL), excess liability (EL) and umbrella comprise the largest segment of the E&S market by type of coverage and the biggest share of these types of coverages are attributable to construction risks. As such, construction risk liability insurance by total percentage of premium is predominant in the E&S market, making it ripe for its own segment of this study.

As shown below in Exhibit 1, New York's E&S market finds significant use covering risks in most industrial sectors of the state's economy. The construction industry typically accounts for the largest share of E&S premiums -- in 2017, amounting to 30% of premium.² The real estate, finance, professional services and transportation sectors are also prominent users of the E&S market.

Exhibit 1 Industry Composition of New York's E&S Market



Source: NovaStance tabulation of 2017 ELANY data

In terms of the number of filed policies or transactions, the E&S market's industry distribution is somewhat different with the real estate industry accounting for the largest share -- some 23% of 2017 policies. The construction industry, however, is still a major user of this market, accounting for some 16% of filed policies. The apparent contradiction between these two views is explained by the fact that the average E&S premium for construction industry policies -- at \$23,390 -- is about two- and one-half times the real estate industry's average policy size.

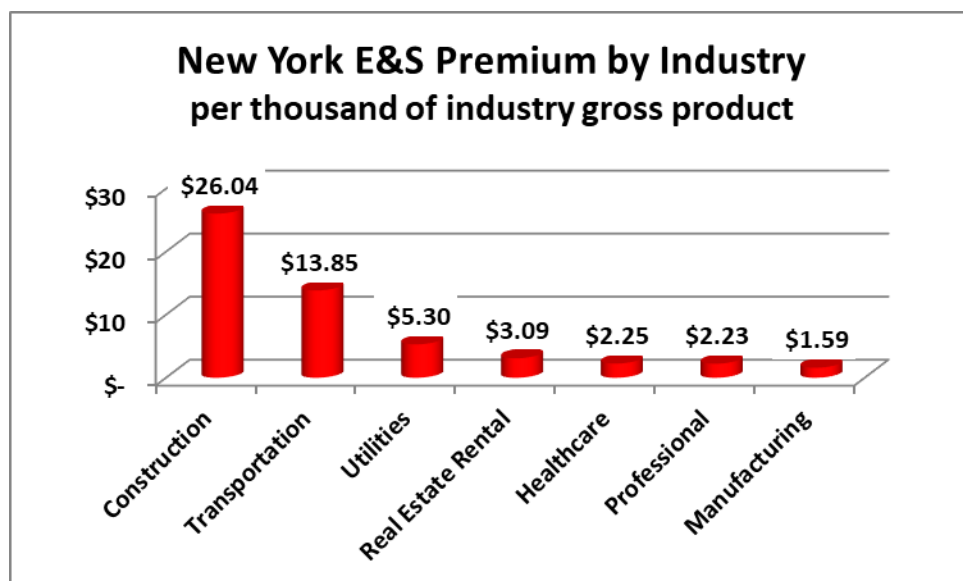
¹The first study, To Each Their Own: The Role of Excess & Surplus Lines Coverage in New York State's Homeowners Insurance Market, examined the E&S market's role in providing homeowners coverage in New York.

² This study utilizes ELANY data from 2017 in order to best align with the calendar year of the most recent Economic Census. This data for calendar year 2017 provides the most comprehensive source of data on business operations in New York and the entire U.S.

Exhibit 2 provides a perspective on the importance of E&S market coverages to each of New York State’s industrial sectors. That is, it expresses the E&S premium dollars spent by each industry per thousand dollars of value added by that industry³. As shown in the graphic, the construction industry’s \$26 of E&S premiums per thousand dollars of that industry’s state product is almost double that of the transportation industry, the second most intensive E&S-using industry, and far above other industries’ scores.

The construction industry’s uniquely high score on this measure reflects a number of factors that will be discussed in this white paper. One is the above average share of the industry’s total insurance coverage provided through the E&S market. Among the others are the higher-than-average general risk characteristics of construction accounts and the unique risks and costs associated with high rise construction work, much of which is concentrated in the New York City metro area.

Exhibit 2: New York Industries’ Reliance on E&S Markets



Source: Census Bureau’s Gross State Product data and tabulation of ELANY data for 2017

New York’s Construction Industry

Given the construction industry’s substantial share of New York’s E&S market and its unique characteristics, this white paper will examine various aspects of the industry and the role that the E&S market plays in providing coverage for these firms.

The construction industry forms a vibrant, growing part of New York State’s economy. In 2017, the industry put in place some \$129 billion in construction value according to Economic Census data -- amounting to some 3% of the state’s gross state product.

As shown in Exhibit 3, by number of firms specialty trade contractors account for about two-thirds of the construction industry and are responsible for almost half the value of construction put in place. However, these artisan contractors tend to be much smaller with, on average, only about \$2 million in construction value. In contrast, the state’s 2,500 nonresidential building contractors tend to be much larger, averaging more than \$12 million in construction value added– or in total, about one fourth the total value of construction in New York State.

³ Value added measures an industrial sector’s net contribution to the economy – that is, net of other industries’ contributions. It falls short of total value of construction in that it is net of products purchased for inclusion in construction projects but produced by other, more primary sectors such as manufacturing.

Exhibit 3: Composition of New York's construction industry

New York Construction Industry					
NAICS	Industry Description	Value of Construction			
		Number of Firms	Total (\$ millions)	Average (\$ millions)	
2361	Residential building	14,868	\$ 21,719	\$ 1.46	
2362	Nonresidential building	2,500	\$ 31,316	\$ 12.53	
2370	Heavy and civil engineering	1,383	\$ 14,987	\$ 10.84	
2380	Specialty trade contractors	30,093	\$ 60,963	\$ 2.03	
2300	All Construction	48,826	\$ 128,985		

Source: 2017 Economic Census of Construction Industries

As shown in Exhibit 4, commercial building contractors are by far the heaviest users of the E&S market, accounting for almost half of policies issued in 2017. While residential building contractors are, by number, the second largest E&S users, average policy limits are less than half that of commercial/industrial building contractors. In contrast, concrete and structural steel contractors have the largest average limit needs, reflecting the much higher value of construction projects on which they are typically engaged as well as the degree of risk typically associated with their activities.

Exhibit 4: Construction Industries Using the E&S Market, 2017

Construction Industries Use of New York's E&S Market					
ELANY NAICCode	Industry Description	Number of Policies	Average		Pct. Citing Export List (%)
			Premium (\$)	Limit (\$ mil)	
	General Contractors				
2302	Commercial	16,482	\$ 25,481	\$ 16.4	9.0%
2301	Residential	9,971	\$ 12,524	\$ 5.0	18.4%
2303	Industrial	248	\$ 43,934	\$ 10.4	5.2%
	Specialty Contractors				
2317	Drywall	1,573	\$ 30,121	\$ 5.2	7.7%
2318	Painting	1,533	\$ 27,335	\$ 3.3	8.5%
2311	Electrical	1,207	\$ 21,748	\$ 6.8	10.4%
2308	Concrete/Masonry	1,196	\$ 25,324	\$ 21.2	9.1%
2313	Roofing	1,087	\$ 20,114	\$ 6.6	11.5%
2316	Plumbing	916	\$ 37,219	\$ 10.0	6.2%
2309	Structural Steel	239	\$ 15,329	\$ 29.9	15.1%
	All Construction	35,851	\$ 36,627	\$ 11.5	11.8%

Source: NovaStance tabulation of 2017 ELANY data

Export List Status

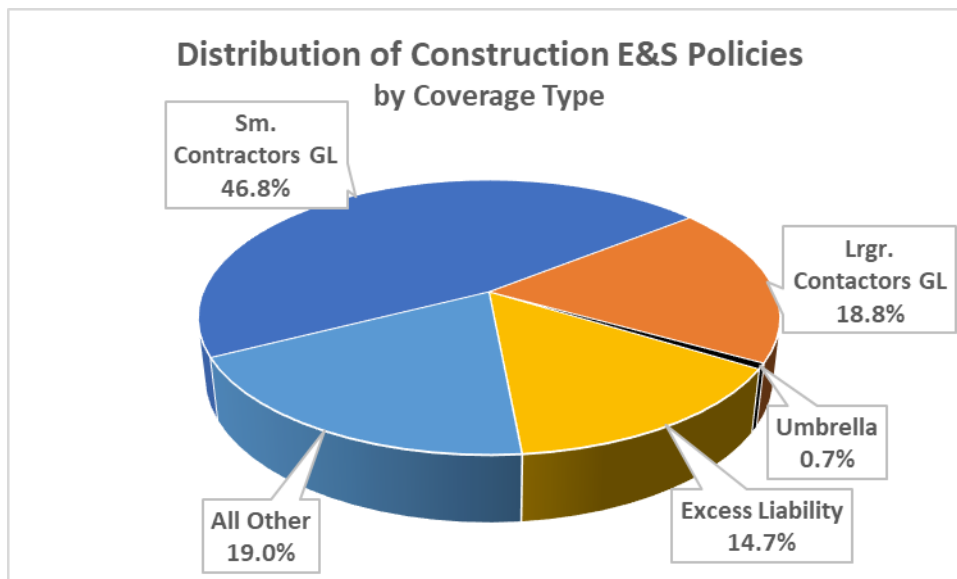
Most construction liability coverages are on New York State's Export List – that is, coverage declarations are not a prerequisite for participation in the E&S market. However, only 11.8% of E&S construction policy submissions to ELANY actually cited the coverage's inclusion on the Export List. In other words, fully 88% of construction risks written in the E&S market were submitted with coverage declarations by admitted carriers.

Residential building contractor policy filings made the most use of the Export List with 18% specifically citing it. This was just about double the proportion of commercial building contractors' submissions making reference to the Export List when obtaining coverage in the E&S market.

Coverage Type

Within the construction industry, general liability policies accounted for two-thirds of the industry's E&S policy purchases (47% + 19% in Exhibit 5). In turn, more than two-thirds of these GL policies were small contractor policies, defined herein as policies with coverage limits of \$2 million or less.

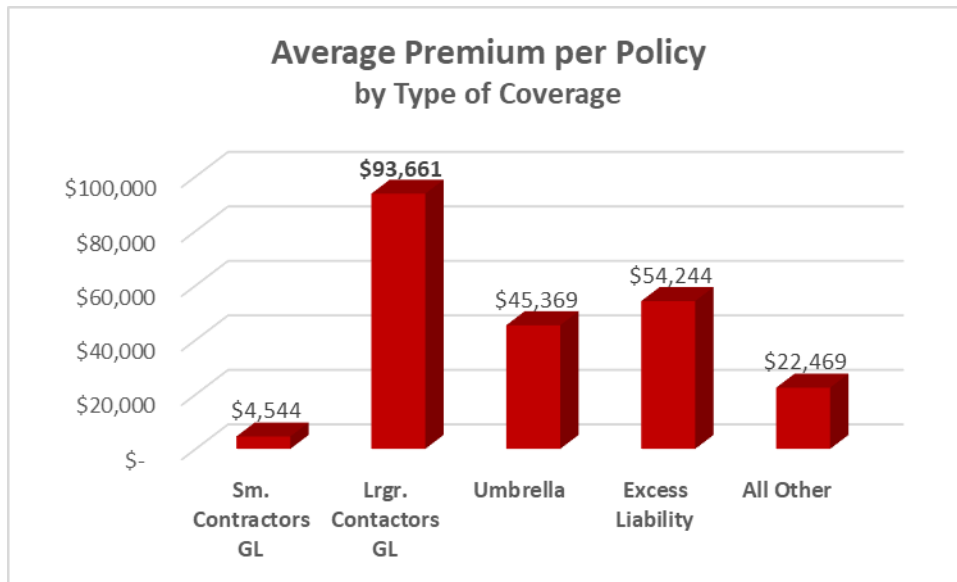
Exhibit 5 Coverage Type Composition of Construction Industry E&S Premiums



Source: NovaStance tabulation of 2017 ELANY data.

While small GL policies accounted for the lion's share of GL issuance in the E&S market, larger GL policies had a dominant impact on E&S premiums from New York contractors. Indeed, their average premium size of \$93,661, as shown in Exhibit 6, was more than 20 times the small contractor GL average of \$4,544. For purposes of this white paper, the Construction GL market has been split into these two size categories to better track various aspects of the relationship between the admitted and E&S markets.

Exhibit 6: Average premium per policy among construction liability in the E&S market.



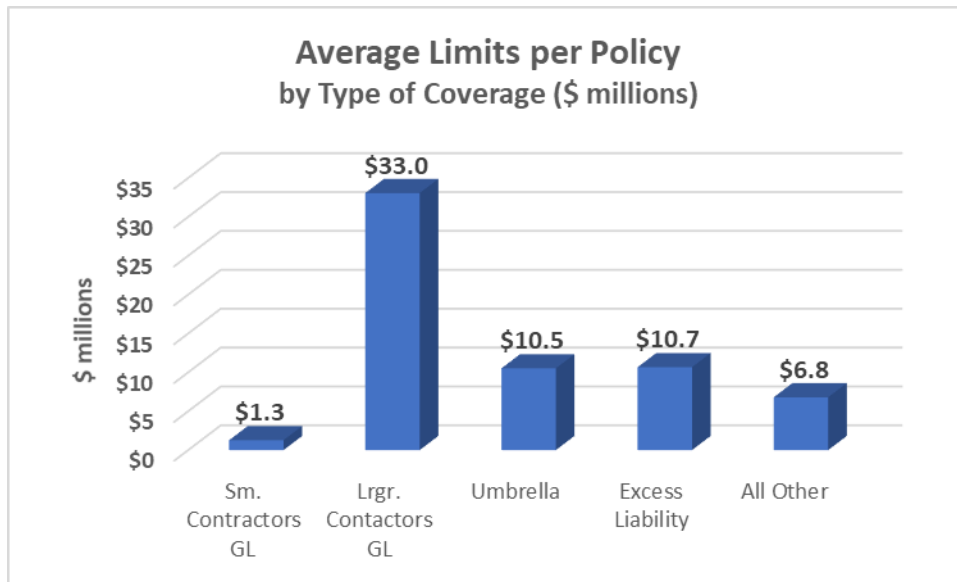
Source: NovaStance tabulations of ELANY 2017 data.

As shown in Exhibit 7, average policy limits for contractors' umbrella and excess liability coverages are also quite sizable, on average amounting to somewhat over \$10 million in limits of liability. However, as mentioned above in Exhibit 5, New York contractors obtain few umbrella policies in the E&S market. In contrast, contractors' excess liability coverage accounts for about 15% of construction E&S coverage in New York.

Reflecting the extent of their operations as well as the size of some construction projects, larger contractors' GL accounts are substantial, with coverage limits for these E&S accounts averaging some \$33 million in 2017. The coverage limits needed by larger contractors, together with the heightened risk associated with construction in New York City are almost certainly among the reasons why these larger accounts typically are placed in the E&S market.

It is generally acknowledged that in New York State, the risk of insuring GL for construction accounts is significantly increased by New York's Labor Law 240. Commonly known as the Scaffold Law, it makes general contractors and property owners fully liable when workers are injured by gravity-related falls from elevated positions. By limiting an employer's ability to defend against fall-related claims, this statute – the only one of its kind in the U.S. -- has reportedly made admitted market carriers extremely hesitant to provide general liability coverage for many types of New York contractors.

Exhibit 7: Average Policy Limits by Type of Coverage

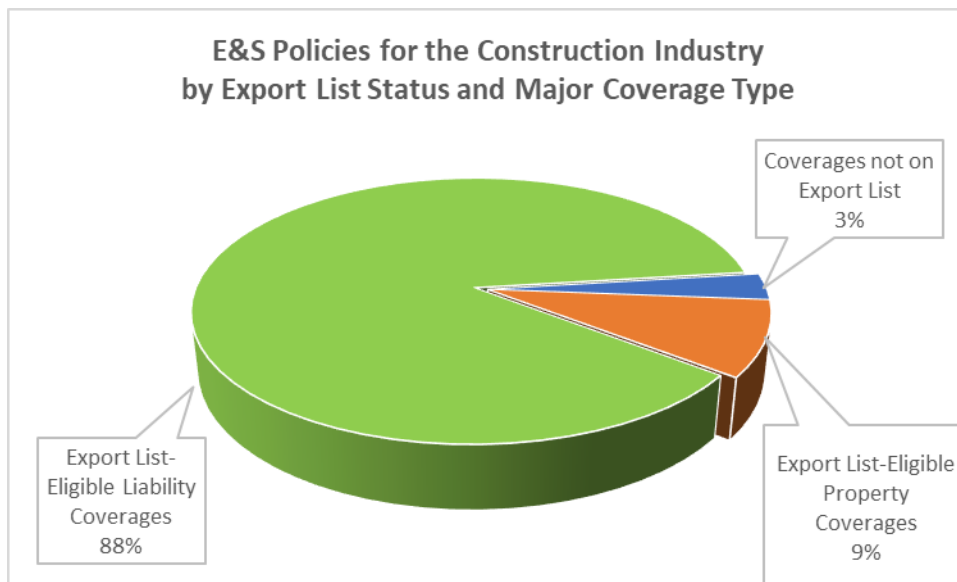


Source: NovaStance tabulations of ELANY 2017 data.

Coverage Types and the Role of New York's Export List

In 2017, the construction industry relied on New York's E&S market for 37 different coverage types as defined by ELANY. **Among these construction-related placements, almost 97% of the coverage type/class of business combinations are listed on New York's Export List as shown in Exhibit 8** – that is, these policies could be placed in the E&S market without obtaining declinations from admitted carriers for comparable coverage.

Exhibit 8: Export List Status for Construction Policies Placed in the E&S Market



Source: NovaStance tabulations of ELANY 2017 data.

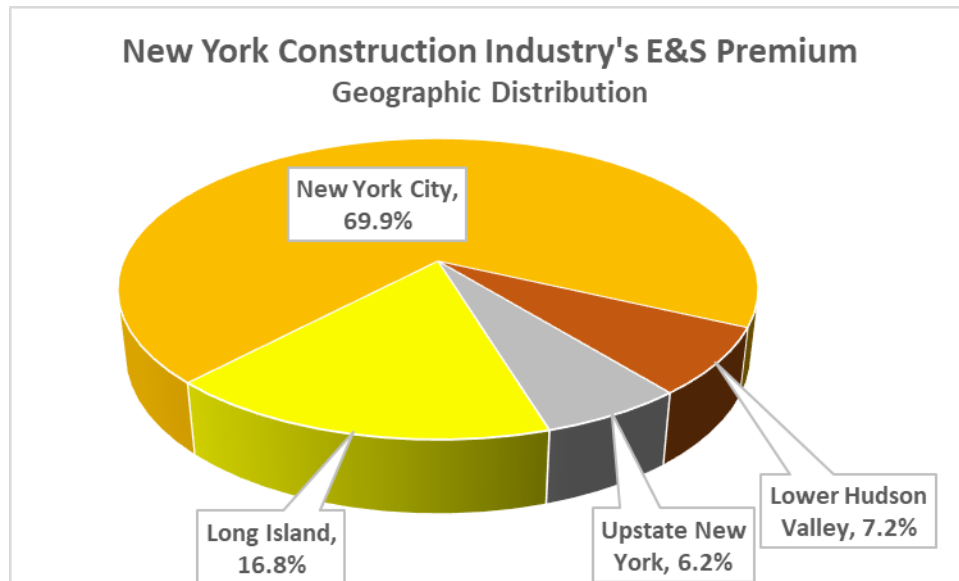
Despite Export List eligibility, this status was relied upon by a relatively small percentage of brokers placing coverage in the E&S market. For example, as shown later in Exhibit 15, only 8.4% of smaller GL policy submissions cited the Export List rather than submitting admitted market declinations. That is, a remarkable 91.6% of small contractor GL accounts were submitted with admitted carrier declinations when applying for coverage in the E&S market despite Export List

status. Likewise, some 81.5% of larger GL policy transactions were submitted with declinations despite these coverage classes' presence on New York State's Export List.

Geographic Distribution of E&S Accounts

In New York's construction industry, E&S policy usage is heavily concentrated in New York City and its extended metro area. As shown in Exhibit 9, about 70% of construction industry-related E&S premiums emanate from the city's five boroughs, another 17% are attributable to Long Island and 7% to the Lower Hudson Valley counties of Putnam, Rockland and Westchester -- all of which are in the greater New York City metro area. In contrast, the 52 counties forming the rest of New York State account for only 6% of E&S premium usage by the construction industry.

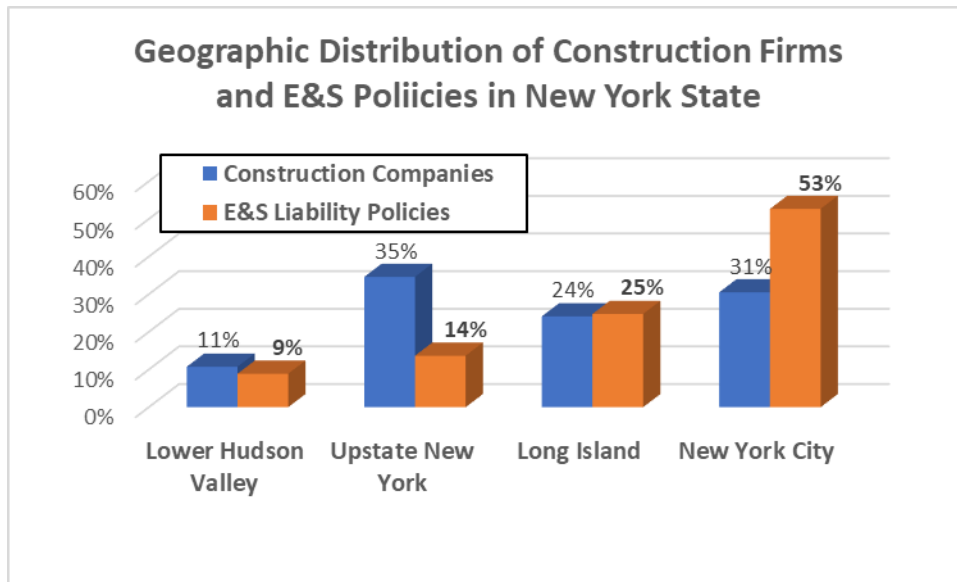
Exhibit 9: Geographic Distribution of E&S Accounts



Source: NovaStance tabulations of ELANY 2017 data.

In New York State's construction industry, the substantial New York City concentration of E&S policies contrasts with Upstate New York's modest use of this market, indicating that New York's admitted carriers likely are averse to writing construction risks in New York City in part due to the state's Scaffold Law and the metro area's concentration of high-rise structures. Note that as shown in Exhibit 10, the Lower Hudson Valley and Long Island territories use of E&S markets are closely proportional to the number of construction companies operating in those areas, whereas New York City has a high ratio of E&S policies to construction companies while Upstate New York has a low ratio.

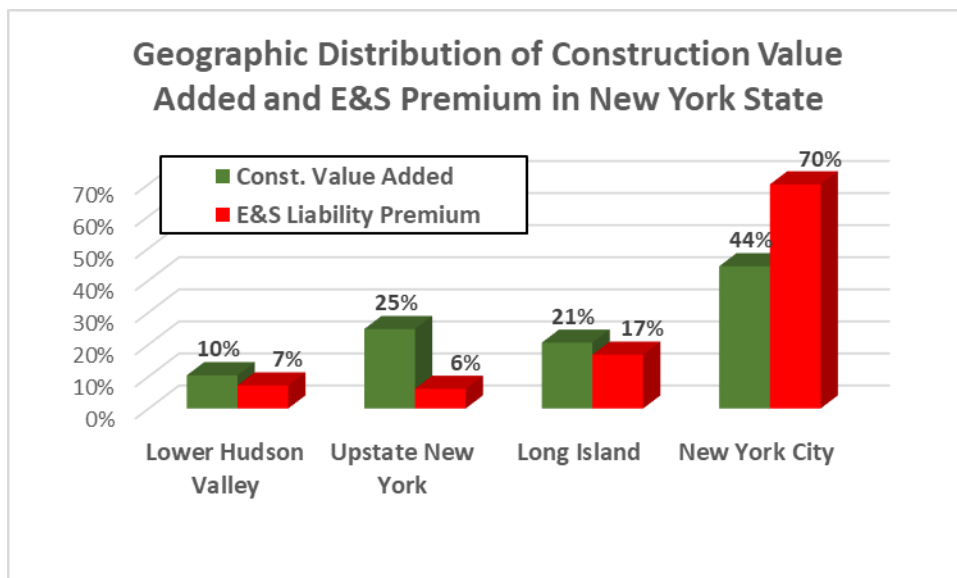
Exhibit 10: Distribution of Construction Firms and E&S Policies



Source: 2017 Census of Construction and NovaStance tabulations of ELANY 2017 data.

As can be seen in Exhibit 11, value added by the state's construction firms -- that is, the total value of construction contracts net of work subcontracted to other firms and goods purchased from other firms -- is even more concentrated than the number of construction firms. Indeed, some 44% of the state's construction value added in 2017 was concentrated in New York City's five boroughs as compared with only 25% in Upstate New York. Admitted carriers apparently have a preference for writing in areas perceived to have lower risk, one element of which is the significantly lesser prevalence of high-rise buildings found in the 52 counties comprising the Upstate New York territory. The increase in premium rates associated with these elevated risk factors likely helps to boost the concentration of E&S premium beyond that suggested by the concentration of value added alone. Indeed, in 2017 fully 70% of construction industry E&S premiums were concentrated in the five boroughs of New York City.

Exhibit 11: Distribution of Construction Value Added and E&S Premiums



Source: 2017 Census of Construction and NovaStance tabulations of ELANY 2017 data.

Market Segments

The above observations suggest that geographic location, account size and coverage type are all factors in the utilization of E&S markets. As a result, the remainder of this study will focus on four identifiable segments of the construction liability market:

- Small account general liability -- Construction accounts with liability limits of \$2 million or less.
- Large account general liability -- Construction accounts with liability limits greater than \$2 million.
- Excess construction liability -- Excess liability coverage on construction accounts.
- Other construction liability – Primarily Owners, Landlords and Tenants and Owners and Contractors Protective coverages.

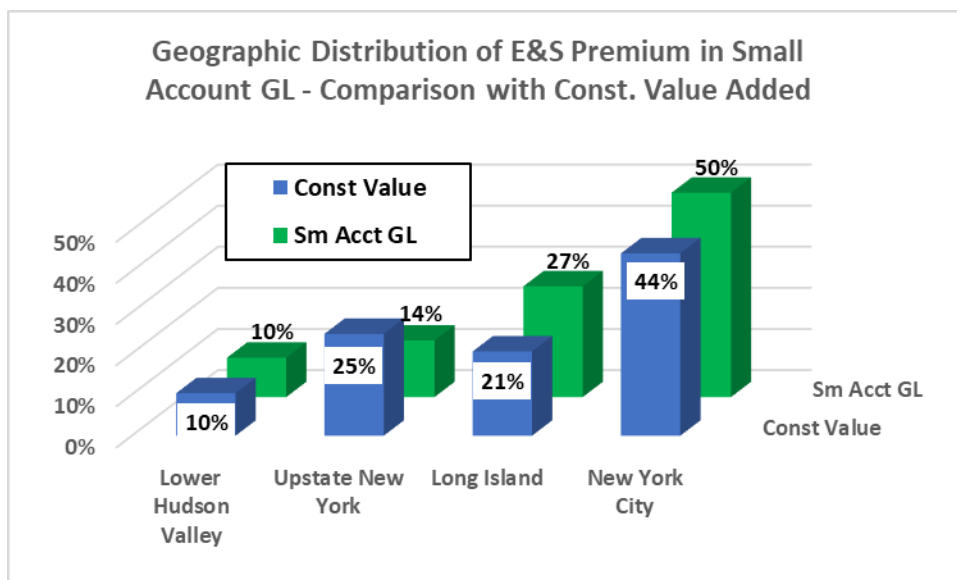
Together these segments accounted for more than 95% of all E&S liability policies generated from New York's construction industry in 2017.

Small Account General Liability

As shown in Exhibit 12, 25% of New York State's construction value added in 2017 was attributed to construction firms located in New York's Upstate territory – that is the area outside of Long Island, New York City and the Lower Hudson Valley. In comparison, only 14% of E&S small GL account premium arose from this territory, which in general has only a modest presence of high-rise structures and lower construction costs compared with the New York City metro area. As a result of these more moderate risk factors, it would appear that a higher percentage of this area's small construction businesses were able to meet their basic liability coverage needs in the admitted insurance market, which typically has been receptive to a wide range of small contractor and special trades risks.

In contrast, usage of the E&S market for small GL accounts is much more pronounced in New York City, which accounted for about 44% of the construction industry's value added in New York State but recorded 50% of the E&S market's small construction GL premiums. New York City's increased reliance on the E&S market for these risks likely reflects the increased volatility and severity associated with work in the five boroughs. Moreover, this territory has an increased incidence of higher risk special trade contractors – such as crane operators and structural steel contractors – who, even under the best of circumstances, find it difficult to gain coverage from the admitted markets and hence are more reliant on the E&S market.

Exhibit 12: Small Account GL and Construction Value Added

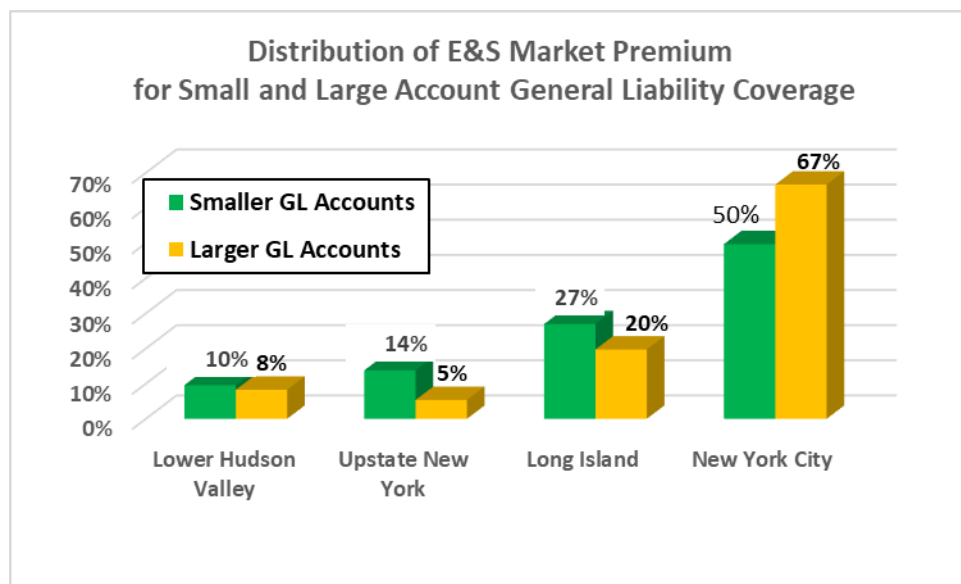


Source: 2017 Census of Construction and NovaStance tabulations of ELANY 2017 data.

Large Account General Liability

Large GL accounts tend to be much more heavily concentrated in the New York City metropolitan area, in part because of the prevalence of large value construction projects in New York City. In addition to the concentration of large projects in New York City, the construction risks in the metro area are subject to inherently higher volatility, frequency and severity of loss associated with high-rise construction projects as well as significantly higher labor costs. Together, these factors account for the Superintendent of Financial Service's decision to place construction liability on the Export List.

Exhibit 13: Distribution of Small and Large Account General Liability



Source: NovaStance tabulations of ELANY 2017 data where small is defined as accounts with \$2 million or less in insurance limits.

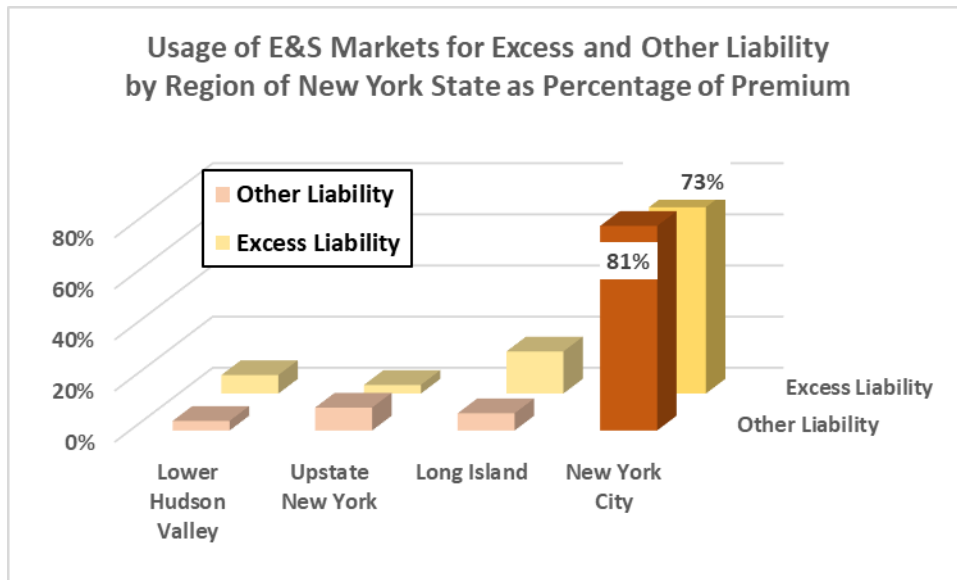
As shown in Exhibit 13 for large construction accounts, New York City accounts for 67% of New York State E&S premiums for general liability coverage – a share far greater than that accounted for by either Upstate New York or the Lower Hudson Valley.

Excess and Other Liability

Relative to large account GL, the use of the E&S market for excess liability and other liability is even more heavily concentrated in New York City. Indeed, as shown in Exhibit 14, some 81% of E&S premium for excess liability coverage arises from New York's five boroughs.⁴ This pronounced concentration of excess liability coverage in large part reflects the elevated costs of high-rise construction in New York City as well as the higher value of limits required in the New York City area. These more intense risk factors contribute to the admitted market's hesitancy to write such risks and the construction industry's attendant, heavy reliance on the E&S market to meet its insurance needs.

⁴Excess liability accounts typically pertain to a specific construction risk location in contrast with construction GL accounts which pertain to the general operation of the construction company.

Exhibit 14: Excess Liability and Other Liability Usage by Territory

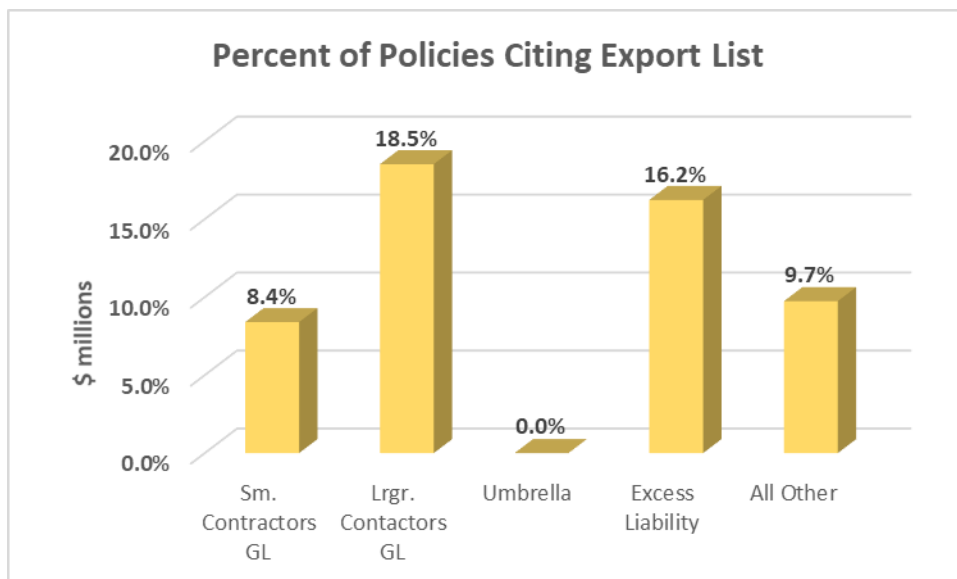


Source: 2017 Census of Construction and NovaStance tabulations of ELANY 2017 data.

Export List Utilization

As shown in Exhibit 15, a remarkably small proportion of E&S placements for the construction industry actually utilize New York's Export List when obtaining coverage in the E&S market. The modest 8.4% proportion for small contractors' GL contrasts markedly with the 18.5% for corresponding larger accounts. Put inversely, the bulk of construction liability accounts, by showing evidence of admitted market declinations, provide direct, compelling evidence that they are outside the admitted market's risk appetite.

Exhibit 15: Percent of Export List-eligible E&S Applications Relying on Export List Status



Source: NovaStance tabulations of ELANY 2017 data.

Conclusions

Construction is the largest industry segment insured in the New York E&S market, accounting for 30% of E&S premiums in 2017. The predominant lines of business purchased by the construction industry as a percentage of construction E&S premiums are GL and EL, accounting for 56% and 22% respectively of all construction liability premiums.

This study of New York's E&S market has relied upon a segmentation of the market for construction liability coverage by:

- type of coverage (GL vs. EL)
- class of risk (general contractor vs. artisan special trade, etc.)
- size of account (small vs. large GL)
- location of risk (metro NYC vs. Upstate New York).

Analysis of these segments has shown that various risk factors associated with different classes of business and different locations have a significant influence on the admitted market's underwriting appetite. E&S policies are heavily concentrated in higher risk locations and classes of business more exposed to factors such as greater limits and New York's scaffold law. Additionally, by placing these risks on its Export List, the DFS has provided regulatory recognition that the excess line and admitted markets do not compete for construction risks. Over 80% of construction submissions to ELANY for E&S coverage provide evidence of declinations by the admitted market even though not required, indicating that when offered these risks admitted insurers declined to write them.

All of these factors lead to the conclusion that the excess line market for liability coverages does not compete with admitted insurers for construction risks in New York State.

Appendix – Data Sources

This study of New York’s construction industry insurance market has relied on three primary data sources:

1. ELANY policy data – Approximately 36 thousand construction industry policy placements in New York’s E&S market for 2017 were geocoded and tabulated. This geocoding permitted accurate calculation of each insureds’ location as well as classification of each policy within the Census Bureau’s complex geographic structure.
2. Economic Census of 2017 – Comprehensive data published by the Census Bureau for New York’s construction industry’s operations in 2017 were analyzed.
3. County Business Patterns for 2017 – Construction industry estimates at the county level were developed from the 2017 County Business Patterns supplemented by data on Gross State Product and Construction Put in Place.

Appendix – Reconciliation with ELANY published totals

This study tapped data directly from ELANY’s transaction records for 2017. However, a number of adjustments caused the totals reported for accounts and premium to diverge somewhat from those published by ELANY. Among these adjustments were:

1. The switch to tabulations based upon effective date of policy as opposed to date submitted to ELANY
2. Some policies have multiple transactions associated with them. The analysis is based on the number of policies irrespective of the number of transactions associated with them
3. The exclusion of policies showing missing or non-positive premium amounts
4. The exclusion of policies with missing or non-positive insured value amounts