

# Arizona Department of Insurance

## 2009 Market Monitoring

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Surety

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### I. Rate System:

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

### II. Market Monitoring Methodology:

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

### III. Annual Statement Data:

The compiled annual statement data for surety evidence that overall in 2008:

- The market is concentrated in the Top 25 insurers that have a market share of 86.7%.
- Thirty groups have a total market share of 92.2%.
- Arizona's surety market is concentrated in contract surety.
- Arizona's 2008 incurred loss ratio of 0.7% is better than the national ratio of 13.7%.

### Historical Experience (All Insurers Page 20, Line 24, Annual Statement Data, Year Ending December 31)

|      | 1               | 2                                  | 3            |
|------|-----------------|------------------------------------|--------------|
| CY   | Written Premium | Earned Premium                     | Paid Losses  |
| 2008 | \$111,484,798   | \$114,267,890                      | \$18,368,108 |
| 2007 | \$117,230,620   | \$114,033,404                      | \$3,054,581  |
| 2006 | \$106,336,966   | \$101,526,516                      | \$16,561,435 |
| 2005 | \$94,449,484    | \$91,509,872                       | \$27,773,237 |
|      | 4               | 5                                  |              |
| CY   | Incurred Losses | Incurred Loss Ratio (Col 4/ Col 2) |              |
| 2008 | \$802,141       | 0.70%                              |              |
| 2007 | \$11,750,664    | 10.30%                             |              |
| 2006 | \$13,069,769    | 12.90%                             |              |
| 2005 | \$16,452,559    | 18.00%                             |              |

### IV. Survey Responses:

Insurers (60) having 97.2% of the market responded to the 2009 survey. The majority said that their particular company:

- Is actively seeking new business.
- Is not increasing the number of declinations or nonrenewals in 2009 as compared to 2008.
- Believes rates impact solvency.
- Believes the availability of reinsurance is becoming less problematic.
- Will not change its underwriting stance in the immediate future.
- Believes underwriting cycles have an impact on surety.

They also reported the following information:

|      | 1               | 2                                | 3                             |
|------|-----------------|----------------------------------|-------------------------------|
| CY   | Written Premium | Policy Count for Active Insurers | Average Premium (Col 1/Col 2) |
| 2008 | \$108,376,343   | 162,290                          | \$668                         |
| 2007 | \$115,189,531   | 169,196                          | \$681                         |
| 2006 | \$104,624,587   | 193,693                          | \$540                         |
| 2005 | \$91,697,126    | 170,048                          | \$539                         |
|      | 4               | 5                                | 6                             |
| CY   | Paid Losses     | # of Paid Losses                 | Average \$ Paid Claim Col 4/5 |
| 2008 | \$13,524,040    | 1,949                            | \$6,939                       |
| 2007 | \$3,798,889     | 1,389                            | \$2,735                       |
| 2006 | \$15,727,474    | 1,369                            | \$11,488                      |
| 2005 | \$24,790,231    | 556                              | \$44,587                      |
|      | 7               | 8                                | 9                             |
| CY   | Incurred Losses | Incurred Loss Ratio              | Combined Ratio                |
| 2008 | -\$960,869      | -0.86%                           | 55.21%                        |
| 2007 | \$7,535,850     | 6.72%                            | 67.09%                        |
| 2006 | \$14,675,895    | 15.00%                           | 71.20%                        |
| 2005 | \$6,985,904     | 8.20%                            | 57.30%                        |

## V. Surety Market Trends:

**Trend # 1:** Most surety written in Arizona is contract surety. In 2008, a market share of 74.2% (73.4% in 2007) responded that it primarily writes contract bonds. The demand for contract surety is dependent on Arizona's population growth and strong economic conditions. As there has been a downturn in both of these factors, this trend may not continue in 2009.

**Trend # 2:** Direct written premium decreased in Arizona. Arizona's direct written premium decreased by 5.9% in 2008 compared to an increase of 2.9% nationally. The decline in Arizona appears to be attributable to the downturn in residential and commercial construction due to a declining economy.

**Trend # 3:** The market is concentrated in the Top 25. The market remains concentrated in the Top 25 that wrote 86.7% of the market in 2008 (86.0% in 2007). The Top Five insurers in 2008 controlled 51.1% (up from 46.5% in 2007) of the market.

**Trend # 4:** Groups control a major portion of the market. Thirty groups control a market share of 92.2% in 2008. The St. Paul Travelers Group ("SPTG") has the largest share with 21.9% in 2008, up from 19.7% in 2007.

**Trend # 5:** Arizona's loss experience is performing better than the national market. The Arizona 2008 all-insurer surety incurred loss ratio of 0.7% is better than the national 2008 incurred loss ratio of 13.7%.

**Trend # 6:** The Arizona surety combined ratio decreased. The 2008 combined ratio of 55.2% is lower than the 67.1% in 2007. Four of the last five years have been profitable; however, because the Arizona surety market is heavily based in contract surety, the volatile nature of these types of bonds could impact future experience.

**Trend # 7:** More insurers are exiting than entering the market. Five insurers entered, while seven exited.

**Trend # 8:** A majority of the market continues to actively seek new surety business. A market share of 76.8% is actively seeking new Arizona surety business in 2009 compared to 63.2% in 2008.

**Trend # 9:** Insurers are not increasing the number of new business declinations or nonrenewals. A majority of the market (94.3% for new business declinations and 94.5% for nonrenewals) is not increasing or decreasing the number of declinations or nonrenewals in 2009.

**Trend # 10:** The degree to which insurers believe rates impact solvency is decreasing slightly. A market share of 44.8% responded in the 2009 survey that rates impact solvency, down from 48.1% in 2008.

**Trend # 11:** Reinsurance is available. A market share of 2.6% says that obtaining reinsurance is problematic in 2009. This is an increase over the .7% share that responded similarly in 2008.

**Trend # 12:** The majority of the market perceives that underwriting cycles impact surety. A market share of 96.9% responded in the 2009 survey that underwriting cycles impact surety.

## VI. Conclusions:

Most surety business written in Arizona is contract surety. Incurred loss ratios and combined ratios improved in 2008. Four out of the past five years have been profitable for surety in Arizona and Arizona performed better than the national market. The market remains concentrated in the Top 25 insurers and more insurers exited than entered the market. Insurers are actively seeking new business, are not increasing declinations or nonrenewals, and find reinsurance is available.