Why Regional Insurers Rate

Regional and Specialty Carriers Are Critically Important Carriers in the Marketplace

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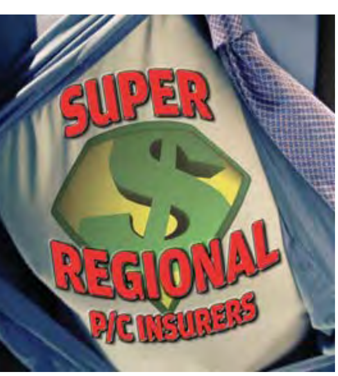
By Joseph L. Petrelli

This year, 2008, marks the second year in a row that Demotech Inc., as *Insurance Journal's* official research partner, published our company classification system, including the list of Super Regional Property/Casualty Insurers™. Although the Super Regionals have received the most attention, the other categories (Nationals, Near Nationals, Regionals, State Specialists, Coverage Specialists, Strategic Subsidiaries, Risk Retention Groups, Surplus Lines Carriers, Reinsurers and Companies with less than $1 million in direct written premium) each play a unique role.

After review of the year-end 2007 financial information from property/casualty insurers, the number of companies in the specified classifications are as follows:

- Nationals (44)
- Near Nationals (63)
- Regional and specialty insurers (1,900)
- Super Regionals™ (152)
- Regionals (285)
- State Specialists (862)
- Coverage Specialists (354)
- Risk Retention Groups (247)

As expected, Nationals and Near Nationals, although small by count, leveraged their substantial resources and wrote the majority of the industry's dollar volume. However, the 1,900 regional and specialty carriers are critically important players in the marketplace.



The industry should be reminded of the importance of regional and specialty insurers. While the international rating agencies remain focused on Nationals and Near Nationals, Demotech has provided Financial Stability Ratings® to regional and specialty insurers since 1988 to level the playing field. As insurers thousands of times larger falter and fail, the overwhelming majority of regional and specialty insurers remain financially sound. They serve specialized markets while successfully weathering the same challenges as the Nationals and Near Nationals.

In terms of insolvency, other rating agencies favor the diversification that larger insurers achieve by offering an array of products in numerous geographic areas. While other rating agencies favor insurers of size, diversity of products and geography, analysis reveals that insurers often fail due to internal practices, including meeting the quarterly earning expectations of external analysts. As loss and loss adjustment expense reserves (LAE) are the largest item to impact earnings, if companies reduce reserves by a dollar, they make a dollar on a pre-tax basis.

By sticking to the knitting, regional and specialty insurers remain financially stable over an extended period. Our Financial Stability Ratings® have a proven record of predicting long-term solvency. That is because we look beyond the size of the insurer. We know what to look for and where to find it in the financial statements.

Since 1989, Demotech has reviewed regional and specialty insurers on a quarterly basis. We expect to find that the insurer, its agents and core customers value stable relationships. Neither the agent nor the insurer is apt to cut and run due to cyclicality. We find that management is typically self-disciplined, avoids ruinous price wars, maintains consistent underwriting guidelines — even at the cost of market share — and seeks to establish adequate, not merely reasonable, loss and LAE reserves.

Regional insurers are self-disciplined, avoid ruinous price wars, maintain consistent underwriting guidelines and have adequate, not merely reasonable, loss and LAE reserves.

The majority of regional and specialty companies were created to address a specific problem — either 150 years ago or today. For example, in the medical malpractice insurance market, numerous regional monoline carriers were founded with the encouragement of medical practitioner associations. With regard to property insurance, since 1996, regional homeowners' insurers have filled a void in Florida, as well as in other jurisdictions.

Are regional or specialty insurers a risky proposition because of limited geographical operations, small size, a limited portfolio of products, or other qualitative and arbitrary criteria? Not the ones that we rate "A" or better. Bigger, with more lines of business in more geographical areas, is not always better — ask anyone associated with Legion, Reliance, Home, Kemper, Mission or Villanova.

Insurance agents, brokers and consumers should be comfortable using financially stable regional and specialty insurers that have earned a Financial Stability Rating® of "A" or better from Demotech. These companies will be serving their markets and paying claims for years to come. IJ

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