STATUS REPORT ON THE SOUTH CAROLINA COMMERCIAL LIABILITY INSURANCE MARKET

SUBMITTED BY:

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Executive Summary

Background

In February 2019, the South Carolina Department of Insurance (SCDOI) received a request from staff of the Senate Judiciary Committee (the Committee) for information on South Carolina's liquor liability insurance market. In response, the SCDOI issued a mandatory data call to the insurance industry in accordance with S.C. Code of Laws Section 38-13-160. That data call was largely framed after those conducted previously by the Iowa Insurance Division and the Missouri Department of Insurance; it requested detailed information on coverage written and claims payments from 2016 to 2018. The SCDOI also contacted insurance agents and brokers to obtain anecdotal information to supplement the data obtained and issued a report on the findings later that year.

In 2023, the Committee expanded its request for information to include additional sub-lines of the commercial liability marketplace. In response, the SCDOI issued an expanded mandatory data call in June 2023. This data call was designed by SCDOI staff with the goal of collecting data more commonly found in traditional actuarial analyses, including premiums, losses, defense and cost containment expenses, claim counts, and subrogation recoveries. As before, industry personnel were consulted for their observations.

Data Limitation

This report was compiled using data submitted by insurers authorized to write coverage in South Carolina in response to the data call. Its contents and conclusions presume the accuracy and reliability of those responses.

Summary Findings

The purpose of the data call and subsequent analysis was to assess the insurance industry's profitability and participation in the following sub-lines of commercial liability insurance: Liquor Liability, Cyber Liability, Foster Home Liability, Commercial Automobile Liability, and All Other Commercial General Liability. Important takeaways from this analysis include assessments of the availability and the affordability of these sub-lines for South Carolina businesses. The primary findings (discussed in more detail later in the report) are summarized here:

> Liquor Liability – The insurance industry has been extremely unprofitable in its writings of this sub-line in South Carolina since 2017, losing about $1.77 for every $1.00 of premium earned over the six years observed. In the best performing of those six years (2018), the industry lost roughly $0.91 per $1.00 of premiums earned, while losing about $2.60 per $1.00 of premiums earned in the worst performing year. These same insurers have experienced

better results in our neighboring states, where the data suggest that insurers have realized a net profit over time. While premiums in South Carolina have grown over the last six years, the number of insurers writing coverage has remained relatively flat since 2019. The data seem to confirm the anecdotal assertions, made by both insurance companies and small businesses, of a very troubled and challenged marketplace.

Cyber Liability – The insurance industry's profitability, while somewhat volatile on a year-to-year basis, has been positive over the last six years for this sub-line. Combined ratios for the industry in South Carolina were well below breakeven in five of the six years, indicating a net profit. Premiums have grown significantly, nearly quadrupling, while the number of insurers writing this business has grown from 41 to 54. This marketplace, while growing substantially, appears to be functioning fairly well according to the data reported.

Foster Home Liability – While this is a smaller market, the premiums earned in South Carolina have tripled since 2017. The number of insurers is small and was no higher than seven. This market has been fairly profitable, only experiencing an average combined ratio above breakeven in one of the six years reported.

Commercial Automobile Liability – This appears to be a very competitive sub-line of business in South Carolina, with industry combined ratios between 99% and 114% in the six years observed. This experience is a little better than that observed in two of the other three states referenced. Earned premiums have nearly doubled, from $259 million in 2017 to $515 million in 2022, while the number of policies written was only 3% higher in 2022 than in 2017. The number of writers has grown steadily, from 71 to 78 over the reference period. This market seems to be functioning fairly well and is relatively competitive, though the rising average premiums seem to correspond with rising loss and expense costs.

All Other Commercial General Liability – This sub-line also appears to be very competitive and well-serviced by the insurance industry despite South Carolina combined ratios ranging from 106% to 158%. This is similar to what is observed in the surrounding states, and while the total premiums earned have risen roughly 44% since 2017, the number of policies written has only increased by about 9%. In other words, insurance premiums have likely risen in response to rising costs being experienced by insurers.

Methodology

Data

The data collected from the insurance industry includes both premium-related information and loss-related information for calendar and accident years 2017 to 2022, valued as of March 31, 2023. The SCDOI collected information from not only insurers that cover South Carolina insureds but also from the insurance policies written by those same companies in Florida, Georgia, and North Carolina.[1]

Premium-related information consists of the number of written policies in each year and the amount of earned premium in each year. From this information, the total earned premium volume, the total number of written policies, the number of insurance groups participating in the markets, and the relative market shares of those insurers were determined. This information is useful in drawing conclusions as to how each of these markets is functioning and how concentrated the markets are. It is also useful in determining the perceived profitability of each of these sub-lines, when these earned premiums are compared with estimated costs incurred (i.e., estimated losses and expenses) by the market participants.

Loss-related information includes incurred losses, incurred defense and cost containment expenses (DCCE), and recoverable amounts collected. In addition to the information from the data call, several aggregate industry reports were referenced for establishing benchmark expense levels and loss development patterns. Since the loss-related amounts from the data call do not represent the final, or ultimate, value of the claims reported, it is necessary to use loss development factors to estimate their final value. The most recent aggregated financial statements were reviewed to determine the loss development factors implied by the industry's carried liabilities. In addition, the most recent South Carolina-specific statistical loss development study from the Insurance Services Office (ISO) was reviewed. The ISO is one of the largest statistical reporting agencies for commercial liability insurance (excluding workers' compensation).

To evaluate the estimated profitability of the industry in these markets, it is necessary to compare the estimated losses and expenses with the premiums earned. To determine estimated expense levels, aggregated financial statement information from both the National Association of Insurance Commissioners (NAIC) and A.M. Best was reviewed to establish benchmark levels for underwriting expense ratios and adjusting and other expense (A&OE) ratios to premiums. These benchmark expense ratios were combined with the estimated ultimate loss and DCCE ratios within each sub-line of business to develop combined ratios. The sum of the loss ratio with the expense ratio is commonly referred to in the

[1] The SCDOI contemplated obtaining data from a broader group of states. However, not all insurers were cooperative, citing the SCDOI's lack of jurisdiction to require insurers that do not write in this state to provide information on coverage written in other states.

industry as the combined ratio. These sub-line-specific combined ratios were then compared to a so-called "breakeven" combined ratio of 100%, not only for South Carolina, but also for each of the three neighboring states mentioned earlier. Reviewing these combined ratios for each of these four states with the breakeven combined ratios, in conjunction with the information collected regarding the market participants, allows for conclusions to be drawn regarding how well the markets have been functioning over the latest several years.

Definitions

This report contains terms common to the fields of insurance and actuarial science. Definitions are as follows:

- *Accident Year* – Losses collected on an accident year basis are from accidents occurring within the same twelve-month period, regardless of when the policy was written and regardless of when the losses were reported or paid.
- *Adjusting and Other Expenses* – Amounts incurred by insurers to investigate and settle claims, including claim department salaries and other operating expenses of the claims department.
- *Underwriting Expenses* – Amounts spent by insurers to acquire and service policies, excluding claim costs, defense costs, and other claim-related expenses.
- *Calendar Year* – Policy information collected on a calendar year basis pertains to the policies written and exposed to loss in the same twelve-month period beginning January 1.
- *Combined Ratio* – The sum of an insurance company's loss ratio (incurred losses as a percentage of earned premiums) and its expense ratio (underwriting expenses as a percentage of written premiums); used to communicate the profitability of the insurer, where a combined ratio below a breakeven 100% would represent underwriting profitability.
- *Defense and Cost Containment Expenses* – Amounts incurred by insurers to pay for defense attorneys, medical evaluations, medical reviews, and other activity related to the defending claims.
- *Earned Premium* – The portion of each policy's premium that has already been exposed to loss.
- *Loss Development Factors* – Factors, estimated typically by actuaries, to apply to current immature losses (paid or incurred) in order to estimate the ultimate settlement value of all claims, both reported and yet-to-be reported.
- *Paid Losses* – The value of all claim payments made at the time of the data collection.

- *Incurred Losses* – The value of all claim payments plus the value of all reserves at the time of the data collection.

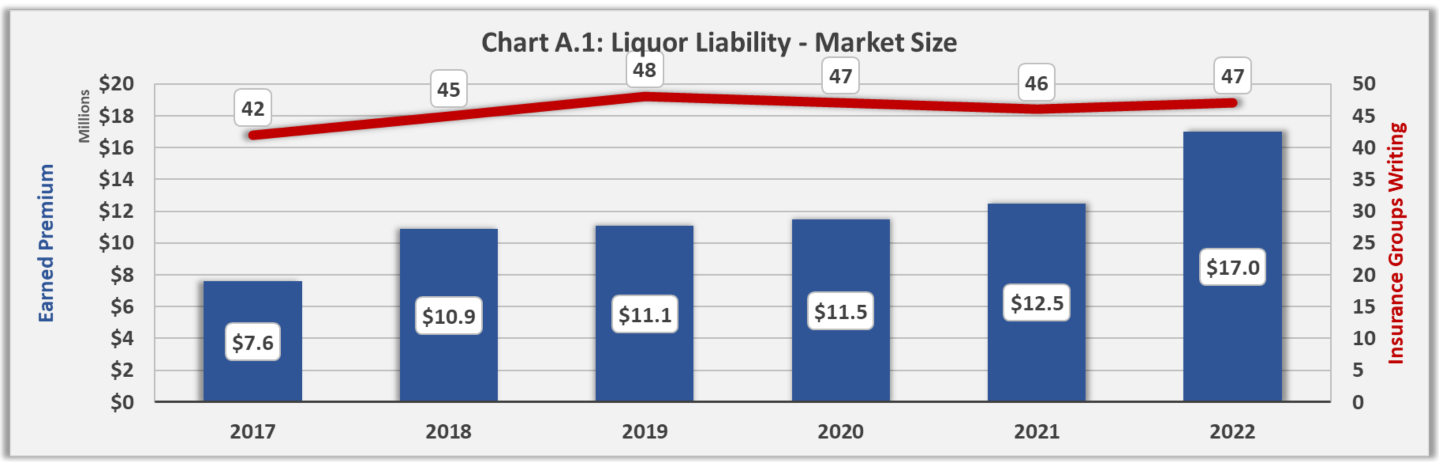
- *Policy Year* – Premium and loss information pertaining to the twelve-month period in which the associated policies were written, regardless of if/when any losses occurred.

- *Recoverable* – Claim-specific amounts that offset the claim costs incurred by insurers, most typically the amounts received for the salvage value of property received by the insurer in exchange for claim payment of total property losses and the subrogation of amounts received from liable third parties for some or all of the claim costs incurred by insurers.

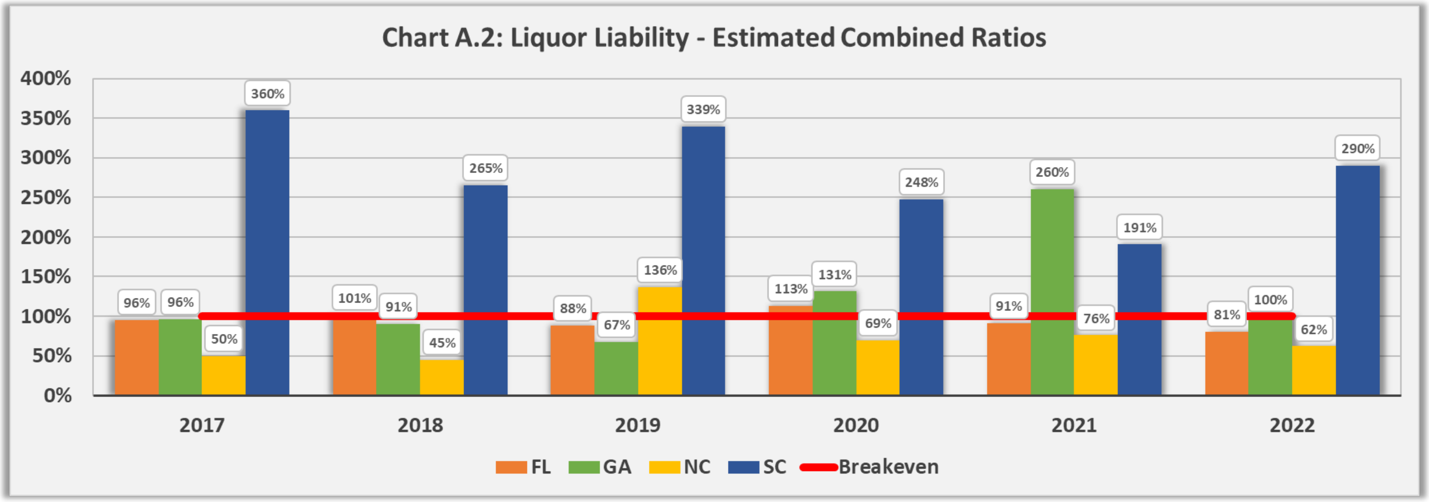
Detailed Findings

A. Liquor Liability

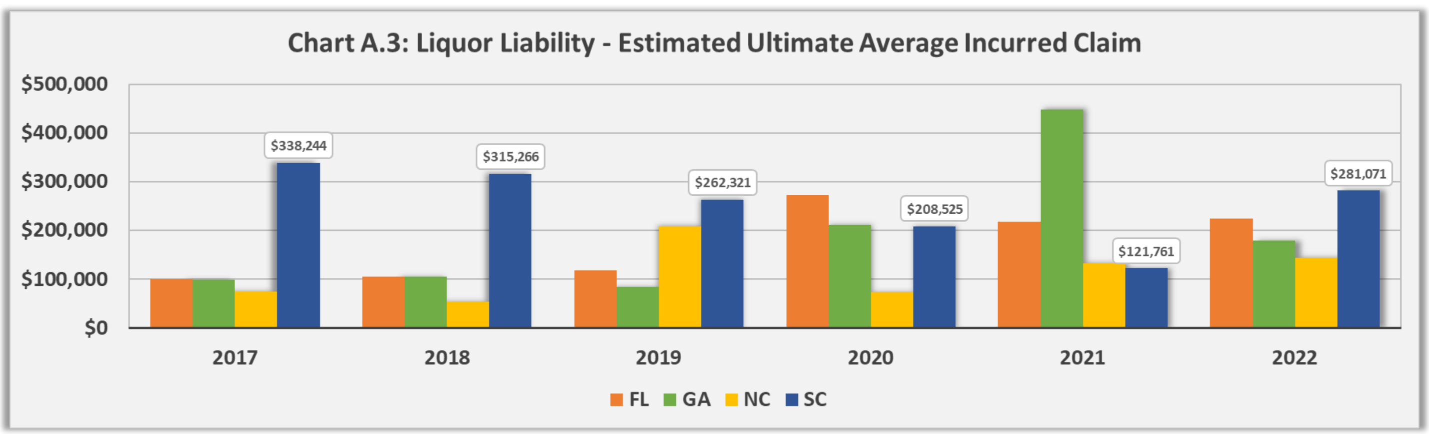
In 2019, the number of insurance groups participating in this market grew from 45 to 48. Since then, the number of participants has remained relatively flat (*see* Chart A.1). The amount of earned premium more than doubled from 2017 to 2022. While there are other factors that can contribute to the rise in the average and total premiums, increasing rates contribute to this growth, and that is consistent with anecdotal information received from various interested parties. The three insurance groups with the most earned premium from business written in South Carolina were Liberty Mutual, IFG, and Berkshire Hathaway.



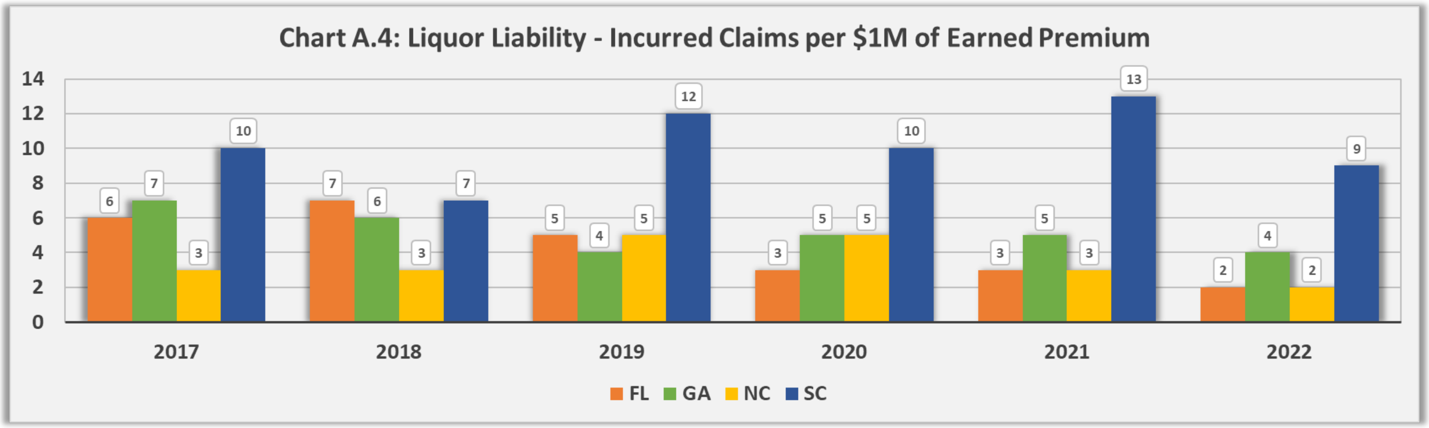
Combined ratios for the industry make it clear that this sub-line of insurance is being written at massive underwriting losses. In comparison to a breakeven combined ratio of 100%, combined ratios in SC have been roughly 190% to 360%, with the most current year being 290% (*see* Chart A.2). For perspective, a combined ratio of 290% means that insurers expect to ultimately spend $2.90 in claims and expenses for every dollar of premium they earned in 2022. The experience in our neighboring states for the South Carolina insurers has been much less unprofitable which is consistent with anecdotal information received from interested parties.



The estimated ultimate average incurred claim value is generally referred to as claim severity, and changes in this metric over time are commonly tracked within the insurance industry. Although higher in previous years, claim severity in South Carolina is more in line with that of the surrounding states over the last few years (*see* Chart A.3).

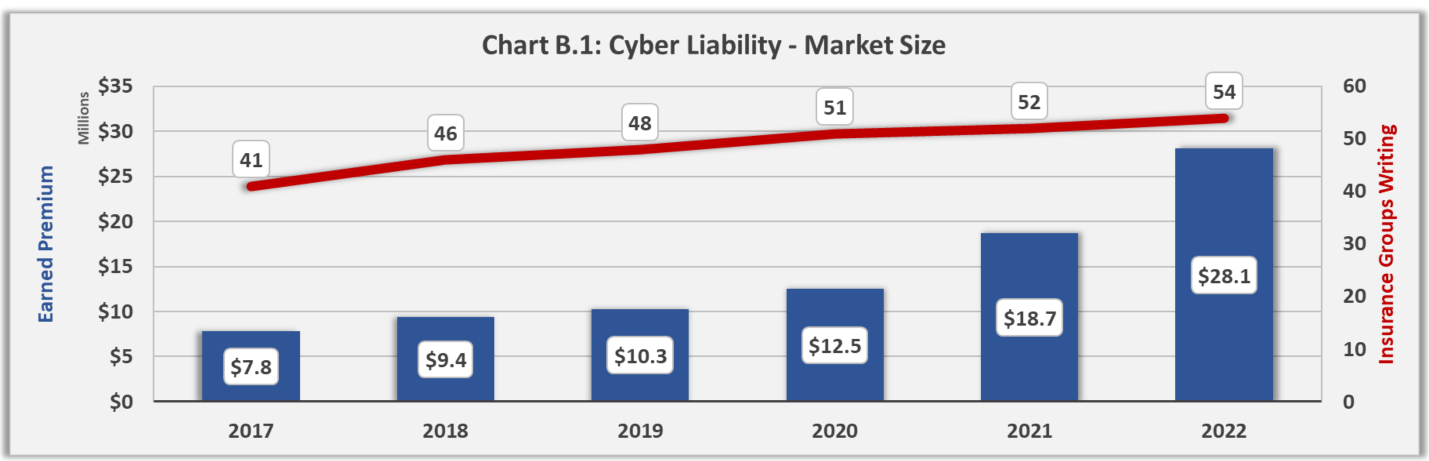


The number of incurred claims per million dollars of earned premium is a measure of claim frequency, which is widely utilized in assessing insurance claim patterns. From 2019 to 2022, South Carolina's claim frequency has outpaced that observed in the other states considerably (*see* Chart A.4).

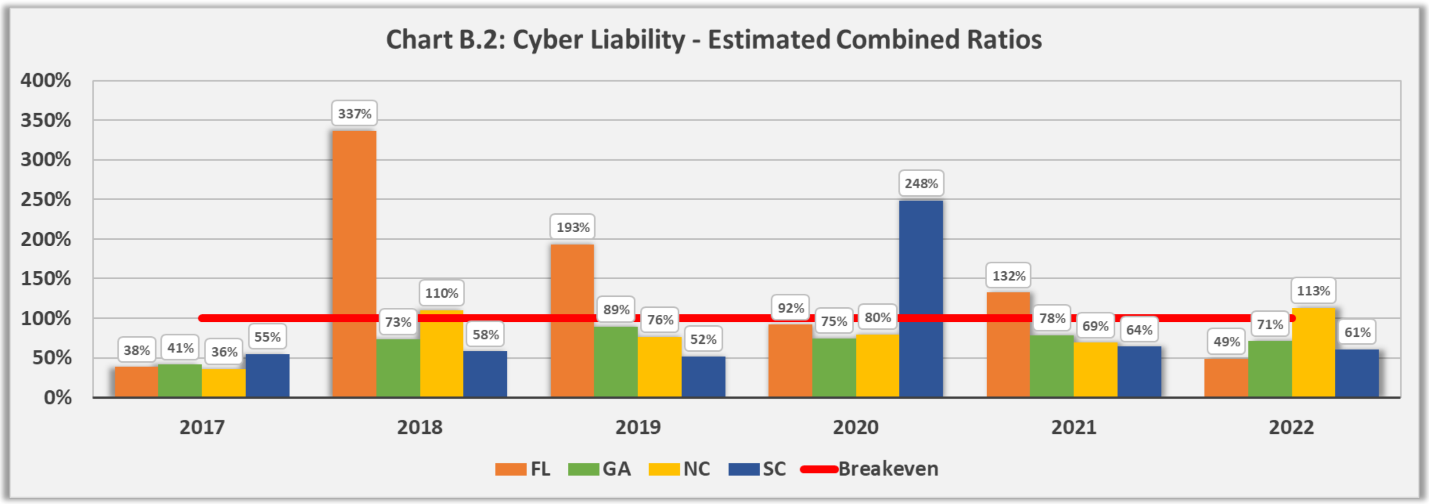


B. Cyber Liability

The number of market participants in this sub-line of business has grown consistently, from 41 in 2017 to 54 in 2022. The earned premiums have grown significantly, from just below $8 million in 2017 to $28 million in 2022 (*see* Chart B.1). The three insurance groups with the most earned premium from business written in South Carolina were Fairfax Financial, Arch, and Travelers.

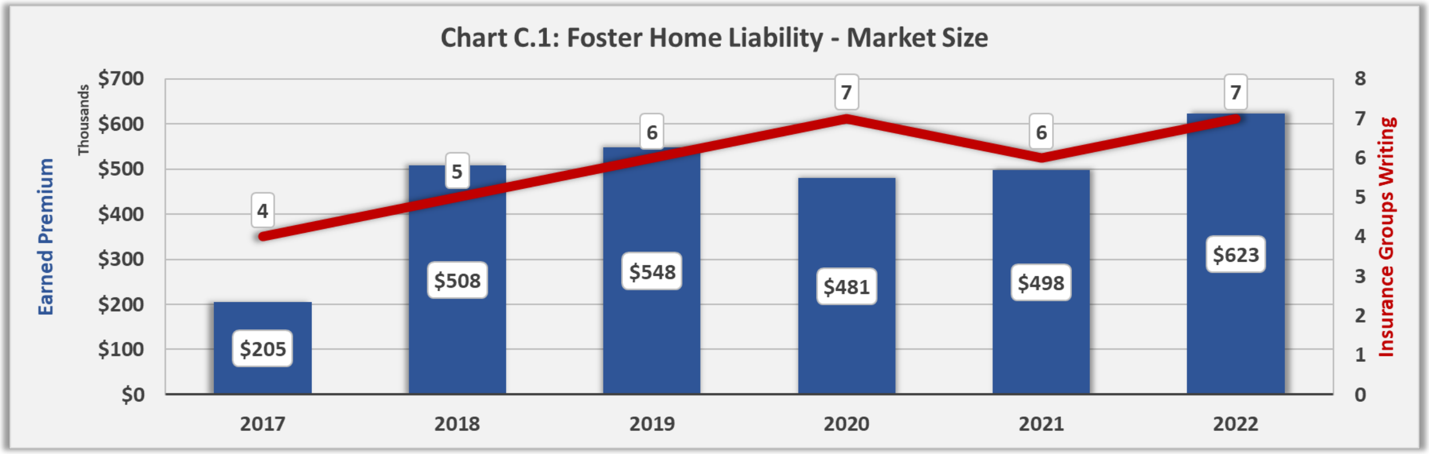


While the profitability of South Carolina business was rather unfavorable in 2020, the other five years were much more profitable (*see* Chart B.2). When writing commercial liability coverages, which generally have much higher limits than most personal lines products, there is more exposure to fairly large claims—which can make year-to-year results more volatile. It is not uncommon for commercial liability writers to experience occasional poorly performing years, and a market of this size can experience such a pattern as well. Based upon these premium and combined ratio results, this appears to be a fairly well-functioning marketplace, although it is growing significantly. The insurance industry's appetite for more of this business is not known, but at this time, there does not appear to be a problem with availability. Since both total and average earned premiums have grown significantly, it is possible that the rates being written are rising. However, we do not have data showing how much of the premium growth is from increasing rates, and how much is from the sheer increasing volume of policies being written.

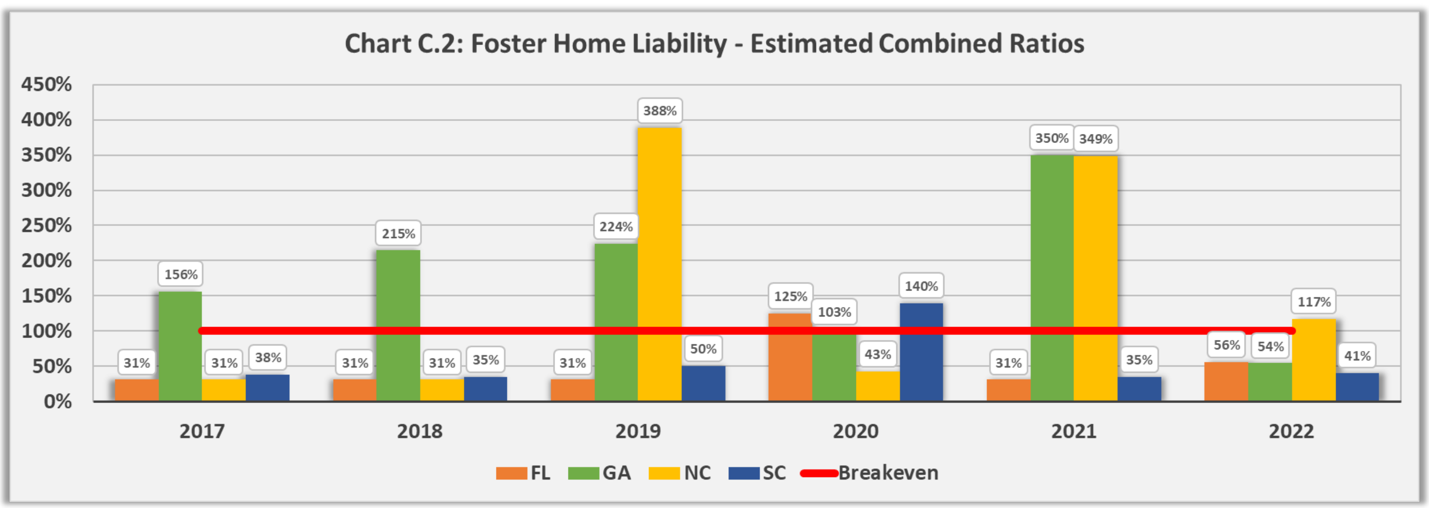


C. Foster Home Liability

Only four to seven insurers reported earning premiums for this specific sub-line of commercial liability insurance over the 2017 to 2022 timeframe, and while the earned premiums have tripled since 2017, the earned premiums in 2022 were still only $623,000 (*see* Chart C.1). Interestingly, the number of policies written in South Carolina decreased substantially, while the average premiums earned rose. Consolidation of providers may be a possible reason for this pattern in written policies and earned premiums, but that is speculative as the data are not extensive enough to draw reliable conclusions for this sub-line.

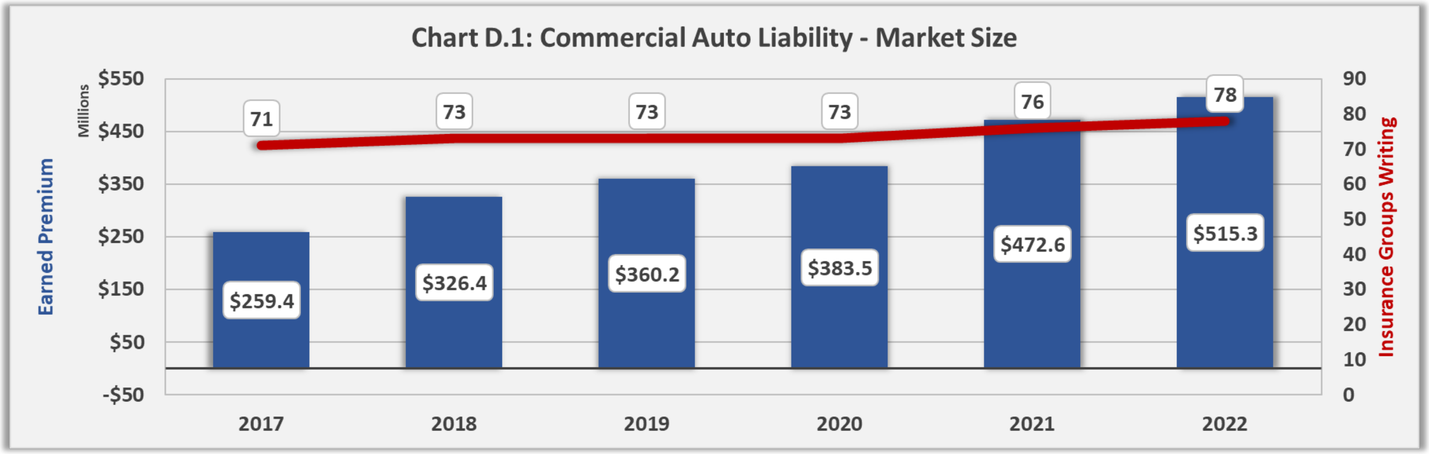


The pattern of combined ratios in South Carolina appears to be typical for a commercial liability product, namely one very unprofitable year out of six, with the other years appearing rather profitable (*see* Chart C.2).

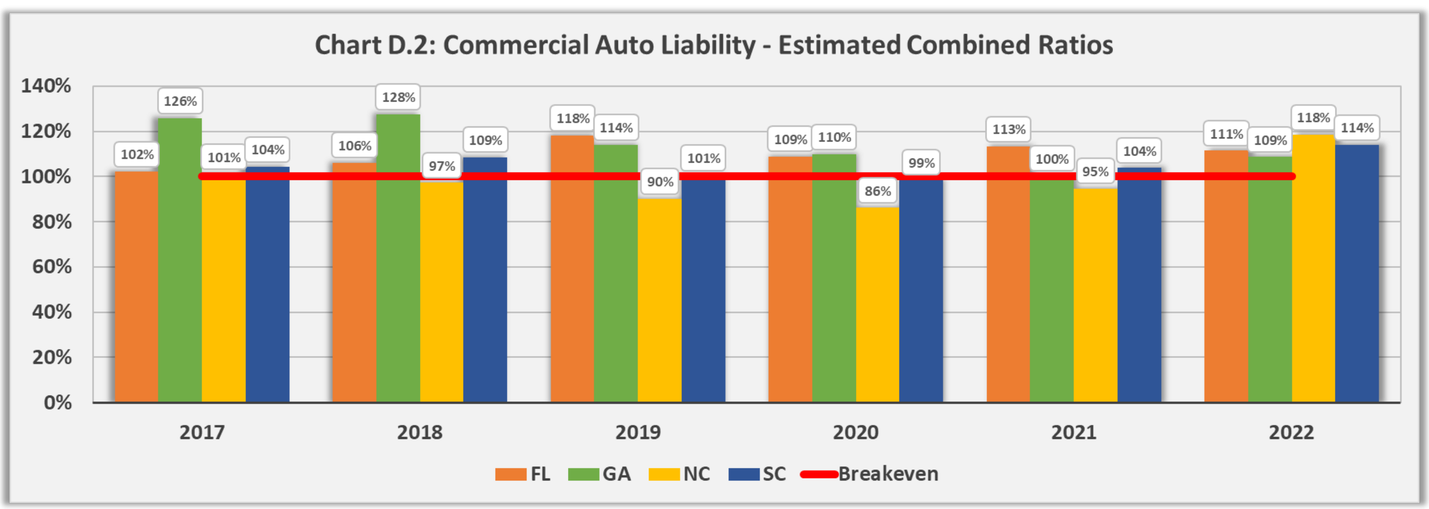


D. Commercial Automobile Liability

The number of market participants in this sub-line of business has grown moderately, from 71 in 2017 to 78 in 2022. The earned premiums have grown significantly, from a little just under $260 million in 2017 to more than $500 million in 2022 (*see* Chart D.1). The three insurance groups with the most earned premium from business written in South Carolina were Progressive, Auto-Owners, and Liberty Mutual.

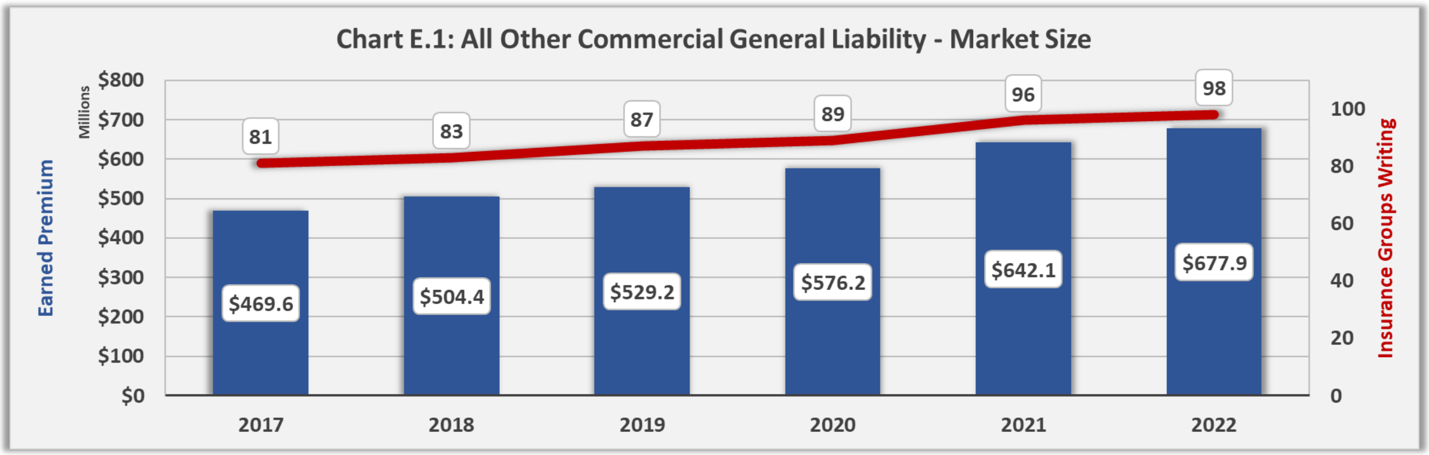


While the profitability of South Carolina business was unfavorable in 2022, combined ratios for all six years appear to have been at or slightly above breakeven (*see* Chart D.2). This is consistent when comparing South Carolina results with the results of the surrounding states, and it corresponds with the perception that commercial automobile liability is sometimes written as an accommodation so that entire commercial accounts may be written by the same insurer. Insurers invest a portion of premiums held as claims reserves until the associated claims are actually paid; the presence of investment income serves to offset underwriting losses to some extent. Based upon these premium and combined ratio results, this appears to be a fairly well-functioning marketplace, although costs have grown significantly.



E. All Other Commercial General Liability

The number of market participants in this sub-line of business has grown consistently, from 81 in 2017 to 98 in 2022. The earned premiums have grown significantly, from almost $470 million in 2017 to about $678 million in 2022 (*see* Chart E.1). The three insurance groups with the most earned premium from business written in South Carolina were Liberty Mutual, Nationwide, and Chubb.



The profitability of South Carolina business was unfavorable, with combined ratios at or above breakeven in all years (*see* Chart E.2). However, the results for the more recent years appear more favorable, and South Carolina's results were not unlike those observed in the neighboring states. As stated in Sub-section D. above, insurer results benefit to a degree from investment income gained on their held claims reserves. Based upon these premium and combined ratio results, this appears to be a fairly well-functioning and competitive marketplace, although costs are rising.