Welcome to the 2016 Annual Meeting
Welcome

Denis Brady
Chair
Board of Directors
Head Table

- **Benjamin McKay**—SLA of California
  *Executive Director*

- **Joy Erven**—SLA of California
  *COO and Director*

- **Jim Woods**—Mayer Brown LLP
  *General Counsel*
Antitrust Resolution

When involved in meetings or other activities of the Association, members of the Association should be mindful of the antitrust laws and not engage in discussions or conduct with the purpose or effect, directly or indirectly, of fixing or stabilizing premiums or producer compensation, engaging in “bid-rigging” or false quotes for insurance, engaging in potential anti-competitive conduct or activities that could adversely affect the cost, quality or availability of insurance products or services, or engaging in any other anti-competitive conduct or activities affecting their businesses or the business of insurance. Members are advised that violations of state or federal antitrust laws may result in civil and/or criminal penalties, and that any member acting contrary to the intent of this resolution shall be subject to disciplinary action under the Association’s Constitution.
Previous Annual Meeting Minutes
Report of the Chair

Denis Brady
Chair
Board of Directors
SLA Website Improvements

- Page views skyrocketed from about 1,000 a month before new website to an average of 24,000 a month after new website launch.
Report of the Chair

Old SLA Website
Report of the Chair

Current SLA Website
SLA Website Improvements

- Ongoing improvements to help provide best and most useful tools to members and other stakeholders
IN 2015

THE SURPLUS LINE ASSOCIATION OF CALIFORNIA

LAUNCHED ITS NEW WEBSITE
Report of the Chair

- Paperless Initiative
  - From paper filings to SLIP online filing
  - From paper checks to ACH/e-check
  - From paper records to cloud-based system
  - Transformed filing room to state-of-the-art training room
Report of the Chair

➢ From Filing Room to Training Room
Report of the Chair

- Rebranding and Outreach
  - Changing our image from old, bureaucratic, reactive to forward-thinking leader focused on serving members, consumers

SLA Logo, 2013

SLA Logo Today
Report of the Chair

- Rebranding and Outreach
  - Increasing our outreach to legislators and regulators so that they understand our crucial role
Report of the Chair

Old Brochure

THE STORY OF NON-ADMITTED INSURANCE IN CALIFORNIA

The Surplus Line Association Of California

Current Brochure

Information for Legislators and Regulators

This informational brochure will explain who and what we are, who we represent, and how important and necessary our industry is to California’s insurance consumers and the state’s economy.

www.sla-cal.org
Report of the Chair

- **Rebranding and Outreach**
  - Providing better-quality communications to our members to help them stay on top of market trends and what is happening in Sacramento and Washington, D.C.
Report of the Chair

SLA Newsletter, 2013

SLA Quarterly

THE SURPLUS LINE ASSOCIATION OF CALIFORNIA | FIRST QUARTER 2013

REPORT OF THE CHAIRMAN

At the beginning of 2013, I expressed the need to raise the standards of excellence in our field. We are committed to provide the highest level of service to our members and to ourselves. The following pages illustrate our progress towards this goal.

The SLA has been actively engaged in a number of initiatives to improve the quality of our services. We have partnered with the California Department of Insurance to provide training and support to our members. We have also increased our efforts to promote the value of our services to potential clients.

I would like to thank our dedicated team of volunteers who work tirelessly to ensure the success of our organization. Their contributions are invaluable, and I am grateful for their dedication.

SLA Newsletter, Today

The Right Fitt

By Clinton Brown

Fitt is the new chairman of the SLA's California Board of Directors. He has been working with the SLA for over 10 years and has served in various capacities during that time. He is a strong advocate for the SLA and its members.

Fitt's leadership has been characterized by his commitment to excellence and his dedication to the success of the organization. He has worked hard to ensure that the SLA remains relevant and effective in a rapidly changing business environment.

As chairman, Fitt has pledged to continue the SLA's commitment to providing high-quality services to our members. He is committed to ensuring that the SLA remains a vital resource for the insurance industry.
Report of the Chair

Moving Toward Full Service For Members

- SLIP Training
- New filer training program
- Tag reduction program
- In-person training visits to member offices
  - 65 in 2015
  - 0 in 2012
- Millennial outreach
- Calendar of educational offerings
- Relevant, timely classes
Report of the Chair

- Financial Analysis Restructuring
  - Led by our new Vice President, Financial Analysis, Susan Bryant, M.B.A.
  - Better practices for analyzing companies
  - Development of specialists, subject-matter experts
  - Better departmental training to meet the new challenges in financial analysis laws and regulations
  - Creation of internal review teams to analyze each other’s work
Report of the Chair

- **Human Resources**
  - Led by our new Vice President, Human Resources, Pamela Boyes, SPHR, SHRM-SCP
  - Crucially important because the SLA, at its core, is its people
  - Moving forward understanding that employee focus leads to world-class service for members and other stakeholders
Report of the Chair

- SLA processes record $6.1 billion in premiums in 2015
- Bested previous record of $6 billion processed in 2006
- Due to technological advances, better hirings and training, and without raising the stamping fee, the SLA processed this record level of premiums with 21 fewer employees in 2015 than it had in 2006.
Summing up 2015:
- More premiums processed than ever before
- More training to members than ever before
- Greater technological advances than ever before
- All with 27 percent less staff than in 2006

The SLA did more in 2015 than during any other year in its 78-year history, with significantly fewer employees than it had 10 years ago
Report of the COO/Director

Joy Erven, M.B.A.
Chief Operating Officer and Director
The SLA continues to be in good financial condition.

- Our revenue from stamping fees for the fiscal year ending November 30, 2015 was $12,081,286.
- Interest income was $96,725 for the year.
- The total revenue was $12,178,011 for the year.
- Expenses totaled $11,833,098 for the year.
- As of November 30, 2015 the net asset balance was $14,976,317.
- The stamping fee was 0.2% for the 2015 fiscal year and remains unchanged.
State Taxes

- Due March 1, 2016
- Forms Available on CDI or SLA websites
Western States 2016

Western States Surplus Lines Conference
July 13-16
Whistler, British Columbia
If you plan to go to Western States in Canada this summer, make sure you have a current, valid passport as soon as possible.
Executive Director’s Report

Benjamin McKay, J.D., M.P.A.

Executive Director
Executive Director’s Report

In Memoriam

James Stephen Carey
1950-2015

President
Admiral Insurance Company
Executive Director’s Report

Thanks For Attending Today

• Crucial for members to be involved
  o Meet fellow brokers
  o Know what’s happening in the marketplace
• Thanks also to legislators, regulators and their staff for being here
  o Important for decision-makers to be exposed to our industry and gain deeper understanding of it
  o We believe in transparency and working collaboratively to ensure consumers are protected and members can give them the quality service they need and expect
This Is the SLA

- 55-employee association with $13 million annual budget
  - These numbers put us in the “large” category of nonprofit associations
  - Vast majority of associations are small or mid-sized
- Record-setting 2015 with $6.1 billion in processed premiums
  - Represents nearly 1/7 of total U.S. market ($45 billion)
  - California SLA is the largest of 14 stamping offices in United States; next largest are New York and Texas
  - Currently 5,170 licensed California brokers
Nominating Committee Slate

Denis Brady
Chair
Board of Directors
Slate: 2016 Board of Directors

Mr. Chris Houska — R-T Specialty
*SLA Chair*
Mr. Tom Ciardello — Worldwide Facilities, Inc.
*SLA Vice Chair*
Mr. Bob Gilbert — Markel West Insurance Services
*SLA Secretary/Treasurer*
Mr. Denis Brady — Burns & Wilcox Brokerage
*SLA Past Chair*
Ms. Janet Beaver — Scottish American
Mr. Ian Fitt — Catalytic Holdings, LLC

Mr. Rupert Hall — M.J. Hall and Company
Mr. Chris Kiley — AMWINS
Mr. Davis Moore — Worldwide Facilities, Inc.
Ms. Terri Moran — Vela Insurance Services
Ms. Pam Quilici — Crouse and Associates Insurance Services of Northern California, Inc.
Mr. Les Ross — Wholesale Trading Co-Op Insurance Services, LLC
Mr. Gerald Sullivan — The Sullivan Group
Appointmenent of Mediator

The SLA Nominating Committee Recommends Reappointing

Judge Harry Low as SLA Mediator for 2016
Legal Update

Jim Woods
SLA General Counsel
Mayer Brown LLP
What Every Broker (and Insurer) Should Know About Cybersecurity: Challenges and Opportunities

2016 Annual Meeting of The Surplus Line Association of California

February 16 & 18, 2016

James R. Woods

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Why Be Concerned About Cybersecurity?

• “Cybersecurity will be the biggest focus of the insurance industry in the immediate future” - NAIC CEO, Ben Nelson

• Consider what a broker (or insurer) is likely to encounter in connection with a significant cyber breach:
  
  • Expense to respond
  
  • Damage to brand/reputation and resulting loss of sales
  
  • Disruption to management, public relations, marketing and operations
  
  • Regulatory sanctions and government investigations
  
  • Shareholder derivative suits against directors and officers
  
  • Consumer class actions against the company
  
  • Collateral damage to other companies, who then sue
  
  • Decline in ratings
  
  • Possible drop in stock price
  
  • Job loss
The Cost of a Data Breach

• Although the average cost of a data breach is about $6.5 million, several notable breaches have significantly exceeded the average.

• Anthem as an example:
  • **80 million** people affected
  • Over **90 lawsuits** filed including several class actions
  • Multiple regulatory and law enforcement investigations
    • $230 million for expenses associated with the breach
      – Legal, forensic, consumer monitoring, PR
    • $130 million in expenses for future defensive measures
  • Total estimated cost of breach to date: **$360 million**
    • $100 million in insurance coverage
  • Evidence of harm to consumers to date: **$0**
Insurance Industry Under Cyber Attack

Goal: To prevent the disclosure of NPI (non public information) and TSI (trade secret information) through external audits and law enforcement/regulatory partnerships and to best position the company as a defendant should a breach occur.
Rating Agency Criteria and Cybersecurity

- **A.M. Best** views cybersecurity as an "essential element of enterprise risk management"
  - Companies are asked to complete a new section of the self-rating questionnaire reflecting the cybersecurity protections offered and the amount of protection purchased.
  - Lloyd’s has requested syndicates to report their **aggregate exposure to cyber attacks**.
Sources of Regulation of Cybersecurity: NAIC’s 12 Principles for Effective Cybersecurity

- **Principle 1:** State insurance regulators have a responsibility to ensure that personally identifiable consumer information held by insurers, producers and other regulated entities is protected from cybersecurity risks. Additionally, state insurance regulators should mandate that these entities have systems in place to alert consumers in a timely manner in the event of a cybersecurity breach. State insurance regulators should collaborate with insurers, insurance producers and the federal government to achieve a consistent, coordinated approach.

- **Principle 2:** Confidential and/or personally identifiable consumer information data that is collected, stored and transferred inside or outside of an insurer’s, insurance producer’s or other regulated entity’s network should be appropriately safeguarded.

- **Principle 3:** State insurance regulators have a responsibility to protect information that is collected, stored and transferred inside or outside of an insurance department or at the NAIC. This information includes insurers’ or insurance producers’ confidential information, as well as personally identifiable consumer information. In the event of a breach, those affected should be alerted in a timely manner.
NAIC’s 12 Principles for Effective Cybersecurity

- **Principle 4:** Cybersecurity regulatory guidance for insurers and insurance producers must be flexible, scalable, practical and consistent with nationally recognized efforts such as those embodied in the National Institute of Standards and Technology (NIST) framework.

- **Principle 5:** Regulatory guidance must be risk-based and must consider the resources of the insurer or insurance producer, with the caveat that a minimum set of cybersecurity standards must be in place for all insurers and insurance producers that are physically connected to the Internet and/or other public data networks, regardless of size and scope of operations.

- **Principle 7:** Planning for incident response by insurers, insurance producers, other regulated entities and state insurance regulators is an essential component to an effective cybersecurity program.

- **Principle 8:** Insurers, insurance producers, other regulated entities and state insurance regulators should take appropriate steps to ensure that third parties and service providers have controls in place to protect personally identifiable information.
NAIC’s 12 Principles for Effective Cybersecurity

• **Principle 9:** Cybersecurity risks should be incorporated and addressed as part of an insurer’s or an insurance producer’s enterprise risk management (ERM) process. Cybersecurity transcends the information technology department and must include all facets of an organization.

• **Principle 11:** It is essential for insurers and insurance producers to use an information-sharing and analysis organization (ISAO) to share information and stay informed regarding emerging threats or vulnerabilities, as well as physical threat intelligence analysis and sharing.

• **Principle 12:** Periodic and timely training, paired with an assessment, for employees of insurers and insurance producers, as well as other regulated entities and other third parties, regarding cybersecurity issues is essential.
Other Sources of Regulation of Cybersecurity

- NAIC’s Roadmap for Cybersecurity Consumer Protections (December 2015)
- The New York Department of Financial Services (NYDFS) letter to CEOs, G.C.s and CIOs of approximately 160 insurance companies (March 2015)
- EU regulation of personal data
- U.S. Cybersecurity Information Sharing Act of 2015
Reasonableness is the Emerging Regulatory and Legal Standard

• Those in the insurance industry who are not proactively managing the threat of cyber incursion are likely to be exposed to significant legal challenges

• FCC enforcement bureau chief Travis LeBlanc provided guidance on what the Commission considers “unreasonable” privacy and cybersecurity practices at a discussion held by the Media Institute in November 2015:
  – Not securing data obtained from unauthorized third-parties
  – Not providing consumers with notice about what the company is doing with their personal data
  – Not notifying everyone when their data is breached and notifying only some people
What’s a Broker (or Insurer) To Do?  
Seven Key Principles for Board Consideration

1. Understand the risks
2. Stay informed
3. Assess your defenses
4. Create a WISP and a DBRP
5. Take responsibility
6. Know your partners
7. Get insured
Process for Preparing a WISP and DBRP

• Proving reasonableness
  – Importance of having a written information security plan (“WISP”) and a data breach response plan (“DBRP”)

• Select data security legal counsel and IT security consultant

• Perform risk assessment (identify sensitive data, where stored, potential threats, potential harms)

• Select appropriate control framework to identify potential additional controls for discussion
  – i.e., National Institute of Standards and Technology’s framework, PCI Data Security Standard

• Identify controls in place and potential additional controls from framework that would enhance protection

• Identify laws that affect cybersecurity

• Conduct periodic assessments
Cybersecurity Insurance: The Opportunity

• Typically, insurance is offered in the $100-200 million range (and even then only after extensive review of the insured’s cybersecurity policies)

• Cybersecurity coverage represents a huge area of opportunity for underwriters
  • Cyber insurance market likely to triple to about $7.5 billion over the next five years, according to PwC

• Effective cybersecurity coverage is not typically contained in a CGL policy: instead a stand alone cybersecurity policy provides the most comprehensive coverage
  • Provides coverage for first party damage and third party liability
Top Ten Questions Every Broker (and Insurer) Should Answer

1. Have you designated a party responsible to manage cybersecurity (i.e., with the board or CTO)?

2. What training in data security is provided to employees?

3. Does your company purchase cybersecurity insurance? If so,
   • What are the policy limits, and
   • What is covered and excluded under such policy?

4. Do you have a Written Information Security Plan and Data Breach Response Plan?

5. How is data safeguarded and what are the best practices regarding data security (i.e., has the company engaged a forensic expert)?
Top Ten Questions Every Broker (and Insurer) Should Answer

6. What practices are in place to ensure compliance to data protection by third-party service providers?

7. What internal and external controls, policies and procedures are in place to manage a data breach or cyber attack (i.e., has the company engaged in tabletop exercises)?

8. Are cybersecurity risks addressed as part of the company’s enterprise risk management process?

9. Has the company considered the ratings implications of cybersecurity?

10. If the company offers Cyber Insurance Products, has their risk been aggregated?
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Keynote Speaker

Dr. George Zanjani
Georgia State University
The “New Normal” and Beyond: E&S in the New Millennium
Onward and Upward?

• The New Normal – astronomical growth in E&S over the past 15 years
  o $40 billion in DPW in 2014 vs $10 billion in 2000
  o 7% of total market today versus historical norm of 3%
  o Only modest retraction after hard market peak in 2004

• What happened? How did we get here?

• Where could we go? Over 10%. Three potential tailwinds for the E&S Market
  o Low interest rates
  o Big Data / Analytics
  o Catastrophes and other emerging risks
What Happened?

• Market share gains across the board, but biggest gains were in property.

“Disappearing risk” in casualty
+ 
Growth of exposure in catastrophe areas
+ 
Retreat of standard underwriters from property catastrophe

Ongoing shift toward catastrophe-exposed property
Property Share of Nonadmitted Market, 1992-2014
Earthquake: Case Study

Before the CEA: California Earthquake Insurance
Premiums Written, 1916-1996 (Log Scale)

Source: California DOI
Before Northridge: California Earthquake Paid Loss Ratio, 1916-1993

Source: California DOI (Paid loss / Premiums Written)

Earthquake: Case Study
Earthquake: Case Study


Source: California DOI (Paid loss / Premiums Written)

Long Beach, 1933
Loma Prieta, 1989
Northridge, 1994
Earthquake: Case Study

Retreat of the Standard Carriers
Earthquake Takeup - California Residential Market, 1996-2014
Earthquake: Case Study

Nonadmitted Share of US Earthquake Insurance, 1994-2014
Nonadmitted Share of US Earthquake Insurance, 1994-2014
Domestic Nonadmitted Share of Property-Casualty Market, 1992-2014
Where could we go from here? Three things to watch:

- Interest rates
- Big Data
- Catastrophes and other emerging risks
Long and intermediate yields have been declining for 35 years.
US Treasury Yield Curves, 1990-2013
Lower Interest Rates Wreak Havoc with Traditional Performance Measures in Long-Tailed Lines

Med Mal (Occurrence) Industry Accident Year Loss and LAE Ratio, 1990-2012

Direct Loss Ratio
Average 1990-2012

Med Mal (Occurrence) Industry Accident Year Loss and LAE Ratio in Present Value Terms, 1990-2012

Direct Loss Ratio (Present Valued)
Average 1990-2012
Lower Interest Rates Wreak Havoc with Traditional Performance Measures in Long-Tailed Lines

Other Liability (Occurrence) Industry Accident Year Loss and LAE Ratio, 1990-2012

Other Liability (Occurrence) Industry Accident Year Loss and LAE Ratio in Present Value Terms, 1990-2012
Workers Compensation Combined Ratio, 1994-2014

Source: Insurance Information Institute

➔ Underwriting “profit” doesn’t mean what it used to mean… but try telling that to an insurance commissioner in a rate filing. Rate suppression, even if unintended, pushes more business into the E&S market.
A personal auto rating formula…

\[ \text{Premium} = f(\text{age, zip code, # of violations, FICO score}) \]

…updated for the cyber age…

\[ \text{Premium} = f(\text{age, zip code, # of violations, FICO score,}
\text{ # of Facebook "defriends", # of vulgar words "retweeted"}, \ldots) \]

…but would you see that in a filed rate classification scheme? Probably not.
Big Data

Advantages of surplus lines

• Freedom of rate and form

• Freedom to hide insights from competitors

• Insights at standard companies may manifest in underwriting rather than pricing, especially in markets with limited rating flexibility.
Catastrophes and other Emerging Risks

- **Traditional business is under threat**
  - Declining frequency in every casualty line
  - Driverless cars?

- **Room to grow…**
  - Earthquake insurance takeup in CA – about 10%
  - Residential flood takeup - 1-2% outside SFHAs; 50% in SFHAs
  - Cyber risk
Catastrophes and other Emerging Risks

• Traditional business is under threat
  o Declining frequency in every casualty line
  o Driverless cars?

• Room to grow…
  o Earthquake insurance takeup in CA – about 10%
  o Residential flood takeup - 1-2% outside SFHAs; 50% in SFHAs
  o Cyber risk
New Business
Denis Brady receives the Lutine Bell in recognition of his tenure as chair of the SLA Board of Directors and his years of service to the California broker community.
Denis Brady’s Service to the SLA

- **Board of Directors Member, 2010-present**
  - Chair, 2015
  - Vice Chair, 2014
  - Secretary-Treasurer, 2013

- **Audit Committee Member, 2013-15**
  - Chair, 2015
The HMS Lutine and Its Bell
Lutine Bell Presentation

Thank You,
Denis Brady!
Thank you for attending.

Please proceed to the foyer for refreshments.