



Premium grade

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Understanding the insurance industry, including reinsurance and surplus lines



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The lawyer sat with a newer associate reviewing the discovery responses and insurance policy documents the defendant had finally disclosed. Stacked layers, including one that listed itself as a surplus lines insurer. The associate, new to more complex insurance coverage, was in for a ride...

The house always wins

Insurance operates on a simple premise: Collect more in premiums than one pays out in claims, then invest the difference. Like a casino, insurers rely on mathematical probabilities across large populations. They know there will be some claims payouts for all the premiums taken in. But the carriers bet that the market returns the invested premiums provide will exceed claims payouts. The difference becomes profit. The threats to profit? What the industry calls thermonuclear verdicts, undervaluing claims risks, and sudden market downturns that deflate the invested premiums.

Attitude adjustment

Adjusters serve as frontline soldiers in the insurers' battles to minimize payouts. Adjusters have limited authority. They can't simply tender the policy limits because they think a case is worth it. They need approval from supervisors, who need approval from managers, who answer to executives who watch the quarterly numbers. Every dollar paid must be justified. This is why a well-documented demand package that answers every question an adjuster and the adjuster's higher-ups might have (with supporting documentation) is more likely to resolve a case than threats and a police report.

Adjusters initially establish reserves. This is their estimate of the case's upper resolution value. The reserves get reported up the chain. The reserves impact the company's financial position, including how much money can be invested and where. Too high, and their superiors question their judgment. Too low, and they look incompetent if they need to request more to settle the case (or if the verdict goes big.) Giving adjusters documentation early helps them properly set reserves. This then provides adjusters the settlement authority our side needs to obtain just results without dragging our clients through trial.

Premium price

Insurance premiums rise and fall with market cycles, catastrophic events, and investment returns. During good times, insurers compete aggressively for business, driving premiums down. When losses mount or investment returns shrink, premiums spike (while the carriers blame plaintiffs' lawyers). Economic downturns create particular pressure. When investment portfolios crater, insurers aggressively protect capital and delay claims, hoping the market returns before the money is needed. Conversely, when the stock market soars, they're more willing to litigate because their investment income cushions underwriting losses.

The coverage puzzle

Primary insurance covers initial losses up to policy limits. But larger risks require excess coverage – additional layers that kick in

once primary limits are exhausted. A small trucking company might carry \$1 million primary with \$9 million excess, creating \$10 million total coverage. Excess carriers often take a hands-off approach. They assume the primary carrier will resolve cases within primary limits. When primary limits are insufficient, excess carriers suddenly become very interested parties, sometime supplementing (or replacing) the defense team. They may assert control over settlement negotiations or demand the primary carrier contribute toward excess-level settlements.

Reinsurance and the global market

Insurers frequently purchase reinsurance (think insurance for insurance companies) to mitigate risk. The result? A global risk-sharing network with major hubs in London, Bermuda, Singapore, and Switzerland. One, Lloyd's of London, founded in 1689 to mitigate shipping risks, identifies itself as "the world's specialist insurance and reinsurance market," with "the largest commercial (re) insurance marketplace in the world." When one sees unusual policy structures or exotic coverage terms, there may be Lloyd's syndicates involved. Lloyd's is its own complex topic. For those interested, check out the Bar Association of San Francisco's CLE on Demand page for "De-mystifying Lloyd's and the London Insurance Market."

Government fallbacks

Sometimes insurers fail despite regulatory oversight. The California Insurance Guarantee Association (CIGA) steps in as the insurer of last resort, but with significant limitations. CIGA coverage only applies to admitted carriers. This becomes important when one encounters surplus lines policies. Surplus lines carriers operate outside normal regulatory oversight, often with tantalizingly low premiums. If surplus lines carriers fail (and they do) CIGA won't step in. The broker, however, sometimes becomes a target defendant. If this very niche issue is yours, check out *Nowlon v. Koram Ins. Center, Inc.*, (1991) 1 Cal.App.4th 1437.

Agents and brokers

Insurance agents represent insurers and owe primary duties to the companies they serve. Insurance brokers represent insureds and owe fiduciary duties to the insured. These distinctions create different liability exposures when coverage disputes arise. An agent who misrepresents policy terms might trigger insurer liability under apparent authority theories. A broker who fails to obtain adequate coverage may face broker negligence claims. This becomes a potential collectability avenue when the defendant has improper or inadequate coverage for a loss.

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Back to our lawyer and newer associate. The associate, now schooled in insurance's mysteries, had new homework: examining that surplus lines carrier's financial viability given where it fell in the insurance stack.

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