MPL OPERATING RESULTS CONTINUED TO IMPROVE DURING Q3 2021

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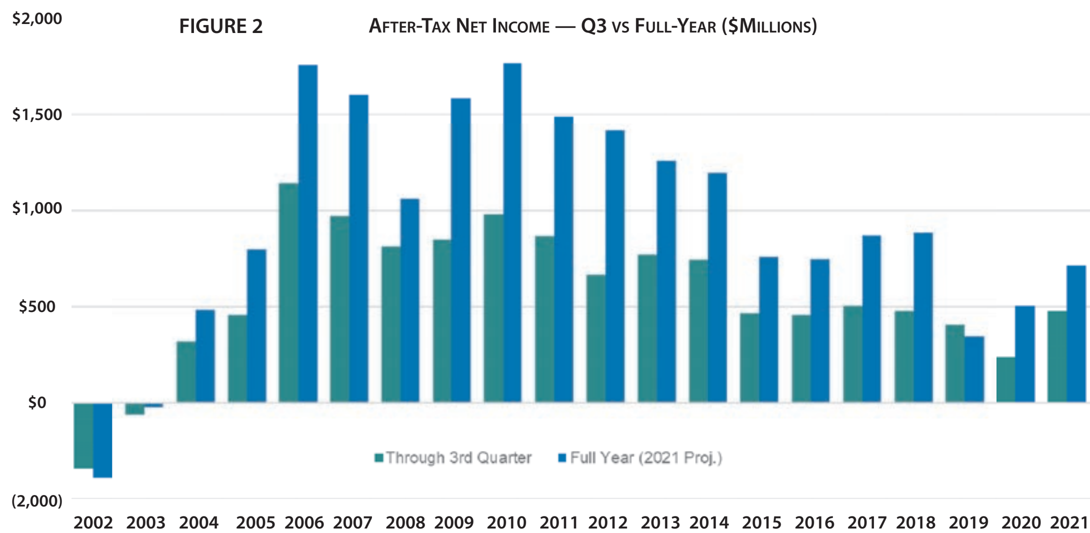
This article summarizes key financial results for medical professional liability (MPL) specialty writers from the third quarter of 2021 and continues our 12th-consecutive year of tracking and publishing these results in MEDICAL LIABILITY MONITOR. As in past years, this article compares historical third-quarter financial results to historical annual results in order to offer a glimpse at where, perhaps, 2021 annual financial results might be headed. With the country — as well as the MPL industry — continuing to feel the effects of the COVID-19 pandemic, and bracing for new variants, we look back at the financial results for the third quarter of 2021.

FIGURE 2 AFTER-TAX NET INCOME — Q3 VS FULL-YEAR ($MILLIONS)



Our analysis is based on the collective financial results of a large group of insurers specializing in MPL coverage. The data used in our analysis dates to 2002 and consists of aggregate statutory financial information compiled from S&P Global Market Intelligence. The current composite includes 173 MPL specialty companies with total direct written premium of more than $6 billion in 2020.

TOP-LINE PREMIUM GROWTH SHOWS CONTINUED DIVERSIFICATION

In our analyses of the first two quarters of 2021, we discussed the hardening market and its associated premium growth in the MPL market. Although that trend continued in the third quarter, it was driven more by non-MPL premiums than earlier in the year. This continues an upward trend that began in 2017, during which non-MPL premiums increased from about 4% of written premium to nearly 10% of written premium this quarter. This increase corresponds with the general premium increases that began in 2017 (see Figure 1). During this time, MPL premiums have been increasing by about 3.5% per annum, whereas non-MPL premiums for the composite have been increasing by more than 30% per annum.

NET INCOME CONTINUES TO LOOK PROMISING

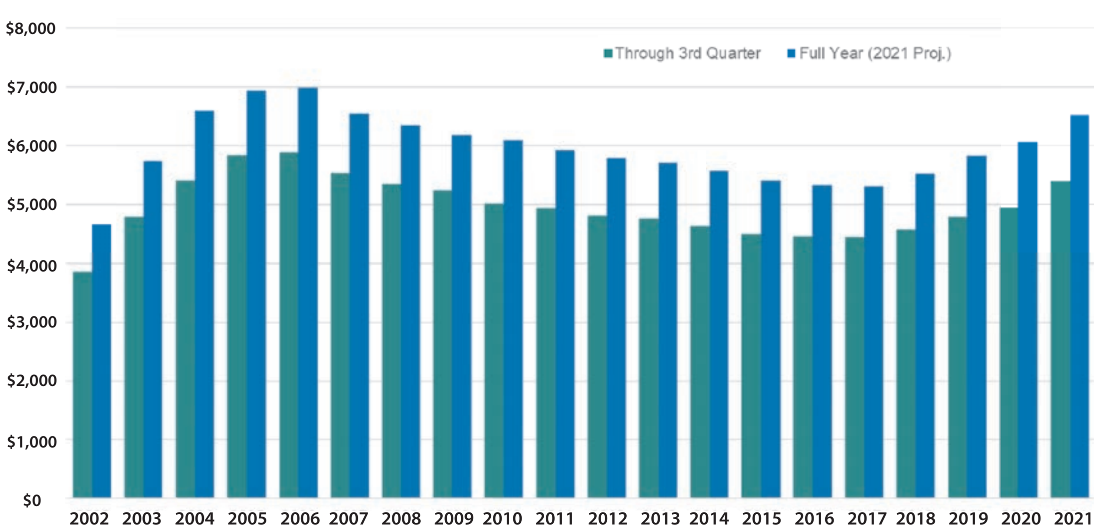
Cumulative net income through the third quarter of 2021 is at its highest point since 2017, increasing by more than 100% relative to the third quarter of 2020 (see Figure 2). Interestingly, one of the drivers of this rebound has been a historically high figure for net realized capital gains. Realized capital gains through the third quarter of 2021 are more than 50% higher than any third quarter over the last 20 years. On the other hand, as surplus continues to rise, the net income as a percent of the composite's surplus has not rebounded as far. Relative net income over the last ten years is only about half of what it had been during the prior 10-year period.

MODEST FAVORABLE RESERVE DEVELOPMENT DURING THE THIRD QUARTER

The composite reported a cumulative adverse development of approximately $1 million through the third quarter (see Figure 3) on reserves related to prior years. This marks a break from recent trends. The first quarter of 2020 through the second quarter of 2021 (with the exception of 2020's fourth quarter) each saw incremental adverse development. This may be a result of coverage year 2020 showing signs of reserve strength given that few COVID-19-specific claims have yet to be reported, a point of uncertainty at year-end 2020.

It's difficult to draw annual conclusions from third-quarter results, as the majority of prior-year reserve revisions occur during the fourth quarter, based on the timing of many actuarial reserve analyses. That being said, the favorable third-quarter development may point to 2021's annual reserve development being better than it was in 2020.

FIGURE 1 DIRECT WRITTEN PREMIUM — Q3 VS FULL-YEAR ($MILLIONS)



CONTINUED ON PAGE 7

MPL OPERATING RESULTS CONTINUED TO IMPROVE DURING Q3 2021

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Combined Ratio Continues to Improve

The composite's combined ratio through the third quarter of 2021 declined by six percentage points, relative to the same period in 2020, to nearly 112% (see Figure 4). The decrease is driven by lower loss and loss-adjustment-expense (LAE) ratios, with only minor decreases to the expense ratio and policyholder dividend ratio. The increased premium levels discussed previously appear to be helping drive the ratio downward.

Figure 4 also provides a comparison of the composite's historical third-quarter combined ratios relative to annual combined ratios. The 2021 annual combined ratio is projected to decrease for the second year since its recent peak in 2019. Although moving in the right direction, this is still about 30 percentage-points higher than its 2008 low.

Investment Income Continues to Slide

With interest rates still low, the composite's investment income through the third quarter of 2021 continues to decline compared to historical levels.

As Figure 5 shows, investment income through the third quarter of 2021 is about $450 million. This represents a $150 million decline in the last two years, and the decline has been steady, including decreases in nine of the most recent 10 quarters relative to the comparable quarter the previous year. This steady march downward while surplus continues to increase begs the question of how to most effectively deploy that capital. Although the long-term strategy of bond holdings has gotten the industry where it is, continued reliance on bonds will put more pressure on underwriting results for the composite to remain profitable. And with a forecast of elevated inflation rates for the foreseeable future, the composite will be searching for ways to keep investment yields high enough to stave off inflation's impact on the value of the dollar.

Conclusion

Top-line revenue for our MPL composite has been growing at a rate not seen since the early 2000s, although it appears to be driven by greater product diversification than by MPL premium increases. However, as reserve releases continue to diminish, additional pressure will be placed on current-year loss and LAE ratios, expense ratios and investment yields. The latest uncertainties appear to be economic inflation and the discovery of Omicron, a new COVID-19 variant. It remains to be seen how the government, economy and MPL market will react to these uncertainties as we look forward to year-end results.

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FIGURE 3 CUMULATIVE RESERVE DEVELOPMENT — Q3 VS FULL-YEAR ($MILLIONS)

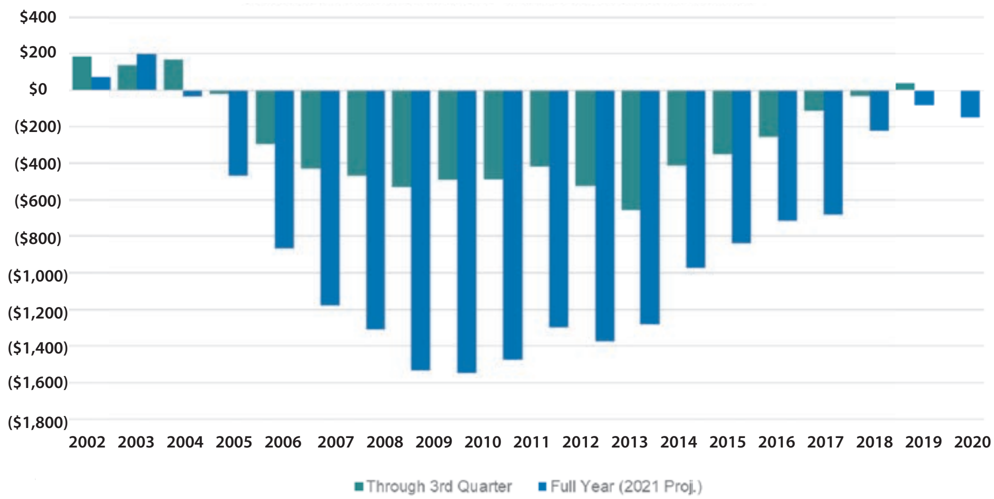
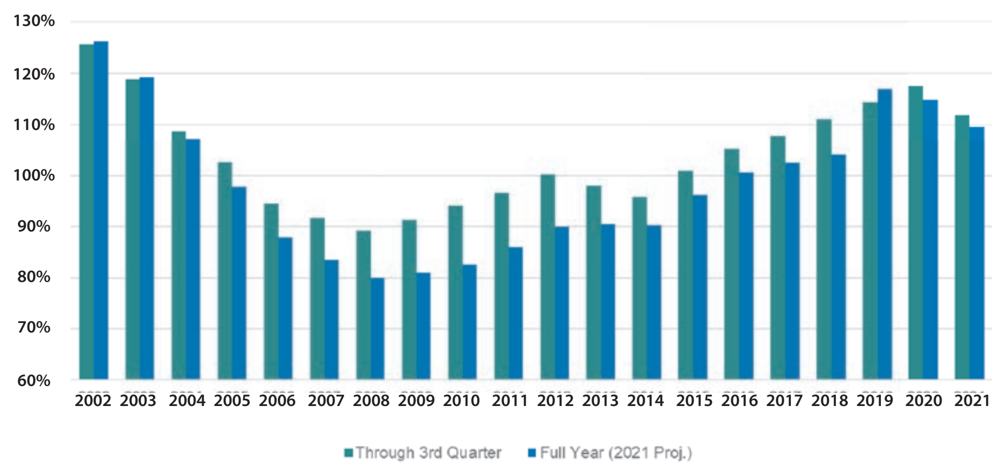


FIGURE 4 COMBINED RATIO (AFTER PH DIVIDENDS) — Q3 VS FULL-YEAR



INVESTMENT INCOME — Q3 VS FULL-YEAR ($MILLIONS)