



# 2019 YEAR-END FINANCIAL RESULTS FOR MEDICAL PROFESSIONAL LIABILITY SPECIALTY WRITERS

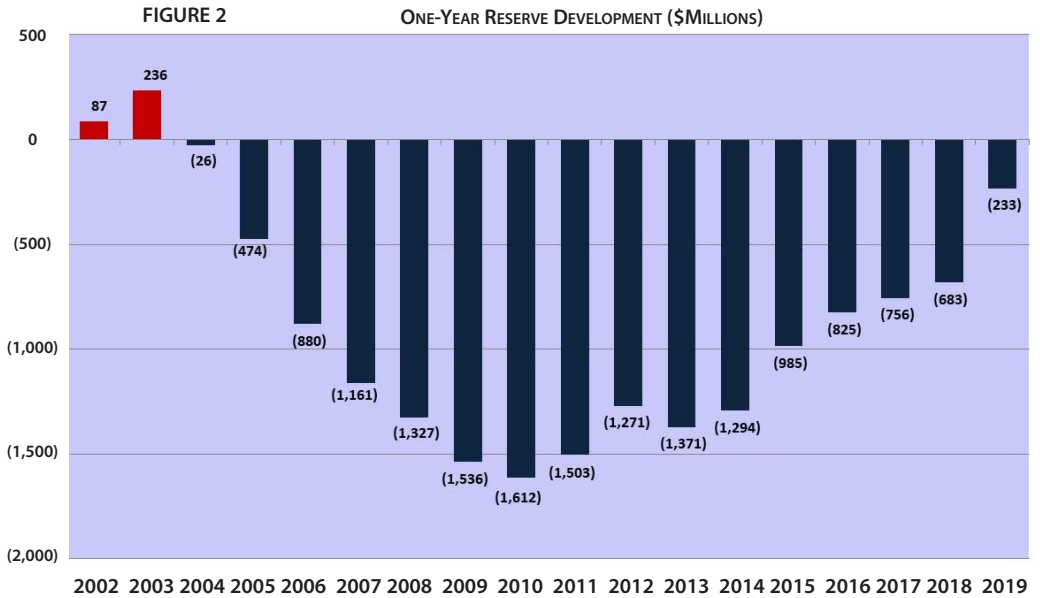
by Eric J. Wunder, FCAS, MAAA, and Brad J. Parker, ACAS, MAAA

This article concludes a full decade of analyzing the quarterly and annual statutory financial results for a composite of medical professional liability (MPL) specialty writers. In 2019, the MPL market, as represented by our composite, experienced another profitable year — although total net income is significantly lower than in recent years. While annual written premiums increased in 2019 at a rate very similar to 2018, underwriting results took a sharp turn for the worse and favorable reserve development on prior coverage years did not see the fourth quarter surge to the degree it has come to rely on.

This analysis is based on a collection of financial results for a large group of insurers that write predominantly MPL coverage. The data used in our analysis dates back to 2002 and consists of aggregate statutory financial information compiled from S&P Global Market Intelligence. The current composite includes 159 companies with total 2019 direct written premium of approximately \$5.2 billion. (Please note that annual financial results for several companies usually included in our analysis were unavailable at the date of publication. These companies were excluded from this analysis. Consequently, the aggregate financial results reflected in the figures are slightly lower when compared to the results from our 2019 quarterly analyses.)

### PREMIUM REVENUE CONTINUES TO GROW

The composite's direct written premium increased by 3.3 percent in 2019 to nearly \$5.7 billion, its highest level since 2013. Premium levels grew at a similar rate in 2018 bringing the composite's total premium 6.7 percent higher than its lowest point in 2017. As companies react to deteriorating combined ratios, more are taking rate increases. Using historical information from MEDICAL LIABILITY MONITOR'S Annual



Rate Survey issues, we took the average rate change of the largest writers in each state and found that rates increased in slightly more than half of all states in 2019. For the previous 10 years, rates increased in an average of less than 20 percent of states.

### RESERVE REDUNDANCY DISAPPEARING

The amount of reserves released by the composite through the first three quarters has declined in each of the past four years. Last year was no exception, with a drop of more than 55 percent. However, since the rise of large reserve redundancies for MPL writers began around 2005, the composite has become accustomed to large fourth-quarter releases that stem from the preparation of year-end financial statements. In 2019, this large fourth-quarter release did not happen.

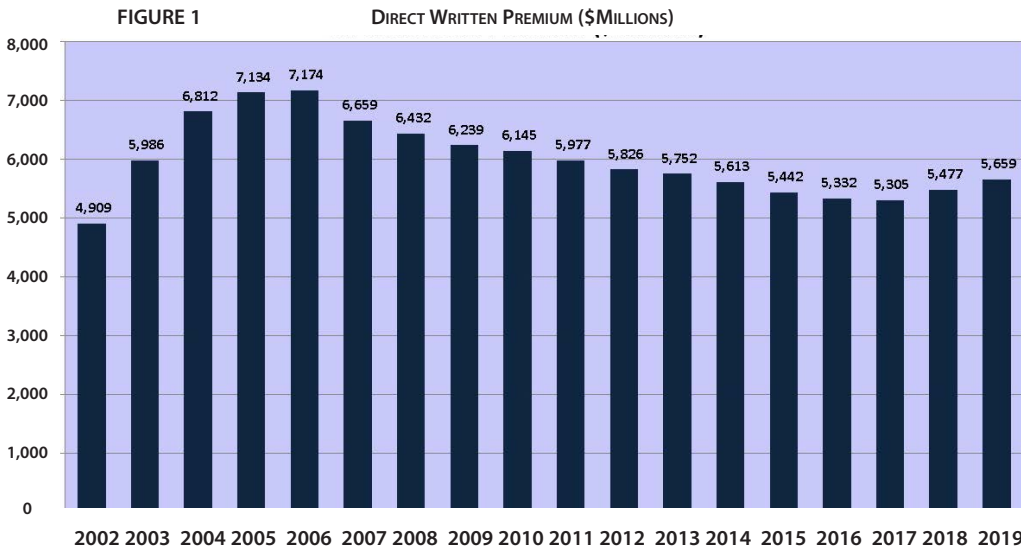
While 80 percent of the \$233 million annual release in 2019 occurred during the fourth quarter, the reserve release dropped by almost 68 percent compared to the fourth-quarter release of 2018.

The annual release fell more than 65 percent (see Figure 2), which sends a strong signal that the composite's long run of reserve redundancies may be drying up.

### SHARP NET INCOME DROP AFTER SPIKE IN COMBINED RATIO

In what was already a deteriorating underwriting situation for MPL writers, things turned worse in 2019. The declining reserve redundancies contributed to a 27-percent spike in incurred losses relative to 2018 and loss adjustment expenses increased by 11 percent.

Figure 3 (on Page 7) shows the historical combined ratios for the composite and what had been a gradual deterioration in underwriting results from 2008 to 2018, followed by a jump to almost 117 percent in 2019. Typically, the composite's annual combined ratio bene



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fits from large fourth-quarter reserve releases, but in 2019 the combined ratio actually went in the opposite direction, up three points from the 114 percent ratio seen through three quarters.

Following a sharp decline in after-tax net income from 2010 to 2015, the composite's profitability had stabilized in recent years — hovering around the \$800 million level until the marked decline in 2019 (see Figure 4). The \$345 million in net income is more than a 60 percent decline from 2018. Yet again, if not for the composite's strong investment performance (the composite earned investment gains of more than \$1.1 billion during 2019), the composite's bottom line would be in the red.

### POLICYHOLDER SURPLUS INCREASES?

As Figure 5 shows, the composite's policyholder surplus increased by 2.6 percent in 2019, relative to 2018.

**Unprecedented volatility in the financial markets calls into question future investment performance, which the composite has relied on to offset its underwriting performance in recent years.**

But as we pointed out in our 2018 year-end summary, we believe the 2018 surplus to be artificially deflated by a short-lived dip in the market at the close of the 2018 year. The impact of this drop was estimated to be about \$900 million due to a temporary drop in the value of the composite's unaffiliated common stock. If we adjust the 2018 surplus upward by this amount, then 2019 would actually show a second-consecutive year of decline in the composite's overall surplus.

The MPL market clearly needs to bring its underwriting performance under control to remain profitable. Unprecedented volatility in the financial markets calls into question future investment performance, which the composite has relied on to offset its underwriting performance in recent years.

Finally, in summarizing the results of the MPL market as of Dec. 31, 2019, we cannot look past the financial impact, both on the MPL industry and the U.S. economy as a whole, from the COVID-19 pandemic. At this early stage, there are no means to measure this impact and we will have to wait for the financial results throughout 2020, and perhaps beyond, to quantify its effect. The pandemic certainly exposes the MPL market to additional uncertainties in the midst of its current and growing number of questions.

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