MPL INSURANCE WRITERS WEATHER THE PANDEMIC IN 2020

by Eric J. Wunder, FCAS, MAAA, and Zachary A. Fischer, ACAS, MAAA

In the paragraphs and charts that follow, we summarize key financial results for a composite of medical professional liability (MPL) specialty writers. Despite global uncertainty surrounding the COVID-19 pandemic, the MPL market, as represented by our composite, experienced another profitable year in 2020. While total net income grew compared to 2019, it was still lower than the levels observed between 2015 and 2018. Direct written premium did increase in 2020, but due to MPL segments other than physicians and non-MPL premium sources as the composite has grown more diversified in recent years. Combined ratios remain well above 100%, and favorable reserve development on prior coverage years was the smallest it has been since 2004.

FIGURE 2 One-Year Reserve Development ($Millions)

Our analysis is based on the aggregate financial results of a large group of insurers specializing in 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 166 MPL specialty companies with a total direct written premium of approximately $6 billion in 2020. (Please note that annual financial results for 10 companies usually included in our analysis were unavailable at press time. Hence, these companies were excluded from this analysis. Consequently, the aggregate financial results reflected here are lower when compared to the results from our 2020 quarterly analyses.)

Premium Revenue Continues to Grow Due to Diversification

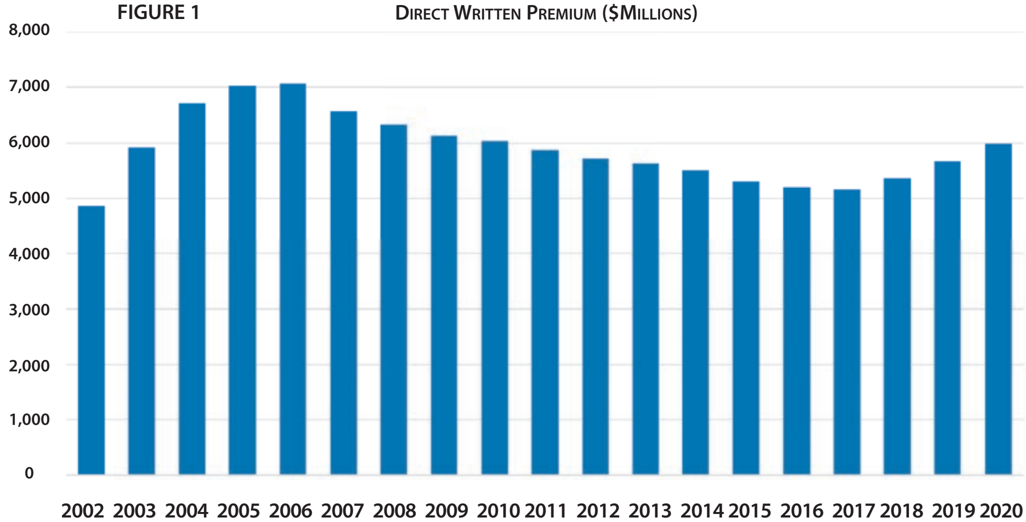
The composite's total direct written premium increased by 5.7% in 2020 to nearly $6 billion, its highest level since 2010. Interestingly, five years ago, the composite's MPL premium made up nearly 97% of total direct written premium. That number has gradually shrunk to less than 90% in 2020, and nearly half of this premium diversification occurred during 2020. It remains to be seen whether this diversification trend is accelerating or the uptick is due to the impact of COVID-19 on the market. Signs in the data indicate it may be the latter. MPL direct written premium experienced a 6% decrease during the 2nd quarter of 2020 relative to 2019, but each other quarter in 2020 saw increases of at least 3% in MPL direct written premium relative to 2019.

Reserve Redundancy Continues to Shrink

The amount of reserves released through the first three quarters by the composite declined each of the past six years. In fact, 2020 was the first time in 16 years where there was adverse reserve development through three quarters. However, since 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.

Similar to 2019, the large fourth-quarter release in 2020 was significantly smaller than recent precedent. Although the overall reserve release for 2020 was still approximately $90 million, the release is down more than 60% from the release taken in 2019 and down more than 85% from the release taken in 2018 (see Figure 2), which sends a strong signal that the composite's long run of reserve redundancies may be drying up. COVID-19 has likely played a role here as well. The data suggests that claim payments made in 2020 were materially lower than expected due to court delays, especially during the second quarter. As the world slowly works its way back into a sense of normalcy in 2021 and beyond, we will see what sort of impact the pandemic continues to have on reserve development.

FIGURE 1 Direct Written Premium ($Millions)



Net Income Recovers Slightly from 2019

The good news is that 2020 was the first time in five years that the composite's combined ratio did not increase. The bad news is that the

CONTINUED ON PAGE 7

2020 YEAR-END FINANCIAL RESULTS FOR MPL SPECIALTY WRITERS

CONTINUED FROM PAGE 5

improvement from the MPL industry's highest combined ratio in the last 15 years (observed in 2019) was only two points. The primary contributing factor to the still-high combined ratio of 115% is largely the same as what caused the significant spike in 2019 — declining reserve redundancies.

Figure 3 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 combined ratios in excess of 115% in 2019 and 2020. In the past, the composite's annual combined ratio has benefited from large fourth-quarter reserve releases, but the significant reduction of these releases in 2019 and 2020 have led to combined ratios not seen since the last hard market.

The saving grace for the composite's poor underwriting results continues to be its strong performance on the investment side. Despite the deteriorating combined ratio, 2020 marks the seventeenth-consecutive year of positive net income for the composite. Additionally, 2020 net income saw an increase of more than 45%, compared to 2019 (see Figure 4). This is particularly good news, given the unprecedented market volatility experienced last year due to COVID-19.

While the composite's overall investment gain was down from 2019, its strong performance in the fourth-quarter — as markets surged on vaccine and stimulus news — resulted in only a slight 3.4% decrease. There is no doubt the MPL industry will have to continue relying on strong investment performance if it hopes to continue the trend of positive net-income, while simultaneously trying to improve underwriting results.

Policyholders Surplus Increases

As Figure 5 shows, the composite's policyholders surplus increased by approximately 2% in 2020, relative to 2019. Despite the slight uptick in total capital for the composite, 2020 marks the third-consecutive year that the increase in the authorized control level risk-based capital has outpaced the increase in total adjusted capital. This results in a declining ratio of total adjusted capital to authorized control level risk-based capital.

While the MPL market again managed to turn an overall profit, it is clear that the underwriting performance needs to improve. The industry likely cannot continue to rely on its history of strong investment results, particularly if the trillions of dollars of federal government stimulus cause inflation that adversely impacts the composite's bond portfolio.

Although plenty of uncertainty remains, it seems as though the MPL market has managed to maneuver its way through the COVID-19 pandemic relatively successfully.

Eric J. Wunder is a consulting actuary, and Zachary A. Fischer an associate actuary, at Milliman Inc., an independent actuarial and consulting firm.

FIGURE 3 ANNUAL COMBINED RATIOS

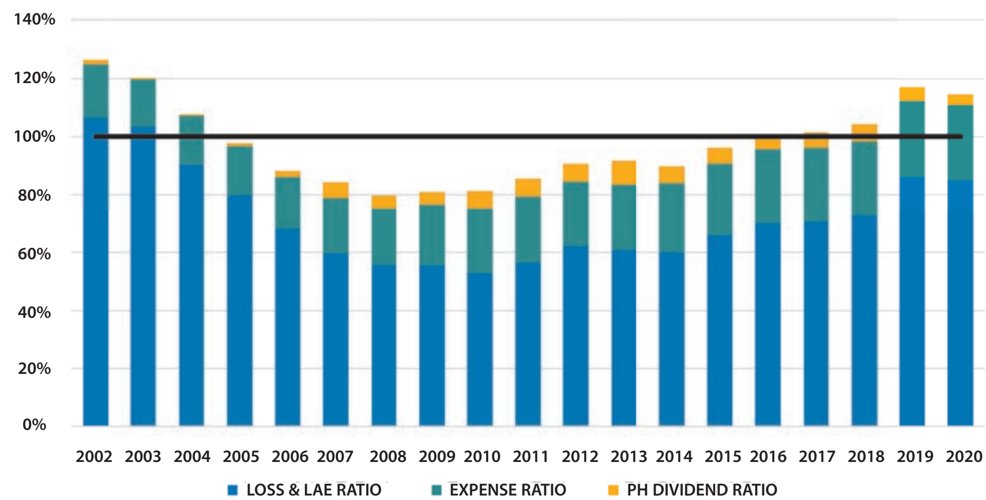


FIGURE 4 ANNUAL NET INCOME ($MILLIONS)

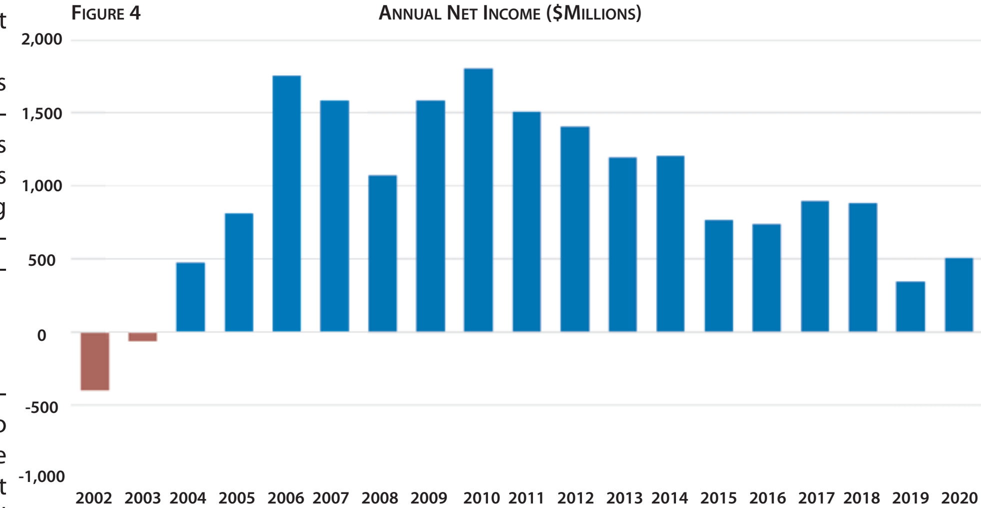


FIGURE 5 POLICYHOLDER SURPLUS ($BILLIONS)