MEDICAL LIABILITY MONITOR

FIRST QUARTER FINANCIAL RESULTS FOR MEDICAL PROFESSIONAL LIABILITY SPECIALTY WRITERS

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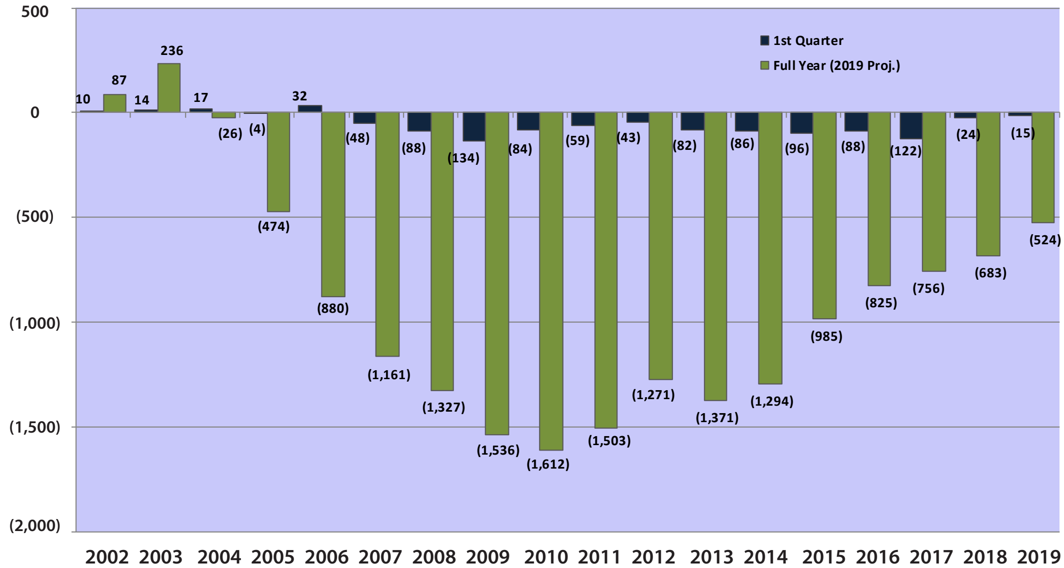
This article summarizes some key financial results for medical professional liability (MPL) specialty writers from the first quarter of 2019 and begins our tenth-consecutive year of tracking and publishing these results in *Medical Liability Monitor*. As in past years, this article compares historical first-quarter financial results to historical annual results to catch a glimpse at where, perhaps, 2019 annual financial results might be headed. As premium levels continue their comeback, reserve releases continue their decline. At the same time, underwriting results continue to deteriorate, but have been offset by strong investment performance.

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 back to 2002 and consists of aggregate statutory financial information compiled from S&P Global Market Intelligence. The current composite includes 177 MPL specialty companies with total direct-written premium of approximately $5.5 billion in 2018.

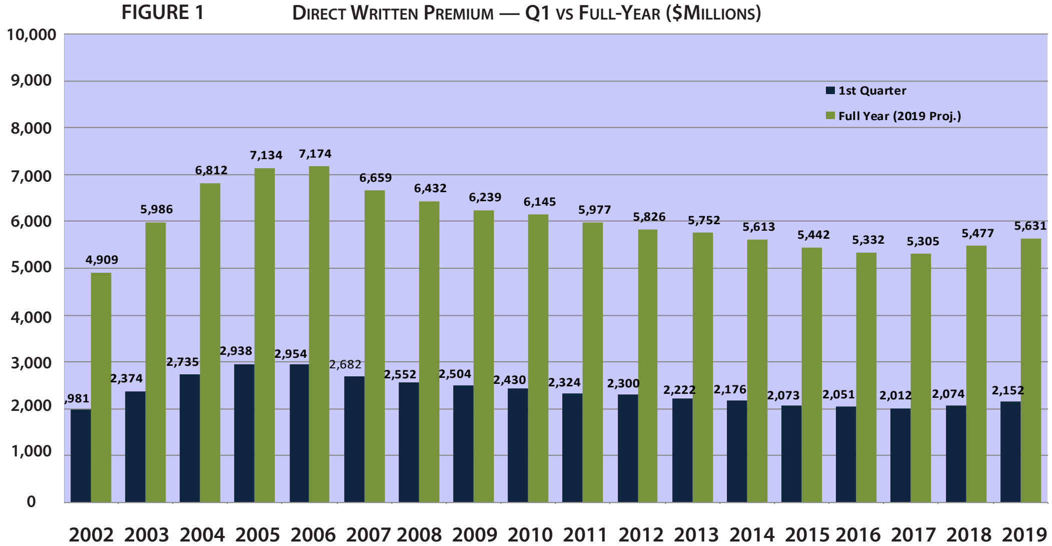
FIGURE 2 CUMULATIVE RESERVE DEVELOPMENT — Q1 VS FULL-YEAR ($MILLIONS)



PREMIUM VOLUME CONTINUES TO RISE

Beginning last year, the composite finally saw MPL direct written premium start to trend upward. That trend has continued in 2019. Now, each of the last two first quarters have seen the composite's direct-written premium increase at a rate in excess of 3 percent when compared to the prior first quarter. The nearly $80 million increase relative to the first quarter of 2018 represents a 3.7 percent rise (see Figure 1). The increase lifts first quarter premium levels over $2.1 billion for the first time since 2014.

FIGURE 1 DIRECT WRITTEN PREMIUM — Q1 VS FULL-YEAR ($MILLIONS)



ANOTHER SLOW START FOR RESERVE RELEASES

Through the first three quarters of 2018, the composite seemed hesitant to release reserves resulting from redundancies in prior years. This appears to be the case again in 2019 with first quarter favorable reserve development slightly lower than in 2018 and the lowest since 2006, which was actually the last quarter the composite experienced adverse reserve development (see Figure 2). Given last year's slow start, there is reason to believe that these reserve redundancies still exist. And as was the case in 2018, we expect year-end 2019 reserve development to remain favorable, but again, less favorable than in recent years.

COMBINED RATIO CREEPING HIGHER

As Figure 3 shows, the composite's combined ratio through the first quarter tends to be at its highest — with results improving each quarter until we reach the full-calendar year combined ratio, which for the past 15 years has benefitted from the favorable year-end reserve development. The composite's combined ratio through the first quarter of 2020 approached 120 percent. The last time the combined ratio was this high was in 2002 and 2003 when the composite, in the absence of reserve redundancies, experienced its last unprofitable years.

INVESTMENT PERFORMANCE REMAINS STRONG FOR NOW

Fortunately for MPL companies, not only are reserve redundancies still providing relief, investments have continued to provide solid returns. The composite's investment income through the first quarter of 2019 exceeded $200 million for the first time since 2012, reflecting strength in

CONTINUED ON PAGE 7

FIRST-QUARTER FINANCIAL RESULTS FOR MPL SPECIALTY WRITERS

→ CONTINUED FROM PAGE 5

securities markets and in the overall U.S. economy in general.

However, as Figure 4 illustrates, Treasury bond yields took a sharp downward turn in 2019 with the Federal Reserve recently leaving the door open to future interest rate cuts. To the extent these events signal a downturn in the overall economy or a prolonged decline in Treasury bond yields, the composite's investment performance could suffer.

Operating Margin, Net Income Remain Steady

It is quite notable that with so many moving pieces — be it increasing premium levels, declining reserve redundancies, increasing combined ratios or improving investment performance — the net impact to the composite's bottom line for the past four years has been negligible. The offsetting nature of each of these variables has led to steady net income during this period that hovers between $750 million and $900 million as well as calendar-year operating margins holding steady near 20 percent (See Figure 5).

The rate of the increase in written premium remained consistent, reserve redundancies remain but continue to decline and the composite's investment performance continues to offset the deteriorating underwriting performance.

To conclude, thus far it appears that 2019 is a continuation of the trends witnessed in 2018. The rate of the increase in written premium remained consistent, reserve redundancies remain but continue to decline and the composite's investment performance continues to offset the deteriorating underwriting performance. While the economy remains strong by most measures, the declining Treasury rates and any future rate action taken by the Federal Reserve merit concern. However, with much of the 2019 story yet to be told, early signs point to yet another profitable year for MPL specialty writers.

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Figure 3 — Combined Ratios (after dividends) — Q1 vs Full-Year

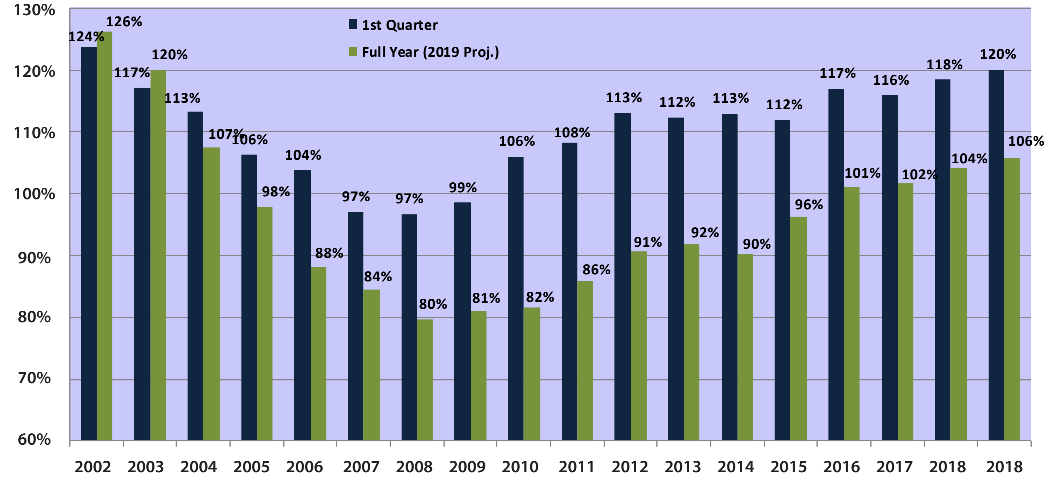

Figure 4 — Industry Yield vs Five-Year Treasury Bond Yield

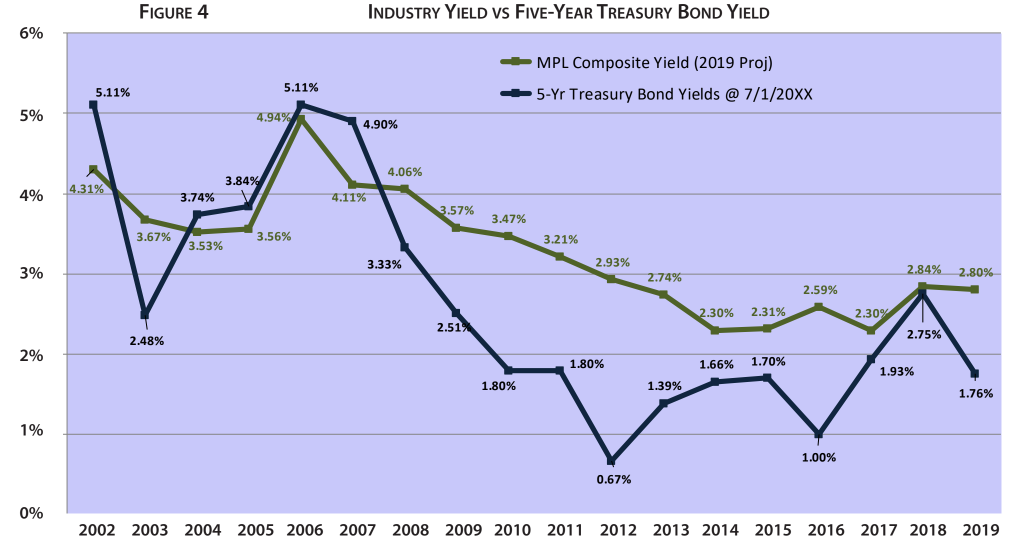

Figure 5 — Calendar-Year Operating Margin