FAVORABLE RESERVE DEVELOPMENT FOR MPL SPECIALTY INSURERS DURING Q3

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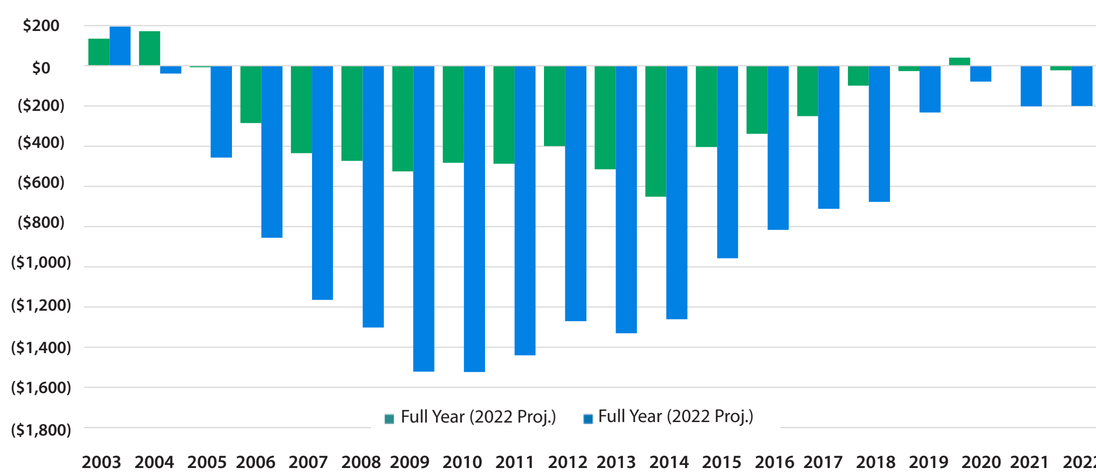
This article summarizes key financial results for medical professional liability (MPL) specialty writers from the third quarter of 2022 and continues our 13th consecutive year of tracking and publishing these results in MEDICAL LIABILITY MONITOR. As in past years, this article compares historical third-quarter financial results to historical annual results in order to offer a glimpse at where, perhaps, 2022's annual financial results might land. With the country — as well as the MPL industry — still rising from the COVID-19 pandemic and experiencing economic anxiety about a possible recession, we look back at the financial results for the third quarter of 2022.

FIGURE 2 CUMULATIVE RESERVE DEVELOPMENT — Q3 VS FULL-YEAR ($MILLIONS)

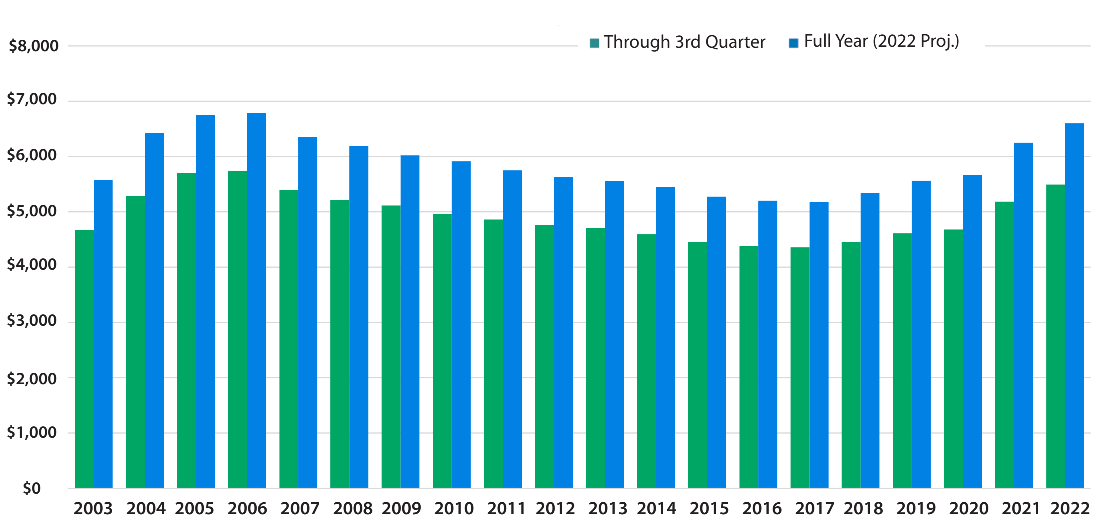


Our analysis is based on the collective financial results of a large group of insurers specializing in MPL coverage. The data used in our analysis covers 20 years and consists of aggregate statutory financial information compiled from S&P Global Market Intelligence. The current composite includes 171 MPL specialty companies with a total direct written premium of more than $6.2 billion in 2021.

THIRD-QUARTER 2022 PREMIUM GROWTH REBOUNDS

While MPL premium growth slowed modestly during the second quarter, it rebounded nicely during the third quarter. The premium written in third-quarter 2022 compared with that written in third-quarter 2021 increased 11.7% (Figure 1). Although the current third-quarter results remain lower than the industry's third-quarter peak in 2006, the composite's direct written premium is up 5.9% in aggregate relative to the third quarter of 2021. Anecdotally, we understand this jump as a combination of increased rate action and decreased discretionary discounts across many jurisdictions.

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



A RETURN TO FAVORABLE RESERVE DEVELOPMENT

The composite reported a cumulative favorable development through the third quarter of approximately $22 million (see Figure 2) on reserves related to prior years. This reflects an improvement relative to the same point in 2021 and 2020 through the third quarter. Third-quarter 2021 saw $200,000 of adverse reserve development, while third-quarter 2020 saw adverse reserve development of nearly $40 million. This favorable reserve development further supports our anticipation that the 2022 annual financial results will also reflect some reserve redundancy. However, how much reserve redundancy remains uncertain.

STEADY IMPROVEMENT FOR COMBINED RATIOS

The composite's combined ratio through the third quarter of 2022 was 108% (Figure 3, on page 7), a decrease of 3.6% from third-quarter 2021 and the lowest third-quarter point during the last five years. The main driver of the decrease in the combined ratio is a decline in the loss and loss adjustment expense (LAE) ratio, with the fixed-expense and policyholder dividend ratios showing minor improvement when compared to the third quarter of 2021. The increased rate actions discussed previously appear to be helping drive the ratio downward towards a more sustainable level.

Figure 3 also provides a comparison of the composite's historical third-quarter combined ratios relative to annual combined ratios. The 2022 annual combined ratio is projected to land around 106%, which reflects a 9-percentage point decrease from the recent peak in 2019. While this represents improvement from prior years,

CONTINUED ON PAGE 7

THIRD QUARTER FINANCIAL RESULTS FOR MPL SPECIALTY WRITERS

CONTINUED FROM PAGE 5

the combined ratio continues to persist at an unsustainable level over the long-term, given the composite's overall underwriting performance during the past decade.

Net Income Continues to Wane

For the third quarter of 2022, net income fell nearly 60%, when compared to the third quarter of 2021 (Figure 4). This decrease was driven by a 42% decline in investment gains (Figure 5). Investment

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gains comprise investment income and net realized capital gains. Although investment income remained relatively steady (down 3% from the third quarter of 2021), net realized capital gains have fallen 82% since this point last year.

Since 2019, net income has experienced a yo-yo effect as companies attempt to traverse not only the MPL insurance market conditions but also the unique macroeconomic environment. If that macroeconomic environment continues to deflate investment performance, the industry may need to pursue additional rate increases to help stabilize its operating ratios.

Conclusion

Top-line revenue continues to reach for an all-time high. Inflationary pressures remain present as insurers attempt to seek additional rate increases to help counter them. Although good signs exist with modest reserve redundancies and an improving combined ratio, investment gains have continued to drag which has adversely impacted the composite's surplus. As we look forward to year-end results, it remains to be seen whether the composite will maintain a positive operating margin this year.

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Figure 3 Combined Ratio (after PH dividends) — Q3 vs Full-Year ($Millions)

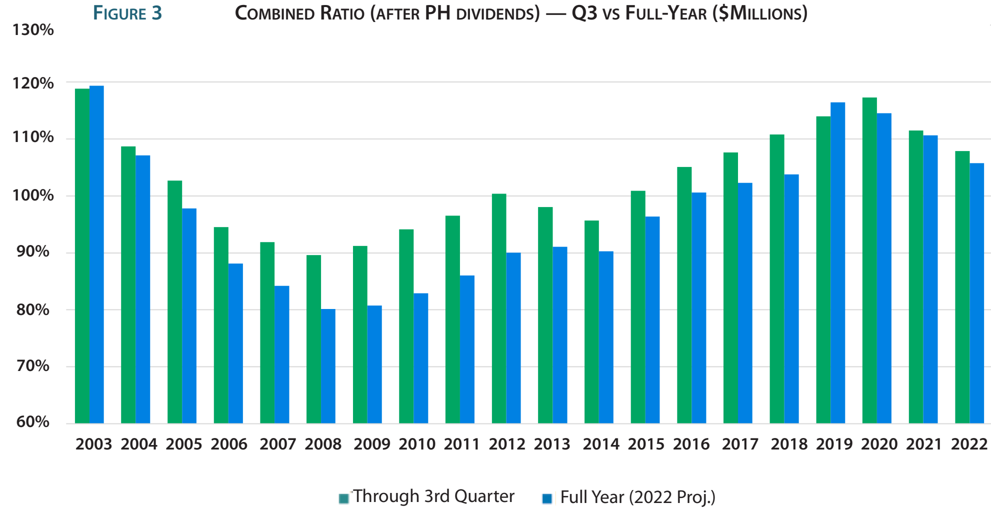

Figure 4 After-Tax Net Income — Q3 vs Full-Year

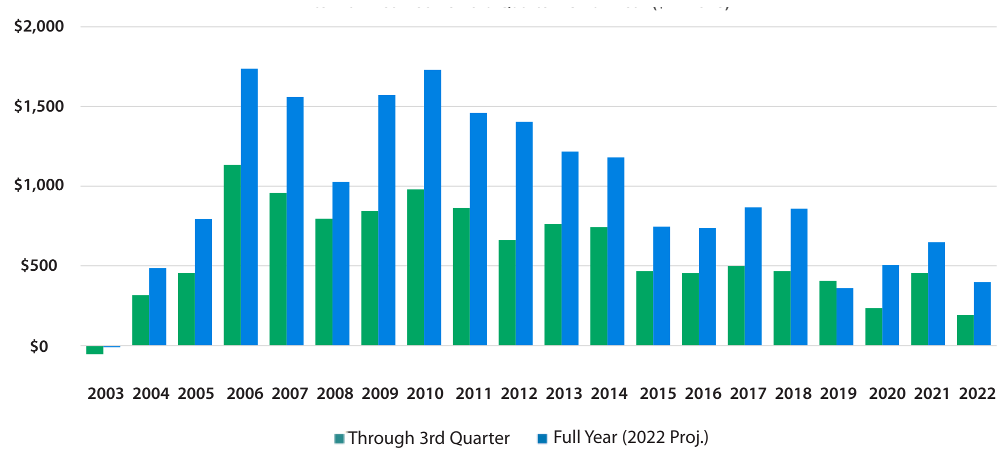

Figure 5 Investment Gain — Q3 vs Full-Year ($Millions)