INDEMNITY PAYMENTS IMPACT FIRST-QUARTER FINANCIAL RESULTS FOR MEDICAL PROFESSIONAL LIABILITY SPECIALTY INSURERS

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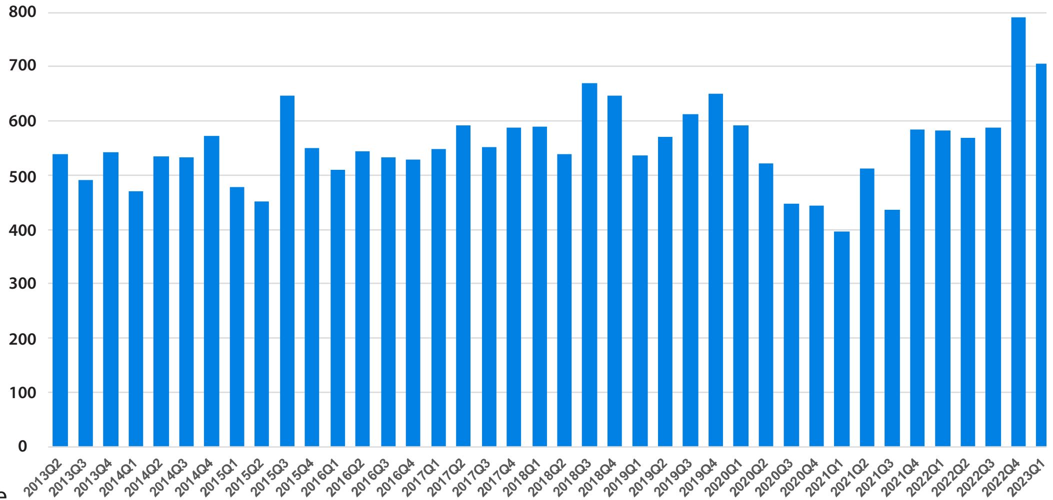
This article summarizes key financial results for medical professional liability (MPL) specialty writers from the first quarter of 2023 and begins our 14th-consecutive year tracking and publishing these results in Medical Liability Monitor. As in years past, this article compares historical first-quarter financial results to historical annual results to offer a glimpse at where 2023 annual financial results might be headed. With the country experiencing increased levels of inflation and the last few months of the COVID-19 pandemic being considered a national emergency, we look back at the financial results for the first quarter of 2023.

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 176 MPL specialty companies with total direct written premium of nearly $6.7 billion in 2022.

FIGURE 2 MPL Direct Paid Loss ($Millions)



2023 Premium Continues to Increase

As the MPL market continues to firm, 2023 first-quarter premiums continue to exhibit an upward trend. The composite's direct written premium increased by more than 3% relative to the first quarter of 2022 (see Figure 1) as MPL writers continue to navigate poor underwriting results by increasing rate levels in many jurisdictions. The current first-quarter premiums are the highest since 2006, and the 2023 full-year premium appears poised to be the highest in recent history. Also shown in Figure 1 is a full-year projection for 2023, reflecting a 32% increase relative to the low point of the composite in 2017.

Indemnity Payments Rebound After COVID-19 Slowdown

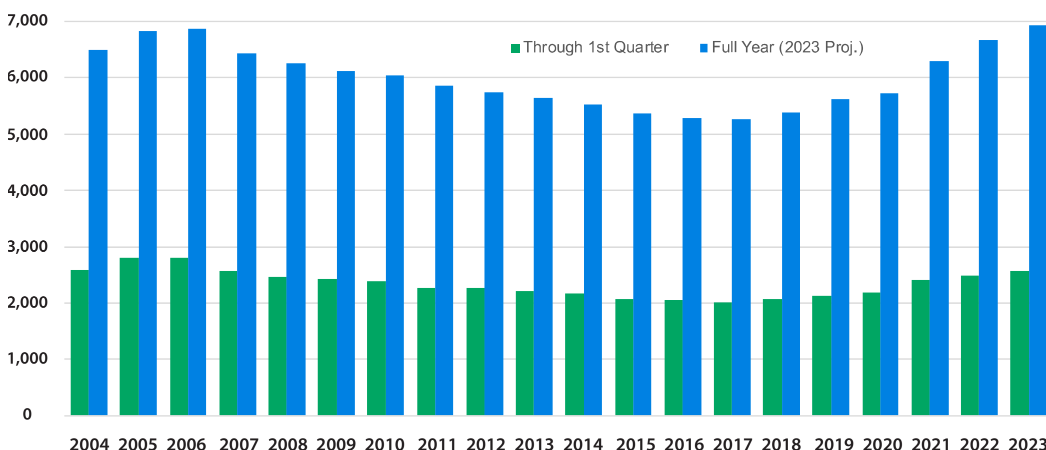
Perhaps the most interesting storyline this quarter was the resurgence of indemnity payments during the fourth quarter of 2022 and the first quarter of 2023. As Figure 2 illustrates, the composite experienced an 18-month slowdown in indemnity payments that started in the second quarter of 2020. This includes the four quarters with the fewest indemnity payments made in the last 10 years. Beginning in the fourth quarter of 2021, it appeared as though payments had stabilized, but the hole created between the second quarter of 2020 and the third quarter of 2021 had not been filled. Now, during the last two quarters, the composite has had its two largest quarters of indemnity payments on record. Based on the depth of the decline in payments during the first 18 months of the pandemic, it would appear as though the composite can expect sizable levels of indemnity payments in the near future as well — especially given the severity concerns noted throughout the industry.

Combined Ratio Results Remain Unsustainable

The composite's combined ratio through the first quarter of 2023 was 114% (Figure 3), an increase of 3% over 2022 and the first increase in first-quarter results year over year since the composite's combined ratio peak in 2020. The loss and LAE ratio also increased year over year, which may indicate that rate increases are not keeping up with the upward trend in costs. It may also be driven by the recent influx of indemnity payments noted in Figure 2. Additional slippage can be found in the fixed-expense ratio and policyholder dividend ratio, both increasing year over year, albeit by smaller percentages than the loss and LAE ratio.

Figure 3 (see page 7) compares the composite's historical first-quarter combined ratios to annual combined ratios and illustrates the continued concern for the MPL market's unsustainable underwriting performance. Notably, reserve development has historically had a large impact on the composite's combined ratio. Most of that development tends to occur in the fourth quarter, which drives the difference in the combined ratio between first quarter and year-end.

FIGURE 1 Direct Written Premium — Q1 vs Full-Year ($Millions)



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Investment Gains Offset Underwriting Losses

Figure 4 tracks the composite's underwriting performance relative to its investment performance over time. While the composite's investment gain (investment income plus net realized capital gains) had remained relatively consistent since the Great Recession, the projected result for 2023 indicates the composite will be able to take advantage of high investment yields. Underwriting losses for the composite have been reported each year since 2016. Even with recent rate increases, projected 2023 results indicate underwriting losses are headed back in the wrong direction. Investment gain has more than made up for the underwriting losses the composite has experienced in recent years, but the continued underwriting losses are still a concern.

Decrease in Policyholders' Surplus

The composite's policyholder surplus levels (Figure 5) decreased more than 3% year over year for the first quarter of 2023, with increases in loss and LAE reserves driving the decrease. However, as of year-end 2023, assuming stability in the financial markets, we expect the composite's net income will push surplus modestly higher than at year-end 2022. With a slight decrease in total adjusted capital last year, the ratio of total adjusted capital to authorized control level risk-based capital (RBC ratio) continues to deteriorate. Not all RBC inputs are publicly available, but our approximations of these risk components indicate that premiums and reserves — the two largest categories — have materially outpaced surplus growth during this period. Increases in these two components stem from higher reserve levels as well as premium growth.

Conclusion

Insurers continue to seek rate increases to combat ongoing inflationary pressures and higher claim severities. Though the U.S. government officially ended its emergency declaration related to COVID-19, and there haven't been significant losses related to the pandemic, the claim process is still playing catch up from court closures, making it difficult to project where claim trends are heading. These external uncertainties make it difficult to project when insurers may be able to trim combined ratios to a sustainable level. However, if MPL insurers continue to increase premium and can take advantage of increasing investment yields, the industry is well positioned to face these ongoing challenges.

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