



MORE OF THE SAME: FIRST QUARTER FINANCIAL RESULTS FOR MEDICAL PROFESSIONAL SPECIALTY INSURERS VERY FAVORABLE

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As part of our continuing effort to track the course of the overall medical professional liability (MPL) market, we submit the latest installment and begin our fourth consecutive year of analyzing quarterly financial results for MPL specialty writers in the *MEDICAL LIABILITY MONITOR*.

Our analyses over the past three years have coincided with an unprecedented span of profitability within the MPL market. As we have discussed repeatedly in this publication, the MPL market has sustained very favorable financial results in the face of gradually declining premium and increasing combined ratios. The saving grace for the market continues to be its sizeable reserve releases, which have exceeded \$1 billion in each of the last six years for the collection of MPL writers that we consider in our analysis.

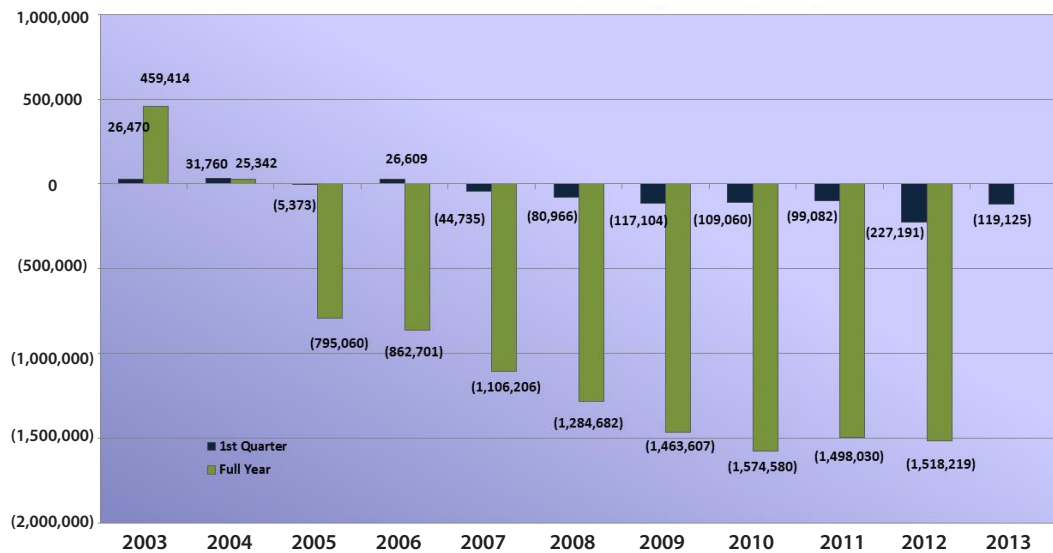
Through the first quarter of 2013, we are seeing a continuation of the financial trends of recent years.

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 2003 and is compiled from the financial statements for each company reported by SNL Financial. The composite includes 83 companies with direct total written premium exceeding \$6.2 billion in 2012.

PREMIUM DECLINE CONTINUES

As shown in Figure 1, first quarter 2013 direct written premium is down 3.5 percent compared to first quarter 2012, marking the lowest first quarter written premium level for the composite since

FIGURE 2 CUMULATIVE RESERVE DEVELOPMENT (\$000s)



2002. This comes after 2012 saw the smallest annual decline in written premium since the downturn began in 2007 and had us speculating whether or not the MPL premium decline might be leveling off. In light of the first quarter drop, we project total direct written premium for the composite to continue its steady decline and dip below \$6 billion in 2013—more than 23-percent below its high mark of \$7.8 billion in 2006. Despite the persistent decline in premium levels, the industry has experienced a simultaneous decrease in MPL claim frequency that has allowed overall rates to remain adequate.

SIZEABLE RESERVE RUN-OFFS SHOWING NO SIGNS OF SUBSIDING

In 2013, the composite showed favorable first quarter reserve development for the seventh consecutive year. Figure 2 suggests that reserve releases made during the first quarter can provide a consistent indication of expected reserve releases for the entire year.

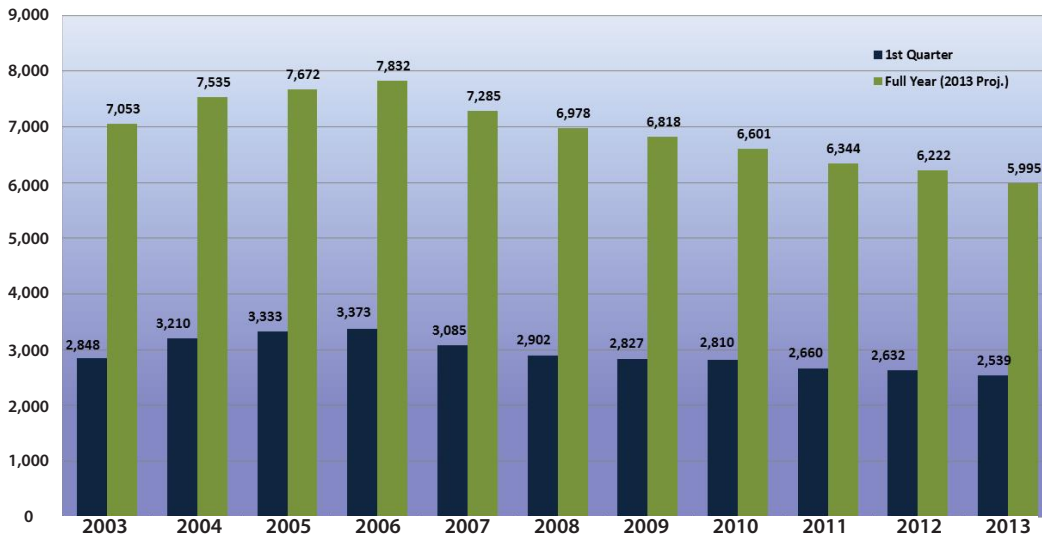
In each of the past six years, favorable reserve development—at a magnitude similar to that shown for the composite for the first quarter of 2013—has led to at least \$1.1 billion in reserve releases for the entire year and an average of over \$1.5 billion during the past four years. If the same pattern holds in 2013, it will no doubt lead to yet another profitable year for MPL specialty writers.

COMBINED RATIOS ON THE RISE

The composite's calendar year 2012 combined ratio of 90 percent was its

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FIGURE 1 DIRECT WRITTEN PREMIUM - FIRST QUARTER VS. FULL YEAR (\$MILLIONS)





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highest since 2005, yet still marked the eighth straight year with combined ratios below the underwriting breakeven point.

As shown in Figure 3, we expect the combined ratio to inch slightly higher in 2013, while the composite's underwriting results remain profitable. The impact from the aforementioned decline in premium—offset to some degree by declining frequency—should result in slightly higher loss and LAE ratios as well as underwriting expense ratios. The reliable profits enjoyed by MPL writers in recent years have led to increased surplus (see Figure 4) and, subsequently, improved risk-based capital positions. This, in turn, has led to continued growth in annual dividend ratios. The composite's annual policyholder dividend ratio, in the years prior to 2005, was resting in the 0.5 to 1 percent range and has since swelled to almost 6 percent in 2012.

STILL WAITING ON HIGHER INVESTMENT YIELDS

Investment yields experienced a spike in June 2013 off historical lows in 2012 (see Figure 5). However, the yields have since stabilized. The question now is whether this upturn is the start of a longer term trend toward higher interest rates. Higher interest rates will hurt MPL insurers' balance sheets on a mark-to-market basis in the short-term. However, they might help to extend the stable rate environment as higher investment yields are considered in prospective pricing. This assumes, of course, that the higher interest rates will not be accompanied by higher loss cost inflation.

CONCLUSION

Our first glance at 2013 financial results reveals an awfully familiar story that history tells us should result in a happy ending for MPL specialty insurers. We project another profitable underwriting year for the composite in 2013, although profit margins will likely decline relative to recent years should the current financial trends continue. Pricing pressure continues to be fueled by increasing surplus levels and the desire to maintain exposures against increasing competition and the migration of physicians to self-insured employment settings. The largest remaining uncertainty lies in the sustainability of prior year reserve releases at the level we've observed in recent years.

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FIGURE 3 ANNUAL COMBINED RATIOS

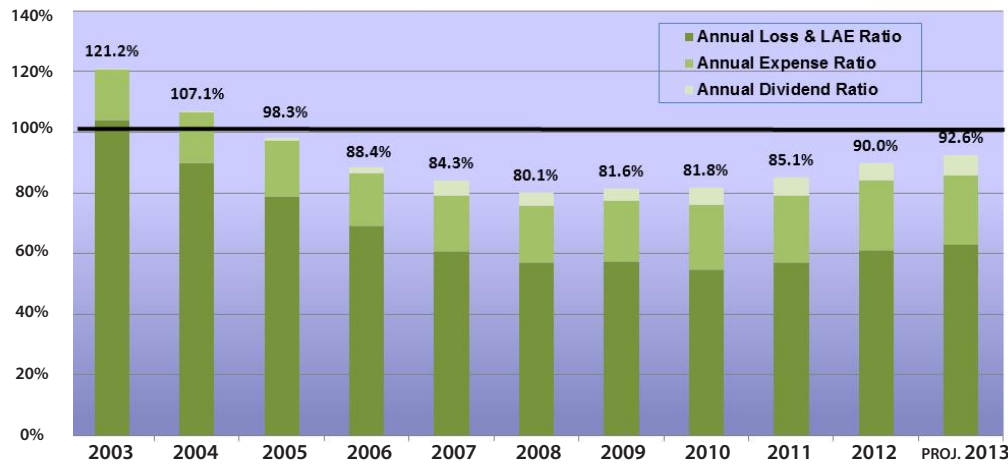


FIGURE 4 POLICYHOLDER SURPLUS - END OF FIRST QUARTER (\$MILLIONS)

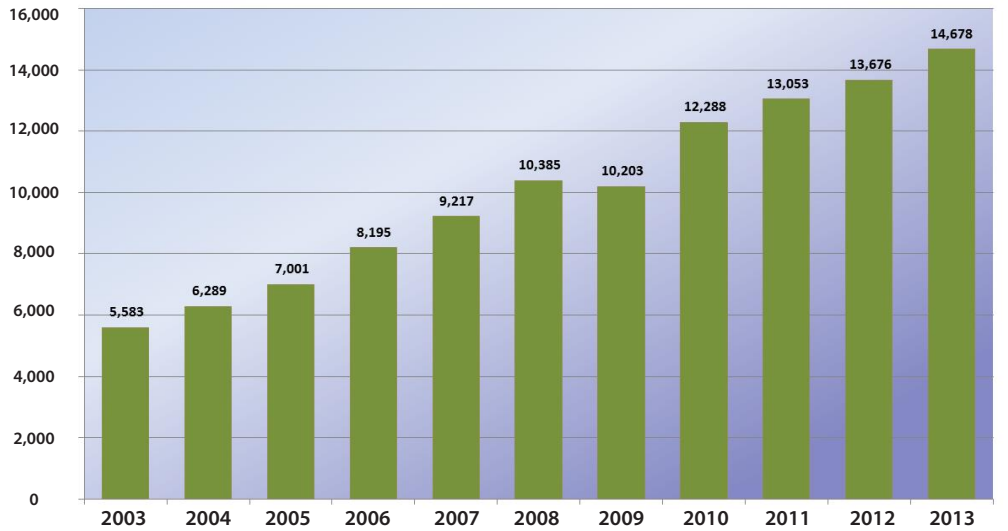


FIGURE 5 INDUSTRY YIELD VS. FIVE-YEAR TREASURY BOND YIELD

