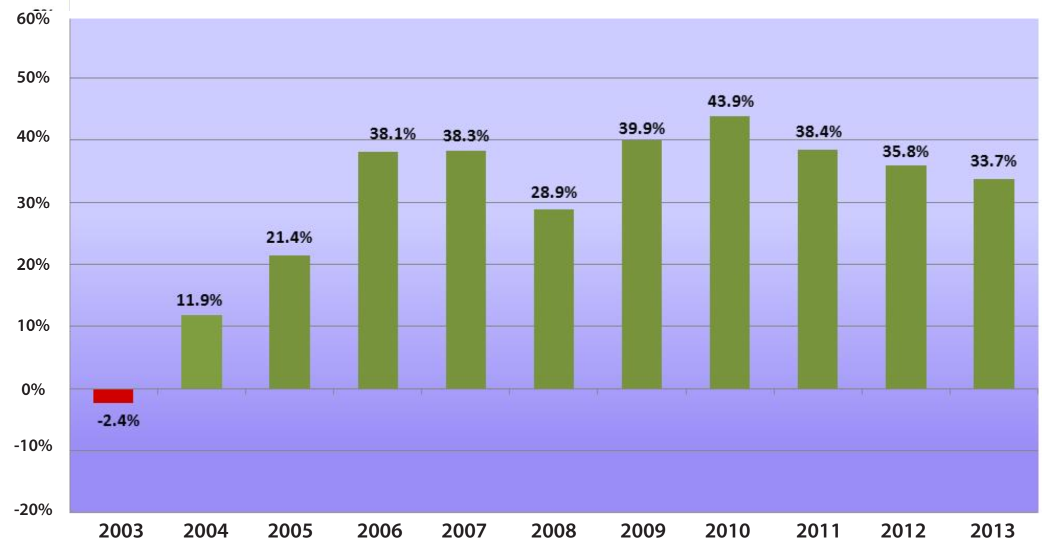
A DECADE OF PROFITABILITY: 2013 YEAR-END RESULTS FOR MEDICAL PROFESSIONAL LIABILITY SPECIALTY WRITERS

by Charles W. Mitchell, FCAS, MAAA and Brad J. Parker, ACAS, MAAA

For the past four years, we have been tracking the development of key statutory financial results on a quarterly basis for a composite of medical professional liability (MPL) specialty writers and publishing our findings in the *Medical Liability Monitor*. With each quarter's results, we attempt to get a better glimpse into what the year-end results might have in store and try to detect changes in the current trends that continue to produce stellar financial results for the MPL segment of the insurance industry. We are compelled to believe that the continuation of these outstanding financial results is unsustainable longterm; however, there is still no clear indication from the year-end 2013 financial statement data that suggests these trends are subsiding. As the information we present in this article demonstrates, the MPL specialty writers, as a whole, enjoyed yet another outstanding year financially.

FIGURE 2 Calendar-Year Operating Margin



The analysis that follows is based on the composite financial results of insurers that specialize in MPL coverage. The data used in our analysis dates back to 2003 and is compiled by SNL Financial. The composite includes 83 MPL specialty companies with direct total written premium exceeding $6 billion in 2013.

As shown in Figure 1, direct written premium for the composite declined in 2013 for the seventh-straight year. The total is down almost 23 percent from its high-water mark of more than $7.8 billion in 2006, dropping another $150 million in 2013. After an average annual decline of 4.1 percent from 2007 through the end of 2011, the decline has slowed somewhat during the past two years—with annual declines of 1.9 percent in 2012 and 2.5 percent in 2013.

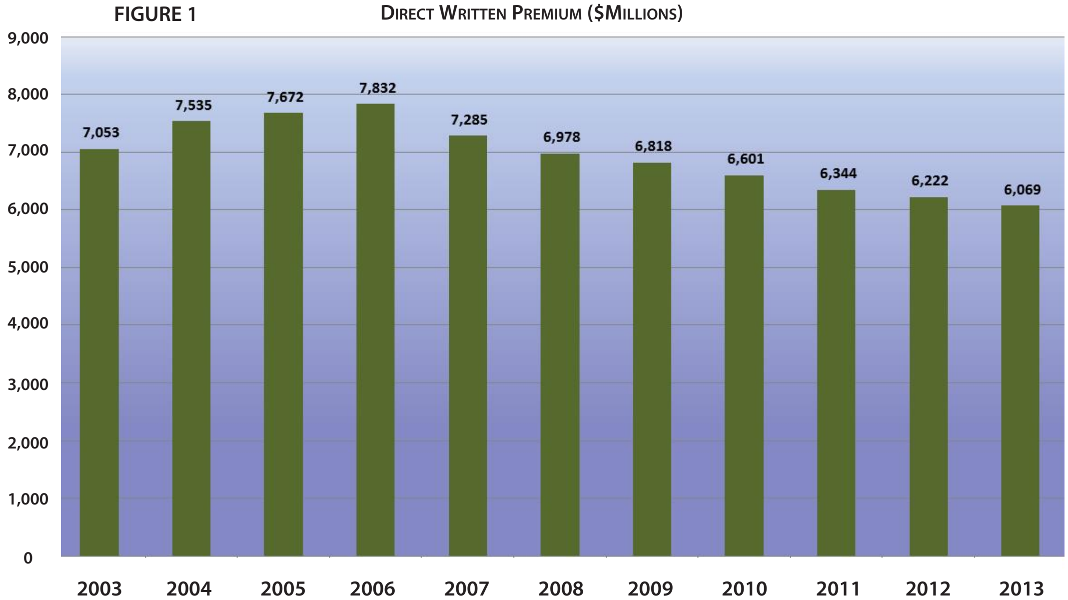
In the face of a continuing drop in written premium, the composite has maintained considerable calendar-year profitability consistent with the broader MPL market.

Ten Consecutive Years of Profitability

Despite a gradual decline in operating margin during the past four years, 2013 marks 10 consecutive years of positive operating profits for the composite (see Figure 2).

The 2.1 percent decrease in operating margin in 2013 occurred despite a small drop in the composite's combined ratio for the first time since 2008. This improved combined ratio, however, was more than offset by a 3.1 percent drop in investment gain as the composite's overall investment results continue to be saddled with historically low investment yields.

FIGURE 1 Direct Written Premium ($Millions)



Naturally, as the composite's operating margin declines, so goes the composite's net annual income (see Figure 3), which also declined for the fourth-straight year. That said, net income still approached the exceptionally healthy sum of $1.4 billion in 2013. Remarkably, this is $100 million lower than the composite's average annual net income since 2006.

Reserve Releases Continue to Impress

As the composite's net income has hovered around the $1.4 billion mark since 2006, it is important to note that the composite's average annual reserve development has been favorable by a similar amount during the

→ CONTINUED ON PAGE 7

2013 YEAR-END RESULTS FOR MPL SPECIALTY WRITERS

→ CONTINUED FROM PAGE 5

same period. In fact, 2013 marks the fifth-straight year that the composite has exceeded the $1.4 billion level in favorable reserve development (see Figure 4). This was achieved in a year where it had appeared through the third quarter that reserve development was lagging behind that of recent years.

Growing Capital

As profits in the MPL market continue to mount, the composite level of policyholder surplus continues to accumulate.

> While worrisome issues remain in the form of declining premiums, an upward trend in combined ratios and the stubbornly low bond yields, MPL insurers as a whole appear well prepared to weather the next decade

Figure 5 illustrates the degree to which the composite capital has grown as evidenced by the dramatic growth during the past decade in the National Association of Insurance Commissioners (NAIC) Risk-Based Capital (RBC) Ratios, which is defined as total adjusted surplus divided by authorized control level capital. Policyholder surplus for the composite has increased 160 percent from $6.1 billion in 2003 to $15.8 billion at year-end 2013.

Conclusion

Despite the rising uncertainty of the future in the healthcare industry and what that might mean for the MPL market, this past decade has treated the industry exceedingly well.

While worrisome issues remain in the form of declining premiums, an upward trend in combined ratios and the stubbornly low bond yields, MPL insurers as a whole appear well prepared—with strong reserve positions and ever-growing amounts of capital—to weather the next decade should it not greet them as kindly as in the past 10 years.

Charles Mitchell is a consulting actuary, and Brad Parker an associate actuary, at Milliman Inc., an independent actuarial and consulting firm.

FIGURE 3 Net Income ($Millions)

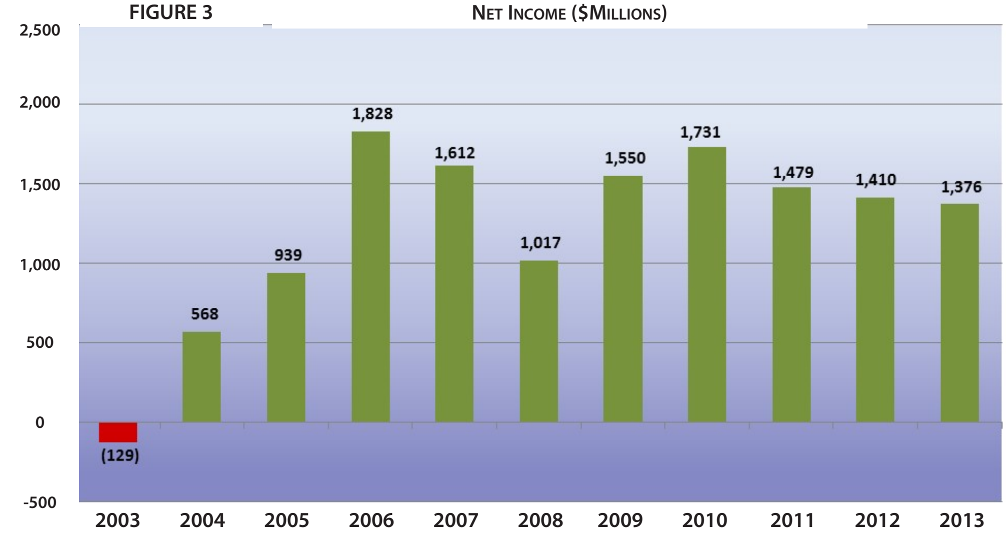


FIGURE 4 One-Year Reserve Development ($Millions)

FIGURE 5 NAIC RBC Ratio