MID-YEAR 2015 FINANCIAL RESULTS FOR MEDICAL PROFESSIONAL LIABILITY SPECIALTY WRITERS

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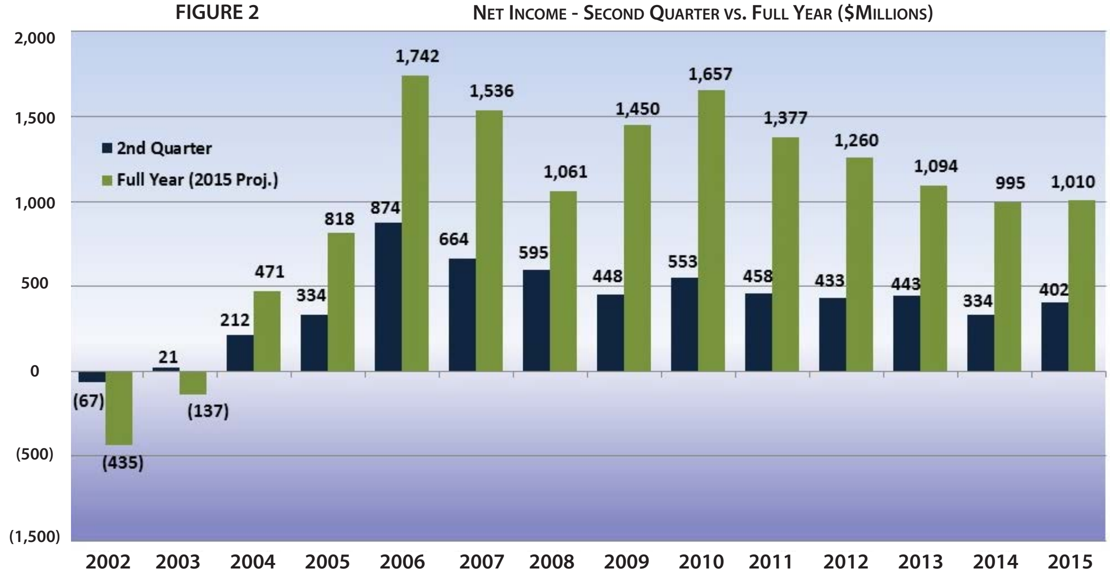
FIGURE 2 NET INCOME - SECOND QUARTER VS. FULL YEAR ($MILLIONS)



With the first six months of 2015 in the books, this article summarizes some key financial results for medical professional liability (MPL) specialty insurers. Calendar-year, net-after-tax income continues its downward trend, coinciding with the continuing decline in premium volume. However, overall calendar-year financial results remain strong in the face of lower premiums. Conservative reserving practices have allowed MPL specialty companies to release large sums of loss reserves, primarily during the fourth quarter of each year, and keep operating margins at a high level.

Our analysis was 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 SNL Financial. The current composite includes 81 MPL specialty companies with total direct-written premium of approximately $5.1 billion in 2014.

PROFITS CONTINUE DESPITE DECLINING PREMIUM LEVELS

Aggregate direct-written premium for this composite of MPL specialty writers continues its decline from a high in 2006 of $6.8 billion to $5.1 billion in 2014, a 26-percent decrease. Six months into 2015, we see this trend continue with direct-written premium down 4.7 percent from the same point in 2014. This suggests that by the end of calendar-year 2015, premium volume for this composite will drop below $4.9 billion—or 29 percent lower than premium written in 2006 (Figure 1).

Despite the decline in net premium, robust competition and historically low investment yields, MPL specialty writers continue to be profitable and continue to increase surplus levels. Net income for this composite is projected to approach $1 billion in 2015 (Figure 2)—the tenth-straight year that net income for this composite has been at, or near, that level.

However, in the face of these positive overall results, pre-tax calendar-year underwriting and investment income are trending downward. Underwriting income projects to roughly $460 million in 2015, down more than 60 percent from its high in 2008, while stubbornly low investment yields have brought the investment income projection to an amount more than 40 percent below its 2006 high (See Figure 3). Note that calendar-year underwriting results reflected in Figure 2 have been buoyed by favorable claim reserve releases.

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

FAVORABLE RESERVE DEVELOPMENT CONTINUES

Going back to 2005, reserve releases from prior coverage years have had a significant impact on calendar-year underwriting results for MPL insurance writers. Similar to the trends mentioned up to this point, the favorable reserve releases appear certain to continue for 2015.

Figure 4 displays reserve movements on prior coverage years through second quarter compared to the annual reserve movements after year-end.

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If the relationship between second-quarter and year-end holds for 2015, we should expect favorable reserve releases of approximately 930 million in 2015, marking the first time the annual reserve release had failed to exceed $1 billion since 2006.

Operating Margins Hold Steady

With concern in the industry that these large loss reserve releases have acted as a buoy for calendar-year results, a look at the latest data for this composite suggests that calendar-year results are still quite strong. Following the remarkable increase from 2002 to 2010, the composite's calendar-year operating margin declined for a few years, but has leveled off at around 30 percent during the last few years (Figure 5).

Through the midpoint of 2015, MPL specialty writers continue to produce exceptional operating results consistent with the past decade. There is cause for debate over whether the declining premium levels for MPL writers are due to the persistence of a soft market or possibly the result of diminishing risk attributed to market trends.

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FIGURE 3 UNDERWRITING VS. INVESTMENT INCOME ($MILLIONS)

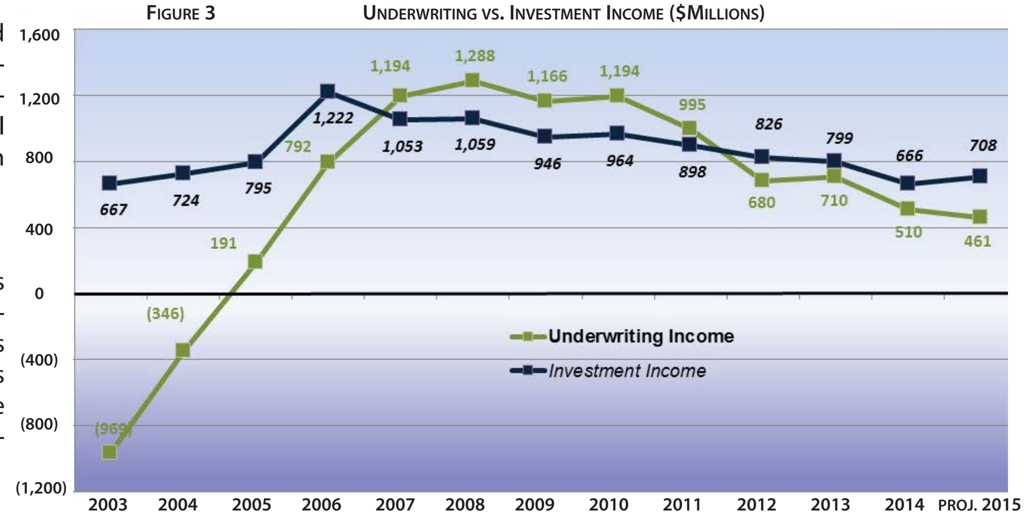

FIGURE 4 CUMULATIVE RESERVE DEVELOPMENT - SECOND QUARTER VS. FULL YEAR ($MILLIONS)

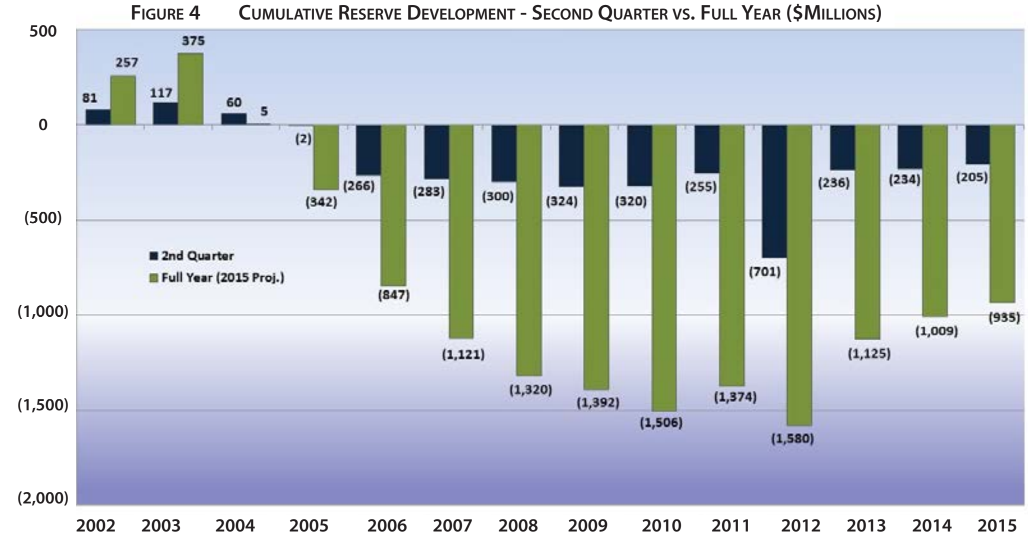

FIGURE 5 CALENDAR-YEAR OPERATING MARGIN