



THE YEAR IN REVIEW: 2012 FINANCIAL RESULTS FOR MEDICAL PROFESSIONAL LIABILITY SPECIALTY INSURERS

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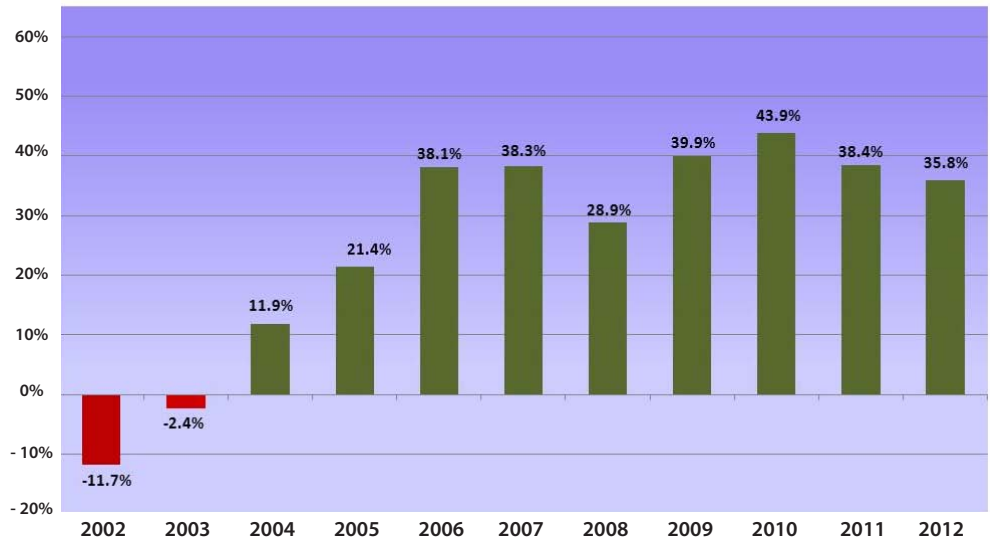
Throughout 2012—as we have done for *MEDICAL LIABILITY MONITOR* during the past three years—we followed the development of key statutory financial results on a quarterly basis for a composite of medical professional liability (MPL) specialty writers. With each quarter's results, we not only attempt to get a better glimpse into what the year-end results might have in store, but, on a broader scale, try to detect changes in the trends that continue to produce stellar financial results for the MPL segment of the insurance industry. Though intuition tells us that the continuation of financial results such as these are not sustainable, there is no clear indication from the year-end 2012 financial statement data to suggest that these trends are subsiding. As the information we present here demonstrates, MPL insurance specialty writers—as a whole—enjoyed another remarkable year financially.

The analysis that follows is based on the composite financial results of a large group of insurers that specialize in MPL coverage. The data used in our analysis dates back to 2002 and is compiled by SNL Financial. The composite includes 83 companies with direct, total written premium exceeding \$6.2 billion in 2012.

As shown in Figure 1, direct written premium for the composite declined in 2012 for the sixth straight year. The total is down more than 21 percent from its high in 2006 of more than \$7.8 billion, however, the 1.9 percent drop in 2012 is the smallest percentage drop during its six-year decline. Despite this steady drop in premium, the composite continues to achieve remarkable calendar-year profitability, which is consistent with the broader MPL market.

FIGURE 2

CALENDAR-YEAR OPERATING MARGIN



OPERATING RESULTS SAFELY IN THE BLACK

Down slightly from last year, yet still comfortably above the break-even point, 2012 marks nine consecutive years of positive operating profits for the composite (see Figure 2).

NET INCOME SLIGHTLY OUTPERFORMS PROJECTIONS

Looking back at our net income projections during the first three quarters of 2012, all indications showed that year-end income would fall somewhere in the \$1.2 billion to \$1.4 billion range. Not to be outdone, actual 2012 net income for the composite comes in just outside the high end of our projected range (as shown in Figure 3 on Page No. 7).

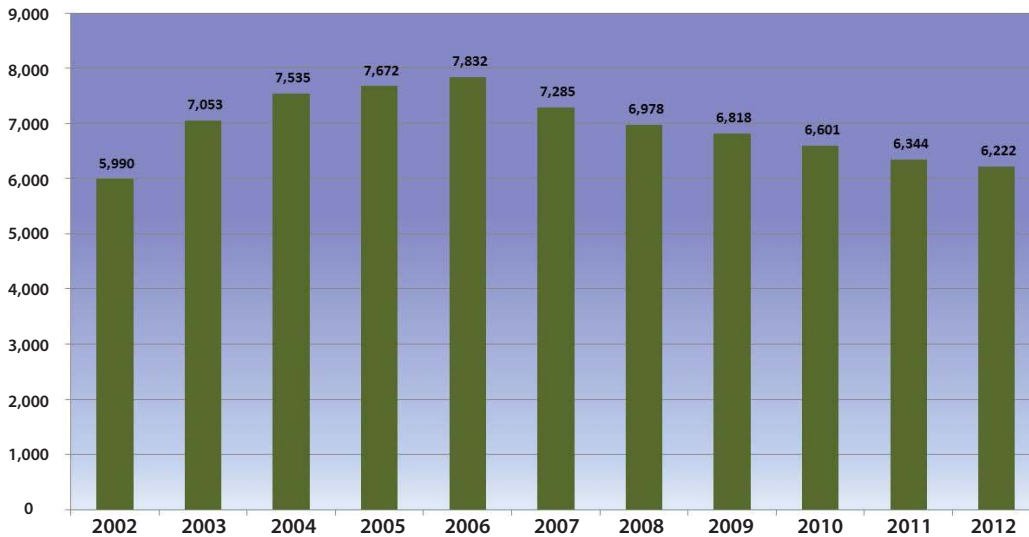
A contributing factor helping to produce higher than projected net income came in the form of realized capital gains, which totaled \$248 million for the composite in 2012. Given the volatile nature of asset prices and the likelihood for companies to rebalance portfolios during the fourth quarter, we typically refrain from any attempt to project these capital gains during the course of the year. With the exception of the years spanning the financial crisis (2007 to 2009), net realized capital gains have been consistently accounting for close to 15 percent of net income for the composite. In 2012, these gains made up nearly 18 percent of net income.

Another factor contributing significantly to the bottom lines of MPL specialty insurers, one to which we've

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FIGURE 1

DIRECT WRITTEN PREMIUM (\$MILLIONS)





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become all too accustomed, is better than expected reserve development, as shown in Figure 4.

RESERVE RELEASES COMPARABLE TO RECENT YEARS

The composite again generated quite favorable reserve development in 2012, exceeding the \$1.5 billion mark, which makes 2012 the fourth straight year that the composite has approached this level (see Figure 4).

IMPROVING CAPITAL POSITION

Clearly, after nearly a decade of persistent profitability for MPL insurers, one would expect to see this reflected by continued growth of policyholder surplus. Indeed, surplus for the composite has increased 160 percent since 2003 (from

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\$6.1 billion to \$14.3 billion at year-end 2012). It should go without saying that this growth promotes the composite as a whole to a much stronger capital position as evidenced by the dramatic growth in the National Association of Insurance Commissioners Risk-Based Capital Ratios (defined as total adjusted surplus divided by authorized control level capital) for the composite—as displayed in Figure 5.

With dramatic changes occurring to the healthcare industry, and with many more likely on the horizon, there is significant uncertainty in both the future of MPL claim costs and the future of the MPL insurance market conditions as a whole. Further, though calendar-year financial results remain strong, it appears that the MPL insurance market is continuing to soften. In the face of these conditions, we restate our position as of year-end 2011: MPL insurers would be wise to maintain strong reserve and capital positions during this period of increased uncertainty and soft market conditions.

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FIGURE 3 NET INCOME (\$MILLIONS)

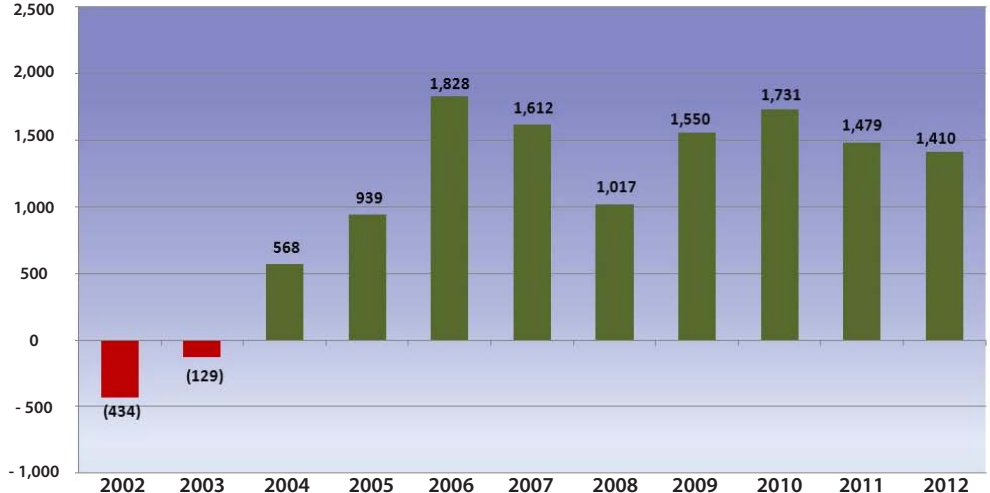


FIGURE 4 ONE-YEAR RESERVE DEVELOPMENT (\$MILLIONS)

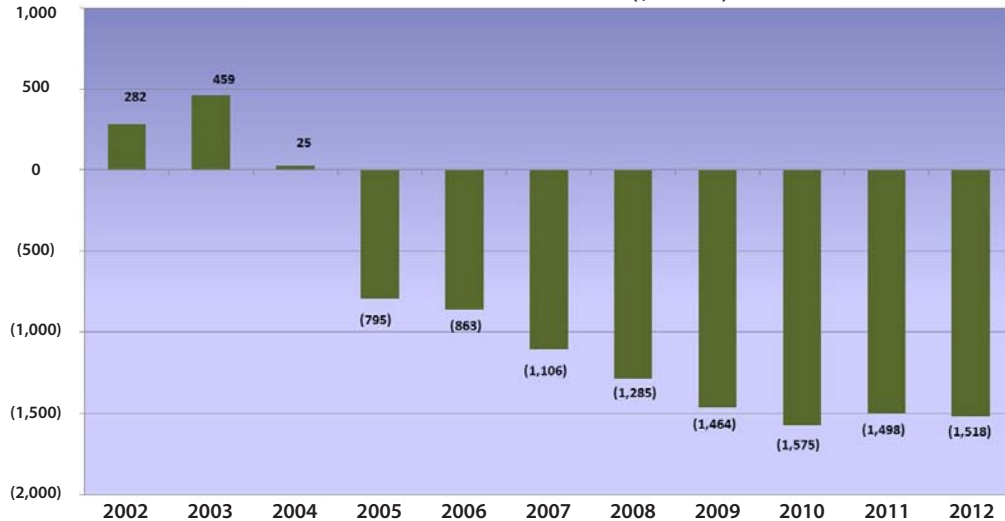


FIGURE 5 NAIC RBC RATIO

