# 2017 YEAR-END FINANCIAL RESULTS FOR MEDICAL PROFESSIONAL LIABILITY SPECIALTY WRITERS SHOW CONTINUED PROFITABILITY

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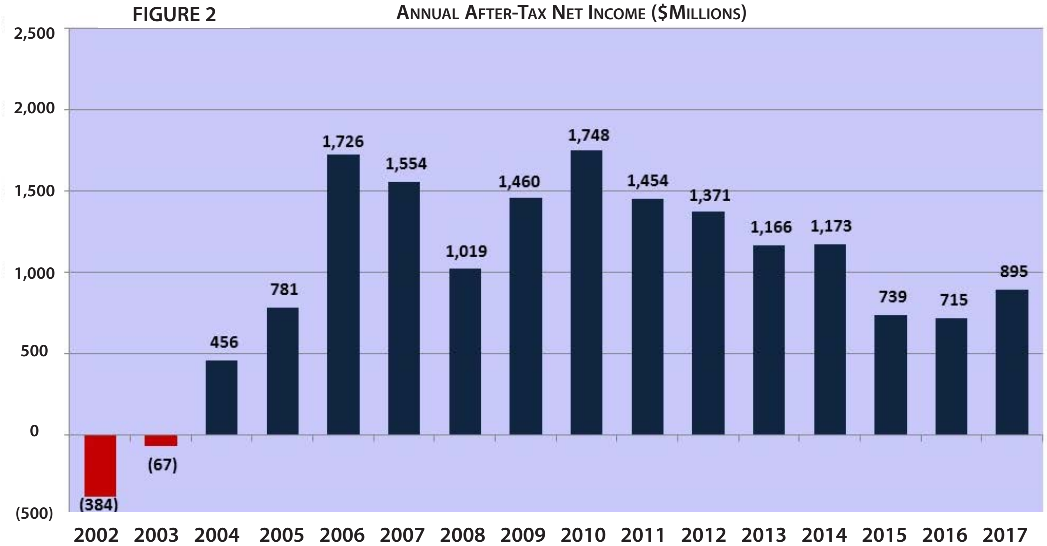
With this article, we complete our eighth year analyzing the quarterly and annual statutory financial results for a composite of medical professional liability (MPL) specialty writers. In 2017, the MPL market, as represented by our composite, experienced another profitable year — with increases in net income and surplus relative to 2016, driven by promising investment performance. Favorable reserve development on prior coverage years still contributes a large portion to the healthy bottom line, as it has for more than a decade, and the decline in direct written premium has slowed, including an increase in the composite's retained revenue and earnings.

FIGURE 2 ANNUAL AFTER-TAX NET INCOME ($MILLIONS)




This month's year-in-review analysis is based on a collection of financial results for a large group of insurers that predominantly write MPL coverage. The data used in our analysis dates back to 2002 and consists of aggregate statutory financial information compiled by SNL Financial. The current composite includes 163 companies with total 2017 direct written premium of approximately $5 billion. (Please note that annual financial results for several companies we usually include in our analysis were unavailable at the date of publication. Hence, these companies were excluded from this analysis. Consequently, the aggregate financial results reflected in the tables below are slightly lower when compared to the historical results from our 2017 quarterly analyses.)

### Are Premium Levels Turning the Corner?

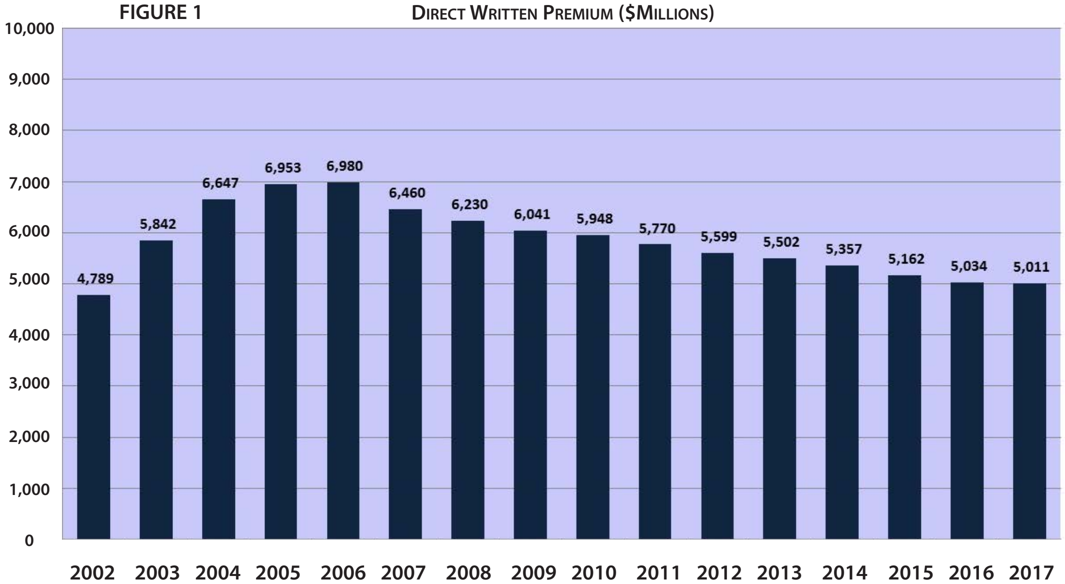
As shown in Figure 1, the composite's annual direct-written-premium declined in 2017 — as it has each year since 2006. However, the 0.5-percent decline is the smallest annual decrease during this 11-year period — a period that saw an average annual decrease of 3 percent. Moreover, the composite's gross written premium and net written premium actually increased in 2017 by 2.6 percent and 1.6 percent, respectively. On both a gross and net written premium basis, this was the first annual increase in premium since 2006.

### Bottom Line Trend Reverses Course

As shown in Figure 2, after-tax net income reversed a six-year negative trend with a 25-percent increase over 2016. The composite's net income of approximately $895 million contributed to a 1.8-percent increase in policyholder surplus for the year. A slight increase in the composite's net earned premium in 2017 was offset by a comparable increase in loss and loss adjustment expenses. This resulted in a 2017 combined ratio after dividends of 100.9 percent — compared to 100.5 percent in 2016.

With underwriting performance relatively flat, it is the composite's investment performance — specifically the capital gains taken from the soaring 2017 financial markets — that gets credit for the increase in net income. The composite's 2017 net realized capital gains increased by more than 500 percent relative to 2016 and reached its highest level since 2010. However, in the current low-interest-rate environment, investment performance not attributable to capital gains has still not recovered from a decade ago.

FIGURE 1 DIRECT WRITTEN PREMIUM ($MILLIONS)




### Reserve Redundancies Persist

As recently as 2016, favorable reserve development on prior coverage years was solely responsible for the MPL market's sustained profitability despite a steady downward trend in the magnitude of the redundancies since 2010. While still responsible for a lion's share of the composite's profitability, the favorable reserve development dipped lower yet again in

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2017 to approximately $768 million.

Figure 3 shows the historical annual reserve development since 2002. Based on recent trends, it appears the market has at least several years of favorable reserve releases remaining. If investment performance continues to improve and the market begins to harden as evidenced by the flattening premium trends, perhaps these reserve redundancies will successfully outlast the MPL industry's persistent soft market and MPL writers will no longer need to rely on this favorable development to turn a profit in coming years.

## 2017 Underwriting Results Repeat 2016

The composite's underwriting experience in 2017 was remarkably similar to that of 2016 (see Figure 4). Loss and loss adjustment expense (LAE) ratios remained flat at 70 percent, while underwriting expense ratios and dividend ratios inched up from 25.1 percent to 25.2 percent and from 5.3 percent to 5.6 percent, respectively. The end result was a second consecutive year of underwriting results slightly worse than break-even, however 2017 offers at least a pause in the rate of worsening results seen during the past several years.

## Capitalization Remains Strong

Capitalization continues to strengthen with the composite's policyholder surplus increasing in each of the past 15 years (see Exhibit 5). That said, the growth rate of surplus slowed considerably during the past four or five years, while during the same period, the composite's required risk-based capital, as measured by the National Association of Insurance Commissioners, has increased proportionately during the same time period. The result is a fairly stable ratio of total adjusted capital to authorized control level risk-based capital (NAIC RBC ratios) since 2013.

## Conclusion

As MPL specialty writers turn the page from their 14th-straight year of collective profitability, the upcoming year offers no shortage of interesting questions. Is the 11-year run of declining direct written premium showing signs of a reversal and perhaps a hardening MPL market? Can the MPL industry sustain its recent investment performance given stubbornly low interest rates and the recent volatility in the U.S. financial markets? What impact will tax reform have on the overall financial results of the industry? We hope to discover the answers to these questions and more as we continue monitoring the financial performance of MPL specialty writers throughout the coming years.

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Figure 3 One-Year Reserve Development ($Millions)

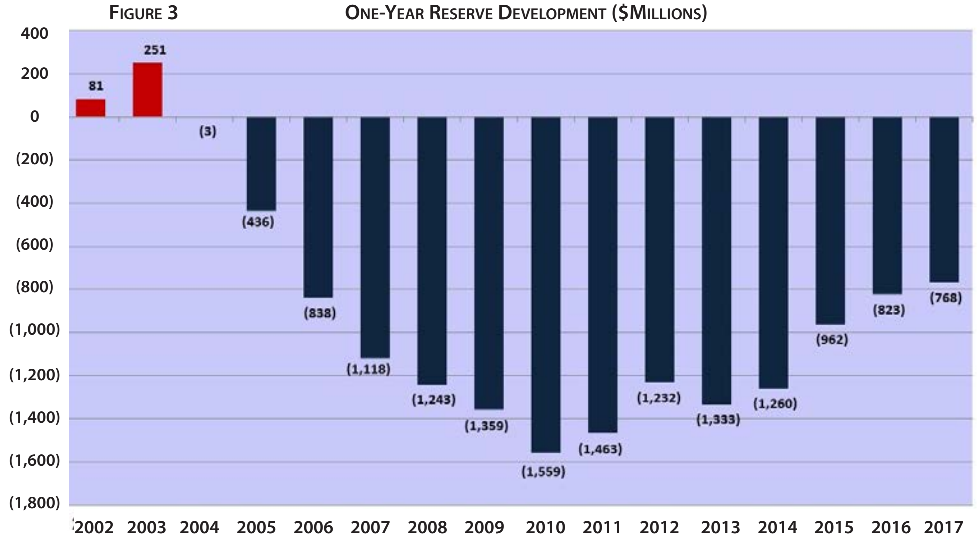


Figure 4 Annual Combined Ratios

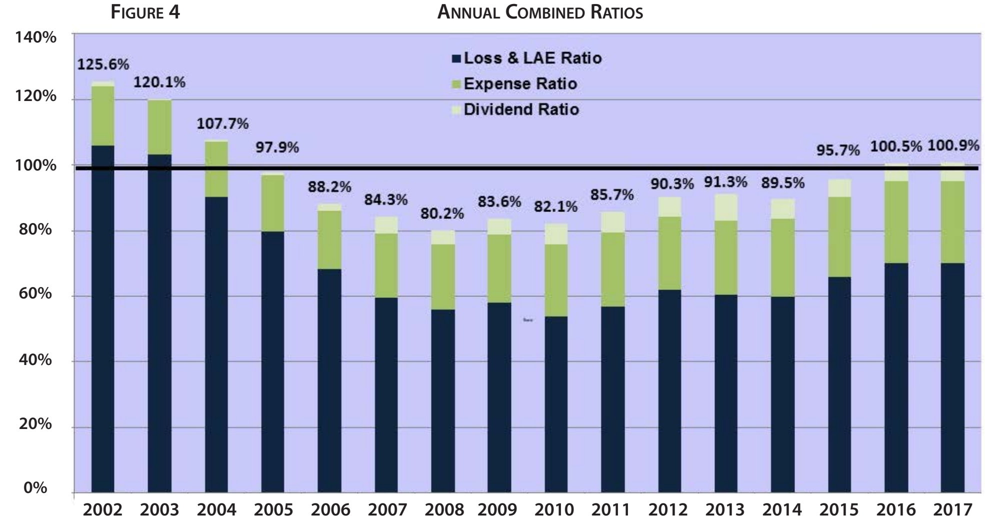


Figure 5 Policyholder Surplus ($Billions)