FIRST-QUARTER FINANCIAL RESULTS FOR MEDICAL PROFESSIONAL LIABILITY SPECIALTY WRITERS

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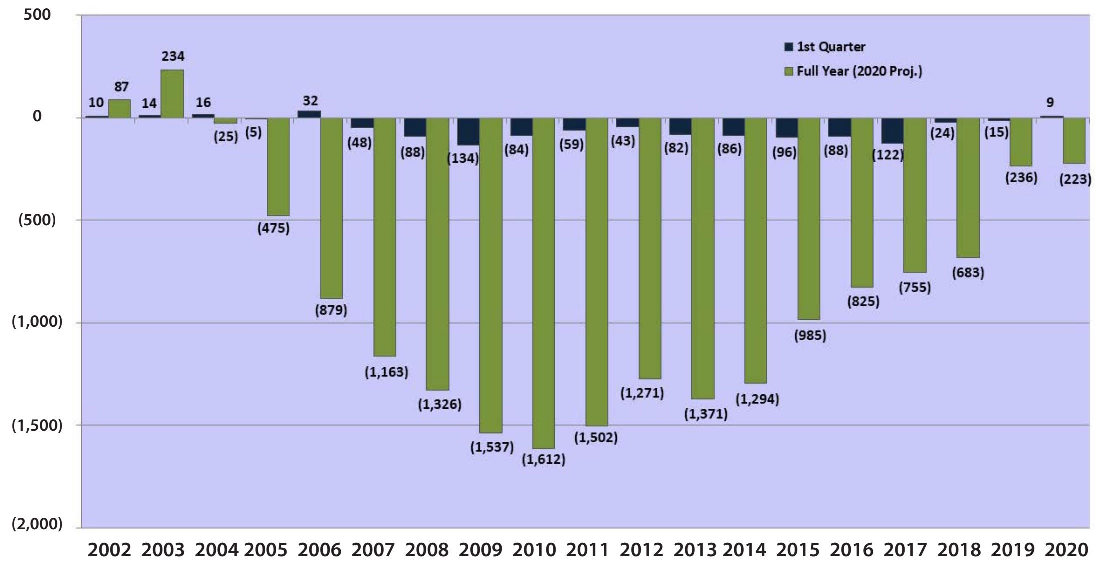
This article summarizes key financial results for medical professional liability (MPL) specialty writers from the first quarter of 2020 and begins our eleventh-consecutive year of tracking and publishing these results in Medical Liability Monitor. As in past years, this article compares historical first-quarter financial results to historical annual results in order to offer a glimpse at where, perhaps, 2020 annual financial results might be headed. With the country — as well as the MPL industry — still in the grips of the COVID-19 pandemic, and all of the uncertainties it creates, we look back at the financial results for the first quarter of 2020, which had just started to experience the pandemic's impacts in its final few weeks.

FIGURE 2 Cumulative Reserve Development — Q1 vs Full-Year ($Millions)



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 to 2002 and consists of aggregate statutory financial information compiled from S&P Global Market Intelligence. The current composite includes 176 MPL specialty companies with total direct written premium of more than $5.8 billion in 2019.

Premium Growth Accelerates

With the MPL market widely considered to have been hardening as it entered 2020, first-quarter premium growth offers some additional evidence to support this claim. The composite's direct written premium increased by a healthy 4.9% relative to 2019 (see Figure 1) as MPL writers continue to increase rates in response to poor underwriting results. This follows consecutive first-quarter premium increases of 3.2% and 4% in 2018 and 2019, respectively. This elevated first-quarter premium levels by 12.6% during the past three years. The full-year projection shown in Figure 1 does not attempt to control for potential premium credits and/or exposure adjustments as a result of COVID-19 adjustments.

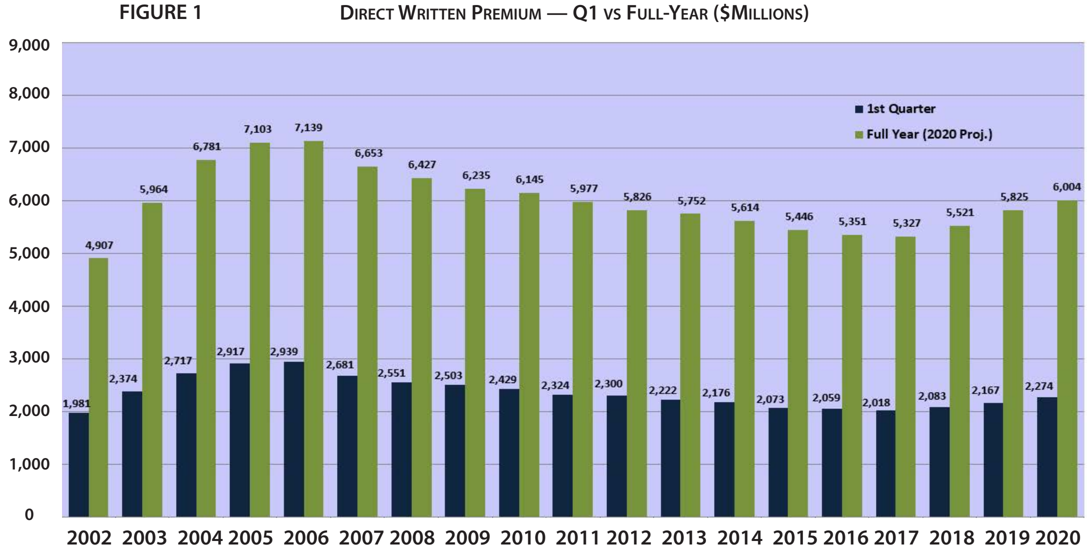
Dwindling Reserve Redundancies Driving-Up Combined Ratios

It is notable, but not entirely surprising, that for the first time in 14 years, the composite saw its first-quarter reserves develop unfavorably. Annual reserve redundancies have been trending downward for a decade — with the composite managing to maintain small, first-quarter reserve redundancies for each of the past few years. In 2020, however, first-quarter reserve levels were approximately $9 million deficient (see Figure 2). While we still consider it likely that 2020's annual financial results will reflect some reserve redundancy, it is becoming increasingly clear that MPL specialty writers can no longer rely on favorable reserve development alone for profitability.

The composite's combined ratio through the first quarter of 2020 reached 121%, its highest mark since 2002. Until recently, the composite's favorable reserve development in prior years has successfully compensated for its deteriorating underwriting results.

Figure 3 provides a comparison of the composite's historical first-quarter combined ratios relative to annual combined ratios. It also acts as an illustration of the growing concern for the MPL market's overall underwriting performance. A comparison of Figure 2 and Figure 3 shows how reserve redundancies have driven underwriting profitability during the past 15 years — with the difference in the combined ratio between first-quarter and year-end in Figure 3 attributable

FIGURE 1 Direct Written Premium — Q1 vs Full-Year ($Millions)



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to favorable reserve development.

Notice the considerable drop in reserve redundancies in 2019 (Figure 2) which resulted in a much smaller decrease in the 2019 combined ratio between first quarter and year-end (Figure 3) relative to prior years. Given the small first quarter reserve deficiency in 2020, it is reasonable to expect only moderate combined ratio relief from reserve development at year-end.

Pandemic Hinders Investment Performance

With underwriting results and prior-year reserve redundancies continuing to deteriorate, the last thing MPL writers needed was a downturn in investment performance. Enter COVID-19. By the end of March 2020, interest rates had plummeted and financial markets were at the height of pandemic uncertainty, having fallen considerably from the record highs seen earlier in the year. Naturally, the composite's investment income took a hit and, as Figure 4 shows, the composite saw its lowest first-quarter investment income in our 19 years of recorded data, dropping nearly 39% compared to 2019.

2020 Profitability in Question

As discussed above, for a large part of the past 15 years, the composite relied on favorable reserve development to remain profitable. As these redundancies were eliminated in recent years, investment gains were relied on to offset underwriting losses. Following the pandemic's impact on first-quarter investment results, the composite was left with it's first operating loss during the first quarter since 2003 (see Figure 5), calling into question whether the composite can maintain its 16-year run of profitability.

Given the first-quarter financial results, combined with the great uncertainty offered by the pandemic, it is quite reasonable to feel pessimistic about the composite's income statement for the remainder of 2020. However, we simply have no representative means to estimate how things will play out. Will the pandemic interrupt premium growth? And how will it impact incurred losses?

At publication time, financial markets had started to make strides in recovering from the initial, catastrophic decline brought by COVID-19, which should provide a boost to second-quarter investment performance. But will this continue? And how will the markets, or the MPL market in general, react should there be another widespread outbreak in the fall, or sooner?

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FIGURE 3 COMBINED RATIOS (AFTER DIVIDENDS) — Q1 VS FULL-YEAR

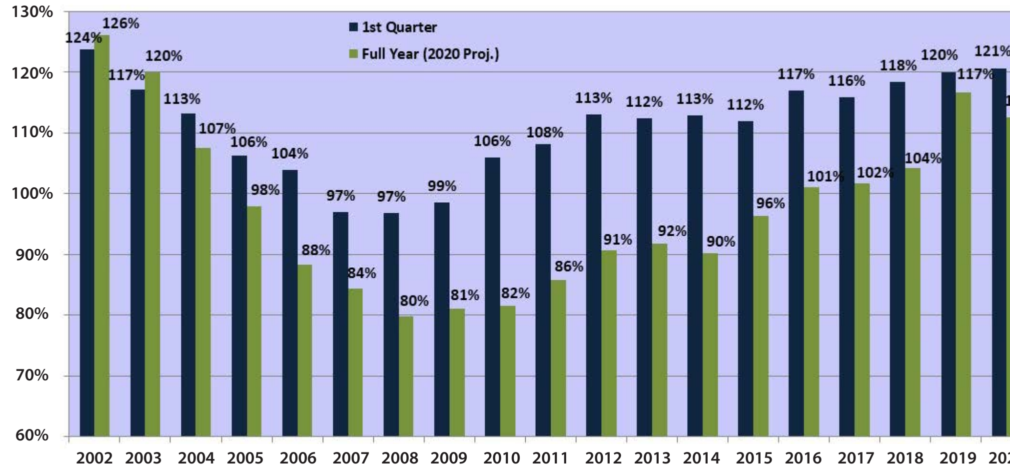

FIGURE 4 INVESTMENT INCOME — Q1 VS FULL-YEAR ($MILLIONS)

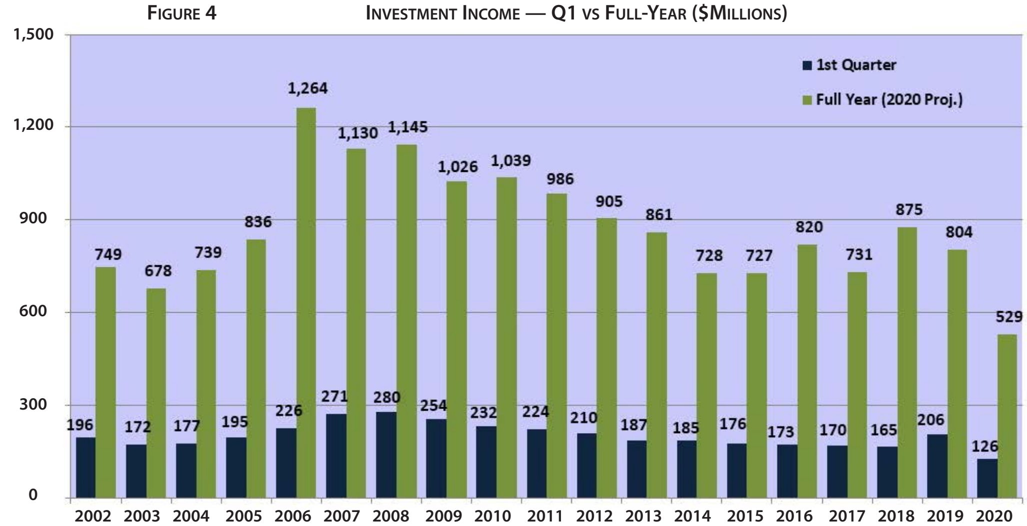

FIGURE 5 AFTER-TAX NET INCOME — Q1 VS FULL-YEAR ($MILLIONS)