MID-YEAR 2020 FINANCIAL RESULTS FOR MEDICAL PROFESSIONAL LIABILITY SPECIALTY WRITERS

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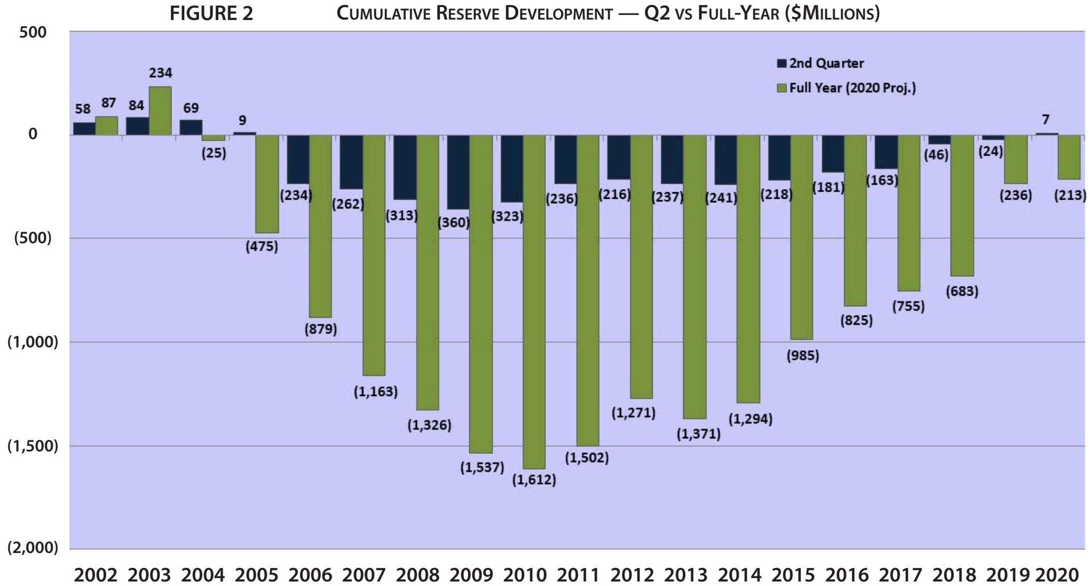
In the paragraphs and charts below, we summarize key financial results for a composite of medical professional liability (MPL) specialty writers through the first six months of 2020. By comparing historic second-quarter financial results to historic annual results — and taking recent trends into consideration — we are afforded an indication of where year-end 2020 financial results might land.

Because the second quarter was the first to entirely coincide with the COVID-19 pandemic, it is interesting to note that recent trends appear, at this point, to be relatively unaffected — with the exception of a rebounding investment performance after the crash of the financial markets near the end of the first quarter.

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 back 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 approximately $5.8 billion in 2019.

FIGURE 2 CUMULATIVE RESERVE DEVELOPMENT — Q2 VS FULL-YEAR ($MILLIONS)



PREMIUM GROWTH CONTINUES

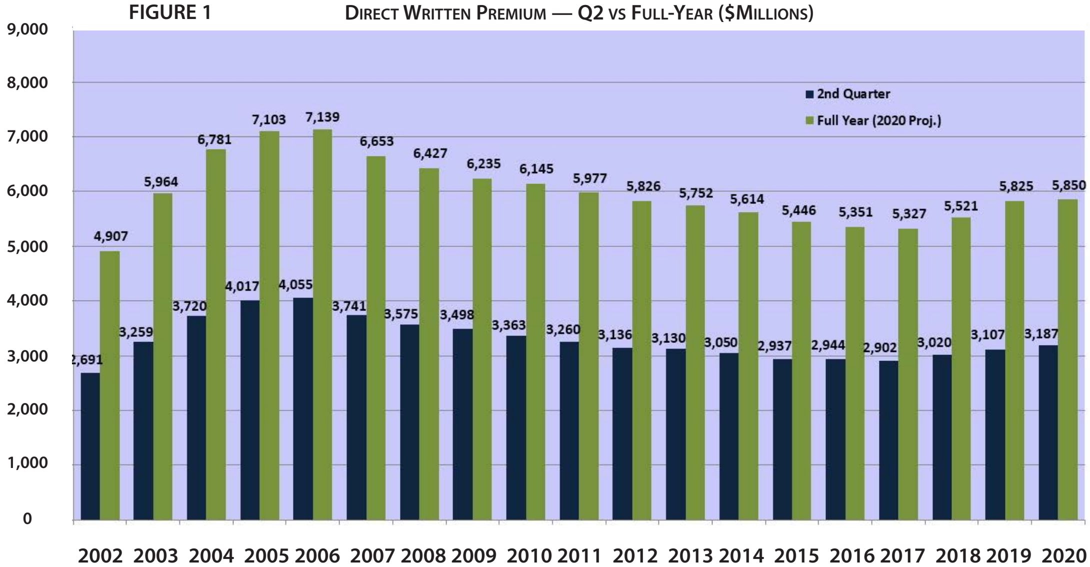
While the composite's direct written premium grew by 2.6% since mid-year 2019 (See Figure 1), it is possible that the rate of premium growth was somewhat depressed during this period because some MPL writers offered premium refunds and discounts to physicians forced to suspend operations during the COVID-19 shut down. Still, the composite's overall premium level is nearly 10%-higher than it was in 2017 when the industry's long-declining premium levels finally reversed course.

Because the industry is starting the third quarter with most physicians back to practice in some capacity, if the worst of the pandemic, or at least the economic shut down, is behind us, it is possible that the rate of premium growth will increase for the remainder of 2020.

RESERVE STRENGTH DECLINING

The composite as a whole saw very little reserve action taken during the second quarter as the small reserve deficiencies seen after the first three months of 2020 remain at about the same level through six months (See Figure 2). The last time the composite saw unfavorable reserve development through mid-year was in 2005, which, incidentally, was the first year of the current 15-year run of favorable reserve development on an annual basis. While we still expect that reserve redundancies will appear yet again at year's end, it is with less certainty, relative to prior years, that we make this projection.

FIGURE 1 DIRECT WRITTEN PREMIUM — Q2 VS FULL-YEAR ($MILLIONS)



A JUMP IN THE COMBINED RATIO

At mid-year 2020, the composite's combined ratio jumped to 119.2%, a 4.6%-increase relative to mid-year 2019 (See Figure 3). With the expense ratio down slightly and dividends relatively flat over the 12-month period, the increase is due almost exclusively to unfavorable incurred loss and loss-adjustment-expense development.

While the overall combined ratio came down by 1.4% since the first quarter of this year, we typically see a much larger decrease from first quarter to second quarter (an average of about 7% during the past 15 years), making the composite's underwriting performance

CONTINUED ON PAGE 7

MID-YEAR 2020 FINANCIAL RESULTS FOR MPL SPECIALTY WRITERS

CONTINUED FROM PAGE 5

more concerning. On the other hand, it is certainly possible that companies are taking a more conservative view given the heightened uncertainty that comes with a pandemic and its resulting economic shut down, each of which materially impacted the insureds in this market in unique and yet-to-be-fully-understood ways.

Investment Performance Rebounds

Although U.S. financial markets bottomed out in mid-March due to the COVID-19 pandemic and its accompanying shut down, by the end of the first quarter we were already seeing the markets begin to rebound. The market rebound continued consistently throughout the entire second quarter, vastly improving the composite's mid-year investment performance relative to the first quarter.

With interest rates still very low, the composite's investment income through mid-year still pales in comparison to 2019 (down nearly 20%). But considering 2020's first-quarter investment performance was down 40% from the 2019's first quarter, and knowing markets have continued to improve through the date of this article's publication, there is cause for some optimism on the investment front.

As Figure 5 shows, the rebound in the composite's investment performance was enough to maintain the composite's profitability through mid-year — but just barely. This has been the case for at least the past several years, but if the composite does not reverse its continued growth in underwriting losses, the ability to stay profitable will become increasingly difficult.

Conclusion

Despite the many challenges presented by COVID-19, when we look at the financial results for the first half of 2020, we see that most of the MPL-industry composite's trends are consistent with those prior to the pandemic. Premiums continue to rise (although possibly at a slower rate), reserve redundancies continue to shrink as underwriting results deteriorate and investment results are on their way back despite depressed interest rates. For now, the positive investment results have been just enough to maintain profits for the MPL industry. The coming months should continue to reveal the true impact the pandemic has had on the MPL market and the composite's financial results.

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Figure 3 2nd Quarter Combined Ratios

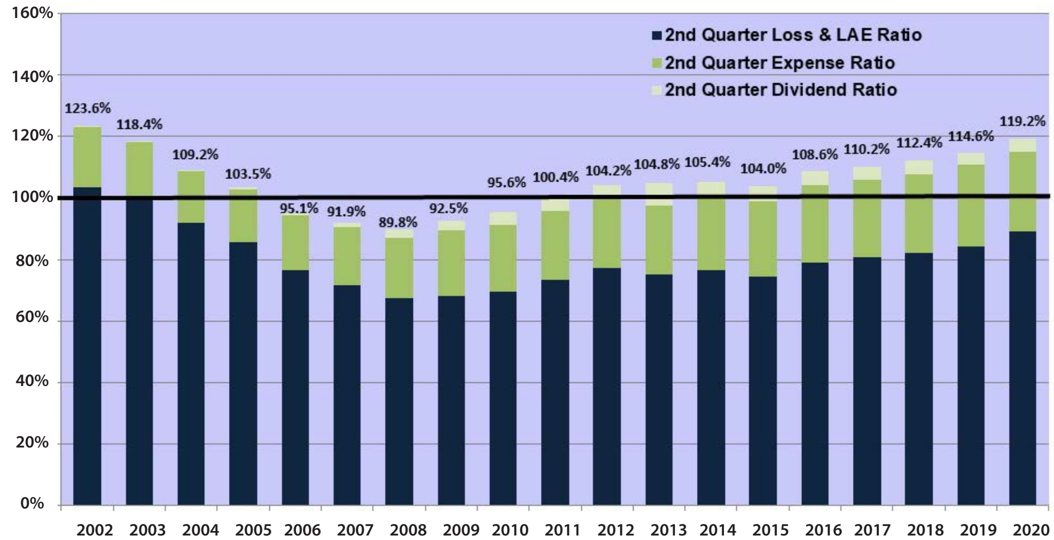

Figure 4 Investment Income — Q2 vs Full-Year ($Millions)

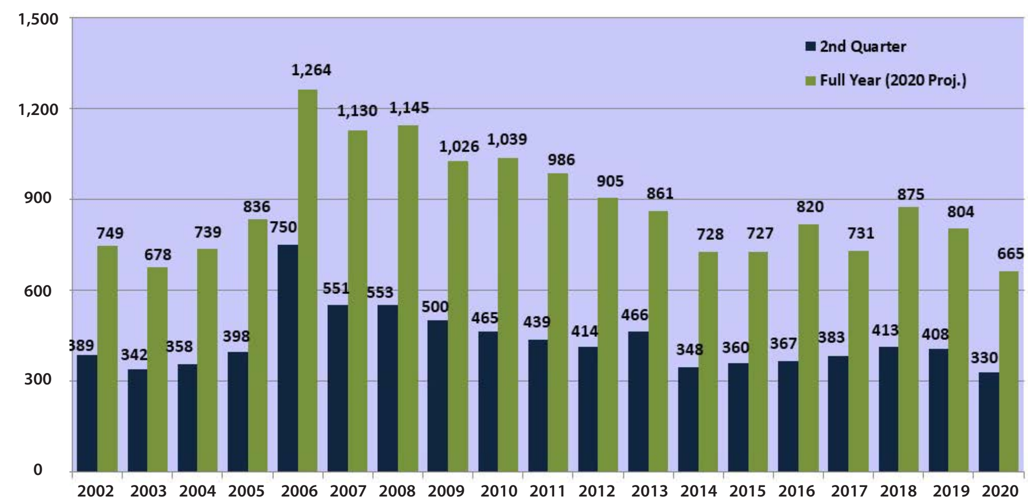

Figure 5 After-Tax Net Income — Q2 vs Full-Year ($Millions)