RECENT RATE INCREASES IMPACT FINANCIAL RESULTS POSITIVELY FOR MEDICAL PROFESSIONAL LIABILITY SPECIALTY WRITERS

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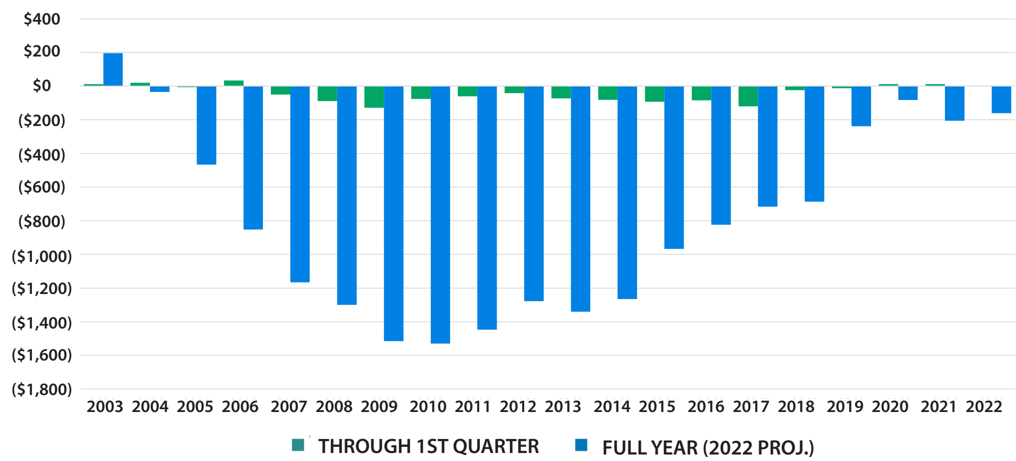
This article summarizes key financial results for medical professional liability (MPL) specialty writers from the first quarter of 2022 and begins our 13th-consecutive year of tracking and publishing these results in MEDICAL LIABILITY MONITOR. As in past years, this article compares historic first-quarter financial results to historic annual results in order to offer a glimpse at where, perhaps, 2022 annual financial results are headed. With the country — as well as the MPL industry — trying to emerge from the COVID-19 pandemic while facing economic turmoil, we look back at the financial results for the first quarter of 2022.

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 covers 20 years and consists of aggregate statutory financial information compiled from S&P Global Market Intelligence. The current composite includes 175 MPL specialty companies with total direct written premium of more than $6.5 billion in 2021.

FIGURE 2 CUMULATIVE RESERVE DEVELOPMENT - Q1 VS FULL-YEAR



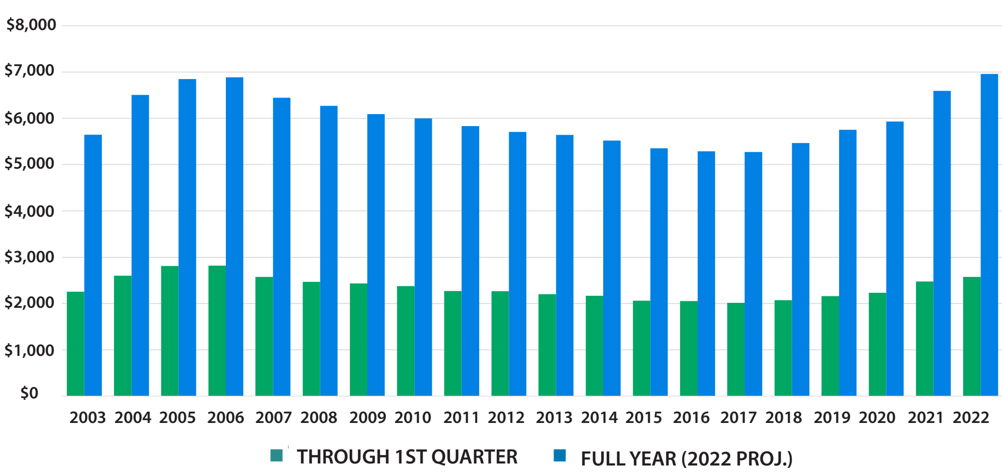
2022 PREMIUM OFF TO A STRONG START

With the MPL market hardening in recent years, it came as no surprise that 2022 first-quarter premiums have extended their upward trend. The composite's direct written premium increased by a healthy 4.1% relative to the first quarter of 2021 (Figure 1) as MPL writers continue to increase rate levels in many jurisdictions in response to poor underwriting results. The current first-quarter results are the highest since 2007, and the 2022 full-year premium will likely challenge the composite's 2006 peak. This full-year projection for 2022 is also shown in Figure 1. It reflects an increase of more than 30% relative to the composite's 2017 low.

FLATTENING RESERVE DEVELOPMENT

Reserve development related to prior years for the first quarter of 2022 was minimally unfavorable at $1 million for the composite, marking the third consecutive first-quarter report of adverse development. Annual reserve redundancies have been trending downward since 2010 — with the composite managing to report small first-quarter reserve redundancies until 2020 (Figure 2). The relatively small amounts of first-quarter adverse development in 2020 ($12 million) and 2021 ($11 million) did not lead to adverse development for their full years. While we still consider it likely that the 2022 annual financial results will reflect some reserve redundancy, it's clear that this MPL composite should no longer expect favorable reserve development at the levels we saw in recent past.

FIGURE 1 DIRECT WRITTEN PREMIUM — Q1 VS FULL-YEAR ($MILLIONS)



IMPROVING (BUT STILL UNSUSTAINABLE) COMBINED RATIOS

The composite's combined ratio through the first quarter of 2022 was 111% (Figure 3, on page 7), a decrease of 9% since 2020 and its lowest mark since 2011. The combined ratio has continued to benefit from the impact of higher rate levels, as evidenced by a lower initial coverage-year loss and LAE ratio. The fixed-expense ratio and policyholder dividend ratio also declined to their lowest points in any first quarter since 2014 and 2009, respectively.

Figure 3 also compares the composite's historic first-quarter combined ratios to annual combined ratios. It illustrates the concern for the MPL market's unsustainable overall underwriting performance. By comparing Figure 2 and Figure 3, we see how reserve redundancies have impacted underwriting profitability historically. The difference in the combined ratio between first quarter and year end in Figure 3 is highly correlated with favorable reserve development. This is evident with the smaller full-year reserve redundancies in 2019 through 2021 (Figure 2) which resulted in much smaller decreases in the respective combined ratios between first quarter and year-end (Figure 3) relative to prior years.

INVESTMENT GAINS OFFSET UNDERWRITING LOSSES

Figure 4 tracks the composite's underwriting per-

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FIRST-QUARTER FINANCIAL RESULTS FOR MPL SPECIALTY WRITERS

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-formance (in terms of dollars) relative to its investment performance over time. While the composite's investment gain (investment income plus net realized capital gains) has remained relatively consistent since the financial crisis and through 2021, the composite's underwriting performance has deteriorated over the same period. Underwriting losses for the composite have been reported each year since 2016, reaching a bottom in 2019 before rate increases began to lift results. Figure 4 also illustrates how investment gain has more than made up for the underwriting losses experienced in recent years, although the financial markets' performance so far in 2022 does not bode well for full-year results.

Increasing Risk-Based Capital Continues to Outpace Policyholder Surplus

The composite's policyholder surplus level (Figure 5) has contracted somewhat during the first three months of 2022 (-0.4%), principally due to the declines in the financial markets causing adverse changes to unrealized capital gains. Assuming relative stability in the financial markets, we expect the composite's net income will push surplus modestly higher at year-end than at year-end 2021, continuing the slow and steady rise since 2018.

Despite the steady increase in held capital since 2018, the composite's NAIC risk-based capital has increased more than proportionately. As a result, the ratio of total adjusted capital to authorized control level risk-based capital (RBC ratio) continues to deteriorate. Not all RBC inputs are publicly available, but our approximations of these risk components indicate that premiums and reserves — the two largest categories — have materially outpaced surplus growth during this period.

Conclusion

Top-line revenue for the composite has been growing for several years and is fast approaching an all-time high. At this moment there are few (if any) signs of a pullback, with insurers seeking additional rate increases to combat medical/social inflationary pressures on claim severity and trim combined ratios to a sustainable level. External uncertainties, including inflation, financial markets, global conflicts and the impact from seemingly everlasting and evolving COVID-19 variants on healthcare, can cloud expectations for future financial results and cannot be disregarded. However, the industry has met and will continue to address these challenges.

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FIGURE 3 COMBINED RATIO (AFTER PH DIVIDENDS) - Q1 VS FULL-YEAR ($MILLIONS)

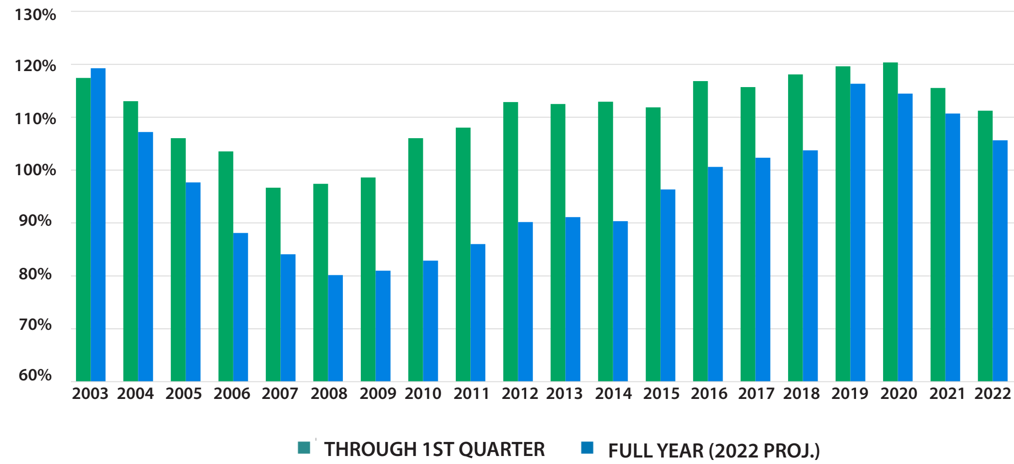

FIGURE 4 UNDERWRITING INCOME VS INVESTMENT GAIN ($MILLIONS)

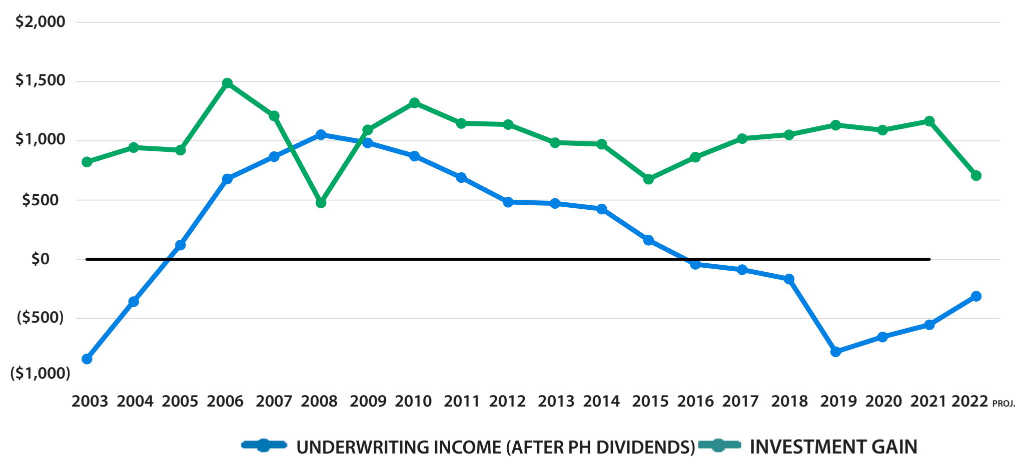

FIGURE 5 POLICYHOLDER SURPLUS - Q1 VS FULL-YEAR ($BILLIONS)