A PIAA PUBLICATION FOR THE MEDICAL PROFESSIONAL LIABILITY COMMUNITY

Inside Medical Liability

WWW.PIAA.US

2017 FOURTH QUARTER

Will InsurTech revolutionize MPL?

PIAA

Has Fortune Turned Its Back on MPL Insurers?

By Stephen J. Koca and Richard B. Lord

Much has been written about the future of traditionally physician-based medical professional liability (MPL) insurers: the impact of the industry's consolidation, its ever-dwindling market, the relentless competition in the current soft market, and the uncertainty of healthcare reform.

And while predictions abound, clarity has been in short supply. So now may be a good time to step back and take stock of what has happened over the past year, before we try to move forward.

There is no better place to start than with the MPL industry's profitability, which in 2016 was still strong, though income was derived from slightly improving investment income and still-favorable prior year loss development. Current policy year underwriting results (i.e., excluding the benefit of reserve releases on older policies) deteriorated by 3 points relative to 2015, likely owing to continued price competition. While the number of significant rate decreases has started to wane, there is as yet little evidence of increasing rates, with overall market pricing essentially flat. With flat pricing and increasing loss severity, particularly the steep upward trend in claims greater than $1 million, rates that were previously resulting in underwriting profits can quickly become inadequate.

Still, the 2016 operating ratio for MPL insurers stayed below the property/casualty (P/C) industry average, and A.M. Best analysis indicates that reserves were still more than adequate as of year-end 2016. However, the question abounds as to how much longer prior year reserve releases will be able to cushion MPL results, and critical to answering that is information about the adequacy of the initial reserves being posted on current policy years.

For more than 10 years, the industry's results have been propped up by reserve releases from prior year policies, which were initially a huge boon to profitability. In the past two years, though, the benefit has moderated. Last year's $0.9 billion reserve release, while still significant, falls far short from those posted between 2008 and 2013, when releases regularly topped $1 billion. Of note during 2016 is the number of companies with significant (defined here as greater than 20% relative to net earned premium) reserve releases, a sharp decline from 2015; and significant reserve development, a sharp increase from 2015.

Last year's curtailment in releases created the first underwriting loss since 2004, as the loss and loss adjusted expense ratio jumped to 77%, and the combined ratio rose to 106%. Adding fuel to the burn-off in reserve releases, the first loss estimates for policies written in more current years have increased substantially year over year and also contributed to the deterioration in calendar-year underwriting results.

The financial picture that emerges vividly shows a fading, though still acceptable, performance. And, in reality, it is probably unreasonable to continue to expect MPL insurers to post operating ratios below 80%, as they did in the earlier part of this decade (Figures 1–3).

The long haul

As serious as the increases in losses are, relentless competition for a contracting market is probably MPL insurers' main challenge. Rates continue to fall for MPL insurers, which are competing for a dwindling market of physicians—many of whom prefer the work-life balance of a hospital or a large group setting, and the often bundled insurance that comes with it, rather than the independence of private practice.

Since 2006's high-water mark of $10 billion, premiums have declined 20%, ending 2016 at approximately $8 billion. Forced to compete with some companies with aggressive pricing, some MPL insurers have eased rates to levels that are now most likely inadequate. Better to retain a risk than to see it move to a competitor, according to the rationale for such decisions.

Stephen J. Koca, FCAS, MAAA, *is a Principal and Consulting Actuary, and* ***Richard B. Lord, FCAS, MAAA,*** *is a Principal and Consulting Actuary, both with Milliman.*

This traditional competition among insurers has been greatly exacerbated over the past 10 years by the migration of physicians to large-group practices or hospitals that are either self-insured or have formed captives. While difficult to track precisely, this trend is evident in the sharp drop in direct written premium for physicians when compared with the level or slightly declining premium for hospitals. Many believe that the uncertainty swirling around healthcare reform will only accelerate this trend.

Despite floundering premiums and the increasing sizes of loss, MPL insurers' capital positions continued to grow in 2016. This increase is one of the best indicators that the soft market will likely continue for at least several years. For as long as MPL insurers continue to add to their capital, there is only a remote possibility that the market will harden. Income breeds, if not complacency, then the lack of resolve to alter one's course. But as soon as MPL insurers see their income begin to evaporate and their surplus shrink, soft market conditions are likely to change, and change rapidly.

But for now, many MPL insurers, having accumulated substantial amounts of capital, have little incentive to change their ways. And in reality, no one insurer can move the market.

An age-old question

The specter of an ever-shrinking market and potentially dynamic changes in the healthcare market per se make for an uncertain future that goes beyond the challenges that MPL insurers have dealt with in their traditional cycle. In many ways, insurers are faced with an age-old question: Should they wait, hoping that more information will provide better direction? Or, by hesitating, will they miss an opportunity to gain a market advantage? The answer is by no means clear. Inaction seems as perilous as action.

One near fail-safe option for insurers is to look for ways to improve efficiency. A perpetual challenge, cost reduction has indeed stymied insurers throughout the P/C industry. In recent years, however, some data-savvy personal lines insurers have started to make headway on costs, by purchasing data on applicants that can speed the acquisition process. A convenience to applicants who no longer have to complete long questionnaires, this change also offers a verifiable source of accurate third-party information for insurers.

While MPL insurers admittedly face a much more complicated underwriting and claims process than personal lines insurers, the progress made by personal lines insurers points to the possible benefits that innovation can have on a long-standing process previously thought to be nearly intractable.

Taking a step further, big data analytics could help some MPL insurers differentiate risk or provide better targeted marketing opportunities. But for MPL

Figure 1. 2007–2016 combined ratios, before and after reserve releases

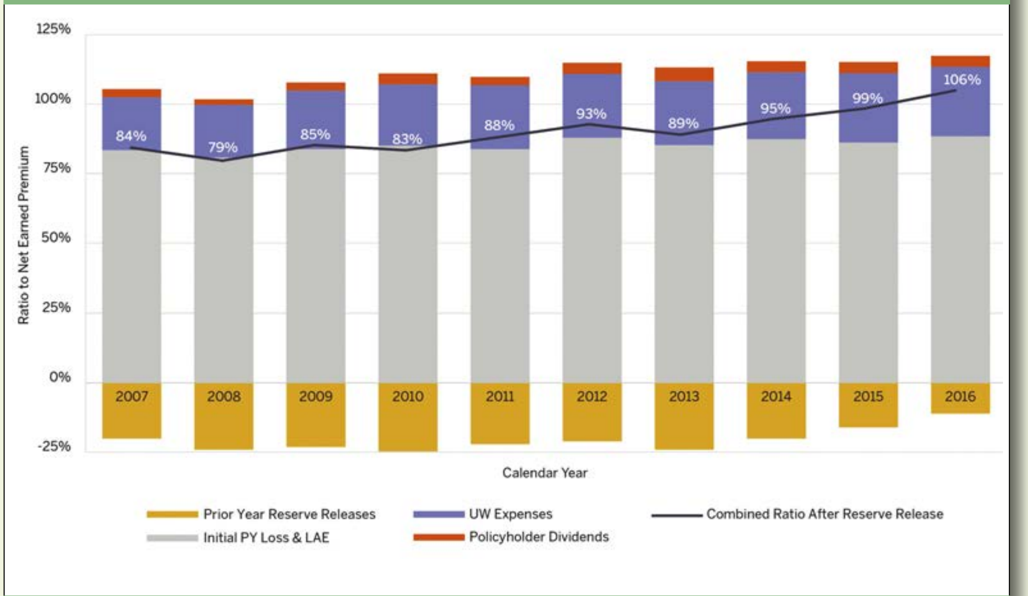
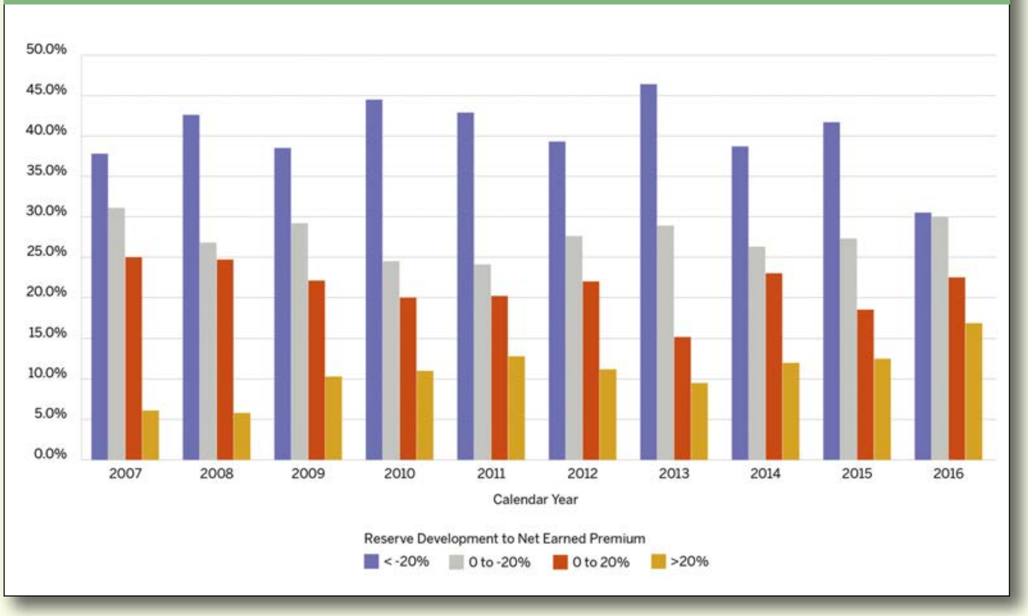
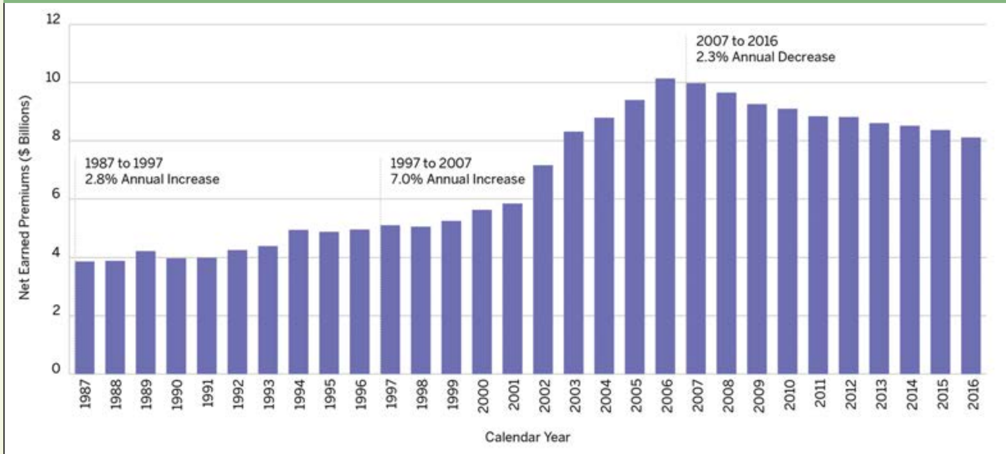


Figure 2. 2007–2016 percentage of MPL writers with reserve releases or development



insurers with high market concentrations in designated states, analytics may not be a necessary option, because they already have deep and extensive knowledge of their market. But for others, it can augment the underwriters' ability to segment risk and facilitate laser-focused pricing strategies that would provide a distinct market advantage over other insurers, and even large medical groups or hospitals that lack pricing sophistication, as well as the flexibility to eliminate marginal physicians from their operations.

Figure 3. Historical MPL net earned premiums



Source: Medical Professional Liability Industry Aggregate, SNL Data/A.M. Best Aggregates & Averages

These examples are in no way intended to provide a roadmap for the future but, rather, some idea of the potential benefits possible from innovation in an uncertain market.

Competition is as much a part of the market as breathing is to life. But the flight of physicians to large groups or hospital systems could make the next downturn unlike any MPL insurers have experienced to date. Could the hard market hasten physicians' migration? Will insurers be competing for an even smaller market? Will competition for fewer risks restrain the traditional hefty increases that insurers have charged in prior hard phases of the cycles? The future is indeed uncertain, but those insurers that choose innovation over habit are likely to be in a better competitive position. PIAA

For related information, see www.milliman.com.

References

1. Greve P, Milford A. Annual Rate Survey Issue. Medical Liability Monitor, October 2016 41(10).
2. Industry Aggregate Supplement A to Schedule T, www.SNL.com.