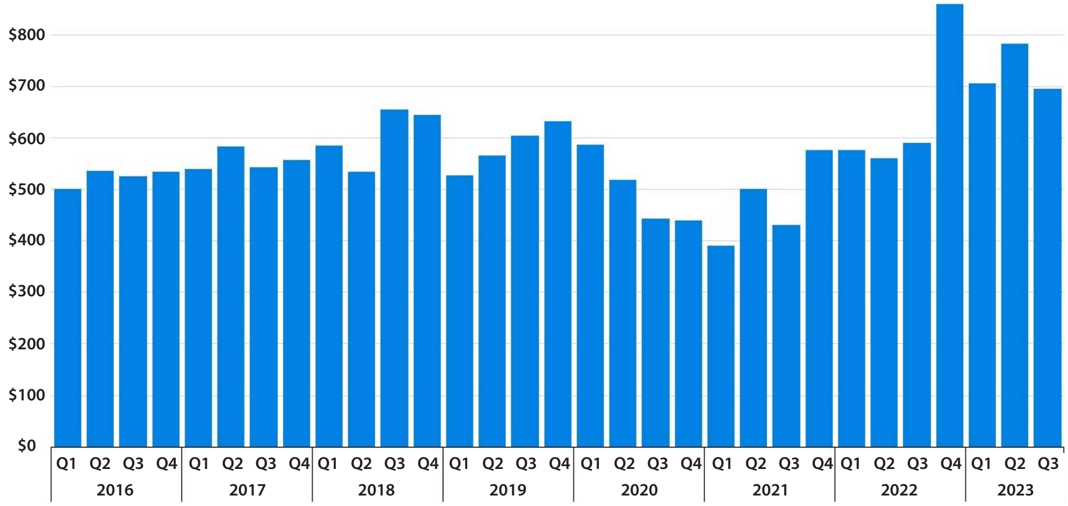
STRONG INVESTMENT RETURNS HIGHLIGHT THIRD-QUARTER MPL FINANCIAL RESULTS

by Eric J. Wunder, FCAS, MAAA, and Andy Kline

This article summarizes the key financial results for medical professional liability (MPL) specialty writers from the third quarter of 2023 and continues our 14th consecutive year tracking and publishing these results in MEDICAL LIABILITY MONITOR. As in past years, this article compares historical third-quarter financial results to historical annual results to offer a glimpse at where 2023 annual financial results might be headed.

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 by S&P Global Market Intelligence. The current composite includes 176 MPL specialty companies with total direct written premium of more than $6.6 billion in 2022.

FIGURE 2 MPL DIRECT PAID LOSS ($MILLIONS)



PREMIUM GROWTH SLOWED

Following a strong start during the first half of 2023, third-quarter premiums continue to trend upward — although at a slower pace. As a result, our full-year growth forecast for the composite's direct written premium is revised downward from +3.2% as of the second quarter to +2.7% (see Figure 1). The incremental premiums written specifically during the third quarter of 2023 total nearly $1.9 billion, which represents the highest third-quarter written premiums in our 20-year dataset. Additionally, the projected 2023 full-year premium is still on target to exceed the market's 2005/2006 peak.

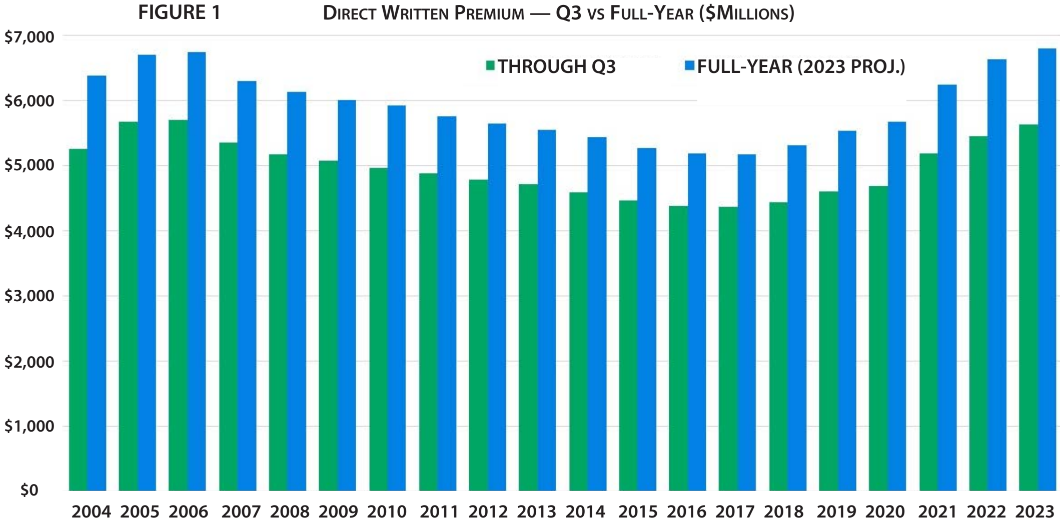
INDEMNITY PAYMENTS CONTINUE TO SURGE AFTER COVID-19 SLOWDOWN

As noted in prior articles (see MLM, July 2023 and September 2023) and shown in Figure 2, our composite experienced a prolonged COVID-related slowdown in the claim adjudication process (most tangibly indemnity payments) for about 18 months — from the second quarter of 2020 through the third quarter of 2021. The past four quarters for our composite, however, have produced the four largest quarterly indemnity payments on record, with the third quarter of 2023 coming in at nearly $700 million. Based on the depth of decline in indemnity payments after the pandemic started — along with general severity concerns in the industry — it is possible our composite can expect sizable levels of "catch-up" indemnity payments to persist as the industry tries to dig out of the hole created by the court slowdown during the COVID-19 pandemic.

UNDERWRITING EXPENSES RISING

Our composite's written premium began increasing during the second half of 2018. Underwriting expenses followed suit, which makes sense as certain of these expenses — agent commissions, brokerage fees and taxes — are tied to premium volume. In reviewing our composite's ratio of underwriting expenses to net earned premium (see Figure 3, page 7), we note a slight downward trend from 2019 to 2022. The implication is that premium levels rose faster than general expenses and other acquisition costs (i.e., fixed expenses) during the period. In 2023, though, underwriting expenses through the third quarter were more than 8% higher than at the same point in 2022. With the gradual return of travel to pre-pandemic levels and recent inflationary pressures on "people costs," the 2023 fixed expenses are outpacing growth in premium, leading to a 1.5-point rise in the underwriting expense ratio.

FIGURE 1 DIRECT WRITTEN PREMIUM — Q3 VS FULL-YEAR ($MILLIONS)



INVESTMENT INCOME COMES ROARING BACK

The composite's investment income through the third quarter of 2023 has spiked to levels not seen since 2011. As Figure 4 (on page 7) shows, investment income through the third quarter of 2023 is about $680 million. This represents a

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60% increase relative to 2022 and the first increase through nine months since 2018. This additional revenue is the other side of the inflation story. While expenses have been driven upward in 2023, as illustrated by Figure 3, the corresponding interest rate hikes implemented by the Federal Reserve have allowed investment income to soar. Although the effects of inflation are much broader than just expenses and investments, the impact on the composite of these two items alone has been a net positive, with investment income rising more, so far, than underwriting expenses have.

Dividend Levels Near a Two-Decade Low

Our composite's third-quarter 2023 policyholder and stockholder dividends were used to estimate annual dividend levels. Our review suggests that the 2023 dividend ratios will be on par with those in 2022, which produced the lowest combined levels since 2005 (see Figure 5). Policyholder dividends may also outpace stockholder dividends for the first time since 2007, assuming our estimates hold up through year-end. The decrease is not driven only by the size of dividends each company in our composite is declaring but also by the number of companies issuing dividends. Policyholder dividends were issued by 20 of the composite's companies in 2022, down from a high of 37 in 2013, and stockholder dividends were provided by 18 of the composite's companies in 2022, compared to an industry high of 29 in 2017.

Conclusion

With nine months of 2023 in the books, the MPL industry appears to be struggling to maintain momentum with regard to increasing direct written premium. This may be driven, in part, by the increased investment yields the composite is experiencing, although it is being partially offset by increases in underwriting expenses. While not discussed above, the composite through the third quarter has seen adverse prior-year reserve development at levels not seen in the last 20 years. This may be a red herring since the lion's share of reserve development each year is recognized during the fourth quarter, but the surge in payment activity so far this year is starting to impact those reserves. We look forward to investigating this further with year-end data in the March edition.

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FIGURE 3 UNDERWRITING EXPENSE RATIO - Q3 VS FULL-YEAR ($MILLIONS)

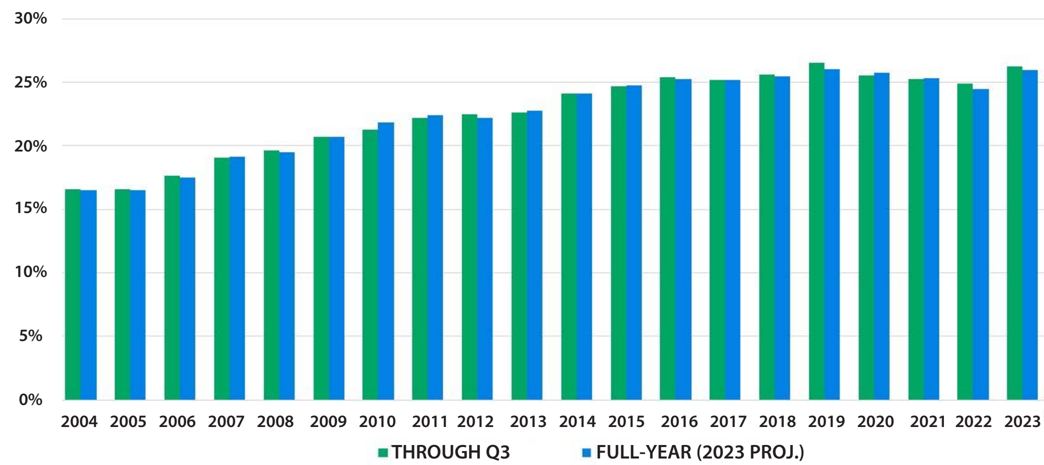

FIGURE 4 INVESTMENT INCOME - Q3 VS FULL-YEAR ($MILLIONS)

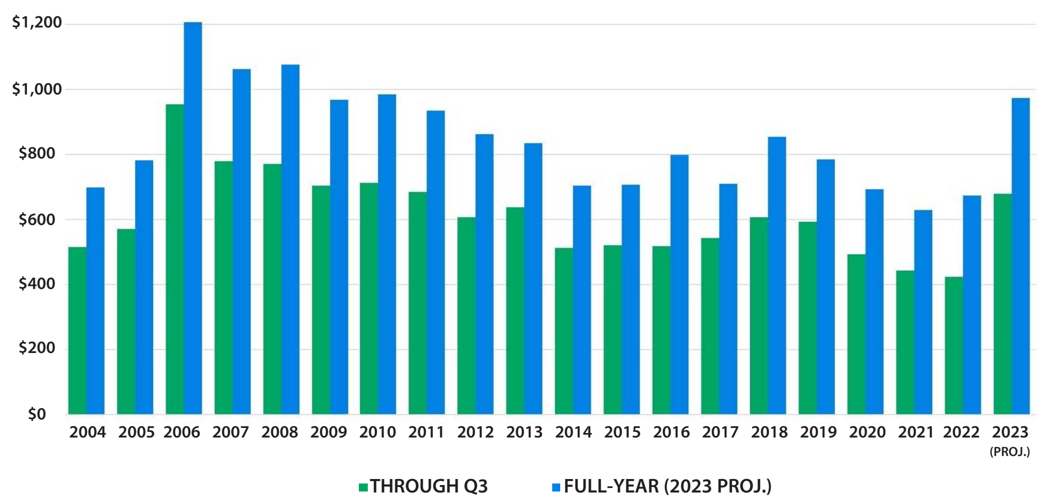

FIGURE 5 DECLARED POLICYHOLDER DIVIDENDS AND STOCKHOLDER DIVIDENDS AS % OF NEP