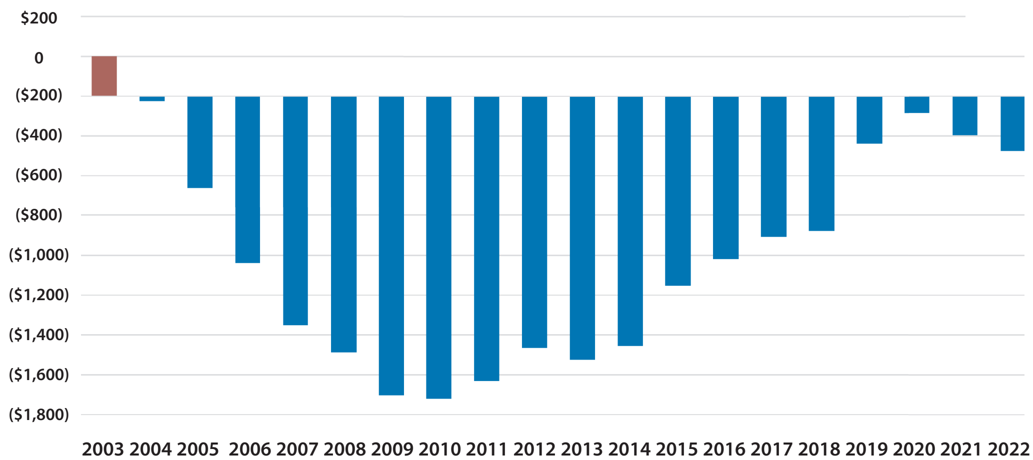
MACROECONOMIC CONDITIONS, UNCERTAINTY LEAD TO A MIXED YEAR FOR MPL INSURERS

by Eric J. Wunder, FCAS, MAAA
and Zachary A. Fischer, FCAS, MAAA

This article summarizes key financial results of medical professional liability (MPL) specialty writers for the year 2022 and completes our 13th-consecutive year of tracking and publishing these results in MEDICAL LIABILITY MONITOR. As much of the country began to put the COVID-19 pandemic into their rearview mirror, 2022 introduced a new hurdle for the entire insurance industry, as inflation hit its highest levels in 40 years.

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 166 MPL specialty companies with a total direct written premium of nearly $6.7 billion in 2022.

FIGURE 2 ONE-YEAR RESERVE DEVELOPMENT ($MILLIONS)



PREMIUM GROWTH CONTINUES

Our composite's total direct written premium increased by 5.7% in 2022 to almost $6.7 billion, its highest level since 2006 (see Figure 1). The percentage of premium increase was smaller than in 2021 but otherwise represents the best growth since 2004. Growth was especially pronounced in the second half of 2022, which saw year-over-year increases of 8% and 11% in the third and fourth quarters , respectively.

While the non-MPL premium within this composite (now representing about 10% of direct written premium) continues to grow, the growth slowed to 13% in 2022, which is the lowest growth rate in non-MPL premium since 2016. Although our composite continues to slowly diversify, the core MPL coverage has seen several recent tort reform initiatives that will impact loss costs in 2023 and beyond and that are likely to require rate action from the MPL industry. As a result, we expect the direct written premium for our composite to continue to grow.

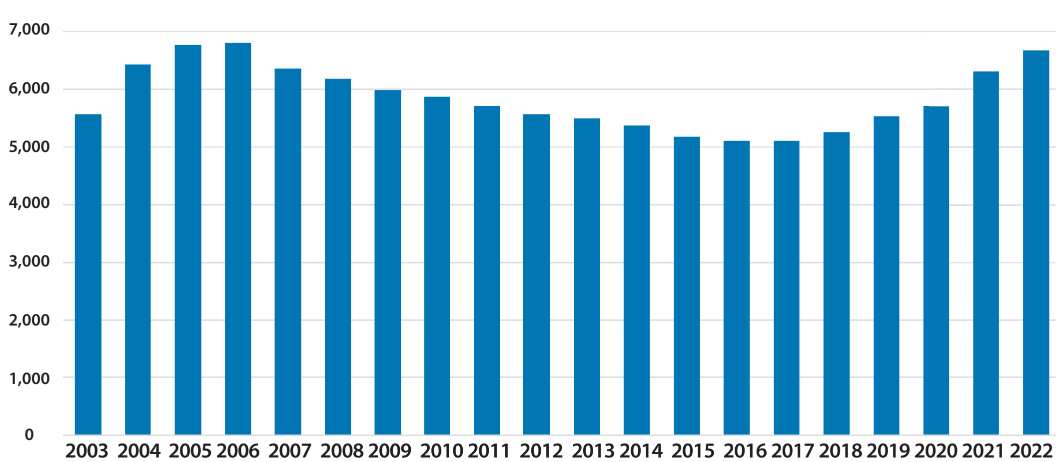
RESERVE RELEASES IMPROVE SLIGHTLY OVER 2021

As shown in Figure 2, the prior-year reserve release for all lines of our composite's business was approximately $250 million in 2022, an increase of nearly 40% from 2021 and the largest release since 2018. Although it previously appeared reserve releases were drying up post-2020, the last two years have experienced a rebound. However, the 2022 release is still significantly lower than those taken from 2005 through 2018. And while there have been no significant losses related directly to COVID-19 claims to date, the pandemic continues to impact our composite by slowing down the claim adjudication process. Reported claim frequency has remained below historical averages since the start of the pandemic, which has led to the initial booked coverage year loss and LAE ratio in Schedule P decreasing each of the last three years. What remains to be seen is whether the frequency decreases are commen- surate with the initial coverage year loss and LAE ratio decreases and whether these will result in future reserve releases or strengthening.

UNDERWRITING RESULTS CONTINUE TO IMPROVE

While 2022 marked the seventh-consecutive year our composite posted a combined ratio greater than 100%, last year continued on a downward trend, inching closer to underwriting profitability. As Figure 3 shows, the combined ratio's 4.5-point decrease from 2021 developed from the combination of a 4-point contraction in the calendar-year loss and LAE ratio and a half-point improvement in the policyholder dividend ratio, while the underwriting expense ratio remained largely unchanged. Further parsing the loss and LAE ratio into its respective parts, we find it interesting to note the magnitude by which incurred losses have outpaced incurred LAE during the last several years. As recently as 2014, the incurred LAE ratio was equal to the incurred loss ratio. In 2022, the incurred loss ratio was 70% higher than the incurred LAE ratio. This speaks to the increases in loss severity that the industry has been experiencing as well as the cutback in reserve releases that, when larger, tended to be driven by loss activity more so than LAE.

FIGURE 1 DIRECT WRITTEN PREMIUM ($MILLIONS)



NET INCOME CONTINUES TO SHRINK

As has been the case since 2016, our com-

CONTINUED ON PAGE 7

MACROECONOMICS, UNCERTAINTY LEAD TO A MIXED YEAR FOR MPL INSURERS

CONTINUED FROM PAGE 5

posite continues to rely on investment performance to maintain its profitability as combined ratios remain above 100%. An after-tax net income of slightly more than $400 million for our composite represents the second lowest amount since our composite experienced its last net loss in 2003 (Figure 4). Improved underwriting results in 2022 were not nearly enough to offset the contraction in investment performance, and net income decreased by nearly 40% compared to 2021. While investment income improved slightly last year, turmoil in the financial markets and rising inflation across the country led to a 90% reduction in net realized capital gains for our composite. This took the total investment gain ratio for 2022 to under 15%, which is the lowest since the financial crisis of 2008.

Surplus Decreases for Second Time in Five Years

As Figure 5 shows, the policyholders' surplus for our composite decreased by 4% in 2022, representing the second-largest decrease on both a dollar basis and a percentage basis during the last 20 years. The decrease was primarily driven by $1.3 billion of unrealized capital losses. The issue is systemic and has caused turmoil throughout the world, especially in the banking industry. Driven by the highest levels of inflation since the 1980s and subsequent Fed rate hikes deployed in an attempt to control that inflation, nearly every company in our composite recorded an unrealized capital loss. Despite the decrease in surplus, our composite's capitalization remains strong, at four times the minimum amount required before regulatory action (based on risk-based capital calculations).

Conclusion

While top-line revenue grew during 2022 and underwriting results continued to improve, the larger story for the MPL industry last year was the macroeconomic conditions. The MPL industry, like virtually every industry in 2022, was not immune to the rising inflation and interest rate hikes. The industry's typically strong investment performance was slashed to the lowest levels since the Great Recession. Despite this, our composite still turned in an operating margin of slightly more than 8%. As many across the country are hoping the Fed's attempts at controlling inflation will offer a soft landing for the economy and improved bottom-line results, the recent developments with Silicon Valley Bank and the global banking industry have us watching with keen interest to see what happens next.

Eric J. Wunder and Zachary A. Fischer are consulting actuaries at Milliman Inc., an independent actuarial and consulting firm.

Figure 3 — Annual Combined Ratios

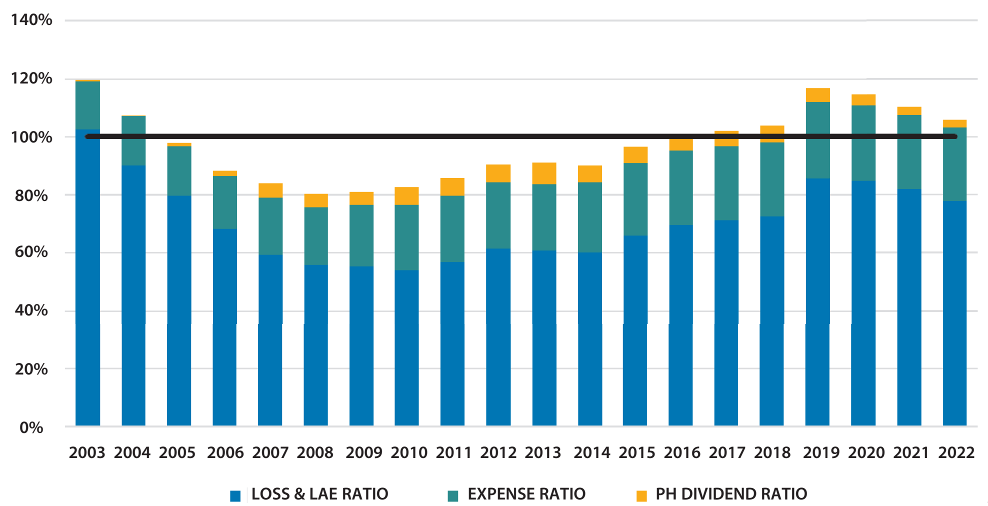


Figure 4 — Annual Net Income ($Millions)

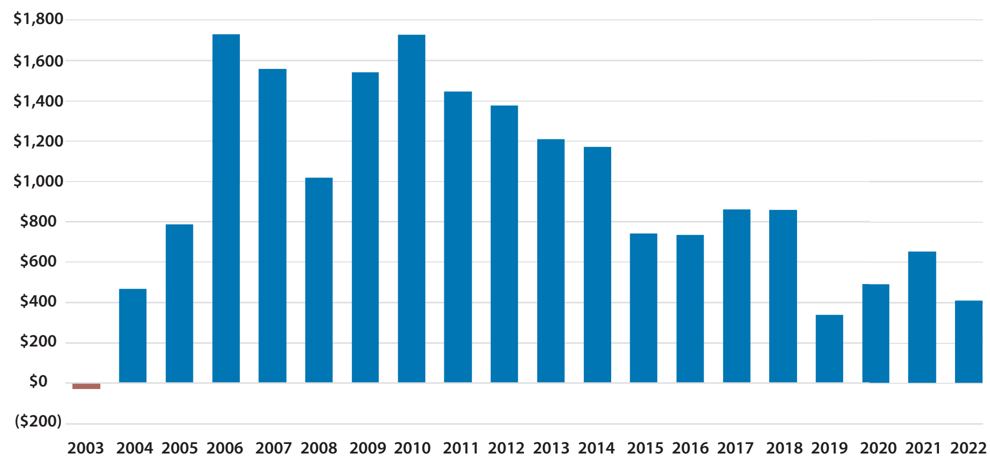


Figure 5 — Policyholder Surplus ($Billions)