INDEMNITY PAYMENTS SWELL DURING SECOND QUARTER FOR MPL SPECIALTY WRITERS

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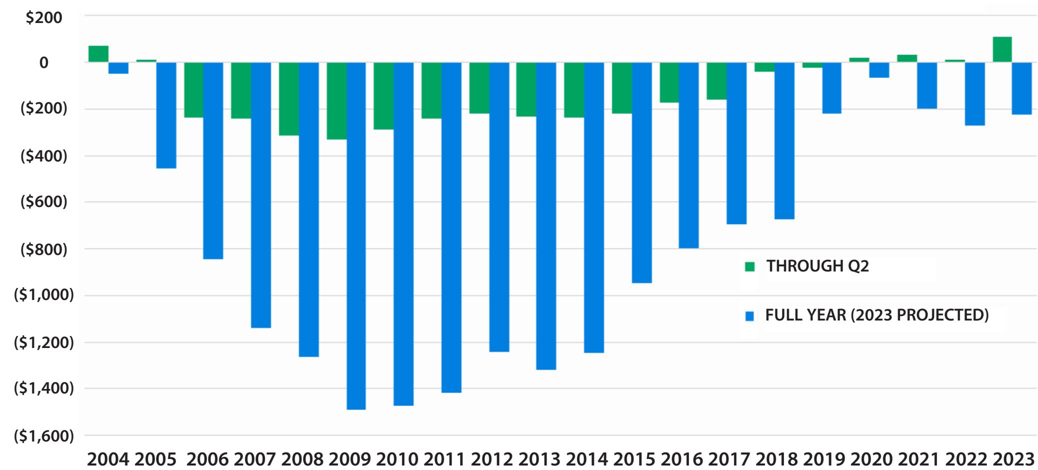
This article summarizes key financial results for medical professional liability (MPL) specialty writers from the second quarter of 2023 and continues our 14th consecutive year of tracking and publishing these results in Medical Liability Monitor. As in past years, this article compares historical second-quarter financial results to historical annual results in order 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 from S&P Global Market Intelligence. The current composite includes 166 MPL specialty companies with total direct written premium of more than $6.5 billion in 2022.

FIGURE 2 Cumulative Reserve Development — Q2 v. Full Year ($Millions)



2023 Premium Continues Its Strong Start

Following a relatively strong start in the first quarter of 2023, second-quarter premiums continue to trend upward. Our composite's direct written premium increased by nearly 5% through the second quarter, relative to 2022 (see Figure 1). The incremental premiums written specifically during the second quarter 2023 total more than $1.1 billion, which represents the highest second quarter written premiums in our 20-year dataset. Additionally, the cumulative second quarter 2023 premiums are the highest since the 2005/2006 peak, with the 2023 projected full-year premium on target to exceed that 2005/2006 peak.

Unfavorable Reserve Development Persists

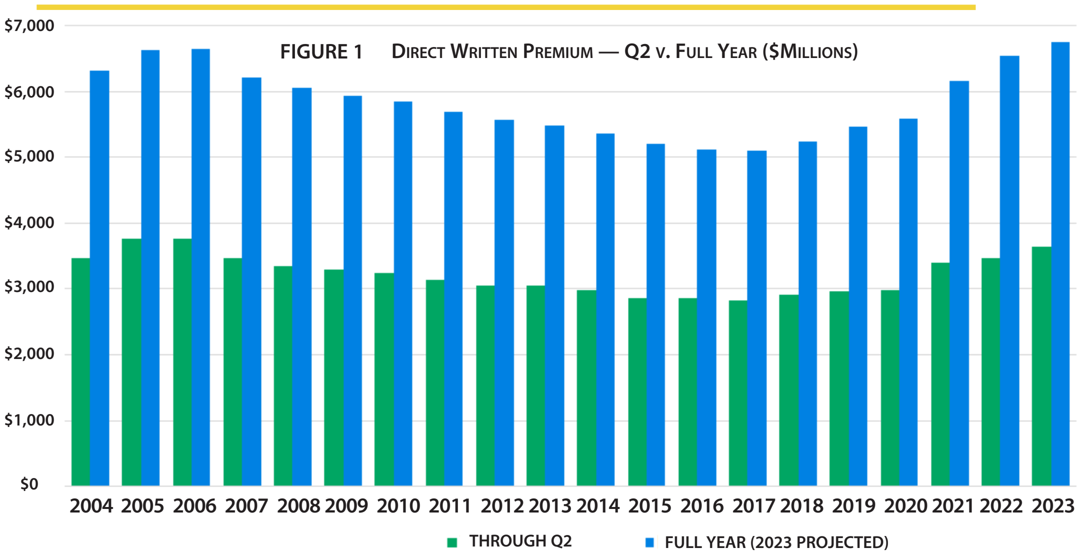
Our composite reported cumulative unfavorable development through the second quarter 2023 of $111 million (see Figure 2) on reserves related to prior years. This reflects the largest unfavorable reserve development in the prior 20 years. This unfavorable reserve development has been persistent for the past three second quarters: second quarter 2020 saw $18 million of adverse reserve development, second quarter 2021 saw $34 million of adverse reserve development and second quarter 2022 saw $10 million of adverse reserve development. Of note is that in the prior three years, the annual reserve development was favorable despite second quarter results that might not have suggested that would be the case. Our anticipation is that the 2023 annual financial results will also reflect some reserve redundancy, and although we attempt to estimate this in Figure 2, the magnitude of any reserve redundancy remains uncertain.

Combined Ratios Back on the Rise

Our composite's combined ratio increased nearly 3% from the second quarter of 2022 to more than 110% (see Figure 3 on Page 7). This is the first increase in second-quarter results year over year since the peak of the combined ratio for our composite in 2020. The main driver of the increase in the combined ratio is an increase to the underwriting expense ratio. The underwriting expense ratio remains a difficult ratio for MPL companies to lower due to the recent inflationary issues. Additional upward pressure on the combined ratio came from the loss and loss adjustment expense (LAE) ratio, as well as the policyholder dividend ratio, with both increasing year over year, but to a lesser degree than the underwriting expense ratio.

Figure 3 also provides a comparison of our composite's historical second-quarter combined ratios relative to annual combined ratios. The 2023 annual combined ratio is projected to come in around 109%, which reflects a 4-percentage point increase from last year's combined ratio of 105% and nearly 30-points higher than the 2008 nadir.

FIGURE 1 Direct Written Premium — Q2 v. Full Year ($Millions)



Indemnity Payments Continue to Surge After COVID-19 Slowdown

Indemnity payments for the MPL industry have continued to rise through the

CONTINUED ON PAGE 7

INDEMNITY PAYMENTS SWELL DURING Q2 FOR MPL SPECIALTY WRITERS

CONTINUED FROM PAGE 5

second quarter of 2023. As noted in last quarter's article (see MLM, July 2023) and shown in Figure 4, our composite had a prolonged slowdown in indemnity payments for about 18 months from the second quarter 2020 through the third quarter of 2021. In the last three quarters, our composite has seen the three largest quarterly indemnity payments on record, with the second quarter of 2023 coming in at nearly $775 million. Based on the depth of the decline in indemnity payments after the pandemic started and general severity concerns in the industry, it is possible our composite can expect these sizable levels of indemnity payments to persist as the industry tries to dig out of the hole created by the court slowdown caused by the COVID-19 pandemic.

This chart may also help explain the recent changes in reserve development. The court slowdowns that drove the lower indemnity payments in 2020 and 2021 may not have been adequately picked-up on by every actuary providing a reserve estimate to this composite. It may be that, with the benefit of hindsight, the reserve releases in 2021 and 2022 were overstated as this payment data continues to realize losses on what were recently uncertain outcomes for open claims. The fact is that claims that have been open for a long time (perhaps eight or more years) tend to resolve towards the ends of the spectrum of possibilities, meaning either no payment or a large payment. If those older claims continue to result in a greater number of large payments rather than no payments, we may continue to see adverse reserve development in the future.

Policyholders' Surplus Holds Steady

Our composite's policyholder surplus levels (Figure 5) increased more than 3% year over year for the second quarter of 2023, coming nearly back in line with 2021 numbers. Furthermore, we expect our composite's year-end 2023 surplus will ultimately fall between the 2021 and 2022 surplus level, bringing our composite back to the slow and steady rise it has experienced since 2018.

Conclusion

The second quarter of 2023 finds the MPL industry continuing to seek rate increases to fend off enduring inflationary pressures and claim severities, while our composite continues to see unfavorable reserve development, higher combined ratios and a continued surge in indemnity payments. Our composite's surplus does appear to have rebounded from its 2022 dip, but questions remain about the pricing and reserving adequacy of the MPL industry.

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FIGURE 3 COMBINED RATIO (AFTER PH DIVIDENDS) — Q2 V. FULL YEAR

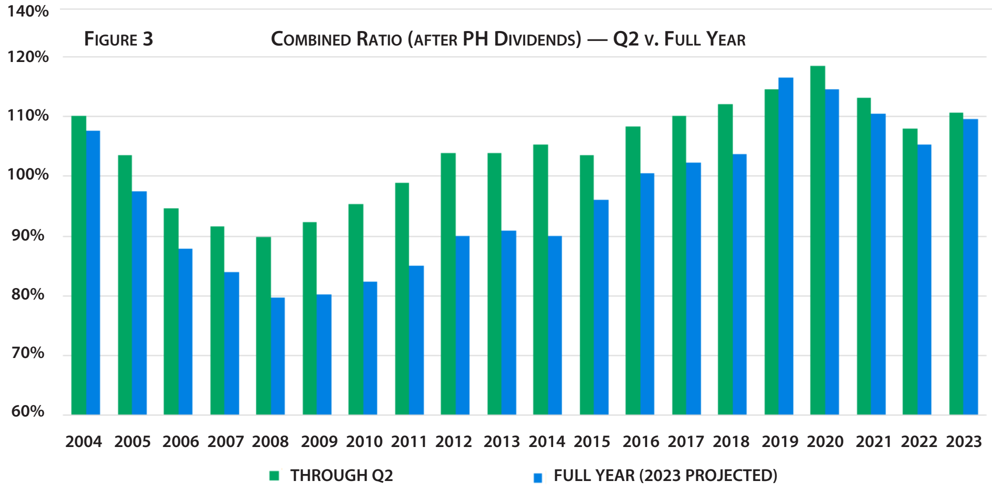

FIGURE 4 MPL DIRECT PAID LOSSES ($MILLIONS)

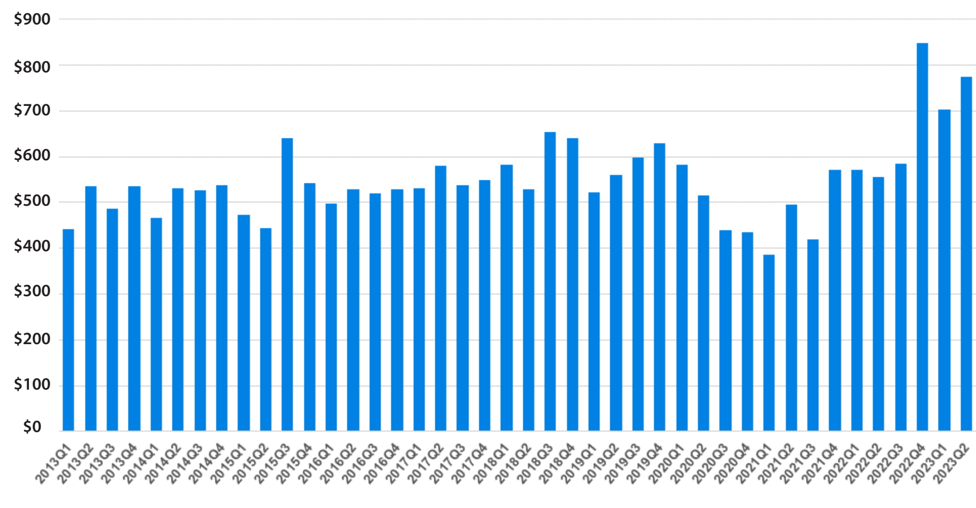

FIGURE 5 POLICYHOLDER SURPLUS — Q2 V. FULL YEAR ($BILLIONS)