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MEDICAL PROFESSIONAL LIABILITY INSURANCE MARKET PERFORMANCE RETREATS

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The U.S. medical professional liability insurance (MPLI) industry took a step backwards in its underwriting performance during 2019. This and several other factors reduce chances for the segment's return to a more profitable footing. Such factors include an increase in higher-severity claims, a weaker loss-reserve position and competitive forces that restrict a more aggressive move toward adequate pricing levels.

The previous decade produced two sharply contrasting halves in underwriting performance for the MPLI market. It generated an average statutory combined ratio of 90% from 2010-2014, jumping to an average combined ratio of 104% from 2015-19, including a 112% result in 2019 [see Table 1].

The MPLI industry has a history of highly volatile performance that includes an industry combined ratio of 154% in 2001. While results are not anticipated to balloon to these levels in the near term, a quick return to underwriting profits is equally unlikely.

Diminished Loss Reserve Strength

Segment loss ratios have risen significantly during the last decade. While claims frequency remains stable, the increase in loss severity tied to more frequent jury verdicts and settlements above $5 million is problematic. The industry's 2019 accident-year loss ratio of 89% is approximately 23 points above its current estimate for 2010.

The MPLI segment has been a source of annual reserve redundancies for the wider P/C industry during the last 15 years, but its deterioration in performance has coincided with a weaker reserve position. On an accident-year basis, the MPLI industry's 2010 loss ratio was lowered by 20 points over time as loss experience emerged. In contrast, the 2018 accident-year has developed upward by 3 points from the original estimate [see Table 2].

Similarly, earnings benefits from calendar-year reserve development are falling. The reported redundancy in 2019 was less than half the previous year's figure at 6% of annual earned premiums [see Table 3].

Reserve weakness is more prevalent in the claims-made, independent-physician segment, which reported net unfavorable development in 2019. The occurrence business, which is predominantly hospitals and facilities coverage, continues to exhibit reserve redundancies.

Pricing Increases Insufficient for a Return to Underwriting Profit

Despite posting weaker statutory underwriting results than any other commercial lines segment in 2019, rate increases in the MPLI segment are lagging other lines, such as general liability, commercial auto, and directors and officers liability.

The Council of Insurance Agents & Brokers' Quarterly Commercial Market Pricing Survey indicates that MPLI renewal pricing

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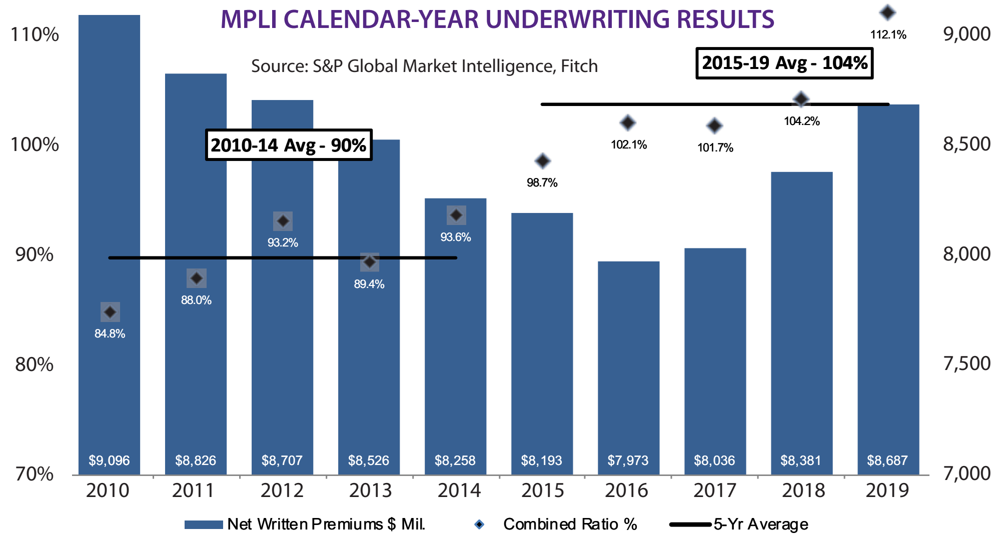
TABLE 1

P/C INDUSTRY AGGREGATE
MPLI CALENDAR-YEAR UNDERWRITING RESULTS



MEDICAL PROFESSIONAL LIABILITY INSURANCE MARKET PERFORMANCE RETREATS

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has increased during each of the last nine quarters. During the first quarter of 2020, renewal pricing increased 2.7%, but that compares to a 9.3% rate increase during the same period for all commercial lines [see Table 4].

A return to rate adequacy for the MPLI segment is being hindered by characteristics unique to itself. Premium and exposure growth are inhibited by the ongoing consolidation of hospitals and medical facilities into larger systems. These large systems employ large numbers of medical providers and are more likely to self-insure than to purchase coverage from the MPLI market. Despite recent modest growth, net written premiums are down 17% from their historic peak in 2006.

Also, an estimated 58% of MPLI net premiums are written by specialty underwriters focused on this segment. These organizations reported strong earnings and capital expansion in the previous hard market. They also have few growth opportunities within MPLI and limited interest or expertise to diversify into other product lines.

MPLI specialists' profitability may have significantly declined in recent years, but a large majority of companies remain very well capitalized. A 2019 year-end review of 46 specialty MPLI writers showed a median net-premium-to-surplus ratio of 0.3x (P/C industry ratio is 0.8x) and a risk-based capital ratio at 567% of the company action level.

A broader shakeout of MPLI specialty underwriting capacity via acquisitions, market exits or loss of capital is likely needed for a return to sector underwriting profitability. More individual underwriters may face reductions in capital going forward due to a recognition of reserve deficiencies. Market fundamentals may shift somewhat if other companies ultimately follow the path of NORCAL Mutual, which reported substantial reserve increases in 2019 in tandem with its announced acquisition by ProAssurance Corp.

Pandemic, Economy Add to Uncertainty

The full effect of the ongoing COVID-19 pandemic on the MPLI segment will likely take some time to unfold. The fact that no cure exists does mitigate failure to diagnose claims. However, treatable complications from the disease can lead to claims. Several states have passed laws limiting legal exposure for medical providers related to the pandemic, but the level of protection they offer varies.

Two areas of claim concern include **(1)** a potential for allegations a plaintiff contracted COVID-19 because a medical facility's lack of procedures resulted in an unsafe and unclean environment and **(2)** an increase in claim severity due to delays in treatment.

However, the reduced patient flow in recent months due to stay-at-home orders or patient reluctance to utilize medical facilities for fear of infection has reduced medical liability exposures and will likely dampen claims frequency in the near term. Some MPLI companies have voluntarily returned or reduced premiums to reflect this reality; some states have made the reimbursement mandatory. This may affect premium flow in the second half of 2020.

The economic lockdown due to COVID-19 could provide short-term positive effects from a cash flow perspective as an inactive judicial system delays the closure of claims and ultimately payments. Plaintiffs facing financial strain may also be more inclined to settle rather than endure an even lengthier litigation process.

The pandemic's disruption of MPLI writer operations and financial results remains unpredictable, hinging largely on the length and severity of the crisis as well as on the nature of emerging litigation. Barring a rash of large pandemic-related losses, the long-run performance of the MPLI market will be more greatly influenced by litigation trends and competitive forces unique to its product line.

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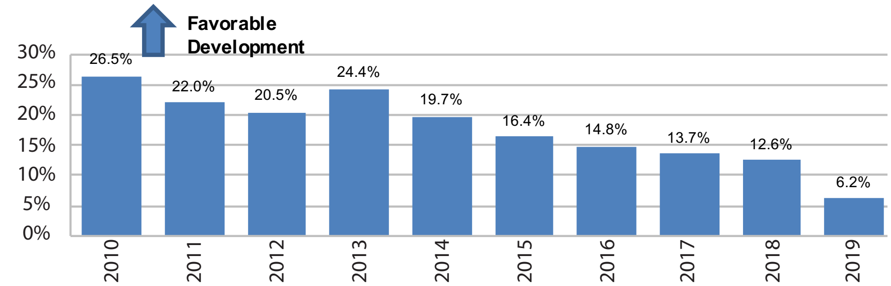
TABLE 3

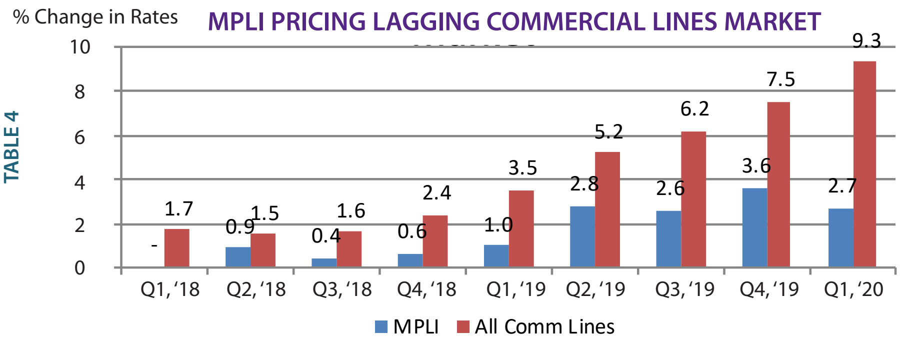
MPLI RESERVE DEVELOPMENT / EARNED PREMIUMS



Source: S&P Global Market Intelligence. Fitch Calendar-Year Reserve Development / Net Earned Premiums Statutory Accounting P/C Industry Aggregate

TABLE 4

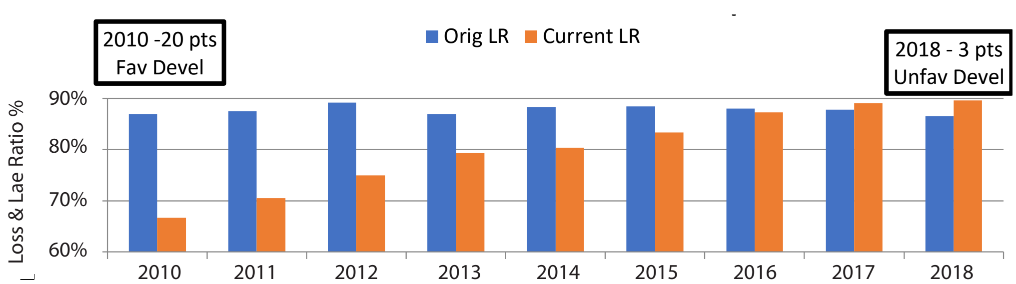
MPLI PRICING LAGGING COMMERCIAL LINES MARKET



Source: Council of Insurance Agents & Brokers Quarterly Commercial Market Survey

TABLE 2

P/C INDUSTRY MPLI ACCIDENT-YEAR LOSS RATIOS & DEVELOPMENT



Source: S&P Global Market Intelligence, Fitch