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MPLI MARKET RECOVERY AT RISK OF STALLING, POSITIVE PRICING WINDOW FINITE

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The U.S. medical professional liability insurance (MPLI) market staged a significant recovery in 2022 with a 102.5% combined ratio (see Table 1), compared to an average of 109% during the previous four years. Positive pricing actions and a more favorable prior underwriting period reserve experience are key factors behind the recent improvement.

While this shift is encouraging, a near-term return to consistent underwriting profits remains unlikely. The level of premium rate increases shows signs of moderating, creating questions about whether premium volume can keep pace with loss-cost patterns influenced by inherently volatile claims litigation and settlement activity, persistent higher inflation and a weaker economy.

MPLI net written premiums moved to a record level of $10.6 billion in 2022. However, written premium growth slowed to 5.7% in 2022, down from more than 10% the prior year. While MPLI premium rates have risen during the last several years, the magnitude of these increases pales relative to those nearly 20 years ago, during the last hard MPLI market that led to many years of strong profits. They also do not compare to recent gains by other volatile liability segments (e.g., cyber or D&O liability), which returned to a more profitable footing during the broader commercial lines hardening market phase.

A review of the Council of Insurance Agents & Brokers (CIAB) Commercial Market Survey shows a decline in positive MPLI rate increases to 2.9% during the latest quarter. During the last 13 quarters (1Q2020-1Q2023), CIAB results show MPLI rates increasing by an average of 5%. During the same period, the overall commercial lines market increased by an average of 9%, D&O rates were up 11% and cyber was up 18%.

Competitive Dynamics Inhibit Performance

The movement toward better underwriting performance is restricted by evolving market factors in both U.S. healthcare and the MPLI business. Particularly, the traditional MPLI-insured physician exposure base is shrinking, tied to a higher proportion of physicians moving to employment within larger medical organizations that tend to manage risk via self-insurance and captives, and to ongoing hospital and medical facilities consolidation.

Statutory financial data reveals that written premiums for physician coverage fell to 47% of industry MPLI totals in 2022, down from 62% a decade earlier, with the difference largely shifting to premiums for hospital and facilities coverage. Healthcare facilities professional liability coverage is written largely by multi-line insurers and a small number of MPLI specialists that can provide the necessary level of underwriting capacity and expertise.

The MPLI market is also uniquely influenced by a large proportion of industry direct premiums (approximately 55%) being held by MPLI specialists with limited product diversification and geographic scope. Many MPLI specialists hold significant excess capital as measured by extremely strong risk-based capital and statutory operating leverage ratios.

These specialty carriers lack the expertise

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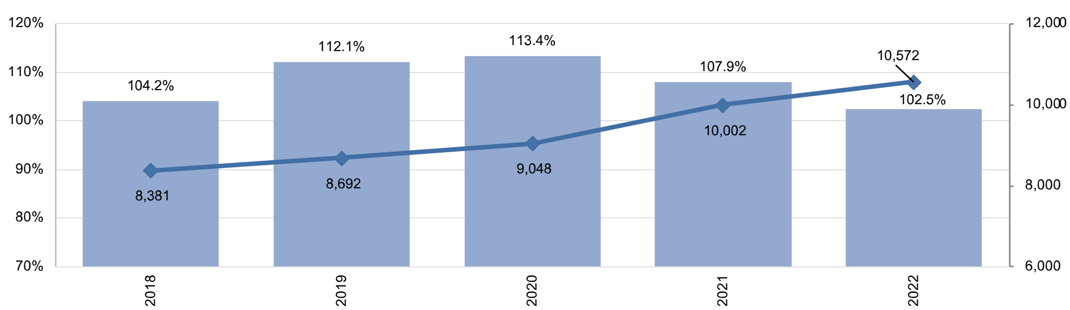
MPLI CALENDAR-YEAR UNDERWRITING RESULTS TABLE 1



Source: S&P Global Market Intelligence, Fitch
Statutory Accounting Practices - P/C Industry Aggregate

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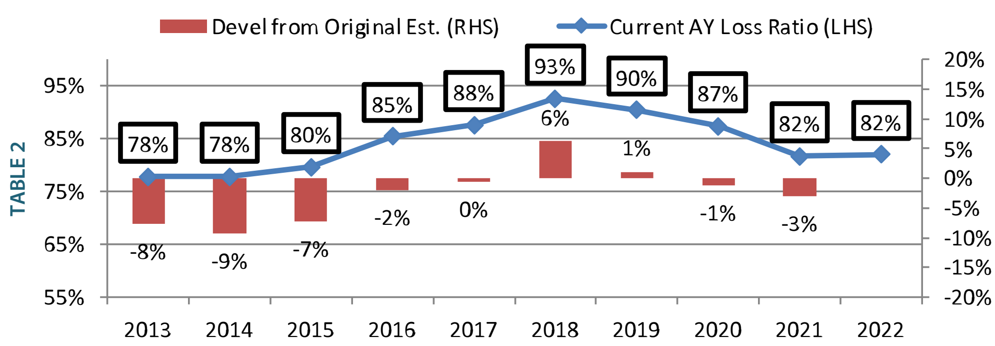
and opportunity to write profitable business outside of MPLI, leading many to focus on business retention rather than pricing adequacy and underwriting profits. Substantive change in the profit fundamentals of the MPLI line will likely require reductions in specialty writers' surplus via an extended period of larger losses or greater market consolidation.

MPLI specialists' capital position provides wherewithal to maintain independence, but a few recent transactions may indicate a future shift toward an increase in acquisition activity. The 2021 acquisition of NORCAL by ProAssurance Corp. combined the previously fifth- and eighth-largest MPLI writers. Other recently announced or closed transactions include the merger of Constellation Inc. and Curi Holdings, as well as MagMutual's purchase of MD Advantage of New Jersey. More substantive transactions that alter market composition are likely needed to change the profit landscape. MPLI pricing, claims, litigation, and competitive conditions also vary widely by state. Outside of market leader Berkshire Hathaway, which holds a 17% MPLI direct market share, larger multi-line insurers are unlikely to have interest in gaining MPLI market share via acquisition.

MPLI PRICE INCREASES TRAIL OTHER LONGER-TAIL SEGMENTS

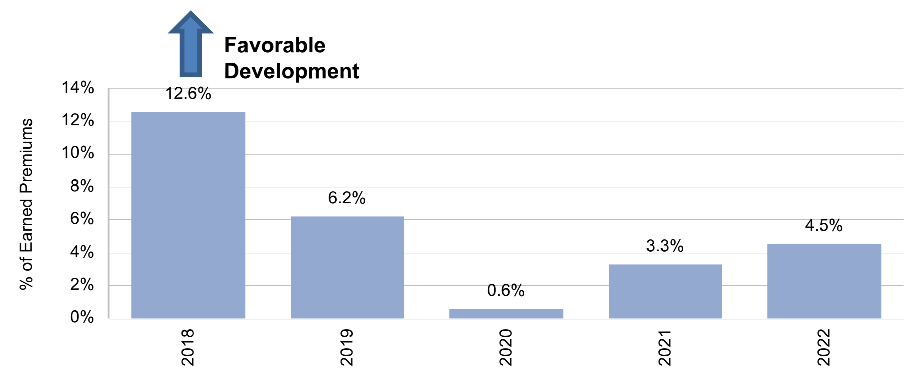
TABLE 2



Source: S&P Market Intelligence, Fitch MPLI Claims Made & Occurrence Segments Combined

MPLI CALENDAR YEAR RESERVE DEVELOPMENT / EARNED PREMIUMS

TABLE 3



Source: S&P Global Market Intelligence, Fitch. Calendar year reserve development / net earned premiums Statutory Industry Aggregate Adjusted for unuslual items for MAG Mutual in 2020.

Recent Reserve Strength May Fade with Uncertain Claims Severity

Pricing and underwriting changes — combined with a slowdown in judicial activity and loss payment trends — contributed to recent underwriting improvement that is revealed through lower accident-year loss ratios (see Table 2). While still not consistent with an underwriting profit, the MPLI industry loss ratio improved by more than 10 percentage points from 2018 to 2022.

MPLI writers have benefited from favorable claims frequency over an extended period that intensified during the pandemic. Industry statutory data reveals that MPLI initial accident-year claims filings dropped by 7% in 2020, and 2022 reported claims are still below 2019 levels.

This shift in claims trends and a more cautious approach to loss reporting have promoted a shift in reserve experience. On a calendar-year basis, favorable prior-period reserve development was 4.5% of MPLI earned premiums in 2022, 4 percentage points better than 2020 figures (see Table 3).

On an accident-year basis, rising loss severity led to an unusual shift toward reserve deficiencies and adverse loss development in the 2018 and 2019 underwriting periods. This pattern reversed in 2020 and 2021 — with the 2021 loss ratio moving down 3 points from initial estimates as of year-end 2022.

Pricing and underwriting changes — combined with a slowdown in judicial activity and loss payment trends — contributed to recent underwriting improvement that is revealed through lower accident-year loss ratios.

Accident years 2020-2022 exhibit some conservatism in reserve levels based on ratio analysis of paid losses to incurred losses and incurred but not reported losses to incurred losses, which reduces the chance of future material reserve deficiencies. However, returns to normalcy in healthcare utilization and the pace of court resolutions may lead to a shift in MPLI claims and loss payments that adds to challenges in setting reserves.

MPLI is greatly affected by the litigation environment. Changes in societal norms, legislation and jury sentiments can particularly expand the nature of MPLI claims litigation and raise the potential for more frequent multimillion-dollar verdicts and higher defense and settlement costs. Material reductions in litigation risk from legislative reforms seem unlikely in the near term. However, prior reforms passed in many jurisdictions periodically face threats of being overturned.

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