MEDICAL LIABILITY MONITOR

PREMIUM GROWTH LEADS POSITIVE YEAR FOR MPL SPECIALTY WRITERS

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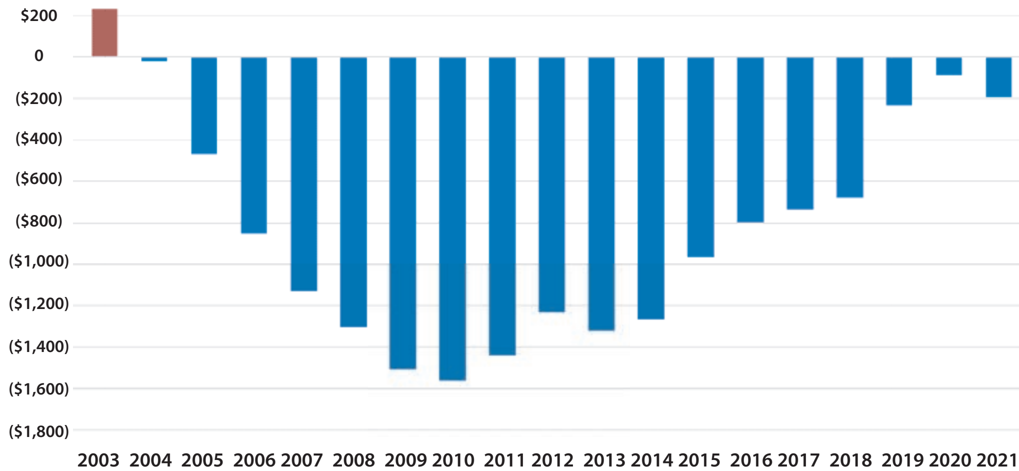
In the paragraphs and figures that follow, we summarize year-end 2021 financial results for a composite of medical professional liability (MPL) specialty writers and complete our 12th year tracking and publishing these results in Medical Liability Monitor. And the results show that while much of the U.S. was weathering a surge in COVID-19 infections due to the Omicron variant, the MPL industry quietly finished up a positive year in regard to a variety of financial metrics. In short, the overall results for 2021 were better than many anticipated just 12 months ago.

Our analysis is based on the collective financial results of a large group of insurers specializing in MPL coverage. The data dates to 2003 and consists of aggregate statutory financial information compiled from S&P Global Market Intelligence. The current composite includes 165 MPL specialty companies with a 2021 total direct written premium of more than $6 billion. (Please note that year-end results for 13 companies included in our analysis of the first three quarters of 2021 were unavailable at press time and were excluded from this analysis. Consequently, the aggregate financial results reflected here are lower when compared to the results of our 2021 quarterly analyses.)

FIGURE 2 One-Year Reserve Development ($Millions)



Rate Increases, Diversification Leads to Significant Premium Growth

The composite's total direct written premium for 2021 increased by 9.8% to $6.2 billion, its highest level since 2008 (see Figure 1) and largest increase since 2004. After a short pause in rate action due to the pandemic, 2021 saw significant premium growth as MPL companies took rate increases and decreased average credits/discounts in response to the continued deterioration of their combined ratios.

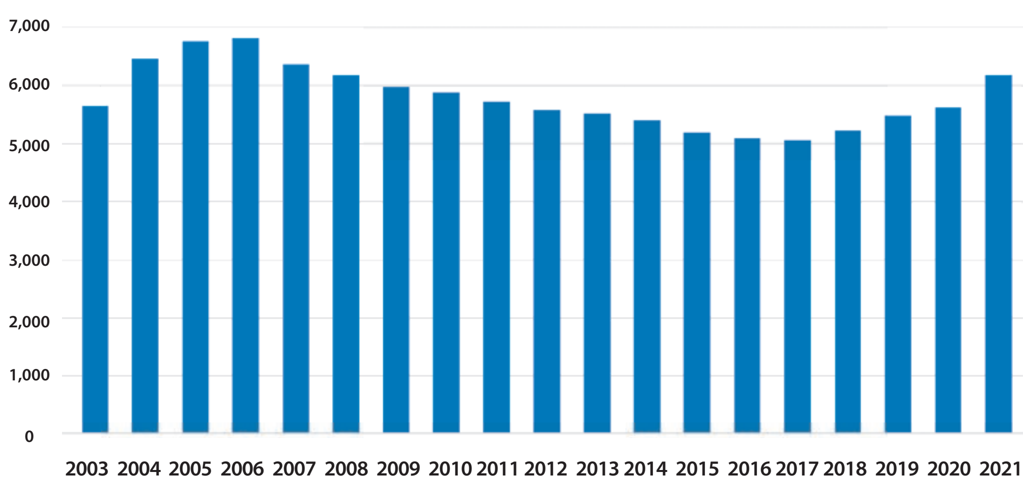
MPL insurance companies also continued to diversify into other lines of business, as non-MPL premium now makes up nearly 10% of the composite's total direct written premium. Since the composite's direct written premium low point in 2017, MPL premium has been increasing by approximately 4% per annum, while non-MPL premium has been increasing by more than 25% per annum. We expect MPL premium to continue to grow, albeit at a much more moderate pace than non-MPL premium, as the market continues to firm and the full impact of rate increases are recognized.

Reserve Releases Recover Slightly After 2020 Low

As shown in Figure 2, the composite's prior-year reserve release was approximately $190 million. Although this represents an improvement from the composite's $90 million release in 2020, it remains a fraction of the releases conducted between 2006 and 2018.

The pandemic's effect on the court system is another possible driver behind the anemic reserve release in 2021. Claim count data suggests fewer claims have been closing, likely due to COVID-related court interruptions and subsequent criminal case prioritization. The increased number of open claims likely resulted in higher aggregate reserves than otherwise would have occurred. If those claims ultimately resolve favorably, as has generally happened during the last 15 years, there may be future reserve releases on these lagging claims.

FIGURE 1 Direct Written Premium ($Millions)



Combined Ratio Continues Positive Trend

Despite posting its sixth-consecutive year with a combined ratio greater than 100%, the composite did record its second-consecutive year of combined ratio improvement. As Figure 3 shows (see page seven), the combined ratio's 4-point decrease in 2021 primarily resulted from the almost 3-point decrease in its calendar-year loss and LAE ratio, with only a slight improvement in the underwriting expense ratio and fewer policyholder dividends paid. The lower loss and LAE ratio in 2021 is likely attributable to a pandemic-related dip in claims frequency, coupled with

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premium increases. Consecutive years with combined ratio improvement is a welcome sight after nearly a decade of deterioration.

Despite the combined ratio's positive trend, underwriting results continue to be unprofitable. As such, the composite remains reliant on investment performance to maintain profitability. Last year was the 18th-consecutive year of positive net income for the composite.

The composite's net income increased by approximately 32% last year and nearly 90% from its recent low in 2019 (see Figure 4). While the total investment gain ratio for the composite has been above 20% for all but two of the last 16 years, the investment income ratio has been trending down for the last decade due to low interest rates (reaching a low point in 2021 when the investment income ratio was only 12.6% of net earned premium). However, recent investment results have been buoyed by increases in net realized capital gains, which reached a new high for this dataset in 2021 at 10.1% of net earned premium. With inflation forecasted to remain high in the near future, the MPL industry will need to find ways to keep investment yields high enough to maintain profitability until underwriting results improve.

Policyholders' Surplus Increases

As Figure 5 shows, the composite's policyholder surplus increased by about 4.7% last year, it's largest since 2012. The surplus increase was relatively widespread across the industry, as approximately 75% of companies in the composite reported surplus growth in 2021. Despite the composite's increase in held capital, last year marks the fourth-consecutive year (and five of the last six) where the increase in required capital has outpaced the increase in held capital.

Conclusion

The MPL industry's top-line revenue growth last year was its strongest in nearly two decades, and a number of other metrics (including combined ratio and investment gains) rebounded from certain worrying trends we observed through 2020 (although concerns about whether this momentum can be maintained persist).

Despite another year of profitability for the MPL industry, external uncertainties do remain, including how the world will navigate the waning pandemic and what effect the conflict in Ukraine might have on inflation and the financial markets. However, as signs of a firming MPL market finally become tangible, the MPL industry appears ready to take on those challenges.

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Figure 3 Annual Combined Ratios

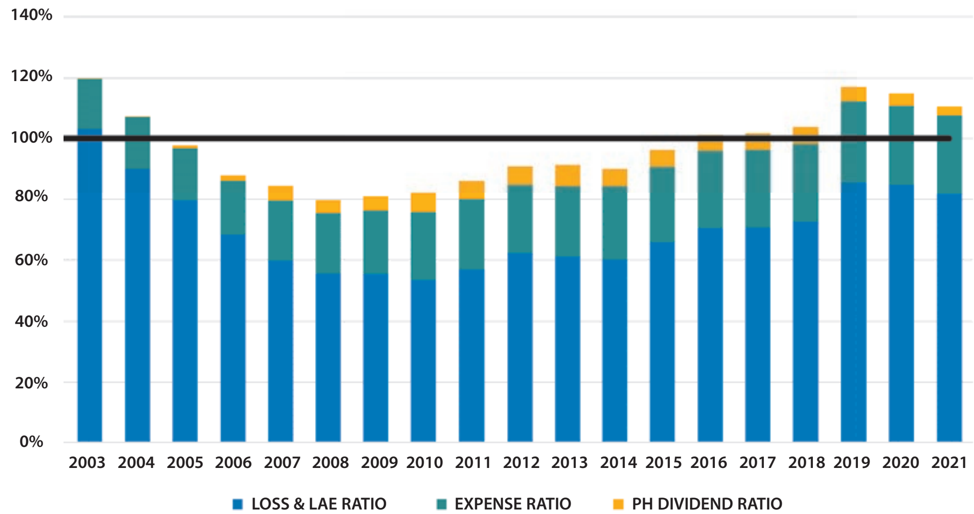

Figure 4 Annual Net Income ($Millions)

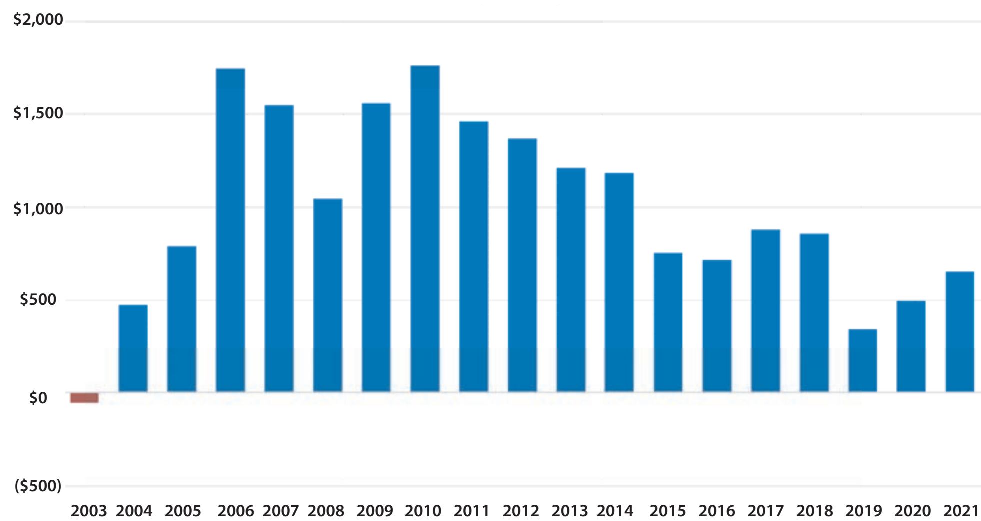

Figure 5 Policyholder Surplus ($Billions)