VOLATILE MARKETS AND PREMIUM GROWTH HIGHLIGHT THIRD-QUARTER FINANCIAL RESULTS FOR MPL SPECIALTY WRITERS

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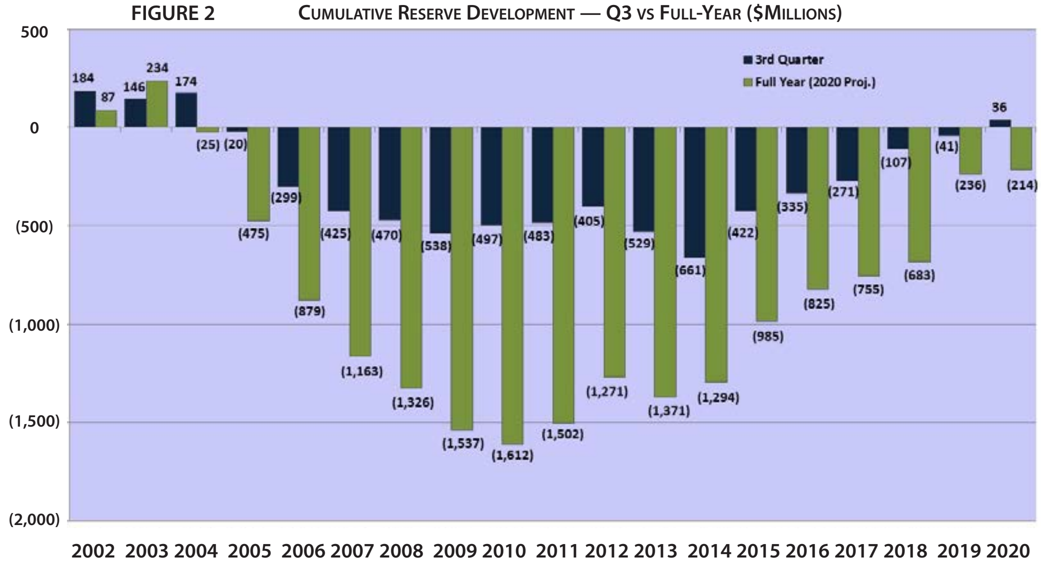
In the paragraphs and charts that follow, we summarize key financial results for a composite of medical professional liability (MPL) specialty writers through the first nine months of 2020. Although the COVID-19 pandemic shows no signs of abating, MPL financial results seem mostly unaffected to date — apart from some volatile investment results. Premium growth has resumed after a temporary lull, but combined ratios continue to deteriorate as reserve redundancies disappear and investment gains remain "just enough" for MPL specialty writers to remain profitable.

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 dates back to 2002 and consists of aggregate statutory financial information compiled from S&P Global Market Intelligence. The current composite includes 176 MPL specialty companies with a total direct written premium of approximately $5.8 billion in 2019.

FIGURE 2 Cumulative Reserve Development — Q3 vs Full-Year ($Millions)

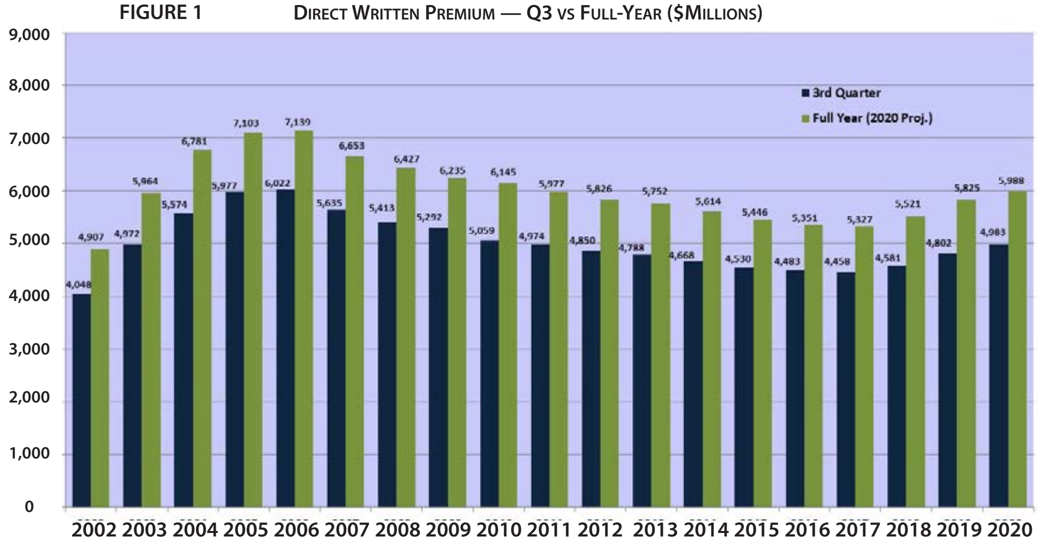


Premium Growth

Figure 1 compares the composite's historical written premium through three quarters to total annual written premium. So far in 2020, the composite's premium has grown by 3.8% relative to 2019.

Breaking down 2020 premium growth by quarter reveals the impact the pandemic has had on the composite's premium revenue. Written premium was up nearly 5% over 2019 in the first quarter, which was largely unaffected by COVID-19. The second quarter saw a premium decline of 3% as many physicians suspended operations during the pandemic-mandated shut down. Premiums rebounded in the third quarter with an increase of almost 6% over 2019 as physicians finally returned to practice. Given that most physicians have managed to maintain operations through COVID-19's recent surge, we expect premium growth to continue for the remainder of 2020. Fortunately for MPL writers, the volume of premium written during the first and third quarters typically combine to account for about two-thirds of total annual premium. This indicates that the pandemic's negative impact on the composite's overall 2020 annual written premium should be minimal.

FIGURE 1 Direct Written Premium — Q3 vs Full-Year ($Millions)



Reserves Develop Unfavorably

Reserves on prior-year loss experience continued to develop unfavorably in the third quarter. But at just $36 million deficient, we still expect year-end reserve action to produce favorable annual reserve development.

Figure 2 illustrates both the annual declines in reserves released through three quarters that lead to a reserve strengthening through the first three quarters of 2020 and the large reserve releases that typically occur during the fourth quarter in preparation for year-end financial statements. The lack of favorable reserve development through three quarters does not necessarily predict the degree to which this favorable reserve development will decline during the final quarter of 2020. Given the unpredictability of the industry's fourth-quarter reserve action, the possibility COVID-19 could inspire more conservative reserve decisions and uncertainty with the remaining reserve redundancy overall, it is difficult to project the total year-end reserve release. However, recent history would still suggest that year-end 2020 should deliver favorable reserve development at some level.

Combined Ratios Still Climbing

Figure 3 compares the composite's historical combined ratios through nine months to its combined ratios at year-end. The composite's third-quarter-2020 combined ratio reached 118%, its highest mark since 2003 and a continuation of the troubling deterioration in underwriting results since 2008.

Beginning in 2004, the composite's year-end combined ratio decreased in relation to its third-quarter combined ratios, due

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primarily to the fourth-quarter reserve releases illustrated in Figure 2. This trend continued until 2019, when despite a fourth-quarter reserve release of nearly $200 million, the full-year combined ratio exceeded the composite's third-quarter combined ratio by three points its incurred loss and loss adjustment expenses exceeding $1 billion during the quarter — more than double the average fourth-quarter incurred amounts during the prior five years. Barring another disastrous fourth quarter, we expect the composite's combined ratio to come down slightly from its third-quarter level. Not nearly enough, however, to deliver break-even results.

Investment Performance Remains Key to Maintaining Operating Profit

The composite's investment results through the third quarter of 2020 strayed from its recent trend of ascending annual investment gain. As Figure 4 indicates, the composite's 2020 investment gain fell nearly 19% relative to the same point in 2019. We should note, however, that in 2020, perhaps more so than any other year, these snapshots in time of the composite's investment performance offer little value due to arguably unprecedented market volatility, including the recent surge in financial markets in reaction to positive news on the COVID-19 vaccine front. Knowing this, it's quite possible the composite sees annual investment gains exceeding 2019 levels to continue its upward trend.

Profitability Declines

Figure 5 shows the composite's after-tax net income through three quarters relative to year-end. In the case of the composite, net income represents the extent to which its investment performance exceeds its underwriting losses. With underwriting performance worsening and investment gains down, the composite's net income through three quarters decreased by 50% relative to 2019, continuing its downward trend. We do anticipate a fourth-quarter rebound will increase net income, as shown in Figure 5, with the composite poised to turn a profit for its 17th consecutive year.

Conclusion

While the COVID-19 pandemic has affected almost every aspect of our lives, financial results for the composite of MPL specialty writers appear to have strayed little from pre-pandemic trends. As reserve redundancies continue to dissipate, additional pressure is placed on underwriting standards and investment results to support the composite's net income. For the time being at least, this appears to provide enough for yet another profitable year.

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Figure 3 Combined Ratios (after dividends) — Q3 vs Full-Year

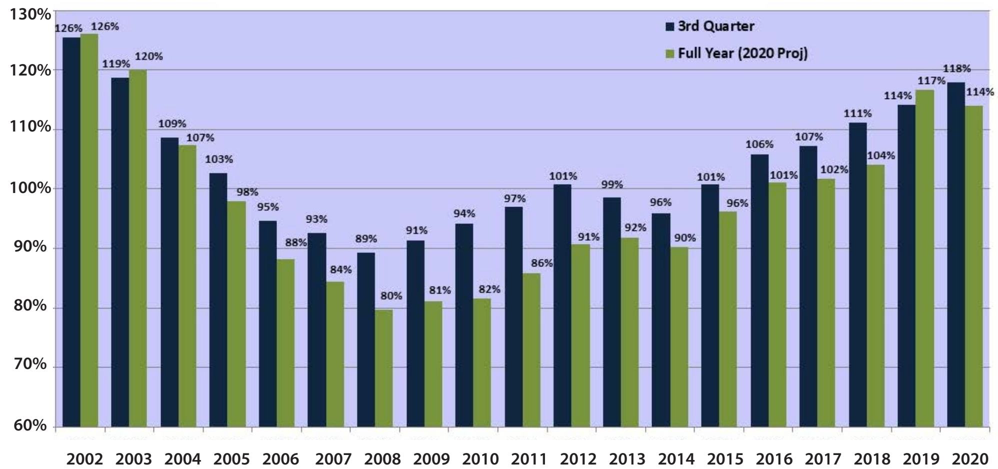

Figure 4 Investment Gain — Q3 vs Full-Year ($Millions)

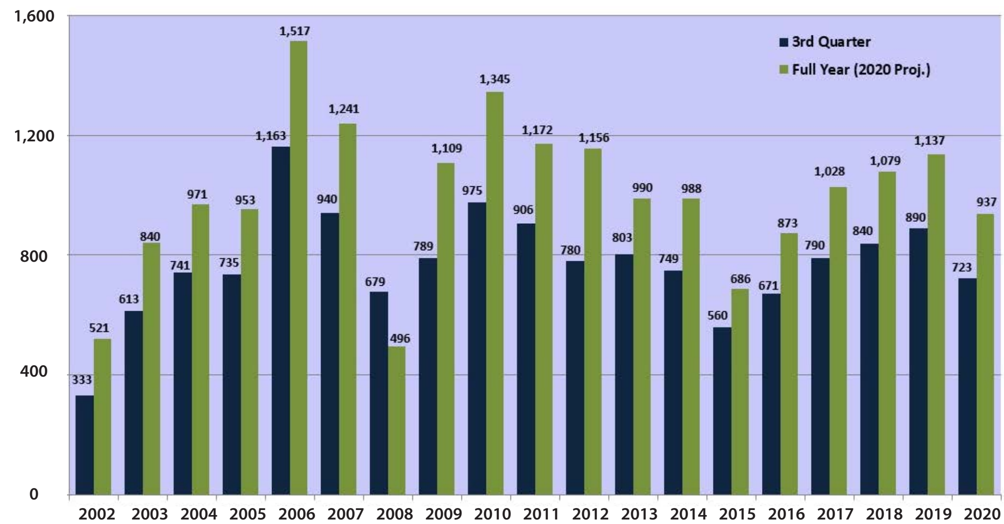

Figure 5 After-Tax Net Income — Q3 vs Full-Year ($Millions)