The medical professional liability (MPL) industry is in a period of transition. A protracted era of strong and stable underwriting has had its margins slowly depleted by soft pricing, with the median MPL insurer facing a net underwriting loss in 2016 and 2017, after years of consistent profits.

The historical pattern of conservative reserving practices leading to a tail-wind of consistent positive development has moderated, and total premium volume has leveled off, due in part to continuing consolidation of healthcare providers, in the wake of the Affordable Care Act.

How MPL insurers will respond to this environment remains to be seen. While they are generally profitable and very well capitalized (the ratio of premiums to surplus has fallen from 53% in 2010 to 35% in 2017), they are unlikely to tolerate persistent underwriting losses for very long. Given limited opportunities for growing policy volume, the issue will come down to their inclination and ability to finally raise rates after years of relative stagnation.

On the one hand, MPL is a competitive industry with many monoline players competing for market share, so this could be a difficult proposition. On the other, many carriers emphasize high levels of customer service and longstanding relationships with their insureds, which could afford them some leeway in adjusting rates, without sparking the same sorts of loss of customers that one would see in more commoditized sectors like private auto.

One possible outcome is that we may see some participants consolidate, change their legal capital structure, or exit the marketplace altogether. For example in New York, Berkshire Hathaway recently completed the demutualization of Medical Liability Mutual Insurance Company and The Doctors Company is purchasing Hospitals Insurance Company, while other carriers are restructuring and using assessments to offset lost premium. There were five monoline MPL insurers founded in 2013, none in 2014, one in
2015, five in 2016, and two in 2017. Meanwhile, only one has ceased ongoing operations during this period, due to declining capitalization.

The MPL industry has faced a trend of declining reserve releases, rising loss ratios, declining premium growth, declining investment returns, and declining returns to surplus for many years. However, in 2017 the industry finally seemed to reach an inflection point, and preliminary results for 2018 through the first three quarters at least partially substantiate the supposition that these trends may now be reversing.

**MPL data**

Recent financial performance across MPL insurers show that their fortunes may be changing for the better, though difficult choices remain.

Figure 1 shows the relationship of returns to surplus for a broad composite of 105 property/casualty (P/C) insurers writing primarily MPL coverage, indicating the 25th–75th percentile range and median for each year. The data show that returns have shown a pattern of consistent decline over time. We attribute this to three underlying factors: slowing premium growth due to limited capacity to increase rates in a mature market, diminished benefit to underwriting gains from favorable reserve development, and reduced investment returns due to low fixed-income reinvestment rates.

After consistent declines since 2010, median returns have begun to stabilize at around 4%, and even show signs of recovery. This trend is evident across much of the data we examined. One factor is a modest turnaround in premium volume noted in 2017 (Figure 2) after several years of declines, thanks to strengthening economic conditions.

Meanwhile, on the reserving side, the trend of consistent favorable development each year, which served as the foundation of strong underwriting returns in many recent years, has potentially begun to stabilize (Figure 3), after years of shrinking (less negative = less favorable) reserve releases.

This, in turn, led to a gradual decline in...
underwriting margin over time, though, once again, we see a pattern of apparent stabilization in the 2017–2018 timeframe (Figure 4).

The investment side
On the investment side, MPL insurers have faced the same declining book yield on fixed-income investments, due to low reinvestment rates, that have affected the whole industry. This has been partly offset by generally strong equity returns ever since the 2008 financial crisis. Figure 5 includes total investment returns for each year (specifically: investment income, realized gains/losses, and unrealized gains/losses marked to surplus below the line) as a percentage of total invested assets, illustrating the downward trend in investment income, but also the strong equity effect from e.g., 2017 (Figure 5).

The good news on this front is that reinvestment rates have begun to rise over the last couple of years amid Fed rate hikes and a gradually accelerating economy. The gross bond yield for our composite bottomed at 2.53% in 2016 and rose to 2.62% in 2017, likely continuing this trajectory into 2018. Median equity exposure also tripled between 2010 and 2015, remaining relatively stable thereafter (Figure 6).

Conclusion: things are improving, but challenges continue
In summary, MPL insurers can look forward to ongoing improvements in earnings, derived from favorable reinvestment yields, a welcome development that has been many years in coming. However, the increasingly challenging underwriting environment for this mature sector has brought an end to the era of reliable combined ratios in the range of 85% to 95%, for many participants, though in the last couple of years, these metrics have begun to stabilize. Whether this ultimately leads to pricing adjustments, consolidation, changes in market structure, or other developments will be the values that we need to watch, going forward.

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