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Insurance Insights

July 2019

CONNING®

INSURANCE RESEARCH | WHITE PAPER

Diversification in the Medical Professional Liability (MPL) Industry

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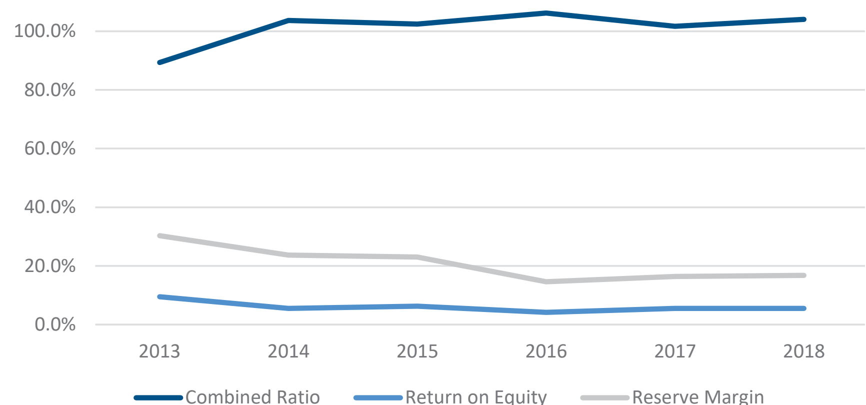
The medical malpractice crisis of the 1970s led to the formation of a number of physician- and hospital-owned medical professional liability (MPL) specialty companies, many of which are still in business. The initial mission of these companies was simple—insure only the doctors or hospitals that had funded the formation of the companies.

By the 1980s and 1990s, companies had started to expand/diversify beyond their original markets. While many companies still derived all of their business from their home state, others began to diversify their writings into new (usually contiguous) states. Sometimes this growth was due to physician-owned companies writing large groups that had practitioners in multiple states and wanted to consolidate their MPL purchasing with a single company. There were also hospital-owned companies that began offering insurance to physicians that had privileges at the owners' hospitals. By this time, companies had lifted restrictions on osteopaths, and most companies were writing medical classes such as dentists, nurses, and other allied professionals.

As a way to grow/diversify in their areas of expertise, companies also expanded their writings through mergers and acquisitions. In 1994, ProAssurance (then Medical Assurance, Inc.) purchased the West Virginia Hospital Insurance Company and began the former's expansion outside Alabama. In 1999, physician-owned MLMIC of New York purchased New Jersey-based Princeton Insurance Company, adding a large block of hospital and health-care facilities business to MLMIC's portfolio. Companies also set up joint ventures, most notably NORCAL, which in 1997 entered into an agreement with the Medical Mutual Liability Insurance Company of Maryland through a 50% stake in Medical Group Holdings. The Doctors Company and PHICO both went national, while St. Paul expanded as far as England and Australia.

Figure 1 - MPL Industry 2013-2018: Combined Ratios Rise, Equity Returns and Reserve Margins Fall



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Behind the Drive to Diversify

By the mid-to-late 1990s, companies were pursuing diversification for several reasons:

- **Expansion into business they knew.** By the 1990s, companies had captured as much market share in their home state as they were likely to write (barring absurdly low pricing). Because the companies understood the underlying risks and had systems and people in place to handle the growth, they saw diversification into other states as a logical extension.

- **A.M. Best ratings.** While many of the companies were strongly capitalized and had an A.M. Best rating of an A- or A, their positive ratings were often partially offset by the companies' "narrow spread of risk." For these companies, diversification was seen as a way to shore up ratings.
- **Changes in the practice of medicine.** In the 1990s, many physicians found themselves contracting with managed care organizations. In addition to their usual malpractice risks, providers were now potentially exposed to contractual liability arising from these involvements. MPL companies responded by offering products to address these managed care exposures.
- **Profitability.** From 1991 through 1998, the average return on GAAP equity for MPL was 14.8%; for the overall property-casualty industry, the average return was 8.9%. Therefore, more business had to be better (right?).

Interestingly, very few MPL specialty companies have ever expanded into other lines of business. Even today, of the non-MPL business written by the specialty companies, most of the premiums are for coverages linked to the underlying health care exposures, i.e., workers' compensation, other liability, and commercial multiperil.

Price Wars, Followed by Rising Rates

The push for growth/diversification in the 1990s led to pricing wars that not all companies survived. From 1999 through 2003, the average combined ratio for MPL was 140%; from 2001 through 2003, the average return on GAAP equity for the industry was negative 5.6%. During this period, several companies went bankrupt and St. Paul, the largest MPL insurer, pulled out of the market.

Starting in 2000/2001, companies began raising rates with a vengeance. In many states, average rate increases were at least 30%. Double-digit rate increases continued for several years, ending around 2004/2005. By the time the smoke had cleared, the industry was booking record levels of profitability in terms of combined ratios, returns on equity, and statutory surplus.

After hitting a peak of almost $12 billion in 2006, MPL direct premiums written have decreased almost every year. These decreases have been due to three factors: price wars that resumed in 2007, reductions in physician and hospital exposures, and health care providers/entities forming alternative risk vehicles such as captives.

Putting Capital to Work

For the past several years, soft pricing and low but steadily increasing loss costs have caught up with the MPL industry. The combined ratio is up 15 points since 2013, ROEs are down to mid-single digits, and loss reserve margins have shrunk by 50% (see Figure 1). However, most specialty companies have very strong balance sheets and want to deploy this capital in a profitable way. So, what have companies been doing and how are these diversification efforts working out?

- Mergers and acquisitions in the MPL space have been few and far between. However, there have been two large transactions that made headlines: Berkshire Hathaway's purchase of MLMIC and The Doctors Company's announcement in November 2018 that it plans to buy Hospitals Insurance Company. While interest in buying companies remains high, it remains to be seen how much interest there is on the part of sellers.

- In 2013, ProAssurance purchased Eastern Insurance Holdings Inc., a monoline workers' compensation insurer. Workers' compensation now represents 30% of ProAssurance's gross written premiums and contributes loss ratios that are approximately 20 points lower than those for MPL.

- Several companies—including ProAssurance, NCMIC, and Coverys—have looked to diversify by investing in syndicates at Lloyd's of London. In its 2013 annual report, ProAssurance said its investment in Syndicate 1729 would "greatly enhance (their) ability to respond to an international array of healthcare-related risks." In February 2019, CEO Stan Starnes said: "We are deeply disappointed in the performance in our investment at Lloyd's and we will be reviewing all our strategic options regarding this investment in the coming months." However, this disappointing performance was not due to health care-related losses but rather to losses related to Hurricane Michael.

- In April 2016, The Doctors Company announced the creation of TDC Specialty Underwriters. The new subsidiary was created to provide coverage to a wide range of health care facilities including hospitals and miscellaneous medical facilities, and to offer other lines of coverage such as D&O, employment practices liability, and managed care E&O. In 2016, TDC Specialty had written premiums of $4 million for hospitals and other facilities; in 2018, the number had increased to $40 million. According to the company's latest annual statement, the average gross loss ratio for accident years 2016 through 2018 is 89%, and the average net loss ratio over the period is 194%.

- In 2015, Coverys launched Coverys Specialty Insurance Company. According to its 2015 annual report, Coverys Specialty "was created to lead the way in meeting the needs of hospitals, health systems and physician groups with unique risk profiles that seek insurance solutions typically not available in the traditional insurance market." In 2016, Coverys Specialty had written premiums of almost $9 million for hospitals and other facilities; in 2018 premiums had increased to $46 million. According to the company's 2018 annual statement, the average gross loss ratio for accident years 2016 through 2018 is 121%.

- Over the past several years, Coverys has been very active in strategic acquisitions of risk management and clinical education companies. In 2014, the company purchased ELM Exchange, a nationally recognized provider of online health care risk management and patient safety educational programs. In 2016, it purchased Med-IQ, an accredited education company that offers solutions throughout the health care delivery continuum. The primary purpose of these entities is to increase patient safety, improve outcomes, and reduce malpractice risk.

Focus on Value, Not Price

Specialty MPL insurers are at an interesting juncture: seemingly all dressed up and no place to go. Capital is at an all-time high, but the population of insureds continues to shrink and/or morph (e.g., hospitals becoming part of larger entities that have different insurance needs). Claim frequency is low compared to historical highs, and claim severity continues to tick upward, but in a predictable manner. Consequently, one strategy for these companies, if they desire to do so, is to continue to keep prices suppressed both to hold onto market share and write new business. However, this strategy ultimately will erode hard-earned capital, drive up operating ratios, and potentially threaten A.M. Best ratings.

> ***Profitable growth will probably require noninsurance diversification so price is not the only factor in the insurance purchase.***

A different strategy would require companies to think in terms of "value" instead of "price." The Coverys strategy of adding risk management and education subsidiaries highlights the company's focus on the value proposition. Another company bringing value to its insureds beyond malpractice insurance is Curi (formerly known as Medical Mutual of North Carolina). Curi Capital offers wealth management advisory services, asset management, and retirement planning solutions to its insureds. At least one other MPL company offers a service that is designed to increase reimbursements that its insureds receive from health care payers.

It remains to be seen which strategies work best for these companies. Profitable growth will probably require noninsurance diversification so price is not the only factor in the insurance purchase. We are aware of many companies that are dedicating significant time and resources in planning their next steps. These companies appear to have learned lessons from prior inflection points in the industry and are heeding Warren Buffett's advice to "not test the depth of the river with both feet."

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