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Insurance Insights

March 2020

INSURANCE RESEARCH | WHITE PAPER

Medical Professional Liability: A Market in Transition

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(Author's note: At our publishing deadline, ProAssurance Corp. announced its agreement to purchase NORCAL Group in a deal valued at $450 million. In 2018, ProAssurance was the fourth-largest writer of MPL (per direct premiums written) in the U.S. while NORCAL was the sixth-largest. The combined entity is projected to be the third-largest MPL company with projected direct premiums written in excess of $800 million. The deal is targeted to close by year-end 2020 and is contingent on NORCAL's demutualization as well as regulatory and policyholder approvals.)

From 2007 to 2013, MPL (medical professional liability) was a superstar of the insurance industry. Over this period, the line of business generated an average annual operating ratio of 62%, more than 27 points better than the entire property-casualty industry. Over this seven-year span, statutory surplus for the MPL sector increased more than 60%, and leverage ratios dropped to historically low levels.

To no one's surprise, the financial success in MPL led to heightened competition and pricing wars of attrition. During this period of outstanding results, rates for most MPL classes of business either went down or, at best, stayed flat. At the same time, claim frequency flattened, but claim severity continued its relentless single-digit upward march. Fortunately, as a result of the hard market that persisted from 1998 to 2006, the industry had built up a war chest of reserve redundancies that was allowing companies to benefit by ~$2 billion a year of favorable reserve development.

As with prior periods of prosperity, it was only a matter of time until the MPL industry's fortunes turned. Starting in 2014, when the industry booked its first underwriting loss since 2005, the average annual combined ratio has been approximately 104%. Although the market is showing signs of price-firming, a consequence of intense competition and the prolonged soft market, Conning expects the combined ratio for MPL will continue to worsen over the next several years. While total carried loss reserves still looked redundant as of year-end 2018, the average annual benefit of favorable reserve development to the industry has been "only" around $1 billion, half of what it was in the halcyon years from 2007 through 2013

Profile of the MPL Market

MPL is not a homogeneous market and historically has consisted of four distinct classes of business:

- **Physicians.** Until 2011, physicians represented approximately 65% of MPL direct premiums written. Starting around 2012, largely due to intense competition and a shift from self- to hospital-employment, physician premiums have been shrinking. In 2018, premiums for this segment represented 55% of the MPL sector.

- **Hospitals.** Over the past 20 years, hospital business has steadily represented about 20% of the MPL market. While the professional liability insurance coverages that hospitals purchase have changed over this time (e.g., from first dollar to high excess coverage), total annual direct premiums written hover at slightly less than $2 billion.

- **Other Professionals.** This segment, which includes most nonphysician medical professionals, once represented less than 10% of the MPL market. However, as these professionals have grown both in absolute numbers and in the scope of care they provide patients, their premiums have grown from less than 8% (in 2005) to represent almost 14% of MPL premium.

- **Other Facilities.** As more medical care is being provided outside the hospital setting, numerous types of other health care facilities now purchase MPL insurance. These facilities represent the fastest-growing segment of the market, and their premiums have grown from 5% (in 2005) to represent almost 11% of MPL written premium.

MPL-specialist companies that were formed in the 1970s and 1980s were usually set up by and for either physicians or hospitals. The other professionals and other facilities in the health care spectrum tended to be insured by multiline companies such as AIG, Chubb, CNA, and St. Paul.

The multiline companies also wrote physicians and hospitals and were in competition with the specialist companies. However, the physicians written by the multiline companies were often those employed by hospitals, whereas the specialist companies wrote independent physicians. Similarly, the multiline companies insured hospitals that did not migrate to the hospital-owned specialist companies. Because the multiline companies could offer higher limits to their insureds as well as insure other risks associated with hospitals, such as property and workers' compensation, the multiline companies historically have had a solid presence in the hospital MPL space.

The delivery of health care has changed and lines between providers and facilities have blurred. More doctors and staffs are now employees of hospitals or integrated health care systems.

Beginning in the 1990s, many of the specialist MPL insurers were having financial success in their home state and wanted to replicate this success in other states. The typical expansion model for a doctor or hospital-owned insurance company was to first start writing business in contiguous states. Over time, a number of companies expanded into noncontiguous states (with several of them eventually writing business coast to coast). While most companies stayed in their lane (e.g., doctor-owned companies looked to write more doctor business), not only were there companies that diversified their MPL writings (e.g., doctor companies writing hospitals and vice versa), but also other companies that went into non-MPL related lines of business (though not always successfully).

Changes in Health Care

Over time, the delivery of health care has changed, and the lines between providers and facilities have been blurred. More doctors and their staffs now find themselves employees of hospitals or integrated health care systems. Their offices are part of a larger system that not only employs doctors and other medical professionals, but also owns hospitals, provider offices, and other health care facilities. Further, these systems are usually not limited to a single state (or even a single country), and some even serve as both health care providers and insurers. UPMC (The University of Pittsburgh Medical Center) is a prime example of integration in health care. What started out as a single hospital in western Pennsylvania is now an international health care system with almost 5,000 employed physicians, 40 hospitals, more than 700 outpatient sites and doctors' offices, and numerous facilities offering various therapies and long-term care. UPMC Health Plan, a subsidiary of UPMC, offers a full range of health insurance to 3.6 million members. In 2018, UPMC reported operating revenues of almost $19 billion, up from $15.6 billion in 2017.

The Specialist Companies

As a result of this integration in health care, MPL is no longer such a clear-cut industry. Specialist companies that were formed to insure doctors find the pool of insurable physicians shrinking (as evidenced by the results of the 2018 Survey of American Physicians, in which only 31% of physicians identified as “independent practice owners,” down from 49% in 2012). In response to this change, several of the larger physician-owned companies are now writing significant amounts of hospital business, including The Doctors Company ($121 million in 2018), Coverys ($58 million), and ProAssurance ($49 million). However, the 2018 calendar-year loss ratios for hospitals for several of the doctor-owned companies were well above 100%, which could suggest the need for better underwriting and/or pricing of the business.

Many of the specialist companies also have increased their presence in both other professionals and other facilities. Some companies have grown through acquisition (e.g., ProAssurance’s acquisition of Podiatry Insurance Company of America in 2009), while others have grown through the deployment of a surplus lines company (e.g., TDC Specialty). However, these markets are dominated by the multiline companies, and competition for every submission is fierce. It remains to be seen how much more growth can be wrung from these segments and whether this business generates the desired profits.

What About the Multiline Companies?

The multiline companies have demonstrated their commitment to the MPL market through good times and bad. With the Berkshire Hathaway acquisition of MLMIC in 2018, multiline companies now write more than half of the premium in the MPL market. These companies also write the majority of the nonphysician business, most notably other facilities, where the multiline companies write nearly 90% of the premium.

As the health care delivery system becomes more integrated and complex, an argument could be made that the multiline companies have a competitive advantage over the specialists. Not only do the multiline companies already write most of the nonphysician business, but also they bring products and capacity that large health care systems need. Berkshire Hathaway Specialty Insurance says it can offer limits up to $100 million on select health care lines. This compares to a doctor-owned company whose website said it can provide capacity up to $21 million in limits. While both of these represent substantial limits in the event of a claim, given recent MPL megaverdicts (such as the $229 million verdict against Johns Hopkins in 2019), health care systems and their insurance brokers will probably have their eye fixed on nine-figure policy limits.

Summary

It is likely both the specialists and multiline companies will always have a place at the MPL table. However, that place might be smaller and more cramped than in the past. While the number of independent physicians will continue to shrink, it will probably never go to zero. As such, the specialists might be faced with the possibility of being smaller versions of what they are today. Similarly, the multiline companies have carved out their niches in the nonphysician spaces, but changes in health care are also disrupting those spaces. With the current price-firming taking place in the market, this could be a good time for insurers to take a deep breath and figure out what they want to be five years from now.

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C#: 9580562