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Q4 BEGINS WITH A MEDMAL BANG

With Q4 earnings now kicking into full gear, the market is widely expecting bad news. However, even before earnings have really begun, medmal exposures were put front and center, again by specialist player **ProAssurance**.

After markets closed Wednesday, the company disclosed a \$37mn adverse development charge for Q4 related to “deteriorating loss experience, driven by a large national healthcare account written since 2016”. For context, the charge likely represents ~15-20pts on the firm wide Q4 CR or around ~30pts on the specialty segment combined.

Additionally, it said it expected to book its accident year loss ratio for its specialty segment between 134% and 148%. Combined with the ~30pts of adverse PYD and an expense load, the firm could be looking at a segment combined north of 200% for the quarter.

The company said the accident year loss picks also reflected the above noted trends, and “to a lesser extent, in the healthcare professional liability excess and surplus lines of business”.

Recall, in April last year, ProAssurance issued a warning on healthcare loss trends in the starkest possible terms, citing an increasing number of large verdicts, increases in the demands of plaintiff attorneys and greater severity in underlying losses. Though management warned this was not yet showing in paid loss data (the tail is long in this business), it took precautionary steps with a 2.5pt lift to its loss pick in that quarter.

The action in Q4 appears an order of magnitude higher. And though the firm appears to attribute most of the PYD impact as due to specific loss data, its references to loss trends in E&S and its impact on AY loss picks appear less clear. A vital point of context on the firm’s earnings call on 21 February is to what extent its current actions are a response to existing paid and reported loss data and to what extent it goes above and beyond that to its understanding of emerging risks, per its prior commentary.

Over the past 18-months, the P&C market has become increasingly focused on signs of rising social inflation. To date these trends have appeared limited largely to the commercial auto line or other lines with auto-related exposures. However, that appears to be changing, with several new segments showing signs of social inflation-linked stress. We continue to believe the emerging pressures in medmal may be one of the brewing hot spots in the industry currently receiving less attention that it should be, as evidenced by lacklustre industry pricing data (details below).

With Q4 results now expected to start thick and fast, we expect this will be the first of many pain-points to emerge as the rubber begins to meet the road, with managements’ views of loss trends forced to make the transformation from conference call rhetoric to cold hard reserves.

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Index	QTD	YTD
Large Cap	1.1%	1.1%
Regional	1.7%	1.7%
Specialty	3.1%	3.1%
Personal	2.0%	2.0%
Bermuda	2.7%	2.7%
Florida	(5.7)%	(5.7)%
Brokers	2.2%	2.2%
IPC Select	1.2%	1.2%
S&P 500	2.8%	2.8%
S&P Fin.	0.2%	0.2%

Source: S&P Global, Inside P&C

Q4 BEGINS WITH A MEDMAL BANG AS PROASSURANCE SOUNDS THE ALARM AGAIN

Over the past 18-months, the P&C market has become increasingly focused on signs of rising social inflation.

To date these trends have appeared limited largely to the commercial auto line. However, that appears to be changing, with several new segments showing signs of social inflation-linked stress.

Numerous companies on earnings calls for the past two quarters have pointed to a worsening tort environment, social inflation pressures, and a spread of severity into other coverages with commercial auto-like exposures (e.g. GL), while public D&O related exposures remain a hot spot.

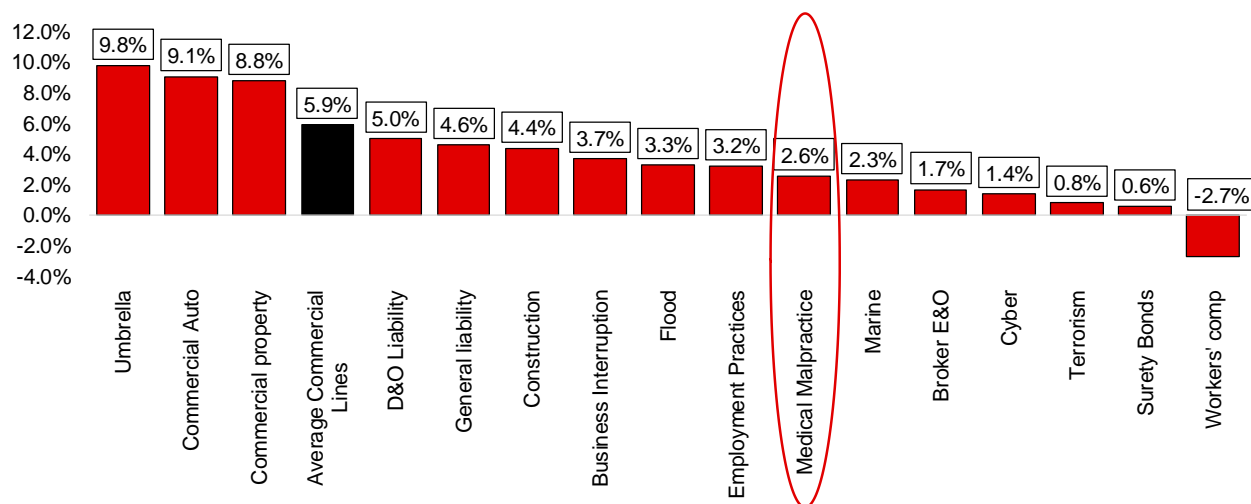
However, we continue to believe the emerging pressures in medmal may be one of the brewing hot spots in the industry currently receiving less attention.

And though we have raised this concern several times before, one way we are able to demonstrate this lack of attention is in the relatively benign pricing trends reported in major indices like the CIAB which show no signs of and urgent response to pain.

Medmal pricing was reported at +2-3% over the past few quarters, versus D&O at +5% and commercial auto, commercial property, and umbrella all in the ~9-10% range.

EXHIBIT: CIAB PRICING INDEX – Q3 2019

Source: CIAB, Inside P&C

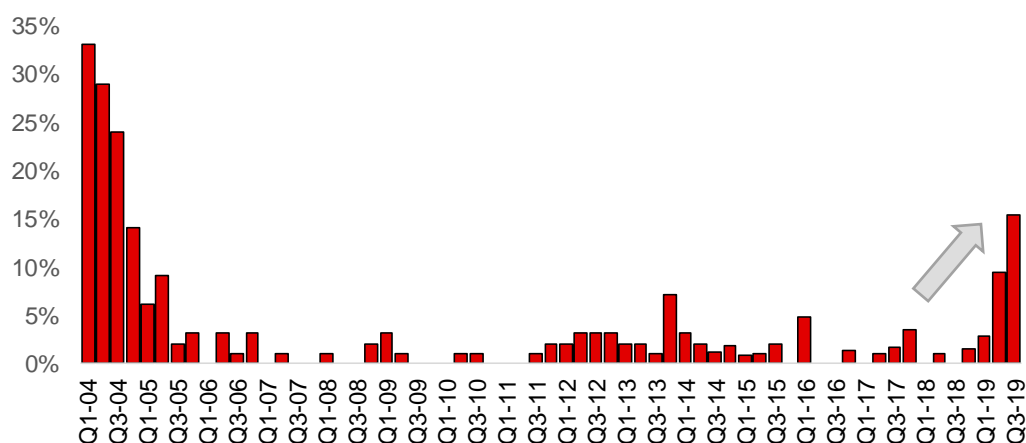


However, as we noted at the time, Medical malpractice is showing early signs of hardening. One interesting data point from CIAB was an increase in respondents indicating +10% increase in medical malpractice. Though well off other harder lines like commercial auto and commercial property, the number of respondents indicating +10% or higher increases jumped to 15.4% from 9% in Q2.

Though well off prior hard market levels, this is the highest level since Q3:04. The sequential increase of 6% followed the highest sequential increase since 2003 registered in Q2:19.

EXHIBIT: CIAB PRICING INDEX Q3 2019: MEDICAL MALPRACTICE: % OF RESPONDENTS INDICATING +10% PRICE INCREASES

Source: CIAB, Inside P&C



ProAssurance disclosures place medmal back front and center in Q4

With Q4 earnings now kicking into full gear with **Travelers reporting this morning**, the market is widely expecting bad news. After months of jaw-boning on social inflation, the combination of the cover provided by “good news” on price increases, the social acceptability of “not going first”, and the pressure from multiple stakeholders like actuaries, auditors, and regulators mean recognizing at least some bad news will likely be unavoidable for many.

However, even before earnings had really begun, medmal exposures were brought into sharp relief yesterday, again by specialist player **ProAssurance**.

After markets closed Wednesday, the company disclosed a \$37mn adverse development charge for Q4 related to “deteriorating loss experience, driven by a large national healthcare account written since 2016”. For context, the charge likely represents a ~15-20pts on the firm wide Q4 CR or around 30-35pts on the specialty segment combined.

Additionally, the company said it expected to book its accident year loss ratio for its specialty segment between 134% and 148%. Combined with the ~30pts of adverse PYD and an expense load, the firm could be looking at a segment combined north of 200% for the quarter.

The company said the accident year loss picks also reflected the above noted trends, and “to a lesser extent, in the healthcare professional liability excess and surplus lines of business”.

This business includes custom physicians, healthcare facilities, correctional healthcare, and long-term care policies, though the company said loss estimates for

its core physicians, podiatric, chiropractic, legal professional liability and medical technology liability businesses “will be in line with expectations”.

“As we have observed and discussed over the past 18 months, results in the medical professional liability line are deteriorating.

“Following our usual year-end review of updated loss data with internal and external actuaries, management concluded that additional reserves were needed in our Specialty Property & Casualty segment, particularly in regard to a single large national healthcare account that has experienced losses far exceeding the assumptions made when the account was underwritten.”

-ProAssurance CEO Edward Rand, Jr:

Background: The sweeping tide

Our interest in healthcare liability spiked in April last year when we first began writing about [stress in the E&S markets](#) where the exposure was described by multiple market specialists as becoming increasingly challenging.

However, ProAssurance was the first company to publically sound the alarm just weeks later in a profits warning for Q1 followed by additional disclosures in its full Q1 report.

At that time, ProAssurance flagged “*concern about the broad loss trends in healthcare professional liability*”, pointing to “*the increasing number of large verdicts, increases in the demands of plaintiff attorneys and greater severity in underlying losses*”.

Recall, the company is a significant specialist player in the medical malpractice market, as the #4 player with 5% market share.

Rank	Company	Market Share (%)	2018 DPW (\$mn)	5YR CAGR (%)	2018 Adj. LR (%)	3YR Avg LR (%)	5YR Avg LR (%)
1	Berkshire Hathaway Inc.	16.7	1,564	2.2	68.6	62.8	61.9
2	The Doctors Co.	7.4	690	(1.3)	77.0	68.1	63.1
3	CNA	5.6	529	1.2	66.9	59.1	55.3
4	ProAssurance Corp.	5.1	475	(0.8)	73.5	62.0	54.9
5	Coverys	4.8	446	(0.1)	86.1	82.9	74.8
6	NORCAL	3.6	342	(0.6)	71.7	68.5	68.0
7	MCIC VT	3.6	340	28.5	99.2	97.2	100.3
8	MagMutual	3.1	287	4.4	80.3	84.2	78.0
9	Hospitals Insurance Co.	2.3	219	(1.1)	36.2	50.9	49.5
10	Physicians' Recpl Insurers	1.9	174	(14.1)	33.9	88.9	85.8
11	Liberty Mutual	1.8	172	3.6	61.8	76.3	72.8
12	MMIC Insurance	1.8	166	(0.8)	76.1	68.2	60.0
13	Controlled Risk Ins Co. of VT	1.7	159	6.6	75.0	75.2	77.0
14	ISMIE	1.6	153	(8.8)	63.2	56.4	54.1
15	Chubb	1.6	152	7.1	95.6	83.6	68.2
16	Alleghany	1.4	128	9.1	56.6	47.7	44.9
17	Medical Mutual Holdings Inc.	1.3	126	4.4	57.3	51.8	51.6
18	State Volunteer Mutual	1.3	120	(4.6)	59.0	47.3	54.7
19	W. R. Berkley Corp.	1.1	105	1.0	52.7	67.7	69.0
20	Medical Mutual (MD)	1.1	100	(7.0)	27.1	41.4	44.5
21	MICA	1.0	97	(3.9)	48.8	48.8	49.9
22	AIG	1.0	96	(23.0)	(34.2)	108.5	101.0
23	Fairfax Financial	1.0	96	(13.9)	63.1	69.4	74.1
24	NCMIC	1.0	95	1.1	46.6	42.9	41.3
25	OMSNIC	1.0	94	0.8	59.1	53.6	57.0
-	Top 25 Companies	74.0	6,926	(0.5)	67.4	68.3	65.8
-	P&C Industry	100.0	9,365	(0.9)	68.6	70.4	67.1

It writes a full spectrum of the health care professional liability market, including both healthcare professionals and entities (including hospitals), predominantly in the admitted market, though with some E&S and self-insurance products.

In short, the company has a wide lens on the market and broad view on trends. It is worth noting that ~60% of the company's statutory premiums come from this line, making it laser focused on the business as an existential issue and not just one minor sub-product among many.

And management commentary back in April put its concerns in the starkest possible terms.

"The environment is changing. Whether a company thrives on the opportunities afforded by such an environment or is swept away by the tide will be determined by its preparation."

– Prior ProAssurance CEO Stan Starnes

Background on Medmal

Significantly, the product line has historically been very cyclical and "cat-like" in its tendency to go through major crisis and capacity withdrawals due to periods of adverse litigation trends.

This is particularly of the occurrence form which ran at fully developed loss ratios from 114-150% from 1996-2001, including as much as 30pts of adverse development in the 2000 accident year.

However, in recent years the product has shown favorable loss trends and reserve development, albeit with more recent accident years showing signs of stress (similar trends at ProAssurance).

Indeed, as recently as February 2019, AM Best flagged medical professional liability as the major line of business it viewed as having the largest reserve redundancies at \$2.0bn, albeit while including a negative outlook and flagging risks around potential increases in claims severity.

EXHIBIT: P&C MEDMAL CLAIMS MADE AY LOSS RATIOS

Source: S&P Global

Accident Year	12M	24M	36M	48M	60M	72M	84M	96M	108M	120M	% of initial inc. (%)
2009	74.86	70.91	67.03	63.9	59.87	58.47	57.71	56.11	55.67	55.09	(26.4)
2010	77.1	73.19	69.2	65.8	64.17	61.44	60.91	59.74	59.4	-	(23.0)
2011	76.15	73.77	71.67	71.97	69.13	67.29	66.1	65.72	-	-	(13.7)
2012	78.96	74.44	76.27	74.2	72.02	70.03	69.55	-	-	-	(11.9)
2013	76.04	78.98	77.62	75.86	74.63	73.45	-	-	-	-	(3.4)
2014	78.89	78.01	78.75	77.44	76.12	-	-	-	-	-	(3.5)
2015	80.61	81.35	80.8	80.06	-	-	-	-	-	-	(0.7)
2016	79.08	79.13	79.34	-	-	-	-	-	-	-	0.3
2017	79.34	79.82	-	-	-	-	-	-	-	-	0.6
2018	78.6	-	-	-	-	-	-	-	-	-	0.0

Trends beyond the loss data

One important point previously raised by ProAssurance was that its view of worsening loss trends (as of Q1) was not yet being seen in its paid loss data.

Recall, instead of paid loss data, ProAssurance pointed to “the increasing number of large verdicts, increases in the demands of plaintiff attorneys and greater severity in underlying losses”.

For example, the firm pointed to a recent ruling in the Supreme Court of Oklahoma which declared capson noneconomic damages unconstitutional. For context, ProAssurance is the #3 medmal writer in Oklahoma, writing around \$5mn in premiums. The state has previously caused problems for the company, with a 146% adjusted loss ratio in 2015, per statutory filings.

Importantly, product results tend to be relatively state or even county specific due to differences in product forms, local laws and regulations, and judicial environment. Market sources have previously described Cook County, Chicago; Philadelphia County, Philadelphia; and Dade Broward, Florida as hot spots for the industry.

Back in Q1, ProAssurance noted that, given the long tail in settling claims, and the high number of open claims, the company noted that increased severity “ripples back through all open claims” ultimately leading to higher paid losses.

This will be a critical factor to hear more from the company about on its quarterly earnings call on 21 February = *To what extent is the Q4 charges and loss pick adjustments fully explained by the paid and reported loss data referenced in its release and to what extent does it rely on the firm’s judgment of trends that suggest worse is still to come that won’t show up in its Schedule P. This will be a critical piece of insight to help understand how to handicap the loss triangles reported by other companies.*

We note that the firm’s prior comments around trends yet to show in data makes us cautious on placing faith in the loss triangles we have to date. The tail is long on this business, with only 3-5% of ultimate losses typically paid in the first year and around 50-60% of claim dollars unpaid after three years, per ProAssurance Schedule P data.

Notably, the industry appears less conservative at ~30% year one paid-to-ultimate incurred.

We thus think additional management commentary to help us better understand this reserve action will be vital in our understanding of trends in this sector.

This research report was written by Insider Publishing's Research team which includes Gavin Davis, Gianluca Casapietra, Dan Lukpanov and James Thaler.

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