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PIAA Profitability and Reserve Position Revisited at Year-end 2011

When BMS last reviewed the profitability of the Physician Insurers Association of America (PIAA) companies as of year end 2010, we explored a few key questions: How has the profitability of member companies changed over the past decade? How profitable is their current business? How much redundancy in loss and loss adjustment expense reserves has been released in recent years? How much, if any, redundancy remains? In our updated analysis of PIAA member company results as of year end 2011, we'll review how the reserve adequacy and profitability picture has changed since year end 2010. Furthermore, we'll also take a look at the results by quartile (based on 2011 gross earned premium) to see if the conclusions for the PIAA companies overall vary depending upon company size.

As with last year's analysis, we've estimated the ultimate loss and defense cost containment (DCC) expenses by report year (for claims-made business) and accident year (for occurrence business) for the PIAA member companies. So let's see how things look with the benefit of an additional year of history.

Market Share

The PIAA member companies account for about half of all MPL gross earned premium*

($ in 000s):

Year	MPL Industry Total Gross EP	PIAA Total Gross EP	PIAA % of Total
2002	9,888,992	4,432,608	44.8%
2003	11,811,056	5,406,279	45.8%
2004	12,685,554	5,991,456	47.2%
2005	13,108,821	6,303,128	48.1%
2006	13,187,763	6,568,941	49.8%
2007	12,750,635	6,409,447	50.3%
2008	12,239,124	6,134,834	50.1%
2009	11,440,644	5,818,095	50.9%
2010	11,275,332	5,673,892	50.3%
2011	10,973,737	5,437,151	49.5%

*Note that this analysis includes only those companies that filed NAIC Annual Statements. There are several PIAA member companies that do not file Annual Statements, which could understate the PIAA market shares noted above.

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The Current Picture

Estimated report year/accident year gross combined ratio for the PIAA member companies

($ in 000s):

Year	Gross Earned Premium	Gross Ultimate Loss+DCC	Gross Ultimate Loss+DCC Ratio	Gross Other Expenses	Gross Other Expense Ratio	Estimated Gross Combined Ratio	Booked Gross Combined Ratio
2002	4,432,608	4,623,334	104.3%	694,488	15.7%	120.0%	**119.0%**
2003	5,406,279	4,548,375	84.1%	777,561	14.4%	98.5%	**97.2%**
2004	5,991,456	3,863,394	64.5%	848,685	14.2%	78.6%	**77.6%**
2005	6,303,128	3,887,201	61.7%	864,940	13.7%	75.4%	**74.4%**
2006	6,568,941	3,748,327	57.1%	933,034	14.2%	71.3%	**72.0%**
2007	6,409,447	3,822,058	59.6%	961,449	15.0%	74.6%	**77.2%**
2008	6,134,834	4,011,623	65.4%	972,006	15.8%	81.2%	**85.0%**
2009	5,818,095	3,857,907	66.3%	1,087,851	18.7%	85.0%	**92.5%**
2010	5,673,892	3,941,533	69.5%	1,115,167	19.7%	89.1%	**99.1%**
2011	5,437,151	3,714,096	68.3%	1,105,305	20.3%	88.6%	**104.8%**

From the table above, it can be concluded that PIAA member companies:

- were very unprofitable in 2002.
- became profitable again in 2003.
- reached peak profitability in 2006.
- have seen profitability decrease since 2006.
- were still profitable in 2011 (based on the Estimated Gross Combined Ratio).

The combination of significant rate increases, positive effects of the tort reform, heightened risk management efforts, benign loss trends, and a capacity decrease due to the exit of The St. Paul from the MPL marketplace led to the significant improvements in PIAA member company results from 2001 through 2006. Since then, softening rates, modest severity trends (as well as continued low frequencies) and historically low investment returns have led to an erosion of profitability.

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And What About Those Reserve Redundancies?

The PIAA member companies have recognized net reserve redundancies each calendar year from 2005 to 2011, totaling about $7.4 billion.

($ in 000s)

Calendar Year	Claims-Made	Occurrence	Total Net Redundancy Recognized
2005	240,241	(78,801)	161,440
2006	408,408	77,600	486,008
2007	825,152	235,257	1,060,409
2008	1,180,717	220,753	1,401,470
2009	1,177,010	326,918	1,503,928
2010	1,075,007	375,203	1,450,210
2011	1,002,897	327,352	1,330,249
Total	5,909,432	1,484,282	7,393,714

As of 12/31/11, the PIAA member companies still maintain an estimated redundancy in gross reserves (about $2.1 billion) to cushion results in future calendar years, but much of the total reserve redundancies have already been tapped.

Year	Estimated Gross Ultimate Loss+DCC	Gross Booked Loss+DCC @12/31/11	Gross Implied Redundancy/ Deficiency
2002	4,623,334	4,579,618	(43,716)
2003	4,548,375	4,476,907	(71,468)
2004	3,863,394	3,799,454	(63,940)
2005	3,887,201	3,824,095	(63,106)
2006	3,748,327	3,796,888	48,561
2007	3,822,058	3,984,799	162,741
2008	4,011,623	4,240,350	228,727
2009	3,857,907	4,291,460	433,553
2010	3,941,533	4,505,490	563,957
2011	3,714,096	4,593,045	878,949
Total			2,074,258

Note: The implied redundancy for the 2010 and prior years is about $1.2 billion as of 12/31/11 (i.e., the $2.1 billion total less the $0.9 billion related to the 2011 year).

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Comparing Year-end 2011 to Year-end 2010

When we looked at the PIAA member companies as of 12/31/10, we noted that they had accessed about $6 billion in reserve redundancies over the past six years. We also estimated that about $1.8 billion in reserve redundancies still remained at year end 2010. As noted above, the companies recognized another $1.3 billion in redundancies in 2011. If losses had emerged as we had expected during 2011, we would have expected a remaining redundancy for the 2010 and prior years of about $500 million (i.e., $1.8 billion less $1.3 billion). However, our new estimate of reserve redundancy for 2010 and prior as of 12/31/11 is $1.2 billion. So what happened? Losses, particularly for claims-made business, emerged much more favorably during 2011 than we had anticipated. Thus, despite another year of significant reserve releases, there still appears to be room for additional future reserve releases, benefiting future calendar year results, and potentially extending the soft pricing cycle even further.

Does size matter?

PIAA membership includes many types of companies (stock, mutual, RRG, etc.) with many scopes of business (national, regional, single state, single specialty, etc.). To explore the differences in our analysis by company size, we sorted the companies into quartiles based on 2011 gross earned premium. The table below summarizes the 2011 year by quartile and in total:

($ in 000s)

Quartile	2011 Gross Earned Premium	2011 Indicated Loss+DCC Ratio	2011 Other Expense Ratio	2011 Indicated Combined Ratio	2011 Booked Combined Ratio	Released Redundancy 2005-2011	Indicated Redundancy 12/31/11	Redundancy as % of 2011 GEP
1st	3,703,905	72.6%	19.4%	92.0%	107.3%	5,294,516	1,095,226	29.6%
2nd	1,070,882	63.9%	21.9%	85.9%	100.6%	1,190,889	588,234	54.9%
3rd	497,015	52.1%	22.4%	74.5%	98.0%	802,936	282,948	56.9%
4th	165,349	48.7%	25.1%	73.8%	95.5%	105,373	107,850	65.2%
Total	5,437,151	68.3%	20.3%	88.6%	104.8%	7,393,714	2,074,258	38.1%

Note: The 1st quartile includes companies with at least $126 million in 2011 gross earned premium; the 2nd quartile includes companies with at least $50 million in 2011 gross earned premium; the 3rd quartile includes companies with at least $25 million in 2011 gross earned premium; and the 4th quartile includes companies with less than $25 million in 2011 gross earned premium.

What can we glean from the above table? As expected, the larger companies, with greater economies of scale, have lower expense ratios. Not as intuitive, on both an indicated and a booked basis, we see the smaller companies have lower loss+DCC and combined ratios. One possible explanation is the preponderance of single state or single specialty writers and risk retention groups in the 3rd and 4th quartiles. The policyholders, typically owners of the insurer, appear to be more loyal to their insurance providers, and thus less price sensitive than the insureds of the larger, national writers. We can also see that the smaller companies have been less aggressive in releasing redundancies than their larger competitors. Smaller balance sheets and less financial flexibility are likely contributors to this more conservative approach to reserve position for these companies.

In Conclusion

Despite a soft market being in its sixth year, the MPL market remains both healthy and profitable. As opposed to prior soft markets, the decreasing price per exposure appears to be driven at least as much by favorable experience as by overzealous competition. The challenge is whether the PIAA member companies can reverse the decreasing trend in profitability before the market returns to the highly unprofitable levels of the early 2000s. Furthermore, adapting to the extremely uncertain future world under the Affordable Care Act (with whatever changes/replacements are made to the act) will challenge the managements of all MPL carriers.

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