Foresight

BMS Group Executive Vice President Mike Larson details the latest trends in the medical professional liability sector, and offers some savvy commentary on what he's observed.

PI: Can you give us an update on the frequency and severity trends that you're seeing for MPL? One company recently reported that frequency is "better than expected," and pegs the increase in severity at 3% to 4%.

Larson: To a great extent, we're seeing "more of the same" with respect to frequency and severity trends. Frequency, for both healthcare providers and institutions, has generally been flat over the last five to six years, after having dropped quite precipitously over the 2002–2005 timeframe. I think some carriers were expecting to eventually see an uptick in frequency, but we have not seen that; hence the reports of frequency being "better than expected."

Severity trends have been fairly consistent for quite some time now, but at relatively moderate levels: 3% to 5% for healthcare providers and something a bit higher than that, 4% to 6%, for healthcare institutions. We've not seen or heard anything to date that would lead us to believe that there is any increased risk of significant pressure on those severity trends, at least in the very near term.

PI: Do you have any sense of what's helping to depress severity trends?

Larson: People who have looked back have had a difficult time explaining exactly why the frequency dropped off as much as it did in that 2002–2005 timeframe. Similarly, people don't necessarily have hard-and-fast answers for why the severity trends have moderated, other than that, in general, as you look at the last five to seven years, you notice that general inflation hasn't been that great. Also, interest rates have been decreasing and are now at all-time lows. So, to the extent that general inflation rates and interest rate levels are at all correlated with the awards typically given in MPL cases, that might help explain, to a certain extent, the moderated severity trends.

PI: Have there been any notable changes in large-loss trends or loss ratio trends? Some companies have noticed a trend toward "large losses." Does that show up in your analysis?

Larson: With regard to a greater incidence of "large losses," we've heard a bit of discussion from market participants about an increased awareness of the potential for "super" losses, but we've not actually seen any increase, per se, in the rate of incidence of these kinds of losses. We don't necessarily see any company with an explicit uptick in the frequency of those very large losses.

Looking at changes in loss ratios, the combination of moderate severity trends and continued rate decreases since the 2004–2006 timeframe means that loss ratios today are much higher than they were in the mid-2000s. As an example, a carrier that experienced a direct loss ratio of 55% in 2005 would today probably be expecting a direct loss ratio in the low 80% range, assuming that they've taken the same average price reductions over that time period as was taken by the industry. While the loss ratio deterioration from 55% to something in the low 80% range looks quite negative, a company with a direct expense ratio equal to the industry average, 21%, is probably still generating a small economic return from underwriting.

PI: Has recent competition in the MPL line been affecting pricing, from your vantage point?

Larson: Given the consolidation that has occurred over the past few years, you'd expect that there should be less competition in the market. And, typically, less competition translates into greater pricing power for the remaining market participants. So, based on this, you'd think that the market should be experiencing an

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upward trend in pricing. But, in general, we're not seeing this happen in any significant way. We've been seeing companies implement price changes that are typically in the -5% to +5% range, depending on the company and the jurisdiction.

PI: Are any differences by medical specialty showing up?
Larson: No, not necessarily. We have a client base that covers both individual providers as well as healthcare facilities. We're not necessarily seeing any significant pressure points on one or another. It seems to be pretty consistent across the space.

PI: Has the trend toward increasing employment of physicians by facilities affected pricing in any way?
Larson: It definitely changes the game a bit. Now you have more and more individual physicians being employed by healthcare facilities. As a result, you may see them being rolled into the overall insurance program of that facility. In the past, you might have had Insurance Company A that was focused specifically on providing insurance to healthcare facilities and Insurance Company B that was focused solely on providing insurance to healthcare providers.

Going forward, you'll now have a blended exposure and, as an insurance company, you'll need to be able to address the exposures that exist for facilities as well as providers. How insurance companies do that is where it gets interesting. You may end up seeing partnerships, in some cases, where companies that don't feel they have the expertise to adequately price and provide cover for the large facilities end up partnering with companies that feel they have the ability to handle the exposure for large facilities, but don't have the expertise from an individual-provider perspective.

But, I don't know that this will necessarily translate into significant price differences, or price pressures, that didn't exist previously.

PI: If less competition should, in theory, be putting upward pressure on pricing, what are some of the other factors that are keeping the price increases in check?
Larson: There are two other factors that I think have been key in keeping price increases in check; one fairly obvious and the other not as obvious. First off, a lot of the companies that are actively writing MPL have seen the strength of their balance sheets improve dramatically over the last seven years. So they can be more accommodating on the price side of the equation, if they need to be, to acquire new business or retain existing business. It is hard to push price increases through when there are other carriers waiting in the wings who would gladly write the policy at the expiring premium levels.

Secondly, to the best of my knowledge, there is only one remaining publicly traded stock insurance company that is primarily an MPL insurer. As a result, a lot of the companies that are actively writing MPL today, and that have these much stronger balance sheets, are either mutual insurance companies, insurance exchanges, or a risk retention group (RRG). Unlike publicly traded stock companies, which are primarily focused on maximizing returns for the stockholders, these other types of insurance organizations are focused on providing the most benefit to the policyholder, which in turn makes them more willing to forego the pursuit of price increases, especially when they have very strong balance sheets that may contain excess capital.

PI: Do you think that the outcome of the recent elections will have any impact on how MPL companies do business?
Larson: The outcome of the most recent elections will certainly have an impact from the standpoint that it is now guaranteed that the Patient Protection and Affordable Care Act (PPACA) will continue to be rolled out and implemented. The creation of accountable care organizations (ACOs) will undoubtedly give rise to changes in "exposure points," and will require the development of new insurance products developed specifically for an ACO—and their potentially new and unique exposure points.

People can define an ACO, but until you have enough of them up and running, on a large-scale basis, most of the discussion is theoretical—hypothetical—trying to envision how these things are going to be rolled out, how they're going to work, what the exposure points may be, and whether the exposure will be greater or lesser. We just don't know for sure.

The way in which healthcare costs are to be reduced under the PPACA is something that MPL companies will also need to constantly monitor and evaluate. Cost-saving initiatives quite frequently have unintended consequences, such as providing plaintiffs with new opportunities for filing claims.

PI: Have there been any changes in how MPL insurers use reinsurance—for example, in the ratio of ceded vs. retained financial risk—in the last few months?
Larson: Not necessarily in the last few months. As I mentioned earlier, balance sheets for companies writing MPL insurance have, on average, strengthened significantly over the past seven years. As a result, many of these companies are in a much better position to be able to retain more risk than they did in the past.

As a result, we have seen some companies opt to retain more risk by increasing their per-claim/per-occurrence retentions or by modifying their reinsurance structure in some other way to effectively retain more risk. Having said that, let me note that these changes have definitely been company specific. I can't say that there's been any wholesale change that has been commonly implemented throughout the industry.

PI: How does investment income compare to 2009 levels? Do you see an increasing interest in equities, in a search for higher yields?
Larson: In general, the trend in investment income over the past two to three years has been down a bit, but probably not as much as you might think. Risk-free investment returns have definitely been

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under pressure, as yields on U.S. Treasuries have declined to record lows. But, companies have been able to avoid a "U.S. Treasury" type drop in overall investment income returns, by continuing to invest in equities and by strategically investing in other fixed-income securities such as municipal bonds, corporate bonds, and mortgage-backed securities. We've also noted an increased appetite from some companies, but not necessarily MPL companies, as respects their willingness to invest in alternative investments.

PI: How has the ongoing automation of claims processing affected the actuarial side of the enterprise?

Larson: Initiatives that focus on the increased automation of claims processing will definitely impact the data that actuaries so naturally rely upon. Changes in the speed with which claims can be processed and/or reserved, along with changes in the makeup of claim record variables, are changes that actuaries need to be aware of.

PI: And of course, I have the usual question about reserves. Any significant changes here?

Larson: While we continue to see companies recognizing reserve redundancies on prior accident/report years, we also continue to see what we perceive as reasonably conservative reserving practices being employed on the more recent accident/report years. So, while reserves are not nearly as redundant now as they were five years ago, we do still feel that there is a bit of redundancy remaining.

PI: What elements of the MPL business might keep an executive up at night?

Larson: Two "up at night" issues for MPL executives that were previously mentioned are the impact of the PPACA and the changing provider landscape, where more and more healthcare providers are opting to be employed by healthcare facilities instead of being part of a solo or group practice. This changing employment relationship between providers and facilities could lead to some interesting changes in the dynamics of the MPL insurance marketplace in that it may provide greater opportunities for companies who are willing to write MPL for both healthcare institutions and providers, and correspondingly less opportunity for those companies that had been focused solely on healthcare facilities or individual providers. In addition to these, MPL executives are undoubtedly concerned about the possibility of a protracted soft market, given the strength of many of the MPL companies' balance sheets today. They may also be concerned about the longer term impact of continued consolidation within the MPL industry.

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