Demotech, Inc.

April 30, 2021

Analysis of Risk Retention Groups – Year-End 2020

Risk Retention Groups Report Favorable Results in 2020

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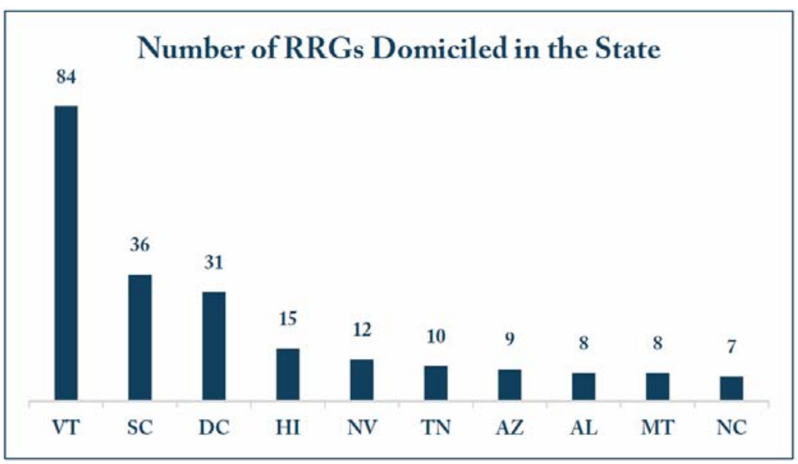
Introduction

A review of the year-end 2020 reported financial results of risk retention groups (RRGs) reveals insurers that continue to collectively provide specialized coverage to their insureds while remaining financially stable. Based on reported financial information, RRGs continue to have a great deal of financial stability and remain committed to maintaining adequate capital to handle losses. It is important to note that ownership of RRGs is restricted to the policyholders of the RRG. This unique ownership structure required of RRGs may be a driving force in their strong capital position.



The state in which an RRG is domiciled is responsible for regulating and monitoring that RRG. In 2020, Vermont was the state of domicile for 84 RRGs, the most for any jurisdiction. South Carolina was the state of domicile for 36 RRGs, and the District of Columbia for 31 RRGs. Hawaii and Nevada rounded out the top five states of domicile by having 15 and 12 RRGs, respectively.

Line of Business

Since RRGs are restricted to liability coverage, they tend to insure medical providers, product manufacturers, law enforcement officials and contractors, as well as other industries with professional liability. RRGs reported direct written premium for nine different lines of business in 2020, with 54.3 percent being Medical Professional Liability.

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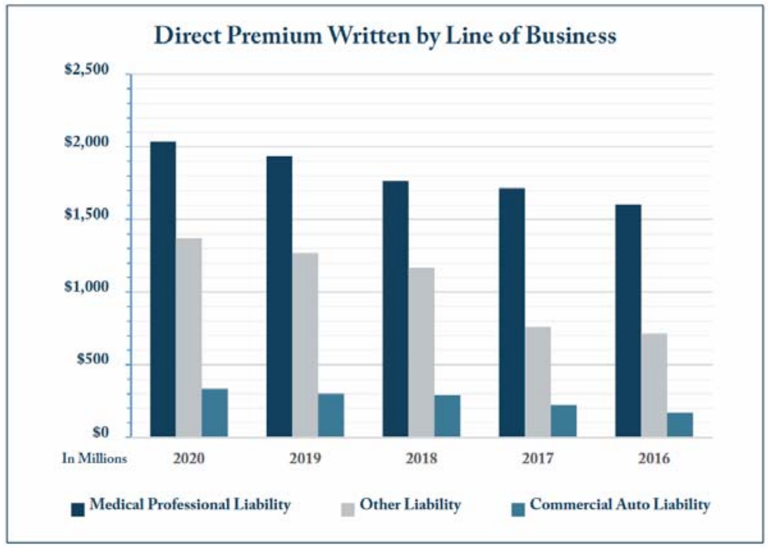
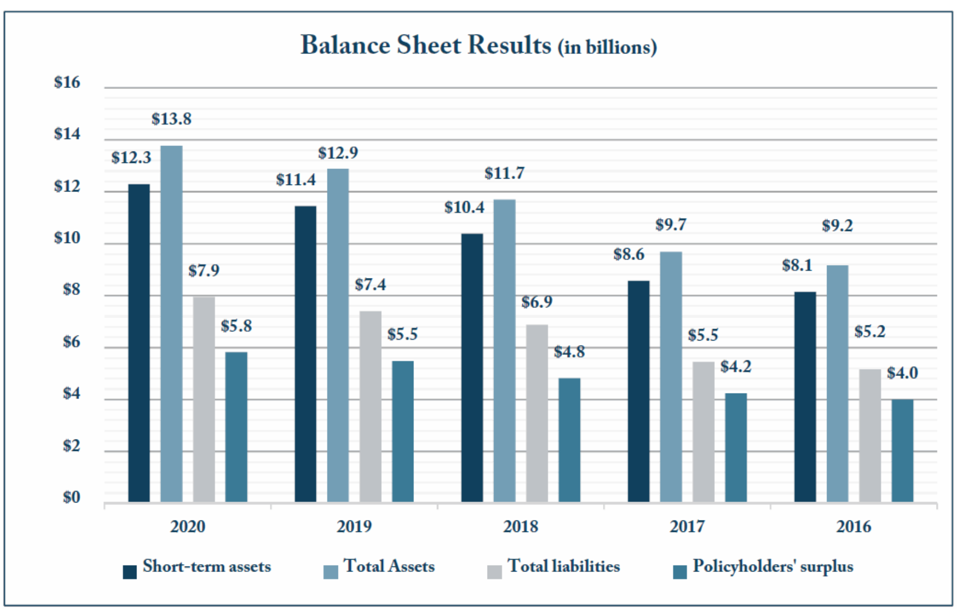
Direct Premium Written by Line of Business										
($ In Millions)	2020		2019		2018		2017		2016	
Medical Professional Liability	$2,035.2	54.30%	$1,936.0	55.09%	$1,764.8	54.58%	$1,715.4	63.26%	$1,604.4	64.21%
Other Liability	$1,369.3	36.54%	$1,268.6	36.10%	$1,165.5	36.04%	$759.9	28.03%	$713.4	28.55%
Commercial Auto Liability	$334.1	8.91%	$299.8	8.53%	$291.9	9.03%	$224.0	8.26%	$169.1	6.77%
All Other Lines	$9.4	0.25%	$10.1	0.29%	$11.3	0.35%	$12.1	0.45%	$11.8	0.47%

The chart above presents the direct premium written by line of business for RRGs for the past five years. The Medical Professional Liability, Other Liability, and Commercial Auto Liability lines continue to report year-over-year increases to direct premium written. The graph to the right further illustrates this growth in direct premium written by these lines of business.



Balance Sheet Analysis

From year-end 2019 to year-end 2020, cash and invested assets increased 7.4 percent and total admitted assets increased 6.9 percent. Also, RRGs collectively increased policyholders' surplus 6.3 percent. The level of policyholders' surplus becomes increasingly important in times of difficult economic conditions by allowing an insurer to remain solvent when facing unfavorable operating conditions. This increase represents the addition of nearly $343.2 million to policyholders' surplus. Over the past five years, aggregately RRGs have increased assets and policyholders' surplus while maintaining sufficient liquidity and leverage as well as other balance sheet ratios.



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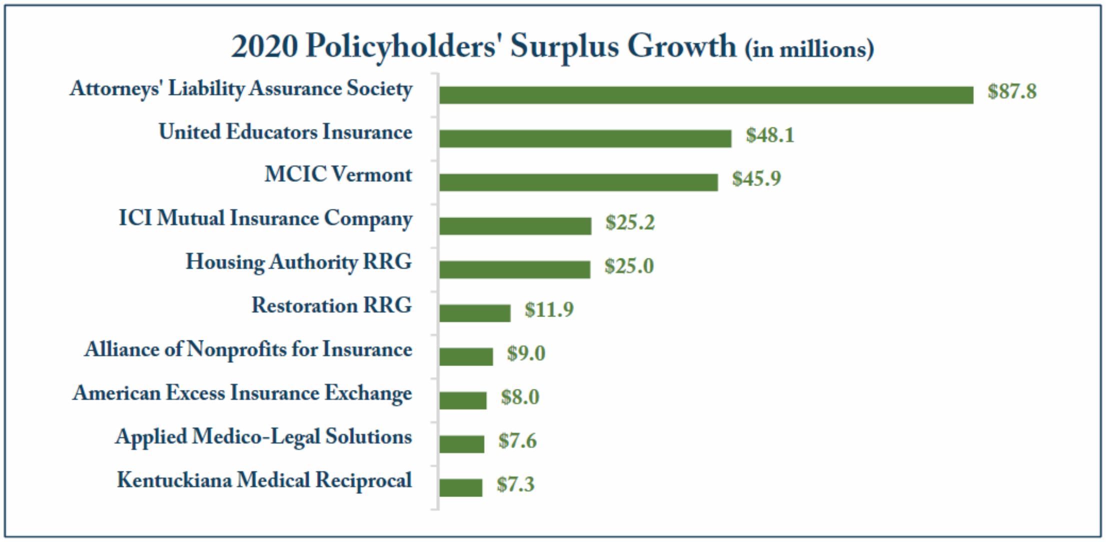
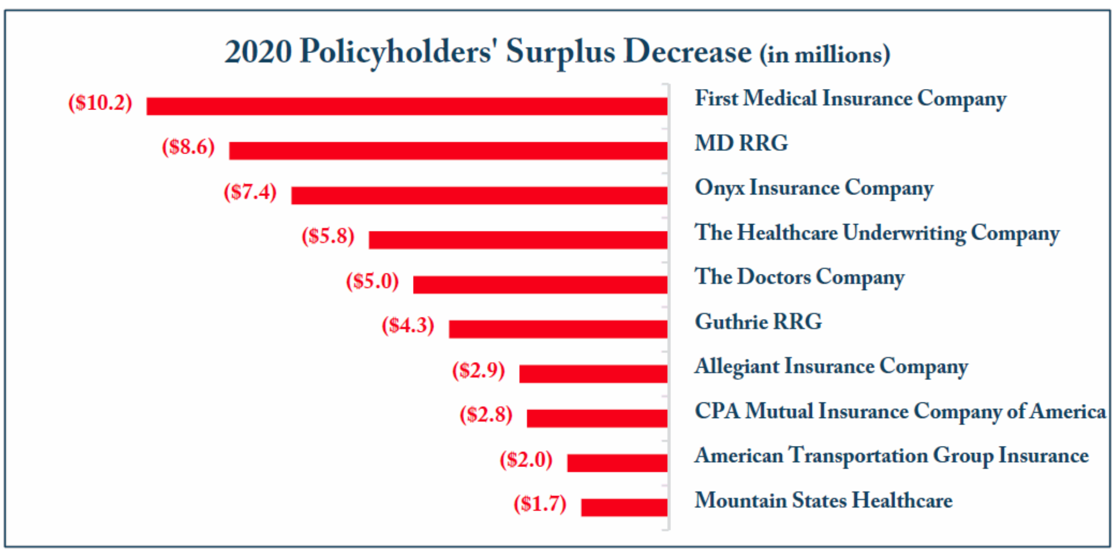
For 2020, 147 RRGs reported policyholders' surplus growth. In examining change in policyholders' surplus in 2020 for individual RRGs, Attorneys' Liability Assurance Society (NAIC# 15445) accounted for $87.8 million of policyholders' surplus growth, which was the highest level of growth reported in 2020. Most of this surplus growth can be attributed to the company's reported net income and net unrealized capital gains.



Conversely, First Medical Insurance Company (NAIC# 11278) reported the greatest decrease to policyholders' surplus. The company reported a $10.2 million decrease to policyholders' surplus, which can be attributed to the company's dividends to stockholders. This dividend was approved by the Vermont Department of Financial Regulation and was paid during the second quarter. In total, 64 RRGs reported a decrease in policyholders' surplus in 2020.



Liquidity, as measured by cash and invested assets to liabilities, for year-end 2020 was 155 percent. A value more than 100 percent is considered favorable as it indicates that there was more than a dollar of net liquid assets for each dollar of total liabilities. RRGs collectively have reported liquidity results between 151 and 158 percent at the past five year ends.

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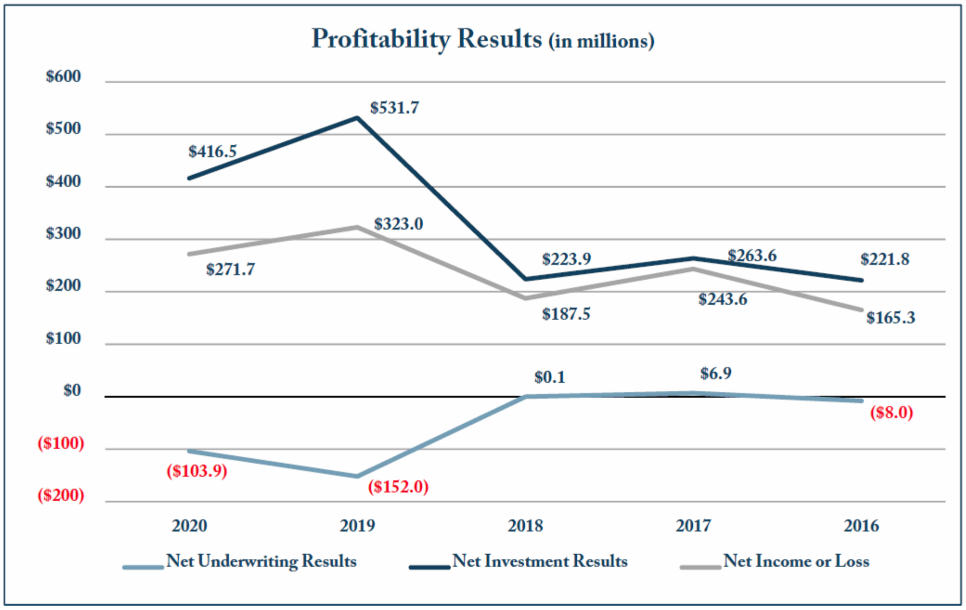


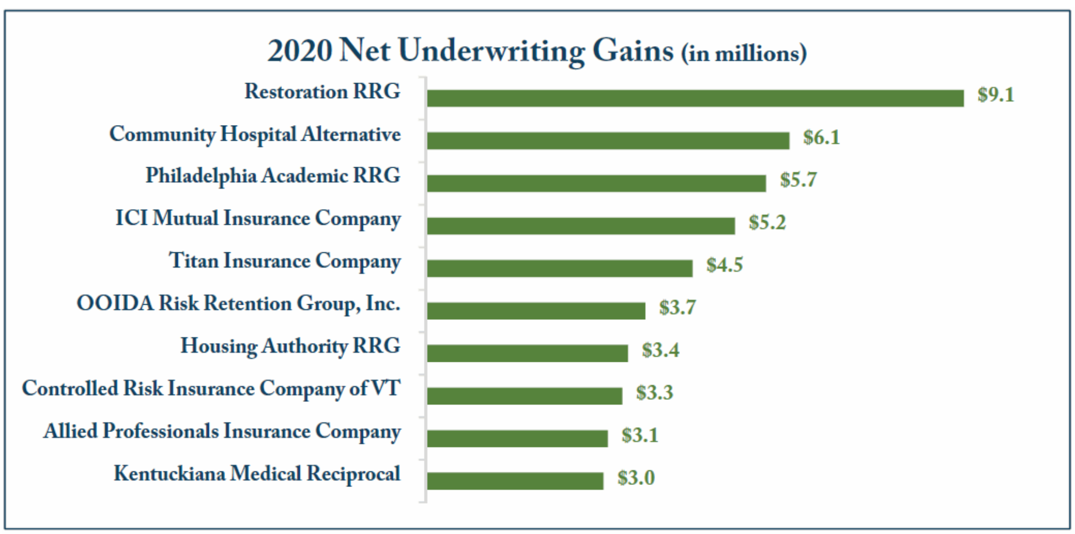
In evaluating individual RRGs, Demotech, Inc. prefers companies to report leverage of less than 300 percent. Leverage for all RRGs combined, as measured by total liabilities to policyholders' surplus, for year-end 2020 was 137 percent. RRGs have collectively reported leverage results between 129 and 143 percent at the past five year ends.

Regarding RRGs collectively, the ratios pertaining to the balance sheet appear to be appropriate and conservative. These reported results indicate that collectively RRGs remain adequately capitalized and able to remain solvent if faced with adverse economic conditions or increased losses.

Income Statement Analysis

Collectively RRGs reported an aggregate underwriting loss for 2020 of $103.9 million. This follows the underwriting loss for 2019. 114 RRGs reported an underwriting loss for 2020 compared to 104 RRGs reporting an underwriting gain.

However, RRGs offset these underwriting losses and collectively reported a net investment gain of $416.5 million and net income of $271.7 million. Looking further back, RRGs have collectively reported annual net income at each year-end since 1996. 147 RRGs reported net income for 2020 compared to 69 RRGs reporting a net loss.



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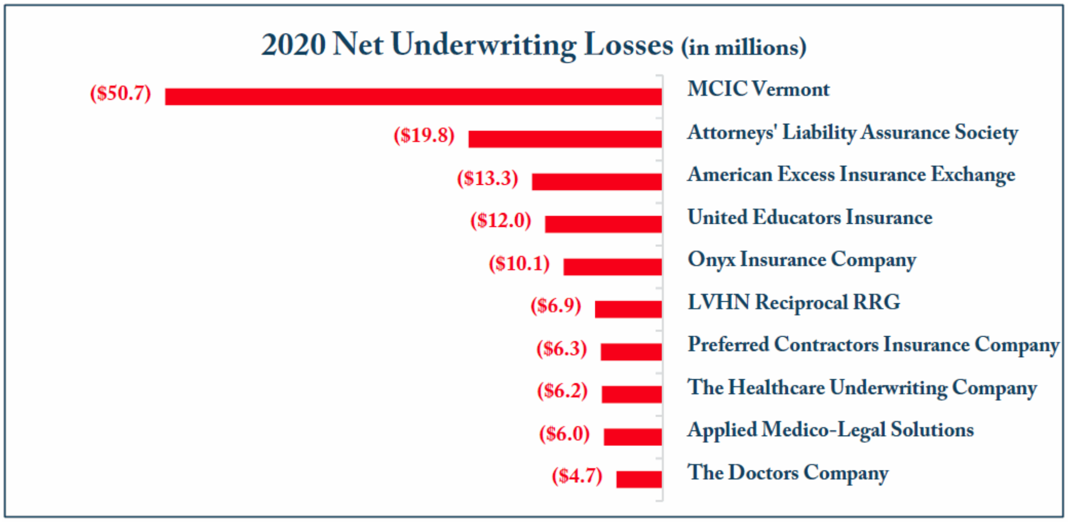


RRGs whose primary line of business is Other Liability reported an average 2020 underwriting loss of $257,613. Other Liability RRGs also reported an average net income of $2.6 million, the largest average net income by primary line of business.

In examining the underwriting results of individual RRGs, MCIC Vermont (NAIC# 10697) reported an underwriting loss of $50.7 million, the largest underwriting loss in 2020. MCIC Vermont was able to report a net income by recording a net investment gain of $72.9 million, the highest investment gain in 2020. Comparatively, Restoration RRG (NAIC# 12209) reported the largest underwriting gain, $9.1 million.

In examining the 2020 averages, RRGs whose primary line of business is Medical Professional Liability saw the greatest underwriting losses. The average 2020 underwriting loss for Medical Professional Liability RRGs was $597,644. Medical Professional Liability RRGs also reported an average net income of $1.3 million.

RRGs whose primary line of business is Commercial Auto Liability reported an average 2020 underwriting loss of $60,179. Commercial Auto Liability RRGs also reported an average net income of $170,206.

The loss ratio for RRGs collectively, as measured by losses and loss adjustment expenses incurred to net premiums earned, at year-end 2020 was 82.1 percent. This ratio is a measure of the underlying profitability of a book of business.

The expense ratio, as measured by other underwriting expenses incurred to net premiums earned, at year-end 2020 was 23.3 percent, the lowest reported level for the last five year-ends. This ratio measurers the operational efficiency in underwriting a book of business.

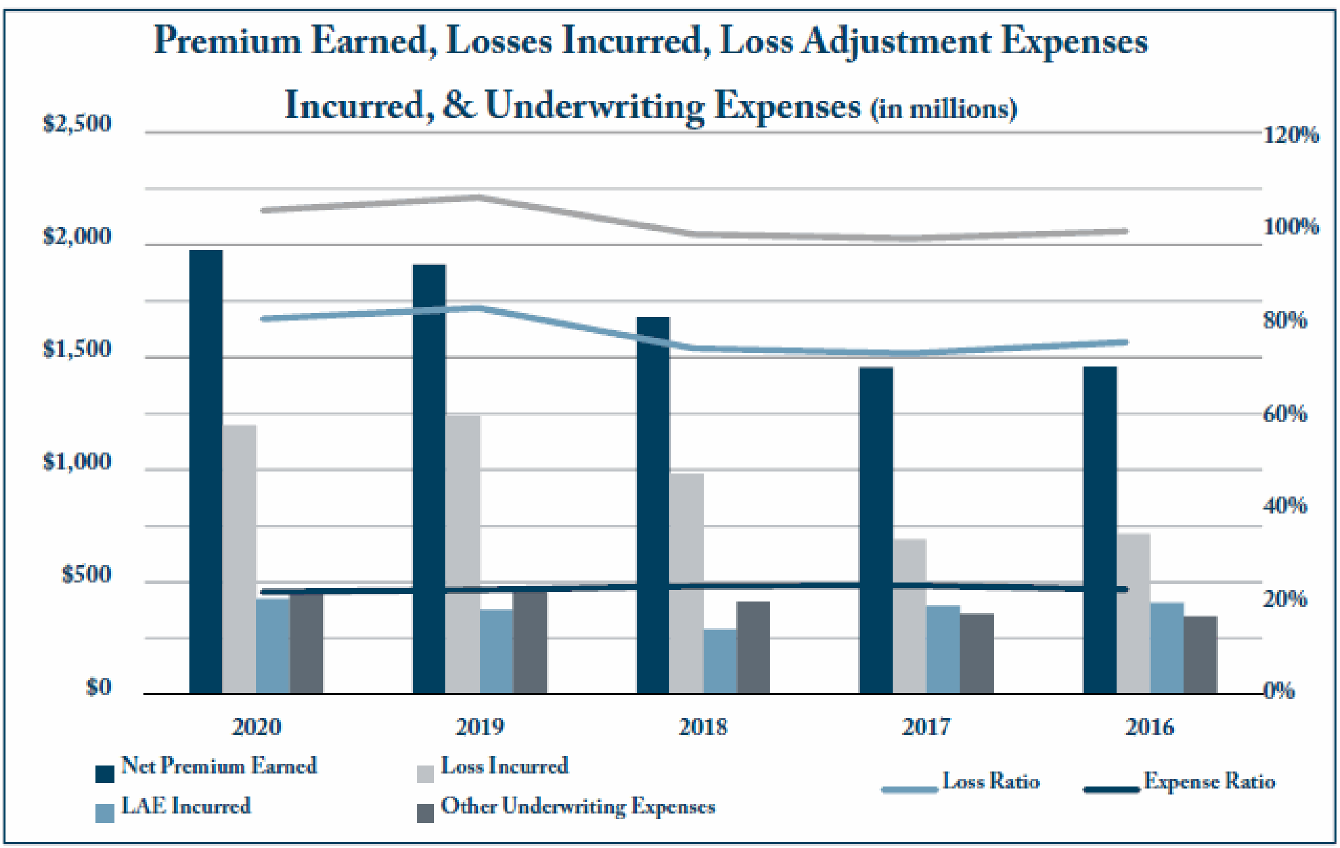
The combined ratio, loss ratio plus expense ratio, at year-end 2020 was 105.4 percent. This ratio measures overall underwriting profitability. A combined ratio of less than 100 percent indicates an underwriting profit and a ratio of more than 100 percent indicates an underwriting loss. RRGs have collectively reported a combined ratio over 100 percent at the last three year-ends.

Despite the underwriting losses, the ratios pertaining to the income statement appear to be appropriate for RRGs collectively.

Premium Written Analysis

RRGs collectively reported $3.8 billion of direct premium written for 2020, an increase of 6.4 percent over 2019. RRGs retained 54.3 percent of this premium and reported $2 billion of net premium written for 2020, an increase of 5.2 percent over 2019. RRGs have retained between 52.3 and 57.7 percent of direct premium written at the last five year-ends.

The direct premium written to policyholders' surplus ratio for RRGs collectively for 2020 was 64.8 percent. The net premium written to policyholders' surplus ratio for RRGs for 2020 was 35.2 percent.



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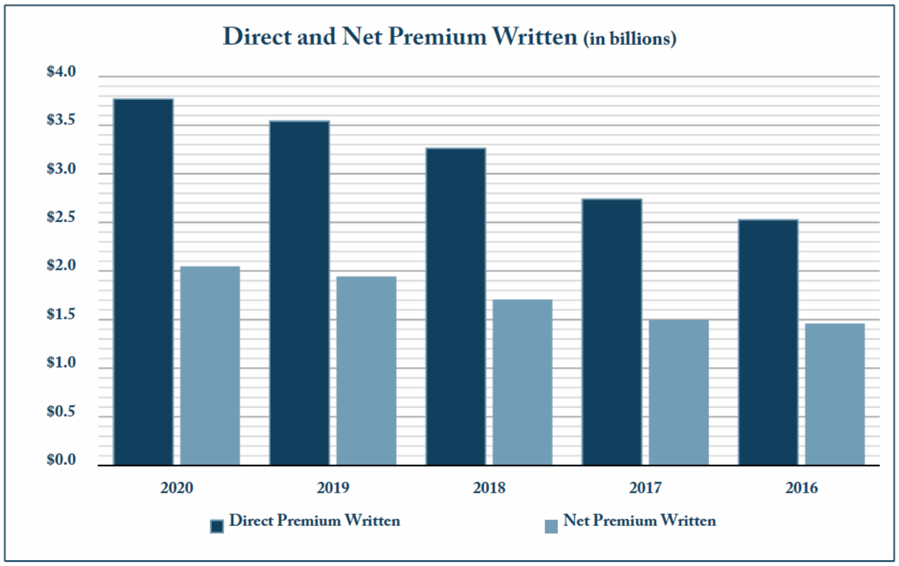


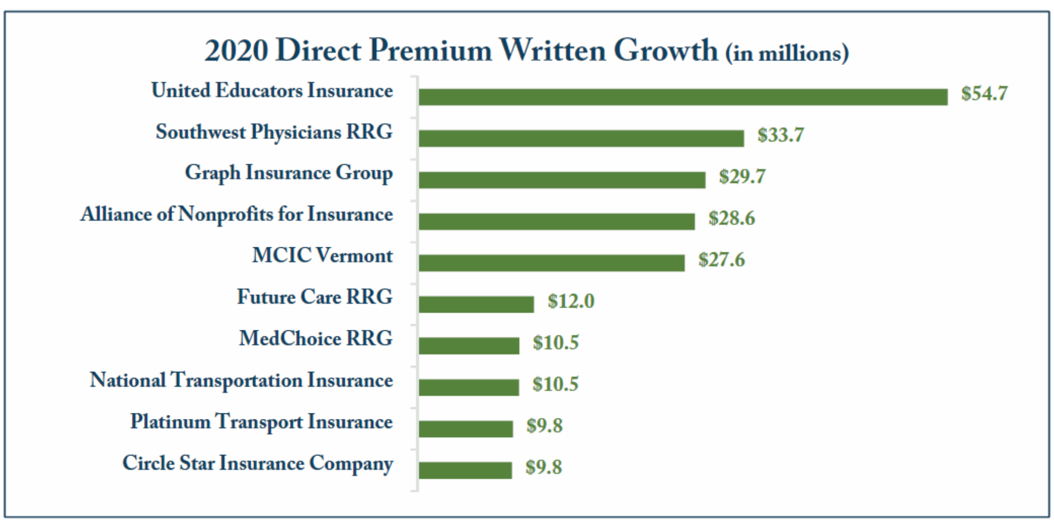
greater scrutiny. In certain cases, premium to surplus ratios in excess of those listed would be deemed appropriate if the RRG had demonstrated that a contributing factor to the higher ratio is relative improvement in rate adequacy.

In regards to RRGs collectively, the leverage ratios pertaining to premium written appear to be conservative.

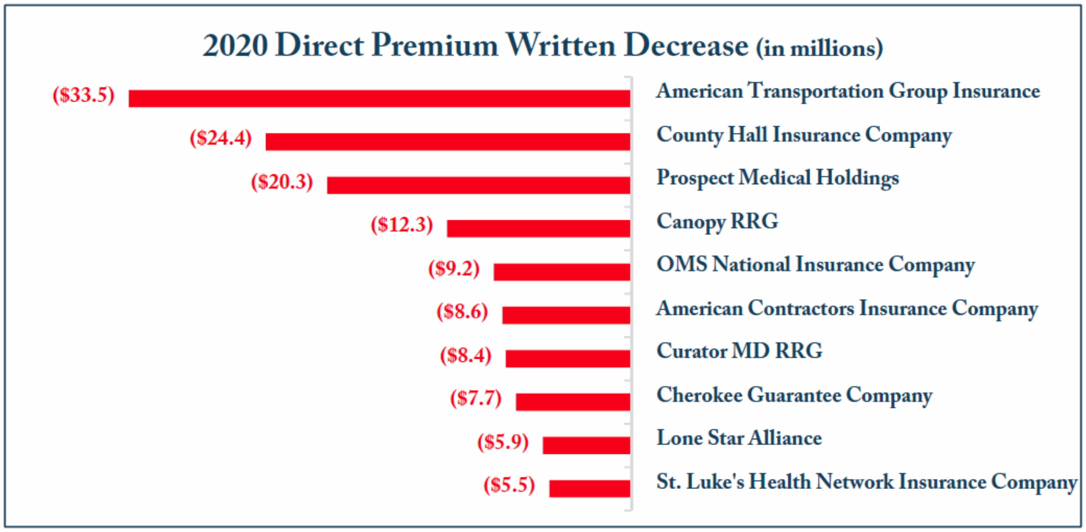
The direct premium written to surplus ratio is indicative of policyholders' surplus leverage on a direct basis, without consideration for the effect of reinsurance. The net premium written to surplus ratio is indicative of policyholders' surplus leverage on a net basis. Relying heavily on reinsurance will create a large disparity in these two ratios.

In examining the change in direct written premium for individual RRGs, United Educators Insurance (NAIC# 10020) reported $54.7 million in premium growth from year-end 2019 to year-end 2020, which is the largest reported level of growth in 2020. There were 137 RRGs that reported direct premium growth in 2020.

A direct premium written to surplus ratio in excess of 600 percent would subject an individual RRG to greater scrutiny during the financial review process. Likewise, a net premium written to surplus ratio greater than 300 percent would subject an individual RRG to



Conversely, American Transportation Group Insurance (NAIC# 16384) reported a decrease of $33.5 million in direct premium written, the largest decrease in 2020. There were 60 RRGs that reported a decrease in direct premium written in 2019.



Loss and Loss Adjustment Expense Reserve Analysis

A key indicator of management's commitment to financial stability, solvency, and capital adequacy is their desire and ability to record adequate loss and loss adjustment expense reserves (loss reserves) on a consistent basis. Adequate loss reserves meet a higher standard than reasonable loss reserves. Demotech views adverse loss reserve development as an impediment to the acceptance of the reported value of current, and future, surplus and that any amount of adverse loss reserve development on a consistent basis is unacceptable. Consistent adverse loss development may be indicative of management's inability or unwillingness to properly estimate ultimate incurred losses.

RRGs collectively reported adverse one-year loss reserve development and favorable two-year loss reserve development at year-end 2020. The loss reserve development to policyholders' surplus ratio measures reserve deficiency or redundancy in relation to policyholders' surplus and the degree to which surplus was either overstated, exhibited by a percentage greater than zero, or understated, exhibited by a percentage less than zero.

The one-year loss reserve development to prior year's policyholders' surplus for 2020 was 1.2 percent. In 2020, 140 RRGs reported favorable or neutral one-year loss reserve development compared to 71 reporting adverse one-year loss reserve development.

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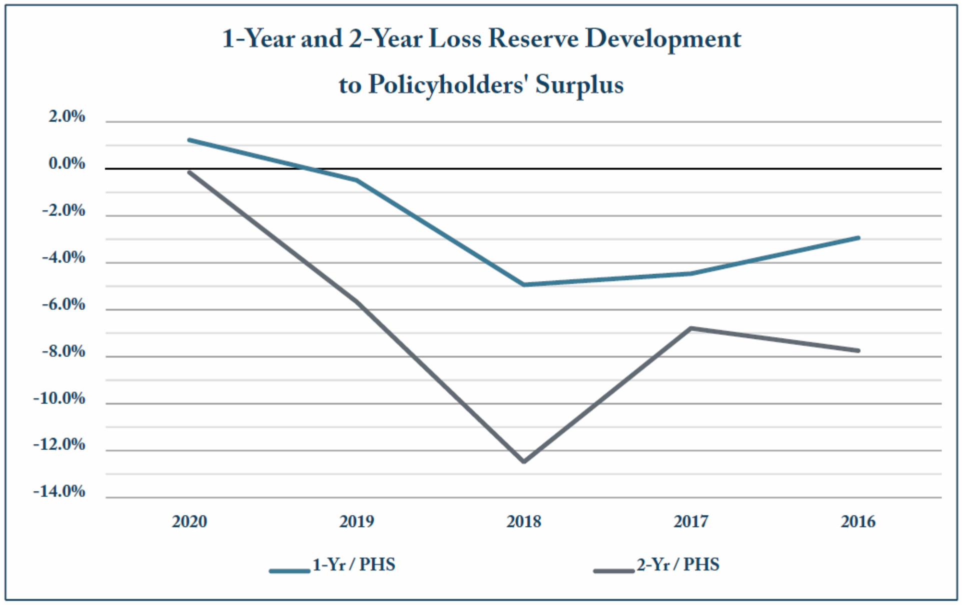
The two-year loss reserve development to second prior year-end policyholders' surplus for 2020 was -0.2 percent. In 2020, 142 RRGs reported favorable or neutral two-year loss reserve development compared to 59 reporting adverse two-year loss reserve development.

In regards to RRGs collectively, both of these loss reserve development ratios would be viewed as acceptable.



Conclusions Based on 2020 Results

Despite political and economic uncertainty, RRGs remain financially stable while providing specialized coverage to their insureds. The financial ratios calculated based on the reported results of RRGs appear to be reasonable, keeping in mind that it is typical and expected that insurers' financial ratios tend to fluctuate over time.

It is important to note again that while RRGs have reported net income, they have also continued to maintain adequate loss reserves while increasing premium written year over year. RRGs continue to exhibit a great deal of financial stability.

Douglas A Powell supports the formulation and assignment of Financial Stability Ratings® (FSRs) for Demotech by providing analysis of statutory financial statements and business information pertaining to insurance companies. He interfaces with clients to assist them in completing a rigorous financial analysis, while also providing insight regarding financial reporting practices and procedures. He also performs financial and operational and peer group analyses, as well as benchmark studies for client companies. Email your questions or comments to dpowell@demotech.com.

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