Analysis of Risk Retention Groups – Second Quarter 2021

2Q YTD: RRGs Report $299 Million Net Income; Increases to Premiums & Surplus

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A review of the 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 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 strengthened capital position.

Balance Sheet Analysis

From second quarter 2020 to second quarter 2021, cash and invested assets increased 14.7 percent and total admitted assets increased 14.3 percent. RRGs collectively reported a 14.3 percent increase to policyholders' surplus. This represents a $770.1 million increase to policyholders' surplus. The level of policyholders' surplus becomes increasingly important in times of difficult economic conditions by allowing an insurer to remain solvent when facing uncertainty.

Liquidity, as measured by cash and invested assets to liabilities, for second quarter 2021 was 145.3 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.

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 second quarter 2021 was 147.2 percent.

The loss and loss adjustment expense reserves (loss reserves) to policyholders' surplus ratio for second quarter 2021 was 92.5 percent. The higher the ratio of loss reserves to surplus, the more an insurer's stability is dependent on having and maintaining reserve adequacy.

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.

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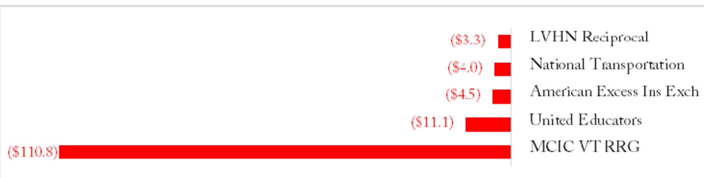
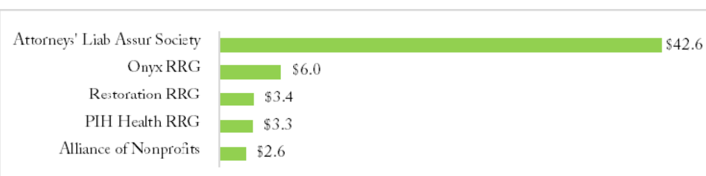
Income Statement Analysis

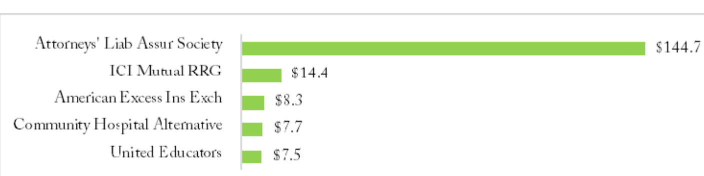
In regards to underwriting results, collectively RRGs were unprofitable through second quarter 2021, as RRGs reported an aggregate underwriting loss of $68.5 million. MCIC Vermont reported a $110.8 million underwriting loss through second quarter 2021, the largest underwriting loss.



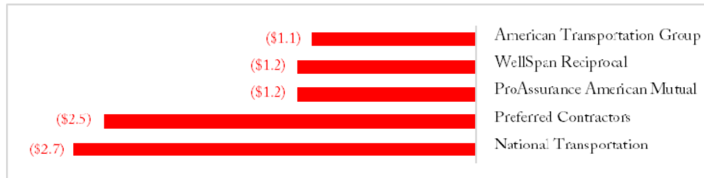
Conversely, Attorneys' Liability Assurance Society reported a $42.6 million underwriting gain, the largest, for the same period. In total, 111 RRGs reported an underwriting gain versus 123 RRGs that reported an underwriting loss year-to-date.



However, RRGs collectively reported a net investment gain of $385.3 million and, as a result, net income of $299.2 million. Attorneys' Liability Assurance Society reported a $144.7 million net gain, the largest, for the same period.



Conversely, National Transportation reported a $2.7 million net loss through second quarter 2021, the largest net loss. In total, 160 RRGs reported a net gain versus 71 RRGs that reported a net loss.



The loss ratio for RRGs collectively, as measured by losses and loss adjustment expenses incurred to net premiums earned, through second quarter 2021 was 82.2 percent. This ratio is a measure of an insurer's underlying profitability on its book of business.

The expense ratio, as measured by other underwriting expenses incurred to net premiums earned, through second quarter 2021 was 24.2 percent. This ratio measurers an insurer's operational efficiency in underwriting its book of business.

The combined ratio, loss ratio plus expense ratio, through second quarter 2021 was 106.4 percent. This ratio measures an insurer's overall underwriting profitability. A combined ratio of less than 100 percent typically indicates an underwriting profit and a ratio of more than 100 percent typically indicates an underwriting loss.

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

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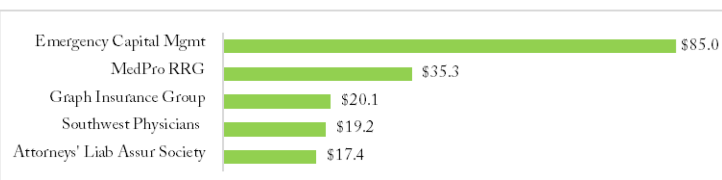
Premium Written Analysis

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 collectively reported $2.6 billion of direct premium written through second quarter 2021, an increase of 15.8 percent over second quarter 2020. RRGs reported $1.6 billion of net premium written through second quarter 2021, an increase of 17.9 percent over second quarter 2020.

Emergency Capital Management reported an increase in year-over-year direct premium written of $85 million, the largest increase for the period. Emergency Capital Management re-entered the market in 2021 and has resumed writing business.



Conversely, Philadelphia Academic reported a $10.4 million decrease in year-over-year direct premium written, the largest decrease for the period.

The direct premium written to policyholders' surplus ratio for RRGs collectively through second quarter 2021 was 85.3 percent. The net premium written to policyholders' surplus ratio for RRGs through second quarter 2021 was 51.6 percent. Please note, the premium written values for these ratios have been adjusted so they can be relatively compared to year-end ratios.

An insurer's direct premium written to surplus ratio is indicative of its policyholders' surplus leverage on a direct basis, without consideration for the effect of reinsurance. An insurer's net premium written to surplus ratio is indicative of its policyholders' surplus leverage on a net basis. An insurer relying heavily on reinsurance will have a large disparity in these two ratios.

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 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 ratios pertaining to premium written appear to be conservative.

Conclusions Based on Second Quarter 2021 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. The results of RRGs indicate that these specialty insurers continue to exhibit 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.

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