Demotech, Inc.

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Analysis of Risk Retention Groups – Year-End 2021

RRGs Report Favorable Results in 2021

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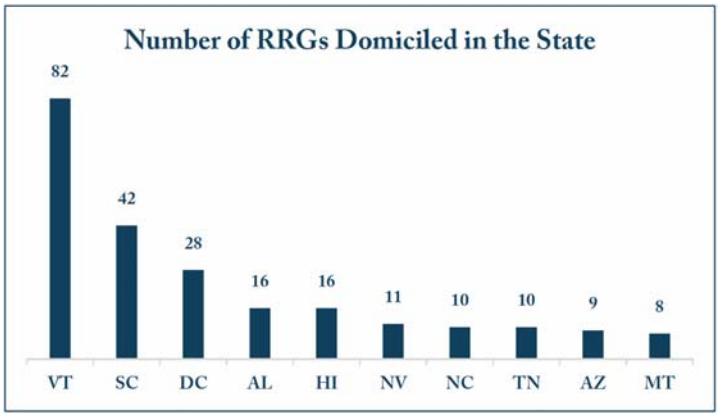
Introduction

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.

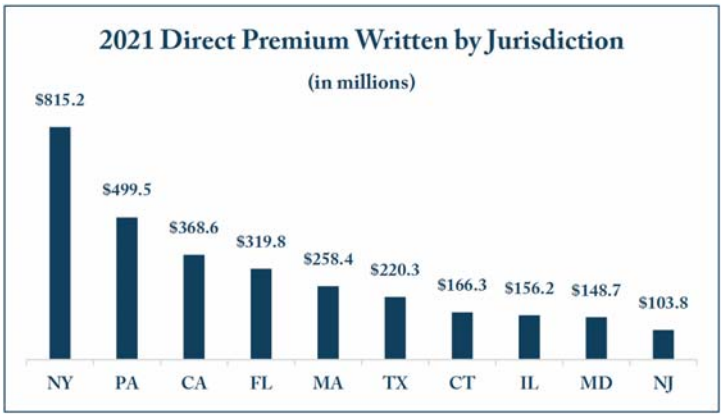
It is important to note that ownership of RRGs is restricted to the policyholders of the RRG. This unique ownership structure required of RRGs may be a driving force in their strengthened capital position.

States of Domicile and Jurisdictions

The state in which an RRG is domiciled is responsible for regulating and monitoring that RRG. In 2021, Vermont was the state of domicile for 82 RRGs, the most for any jurisdiction. South Carolina was the state of domicile for 42 RRGs, and the District of Columbia for 28 RRGs. Alabama and Hawaii rounded out the top five states of domicile by each having 16 RRGs.



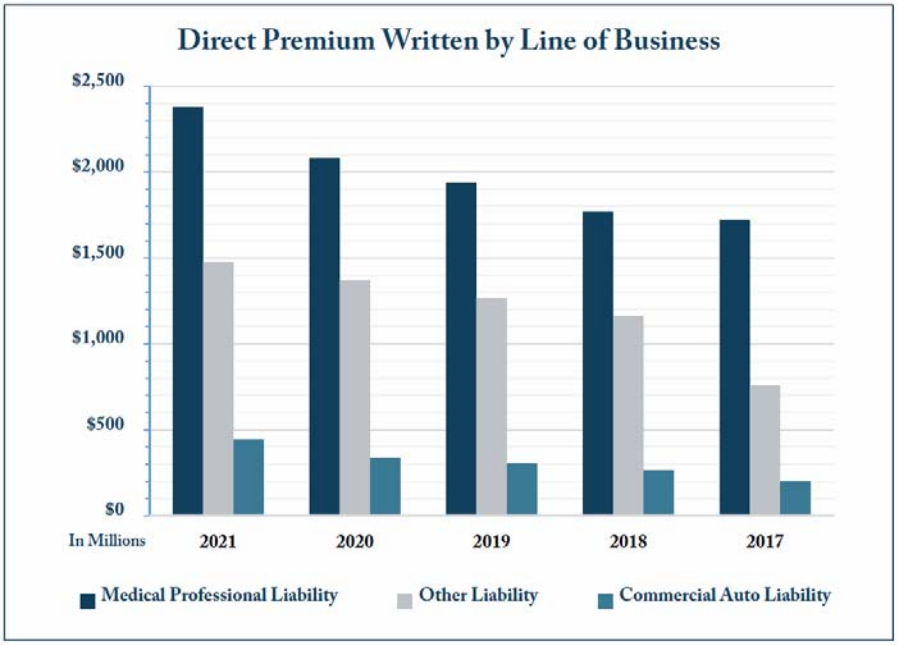
In terms of direct premium written, RRGs licensed to do business in New York wrote $815.2 million in the state. New York accounted for 18.8 percent of the total direct premium written in 2021.



Lines of Business

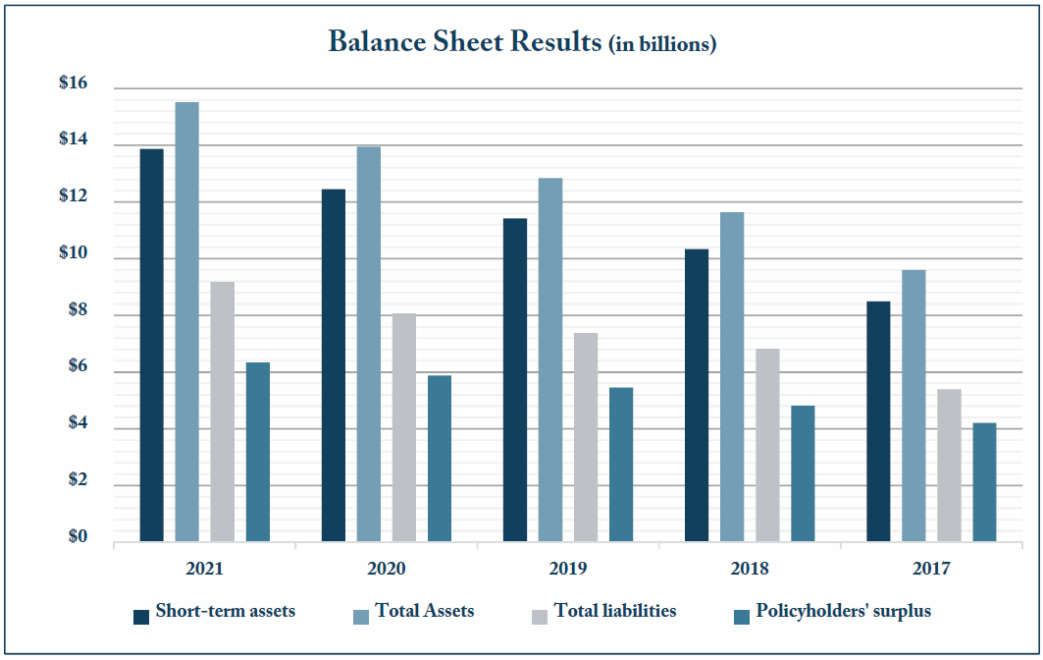
Since RRGs are restricted to liability coverage, they tend to insurance medical providers, product manufacturers, law enforcement officials, and contractors, as well as other industries with professional liability.

RRGs reported direct premium written for eight different lines of business in 2021, with 55.2 percent being Medical Professional Liability. Other Liability accounted for 34.3 percent and Commercial Auto Liability account for 10.3 percent. All other lines of business accounted for 0.2 percent.

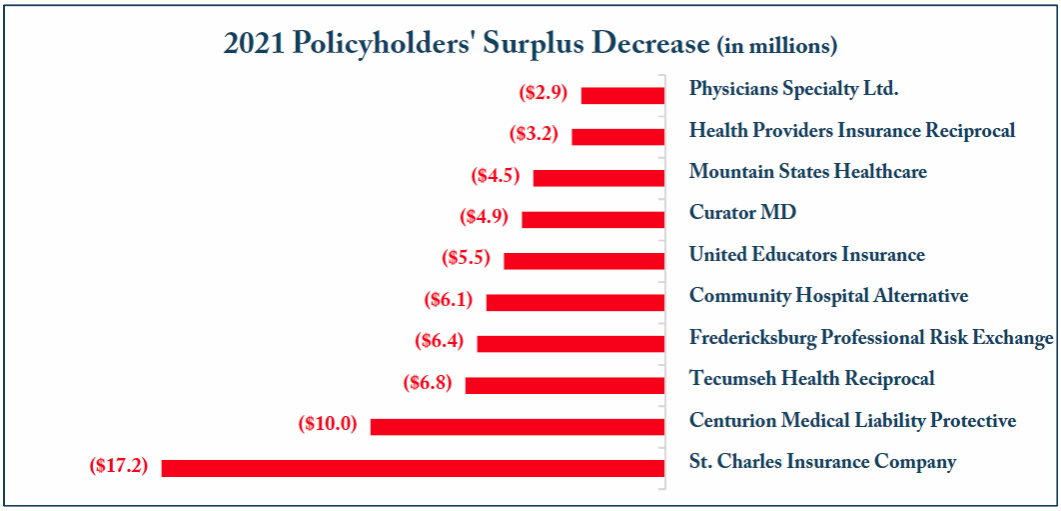


Balance Sheet Analysis

From year-end 2020 to year-end 2021, cash and invested assets increased 11.4 percent and total admitted assets increased 11.3 percent. RRGs collectively reported a 7.8 percent 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. This represents a $455.9 million increase to policyholders' surplus.



Over the past five years, RRGs have aggregately increased assets and policyholders' surplus while maintaining sufficient liquidity and leverage as well as other balance sheet ratios.

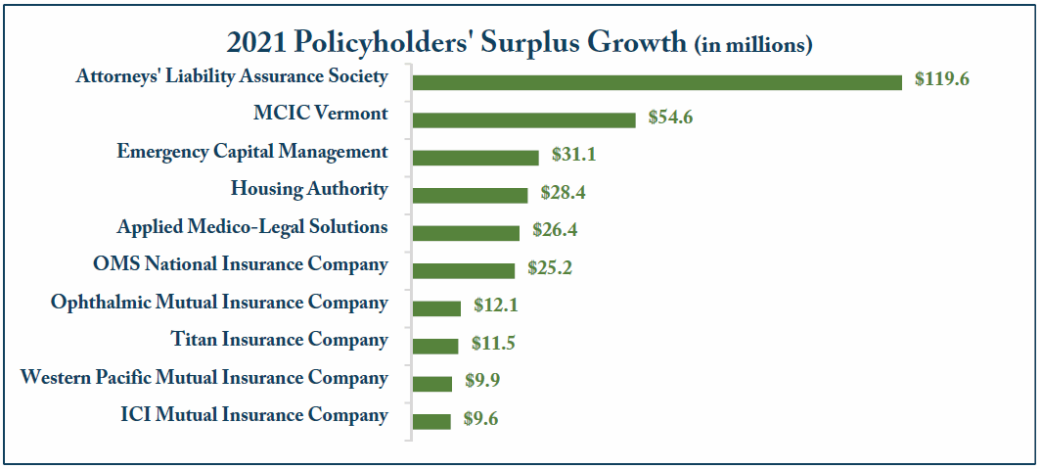


Liquidity, as measured by cash and invested assets to liabilities, for year-end 2021 was 151.0 percent. A value more than 100 percent is considered favorable as it indicates that there was more than a dollar of net liquid assets for each dollar of total liabilities. RRGs have collectively reported liquidity results between 151 and 158 percent at the past five year-ends.

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 2021 was 145.0 percent. RRGs have collectively reported leverage results between 128 and 145 percent at the past five year-ends.

For 2021, 149 RRGs reported policyholders' surplus growth. In examining change in policyholders' surplus in 2021 for individual RRGs, Attorneys' Liability Assurance Society (NAIC# 15445) accounted for $119.6 million of policyholders' surplus growth, which was the highest level of growth reported. This surplus growth can be attributed to the company's reported net income.

Conversely, St. Charles Insurance Company (NAIC# 11114) reported the greatest decrease to policyholders' surplus. The company reported a $17.2 million decrease to policyholders' surplus, which can be attributed to a shareholder dividend.



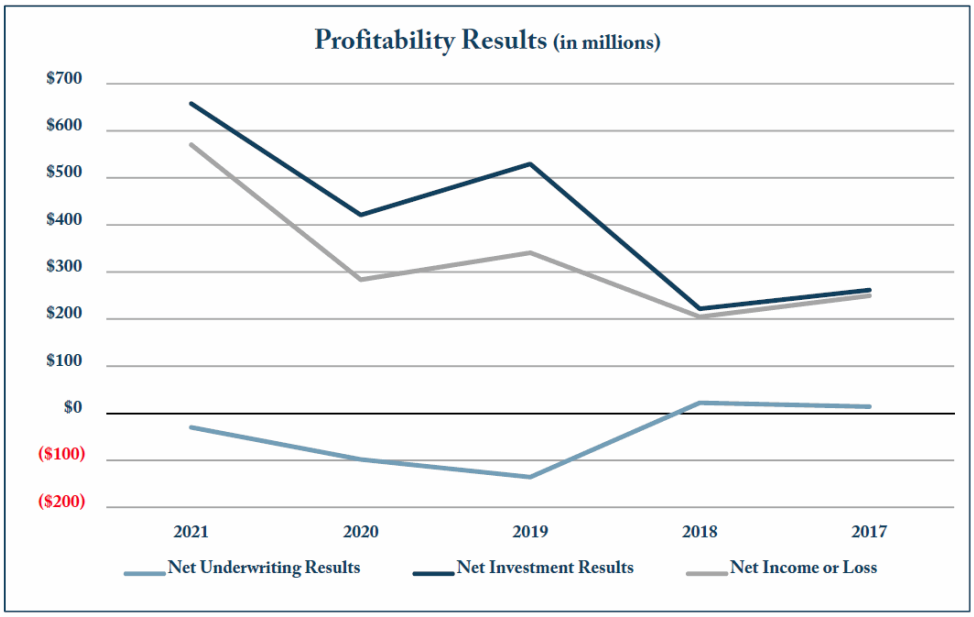
Regarding RRGs collectively, the ratios pertaining to the balance sheet appear to be appropriate and conservative. These reported results indicate that collectively RRGs remain adequately capitalized.

Income Statement Analysis

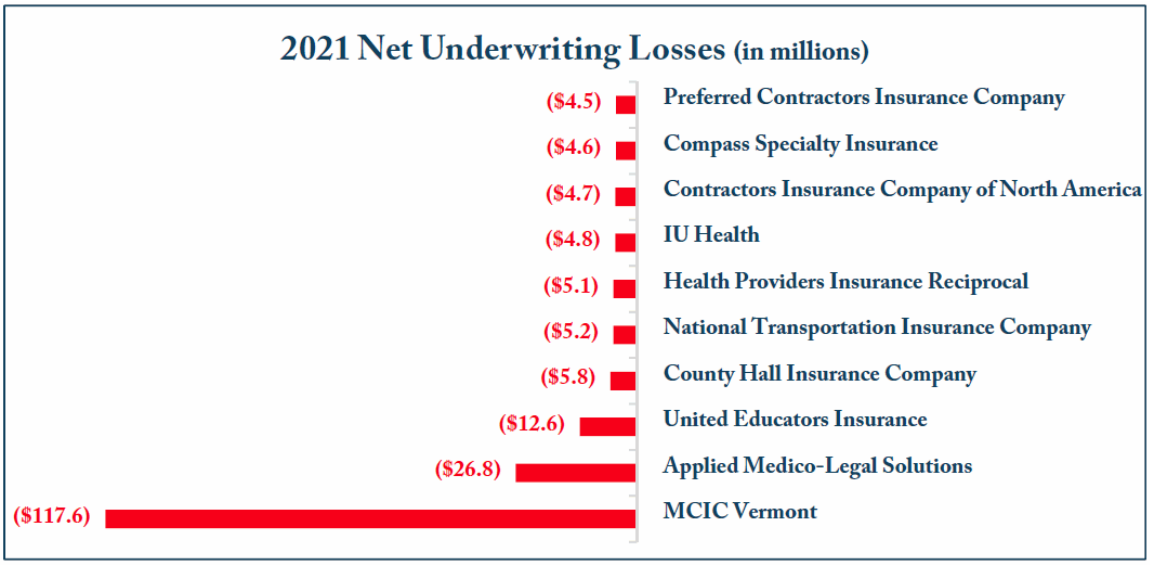
In regards to underwriting results, collectively RRGs were unprofitable in 2021, as they reported an aggregate underwriting loss of $30.3 million. This follows the underwriting losses for 2019 and 2020.

For 2021, 120 RRGs reported an underwriting loss compared to 121 RRGs reporting an underwriting gain.

However, RRGs offset these underwriting losses and collectively reported a net investment gain of $657.8 million and net income of $570.3 million. Looking further back, RRGs have collectively reported annual net income at each year-end since 1996.

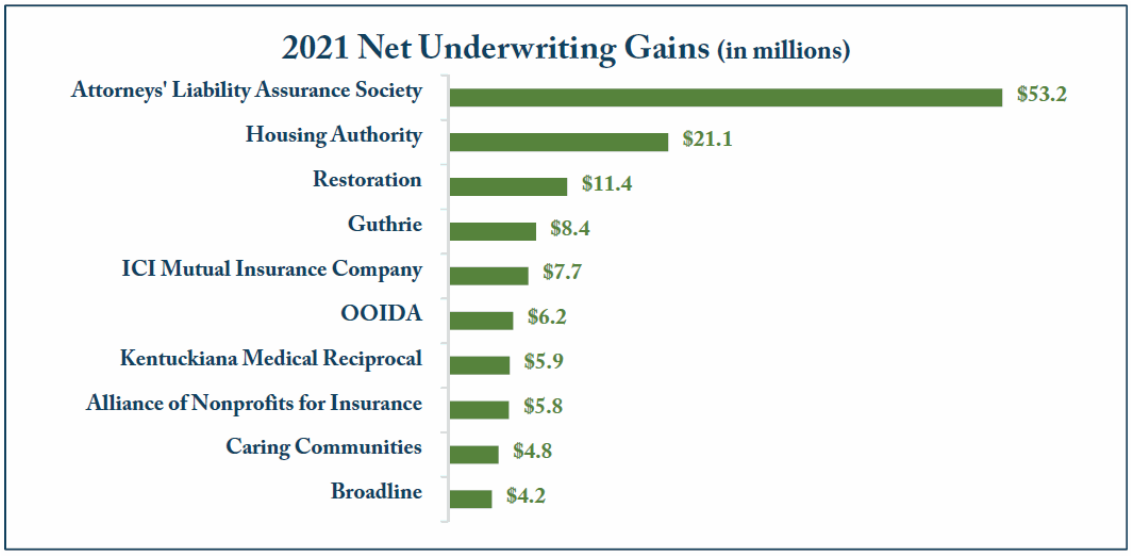


For 2021, 161 RRGs reported net income compared to 80 RRGs reporting a net loss.



In examining the underwriting results of individual RRGs, MCIC Vermont (NAIC# 10697) reported an underwriting loss of $117.6 million, the largest underwriting loss in 2021. MCIC Vermont was able to report a net income by recording a net investment gain of $162.5 million.

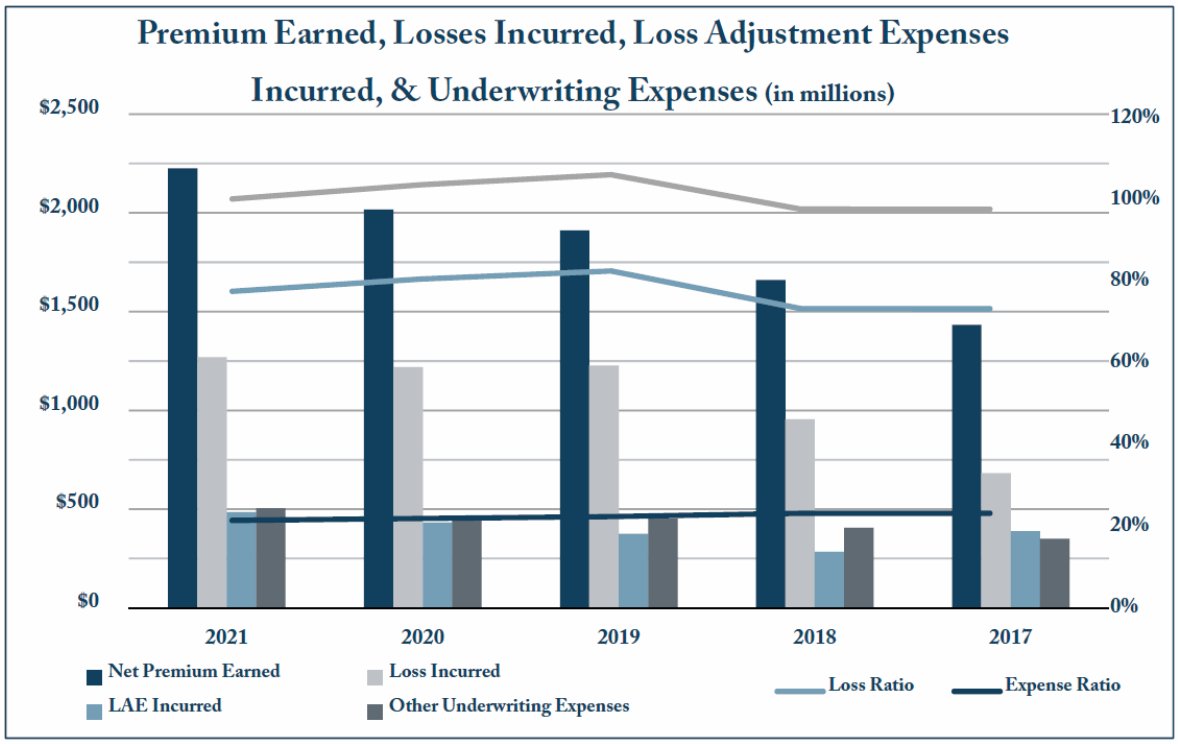
Comparatively, Attorneys' Liability Assurance Society (NAIC# 15445) reported the largest underwriting gain, $53.2 million.



The loss ratio for RRGs collectively, as measured by losses and loss adjustment expenses incurred to net premiums earned, for 2021 was 78.8 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, for 2021 was 22.6 percent. This ratio measures an insurer's operational efficiency in underwriting its book of business.

The combined ratio, loss ratio plus expense ratio, for 2021 was 101.5 percent. This ratio measures an insurer's overall underwriting profitability.

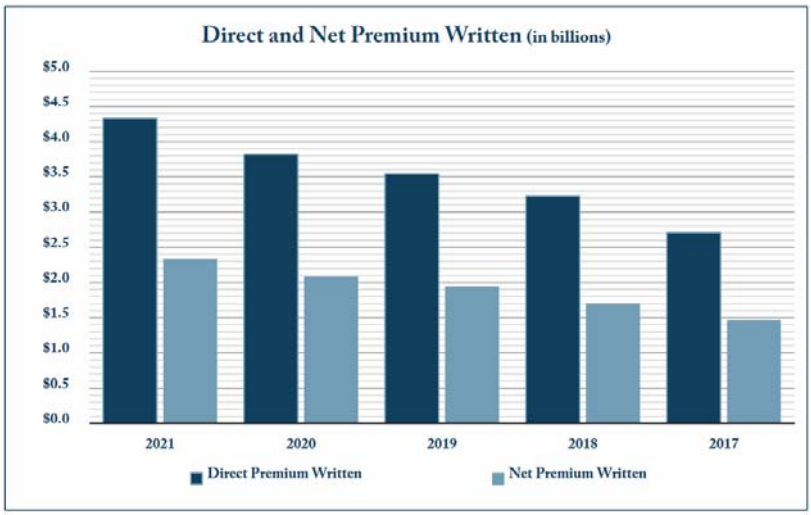


A combined ratio of less than 100 percent indicates an underwriting profit and a ratio of more than 100 percent indicates an underwriting loss.

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

Premium Written Analysis

RRGs collectively reported $4.3 billion of direct premium written for 2021, an increase of 13.4 percent over year-end 2020. RRGs retained 53.9 percent of this premium and reported $2.3 billion of net premium written for 2021, an increase of 12.1 percent over 2020.

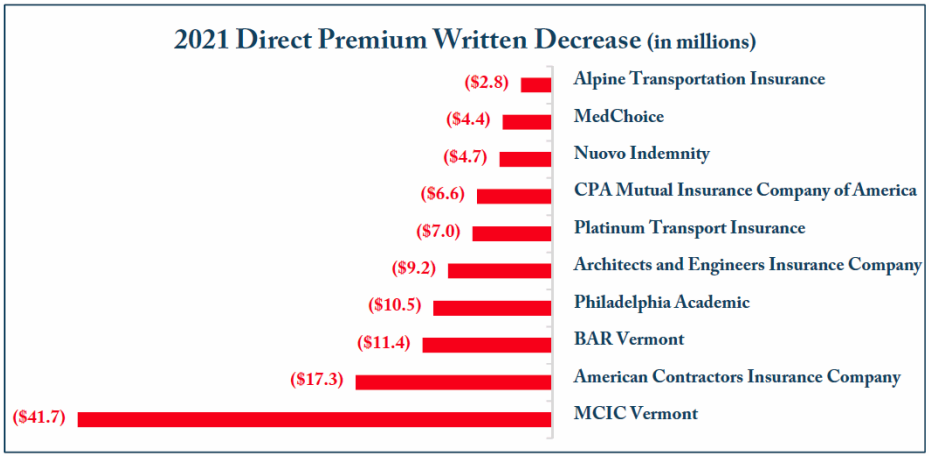


Emergency Capital Management (NAIC# 14163) reported an increase in year-over-year direct premium written of $86.5 million, the largest increase for the period. Emergency Capital Management re-entered the market in 2021 and has resumed writing business.

The direct premium written to policyholders' surplus ratio for RRGs collectively for 2021 was 68.4 percent.

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.

Conversely, MCIC Vermont (NAIC# 10697) reported a $41.7 million decrease in year-over-year direct premium written, the largest decrease for the period.



The net premium written to policyholders' surplus ratio for RRGs for 2021 was 36.9 percent.

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.

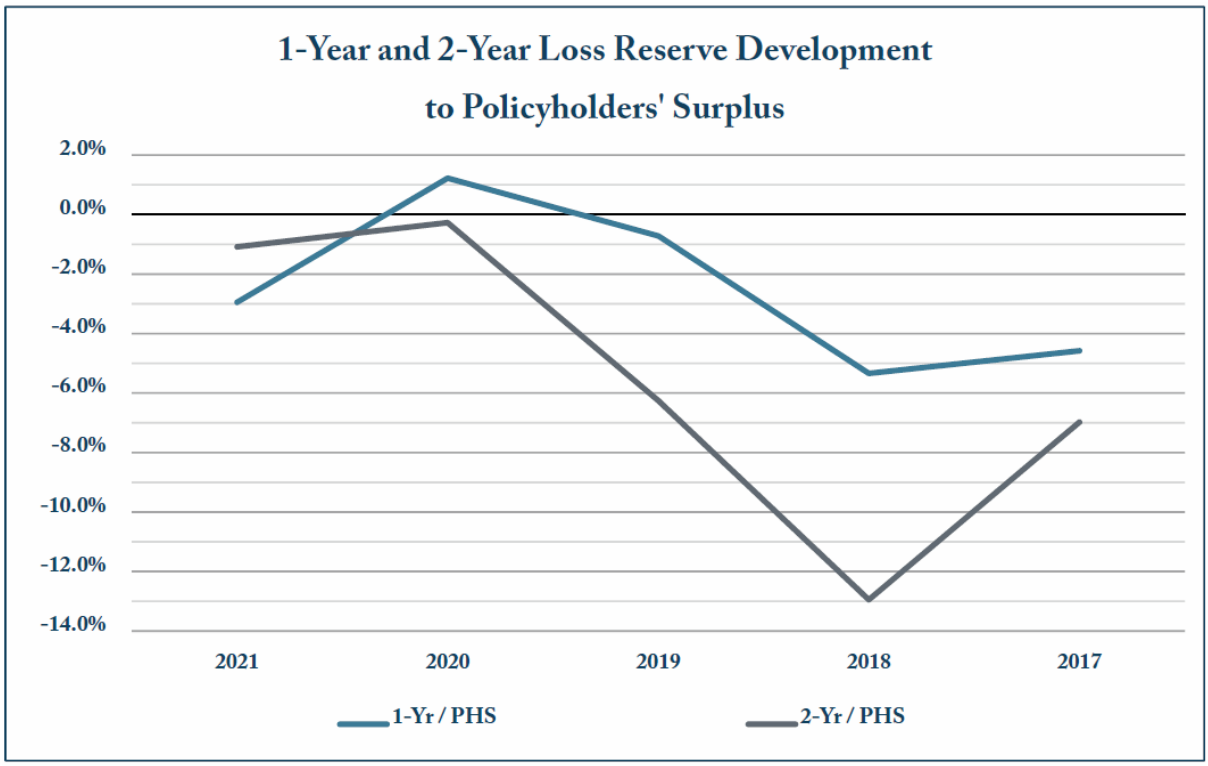
In certain cases, premium to surplus ratios in excess of those listed would be deemed appropriate if the RRG had demonstrated that a contributing factor to the higher ratio is relative improvement in rate adequacy.

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

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 favorable one-year and two-year loss reserve development at year-end 2021.

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 2021 was -2.9 percent. In 2021, 178 RRGs reported favorable or neutral one-year loss reserve development compared to 67 reporting adverse one-year loss reserve development.

The two-year loss reserve development to second prior year-end policyholders' surplus for 2021 was -1.1 percent. In 2021, 173 RRGs reported favorable or neutral two-year loss reserve development compared to 72 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 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.

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 and increasing policyholders' surplus year over year. 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.

Email your questions or comments to **dpowell@demotech.com**.

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