RRGs Report Nearly $287 Million Profit in 2017, Remain Financially Stable

By Douglas A Powell, Senior Financial Analyst, Demotech, Inc.

This article originally appeared in Demotech's "Analysis of Risk Retention Groups – Year End 2017

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 year-end 2016 to year-end 2017, cash and invested assets increased 4.5 percent and total admitted assets increased 4.9 percent. More importantly, over the last year, RRGs collectively increased policyholders' surplus 7.4 percent. The level of policyholders' surplus becomes increasingly important in times of difficult economic conditions by allowing an insurer to remain solvent when facing uncertain economic conditions. This increase

represents the addition of nearly $343 million to policyholders' surplus. During this same time period, liabilities have only increased 3.2 percent. These reported results indicate that RRGs remain adequately capitalized in aggregate and able to remain solvent if faced with adverse economic conditions or increased losses.

Liquidity, as measured by liabilities to cash and invested assets, for year-end 2017 was 64.7 percent. A value less 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. This also indicates a decrease for RRGs collectively as liquidity was reported at 66.5 percent at year-end 2016.

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 2017 was 138.2 percent and indicates a decrease compared to year-end 2016, as this ratio was 143.7 percent.

The loss and LAE reserves to policyholders' surplus ratio for year-end 2017 was 98.9 percent and indicates a decrease compared to year-end 2016, as this ratio was 104.3 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.

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 professional industries. RRGs collectively reported over $3.2 billion of direct premium written (DPW) through year-end 2017, an increase of 5.9 percent over 2016. RRGs reported nearly $1.8 billion of net premium written (NPW) through year-end 2017, an increase of less than 1 percent over 2016.

The DPW to policyholders' surplus ratio for RRGs collectively through year-end 2017 was 64 percent, down from 64.9 percent in 2016. The NPW to policyholders' surplus ratio for RRGs through year-end 2017 was 35.8 percent and indicates a decrease over 2016, as this ratio was 38.2 percent.

An insurer's DPW to surplus ratio is indicative of its policyholders' surplus leverage on a direct basis, without consideration for the effect of reinsurance. An insurer's NPW 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 DPW to surplus ratio in excess of 600 percent would subject an individual RRG to greater scrutiny during the financial review process. Likewise, a NPW 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 adequate loss reserves at year-end 2017 as exhibited by the one-year and two-year loss development results. The loss reserve development to policyholders' surplus ratio measures reserve deficiency or redundancy in relation to policyholder 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.

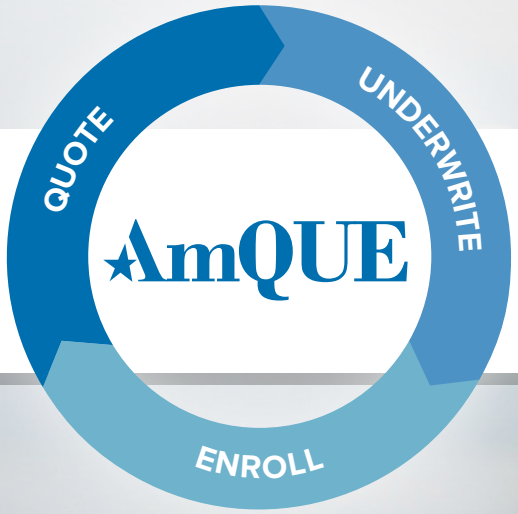
The one-year loss reserve development to prior year's policyholders' surplus for 2017 was -5.2 percent and was more favorable than 2016, when this ratio was reported at -2.4 percent. The two-year loss reserve development to second prior year-end policyholders' surplus for 2017 was -7.5 percent and was more favorable than 2016, when this ratio was reported at -6.9 percent. In regards to RRGs collectively, the both of these loss reserve development to prior year's policyholders' surplus ratios would be viewed as favorable.

Income Statement Analysis

In regards to underwriting results, RRGs collectively were profitable in 2017. RRGs reported an aggregate underwriting gain for 2017 of $46.6 million. RRGs also collectively reported a net investment gain of $299.5 million and net income of $286.9 million. Looking further back, RRGs have collectively reported an annual net income at each year-end since 1996.

The loss ratio for RRGs collectively, as measured by losses and loss adjustment expenses incurred to net premiums earned, through year-end 2017 was 73.3 percent,

AmQUE: DESIGNED FOR BROKERS, EMPLOYERS & EMPLOYEES



INTRODUCING AmQUE:

THE NEW, EXCLUSIVE TECHNOLOGY PLATFORM FOR HEALTHYADVANTAGE™

- Web based platform to quote, underwrite and enroll
- Broker and Employer Dashboards to measure enrollment campaigns
- Mobile app for employees to complete underwriting and enroll in benefits
- Electronic signature and submission of employer paperwork via DocuSign
- Aggressive compensation
- Attract and retain clients on one Enterprise System

GBS
Group Benefit Services

An AmWINS Group Company

Contact GBS today at sales@gbsio.net to find out more.

a decrease over 2016, as the loss ratio was 78.9 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 written, through year-end 2017 was 23.7 percent and indicates an increase compared to 2016, as the expense ratio was reported at 23.4 percent. This ratio measurers an insurer's operational efficiency in underwriting its book of business.

The combined ratio, loss ratio plus expense ratio, through year-end 2017 was 97 percent and indicates a decrease compared to 2016, as the combined ratio was reported at 102.4 percent. This ratio measures an insurer's overall underwriting profitability. A combined ratio of less than 100 percent typically indicates an underwriting profit.

Regarding RRGs collectively, the ratios pertaining to income statement analysis appear to be appropriate. Moreover, these ratios have remained within a profitable range.

Douglas A. Powell

Conclusions Based on 2017 Results

Despite political and economic uncertainty, RRGs remain financially stable and continue to provide 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. 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 is a Senior Financial Analyst at Demotech, Inc. Mr. Powell supports the formulation and assignment of Financial Stability Ratings® by providing analysis of statutory financial statements and business information. 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.

For more information about Demotech visit www.demotech.com.