American
Insurance
Association

MEDICAL LIABILITY REFORM

The current and ongoing difficulties in the medical malpractice insurance market – driven primarily by the excesses and unpredictability of the tort system – underscore the need for medical liability reform at the state and federal levels.

Key Facts About the Current Medical Malpractice Market

- Market Conditions: Deteriorating financial conditions for insurers in the medical malpractice insurance market are real. The NAIC reported a combined ratio for medical malpractice of 104.8% in 1997 (claim losses and expenses equal 104.8% of premium), but a combined ratio of 155.5% in 2001. Results in 2002 improved modestly with a combined ratio of 141.6%.

- While many p&c lines experienced poor results in 2001, the med mal line produced the highest combined ratio of any property/casualty industry segment that year.

- A Key Underlying Force -- The Tort Liability System: One of the chief underlying forces driving current problems is the tort liability system, where the potential for extremely large verdicts and settlements is highly unpredictable.

    - Mega claims, involving payments of $1 million or more, are having a dramatic impact on medical malpractice claims experience. One recent survey of claims found that the percentage of claims with payments of $1 million or more increased from less than one percent (.64%) in 1995 to almost 5% in 1998, a relative increase of over 600% (Source: Physician Insurance Association of America Claim Trend Analysis).
    - Number of Claims: The number of malpractice payments countrywide reported to the National Practitioner Data Bank increased 12.7% between 1997 and 2001.
        - Nearly one-half (6.2%) of this increase, however, occurred in the last year (2000-2001), suggesting that the frequency of claims may be increasing at a higher rate.
        - It also is important to note that certain individual states experienced extraordinary increases in the number of malpractice payments, including several with increases ranging between 50%-100%. (Source: National Practitioner Data Bank, 2001 Annual Report).
    - Average & Median Medical Malpractice Payments (claim severity): The countrywide average medical malpractice payment reported to the National Practitioner Data Bank increased 46%, from $185,700 to $271,000 from 1997-2001. The median payment increased 80%, from $75,000 to $135,000 (Source: National Practitioner Data Bank, Annual Reports, 1996, 2000).
    - Claim losses are the primary factor driving medical malpractice premium increases, according to a recently released study of the med mal market by the General Accounting Office. (Source: General Accounting Office, *GAO-03-702 Medical Malpractice Insurance*, June 2003).

- States Where There Are Difficulties: The American Medical Association has identified the following 19 states as having med mal affordability/availability problems: Arizona, Connecticut, Florida, Georgia, Illinois, Kentucky, Mississippi, Missouri, Nevada, New Jersey, New York, North Carolina ,Ohio, Oregon, Pennsylvania, Texas, Washington, West Virginia and Wyoming. The report also listed 30 additional states experiencing early signs of problems.

Key Facts About Medical Malpractice Rates and Antitrust Law

- Medical malpractice rates are regulated by the states. As with other lines of business, state regulators are required by law to turn down rates that are excessive, inadequate or unfairly discriminatory.

- The McCarran-Ferguson Act is the federal charter for state regulation of insurance. As part of this federal charter, McCarran provides an exclusion from federal antitrust laws for states that regulate insurance rates, where the state has final authority over the price of medical malpractice insurance. If a state doesn't regulate insurance rates, there is no federal antitrust exemption under McCarran for them. A similar antitrust principle applies for all other state regulated industries; this principle is called the "state action" doctrine.

- Therefore, as medical malpractice insurance rates are ultimately governed by state regulators, not private insurers, it would be a wholly irrelevant act to repeal McCarran antitrust provisions as a price reduction measure. This is true because repealing McCarran would not change, in any way, the underlying costs of medical malpractice claims that premiums must cover. As stated above, the McCarran-Ferguson Act only applies to medical malpractice insurance rates because those rates are state regulated.

- As a legal requirement, insurance rates for medical malpractice insurance – as for other lines of insurance – are based on estimates of future losses (derived both from data about the particular policyholder and about the general risk environment), and future investment income. Insurance companies are expressly prohibited by law from attempting to recoup prior losses through future rates. Any unanticipated losses must be paid from the company's own capital. In other words, policyholders do not pay for any past losses in current premiums.

Key Facts About Insurance Solvency and Investment Practices

- Insurer solvency is heavily regulated. The primary function of state insurance regulators should be to make sure that insurance companies are solvent in order to pay claims to the policyholders. Insurer investments also are heavily regulated and must be reported to state regulators at least once a year.

- Medical liability insurers are very conservative investors, as required by state law. In 2001, stock market investments comprised just 9% of the portfolios of the entire medical liability insurance industry. This percentage has stayed relatively constant regardless of market

conditions. (Source: Brown Brothers Harriman*, Did Investments Affect Medical Malpractice Premiums?,*1/21/03)

- Most investment assets are in bonds, usually a combination of U.S. Treasury, municipal and corporate bonds. In 2001, the 15 largest med mal writers invested an average of 79% of their investment assets in bonds. (Source: General Accounting Office, *GAO-03-702 Medical Malpractice Insurance*, June 2003).

- In 2001, the return on stock market investments for the medical liability industry matched that of the S&P 500 – an indication that the industry's equity investments are no riskier than the market as a whole. (Source: Brown Brothers Harriman, 1/21/03)

- Since 1997, average investment returns of the 15 largest med mal insurers have fallen from 5.6 percent to 4 percent in 2002. (Source: General Accounting Office, June 2003)

- Critics have charged that the cause of the current problems in the medical malpractice insurance market is tied to insurers' losses in the stock market. That criticism ignores the realities of insurance pricing. In the first half of the 1990's med mal insurers were able to sell their product for less than the actual price of the product, due to positive investment results, and policyholders were the beneficiaries.

- It's disingenuous for critics to turn around now and blame insurers for the upward pressure on malpractice premiums due to falling investment gains. In any event, increasing claims costs have played a much more significant role in driving ultimate insurance results and premium rate increases than falling investment gains.

- Much of the medical malpractice coverage (more than 60 percent of physicians) is written by physician-owned mutual insurers. The idea that those companies would price gouge the very physicians who own them is preposterous.

The Solution: Medical Liability Reform

- <u>Support for Reforms</u>: AIA supports medical malpractice tort reform. Comprehensive reform will bring fairness and predictability back to the medical liability system.

- Reform proposals include:
    - Limits on non-economic damages
    - Offsets for reimbursements from collateral sources
    - Abolishment of joint liability
    - Pretrial screening panels
    - Shortened statutes of limitations
    - Periodic payments of future damages
    - Limits on punitive damages
    - Stricter rules on expert witness testimony
    - Controls on attorney fees

- Positive Examples: California's MICRA (Medical Injury Compensation Reform Act), enacted in 1975, is a key example of comprehensive reform. MICRA's positive impact has been significant.

    - For example, National Practitioner Data Bank reports show that for 2000, the average malpractice payment in California was only 57% of the average payment countrywide.
    - Since MICRA was enacted in 1975, medical liability premiums in California have increased 168% versus an increase of 420% countrywide.
    - MICRA was also a significant basis for HR 5, the federal medical liability reform bill now pending in Congress. AIA joined nearly 50 other organizations in urging the US Congress to enact H.R. 5 to help stabilize the current medical liability system. While H.R. 5 passed the House of Representatives in March 2003; a companion Senate bill, S. 11, was not voted on by the Senate during 2003.
    - Critics charge that Proposition 103 (insurance reforms passed by voters in 1988 targeted primarily at auto insurers), not MICRA, is responsible for keeping malpractice liability premiums in California lower than in other states. Such claims are not correct: med mal rates stabilized after MICRA's passage in 1975 and dropped significantly once the state Supreme Court ruled the law constitutional in 1985. Prop 103 did not take effect until 1989, after rates had begun to stabilize. (Source: Californians Allied for Patient Protection, Prop. 103 Myths)

- The Importance of Caps. Adopting a $250,000 cap on non-economic damages is the single most important step legislators can take to improve the insurance environment in their states. Similar conclusions have been reached by the Joint Economic Committee of Congress, the Congressional Budget Office, and the U.S. Department of Health and Human Service. Recent studies have found that caps have a positive impact in the areas of claim costs, rates, and physician supply.

    - Claim costs are lower in states that have enacted caps on non-economic damages. An analysis of med mal claims in the 15 largest states from late 1990 to early 2001 shows that the large states with caps on non-economic damages (California, Colorado, Indiana and Maryland) have below-average loss costs per physician. Large states without caps (including Florida, Illinois, New Jersey, New York and Pennsylvania) have the highest med mal loss costs. (Milliman USA, April 2003)
    - Over the last two years, states with limits of $250,000 or $350,000 on non-economic damages have seen average combined highest premium increases of 18%, but states without such limits on non-economic damages have seen average increases of 45%,(U.S. Office of Health and Human Services, *Addressing the New Health Care Crisis: Reforming the Medical Litigation System to Improve the Quality of Healthcare*, March 2003)
    - And a recently released study by the GAO reveals that premium growth and claims payments have been slower in states that have enacted certain caps on damages for pain and suffering…than in states with more limited reforms. (Source: General Accounting Office, *GAO-030836 Medical Malpractice – Implications of Rising Premiums on Access to Health Care*, August 2003.)

  - States with caps on damages also typically have more physicians per capita. A study by HHS revealed that states with caps on non-economic damages experienced about 12 percent more physicians per capita than states without such a cap. (U.S. Office of Health and Human Services, Agency for Healthcare Research and Quality, *The Impact of State Laws Limiting Malpractice Awards on the Geographic Distribution of Physicians,* July 2003).

- A review of academic studies on the effect of tort reform on medical malpractice system costs was done by the Office of Technology Assessment (OTA, an arm of the U.S. Congress). OTA concluded that caps on non-economic damages and offsets for collateral sources of reimbursement have the clearest and greatest positive effect on medical malpractice system costs. (U.S. Congress, Office of Technology Assessment, *Impact of Legal Reforms on Medical Malpractice Costs*, September 1993).

- Other possible solutions: Some have suggested that the answer to current problems is to implement joint underwriting authorities (JUAs). But the establishment of a JUA does not alleviate the underlying conditions that are creating the problem. It makes more sense to focus on the areas that present problems and to respond directly to those concerns. That's why AIA calls for medical malpractice liability reform.

More about the Medical Malpractice Market

- Medical malpractice, or medical liability, is a small, specialty line in terms of premium volume, with a relatively small number of companies writing coverage for physicians and/or healthcare facilities.
- In 2001 medical malpractice direct written premiums totaled $7.3 billion; by comparison homeowners premiums were $37 billion; workers' compensation $38 billion; total auto $154 billion (Source: A.M. Best).
- Medical liability premiums comprise 2.1% of total property & casualty industry premiums (Source: A.M. Best).
- More than half of physicians receive their coverage through a physician owned mutual.
- In 23 states the largest writer is a physician-owned mutual.
- For multi-line companies that write med mal, the line comprises less than 5% of total company premiums (Source: A.M. Best).

For more information, contact Julie Pulliam at jpulliam@se.aiadc.org or (404) 261-8834, or visit AIA's Website at www.aiadc.org.

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