



Medical Malpractice Insurance: Stable Losses/Unstable Rates in Virginia

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Introduction and Summary of Findings

Americans for Insurance Reform (AIR) is a coalition of over 100 consumer groups from around the country, including Virginia-based Citizens' Committee to Protect the Elderly and Safetyforum.com.

For the first time, AIR has produced a comprehensive study of medical malpractice insurance in the state of Virginia, examining specifically how much insurers have taken in and how much they've paid out over the last 30 years. AIR examined everything that medical malpractice insurers have paid in jury awards, settlements and other costs over the last three decades, and compared these actual costs with the premiums that insurers have charged doctors. This study makes three major findings:

- First, the amount that medical malpractice insurers have paid out per doctor, including all jury awards and settlements, tracks the rate of medical inflation. Not only has there been no "explosion" in medical malpractice payouts, but payments (in constant dollars) have been extremely stable and flat since the mid-1980s.
- Second, medical insurance premiums charged by insurance companies do not correspond to increases or decreases in payouts. Rather, premiums rise and fall in concert with the state of the economy – insurance premiums (in constant dollars) increase or decrease in direct relationship to the strength or weakness of the economy, reflecting the gains or losses experienced by the insurance industry's market investments and their perception of how much they can earn on the investment "float" (which occurs during the time between when premiums are paid into the insurer and losses paid out by the insurer) that doctors' premiums provide them.
- Third, contrary to what the insurance and medical lobbies have alleged, over the last two years (2000 to 2002), there was no jump in medical malpractice insurer payouts or costs to justify sudden rate hikes. In fact, rather than exploding, inflation-adjusted payouts per doctor dropped over each of the last two years.

Background

Virginia's insurance industry is advancing a legislative agenda to limit liability for doctors, hospitals, HMOs, nursing homes and drug companies that cause injury. State and federal lawmakers and regulators (and the general public) are being told by insurance and medical lobbyists that doctors' insurance rates are rising due to increasing claims by patients, rising jury verdicts and exploding tort system costs in general.

The insurance industry argues and, worse, convinces doctors to believe that patients who file medical malpractice lawsuits are being awarded more and more money, leading to unbearably high losses for insurers. Insurers state that to recoup money paid to patients, medical malpractice insurers are being forced to raise insurance rates or, in some cases, pull out of the market altogether.

Since insurers say that jury verdicts are the cause for the current "crisis" in affordable malpractice insurance for doctors, the insurance industry insists that the only way to bring down insurance rates is to limit an injured consumer's ability to sue in court.

Insurance rates for doctors have skyrocketed twice before: in the mid-1970s and in the mid-1980s, each "crisis" occurring during years of a weakened economy and dropping interest rates. Each of these periods was followed by a wave of legislative activity to restrict injured patients' rights to sue for medical malpractice. Insurance and medical lobbyists told legislators that changes in tort law were needed to reduce medical malpractice insurance rates.

However, history shows that the insurance industry has not cut, and has no plans to cut, insurance premiums as a consequence of tort restrictions. The American Insurance Association (AIA) and representatives of the American Tort Reform Association (ATRA) have already gone on record admitting this, with the AIA stating on March 13, 2002, "[T]he insurance industry never promised that tort reform would achieve specific premium savings."

The Center for Justice & Democracy's 1999 study, *Premium Deceit – the Failure of "Tort Reform" to Cut Insurance Prices*, found that tort law limits enacted since the mid-1980s have not lowered insurance rates in the ensuing years. Some states that resisted enacting any "tort reform" experienced low increases in insurance rates or loss costs relative to the national trends, and some states that enacted major "tort reform" packages saw very high rate or loss cost increases relative to the national trends. In other words, there was no correlation between "tort reform" and insurance rates.

More recently, Weiss Ratings, an independent insurance-rating agency, found that between 1991 and 2002, states with caps on noneconomic damage awards saw median doctors' malpractice insurance premiums rise 48 percent -- *a greater increase than in states without caps*. In states without caps, median premiums increased only 36 percent. Moreover, according to Weiss, "median 2002 premiums were about the same" whether or not a state capped damage awards.

In June 2003, the Texas legislature passed a cap on medical malpractice compensation for injured patients. In September 2003, with heavy funding from the insurance industry and other major corporations, Texans narrowly approved a referendum (51 to 49 percent) to

constitutionally allow such caps on compensation for victims of medical malpractice and other wrongdoing. During the campaign, insurers' ads promised medical malpractice insurance rate cuts if caps were passed. But, soon after the votes were cast, major insurers requested rate hikes as high as 35 percent for doctors and 65 percent for hospitals.¹

In Florida, "when Gov. Jeb Bush and House Speaker Johnnie Byrd pushed through a sweeping medical malpractice overhaul bill last August, the two Republican leaders vowed in a joint statement that the bill would 'reduce ever-increasing insurance premiums for Florida's physicians . . . and increase physicians' access to affordable insurance coverage.'" But, insurers soon followed up with requests to increase premiums by as much as 45%.²

In 2003, Oklahoma passed a "tort reform" bill that included a severe cap on compensation available to certain medical malpractice victims. The insurance company owned by the state medical association, which insures "practically all of the state's physicians," then requested an astounding 83 percent rate hike (which was approved on the condition it be phased in over three years).³

In January 2003, Ohio lawmakers enacted a cap on compensation for patients injured by medical malpractice. Almost immediately, all five major medical malpractice insurance companies in Ohio announced they would not reduce their rates. One insurance executive predicted his company would seek a 20 percent rate increase.⁴

In Mississippi, lawmakers enacted a cap on medical malpractice verdicts in October 2002. Four months later, investigative news articles reported that surgeons still could not find affordable insurance and that many Mississippi doctors were still limiting their practice or walking off the job in protest.⁵

Nevada also enacted a severe cap on compensation in 2002. Within weeks of the law's enactment, two major insurance companies proclaimed that they would not reduce insurance rates for at least another year to two, if ever. The Doctor's Company, a nationwide medical

¹ See, e.g., Darrin Schlegel, "Some Malpractice Rates to Rise Despite Prop. 12," *Houston Chronicle*, Nov. 19, 2003; Darrin Schlegel, "Malpractice Insurer Fails in Bid for Rate Hike," *Houston Chronicle*, Nov. 21, 2003.

² See, e.g., Julie Kay, "Medical Malpractice; Despite Legislation that Promised to Rein in Physicians' Insurance Premiums, Three Firms File for Big Rate Increases," *Palm Beach Daily Business Review*, Nov. 20, 2003.

³ See, e.g., "Oklahoma's Largest Medical-Liability Company Gets 83% Rate Increase Over Three Years," *BestWire*, Dec. 2, 2003.

⁴ Laura A. Bischoff, "Taft Signs Malpractice Reform Bill; Cap on awards for pain and suffering," *Dayton Daily News*, Jan. 11, 2003; Andrew Welsh-Huggins, "Doctors pushing for short-term relief from malpractice rates," *Associated Press*, Jan. 10, 2003; "Despite new law, insurance companies won't lower rates right away," *Associated Press*, Jan. 9, 2003; Spencer Hunt, "Docs look for insurance cure," *Cincinnati Enquirer*, Nov. 26, 2002.

⁵ "Miss. Tort Reform Effort Falls Short," *Commercial Appeal*, Feb. 18, 2003; Reed Branson, "Doctors In Oxford Shut, Cite Insurance," *Commercial Appeal*, Feb. 14, 2003; Ben Bryant, "Tort reform has done little to ease malpractice crisis," *Biloxi Sun-Herald*, Feb. 2, 2003; Emily Wagster Pettus, "Insurance Woes Causing Headaches For Miss. – Va. Insurer's Takeover Adds To Uncertainty," *Commercial Appeal*, Jan. 30, 2003; Julie Goodman, "Uninsured doctors up 1 percent," *Clarion-Ledger*, Jan. 9, 2003; Julie Goodman and Patrice Sawyer "Governor signs medical tort reform bill," *Clarion-Ledger*, Oct. 9, 2002; Jerry Mitchell, "Malpractice plan unveiled," *Clarion-Leader*, Aug. 29, 2002.

malpractice insurer, then filed for a 16.9 percent rate increase. Two other companies filed for 25 percent and 93 percent rate increases.⁶

The “liability insurance crises” of the mid-1970s and mid-1980s were ultimately found to be caused not by legal system excesses but by the economic cycle of the insurance industry. The reason, of course, is that “tort reform” is based on an untrue premise: that the legal system, rather than the underwriting practices of the insurance industry, is responsible for gyrations in the cost and availability of insurance. Just as these earlier liability insurance crises were found to be driven by this cycle and not a tort law cost explosion as many insurance companies and others had claimed, the “tort reform” remedy pushed by these advocates failed.

As this study confirms, it will fail again.

The 2003 Study

AIR, under the direction of actuary J. Robert Hunter (Director of Insurance for the Consumer Federation of America, and former Federal Insurance Administrator and Texas Insurance Commissioner), has produced a comprehensive study of medical malpractice insurance, examining specifically what insurers have taken in and what they’ve paid out, in constant dollars, over the last 30 years through 2002. AIR examined everything that medical malpractice insurers have paid in jury awards, settlements and other costs over the last three decades, and compared these actual costs with the premiums that insurers have charged doctors, as well as with the economic cycle of the insurance industry.

This AIR study explores whether or not there is, as the insurance industry claims, an explosion in lawsuits, jury awards or tort system costs justifying an increase in insurance premium rates, or whether premium increases simply reflect the economic cycle of the insurance industry, driven by interest rates and investments.

The Insurance Industry’s Economic Cycle

Insurers make most of their profits from investment income. During years of high interest rates and/or excellent insurer profits, insurance companies engage in fierce competition for premium dollars to invest for maximum return. Insurers severely underprice their policies and insure very poor risks just to get premium dollars to invest. This is known as the “soft” insurance market.

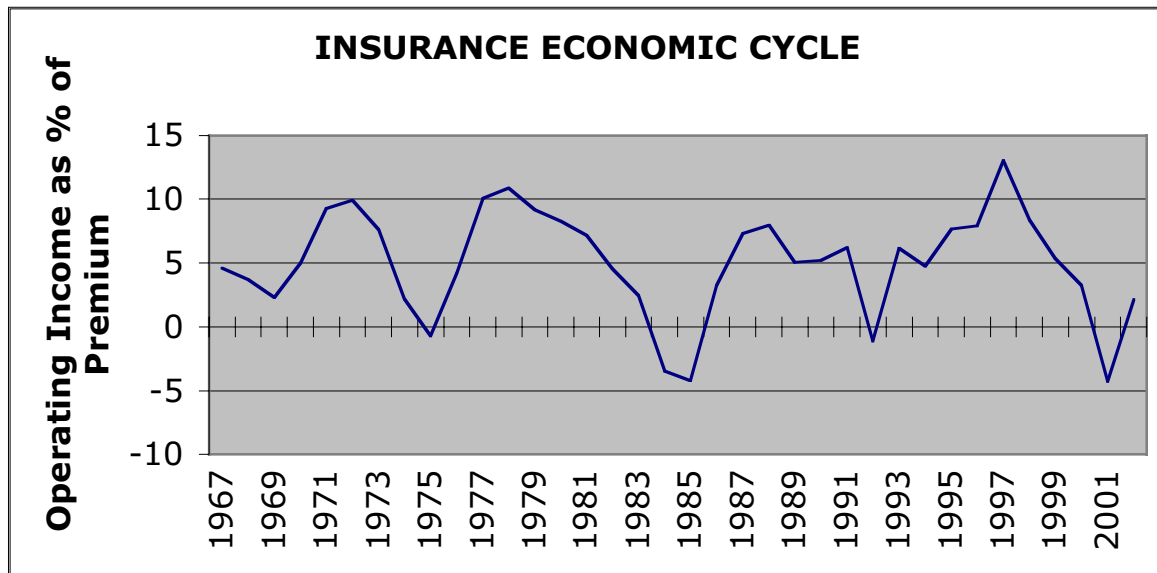
But when investment income decreases – because interest rates drop or the stock market plummets or the cumulative price cuts make profits become unbearably low – the industry responds by sharply increasing premiums and reducing coverage, creating a “hard” insurance market usually degenerating into a “liability insurance crisis.”

⁶ Joelle Babula, “Medical liability company requests premium increase,” *Las Vegas Review-Journal*, Feb. 11, 2003; Joelle Babula, “Medical Liability Laws: Doctors remain unsatisfied,” *Las Vegas Review-Journal*, Jan. 27, 2003; “Deliveries In Limbo: Women search for care,” *Las Vegas Review-Journal*, Jan. 10, 2003; Lawrence Messina, “Wise mulls trauma care solutions amid Nevada reports,” Associated Press, Oct. 7, 2003; Joelle Babula, “Obstetricians say problems remain,” *Las Vegas Review-Journal*, Oct. 1, 2002; Joelle Babula, “State insurance program holds off on lowering rates,” *Las Vegas Review-Journal*, Aug. 14, 2002; Joelle Babula, “Medical Malpractice: Insurer has no plans to lower costs,” *Las Vegas Review-Journal*, Aug. 10, 2002.

A hard insurance market happened in the mid-1970s, precipitating rate hikes and coverage cutbacks, particularly with medical malpractice insurance and product liability insurance. A more severe crisis took place in the mid-1980s, when most liability insurance was impacted. Again, since late 2000-early 2001, the country has experienced a “hard market,” this time impacting property as well as liability coverages with some lines of insurance seeing rates going up 100% or more.

The following Exhibit shows the national cycle at work, with premiums stabilizing for 15 years following the mid-1980s crisis. (The 1992 data point was not a classic cycle bottom, but reflected the impact of Hurricane Andrew and other catastrophes in that year.)

Exhibit 1. The Insurance Cycle



Prior to late 2000, the industry had been in a soft market since the mid-1980s. The strong financial markets of the 1990s had expanded the usual six- to ten-year economic cycle. No matter how much they cut their rates, the insurers wound up with a great profit year when investing the float on the premium in this amazing stock and bond market. (The “float” occurs during the time between when premiums are paid into the insurer and losses paid out by the insurer – e.g., there is about a 15 month lag in auto insurance and a 5 to 10 year lag in medical malpractice.) Further, interest rates were relatively high in recent years as the Fed focused on inflation.

But in 2000, the market started to turn with a vengeance and the Fed cut interest rates again and again. This took place well before September 11th. The terrorist attacks sped up the price increases, collapsing two years of anticipated increases into a few months and leading to what some seasoned industry analysts see as gouging.⁷ However, the increases we are witnessing are

⁷ “[T]here is clearly an opportunity now for companies to price gouge – and it’s happening.... But I think companies are overreacting, because they see a window in which they can do it.” Jeanne Hollister, consulting actuary, Tillinghast-Towers Perrin, quoted in, “Avoid Price Gouging, Consultant Warns,” *National Underwriter*, January 14, 2002.

mostly due to the cycle turn, not the terrorist attack or any other cause. This is a classic economic cycle bottom.

Smoking Guns

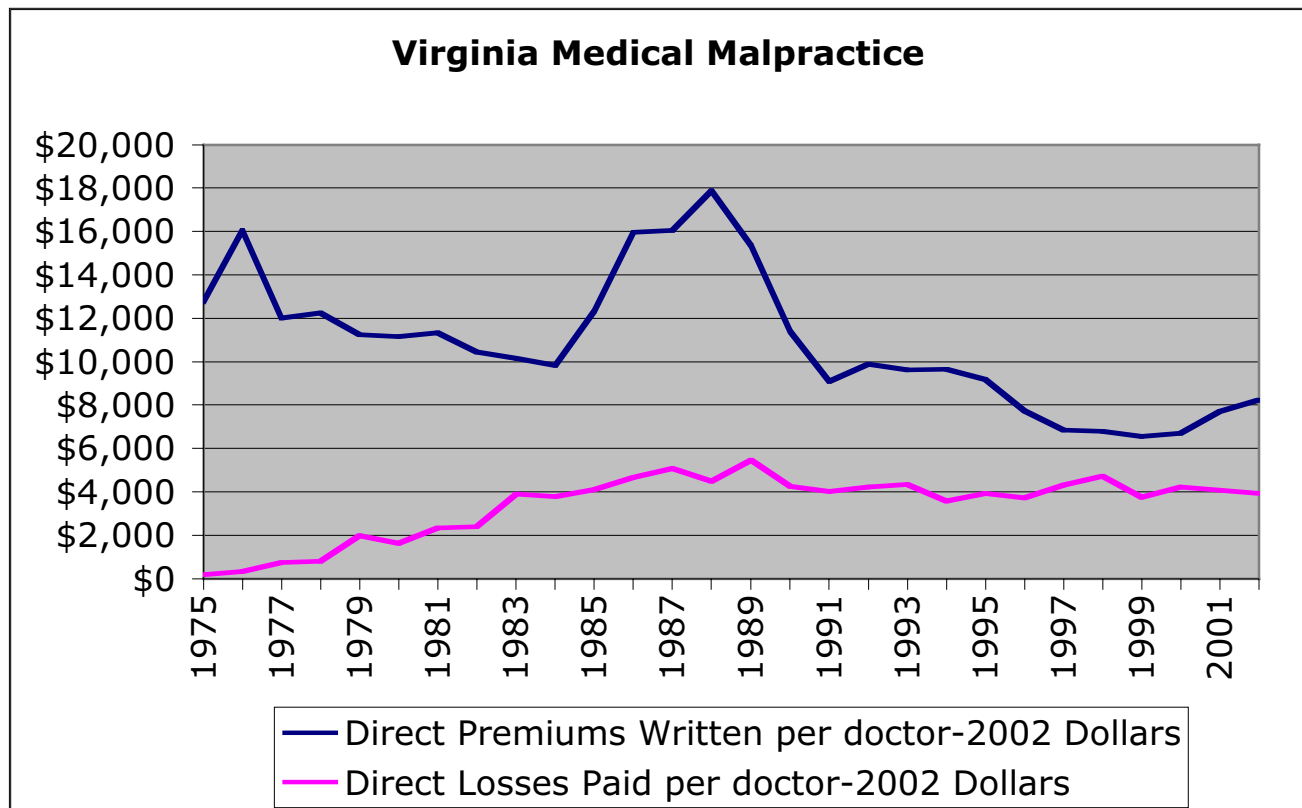
AIR tested two hypotheses advanced by the insurance industry: First, if large jury verdicts in medical malpractice cases or any other tort system costs are having a significant impact on the overall costs for insurers' and are therefore the reason behind skyrocketing insurance rates, then losses per doctor should be rising faster than medical inflation over time. Second, if lawsuits or other tort costs are the cause of rate increases for doctors -- rather than decreasing interest rates and other economic factors -- those losses should be reflected in rate increases in line with such losses, not in ups and downs that instead reflect the state of the economy, the well-documented insurance economic cycle (Exhibit 1), interest rates, the stock market or the level of insurers' investment income.

AIR finds both hypotheses are completely false, demonstrated by Exhibits 2 and 3 below. First, these charts show that for decades, medical malpractice paid claims per doctor have tracked medical inflation very closely (higher than inflation from the late 1970s until 1983 and flat since). In other words, since 1983, payouts have risen almost precisely in sync with medical inflation. Moreover, contrary to what the insurance and medical lobbies have alleged, the last few years saw no "explosion" in medical malpractice insurer payouts or costs to justify sudden rate hikes. In fact, rather than exploding, inflation-adjusted payouts per doctor *dropped* during each of the last two years. These data confirm that neither jury verdicts nor any other factor affecting total claims paid by insurance companies that write medical malpractice insurance have had much impact on the system's overall costs over time.

Second, while payouts closely track medical inflation, medical malpractice premiums are quite another thing. They do not track costs or payouts in any direct way. Since 1975, the data show that in constant dollars, per doctor written premiums – the amount of premiums that doctors have paid to insurers – have gyrated almost precisely with the insurer's economic cycle, which is driven by such factors as changing interest rates and insurers' mismanaged business and accounting practices, not by lawsuits, jury awards, the tort system or other causes. Moreover, medical malpractice insurance premiums rose much faster over the last two years than was justified by the falling insurance payouts. This hike is similar to the rates hikes of the past, which occurred in the mid-1980s and mid-1970s and were not connected to actual payouts.

In sum, the results of AIR's analysis illustrated in Exhibits 2 and 3 are startling; premiums rise and fall with the insurance industry's economic cycle, as illustrated in Exhibit 1, but losses paid do not.

Exhibit 2



Sources:

A.M. Best and Co. special data compilation for AIR, reporting data for as many years as separately available; U.S. Bureau of the Census.⁸ See Exhibit 3 for underlying data.

Definitions:

- **“Direct Premiums Written”** is the amount of money that insurers collected in premiums from doctors during that year.
- **“Direct Losses Paid”** is what insurers actually paid out that year to people who were injured – all claims, jury awards and settlements – plus what insurance companies paid their own lawyers to fight claims.⁹

⁸ We calculate the paid losses on a per doctor basis to remove from the trend we are studying the effect of the ever increasing number of doctors in America. We acknowledge that the number of doctors includes a certain number of doctors that are retired or otherwise not in the medical malpractice system, but since we are interested in overall loss trends over time, and since the percentage of doctors in that category should not vary much year to year, this fact should not significantly impact our results.

⁹ “Paid losses” are a far more accurate reflection of actual insurer payouts than what insurance companies call “incurred losses.” Incurred losses are not actual payouts. They include payouts but also reserves for possible future claims – e.g., insurers’ estimates of claims that they do not even know about yet. While incurred losses do exhibit more of a cyclical pattern, observers know that this is because in hard markets, as we are currently experiencing, insurers will increase reserves as a way to justify price increases. In fact, the current insurance “crisis” rests significantly on a jump in loss reserves in 2001. Historically, reserves have been later “released” to profits during the “softer” market years. For example, according to a June 24, 2002, *Wall Street Journal* front page investigative

Exhibit 3

Year	Written Premiums	Paid Losses	Number of Doctors	Medical Care Inflation (CPI-U)	Direct Premiums Written per doctor	Direct Losses Paid per doctor	Direct Premiums Written per doctor-2002 Dollars	Direct Losses Paid per doctor-2002 Dollars
1975	15,099,744	237,220	7183	47.3	\$2,102.15	\$33.03	\$12,737.34	\$200.11
1976	22,241,924	428,886	7682	51.7	\$2,895.33	\$55.83	\$16,050.32	\$309.49
1977	19,454,882	1,190,355	8183	56.8	\$2,377.48	\$145.47	\$11,996.21	\$733.99
1978	22,711,996	1,490,323	8682	61.3	\$2,615.99	\$171.66	\$12,230.70	\$802.56
1979	24,087,214	4,277,186	9182	66.9	\$2,623.31	\$465.82	\$11,238.27	\$1,995.59
1980	28,075,406	4,066,158	9682	74.5	\$2,899.75	\$419.97	\$11,155.29	\$1,615.62
1981	32,791,827	6,742,420	10121	82.1	\$3,239.98	\$666.18	\$11,310.33	\$2,325.55
1982	35,270,362	8,143,610	10559	91.9	\$3,340.31	\$771.25	\$10,417.12	\$2,405.22
1983	38,965,640	15,005,430	10998	100.1	\$3,542.98	\$1,364.38	\$10,144.02	\$3,906.40
1984	41,625,654	15,975,656	11436	106.4	\$3,639.88	\$1,396.96	\$9,804.41	\$3,762.87
1985	57,846,294	19,178,690	11875	113.1	\$4,871.27	\$1,615.05	\$12,343.99	\$4,092.60
1986	83,097,270	24,136,989	12259	121.6	\$6,778.47	\$1,968.92	\$15,976.23	\$4,640.56
1987	91,907,460	29,074,296	12643	129.9	\$7,269.43	\$2,299.64	\$16,038.64	\$5,073.72
1988	112,375,243	28,227,369	13027	138.2	\$8,626.33	\$2,166.84	\$17,889.34	\$4,493.60
1989	106,398,335	37,891,155	13411	148.5	\$7,933.66	\$2,825.38	\$15,311.70	\$5,452.89
1990	88,689,557	33,057,021	13795	161.9	\$6,429.11	\$2,396.30	\$11,380.99	\$4,242.01
1991	80,024,200	35,146,400	14308	176.2	\$5,592.97	\$2,456.42	\$9,097.30	\$3,995.51
1992	96,898,294	41,424,855	14822	189.4	\$6,537.46	\$2,794.82	\$9,892.49	\$4,229.12
1993	103,509,760	46,484,898	15335	201.1	\$6,749.90	\$3,031.29	\$9,619.70	\$4,320.08
1994	112,256,108	41,501,314	15849	210.4	\$7,082.85	\$2,618.54	\$9,648.03	\$3,566.90
1995	115,154,057	49,406,496	16362	219.8	\$7,037.90	\$3,019.59	\$9,176.80	\$3,937.28
1996	103,512,029	49,815,574	16870	227.8	\$6,135.86	\$2,952.91	\$7,719.66	\$3,715.12
1997	97,598,944	61,416,372	17407	234.4	\$5,606.88	\$3,528.26	\$6,855.51	\$4,313.99
1998	103,239,828	71,962,137	18023	242.0	\$5,728.23	\$3,992.79	\$6,783.92	\$4,728.66
1999	106,394,935	60,393,561	18504	251.1	\$5,749.83	\$3,263.81	\$6,562.73	\$3,725.24
2000	117,780,502	74,134,617	19255	261.4	\$6,116.88	\$3,850.15	\$6,706.57	\$4,221.32
2001	145,355,426	76,883,760	19814	273.1	\$7,336.00	\$3,880.27	\$7,698.63	\$4,072.09
2002	167,730,316	80,039,635	20373	286.6	\$8,232.97	\$3,928.71	\$8,232.97	\$3,928.71

Conclusion

Stable Losses/Unstable Rates in Virginia analyzes what medical malpractice insurers have taken in and what they've paid out over the last 30 years, including jury awards, settlements and other

article, St. Paul, which until 2001 had 20 percent of the national med mal market, pulled out of the market after mismanaging its reserves. The company set aside too much money in reserves to cover malpractice claims in the 1980s, so it "released" \$1.1 billion in reserves, which flowed through its income statements and appeared as profits. Seeing these profits, many new, smaller carriers came into the market. Everyone started slashing prices to attract customers. From 1995 to 2000, rates fell so low that they became inadequate to cover malpractice claims. Many companies collapsed as a result. St. Paul eventually pulled out, creating huge supply and demand problems for doctors in many states. Christopher Oster and Rachel Zimmerman, "Insurers' Missteps Helped Provoke Malpractice 'Crisis,'" *Wall Street Journal*, June 24, 2002.

costs. Its findings are startling. While insurer payouts track the rate of medical inflation, medical insurance premiums do not. Rather, they rise and fall in relationship to the state of the economy. Not only has there been no “explosion” in lawsuits, jury awards or any tort system costs at any time during the last three decades, but the astronomical premium increases that some doctors have been charged during periodic insurance “crises” over this time period are in exact sync with the economic cycle of the insurance industry, driven by interest rates and investments. In the last few years, rates have been spiking, but payouts have stayed relatively flat before dropping between 2001 and 2002. In other words, insurance companies raise rates to make up for declining interest rates and market-based investment losses.