



Medical Malpractice Insurance: Stable Losses/Unstable Rates in Colorado (January 2003)

Introduction and Summary of Findings

Colorado doctors are protesting high malpractice insurance rates in the state. In formulating a solution to assist doctors who are being price-gouged, it is critical first to determine why physicians are suddenly being hit with skyrocketing insurance rates.

Now for the first time, Americans for Insurance Reform (AIR), a coalition of over 100 consumer groups around the country, has produced a comprehensive study of medical malpractice insurance in Colorado, examining specifically what insurers have taken in and what they've paid out over the last 30 years. Similar to a national study that AIR conducted in October 2002 entitled, *Stable Losses/Unstable Rates* (see <http://www.insurance-reform.org>), AIR has examined everything that Colorado 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 two major findings similar to what AIR earlier observed on a national level, demonstrating that the causes of and solutions to this "crisis" lie not with the tort system (*i.e.*, capping damages) but with the business practices of the insurance industry itself:

- First, over the last 16 years, the amount that medical malpractice insurers have paid out, including all jury awards and settlements, has approximately tracked rates of medical inflation or fallen. When measured in constant dollars, the average payout per doctor rose somewhat from 1976 to 1985, but fell between 1986 and 2001. In other words, medical malpractice claims payments (in constant dollars) have been flat or decreasing over the last decade.
- Second, medical insurance premiums charged by insurance companies over the last 30 years in Colorado have not corresponded to increases or decreases in payouts. Rather, premiums have risen and fallen in concert with the state of the economy — insurance premiums (in constant dollars) have increased or decreased 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.

Background

The nation's insurance companies have convinced medical lobbies in Colorado and nationwide to advance a legislative agenda to limit liability for doctors, hospitals, HMOs, nursing homes and drug companies that cause injury. Federal and state lawmakers and regulators (and the general public) are being told by medical and insurance lobbyists that doctors' insurance rates are rising due to increasing claims by patients, rising jury verdicts and exploding tort system costs in general. But the cause of the spike in rates is not the legal system; the cause is the insurance system.

In Colorado, the insurance industry argues and worse, has convinced surgeons and other physicians 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 Colorado 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. This is precisely what Colorado surgeons are demanding be enacted.

As on the national level, insurance rates for doctors in Colorado 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. News reports today are nearly identical to news reports during previous cycles. Compare, for example, the following two *Washington Post* stories, one from 1986 and the other from 2003:

"Doctors and hospitals...have been saying for weeks that they would have to close their doors." *Washington Post*, May 24, 1986.

"[D]ouble-digit increases in medical malpractice insurance premiums...are prompting doctors to flee states with the highest rates, refuse to perform high-risk procedures, retire early out of frustration or stage protests." *Washington Post*, January 5, 2003.

Today's rerun of these "old" stories is evidence of the economic cycle of the insurance industry at work in Colorado as it is in the nation (explained below). Yet each of these periods has been followed by a wave of legislative activity not to reform insurance industry practices that cause such volcanic eruptions in premiums, but to restrict — over and over again — injured patients' rights to sue for medical malpractice. Indeed, in 1986 and 1988, Colorado enacted a series of severe tort restrictions, including "caps" on liability for doctors.

One of the first states to react to this now third insurance "crisis" for doctors was Nevada. At the end of July 2002, Nevada enacted a \$350,000 cap on non-economic damages for injured patients. Within weeks of the law's enactment, two major insurance companies announced that despite the

new law, they would not reduce insurance rates for the foreseeable future. Quite simply, this is because, as we show below, the legal system is largely irrelevant to the problem.

The Study

For the first time, AIR, under the *pro bono* 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 in Colorado, examining specifically what insurers have taken in and what they've paid out, in constant dollars, over the last 30 years. AIR examined everything that Colorado 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 represents the first major analysis exploring whether or not there is, as the insurance industry claims, an explosion in lawsuits, jury awards or tort system costs in Colorado 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

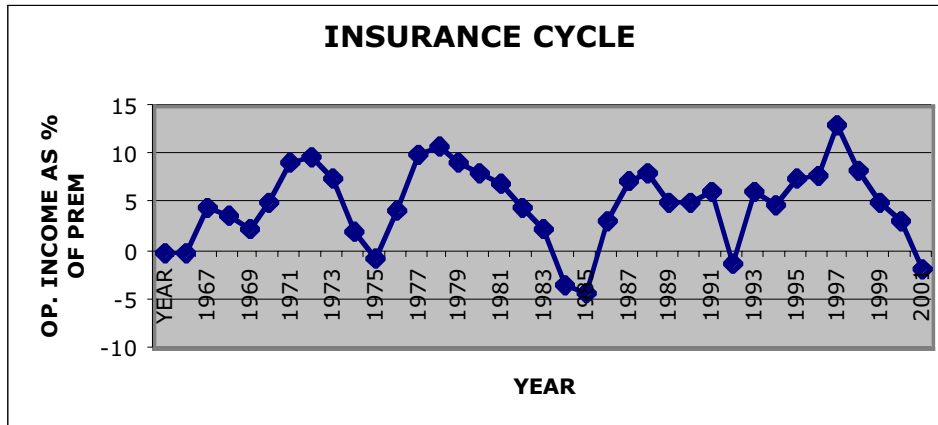
Insurers make most of their profits from investment income. During years of high interest rates and/or excellent insurer profits, insurance companies engage in fierce competition for premium dollars to invest for maximum return. Insurers severely underprice their policies and insure very poor risks just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

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, in 2002, the country is experiencing 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. This graph reflects the experience of the entire property/casualty industry (not just medical malpractice insurance) and reports operating income (underwriting results plus investment returns on insurance reserves) as a percentage of premiums.

Exhibit 1. The Insurance Cycle



(The 1992 data point was not a classic cycle bottom, but reflected the impact of Hurricane Andrew and other catastrophes in that year.)

Prior to late 2000, the industry had been in a soft market since the mid-1980s. The usual six- to-ten-year economic cycle had been expanded by the strong financial markets of the 1990s. 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 the last two years, the market turned 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.¹ However, the increases we are witnessing are mostly due to the cycle turn, not the terrorist attacks 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 Colorado 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 Colorado doctors rather than decreasing interest rates and other economic factors, those losses should be

¹ “...there 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.

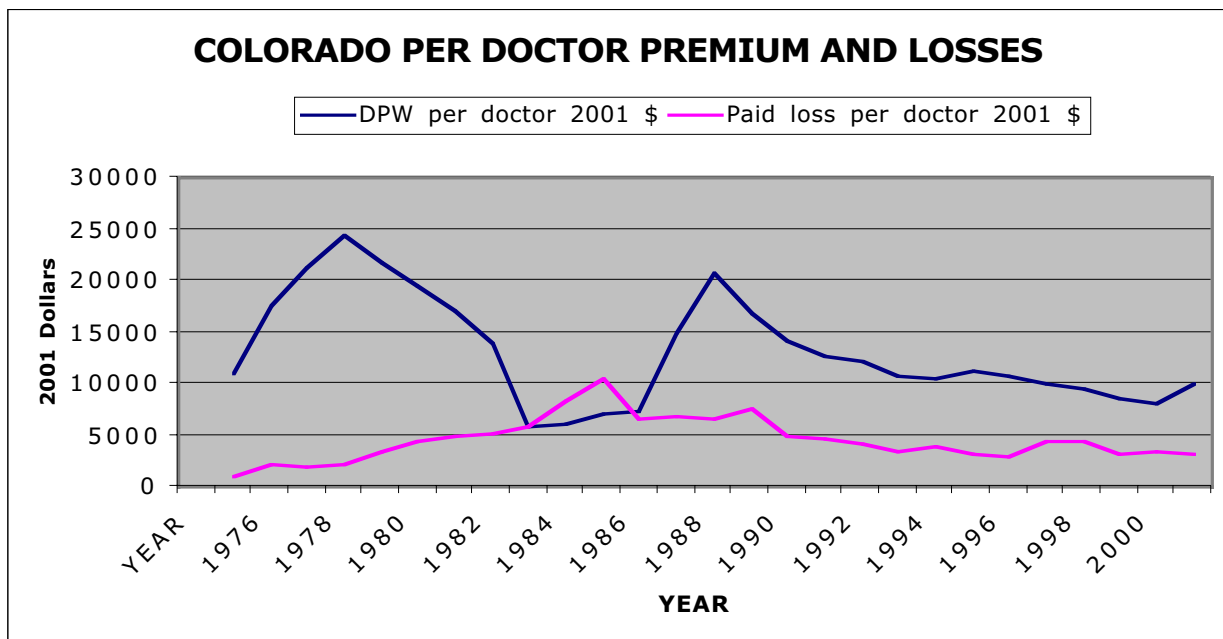
reflected in steadily increasing rates, not in sharp ups and downs that might instead reflect the state of the economy, the well-documented insurance economic cycle (Exhibit 1), interest rates, the stock market or the level of insurers' investment income.

AIR finds both hypotheses are false. The data in Exhibits 2 and 3 below are more than simply conclusive. They are "smoking guns" which should, once and for all, end the debate about the cause of these periodic medical malpractice "crises" in Colorado. First, they show that since 1986, medical malpractice paid claims per doctor have tracked medical inflation very closely or have fallen. In fact, while the average payouts per doctor rose from 1976 to 1985, they fell between 1988 and 2001. In other words, between the beginning and end of the last decade, payouts have risen almost precisely in sync with medical inflation, which should surprise surgeons and other doctors who dutifully march off at the insurers' trumpet call to seek tort law changes.

Second, 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 insurer mismanagement and changing interest rates, not by lawsuits, jury awards, the tort system or other causes.

In sum, the results of AIR's analysis of data from 1975 to 2001, illustrated in Exhibits 2 and 3, are startling; Colorado premiums rise and fall with the economic cycle, as illustrated in Exhibit 1, but losses paid do not.

Exhibit 2



Sources:

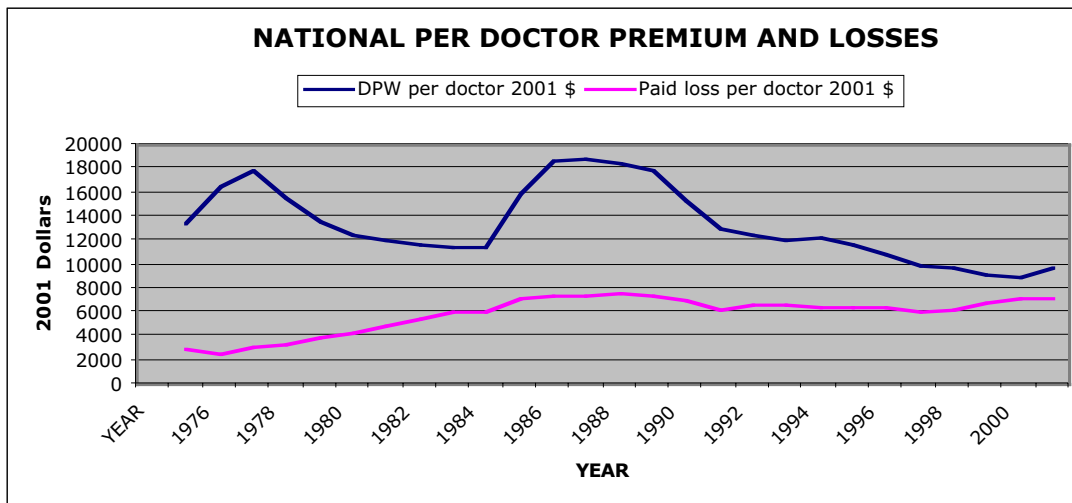
A.M. Best and Co. special data compilation for AIR, reporting data for as many years as separately available; U.S. Bureau of the Census, 1975 (2001 Estimated); Inflation Index: Bureau of Labor Statistics, 1975 (1985 estimated).

Definitions:

“DPW” or “Direct Premiums Written” is the amount of money that insurers collected in premiums from doctors during that year.

“Paid losses” is what insurers actually paid out that year to people who were injured — all claims, jury awards and settlements — plus what insurance companies pay their own lawyers to fight claims.²

In addition, it should be noted that the Colorado experience closely tracks the national experience, as this chart reveals:



² 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 Colorado and 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.

Exhibit 3 – Colorado Data

YEAR	direct prems written (DPW)	direct losses paid (PL)	loss # ratio	doctors in CO	medical inflation (cpi-u)	DPW per doctor	PL per doctor	YEAR	DPW per doctor 2001 \$	PL per doctor 2001 \$
1975	8,777,256	799,862	0.091	4646	47	1889	172	1975	10965	999
1976	16,536,419	1,978,183	0.120	4917	52	3363	402	1976	17643	2111
1977	23,097,262	2,053,594	0.089	5187	57	4453	396	1977	21311	1895
1978	30,013,306	2,770,794	0.092	5458	61.8	5499	508	1978	24274	2241
1979	30,839,548	4,911,868	0.159	5728	67.5	5384	858	1979	21759	3466
1980	32,148,685	7,320,212	0.228	5999	74.9	5359	1220	1980	19519	4444
1981	31,739,928	8,909,741	0.281	6135	82.9	5174	1452	1981	17025	4779
1982	29,569,139	10,864,092	0.367	6271	92.5	4715	1732	1982	13906	5109
1983	14,114,145	13,982,167	0.991	6407	100.6	2203	2182	1983	5974	5918
1984	15,314,944	21,490,543	1.403	6543	106.8	2341	3285	1984	5979	8390
1985	19,827,658	28,940,359	1.460	6679	113.5	2969	4333	1985	7135	10415
1986	22,815,729	20,356,190	0.892	6864	122	3324	2966	1986	7433	6631
1987	50,044,867	22,861,866	0.457	7050	130.1	7099	3243	1987	14885	6800
1988	76,376,253	24,104,426	0.316	7235	138.6	10556	3332	1988	20778	6558
1989	67,950,454	30,867,744	0.454	7421	149.3	9157	4160	1989	16731	7600
1990	67,295,735	23,571,861	0.350	7606	162.8	8422	2950	1990	14113	4944
1991	68,390,588	25,282,592	0.370	7990	177	8167	3019	1991	12587	4653
1992	73,844,574	25,797,542	0.349	8374	190.1	8433	2946	1992	12101	4228
1993	73,241,145	22,513,618	0.307	8757	201.4	8012	2463	1993	10853	3336
1994	77,396,393	28,338,079	0.366	9141	211	8126	2975	1994	10506	3847
1995	86,114,289	24,488,998	0.284	9525	220.5	9041	2571	1995	11185	3181
1996	89,026,130	25,303,022	0.284	9923	228.2	8972	2550	1996	10725	3048
1997	87,914,349	39,579,322	0.450	10320	234.6	8519	3835	1997	9906	4460
1998	90,102,535	42,597,407	0.473	10718	242.1	8407	3974	1998	9473	4478
1999	85,972,349	31,423,771	0.366	11115	250.6	7735	2827	1999	8420	3078
2000	88,703,545	38,740,176	0.437	11513	260.8	7705	3365	2000	8059	3520
2001	119,326,372	36,623,850	0.307	11910	272.8	10019	3075	2001	10019	3075

Sources: Premiums Written (Net), AM Bests Special
Data Run for AIR

Number of Total NonFed Doctors: U.S. Bureau of the Census (data for 1975, 80, 85, 90, 95 and 99; other years Estimated)

Inflation Index: Bureau of Labor Statistics (1975 and 1985 estimated)

Note that “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 (over a billion dollars) in loss reserves in 2001 – which is

accompanied by a similar jump in premiums nationally. In Colorado, the reserve jump is about \$30 million, also mirroring the premium jump (while losses paid declined).

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 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.

Fool Me Twice, Shame On Me

In 1988, Colorado physicians and the medical malpractice industry came to the Colorado legislature asking for relief from an alleged huge number of medical malpractice lawsuits and giant settlements and awards for medical malpractice. On a per-doctor basis, as Americans for Insurance Reform data show, Colorado’s insurance industry had quadrupled its malpractice premium charges over the four years from 1984 to 1988. It is scarcely any wonder that doctors led the charge for limitations on recovery by survivors of malpractice.

The legislature did not see what was going on in medical malpractice direct losses paid. They saw only the huge boost in premium charges. They made a panic decision.

Just two years before, in 1986, the Colorado legislature had already passed a panoply of “tort reforms.” They limited ordinary non-economic damage claims to no more than \$250,000. They abolished “joint and several” liability. They strictly limited punitive damages.³ But that wasn’t enough for the insurance industry in medical malpractice cases.

As a result of their special pleadings, in 1988 the Colorado legislature limited non-economic damages to \$250,000 without the ability to increase them on the basis of clear and convincing evidence. Total damages were limited to a presumptive cap of \$1 million, which could be raised only if it unfairly impacted recovery for lost wages and medical bills, but not for non-economic or economic losses other than wages and medical care. (Even today, almost 15 years later, less than a handful of other states have similarly limited all damages in medical malpractice cases.)⁴

In sum, Colorado passed a host of “tort reforms” dealing with medical malpractice in the 1986 – 1988 period. We can now ask the question: “Was it rational for them to have done so?” The answer is no. It wasn’t a rationally based decision – no matter how strong its emotional appeal.

³ John G. Salmon, “Fifteen Years of Colorado Tort Reform: Where Are We Now?” *The Colorado Lawyer*, February, 2001, pp 5 – 16.

⁴ *Id.*

During the period 1984–1988 when per doctor premiums quadrupled in Colorado, we now know that paid losses per physician grew less than \$50 (from \$3,285 to \$3,332). However, in 1988, premiums were set too high when compared to that year’s (and future years’) claims payments. It isn’t rational to suppose that medical malpractice premiums will never increase; they must logically follow the rate of medical inflation since so much of the losses from medical malpractice are because of the need for medical care⁵.

The 1988 “crisis” was artificially created by medical malpractice insurers’ premium increases. We now know they lacked a basis for the size of the increases they promulgated. Their reluctance to tell Colorado legislators what their actual losses had been in 1987 and 1988 was a strategic decision not to reveal damaging information about the real nature of the “crisis,” namely that it was purely insurance – and not tort – generated.

Now Colorado faces (as does the nation) renewed cries of panic from medical malpractice insurers and doctors. Premiums have bounced upward. National and Colorado paid losses, however, have remained flat or gone down, when adjusted for physician growth and medical inflation.

If anything demonstrates the futility of attempting to overcome national insurance cycle trends – ones that are directed, managed and guided by the insurance industry – through state tort, as opposed to insurance, action, it is Colorado’s misguided, failed attempts. As the old saw has it: “Fool me once, shame on you. Fool me twice, shame on me.”

Conclusion

Stable Losses/Unstable Rates in Colorado represents the first comprehensive report on medical malpractice insurance in that state, analyzing what insurers have taken in and what they’ve paid out over the last 30 years, including jury awards, settlements and other costs. Its findings are startling. Medical insurance premiums have risen and fallen in relationship to the state of the economy while payouts over the last decade have approximately tracked the rate of medical inflation or fallen. Not only has there been no real increase in lawsuits, jury awards or any tort system costs in recent years, 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 other words, insurance companies in Colorado and nationwide raise rates when they are seeking ways to make up for declining interest rates and investment losses.

⁵ Eric J. Thomas, MD, et al., “Costs of Medical Injuries in Utah and Colorado.” *Inquiry*, Vol 36:255-264 (Fall 1999).