



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

Introduction and Summary of Findings

On February 3, 2003, New Jersey doctors have scheduled to go on strike to protest high malpractice insurance rates in the state. This is even though a newly-released study by New Jersey regulators has found that from January through August 2002, less than 10 percent of medical malpractice policyholders experienced large rate increases.”¹

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 New Jersey, 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 New Jersey 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 1983, but was stable to slightly down between 1984 and 2001. In other words, medical malpractice claims payments (in constant dollars) have been flat over the last decade.
- Second, medical insurance premiums charged by insurance companies over the last 30 years in New Jersey 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

¹ “N.J. Regulators Say Few Providers Faced Large Med-Mal Premium Hikes,” *BestWire*, January 27, 2003.

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 New Jersey 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 New Jersey, 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 New Jersey 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 New Jersey doctors are demanding be enacted.

As on the national level, insurance rates for doctors in New Jersey 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 New Jersey 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.

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 New Jersey, 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 New Jersey 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 New Jersey 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

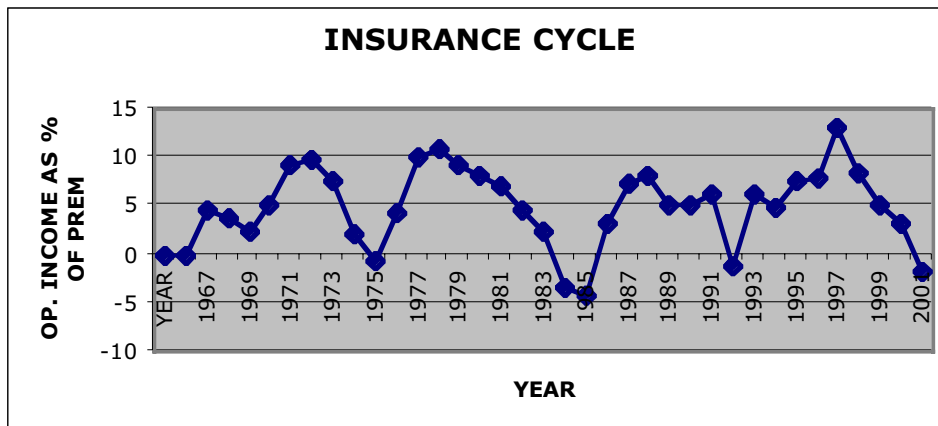
Insurers make most of their profits from investment income. During years of high interest rates and/or excellent insurer profits, insurance companies engage in fierce competition for premium dollars to invest for maximum return. Insurers severely underprice their policies and insure very poor risks just 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.² 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 New Jersey insurers and are therefore the reason behind skyrocketing insurance rates, then losses per doctor should be rising faster than medical inflation over time.

² “...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.

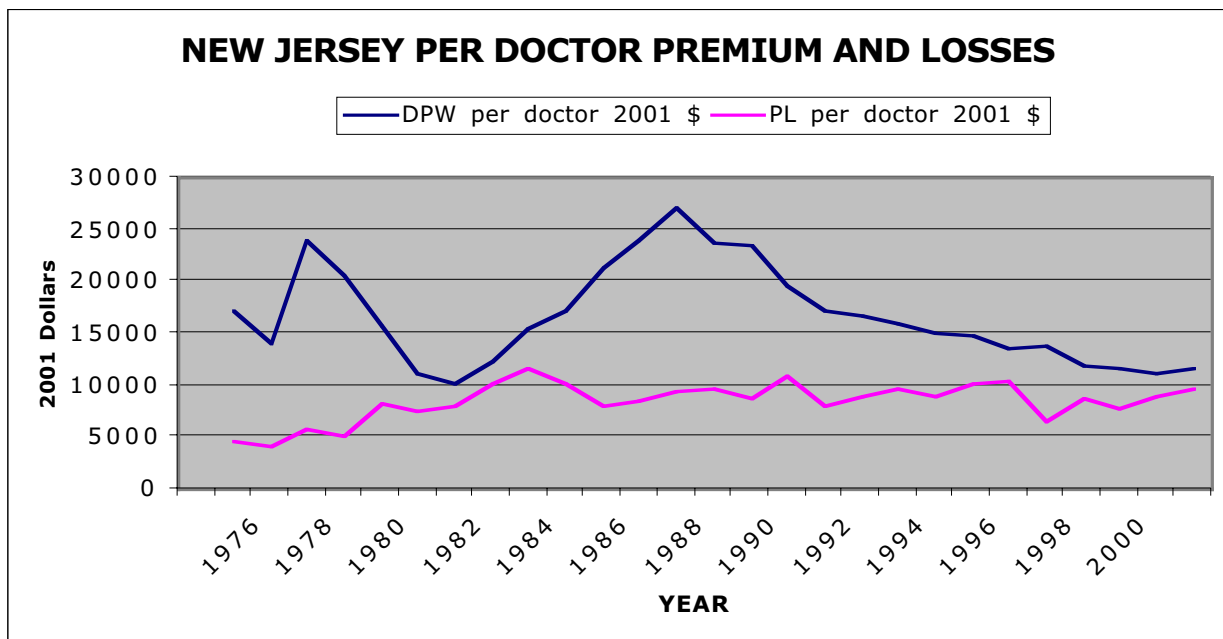
- Second, if lawsuits or other tort costs are the cause of rate increases for New Jersey doctors rather than decreasing interest rates and other economic factors, those losses should be reflected in steadily increasing rates, not in sharp ups and downs that might instead reflect the state of the economy, 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 New Jersey. First, they show that the average payout per doctor rose somewhat from 1976 to 1983, but was stable to slightly down between 1984 and 2001. In other words, medical malpractice claims payments (in constant dollars) have been flat over the last decade, which should surprise surgeons and other striking 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; New Jersey premiums rise and fall with the economic cycle, as illustrated in Exhibit 1, but losses paid do not.

Exhibit 2



Sources:

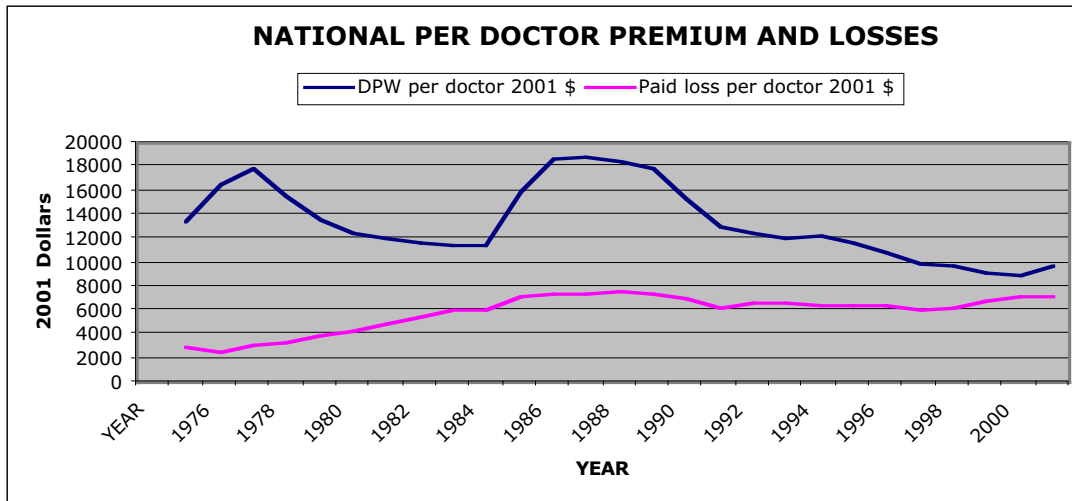
A.M. Best and Co. special data compilation for AIR, reporting data for as many years as separately available; U.S. Bureau of the Census, 1975 (2001 Estimated); Inflation Index: Bureau of Labor Statistics, 1975 (1985 estimated).

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.³

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



³ 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 New Jersey 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 – New Jersey Data

YEAR	direct premiums written (DPW)	direct losses paid (PL)	loss ratio	number doctors in NJ	Med. Care Inflation (cpi-u)	DPW per doctor	PL per doctor	YEAR	DPW per doctor 2001 \$	PL per doctor 2001 \$
1975	37,696,699	9,971,730	0.265	12672	47	2975	787	1975	17267	4567
1976	34,742,742	10,136,970	0.292	13097	52	2653	774	1976	13917	4060
1977	67,788,000	16,089,478	0.237	13523	57	5013	1190	1977	23991	5694
1978	64,675,773	15,976,740	0.247	13948	61.8	4637	1145	1978	20468	5056
1979	55,904,434	29,315,454	0.524	14354	67.5	3895	2042	1979	15740	8254
1980	45,476,318	30,499,543	0.671	14799	74.9	3073	2061	1980	11192	7506
1981	47,974,233	37,886,410	0.790	15502	82.9	3095	2444	1981	10184	8042
1982	67,543,592	55,206,061	0.817	16205	92.5	4168	3407	1982	12292	10047
1983	95,822,750	71,947,587	0.751	16907	100.6	5668	4255	1983	15369	11540
1984	118,233,055	69,261,974	0.586	17610	106.8	6714	3933	1984	17150	10046
1985	162,233,091	60,564,788	0.373	18313	113.5	8859	3307	1985	21293	7949
1986	201,625,699	71,906,023	0.357	18766	122	10744	3832	1986	24025	8568
1987	247,791,834	85,441,495	0.345	19219	130.1	12893	4446	1987	27035	9322
1988	237,563,174	96,477,091	0.406	19673	138.6	12076	4904	1988	23768	9652
1989	259,073,013	96,252,033	0.372	20126	149.3	12873	4782	1989	23521	8739
1990	248,512,292	138,705,615	0.558	20579	162.8	11702	6531	1990	19609	10944
1991	243,428,570	115,028,576	0.473	21237	177	11118	5254	1991	17136	8097
1992	260,484,847	139,672,837	0.536	21895	190.1	11549	6193	1992	16574	8887
1993	271,880,668	167,177,730	0.615	22554	201.4	11713	7202	1993	15865	9756
1994	276,626,289	167,465,222	0.605	23212	211	11589	7016	1994	14983	9071
1995	284,043,362	197,198,205	0.694	23870	220.5	11900	8261	1995	14722	10221
1996	277,417,527	212,706,642	0.767	24554	228.2	11298	8663	1996	13506	10356
1997	299,286,983	142,305,625	0.475	25238	234.6	11859	5639	1997	13790	6557
1998	273,347,342	202,492,444	0.741	25922	242.1	10545	7812	1998	11882	8802
1999	285,061,450	187,711,787	0.658	26606	250.6	10714	7055	1999	11663	7680
2000	289,904,965	235,154,814	0.811	27290	260.8	10623	8617	2000	11112	9013
2001	322,130,917	273,956,677	0.850	27974	272.8	11515	9793	2001	11515	9793

Sources: Premiums Written (Net), Bests Aggregates and Averages, 2001 Edition

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 New Jersey, 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.

Conclusion

Stable Losses/Unstable Rates in New Jersey 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 have approximately tracked the rate of medical inflation. 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 New Jersey and nationwide raise rates when they are seeking ways to make up for declining interest rates and investment losses.