



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

Introduction and Summary of Findings

On February 3, 2003, New Jersey doctors began a staged walk-out over malpractice rate increases, even though less than 10 percent of medical malpractice policyholders have been experiencing large rate hikes.”¹ Now, New York doctors are indicating in media reports that they might strike as well.² They cite an American Medical Association study that names New York State as a “crisis” state where medical liability premiums have supposedly risen most – *even though malpractice insurance rates are not even rising in New York State*. Last summer, New York’s largest medical malpractice insurer was denied its requested premium increase, with State Insurance Superintendent Gregory Serio stating, “I don’t think there is any further need for more rates at this point.” Moreover, according to the New York Public Interest Research Group (NYPIRG), the number of physicians practicing in New York State has skyrocketed and is increasing at a rate faster than the national average.

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 York, 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 York 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:

¹ “N.J. Regulators Say Few Providers Faced Large Med-Mal Premium Hikes,” *BestWire*, January 27, 2003. According to the national consumer group Public Citizen, the New Jersey doctors’ strike violates federal and state antitrust laws and should be investigated by the Federal Trade Commission and the state Attorney General. “Striking doctors in New Jersey are violating federal and state anti-trust laws,” Public Citizen Release, February 4, 2003.

² “Will NY Docs Be Next to Walk Out?,” *Newsday*, February 5, 2003.

- First, over the last 18 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 York 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 New York 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 – *even though malpractice insurance rates are not actually rising in New York State*. Last summer, New York’s largest medical malpractice insurer was denied its requested premium increase, with State Insurance Superintendent Gregory Serio stating, “I don’t think there is any further need for more rates at this point.” Moreover, according to the New York Public Interest Research Group (NYPIRG), the number of physicians practicing in New York State has skyrocketed and is increasing at a rate faster than the national average.

As on the national level, insurance rates for doctors in New York skyrocketed before, particularly in the mid-1980s, a “crisis” precipitated by a weakened economy and dropping interest rates. News reports today are nearly identical to news reports during the previous cycle. 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 York 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. In the mid-1980s, New York enacted severe limits on the legal rights of patients injured or killed as a result of medical malpractice.

One of the first states to react to the current 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 York, 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 York 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 York.

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.

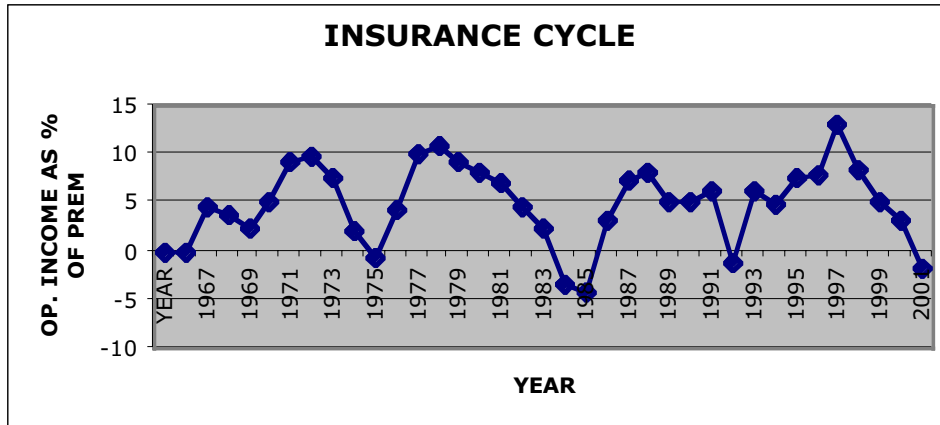
But when investment income decreases — because interest rates drop or the stock market plummets or the cumulative price cuts make profits become unbearably low — the industry responds by sharply increasing premiums and reducing coverage, creating a “hard” insurance market usually degenerating into a “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.³ 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:

³ “...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.

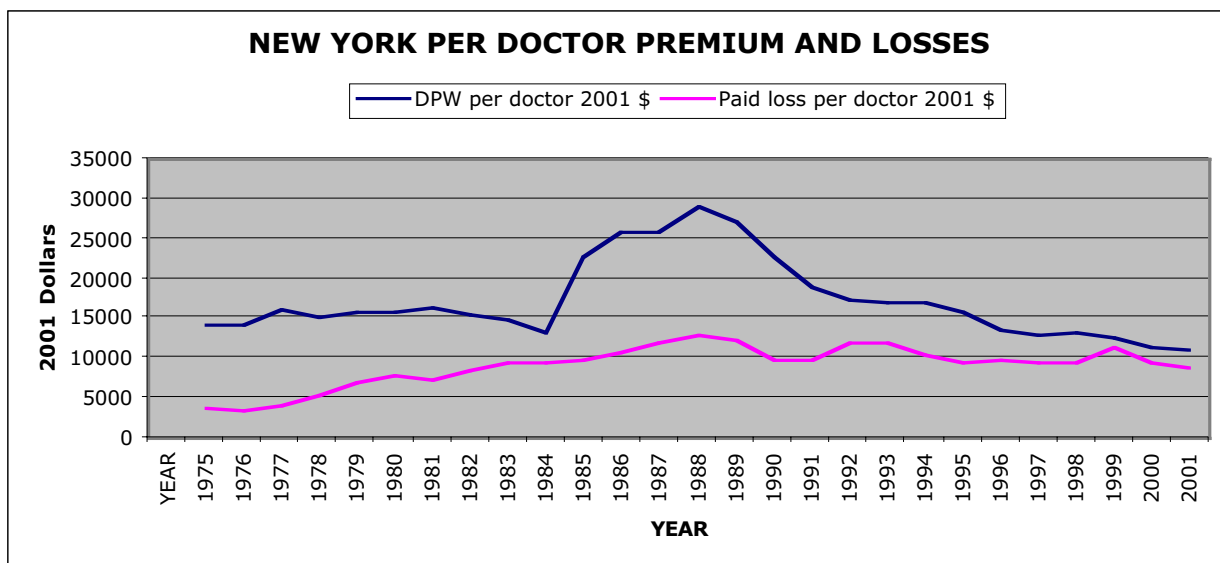
- First, if large jury verdicts in medical malpractice cases or any other tort system costs are having a significant impact on the overall costs for New York insurers, then losses per doctor should be rising faster than medical inflation over time.
- Second, if lawsuits or other tort costs have been the cause of any rate increases for New York 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 periodic medical malpractice “crises” in New York. 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 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. 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 York premiums rise and fall with the economic cycle, as illustrated in Exhibit 1, but losses paid do not.

Exhibit 2



Sources:

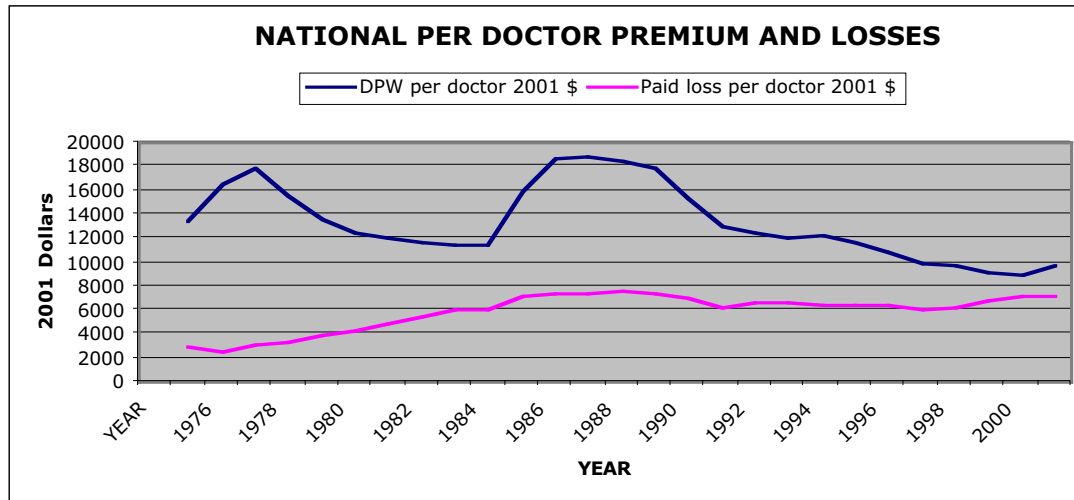
Premiums Written (Net), Bests Aggregates and Averages, 2001 Edition, A.M. Best and Co., special data compilation for AIR, reporting data for as many years as separately available; U.S. Bureau of the Census, 1975 (2001 Estimated); Inflation Index: Bureau of Labor Statistics, 1975 (1985 estimated); Number of Total NonFed Doctors: U.S. Bureau of the Census (data for 1975, 80, 85, 90, 95 and 99; other years 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.⁴

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



⁴ 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 York 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 York Data

YEAR	Direct Premiums Written (DPW)	Direct Losses Paid (PL)	Loss Ratio	Number Doctors In NY	Med. Inflation (cpi-u)	DPW Per Doctor	PL Per Doctor	YEAR	DPW per doctor 2001 \$	PL per doctor 2001 \$
1975	112,651,522	31,039,310	0.276	46393	47	2428	669	1975	14094	3883
1976	127,679,765	30,018,024	0.235	46935	52	2720	640	1976	14271	3355
1977	160,860,475	41,003,255	0.255	47478	57	3388	864	1977	16215	4133
1978	166,062,891	58,520,232	0.352	48020	61.8	3458	1219	1978	15265	5379
1979	189,000,515	85,184,416	0.451	48563	67.5	3892	1754	1979	15729	7089
1980	212,169,479	107,385,433	0.506	49105	74.9	4321	2187	1980	15737	7965
1981	252,103,328	112,760,851	0.447	50562	82.9	4986	2230	1981	16408	7339
1982	271,923,193	148,956,326	0.548	52020	92.5	5227	2863	1982	15416	8445
1983	293,240,995	188,977,759	0.644	53477	100.6	5483	3534	1983	14870	9583
1984	283,861,417	205,377,839	0.724	54935	106.8	5167	3739	1984	13199	9549
1985	530,787,017	230,263,811	0.434	56392	113.5	9412	4083	1985	22623	9814
1986	660,307,449	272,951,926	0.413	57262	122	11531	4767	1986	25785	10659
1987	712,816,848	332,134,833	0.466	58133	130.1	12262	5713	1987	25711	11980
1988	865,125,258	383,778,736	0.444	59003	138.6	14662	6504	1988	28859	12802
1989	884,623,310	402,302,269	0.455	59874	149.3	14775	6719	1989	26996	12277
1990	854,403,798	362,843,038	0.425	60744	162.8	13617	5783	1990	22818	9690
1991	793,879,724	409,388,834	0.516	62745	177	12261	6323	1991	18898	9745
1992	811,974,970	559,175,764	0.689	64746	190.1	12165	8377	1992	17457	12022
1993	870,300,422	615,013,468	0.707	66748	201.4	12659	8946	1993	17147	12117
1994	923,163,546	576,724,483	0.625	68750	211	13048	8151	1994	16870	10539
1995	905,070,538	544,403,418	0.602	70751	220.5	12792	7695	1995	15827	9520
1996	822,075,016	591,710,868	0.720	72314	228.2	11368	8183	1996	13590	9782
1997	816,663,055	598,744,431	0.733	73877	234.6	11054	8105	1997	12854	9424
1998	886,935,822	634,166,913	0.715	75440	242.1	11757	8406	1998	13248	9472
1999	900,034,082	795,112,336	0.883	77003	250.6	11688	10326	1999	12724	11240
2000	849,687,717	700,772,374	0.825	78566	260.8	10815	8920	2000	11313	9330
2001	881,194,813	698,555,720	0.793	80129	272.8	10997	8718	2001	10997	8718

Sources:

Premiums Written (Net), Bests Aggregates and Averages, 2001 Edition, 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); Number of Total NonFed Doctors: U.S. Bureau of the Census (data for 1975, 80, 85, 90, 95 and 99; other years 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 York, 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 York 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 York and nationwide raise rates when they are seeking ways to make up for declining interest rates and investment losses.