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TO
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EXECUTIVE DIRECTOR, CENTER FOR JUSTICE & DEMOCRACY
ON
THE CURRENT NEW YORK STATE MEDICAL MALPRACTICE SITUATION
DECEMBER 17, 2007

On July 2, 2007, the New York State Insurance Department ("department") issued a news release announcing a medical malpractice insurance rate increase in New York State. In the release, the department states:

> Between 1992 and 1997, the State appropriated $691 million from the reserves of the Medical Malpractice Insurance Association (MMIA) - established by the State as the insurer of last resort – to close gaps in the State's operating budget. Had MMIA's reserves been preserved and allowed to grow by collecting interest over the years instead of being so severely depleted, New York's medical malpractice insurers would be in a much stronger financial position today, and the problem confronting New York would be far less serious. But by 2001, the State dissolved MMIA altogether, replacing it with the Medical Malpractice Insurance Plan (MMIP), an assigned risk plan in which all medical malpractice insurers participate. Unfortunately, MMIP has accumulated a deficit of approximately $525 million as of March 31, 2007 – a sum that, by law, must be shouldered by the few companies selling malpractice insurance in the state, exerting further pressure on insurance rates.

The department is now saying the deficit is not $525 million, but quickly raised that number to $1.5 billion and now in some documents it appears to be of the order of $2 billion. To say that

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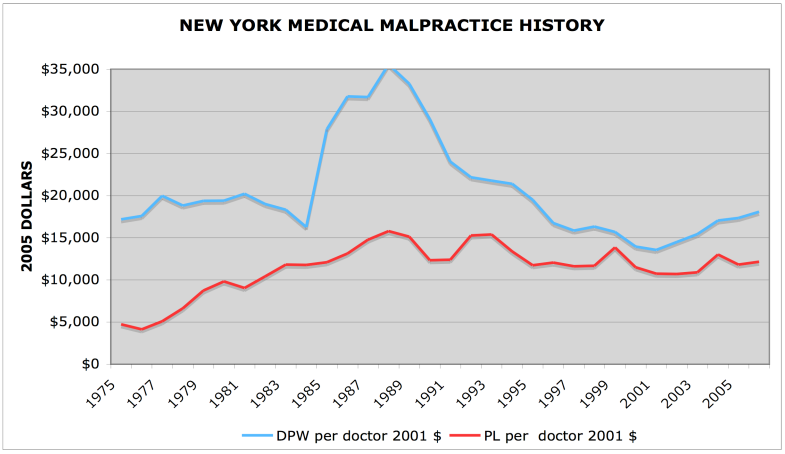
the size of the deficit is mysterious is to understate the situation; the size if the deficit is better described as "unknown."

The Governor has appointed a task force, of which you are a member, to evaluate this situation. At your request, I have reviewed various documents supplied by the department, [2] to determine whether there is evidence of this deficit and if so, what should be done about it. My findings are as follows:



The above chart of direct written premiums (what the doctors actually pay to the insurers – blue line) and direct paid losses (what the injured victims actually get from the insurers – red line) shows that on a per doctor basis, medical malpractice paid claims cost, in real terms, has slightly declined from $15,778 in 1988 to $12,145 today. These costs have been flat to down since the mid 1980s, the previous "crisis" in medical malpractice insurance. The data and calculations are shown in Attachment 1.

Premiums per doctor spiked, in real terms, in 1988, at $35,566. These average premium charges dropped to a low of $13,553 per doctor in 2001. Today the figure is $18,078.

The recent power point presentation by the New York State Department of Insurance confirms that the carriers received about half of the rate increases they requested over the last decade.[3] It

[2] The materials we have reviewed are: July 2, 2007 Press Release of the New York Insurance Department, presentations to the Medical Liability Advisory Task Force from MLMIC, Academic Health Professionals Insurance Association, MMIP and Physician's Reciprocal, The Status of the Primary and Excess Medical Malpractice Market and the Future Need for the Medical Malpractice Insurance Association, December 1, 1997, Audit of MMIP by KPMG dated September 28, 2007 (with cover letter dated October 1, 2007), New York Insurance Department memo dated July 12, 2007 entitled "Physicians and Surgeons Medical Malpractice Insurance, Summary of MEDMAL 1 Special Report," New York Insurance Department memo dated July 11, 2007 entitled "Physicians and Surgeons Pursuant to Regulations Insurance Segregated Account Report Summary of Data Reported Pursuant to Regulation 101," Annual Statements for year end 2005 and 2006 for Physicians' Reciprocal Insurance Company, MLMIC, Academic Health Professionals' Insurance Association and HANYS/Hospital Insurance Company, and presentations to the Medical Liability Advisory Task Force by the New York State Department of Insurance: "Cost Drivers in Ratemaking – An Overview," and "Medical Malpractice Financial Data Overview."

[3] New York State Department of Insurance, Cost Drivers in Ratemaking – An Overview, "Physicians & Surgeons Primary Coverage Proposed and Approved Rate Level History."

is not unusual for carriers to ask for greater rate hikes than they need or ultimately receive. Documents supplied to the task force from one company, Physician's Reciprocal Insurance, show average rate increases of 4.6% over the period 1996 to 2007, with average requests for increases of 8.9%. MLMIC's approved rate hikes for the past 10 years average 4.0 percent, with requests averaging 10.2%. The approved hikes for both insurers are less than medical inflation during that period.

Therefore, today, there is no crisis in terms of payouts or even in increases in the premium charges. To the extent there are problems, they are of recent vintage[4] and it is in the deficits projected to be paid out over many future years, not immediately. The following discuss these projections that lead to these alleged deficits.

RESERVES

Reserves are the estimates of future expected payouts that will be made over the coming years. The loss and defense reserves include both reserves on known claims, called "case-basis" reserves and reserves on claims the insurers do not know about yet, called "Incurred But Not Reported" or "IBNR" reserves. In medical malpractice, the reserves tend to be highly cyclical.

In 2001, reserves of all sorts (unearned premium, loss and defense costs) were $5.9 billion.

Currently, **according to A. M. Best & Co., reserves in New York for medical malpractice are over $8.0 billion.** This is made up of $6.1 billion in reserves for future payments to victims, $1.3 billion in reserves for future defense costs and $0.7 billion in unearned premium reserves (the amount the insurers would owe to doctors if they all cancelled their policies).

- Reserve strengthening from 2001 was $740 million for MLMIC alone.
- Physician's Reciprocal had significant reserve development in 2001 to 2004.

The reserve strengthening cycle appears near the end (See Exhibit 7 of MLMIC presentation to the task force to see the cycle of reserve development.) The Schedule P data from the other carriers indicate a similar slowdown of reserve buildup that implies an end to reserve inadequacy and the possibility of future reserve declines and releases.

There is no Annual Statement for MMIP, so we could not examine Schedule P to test the reserves. However, we did examine a KPMG audit dated September 28, 2007, which does show balance sheets and income statements for MMIP through years ending June 30, 2006 and 2007. The income statement shows a $6,122,098 profit for the year ended June 30, 2007, in large part due to a huge drop in reserves. Because of this profit, the member's deficit from the beginning of the year, $492,016,610, dropped to $482,725,663. KPMG notes that, "The ultimate loss and LAE estimate for accidents occurring June 30, 2006 and prior decreased by approximately $68 million...mainly the result of lower than expected loss emergence during the period..."

[4] New York Department of Insurance, *The Status of the Primary and Excess Medical Malpractice Market and the Future Need for the Medical Malpractice Insurance Association* (December 1, 1997) (finds the market very competitive and prices increasing only at about inflation for the decade.)

This is further evidence that the cycle may have turned from ever increasing reserve developments to flat, and perhaps even declining, reserve developments.

There have been huge overestimates of reserves by medical malpractice insurers before, which should serve as a warning about the reliability of reserves at the end of a hard market (as we are in today). St. Paul alone drew down over $1 billion from reserves into profits following the mid-1980s hard market. There is evidence of reserves releases in other states starting now.[5] This insurance department found that estimates that actuaries made in the 1980s as to ultimate liabilities in New York State were exaggerated.[6] **Therefore, an important question that remains unanswered is, have the reserves been made excessively strong in recent years, as typically happens at the end of the reserve build-up cycle, and will we see a decline in reserves in the near future?**

LOSSES

In 1997, the state reported that insurance was readily available and the market extremely competitive.[7] The rates had risen by only 6% from 1990 to 1997. Certainly there was no crisis a decade ago; indeed the state was appropriating what it saw as excessive surplus in the market for other uses (another indication of reserve cyclicality).

In their presentations to the task force, both Physician's Reciprocal and MLMIC say the severity of paid losses is increasing. But MLMIC shows closed claim severity increasing only at expected rates (at about an average of 4.8% per year from 2000 to date – see chart 11 of its task force submission). MLMIC has a flat to down CWIP (claims with insurance payment) claim count (see chart 10 of its task force submission). Moreover, MMLIC did not supply the task force with the affiliated claim frequency figures or the number of doctors insured by year so the frequency could be calculated. Clearly, the data supplied so far is inadequate to judge the trends in costs and frequencies.

PRI's data show a more severe severity trend but offer no data on claim frequency. They do say in their task force submission that the severity is up because of "Plaintiff law firms have become more successful at directing a more focused effort on claims with a high severity," implying fewer, higher value claims. So, the frequency of claims might be sharply down. It is necessary to study the pure premium trends of each carrier since studying cost or frequency alone can lead to inaccurate results and is actuarially inappropriate.

In the recent power point presentation by the department entitled "Good News," the department states that frequency is stable, but in the same sentence indicates that frequency is not only down,

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[5] See, e.g., M. William Salganik, "Malpractice insurer, Md. reach deal; Med Mutual to cut rates, pay dividend, fully reimburse state," *Baltimore Sun*, December 14, 2007, for an example of a medical malpractice insurer just last week releasing $100 million from overstated reserves in Maryland. http://www.baltimoresun.com/business/bal-te.bz.malpractice14dec14,0,5673116.story.

[6] New York Department of Insurance, *The Status of the Primary and Excess Medical Malpractice Market and the Future Need for the Medical Malpractice Insurance Association,* at 11 (December 1, 1997).

[7] New York Department of Insurance, *The Status of the Primary and Excess Medical Malpractice Market and the Future Need for the Medical Malpractice Insurance Association* (December 1, 1997).

but "at a new low." In addition, the department confirms that severity is increasing at just 3 percent annually.

To analyze overall trends in frequency, severity and pure premiums properly, we must have data from all carriers showing paid losses by quarter, number of doctors insured by quarter and number of paid claims by quarter.

However, even by the department's own admission, frequency "is at a new low" and severity increases are below inflation. There is no crisis indicated in the numbers we have seen so far.

DEFICIT

We examined the power point presentation "Medical Malpractice Financial Data Overview." The last page indicates:

> MMIP total deficit: $483 million. [Note that we do not know where this figure comes from in that the underlying data and analysis are not shown.]
> Present Value of MMIP deficit: $276 million.
> Rate Deficiency of carriers: $1.691 billion. [Note that we do not know where this figure comes from in that the underlying data and analysis are not shown. Also, it is unclear how much of this number is adjusted to present value.]
> Total Deficiency: $1.967 billion.

In addition, we examined the "Combined Surcharge Report" and the more specific chart of MLMIC numbers for eight years.

There is no definition for the term "rate deficiency of carriers," in the documents. But it appears that a rate deficiency is not a surplus deficiency. Looking at the MLMIC chart from the power point presentation "Medical Malpractice Financial Data Overview," line 12, the figure called "estimated surplus (deficiency) for the policy year" jumps from $85 million in 1999-2000, to $259 million in 2002-2003, back down to $128 million from 2006-2007[8]. The table is very confusing. Starting right at line 1, the "Account balance as of June 30 of last year (line 9 of last year's report)" does not agree with line 9 from the previous year report shown in the table. This needs explanation. Line 8 shows negative investment income in some years. As we understand it, this is not possible given that bonds are bought and investment losses cannot occur.

It appears from the MLMIC chart that the "estimated surplus/deficiency" is calculated from reserves (incurred losses), which are not actual losses but include reserves containing IBNR. The department admits that it does not know if recent figures are accurate (it states "recent data are less stable."[9]). Nonetheless, the department bases its analysis on these data without caveat.

[8] The other carriers reflect a similar jumping around on the Combined Surcharge Report.
[9] New York State Department of Insurance, "Cost Drivers in Ratemaking – An Overview, "What Makes Malpractice Ratemaking Imprecise?"

There is no way to get an accurate picture without examining only more mature data. Deficit cannot be predicated on immature data. Also, the calculation is made by totaling estimates for each of the last 10 policy years. This is an arbitrary time period that is not explained, and could just as well be 5 years or 20 years.

The so-called "deficit" or "rate deficiency of carriers" does not relate to the carriers' actual surplus. The deficit seems related only to premiums and base largely on unreliable reserves, which is why the department's estimate of "deficit" varies wildly from day to day. A clear definition is required. If possible, the department should define it in a way to avoid collecting monies other than cash flow need, plus a safety margin.

Certainly, deficit cannot mean using recent year's IBNR as valid given the lack of reliability of such estimates. Not only would it be odd to use this figure to calculate whether a large influx of money is needed, but this seems an especially erroneous thing to do with $8 billion in reserves currently in New York medical malpractice market much of which is from recent, unreliable estimates that may well be overstated. The department needs to evaluate this situation on a year-by-year cash flow basis. It should not be trying to collect money for something that may never happen.

(It should also be noted that department's profitability report does not support the notion of a urgent and immediate crisis.[10])

SOLUTIONS:

- **Because reserves do not require immediate payout, there is time to address any inadequacies in reserves. Precipitous action is not warranted. For instance, even if the reserve shortfall is one and a half or two billion as some allege, there are still $8 billion in reserves to use up prior to needing any cash.**
    - The present value of the monies the state "appropriated" (i.e. took) from MMIA is at least $1.4 billion, when interest at 4% is reflected. If we include the monies taken from the HIC by the state, the present value is $1.7 billion. In other words, had the state not taken the money; there would be little or no shortfall today.

- **The State should pledge to pay back the monies it appropriated over time if the crisis actually develops into a cash (as opposed to an accrual) need. This will give the state many years to return the monies it took.**

- **If assessments are ultimately needed, all P/C insurers should be billed, not just the medical malpractice insurance writers, and should be billed only as necessary for the cash needs of the next period for which the assessment is made.**
    - The assessment base is too small and should be allocated to all P/C carriers in the state once more.

[10] New York State Department of Insurance, "Cost Drivers in Ratemaking – An Overview, 2006 Profitability Report New York Medical Malpractice." This chart indicates that there is certainly no crisis here. Notably, profit on insurance transactions does not include investment return on surplus.

ATTACHMENT 1

NEW YORK MEDICAL MALPRACTICE EXPERIENCE DEVELOPMENT OF INFLATION-ADJUSTED PER DOCTOR WRITTEN PREMIUM AND PAID LOSSES FROM 1975 TO DATE

YEAR	Direct Premiums Written (DPW)	Direct Losses Paid (PL)	Loss Ratio	Number of 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	27.6%	46,393	47.5	$2,428	$669	1975	$17,187	$4,735
1976	$127,679,765	$30,018,024	23.5%	46,935	52	$2,720	$640	1976	$17,588	$4,135
1977	$160,860,475	$41,003,255	25.5%	47,478	57	$3,388	$864	1977	$19,984	$5,094
1978	$166,062,891	$58,520,232	35.2%	48,020	61.8	$3,458	$1,219	1978	$18,813	$6,630
1979	$189,000,515	$85,184,416	45.1%	48,563	67.5	$3,892	$1,754	1979	$19,384	$8,737
1980	$212,169,479	$107,385,433	50.6%	49,105	74.9	$4,321	$2,187	1980	$19,394	$9,816
1981	$252,103,328	$112,760,851	44.7%	50,562	82.9	$4,986	$2,230	1981	$20,221	$9,044
1982	$271,923,193	$148,956,326	54.8%	52,020	92.5	$5,227	$2,863	1982	$18,999	$10,407
1983	$293,240,995	$188,977,759	64.4%	53,477	100.6	$5,483	$3,534	1983	$18,326	$11,810
1984	$283,861,417	$205,377,839	72.4%	54,935	106.8	$5,167	$3,739	1984	$16,266	$11,769
1985	$530,787,017	$230,263,811	43.4%	56,392	113.5	$9,412	$4,083	1985	$27,881	$12,095
1986	$660,307,449	$272,951,926	41.3%	57,262	122	$11,531	$4,767	1986	$31,777	$13,136
1987	$712,816,848	$332,134,833	46.6%	58,133	130.1	$12,262	$5,713	1987	$31,687	$14,764
1988	$865,125,258	$383,778,736	44.4%	59,003	138.6	$14,662	$6,504	1988	$35,566	$15,778
1989	$884,623,310	$402,302,269	45.5%	59,874	149.3	$14,775	$6,719	1989	$33,270	$15,130
1990	$854,403,798	$362,843,038	42.5%	60,744	162.8	$14,066	$5,973	1990	$29,047	$12,336
1991	$793,879,724	$409,388,834	51.6%	62,745	177	$12,652	$6,525	1991	$24,033	$12,393
1992	$811,974,970	$559,175,764	68.9%	64,746	190.1	$12,541	$8,636	1992	$22,179	$15,274
1993	$870,300,422	$615,013,468	70.7%	66,748	201.4	$13,039	$9,214	1993	$21,766	$15,381
1994	$923,163,546	$576,724,483	62.5%	68,750	211	$13,428	$8,389	1994	$21,395	$13,366
1995	$905,070,538	$544,403,418	60.2%	70,751	220.5	$12,792	$7,695	1995	$19,505	$11,732
1996	$822,075,016	$591,710,868	72.0%	72,314	228.2	$11,368	$8,183	1996	$16,748	$12,055
1997	$816,663,055	$598,744,431	73.3%	73,877	234.6	$11,054	$8,105	1997	$15,842	$11,615
1998	$886,935,822	$634,166,913	71.5%	75,440	242.1	$11,757	$8,406	1998	$16,327	$11,674
1999	$900,034,082	$795,112,336	88.3%	77,003	250.6	$11,688	$10,326	1999	$15,681	$13,853
2000	$849,687,717	$700,772,374	82.5%	78,566	260.8	$10,815	$8,920	2000	$13,942	$11,498
2001	$881,194,813	$698,555,720	79.3%	80,129	272.8	$10,997	$8,718	2001	$13,553	$10,744
2002	$992,924,544	$732,555,312	73.8%	80,667	285.6	$12,309	$9,081	2002	$14,490	$10,690
2003	$1,107,374,159	$781,788,782	70.6%	81,199	297.1	$13,638	$9,628	2003	$15,433	$10,895
2004	$1,284,228,574	$980,901,472	76.4%	81,716	310.1	$15,716	$12,004	2004	$17,038	$13,014
2005	$1,372,467,390	$935,093,278	68.1%	82,301	323.2	$16,676	$11,362	2005	$17,347	$11,819
2006	$1,500,463,000	$1,008,063,000	67.2%	83,000	336.2	$18,078	$12,145	2006	$18,078	$12,145

Sources: Premiums Written (Net), A.M. Best and Co., special data compilation for AIR, reporting data for as many years as separately available; Number of Total NonFed Doctors: U.S. Bureau of the Census; 2006 estimated as the data are not due for publishing until 12/07. Inflation Index: Bureau of Labor Statistics.