



## **Medical Malpractice Insurance: Stable Losses/Unstable Rates in Illinois (February 2003)**

### **Introduction and Summary of Findings**

On February 26, 2003, Illinois doctors have scheduled a walkout to protest high malpractice insurance rates in the state. In formulating a solution to assist those doctors who are being price-gouged, it is critical first to determine why some 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 Illinois, 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 Illinois 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, since 1991, the amount that medical malpractice insurers have paid out in Illinois, including all jury awards and settlements, has steadily dropped below rates of medical inflation. When measured in constant dollars, the average payout per doctor rose from approximately 1979/1980 to 1991, but has declined since then. In other words, medical malpractice claims payments (in constant dollars) have been essentially decreasing for the last decade in Illinois.
- Second, medical insurance premiums charged by insurance companies over the last 30 years in Illinois have not corresponded to increases or decreases in payouts. Rather, premiums have spiked, and then 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

Insurance companies have convinced medical lobbies in Illinois 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 Illinois, 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 Illinois 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 Illinois doctors are demanding be enacted.

As on the national level, insurance rates for doctors in Illinois 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 Illinois 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 1985 in Illinois, the legislature enacted several "tort reform" measures for medical malpractice cases, including structured settlements and restrictions on lawyers' fees for patients' attorneys.

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. The same has been true for Ohio and Mississippi. 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 Illinois, 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 Illinois 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 Illinois 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**

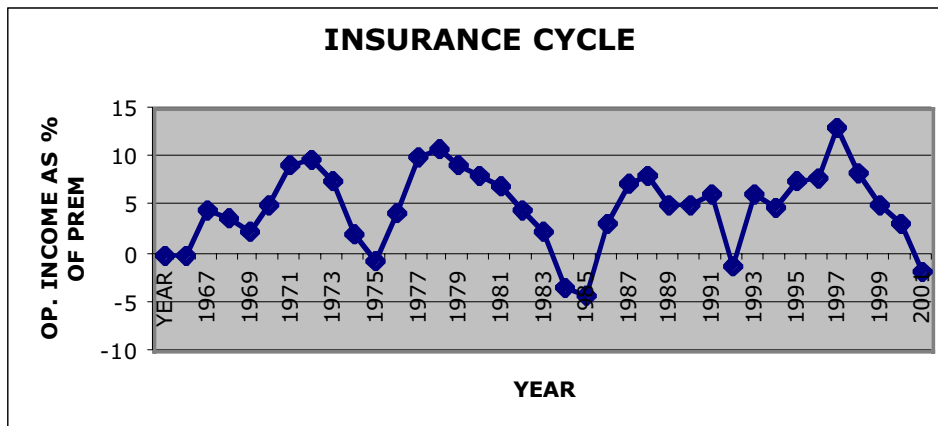
Insurers make most of their profits from investment income. During years of high interest rates and/or excellent insurer profits, insurance companies engage in fierce competition for premium dollars to invest for maximum return. Insurers severely underprice their policies and insure very poor risks just 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 five-to-ten 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 11<sup>th</sup>. 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.<sup>1</sup> 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 Illinois insurers and are therefore the reason behind skyrocketing insurance rates, then losses per doctor should be rising faster than medical inflation over time.

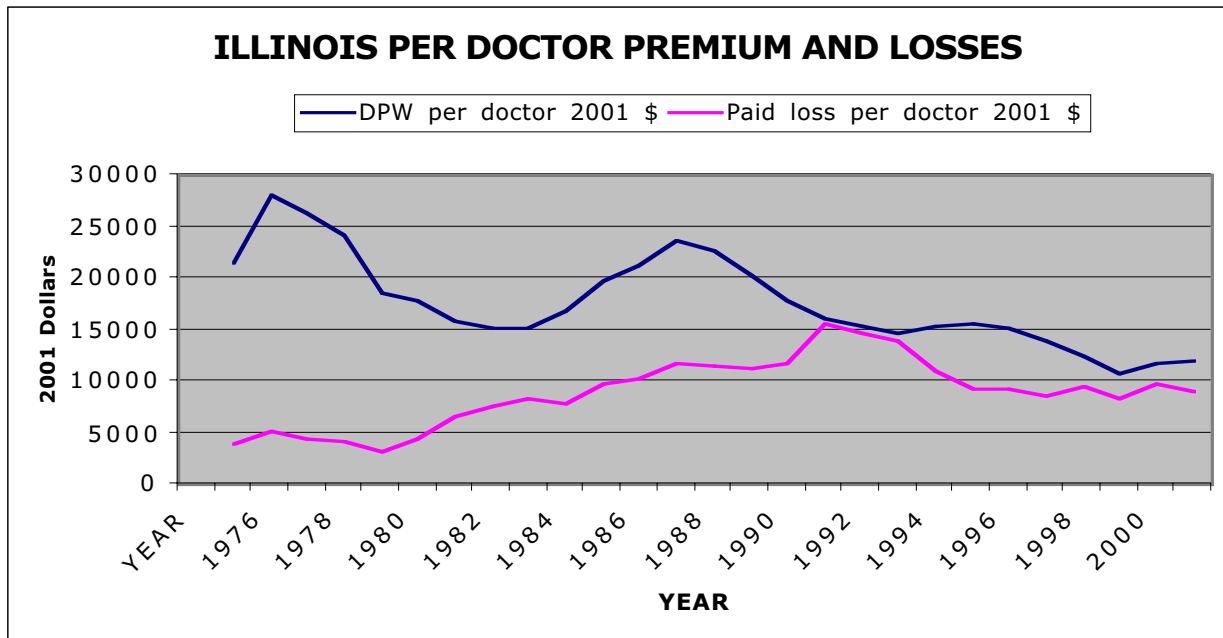
<sup>1</sup> “...there is clearly an opportunity now for companies to price gouge – and it’s happening.... But I think companies are overreacting, because they see a window in which they can do it.” Jeanne Hollister, consulting actuary, Tillinghast-Towers Perrin, quoted in, “Avoid Price Gouging, Consultant Warns,” *National Underwriter*, January 14, 2002.

- Second, if lawsuits or other tort costs are the cause of rate increases for Illinois 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 Illinois. First, they show that the average payout per doctor rose from about 1979/1980 to 1991, but has dropped since then. In other words, medical malpractice claims payments (in constant dollars) have been essentially decreasing 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. Rates spiked in 1976 and in 1988 (three years after “tort reform” was enacted in Illinois.) In sum, the results of AIR's analysis of data from 1975 to 2001, illustrated in Exhibits 2 and 3, are startling; Illinois premiums rise and fall with the economic cycle, as illustrated in Exhibit 1, but losses paid do not.

## Exhibit 2



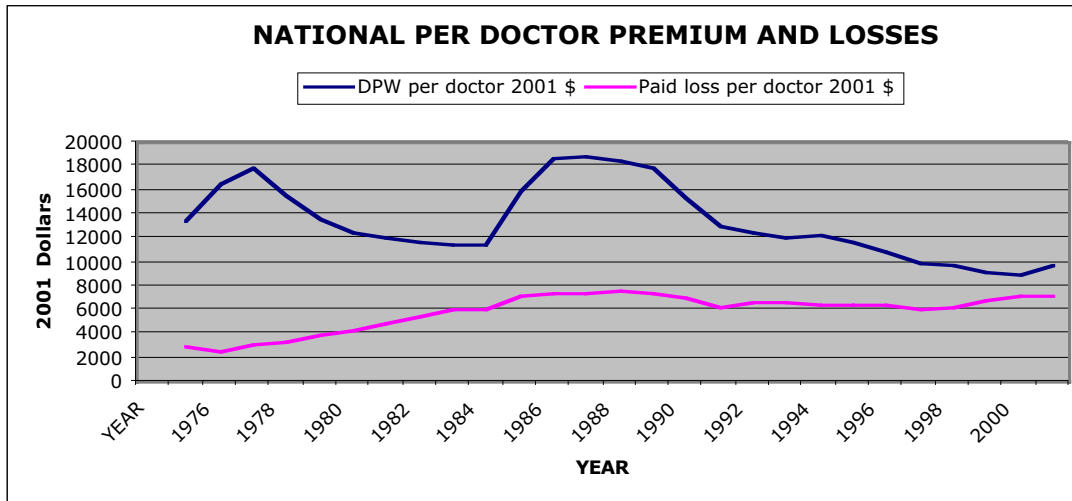
**Sources:** A.M. Best and Co. special data compilation for AIR, reporting data for as many years as separately available; Number of Total NonFed Doctors: U.S. Bureau of the Census (data for 1975, 80, 85, 90, 95 and 99; other years estimated); Inflation Index: Bureau of Labor Statistics (1975 and 1985 estimated)

**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.<sup>2</sup>

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



<sup>2</sup> 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 Illinois 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 – Illinois Data

YEAR	Direct Premiums Written (DPW)	Direct Losses Paid (PL)	Loss Ratio	Number Doctors Illinois	Medical Inflation (cpi-u)	DPW Per Doctor	PL Per Doctor	YEAR	DPW Per Doctor 2001 \$	PL Per Doctor 2001 \$
1975	67,432,311	12,289,578	0.182	18234	47	3698	674	1975	21465	3912
1976	101,203,247	18,302,241	0.181	18935	52	5345	967	1976	28039	5071
1977	107,593,153	18,439,482	0.171	19636	57	5479	939	1977	26224	4494
1978	111,626,431	19,383,778	0.174	20338	61.8	5489	953	1978	24228	4207
1979	96,219,255	16,922,588	0.176	21039	67.5	4573	804	1979	18483	3251
1980	105,712,597	26,551,955	0.251	21740	74.9	4863	1221	1980	17710	4448
1981	107,053,572	45,383,354	0.424	22377	82.9	4784	2028	1981	15743	6674
1982	118,173,360	59,749,688	0.506	23005	92.5	5137	2597	1982	15150	7660
1983	131,423,543	71,609,712	0.545	23638	100.6	5560	3029	1983	15077	8215
1984	160,194,191	74,913,601	0.468	24270	106.8	6601	3087	1984	16860	7884
1985	205,510,587	101,448,745	0.494	24903	113.5	8252	4074	1985	19835	9791
1986	240,057,176	115,191,500	0.480	25243	122	9510	4563	1986	21265	10204
1987	289,062,600	143,620,045	0.497	25583	130.1	11299	5614	1987	23692	11771
1988	299,658,424	150,048,436	0.501	25923	138.6	11560	5788	1988	22752	11393
1989	292,337,783	161,628,411	0.553	26263	149.3	11131	6154	1989	20339	11245
1990	294,238,391	193,348,978	0.657	26603	162.8	10683	7020	1990	17901	11763
1991	299,548,304	288,745,327	0.964	27543	177	10517	10137	1991	16209	15624
1992	313,975,672	298,041,594	0.949	28483	190.1	10671	10129	1992	15313	14536
1993	326,445,451	311,508,047	0.954	29424	201.4	10751	10259	1993	14563	13896
1994	371,407,980	265,653,838	0.715	30364	211	11865	8486	1994	15340	10972
1995	392,317,358	235,966,882	0.601	31304	220.5	12532	7538	1995	15505	9326
1996	405,418,830	247,345,667	0.610	32113	228.2	12625	7702	1996	15092	9208
1997	392,770,265	238,619,299	0.608	32922	234.6	11930	7248	1997	13873	8428
1998	373,543,376	284,467,283	0.762	33731	242.1	11074	8433	1998	12478	9503
1999	341,766,048	262,626,802	0.768	34540	250.6	9895	7604	1999	10771	8277
2000	393,725,344	332,924,227	0.846	35349	260.8	11138	9418	2000	11651	9852
2001	432,425,486	323,015,606	0.747	36158	272.8	11959	8933	2001	11959	8933

**Sources:** 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 (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.

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 Illinois* 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 essentially fallen below rates of medical inflation for the last decade. 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 Illinois and nationwide raise rates when they are seeking ways to make up for declining interest rates and investment losses.