Americans for Insurance Reform
"PROTECTING RIGHTS, NOT WRONGS"

Medical Malpractice Insurance: Stable Losses/Unstable Rates

October 10, 2002

Introduction and Summary of Findings

For the first time, Americans for Insurance Reform (AIR), a coalition of nearly 100 consumer groups around the country, has produced a comprehensive study of medical malpractice insurance, examining specifically what insurers have taken in and what they've paid out over the last 30 years. AIR examined everything that 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:

- First, the amount that medical malpractice insurers have paid out, including all jury awards and settlements, directly tracks the rates of medical inflation. Not only has there been no "explosion" in medical malpractice payouts at any time during the last 30 years, but payments (in constant dollars) have been extremely stable and virtually flat since the mid-1980s.

- Second, medical insurance premiums charged by insurance companies do not correspond to increases or decreases in payouts, which have been steady for 30 years. Rather, premiums rise and fall in concert with the state of the economy —insurance premiums (in constant dollars) increase or decrease 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 them.

Background

The nation's insurance companies are advancing 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.

The insurance industry argues and worse, convinces doctors 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 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.

Insurance rates for doctors 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. Each of these periods was followed by a wave of legislative activity to restrict injured patients' rights to sue for medical malpractice. Medical and insurance lobbyists told legislators that changes in tort law were needed to reduce medical malpractice insurance rates.

One of the first states to react to this now third insurance "crisis" for doctors has been 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 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, 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 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 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

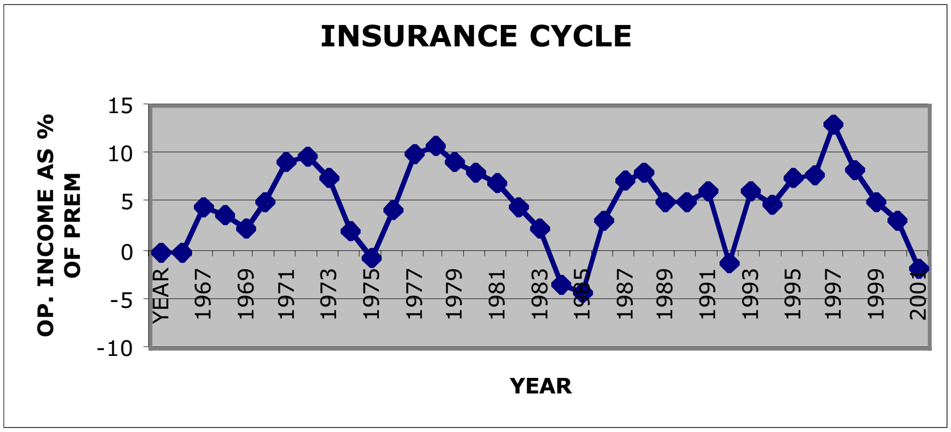
Insurers make most of their profits from investment income. During years of high interest rates and/or excellent insurer profits, insurance companies engage in fierce competition for premium dollars to invest for maximum return. Insurers severely underprice their policies and insure very poor risks just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

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 attack 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 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 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.

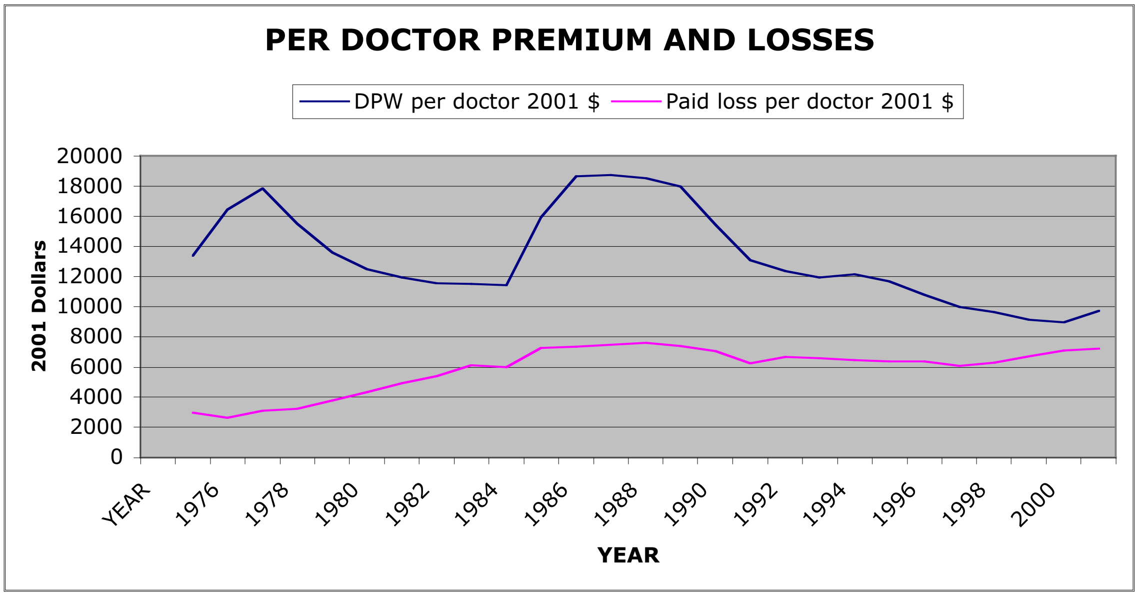
AIR finds both hypotheses are completely false. The data in Exhibits 2 and 3 below, are more than simply conclusive. They are "smoking guns" which should, once and for all, end the debate about the cause of these periodic medical malpractice crises. First, they show that since 1975, medical malpractice paid claims per doctor have tracked medical inflation very closely (slightly higher than inflation from 1975 to 1985 and flat since). In other words, payouts have risen almost precisely in sync with medical inflation, which should surprise the doctors who dutifully march off at the insurers' trumpet call to seek tort law changes. These data confirm that neither jury verdicts nor any other factor affecting total claims paid by insurance companies that write medical malpractice insurance have had much impact on the system's overall costs over time.

Second, while payouts closely track medical inflation, 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 illustrated in Exhibits 2 and 3 are startling; premiums rise and fall with the economic cycle, as illustrated in Exhibit 1, but losses paid do not.

[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.

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)[2]; 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]

[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 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.

[3] "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 in loss reserves in 2001. 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 the1980s, 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.

Exhibit 3

	Direct	Direct		Number	Medical	Direct	Direct		Direct	Direct
	Premiums	Losses		Doctors	Care	Premiums	Losses		Premiums	Losses
	Written	Paid	Loss	in USA	Inflation	Written	Paid		Written	Paid
Year	(thousands)	(thousands)	Ratio	(active)	(CPI-U)	per doctor	per doc.	Year	per doctor	per doctor
									2001 $	**2001 $**
1975	865,208	190,867	0.221	366,425	47	2361	521	1975	13705	3023
1976	1,187,978	188,545	0.159	378,572	52	3138	498	1976	16463	2613
1977	1,423,091	248,969	0.175	381,969	57	3726	652	1977	17831	3120
1978	1,412,555	294,456	0.208	401,364	61.8	3519	734	1978	15535	3238
1979	1,405,991	391,800	0.279	417,266	67.5	3370	939	1979	13618	3795
1980	1,493,543	521,849	0.349	435,545	74.9	3429	1198	1980	12490	4364
1981	1,616,470	665,570	0.412	444,899	82.9	3633	1496	1981	11956	4923
1982	1,815,056	847,543	0.467	462,947	92.5	3921	1831	1982	11563	5399
1983	2,033,911	1,079,862	0.531	479,440	100.6	4242	2252	1983	11504	6108
1984	2,282,590	1,197,979	0.525	511,090	106.8	4466	2344	1984	11408	5987
1985	3,407,177	1,556,300	0.457	514,000	113.5	6629	3028	1985	15932	7277
1986	4,335,863	1,709,883	0.394	519,411	122	8348	3292	1986	18666	7361
1987	4,781,084	1,905,491	0.399	534,692	130.1	8942	3564	1987	18750	7473
1988	5,166,811	2,128,281	0.412	549,160	138.6	9409	3876	1988	18518	7628
1989	5,500,540	2,273,628	0.413	559,988	149.3	9823	4060	1989	17948	7419
1990	5,273,360	2,415,117	0.458	572,660	162.8	9209	4217	1990	15431	7067
1991	5,043,773	2,423,418	0.480	594,697	177	8481	4075	1991	13072	6281
1992	5,228,362	2,808,838	0.537	605,685	190.1	8632	4637	1992	12387	6655
1993	5,469,575	3,028,086	0.554	619,751	201.4	8825	4886	1993	11954	6618
1994	5,948,361	3,174,987	0.534	632,121	211	9410	5023	1994	12166	6494
1995	6,107,568	3,326,846	0.545	646,022	220.5	9454	5150	1995	11697	6371
1996	6,002,233	3,556,151	0.592	663,943	228.2	9040	5356	1996	10807	6403
1997	5,864,218	3,587,566	0.612	684,605	234.6	8566	5240	1997	9961	6094
1998	6,040,051	3,957,619	0.655	707,000	242.1	8543	5598	1998	9627	6308
1999	6,053,323	4,446,975	0.735	720,900	250.6	8397	6169	1999	9141	6715
2000	6,303,206	4,988,474	0.791	735,000	260.8	8576	6787	2000	8970	7099
2001	7,288,933	5,424,197	0.744	750,000	272.8	9719	7232	2001	9719	7232

Conclusion

Stable Losses/Unstable Rates represents the first comprehensive report on medical malpractice insurance 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. While insurer payouts directly track the rate of medical inflation, medical insurance premiums do not. Rather, they rise and fall in relationship to the state of the economy. Not only has there been no real increase lawsuits, jury awards or any tort system costs at any time during the last three decades, but the astronomical premium increases that some doctors have been charged during periodic insurance “crises” over this timeperiod are in exact sync with the economic cycle of the insurance industry, driven by interest rates and investments. In other words, insurance companies raise rates when they are seeking ways to make up for declining interest rates and market-based investment losses.