A REPORT TO THE LEGISLATIVE COUNCIL AND
THE SENATE AND HOUSE COMMITTEES
ON INSURANCE AND COMMERCE
OF
THE ARKANSAS GENERAL ASSEMBLY
(AS REQUIRED BY ACT 1007 OF 2003)

ANNUAL STUDY OF MEDICAL MALPRACTICE INSURANCE MARKET IN ARKANSAS

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REPORT TO THE LEGISLATURE ON ACT 1007 OF 2003 ANNUAL STUDY OF MEDICAL MALPRACTICE INSURANCE MARKET IN ARKANSAS

INTRODUCTION AND BACKGROUND MATERIAL

Act 1007 of 2003 requires the following:

(a) The Insurance Commissioner shall conduct an annual study of malpractice insurance rates in Arkansas and report the findings to the Legislative Council and the chairs of both the House and Senate Interim Committees on Insurance and Commerce.

(b) The study shall include:

(1) Any findings regarding any changes in medical malpractice rates;

(2) Any other finding that is relevant to malpractice insurance rates; and

(3) Any recommendations in respect to any law relating to medical malpractice insurance.

Arkansas has a "competitive rating law" for the medical malpractice line, Ark. Code Ann. §§ 23-67-501 *et seq*., which is cumulative to any applicable provisions found in §§ 23-67-201 *et seq*., §§ 23-67-509. Rates are approved or disapproved within sixty (60) days after the date of filing, Ark. Code Ann. § 23-67-506(d). The Commissioner is required to use standards for rates promulgated in Ark. Code Ann. § 23-67-502 in determining whether to approve or disapprove a filing. Ark. Code Ann. § 23-67-502 requires that rates shall not be excessive, inadequate or unfairly discriminatory; however, the Commissioner may approve an excessive rate if failure to approve the rate may tend to substantially lessen competition in the Arkansas malpractice insurance market, Ark. Code Ann. § 23-67-506(e).

There are two common misconceptions about the role of the Legislature and Insurance Department regarding insurance rates. The first misconception is that either entity has the ability to control market exits of companies. There is no statutory authority to compel an insurer to provide medical malpractice insurance coverage; furthermore, any law requiring an insurer to do business in Arkansas would be disruptive to the entire marketplace, spilling over into other lines of insurance.

The second misconception concerns the Department's oversight of rates. Medical malpractice rates must be filed at least sixty (60) days prior to the proposed effective date for use in the state. The Department has broad authority to review how the rate is distributed among insureds according to factors that might predict future losses; we cannot, however, disapprove an overall rate unless it is actuarially "excessive, inadequate or unfairly discriminatory."

Definitions

- "Excessive:" A rate becomes excessive when the loss ratio (losses, including adjustment expenses and operating expenses, divided by premium paid) drops to a point which results in the insurance company earning an excessive amount of profit.

- "Inadequate:" A rate is inadequate if it will lead to immediate solvency problems or has the potential for long-term solvency implications in that it may not provide sufficient funds to pay future claims, the costs of adjusting those claims and operating the business.

- "Unfairly Discriminatory:" All insurance discriminates among various risks. There is "fair," i.e., "legal" discrimination, and "unfair," i.e., illegal discrimination. "Unfair" discrimination basically means not treating similar risks the same in rates and coverages.

Overall base rates for an insurer are determined by the application of actuarial expertise to the standards set forth in the applicable state law.[1] To this amount is added an expected amount for adjusting claims, distribution or sales expenses, administration, taxes and fees, and defense costs.

An individual insured's rates are normally established by applying discounts and credits or surcharges/debits to a base rate. Under our law those discounts, credits or surcharges/debits must be such that they "…measure differences among risks that can be demonstrated to have a probable effect upon losses or expenses."[2]

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[1] 23-67-209. Rating criteria.

(a) Due consideration must be given to past and prospective loss and expense experience within and outside this state, to catastrophe hazards and contingencies, to events or trends within and outside this state, to loadings for leveling rates over a period of time, to dividends or savings to be allowed or returned by insurers to their policyholders, members, or subscribers, and to all other relevant factors. All submissions for rate changes or supplementary rate changes must include this information with Arkansas' experience shown, as well as companywide experience for the past five (5) years for the class of business which this filing affects. The determination of the weighting of credibility assigned to Arkansas must be fully explained. If, within a particular class, the data is not sufficiently credible for Arkansas or companywide, and common classes are grouped together for rate-making purposes, all class codes utilized in developing credibility shall be shown as an exhibit in the filing, with Arkansas' experience for each class affected shown separately. If significant trends within the state are utilized, a narrative describing the basis of the trend must be included.

(b) Risks may be classified in any reasonable way for the establishment of rates, except that no risks may be grouped by classifications based in whole or in part on race, color, creed, or national origin of the risk.

(c) The expense provisions included in the rates to be used by any insurer shall reflect the operating methods of the insurer and its actual and anticipated expense experience.

(d) The rates may contain provisions for contingencies and an allowance permitting a reasonable profit. In determining the reasonableness of the profit, consideration must be given to all investment income attributable to premiums and to the reserves associated with those premiums and to loss reserve funds.

23-67-503. Rating criteria.

(a) A malpractice insurer shall consider past and prospective loss experience solely within this state.

(b)(1) If insufficient experience exists within this state upon which a rate can be based, the malpractice insurer may consider experience within any other state or states that have similar claim costs and frequency.

(2) If sufficient experience from any other state is not available, the malpractice insurer may use nationwide experience.

(c) In its rate filing and records, the malpractice insurer shall provide detailed information on the data supporting the experience it is using.

(d) When experience outside this state is considered, as much weight as possible shall be given to state experience.

[2] 23-67-210. Rating plans.

(a) Rates may be modified to produce premiums for individual risks in accordance with filed rating plans which establish standards for measuring variations in hazards or expense provisions. Those standards may measure differences among risks that can be demonstrated to have a probable effect upon losses or expenses. The modification shall apply to all risks under the same or substantially the same circumstances or conditions.

23-67-506. Review of filings.

… (e) Notwithstanding subsection (d) of this section, the commissioner may approve an excessive rate if he or she finds that the failure to approve the rate may tend to substantially lessen competition in the Arkansas malpractice insurance market.

Typical characteristics used to measure those differences may include:

- Medical specialty involved, including multiple practice characteristics
- Claims defense and history of paid claims and amount of payment
- Exposures - number of patients
- Emergency room practice
- Length of time in practice
- Location of practice
- Implementation of risk management practices
- Staff size and training
- Continuing education
- Board Certification

The most basic factor affecting availability for an individual seeking medical malpractice coverage is whether they meet the underwriting criteria of the insurer. Some underwriting concerns include:

- Professional sanctions
- Nursing home affiliation
- Willingness to implement risk management procedures
- Type of claims - severity and certainty of negligent conduct

FINDINGS

No filings affecting the various lines comprising medical malpractice insurance were made with the Arkansas Insurance Department during this past reporting period by an existing company actively seeking new business.

Each filing is subject to the normal rate review for excessive, inadequate, or unfairly discriminatory levels, as well as the other statutory requirements set forth in Ark Code Ann. §§ 23-67-201 *et seq*. and §§23-67-501 *et seq*. Filings that trigger concerns about excessive or inadequate rates or that contain significant increases are referred to an actuary. While the companies provide actuarial justification as part of the filing, the Department's actuary may require additional supporting documentation as a part of his review.

Impact statements regarding the affect of Act 649 of 2003 are filed pursuant to Bulletin 2-2003 that was promulgated as a result of the passage of the Act, which dealt with certain procedural and substantive issues in the state's tort system.

Arkansas still has a limited number of companies actually writing new medical malpractice liability policies. Currently, there are 19 companies renewing existing business or seeking new policyholders. They are:

The Doctors Company, an Interinsurance Exchange
First Professionals Insurance Company
Medical Protective Company
Podiatry Insurance Company of America (podiatrists only)
Preferred Professional Insurance Company
State Volunteer Mutual Insurance Company
Louisiana Medical Mutual Insurance Company (LAMMICO)
Granite State Insurance Company
Medicus Insurance Company
MAG Insurance Company
Arkansas Mutual Insurance Company
ProAssurance Indemnity Company, Inc.
Fortress Insurance Company
Liberty Insurance Underwriters, Inc.
State Farm Fire and Casualty Company (dentists)
Continental Casualty Company (only renewing existing business)
American Casualty of Reading, PA (nurses only, only renewing existing business)
National Union Fire Insurance Company of Pittsburgh, PA (Healthcare agencies only, only renewing existing business)
Capson Physicians Insurance Company

Since August 1, 2014, no rate actions have occurred.

Our review of previous rate filings indicates existing rates for the companies in question are adequate and the rate level changes do not create statutorily excessive rate levels. We did not find anything in the filings that results in unfair discrimination between similar risks. Each filing complies with Ark. Code Ann. §§ 23-67-201 *et seq*. and §§ 23-67-*501 et seq*. at the time of filing.

The aggregate loss and defense and costs containment expense ("DCCE") ratio for Arkansas for 2014 was 74.4%. The pure loss ratio was 58.46%. [3]

The ratios above are for the entire market of medical malpractice including technical and allied support, in addition to physicians, surgeons and hospitals, and include many adjustments made by companies that are presently not writing the coverage and are not reflective of current experience. It is likely those numbers reflect the fact that pending claims are being settled, dismissed or otherwise resulted in final disposition. When you examine the results of only those companies writing the coverage you see similar results. For this group, the aggregate loss and defense and costs containment expense ("DCCE") ratio for Arkansas for 2014 was 75.44 %. The aggregate pure loss ratio for the line was 61.21%.

[3] All loss results are those paid during 2014.

A point to note is that for the coverages of most concern – physicians, surgeons, and hospitals – loss ratios have continued to remain favorable and constant prior to 2014. Most companies continue to use 2010 rates.

Loss adjustment expenses and the cost of defense are still significantly higher in the medical malpractice line than in other lines of insurance. A significant portion of medical malpractice premiums is derived from the cost to investigate and defend claims (even when a claimant abandons a claim, loses in court or prevails). Due to the nature of the claim, expert witnesses are needed (which are other medical professionals) and highly specialized litigation counsel is often required. Sometimes the cost of defending a claim can equal or exceed the amount paid in judgments or settlements. Providing a defense is both an obligation of the insurance company and a benefit to the insured medical provider. The following table presents a comparison of medical malpractice loss and expense ratios of those companies actually writing medical malpractice coverages as compared to commercial liability coverage and private passenger auto liability coverage.

YEAR	2014			2013		
Line of Insurance	Medical Malpractice	Commercial Multi Peril (Liability Portion)	Private Passenger Auto Liability	Medical Malpractice	Commercial Multi Peril (Liability Portion)	Private Passenger Auto Liability
Pure Loss Ratio	58.46%	34.43%	60.78%	72.44%	62.93%	62.38%
DCCE Ratio	15.94%	-1.21%	1.70%	11.41%	8.3%	1.69%
Pure plus DCCE	74.40%	33.22%	62.48%	83.23%	48.94%	63.84%

YEAR	2012			2011		
Line of Insurance	Medical Malpractice	Commercial Multi Peril (Liability Portion)	Private Passenger Auto Liability	Medical Malpractice	Commercial Multi Peril (Liability Portion)	Private Passenger Auto Liability
Pure Loss Ratio	38.04%	40.24%	62.19%	50.18%	64.4%	59.57%
DCCE Ratio	45.19%	8.7%	1.66%	10.33%	5.26%	1.63%
Pure plus DCCE	60.51%	69.73%	61.2%	34.10%	73.26%	66.54%

CONCLUSION

Since the passage of Acts 1007 and 649 of 2003, the number of filings for companies actively writing insurance in the medical malpractice market has slowed. New offerings have become available. Loss experience for the entire market has generally decreased to where it is often less than other liability lines; when you consider loss adjustment, selling and operating expenses of the writing companies, the combined ratio for the active companies will likely remain below 100% reflecting a profitable market.

Loss ratios for those companies actively soliciting new business remain high when compared to other liability lines. Due to the specialized nature of litigation in this area, claims investigation, adjustment and defense costs are, on average, substantially higher than for other liability lines. The effects of Act 649 of 2003 have encouraged new entries into the market. The impact statements of existing writers still express a very conservative approach to the Act's long-term effect.

Repeal of all or a portion of Act 649 of 2003 in a future legislative session would make Arkansas less attractive to those companies providing medical malpractice coverage to Arkansas's medical community. Arkansas has seen more interest by insurers in the market since the passage of the Act; however, two Supreme Court cases in 2010 struck down significant parts of this Act. It remains to be seen whether this will have any significant effect on the growth of the medical malpractice market or malpractice insurance rates in Arkansas.

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