

# Understanding Changes in the Medical Malpractice Insurance Market

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## Introduction

You have probably heard that the insurance marketplace is hardening. Simply put, insurance exists to transfer financial risk from one company to another which guarantees payment of claims or losses for a specified amount of premium. That premium can fluctuate in any given year for a variety of reasons, much to the ire of many CFOs, and sometimes due to no “fault” of the insured. This is because while insurance companies look to invest premiums collected to pay for future claims, sometimes the rate of incurring those claims can outpace the returns on investment. When insurers are asked to contribute an increasing amount of money to claim settlements, this creates a need for more premium to cover the spread of their total losses.

For some insurance products, like Property for example, insurers immediately feel the impact of losses as soon as they hit their balance sheet. A hurricane that levels an entire office building directly impacts the company’s profits and losses at the close of that fiscal year. Pricing corrections are immediately implemented to return the insurer’s business back to being profitable.

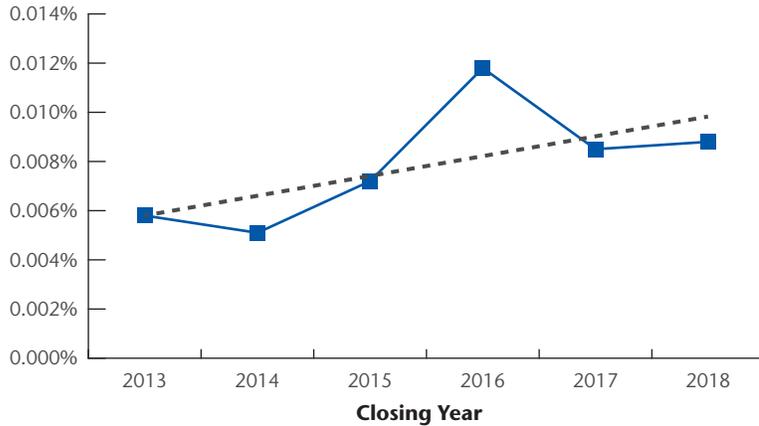
Medical Professional Liability (MPL) insurance operates differently. When an insurer writes a malpractice policy, it typically does not know how that year will perform for 5-7 years afterwards due to the length of time to discover injury, bring a claim or file suit, settle a claim, or reach a trial verdict. MPL insurance is a waiting game that can have a cumulative negative impact on insureds and insurers alike when losses outpace policy year projections.

The MPL insurance marketplace previously enjoyed decades of soft market conditions, driving competition for buyers and insurers. Low premiums, abundant capacity, and relaxed underwriting guidelines allowed insurers to aggressively compete for increased market share, all the while hospital merger and acquisition activity dramatically increased as physician practices were acquired, and hospital systems grew through mergers. This soft market allowed insureds to inexpensively purchase large limit insurance towers, negotiate long-term deals to keep pricing or rates flat over the deal term, and add in mid-term exposure growth for little to no premium up-front. Coverage terms and conditions were generally broad, and coverage grants typically permitted without much negotiation. Such was the calm before the storm.

## Large Claim Trends

As reported in previous Aon benchmark studies, there continues to be a steady increase in the frequency of extremely large claims. The chart below shows that continual increase in large claim frequency of claims greater than \$5 million.

**Aon Database: Frequency of Claims Greater than \$5 Million per OBE**



News headlines from around the U.S. commonly detail \$30 million, \$80 million, and greater than \$150 million jury awards with no apparent end in sight. As plaintiff attorneys have become successful in achieving these high value verdicts in their hometowns, they have become more confident in trying cases in new venues. In recent news, Pennsylvania is proposing to eliminate a venue rule, which would allow venue shopping instead of limiting medical malpractice cases to the county where the claimant’s injuries occurred. It is unknown if this will go into effect, however, it sparks the question of how this will impact medical malpractice trends, especially large claims.

As the frequency of large claims has increased, settlement amounts have also trended upward during the same period, contributing to a frequency of severity. As shown in the chart below, the Aon database reports that the average indemnity paid for claims over \$5 million was \$8.6 million a few years ago, compared to \$10 million now. This supports the idea that a large claim is even larger today, on average.

**Aon Database: Claims Greater than \$5 Million; Closed Claims Only**

Closing Year Band	Number of Claims >\$5M per 10K OBEs	Average Indemnity Paid - Unlimited
2013-2015	0.602	8,600,000
2016-2018	0.969	10,000,000

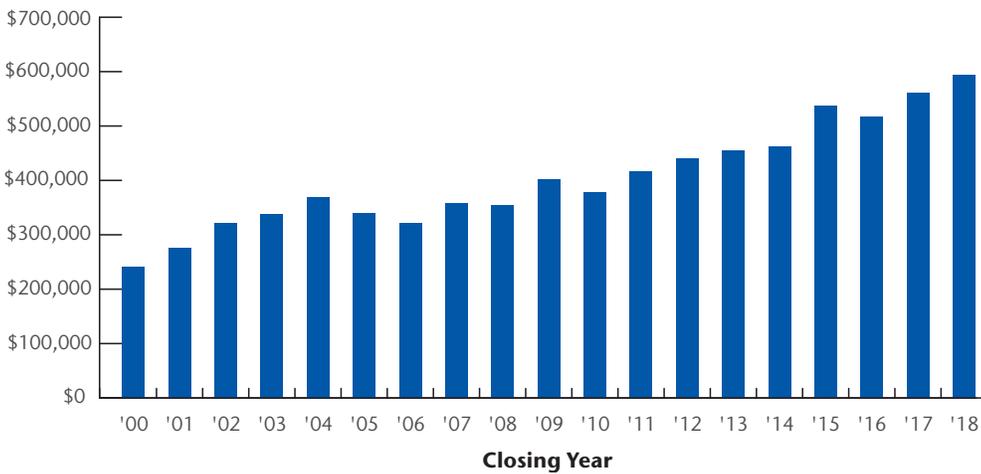
**Further Support on Large Medical Malpractice Claim Trends from Beazley Group**

Each year, Beazley evaluates current trends in U.S. hospital professional liability (PL) claims using its HealthRate database, which contains more than 850,000 unique hospital PL claims and represents 47% of U.S. hospital beds. Beazley’s analysis shows that once again in 2018 there was a rise in the increased cost of paid professional liability claims.

For claims with indemnity closing in the 2018 calendar year, the average paid claim increased by 6% versus 2017. The cumulative effect of year-on-year increases is that over the past decade, average PL claim values have increased by 50%, from \$400,000 per claim in 2009 to almost \$600,000 in 2018.

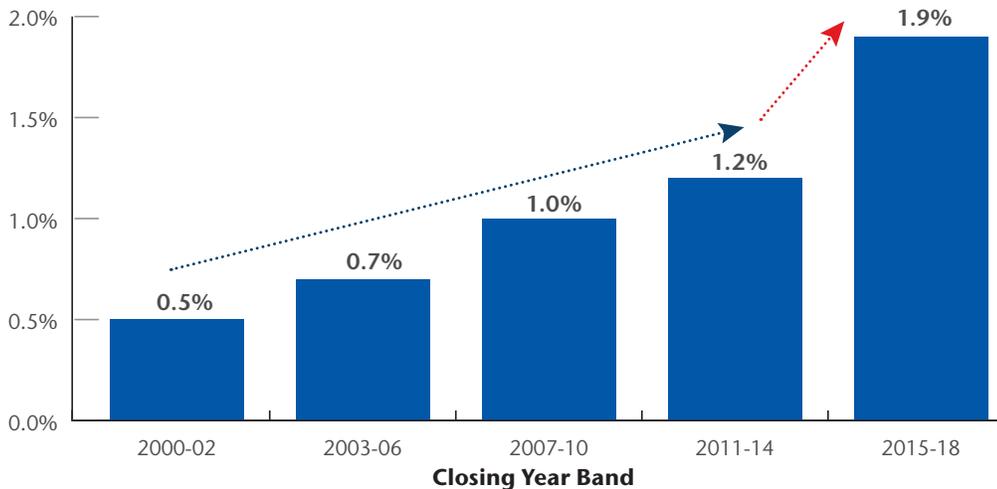
Furthermore, average paid values have more than doubled since 2000, with the largest step up in average cost occurring within the four most recent closing years (from 2015 to 2018).

**Beazley Database: Average Cost of Claims with Indemnity (>\$10,000)**



An increase in the average cost of claims with indemnity is driven by a higher portion of large claims in recent years. Beazley have observed that the cost of the highest value claims is increasing at an even faster rate. The chart below shows the steepest increase in the proportion of claims greater than \$5 million since 2000 occurs in the last four closing years.

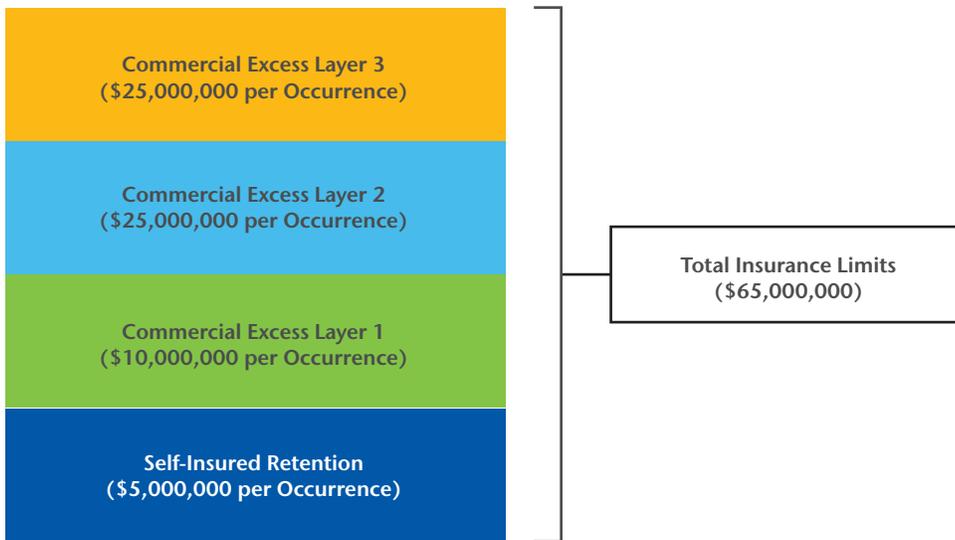
**Beazley Database: Proportion of Claims Exceeding \$5 Million by Closing Year Band**



Both Aon and Beazley confirm that medical malpractice claims greater than \$5 million look different today than how they looked several years ago. This begs the question of how the insurance market is reacting to these changes as a number of industry stakeholders face the consequences of this trend, including pressures to the insurance carrier balance sheet as well as pressure on health care organizations' risk transfer program structures.

### Insurance Market Trends and Consequences

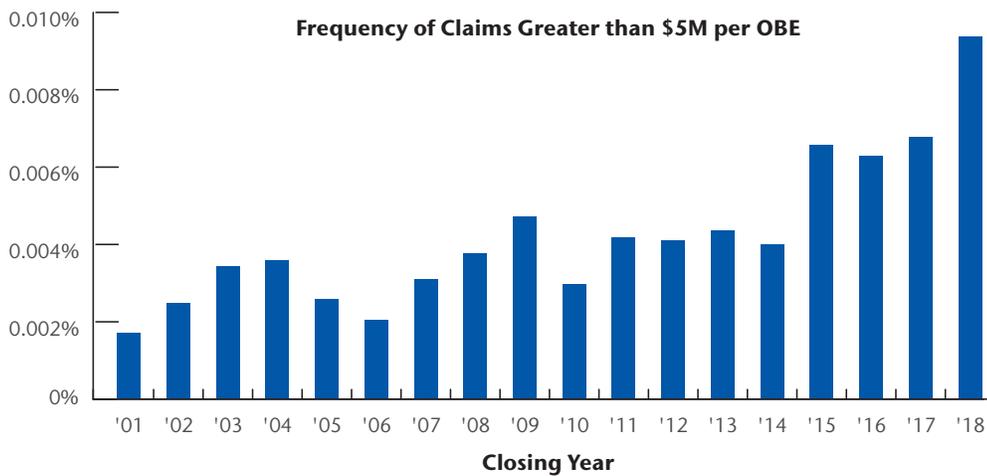
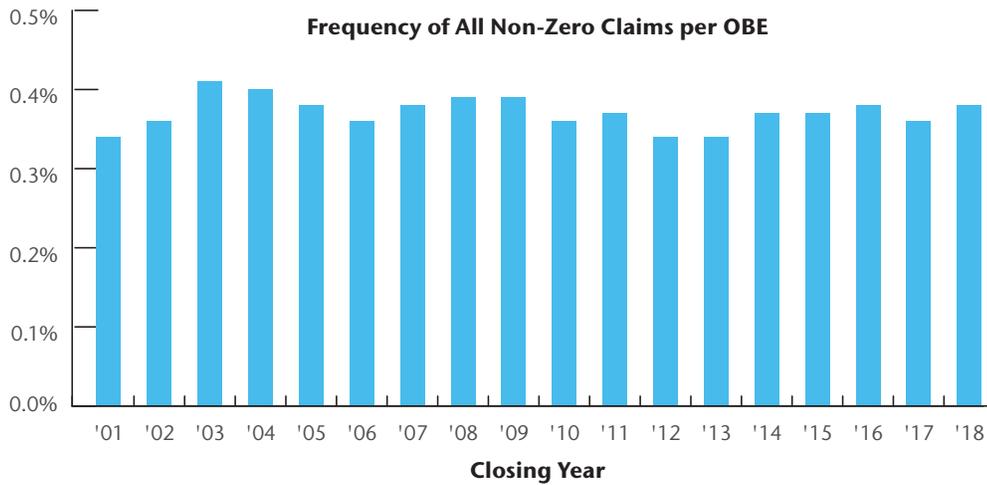
The medical malpractice liability insurance marketplace is different than other insurance lines of business because the risk transfer to the commercial insurance market typically occurs above a very high self-insured retention layer, i.e., commercial excess layer. The graphic below provides an example of a medical malpractice insurance tower that would apply to any given MPL occurrence, where the commercial insurance excess coverage would begin after a MPL occurrence breaches the initial \$5 million retention.



Interestingly, this year's Aon/ASHRM benchmark report found that loss rates limited to \$2 million per occurrence are trending at a modest 2% annual rate. This finding suggests that health care organizations are expected to experience relatively modest annual increases in actuarial funding requirements within their self-insured retention layer. However, as claims being paid by (re)insurers in the higher excess layers have become more significant, premiums have started to increase.

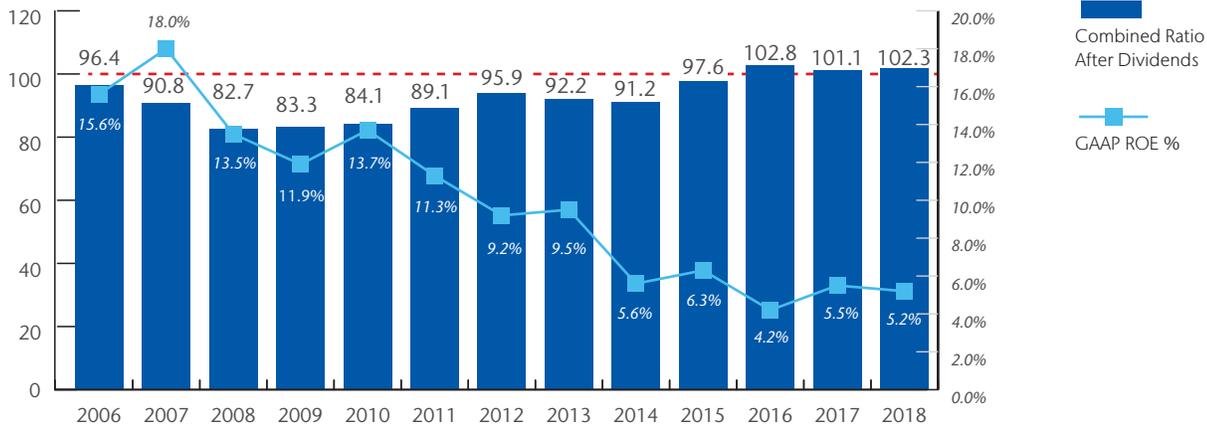
This is apparent when comparing the frequency of all non-zero claims as well as frequency of claims greater than \$5 million. As shown below, the frequency trend for all claims is relatively stable. However, when we observe the frequency of claims exceeding \$5 million, the trend has increased significantly in the last few years.

**Beazley Database: Frequency of Claims with an Indemnity Payment per OBE**



As the number of these sensational verdicts increases, insurers’ surplus may become depleted and potentially impact their ability to pay claims. Some portfolios have become so unprofitable that insurers have exited the malpractice marketplace altogether, while others that continue to write malpractice insurance have begun to look for other insurance products or service offerings to strengthen their portfolios. As shown in the chart below, insurance carriers have experienced a combined ratio greater than 100%. In an environment where expenses are fairly stable, this suggests that losses are deteriorating.

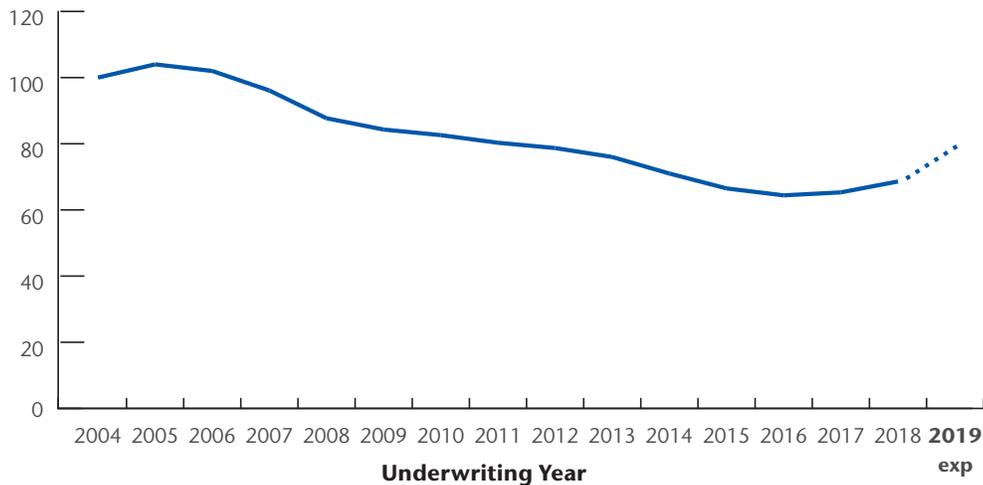
### U.S. Medical Professional Liability - Financial Ratios (2006-2018)



Source: A.M. Best data and research (Market Segment Reports U.S. Medical Professional Liability)  
 ROE Source: Conning Year-End Report based on Best's data

The majority of U.S. hospitals and health systems, including Beazley's clients, have benefited from years of declining rates, combined with significant exposure increase. However, this is not sustainable in the current marketplace. Throughout the soft market, Beazley's rate change index fell below 100, through a combination of both pure premium reductions as well as taking on more exposure (such as more employed physicians, acquisition of hospitals and health systems, widening of terms & conditions). In 2017-18, Beazley began to see a firming in premium rates (which we expect to continue in 2019), however, the chart illustrates that there is considerable way to go to make up the rate erosion of the sustained soft market.

### Beazley Database: Rate Change Index



## What is the Difference Between a Soft Market and a Hard Market?

Another challenge to health care organizations in the current “hardening” market is MPL insurers looking to cut or limit capacity on renewal programs. Especially in more severe venues, carriers are not willing to insure to full capacity on a risk transfer program. Those insurers that previously would supply \$25 million in capacity may look to provide only \$10 million or \$15 million for an expiring layer. Unfortunately, reductions in capacity do not equate to reductions in pricing during a hard market cycle and more pressure is put on the attachment point resulting in increased retentions for insureds, which helps offset some of the premium increases required by (re)insurers. Ultimately, this does add financial pressure to insureds.

A few consequences of the combined effect of reduced MPL insurer capacity, increased self-insured retentions, and premium increases are (1) rate increases are occurring for some accounts with no MPL losses and no exposure growth, (2) mid-term exposure additions are seeing premium collected at the time the increased exposure was contemplated rather than at the next renewal, and (3) MPL excess layers are often experiencing double digit rate increases. Another insurance market trend observed during the current “challenging” market is insurers purchasing reinsurance and moving away from “net” writing to insulate their portfolios from catastrophic losses. As reinsurance costs and loss ratios rise, surplus is depleted, capacity is limited, and coverage grants are either restricted or lessened, thus, hard market persists. The chart below summarizes in more detail the main differences between soft and hard market.

Indicator	Soft Market Trend	Hard Market Trend
<b>Capacity</b>	▲ Capacity remains abundant	▼ ↔ Restrictions to capacity exist especially in difficult jurisdictions or by line of business
<b>Coverage</b>	▲ Expanded coverage with fewer exclusions	▼ ↔ Coverage grants lessened as underwriting becomes more stringent. Some restrictions imposed
<b>Limits</b>	▲ Additional limits purchased taking advantage of competitive pricing	▼ ↔ Additional limits may be purchased based on exposure growth. Some may look to reduce total limits to offset rising reinsurance/insurance costs
<b>Retention</b>	▼ ↔ Retentions stay stagnant and may see some reductions	▲ Retentions increase, buffer layers may be added. Certain insurers will impose minimum attachment points
<b>Pricing</b>	▼ Competition helps drive down pricing, multi-year deals achievable	▲ Pricing increases and cost of reinsurance rises. Rate negotiations become difficult, especially if exposures grow or loss activity rises
<b>Losses</b>	▼ ↔ Loss development remains stable or experience decrease in frequency and severity	▲ Increased severity and frequency of losses. Reserves inadequate relative to large claim development

Legend: ▲ = Increasing ▼ = Decreasing ↔ = Stable

## How Do Health Care Organizations Weather the Storm of a Hard or “Challenging” Market?

1. Risk financing vehicles like a captive insurance company become incredibly valuable and important to help an organization navigate a volatile insurance market. Existing captive companies with strong surplus levels may find they are better equipped to manage increased claims and defense activity. Established captive companies may also assess the performance of the current lines underwritten through the captive and could consider adding additional lines of business to help strengthen and diversify the captive’s balance sheet. Oftentimes adding in low volatility/low risk lines of business can also help build up captive surplus which can be vital if loss activity within the captive were to increase. Programs like Equipment Maintenance and Provider or Employee Stop Loss can help achieve positive rates of return for a captive. Furthermore, a captive will also help an insured access reinsurance markets and provide coordinated coverage terms and claims control throughout the entire insurance tower.
2. Using a qualified and knowledgeable actuary to help develop a loss forecast and pricing analysis of the entire MPL insurance tower can be the difference between a positive insurance renewal, or a negative one. Actuaries are heavily relied on by insurance companies to price for the products they are selling. Consulting actuaries are often hired by health care organizations (i.e., the “insured”) to assist with the estimation of losses within its self-insured retained layers. It is often helpful if the goals of these two actuaries are aligned, which may not always be the case. Thus, insureds may consider having an independent actuary review what the total cost of risk to the organization may be at various retention levels and pricing for the excess layers above the retention. This in turn allows the broker to factually negotiate pricing on behalf of the insured.
3. Spend time getting to know your underwriters and their claims team. Understand what the insurers expectations are up front on loss run reporting, litigation updates, claims reviews, and their overall philosophy to claims handling. Insurance should work for an insured, not against them and the value of a company or its product isn’t realized for many insureds until a claim arises. If insureds are considering marketing coverage, then they should look to interview the claims team before binding coverage and agree to certain parameters on how claims will be managed when the relationship begins. It may be worth paying higher premium to have greater comfort with the claims team.
4. Insureds should also look to develop strong relationships with insurance carriers. Hard markets typically mean insurance coverage may be marketed to find capacity, minimize rate increases, or seek better/broader terms. Therefore, underwriters are inundated with submissions to review and quote. A relationship that has been percolating over time will have a better chance of being underwritten. Ultimately, insurance continues to be a personal business and if an underwriter feels they have good insight into a company’s operations, business model, and quality initiatives they will be more likely to offer terms at renewal, or mid-term if needed.

5. Accessing the global marketplace for insurance will become extremely important. Insureds should look at Domestic, European, and Bermudian insurers to participate in their MPL program. By engaging the global marketplace for participation, insureds can create stability within their insurance portfolio as insurer appetite routinely changes. Furthermore, accessing international markets can offer enhanced coverage options like the Bermuda Cat IO form which provides catastrophic coverage for batch claims, for example. Syndication and quota shares can also offer solutions to capacity issues on expiring layers and can further help stabilize pricing to those layers. As insurers either reduce capacity or announce changes in appetite, splitting up participation on a single layer will make it much easier to replace insurers as necessary; it is less problematic to refill 20% of the whole versus 100%.

### Impacting Outcomes with Defense Strategies

While there appears to be no “magic bullet” for successfully defending claims, we have seen insureds intelligently use mock juries and focus groups in trial preparation. Additionally, insureds can look to strategically assign defense counsel based on the known prowess of plaintiff’s counsel. While a health care organization may have a long-standing relationship with one firm, they may not be best equipped at managing defense of a claim depending on the strength and previous success of plaintiff’s counsel. Hosting regular workshops and retreats for counsel to share best practices can also assist to this end. Lastly, early resolution of a claim is generally a best practice which can cut down on time, expense, and overall value of a claim. However, sometimes saying “no” to demands can be the best strategy, and insureds should always be prepared for trial and not shy away from defending the hospital, or its physicians.

### Conclusion

Health care organizations have made incredible progress in their clinical safety programs and other risk management strategies after the first hard market, which occurred over 20 years ago. But as all medical malpractice liability insurance stakeholders confront the trends today, after years of soft market experience, it is extremely important that health care organizations have a cohesive team supporting their risk management strategy. This includes not only the internal risk management or financial leaders of the health care organization itself but reinforcing the need to have support from health care industry-focused brokers, consultants, actuaries, insurance carrier partners, and even experienced and effective defense counsel. It’s the collaborative approach of the entire team inside and outside the health care organization that will drive change in this marketplace.