

**Illinois General Assembly
House Judiciary 1 – Civil Law Committee Hearing**

Subject: Medical Malpractice

**Testimony of Lawrence E. Smarr, President
Physician Insurers Association of America**

April 7, 2005

INTRODUCTION

Chairman Fritchey, Representative Hultgren and Members of the Committee, I am Lawrence E. Smarr, President of the Physician Insurers Association of America (PIAA). The PIAA is an association comprised of professional liability insurance companies owned and/or operated by physicians, dentists, hospitals and other health care providers. Our 48 domestic insurance company members insure over 300,000 doctors and 1,300 hospitals in the United States. Our members providing insurance protection in Illinois are: ISMIE Mutual Insurance Company, American Physicians Assurance Corporation, ProAssurance Corporation, OMS National Insurance Company, The Doctors' Company, PIC Wisconsin, Medical Liability Mutual Insurance Company, First Professionals Insurance Company, the Podiatry Insurance Company of America, Ophthalmic Mutual Insurance Company, and NCMIC Insurance Company. These companies, all provider owned or operated, insure almost 75% of the Illinois market.

PIAA members can be characterized as healthcare professionals caring for the professional liability risks of their colleagues - doctors insuring doctors, hospitals insuring hospitals. The provider owned/operated insurance company members of the PIAA insure over 60% of America's doctors, thus being the primary source of medical professional liability insurance coverage across the nation, and also here in Illinois. I thank the Committee for providing me the opportunity to appear here before you today to provide our perspective on the medical liability crisis on a national basis.

INSURANCE INDUSTRY UNDERWRITING PERFORMANCE

Over the past five years insurers have seen their financial performance deteriorate substantially due to the rapidly rising cost of claims. According to A.M. Best, the medical liability insurance line of business incurred \$1.34 in losses and expenses for every dollar of premium it collected in the year 2000. This statistic rose to \$1.55 in 2001, and has gradually declined to an estimated \$1.33 for 2004, and Best estimates this statistic to be \$1.31 for 2005. The impact of insurer rate increases accounts for the gradual improvement. However, Best also calculates that the industry can only incur \$1.14 in losses and expenses in order to operate on a break-even basis. This implies that future rate increases can be expected as the carriers move toward sustainable operations.

INCREASING CLAIM COSTS

The primary driver of the deterioration in the medical malpractice insurance industry performance, as confirmed by both the Government Accountability Office (GAO) and the National Association of Insurance Commissioners (NAIC), has been paid claim severity, or the average cost of a paid claim.

Exhibit A

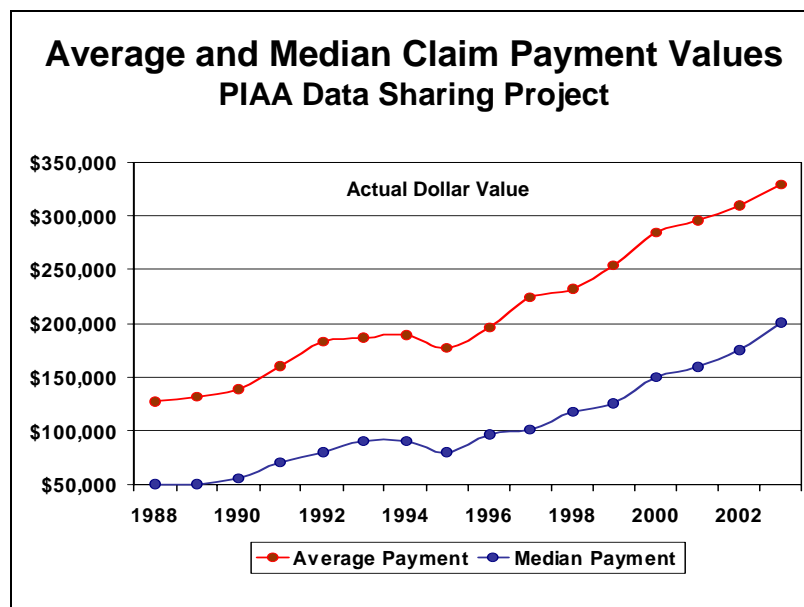
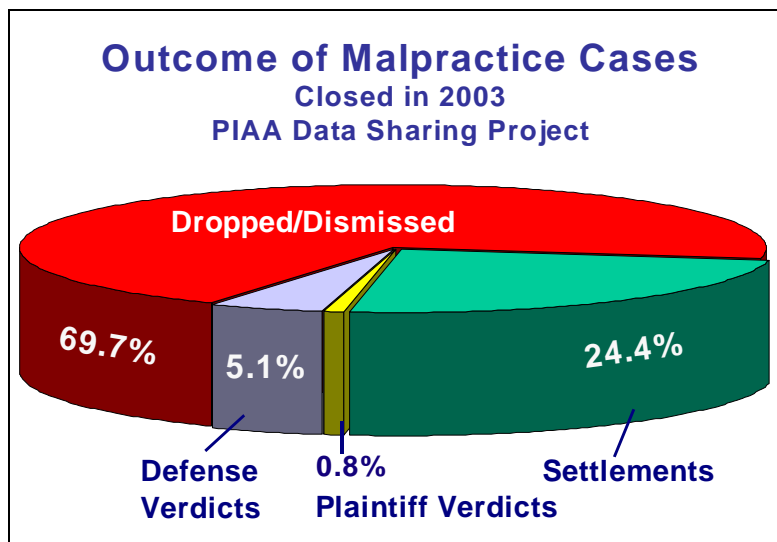


Exhibit A shows the average dollar amounts paid to plaintiffs on behalf of individual physicians since 1988. The mean payment amount has risen by 6.6% per year during this period, as compared to 2.9% for the Consumer Price Index (CPIu). The data for this exhibit comes from the PIAA Data Sharing Project, which is a patient safety database created in 1985 to identify common trends among malpractice claims. To date, over 199,000 claims and suits have been reported.

One very troubling aspect of medical malpractice claims is the proportion of those filed which are ultimately determined to be without merit, shown in EXHIBIT B. Almost 70% of all claims filed against individual practitioners reported in 2003 were dropped or dismissed by the court. When claims went to verdict, 5.1% were won by the doctor, and only .8% were won by the plaintiff. The remainder, 24.4% resulted in a settlement payment. While the experience varies somewhat from year-to-year, our long-term data shows that the plaintiff receives remuneration in only 30% of all claims filed, and when the claim was concluded at verdict, the plaintiff prevails only 20% of the time.

EXHIBIT B



A review of the average claim payment values for 2003 is revealing. As shown on Exhibit C, the mean indemnity payment amount on behalf of an individual defendant was \$328,757. Average verdicts cost \$431 thousand, and settlements “only” \$323 thousand. Most medical malpractice cases have multiple defendants, and thus, these values are below those which may be reported on a case basis.

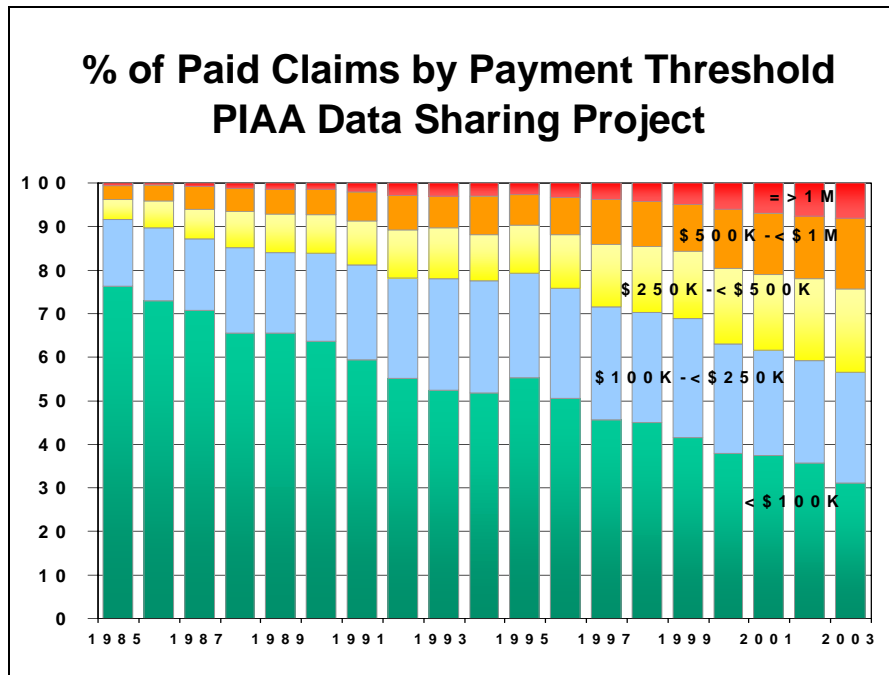
EXHIBIT C

PAYMENT VALUES - 2003	
<small>PIAA Data Sharing Project (As of May 2004)</small>	
Mean Indemnity Payment	\$ 328,757
Mean Expense Payment	\$ 29,683
Won at Trial	\$ 87,720
Lost at Trial	\$ 123,543
Settled	\$ 45,716
Dropped/Dismissed	\$ 17,408

It is very costly for insurers to defend these cases, with the cost to proceed through trial approaching \$100,000.

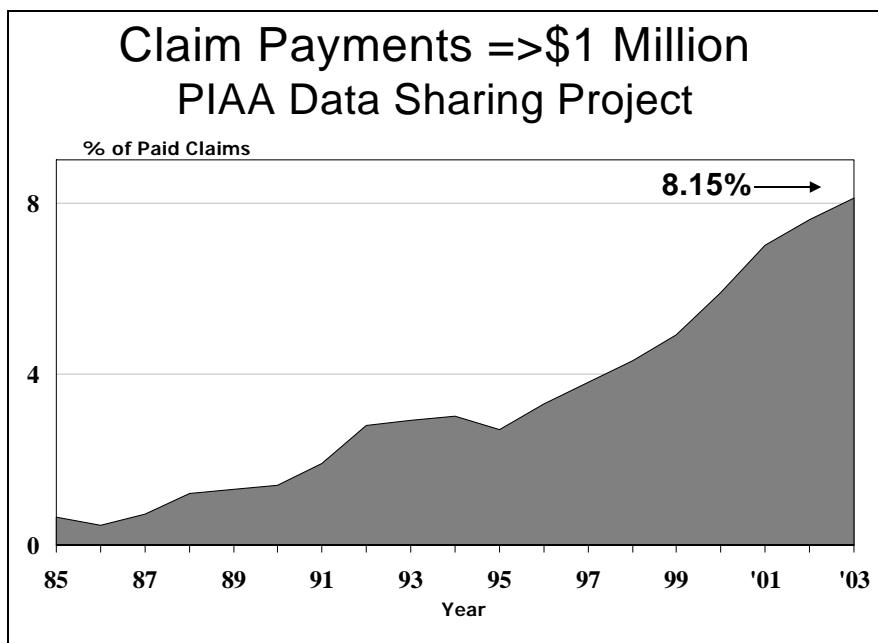
Exhibit D shows the distribution of claim payments at various payment thresholds. It can be readily seen that the number of larger payments are growing as a percentage of the total number of payments.

EXHIBIT D



This is especially true for payments at or exceeding \$1 million, which comprised 8.1 percent of all claims paid on behalf of individual practitioners in 2003, as shown on Exhibit E. This percentage has almost doubled since 1998.

EXHIBIT E



THE ROLE OF INVESTMENT INCOME

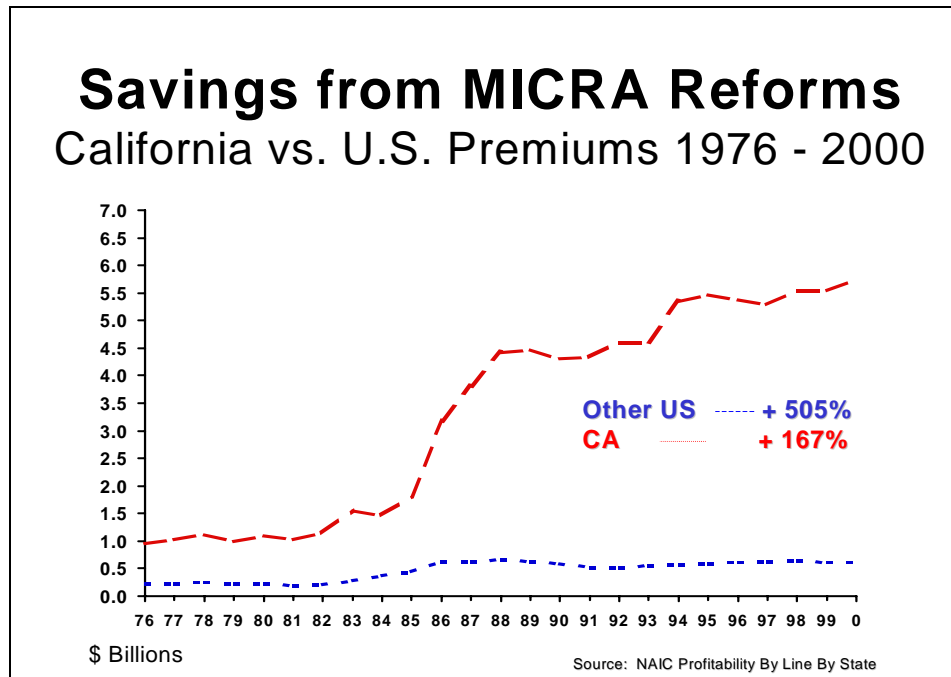
In addition to rising claim severity, like all other investors, medical liability insurers have faced declining market interest rates. Insurers invest the premiums they collect and use the resulting investment income to offset premium needs. While insurer interest income has declined due to falling market interest rates, the net investment income of insurers has remained positive in all years. While opponents of tort reform often make false allegations that the crisis is caused by insurers who lost great sums in the stock market, this is simply false. Industry analyses, which I will address later, clearly indicate that medical malpractice insurers are primarily invested in bonds, not stocks, and that market decreases in bond interest rates have had only a minor effect on increasing medical malpractice premiums.

THE ANSWER

The PIAA advocates the state and federal adoption of the reforms found in the Medical Injury Compensation Reform Act (MICRA) which became effective in California in 1976.

Using data published by the National Association of Insurance Commissioners, Exhibit F documents the savings California practitioners and health care consumers have enjoyed since the enactment of MICRA over 25 years ago. Here, total malpractice premiums reported to the NAIC between 1976 and 2000 have grown in California by 167%, while premiums for the rest of the nation have grown by 505%.

EXHIBIT F



We have been keeping track of this data over time, and the changes since 2000 are remarkable, as demonstrated on the next three charts.

EXHIBIT G

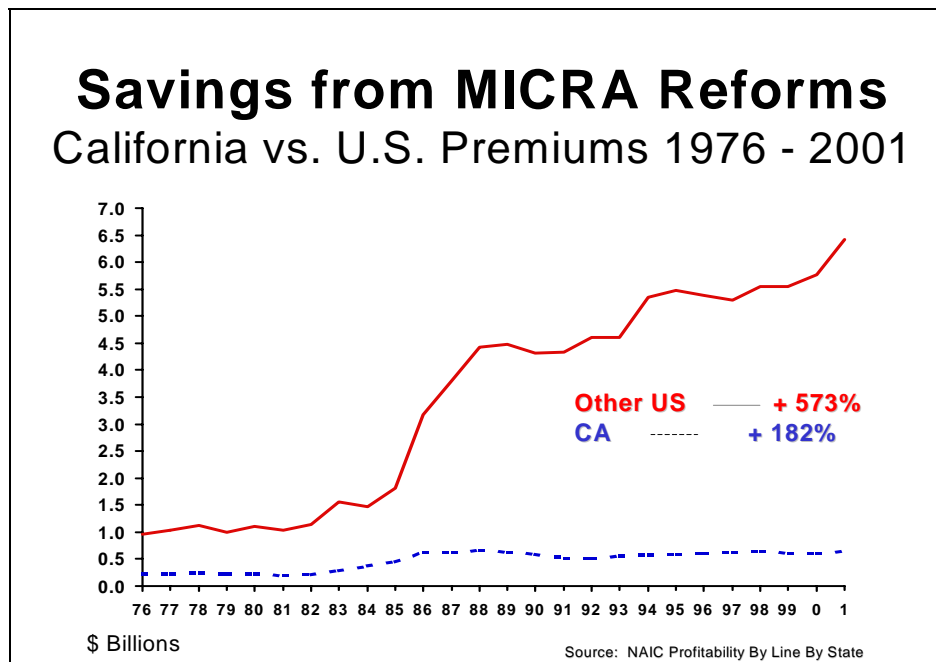


EXHIBIT H

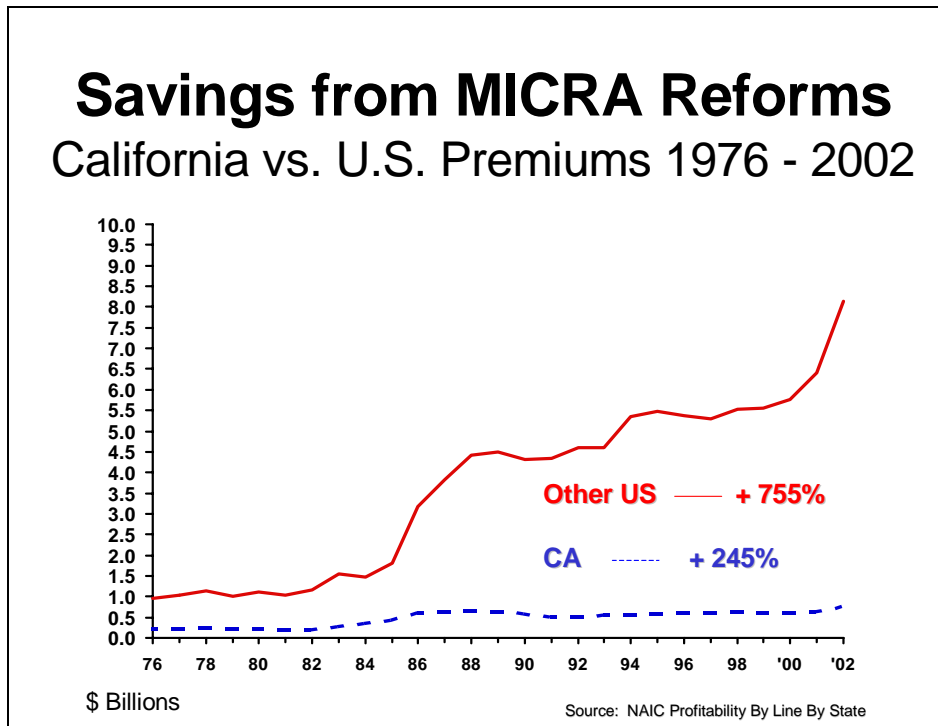
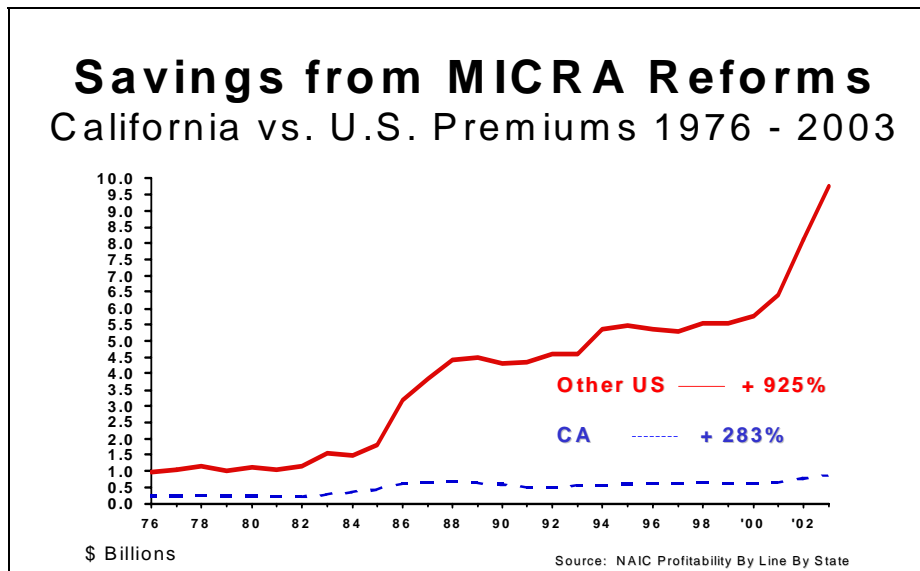


EXHIBIT I



By 2003, the latest year for which data is available from the National Association of Insurance Commissioners, total malpractice premiums have grown 3.26 times faster

in the rest of the nation as compared to California alone – proof that California's MICRA law works.


These savings are clearly demonstrated in the rates charged to California doctors as shown on Exhibit J. Successful experience in California and other states such as Colorado makes it clear that these tort reforms do work without lowering health care quality or limiting access to care. For example, an OB/GYN in Los Angeles pays \$66,000, compared to his/her Miami counterpart who pays \$277,000 per year. While a little better than Miami, Chicago doctors face extremely high premiums as well.

EXHIBIT J

California Premiums Low w/Tort Reform:
Data Source: Medical Liability Monitor
2004 Premium Survey Data for Selected Specialties
\$1 million/3 million limits

Specialty	Los Angeles ¹	Denver ²	Chicago ³	Miami ⁴
Internal Medicine	\$13,808	\$12,711	\$38,424	\$69,310
General Surgery	40,436	43,529	102,700	277,241
OB/GYN	66,100	39,973	147,540	277,241

1 SCPIE Indemnity Co.
2 COPIC Insurance Co.
3 ISMIE Mutual Insurance Company
4 First Professionals Insurance Company



WHO CAN YOU BELIEVE?

You have, no doubt, been told by others who have testified before you that medical liability tort reforms do not work, and that states having non-economic damage caps do not have lower premiums than those that do. There are plenty of bogus analyses which have surfaced on this issue, such as the one produced by Weiss Ratings, which has been widely discredited. As reported by the National Association of

Insurance Commissioners in their recent market analysis¹, both of Mr. Weiss' data sources, the National Practitioner Data Bank and the Medical Liability Monitor, have disagreed with his methodology. I have our analysis of Weiss' work to provide to you, and you can be the judge. There's also the notion that something called Prop 103 is responsible for California's low premiums, and that's not true either. Prop 103 was an automobile and homeowner's insurance initiative intended to control rates in these lines of insurance. Medical liability insurers were also subject to Prop 103, which had no material effect. Contrary to what you may have been told, no medical malpractice insurer rolled back their rates one cent because of this initiative, but rather, they made a one-time return of premium in 1992 which was included as part of their normal dividend payment process. Prop 103 is unique to California, and it does not explain why other states having meaningful non-economic damage caps have similar experience, such as Colorado, Kansas and most recently, Texas, where rates for most doctors have dropped by 17% since its cap was enacted in late 2003.

Mr. Chairman, I do have a dog in this fight, and some may want to characterize me as being a little biased. Even though I fervently believe and attest that everything I have presented is accurate and truthful to the best of my knowledge, I won't be too surprised if some don't want to believe all I have said here today. But, I do ask you to also look to the independent entities which have examined this issue and give credence to what they have found in their investigations.

- 1) United States Government Accountability Office [formerly known as the General Accounting Office] (GAO)

In June of 2002, the GAO was requested by nine Democratic Members of Congress known to be opponents of tort reform, including Senator Richard Durbin of Illinois, to investigate the nature and causes of the medical liability crisis, focusing on the insurance industry. They specifically asked the GAO to

¹ National Association of Insurance Commissioners, *Medical Malpractice Insurance Report: A Study of Market Conditions and Potential Solutions to the Recent Crisis*, September 12, 2004, page 48.

investigate insurers' underwriting results, investment income, loss reserves, and market practices to see how these issues may relate to the crisis situation. The GAO's extensive report was published a year later, and here are the major findings as found on pages 4 and 5 of the report².

- "Multiple factors have contributed to the recent increases in medical malpractice premium rates..."
- "...increased losses appeared to be the greatest contributor to increased premium rates..."
- "...medical malpractice insurers experienced decreases in their investment income as interest rates fell on the bonds that generally make up around 80 percent of these insurers' investment portfolios."
- "almost no medical malpractice insurers experienced net losses on their investment portfolios..."
- market competition during the 1990s may have forced rates too low for some carriers
- "...beginning in 2001 reinsurance rates for medical malpractice insurers also increased more rapidly than they had in the past, raising insurers' overall costs."

I have a copy of the GAO report here to provide to the Committee for your reference, and also copies of the other documents I will now briefly address.

2) Congressional Budget Office (CBO) – Scoring of the Help, Efficient, Accessible, Low-Cost, Timely Healthcare (HEALTH) Act of 2003.

The CBO was asked to perform an evaluation of federal legislation named the HEALTH Act which proposed tort reforms similar to those enacted in California in 1975 (Medical Injury Compensation Reform Act, MICRA). Identical reforms were

² US General Accounting Office, *Medical Malpractice Insurance, Multiple Factors Have Contributed to Increased Premium Rates*, GAO-03-702, June, 2003.

included in bills HR 4600 and HR 5 in the 108th Congress. Both bills were scored (evaluated) by CBO, and as the results are similar, I will only address the most recent bill, HR 5. The CBO estimated that HR 5 would provide savings of \$18.1 billion to the Federal Government through savings in Medicare costs and the Federal Employees Health Benefits Program. State and local governments would also save an additional \$8.5 billion in reduced healthcare costs and Medicaid payments over the ten years of the CBO's analysis. When evaluating the impact of the tort reforms included in the bill, CBO states:

“CBO estimates that, under this bill, premiums for medical malpractice insurance ultimately would be an average of 25 percent to 30 percent lower than what they would be under current law.” Due to variations in individual states' legal climates, the CBO further states, “There would be almost no effect on malpractice premiums in about one-fifth of the states, while reductions in premiums would be substantially larger than the overall average in about one-third of the states.”³

3) National Association of Insurance Commissioners – Response to Senator Gregg

Opponents of tort reform often cite insurance industry misconduct as being the cause of the crisis. Senator Judd Gregg, as chair of the Senate Committee on Health, Education, Labor and Pensions (HELP), wrote to the National Association of Insurance Commissioners posing many questions regarding insurance industry operations. A copy of the February 7, 2003 response from the President of the NAIC, Arkansas Insurance Commissioner Mike Pickens, is also provided for your information. As you will see, the NAIC finds no evidence of alleged “price fixing, bid rigging, and market allocation,” which have been cited by opponents of tort reform as causes for high malpractice premiums. This letter

³ Congressional Budget Office Cost Estimate, H.R. 5, Help Efficient, Accessible, Low-cost, Timely Healthcare (HEALTH) Act of 2003, March 10, 2003.

speaks to the effectiveness of state insurance regulation in preventing such practices.

4) National Association of Insurance Commissioners Study of Market Conditions

The National Association of Insurance Commissioners recently undertook a comprehensive analysis of medical malpractice insurance market conditions and potential solutions to the crisis. The NAIC's findings are found in a report published last September. When evaluating the reasons for the crisis, they state "...the research indicates that underwriting losses were the major factor influencing the rate increases experienced by physicians and other healthcare providers over the past several years." And, they note that the GAO reached a similar conclusion in its June 2003 report. Noting that insurers are primarily invested in bonds, the NAIC states that during the period of its analysis (1992 – 2002), underwriting gains declined by 74.27 percent, while investment income was down by only 16.52 percent⁴, again validating that the medical liability crisis is primarily due to increased jury awards and the settlements they drive. The NAIC further states, "Relative to changes in earned premium and, in particular, net underwriting gains, changes in investment income have been minor." Premiums earned increased by 54.09 percent during the period of the analysis, far less than the cost of claims and reduction in investment income.⁵

5) American Academy of Actuaries

The independent American Academy of Actuaries (AAA) has evaluated the medical malpractice crisis and provides us with an analysis of what has happened and the potential effects of tort reform. Like the other independent groups, the AAA finds that underwriting losses, coupled with decreased bond income and higher reinsurance costs have contributed to increasing medical malpractice insurance rates. The AAA notes that "A 2.5 percent drop in interest

⁴ National Association of Insurance Commissioners, *Medical Malpractice Insurance Report: A Study of Market Conditions and Potential Solutions to the Recent Crisis*, September 12, 2004, page 27.

⁵ *ibid*

rates, which has occurred since 2000, can translate into rate increases of between 5 percent and 10 percent.⁶ This is hardly the problem we see in the market today. While the Academy takes no official position for or against tort reform, they state that their research indicates that a coordinated package of tort reforms is more likely than individual reforms to achieve savings in malpractice losses and insurance premiums, and that key among these reforms are a cap on non-economic damages at a level low enough to have an effect, such as MICRA's \$250,000, and a collateral source offset rule.⁷

CONCLUSION

Mr. Chairman, I thank you for your indulgence in letting me introduce the authoritative studies I have just referred to. These studies are produced by independent governmental and oversight groups, and are not funded or influenced in any way by insurers, plaintiffs' lawyers, doctors, or any other groups. And, they all say the same thing – that increased loss costs are the primary reason medical malpractice insurance premiums have risen, and that effective tort reforms, such as those passed in California in 1975, will mitigate the crisis. Increasing medical malpractice claim costs, on the rise for over three decades, have finally reached the level where the rates that insurers must charge can no longer be afforded by doctors and hospitals. Many will face little choice other than to move out of crisis states, such as Illinois, to less litigious states, or leave the practice of medicine altogether. This can only result in restricted access to health care in those states not able to temper our out-of-control tort system.

Mr. Chairman, that concludes my remarks. Thank you for inviting the PIAA to appear here today.

⁶ Statement of James Hurley, ACAS, MAAA, Medical Malpractice Subcommittee of the American Academy of Actuaries, before the Subcommittee on Health, Committee on Energy and Commerce, US House of Representatives, February 10, 2005, page 6.

⁷ Ibid, page 9.