HEALTH CARE PRACTICE

PROFESSIONAL LIABILITY MARKET UPDATE 2010

May 2010

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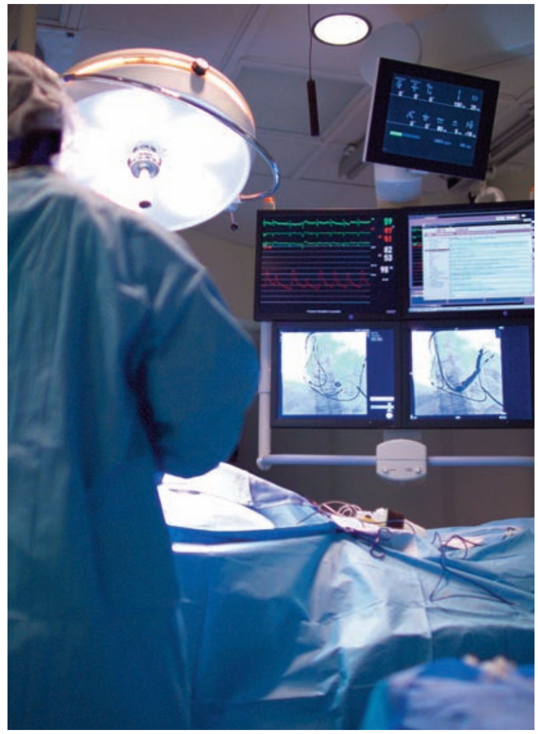
2009 was a good year for buyers of health care professional liability (HPL) insurance across the U.S., and 2010 is looking good as well. Many purchasers of this coverage enjoyed lower premiums and better terms as insurers competed aggressively to keep their existing clients, while newer players in the marketplace put heavy pressure on incumbents. Lawyers, insurers, health care organizations and insurance experts point to several reasons for this trend:

- Improvement in quality, risk management and patient safety
- Reduction in medical errors
- Tort reform measures adopted in many states, particularly those with caps on non-economic damages
- Improving claim trends in many parts of the country
- Strong profitability of this line as reported by many malpractice insurers

Too many insurers chasing too few insureds fuels an oversupply condition that allows buyers to shop for the greatest value for their insurance dollar. In addition to insurers' duties to pay for their contractual obligations, insurers offer many pre-loss and post-loss services, and the competitive marketplace offers consumers the opportunity to take advantage of these value-added services. The most alluring of all benefits to most financial buyers in 2010 is the potential to reduce their health care professional liability insurance costs, and for health care institutions that are struggling to make it financially, this news couldn't come at a better time.

A NEW YORK STATE OF MIND

While many health care providers across the country are enjoying dramatic reductions in insurance premiums – some as much as 30-40% for accounts with excellent experience and operating in very good jurisdictions – New York State is a bit of a mixed bag. With no current tort reform in sight, New York maintains its distinction as having some of the highest malpractice rates in the nation. The claim environment drives rates, so institutions and individual health care providers operating in downstate New York will generally experience higher premium rates than providers in other regions of the state. A recent analysis of the National Practitioner Databank (NPDB) by

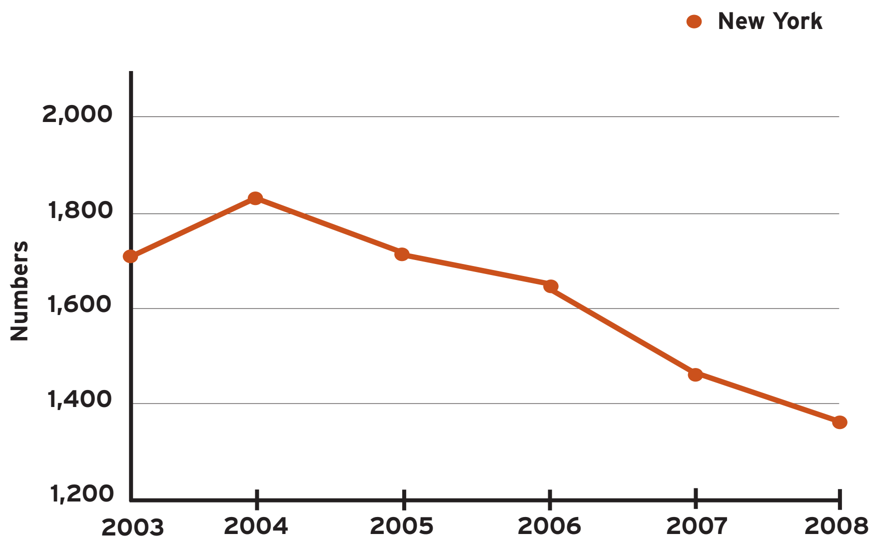


Kaiser Family Foundation finds that New York produces the country's highest number of claims paid and the largest amount of payments made from 2004 to 2008 (as per the latest available data). The good news, however, is that even New York is experiencing a lower number of claims reported to the National Practitioner Data Bank and less total dollars paid out for malpractice claims. However, the average severity of claims is increasing, which appears consistent with national trends.

The marketplace for provider HPL insurance is generally divided into the following market segments:

- Primary/Excess Hospital Professional Liability
- Physicians and Surgeons Professional Liability
- Nursing Home Professional Liability
- Miscellaneous Facility Medical Professional Liability

Number of Paid Medical Malpractice Claims, 2003-2008: Total Number of Paid Claims



statehealthfacts.org
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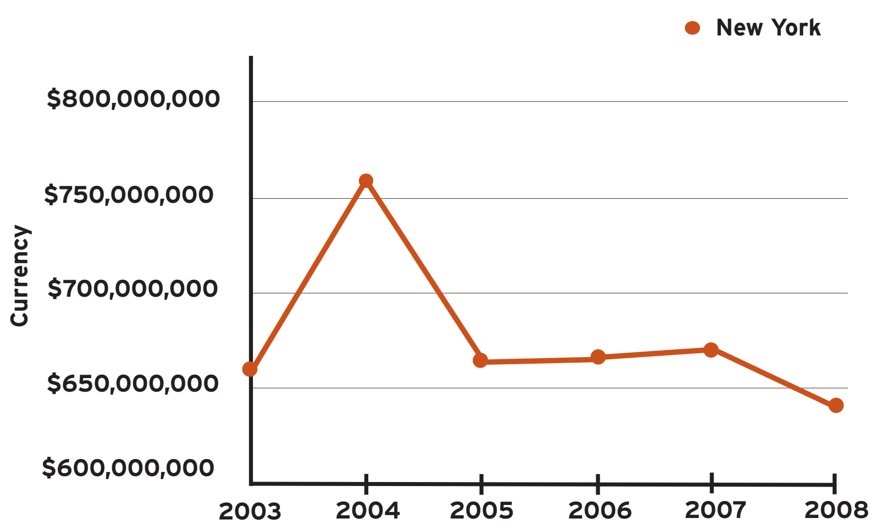
Payments on Medical Malpractice Claims, 2003-2008: Total Number of Paid Claims



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Sources: Kaiser Family Foundation analysis of data from the National Practitioner Data Bank (NPDB), Public Use Data File (NPDB0906.POR), U.S. Department of Health and Human Services, Health Resources and Services Administration, Bureau of Health Professions, Practitioner Data Banks; accessed 2/24/10.

PRIMARY HOSPITAL PROFESSIONAL LIABILITY

Hospitals that purchase a primary layer of insurance coverage (limited to $1M per claim of coverage in most jurisdictions) typically purchase this layer through one of the New York admitted insurers, such as MLMIC, PRI and/or Hospitals Insurance Company (HIC). There are several advantages to purchasing a primary Hospital Professional Liability:

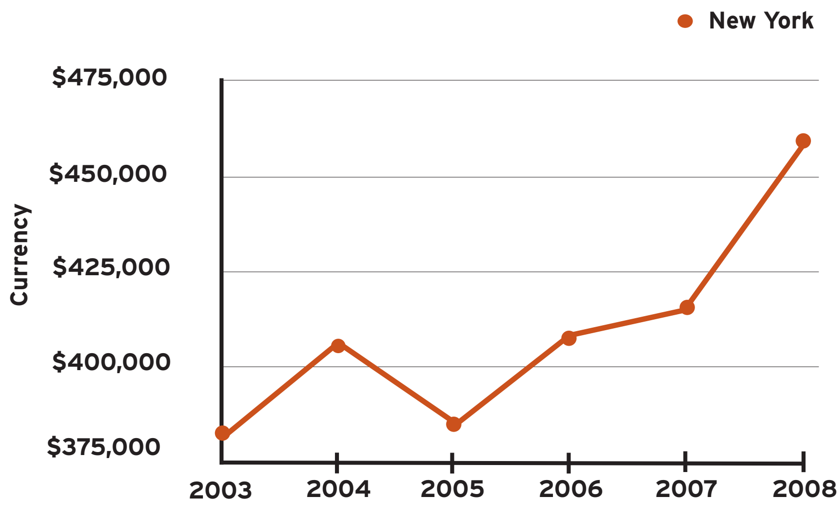
- Voluntary attending physicians are eligible for a 7.5% premium discount for their malpractice policies through the same company insuring the hospital
- New York State law protects insolvency of admitted and licensed medical malpractice writers
- The guarantee fund in New York protects up to $1M per claim in the event of insurer insolvency
- Primary insurer provides claim and risk management support services as part of premium charge
- Treatment of defense expenses: ALAE (allocated loss adjustment expense) outside of the aggregate limit of liability afforded in the policy, and in some cases provided on an unlimited basis

PRICING TRENDS

Pricing for the primary layer of coverage is highly correlated to:

- The aggregate limit of liability purchased by the entity

Payments on Medical Malpractice Claims, 2003-2008: Average Claims Payments



- Historical loss experience (typically based on a 10-year history)
- Financial condition of entity seeking insurance
- Existence and amount of retention
- Type of policy – claims-made or occurrence
- Exposures – types and volume of clinic activities

Many hospitals chose to assume the entire layer or a proportional share of the risk though deductibles, self-insured retentions, dedicated trusts or by utilizing their own captives.

The pricing options available in the primary market, outside of the admitted markets mentioned above, are typically not attractive to hospitals when compared to the cost of self-insuring this layer. Thus, the competition for this layer of coverage is generally limited to the admitted markets (PRI, MLMIC, HIC, etc.).

EXCESS HOSPITAL PROFESSIONAL LIABILITY

Many hospitals in New York State seek to protect their balance sheet from the inherent volatility of health care liability risks, especially the potential for high damage awards. Thus, many organizations seek to transfer some of the higher volatility exposure to insurers/reinsures. Those organizations that do purchase excess Hospital Professional Liability insurance or reinsurance for their captive will find a highly competitive marketplace.

Those hospitals that have opted to forego purchasing excess Hospital Professional Liability coverage because of the perceived high cost or unavailability of acceptable terms may perhaps now seek to explore the marketplace in 2010. Hospitals will find eager insurers and underwriters who will offer creative and cost-effective programs to shift malpractice liabilities off the hospital's balance sheet. Some of the more prominent companies that are actively soliciting and writing policies in New York are:

- ACE USA
- Allied World
- Arch
- Beazley
- Berkley Medical
- Canopius
- Chartis (formerly AIG)
- CNA
- Endurance
- Ironshore
- Torus
- Zurich
- XL

These companies all have different appetites, capacity and capabilities, and all are generally eager to listen, learn and structure a competitively priced health care professional liability program to meet a hospital's risk financing needs. Even downstate hospitals that are perceived to have the most difficult risk profile due to challenging court venues will find a number of eager insurers and reinsurers willing to offer relatively competitive options. For example, hospitals that have historically been required to retain liability risks up to $10M per claim are now obtaining options at $5M – $7M retention levels. One hospital in the downstate region, for example, was able to recently reduce its retention level from $10M per claim to $7M per claim for less than it was paying in premiums in 2009.

. . .Wrynn is initiating two major changes intended to make New York State more attractive to medical malpractice insurers. The first initiative is for the state to establish an independent body to help set acceptable rates for physician medical malpractice insurance. The independent rating service organization would, in theory, separate the New York State Insurance Department from the historically politically charged process of setting rates each July 1.

Additionally, hospitals in New York that maintain a captive to retain losses can also seek excess facultative reinsurance options from many of the organizations listed above as well as from reinsurers such as Munich Re, Hanover Re, Transatlantic Re, Swiss Re, various Lloyd's of London syndicates and several Bermuda-based reinsurers.

PHYSICIANS AND SURGEONS PROFESSIONAL LIABILITY

Most states in 2009 experienced flat or decreasing physician premiums. New York experienced flat physician insurance premiums for the second year in a row from the admitted and licensed carriers (MLMIC, PRI, Academic, HIC). This is the good news. However, the bad news for physicians, especially those practicing in the New York downstate region, is the relatively high cost of their malpractice insurance premiums compared to the rest of the country. When this factor is coupled with a highly regulated insurance marketplace that does not necessarily promote competition, it makes for a very difficult marketplace for this segment.

Some of the larger physician groups in the state have taken their malpractice risk into their own hands, creating their own malpractice funding vehicles with the goal of gaining more control over their insurance program costs. Some hospitals have created a sponsored insurance vehicle as a potentially lower cost alternative for their attending physicians.

Additionally, there are a number of commercially viable Risk Retention Groups (RRGs) operating in the state, such as JM Woodworth, Academic Health, Oceanus and Doctors and Surgeons National Risk Retention Group. Because RRG rates are not regulated by the New York Department of Insurance, an RRG offers the potential advantage of lower malpractice rates. However, there are several considerations a physician should keep in mind prior to joining a risk retention group:

- Absence of the guarantee fund protection from the state in the case of insolvency
- No Section 18 excess coverage available
- Capital requirements to join RRG
- Difficulty assessing the financial viability of some RRGs

A recent article written in *Business Insurance* entitled "N.Y. Attempts to Lure More Med Mal Insurers" indicates that the current New York insurance superintendent James J. Wrynn is initiating two major changes intended to make New York State more attractive to medical malpractice insurers. The first initiative is for the state to establish an independent body to help set acceptable rates for physician medical malpractice insurance. The independent rating service organization would, in theory, separate the New York State Insurance Department from the historically politically charged process of setting rates each July 1.

The second initiative is that regulators have reached an agreement with property/casualty insurers on an assessment to fund medical malpractice losses from the state-run residual market for difficult-to-place medical malpractice risks. During a February 2010 speech to the Association of Professional Insurance Women in New York, Wrynn said, "Property/casualty insurers have agreed to pay a pass-though assessment that would wipe out the $480 million liability." Whether or not these reported changes will impact the competition in the state for physician medical malpractice remains to be seen.

NURSING HOME PROFESSIONAL LIABILITY

The nursing home professional liability insurance marketplace nationally is very competitive. A number of insurers are soliciting nursing homes in New York, the most competitive of which are CNA HealthPro, One Beacon, Ironshore, PRI, Chartis, Hartford and several Risk Retention Groups.

Some rate disparity exists between upstate and downstate, as downstate facilities typically experience more claims – and therefore higher rates. Rates are typically calculated on a per-bed basis and can vary widely, from$200 to $1,000 for a $1M policy limit. Bed rates will also vary based on claims-made or occurrence coverage, deductibles chosen, if any, claim history and risk/quality indicators.

CNA Healthpro publishes an aging services claim study that evaluates and analyzes claim data nationally with some state-specific information. Their latest report evaluates claims from 2004-2008 and indicates that on a national basis the frequency of reported claims per 1,000 beds has essentially remained unchanged since 2004 (2.4 claims per 1,000 beds), while severity of closed claims is trending upward from an average of $92,651 per claim in 2004 to $105,163 in 2008. The report classifies New York as a "moderate" severity state with average claims between $125,000 and $225,000.

MISCELLANEOUS HEALTH CARE PROFESSIONAL LIABILITY

This segment of the market, reserved for all health care providers that are not acute-care or long-term care facilities, includes home health care, ambulatory surgery centers, dialysis centers, blood centers, medical labs, imaging centers, hospices and other health care facilities.

Because insurers view it as offering the largest long-term growth within the health care industry, this segment is perhaps the most competitive of any, with more than 20 insurance companies competing in this sector. Buyers will find such companies as ACE USA, Admiral, Arch, Allied World, Beazley, Chartis, CNA Healthpro, Gen Star, Hiscox, Markel and Zurich that are eager to offer malpractice insurance policies for these segment participants.

Like the other segments of health care professional liability insurance noted above, pricing is predicated on limits, retentions, loss history, size, geography and type of services provided.

CHOOSING A CARRIER

Premium must be weighed against protection, service, financial strength and long-term stability provided by the insurer. Organizations and physicians are urged to review an insurer's claim defense performance, risk management services, underwriting standards, actuarial discipline and experience of writing policies.

Finding the right health care professional liability carrier can be time consuming, but it is one of the most important decisions an institution or a health care professional will make. Take the time to learn all you can about the quality of the carrier and the people entrusted to protect the purchasing of health care professional liability insurance.

CONCLUSION

In summary, with the exception of physicians and surgeons malpractice insurance segment (which is highly regulated in New York) and the primary hospital professional liability segment (which is limited) the rest of the health care professional liability insurance market in New York is very competitive.

Do your homework and then go shopping. You'll be glad you did, because 2010 can offer significant opportunities for improvement in costs, program structure and services.

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