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Current Issues in Property and Casualty

The end of an era for noneconomic caps?

Stephen J. Koca, FCAS, MAAA

In November, California voters are likely to decide whether the state's landmark medical professional liability (MPL) cap on noneconomic damages, enacted nearly 40 years ago, will remain intact. Ballot initiative #13-0016 would peg the cap on noneconomic damages to inflation, more than quadrupling the current limit. What will the measure mean to insurers and healthcare providers if voters give it the nod in November?

A product of the mid-1970s, when skyrocketing MPL premiums and policy cancellations were forcing physicians to retire or leave the state for greener pastures, California's Medical Injury Compensation Reform Act (MICRA) was passed as a means to lower MPL insurance premiums and control costs. The centerpiece of the legislation is a cap on noneconomic damages of \$250,000. The law places no restrictions on awards for economic damages such as loss of wages and medical costs.

An uncertain future

Since MICRA was first enacted in 1976 and then was upheld by the California Supreme Court in 1985, premiums in California have increased at rates far below the national average. When overall premiums spiked in the middle of the past decade as the market hardened, California also saw significant increases, but they were modest when compared to national trends. (See Chart 1.)

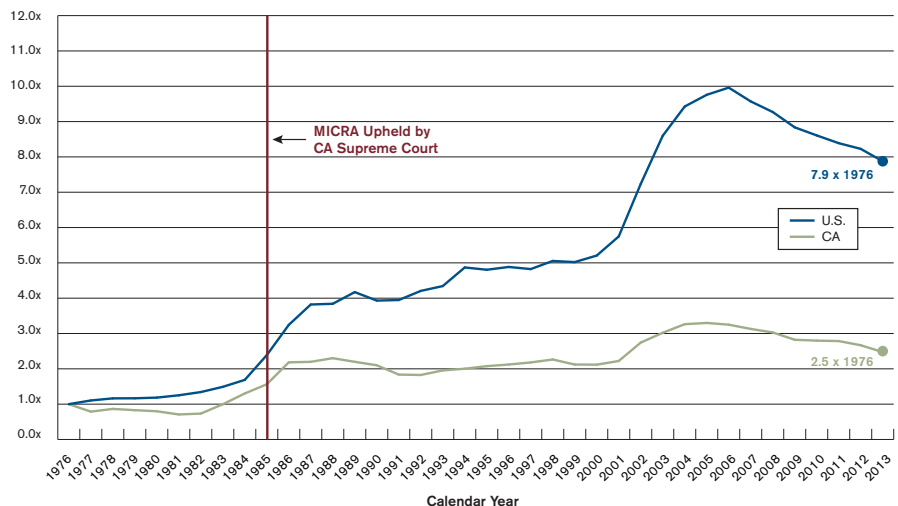
The relative calm that has characterized the California market could be in peril with the proposed ballot initiative, which, as proposed, would "adjust the \$250,000 cap on compensation for pain, suffering, physical impairment, disfigurement, decline of quality of life, and death in medical negligence lawsuits set by the Legislature in 1975 to account for inflation and to provide annual adjustments in the future in order to boost health care accountability, act as a deterrent, and ensure that patients, their families and others who are injured by negligent doctors are entitled to be made whole for their loss." This change would raise the noneconomic damages cap to approximately \$1.1 million effective January 1, 2015.

The increase in the cap on noneconomic damages is tied to a patient safety act that includes various other provisions regarding drug and alcohol testing of physicians and the consultation of the State's Controlled Substance Utilization Review and Evaluation System (CURES) database prior to prescribing Schedule II or III controlled substances to a patient for the first time.

Supporters of the MPL initiative have submitted some 840,000 signatures—an amount that far exceeds the state's requirement of 504,000. If valid, these signatures would put the initiative on the November ballot, turning over the question of the noneconomic damages cap to California voters.¹

An enactment of the proposal would raise the cap on any outstanding claim no matter when it was originally filed, effective January 1, 2015. **Overnight, the liability of California MPL insurers and self-insured healthcare entities would increase not only for future claims but also for any unsettled claims on their books.**

CHART 1: MPL DIRECT WRITTEN PREMIUMS INDEXED TO 1976; CALIFORNIA VS. U.S. TOTAL



Source: 1976-1995 from A.M. Best's Aggregates & Averages; 1996+ from SNL Aggregate of P&C Industry, Statutory Page 14 Data.

¹ Robeznieks, Andis (August 19, 2013). Raising the cap. *Modern Healthcare*.

What kind of impact?

The increase in the cap on noneconomic damages will most assuredly increase the amounts paid to settle or otherwise resolve medical liability claims. It is also likely to increase the number of filed claims, as plaintiff lawyers make customers more aware of the merits of filing or following through with a claim.

And while pinning down an estimate for an increase in the number of claims is speculative, we have only to look to the mid-2000s for an example of a wide swing in claim frequency that has happened in the past. At that time, a drop in the number of claims being filed drove an unprecedented improvement in the financial results of MPL specialty insurers. Some portion of the rapid decrease in claim frequency was almost assuredly related to the interaction of several factors, including improvements in patient safety and risk management, along with increased adoption of disclosure and early offer programs. However, the shift in claim frequency was so significant that it remains largely unexplained to this day.

The ballot initiative is also gaining traction at a time when the Patient Protection and Affordable Care Act (ACA) is changing the way healthcare is delivered in the United States and adding uncertainty to future MPL trends. In a way similar to the likely interaction of several factors that contributed to the decrease in claim frequency last decade, we could see the reverse situation happen soon. The conflux of various factors, including but not limited to the sheer numbers of insured individuals overwhelming the healthcare community, the acuity of formerly uninsured patients, and an increased incentive to file MPL claims could partially overcome the factors that improved claim frequency in the last decade.

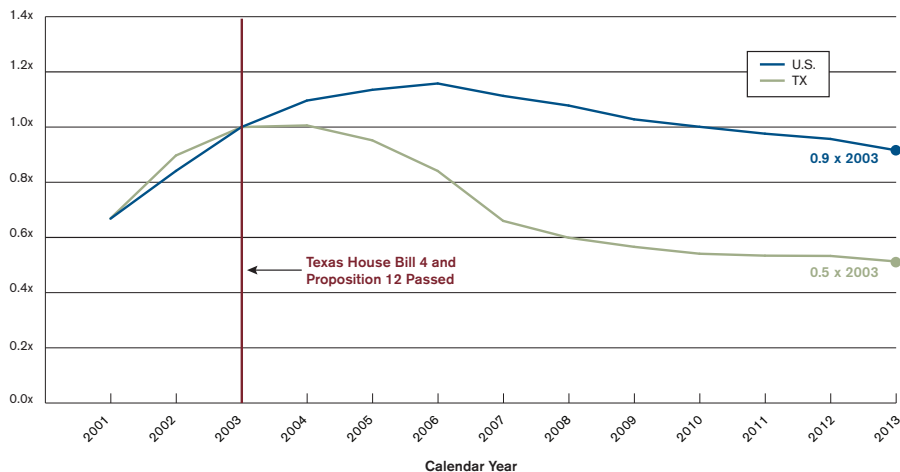
Texas example

Following California's lead, nearly three dozen states adopted some form of a cap on damages over the years. One of the best examples is in Texas, where MPL insurance premiums had been in close step with national trends until 2003. At that time certain reforms, including a \$250,000 cap on noneconomic damages, were enacted in the state. Premiums declined relative to national levels a year after the reforms were enacted, and continued to moderate for several years. Nationwide, MPL premiums are approximately 9% less than their 2003 levels, but the

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CHART 2: MPL DIRECT WRITTEN PREMIUMS INDEXED TO 2003; TEXAS VS. U.S. TOTAL



Source: SNL Aggregate of P&C Industry, Statutory Page 14 Data.

premiums in Texas were approximately 50% of that baseline in 2013—a clear demonstration of the impact that reforms have had on the MPL costs in the state and a warning sign of potential increases that could be seen in California if the cap is increased. (See Chart 2.)

A rock and a hard place

An increase in MPL costs could also quicken the pace of consolidation in the healthcare market, which has been besieged by cost constraints in recent years. And while large healthcare systems are likely able to weather a potential increase in MPL costs, small community systems and individual physicians or small physician groups may be even more likely to join forces with larger systems or groups, which has become a trend over the past 15 years and is already expected to accelerate with the implementation of the ACA.

How a higher cap on noneconomic damages will play out in the market is still a matter of much conjecture, but there is little question that an increased cap on noneconomic damages will expand insurers' and healthcare providers' liabilities, and most likely increase healthcare costs across the board. Whether this happens may well be in the hands of voters in California, which has been the bellwether for the nation on initiatives from environmental protection to employment practices to MPL reform.

Stephen J. Koca, FCAS, MAAA, is a principal and consulting actuary with the Los Angeles office of Milliman. Contact him at stephen.koca@milliman.com.

Inquiries may be directed to:

P&C Perspectives Editor
1301 Fifth Avenue, Suite 3800
Seattle, WA 98101-2605
+1 206 624 7940
pnc.perspectives.editor@milliman.com