

BY CHARLES W. MITCHELL

# The Death, Disability, and Retirement Extended Reporting Endorsement:

**T**he death, disability, and retirement (DDR) tail benefit has qualifications and limitations that may not be fully understood by insureds. Confusion surrounding the provisions of this benefit has, in the past, led to misunderstandings between insurance carriers and insureds. It is important that both parties fully understand this benefit, and thereby avoid potential conflicts. Insurance providers have designed this benefit as a service for their insureds. They do not want it to have the opposite impact: confusion and potentially costly errors. Likewise, healthcare practitioners want to understand the provisions, so they can take full advantage of this valuable benefit, and avoid possible pitfalls.

## The DDR tail benefit

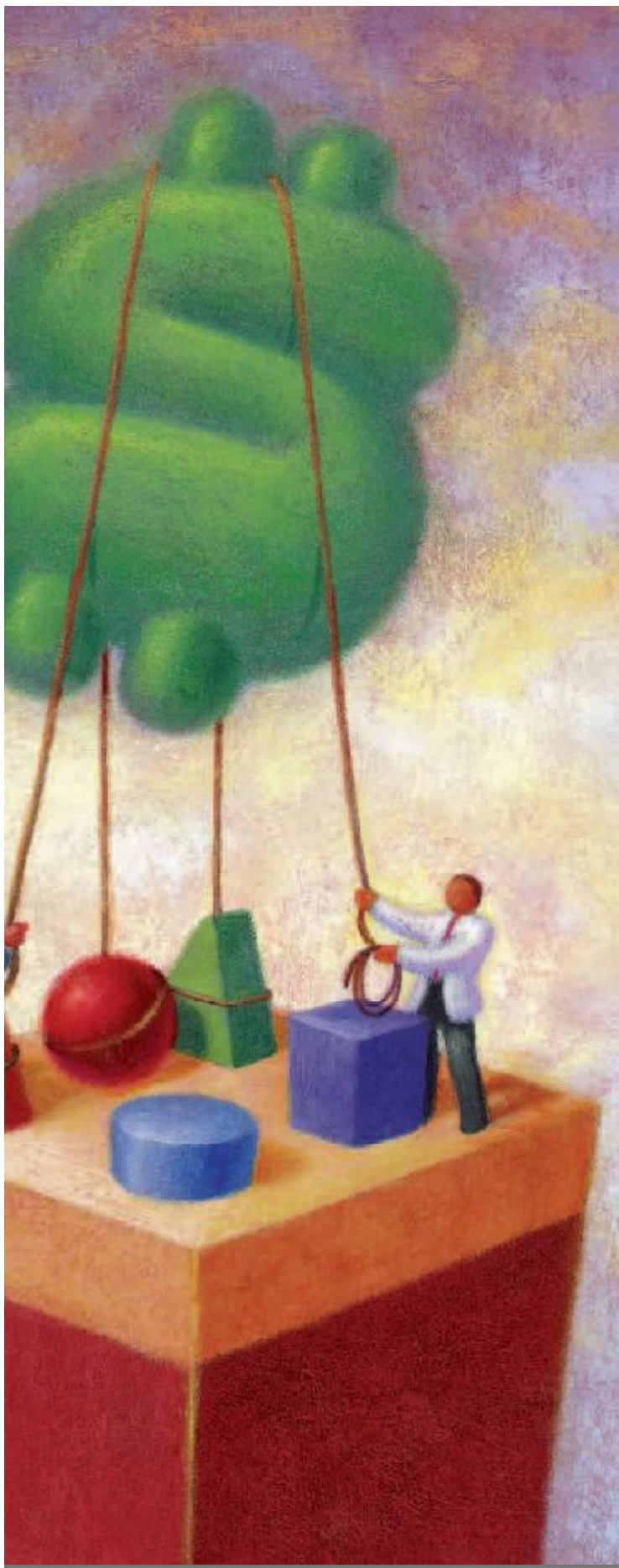
In response to the first MPL insurance crisis of the early 1970s, The St. Paul Companies (St. Paul) converted its MPL policy from an occurrence basis to a claims-made basis. Other insurers would later follow suit, and today the majority of MPL coverage is written on a claims-made coverage form.

Claims-made policies cover claims reported during the policy term. A medical provider who ceases to purchase claims-made coverage will need to obtain a tail policy, to insure medical misadventures that may have happened during the historical coverage period, but are not reported until after the expiration of his final claims-made policy. Because tail policies are expensive, there were concerns about the additional cost of purchasing a

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# What it Means for Physicians and Physician Insurers

tail if an insured should die, become disabled, or retire. To address this concern, insurers incorporated a provision in the claims-made coverage form to waive the premium for a tail policy in the event of death, disability, or retirement. However, insurers usually require that the insured has attained a certain age, commonly 55, and has been insured for about five years of continuous coverage to qualify for the retirement benefit.

## **No free lunch**

Although this DDR coverage benefit is commonly referred to as “free” tail coverage, it is generally paid for by an explicit provision in the claims-made coverage rates. In MPL insurance policies, this provision usually represents 3% to 5% of an insured’s claims-made premium.

## **Buyer beware**

Suppose a doctor has carried claims-made coverage with an insurance company for a number of years, so that he is now fully qualified for a free tail when he retires, which he plans to do in two years. For whatever reason (insured claims history,

## One might argue that, as an industry group, physicians

insurer insolvency, or voluntary withdrawal), the doctor's policy is cancelled or non-renewed by the insurance company. The doctor now, unexpectedly, needs to insure his tail claim exposure. Assuming that he is unwilling to take on the risk of going uninsured for this exposure, he has several choices. He can retire earlier than planned and exercise his right to a free tail policy; he can retire when he originally planned and purchase tail coverage; or he can obtain coverage from another carrier and work a few extra years until he is eligible for that company's free retirement tail.

In any case, the doctor faces a potential setback. He retires and foregoes future income, purchases a tail policy that he had expected to get for free a couple years down the road, or works beyond his original retirement plan. A doctor practicing in a higher-risk specialty may face the option of paying \$200,000 for a tail policy or changing his retirement plans.

Assuming that he is not ready to retire, is the doctor in this example entitled to anything for the DDR premiums he has paid to this company over the years? In general, the short answer is, "No."

Physicians insured under claims-made coverage also need to remember that their own actions may impact their DDR qualification. As discussed above, because most insurers require a number of years of continuous coverage to qualify for the retirement tail benefit, a physician who is within a few years of retirement and switches to a new insurance provider may find that she no longer qualifies for a free tail at retirement. In addition, in most cases, a formal request must be made for the free tail, to exercise the benefit (by the physician in the case of disability or retirement, or by the physician's estate in the event of death). A physician who does not ensure a tail policy is issued will be unpleasantly surprised if a claim emerges.

### A vested interest in the DDR?

The example above, in which a doctor's claims-made policy is cancelled close to retirement, highlights the need to address the question, "Do policyholders have a vested interest in the DDR benefit?" In light of the incremental rate provision that policyholders pay over time, to fund the DDR benefit, they may assume that they have a vested interest in this accrual. Furthermore, statutory accounting rules generally require that a reserve for future DDR benefits be established as part of an insurance company's unearned premium reserve. This accounting treatment reinforces the impression that there is a vested policyholder benefit, since unearned premiums are generally returned to a policyholder in the event that the policy is cancelled prior to expiration.

However, this is not the case with the DDR reserve. There is evidence for this conclusion in several references. First, the typical MPL policy does not provide for any premium return or compensation in situations where an insured does not qualify

for the DDR benefit. Second, statutory accounting practices and procedures specify that in establishing the DDR reserve, "Funding should not anticipate vesting or cash values for individual insureds unless specifically provided by contract." Last, and most important, several court rulings have established that policyholders are not entitled to compensation for any perceived DDR benefit vesting in the event of cancellation.

### Lawsuits against St. Paul

The question, "Do policyholders have a vested interest in DDR benefits?" was answered definitively in lawsuits brought against St. Paul. For several decades, St. Paul was the largest MPL insurance writer in the country; but then, in 2001, the company withdrew from the MPL insurance market. At one point prior to withdrawal, St. Paul carried a reserve for future DDR benefits that was in excess of \$100 million. Consistent with guidance from the National Association of Insurance Commissioners, St. Paul carried the DDR reserve as part of the unearned premium reserve. Once the company had non-renewed all policies and fulfilled its DDR obligations, it was able to take down the remainder of the DDR reserve. St. Paul was obligated to provide only a few million dollars worth of DDR tail benefits for physicians who qualified for them within the policy terms. The rest of the DDR reserve was recognized as income.

Some insured physicians were close to retirement and needed tail coverage, and they had expected to get it for free in the near future. The physicians contended that because their historical claims-made premiums had included an incremental charge to fund the DDR benefit over time, they had in fact paid for the benefit that St. Paul now refused to provide. As such, they felt they were entitled to compensation. Although St. Paul made some exceptions, for example by extending coverage for up to six months for physicians who planned to retire within that period, it held that unless a doctor retired fully from the practice of medicine, he was not entitled to a free tail or a refund of any DDR premium.

The various lawsuits contended, under diverse theories of law, that physicians previously insured by St. Paul were owed compensation. The suits alleged compensatory damages, plus punitive damages for what they claimed was egregious behavior by St. Paul. One assessment of compensatory damages alleged that the physicians were entitled to a return of the DDR unearned premium reserve, which topped \$100 million prior to St. Paul's decision to exit the line of business. Millions more were sought for punitive damages.

Ultimately, St. Paul prevailed. In the initial suits, the courts issued summary judgments finding in St. Paul's favor, as a matter of contract law. The courts essentially ruled that the policy was specific as to the conditions required for eligibility for the DDR benefit, the policy was subject to cancellation by either the insurer or the insured at any time and for any reason, and the

## do fund their DDR benefits.


policy did not provide for any DDR compensation in the event of cancellation, other than the qualified benefit as specifically defined. The final lawsuit against St. Paul took place in West Virginia and was certified as a class action lawsuit. The case ultimately went to trial, and the jury found in St. Paul's favor.

### Did physicians really pay for DDR?

As noted previously, a tail policy can cost 200% of an insured's claims-made premium. If we assume a 4% annual premium loading and a 4% investment yield on premium accruals, the simplistic conclusion is that the insurance company would have to insure an individual physician about 30 years to collect enough money to absorb the cost of the tail. However, only rarely are physicians insured by the same company for this long a period. One of the plaintiffs in a St. Paul lawsuit had been insured with St. Paul for only a couple of years. Although he may have paid DDR premiums to prior insurance companies over his career, he actually paid very little to St. Paul. Hence, considering individual insurance companies and individual physicians, insureds do not fund their own DDR benefit. This particular plaintiff argued that he would not have switched insurance carriers and insured with St. Paul had he not believed that St. Paul would continue to provide coverage. However, this argument was not persuasive.

One might argue that, as an industry group, physicians do fund their DDR benefits. When St. Paul non-renewed such a large book of business, it removed a significant amount of DDR funding from the industry that would need to be picked up by other insurance companies and paid for by future physician premiums. Regardless of this assertion, the DDR benefit provisions are specific to the individual policy, not the industry as a whole.

### Securing the retirement tail benefit

It is in the best interest of both MPL insurers and practitioners to understand the DDR benefit provisions, to avoid future misunderstandings. Insurance providers could do several things to help avoid conflicts. First, they could educate their insureds about the availability and specific provisions of the DDR tail benefit. They would benefit from explaining the full value of this benefit to their insureds. Second, insurance companies could consider changing tail provisions. For example, insurers could offer claims-made coverage that provides tail discounts based on the number of years a person is insured with the company, thereby removing the retirement provision. Some companies already offer similar vested tail benefits. Note that the rate provision incorporated into claims-made rates would be higher. It should be carefully analyzed and tailored to a company's specific tail benefit qualifications. 

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