INDUSTRY TREND

Young Guns: How Are the Young Medical Professional Liability Insurance Start-Ups Performing?

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The medical professional liability (MPL) coverage crisis in the early part of this decade provoked the creation of a large number of new MPL insurance programs, particularly in 2003 and 2004. With a couple of years behind us now, it's time to see how these young guns are performing relative to their industry peers. As presented in this article, the recent financial results of these companies have benefited from the hard market that followed the latest crisis and a reduction in claims frequency. However, a number of challenges loom. Softer rate levels, lower investment return expectations, and high underwriting expenses will put pressure on the financial results of these companies going forward.

Based on our analysis of National Underwriter Insurance Data Services from Highline Data, we have identified 154 new MPL programs that have been created since 2002, over half of which were formed in 2003 and 2004. As with the response to previous crises in the 1970s and 1980s, most of these programs were created and are owned by the healthcare providers themselves. In addition, approximately 70 percent of these companies were formed as risk retention groups, which is not surprising given that the regulatory requirements for establishing and operating a risk retention group are less demanding than those of a mutual or stock insurance company, particularly for those operating in multiple states.

Fourteen of these start-up programs have already re-organized or stopped writing business. At least five programs were merged or acquired and a couple of risk retention groups converted to insurance companies in order to expand coverage beyond their original focus. Several other programs have stopped writing premiums or otherwise ceased filing statutory financial statements.

The focus of our analysis was to see how the start-ups of the latest MPL coverage crisis were performing financially compared to their established peers. To this end, we reviewed financial results for two composites. The composite of start-up companies consisted of 104 of the recently formed companies profiled above that began operations in 2005 or prior and had filed 2008 statutory financials. These companies accounted for about $950 million of direct written MPL premium in 2008 out of approximately $1.1 billion written by all 154 start-ups. Focusing on these companies allowed us to develop comparisons over a period of time that are not distorted by new programs entering the composite.

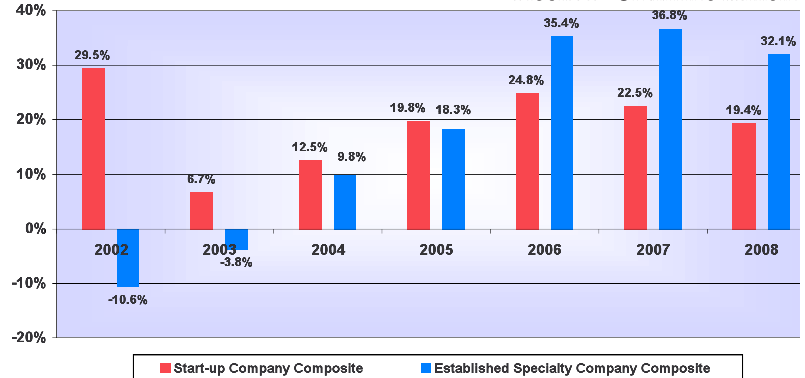
This start-up composite is compared to a composite of 49 "established" MPL coverage providers whose total MPL direct written premium was approximately $4.6 billion in 2008. Similar to the start-up companies, many of these established companies were formed in reaction to prior crises and are predominantly provider owned and operated companies that specialize in providing MPL insurance coverage.

In terms of the financial performance and stability of these start-up companies, we compared each composite's operating results and capitalization levels.

Impressive Earnings Overall

Overall operating results. The start-up companies in the aggregate have performed well and posted profitable operating results every year since their formations as evidenced by Figure 1, which shows the composites' pre-tax net income relative to net earned premium. Although both composites show improved operating ratios in recent years, the results of the established-company composite has improved to a greater extent, such that the established companies have outperformed the start-ups in each of the last three years.

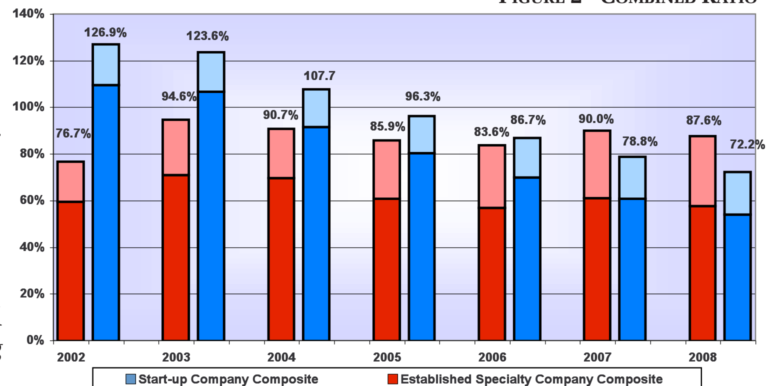
FIGURE 1 - OPERATING MARGIN



To explore what is driving these results, we reviewed the major components of the composites' operating results—loss and loss adjustment expense (LAE) costs, underwriting expense costs, and investment returns.

Claims expense and underwriting expense ratios. The combined ratios in Figure 2 are divided into the loss and LAE (lower portion of bars) and underwriting expense (upper portion of bars) components. The main driver behind the improving results for the established companies is the substantial improvement in the loss and LAE ratio since 2002. The start-up companies on the other hand have posted relatively consistent and favorable results for this metric.

FIGURE 2 - COMBINED RATIO

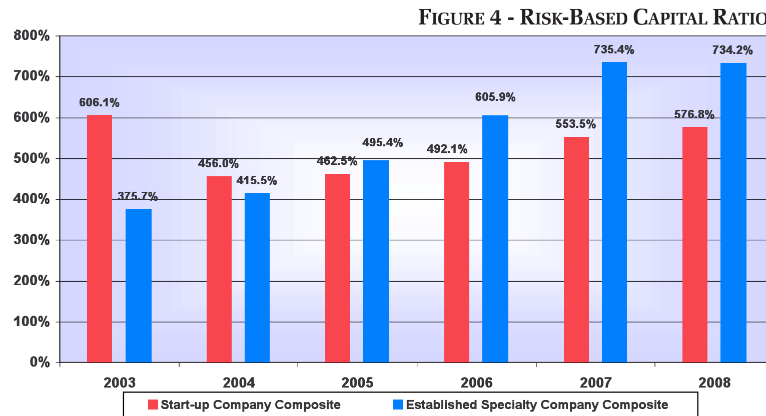


The calendar year loss ratio results have been significantly impacted by the amount of reserve development from

prior coverage years. The ratios for the established companies were negatively affected by adverse reserve development in the earlier years of the chart by approximately 3 to 10 percentage points. The start-ups, however, were not exposed to these legacy claims and thus had much less adverse reserve development for these years. Since 2005, both composites have demonstrated favorable reserve development, which we believe can be largely attributed to the unanticipated drop in claims frequency generally seen throughout the MPL industry that began in the first half of this decade. In particular, the 2008 loss ratios were favorably impacted by 14 percentage points for the start-up composite and nearly 30 points for the established companies.

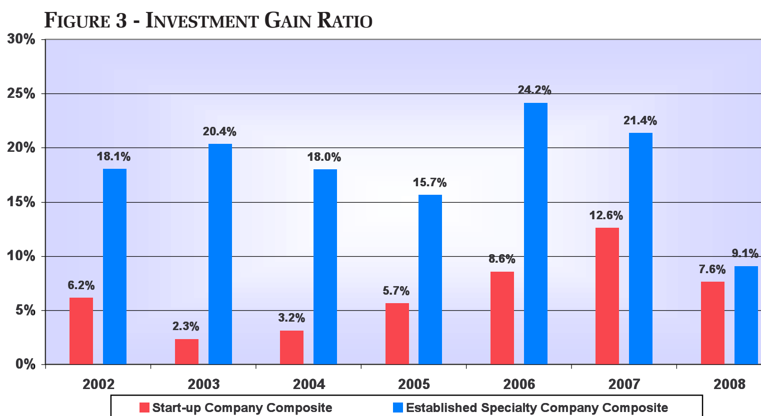
A higher and increasing underwriting expense ratio has negatively impacted the start-up companies with the start-ups composite expense ratio of 30 percent being 12 points higher than the established composites' 18-percent ratio (see Figure 2). While it is expected that start-ups will have relatively higher costs in early years because of initial start-up costs and the adverse impact of statutory accounting rules with regard to recording underwriting expenses, the increasing trend is somewhat alarming. The 2005 expense ratio of 25 percent has grown to 30 percent in 2008. The favorable loss reserve development discussed above has offset this trend and to some extent masked its impact on the operating results. The increasing expense ratio in recent years is most likely a product of fixed overhead costs relative to declining rate levels. The start-ups are more significantly impacted because they do not benefit from the economies of scale enjoyed by the larger, established companies.

FIGURE 4 - RISK-BASED CAPITAL RATIO



Investment results. Both groups have benefited from investment gains (see Figure 3), which reflect net investment income plus realized capital gains relative to net earned premium. The higher investment ratios of the established companies reflect the greater leverage derived from a larger reserve base as well as a relatively greater proportion of assets invested as opposed to being held in cash. Each composite experienced a significant drop-off in 2008 as the broad economic downturn manifested itself in the form of realized losses for the entire industry taken during 2008.

FIGURE 3 - INVESTMENT GAIN RATIO



Capitalization Levels Remain Strong

Risk-based capital ratios. In addition to the ongoing operating performance of these companies, we utilized statutory risk-based capital ratios to compare the balance sheet strength of these companies. These ratios represent policyholders surplus relative to the amount of capital required before specifically defined regulatory action is triggered. In aggregate, both groups demonstrate strong capital positions (see Figure 4). However, there has been some separation between the composites over the past three years.

Looking beyond the aggregate. Both composites have posted profitable operating results of late and have strong capital positions. However, these overall results mask the divergent individual company results. In order to get some sense of individual performance, we stratified the current operating ratios and risk-based capital ratios by quartile in Table 1 below.

When we stratify the 2008 operating results for each composite, we see that the worst performing quartile of companies in the start-up composite lost money on an operating basis, whereas the worst performing quartile for the established companies still produced an operating profit in the aggregate.

	Operating Margin Quartiles		RBC Ratio Quartiles	
	Start-up Company Composite	Established Specialty Company Composite	Start-up Company Composite	Established Specialty Company Composite
Quartile 1	-24.3%	4.1%	259.2%	484.5%
Quartile 2	6.6%	23.1%	452.0%	781.3%
Quartile 3	21.9%	35.7%	741.1%	1018.6%
Quartile 4	65.2%	68.1%	1625.8%	1684.2%
Total	19.1%	32.1%	574.2%	734.2%

TABLE 1

As with the operating results, the risk-based capital position was relatively strong in the aggregate. Specifically, the overall risk-based capital ratio of 574 percent for the start-up composite suggests that these companies had almost three times the capital required before triggering the regulatory "Company Action Level."

However, a policyholder does not purchase a policy from the aggregation of the companies but rather from individual companies. When one examines this metric on an individual company basis, it turns out that 17 of these companies had a risk-based capital ratio below 300 percent. Further, the overall risk-based

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Pennsylvania Number of MedMal Cases Showing a Steady Decline

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by the General Assembly," Chief Justice Castille said. "Continual evaluation of our procedures will ensure that both plaintiffs and defendants can rely on an accessible court system where professional liability actions are impartially and promptly resolved."

The United Judicial DSystem of Pennsylvania began the systematic collection of data from each of Pennsylvania's 67 counties five years ago as part of the Judiciary's commitment to intergovernmental collaboration in addressing medical malpractice litigation issues. New statewide Rules of Civil Procedure were promulgated—Pa.R.C.P. 1018 and 1042.16—to help identify med mal cases together with a new Rule of Judicial Administration—Pa.R.J.A. 1904—to codify the reporting requirements.

An extensive collection of data, rules and other information can be viewed on the Medical Malpractice Resource page of the Pennsylvania Judiciary's website at www.pacourts.us.

Judge Decides Maryland Damage Caps Not Applicable in Malpractice

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own suffering as he battled the cancer during the last year of his life.

The judge rejected a post-trial motion by the defendant to reduce the $3 million in non-economic damages to $812,500, the maximum that would have applied under the damages cap passed in a special session of the legislature in 2005. Maryland has had a limit on non-economic damages in all personal injury lawsuits since 1986. The new statute passed in 2005 applied only to malpractice cases, and cut the cap in half for victims of malpractice.

Judge Debelius noted in his decision that the original version of the 2005 legislation would have applied to all malpractice cases, but that as finally passed, the statute only referred to cases that had been previously arbitrated, not the majority of cases in which one or both sides waive out of arbitration and proceed only in court. In rejecting an effort by the defense to read the statute as including all malpractice claims, whether arbitrated or not, Judge Debelius ruled: "[T]his court is without authority to amend the statute to reinstate language deleted from a draft version of the legislation, or to insert new words to the same effect, whether consistent with the perceived legislative intent or otherwise."

The judge rejected several other arguments by the defendant to reduce the damage award, but did agree that the award should be reduced to give credit for an out-of-court settlement with another defendant. He held that the Semsker family was entitled to recover $2,860,436 from Dr. Albert and Lockshin's practice.

How Are the MPL Insurance Start-Ups Performing?

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capital ratio of the bottom quartile of companies was only 260 percent, not far from the first regulatory action level.

In summary, it is clear that the impact of this latest generation of MPL specialty companies has been and will continue to be significant. In the aggregate, these companies are currently well-capitalized and profitable. However, the results vary significantly by individual company.

Going forward, these young companies will face a number of challenges. First, they have no doubt benefited from the overall decline in the frequency of professional liability claims generally seen over the last few years. It is difficult to say whether many of these companies can continue to operate profitably once claim frequency levels off or, even more so, in an environment of rapidly increasing claim costs regularly seen in this line of business. Second, increased competition and softer rate levels in recent years will pressure both the loss ratio and underwriting expense ratio. Furthermore, the overall underwriting expense ratio currently produced by the start-up companies is probably not sustainable and softer rate levels and increased competition will make it more difficult for many of them to develop the premium volume needed to reduce expense ratios to manageable levels. Lastly, the lower investment income yields will also put pressure on the operating results for all insurance carriers. This may be particularly true for the start-up companies that do not yet have the asset base relative to premium volume of the established companies.

Venous Thromboembolism: Risk Factors, Prevention & Diagnosis

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Magnetic resonance venography—as accurate as contrast venography with a sensitivity of 100 percent and specificity of 96 percent. High cost limits its use.

The following is a practical approach to diagnosing DVT:

1. If the Wells score indicates a low probability of DVT and the D-dimer is negative, the likelihood of DVT is low and additional tests may not be needed.

2. If the Wells score indicates an intermediate to high probability of DVT, ultrasound evaluation is recommended. Compression ultrasonography is usually preferred; if not available, impedance plethysmography is acceptable and is the preferred test when recurrent DVT is suspected.

Reference

1. Geerts WH, Pineo GF, Heit JA, et al. Prevention of venous thromboembolism: The seventh ACCP conference on antithrombotic and thrombolytic therapy. Chest. 2004;126:338S.

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