

Medical Professional Liability in 2018: Major Challenges

by: Susan Forray, Paul Greve & Richard Henderson

The MPL insurance industry has experienced its most extended period of profitability over the last decade. But the last two years have seen the industry's combined ratio creep up to 100% and over.¹ Many positive factors remain in play but there are a growing number of negative factors that must be considered as we move into the future. Industry conferences this year have had many presenters comment on whether a firming of the MPL insurance market may be beginning.

This article will provide an overview of the state of the MPL insurance industry through the first half of 2018. We will focus on:

- Key MPL environmental factors
- MPL litigation trends
- MPL industry financials

MPL: Key Environmental Factors

Perhaps the two most important and daunting environmental factors are the shrinkage of industry premium and rising loss severity. The shrinkage of premium is due to a marked decrease in the numbers of buyers in what historically have been the two largest segments within MPL: physicians and surgeons; hospitals.

This has been driven by the move from the physician private practice model to either hospital employment or into large multispecialty groups as well as mergers and acquisitions in the hospital industry, which have not slowed.^{2,3} There has been a deceleration in the movement of physicians into hospital employment and any continued movement into employment by hospitals and multi-specialty groups will not occur as rapidly in the future.⁴ But hospital mergers and acquisitions have not slowed and thereby have reduced the number of buyers in that segment. These two factors plus price

competition for the shrinking numbers of buyers in these segments have driven down MPL industry premium. Price competition across all segments has affected industry profitability as well.

The issue of rising loss severity will be discussed in more detail within. But it is one of the most critical environmental factors facing the MPL insurance industry. The numbers of large verdicts and settlements has increased markedly in recent years

MPL: Is 2018 a Pivotal Year?

The industry combined ratio has moved to over 100 in the two most recent years. But buyers and brokers continue to have many choices in an industry that is strongly capitalized. The excess capital in the MPL insurance industry combined with fewer buyers has exerted downward pressure on rates. But there has been more of a firming of MPL rates in the last eighteen months than in many years.

There are some definite signs that rate levels have bottomed out and are headed back up in most industry segments, with miscellaneous facilities and allied health professionals as the notable exceptions. However, accounts with good loss experience in good venues typically are experiencing flat renewals and occasional slight decreases, especially in the physicians segment. The firming of rates is most notable in the long term care and hospital segments due to high severity. Some carriers are exercising limits management in poor venues. Accounts with poor loss experience and in poor venues may see marked increases at renewal.

There are a number of positive environmental factors in play in 2018. These include continued low claim frequency, the strong capitalization of almost all MPL insurers, and a

favorable legal environment in most states, especially the maintenance of tort reform laws.

Overview and Analysis of MPL Verdicts

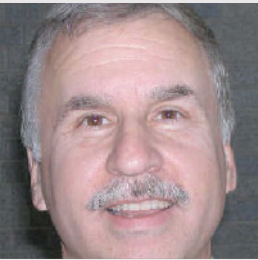
Recent MPL verdict trends have been cause for concern. The number of very large verdicts is increasing.

Why pay so much attention to MPL verdicts, given that the verdict amount rarely equals the ultimate indemnity payment? And what value lies in verdicts, given the overwhelming majority are for the defense?

Verdicts are the truest barometer the plaintiff and defense have with respect to whether their respective theories of liability, causation and damages successfully resonate with a jury or judge. Analysis of jury verdicts can shape not only the plaintiff's claim selection process, but also impact their tactical approach, including the choice of experts and alleged damages. Verdicts can also be an indication of whether tort reforms will ultimately be found unconstitutional, with Florida being just one recent example.

Verdicts are the pulse of jury perception across the country. MPL jury verdicts remain a source of media attention but can also impact the fluidity of claim management and legal defense strategies, regardless of the technical legal standard of care in a given jurisdiction. To ignore the lessons that can be learned from such verdicts, regardless of the eventual outcome or settlement amount, could be an opportunity wasted, especially in light of recent MPL verdict trends.

To make an assessment of MPL verdicts, multiple data sources are required. Some states keep excellent detailed records of MPL verdicts. Various publications track such data on a broader basis, occasionally identifying claims that state-specific resources do not capture. MPL



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insurers track verdicts as well, at least for their insureds and perhaps others. The analysis of verdicts discussed here is based on an aggregation of these sources maintained by TransRe. Certainly, we make no representation that our verdict roster is all-encompassing for the totality of verdicts within the entire the med mal universe.

MPL Verdicts: Analysis of Recent Trends

Recent years have shown an uptick in large verdicts, culminating in “record” large verdicts in 2017. This includes not only verdicts at \$10 million or

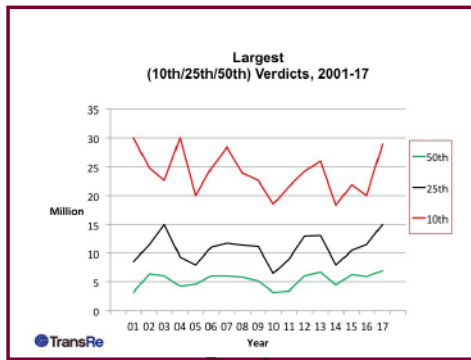


Figure 3

MPL Verdicts: Where are we Headed?

Is the uptick in adverse MPL verdicts is tied to a “millennial effect”? Some jury research professionals, tasked with organizing extensive focus group and mock trial studies, believe different approaches must be

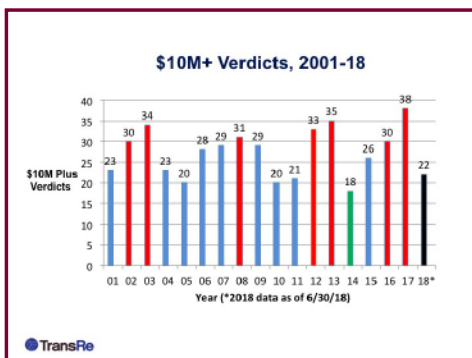


Figure 1

greater (Figure 1), which by our count were 38 in 2017—the highest figure for such verdicts since TransRe began tracking in 2001—but also verdicts at \$25 million or greater (Figure 2), which were 13, tying the high for that

“frequency of severity” of such verdicts and account for what may be only an inordinate number of large verdicts at the very top of the roster. 2017 again shows record or near record results at all three data points. In short, the adverse verdict results of 2017 were not confined to a handful of very large verdicts by themselves; there were ample additional adverse verdicts as well. Further, MPL claim frequency has dropped to record lows at the same time. Thus, even with a reduced claim inventory, the frequency of mega-verdicts remains at or above past levels.

The first 6 months of 2018 are on pace to exceed the MPL verdicts of 2017, itself a record-setting year (Figure 1). We have already seen more verdicts at both \$10M or greater and \$25M or greater through 6/30/18 compared to prior years—and this does not include a \$135 million Michigan verdict rendered July 2nd. Even excluding this most recent verdict, we have seen 7 MPL verdicts at \$40M or more in the first half of this year—this compares to 7 during 2017 and 8 in total for the preceding three years.

We also see an upward trend in the 10th and 25th largest verdicts for the first six 6 months of each year (Figure 4). The consistency of this upward pattern suggests it is not a handful of aberrational verdicts at the top of the heap but, rather, an increasing frequency of large verdicts.

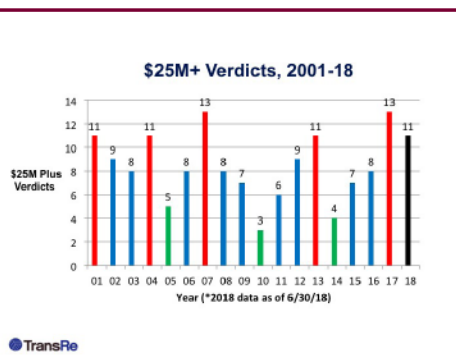


Figure 2

same period. Beyond that, for 2017 we saw 7 verdicts at \$40 million or more whereas the prior three years combined we counted 8 such verdicts.

Drilling down further, we analyze the 10th, 25th and 50th largest verdicts in each year (Figure 3). In this fashion, we are able to look more closely at the

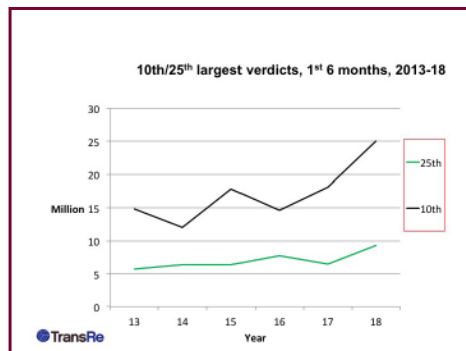


Figure 4

implemented when there is significant millennial participation on a jury. These consultants believe strategies yielding defense verdicts in the past do not resonate as effectively with millennials. Others argue against such blanket statements and that, in the end, the talents of the respective trial counsel and effectiveness of the key witnesses will carry the day. Regardless, we are seeing no shortage of utilization of focus group professionals, particularly in claims of significant verdict potential.

One consistent theme in mega-verdicts is plaintiff demands for life care plans (LCPs) of \$50 million or even in excess of \$100 million in present value. These LCPs are the driving force behind corresponding demands in the mid-to-high eight-figures, if not more. Such demands often trigger attention from the higher reaches of an insurance coverage tower and, in some instances, trigger friction between different participants with respect to claim valuation or strategy. This can lead to excess insurers “hammering” an underlying insurer to settle within underlying limits, even if that underlying insurer does not believe this is warranted.

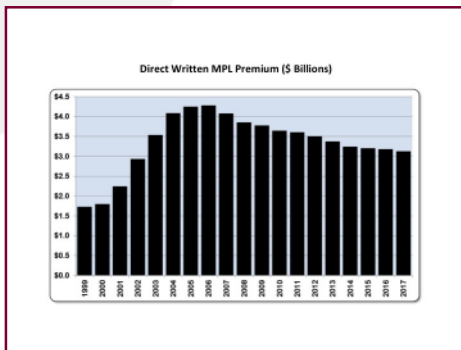
There are also reports of a perceived increase in third party funding sources, which could fuel additional claim frequency but also embolden plaintiff firms to hold out for larger settlements. The scope of such third party funding remains difficult to quantify, and efforts to uncover such sources via traditional legal discovery have been met with uneven rulings. As well, use of the Reptile Theory by many plaintiff firms continues to be a widely recognized concern and remains a highly publicized topic.

Specialty counsel either enter a claim on a pro hac basis or associate with local trial counsel in formulating the most effective trial strategy.

This can also include enhanced efforts to challenge damages in a non-traditional manner. For example, instead of avoiding discussion of damages before a jury for fear of setting a floor or signaling inability to defend a claim, many hold that a jury wants to hear an alternative damages figure from the defense and evaluate this figure against the plaintiff's. This is a marked departure for many senior defense attorneys and claim professionals, but those who espouse this strategy feel confident it will yield more favorable results—even defense verdicts—but only if done in a careful manner.

MPL Insurance Industry Financials

Beyond the effect of large verdicts, the most notable aspect of change in the industry's financial picture is its dramatic decline in premium. Figure 5 provides an almost-twenty-year history

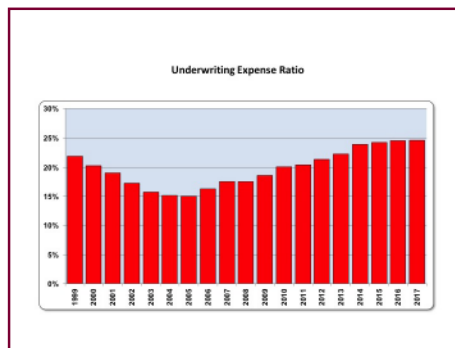


of direct written premium for the MPL industry, as represented by a composite of 35 of the largest MPL specialty

writers. Premium for the MPL industry has now been in decline each year since 2006. Cumulatively, premium has decreased by over \$1.1 billion since this time—more than 25% of the premium written in that year.

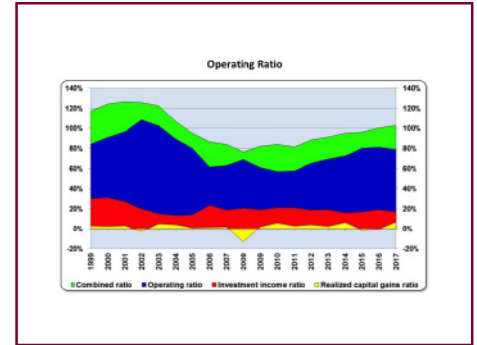
There have been two primary drivers of premium decreases for the industry during this time—rate decreases and the loss of business to self-insurance mechanisms. Throughout this timeframe, companies have been losing business due to health care system acquisitions of both hospitals and physician practices. In earlier years—through about 2008—companies also frequently lost business due to the formation of new captives. Rate decreases have been a more significant driver in the later years of this timeframe and have taken the form of both manual rate decreases as well as increases in schedule credits.

Declining premium has, in turn, been a significant contributor to the rise of the MPL industry's underwriting expense ratio during the same timeframe (Figure 6). It is no



coincidence the industry's expense ratio has risen almost every year since 2005—approximately the same time the decline in premium began. However, given the magnitude of the decline in premium discussed above, at most half of the increase in expense ratio can be explained by a decreasing denominator—and likely less than this. Given declining premium, MPL writers have in many cases been forced to increase commissions to retain business from their agents—an example of the premium decline hitting MPL writers twice over.

The operating ratio for the industry remains at about 80% (Figure 7),

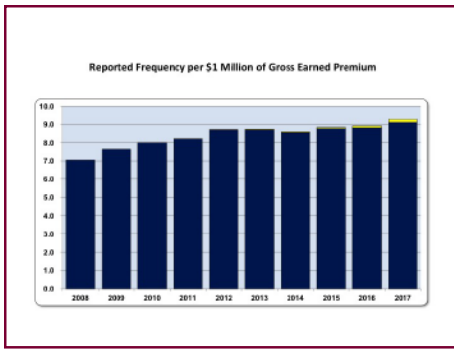


although a significant contributor to the pattern of favorable operating ratios has been reserve releases. Reserve releases have contributed on average over 25% to the industry's operating ratio each year for the past decade, although this has dropped to about 17% over the past two years. Hence the industry would remain profitable absent these reserve releases, but just barely.

Increases in claim severity naturally continue. Trends in defense costs remain in the range of 4% to 6% per annum. Indemnity severity trends remain manageable for smaller-dollar claims, but an increased frequency of larger claims has fueled overall increases in indemnity costs.

Several years ago, the industry's premium decreases were more manageable as they were accompanied by a decrease in claim frequency in addition to a decrease in claim exposure. However, the industry's one-time pattern of declining frequency has since ended. Claims counts have stabilized for most companies with some volatility evidenced for certain writers and increases seen in certain markets.

Figure 8 provides a ten-year history of the industry's frequency as measured per million dollars of gross earned premium (the yellow portion of these bars represents estimated future development on these report-year frequencies, stemming from incident conversions). As shown by this pattern, for every claim reported within the



The industry’s future profitability could very well be affected by megaverdicts—possibly driving smaller claim values higher—and claim frequency, for which further increases would be a primary contributor to possible future deterioration in the industry’s operating ratio. However, given current capitalization levels in

MPL industry today, there are 25% fewer premium dollars available to pay that claim than there were ten years ago. If one also considers that the rising expense ratio eats up more of these dollars than was the case a decade ago, the decline in available premium dollars per claim is even greater.

Relative to underlying exposure—whether quantified by physicians insured or another measure—the increase in claim frequency has, of course, been less than when measured relative to premium. As noted above, increases in “true” claim frequency has been seen in certain markets. The industry’s future profitability will largely be a function of megaverdicts—possibly driving smaller claim values higher—and claim frequency, for which further increases would be a primary contributor to possible future deterioration in the industry’s operating ratio.

Conclusion

For the MPL insurance industry in 2018, there are several positive environmental factors but some very concerning negative factors. On the positive side, claim frequency remains low and stable, the tort environment in most states is favorable and the industry as a whole is well-capitalized. But the numbers of very large verdicts and shrinking industry premiums are major challenges.

the industry, it is possible that such increases may have little impact on rates. To trigger the next hard market, a period of extended underwriting losses sufficient to result in the decline of capitalization levels would likely be necessary. But MPL premiums are firming and headed upward for the first time in many years. 2018 appears to be a pivotal year.

Endnotes

1 Burns, William. “MPL Market Update”, presentation, PLUS MPL Symposium, March 20, 2018.

2 <https://revcycleintelligence.com/news/healthcare-mergers-acquisitions-activity-strong-in-q1-of-2018>Div. 2001)

3 <https://wire.ama-assn.org/practice-management/first-time-physician-practice-owners-are-not-majority>

4 <https://wire.ama-assn.org/practice-management/private-practice-really-giving-way-hospital-owners>