

How Risk Retention Groups Will Force Much-Needed Change in NY

In 1945, The McCarran-Ferguson Act gave the power to regulate insurance to the States. The Risk Retention Acts of 1981 and 1986 may be quietly shifting this power to the Federal Government. New York provides perhaps the clearest example of how these Risk Retention Acts allow insurers to circumvent state regulations and also impact their respective markets.

The New York medical malpractice insurance market has long been considered the prototype of an overregulated industry, as the State has taken virtually complete control over the pricing of policies. The short-term benefits to physicians were evident when New York kept premiums at bay during the recent med mal crisis, but hindsight has revealed the many ways in which these physicians are now the paying for a broken policy.

The History

In the mid nineteen nineties, the entire medical malpractice insurance industry was convinced that diversification was the key to its future financial stability, and carriers began investing heavily in geographic expansion, as well as new product lines. But irresponsible growth ended up spreading companies too thin, and fierce competition caused underpricing. As claims mounted, strong investment returns provided a crutch, but only temporarily. When the bubble finally burst at the turn of the century, the market was battered, and needed drastic help, such as significant price increases and tort reform. While most states recognized the crisis, allowed for substantial premium increases, and provided at least some level of tort reform, New York did not. As a result, its market continues in distress, and the failure to reform has both harmed existing carriers and effectively prevented competition, creating the perfect storm for physicians.

New York finally implemented a correction plan last year by approving major premium increases, but it also continued to shelter existing companies from outside competition. Since no effective tort reform was included, physicians are forced to pay hefty prices for what is perhaps better characterized as a bailout plan.

Risk Retention Groups (RRG's) Emerge

Despite the significant protections New York has in place for its companies, it has not found a way to deal with RRG's, as they are formed under, and protected by, federal law. If the assumption that premiums in NY are inflated to compensate for prior deficiencies is true, then it follows that RRG's, not similarly burdened, can offer very attractive pricing and undermine efforts to overcome years of artificially suppressed premiums.

The PLIGA Problems

Like most states, NY has a Property-Liability Insurance Guarantee Association (PLIGA), which provides coverage for individuals once covered with insolvent, "admitted"

insurance companies. Unlike some states, NY provides a \$1,000,000 backstop per covered claim. PLIGA is funded through surcharges on participating insurance policies, and already adds to the cost of insurance for many NY citizens. Given the amount of potential outstanding liability in NY for medical malpractice claims, the collapse of a major carrier would produce an overwhelmingly large bill to PLIGA, and consequently the insured population.

RRG's, which are "nonadmitted" companies, do not participate in this fund, so physicians that join RRG's would lose this safety net. This leaves physicians with a choice: pay the high premiums of admitted carriers, or seek more competitive rates with nonadmitted carriers. The question may well come down to whether physicians believe that PLIGA is worth the added cost.

Taking advantage of RRG's:

Many physicians are faced with financial pressures, but lack guidance to properly evaluate the risks and benefits of an RRG. The 5 most important concerns are summarized below:

1) Claims-made vs. Occurrence:

Occurrence policies are generally preferable to claims-made policies, primarily because they offer "permanent" protection. This feature eliminates the need for purchasing expensive extended reporting coverage (a "tail") at a future date, although the policies are typically more expensive in the short-term.

Claims-made policies can also have advantages, and can save physicians large sums of money in comparison to claims-made policies if used properly. The temporary nature of claims-made coverage can also give physicians the ability to transfer exposure from a failing company to a more financially stable one. This is especially significant with RRG's, as there is no fund to protect against insolvencies. Indeed, choosing occurrence coverage with an RRG could ultimately prove to be a waste of money.

2) Financial Strength:

Since few RRG's carry an AMBest, or related financial strength rating, it is important to consult independent professionals familiar with key financial indicators. As more RRG's continue to emerge, these measures will help determine which are better positioned to be long-term players. Strong contracts with reinsurance companies are also critical.

3) Financial Commitment:

Many RRG's require upfront commitments, referred to as capital contributions, to help fund them. Some capital contributions are payable over time, but require payment even if a physician is no longer with the company.

Another important feature of RRG's is their assessability. Assessable policies could force its physician-members to provide additional capital in the event of financial difficulty.

4) Sufficient Risk Spreading:

To differentiate themselves, RRG's often tout one distinction to entice physicians, such as being a "single-specialty" RRG. These carriers offer both advantages and disadvantages, but before joining, physicians should ensure that the company has a large enough pool of insureds to adequately spread risk.

5) Hospital Privileges:

Hospital privileges remain one of the most important, and controversial, aspect of RRG's. Since some hospitals will not accept coverage from certain RRG's, physicians should inquire about this prior to joining.

Hospitals attempting to close their doors to physicians covered by RRG's may find themselves navigating in uncharted territory, and ultimately controlled by their own bylaws. The extent to which bylaws can discriminate, and on what basis, against RRG's may eventually spawn a legal battle pinning state institutions against the federal government.

Is there a solution in sight?

The extent of RRG proliferation may well determine the fate of the New York medical malpractice market, and the longer that competition is stifled, the more pervasive RRG's will become. The last New York administration was scheduled to publish a report on the medical malpractice crisis, but it was never released. While the State Government struggles to find ways to renovate its own home, the Federal Government is already moving in.