Medical Malpractice Carriers Prepare for Battle

By Brian S. Kern, Esq. (12/06)

Is New Jersey's more than four-year-old medical malpractice insurance crisis finally coming to an end? Nationally, companies have observed the medical malpractice insurance industry turn profitable, as a result of both increased rates and some effective tort reform. The profits have already caused competition to heat up, and many companies are relaxing their strict underwriting guidelines, changing the products offered, or even applying new or additional credits to policies to ensure that current business is retained, and new business continues. But before physicians being to celebrate, it is important to analyze the market changes during the past four years, and discuss the potential impact on New Jersey.

Several factors led to the first crisis in New Jersey in nearly thirty years. Unsound reliance on temporarily strong investment return led to cutthroat competition, forcing many carriers to underprice policies, and operate on razor thin margins. While the frequency and severity of medical malpractice cases continued to rise, prices did not. Once the unsustainable returns diminished, the aggressive carriers realized that they were undercapitalized, and in some prominent cases, unable to pay existing liabilities. When these large, specialized carriers ceased offering coverage, the market did not have the capacity to support the unanticipated new demand, and the well-financed companies decided not to answer the call, instead choosing to sit on the sidelines, fearing that the situation could worsen.

In reaction to this capacity shortage, several start-up insurance companies and risk retention groups entered the market. These companies rushed to take advantage of a crisis, and attempted to get approval to operate in NJ in any way possible. "Admitted Carriers" filed the necessary paperwork with State Departments of Banking and Insurance, and "Risk Retention Groups" avoided some of the State complexities by operating under Federal Charter, The Liability Risk Retention Act of 1986.

After overcoming what was perhaps a relaxed regulatory environment that encouraged new companies to enter NJ and help quell the crisis, these companies still had to satisfy the continuing governmental issues, battle the more established carriers for clients, secure reinsurance to guard against catastrophic loss, and deal with unproven financials, which meant that new prospects had no way to gauge future claim-paying ability. These new companies also required physicians to pay an additional capital contribution to fund their creation. Risk retention groups had the added disadvantage of not participating in state guarantee funds, so that if they fail, there is no backstop, and member physicians become

personally liable. (Admitted NJ carriers are afforded guarantee fund coverage of $300,000, but are perceived to be personally liable for any balance under NJ case law). All of these factors made it difficult to attract the best physicians actuarially, causing adverse selection to occur.

Historically, professional liability insurance companies have at least a two-year lag before they must respond to claims. The reason is that alleged negligence is often not discovered at the time of an incident (like a car accident), but perhaps months or years later, when the damages finally manifest (ex: failure to diagnose cancer). Once a patient traces blame for an illness or injury back to a physician, she still needs an attorney and a medical professional to agree with her, and then file the necessary paperwork to commence a lawsuit. Therefore, companies should try to reserve as much premium as possible to ensure that money will be readily available once the claims finally arrive.

Companies must also demonstrate success in several other areas to remain viable: keeping costs down; bringing in a sufficient number of new members to pay for ongoing expenses; and practicing underwriting discipline (perhaps the most difficult challenge to a new company), which requires sacrificing money today to avoid the risk of big claims tomorrow. Those unable to achieve these goals will soon find themselves in a difficult position, especially as the old players that have been observing the new market developments from the sidelines come back into the game.

Some of the largest medical malpractice insurance companies in the country underwent enormous changes in the wake of the national crisis and huge losses. Rate increases, underwriting guideline tightening, and significant pullbacks from the nonprofitable market was the popular model followed. The same companies that left states like New Jersey have seen enough, and want a piece of some of the perceived newfound profits enjoyed by some that were tough enough to weather the storm. New Jersey is now seeing some old faces again, but their success may hinge on whether the physicians they abandoned have long memories. These carriers are betting that short-term interests will prevail, and that only one selling point will be necessary to win the market over: lower rates. As physicians start to take advantage of these new rates, the competition will at least temporarily increase once again; bringing some much needed relief to medical practices. How long prices can and will remain depressed given the litigious environment in NJ is the big unanswered question.

The risk retention groups and start-up carriers will have to fight hard to survive, as substantial upfront commitments will render new business less promising, especially given the attractive financial stability of some of the latest entrants. If carriers begin to fail, a new capacity issue may quickly develop, causing rates to creep back up. In fact, some insurance models promote short-term underpricing precisely to force out some competition. The result is more demand and less supply, allowing companies to then once again raise rates.

Of greater concern is that some carriers may not only find their low prices short-lived, but also their New Jersey presence. According to the most comprehensive statistical data on

the NJ medical malpractice market, this new competition is actuarially unsound. Despite minimal tort reform, and a reported flattening of newly filed medical malpractice suits, claim severity continues to increase, questioning the sensibility and sustainability of the companies ready to declare another rate war.

The battle for longevity between the new insurers and the old in New Jersey could get fierce. While the physicians will clearly be the immediate beneficiaries of a price war, the benefits will be short-lived, and those insured on the losing side of this high-stakes game could find themselves paying far more in the years to come.

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