GOVERNANCE THOUGHT LEADERSHIP SERIES

Texas Healthcare Trustees

Health Care Professional Liability Insurance's Changing Market: What Trustees Must Know

Providing education, resources, leadership development to inspire excellence in health care governance.

Hospital trustees oversee every aspect of their institution's mission and strategy, including its financial health and sustainability. Health care professional liability (HCPL) insurance provides stability by protecting and defending physicians and health care facilities against claims of improper or inadequate patient care. This white paper reviews key trends affecting professional liability insurance pricing.

Why the Market Cycle Matters

The market for HCPL insurance is cyclical. Brokers and insurers often talk about its two extremes: soft and hard markets. In a soft market, coverage is widely available and premiums are very competitive. Soft market conditions can persist for a long time, but eventually losses from claims cause some insurers to tighten their underwriting standards and raise prices, while others may stop offering the product. These dynamics trigger a hard market: coverage can become scarce or prohibitively expensive.

What Causes a Hard Market?

Individuals' perceptions can drive changes in the market cycle. Their responses, such as uncertainty, overconfidence and overreaction, stem from the "long tail" nature of health care professional liability insurance — the gap of years or decades between a policy's purchase and the closure of its claims. For example, underwriters address the uncertainty of future claims expenses by conservatively pricing policies upfront. However, when things are going reasonably well, many insurers tend to become overconfident, due to this lag in results, and begin to push the envelope on pricing, terms and risk selection.

When an insurer's claims expenses rise over time, its profitability declines: its management team and rating agencies, state regulators and actuaries tend to overreact. There can be a sharp downturn in the insurer's financial results, followed by rapidly increasing premiums and a dramatic return to profitability. Depending on the degree of downturn and correction, the hospitals and physicians who are policyholders may suffer higher prices and stricter underwriting. It can also be much worse.

Uncertainty, Overconfidence and Overreaction: The Pattern Repeats

There have been three hard markets in the last 50 years. Although each was unique, the fundamental underlying causes — claims frequency and severity — and reactions were the same. The first was the medical malpractice crisis in 1975, so-called because many physicians and hospitals suddenly were unable to find coverage for their medical malpractice exposures at any price. The second hard market in the mid-to-late 1980s was complicated by reinsurers' unwillingness to support occurrence coverage, the preferred form of HCPL insurance at the time. Claims-made coverage, a more conservative product design, is now widely available. The third hard market of the early 2000s hit when the St. Paul Companies, the nation's fourth-largest business insurer, left the market, ending coverage for 750 hospitals and 115,000 physicians and health care providers according to *The New York Times**; several health care professional liability specialty insurers also failed, further reducing availability.

Where Are We Now?

The current soft market, characterized by falling or stable premiums and abundant availability of coverage, has existed for the past 12 years. The industry moved past the uncertainty phase several years ago, finally concluding that the decline in claim frequency was real — despite no good explanation for it. After a brief period of time in which rates and underwriting criteria stabilized, the market entered the overconfidence phase. This was characterized by ever-lower pricing and a strong appetite for new business, regardless of price or terms. The larger the account, the better it looked.

Reactions Ahead

Now the consequences of overconfidence are starting to become apparent and as expected, for many HCPL insurers and their policyholders, they are scary. Aggressively priced coverage with thin profit margins, coupled with the threat of increasing claim severity after a period of very low inflation, has added pressure to loss ratios, an important measure of an insurer's financial health that compares claims paid to premiums earned.

At this point, the industry largely has been through the overconfidence phase and is moving into the reaction (and eventually the overreaction) phase. The market cycle is now in that interim period. After some financial pain as insurance premiums increase and some insurers become less financially stable, there will be significant opportunities for responsibly priced insurance from stable carriers for insureds. The main challenge for hospitals and their agents and brokers during this interim period will be choosing appropriate, sustainable coverage from a financially strong insurer at the right price.

What's New?

While the fundamental causes of the cycle are unchanged, there are some differences this time around. Interest rate yields are much lower than in the past, so there will be little salvation from investment earnings. On the other hand, most of the industry is in a much better capital position than in past cycles, so the risk of insolvencies is diminished. Reinsurers appear to be more focused on pricing and terms, which may create more accountability on the part of insurers. A.M. Best and other rating agencies also seem to be more concerned about profitability rather than pure capitalization levels. The combination of these factors may result in a less severe swing

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**Fruedenhem, Milt, "St. Paul Cos. Exits Medical Malpractice Insurance, The New York Times, December 13, 2001, p. C00014, https://www.nytimes.com/2001/12/13/business/st-paul-cos-exits-medical-malpractice-insurance.html.*

from soft to hard market, simply because the reaction will be quicker and more disciplined.

Challenges Still Ahead

On the other hand, the basic forces of claims expenses versus premium cannot be overstated in how it shapes insurers' financial health and coverage pricing. Recent signs of more frequent and larger medical professional liability claims, especially those naming larger hospitals and their employed physicians, are compounding the effect of price deterioration, accelerating the level of concern and reaction. The aggregation of loss exposure as a result of employment of physicians and acquisition of smaller hospitals is driving larger verdicts and settlements. Claims against individual physicians who previously carried $1 million of insurance coverage are no longer constrained by those coverage limits when the physician is employed by a large hospital. Similarly, smaller hospitals that carried $5 million of coverage are now part of large health care systems with significantly more insurance. As health care organizations consolidate and their coverage limits increase, the opportunity for higher verdicts also grows.

Throughout the hospital and larger account segments of the HCPL insurance market, rates are increasing and terms tightening. Price increases are being enforced and competing carriers generally are not jumping in to undercut. Although these changes may be sufficient to restore insurers' stability, the tide had turned. Even for small, traditional physician practices, rates are no longer declining as they had previously.

The End of the Soft Market

While not minimizing the challenges ahead, there are clear signs that the soft market in HCPL is moving toward an end. Claims frequency and severity will continue to grow. Find an insurance provider who can be responsible in its decisions throughout the soft phase of the market cycle and has the financial capacity, products, geographical spread and people to help hospitals succeed whatever comes next.

Next Steps for Hospital Trustees

The move toward a hard market is exposing weaknesses that will affect coverage for many hospitals.

1. Trustees should consider having their organization review its insurance program with a trusted adviser; it may be prudent to shop a hospital's coverage.
2. In addition to taking a close look at pricing and the insurer's financial ratings, use this opportunity to conduct a thorough risk assessment to identify potential gaps in coverage. As an organization adds new services, delivery systems and procedures, exposures increase in ways that may go unidentified without a careful review. Revisit an insurer's claims management philosophy and defense statistics as part of the evaluation. Given the potential for more severe health care professional liability claims, hospitals should want an insurer who will encourage a unified defense strategy when the facts and jurisdiction allow, improving claims outcome and enhancing trust between physicians and the hospital.
3. Evaluate the risk management services the hospital's insurer provides for its ability to support the organization's patient safety initiatives and increase defensibility in the event of a claim.

In short, consider responsible pricing, financial strength and above all value.

Bottom line: Health care professional liability coverage is becoming more expensive, risks are becoming more complex, and claims are increasing. Now is the time to review a hospital's coverage and make sure it is with a stable insurance partner who can serve the organization admirably for the long haul.

There is a lot to keep up with in health care. Texas Healthcare Trustees is here to help our members, trustees of hospitals and health care systems throughout Texas, with resources that will help to stay up-to-date on important information that can impact how they lead their organization. THT's Governance Thought Leadership Series is one of many resources THT has available for health care board members. To learn more about this series and to view other tools and resources available, visit **www.tht.org**.

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