TOWERS PERRIN

Medical Malpractice Cycle

2008 Casualty Loss Reserve Seminar – Washington, DC

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September 19, 2008

Objectives

- Objectives:
  - Understanding the building blocks of malpractice costs
  - Malpractice cycles
- Relationship to reserving
  - Limitation of actuarial methods without solid understanding of business fundamentals
  - Understanding what drives the cycle helps us better recognize when underlying changes are occurring; helps us react more quickly on more recent years where
    - data is immature and more difficult to read
    - a substantial portion of the overall reserve resides
- Overcoming perception that actuaries are great at looking backwards but of little help looking forward
  - Leading indicators

Components of the Insurance Cycle

- The insurance cycle is really composed of two ‘cycles’ – the underlying cost cycle and the pricing cycle
- The pricing cycle is driven by a number of factors:
  - Market capacity – more capacity chasing the same business leads to lower pricing
  - Investment returns
  - Underlying cost cycle
  - Memory (or lack thereof)
- For medical malpractice these two cycles tend to run out of phase by two to four years depending on the underlying circumstances

Pricing cycle

- Primary hospital market is fairly limited
- Excess hospital market has had multiple consecutive renewals with decreases but still appears to be rational
  - Markets willing to quote lead layer are still fairly limited and so is the competition
  - Attachments are not changing materially as many hospitals are reluctant to lower there retention
  - Aggregate limits on retention are still rare but in some cases available and reasonable
- Physician market has also had multiple years of rate decreases; starting to see signs of irrational pricing
  - Carriers fighting hard to keep business via discounts
  - Expansion of alternative programs (captives, RRGs, etc.)

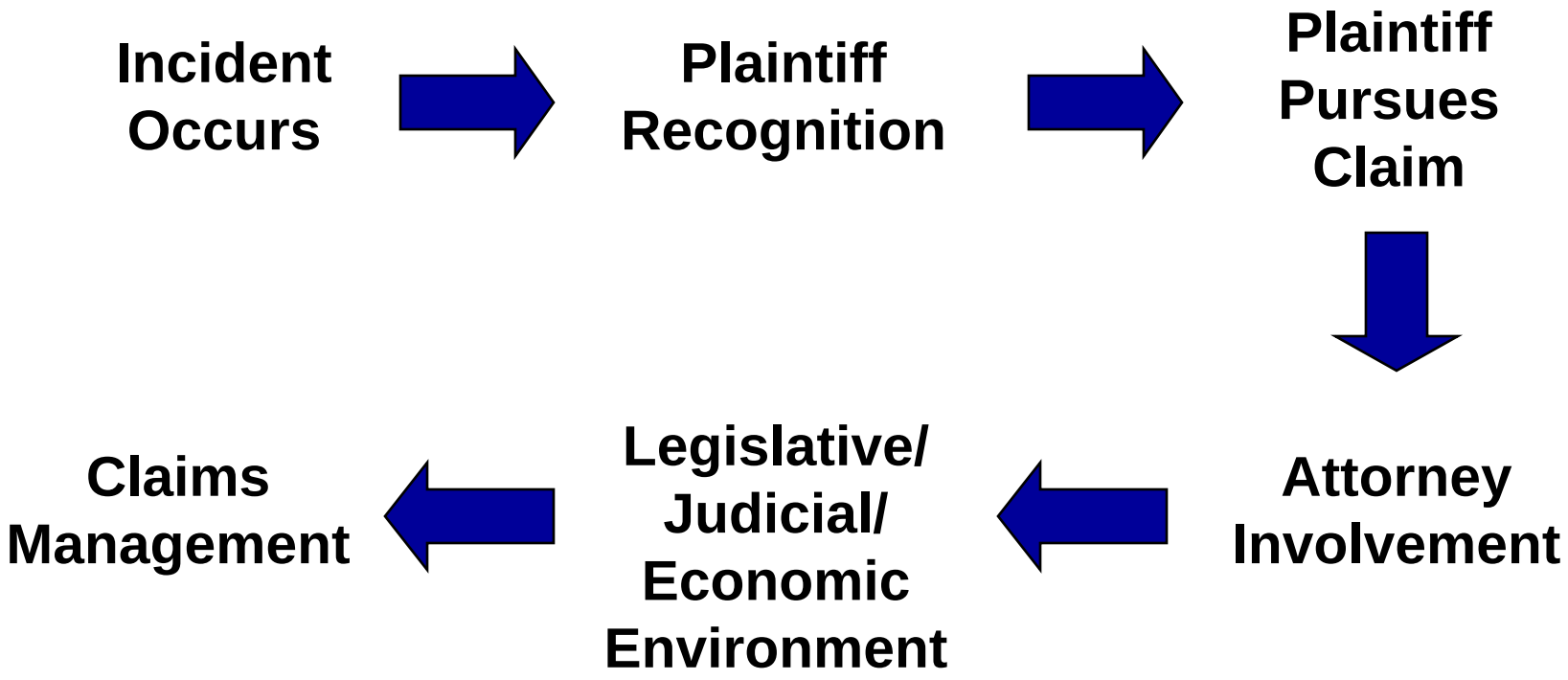
Elements of a Successful Malpractice Claim

- A plaintiff must establish all of the following elements of the tort of negligence for a successful malpractice claim:
  1. A duty was owed
     - Good samaritan
  2. A duty was breached
     - Standard of care:
       - Expert testimony
       - Obvious error or res ipsa loquitor or 'the thing speaks for itself').
  3. The breach caused an injury
     - Proximate cause
  4. The injury resulted in damages to the plaintiff

Types of Damages

- Compensatory damages can be both economic and non-economic
  - Economic: lost wages, medical expenses, life care expenses
  - Non-economic: physical and psychological harm
    - Loss of vision, limb, etc.
    - Reduced enjoyment of life due to disability or loss of loved one
    - Severe pain and emotional distress
- Punitive damages for wanton and reckless conduct

Malpractice Cost Levers



Changes in any one of these levers can significantly alter the flow of malpractice costs

Occurrence of Malpractice Incidents

- 1999 report by Institute of Medicine estimated that between 44,000 and 98,000 people are killed annually due to medical errors
- A recent study by Healthgrades found that an average of 195,000 hospital deaths in each of the years 2000, 2001 and 2002 in the U.S. were due to potentially preventable medical errors
- A 2006 follow-up to the 1999 Institute of Medicine of the National Academies study found that medication errors are among the most common medical mistakes, harming at least 1.5 million people every year. According to the study, 400,000 preventable drug-related injuries occur each year in hospitals, 800,000 in long-term care settings, and roughly 530,000 among Medicare recipients in outpatient clinics

Occurrence of Malpractice Incidents (Cont'd)

- One study estimates that sponges or instruments are left behind at least 1,500 times a year in the United States -- a tiny fraction of the total operations, which exceed 28 million. That works out to about one case a year for a typical large hospital. But, the authors note, the cases "attract wide, critical press coverage," and patients often sue… researchers acknowledged that counts might not be enough, particularly in emergencies, where they may be wrong. The study found that when objects were lost and counts done, the count was thought to be correct in 88 percent of the cases -- and obviously, it was wrong.
- Operating on the wrong arm or leg… the list goes on
- Malpractice vs. bad outcome
  - Communication (or lack thereof) can affect patients view
    - Two decades ago, in 1984, researchers showed that on average, patients were interrupted 18 seconds into explaining their problems. Fewer than 2 percent got to finish their explanations.
    - In 1999 Dr. Beckman and his colleagues published a follow-up to his original study in The Journal of the American Medical Association. Patients, they found, were no longer interrupted, on average, at 18 seconds. Instead, it took 23 seconds for the doctor to interrupt.

Occurrence of Malpractice Incidents (Cont'd)

- Impact of rising standard of care
- Emergence of new exposures (i.e. robotic surgery)
- Recent history: hospitals and physicians continue to take steps to decrease malpractice incidents
  - Root cause analysis
  - Adopting best practices
  - Risk management, patient safety and quality initiatives
  - Senior management attention
  - Return on investment
- Future outlook: likely continued decreases
  - Unless senior management attention is lost.. perceived decrease in return on investment
  - Many of the risk management, patient safety and quality initiatives need to be periodically revisited
    - Impact of turnover in staff
  - Pay for performance will help keep incentives aligned

Recognition of Incident by Plaintiff/Decision to Pursue a Claim

- Only a fraction of the instances of negligent treatment is actually recognized by the plaintiff…
  - Recent studies have found that one of every 100 hospital patients suffers negligent treatment, and that as many as 98,000 die each year as a result. But studies also show that as few as 30 percent of medical errors are disclosed to patients.
- Only a small fraction of injured patients — perhaps 2 percent — press legal claims.
- What factors effect a patients ability to recognize and desire to pursue a malpractice claim?
  - Public sentiment and perception of impact of malpractice costs
    - — Recent history has been favorable
  - Communication, Communication, Communication
    - — Malpractice lawyers say that what often transforms a reasonable patient into an indignant plaintiff is less an error than its concealment, and the victim's concern that it will happen again.

Recognition of Incident by Plaintiff/Decision to Pursue a Claim (cont'd)

- Just how often does communication between doctors and patients run amok? Research shows that only 15 percent of patients fully understand what their doctors tell them, and that 50 percent leave their doctors' offices uncertain of what they are supposed to do to take care of themselves. Studies suggest that women are better at building relationships with their doctors than men. The typical number of questions a male patient asks during a 15-minute doctor's visit is zero, while women average six, according to a study by Dr. Kaplan.
- Doctors as well as patients may suffer the consequences of communication gone awry. A common theme of malpractice lawsuits is a breakdown in communication, said Dr. Wendy Levinson, vice chairwoman of the University of Toronto's department of medicine. What often prompts people to sue their doctors, said Dr. Levinson, who has studied the issue extensively, "is the feeling that they were not listened to, that they didn't have the doctor's full attention."

Recognition of Incident by Plaintiff/Decision to Pursue a Claim (cont'd)

- To apologize or not apologize…
  - By promptly disclosing medical errors and offering earnest apologies and fair compensation, they hope to restore integrity to dealings with patients, make it easier to learn from mistakes and dilute anger that often fuels lawsuits.
  - The number of malpractice filings against the University of Illinois has dropped by half since it started its program just over two years ago, said Dr. Timothy B. McDonald, the hospital's chief safety and risk officer. In the 37 cases where the hospital acknowledged a preventable error and apologized, only one patient has filed suit. Only six settlements have exceeded the hospital's medical and related expenses.
- In Michigan, trial lawyers have come to understand that Mr. Boothman will offer prompt and fair compensation for real negligence but will give no quarter in defending doctors when the hospital believes that the care was appropriate.
- To give doctors comfort, 34 states have enacted laws making apologies for medical errors inadmissible in court. Four states have gone further and protected admissions of culpability. Seven require that patients be notified of serious unanticipated outcomes.

Recognition of Incident by Plaintiff/Decision to Pursue a Claim (cont'd)

- What about the impact of frivolous claims?
  - A 2006 study published in the New England Journal of Medicine concluded that claims without evidence of error "are not uncommon, but most [72%] are denied compensation.
  - Physicians examined the records of 1452 closed malpractice claims.
    - 97% were associated with injury; of them, 73% got compensation.
    - 3% of the claims were not associated with injuries; of them, 16% got compensation.
    - 63% were associated with errors; of them, 73% got compensation
    - 37% were not associated with errors; of them, 28% got compensation
    - Claims not associated with errors accounted for 13 to 16% percent of the total costs.
    - For every dollar spent on compensation, 54 cents went to administrative expenses (including lawyers, experts, and courts).
    - Claims involving errors accounted for 78 percent of administrative costs

Attorney Involvement

- There is a clear link between the level of attorney involvement and malpractice costs
- Many clients have significantly changed their claims management philosophies to get to patients before they get to attorneys
  - Apologies are part of this
- Recent history has shown decreased plaintiff activity
  - Impact of tort reforms
  - Rising costs to build successful claims
  - Leads to attorneys moving on to other torts…
    - — Nationally, defendants prevail in nearly 80 percent of the medical malpractice cases that go to trial. Many malpractice suits, legal analysts say, are filed by personal-injury lawyers, accustomed to handling simpler cases like those involving auto accidents, but not as experienced in medical negligence work. In a 2002 survey by the trial lawyers association, only 11 percent of its 60,000 members said medical malpractice was their primary area of practice; 40 percent replied that medical negligence cases were some part of their practice.
- Contingency fees collected by his firm would typically be 20 percent of the total, a limit set by Illinois state law on all awards over $1 million

Attorney Involvement (cont'd)

- California malpractice lawyers say the law also discourages them from taking wrongful-death cases if the victims are children or retirees. Those groups have no economic value by the cold logic of the courtroom because they are not earning salaries, so the maximum award would be $250,000. Complex cases, which often require many expert witnesses and years of research, can cost that much to bring to trial.
- Future outlook:
  - Increased activity from the plaintiff bar pursuing class action type claims
    - Example: Unnecessary surgery case involving two surgeons and Tenet in California
  - Emergence of new theories, workarounds for tort reform, Increased activity from the plaintiff bar pursuing class action type claims

Legislative/Judicial Environment

- A number of states have adopted various levels of tort reform
  - Texas tort reform has been among the most successful
    - For pain and suffering, so-called noneconomic damage, patients can sue a doctor and, in unusual cases, up to two health care institutions for no more than $250,000 each, under limits adopted by the Legislature. Plaintiffs can still recover economic losses, like the cost of continuing medical care or lost income, but the amount they can win was capped at $1.6 million in death cases
  - In 1975, California passed the Medical Injury Compensation Reform Act, which included a cap of $250,000 for damages like pain and suffering in malpractice cases. It did not limit economic damages for things like the cost of continuing care for a person disabled or wages lost because of medical errors. The law also curbed attorneys' fees on a sliding scale that prohibited them from collecting more than 15 percent on award amounts over $600,000, with higher percentages for the amounts below that sum. (In states without limits on fees, contingency payments to malpractice lawyers are typically about one-third of awards.)
  - All but 15 states have adopted some limits on medical damage awards, according to the National Conference of State Legislatures.

Legislative/Judicial Environment (cont'd)

- Clearly the recent history has been favorable but the there are signs that the pendulum is swinging in a different direction
  - Some states have already overturned tort reform
  - As time goes by plaintiff bar will be creative in finding ways around the tort reform (i.e. elder abuse)
- Still the potential for cases with very significant economic value
  - Bad baby claims are still going to be an issue
  - Removing the wildcard of non-economic damages significantly impacts the leverage of the plaintiff attorney
    - — Effects marginal cases or cases based on sympathy value
- Public awareness of malpractice costs in recent years has likely made the courts (judges and juries) more conservative
  - That pendulum will likely swing back
- Medicare's list of never events
  - Emergence of potential strict liability

Legislative/Judicial Environment (cont'd)

- Many clients are also looking at different approaches to handling claims
  - Mediation, binding arbitration
- Mediation is increasingly effective for delivering faster compensation to injured patients while at the same time creating more stability/cost certainty for both the health care provider and the plaintiff attorney
- More and more health care providers are pushing for binding arbitration -- in which an arbitrator or panel of arbitrators unconnected to a case hears arguments from both sides and renders a decision -- to reduce their costs.
- Arbitrator is often a lawyer or a retired judge; obviously selection is a pivotal issue
- Patients have often had difficulty finding a lawyer to represent their case. Many lawyers are hesitant to take these cases, because arbitration awards are often lower than jury trial awards and are perceived as being harder to win.

Legislative/Judicial Environment (cont'd)

- Arbitration isn't cheap. The two parties generally split the cost of the arbitrator's time, whose rates are often several hundred dollars an hour. This is in addition of the typical defense costs, expert witness fees, etc.
- Critics say one troubling aspect of arbitration is its secrecy. Proceedings are often confidential. There is no public airing of issues or acknowledgment of error, and no development of case law or establishment of precedent. "Part of the value of the Seventh Amendment right to a trial by jury is that the public sees the facts," said Jamie Court, executive director of the Foundation for Taxpayer and Consumer Rights.

Conclusions

- Historically malpractice cycles have run 10-15 years and we are approximately 8 years into the current cycle
  - Turn in the cost cycle is likely not far away
  - Turn in pricing cycle may closely lead/follow given investment markets
- Significant factors driving the improvement in recent years have begun to moderate and some factors are emerging that could lead to higher costs
  - Will inflation rear it's ugly head?
  - Public sentiment swinging back in the other direction
  - Can't keep a good attorney down