FALLING CLAIMS AND RISING PREMIUMS IN THE MEDICAL MALPRACTICE INSURANCE INDUSTRY

by

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Executive Summary

This Report analyzes the 2000-2004 performance of each of the 15 largest medical malpractice insurers in the United States rated by A.M. Best, the principal rating service for the insurance industry. The Report is based primarily on data from the carriers' 2004 Annual Statements filed with state insurance departments.

The Report finds the following:

* Over the last five years the amount the major medical malpractice insurers have collected in premiums has more than doubled, while their claims payouts have remained essentially flat.
* Some malpractice insurers substantially increased their premiums while both their claims payments and their projected future claims payments were decreasing.
* Malpractice insurers accumulated record amounts of surplus over the last three years.

Taken together, the malpractice carriers analyzed increased their net premiums by 120.2% during the period 2000-2004, although their net claims payments rose by only 5.7%. Thus, they increased their premiums by 21 times (120.2/5.7 = 21.09) the increase in their claims payments.

As a result of these two dramatically different trends, the ratio between these insurers' claims payments and premiums fell by more than half between 2000 and 2004: it declined from 69.9% to 33.6% on a net basis, and from 68.8% to 32.1% on a gross basis. Put another way, in 2004 the leading medical malpractice insurers took in approximately three times as much in premiums as they paid out in claims.

Moreover, several insurers substantially increased their premiums even though their claims payments actually fell--and fell substantially. For example:

* Healthcare Indemnity, Inc. (HCI), an affiliate of HCA corporation, increased its premiums by $173 million, or 88%, while its claims payments fell by $74 million, or 32%. As a result, in 2004 it paid out only 43 cents in claims for each premium dollar it collected.

* ProNational, an affiliate of ProAssurance Corporation, increased its premiums by $87 million, or 79%, while its claims payments fell by $43 million, or 63%. As a result, in 2004 it paid out only 13 cents in claims for each premium dollar it collected.

* Medical Assurance, another ProAssurance affiliate, increased its premiums by $151 million, or 89%, while its claims payments fell by a third. As a result, in 2004 it paid out only 10 cents in claims for each premium dollar it collected.

In addition, Lexington Insurance Company, an affiliate of AIG, reported that its net written premiums increased from $21.1 million in 2000 to 483.0 million in 2004—an increase of $461.9 million, or 2200%--while its net paid losses increased by only $52.9 million. As a result, in 2004 it paid out only 14 cents in claims for each premium dollar it collected.

Finally, even the ratio between the amount the leading malpractice insurers estimated they would pay out in the future and the premiums they earn--what insurers somewhat counter-intuitively call their "incurred loss" ratio--declined by almost 25% between 2000 and 2004. Due to this decline--which is in addition to the decline in the amounts these insurers have actually been paying out--they estimated in 2004 that they would <u>ultimately</u> pay out in claims only 51.4 cents of each premium dollar they earned. Perhaps most striking, in 2004 these 15 insurers taken together increased their earned premium by 9.3%, even though their incurred losses--the amount they estimated they would pay out in the future--declined by 21.1%.

Because of the overall surge in malpractice premiums with no corresponding surge in claims payments during the last five years, the leading malpractice insurers have increased their surplus by more than a third in only three years, and they are now charging more for malpractice insurance than either their actual payments in malpractice cases or their estimated future payments in malpractice cases would justify.

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I. Introduction

This Report analyzes the 2000-2004 performance of the 15 largest A.M. Best-rated[1] medical malpractice insurance companies in the United States based primarily on data from their 2004 Annual Statements filed with state insurance departments. The insurers analyzed include both investor-owned stock companies, such as AIG-affiliate Lexington Insurance Company, and doctor-owned mutual companies, such as ISMIE Mutual Insurance Company in Illinois.

The Report analyzes the performance of these insurers, who account for the majority of the medical malpractice business written in the United States, in three different ways:

- it compares the amount they have collected in premiums in each of the last five years to the amount they have paid out in claims in each of those years;
- it compares the premiums they have earned in each of those years to the amount they projected they would ultimately pay out on policies in effect in each of those years; and
- it analyzes the growth during the past three years in each insurer's surplus--the extra cushion the insurer holds in addition to the amount it has set aside to pay projected future claims.

The Report finds the following:

- Over the last five years the amount the major medical malpractice insurers have collected in premiums has more than doubled, while their claims payouts have remained essentially flat.
- Some malpractice insurers substantially increased their premiums even while both their actual claims payments and their estimated future claims payments decreased.

[1] A.M. Best, headquartered in Oldwick, New Jersey, is the principal rating agency for the insurance industry. All 15 insurers are rated at least B+ (Very Good) by Best's. Eleven are rated A- (Excellent) or better. The only major malpractice insurance company not rated by Best's is Medical Liability Mutual Insurance Company (MLMIC), which writes almost exclusively in New York and does not disclose its surplus in its Annual Statement.

- Malpractice insurers have accumulated record amounts of surplus over the last three years. As a result, the surplus the leading medical malpractice insurers now hold is almost double the amount the National Association of Insurance Commissioners deems adequate for those insurers.

II. Methodology

A. Written premiums vs. paid losses

The performance of insurance companies can be measured in several ways. The first is to compare the premiums an insurance company collects in a given year--known as "written premium"--with the amount the insurer pays out in claims in a given year--known as "paid losses." This comparison can be done on a "gross" or "net" basis. A gross analysis analyzes the amounts the insurer takes in and pays out before accounting for reinsurance--reinsurance is the insurance insurers themselves buy to cover claims above a certain amount, or to pay portions of certain claims. A net analysis, in contrast, analyzes the amounts the insurer takes in and pays out after accounting for reinsurance. This Report compares written premiums to paid losses on both a gross and a net basis.

Comparing the premiums an insurer takes in in a given year with the claims it pays out in that same year does not provide a complete picture of its performance, since claims paid out in a given year are typically covered by policies written in prior years. Nevertheless, the trend in an insurer's written premiums and paid losses over several years is one relevant indicator of an insurer's performance. This Report shows that trend for each insurer during the past five years, and also sets forth the ratio between the insurer's losses and premiums for each of those years. That ratio is referred to as the paid loss ratio.

B. Earned premiums vs. projected losses

Another way to measure the performance of an insurance company is to compare the premiums it earns in a given year with the claims it projects it will pay in future years on policies in effect in that year.

Earned premium refers to the portion of the premium that is attributable to a particular period of coverage. For example, if a policy covering the period July 1, 2004 through June 30, 2005 costs $100, the insurance company writes $100 in premium for calendar year 2004, but earns only $50 in premium for calendar year 2004, since only half of the coverage provided by that policy occurs in 2004. Because insurance companies continually write policies, earned premium and written premium typically do not differ greatly.

The claims an insurer projects it will ultimately pay that are covered by premiums earned in a given year are referred to as the insurer's "incurred losses" for that year. To the lay person the term "incurred losses" is misleading, since an insurer's "incurred losses" are not payments the insurer has made but rather are estimates of the claims the insurer projects it will pay in the future which ultimately may or may not be paid. In fact, many malpractice insurers have in the past posted incurred loss estimates that ultimately proved to be substantially overstated -- sometimes by as much as 40%. Accordingly, insurers acknowledge in their Annual Statements that their reserves – the amount they have set aside to pay their projected incurred losses – are likely to be materially inaccurate and in the past have been materially inaccurate. Nevertheless, insurers and regulators typically use the incurred loss ratio as a measure of profitability. The Report therefore sets out the insurers' earned premium and projected losses, along with the ratio between those two numbers, for each of the last five years. That ratio is referred to as the incurred loss ratio.

C. Surplus analysis

Surplus is the extra cushion an insurance company accumulates over and above the amount it has set aside to pay its estimated future claims. A company increases its surplus to the extent that, after setting aside a sufficient amount to pay all projected future claims, it both earns a profit and declines to distribute that profit to its shareholders (in a stock company) or policyholders (in a mutual company). The National Association of Insurance Commissioners (NAIC) has developed a formula, based on the risk assumed by the insurer and the quality of the assets it holds, that calculates the level of surplus the NAIC views as adequate for each company.

This Report analyzes the change in each insurer's surplus during the most recent three-year period--the period during which insurers have publicly maintained that their surplus is being threatened by increasing claims payments. It also compares each insurer's actual surplus as of December 31, 2004 to the surplus the NAIC deems adequate for that company.

III. Findings

A. Written premiums vs. paid losses

Whether one looks at gross or net paid losses, the amount the 15 leading medical malpractice insurers have taken in in premiums during the 2000-2004 period has more than doubled, whereas the amount they have paid out in claims has remained essentially constant. Specifically, as Table 1[2] and Chart 1 indicate, the net written premiums of those insurers grew by 120.2%, while their net paid losses grew by only 5.7%.

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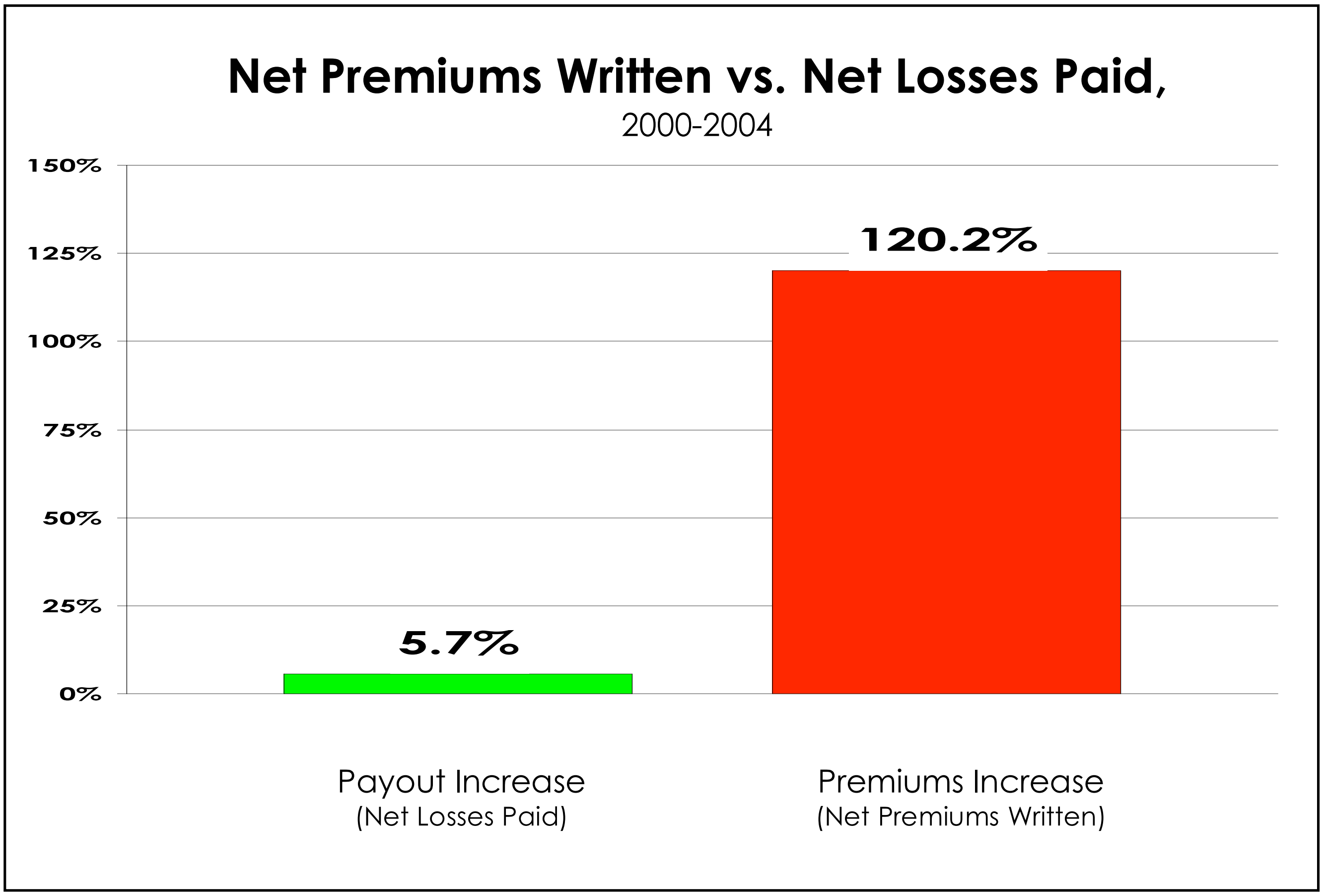
[2] For all companies except Lexington, Continental Casualty and Evanston, the source of the data in the tables is the Five Year Historical Data pages from the 2004 Annual Statements. For Lexington, Continental Casualty, and Evanston, the source of the data in the tables is pages 6-9 of each Annual Statement between 2000 and 2004. The Annual Statement for each of those years for each of those three carriers had to be reviewed because the Five-Year Historical Data pages in the 2004 Annual Statement do not break out data by line of insurance within a company, and unlike the other 12 carriers Lexington, Continental and Evanston write substantial amounts of other types of insurance in addition to medical malpractice.

Table 1
Net Written Premium vs. Net Losses Paid,
2000-2004 (in millions of dollars)

Company[3]		2000	2001	2002	2003	2004	Change
MedPro	NPW	267.1	345.0	538.4	713.5	526.3	+97.0%
	NPL	152.4	151.9	190.4	216.9	257.8	+69.2%
	Ratio	57.0%	44.0%	35.4%	30.4%	49.0%	
Lexington	NPW	21.1	94.2	274.5	442.7	483.0	+2200.0%
	NPL	12.2	33.4	25.9	14.6	65.1	+433.6%
	Ratio	58.1%	35.5%	9.4%	3.3%	13.5%	
TDC	NPW	209.7	274.1	389.2	332.0	457.2	+118.0%
	NPL	115.1	123.8	171.5	167.6	143.2	+24.4%
	Ratio	54.8%	45.2%	44.1%	50.5%	31.1%	
HCI	NPW	197.1	260.3	318.6	377.0	370.1	+87.8%
	NPL	231.8	168.0	182.5	190.7	157.6	-32.0%
	Ratio	117.6%	64.5%	57.3%	50.6%	42.6%	
Continental	NPW	114.3	89.5	196.5	245.1	347.1	+232.8%
	NPL	208.7	188.7	71.5	-79.4	157.0	+24.8%
	Ratio	182.6%	210.8%	36.4%	-32.4%	45.2%	
MedAssurance	NPW	170.5	156.9	227.0	294.2	321.7	+88.7%
	NPL	48.2	68.1	62.5	48.1	32.0	-33.6%
	Ratio	28.3%	43.4%	27.5%	16.3%	9.9%	
ProMutual	NPW	98.1	127.0	171.2	190.9	263.4	+168.4%
	NPL	115.7	107.8	78.8	90.6	93.6	-19.1%
	Ratio	117.9%	84.8%	46.0%	47.5%	35.6%	
MAG Mutual	NPW	82.7	114.1	142.2	157.2	256.6	+210.2%
	NPL	38.1	40.4	60.5	77.2	83.3	+118.4%
	Ratio	46.1%	35.4%	42.6%	49.1%	32.5%	
ISMIE	NPW	139.4	175.5	217.5	276.8	223.8	+60.1%
	NPL	129.8	115.1	119.4	126.2	126.6	-2.5%
	Ratio	93.1%	65.6%	54.9%	45.6%	56.6%	
Norcal	NPW	129.3	170.3	169.2	201.2	200.8	+55.3%
	NPL	52.8	70.1	82.0	81.5	69.7	+32.0%
	Ratio	40.8%	41.2%	48.5%	40.5%	34.7%	
ProNational	NPW	110.1	132.1	148.7	193.0	197.2	+79.1%
	NPL	67.6	77.3	56.9	53.1	25.0	-63.0%
	Ratio	61.4%	58.5%	38.3%	27.5%	12.7%	
AP Capital	NPW	157.1	179.6	208.7	109.8	170.9	+8.8%
	NPL	61.8	90.1	117.3	118.3	64.6	+4.5%
	Ratio	39.4%	50.2%	56.2%	107.7%	37.8%	
State Vol.	NPW	77.4	94.5	130.8	135.2	150.0	+93.9%
	NPL	41.8	54.5	56.6	50.7	70.7	+69.1%
	Ratio	54.0%	57.6%	43.2%	37.5%	47.1%	
FPIC	NPW	110.3	93.6	94.0	103.4	136.5	+23.7%
	NPL	45.0	53.2	48.3	27.9	49.1	+9.1%
	Ratio	40.7%	56.9%	51.4%	27.0%	35.9%	
Evanston	NPW	38.1	60.4	123.3	137.3	128.5	+237.3%
	NPL	23.4	21.1	30.0	32.1	26.0	+11.1%
	Ratio	61.4%	34.9%	24.3%	23.4%	20.2%	
Totals	NPW	1,922.2	2,367.1	3,349.8	3,909.3	4,233.1	+120.2%
	NPL	1344.4	1363.5	1354.1	1216.1	1421.3	+5.7%
	Ratio	69.9%	57.6%	44.4%	31.1%	33.6%	

[3] Appendix A sets forth the full name of the company, along with its insurance holding company parent, if any, and its Best's rating. It also lists the states in which the company writes medical malpractice coverage.

Chart 1

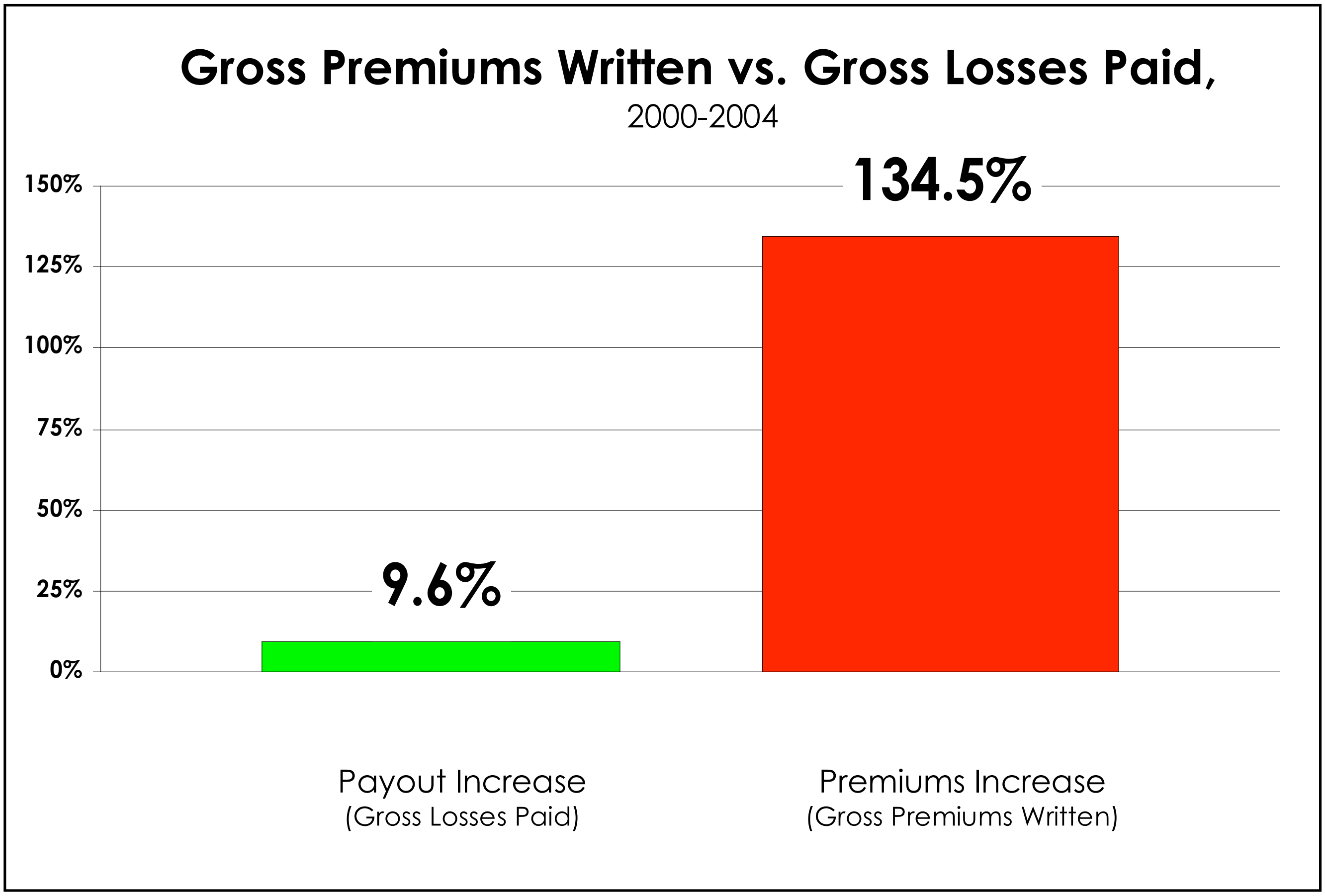


The difference between the leading malpractice insurers' written premiums and paid losses on a gross basis is similarly stark: as Table 2 and Chart 2 indicate, their gross written premiums increased by 134.5% between 2000 and 2004, while their gross paid losses rose by only 9.6%.

Table 2
Gross Written Premium vs. Gross Losses Paid,
2000-2004 (in millions of dollars)

Company		2000	2001	2002	2003	2004	Change
Lexington	GPW	71.8	170.4	567.4	788.9	778.6	+984.4%
	GPL	23.9	75.7	65.9	100.1	124.2	+419.7%
	Ratio	33.3%	44.4%	11.6%	12.7%	16.0%	
MedPro	GPW	296.8	380.2	586.5	849.3	736.5	+148.1%
	GPL	200.2	189.3	230.0	250.9	296.8	+48.2%
	Ratio	67.5%	49.8%	39.2%	29.5%	40.3%	
TDC	GPW	236.6	311.3	428.1	431.3	489.6	+106.9%
	GPL	130.4	140.7	196.0	197.5	155.0	+18.9%
	Ratio	55.1%	45.2%	45.8%	45.8%	31.7%	
ISMIE	GPW	164.8	209.0	265.6	364.3	425.3	+158.1%
	GPL	163.8	141.3	158.1	165.2	153.4	-6.3%
	Ratio	99.4%	67.6%	59.5%	45.3%	36.1%	
HCI	GPW	243.6	288.4	344.7	386.5	382.2	+56.9%
	GPL	276.8	193.5	237.3	206.9	187.1	-32.4%
	Ratio	113.6%	67.1%	68.8%	53.5%	49.0%	
MAG Mutual	GPW	87.8	131.4	216.3	286.9	358.7	+308.5%
	GPL	48.8	50.8	79.1	95.6	102.7	+110.5%
	Ratio	55.5%	38.7%	36.6%	33.3%	28.6%	
Med Assurance	GPW	196.3	224.5	292.3	335.8	357.0	+81.9%
	GPL	76.4	96.4	83.5	60.5	59.9	-21.6%
	Ratio	38.9%	42.9%	28.6%	18.0%	16.8%	
ProMutual	GPW	107.0	148.4	182.8	216.2	273.3	+155.4%
	GPL	117.9	117.7	84.0	92.3	100.6	-14.7%
	Ratio	110.2%	79.3%	46.0%	42.7%	36.8%	
FPIC	GPW	179.3	212.2	295.8	287.0	285.2	+59.1%
	GPL	59.7	79.1	70.3	78.9	101.0	+70.4%
	Ratio	33.3%	37.3%	23.8%	27.5%	35.7%	
State Vol.	GPW	98.0	120.4	164.0	212.6	241.5	+146.4%
	GPL	51.7	61.8	64.1	59.3	76.9	+48.8%
	Ratio	52.7%	51.3%	39.1%	27.9%	31.8%	
Norcal	GPW	150.7	179.0	181.9	212.2	209.5	+39.0%
	GPL	57.4	85.0	89.8	86.1	73.7	+28.4%
	Ratio	38.0%	47.5%	49.4%	40.6%	35.2%	
ProNational	GPW	139.6	151.9	167.8	203.6	207.5	+48.6%
	GPL	81.4	89.4	68.2	67.5	39.4	-51.6%
	Ratio	58.3%	58.9%	40.6%	33.2%	19.0%	
Continental	GPW	72.2	140.2	177.5	173.0	196.6	+172.3%
	GPL	165.7	150.7	151.8	111.9	108.4	-34.6%
	Ratio	229.5%	107.5%	85.5%	64.7%	55.2%	
AP Capital	GPW	170.0	209.7	236.8	135.7	192.3	+13.1%
	GPL	69.7	109.2	142.1	142.9	88.1	+26.5%
	Ratio	41.0%	52.1%	60.0%	105.3%	45.8%	
Evanston	GPW	45.1	78.1	171.2	182.4	164.5	+264.7%
	GPL	26.2	23.7	36.1	38.4	30.9	+17.9%
	Ratio	58.1%	30.3%	21.1%	21.6%	18.8%	
Totals	GPW	2,259.6	2,955.1	4,278.7	5,065.7	5,298.3	+134.5%
	GPL	1,550.0	1,604.2	1,756.3	1,754.0	1,698.8	+9.6%
	Ratio	68.6%	54.3%	41.0%	34.6%	32.1%	

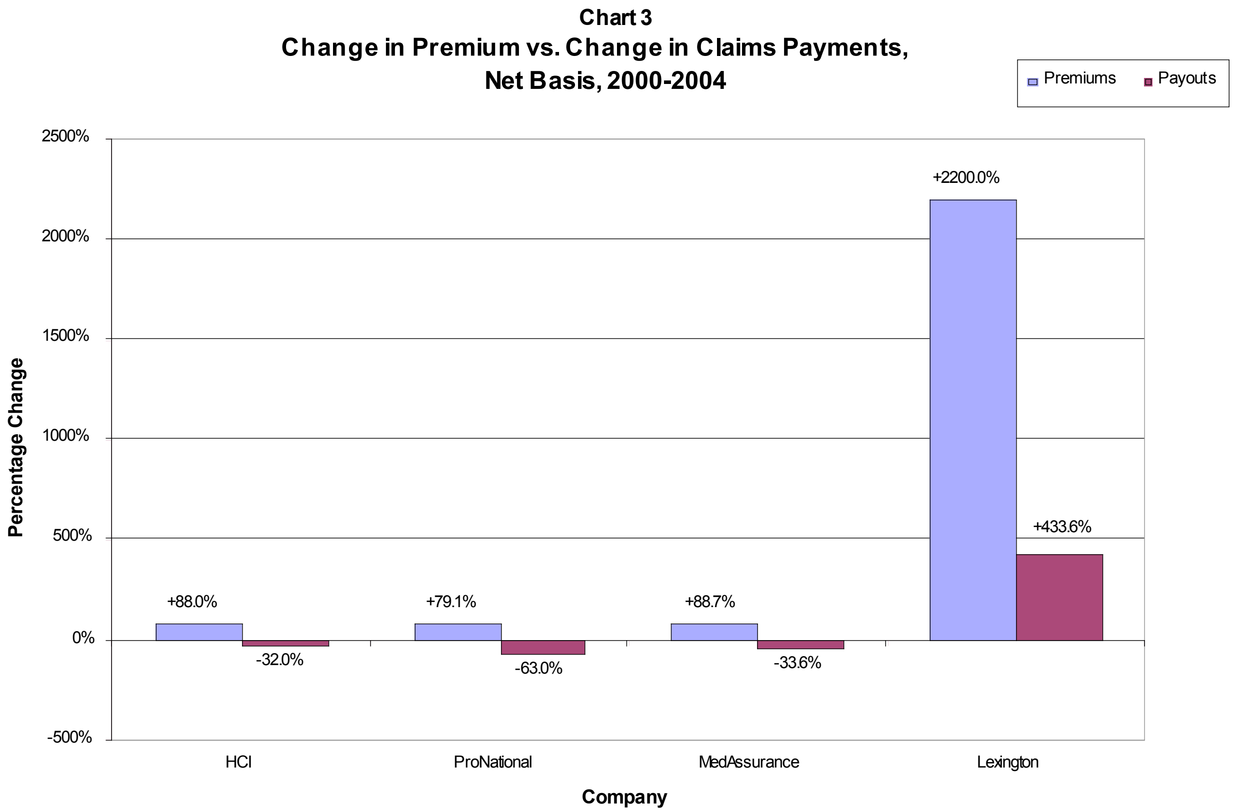
Chart 2



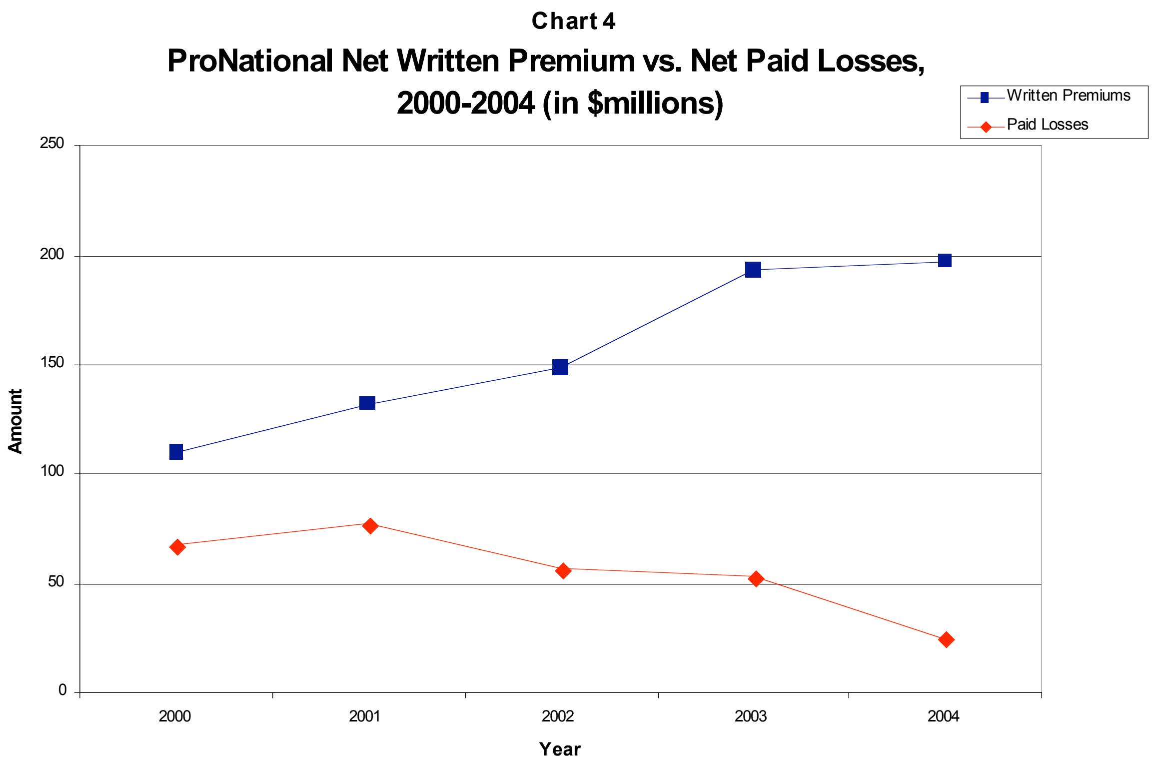
Put another way, between 2000 and 2004 the increase in the premiums collected by the 15 leading malpractice insurers was 14 times as great as the increase in their claims payments on a gross basis (134.5/9.3 = 14.01), and 21 times as great as the increase in those payments on a net basis (120.2/5.7 = 21.09).

As a result of this surge in premiums while claims payments remained virtually unchanged, the paid loss ratio for the leading medical malpractice insurers fell by more than half between 2000 and 2004: it declined from 69.9% to 33.6% on a net basis, and from 68.8% to 32.1% on a gross basis. Looked at another way, in 2004 the leading medical malpractice insurers took in approximately three times as much in premiums as they paid out in claims.

Moreover, several insurers substantially increased their premiums even though their claims payments fell substantially, as Chart 3 indicates.



For example, HCI increased its net premiums by $173 million, or 88%, during the same period in which its claims payments fell by $74.2 million, or 32%. Even more striking is the divergence between the premiums and claims payments of Medical Assurance and ProNational, both of which are subsidiaries of the same parent company, ProAssurance Corporation. Unlike HCI, both those companies had net written premium which already exceeded their claims payments in 2000, yet they continued to increase their premiums substantially while their claims payments declined substantially. ProNational, for example, had net premiums of $110.1 million and net claims payments of $67.6 million in 2000, for a paid loss ratio of 61.4%. Yet over the next four years it increased its premiums by $87.1 million, or 79%, while its claims payments fell by $42.6 million, or 63%, as Chart 4 indicates.

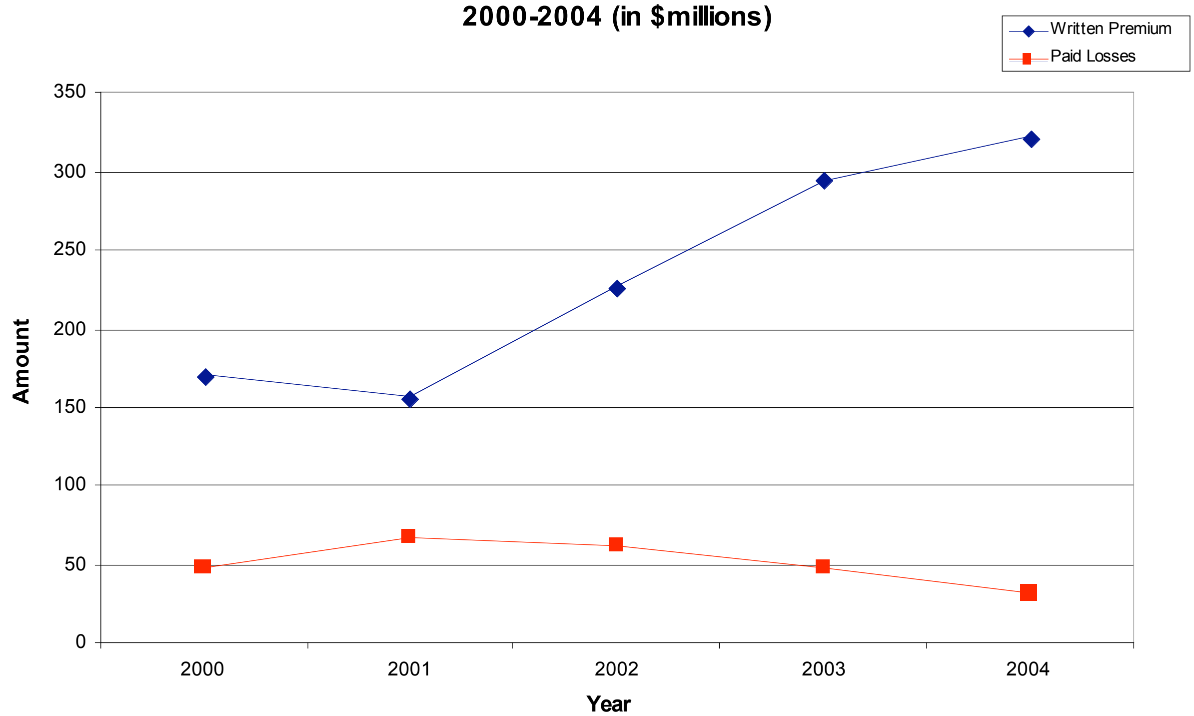


As a result of these countervailing trends, in 2004 ProNational had a paid loss ratio of only 12.7%, i.e., it was paying out less than 13 cents in claims for each dollar it was collecting in premium.

More striking still, in 2000 Medical Assurance reported a paid loss ratio of only 28.3%--it took in $170.5 million in premium while paying out only $48.2 million in claims. Nevertheless, over the next four years, Medical Assurance increased its premiums by $151 million, or 89%, while its claims payments declined by a third as, Chart 5 indicates.

Chart 5

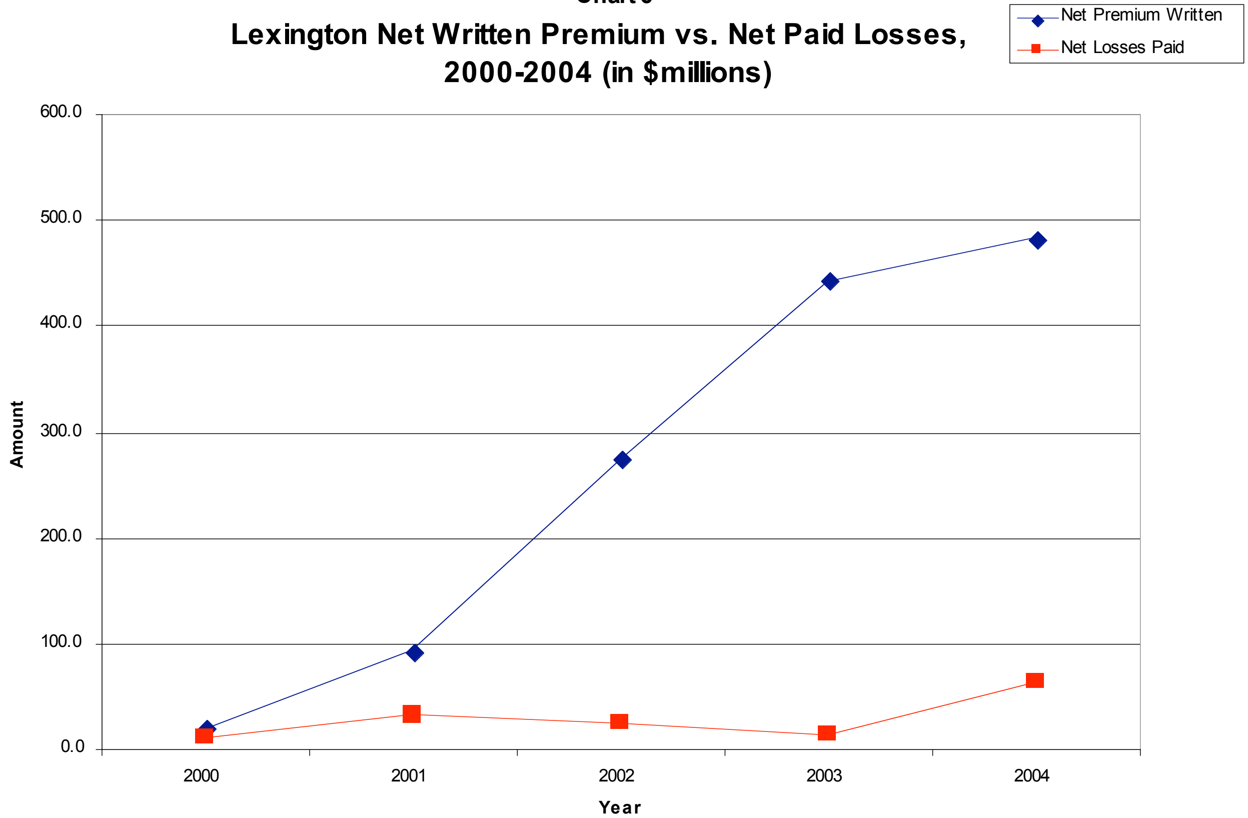
Medical Assurance Net Written Premium vs. Net Paid Losses, 2000-2004 (in $millions)



As a result, in 2004 Medical Assurance took in $322 million in premiums but paid out only $32 million in claims, for a paid loss ratio of 9.9%. In other words, it was paying out only 10 cents in claims for each dollar it was collecting in premium.

The most striking results of all, however, were reported by AIG subsidiary Lexington Insurance Company. As Chart 6 indicates, Lexington reported that its net written premiums increased from $21.1 million in 2000 to 483.0 million in 2004—an increase of $461.9 million, or 2200%--while its net paid losses increased by only $52.9 million.

Chart 6

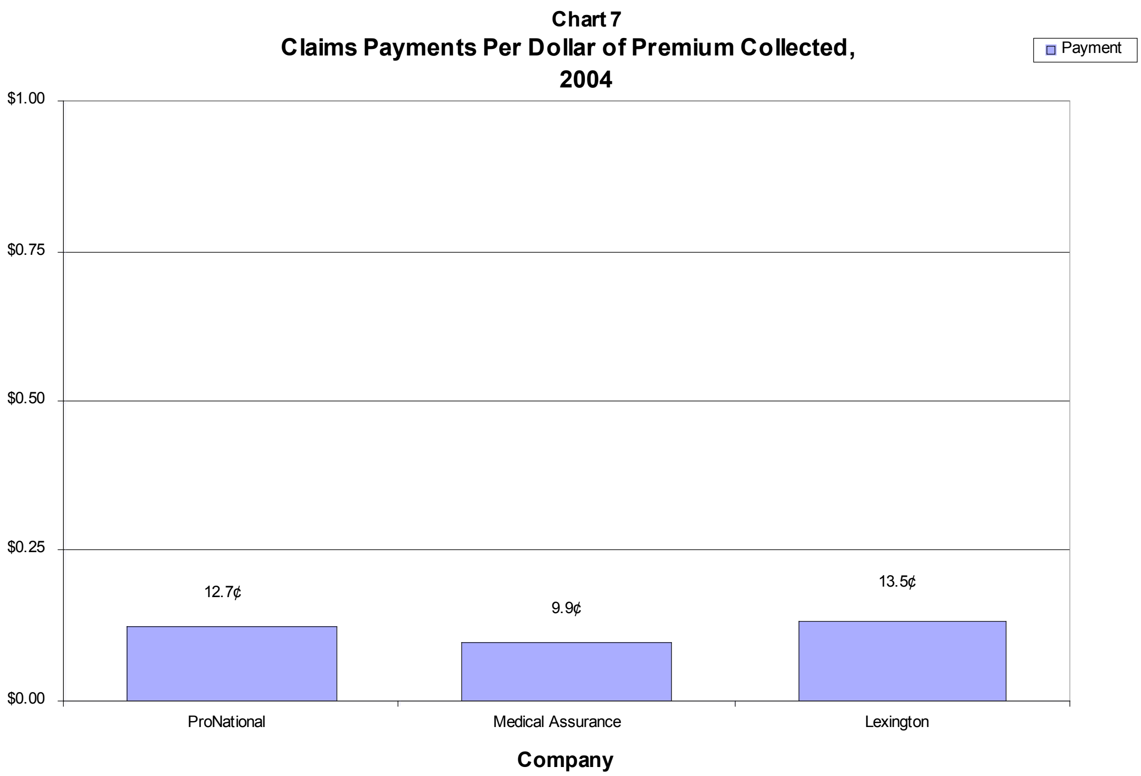


As a result, Lexington had a paid loss ratio of only 13.5% in 2004. Moreover, during the three year period 2001-2003, in which Lexington increased its net premiums from $94 million to $442 million, or by 370%, its paid losses fell by 56.3%, from $33.4 million to $14.6 million. As a result, in 2003 Lexington had a paid loss ratio of only 3.3%--i.e., it paid out 3.3 cents in claims for each premium dollar it collected. Notwithstanding the malpractice insurance industry's insistence that it is insuring fewer doctors today than in the past, it is possible that Lexington is insuring more doctors today than in the past; if so, its premium volume could increase substantially even if its rates did not.[4] It strains

[4] To be sure, because claims paid out in a given year are typically covered by policies written in prior years, one would not expect paid losses to increase at the same rate as premiums if an insurer were loosening its underwriting standards—i.e., insuring more doctors. According to the Physicians Insurers Association of America, however, insurers have been tightening their underwriting standards, and thus insuring fewer doctors. For example, on February 17, 2005, PIAA president Larry Smarr told Congress that "the recent exodus from and transformation of the market is of such magnitude that the carriers remaining do not have the underwriting capacity to take all comers," that "many of the carriers remaining in the market are forced to tighten their underwriting standards," and that "this includes the withdrawal from recently expanded markets." Testimony of Larry Smarr before the House Small Business Committee, Feb. 17, 2005, at 3 (available at www.thepiaa.org). If what the PIAA told Congress is accurate, then the leading medical malpractice insurers are not only paying out less while taking in more—they are paying out less while both taking in more and insuring fewer doctors.

credulity, however, to believe that since 2000 the number of doctors insured by Lexington could have increased by anywhere near the 2200% by which its premiums have increased.

The amount paid out in claims in 2004 for each dollar of premium collected in 2004 by ProNational, Medical Assurance and Lexington is shown in Chart 7:



B. Earned premiums vs. projected losses

Like their paid loss ratios, the incurred loss ratios of the 15 leading malpractice insurers have plummeted: as Table 3 indicates, the average incurred loss ratio for those carriers fell by almost 25% during the period 2000-2004, to 51.4%. Looked at another way, those carriers taken together earned in premiums in 2004 almost twice as much as they estimated they would ultimately pay out in claims on those premiums.

Moreover, all but one carrier reduced its incurred loss ratio between 2003 and 2004, all 15 had 2004 incurred loss ratios of 62.6% or less, 12 had incurred loss ratios of less than 60%, and six had incurred loss ratios of less than 50%. By way of comparison, the average incurred loss ratio for the property-casualty insurance industry as a whole during the most recent reported 10-year period was 67.5, according to the NAIC[5]. Each of the 15 leading medical malpractice insurers thus had a 2004 incurred loss ratio that was far more favorable than the long-run industry average.

Table 3

Ratio Of Projected Losses To Earned Premiums:
Largest Medical Malpractice Insurers, 2000-2004

Company	2000	2001	2002	2003	2004	Change 2000-2004	Change 2003-2004
ISMIE	83.6	72.4	100.7	73.2	60.8	-27.30%	-16.90%
MAG Mutual	66.8	58.4	81.3	61.9	60.4	-9.60%	-2.40%
TDC	42.5	73.5	69.1	69.4	54.1	27.30%	-22.00%
MedPro	41.1	50.4	78.9	63	50.7	23.40%	-19.50%
ProMutual	128.9	117.6	101.4	96.5	59.7	-53.70%	-38.10%
AP Capital	58.8	90.5	75.7	82.3	55.2	-6.10%	-32.90%
State Volunteer	75.9	69.6	72.3	51.7	54.2	-28.60%	+4.80%
HCI	74.4	97.2	88.1	89.1	47.6	-36.00%	-46.60%
Norcal	56.9	60.5	41.7	46.5	46.1	-19.00%	-0.70%
FPIC	70.6	72.9	64.1	55.8	42.2	-40.20%	-24.40%
MedAssurance	21.7	45.9	45.9	45.3	34.4	58.50%	-24.10%
ProNational	82.4	93.8	61.4	50.8	33.1	-59.80%	-34.80%
CCC	62.1	215.4	54.1	81.5	62.6	0.1%	-18.9%
Evanston	75.7	63.8	58.8	50.8	43.1	-43.1%	-7.7%
Lexington	71.8	153.8	56.9	85.3	57.0	-14.8%	-33.2%
Average (non-weighted), all 15 insurers	68.0	100.0	67.3	68.0	51.4	-24.4%	-24.4%

[5] NAIC Report on Profitability by Line by State in 2003 (NAIC 2004).

Notably, two insurers--ProNational and Medical Assurance--had extraordinarily low 2004 incurred loss ratios of 33.1% and 34.4%, respectively. Thus, those insurers earned in premium in 2004 approximately three times as much as they projected they would ultimately pay out in claims covered by those premiums.

Perhaps most significant, as Table 4 indicates, in 2004 the 15 leading malpractice carriers taken together increased their premiums while at the same time reducing the amount they projected they would ultimately pay out on those premiums: their earned premiums rose by 9.3%, while their incurred losses fell by 21.1%.

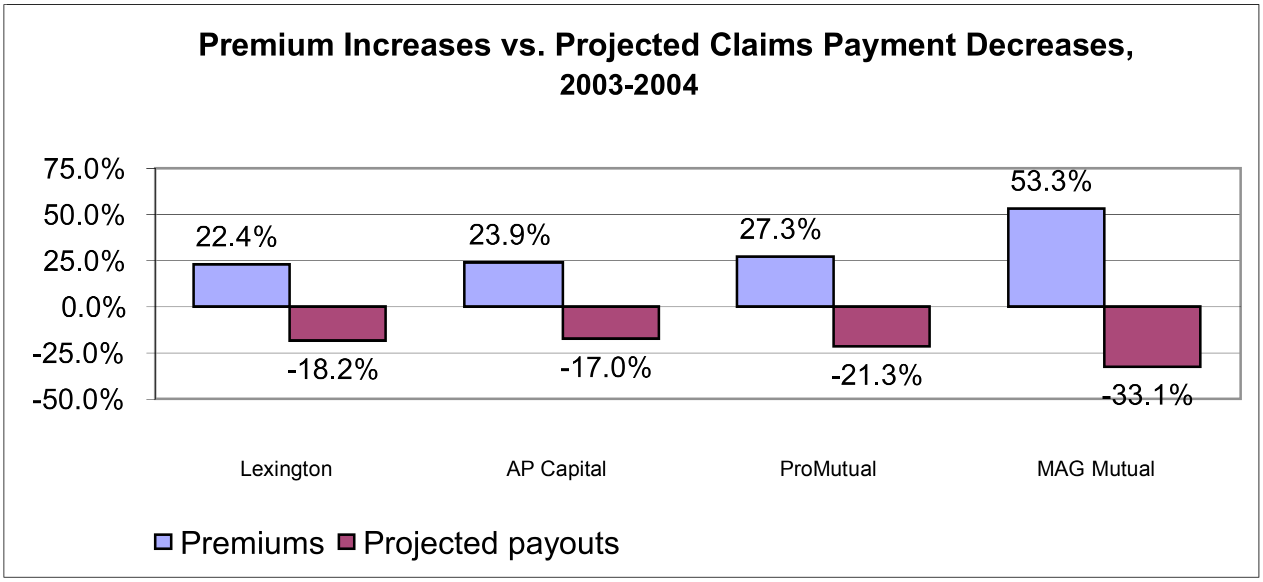
Table 4

Earned Premium vs. Incurred (Projected) Losses,
2003-2004
(in millions of dollars)

Company		2003	2004	Change 2003-2004
MedPro	EP	701.8	555.0	-20.9%
	IL	441.9	281.2	-36.4%
Lexington	EP	364.5	446.3	+22.4%
	IL	311.0	254.5	-18.2%
TDC	EP	331.3	444.4	+34.1%
	IL	230.0	240.5	+4.6%
HCI	EP	374.7	369.4	-1.4%
	IL	334.0	175.7	-47.4%
MedAssurance	EP	274.0	317.9	+16.0%
	IL	124.1	109.2	-12.0%
Continental	EP	227.3	293.3	+29.0%
	IL	185.3	183.5	-1.0%
ISMIE	EP	257.7	247.8	-3.8%
	IL	188.6	150.7	-20.1%
ProMutual	EP	182.6	232.2	+27.3%
	IL	176.2	138.7	-21.3%
MAGMutual	EP	131.4	201.3	+53.3%
	IL	121.6	81.3	-33.1%
Norcal	EP	202.1	198.7	-1.7%
	IL	94.0	91.6	-2.6%
ProNational	EP	178.9	190.8	+6.7%
	IL	91.0	63.2	-30.5%
APCapital	EP	146.4	181.4	+23.9%
	IL	120.5	100.0	-17.0%
StateVolunteer	EP	116.3	140.4	+20.8%
	IL	60.1	76.1	+26.6%
Evanston	EP	131.3	134.4	+2.4%
	IL	66.7	57.9	-13.2%
FPIC	EP	95.1	106.1	+11.5%
	IL	53.1	44.8	-15.7%
Totals	EP	3715.4	4059.4	+9.3%
	IL	2598.1	2048.9	-21.1%

Most impressive, as Chart 8 indicates, were the performance of Lexington, which increased its premiums by 22.4% while projecting an 18.2% decline in its future payments; AP Capital, which increased its premiums by 23.9% while projecting a 17% decline in future payments; ProMutual, which increased its premiums by 27.3% while projecting a 21.3% decline in future payments; and MAG Mutual, which increased its premiums by 53.3% while projecting a 33.1% decline in future payments.

Chart 8



C. Surplus analysis

As a result of having increased their premiums while reducing both their actual and projected claims payments over the last several years, the leading medical malpractice insurers have substantially increased their surplus. Specifically, the twelve "monoline" medical malpractice insurers--those which write primarily medical malpractice insurance--increased their surplus by an average of more than 34% between 2002 and 2004. Two of those insurers--Healthcare Indemnity and Norcal--increased their surplus by more than 50%. See Table 5.

Table 5

Increase In Surplus,
12 Monoline Medical Malpractice Insurers,
2002-2004
(in millions of dollars)

Company	2002 Surplus	2003 Surplus	2004 Surplus	Dollar Change 2002-2004	Percent Change 2002-2004
HCI	482.5	626.5	767.8	285.3	59.1%
MedPro	401.7	442.9	510.8	109.1	27.2%
TDC	341.4	350.2	405.6	64.2	18.8%
ProMutual	300.3	342.7	378.5	78.2	26.0%
Norcal	204.2	246.0	309.1	104.9	51.4%
MedAssurance	193.3	238.7	276.9	83.6	43.2%
ProNational	197.0	187.9	241.8	44.8	22.7%
ISMIE	170.5	201.7	212.5	42.0	24.6%
AP Capital	163.5	113.3	200.1	36.6	22.4%
MAG Mutual	142.9	177.2	194.9	52.0	36.4%
State Volunteer	129.3	155.9	167.9	38.6	29.8%
FPIC	110.8	118.9	145.4	34.6	31.2%
Totals	2837.4	3201.9	3811.3	973.9	34.3%

As a result of these substantial additions to surplus, the surplus of each of the twelve monoline medical malpractice insurers now substantially exceeds the surplus the NAIC deems adequate for the company. In particular, seven of those 12 insurers--Medical Protective, The Doctors Company, Norcal, AP Capital, MAG Mutual, FPIC, and State Volunteer Mutual--have surplus of more than twice the amount the NAIC deems adequate, and one--FPIC--has almost three times the surplus the NAIC views as adequate. See Table 6.

Table 6

Excess Surplus
12 Largest Monoline Medical Malpractice Insurers, 2004
(in millions of dollars)

Company	Actual Surplus	Adequate Surplus (per NAIC)[6]	Excess Surplus	Actual As % Of Adequate
HCI	767.8	418.5	349.3	183.5%
MedPro	510.8	213.2	297.6	239.6%
TDC	405.6	162.0	243.6	250.4%
Norcal	309.1	120.0	189.1	257.6%
MedAssurance	276.9	149.1	127.8	185.7%
ProNational	241.8	126.6	115.2	191.0%
AP Capital	200.1	85.7	114.4	233.6%
MAG Mutual	194.9	90.2	104.8	216.2%
ISMIE	212.5	110.6	101.9	192.1%
FPIC	145.4	49.1	96.3	295.9%
State Volunteer	167.9	80.9	86.9	207.4%
ProMutual	378.5	302.4	76.0	125.1%
Totals	3811.3	1908.3	1902.9	199.7%

The three leading medical malpractice insurers who also write substantial amounts of other types of insurance also greatly increased their surplus between 2002 and 2004. However, they do not allocate their surplus by line in their Annual Statements, and therefore their surplus is not included in Tables 5 and 6.

D. A note about medical malpractice insurance stock performance

Of the 15 insurers analyzed in this study, nine are mutual insurers owned by their policyholders rather than stockholders, three are stock companies for whom medical malpractice constitutes a relatively small part of their business, and three are stock companies writing primarily medical malpractice insurance. The performance of the stocks of these latter three companies – AP Capital, FPIC, and ProAssurance – is therefore the best indicator we have of how Wall Street views the medical malpractice insurance business.

[6] Adequate surplus pursuant to the Risk-Based Capital standards promulgated by the National Association of Insurance Commissioners and adopted by the states.

Notably, as Table 7 indicates, the stock price of all three companies has doubled during the past three years, while the Dow Jones Industrial Average has remained essentially unchanged. Specifically, the stock price of AP Capital has increased from $16.57 to $34.20, or by 106%; the stock price of FPIC has increased from $14.95 to $29.72, or by 99%; and the stock price of ProAssurance has increased from $19.10 to $39.98, or by 109%.

Table 7

Stock Performance, Last 3 years,
Medical Malpractice Stocks vs. Dow Jones Industrial Average

	May 17, 2002	May 17, 2005	Percent Change
DJIA	10,353	10,332	0%
AP Capital	$16.57	$34.20	+106%
FPIC	$14.95	$29.72	+99%
ProAssurance	$19.10	$39.98	+109%

IV. Conclusion

The Annual Statement data for 2004 indicate that many of the leading malpractice insurers have increased their premiums substantially while (1) their actual claims payments decreased, (2) they reduced the amount they projected they would pay out in the future, and (3) their surplus increased substantially. Doctors are therefore paying more for malpractice coverage than either actual payments in malpractice cases or estimated future payments in malpractice cases would justify.