February 4, 2005

VIA FACSIMILE

Mr. Timothy J. Ward Assistant Vice President Marsh USA Post Office Box 128 Greenville, South Carolina 29602-0128

Dear Tim:

Thank you for ageeing to help answer Senator McConnell's several questions regarding the JUA/PCF. As we discussed this morning, please, if possible, forward a draft of your responses to me prior to noon on Monday, February 7, 2005 so that you and I might review them prior to your finalized response to the Senator. As you know, S. 83 (Medical Malpractice Reform) is likely to be debated on Tuesday, February 8, 2005. Senator McConnell anticipates utilizing your information during Senate debate.

I realize that while the questions posed may allow for a brief answer, they might best be answered through explanation of historical or factual context, and industry practice. I would ask that a brief and direct response to each question precede any broader discussion of context or practices.

Senator McConnell's specific queries are:

- 1) Proportionally what does the annual payout bear to the amount of income for 2003 and 2004?
- 2) How many private insurance companies are still in South Carolina writing medical malpractice insurance and at what limits?

Mr. Timothy J. Ward February 4, 2005 Page 2

- 3) What is the percentage of the medical malpractice written by the JUA in the last year versus that written by the private carriers?
- 4) Please list the top 3 criticisms of the Legislative Audit Council regarding JUA or PCF operations and the corrective steps taken by the JUA/PCF since the audit regarding those criticisms.
 - 5) What are the maximum limits sold by the JUA and the PCF?
- 6) Please describe what impact a \$250,000 cap on non-economic damages would have on future rate increases and on actuarial calculations for rates for the future.

Thank you for continuing assistance.

Sincerely,

Michael N. Couick

MNC/sss

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February 7, 2005

Mr. Michael N. Couick Senate Judiciary Committee P O Box 142 Columbia SC 29202

Dear Mike,

Thank you for allowing the JUA to provide you with information involving the Senate's review of the medical malpractice issues in South Carolina. As I have done before I will attempt to address each concern as clearly as possible. I hope this information will be easy to understand and if you have any areas that need clarification please feel free to contact the.

1) The brief answer is that this information has no bearing on the premiums set for our insureds today. I have attached an exhibit that shows the premiums collected versus the claims paid for that policy period rather than the calendar year activity.

The long answer is that this issue deals with the annual payouts for 2003 and 2004 and how they relate to the amount of income received for those time periods. I believe an explanation of how the insurance industry sets rates and receives income would help answer this question. I will try to be as brief as possible while still giving the detail required to explain this most important aspect of the malpractice insurance industry.

The premiums collected today are intended to pay for claims that will occur today but will be reported and settled some time in the future. Conversely the payouts made today are for claims that have occurred sometime in the past. These claims were intended to have been funded with the premiums collected in the year in which the claim occurred. (the policy year) Therefore a positive cash flow for this year has no bearing on the profit or loss of an insurance company. We will have to wait several years to determine if today's premiums are adequate to pay for the claims that are occurring today. This is a basic explanation of the policy year data that we measure. The attached an exhibit shows the policy year eash flows and as you can see, the premium set in the past was not adequate to pay for the claims that occurred. Keep in mind that the JUA policy limit

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increased from \$100,000 per claim to \$200,000 per claim in November of 2000. Therefore the payouts will be increasing in severity compared to the prior years.

Our rates that are set today are based on the actuarial study that predicts the payouts that will occur in the future. Our rate includes 5% to impact the huge deficit that has accrued. This is the only charge that has been targeted at the reduction of the prior deficit.

2) Short answer is that 3 other carriers are active and write primarily limits of \$1,000,000/\$3,000,000 in coverage.

I have requested additional confirmation on this question but for all practical purposes there are just a handful that have any impact. Mag Mutual, Medical Protective and The Doctors Company are the only carriers actively writing in addition to the JUA/PCF. There are some other specialty earriers for opthamologists, podiatrists and dentists but their impact is not significant. Most other carriers have limits of \$1,000,000/\$3,000,000. Some may write increased limits but are priced in such a way to discourage their selection. None write unlimited coverage. The St. Paul pulled out of the market and Frontier Insurance Company along with PHICO have gone into receivership.

- 3) Our best estimate is 80% of the physicians are insured through the JUA.
- 4) I have attached the follow up audit that was completed in January 2004 by the LAC. The primary criticisms dealt with the setting of inadequate reserves, lack of oversight by the SCDOI, and improper management controls. As you can see in the follow up report these issues have been corrected and are no longer an issue.

Specifically the following items were developed: a plan of operations, a manual of rules and rates along with a claims manual.

- 5) The JUA sells a \$200,000/600,000 policy that is primary to the PCF policy. The PCF still sells unlimited coverage but also offers lower limits such as \$1,000,000/\$3,000,000. The majority of members still purchase the unlimited coverage option.
- 6) This is a more difficult question to answer, as there are too many variables to consider. It would be most appropriate to look at other states that instituted meaningful reforms with hard caps for comparison. But in an effort to give some indication we have asked for some preliminary analysis. We were limited in our data, as we do not have a mechanism for measuring the percentage of verdicts/settlements that were allocated to noneconomic damages. We reviewed only verdicts and our preliminary findings would indicate a potential PCF rate reduction of 7% with a \$250,000 cap and approximately 5% with a \$500,000 cap. These are predictions based on assumptions that we do not know to be factual. I hesitate to make any statements in this area, as our data is just not adequate. I do believe however that an exception for paralysis will make the cap virtually meaningless on a large percentage of our most serious cases. This would make the impact on rates minimal.

The impact on the JUA rating structure is much more difficult to determine. Our impact

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would be primarily in the reduction of legal expenses and potentially lower frequency.

I hope this information is what you are looking for. I will be glad to send you studies that have been done in other states if you would like.

Please feel free to contact me if you have any additional questions or concerns.

Sincerely,

Timothy J. Ward

MIKE COUICK - LAC Update January 2004.pdf

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FOLLOW-UP

January 2004

A Review of the Medical Malpractice Patients' Compensation Fund

BACKGROUND Most modical providers in South Carolina obtain their medical malpractice insurance from the Joint Underwoting Advocation (JUA) and the Patients Compensation Fund (PCF). The JUA, crepted by the General Assembly in 1875, is a monorafit corporation whose members! are insurance companies. The JUA offers coverage with imits of \$200,000 per occurrence and \$600,000 annually The PCF is a state agency created in 1976 to offer nealth care providers coverage (pr maipractice) clanns thut exceed the providers primary coverage (provided by the JUA or other insurer) The PCF offers unlimited chiverage Baginning In July 2003, the PCF began offering limited coverage in addition to unlimited coverage.

INTRODUCTION

Malpractice Patients' Compensation Fund (PCF). In addition, the requesters asked a number of questions relating to the operations of the PCF and medical malpractice insurance in South Carolina. We followed up on the recommendations in our 2000 audit and obtained information to answer the questions, as discussed below.

SUMMARY OF 2000 AUDIT

At the time of our 2000 audit, the requesters were concerned about the solvency of the Patients' Compensation Fund and whother the state would be liable in the event of a default. A July 1999 informal opinion from the Attorney General's office concluded that the state should not be liable for claims made against the PCF. However, we found that the PCF operated with a high level of risk.

The PCF had not maintained adequate reserves to pay future daims. The PCF's methods for establishing reserves were inadequate and resulted in a pattern of reservo deficiencies (estimated deficiency from \$30 million to \$108 million). Also, the PCF was not subject to the oversight of the S.C. Department of Insurance (DOI). Other insurance entities in the state regularly lite reports with and are examined by the DOI. Further, there is no limit on the amount of an award for which the PCF could be responsible. Since membership in the PCF is valuntary, its mambers could opt out if faced with large premium increases.

The PCF did not have adequate management controls to ensure the proper administration of the fund. It mutinely granted retroactive coverage to members eiter a claim had been filed. The PCF did not have adequate written policies and procedures nor appropriate controls to ensure the accuracy of key information about claims in its computer database.

We also found that the PCF violated the Freedom of Information Act (FOIA) in the way it conducted its meetings and violated the Administrative Procedures Act by not promulgating regulations to establish board policy for fund membership and administration. Also, although not allowed by state law, the PCF's executive director worked for a private organization as part of his state job.



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STATULORY CHANGES FOLLOWING THE AUDIT

With the passage of Act 313 of 2000, the General Assembly enacted changes to increase the PCF's accountability and lossen its future liability. Act 313 made the PCF subject to the oversight of the Department of Insurance. S.C. Code §38.79-430 requires the PCF board to develop a plan of operations subject to the approval of the department. The PCF's plan of operations, approved in October 2002, calls for the DOI to examine PCF operations every three years. The PCF also must file an annual report containing information on its financial condition with the department. These provisions increase the PCF's accountability for its actions.

Additionally, Act 313 increased the minimum limits of coverage for primary insurance from \$100,000/\$300,000 to \$200,000/\$600,000. Increasing the amount covered by primary insurance reduces the PCF's liability. To be eligible for PCF coverage, an individual must have minimum coverage of \$200,000/\$600,000. The PCF covers claims only in excess of the primary limits. Act 313 also amended §38-79-450 to specify that the state is not liable for claims against the PCF.

The General Assembly has not acted an other recommendations in the audit, such as placing a cap on the °CF's liability, discontinuing the PCF, or enacting statutory requirements for primary insurers' reporting of claims to the PCF.

CHANGES IN PCF OPERATIONS FOLLOWING THE AUDIT

The Patients' Compensation Fund made significant operational changes in response to the audit. It has substantially complied with most of the audit's recommendations. The PCF has developed and implemented a plan of operations, a monual of rules and rates, and a claims manual. These policies cover many capacits of the PCF's operations and provide a system of management controls. The PCF is now prohibited by statute from granting retroactive coverage to members when a claim has been filled, and this policy is also stated in its manual of rules and rates. The agency has upgraded its computer system and improved its training and controls over information.

The PCF plan of operations contains provisions for conducting meetings in compliance with the Fraedom of Information Act, including a prohibition on the use of proxies to establish a quorum and provision for the appropriate use of executive sessions. The PCF attempted to pramulgate a regulation to comply with the Administrative Procedures Act as recommended in the audit. However, the regulation was withdrawn in the face of apposition and has not been resubmitted. The former executive director resigned his position; the PCF is now staffed with a program manager and has contracted with the Joint Underwriting Association for management oversight services.

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(3) OVER THE PAST FINE YEARS, 4097 MUCH HAVE THE PREMIUMS OF THE VARIOUS MEDICAL SPECIALTICS INCREASED AN VUALLY?

Premiums for the medical specialities of lamily practice, OB-GYN, and emergency medicine have all increased annually between 1999 and 2003. Over this period, the average annual increase has been 40% for both family practice and OB-GYN and 47% for emergency medicine.

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2002	\$4,116 \$5,745	53% 40%	\$20,831 \$28,883	48%	\$5,698	40% 50%				
2003	\$7,162	25%	\$37,567	30%	<u>59,795</u> \$14,930	52%				

Does not include special apparament of 100% of annual promium

Source; JUA/PCF

In addition, under state law, the PCF can assess members additional fees if needed to cover its liabilities. In September 2000, the PCF did a special assessment of 100% of the members' annual premium. This amounted to approximately \$16 million.

(4) HAS THE POF INCREASED ITS RESERVES SINCE THE RELEASE OF THE LAC'D REPORT IN 2000? IF SO, that the increase had a significant impact on medical malpractice premiums?

The PCF has not increased the amount of funds on hand to pay claims since the release of our report in 2000. This is due, in large wart, to an increase in the amount of claims paid (see Table 2). According to the PCF's 2003 financial audit, the PCF has experienced large operating losses for the last several years.

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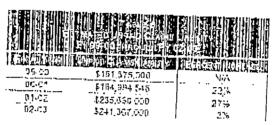
in FY 02-03, the General Assembly transferred \$1,489,550 from the PCF to the state's general fund.

Source: PCF = nancial Statemento

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Even your on definity estimates it is employed appear define liability for the Patific Theory years along tability has increased significantly since 2000



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