Will Severity Increases Finally Drive Premiums Higher?

BY TIMOTHY C. MOSLER

For more than a decade, medical professional liability (MPL) insurers’ loss experience has been characterized by fewer claims and a relatively stable cost per claim. The magnitude of the frequency decrease has been extraordinary, resulting in highly favorable operating results for MPL insurers, as well as lower premiums for their policyholders.

Nearly as remarkable, during this period of plummeting frequency, the average cost per claim has increased only modestly. This article will examine the recent history of MPL claim severity trends, as well as recent changes in these trends and their potential impact going forward.

Overall claim severity trends

The data referenced throughout this article is extracted from PIAA’s 2016 Closed Claim Comparative, which summarizes data submitted by participating MPL insurers in conjunction with PIAA’s Data Sharing Project. The 2016 study includes data on claims closed from 2006 through 2015. Given the study’s level of detail, it is easily the largest nonproprietary data set available for studying MPL severity trends.

Figure 1 displays the average cost per claim, including indemnity and ALAE, by closure year, over the latest 10 years.

Expanding on the data in Figure 1, Figure 2 separates the claim severity amounts into their indemnity and ALAE components.

Key observations from Figures 1 and 2 include:

■ After a period of stable per-claim costs between $320,000 and $340,000, through 2013, the size of the average indemnity payment increased during 2014 and 2015.
■ ALAE increased in six of the nine years.
■ While the increase in the average cost of ALAE as shown in Figure 2 can be significant, it is small enough relative to indemnity that the overall increase in the amounts shown in Figure 1 is small. The
most significant increase depicted in Figure 1 occurs between 2013 and 2014, and it’s primarily driven by indemnity (indemnity increased by $35,000 and ALAE increased by $10,000).

While not shown in the figures, including ALAE dollars from claims that closed without indemnity would not significantly impact the pattern of increases in the overall cost per claim.

Because the indemnity component is driving the overall cost and has increased in the two most recent closure years, we also analyzed additional underlying indemnity trends.

Analysis by claim size
Figure 3 illustrates the percent of claims by closure year that fall within each indemnity-claim-size range. The smallest claims are shown to the left, and the largest claims are shown to the right. To help understand this figure, note that only claims closing with an indemnity payment are included, and all of those indemnity claims are included in one of the claim-size groups. So, the sum of a given closure year’s percentages across each of the five claim-size groups will always equal 100%.

On the right side of Figure 3, we notice an increase in the percentage of claims closing at more than $1 million in the 2014 and 2015 closure years. To quantify this increase, Table 1 shows the average of the 2014 and 2015 closure years for each size-group compared to the average for the 2006 through 2013 years. These percentages are very similar, with the exception of the increase in claims above $1 million and the corresponding decrease in claims in the $100,000–$250,000 range.

Note that for Figures 1, 2, and 3, the results could have been impacted by policy-limit changes. For instance, if a segment of policyholders previously purchased $1 million-limits policies and are now purchasing $2 million-limits policies, this would account for part of the increase in claims above $1 million. It’s possible that this contributes to the observed increases, but it is unlikely to explain the entirety of the severity increase or the shift to higher claim sizes. Other potential causes include changing jury views, erosion of tort reforms, and the verdict trends discussed later in this article.

A separate view of the data considers the average claim size per group, as shown in Figure 4. We can observe very consistent severities for the four lowest claim-size groups, but also a notable increase in claim severities for claims of more than $1 million. For this largest claim-size group, the three most recent closure years contain three of the four highest severities.

When considered together, Figures 3 and 4 demonstrate that the increase in overall severity is not driven by all claim sizes, but rather, by the largest claims. However, with these largest claims, two factors come into play: There are more large claims, and the large claims cost more.

Claim resolution and verdict trends
To understand recent years’ large claims
trends, it helps to consider changes in claim resolution. Figure 5 depicts trends by resolution type that appear favorable. There is an increase in the number of dropped, dismissed, or withdrawn (DDW) claims in which the defense wins without risking a verdict or making a settlement.

There is also a decrease in the number of settlements and a small decrease in the number of verdicts. These shifts indicate that MPL insurers are limiting the number of verdicts and their accompanying risk, but are also, in general, doing so without paying on claims they could have defended.

By drilling down into the outcomes of verdicts, we can see another material aspect of resolution changes. As shown in Figure 6, the number of plaintiff wins per verdict has sizably increased during the last two

---

**Figure 2. MPL Claim Severity (Indemnity and ALAE) by Component, 2006–2015**

![Graph showing MPL Claim Severity from 2006 to 2015](image)

**Figure 3. Percent of Claim Counts by Indemnity Size Range, 2006–2015**

![Bar chart showing percentage of claim counts by indemnity size range from 2006 to 2015](image)
years, rising from approximately 10% of 2013 verdicts to about 12.5% of 2015 verdicts. Expressed another way, plaintiffs used to win one out of every 10 verdicts. Now, they win one out of every eight verdicts. With a historical average of about $800,000 per plaintiff verdict and more than $1.1 million per plaintiff verdict for claims closing in 2015, any difference in the verdict rate can be material.

The trend shown in this graph could possibly be overstated by the increase in DDW claims. MPL insurers will always prefer a DDW claim to a verdict. But that leaves the tougher claims in the verdict category, and one could argue that it unfairly diminishes the MPL insurers’ verdict record. Not giving an insurer as much credit for a DDW claim as for a defense verdict is like not giving a boxer credit for a first-round knockout.
Figure 7 reproduces Figure 6, but with the plaintiff verdict wins expressed relative to both the number of verdicts and the number of DDW claims. As Figure 6 may have overstated the trend, Figure 7 represents a best-case scenario. There are likely to be a number of DDW claims that would have been decided in favor of the plaintiff had they gone to a verdict, but Figure 7 assumes that every claim would have been a defense verdict. Even in this best-case scenario, we still see an upward trend.

Looking Forward

In conclusion, both the proportion of large claims and the cost per large claim are increasing. These trends do not seem random, as they coincide with a higher percentage of plaintiff verdicts. Going forward, there seem to be two general paths that these trends could follow.

It could be that the current levels of severity, distribution by claim size, and plaintiff-verdict percentage are sustained at these levels or even reverse. In either of these cases, it’s unlikely that they cause a material impact on premium or a continuing effect on the financial results of MPL insurers overall.

Alternatively, these metrics could continue to increase, in which case there will continue to be greater pressure on MPL insurers to settle more claims in order to avoid the risk of a large verdict. Further, as more claims are settled, that could provide an incentive for plaintiff attorneys to file more claims, given that there would be a greater chance of a payout, without the need to invest in the effort required to win a verdict. This sequence of events would almost certainly require premium increases.

If this is going to happen, it is probably still several years away, because the first step will be an increase in settlements.

Figure 5 shows that the movements have continued to be downward for settlements and, for 2015, they are near the lowest point in 10 years. Settlements as a percent of all claim resolutions will be a key number to monitor in measuring how any subsequent increases in severity are altering the insurers’ claims strategy and what the ultimate effect on premium will be.

The new 2017 PIAA Closed Claim Comparative will be released later this year, and we look forward to reexamining these trends with another year of data.

For related information, see www.pinnacleactuaries.com.
Pinnacle is committed to our employees, to our profession, to our community, and most importantly, to you.

A full-service actuarial firm, Pinnacle’s mission is simple: We’re here to provide professional expertise and superior customer service. Through data-driven research backed by clear communication, we work hard to ensure that our work is of substantial value to your business. You can trust Pinnacle’s commitment to work with you to look beyond today’s numbers in planning for tomorrow.