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Doctors' Creed: Insure Thyself

Health-Care Providers Create Alternative Market as Firms Abandon Malpractice Coverage

By Shefali Anand

PUBLICLY TRADED insurance companies have abandoned swaths of the medical-malpractice market in recent years, leaving many hospitals, doctors and other medical professionals to set up their own insurance shops.

This shift toward the alternative insurance market has gotten scant attention, as the debate over skyrocketing medical-malpractice insurance rates has focused on high jury awards and insurers' poorly performing investments.

Health-care providers have set up hundreds of so-called risk-retention groups, captive insurers and other entities to meet their malpractice-insurance needs. These insurers have advantages over publicly traded companies because they have no old claims to worry about and no profit motive, which could help them to keep premiums down. But their lack of experience could be a disadvantage because they can't be sure how much to charge for coverage—and how to keep premiums down—until they get a few more years' worth of claims to evaluate.

Estimates of the size of the alternative market vary, but all show a large role for self-insurance vehicles. Conning Research & Consulting Inc., a unit of Swiss Reinsurance Co., pegs it at $18 billion in annual premiums, compared to $12 billion estimated for conventional insurance companies. Actuarial firm Milliman Inc. estimates the alternative-market premium at $9 billion, or about 40% of a $21 billion market. These estimates suggest that at least four in 10 medical professionals have turned to alternative sources for coverage.

In the Cayman Islands, the number of captive insurance companies licensed to write medical-malpractice coverage jumped to 269 this year, up from 178 in 2001, according to the Cayman Islands Monetary Authority. Captive insurers serve only the organizations that established them. Regulators in U.S. states that allow captives to set up shop say that many entities they license specialize in medical malpractice. The creation of these captives has slowed in recent months, however, leading some analysts to conclude that the trenc be peaking.

Another popular option: cooperative insu pools set up under the federal Liability Risk] tion Act of 1986. These vehicles are licensed state but can sell policies in all states. (

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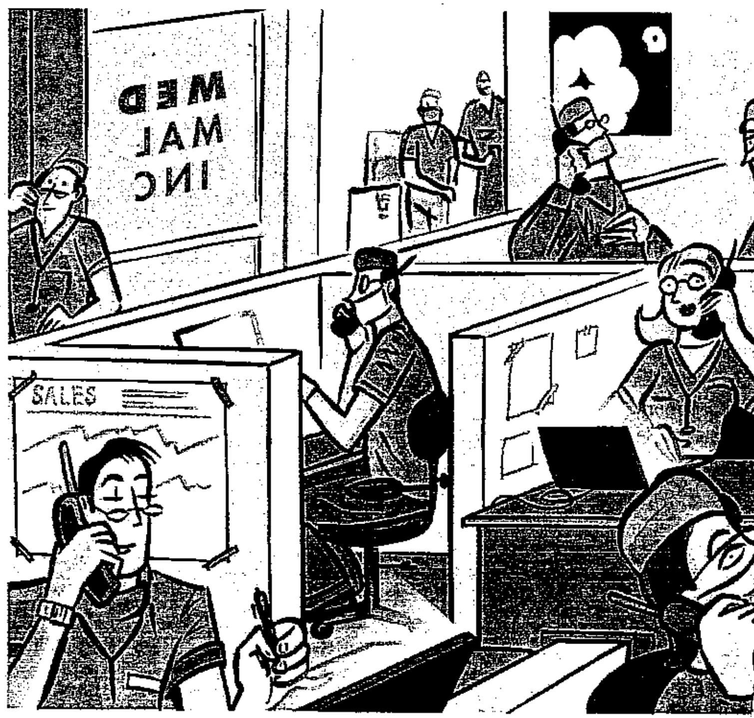

Doctors Set Up Insurance Shops

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risk-retention groups in the U.S., medical-related groups total 111, according to Risk Retention Reporter, a newsletter in Pasadena, Calif., that tracks these entities. These have been set up by doctors or hospitals.

Typical of this new breed is Community Hospital Alternative for Risk Transfer, which is owned by 31 hospitals mostly from rural parts of Pennsylvania. Mount Nittany Medical Center in State College, Pa., signed on in 2002. The hospital's previous insurer, MIIX Insurance Co., was shutting down its medical-malpractice line in Pennsylvania, and other big commercial insurers were jacking up prices to cover high costs in the state's more-litigious urban areas. Mount Nittany faced a 375% rise in its premium, but by joining the risk-retention group, it held its increase to 71%. That smaller increase was based on the lower costs of rural Pennsylvania.

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"There was no market on the outside that we could see. So we had to do it ourselves," says Thomas Murray, the hospital's president.

The Community Hospital group now is the eighth-largest writer of medical-malpractice insurance in Pennsylvania. It is unclear, however, if its members' relatively low-rate increases are typical, since national statistics for self-insurance groups don't exist. Comparisons with conventional insurance carriers are tricky because captives have a narrower focus. For instance, a group that insures dentists, who typically file fewer claims, can charge smaller premiums than commercial carriers insuring a broad mix of doctors.

The alternative market took off as some traditional insurers collapsed after suffering losses from mounting claims. Others pulled out of the business line. St. Paul Cos., now part of St. Paul Travelers Cos. Inc., in 2001 insured nearly 40,000 physicians and 72,000 other health-care professionals. But late that year it said it would shut down its medical-liability unit, citing losses of $940 million. With fewer insurers in the market, doctors, hospitals and others faced double- and even triple-digit annual premium increases.

Insurers American International Group Inc. and General Electric Co.'s GE Insurance Solutions Corp. kept selling the policies, as did decades-old "mutual" insurers. Like captives and risk-retention groups, mutuals are owned by their policyholders, but in many ways they resemble conventional insurers because policyholders can't be forced to cough up more money if assets run short in paying claims. And they, too, raised their rates sharply, fueling the alternative insurance market.

Whether the alternative vehicles will be able to keep down premium increases remains to be seen. It takes years for medical-malpractice claims to work their way through courts, so "you may find a lot of captives suddenly being stressed by increasing losses coming to be paid," says Stephan Christiansen, Conning's research director.

In recent years, traditional insurers have paid out more in claims than they earned in premiums. Last year, claims and related costs totaled an estimated $1.10 for every dollar of premium income, down from $1.55 in 2001, according to Robert Hartwig, chief economist of the Insurance Information Institute. Results have been aided by high premiums, legislative reforms limiting damage awards in some states and rising interest rates, which improve investment income.

"This marketplace in general will return to profitability in 2006," says Chad C. Karls, a consulting actuary at Milliman. Indeed, Warren Buffett, the billionaire investor who heads Berkshire Hathaway Inc. and is known for picking up bargain-priced investments, made a bet on the sector in July by acquiring Medical Protective Corp., a GE unit.