

February 13, 2006

**Actuarial Analysis of  
Office of Insurance Regulation  
Filing Number 05-14789  
Physicians & Surgeons Professional Liability  
MAG Mutual Insurance Company**

**Office of the Consumer Advocate**  
State of Florida

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PRELIMINARY

## CONCLUSIONS

Using Towers Perrin Tillinghast's (Tillinghast) methodology, but reducing the projected loss ratio to 47.0% from Tillinghast's 80.5%, MAG Mutual Insurance Company's (MAG) rates should be decreased 28.6% rather than increased 9.2%. Therefore, the proposed rates should be disapproved as excessive, because they are "likely to produce a profit from Florida business that is unreasonably high in relation to the risk involved in the class of business ....." 627.062 (2)(e)1. Florida Statutes.

Furthermore, to determine if excessive profits are being realized as a result of tort reforms, it is recommended that the Florida Office of Insurance Regulation (OIR) proceed under the authority granted by 627.062 (2)(g) Florida Statutes to order a review of the rates, rating schedules, and rating manuals of all medical malpractice insurers operating in the state of Florida. Such review should specifically require reporting of experience and projection of ultimate losses for the 2003, 2004 and 2005 report years.

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## AUTHORITY

This actuarial examination is conducted pursuant to Section 627.0613 Florida Statutes, which provides that: “the Chief Financial Officer must appoint a consumer advocate who must represent the general public of the state before the department and the office. The consumer advocate must report directly to the Chief Financial Officer, but is not otherwise under the authority of the department or of any employee of the department. The consumer advocate has such powers as are necessary to carry out the duties of the office of consumer advocate, including, but not limited to, the powers to:

- (1) Recommend to the department or office, by petition, the commencement of any proceeding or action; appear in any proceeding or action before the department or office; or appear in any proceeding before the Division of Administrative Hearings relating to subject matter under the jurisdiction of the department or office.
- (2) Have access to and use of all files, records, and data of the department or office.
- (3) Examine rate and form filings submitted to the office, hire consultants as necessary to aid in the review process, and recommend to the department or office any position deemed by the consumer advocate to be in the public interest.
- (4) Prepare an annual budget for presentation to the Legislature by the department, which budget must be adequate to carry out the duties of the office of consumer advocate.”

## BACKGROUND

Tillinghast prepared the subject filing, Company File Number: 020801-0502, OIR File Number: 05-14789 (filing) on behalf of MAG on December 6, 2005. Filing was subsequently filed with the OIR on December 12, 2005. Filing proposes to raise rates an average of 9.2%, increasing premiums for 3,694 Florida practicing physicians insured by MAG by \$9,101,345 effective May 1, 2006. Since there are approximately 47,700 practicing physicians in Florida, this filing would impact approximately 7.7% of the practicing physicians in the state.

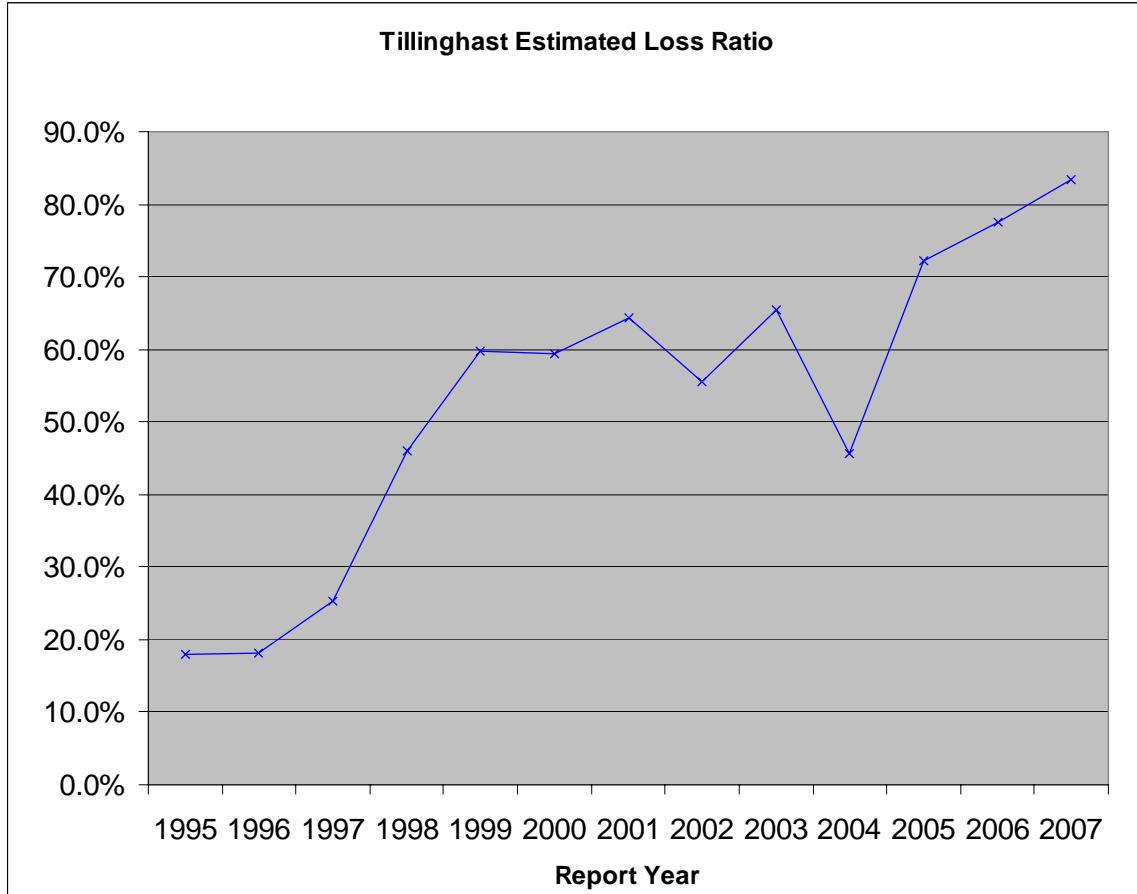
Florida enacted significant medical malpractice liability tort reform (damage caps) effective September 15, 2003. Florida's damage caps are as follows: for physicians, \$500,000 cap on non-economic damages per claimant with any one physician not responsible for more than \$500,000. For non-practitioners, \$750,000 cap on non-economic damages. The cap increases to \$1 million in non-economic damages for physicians if the negligence resulted in death or a permanent vegetative state or if the court finds that a manifest injustice would occur unless the non-economic damages cap was increased because the non-economic harm sustained by the patient was particularly severe and the defendant's negligence caused a catastrophic injury to the patient.

On April 27, 2004 a Circuit Court Judge in Seminole County, Florida, found a portion of the 2003 medical malpractice reform legislation unconstitutional. The new legislation went into effect September 15, 2003, but under its terms it applies to malpractice incidents occurring both before and after that date.

On April 22, 2004, Circuit Court Judge Marlene Alva issued a short written order stating that the application of the new law was unconstitutional because it retroactively took away vested rights of patients who were already injured by malpractice before the date the new legislation was enacted. The court's ruling is limited solely to the retroactivity issue, and what it means is that there is no immunity for any negligence occurring before September 15, 2003. But the case has broader importance because the same legal reasoning should also apply to the retroactive application of the damage caps on doctors and hospitals.

## ANALYSIS

Based on the Tillinghast analysis, MAG’s projected ultimate loss ratios at current rates for \$1,000,000 of coverage are as follows:



Tillinghast’s estimated loss ratios for the 1995 through 2004 report years are based on the actual experience of MAG. For the years 2005 through 2007, Tillinghast relied upon a study of industry data and judgment to select a 7.5% annual loss trend applied to MAG’s 1995 through 2004 report year loss ratios. Based upon this methodology, Tillinghast projected a 80.5% loss ratio for the 2006 policy year (average of the 2006 and 2007 report years).

Tillinghast's methodology is flawed because: 1) it fails to respond to the leveling in MAG's loss ratios that Tillinghast's own estimates show for the 1999 to 2003 report years, and 2) fails to respond appropriately to MAG's loss ratio decline that occurred in 2004. This decline is most likely a consequence of tort reforms effective for claim occurrences after September 15, 2003. MAG's loss ratios should continue to decline in the 2005 and 2006 report years (instead of reversing upward as predicted by Tillinghast) as more claims come under the tort reform caps. After 2006, it is reasonable to assume that the upward trend in loss ratios will resume due to the reassertion of the dominance of inflation in claim costs, but at a moderated rate due to the influence of the caps.

MAG's claims occurring in a given calendar year will be reported over the 5 years after occurrence in approximately the following percentages: 35.0% within the first year, 60.0% within 2 years, 83.0% within 3 years, 92.0% within 4 years and 100.0% within 5 years. Based on these percentages, roughly 40% to 45% of MAG's claims reported in 2004 occurred after the September 15, 2003 effective date of the reforms, and are subject to the caps. Furthermore, nearly all claims reported in 2006, the year in which the proposed new rates take effect, will be subject to the caps.

## **EXHIBITS**

Exhibit 1: Indicated Rate Change

Exhibit 2: Indicated Pure Premium

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Review of OIR Filing Number 05-14789  
MAG Mutual Insurance Company

## Indicated Rate Change

	<u>MAG Mutual</u>	<u>Consumer Advocate</u>	<u>Difference</u>
(1) Selected \$1,000,000 / \$3,000,000 Limits Base Class Pure Premium	\$14,893	\$8,703	\$6,190
(2) ULAE Factor	1.045	1.045	0
(3) DD&R Factor	1.035	1.035	0
(4) Average Class Relativity	1.466	1.466	0
(5) Average Territory Relativity	1.136	1.136	0
(6) Average Maturity Relativity	0.869	0.869	0
(7) Fixed Expense	\$1,058	\$1,058	\$0
(8) Variable Expense Provision	0.066	0.066	0
(9) Off-Balance Premium Credit Program	0.178	0.178	0
(10) Indicated \$1M/\$3M Limits Average Claims-Made Rate	\$31,721	\$19,110	\$12,611
(11) Current \$1M/\$3M Limits Average Claims-Made Rate	\$26,783	\$26,783	\$0
(12) Indicated \$1M/\$3M Limits Average Claims-Made Rate	18.4%	-28.6%	47.1%
(13) Adjustment for Law Change	-7.8%	0.0%	-7.8%
(14) Indicated Overall Manual Rate Change	9.2%	-28.6%	37.8%

## Notes:

Based on MAG Mutual Filing Exhibit 2  
(1) for Consumer Advocate from Exhibit 2

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Indicated Pure Premium

Report Year	Current Level \$1M Manual Earned Premium (\$000s)	Ultimate \$1M Losses (\$000s)	Tillinghast Estimated Loss Ratio	Fitted 6 Point Loss Ratio	Fitted 4 Point Loss Ratio	Consumer Advocate	Difference
(1)	(2)	(3)	(4)	(6)	(7)	(8)	(9)
1995	2,938	529	18.0%				
1996	5,151	931	18.1%				
1997	9,272	2,353	25.4%				
1998	11,843	5,448	46.0%				
1999	19,056	11,375	59.7%	63.1%			
2000	26,687	15,826	59.3%	61.0%			
2001	47,928	30,851	64.4%	58.9%	65.2%		
2002	72,904	40,544	55.6%	56.9%	59.7%		
2003	75,636	49,474	65.4%	55.0%	54.7%		
2004	78,591	35,838	45.6%	53.2%	50.2%		
Estimated 2005			72.2%	51.4%	46.0%		
Estimated 2006			77.6%	49.7%	42.1%	45.9%	31.7%
Estimated 2007			83.4%	48.0%	38.6%	48.2%	35.2%
Total	350,006	193,169					
(10)	Selected Loss Ratio for Policy Period 1/1/2006 to 1/1/2007		80.5%			47.0%	33.5%
(11)	Current MAG Mutual \$1M/\$3M Territory 3 Base Class Mature Manual Rate		18,501			18,501	0
(12)	Indicated \$1M/\$3M Territory 3 Base Class Mature Pure Premium		14,893			8,703	6,190

## Notes:

Based on MAG Mutual Filing Exhibit 3, Sheet 2.1  
(8) for 2007 based on moderated 5.0% annual trend  
(10) for Consumer Advocate from Exhibit 3

PRELIMINARY

