

## A Review of the Medical Malpractice Patients' Compensation Fund

### BACKGROUND

Most medical providers in South Carolina obtain their medical malpractice insurance from the Joint Underwriting Association (JUA) and the Patients' Compensation Fund (PCF). The JUA, created by the General Assembly in 1975, is a nonprofit corporation whose members are insurance companies. The JUA offers coverage with limits of \$200,000 per occurrence and \$600,000 annually. The PCF is a state agency created in 1976 to offer health care providers coverage for malpractice claims that exceed the providers' primary coverage (provided by the JUA or other insurer). The PCF offers unlimited coverage. Beginning in July 2003, the PCF began offering limited coverage in addition to unlimited coverage.

### INTRODUCTION

Members of the General Assembly requested the Legislative Audit Council to perform a follow-up review of our January 2000 *Review of the Medical 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 whether 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 claims. The PCF's methods for establishing reserves were inadequate and resulted in a pattern of reserve 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 file 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 voluntary, its members 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 routinely granted retroactive coverage to members after 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.



## STATUTORY CHANGES FOLLOWING THE AUDIT

With the passage of Act 313 of 2000, the General Assembly enacted changes to increase the PCF's accountability and lessen 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 on other recommendations in the audit, such as placing a cap on the PCF'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 manual of rules and rates, and a claims manual. These policies cover many aspects 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 filed, 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 Freedom 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 promulgate a regulation to comply with the Administrative Procedures Act as recommended in the audit. However, the regulation was withdrawn in the face of opposition 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.

## QUESTIONS ON PCF OPERATIONS AND MEDICAL MALPRACTICE

**(1) OVER THE PAST FIVE YEARS, HAS THE NUMBER OF MEMBERS OF THE PATIENTS' COMPENSATION FUND INCREASED ANNUALLY?**

The number of members has decreased by 7% since 1999. A reduction in the number of physician members accounts for the decrease.

DATE	PHYSICIANS	OTHERS*	TOTAL
09/30/99	5,304	2,936	8,240
09/30/00	5,409	3,016	8,425
03/31/01	5,251	3,025	8,276
11/30/02	4,875	3,007	7,882
05/28/03	4,645	3,018	7,663

\* Includes other medical professionals (i.e. dentists, nurse practitioners, and professional associations).

Source: PCF

**(2) OVER THE PAST FIVE YEARS, HAS THE AMOUNT OF MEDICAL MALPRACTICE PAYOUTS INCREASED ANNUALLY?**

Medical malpractice claims have increased each year over the last five years. In 2002, in order to manage cash flow, the JUA and PCF began deferring payments on certain claims.

YEAR	CLAIM PAYMENTS*	PERCENT INCREASE
1998	\$19,843,569	N/A
1999	\$23,764,764	20%
2000	\$44,706,560	88%
2001	\$49,428,124	11%
2002**	\$51,036,608	3%

\* Does not include expenses associated with defending claims.

\*\* Figure includes \$10,289,759 in deferred payments.

Source: JUA/PCF

**(3) OVER THE PAST FIVE YEARS, HOW MUCH HAVE THE PREMIUMS OF THE VARIOUS MEDICAL SPECIALTIES INCREASED ANNUALLY?**

Premiums for the medical specialties of family 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.

YEAR	FAMILY PRACTICE	PERCENT INCREASE	OB-GYN	PERCENT INCREASE	EMERGENCY MEDICINE	PERCENT INCREASE
1999	\$1,924		\$9,975		\$3,180	
2000*	\$2,696	40%	\$13,982	40%	\$4,454	40%
2001	\$4,116	53%	\$20,631	48%	\$6,698	50%
2002	\$5,745	40%	\$28,883	40%	\$9,795	46%
2003	\$7,162	25%	\$37,597	30%	\$14,930	52%

\* Does not include special assessment of 100% of annual premium.

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 PCF INCREASED ITS RESERVES SINCE THE RELEASE OF THE LAC'S REPORT IN 2000? IF SO, HAS 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 part, 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.

FISCAL YEAR	TOTAL ASSETS	PERCENT DECREASE
00-01	\$12,268,295	N/A
01-02	\$10,416,821	(15%)
02-03*	\$3,947,151	(62%)

\* In FY 02-03, the General Assembly transferred \$1,499,559 from the PCF to the state's general fund.

Source: PCF Financial Statements

Each year an actuary estimates the amount of unpaid claims liability for the PCF. The unpaid claims liability has increased significantly since 2000.

FISCAL YEAR	UNPAID CLAIMS LIABILITY	PERCENT INCREASE
99-00	\$151,575,000	N/A
00-01	\$184,994,546	22%
01-02	\$235,638,000	27%
02-03	\$241,367,000	2%

Source: PCF Financial Statements

**(5) HAS THE PCF CONTINUED TO GRANT RETROACTIVE COVERAGE TO MEMBERS WHEN A CLAIM IS FILED AGAINST THEM?**

Section 38-79-430 of the South Carolina Code of Laws has been amended to prohibit the PCF from granting retroactive coverage. In addition, the PCF's manual of rules and rates prohibits granting retroactive coverage.

**(6) HOW MUCH DO SOUTH CAROLINA PROVIDERS PAY FOR COVERAGE COMPARED TO OTHER STATES WITH FUNDS LIKE THE PCF?**

There are seven states that have funds similar to the PCF. However, it is difficult to compare malpractice insurance rates among these states. The amount of coverage varies by state. Only Wisconsin and South Carolina offer unlimited coverage. A state's policy on whether coverage is provided on an occurrence or claims-made basis also affects rates. Occurrence coverage insures members as long as they had coverage at the time of the incident, whereas claims-made coverage requires the member to have coverage at the time the claim is filed. In addition, the policy on accumulating reserves to pay future claims can affect rates. Below is a listing of rates for three medical specialties, and the coverage amounts, in those states that have funds similar to the PCF. The factors discussed above should be considered when examining the information contained in the table.

STATE	INTERNAL MEDICINE	GENERAL SURGERY	OB-GYN	COVERAGE AMOUNT
South Carolina	\$7,162	\$30,297	\$37,597	Unlimited
Indiana*	\$ 5,426 – \$ 8,467	\$21,426 – \$ 30,343	\$32,510 – \$ 46,984	\$1,250,000
Kansas*	\$ 4,123 – \$ 7,798	\$17,242 – \$ 31,571	\$36,355 – \$ 48,916	\$1,000,000
Louisiana*	\$13,327 – \$14,556	\$43,545 – \$ 47,768	\$68,439 – \$ 74,293	\$1,400,000**
Nebraska*	\$ 3,212 – \$ 3,326	\$12,812 – \$ 14,170	\$16,194 – \$ 21,688	\$1,250,000
New Mexico	\$11,706	\$55,229	\$61,982	\$ 600,000
Pennsylvania*	\$14,296 – \$29,667	\$54,930 – \$131,348	\$70,571 – \$152,730	\$1,000,000
Wisconsin*	\$ 7,873 – \$ 8,338	\$24,381 – \$ 26,007	\$32,881 – \$ 39,508	Unlimited

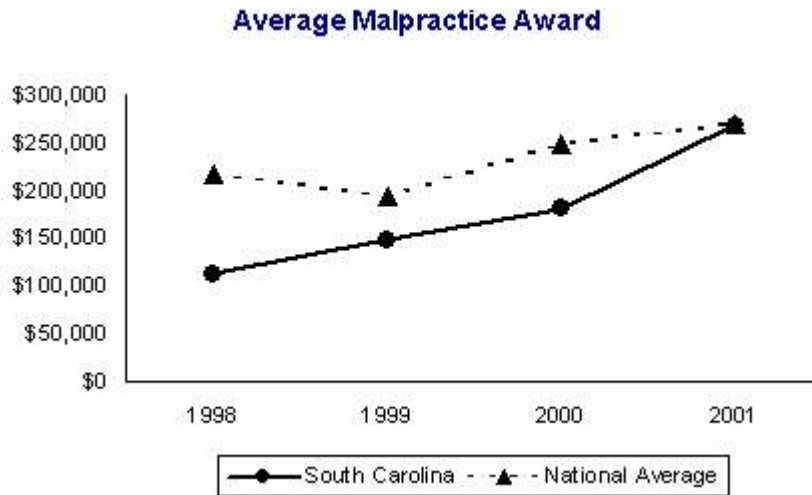
\* Can vary depending on where in the state the physician practices and/or which insurance company provides coverage.

\*\* The primary insurer normally provides \$100,000 in coverage. The Louisiana PCF then provides the next \$400,000 plus unlimited future medical payments. Physicians can purchase higher limits. Rates shown are for \$1 million primary coverage plus the PCF charge for \$400,000 and unlimited future medical payments.

Source: October 2003 Medical Liability Monitor rate survey for 2003 and officials in other states.

**(7) HOW DOES SOUTH CAROLINA COMPARE TO OTHER STATES IN THE NUMBER OF REPORTED MEDICAL MALPRACTICE AWARDS?**

According to the data from the National Practitioner Data Bank, the number of medical malpractice awards in South Carolina increased from 101 in 1997 to 131 in 2001. South Carolina has stayed below the national average in the number of medical malpractice payments per 1,000 active physicians. The size of South Carolina's average malpractice award has been increasing since 1998 and in 2001 nearly reached the national average (see figure).



Source: 2003 National Practitioner Data Bank Annual Report

**(8) WHAT IS THE BREAKDOWN AS TO THE AMOUNT FOR THE NUMBER OF MEDICAL MALPRACTICE PAYOUTS OVER THE PREVIOUS FIVE YEARS?**

The majority of medical malpractice claims (78%) result in payouts of less than \$250,000. However, claims over \$1 million account for 36% of the total amount paid in the last 6 years.

**TABLE 7  
JUA AND PCF PAID CLAIMS BY DOLLAR AMOUNT 1998 THROUGH 12/22/03**

AMOUNT	NUMBER OF CLOSED CLAIMS	PERCENT OF ALL CLAIMS *	AMOUNT PAID*	PERCENT OF AMOUNT PAID*
\$0 – \$ 100,000	555	47%	\$20,758,353	8%
\$100,001 – \$ 250,000	361	31%	\$52,737,063	20%
\$250,001 – \$ 500,000	162	14%	\$57,458,275	22%
\$500,001 – \$ 750,000	43	4%	\$25,879,893	10%
\$750,001 – \$1,000,000	15	1%	\$12,997,390	5%
Over \$1,000,000	43	4%	\$95,149,248	36%
<b>TOTAL</b>	<b>1,179</b>		<b>\$264,980,223**</b>	

\* Figures may not add due to rounding.

\*\* Total does not include \$10,289,759 in deferred payments.

Source: JUA/PCF

**(9) WHAT ARE THE MOST SIGNIFICANT FACTORS IN THE INCREASE IN MALPRACTICE PREMIUMS OVER THE PAST FIVE YEARS?**

According to officials with the PCF and the Department of Insurance, an increase in the size of malpractice awards (severity) and an increase in the total number of claims (frequency) have been major contributing factors in the increase in medical malpractice premiums. Another factor we noted that contributed to the size of the rate increase was the PCF's decision in the 1990s to operate on a pay-as-you-go basis. The PCF did not set its rates high enough to build cash reserves for future claims, and thus had to increase rates dramatically as its claim payments increased (see pp. 3-4).

A June 2003 report by the United States General Accounting Office (GAO) found that increased losses was the most significant contributing factor to increasing medical malpractice insurance rates in the seven states analyzed. However, due to a lack of data, the causes for the increased losses could not be determined.

According to the GAO, based on limited data, rates of premium growth have been, on average, slower in states that have enacted tort reforms with non-economic damage caps. However, the GAO further stated that premium rates are influenced by a number of factors, and their analysis did not allow them to determine the effect tort reform had on medical malpractice rates. The GAO also did a study in August 2003 on the effect of rising medical malpractice premiums on the access to health care. The study found that in five states which reported problems, there were instances of reduced access to hospital-based services affecting emergency surgery and newborn deliveries in scattered, often rural, areas. However, many provider-reported instances of reduced access were either not substantiated or did not affect access to health care on a widespread basis.

**(10) DOES THE PCF HAVE A SYSTEM THAT SETS PREMIUMS BASED ON RISK?**

The PCF's rates for different specialties are determined based on actuarial opinions of the relative risk of each specialty. However, the PCF does not charge a higher premium based on an individual's risk unless the individual is subject to the PCF's experience rating plan (see question 11). For example, an OB-GYN is charged the same premium regardless of the number of babies delivered. The PCF does, however, give its members a one-time discount for attending a risk management seminar. The discount is equal to 25% of the base premium, up to \$2,000.

Beginning in July 2003, the PCF implemented variable coverage limits which allow members to pay a lower premium for a lower level of coverage. For example, the premium for an ER physician for coverage of \$1 million per occurrence and \$3 million annually would be \$4,822, whereas the cost would be \$8,036 for unlimited coverage. As of December 2003, approximately 5% of PCF's members had elected to purchase limited coverage. A PCF official stated that more members will likely choose this option in the future.

## METHODOLOGY

We received information from the Medical Malpractice Patients' Compensation Fund regarding the implementation of the audit's recommendations. We reviewed this and other information, interviewed officials, and verified evidence supporting the PCF's information as appropriate.

### FOR MORE INFORMATION

Our full report, its summary, and this document are published on the Internet at

[www.state.sc.us/sclac](http://www.state.sc.us/sclac)

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### **(11) DOES THE PCF HAVE A SYSTEM THAT SETS PREMIUMS THAT REFLECT PREVIOUS CLAIMS/PAYOUTS AGAINST A PROVIDER?**

The PCF implemented an experience rating plan effective June 1, 2002. A member can be assessed a surcharge ranging from 0% to 300% based on the number of claims and total amount paid.

### **(12) WHAT IS THE AVERAGE COST OF DEFENDING MEDICAL MALPRACTICE LAWSUITS?**

According to a PCF official, the average cost to defend medical malpractice lawsuits, based on historical data, is \$25,000 per case. The PCF does not pay any part of the cost of defending claims. The JUA or relevant carrier pays the expenses of defending the case.

### **(13) IS IT A FEW LARGE CASES OR NUMEROUS SMALL CASES THAT ARE DRIVING UP THE COST OF MEDICAL MALPRACTICE INSURANCE?**

From 1975 through September 2003, the JUA and PCF closed 3,111 claims totaling \$354 million. Over 90% of these claims were closed with payments of \$300,000 or less. These claims accounted for 44% of the total claims payout, or \$155 million. The PCF has had 9 claims where the payout exceeded \$3 million. The total payout for these claims was \$53 million or 15% of the total claim payout. According to officials with the JUA and PCF, an increase in *both* the severity and frequency of claims has contributed to the rising cost of medical malpractice insurance.