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I:\Research\Share\administrative and performance issues of pcfs

TO: Senator Stouffer

FROM: Stephen Witte, Staff Attorney

DATE: July 27, 2005

RE: Administrative and Performance Issues of Patient Compensation Funds

You recently requested information regarding the governance aspects of the various state patient compensation funds. You also requested information regarding the success of the various state funds and whether such funds reduce rates, reduce the total number of malpractice claims and whether the funds discourage lawsuits. These issues are addressed below. Please contact me if you need further information.

Patient Compensation Fund Administration

1. Governance Structure

Typically, patient compensation funds are governed either by department of insurance administration or by a board of governors or directors. In some states, including Indiana, Nebraska, New York, and Pennsylvania, the department of insurance is given broad administrative responsibilities for the patient compensation fund. Other states, including Florida, Kansas, South Carolina, and Wisconsin, call for the appointment of a board of directors or governors charged with administering the fund. It is common for the governor to have authority to appoint members to the board.[1] The boards are typically comprised of various interests such as the insurance industry, the state medical profession, hospitals, the state bar association and other

[1] In Kansas, the commissioner of insurance appoints ten members of the medical profession to the board from a list of nominees submitted by various medical associations. An official from the Kansas Health Care Stabilization Fund has noted that having the members appointed by the commissioner rather than the governor has made the board less political.

groups.

2. Administrative Duties of the Fund

The statutory duties assigned to a board include collecting premium surcharges, collecting claims experience, employing or contracting for services necessary to the operation of the fund, defending claims made against the fund, and paying valid claims and administrative expenses associated with the fund.[2] Surcharges or assessments are generally paid to the primary insurance company when the underlying insurance policy premiums are paid. The insurance company, in turn, remits the assessment to the fund. Failure to remit the assessments can lead to the insurer having its license revoked.

Perhaps the most important duty performed by a board or its staff is claims management. Claims management consists of all functions, including legal representation, that aim to lower payments from the fund. Most patient compensation funds are authorized to hire independent counsel to represent the interests of the fund. Louisiana, for example, contracts with the state's office of risk management for the administration and processing of claims against and legal defense of claims against the fund. Some funds require the primary insurer to defend the fund prior to involving the patient compensation fund in the defense of a claim.[3] Imposing a statutory duty upon an insurer to defend the fund helps reduce inflated claim settlements when claims exceed the primary insurance coverage level.[4]

3. Involvement of the Department of Insurance

In many states, the states' departments of insurance provides regulatory oversight and staff services necessary for the operation of the patient compensation fund. A key decision when creating a patient compensation fund is whether to house it in

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[2] Pinnacle Actuarial Resources, Inc., "Final Report on the Feasibility of an Ohio Patient Compensation Fund," 2003, page 18.

[3] Kansas law requires a medical malpractice claim to be defended by the insurer, but allows the board to employ independent counsel if it believes that it would be in the best interest of the fund. Similarly, Wisconsin law requires insurers to act in good faith and in a fiduciary relationship with respect to any claim affecting the fund.

[4] Pinnacle, *supra* note 2, page 19.

the state's department of insurance or to establish the fund as a separate state agency. According to one commentator, insurance departments potentially offer expertise and economies of scale.[5] Establishing the patient compensation fund as a separate state agency, however, may insulate it from the political considerations that affect the state's department of insurance more generally.[6] In some states, the influence of state departments of insurance over administering patient compensation funds has decreased. In Kansas, for example, the Health Care Stabilization Fund was administered by the insurance commissioner until 1995. In 1995, the board of governors took over all administrative responsibilities of operating the fund.

4. Patient Compensation Fund Staffing

Staffing among the various patient compensation funds varies greatly. Authorized staff sizes ranges from zero in New York to 55 in Pennsylvania. As noted above, in many states the insurance department provides staff services necessary for the operation of the fund. Some services, such as actuarial, legal, loss prevention, and billing are outsourced. In Wisconsin, administrative staff is provided by the Office of the Commissioner of Insurance. Fund staff consists of an administrative officer and six full-time employees. The staff ensures compliance with the filing of primary insurance certificates, billing and collection of assessments, and claims. The fund contracts with outside consultants for other types of services, such as claims administration and actuarial services. The Kansas Health Care Stabilization Fund is staffed by 16 full-time employees and 2 part-time employees. The executive director oversees the daily office management and administrative activities on behalf of the board of directors while the chief attorney is responsible for fund activities related to claims.

An efficient staff will help keep administrative costs low and thereby make the excess liability insurance more affordable. A Louisiana report states that on average, commercial insurance carriers have an expense ratio above 20% (i.e., every dollar

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[5] Sloan, F.A., C.A. Mathews, C. J. Conover, W.M. Sage, Public Medical Malpractice Insurance: An Analysis of State-Operated Patient Compensation Funds, 54 DePaul Law Review 247, 255 (2005). According to this article, seven patient compensation funds are located in their state department of insurance. Id. at 256.

[6] Id. at 255.

received loses 20 cents for expenses). In contrast, the Louisiana Patient's Compensation Fund averages a 4-5% expense ratio.[7]

Success of State Patient Compensation Funds

Whether patient compensation funds are effective or successful is a disputed issue. Proponents of patient compensation funds argue that such funds alleviate medical malpractice crises by: 1) stabilizing private market premiums, 2) increasing medical malpractice insurance availability, and 3) ensuring injured patients receive full compensation.[8] Since the purpose of a patient compensation fund is to promote the affordability and availability of medical malpractice insurance, the issue to determine is whether such funds have furthered this goal. In some respects, patient compensation funds have been successful in that they have been around for almost thirty years. It is often difficult, however, to determine whether patient compensation funds have made medical malpractice insurance more affordable and available due to the diversity of the different state funds. In fact, one study has noted that "[t]he notion that medical malpractice insurance is more available and affordable because of the presence of [patient compensation funds] cannot be conclusively demonstrated with available data or data that could be assembled at reasonable cost."[9]

A. Availability

With respect to medical malpractice insurance availability, private insurance was available in most states with patient compensation funds. A recent study found "no evidence that private excess insurance was unavailable in any [patient compensation fund] state except where [the funds] had crowded out the coverage."[10]

Some representatives of the state patient compensation funds, however, provided anecdotal evidence that their funds made

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[7] See "A Brief History of the Louisiana Patient's Compensation Fund, http://www.lapcf.louisiana.gov/Brief%20History%20Of%20LAPCF.htm.

[8] Iowa Medical Society, "Iowa Medical Society Patient Compensation Funds White Paper," November 11, 2004, page 1.

[9] Sloan, *supra* note 5, page 261.

[10] Id. at page 267.

excess coverage more available. Theresa Wedekind, the top official for the Wisconsin Patient Compensation Fund, stated that their fund has made coverage more available. She noted that in 1975 there was only a handful of insurance carriers, but today there are over 20 carriers in Wisconsin.

B. Affordability - Impact on Rates

On cost of coverage, premiums have increased spectacularly in some states, including states with funds, but the increases are most likely for reasons beyond the control of funds.[11] The losses paid by patient compensation funds during 1998-2002 varied among the states. While Kansas experienced a decrease in paid losses during this period, Pennsylvania, Louisiana, Wisconsin, and South Carolina experienced increases in paid losses.[12] One study notes that patient compensation funds will not control costs in that such funds merely shift a portion of private insurance costs from the private market to the state-run fund. Since the health care provider will pay two premiums, one to the private insurer and one to the fund, the provider may still pay approximately the same amount as before.[13] Whether a health care provider will realize any savings by the implementation of a patient compensation fund may depend upon the administrative costs of operating the fund and other structural designs of the fund.[14]

Some states that were contacted noted that the creation of their patient compensation fund helped stabilize rates. For example,

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[11] Id. at page 262.

[12] Id.

[13] Iowa Medical Society, *supra* note 8, page 2.

[14] A General Accounting Office report from 2003 titled "Medical Malpractice: Multiple Factors Have Contributed to Increased Premium Rates" (GAO-03-702) indicated that losses on medical malpractice claims are the primary long-term driving force for insurance companies in setting insurance premium rates. While legal reforms such as damage caps are associated with reducing medical expenditures, indirect medical malpractice reforms such as patient compensation funds are not generally associated with reducing expenditures. See, Daniel P. Kessler and Mark B. McClellan, "Do Doctors Practice Defensive Medicine?" *Quarterly Journal of Economics*, vol. 111, no. 2 (1996): 353-90.

an official from Nebraska noted that the creation of the Nebraska Excess Liability Fund limited the liability of insurers to a point where an insurer of modest size could write the business without being totally dependent on reinsurance. Without the provision of excess liability coverage, private insurance companies would have to purchase more reinsurance to cover potential large losses. In turn, private insurance companies would have to increase their premium rates to reflect the cost of reinsurance.

Wisconsin also noted that their patient compensation fund has made coverage more affordable; noting that the fund rates for the excess coverage could not be matched on the private market. Wisconsin officials noted that their rates are low due to mandatory participation within the fund (large pool).

C. Frequency of Claims

I could not find any objective evidence that state patient compensation funds impacted the total number of claims filed or that the funds encouraged or discouraged medical malpractice lawsuits. One study notes that the trends in claim frequency are very similar between states with patient compensation funds and states without such funds.[15] From an intuitive standpoint, this makes sense. Patient compensation funds are not really designed to limit lawsuits or reduce claims. Instead, patient compensation funds more aptly address the issues of affordability, availability, and compensation for malpractice victims. Tort reforms, such as damage caps, statute of limitations, risk prevention strategies, and other similar measures are more likely to address the issue of claims frequency or lawsuit prevention.

D. Successful Design of a PCF

The same study noted that it may be valuable to have a patient compensation fund in reserve as a 'back-up' plan in case coverage goes away. With a patient compensation fund already in place, the state will be more aptly able to address a medical malpractice crisis when it arises."[16] The study notes that the

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[15] Sloan, *supra* note 5, page 262. Officials from both Nebraska and Louisiana noted that they had no evidence that their funds reduced the number of claims filed within their respective states.

[16] Id. at 267.

key to the value and success of a patient compensation fund lies in the details of its design. The authors of the study offer the following recommendations for creating an effective patient compensation fund:

1) Determine whether participation within the fund should be voluntary or mandatory. Voluntary participation lends itself to the problem of adverse selection, leaving a pool of high-risk providers while mandatory participation negates adverse selection and spreads the risk across a larger pool.

2) The patient compensation fund limits should clearly position the fund as an excess liability insurer.

3) Establish liability limits on non-economic damages and total medical malpractice damages. Caps are a useful tool for loss control. Recently, the Wisconsin Supreme Court held that the state cap on noneconomic damages is unconstitutional. Whether or not this decision will dramatically affect the operation of Wisconsin's patient compensation fund remains to be seen.

4) Require the patient compensation funds to offer incentives for injury deterrence. This can be done by experience-rating premiums or by providing premium discounts to low-risk health care providers.

5) Avoid pay-as-you go financing. In the first few years of a pay-as-you-go financing system, losses are low because most claims have not been reported or resolved. Later, however, losses will rise, and fund administrators will be forced to raise surcharges to pay off claims.

***Exhibit 1 Patient Compensation Fund State Comparison**

	Florida Birth-Related Neurological Injury Compensation Association	Florida Patient Compensation Fund	Indiana Patient Compensation Fund	Kansas Health Care Stabilization Fund	Louisiana Patient Compensation Fund	Nebraska Excess Liability Fund	New Mexico Patient Compensation Fund	Medical Care Availability and Reduction of Error (Mcare) (PA)	South Carolina Patients Compensation Fund	Virginia Birth-Related Injury Compensation Fund	Wisconsin Injured Patients and Families Compensation Fund
Goal of PCF	To provide an exclusive no-fault remedy for birth-related neurological injury claims	"paying out that portion of any claim arising out of the rendering of or failure to render medical care services.. For health care providers.. Which is in excess of the fund entry level"	To provide a system of excess insurance for health care providers	"to provide excess professional liability coverage for defined health care providers"	"to guarantee that affordable medical malpractice coverage was available to all private providers"	"an alternate way to determine medical malpractice claims and to ensure that malpractice insurance coverage in Nebraska is available at reasonable rates"	"to promote the health and welfare of the people of New Mexico by making available professional liability for health care providers in New Mexico"	"to pay claims against participating health care providers for losses or damages awarded in medical professional liabililty actions in excess of the basic insurance coverage required"	To pay that portion of a medical malpractice or general liability claim, settlement, or judgment against a licensed health care provider which is in excess of $100,000	The exclusive remedy for birth-related neurological injuries in Virginia	"(T)o provide excess medical malpractice coverage for health care providers"
Enabling Legislation	Florida Statute 766.303	Florida Statute 766.105	IC 34-18	K.S.A. 40-3401 K.S.A. 40-3419	R.S. 40:1299.41 R.S. 40:1299.48	Neb. Rev. Stat. 44-2801-2855	N.M.S.A 41-5	MCARE Act	Code of Laws, Section 38, Chapter 79	V.C.A. 38.2-5000 V.C.A. 38.2-5021	W.S. 655.27
Creation Date	1988	1975	1975	1976	1975	1976	1978	2002	1976	1987	1975
Governance	5 member Board of Directors	11 Member Board of Governors	Commissioner of Department of Insurance	10 Member Board of Governors	PCF Oversight Board	Director of Department of Insurance	Director of Department of Insurance	DOI Administers the Fund	13 Member Board of Governors	7 Member Board of Directors	13 Member Board of Governors
Participation	Voluntary	Hospitals Mandatory, Physicians Voluntary	Voluntary	Mandatory	Voluntary	Voluntary	Voluntary	Mandatory	Voluntary	Voluntary	Mandatory, with exemptions
Eligibility **	Physicians	Physicians, Hospitals, HMOs, Ambulatory Surgical Centers, other medical facilities	Physicians, Hospitals	Physicians, Ostepaths, Chiropractors, Podiatrists, RNAs, Medical Care Facilities, Mental Health Clinics, Dentists, health care LLCs Corps, etc.	Physicians, Hospitals, other health care providers	Physicians, Hospitals, other Health Care Providers	Physicians, Hospitals, other Health Care Providers	Physicians, Hospitals	Physicians, Hospitals	Physicians, Registered Nurses, Midwives, Hospitals	Physicians, Osteopaths, RNs, Nursing Homes, Hospitals, Ambulatory Surgery Centers, Cooperative sickness care associations
Required Primary Coverage ***		$250 K/claim or $500 K/ occurrence	Physicians $250 K/$750 K, Hospitals $250K/ $5M	$200 K /$600K	$100K/$300K	Physicians $500K/$1M, Hospitals $3M aggregate limit	$200K/$600K	Physicians $500K/$1.5M, Hospitals $500K/$2.5M	$200K/$600K	Not applicable, exclusive remedy	$1M/$3M
Primary Coverage Options		Private Insurance or qualified Self-insurance (for hospitals), of JUA	Private Insurance or Qualified Self-Insurance (for Hospitals)	Private Insurance or qualified Self-Insurance	Private Insurance or qualified Self-Insurance	Private Insurance or qualified Self-Insurance	Private Insurance	Private Insurance, JUA or qualifed self-insurance	Private Insurance or qualified Self-Insurance	Not applicable, exclusive remedy	Private Insurance, WHCLIP, or qualified Self-Insurance

	Florida Birth-Related Neurological Injury Compensation Association	Florida Patient Compensation Fund	Indiana Patient Compensation Fund	Kansas Health Care Stabilization Fund	Louisiana Patient Compensation Fund	Nebraska Excess Liability Fund	New Mexico Patient Compensation Fund	Medical Care Availability and Reduction of Error (Mcare) (PA)	South Carolina Patients Compensation Fund	Virginia Birth-Related Injury Compensation Fund	Wisconsin Injured Patients and Families Compensation Fund
PCF Coverage Limits	Unlimited	Physicians either $1M/3M or $2M/$4M (including entry limits), Hospitals $2.5M per claim (no agg.)	$1.25M per occurrence in excess coverage	1. 100K/300K; 2. 300K/900K; 3. 800K/2.4M options available	$500K plus future medical expenses less primary coverage	$1.25M per occurrence in excess coverage	$600K non-economic, unlimited medical	$500K/1.5M	Unlimited	Unlimited medical and 1/2 VA average weekly wage after age 18 for all birth-related neurological injuries	Unlimited
Funding Approach & Revenues	Hospitals ($50 per live birth) and physicians ($5K annually) are assessed by the Association	Annual, Semi-annual, or quarterly assessments	Assessments "on the same as premiums"	Assessments "on the same basis as premiums"	Assessments "on the same basis as premiums"	Assessments as a percentage of underlying premiums	Assessments "on the same basis as premiums"	"rates shall be based on the prevailing primary premium"	Pay-as-you-go Funding	Hospitals ($50 per live birth) and physicians ($5K annually are assessed by the Fund	Administrative costs, operating costs, and claim payments are funded through assessments on participating health care providers"
Funding Collection		Paid to Fund	Collected primary insurer or risk manager as "pass through"	Collected by primary insurer as "pass through"	Collected by primary insurer as "pass through"	Collected by primary insurer as "pass through"	Collected by primary insurer as "pass through"	Collected by primary insurer as "pass through"	Annual payments to the Fund		Health Care providers are billed annually with lump sum or quarterly payments
Claims Administration	Administrative law judge determines covergae, Association staff administers		DOI Staff	Fund Staff monitors all Med Mal claims and suits in the state	Executive Director, Office of Risk Management	Director Administrative Services	DOI Staff	Outsourced	Agency Staff	VA Workers Compensation Commission, servicing carrier to administer payment of claims	Outsourced
Medical Review Board/Pretrial Screenings		Each insurance company has a 90-day period to do any internal pretrial screening	Mandatory for Claims > $15K		Mandatory	Mandory, unless waived	Mandatory		None	Review Panel set by Medical School Deans to determine Fund average	PCF Peer Review Council
Damage Caps	Punitives are limited to three times compensatory damages	Punitives are limited to three times compensatory damages	$250,000 per provider, $1.25M for all qualified providers and the Fund	$250K for non-economic, punitives limited to $5M or highest income in the last 5 years	$500K plus future medical expenses	$1.75M per occurrence	$600K non-economic, unlimited medical	Punitives cannot exceed 200% of compensatory but cannot be < $100K	None	$1M cap on recoveries for bodily injury or death, $350K on punitives	Limits on non-economic damages

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Attorneys' Fees	Sliding scale depnding on recovery amount and type of judicial processes required	Sliding scale depnding on recovery amount and type of judicial processes required	15% of PCF awards	Fees require judicial approval	None	No limits, fees are reviewable by judge	None	Unconstitutional	None	None	(a) 33 1/3% of first $1M; (b) 25% of first $1M if liability stipulated within 180 days; and (c) 20% of amount that exceeds $1M
Structured Settlements	Any party may request for future economic damages in excess of $250K	Any party may request for future economic damages in excess of $250K	Allowed, but not required	Not mandatory, but judges are authorized to require	PCF payments "paid as incurred"	Not required	Medical Payments must be paid as they are incurred	Allowed, but not Mandated	Allowed, but not Mandated	Allowed	Encouraged for payments > $100K
Arbitration: Alternative Dispute Resolution (ADR)	Judges can refer cases to nonbinding arbitration. Defendants who admit liability can enter binding arbitration to limit non-economic damages	Judges can refer cases to nonbinding arbitration. Defendants who admit liability can enter binding arbitration to limit non-economic damages	Mandatory Medical Review panel for Claims > $15K	Arbitration Option available	Allowed, but optional	Medical review Panel is a non-binding option	Medical Review Commission Mandatory	Unconstitutional	None		Mediation System

1. This chart is based upon an exhibit found in "Report and Recommendations on the Feasibility of a West Virginia Patient Injury Compensation Fund (2003)."

** The types of providers eligible to participate in a fund are explictly stated in state law. Other health care providers that are listed in this chart may be eligible to partcipate in the fund

*** Where there are two numbers, the first is the limit for each occurrence and the second is the aggregate limit for one year.

		Florida Patient's Compensation Fund	Indiana Patient's Compensation Fund	Kansas Health Care Stabilization Fund	Louisiana Patient's Compensation Fund	Nebraska Excess Liability Fund	New Mexico Patients Compensation Fund	Hospital Excess Liability Pool (NY)	Medical Care Availability and Reduction of Error (Mcare)(PA)	South Carolina Patients' Compensation Fund	Wisconsin Patients Compensation Fund	Wyoming Medical Liability Compensation Account
Governance	**Type of Governing Structure**	11 Member Board of Governors	Commissioner of Department of Insurance	10 Member Board of Governors	9 Member Patient's Compensation Fund Oversight Board	Director of Department of Insurance	Superintendent of Department of Insurance	Commissioner of Health and Superintendent of Insurance	Department of Insurance	13 Member Board of Governors	13 Member Board of Governors	6 Member Medical Liability Compensation Account Board
	Makeup of Board	Board consists of various interest groups: attorney, hospitals, physicians, insurance companies, etc.	Not applicable	Board consists of various medical professionals: MDs, hospitals, nurses, D.O.s, chiropractors	Board is represented by various health care providers based upon percentage of surcharge contribution	Not applicable	Not applicable	Not applicable	Not applicable	Board is comprised of 3 doctors, 2 dentists, 2 hospital representatives, 2 attorneys, 2 insurance representatives and 2 members of general public	Board is compirsed of various interest groups -attorneys, doctors, insurance industry, hospitals, etc.	Board consists of 1 physician, 1 attorney, 1 health care consumer, 1 insurance agent, the commissioner of insurance, and the state treasurer
	Appointment Process	Members are appointed by various interest groups such state bar association and hospital association	Not applicable	Members are appointed by the commissioner of insurance. Commissioner receives a list of nominees from the various associations to choose from	Members are appointed by the governor, subject to Senate confirmation. Governor receives a list of nominees from various professional organizations.	Not applicable	Not applicable	Not applicable	Not applicable	Members are appointed by the governor after consultation with the various professional associations	Members of insurance industry are appointed by commissioner, others are named by professional organization, and governor appoints 4 members of the general public	Members are appointed by the governor with the advice and consent of the Senate

Administration		Florida Patient's Compensation Fund	Indiana Patient's Compensation Fund	Kansas Health Care Stabilization Fund	Louisiana Patient's Compensation Fund	Nebraska Excess Liability Fund	New Mexico Patients Compensation Fund	Hospital Excess Liability Pool (NY)	Medical Care Availability and Reduction of Error (Mcare)(PA)	South Carolina Patients' Compensation Fund	Wisconsin Patients Compensation Fund	Wyoming Medical Liability Compensation Account
	Compliance/Policy Management Staff	Agency for Health Care Administration (for Board of Governors)		Fund Employees	Executive Director	DOI Administrative Staff		Commissioner of Health and Superintendent of Insurance	Department of Insurance Staff	Agency Staff	Administrative Staff	Never formally created
	Billing & Collection		DOI Staff administer payments from Primary Insurers	Fund Employees	Executive Director	DOI Administrative Staff	DOI Staff administer payments from Primary Insurers		Department of Insurance Staff	Agency Staff	Administrative Staff	Never formally created
	Claims Administration		DOI Staff	Fund Staff monitors all Med Mal claims and suits in the state	Executive Director, Office of Risk Management	Director of Administrative Services	DOI Staff	HANYS Services, Inc.	Outsourced	Agency Staff	Outsourced	Never formally created
	Asset Management		Commissioner of Insurance	Director of Investments	PCF Oversight Board	State Treasurer	State Investment Department		State Treasury	State Treasurer	State of Wisconsin Investment Board	State Treasurer
	Asset Allocation	Board of Governors	Claims handling, attorney fees, expense approval, rate setting	Board of Governors, legislative limits		State Treasurer			Old "Cat Fund" Assets and Liabilities were transferred	State Treasurer	Developed by Board of Governors	State Treasurer
	Actuarial Services		Outsourced, Annual reserve and funding study	Outsourced, Annual reserve and funding study	Outsourced, Annual reserve and funding study	DOI Administrative Staff	Outsourced, Biennial Report			Outsourced	Outsourced, annual report required	Never formally created
	DOI Obligations		Claims Handling	Expertise and assistance to Board	Rate Approval	Very broad administrative responsibilities	Rates, administration, claims	Broad Administration	DOI Administers the Fund	Minimal	Provides administrative staff	Administer, Premium Collection, Rates, Reinsurance Purchase

This chart is based upon a chart found in "Preliminary Report on the Feasibility of an Ohio Patients Compensation Fund" prepared by Pinnacle Actuarial Resources, Inc. (February 2003)