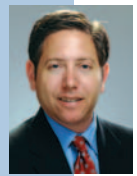

By Kevin J. Atinsky

Disciplined Pricing: An Elusive Target

The title of this segment may make more sense in light of the fact that I am an actuary by profession.

In particular, over the past 10+ years, I have followed the medical professional liability insurance (MPLI) industry from not only an actuarial perspective, but a financial one as well. Through the aid and mentoring from my knowledgeable colleagues, I have also captured the experience for the 20 years prior to my entry into the field. For those familiar with my first article published in *The Physician Insurer* circa Third Quarter 2003 or are industry veterans; this industry has experienced a tremendous amount of turbulence over the past 30 years.

A good portion of the financial roller-coaster can be attributed to volatility in the underlying frequency and severity components of the loss cost, of which the actuaries would argue confounded the predictability of the models. With regard to another portion of the cause, the so-called underwriting cycle, it is important to recognize certain key factors surrounding the latest financial turbulence. First, as noted above, the volatility in the claims environment (i.e., spike in claims severity) played a material role in the onset of the financial troubles. Additionally, the financial crisis was exacerbated by the actions of a relatively few number of players in the industry. These retrospectively misguided decisions, at least to a certain degree, extended and heightened the softer market period of the late 1990's, which also contributed to the onset of the financial turmoil. While there are other circumstances involved, these two factors played an important role in producing the financial difficulties, and ultimately resulted in the absolute necessity for insurers to increase premiums charged to doctors and eventually created the defining issue surrounding the latest crisis, access to healthcare.

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It is interesting to note that these same doctors, in the case of PIAA member companies, happen to be the owners making the decisions to increase rates. In hindsight as well as at the time, it is clear to me as a general statement, that the actions taken were prudent and appropriate (i.e., where would the industry be today had those actions not been taken).

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I believe it is in all parties' best interests to mitigate future financial swings by doing our part in resisting the potential pressure of cut-throat competition as we enter this next relatively softer market period. I could foresee this type of pressure potentially emanating from one or more of the following sources:

- Multi-line commercial carriers seeking to achieve growth targets;
- Start-up operations seeking to maintain critical mass thresholds; or
- Companies seeking competitive advantages created by the use of more sophisticated underwriting and risk management techniques (e.g., predictive modeling).

The only item listed above that I would consider healthy for the industry would be the last item, which involves leveraging recent advancements in actuarial technology and procedures in order to better understand the complex relationships and factors involved in medical liability claims.

The benefit of maintaining pricing discipline and enhancing rate stability inures to the following stakeholders:

- The PIAA membership;
- The owners of the PIAA companies (i.e., doctors); and
- The public at large.

The PIAA Membership

With regard to the majority of this constituency, the first item I would like to mention is the fact that there is not and never was any incentive to charge excessive rates to its policyholders. The simple but powerful fact that the policyholders and the owners are one and the same group makes the claims of profiteering that have been put forth by some illogical and inconsistent with the operating philosophy of these companies.

During the latest financial crisis, there were a number of PIAA companies that were concerned about the long-term ability to carry out the mission of providing coverage and advocating for the healthcare community. Following the rate increases as well as a difficult to explain turnaround in the MPLI loss cost environment, those carriers that are able to have already begun to return premiums in the form of policyholder dividends and/or rate reductions where warranted by the data. In other words, to the extent that difficult to predict rates bear out to be redundant, the mutual status of most PIAA members allows for the natural return of premiums while helping to ensure adequate capitalization.

Thus, one of the benefits of mitigating rate volatility is that it is in the best interest of the customers and enhances customer relations. Additionally, maintaining pricing discipline will work to improve financial stability and maintain appropriate capitalization levels. While the volatility in the underlying claims frequency and severity components may never subside and will always be a significant challenge for the industry and its financial results, this item is more within the control of the MPLI insurance industry and can have a favorable impact on financial stability, customer satisfaction, and public relations.

Healthcare Providers

For healthcare providers, the benefits of enhanced rate level stability are quite clear and compelling. First, it is often the case that healthcare delivery operations practice year-to-year budgeting and capital allocation planning. One of the top cost components of a typical physician group practice is medical liability insurance and to the extent that there is more stability in this cost category would enhance the overall operational functioning. In other words, it becomes difficult to manage annual budgeting and capital purchase decisions when one of the key cost components is unpredictable from year to year. In fact, this is one of the chief motivations behind the formation of MPLI captive programs.

Another benefit from the healthcare provider standpoint is that pricing discipline tends to correlate well with financial stability and the long-term viability of an insurer to protect its policyholders by meeting its claim obligations. The awareness of this issue was heightened during the latest crisis and I am sure that any doctor that faced these sorts of concerns will not soon forget the feelings of anxiety that accompanied them.

The General Public

With the defining issue of the latest crisis being one of access to healthcare, the benefits of mitigating the rate volatility may be more apparent than ever before to the public at large. When the availability of high risk specialists becomes jeopardized, it tends to raise awareness as to the importance of promoting price stability, which by producing a benefit to the healthcare providers, also serves to avert additional issues related to the public's access to healthcare delivery.

Closing Thoughts

We all recognize that there are numerous other considerations that determine the appropriate course of action with respect to

> **"it is difficult to refute the proper alignment of interests when the owners are the customers themselves."**

optimal rate levels, and some of those do legitimately work in the direction of downward pressure on rates. Alternatives to the extension of rate reductions (unless of course justified by the data) and additional credits include policyholder dividends. I have observed some activity along these lines in 2006 and would not be surprised to see additional announcements during the remainder of 2007.

One advantage to this approach is that they do not need to be "unwound" in the future due to their one-time nature. Another advantage to this approach is that it plays up one of the PIAA's core defenses regarding the predominantly mutual status and physician advocacy principles of its membership (i.e., "excessive" profits can be returned from whence they came). There is no counter to this defense; it is difficult to refute the proper alignment of interests when the owners are the customers themselves. For those in the fortunate financial position to afford a give-back, one of these approaches may buy enough time to fend off overly aggressive pricing, and allow reality to work its way into the actuarial and financial statistics.

I like to think that all vested parties remember all too well the financial discomfort faced by the healthcare community as well as the medical liability insurance industry during the most recent crisis. Stay tuned for more commentary and analysis in future columns. PIAA

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