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# **How Insurance Reform Lowered Doctors' Medical Malpractice Rates in California**

## And How Malpractice Caps Failed

Presented by the Foundation for Taxpayer and Consumer Rights  
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### **Summary**

A 1988 California insurance reform initiative (Proposition 103), and not the state's 1975 malpractice law, is the reason California doctors' medical malpractice premiums have dropped and stabilized over the last 14 years.

In this report we demonstrate the following:

#### **Insurance regulations, not liability caps, reduce rates**

- Thirteen years after the enactment of malpractice caps, doctors' premiums had increased by 450% and reached an all-time high in California.
- Insurance reform Proposition 103 reduced California doctors' premiums by 20% within three years.
- Insurance reform required medical malpractice insurers to directly refund more than \$135 million to policyholders.
- Three of the state's largest malpractice insurers – The Doctors Co., Norcal Mutual and SCPIE – refunded \$69 million to doctors to comply with Proposition 103.

#### **Malpractice caps result in a smaller fraction of premiums being used to pay claims and a higher percentage devoted to insurer profit and insurance defense lawyers**

- During the first twelve years of California's malpractice law, insurers used 68.6% of doctors' premium to pay for profit, overhead and defense costs; *only thirty-one cents of every premium dollar actually paid injured victims' claims.*
- California insurers now spend approximately 35% of every premium dollar fighting claims, while the national average is 21%.

# I. Malpractice Caps and Insurance Regulation in California\*

## A. The MICRA experiment

In 1975, in response to striking doctors, California lawmakers passed a series of legal restrictions on injured patients (known as the Medical Injury Compensation Reform Act), including an arbitrary cap on recovery for "noneconomic" damages, no matter how egregious the malpractice or serious the injury. These noneconomic damages compensate for injuries that do not result in a tangible bill, such as the loss of fertility, severe disfigurement and the death of a child or senior citizen. As a result, many victims without large wage loss or medical bills cannot find an attorney in California.

Additionally, juries are not told of the cap, and jury decisions are reduced without jurors' knowledge.

### MICRA (1975):

- Placed a \$250,000 cap on the amount of compensation paid to malpractice victims for their "non-economic" injuries.
- Eliminated the "collateral source rule" that forces those found liable for malpractice to pay all the expenses incurred by the victim.
- Permitted those found liable for malpractice to pay the compensation they owe victims on an installment plan basis.
- Imposed a short "statute of limitations" on malpractice victims (generally three years).
- Established a sliding scale for attorneys' fees that discourages lawyers from accepting serious or complicated malpractice cases.

MICRA was endorsed by doctors and insurers, who assured lawmakers that the caps would solve the "insurance crisis" of the day and the high prices of medical malpractice insurance for good. However, under MICRA malpractice rates continued to fluctuate dramatically and a dozen years after its enactment, doctors were again facing steep increases.

## B. Another Insurance Crisis Leads to Insurance Reform and Regulation

In response to the re-escalation of insurance rates in the mid 1980s, California voters passed Proposition 103 in 1988, which rolled back insurance rates for most policyholders, including doctors, froze premiums and refunded millions of dollars to doctors to compensate for excessive past premiums. Thereafter, medical malpractice insurance was subject to the nation's toughest rate regulation system in the country and premiums have been relatively stable for California doctors since the passage of insurance reform.

### Proposition 103 (1988):

- Rolled back rates to 20% lower than rates in effect on November 8, 1987, for all property and casualty insurers including medical malpractice insurers.
- Statutorily froze rates for one year.
- Refunded billions of dollars to policyholders.
- Created "prior approval" regulation of insurers, which allows the insurance commissioner to reject or alter rate increase requests.
- Allowed consumers to challenge insurers' rate increase proposals.
- Ended the insurance industry's exemption from state and federal anti-trust laws.
- Made the Insurance Commissioner an elected position (starting in 1990).

\* This report is based on data obtained from the National Association of Insurance Commissioners' Reports on Profitability By Line By State, 1976-2001, unless otherwise noted.

## II. Impact of MICRA on Medical Malpractice Insurance Premiums

MICRA was enacted in 1975. However, premiums continued to rise. By 1988, twelve years after the passage of MICRA, California medical malpractice premiums had reached an all-time high – 450% higher than 1975, when MICRA was enacted.

During the mid 1980s, California malpractice premiums increased by more than 20% annually. Insurance companies argue that premiums continued to increase after MICRA’s passage because of court challenges to the law; the California Supreme Court upheld the damage cap in 1985. Despite that ruling, however, malpractice premiums in California increased more dramatically in 1986 than any year since the passage of MICRA. Between 1985, when the cap was upheld, and 1988, malpractice premiums soared 47%.

**Figure 1. Premium Increases During the Last Insurance Crisis**

Year	California Premiums Earned	Percentage Change
1983	\$287,256,000	36.37%
1984	\$374,661,000	30.43%
1985	\$449,727,000	20.04%
1986	\$629,448,000	39.96%
1987	\$633,903,000	0.71%
1988	\$663,155,000	4.61%

SOURCE: National Association of Insurance Commissioners’ Reports on Profitability By Line By State, 1976-2001

## III. Impact of Proposition 103 on Malpractice Insurance Premiums

### A. Premiums Dropped by 20% After Proposition 103

Unlike MICRA, Proposition 103 explicitly required a rate rollback of up to 20%. The relevant portion of California Insurance Code Section 1861.01 reads:

For any coverage for a policy . . . of insurance subject to this chapter . . . every insurer shall reduce its charges to levels which are at least 20% less than the charges for the same coverage which were in effect on November 8, 1987.

Medical malpractice rates in California began to fall immediately after the passage of Proposition 103, and, within three years of the passage of insurance reform, total medical malpractice premiums had dropped by 20.2% from the 1988 high.

**Figure 2. Premiums Decline After Proposition 103**

Year	Cal. MedMal Premiums (total)	% change	Cumulative % Change
1988	\$663,155,000	--	--
1989	\$633,424,000	-4.5%	-4.5%
1990	\$605,762,000	-4.4%	-8.7%
1991	\$529,056,000	-12.7%	-20.2%

SOURCE: National Association of Insurance Commissioners’ Reports on Profitability By Line By State, 1976-2001

After adjusting for inflation, the premium drop is actually 30.7%.

**B. Insurance Reform Required Medical Malpractice Insurers to Refund Millions to Doctors.**

Medical malpractice insurers were among the first insurance companies in California to comply with Proposition 103's mandatory rate rollback. Three of the state's largest malpractice insurers – Norcal Mutual, SCPIE and The Doctors Company – refunded \$69.1 million to doctors by 1992. By 1995, insurers providing medical malpractice coverage issued more than \$135 million in refunds to policyholders.

According to a California Department of Insurance news release of February 18, 1992:

The Doctors' Company follows two other medical malpractice insurance groups and the Automobile Club of Southern California in agreeing to voluntarily comply with the rollback provisions of Proposition 103. The agreement calls for the return of \$18.5 million to the company's 9,500 California physician members, a 19.24% rebate...

The company joins two other medical malpractice insurers, Norcal Mutual and the Southern California Physicians Insurance Exchange (SCPIE) that have already agreed to pay Proposition 103 rebates to their policyholders. Norcal Mutual agreed to pay 9,000 policyholders \$19.9 million, while SCPIE's agreement calls for \$30.7 million to be paid to its 13,800 members.

News releases about the malpractice rollbacks are attached as Appendix A

**Figure 3. Proposition 103 Mandated Refunds Paid by Major Medical Malpractice Insurers**

<b>Malpractice Insurer</b>	<b>Total Refund**</b>	<b>Date Paid</b>
Norcal Mutual Insurance Co.	\$19,875,172	10/6/91
SCPIE	\$30,730,384	10/15/91
Doctors Insurance Co.	\$18,519,217	2/20/92
Medical Insurance Exchange of CA Gp.	\$4,725,452	10/8/93
St. Paul Cos.*	\$10,000,000	6/28/94
Dentists Insurance Co.	\$1,886,342	5/26/95
Zurich-American Insurance Gp.*	\$13,495,977	10/25/95
Farmers Insurance Gp.*	\$35,978,041	12/14/95
<b>Total Paid by Major Malpractice Insurers</b>	<b>\$135,210,585</b>	
Source: California Department of Insurance *Insurer carried several property-casualty lines, which were subject to Prop 103 Rollback. Refund amount was paid to policyholders in all lines, including physicians. Other insurers carried medical malpractice exclusively at the time of the rollback. **Refund amount includes interest.		

**C. Insurance Reform Imposed Moratorium on Rate Increases in California**

According to Proposition 103, all insurance rates were to be frozen for one year at the rolled-back rate level. After the passage of the initiative, a moratorium was declared on all rate increases by medical malpractice insurance companies, as well as other insurers, pending

resolution of the insurers' legal challenges and the promulgation of regulations governing the rollback process. News articles describing the rate freeze are attached as Appendix B.

The initiative itself, including the rollback requirement, was upheld by a unanimous California Supreme Court in May, 1989. The insurance commissioner at the time imposed a freeze while developing rollback regulations. Litigation delays blocked the regulations, and when California's first elected insurance commissioner took office, he announced rollback regulations and ordered a rate freeze pending payment of the rollbacks by each insurer. Largely because of lawsuits brought by the insurers against the rollback regulations, the rate freeze remained in effect for many insurers for four years.

**D. Strict Regulation of Rate Increases Followed Rate Freeze, Rollbacks**

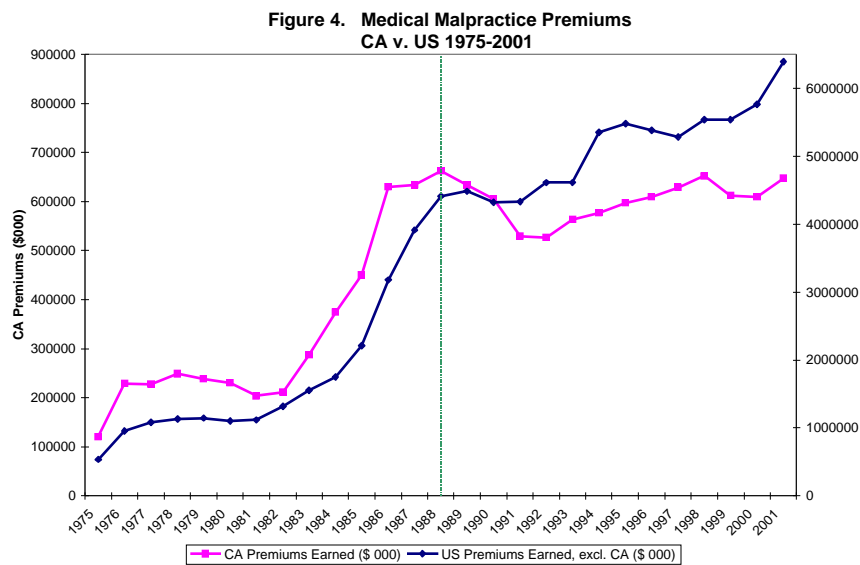
Upon payment of the rate rollback refunds, insurers were then subject to Proposition 103's "prior approval" regulatory system, which requires medical malpractice insurers to justify rate increases or decreases to the Department of Insurance, and the commissioner may, at any time, invalidate an insurers' rate if it is too high or too low.

**IV. Comparing MICRA v. Proposition 103**

**A. Proposition 103, not MICRA, reduced malpractice premiums in California.**

California doctors' premiums generally tracked premiums countrywide between 1975 and 1988, following the recognized boom-bust "insurance cycle" that has coincided with each insurance "crisis" in this country, including the present one.

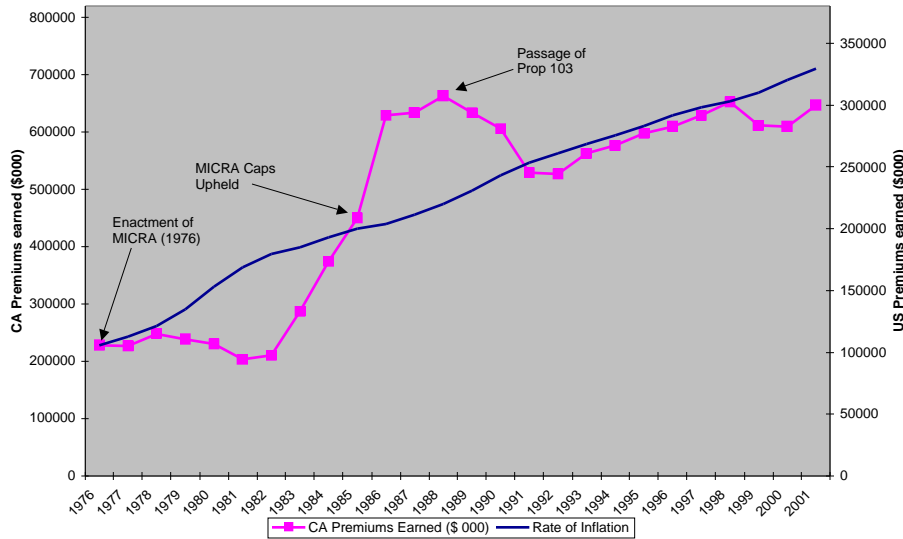
But malpractice premiums fell sharply in California immediately after passage of Prop 103. Moreover, they continued to drop in ensuing years, bucking the national trends, and then stabilized while national rates continued to fluctuate.



## B. From Premium Chaos to Price Stability

In the twelve years after the enactment of MICRA, California doctors' premiums rose much faster, overall, than the national rate of inflation. After California voters enacted insurance reform Proposition 103 in 1988, medical malpractice rates first fell dramatically and then generally followed the rate of inflation or declined still.

Figure 5. Total Premiums Earned California v. Rate of Inflation (1976-2001)



SOURCE: National Association of Insurance Commissioners' Reports on Profitability By Line By State, 1976-2001 and Consumer Price Index, All Urban Consumers (Bureau of Labor Statistics)

The data also show that Proposition 103's "prior approval" system, under which the commissioner may, at any time, invalidate an insurers' rate if it is too high or too low, has ameliorated some of the premium instability induced by the cycle. The price chaos of the 1970s and 1980s was replaced with a steady reduction of rates and then continued price stability for California doctors in the 1990s and through the current "insurance crisis."

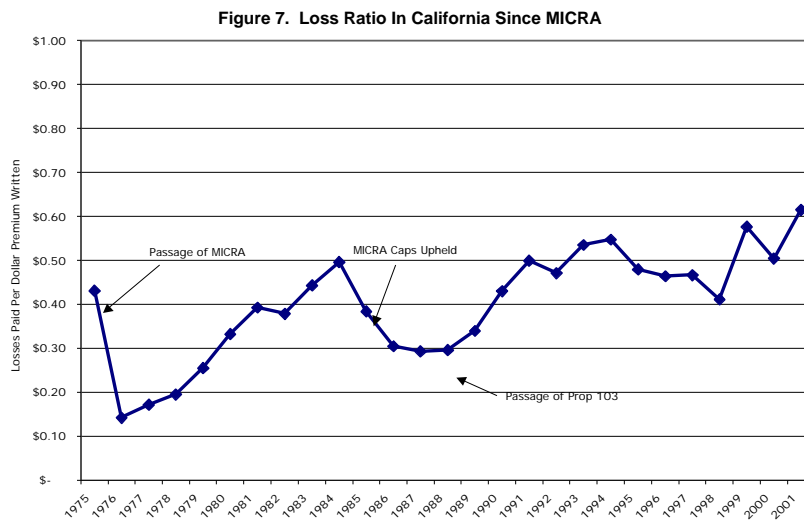
Figure 6. Annual Change in California Medical Malpractice Premiums

MICRA years	Premium Chaos	Proposition 103	Price Stability
1975-1976	89.35%	1988-1989	- 4.48%
1976-1977	-0.60%	1989-1990	- 4.37%
1977-1978	+9.53%	1990-1991	-12.66%
1978-1979	-3.94%	1991-1992	- 0.48%
1979-1980	-3.64%	1992-1993	+6.93%
1980-1981	-11.47%	1993-1994	+2.45%
1981-1982	+3.35%	1994-1995	+3.62%
1982-1983	+36.37%	1995-1996	+2.07%
1983-1984	+30.43%	1996-1997	+3.09%
1984-1985	+20.04%	1997-1998	+3.78%
1985-1986	+39.96%	1998-1999	- 6.25%
1986-1987	+0.71%	1999-2000	- 0.34%
1987-1988	+4.61%	2000-2001	+6.15%

SOURCE: National Association of Insurance Commissioners' Reports on Profitability By Line By State, 1976-2001

### C. Malpractice Caps Resulted in Less for Injured Patients, More for Insurance Companies and Insurance Defense Lawyers

As a result of the severe malpractice caps in MICRA, insurance companies in California have consistently retained more of the premium dollar and paid a lower percentage of each premium dollar to victims than the national average. As would be expected under the onerous provisions of MICRA, the losses paid by insurers dropped in California immediately after the passage of MICRA, and for the next three years malpractice insurers paid less than twenty cents toward victims' compensation for every dollar worth of premium paid to insurers by doctors.



Source: A.M. Best and Co. special data compilation for Americans for Insurance Reform, reporting data for as many years as separately available.

In fact, between the enactment of MICRA in 1975 and the 1988 passage of Proposition 103, which disallowed excessive rates (and thereby forced loss ratios towards more appropriate levels), California insurers never paid out in claims more than half of premiums written. Between 1976 and 1988, the average percentage of each premium dollar paid out in the form of compensation to malpractice victims – expressed as a “loss ratio” – was 31.4%. The balance – sixty-eight cents of every premium dollar – paid for other insurer costs, primarily profits, insurance company lawyers and overhead. That is, more than sixty-eight cents of every premium dollar paid by doctors was used for purposes other than compensating victims. Insurers had promised doctors lower premiums, but instead of reducing premiums commensurate with the lower claims payouts associated with malpractice caps, insurers simply captured higher profits in California.

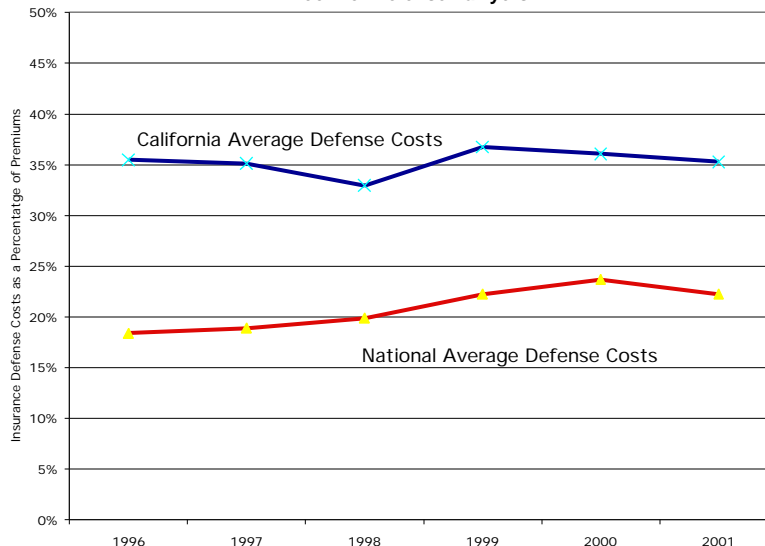
While the malpractice loss ratio has improved in California under Proposition 103, it continues to oscillate around 50%, indicating that an astonishing fifty cents of every malpractice premium dollar that physicians pay remains with insurers. What are insurers doing with this money?

The data expose another product of MICRA: medical malpractice insurers in California are spending far more money fighting the claims of injured patients than the national average. That is, California malpractice insurers spend a disproportionate amount of a premium



dollar on direct defense costs, which includes insurance company lawyers, expert witnesses and other claim adjustment expenses. Between 1996 and 2001, California medical malpractice insurers spent an average of 35% of premiums on defense costs compared to the 21% national average.

**Figure 8. Malpractice Caps:  
A Boon for Defense Lawyers**



Source: Special data collection for FTCR. National Association of Insurance Commissioners, by permission. The NAIC does not endorse any analysis or conclusion based upon the use of its data.

Indeed, data show that California medical malpractice insurers incurred more costs fighting claims than actually paying claims in 1992 and 1993, and in 1994 and 1995, defense costs continued to be exceptionally high as compared to the losses incurred in California.

**Figure 9. Malpractice Defense Expenditures (1992-1995)**

Year	Total California Losses Incurred/ (As Percentage of Premium Earned)	California Defense Costs Incurred/ (As Percentage of Premium Earned)	Countrywide Losses Incurred/ (As Percentage of Premium Earned)	Countrywide Defense Costs Incurred/ (As Percentage of Premium Earned)
1992	\$209,545,400 (39.8%)	\$216,389,850 (41.1%)	\$3,571,184,500 (69.5%)	\$1,644,286,400 (32.0%)
1993	\$214,504,520 (38.1%)	\$226,327,600 (40.2%)	\$3,342,439,500 (64.6%)	\$1,554,157,200 (27.9%)
1994	\$216,289,120 (37.5%)	\$203,600,160 (35.3%)	\$3,514,615,500 (59.3%)	\$1,554,157,200 (26.2%)
1995	\$248,028,900 (41.5%)	\$226,513,140 (37.9%)	\$3,571,184,500 (59.3%)	\$1,830,272,300 (30.1%)

SOURCE: National Association of Insurance Commissioners' Reports on Profitability By Line By State, 1976-2001

The insurance industry and doctors argue for limits on attorneys' fees under the guise of returning more money to the victims of malpractice. However, in some years, insurers have spent a greater proportion of doctors' premiums on their own lawyers and defense costs in California, with liability limits in place, than on compensating patients, contradicting a premise of "liability reform." In other states, victims receive more of the premium dollar, while the insurers' own legal expenses are less.

What explains this behavior? Because the rigid caps make it more difficult for victims to obtain representation and prosecute a case, and because such caps limit companies' exposure, insurers have an incentive to withhold claims payment as a negotiating tactic, which will force plaintiffs and their attorneys to spend inordinate resources to recover losses, thereby discouraging cases and forcing lower recoveries.

Although, under the strictures of MICRA, insurers will continue to pay limited claim settlements in California, sustained and increasingly rigorous regulation will continue to improve insurers' loss ratio over time. Under Proposition 103, our organization has challenged a recent rate increase proposed by the state's second largest medical malpractice insurer. Using the consumer intervention aspect of the law, we are investigating the company's loss ratio and the company's defense costs. Due to our regulatory challenge, that company's policyholders have been shielded from 15% rate hikes.

## **VI. Conclusion**

California's malpractice caps and other restrictions on injured patients' rights, collectively known as MICRA, did not address the problem of rapidly escalating premiums faced by California doctors in the early 1970s. While insurers and doctors seek to highlight California's malpractice caps and other tort limits in the debate about medical malpractice, the facts do not bear out the claims. Indeed, only because California voters enacted stringent insurance rate reform after tort reforms failed did doctors' premiums fall. In the thirteen years in which California's malpractice caps were in effect without rate regulation, doctors' premiums increased 450%.

Furthermore, with Proposition 103's rate regulation system in place, malpractice premiums not only fell, they stabilized. The annual variations from year to year are significantly less drastic and, as a result of the regulatory process, far more predictable under the regulated system than ever before.

With the current debate over malpractice caps raging in Washington, D.C. and many states throughout the country, policymakers should look to the experience of California. The state has tried both tort limits and insurance reform. According to the data, insurance reform – that is, mandatory rate reductions and stringent, on-going regulation of malpractice insurance rates – lowered premiums for doctors, while malpractice caps and other restrictions on the tort system failed to provide doctors the relief they sought.