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Human Resources Division

150899

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February 28, 1994

The Honorable John Bryant, Chairman
Subcommittee on Administrative Law
and Governmental Relations
Committee on the Judiciary
House of Representatives

Dear Mr. Chairman:

Public Law 102-501, the Federally Supported Health Centers Assistance Act of 1992, makes Federal Tort Claims Act (FTCA) coverage available to federally funded community and migrant health centers and certain of their health care providers for designated activities during 1993 through 1995.[1] In a September 1993 report to the Subcommittee on Labor, Health and Human Services, Education, and Related Agencies, Senate Committee on Appropriations, we estimated the costs and savings associated with full FTCA coverage for all community and migrant health centers compared to purchasing medical malpractice insurance from commercial and other insurers.[2]

After we issued that report, you asked us to provide you with estimates of the costs and savings associated with federally funded community and migrant health centers obtaining medical malpractice insurance through two other insurance options. Specifically, you asked for estimates of the cost of medical malpractice insurance and any savings for the centers under (1) a risk-purchasing group and (2) a risk-retention group compared to their prior insurance coverage. Through a risk-purchasing group, centers would join together to purchase malpractice insurance from an existing insurance source. As a risk-retention group, the centers would form an insurance company to self-insure against malpractice claims.

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[1]Public Law 102-501, the Federally Supported Health Centers Assistance Act of 1992, was enacted on October 24, 1992.

[2]Medical Malpractice: Estimated Savings and Costs of Federal Insurance at Health Centers (GAO/HRD-93-130, Sept. 24, 1993).

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As agreed with your office, the cost and savings estimates we present in this letter were developed by Tillinghast, a nationally known management and actuarial consulting firm. Tillinghast developed these estimates when they developed similar estimates associated with full FTCA coverage that we reported in September 1993. Tillinghast's estimates associated with implementing either a risk-purchasing group or a risk-retention group for the centers cover the 5-year period from 1993 through 1997.

To develop the estimates, Tillinghast used data that we collected from (1) 370 center grantees that responded to a medical malpractice questionnaire we sent to 513 grantees operating centers in 1992[3] and (2) a telephone survey we conducted in 1992 of a random sample of 40 center grantees that did not respond to our questionnaire. Also, Tillinghast used industry trend data on medical malpractice insurance premiums, claims, and payment patterns.

Tillinghast made several assumptions when developing the cost and savings estimates associated with a risk-purchasing group and a risk-retention group. For example, for both options, Tillinghast assumed that the centers would be covered beginning January 1, 1993, and coverage would be provided to all of the centers and their full- and part-time health care providers. Because Tillinghast's estimates are determined from assumptions, the results are subject to a significant range of uncertainty.

In summary, Tillinghast's work suggests that centers could save an estimated $57 million in medical malpractice insurance premiums over a 5-year period if all centers and their full- and part-time health care providers were insured through either a risk-purchasing or a risk-retention group rather than through policies purchased individually from insurers. However, before centers could obtain insurance through a risk-purchasing group, an insurer would have to be willing to assume the risk; and, if the centers formed a risk-retention group, they would have to provide an estimated $17 million in capital for the group's insurance company, thereby reducing risk-retention group savings to less than $40 million. In addition, the estimates do not capture any of the costs associated with forming the groups. Furthermore, these insurance options

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[3]We received a total of 374 responses (73 percent) to our questionnaire. However, only 370 were received in time to be used by Tillinghast in the analysis.

would provide either limited or no protection to the centers against insurer insolvency.

BACKGROUND

The Department of Health and Human Services awards grants through sections 330 (community health centers) and 329 (migrant health centers) of the Public Health Service Act to public and nonprofit private entities to plan, develop, and operate health centers for medically underserved populations in the country. The centers are required to provide such primary health care services as physician services, diagnostic laboratory and radiology services, and emergency medical services. The centers may also provide such supplemental health services as ambulatory surgery and mental health services to support the primary health care services. A sliding scale that establishes fees determined from a patient's ability to pay is used to charge for the services provided by the centers.

Health care providers and facilities are accountable for the quality of services they deliver. Patients or their representatives may file medical malpractice claims to seek compensation for economic and noneconomic losses that result from treatment that does not meet an acceptable standard of care.[4] To protect against claims of medical malpractice, health care providers and facilities usually purchase medical malpractice insurance from commercial insurers and other sources.

RISK-PURCHASING GROUPS

Under federal law, entities or individuals with similar liabilities can form an organization--a risk-purchasing group--to buy insurance on a group basis.[5] The law exempts

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[4]Economic losses include lost income, medical bills, and rehabilitation costs. Noneconomic losses include pain and suffering.

[5]The Congress enacted Public Law 97-45 in 1981 allowing product manufacturers, distributors, and retailers--who had similar risks and who were buying product liability insurance--to form groups no matter where they were located to (1) purchase insurance or (2) self-insure and retain the risk. Through Public Law 99-563, the Congress, in 1986, expanded the law to include liability arising out of any business or professional service including medical malpractice.

the risk-purchasing group from certain state laws such as those that would prohibit establishing such a group or interfere with a group's ability to purchase insurance based on the group's loss and expense experience. The group usually purchases insurance for all its members from an established insurer.

A risk-purchasing group representing many members should have more negotiating power in the insurance market than each individual member. In addition, under risk-purchasing groups, insurers should generally tailor the insurance provided to meet the needs of the members of the group. In theory, an insurer would first have to be persuaded to provide insurance to a risk-purchasing group for the community and migrant health centers. Then, all or a large number of the centers should participate in the group. Finally, the insurer would set premiums to reflect the centers' expected loss experience. However, if the risk-purchasing group insurer goes bankrupt, each group member is not protected by state guaranty funds unless the insurer is licensed in the group member's state.[6]

Estimated Cost and Savings of a Risk-Purchasing Group for the Centers

The centers' estimated insurance premium costs under a risk-purchasing group could range from about $13 million in 1993 to about $26 million in 1997 as shown in table 1. These estimated premiums reflect the centers' favorable loss experience.[7] However, because the risk-purchasing

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[6]Entities who purchase insurance usually are protected by an insolvency fund maintained by each state if an insurer cannot meet its financial obligations. Generally, these funds cover the failure of insurers that are licensed to do business in that state. In most cases, these insurers are assessed to finance the funds.

[7]When developing the estimated risk-purchasing group premiums for the centers, Tillinghast estimated amounts to cover the centers' expected loss experience that were determined from the centers' historical claims experience and type of malpractice insurance and from expected trends and losses in malpractice claims. In addition, Tillinghast estimated amounts to cover such insurer operating costs as loss adjustment and underwriting expenses, federal income taxes, contingencies, and profits. Also, Tillinghast reduced the estimated premiums to account for insurers' investment income credits.

group estimated premiums also reflect the type of insurance offered to the group, they could increase at a faster rate than the estimated premiums that would have been paid under prior insurance arrangements.[8] However, the centers could save an estimated $57 million during the 5-year period.

Table 1: Estimated Cost and Savings to the Centers With a Risk-Purchasing Group During Calendar Years 1993 Through 1997

Dollars in millions

Calendar year	Estimated premiums paid under prior arrangements	Estimated cost of risk-purchasing group premiums	Estimated savings[a]
1993	$29.8	$13.4	$16.4
1994	30.4	16.1	14.3
1995	31.0	19.8	11.2
1996	31.7	22.6	9.1
1997	32.3	25.9	6.4

[a]Savings do not account for any costs that may be associated with forming the risk-purchasing group.

[8]Malpractice insurance is written on either an occurrence or claims-made basis. An occurrence policy covers all incidents that occur during the policy period, regardless of when a claim is filed. A claims-made policy covers only claims filed while the policy is active. Claims-made policy premiums are initially lower and generally increase each year during the first 5 years as the exposure to risk increases. However, usually after 5 years, the premiums mature or stabilize. Because the risk-purchasing group would offer claims-made coverage, centers that had occurrence policies would receive an initial rate reduction when converting to claims-made coverage; this rate would increase over time.

RISK-RETENTION GROUPS

Risk-retention groups are similar to risk-purchasing groups in some respects. However, members of a risk-retention group organize not to purchase insurance from an insurer, but to retain the risk and to self-insure. With a risk-retention group, a new insurance company is formed to write coverage for its members.

A risk-retention group can solicit business and insure its members nationwide without meeting the licensing requirements of each state if the group is chartered in at least one state. For the most part, a risk-retention group is exempt from the regulations of any state except the state in which it is chartered.[9]

Theoretically, insurance premiums for a risk-retention group should be determined from the actual loss experience of the members of the group. However, the group must assure that premiums paid to the insurance company formed by the risk-retention group are sufficient so that the company remains fiscally sound. If a risk-retention group insurance company becomes bankrupt, its members are likely to be without any coverage because a risk-retention group cannot participate in any state guaranty funds.

Estimated Cost and Savings of a Risk-Retention Group for the Centers

Tillinghast estimated the cost of the risk-retention group insurance premiums at the same level to cover the same items as the premiums for a risk-purchasing group--premiums range from about $13 million in 1993 to about $26 million in 1997.[10] Similar to a risk-purchasing group, the centers could save an estimated $57 million in premiums over the 5-year period, compared to the estimated premiums they would

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[9]Traditional insurance companies that operate in more than one state must abide by the regulations of each state in which they do business. Virtually all insurance activities in the United States are regulated at the state level. Medical malpractice insurers must follow state regulations governing such aspects of insurance as marketing, ratemaking, reporting of claims, and solvency.

[10]Although Tillinghast estimated the risk-retention group premiums at the same level as the premiums for a risk-purchasing group, they stated that the risk-retention group premiums might be slightly higher.

have paid under prior insurance arrangements. However, because providing capital for the risk-retention group would also cost the centers an estimated $17 million during the first 2 years,[11] the centers' estimated net savings could be further reduced to about $40 million.

In addition, there would be expenses associated with staffing and implementing the systems of the risk-retention group insurance company. Tillinghast did not include these initial start-up costs when it developed the estimates. If these costs were included, the centers' initial estimated cost would be somewhat higher and net savings would be somewhat lower than $40 million.

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Should you have any questions about these data, please call me on (202) 512-7117.

Sincerely yours,

Leslie G. Aronovitz
Associate Director
Health Financing Issues

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[11]In developing the amount of capital needed for the centers' risk-retention group between 1993 and 1997, Tillinghast estimated that the centers would have to contribute 100 percent of their estimated premiums in 1993 ($13.4 million) and 25 percent of their estimated premiums in 1994 ($4.0 million).