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REPORT TO THE LEGISLATURE

AMBULANCE SERVICE LIABILITY INSURANCE STUDY

MINNESOTA DEPARTMENT OF COMMERCE

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INTRODUCTION

The Minnesota appropriations bill, passed by the 2003 legislature, required a study of Ambulance Services Insurance in Article 4, Section 3:

> The commissioner of commerce shall study the availability and cost to ambulance services of vehicle and malpractice insurance and the factors influencing cost increases. The commissioner shall report the results of this study and recommendations on means to ensure continued availability of affordable insurance to the legislature by January 10, 2004.

SUMMARY

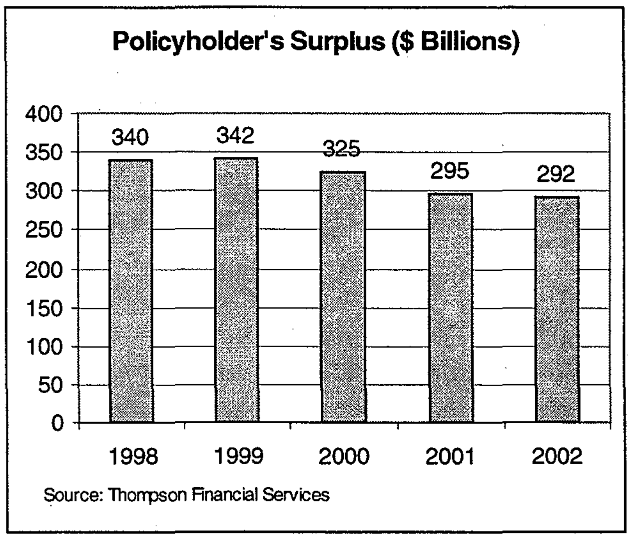
- The commercial insurance industry is in the third year of a hard market, a result of inadequate prices during the 1990's, decreased investment income, court decisions that expanded liability in ways not anticipated by the industry, and the World Trade Center terrorist losses in 2001. Many businesses seeking insurance have had availability and affordability concerns. Although there are some expectations that insurance price increases will be less in 2004, the conditions that led to the lower rates and readily available insurance in the 1990's are unlikely to reoccur.
- Those businesses needing medical malpractice insurance have had an even more difficult time. Insurance companies writing this line have had such unprofitable results that several major writers, including The St. Paul Companies, have withdrawn from the market. The lack of competition in the medical malpractice insurance market is a serious problem. Many Minnesota firms formerly insured with The St. Paul, including some Ambulance services, have had difficulty finding insurance and have seen dramatic increases in the cost of insurance over the past few years.
- Minnesota believes that competition is the most effective regulator of insurance prices. However, for those situations where insurance is required by statute and is not available, the legislature has established residual market mechanisms. The Minnesota Market Assistance Program is a referral service that helps applicants find insurance in the private insurance market. The Minnesota Joint Underwriting Association (JUA) is a source for most types of liability insurance. AIPSO (Automobile Insurance Plan Service Organization) provides automobile insurance. These groups charge market rates and are intended to be a short-term solution until a business can again find insurance in the private market.
- The most effective way to lower the cost of insurance is to lower either the frequency or average cost of losses. The insurance industry believes that changes in the tort liability system are needed, including a limit on non-economic and punitive damage awards. Ambulance Services insured through the League of Minnesota Cities Insurance Trust already have limited liability by statute. The legislature could limit the liability of all Ambulance Services for accidents. There are, of course, pros & cons for limiting tort liability.
- Businesses seeking insurance need to be actively committed to a risk-management program. Formal programs, written procedures and management involvement are all indicators of a safety conscious business. If losses have occurred, management must be able to explain what stops have been taken to ensure that similar incidents do not happen again. Businesses may also need to assume more of the risk through higher deductibles.

WHY COMMERCIAL INSURANCE PRICES HAVE RISEN

The insurance industry is currently in the third year of a hard market, plaguing many insureds with availability and affordability concerns. The root of the problem was a steady deterioration in insurance industry capital during the1990's, caused primarily by the industry's inability to adequately price their product. This was further exacerbated by stock market losses and a decline in interest rates, a major setback since two-thirds of insurance investments are in bonds. Additional problems developed as legal decisions expanded the types of losses that insurance policies covered in ways not anticipated by the industry. Medical costs also rose dramatically, forcing insurers to increase the amounts they hold in reserve to pay for past losses. Finally, the World Trade Center attack resulted in a sudden, severe capital loss that focused sharp attention on the potential weaknesses of many insurers and re-insurers. When the capital of an insurance company decreases, regulators and rating agencies and prudent business practices require the insurer to restrict writings until the capital is rebuilt. With the industry capital problems so widespread, many insurers were forced to be more selective and to raise prices. The market will remain hard until the capital position of the major insurers improves.

THE DETERIORATION IN INSURANCE INDUSTRY CAPITAL

The graph at the right summarizes the deterioration in insurance industry capital. In insurance terminology, capital is referred to as "Policyholders' Surplus". That phrase is misleading since this money is not surplus; it's the capital that supports past and future losses. The hard market arose from this decline. When capital falls below certain levels, regulators and financial rating firms and prudent business practices require insurers to restrict their writings until the capital is rebuilt.



There are various reasons why premiums and investment income did not adequately cover costs in the past years.

- In general, insurance costs rise because the costs of claims rise. When costs rise faster than insurance companies expect, the resulting shortfall results in lower profits or even losses that must be paid from insurance company capital funds.

  Increases in the cost of medical care, automobile repair and building repair and construction will all increase the cost of insurance. These are major things that insurance pays for. Insurance costs also increase when the number of claims increases. For example, more lawsuits lead to higher insurance costs. Similarly, the recent increase in the number of mold claims led to higher premiums for many property owners and construction companies.

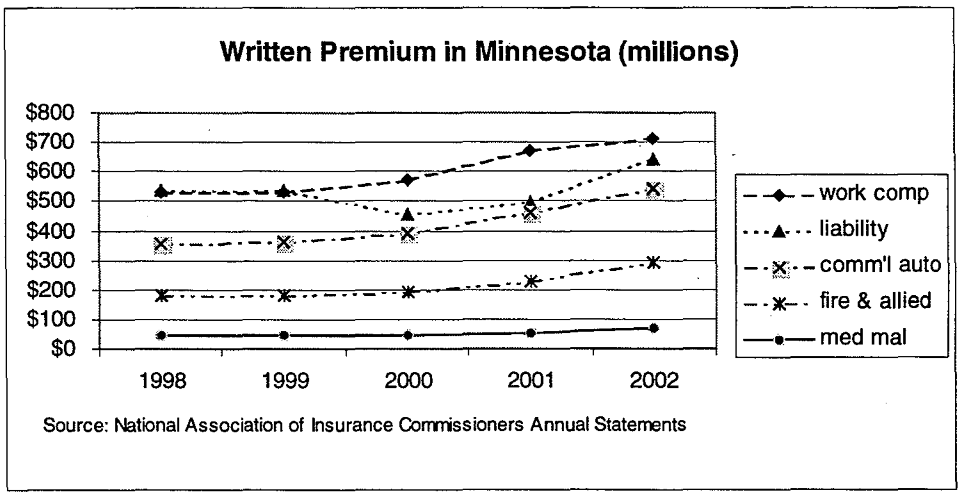
Changes in the law by the legislature or the courts can also increase the cost of insurance. Higher jury awards and settlements increase insurance rates.

An increasing number of catastrophic events have resulted in higher than expected losses and subsequent premium increases in property lines. The ten most costly catastrophes in the United States have all occurred since 1989 – including Hurricane Andrew & the Northridge earthquake.

- The recent problems in the United States economy also contributed to the insurance industry's lack of profitability. The decline in the equity market resulted in serious capital losses for the industry. In addition, investment income dropped as interest rates fell. Insurance investments are regulated by the states and about 2/3[rds] of invested assets are in bonds. The decreased investment income meant that premium income had to cover a greater share of insurers' costs.
- Losses on past policies have also been greater than expected. When reserves for past claims must be increased, this money comes from the insurer capital. Asbestos losses, in particular, have been a major problem for the insurance industry. Court decisions have expanded the coverage of policies in ways not anticipated by insurers when the policies were written. This additional coverage was not included in the price at the time and must now be funded from capital.
- The World Trade Center terrorist attack resulted in a sudden, severe erosion of the capital of insurers and re-insurers. This reduced immediately the ability of insurance companies to write new policies.
- Finally, reinsurance has become much more expensive. This segment of the insurance industry has faced even more acute profit and investment income problems. In the past year, 10 of the world's 15 largest reinsurers have been downgraded by the rating agencies. This increase in reinsurance costs for the primary company is passed through to the policyholder.

PREMIUM GROWTH IN MINNESOTA FOR SELECTED COMMERCIAL LINES

Commercial premiums were relatively stable and even decreasing during the competitive market of the1990's. However, this changed in 2001 and 2002, as most lines saw increases of 15% to 20%.



The graphs above show how wide-spread the insurance problems have been. Rates for almost all lines of business increased in 2001 and 2002. Underlying all of these increases is the decline in insurance industry capital discussed before. However, specific factors also influence the size of the rate increase by line of business. For example, the widespread increases in medical costs effect liability lines such as workers compensation and commercial automobile. An increase in the number of lawsuits or an expansion of what the policy covers or higher jury awards also effect the liability lines. Property lines are effected by the number and size of catastrophes. The increased reinsurance costs connected with the World Trace Center attack also had a direct and immediate effect on property lines.

The tables below show the actual dollars of premiums collected in Minnesota from 1997 through 2002 for the major commercial lines.. These are the numbers underlying the above graphs.

Minnesota Direct Written Premium

Year	Workers Comp		General Liability		Comml Multi Peril	
1997	467,000,000	-11%	486,000,000	2%	290,000,000	-10%
1998	529,000,000	13%	537,000,000	10%	336,000,000	16%
1999	529,415,000	0%	539,746,000	1%	357,554,000	6%
2000	569,680,000	8%	455,375,000	-16%	383,074,000	7%
2001	671,552,000	18%	495,143,000	9%	456,499,000	19%
2002	713,070,000	6%	645,289,000	30%	543,835,000	19%

Year	Commercial Auto		Fire & Allied Lines		Medical Malpractice	
1997	285,000,000	-13%	152,000,000	-9%	38,000,000	-24%
1998	354,000,000	24%	182,000,000	20%	45,000,000	18%
1999	361,984,000	2%	182,084,000	0%	48,219,000	7%
2000	388,699,000	7%	190,377,000	5%	49,089,000	2%
2001	459,381,000	18%	229,690,000	21%	54,394,000	11%
2002	541,585,000	18%	292,523,000	27%	68,280,000	26%

Pricing for commercial insureds is more flexible than pricing for personal auto or homeowners insurance. The rating structure typically allows for a wide range of underwriting judgment involving credits and debits. Various types of individual risk rating plans are also used. One result of this is that commercial insurance prices respond more quickly to changes in the market than do personal lines prices. Premiums go up and down more quickly.

PARTICULAR PROBLEMS ASSOCIATED WITH MEDICAL MALPRACTICE INSURANCE

The general insurance problems described above have been further compounded for those insurers writing medical malpractice insurance. This line has been particularly unprofitable for the insurance industry.

Medical Malpractice is a specialty line of insurance. A relatively small number of companies write this line. In 2000, when the St. Paul was an active writer, there were 56 companies writing med mal in Minnesota. However, two companies, Midwest Medical and St. Paul had 88% of the premium, with market shares of 49% and 39%, respectively. In contrast, there were 238 companies writing workers compensation and the two largest companies had only 16% of the market. To reach 88% of the market in workers compensation requires the combined premium from the top 84 companies. The lack of competition in medical malpractice is a serious problem.

During 2002, there were 61 companies writing malpractice insurance in Minnesota. Their written premiums and market share are shown in the table below. Clearly, no company has wanted to come in and write the book of business that the St. Paul had.

Malpractice Insurance Writers in Minnesota

Insurance Company	2002 Written Premium	2002 Market Share
Midwest Medical Ins Co	$35,523	52%
Lexington Ins Co	6,200	9%
St Paul Fire & Marine Ins Co	4,669	7%
Continental Cas Co	2,953	4%
Medical Protective Co	1,893	3%
NCMIC Ins Co	1,381	2%
American Excess Ins Exchange RRG	1,256	2%
American Cas Co Of Reading PA	1,248	2%
OneBeacon America Ins Co	1,150	2%
Evanston Ins Co	1,106	2%
All Other Companies	10,901	16%
Total Malpractice Insurers	68,280	100%

The medical malpractice insurance problems are countrywide. The losses incurred by medical malpractice insurers have led to several bankruptcies & exits from the market, depleting capacity. In 2001, Phico Group, which wrote $182 million in premium in 2000, was taken under control by regulators. That same year, Frontier Insurance Group, which wrote $69 million in premium, and the St. Paul Companies, with $575 million in premium, withdrew. At the time of its withdrawal, the St. Paul was the leading malpractice writer in the country, with approximately 10% of the market. In 2003, Farmers, another large writer of medical malpractice with 5% of the market, announced its withdrawal. The largest remaining writer, New York based Medical Liability Insurance Company has been downgraded by Bests' rating agency to B+++ (very good). There have never been many insurance companies that wanted to write med mal. Those insurers that remain in the market underwrite and price carefully. They may or may not be interested in absorbing displaced policyholders.

The decision of The St. Paul Companies to exit the medical malpractice business has had particularly serious repercussions for many health-related businesses in Minnesota, including Ambulance Services. The Minnesota Ambulance Association (MAA) surveyed some of their members about the availability & cost of insurance. Those Ambulance Services that are insured through the League of Minnesota Cities Insurance Trust or the Association of Minnesota Counties Insurance Trust are not experiencing any problems with availability & have not seen large price increases. However, insureds in the private market that were insured by the St. Paul have had trouble finding insurance and, when it is available, it is more expensive.

The MAA provided the Department of Commerce with responses from eight businesses. The survey did not break down the premiums by line of business so we cannot say where the increases have occurred. Ambulance Services would purchase professional liability, workers' compensation, commercial auto liability, general liability and, possibly, Directors & Officers & property coverages. Two of the eight companies who responded to the survey reported no problems. The other six have had significant cost increases. Five of these were insured by the St. Paul.

(1) Company #1 reported that insurance was not difficult to obtain but insurers were charging higher premiums & requiring increased deductibles. Premiums were $598,000 with no deductible in 2001 versus $194,000 with a $250,000 deductible in 2003. The company was insured by the St. Paul.

(2) Company #2 reported premiums of $265,000 in 2002 & $525,000 in 2003. They were insured by the St. Paul.

(3) Company #3 reported that they were part of a coop & that prices had not risen sharply for them.

(4) Company #4 reported a 35% increase in 2002 & a 15% increase in 2003.

(5) Company #5 reported that their major problem was with commercial automobile insurance. When premiums of $140,000 in 2000 were quoted at $380,000 in 2001, the service dropped the physical damage coverage & purchased only liability. The premium was $116,000 with a $250,000 per occurrence deductible. They were insured by the St. Paul.

(6) Company #6 also reported problems with commercial auto coverage. Premiums increased from $146,000 in 2001 to $374,000 in 2002. They were insured by the St. Paul.

(7) Company #7 reported premium increases for vehicle & business insurance of 5% in 2000, 7% in 2001 & 38% in 2002. Premiums rose from $29,000 in 1999 to $30,500 to $32,700 to $45,000 in 2002. They were insured by the St. Paul.

(8) Company #8 has not had any problems securing coverage & has not seen significant increases. However, they are concerned that this may change in the future.

Insurance for Ambulance Services is a countrywide issue & has been a problem for a long time. The American Ambulance Association at a professional education conference in Minneapolis in July 2003, had one session devoted to insurance issues, which I attended. There were two speakers from the insurance industry. These men both made it clear that when the St. Paul exited the medical malpractice market, they joined a long line of companies that tried to write health related insurance and found it to be too unprofitable to continue. One man read a list of 31 insurance companies that had been in this market at one time & had left. In his opinion, current rates are commensurate with the risk & are where they should have been years ago. Both men stressed the importance of loss control and risk management.

Currently, in Minnesota, although prices are high, there do not appear to be problems with availability. Beth Devine at the JUA (Joint Underwriting Association) has not had any applications from ambulance services or any questions about coverage. This is not an activated class at the JUA.

COMPETITION IS THE MOST EFFECTIVE REGULATOR OF INSURANCE PRICES

Minnesota believes that price competition is the most effective way to assure the availability of property/casualty insurance at costs that are fair and reasonable. Price controls are difficult to implement and enforce and have unanticipated side effects. Even in a tight insurance market, not all commercial businesses looking for insurance have the same problems. In particular, those businesses with fewer losses and well-managed safety programs have a better chance of finding coverage.

Even though capital problems are widespread throughout the insurance industry, insurance companies are also not affected equally. For example, some insurers were hurt more than others by the stock market decline. Similarly, the tremendous losses from asbestos claims are not being incurred by all insurers. As insurance companies with capital resources become aware of profitable options, they will seek to expand their markets in those areas. However, given the historic profitability of medical malpractice insurance, insurance companies may be reluctant to move into this line.

Alternative market options may also develop. Currently, about 60%-70% of the U.S. malpractice business is handled by physician-owned mutuals. The American Ambulance Association is also facilitating the discussion of captive options.

In Minnesota, those situations where insurance is required by statute and is not available receive special attention. For these areas, the legislature has established residual market mechanisms, such as the Workers Compensation Assigned Risk Plan, the Automobile Insurance Plan (AIPSO) for commercial and personal automobile insurance, and the Minnesota Joint Underwriting Association (JUA) for other types of commercial liability insurance.

The JUA provides liability insurance to businesses that cannot obtain insurance through ordinary methods. The insurance must be required by law or it must be necessary to earn a livelihood or conduct a business and must serve a public purpose. It is not available for product liability or environmental impairment coverage. The application is forwarded to the JUA through the Minnesota Market Assistance Plan (MMAP). The MMAP has 30 days to produce a quote for the applicant before the JUA can provide coverage. If the MMAP is not able to produce a quote, and the statutory requirements for JUA coverage have been met, the JUA then provides coverage. The JUA issues a standard policy and charges market rates. It is intended to function as a short-term provider of basic coverage. The JUA is not a true insurance company. It is ultimately funded by the taxpayers in Minnesota.

The most effective way to lower the cost of insurance is to lower either the frequency or the average cost of claims. One way to lower the average cost of claims is to limit the liability of Ambulance Services. As previously stated, services that are insured through the League of Minnesota Cities Insurance Trust or the Association of Minnesota Counties Insurance Trust have experienced very little problems in obtaining coverage with "affordable" prices. The major reason for this appears to be the fact that the members' municipalities of these trusts have limited liability for their tort claims, based on Minnesota Statutes 466.01 to 466.15. The private ambulance companies might pursue legislative action to have their limits of liability capped similar to municipalities.

> Every municipality is subject to liability for its torts and those of its officers, employees and agents acting within the scope of their employment or duties when arising out of governmental or proprietary function. However, based on Minnesota Statute §466.04, limits of liability for any municipality on any claim shall not exceed:
>
> (1) $300,000 when the claim is 1) for death by wrongful act or admission and $300,000 to any claim in any other case;
>
> (2) $750,000 for any number of claims rising out at a single occurrence, for claims rising on or after January 1, 1998 and before January 1, 2000;
>
> (3) $1,000,000 for any number of claims rising out at a single occurrence, for claims arising on or after January 1, 2000; or
>
> (4) Twice the limits provided in cause (1), (2), (3) when the claim arises out of the release of a hazardous substance.
>
> No award for damages on any such claim shall include punitive damages.

WHAT OPTIONS DO CONSUMERS HAVE IN A TIGHT MARKET?

In a hard market, it is even more important for businesses to be actively committed to a risk-management program. Formal programs, written procedures and management involvement are all indicators of a safety conscious business. If there have been losses, management must be able to explain what happened and what steps have been taken to ensure that similar incidents do not occur again.

Businesses also need to reevaluate their insurance needs in cost/benefit terms. They may find it necessary to assume more of the risk through higher deductibles.

As mentioned before, Minnesota has a Market Assistance Plan (MMAP) and a Joint Underwriting Association (JUA) to assist businesses that are having problems finding coverage. The MMAP will assist in contacting admitted insurers as well as alternative insurance markets, primarily excess and surplus lines carriers. The JUA, if necessary, will write basic coverage.

The JUA can be reached at 651-222-0484.

This study cost the Department of Commerce $10,875.00.

Nancy Myers, Department of Commerce
John Gross, Department of Commerce