The State of New Hampshire
Insurance Department
21 South Fruit Street, Suite 14
Concord, NH 03301
(603) 271-2261 Fax (603) 271-1406
TDD Access: Relay NH 1-800-735-2964

Roger A. Sevigny
Commissioner

Alexander K. Feldvebel
Deputy Commissioner

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New Hampshire Medical Malpractice Joint Underwriting Association: The New Hampshire Insurance Department's Determination of Required Surplus

The NHMMJUA was established in 1975 by the Insurance Commissioner, pursuant to his authority under RSA 404-C:1 "to provide such insurance coverage for any risks in this state which are equitably entitled to but otherwise unable to obtain such coverage." The creation of the NHMMJUA was a broad public policy response to an increasingly tight market for malpractice insurance at reasonable rates, which was ultimately harming the public by reducing the availability and affordability of health care. The NHMMJUA is a state created entity. Its operation is controlled by regulations promulgated by the Commissioner and set forth at Ins 1700.

The NHMMJUA provides malpractice insurance at competitive market rates to any eligible health care provider. All insurers eligible to write liability insurance of any kind in New Hampshire must be "members" of the NHMMJUA, and are subject to assessment should the NHMMJUA be unable to pay losses and expenses from premium collected. Ins 1703.07. As is the case with a private insurance company, accumulated surplus in the NHMMJUA is also available to pay losses and expenses when collected premiums are inadequate.

In 1985, the NHMMJUA was facing substantial future deficits in meeting expected claims. Following the recommendations of Governor Sununu's Medical Liability Committee, a Stabilization Reserve Fund Trust (SRFT) was set up to fund all obligations on policies written prior to January 1, 1986. The Trust was capitalized with the then existing assets of the NHMMJUA and with a 15% surcharge on medical malpractice liability insurance. This surcharge was in place for a number of years. The SRFT now has a surplus of approximately $8 million, and the NHMMJUA Board is in the process of seeking bids on a reinsurance agreement whereby a private reinsurer would take over the remaining liabilities of the SRFT for approximately the amount of the remaining surplus, allowing it to be closed.

The NHMMJUA's business written on or after January 1, 1986 is separately accounted for and, under Ins 1700, is subject to different rules as to who is assessed or surcharged for any deficit. Member insurers are assessed in the first instance, but may be reimbursed through an assessment of health care providers and a surcharge on liability insurance policies.

Members of the post 1985 NHMMJUA have never been assessed. Neither has there been an assessment on health care providers or a surcharge on liability policies. Instead, the NHMMJUA has accumulated a very large surplus. Although the year end 2008 financial statement has not been finalized, the reported surplus is expected to be in the range of $140 million to $145 million. This surplus is a result of very efficient operations, good claims management and sound investments over a number of years by the NHMMJUA board and its management staff. The surplus has also accumulated as a result of the fact that the NHMMJUA does not pay New Hampshire premium tax under RSA 400-A:32, annual federal income tax on operational profits, if any, and the assessment on insurers pursuant to RSA 400-A:39 that funds the operations of the Insurance Department.

The Department believes that the current estimated statutory surplus significantly exceeds the amount of capital needed to support the NHMMJUA. The Department has not engaged in any formal actuarial exercise in reaching this conclusion. The Department bases its belief on a number of considerations, including: (1) possible changes to the New Hampshire medical malpractice market that would increase the NHMMJUA's market share; (2) the NHMMJUA's performance and experience over the past 10 years and the likelihood that this experience will continue; (3) medical malpractice insurance industry premium to surplus ratios which can be used as a benchmark of financial solvency and stability; (4) Risk Based Capital ratios calculated as part of an independent analysis performed by Towers Perrin for the NHMMJUA and provided to the NHID for this purpose; (5) consideration of the Risk Based Capital level maintained by a local and major insurer in the New Hampshire medical malpractice insurance market; and (6) a recognition that the financial results for medical malpractice insurers are subject to significant variability and uncertainty.

The Department believes that it would be reasonable to retain a surplus of $55 million to support the NHMMJUA, allowing the remainder of the surplus to be transferred to the General Fund without placing the NHMMJUA under any significant financial risk. The Department's view is that a surplus level of $55 million would provide surplus in excess of the current capital needs of the NHMMJUA, thus offering a cushion that would not only provide sufficient protection against future contingencies, but would also help the NHMMJUA fulfill its purpose of providing a viable backstop in the event of the deterioration of the voluntary medical malpractice marketplace.

The following provides additional detail regarding the Department's methodology.

<u>Facts and Assumptions</u>

1. 2008 written premium for the NHMMJUA was approximately $8.5 million

2. The written premium in 2008 for the entire medical malpractice market is estimated to be approximately $40 million, based on the most recent calculation of the NHMMJUA market share of 20% (based on 2007 data).
3. Historically, a premium-to-surplus ratio of 2.0 to 1.0 is considered to be the benchmark at which regulators become concerned that an insurer does not have the financial strength to support its premium writings. This ratio is a "rule-of-thumb" for a multi-line property and casualty insurer, writing a well-balanced and distributed book of business.
4. Based on 2007 Annual Statement data, the premium-to-surplus ratio for the two leading insurers writing medical malpractice insurance in New Hampshire (Medical Mutual of Maine and ProSelect) as well as two other insurers with small New Hampshire market share but with extensive medical malpractice writings nationally (Medical Protective and The Doctors Company) is approximately 0.5 to 1.0.
5. The NHMMJUA has reported favorable experience for many years. The surplus has grown from essentially $0 in 1986 to its present level in 2008, in large part due to favorable experience, favorable state and federal tax treatment, and investment returns from the business written in the late1980's and early 1990's.
6. The Department believes it is prudent to retain a surplus amount that is somewhat conservative in order to address the significant uncertainties associated with the market dynamics for medical malpractice insurance.

Calculations Using Different Benchmarks of Capital Adequacy and Various Scenarios Regarding Market Share

A. Capital Adequacy Benchmark: Premium-to-Surplus Ratio
Market Share Scenario: Ranging from Current Voluntary Market Dynamic to Complete Voluntary Market Collapse

1. Using a premium-to-surplus ratio of 0.5 to 1.0 (matching the average ratio of leading medical malpractice insurers in New Hampshire), approximately $17 million would be a reasonable level at which to carry surplus, assuming that there will not be any need to have the NHMMJUA assume a larger percentage of the market. (8.5 / 0.5)
2. Today's medical malpractice market is reasonably healthy (not competitive as defined in RSA 412:13 through 15, but healthy in that there are a few insurers, regulated and not, who chose to do business here). However based on past history of this market, there is a possibility that most or all insurers could exit the market, leaving the NHMMJUA as, effectively, the sole writer of medical malpractice insurance. Assuming that the NHMMJUA's current market share is 20%, and assuming present rate levels are maintained, approximately $85 million of surplus would be necessary.
3. This leaves a surplus range from $17 (needed to support a NHMMJUA that stays at the current level of writing) to $85 million (needed to support all persons currently insured

by either the NHMMJUA or the voluntary market).

B. Capital Adequacy Benchmark: Risk Based Capital – General Industry Standard
Market Share Scenario: Ranging from Current Voluntary Market Dynamic to a Major Voluntary Market Breakdown

1. Towers Perrin performed an analysis of Risk Based Capital (RBC) levels for the NHMMJUA reflecting current performance metrics as well as possible changes in the market. RBC is a method developed by the National Association of Insurance Commissioners to measure the minimum amount of capital that an insurance company needs to support its overall business operations. RBC is used to set capital requirements considering the size and degree of risk taken by the insurer, which considers various factors including growth, profitability and the characteristics of the exposure written.

2. Four scenarios were modeled ranging from the NHMMJUA continuing to grow modestly to the departure of two major carriers from the New Hampshire market.

3. Since most insurance companies try to operate at an RBC level that is at least 300-350% of the "Authorized Control Level" (ACL), Towers Perrin used 300% of ACL as the industry minimum benchmark.

4. Using this method, in 2012, the NHMMJUA will need a surplus of at least $15 million under the modest growth scenario and at least $46 million under the scenario in which the two major voluntary writers have left the market.

C. Capital Adequacy Benchmark: Risk Based Capital of a Leading Medical Malpractice Insurer Doing Business in New Hampshire
Market Share Scenario: Current Voluntary Market Dynamic

1. Because the medical malpractice insurance market is, arguably, an inherently volatile market with long tail exposures, there is some reason to apply an RBC standard that is higher than the 300%—350% industry benchmark that is based on all lines of insurance.

2. To establish a meaningful alternate standard, the Department selected a major carrier in the New Hampshire voluntary market whose book of business reflects local market conditions and whose surplus appears to be maintained at a managed level. This company was Medical Mutual of Maine, whose RBC is 1175% of ACL, based on 2007 statutory financial information.

3. Based on the NHMMJUA's current level of writing, surplus would have to be maintained at $56 million in order to be at 1175% of ACL.

Combining the Benchmarks for Capital Adequacy as Well as the Different Ways of Viewing the Contingencies Regarding Market Share

1. A reconciliation of the above calculations requires consideration of the interplay between three different benchmarks for capital adequacy and two different worse case scenarios regarding the market share that the NHMMJUA would have to assume in the event of a partial or complete breakdown of the voluntary market.
2. In balancing these considerations, the Department found the following three numbers to be the most meaningful:

    a. $ 51 million – this is the midpoint of the range developed from Calculation A.
    b. $ 46 million – this is the high end of the range developed from Calculation B.
    c. $ 56 million – this is the point estimate from Calculation C.

3. Based on these three numbers, the Department believes that it is appropriate and sound policy to maintain a surplus level for the NHMMJUA of $55 million.