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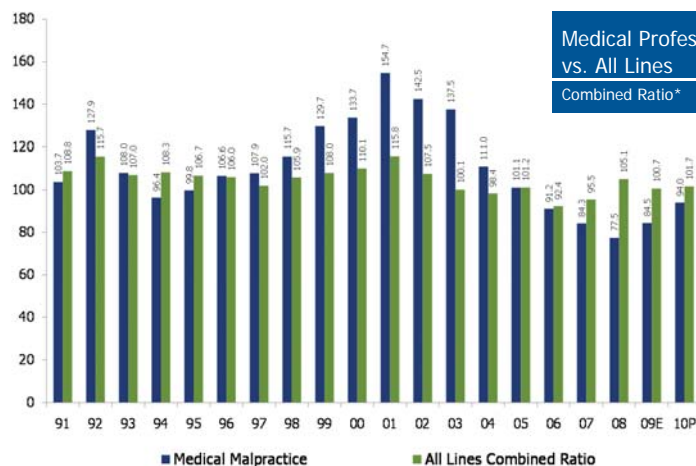
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Frequency in medical malpractice claims has dropped consistently since 2000. Although industry experts cannot agree on a single reason for the frequency decline, improved patient safety measures, physicians becoming more risk averse, tort reform in several states, and increasing selectivity of plaintiff attorneys have been cited as possible factors.

2008 was one of the best years ever for medical malpractice insurers. A.M. Best reports the combined ratio dropped steadily from 137.5 percent in 2003 to 77.5 percent in 2008 (see graph). A key contributing factor was favorable reserve development, which means insurers had set aside more dollars than were ultimately needed to pay claims. Favorable reserve development accounted for slightly more than \$1 billion in favorable underwriting results in 2008.



Medical Professional Liability vs. All Lines

Combined Ratio*

E: Estimated
P: Projected

*The combined ratio is a measurement of carrier profitability and is calculated by dividing the sum of the ultimate projected losses plus carrier expenses by the premium. Combined ratios also offer evidence of pricing sufficiency and provide clues to future pricing trends. As a general rule, primary insurance carriers can produce a profit when combined ratios are in the 105.0-108.0 for longer-tail casualty lines due to their ability to invest the "float" and generate substantial income.

Source: AM Best, Co.

Medical Professional Liability market capacity is plentiful. We are currently experiencing flat to slight decreases during the majority of our renewals.

There are signs, however, that the soft market may be coming to an end. Some actuaries speculate the frequency decline may have leveled off and expect to see trends creep back up, with a 1 percent increase projected for 2010. Claim severity, including both indemnity and defense costs, continues to increase at a consistent rate of 3 percent to 4 percent per year. Tort reform is under attack in some states. Illinois law was recently struck down by its Supreme Court and other states' laws are being challenged in the courts, including those of Kansas and Missouri.

Factors that may influence medical professional market conditions include uncertainty surrounding the impact of healthcare reform and continued economic pressures. In the 1980s, claim frequency spiked in 1985, three years after unemployment reached 10 percent. If frequency begins to increase at a greater pace than anticipated, it will only take a short time to adversely impact underwriting results.

A.M. Best projects that for every percentage reduction in investment yield, medical malpractice insurers must reduce their combined ratio by a corresponding 5.2 percentage points in order to maintain the same profit. A sustained period of significantly lower investment returns, along with an increase in claim frequency, will mean insurers must maintain or improve underwriting results in order to survive.

Network Security/Privacy Impact on the Healthcare Industry

Healthcare organizations are facing many new and evolving privacy and security breach laws at both the state and federal levels. In 2009, the federal government enlarged the scope and impact of its enforcement. Under the Health Information Technology for Economic and Clinical Health (HITECH) portion of the American Recovery and Reinvestment Act, Congress changed Health Insurance Portability and Accountability Act (HIPAA), increasing the risks and responsibilities for the healthcare industry. These changes include a mandatory notification obligation on covered entities in the event of a personal healthcare information breach when the information is in an “unsecured format” and has been or is reasonably likely to be accessed, acquired, or disclosed. In addition, the HITECH Act establishes four tiers of Health and Human Service penalties ranging from \$100 to \$50,000 for each violation not to exceed \$25,000 to \$1,500,000 per calendar year. HIPAA has now become the first national data breach notification law after six years of state-by-state notification laws. These changes have had a profound impact on consumer-based businesses, including covered healthcare organizations and their business associates from a financial and reputational harm perspective.

With stakes being much higher and the scope of regulations affecting the wider healthcare industry as never before, it is important for healthcare organizations to review their organizational network security/privacy exposures and prevention efforts including:

- ❖ Cross-functional risk management team or committee
- ❖ Risk management policies and procedures
- ❖ Privacy and security prevention programs
- ❖ Business associate and vendor management due diligence and contracts
- ❖ Data breach notice response plan
- ❖ Insurance protection for security and privacy risks

While many of the traditional property and casualty insurance policies may have significant limitations or may not effectively transfer network security and privacy risks, the insurance industry has developed more comprehensive insurance coverage solutions that will allow an organization to transfer this risk to an insurance carrier, including notification costs and privacy regulatory investigations. Some healthcare organizations have considered “Cyber Liability” policies previously and found them to be difficult to understand, too narrow in focus, or not cost effective. The good news is that the best industry products today are much better in scope of coverage and value. Lockton is in the leadership position on expanded and cost-effective insurance programs, including the development of reputational harm coverage from a data breach.