

Private Hospitals

Benchmarking Study of Liability Insurance

Prepared for APHA, CHA & Mayne

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Summary of Key Findings

The medical indemnity insurance market for private hospitals is in turmoil.

SURVEY COVERAGE

This benchmarking study includes 160 hospitals with 70% of Australia's private hospital beds, and is thus representative of the industry

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COST OF PREMIUMS

Premiums in 2002 increased by 130% over 2001, averaging \$1,700 per bed (up from \$750 per bed)

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EXCESSES

At the same time the per claim excess carried by hospitals is much higher (averaging \$75,000 compared with \$23,000 in 2001), with many hospitals carrying the first \$100,000 or more of each claim. The cost to hospitals of the excesses is likely to be \$10m to \$20m

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COVER

Hospitals are obtaining less cover. Out of 38 respondents, 13 obtained less cover in 2002, and only 1 obtained more

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HOSPITAL SIZE

Smaller hospitals have experienced the sharpest increase in premiums (average 290% compared with 160% for larger independent hospitals and 110% for hospital groups)

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The study highlights a number of financial and strategic issues for the industry, warranting attention both by individual hospitals and at an industry level

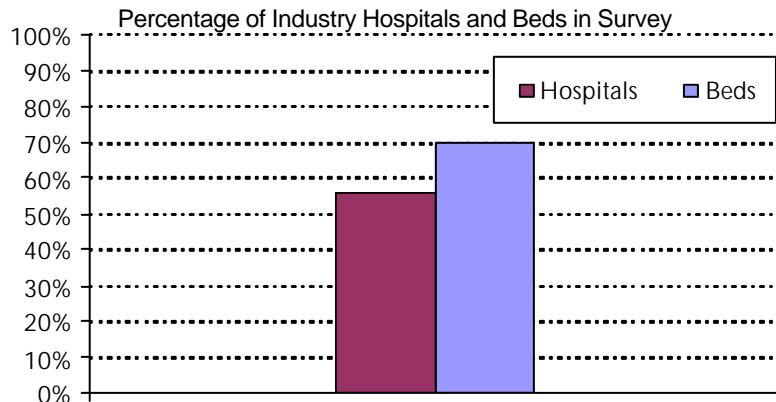
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Introduction

- Trowbridge Deloitte has been asked to undertake a benchmarking study for Australian private hospitals, to be made available to the industry and individual participants. The study examines the cost of liability insurance (medical professional liability and public liability) and particularly the increase in cost in 2002.
 - The study relies on the provision of relevant information by hospitals based on a questionnaire designed by Trowbridge Deloitte and agreed by the respective associations. The process involved collating and analysing available data relating to insurance policies for 2002 and 2001.
 - All individual details provided by hospitals for the study are confidential and have been published on an aggregate basis to protect confidentiality. Information on policy excesses has not been shown for the largest hospital groups because of the distortion caused to the overall results.
 - The results primarily describe the changes in premiums and excess levels private hospitals are experiencing in 2002 compared to 2001. They are expressed as follows:
 - Premiums - dollar amount as supplied : actual increases
 - \$ cost per bed : an expression of premium increase per unit of exposure
 - as a % of hospital revenue
 - Excess - Weighted¹ by bed count to give an average excess
 - Results were also examined against a number of factors (subject to having adequate data): type of hospital, number of beds, group vs independents and locality.
1. $\text{Sum of (Excess level * beds) / (Total number of beds)}$

Survey Market Participation

The study is representative of the industry, being based on data covering 160 hospitals representing 70% of the beds in the industry



Data represented by:

	Number of Responses	Number of Hospitals	Number of Beds
Groups of Hospitals	8	129	13,338
Individual Hospitals	31	31	3,380
Total Benchmarking study	39	160	16,718
Industry Total		302	23,665
% of Industry Total		53.0%	70.6%

- Questionnaires were distributed to private hospitals through their industry associations. Responses were received individually by Trowbridge Deloitte over a three week period. However in some cases not all data sought was able to be obtained, in particular claims history and exclusion clauses.
- Hospital groups are described as where a single policy covers more than one hospital. Individual hospitals are described as where a separate insurance policy covers one hospital. Single returns were received from groups. Industry total figures are sourced from the Australian Bureau of Statistics for year 1999/00.
- The data excludes 15 hospitals that had their last insurance renewal prior to January 2002 and thus have not yet had a renewal in calendar year 2002. It also excludes Day Surgeries.

Summary at an Aggregate Level

Liability insurance costs on average \$1,731 per bed, an increase of 130% over the previous year. At the same time, the average excess met by hospitals is \$75,000 on each claim, an increase of 250% over the previous year

Average Premium per Bed - Liability Insurance



Industry			
Total Aggregate	2002	2001	Increase
Premiums Paid	28,945,030	12,012,815	141%
Premium Rate per Bed	1,731	764	127%
Premium rate as % Revenue	0.87%	0.43%	106%
Weighted Average Excess*	74,455	21,255	250%

* These figures exclude the experience of the groups which severely distort the experience

- *Note that this cost is premium only it does not include the anticipated cost of excesses.*
- As a percentage of hospital revenue, liability insurance costs 0.87% on average, up from 0.43% last year.
- Aggregate liability premiums in 2002 in the sample are \$28.9 million, an increase of 141%, even with a significant increase in excess assumed by hospitals.
- The total premiums for the industry are likely to be about \$40 million, based on 70% of beds covered by the survey. This excludes the cost of excesses which are discussed on the next page

Implications of Higher Excesses

- Excesses per claim of \$100,000 are now common, with a few hospitals carrying \$250,000 or \$1 million per claim.
- Most claims will fall entirely under the excess for most hospitals. It is a major challenge for hospitals to manage this risk, both administratively and financially.
- Few hospitals have made estimates of the likely cost to them of excesses. Across the industry, this cost is likely to total \$10 million to \$20 million, in addition to the premiums paid.
- Claim excesses can represent a substantial unrecognised liability, especially given this is long tail business.
- For one hospital the per claim excess is 2.5% of its annual revenue. If it had two large claims in a year, the cost would be 5% of revenue.
- With an excess of \$250,000 or more, a hospital should consider itself to be a “self insurer” buying catastrophe insurance, and manage this risk accordingly.
- Hospitals should not overlook the potential of multiple occurrences of claims below the excess in a single year and the effect that this would have on the hospital’s finances.

Some Typical Examples

Urban Specialty Clinic – 20 Beds

2001	-	\$20m cover, \$10,000 excess	\$57,000 premium
2002	-	\$10m cover, \$100,000 excess	\$290,000 premium

2 Rural Hospitals, 90 Beds – Medical and Surgical

2001	-	\$20m cover, \$10,000 excess	\$32,000 premium
2002	-	\$10m cover, \$35,000 excess	\$60,000 premium

Forced to cease elective caesarean sections and post natal services

Regional hospital 44 Beds – Surgical and Medical

2001	-	\$10m cover \$10,000 excess	\$37,000 premium
2002	-	\$5m cover \$250,000 excess	\$360,000 premium

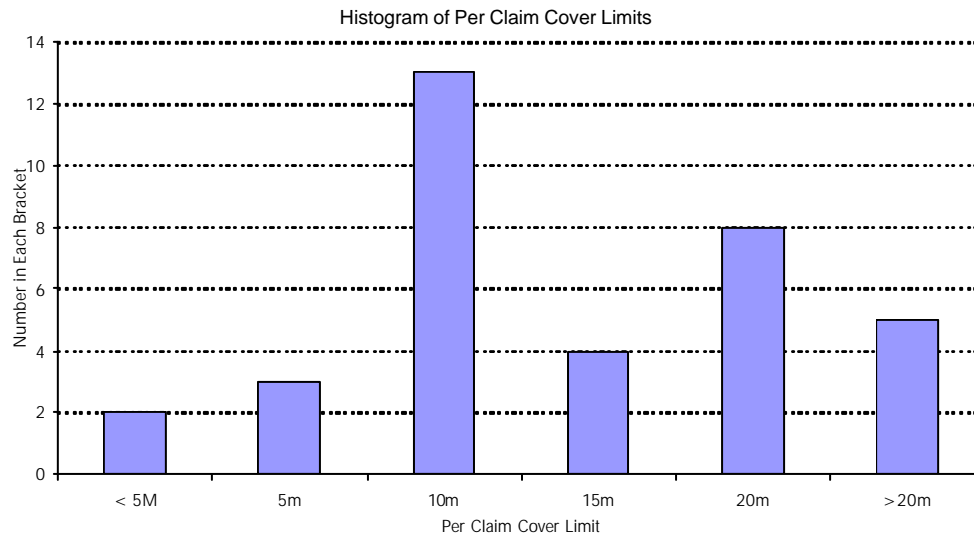
This was one of the more extreme examples

Amount of Cover Purchased

Many hospitals bought less cover in 2002

Of the 38 respondents:

- 10 bought less cover than in 2001 (both per claim and aggregate)
- 2 bought less “aggregate”, but the same per claim
- 1 bought more per claim but less aggregate
- 1 bought more per claim and aggregate
- 24 bought the same cover as in 2001

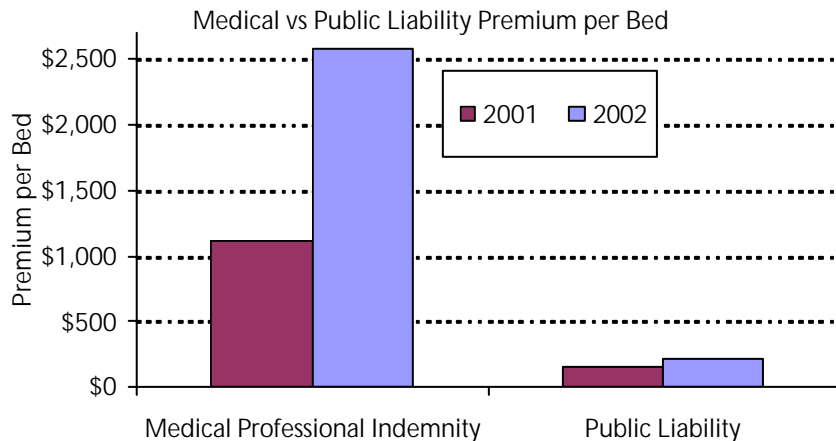


The reference to “aggregate” is a reference to the total cover available to the hospital for all claims reported for a given year. For many hospitals, the annual aggregate was the same as the limit of cover.

We would have some concern about the adequacy of cover for those with \$5 million or less.

Medical Professional Liability vs Public Liability

Medical professional indemnity contributes most of the premium cost (92%), and has increased much more than public liability



Hospitals with Separate Policies Only*			
	2002	2001	Increase
<i>Premium as an Actual Dollar Amount</i>			
Medical Professional Indemnity Premiums	17,694,894	7,511,439	136%
Public Liability Premiums	1,511,972	1,077,263	40%
Total Liability Premium	19,206,866	8,588,702	124%
<i>Premium per bed</i>			
Medical Professional Indemnity Premiums	2,584	1,113	132%
Public Liability Premiums	221	160	38%
Total Liability Premium	2,805	1,272	120%
<i>Premium as a % of Revenue</i>			
Medical Professional Indemnity Premiums	1.21%	0.60%	102%
Public Liability Premiums	0.10%	0.09%	20%
Total Liability Premium	1.32%	0.69%	91%

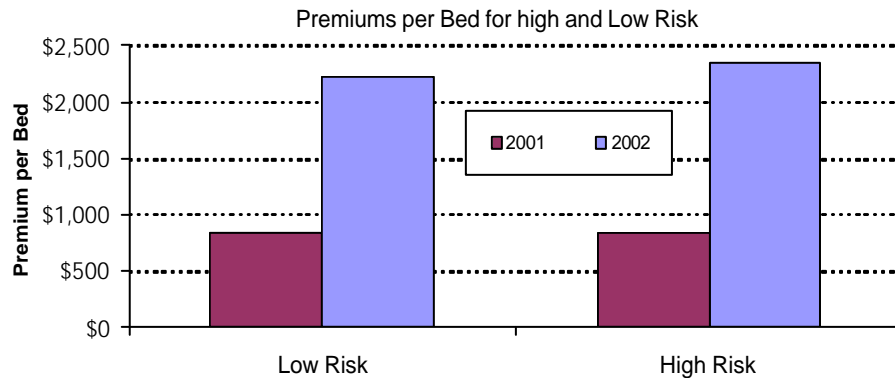
* Sample of 31 hospitals

- There appears to be a slight move towards combined Medical Professional Indemnity/Public Liability coverage. This may have been to achieve the most favourable placement of cover. The remaining hospitals purchase separate policies, and the table shows the data for these 31 hospitals separately for the two classes of insurance. While only covering 41% of beds in the survey, we believe the data reasonably reflects the trends in each type of insurance.
- It is evident that Medical Professional Indemnity is the dominant issue in terms of cost as it contributes 92% of the liability cover where they remain separate and has experienced an increase much higher than public liability.

High Risk vs Low Risk Comparison

Liability premium costs and the increase in costs are broadly similar across risk profiles.

Hospitals offering “High Risk” services have a higher excess level on average.

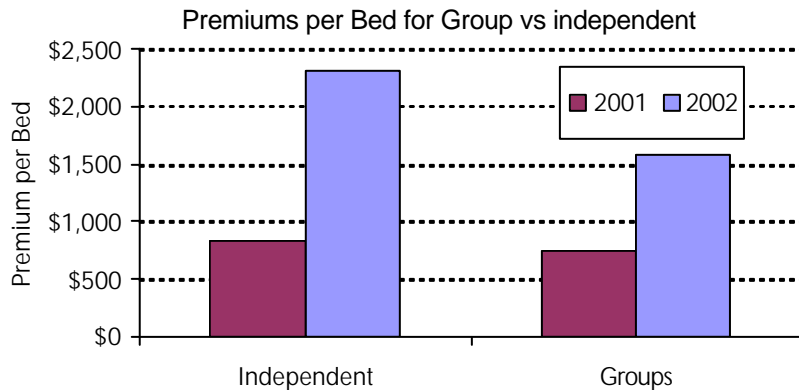


High Risk Vs Low Risk Service Hospitals (independents only)			
	2002	2001	Increase
HOSPITALS WITH HIGH RISK SERVICES			
Total Premium	5,698,624	2,009,650	184%
Premium per bed	2,349	828	184%
Premium as % of Revenue	0.95%	0.36%	165%
Weighted Average Excess	93,469	23,956	290%
HOSPITALS WITHOUT HIGH RISK SERVICES			
Total Premium	2,118,486	795,350	166%
Premium per bed	2,221	847	162%
Premium as % of Revenue	1.4%	0.6%	147%
Weighted Average Excess	52,549	13,740	282%

- The combined liability premium for hospitals with high risk services increased by about 20% more than those without high risk services .
- The per bed cost for high risk is 6% more than low risk.
- **We have defined high risk to be those hospitals that perform any obstetrics and/or neurosurgery. While this is a crude measure it gives some guide to possible differences.**

Group vs Independent Hospitals

There is a clear difference between the experience of the independents and the group hospitals.



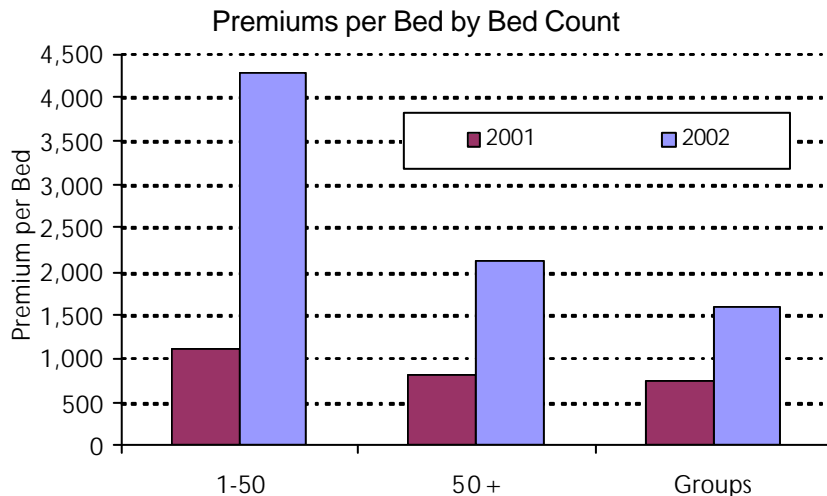
Group vs Independent Comparison			
	2002	2001	Increase
GROUP HOSPITALS			
Total Premium	21,127,920	9,207,815	129%
Premium per bed	1,584	745	113%
Premium as % of Revenue	0.83%	0.43%	90%
Weighted Average Excess	N/A*	21,296	
INDEPENDENT HOSPITALS			
Total Premium	7,817,111	2,805,000	179%
Premium per bed	2,313	834	177%
Premium as % of Revenue	1.03%	0.40%	160%
Weighted Average Excess	81,919	21,105	288%

* These figures have been distorted by the experience of three large groups and these have been excluded.

- Costs per bed are around 45% higher for independents.
- Independents experienced a higher average increase (on all measures).

Summary by Bedsize

The smaller hospitals have experienced the sharpest increase in premiums and pay more per bed



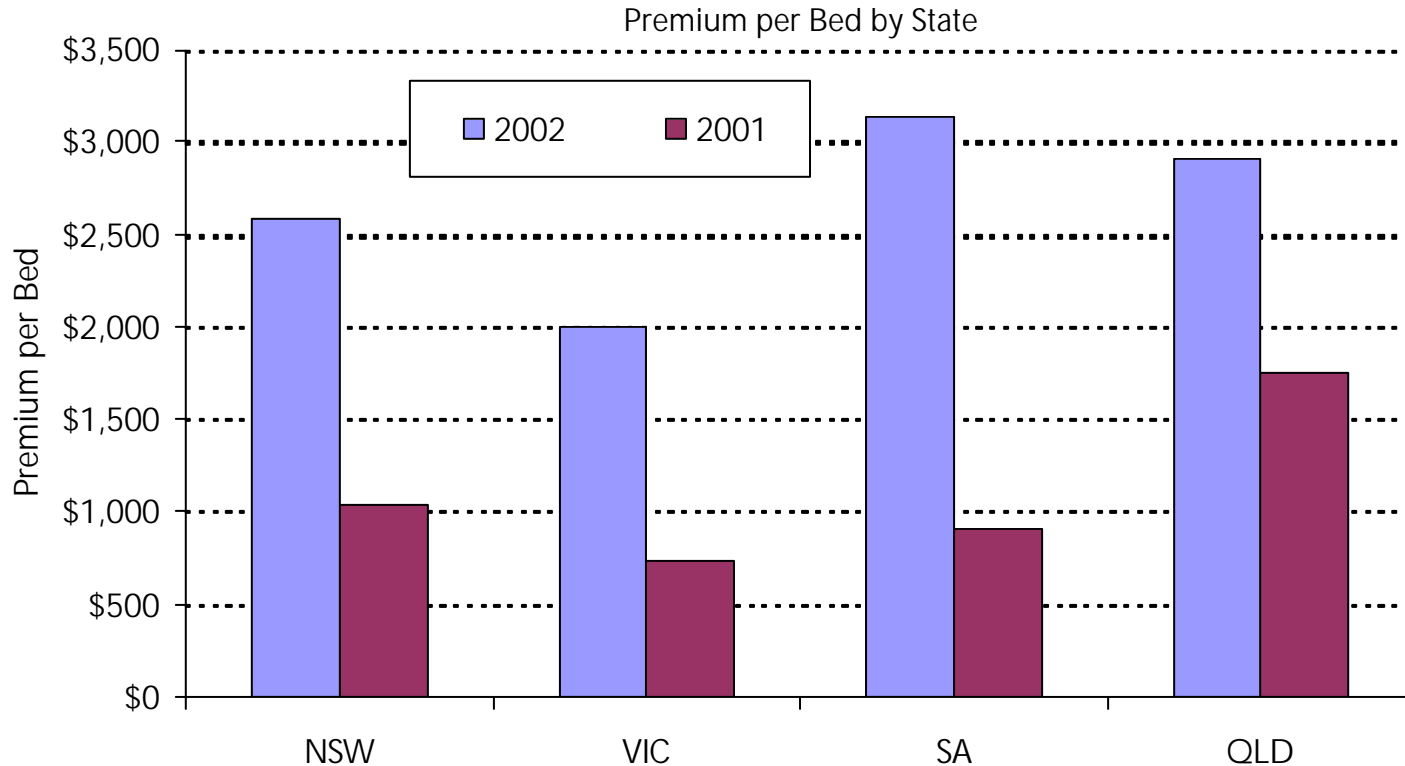
Premium/Excess			
	2002	2001	Increase
1-50 (independent hospitals)			
Total Premium	1,342,712	347,285	287%
Premium per bed	4,276	1,106	287%
Premiums % of Revenue	2.34%	0.63%	270%
Weighted Average Excess	64,686	17,473	270%
51+ (independent hospitals)			
Total Premium	6,474,399	2,457,715	163%
Premium per bed	2,112	806	162%
Premiums % of Revenue	0.92%	0.38%	145%
Weighted Average Excess	83,684	21,479	290%
Groups			
Total Premium	21,127,920	9,207,815	129%
Premium per bed	1,584	745	113%
Premiums % of Revenue	0.83%	0.43%	90%
Weighted Average Excess*	N/A*	21,296	

* These figures have been distorted by the experience of three large groups and these have been excluded.

- When examined by number of beds, there appears to be evidence of market power and scale. The recent experience has been more dramatic for small independents, than the large independents. Groups have had the most favourable terms.
- In addition to having higher increases small hospitals also pay much higher per bed premiums.

Comparison by State (for independent hospitals)

It appears from the data that NSW and Qld have not suffered as large an increase in premiums as Victoria and South Australia. However this analysis should be viewed with caution due to the small volume of data.



N.B Other states have been excluded due to a lack of relevant data

Insurance Availability

- Of the 38 respondents with complete data, 23 or 60% changed their medical liability insurer in 2002. This is an extraordinary rate of turnover.
- Two major insurers and some others appear to have withdrawn from the market.
- Only two Australian insurers have been relatively stable suppliers in 2002.
- The great majority of the displaced business has gone to Lloyd's, in particular to two syndicates.
- Hardly any hospitals changed their insurance broker in 2002.

Impact of Insurance on Hospital Services

There is some evidence of new conditions and exclusions applying:

- one rural hospital was forced to withdraw “low risk” caesarean sections and post natal care
- one hospital could not cover employed doctors, and presumably has had to buy cover from an MDO for them
- some policies have an exclusion or partial exclusion for AIDS/HIV and Hepatitis related claims
- some policies have a “double excess” for obstetric claims
- another hospital is considering ceasing obstetric work.

Strategic Issues Arising from the Study

Among the issues for the industry that arise from the findings in this study are:

- **Increase in cost:** the premium increases alone, without factoring in the cost of excesses, are severe and impact the business economics of hospitals.
- **Financial management of large excesses:** the large excesses transfer significant risk to the hospital, which must be able to bear the costs and also account properly for the financial liabilities (this situation can easily give rise to unrecognised liabilities).
- **Expertise to manage under-excess claims:** most claims will fall under the new excess levels, and hospitals must ensure all claims are professionally managed.
- **Lack of local expertise:** almost all the displaced business is going to Lloyd's, which gives financial protection but is likely to offer little expertise in the local market to develop risk management and professional claim handling procedures.
- **Adequacy of cover:** we have some concern that the lower limits of cover purchased (both per claim and aggregate if there are several claims in a year) might be inadequate.
- **Restrictions on services:** there is some evidence that insurance availability may be restricting the range of services and limiting future development of services.
- **Exclusions and gaps:** some of the exclusions can give rise to gaps in cover that may not be recognised and understood by the hospital.