

**Florida Long Term Care
General Liability and
Professional Liability
Actuarial Analysis**

Submitted by:



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January 17, 2000

Introduction

At the request of the Florida Health Care Association (FHCA), Aon Worldwide Actuarial Solutions (AWAS) has conducted an actuarial analysis of the cost of general liability and professional liability (GL/PL) claims to the long term care industry operating in Florida. All of the long term care providers included in this study are for-profit, multi-facility providers.

The specific objectives of this study are to:

- 1. Identify differences in GL/PL claim activity between Florida and the rest of the country.** These differences are measured by the number of claims reported (frequency), the size of claims (severity) and the overall cost per exposure (loss cost). Specific areas of the country for which separate analysis is included in this study are the states of Florida, Texas and California. All other states are analyzed as a group and labeled accordingly in the exhibits contained in this report.
- 2. Evaluate historical changes in the GL/PL commercial insurance marketplace.** Marketplace conditions are evaluated by monitoring the change over the past few years in annual premium, self-insured retentions/deductibles and availability of insurance. These changes are separately evaluated for Florida and the rest of the country.
- 3. Compare and contrast differences in claim activity to patient rights statutes in Florida versus the rest of the country.**
- 4. Estimate the portion of GL/PL loss costs paid as indemnification to claimants versus the portion paid to attorneys.** Defense attorney costs are easily identified in the claim detail files used to perform this study and its portion to total claim costs is based on the average of the claim data provided to us. Plaintiff attorney costs are estimated as a portion of indemnity payment to the plaintiff.

The results of this study are based on a comprehensive database of long term care general/professional liability losses and allocated loss adjustment expenses (ALAE) as reported to us by long term care providers operating in Florida and around the country. Approximately 12,400 individual non-zero claims from long term care facilities were aggregated to perform this study. The facilities included in this study combined operate approximately 28,000 licensed nursing home beds in the state of Florida and 350,000 licensed beds countrywide. They represent almost 35% of the Florida long term care beds and 20% of the beds in the United States. An executive summary containing our conclusions and recommendations can be found in this report. It is provided to give an overview of our findings. More detailed benchmarks comparing Florida to Texas, California and all other states are provided after the executive summary. Sections describing the data sources and defining common actuarial terms follow.

Should there be any questions regarding this report, we will be available to discuss them with you.

Respectfully Submitted,

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Conditions and Limitations

The projections contained in our analysis rely on methods and assumptions that are in accordance with standard actuarial practice. The results of this analysis are based entirely on the loss and exposure data provided to us by the long term care facilities who responded to the FHCA data call. Readers of this report should keep the following observations in mind:

1. We have relied on this loss and exposure information without detailed verification or audit other than checks for reasonableness. We do not assume any responsibility for errors or omissions in the data or material provided to us.
2. We have assumed that losses reported to us in the aggregate will develop to higher ultimate amounts by the time all claims arising from incidents that have occurred in the historical period under study are reported and eventually closed. This assumption is based on the historical reporting patterns of the long term care industry and is in accordance with standard actuarial practice. In projecting ultimate losses based on historical reporting patterns, consideration was given to recent changes in case reserving philosophy by several long term care providers. Individual claims will likely develop more or less than the percentage of aggregate development. The adjustments we have made to past experience reflect the average effects of changes in the cost of claims.
3. We have assumed that the losses reported to us represent the unlimited amount of indemnity, ALAE and punitive damages paid and reserved as of the report date. To the extent losses have been limited and/or punitive damages not reported, our loss projections may be understated.
4. The losses presented in this report are on a nominal, undiscounted basis. They represent the actual dollars expected to be paid by the time all claims are closed.

No recognition of the time value of money or the cost of capital has been included in our projections.

5. The loss projections presented in this report are based strictly on the claim detail provided to us and, therefore, are a function of the exposure characteristics of the twelve long term care providers who responded to the data call. Specifically, these long term care providers are predominantly multi-facility, for-profit operations providing primarily skilled nursing care. An attempt was made to include data from independent and/or non-profit facilities; however, no responses from these facilities were received within our tight time frame. Individual nursing home operators in the state of Florida may have different loss costs depending on their level of nursing care, profit status, and independence.
6. The report is strictly for the use of the Florida Health Care Association and its members. In addition, this report is being made available to all long term care providers who participated in the data request. This report may also be released to regulatory authorities. If this report is distributed, the report should be distributed in its entirety. All recipients of this report should be aware that the AWAS actuaries that signed the report are available to answer questions about it.

The above notwithstanding, we believe that the projections in this report are reasonable, and are based on sound actuarial methods and assumptions. Our conclusions are subject to the ordinary limitations involved in any actuarial analysis, and must not be viewed as absolute or guaranteed results.

Executive Summary

General liability and professional liability (GL/PL) costs for the long term care industry in Florida have become astronomical and extremely difficult to forecast. Unprecedented increases in both the number of claims and the size of a typical claim have created what is clearly a long term care liability crisis. The results of our analysis show that long term care GL/PL costs in Florida are undoubtedly higher than any other state (including Texas and California) in the United States.

Based on our actuarial analysis of the long term care industry data provided to us, which represents 35% of Florida and 20% of the U.S., we find the following:

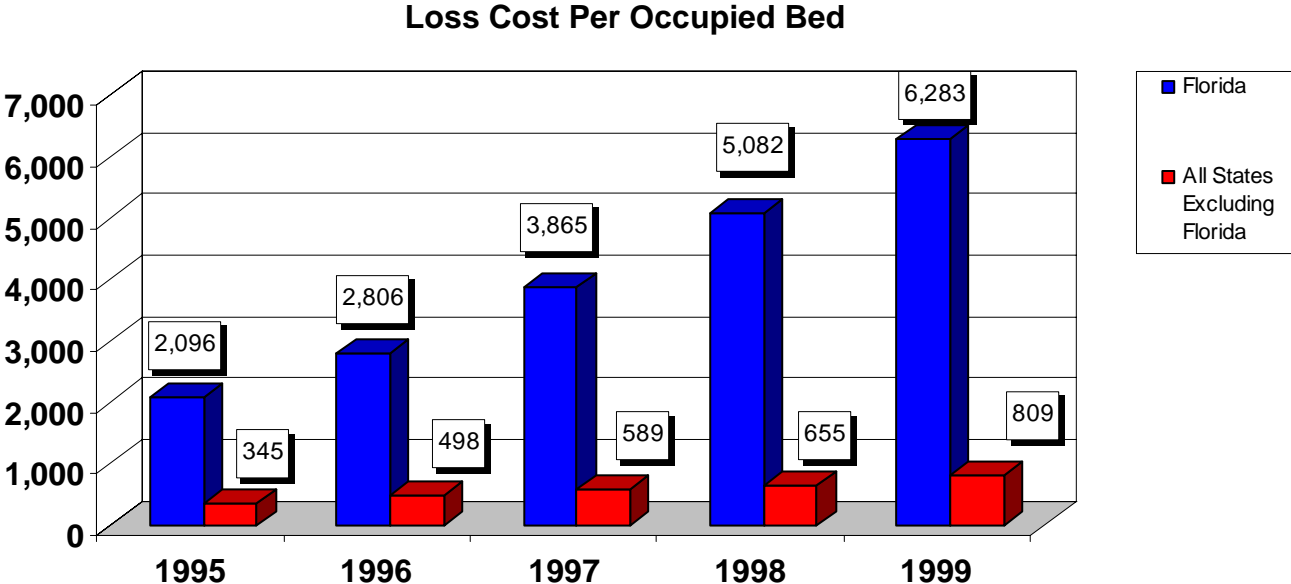
- The average long term care GL/PL cost per annual occupied bed in the state of Florida is currently \$6,283, which is 8 times the average cost for the rest of the country.
- Florida accounts for only 10% of the total U.S. beds but 40% of losses.
- The average size of a 1999 claim in Florida (\$278,637) is projected to be 250% higher than the rest of the country (\$112,351).
- Florida long term care operators incur 3 claims for every 1 claim incurred in the rest of the country.
- Long term care GL/PL loss costs in the state of Florida have increased 37% *annually* over the past 5 years while the rest of the nation has seen annual increases of 20% during that time period.
- Approximately half of the total amount of claim costs paid for GL/PL claims in the Florida long term care industry are going directly to the attorneys.
- It now costs twice as much to insure a Florida nursing home bed than a hospital acute care bed.

Insurance markets have responded to this claim crisis by severely restricting their capacity to write long term care GL/PL insurance. In the past year, at least 10 companies that historically wrote this coverage in Florida are no longer writing new business. In addition, several other companies are only offering claims-made coverage, not full occurrence coverage, as in the past. Insurance companies are exiting the state and cannot provide coverage when faced with this magnitude of losses and explosion in growth of claims.

Benchmarks: Florida vs. The Rest of the Country

GL/PL Loss Costs in Florida are the Highest in the United States

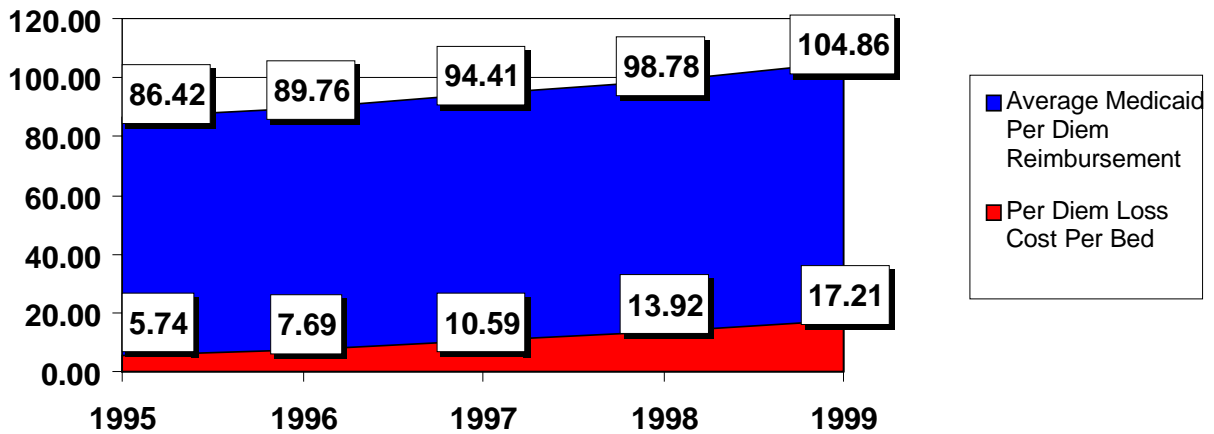
The cost per occupied long term care bed of GL/PL losses are materially higher in Florida than the rest of the United States as the following graph shows:



Florida GL/PL long term care loss costs are now greater than hospital professional liability (HPL) loss costs for an acute care hospital bed. In fact, based upon AWAS' countrywide database of HPL claims, the Florida long term care GL/PL loss cost is approaching double the size of the countrywide HPL loss cost. In the early 1990's, Florida long term care GL/PL costs were only one third of HPL loss costs.

On a per diem basis, the loss cost is increasing as a percent of Medicaid reimbursements, from 7% in 1995 to 16% in 1999 as shown in the graph below. As Medicaid reimbursements have increased 21% over the past four years, the GL/PL loss cost has increased 200%. As a result, although the reimbursement rate has increased \$18.44 during this period, insurance costs have eaten up most (\$11.47) of that growth.

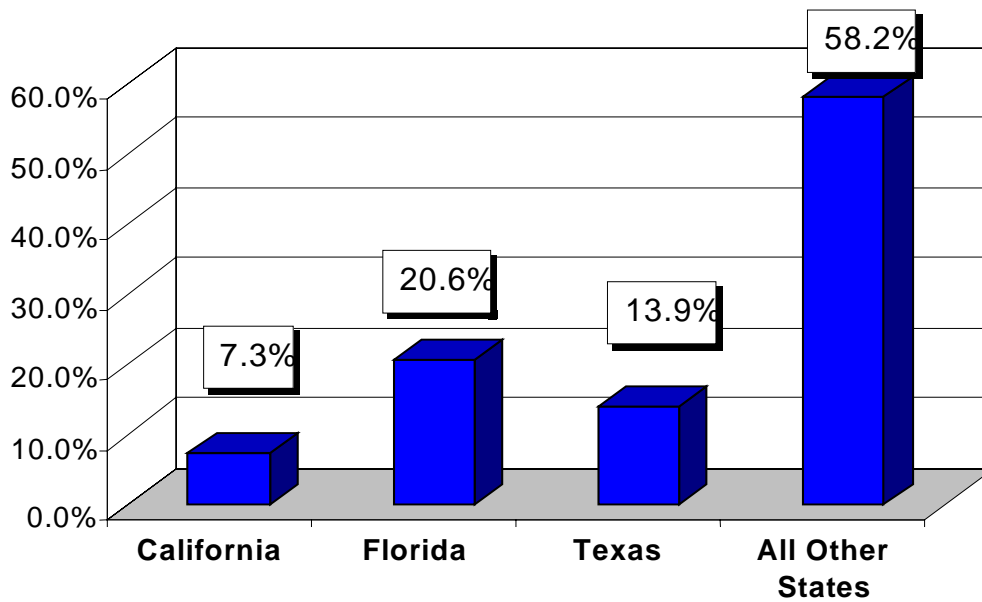
Per Diem Loss Cost Versus Medicaid Reimbursement



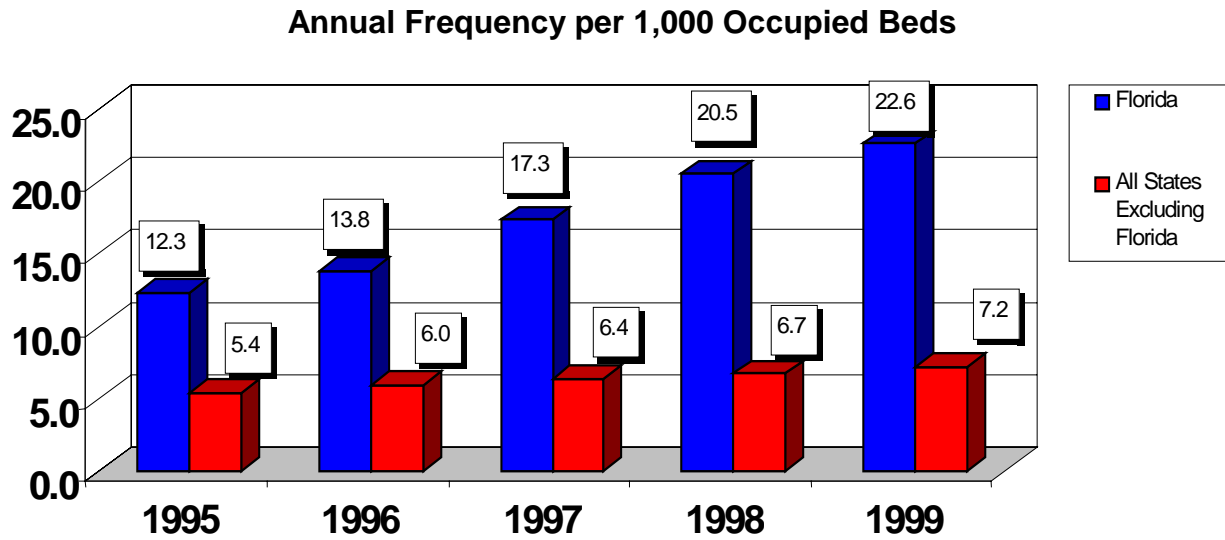
Florida has the Largest Number of GL/PL Claims in the United States

Based on our study, the number of reported GL/PL claims in Florida represent approximately 21% of the total number of claims reported in this country. Yet, Florida represents only approximately 10% of the total beds.

Percentage of Claims Reported by State

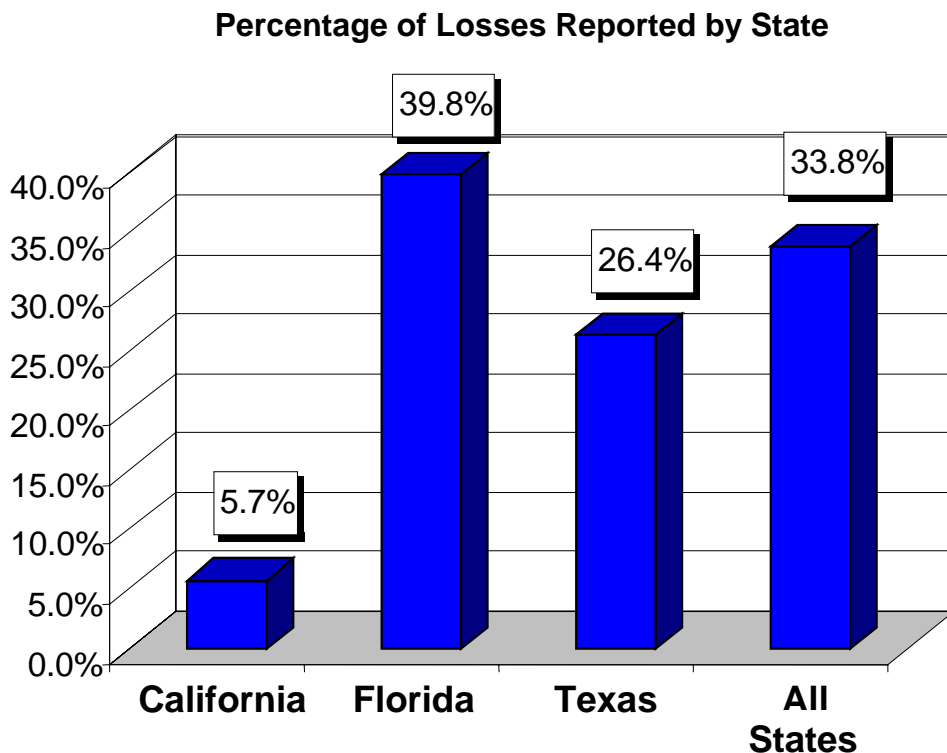


The annual number of Florida GL/PL claims per 1,000 beds has been increasing over the last five years and currently is three times higher than the rest of the country:

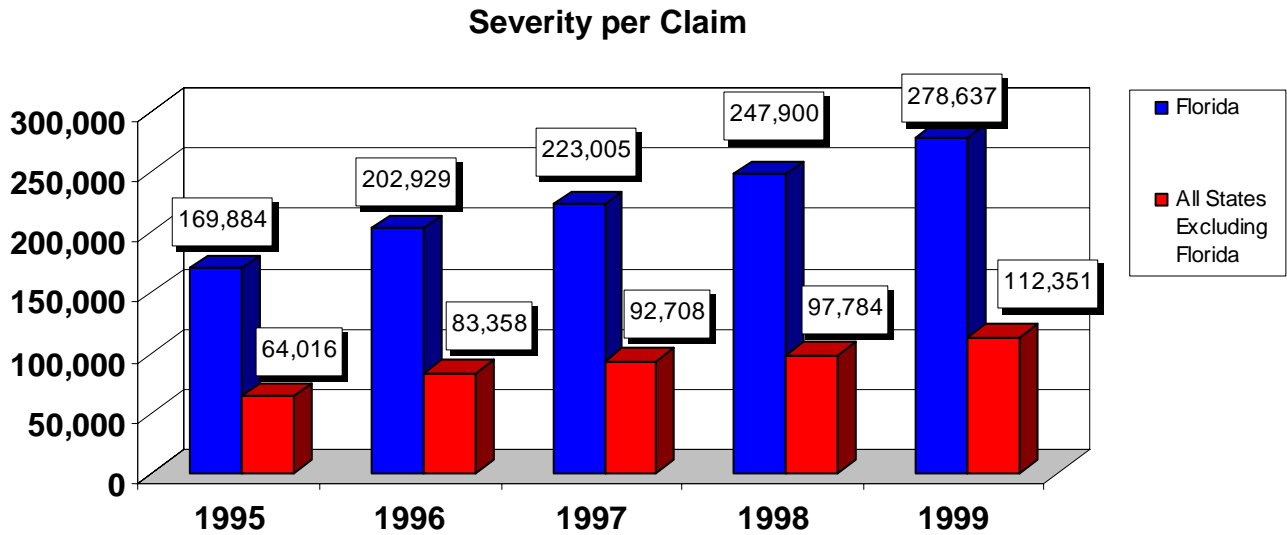


Florida has More GL/PL Loss Dollars than any other State in the United States

Based on our study, reported GL/PL losses in Florida make up approximately 40% of the total loss dollars reported in this country as compared to only 10% of the beds:

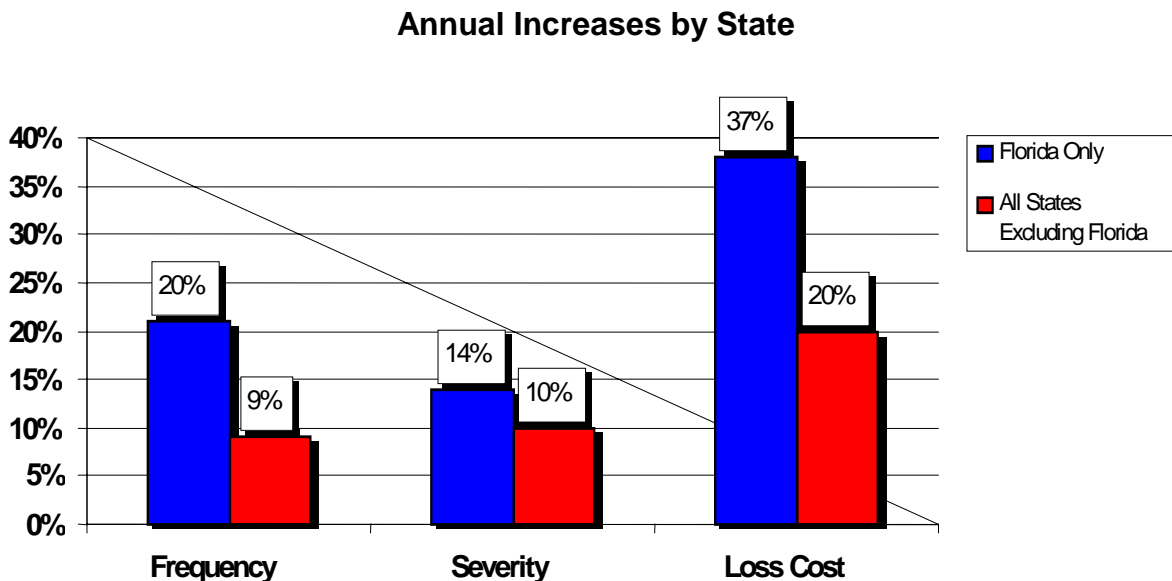


The average size of Florida GL/PL claims is more than double the average size for the rest of the country:



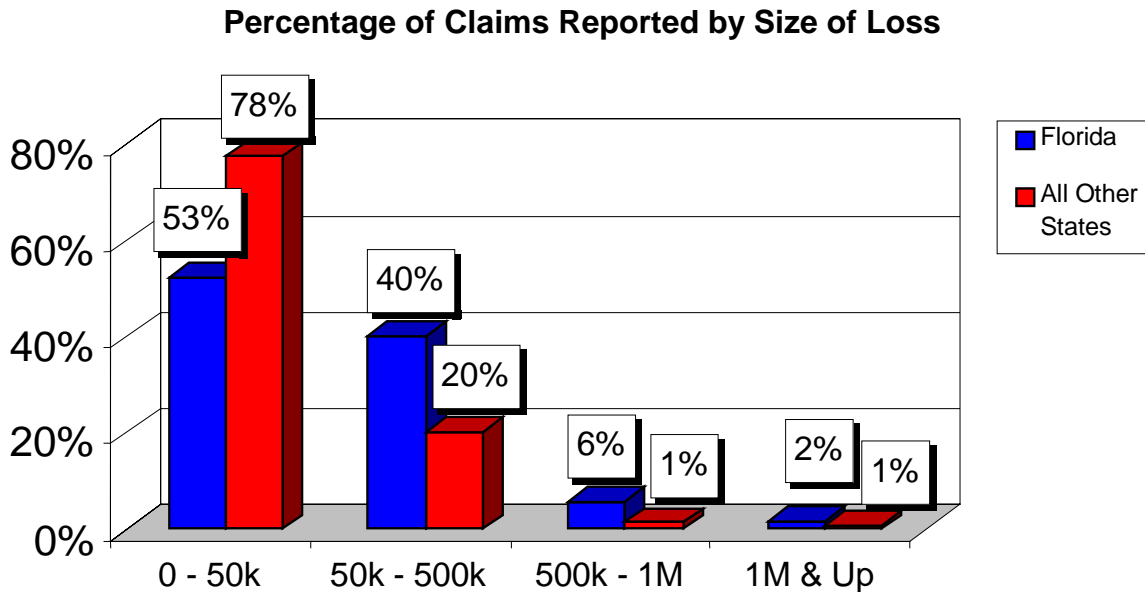
Florida GL/PL Costs are Increasing Faster than any other State in the United States

Loss costs have been increasing at unprecedented levels in most states for the long term care industry over the last five years. However, the annual increase in costs in the state of Florida is almost double the annual increase in the rest of the country. The increase in loss costs is driven by both an increase in the number of claims (frequency) and the size of claims (severity.)



Florida has a Disproportionate Number of the Largest Losses in the United States

The distribution of Florida GL/PL losses by size shows that almost half of the currently reported Florida losses are greater than \$50,000. In contrast, only 22% of the losses for the rest of the country are reported to be greater than this amount as the following graph shows:



In addition, of the 102 claims reported in our survey to be greater than or equal to \$1 million, 41, or approximately 40%, are in Florida.

While the majority of the above benchmarks compare Florida to all states excluding Florida, our analysis also includes individual studies of the loss costs in Texas and California. These states were originally identified for separate analysis due to the perception that the litigious environment is similar to Florida. As a result of our study it is evident that Florida's exposure to long term care GL/PL claims is far more costly than either of these states. For complete details of our Texas and California analyses refer to the next section: Additional Benchmarks.

GL/PL Commercial Insurance Markets are Significantly Restricting Coverage

The availability of commercial insurance for the GL/PL exposures of long term care facilities operating in Florida has significantly declined. Where coverage has been available premium levels have been increased significantly and/or retention levels have been raised.

As of the writing of this report, based on information from long term care facilities operating Florida and insurance company representatives, it is estimated that at least 10 companies have either exited the state or placed a moratorium on new business. In addition, several other companies are only offering claims-made coverage, not full occurrence coverage as has been provided in the past.

GL/PL Loss Costs are Correlated to Strong Patient Rights Laws

Significant increases in liability costs typically follow changes in societal attitudes regarding liability and/or legislative changes affecting liability. In the case of the long term care industry, the strong increase in frequency and severity that has occurred during the 1990's follows the passing in 1987 by the United States Congress of the Nursing Home Reform Act. This act applies to Medicaid and Medicare participants and establishes minimum quality of care requirements. Violations of this act apply at both the state and federal levels.

In addition to the correlation of countrywide loss increases to federal legislation, the two states with the highest per bed loss cost both have very strong patient rights statutes. Florida's Patients Bill of Rights (Statute 400.002) guarantees the patient's right to be informed, provided adequate care and treated with dignity, among many other rights. The violation remedies provided under this statute include actual damages, punitive damages and attorney's fees.

Texas' Residents' Bill of Rights (Chapter 247 of the Texas Health and Safety Code) itemizes 14 rights including, "the right to ... a safe and decent living environment and

considerate and respectful care that recognizes the dignity and individuality of the resident.” While the Texas statute does not specifically provide for punitive damages as a remedy for violations, cases involving injury to the elderly were specifically exempt from the 1995 Texas tort reform punitive damage cap.

Despite the correlation in Florida and Texas, not all states with patient rights statutes have experienced the same trends in the cost of GL/PL claims. California, for example has the Elder Abuse and Dependent Adult Civil Protection Act. Yet, our projection of \$770 for California’s 1999 loss cost is not materially different than our projection of \$809 for the rest of the country.

Almost Half of the Total Claim Dollars are Paid to Attorneys Rather than to Patients

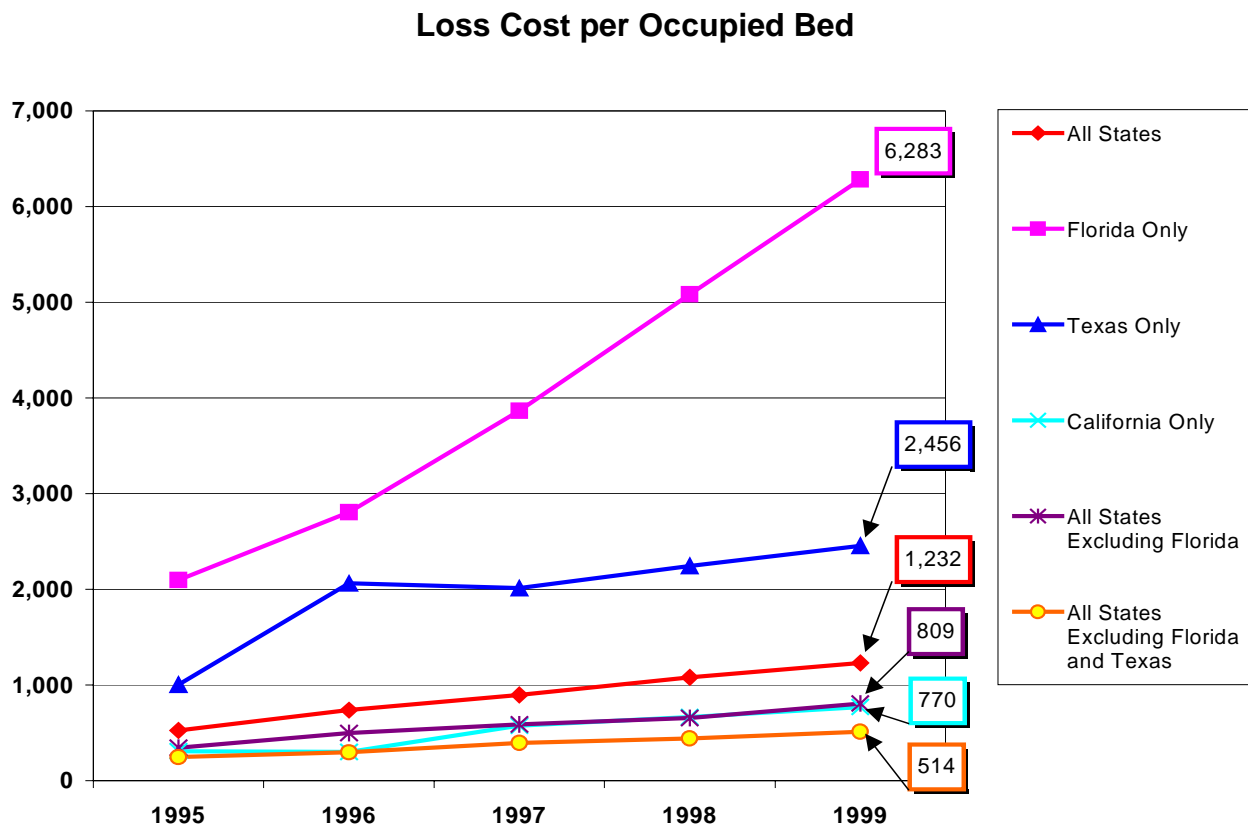
It is estimated that 49% of the total amount of claim costs paid for GL/PL claims of the Florida long term care industry are going directly to the attorneys who either prosecute or defend the long term care facilities. Based on the database of claims used in this study, 21.4% of total losses are allocated loss adjustment expenses, which represent defense costs. The remaining 78.6% represent the amount paid in total to the plaintiff, including amounts retained by the prosecuting attorneys. Of this amount, based on the Florida Bar standards for contingency fees^{*}, it is estimated that approximately 35% is retained by the plaintiff’s attorneys. Of the total loss dollars, this represents 27.5%. Consequently, 48.9%, or almost half, of total long term care industry GL/PL loss dollars are paid to plaintiff and defense attorneys.

^{*} Insurance claim data does not break down the indemnity component of loss between plaintiff and attorney because this is privileged information. However, the Florida Bar Rules of Professional Conduct, Section 4.1, Client – Lawyer Relationship, provides a standard of contingency fees that, if exceeded, would be considered to be clearly excessive. The fee schedule shown in this section varies depending on the timing of filing for arbitration or the entry of judgment, but generally ranges from 33 1/3% to 40% for any recovery up to \$1 million. Lower contingency fees are recommended for the portion of recoveries above \$1 million.

Additional Benchmarks

Loss Cost Differences

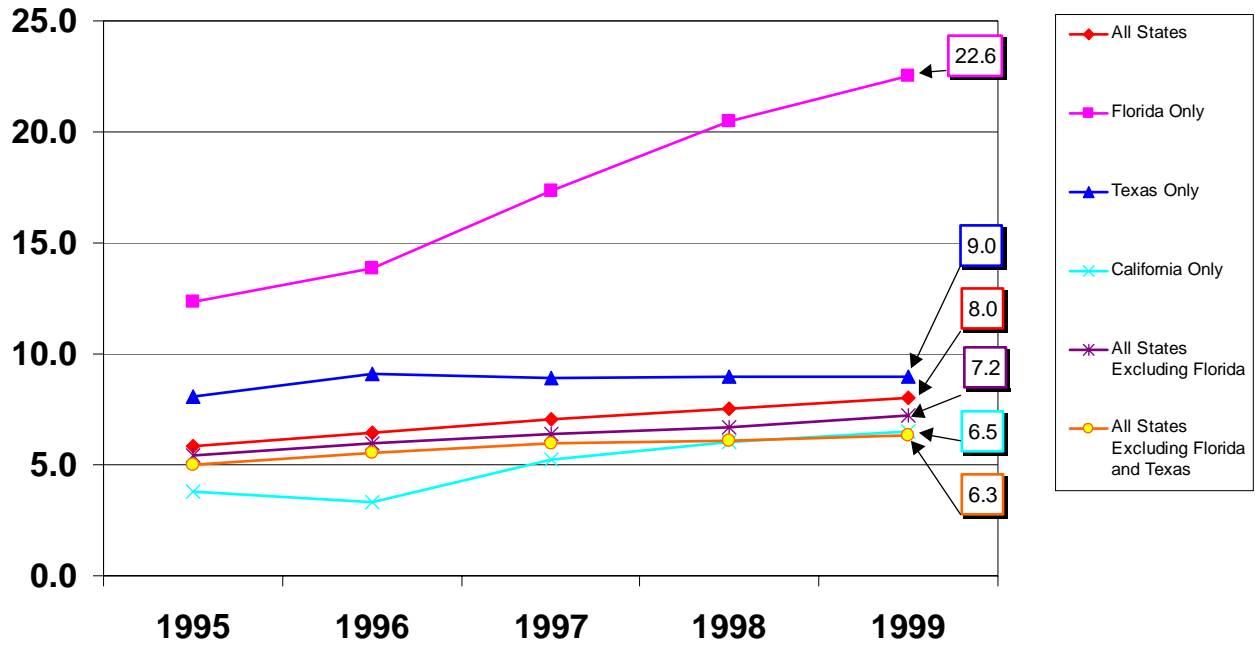
The cost per bed of GL/PL losses are materially higher in Florida than the rest of the United States as the following graph shows:



Frequency

Florida long term care operators incur 3 claims for every 1 claim incurred in the rest of the country. For incidents occurring during 1999, Florida facilities will report approximately 23 claims for every 1,000 occupied beds, while facilities in the rest of the country will report only 7 claims.

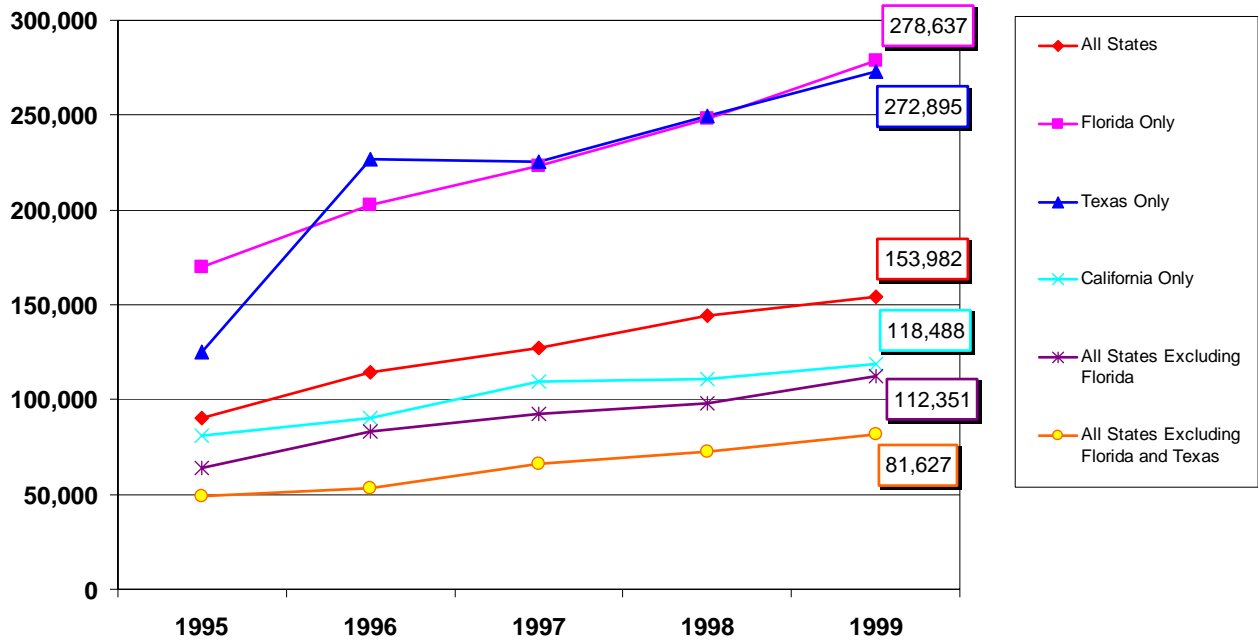
Frequency per Claim



Severity

Over the last five years the average size of a GL/PL claim in Florida has been significantly larger than the rest of the country. The average size of a 1999 claim in Florida is projected to be 250% higher than the rest of the country.

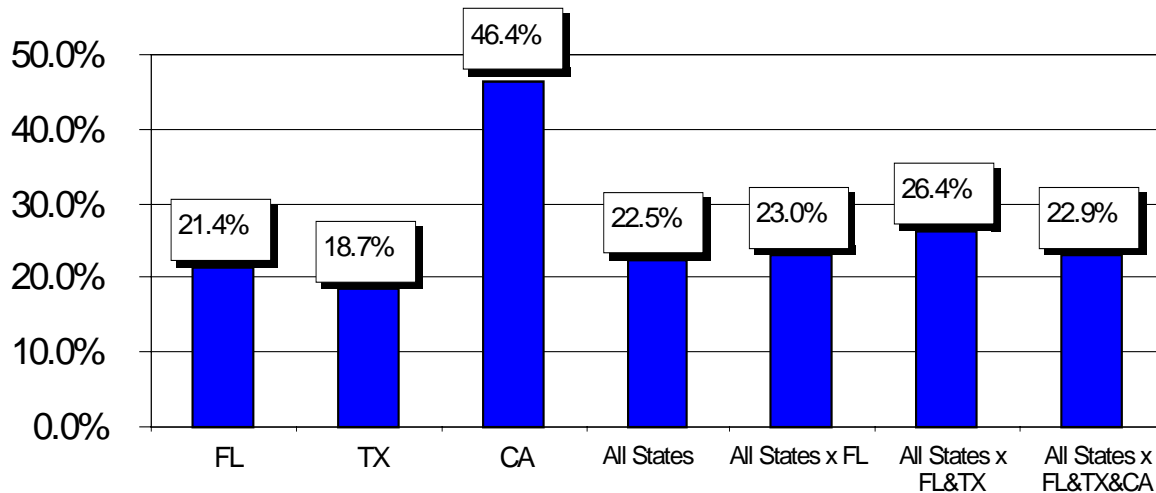
Severity per Claim



ALAE

The component of total claim dollars used to defend claims, referred to as allocated loss adjustment expenses or ALAE, in Florida is similar to the rest of the country.

Percentage of Paid ALAE to Total Paid*

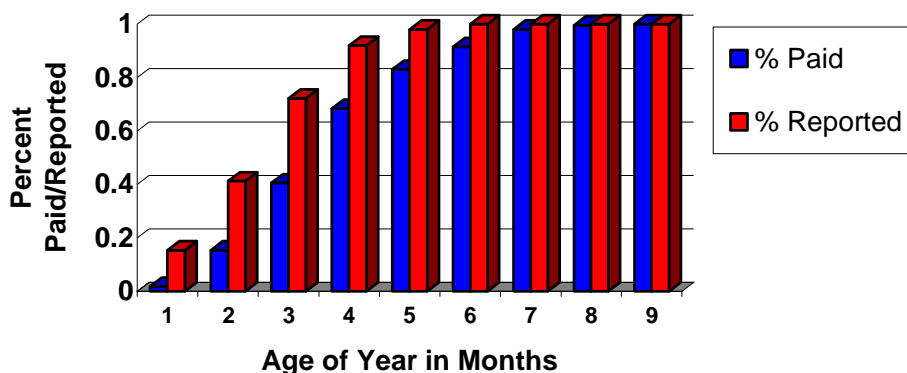


*Although CA has the highest percentage of ALAE to Total Paid, the average ALAE payment in CA is approximately the same as in Florida. However, the indemnity component in California is much lower than in Florida.

Loss Development

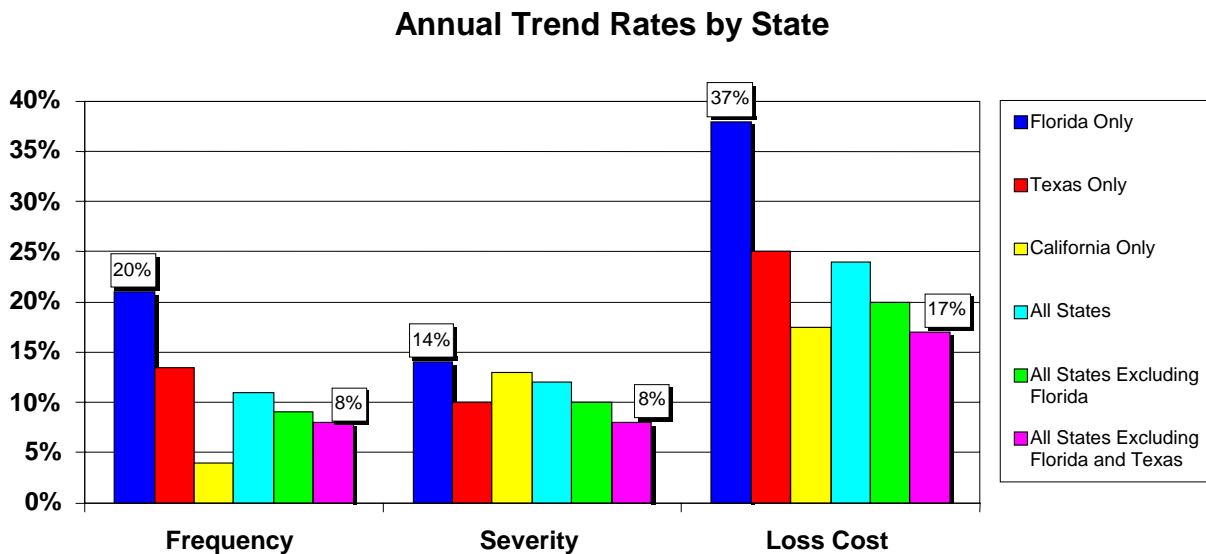
For the long term care industry, it takes approximately six years before all claim cost estimates related to incidents from a particular period of time are reported. It takes approximately nine years before all claims from incidents occurring during a year of operations are closed and the actual costs are known. The following graph shows the percentage reported and paid at each age until all claims are closed:

GL/PL Development Patterns



Trend

Each year the long term care industry is seeing more claims being reported per occupied bed with the size of each claim increasing, as well. Over the past five years, the number of claims being reported per occupied bed has increased approximately 20% each year in Florida while increasing at an annual rate of 8% in other states. During this same time period, the average size of a claim has increased approximately 14% each year in Florida, while increasing at an annual rate of 8% in other states. These two components have a multiplicative effect on the annual loss cost trend. Loss costs in the state of Florida have been increasing twice as fast as the rest of the country over the past five years. The graph below illustrates frequency, severity, and loss cost annual trend rates by state.



Data Sources

The analyses contained in this report are based on an industrywide call to long term care operators in Florida for data on GL/PL claims incurred during the last five years in Florida and the rest of the country.

Twelve long term care providers responded to our call in whole or in part. All of the respondents are for-profit, multi-facility long term care providers providing primarily skilled nursing care.

In developing the benchmarks presented in this report we have relied on the following data.

- **Individual claim detail** – This database is a compilation of 12,410 non-zero long term care general/professional liability claims occurring over the past years. The information included by individual claim is status, accident date, report date, close date, state, indemnity paid, allocated loss adjustment expense paid, total paid, indemnity incurred, allocated loss adjustment expense incurred, and total incurred.
- **Historical Loss Development Triangles** – Incurred and paid loss development factors and claim count development factors are derived from a consolidation of the reporting patterns of three of the largest long term care providers. These three providers represent approximately 60% of the loss data reported to us. Historical reporting patterns are not available from the other long term care providers. However, the similarity of the patterns for the three reporting providers and the credibility of the consolidated development pattern justify the use of these patterns to estimate ultimate development for the multi-chain providers as a whole.
- **Occupied Beds** – Annual occupied bed counts corresponding to the years for which loss experience is provided were utilized in this analysis to develop the relative loss cost per bed. Annual licensed bed counts were multiplied by average occupancy rates to derive annual occupied beds. For long term care providers who could not provide average occupancy rates an occupancy rate of 87.5% was assumed. For all states combined, there are approximately 350,000 licensed beds of which more than 300,000 were occupied. For the state of Florida, our study is comprised of approximately 28,000 licensed beds of which almost 25,000 are occupied.
- **FAHA Tort Reform Survey Results** – A one half page summary of the results of a survey the Florida Association of Homes for the Aging administered to assess the extent of members' involvement with resident care litigation. This was the only information we were able to obtain on the not-for-profit sector of the nursing home industry. Unfortunately, because the survey results do not provide individual claim detail and do not distinguish between the claim occurrence date and the report date, we are unable to incorporate this information into our analysis.

Definitions

The following definitions are provided to help the users of this report fully understand the analyses presented and the resulting conclusions.

ALAE

ALAE is an abbreviation for allocated loss adjustment expense. ALAE refers to costs, in addition to indemnity payments and reserves, that are incurred in handling claims. Typically, these costs are comprised of legal fees paid by the insured entity in investigating and defending claims. In the context of this study ALAE represents defense costs. The majority of claim data used in this study contained a separate field to identify ALAE costs separately from indemnity costs. Whether separately identified or not, allocated loss adjustment expenses are included in the reported loss information, loss reserving methodologies and loss projections contained in this report. All references to losses throughout our report and exhibits include ALAE except where noted otherwise.

Deductible

A deductible is a layer of loss retained by an insured entity. The insured pays amounts below the deductible and the insurance company pays amounts above the deductible. The higher the deductible the lower the commercial insurance premium. However, this is largely offset by the cost of the portion of claims below the deductible.

Retention is another word commonly used to refer to a deductible. Companies with high deductibles, or retentions, are commonly referred to as self-insured.

A deductible can apply on a per occurrence basis, that is for each individual loss, and/or on an aggregate basis for a given period of time. A typically GL/PL deductible for the health care industry may be expressed as \$1,000,000/\$3,000,000, meaning \$1 million per occurrence and \$3 million in the aggregate for the year. With this deductible the insured is responsible for paying the first \$1 million of each claim, subject to a maximum total of \$3 million for the year.

Deductibles can apply to the indemnity portion of losses only or the combined cost of indemnity and ALAE.

Defense Costs

In the context of this report, defense costs include attorneys' fees and other directly allocable costs associated with defending a company against GL/PL claims.

Exposure

Actuaries select an exposure base such that the incidence of claims will tend to vary directly with the exposure of the entity at risk. The actuary must consider both the historical loss level and the corresponding exposures in evaluating historical claim liabilities and expected future costs. It is important to choose an exposure measure that is relevant to the unique situation of each risk group.

In this study we use an exposure base of occupied beds. Occupied beds are calculated by multiplying the number of licensed beds by the average annual occupancy rate. There is a strong correlation between the number of occupied beds and the total amount of losses incurred by a long term care facility. Not all beds are equal in terms of their risk exposure, however. An assisted living bed generates fewer dollars of GL/PL claim activity than a skilled care bed. Consequently, we have adjusted all beds in this study to the equivalent of a skilled care bed.

By dividing losses by exposures we develop comparative estimates of the long term care industry GL/PL loss costs between states, types of facilities (multi-chain vs. independent) and years of operation.

Frequency

Frequency is the ratio of the number of claims divided by exposures. In this report we measure frequency on an annual basis as the number of claims projected for the given time period divided by the number of occupied beds during that same period. In our summary exhibits we present frequency as the number of claims a year for every 1,000 beds.

General Liability

General liability insurance coverage generally pays those sums the insured becomes legally obligated to pay as damages because of a bodily injury (typically including personal and advertising injury) or property damage to which the insurance applies subject to the conditions and exclusions of the contract.

Indemnity

Indemnity refers to the component of claim costs actually paid or reserved to be paid to the plaintiff. Indemnity costs include both the amount provided for the plaintiff, either as a jury award or a settlement, and the amount retained by the plaintiff's attorney. However, in most claim files, including those used to do this study, the split between plaintiff award and plaintiff attorney is not provided. Indemnity may also include punitive damages, although this is not consistently treated among companies.

Limit of Liability

A limit of liability is a maximum amount of coverage provided by an insurance transaction. Above the limit of liability, the insured is responsible for all losses. Limits of liability may be expressed on a per occurrence basis or an aggregate basis, similar to deductibles.

Loss Cost

Loss cost is the cost per exposure of settling and defending claims. Loss cost is calculated as the ratio of total dollars of losses (indemnity and ALAE) to total exposures for a given period of time. In this report exposures are selected to be occupied beds and the time period is one year. Consequently, a loss cost represents the annual amount per occupied bed expected to be paid to settle and/or defend GL/PL claims arising from incidents occurring during the respective year.

Loss Development

Loss development refers to the change in the estimated value of losses attributable to a body of claims or to a time period until all the claims are closed.

Generally, the reported losses will increase over time for several reasons. First, it is impossible to estimate precisely the ultimate losses and legal expenses for claims when they are initially reported. The estimated unpaid loss for a claim, called a case reserve, is adjusted up or down as more information is obtained. In the aggregate, the upward adjustments tend to be greater than the downward ones. Second, it takes a period of time for some claims to be discovered, reported, and recorded. Claims which have been incurred but have not been reported are called “pure” IBNR claims. Third, closed claims are sometimes reopened. This may be due to legislation which applies retroactively to claims which have closed. In this report, we collectively refer to reserves for these three cases as IBNR reserves.

Loss development also refers to the increase in paid losses as claims are reported, paid to their ultimate values, and closed.

Loss Trend

Loss trend is the change in claim frequency and/or severity from one time period to the next. Factors that affect the frequency and severity of claims are constantly changing over time. Examples of causes include inflation, societal attitudes toward legal action, and changes in laws. Actuaries use trend factors to adjust historical loss experience to comparable levels.

Premium

Premium is the amount paid to an insurance entity to cover costs associated with claims arising from a specifically defined risk. In the context of this report, premium refers to the premium paid for GL/PL insurance. Premium generally is developed as the expected loss cost for the period of coverage plus other underwriting expenses including commission, premium taxes, and general expenses incurred operating an insurance company.

Professional Liability

Professional liability insurance coverage generally pays on behalf of the insured all sums the insured becomes legally obligated to pay as damages and associated claims and defense expenses because of a negligent act, error or omission in the rendering or

failure to render professional services. Carriers vary on their ability to delete or amend exclusions relating to punitive damages, intentional or criminal acts committed at the direction of the insured (including sexual molestation), and performance by an insured under the influence of intoxicants.

Retention

Retention is another word commonly used for deductible. Throughout this report deductible and retention are used interchangeably to mean the same thing: the portion of a loss retained by the insured entity.

Severity

Severity refers to the total dollar amount of a claim including indemnity and ALAE. In this report we measure the average severity for a given year by dividing the total dollars of losses for all claims incurred in the year by the total number of claims.

Underwriting Expenses

Underwriting expenses are expenses incurred in writing commercial insurance in addition to claim (indemnity and ALAE) expenses. Underwriting expenses generally include commission paid to agents and brokers, premium taxes and other general expenses incurred operating an insurance company. Underwriting expenses, when added to claim expenses, represent the total cost underlying commercial insurance premium.

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