

1 RESPONSE OF JAMES ROBERTSON TO QUESTIONS 1(a), 1(b), 3(a), 4(b), and 7
2 IN ORDERS BY THE COURT DATED APRIL 21, 2003 AND APRIL 24, 2003
3 REQUESTING ADDITIONAL EVIDENCE
4

5 April 30, 2003
6

7 My name is James Robertson, Assistant Vice President and Associate Actuary for SCPIE
8 Holdings, Inc., the parent company of the Applicants in this case, SCPIE Indemnity
9 Company ("SIC") and American Healthcare Indemnity Company ("AHI") (together,
10 "SCPIE"). I am presenting this additional written testimony to several of the questions posed
11 by Judge Rasmussen's questions directed to SCPIE. Remaining questions will be addressed
12 by other SCPIE witnesses in this case.

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15 **1. Referring to SCPIE Exhibit 38, page Bates stamp number 0434:**
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17 **(a) The trend factor from Model A in line item 10(a) under the 1999 data column**
18 **is listed as 1.285. Should this figure be 1.287 based on SCPIE page Bates stamp**
19 **number 0434?**
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21 The trend factor on Bates 0434 on Line 10(a) should be 1.287, not 1.285. As a
22 result of your question, I changed the factor to 1.287 and recalculated the
23 resulting indicated rate change on Bates 0434, Line 25. The resulting indicated
24 change is still +15.5% due to the fact that this change is so small and affects the
25 indicated rate change only in the fourth decimal place. A corrected Exhibit 20
26 (the indicated rate level calculation) of the Trued Up Rate Application (SCPIE
27 Exhibit 38, p. 0434) is attached hereto as SCPIE Exhibit 44 (Bates No. 00447).
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29 **(b) From where in SCPIE's Exhibit 38 did you get the development factors**
30 **1.0486, 2.6188 and 541.5097 in line item 8(c) on SCPIE 0434 for the 1999, 2000 and**
31 **2001 data columns? (I found the development factor listed in lines 8(a) and 8(b) on**
32 **SCPIE pages 0397 and 0401 but could not find the correlating factors for 8(c) on**
33 **SCPIE page 0405.)**
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35 The development factors on SCPIE Exhibit 38, Bates number 0434, Line 8(c) are
36 1.0486, 2.6188 and 541.507 for 1999, 2000, and 2001, respectively. They are not

1 to be found on Bates number 0405, but rather they are calculated from figures
2 elsewhere in Exhibit 38, on Bates 0409 and on Bates 0434. I will explain this in
3 more detail.

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5 These three figures are the development factors that apply to the layer of losses
6 that is in excess of \$1 million per claim. For this layer of losses, the development
7 factors are not calculated in the same manner as for the underlying two layers.
8 They are calculated in a two-step procedure called a Bornhuetter-Ferguson
9 approach.

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11 The first step in the calculation for this highest layer begins on Bates number
12 0405, which is similar to Bates 0397 and 0401 for the lower two layers. But it
13 does not stop there, as it does for the lower two layers of loss. The figures for
14 1999, 2000, and 2001 from the final column labeled "undeveloped" are then
15 transferred to Bates number 0409 and appear as percentages in column (2).
16 Taking 1999 as an example, the figure 0.0343 from Bates 0405 in the column
17 labeled "undeveloped" appears on Bates number 0409, column (2). It is then
18 combined with the figures in columns (1), (3), and (4) to result in the estimated
19 ultimate loss in column (5). For 1999, the result in column (5) is \$7,916,930.

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21 This calculation that I described above, which appears on Bates 0409, is the
22 Bornhuetter-Ferguson calculation. To follow the process to its conclusion, I will
23 focus on the calculation for 1999. For 1999, the estimated ultimate losses of
24 \$7,916,930 from Bates 0409 in column (5) are then copied and appear on Bates
25 0434 (the indicated rate level calculation) on line 9(c) for 1999. When this figure
26 of \$7,916,930, which is the estimated ultimate developed losses, is divided by the
27 incurred losses as of 3/31/02, which is \$7,550,000 on line 5(c) of Bates number
28 0434, the result is the loss development factor of 1.0486. The development
29 factors for the other two years are calculated analogously. Hence, in this case the
30 loss development factor is actually done in this two-step process and the
31 development factors on SCPIE Exhibit 38 (Bates 0434, line 8(c)) are correct.

1 These, incidentally, are the same figures used by Mr. Schwartz in his calculation
2 on Bates FTCR 0004.

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4 **3. Referring to Death, Disability and Retirement experience.**

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6 a) **Is the data contained in SCPIE Exhibit 29, "12/31/2001 Reserve Review For**
7 **Future Utilization of DD&R Benefit" Bates Stamp 0340 and 0342 based on**
8 **California-only policyholder data?**

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10 The "12/31/2001 Reserve Review For Future Utilization of DD&R Benefit," also
11 known as the DD&R Reserve Study was prepared by Tillinghast based on data
12 that SCPIE provided. SCPIE provided California-only data to Tillinghast for
13 utilization in the DD&R Reserve Study. Therefore, the DD&R Reserve Study
14 used California-only data. No data from any other state is used.

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16 **4. Rate of Return**

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18 **(b) Include in your analysis to question 4a your opinions(s) with respect to any**
19 **impact the statutory provisions of The Medical Injury Compensation Reform Act of**
20 **1975 (MICRA) have on the magnitude of the risk covered by medical malpractice**
21 **insurance in California.**

- 22
23 a. SCPIE believes that a rate of return of 15% has been supported as the
24 maximum permitted rate of return. Dr. Appel in his response to the court's
25 Question 4(a) supports his opinion of 15 percent, and provides an alternative
26 rate of return of 13 percent.

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29 To understand the impact of MICRA on the risk of Medical Malpractice
30 Insurance in California, some historical background will be helpful. Medical
31 malpractice has historically been one of the most volatile and risky lines of
32 business in California. In the mid 1970s, California experienced a medical
33 malpractice crisis in which huge losses in that line of business caused insurers to
34 reduce or cease selling medical malpractice insurance and consequently restricted
35 the ability of doctors to purchase that insurance. As a result, physicians
36 themselves formed four different mono-line insurers to write the coverage and to

1 ensure availability of the insurance for physicians. These four companies
2 currently insure approximately 59.5 percent of the medical malpractice risks in
3 California. SCPIE's predecessor company, formed as a reciprocal for its member
4 physicians, was one of those four insurers. SCPIE reorganized in 1997 as a stock
5 insurance company and SCPIE Holdings Inc., its parent insurance holding
6 company, is publicly traded on the New York Stock Exchange. Many of its
7 stockholders are insured physicians, and 9 physicians serve on SCPIE Holding's
8 board.

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10 SCPIE has experienced severe volatility in profits. In the last four years SCPIE
11 has experience losses averaging 11.2 percent, as reflected in Dr. Appel's Rebuttal
12 Testimony, at page 4. As SCPIE's policyholders, including some board members,
13 are physicians, they recognize the volatility and risk of this line of business.
14 Therefore the board authorized the rate filing with no resulting complaints from
15 insureds upon notification of the pending rate increase.

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17 * While MICRA was the legislature's attempt at remedying the medical malpractice
18 crisis in California in 1975, it did not substantially reduce the relative risk of
19 medical malpractice insurance in California. MICRA placed a cap of \$250,000
20 per claimant on non-economic damages, defined as pain and suffering,
21 inconvenience, etc. Nonetheless there are cases where economic damages can be
22 quite substantial and vary significantly from the average loss. Economic damages
23 are those that can be objectively quantified, including medical expenses, lost
24 wages and loss of use of property. The potential of high economic damage
25 awards increases the risk of the California medical malpractice line of business.

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27 Many of the large claims experienced by SCPIE arise from what we call "XPL"
28 claims, meaning excess of policy limits. Medical malpractice, unlike other
29 liability lines of business such as automobile liability, operates such that the
30 insured doctor must give the insurer permission to settle a claim out of court
31 before the insurer can pursue this avenue of settlement. If the doctor does not

1 give his permission for the insurer to settle, and the claim instead goes to court,
2 and a verdict is reached which is higher than the policy limits, the insurer pays the
3 policy limits, but the individual doctor is responsible for the amount in excess of
4 the policy limits. As a result of the doctor's potential liability, doctors routinely
5 demand that the insurer settle his claim within the policy limits, and doing so in
6 writing eliminates his responsibility for any adverse judgment over the policy
7 limits should the case go to trial. This is because if there is an adverse judgment
8 in excess of the policy limits, the insurer must pay the entire claim, not just the
9 policy limits. As a result, there is potential for the insurer to pay claims that are
10 very large, in excess of the policy limits.
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12 SCPIE has indeed experienced a number of very large losses over the years. The
13 following table displays incurred losses for California for report years 1997-2001
14 that are in excess of \$1 million each.
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16 Table 1
17 California Physicians' Medical Malpractice
18 Claims in Excess of \$1 Million by Report Year
19 (\$ in millions)
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<u>Report Year</u>	<u>Number</u>	<u>Dollar Amount</u>	<u>Average Size</u>
1997	3	\$10.5	\$3.5
1998	7	\$16.6	\$2.4
1999	3	\$11.9	\$4.0
2000	10	\$21.0	\$2.1
2001	8	\$9.7	\$1.2
Total	31	\$69.7	\$2.2

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Displaying these same large losses by size of loss produces Table 2:

Table 2
California Physicians' Medical Malpractice
Claims in Excess of \$1 Million by Size of Loss
(\$ in millions)

<u>Size of Loss</u>	<u>Number</u>	<u>Dollar Amount</u>	<u>Average Size</u>
Over \$1 Million	31	\$69.7	\$2.2
Over \$2 Million	9	\$40.7	\$4.5
Over \$5 Million	3	\$22.4	\$7.5

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This riskiness translates into high premiums for insured physicians. However, SCPIE's current rates, risky as they are, are not even the highest in the marketplace. SCPIE's main competition is NORCAL, the largest writer of medical malpractice insurance in California, insuring 23.5 percent of the market. The following chart compares NORCAL's average rates with SCPIE's for three Southern California counties. It also shows the average rates for San Luis Obispo, a county in the northern section. I have not given a complete listing of all the northern counties since SCPIE does not write much business there and because there is not much variability among the rates in the northern counties, so one example will suffice.

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Accordingly, even though MICRA limited non-economic damages, the potential of high economic damages in California makes medical malpractice a high-risk line of business.

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Table 3
California Physicians' Medical Malpractice
Average Mature Annual Rates for All Specialties
(\$1 Million / \$3 Million Limits)

<u>County</u>	<u>2003 NORCAL</u>	<u>2002 SCPIE</u>
Los Angeles	\$23,085	\$15,591
Orange	\$23,085	\$17,079
San Diego	\$20,635	\$14,282
San Luis Obispo	\$12,205	\$10,744

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A. Expense Trend:

(a) Show SCPIE's calculation for its fixed expense trend factor of 0.9967 used in Exhibit 35 and 37 and in support of Exhibit 38. From where did SCPIE obtain the data to use in the regulatory formula? Indicate the SCPIE Exhibits along with the Bates stamped page number for each supporting document.

The expense trend calculation is displayed in the table below. The explanation of the data sources is contained in the footnotes to the table.

When the expense trend was calculated for Exhibit 35, the miscellaneous losses were not included in the calculation. The expense trend factor at that time was 0.9967. However, when the miscellaneous losses were added into the calculation, the expense trend changed somewhat due to the inclusion of more losses and premiums, of which the expenses are a function. However, the resulting trend factor changed only in the fourth decimal place to 0.9970. If rounded to the third decimal point, as are most of the calculations associated with trend, the difference would disappear due to rounding.

Expense Trend Calculation

Expense Item	1999	2000	2001
	(a)	(b)	(c)
(1) Non-ULAE fixed expenses	\$17,368,193	\$17,966,744	\$15,681,366
(2) ULAE expenses	\$8,867,432	\$10,137,731	\$7,802,233
(3) Disallowed expenses	\$331,876	\$317,060	\$217,797
(4) Total fixed expenses	\$25,903,748	\$27,7878,415	\$23,265,802
(5) Exposures	16,807	16,187	15,398
(6) Average fixed expense	\$1,541	\$1,717	\$1,511
(7) Annual change		.1138	-.1198

Notes to Expense Trend Table:

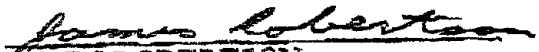
- (1) On SCPIE Ex. 38, Bates 423, non-ULAE fixed expenses are calculated as a percentage of premium for other acquisition, general, and taxes and fees other than CA premium taxes. For example, for 1999 this is $8.0\% + 6.8\% + 0.9\% = 15.7\%$. Fixed expense dollars come from an internal allocation report done by SCPIE. This percentage is then applied to the total limits earned premium displayed on SCPIE Ex. 38, Bates 0434, line 2 to arrive at the non-ULAE expenses in this line. For example, for 1999, 15.7% times $\$110,625,432 = \$17,368,193$. Calculations for 2000 and 2001 are analogous.
- (2) ULAE expense dollars are taken from the Insurance Expense Exhibits, Part III. Since these figures are not California-specific, a ULAE percentage is then calculated by dividing these ULAE dollars by the sum of losses and ALAE dollars. This percentage is then applied to the total limits ultimate loss and ALAE before trend is applied, which appears on SCPIE Ex. 38, Bates 0434, line 9. For example, the ULAE percentage for 1999 is 9.1% and 9.1% times $\$97,444,305 = \$7,867,432$.
- (3) Disallowed expenses are displayed on SCPIE Ex. 38, Bates 0425. These dollars come from an internal expense report of SCPIE. These dollars are then stated as a percentage of premium. These percentages are then multiplied by the total limits earned premium for each year to arrive at the disallowed expenses. For example, for 1999 disallowed expenses are equal to 0.3% of premium. Hence, 0.3% times $\$110,625,432 = \$331,876$.
- (4) $(1) + (2) - (3)$
- (5) Exposures are equal to the number of physicians insured for one year, stated in terms of Class 1 equivalents. That is, if a physician is insured for one year and is in a category such that his rate is 1.4 times the Class 1 physician rate, then the amount of exposures captured here is 1.4 units. Exposures are taken from internal SCPIE reports.
- (6) $(4) / (5)$

- 1 The average change then is the average of the two factors on line (6) in Table 1, or -.003
- 2 which, stated in terms of an expense trend factor is 0.997.
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I declare under penalty of perjury under the laws of the State of California that the foregoing testimony is true and correct.

Dated: April 30, 2003
at Los Angeles, California


JAMES ROBERTSON
Assistant Vice President/
Associate Actuary
THE SCPIE COMPANIES