1 Insuring the Practice of Medicine

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SUMMARY

Although all physicians are aware that practicing medicine in the United States is virtually impossible without some form of liability insurance, many have only a limited understanding of how the American system of professional assurance really works. It is important for the practicing physician to understand not only some of the technical language regarding insurance but also the various forms in which it is available. Doctors should understand the distinguishing features of an effective insurance program.

Key Words: Spread of risk; underwriting; claims made; occurrence; surplus.

INTRODUCTION

Virtually all practicing physicians in the United States require medical malpractice insurance. Although malpractice insurance is legally required in only a few states, the vast majority of hospitals and other health care institutions mandate that all medical staff members be insured. Specialty insurance companies that provide only professional liability insurance and multiline companies that cover this type of risk and many others provide this coverage.

From: *Medical Malpractice: A Physician's Sourcebook*
Edited by: R. E. Anderson © Humana Press Inc., Totowa, NJ

About two-thirds of America's doctors are insured by mutual or reciprocal companies. These are owned by the physician policyholders and are not responsible to outside shareholders. Virtually all of these companies specialize in professional liability insurance with limited or no exposure to other lines of business. The remaining one-third of doctors are insured by publicly traded commercial carriers owned by shareholders rather than policyholders. Most, but not all, of these companies sell multiple lines of insurance and tend to move in and out of malpractice coverage as business conditions warrant.

The fundamental business principles that apply to all American businesses also apply to insurance companies: income must cover expenses. For insurance companies, the major categories of expenses are as follows:

1. *Losses* represent the payments made to plaintiffs as a result of jury verdicts or settlements.
2. *Legal defense* represents the legal costs associated with settling or litigating individual claims; these are primarily defense attorney and expert witness fees.
3. *Operating expenses* include all other expenses incurred by the insurance company. Such expenses include underwriting, claims administration, finance, computer systems, marketing, and agent commissions.

However, there are a number of areas in which insurance differs from other businesses. The most important area is the need to collect an appropriate amount of premium today to cover the cost of losses and legal defense that may, and often do, occur 4 to 6 years in the future. By definition, actual future costs are unknown at the time the insurer must price and sell the policy. If insurers seriously underestimate future costs and fall into insolvency, the physician is left without the liability protection that he or she paid for, but the liability remains. Therefore, the choice of a malpractice insurance company is an important one for physicians. The true value of a policy (as opposed to its cost) may not be apparent until years after the purchase, when a claim must be defended and possibly paid.

The following principles of insurance and definitions of key terms are intended to facilitate that choice.

SPREAD OF RISK

Physicians as a group, knowing some of them will be sued and will have to pay litigation costs and losses, pool resources to share the total burden of the group. In any given year, not every physician will be sued,