

Regulatory Analysis Form

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REGULATORY REVIEW COMMISSION



IRRC Number: 2154

(1) Agency

Insurance Department

(2) I.D. Number (Governor's Office Use)

11-197

(3) Short Title

Discounting Medical Malpractice Loss Reserves

(4) PA Code Cite

31 Pa. Code, Chapter 118, §§118.1-118.6

(5) Agency Contacts & Telephone Numbers

Primary Contact: Peter J. Salvatore, Regulatory Coordinator,
1326 Strawberry Square, Harrisburg, PA 17120, (717) 787-4429
Secondary Contact:

(6) Type of Rulemaking (check one)

- Proposed Rulemaking
 Final Order Adopting Regulation
 Final Order, Proposed Rulemaking Omitted

(7) Is a 120-Day Emergency Certification Attached?

- No
 Yes: By the Attorney General
 Yes: By the Governor

(8) Briefly explain the regulation in clear and nontechnical language.

The Department is amending §§118.1-118.6 to assure the continued availability of medical malpractice insurance via the voluntary market at the primary level and to be consistent with current actuarial practice and economic conditions. The amendments will prohibit discounting on policies with an effective date following final publication of this regulation in the *Pennsylvania Bulletin*. The amendments will also allow insurers who currently discount to be able to run off that discounting over a 10 year period.

(9) State the statutory authority for the regulation and any relevant state or federal court decisions.

The Department proposes to amend this regulation under the authority of the act of May 17, 1921, P.L. 682, No. 284 (40 P.S. §§341-999); the act of May 17, 1921, P.L. 789, No. 285 (40 P.S. §§1-321); and Sections 206, 506, 1501 and 1502 of the Administrative Code of 1929 (71 P.S. §§66, 186, 411 and 412).

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(10) Is the regulation mandated by any federal or state law or court order, or federal regulation? If yes, cite the specific law, case or regulation, and any deadlines for action.

No.

(11) Explain the compelling public interest that justifies the regulation. What is the problem it addresses?

The Insurance Department seeks to amend Chapter 118, §§118.1-118.6 to be consistent with the authorizing statute. Moreover, it is in the public interest to amend the regulation to prohibit future discounting of medical malpractice insurance to ensure that proper reserves are maintained for future claims.

(12) State the public health, safety, environmental or general welfare risks associated with nonregulation.

There are no public health, safety, environment or general welfare risks associated with this rulemaking.

(13) Describe who will benefit from the regulation. (Quantify the benefits as completely as possible and approximate the number of people who will benefit.)

The medical profession and the general public will benefit from the regulation to the extent that the regulation will be more consistent with the authorizing statute and ensure that proper reserves are maintained for future claims.

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(14) Describe who will be adversely affected by the regulation. (Quantify the adverse effects as completely as possible and approximate the number of people who will be adversely affected.)

There will be no adverse effects on any party as a result of the amendment of this regulation.

(15) List the persons, groups or entities that will be required to comply with the regulation. (Approximate the number of people who will be required to comply.)

The regulation applies to all insurers licensed to sell medical malpractice insurance and who do business in the Commonwealth.

(16) Describe the communications with and input from the public in the development and drafting of the regulation. List the persons and/or groups who were involved, if applicable.

Comments regarding the amendment of this regulation were solicited from the various trade associations representing the insurance industry. The Pennsylvania Medical Society Liability Insurance Company (PMSLIC) was instrumental in assisting the Department with language that achieved the desired results.

(17) Provide a specific estimate of the costs and/or savings to the regulated community associated with compliance, including any legal, accounting or consulting procedures which may be required.

The amendment of the regulation will not have any impact on costs associated with insurance companies or the medical profession. Currently, medical malpractice carriers are allowed to discount their liabilities, if they satisfy certain minimum requirements. The amendment of this regulation will require carriers to get the Department's permission to discount liabilities written after the effective date of publication in the *Pennsylvania Bulletin*. There is no cost associated with this change. Insurers who previously discounted their medical malpractice reserves will be permitted to discount booked reserves until December 31, 2010.

Regulatory Analysis Form

(18) Provide a specific estimate of the costs and/or savings to local governments associated with compliance, including any legal, accounting or consulting procedures which may be required.

There are no costs or savings to local governments associated with this rulemaking.

(19) Provide a specific estimate of the costs and/or savings to state government associated with the implementation of the regulation, including any legal, accounting, or consulting procedures which may be required.

There are no costs or savings to state government associated with this rulemaking. The current practice and method of reviewing financial statements will not change due to the amendment of this regulation.

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(20) In the table below, provide an estimate of the fiscal savings and costs associated with implementation and compliance for the regulated community, local government, and state government for the current year and five subsequent years. N/A

	Current FY Year	FY +1 Year	FY +2 Year	FY +3 Year	FY +4 Year	FY +5 Year
SAVINGS:	\$	\$	\$	\$	\$	\$
Regulated Community						
Local Government						
State Government						
Total Savings						
COSTS:						
Regulated Community						
Local Government						
State Government						
Total Costs						
REVENUE LOSSES:						
Regulated Community						
Local Government						
State Government						
Total Revenue Losses						

(20a) Explain how the cost estimates listed above were derived.

N/A.

Regulatory Analysis Form

(20b) Provide the past three year expenditure history for programs affected by the regulation.
N/A.

Program	FY -3	FY -2	FY -1	Current FY

(21) Using the cost-benefit information provided above, explain how the benefits of the regulation outweigh the adverse effects and costs.

No costs or adverse effects are anticipated as a result of this regulation.

(22) Describe the nonregulatory alternatives considered and the costs associated with those alternatives. Provide the reasons for their dismissal.

Amending Chapter 118, §§118.1-118.6 is the most efficient method to achieve consistency with the authorizing statute. No other alternatives were considered.

(23) Describe alternative regulatory schemes considered and the costs associated with those schemes. Provide the reasons for their dismissal.

No other regulatory schemes were considered. The amendment of the regulation is the most efficient method of updating the regulatory requirements.

Regulatory Analysis Form

(24) Are there any provisions that are more stringent than federal standards? If yes, identify the specific provisions and the compelling Pennsylvania interest that demands stronger regulation.

No.

(25) How does this regulation compare with those of other states? Will the regulation put Pennsylvania at a competitive disadvantage with other states?

The rule making will not put Pennsylvania at a competitive disadvantage with other states. Only one other state (Indiana) currently allows medical malpractice insurers to discount loss reserves. Under the current regulation, there is an inconsistency in financial reporting between insurance companies that discount and those that don't.

(26) Will the regulation affect existing or proposed regulations of the promulgating agency or other state agencies? If yes, explain and provide specific citations.

No.

(27) Will any public hearings or informational meetings be scheduled? Please provide the dates, times, and locations, if available.

No public hearings or informational meetings are anticipated.

Regulatory Analysis Form

(28) Will the regulation change existing reporting, record keeping, or other paperwork requirements? Describe the changes and attach copies of forms or reports which will be required as a result of implementation, if available.

The amendment of the regulation imposes no additional paperwork requirements on the Department, the insurers, the medical profession or the general public.

(29) Please list any special provisions which have been developed to meet the particular needs of affected groups or persons including, but not limited to, minorities, elderly, small businesses, and farmers.

The rulemaking will have no effect on special needs of affected parties.

(30) What is the anticipated effective date of the regulation; the date by which compliance with the regulation will be required; and the date by which any required permits, licenses or other approvals must be obtained?

The rulemaking will take effect upon approval of the final form regulation by the legislative standing committees, the Independent Regulatory Review Commission, the Office of the Attorney General and upon final publication in the *Pennsylvania Bulletin*.

(31) Provide the schedule for continual review of the regulation.

The Department reviews each of its regulations for continued effectiveness on a triennial basis.

CDL-1

FACE SHEET
FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE
BUREAU

(Pursuant to Commonwealth Documents Law)

2001 APR 19 PM 2:50

REVIEW COMMISSION

2154

DO NOT WRITE IN THIS SPACE

Copy below is hereby approved as to
form and legality. Attorney General

By _____
(Deputy Attorney General)

Date of Approval

→ Check if applicable.
Copy not approved. Objections
attached.

Copy below is hereby certified to be a true and correct
copy of a document issued, prescribed or promulgated
by:

Insurance Department

(AGENCY)

DOCUMENT/FISCAL NOTE NO. 11-197

DATE OF ADOPTION: _____

BY: M. Diane Koken
M. Diane Koken

Insurance Commissioner
TITLE: _____
(EXECUTIVE OFFICER, CHAIRMAN OR
SECRETARY)

Copy below is hereby approved as to form and
legality. Executive or Independent Agencies

BY: John V. Turner

DATE OF APPROVAL

(DEPUTY GENERAL COUNSEL)
(CHIEF COUNSEL, INDEPENDENT AGENCY)
(STRIKE INAPPLICABLE TITLE)

→ Check if applicable. No Attorney General
approval or objection within 30 days after
submission.

Insurance Department
Notice of Final Form Rulemaking

31 PA Code, Chapter 118
§§118.1-118.6

Discounting Medical Malpractice Loss Reserves

PREAMBLE

The Insurance Department (Department) hereby amends §§118.1-118, Discounting Medical Malpractice Loss Reserves, as set forth in Annex A.

Statutory Authority

The final form regulation is adopted under the authority of the act of May 17, 1921, P.L. 682, No. 284 (40 P.S. §§341-999); the act of May 17, 1921, P.L. 789, No. 285 (40 P.S. §§1-321); and sections 206, 506, 1501 and 1502 of the Administrative Code of 1929 (71 P.S. §§66, 186, 411 and 412).

Comments and Response

Notice of proposed rulemaking was published at 30 Pa.B. 5452 (October 21, 2000) with a 30-day comment period. During the 30-day comment period, comments were received from the Insurance Federation of Pennsylvania, Inc. (IFP) and the Professional Insurance Agents Association of Pennsylvania, Maryland and Delaware, Inc.(PIA). During its regulatory review, the Independent Regulatory Review Commission (IRRC) submitted comments to the Department. The following is a response to those comments.

The IFP supported the regulation in its entirety.

The PIA asked how the Department determined that there would be no fiscal impact. The PIA stated that it “[...] has always understood that the Insurance Department has always considered investment income during the rate review process. This consideration thus reduced the ultimate rate approved in accordance with the statutory duty of the Commissioner that rates shall not be excessive, inadequate or unfairly discriminatory. By not permitting loss reserve discounting, it would appear that rates would have to be adjusted upward to compensate in the rate filing. That would produce higher premium rates to policyholders, however, PIA recognizes that premiums may remain the same.”

Discounting is a reflection of investment income, which is one of many factors that insurance companies take into account in setting rates. As a practical matter, the impact that discounting may have on insurance rates is a reflection of a particular insurance company’s financial strength. Currently, only one medical malpractice insurer in the Commonwealth discounts its loss reserves. Because this company has more than adequate reserves, the Department does not anticipate that its rates will increase due to the amendments to this regulation. The regulation should have no impact on the rates of the remaining insurance carriers writing medical malpractice insurance in the Commonwealth because none of these insurers discount their loss reserves.

In addition, in January 2001, the National Association of Insurance Commissioners (NAIC) required all insurers to follow the recently adopted Statements of Statutory Accounting Principles which specifically prohibits discounting of medical malpractice loss reserves unless

the insurer is allowed to do so by statute or regulation or requests a permitted practice from the Department (or other regulatory authority). Also, the majority of the states do not permit discounting of loss reserves. Therefore, the phase out of discounting in the Commonwealth should have minimal impact on the insurers engaged in the business of medical malpractice insurance.

During its 30-day review, the IRRC questioned whether an effective date of January 1, 2001 was feasible as that date has passed. The IRRC recommended that 118.3(4) be revised to apply prospectively to policies that become effective after the date of final publication of the regulation.

The Department has no objection to making this change. Discounting will not be permitted on policies sold on or after the effective date of the regulation.

Affected Parties

The rulemaking applies to insurance companies, doing the business of Medical Malpractice insurance in this Commonwealth.

Fiscal Impact

State Government

There will be no increase in cost to the Department due to the adoption of the Chapter 118.

General Public

There will be no fiscal impact to the public.

Political Subdivisions

The rulemaking will not impose additional costs on political subdivisions.

Private Sector

The rulemaking will not impose additional costs of insurance companies doing the business of Medical Malpractice insurance in the Commonwealth.

Paperwork

The adoption of the rulemaking will not impose additional paperwork on the Department or the insurance industry.

Effectiveness/Sunset Date

This rulemaking becomes effective upon publication in the Pennsylvania Bulletin. No sunset date has been assigned.

Contact person

Any questions regarding this regulation, should be directed to Peter J. Salvatore, Regulatory Coordinator, Office of Special Projects, 1326 Strawberry Square, Harrisburg, PA 17120, phone (717) 787-4429. In addition, questions may be e-mailed to psalvatore@state.pa.us or faxed to (717) 772-1969.

Regulatory review

Under section 5(a) of the Regulatory Review Act (71 P.S. §745.5(a)), the agency submitted a copy of this regulation on October 11, 2000 to the Independent Regulatory Review Commission (IRRC) and to the Chairpersons of the Senate Committee on Banking and Insurance and the House Committee on Insurance. In addition to the submitted regulation, the agency has provided IRRC and the Committees with a copy of a detailed Regulatory Analysis Form prepared by the agency in compliance with Executive Order 1996-1, "Regulatory Review and Promulgation." In compliance with section 5(c) of the Regulatory Review Act (71 P.S. § 745.5(c)), the agency also provided IRRC and the Committees with copies of the comments received. A copy of that material is available to the public upon request.

This final-form regulation was deemed approved by the Senate Committee on Banking and Insurance on _____ and deemed approved by the House Committee on Insurance on _____ in accordance with section 5a(d) of the Regulatory Review Act (71 P.S. § 745.5a(d)). The IRRC met on _____ and deemed approved the regulation in accordance with section 5a(e) of the Regulatory Review Act (71 P.S. §745.5a(e)).

Findings

The Commissioner finds that:

(1) Public notice of intention to adopt this rulemaking as amended by this order has been given under sections 201 and 202 of the act of July 31, 1968 (P.L. 769, No240) (45 P.S. §§1201 and 1202) and the regulations thereunder, 1 Pa. Code §§7.1 and 7.2.

(2) The adoption of this rulemaking in the manner provided in this order is necessary and appropriate for the administration and enforcement of the authorizing statutes.

Order

The Commissioner, acting under the authorizing statutes, orders that:

(1) The regulations of the Department, 31 Pa. Code, are amended by adopting §§118.1-118.6, to read as set forth in Annex A.

(2) The Commissioner shall submit this order and Annex A to the Office of General Counsel and Office of Attorney General for approval as to form and legality as required by law.

(3) The Commissioner shall certify this order and Annex A and deposit them with the Legislative Reference Bureau as required by law.

(4) The regulation adopted by this order shall take effect upon final publication in the *Pennsylvania Bulletin*.

Diane Koken
Insurance Commissioner

CONTINUATION SHEET FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE BUREAU
(Pursuant to Commonwealth Documents Law)

ANNEX A

Title 31. Insurance. Part VII. Property, Fire and Casualty Insurance, Chapter 118. Discounting of Medical Malpractice Loss Reserves.

Sec.

118.1. Definitions.

118.2. Reporting and data collection requirements.

118.3. Restrictions on discounting loss reserves.

118.4. Actuarial certification.

118.5. Reserves for loss adjustment expenses.

118.6. Increased loss reserves and loss adjustment expense reserves.

§ 118.1. Definitions.

(a) The definitions utilized in Chapter 116 (relating to discounting of worker's compensation loss reserves) are incorporated for use in this chapter except that language utilizing the term[s] "worker's compensation" shall be amended for use in this chapter utilizing the term[s] "medical malpractice".

(b) For purposes of this chapter, the definition of "insurance company" in § 116.1 (relating to definitions) also includes the Pennsylvania Professional Liability Joint Underwriting Association, an insurance entity created under section 801 of the Health Care Services Malpractice Act (40 P. S. § 1301.801).

(c) The term "independent actuary" as used in § 118.4(a) (relating to actuarial certification) means a fellow or associate of the Casualty Actuarial Society with appropriate experience in responsible actuarial work, including medical malpractice, who is not an officer, director or employe of the insurer whose reserves he is certifying.

(d) Other definitions:

Act - The Insurance Department Act of 1921 (40 P.S. § 1 et seq.)

Commissioner - The Insurance Commissioner of the Commonwealth

Department - The Insurance Department of the Commonwealth

§ 118.2. Reporting and data collection requirements.

For loss reserves established by insurance companies under sections 312-316 of [The Insurance Department Act of one thousand nine hundred and twenty-one] the act (40 P. S. §§ 111-115), a company is permitted to discount the medical malpractice reserves to their present value if the company complies with the following requirements. The insurance company shall:

(1) File an annual actuarial certification of its medical malpractice loss reserves and loss adjustment expense reserves with the Department simultaneously with the filing of the company's annual statement.

(2) Provide a written notice to the Department stating its intent to maintain separate data regarding the company's loss payment patterns for allocated loss adjustment expenses and losses. This data shall be regularly compiled and submitted to the Department upon request.

(3) Comply with existing annual statement instructions for reporting loss and loss adjustment expense reserves including completion of supplemental Schedule P, Part 4C of the annual statement.

(4) File with its annual statement a description of the underlying assumptions for the calculation of the discount to present value of its loss reserves and allocated loss adjustment expense reserves.

§ 118.3. Restrictions on discounting loss reserves.

The discounting of loss reserves is subject to the following limitations:

(1) The loss reserves discounted to present value in accordance with this chapter may not be less than those required in accordance with section 313(b) of [The Insurance Department Act of one thousand nine hundred and twenty-one] the act (40 P. S. § 112(b)).

(2) The maximum rate of interest which an insurer may assume for purposes of discounting is 6%.

(3) An insurer may request an exception to the maximum interest rate in paragraph (2) if the insurer can demonstrate to the satisfaction of the Commissioner that its investment yield justifies a higher interest rate assumption. The Commissioner may require the insurer to submit additional documentation to support its request for approval of a higher interest rate assumption. The Commissioner will act upon requests for exceptions made under this paragraph within 90 days of the date the request is received by the Insurance Department.

(4) An insurer shall not discount loss reserves or loss adjustment expense reserves for policies with an effective date on or after ~~January 1, 2001~~ (EDITOR'S NOTE...INSERT DATE OF FINAL PUBLICATION).

(5) An insurer may not discount loss reserves or loss adjustment expense reserves after December 31, 2010.

§ 118.4. Actuarial certification.

(a) The actuarial certification required in accordance with this chapter shall be prepared by an independent actuary and filed by the insurer with its annual statement.

(b) The actuarial certification shall be filed each year in which the insurer discounts its loss reserves.

(c) The actuarial certification shall include the opinion of an independent actuary with respect to the following:

(1) The adequacy of medical malpractice loss reserves on an undiscounted basis.

(2) The sufficiency of the investment yield on invested assets to fund the discount.

(3) The reasonableness of the matching of the invested assets and loss reserves attributable to the medical malpractice business to provide an adequate income stream to fund the discount.

§ 118.5. Reserves for loss adjustment expenses.

(a) Loss adjustment expense reserves shall be calculated in accordance with the following standards:

(1) Insurance companies are not permitted to discount loss adjustment expense reserves which are not allocable to specific claims.

(2) Insurance companies are permitted to discount loss adjustment expense reserves which are allocable to specific claims if:

(i) The company demonstrates, to the satisfaction of the Commissioner, the validity of the assumptions underlying the calculation of the reserves.

(ii) The actuarial certification which includes the opinion of an independent actuary with respect to the criteria in § 118.4 (relating to actuarial certification) is applicable to the loss adjustment expense reserves as well as the loss reserves.

(b) In evaluating an insurance company's request to discount allocated loss adjustment expense reserves, the Commissioner will consider the company's specific loss adjustment expense payment pattern and the interest rate assumption.

§ 118.6. Increased loss reserves and loss adjustment expense reserves.

Under section 316 of [The Insurance Department Act of one thousand nine hundred and twenty-one] the act (40 P. S. § 115), the Commissioner may require an insurance company to restate its loss reserves or its allocated loss adjustment expense reserves by reducing or eliminating the discount if the Commissioner determines it is necessary to insure that reserves are established at an adequate level.



**COMMONWEALTH OF PENNSYLVANIA
INSURANCE DEPARTMENT**

SPECIAL PROJECTS OFFICE
1326 Strawberry Square
Harrisburg, PA 17120

Phone: (717) 787-4429
Fax: (717) 772-1969
E-mail: psalvatore@state.pa.us

April 19, 2001

Mr. Robert Nyce
Executive Director
Independent Regulatory Review Comm.
333 Market Street
Harrisburg, PA 17101

Re: Insurance Department Final
Form Regulation No. 11-197,
Discounting of Medical
Malpractice Loss Reserves

Dear Mr. Nyce:

Pursuant to Section 5a(c) of the Regulatory Review Act, enclosed for your review and approval is final form regulation 31 Pa. Code, Chapter 118, Discounting of Medical Malpractice Loss Reserves.

Chapter 118 was initially promulgated to establish procedural and reporting requirements and restrictions on the discounting of medical malpractice loss reserves. This final form rulemaking amends Chapter 118 of Title 31 of the Pennsylvania Code to be consistent with current actuarial practice and economic conditions.

If you have any questions regarding this matter, please contact me at (717) 787-4429.

Sincerely yours,

A handwritten signature in cursive script that reads "Peter J. Salvatore".

Peter J. Salvatore
Regulatory Coordinator

**TRANSMITTAL SHEET FOR REGULATIONS SUBJECT TO THE
REGULATORY REVIEW ACT**

I.D. NUMBER: 11-197
 SUBJECT: Discounting Medical Malpractice Loss Reserves
 AGENCY: DEPARTMENT OF INSURANCE

TYPE OF REGULATION

- Proposed Regulation
- X Final Regulation
- Final Regulation with Notice of Proposed Rulemaking Omitted
- 120-day Emergency Certification of the Attorney General
- 120-day Emergency Certification of the Governor
- Delivery of Tolloed Regulation
 - a. _____ With Revisions
 - b. _____ Without Revisions

RECEIVED
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 INDEPENDENT REGULATORY
 REVIEW COMMISSION

FILING OF REGULATION

DATE	SIGNATURE	DESIGNATION
4/14/01	<u>Shilo Eckhart</u>	HOUSE COMMITTEE ON INSURANCE
4/19	<u>MC Nitchel</u>	
4/19	<u>Dwight Nitchel</u>	SENATE COMMITTEE ON BANKING & INSURANCE
4-19	<u>MT Gallagher</u>	
4/17/01	<u>Stephen J. Hoff</u>	INDEPENDENT REGULATORY REVIEW COMMISSION
_____	_____	ATTORNEY GENERAL
_____	_____	LEGISLATIVE REFERENCE BUREAU

April 10, 2001