State of New Mexico
LEGISLATIVE FINANCE COMMITTEE
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David Abbey
Director

February 15, 2018

John Franchini, Superintendent of Insurance
Office of the Superintendent of Insurance
1120 Paseo de Peralta, 4th Floor
Santa Fe, NM 87504

Dear Superintendent Franchini:

LFC staff were asked to review the current status of the Patient Compensation Fund, and we have now completed that review. While the project was not a formal evaluation, during our review LFC staff identified several opportunities for improvement, as noted in the attached memo, that you may want to consider.

We very much appreciate the cooperation and assistance we received from you and your staff. Mr. Vargas and Mr. Seeley were particularly helpful.

Sincerely,

Charles Sallee, Deputy Director

CS/jf

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MEMORANDUM

TO: Charles Sallee, LFC Deputy Director

FROM: Jenny Felmley, Ph.D., LFC Program Evaluator

SUBJECT: The Patient Compensation Fund

This memo was prepared in response to a request for a brief overview and current status update of the Patient Compensation Fund.

The 1976 New Mexico Medical Malpractice Act (Act) was passed to promote the health and welfare of New Mexicans by ensuring that health care providers in the state are able to obtain malpractice insurance at a reasonable cost. The Act established the Patient Compensation Fund (PCF) as a mechanism to assist qualified health care providers with payment of malpractice claims. The PCF was created in the state treasury, and the Superintendent of Insurance is the custodian and trustee for the fund.

Benefits

For qualified providers, the Act limits personal liability to the first $200,000 of a claim, after which the PCF covers any amount between $200,000 and the $600,000 cap, as well as unlimited ongoing patient medical care and related benefits; punitive damages are separate and remain the provider's responsibility. In addition, the Act provides the benefit of a three year statute of limitations for health care providers who qualify under its provisions and requires all malpractice claims be reviewed by the NM Medical Review Commission prior to being filed in a court.

Eligibility

Under the Act, a health care provider means 'a person, corporation, organization, facility or institution licensed or certified by this state to provide health care or professional services as a doctor of medicine, hospital, outpatient health care facility, doctor of osteopathy, chiropractor, podiatrist, nurse anesthetist or physician's assistant' (Section 41-5-3, NMSA 1978).

To be qualified under the Act, health care providers are required to have their own primary insurance that covers up to $200,000 per occurrence, for no more than three occurrences per year; alternatively, providers other than hospitals and outpatient facilities may keep $600,000 in cash on deposit with the OSI.

Qualified providers then pay an annual surcharge into the fund (through their insurance carrier) in an amount determined by the superintendent. Individual provider surcharges are based on the provider's specialty or, for hospitals or outpatient facilities, on a risk assessment and actuarial study arranged for by the superintendent.

Current membership

According to OSI, there are currently 2,437 physicians, 309 physician assistances, 84 certified registered nurse anesthetists in the PCF pool, as well as 24 hospitals and 52 outpatient facilities. Over 45 percent of all physicians in the pool are employed by hospitals. Presbyterian Health Systems' entry into the PCF dramatically increased the size of the covered population, bringing 727 physicians, eight hospitals and 48 outpatient facilities.

Hospitals

Although the Act clearly lists hospitals as possible qualified providers, no hospital entered the PCF until Christus St. Vincent Hospital joined in 2009; there was then a seven year period before the next hospitals entered in 2016. According to the NM Hospital Association, the primary stumbling block for hospitals was the lack of a carrier to provide occurrence-based coverage; independent physicians initially had the same problem and ultimately formed their own carrier. In September 2016, the NMHA and its members overcame this hurdle by forming the Risk Purchasing Group (RPG), which contracted with Coverys/ Preferred Professional Insurance Company (PPIC) as their carrier; that same month, 19 hospitals and outpatient facilities entered the PCF. In 2017, two more hospitals/hospital systems entered, Gerald Champion via the RPG and Presbyterian Health Systems independently.

Brief recent history of the PCF

Since 2009, individual providers have paid a total of $96.6 million in surcharges, and the PCF has paid out a total of $132 million in provider claims. Physician surcharges have fluctuated very little since 2009, hovering around $10 million per year. However, surcharges should have increased by around $2 million for FY17, as almost 300 new hospital employed physicians joined the pool; OSI is currently auditing its surcharge receipts for the year.

Physician-based claims, on the other hand, have increased every year except 2011, sometimes dramatically. Both 2012 and 2016 were particularly difficult years, during which $21 million of claims were paid out on behalf of just two doctors with dozens of suits (Chart 1).

Chart 1: Physicians Only
in millions

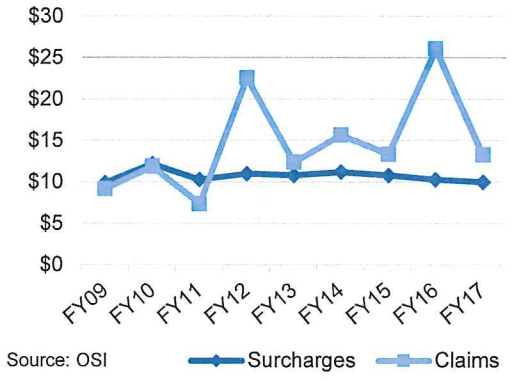
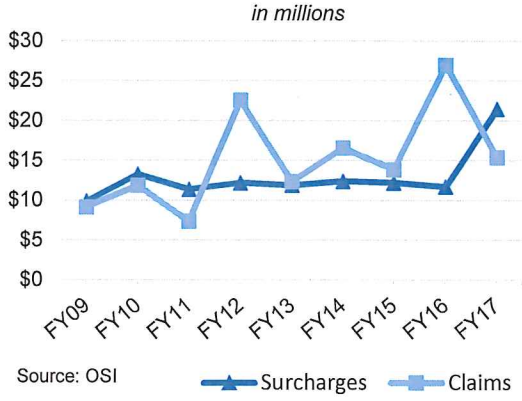


Chart 2: All Qualified Providers
in millions



Since 2009, hospitals and facilities have paid a total of $20 million in surcharges – just Christus St. Vincent's $1.1 million to $1.3 million until 2017, when $11.5 million in surcharge revenue started coming in from the newly-admitted hospitals (Chart 2). For 2018 that amount should increase to $18.1 million. The PCF has paid out a total of $4.5 million in hospital claims; Christus St. Vincent entered the fund in 2009 but did not have any claims paid by the PCF until 2014.

Presbyterian entered the PCF in FY18 and so revenues for its hospitals, facilities, and physicians are not reflected in the tables above. Presbyterian's hospital surcharge of $9.7 million and the combined surcharges for its over 700 employed physicians, $5.3 million, will more than double the previous totals for these categories. Based on data provided by OSI, total FY18 hospital surcharge revenue should be approximately $18.8 million, while total physician surcharges should be approximately $19 million. Surcharges for other providers types, including physician's assistants, certified registered nurse anesthetists, and doctor-owned businesses, will add at least another $500,000 to the PCF's revenues.

The full financial impact of hospital entry into the PCF will not be clear for some time. In the short run, the influx of hospital and hospital-employed physician surcharge revenues is of significant value to the PCF; the addition of hospital surcharges to the fund made 2017 the first year since 2011 that surcharge revenue was sufficient to pay all claims. On the other hand, malpractice suits can take years to reach settlement and there will almost certainly be substantial hospital claims a few years from now. It is worth noting that by the time the first claim against Christus St. Vincent was paid by the PCF, the hospital had paid more than six times the value of that settlement in surcharges.

2016 Actuarial Report

The 2016 actuarial report by OSI's contracted actuary noted that the PCF's projected liabilities exceed projected revenues and fund balances. As of December 31, 2015, the PCF had a fund balance of $36.6 million, estimated loss reserves of between approximately $73.3 million and $81.2 million (depending on the risk margin), and a resulting fund deficit of between approximately $29.8 million and $44.7 million.

The actuary recommended a surcharge increase of a minimum of 18.1 percent to stabilize the fund; a higher increase of 46.8 percent would include the risk margin and improve the likelihood that surcharges would be enough to cover all claims for the coming year.

The report also notes that OSI provided much less PCF financial and claims data than had been provided for prior analyses, and that its projections were therefore subject to a degree of uncertainty. No detailed claims data was provided and claims could not be, for example, evaluated by physician specialty; the actuary did nonetheless identify over 30 different provider specialties to consider for rate adjustment.

The actuary's report does not distinguish between surcharges and claims related to individual health care providers and those related to hospitals and outpatient healthcare facilities. So the analysis does not address the current debate about the potential impact of hospitals joining the fund, although the data makes clear that the PCF has been financially unstable for years.

2016 State Audit

The State Auditor's 2016 annual OSI financial and compliance audit echoed the actuary report in finding a PCF deficit and raised concerns about OSI financial controls and oversight throughout the agency.

Finding 2016-002 concludes that PCF deficits have been increasing each year. The audit notes a total of $33.3 million in assets at the end of FY16, and total liabilities of over $68.3 million, leaving a deficit of over $35 million, and concludes that assets in the PCF may not be enough to cover existing claims. The Act stipulates that if payable claims exceed the fund balance, each claimant is to receive a prorated amount. Despite projected shortfalls, to date the PCF has not had to prorate payments.

The report points out that surcharges have not increased since 2009, but also includes a response from OSI indicating the office has already taken steps to increase surcharges for individual providers over two years for a combined increase of 18.2 percent, and plans future annual or biennial increases based on recommendations of the actuary.

Finding 2016-006 points out that there is no specific bureau responsible for the PCF and process ownership for the fund is not defined. OSI responded to this finding by saying that it had tried to create a new position of PCF director, with one supervised FTE, but SPO had disapproved the plan because it requires management positions to have two or more supervised FTEs. Findings 2016-012 and 2016-020 are related to inaccurate surcharge revenues and contract invoices.

2017 State Audit

The 2017 audit finds a total of approximately $42.2 million in assets at the end of FY17, and total liabilities of over $68 million, leaving a deficit of over $25.8 million. The PCF is an investment fund with the State Treasurer's office, but the primary purpose of the fund is to pay claims and investment income ($2.4 million in FY17) is not sufficient to cover the deficit. Surcharges for FY17 are reportedly nearly double the FY16 total, rising from approximately $11.7 million to approximately $21.5 million; paired with a FY17 claims paid amount that is about half the claims amount for FY16, the result is a $9 million net fund increase for the year.

Findings 2016-006 and 2016-012 were revised and repeated. OSI is reportedly developing enhancements to the PCF system for FY18 that will allow it to automatically calculate surcharges, rather than rely on insurance carriers' calculations.

Current dispute

On July 28, 2017, four physicians, all qualified health care providers under the NM Medical Malpractice Act and contributors to the PCF, and all past or current presidents of the New Mexico Medical Society, filed a complaint for injunctive and declaratory relief against Superintendent of Insurance John Franchini and the OSI with the First Judicial District Court.

Plaintiffs are, essentially, concerned about the entry of hospitals into the PCF, which they believe will further destabilize the already actuarially unsound PCF by introducing the possibility of unlimited numbers of new claims. However, they are not asking the court to adjudicate the actual decision to allow the hospitals to join nor are they asking the court to review the surcharges to determine whether they are appropriate. Their focus is administrative: they allege OSI is subject to the NM Administrative Procedures Act and has failed to promulgate the rules necessary to establish a process for reviewing and approving hospital requests to join PCF. Without established

rules and procedures, they allege, OSI did not conduct its decision-making process publicly and did not allow existing beneficiaries of the PCF, other stakeholders, and members of the public the opportunity for appropriate public scrutiny and input.

Plaintiffs request the court set aside OSI's decisions to admit the hospitals, from 2009 forward, effectively removing the hospitals from the PCF, and require OSI to promulgate appropriate rules prior to any further action of this sort.

OSI responds that plaintiffs do not have standing to bring this suit because they have not been harmed by the entry of hospitals into the PCF. OSI also asserts that the NM Medical Malpractice Act only has two rulemaking requirements, neither of which are relevant to plaintiffs' arguments; the office is therefore not subject to the full scope of the NM Administrative Procedures Act. In its discussion of other points raised in the complaint, OSI acknowledges the PCF is running a deficit but stresses the fund has never been unable to pay claims, denies any present threat that it will be unable to do so, and affirmatively argues the superintendent has been a good trustee of the PCF, raising surcharges when necessary to protect the fund.

LFC staff recommendations

Improve OSI management of the PCF.
The PCF took in over $21 million in surcharge revenue in FY17, and paid out approximately $15.4 million in claims. Surcharge revenue will increase by at least $15 million during FY18 with Presbyterian Health Systems' entry into the fund, and both revenues and claims are projected to continue to increase in the coming years. Yet OSI has no staff member dedicated full time to the PCF, which limits its ability to manage the fund effectively, autonomously, and accountably.

OSI should reorganize internally to address the 'control environment' concerns raised by the State Auditor and to provide more staff resources for the PCF. There are many ways to accomplish this goal and the State Personnel Office is not responsible for OSI's lack of action in this area.

To address PCF financial stability, OSI needs to follow the recommendations of its contracted actuary and the State Auditor and review/increase surcharges for individuals and hospitals on an annual basis until the fund stabilizes. OSI decision-making should be autonomous and less reliant on actuarial analysis provided by applicants.

Increase transparency of OSI process and documents.
The OSI process for admitting hospitals into the PCF and determining their surcharges should be more transparent. OSI is a state agency and should not make decisions assuming state responsibility for millions – or more likely tens of millions – of dollars in hospital-associated claims without a greater degree of accountability. If the court determines that OSI is, in fact, subject to the NM Administrative Procedures Act, then the agency needs to get on with promulgating rules. This seems like a prudent thing to do; if the court does not order OSI to develop rules, the Legislature should consider amending the Act to give OSI explicit rule-making authority.

Public confidence in the process could be enhanced by periodic public meetings about upcoming changes to the PCF – or even just postings to the OSI web page. Most of the documents related to OSI's decisions to admit hospitals to the PCF should be available for public review. OSI attorneys determined all studies done by NMHA's actuary are confidential pursuant to NMSA 1978, 59A-

2-12(B); relying on its interpretation of this statute, OSI was unwilling to provide copies to the plaintiffs and denied the LFC's request for copies. LFC staff were, however, allowed to view the NMHA documents in the OSI office and to have copies of the reviews completed by OSI's contracted actuary, which include a secondary review of the NMHA document as well as original reports for Christus St. Vincent and Presbyterian. OSI's own reviews should be made readily available and OSI could also consider establishing content standards for hospital actuarial studies so that they contain at least a core set of data that could be made public.

Increase accountability through more robust oversight.
There appears to be variability in the extent of review provided by OSI for initial and subsequent surcharge setting for hospitals and facilities. For example, the NMHA actuary conducted detailed evaluations for the initial review and rate setting for all hospitals except Christus and Presbyterian. For all the NMHA hospitals except Gerald Champion, OSI's contracted actuary did a written secondary review. For Gerald Champion, the OSI actuary's review was limited to emails exchanged between OSI and the actuary. Similarly, for 2017, the NMHA actuary did a detailed update but OSI review was limited to an email exchange, even though the NMHA actuary recommended (and OSI accepted) reductions to some hospital surcharges.

Consider separate funds for individual providers and hospitals and facilities.
One way to address the underlying concerns of the lawsuit about the dangers posed to the fund by hospitals would be to split the PCF into two funds, one for hospitals and outpatient facilities and one for individual qualified health care providers. However, since hospital and hospital-employed physician surcharges are currently helping keep the PCF solvent, it may be better to delay a decision about splitting the fund until claims for the newly-admitted hospitals can be evaluated. This recommendation would require the Legislature to amend the Act.