On January 22, 2020, Superintendent of Insurance Russell Toal, as Custodian of the New Mexico Patient's Compensation Fund ("PCF"), announced a "second look" actuarial study to determine the soundness of the actuarial analysis underlying qualified health care provider surcharges that will go into effect on March 1, 2020. The "second look" actuarial study was received late on February 21, 2020 and is posted on the PCF and OSI websites.

The "second look" supports implementing the previously ordered surcharges on March 1, 2020; however, the study also underlined issues which must be addressed. One such issue, as described in item 3 of the Executive Summary, is the deficit position of the PCF. In order to determine actuarially credible ways to address the deficit, and to respond to items 4 and 5 of the Executive Summary, the Superintendent as PCF Custodian will be issuing a data call to medical malpractice insurance carriers to support a more thorough actuarial analysis in the coming year and to support a new rate hearing.

As also mentioned in the January 22 press release, the PCF will commission a further actuarial study to address these questions for discussion among interested stakeholders:

1. Whether, and how, expanding or narrowing the types of providers who can participate in the PCF may impact the availability and cost of healthcare in New Mexico, the cost of healthcare insurance, and the financial viability of the PCF;
2. Whether, and how, increasing the damages cap under the MMA, or increasing the amount of underlying coverage a QHP must maintain, may impact the availability and cost of healthcare in New Mexico, the cost of healthcare insurance, and the financial viability of the PCF;
3. Whether, and how, expanding or narrowing the types of providers who can participate in the PCF, increasing the damages cap under the MMA, or increasing the amount of underlying coverage a QHP must maintain, will impact QHP surcharges; and
4. The viability of separate PCF funds for different provider types.

Ensuring access to quality healthcare for all New Mexicans depends on our ability as a state to attract and retain quality healthcare providers. Significant factors in provider retention and recruitment are the cost of malpractice protection and exposure to potentially uninsured risks. The larger actuarial study will also address how changes to the PCF and MMA will impact malpractice exposures and coverage rates relative to those exposures and rates in other states.

February 20, 2020

Ms. Anna Krylova, FCAS, MAAA
Chief Actuary
State of New Mexico
Office of Superintendent of Insurance
Patient Compensation Fund
P.O. Box 1689
Santa Fe, New Mexico 87504

RE: Second Opinion Actuarial Review of the October 2019 Actuarial Analysis of the New Mexico Patient Compensation Fund's Loss Reserves and Surcharge Estimates

Dear Ms. Krylova:

Please find enclosed our Second Opinion Actuarial Review of the October 2019 Actuarial Analysis of the New Mexico Patient Compensation Fund's loss reserves and surcharge estimates.

We have enjoyed working with you on this engagement.

Sincerely,

David Shepherd, FCAS, MAAA

Brett E. Miller, FCAS, MAAA, ARM

State of New Mexico
Office of Superintendent of Insurance
Patient Compensation Fund

Second Opinion

Actuarial Review of the October 2019 Actuarial Analysis of the New Mexico Patient Compensation Fund's Loss Reserves and Surcharge Estimates

Merlinos & Associates, Inc.
February 2020

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Introduction/Scope

Merlinos & Associates, Inc. (M&A) was engaged by the New Mexico Office of Superintendent of Insurance (OSI) to perform a second opinion of the October 2019 Actuarial Analysis of the New Mexico Patient Compensation Fund (PCF). The scope of our review is as follows:

- Provide a second opinion related to the PCF's loss and loss expense reserves, the proposed surcharge increases and the proposed rating plan changes.

- Provide a memorandum detailing our observations and opinion as to whether the assumptions, methods, and conclusions in the PCF's Actuarial Report are reasonable.

This second opinion will be limited in nature, as the results of this review are intended to address stakeholder concerns about the accuracy of the 2019 report before the proposed rates become effective March 1, 2020. As a result, our scope was limited to a high-level review of the 2019 Actuarial Report.

Qualifications

Both Mr. Shepherd and Mr. Miller are credentialed by the Casualty Actuarial Society and members in good standing of the American Academy of Actuaries. They both have extensive experience in property and casualty loss reserves and rate analyses, including medical malpractice analyses. They have fulfilled all of the required continuing education requirements. As such, they are qualified to perform this review.

Background

The New Mexico Patient Compensation Fund was established in 1978 by the New Mexico Medical Malpractice Act NMSA 1978, § 41-5-1, et seq. The PCF is funded solely through the surcharges paid by its participants and is administrated by the Superintendent of Insurance.

The purpose of the PCF is to promote the availability of coverage for medical professional liability to health care providers practicing in New Mexico. The PCF provides an excess layer of coverage to doctors, hospitals, and other health care providers who qualify under the provisions of the Medical Malpractice Act. The PCF provides limitations on monetary awards, time limits for filing claims, and mandatory panel review of claims.

The health care providers participating in the PCF must meet the financial responsibility requirements of the Act by purchasing medical professional liability insurance policies written on occurrence policy forms at $200,000 per claim from PCF authorized insurers. These insurers collect the primary layer of premium and the PCF surcharge from the health care provider and remit the surcharges to the PCF.

For each incident exceeding the $200,000 retention, the PCF provides coverage of $400,000 for the non-medical indemnity portion of a claim (pain and suffering, and economic losses) plus unlimited medical expense amounts. The $600,000 ground-up maximum cap on the non-medical indemnity amounts has been in effect since 1995.

Through 2015, the PCF has covered physicians along with one small hospital, and two larger hospital groups became covered by the PCF, one in 2016 and one in 2017.

Executive Summary

We have reviewed Pinnacle's analysis and the other information made available to us.

In total, we have concluded that the selections and recommendations underlying Pinnacle's analyses are reasonable. That being said, we would have likely made some different choices throughout the analysis if asked to do so. These differences may disappear after further review and discussing Pinnacle's analysis with them. It is our conclusion that, in total, these different choices would not have indicated that Pinnacle's proposed reserves, surcharges and rating plans are unreasonable.

Actuarial Support for Proposed Reserve and Surcharge Levels

1. The overall approach and methodologies used with the Actuarial Report appear reasonable. Estimates of ultimate losses are calculated using generally accepted actuarial methodologies, as is the projection of ultimate loss costs for the 2019/2020 surcharge period.

Observations related to Pinnacle Analysis

2. Pinnacle calculated both the estimated loss reserve requirements and the estimated surcharges using confidence levels risk loads. We noted that the risk load factor at the 80% confidence level was 13.1% and the risk load factor at the 90% confidence level was 20.6%. We do not have an opinion as to appropriateness of using an 80% confidence level risk load, a 90% confidence level risk load or no risk load for the loss reserves and for the 2019/2020 estimated surcharges as those are management and philosophical questions rather than actuarial questions.

   It is worth noting that the PCF decision whether to include an additional risk margin will likely have a greater impact on the surcharges than the variability in reasonableness of the actuarial analysis. Said another way, the higher the risk load accepted by the PCF, the less important the actuarial analysis detailed assumptions are.

3. The 3.5% interest rate to use for the discounting calculations appears to be reasonable based upon a review of the PCF's financial data as of 12/31/2018. We note that since the PCF is in a deficit position, the assumption that there are enough invested assets to support the investment income required for the loss reserve discounting is not reasonable. We also note that this is a somewhat different concern from the discounting of the proposed future surcharges, which may be affected by the lack of invested funds if the PCF has to use some of the assets from future surcharges to pay prior losses.

4. The proposed Hospital rates are based on the experience of the PCF itself, and do not directly reflect the entire historical experience of each of the Hospital insureds. We understand that the reported loss experience included in the individual hospital actuarial pricing analyses is not readily available to the PCF outside of what is provided within these analyses. We have concluded that the proposed base rates may be more credible if they reflected the actuarial pricing analyses instead of relying solely on the limited PCF paid hospital experience.

5. We have concluded that the proposed Hospitals Experience Rating Plan and Hospital Rating Plan rate per Acute Care Bed could benefit from additional information about the hospital insureds. Such information might include, but is not limited to:

    a. Case reserves in the PCF layer
    b. Loss experience on underlying primary policy layer
    c. Claim count information (open, closed or closed with no payment)
    d. Historical exposures

6. The changes in the proposed rating factors for the P&S business and the proposed rating plan for Hospitals are reasonable based on the information currently available to the PCF. The Hospitals Experience Rating Plan is reasonable based on information currently available to the PCF.

Distribution and Use

This report has been prepared for internal use by the OSI. This report may also be provided to the New Mexico Legislature if documentation of this second opinion analysis is requested. We also understand that this report may also be distributed to a number of interested third parties.

Such distribution is permitted, subject to the condition that the report is distributed in its entirety. The intended recipients of this report and third parties are cautioned that this analysis constitutes a statement of professional judgment; it is in no way intended to replace the informed judgment and due diligence of its users. M&A cannot warrant or guarantee the results, conclusions, or opinions produced by this report.

M&A assumes no responsibility for any loss or damage that might arise from the use of, or reliance on, this second opinion report for any purpose other than for a description of the limited-scope analyses of the October 2019 Actuarial Report prepared for the PCF.

Conditions and Limitations

The projection of the adequacy of surcharge levels by class are based on estimates of future events, the outcomes of which are unknown at this time. Considerable uncertainty and variability are inherent in the estimation of loss reserves and resultant surcharges by class. As a result, it is possible that actual PCF experience may be different than the estimates opined on in this report, and such difference may be material. As such, we cannot guarantee that future experience will be as expected in this second opinion report or as presented in the PCF's actuarial analysis.

In preparing our second opinion analysis, we relied on data and qualitative information provided within the Actuarial Report, on data and information provided directly from the OSI and on discussions with the OSI. We have relied without audit or verification on the oral and/or written statements of the OSI regarding the quality, accuracy, and completeness of the data and information supplied to us. Any inaccuracies or inconsistencies in the data could have a significant effect on our opinion.

Our second opinion analysis does not anticipate any extraordinary changes in the legal, social or economic environments that could affect the ultimate outcome of claims, or the emergence of claims from causes not currently recognized in the historical data. Such extraordinary changes or claim emergence may impact the level of required surcharges and reserves in ways that are not presently quantifiable. No guarantee should be inferred from this second opinion report that the ultimate cost of all unpaid claims for the September 1, 2019 to September 1, 2020 period will necessarily fall within recommended funding levels, thus requiring additional monies to be funded.

Our actuarial review was conducted under time constraints driven by the upcoming effective date of new surcharges. As with any actuarial analysis, having additional time might have lead us to identify additional issues or reach different conclusions.

The PCF does not determine nor record case reserves on their individual claims. Case reserves are estimates made by claims experts that reflect their expectation of the ultimate cost of each claim and are standard practice in the insurance industry. Our analysis reflects additional uncertainty because we have neither case reserves nor the number of open and outstanding claim counts available.

The PCF began providing coverage to a small hospital system in the 2009 calendar year, and began providing coverage to two larger hospital groups, one in the 2016 calendar year and one in the 2017 calendar year. Based upon surcharges levied, the latter two hospital groups are much larger than the first hospital group. Our analysis reflects additional uncertainty caused by a lack of credible data due to both the limited time that the PCF has provided hospital coverage and the heterogeneous mix of hospitals that are provided coverage.

Data and Information Reviewed

We relied on data and information provided by the OSI for our analysis. This data and information included the following:

1. Reports prepared by Mr. Robert Walling III, FCAS, MAAA, CERA, of Pinnacle Actuarial Resources, Inc. (Pinnacle) (collectively the Actuarial Report):
    a. "New Mexico Patient's Compensation Fund, 2019 Surcharge Rate Hearing", dated October 7, 2019;
    b. "2018 Actuarial Analysis of the New Mexico Patient's Compensation Fund", dated July 10, 2019;
    c. "Actuarial Report Addendum: New Mexico Patient's Compensation Fund Class Plan and Entity Coverage Review", dated October 7, 2019;
    d. "Actuarial Report Addendum: New Mexico Patient's Compensation Fund Hospital & Outpatient Health Care Facility Rating Plan", dated October 7, 2019;
    e. "New Mexico Patient's Compensation Fund Indicated Rate Change Effective 9/1/19 through 9/2/20 – Physicians & Surgeons", dated October 7. 2019; and
    f. New Mexico Patient's Compensation Fund Indicated Rate Change Effective 9/1/19 through 9/2/20 – Hospitals & Outpatient Facilities", dated October 7. 2019

2. Rate hearing testimony dated November 18, 2019

3. Discussions with the OSI, along with additional information they provided, including a surcharge change history since PCF inception, financial information provided to Pinnacle for use in their studies, and details of the batch claim reinsurance policy;

4. A discussion and correspondence with Christina Negley, ACAS, MAAA of Pinnacle;

5. Complete copies of or excerpts from Hospital pricing analysis reports:
    a. "New Mexico Hospital RPG - 2019 Funded Losses for the New Mexico Patient Compensation Fund and New Mexico Medical Malpractice Liability Act, Based on Data Valued as of March 31, 2018", draft dated July 20, 2018 and prepared by Milliman, Inc.
    b. "New Mexico Hospital RPG - 2020 Funded Losses for the New Mexico Patient Compensation Fund and New Mexico Medical Malpractice Liability Act, Data Valued as of March 31, 2019", draft dated July 19, 2019 and prepared by Milliman, Inc.
    c. "New Mexico Department of Insurance, CHRISTUS St. Vincent's Regional Medical Center, PCF Funding Analysis for 7/1/2018 – 2019", dated August 23, 2018 and prepared by Pinnacle; and
    d. "New Mexico Patient's Compensation Fund, Presbyterian Healthcare Services, Indicated PCF Charge for 7/1/18- 6/30/19", dated September 18, 2018 and prepared by Pinnacle.

6. Review of a number of rate filings noted in the Actuarial Report, including:
    a. The Doctors Company
    b. The Medical Protective Company
    c. MMIC Insurance, Inc.
    d. The Continental Insurance Company

7. Aon/ASHRM Hospital and Physician Professional Liability Benchmark Analysis, dated October 2015.

The data provided in the Actuarial Report included paid claims amounts and closed claim counts, but no case reserve estimates or open claim counts. The loss and claims data are used for both development purposes and for projection purposes.

Per the Actuarial Report, data was provided to Pinnacle in a number of different levels of completeness and detail since 2010. These data issues led Pinnacle to compile the loss and claim count triangles without details of case loss reserves or open counts, respectively. In addition, for a number of years Pinnacle disclosed that there was not sufficient detail to segregate P&S losses from Hospitals losses, which led to Pinnacle combining the P&S and Hospital data for development triangle purposes. Finally, Pinnacle excluded the batch payments from development triangles due to the distortions that these claims would have on the calculated development patterns. Based on our review of the underlying issues and adjustments that were made to the data provided to Pinnacle, it is our opinion that these data adjustments are reasonable.

Methodology and Analysis

We will document our observations and conclusions in the remainder of this report. Our review will be split into the following two sections:

A. Proposed Reserve and Surcharge Levels
B. Class Plan Review

Proposed Reserve and Surcharge Levels

The proposed surcharge change is determined by first selecting the PCF's ultimate historical losses by accident year (AY). This is done through the use of several actuarial projection methodologies. Once the ultimate losses are determined by AY, the experience is adjusted to bring it up to current surcharge and loss cost levels. From this adjusted experience, the actuary selects an expected loss ratio for the upcoming year.

After an expected, on-level loss ratio is determined, adjustments are made to reflect expenses and investment income. The end result is an indicated surcharge change. This analysis is done both at the expected value and 80% confidence level, and separately for Physicians and Surgeons (P&S) and Hospitals.

Each of these steps rely on methodologies and assumptions. Below are our comments and observations as to their reasonableness.

Overall Indications

The calculation of selected ultimate losses by AY rely on the following methodologies and assumptions.

a. Pinnacle used four methodologies to estimate ultimate losses. These are the paid development method, the paid Bornhuetter-Ferguson (B-F) method, the expected Loss Ratio Method, and the Frequency-Severity Method (P&S only). These are all generally accepted actuarial methodologies used to estimate ultimate loss amounts and are reasonable.

b. Loss Experience used by Pinnacle in their ultimate loss projection methods include the batch claims. Generally, inclusion of batch claims or other catastrophic claims can distort needed reserves, so they are often excluded from the projection methods. Including the batch claims may bias both the needed reserves and needed surcharge change high, but we have concluded that this is not material because it doesn't appear to impact Pinnacle's selections.

c. Paid loss development factors - The paid loss development data is a combination of the P&S and Hospitals loss experience, and excludes batch claims. Combining the P&S with Hospital experience is reasonable when selecting loss development factors. Based on the PCF data, the selected development factors for the 12 months through 96 month periods appear to be reasonable, even though some of the factors within each column are can vary significantly.

d. There is low loss activity past 96 months of maturity. Pinnacle did not provide a discussion of how the tail factors are determined (96-108, etc.), but the selected factors appear to be based on actuarial judgment. We compared the selected tail factors to industry experience as shown in industry annual statements. We discussed Pinnacle's reasons for their selected tail factors with them and concluded that they were reasonable.

e. Given the range of indications by accident for the methodologies used, the selected ultimate losses by accident year for each of the P&S and Hospitals segments appear reasonable.

f. The initial and projected 2019-2020 expected loss ratio of 115% used for P&S, given the historical selected ultimate losses, is reasonable.

g. The initial and projected 2019-2020 expected loss ratios for Hospitals of 98%, given the historical selected ultimate losses, appears reasonable. We note that the two new hospitals are expected to be rated in the future by the proposed surcharges and adjusted by an experience rating modification factor.

   Because of a recent judicial decision, the PCF must conduct risk assessments for each hospital and outpatient facility. Surcharges must also be assessed using the same methodology. Because smaller hospitals and outpatient facilities may not have credible loss data to support an experience rating based risk assessment, the PCF asked Pinnacle to propose an exposure model that can be implemented by PCF staff.

   The proposed changes to the Hospital surcharges are based significantly on the experience of the single smaller hospital, as the more recent experience of the larger hospitals does not reflect any material claim experience. The experience of the two larger hospitals are assumed to be priced to a similar loss ratio. We have reviewed the pricing analysis for these hospitals, and concluded that this is a reasonable assumption.

Potential improvements to Pinnacle's Hospital reserving approach would include reflecting the actual individual Hospital pricing analyses, which would produce a more credible estimate of expected losses (because of the use of case reserve information) rather than basing it solely on the PCF's historical paid loss experience.

h. We note that due to the large size of Presbyterian and RPG hospital insureds, each of which is approximately six times the size of Christus, they may have underlying exposures that are materially different than that of Christus. The experience rating plan will attempt to reflect any potential differences, but it currently would provide just over 50% credibility for the two large hospitals.

i. Loss Trend Rate of 5.0% - For P&S, Pinnacle calculates the average paid severity of claims closed with payment (CWIP), calculates an indicated trend of 3.1%, and selects a 5.0% trend to get average severity to 12/31/2018 cost levels. While Pinnacle did not explain the higher selected trend, in our opinion, the selected 5.0% severity trend factor appears slightly high but reasonable, given that this is an excess of loss trend, which is generally higher than 1st dollar trend. We also note that the overall trend rate of 5.0% implies a frequency trend of 0.0%, which is also a reasonable assumption. Lastly, the trend factor impacts the selected projected loss ratio, and we concluded that even at a slightly lower trend factor, the selected projected loss ratio is reasonable.

j. For P&S, a weighted average severity is projected. This average severity is then used to calculate each accident year's severity by detrending from the overall selected severity. This is a reasonable calculation.

k. For P&S, Pinnacle estimates ultimate closed claims with payment (CWIP) using the development, B-F, and frequency methodologies. We note that the selected CWIP development factors are selected in a manner analogous to that of paid losses. The selected CWIP development factors appear reasonable. The initial expected claims frequency is based on the ratio of developed ultimate CWIP to $1 million of practitioner surcharges at current surcharge levels, and the selected frequency is then applied to each accident year's surcharges at current surcharge levels. We note that due to data limitations in the PCF's experience, we do not know the actual number of open claims and thus a reasonability comparison to number outstanding is more difficult.

The calculation of indicated surcharge changes rely on the following methodologies and assumptions.

a. Projected Loss Adjustment Expenses (LAE) loading – The LAE loading is estimated as a percentage of loss. The LAE expenses are comprised of New Mexico Medical Society/Medical Panel expenses, and expenses for contracts and consultants. The analysis was performed using an incremental calendar year paid-to-paid methodology. The LAE expenses are compared to the total of P&S and Hospital paid losses. A spot check of the latest 3 paid diagonals shown in the development triangles to the calendar year paid amounts shown in the expense analysis exhibit shows higher payments in the expense analysis of over 15% compared to development triangles. This distortion is likely due the inclusion of batch claims in the expense analysis. The overall selected LAE factor of 2.7% is based on the 5-year average and is reasonable.

b. Discount rate @3.5% - Pinnacle uses a 3.5% interest rate to use for the discounting calculations. Pinnacle did not provide support for the factor, other than to caveat that the rate was provided by the OSI. Based upon review of the PCF's financial data, we note that the 3.5% interest rate is reasonable.

We do note that since the PCF is in a deficit position, the assumption that there are enough invested assets to support the investment income required for the loss reserve discounting does not appear to be reasonable. We also note that there is a similar concern regarding the discounting of the proposed surcharges, but it has less of an impact. For the surcharges, the amount of discount will be affected if the invested assets in the future fall to a certain level and the PCF needs to use assets underlying the 2020 policies to pay prior losses.

c. Projected Underwriting Expenses – The underwriting expense load is estimated as a percentage of the combined P&S and Hospital (participant) surcharges. The underwriting expenses are comprised of IT services, PCF employee services, rent, and Intra-Agency transfers. The analysis was performed using an incremental calendar year paid-to-paid methodology. The estimated factor selections for each of the four underlying categories, and the resultant total underwriting expense load of 2.7%, appear reasonable. The largest category is related to intra-agency transfers, which comprises 2.4% out of the total 2.7% estimate. We do not have a conclusion as to the appropriateness of the actual intra-agency transfer expense dollars, but are assuming they are reasonable and won't materially change going forward.

d. Projected batch claim reinsurance load – Effective 9/1/2017, the PCF purchased batch claim reinsurance with limits of $20.0 million excess of $7.5 million aggregate. The batch claim reinsurance load is estimated as a percentage of the combined P&S and Hospital participant surcharges.

   It is our opinion that the estimated 6.0% factor for batch reinsurance appears somewhat high based on the actual premiums being charged. Based on a review of the premiums charged and conversations with the OSI, we concluded that a more reasonable factor for the batch claim reinsurance is 5.0%.

Pinnacle includes the batch claims in the projection data and the analysis of ultimate loss ratios. For historical reasons in setting reserves, this is reasonable. However, when the loss experience including batch claims are reflected in the selected projected loss ratio, there is double counting of these claims, as the potential excess claims are accounted for in the proposed surcharges through inclusion of a reinsurance charge. This bias is not material.

e. Confidence level loadings at 80% and 90% Confidence Levels – Pinnacle calculated both the estimated loss reserve requirements and the estimated surcharges confidence levels risk loads. Within the Actuarial Report, Pinnacle characterized each iteration of the simulation modeling that estimated the confidence levels as a calculation for each of the PCF's projected unpaid claims that will ultimately result in payments. While Pinnacle provided a high-level description of the simulation model, they did not provide support as to the parameterization of the model.

   We noted that the risk load factor at the 80% confidence level was 13.1% and the risk load factor at the 90% confidence level was 20.6%. We also note that confidence level risk load factors are not necessarily equivalent for different volumes and profiles of business. (We understand that Pinnacle developed the confidence levels based on an analysis of the reserves.) As such, the percent risk charge for different confidence levels will vary between P&S and Hospitals, and between their surcharges and reserves.

   This reflects how the law of large numbers impacts confidence levels. For example, expected value of a coin toss is 50% heads and 50% tails. A 90% confidence level risk load of 20% means you would be 90% confident that you get heads 60 % (= 50% x 1.2) of the time. It is apparent that the confidence that you get 3 or less heads out of 5 coin flips is much less than the confidence of getting 600 or less heads based on 1,000 coin flips.

We offer no opinion as to appropriateness of using an 80% confidence level risk load, a 90% confidence level risk load or any risk load for the loss reserves and surcharges, as this is a strategic question and not an actuarial question.

It is our opinion that, given all of the assumptions noted above and the methodologies used and described in the Actuarial Report, the overall recommended surcharge levels for P&S and Hospitals appear reasonable.

Class Plan Review

P&S Class Plan

Pinnacle recommended several revisions to the current P&S class plan. They used the following approach to review the rating factor relativities:

1. For comparative purposes, Pinnacle used the rate filings of two the largest writers of medical professional liability insurance in New Mexico, based on market share. The rate filings are from The Doctors Company (submitted 8/11/2014) and The Medical Protective Company (submitted 12/21/2010). Additionally, Pinnacle utilized the rating plans for the Indiana and Wisconsin PCFs. This methodology, and the same competitors, were used for both the P&S classes and for Allied Health professionals. Given that The Doctors Company and Medical Protective are two of the largest medical malpractice insurers in the country, they are a reasonable base from which to make class plan comparisons.

2. We spot checked the reasonability of competitor factors against filed plans.

3. Based on their review of the competitor class plans, a number of physicians' specialties were reassigned to different classes. For example, Nephrology – No Surgery was reassigned from class 3 to class 2. The re-assignment of this and other specialties to other classes appears reasonable.

4. The selected class factors were compared to the competitor factors for the analogous classes, and changes in the rating factors for three physicians' class groups and for one allied health professional grouping. The change in class factors is consistent with the competitors and not unreasonable.

5. Pinnacle estimated the surcharge impact of re-assignment of the P&S specialties, along with the surcharge factor changes. These changes are approximately 1.0% of the indicated surcharge change and is used as an offset to the indicated overall surcharge assessment level.

Corporate Entity Coverage - Pinnacle stated that they reviewed industry rate filings and determined that the typical entity charge was 10% for each covered provided in the entity. Pinnacle concluded that because there was no indication that this industry standard was unreasonable, following the industry practice was appropriate for the PCF.

Pinnacle then estimated the surcharge impact of the change from the per provider charge to the flat 10% entity charge by using information that showed that 80% of PCF-covered physicians, surgeons, et. al. are employed as providers by a business entity. The PCF requested this data from the Doctors Company specifically for Pinnacle to use in its analysis. PCF participating insurers do not file reports with this data.

The proposed change in the entity charge is approximately 7.2% of the indicated surcharge change and is used as an offset to the overall surcharge assessment level. It is our opinion that the change in the charge from a dollar amount per physician, CRNA or PA to a flat 10% charge is consistent with our experience with how insurers charge for the exposure and reasonable.

Hospital Rating Plan

The proposed Hospital Rating Plan is new, and is a change from the PCF's current approach of the surcharges being set through an individual actuarial review. Pinnacle's approach to producing a rating plan was to review some competitors' rating plans and make selections of exposure relativities to the Acute Care Bed exposure. The base rates were determined by analyzing the current hospital exposures and the needed surcharges developed through the rate level analysis. From this analysis, they determined the base rate per Acute Care Bed. Pinnacle also produced an Experience Rating Plan for those hospitals of sufficient size.

Our comments and observations on the assumptions and selections are below. The overall rating and experience modification factor plans are reasonable.

1. Selection of competitors used in the competitive analysis for OBE relativities. Pinnacle included the IN PCF and two traditional insurers (MMIC and CNA) in their comparison. MMIC was selected because of their recent Hospital filing, and CNA was selected because they write a substantial amount of hospitals countrywide. It should be noted that it is possible that the relativities for the PCF's excess coverage should be different than ground up relativities, due to potential differences in severities by exposure. The competitor selection is reasonable.

2. Selected relativity to Acute Care Beds for each exposure type. The selected relativities are within the range of indications. Most of the ranges by exposure were relatively large. No explanation was given for the reasons for each relativity selection. The selections are reasonable.

3. Use of Historical Hospital Experience. It is our understanding that the PCF statute requires the use of New Mexico experience when possible. The proposed Hospital Rating Plan complies with this requirement to some degree. The proposed Experience Rating plan uses historical reported claims and complies to a material degree. The derivation of the proposed base rate is based on the PCF experience, but the PCF experience does not

currently include many years of experience for the two big hospital insureds, nor does it reflect case reserve or reported claim count information. We understand that this information would need to be specifically requested through a data call.

4. Selected Surcharge for Acute Care Beds. Acute Care Beds are the base exposure to which the relativities are applied to generate premiums. The Acute Care Bed premium was derived through an analysis of the overall surcharge need, the proposed relativities and the three insured hospitals exposures. The approach is reasonable and the calculations were confirmed to be accurate.

   However, we note that the selected charge for Acute Care Beds is based on the reserving analysis. It is our conclusion that the derivation of the initial rate for an Acute Care Bed would be more credible if it were based on the various actuarial pricing analyses, as these pricing analyses utilize more information in the form of reported claim counts and case reserves. We have not performed the exercise to determine if using the pricing studies would increase or decrease the indicated base rate.

5. Design of Experience Rating Plan. Pinnacle's experience rating plan design is based on claim frequency, as opposed to loss dollars. This is simple, but reasonable. Pinnacle selects 250 claims for full credibility, reflecting the maximum 5-year total of the three current insureds. The standard appears reasonable.

6. Expected and Actual Claims per Exposure for Experience Rating Plan. The use of reported claim data as the base for the Experience Rating Plan produces a potential issue in that the PCF provides occurrence coverage, which reflects claims that can take a long time to be reported. The formula uses 5 years of reported excess claims, excluding the latest two policies. The total claims of all three insureds from the same time period is 205, versus the 250 selected by Pinnacle based on a more mature 5-year period. This time mismatch reduces the amount of credibility the formula produces. In spite of this issue, the formula and parameters are not unreasonable. Note that the calculations of both the actual and expected claim counts uses the same exposure period of the five years prior to the most recent two years.