



## **Report on New York State Medical Indemnity Fund**

June 12, 2017

# **New York State Medical Indemnity Fund 2017 Legislative Report**

## **Purpose & Scope**

Chapter 517 of the Laws of 2016, as modified by Chapter 4 of the Laws of 2017, provides that the New York State Department of Financial Services (DFS) shall issue “a report to the governor and the legislature on the financial condition of the state medical indemnity fund, the future solvency of such fund, and any issues relating to the operation of such fund that the superintendent, in his or her sole discretion, elects to include in such report.” This report is provided by DFS pursuant to this provision. DFS, along with an independent actuary, has reviewed the state medical indemnity fund’s (Fund) financial condition based on enrollment, claims paid, administration costs, comparable data from similar funds in other states, and other actuarially relevant factors.

Pinnacle Actuarial Resources, Inc. (Pinnacle) had been retained to provide quarterly assessments of the Fund’s financial condition. Pinnacle’s scope of work was enlarged to prepare an analysis to DFS for this report. This report “addresses the financial condition of the state medical indemnity fund, the future solvency of such fund, and any issues relating to the operation of such fund that the superintendent, in his or her sole discretion, elects to include in such report.” This analysis is based on the Fund valued as of December 31, 2016.

## **Background**

The Fund, created in 2011 under the Public Health Law, provides funding for future health care costs of children with birth-related neurological injuries. The Fund was created to provide a funding source for future health care costs associated with birth-related neurological injuries and reduce medical malpractice insurance premiums. Enrollees of the Fund have been plaintiffs in medical malpractice actions who have received either court-approved settlements or favorable judgments.

Under the statute, a “birth-related neurological injury” is “an injury to the brain or spinal cord of a live infant caused by the deprivation of oxygen or mechanical injury occurring in the course of labor, delivery or resuscitation, or by other medical services provided or not provided during the delivery admission.” To be eligible, these injuries must result in a “permanent and substantial motor impairment” or a “developmental disability” or both.

Once enrolled, a qualified plaintiff will remain in the Fund for his or her lifetime. The Fund pays or reimburses the cost of qualifying health care services. “Qualifying health care costs” include future medical, hospital, surgical, custodial, home modifications, transportation to health care appointments, prescriptions, and similar costs related to the child’s care. N.Y. Pub. Health L. § 2999-h. Qualifying health care costs are paid at the Medicaid reimbursement rate, and private physicians are paid at the usual and customary rate.

A third-party administrator makes enrollment and claim determinations using regulations promulgated by the Department of Health (DOH). Denials of enrollment are reviewable by a court and claims denials are handled by a DOH administrative law judge, which is subject to court

review. To date, there have been only 20 appeals of claims denials decided by a DOH administrative law judge during the Fund's history.

The Fund, which presently covers nearly 500 children, receives an annual appropriation in an amount of \$52 million (N.Y. Pub. Health L. § 2999-i(5)). The funds come from Health Care Reform Act pools which are in turn funded by surcharges imposed on health care services. The Fund held approximately \$162.2 million at the end of 2016 and made over 15,000 claims payments in 2016.

According to the Public Health Law, the Fund is designed to be funded by an appropriation from the state up to a limit. If the estimated amount of current liabilities in the Fund equals or exceeds 80% of the Fund's assets, then the Fund stops accepting new enrollments until a new deposit into the Fund is made to bring the liabilities back below the threshold. N.Y. Pub. Health L. § 2999-i(6). Fund enrollees are not impacted by a suspension in enrollment. Those liabilities will continue on unaffected by the suspension of enrollment.

In 2016, a number of changes were made to the Fund's governing statutes (the Recent Amendments). Specifically:

1. Since its creation in 2011, the Fund has applied solely to children born in a hospital. Under the Chapter 517 of the Laws of 2016, as modified by Chapter 4 of the Laws of 2017, (the "Recent Amendments"), that limitation has been abolished. N.Y. Pub. Health L. § 2999-h. Naturally, the effect of that change is to increase the total possible pool of children who may be eligible for the Fund. The greater the number of enrollees, it is reasonable to assume that there will be a higher cost to the Fund.
2. Additional qualified benefits were included as part of the Fund. The costs of "habilitation, respite, . . . [and] transportation for purpose of health care related appointments" are now included in qualified benefits. N.Y. Pub. Health L. § 2999-h. Again, the more benefits that are included, there is a greater likelihood of higher costs to the Fund.
3. Effective June 30, 2017 through December 31, 2019, the reimbursement rates will increase, and all services will be paid at the usual and customary rate. If no such rates are available, then qualifying health care costs will be paid at the greater of 130% of Medicaid or Medicare rates. Under the Recent Amendments, the usual and customary rate means "the eightieth percentile of all charges for the particular health care service performed by a provider in the same or similar specialty and provided in the same geographical area as reported in a benchmarking database maintained by a nonprofit organization specified by the superintendent of financial services" (N.Y. Pub. Health L. § 2999-j(4)). These changes substantially increase the costs to the Fund and will have the most significant impact on the financial condition of the Fund. The increased costs will be substantial, particularly if a decision is reached in 2019 to extend the period of increased reimbursement.

## **Financial Condition**

Pinnacle provided estimates under the following scenarios:

**1. Original Statute Without Giving Effect To Recent Amendments.** It is projected that based on the original statute without giving effect to the Recent Amendments the present value of the Fund's total unfunded liability would have been approximately \$461.1 million growing to \$2.13 billion by 2027. In that case, the 80% threshold at which no additional children are admitted to the Fund without further financial appropriation over the expected \$52 million per year from the state, would not have been reached in the next ten years.

**2. Current Statute With The Recent Amendments With Sunset of Increased Reimbursement.** Giving effect to the Recent Amendments, including the sunset of increased provider reimbursement at the end of 2019, it is projected that the present value of the Fund's total unfunded liability is now approximately \$574.92 million. That unfunded amount would rise to \$2.33 billion by 2027. The 80% threshold at which no additional children are admitted to the Fund without further financial appropriation over the expected \$52 million per year from the state, will not be reached within the next ten years.

## **Data, Assumptions and Analysis**

The data reviewed in preparation of this report includes detail by Fund enrollee, benefit category (i.e. nursing, medical, hospital, prescription drugs, etc.) and injury type. In this report some of the long term forecasts and industry benchmarks used in the analysis are based on data for the birth injury funds in Virginia and Florida, as well as medical professional liability insurers in the State of New York. When Fund data has been deemed to be actuarially credible, the assumptions incorporated actual Fund experience.

DFS staff, including actuaries, reviewed Pinnacle's work, including its data, methods and assumptions, and found them to be reasonable.

### **A. Number of Qualifying Participants**

As of March 31, 2017, there were 455 enrollees in the Fund; because the work to prepare this Report was done prior to that date, it was assumed that there would be 460 living participants in the Fund at March 31, 2017.

Based on the experience of the Fund, it is estimated that on average there will be 4.5 enrollees accepted to the Fund per 10,000 live births in the state of New York. This frequency rate is substantially higher than the birth funds in Virginia and Florida and reflects differences in definitions of birth injuries and differences in eligibility determination between the states. This rate has been adjusted over time as actual, credible experience has emerged.

The Recent Amendments have created the possibility of an increase in the number of participants. The Recent Amendments opened the Fund to those not born in a hospital setting. Based on national data, approximately 1.5% of all live births occur outside of hospitals. It is therefore reasonable to assume that participation rates will increase by 1.5% annually as

compared to what would be expected without the Recent Amendments, though this may be higher given the potential added risks outside a hospital setting, or may be lower since high-risk births may be more likely to occur in a hospital.

### **B. Effect of Inflation**

There is ample evidence that the cost of medical and related services in the United States has increased over time. Therefore, those increases must be taken into account in projecting out the future cost of services. That increase, or inflation, is tracked by the federal Bureau of Labor Statistics. The rate of increase in the cost of future benefits payments is assumed to be 3.5% annually in this report. The benefits covered include: medical, dental, surgical and hospital care; nursing and custodial care; medication; rehabilitation; medical equipment; home and vehicle modifications, and certain others. The rate of 3.5% was determined based on a review of the consumer price index from the Bureau of Labor Statistics and recalculating that index using the Fund's distribution of benefits. For purposes of this exercise, consumer price index categories were matched to each type of benefit provided by the Fund to better estimate the impact of inflation.

### **C. Discount Rate**

In practice, presently the Fund makes promises to pay for medical care currently and well into the future. In order to have the money available in the future, the Fund invests the money that it has today so that there is enough money to pay out in the future. The income derived from those investments play a large role in the Fund's or an insurer's ability to make payments in the future.

An essential element of all birth injury funds in the United States is their ability to generate investment income on the funds available to pay benefits from the time these funds are available until the benefits are provided. In this report it is assumed that money paid today into the Fund will earn 2.5% over time. That earning is referred to as a "discount rate." The discount rate shows how much money will be worth in the future if invested today. The rate of 2.5% is an assumption used by some New York insurance carriers with similar types of obligations for the purpose of discounting loss and loss adjustment experience (the cost of handling claims) and setting prospective insurance rates. Available information indicates that actual returns on monies in the Fund have not been as high as 2.5%. To the extent the Pinnacle had previously utilized a 4% discount rate, it did so based on programs in other states. However, 2.5% is consistent with New York insurer practice and rules concerning investment and reserves. It is also more realistic given the lower Fund balance available for investment purposes.

Because enrollees today will have costs to be paid many years from now, the impact of a change in the investment earnings of the money set aside today for the payment of costs in the future can be substantial. A change of .5% in the discount rate assumption results in a change in investment income of less than \$10 million until fiscal 2025, but the impact on the Fund balance is much more dramatic. For fiscal year 2017, a .5% drop in the discount rate changes the Fund's deficit by more than \$130 million. By fiscal year 2026, this impact increases to more than \$400 million.

## **D. Benefits Payments**

Another element of the projections is how much and for how long will payments have to be made. That depends on the number of qualifying participants and how long they will need care. Because care is provided for the life time of the enrollee those payments are tied to the lifespans of the enrollees, which may last a long time. Based on the Fund benefit payments to date and payment timing and mortality data from the Virginia medical benefit fund, it is estimated that, prior to the Recent Amendments, the average Fund enrollee will currently receive approximately \$3.35 million in nominal (i.e. not subject to discounting as described above) benefits. Virginia's experience was also utilized to estimate the timing of these payments. This allowed an estimate of future benefit payments by fiscal year and to compute the present value of these payments based on the selected discount rate.

## **E. Fund Balance**

The income statements are used to estimate the Fund balance at the end of each fiscal year. The fiscal year-end Fund Balance is computed as the initial Fund balance (i.e. the ending balance from the previous year), plus the expected annual funding contribution of \$52 million and any investment income realized by the Fund during the year. Benefit payments and administrative expenses paid during the fiscal year are then subtracted producing the fiscal year end Fund balance.

The balance sheets estimate the Fund's surplus (positive) or unfunded liability (negative) at the end of each fiscal year by subtracting the present value of all future benefit payments of participants admitted to the Fund as of the end of that fiscal year, along with the estimated future administrative expenses needed to provide these benefits. The future benefit payments are based on the future benefit payments by enrollee entry quarter and payment quarter as described in developing the income statement. The difference between these future liabilities (benefits and expenses) and the current funds available to pay them is the unfunded liability.<sup>1</sup>

The Fund is required by law to suspend new enrollment when liabilities equal or exceed 80% of the Fund's assets. As stated above, assuming that the increase in reimbursement rates in the Recent Amendments lapses as stated in those amendments, that 80% threshold is not expected to be breached in the next ten years.

## **F. Increase in Reimbursement Rates**

Pinnacle has estimated the increased costs attributable to these increased reimbursement rates based on various assumptions concerning the current procedural terminology (CPT) and other codes. Assumptions are necessary as there may not be an exact match between existing CPT codes used by Medicaid and the usual and customary costs as defined in the Recent Amendments and/or such costs may not be available in the benchmarking database that is to be

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<sup>1</sup> Note that by using the present value of the future benefit payments, this estimate is already reflecting future investment income received by the Fund. While this is not consistent with statutory accounting, it is consistent with practice among relevant New York domiciled insurers and has been approved by the New York Department of Financial Services for presenting year-end financial statements.

utilized under the Recent Amendments. Therefore, the actual increase in costs in the future may be higher or lower than Pinnacle has estimated.

Based in part on the assumptions described, Pinnacle estimated that after giving effect to the Recent Amendments, average lifetime benefits are estimated to increase over 3.5 times or 250% due to the impact of increasing reimbursement rates from Medicaid rates to the 80<sup>th</sup> percentile of all amounts billed by providers for the particular health care service performed by a provider in the same or similar specialty and provided in the same geographical area as reflected in the FairHealth database. The impact of the increase in reimbursement was selected for each benefit category. This is important as some benefit categories, such as hospital and rehabilitation benefits, are expected to demonstrate larger than average increases while some other categories, such as home modifications, may experience no change.

### **G. Administrative Expenses**

In 2017, the third-party administrator is currently charging the fund \$809 per Fund participant per month. That number was used to develop the estimated levels of administrative expense in the various scenarios referenced in this report under the assumption that the legislation has no impact on the per participant per month cost to administer the Fund, all other things being equal.

### **Conclusion**

Presently the Fund has unfunded future liabilities. Had the Recent Amendments not been enacted, that liability would have been approximately \$461 million and would have been expected to increase to approximately \$2.13 billion over the next ten years. After giving effect to the Recent Amendments the present value of the Fund's total unfunded liability is projected to be approximately \$575 million and is expected to grow to approximately \$2.33 billion over the next ten years. Under both scenarios, however, in the next ten years based on current law the Fund is not expected to exceed the threshold after which further enrollment is suspended. This liability projection assumes the Recent Amendments expire in 2020 as scheduled. Extending the Recent Amendments beyond 2020 could more than double the Fund's liabilities.