

NEBRASKA HOSPITAL-MEDICAL LIABILITY ACT

ANNUAL REPORT



as of December 31, 2009

THE EXCESS LIABILITY FUND
(under the Nebraska Hospital-Medical Liability Act)

The Nebraska Hospital-Medical Liability Act was adopted in 1976. Its intent is, “to serve the public interest by providing an alternative method for determining malpractice claims in order to improve the availability of medical care, to improve its quality and to reduce the cost thereof, and to insure the availability of malpractice insurance coverage at reasonable rates.” Pursuant to this law, the primary functions of the Fund are to provide excess liability insurance for health care providers and to provide assurance to persons receiving health care from these providers that medical professional liability insurance is in place. Another function of the Fund is to provide underlying (“first dollar”) medical professional liability insurance for health care providers that are unable to purchase such coverage from a licensed insurer.

Participation by a health care provider in the Fund is voluntary, although most Nebraska physicians now take advantage of the Fund to purchase excess medical professional liability coverage. To participate in the Fund, a health care provider must submit proof of financial responsibility in the form of an underlying professional liability policy with specified coverage limits and pay a premium (“the surcharge”) to the Fund. The act also establishes a “cap” on the amount a plaintiff can recover from all qualified health care providers.

The exhibits and discussions itemized below provide details.

– Exhibits & Discussions –

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Number of Health Care Providers Participating in the Fund

| Year | Average # of Physicians | Average # of DOs* | Average # of CRNAs* |
|--------|-------------------------|-------------------|---------------------|
| 1976** | 188 | 0 | 0 |
| 1977 | 418 | 0 | 0 |
| 1978 | 717 | 0 | 3 |
| 1979 | 822 | 0 | 7 |
| 1980 | 882 | 0 | 11 |
| 1981 | 971 | 0 | 18 |
| 1982 | 1144 | 0 | 30 |
| 1983 | 1298 | 2 | 33 |
| 1984 | 1526 | 2 | 36 |
| 1985 | 1667 | 3 | 37 |
| 1986 | 1707 | 4 | 37 |
| 1987 | 1773 | 4 | 39 |
| 1988 | 1846 | 8 | 43 |
| 1989 | 1925 | 14 | 44 |
| 1990 | 1991 | 15 | 48 |
| 1991 | 2073 | 16 | 72 |
| 1992 | 2165 | 20 | 81 |
| 1993 | 2259 | 25 | 84 |
| 1994 | 2337 | 27 | 93 |
| 1995 | 2402 | 31 | 103 |
| 1996 | 2536 | 36 | 109 |
| 1997 | 2636 | 36 | 110 |
| 1998 | 2691 | 38 | 125 |
| 1999 | 2759 | 43 | 146 |
| 2000 | 2903 | 52 | 172 |
| 2001 | 3101 | 61 | 176 |
| 2002 | 3279 | 71 | 182 |
| 2003 | 3417 | 78 | 204 |
| 2004 | 3508 | 87 | 228 |
| 2005 | 3576 | 102 | 241 |
| 2006 | 3661 | 109 | 236 |
| 2007 | 3728 | 114 | 258 |
| 2008 | 3726 | 120 | 266 |
| 2009 | 3788 | 120 | 280 |

* A “DO” is a Doctor of Osteopathy and a “CRNA” is a Certified Registered Nurse Anesthetist.

** The Fund also covers hospitals and professional corporations (PCs). With a PC, it is typical for the PC as well as all of its member providers to opt to be covered by the Fund. With hospitals, participation has increased over the years, although not as rapidly as for physicians. The problem with showing numbers for hospitals is that large hospitals often own a number of entities that also provide health care, and these entities are also coded as “hospitals.” Thus, the number of entries that we have for “hospitals” would be a deceptively large number.

***The first day of the Fund was 7/8/1976, and the averages shown for 1976 are for the part of a year that the Fund was in effect. The numbers for all other years are “provider-years”. That is, these numbers show average number of providers insured each day throughout the calendar year (except for 1976).

Residual Coverage Provided under the Act

| Number of Covered Residual Providers by Year | | | | | |
|---|-------------------|------------------|--------------|------------|------------|
| Year | Physicians | Hospitals | CRNAs | DOs | PCs |
| 2000 | 1.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 2001 | 3.95 | 0.00 | 0.00 | 0.00 | 0.48 |
| 2002 | 17.44 | 0.25 | 0.00 | 0.42 | 4.01 |
| 2003 | 21.25 | 0.75 | 1.96 | 0.58 | 5.59 |
| 2004 | 25.31 | 0.00 | 1.90 | 0.00 | 5.26 |
| 2005 | 28.09 | 0.00 | 3.86 | 0.00 | 7.54 |
| 2006 | 30.18 | 0.00 | 3.00 | 0.00 | 10.05 |
| 2007 | 26.79 | 0.00 | 2.95 | 0.00 | 10.00 |
| 2008 | 25.89 | 0.00 | 2.81 | 0.00 | 9.61 |
| 2009 | 15.49 | 0.00 | 2.00 | 0.00 | 5.06 |

As with the exhibit showing the total numbers of providers covered, these numbers are on a provider-year basis. That is, these numbers show average number of providers insured each day throughout the calendar year. This can be less than one for year if only one provider is insured and that provider is insured for less than the full year.

The Residual Authority provides coverage for health care providers that are unable to purchase medical professional liability insurance in the private admitted market. The premiums charged by the Residual Authority are considerably higher than in the voluntary marketplace, as the expected exposure is greater for physicians that private insurers are unwilling to write.

In the 1980s and 1990s, there were periods of time where no providers purchased coverage through the Residual Authority, and never more than two doctors were insured with the Residual Authority at any one time. While insurers in the past decade have declined to write the providers noted in the table above, the number of physicians covered by the Residual Authority is still only a fraction of a percent of the total number of physicians in the state, which indicates a healthy market for medical professional liability insurance.

History of Underlying Coverage Requirements and the “Cap”

To participate in the Fund, a health care provider must submit proof of financial responsibility in the form of an underlying professional liability policy with specified coverage limits and pay a premium (“the surcharge”) to the Fund. The act also establishes a “cap” on the amount a plaintiff could recover from all qualified health care providers. The Legislature has updated these limits and the cap over the years:

- When the Fund was established in 1976, these limits were set at \$100,000/300,000 for physicians and nurse anesthetists and \$100,000/1,000,000 for hospitals, with a \$500,000 cap on the amount a plaintiff could recover from all qualified health care providers.
- LB 692 passed by the 1984 Legislature raised the cap to \$1,000,000 for incidents occurring after January 1, 1985.
- LB 1005 passed by the 1986 Legislature increased the amount of required underlying insurance to \$200,000/600,000 for physicians or nurse anesthetists and \$200,000/1,000,000 for hospitals effective January 1, 1987.
- LB 1006 passed by the 1992 Legislature then raised the cap to \$1,250,000 for incidents occurring after January 1, 1993.
- LB 146 passed by the 2003 Legislature raised the cap to \$1,750,000 for incidents occurring after January 1, 2004.
- LB 998 in 2004 raised the underlying coverage requirement to \$500,000/\$1,000,000 for all providers other than hospitals, and to \$500,000/\$3,000,000 for hospitals. The effective date of this change was the date of the provider’s first qualification on or after January 2, 2005.

History of Surcharge Levels

| <u>Hospital Surcharge</u> | <u>Time Period</u> | <u>Surcharge for Physicians & Others</u> |
|---------------------------|------------------------|--|
| 15% | Original | 50% |
| 10% | 1-1-81 | 25% |
| 1% | 1-1-82 - 12-31-84 | 1% |
| 50% | 1-1-85 - 12-31-87 | 50% |
| 50% | 1-1-88 | 45% |
| 45% | 1-1-89 | 45% |
| 40% | 1-1-90 | 40% |
| 35% | 1-1-91 | 35% |
| 40% | 1-1-92 - 12-31-93 | 40% |
| 30% | 1-1-94 - 12-31-94 | 30% |
| 15% | 1-1-95 - 12-31-95 | 30% |
| 10% | 1-1-96 - 12-31-96 | 10% |
| 5% | 1-1-97 - 12-31-00 | 5% |
| 20% | 1-1-01 - 12-31-01 | 20% |
| 35% | 1-1-02 - 12-31-02 | 35% |
| 50% | 1-1-03 – 12-31-05 | 50% |
| 45% | 1-1-06 – 12-31-06 | 45% |
| 40% | 1-1-07 – 12-31-07 | 40% |
| 35% | 1-1-08 – until revised | 35% |

A 50% surcharge, which is the maximum allowed by the Act, was instituted by the Department when the Act was first put into effect so that a fund could be established to pay claims. The Legislature did not provide any “seed money” for this purpose and there was a concern that the Fund would not have money to pay a claim made shortly after the Act’s inception. (A loss payment was not made by the Fund until 1984, when it paid 6 claims.)

As originally written, the Act placed a statutory cap of \$5 million on the assets of the Fund, without regard to the Fund’s liabilities. As the Fund’s assets approached \$5 MM, the surcharge for 1981 was reduced. A further reduction to the minimum surcharge of 1% was made for 1982 as the amount in the Fund exceeded the statutory cap.

LB 692 passed during the 1984 Legislature modified the cap to allow for consideration of future claim costs. Following that, the surcharge was raised to 50% (the maximum allowed by the Act) for all categories effective January 1, 1985. This amount was reduced in succeeding years as experience was favorable and the total assets of the Fund increased. This practice was reversed starting with January 1, 2001 as it became apparent that losses were increasing significantly and past loss reserves were developing upward.

The passage of LB 998 in 2004, which increased the underlying coverage requirement to \$500,000 from \$200,000 on a phased-in basis during 2005, resulted in the surcharge for 2006 being lowered to 45%, to 40% effective 1/1/2007 and to 35% effective 1/1/2008. As is discussed on the final page of this report, it is anticipated that a further reduction of the surcharge will occur effective 1/1/2011 following the Fund’s annual surcharge hearing in the fall of 2010.

Assets and Operating Results of the Fund

| Year | Fund Assets, 1/1/XXXX | Revenue | Investment Activity | Calendar Year Paid Loss & LAE | Admin Expenses | Net Annual Results (cash basis) | Fund Assets, 12/31/XXXX |
|------|-----------------------|------------|---------------------|-------------------------------|----------------|---------------------------------|-------------------------|
| 2000 | 58,940,974 | 901,435 | 3,754,219 | 9,531,986 | 231,320 | (5,107,651) | 53,833,323 |
| 2001 | 53,833,323 | 3,866,753 | 6,679,229 | 8,101,409 | 184,665 | 2,259,908 | 56,093,231 |
| 2002 | 56,093,231 | 6,444,233 | 3,223,109 | 10,848,482 | 124,500 | (1,305,639) | 54,787,592 |
| 2003 | 54,787,592 | 10,041,551 | 3,464,168 | 11,118,182 | 122,869 | 2,264,669 | 57,052,261 |
| 2004 | 57,052,261 | 11,418,984 | 1,180,401 | 11,305,525 | 236,352 | 1,057,508 | 58,109,769 |
| 2005 | 58,109,769 | 12,799,247 | 3,699,006 | 14,126,368 | 133,643 | 2,238,241 | 60,348,010 |
| 2006 | 60,348,010 | 12,466,351 | 2,593,113 | 11,394,986 | 188,193 | 3,476,285 | 63,824,295 |
| 2007 | 63,824,295 | 10,407,093 | 2,581,239 | 8,491,084 | 171,892 | 4,325,356 | 68,149,651 |
| 2008 | 68,149,651 | 9,495,284 | (497,649) | 14,808,033 | 165,652 | (5,976,050) | 62,173,601 |
| 2009 | 62,173,601 | 9,298,293 | 9,681,857* | 5,857,305 | 185,933 | 12,936,912 | 75,110,513 |

- * The excellent investment income results in 2009 during bad economic times were the result of the relationship between the stock market and the bond market. As the stock market decreased, money moved from this investment vehicle to the more stable bond market. This movement created a demand in the bond market which was reflected in a substantial increase in the carrying value of the investments in the Excess Liability Fund, since the Fund is heavily invested in the bond market. As a point of reference, the benchmark from Barclays Capital Aggregate Bond index showed returns of 8.6% for the period ending 12/31/09 and 2.4% for the period ending 12/31/08.

Following the drop in payments seen in 2007, and anticipating the favorable effect of LB 998 passed a few years before, the paid losses in 2008 exceeded expectations and the Fund's investments suffered from the financial crises of 2008. In 2009, losses were less than expected and the year's investment income was greater than expected.

Liabilities of the Fund

The loss liabilities of the Fund are subject to significant uncertainty. Some of these sources of uncertainty are the same as those faced by insurers of medical professional liability – a long time to settlement and the uncertain outcome of cases. For the Fund, the relatively small number of cases paid each year increases variability for purely statistical reasons. Underscoring the potential variability of Fund results was a series of many claims that arose from Hepatitis “C” infections and a Fremont oncology clinic. While this set of claims no longer contributes to uncertainty in the Fund’s liabilities, the Fund’s experience with them only underscores the uncertain nature of the Fund’s liabilities.

As of 12/31/2009, the Fund’s liabilities are estimated at \$23,132,663.25, which consists of \$18,483,516.94 for unpaid losses and \$4,649,146.31 for unearned premium. The reserves for unpaid losses arise primarily from claims that have already been reported, but are in various stages of litigation or negotiation. Medical professional liability claim disposition often requires a number of years. Claims reserves also include so-called “IBNR” claims – claims that have been “incurred” but have not yet been reported. On account of extended-reporting (“tail”) endorsements, as well as a relatively small number of occurrence policies, the Fund is currently liable for some claims that will not be reported for a period of several years. Most coverage provided by the Fund is on a claims-made basis, where IBNR is typically not a consideration, but some coverage involves IBNR.

The estimated total liabilities of \$23,132,663.25 as of 12/31/2009 versus assets of \$75,110,512.66 as of the same date imply an operating reserve of \$51,977,849.41 for unforeseen events, variation in year-to-year results and the possibility of inadequate reserve estimations. As was demonstrated with the Hepatitis “C” cases, events with many defendants – which can produce losses far outside the range of normal statistical variation – are possible. In addition, hindsight now shows that we have both underestimated as well as overestimated the liabilities of the Fund at times in the past. While the current operating reserve is higher than recent targets and is almost certain to result in a reduced surcharge rate for 2011, it should be stressed that large scale events with many plaintiffs (as with the Hepatitis “C” case in Nebraska) still have the potential to be larger than the Fund’s current reserves.

Persons that compare this report with Annual Reports as of 12/31/2006 and prior will see that loss reserves have dropped substantially from those older reports. The primary reason for this drop was the impact of LB 998, which was passed in 2004. This raised the underlying coverage requirement to \$500,000 on a phased-in basis starting on January 2, 2005 and with an average effective date in the latter half of 2005. This effective date applied to occurrences, not claim reports. A large percentage of claims are not reported until several years following the medical incident, which is then followed by legal processes involving litigation and/or negotiation. As a result, the effect of this legislation wasn’t strongly felt for a number of years, and it now appears to have caused a larger drop in claim payments than had been expected.

The loss reserve exhibits contained in this report allow one to see a good picture of what loss reserves should have been a few years ago. While current reserves are only estimates, the reserves shown for older years – particularly for more than 3 years ago – represent claims that

are now mostly paid. All claims reported during the first 25 years of the Fund's existence are now entirely paid. For instance, the reserve shown in this exhibit for reported losses in 2000 is no longer an estimate, because all of the claims reported as of 12/31/2000 have since been paid.

As one can see by looking at these losses, year-to-year results are subject to considerable random variation. This random variation makes it more difficult to estimate current unpaid losses, as we can never be sure whether recent good experience is the result of decreases in underlying exposure or whether it is just random variation. The selected reserves for future payments assume that some of the recent dip in claims is simply statistical variation, but that a significant portion of it is attributable either to a decline in the underlying loss causes of loss or to the previously underestimated effect of the \$500,000 threshold.

Loss experience of the Fund
(on a reported basis)

| Year | Calendar Year Paid Loss & LAE | Report Year Incurred Loss & LAE | Unpaid Reported Loss & LAE, End of Year | Paid Claim Counts Excl. Mass Torts | Paid Claim Counts Incl. Mass Torts |
|---------------|-------------------------------------|---------------------------------------|---|--|--|
| 1976 | 0 | 0 | 0 | 0 | 0 |
| 1977 | 0 | 0 | 0 | 0 | 0 |
| 1978 | 0 | 0 | 0 | 0 | 0 |
| 1979 | 0 | 0 | 0 | 0 | 0 |
| 1980 | 0 | 305,129.50 | 305,129.50 | 0 | 0 |
| 1981 | 0 | 326,368.51 | 631,498.01 | 0 | 0 |
| 1982 | 0 | 600,254.75 | 1,231,752.76 | 0 | 0 |
| 1983 | 0 | 1,690,217.34 | 2,921,970.10 | 0 | 0 |
| 1984 | 1,294,322.00 | 1,473,660.43 | 3,101,308.53 | 6 | 6 |
| 1985 | 1,031,917.83 | 1,827,658.67 | 3,897,049.38 | 4 | 4 |
| 1986 | 1,845,684.83 | 2,413,511.58 | 4,464,876.13 | 9 | 9 |
| 1987 | 1,282,502.25 | 2,036,836.45 | 5,219,210.33 | 6 | 6 |
| 1988 | 1,160,457.68 | 2,496,987.74 | 6,555,740.38 | 5 | 5 |
| 1989 | 1,927,508.62 | 1,640,986.45 | 6,269,218.21 | 8 | 8 |
| 1990 | 1,827,716.17 | 1,888,430.46 | 6,329,932.50 | 8 | 8 |
| 1991 | 4,305,512.25 | 2,170,941.36 | 4,195,361.61 | 8 | 9 |
| 1992 | 2,098,858.64 | 4,179,956.00 | 6,276,458.98 | 10 | 10 |
| 1993 | 2,147,007.22 | 3,511,126.15 | 7,640,577.90 | 9 | 9 |
| 1994 | 3,251,669.50 | 3,611,432.72 | 8,000,341.12 | 11 | 11 |
| 1995 | 2,855,918.71 | 4,150,285.41 | 9,294,707.82 | 9 | 9 |
| 1996 | 2,916,493.25 | 7,884,592.27 | 14,262,806.84 | 15 | 15 |
| 1997 | 3,421,227.66 | 4,753,051.23 | 15,594,630.40 | 11 | 11 |
| 1998 | 2,916,649.16 | 3,582,770.55 | 16,260,751.80 | 11 | 11 |
| 1999 | 4,775,454.51 | 8,166,224.80 | 19,651,522.09 | 13 | 13 |
| 2000 | 9,531,985.58 | 9,382,286.54 | 19,501,823.05 | 23 | 23 |
| 2001 | 8,101,409.04 | 7,765,236.58 | 19,165,650.59 | 23 | 23 |
| 2002 | 10,848,481.82 | 21,270,678.19* | 29,587,846.95 | 28 | 28 |
| 2003 | 11,118,181.55 | 7,942,159.14 | 26,411,824.55 | 28 | 28 |
| 2004 | 11,305,525.30 | 8,842,167.91 | 23,948,467.15 | 24 | 34 |
| 2005 | 14,126,368.48 | 14,226,846.60 | 24,048,945.27 | 21 | 82 |
| 2006 | 11,394,985.64 | 11,354,211.95 | 24,008,171.58 | 27 | 36 |
| 2007 | 8,491,084.02 | 10,946,663.49 | 26,463,751.05 | 19 | 20 |
| 2008 | 14,808,032.62 | 5,090,598.21 | 16,746,316.63 | 26 | 27 |
| 2009 | 5,857,305.27 | 5,658,768.28 | 16,547,779.65 | 15 | 15 |
| Totals | 144,642,259.60 | 161,190,039.25 | | 377 | 460 |

* The 2002 reported losses include about \$9.3MM for cases arising out of a large number of claims made arising out of Hepatitis “C” infections and a clinic in Fremont.

(See the next two pages for an additional discussion of these results.)

Calendar Year Paid Loss & LAE – The paid loss and loss adjustment expense (LAE) numbers shown in the first data column of this table are taken directly from the Fund’s financial records and should be accurate to the penny. Please note that the loss & LAE numbers in these exhibits do not include loss & LAE incurred by the primary insurer unless the primary insurer is the Residual Authority. Residual Authority losses are included, but are not a material part of the total losses, as the Authority only covers a small number of health care providers.

Report Year Incurred Loss & LAE – The report-year numbers are from individual claim files and actuarial estimates. For older years, where no reported claims remain open, these numbers should agree to the penny with numbers from the Fund’s financial records, but they do not. In the last 10 years or so, the only differences between these two sets of records arise from rounding, because the dollars in the claim records are rounded to the nearest dollar. For older years, however, there was not the same rigorous balancing between financial and claim records that exists today. As a result, there were LAE amounts that were paid and thus included in the financial numbers that were not included in the claim file numbers. As a result, there was about \$66,000 in LAE included in the financial numbers that was never included in the individual claim files. As the report-year numbers must be developed from claim files, the “solution” to this problem is that the total claim file numbers for all years combined were increased by a very small factor so that they total \$161,190,039.25 instead of about \$66,000 less. With this small caveat, the report-year numbers for older years can be viewed as being precise, while the numbers for recent years include a combination of known paid losses and estimated unpaid losses.

Unpaid Reported Loss & LAE, End of Year – The unpaid reported loss and LAE is the largest part of expected liabilities. The other material liabilities are unearned premiums (surcharges) and incurred but not reported (IBNR) losses. With regard to this column, the numbers are somewhat different than is typical for an exhibit of this sort. The numbers for every year represent our estimation *at this time* of the reported losses that were unpaid as of the end of the corresponding year. For the most recent year – 2009 – that means that all of these losses were unpaid as of 12/31/2009. But with regard to another year – take 2005 as an example – there were only a small number of claims that were unpaid as of 12/31/2005 that are still open and potentially unpaid as of 12/31/2009. This gives us the advantage of 20-20 hindsight when it comes to selecting these numbers for older and older years, because we now know with certainty what happened with most (or all) of these claims. As such, while the most recent year’s unpaid losses can be viewed as an actuarial estimate, we can compare this actuarial estimate to what we now know would have been the correct numbers or more likely estimates for previous years.

Paid Loss Counts – These counts represent the number of losses with an indemnity payment that were closed by the Fund in a given calendar year. Thus, this does *not* include claims that were closed without an indemnity payment by the Fund, even though the underlying insurer (other than the Residual Authority) may have made an indemnity payment. It also does not include claims where the Fund had LAE, but didn’t pay indemnity. In this regard, if one divides calendar year loss & LAE for a year by the number of closed claims for a year, it is possible that this will include LAE for claims without indemnity payment and for claims that are ultimately closed in another year, but this “distortion” should be insignificant as the Fund’s total LAE is typically only a percent or two of its total indemnity. Most LAE is incurred by the underlying carriers, which have LAE-to-indemnity ratios that are much higher.

Mass Torts (in Loss Counts & elsewhere) – The reference to “mass torts” includes two situations. The first relates to treatments that were administered by a physician in 1976, that were reported in 1986 and paid in 1991. The Fund made a single global payment of \$1,500,000 as part of a total settlement of \$4,500,000. There were ultimately 213 plaintiffs represented, but it was handled as a single large case by the Fund.

The second “mass tort” situation dealt with a clinic in Fremont and a number of cases of Hepatitis “C” that arose following patients’ treatments by the clinic. The Fund opened a total of 92 cases out of this situation and ultimately paid \$8,706,345 in indemnity costs and \$568,282 in LAE with regard to these cases. (The total payments to all plaintiffs were considerably higher, as there were other parties that contributed to settlements.) As of 12/31/2009, the Fund participated in indemnity payments to close 82 of these cases; 9 cases were closed without a Fund payment (although other defendants may have paid), and the last case was closed in 2010.

The Fund's Operating Reserve

| Year | Fund Assets, 12/31/XXXX | Unpaid Reported Loss & LAE | IBNR | Unearned Premiums | Operating Reserve |
|------|----------------------------|----------------------------------|--------------|----------------------|----------------------|
| 2000 | 53,833,322.75 | 19,501,823.05 | 1,642,381.13 | 450,717.68 | 32,238,400.89 |
| 2001 | 56,093,231.00 | 19,165,650.59 | 1,794,763.85 | 1,933,376.27 | 33,199,440.29 |
| 2002 | 54,787,591.56 | 29,587,846.95 | 1,960,531.79 | 3,222,116.64 | 20,017,096.18 |
| 2003 | 57,052,260.61 | 26,411,824.55 | 2,125,717.60 | 5,020,775.70 | 23,493,942.76 |
| 2004 | 58,109,768.77 | 23,948,467.15 | 2,559,847.16 | 5,709,492.23 | 25,891,962.23 |
| 2005 | 60,348,009.67 | 24,048,945.27 | 2,710,676.25 | 6,399,623.26 | 27,188,764.89 |
| 2006 | 63,824,294.68 | 24,008,171.58 | 2,210,379.78 | 6,233,175.42 | 31,372,567.90 |
| 2007 | 68,149,650.78 | 26,463,751.05 | 1,906,226.86 | 5,203,546.45 | 34,576,126.42 |
| 2008 | 62,173,601.05 | 16,746,316.63 | 1,893,692.30 | 4,747,642.01 | 38,785,950.11 |
| 2009 | 75,110,512.66 | 16,547,779.65 | 1,935,737.29 | 4,649,146.31 | 51,977,849.41 |

Fund Assets – This is simply the estimated value of the Fund's assets as of the date specified.

Unpaid Reported Loss & LAE – As explained in previous exhibits, this represents the Fund's estimated liability for claims that have been reported to the Fund, but are in various stages of the dispute and/or settlement process.

IBNR – Incurred but not reported (IBNR) losses represent obligations of the Fund on account of medical incidents or treatments that had already occurred as of a specified date, but where the physical condition giving rise to a claim had not yet manifested itself, or where the condition was known to the plaintiff, but where a claim had not yet been made and/or communicated to the Fund. As most underlying medical professional liability coverage is claims-made, the amount of this liability is typically expected to be considerably less than liabilities on account of claims that have already been reported. For the Fund, the primary sources of IBNR are occurrence coverage written by the Residual Authority and so-called "tail" coverage provided by underlying insurers when a physician switches insurers, retires, dies or is disabled.

Unearned premiums – At any given time, approximately half of the premiums (surcharges) received in the past year will be for excess and primary coverage yet to be provided. The unearned premium number thus represents 50% of the premiums & surcharges collected by the Fund during the previous year.

Operating Reserve – The ideal operating reserve for the Fund can be debated, but it clearly must be a significant amount. The Fund may suffer from years of bad experience, as is demonstrated by previous exhibits, and estimations of future losses may prove inadequate. The most obvious viability concern for the Fund's would be a many-defendant case. The Department's current pricing position is to set surcharge levels approximately equal to expected future loss rates if the operating reserve is between \$30MM and \$35MM, and to set the

surcharge levels somewhat higher or lower, respectively, if the operating reserve is below or above this range. It therefore follows – absent any shocks or unusually unfavorable developments prior to the annual surcharge hearing on October 28, 2010 – that surcharge rates will be reduced and are likely to be somewhat lower than expected losses for 2011. This will make up for the fact that hindsight now allows one to see that the Fund has collected surcharges at a higher rate than necessary for the past several years.

Given that the current evaluation of the operating reserve as of 12/31/2008 is \$38,785,950.11 and the operating reserve as of 12/31/2009 is \$51,997,849.41, it begs the question as to why a lower surcharge rate was not selected for 1/1/2009 and 1/1/2010. In fact, quite a bit of consideration was given to doing that for 1/1/2010, but paid losses during 2008 had been quite high (\$14,808,032.62) and there was a concern that the lower losses that were paid during the first half of 2009 were only a temporary dip. With hindsight, it can now be seen that losses have continued to be significantly lower than for a number of previous years, and the very favorable investment results in 2009 were certainly not expected.

Questions?

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