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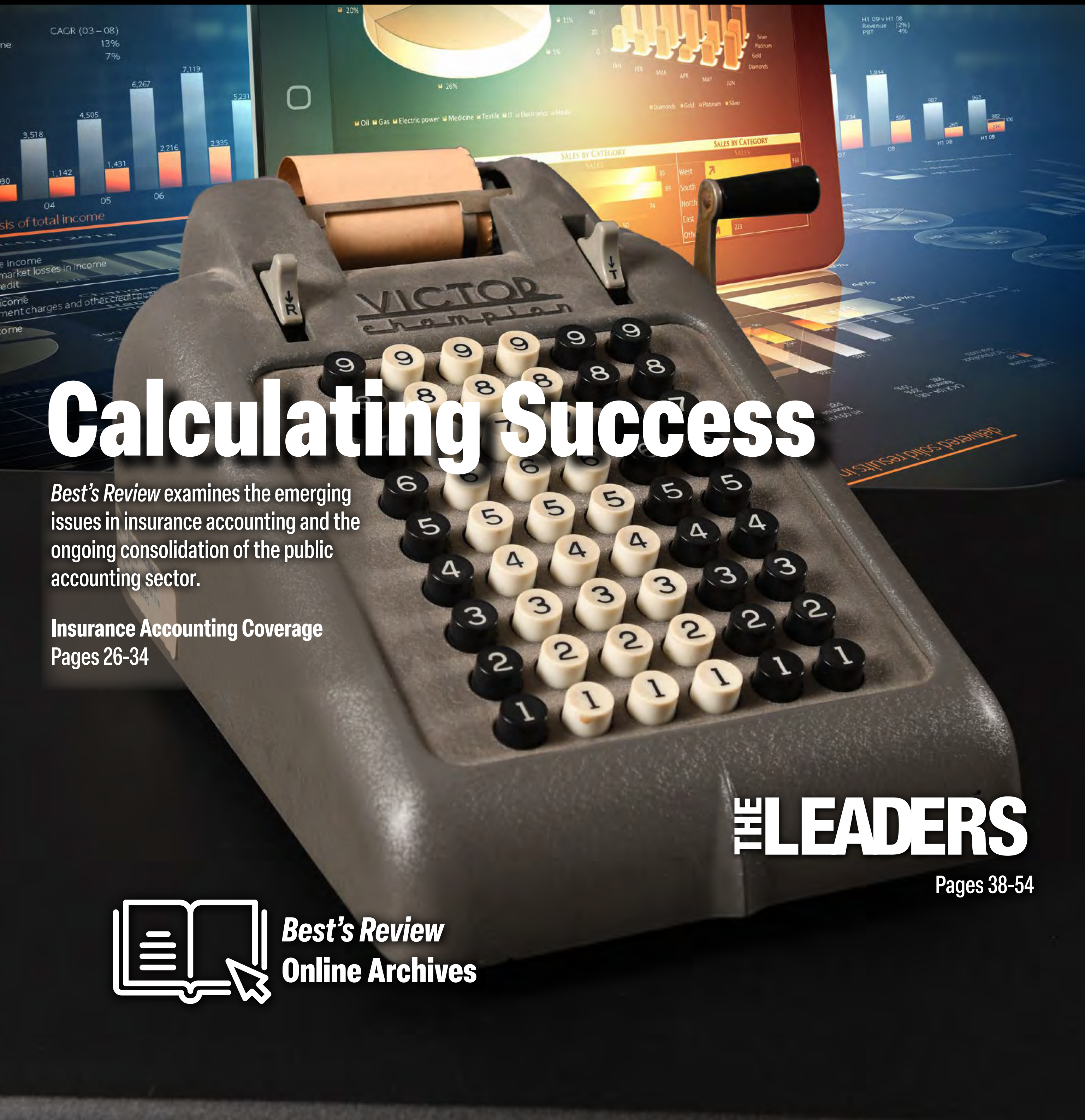

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AM Best: Social Inflation Remains a Thorn in the Side of Casualty Insurers

Cultural attitudes toward corporations and the erosion of tort reform in a number of states are among the factors driving social inflation.

by John Weber

Social inflation continues to test the ability of casualty insurers with unpredictable and excessive claim costs, David Blades, AM Best associate director of industry research and analytics, and Justin Aimone, associate analyst, said in discussing a recent Best's Special Report. Following is an edited transcript of the interview.

How did we get to this point where social inflation has become such a negative driver for the insurance industry?

Blades: Well, I don't think we can kind of point to just one specific catalyst for how we've gotten here. I think the rise of social inflation and the impact that it's having on casualty claims and casualty insurers has happened over time. I think initially what we saw was, it's a reflection of shifting social and cultural attitudes toward corporations in general. A lot of people in the general public and attorney firms are looking at corporations in terms of having deep pockets.

So, when people have claims or file claims and they look at corporations and the possibilities of these claims, they're looking at the deep pockets of the corporations and figuring that, "Hey, somebody has to pay for my misfortune."

The attitudes and the expectations of corporations being the appropriate party to bear those particular costs are going up. One catalyst over the past few years, when you look at what happened, was the onset of COVID-19 and the coronavirus. The second half of 2020, we saw a lot of television and radio legal advertising in terms of presenting the

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David Blades
AM Best

public with any problems they might be having and are they directly related to the coronavirus or what companies are doing in reflection to COVID-19.

A lot of that led to an increase in lawsuits over the second half of the year and a lot of it probably was attributable to that particular catalyst, but I think over time, in general, we’ve seen a change in the attitudes toward corporations.

We’ve seen the erosion of tort reform in a number of states, which is a factor that has increased the impact of social inflation. We’ve seen just a change in overall attorney tactics and in terms of attorneys getting involved in claims quickly, in addition to law firms increasing their amount of resources expended on advertising.

So, we’ve seen some of these things that are reflective of the overall factors that are attributable to social inflation, having greater impact on insurers, and how they’re looking at their long-tail lines of coverage, specifically general liability, and commercial liability, etc.

Casualty lines seem to be the ones that are most affected. What do you suppose that’s all about?

Blades: Well, I think just overall the effect of social inflation is higher volatility and greater uncertainty for insurance companies when they’re looking at their casualty lines of coverage. So, as they analyze their casualty claims in their overall portfolio, what is being revealed is the impact third-party litigation funding and social inflation are having on that book of business, which is causing greater uncertainty.

As a consequence, what you see from the insurance companies is they’re really putting more reserves away until more of these settlements come through and they get more data on which they can then rely from looking forward in terms of how they’re going to address these lines of business.

What we did see in looking at the different lines of business is that for general liability and for umbrella and excess liability, for commercial auto liability, in particular commercial trucking, and even for professional liability, including medical professional liability, there has been an increase in loss severity over recent years.

The loss severity trend for some of those lines has been slightly above economic inflation, and for some of them, the trend lines for severity has far outpaced economic inflation. So, that’s been reflective of other factors at play having an impact on these overall claims. Looking at claim trends, it is also clear that greater attorney involvement has increased expenses for insurance companies and increased the size of some of the overall settlements.

We’ve also seen the impact of nuclear verdicts that are 10 million [dollars] and more. I think what we’ve seen is that reading reports of such verdicts increases the expectation that some people have in terms of the potential payments that they may be able to get from lawsuits over and above just being indemnified for their medical injuries, meaning payments that they might be able to get for pain and suffering. I think that’s what’s blown some of these claim trends out of the water in terms of recent claim trends.

These are the trends and the factors that insurance companies are recognizing. As I mentioned earlier, just the erosion of tort reform has been a factor increasing the impact of social inflation. In some states, there were caps on the noneconomic damages, referring to the pain and suffering payout portion of claims that have been put in place.

However, there have been challenges to a lot of these caps in different states where they've ended up being repealed, or there's more fighting going on from a legal perspective. So, that's also had an impact in those states on the claim possibilities and how severe the claims might be.

All these trends are things that insurance companies are having to look at. Concerning the lines of business that I have referenced, one thing that's good from an industry standpoint is that in the last AM Best P/C industry loss reserve review, despite some of these negative trends for general liability and medical professional liability in particular, P/C industry reserves appear to be redundant.

Conversely, commercial auto liability was the one line that seems to be most deficient in terms of the industry's current reserve base, in the aggregate. Again, the factors reflecting of social inflation are definitely impactful and are contributing to the deficiency there.

Is there anything the insurance industry can do to combat the increased use of third-party litigation funding or some of these other social inflation triggers?

Aimone: Yes, well, there have been efforts to combat these triggers, third-party litigation funding in particular. In 2021, the Litigation Funding Transparency [Act] was introduced in both chambers of U.S. Congress, which requires disclosure of these third-party financing agreements and federal civil lawsuits.

The bill aims to shed light on the billion-dollar industry that is third-party litigation funding and also aims to have the courts and opposing parties know who is financing these agreements and whether or not there's a conflict of interest at hand.

Additionally, there have been industry-led initiatives to promote alternative dispute methods, such as arbitration and mediation, as a means to drive down litigation costs and delays. With respect to some other social inflation triggers such as nuclear verdicts, companies have been turning to technology such as artificial intelligence data-driven software to help identify certain risks.

In respect to the trucking industry as a whole, there have been efforts such as installing drive cameras or looking into the future of self-driving vehicles as a way to prevent social inflation and effects of it.

Can companies at least plan for social inflation if not mitigate it altogether?

Aimone: Yes. One big way to help mitigate social inflation is through data analysis and monitoring. Regularly analyzing claims data can help identify patterns and trends related to social inflation, which then can help identify these emerging risks that companies are facing and help them adjust their strategies accordingly.

I do want to go back to what I was talking about with third-party litigation funding. One of the most impactful ways to avoid litigation costs and delays is to avoid litigation entirely. The way to do this is through early claims resolution.

The litigation process can exponentially increase costs and delays, and going through the early claims resolution route, this allows companies to resolve and identify cases that have the potential to go nuclear and reach a nuclear verdict and drive down the costs and expenses significantly.

Now, a pre-litigation settlement is not always possible. So, a defense team having a defined strategy heading into a trial or court is a great way to have the jury focus on the matter at hand and the theme that they want to convey at trial. One of the things actually talked about in our report is anchoring, which ... is a tactic [plaintiff attorneys] use to try to set an exorbitant dollar amount at the start of trial that gets the jurors focused on a certain figure that they've relayed.

Battling anchoring is something that can largely drive down some of the settlements and the large nuclear verdicts by exposing to the jury that this is simply a psychological tactic that attorneys are using to get them to focus on and then presenting a counter anchor in a way that doesn't concede liability to the defense, but [is] just a more reasonable way of assessing the damages of the claim and case at hand. BR

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Scan to watch the interview with David Blades and Justin Aimone.