

NAMIC ISSUE ANALYSIS



SOCIAL INFLATION IS COMPLICATED AND COSTLY –
A FIVE-PART SERIES EXAMINING SOCIAL INFLATION AND ITS
IMPACT ON INSURERS



For more information about this NAMIC Issue Analysis, please visit www.namic.org/issues/our-positions or contact:

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The National Association of Mutual Insurance Companies is the largest property/casualty insurance trade group with a diverse membership of nearly 1,500 local, regional, and national member companies, including seven of the top 10 property/casualty insurers in the United States. NAMIC members lead the personal lines sector representing 66 percent of the homeowner's insurance market and 53 percent of the auto market.

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SOCIAL INFLATION IS COMPLICATED AND COSTLY – FIVE PERSPECTIVES TO HELP INSURERS IDENTIFY TRENDS AND RESPOND

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If you're a regular consumer of television, you've no doubt seen at least one, or perhaps multiple, commercials from accident lawyers promising big dollar settlements against rich insurance companies. The number of such commercials has only increased over the past several years, as a phenomenon called "social inflation" has taken root in our legal system.

Since the term social inflation first emerged in the 1970s, it has grown and expanded into a catch-all of sorts to describe a host of deleterious cost-drivers that involve litigation and that chip away at insurers' books of business, increase their operating costs, and eventually metastasize in the form of higher premiums for policyholders. Unusually large or so-called nuclear verdicts catch our attention, but the underlying causes are broader and deeper. Many of these cost-drivers have existed in some capacity for decades, yet the past several years have demonstrated that the insurance industry really needs to understand the social inflation landscape so we can begin to address it.

Some insurers may be wondering why they should be concerned about social inflation when so many more pressing matters are threatening the profitability of their businesses. Social inflation hasn't had an impact on businesses and insurers the way COVID-19 did in 2020. Instead, the progression of social inflation has been slow and almost imperceptible, making it harder to identify and address. While some insurers have not observed an upward severity trend in their books of business, chances are that social inflation is quietly making inroads right now.

Actuarial, claims, and legal professionals are often the first to spot a shift in loss severity through the emergence of nuclear verdicts, rising compensatory demands, or an upward movement in losses. How early and deep the impact depends, in part, on the insurer's classes of business and territories, so some carriers may not yet have seen the signs. To learn more about how social inflation is affecting the Property/Casualty insurance industry, NAMIC has partnered with Gen Re to find out what those on the front lines of social inflation – actuaries, claims, legal, and emerging issues – are witnessing, in order to share with readers a multipart analysis of social inflation, starting with this overview.

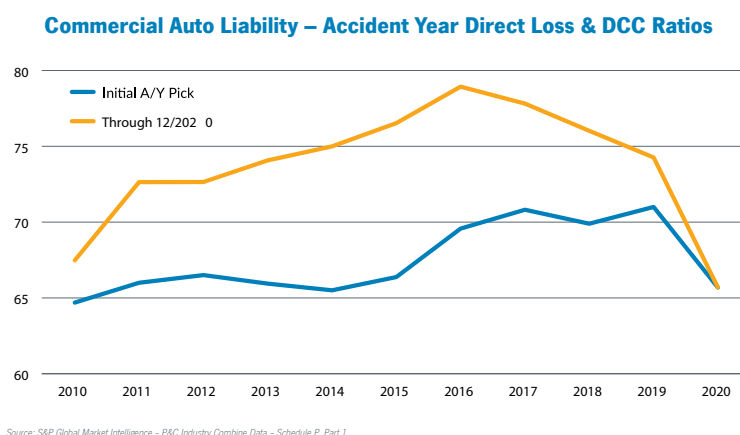


SOCIAL INFLATION IS COMPLICATED AND COSTLY – FIVE PERSPECTIVES TO HELP INSURERS IDENTIFY TRENDS AND RESPOND

TICKING UPWARD IN COMMERCIAL AUTO

When a jury awards \$50 million in a non-fatal single-victim auto accident, insurers take note and label it an anomaly, but don't necessarily see it as cause for alarm. Yet, when awards and settlements for such accidents routinely top \$10 million, often coupled with an insurer bad faith component, it's time for insurers to take notice.

NAMIC and Gen Re, along with other insurance companies, first observed an uptick in loss values in the Commercial Auto line starting in 2015. Prior to that, the industry had been reserving commercial auto in a loss ratio range that was consistent with historical performance. By 2015, it became clear that the line was performing worse than expected and the actual results climbed to more than 10 points above industry reserving picks for the preceding five years. It took nearly five years of development before the actual and projected loss ratio divergence became apparent, and that is a relatively short-tail line. The industry continued to underestimate loss experience on the line despite significant rate adjustments that chased but never caught up with trend. In short, Commercial lines insurers missed the loss inflection point – something hard to spot and costly to miss.



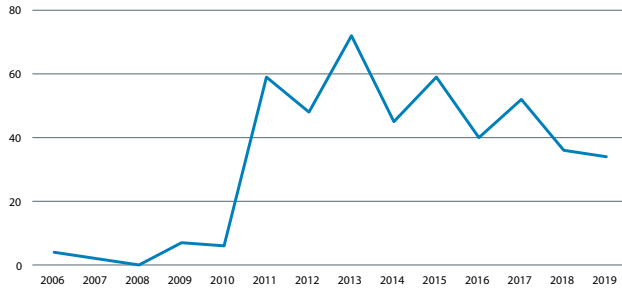
More recently, the American Transport Research Council shared its research on the verdicts that underlie the insurance industry's numbers. It highlighted an increase in verdicts over \$1 million starting in 2010 and an average verdict size sharply rising in 2017.

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Dramatic Increase in Frequency and Severity of Nuclear Verdicts

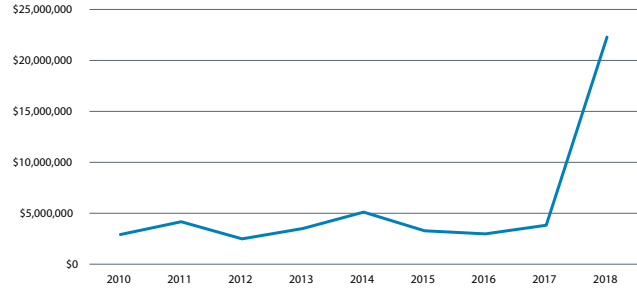
The American Transport Research Institute recently analyzed 451 verdicts over 2006-2015

Number of Cases With Verdicts Over \$1 Million



Source: American Transport Research Institute, "Understanding the Impact of Nuclear Verdicts on the Trucking Industry", June 2020

Average Size of Verdict



Source: American Transport Research Institute, "Understanding the Impact of Nuclear Verdicts on the Trucking Industry", June 2020

Insurers are no doubt wondering if social inflation has migrated to other lines of business, most notably General Liability, Umbrella (non-auto) and Personal Auto. There is early evidence of some unusual loss activity in Premises Liability, but nowhere as pronounced as in Commercial Auto. To evaluate the threat to other lines of insurance, this project seeks to analyze the drivers of social inflation seen in Commercial Auto and other areas and gauge how they may impact premises, products, and General Liability business.

SEVERITY DRIVERS

Although a few economic and demographic trends are unique to Auto, most trends cross over to other Liability lines. Bodily Injury is certainly the defining element in large Auto losses, but serious injuries also occur in Premises and Products Liability. Some of Gen Re's clients, particularly in the claims departments, have observed early notices of losses, attorney tactics, and unexpected trial outcomes first-hand.

Specifically, below is a list of likely causes of social inflation, identified by Gen Re and its clients, which have resulted in an undermining of profitability in the Commercial Auto and Liability lines in recent years:

- **More Miles Driven/Personnel Shortages** – With the economic recovery following the Great Recession (2007-2009), more trucks have been on the road, yet there are fewer experienced drivers to pilot them (subject to a COVID pause in activity).
- **Distracted Driving** – Smartphones and other distractions contribute to higher accident severity.
- **Litigation Funding** – The stronger cases are well-funded and under pressure to produce higher settlements and verdicts.
- **Widening Wealth Gap** – Jury backlash against "rich corporations" reflects a wealth disparity gap that has expanded by disproportionately higher COVID-related job losses in low-wage occupations.
- **More/Earlier Attorney Involvement** – This is indicated by an increasing number of first notice of losses where an attorney is already involved.
- **Increasing Plaintiff Bar Sophistication** – This trend has crystallized through trial bar networking, training, technology, and techniques to improve success rates on a nationwide scale.

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- Defense Bar Complacency – Insufficient preparation and financial incentives weaken the ability to counter aggressive trial bar efforts.

Previous research on the relationship between wealth disparity and loss ratios has found that, all else being equal, jury awards are higher in geographic areas with greater levels of income inequality. However, studies connecting causes and social inflation, or quantifying its impact on insurers, are few and limited in scope. That absence means insurers must draw lessons from their own loss experience and from their reinsurers, who have a broader, national view of the market. Even with insurers and reinsurers sharing perspectives, pricing for social inflation is incredibly challenging. The industry's experience with Commercial Auto tells that story.

ADDRESSING SOCIAL INFLATION

Over the last few years, Commercial Lines results have experienced an upward inflection point driven by social inflation. It is nearly impossible to detect this kind of inflection point in real time, but carriers should be vigilant, identifying trends and reacting quickly when the industry around them starts to shift. Staying alert to underwriting and claim developments – and listening to colleagues both internally and externally – can provide valuable insights. Social inflation is a complex issue for even the largest carriers with rich data and vast resources.

Throughout this series on social inflation, specialists from various disciplines – actuarial, claims, legal, and emerging issues – will share the latest data and perspectives. While COVID claims may be dominating the focus of management now, social inflation remains a critical issue that deserves a much higher degree of attention going forward.

ENDNOTES

1. Gen Re blog on Personal and Commercial Auto trends, <https://www.genre.com/knowledge/blog/spotlight-on-commercial-and-personal-auto-en.html>
2. "Understanding the Impact of Nuclear Verdicts on the Trucking Industry" (June 2020) at <https://truckingresearch.org/wp-content/uploads/2020/06/ATRI-Understanding-the-Impact-of-Nuclear-Verdicts-on-the-Trucking-Industry-06-2020-2.pdf>; see articles at www.ccjdigital.com.
3. "Understanding the Impact of Nuclear Verdicts on the Trucking Industry" (June 2020) at <https://truckingresearch.org/wp-content/uploads/2020/06/ATRI-Understanding-the-Impact-of-Nuclear-Verdicts-on-the-Trucking-Industry-06-2020-2.pdf>
4. Research by Frank Schmid, Gen Re CIO, reported by Chris Mackeprang, Gen Re actuary, <https://www.genre.com/knowledge/blog/social-inflation-measures-of-wealth-and-income-inequality-warrant-attention-from-underwriters-en.html>



SOCIAL INFLATION IS COMPLICATED AND COSTLY – LEGAL AND REGULATORY CHANGES

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In the U.S., the Property and Casualty insurance marketplace, along with the rest of the insurance industry, faces a wide range of issues arising out of the COVID-19 global pandemic. Meanwhile, social inflation continues to present significant long-term challenges to those Property and Casualty insurers.

The causes of social inflation are numerous and the source of much debate among insurance professionals, industry advocates, consumer advocacy groups, and legal professionals. From a legal and regulatory perspective, the simplest description of social inflation is “legislative and litigation changes which shape and ultimately impact insurers’ legal liabilities and claims costs.” These transformations have accelerated over the past five years and appear poised to continue for the foreseeable future. There is no greater contributor to social inflation than legal and regulatory changes. This installment of the NAMIC/Gen Re social inflation series focuses on those changes and offers potential responses for insurers and their reinsurers to consider.

A rise in third-party litigation funding is often identified as a leading cause of social inflation. There are various litigation funding business models, but in all of them, a funding firm provides working capital to contingency fee plaintiffs firms.

Three factors have fueled an increase in such litigation:

- The proliferation of funding firms combined with the appetite of the plaintiffs’ bar for capital to support case filings;
- The hiring of testifying experts; and
- The use of sophisticated technology to aid trial presentations.

In addition, these three factors have given plaintiffs and their lawyers the capacity to hold out for larger recoveries while increasing case investment returns.

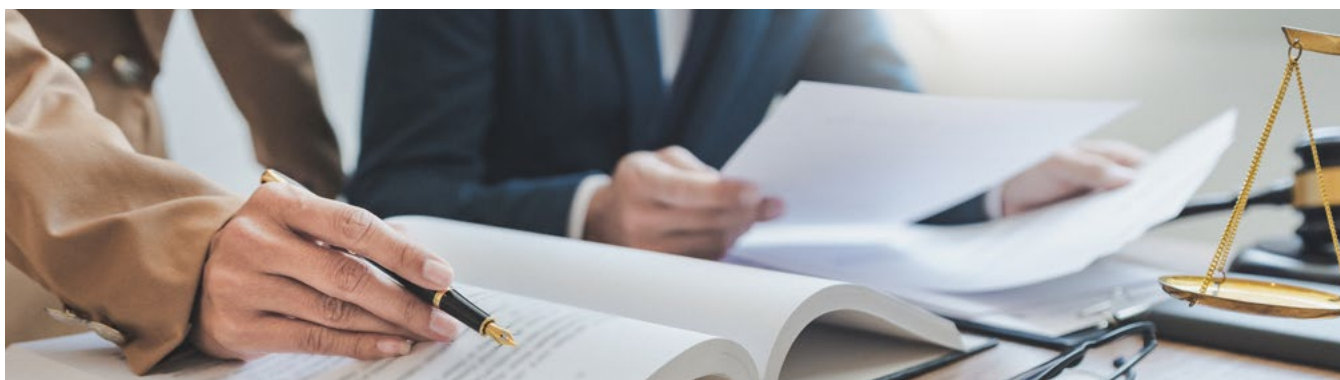
To date, there has been no meaningful legal or regulatory check on the growth of litigation funding or its use in litigation. While a number of state legislative measures – which could have meaningfully addressed this concern – emerged in 2020, attempts to require disclosures of litigation funding arrangements have had difficulty gaining traction. Even more concerning is the recent development in Arizona and Utah allowing non-lawyer investment in law firms. If these trends continue unchecked, the plaintiffs’ bar will continue to have ever-increasing access to capital to pursue litigation against corporate targets, including the insurance industry.

Another disturbing trend concerns legal and legislative attempts to circumvent statutes of limitation, which have long been an accepted and critical feature of the U.S. legal system. Legally established limitation periods to pursue a claim provide certainty with regard to the time period in which claims can be brought. The reasons for statutes of limitations are familiar: not only do they provide certainty, but they avoid serious questions about the reliability of claims asserted or evidence offered many years after an event allegedly occurred. Nevertheless, a broad assault on limitation periods has occurred in recent years as many states have taken action to “revive” the period in which claims can be brought, by either extending statutes of limitation or passing legislation allowing claimants to “revive” claims that were previously time-barred.

While indisputably well-intentioned, attempts to address the personal tragedy experienced by some individuals may prove, from a purely economic standpoint, to be a short-sighted reaction to arguably isolated incidents. Not only do such measures present constitutional questions and lead to many claims of dubious merit, but they also undermine a core principle of the American legal system and raise broader concerns that American businesses – including by extension insurers and reinsurers – will be faced with concerns of perpetual liability exposure.

SOCIAL INFLATION IS COMPLICATED AND COSTLY – LEGAL AND REGULATORY CHANGES

In addition to the many challenges already facing the Property and Casualty insurance industry in the U.S., it faces the growing acceptance of a public nuisance theory of liability in litigation relating to opioids, talc, climate change, and more recently, claims of alleged COVID-19 infection in the workplace. The essence of these claims is that a product manufacturer, distributor or employer has engaged in legally permissible activity but has ultimately created or contributed to a public health crisis by engaging in that activity, and therefore needs to be found liable to “fund” the alleged societal cost. Plaintiffs argue that traditional requirements of causation should be disregarded because of the grave social issues involved.



Not only does this approach eviscerate longstanding legal principles, and in many instances, bargained-for contract provisions, but it effectively asks courts and juries to supplant legislators and regulators. Long-established causes of action already exist and allow plaintiffs to seek redress for alleged injuries or for a party’s violation of a duty or failure to adhere to a law or regulation. However, bypassing these established legal standards to create an avenue for recovery where none previously existed will harm not only businesses, but the insurers and their reinsurers who provide needed support.

In a related development, there is a growing trend of states enacting liability presumptions, particularly – though by no means exclusively – with respect to liability for alleged COVID-19-related losses or illnesses. Pressure is growing in a number of states to enact more of these presumptions or to extend those already in place. Some of these measures have been effectively challenged in the courts, while others have been headed off by effective advocacy concerning the long-term ills of such presumptions, particularly where they look to rewrite bargained-for written contracts. The insurance industry needs to continue to provide awareness regarding the risks of these measures and support advocacy efforts to prevent additional legislation that features presumption of liability.

Equally concerning is the declining enforcement of liability waivers. Where no reckless or intentional conduct has taken place, liability waivers – clearly written, identifying known risks, and agreed upon by knowledgeable parties – should be enforced.

Consensus is lacking among insurance industry commentators as to whether the roll-back of tort reform measures in certain states, such as Missouri, have contributed to the rise in social inflation in recent years. Regardless of the degree of the impact, tort reform in the 1980s and 1990s – such as the establishment of caps on non-economic damages – helped to curb the last major bout of social inflation in the U.S. Limits on non-economic damages have proven to be the key to stemming “nuclear” verdicts that drive social inflation.

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In the U.S., the Property and Casualty insurance industry can make significant strides toward reversing the serious threat of ballooning social inflation by instituting four strategies:

- Advocating for legislation aimed at the regulation of third-party funders that fuel growth in litigation;
- Adhering to accepted legal principles;
- Promoting awareness of the long-term harm of liability presumptions; and
- Encouraging renewed focus on tort reform measures.

There is no simple cure to the ills of social inflation, but a sustained and consistent effort by insurers, and the advocacy groups they support, can start to address some of the symptoms.

ENDNOTES

1. Social Inflation: Navigating the evolving claims environment, Geneva Association Report at 9.
2. <https://www.advocatecapital.com/about.html>.
3. <https://www.claimsjournal.com/news/national/2020/02/18/295539.htm>.

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SOCIAL INFLATION IS COMPLICATED AND COSTLY – THE PRODUCTS LIABILITY PARADOX

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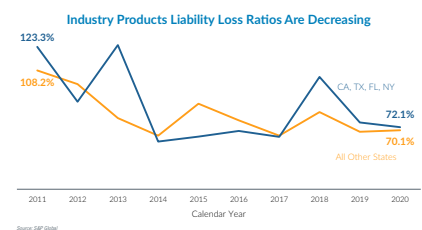
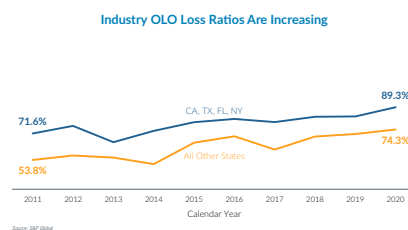
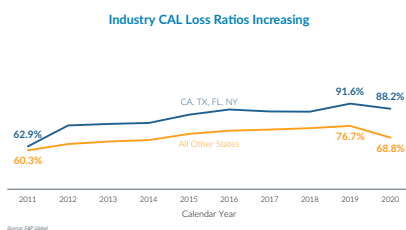
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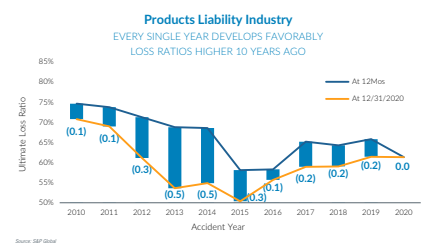
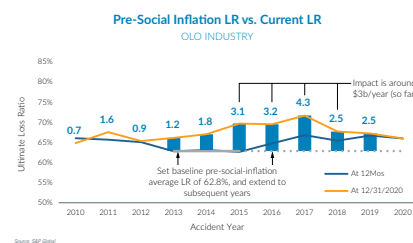
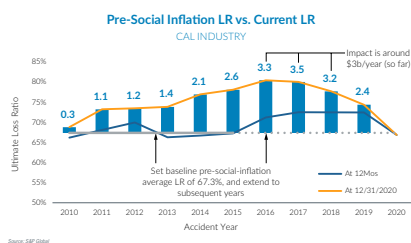
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As social inflation has been more widely examined in recent years, it has grown to encompass almost any unfavorable aspect of modern Casualty insurance. However, while many Casualty lines are under strain, there are also some Casualty lines that are performing well despite purportedly being susceptible to many of the same social inflationary forces. Segmenting Casualty lines into those performing well and those under strain, and considering what the well-performing lines have in common that is not shared by the lines under strain, can help further define which aspects of social inflation are most impactful. This information is crucial to formulating an effective response against these damaging influences.

Consider that industry-wide loss ratios have grown steadily over the past 10 years in Commercial Auto Liability and Other Liability Occurrence, which includes Umbrella, but have shrunk in Products Liability. The change in calendar year loss ratios reflects the late development from prior accident years, which highlights unexpected changes in market conditions – such as social inflation. Most PL business is written on a claims-made basis, but the downward trajectory of calendar year loss ratios is still indicative of improving market conditions for the line. The four largest states – California, Florida, New York, and Texas – represent roughly 40 percent market share in each of these lines and have loss ratios higher than the rest of the states, but loss ratios are moving in the same direction for all states. What is happening in CAL and OLO that is not happening in PL?



To answer that question, it is helpful to put some context around these increasing loss ratios by estimating the overall dollar impact. If what the loss ratio would have been in recent years without social inflation was known, it could be compared against the actual loss ratio and that difference multiplied by the premium to measure the magnitude. This is impossible, of course, but an approximation based on historical data can be made. One rough estimate of this “pre-social-inflation” loss ratio is the average ultimate loss ratio at 12-months maturity for the years leading up to the onset of social inflation – widely accepted as around 2016. For CAL this baseline is 67.3 percent and for OLO this is 62.8 percent. If these loss ratios had continued, instead of the actual loss ratios at the latest valuation, then industry-wide losses would have been more than \$3 billion per year lower for CAL and roughly the same for OLO, or more than \$6 billion per year total. It’s impossible to know for certain how these years would have played out under different circumstances, but this gives a rough estimate of the magnitude.



SOCIAL INFLATION IS COMPLICATED AND COSTLY – THE PRODUCTS LIABILITY PARADOX

Meanwhile, for PL, every single recent accident year has developed favorably by around \$200 million per year, and loss ratios were higher 10 years ago than they are today. Note that the upward trajectory of recent loss ratios is somewhat conjecture since it can safely be assumed that recent years will also experience future favorable development similar to prior years. Granted, the fact that most PL business is written on a claims-made basis helps shorten the reporting pattern, but this favorable development is in stark contrast to the deterioration seen in CAL and OLO. This is counterintuitive, as PL would seem to be susceptible to many of the same causes of social inflation that are driving up the CAL and OLO loss ratios, including:

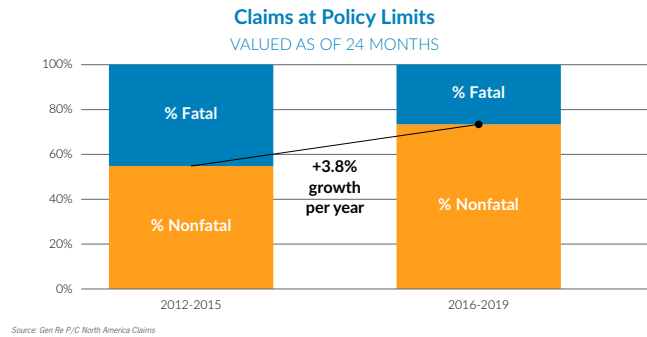
- Nuclear verdicts, since many of the largest verdicts in recent years come from products cases such as weed killer, talc powder, tobacco, car manufacturers, pharmaceuticals, etc.
- Reptile Theory tactics, where a plaintiff's lawyer appeals to jurors' emotions by portraying the defendant as a threat to society that demands harsh punishment
- Increased anti-corporate sentiment among jurors

Furthermore, since PL is a much smaller line than the other two, it would not take as much claim activity to have a noticeable impact on results. Various measures of industry-wide rate change suggest that PL rates have not increased as much as other Casualty lines, implying that loss activity, rather than premium adequacy, is to blame. There are many other differences between these three Casualty lines, but one would still expect that they all would suffer if the above judicial phenomena were the leading drivers of social inflation. While the importance of the issues listed above cannot be discounted, other factors appear to be having an even greater impact.

One notable distinction between these lines is the types of injuries sustained. The claims for CAL and OLO – of which Umbrella is a major component – contain a high concentration of auto accidents, where high-speed blunt force trauma injuries result from vehicle operation. PL claims contain a much broader range of injury types, from a wider array of potential hazards, and the PL line is more diversified. For example, if exercise equipment gets 5 percent more dangerous next year, that only affects a small subset of PL risks, whereas if vehicles get 5 percent more dangerous next year, that affects all of CAL and much of OLO.

Looking at General Re's Personal Umbrella claim experience provides further insight. Personal Umbrella was selected because it contains fairly homogenous exposures and claim types, is a Casualty line that appears to be impacted by social inflation, and is an excess cover that captures changes in large claim severity. A key finding was that among claims that hit the Personal Umbrella policy limit, a growing proportion of those claims are coming from non-fatal injuries. This would be expected if improved vehicle safety was preventing fatalities and instead an otherwise-fatal crash resulted only in injury, but National Highway Traffic Safety Administration data suggests this accounts for only a small part of the growth. Instead, a dramatic shift in the make-up of large claims is occurring. Insurance claims executives have observed a marked increase in non-fatal traumatic brain injuries, and more work is being done to quantify this. It appears that this increase, which would have a substantial impact on CAL and OLO but a relatively minor impact on PL, may be driving much of the social inflation seen across Casualty lines.

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Social inflation has had a profound impact on Casualty insurers in recent years and is expected to increase for the foreseeable future. There is still much to learn about social inflation, its causes, and its impacts. Understanding what is driving social inflation is crucial to developing an effective response; for example, is it more important to focus on improved safety to reduce injuries, or on tort reform to reduce bias in the judicial system? While many interconnected factors contribute to social inflation, this analysis suggests that an increase in non-fatal auto accidents may be one of the most influential. Unless specific appropriate actions are taken to address the recognized causes of social inflation, Casualty insurance results will continue to suffer.

ENDNOTES

1. <https://cdan.nhtsa.gov/tsftables/National%20Statistics.pdf>

Per NHTSA data, the ratio of $\frac{(\text{Traffic Injuries})}{(\text{Traffic Fatalities}) + (\text{Traffic Injuries})}$ is only growing 0.017% per year. Because only 1.4% of total traffic crash victims are fatalities and 98.6% are non-fatal injuries, the proportion of non-fatal injuries cannot grow much before approaching 100%.

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SOCIAL INFLATION IS COMPLICATED AND COSTLY – A CLAIMS PERSPECTIVE

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Social inflation is seemingly being discussed everywhere, from news articles to conferences to quarterly earnings calls. And those working in claims are likely dealing with it in some capacity on a daily basis. But what can be done to combat it?

In simple terms social inflation is the increase in defendants'/insurers' claim costs over and above general economic inflation. It is not a new phenomenon. Social inflation occurred in the 1980s, manifesting in the swarm of asbestos and environmental claims/liabilities, and again in the late 1990s/early 2000s in connection with medical malpractice developments. Moreover, social inflation is not unique to the United States; it affects economies across the globe.

CAUSES

Class action filings have increased, nuclear verdicts are on the rise, and large settlements are becoming more commonplace. Numerous factors are driving these trends:

- **Plaintiffs' Attorneys** – To give credit where credit is due, plaintiffs' counsel has become increasingly aggressive, coordinated, and savvy. Their advertising investment is up considerably, they have embraced technology and social media, and are utilizing the reptile theory quite effectively.
- **Legislative Reform** – Numerous states have recently enacted laws to not only extend statutes of limitations, but actually “revive” previously time-barred claims such as sexual molestation claims, for example.
- **Third-Party Litigation Financing** – Increased third-party litigation funding has provided significant capital to plaintiffs' firms. For more detail, please refer to the previously published part two in this series – Social Inflation Is Complicated and Costly – Legal and Regulatory Changes.
- **Jury Makeup** – Mistrust in large corporations remains, and jurors – particularly millennials – are more than ever aware of social injustices and income inequalities.

COMBATTING SOCIAL INFLATION

How do businesses/defendants and carriers combat the effects of social inflation? It is definitely not a simple challenge, but some considerations include:

- **Case Evaluation/Communication** – Early, candid analysis is critical. Generally speaking, claims/cases do not improve over time. Attorneys get involved, demands escalate, bad faith and time limit demand strategies are employed, etc. Internally, it is important to cultivate a “no surprises” culture. Claims professionals are the constant bearers of bad news and must be comfortable both receiving and delivering it, the earlier the better. Identify the challenging cases early and develop a strategy to proactively attack.
- **“Embrace the Suck”** – This is an old military expression that counsels one to lean into the suffering and get comfortable being uncomfortable. The claims world is a challenging one. Days are filled with layers of gray, difficult choices, challenging outcomes and associated risk. Outcomes won't be perfect. Verdicts are unpredictable, and some losses will be suffered along the way. But it's important to embrace the process, ensure certain cases are resolved early, and identify the right ones in which to invest and bring to trial.
- **Talent** – The insurance industry as a whole is faced with talent challenges. Unfortunately, insurance does not top the list of most desirable industries for college graduates – they just don't know what they are missing! Recruiting, training, developing, and retaining top, diverse talent must remain a priority for our industry. Outside counsel is

another critical component. It is not only imperative that potentially challenging cases are identified early, but appropriate counsel must be retained; we have to get the right cases to the right attorneys.

TECHNOLOGY TO THE RESCUE?

While still fairly limited in number countrywide, many “nuclear verdicts” – generally defined as those of \$10 million and above – share a common theme: they too often come as a complete surprise to the policyholder, defense attorney, and the insurance carrier. Furthermore, any unexpected trial result carries the potential for a claim department to harvest learnings, find commonalities that may appear again, and then apply those learnings to future cases that may contain similar attributes. In the past, an astute claims department may have held a “post-mortem” on such a case, possibly captured a key point or two, and then passed that information on to the larger organization. However, such practices have historically brought mixed and inconsistent results.

It has been noted that no industry takes in more data than does insurance, but then does so little with it. Contained within each claim file is a trove of structured and unstructured data. Could analytics and predictive modeling take those data elements and then forecast a range of outcomes that could enable claim professionals to better quantify the “downside” of a catastrophic injury case, or – perhaps even more beguilingly – identify the “outlier” case with unforeseen potential to generate a nuclear award? Developers are working on such data-driven approaches, with great strides expected to be made in the coming years.

Other tools are on the horizon that may further stem the rising tide of social inflation. One such area involves employing analytics to better manage legal expense that, according to one author, consumes between three and eight percent of direct written premium. The ability to better quantify law firm expertise and efficiency would bring a litany of benefits, ranging from being better able to “match” the defense attorney expertise to that of an adversary, to assessing which firms complete discovery most efficiently. Related is the possibility to better tie firm compensation to claim outcomes in a way that would move away from the traditional hourly billing model. Development in this area continues as well, with a handful of products coming to market in recent years and greater refinement expected over time.

THE FUTURE

Social Inflation has hit the defense/insurance industry like a large wave in recent years. By refining claim handling practices, recruiting top-flight talent, and jumping onto the potential benefits that artificial intelligence and predictive modeling potentially represent, claim departments can hopefully stem the social inflation tide.

ENDNOTES

1. "Social Inflation: Navigating the evolving claims environment," Geneva Association Report, https://www.genevaassociation.org/sites/default/files/research-topics-document-type/pdf_public/social_inflation_web_171220.pdf.
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SOCIAL INFLATION IS COMPLICATED AND COSTLY – PEERING INTO THE CRYSTAL BALL: WHAT WILL SOCIAL INFLATION HOLD FOR THE FUTURE?

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NAMIC ISSUE ANALYSIS

As society continues its halting emergence from the COVID-19 pandemic, court activity has resumed. With that activity has come a return to the eyebrow-raising verdicts that we saw pre-pandemic:

State	Verdict	Description
Florida	\$412,000,000	Motorcyclist injured in multicar pileup
Florida	\$120,000,000	Injury to passenger hit by public utility SUV
Illinois	\$51,600,000	Alleged excessive force used by bar bouncer, resulting in paralysis
Nevada	\$29,000,000	Failure to administer epinephrine to fashion model
New Mexico	\$27,000,000	Wrongful death of female motorcyclist struck by tire thrown from tractor trailer
California	\$23,700,000	Motorcyclist injured by at-fault commercial truck
Georgia	\$12,000,000	Permanent brain injury to woman accidentally administered wrong medication
West Virginia	\$10,800,000	Birth-related injury due to negligent treatment during labor and delivery

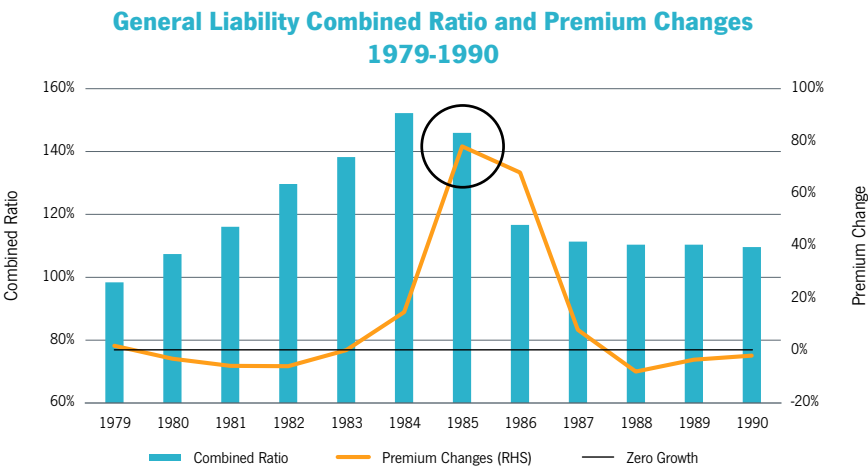
Source: Law360

Fueling those verdicts are the trends that we’ve discussed previously in this series – changing juror demographics and attitudes, a plaintiffs’ bar eager to feed juror concerns over personal safety and perceived disenfranchisement, as well as litigation funders seeking to maximize returns in the current low-interest environment.

With preliminary signs indicating that social inflation will continue its seemingly inexorable rise, an obvious question comes to mind: At what point does social inflation severely constrict the availability of certain lines of coverage and thereby give rise to legal remedies, such as tort reform? Are we approaching a precipice?

PAST AS PROLOGUE

A look backward reveals a time when social inflation ran rampant and caused much consternation among policyholders and carriers alike:



Source: A.M. Best, Assured Research

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During this period, the liability combined ratio peaked at 151% in 1984². Liability premiums skyrocketed as well, increasing 78% in 1985 and 68% in 1986³. Not surprisingly, coverage for certain lines vanished, with specialty lines – such as medical malpractice – being particularly hard hit. Seeking to quell this maelstrom, state legislatures ushered in an unprecedented era of tort reform that resulted in 39 states passing 82 different tort reform measures between 1985 and 1990.⁴ The era also spawned creation of well-known advocacy groups, such as the American Tort Reform Association (ATRA).

By placing caps on noneconomic damages, reducing statutes of limitation, and implementing other procedural changes, tort reform stabilized and ultimately reduced liability premiums. However, its full effect proved over time to be only temporary, as evidenced by a number of successful legal challenges on equal protection and other grounds. Nevertheless, many of the late 20th century tort reform measures remain intact but continue to be under attack.

BACK TO THE FUTURE?

While social inflation shows signs of someday igniting into a full-blown conflagration, the indications are mixed as to whether that will occur sooner or later. While there are many metrics to consider, industry combined ratios for 2020 remain below 100; moreover, the top eight writers of personal auto saw their combined ratio drop to 87.9 in 2020 versus 93.4 in 2019.⁵ While pandemic-driven lockdowns and working from home likely caused the temporary dip in 2020, the fact remains that combined ratios will need to climb stratospherically upward before we face a reprise of the crisis conditions last seen in the 1980s, although even incremental growth has ramifications.

Nevertheless, the social inflation fires could be either fanned or extinguished, at least partially, by a number of cultural factors:

- Individual perceptions of risk tolerance: During this COVID-19 pandemic, each of us are making personal decisions as to how much – or how little – risk we are willing to tolerate. Do we return to the office? How comfortable are we eating in restaurants? To what degree is out-of-state travel (and what by means) acceptable? How an individual answers these questions will provide insight as to attitudes toward personal responsibility, risk tolerance, and expectations of a corporation or business defending itself in a tort liability lawsuit.
- Intergenerational wealth disparity/ongoing economic inequality: Much has been written about increased wealth concentration, the decline of the traditional “middle class” and the growing number of dislocated workers subsisting on “gig” or “part-time” jobs. Similarly, multiple data points suggest that Baby Boomers hold a disproportionately large percentage of the country’s wealth. Will these economic trends continue to fuel the distrust and resentment that is thought to partially explain the spate of “nuclear” verdicts and out-sized settlements? Or will the promise of an estimated \$3 trillion wealth transfer from the baby boom generation and hoped-for economic improvement post COVID bear out and level the economic disparity, and could it restore the societal faith in institutions that once existed?
- Impact of social media: Twitter, Facebook and LinkedIn are only a few of the tech companies that have enabled people to connect in ways unimaginable a generation ago. However, to varying degrees these platforms have also become fruitful ground for the spread of misinformation – and in some instances outright disinformation campaigns. One commentator suggests conditions are ripe for groups to display what social scientists refer to as “ingrouping,” that is, a belief that social identity is a source of strength and superiority and that other groups are to be blamed for their problems.⁶ Could this spread of misinformation be influencing juror attitudes and perceptions of certain groups? Do we now have a growing number of Americans living in an alternate reality that does not comport with reliable and credible factual information? Or is the effect too slight to be much of a factor at all?

- Insurance industry response: As with other industries, insurance will continue to experience significant transition. Over time, the industry's 2.8 million employees have moved from being managed by Baby Boomers and Gen Xers to Millennials. Filling entry-level underwriting positions are recent Gen Z graduates, with many coming from the growing number of strong risk management and insurance programs that have arisen in the last two decades. At one level, this transition will entail loss of decades of practical experience. At another, it will represent the career dawn of a workforce more educated and more culturally diverse than its predecessors. Presumably, with their greater educational and cultural diversity will come creative and "out of the box" solutions to vexing industry problems, such as social inflation. As mentioned elsewhere in this series, "big data," AI and predictive modeling hold the key.

CONCLUSION

Over the past several years social inflation has caused much discussion – and the initiation of exhaustive searches for its root causes and potential solutions. This series has endeavored to contribute to that effort, with perspectives offered from a variety of disciplines. While the journey will continue for many more months and possibly years, with the ultimate solution far from known, the insurance industry has shown itself capable of meeting great challenges, such as the one social inflation represents. How quickly and effectively the industry meets that challenge rests on the shoulders of the dedicated professionals who have made insurance their chosen career.

ENDNOTES

1. From Assured Research report dated 04/01/2020.
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BIOGRAPHIES

CRAIG BEARDSLEY

Craig is a Senior Vice President and the Underwriting Manager for The Mutual Practice in Treaty North America. Previously, he served as a Treaty production underwriter working with Regional, Specialty and National accounts. He has also served as manager with responsibility for Gen Re's Umbrella products. Craig joined Gen Re in 1990 in the Casualty Facultative department, working in Atlanta and Charlotte. He joined the Treaty department in 1998 as an account executive and later assumed an underwriting role in the Home Office in Stamford, CT. Craig holds a BS in Business Administration from Boston University.

ERIN COLLINS

Erin Collins has spent nearly 20 years as a policy advocate across the financial services and insurance sectors. Erin currently manages the National State Legislative and Regulatory Team and related lobbying objectives for the National Association of Mutual Insurance Companies. She also leads NAMIC's involvement with the National Conference of Insurance Legislators and participates in NAMIC's activities with the National Association of Insurance Commissioners. Erin has testified before numerous state legislatures and Congress on behalf of the association's 1,400 member companies and their 170 million policyholders on topics ranging from frequency and severity of auto accidents, reform of opioid abuse in the workers' compensation sector, and pre-disaster mitigation aimed to harden local communities throughout the United States.

Erin received her bachelor's degree in political science from Mary Baldwin University and her master's degree in public administration from Virginia Commonwealth University.

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Tim Fletcher, J.D., CPCU, is Gen Re's Senior Emerging Issues Specialist and a Vice President. He heads the company's Emerging Issues unit, drawing from 36 years of experience and a wide range of responsibilities. In his former claims role, Tim helped clients successfully resolve high-exposure cases and respond to various claim and legal issues. He is also a guest lecturer on Risk Management and Insurance at Georgia State University, and he's based in Gen Re's Atlanta office. Tim is the Immediate Past President of the Atlanta CPCU Chapter and currently serves on CPCU's RE&S (Reinsurance, Excess, & Surplus) Interest Group.

GLENN FRANKEL

Glenn is Senior Vice President and Head of North America Property/Casualty Claims. He joined Gen Re in 2020 bringing with him extensive experience in the insurance and reinsurance space. He was last at CNA where he led Complex Commercial Claims, including Environmental and Mass Tort, Construction Defect, Life Sciences and Opioid exposures. Prior to that, he was in leadership roles at The Hartford's insurance and reinsurance units. Glenn started his career with the law firm of Day Pitney and as Managing Counsel at Travelers.

ANDREW GIFFORD

Andrew Gifford is Senior Vice President, General Counsel and Secretary for General Re Corporation. Andrew oversees the global legal, compliance and regulatory functions for the Gen Re group's insurance, reinsurance and financial services businesses. Prior to joining Gen Re, he was a partner with a global law firm, where he represented clients in a variety of international businesses, including insurance and reinsurance, auditing and consulting services, banking, mortgage lending and real estate. Andrew is a graduate of the University of Michigan Law School.

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Tom Karol serves as general counsel - federal in NAMIC's Washington office. Tom represents NAMIC on issues impacting property/casualty insurance companies and has primary management of NAMIC's response to Dodd-Frank legislation and regulation. Tom is also the leader of NAMIC's Investment Services Practice.

Tom has extensive legal, regulatory, and operations experience with major financial services companies, law firms, regulatory agencies, and Congress. He has been involved in asset management operations and regulation for decades and has experience in socially oriented investing. Tom was a leader in Deloitte's Global Financial Services practice, supervisory principal for a broker dealer, served with the SEC Division of Enforcement and the U.S. Senate Committee on Governmental Affairs.

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Chris is a Vice President and Treaty Senior Pricing Analyst. He joined Gen Re in 2007 after graduating from Colgate University with a major in Mathematics. He spent eight years in the Corporate Actuarial department, helping calculate reserves across all of Gen Re's diverse portfolio and gaining high-level insight from financial reporting. In 2015, Chris moved into Gen Re's Treaty department as a pricing actuary on the Portfolio Pricing & Metrics team. He works on pricing for all Property and Casualty lines, with a focus on Mutual companies. Chris is a Fellow of the Casualty Actuarial Society.

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Ridge is a Senior Vice President and the manager of The Mutual Practice in Treaty North America. He has been with Gen Re since 2002 when he was first a Casualty Facultative Underwriter. He joined the Treaty department in 2014 as an Account Executive on the Northeast team where he was also responsible for clients and prospects in the Mid-Atlantic region and business development for the Umbrella business. In 2017 Ridge joined The Mutual Practice where his responsibilities expanded to the Southern and Northern states. As an Account Executive he would routinely speak on various industry topics to our clients and industry organizations. Ridge assumed his current position in 2018.

Ridge graduated from The Pennsylvania State University with a BS in Insurance in 2002. He holds the CPCU, ARe, ARM, ASLI, and RPLU designations.

ANDREW PAULEY

Andrew Pauley, JD, CPCU serves as government affairs counsel for NAMIC in a cross-functional role supporting the state, federal and international/regulatory divisions of the Government Affairs Department. Andrew additionally works with the Workers' Compensation Council, Amicus Working Group, NAIC Working Group and Policy Research Council. He covers civil justice reform issues and other international and regulatory concerns among other issues.

Prior to NAMIC, Andrew served in multiple roles including Deputy Commissioner and General Counsel in the West Virginia Insurance Commissioner's Office for over ten years. His responsibilities included serving as liaison with the state legislature, litigating cases before the highest court in the state and serving as counsel to three insurance commissioners in all areas of insurance operations and regulatory policy. Andrew participated regularly at the National Association of Insurance Commissioners (NAIC). Further, Pauley directly participated in several insurance initiatives including the privatization of the state workers' compensation monopolistic system and residual claim run-off, medical malpractice insurance reform and third party unfair trade practice reform.

Andrew has an undergraduate and law degree from West Virginia University. He also holds the Chartered Property and Casualty Underwriter designation conferred by The Institutes. He is a member of the West Virginia state bar.

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