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The Impact of Social Inflation on the Liability Insurance Industry, authors Michael Zigelman & Kristina Duffy, Reuters, 11-28-2022

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Reuters 11-28-22 The impact of social inflation on the liability insurance industry - Zigelman - Duffy

November 28, 2022 - In recent months, economic inflation has dominated headlines as the global market grapples with supply-chain issues, Russia's invasion of Ukraine and the rising costs of goods and services. The insurance industry, however, has had its eye on a different type of inflation: social inflation.

According to the Insurance Information Institute, social inflation refers to "the trend of rising insurance costs due to increased litigation, plaintiff-friendly judgments, and higher jury awards," ("Social Inflation and Loss Development," February 2022). The Institute also estimates that social inflation (as reflected by the difference between estimated and actual losses) has risen by 14% between 2010 and 2019 ("Social Inflation: What it is and why it matters," February 2022).

Other industry leaders surmise that social inflation has contributed to general liability and medical malpractice lines, in particular, experiencing seven consecutive years of underwriting losses ("US litigation funding and social inflation," Swiss Re Institute, 2021).

Since social inflation specifically refers to the rise in claim costs beyond economic inflation, it is generally believed to reflect society's shifting perspective on who should be accountable for a given risk and how that risk should be valued ("Social inflation: hard to measure, important to understand," Insurance Information Institute, July 2022).

However, there are two distinct causes of social inflation: (1) society's evolving values, trends, perspective or mood; and (2) other market players' identification and exploitation of these changes.

Of the factors included in the first category, increasing distrust of corporations, resentment towards rising inequality, reversals in tort reform and willingness to award stratospheric jury awards have received considerable attention. As the effects of inequality, polarization and disenfranchisement become more tangible, it seems jurors are inclined to view their vote on a jury as an opportunity to express their values and effect change, a power that feels lacking in their daily lives. See: "COVID's Effect on Juror Perspectives & Damages," Magna Legal Services (April 8, 2021).

These societal changes leave the civil litigation system vulnerable to factors falling under the second category, which include: lawyer-driven class action lawsuits, reptile theory, anchoring, and third-party litigation financing ("Social Inflation: What it is and why it matters"). Using these tactics, the plaintiff bar utilizes these societal frailties for strategic advantage in litigation.

Lawyer-driven class action lawsuits refer to class actions for acts that technically constitute statutory violations but are unlikely to have been brought absent a plaintiffs' firm corralling a class together. Because the harm was so negligible, individual consumers often would not have gone through the trouble of (or even considered) bringing such cases on their own. However, given the potential for an attorney fee award, exponentially higher than any individual class member's recovery, plaintiffs' firms appear to seize the opportunity to assert these expensive claims. (See: "Class Action Chaos, The Rise of Consumer Class Action Lawsuits in New York," Cary Silverman, New York Civil Justice Institute, at p. 2 (May 2021))

Reptile theory is seen as another prevalent tactic, which has attracted considerable scrutiny since the 2009 publication of "Reptile: The 2009 Manual of the Plaintiff's Revolution," by David A. Ball, MD, and Don Keenan (Balloon Press). According to this theory, humans have a basic instinct to avoid danger and establish safety. Plaintiffs can cater to this instinct by collapsing the boundaries between the jurors and the plaintiff to create the illusion that the defendants pose a danger, not only to the plaintiff, but to the jurors themselves and society as a whole. Such tactics (seemingly relying heavily upon decontextualization and indifference to the reasonableness standard) are primed for success in a society that already instinctually resents institutions for leaving them out of the "American Dream."

Anchoring refers to the plaintiff attorneys' use of people's tendency to rely on reference points when making determinations ("Counter Anchoring and the Reverse Reptile," DRI's "For the Defense," 2021). During trial, the plaintiff's attorney will propose a high award in an effort to "anchor" the jurors' perspective on damages. Jurors without any fixed notion of how to value the injury at issue may be inclined to use the number proposed as a reference point, regardless of how arbitrary or unreasonable.

Third-party litigation financing, in many ways, maximizes the ability to take advantage of each of the societal changes and litigation tactics discussed above. Litigation financing has been defined as "the practice by which a nonparty" (private equity firm, hedge fund, wealthy individual and others) "funds a plaintiff's litigation either for profit or for some Finance Agreements," (53 U.C. DAVIS L. REV. 1073, 1075 (2019)).

By equipping plaintiffs' firms with resources, this $17 billion industry enables litigants to take on lawsuits that may never have been brought otherwise, delay resolution, retain the most effective (and expensive) vendors in the business, and pursue data-driven strategies.

These factors have led to a rise in class action lawsuits, prolonged litigation, higher settlements and higher jury awards, resulting in increased claims costs ("Social Inflation: What it is and why it matters").

The rise in claim costs has important ramifications for consumers. Historically, the insurance market responded more reactively to rising social inflation. Confronted with unforeseen and unfamiliar risks, soaring inflation and atmospheric jury verdicts in the mid-1980's, the insurance industry struggled to respond ("1980s: Risk Management and the Liability Crisis," Swiss Re Institute, November 2022).

As a result, premiums skyrocketed, insurers stopped writing policies for certain types of risks, and some insurers failed. Not unsurprisingly, consumers then struggled to afford insurance and, often, were priced out of the market entirely.

Fortunately, these days, insurers are better equipped to respond with measure. Increasing use of data to assess risks and vigilance towards changes in the market have enabled insurers to more accurately predict claim costs and price premiums accordingly ("1980s liability crisis forged better market," Business Insurance, Jan. 23, 2011).

Even with these advances, however, insurers must still offset the rise in claim costs by increasing premium rates, limiting the amount of coverage offered, and even discontinuing certain coverage lines entirely ("US litigation funding and social inflation," Swiss Re Institute (Dec. 2021)). However, as awareness of this inflation-inducing pattern continues to grow, it may eventually lead to greater regulatory measures put in place to break the cycle — that is at least the hope of those in the insurance industry.

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