



Don't cry over spilled coffee; 6 strategies to mitigate the impact of social inflation

What is social inflation, and how has it evolved?

Social inflation - a topic that is on the minds of carrier leadership across North America and is often accompanied by a common fallacy that its impact is - to a large extent - uncontrollable. In this white paper, we'll dive into how social inflation has evolved, the root causes and, most importantly, how some aspects can be mitigated.

Social inflation is a concept that was first introduced in 1977 and is defined as rising costs of claims resulting from increasing litigation, broader definitions of liability, more plaintiff-friendly legal decisions and larger compensatory jury awards than reasonably expected.

Do you remember the high-profile case 30 years ago when a cup of hot coffee spilled on a customer's lap upon leaving the drive-through of a fast-food chain, resulting in a \$2.7 million settlement? It was one of the most infamous cases of social inflation against the perceived "big corporation" and is viewed by many as a springboard for social inflation trends. While not many cases have been as visible, these types of settlements didn't stop there. In the last five years, the claims industry has experienced higher rates of litigation and litigated claim severity increases - outpacing the general rate of inflation and nonlitigated claim severity increases. Verdicts and settlement amounts are becoming more unpredictable and difficult to evaluate, further justifying the need for more focus on the claim litigation management function.

The problem with this very real trend is that allocated loss adjustment expenses and indemnity costs continue to rise, which is a concern not only for insurers, but for the larger society as insurance premiums become unaffordable. These trends (driven in part by social inflation and perceived legal system abuse) have resulted in unintended, but predictable, impacts on society through business failures, layoffs and increasing insurance premiums, which are being passed down to the general public through increases in the costs of goods and services.

What is driving social inflation trends?

There are three modern drivers of social inflation that are impacting the insurance claims industry

1 Litigation trends and tactics

2 Nuclear verdicts

3 Societal views

Let's dive into these drivers to understand the root causes behind each of them:

1 Litigation trends and tactics

Litigated P&C claim frequency and severity are increasing at higher rates than general claim frequency and severity. According to a recent report:¹

- ▶ Litigation rates across all P&C lines increased by 47% from 2017 to 2021, which included higher rates of litigation within general liability and auto liability.
- ▶ From 2017 to 2021 within auto, while overall collision claim frequency dropped by approximately 25%, the percentage of those claims with a reported bodily injury increased.

In 2022, according to Property Casualty 360's report on Lex Machina,² litigated cases involving insurance in federal court increased 30% from 2021 and 73% since 2013.

One strong theory behind these spikes is that the **organized plaintiff's bar is more coordinated than the defense bar**. This includes better data collection among plaintiffs' firms through advanced analytics to identify intelligence that will shift verdicts in their favor and more aggressive marketing techniques to target their clients. Other more recent coordinated litigation strategies include:

- ▶ **Third-party litigation funding (TPLF):** The practice of an outside party investing in lawsuits in exchange for a percentage of the settlement or judgment grew by 414% in the US from 2012 to 2017. According to GAO's 2023 Report to Congressional Requesters,³ from 2017-2021, formal requests for funding agreements increased by 27%, while total new agreements increased by 19%. Furthermore, the TPLF strategy is not consistently regulated across states, creating the potential for ethical issues and conflicts of interest. As of 2022, 10 states had some type of TPLF requirement, but these were limited to disclosing certain information in funding contracts, financial term language, reporting requirements, interest rates and fees that funders can charge. This strategy is expected to grow due to the lack of regulation, the high potential for return on investment and the attractiveness for litigants to be able to finance cases with limited risk.
- ▶ **More aggressive plaintiff counsel advertising:** Attorneys are spending about \$1 billion for 15 million advertisements per year in both digital and offline channels, as well as using emerging analytics to determine the most generous jurisdictions in terms of awards. This has led to not only higher, but also quicker, attorney representation (AR) rates across all lines of business. In 2022 according to a report,⁴ **54% of AR claims** that were eventually litigated had attorney involvement within 24 hours of first notice of loss (up from 43% in 2017).

2 Nuclear verdicts

The claims industry has experienced an increasing frequency of nuclear verdicts, also known as jury awards that are considered to be substantially higher than expected based on case facts. Jury trial results in 2022 created some of the highest plaintiff verdicts in history.

A new analysis by Marathon Strategies⁵ found that the median verdict greater than \$10 million against corporate defendants in the five years before COVID-19 saw a particularly sharp rise in both the sum of these verdicts (178% increase) and their median (41% increase). Though this trend was interrupted due to court closures in 2020, the sum of all nuclear verdict amounts nearly quadrupled in 2021 and 2022, the median verdict rose from 2020 to 2022 by 92%, and the number of verdicts doubled.

Year	Sum of nuclear verdicts	Sum of nuclear verdict increase	Median nuclear verdict	Median nuclear verdict increase
2020	\$4.9b	-	\$21.5m	-
2022	\$18.3b	+ 370%	\$41.1m	+ 92%

*Source: Marathon Strategies.

These factors have created significant pressure on umbrella and excess lines due to increased frequency and severity of claims piercing these layers.

Below are a few recent examples of how nuclear verdicts have recently impacted businesses, with portions of these verdicts often being paid directly by the business through their self-insured retention or deductible:

- ▶ In 2021, a large, US-based retail and pharmaceutical corporation - was ordered to pay a \$43 million verdict to a man who was robbed and shot in their parking lot. When an unknown man brandished a gun, the victim pulled out his own gun, and the assailant shot the victim. The court found negligence against the pharmacy, stating that it knew that this was a high crime area but did not take the proper precautions to protect the public. This case sets a precedent that, even though the victim presented his own gun, which triggered the assailant's reaction, the victim was found minimally liable.
- ▶ In 2022, a large, US-based multinational chain of coffeehouses and roasteries - was ordered to pay \$9 million after a pedestrian was hit at a low speed in the drive-through lane. The plaintiff's counsel alleged that the sight lines were blocked by a pillar that created an inherently unsafe situation that forces patrons to walk in front of cars, and the jury agreed.⁶
- ▶ In December 2021, a Texas jury returned a verdict of \$730 million to the family of a 73-year-old who died in a truck accident where the truck driver unsuccessfully attempted to haul a 197,000-pound submarine propeller across a narrow bridge, leading to the driver leaving his lane and striking the decedent. The verdict cited failure on the trucker's part to maintain proper lookout and failure to ask for assistance from local and state government to get across the bridge, making it one of the largest wrongful-death verdicts in the nation, sending shockwaves through the commercial auto claim industry.

3 Societal trends

According to Gallup's latest Confidence in Institutions survey,⁷ the percentage of Americans expressing "very little confidence" in big business grew from 22% in 2000 to 32% in 2019, while those expressing "a great deal" of confidence decreased from 29% to 23%. These statistics support the hypothesis that many jurors no longer feel that large corporations and their insurance carriers are the backbone of the economy, but rather part of the "privileged elite." This is exacerbated by plaintiff attorneys' frequent use of large figures from previous verdicts and settlements during trial (when permitted).

There's also a unique industry hypothesis that societal perception impacts not only jurors, but also defense firms. Many claims professionals believe that society's perception may be used as a scapegoat for defense firms to use to avoid trial on defensible cases or as an attempt to justify performance associated with inflated settlements.



How can insurers mitigate the impact of social inflation?

So, is it all doom and gloom for insurers? Absolutely not. While societal trends, the Great Resignation and a surge in early attorney representation may be largely uncontrollable, several aspects of litigation trends are controllable. Amid the industry's "innovation and automation" push, some carriers have neglected the litigation management function, which has further enlarged avoidable levels of litigation frequency and severity – a problem that can be mitigated with proper focus. Carriers must refocus their operation by providing data insights into the appropriate claim-level defend vs. settle strategy, which defense firms and attorneys to hire, more accurate and thorough case evaluations and negotiation strategies, and clearer enterprise accountability for successful litigated claim outcomes.

So, where do carriers start? Cleansing, normalizing and understanding your data for effective prioritization and decision-making will enable a more simplified litigated claims transformation. There are six strategies that every claim organization can implement to mitigate the controllable portions of social inflation:

1. Create a culture of proactively evaluating claims with potential for attorney representation and litigation.

Traditionally, carriers will evaluate cases at an early stage, often well before mediation or settlement negotiations. However, with all of the data at their disposal, evaluations should begin as soon as the claim is reported through combinations of claim characteristics and the use of leading metrics. Carriers should use their data to thoroughly understand and proactively identify higher risk claims and prioritize them with their highest-skilled litigated claim handling employees by developing answers to the following questions:

- ▶ What are the key decision points in the evolution of a file, and how can we measure them with leading metrics?
- ▶ Are there certain combinations of jurisdictions, plaintiff firms or plaintiff profiles that are known to drive adverse outcomes?
- ▶ What can you learn from your quality assurance (QA) and leakage results to understand characteristics of litigated claims that lead to controllable?
- ▶ Is there a need to elevate and refresh your current QA and leakage approach to be more rigorous?
- ▶ What factors determine adjuster skill level and case allocation?

2. Understand who your best-performing defense firms are and provide incentives for top performers to work with you.

- ▶ Leverage the right metrics to assess performance, focusing on a balance between expenses and outcomes. For example, if one firm typically has favorable bill rates and expenses, but often unfavorable trial success, the indemnity costs likely outweigh the expense savings.
- ▶ Through a contracted and rigorously managed counsel list, create leverage through incentives and accountability for quality outcomes.
- ▶ Leverage targeted QA to assess defense counsel effectiveness for another powerful metric to inform quality

3. Identify the right claims at the right time with the right expertise.

Discontinue the outdated mandatory supervisory file touch points at arbitrary intervals (60, 90, 120 days). These claims touch point concepts are outdated in today's data-rich environment. Instead, flag claims throughout their lifecycle for the opportunity to proactively intervene prior to adverse development at key decision points, such as:

- ▶ The need to engage defense counsel
- ▶ The need to engage experts
- ▶ Decisions to settle or file a motion to dismiss

4. Avoid handing defense counsel a blank check.

Following defense counsel assignment, proper collaboration and obtaining justification from counsel at key decision points (while being cognizant of the rules of professional conduct) is critical. There are several key decision points where expenses vs. value should be considered by claims professionals:

- ▶ The need for defense counsel – Can the claim be managed without defense counsel involvement?
- ▶ Defend vs. settle strategy – What is the anticipated settlement figure vs. continuing to defend, and will continued activities that are driving expense create value?
- ▶ Potential dismissal – Is there opportunity to dismiss vs. incurring additional expenses?
- ▶ Engagement of experts – What is the value of initiating and continuing to engage experts vs. the cost?

5. Remove the noise and focus where the skill is needed.

De-emphasize activities that don't matter as much to create capacity for adjusters and supervisors to focus on activities where their skills are needed throughout the claims process, which includes:

- ▶ Defend vs. settle strategy – collaborating with defense counsel as new information comes in to evaluate continued defense, moving into settlement or filing for dismissal
- ▶ Case evaluation – a thoroughly supported and well-documented range of settlement values
- ▶ Negotiation strategy – developing a negotiation strategy based on strengths and weaknesses of the claim and executing on that strategy
- ▶ Expense management – implementing budgets and revisiting budgets as the file develops

With so many organizations focused on **adding** more activities to their adjusters' plate, they should consider **removing** unnecessary tasks to increase the adoption rates of new initiatives and best employ the use of their adjusters' skills. If adjusters and front-line supervisors do not have capacity to focus on these four key areas, insurers should question what their staff is doing that's more important. This encompasses not only litigated, but also nonlitigated handlers since nonlitigated claims become litigated in often avoidable situations.

6. Establish an internal feedback loop, training, accountability and collaboration.

- ▶ There should be clear ownership of litigated claims outcomes, which includes ongoing action plans to improve such outcomes based on performance data. Often, there are too many parties involved, and cases that go sideways become a game of finger-pointing.
- ▶ Due to the evolving litigation environment, the aforementioned action plans should include ongoing targeted training based on performance to even the most experienced staff.
- ▶ There should be organizational buy-in to focus on the litigated claims process. Claims leaders, C-suite, actuarial (pricing and reserving) and underwriting should collaborate often to identify litigation trends, difficult jurisdictions, etc. This will enable proactive understanding of where there's emerging risk so that carriers can price properly and make more informed decisions before entering new markets.

Based on these social inflation trends and controllable aspects, one critical question that carriers should be asking themselves is this: **Do we have the right strategy to mitigate and survive this evolving era of social inflation, and where do we stand in the evolution of these six strategies?**

The views reflected in this article are the views of the author(s) and do not necessarily reflect the views of Ernst & Young LLP or other members of the global EY organization.

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Author



Michael Curcio

Senior Manager, Business
Consulting Claims Transformation,
Ernst & Young LLP
michael.curcio@ey.com
+1 224 636 0155

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