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Regulator Insight: Social Inflation

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Regulator Insight: Social Inflation

The NAIC/CIPR Research Library has compiled a summary of recent articles, news coverage, and industry/trade reports about the rising attention of social inflation in the insurance industry. The Library's *Regulator Insights* series is aimed at assisting state insurance regulators in quickly understanding the breadth and depth of recent information produced on a key topic of interest across mass media and other sources.

What Is Social Inflation and Why Is It Important?

While there is no single definition, social inflation generally describes the increase of insurance claims payouts and loss ratios due to non-economic factors resulting from the high costs of liability litigation. Drivers of social inflation include:

- “Nuclear” jury verdicts (awards of \$10 million or more);
- third-party litigation funding (TPLF);
- use of plaintiff attorney court room techniques to influence jurors;
- changing societal attitudes regarding liability and responsibility; and
- emerging risks like new diseases (Covid) or harmful substances, such as PFAS (per-and polyfluorinated alkyl substances).

Social inflation risks can be difficult to quantify and predict, as they are moved by “soft” social ideas and perceptions. Public distrust of large corporations, widespread use of social media, and shifting social attitudes around justice held by a changing demographic all play a role in social inflation. These non-quantitative metrics can make it challenging for insurers to accurately reserve and price products to account for potential litigation costs.

A Brief History of Social Inflation

Though social inflation is making headlines in the insurance industry today, the concept is not new. Warren Buffet first coined the term in 1977 in a letter to shareholders when he wrote that insurance costs were expected to rise. Buffet [described](#) social inflation as “a broadening definition by society and juries of what is covered by insurance policies.” At the time, he was referring to asbestos and the resulting litigation from claims made against companies from people who fell ill due to asbestos exposure.

A wave of medical malpractice claims in the 1980s elevated awareness of the financial impact of social inflation on insurers as lawsuit expenses soared, [causing rising loss ratios](#) and insurer insolvencies. These effects ultimately constrained other professionals attempting to acquire affordable liability insurance. Eventually, tort reforms were passed, and losses declined. Presently, rollbacks of these tort reforms in some states may be contributing to social inflation but the research is not definitive.

Currently, the risk of large jury verdicts has expanded to other lines of liability insurance, particularly the trucking industry, which has been subject to nuclear verdicts. In 2021, a jury returned a landmark [\\$1 billion judgment](#) (\$900 million in punitive damages) against two trucking companies in the death of a teenager. Other lines of [insurance impacted](#) by social inflation include commercial auto, pharmaceutical, and medical device manufacturers. Large corporations are seeing the effects of social inflation in directors & officers and errors & omission insurance. Another liability line that is emerging as a social inflation concern is [private passenger auto](#).

Social inflation is mostly a U.S. phenomenon. However, similar drivers of U.S. social inflation are emerging internationally, as well.



“Research by the Insurance Information Institute and the Casualty Actuarial Society indicated that, between 2010 and 2019, social inflation increased claims for commercial auto liability insurance by more than \$20 billion.”

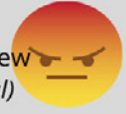
–Risk & Insurance, Third-party Litigation Funding and its Impact on Commercial Auto - Part 1, Oct. 23, 2022

10 trends driving social inflation

1

Public distrust of large corporations

48% of Americans said they have a negative view of large businesses (Source: *AmTrust Financial*)



2

Appealing to jury's emotions

Plaintiff's attorneys are more aware of how a jury's emotions affect a ruling, despite the facts of the case.

3

Changes in jury demographics could bring different perspectives to a case



Tort reform rollbacks

4

5

Increased legal advertising and marketing to consumers

Increase in attorney advertising led to increased claim frequency and expectation of larger settlements. Attorneys also use social media to find prospective pro-plaintiff jury members.



Changes in third-party litigation funding (TPLF)

6

The practice of TPL financiers funding lawsuits for a portion of the settlements are increasing insurance payouts and loss ratios, as are cutbacks in TPLF bans.

7

Definition of what "liability" means

Public sentiment is shifting toward liability meaning *someone* should pay for an injury or death, regardless of negligence.

8

Media attention around large verdicts

The publicity around large verdicts sets an expectation with juries that this is the norm and corporations can pay out larger sums.



Social media magnifies a wide array of public opinions and attitudes that spread quickly

9

10

Rollbacks on caps on punitive damages

A number of state courts struck down noneconomic and punitive damages caps. Punitive damages are used to punish defendants for malicious and intentional acts.



Source: [Drivers of social inflation for the insurance industry](#), *PropertyCasualty360*, 8/20/21

Daily News

Politics

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Industry News Coverage

- **Social inflation: hitting the insurance industry hard** (Carrier Management, August 4, 2022).
 - Insurers are aware of social inflation but due to the difficulty of quantitatively measuring it, struggle to find methods to respond.
 - Since social inflation is a human risk, it can be analyzed using non-traditional data that focuses not on historical numbers, but current/live activities like social media, smart technology, and Internet activity. Used in tandem with analytics, this can then be scaled as a useful predictive modeling tool.
 - By pairing behavioral data with claims data to create predictive models, insurers are in a better position to accurately price risk that also accounts for social inflation.
- **How the insurance industry can tame social inflation** (Carrier Management, April 22, 2022)
 - Insurers' defense attorneys need to alter their trial strategies to help juries connect emotionally, not just factually, with corporate clients. This may help mitigate the anger from jurors that often accompanies large nuclear verdicts.
 - One way defense attorneys can help humanize their client is by telling the story of the corporation. By focusing on the company's values/mission, the employees who work there, and the contributions the company makes to the community, the jury can better relate to the defendant.
 - Remembering to continuously emphasize the human story behind the corporation is important in all aspects of trial - from jury selection, opening statements, witness testimony, and closing arguments.
- **Lawsuits elevate social inflation to new levels of concern** (Best's Review, March 2022)
 - Social inflation is not just an insurance issue. It has widespread economic implications for businesses and consumers, as well.
 - Factors influencing social inflation include negative consumer sentiment toward big corporations (driving larger jury verdicts), increases in class-action lawsuits, and plaintiff attorneys' aggressive

and psychological tactics used in the courtroom to sway juries to make decisions based on emotions, rather than facts.

- The notion that “someone needs to pay” for plaintiff injury or death, and that big corporations have deep pockets to do so influences juries to award nuclear verdicts.
- The consequences for nuclear verdicts may result in insurers raising the costs of premiums to the point where insurance may become unaffordable for businesses or consumers.
- **Shock verdicts: Insurers sound the alarm as billion-dollar jury awards drive up claims costs** (Best’s Review, March 2022)
 - Once increasingly rare, juries have recently been issuing excessively large (“shock”) verdicts to plaintiffs, with the most recent one a record \$300 billion payout.
 - These verdicts are especially troubling for the trucking industry, which is finding it more difficult to insure drivers due to the increased cost of liability coverage, which could further disrupt supply chain problems in delivering goods to consumers.
 - Large verdicts are also influencing how much consumers pay for insurance, as several lines of business have increased premiums from 5-25% since mid-2019 after years of relative premium stability. Insurers are responding by pushing for tort reform, greater transparency regarding third-party litigation financing, and building relationships with government officials and business groups to tame the rise of shock verdicts and their rebounding effects on the economy.
- **Insurers: Third-party litigation is fueling rise in shock verdicts** (Best’s Review, March 2022)
 - Gaining capital from venture capital firms and hedge funds to finance lawsuits is becoming big business for third-party litigation financing (TPLF) and is the primary reason for social inflation, insurers say.
 - With the potential for large returns on their investments, investors want to direct their money into promising plaintiff cases against insurers.
 - Opponents of TPLF argue the financial incentives of all the parties involved in lawsuits take away resources from the families or individuals who have been injured and gives litigation funders more control over the cases they have only a monetary investment in.
 - Defenders of TPFL note the extra financing gives plaintiffs additional monetary resources they may need to pursue expensive trials against a multibillion-dollar insurance industry.

Reports and Surveys by Industry and Research Organizations

- **It's Not Just the Weather: The man-made crises roiling property insurance markets** (American Property Casualty Insurance Association, Reinsurance Association of America, & Association of Bermuda Insurance & Reinsurers, August 2022)
 - Legal system abuse is contributing to higher loss costs and the affordability of property insurance to consumers. This is especially problematic in states that are prone to catastrophes, where opportunists look to take advantage of families in distress after a disaster.
 - Florida, Louisiana, and California are all experiencing property insurance affordability and availability issues due in part to an aggressive litigious environment.
 - Suggested legal reforms include disclosing third-party litigation financiers, transparency in attorney advertising, eliminating reptile theory and other courtroom tactics, eliminating phantom damages, and restoring the original intent of public nuisance litigation law.
- **Majority of U.S. Agrees Attorney Ads Increase Number of Lawsuits, IRC Survey Finds** (Insurance Research Council, June 2022).
 - Survey results show most American consumers believe increased attorney advertising affects rising liability claims. Approximately 60% of respondents believe this leads to higher insurance costs.
 - However, about 40% of respondents were unfamiliar with the term "litigation funding."
 - Overall survey results indicate there is a need to educate consumers about factors that affect rising insurance costs.
- **US Litigation Funding and Social Inflation: The rising costs of legal liability** (SwissRe, Dec. 2021)
 - Third-party litigation financing (TPLF) investments in lawsuits were up 16% from 2020 to 2021 and totaled about \$17 billion.
 - TPLF typically funds commercial litigation and mass torts, with the monies going toward legal fees and cash advances to victims.
 - The rationale for TPLF is that it could help low-income litigants who otherwise wouldn't be able to afford the costs of litigation; however, research shows that law firms and large corporations are the main parties using TPLF, not individuals.

"The third-party litigation funding industry is valued at \$17 billion dollars and may increase up to \$30 billion by 2028."

–SwissRe, *US Litigation Funding and Social Inflation: The rising costs of legal liability, 2021*



- Aside from contribution to the rising costs of social inflation, TPLF also poses conflicts of interest between attorneys, funders, and clients. Additionally, there are questions around transparency/disclosure concerning who is providing the funding. TPLF is not federally regulated and has the potential to create economic and ethical harm.
- **The Scourge of Social Inflation** (R Street Policy Study No. 247, Dec. 2021)
 - Psychological courtroom strategies employed by plaintiff attorneys play a role in large verdicts against insurers. Tactics such as reptile theory and psychodrama all seek to influence jurors by triggering their emotional response to the case. Meanwhile, anchoring is a technique aimed at juries whereby plaintiff's attorneys suggest a specific monetary amount for judgement that appears to be a reasonable reference point for compensation of injuries.
 - The author suggests two strategies to inhibit the continuing rise of social inflation. One is state and federal policy involvement to control excesses. The second strategy suggests insurers and defense counsel deploy more aggressive courtroom strategies to push back against existing plaintiff attorney behavior.
 - Specific actions to take now include education and advocacy about anchoring and TPLF; creation of coalitions that include not only insurers and trade associations, but tort reform organizations and local chambers of commerce; and defense attorneys citing violations of the Rules of Evidence and other rules to keep a reasonable check on non-economic damages.

Appendix

Social inflation and the insurance industry:

- [Insurance 101: What is social inflation?](#) Niji Sabharwal. Insurance Journal. Sept. 21, 2022.
- [CAS Research Paper: Social Inflation and Loss Development.](#) Sponsored by Casualty Actuarial Society and Insurance Information Institute. Sept. 2022.
- [Social Inflation: Hitting the Insurance Industry Hard.](#) Paul Mang. Carrier Management Magazine. August 4, 2022.
- [Social inflation: hard to measure, important to understand.](#) Insurance Information Institute. July 2022.
- Triple-I Issues Brief [Trends and Insights: Social Inflation: What it is and why it matters.](#) Insurance Information Institute.
- [Social inflation and property/casualty insurance: Frequently asked questions.](#) Verisk. 2022.
- [Unpacking “Social inflation.”](#) Ken Klein, NAIC Consumer Representative, presentation at NAIC Summer National Meeting. Aug. 12, 2022.
- [Research Brief: Social Inflation - Navigating the evolving claims environment.](#) Darren Pain, The Geneva Association. December 2020.
- [Social inflation: Evidence and impact on property-casualty insurance.](#) Insurance Research Council, The Institutes. June 2020
- [Medical Professional Liability: Change in diagnosis.](#) Timothy Darragh. Best’s Review. February 2020.

Third-party litigation funding:

- [Third-party litigation funding and its impact on commercial auto - Part One.](#) Brian Brown, Christopher Fredericks, Drew Groth, and Katie Pipkorn. Risk & Insurance. October 23, 2022.
- [Third-party litigation funding and its impact on commercial auto - Part Two.](#) Brian Brown, Christopher Fredericks, Drew Groth, and Katie Pipkorn. Risk & Insurance. October 23, 2022.
- [Litigation funding: Competing mythologies.](#) Jerry Theodorou. Insurance Journal. October 18, 2022.

- [Triple-I: Investors Fund Lawsuits Without Disclosing Their Role.](#) Insurance Information Institute. July 27, 2022.
- [What is third-party litigation funding and how does it affect insurance pricing and affordability?](#) Insurance Information Institute. July 2022.
- [A piecemeal approach toward transparency in litigation finance.](#) Insurance Information Institute. April 27, 2022.
- [How unrelenting litigation funding, social inflation, and other trends affect the E&S markets](#) (Risk & Insurance, March 8, 2022)
- [US litigation funding impacting costs of liability claims](#) (Insurance Business, Feb. 25, 2022)
- [Third-party litigation funding in 2022 - three issues for your radar.](#) Verisk. January 31, 2022.
- [US litigation funding and social inflation.](#) SwissRe Institute. December 2021.
- [Selling More Lawsuits, Buying More Trouble: Third Party Litigation Funding a Decade Later.](#) U.S. Chamber Institute for Legal Reform. January 2020.
- [Following the money: Should federal law require litigants to disclose litigation funding agreements?](#) Congressional Research Services. May 2018.
- [Third-Party Litigation Funding: Tipping the Scales of Justice for Profit.](#) National Association of Mutual Insurance Companies. May 2011.
- [Third-Party Financing: Ethical and Legal Ramifications in Collective Actions.](#) U.S. Chamber Institute for Legal Reform. November 2009.

State actions on third-party litigation funding:

California:

- [District Court Adopts First-of-its-Kind Litigation Funding Disclosure Requirement](#) The D&O Diary. January 26, 2017.
 - Related: [Standing Order for All Judges of the Northern District of California: Contents of Joint Case Management Statement](#)

Delaware:

- [Delaware wants to take a closer look at the TPLF industry.](#) U.S. Chamber Institute for Legal Reform. July 21, 2022.
 - Related: [Delaware State Senate, Senate Concurrent Resolution No. 127](#)
- [Delaware judge requiring disclosure of third-party litigation funders.](#) National Underwriters *PropertyCasualty360*. May 16, 2022.
 - Related: [Standing Order Regarding Third-Party Litigation Funding Arrangements.](#)

Indiana:

- [IN Code §24-12](#)

Maine:

- [Title 9-A, §12](#)

Missouri:

- [Missouri bill calls for regulation of third-party litigation financing.](#) Business Insurance. February 25, 2022.
 - Related: [House Bill No. 2771](#)

Nebraska:

- [Neb. Rev. St. §25-3301](#)

Nevada:

- [NRS §604C](#)

New Jersey

- [N.J. federal courts will now require disclosure of litigation financing.](#) U.S. Chamber Institute for Legal Reform. June 24, 2021.
 - Related: [Civ. L.R. 7.1.1](#)

Oklahoma:

- [Okla. Stat. §14A-3-801\(6\)](#)

Tennessee:

- [Tenn. Code Ann. §47-16-101, et. seq.](#)

West Virginia:

- [West Virginia Legislature amends consumer protection statute to regulate and impose restrictions on litigation financiers.](#) JD Supra. November 5, 2019.
 - Related: [W.Va. Code Ann. § 46A-6N-6 \(2019\)](#)

Wisconsin:

- [Wisconsin law requires all litigation funding arrangements to be disclosed.](#) ABA Journal. April 10, 2018.
 - Related: [Wis. Stat. §804.01](#)

Vermont:

- [8 VSA §2252](#)

Nuclear verdicts:

- [National Studies Rank NJ Civil Justice System One of the Most Expensive in the U.S.](#) Insider NJ. December 6, 2022.
- [Nuclear Verdicts: Trends, Causes, and Solutions.](#) U.S. Chamber of Commerce, Institute for Legal Reform. September 2022.
- [I Registered the Term Nuclear Verdicts®. Here's Why.](#) Robert F. Tyson, Jr. Carrier Management Magazine. August 10, 2022.
- [Runaway verdicts: Reversing the trend.](#) Mark Lowers and Robert Tyson. Claims Magazine. July/August 2022.
- [Insurers call for reform, public awareness in fight to curb shock verdicts.](#) Tom Davis. Best's Review. March 2022.
- [Shock verdicts: Insurers sound the alarm as billion-dollar awards drive up claims.](#) Tom Davis. Best's Review. March 2022.
- [Insurers: Third-party litigation is fueling rise in shock verdicts.](#) Tom Davis. Best's Review. March 2022.
- [Lawsuits elevate social inflation to new levels of concern.](#) Tony Kuczinski. Best's Review. March 2022.
- [What attorneys, insurers should know amid rise of shock verdicts.](#) Jeff Fegan. Best's Review. March 2022.
- [Top 100 Verdicts.](#) Traveler's Insurance.

Specialty websites:

- [Judicial Hellholes.](#) The American Tort Reform Foundation (ATRF).
 - Focuses on civil litigation cases in the U.S. where “judges systematically apply laws and court procedures in an unfair and unbalanced manner.” Includes updated news, annual reports, and commentary on the justice system and nuclear verdict court rulings across the U.S.
- [Institute for Legal Reform.](#) U.S. Chamber of Commerce for Legal Reform.
 - “The Institute for Legal Reform shines a light on what is wrong in the legal system. We conduct cutting-edge research and advance pragmatic solutions. We then tirelessly advocate for those solutions with Congress, state legislatures, federal regulators, international policymakers, and the courts to effect meaningful change.”
- [2022 Edelman Trust Barometer:](#)
 - The Edelman Trust Barometer is a survey of over 36,000 respondents from 28 countries that measures people’s trust in societal institutions (government, NGOs, media, employers) and

leaders to effect positive global changes. Edelman believes trust “is the ultimate currency in the relationship that all institutions [...] build with their stakeholders.”

- Related: [Public Trust Increases in Most Businesses and Industries: New Report](#) (*Forbes*, Jan. 18, 2022).

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