Inflating The Truth: The Impact of Social Inflation

Mary, the plaintiff, a 40-year-old working mother of two, was in an auto accident with a semi-tractor owned by ABC Trucking. Mary briefly lost consciousness at the scene, and her injuries included severe neck and knee pain. Fault for the accident was unclear – each driver blaming the other.

Mary was already in debt and had recently lost her job. She required knee surgery, and with her medical bills mounting, she hired a lawyer to help with her claim. Mary's lawyer found doctors who were willing to wait for payment until the claim settled. They also referred her to a litigation funding company – who gave Mary a $200,000 loan against her future settlement. Mary jumped at the opportunity to take the money.

Mary's claim evolved into a case of disputed liability with Mary bearing a sizable portion of fault. The insurance company for ABC Trucking attempted to settle the claim but was unable to do so because their evaluation was less than the amount of Mary's $200,000 loan – forcing the case to trial, where Mary received an award of $450,000.

In years past, a claim like this would have settled for a more reasonable amount. Today, cases such as these end up in protracted litigation, with some going all the way to trial, contributing to the phenomenon called social inflation.

What Is Social Inflation?

Social inflation is the term used to refer to the rising cost of insurance claims, caused by many contributing factors, including:

- Shifts in the societal mindset to be more litigious
- Negative public sentiment toward larger businesses and corporations
- The emergence of third-party litigation financing
- A greater division or separation of wealth
- The feeling that someone needs to be punished for causing injury or damage

In Mary's case, the litigious mindset, division of wealth, and the feeling that someone needs to pay were all contributing factors.

Over the years, plaintiffs' lawyers have become better-organized and developed techniques to drive claim settlements and verdicts higher. While there are many techniques they use, there are two standouts.

The Reptile Theory. In the past, a plaintiff's lawyer would try to evoke sympathy from a jury to obtain an award. While this worked, they've discovered a more lucrative approach known as the Reptile Theory. This approach aims to anger a jury against a defendant and his / her conduct that jeopardized the safety of the plaintiff. They present the case that if this conduct were left unchecked, it would put other people in harm's way, inciting an instinctive or reptilian "kill or be killed" sort of mentality. In practice, angering a jury can yield larger verdicts.

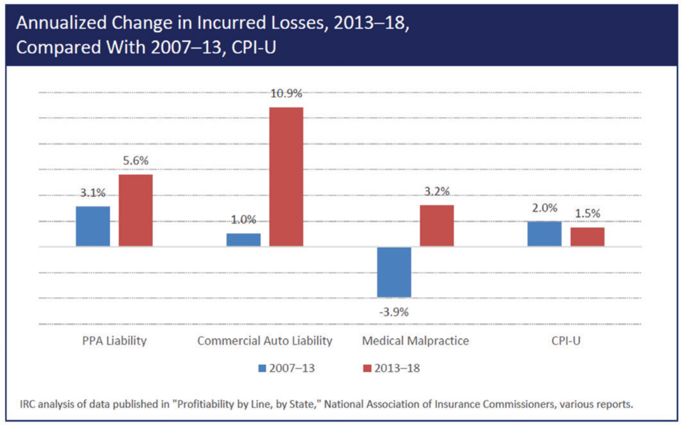
Litigation Financing. Lawsuits are expensive. Plaintiffs need money to treat their injuries. Some plaintiffs need or want money immediately and are unwilling to wait for a settlement or their day in court. Plaintiffs' lawyers also incur costs to prepare a case that frequently means hiring experts. These factors led to the development of litigation funding companies. These businesses invest in plaintiffs' cases but have no vested interest in the outcome, except for recovering their investment if the plaintiff obtains a settlement or prevails at trial. As a result, plaintiffs may get their money sooner, and law firms are financed much better to pursue claims.

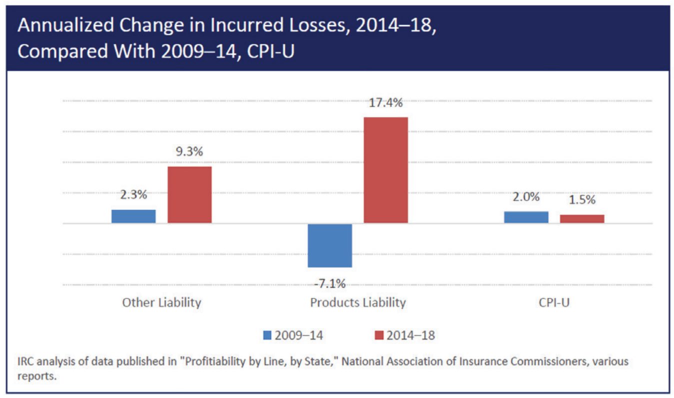
Importantly, some states allow a plaintiff to claim the "sticker price" of the medical bills, not what was actually paid to the medical providers. There have been instances in the litigation financing realm where the financier's amount paid to the doctor was less than the sticker price of the medical bills presented at trial.

Lawsuits have been prevalent in the insurance realm for years. Jury verdicts are now more plaintiff-friendly than ever, and plaintiff awards are growing exponentially due to social inflation[1].

Social inflation has manifested in part due to the Reptile Theory and Litigation Financing, but the erosion of tort reform, negative attitudes towards large corporations, and negative attitudes towards insurance companies are all influencing factors.

Social inflation has manifested more prominently in auto liability, medical malpractice, and excess and umbrella realms. Nautilus has not been hit hard by the impacts of social inflation yet, largely due to our target risk profile, but that does not mean that we are immune from it.





The Trends Are Clear

The social inflation trend is not merely anecdotal. Rather, it has been studied and its impact documented. The Insurance Research Council from The Institutes did a study and report in June 2020 entitled, Social Inflation Evidence and Impact on Property & Casualty Insurance, which reports in part:

> Based on [Insurance Research Council]'s analysis of data published by the [National Association of Insurance Commissioners], incurred claim losses have increased rapidly in recent years—much more rapidly than in preceding years and more rapidly than economic inflation would predict. As shown in the included charts, commercial auto incurred losses increased at an annualized rate of 5.4 percent from 2007 through 2018. However, almost all of the increase over that 12-year period actually occurred during the second half of the period. From 2013 through 2018, commercial auto claim losses increased at an annualized rate of 10.9 percent, compared with a 1.0 percent annualized rate from 2007–13. Also, while inflation over the 12-year period averaged only 1.8 percent, the annualized inflation rate from 2013–18 was 25 percent less than the annualized rate from 2007–13. Two other commercial insurance lines significantly affected by social inflation trends are products liability and other liability.[1]

What Can We Do About It?

The answer to this is not easy, and there are many factors at play. Social inflation may very well have to get worse before it gets better. The insurance industry will need to lobby for tort reform and attempt to educate the public about the ramifications of large jury awards. If left unchecked, social inflation may lead to premium increases and market hardening.

Right now, the Claims Department must do everything it can to defend the insureds against runaway verdicts to which social inflation contributes. There are instances where our policy terms and conditions help us because we limit or exclude certain exposures. We also intelligently invest in defending lawsuits, which can include means to mitigate social inflation by attacking the sticker price of submitted medical bills.

We All Pay The Price

The results are clear. More lawsuits are filed that otherwise would have been settled, and awards are significantly higher to punish those found to be negligently at fault. The impact of social inflation is significant, ultimately leading to increased insurance costs for businesses and consumers.

[1] The Institutes' Insurance Research Council, Social Inflation: Evidence and Impact on Property and Casualty Insurance, at 3-4 (June 2020) (footnotes omitted, charts included).