

SOCIAL INFLATION: THE ONLY WAY IS UP – OR IS IT?

With social inflation threatening to spiral ever higher in the US, could UK carriers see the cost of claims follow a similar trajectory?

Between 2007 and 2013, payments on commercial auto claims in the US increased at an annualised rate of 1%. Between 2013 and 2018, though, something strange happened. Instead of a 1% increase, losses increased at an annualised rate of 10.9%.

For private auto claims the increase over the same periods was less stark, but still significant (3.1% to 5.6%). A similar trend has also been seen in medical malpractice (-3.9% to +3.2%), product liability (-7.1% to +17.4%) and claims categorised as 'Other liability' (2.3% to 9.3%).

The message is clear. Litigation in the US is becoming more expensive for defendants and their insurers. Furthermore, this process did not begin in 2013. In fact, it has been a fundamental reality for most insurers and reinsurers for the last four decades. There has always been an upward pressure

on the cost of insurance claims in the US, but the statistics show that a long-term problem has in recent years become a crisis.

This crisis has a name: social inflation. This is the catch-all term that has been coined to describe the wide variety of societal pressures within the US that are driving up the exposures of defendants.

Some of these pressures are nebulous, such as increasingly negative attitudes towards big business. Some, however, are more precise, such as the increase in third party litigation funding,



a flourishing of attorney advertising, the growth in class actions, allegations of bad faith against insurers and the existence of punitive damages.

At the heart of many of these trends is the US jury system for civil claims, a system that is protected and enshrined in the Seventh Amendment.

In the 1400s, Sir John Fortescue wrote that, "Trial by jury is the most rational and effective method for discovering the truth". However, the evidence now suggests that Americans, and therefore American jurors, are angrier, more entitled, less trusting of authority, more willing to sue and, ultimately, more susceptible to the combined charms of social media bubbles and an increasingly well-funded plaintiff's bar.

The consequence of all this is an increase in the cost of litigation. Average jury verdicts against trucking firms, for example, increased from \$2.6mn in 2012 to \$17mn in 2019. With every large verdict, a new norm is set, a new baseline is established.

Please forgive the use of a footballing analogy, but in 1996 Alan Shearer was sold to Newcastle United for a world record fee of £15mn. Just three years later, the world record fee had doubled; 10 years later it had doubled again and it currently stands at £198mn. It is the same with jury verdicts.

Furthermore, as the [Insurance Research Council](#) says, "[Very large verdicts] contribute to the underlying attitudes and opinions associated with social inflation by normalising litigiousness and entitlement to compensation and thus encouraging even more claiming activity and litigation".

In other words, the US finds itself in the middle of an endless upward spiral of social inflation. Indeed, the fear is that we may be approaching a period of social hyper-inflation.

As we have learned with the pandemic, if everything is trending in one direction, the result is exponential growth. With the pandemic, this growth cycle is broken with counter-measures such as lockdowns, social distancing and vaccines.

However, with social inflation in the US, there is no evidence that counter-measures are being put in place. Indeed, with fee-shifting statutes, pro-policyholder rulings and the reversal of tort reforms, the evidence is that counter-measures are in fact being removed. A bad situation is being made worse.

Many of these trends are unique to the US. However, we are seeing similar pressures in the UK, albeit on a much reduced level.

Statutes such as the Consumer Insurance (Disclosure and Representations) Act 2012 and the Insurance Act 2015 have improved the position of insureds, particularly consumers, in coverage disputes.

Regulators have also imposed obligations upon insurers to ensure fair treatment of customers. This is, of course, a principle that many insurers wholeheartedly support, but the principle of fairness is less rigorous than age-old legal principles.

This feeds into the decisions of the Financial Ombudsman Service (FOS), which are not based on legal precedent, but on "what we think is fair and reasonable". There are even signs that these trends are influencing the Supreme Court. In the recent Covid-19 business interruption case, Lord Briggs decided in favour of the policyholders on the basis that "the spirit and intent" of the policies was to provide pandemic cover.

We may therefore see greater latitude being given to policyholders by both the FOS and the courts. However, this should not result in the exponential increase in awards that has been seen in the US. Because the UK does not have a system of punitive damages, there is less scope for damages to spiral.

However, even within a compensatory system, there is flexibility. In March 2017, the discount rate was reduced from 2.5% to -0.75% (later increased slightly to -0.25%), thereby increasing the figure payable by insurers in relation to future losses.

Overall, the social trends affecting the US also affect the UK. However, whether by accident or by design, the counter-measures in the UK are stronger, most obviously our awards are set by judges, rather than jurors. As a result, whilst we have the same societal pressures as the US, this should not translate into the same social inflation.

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Written by:

Simon Laird
Global Head of Insurance
at international law firm RPC

Scott Seaman
Partner at the US-based law firm
Hinshaw & Culbertson LLP

