WHITE PAPER

Tackling Social Inflation:

A Strategic Imperative for P&C Insurers

April 2024
By Nathalia Bellizia, Nadine Moore, Alexandria White and Charis Lee

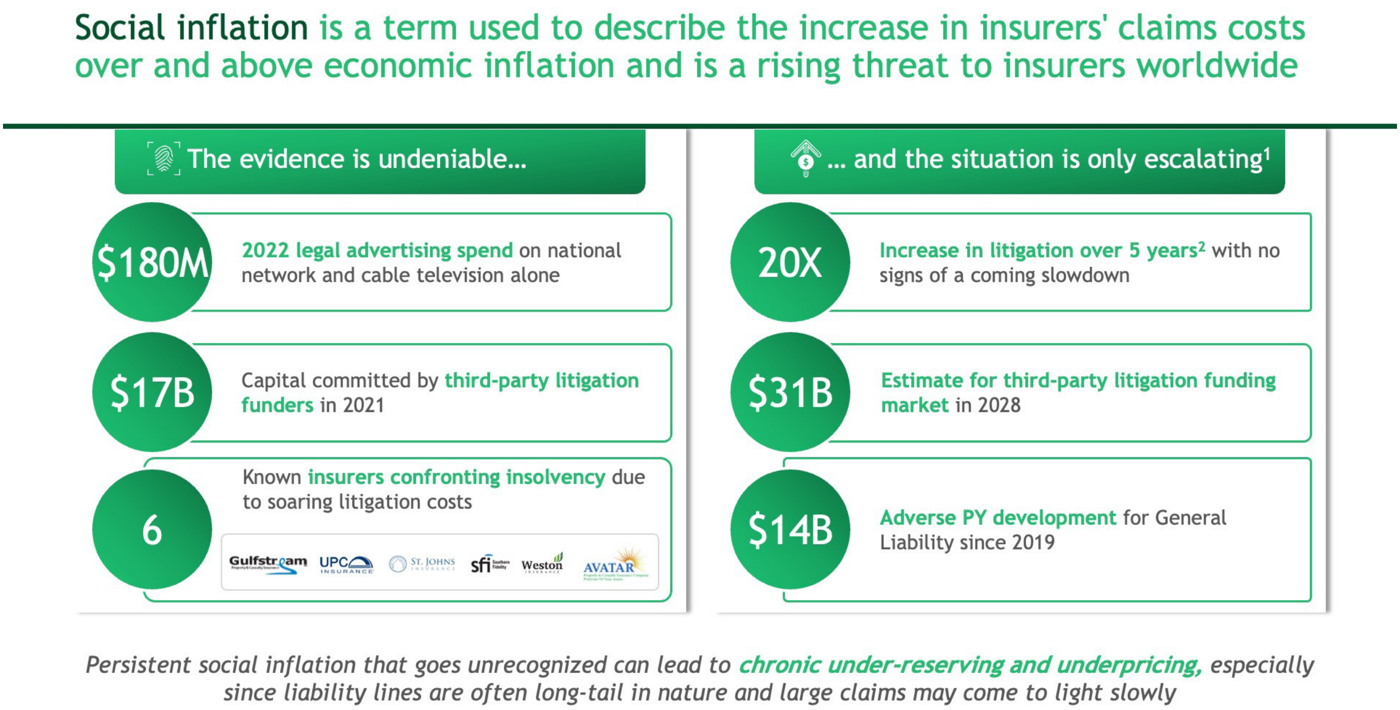
Boston Consulting Group partners with leaders in business and society to tackle their most important challenges and capture their greatest opportunities. BCG was the pioneer in business strategy when it was founded in 1963. Today, we work closely with clients to embrace a transformational approach aimed at benefiting all stakeholders—empowering organizations to grow, build sustainable competitive advantage, and drive positive societal impact.

Our diverse, global teams bring deep industry and functional expertise and a range of perspectives that question the status quo and spark change. BCG delivers solutions through leading-edge management consulting, technology and design, and corporate and digital ventures. We work in a uniquely collaborative model across the firm and throughout all levels of the client organization, fueled by the goal of helping our clients thrive and enabling them to make the world a better place.

Introduction

In our latest article in the P&C Underwriting Excellence series, "P&C Insurance topics for 2024: Exploring Emerging Trends and Strategies in Underwriting Excellence," we provided a comprehensive forecast of the influential trends set to shape the industry. Among the critical subjects discussed is social inflation—a serious issue with significant implications for insurers worldwide. This article will delve into the depths of social inflation, dissecting its causes, examining its increasing prevalence, and unpacking the strategic responses it necessitates from property and casualty (P&C) insurers and other industry participants.

Exhibit 1 — Overview of Social Inflation



1. Rise of digital advancements and AI technologies is further fueling the issue of social inflation, as law firms harness tools like SEO to effectively target potential clients. 2. As measured by number of new litigations in Florida's homeowners' insurance market.
Source: III, NAIC, Swiss Re, 4WARN, Geneva Association, Travelers

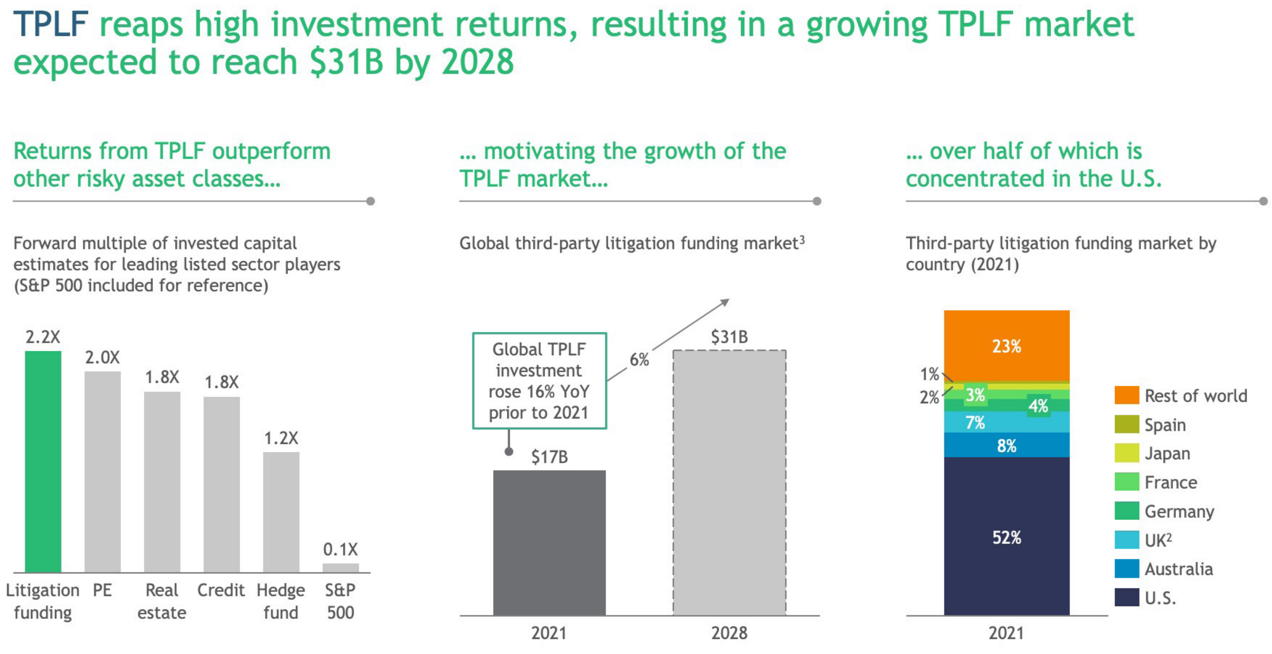
Social inflation's ramifications extend far beyond the immediate financial pressures of escalated claims costs, by posing substantial threats to insurers' pricing strategies, reserve adequacy, and long-term sustainability. With documented losses attributable to social inflation reaching a total of $20 billion for commercial auto liability, personal auto liability, general liability, and product liability in 2019, the urgency for insurers to recalibrate their risk assessment methodologies and pricing models has never been more pronounced.

Drivers of Social Inflation

Economic drivers

Third-party litigation funding (TPLF), where hedge funds and other financial backers invest in legal disputes, has significantly influenced the legal landscape. Valued at $17 billion in 2021 and projected to escalate to $31 billion by 2028, TPLF has been a catalyst for an uptick in litigation, often incentivizing more aggressive legal strategies and inflated settlement demands.

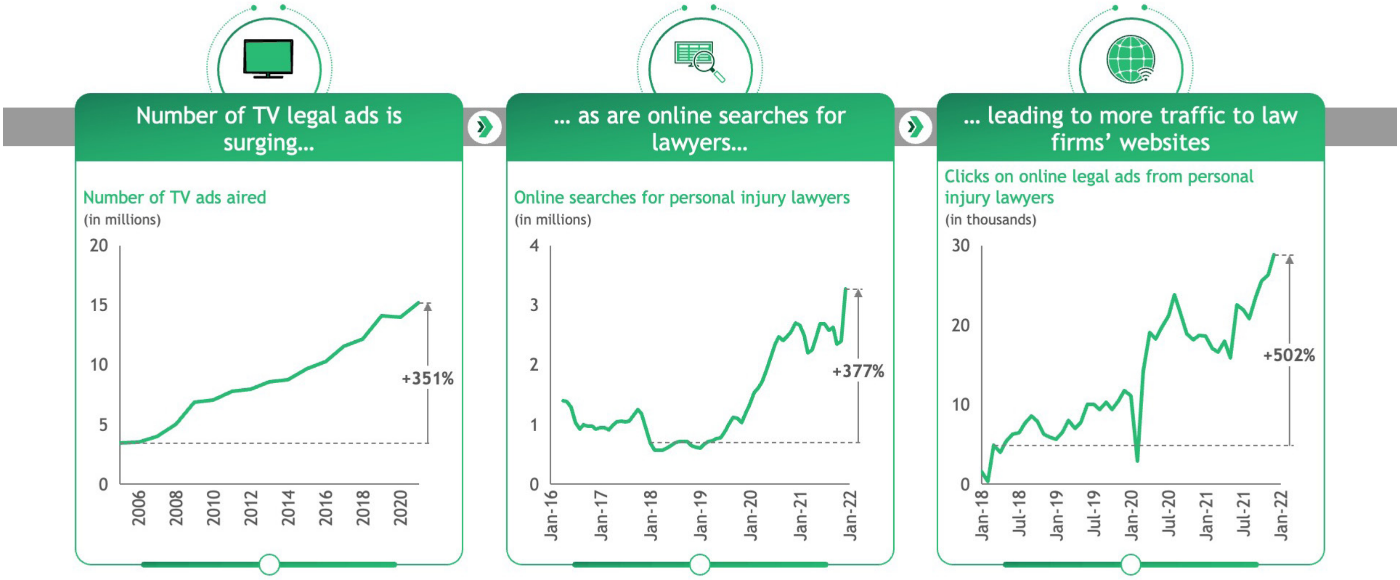
Exhibit 2 — Third-Party Litigation Funding (TPLF)



3. Omni Bridgeway Ltd., a public Australian funder, estimates a $100B global addressable market.
Source: Morning Investments, Research Nester, Swiss Re Institute, Bloomberg, BCG analysis

An additional economic force driving social inflation is the intensification of legal marketing efforts. Law firms have substantially increased their marketing efforts, through both digital channels such as search engine optimization (SEO) and traditional media such as TV, radio, and billboards. This increased visibility and accessibility have led to a rise in claim frequency and the expectation of larger settlements among claimants, fueling social inflation.

Exhibit 3 — Legal Marketing

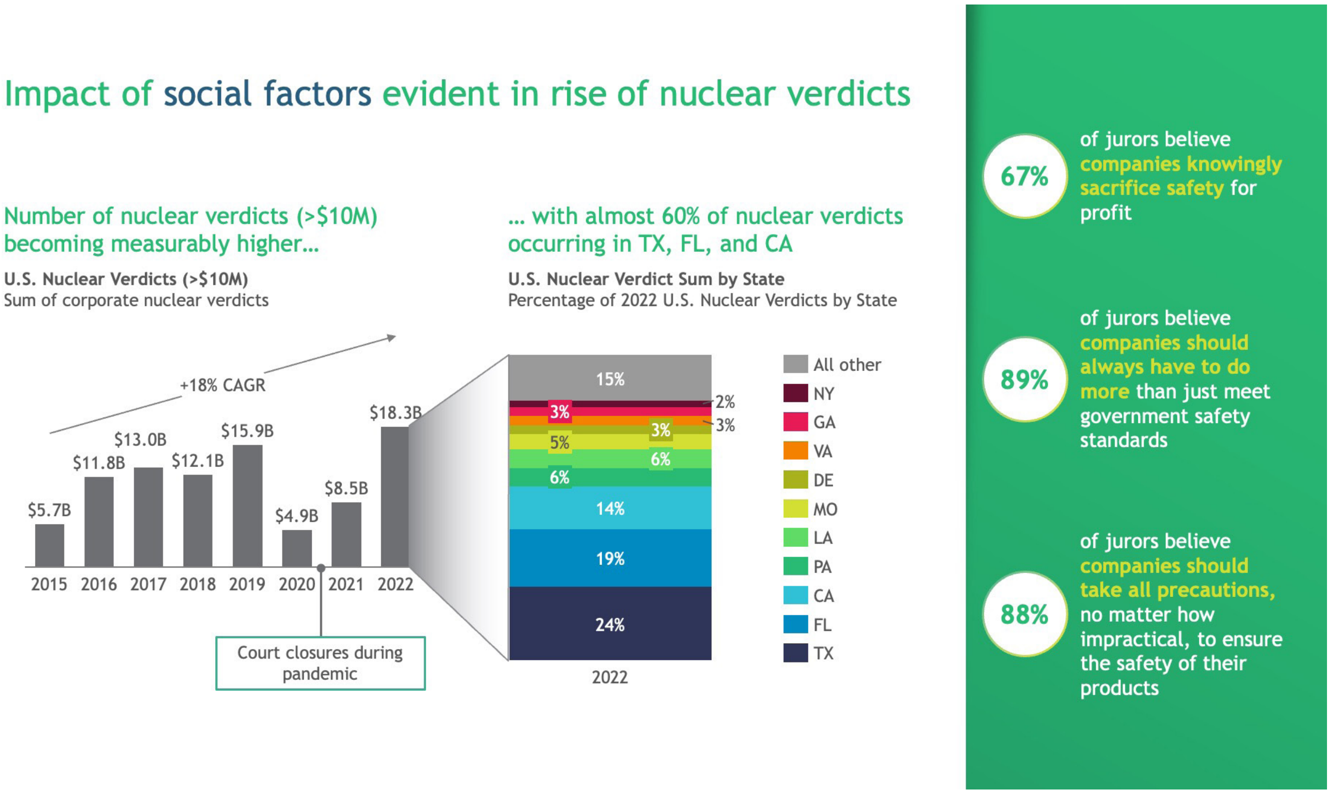


Source: X-Ante Legal services Ad Trends, Google Trends, SEMrush, Swiss Re Institute

Social drivers

The escalating jury verdicts in the United States are symptomatic of a deepening distrust in corporate practices and an expansive view of insurance coverage, often influenced by younger jurors with evolving perceptions of rights and corporate accountability. This shift is further exacerbated by attorneys employing psychological tactics such as the "reptile strategy," which manipulates jurors' fears to obtain larger damages by portraying defendants as ongoing societal threats. Amplified by substantial media coverage, these large verdicts set precedents that shape public expectations, fostering an environment where escalating awards could become the new norm in litigation outcomes.

Exhibit 4 — Changing Social Attitudes



Source: Marathon Strategies, Travelers, BCG analysis

Regulatory drivers

Regulatory shifts have also played a pivotal role in tilting the scales toward plaintiffs within the U.S. legal system. Legislative reforms have gradually dismantled many of the barriers that once contained the surge in liability claims, creating a fertile ground for expanded litigation. Such legal transformations include the abolition of monetary caps on damages, which previously served as a check against exorbitant claims. Now, with these caps removed, there is an unrestricted avenue for plaintiffs to seek—and often receive—large sums as restitution.

Furthermore, the extension of statutory limits for filing claims means that plaintiffs have extended windows of opportunity to initiate legal proceedings, a factor that not only increases the likelihood of lawsuits but also creates additional complexity for insurers. This elongation of the claim filing period delays the closure of insurers' potential liability, exacerbating the challenges of setting aside adequate reserves.

These regulatory factors necessitate heightened vigilance and adaptability. Highlighting the urgency of this situation, a 2022 report by the U.S. Chamber Institute for Legal Reform revealed that every American household pays a substantial "tort tax" exceeding $3,600, which inflates the cost of everyday necessities, including gas and groceries. This underscores the pressing need for the industry to engage more proactively with policymakers. Advocating for balanced reforms is critical to safeguard against excessive litigation, while ensuring just compensation for genuine claims.

Social Inflation in the U.S.

Social inflation is most prominent in the U.S. due to a range of factors that create an environment conducive to increasing claim sizes and litigation costs. The U.S. legal system, which allows for punitive damages and jury trials in civil cases, often leads to higher compensation awards than systems that rely solely on judge-made decisions (for example, much of Europe). Furthermore, the U.S. has seen a substantial rise in attorney advertising and a robust market for third-party litigation funding, both of which contribute to a greater number of claims and more litigious behavior, as discussed in the previous section.

The impact of social inflation is felt across various lines of business in the U.S., but according to research from the Insurance Information Institute, it is particularly pronounced in Commercial Auto Liability, Personal Auto Liability, and General Liability. In the realm of Commercial Auto Liability, social inflation accounted for a staggering 35 percent of incurred losses in 2019. This significant figure reflects the broader trend of rising legal settlements, which have contributed to a $16 billion cumulative negative reserve development in this line since 2013.

Social inflation has also made its mark in Personal Auto Liability, albeit to a lesser extent, accounting for 5 percent of incurred losses in 2019. Although Personal Auto Liability often features lower policy limits and typically involves individual defendants rather than financially robust corporations, the trend of escalating claim settlements is still present.

Social Inflation in Europe

The issue of social inflation, predominantly recognized within the U.S. insurance market, has begun to assert its influence globally, particularly across Europe. Driven by the economic and regulatory drivers, the trend is mirroring patterns previously exclusive to the U.S. For example, the European litigation funding market is projected to grow from $1.8 billion in 2020 to an estimated $2.9 billion by 2025, infusing the legal landscape with resources that embolden claimants. Litigation funders are becoming integral to the European legal sphere, with over 60 percent of EU and UK class actions in 2021 featuring litigation funder participation. Recent high-profile cases supported by such funding include Merricks vs. Mastercard in the U.K. and Dieselgate in Germany, among others.

Social inflation in Europe has also been accentuated by the regulatory landscape. Regulatory adjustments, such as the rollback of established tort reforms and the advent of the EU's Representative Actions Directive, contribute to a legal environment that is progressively aligning with the interests of claimants. These legislative changes are priming the European legal system for a potential increase in social inflation, paralleling the trajectory seen in the U.S. This is clearly manifested in the escalating number of class actions across key European nations—underscored by the U.K., Netherlands, Germany, Slovenia, and Portugal. According to CMS's 2023 European Class Action Report, the UK's class action landscape is particularly noteworthy, with claims surpassing €120 billion from 2016 to 2022, illustrating a profound economic impact of social inflation.

The "So What?"

In discussing social inflation, this section emphasizes the importance for insurers to strategically address the challenges of mitigating represented and litigated claims. P&C insurers' ability to handle these claims is increasingly challenged by a variety of issues, including unclear role definitions, inefficient collaboration between claims and legal teams, and significant operational complexity. This calls for a comprehensive strategy that not only focuses on improving internal processes but also on adapting to the evolving landscape of claims management.

As insurers forge ahead, a three-tiered solution strategy surfaces, each aligned with distinct claim lifecycle phases:

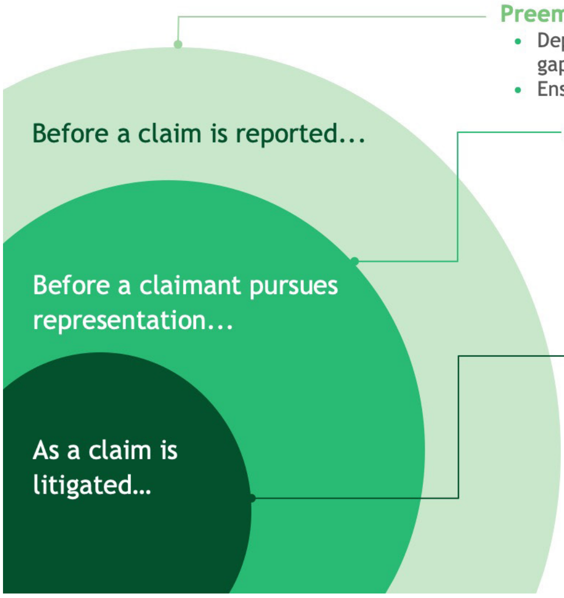
1. *Preemptive and mitigating measures:* To address social inflation proactively, insurers must implement strategies that tackle its root causes before claims are filed. Deploying sophisticated tools such as those offered by 4WARN, insurers can combat escalating lawyer advertising by conducting thorough keyword gap analysis and employing geo-targeted SEO strategies. This digital foresight can reduce the risk of inflated claims by ensuring potential claimants receive balanced information, limiting one-sided narratives provided by aggressive legal advertisements. Moreover, aligning marketing and claims teams in their SEO deployment ensures a unified front in digital spaces, preventing any disconnect that could lead to increased litigation.

2. *Early signal detection:* At the onset of a claim, the ability to identify and manage early signs of representation and litigation is paramount. Effective claim triage systems are critical in distinguishing claims that require special attention, potentially mitigating lengthy and costly legal battles. Insurers must also refine their decision-making processes to control the claim from its inception—determining liability swiftly, making initial offers where appropriate, etc. Streamlining interactions within claims and legal teams can prevent procedural delays and foster consistency in managing claims, thereby limiting the scope for legal disputes to escalate.

3. *Litigation cost control:* As claims progress to litigation, insurers need to exert control over the legal costs and the overarching influence of social inflation. Employing analytics to inform and refine litigation strategies enables insurers to select the right internal or external counsel for each case, optimizing both the defense and the allocation of resources. Enhancing workflow efficiency, honing negotiation capabilities through consolidated data, and ensuring performance transparency in claims spend are additional strategies that can help insurers minimize the impact of social inflation on the bottom line.

Exhibit 5 — BCG's Perspectives on Tackling Social Inflation

Our hypotheses for addressing social inflation span the entire lifecycle of a claim



Preemptive and mitigating measures

- Deploy tools (such as 4WARN) to counter increased lawyer advertising (e.g., keyword gap analysis, geo-targeted SEO strategy)
- Ensure marketing and claims teams are aligned in SEO deployment

Monitor and address early signals of representation and litigation

- Effective claim triage to ensure challenging claims are consistently treated with special attention
- Accelerate decision-making (e.g., determine liability, make initial offers) to control the claim
- Improve speed to proficiency and simplify interaction models within claims and legal teams to avoid errors and delays and homogenize outcomes for normalized claim types

Control claims and legal costs, minimize impact of social inflation

- Deploy analytics to determine litigation strategy
- Select right internal/external counsel to support the right cases
- Improve workflows and litigation management guidelines
- Improve negotiation capabilities with consolidated data
- Track performance and improve transparency on claims spend

The phenomenon of social inflation presents multifaceted challenges that necessitate strategic foresight and adaptability from insurers. To effectively navigate this complex landscape, insurers must implement a comprehensive suite of preemptive measures, maintain keen monitoring, and manage claims judiciously. These efforts are crucial for addressing the ramifications of increased litigation and claims costs. Furthermore, embracing innovation through predictive analytics and leveraging technological advancements are key strategies for developing robust defenses against the intricate dynamics of social inflation.

Finally, engaging with policymakers is an essential component of addressing social inflation. Insurers should actively participate in policy discussions and regulatory reform efforts to advocate for environments that mitigate the impact of social inflation, ensuring fair outcomes for all stakeholders. Through concerted effort and a proactive approach, insurers can protect their operations, maintain the integrity of their risk assessments, and continue to deliver value to stakeholders in an ever-evolving market.

About the Authors

Nathalia (Nathi) Bellizia is a Managing Director and Partner and is the global leader for Corporate Finance & Strategy in Insurance at Boston Consulting Group. Bellizia.Nathalia@bcg.com.

Nadine Moore is a Managing Director and Partner and is the global leader for Property & Casualty (P&C) Insurance at Boston Consulting Group. Moore.Nadine@bcg.com.

Alexandria White is a Partner at Boston Consulting Group White.Alexandria@bcg.com.

Charis Lee is an Associate at Boston Consulting Group Lee.Charis@bcg.com.

For Further Contact

If you would like to discuss this report, please contact the authors.


bcg.com