

Social Inflation is Alive and Well

It will conflate with the pandemic – Covflation!

Midwest Actuarial Forum

October 1, 2020

ABOUT ASSURED RESEARCH

- ◆ Assured Research is a research firm focused exclusively on the P/C insurance industry. (Re)insurers controlling some \$175 billion in premiums subscribe to the Assured Research Package.
- ◆ We also offer educational presentations to subscribers.
- ◆ We offer investment-oriented research through our affiliation with Gordon Haskett Research Advisors.
- ◆ More information and research at www.assuredresearch.com
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ABOUT US

◆ William Wilt, President

In Bill's 30-year+ insurance career, he has played many roles: (re)insurance executive, equity and credit analyst, and actuarial consultant. His wide range of experience gives him a unique perspective on the industry.

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◆ Alan Zimmermann, Managing Director

Alan is a long-time insurance industry analyst who while working on Wall Street was for many years named to *Institutional Investor Magazine's* All America Research Team. In addition to being an analyst, Alan was the Head of US Equities and Director of Research at insurance research boutique, Fox-Pitt, Kelton.

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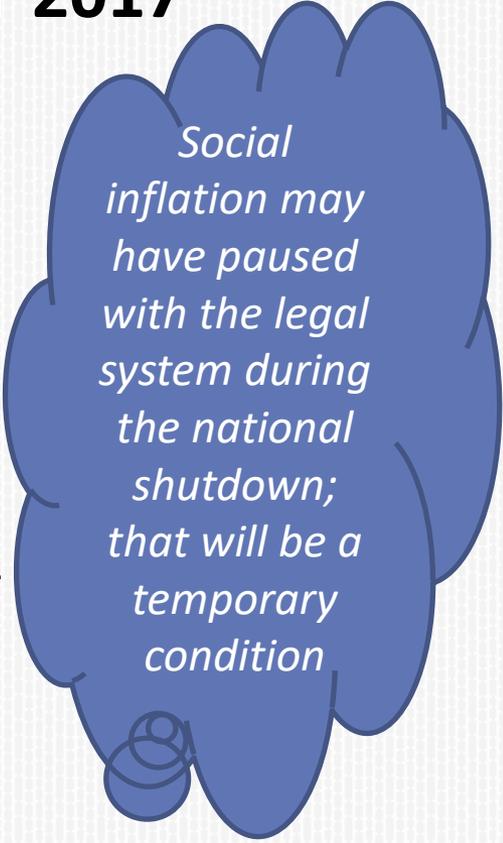
Research and Analysis for Insurance and Investment Professionals

SOCIAL INFLATION AND COVID-19 LITIGATION

- ◆ **Introduction**
- ◆ **Definition**
- ◆ **Legal Trends**
- ◆ **Judiciary**
- ◆ **Third Party Litigation Finance**
- ◆ **Measures of Inequality**
- ◆ **Tort Reform**
 - **Look Back to Past Bouts of Social Inflation**
- ◆ **Concluding Remarks**

SOCIAL INFLATION – A TOPIC SINCE EARLY 2017

- We began our series entitled *Social Inflation is Back!* in early 2017. The topic has consistently been our most requested for speaking engagements .
- Initially, we suggested that our efforts were meant to define and quantify elements of social inflation.
- But we now know that *quantify* is the wrong word – **trying to find objective signals of social inflation in the economy** better describes our efforts.



Social inflation may have paused with the legal system during the national shutdown; that will be a temporary condition

SOCIAL INFLATION AND COVID-19 LITIGATION

- History shows that litigation typically accelerates after a recession and we expect that will be the case as we emerge from this pandemic.
- Litigation specific to Covid-19 will add to the litigation already in the pipeline. There are calls for federal grants of immunity (related to Covid-19) and some states have granted same.
- Our focus here is on claims ('social inflation') already in the legal pipeline and emerging socioeconomic conditions that could exacerbate pre-Covid legal trends
- But realistically, the two trends will conflate to form covflation and their distinction will matter less with time.



We expect there will be a conflation of reemerging social inflation and Covid-19 litigation: "Covflation"!

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SOCIAL INFLATION BURST ONTO THE SCENE ~2017



I may not know how to define it, but I'll know it when I see it!

An understandable viewpoint, but it puts actuaries, claims, and underwriting professionals immediately on their heels and behind the trends

What exactly is social inflation and how can we find objective signals to monitor?

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SOCIAL INFLATION LOOKS LIKE THIS TO AN ACTUARY!

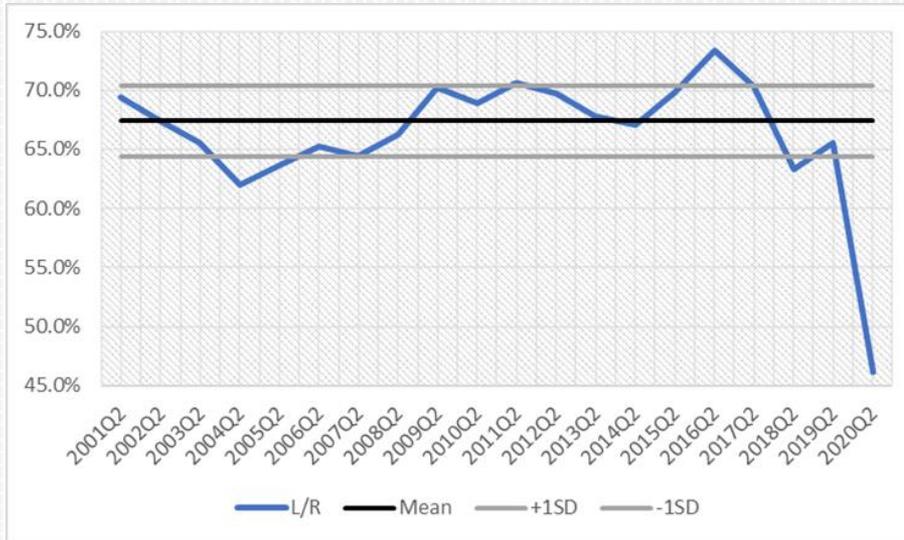
Incremental Incurred Loss Ratio

Accident Years	12 Months	24 Months	36 Months	48 Months	60 Months	72 Months	84 Months	96 Months	108 Months	120 Months
2005	16.8%	9.7%	6.7%	5.8%	3.7%	1.4%	1.7%	1.7%	1.1%	1.0%
2006	15.4%	9.5%	7.8%	5.4%	3.1%	2.3%	2.1%	0.8%	0.6%	1.1%
2007	16.0%	10.9%	8.2%	5.5%	4.3%	3.6%	1.7%	1.1%	1.1%	0.7%
2008	15.1%	11.5%	8.8%	6.4%	5.4%	2.6%	2.2%	1.1%	1.3%	1.2%
2009	16.6%	11.9%	8.4%	7.5%	4.7%	2.9%	1.8%	1.8%	1.6%	0.8%
2010	15.6%	12.4%	11.0%	7.4%	5.1%	2.8%	3.0%	2.1%	1.2%	0.1%
2011	15.3%	12.8%	10.7%	8.5%	5.4%	3.9%	3.0%	1.9%	0.6%	
2012	14.2%	12.2%	10.7%	8.8%	4.9%	4.8%	2.2%	1.1%		
2013	13.3%	12.1%	11.1%	8.6%	6.4%	3.7%	2.4%			
2014	14.2%	12.3%	11.1%	8.8%	5.8%	3.6%				
2015	14.1%	13.7%	11.6%	9.8%	6.6%					
2016	14.2%	13.0%	11.1%	10.1%						
2017	13.6%	15.3%	11.8%							
2018	14.4%	13.6%								
2019	15.1%									

Source: S&P Global, Assured Research, Credit OneBeacon and Intact Financial for the visual technique

Other Liability Occ. Red cells > column average, green cells < column average
In theory, the cells should be intermittently red and green in a random pattern.
This is not random!

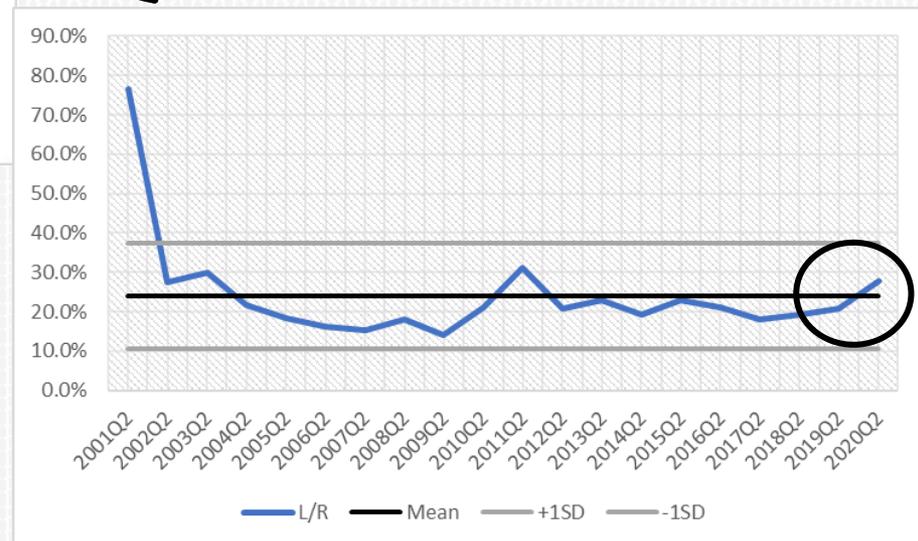
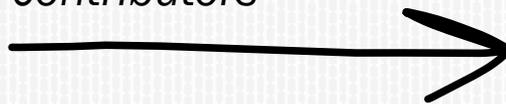
SOCIAL INFLATION – OR IT MIGHT LOOK LIKE THIS



The reported loss ratio for most private passenger auto insurers plummeted during the 2Q20 – no one was driving!



But the loss ratio for other liability claims made (professional lines) actually increased; we suspect EPLI and cyber claims are major contributors



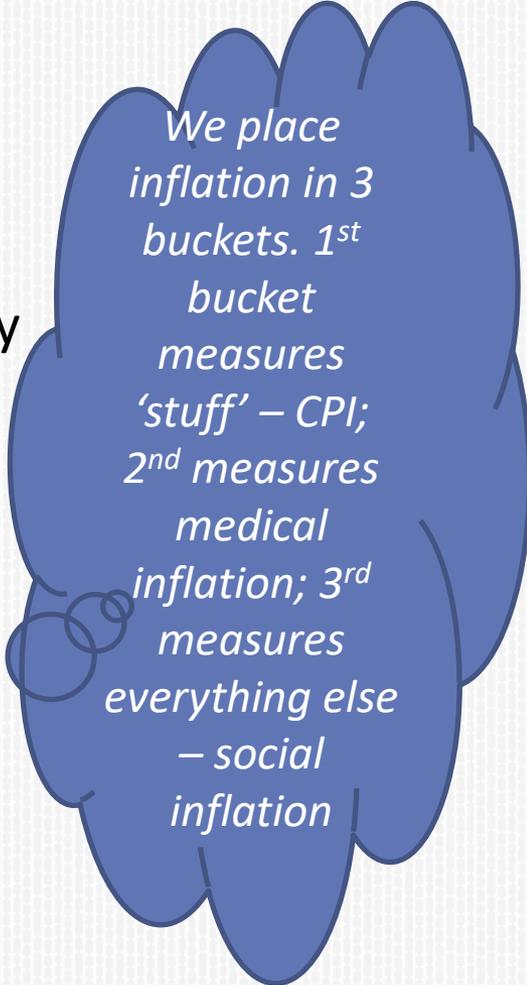
Sources: S&P Global, Assured Research

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SOCIAL INFLATION – WHAT IS IT?

(Pre-Covid) Social inflation:

- It captures an increased propensity to sue; rising jury awards and expanding judicial theories beyond the ‘four corners’ of a contract.
- Our efforts to find signals of social inflation have included examining: 1) legal trends, 2) judicial appointments, 3) third party litigation funding, and 4) measures of inequality



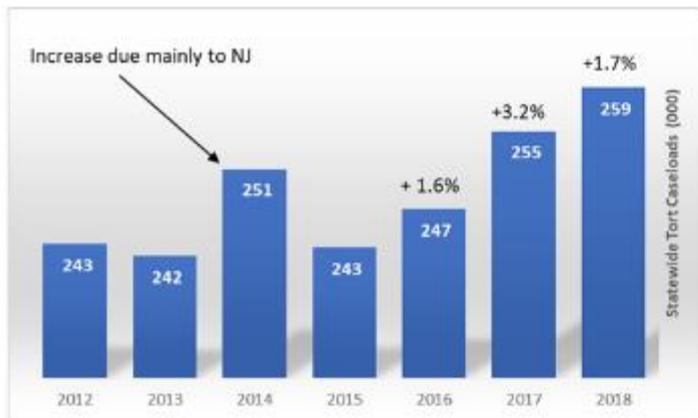
We place inflation in 3 buckets. 1st bucket measures ‘stuff’ – CPI; 2nd measures medical inflation; 3rd measures everything else – social inflation

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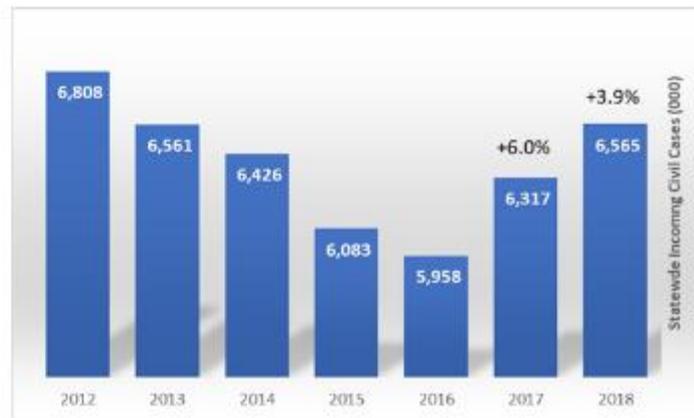
SOCIAL INFLATION IS ALIVE AND WELL! *LEGAL TRENDS AT STATE COURTS*

Tort Caseloads



Tort cases from 17 states representing about 33% of Liability Premiums.

Civil Caseloads

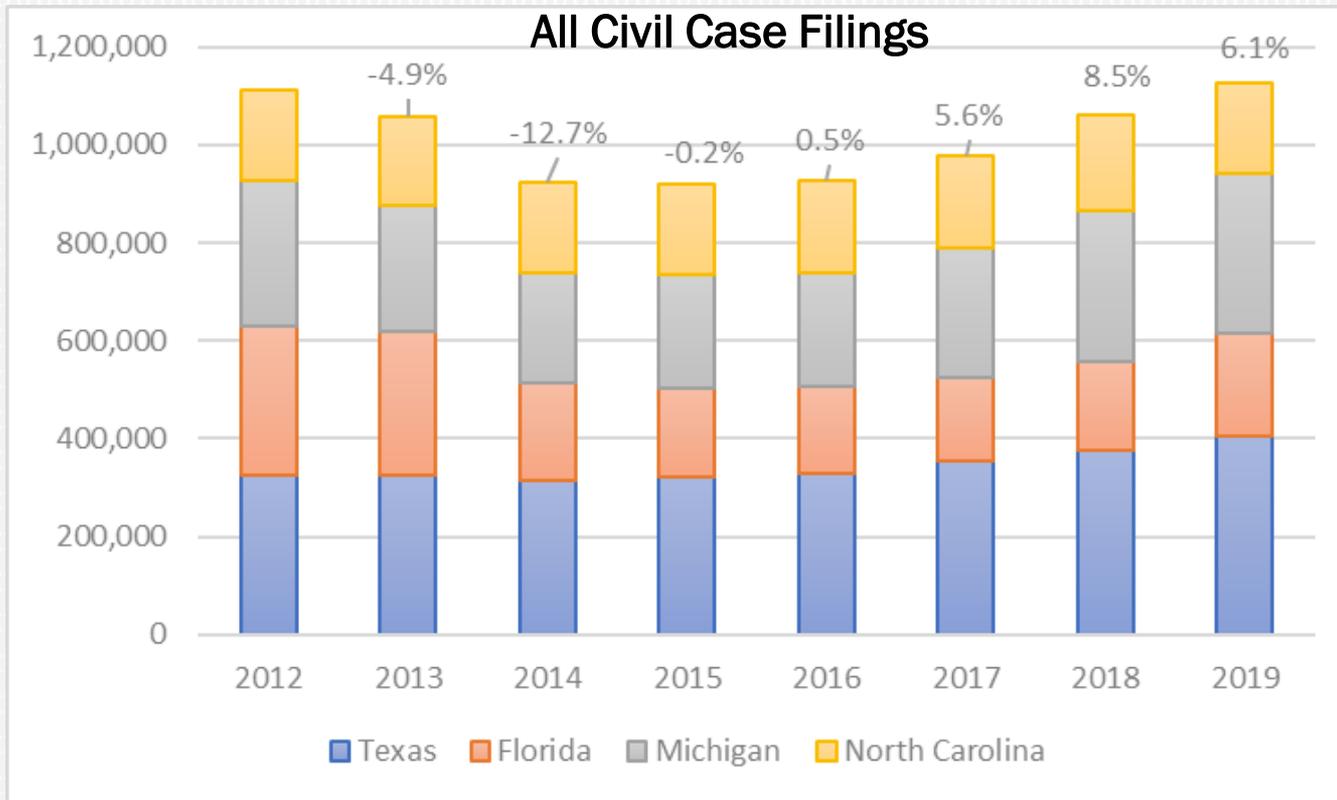


Civil cases from 7 states representing about 50% of Liability Premiums

Source: National Center for State Courts, Assured Research

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SOCIAL INFLATION IS ALIVE AND WELL! *LEGAL TRENDS AT STATE COURTS*

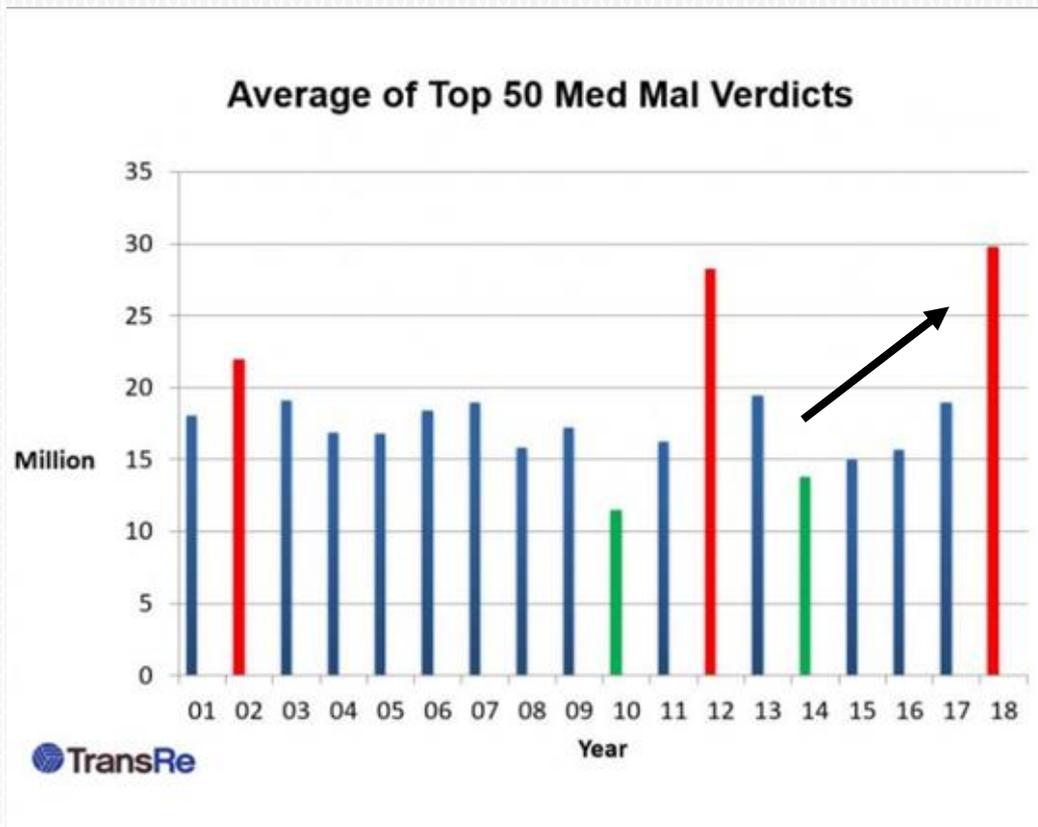


On this and the preceding slide we see an inflection point in the frequency of tort and all civil cases in the 2015/2016 timeframe

Source: State Court websites, Assured Research

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MEDICAL PROF. - 2015/16 INFLECTION POINT IN SEVERITY



The largest MPL jury verdicts have been rising (and at all size ranges such as \$10, \$25, and \$50 mil.)

Verdicts are small fraction of total claims but have outsized influence on claim settlements

Source: *Captive International* with data and analysis by TransRe, Assured Research. Arrow added by A/R for emphasis

COST OF A FATALITY – 2015/16 INFLECTION POINT

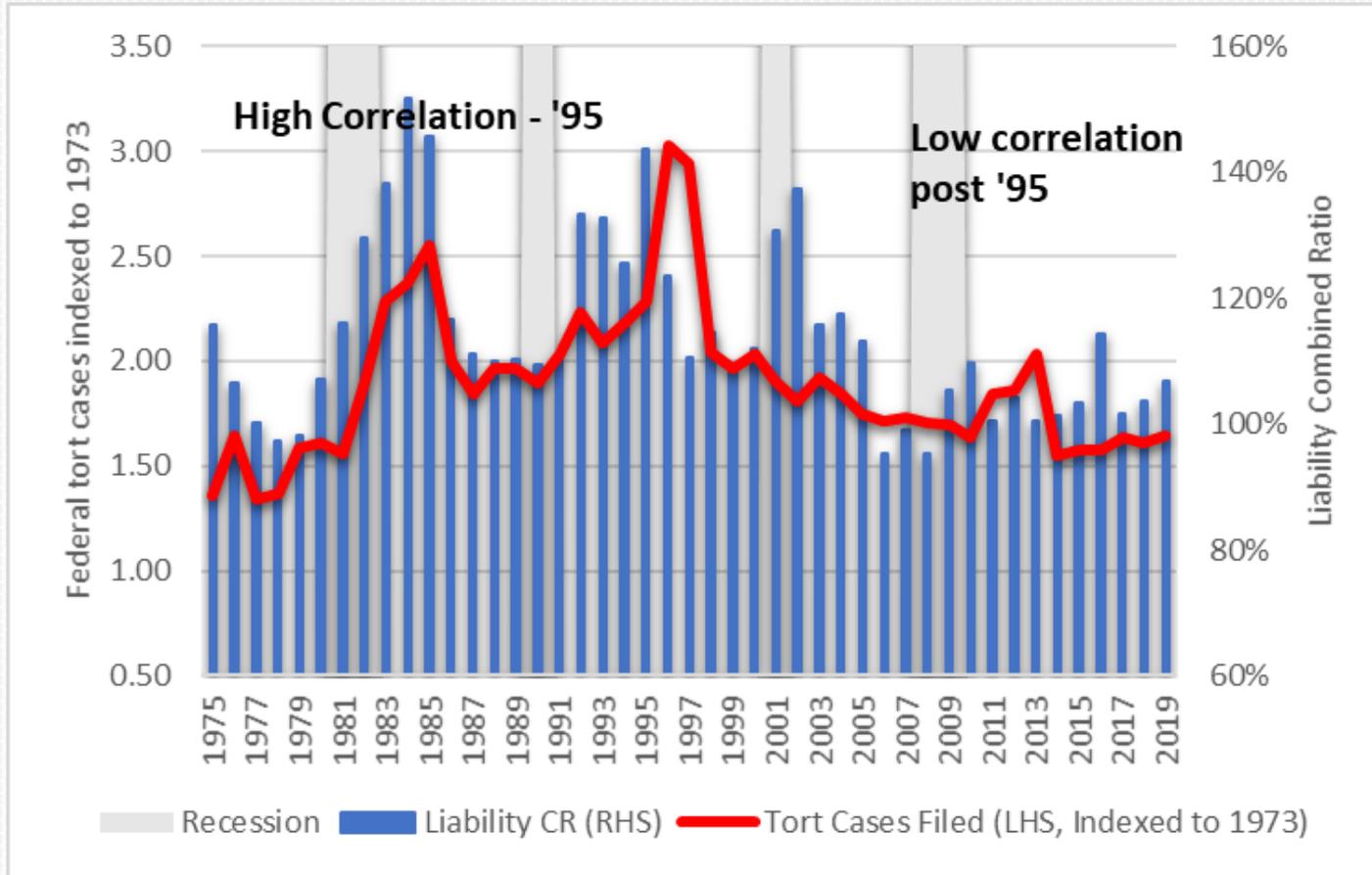
Exhibit 1:



Appears to us that all slides showing data on severity of claims show an inflection point in the 2015/2016 timeframe

Source: Advisen (3/13/2020), Assured Research

SOCIAL INFLATION: TORT CASES FEDERAL COURTS/LOSS RATIO



Tort cases have tended to rise/spike in the years after a recession, though correlation has declined since mid 1990s

AZ

Source: Office of the U.S. Attorney, National Bureau of Economic Research, Assured Research

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MULTIDISTRICT LITIGATION: GOOD NEWS AND BAD NEWS

- ◆ **We monitor trends in multidistrict litigation (MDL)**
 - **The most prominent cases (often product liability and mega torts) are frequently self-insured, but the verdicts can influence other decisions and settlement values**
- ◆ **Good news: Overall MDL cases are down 36% since 2012**
 - **Less good news: Products liability cases are only down 18%**
- ◆ **Bad News: The number of large cases is up significantly**

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MULTIDISTRICT LITIGATION –THERE’S GOOD NEWS AND THERE’S BAD NEWS

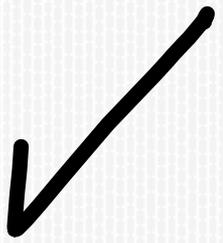
	Cases			Percentage	
	Total	Products Liability	All Other	Products Liability	All Other
2012	291	72	219	25%	75%
2013	287	67	220	23%	77%
2014	290	70	220	24%	76%
2015	273	70	203	26%	74%
2016	250	71	179	28%	72%
2017	221	70	151	32%	68%
2018	207	68	139	33%	67%
2019	196	65	131	33%	67%
Current	181	59	122	33%	67%
Change	-38%	-18%	-44%		

The good news-MDL cases are down 38%

The less good news – products liability cases only down 18%

The bad news - the number and size of large cases (over 1,000 claimants) is up big time!

	2012	Current
Large cases	14	16
Claimants	47,815	246,378



Source: Joint Panel on Multidistrict Litigation, Assured Research, as of 8/17/2020

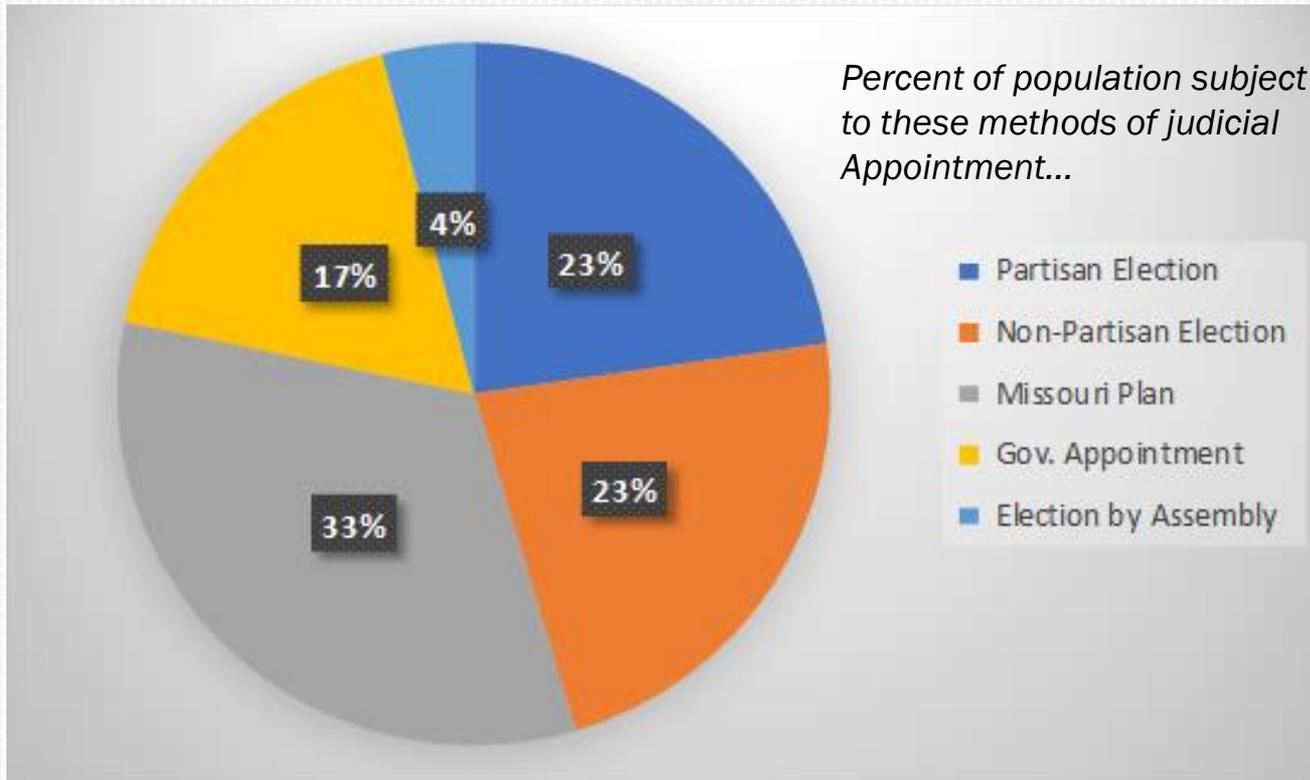
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THE JUDICIARY – ANOTHER FEDERAL ELECTION LOOMS!

- ◆ **The outcome of federal elections matters over time...but not to the degree commonly expected**
 - **State courts matter more to insurers than federal courts**
 - **Federal judges are appointed for a lifetime, but remember many appointments will be from the same political party**
 - **But politics do matter at state and federal levels...worthwhile underwriting/actuarial consideration in liability lines**

JUDICIAL APPOINTMENTS AT STATE LEVEL



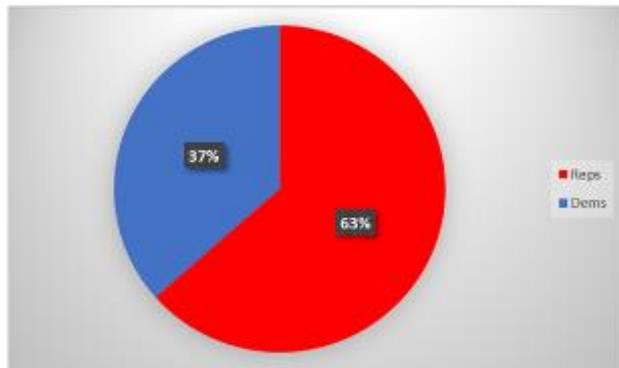
Politics do matter and warrant consideration. Most state judges serve for 6-10+ years so tide does not immediately change with political winds

Sources: uscourts.gov, S&P Global (population), Assured Research

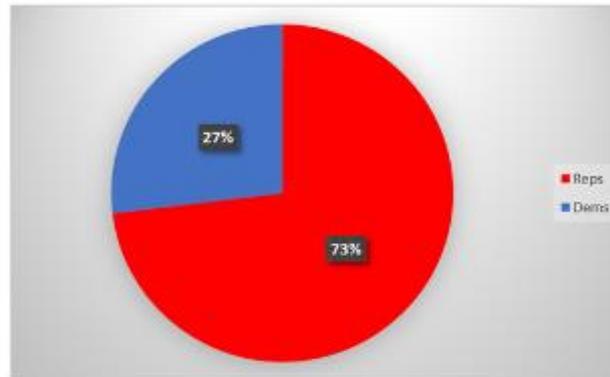
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FEDERAL COURTS MATTER...BUT

Approx. party split of vacancies filled during Trump Admin.



Current federal vacancies outstanding



The Trump administration has filled about 25% of the approx. 900 federal judicial seats

The current administration has had a material impact on federal courts. But remember that many appointments are from the same political party

Sources: uscourts.gov, State websites, Assured Research

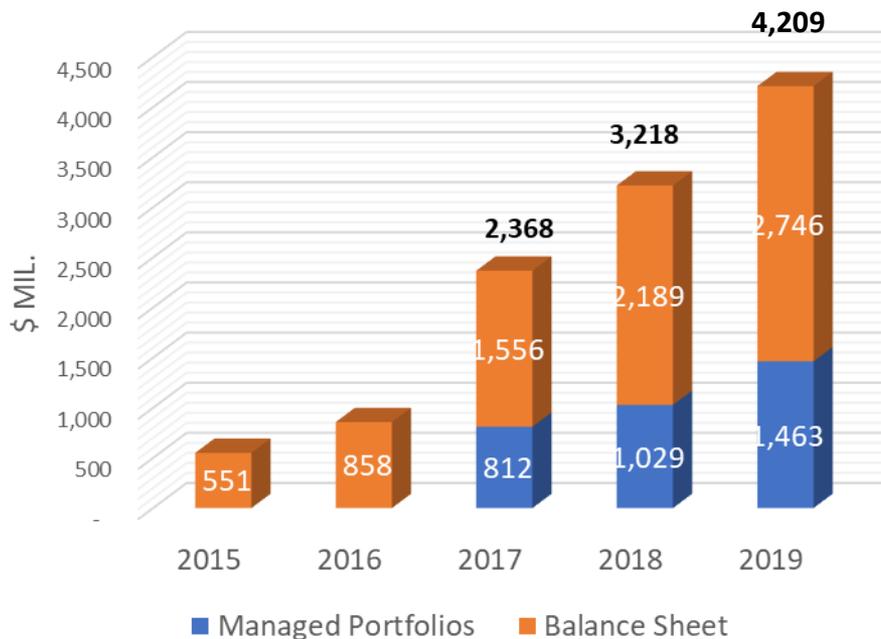
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3RD PARTY LITIGATION FINANCE: CHANGING THE ECONOMICS OF THE LEGAL PROFESSION

Burford Capital Investment Portfolio (CAGR=66%)



We expect the litigation funding business to benefit from the pandemic-- more legal activity and depressed economics for law firms and plaintiffs.

Source: Burford Capital Annual Report, Assured Research

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DECONSTRUCTING LITIGATION FINANCE – 3 ELEMENTS

1. Commercial Litigation Finance

- Esoteric B2B litigation; some involvement in mass torts



Not us!

2. Consumer Litigation Finance

- Involved in 'regular torts' like auto, premises liability, professional liability, etc.
- But amounts advanced are small (~\$4,000) and used for daily living



Not us!

3. Specialty Finance Firms

- Specialty finance firms providing capital to personal injury firms
- Video Clip – [Advocate Capital Inc.](#) View this for insight into the 3rd element of Litigation Finance



If not them, who?

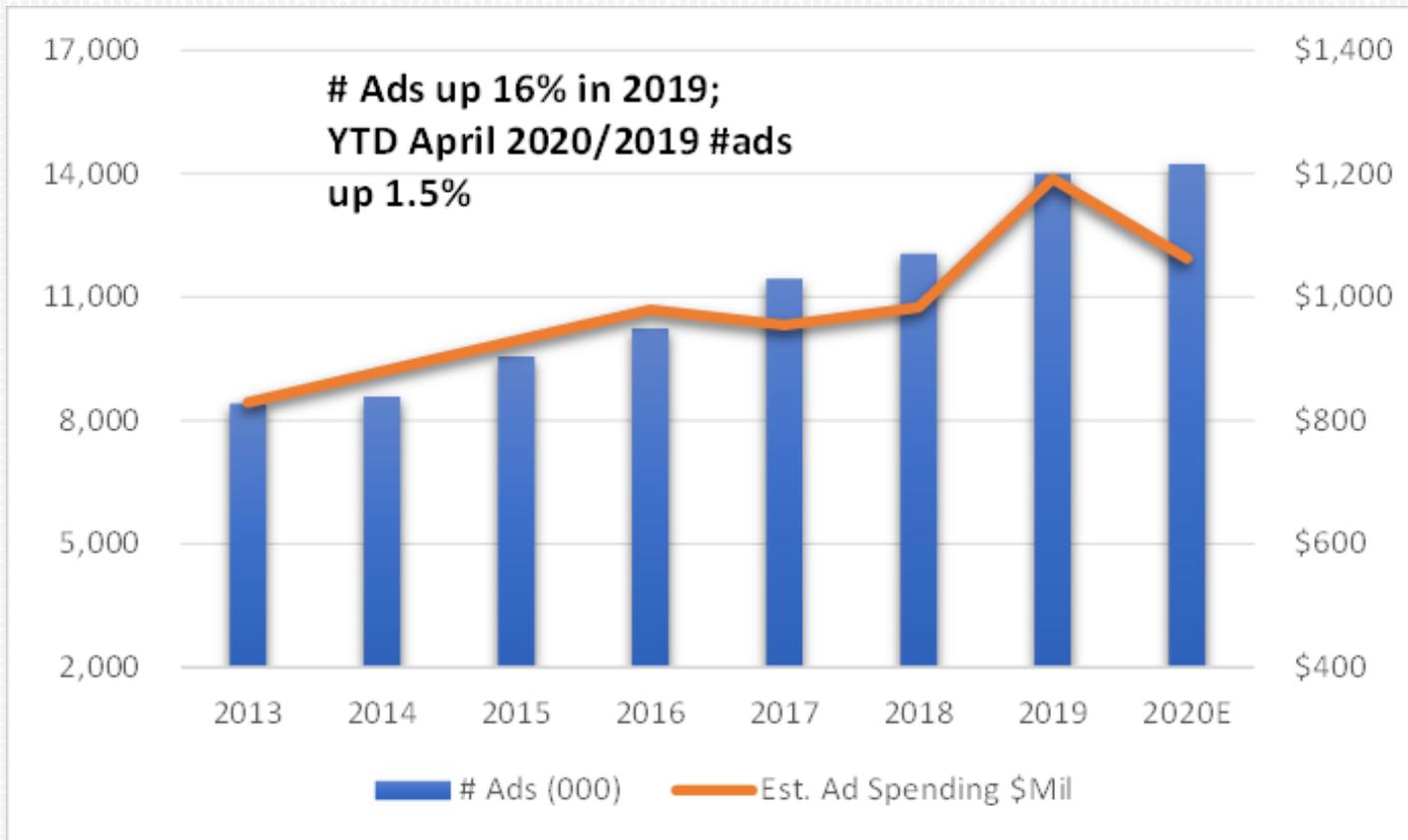
SPECIALTY FINANCE FIRMS ARE “GAME CHANGERS”

“We are a game changer for contingency fee law firms. We help them give them the confidence to be able to go into negotiations and reject low settlement offers.”

Advocate Capital (and peers) are specialty finance firms that provide ‘working capital’ to contingency fee law firms

Tina Burns, VP of Advocate Capital, Inc. speaking on a promotional video found at their website.

SOCIAL INFLATION – LEGAL ADVERTISING IN U.S.



Some of that working capital being used to fuel the rise in legal advertising

Source: X Ante analysis utilizing data provided by Kantar Media CMAG, Assured Research. Data through April 30th annualized by Assured Research

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INEQUALITY – THINK IT MATTERS?

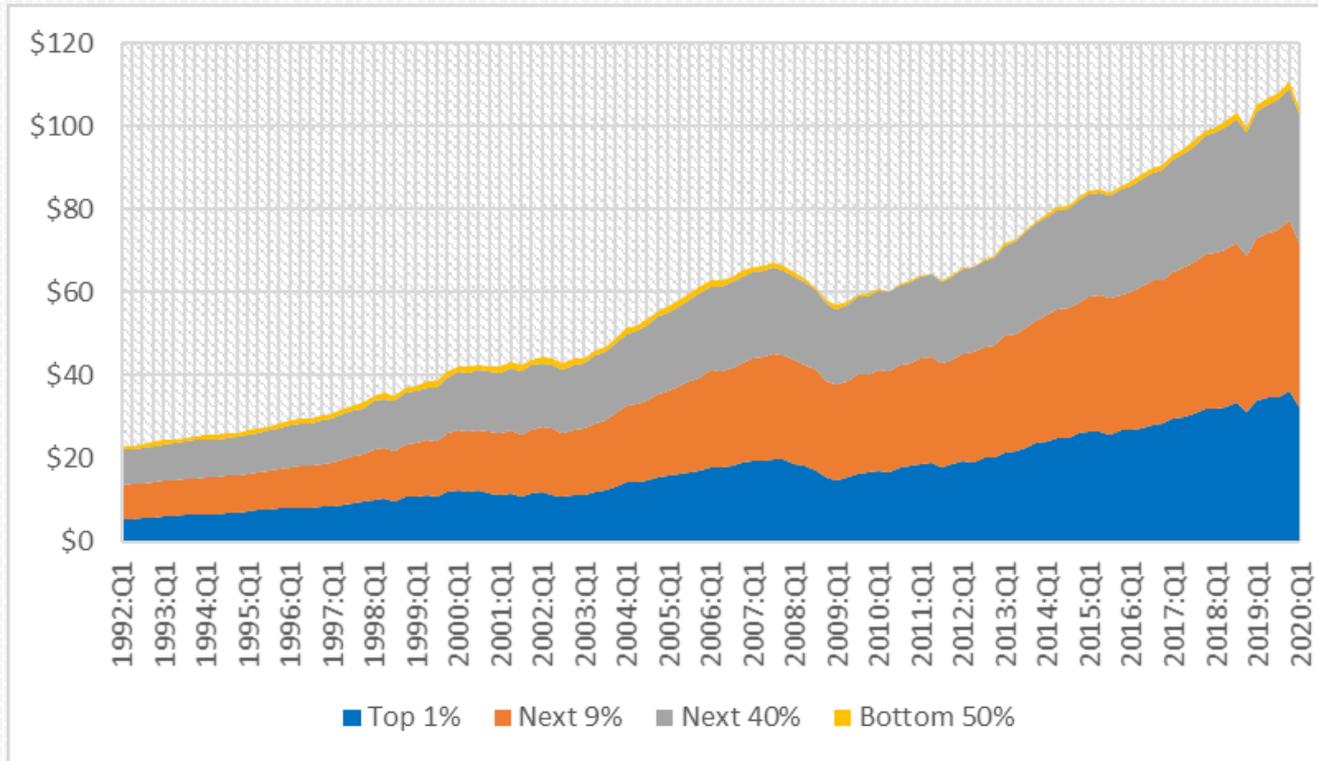
In the years that followed [the financial crisis of 2008], the market bounced back and progressed through its longest expansion in history.

Meanwhile employment rates and hourly wages remained stagnant. As the middle class shrank, we heard jurors talk more and more about the “Two Americas...One for the elite and one for the rest of us.”

We continued to observe the trend away from juror concerns over the harms of frivolous lawsuits and toward the threats of corrupt executives and unbridled corporate influence and power. The culture eventually shifted so strongly that large corporations were being demonized as a group, with each being treated as guilty unless proven innocent. Verdicts became nuclear because anti-corporate beliefs had become the norm, and the pervasive loss of trust was being reflected in the deliberation room.

Excerpt from The Impact of the COVID-19 Crisis on Social Inflation by Boesen Litigation Consulting. Contact us for an introduction.

WEALTH INEQUALITY: HOUSEHOLD NET WORTH

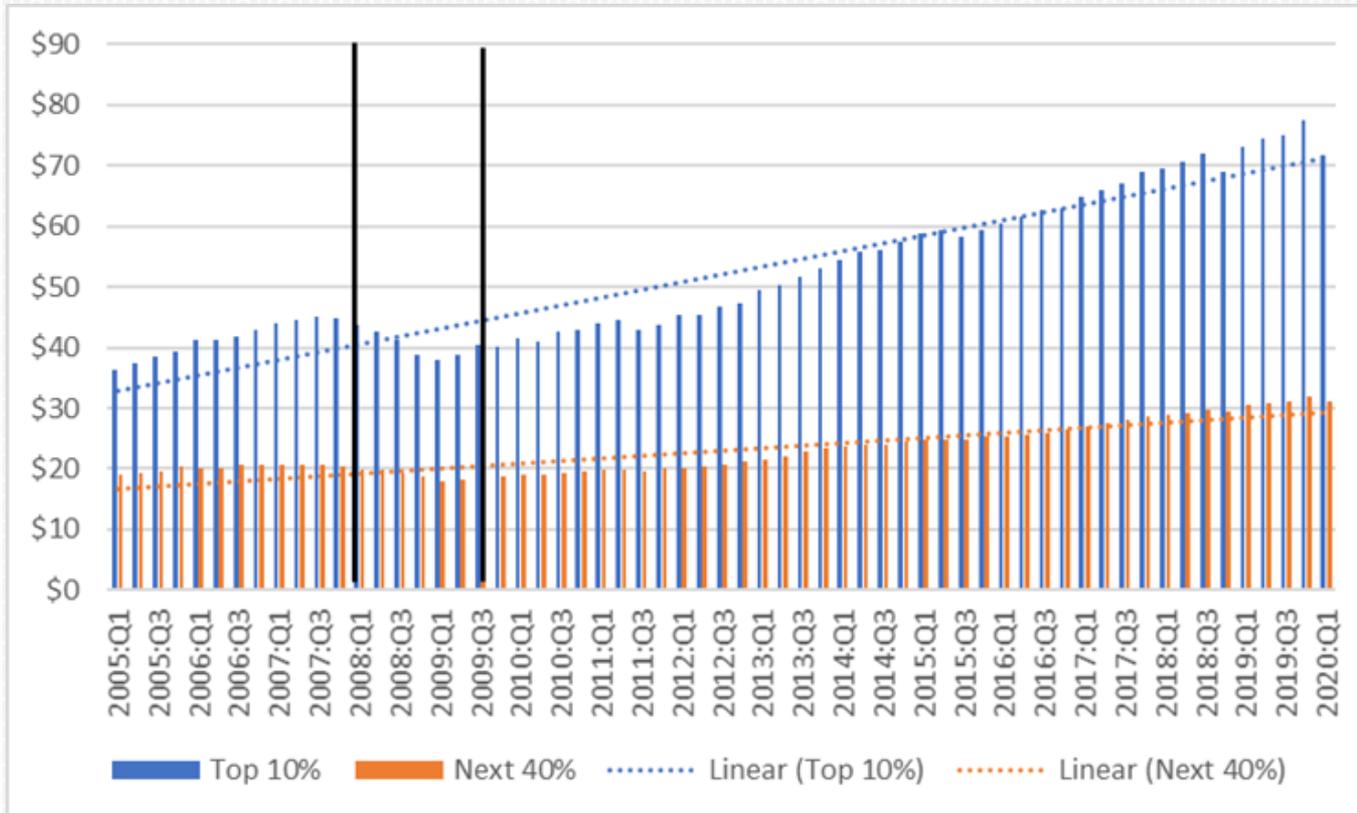


Wealth inequality has been growing for decades. Notice that the 'bottom 50%' barely appear on this chart of household net worth

Sources: Federal Reserve, Assured Research

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WEALTH INEQUALITY: HOUSEHOLD NET WORTH



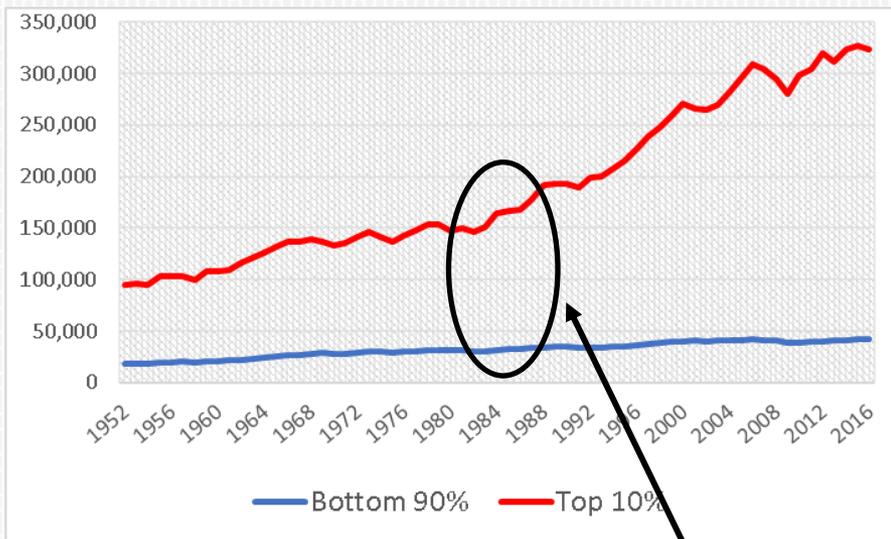
HNW of top 10% has grown at 5% per annum vs. 2% for the 'next 40%'.

Sources: Federal Reserve, Assured Research; vertical bars approximate the Financial Recession

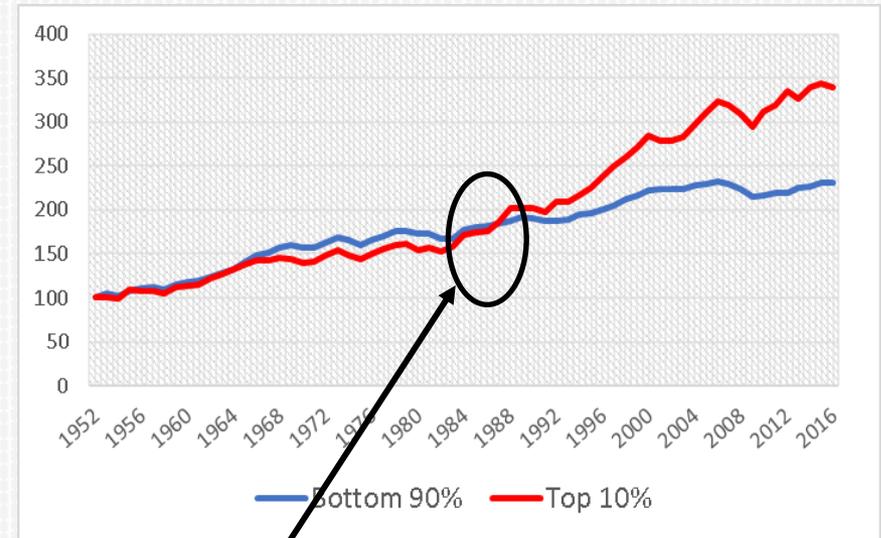
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INEQUALITY: INCOME DIVERGENCE BEGAN MID 1980S

Income levels: Top 10% vs remaining 90%



Same data: Index basis



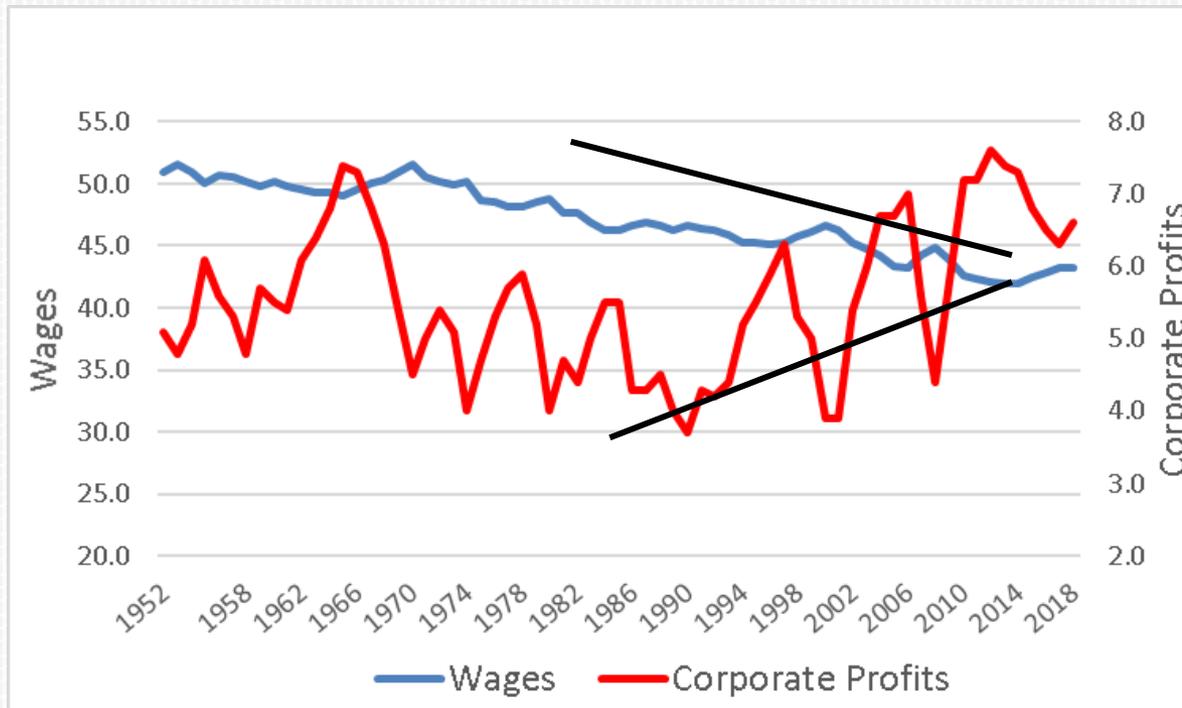
inflection point in mid-1980s

Source: *Distributional National Accounts: Methods and Estimates for the United States*, Picketty, Saez, Zucman.

Data available at: <http://Gabriel-Zucman.eu/usdina/>, Assured Research

INEQUALITY: CORPORATIONS KEEPING MORE PROFITS

Wages and corporate profits as a % of national income



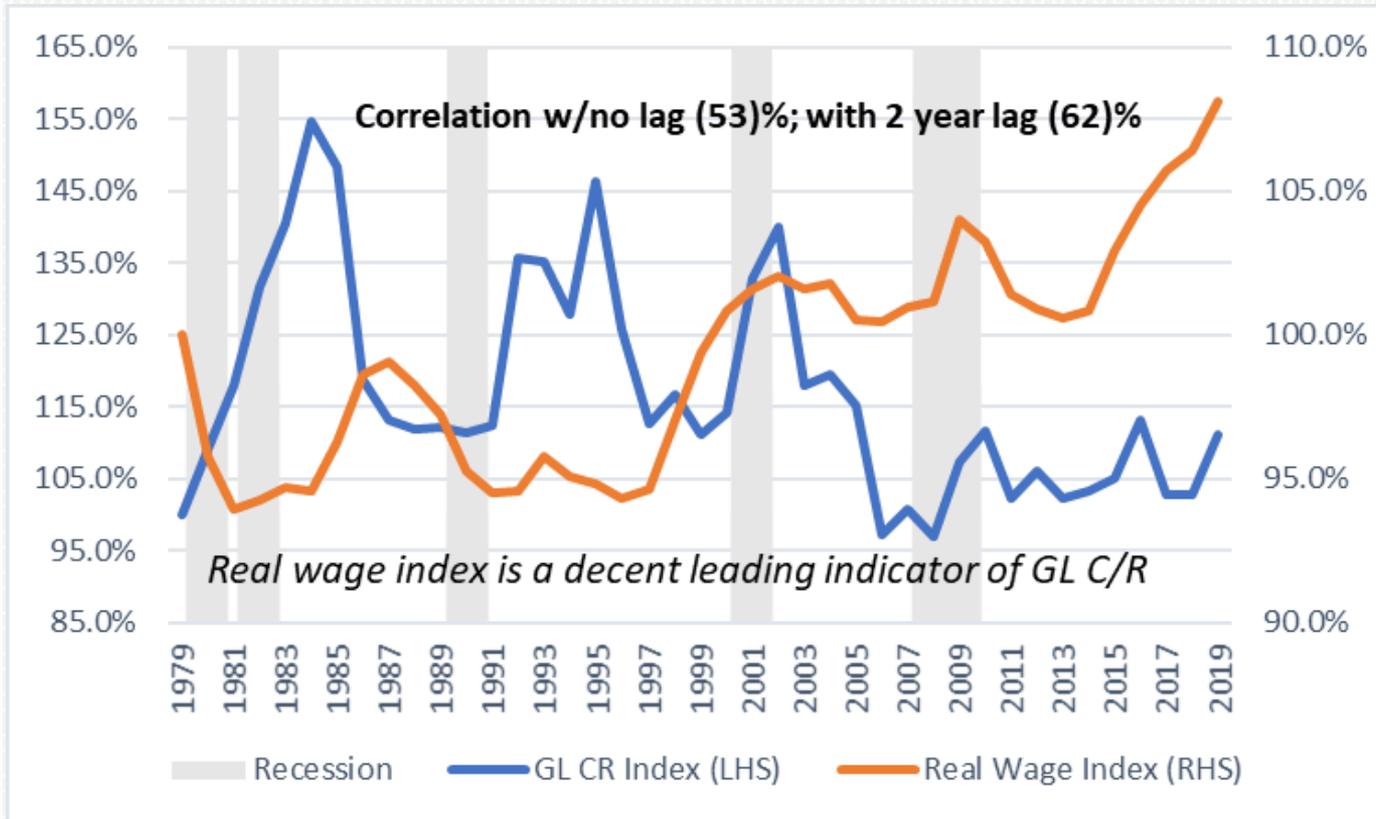
Think these trends don't fuel anti-corporate sentiment? About 55% of Americans own stocks, down from 62% before the financial crisis.

AZ

Sources: Federal Reserve Bank of St. Louis (FRED), Assured Research. Gallup Poll (stock ownership)

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INEQUALITY: MAYBE REAL WAGES ARE AN INDICATOR?



Real wage index will not look good in 2020. Does that foreshadow a rising liability combined ratio?

Sources: Federal Reserve, St. Louis Fed (FRED), Assured Research

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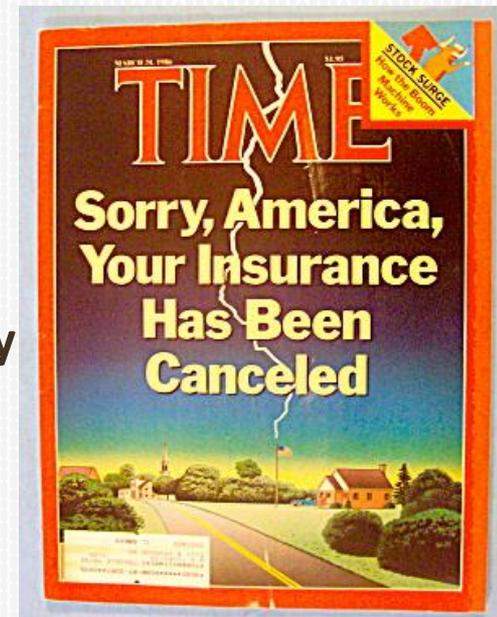
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TORT REFORM STOPPED SOCIAL INFLATION IN THE '80S

- ◆ 39 states passed reform measures between 1985 and 1990 in response to difficult tort environment and public pressure. Time Cover March 1986
- ◆ Those reforms reduced the number of lawsuits and stopped the growth of P/C insurance losses.

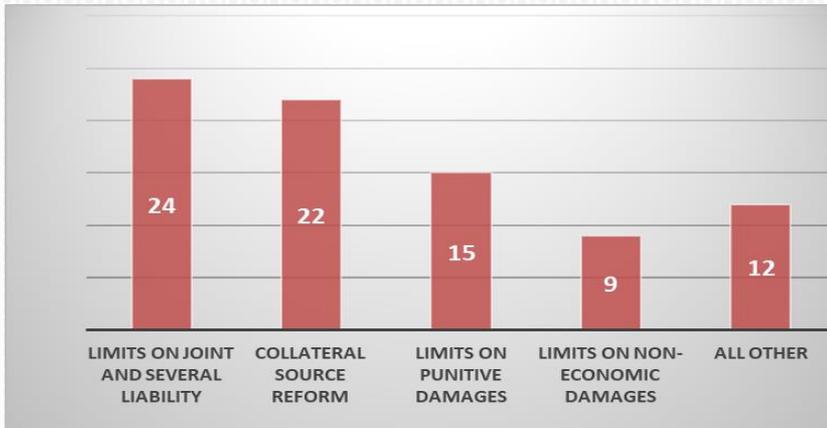
BUT WE DON'T EXPECT THAT NOW!

1. Industry losses aren't *that* bad!
2. The 'hellhole' states are not suffering economically
3. There is no political will for a tort reform fight

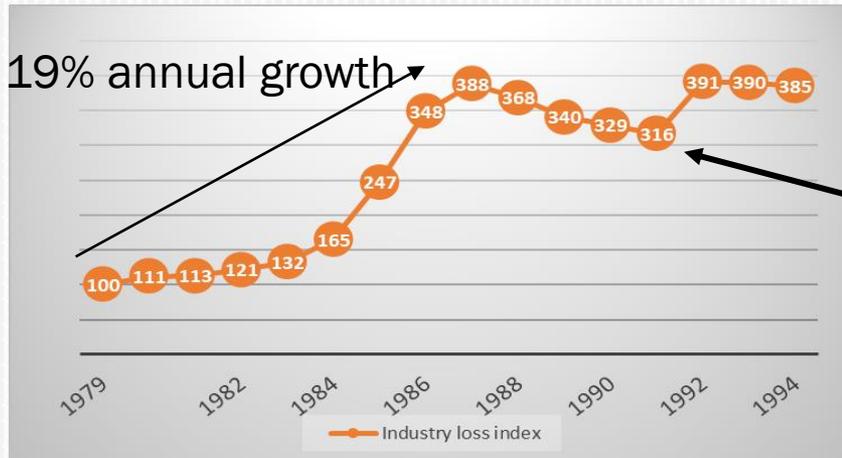


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TORT REFORM STOPPED SOCIAL INFLATION IN THE '80S



39 states passed 82 tort reform measures between 1985 and 1990...



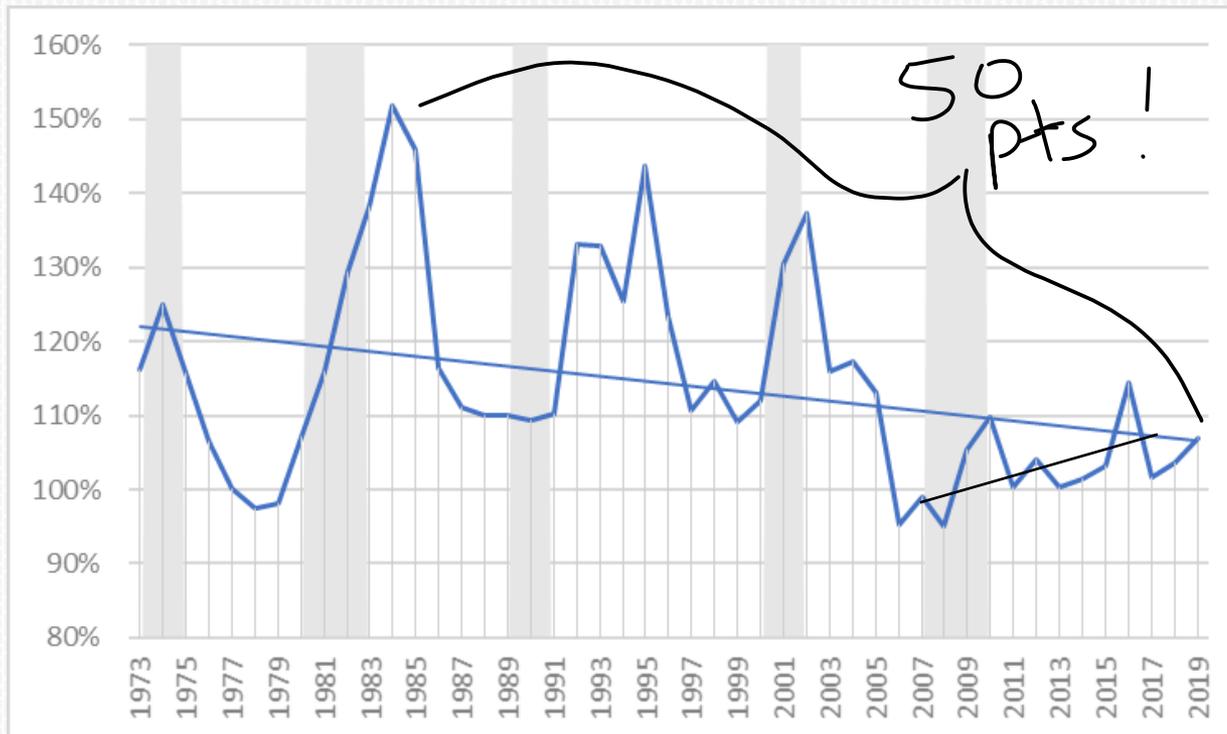
...and that stopped the growth of industry losses

Sources: American Tort Reform Association, A.M. Best, Assured Research

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INDUSTRY LOSSES TODAY ARE NOT *THAT* BAD

Liability Combined Ratio since 1973



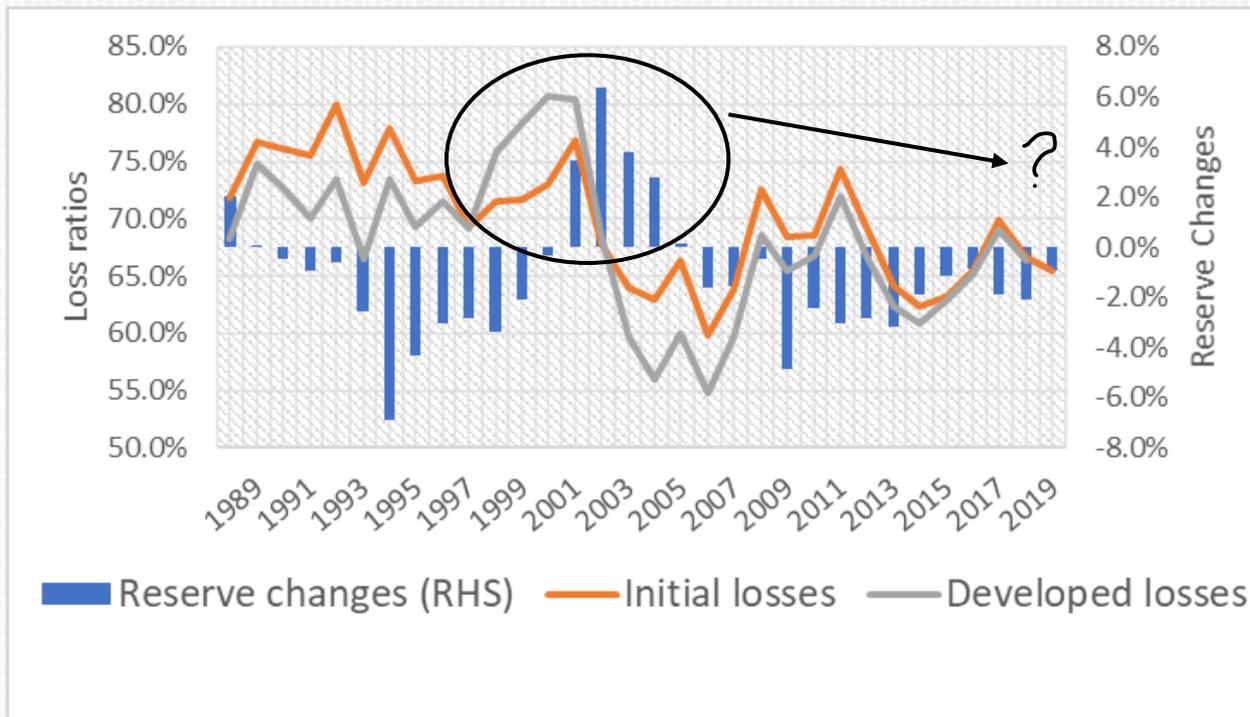
An upward trend since ~2007 warrants correction; different order-of-magnitude from mid 1980s

Source: A. M. Best, S&P Global, Assured Research

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INDUSTRY LOSSES TODAY ARE NOT *THAT* BAD

Loss Ratio vs. Reserve Development 1989-2019



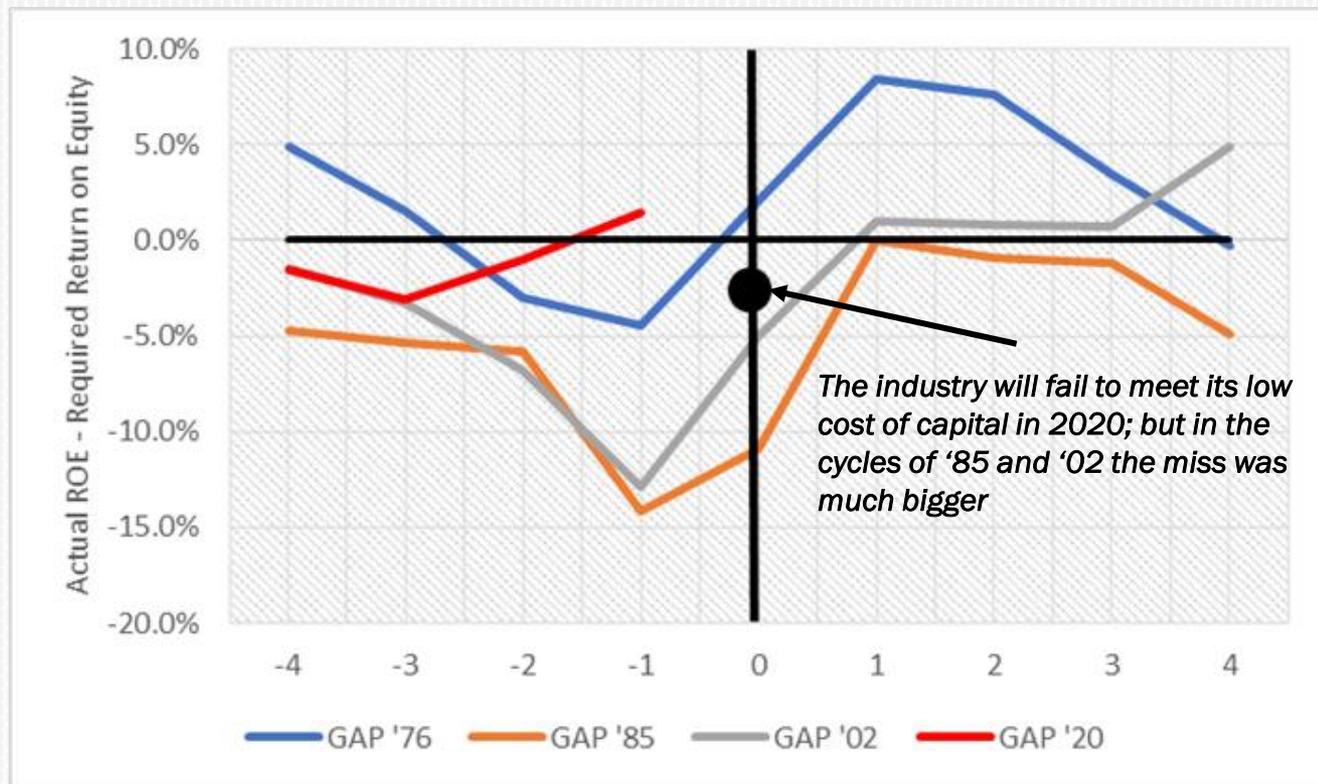
We forecast a reserve deficiency at YE2019, but losses would have to explode to deteriorate at rate like the late 1990s

Source: A. M. Best, S&P Global, Assured Research

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INDUSTRY LOSSES TODAY ARE NOT *THAT* BAD

GAP refers to difference between actual and required ROE in years preceding the peak of past HARD markets

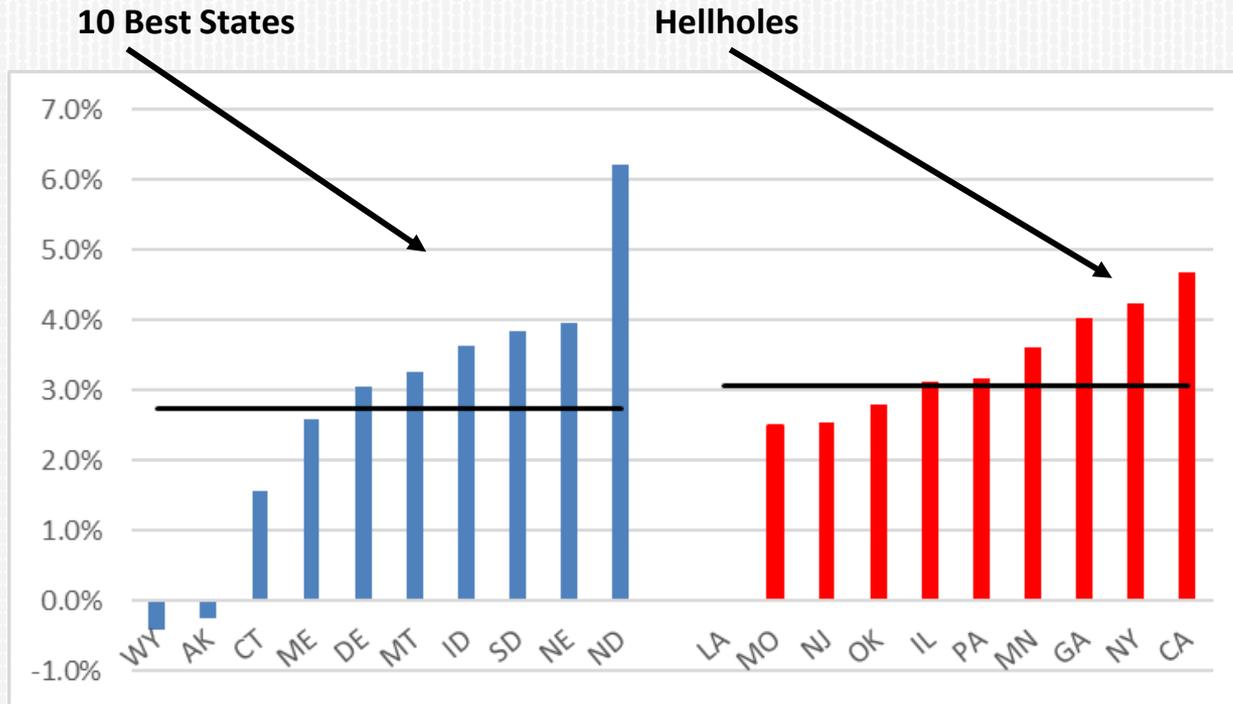


Even allowing for a \$30 bil. U.S. loss from Covid-19, the industry ROE in 2020 might be about 2.5% to Cost of capital at ~5%; Gap of 2.5%

Source: A. M. Best, S&P Global, Assured Research

ECONOMY IN HELLHOLE STATE NOT SUFFERING FROM LITIGATION

State Legal Environment vs. 10-yr GDP Growth



States with difficult legal environments were growing faster than "best" states: 3.1% vs 2.7%. Much to be sorted post Covid...

Source: Institute for Legal Reform (State rankings), American Tort Reform Association (Hellholes), Bureau of Economic Analysis w/ data through 2019 (GDP), Assured Research

SOCIAL INFLATION AND COVID-19 LITIGATION

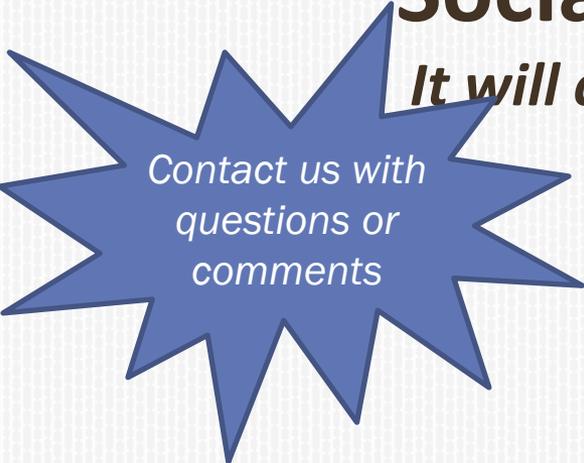
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SOCIAL INFLATION IS ALIVE AND WELL!

- The political cycle during 2020 is likely to extend (and maybe exacerbate) the social divisiveness in the U.S. that seems both simultaneously symptom and contributing cause to social inflation.
- Even if Covid-specific litigation is curtailed through federal/state grants of immunity, litigation usually spikes following recessions and, combined with the widening wealth and income inequalities, we expect it will have legs at least into 2021.
- We don't see a groundswell of support for major tort reform (esp. if federal legal immunity re: Covid is granted). **Best course of action for P/C insurers may be to U/W, price and reserve for continued high loss trends. As that cost works its way into retail prices; perhaps then a catalyst for change.**

Social Inflation is Alive and Well

It will conflate with the pandemic – Covflation!



Contact us with
questions or
comments

Midwest Actuarial Forum

October 1, 2020



Thank you!