



# Social Inflation

Overview

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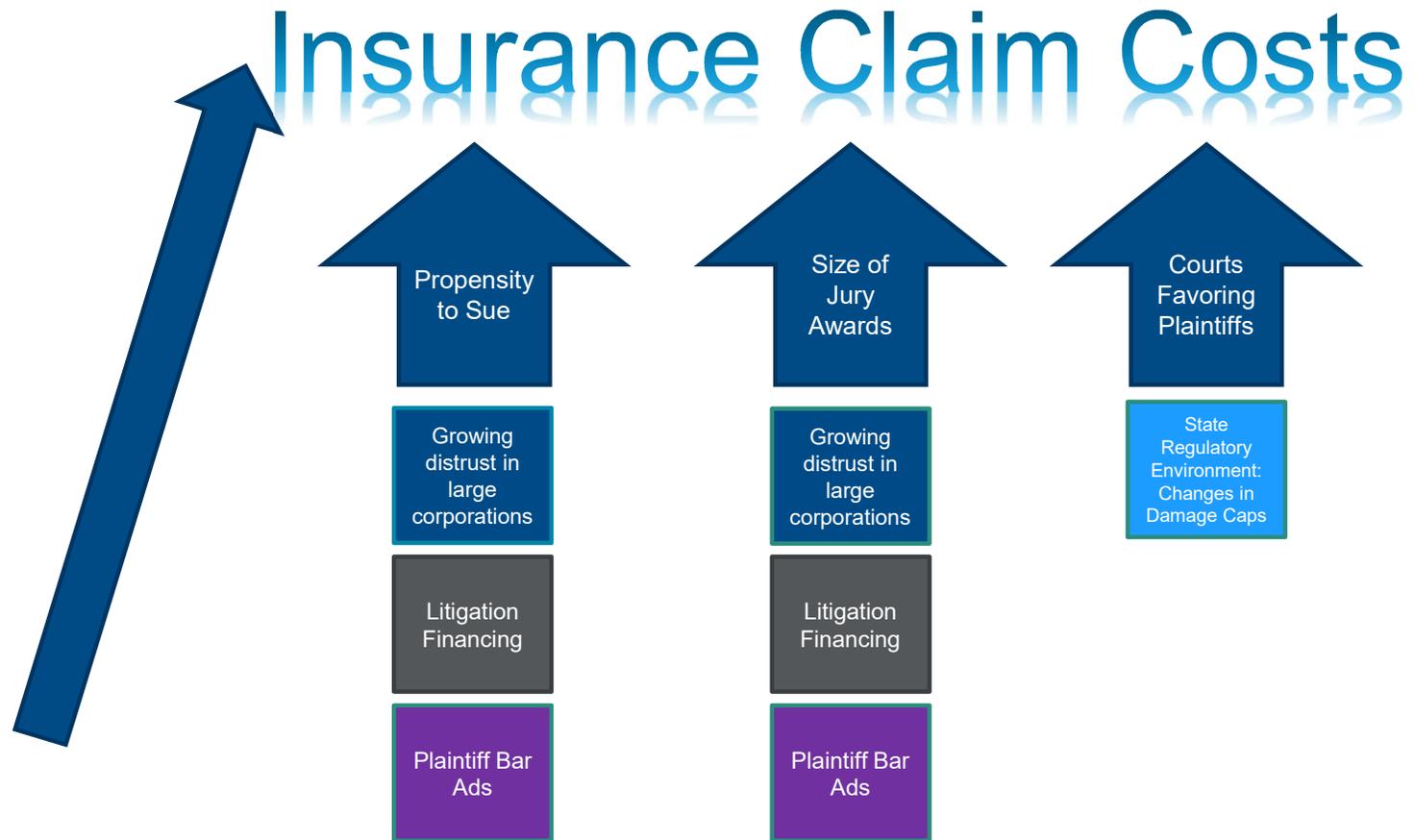
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## Agenda - Overview

- Trying to define "Social Inflation"
- What trends are potentially related to social inflation?
- What about the pandemic?



## Trying to Define Social Inflation





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## Some Trends Potentially Related to Social Inflation

- State Regulatory Environments
- Legal Advertising
- Litigation Financing
- Jury Awards



## State Regulatory Environments

Erosion of  
Some Tort  
Reform in  
Some States

- State court decisions strike down, in part, **noneconomic damage caps** (e.g. pain and suffering) for medical malpractice cases in some states, for example:
  - Georgia (2010), Florida (2017)
- State court decisions strike down, in part, **punitive damages reforms** in some states, for example: \*\*
  - Georgia (1990), Virginia (1992), Oregon (1998), Utah (2005), Missouri (2014)

States Following  
Champertous  
Doctrines May  
Hinder Some  
Litigation Funding  
Arrangements

Some states that may follow champertous doctrines include: Alabama, Delaware, Georgia, Minnesota, Mississippi, New York and Pennsylvania \*\*\*

\*<https://www.law.com/dailyreportonline/2020/05/11/tort-reform-capping-nuclear-insurance-verdicts-stymied-by-covid-19/>

\*\* <https://www.atra.org/issue/punitive-damages/>

\*\*\* <https://www.mondaq.com/unitedstates/patent/774162/a-strategic-look-at-champerty-and-third-party-litigation-financing?>



## Legal Advertising

Over \$1 billion  
spent on  
advertising in  
2017

Example top firm spent about  
45% on TV/45% on internet  
/10% social media

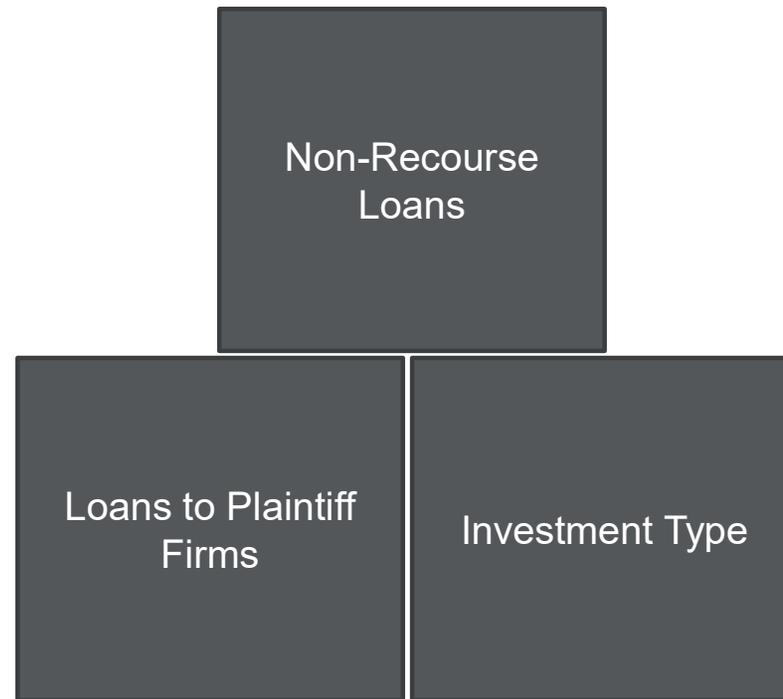
A 2015 study: top Google  
paid search terms were  
mostly purchased by lawyers  
focused on personal injury  
and mass tort.

[http://www.abajournal.com/magazine/article/legal\\_advertising\\_viral\\_video](http://www.abajournal.com/magazine/article/legal_advertising_viral_video)



## What is Litigation Financing?

According to an American Bar Association guide, litigation financing generally means a transaction in which a third party who is not party to a legal claim chooses to provide capital to a party in a legal claim or its counsel in exchange for a financial interest in the outcome of the legal claim if it is successful. Both defendant and plaintiff sides can reportedly be funded in this manner.



[https://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2015\\_spring\\_leadership\\_meeting/guide\\_to\\_litigation\\_financing\\_may\\_2014\\_charles\\_agee.authcheckdam.pdf](https://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2015_spring_leadership_meeting/guide_to_litigation_financing_may_2014_charles_agee.authcheckdam.pdf)



## Trends in Jury Awards

- Societal trends may reportedly affect how juries decide.
- For example, a 2019 Law.com [article](#) discusses, in part, how a jury's attitude towards large corporations may be the reason for the increase in awards in civil cases against corporations. Per the article, it may be that "jurors are increasingly familiar with corporate wrongdoing. When it comes to punitive damages, the idea is to punish a corporation and deter it from future wrongdoing..."
- A 2019 [article](#) in the *Wall Street Journal* reported "a more than 300% rise in the frequency of verdicts \$20 million or over in 2019 from the annual average from 2001 to 2010."
- A 2019 [article](#) in the *Financial Times* reported the "median cost of the top 50 [single plaintiff] bodily injury [verdicts] in the US rose from around \$28m in 2014 to just over \$54m [in 2018]."

Growing distrust in large corporations

Use of So – called "Reptile Theory" By Plaintiff's Counsel

<https://www.law.com/2019/10/17/jurors-want-to-punish-why-a-jury-verdict-goes-nuclear/>

<https://www.wsj.com/articles/the-specter-of-social-inflation-haunts-insurers-11577442780>

<https://www.ft.com/content/5fb9aef8-07fb-11ea-a984-fbbacad9e7dd>

"The Age of Reptiles" <https://www.lexology.com/library/detail.aspx?g=b640404b-c8b7-4ef8-852e-9c693ec70431>



## Social Inflation and the Pandemic

- Potential impact of social inflation trends on litigation activity related to the pandemic
- Potential impact of pandemic-related changes on social inflation trends



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# Credit Ratings and Social Inflation

**Greg Dickerson – Associate Director**

**Chris Draghi – Sr. Financial Analyst**

**CAS Annual Conference**

**November 12<sup>th</sup>, 2020**

# Agenda

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- Introduction
- What are Ratings?
- Social Inflation and Ratings
- Personal Lines (Florida Property)
- Commercial Lines (Impacted Lines)
- Q&A

# Introduction to AM Best



# AM Best Overview

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**Established in 1899**

**Only Global Insurance Focused Rating Agency**

- Office Locations: Oldwick, London, Hong Kong, Singapore, Dubai (rep office), Mexico City, Amsterdam
- Rating over 3,600 insurance companies worldwide, over 800 outside the U.S. in over 95 countries
- Cover 16,000 insurance companies globally through a wide range of analytical resources, references, directories and periodicals

**Over 600 Employees Focused on Insurance**

- 135 analysts averaging 6 years tenure and 17 years industry experience
- Skills and designations: CPA, CFA, MBA/MS/MA, CAS/SOA, Ph.D.

# Market Coverage

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- **Property/Casualty (non-life)**
- **Life and Annuity**
- **Health**
- **Reinsurance**
- **Mutual Insurers and Protection & Indemnity (P&I) Clubs**
- **Surety Companies**
- **Title Insurance**
- **Takaful, Retakaful and Co-operative Insurers**

- **Start-up Reinsurers**
- **Lloyd's and Its Syndicates**
- **Alternative Risk Transfer (ART) Vehicles – Captives, Pools and Risk Retention Groups**
- **Debt**
  - **Corporate Debt**
  - **Preferred Stock and Hybrid Securities**
  - **Commercial Paper**
  - **Insurance-based Liability or Asset-backed Securitizations**
  - **Closed-block Monetizations**

# What Are Ratings?

## AM Best Credit Ratings

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- Best's Issuer Credit Rating (ICR)
  - An independent opinion of an entity's ability to meet its ongoing financial obligations and can be issued on either a long or short-term basis
    - A long-term ICR is an opinion of an entity's ability to meet its ongoing senior financial obligations
    - A short-term ICR is an opinion of an entity's ability to meet its ongoing financial obligations with original maturities generally less than one year
- Best's Financial Strength Rating (FSR)
  - An independent opinion of an insurer's financial strength and ability to meet its on-going insurance policy and contract obligations

# FSR & ICR Equivalents

FSR	ICR
A++	aaa aa+
A+	aa aa-
A	a+ a
A-	a-
B++	bbb+ bbb
B+	bbb-

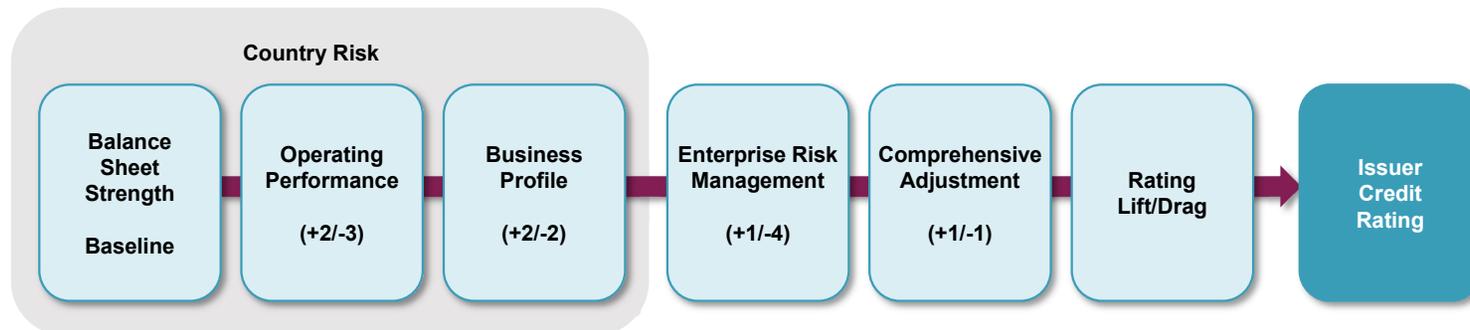
FSR	ICR
B	bb+ bb
B-	bb-
C++	b+ b
C+	b-
C	ccc+ ccc
C-	ccc- cc

# Social Inflation and Ratings



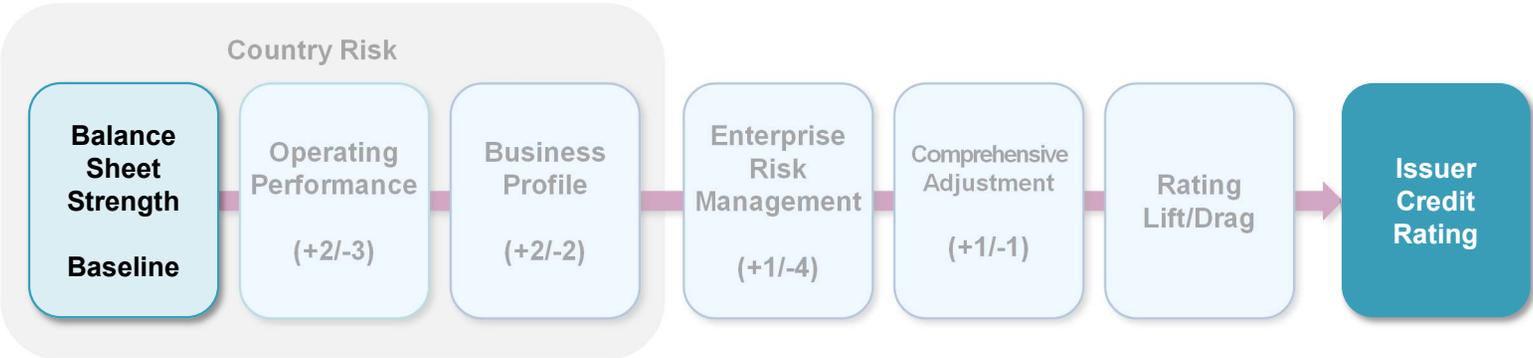
## AM Best's Rating Process

- AM Best's interactive rating process is intended to provide an opinion of a company's ability to meet its ongoing obligations to policyholders.
- The building blocks of AM Best's ratings process are outlined below



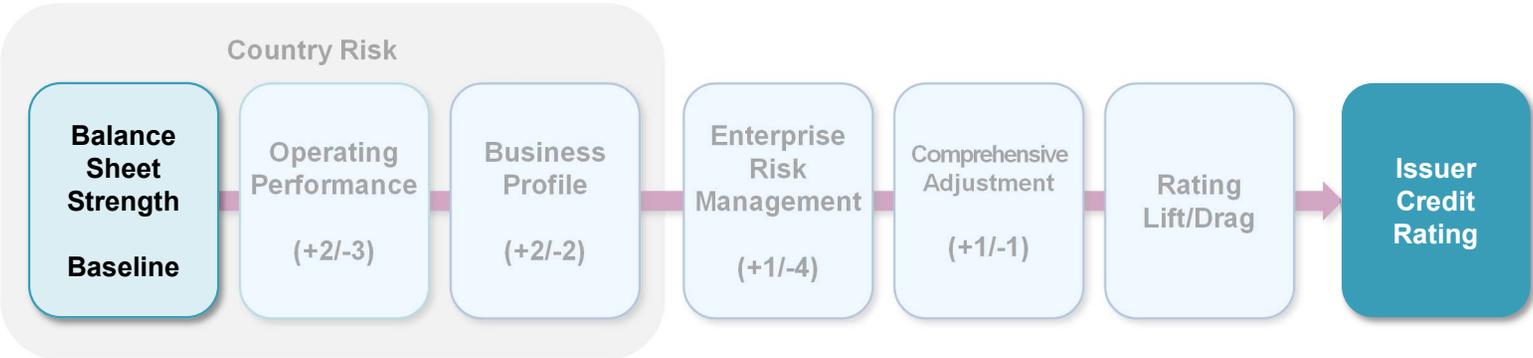
- Evaluation of a insurance company's financial strength is based on an in-depth analysis of its balance sheet strength – including capital adequacy and claims-paying resources – along with a review of its operating performance, business profile, and ERM

# BCRM Building Blocks – Balance Sheet Strength



Balance Sheet Strength Components	
• BCAR	• Quality of Capital
• Stress Tests	• Quality of Reinsurance
• Liquidity	• Reinsurance Dependence
• Asset Liability Management	• Appropriateness of Reinsurance Program
• Internal Capital Models	• Financial Flexibility

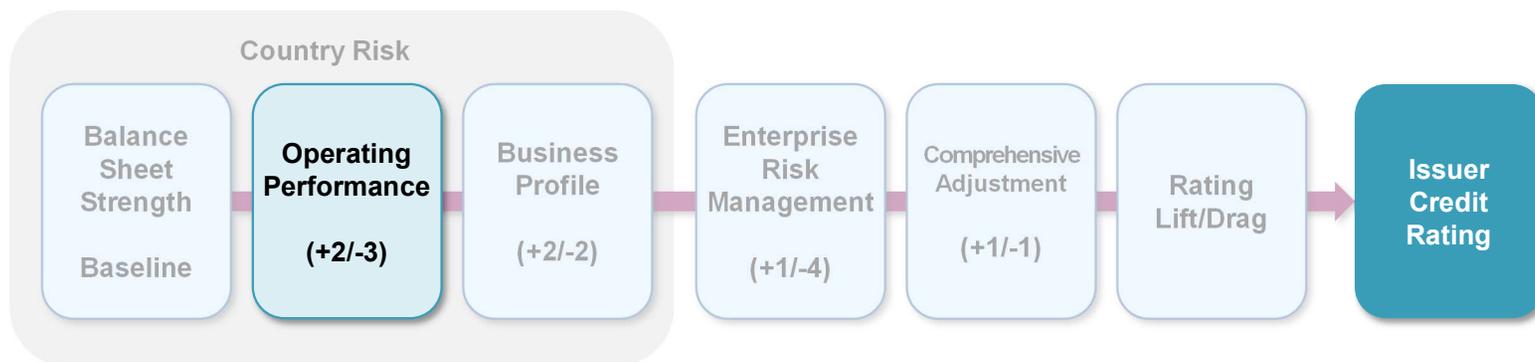
# Social Inflation & Balance Sheet Strength



### Balance Sheet Strength Considerations

- Impact on Policyholders' Surplus
- Loss Reserve Development
- Adjustments to reserving/claims practices to account for trends

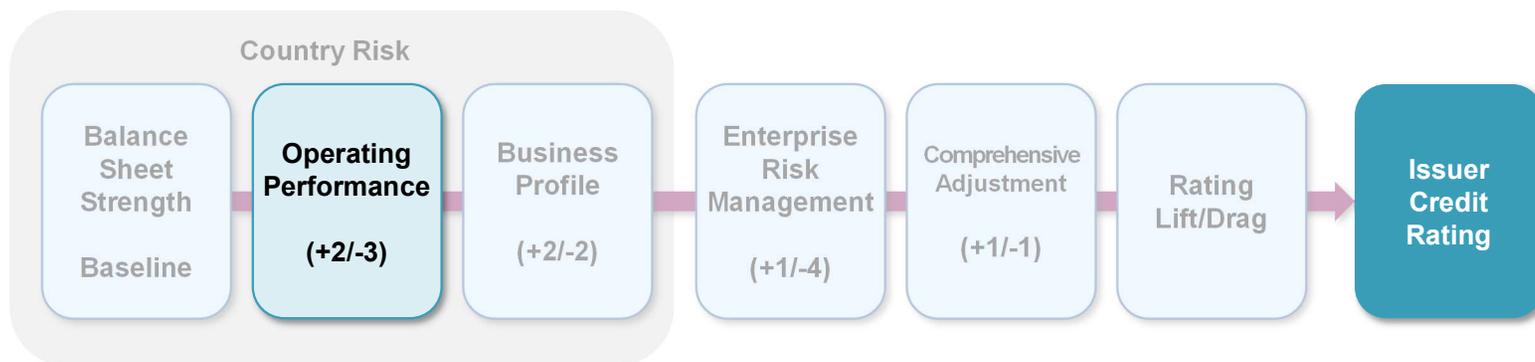
## BCRM Building Blocks – Operating Performance



### Operating Performance Components

- Change in NPW
- Change in Total Reserves
- Financial Forecasts/Plans
- Combined Ratio
- Pre-Tax Total Return
- Pre-Tax Operating ROR
- Operating ROE

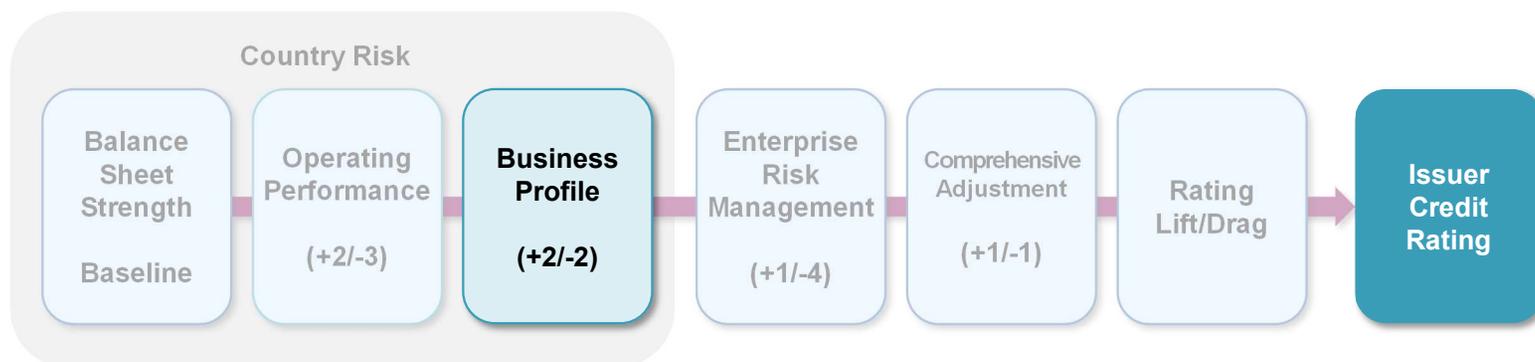
## Social Inflation & Operating Performance



### Operating Performance Considerations

- Unfavorable impact on bottom line
- Trends in frequency and severity of claims
- Shifts in underwriting guidelines to mitigate impact
- Inherent difficulty in quantifying and predicting attributable losses

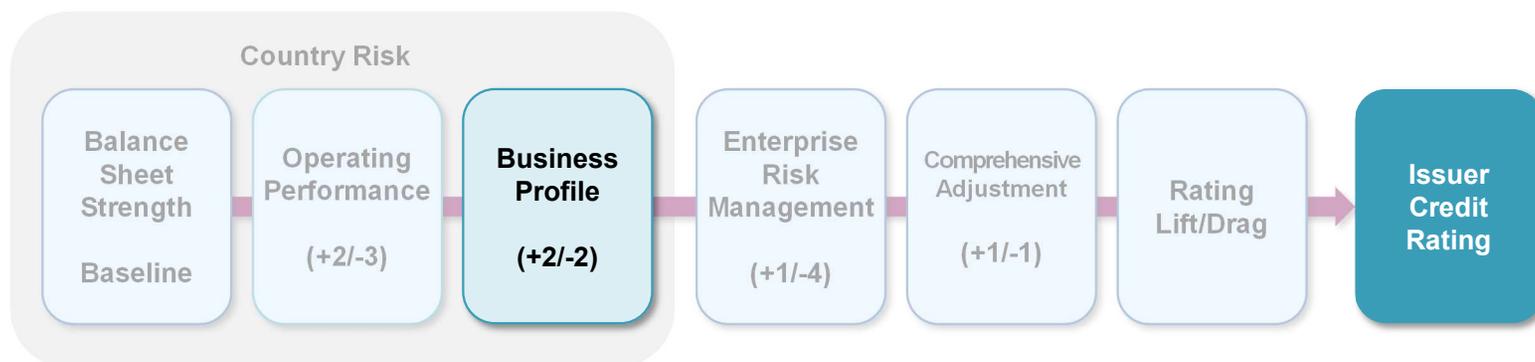
## BCRM Building Blocks – Business Profile



### Business Profile Components

- Market Position
- Pricing Sophistication & Data Quality
- Product Risk
- Degree of Competition
- Innovation
- Management Quality
- Regulatory, Event, and Country Risks
- Distribution Channels
- Product/Geographic Concentration

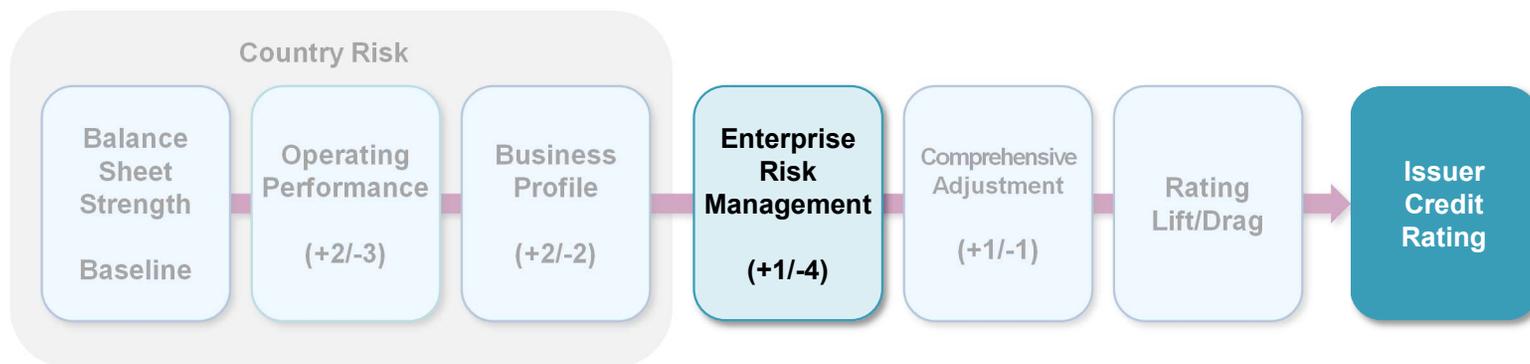
## Social Inflation & Business Profile



### Business Profile Considerations

- Influence of portfolio composition (product and geographic mix)
- Responsiveness of regulatory bodies
- Sophistication of pricing schemes

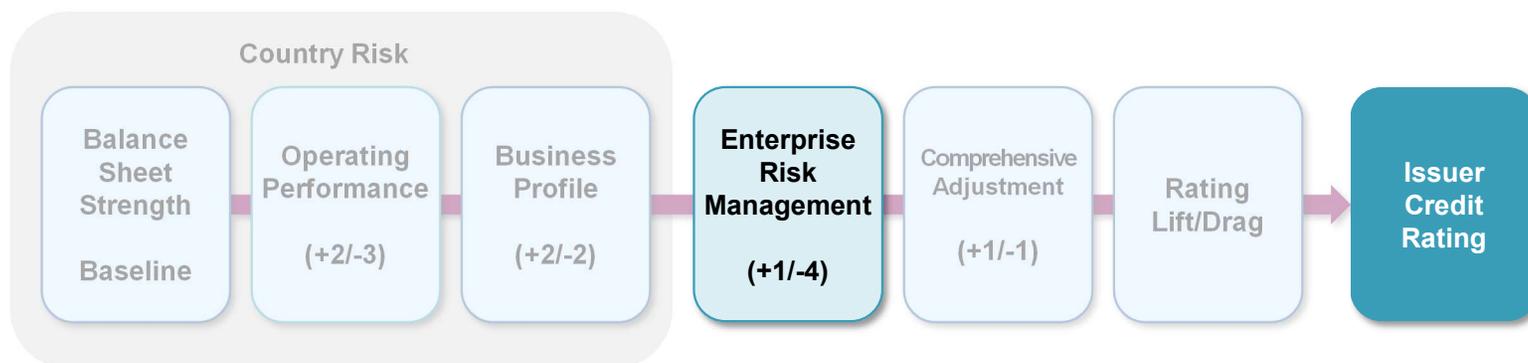
## BCRM Building Blocks – ERM



### Enterprise Risk Management Framework Components

- Risk Identification and Reporting
- Risk Management and Controls
- Risk Appetite and Tolerances
- Governance and Risk Culture
- Stress Testing

## Social Inflation & ERM



### Enterprise Risk Management Framework Components

- Efficiency in developing mitigation strategies for emerging risks
- Appetite for affected products/geographies
- Bucket likely influenced only if a company displays a systemically ineffective response to ongoing pressures

## AM Best Rating Implications

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- The complexities of social inflation vary and can, in one form or another, be considered in each building block
- When reflected in rating movement, the impact is reflected in the block that is deemed most appropriate, generally manifesting first in operating performance
- Deterioration in operating performance and loss reserve development, which subsequently challenges surplus growth
- Companies are expected to develop risk management practices for current and emerging risks

# Personal Lines (Florida Property)

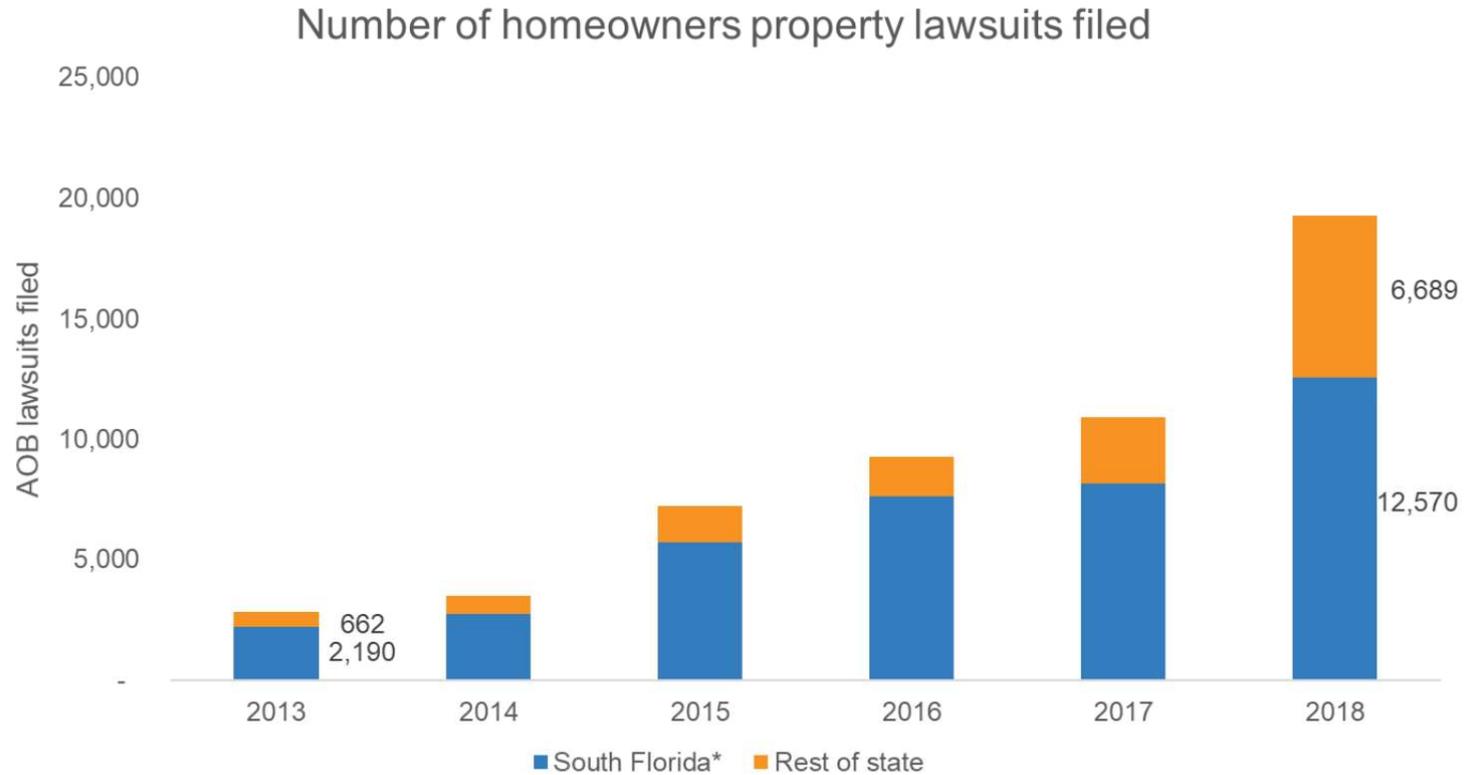


## Florida Personal Property – Brief History

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- Assignment of Benefit (AOB) issues within the homeowners line of business began to rise in 2014/2015
- Unscrupulous contractors solicited the rights afforded by an AOB and inflated repair costs, leading to disputes with insurers
- Severity of claims tried in court have been exacerbated by one-way attorney fee rule in Florida
- First party lawsuits have been problematic
- Unfavorable impact on hurricane loss development

# Assignment of Benefits (AOB)



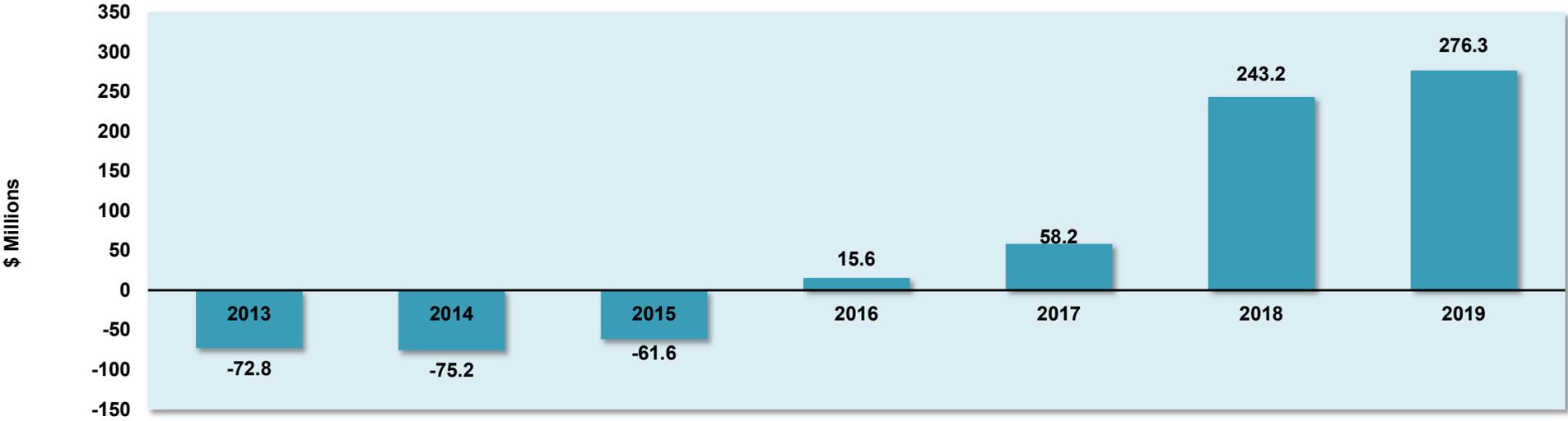
Source: Insurance Information Institute

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# Loss Reserve Development Trends

## Florida Domiciled Personal Property One-Year Loss Reserve Development



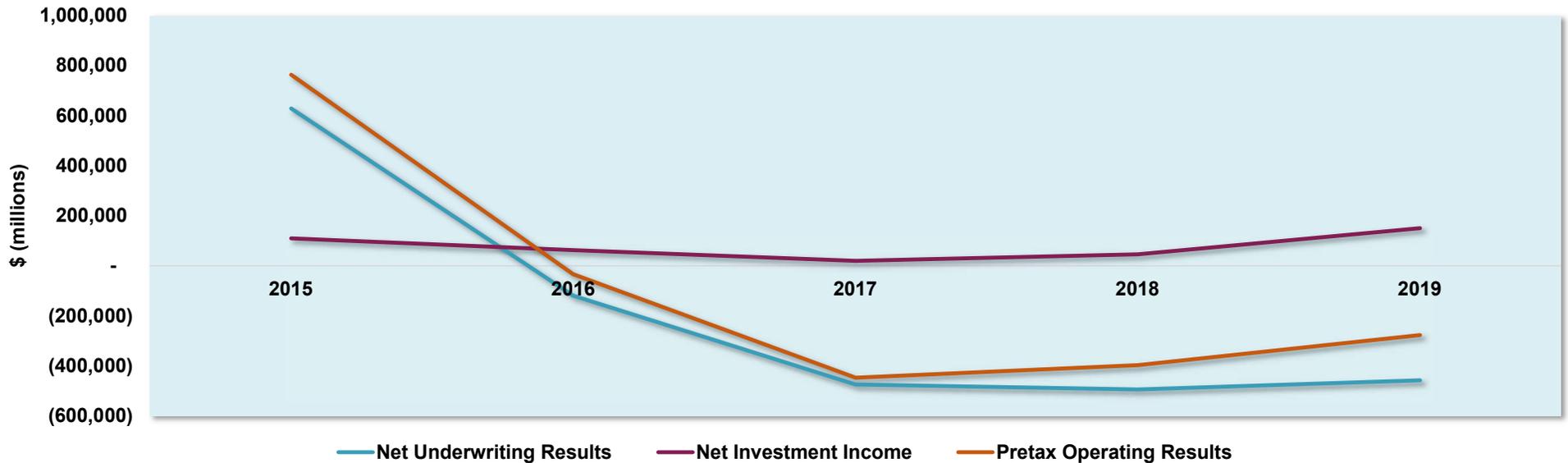
- Loss reserve development began to shift in 2015, noticeably around the same time AOB and litigation issues began to rise.

Source: AM Best data and research  
Data based on Florida Domiciled Personal Property Companies, excluding Citizens Property Insurance Corporation  
Note: While trends include the impact of social inflation, they do not wholly reflect that isolated variable



# 5 Year Operating Performance Trends

Florida Domiciled Personal Property Operating Results 2015 - 2019



- Significant decline in performance beginning in 2016 reflects catastrophes and litigation
- Modest investment income growth as companies reach for yield

Source: AM Best data and research  
 Data based on Florida Domiciled Personal Property Companies, excluding Citizens Property Insurance Corporation  
 Note: While trends include the impact of social inflation, they do not wholly reflect that isolated variable

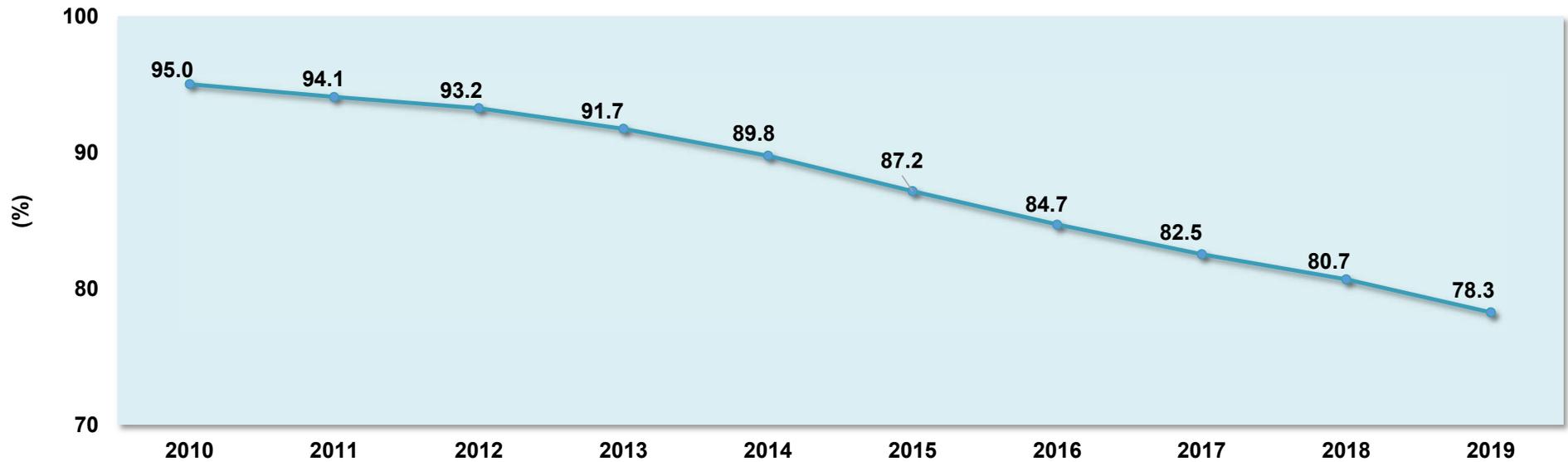
## Florida Pricing Activity

- Recent Filings
  - Capital Preferred Ins. Co. – 33.5%
  - National Specialty Ins. Co. (Velocity) – 28.1%
  - Edison Insurance Co. – 21.9%
  - Security First Insurance Ins. Co.– 12.8% for reinsurance
    - Non-renewing 5k coastal policies
  - Universal Property and Casualty Ins. Co. – 12.4%
  - People's Trust Ins. Co. – 10.9%
- Rate hearing required for anything above 15%

Note: While trends include the impact of social inflation, they do not wholly reflect that isolated variable.

# Shifting Risk Profile

Florida Domiciled Personal Property Percentage of Total Direct Premiums Written in Florida



- Declining trend in Florida premium as insurers diversify
- Appetite for Tri-County and more recently SOLO counties has contracted

Source: AM Best data and research  
Data based on Florida Domiciled Personal Property Companies  
Note: While trends include the impact of social inflation, they do not wholly reflect that isolated variable.

## Combating Social Inflation in Florida

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- Strengthening the claims process
  - Implementing litigation management processes
  - Strengthening claims and in-house litigation bench strength
  - Leveraging technology to improve claims reporting processes
  - Setting more conservative reserves based on recent trends
- Refining coverage descriptions and contract language to reduce leakage
- Preferred vendor/contractor networks
- Consulting remediation experts

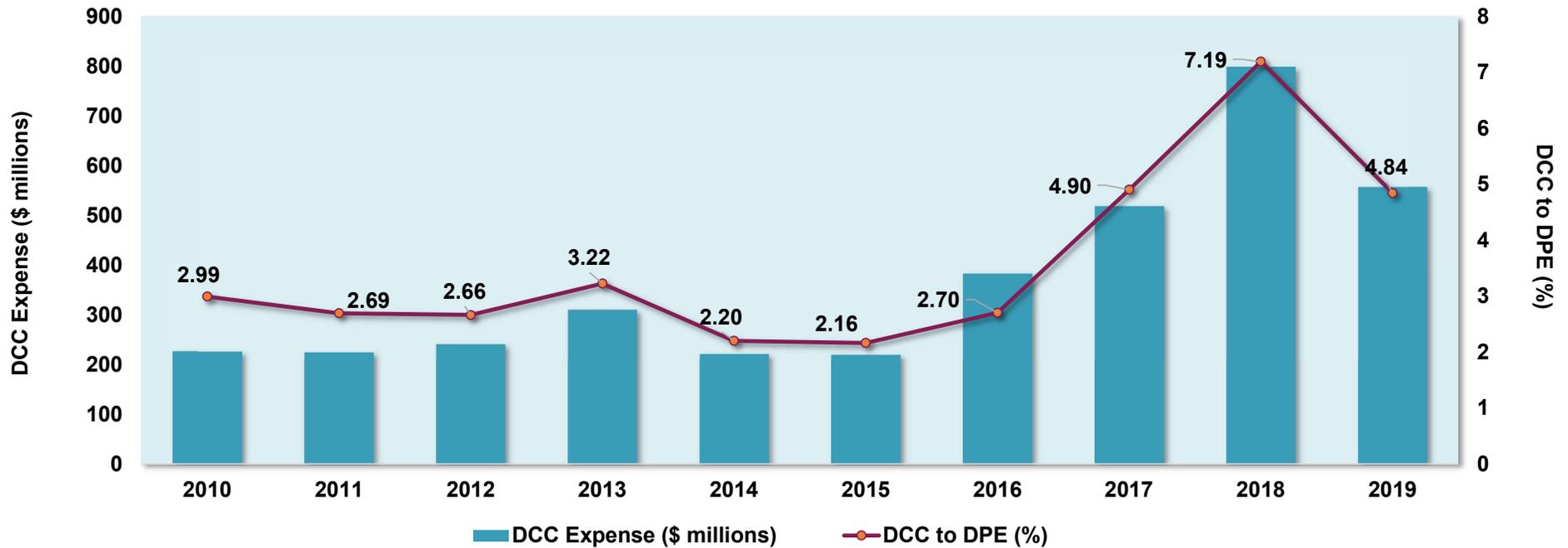
## AOB Reform SB 122/HB 7065 (July 2019)

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- Allowed insurance companies to offer AOB-restricted policies
- Established contract requirements
- Outlined duties and obligations of assignees under AOB contracts
- Established rights of the assignor
- Set up payment scale for attorneys' fees
  - When the difference between the judgement obtained and the pre-suit settlement offer is:
    - Less than 25% of the disputed amount – Insurer is awarded fees
    - 25% but less than 50% – No party is awarded fees
    - 50% or greater – The assignee is awarded fees

# Assignment of Benefits (AOB)

Florida Domiciled Personal Property DCC Expense Totals and DCC as a Percentage of Direct Premiums Earned (DPE)



Source: AM Best data and research  
 Data based on Florida Domiciled Personal Property Companies  
 Note: While trends include the impact of social inflation, they do not wholly reflect that isolated variable.

## 2020 Florida Legislative Session

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### While bills have not passed, issues have been raised in the legislature:

- SB 914 – Limits attorney fees by tempering contingency risk multipliers
- SB 924 – The insured/claimant is responsible for the burden of proof in bad faith actions against insurers
- SJR 1460 – Proposes making the Insurance Commissioner role an elected official

# Commercial Lines



## Commercial Lines – Key Drivers of Social Inflation

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**Jury composition**

**Attitudes toward big business**

**Increasingly aggressive and well organized plaintiff's bar**

**Third party litigation financing**

## Commercial Lines of Business Most Impacted

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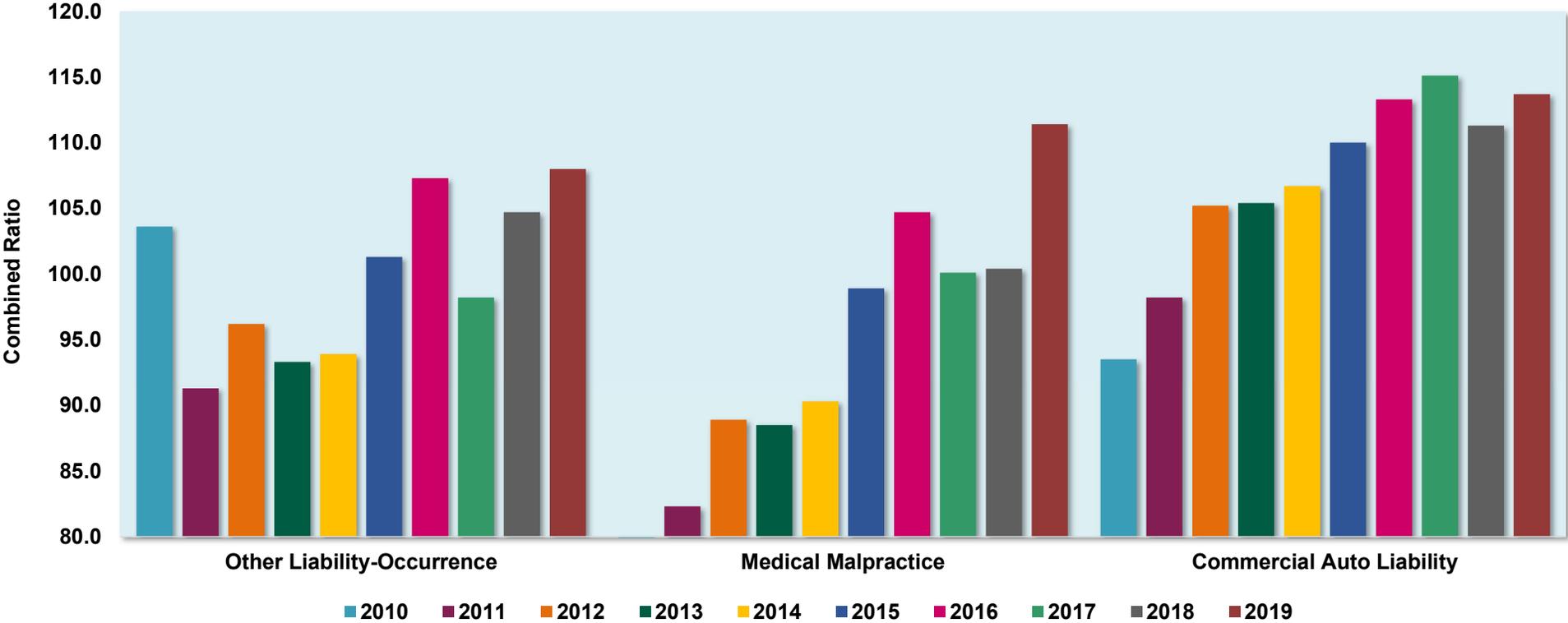
**Commercial Auto**

**General Liability**

**Medical Malpractice**

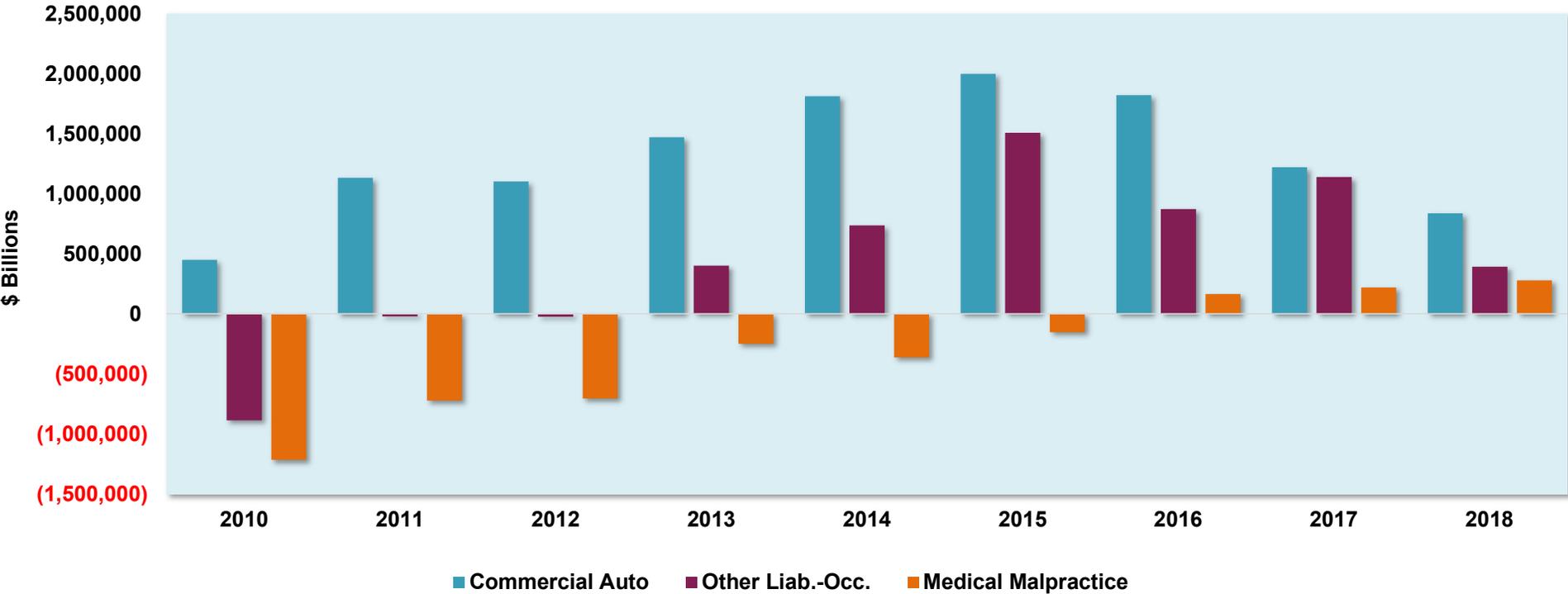
**Director's and Officers Liability**

# Underwriting Results Have Deteriorated



# Unfavorable Loss Reserve Development Trends

Accident Year Loss Reserve Development



# D&O Liability – A Deeper Dive

US Directors & Officers Liability – Standalone Direct Premiums Written and Direct CY Loss Ratio as of 3Q 2019



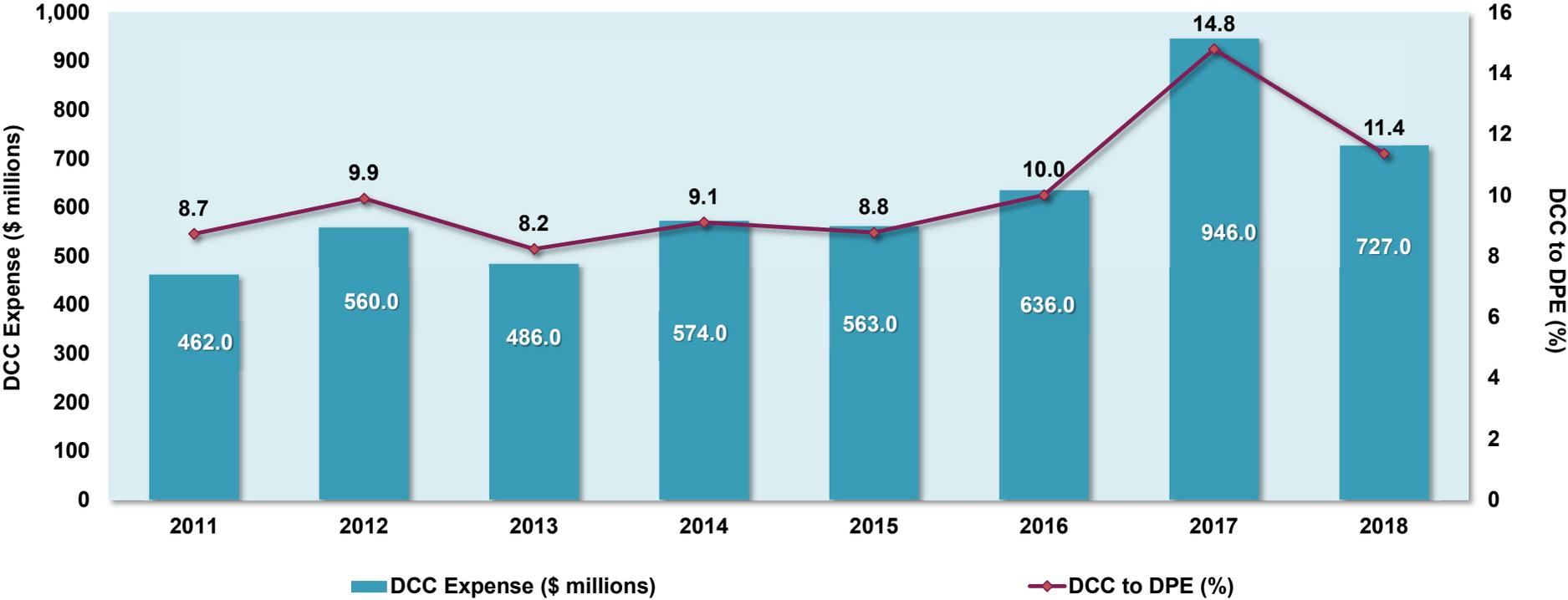
Directors & Officers Liability

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# D&O Liability – A Deeper Dive (cont.)

US Directors & Officers Liability – DCC Expense as a Percentage of Direct Premiums Earned



Directors & Officers Liability

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## Actions Taken by Insurers to Mitigate Impact

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**Rate Increases**

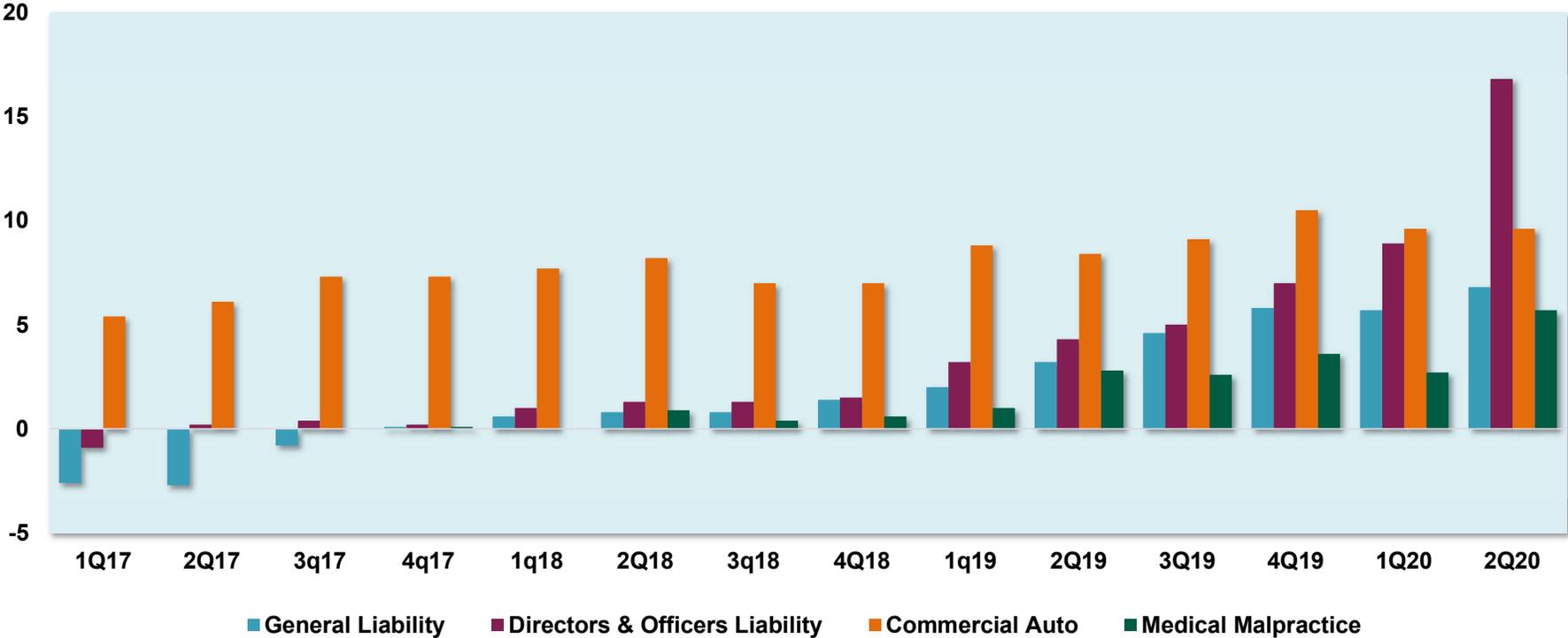
**Raising Deductibles**

**Lowering Policy Limits**

**Narrowing Coverage**

**Re-underwriting Portfolio**

# Rates Are Rising In Impacted Business Lines



Source: Council of Insurance Agents & Brokers P&C Market Surveys



## Social Inflation – Key Takeaways

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- Difficult to quantify impact, but it is significant
- Best underwriters were first to identify and react to the trends
- No signs of abating any time soon
- Rate increases are in excess of trend, but more work to do
- Impact is fully considered in each part of AM Best's rating process

Questions?

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