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Economic Insights
US social inflation amid the COVID-19 recession – here to stay?

Key takeaways
- Social inflation in the US is driven primarily by outsized awards for non-economic damages.
- Disinflationary forces from the COVID-19 recession will provide temporary relief, but the crisis is aggravating trends like inequality.
- A policy reset that prioritises inclusion and equality could reverse some of the underlying trends contributing to social inflation.
- The insurance industry may benefit from more focus on forward-looking liability exposure management and product innovation, as well as adapting their defence strategies.

About Economic Insights
Analysis of key economic developments and their implications for the global re/insurance industry.

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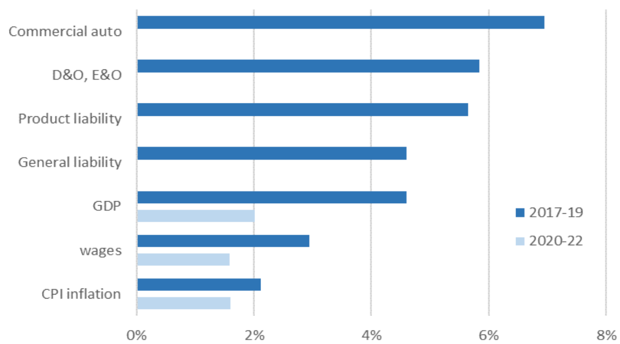
In a nutshell

We believe social inflation in the US is here to stay. The pain has spread across commercial liability lines of business, due to outsized awards for non-economic damages. The COVID-19 recession will ease pressure from economic drivers but will aggravate contributing social trends like inequality. A policy reset towards societal inclusion is needed. Insurers may benefit from more focus on forward-looking liability exposure management, product innovation and on adapting their defence strategies.

We have flagged social inflation for some time as a key factor pushing up loss costs in US excess liability and reinsurance.[1] We expect this trend to continue in the next couple of years, despite the short-term disinflationary forces from the COVID-19 recession. Social inflation generally refers to the increasing severity of insurance claims beyond economic drivers, due to societal trends. There will be casualty claims directly linked to COVID-19 that are out of scope of this note. Social inflation has spread across commercial casualty lines in recent years due to non-economic drivers that include the trial bar's use of psychology-based strategies; litigation funding; and inequality (see Table 1).

The effects of social inflation are felt most heavily in the US due to a rise in nuclear verdicts, mostly driven by outsized awards for non-economic damages.[2] The recent escalation of US liability insurance claims is concentrated on large verdicts and (large) commercial defendants. For general liability, the probability distribution of losses has become more skewed towards large claims rather than a trend of accelerating average claims severity. In commercial auto, professional liability and product liability lines, also average claims growth has accelerated and exceeds economic activity as measured by nominal GDP (see Figure 1).

Figure 1
US claims growth and economic drivers; annual average growth [3]



[1] For example: *Social inflation: a building pain point in US liability insurance,* Swiss Re Institute, Economic Insights, November 2019.
[2] Loosely defined as jury verdicts that exceed USD 10 million.
[3] Claims growth is based on accident-year schedule P data. Sources: SNL, Swiss Re Institute.

We expect economic drivers of claims inflation, such as consumer price inflation and wage growth, to be lower than recent pre-COVID 19 trends for next year. However, this relief will only be temporary while there is slack in the economy and inflation risks are rising in the medium term. It is primarily the non-economic factors that explain the increase in nuclear verdicts and so contribute to social inflation (see Table 1). These include a general anti-corporate environment, expanding concepts of liability, greater willingness to settle conflicts via the legal system, attorney advertising, application of psychology-based strategies, litigation funding, broader insurance policy interpretation and more generally, a plaintiff-friendly environment.

The current crisis is likely to amplify rather than alleviate the societal factors in play, such as economic, educational and health inequality. Without a broader policy reset to reduce inequality, social inflation is here to stay. From an insurance industry perspective, investments into forward-looking liability exposure management and product innovation will need to be more prominent, alongside adapting their defence strategies.

Table 1
Outlook for the non-economic factors contributing to social inflation

Plaintiff / defendant bar tactics	• The plaintiff bar's applied psychology tactics (focus on emotions rather than facts) will spread as more law firms adopt them. • Defence lawyers are only slowly adapting to react effectively to the tactics of the plaintiff bar, hence the defence bar may regain some control but catching up will be challenging and take time.
Litigation funding	• Litigation funding is expected to continue to grow over the next five to 10 years as more players enter the space and awareness among lawyers increases. • Regulation could be a counter-force, e.g. requiring disclosure of litigation funding or capping usury rates of funders.
Social attitudes	• Mismanagement of the COVID-19 crisis is likely to further erode trust in corporations and institutions and strengthen support for social activism through the tort liability system. • (Social) media continue to swiftly broadcast negative news driving outrage and polarisation. • Mid- to long-term changes are less clear and will depend on whether society and politics are further divided or manage to come closer together and adopt inclusive policy changes.
Inequality	• COVID-19 has deepened economic, educational and health inequality. • Without a major policy reset, there is no indication that the long-term trend of rising inequality would change.
Tort reform	• Tort reform has curbed prior episodes of social inflation. No significant legislative developments on tort reform are expected in the next few years. It is not considered a pressing issue by either major political party and a divided Congress makes reforms unlikely at federal level. • There is no clear trend at state level.
Court leaning	• A large number of federal judge appointments by the Trump administration (> 222) has turned federal courts more conservative, which could tilt decision-making to be more defendant-friendly. • However, most cases (97%) are treated in state courts where no clear trend is apparent.

Source: Swiss Re Institute