

CAP SPECIALTY® WHITE PAPER

Social Inflation

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Loss cost inflation as it relates to claim value is not a new concept. Increasing medical costs and general increases in consumer pricing will cause the costs of claims to increase over time. However, the newest driver of increased claim cost is “social inflation.” What is that?! Is society more expensive today than it was yesterday? Maybe. Social inflation is as exciting as a film written by John Grisham and directed by Michael Bay. It mixes nuclear trial verdicts, cutting edge technology and, of course, millennials. In a nutshell, social inflation describes a group of related trends in litigation and regulation that are causing damage awards to outpace inflation.

This paper provides insight into several drivers of social inflation, including social justice issues, a distrust of corporate America, a new generation of jurors influenced by technology, and a general desensitization to large verdicts.

With a solid understanding of modern day loss cost inflation, underwriters, brokers and policyholders will better understand why it is so important that insurance is priced adequately to account for where costs *will* be and not where they have been, why insurance companies must manage their volatility by reducing limits, and why it’s so important to practice the craft of underwriting which includes a thorough understanding of an insured and its business operations *before* offering terms and conditions. The time to learn about the quality of the insured or its business practices is NOT after a claim is made or an insured needs to be defended in litigation.

JURIES AS SOCIAL JUSTICE TOOLS

Achieving that fair treatment has, especially over the past century, been accelerated by collective action, rather than through traditional legislative means. Social justice refers to the fair treatment of all people in a society, regardless of race, religion, gender affiliation, wealth or any other basis. Before the age of smart phones, organizing a social justice initiative could be costly and overwhelming but with the explosion of social media, movements like Occupy Wall Street, #MeToo and Black Lives Matter have gained attention globally, and with great speed at little cost to the organizers.

Technology has also resulted in the average person becoming more aware, more quickly, of when they are being taken advantage of by institutions of power. Correspondingly, there is a much lower tolerance when they believe that is happening, especially if it relates to personal safety. With this increased awareness, citizens have taken jury service as an opportunity to right a wrong or “set standards that influence social behavior”.¹

DISTRUST OF BUSINESS

Confidence in Corporate America took a major hit after the 2008 financial crisis and the ensuing Great Recession. The 2014 Corporate Perception Indicator survey revealed that almost half of Americans felt corporations had too much influence on the future. Generationally, the results were even more stark, as 40% of millennials believed corporations undertake philanthropic efforts solely for tax benefits.² Consider two things with these findings: millennials were the largest group of people looking for jobs

in 2008, and millennials now represent the largest pool of potential jurors.

Distrust of corporate America extends to all sizes of businesses, not just the juggernauts. Research by Magna Legal Services indicates that 81% of people either somewhat or strongly agree that corporations place profits over people's safety.

In addition, corporations, especially financial institutions, are being held accountable to a greater degree than ever for facilitating the actions of their clients. JPMorgan Chase (JPMC) is currently being sued for underwriting the pipeline that Flint, Michigan and its contractors built. Tragically, toxic levels of lead were discovered in the water, which harmed children and will involve millions of dollars in remediation. JPMC had nothing to do with the design, building, or operation of the water system, but because of a perception of it facilitating the project and reputation as a deep pocket, it was sued. Historically, a strong correlation between negligent behavior and the resulting harms has been required, but that standard is eroding.

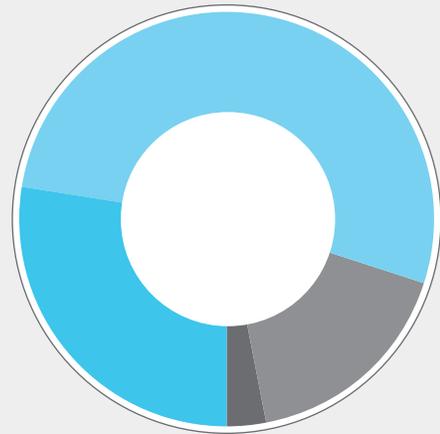
THE TECHNOLOGY INFLUENCE

Millennials are now the largest adult population in the United States³ - they now make up a large percentage of jurors. A well-known characteristic of a millennial is the use and reliance on technology to provide instant answers to a question. Therefore, it has been noted that jurors today have shorter attention spans, get bored very quickly and are used to communicating in "140 character tweets or disappearing Snapchat messages."⁴ Jurors may be unable to focus on complex legal issues at a trial and will typically try to "find the answer for themselves." Many jurors view expert testimony skeptically as they consider themselves the experts on the topic based on their own superficial, online research.⁵

This reliance on technology impacts how defense attorneys must approach the presentation of the case and, more importantly, how the insured's business is depicted. Is the insured transparent with safety protocols? Are the representatives of the business sincere and credible?

Failure to present simple, concise defenses in an engaging way will cause jurors to revert to their own expectations of the principles at issue – including the behaviors identified above of making a social justice statement in favor of a plaintiff or vindictive behavior against the corporate defendant, each of which is perilous to the defendant.

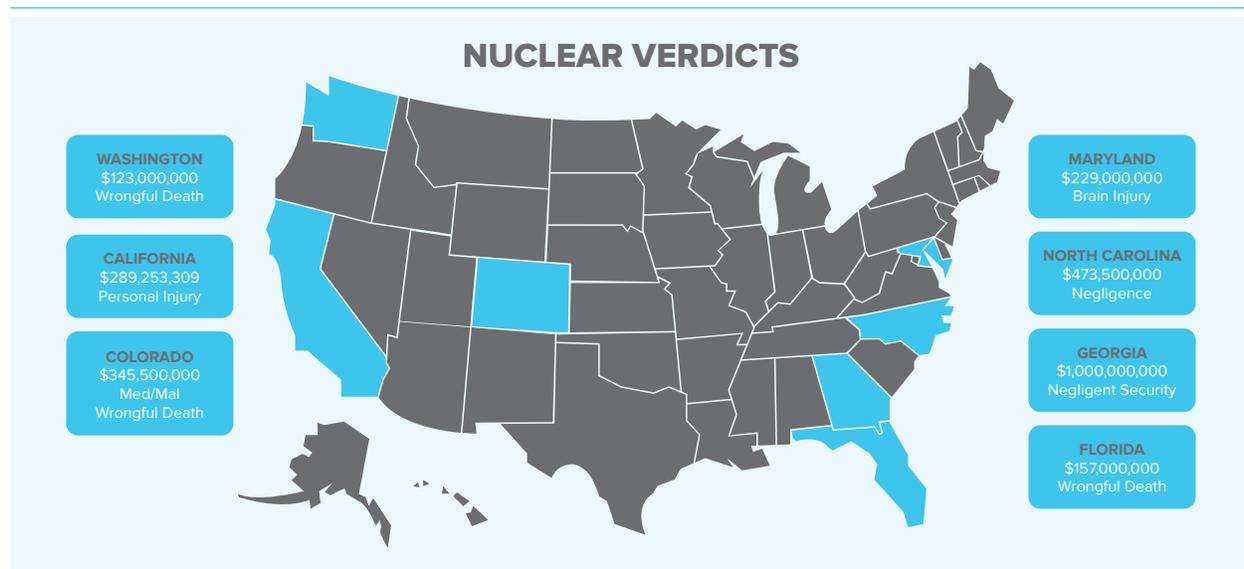
DO YOU BELIEVE THAT CORPORATIONS CARE MORE ABOUT PROFITS THAN PEOPLE (INDIVIDUAL SAFETY)?



Source: Magna Legal Services

DESENSITIZATION TO EXTREME VERDICTS

The reporting on massive jury verdicts and settlements is pervasive and the information is updated by the minute to our smart phones. 2018 and 2019 continued the trend of extreme, mega-million and even billion-dollar jury verdicts. To illustrate:



It appears the public is becoming desensitized to extreme numbers. For instance, the United States national debt is \$26.7 *trillion*⁶ and can be watched in real time online. Patrick Mahomes, quarterback of the Kansas City Chiefs, signed a \$503 million, 10-year contract with \$165 million guaranteed. Walmart reported revenue in 2019 of \$514 *billion*.⁷ In 2019, Elon Musk (CEO – Tesla, Inc.) earned \$595 million, Tim Cook (CEO – Apple, Inc.) earned \$134 million and Tom Rutledge (CEO – Charter Communications, Inc.) earned \$117 million.⁸ The salaries of sports stars and CEOs of major corporations continue to grow substantially out of balance with the median family income of \$78,500 in 2020.

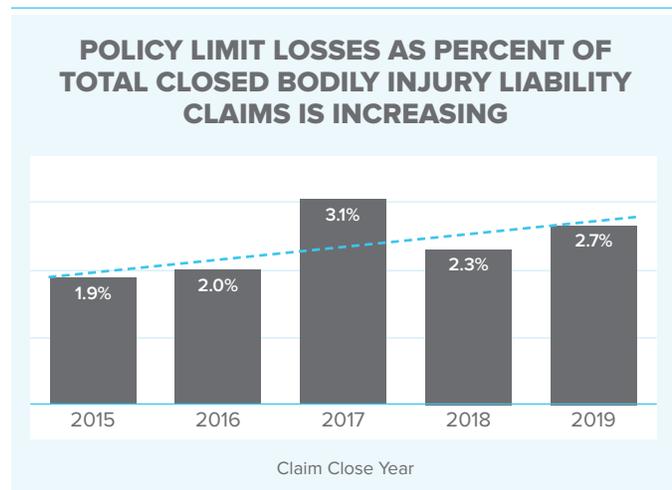
Numbers like these are often used in closing arguments by lawyers to put damages claims into context when arguing for pain and suffering or in favor of valuing a person's life for millions of dollars. Suddenly, multiple millions of dollars for someone's injury or for the value of a life does not sound so extreme.

CONCLUSION

Loss cost has always been a key determinant in setting adequate rates for insurance. And even though the “social” influence on jury verdicts is not new, modern day social influence is accelerated by the instant availability of information and a desensitization to the value of a dollar, increasing the likelihood of extreme verdicts. So, how can the insurance industry manage these dynamics?

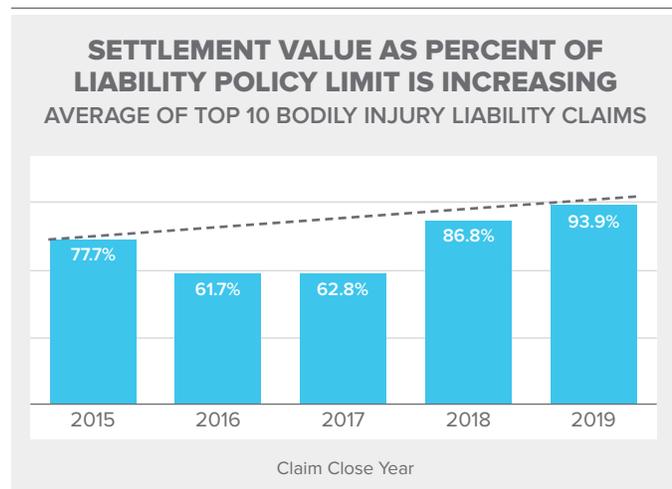
- **Policy Limit Management:**

Often, the best tool for an underwriter to navigate social inflation is offering lower policy limits to curb the downside of adverse claims. Data shows, in the case of bodily injury claims, the frequency of policy-limit losses is increasing. The industry is responding by meaningfully reducing its limits across most commercial lines of business.



- **Price/Rate:**

Price for future claim values based on social inflation factors, not where the loss costs have been in the past. The average time between a bodily injury and closure of the resultant claim is about 2.5 years. Although social inflation doesn't necessarily mean there will be more claims, the data suggests average incurred claim values are increasing; anecdotally, increased severity may cause increased frequency, as plaintiffs and



their counsel may be more inclined to pursue claims just because the possible recovery is so great. As average claim values increase, higher rates are necessary to maintain rate adequacy.

- **Understand the policyholder's business including the insureds contractual relationships:**

Think in terms of quality risk management and what the policyholder is doing to conduct business in a safe manner. Insurance underwriters and brokers should apply their insights and experience through risk selection, terms and conditions and pricing.

As jury verdicts drive growth in loss costs, it is important for carriers, producers and insureds to be prepared. The first line of preparation is always risk management and avoiding a claim entirely. But understanding this trend and the outsized exposure it presents highlights the need for proper liability insurance.

- 1 [5 Reasons Why Juries Are Awarding Billion-Dollar Verdicts](#), Autumn Heisler
- 2 [Quantifying Americans' Distrust of Corporations](#), Bourree Lam
- 3 [Presenting Expert Testimony to a Millennial Jury](#), Anjelica Cappellino
- 4 [The Millennial Juror: Seeing What is Really There](#), Thomas Kendrick
- 5 [6 things You Need to Know About Millennial Jurors](#), Lee Hollis and Zachary Martin
- 6 <https://usdebtclock.org/>
- 7 <https://medium.com/technicity/worlds-100-largest-companies-by-revenue-in-2019-d6d53dd1851d>
- 8 <https://medium.com/technicity/worlds-100-largest-companies-by-revenue-in-2019-d6d53dd1851d>

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