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Part 2: Exploitation of Insurance Vulnerabilities

P&C INDUSTRY, AS WELL AS PLAINTIFF LAW, VULNERABILITIES WERE RECOGNIZED BY DISRUPTORS AS BLINDSPOTS CREATING SIMULTANEOUS EXPONENTIAL OPPORTUNITIES.

During 2018-2020 opportunists recognized key vulnerabilities within the P&C insurance industry, as well as across plaintiff trial law. Boldly, a plan was devised, relying upon best-in-class innovation practices to generate a multibillion-dollar annual revenue stream. The singular goal remains harvesting consumer premiums flowing through insurers who serve as the distribution mechanism for selfish gains. Embracing both the vulnerabilities and the methods in operation leveraging them is critical to begin formulating countermeasures.

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THIS SERIES AND WHAT TO EXPECT:

Regardless of the descriptor Social Inflation or Litigation Economy, what is in operation is a finely tuned machine with numerous interdependent parts. Isolating each category by publishing installments focused on the respective component's risks sacrificing their connecting points. Please remember, despite releasing installments, the overarching subject is a multi-faceted single revenue machine.

The introduction focused on defining Social Inflation as a Litigation Economy. The other key takeaways included marking 2020 as the year the litigation economy began to grow scaled operations. Finally, the other key message is the litigation economy represents a long-term systemic threat to the insurance business model by challenging actuarial practices used to underwrite, price, and set reserves.

Part 2 Insurance Vulnerabilities: Defining the vulnerabilities in the insurance industry and P&C claims management lays the foundation for understanding the means of exploitation, as well as the suggested counter measures. Parts 3-5 drill deeper in these vulnerabilities and include recommended counter strategies.

Part 3 Third Party Litigation Funding (TPLF): TPLF is experiencing proliferation and diversification into litigation marketing, client recruiting, and phantom billing. Included are TPLF summary financials including portfolio allocations.

Part 4 Plaintiff Marketing: The modernization of litigation advertising and digital influence strategies, with recommended insurer counter strategies.

Part 5 Technology- The Revenue Engine: The highly innovative and sophisticated technological tool kit at the heart of the litigation engine, as well as how insurers can counter-act, if not improve upon, capabilities developed for the litigation economy.

Please use this link: to complete a survey for continued research. All responses will remain anonymous.

In return for completing the survey, respondents will receive:

1. The complete, full cited report on countering social inflation,
2. Aggregated survey data and,
3. An offer to participate/schedule a Zoom or Teams briefing at no cost.

If easier, this QR code will also take you to the survey:

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What Are Liability Insurance Vulnerabilities?

With respect to the Litigation Economy, opportunists identified multiple vulnerabilities each with a distinct scale. However, the inter dependence of each area exploited is one cornerstone to success upon which focus upon which the litigation economy is achieving growth. The three categories of insurance vulnerabilities are

1. Human nature- the brain's hardwiring
2. Industry vulnerabilities: Industry wide attributes
3. Process vulnerability: Insurer defense panelist selection and management
4. Transactional vulnerabilities: Specific moments in time during the lifecycle of a liability claim, particularly in vehicle, commercial, and liability umbrella lines of business.

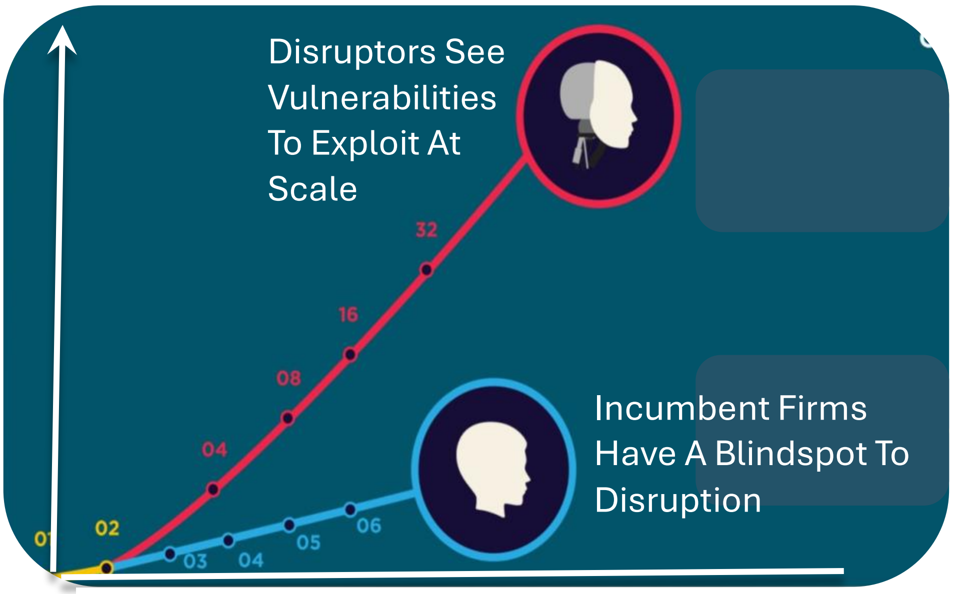

Figure 1: Incumbent incremental thinking VS Disruptor exponential thinking

Figure 1 is in an illustration of how disruptors, game-changers, leverage our knowledge and experience against us. Simply put, people within a community, or industry, manage fight or flight responses to potential disruption by seeing all change as incremental. This belief system is further reinforced with compensation packages and promotional practices. The larger the population, and the longer they achieve success, the stronger the influence of company cultures, which results in reinforcing belief that forward focused change will remain incremental.

For example, post 2020 the erosion of profitable results across liability lines of business does have a deceptively familiar feel to previous hard markets. Managing these cycles has historically been a unique industry strength. However, the associated familiarity can mislead insurers to conclude current market conditions are just another temporary cycle. Once again, the industry's standard solutions of raising rates, addressing risk selection, and modifying contract language have once again been deployed in 2021-2024.

Again, referring to Figure 1, disruptors typically have expertise in their target market and/or solution sets needed to execute on the identified opportunity. They don't see historical, regulatory, or cultural roadblocks. They are constrained, not by unrecognized assumptions nor corporate cultures, but by time and funding. They differentiate perceived constraints from authentic roadblocks. Genuine constraints are then leveraged to drive pace and achieve goals. They launch, iterate, experiment, and chase scale with extraordinary focus. Scale in social inflation began by identifying exploitation opportunities. Those exploiting P&C insurance attributes are redistributing policyholder premiums as a revenue stream. The more money (rates, investments, expense savings) in the insurance ecosystem the better. Litigation opportunists are counting on continued reliance of these same solutions.

Reviewing vulnerabilities begins at the industry scale, followed by the claim transaction. Figure 2 is a graphical representation of insurer vulnerabilities under attack. Note how each vulnerability is paired to a method of exploitation. Figure 2 also begins to reinforce the interdependent relationship among the pieces.

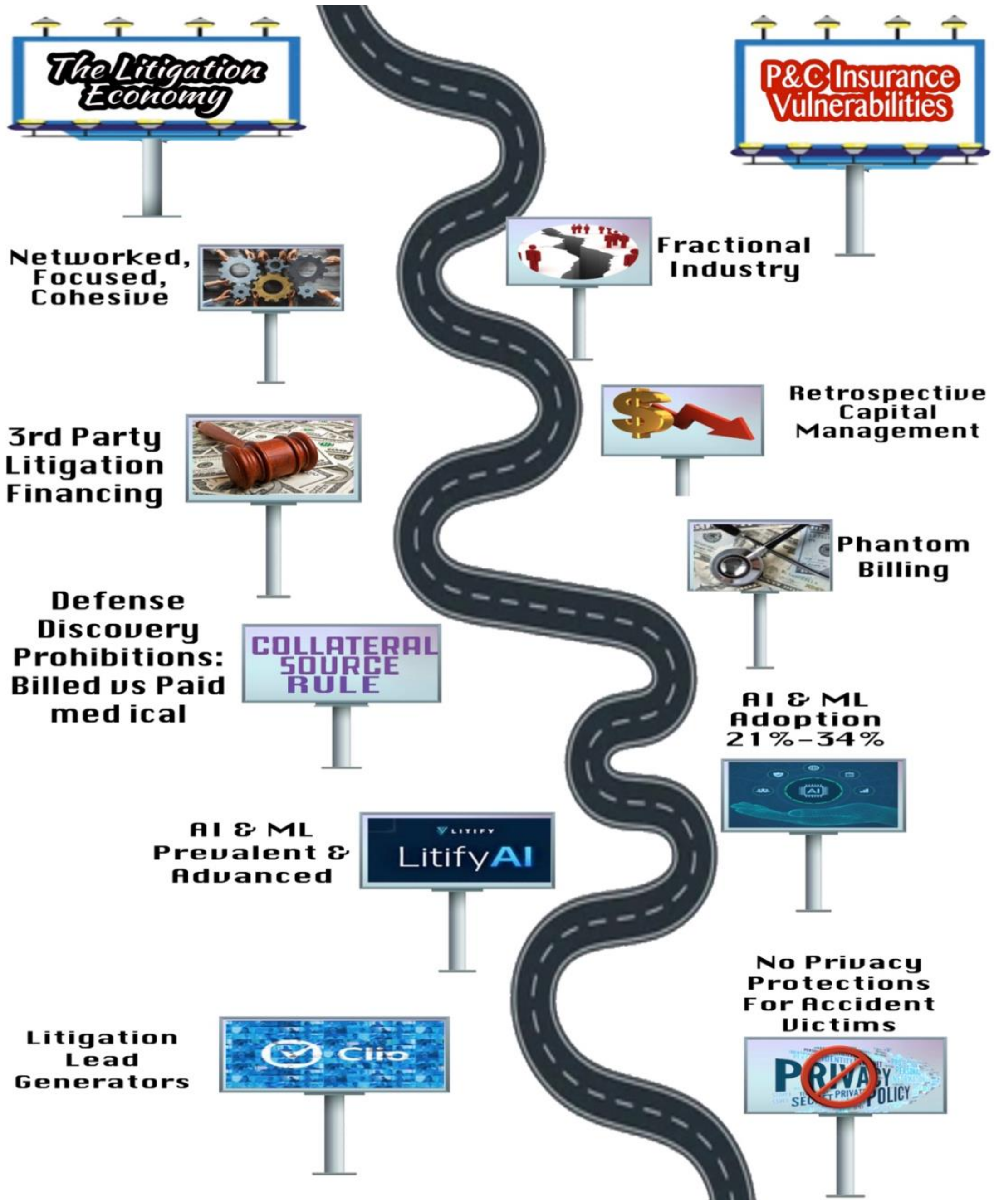

Figure 2 Insurance vulnerabilities & means of exploitation at the Industry scale

Starting at the top of Figure 2, the P&C insurance industry is fractional. Politically, philosophically, and with respect to regulatory policy priorities. As reported by Sedgwick, for all *new* auto BI claims, average paid increased by +44% for 2023 in comparison to 2022. The resulting aggregated vehicle insurance rate increases approved in 2023 and 2024 were an unprecedented 22%. Yet, the regulatory structure prevents industry close collaboration to protect consumers from further social inflationary rate increases. Additionally, trade associations and political action groups lack unity. Again, the same applies to Insurance Commissioners who must operate within fifty unique legislative environments with distinct priorities. Again, this is not a declaration of criticism but stating a weak link within the insurance industry being exploited.

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Contrary to the P&C insurance industry, disruptive sectors operating within the litigation economy collaborate and coordinate for growth. Thousands of unrelated medium and small businesses share goals, strategies, data, files, lead generators, and even technology co-development. For these entities, the time between investing in a capability and capturing returns is measured in months, not years. A new trial strategy such as tips on generating extracontractual payments can go viral within 48 hours. Time to market, and growth of coordination, underwent rapid development during the Covid disruption of court calendars in 2020.

Secondly, insurers tend to rely on data that spans 18 to 36 months retrospectively, generated by relatively inflexible technological backbones. Social Inflation network members are leveraging extremely sophisticated predictive technological platforms, enabled by an exponential growth of capacity, to become highly adaptive and focused. Historically, insurers have been able to control the market rules that guided decision making. Over the most recent 3 years, many of the rules and practices governing insurance costs began to be exploited to the detriment of carriers and their customers. Reinsurance News recently quoted a 2022 commercial vehicle insurance report by Morgan Stanley analysts, "Morgan Stanley's research underscores the critical need for the commercial auto industry to reassess its risk management strategies and pricing models in response to the ongoing challenges posed by social inflation. "[1]

Plaintiff firms and Third-Party Litigation Funding (TPLF) firms are forming networks of participating physicians, even building accident injury diagnostic centers just for the purposes of controlling the billed charges while accepting payments based on a significantly lower fee schedule. Whether the claim is resolved via pre-trial settlements, or becomes a fully litigated claim, insurer defense panelist will only receive the billed schedule in discovery. The margin between billed and paid represents cash flow that can be distributed among the attorney, the TPLF entity and/or the participating physician.

One result from this injection of capital is the growth of phantom billing on medical treatments related to liability claims. As many within the insurance industry know all too well, the evidentiary discovery of claim based *paid* medical costs are either prohibited entirely, or restricted, via Collateral Source Rule (CSR) statutes. Phantom medical billing related to liability claims has been on a growth trend for some time now. What is so different now?

Collateral Source Rules vary state to state. See Map 1 which provides the CSR model for each state:
Those states that strictly prohibit the disclosure of actual paid amounts are labeled "B.O." for "Billed Only". States that are guided by Hybrid CSR rules are labeled "H". Most "Hybrid" states allow some discovery of the paid amounts either on appeal, or if settlement adjustments are sought following the resolution of the litigation. States that force plaintiffs to disclose, as evidence, the actual amount paid are labeled, "P". By way of explanation, those states identified as "Judicial Hellholes" by the American Tort Reform Association (ATRA) are marked by the flaming gavel. Note the alignment of Judicial Hellholes with "Billed Only" Collateral Source Rule discovery restrictions.

[1] Reinsurance News: Social inflation driving billions of dollars of excess losses in commercial auto: Morgan Stanley

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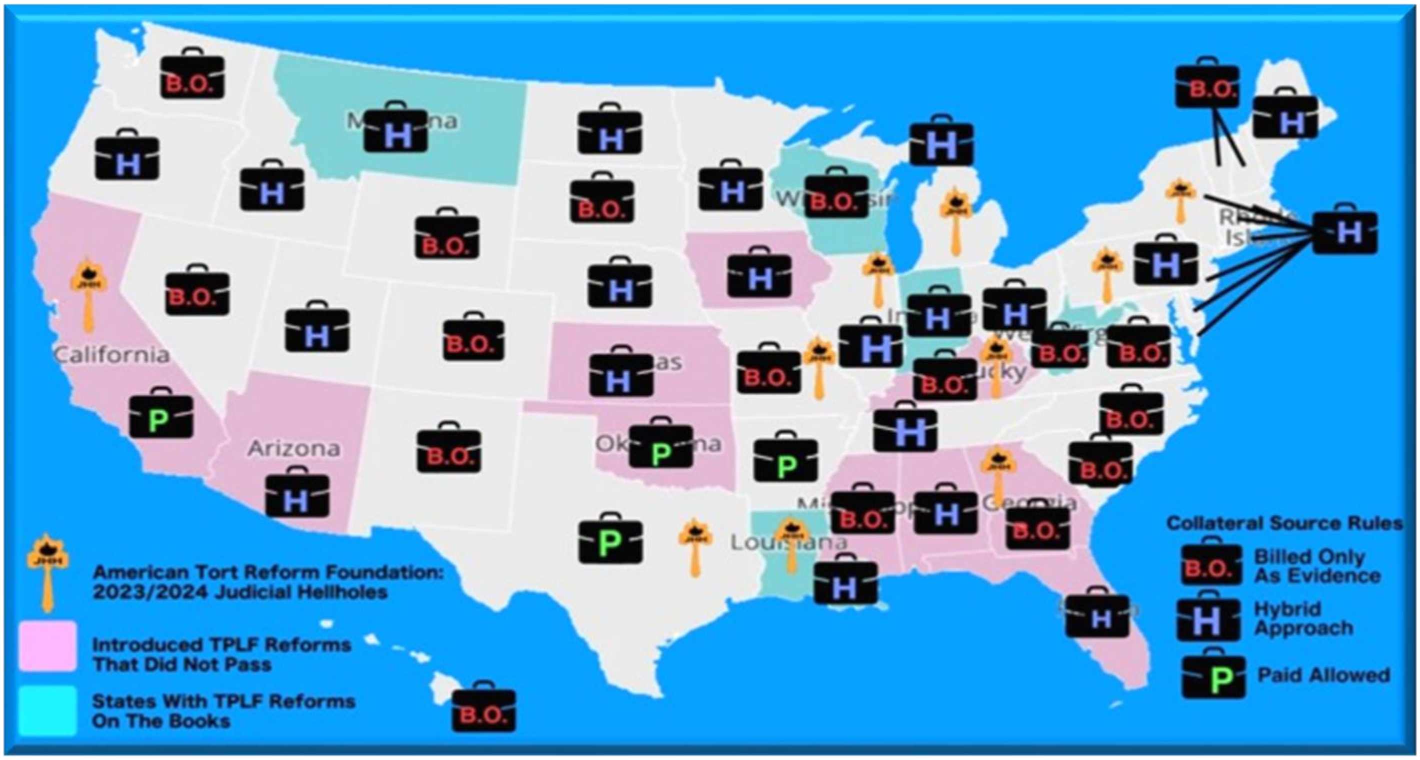

Map 1: State by state jurisdictional status re- TPLF Regs, Collateral Source Rule restrictions, ATRA Judicial Hellholes

The next vulnerability is the difference in technological capabilities driving litigation growth vs those in use throughout typical insurers. The growth engine for social inflation operations is a convergence of sophisticated technological capabilities. Installment 5 is dedicated to these capabilities and how insurers can overcome them. However, as a primer, the litigation economy runs on machine learning, augmented intelligence, natural language processing, SEO strategies[2],[3] and predictive analytics. Although included in the Introduction, brief definitions are worth repeating:

Augmented Intelligence (AI): Augmented intelligence is a design pattern for a human-centered partnership model of people and artificial intelligence working together to enhance cognitive performance, including learning, decision making and new experiences.

Machine Learning: Machine learning (ML) is a branch of artificial intelligence (AI) and computer science that focuses on the using data and algorithms to enable AI to imitate the way that humans learn, gradually improving its accuracy.
Structured and Unstructured Data: Structured data is data that fits neatly into data tables and includes discrete data types such as numbers, short text, and dates. Unstructured data doesn't fit neatly into a data table because its size or nature: for example, audio and video files and large text documents.

Predictive Analytics: A branch of advanced analytics that makes predictions about future outcomes using historical data combined with statistical modeling, data mining techniques and machine learning.

Natural Language Processing (NLP): A machine learning technology that gives computers the ability to interpret, manipulate, and comprehend human language. This allows existing structured and unstructured data to be read, interpreted, and fed into current and predictive analytics regardless of format. Think claim adjuster notes, scanned handwritten notes, case data, handwritten documents.

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[2] The Plaintiff Bar Is Winning in AI | Insurance Thought Leadership.pdf, by **Taylor Smith**, **John Burge** MARCH 10, 2024

[3] Milliman: The role of NLP and AI in third-party litigation funding

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Finally, the last insurance vulnerability noted in Figure 2 is grounded in the lack of privacy protections with respect to accident parties. IN many states statutes are on the books prohibiting the sale of accident party identity information, in reality they might as well not exist. According to a LexusNexus study, 85% of consumers involved in a liability loss receive an unsolicited call from an attorney within 48 hours of the accident and 61% heard from more than one. Why is this important? According to Tripple-I, Milliman, and Sedgwick, 57%-61% of liability accident parties hire an attorney prior to contacting an insurer to submit the claim. Of those who hired an attorney prior to submitting the claim, 71% stated their attorney encouraged them to seek additional medical treatments prior to submitting the claim. Note, among these claimants, these activities are occurring during the lag time, prior to claim submission.

Transitioning from an industry scale down to the individual lifecycle of a claim, finely tuned tactics can be identified. First, Figure 3 represents a simplified, generic, lifecycle of an auto liability loss event. Note the representation of two critical timelines: lag time and cycle time. Each red arrow represents a focal point in litigation exploitation. Moving from left to right, the arrow 1 represents traditional billboard, television, and radio attorney advertising. Arrow 2 represents digital marketing, social media strategies, SEO marketing. Arrow 3 represents litigation lead gen aggregators, and the ability to initiate contact with accident victims within 48 hours of the loss.

Moving down to arrow 4, highlighting lag time, between loss and claim submission which has become a significant tool in exploiting claims. Liability claimants who are converted from being “a lead” to becoming a client are encouraged to seek medical providers, repair facilities, obtain substitute transportation prior to submitting a claim. Plaintiff’s will even reach out to the at fault party notifying them of their representation and if possible, delay reporting the claim for a certain brief period. Liability claims seeking damages over $100K tend to have notably longer lag times. Moving to another time frame with arrow 5, growth of litigated cycle times is an indicated of the influence from Third Party Litigation investors. Lawsuits backed by TPLF investments are influenced to avoid settlements in favor of jury trials. For those claims that do settle pre-trial, a variety of means are employed to capture extracontractual payments. Longer cycle times also present challenges to year end reserve estimates.

Next, arrow 6 reflects data indicating inconsistent defense panelist selection and management processes among insurers. This same arrow also represents the remarkably comprehensive profile developed for plaintiff firms of a defense panelist. This also highlights a disconnect in understanding the use of litigation management technologies between insurers and their defense firms. Finally, the last arrow (7) reflects the challenges facing insurers with respect to reserving and subsequent adverse reserve development.

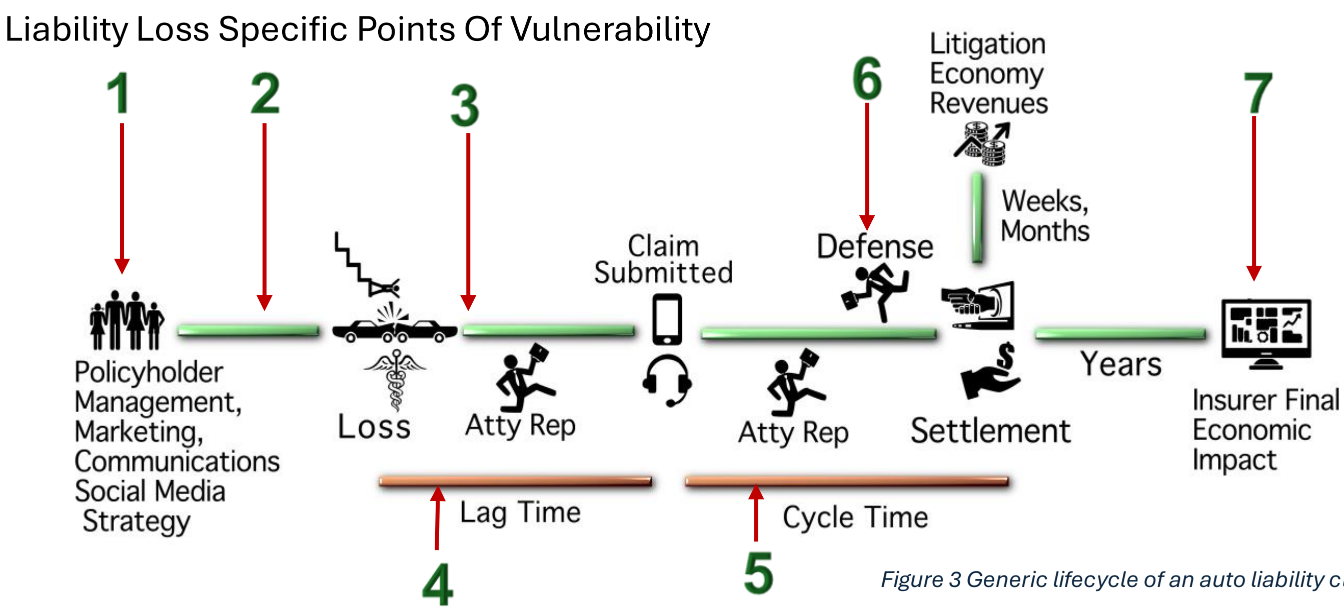

Figure 3 Generic lifecycle of an auto liability claim

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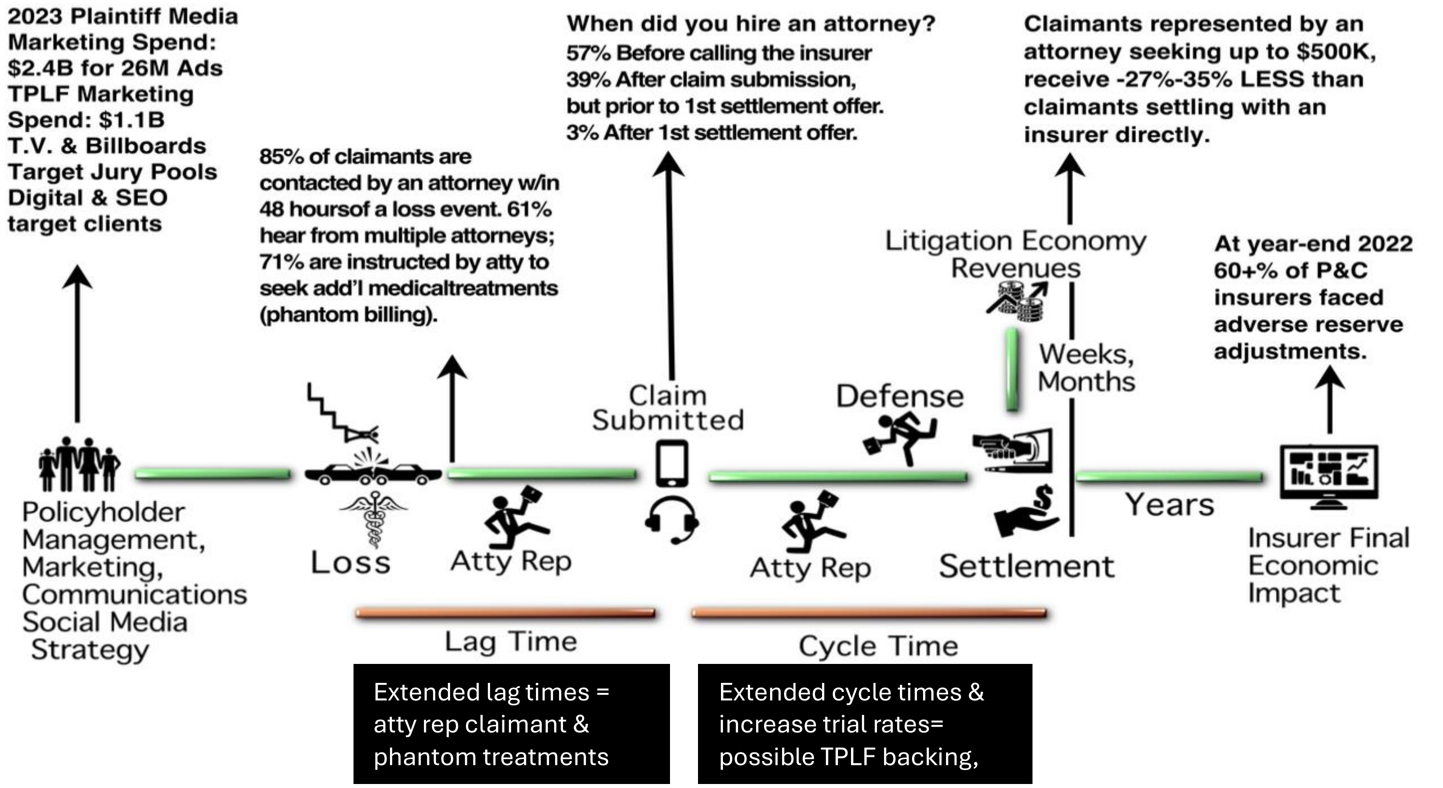
Figure 4 Vulnerabilities in the life of an auto liability claim and examples of exploitation



Conclusion

During 2019 and 2020 Social inflation was reinvented into a nationwide litigation economy. The primary drivers are an extensive adoption of predictive analytics, AI, ML, TPLF funded expansion of capacity, and sophisticated influence campaigns targeting both potential claimants and future jury pools. These practices have been significantly enabled by a lack of TPLF regulations, restrictive collateral source rules, by exploiting specific industry attributes. Recent results described as pricing stability are being attributed to unprecedented rate increases. However, this stability will be temporary as the increased premiums will also be exploited moving forward.

To use a medical analogy, treating causes vs symptoms requires fighting fire with fire. Specifically, strategies that include adopting comparable technological capabilities, modifying marketing plans to include educational & influence strategies, and embracing systematic product innovation can combat the exploitation of insurer capital and policyholder premiums. Think of litigation economy practices as targeting specific phases in the lifecycle of a typical loss event found on pages 4 & 5. Vulnerabilities being exploited first and most significantly are in the lag time, followed by cycle times, accountability for settlement delays. The first step for any insurer is to engage in examining diagnostic metrics to assess relative impact and thus urgency

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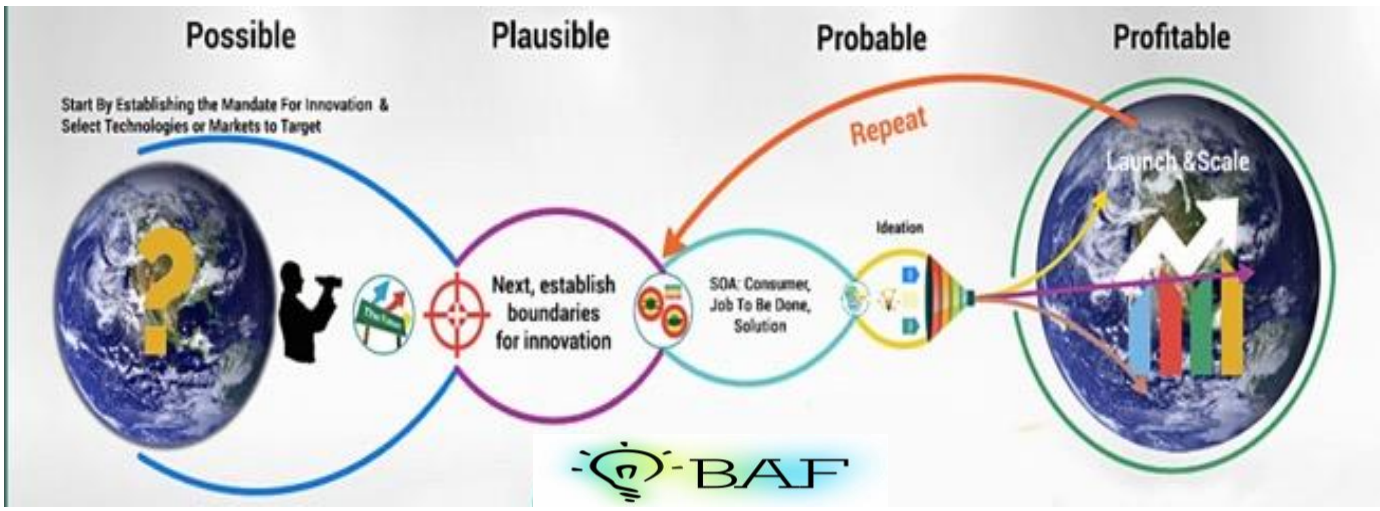
About Guy Fraker, and BAF Insurance Innovation Advisory

BAF Advisory, previously cre8tfutures, LLC has been working with insurers, early-stage companies, and lawmakers to convert complex scaled challenges into profitable opportunities for over a decade. Successes have been achieved establishing systematic and consistent innovation practices to discover and scale opportunities. Success has equally been achieved working with insurers, stuck midstream while attempting to either discover growth and/or problem-solving solutions. Working across intrapreneurs, entrepreneurs, regulators and legislative bodies, significant capital and new revenues have benefited both insurers and scaled markets. Social Inflation factors will continue to challenge the fundamental building blocks of the insurance business model. However, and hear this with confidence, SI trends and influences also hold significant opportunities for insurers to preserve, to grow, capital and profitable revenue streams.



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