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HOW INSURERS CAN COUNTER SOCIAL INFLATION

ABSTRACT
Counteracting innovative business practices challenging insurers' abilities to accurately price, and affordably provide, insurance protections may require: Additional technological and procedural solutions; Capital investments; Solutions that may challenge established protocols.

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Please use the link included to complete an 11 question survey as a contribution to ongoing research. Each respondent will receive a comparative analysis of the aggregated result, the complete, cited, report, and an option to schedule a conversation about these materials.

Litigation Economy Starter Survey

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Social Inflation Counter Measures

Background & Context:

Social Inflation Is Abuse of Legal Practices Scaled Into A National Litigation Economy. Is America Facing An Insurance Affordability Crisis? For Those Within The P&C Insurance Industry, Are Your Policyholder's Wallets Being Impacted?

Social Inflation is non-specific and safe, which leads many to be either confused about which activities fall under this over-used descriptor, or worse overwhelmed when devising strategies to protect their company, employees, and customers. "Litigation Economy" seems to be a more accurate descriptor speaking to both the core cause and the scale. The reinvention of social inflation into a scaled litigation economy occurred during 2019 and 2020. The litigation economy represents a systemic threat to the existing P&C business model. Insurers are facing a long game. The phrase "long game" is a reference to a long-term shift in market conditions. For the past 4 years, I have been dedicated to reverse engineering the exponential growth of liability and homeowners' insurance litigation. This work has been in service of state legislators, a U.S. Government agency, primary insurers, reinsurers, and private equity entities. This this work resulted in actionable counter measures for insurers, self-insureds, and lawmakers.

The simple reality is the scaled litigation economy represents a systemic threat to the existing P&C business model and thus requires a fresh look at potential solutions. Before company specific counter-measure strategies can be developed, a detailed understanding of Social Inflation practices must be embraced. First, to prevent misunderstanding, what is meant by liability claim litigation? For the purposes of this report, a litigated claim as well as attorney rep claims, refers to liability claims with claimants represented by an attorney. While most of such claims are settled as opposed to fully litigated via trials, these files represent significant additional costs, and pricing challenges to insurers and thus consumers. The exponential growth and diversification of Third-Party Litigation Financing (TPLF) requires this distinction. Additionally, previously published reports focused on residential fire insurance have been previously published covering the impact of these same unethical practices upon residential property insurance. This report focuses on liability insurance: personal and commercial lines vehicle BI, UM, UIM, and umbrellas.

Additionally, his report does not delve in the assignment of benefit (AOB) crisis insurers are facing with respect to property losses nor glass claims. This author has written extensively about AOB abuses and held those abuses as a high priority in the development of public policy reforms. For the better part of 2021-2023 the warning bell was front and center in all published articles that Florida was simply where many of the litigation economy capabilities were launched and iterated, but the spread of those practices would affect every state vulnerable to repetitive cat losses. That said, a map of 2023 & 2024 aggregated HO insurance rates changes are included in the appendix. Quite frankly, the NAIC would benefit consumers by allowing a coverage exclusion on claims involving executed AOBs prior to claim submission, subject to advance policyholder communication mandates. P&C insurers should have this option in form filings.

Based on a plethora of research and reports, insurers seem to be wrestling with how to determine whether their specific company is facing more, or less, of a negative impact upon liability coverages results than the industry. This is an extremely challenging question to answer definitively. First, given standard financial reporting practices across the insurance industry, actual results trail loss events by 1 to 3 years or more. Secondly, much of the claim data needed for analysis is not readily accessible within many carriers' data systems. In contrast to the retrospective orientation of insurance data, social inflation instigators are future focused and on a well-established growth trajectory.

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Therefore, the question must be reframed into two distinct questions.

1. Has an insurer been impacted to a greater degree than the industry as of 2021, possibly 2022, with respect to liability coverage results? The best data available to address this question in 2024 is a mix of results spanning 2020 to 2023.
2. Given the trends across exploitive litigation-based business practices, what is the risk, or likelihood, any given insurer will experience greater negative impacts moving forward?

Counteracting innovative business practices challenging insurers' capabilities to accurately price, and affordably provide, insurance protections will require corporate leaders to be open to:

- Potential adoption of additional technological and procedural solutions.
- Capital investments to protect the business model and generate higher capital returns.
- Solutions that may challenge historical business practices, cultural norms, and established protocols.

However, the litigation economy represents a sea-change. Consider the quotes from the American Property Casualty Insurance Association CEO David Sampson and Jad Ariss, Managing Director for The Geneva Association [1]

"Beyond new technologies, social inflation is one of the biggest disruptors facing the insurance industry." David Sampson, APCIA

"Insurers need to accurately model the risks they underwrite and price them accordingly. Otherwise, unexpected claims payments can seriously damage insurers' balance sheets and challenge their capacity to provide vital support to society. Social inflation linked to liability risks, gone unchecked, poses such a threat." Jad Ariss,

How were the recommended plans developed?

Recommendations to mitigate, if not reduce, social inflation impacts are an outgrowth of 4 years:

1. Reverse engineering exploitation practices impacting P&C insurers
2. Identify actionable vulnerabilities.
3. Extensive industry literature research
4. Firsthand stakeholder interviews
5. Analysis of Insurer data points
6. Live platform demonstrations
7. Experience developing and enacting counter measures in both public policy and private sectors.

Recommendations, fully described in subsequent sections of this report, include creating actionable detailed strategies to counter-act detrimental impacts. More specific steps that apply to each action plan include, systematically analyzing internal data, determining expectations, identifying trends, pros and cons, definitive metrics to assess effectiveness, and the likelihood of achieving minimum, moderate, maximum benefits. Additionally, an

[1] Social Inflation: Navigating the evolving claims environment, The Geneva Association

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analysis of insurer requirements, defense selection and management practices will be needed to identify potential vendors.

> *"The most powerful defenses to litigation exposures are execution of avoidance and mitigation strategies. This begins with loss control. Using data and predictive analytics and leveraging emerging technologies like telematics is useful in developing overall avoidance and mitigation plans of the initial losses." Sedgwick, Winter 2024: Casualty, Auto*

Specific technological capabilities are driving disruptive growth of the litigation economy. These same technologies are also core to insurer counter measures. Therefore, the best place to start is with a brief set of technology definitions.

Technological Capabilities Defined

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.

Figure 1 is a graphical representation of a standard lifecycle of a liability claim. The statistics provided indicate both the warning signs of industry disruption as well as insurer opportunity. As for the opportunities: Insurers need to rethink marketing and social media spends as consumers appear open to hearing counter-litigation messages. An upcoming chapter of the report goes into detail about countering attorney influence strategies.

Secondly, the numbers regarding ***when*** claimants hire an attorney must be taken very seriously. Let's begin with the baseline stat for perspective. Depending upon the state and line of business, 62% to 94% of liability claimants seek representation. Consider the average for personal lines vehicles of 62%. Within this cohort, 57% hire their lawyer prior to insurers knowing a loss has occurred. A total of 96% hire an attorney prior to insurers 1st settlement offer. One really damaging statistic not included in Figure 1 is the 71% of claimants, represented by an attorney prior to claim submission, who are encouraged by their attorney to seek additional medical treatments such as 2nd & 3rd opinions, often involving expensive specialized diagnostics. Again, one section/chapter of the report explains the interconnectivity of third-party litigation investors, plaintiff attorneys, and the status within each state of evidentiary challenges with the Collateral Source Rule. i.e. legal phantom billing.

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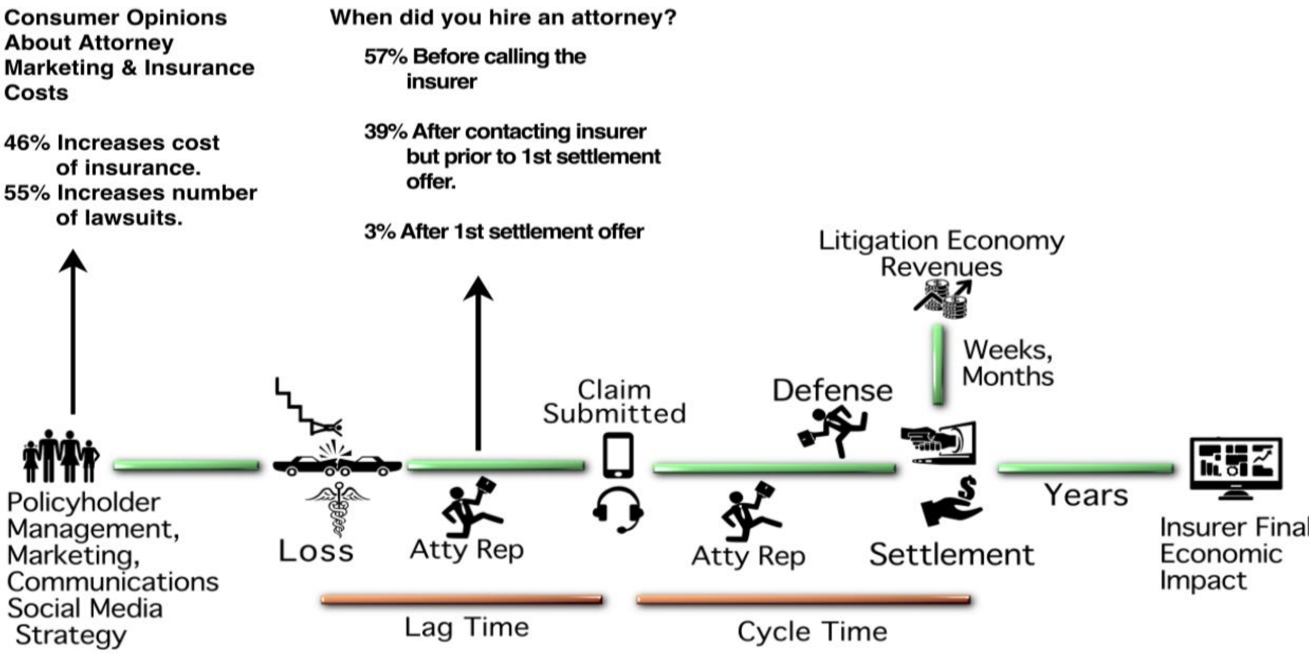

Figure 1: A simplified claim cycle with key relevant stats

Section 2 explains how the litigation economy has been able to drive "hockey-stick" exponential growth, by exploiting insurance industry vulnerabilities.

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.

Advisory services rely upon quantifying impacts as well as external core drivers that have resulted in complex problem-based opportunities. Qualitative analyses are also leveraged to assess roadblocks, potential conflicts within incumbent cultures. Finally, the process of developing strategies based on forward focused relevance and achieving scaled success rely upon best-in-class methods known as design thinking, innovation, and scenario planning.