Casualty claims severity significantly outpacing economic inflation

By Erin Ayers, Front Page News

Claims costs for commercial auto, professional liability, product liability and directors and officers liability insurance have exceeded economic inflation over the last decade, with social inflation the likely culprit, according to new data from AM Best.

Social inflation has been a “thorn in the side of casualty insurers” for some time, the ratings agency said, with loss severity rising at double the pace of economic inflation. For example, the average loss severity increase from 2013-2023 for product liability was 20.4% while average annual economic inflation was at 2.7%.

“The “social” part of the term refers to shifting social and cultural attitudes about who is responsible for absorbing risk (the insurer or the plaintiff), which makes social inflation tough to quantify—and makes it even more difficult for insurers to predict and mitigate its impact,” said Best in its report. “As social dynamics continue to evolve, navigating the complexities of social inflation will remain a challenge for the insurance industry.”

For excess liability and umbrella coverage, loss severity increased by an average of 11.1% over the last decade.

“The rise is not just a one-year phenomenon — loss severity has been rising for 10 years,” said the firm, noting that social inflation has been the largest cause of adverse loss development over the last decade. While economic inflation can be assessed based on historical data typically; even when economic inflation spiraled higher in 2021, it is measured with a range of values by economists.

“The same is not true of social inflation. When a nuclear verdict is awarded, it affects not just the one claim, but also all other open claims, as plaintiffs, guided by their attorneys, seek a similar verdict or settlement, rendering an insurer’s existing reserves inadequate,” said Best.

Best also attributed some of the rise in claims costs of more attorney involvement in commercial lines, with the COVID-19 pandemic a “catalyst” for

more legal activity. The American Tort Reform Association has reported that between March 2020 and December 2020, more than 176,000 television ads for legal services mentioning COVID-19 had aired in the U.S. By February 2021, at least 8,200 lawsuits tied to the pandemic were filed.

With lawsuits increasingly comes third-party litigation funding, a factor that has complicated the situation.

“Insurers have been challenged in using pricing models to mitigate legal costs arising from the growing number of outsized jury awards, or owing to legal proceedings that are taking longer than expected to be resolved,” said Best. The firm noted that it would be analyzing how insurers demonstrate their understanding of the exposures in their portfolios and efforts to limit large losses.

Best’s research came out just after Moody’s Ratings issued a report on social inflation that predicted the phenomenon would press property/casualty insurers to keep raising prices.

“We expect social inflation to continue, and insurers to respond by building higher expected losses into their policies, raising prices and boosting reserves,” said Jasper Cooper, CFA, VP, and senior credit officer at Moody’s Ratings.

Moody’s highlighted the fact that P/C insurers’ reserve releases have declined, with companies strengthening reserves particularly in commercial auto and general liability for accident years 2015-2019.

“Commercial auto liability losses have more than doubled in the last decade, Moody’s found, noting that the effects of social inflation may be hitting harder now.”

“Social inflation tends to hit personal auto first since claims tend to be more numerous, smaller and settle more quickly. The same factors that cause personal auto claims to increase tend to take longer to play out in longer-tail lines such as commercial auto and general liability,” said the firm, adding, “Some insurers have been slower to raise rates and boost reserve assumptions because commercial auto is often written as part of a package with more profitable lines.”

Moody’s said it saw “modest reserve deficiency” in long-tail lines of insurance. These have partially been offset by reserve redundancies in other lines.

“We expect that insurers will continue to report favorable development for short-tail lines and workers’ compensation, helping to offset adverse development for commercial auto and general liability,” said Moody’s.