life annuity specialist

Carriers Warn the Skyrocketing Cost of Lawsuits Will Lead to Premium Hikes

So-called "nuclear verdicts" are fueling ever larger damage awards that are eating into insurers' earnings — and could make their products more expensive.

By Warren S. Hersch | April 22, 2024

Life insurers are shelling out ever more in jury awards, settlements and legal fees arising from lawsuits from policyholders, employees, and others. The mounting dollar amounts can strain finances, and so spur carriers to boost premiums, making their products less affordable.

When payouts stemming from claims outpace the general increase in prices, it's known as social inflation. The phenomenon, turbocharged by so-called "nuclear verdicts" — jury awards exceeding $10 million or where noneconomic damages are disproportionate to economic damages — are at the heart of social inflation, according to **Rob Olson**, a senior counsel at the law firm **Tyson & Mendes**.

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"We have determined juror anger to be the biggest driver of nuclear verdicts," Olson said in an email, referencing the firm's analysis of the judgments. "Insurers are notoriously unpopular defendants, so life insurers are ripe for bad faith claims that could easily go nuclear."

This risk profile, he added, necessarily results in higher claim payouts and loss ratios. The latter is a measure of the percentage of claims paid plus adjustment expenses compared to premiums earned.

Ashley Paige Fetyko, a senior counsel and communications director at **Tyson & Mendes,** said that nuclear verdicts are being handed down in every type of case and almost daily. In recent years, they've also been happening in places outside the usual so-called "judicial hellholes" — plaintiff-friendly jurisdictions where juries are more prone to awarding higher damages.

Chain Reaction

Publicity about such huge judgments erodes both future jurors' and plaintiffs' understanding of what is reasonable, thus desensitizing them to big numbers, she said. The result is a domino effect where each nuclear verdict boosts the next, leading to increasingly exorbitant settlements and jury awards disconnected from any quantifiable economic harm done.

Ashley Paige Fetyko, a senior counsel and communications director at Tyson & Mendes

"How can an insurer accurately predict claim costs when they are constantly rising, with no barometer in place to keep them in check?" Fetyko asked. "Insurers are tasked with an almost-impossible feat in pricing for risk given the current climate — which shows no sign of stopping."

Catherine Leatherwood, a member of the DRI Center for Law and Public Policy

Catherine Leatherwood, a member of the **DRI Center for Law and Public Policy**'s social inflation task force, said in an email that she expects claims costs will continue to outpace general economic inflation at "an astounding rate" absent significant change in the drivers underpinning the trend. She also anticipates a greater effect of social inflation on life insurance premium-setting and affordability.

"This is something that both juries and the plaintiffs' bar need to understand," she said, referencing attorneys who represent claimants in suits. "If they represent individuals for a living, it's doing them a disservice by contributing to increasing all insurance costs for everyone across the board."

Quantifying the Damage

Social inflation's impact is commonly viewed as less pronounced on life insurers than on their peers among property and casualty carriers, notably issuers of auto and homeowners insurance. But if the trendline in the P&C segment is any guide to future payouts by life carriers — among them sellers of litigation-prone disability income products, and mispriced life and long-term care policies hit with premium hikes — the outlook appears grim.

A report from the **Insurance Information Institute** reveals that commercial auto liabilities increased every year from 2012 to 2023, totaling nearly $30 billion over the nine-year period. The report flagged several drivers of legal system abuse, where insurance claims could have been resolved without litigation. They include litigation funding from third parties like institutional investors, and billions of dollars that plaintiff attorneys' spend annually on advertising. The III report also cited a rise in plaintiff attorneys' contingency fees, and eroding caps on damage awards, which increased on average 27.5% between 2010 and 2019.

"Greedy and unethical plaintiff lawyers are seeing an opportunity — almost an arbitrage opportunity — to exploit societal attitudes and make a buck off of insurance companies," **Kenneth Klein**, professor of law at the **California Western School of Law**, said Thursday during webcast of the **Society of Insurance Research**. A focus of the event was a paper he authored examining the need for legal system reforms necessitated by social inflation.

Findings From a New Survey

A particular concern for insurers is the massive damage awards that can arise from class action litigation. A 2024 survey from the law firm **Carlton Fields** reveals that spending on class actions now represents about 14.6% of corporate legal spending, up from 14.4% last year, and is approaching $4 billion. By type of action, the top categories are labor and employment (38.9% of spending), consumer fraud (18.9%), securities (12.8%), and product liability (9%).

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Jack Clabby, co-director of the survey, highlighted in an interview a rise in consumer fraud-related lawsuits, such as those arising from alleged misrepresentations in product illustrations and sales presentations, as top risks for carriers. He noted that social media has often been used as the basis for filing claims.

He also cited the growth of data privacy and cybersecurity-related class actions as an area of concern. The issue has become an increasingly urgent one for carriers to address following a flood of class-action litigation last year stemming from data breaches, including lawsuits against **Athene**, **Corebridge Financial**, **Global Atlantic**, **Prudential Financia**l, and **TIAA**.

Data privacy, the survey noted, dominates the expected class actions arising from the use of generative artificial intelligence. Respondents said they see claims increasing from the unintended release of sensitive data, misuse of AI, limited controls over access, and targeted phishing using chatbots.


Jack Clabby, co-director of Carlton Fields' Class Action Survey

Clabby flagged two particular risks for carriers regarding data privacy liabilities and artificial intelligence.

First, if insurers train their generative AI models on a large set of company data, they could be held liable if they fail to secure customers' consent to collect and use their personal information in such a way.

Second, if they employ a third-party vendor to develop an AI-driven product or service, carriers can be held responsible if they fail to ensure that their contractors implement robust data security and privacy measures when handling their customers' information.

"Those are the two areas where there already has been a fair number of lawsuits," he said. "And that has been driving a lot of the worry."

Yet AI may also help insulate the industry for social inflation. Olson of Tyson & Mendes said a product from **Schaefer City Technologies** uses AI to identify claims likely to go nuclear, so insurers can address them before they ever get to court.

"This kind of adaptation and innovation is what it is going to take to manage risks in the nuclear verdicts era," Olson said.