



DAC BEACHCROFT

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SOCIAL INFLATION

NASCENT BUT NOTABLE: SOCIAL INFLATION IS CREEPING BEYOND THE US

CRITICAL CERTAINTIES

AN INTRODUCTION TO OUR LATEST THOUGHT LEADERSHIP: **CRITICAL CERTAINTIES IN AN UNCERTAIN WORLD**

One of the key objectives of our Informed Insurance thought leadership has been to focus on critical uncertainties - those potentially disruptive challenges that loom on the far horizon of everyday business but have the potential to fundamentally reshape the world of insurance.

When we published our scenario planning tools just four years ago, our map of critical uncertainties aimed to encourage the industry to focus on these growing future challenges. Today, many of these distant uncertainties are in fact part of our day-to-day life. Artificial intelligence, the rise of political violence, the pressures of social inflation and the need to prioritise the mental health of staff, especially those dealing with traumatic claims, are now critical certainties. The impact extends to all boardroom agendas as a myriad of resulting new regulations increases the level of responsibility placed on business leaders.

The rapid pace of change and the dramatic impact of these critical certainties will themselves create new uncertainties. Our aim through Informed Insurance is to give you the insight to face such challenges and opportunities with confidence.



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NASCENT BUT NOTABLE: SOCIAL INFLATION IS CREEPING BEYOND THE US

Traditionally identified as a US-centric issue, insurers' financial exposure to the risk of social inflation is now being widely discussed in other insurance markets. In 2024, this is a global issue that all casualty insurers need to factor into their scenario planning.

Social inflation can be defined as the increase in insurers' claims costs beyond general economic inflation.

There are a number of factors that give rise to social inflation: collective redress mechanisms, litigation funding, emerging risks, public sentiment, jury trials and strategies employed by claimants. These factors do not apply uniformly across jurisdictions. While there are no other jurisdictions that come close to matching the nuclear verdicts seen in the United States, changes in the approach of regulators and the courts mean that insurers must consider the current profile of each jurisdiction to ensure the impact of social inflation is accounted for in modelling and reserving.

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Collective redress

“Social inflation may have been born in the United States,” comments Duncan Strachan, a partner at DAC Beachcroft in London and class actions lead, “but a number of jurisdictions globally are developing frameworks for both collective redress and litigation funding which could see social inflation become more of an international issue.”

Collective redress mechanisms, such as group actions, are a significant driver of social inflation. By allowing large numbers of claimants to pursue actions not ordinarily pursued individually, successful actions drive increased insurer costs.

The United States has long-established collective redress mechanisms, whether state or federal in nature. Some claims involve tens of thousands of plaintiffs. There are various different forms of group action in England and Wales. Mechanisms also exist in other parts of the world including Singapore and many Latin American countries.

By comparison, European nations historically have not encouraged collective redress, with routes often limited in scope. The Netherlands is seen as an exception, with its WAMCA group action regime helping inform the creation of the European Union Representative Action Directive (RAD). Introduced in 2020, the RAD mandated the establishment of both domestic and cross-border representative actions in member states for breaches of defined pieces of European Union consumer law.

Despite inconsistent implementation of the RAD in Member States to date, Strachan highlights: “The introduction of representative actions will lead to more litigation in certain jurisdictions, particularly those considered favourable to litigants. However, developments are at a very early stage. The impact of some states such as Germany choosing to widen the scope of their domestic legislation beyond that required by the RAD could make them jurisdictions of choice.”

Anthony Perotto, an insurance and reinsurance partner at DAC Beachcroft in Milan, agrees: “In Italy, the implementation of the RAD in June 2023 through Legislation Decree 28/2023, which inserted new articles into the Italian Consumer Code, is likely to increase consumer actions. Such expectation is further strengthened by certain material advantages allowed to the consumers by the new legislation.”

The full impact of the RAD on claims costs cannot yet be assessed, but casualty insurers should keep track of issued representative actions and outcomes in order to understand trends and possible impacts.

Litigation funding

Heavily linked to expectations of increased group or class actions is the use of litigation funding, which can generate increased claims and subsequent claims awards and costs. Third party litigation funding allows claimants to pursue actions previously considered financially prohibitive and the litigation funding markets in England and Wales, and certain European nations, are growing.

“Attitudes are definitely changing in Europe on litigation funding,” says Strachan. “However, there are concerns about undue influence on litigation. Both the Civil Justice Council in England and Wales, and the European Union are considering formal regulation of funders. Similar measures are being considered across various states in the US too. We expect that any regulation in Europe will be relatively light-touch in order not to strangle nascent funding markets.”

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Emerging risks

The emergence of new risks and their impact on insurers' claims costs is a cross-jurisdictional concern. Certain emerging risks may drive social inflation across a number of jurisdictions.

For example, in Europe, the introduction of the new Product Liability Directive, when combined with the provisions of the RAD, should place insurers on alert. In the US, product liability claims form a significant proportion of mass litigation.

Another major product risk developing worldwide is that of PFAS (and related compounds), better known as forever chemicals. The use of PFAS in a wide range of consumer products such as Teflon has been ongoing since the 1960s. However, there is now significant concern over the health and environmental risk posed by exposure to PFAS. Regulatory action worldwide remains slow-moving, yet manufacturers of products containing PFAS are already the subject of class actions in the US, despite an absence of scientific consensus on health effects.

Ian Plumley, London-based international coverage, defence and subrogation disputes partner at DAC Beachcroft says: "It is difficult to overstate how widespread the use of these chemicals was, and by extension, the potential claims exposure. Traditionally the US has been the home of social inflation and the epicentre of PFAS-related litigation but, in Europe, it has been Sweden and Belgium that have taken the lead so far in tackling the impact of PFAS. The litigation that has resulted and the regulatory measures adopted in those countries will likely create more political pressure for other European jurisdictions to act."

Vladimir Rostan d'Ancezune, industrial risks and product liability partner at DAC Beachcroft in Paris, confirms: "PFAS litigation has been significantly increasing over the last few years in the US, and in Western and Northern Europe. At the same time, both PFAS-ban legislation and PFAS-duty to report statutes are being enacted across the globe. A new development in France has been the increase in criminal prosecutions relating to PFAS. The pressure, and associated costs, on manufacturers and distributors has sky rocketed".

There will also be risks that are unique to each jurisdiction, with the risk of litigation heavily influenced by the nature of the legal system. Certain jurisdictional factors will keep elements of the social inflation phenomenon closely tied to the American legal system for the foreseeable future.

US-style claims relating to glyphosate or actions for opioid addiction are unlikely to occur in EU member states, England and Wales. US glyphosate litigation has generated a number of significant multi-million (and billion) dollar awards, identified as 'nuclear verdicts', despite a lack of conclusive medical evidence demonstrating a causative link to cancer.

Strachan highlights that "In the UK and Europe, quantum is based on putting the claimant back into the position that they would have been in prior to the injury. In the US, because the jury decides the award and punitive damages can be awarded too, anything goes. There's less control over the level of compensation in US civil trials, although nuclear awards are frequently reduced by the trial court or on appeal."

Public sentiment

Public sentiment in the United States can have a disproportionately large impact on civil claims, as outcomes can be influenced by personal bias, such as mistrust of corporations and social activism. Understanding these sentiments and prejudices, the US plaintiff bar has developed strategies to maximise awards, often using previous decisions to 'anchor' jury expectations about what is a standard settlement figure. There are even signs that the factors influencing the juries are spreading to judges, as seen in a recent US\$60m judgment handed down by a judge in a Texas personal injury claim.

In the UK and Europe, judicial-led decisions and damages awards based on statutory guidelines mean that the headline grabbing figures seen in the US are rare. Perceptions of fairness and public sentiment may result in courts and legislatures being willing to expand liability in certain instances where public policy and access to justice dictates, but decisions are not led by the passions or prejudices of a civil jury.

The picture is more complicated in Latin America, where some jurisdictions, such as Mexico and Argentina, are witnessing increasing examples of the courts implementing social justice through substantial increases in damages. This is achieved through a combination of a lack of statutory limits on compensation and a range of measures that include judges inflating damages to include a punitive element and awarding double asset interest.

Samantha Ellis, Head of Casualty Claims at Tokio Marine Kiln, supports this view: "Courts in some LatAm countries appear to be issuing rulings in an attempt to address societal or individual rights, as opposed to allowing the legislatures to address those issues. Those rulings are often in cases brought against corporations, who shoulder the increased costs of the judgments, which in turn are then passed down to their insurers."

This is confirmed by Miguel De la Fuente, a partner at DAC Beachcroft in Mexico: "Mexico is starting to follow a similar approach to the US. The courts are endorsing a pro-human rights view based on the concept of 'full damage reparation' from the Inter-American Court of Human Rights and the constitutional amendments enacted in 2011. As a result, the courts have recognised new heads of damage and adopted punitive damages as a way to deter wrongful conduct from tortfeasors."

Martín Argañaraz, Managing Partner at DAC Beachcroft Argentina adds: "In Argentina, even though the Supreme Court has said that the limits of indemnity in policies should be respected (as recently as in December 2023), lower courts are still handing down judgments that disregard policy limits, causing uncertainty to insurers and reinsurers."

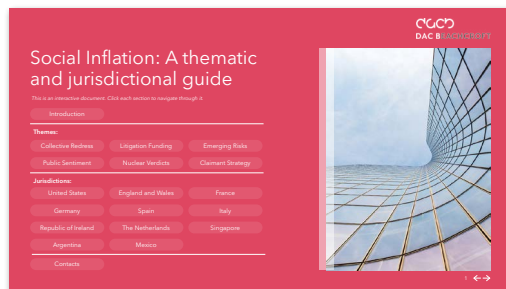
It would not be surprising to see this trend spread, particularly in emerging markets where there is more flexibility when it comes to determining liability and making compensation awards.



The future?

As Plumley summarises: “Casualty insurers in the UK and Europe will need to be mindful of social inflationary trends in the US, but this should not be used as a model or benchmark for future development. While a one-size-fits-all approach is not appropriate, insurers should study various thematic touchpoints such as collective redress and litigation funding when considering social inflation in their jurisdiction.”

DAC Beachcroft’s thematic and jurisdictional guide to social inflation can be found here at:



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