Coverage Insights

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The Impact of Social Inflation on the Commercial Auto Insurance Market

In recent years, social inflation has become a growing concern within the commercial insurance market. Social inflation refers to the rising costs of insurance claims. These inflation issues are the result of several societal shifts, such as increased litigation funding, tort reform challenges and deteriorating public sentiment toward corporations.

Although social inflation has affected various lines of commercial coverage, the auto insurance market has been particularly impacted. This is mainly due to trends occurring in the trucking industry, including a surge in costly lawsuits and subsequent settlements brought on by increasing crash frequency and severity.

Amid these difficult conditions, it’s important for businesses to understand what’s causing social inflation and how to respond properly. Review the following article for more information on the primary drivers of social inflation, how social inflation is affecting the commercial auto insurance space and what businesses can do to mitigate associated coverage concerns.

Primary Drivers of Social Inflation

Multiple factors have been frequently cited as reasons for social inflation issues over the past few years. These factors include the following:

- **Litigation funding**—One of the main drivers of social inflation is increased litigation or, more specifically, litigation funding. Litigation funding is when a third party provides financing for a lawsuit. In exchange, the third party receives a portion of the settlement. In the past, the steep cost of attorney fees would often scare plaintiffs away from taking a lawsuit to trial. But, through litigation funding, most or all costs associated with litigation are covered by a third party, which has increased the volume of cases being pursued. Not only is litigation funding becoming more common, but it also increases the cost of litigation overall—sometimes to seven figures. This is because plaintiffs can take cases further and seek larger settlements.
- **Tort reform rollbacks**—Tort reform refers to laws designed to reduce litigation. In particular, tort reforms are used to prevent frivolous lawsuits and preserve laws that prevent abusive practices against businesses. Over the last several decades, many states have enacted tort reforms, leading to fewer claims and caps on punitive damages. However, in recent years, a number of states have modified tort reforms or challenged them as unconstitutional. Complicating matters, tort reform is subject to uncertainty, as it’s primarily tied to the interests of individual states. Should tort reform continue to erode, there could be fewer restrictions on punitive and noneconomic damages—which can drive up the cost of claims and exacerbate social inflation.
- **Public sentiment toward corporations**—In the past decade, overall public sentiment and trust toward businesses (especially large corporations) have deteriorated. These attitudes have been fueled by the spreading of extreme ideas and opinions via media outlets and social media platforms as well as the growing perception that businesses should be held liable for incidents involving injuries or other damages, regardless of whether such incidents stemmed from their negligence. This trend has had a considerable impact on how businesses are perceived by a jury in court, and employers are held to a high standard for issues related to the way they conduct their business. In fact, juries are increasingly likely to sympathize with plaintiffs, especially if a business’s reputation has been tarnished in some way in the past. As a result, plaintiff attorneys are likely to play to a jury’s emotions rather than the facts of the case. Compounding this issue, there’s an increasing public

perception that businesses—particularly large ones—can afford the cost of any damages. This means juries are likely to have fewer reservations when it comes to awarding damages, thus resulting in larger settlements, increased claim costs and subsequent social inflation issues.

The culmination of these factors has allowed for a surge in litigation against businesses and related insurance claims. Furthermore, the settlements resulting from such litigation have soared in price, leading to a rising number of nuclear verdicts—jury awards with penalties exceeding $10 million. According to recent loss data from Advisen (a Zywave company), the median cost of a nuclear verdict increased from $20 million to $27 million between 2015 and 2020, representing a 35% jump. What's worse, lasting impacts and trends from the ongoing COVID-19 pandemic are expected to contribute to additional nuclear verdicts in the months and years to come. As these verdicts continue to surge in cost and frequency, excessive insurance claim expenses and social inflation issues will likely follow suit.

How Social Inflation Affects the Commercial Auto Insurance Market

Social inflation can create difficulties for all lines of commercial coverage. Specifically, the rising litigation expenses associated with social inflation often result in costly insurance claims, forcing insurers to make major payouts to affected policyholders. These substantial payouts can lead to poor loss ratios and reduced underwriting profits. To combat such losses, insurers are increasingly likely to elevate policyholders' premium costs and introduce additional coverage restrictions.

While these challenges have occurred throughout the commercial insurance space, the auto insurance segment has faced significant struggles due to social inflation. This is primarily because the commercial auto market had already been unprofitable for insurers over the past decade. According to a recent report from AM Best, commercial auto underwriters saw more than $22 billion in underwriting losses between 2011 and 2020 despite underwriters increasing commercial auto premium pricing for more than 40 consecutive quarters, dating back to Q3 of 2011. Consequently, rising social inflation issues have simply exacerbated the commercial auto segment's existing profitability concerns, extending the hard market and creating continued challenges for insurers and policyholders alike. Looking ahead, industry experts predict that this hard market will continue to be a concern in 2022 and beyond.

As such, the majority of businesses with commercial auto exposures—regardless of their industry or vehicle class—will likely have a more difficult renewal process by way of greater premium rates, lowered capacity and more stringent policy requirements or restrictions. Further, policyholders with larger fleets or a poor loss history may experience more severe rate increases.

Taking a closer look into the reasons why the commercial auto insurance market has encountered prolonged profitability issues and is being more substantially affected by social inflation, it's important to note that various trends within the trucking industry have contributed to these market challenges. Namely, certain sector-specific developments have resulted in increased litigation, a rise in nuclear verdicts and—subsequently—greater losses for the commercial auto segment overall. Such trucking industry trends include the following:

- **Elevated accident frequency**—First, fatal truck crashes have become increasingly common over the last decade, leading to further litigation and associated expenses. In fact, the National Safety Council (NSC) reported that fatal crashes involving large trucks have risen 43% since 2010, totaling more than 5,000 incidents annually. According to the National Highway Traffic Safety Administration, such crashes have been linked to an increase in unsafe or negligent behaviors behind the wheel (e.g., speeding, hard braking and distracted driving).
- **Greater accident severity**—In addition to elevated accident frequency, road incidents have also surged in severity. This rise in severity is evident through the aforementioned increase in fatal truck crashes as well as the surging cost of a single fatality. According to loss data from Advisen (a Zywave company), the median cost of a single fatality jumped to $3.7 million in 2020, which represents a 60% increase from $2.3 million in 2010. Apart from fatalities, road incidents resulting in major injuries have also contributed to elevated crash severity. Data from the NSC confirmed that 160,000 injuries result from truck crashes each year. These injuries often require multiple doctor visits, complex procedures (e.g., surgery) and advanced treatment plans, which can extend recovery time and influence overall medical costs. In any case, such severe accidents have been a driving factor in increased trucking industry litigation and related losses.
- **Increased violations**—Lastly, both driver and vehicle violations have led to additional litigation (and subsequent costs) across the trucking sector. These violations can stem from a lack of driver safety education and poor vehicle maintenance protocols. The latest Federal Motor Carrier Safety Administration (FMCSA) data found that the most common driver violations include inadequate licensing, driving record issues and electronic logging device concerns. On the other hand, the most common vehicle violations include tire problems, defective brakes and inoperative turn signals. According to the

American Transportation Research Institute (ATRI), the top violations that have resulted in plaintiff-favored verdicts include those related to hours-of-service rules, poor driver history, fatigued driving and the use of controlled substances behind the wheel.

As a result of these industry trends, the average jury award for a lawsuit above $1 million involving a truck crash has skyrocketed by 1,000% over the past decade—climbing from $2.3 million to $22.3 million, according to the ATRI. Additionally, the percentage of trucking awards exceeding $10 million increased 15% between 2017 and 2021, with these significant losses accounting for more than one-third (35%) of trucking losses over $1 million. This is a notable increase from the prior eight years, when trucking awards over $10 million accounted for just 20% of losses over $1 million, according to loss data from Advisen (a Zywave company).

Steps Businesses Can Take

As increased litigation, nuclear verdicts and social inflation continue to impact the commercial auto insurance market, it's important that policyholders consider the following measures to prevent potential claims and minimize coverage challenges:

- **Ensure adequate hiring practices.** Make sure to hire experienced and qualified drivers. Specifically, drivers should be able to provide proof of proper licensing and a clean driving record. After all, the ATRI found that in 100% of nuclear verdicts reported during 2020 in which a driver's history was used as evidence against a business, the business lost the case.
- **Prioritize retention.** In addition to hiring adequate drivers, it's critical to retain these employees. According to recent research from Idelic, drivers are 40% less likely to get involved in a crash during their second year with a business when compared to their first year—showcasing just how valuable employee retention is. Possible driver retention tactics may include increasing drivers' salaries, allowing extra paid time off or offering well-being stipends.
- **Establish a culture of safety.** It's also vital to communicate the importance of road safety and accident prevention to drivers. This can be accomplished by offering routine driver safety training, scheduling regular safety meetings, providing ample road safety resources and giving rewards to drivers who demonstrate safe behaviors behind the wheel (e.g., a monetary bonus).
- **Utilize technology.** A range of vehicle technology can be used to monitor road conditions, assess drivers' behaviors and prevent accidents. In other words, this technology can collect important data and offer additional insight on how to maintain safe driving operations. Examples of such technology include telematics devices, vehicle cameras, communication systems and advanced navigation programs.
- **Maintain compliance.** To prevent litigation and associated claims due to driver or vehicle violations, it's best to reach out to proper legal counsel to assess compliance requirements—particularly as it relates to Department of Transportation and FMSCA standards. Any applicable requirements should be reflected within workplace policies and procedures.
- **Consult an insurance professional.** Finally, be sure to regularly communicate with a trusted insurance professional regarding proper risk management tactics and coverage solutions. This professional should also be able to determine whether any policy adjustments are necessary and may discover opportunities for premium discounts.

For more coverage guidance, contact us today.