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GENESIS | 2023 CLIENT FORUM

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LEADING *for* TOMORROW.**

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William Wilt, President, Assured Research, LLC

Trends in Economic and Social Inflation



- Economic Inflation Matters
 - As does the distinction between flexible and sticky inflation
 - We're bearish (cautious) on medical trends
- Insurers have Historically Performed OK during Inflationary Periods
 - Data back to the early 1950s and 1970s
 - A look ahead to 2024e
- Social Inflation Matters More
 - We offer some ways to monitor social inflation
- Don't Bet on Tort Reform
 - Nuclear verdicts have NOT led to below average economic growth



Economic Inflation Matters

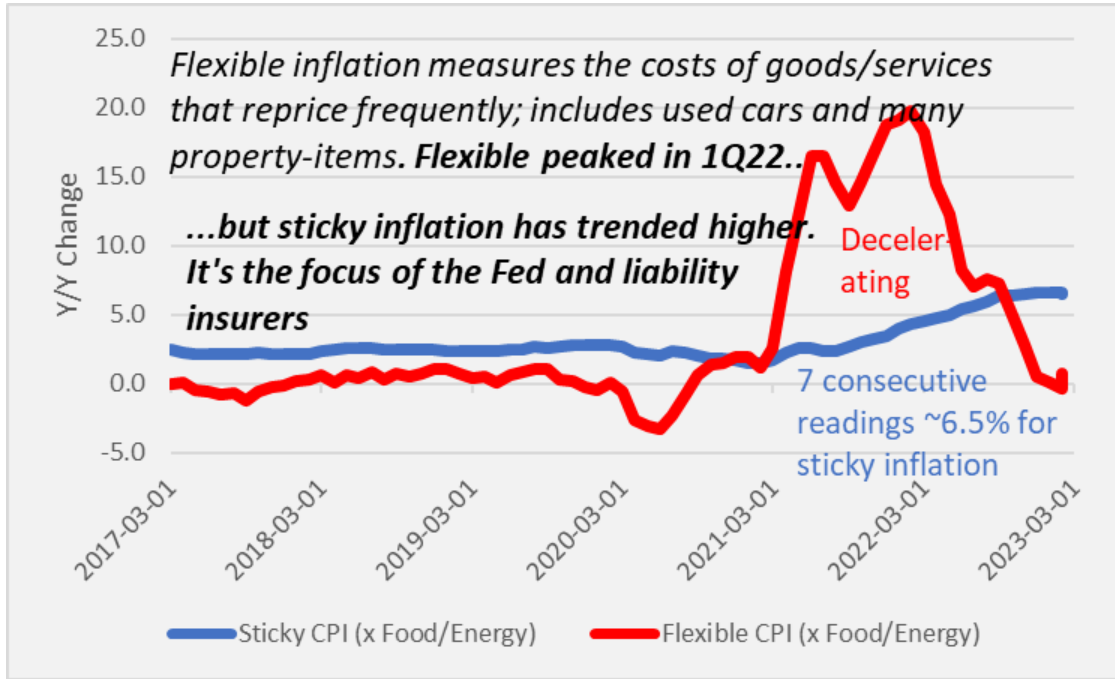
Insurance professionals (actuaries) have proven adept at incorporating changes in economic inflation into pricing; effectively neutralizing its impact on U/W results.*

**That's not to say the track record is perfect or that price changes occur simultaneously with inflection points in inflation*

Flexible Inflation is Receding; Sticky Proving Aptly Named



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It's reasonable to think of flexible inflation as being primarily relevant for property claims and 1st party coverages. It is receding, though auto insurers are still struggling with it.

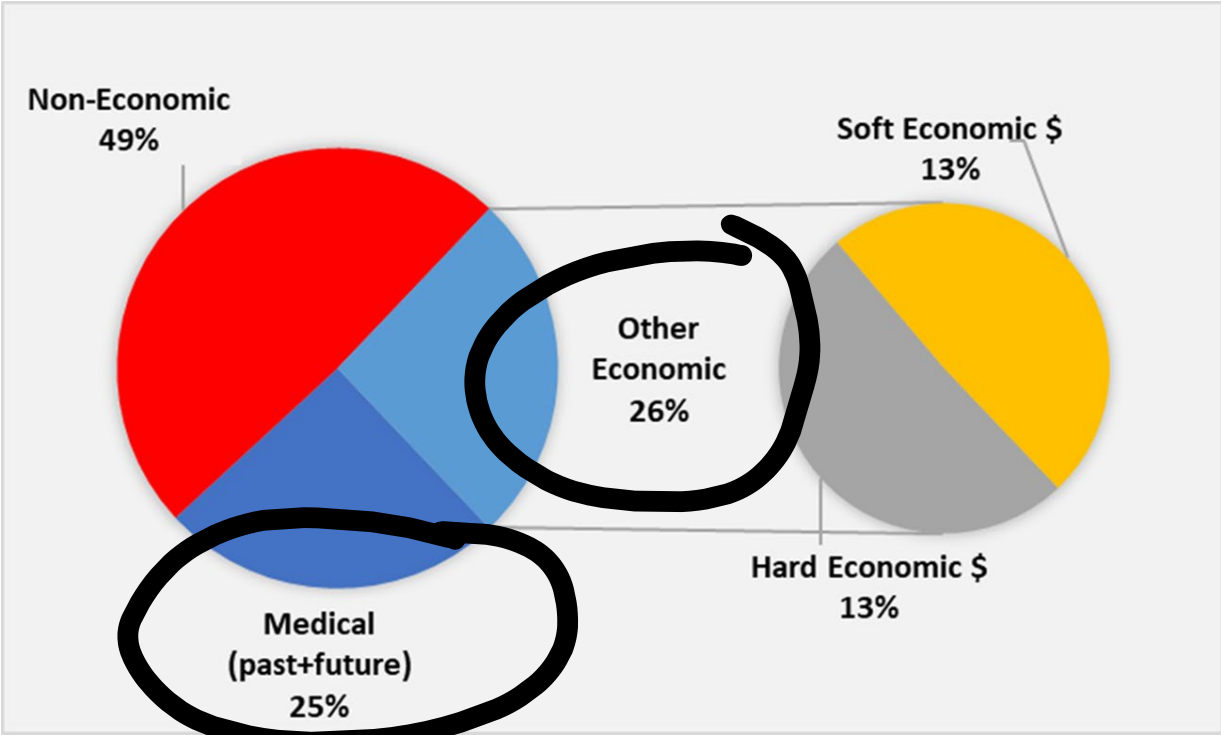
Sticky inflation incorporates longer-lived contracts including medical, wage, and legal services. It is-sticky!

Source: BLS, Assured Research

Quantifiable Economic Costs are about 1/2 Liability Claims



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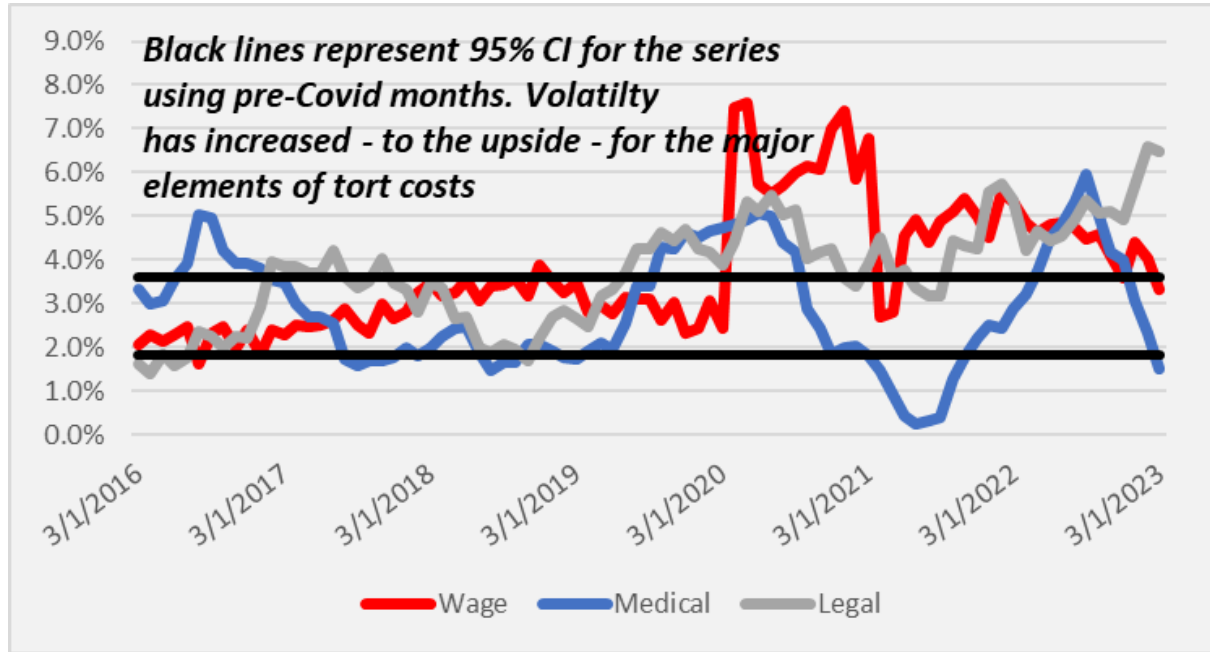
Of the roughly 50% of liability claims represented by readily quantifiable economic costs, medical costs, wages, and legal expenses are among the leading costs.

Source: VerdictSearch, Assured Research

Wages, Medical, Legal Costs: Volatile Since 2020



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Our main observation on these important liability cost drivers:

They've become noticeably more volatile since the start of the pandemic... and mostly to the upside.

We'll comment on the downtick in the medical CPI a bit later...

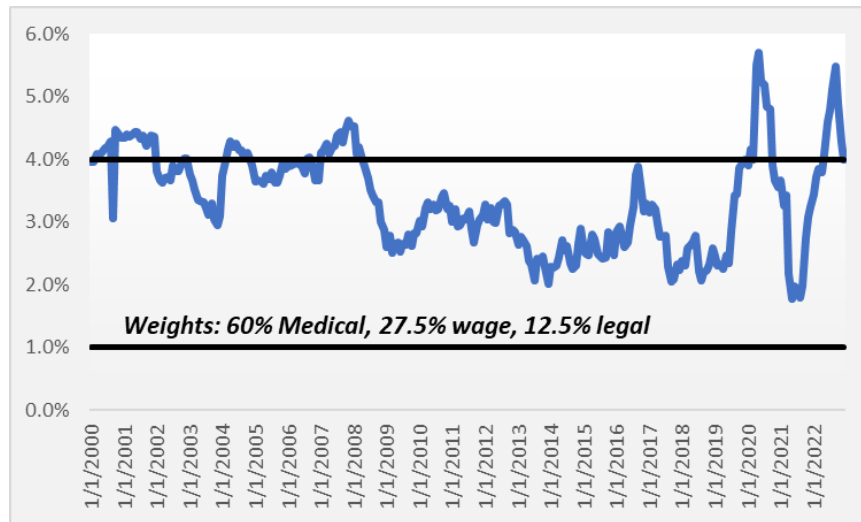
Source: BLS, Assured Research

A Longer-Term Look and Why the Trends Matter



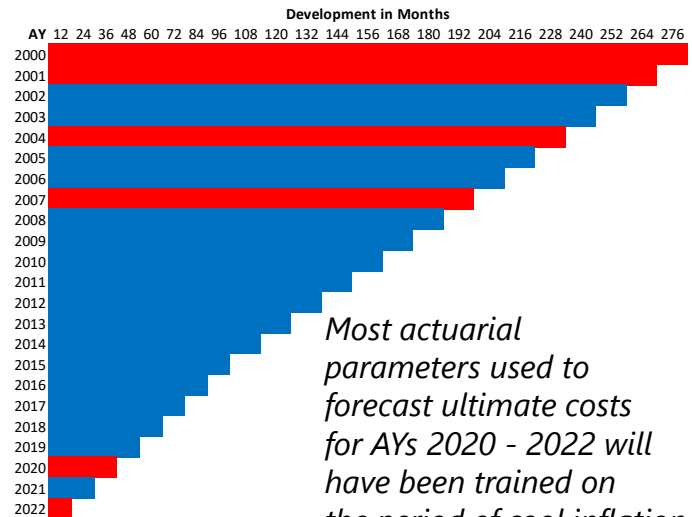
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Wages, medical, and legal costs behaved well from ~ 2000



Source: BLS, Assured Research

Past performance not indicative of the future – caution on recent AYs





Why? Economics

- Longer term supply/demand imbalances
- Over half of U.S. hospitals are losing money (CEO of American Hospitals Assoc.)

Why? Gov't policies

- Recipients of Medicaid rose from 19% of the population pre-pandemic to 27% post-pandemic
- That's relevant because Medicaid reimburses at 50% (or less) of private payers
- P/C insurers typically reimburse at rates higher than private payers

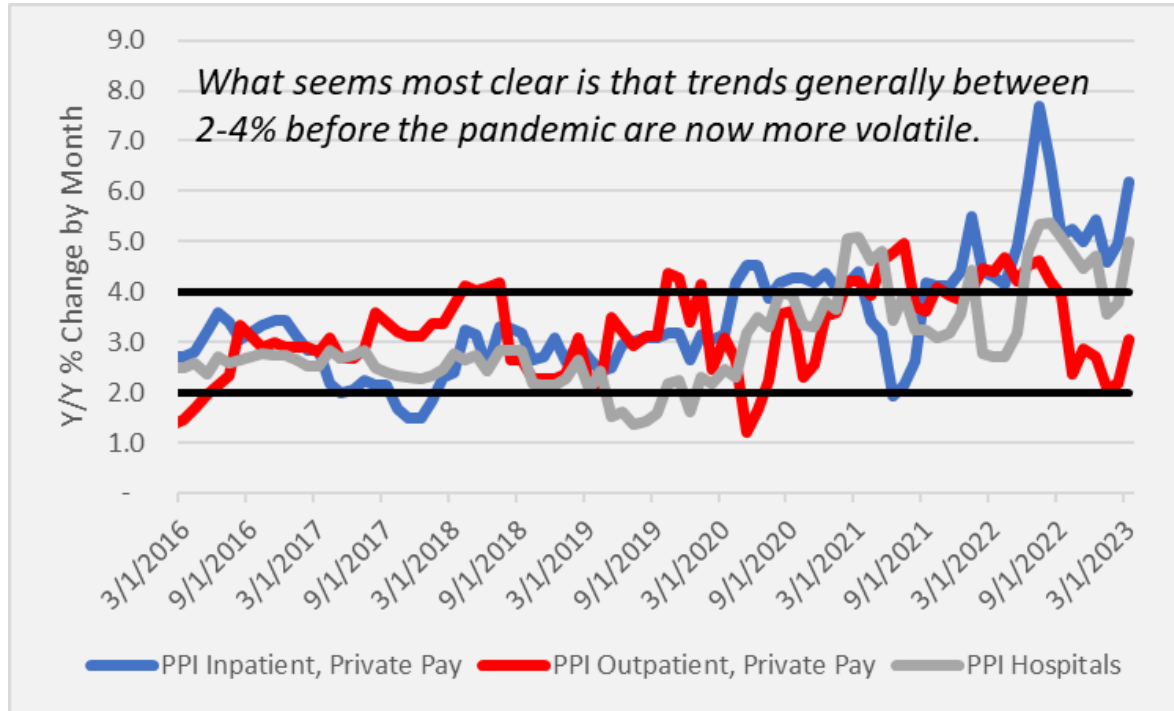
The issue? Cost shifting

- What does a company do if it is losing money and its lower-margin payers are growing?
- Answer: shift costs to the segment that reimburses at higher rates (and for which there is an inelastic demand)

Important Medical PPI Indicators – Volatile and Higher



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Source: BLS, Assured Research

The medical CPI has been ticking lower; we think partly because of the vagaries of measurements (esp. for healthcare costs).

The PPI series may be more relevant, and those series are both more volatile and recently ticking higher.

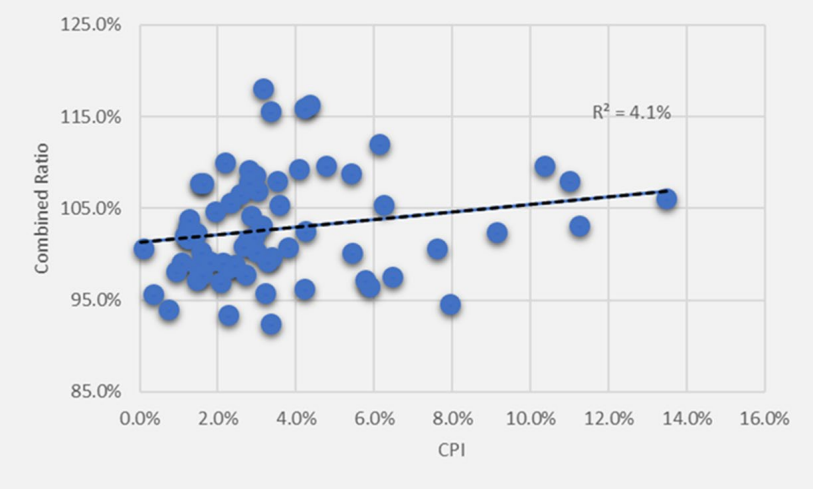


Insurers Have Performed OK During Periods of Inflation

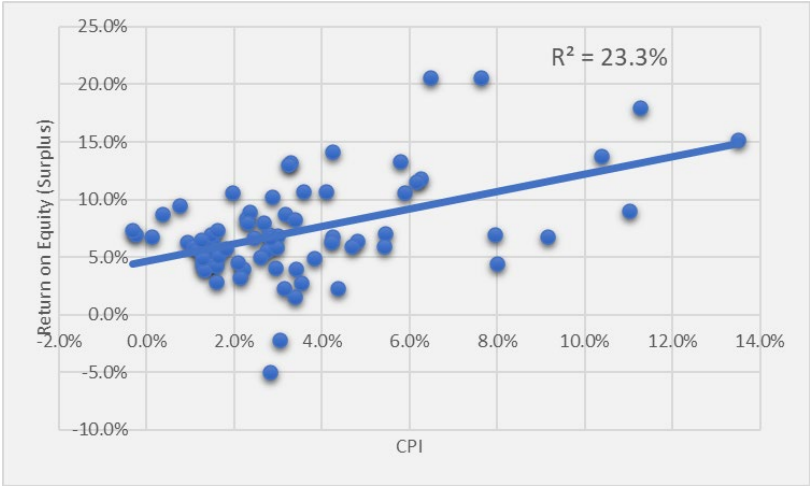
With data back to the early 1950s and again to the 1970s we see that actuaries are adept at incorporating inflation into their prices, thus neutralizing its impact on U/W results. Meanwhile, investment income rises with higher investment yields.



U/W Results not much Influenced – data to 1951



Return on equity (surplus) shows modest correlation through NII

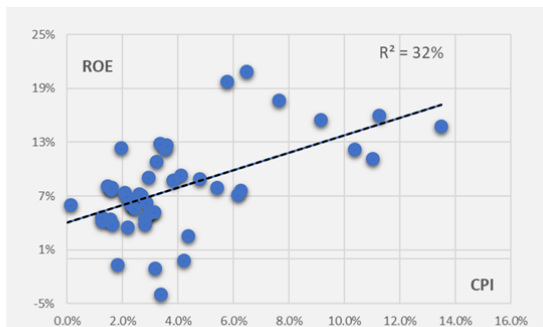


Commercial Insurers Have Performed - OK



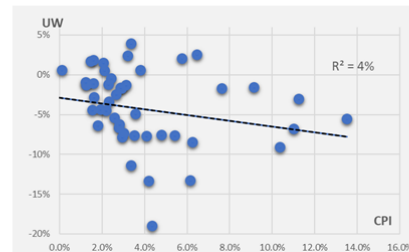
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Commercial Lines: ROE and the CPI (1 Year Lag)

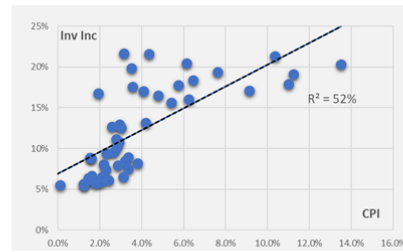


Source: A.M. Best, ©2023 S&P Global Market Intelligence, Assured Research

Commercial Lines: UW/CPI (1 Year Lag)



Commercial Lines: NII/CPI (1 Year Lag)



Source: BLS, Assured Research

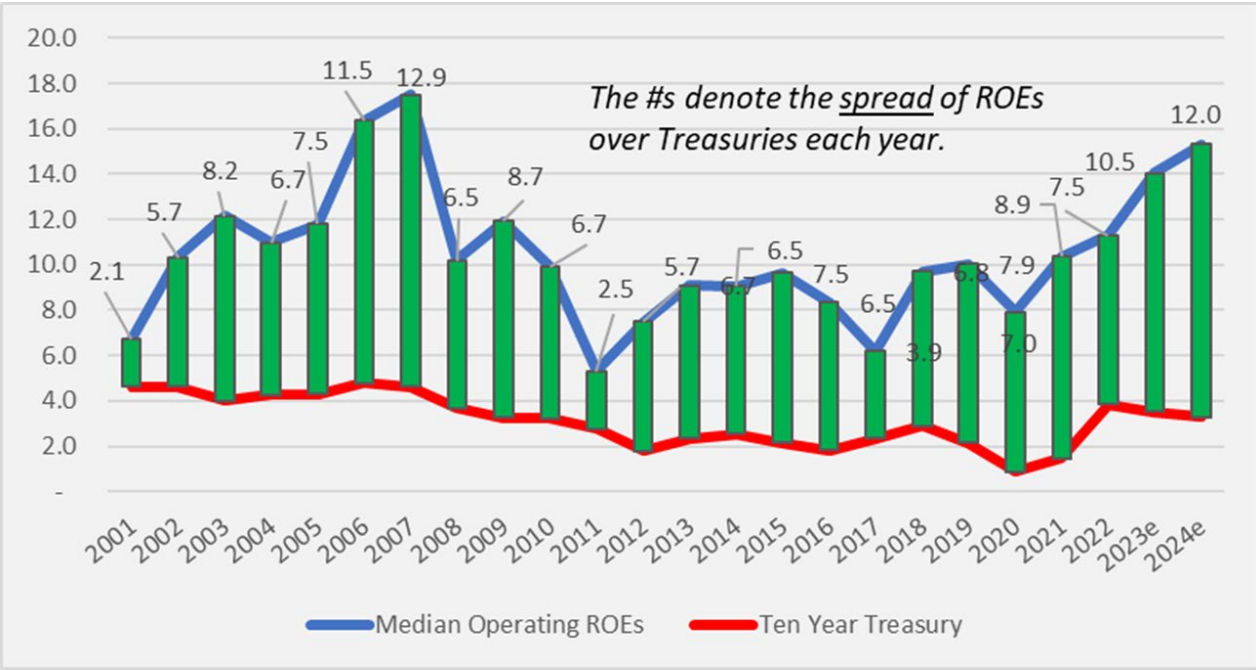
Weather is the main driver of industry results (uncorrelated with the CPI or the economy) and the pricing cycles have typically not been correlated with the economy.

Insofar as commercial insurance is 1) less weather dependent, and 2) slightly more reliant on investment income; the correlations here are even higher than industry average

P/C Insurers Expected to Perform Well into 2023e and 2024e



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Despite high inflation (higher than Fed 2% target) P/C insurers are forecasted to earn generous spreads over the 10-year Treasuries.

Economists polled by the WSJ anticipate the CPI at 3.9% in 2023 and 2.6% in 2024.

Source: ©2023 S&P Global, BLS, WSJ (Treasury Forecasts, April '23), Assured Research



Social Inflation Matters More...

... more than economic inflation.

That is, we believe social inflation holds greater sway over the liability loss ratio than does economic inflation.

Social Inflation is Not Going Away



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Ingredients for social inflation remain in place

"Anger" at corporate America stemming from wealth inequality

Litigation funding, successful plaintiff strategies and tactics

An early warnings system – real wages

Real wages and the liability loss ratio are inversely correlated.

Real wages tend to be a leading indicator of changes in the liability loss ratio

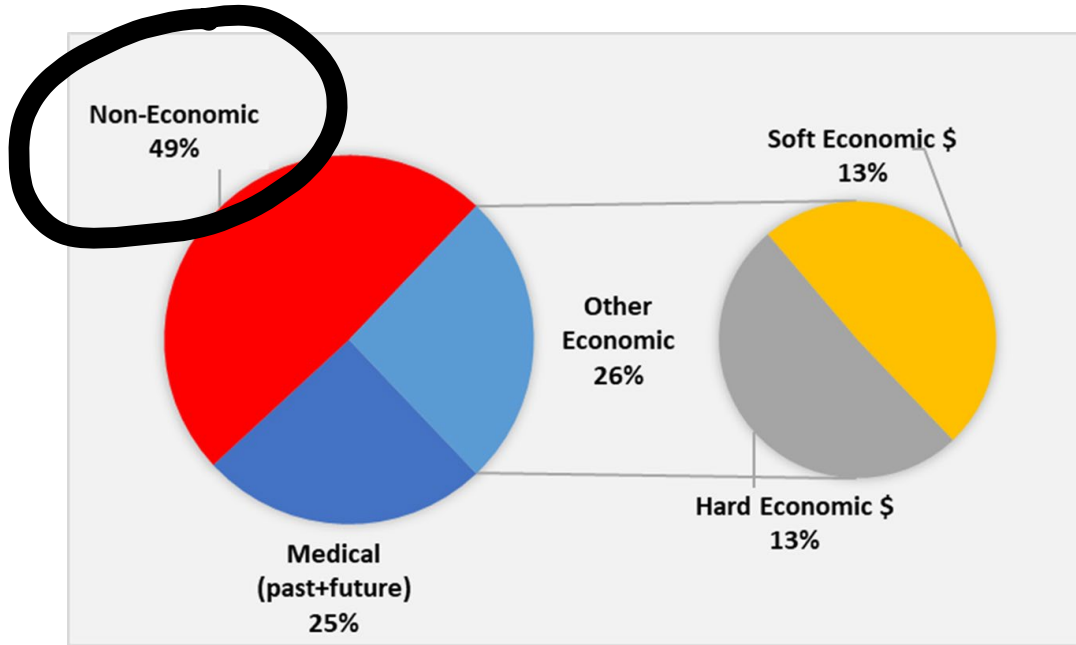
Good news: Case disposition rates suggest lower liability claims

Cases are down, but severity is generally higher

Non-Economic Costs are About 1/2 Liability Claims



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Source: VerdictSearch, Assured Research

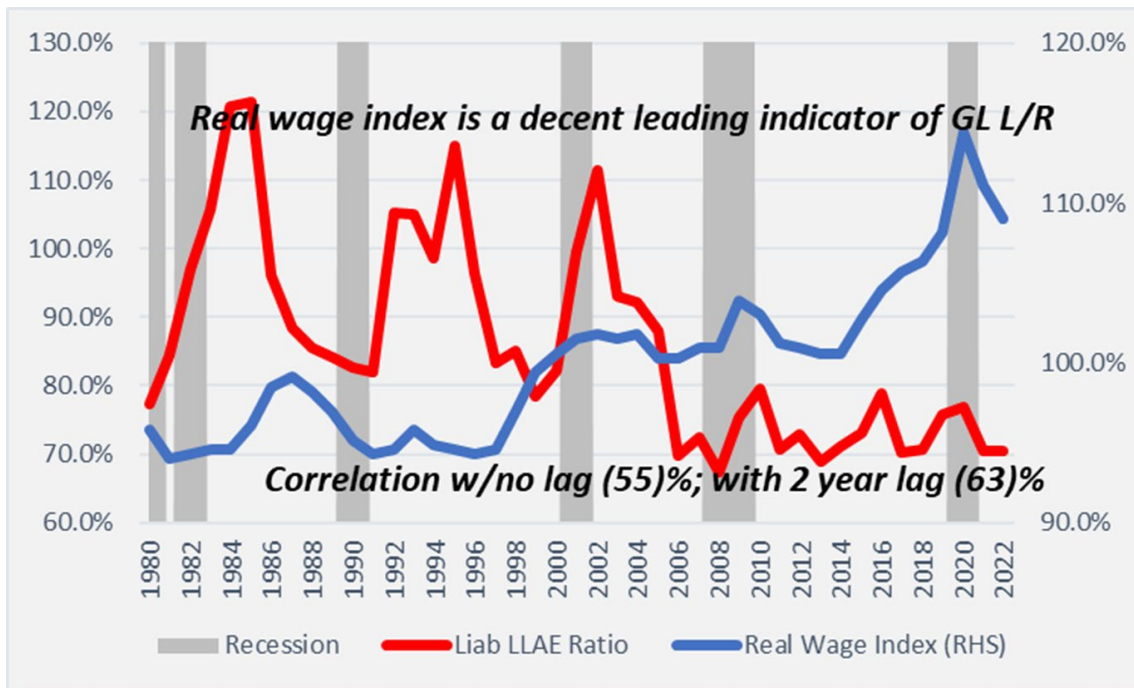
Non-Economic costs are the classic 'pain and suffering' award and its many cousins: loss of enjoyment, mental anguish, loss of consortium, etc.

All elements of liability awards can expand during times of social inflation; non-economic awards are surely the most variable.

We're Watching the Trend in Real Wages



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Two observations:

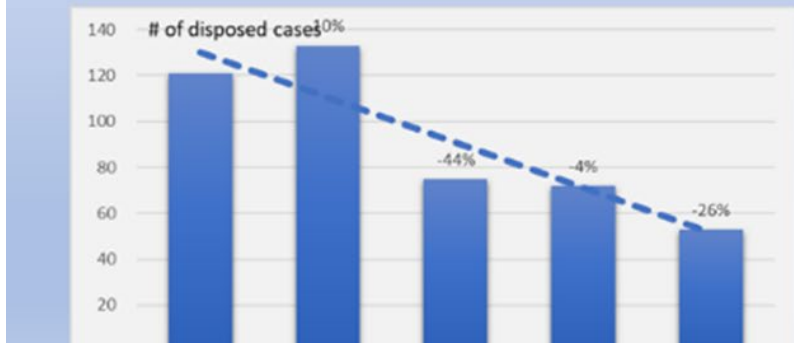
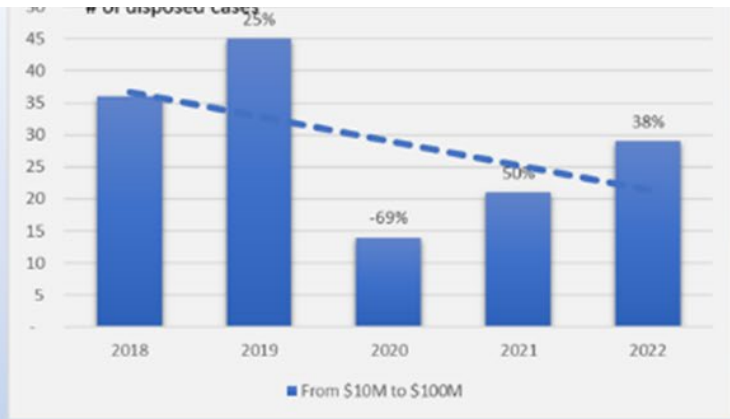
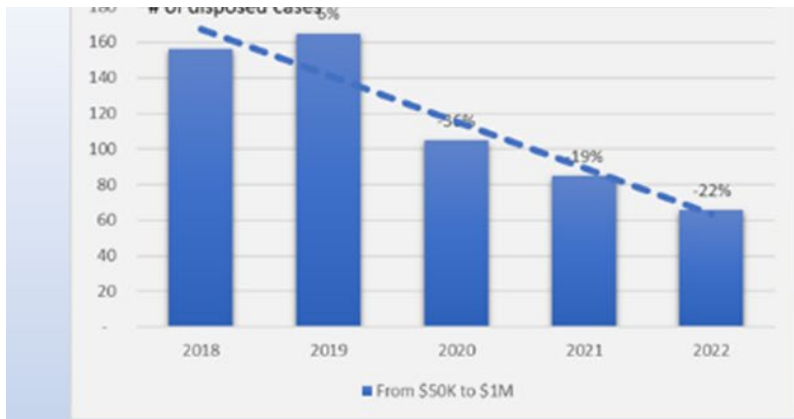
- 1) The liability loss ratio has tended to rise coincident with or after recessions;*
- 2) The liability loss ratio is inversely correlated with real wages.*

Falling real wages, for instance, likely signal economic frustration, may indicate a greater willingness to hire an attorney, pursue civil litigation, etc.

Source: BLS, A.M. Best, ©2023 S&P Global, Assured Research



Good News in Disposition of Legal Cases...# Disposed Cases is Down

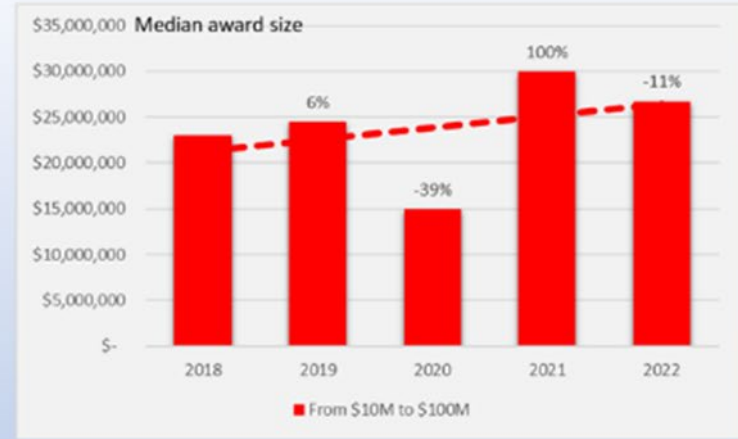
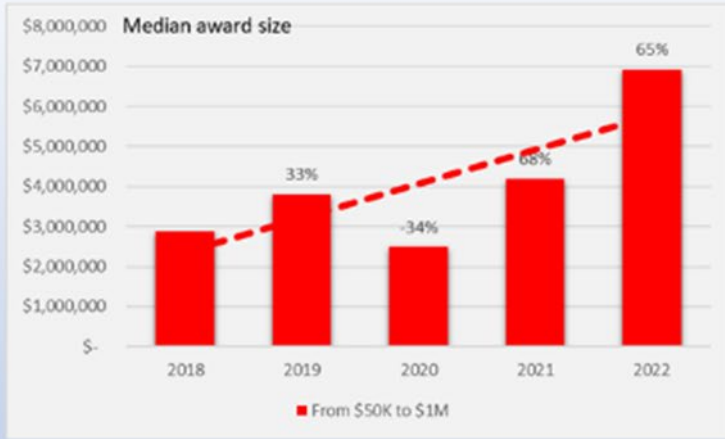


Wrongful Death Cases: Trend in case dispositions is lower, again, though less pronounced in the highest claim category.

Severity of Disposed Cases is Generally Flat(ish)-to-Higher



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Wrongful Death Cases: Trend in median settlement values is clearly higher. We're watching S74 in New York state (The Grieving Families Act) which seems like it could add to this trend.



Don't Bet on Tort Reform

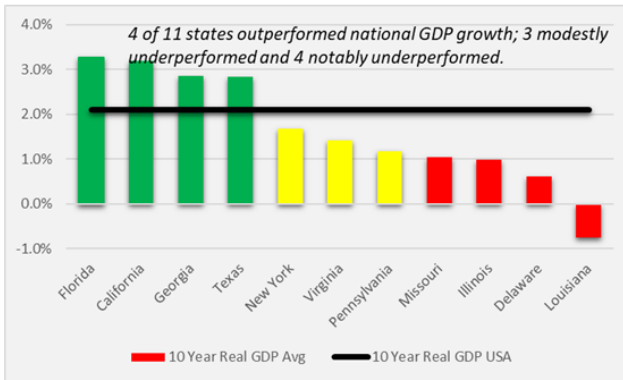
The data would not support the assertion that nuclear verdicts result in below-average levels of economic growth

And states with plaintiff friendly legal systems account for far more GDP than states with the 'best' legal systems.

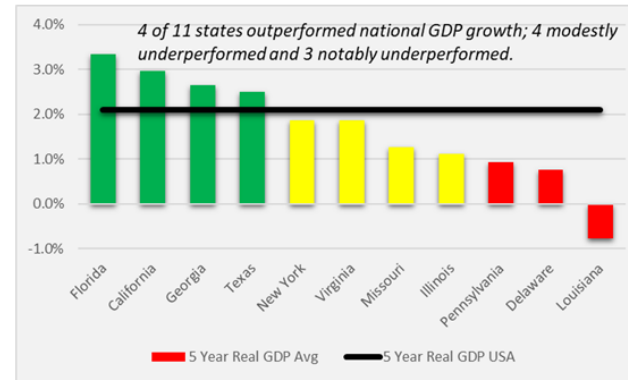


Top States for Corporate Nuclear Verdicts

10-Year Real GDP Performance vs. National Average



5-Year Real GDP Performance vs. National Average



The data would not support an assertion that nuclear verdicts retard economic growth

Source: [Corporate Verdicts Go Thernuclear](#) (Marathon Strategies), U.S. BEA, Assured Research

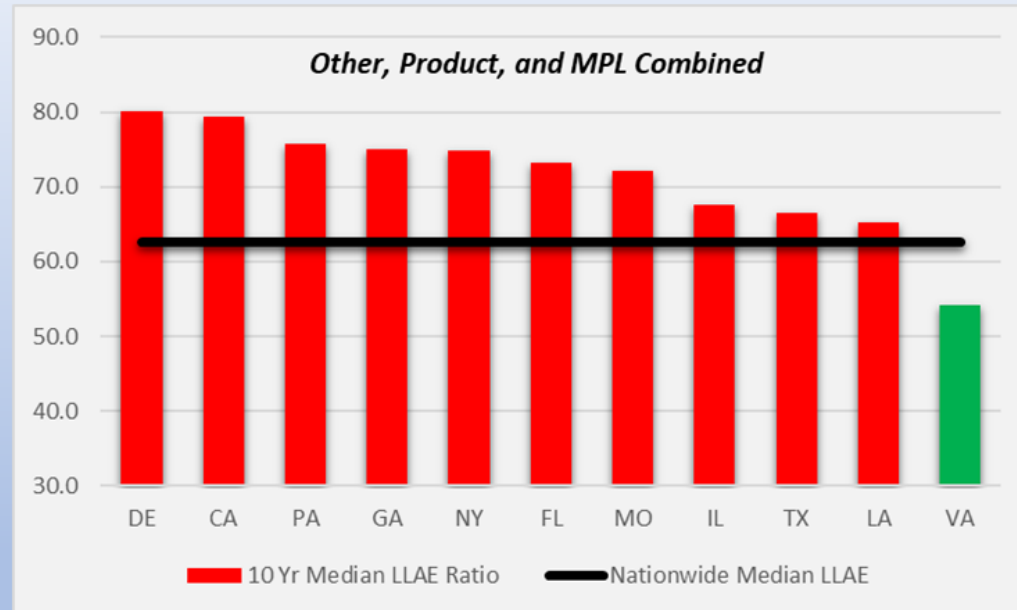


Loss and LAE Ratios of the 11 Top States For Corporate Nuclear Verdicts

More nuclear verdicts = higher loss ratios.

The evidence suggests social inflation tags insurers but not local economies.

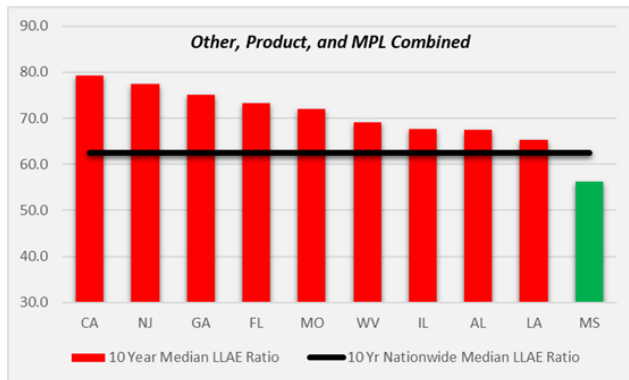
That is, unless insurers stop insuring or charge premiums so high businesses begin to make the issue political.



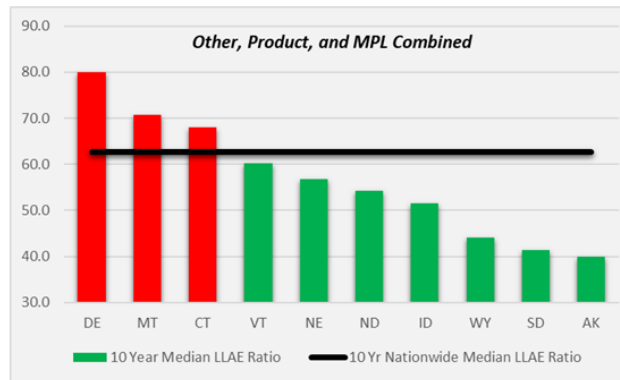


Comparing Loss and LAE Ratios Ten Best/Worst States

10 States Ranking **Lowest** on Liability System Survey



10 States Ranking **Highest** on Liability System Survey



Here the 'evidence' seems a bit more convincing: States ranking lower on the liability survey have higher-than-national average L&LAE ratios; better states lower ratios.

The aggregate GDP of the bottom ten states is some 9x larger than the summed GDP of the top ten states.

Conclusion: P/C insurers can't avoid difficult jurisdictions (not unless they are happy to be small)

Source: [Rich States/Poor States](#) 15th ed. (American Legislative Exchange Council), ©2023 S&P Global Market Intelligence, Assured Research



Thank
you!

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Trends in Economic and Social Inflation
2023 Genesis Client Forum

April 27, 2023

Questions?

Research and Analysis for Insurance and Investment Professionals

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