
# Current Trends in Economic & Social Inflation

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Assured Research
Hosted by Regina Pettus, Genesis

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# TODAY'S TOPICS

- **Inflation: How did we get here?**
- Trends We're Watching – Economic Inflation
- Tends We're Watching – Social Inflation
- A Look Back to the 1980s – Could it happen again?

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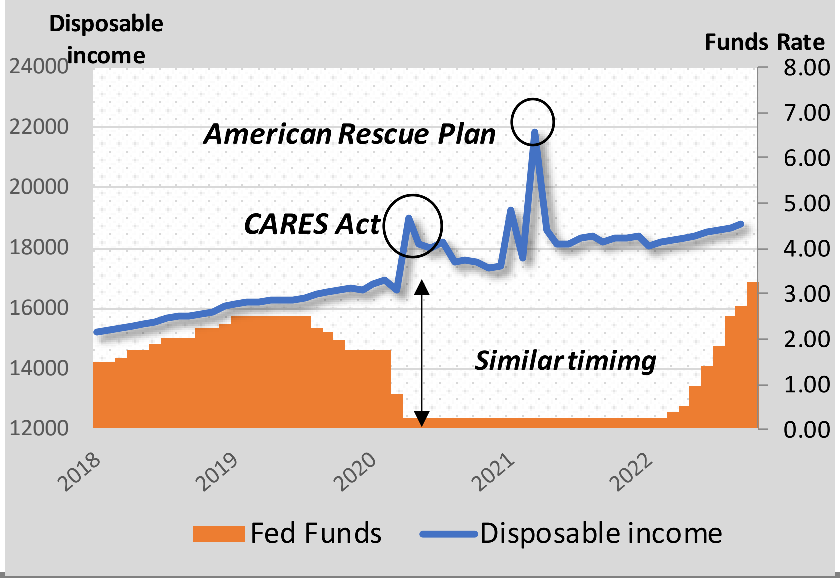
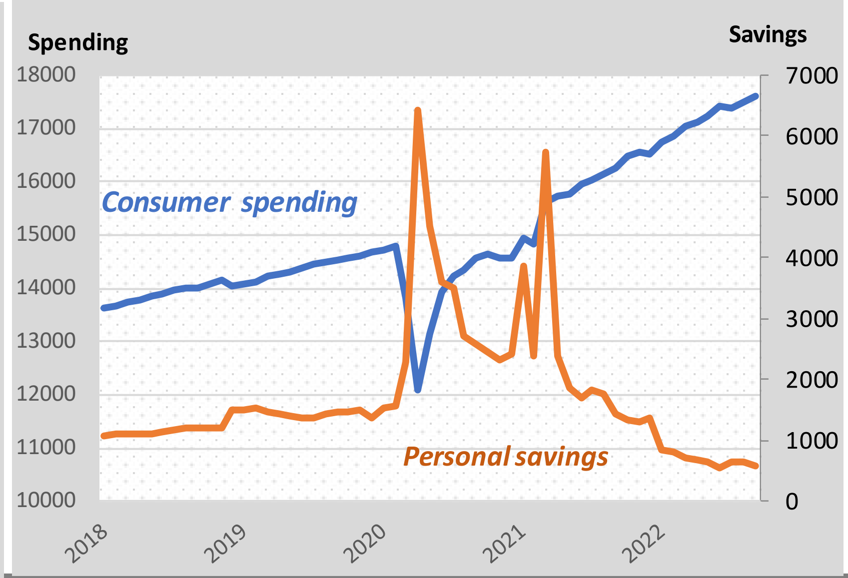
# HOW DID INFLATION GET SO HIGH?

*In March 2020 Congress passed the CARES Act which boosted disposable income. Followed by the ARP (March 2021) At the same time the Fed cut interest rates and expanded its lending programs.*

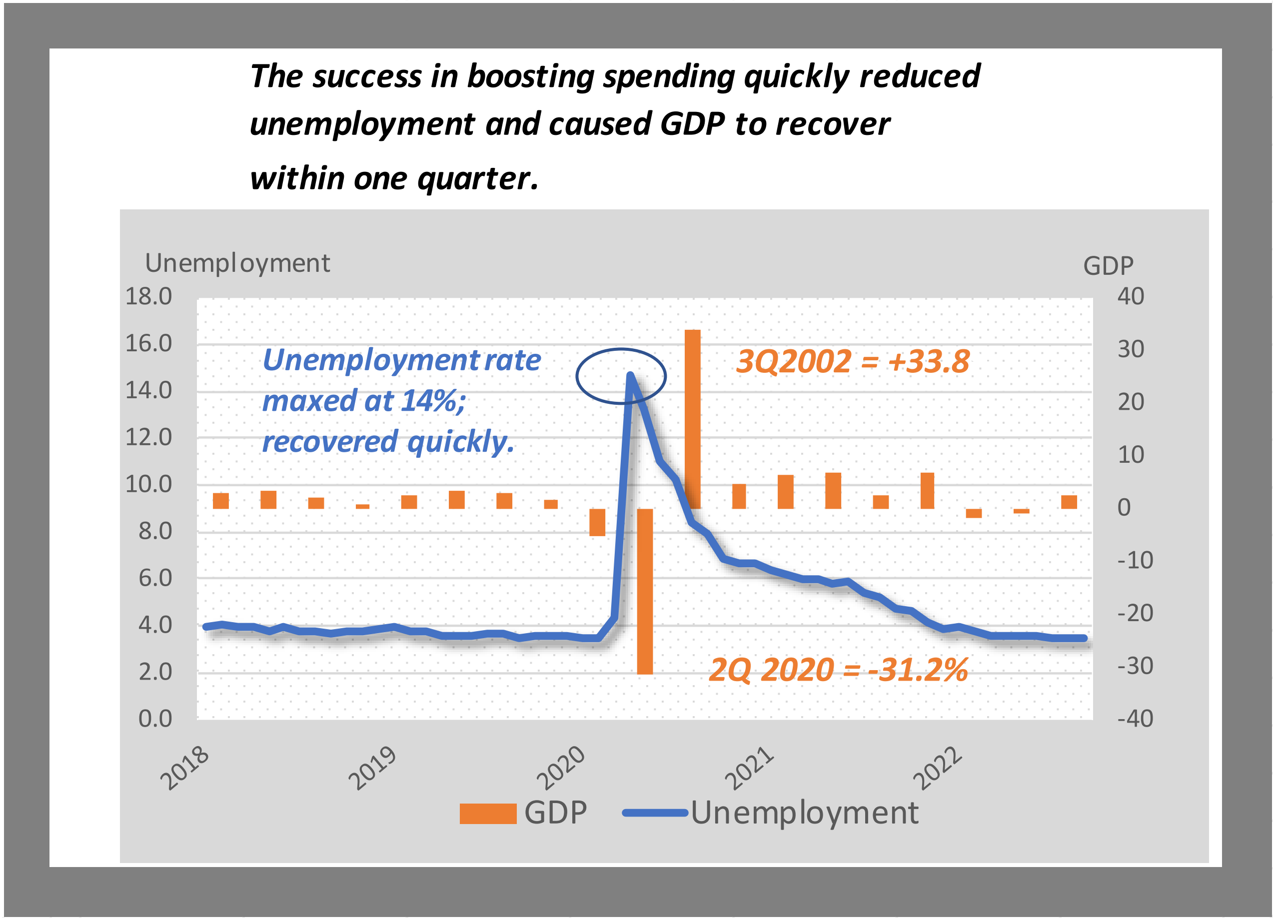
*These actions replenished personal savings which eventually lend to a resurgence in consumer spending.*




Source: Bureau Economic Analysis, Federal Reserve, Assured Research

# HOW DID INFLATION GET SO HIGH?

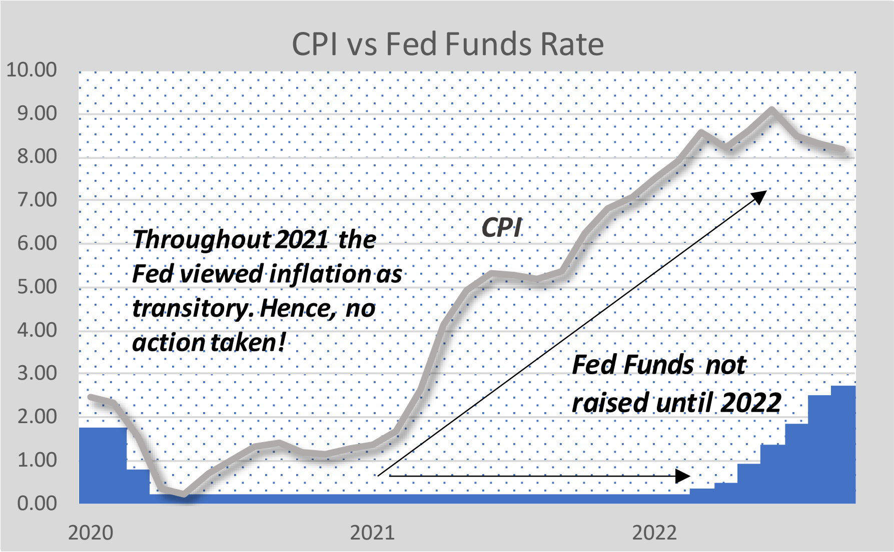



Source: Bureau Economic Analysis, Bureau Labor Statistics, Assured Research

# HOW DID INFLATION GET SO HIGH?

***But the combination of the Fed's inacton on rates and too much money in the system led to rising inflation.***

***Inflation is too much money chasing too few goods!***




**2020 Rate Cuts**

| Date | From | To | Change |
|---|---|---|---|
| 3-Mar | 1.75 | 1.25 | -0.50 |
| 15-Mar | 1.25 | 0.25 | -1.00 |

**For two years rates were effectively zero!**

**2022 Rate Increases**

| Date | From | To | Change |
|---|---|---|---|
| 16-Mar | 0.25 | 0.50 | 0.25 |
| 4-May | 0.50 | 1.00 | 0.50 |
| 16-Jun | 1.00 | 1.75 | 0.75 |
| 27-Jul | 1.75 | 2.50 | 0.75 |
| 21-Sep | 2.50 | 3.25 | 0.75 |
| 2-Nov | 3.25 | 4.00 | 0.75 |

Source: Bureau Economic Analysis, Federal Reserve, Assured Research

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# TRENDS WE'RE WATCHING – ECONOMIC INFLATION

- **Economic inflation is transitioning from flexible to sticky**
  - *From short(er)-tailed lines to liability lines*
  - *That does not mean all hope is lost for liability lines…see below*

- **We are watching medical inflation closely**
  - *A big source of benefit and positive surprises for past decade*
  - *Unique pressures are building (as we see it)*

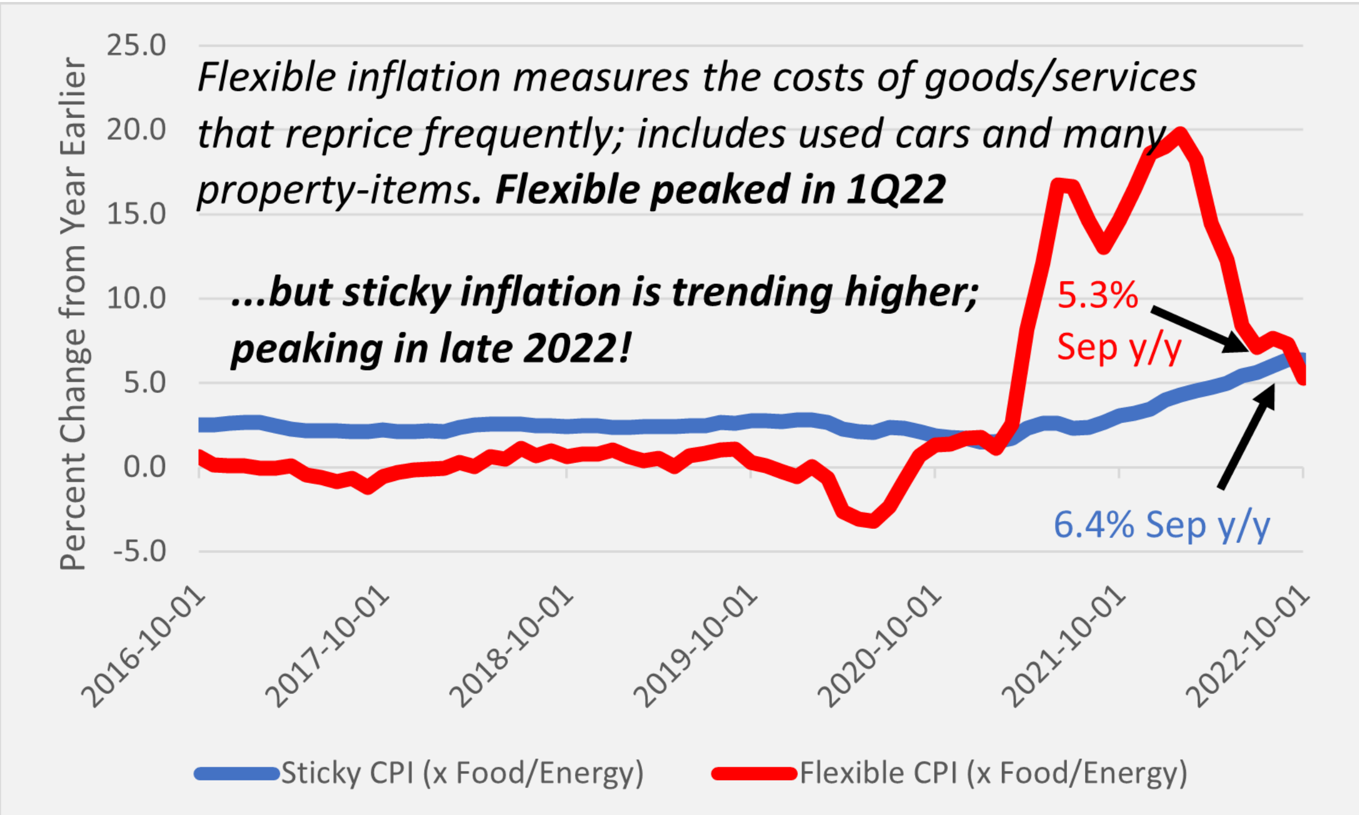
- **A look at the P/C long-term track record in inflationary environments**

*"…we have planned and priced for our cost trend a little higher than historical norms."*

*CEO of United Health 10/14/2022*

***Social inflation holds larger sway over the liability L/R than does economic inflation. Corollary: Actuaries have proven adept at neutralizing the adverse impact of economic inflation through pricing process***

# INFLATIONARY PRESSURES ON PROPERTY/AUTO CLAIMS ARE RECEDING




*We're not suggesting the 'work is finished,' but think it important to ensure effort and resources are dedicated to getting ahead of (or, at least on top of) sticky inflation; think wages, medical, longer-lived services. The stuff of tort claims!*

Source: BLS via St. Louis Fed (FRED), Assured Research

# INFLATIONARY PRESSURES ON LIABILITY CLAIMS ARE GATHERING STEAM

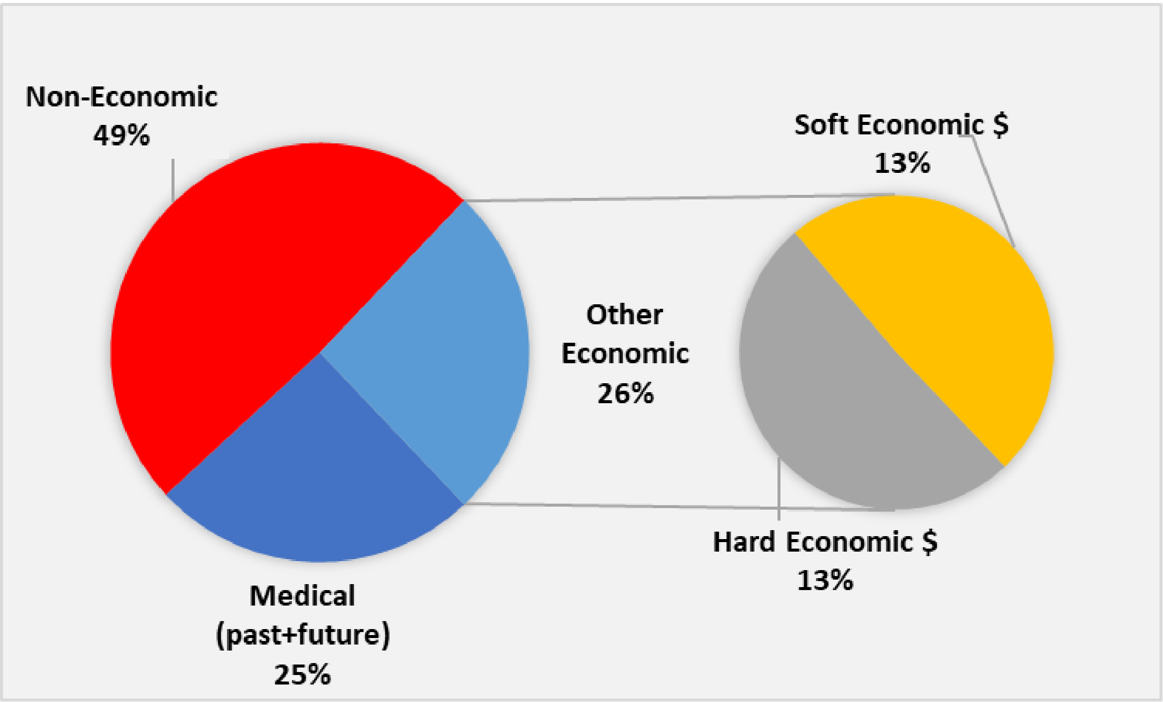



*Chart shows award values across 15 recently disposed liability cases. Largely anecdotal, but this is broadly consistent with guidance from claims professionals. Illustrates the importance of medical inflation (25%) and lost wages (hard economic $ at 13%).*

*Think social inflation matters? 49% are awards for non-economic damages.*

Source: VerdictSearch, Assured Research

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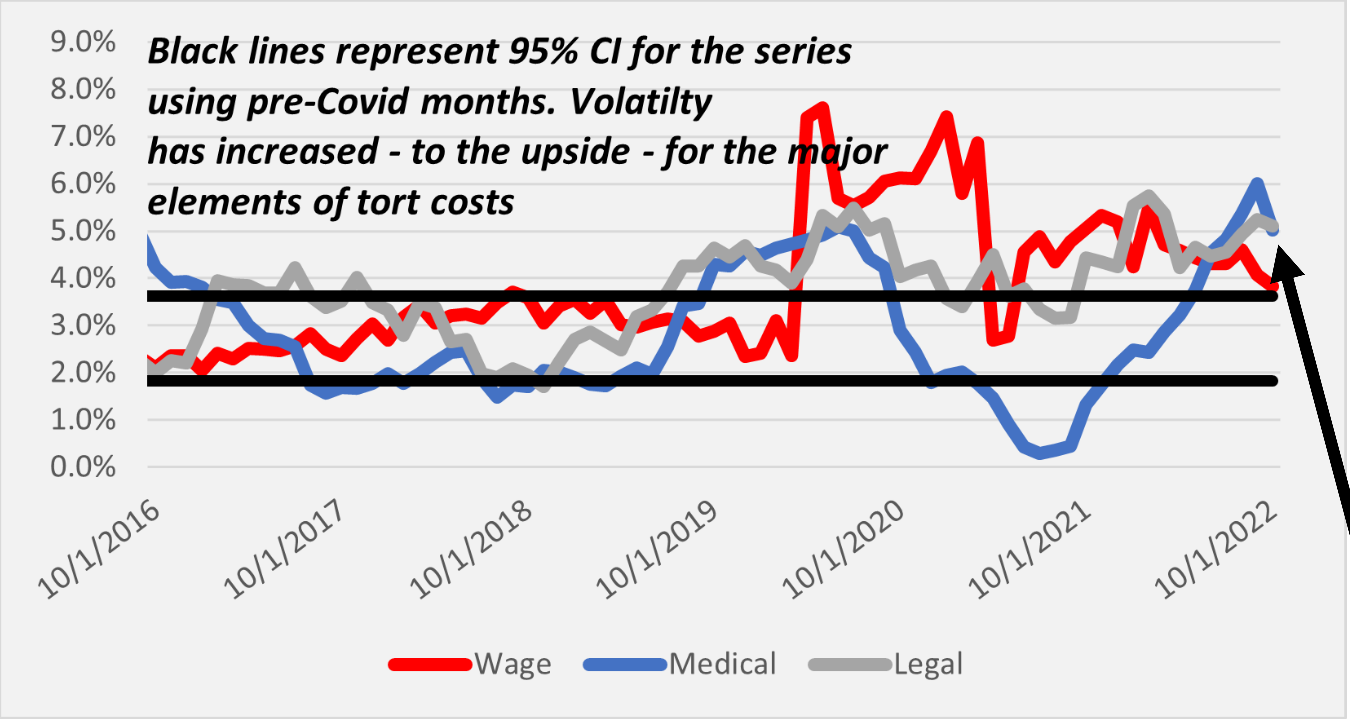



*Major elements of tort claims were in a 2-4% range for many years before the pandemic. All series shown here are both a) more volatile and b) have broken to the upside.*

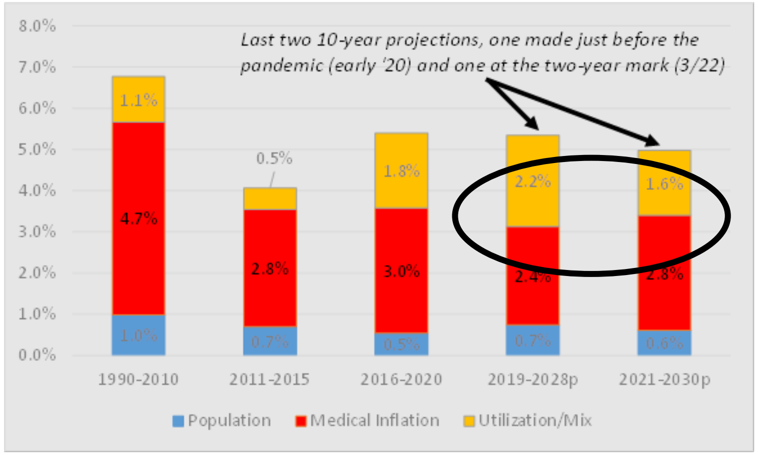
*Let's focus on medical trends.*

Source: BLS vis St. Louis Fed (FRED), Assured Research

# WHY WE'RE CONCERNED ABOUT MEDICAL TRENDS

- **First – complacency**
  - *They were benign for the better part of a decade.*
  - *The CMS forecasts just a 2.8% inflation rate from 2021-2030.*

CMS Office of the Actuary Projections



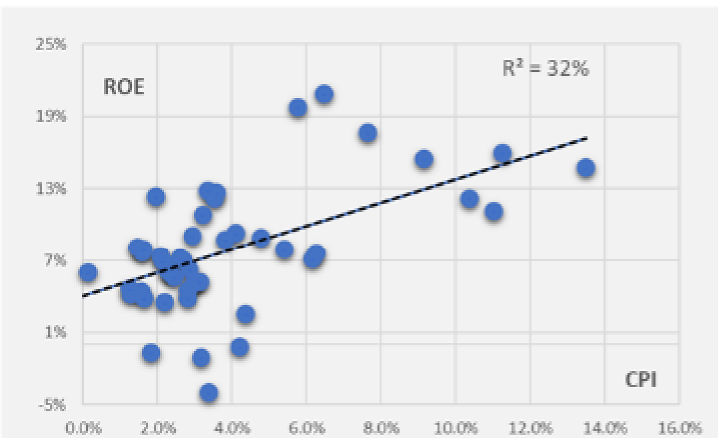

- **Second – supply/demand imbalances**
  - *Supply – well advertised health care shortages…but efforts to address seem to lack urgency*
  - *Demand – Aging Boomers, resurgence in manufacturing and reshoring of jobs in the U.S. (i.e., more workplace accidents?)*
- **Third – Technical factors stemming from passage of the first Covid Relief bill**
  - *The Families First Coronavirus Response Act (FFCRA) of March 2020*

# WHY WE'RE CONCERNED ABOUT MEDICAL TRENDS

- **The FFCRA included provisions to expand and stabilize enrollment in Medicaid. Here are the numbers since March 2020:**
  - 18.3 million people have gained coverage under Medicaid
  - That's a 26% increase in Medicaid coverage
  - Putting Medicaid enrollment at 89 million people
  - That's about 27% of the U.S. population
    - as compared to 17% in 2010 and 20% in 2019
- **Why is this relevant?**
  - Medicaid reimburses at ~40% of private payer rate for hospital services
  - Medicaid reimburses at ~50% of private payer rate for physician services
  - The gap between WC/Auto reimbursement rates and Medicaid – even greater!
- **What does a business do if it faces an inelastic demand curve and experiences a rise in lower-margin customers? Raises prices on the rest!**

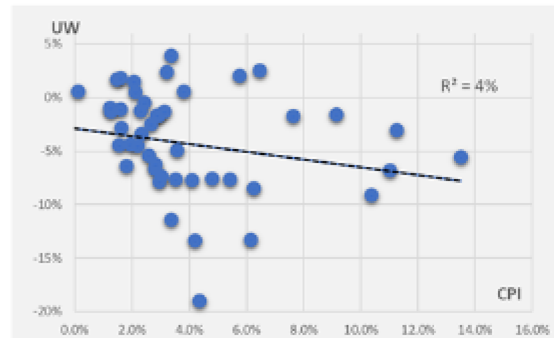
# TAKE HEART – ACTUARIES GOOD AT PRICING FOR ECONOMIC INFLATION

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

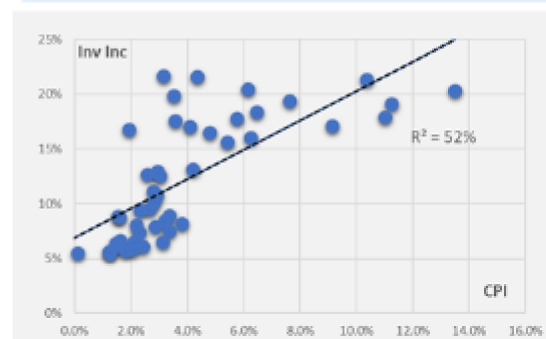



Source: A.M. Best, ©2022 S&P Global Market Intelligence, Assured Research

Commercial Lines: UW/CPI (1 Year Lag)




Commercial Lines: NII/CPI (1 Year Lag)



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# TRENDS WE'RE WATCHING – SOCIAL INFLATION

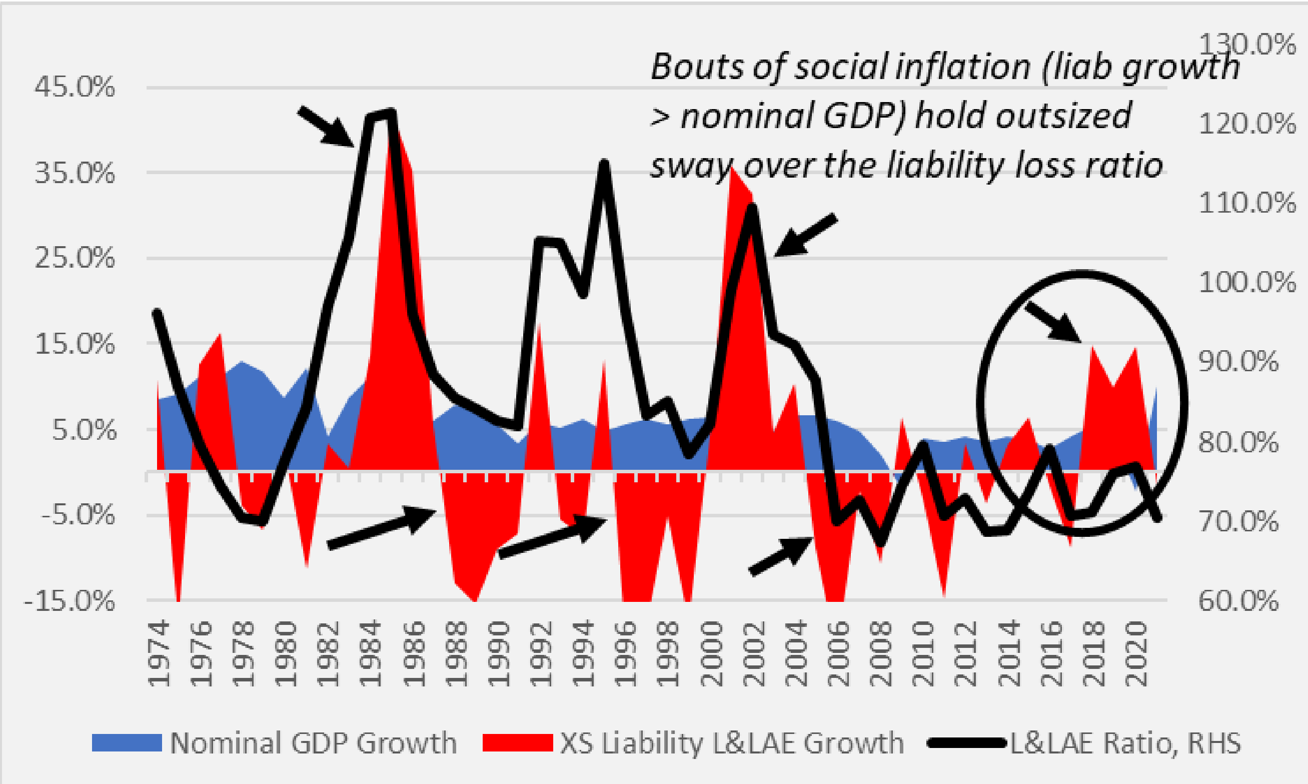
- **Ingredients for social inflation remain in place**
  - *Anger at corporate America, inequality, sharpening social divide, lit funding*
  - *Remember the first word is 'social'…doesn't always have numerical indicator*

- **We're getting better at identifying…an early warning system (of sorts)**
  - *The liability loss ratio is correlated with the trends in excess of nominal GDP*
- **A look at case disposition trends…some good news**
- **We're not banking on tort reform as in the 1980s**

***Social inflation holds larger sway over the liability L/R than does economic inflation.***

***Corollary: Actuaries have proven adept at neutralizing the adverse impact of economic inflation through pricing process.***

## AN EARLY WARNING SYSTEM…OF SORTS




*In a stable tort environment, it seems reasonable to expect the growth in liability losses to be correlated with nominal GDP (=real GDP + economic inflation). It is not!*

*Bouts last for a few years…early warning.*

*Instead, the liability loss ratio correlates closely with changes in incurred liability losses in excess of (or, below) nominal GDP – periods of social inflation or retrenchment.*

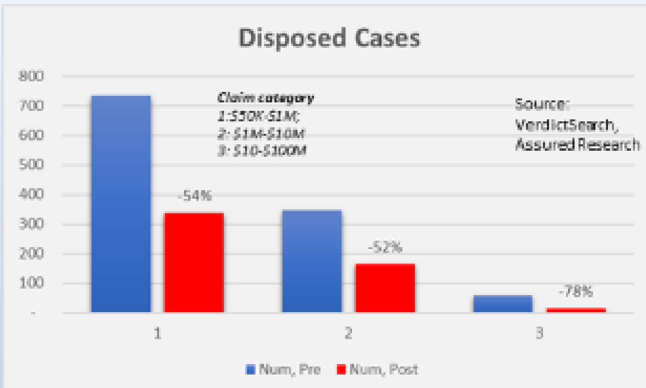
Source: A.M. Best, ©2022 S&P Global Market Intelligence, U.S. BEA (via FRED), Assured Research. Liability includes Other and Product Liability

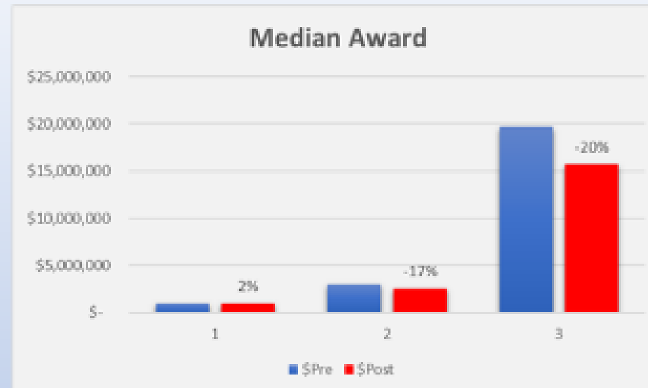
# SOME GOOD NEWS IN DISPOSITION TRENDS…A REAL SIGNAL OR JUST BACKLOG?

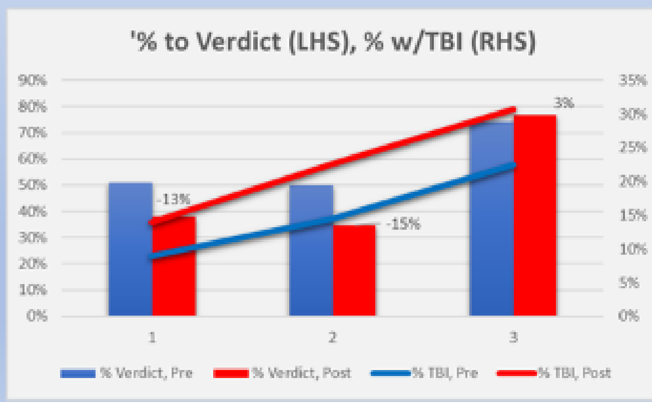
## Premises Liability Cases (incl slips, trips, and falls) Nationwide

***Claim category***
*1:$50K-$1M;*
*2: $1M-$10M*
*3: $10-$100M*

***Pre:** Claims disposed from 7/1/2017-12/31/19;*
***Post:** Claims disposed from 1/1/2020-6/30/2022*



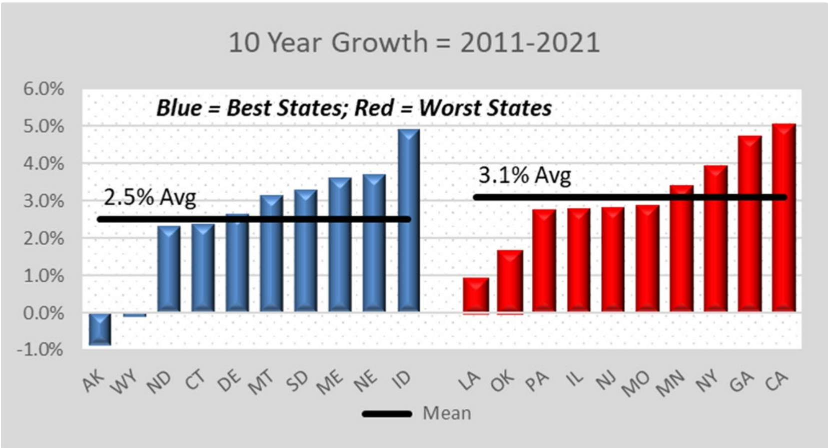

*The number of disposed premises liability cases fell by half or more. We know from annual statement data that accident year claims for GL fell by 20-30% across accident years 2020/21. That could mean that **about one-half of this decline is due to some combination of the lower case throughput in state courts and, perhaps, a lower propensity to file claims.** We'll examine this data again in about 6 months.*

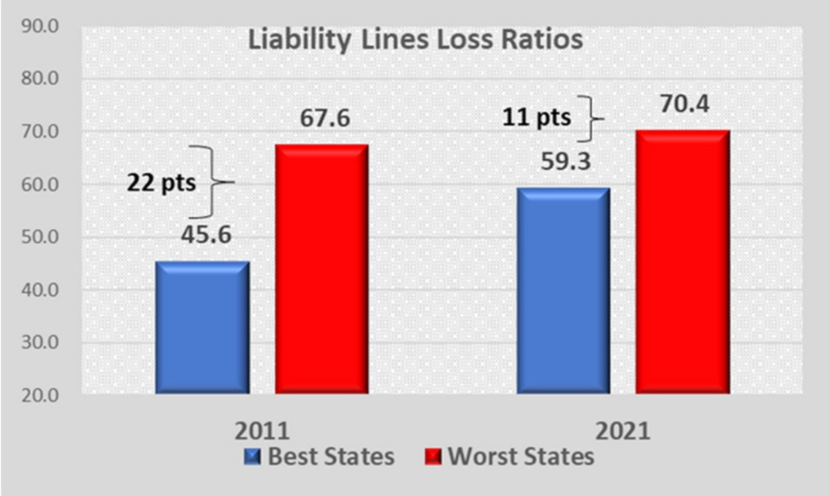
*The median award value has generally declined; this despite the occasional well-publicized nuclear verdict. And again, resolutions by verdicts were down which means **settlements were generally higher. We also see the rising prevalence of claims alleging a traumatic brain injury.***

***Putting this all together. We appreciate the need for and advocate for actuarial conservatism at YE2021…and into YE2022. But as we get into the middle of 2023, we expect there will be enough clarity on underlying claims and litigation to begin refining loss picks for accident years 2020 and 2021 more assertively.***

Source: VerdictSearch, Assured Research

# BUT WE'RE NOT BETTING ON TORT REFORM




*We don't expect tort reform to happen anytime soon.*

*Top graph shows GDP growth in "worst" legal states > than the "best" states. Reform…why?*

*Bottom graph shows the liability L/R has deteriorated faster in states with the "best" legal environment.*

*Liability reform in the 1980s was substantial, but that followed a liability crisis that made the cover of Time magazine. We're not there!*

Source: Institute for Legal Reform, BEA (via FRED), ©2022 S&P Global Market Intelligence, Assured Research

# SUMMARIZING

**We're not suggesting that the incorporation of economic inflation into ratemaking is easy or that it results from a passive process. (The experience of auto insurers, for instance, during 2021 and into 2022 - used car prices – shows that negative surprises happen.)**

**But…**

***Social inflation holds larger sway over the liability L/R than does economic inflation.***

***Corollary: Actuaries have proven adept at neutralizing the adverse impact of economic inflation through pricing process.***

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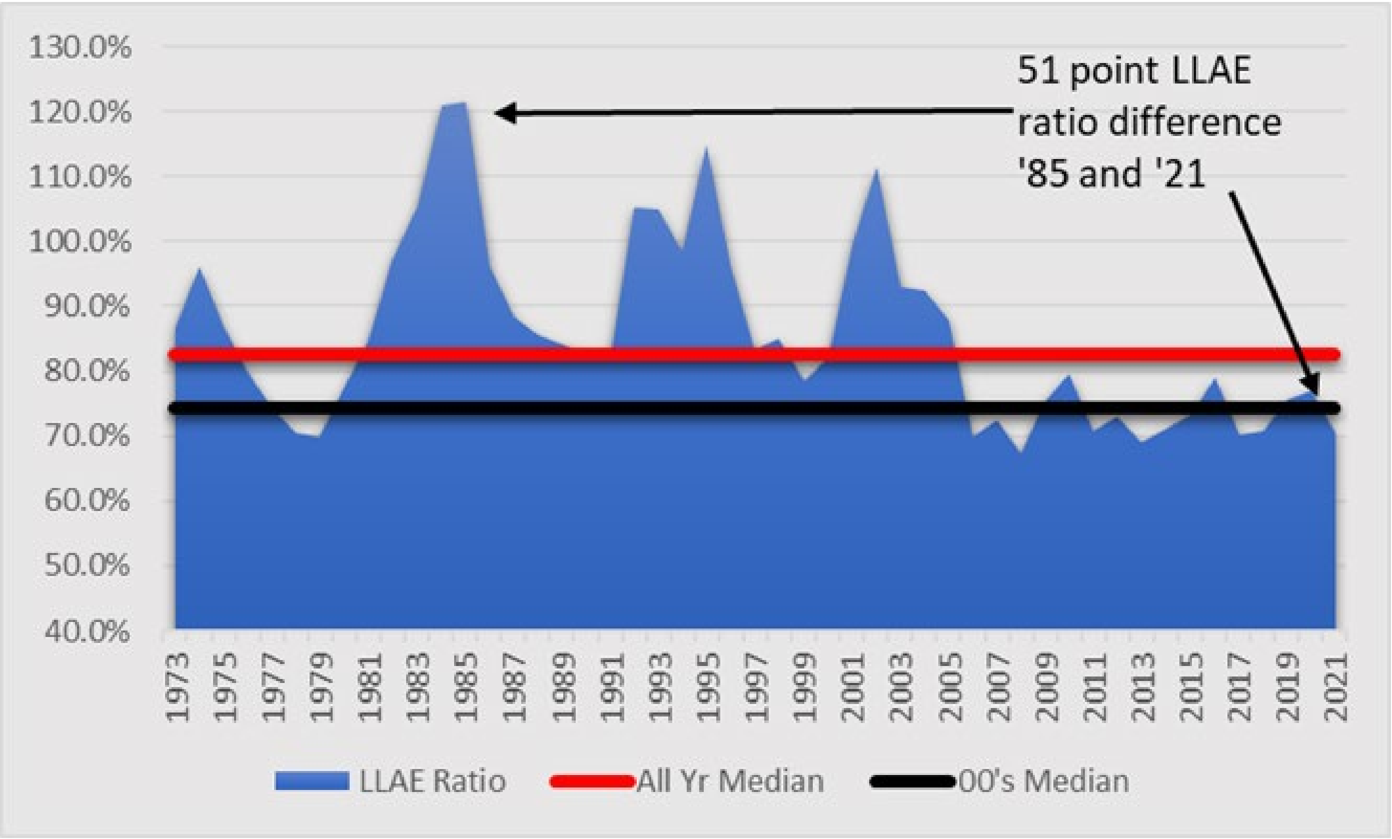
# A LOOK BACK AT THE 1980S. COULD IT HAPPEN AGAIN?

- **The early '80s were a disastrous U/W period for P/C insurers.**
  - The Liability net loss ratio peaked north of 120% in 1984/85.
- **And there are plenty of parallels between today and early 1980s**
  - Inflation (economic and social), geopolitical instability, a looming recession
- **But there are important differences…**
  - The liability loss ratio is dramatically lower today (vs. 1980s) with broad pricing discipline and sharply lower liability limits vs. a handful of years ago
  - Many P/C insurers are forecasted to earn 15%+ ROEs in 2023 and 2024; hardly return levels requiring rate increases meaningfully in excess of loss trends.
  - In our review of the period from 1982-1990, where liability incurred losses increased by 153% cumulatively (or, about 12% annually) we attribute about ½ of the increase in incurred losses to economic inflation and the other ½ to social inflation

# LIABILITY LOSS & LAE RATIO 1973 TO 2021




*We recognize that policy years 2016-2019 (or so) were 'soft' with social inflation taking hold. But there is an 'order of magnitude' difference between the recent past and the early 1980s*

Source: A.M. Best, ©2022 S&P Global Market Intelligence, Assured Research. Liability includes Other and Product Liability)

## 4 STAGES OF LIABILITY DEVELOPMENT IN THE 1980S

| $ mil. | 1990 | 1989 | 1988 | 1987 | 1986 | 1985 | 1984 | 1983 | 1982 | 1981 |
|---|---|---|---|---|---|---|---|---|---|---|
| Net Premiums Earned | $18,213 | $18,449 | $19,662 | $19,964 | $16,545 | $9,140 | $5,996 | $5,472 | $5,415 | $5,775 |
| % change | -1% | -6% | -2% | 21% | 81% | 52% | 10% | 1% | -6% | |

3

Loss & LAE Ratio Development

*Premiums 20% annual growth*
*Losses 12% annual growth*

Accident Year

| As Of | 1990 | 1989 | 1988 | 1987 | 1986 | 1985 | 1984 | 1983 | 1982 | 1981 |
|---|---|---|---|---|---|---|---|---|---|---|
| 1981 | | | | | | | | | | 72.4% |
| 1982 | | | | | | | | | 81.1% | 73.9% |
| 1983 | | | | | | | | 87.0% | 82.8% | 75.9% |
| 1984 | | | | | | | 93.2% | 93.2% | 90.1% | 78.3% |
| 1985 | | | | | | 88.4% | 104.2% | 103.4% | 95.9% | 80.8% |
| 1986 | | | | | 76.2% | 90.4% | 115.0% | 110.8% | 100.9% | 84.1% |
| 1987 | | | | 72.2% | 72.7% | 95.9% | 124.7% | 117.9% | 106.2% | 87.5% |
| 1988 | | | 72.0% | 69.8% | 72.8% | 99.3% | 129.4% | 121.3% | 108.8% | 88.9% |
| 1989 | | 75.1% | 69.2% | 66.7% | 68.3% | 103.7% | 135.0% | 125.9% | 112.0% | 91.1% |
| 1990 | 75.2% | 72.7% | 67.5% | 62.3% | 66.6% | 106.5% | 140.6% | 129.8% | 114.4% | 93.6% |

*Deterioration* 1

*Improvement* 4

2

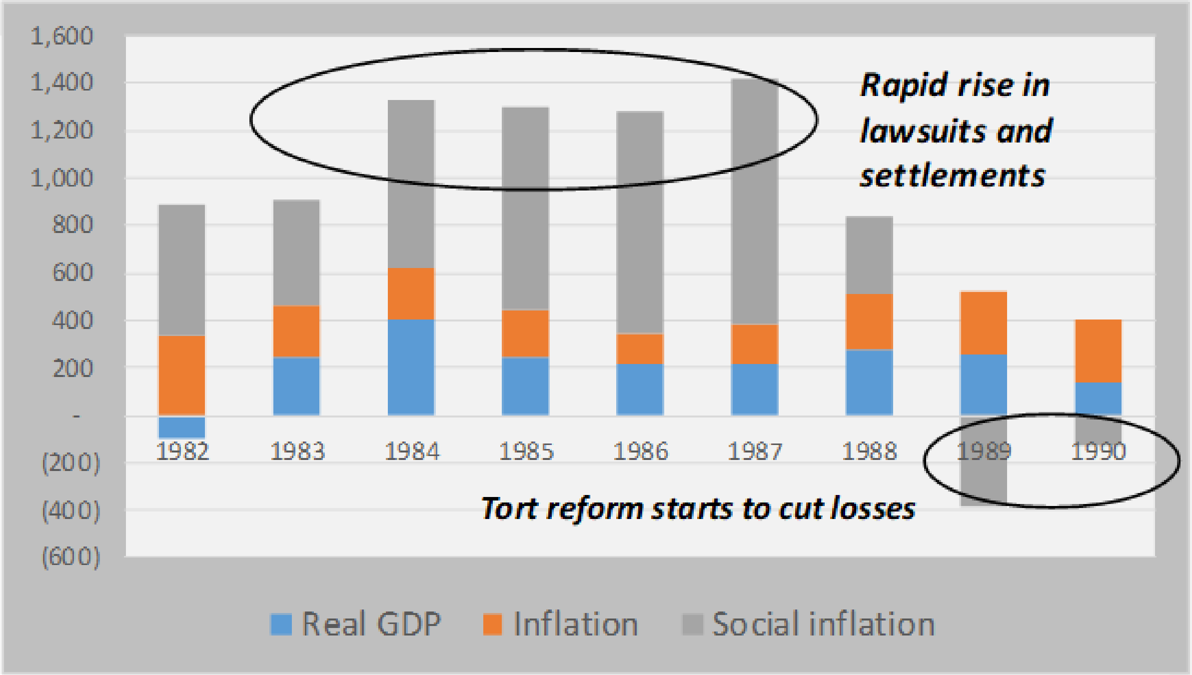
| | 1990 | 1989 | 1988 | 1987 | 1986 | 1985 | 1984 | 1983 | 1982 | 1981 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Cumulative Point Change** | | -2.4% | -4.4% | -9.9% | -9.6% | 18.1% | 47.5% | 42.8% | 33.4% | 21.2% |
| **Developed losses** | $13,697 | $13,417 | $13,279 | $12,441 | $11,018 | $9,734 | $8,433 | $7,101 | $6,197 | $5,405 |
| **% change** | 2% | 1% | 7% | 13% | 13% | 15% | 19% | 15% | 15% | |

***It's smart to study the past, even if we don't expect it to repeat***

Source: A.M. Best, ©2022 S&P Global Market Intelligence, Assured Research. Liability includes Other Liability

## LIABILITY LOSSES IN THE 1980S – THE UNDERLYING CAUSES…

Annual increase in losses ($ million)




| Cumulative increase in losses attributed to: | |
|---|---|
| *Real GDP* | *23%* |
| *Inflation* | *25%* |
| *Social inflation* | *53%* |

*Liability losses grew because of: ½ economic activity (economic growth + inflation); ½ social inflation*

Source: A.M. Best, ©2022 S&P Global Market Intelligence, Assured Research. Liability includes Other Liability


Do you
have any
questions
that we
can answer

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