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Economic Insights

Liability premiums to soar 150% by 2040 due to social trends, technology and climate change

Key takeaways

- Liability insurance markets will continue to grow faster than the economy, driven by social, legal and technological trends.
- We forecast that liability premiums will increase to USD 583 billion by 2040, representing 13% of the global P&C market.
- In the medium term, social inflation-related factors will continue to drive the frequency and severity of large verdicts and settlements in the US.
- In the longer term, emerging risk factors such as new technologies and environmental liability will contribute to additional liability exposure growth.
- Insurers must respond with new analytical approaches and products to keep the growing risks insurable.

About Economic Insights
Analysis of key economic developments and their implications for the global re/insurance industry.

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In a nutshell

Social trends are driving more frequent and severe claims verdicts, particularly in the US. Changes in legal practices, new technologies and environmental concerns will see rapid growth in liability exposures and associated insurance premium volumes. We forecast that liability premiums will grow annually by 7.7% in emerging markets and 4.3% in advanced markets by 2040.

We forecast that global liability premiums will grow by 4.7% on average each year to 2040, reaching USD 583 billion, and accounting for 13% of all Property & Casualty business (P&C). This will result from continued growth in liability exposures, these in turn largely driven by new and emerging risk factors. Economic development is, and will remain, the strongest long-term driver of liability risks. Historically, liability claims have displayed a strong cyclical nature but notably, on average they have also grown faster than GDP (see Figure 1, showing data from the US). This claims inflation in excess of the inflation driven by economic growth effects is referred to as "social inflation." We expect that social inflation will be an important driving force for liability exposures over the next 20 years, and will lead to premium volume expansion in excess of the rate of economic growth.

An expansion in the scope of liability and societal shifts drove surges in liability claims in the mid 1980s, early 2000s and late 2010s. And since 2015, there has been a strong rise in casualty claims in the US, due to the increased use of applied psychology tactics by the plaintiffs' bar, more litigation funding, and juries' growing consciousness of social justice and eroding trust in corporations and institutions.[1] For vehicle negligence and general liability, the probability distribution of legal awards has become more skewed towards large legal awards. There has also been an accelerating severity in average awards. Legislation and case law is also expanding the scope of legal liability and drive up liability claims costs. For example, in November 2020 the European Parliament and Council adopted EU Directive 2020/1828, with the goal of standardising mass torts across the EU. This will likely lead to an increase in claims activity once it comes into effect in 2023.

Technological and environmental risk factors also have the potential to broaden the scope of liability exposures,for insurers, accelerating historical trends. We expect artificial intelligence (AI) to be a primary transformative technology for industries such as manufacturing, transportation, and healthcare. But AI systems can make mistakes, and these mistakes can lead to tort liability and discrimination claims. The question of how to allocate liability amongst the parties involved remains open. The challenges presented by AI do not fall neatly within current liability products, and we expect a coverage gap related to AI

[1] *US social inflation amid the COVID-19 recession – here to stay*, Swiss Re Institute, 3 December 2020.

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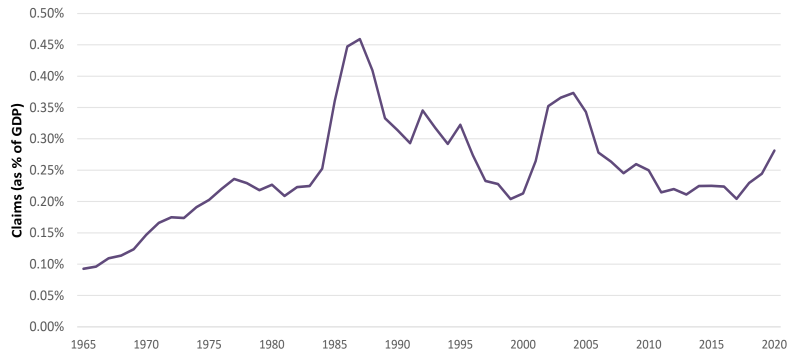
losses to emerge, leading to the development of new insurance products and coverages.[2]

Climate change litigation has gained momentum recently, increasing in volume, scope and geographical coverage since the Paris Agreement in 2015.[3] The increase in environmental liability litigation coincides with a growing focus on ESG criteria, which are increasingly part of corporate pledges and disclosure requirements. Additionally, advances in attribution science are increasing the risks that corporations are held liable for causing climate change and found negligent in their duty to protect the public from its harmful effects.

Figure 1
Claims as share of GDP in the US



Source: AM Best, Swiss Re Institute

Table 1: Key factors affecting long-term liability risk pools

Long-term factors	Implications for risk pool	Impact on premiums
Economic development	Increase in exposure	↗
Climate change	Climate change litigation	↗
Technology, digitisation	Cyber risk exposure, litigation	↗
Expansion of legal liability	Social inflation	↗

Source: Swiss Re Institute

To date, social inflation has had most impact on large corporate risks in the umbrella and excess liability space, commercial auto, medical malpractice and directors & officers liability. For exposure growth to yield premium growth, the exposures must remain insurable. Insurers must continually adapt to the evolving social, technological, and environmental context. New risks will require new modeling approaches and ongoing monitoring to ensure accurate pricing. Investment and innovation in product development and data and analytics tools are necessary to expand the range of insurable risks.

There are several areas that need government action to keep the tort liability system and commercial liability sustainable. For example, attacks on critical supply chain components such as oil pipelines and food producers have demonstrated the systemic risks posed by cyber events. In addition to potentially providing a backstop for risks beyond private sector capacity, government action can include mandatory transparency about litigation funding and tort reforms on state and federal level in areas where claims developments turn unsustainable.

[2] *Trend Spotlight: Is the insurance industry ready for Artificial Intelligence losses?* Swiss Re, 2021.
[3] *Climate Change Litigation – Insights into the evolving global landscape*, Geneva Association, April 2021.