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# Swiss Re: Litigation Funders Driving Social Inflation, 'Outsize' Verdicts

Swiss Re said in a report released Thursday that litigation funding has become a $17 billion industry globally, with 52% of that money being spent in the United States.

The reinsurer said third-party litigation funding (TPLF) is increasing the number of "outsize" legal awards and contributing to growing loss ratios for excess liability, commercial auto, medical malpractice and general liability. Global investment in the sector increased 16% since last year, the report says.

"We see TPLF as a contributing factor to the trend of social inflation in the US," the report says. "US general liability and commercial auto lawsuit data show a strong rise in the frequency of multi-million-dollar claims over the past decade."

Swiss Re said litigation funding is helping drive up the size of verdicts in US courts. From 2010 to 2019, for cases with awards of more than $1 million, the share of verdicts of more than $5 million increased from about 29% of liability cases to 36%, the report says. For vehicle negligence claims, the percentage increased from about 21% to 30%.

During the same period, the average award, for cases with awards of more than $1 million, climbed from $8 million to more than $10 million for general liability and from $6 million to $8 million for vehicle negligence.

Those larger verdicts, in turn, are driving higher loss ratios for insurers and increasing premiums. Swiss Re said in 2020, directors and officers rates jumped 15.8%, umbrella rates 22.6%, general liability 7.3% and medical professional liability 8.8%, the report says.

Insurers are trying to recoup for underwriting losses. Swiss Re said in 2020 the average 2020 combined ratio for general liability was estimated at 105.7% and for medical malpractice at 117.5%. That was the seventh straight year of underwriting losses for both lines. The 2020 commercial auto liability combined ratio was 104.1%, the tenth year of underwriting losses, according to the report.

While insurers are eating losses, litigation funding companies are enjoying enviable returns on their investment. The report says data from Morning Investments, which advises litigation funding investors, shows that the average internal rate of return on personal injury cases ranged from 25% to 35% from 2019 to 2021. For mass-tort lawsuits, profits ranged from 20% to 25%.

Swiss Re said that is significantly higher returns than other types of investments. Private equity and venture capital deals saw average returns of 13% over the past 15 years. The S&P 500 index enjoyed an average return rate of 10%.

What's more, the report says 80% of venture capital cases don't pay off. Profits are made from the occasional big success. But in litigation finance, only 10% to 15% of cases do not succeed.

"Although risks may be low, especially across a portfolio of cases, TPLF returns are typically high since funders are able to apply their financial expertise, data analytics and legal experience with complex cases in negotiations with consumer and commercial borrowers," the report says.

While litigation funders are enjoying profits, plaintiffs in the cases that are funded are receiving less. The report, citing data from the US Chamber of Commerce's Institute for Legal Reform, says plaintiffs received 55% of awards in cases that were not funded by third parties, but only 43% of awards in cases financed by third-party litigation funders.

"We assume that TPLF involvement will on average lead to higher award amounts and total liability costs, given that third-party funding allows plaintiffs to pursue better-prepared cases further and make more effective use of the litigation strategies that have contributed to social inflation," the report says.

Michael B. McDonald, a principal with Morning Investments Consulting and the source of much of the data cited in Swiss Re's report, said he doesn't agree that litigation funding drives up the size of verdicts.

"If litigation finance makes it easier to finance meritorious lawsuits, then that might increase the supply/number of lawsuits going through the court system, but it doesn't mean that lawsuits become any more expensive," he said in an email. "Indeed, one could argue that with more claims getting in front of judges and juries, those arbiters would have more experience dealing with similar claims and are able to more fairly assess them and the appropriate financial sanction."

McDonald, who is also a finance professor at Fairfield University in Connecticut, said the biggest impact of litigation funding companies is that they provide access to capital for law firms who have been historically barred from raising equity capital. The industry also provides opportunities for gathering data and rationally pricing the value of legal claims, he said.

"Smart insurers, law firms, and plaintiffs alike can therefore benefit if they are using a data-driven approach to the litigation finance investment space," McDonald said. "Indeed, we have even seen a couple of insurance firms invest in litigation funds through their investment arms as a way to diversify their portfolio and hedge their risk. So in sum, it's a rapidly evolving space, but it would be short-sighted to see litigation finance as either 'good' or 'bad' for defendants or plaintiffs."

Swiss Re has a different view. The reinsurer is calling for more regulation of third-party litigation funders, including universal disclosure of funding agreements and caps on the amount of interest charged through funding agreements that are usually structured as loans.

The reinsurer noted that 25 out of 94 US district courts have adopted rules that require disclosure of litigation funding agreements in civil cases. That is part of trend toward requiring more disclosure that was previously noted by an article posted in the Claims Journal in September.

Swiss Re said lawmakers should push more more disclosure across more jurisdictions. Lawmakers should also subject litigation funders to anti-usery regulations to protect consumers from excessive interest rates. The report says many consumer litigation funding agreements, which provide cost of living assistance to plaintiffs while they go through litigation, charge interest that is compounded monthly, greatly increasing the amount that is necessary to pay off the loan.

"We believe litigation funding contracts should be subject to comparable protections as other consumer financial products, that benefit from enhanced consumer protection," the report says.

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