THE GENEVA ASSOCIATION

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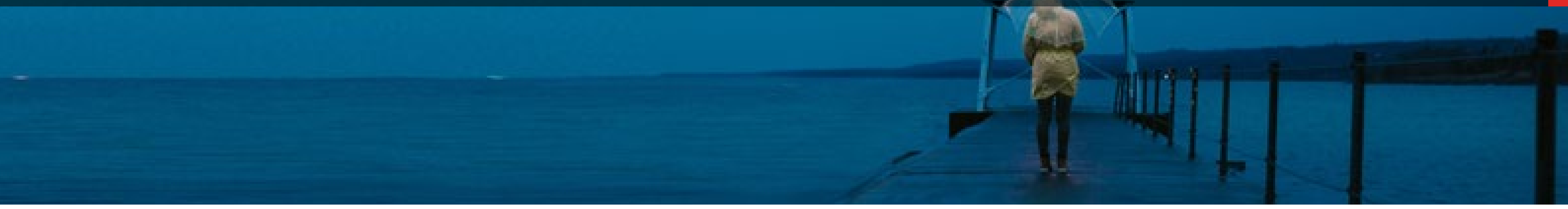
FOREWARNED IS FOREARMED:
Emerging commercial liability trends

Research summary
March 2023



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Societies are complex and economic and technological development, as well as changes in prevailing social customs and institutional structures, continue to add to that complexity. Outsourcing and interdependent supply chains, for instance, increase interconnectivity while new digital technologies provide unprecedented access to information and globalise potential problems. As a result, the ways in which individuals, companies and other legal entities may cause harm to third parties is expanding and, with it, the potential to be held liable to compensate victims.

Drivers of commercial liability

Broadly, corporate liability risk exposure can be traced to one or more of five underlying drivers:

- *Socio-economic/political context.* Developments in the way economic activity is organised and how individuals/firms behave or interact will influence the type and scale of harm or damage that can occur as well as societal attitudes to risk bearing. For example, past periods of industrialisation, electrification, urbanisation and, more recently, digitalisation all shape the commercial risk environment and potential liabilities firms may incur.

- *Technology.* New materials, techniques or methods open up new ways of producing, working and communicating, yet they may not work as intended and/or have unexpected damaging side effects. For example, the use of a new medical device or procedure could create unforeseen bodily injuries to patients.

- *Environmental hazards.* Private actions that threaten the surrounding natural environment or adversely affect peoples' health can create liability and a corresponding claim for compensation. Industrial pollution is a classic example, giving rise either to temporary, localised harm or contributing to secular adverse shifts such as climate change and biodiversity loss.

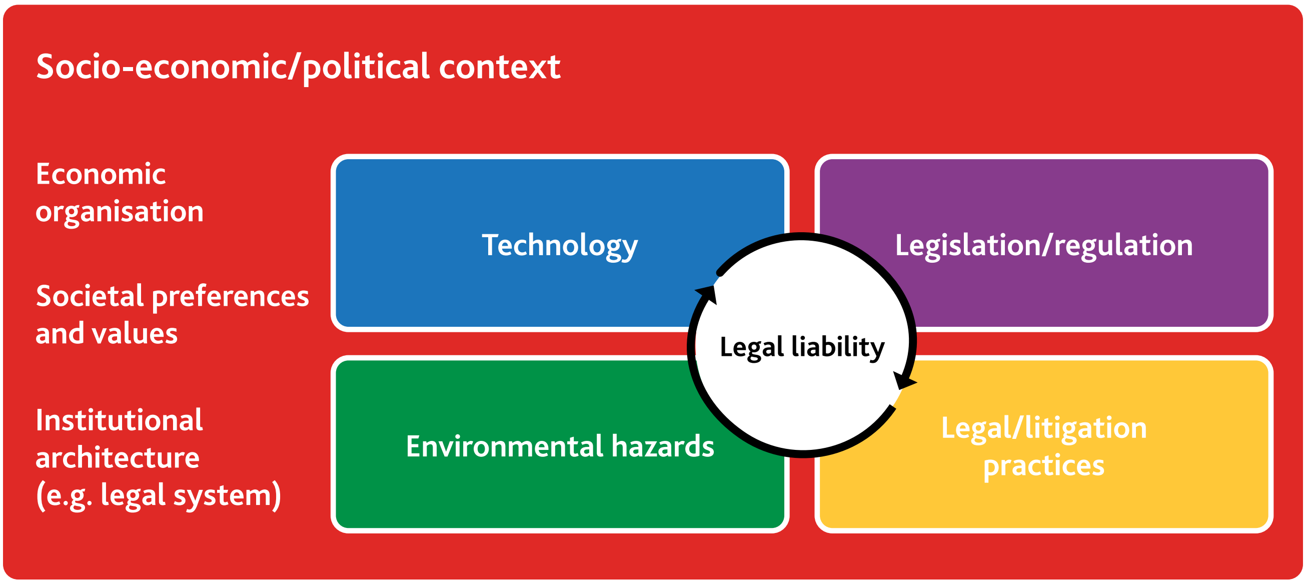
- *Legal/litigation practices.* The pursuit of claims and the success of victims in establishing liability will depend on the types of cases litigated and any associated extension in the scope of legal doctrines (e.g. negligence under tort law) and practices that support the cause of action. For instance, a plaintiff may bring lawsuits under novel legal theories, or procedural mechanisms may develop that allow combined legal actions by a group of claimants, which can strengthen the chances of a successful claim.

- *Legislation/regulation.* Legislatures codify individual rights and legal obligations in statutes or regulations and impose sanctions against those who breach the rules. Statutory and regulatory infringements may give rise not only to enforcement actions but could also form the basis of civil (and criminal) lawsuits. Examples include claims under consumer protection legislation, against issuers of securities who may have misled investors or claims based on breaches of directors' duties under company law.

These drivers are not independent but interact. Socio-economic/political conditions often set the backdrop to the adoption of technological innovations as well as shifts in business activities that impact the natural environment and/or human habitats. To the extent that those developments harm others in society, this may create an obligation on individuals or firms who are responsible to compensate victims, or at least curtail the activity. However, legal liability will only attach if some law or regulation has been broken and/or a cause of action can otherwise be established against the culprit – for example, a claim for negligence or nuisance.

By the same token, laws and regulations are not static. New legislation is passed, novel cases are litigated and legal accountability determined through judicial adjudication. Ultimately, the law changes over time to reflect societal preferences over what is perceived as fair, who is best placed to absorb risk and who should be accountable for harm or damage caused to others.

FIGURE 1: UNDERLYING DRIVERS OF LIABILITY



Source: The Geneva Association

Role and types of liability insurance

Liability insurance typically provides protection against claims resulting from injuries and damage to third parties and their property/assets. Such policies help ensure that innocent victims are appropriately compensated, regardless of the financial well-being of the insured. Furthermore, well-designed terms and conditions in insurance contracts incentivise policyholders to take steps to reduce the risk of harm or injuries. For instance, increasing premiums, reducing limits of liability, restricting coverage terms or refusing to underwrite certain risks altogether, ensure policyholders face some of the potential liability costs, which may encourage them to take preventive actions.

Although definitions vary across countries and insurers, commercial liability insurance can broadly be distinguished between casualty and management/professional lines. Casualty policies protect against liability for physical damage to other people's property or bodily/psychological injuries arising from regular business activities or the use of a product. Management/professional liability policies cover third-party claims for financial losses and include policies such as Directors and Officers (D&O) and Errors and Omissions (E&O) insurance.

A survey of re/insurers

To shine more light on some of the current uncertainties affecting future commercial liabilities over the medium to long term, The Geneva Association surveyed its member firms. The survey provides a unique, collective perspective from the insurance sector and, compared with other surveys about emerging corporate risks, focuses specifically on firms' potential *liability* exposures and the fallout for their insurers. While other surveys concentrate on particular areas such as D&O,[1] ours focuses on the full range of liability insurance – both casualty and managerial/professional lines – providing a more complete take on the contours of the commercial liability risk landscape.

1 For example, WillisTowersWatson publishes an annual Directors' Liability Survey Report. See WillisTowersWatson 2022.

In terms of their relative importance for future commercial liability, each of the five drivers outlined above were all ranked highly by at least some survey respondents. Legal/litigation practices appear to be the top influence, with close to 40% of respondents ranking this the highest. This chimes with recent re/insurer worries about a re-emergence of social inflation in the U.S and its potential to spread to other countries. Social inflation is often linked (in part at least) to developments in litigation practices and legal doctrines that shape and ultimately impact insurers' liability claims costs.[2]

TABLE 1: MAPPING THE SURVEY THEMES AGAINST UNDERLYING LIABILITY DRIVERS

Driver / Theme	Socio-economic/political context	Technology	Environmental hazards	Legal/litigation practices	Legislation/regulation
The civil litigation environment increasingly favours claimants	✓			✓	
Ongoing digitalisation is reconfiguring the liability risk landscape	✓	✓			✓
Climate change litigation against companies is growing in importance and scope	✓		✓	✓	✓
Industrial contaminants are rising up the corporate risk agenda			✓		✓
The focus on corporate social responsibilities and governance is intensifying	✓	✓			✓

Note: Tick marks indicate major drivers of a particular theme
Source: The Geneva Association

The survey results reveal a number of themes, which have links to important underlying liability drivers (summarised in Table 1).

- *The civil litigation environment increasingly favours claimants.* A number of legal/litigation trends are coalescing to create an ever more plaintiff-friendly environment, including the impact of more expansive judicial interpretations/juror attitudes about the perimeter of corporate responsibilities, more aggressive tactics of the plaintiffs' bar and the development of third-party litigation funding models. These are most prominent in common law jurisdictions, especially the U.S., a situation that is expected to persist. However, initial worries that the COVID-19 pandemic could amplify prevailing trends in litigation and compensation awards appear to have receded; the majority of survey respondents believe this is unlikely.
- *Ongoing digitalisation is reconfiguring the liability risk landscape.* Increasingly interconnected and geographically dispersed digital ecosystems increase organisations' exposure to intangible risks, especially those linked to cybersecurity, privacy and intellectual property breaches. Over 90% of survey respondents report that digitalisation will have a significant effect om the liability outlook. Most attention is currently concentrated on relatively mature technologies such as cloud computing and artificial Intelligence, with more than three quarters of respondents highlighting these as important influences. But re/insurers need to stay alert to more nascent developments such as the metaverse, which though still highly uncertain could develop rapidly and have far-reaching liability implications.

2 For a fuller discussion of recent social inflation trends, see The Geneva Association 2020. Author: Darren Pain.

- *Climate change litigation against companies is growing in importance and scope.* Once a mainly U.S. phenomenon targeting companies in the fossil fuel sector, climate change litigation has expanded to incorporate new types of plaintiffs, claimants from different industries as well as other national jurisdictions. More than 90% of survey respondents cite failure to prevent/mitigate climate change and around 90% cite greenwashing as significant liability risks for companies. The precise pathways to legal liability remain uncertain, but the most immediate threat may come via claims that companies miscommunicated or failed to disclose adequately climate-related information to protect consumers, shareholders and investors, and may be fuelled by various new environmental, social and governance (ESG) regulations.

- *Industrial contaminants are rising up the liability risk agenda.* Close to 50% of liability insurance experts highlight industrial pollutants (e.g. per- and polyfluoroalkyl substances (PFAS) and microplastics) as a very significant influence on the medium-term commercial liability outlook. Toxicological evidence of the adverse effects of many of these chemicals is growing, which has prompted an increase in litigation and heightened regulatory scrutiny. The extent to which any liability claims for harm caused by emerging contaminants is covered by insurance will depend on the terms of their policy and their future interpretation in court or arbitrage. This could lead to legal disputes over coverage, especially concerning the applicability of specific pollution exclusions.

- *The focus on corporate social responsibilities and governance is intensifying.* Investors, employees and consumers increasingly expect companies and their executives to live up to the full range of their corporate responsibilities. This extends beyond the ‘E’ in ESG to include, for example, promoting diversity, equity and inclusion (DEI) and implementing prudent cybersecurity. Firms that fail to meet the expected standards open themselves up to the risk of litigation and/or regulatory action, challenging, for example, the veracity of ESG statements or the propriety of the firm’s activities and performance. A large proportion of surveyed liability experts highlight a lack of transparency and specificity around DEI standards and breaches of directors’ fiduciary duties to manage companies responsibly as bases for potential ESG-related liability. Likewise, around 80% of respondents expect data security/privacy regulations to have a significant bearing on future corporate liability.

Responses to the survey suggest re/insurers recognise the need to continually adapt their products and solutions to the emerging liability risk landscape. They point to a wide range of ways re/insurers can align exposures with their risk appetite and risk-absorbing capacity. While mainstay approaches like repricing available cover (including adjusting policy limits) and refining policy language inevitably feature highly in the survey results, they are by no means the only mechanism liability re/insurers expect to implement. Other methods such as investment in improved exposure modelling, partnerships to gather relevant data/intelligence and share risks as well as product innovation (e.g. more bespoke and modular affirmative covers) are equally cited as effective complementary strategies. Successfully executed, such innovations will help ensure liability insurance maintains its socially useful function: ensuring victims are adequately compensated while also incentivising policyholders to take steps to reduce the risk of harm to themselves and others.

References

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WillisTowersWatson. 2022. *Directors’ Liability Survey Report April 2022*. https://www.wtwco.com/en-GB/insights/2022/04/d-and-o-liability-survey-2022