Marsh

US bad faith claims

An increasing trend?

November 2024

As reported in **Marsh UK's Financial Institutions claims insights data report: 2023 year in review**, Marsh UK claims data collected in 2023 indicated a sharp rise in recorded US bad faith claims against our insurance company clients.

The figures recorded in 2024 up to October, suggest the numbers are tracking to a lower annual figure, but will still show material increase on earlier years.

Marsh acts for 12 of the top 20 carriers in the London market. Below we analyse and consider the factors contributing towards what might be a continuing trend.

Our analysis of the financial institution (FI) bad faith claims notifications received by Marsh Specialty in 2023 and 2024, only relates to Marsh's FI insurance programmes placed in the UK, and do not reflect bordereau reported matters which fail to trigger policy reporting thresholds or might settle within policy retention. For the purposes of this review, reference to claims includes notifications of policy defined claims, losses, and circumstances.

What is a “bad faith” claim?

Bad faith is one of the biggest professional indemnity risks for any insurance company underwriting insurance policies in the US. Bad faith risks stem from an insurance company’s handling or defence of an insurance claim, including where handling is conducted on behalf of an insurer via a third party.

There are two types of bad faith claims:

Extra-contractual obligations (ECO)

These claims pursue damages in excess of policy limits sitting outside the coverage of the underlying insurance policy. ECO claims are intended to compensate a policyholder for insurer misconduct during the insurer’s handling of the policyholder’s claim.

Excess of policy limits (XPL)

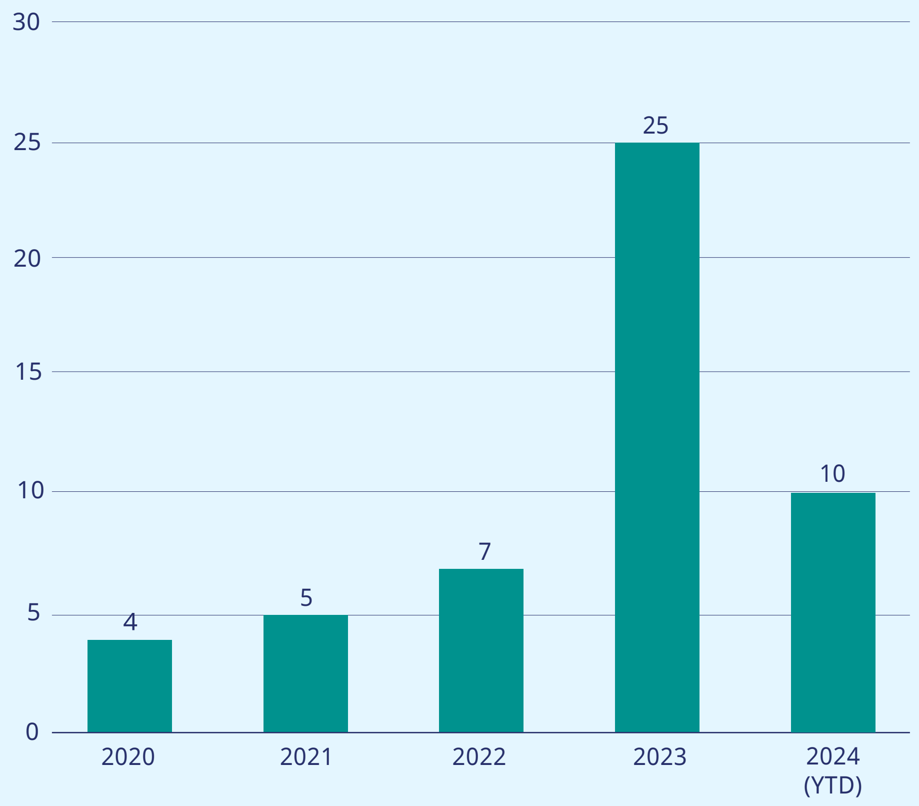
In contrast with ECO claims, XPL claims are for losses otherwise covered by the underlying policy, but exceeding policy limits. The most common cause of an XPL claim is an insurer’s failure to settle the underlying (third party) claim within policy limits, exposing the policyholder to a judgment or liability in excess of the policy limits.

Are bad faith claims increasing?

According to Marsh UK’s claims data for 2023, the answer was “yes”, with the data showing a three-fold increase from the prior year. The number of reported claims up to October 2024, suggests the figure is tracking to a lower number for the whole of 2024 with just two months remaining. However, the overall number is still already higher than earlier years, suggesting that whatever the final 2024 figure might be, across multiple years the overall trend is upwards.

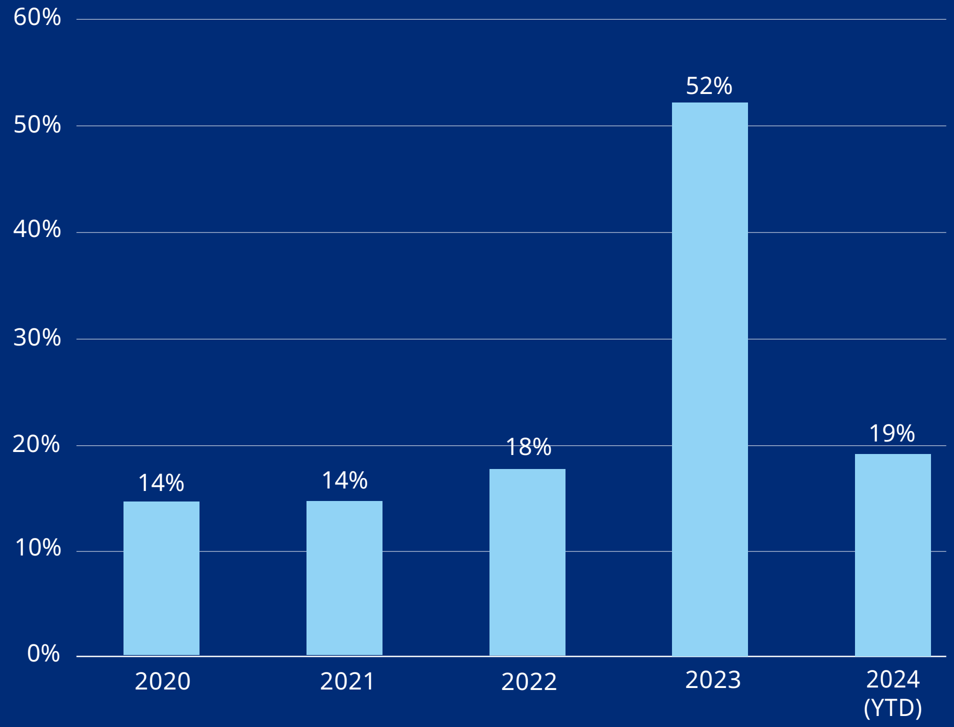
As the tables below demonstrate, Marsh UK handled more notifiable bad faith claims against insurance companies in 2023 and 2024 (so far), compared to previous years, with 2023 showing a significant increase from seven in 2022 to 23 in 2023 (Table 1). As discussed, our 2024 data collected up to October points towards a year-on-year reduction compared to the high figure recorded in 2023. This could, of course, suggest 2023 was something of an outlier year — future data will help us answer that question and prompt us to query the reasons for that. However, tracking across the five-year period, the numbers are up.

Table 1: Number of bad faith claims



The ratio of bad faith claims reported compared to the number of insurance company E&O policies placed by Marsh UK, also shows an increase, moving from 14% in 2021, to 52% in 2023 (Table 2). 2024 data collected so far shows a ratio of 19%, which again is a dip since 2023, but still an increasing overall trend.

Table 2: Number of bad faith claims



1| *This claims data does not include bad faith claim notifications recorded and presented to insurers via bordereau.*

Why has this increase occurred, and can we expect this trend to continue?

There are multiple, potential reasons to explain this overall increase in bad faith claims. Some are associated with "social inflation" factors driving up insurance claim costs across the board. Other reasons are more sector and jurisdiction specific. These include:

- Aggressive plaintiff lawyers issuing inflated claim demands — leveraging their knowledge of unrelated high value settlements to increase pressure on insurers to settle.
- High value "nuclear verdicts" (a term often used to describe jury verdicts above US$10 million) with heightened awareness raising plaintiff settlement expectations. Further information is available on minimising the risk of nuclear verdicts.
- Unfavourable jury trials in policyholder-friendly US states.
- Adverse public sentiment regarding the way large Financial Institutions are perceived to treat their customers.
- Sector specific reasons — healthcare insurers declining cover for claims relating to ever-increasing experimental treatments and/or involving new medical technology, for example.

To stem the tide of inflated bad faith claims, the state of Florida recently made a raft of legislative changes — a step which illustrates how the nature and value of bad faith claims are subject to local variation. In 2023, the state introduced a new insurer-friendly regime for bad faith claims by amending laws relevant to:

1. The 'comparative fault' standard required for a bad faith claim.
2. Limitation and disclosure rules.
3. Limiting attorney use of contingency fee multipliers.

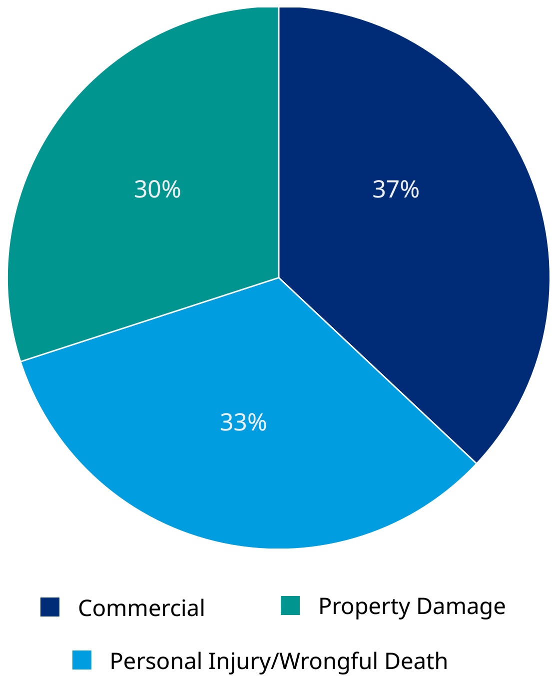
While these changes mark a positive development for insurers issuing policies in Florida, for the reasons set out above, the bad faith landscape in other US states is less positive for insurers and should be closely monitored.

The underlying issues

As well as recording claim frequency, Marsh claims data also details the type of underlying insurance policy and issue to which bad faith claims relate. While insurers might expect to face bad faith claims in connection with policies providing cover for property damage and personal injury, where the risk of bad faith claims tends to be higher, often due to the perceived wrongdoing and impact on individuals' livelihoods (resulting in more sympathetic jury awards), our data shows a more mixed picture.

Aggregated together, Marsh's annual bad faith claims data collected to date tells us that 30% of the bad faith claims notified arose from a variety of underlying commercial policies — a category that includes D&O and professional indemnity/E&O related bad faith claims made across industries. Perhaps surprisingly, this did not involve any element of personal injury, wrongful death, or property damage.

Underlying issues



Marsh's data demonstrates how bad faith claims can relate to various underlying policies, and emphasises why insurance clients should consider ways in which the risk of claims arising might be reduced. These steps could include:

1. Training claims handlers and raising general awareness around the bad faith regime in the US.
2. Stress testing and peer reviewing the handling of US claims files. The rationale for coverage declinatures and decisions not to settle should be carefully assessed and recorded.
3. Engaging experienced coverage counsel and loss adjusters to ensure liability, quantum, and coverage assessments are reliable, robust, and documented on the claim file.
4. Sense checking the insurance position and questioning how a US jury in a bad faith trial might reflect — albeit with hindsight — on insurers' conduct.

Next steps

Please contact the authors of this report or your usual Marsh contact to discuss US bad faith claims, including how to manage the risk they present to insurers underwriting US policies.

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