

THIRD-PARTY LITIGATION FUNDING

By Associates Insurance Agency



THIRD-PARTY LITIGATION FUNDING IS FORCING COMMERCIAL INSURED TO PROACTIVELY MANAGE THEIR LEGAL RISK

By: [Courtney DuChene](#) |
Insurers want to protect their customers. But the cost of that is increasing.

Over the past several years, companies and their insurers have grown increasingly concerned about the costs of out-sized settlements and jury verdicts.



This comes at a time when some insurance carriers are grappling with significant losses in some liability lines.

Insurers are struggling to profitably manage portfolios — and high levels of litigation and high dollar jury awards aren't helping policies remain affordable. If insurers take big hits in a legal settlement, the result will likely be higher premiums for their customers.

"These large verdicts not only impact the defendant companies but also contribute to higher costs for consumers as businesses seek to mitigate risk," said Russ Johnston, president of E&S, Specialty, and Commercial Lines at Nationwide.

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COMPANIES MAY FACE INCREASED COSTS, REPUTATIONAL DAMAGE, AND A DIVERSION OF RESOURCES AWAY FROM INNOVATION AND GROWTH. CONSUMERS, IN TURN, MAY ENCOUNTER HIGHER PRICES, REDUCED ACCESS TO PRODUCTS OR SERVICES, AND A POTENTIAL STIFLING OF ECONOMIC DEVELOPMENT.

One of the more significant contributors to the increase in lawsuits is driven by third-party litigation funding. "One of the primary sources is the growing trend of third-party litigation funding, which enables plaintiffs' attorneys to pursue low-merit cases they might not otherwise have the resources to pursue," Johnston explained.

Insureds need to proactively manage their exposures as a result of third-party funders with meritless claims and they need to advocate for legal reforms, lest their policies become unaffordable.

WHAT IS THIRD-PARTY LITIGATION FUNDING?

In third-party litigation funding, an investor funds a lawsuit in which they are neither the plaintiff, nor the defendant. The funder takes on a portion of a plaintiff's legal costs as an investment — with the hopes that they'll make a return once the verdict is in.

"In many cases, it's no longer solely about making the injured person whole but about another party economically benefiting from that person's injury," Johnston said.

The practice is only a few years old in the U.S., but it's existed in Australia since the 1990s and in the UK it can be traced back to 1967, according to the Harvard Law School Center on the Legal Profession.

Third-party litigation funding is contributing to several already troubling trends within the U.S. legal system. Jury awards over \$10 million (known as nuclear verdicts in the industry), are on the rise. Last year, scores of lawsuits against corporations reached the nuclear level, per a Marathon Strategies report. The size of pre-trial settlements also continues to dramatically rise to avoid making the nuclear verdict list. High verdicts are a boon to third-party litigation funders — it means they get a larger payout.

"Litigation funding [has] been driving a dramatic increase in loss costs, unlike anything we've seen in the history of liability insurance," Johnston said.

High verdict costs mean insurers are seeing increased claims costs. They're likely to increase their prices in turn, meaning insureds may be unable to afford their previous limits and policy coverages.

"In the next 5 to 7 years, the cost of an umbrella policy for a customer could double. This impending affordability crisis is something that customers are not thinking about or prepared for, and it poses a significant problem for both customers and the industry," Johnston said.

This practice of seeking investment return from litigation funding also contributes to slowing down the judicial process for plaintiffs with legitimate cases who deserve to receive their decisions quickly.

COULD LEGAL SYSTEM REFORM GIVE INSURERS RELIEF?

Many carriers, regulators and insureds are aware of the challenges third-party litigation funding presents. They're pushing for reforms to the legal system that could tamp down the practice.

"I believe we haven't made a strong enough case to our customers about the potential implications," Johnston said. "Earnings calls from various companies suggest that liability trends, particularly in umbrella and excess liability, are increasing by 10% or more.

"To effectively address this issue, customers need to have a bigger voice in the conversation. The industry must work to connect the dots and communicate the potential long-term implications of the current trends to our customers," he continued.

One reform many would like to see: disclosure requirements for third-party litigation funders. In Florida, Senate Bill 1276, introduced this year, would require plaintiffs to disclose the source of their litigation financing, letting jurors know if a third-party is involved. It would also ban third-party lenders from influencing litigation. At the federal level, the U.S. Chamber of Commerce Institute for Legal Reform has proposed similar amendments, Johnston said, requiring plaintiffs to disclose funding sources at the start of litigation.

"There needs to be transparency about the existence of third-party funding," Johnston said.

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PROACTIVE RISK MANAGEMENT

Today's contentious litigation environment means that insureds need to proactively manage their legal risk. Resources like jury consultants, mock trials and other risk management tools can help insureds prepare for trials — and know when it's better to settle.

"To protect against litigation abuse, companies must adopt best practices, such as robust risk management strategies, proactive legal defense, and engagement with policymakers to advocate for balanced reforms," Johnston said. "By taking a comprehensive approach, businesses can mitigate the negative impacts of litigation abuse while preserving access to justice."

Some insurers are turning to new technology, like AI, to assess claims and enable claim associates to more readily identify the most effective options for defending insureds.

"We have implemented AI to analyze claims in the early stages, typically within the first 30 to 60 days. By collecting fact patterns around the nature of the claim, such as jurisdiction, parties injured, nature of injuries, and other factors, we can begin to determine the likelihood of litigation," Johnston said.

"Identifying these claims early allows us to bring the right tools and techniques to the adjudication process."

A combination of robust risk management and legal system reform can help keep insurance prices in check, while still allowing the legal system to offer protection for people who have been injured or wronged by corporations, according to Johnston.

"People buy insurance because sometimes the financial responsibility of making an injured person whole exceeds their personal assets," he said.

"Our goal is to do the right thing when someone is injured while protecting our customers from a legal system that is often stacked against them."

SOURCES

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