LLOYD'S

Allowing for Inflation in Reserving

A thematic review of Lloyd's Market reserving approaches for claims inflation

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Key Contacts

Any queries regarding this report or the work underlying it should be addressed to:

Market Reserving and Capital Team

Emma Stewart, Chief Actuary

Emma.Stewart@lloyds.com – 020 7327 5654

Louise Bennett, Head of Reserve Modelling

Louise.Bennett@lloyds.com – 020 7327 5534

Priye Kanabar, Senior Actuary

Priye.Kanabar@lloyds.com – 020 7327 5883

Disclaimer

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Introduction

Foreword

The Lloyd's Market Oversight Plan for 2021 included a thematic review into claims inflation and noted the following: "Inflation is an evolving risk area resulting in unexpected rising insurance claim costs and in particular social inflation can cause increases due to societal trends and views toward litigation. The impact of this cuts across underwriting, reserving and capital setting."

Underwriting remains focused on the impact of inflation to Syndicates' profitable underwriting of affected classes and, alongside robust review and challenge to Syndicates' inflationary assumptions in planning, there is ongoing engagement and oversight of the market within underwriting's quarterly oversight patterns. The capital workstream completed its work in August 2021 and published the "Modelling of claims inflation" report for the Lloyd's market.

The reserving thematic review on claims inflation was initially designed to focus on social inflation, given that in the last few years there have been rising cost of claims resulting from increasing litigation, broader definitions of liability, more plaintiff-friendly legal decisions and larger compensatory jury awards. However, due to the significant changes in the recent general economic inflationary environment, the review was adapted to include conversations with managing agents around claims inflation more broadly.

Lloyd's reserving inflation thematic review

This report looks at a range of approaches used by the market to consider social inflation and the current economic inflationary environment when setting their reserves. It highlights good practice approaches as well as areas we identified that generally require improvement and further consideration.

Lloyd's prepared two questionnaires in order to ensure appropriate information was gathered for the review. All managing agents were invited to complete the "voluntary" questionnaire, which collected high level details on approaches considered by agents to allow for social inflation – there were 13 managing agents that responded. In addition, Lloyd's selected 12 agents to provide more detailed information, via a "detailed" questionnaire, on how social inflation is considered as part of their reserving processes. The report provides a summary of the key themes emerging from these responses and discussions.

Additionally, Lloyd's met with each of the 12 agents to further discuss the responses to the questionnaires. These meetings were also used to obtain information on how agents are considering the increased economic inflationary environment from a reserving perspective. The report provides features of best practice approaches adopted in the market, but also highlights areas that are difficult to assess and quantify and as such further consideration is required.

Definition of inflation

We define claims inflation as the change in claims cost of a like for like policy over time. Claims cost is considered as all costs in relation to the payment and settlement of a (re)insurance claim. This includes loss adjustment expenses directly associated with the claim, such as claims handling.

Like for like means having consistent policy wording, exposure and level of coverage, such that the change in claims cost is considered after normalising for changes in policy terms and other differences in the policy.

The definition of claims inflation covers changes in claims cost due to trends which affect the number (frequency) and/or size (severity) of claims. Claims inflation is the sum of economic and excess inflation:

- **Economic inflation**: Changes in claims costs as captured through published economic indices relevant to a (re)insurer's mix of business. Typically, this is inflation in the cost of a basket of selected goods and services or average wage costs, which are captured in price and wage indices (such as RPI, CPI and ASHE in the UK, which are produced by ONS).
- **Excess inflation**: Changes in claims costs beyond what is captured in economic indices, including factors which are specific to a (re)insurers' business and including social inflation. Typically, this is inflation associated with resources specific to the nature of the claims costs of the (re)insurer (beyond that captured in generic inflation indices); or emerging risk from new materials, medicines and technologies; changes in the legal environment; evolving social attitudes towards claiming; and political developments.

We define **social inflation** as a subset of excess inflation, which more narrowly pertains to claims inflation as a result of societal trends. This includes rising costs of claims resulting from increased litigation, broader definitions of liability (excluding those caused by changes in policy terms and conditions), more plaintiff-friendly legal decisions, larger compensatory jury awards and social movements.

Please note that when we refer to “inflation” in this report this means “claims inflation” – i.e., the sum of economic and excess inflation as defined above, unless otherwise stated. Additionally, where commentary on best practice approaches related to economic inflation are included in this report, these are also applicable to excess (excluding social) inflation.

Executive summary

Key findings

Consideration of economic inflation

The significant changes in the economic inflationary environment since 2021 Q2 in particular, and the expected heightened level of uncertainty around this in the medium term, is something that is posing syndicates across the market a great deal of challenge.

The greatest challenge comes from the large number of interlinked drivers of the current environment and understanding the impact of these on the claims expected to arise from particular areas of a syndicate’s portfolio. Historically inflation has been assumed to impact the longer-tailed lines of businesses the most. However, given the pace and extent of the increase and drivers of the current inflationary environment, the shorter-tailed classes, such as Property are also expected to be impacted adversely now.

Annual economic inflation over the next few months is widely expected to be significantly above the observed average over the recent history, before returning to long-term inflation targets set by central banks (although the timing of this is still highly uncertain). Therefore, syndicates should carefully consider the impact on the cost of claims expected to settle over this period, and beyond. The typical reserving approaches adopted by syndicates up to now cannot readily incorporate such changes in the inflationary environment.

Some syndicates have reacted quickly to the changes in the inflationary environment and demonstrated great flexibility in approach. They have recognised the need to perform additional analyses to supplement the outputs from their more embedded reserving processes in order to ensure the overall reserves appropriately reflect the recent changes. Furthermore, these syndicates recognise the need to ensure these supplementary processes continue to be enhanced, and possibly embedded as part of the overall process, such that monitoring the appropriateness of future reserves becomes easier.

The majority of syndicates are taking significant action to ensure appropriate inflation allowance can be made to their business plan loss ratios, and through this, to their latest year of account’s Initial Expected Loss Ratio (“IELR”) used for reserving. Some of these syndicates had plans to also look at adjusting IELRs used for older years of account. To the extent that these adjustments can appropriately allow for expected fluctuation in inflation over the medium term, the years of account reserved for using the IELR may be adequate.

However, there are many syndicates who are yet to determine an appropriate course of action to ensure adequate adjustments can be made to the reserves relating to those years of account that are not a function of the IELR, and ensure that sufficient justification can be provided in cases where an adjustment is not deemed to be required.

As part of the broader oversight relating to inflation, Lloyd’s will seek to understand the progress made by these syndicates. It is worth noting that the Lloyd’s expectations, “Reserving Guidance – Allowing for Inflation”, were communicated after the conversations Lloyd’s were held with syndicates within this thematic review (on 6 June 2022) and approaches may have moved on since then.

Consideration of social inflation

Social inflation has been recognised as a driver of claims costs within certain lines of business for a long time, however changes in certain societal trends and rise in litigation funding have increased the impact of social inflation over the last few years, in particular since 2015.

The greatest challenge syndicates face with social inflation is the difficulty in quantifying the historical impact of it on claims. This is due to the unique nature of all claims which makes it challenging to isolate the impact of social inflation amidst numerous other drivers of the cost of claims. As such, where syndicates are making an explicit allowance for social inflation within their reserving assumptions, these are highly subjective, and based more on qualitative inputs. To facilitate this, one of the key process changes adopted by syndicates in general has been to improve feedback loops between different functions, in particular between the reserving actuaries and the claims teams. In some cases, this has allowed syndicates to appropriately reserve for emerging issues, such as #MeToo and Black Lives Matter, before the impact of this is witnessed in the claims data.

Syndicates that write a significant volume of business in classes and geographies that are most impacted by social inflation are, unsurprisingly, better able to identify impact of social inflation within their own claims data. Therefore, they are able to combine the qualitative view from various sources with the quantitative information from their own data when selecting their reserving assumptions.

More than half of the syndicates that responded to the questionnaire make an explicit allowance for social inflation within their assumptions. From those that do not make an explicit allowance within their assumptions, they all do consider social inflation as part of the broader claims inflation and trend conversations that are had internally, particularly between the claims and reserving teams. This in turn forms the basis of the overall claims inflation and trend assumptions made. The key risk with not having an explicit social inflation allowance, however, is the lack of transparency. This makes it difficult for boards to understand and challenge the appropriateness of reserves considering social inflation, as well as for the reserving actuaries to monitor the appropriateness of reserves going forwards. **Therefore, Lloyd's would recommend syndicates to consider making an explicit allowance for social inflation.**

The classes and geographies that were most mentioned in the responses received were in line with expectations, i.e. General Liability, Professional Liability, and D&O classes exposed to the US. However, there were also some classes that were mentioned, albeit less frequently, which indicate the wider impact of changes in societal trends than has been the case historically. An example of this is the Energy Offshore Liability class, which is increasingly impacted by climate change litigation exposures. **As such, syndicates should broaden their discussions around social inflation to consider a wider set of drivers of social inflation and ensure classes that have not historically been impacted by social inflation are considered where appropriate.**

Next steps

Given the significant and rapid changes in the economic inflationary environment, ensuring syndicates are appropriately considering the impact of this on their portfolios has become a high priority oversight activity for Lloyd's in 2022. The oversight will cover the whole market. As such, findings from conversations had as part of this thematic review will be incorporated into the market-wide oversight.

Review process

Purpose and scope of the review

The 2021 Market Oversight Plan for Lloyd's included thematic reviews on social inflation given the societal trends that are impacting cost of claims in the recent years. The Capital team at Lloyd's conducted its thematic review in 2021 and issued the "Modelling of Claims Inflation – Lloyd's Syndicate Capital Thematic Review" report in August 2021.

The Reserving thematic review was re-scheduled for 2022. The initial scope of the review was focussed on social inflation. However, given the significant changes in the general economic inflationary environment since the initial scope of the review was decided, the scope of the review was expanded part-way through to also cover economic inflation.

From a social inflation perspective, the key objective of the review was to understand the extent to which social inflation has impacted syndicates, and if syndicates are explicitly considering social inflation when setting their reserves. In addition, the review aimed to understand the common approaches syndicates adopted where explicit allowances were made relating to social inflation.

The inclusion of economic inflation in the scope was to understand if and how syndicates were planning to assess the impact of the rapid and unforeseen changes in the general inflationary environment on their reserves. Given the late inclusion in the scope, the information collected on economic inflation was largely anecdotal.

Format of the review

The findings that are shared in this report are based on the following key sources of information:

1. Detailed questionnaire – completed by 12 syndicates that formed part of the detailed review

2. Lighter questionnaire – was designed to be completed by any managing agent on a voluntary basis. 13 agents completed the questionnaire

3. Meetings – with the 12 agents that were part of the detailed review

The two questionnaires were designed with input and feedback from an inflation working group, which included participants from the market to ensure the questions were appropriate. The focus of questionnaires was predominantly social inflation given the initial scope of the review.

The meetings were used to gain a deeper understanding of the responses provided in the questionnaire, but also were key in obtaining information around economic inflation.

Economic inflation

General Observations

General observations in respect of economic inflation are largely based on the conversations with the 12 agents involved in the detailed review. From these meetings, the key finding that was observed was that the level of consideration given to the latest year of account was materially greater than the consideration given to the prior years of account.

Latest Year of Account

It was widely acknowledged that the speed, magnitude and the unexpected nature of the change in economic inflation required significant and urgent attention from syndicates. Many agents had already established cross-functional working groups on inflation to ensure inflation was considered holistically and consistently across the syndicate. Working groups were seen as a key requirement to ensure the risks posed by the change in inflation can be appropriately responded to and updated over time.

The output from these working parties was largely focused towards ensuring that the plan loss ratios for the upcoming year is appropriately capturing the recent changes in inflationary environment. As the link between plan loss ratios and the reserving IELRs for the latest year of account is generally strong and clear, this suggested that the reserving IELR for the latest year of account included appropriately considered allowances where required.

Prior Years of Account

In respect of the prior years of account, there was a large variance in terms of the level of consideration given to the changing inflationary environment. A few of the syndicates that we spoke to in May 2022, had made considerable advances in the approach they are adopting for the change in economic inflation. These syndicates considered the expected future inflation by calendar years alongside the payment profile of classes of business to understand the potential impact on unsettled claims across all prior years of account. However, on the other end of the spectrum, there were several syndicates that had not yet considered how they planned to:

- adapt their methods such that appropriate adjustments to reserves can be determined. We acknowledge that these conversations had taken place before the Lloyd’s Reserving Guidance on Claims Inflation was published on 6 June 2022. However, we would now expect all syndicates to ensure they are taking adequate action to understand the potential impact of the change in economic inflation across all years of account, **OR**
- gain comfort around the on-going appropriateness of their reserves and methods.

Best Practice

This section of the report provides further detail on the key aspects of the best practice approaches we observed during this review. These observations relate to syndicates which were at a more advanced stage in terms of their consideration of economic inflation. The aspects are broken down into 5 categories:

1. Early action was taken:

- Syndicates had processes and feedback loops in place that allowed the changing inflationary environment to be raised as an area of additional uncertainty and risk in 2021. The results of the analyses that followed this were explicit allowances being made to the reserves in 2021 Q4.
- Cross-functional inflation working groups were set up in either 2021 or early in 2022 to investigate the impact on change in economic inflation across the syndicate and ensure that there was a consistent approach to addressing the additional risks being faced by the syndicate. Working groups typically allowed underwriters to share their views on how inflation is expected to impact their class of business, and the wider group to understand and challenge the assumptions. Based on this, appropriate class-specific adjustments were made where required.

- There was recognition of the fact that there has been significant changes in economic inflation since the initial analysis was carried out. Following this there were clear plans to ensure that they refined their processes and revisited their assumptions going forward.

2. Impact of change in economic inflation was considered on all years of account:

- Syndicates made assumptions around the expected levels of future inflation by calendar year (which requires a view of how long the heightened inflationary environment is expected to persist). This was then considered alongside when payments relating to outstanding and future claims were expected to be made in order to determine an appropriate adjustment to reserves. The key benefits of making explicit assumptions such as these are that these can be understood and challenged by various stakeholders, as well as monitored and adjusted if required in the future.

3. Impact of change in economic inflation was considered on all classes:

Detailed conversations with class underwriters had taken place to understand how their classes of business are expected to be impacted by the heightened inflationary environment. Albeit this does not mean that there was an explicit allowance made to all classes.

- Typical insight gained from underwriters included the types of inflation that are most relevant to the class, and the approximate weight that should be given to each type to determine the overall inflation index for the class.
- Through the above, syndicates identified their classes of business that were expected to be most materially impacted by the change in economic inflation and focus their attention on areas of the business that most required it.
- An example of how class-specific features are being considered is on Treaty classes. Given these classes are subject to gearing effect of claims inflation, and therefore a percentage increase in cost of claims is greater on claims to an excess layer compared to claims in the primary layer, specific adjustments were considered to address this risk.

4. Validation of approach adopted, and assumptions made to understand impact of change in economic inflation:

Syndicates had external views that they could compare their analysis and assumptions to. Typically, the audit and Statement of Actuarial Opinion providers had independently carried out their own analysis of the potential impact of change in economic inflation. In this instance, syndicates performed a detailed comparison of the adopted methods and assumptions made. Areas of material differences were investigated and understood to either gain further comfort around the assumptions made or to identify areas which need further work in the future.

5. The large uncertainty around economic inflation and its impact on the syndicate was appropriately communicated to Boards:

- Following on from the point above relating to the comparison of syndicate’s view against external views, the key findings from this exercise were clearly communicated to the Board, along with the associated proposed next steps. The wide range of views and possible estimations of reserves allows the Board to understand the inherent uncertainty around this risk.
- Syndicates also utilised stress and sensitivity tests to understand the materiality of the assumptions being made and to communicate the wide range of plausible outcomes to the Board.

Conclusions and recommendations

Economic inflation is already widely being considered and significant amounts of thinking, and action has taken place within syndicates. However, at the time of the review many syndicates were not considering the impact of the current environment on prior years of account. Lloyd’s has since published the Reserving Guidance on Inflation which sets out Lloyd’s expectations. Therefore, those agents who at the time of the study were not considering impact on prior years would be expected to do so now.

Change in economic inflation should be considered explicitly by syndicates, to understand whether adjustments to reserves are required, and if so, what the appropriate adjustments are. Where adjustments are not required, syndicates should be able to obtain comfort, and explain, as to why the reserves continue to be appropriate. The approaches adopted should reflect the specificities of classes of business, rather than broad-brush adjustments made to all classes.

Any assumptions made relating to this will inevitably be highly subjective and often based on expert judgement. As such, it is vital that this message is communicated to the Board along with sufficient information for them to understand the wide range of outcomes.

Social inflation

This section highlights the key findings and overall themes in respect of the reserving approach to social inflation. As aforementioned, Lloyd's prepared two questionnaires in order to ensure appropriate information was gathered for the review. Additionally, Lloyd's met with each of the 12 agents involved in the detailed review, to further discuss the responses to the questionnaires. Further, the responses from both questionnaires are corroborated with the findings from the syndicate meetings. The graphs in this section of the report are based on 25 responses, i.e., 13 managing agents provided responses to the Lighter questionnaire in addition to the 12 managing agents that formed part of the review,

Definition

Social inflation is the rising cost of claims resulting from increasing litigation, broader definitions of liability, more plaintiff-friendly legal decisions, and larger compensatory jury awards. The list below includes several drivers of social inflation. It is worth noting that that this is not an exhaustive list and there are potentially other drivers of social inflation that could cause increases in claims costs over and above those caused by general inflation that we may not have captured.

- **Societal trends:** Increasing public distrust of large corporations and widescale movements such as #MeToo and Black Lives Matter
- **Increases in litigation funding:** The litigation funding industry has ramped up activity in the US, and increasingly outside of the US, and there is the emergence of more firms being set up to fund tort activity
- **Increases in the number of litigated claims:** With the growth of the litigation industry, it's become easier to finance high risk and costly court proceedings, escalating the number of claims being taken to court
- **Erosion of existing tort reform:** While limits are in place in many US states to mitigate the size of jury awards, in recent years these are being challenged and reformed so that larger awards become possible. Plaintiff panels use this to their advantage by jurisdiction shopping, among other sophisticated targeting approaches. Defence panels have not been able to keep pace with this.
- **Emerging concepts in tort law:** Cyber, environmental, and large multinational company liability torts are examples of emerging areas that are not fully defined by statute.

Social inflation is a major contributor to the worsening of (re)insurance industry results for Casualty business in the US. While this is an emerging issue driving up the cost of claims in the US, there are signs that countries such as the UK, Canada and Australia are also being affected and the extent of this could increase in the near future. This is in large part because these countries operate on a common law basis like in the US, where judicial precedents can be set.

General Observations

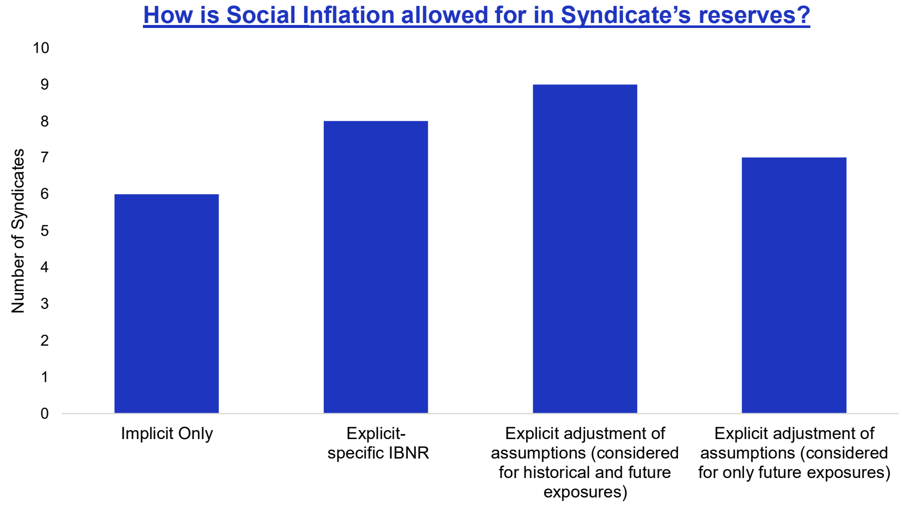
Social inflation has historically been recognised as a driver of claims costs within certain lines of business, albeit the terminology is recent. However, recent trends show signs that it is picking up pace again, with various high-profile movements and legal cases (#MeToo, Black Lives Matter and the opioid epidemic to name a few) garnering media spotlight and public interest. Following on from the above definitions, social inflation is not limited to societal trends, but also litigation funding and US tort activity. Further, the number of claims being pursued through courts and the level of award have been increasing. Additionally, it is worth noting that despite the recent increasing trends, social inflation has the potential to increase at even greater rates.

Through engagement with managing agents, Lloyd's identified that the greatest challenge syndicates face with social inflation is the difficulty in quantifying the historical impact of social inflation on claims. This is due to the unique nature of all claims which makes it challenging to isolate the impact of social inflation amidst numerous other drivers of the cost of claims. This is evidenced in the questionnaire responses, where Lloyd's has observed a variety of approaches to making an allowance for social inflation, but all heavily reliant on expert judgement.

Where syndicates are making an explicit allowance for social inflation within their reserving assumptions, these are highly subjective, and based more on qualitative inputs. To facilitate this, one of the key process changes adopted by syndicates in general has been to improve feedback loops between different functions, in particular between the reserving actuaries and the claims teams. In some cases, this has allowed syndicates to appropriately reserve for emerging issues, such as #MeToo and Black Lives Matter, before the impact of this is witnessed in the claims data. However, there are a number of syndicates who have not considered social inflation to the same extent and have opted for a more implicit approach.

Explicit vs Implicit allowances

From a social inflation perspective, a key question of the review was to understand how syndicates are allowing for social inflation when setting their reserves and if syndicates are considering this explicitly. The main finding is that more than half of the syndicates that responded to the questionnaires allow for social inflation explicitly within their reserving. It should be noted that some syndicates considered explicit allowances in more than one way.



Explicit consideration – The syndicates that considered social inflation explicitly, had a number of different approaches:

- Most syndicates achieved this through including an explicit load for social inflation within their selected IELR. Some syndicates' processes included consideration to adjust previously added explicit loads on older years of account during the selection of IELR for the latest year of account. Whereas other syndicates by default did not consider adjustments to previously determined explicit loads to IELRs. The drawback of the latter approach is that in instances where there is a change in the social inflation environment that impacts the prior years of account, this may not be appropriately considered if prior year social inflation assumptions are not revisited.
- Some syndicates supplemented the explicit loads to the IELR with specific IBNRs, in respect of issues such as #MeToo and Black Lives Matter movement. Allowances such as these are typically based on detailed and frequent conversations between the Claims and Reserving teams, where provisions are added based on emerging trends, i.e., before material evidence of the issue impacting the internal claims data
- There were also examples of syndicates who had added more general manual IBNRs in addition to the formulaic IBNR allowances calculated based on the default reserving method to specifically reflect uncertainties on classes which are exposed to social inflation.

In cases where explicit allowances were made through a load added to the IELR, the allowances were assumed to run-off in line with class development pattern. Where manual provisions were added (either in respect of general exposure to social inflation or related to a specific issue), these were regularly monitored and adjusted based on the latest information available at the time.

Implicit consideration – There were some syndicates that did not allow for social inflation explicitly. However, it is worth noting that social inflation was broadly considered when determining the appropriateness of overall class-level reserves. The common ways in which this was done are described below.

- Reserves were held back despite favourable claims experience on classes exposed to social inflation in recognition of the fact that social inflation increases the uncertainty around the unsettled claims. The main limitation of this approach is the reliance on claims experience being favourable. If claims experience is adverse, and not due to social inflation, this method could lead to inadequate allowance for social inflation. Additionally, it becomes challenging for syndicates to understand and justify how much reserves are being held in respect of social inflation (and other issues). Favourable experience being held back may be utilised as rationale to cover a range of drivers of possible deteriorations.

- Case reserves are frequently updated, particularly on classes that are exposed to social inflation. To the extent that the projection of IBNR is based on incurred claims, for example using the Chainladder method, this approach would implicitly include an allowance for social inflation within IBNR provisions. However, there are two key limitations with this approach:
    - The adequacy of social inflation allowance within the IBNR is reliant on the historical experience being a strong indicator of future expectations
    - IBNR calculated based on exposure-based approaches, such as the Bornheutter-Ferguson (“BF”) method, may not include an allowance for social inflation depending on the approach used to derive the initial loss ratios.
- Reserving assumptions were set with awareness of social inflation. For example, when determining an overall claims inflation allowance used for IELR derivation, social inflation would be considered along with other drivers of inflation.

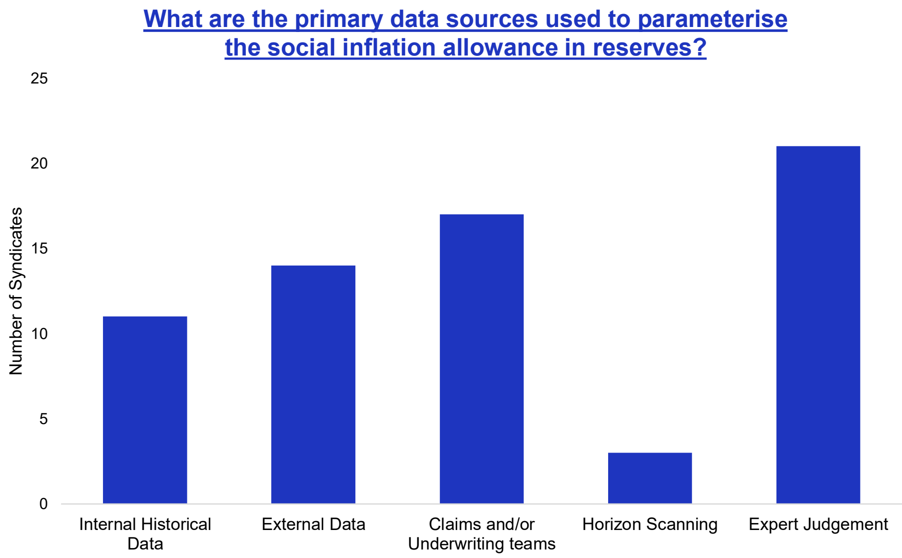
In addition to specific limitations mentioned above, the key general limitations of not making an explicit allowance for social inflation are as follows:

- The lack of transparency makes it difficult for the Board to gain comfort and / or challenge that the reserves are appropriate given the current social inflation environment. An explicit allowance, albeit highly subjective, along with appropriate communication gives the Board an opportunity to understand how material the risk is to the syndicate and the uncertainty around it.
- The on-going monitoring of the appropriateness of reserves becomes challenging, particularly when there is a significant change in view of how social inflation will impact claims thereafter.

It is worth noting that some of the syndicates that were only allowing for social inflation implicitly at the time of the review, did mention that they were in the process of investigating whether they should be making an explicit allowance for social inflation going forwards.

Data sources and Analysis

A variety of data sources were used to evidence whether the reserves require an allowance for social inflation, as well as to parameterise the allowance. Unsurprisingly, syndicates that write a significant volume of business in classes and geographies that are most impacted by social inflation are better able to identify the impact of social inflation within their own claims data. Therefore, they are able to combine the qualitative view from various sources with the quantitative information from their own data when selecting their reserving assumptions. The graph below shows the key sources of data considered by syndicates when determining allowances for social inflation.



Those syndicates that used internal historical data would corroborate this with at least one other source of data. For some syndicates this was evidence of the improved feedback loops between different functions, and the success of the cross-functional working parties. In some instances, the secondary source would be used to identify further trends, however, this was also used as a validation tool.

On the other hand, there were a number of syndicates that had insufficient internal historical data. Those syndicates which fell into this end of the spectrum either relied heavily on insight from other internal functions such as claims and underwriting or relevant external data

Regardless of the volume of internal data or expertise available to syndicates, use of expert judgement was the overriding common theme across all syndicates when considering social inflation. This makes it more important that syndicates appropriately capture and communicate the judgements that are being made such that adequate understanding and challenge of these is possible.

Class Trends

Social inflation has been and is expected to continue to have an impact on the claims environment for many commercial insurance policies. Some of the classes where the effect has been most prevalent and substantiated by research to date are outlined below. It is expected that other classes are similarly being impacted and US tort activity will continue to influence social trends and claims experience outside of the US.

- **Casualty –** Casualty business is generally recognised as having the greatest exposure to social inflation, namely the US elements of the book. These elements of the book have been impacted by emerging issues, such as #MeToo and Black Lives Matter.
    - US General liability and US Casualty Treaty are the reserving classes expected to be most impacted by social inflation out of the casualty classes. These classes are particularly impacted by societal trends, as well as the increases in litigation funding and larger jury awards. In line with this, a number of syndicates have noted an increase in defence costs spend on recent years.
    - As part of their analysis, a number of syndicates are considering the movement of CPIs and numerous indices with claims inflation (of which social inflation is a subset), albeit this is not limited to the US Casualty business. These syndicates have noticed trends between historical increases in settlement values and a number of inflation metrics e.g., wage inflation.
    - In respect of Casualty FinPro classes, they have been impacted by the increases in third-party litigation funding and court award trends. There have been many claims incurred that relate to societal trends such as #MeToo and Black Lives Matter movement.

- There are a few syndicates that acknowledge these trends in the wider market, however, have not yet seen it come through in their data. This is more often the case with long tailed business, where the loss experience is not yet mature.

- **Property –** The Property classes have had exposure to social inflation, largely due to business interruption, but also due to societal trends.
    - A few syndicates mentioned litigation of business interruption claims as a primary reason for the uptick in property type claims.
    - There were also some syndicates that noticed an increase in claims frequency through damage caused in protests associated with social movements.

Other findings

Other findings were around the exposure to social inflation in terms of classes and geography. Most of the findings were in line with expectations i.e., social inflation materially impacts the FinPro and A&H classes, and in terms of geography, predominantly US exposure. However, there were a few notable examples which were less common:

- Classes: Energy offshore liability is a good example of where social inflation was considered in respect of climate change litigation.
- Geography: Aside from the US, geographies that were mentioned the most were Australia and New Zealand. There were also potential early signs of impact in other regions such as Europe.

This suggests that the impact of social inflation is expanding beyond classes and geographies that have thus far been impacted. This emphasises the need for syndicates to have robust processes and feedback loops that allow early identification of potential emerging trends such that impact of social inflation is appropriately considered across the whole syndicate, not just in areas of the portfolio that has historically been impacted.

Risk management and mitigation approaches

Given the increase in social inflation over the last few years, syndicates have taken various steps to manage and mitigate this risk. Some steps have been taken to manage the risks associated with policies already written, whereas other steps have been taken to reduce the risk from future policies.

Steps taken in respect of existing exposures

1. Specific RI programmes purchased – The most common risk management measure taken was to purchase reinsurance cover for classes that are specifically exposed to social inflation. It is worth noting that whilst the reinsurance programmes are expected to provide some protection against social inflation, programmes were not necessarily purchased to solely cover the risk of social inflation.

2. Enhanced feedback loops

- **Detailed emerging risks reports from claims –** This is particularly seen between the claims and the reserving teams, where there were notably good examples of reports that the claims team provides to the wider business. The focus of these reports being particular emerging trends – including social inflation – observed across different parts of the globe that could potentially impact a syndicate's portfolio. The enhanced feedback loop enables reserving actuaries to make informed decisions when setting reserves.
- **Watchlists improved and the focus of conversations –** There have been vast improvements in watchlists that the claims teams and reserving teams are using to have discussions as part of the quarterly reserving processes. This allows the teams to particularly identify claims that might be impacted by social inflation and having multiple estimates for a single loss. The estimates range from a best estimate to a more pessimistic view to give the reserving actuaries more of a context, such that they can make a more informed decision about the overall level of IBNR.

3. Change in philosophy adopted by the claims team – This was a less common approach, however, there were a few examples where the claims team were actively looking to settle claims that they thought might be exposed to social inflation early.

Steps taken in respect of future exposures

These were mostly focussed on actions taken by underwriters. Generally, this involved reducing exposure to geographies and classes which are expected to be impacted by social inflation. In some instances, this meant that syndicates were exiting these classes altogether.

Conclusions and recommendations

Many syndicates are explicitly allowing for social inflation when setting reserves, which is mostly done through a specific load included within the IELR assumptions. Whilst understandably the focus of each IELR setting exercise may be the latest year of account, syndicates should consider whether assumptions for older years of account need to be re-visited considering the latest information they have available.

Some syndicates that are not making any explicit allowances for social inflation, are mindful of social inflation and consider the potential impact of it on their portfolio when setting reserves. This is mostly done through conversations with the internal claims team. A subset of these syndicates have not seen any significant evidence of social inflation within their claims data, which is a key reason for not considering explicit social inflation allowance. However, these syndicates should be mindful of the limitations of only implicitly allowing for social inflation, in particular the lack of transparency and the consequences of that. Syndicates should also be mindful of the widening impact of social inflation beyond what has been witnessed historically. This is even more applicable to syndicates who have taken significant re-underwriting steps to reduce their exposure to social inflation, as they may more readily assume that their portfolio has no longer the potential to be materially impacted by social inflation. For example:

- With the increased litigation related to Climate Change, are there areas of a syndicate’s portfolio (by class and geography) that may be impacted by social inflation?
- Due to the increased geopolitical and social tensions are classes such as Terrorism likely to be more affected by social inflation than in the past?

Due to the difficulty in quantifying the historical impact of social inflation, syndicates understandably rely heavily on expert judgement to make allowances. The judgements made and the impact of those judgements should be clearly documented and communicated to the relevant stakeholders including the boards, such that the subjective and uncertain nature of any allowance is transparent and appropriately challenged.