

## Insights from Lloyd's Reserving and Market Monitoring ahead of 2024 Year-End

Dear Chief Actuaries of Lloyd's Syndicates and Lloyd's Signing Actuaries

The purpose of this letter is to highlight key areas of consideration for Chief Actuaries and Signing Actuaries within the Lloyd's market in preparation for the 2024 year-end reserve setting exercises. While this is not an exhaustive list and does not account for the unique risk profiles of individual syndicates, it highlights thematic concerns identified through Lloyd's market oversight and central reserving analysis and we expect these areas to be explicitly considered in 2024 year-end reserving exercises.

Consistent with our messaging in previous years, the reserving landscape is continually evolving. We see this as covering three categories of consideration: unique events, the position in the underwriting/reserving cycle and the economic environment.

Firstly, we are encountering and responding to events and trends that are unprecedented in our data history, with traditional reserving methods at risk of being inadequate in isolation and increased uncertainty around the reserves to consider and capture. Reserving for Ukraine has required more scenario-based approaches to be adopted and COVID-19 has disrupted development profiles differently across various classes, complicating the assessment of experience in informing initial expected loss ratio setting for recent years. Moreover, the recent US hurricanes require the consideration of specific uncertainties that are unique – including the potential for post-loss amplification due to the compounded effects of Helene and Milton. It continues to be crucial for actuaries to communicate the uncertainty around the reserves effectively to their boards and to explain the range of possible outcomes, so that this can be linked to any margin considerations and the understanding of reserve strength in a holistic way.

Additionally, there is a need for explicit consideration of the impact of the underwriting cycle and reserving cycle in setting initial expected loss ratios. We highlighted this using the D&O class as an example in our Reserving Forum last year and this has continued to be a focus area of Lloyd's reserving and capital oversight in 2024.

Furthermore, the severity and frequency of claims is impacted by the changing economic and claims environment. Economic inflation levels have reduced this year, but claims inflation is impacted by other factors. Most notably, in the US where Casualty classes are seeing strong social inflation driven by Third Party Litigation funding, but also in the UK with the forthcoming Ogden discount rate change.

A summary of the key considerations for 2024 year-end reserving across these categories is as follows:

1. **Credit for Remediation** - Remediation actions over recent years have improved claims experience (e.g. for Casualty FinPro). However, we urge reserve setting to only take these into account if proven effective and to also monitor and reflect the underwriting/reserving cycle given the weakening rating environment on some of these classes.
2. **Lengthening and potential distortions of development patterns** - We have observed deteriorations on Casualty lines of business, notably US exposed classes, and it's not clear if this has reached its peak as development patterns have lengthened. There is also uncertainty on the more recent years with COVID-19 distorting the claims development patterns and this varies by class and territory. Reserve estimates need to be fortified with additional analysis, e.g. claim watchlists, to supplement chainladder analysis to either help parameterise or validate current reserves.
3. **Social inflation** - Rates of social inflation have increased since last year, notably in the US. Reserves must account for the impacts on claims severity and frequency in a way that considers the risk profile of their book (e.g. limits and attachment points) as well as the possibility of future increases and the uncertainty associated with this.
4. **Economic Inflation** – Explicit economic inflation uplifts are reducing in the market as the levels of inflation are more integrated into case estimates. However, there is still uncertainty around the level of economic inflation allowance in long-tail classes, given the difficulty of isolating the effects and monitoring it in the data.
5. **US Hurricane season** – Uncertainty around the reserve estimates for the hurricanes in the US might be heightened in comparison to historical similar events due to impact from flooding, potential litigation costs and post-loss amplification. In particular, the potential for post-loss amplification might be heightened due to the compounded effects of Helene and Milton being back to back hurricanes both making landfall in the region of the Gulf coast of Florida and both heavily impacting the west-central coast of Florida.
6. **Ukraine** – The key uncertainty remains around the aviation losses – and syndicates need to continue to monitor any developments in this area and allow for the range of possibilities in their estimates.
7. **Ogden discount rate** – The Ogden discount rate is currently under a formal review with a new rate to be announced in January. Syndicates will need to understand their exposure to this change and consider any knock-on effects such as a change to PPO propensity which is highly uncertain.

Further detail has been provided below, including insights from class-specific reserving oversight Lloyd's has carried out this year, however these areas should be considered across other classes where relevant.

## **Key findings and observations on Casualty reserving from our analysis and oversight**

During 2024, Lloyd's carried out a high-level market metrics analysis as at 31 December 2023 based on the Technical Provisions Data (TPD) received from the market. This represented a reduced scope compared to previous (and planned future) years' analysis, due to focussing on the development of the new reserving returns which will bring benefits to the market. Nonetheless, there are insights from this and our market oversight across 2024, most notably on the Casualty classes, which we believe are valuable to share.

At a total market level, experience over 2023 calendar year when compared to our 2022YE analysis showed better ex-cat claims development on the 2022 and prior YoAs. However, this was partially offset by continued deterioration on the 2015-2019 YoA, predominantly driven by the 'Casualty Other' high level class. While we have not carried out our own full assessment of reserves as at 2023YE, historically the main divergences in view between Lloyd's central view and syndicate reserves have been in the 'Casualty FinPro' classes.

Therefore, in 2024 we have continued our oversight on Casualty FinPro (particularly US D&O) and additionally Lloyd's Performance Management and Reserving teams have performed a review of US Casualty business (in particular, Non-Marine General Liability US and Casualty Treaty US).

This letter provides insights from our market metrics analysis on highlighted classes and from the reserving component of the US Casualty review. We have included 2023YE market level information of key Casualty classes in the Appendix, including loss ratio trends over time for each year of account and market level development patterns.

### Casualty FinPro

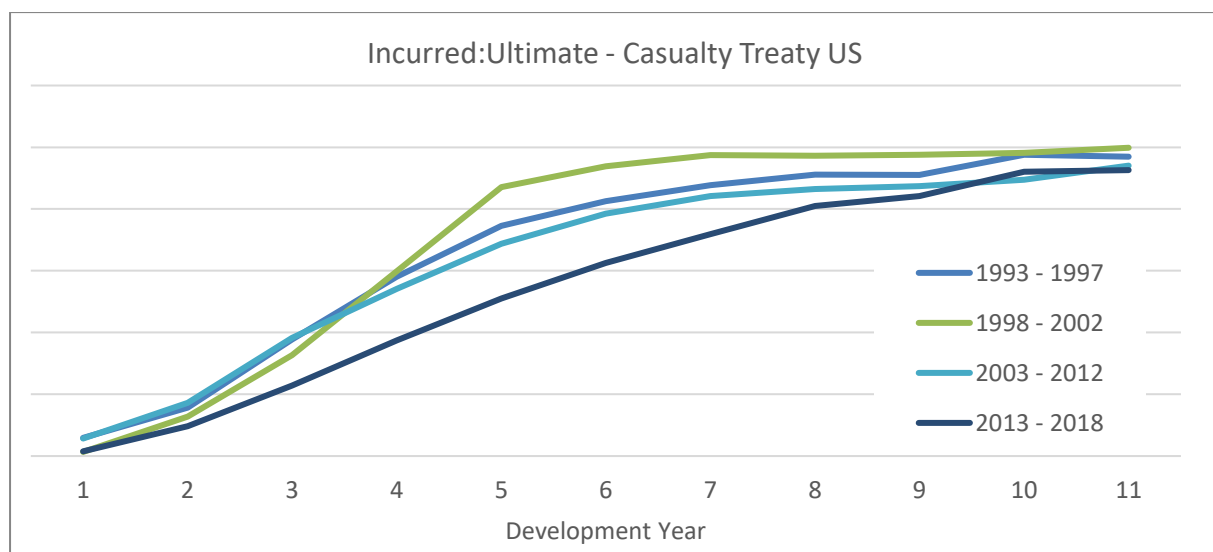
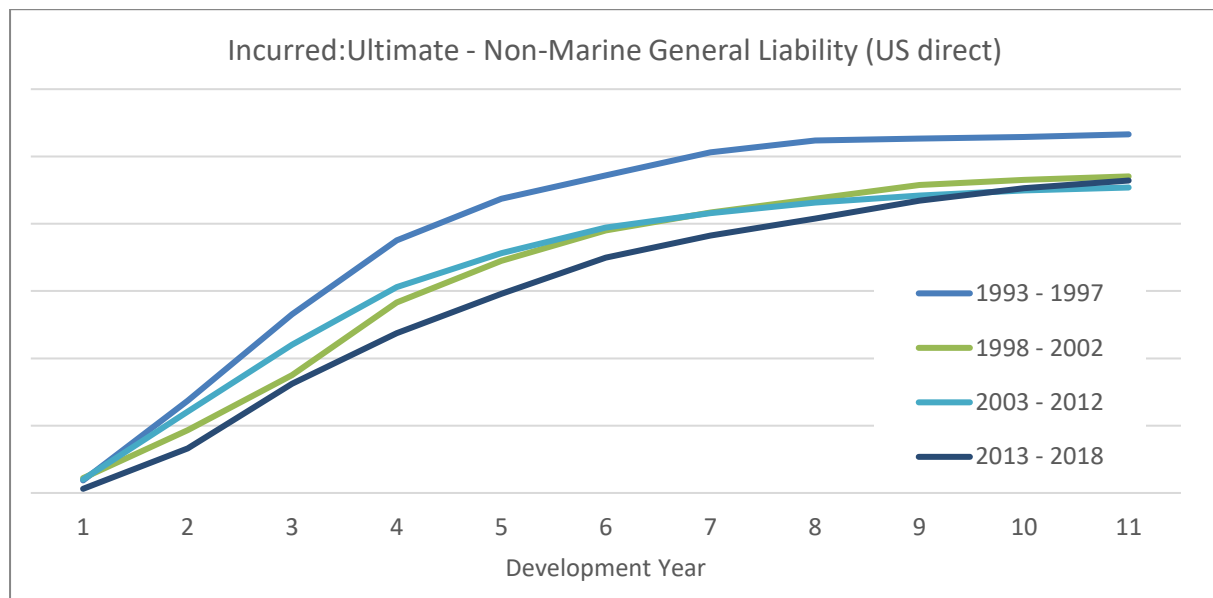
Our 2023YE market analysis has shown that actual incurred claims for Casualty FinPro are developing as expected (according to Lloyd's central reserving view) on the 2015-2019 underwriting years and better than expected experience is seen on the 2020 to 2022 YoAs. We would like to stress that this is based on expectations from Lloyd's central reserving view – which has been more conservative than the market's over the last years, so this might not be in line with what syndicates observe.

The market's and Lloyd's views have diverged on the more recent underwriting years due to the allowance for remediation, where our central view has not given as much credit for this. We continue to urge caution when projecting forward this 'better' experience observed on the most recent YoAs. Managing Agents should consider the drivers of the experience and whether it should be expected to continue in the future: Has the profile of the class consistently changed due to improved underwriting, or is the better experience driven by something (e.g. an unexpected drop in frequency) that might not be expected to continue? Where there is growth in the class, the relevance of the 'better' experience seen on the subset of the class should be questioned, i.e. explicit consideration of new business performance relative to renewal business.

As per our guidance, remediation should only be allowed for once it has been evidenced in the data and syndicates should consider the appropriateness of reflecting this in their assumption setting on the more recent underwriting years. Moreover, we urge managing agents to consider the position in the underwriting and reserving cycle – where a weakening cycle might lead to under-reserving.



The continued reserve deteriorations have been due, in part, to unprecedented late claim movements compared to historical claims experience. This is demonstrated in the chart below which shows the average incurred:ultimate claim ratios grouped into broad soft / hard market years for the Non-Marine General Liability US business and Casualty Treaty US classes of business. For both classes, the latest soft market period (2013-2018) shows claims ratios significantly lower than historical prior years.



We highlight some of the key observations and areas of improvement from our review below.

Reserving Methodology

The Managing Agents in the review all had broadly the same approach to reserving the back years which consisted of a combination of traditional actuarial techniques coupled with supplementary analysis. Namely the use of: own data chainladder analysis, benchmark chainladder analysis (Lloyd's and/or wider company data) and claims watchlist analysis.

Most agents continue to use incurred chainladder methodologies to derive claim estimates supplemented with specific IBNR in some instances. It is evident that the underlying data used to parameterise the development patterns, either from the agents' own data and/or benchmark data has proven to be inadequate in recognising the extent to which claims have developed later in the tail. Several managing agents have supplemented their development pattern tail factors using expert judgement derived from both the claims and underwriting functions as these late claim movements have been unprecedented and are not contained in the historical data.

However, managing agents were unable to demonstrably explain why claims development for the back years has deteriorated beyond expectations. Delays due to COVID-19 was cited as a potential reason but further work is needed in this area to evidence this is the case. We expect managing agents to identify the specific reasons and causes for the late claim developments to help inform parameterisation of more recent years as they transition to experience-based methodologies.

Claim watchlists are used by most managing agents to provide insights regarding IBNR reserves given the uncertainty in the tail of the development. The watchlists are used to validate IBNR estimates and in some situations parametrise the reserve estimates. The sophistication of the watchlists varies materially between managing agents. Best practice observed, in a few instances only, was backtesting of the material assumptions within the claim watchlist and using the outcomes of this analysis to parameterise the judgements. For example, backtesting the likelihood of a watchlist notification settling as a claim and subsequently the settlement value relative to exposure. For mature years, where the number of potential claims is limited and the outcomes uncertain, it is essential managing agents use a claim watchlist to inform IBNR estimates, this should include low and high range of outcomes to help demonstrate reserve uncertainty. Moreover consideration should be given to the current and anticipated future claims environment relative to history which backtesting results are based on. Changes relative to history may mean your key assumptions/expert judgements need adjustments, for example social inflation rates in the US have materially increased over the last calendar year relative to historical rates.

### Underwriting Remediation

Since the 2020 underwriting year the business has undergone significant remediation. The primary approach, affecting both direct and treaty business, has been a material reduction in individual and aggregate line size deployment. We have observed very significant contraction in limit size particularly in larger lines at low attachments. In addition, syndicates have non-renewed significant tranches of poorly performing business. We observed that this was largely focused on specific Coverholders, States, or on an individual risk-by-risk basis rather than wholesale changes in the occupation mix within the portfolio. From a reserving perspective, we found no explicit analysis which considered the change in limit profile of the business either for the point estimate of reserves or the sensitivity analysis. Indirectly, managing agents consider the portfolio changes, including the limit profile, through the use of RARC and inflation assumptions when on-levelling historical loss ratios. Reserving functions should be actively monitoring changes in the underlying business (e.g. limit profiles, industry mix) to understand the change to reserve uncertainty and appropriately reflect these changes within the reserves. For example, where business mix changes indicate increasing risk such as increased limit profile, we would expect best-estimate reserves to adequately reflect this risk and in addition that the increased uncertainty from larger limits is appropriately communicated to management.

### Social Inflation

Social Inflation is a core concern for the US casualty market and we discussed this issue with every managing agent in the review. Social inflationary trends are currently

predominantly directly impacting the severity of claims, with a resulting increase to the 'frequency' of claims in the mid-higher attachment points.

We observed the following practices:

1. There were two primary areas, aside from class of business, that agents consider in assessing their exposure to social inflation:
  - 1) the attachment profile within a class of business – with primary and low excess layers tending to have lower allowances, and 2) the mix of industry exposure – for example, railroads.
2. Managing agents' own data is generally insufficient to measure social inflation in isolation. As such, industry data (e.g. from actuarial consultancies or legal firms) is used to inform social inflation assumptions.
3. Monitoring social inflation is limited across the market. For the majority, the market is unable to monitor social inflation in isolation on their books of business and instead consider Actual vs Expected for aggregate claims on a quarterly basis and investigate drivers of experience relative to expectations. Part of this consideration is the appropriateness of the inflation assumption.
4. There is a large reliance upon the claims function to appropriately consider inflation allowances for known claims.

Within their reserve-setting, managing agents should consider testing the appropriateness of case estimates given the impact of social inflationary trends on the sensitivity of the reserves to them. Furthermore, the difference in ownership of the reserves (set by the actuaries) and the case estimates (set by the claims function) gives rise to greater scope for uncertainty in the reserves. It is important to perform stress tests around the appropriateness of the case estimates to articulate the uncertainty around the reserve point estimate.

We expect the most recent social inflationary environment indicators are used to inform allowances with the 2024YE reserves.

In addition, we expect more considered analysis of reserve uncertainty due to social inflationary trends. Currently, the uncertainty analysis carried out generally uses generic scenarios which do not consider the profile of the business and changes overtime, such as limit profile, which we know to be a key driver of inflation impacted claims costs and reserve risk.

### **Other Key Uncertainties for 2024 year-end**

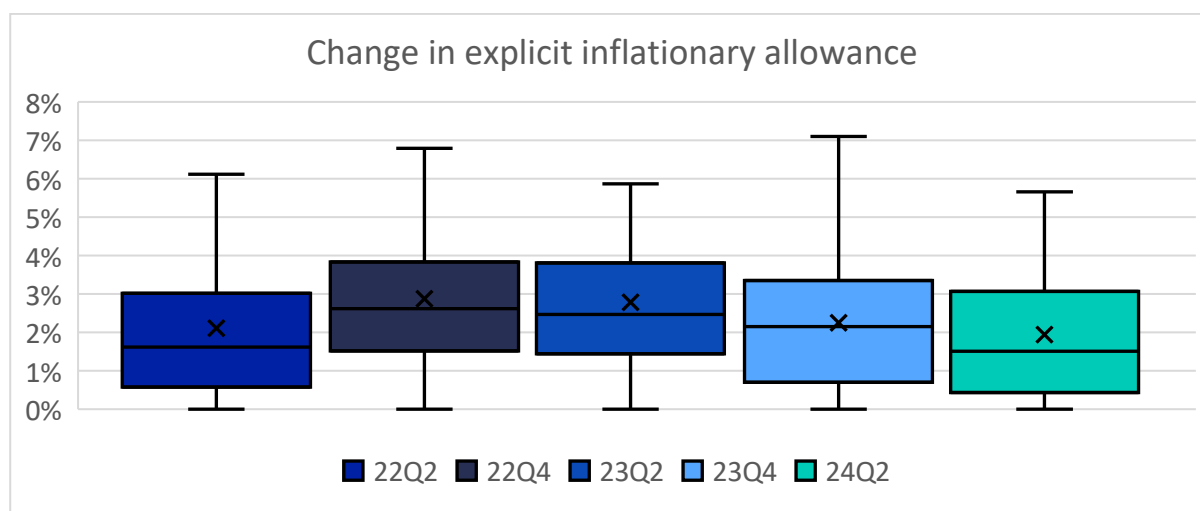
In addition to the key focus areas arising from our class-specific analysis and market oversight, there are other areas of uncertainty which we discuss here.

#### Economic Inflation

Overall, we have observed good examples of holistic frameworks in place by syndicates to consider changes to the macroeconomic inflationary environment and as a result explicitly allow for this as part of their reserving.

Over 2024 Lloyd's has focused oversight on emergence of inflation in claims data. Based on our oversight we believe that we have been transitioning between "phase 2" - where the heightened inflation is emerging in the claims data - and "phase 3" - where new inflation environment is fully integrated into the case estimates. This is more prevalent for short tail classes.

The chart below shows the trend over time for the explicit inflationary uplift in reserves since Lloyd's requested this information from managing agents.



Average uplift to net reserves as at Q2 2024: 1.9%

The chart shows there is a downwards trend over time since the emergence of the heightened inflationary environment. This is consistent with expectations given: 1) the downwards trend in headline inflation indices, with forecasts expecting macroeconomic inflation to remain stable for the remainder of 2024, and 2) less explicit allowance is needed on top of traditional reserving methods if case reserves in claims triangles are updated to incorporate the impact of the heightened inflationary period and loss development factors reflect this.

Overall we have observed a decrease of 0.5%ppt in the market level of explicit uplift as at Q2 2024 (1.9%ppt) vs Q4 2023 (2.4%ppt). The decrease is driven by the trend of reduced levels of inflation and the higher proportion of paid claims and case reserves now allowing for the heightened inflation (notably in the short-tailed classes of business), but also by the growth in prior year reserves and the run-off of explicit adjustments on prior YoA in line with reserves.

The main uncertainty on economic inflation is that it remains difficult to isolate and monitor. It is complex to understand what level of inflation has actually been allowed for in the data – with reliance on the claims function to update case estimates – and hence where additional allowances remain necessary. This particularly applies to long-tail classes where the emergence and effects are likely to lag the short-tail classes.

Therefore, as with social inflation, it is important to understand the uncertainty in the assumptions made and how this can vary by class of business.

### The US hurricane season

Hurricane Milton was the fifth hurricane of the season to make landfall in the continental US – and has caused significant damage from wind and storm surge in Florida. Uncertainty for the reserve estimates for the event might be driven by the loss from storm surge, inland flooding and tornado impacts as well as post-loss amplifications (availability of resources), and social inflation.

Additionally, back to back hurricanes making landfall in the region of the Gulf coast of Florida and both heavily impacting the west-central coast of Florida creates additional uncertainty, where retentions/aggregates have been affected but it is not clear how much yet, availability of resources is further impaired in the region and potential additional complications arise, such as increased LAE and difficulty in loss attribution.

### Ukraine

We have continued to collate information relating to the conflict in Ukraine via the QMA Additional Information Return in the 2024 Calendar Year. Lloyd's is planning to meet with managing agents with material exposure in Q4 2024 and Q1 2025 to discuss any changes in their methodology and assumptions underlying the aviation best estimate.

Lloyd's notes that there is still a considerable amount of uncertainty in the reserving best estimate of the aviation classes and that Syndicates should consider the possible impacts of any recent and ongoing court cases, settlements, evolving sanctions, legal costs, RI assumptions and contract wording in deriving the best estimate. Where appropriate, Lloyd's expects alternative scenarios to be presented to the board and expects the board to apply scrutiny on reserving assumptions given this level of uncertainty.

### Ogden

The Personal Injury Discount Rate (PIDR) in England and Wales is -0.25% as of August 2019 with formal reviews required to take place every five years. The Ministry of Justice is currently undertaking a formal review with a new rate expected to be announced by January 2025.

Syndicates will need to understand their exposure to this change and consider any knock-on effects such as a change to PPO propensity which is highly uncertain.

Lloyd's expects the Signing Actuary to report reserving assumptions related to personal injury claims to consider an appropriate PIDR rate. These should be reported in the SAO Addendum return and SAO Report. Lloyd's expects the Signing Actuary to include an impact assessment on the gross and net baseline reserves in respect of personal injury claims based on the revised rate when announced on January 2025 as outlined in the SAO Addendum return instructions.

### **Next Steps**

We hope this letter will be useful for you and your firm ahead of the 2024 year-end reserving Exercise, which many of you will already be well underway with. We encourage you to assess the extent to which the points raised are relevant to your business/risk profile and how they are being addressed, and be able to explain where these have been deemed as inapplicable.

It is our expectation that you will bring this letter to the attention of your audit and/or reserving committee. As part of our regular reserving oversight of the Lloyd's market, we may ask how you have considered the areas set out below as part of your 2024 year-end reserving.

In the appendix to this letter we have included playback of relevant information from Lloyd's aggregated Technical Provisions Data (TPD) for specific Casualty classes of business which we believe is important for managing agents to consider. This information reflects the data

submitted by Syndicates to Lloyd's and therefore the reliance on accurate data submissions should be noted. Additionally, ultimate loss ratios and development patterns reflect the estimates of syndicates, and therefore contain considerable uncertainty and are not necessarily the view of Lloyd's.

If you would like to discuss the content of this letter please get in touch with us.

Yours Sincerely

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Head of Actuarial Oversight

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## Appendix

*Key trends from the aggregated 2023YE Technical Provisions Data return by class:*

- *Directors and Officers (Non-US)*
- *Directors and Officers (US)*
- *Professional Indemnity (Non-US)*
- *Professional Indemnity (US)*
- *Non-Marine General Liability (Non-US Direct)*
- *Non-Marine General Liability (US Direct)*
- *Medical Malpractice (US)*
- *Non-Marine Casualty Treaty (US)*

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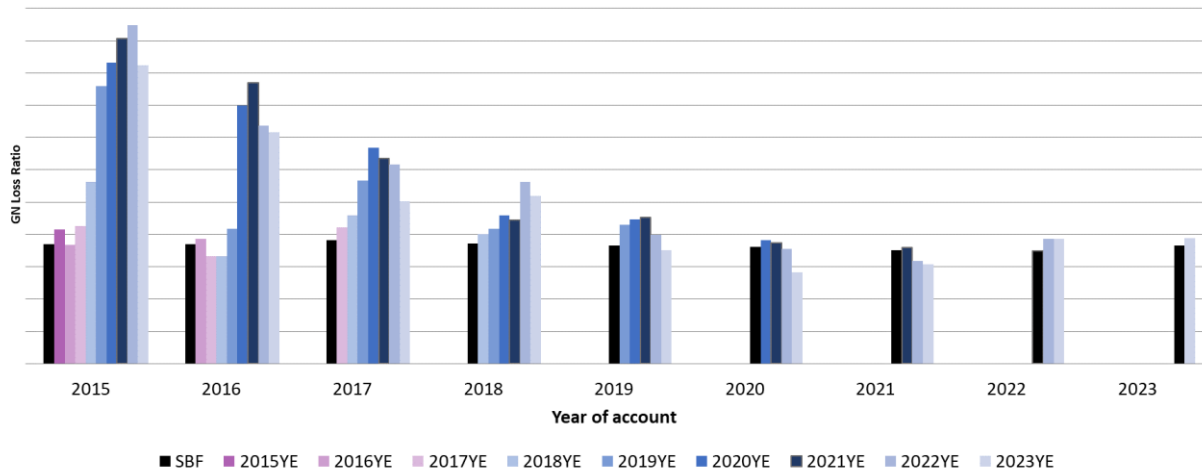
*Market development patterns have been grouped into cohorts of years of account. A simple average of the reserve diagnostic ratios (e.g. paid to ultimate ratios) for individual years as at each development period, has been used to reflect the cohort value at each development period. Please note axis of market development pattern charts have been truncated to more readily display observable trends within the data. Selected class/underwriting year combinations have been presented to convey observable trends.*

# Directors and Officers (Non-US)

## Loss Ratio Trends

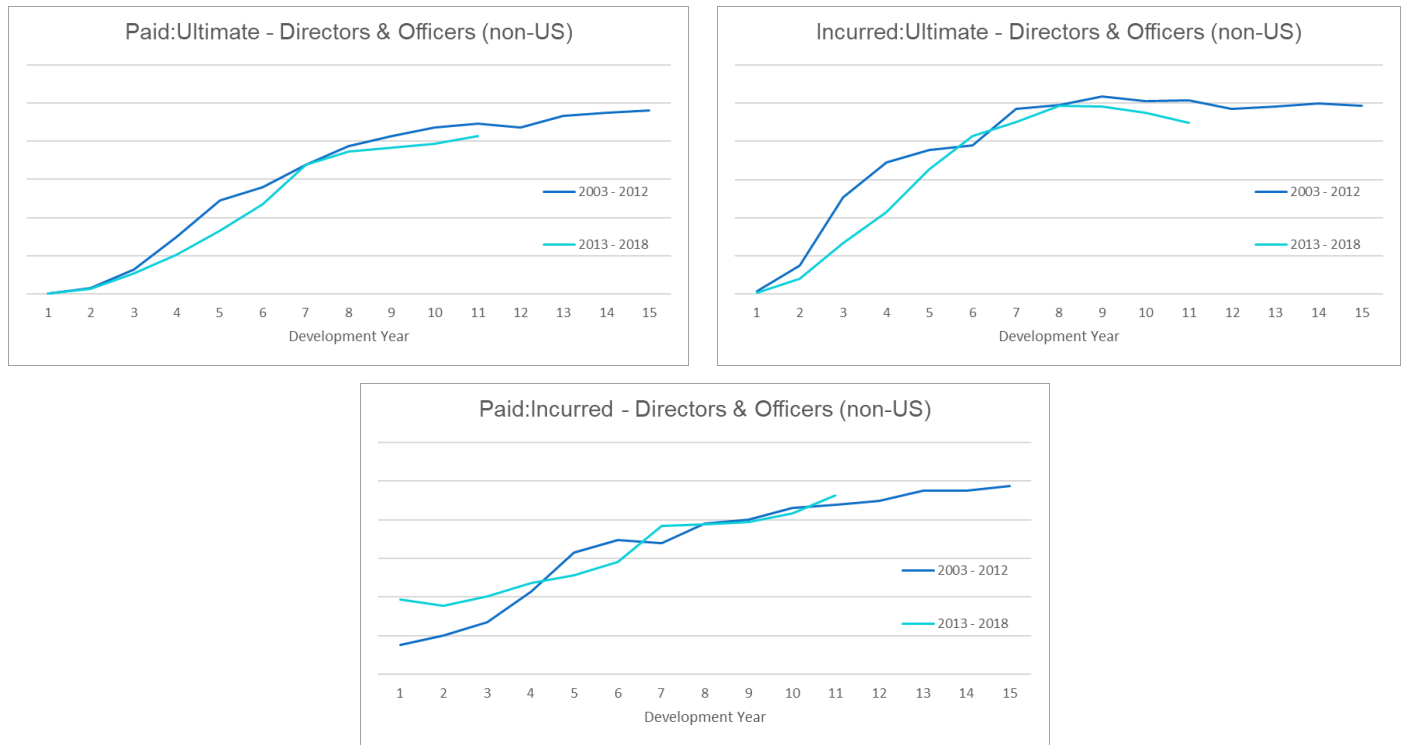
The gross net written ultimate loss ratio over time for each year of account as at 2015YE to 2023YE. This is calculated using the aggregate market view from the TPD for this class.

Market Gross Net Written Loss Ratio over time

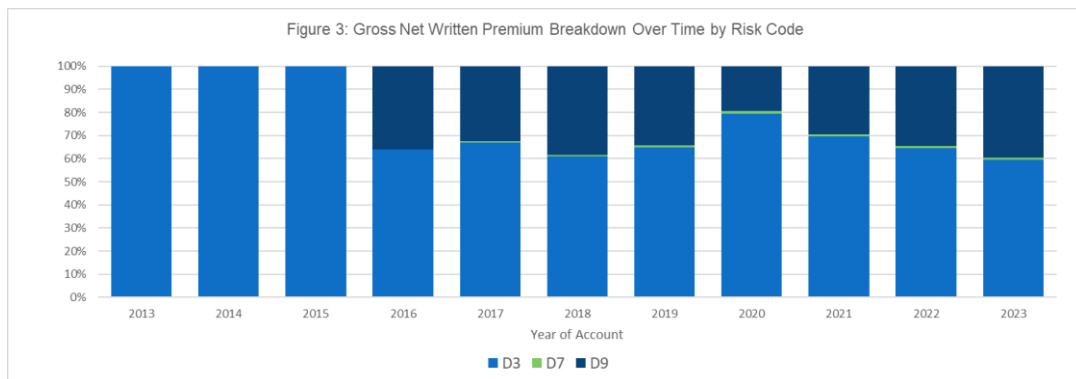


## Market Development Patterns

The development patterns are gross of reinsurance and include catastrophes and ULAE.



## GWP by Risk Code

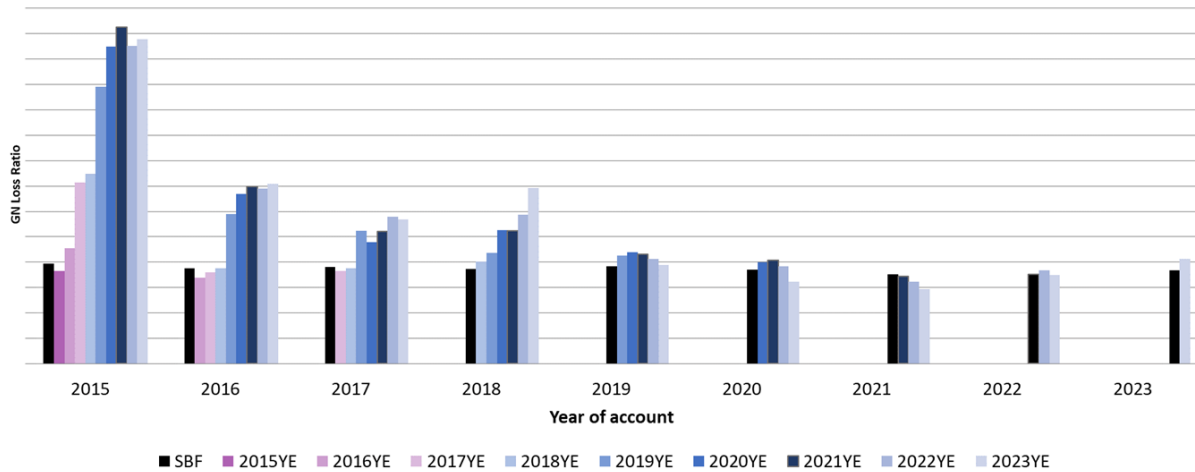


# Directors and Officers (US)

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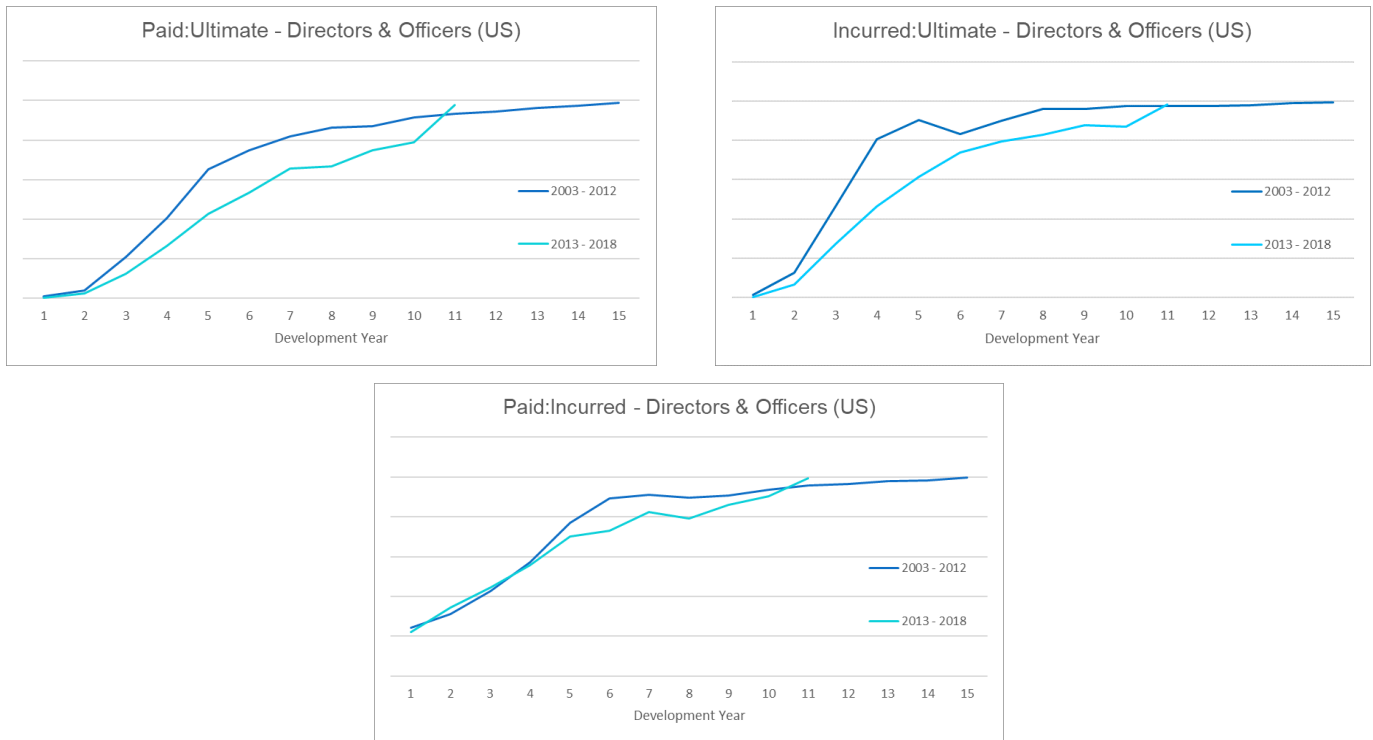
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Market Gross Net Written Loss Ratio over time

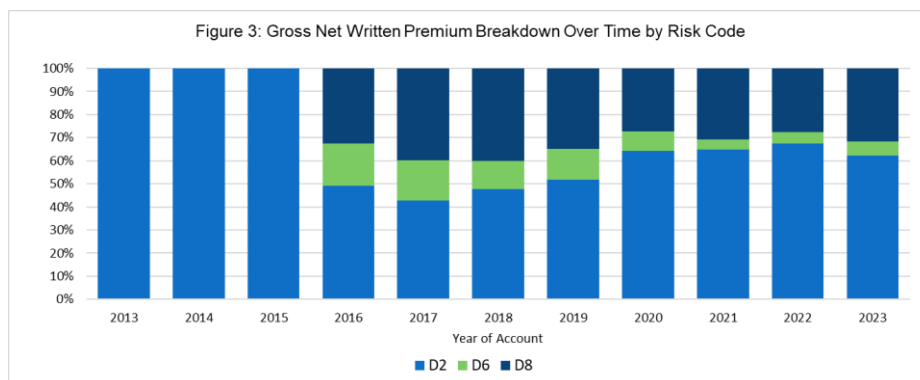


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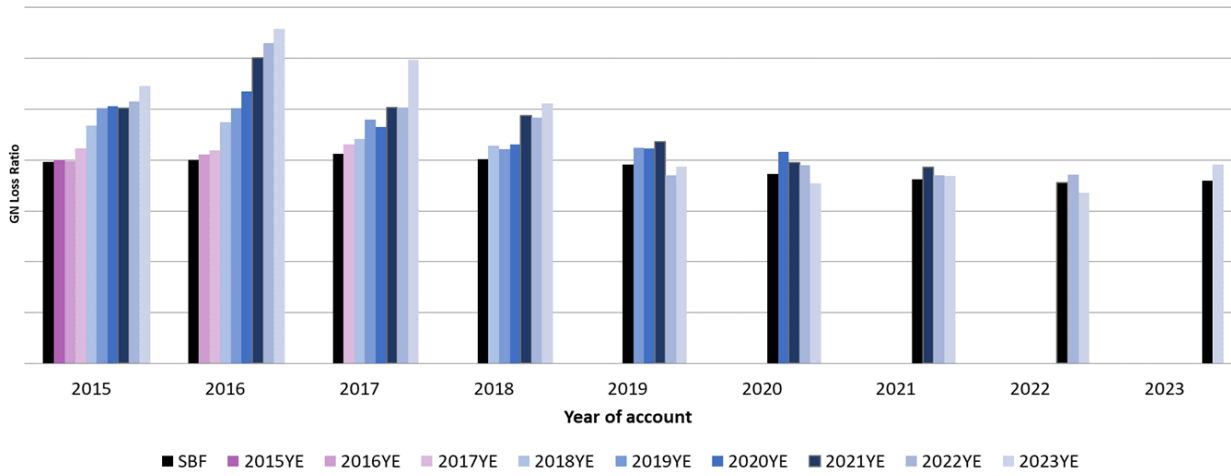


# Professional Indemnity (Non-US)

## Loss Ratio Trends

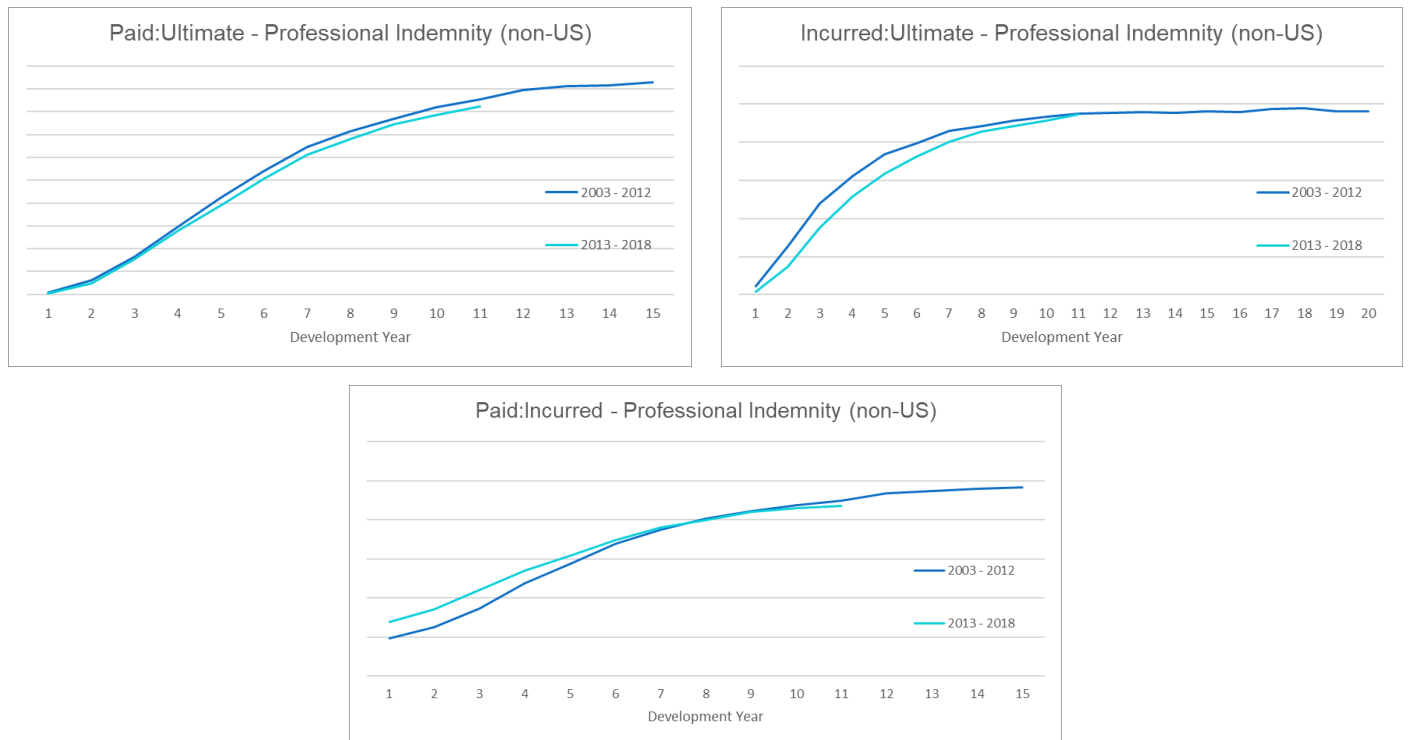
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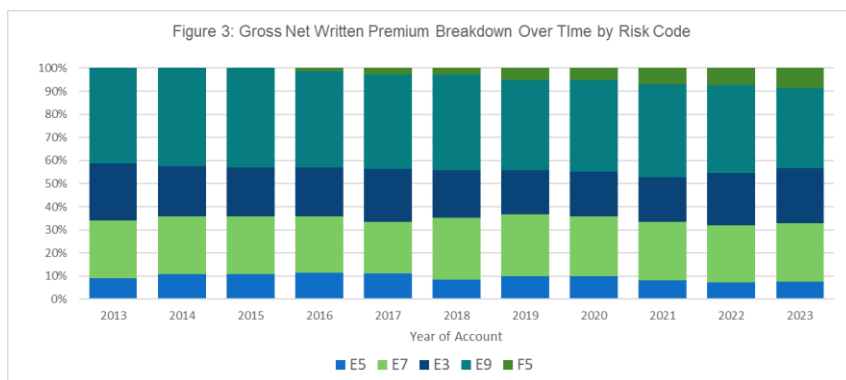


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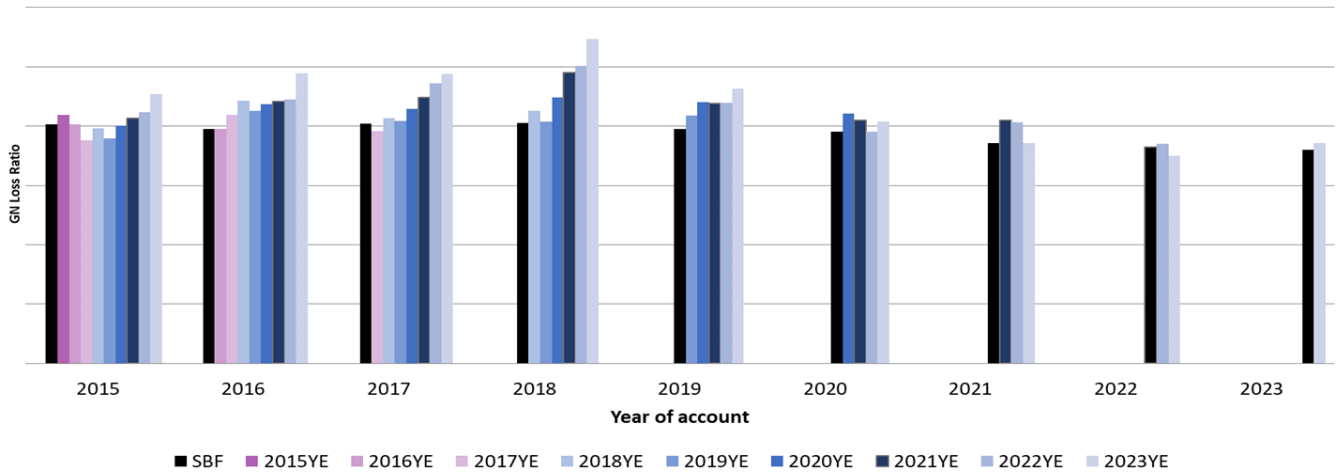


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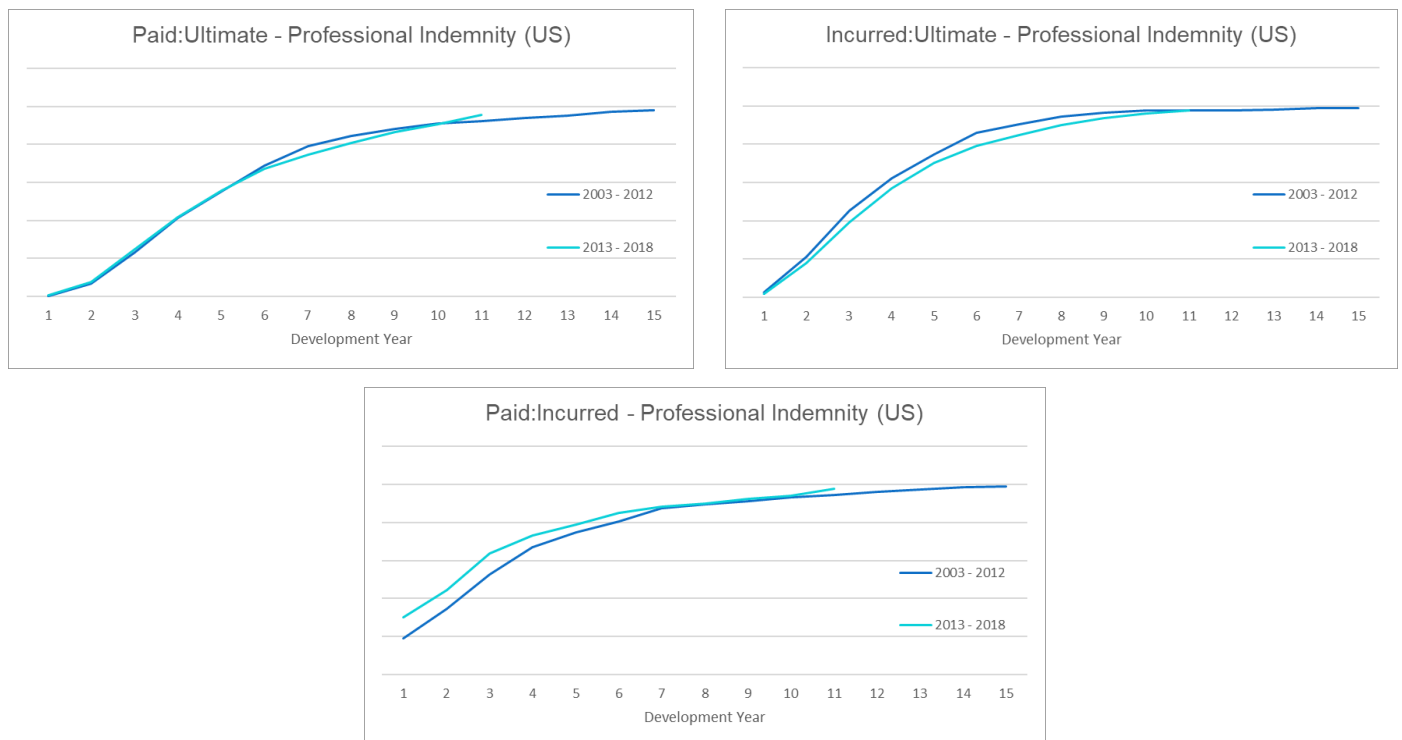
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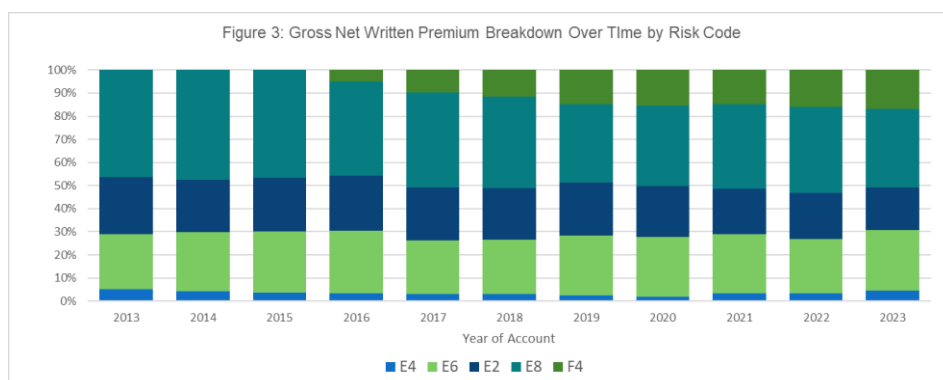


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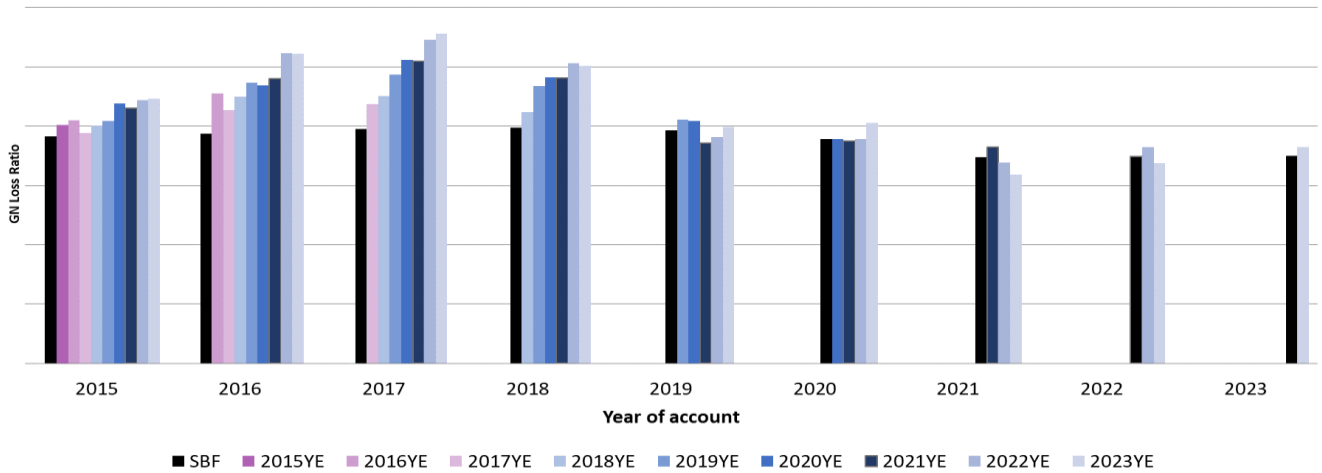


# Non-Marine General Liability (Non-US)

## Loss Ratio Trends

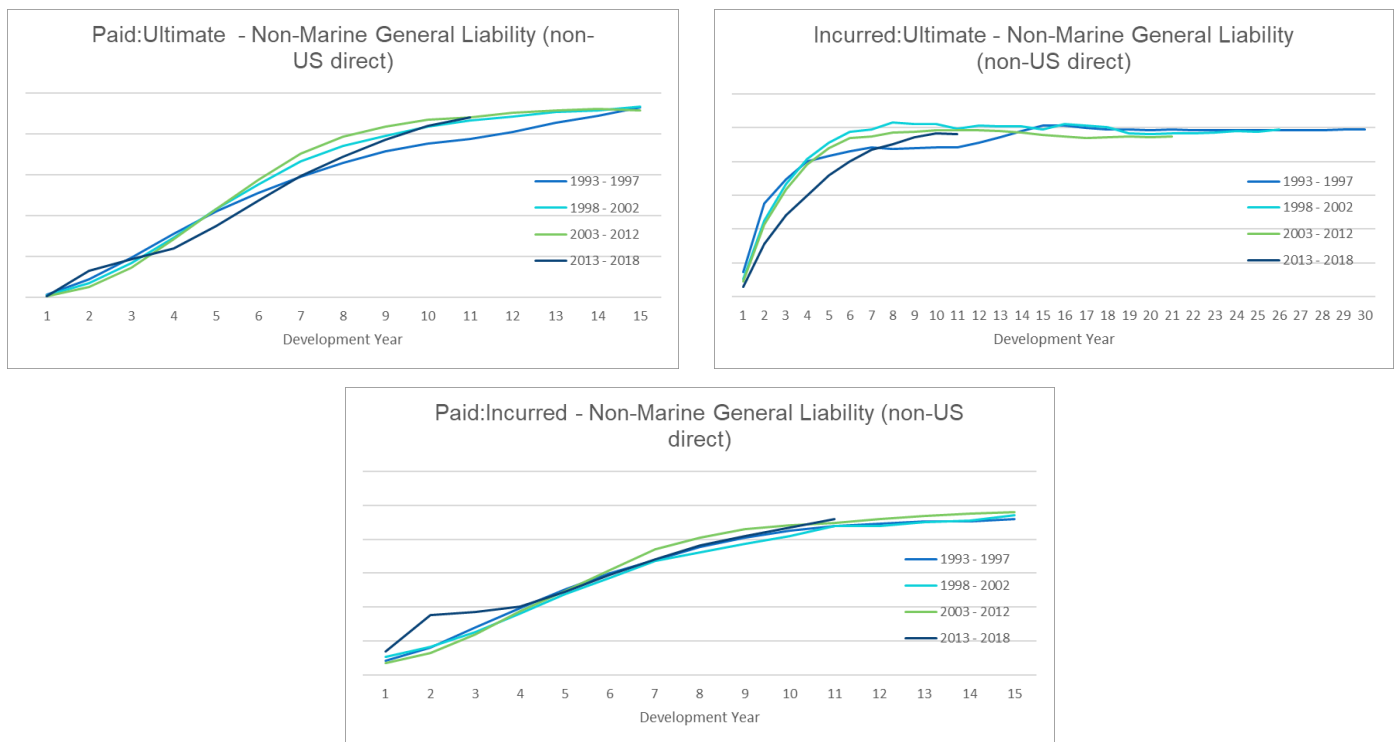
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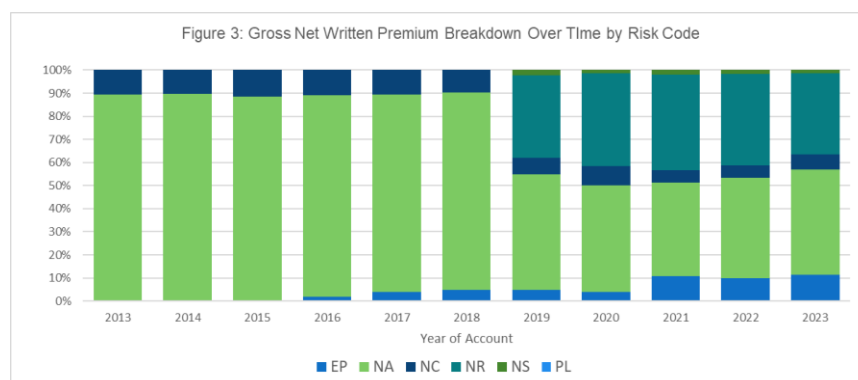


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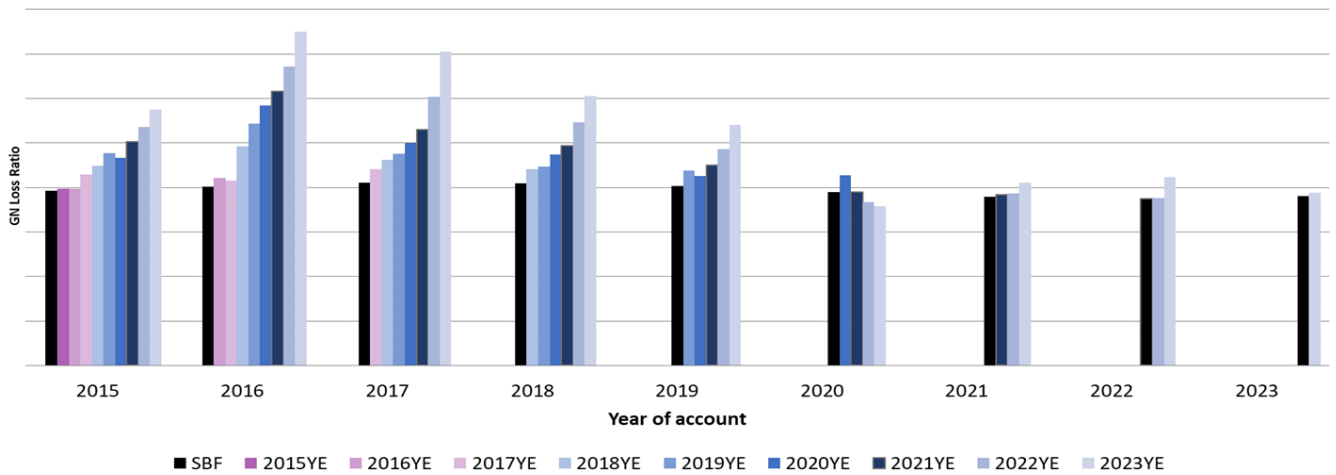


# Non-Marine General Liability (US Direct)

## Loss Ratio Trends

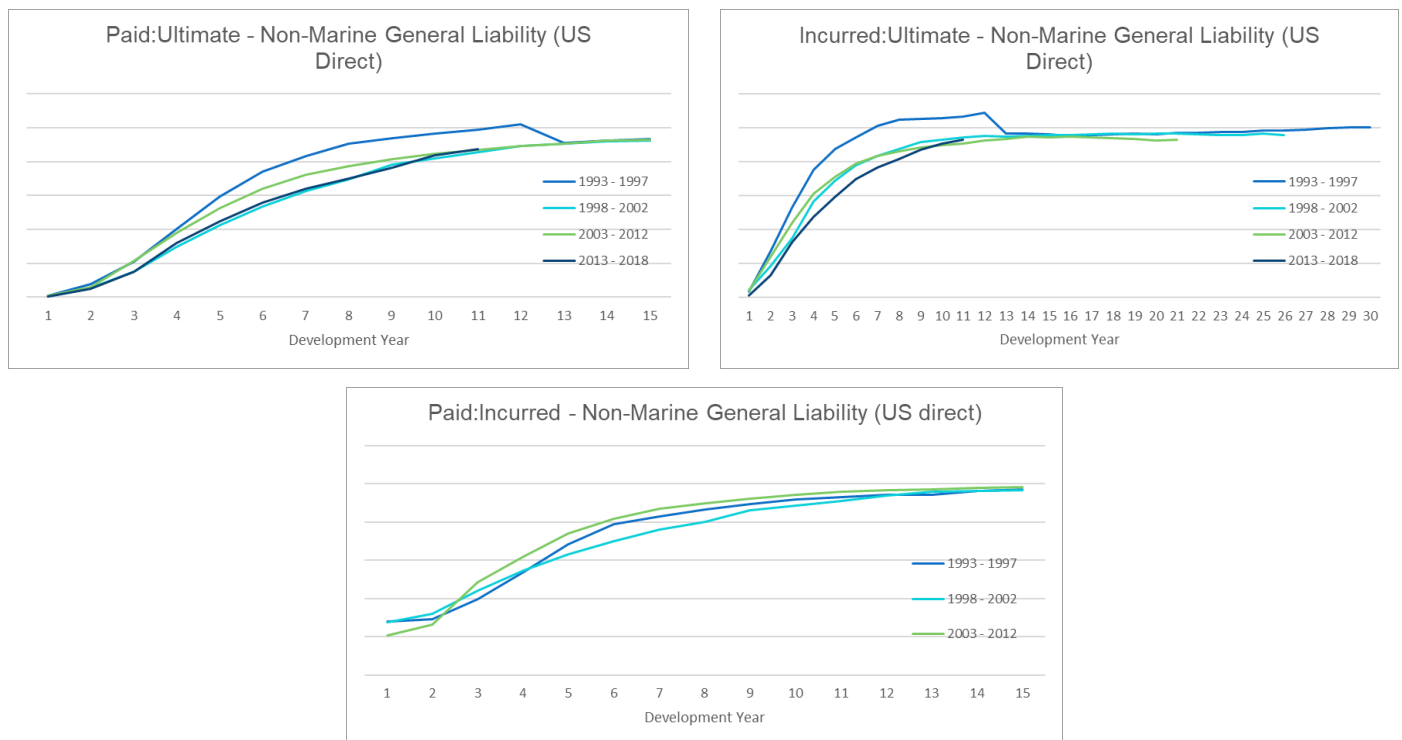
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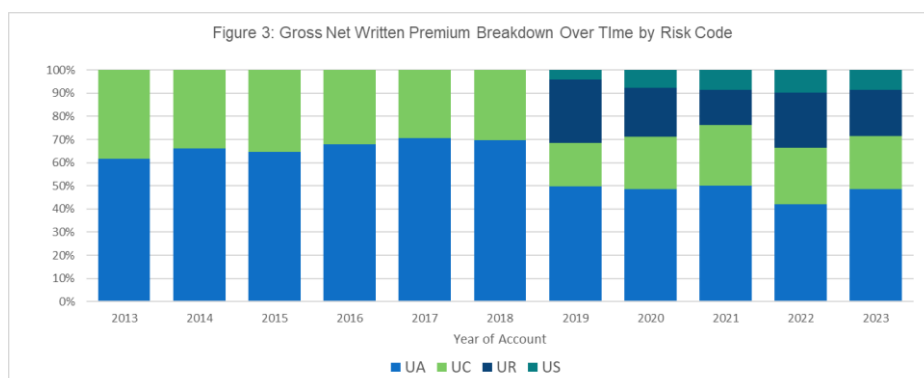


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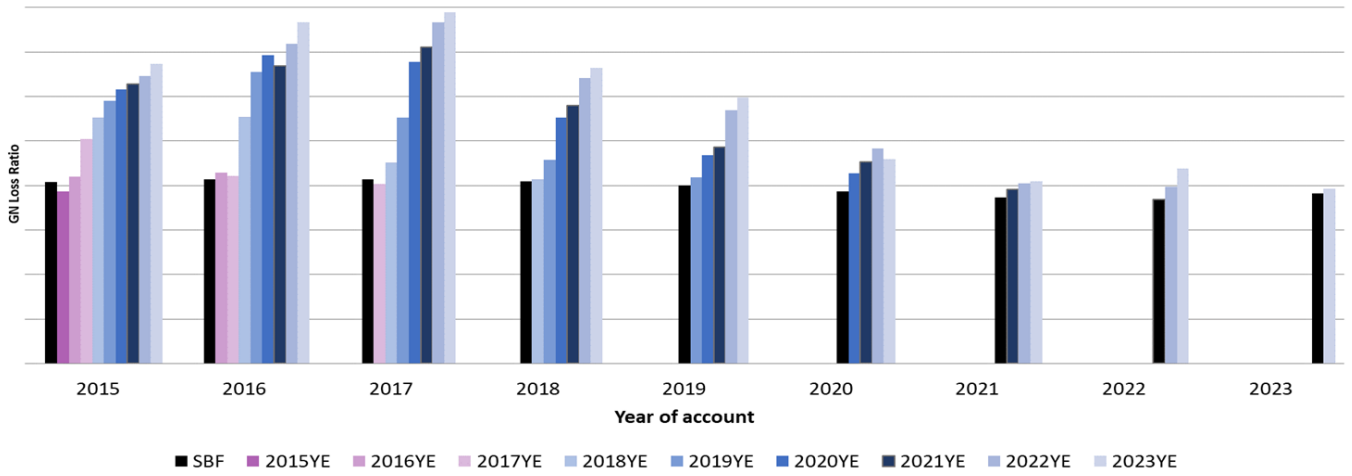


# Medical Malpractice (US)

## Loss Ratio Trends

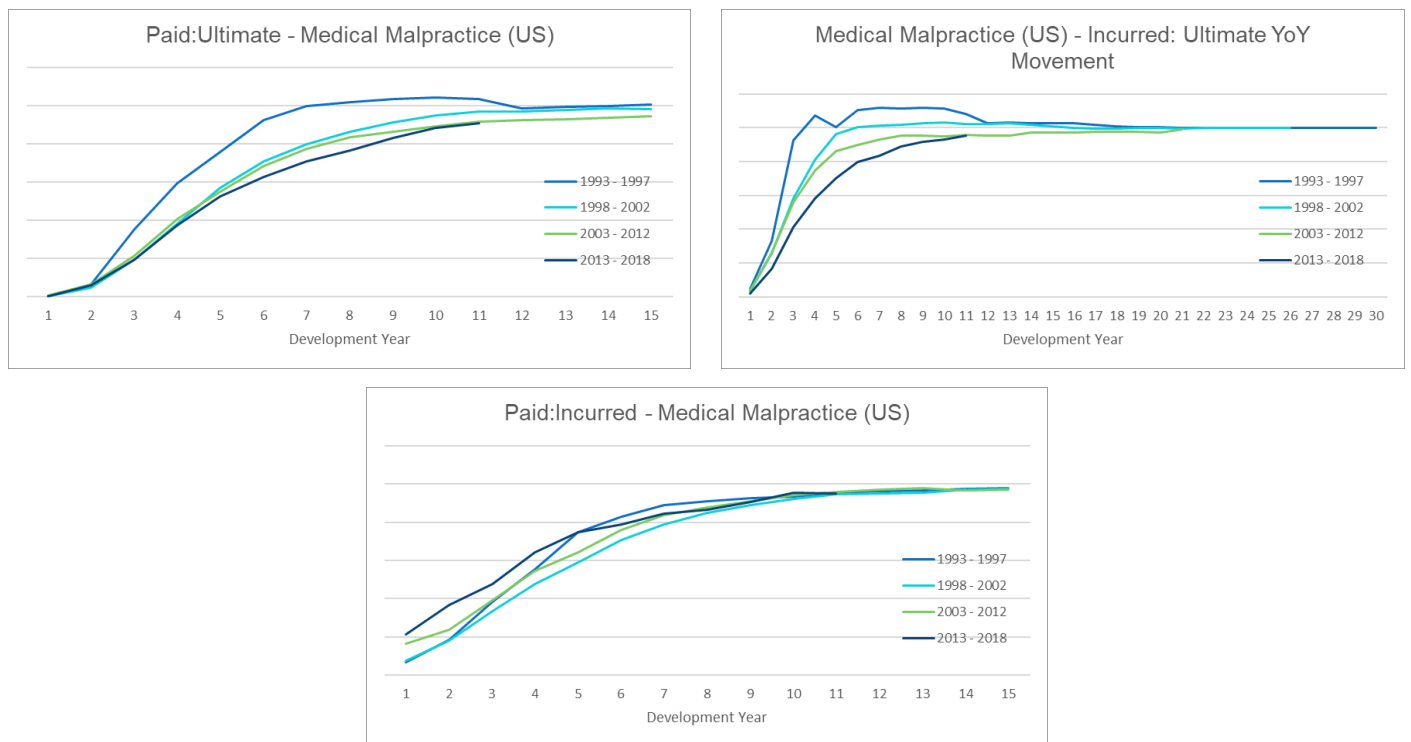
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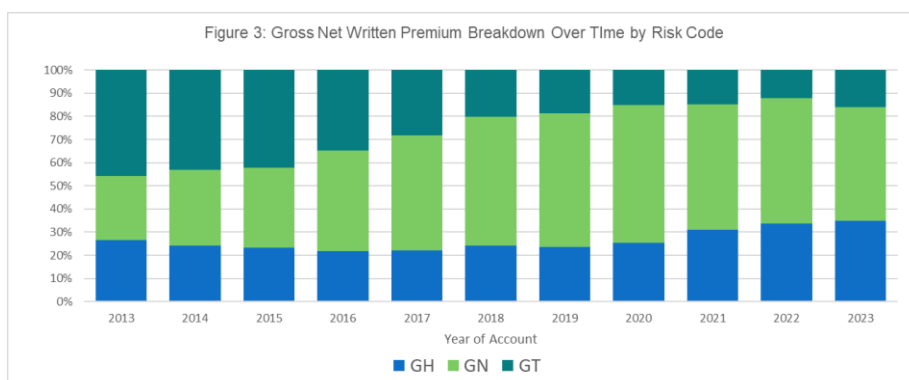


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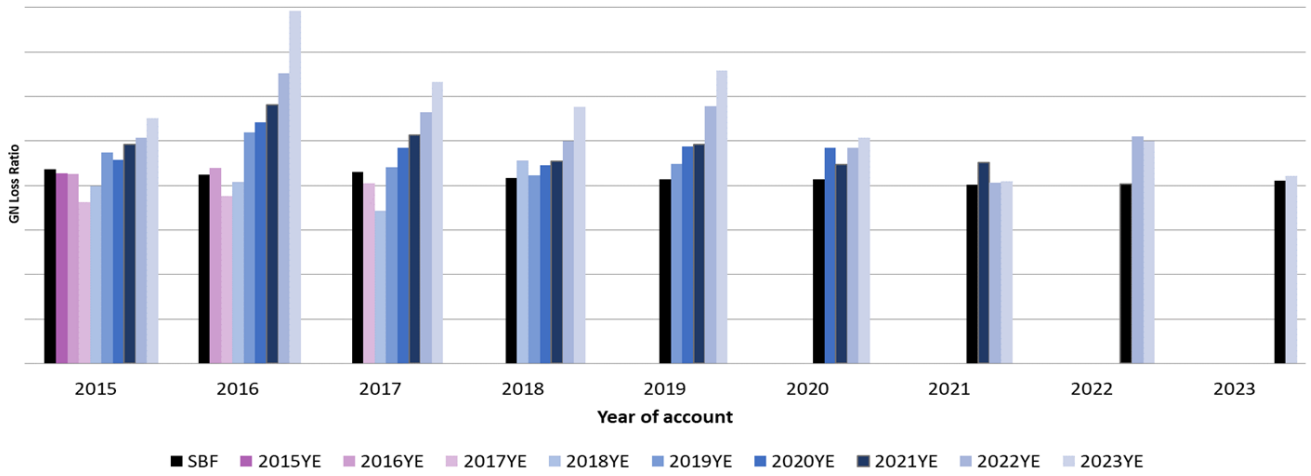


# Casualty Treaty (US)

## Loss Ratio Trends

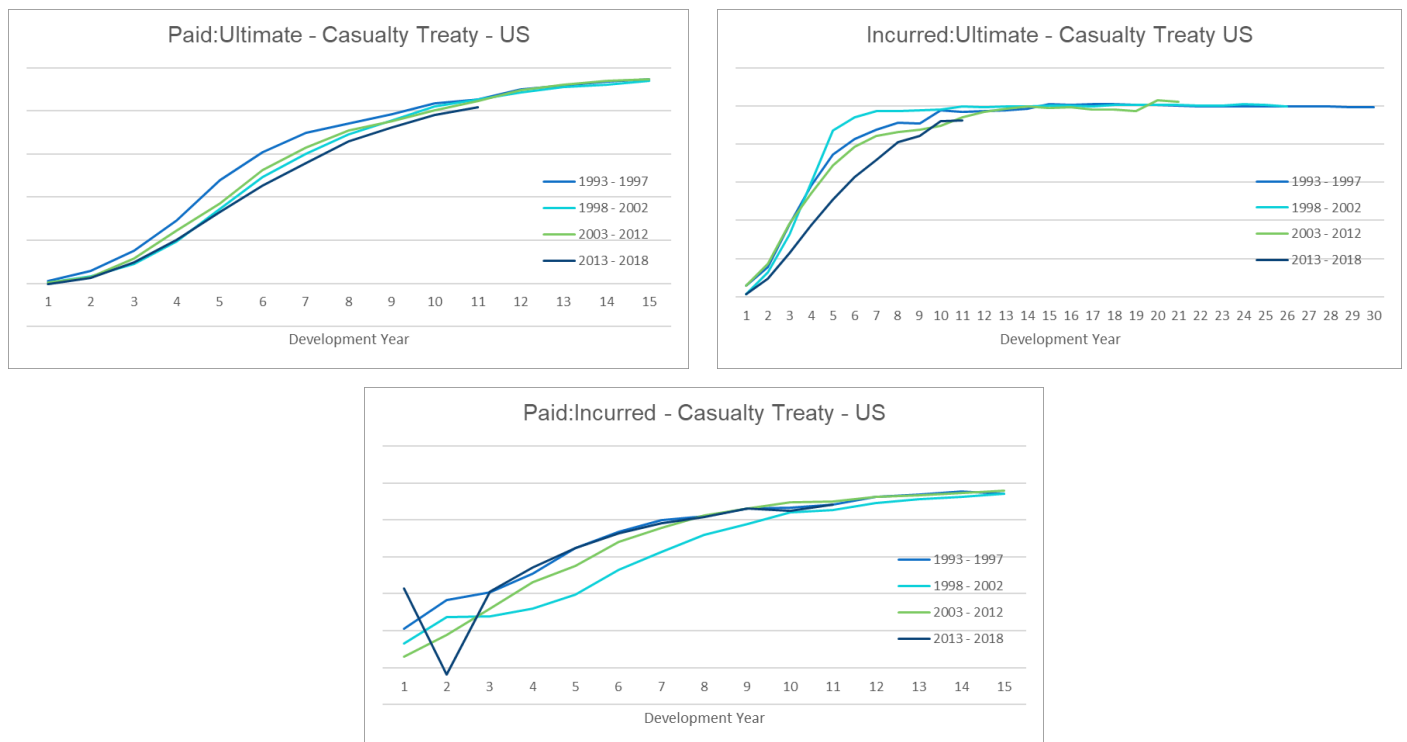
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