Claims inflation in non-injury insurance losses: a global review

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Foreword

Excess claims inflation remains a topic of primary concern for (re)insurers worldwide. Indeed, it is now viewed as a significant contributing factor to the widening protection gap, alongside unpredictable natural catastrophes.

This report analyses the driving inflationary factors in nine countries across Europe, Asia Pacific and Latin and North America, to assist (re)insurers when addressing the impact of these factors on their business lines, their cross-border markets, their (re)insureds, and the insurance industry as a whole.

> We show there are many fundamental causes of claims inflation, including the volatile economic landscape, the continuing war in Ukraine, the ongoing disruption to global supply chains and the lingering effects of the COVID-19 pandemic.

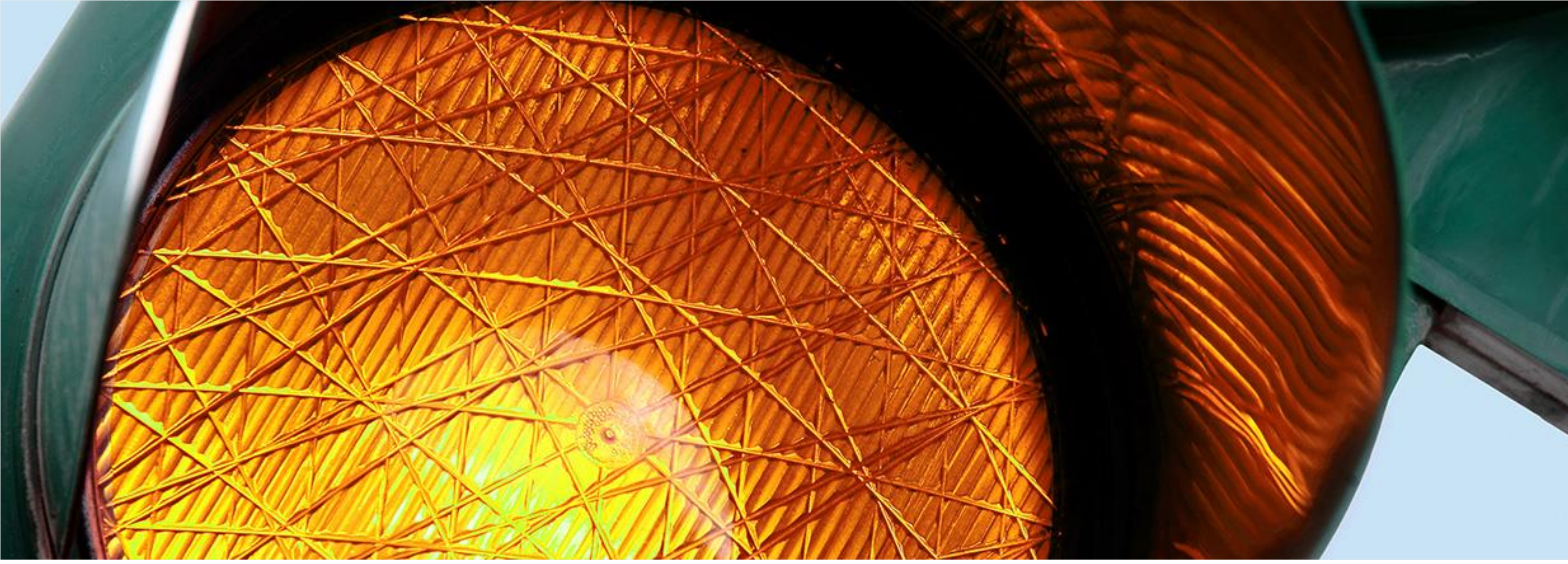
Inflationary pressures are a truly global issue, driven by regional influences and affecting every insurance peril. It is, therefore, imperative that (re)insurers adopt an action plan to address immediate and longer-term impacts. This includes working closely with their brokers and regional experts to help limit the potential effects of those pressures, including addressing the risk of under-insurance and increasing internal counter-fraud procedures.

Claims professionals are required to consider the nature of their business lines, individual geographical characteristics and other contributory factors that may impact claims inflation on a claim-by-claim basis. This is underpinned by Lloyd's of London reinstating that its "primary reserving oversight focus will be to ensure syndicates adequately allow for inflation in reserves" – no doubt mindful of the reputational risk on the sector following the COVID-19 pandemic when public sentiment towards (re)insurers was tested.

Economic challenges are giving rise to increased cost of living prices, insolvencies, and fraud across many countries. General public dissatisfaction in governments and corporations is fuelling the claims appetite, which is felt most acutely in the US where public sentiment is being reflected in 'nuclear' jury verdicts and in a rise in public nuisance claims. However, this trend towards high value group actions is no longer limited to North America, and (re)insurers across all regions are now feeling the impact.

These challenges are reflected across the claims landscape: claims presented are increasingly more varied, diverse, and costly. Consequently, (re)insurers will need to take action, such as implementing higher level fraud prevention measures and restructuring internal processes to monitor loss activity. Accepting that (re)insureds will again look to (re)insurers to guide and help manage their risk exposure, the industry will need to respond with certainty and transparency.

Collaboration is key in responding to the challenges. Loss prevention and risk mitigation can be achieved by (re)insurers working with their (re)insureds and other stakeholders - such as brokers and loss adjusters - and by working more closely with other (re)insurers to facilitate a more commercially effective response.



What is claims inflation?

Economic or 'ordinary' inflation

'Ordinary' economic inflation is calculated by use of standard economic indices. For example, the UK uses the Retail Price Index (RPI), the Consumer Price Index (CPI) and the Annual Survey of Hours and Earnings (ASHE), all of which are provided by the UK Government's Office of National Statistics.

Excess claims inflation is the increase in the cost of a claim beyond that of ordinary economic inflation.

Excess claims inflation

Excess claims inflation is driven by many different types of inflationary factors, including for example, the rising risk and costs associated with using new materials and technologies.

Social inflation

Social inflation is a subset of excess claims inflation. It is referred to as social inflation because the increased costs are largely attributed to social trends or movements. The rise of these social trends and movements resulting in an increase in the volume and costs of claims has meant this is an area causing understandable concern for (re)insurers and their customers.

> The 'social trends' that are increasing the volume and costs of claims include unanticipated emerging risks, shifts in the legal and regulatory environment, evolving societal attitudes, and demographic and political developments.

Examples of recent social movements resulting in an increase in both volume and value of claims include the activities and actions associated with #MeToo, climate change activism (Just Stop Oil), gender inequality such as *Roe v Wade* and protests in Iran and, currently, the cost of living crisis.

Findings and recommendations

One year on from our first report, it is clear that excess claims inflation remains a topic of considerable concern for (re)insurers.

This is understandable; if (re)insurers fail to respond to the global factors driving excess claims inflation, they risk inaccurate reserves - which are subject to increasing scrutiny on a product line and geographical level. (Re)insureds are also at risk of under-insurance, resulting in the application of average provisions and a widening protection gap. There are, however, some practical steps (re)insurers can take to address these challenges.

A new normal?

Pricing, reserving and reviewing policy limits are baked into a (re)insurers' everyday business operations. The shift required now, however, is in the level of scrutiny required, the use of technological advancements and enhanced collaboration amongst all stakeholders.

As our report demonstrates, an effective response requires a holistic, internal approach from (re)insurers. All teams across all departments need to work together to ensure collective awareness and knowledge. This requires c-suite, managers, claims handlers, actuaries and underwriters all working together with a common goal, built from a shared understanding.

To assist, (re)insurers should embrace external expertise. As well as sector specific experts, legal professionals and technological solution providers, the insurance market itself is a wealth of collective knowledge. A more open dialogue amongst (re)insurers could move industry practices forward, benefiting both (re)insurers and their customers. This ultimately, could result in fewer challenges around the type and level of cover provided, and an increased confidence in the industry.

Global differentiators

An effective, successful response is, however, not straightforward. As this report has shown, the factors (re)insurers need to consider are a combination of universally applicable drivers combined with regional differentials.

Some of the themes identified in this report include:

- An increase in the prices of goods and materials and the ongoing effects of the COVID-19 pandemic continue to drive claims inflation in every country covered in this report, across multiple business lines.
- Property and construction claims globally are at the mercy of supply chain disruption. Extreme weather and geo-political events have combined to create a shortage of supplies and materials (such as timber and steel), disrupted transportation routes, and labour shortages. The resulting increase and fluctuation in prices makes it challenging for (re)insurers to accurately predict restoration and project costs.
- Political risk and business interruption policies have seen an increase in claims presented following the pandemic and for instances of civil unrest. Ongoing political instability and economic uncertainly is likely to persist, as will the claims presented. The inconsistent interpretation of business interruption covers means that uncertainty remains in some jurisdictions for future claims.

- Group actions are gaining global momentum, but as many of the jurisdictions are still developing their legal mechanisms, uncertainly around ultimate liabilities for (re)insurers remain.
- The level of awards (particularly in the US) are rising and the nature of claims diversifying, making it increasingly difficult for (re)insurers to accurately price their products.

The insights from Denmark show that even in more stable economic times, excess claims inflation is still a topic of concern for global (re)insurers.

Practical steps for (re)insurers

- **Speak to local experts.** Legislation and regulation is evolving to respond to global events, such as business interruption following the pandemic and ESG regulatory requirements. The cost of commodities (particularly those in the energy sector) is ever shifting. Also, subtle shifts in how courts interrupt policy clauses can result in significant differences in the losses covered. Each of these factors look very different depending on the jurisdiction and local expertise will assist the underwriting process.
- **Explore mitigation strategies.** Could technology help? Would parametric products assist in providing more accurate cover – and payments – when considering losses incurred through extreme weather events? Would AI assisted aerial imagery avoid the need for physical inspections? These are each worthwhile avenues to explore.
- **Collaborate with other defendant insurers.** The benefits of this are already evident in the US where, even in a competitive market, defendant insurers are seeing the benefits of working together and forming defense groups to combat evolving litigation tactics.
- **Review values of disputed claims.** If a claim reaches trial or arbitration, (re)insurers, with their legal experts, should consider all factors that may help predict the likelihood of nuclear verdicts. The importance of this was highlighted in a recent Australian case (*Owners Corporation PS623721 v Shangri-La Construction Pty Ltd* [2022]), where the plaintiff was the only party to update its evidence during the pandemic to take account of inflationary factors. As a result, the plaintiff's evidence was wholly accepted and the court awarded damages of AUS$8.2 million, with the rectification costs being more than the building cost.

> Excess claims inflation has created a challenging underwriting environment. Regional variations mean that business planning for global (re)insurers is increasingly complex and volatile.

However, if (re)insurers, experts, brokers and (re)insureds work together, share expertise, and embrace technological solutions, the industry could ultimately benefit from a more transparent, collaborative and dynamic approach to risk.

Claims inflation – a snapshot

Here, we explore in more detail the most significant inflationary factors impacting insurance and coverage claims across nine jurisdictions on a country by country basis.

	Australia	Chile	Denmark	England	Hong Kong	Israel	Singapore	Spain	United States
Excess economic factors									
Increase in prices of goods and material	X	X	X	X	X	X	X	X	X
Supply chain delays	X	X		X	X	X	X		
Using alternative/inferior goods				X		X	X		
Cost of living crisis	X	X		X	X	X	X	X	X
Technological advancements			X	X	X	X			X
Cyber threats	X		X		X				
Increase in cost of professional services	X	X			X	X			X
Availability of alternative accommodation	X								
Insolvencies	X			X					X
Social inflation factors									
Third party litigation funding	X	X		X	X	X			X
Collective/group actions	X	X	X			X			X
Claims management companies	X					X			X
Civil justice jury system/nuclear awards									X
COVID-19 impact	X	X	X	X	X	X	X	X	X
Climate-related claims	X	X	X	X	X				X
Diversity-related claims						X			X
Civil unrest-related claims		X				X			X
Rise in crime and fraud		X		X	X				X
Legislative reform	X		X		X				X

As this table shows, no jurisdiction has escaped the impact of claims inflation. For (re)insurers, this translates into a universal rise in the cost of claims. This is a clear indicator that, in order to stay profitable and competitive, consideration and response to the inflationary factors impacting the jurisdictions in which they operate and invest is key.

Australia

Inflation has been a significant issue in property and construction claims in Australia. CoreLogic's Cordell Construction Cost Index, a quarterly index measurement that tracks the rate of change of residential construction costs, ended 2022 at a new high, climbing 11.9% over 2022. This is the largest annual increase on record.

Key takeaways		
Property and construction lines hit hardest.	Limits and exclusions on policies which may be impacted by increased cost of steel and timber need careful review.	Extreme weather events continue to impact multiple sectors.

Key drivers of excess economic claims inflation in Australia

Supply chain disruption
We have seen significant increases in the cost of building materials in Australia, including:

- Steel - dramatic price increases of around 50%. Made worse by the fact the building industry is arguably at the mercy of a monopoly by BlueScope Steel in the light gauge steel framing market. Steel costs can amount to 50-60% of the cost of a project.
- Timber – cost has risen by 40%. Contributed to by an undersupply in 2021 combined with a huge growth in domestic prices.
- Costs of plastic pipes and fittings have increased more than 26% in 2022.
- Glass and joinery shortages continue.

Rising fuel prices have increased the cost of all items. In Australia, transport costs are always a significant factor due to the vast distances covered, so fuel price rises really bite.

The cost of labour has increased due to a significant labour shortage caused by COVID-19 as borders closed. There was no migrant labour and restrictions were placed on the attendance of workers. This affected the direct costs of construction projects, but also the costs of components, including cabinetry, along with transport.

There is still limited availability of qualified tradespeople to complete repairs. Consequently, repairs are taking longer, resulting in increased costs.

Low availability of alternate accommodation
The availability of alternative accommodation is low and it is difficult to find suitable rental properties. This has been exacerbated by the number of properties damaged by flooding on the eastern coast of Australia. This has led to (re)insurers incurring higher costs for alternative accommodation in both third and first party claims.

There does not appear to be any immediate relief in the housing and rental crises and increased costs of alternative premises and accommodation will continue to add to the inflated cost of claims.

Extreme weather events
Extreme weather events along Australia's east coast have added to excess claims inflation, including:

- Widespread and devastating flooding in Queensland and New South Wales during 2021 and 2022. Ongoing wet weather further delayed projects and increased demand for materials.
- Loss of timber plantations due to extreme weather events put further pressure on the availability and cost of timber.

Weather events have also resulted in an increase in claims for road projects, which have seen significant delays and weather related damage.

Insolvencies
Australia has seen an increase in insolvencies in the construction industry. Construction companies who had agreed fixed price contracts years ago have found themselves working at a loss.

> A number of well-publicised collapses have occurred, including Probuild in February last year and Condev in March. Many industry experts believe the worst is yet to come, with increasing numbers of insolvencies this year.

Insolvencies will likely affect the number of claims across construction, property damage, D&O and professional liability lines. As construction companies fold and are no longer in a position to negotiate their way out of claims, those looking to reinstate or recover will increasingly look to (re)insurers.

Key drivers of social inflation

Third party litigation funding
In December 2022, the Federal Government announced the commencement of the new litigation funding regulations, the Corporations Amendment (Litigation Funding) Regulations 2022. This reversed regulatory changes introduced by the previous Federal Government, which required litigation funders in Australia to hold an Australian Financial Services Licence (AFSL) and comply with the managed investment scheme (MIS) regime and other financial services regulatory requirements.

Following the commencement of these new regulations, funded class actions are exempt from the MIS regime and litigation funders are exempt from holding an AFSL.

Increases in collective or group actions
In the 30 years since the class action regime was first introduced in Australia, it remains one of the most active jurisdictions in the world for class actions, or representative proceedings as they are called here. This increases the prospects of corporations being sued in Australia.

> It also increases the vulnerability of (re)insurers to forum shopping as claimants seek to pursue claims in the most advantageous jurisdictions. This includes, for example, the commencement of class action proceedings in New South Wales by overseas and interstate litigants to avail of the NSW-specific Civil Liability (Third Party Claims Against Insurers) Act 2017. This Act permits third party claimants to pursue insurers directly in a court of NSW in certain instances.

In a commonality with the US, each of the State Supreme Courts have their own regimes, including Western Australia which, in September 2022, became the fifth State in Australia to introduce its own class action scheme.

The types of representative proceedings that have commenced include product liability combustible cladding (to which insurers have recently been joined) and privacy and data breaches (Optus and Medibank).

Growth of claims management companies
A major reform of the insurance industry came into effect in January 2022. Claims handling is now a financial service. This means that a growth of claims management companies is likely to further fuel claims inflation, particularly around the commencement of representative actions.

An increase in climate related claims (the 'E' in ESG)
In addition to the cases arising out of extreme weather events, Australia has also led the way with some significant climate related decisions which are adding to the excess claims inflation burden.

These include:

- **First greenwashing case:** In 2022, proceedings brought by the Australasian Centre for Corporate Responsibility (ACCR) against Santos, one of Australia's largest suppliers of oil and gas, were expanded to include alleged greenwashing in its 2020 Investor Day Briefing and 2021 Climate Change Report. In June 2023, the ACCR filed a Further Amended List Statement which alleges 'misleading and deceptive' claims about its carbon emissions reductions and its 'net zero' claims in contravention of the Australian Consumer Law.
- **Disclosure obligations and compliance with ESG policies**: Shareholders of the Commonwealth Bank of Australia (CBA) alleged that the company had failed to disclose climate change risks in its 2016 annual report, in breach of its disclosure obligations under the Corporations Act. The applicants discontinued the proceedings after CBA released an annual report acknowledging the risks of climate change and pledging to undertake analysis of climate risks.

Legislative reforms

Reforms to the Design and Building Practitioners Act 2022 (NSW), are likely to increase the incidence and value of third party claims. The reforms focus on creating clear lines of accountability for defective building work and include the introduction of a statutory duty of care owed by ‘persons’ who carry out ‘construction work’ to take reasonable care to avoid economic loss caused by defects.

The duty extends beyond designers, engineers, and builders to include those involved in the management of a company to ensure compliance with the legislative changes. This can expose directors and others to personal liability in certain instances. However, it usually arises where the company is in liquidation.

Outlook

Despite these drivers of inflation, it is expected that the global demands for goods will continue to ease. This should mean a softening of material prices and a relaxation of pressure points in supply chains. Australia’s borders are open once more and the government has boosted its permanent migration program, which is assisting with the availability of skilled workers.

> Inflation is still expected to rise, but not at the rates we have seen to date. Although inflation recently increased from 4.9% annually in July to 5.5% in August, once volatile measures such as fuel and energy prices were stripped out, annual growth in the monthly CPI did continue to ease to 5.3% (down from 5.6%).

Construction cost inflation is expected to halve this year across the major cities, dropping from around 8% last year to 4% this year. Shipping costs, which more than doubled in 2021, and were predicted to spiral in 2022, are easing more quickly than expected. Inflation will still affect the costs of claims, but it is not expected to be as dire as was previously feared.

Chile

Chile has seen an increase in riots, a lack of building and infrastructure supplies, increases in the cost of materials, and rises in professional services costs in recent years.

Key takeaways		
Policies have adapted to respond to an increase in civil unrest.	Extreme weather events require adoption of preventative measures.	Will the introduction of parametric insurance provide solutions?

The effects of climate change have led to an increase of natural disasters, resulting in property damage and business interruption. These, compounded by global events such as the COVID-19 pandemic, the war in Ukraine, the cost of living crisis and supply chain disruption, have hit the Chilean (re)insurance market hard and have led to a sharp increase in claims inflation.

In response, (re)insurers have been compelled to adapt their coverage structures, premiums, and risk appetite in order to take account of these new circumstances.

Key drivers of excess economic claims inflation

Civil unrest
After riots in 2019 and 2020, political risks coverages were split from property policies, requiring separate insurance contracts. In addition, due to the aggravation of territorial and political conflicts in some southern areas, political risk cover has been excluded from property coverages entirely – or the premiums have been drastically increased.

Cost of materials
The cost of building materials has risen 21% in 2022, in addition to the even higher rises seen in 2021. This resulted in a 6.1% increase in property insurance premiums in the last quarter of 2022 alone.

Likewise, the sharp increase in vehicle thefts – a 67.7% rise of violent thefts in 2022 - the lack of spare parts and the high number of claims, have led to higher premiums for vehicle insurances.

Supply chain disruption
The global lack of shipping containers crisis and the supply chain disruption have impacted on times and costs of vehicles reparation. It is increasingly difficult to find the required parts, the prices are more expensive, and it is taking a lot of time for spare parts to become available. According to the insurance regulator (CMF), the average number of days for vehicles reparation has increased from 41 days in 2018 to 73 days in 2022. As a result, automobile premiums increased around 50% last year.

Professional services spend
Professional services costs have also experienced an escalation. Annual inflation hit 12.8% in 2022 (the highest since 1991), and as of 1 January 2023, 19% VAT is now applied to professional services fees. This has led to an inevitable rise in costs for these services.

Extreme weather events
There is another substantial dimension to the claims landscape in Chile – the impact of climate change.

> Chile is currently facing a huge drought that has strongly undermined the agriculture industry in recent years. During February and March 2023, large fires harmed six regions with almost 450,000 hectares burned, more than 2,500 homes destroyed, around 1,500 damaged homes and almost 12,000 farmers affected.

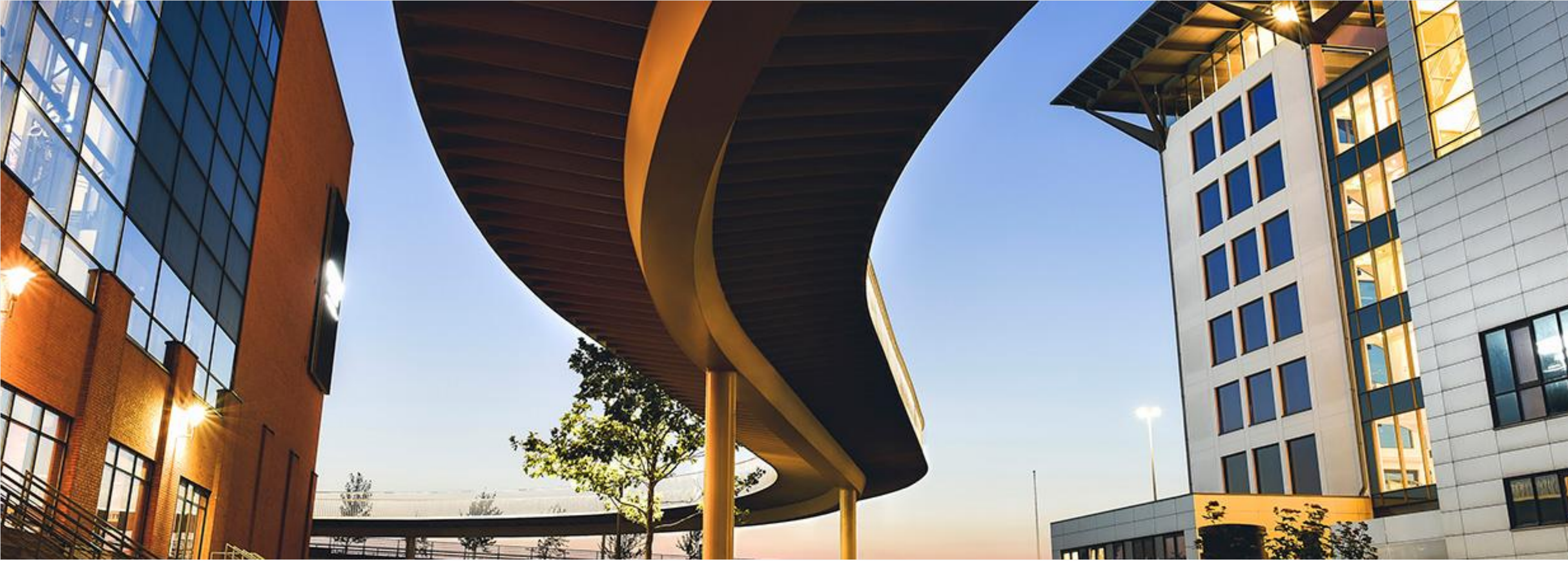
2023 has also produced two significant frontal systems along the central zone that have caused landslides, numerous rivers to overflow, floods, destruction of roads and crops, and significant damage to homes and infrastructure.

The frequency of these occurrences is crucial to (re)insurers when determining premiums for properties in some areas. The level of cover provided for such properties will need close review upon renewal.

Outlook

In order to prevent exorbitant rises in premiums across key insurances for many people and industries, (re)insurers, brokers and insureds should seek to work together even more closely. Jointly assessing the risk factors and agreeing safeguards and preventive measures which insureds might take to minimise their exposure could assist all parties in reducing costs and instances of under-insurance.

Another potential solution to reduce rising premiums is the use of parametric insurances, which were incorporated into Chile’s legislation this year. If this type of insurance is embraced, benefits such as the speed of claims determination and reduced administration costs could assist (re)insurers and insureds alike.



Denmark

Claims inflation remains a significant challenge for Denmark's insurance sector, even as the Danes experience indications of slightly more stabilised general inflation.

Key takeaways		
Bucking the general economic inflation trend – but claims inflation still rising.	Higher consumer confidence and use of technology causing rising cost of claims.	Appetite for group actions growing.

In August 2023, Denmark's general inflation rate fell to 2.4% compared to the same month in 2022, down from 3.1% in July. The Danish general inflation has trended downward consistently throughout the past 12 months. This contrasts with the eurozone, which experienced an inflation rate exceeding 5% in August 2023.

The slower pace of the Danish inflation is mainly due to decreased energy prices whereas food prices continue to rise, although those are also trending downwards (5% in August 2023 down from 8.8% in June 2023). Building materials and spare parts for automobiles appear to be rising, although at a slower pace than previously in 2023.

Key drivers of excess economic claims inflation

Economic growth and consumer behaviour
Denmark's stable economic growth has led to increased consumer spending and a rise in the number of insured assets, such as homes, vehicles, and businesses. With a higher volume of insured entities, the likelihood of claims also increases, contributing to claims inflation.

Rising repair and replacement costs
The costs associated with repairing and replacing insured assets have risen steadily in Denmark. Factors such as higher material costs, skilled labour shortages, increasing salaries and technological advancements have all played a role in driving up the expenses of claims settlement.

Legal transformations
Changes in legal regulations can directly impact the size and frequency of insurance claims, thereby influencing claims inflation. An example is the Danish Parliament's amendment of the Danish Liability Act in 2022 which clarified that the compensation for digital sexual offences should be assessed independently if such offences were committed separately from each other.

Technological advancement
Innovations such as advanced driver assistance systems (ADAS) and Internet of Things (IoT) have led to safer roads and fewer accidents. However, the nature of these technologies amplifies repair and replacement costs, leading to higher claims expenditures in the event of accidents.

Key drivers of social claims inflation

Climate change effects
Denmark's susceptibility to climate change has heightened the occurrence of extreme weather events, contributing to claims related to property damage and natural disasters.

Security claims on the rise
In recent years, Danish courts have experienced an increase of security claims. Danish and international investors more frequently seek indemnification from stock-listed companies. As an example a number of Danish and international investors have filed class actions against the largest Danish bank for a total of approximately DKK 14 billion.

Another bundle of securities claims involve the former Danish bunker oil trading company, OW Bunker A/S. Security claims can further be fuelled as the number of Danish bankruptcies have risen steadily since 2021.

Outlook

Over the last six months, the price of insurance products have risen considerably compared to previous years. According to the Statistical Bureau of Denmark, the price of insurance products have risen by approximately 6% each month when compared to the corresponding months in 2022. This considerable increase deviates significantly from the usual developmental trajectory, underscoring the extraordinary nature of the current situation.

Navigating the complex landscape

Balancing Act: The coexistence of stabilised general inflation and escalating insurance costs means that (re)insurers must strike a balance between premium adjustments and policyholder affordability.

Mitigating impacts: (Re)insurers may adopt innovative risk management strategies to counter the effects of claims inflation. Leveraging technology and data-driven insights can aid in predicting, preventing, and managing claims.

As Denmark's insurance industry moves forward, proactive collaboration between (re)insurers, regulators, and consumers is recommended. By fostering adaptability and embracing technological advancements, the industry can bolster its ability to navigate the complex landscape posed by claims inflation.

The dynamic between claims inflation and general inflation within Denmark's insurance sector highlights the challenging nature of managing insurance relationships within an evolving economic context. The substantial increase in insurance costs against the backdrop of (likely) stabilised general inflation calls for a combination of innovative strategies and collaborative efforts in order to mitigate these challenges.

England

Claims inflation continues to impact (re)insurers in the UK across a multitude of business lines.

Key takeaways		
Excess claims inflation impacting a wide range of business lines.	Geopolitical events continue to hit supply chains.	Uncertain economic climate is driving thefts, insolvencies and fraud.

The ongoing impacts of Brexit, the COVID-19 pandemic and the war in Ukraine have resulted in delays across supply chains, a shortage of workers and a rise in the price of goods and materials. There has been an increasing number of extreme weather events, including extreme heat and floods, putting yet more pressure on infrastructure, supply chains and property and construction lines.

Key drivers of excess economic claims inflation

Logistics and warehousing
In logistics and warehousing, the cost of living crisis has been a real driver of claims inflation. The supply chain is vulnerable to theft. This might be small scale theft, such as pilferage by drivers and warehouse staff, or larger, more organised theft, such as the release of goods by deception or fraudulent ordering of goods by criminals pretending to be supermarkets or other major purchasers of goods. As the cost of living crisis bites, the frequency of such theft increases.

The logistics industry is affected by driver and equipment shortages driven by the COVID-19 crisis and then Brexit. This has resulted in increased costs of haulage and many goods remaining on the quay or in warehouses for longer periods. These delays and the increased costs associated with carriage and storage of goods have given rise to some sizeable claims as parties argue over who should bear these costs. They have also resulted in an increase in the value of such claims.

Professional indemnity
As accountability grows, regulatory frameworks expand and costs are squeezed, many professions - including solicitors, accountants, construction professionals and brokers - are feeling the impact of excess claims inflation on the value and the volume of claims presented.

Soaring inflation, supply chain disruption, shipping delays and labour shortages have impacted claims values, particularly in relation to the cost of remedial works, business interruption and losses of stock or materials.

During such a volatile economic environment, policyholders may query the advice they receive from their brokers on applicable limits. With prices fluctuating, policyholders are at risk of uninsured losses if they have not built in an element of excess claims inflation around the costs of goods, materials, energy and supply chain delays. Loss of profit claims will also by their very nature be higher than they once were. This also has an impact on defence costs (especially if a defence inclusive limit) with limits not going as far as they used to.

The availability of litigation funding means that claims are being pursued which previously would have been abandoned due to lack of funds. This is impacting valuers and surveyors involved in valuing commercial property.

Valuers and surveyors involved in construction projects are also feeling the impact of claims inflation due to the rising costs of materials and labour shortages. When profit margins are squeezed, there is an increased appetite to pursue claims against professionals and recovery actions are becoming more prevalent than they once were.

Financial lines
D&O and financial lines claims are susceptible to inflationary pressures through rising legal defence costs and higher settlements.

Costs are rising because of an increase in group actions. It is anticipated that future claims against D&Os may well have an environmental, social or governance (ESG) element, which is another aspect fuelling claims.

Property damage
We are seeing the impact of claims inflation on repairs and rebuilds by reason of higher costs of materials, labour and energy. Shortages of materials and longer delivery times inflate business interruption values. In turn this can lead to increased examples of underinsurance (inadvertent or otherwise) and higher premiums.

Extreme and unseasonal weather events are also leading to increased claims, thus exacerbating the problem.

Outlook

There are slow signs that the economic environment is easing, with energy prices falling and interest rates steadying. This could cause (re)insurers to be cautiously optimistic of a more certain and predictable time ahead.

However, the impact of excess economic inflationary factors is likely to be felt for months, if not years, to come. Complex claims still take many months to reach resolution, and inflationary factors will continue have an impact. This applies to active claims, renewals and new risks.

The adoption of technological solutions may assist those (re)insurers willing to adopt new methods of working. Benefits include an improved customer experience, faster and more efficient processes, and easier identification of fraudulent practices. But for these to become truly transformational a wholesale review of (re)insurers' practices and systems will be required which will take time.

Hong Kong

As a major international financial centre, Hong Kong has recently experienced a wide range of disruptions across many industries, including cyber threats, the inflation in the hourly rates of lawyers and barristers, and legislative reforms on litigation funding.

Key takeaways		
Cyber threats and financial, social and governance disputes contributing to increased claims risk.	Greater emphasis on healthcare and life claims after the COVID-19 pandemic.	Unprecedented weather events and legislative reforms driving greater claims inflation.

Unprecedented weather events, the aftermath of COVID-19 pandemic and a rapidly ageing population have continued to threaten the claims landscape in property and health insurance industries in Hong Kong.

Key drivers of excess economic claims inflation

Cyber security
With Hong Kong's aspirations to become a tech hub, cyber security has been a growing concern in recent years. As reported by the Hong Kong Computer Emergency Response Team Coordination Centre, cyber security incidents increased by 9% in 2022. In 2023, there were reports of major data breaches on Hong Kong Cyberport and the Hong Kong Consumer Council, with sensitive personal information purportedly being stolen.

As the demand for coverage increases in response to cyber threats, claims on cyber insurance are likely to increase exponentially.

Corporate liability and governance
Claims involving directors, officers, companies and financial institutions remain prominent in Hong Kong including large-scale litigation and regulatory actions. Notably for (re)insurers, listed companies in Hong Kong are required to arrange insurance cover in respect of legal actions against its directors.

It has also become more expensive to engage lawyers and barristers to defend these claims in Hong Kong. We anticipate that legal defence costs will continue to rise, leading to escalated expenses in claims settlement for (re)insurers.

Medical claims
After the government's relaxation of COVID-19 restrictions, it is anticipated that the spike in hospitalisations will result in a higher medical inflation of 8.8%. Healthcare costs will inevitably rise as treatments become increasingly costly, along with increases in wages of healthcare personnel and consumer prices.

With potentially higher claims pay-outs and operating costs, premiums for healthcare insurance are likely to continue to rise which may cause some customers to drop their coverage or switch policies to save on costs.

Extreme weather events
As climate change looms, Hong Kong has been subjected to extreme weather conditions. In early September 2023, Hong Kong was hit by 'Super Typhoon Saola', followed by the most severe rainstorm ever recorded. Soon after the government announced that September 2023 was "an eventful month", in terms of extreme weather; in early October 2023, Hong Kong was hit by 'Typhoon Koinu'.

It is speculated by some (re)insurers and financial analysts that the claims in relation to extreme weather events this year will reach a record high, exceeding HK$3.9 billion. It is very likely that premiums for property insurance will increase as a result.

Key drivers of social claims inflation

Opportunities from Guangdong-Hong Kong-Macao Greater Bay Area (GBA)
Mainland China residents are a prominent consumer segment for Hong Kong life (re)insurers as Hong Kong life insurance products often offer greater flexibility and higher returns compared to China.

Hong Kong's life and health insurance industry is anticipating a rebound in business in 2023 as cross-border travel resumes with mainland China after three years of restrictions. The reconnection of GBA cities and the accelerating flow of visitors from mainland China will give Hong Kong (re)insurers an opportunity to recover a huge potential customer base, contributing to enhancing Hong Kong (re)insurers' life and health premium growth.

It is anticipated that the corresponding life and health premium from GBA customers will increase as well as the associated life insurance claims from GBA customers.

Increasing needs on healthcare
The COVID-19 pandemic had a dire effect on mental and behavioural health among Hong Kong people and led to a greater emphasis on available health products. There is an increased appetite for healthcare insurance, and awareness has been raised around critical illnesses. As a result, (re)insurers might expect a rise in healthcare insurance claims in the future.

> A recent survey by an insurer in Hong Kong revealed that Hong Kong has one of the highest stress levels among 23 countries surveyed, with 92% respondents indicating they are stressed. This is fuelling a trend for health insurance providers to provide cover for mental health, increasing healthcare insurance costs and the risk of future claims.

Legislative reforms
In recent years, Hong Kong has encountered numerous legislative changes including, most significantly, reforms to the Arbitration Ordinance (Cap. 609 of the Laws of Hong Kong) in 2022 which introduced outcome-related fee structures in arbitrations taking place in and outside of Hong Kong. These structures include conditional fee agreements, damages-based agreements, and hybrid damages-based agreements.

> We predict that this may result in more parties being encouraged to pursue legal actions without the concern of limited litigation resources. However, these reforms currently have limited impact on the claims landscape in Hong Kong as they are restricted to arbitration proceedings and exclude personal injuries claims.

There are also advanced proposals to amend personal data-related legislation and ESG disclosure requirements for listed companies in Hong Kong.

Outlook

Although (re)insurers can analyse recent trends across industries such as cyber security, corporate liability and governance and healthcare to more accurately predict future claims activity, the impact of extreme weather events, for example, have caught Hong Kong by surprise and remain difficult to predict.

It is expected that the numerous legislative changes, especially those involving arbitrations, and other changes anticipated in the near future, will bring further disruption to the claims landscape in Hong Kong. Nevertheless, with careful planning and foresight, the insurance industry in Hong Kong will be able to tackle excess economic and social claims inflation effectively.

Israel

Claims inflation in Israel is affected by many global events including climate events, war in Europe and the global pandemic.

Key takeaways		
Domestic political uncertainty driving increased claims risk.	Reform of group action legislation underway.	The impact of the pandemic is still evident in disrupted supply chains.

These global events paralysed the Israeli economy and led to disruptions in supply chains, shortages of critical products, increases in raw material prices and shipping and transportation costs, interest rate increases, high inflation, sharp increases and sharp declines in the financial markets.

This has resulted in an increase in the cost of insurances in excess of 10%. For example, the price of automobile insurance in June 2023 was 30% higher than in June 2022.

Israel Gaza war

On 7 October 2023, the Hamas terrorist organisation launched a sudden attack on Israel that lead to the declaration of war in the State of Israel. It is essential to highlight that given that this document was published only a few days into the war, it is impossible to assess the implications of this security situation on the insurance market and in particular in respect of claims inflation.

It should be noted, that as a general rule, direct property damages that derive from war and/or terrorism, are covered by the State.

Changing the legislation in Israel - a political and social crisis

The Bank of Israel's financial stability report for the first half of 2023 indicates that the financial system in the Israeli economy was affected by two main factors:

1. The continued tightening of monetary policy and the slowing of economic growth in Israel and around the world, along with difficulties in the banking system.
2. Uncertainty surrounding the consequences of the legislative changes to the legal system in Israel impacting the functioning of the economy and the financial system as a whole. If these processes - in Israel and the rest of the world - intensify, they may challenge the financial system in the medium term.

When the 37th government took office at the end of 2022, it worked to pass legislative initiatives with the aim to remove the checks and balances which affected the executive authority's ability to act, and in particular, limited its independence and the oversight ability of the Supreme Court. These created a political and social crisis in Israel.

The uncertainty surrounding the legislative changes increased the economy's risk premium and was accompanied by a devaluation of the exchange rate (which contributed to the increase in inflation), a drop in stock prices and increased volatility in the foreign exchange markets and financial markets, including the (re)insurance market.

Construction claims
Policies that insure the construction of plants or projects have been affected by the supply of spare parts, their cost, the delivery times, the increase in transportation costs and the cost of labour (employers are offering high wages to attract and retain staff). These are all resulting in an increase in the cost of claims.

Property damage
In the property damage liability sector, the cost of claims is related to the market prices of vehicles (new and used), prices of spare parts and labour wages. The main cause of the large expenses is the spare parts market. Since the outbreak of the pandemic, the supply of spare parts has been small, bottlenecks have arisen in the supply chain that have caused delays in delivery and accordingly the price of spare parts has increased.

In the housing sector, the market value of the property itself is not insured, but only the value of the construction (reconstruction) of the building. Therefore, it is specifically related to the index of construction factors, including increases in the cost of materials and products, wages, rental of equipment and vehicles.

> The value of the contents of the property have also increased, again adding to the overall cost of a claim. In Israel, the change in the value of the contents is best measured by the consumer price index, which is calculated by the Central Bureau of Statistics. According to the March 2023 - June 2023 data, the annual rate of increase of the consumer price index reached 2.6%.

Class actions
The increase in class actions – which have a significant effect on D&O policies – has been subject to the attention of the Ministry of Justice. A report has recently been submitted, recommending an amendment to the Law of Class Actions in order to reduce the filing of frivolous lawsuits.

As part of its recommendations, it was suggested that lawyers who represent class action plaintiffs should pay the legal expenses. This is in contrast to the current default position where the plaintiffs pay the legal expenses. The report even suggests that in the event of a loss, the costs of the proceeding will be charged to the lawyer.

Until it is decided what, if any, recommendations are adopted, claims against D&Os are expected to remain high. There is even a possibility that they will continue to increase, due to the necessity for D&Os to make decisions, manage risks and lead organisations in an era of fundamental changes.

ESG claims
Israel has already seen an increase in civil and criminal lawsuits on environmental issues, such as oil spills, air pollution, discharge of industrial wastewater to seashores and water sources. We anticipate that there will be growth in climate litigation in Israel, which will be influenced by developments in claims commenced throughout the world, and which will lead to climate legislation (which currently does not exist) that can be relied upon when seeking to initiate legal proceedings.

Another important factor is the environmental, social and corporate governance field (ESG). This is in the development phase in Israel, and currently is not supervised by a single regulator. This makes it difficult to assess the level of accuracy of company ratings based on ESG performance.

Adoption of international standards and ensuring compliance with a quality supervisory and control mechanism will ensure quality, transparent, relevant, and comparable reporting. This, in turn, will create long-term value for corporations that will allow them to predict the risks and consequences for the people, the economy and the planet.

Outlook

Insurtech and artificial intelligence will continue to affect claims inflation. A team made up of representatives from the Ministries of Finance, Justice, Financial Regulators, and the Competition Authority, is currently working hard to examine the regulatory and legal implications of the use of artificial intelligence on financial activities and services.

> It is expected to formulate recommendations around the promotion of innovation, the removal of barriers to adoption, the need for regulation, and how it is designed. Its recommendations are expected in October 2023.

It remains to be seen how the use of artificial intelligence - through the accuracy and optimisation of risk assessment, improving the ability to handle claims, while identifying idle claims - will ultimately reduce the cost of insurance claims.

Singapore

With increasing economic inflation, the Singapore insurance market has seen a number of claims where a fully insured asset at the start of the policy has become significantly underinsured over a relatively short period of time. Costs of reinstatement have also become easier to underestimate.

Key takeaways		
Increasing instances of underinsurance.	Adverse consequences of using alternative materials or suppliers.	Ongoing impact from COVID-19.

These challenges have been exacerbated by the post-COVID supply chain disruptions which have forced insureds to use materials from alternative sources (even if they come at significantly higher costs), so as to prevent further delays to repair works and the corresponding increase in business interruption losses.

Key drivers of excess economic claims inflation

While multiple factors are contributing to the increased inflation, key influences include the ongoing war between Russia and Ukraine, and the post-COVID supply chain disruptions. This is particularly relevant in Southeast Asia, due to the wide ranging connections of supply chains with China.

Energy prices
Asia remains highly dependent on coal. Most countries in Asia are also net importers of fossil energy, making it susceptible to energy price fluctuations.

> Although Asian countries have generally not imposed sanctions on Russia, the disruption caused by US and European sanctions has nevertheless impacted fuel prices in Asia as elsewhere. The global nature of the energy markets means that the effect of the conflict is ultimately still felt by Asia.

This is also against the backdrop of already increasing energy demand in Southeast Asia over the past two decades.

The immediate impact of these higher energy prices is seen in rising freight and cost of production across many sectors – whose supply chains were barely recovering from the COVID-19 pandemic.

Ongoing COVID-19 impact and supply chain disruption

Supply chain issues remain as suppliers navigate the backlog of demand, changing import/export protocols, changing COVID-19 restrictions (particularly in China, which only began easing its zero-COVID policy in the last 12 months), and as businesses worldwide experience a post-COVID labour shortage. In particular, reports indicate that worker migration has been slow to return to pre-COVID levels and that this is impacting both labour costs and output capacity across Asia.

Reports indicate significant impact over the past three years and that labour is only just returning to pre-pandemic levels.

Outlook

Recent typhoons have again demonstrated that inflation outlook and performance across Southeast Asia can be very country specific. As a hub for the region, Singapore is expected to remain heavily influenced by China, where supply chains are likely to continue to be a determinative factor of inflationary pressure across the region.

Spain

As the effects of recent global crises begin to settle, from the economic aftermath of armed conflicts and the COVID-19 pandemic, the Spanish insurance market is experiencing the challenges of excess claims inflation, amplified by a lack of preparation across the industry.

Key takeaways		
Energy prices have impacted property and casualty claims.	Conflicting application of business interruption wordings following COVID-19 claims.	Increased collaboration is needed to combat current uncertainty.

Key drivers of excess economic claims inflation

Cost of energy

In Spain there are two ways of accessing electricity: the free market and the regulated market (PVPC), and the user is free to choose which they prefer.

- **Free market:** This method is used by 16 million people in Spain. The price of energy is determined by the company who commercialises this electricity. Prices are more stable, as the consumer who selects a fixed fee knows the price they are going to pay beforehand.
- **Regulated market:** This method is used by 10.5 million people. The price under this market changes every hour of the day and it is determined by the energy sector with the supervision of the Ministry of Energy.

In the past year, the prices under the regulated market have increased significantly due to lack of resources, the war in Ukraine and gas prices. This has translated into a cost increase of 20% in the price of electricity compared to 2019. The impact has been felt mostly in terms of property and casualty claims.

However, the cost of energy has been mitigated due to the European exemption applied in Spain and Portugal and due to the promotion of green or renewable energies which has triggered a price decrease of a 6.9% in Q1 of 2023.

The COVID-19 pandemic
The COVID-19 pandemic has generated a widespread legal discussion on the loss of profit clauses in insurance policies.

The interpretation of these clauses are subject to Articles 63 and 67 of the Spanish Insurance Act 1980, which require that the paralysation or interruption of business has to be a consequence of a material damage previously foreseen and covered by the policy.

Therefore, the losses caused by the decisions, limitations or restrictions imposed by a Public Authority – such as the lockdowns imposed by the Spanish Government in 2020 during the COVID-19 pandemic - should not be covered by the insurers.

However, the Spanish courts have issued diverse and contradictory judgments in this area. Some High Tribunals have held that it would be harmful and detrimental to the insured to limit coverage this way and have held in favour of the insureds, contrary to the principles of the Spanish Insurance Act.

This has set off alarms for many insurers who have increased their premiums to respond to the possible consequences of further judgments that follow these decisions, setting a precedent for future actions.

However, other courts and tribunals have maintained a strict interpretation of the Insurance Act and held that the lockdowns should not be subject of coverage of the loss of profit policies.

This has created a state of legal uncertainty, the effects of which are yet to be seen and analysed.

The cost of living crisis
The impact of inflation on the cost of living in Spain is measured by the Consumer Price Index (CPI).

The table below shows the increase in prices in the years 2022 and 2021:

Annual consumer price index		
	2022	**2021**
Food and drinks	+ 15.7%	+ 5%
Clothing	+ 1.8%	+ 1%
Housing	- 4.5%	+ 23%
Medical treatments	+ 1%	+ 0.9%
Transport	+ 3.3%	+ 10.9 %
Communications	- 1.9 %	- 0.3%
Leisure and culture	+ 3.8%	+ 1.7%
Tourism	+ 7.8%	+ 3.1%

As shown here, the highest increases relate to day to day products such as food and drinks, transport (gas prices) or leisure and culture.

The impact of economic inflation determined by the CPI is used by the Spanish Courts to measure the change in prices depending on the different sectors. This results in an increase in certain awards of damages in construction, automobile or energy lines. This is because the estimations of some losses from the date of loss to when the quantum is established in a judicial resolution awarding damages can change significantly.

In relation to property lines, (re)insurers have had to deal with a high level of uncertainty in relation to the adjustment of the assets' value. This is normally done once a year, but inflation varies drastically from month to month and sometimes, from day to day. This also impacts losses, where estimations of reconstruction can drastically increase due to the cost of living and products.

Outlook

Global inflation has a huge impact in the insurance sector in Spain.

Firstly, because the price of energy and almost all other goods has significantly increased, and this increase is directly reflected in the claims amounts. This results in a difficult scenario for (re)insurers when establishing reserves or foreseeing damages' compensations.

> Secondly, the impact of the COVID-19 crisis has set an important precedent for loss of profit claims, which raises the level of uncertainty on future judicial resolutions, and can impact the level to which a policy responds.

These challenges necessitate a higher level of coordination with other (re)insurers and insurance authorities - in Spain, this is the DGS or General Insurance Directorate. This will allow the industry to implement unified measures to combat the uncertainty of costs variations.

(Re)insurers should also increase the communications with brokers, insureds, and legal counsels to ensure more precise reserves when facing judicial claims.

United States

Claims inflation in the United States has been driven by a myriad of factors, including the proliferation of class action complaints, jury verdicts that often reflect more of the economic and racial disparity across jurisdictions than the actual facts of a given case, the election of judges in certain states, and nuclear verdicts, which are further amplified by the allowance of punitive damage awards and fee-shifting statutes in select circumstances.

Key takeaways		
Public sentiment is being reflected in jury verdicts.	Time-limited settled offers are putting pressure on insurers.	Public nuisance claims are continuing to rise.

Key drivers of social claims inflation

Litigation strategies
Another key development that we have observed over the past several years is the increasing influence and strategies of the Plaintiffs' Bar.

Plaintiffs' attorneys throughout the United States are implementing sweeping advertising campaigns to gather clients. In many instances, this gives rise to class or group action litigation. By obtaining sources of litigation funding, client-victims are provided with the ability to pursue otherwise costly litigation. The utilization of contingent fees are often relied upon to drive higher settlements. Plaintiffs' attorneys can also be seen exploiting a growing level of public distrust of large corporations.

Plaintiffs' attorneys have further increased the use of time-limited settlement demands. These are being used in an effort to promote early resolution of claims by placing pressure on insurance companies to offer their policy limits.

Such time-limited settlement demands are often part of attempted ‘bad faith set-ups’. These are attempts by plaintiffs’ attorneys to lure insurers into making mistakes in hurried responses, which can potentially give rise to extra-contractual liability on claims that might otherwise have only limited insurance available.

Virtually every individual state has its own laws and requirements governing these demands and the responses provided by insurers. This requires significant coordination among insurers, their policyholders, and their defence counsel.

While these time-limited demands may not always have merit, the threat of a potential nuclear verdict means that insurers should give them serious consideration. Indeed, plaintiffs’ attorneys, just like insurers, are well-aware of claims inflation, and in this context, the Plaintiffs’ Bar appears to be using these demands as a way to assert aggressive positions on the purported values of their cases with the hope that insurers will be more willing to settle for higher amounts rather than face excess verdicts at trial.

In other words, the use of time-limited settlement demands serves as an example of where the mere existence and prevalence of claims inflation may be giving rise to the further inflated value of claims.

Increase in public nuisance claims
Yet another key driver of claims inflation is the increase in claims based on public nuisance. These are claims that seek damages that are forward-looking and are aimed at abating or addressing issues that society deems morally wrong or otherwise needs fixing.

> The definition of ‘public nuisance’ is open-ended and the Plaintiffs’ Bar, consistent with their aggressive approach to litigation, has attempted to apply this concept to a wide range of situations. The most notable examples have involved: various products-related litigation (opioids, e-cigarettes, guns); third-party COVID-19 claims; mass shootings cases, climate change litigation; and pollution-related claims alleged to cause third-party bodily injury.

There are no signs that the application and use of public nuisance claims will be slowing down any time soon. Recently, social media platforms like Meta, TikTok, YouTube and Snapchat have faced public nuisance claims filed by school districts, alleging responsibility for contributing to the nation’s mental health crisis and other behavioural disorders such as depression, anxiety, and eating disorders.

The alleged costs to abate such amorphous issues such as mental health, the opioid epidemic and global warming are extraordinary and unprecedented - and easily in the range of billions of dollars. In addition, certain statutory mechanisms have expressly allowed governmental entities to pursue claims for public nuisance on behalf of the public. Thus, these claims are not expected to go away anytime soon, but will more likely evolve and expand into areas not previously anticipated.

Outlook

On the whole, the disparity of these factors driving claims inflation has made it increasingly difficult to predict case outcomes from jurisdiction to jurisdiction and quantify potential loss and exposure.

(Re)insurers can respond to the impact of claims inflation by continuing to increase coordination and communication with and among their policyholders, defence counsel and other (re)insurers. It will be important to pay close attention to detail about the nuances of each claim as well as to exhibit flexibility and collaboration in approaches to claims brought in the United States.

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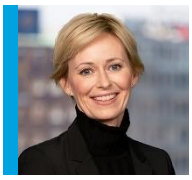

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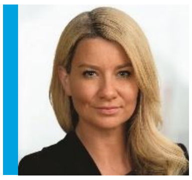

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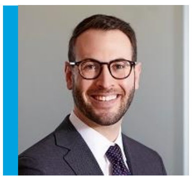

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