



Insurance forecast 2023

Claims trends and future risks

January 2023

Kennedys



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Foreword

The global insurance market is no stranger to significant unanticipated events, including the catastrophic effects of natural disasters. The losses sustained as a result of such events means that the sector has to adapt, by reviewing the scope of cover it provides, the manner in which it approaches risk assessment and how it prices its products in order to continue to remain relevant and thrive in a global marketplace.

The experiences of recent years suggest that unexpected events are becoming increasingly widespread. Alongside ever-present natural disasters, the industry continues to navigate the aftershocks of the COVID-19 pandemic, as well as the war in Ukraine. This suggests that the range of issues which insurers need to be mindful of when assessing risks is likely to expand in the next 12 months.

Consequently, understanding the key trends driving claims activity across different lines of business is vitally important. Gaining insight from recent claims experience should afford insurers and reinsurers the opportunity to identify and implement more effective loss prevention measures.

Drawing on Kennedys' experience across various risks, we highlight some of the key trends that we anticipate will shape the insurance agenda for 2023 and beyond. Rising inflation and geopolitical tensions will continue to impact claims activity, as will ongoing supply chain challenges.

At the same time, extreme weather events - including those exacerbated by climate change - may intensify claims activity and lead to increased losses. More broadly, the growing importance attributed to environmental, social and governance (ESG) requirements may lead to an increase in claims against businesses that fail to take account of these, and the potential negative impact that such failures can have on share price and reputation.

As business lines are tested, not only will insurers look to their corporate leaders to help identify new risks, they will also need to liaise with their external business partners, as well as brokers and insureds, to draw on as wide a field of experience as possible.

Innovative technology has an important part to play in the review process, including by providing a clarity of understanding for brokers, insurers and their insureds as to the scope of cover provided by insurance contracts - particularly when considering new and evolving risks. This will assist the sector to meet customer service expectation, as well as securing market profitability to fight another day.



Environmental, social and governance (ESG)

How effectively all businesses, including insurers, are perceived to address ESG requirements, such as their corporate disclosures, will increasingly impact the competitive position and reputation of those businesses in the marketplace. As such, embracing sustainability goals as part of a business's own corporate governance is vital, and requires a sound understanding of the ESG regulatory landscape.

As part of the regulatory focus on ESG requirements, insurers (and all prudent forward-looking businesses) will need to assess and incorporate sustainability targets into their investment strategies, and - with the focus of our forecast report in mind - ESG factors will need to be taken into account when assessing the risk of claims arising from various classes of insurance business.

// Pressures from ESG-related factors will impact every aspect of an insurer's business; from their own investments and levels of claims, to the treatment of their customers and employees. Effective, technology-driven stress testing of products and procedures against ESG standards will be essential to helping insurers and their customers mitigate ESG impacts.

Looking forward, regulatory pressure is set to increase in force and complexity, and to spread globally. The EU and other world leaders are no longer leaving choices to legislators, but rather will ramp up the regulatory landscape.

Climate change and biodiversity loss will be a particular focus of regulators, as two of the most pressing issues. Overall, the return of the ‘visible hand’ is here to stay for at least the next decade. Prudent businesses should, therefore, take ESG far deeper into their global value chains and embrace the opportunity to ascend the ESG maturity curve in order to create value.

Deborah Newberry, Corporate Affairs Director, London

Classes of business most at risk of ESG regulation

Classes of insurance business which are brought into the frame by increasing regulatory pressure include: Directors’ and officers’ liability (D&O), professional liability, employers’ liability, cyber risks, property and casualty, construction and product liability.

Corporate strategies and professional advice

In order to gain market share or enhance their reputation, companies can be tempted to go over and above current regulatory obligations when providing details around their ESG credentials. This is understandable given the consumer pressure on businesses to demonstrate a positive environmental impact. This can, however, leave companies open to allegations of so-called ‘greenwashing’ - the suggestion that the business has made misleading, or false claims, when describing the positive environmental impact of its products, services or brand.

If advice had been sought from a professional adviser regarding the company’s ESG strategy - as is increasingly common - this could result in allegations of negligence against the professional advisor, if that advice could be shown to have contributed to decisions made by the company that exposed it to accusations of greenwashing.

In the property and construction space, future claims may arise from allegedly negligent ESG advice provided by surveyors, solicitors and geotechnical experts; claimants may assert that these professionals failed to advise on climate related risks, as a consequence of which property damage has resulted or property valuations have been inaccurate. The current economic and social environment means that claimants may be more inclined to pursue such claims which perhaps in more buoyant and less socially aware times they might not have done.

Classes of business at risk of claims

D&O; professional liability; property; construction.



Climate change and workers' rights

Last year's summer heatwave in the UK, coupled with the expectation of even hotter summers in the future have resulted in trade unions calling for the introduction of a legal maximum workplace temperature. Consequently, employers should carefully consider temperatures in the workplace as well as heat protection for outdoor workers.

In addition to the potential for stimulating employers' liability claims, insurers should be alive to other policies being activated as a result of supply chain delays and business interruption issues arising from allowances made to working conditions and shift patterns.

From a practical perspective, new, unanticipated hazards caused by extreme weather conditions may also mean that employers will need to implement measures to mitigate the risk of personal injury arising from extreme heat, such as asking employees to avoid travelling to the workplace.

Classes of business at risk of claims

Employers' liability; business interruption.

Synthetic chemicals and environmental risks

Concern over the potential environmental damage and harm to human health caused by use of Perfluoroalkyl and Polyfluoroalkyl substances (PFAs) found in everyday consumer products continues to rise. This has resulted in significant legal and regulatory developments aimed at increased transparency regarding the risks of using these chemicals.

PFAs litigation in the United States and Europe is impacting chemical producers, as well as producers of the products that contain those chemicals. Escalating consumer activism suggests that future group litigation in the UK is likely, particularly if a more stringent regulatory regime is implemented. The development and outcome of legal cases in other jurisdictions should, therefore, be closely monitored.

Concerns have also been raised around the use of titanium dioxide (TiO₂), a chemical widely used in a range of consumer products. Several class action lawsuits have been filed in the US concerning the use of TiO₂ in products ranging from confectionary to pain relief medication to tampons.

Given the restrictions on the use of TiO₂ in the EU, and with the UK's Foods Standards Agency and Food Standards Scotland currently undertaking their own risk assessments, this is an emerging risk for insurers to be aware of in 2023, particularly as it has the potential for claims to be brought by way of group litigation.

Classes of business at risk of claims

Product liability; product recall and contamination

Supply chain management

Supply chains are particularly vulnerable to a multitude of ESG factors. For example, extreme weather events can result in delays to the manufacturing and distribution processes; companies face rising obligations to publish the steps they are taking to prevent modern slavery and to protect local communities; and data protection governance is increasingly complex when dealing with an ever more digitised global network.

// We are starting to see claims against corporations where modern slavery is alleged either against the corporation itself (relating to its overseas operations) or to companies within its global supply chain. Further, within the UK, cases are being brought against recruitment agencies for psychological and physical injuries where organised crime gangs have allegedly involved those agencies' recruiters to help place trafficked victims in work.

James Shrimpton, Partner, Birmingham

Insurers, therefore, need to take into account all such factors when providing cover and reviewing insured risks.

Classes of business at risk of claims

Marine; logistics; product liability; product recall and contamination; construction; D&O; cyber and data privacy.



ESG regulatory and legislative developments to watch

Global regulatory intervention in the ESG space is expected to rise, as the drive for transparency, clarity and consistency gathers pace. While the 'E' has dominated the introduction of standards so far, we anticipate seeing escalating regulatory attention on social issues such as diversity, equity & inclusion (DEI), human rights, and modern slavery.

COP messages: Global Shield against Climate Risks

The declarations made at the UN's annual climate conference often refer to long term goals and staged actions. However, COP27 in November 2022 saw an initiative launched which will have a direct impact on insurers in the more immediate future - the Global Shield against Climate Risks (the Global Shield).

The Global Shield comprises climate risk parametric insurance and finance strategies to provide protection against damage caused by extreme climate and weather events. This will increase the use of parametric products, especially across casualty and property lines. Parametric insurance provides payment when a predefined event occurs, such as when a Category 5 tropical cyclone is registered in a defined area.

Therefore, whilst parametric insurance products will not cover all losses, any gaps in cover can be avoided when combined with other traditional policies. This does, however, require careful consideration by insurers and brokers alike.

The FCA Consumer Duty

The new Consumer Duty will come into force in July 2023. The FCA are using the new Consumer Duty to introduce a higher and more consistent standard of consumer protection for retail financial services consumers.

Insurers will be required to ensure that their culture is aligned to the holistic approach expected by the regulator. Firms will be required to focus on and monitor customer outcomes of their products and services, putting customers' interests at the heart of their business. Firms will also be expected to rectify and remediate where consumers are not receiving good outcomes, thereby enabling and supporting them to pursue their financial objectives and avoiding foreseeable harm.

Even insurers who already have their customers' interests at the forefront of their business models and decisions, and comply with existing pricing rules, will need to consider carefully how the new Consumer Duty might impact their products and services.

The scope of the Consumer Duty covers commercial as well as individual customers in many circumstances and so is likely to have a far-reaching effect across the industry.

FCA's new sustainability rules

2022 saw a drive from the FCA to strengthen future sustainability regulations, with some standards potentially taking effect from as early as June 2023. The refreshed strategy sets out key actions for the year ahead, including:

- Promoting well-designed, well-governed, credible and effective net zero transition plans by listed companies and regulated firms.
- Developing a Code of Conduct for ESG data and ratings providers (announced in November 2022).
- Introducing sustainable investment product labels and restrictions on how certain sustainability-related terms - such as 'ESG', 'green' or 'sustainable' - can be used in products which do not qualify for the sustainable investment labels.

The proposed measures, once implemented, should enhance consumer protection by bringing greater transparency, clarity and consistency to climate disclosure obligations and the interpretation of ESG ratings. However, they also represent an additional regulatory challenge to insurers and their policyholders which could result in an increase in liability exposures.

Insurers, as with their corporate clients, will need to continue to respond to the shifting expectations of corporate responsibility. A failure to do so could result in a challenge by the regulator and consequential reputational harm.

Diversity, Equity and Inclusion (DEI)

Regulation in the DEI space is continuing to develop, raising the prospect of an increased risk of claims against directors and officers and reputational damage to corporates.

Drivers of activity include:

- The FCA rules on diversity and inclusion in executive management, which set targets for reporting purposes in 2023 on a 'comply or explain' basis for listed companies.
- The EU Women on Boards Directive, which requires listed companies to implement quotas to increase gender diversity on corporate boards throughout the EU by 2026.
- The US Securities and Exchange Commission's diversity and disclosure rules for Nasdaq-listed companies (introduced in 2021) has led to an increase in high value US derivative lawsuits regarding board diversity.



Geopolitics

The impact of geopolitical risks - those risks associated with conflict or tension between countries or states - can be felt across almost all lines of business. There is also a clear interrelation between the geopolitical landscape and other priority topics for insurers, including rising inflation, ESG considerations and reputational risk. This report outlines some of the key geopolitical factors for insurers to be alive to in the months ahead.

Civil unrest

Governments across the globe are facing vocal, hostile opposition voices. Social movements such as climate related activism, as well as the cost-of-living crisis, are stoking societal dissatisfaction. The need to transition to greener energy being pitted against the loss of employment in some countries can cause real tension.

This tension is leading to a shift in public sentiment against corporates and policy makers, raising the risk of populist and shareholder activism and civil unrest, protests and strikes across the globe.

The rise of these social movements has been clearly demonstrated by the recent protests in China - the first there since 1989. What started as unrest over China's zero-COVID policies turned into broader calls for freedom. Such unrest and increasing volatility is a recurring pattern. For instance, in October 2019, the introduction of a 30 peso increase in Metro fares in Chile was the catalyst for a wave of civil unrest, protesting against years of government reforms.

More recently, water shortages were the catalyst for civil protests in Iran. These escalated into protests regarding the economic crisis more broadly, including reaction to a hike in wheat prices, and to the treatment of women for alleged breaches of Islamic law.

With social media providing a platform for these voices to gather global support and momentum, we anticipate that 2023 will see a continuation of civil unrest events globally giving rise to increased claims activity.

Classes of business at risk of claims

Business interruption; property damage; marine; logistics; energy; political risk, trade credit and surety.

Supply chain impacts

The growing interdependence of global corporate supply chains means that when these are disrupted, multiple insurance lines are exposed to claims activity. The global supply chain network has come under increased pressure recently, suffering disruption as a result of the COVID-19 pandemic, extreme weather events, cyber attacks and the war in Ukraine.

These events have led to manufacturing shutdowns, port closures, trade conflicts and labour shortages. As a consequence of the continuing high level of COVID-19 cases in China, we are likely to see further disruption to the Chinese manufacturing industry and export supply chains during the early part of 2023.

As we move through 2023, we anticipate seeing further business interruption claims and delays - and costs increases - to construction projects due to a shortage of materials. Medical treatment is likely to be postponed due to an inability to source medical or rehabilitation equipment, and loss of profits for perishable or time sensitive products will be claimed under shipping and logistic contracts.

// If manufacturers are unable to obtain ingredients or component parts from their regular suppliers and are forced to source those products from unknown third parties with whom they have no trading history, this raises the possibility of unreliable or inferior products entering the supply chain.

A consequence is that those manufacturers may release finished products into the stream of commerce with quality issues, increasing the risk of product liability, recall and contamination claims developing where there is a risk of injury or damage as a result of use or consumption of those products.

Ingrid Hobbs, Partner, London

Classes of business at risk of claims

Business interruption; construction; healthcare; marine; logistics; product liability; product recall and contamination.



Predicted rise in insolvencies

Struggling businesses, propped up by pandemic support measures, are now faced with a triple whammy of high energy bills, soaring interest rates and rising wages, all of which are likely to have a significant impact on profitability. Current energy prices alone could wipe out the profits of many corporates, as businesses are unable to pass on such price increases to their customers during a time of already decreasing demand.

Historically, when insolvencies rise, so too do trade credit claims. An increase in fraudulent claims activity can also be anticipated. The UK government is facing mounting pressure to introduce new measures to tackle fraud but, in the meantime, insurers should continue to train their employees in detecting fraud and strengthen their fraud prevention strategies.

// High inflation, coupled with recession in some countries across Europe, could see a rise in corporate insolvencies, particularly in the construction sector where the high costs of materials has further squeezed profit margins. In Ireland, we have already seen major construction companies go into liquidation.

Their collapse may expose shortcomings in the management of such companies, leading to claims by liquidators and regulators against the former directors, exposing D&O liability policies. There may also be an increase in claims against surety bonds following a building contractor going into liquidation.

Andrew McGahey, Partner, Dublin

Classes of business at risk of claims

All classes, particularly trade credit; construction; D&O.

Cyber attacks

Geopolitical tensions can result in a spike in cyber attacks, often from opposing nations. This was reflected in Lloyd's announcement in August 2022 that, as of March 2023, it will no longer cover losses resulting from nation-backed cyber attacks.

As well as the increase in claims under cyber policies from attacks on individual companies, related losses as a result of supply chain disruption and individual business interruption are indicated. Businesses are also at risk of reputational damage if they fail to respond adequately; customers are quick to move their business if they do not think that their data is being properly protected.

There is also a risk of cyber attacks targeting the infrastructure of a country, such as energy or transport links. These cause widespread disruption, and can give rise to associated claims.

Classes of business at risk of claims

Business interruption; cyber and data privacy; energy; logistics.

Regulatory and legislative developments to watch

In the UK, the Brexit 'bonfire' of EU laws is yet to materialise, and the government's attempts to "review or revoke" some 4,000 pieces of EU legislation by the end of the year is facing growing opposition in both Houses of Parliament.

Nevertheless, there have already been some significant developments that are leading towards a re-defined legal landscape for insurers and corporates to consider, with financial services emerging as the key area in which the government is seeking to decisively diverge from EU regulations in 2023.

Retained EU Law (Revocation and Reform) Bill

The 'sunset clause' in this Bill could see large numbers of retained EU laws simply expire at the end of 2023. This includes laws covering employment rights, consumer and environmental protections. Only the laws which are expressly selected by ministers will be retained.

Concerns around this clause have led to peers in the House of Lords warning they will "slow down" the Bill and, in the Commons, there is a growing cross-party movement for an amendment that would force the government to spell out exactly which laws it plans to scrap, amend or keep.

If the UK government opts for significant regulatory divergence with the EU, this could make international trade more difficult for UK businesses and would add another layer of complexity for insurers and corporates to adapt to.

Protect Duty

Towards the end of 2022, the UK government renewed its commitment to introduce the Protect Duty to enhance public security. The legislation is expected to be brought forward and passed in 2023.

Whilst the details of the new legislation are awaited, it is expected that many businesses will be required to formally assess terrorism risk for the first time; including venues with capacity of 100 people or more. For insurers, this translates to continuing to work with existing and new clients in terrorism risk mitigation. The Protect Duty is expected to have implications in terms of both the cost and scope of insurance bought by, among others, local authorities, owners and operators of publicly accessible venues.

In-scope businesses should begin developing or revisiting their counter-terrorism measures, paying specific attention to how best to manage and mitigate the identified risks.

Financial Services and Markets Bill

The landmark Financial Services and Markets (FSM) Bill was finally introduced to UK Parliament on 20 July 2022 - the last piece of legislation under the Johnson Government.

The FSM Bill is designed to give the UK the chance to create a more competitive financial services sector post-Brexit, repealing the financial services framework inherited from the EU and offering regulators vast new powers to reform EU rules.

This intention was reinforced by the 'Edinburgh Reforms' unveiled in December 2022 - a new 30-point plan for the deregulation of the UK financial services sector in the wake of Brexit. Amongst the announcements was a commitment to commence a review into reforming the Senior Managers and Certification Regime in Q1 2023 and a separate review on bringing ESG ratings providers within the regulatory perimeter.

The FSM Bill is currently making its way through parliament, with Prime Minister Sunak keen for it to become law by Spring 2023. This means that we should see the detail of the new UK Solvency regime early in 2023, which will impact insurers across the board.



Technology

Innovation through the use of technology is poised to continue transforming the insurance industry and the businesses that it serves, facilitating growth and furthering broader ESG-related objectives.

Despite the economic downturn, funders are continuing to invest in insurtech companies in order to develop novel technologies that aim not only to improve customer experience, but also to provide a more accurate prediction of risk. Indeed, according to recent research, approximately US\$4 billion was invested in global insurtech companies during the first half of 2022.

Technological and process change is also a priority for the London Market, with Lloyd's of London's transformation project, 'Blueprint Two', predicted to come to fruition in 2024. Blueprint Two aspires to be the first significant step towards full digitalisation of the London insurance market, making it 'better, faster, and cheaper for all participants'. The programme aims to reconfigure the entire insurance lifecycle process from claims to reporting, thereby helping customers address new risks.

Digitalisation should provide accurate risk analysis and fair pricing, thereby creating significant time and cost savings. This will assist insurers in setting accurate premiums reflecting the impact of the COVID-19 pandemic, the Ukraine crisis, the energy crisis and supply chain disruption. It should also serve to enhance the reputation of the market, and provide customers with a fair, transparent and responsive product experience.

Clamping down on cybersecurity risks

With the solutions that technology allows also come problems, as best illustrated by cybersecurity risks that continue to rank highly on the list of concerns of businesses and their insurers. Connected devices used by consumers and businesses are at risk of unauthorised access to data or malicious interference. These can include ransomware and malware attacks, resulting in data breaches and the potential infringement of privacy rights of consumers, as well as reputational damage to businesses.

EU and UK legislators are taking action, having proposed to further incorporate cybersecurity provisions into their mainstay general product safety regulatory regimes. These will exist alongside parallel obligations that are contained within specific, standalone legislation with a view to reducing the risk of disruption caused by cyber attacks.

Notwithstanding these positive developments, the risk of cybersecurity attacks remains high. The UK's Cyber Security Breaches Survey 2022 reported that over a 12-month period, 39% of UK businesses had identified a cyber attack, consistent with the number reported in 2021. It is expected that there will be a similar level of risk in 2023.

// As far as the Australian cyber insurance market is concerned, 2023 is shaping up to be an interesting one. We are seeing the market starting to soften, with a number of insurers returning to the cyber insurance market or offering increased capacity.

But at the same time, a number of recent high profile data breaches have led to a strengthening of data privacy regulations, increased media scrutiny of data breaches, and a number of class actions, all of which could increase the costs of responding to a data breach in Australia in the future.

Nicholas Blackmore, Partner, Melbourne

Classes of business at risk of claims

All classes, particularly cyber and data privacy; business interruption; product liability; D&O; logistics; energy.

The metaverse

The revolutionary concept of the metaverse is an alternative, online, virtual world which is typically accessed through virtual reality headsets or augmented reality glasses. Although its popularity has developed through gaming, it is now gaining traction for commercial use - from a platform for buying and selling goods using non-fungible tokens (NFTs) to training surgeons.

The metaverse technology is likely to give rise to complex and novel regulatory and legal issues such as those relating to data privacy and cybersecurity, personal injury, product safety and liability.



The increase in trade within the metaverse over the course of 2023 and beyond is likely to result in close inspection by insurers of their policy wordings and application, as they did when cyber-related claims first began to impact the market.

Classes of business at risk of claims

Cyber and data privacy; personal injury; product liability; D&O.

Intangible harms

Modern technologies and supply mechanisms can give rise to a variety of intangible risks, ranging from data privacy and cybersecurity to exposure to psychologically damaging content online, as well as reputational and brand damage.

This is reflected in the increasing number of claims brought before the UK and EU courts in recent years for pure intangible, non-material damage and loss. Claims include those for pure psychological injury or distress, particularly in the cybersecurity and data privacy sphere, and often in the context of large-scale group litigation. As product safety and liability legislation, and the rules governing cybersecurity and data privacy, continue to evolve, these types of intangible harms will face increasing scrutiny.

Classes of business at risk of claims

D&O; cyber and data privacy; personal injury; product liability.

Regulatory and legislative developments to watch

2022 saw the foundations of new regulatory and legal frameworks being built, many at EU level, to address the risks and challenges associated with new technologies, with a particular focus on artificial intelligence (AI).

Whilst UK legislators have also introduced a series of policy and legislative initiatives, the development of these proposals has been hampered owing to political uncertainty and the cost-of-living crisis taking up parliamentary time. Against a more stable political backdrop, and with 'innovation' being cited as one of three growth priorities in the UK government's autumn 2022 statement, insurers can expect to see a continuation of the development of these proposals over the course of 2023.

Data Protection and Digital Information Bill

The Data Protection and Digital Information Bill (DPDI Bill), introduced in July 2022, aims to reform the existing data protection regime provided by the UK General Data Protection Regulation (GDPR).

Some of the proposed changes to the existing regime include easing rules around cookie banner pop-ups, the use of personal data for scientific research and reform of the Information Commissioner's Office. As a result of the changes in government leadership during 2022, the DPDI Bill's progress was stalled.

Further consultation on the DPDI Bill has been proposed and it, therefore, remains unclear exactly how different the final version will be, or the extent to which the UK's future data protection regime may diverge from the EU GDPR. At the Conservative Conference in October 2022, the government pledged to replace the GDPR with 'our own business and consumer-friendly, British data protection system'. Significant divergence - if it occurs - could have considerable implications for businesses and their insurers, and the rights of data subjects.

Proposed legal framework for artificial intelligence (AI)

There has been increasing focus on the potential for AI to cause harm including personal and psychological injury, such as the impact of algorithms which generate harmful content on social media targeted at children.

In response, EU and UK regulators are proposing to regulate AI. The EU has introduced draft regulation, the Artificial Intelligence Act (AI Act), which adopts a risk-based approach. This means that the 'riskiest' forms of AI - including those used for insurance purposes, such as setting insurance premiums - are subject to the most stringent requirements and obligations. Non-compliance under the proposed AI Act may expose those in breach to multibillion euro fines and civil liabilities.

The European Commission has also proposed a "targeted harmonisation of national liability rules for AI" (known as the AI Liability Directive) which, when enacted, will enable individuals who have been harmed by AI to sue the AI 'provider'.



Although the UK government is yet to publish its draft AI regulation, it set out its stance in a July 2022 policy paper which focused on establishing a pro-innovation approach to AI. Whilst we anticipate that the UK will take a less draconian approach to regulation than the EU, striking a balance between risk-based regulation and a pro-innovation approach could prove challenging. Against the backdrop of this developing liability framework, claims arising from the use of allegedly harmful AI are an emerging risk for insurers in 2023.

// Technologies incorporating AI - the application of algorithms with the intent to imitate human decision making - are becoming increasingly sophisticated. As these continue to be adopted to assist insurers in providing consumers with a higher standard of service, so the need for regulation to protect those consumers grows more and more pressing.

However, there is a delicate balance to be struck; while protections are vital, the regulatory framework cannot be so rigid that it restricts the advancement of this progressive technology.

Richard West, Partner & Kennedys IQ Director, London



Claims inflation

According to the Economist Intelligence Unit's recent report, prices have risen 8.1% in local currency terms over the last year. This is the highest inflation rate recorded globally since their digital surveys began almost 20 years ago. The report tracked the cost of 200 goods and services over 172 global cities.

Barring another escalation of the war in Ukraine, prices are anticipated to ease in 2023 as a result of less economic activity. Current supply chain blockages should then begin to reduce.

Nevertheless, the 'hangover' of high prices of goods purchased last year, together with interest rates remaining relatively high, means that the impact of claims inflation will continue to be felt across all insurance lines in the year ahead. For supply chains, it is predicted that wage inflation will overtake logistics and commodity prices as a driver of increased supply chain costs.

Against that general picture, developed markets such as Europe and the US are predicted to see energy and food prices remaining high. This is likely to result in a reduction in imports from emerging markets as consumer confidence and, therefore, expenditure remains low.

Overall, an unstable economic environment makes the job of accurately predicting excess inflation increasingly difficult.

London Market

In 2022, Lloyd's of London asked their syndicates and members to expressly consider excess inflation (including social inflation) at both a class of business and geographical level. As we move into 2023, excess inflation will require continued consideration when reserving and adjusting claims.

Driving factors

There are some factors which can assist in predicting the direction of travel:

- **Technological advancements** will continue to be utilised, which can both reduce costs through efficiencies, and raise costs when it comes to replacement parts or medical procedures. Whilst recent advances in life sciences - such as the use of AI in drug development, robotics and innovation in prosthetic design - have improved patient treatment and increased the lifespan of a product, they have also contributed to rising healthcare and personal injury costs.
- **Group action mechanisms** are increasingly allowing a wider scope of claimant, thereby increasing the volume and value of such claims. For example, on 29 November 2022, MasterCard lost their appeal against the ruling which allowed the claims of approximately three million people who had died since the proceedings began to continue.
- **Shifts in public sentiment** towards corporates and policy makers can result in an increase in social claims inflation, as demonstrated in the rising value of awards handed down in US jury trials.
- **Extreme climate events** are predicted to continue throughout 2023, resulting in surges in demand for construction materials, temporary accommodation and damage surveys, amongst others. This will lead to an increase in the cost of claims.
The La Niña weather pattern alone is expected to result in heavy rainfall in Australia, a greater risk of droughts and wildfires in the US, and changing hurricane and monsoon patterns across the Pacific and Atlantic oceans in 2023.

Such changes will likely result in damage to crops and properties, as well as disruption to transportation and business operations. The provision of replacement goods and services could also be delayed due to supply chain interruption as well as a surge in demand for goods and materials.



Insurer response

In response to this increasingly volatile risk landscape, insurers are reviewing their programs to ensure that the cover they are providing is clear, suitable and fit for the demands that may be placed upon it in the year ahead. There are a number of significant factors to consider, but undoubtedly insurers are now better equipped than ever to review, assess and respond to these risks given their claims experience over recent years and the innovative technology available to them when considering future business.

To safeguard business resilience and to provide efficient claims management, consideration will need to be given to the continuing impact of excess claims inflation, in particular. Insurers and brokers will wish to continue to work closely with their insureds to facilitate clear information sharing regarding the business of the insured, declared values, replacement costs and scope of cover so that key aspects of the risk and the policy are understood by all parties.

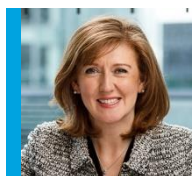
As ever, contract certainty is key to ongoing business stability and reputation. As highlighted in this forecast report, the impact of the ongoing disruption to global supply chains is likely to form part of this review for many insureds. This may also provide an opportunity for insurers to re-evaluate their own supply chains, while also encouraging an enhanced dialogue between insurers, brokers and insureds. As the regulatory demands on insurers steadily increase, the requirement to ensure that customers are treated fairly, particularly those in vulnerable circumstances, will remain a key consideration.

When taking account of insureds' expectations, insurers will need to be ever mindful of the increasing importance of ESG related factors both in the provision of their services and in their assessment of insured businesses seeking cover.

In the current climate, risks will continue to morph and evolve, as will the insurance products which the market will continue to develop to meet the challenges presented by such changes in risk.

Harnessing the benefits afforded by increasingly sophisticated technology when assessing risk, loss history, patterns, pricing and policy wordings can assist insurers to keep pace with change, build resilience, sustain high levels of client service and ensure that the market continues to thrive.

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