

# Claims Inflation – does it exist, and, if so, how does it effect premium and profit?

- Paul Castellani
  - Robert Kastner
- Eversheds LLP  
Syndicate 1218

*OdysseyRe*<sup>®</sup>

# Claims Inflation – the context

- *“The modern liability environment brings with it a number of stereotypes, from individuals who treat a perceived tort by a major corporation as a **lucky lottery win**, to **ambulance-chasing lawyers** who help self-styled victims seek their fortunes. But beyond the stereotypes, liability is a serious issue for companies and one that cannot be ignored. To manage the risks involved effectively, businesses first need **accurate information** – on both **current issues** and likely **emerging trends**. But just as importantly, they need to put in place robust policies and process to anticipate and mitigate what is becoming a more prevalent and costly problem.”<sup>1</sup>*

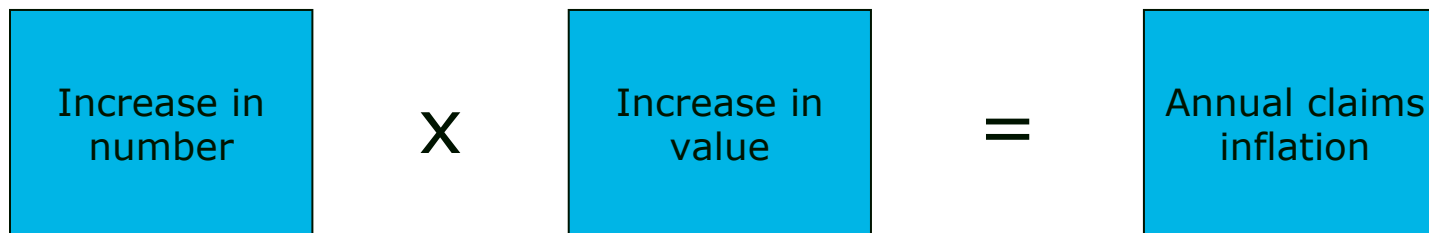
<sup>1</sup> Directors in the Dock – Lloyd’s 2008

# Claims Inflation – an overview

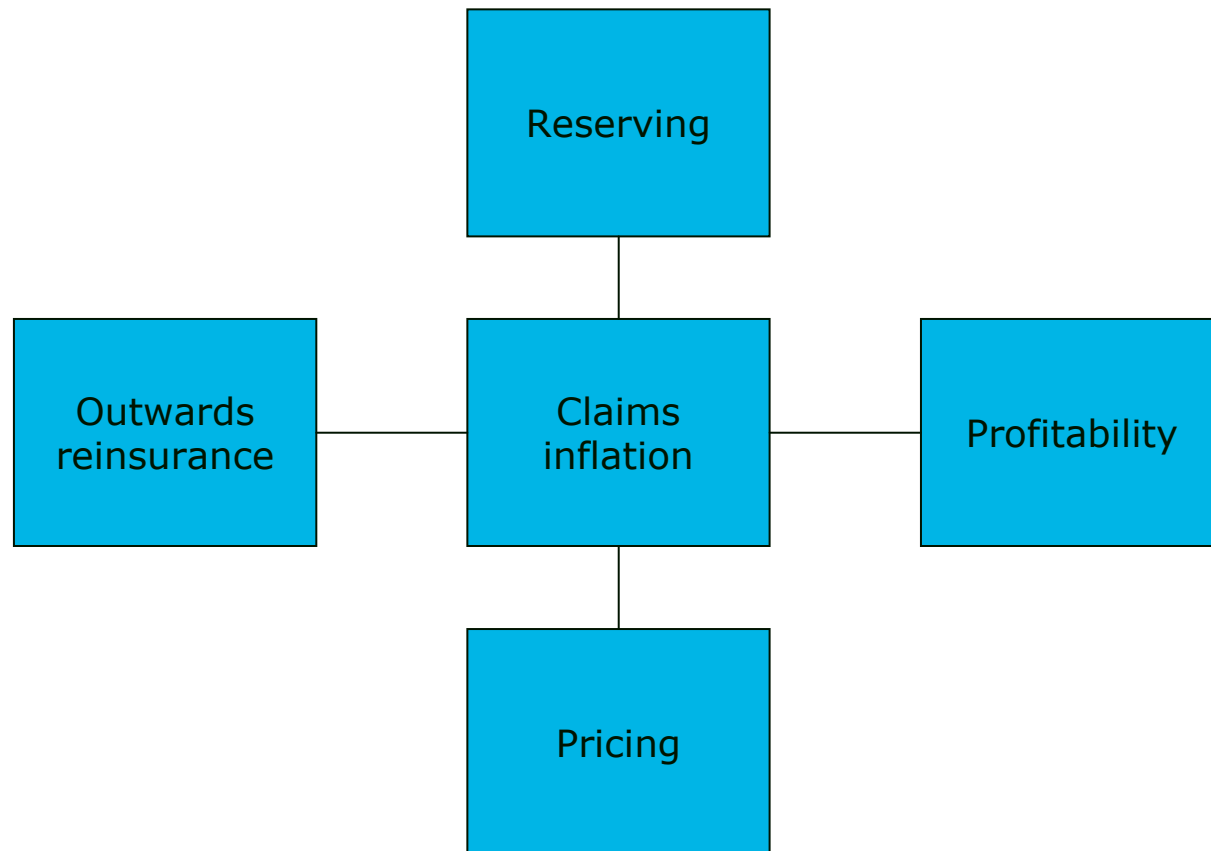
- claims inflation – **what** it is and **why** important
- some statistics – are there **more** (and **larger**) claims than there used to be?
- if so, **why**?
- what are the **commercial** ramifications?
- how can claims inflation be **mitigated**?

# Claims Inflation – what is it?

- Amount by which claims
  - increase in number (**frequency**)
  - increase in value (**severity**)
- Product of the two variables – expressed as an annual percentage



# Claims Inflation – why important?



# Claims Inflation – a quiz

- Myth 1 – “**compensation culture**”
  - have court proceedings for BI claims increased or decreased since 1999?  
1999-1187  
2003-570
  - have court proceedings for “other negligence claims” increased or decreased since 1999?  
1999-373  
2003-128<sup>1</sup>

<sup>1</sup> University of Warwick School of Law 2008

# Myth 1 – Despite the evidence, is the myth true?

- number of litigated claims = crude measure of frequency; because
  - compulsory protocols
  - Regulatory forms of redress – FOS, SRA, Ombudsman
  - pre-action mediation
  - litigation less frequently used as a tool in rising economic market
- Better measure: 38% of companies seen an increase in number of claims<sup>1</sup>

<sup>1</sup> Directors in the Dock – Lloyd's 2008

# Fourth UK Bodily Injury Awards Study

- claims were rising at a rate of 9.5% per annum
- larger claims probably growing at a faster rate than smaller claims
- Compounded, claims have risen 247.82% in a decade
- Claims Frequency increasing at 3% per annum
- Claims Severity increasing at 6% per annum
  - Claims over £2m – 12%
  - Claims over £5m – 30%



## Myth 2 – People are now more likely to claim if something goes wrong?

- Third of companies seen an increase in litigation during recent “bull” market <sup>1</sup>
- 90% of people agree that we are more likely to sue now than 5 years ago<sup>2</sup>
- Situation can only deteriorate as economy worsens

<sup>1</sup> Lovells – The Shrinking World 2008

<sup>2</sup> Brit Insurance - YouGov Survey 2007

# Myth 3 – are claims more expensive?

- Liability awards
  - Higher or lower?
- Costs (defence/claimants)
  - Higher or lower ?
- 34% of companies seen increase in size of claims <sup>1</sup>

<sup>1</sup> Directors in the Dock – Lloyd's 2008

# Compensation Culture – the Biggest Myth of them all?

- What actually is Compensation Culture?
- Does one exist?
- Papers and politicians say “yes”
- Constitutional Affairs Committee says “no”

# The Myths – What are their relevance to professional indemnity?

- PI is a liability account and affected by same trends
- consumers –IFAs, solicitors, surveyors = “frontline professionals”
- Businesses – when feel economic pinch, review old advice
- Reduction in capital available for PI

# Claims Inflation – why are there more claims?

- “compensation culture” (?)
- access to justice
  - CFA
  - third party funding
  - BTE
  - ATE
- economic factors – “transfer of risk” to insurers
- ‘laxity’ of quality in a bull market (?)

# Claims Inflation – severity do claims cost more? Why?

- Professional Indemnity Claims – common heads of loss
  - loss of income
  - loss of profit/business interruption
  - property rights
  - cost of repair
  - bodily injury
- So, if any individual head of loss increases, so will **severity** of PI claims
- Legal costs and expenses

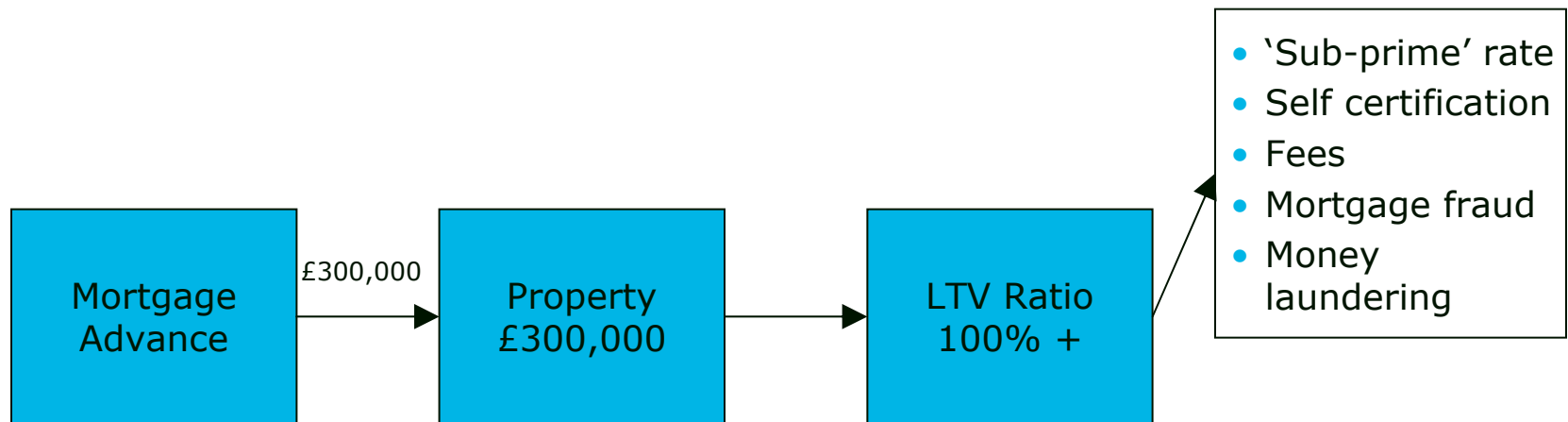
# Claim Severity – an example

- Lender's claim against a solicitor – 1990's example – Colin Bishop



# Claim Severity – an example

- Lender's claim against a solicitor – 2008





## So what rate of claims inflation applies?

- Should PI be greater than – BI?  
EL?  
PL?  
Medmal?
- What rate should we apply?
  - 2.5%
  - 5%
  - 7.5%
  - 10%
  - 12.5%

# What rates does the market apply? <sup>1</sup>

<b>Class</b>	<b>Min (%)</b>	<b>Max (%)</b>	<b>Average (%)</b>
Motor BI	6	12	8.9
EL	5	12	8.4
PL	3	10	6.9
<b>PI</b>	<b>5</b>	<b>10</b>	<b>7.5</b>
MedMal	7.5	15	10.9

<sup>1</sup> Institute of Actuaries Survey

# Commercial Ramifications?

- Reserving
  - old claims – “step reserving”
  - re-analyse reserves for adequacy
- Pricing
  - in a logical world, more claims and higher value – higher premiums
  - in a real world, we are a market!

- Outwards Reinsurance
  - Adequacy of cover
  - Obligations to notify
  - Rates being charged
- Profitability
  - is book still profitable if 10% added to expected claim profile?
- 3<sup>rd</sup> Party Supplier
  - claims strategy?
  - pay early pay less?
  - buy on quality, not on price

## Mitigation – how can claims inflation be reduced? An **insurer's** perspective

- only write good risks (!)
- do not chase premium (!)
- risk management – insistence not lip service
- deductibles
- early claim assessment

## Mitigation – how can claims inflation be reduced? An insured's perspective

- adequate scoping
- limitation of liability
- proportional liability
- clearly defined roles amongst professionals
- client selection

# What does the future hold?

- **Frequency**
  - sub-prime – D&O liabilities
  - valuation claims
  - mortgage fraud
  - insolvency claims against accountants
- **Severity**
  - increase in house price inflation
  - increase in RPI
  - increase in PI awards (Ogden tables, structured settlements)
  - legal fees and expenses (CFA, ATE)
- Prediction – what will claims inflation be next year?