Institute and Faculty of Actuaries

Steer report

Subject	The impact of high inflation on GI Reserving and the work of actuaries
Regulatory Board meeting	5 July 2022
Previous Board Steer/Approval	N/A
International Issues Considered?	Yes
Author	IFoA Executive and GI Board
Purpose	Steer

A EXECUTIVE SUMMARY

1. **This paper introduces a 'deep dive' for the Regulatory Board ('the Board') on the impact of inflation on General Insurance (GI) reserving and the work of actuaries.**

2. The Board looks to identify a topic from its Horizon Scanning Register (HSR) to explore in more detail at its meetings, which includes public interest regulatory risks affecting the work of actuaries. This particular risk on the HSR is described as:

   'Due to increasingly high inflation because of rising prices in the UK, there is a risk to general insurance reserving after years of benign inflation in many classes, as this is intrinsically projected forward by chain-ladder based techniques.'

3. This paper provides some background information, as well as some key issues for the Board to consider during their deep dive.

4. **Kevin Wenzel, IFoA GI Board member, has been invited to the meeting to provide further background and expert views. He has provided further information on this risk for the Board, which can be found at Appendix A.**

B: BACKGROUND

5. The Board will be aware that inflation refers to the change in prices for goods and services over time and that there is concern about the rate in which inflation is currently rising, both in the UK and around the globe. There are several measures used by the UK Office for National Statistics (ONS) to measure this including the consumer price inflation (CPI), producer price inflation (PPI input and output) and the House Price Index.

6. Given the high inflation coming through with specific components of claims costs reaching double figures, there may be is a risk to the adequacy of both actuarial reserves and the underlying case estimates. It has been over a decade since reserving actuaries in GI faced widespread pressures of high inflation, which can lead to under-reserving, straining the adequacy of companies reserves required to pay customers for their claims.

7. This has been caused by the vulnerability of reserves from inflation arguably as a result of the COVID-19 pandemic and worldwide shutdown, and swift reopening globally. In the UK, there may be some further impacts because of Brexit.

UK regulatory focus

8. The Prudential Regulation Authority (PRA) in the UK has had ongoing interaction with GI firms in relation to reserving assumptions and methodologies. This has included the publication of "Dear Chief Actuary" letters containing feedback to industry, including expectations around improvements to reserving work carried out. Claims inflation is likely to be a current area of focus. There is also the wider PRA focus on the financial stability of firms and their ability to meet customer claims as they fall due.

9. The UK Financial Conduct Authority (FCA) is focused on customer outcomes and that these represent fair value, as set out in the upcoming Consumer Duty rules. The current pressures on claims inflation may represent a particular challenge for firms in meeting the new requirements.

10. The Board can find further information and background within **Appendix A**.

C: DISCUSSION AND ISSUES TO CONSIDER

11. The IFoA General Insurance Practice Board has flagged this risk to the Board as the impact of increasingly high inflation on GI reserving could thereafter impact of consumers and market confidence in the work of actuaries.

12. Actuarial reserves are generally set in GI companies using variations of chain-ladder methods where future development of claims is assumed to be similar to recent history and thus inflation also is assumed to be a weighted average of recent historical experience. As we have been in a low inflation environment for many years, use of these traditional methods will, without explicit adjustment, project forward with insufficient allowance for current inflation.

13. Whilst the immediate concern may be on the sufficiency of claims reserves, the reserving results will be an important area of feedback into pricing. There is a risk that the market will be slow to respond if this input to the technical pricing is in some way lagging.

14. From a capital perspective, Lloyd's is pushing hard to ensure syndicates make explicit allowance for inflation in their capital setting and internal model validation. This should be happening in firms across the wider market, as otherwise insurers' capital requirements may not increase in-line with the added uncertainty.

15. The GI area of the profession may be less familiar with inflation and coping with this than other areas which tend to focus on much longer-term outlooks because of the unprecedented rate of inflation.

16. Combining the rising building costs, higher overall inflation, fears of social inflation pressure on longer-tailed reserves and the change in underlying risk to frequency as society has been opening more, there is a significant risk to actuarial reserves.

17. Without explicit adjustment and a reasoned range of estimates actuaries may struggle to meet the needs of Boards to consider current changes in pricing levels in estimating total claims costs and help Boards consider the external environment in setting the corresponding potential reserves.

D: CONCLUSION

18. The Board is asked to consider whether any of the issues raised during the course of its deep dive demonstrate the need for regulatory intervention to address any perceived risks.

In particular:

- Are there any specific requirements that ought to be imposed by way of an APS (or TAS if relating to a technical issue)? If so, what might these be?
- Would non-mandatory guidance be appropriate and helpful for members in relation to any technical or ethical issues relating to the fast-track route (recognising that any technical guidance would require the consent of the FRC)?
- Are there any specific issues identified that the Board considers should be communicated to Members by way of a Risk Alert?
- Is there other educational or CPD material that could be developed to provide support to Members working in this area?

E: Appendices

Appendix A: Measurements and example of inflation (A note by Kevin Wenzel, GI Board Member)