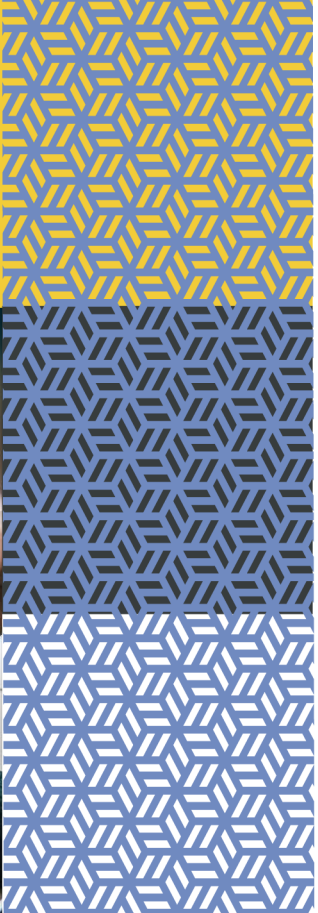


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Risk control
Claims Cost Inflation



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Risk Control

Claims Cost Inflation

What is Cost Inflation?

Cost inflation is the increase in the price of products or services as a result of raw materials and wages costing more¹.

The UK inflation rates continues to climb – 8.7% (June 23) and according to the Office for National Statistics (ONS) this is due to a mixture of buying flights abroad, second-hand cars and gig tickets!

Inflation is effectively the loss of purchasing power over time, so a pound coin won't go as far today as it did yesterday².

What are the Drivers of Claims Cost Inflation?

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

There are a number of factors driving claims inflation – being both social and economic trends, including:

- Brexit
- Geo-political factors
- The long-tail impact of the COVID-19 pandemic
- Fraud
- The #MeToo movement in addition to similar social media driven groups
- The cost of living crisis
- Global events such as the Suez Canal blockage, natural disasters and the situation in Ukraine.

The challenge presented for insurers and claims management companies, is that historical claims data no longer provides sufficient information for the reserving process or for claims adjustment purposes³.

Property

Property claims inflation drives the sums insured and settlement costs. General price increases can be seen due to:

- Availability of labour
- Availability of materials
- Other inflationary pressures such as energy and haulage costs.

There is no doubt that COVID-19 has been an influencing factor here. We have seen 'early retirees' and supply chain disruption as a direct consequence of the pandemic.

There has also been increased demand following the delays created by the pandemic when projects were paused. These are now back up and running, creating supply pressure in the system and pushing up costs.

There is a longer lead-time on training trades – typically 3 years and with 244,000 fewer workers in the construction industry over the last 3 years the impact is now beginning to show.

The average cost of construction materials rose by 4.7% in April 2023 compared to the same month in the previous year as we suffer shortages of key products such as bricks, blocks and cement⁴.

Due to high levels of demand on contractors – they can be selective of the work they take on and may opt for more profitable construction projects over less profitable insurance repair work.

This can create backlogs and delays both of which raise costs and can impact on business interruption indemnity periods and place sums insured under increasing pressure.

Motor Claims and Repairs

There was a huge reduction in motor claims that occurred because of the COVID-19 pandemic. During the lockdown period, several motor insurers reported a 70%-80% fall in the number of claims, which was to their benefit, however, it directly and adversely impacted on the accident repair sector.

The steep decline in claims was only temporary and as traffic volumes rose, motor claims increased, but seemingly to a lesser degree to pre-COVID for reasons that are unknown (potentially differing driving patterns and behaviours). We are now seeing the number of claims rise, premiums increase and claims inflation spike – all adding to the pressure⁵.

The shortage of both new and second hand vehicles is also leading to an increase in vehicle theft and therefore an increase in claims – while catalytic converter thefts also continue to be an issue⁶.

The motor repair industry is suffering the impact of rising energy prices, a rise in courtesy vehicle costs due to new car demands and changing staffing demographics with migrant workers returning to their home countries as economies change on a global scale.

The Association of British Insurers (ABI) provided an interesting update to its members in May 23 including the following statistics:

- Energy inflation is adding £71.75 to each repair
- The average paint and material costs have increased by nearly 16%
- Comparing 2022 Q3 with 2021 Q3; the average paint cost on repair has increased by 20%
- An estimated 40% of all work is now being affected in some way by parts delays
- Courtesy car costs to repairers are increasing at around 30%
- The average price of a second-hand car increased by 19% in the year ending July 2022(as per auto trader statistics)⁷.

The delay of repairs largely due to challenges with parts and labour is consequently increasing credit hire costs as vehicles are 'off the road' for longer periods of time and so it can on some occasions cost less to write a vehicle off than repair it.

Vehicle accident repairs are not likely to return to pre-COVID levels until 2024 and this will continue to negatively impact on repair cost inflation and bodyshops repairing vehicles incorporating newer technologies, which in turn leads to increasing parts and paint prices⁸.

Personal Injury

A recent case heard in the Coventry Combined Court in June 23 has addressed the issue of the rise in inflation and in particular, the impact that inflation will have on awards for Pain Suffering and Loss of Amenity (PSLA) in personal injury claims going forward and until inflation levels reduce.

The Court in 'Blair v Jaber' determined that the brackets for PSLA in the Judicial College Guidelines (JCG) should be adjusted to reflect the significant increases in inflation that have occurred in the UK in recent months. The Recorder held that, since publication of the Guidelines in April 2022, inflation had been running at levels not seen since the 1970's. This was a change in circumstance between April 2022 and today and needs to be taken into account when assessing damages. The Court stated that:

"The very substantial drop in the value of money which has taken place since April 2022 is just such a circumstance. Accordingly, the Judicial College figures need to be increased by, in my judgement, about 12%".

This is a significant increase to the already uplifted 16th edition of the JCG, which saw the average increases of circa 7% across the board; we are likely to see this argument more and more when relying on the JCG in making offers for PSLA. Part36 offers in order to provide protection, will need to consider these arguments in

particular, where only quantum is in dispute. That being said, a blanket increase on all offers is not the desired approach in order to control indemnity spend but each case should be taken on its merits and we need to ensure our assessment of the medical evidence and arguments used are documented accordingly.

Needless to say, inflationary pressures on indemnity spend will continue as we progress through this year and beyond. Judgement: [Blair v Jaber \[2023\] EW Misc 3 \(CC\) \(08 March 2023\) \(baillii.org\)](#)

Keeping Costs Down

There are steps that can be taken to help keep claims costs down:

- Early intervention can help lower the overall claims costs.
- Improvements to your data analytics will support you in being able to make better-informed decisions more quickly.
- Settling claims promptly and efficiently will help to minimise costs.
- Demonstration of effective risk management and proactive approach to managing risk within the organisation could influence premium rates.
- Additional tools to help raise defensibility such as CCTV, dashcam footage, witness statements can support an investigation and help tackle fraudulent claims – a key driver of higher premiums.
- Keep reserves under review.

Summary

Global markets remain volatile with ongoing political instability adding to the uncertainty. The Bank of England's current forecasts suggest that inflation will remain high throughout 2023. For some lines, the impact of inflation has been felt immediately as the supply of goods and materials and rising energy costs have a direct impact. The only control tool at your disposal is to actively work to mitigate the cost of this economic environment by seeking out efficiencies in how claims are being managed and developing strategies to help reduce the claim lifecycle⁹.

References

- 1 [Definition of Cost Inflation - COST INFLATION definition | Cambridge English Dictionary](#)
- 2 [Inflation remains at 8.7% despite hopes it would fall amid cost of living crisis \(msn.com\)](#)
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- 4 [Building materials experience rise in prices and declining availability causing 'significant' increase in building costs | Homebuilding](#)
- 5 Pg 194. The UK Vehicle Body Repair and Motor Insurance Market 2020-2023 – Trend Tracker Ltd.
- 6 [Claims inflation: Why are claims costs rising? | Gallagher UK \(ajg.com\)](#)
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- 9 [Claims inflation will continue to impact insurers in 2023 : Clyde & Co \(clydeco.com\)](#)

Further information

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