Impact of Inflation

Derek Freihaut, Principal and Consulting Actuary for Pinnacle Actuarial Resources, said that inflation in 2022 was particularly significant to many insurers because of the replacement costs of big-ticket items. "Insurers will have to deal with rising reinsurance costs as a percentage of their overall premium at the same time they are dealing with increases in overall losses due to inflation," he said. Following are excerpts from an interview.

PINNACLE ACTUARIAL RESOURCES

Derek Freihaut
Principal and Consulting Actuary
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What trends are the biggest concerns in the insurance space that you are hearing from clients?

The impact on claims from inflation and supply chain disruptions are the topics that we have had the most conversations with our clients about during year-end analyses. After a decade of low inflation, we saw the rate begin to increase in 2021 and jump to over 8% in 2022. The impact to some insurers was even more significant due to higher inflationary trends for replacement costs of big-ticket items such as homes and cars. In addition to higher inflationary trends, there have also been several supply chain disruptions impacting the insurance marketplace. Supply and labor shortages lead to temporary increases in cost to settle claims but also lead to claims remaining open longer until a claim can be adjusted and closed. This delay in repairs and closing claims can also lead to higher costs.

Higher inflation and supply chain disruptions obviously lead to higher claims cost. Are there other impacts to premiums and reserves?

There are certainly other notable impacts. For example, supply chain disruptions have led to slower settlement patterns for claims because it takes longer to get the necessary parts or labor to make repairs. When claims stay open longer, they tend to cost more. It also stretches out the claim development process. Actuaries often make projections based on how claims have developed historically, but now must recognize that claims in the current environment may be settling slower than historical patterns.

Another important factor is that inflation impacts losses differently based on the layer of coverage being considered. While an entire segment of business may experience an 8% inflationary trend, the trend is not the same for each insured layer of loss. The impact of the inflationary trend on claims capped at $100,000 per occurrence will be less than the trend on claims capped at $500,000 due to the lower cap. Claims in the layer excess of $500,000 will experience an even higher trend. This isn't something that is always considered when we talk about inflation. That distinction, however, has a very real impact on the insurance market. For insureds, deductibles will result in fewer savings as a percentage of premium and there may be need for higher limits. For reinsurers covering excess of loss contracts, increases in premium may be significantly higher than the overall trend. While it is easy to recognize and understand how inflation leads to higher premiums and reserves, there are other impacts for insurers that also need to be considered.

Are inflation and supply chain disruptions impacting all carriers similarly?

We have seen significant differences by company. The entire industry is feeling the impact of these issues but there are differences by types of coverages and a company's geographic footprint. As noted previously, there are also material differences based on the limits profile of a company's insureds as well as their reinsurance agreements.