Weathering the storm:
Overcoming the challenges in the UK general insurance personal lines market
November 2022
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Executive summary

Insurers will need to take action now to navigate the economic, regulatory and ecosystem pressures they will face in 2023/4. Why act now? Expected inflation of 7.4% into 2023, expected motor and home combined ratios of 100-120, ongoing costs of conduct regulatory compliance of up to £120m a year, and expected real premium growth to be low to negative due to cost of living crisis (*).

The UK Personal Lines (PL) sector has been under significant pressure for several years. It continues to face unprecedented challenges, including through market and economic factors, heightened regulatory requirements, and changes to the overall PL ecosystem. Considered in aggregate, these challenges could create a perfect storm over the next 12 to 24 months, with PL insurers having to navigate increasingly complex and interconnected pressures in an already difficult environment.

In the short to medium term, regulatory pressures are also increasing - most notably the Consumer Duty (the Duty) will come into force in July 2023. Insurers should think about what a higher bar of consumer protection means for the division of responsibility across the distribution chain, and whether to take the Duty as an opportunity to differentiate themselves and increase retention rates. Finally, as regulatory expectations will undoubtedly evolve over time, a continuous improvement approach might be the most cost-efficient approach to Duty implementation.

We believe insurers need to explore one, or a combination, of four different strategies to manage the mounting pressures and maintain/return to profitability. These include focusing on growing through the storm, divestment of non-core business, engaging in extensive cost-cutting programmes, and, lastly, going niche – doing more of what you do best. In this report, we explore each of these strategies in turn.

Economic, regulatory and broad ecosystem pressures operate in a dynamic way, influencing each other. Firms need to consider the combined impact of all three, including the potential feedback loops between them.

(*) See Annex for details on estimations and assumptions
Overview
Overview
A tough place to be - three unprecedented challenges coming together all at once

The UK PL insurance industry has been at the sharp end of significant challenges over the past few years. Low profit margins coupled with tough competition and increasing expenses have meant that many players have struggled for a long time to maintain profitability. Recently, these pressures have been exacerbated by inflation, COVID-19 related supply chain issues, and increasing regulatory requirements and expectations.

In this report we elaborate on these challenges, and outline four response strategies - Divest, Grow, Cut costs, and Go niche. These could be deployed either in isolation or combination. For most insurers, the choice of strategy will be informed by where they want to position themselves in the insurance value chain - from a pure carrier to a fully-fledged insurer and distributor.

The pressures that PL insurers are facing can be categorised as market and economic, regulatory, and ecosystem challenges – in many cases, these also interact with each other and therefore represent an even greater risk when considered in aggregate. We conclude with some potential steps that PL insurers can take to navigate this complex environment successfully.
Strategies
Different strategies depending on value chain position

Where do you want to position yourself?

There is a wide spectrum of business models available within the PL insurance value chain, ranging from comprehensive service providers that both manufacture and distribute their products, to those with a more focused business model that specialise in providing capital to underwrite insurance risk (capacity provider) while relying on others for pricing, distribution, and claims. Insurers should establish where they want to position themselves across the value chain in the current environment and then explore deploying one, or a combination, of our four strategies to manage the pressures facing the PL sector.

**Focused business model:** Insurer focusing on providing capacity/underwriting risk

**Mixed business model:** Insurance manufacturer using affinity schemes/Delegated Authorities/Appointed Representatives, etc. for distribution

**Comprehensive business model:** Holistic insurance group focusing on product manufacturing and distribution through own and other brands

Regulatory scrutiny increases proportionately in line with the complexity of business model and range of services offered
Four strategies

Divest, grow, cut costs, or go niche

We have developed four possible strategies that PL insurers, depending on where they want to position themselves in the market, may want to deploy to address the economic, ecosystem, and regulatory pressures the sector is facing. Some insurers may want to focus on one strategy only, while others may prefer to apply a combination of more than one.

1. Withdraw from non-core business areas: Dispose of portfolios that are no longer aligned with your core strategy

2. Growing through the storm: Grow market share and business volumes organically through bold product innovation or inorganically through acquisition

3. Focus on cost reduction: Maximise value by keeping expenses at a minimum, focusing on cutting costs where possible and maintaining underwriting discipline

4. Back to the roots: Do more of what you do best
DIVEST: Withdraw from non-core business areas
Dispose of portfolios that are no longer aligned with your core strategy

Key features of strategy
• Identify and plan divestment of portfolios that are no longer aligned with core strategy or expertise
• Invest in capital, cash flow, and IP/brand analysis to back valuations ahead of sale
• For core portfolios, maintain market share and robust operations. Enhance product offering and consider new partnerships to boost existing products
• Consider product and operational simplification – moving to a pure manufacturer role and focusing on distribution through third parties

This strategy could be relevant for...
Firms operating at an underwriting loss with a combined ratio expected to be over 100 for the next two years, with between one and three business lines representing the biggest drag on profitability.

Opportunities
• Opportunity to focus on areas of strength and competitive advantage
• More attention on the most profitable product lines and associated customers
• Reduction of compliance risks and costs by focusing on fewer activities and portfolios
• Proceeds from sale could be used to invest in business or distribute as dividend

Risks
• Putting all eggs in one basket – loss of diversification with increased divestment
• Risks associated with sale of business – data loss/failed migrations/poor customer outcomes/reputational and regulatory risks
• Loss of customers of non-core products could lead to more switching in other lines of business
GROW: Growing through the storm
Grow market share and business volumes organically through bold product innovation or inorganically through acquisition

Key features of strategy
- Maintain and/or increase market share and business volumes
- Engage in product innovation and/or enhance existing product offering to attract broader customer base
- Identify acquisition targets to provide economies of scale or complementary product offerings
- Consider new partnerships, distribution methods, and M&A opportunities to build out business

This strategy could be relevant for...
Firms operating at an underwriting loss with a combined ratio expected to be over 100 for the next two years, requiring a bold strategy to resume profitability. Confidence in the business model is high.

N.B. Given how competitive the PL market in the UK is, a growth strategy is likely to be a higher risk than the other strategies presented in this paper.

Opportunities
- Improved market share and performance if successful
- Growth of product offerings and customer base
- Consolidation of market position if growing towards a more holistic approach including insurance distribution

Risks
- Conduct risks linked to product innovation including value for money/product governance rules
- Need to manage expenses and claims cost (capital impact)
- Operational, integration and regulatory risks linked to M&A
- Potential impact of growing into new lines of business that have not been tested – prudential and conduct risks
- Reduced dividend for shareholders
CUT COSTS: Focus on cost reduction
Maximise value by keeping expenses at a minimum, focusing on cutting costs where possible and maintaining underwriting discipline

Key features of strategy
• Maintain low expense base with full use of automation and insurtech tools
• Focus on improving internal operational efficiency while maintaining support standards for existing customers
• Manage claims inflation with detailed analysis of drivers per line of business (LoB) and controls
• Tight underwriting and pricing, maintaining underwriting discipline
• Explore new direct distribution channels, and assess continued use of affinity schemes

This strategy could be relevant for...
Firms operating at an underwriting loss just over 100 for the last two years, where cost reductions could be the solution to achieve profitability. Cutting costs is a reliable way of improving combined ratio.

Opportunities
• Opportunity to improve organisational efficiency and reduce redundant processes
• Potential to streamline operations and simplify product offering may lead to reduced regulatory risks and more efficient compliance processes
• More efficient operations might provide a springboard to resume growth after this period

Risks
• Cost reductions could translate into worse outcomes for customers - including increasing complaints and declined claims, poor customer service, etc.
• Potential high regulatory costs through 2023/2024 (e.g. the Consumer Duty scrutiny). Regulatory intervention could also derail strategy
• Potential risks in increased use of AI and automation with impact on customer outcomes
Key features of strategy

• Focus on profitable market and core portfolio
• Consider position in value chain and what activities you excel at: manufacturing and design/pricing/reserving/distributing
• Focus on the activities where you have a differentiator and consider outsourcing or partnering for other areas
• Reduce new business levels in less profitable LoBs
• Review distribution methods for core products, reconsider use of affinity schemes

This strategy could be relevant for...
Firms operating at an underwriting loss with a combined ratio expected to be over 100 for the next two years. Confidence in the core business model is high, and going back to the roots could mean a quick return to profitability.

Opportunities

• Could lead to growth of core product offerings and customer base with a simplified structure and cost base
• Opportunity for a more focused and targeted product offering, marketing, and distribution strategy
• Clarity in strategy and narrative to market and shareholders

Risks

• Loss of business diversification and customers
• Might lead to a need to cut costs/expense base if volumes decrease significantly
• Could lose out on profits in new and emerging classes of business
• Regulatory and operational risks arising from relying on third parties in the value chain
Pressures: Market and economic, regulatory and ecosystem
Highly competitive market

The UK PL market is sizeable with gross written premiums (GWP) in the motor and home PL insurance markets collectively exceeding £19 bn in 2020 - 53% of which was motor and 47% home insurance. (Bank of England)

There were hundreds of insurers operating across these markets in 2022, but the top ten firms underwrite 85% of motor business, with a similar concentration in the home insurance market. (Nimblefins)

Overall, there is tight competition to gain market share. Customers remain focused on price rather than value when it comes to choosing their insurance. As a result, there is a high rate of switching between different providers at renewal. Switching rates went down in the first half of 2022 following the ban on price walking but are expected to increase due to the cost-of-living crisis towards the end of 2022 and in 2023.

History of low profitability

These market features, coupled with rising expenses, have resulted in low profit margins in the sector, particularly in the motor insurance market.

Motor insurers have struggled to achieve profitability over the past 15 years, with the exception of 2020 when there was a lower claims frequency due to COVID-19 lockdowns.

In contrast, the home sector had a worsening of its combined ratio during the COVID-19 pandemic, in part due to a rise in accidental damage claims as people spent more time in their homes.
Market and economic pressures (2/2)
Inflation, cost-of-living crisis, and interest rates

Inflationary pressures: Rising inflationary pressures are exacerbating the problems that PL insurers face. Inflation is affecting home and motor insurers mainly through increased cost of claims because of the rising costs of labour, services, and goods necessary to repair or replace insured property and vehicles. There was a marked increase in the average value of claims paid in Q1 2022, reflecting the rising level of inflation. We expect the value of claims to continue increasing in 2022 and possibly into 2023. The recent depreciation of sterling is a significant cause of concern as it will directly affect the cost of auto parts, new cars and white goods, thereby pushing claims inflation to higher levels than initially expected. The PRA expressed its concern on inflation in a recent Dear Actuary letter to the general insurance market.

Cost-of-living crisis: The current cost-of-living crisis means there is a risk that customers will reduce or not renew insurance coverage to achieve cost savings. This in turn would result in more people being underinsured and a widening of the insurance protection gap. There is also a risk that insurance customers turn to products that offer less value for money. This could lead to customers feeling forced to make decisions that result in potential harm, which would spark conduct concerns, especially in the context of the Duty. The FCA is particularly concerned about the increase in the offers of ‘basic’ products and has already warned the industry in a Dear CEO letter on the impact of the cost of living in insurance.

Interest rates: PL insurers’ investment gains have long been squeezed due to historically low interest rates, leading to some insurers moving to more illiquid alternative investments in the search for yield. The interest rate hikes in response to rising inflation are therefore beneficial for insurers as they create a more profitable environment for their investments. But, geopolitical and economic uncertainty also creates market volatility, and the increased interest rates are unlikely to match the increased costs arising from inflationary pressures. Sterling’s depreciation and overall volatility is also causing issues for many insurers holding derivative/hedging positions with increased margin calls requiring them to use liquidity buffers.
The new Consumer Duty

Growing regulatory scrutiny

- The home and motor insurance markets have been subject to significant regulatory scrutiny over the past several years, in particular by the FCA. New regulatory requirements are in many cases extensive and require significant resources in order to comply, adding to insurers’ already high costs.

- The nature of the requirements also mean that PL firms need to be strategic in determining who they partner with, defining their target market, what products they offer, and what their overall place in the general insurance ecosystem should be going forward.

Citizens Advice (CA) report on discrimination by ethnicity

General insurance pricing practices (GIPP)

Appointed representatives (ARs)

Fair Treatment of Vulnerable Customers

Product governance enhanced rules and value assessments
The previous slide listed the major regulatory initiatives affecting PL insurance. The table below illustrates the substantial costs of compliance that insurers have incurred recently and on an on-going basis for some of these regulations. Insurers could face as much as roughly £120m in ongoing costs every year to comply with the requirements listed in the table, not to mention the high initial one-off costs to implement, e.g., the Duty.

<table>
<thead>
<tr>
<th>Conduct regulatory initiatives</th>
<th>One-off cost to industry</th>
<th>Ongoing annual cost to industry</th>
<th>One-off cost to insurers</th>
<th>Ongoing annual cost to insurers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer Duty</td>
<td>£688.6m - £2.4bn</td>
<td>£74.0m - £176.2m</td>
<td>£137.72m - £480m</td>
<td>£12.8m - £35.24m</td>
</tr>
<tr>
<td>ARs</td>
<td>£22.8m</td>
<td>£5.4m</td>
<td>£7.6m</td>
<td>£1.8m</td>
</tr>
<tr>
<td>GIPP</td>
<td>£361.4m</td>
<td>£83.9m</td>
<td>£361.4m</td>
<td>£83.9m</td>
</tr>
</tbody>
</table>

**Consumer Duty:** Cost to insurers is estimated based on the general insurance industry constituting approximately a fifth of the total number of FCA regulated firms and therefore bearing a fifth of the total costs outlined in the FCA’s cost/benefit analysis.

**ARs:** Cost to insurers is an estimation based on the insurance industry accounting for approximately a third of the total number of appointed reps [as per FCA consultation] and therefore bearing a third of the total costs outlined in the FCA’s cost/benefit analysis.

**GIPP:** Only applies to general insurance sector so total cost to sector and total cost to insurers are identical, as per the FCA’s cost/benefit analysis.
Consumer Duty (the Duty)

- The Duty was published in July 2022, setting higher expectations for the standard of care that firms give consumers.
- For many firms, including PL insurers, the work needed to implement the rules and evidence compliance will be material.
- The Duty is underpinned by three cross-cutting rules and four outcomes (see our blog here). The scope and depth of the Duty is very significant and affects activities across the product life cycle.
- Overall, the Duty will require firms to deploy a more proactive approach to potential customer harm. For example, avoiding foreseeable harm may require stress testing products under a variety of conditions, and producing a concrete action plan in response.
- The GIPP and value assessments have brought insurers closer to complying with the Duty (e.g. in relation to product design and value outcomes.) But, as the FCA reviews insurers’ value assessments, more work might be required and insurers will need the evidence required for attesting compliance with Outcomes 1 and 2.
- General insurers will need to demonstrate they have a consistent approach across the four outcomes to ensure they comply with the overall Duty.
- Customer understanding will be at the top of the agenda and testing communications is likely to require significant effort given the number of communications and the extensive use of jargon in the market.

GIPP

- The FCA’s GIPP rules in the home and motor insurance markets, including a ban on price walking, came into force 1 January 2022.
- There continues to be controversy around the implementation of these rules, with the FCA seeking evidence and records from firms following their attestations submitted in March 2022.
- The ban on price walking put into question many pricing practices and business models of PL insurers, in particular customer acquisition strategies of motor and home insurers.
- All players in the UK motor insurance distribution chain have been affected by the ban, including insurers, agents, brokers, affinity partners, ARs, and price comparison websites.
- While it is difficult to isolate the impact of the ban on price walking, it is estimated that switching rates at renewal have fallen significantly in the first half of 2022, with the full impact across the industry still to unfold over the coming months.
Product governance and discrimination by ethnicity

Product governance enhanced rules and value assessments

- The enhanced product oversight and governance rules intend to avoid insurance products being hollowed out for renewing customers.
- Most importantly, the rules require firms to carry out value assessments for each product on a regular basis.
- Firms had until the end of September 2022 to finish their first cycle of new product reviews including the value assessment.
- Firms offering products through complex distribution chains may find it challenging to get the right information from all parties in their distribution chain.
- Some firms may have to decide whether to continue with certain distribution relationships following assessments.
- The FCA is conducting a thematic review of insurers’ work on value assessments, after which we expect further scrutiny.
- An FCA report on value measures reporting in the general insurance market is imminent and will likely shed further light onto the meaning of value in this market.

CA report on discrimination by ethnicity

- In March, the CA issued a report on its research on potential insurance price discrimination of ethnic minorities.
- The research found that there is a “strong correlation between higher ethnic share of a population in a postcode area and higher premiums”.
- The FCA commented that it will continue to monitor pricing as part of its supervisory work - this could represent a new frontier for insurers when it comes to assessing fair pricing.
- The Duty is likely to put some of the fairness of current pricing practices to the test.
- The CA report findings are a possible example of areas where practices will need to be scrutinised.
- Firms should explore their use of AI and potential biases in their pricing techniques in relation to postcode and correlation with ethnicity.
Regulatory pressures (5/5)
Appointed representatives and fair treatment of vulnerable customers

**ARs**
- The FCA’s updated rules for principal firms making use of ARs introduce new responsibilities and requirements that will be effective from 8 December 2022.
- They signal a clear step-change in the intensity of the FCA’s supervision of principals.
- The new requirements cover three key areas:
  - design and implementation of a robust AR oversight framework;
  - annual gathering and reporting of AR data; and
  - evidencing compliance with the rules in an annual self-assessment report approved by senior management.
- Among other things, principals will need to produce an annual self-assessment of any risks and gaps in compliance with the new rules.
- Firms have up to 8 December 2023 to prepare and approve their first self-assessment.

**Fair treatment of vulnerable customers**
- Vulnerable customers should receive as good of outcomes and as fair of treatment as other customers. This requires firms to understand their target market/customer base and their specific needs.
- Firms are expected to provide an appropriate level of care for customers given the customer’s characteristics, including any vulnerabilities.
- Different levels of care will be required for customers with different characteristics.
- To achieve good outcomes for vulnerable customers, firms should:
  - work to identify the volume and types of vulnerabilities in the customer base;
  - ensure staff have the right skills and capability to recognise and respond to the needs of vulnerable customers; and
  - respond to customer needs throughout product design, flexible customer service provision, and communications.
Ecosystem pressures
Disruptions to business as usual

• The GI PL sector is a complex ecosystem with many players including insurers, brokers, managing agents, appointed representatives, and price comparison websites (PCWs). Over the past 15 years most new home and motor insurance has been increasingly sold through PCWs, where - as the name suggests - the focus of comparison has been price. This has led to a commoditisation of the market and its products.

• Recent regulatory changes, such as the ban on price walking, are starting to affect how much customers are willing to switch providers. As customers see less price differential at renewal, their incentive to switch is likely to fall, but in the current cost-of-living crisis even small price differences might still be enough to prompt switches.

• This is a dynamic market where the role of the different types of players is likely to continue to evolve. Importantly, under Duty rules, the regulator expects all firms in a distribution chain to be able to understand the value they and others provide to the customer. Some relationships will have to be scrutinised, in particular where a firm finds that certain parties are providing little value relative to their corresponding fee.
Actions for future success
• There are only small margins for error for PL insurers. Even seemingly minor decisions can have significant consequences due to the various challenges we have discussed in this report. There are, however, actions that firms can take to navigate these challenges as successfully as possible.

• Most importantly, the market and economic, regulatory, and ecosystem pressures should be analysed simultaneously, as they are interconnected and mutually reinforcing. For example, as firms navigate the difficult economic environment, they should consider whether any potential cost reductions lead to worse outcomes for customers, bearing in mind the Duty.

• Below, we summarise some overarching actions for insurers. On the next slide, we provide some specific actions in relation to the areas of pressure described in the previous section. Some of these are informed by our report The future of home and motor insurance – What do your UK customers want?

**Strategic**

1. **Value chain:** Assess your position and roles in the value chain, from capacity provider to manufacturer distributor, in light of current pressures. Insurers should ask themselves: where do I have an advantage compared to the competition, which activities add value to my business, where do I have scale and are my current partnerships working?

2. **Consider how the four strategies can** help navigate the storm: Grow, Divest, Cut costs, Go niche

3. **Risk appetite:** Evaluate overall risk appetite and underwriting capacity under different economic forecasts alongside capital optimisation. This should also inform the pricing strategy, speed of rate hardening, and target markets involved

4. **Innovation:** Consider partnerships with insurtech, data, and technology firms to help increase actuarial precision and to improve product flexibility and innovation to satisfy customer needs better

5. **Customer centric:** Consider using the Duty as a potential opportunity to drive a truly customer centric approach to differentiate your firm in the market
Summary of actions for future success (2/2)

Below we include some specific actions in relation to each of the areas of pressure described in our report.

<table>
<thead>
<tr>
<th>Market and economic</th>
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<tbody>
<tr>
<td>• Develop metrics to monitor both claims inflation movements and possible changes in renewals, including understanding granular claims inflation drivers</td>
</tr>
<tr>
<td>• Pricing and reserving teams to ensure updated inflation estimates are captured in key models, and where necessary ensure Line 2 involvement in approval of assumptions</td>
</tr>
<tr>
<td>• Review investment strategy and risk appetite</td>
</tr>
<tr>
<td>• Consider expanding product offerings that provide flexibility to customers whilst ensuring they continue to meet customers’ needs (e.g. expanding flexible motor insurance plans that are user-dependent, such as pay-per-mile plans, so that policyholders can reduce their costs while maintaining appropriate levels of coverage)</td>
</tr>
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<table>
<thead>
<tr>
<th>Regulatory</th>
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<tbody>
<tr>
<td>• Consider regulatory initiatives in the round to ensure consistent approach and identify opportunities to achieve synergies between different programmes, e.g., product governance, Consumer Duty, ARs and vulnerable customers</td>
</tr>
<tr>
<td>• Adopt a continuous improvement approach to compliance with the various requirements. We expect regulatory expectations to evolve in the first few years of implementation, an approach adaptable to changing expectations may help keep costs of ongoing compliance under control and avoid the need to redesign frameworks, policies, or procedures every few years or following regulatory scrutiny and challenge</td>
</tr>
<tr>
<td>• Pricing factors and optimisation techniques should be assessed carefully in light of the Consumer Duty and the CA report on ethnicity</td>
</tr>
<tr>
<td>• Define and agree on roles and responsibilities through the distribution chain with other parties to ensure they remain within conduct risk appetite</td>
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<tr>
<th>Ecosystem</th>
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<tbody>
<tr>
<td>• Determine how best to transition from an industry focused on products to an industry focused on meeting customers’ needs through a more flexible and versatile product and service offering – assess what roles to play for each product across the distribution chain and who to partner with</td>
</tr>
<tr>
<td>• Insurers to assess impact of lower switching rates and how to capture and retain business in the new environment</td>
</tr>
</tbody>
</table>
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Baseline assumptions (1/3)
Underlying assumptions underpinning each of our four strategies

Continued high levels of inflation, falling back to 7.4% in 2023 (OBR Outlook November 2022)

Rising interest rates, reaching up to 4% in 2023

Claims inflation remains at as much as 13% in Q1 2023, thereafter slowly reducing

Home and motor insurers will be loss-making with a Combined Ratio of between 100-120

Cost of compliance is increasing, with the new Consumer Duty estimated to cost the financial services industry as much as £2.4bn

Low to negative premium growth due to ongoing cost-of-living crisis

1 year time horizon – from Q4 2022 until Q4 2023
Baseline assumptions (2/3)

Case in point: our projections for the motor insurance industry indicate continued challenges ahead

Projected Combined Ratios of UK motor insurers

Source: Deloitte Analytics based on ABI data, AM Best data, IFOA Third Party Working Party data, CPI Indices, ASHE Care Cost Index and Bank of England CPI forecasts
Baseline assumptions (3/3)

Case in point: our projections for the motor insurance industry indicate continued challenges ahead

Motor claims inflation forecast

Source: Deloitte Analytics based on ABI data, AM Best data, IFoA Third Party Working Party data, CPI Indices, ASHE Care Cost Index and Bank of England CPI forecasts
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