

## COST OF INSURANCE

# Indexation and rate strength

We're currently seeing market conditions where customers are faced with a rising cost of insurance due to a combination of indexation and rate strengthening across the market.

Whilst both of these factors increase the cost of insurance for a customer, it's important to remember that they are applied for different reasons.

### Rate Strength

Insurers apply rate changes to reflect any changes in the cost of underwriting business from one year to the next.

These cost changes could be linked to any of the following:

- **Claims inflation** – this could be as a result of a change in frequency or severity of claims, or through the associated cost of settling claims, all of which could be driven by a number of influencing factors, including socioeconomic trends, legislative changes, industry segmentation or changes to coverage and wordings amongst others.
- **Reinsurance costs** – any changes in the cost of an insurer's reinsurance treaty will need to be factored into their rating.
- **Expense costs** – as with all trade sectors at the moment, insurers also suffer from rising costs of utilities and other business expenses due to the high levels of inflation we are witnessing.
- **Levies** – any changes to the amount an insurer must pay in levies will need to be factored into their rating.

The impact of rate strength also has a multiplicative effect impacting future year's earnings with the intention of offsetting the increase in claims costs that follow year on year.

### Indexation

It is important that customers have the correct level of insurance, and therefore the correct sums insured need to be declared at each renewal. One way of ensuring that sums insured are updated each year is through the application of indexation, which takes into account the change in the various costs associated with rebuilding or repairing their property, for example through changes to the cost of materials, labour, or to the fees charged by various professionals (e.g. surveyors and architects).

If the sums insured are too low then the customer will be underinsured and any claim will be subject to average, meaning they may not receive the amount they expected from their claim, which in the event of a total loss, could be catastrophic for their ability to continue to trade moving forwards.

In addition to ensuring the sums insured in relation to physical property are updated, it is also important to update any Business Interruption sums insured to reflect the trends that the insured expects to see over the course of their indemnity period, as well as reviewing the indemnity period to ensure it's adequate in the face of increased lead times for certain materials, and a shortage of labour in some sectors.

In conclusion, without applying indexation, a customer could be left in the position where they are underinsured and would suffer the effects of average in the event of a claim, thus potentially leaving them in a financially precarious state. Similarly, if an insurer fails to ensure that their pricing is adequate for the risks that they expose themselves to, their profitability may suffer which could lead to them withdrawing capacity from segments of the market, thus exacerbating the increase in rating currently being seen.

It is for these reasons that insurers are currently looking to increase their rating whilst also ensuring customers are adequately insured through increases in sums insured where necessary.



Please contact your local Allianz Commercial representative for further information.

For Intermediary Use

This document should only be used for intermediary reference only.

Allianz Insurance plc. Registered in England number 84638. Registered office: 57 Ladymead, Guildford, Surrey GU1 1DB, United Kingdom. Allianz Insurance plc is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Financial Services Register number 121849.

**ALLIANZ.CO.UK**