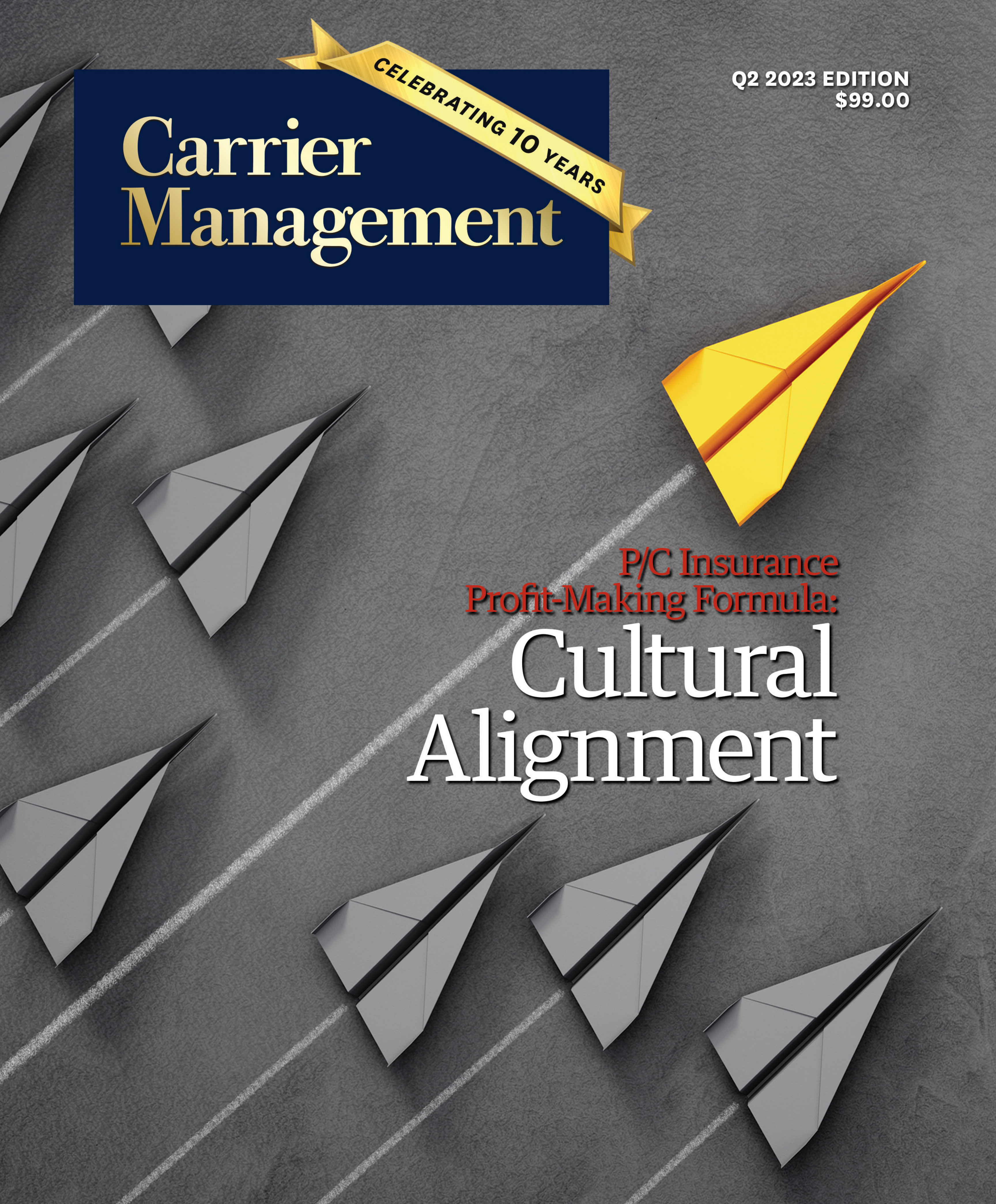
Q2 2023 EDITION
$99.00

Carrier Management

CELEBRATING 10 YEARS



P/C Insurance Profit-Making Formula: Cultural Alignment

IICF Inclusion in Insurance Global Conference

ESTABLISHED IN 2013
AS THE WOMEN IN INSURANCE
CONFERENCE SERIES

Register today!

IICF Inclusion in Insurance Global Conference

Explore inclusive leadership, personal growth and the business of insurance topics with colleagues & industry leaders.

Register at: https://inclusion.iicf.org

June 13–15, 2023, New York City | New York Hilton Midtown

Jean Chatzky
Founder & CEO of HerMoney.com, Chatzky is an award-winning journalist and broadcaster, a New York Times and Wall Street Journal best-selling author, and a fierce advocate for financial literacy. The Financial Ambassador for AARP, she was the Financial Editor for NBC Today for 25 years.

Emily Donahoe
Founder and Principal at WOMENSPEAK, Donahoe will discuss current research regarding women speaking publicly in organizations, and provide an introduction to tools for public communications best practice that both interrupt bias and build more inclusive cultures of speaking and listening.

Eric M. Bailey
The bestselling author of "The Cure for Stupidity: Using Brain Science to Explain Irrational Behavior" and leading expert on human relationships and communication. Eric has a diverse set of experiences that includes helping NFL All-Pro Larry Fitzgerald pet a rhinoceros, doing barrel rolls in an F-16, and chatting with LL Cool J on the campus of Harvard University.

Claudia Brind-Woody
IBM Managing Director in the UK and Ireland. Recipient of numerous awards, Claudia was named to the Financial Times Global LGBT Role Models Hall of Fame in 2016 after having been in the top 10 on their list for the three previous years. Brind-Woody is the Global Co-Chair for the LGBT Executive Taskforce at IBM.

Claire Burns
As Chief Marketing and Communications Officer at The Harford, Burns will provide expert insight on the customer experience through her discussion of: Bought not Sold – Attracting customers to the insurance offer (in an inclusive way). She also chairs the company's Sustainability Governance Committee.

Chris De Santis
An independent organizational behavior practitioner, speaker, podcast host of Cubicle Confidential, and author of "Why I Find You Irritating: Navigating Generational Friction at Work." He has developed a framework for understanding generational perspectives, explaining when it makes sense to talk about these differences and when it doesn't.

Proceeds benefit nonprofit and charitable organizations across the US and UK through the IICF Community Grants Program.

Thank you to our earliest 2023 Sponsors

Diamond Sponsors

USAA | AMWINS

Sponsors

CNA | EY Building a better working world | Markel

Mayer Brown | AXA | Chubb | FM Global | Liberty Mutual Insurance | Ryan Specialty | RT Ryan Turner Specialty | The Hartford | Travelers

AmRisc Group | Ascot | Nationwide is on your side | Newfront | Zurich | Berkshire Hathaway Specialty Insurance | Burns & Wilcox

Coverys | Crum & Forster | Everest | Gen Re | HUB | Intact Insurance specialty solutions | Marsh

Munich RE | NEIL | QBE | RLI Different Works | Starr Insurance Companies | Swiss Re | ACORD | BIG i Diversity Council

Congratulations (x9)

to Our Award-Winning Editorial Team

GOLD REGIONAL AWARD · GOLD REGIONAL AWARD · GOLD REGIONAL AWARD · SILVER REGIONAL AWARD · SILVER REGIONAL AWARD · SILVER REGIONAL AWARD · BRONZE REGIONAL AWARD · BRONZE NATIONAL AWARD · BRONZE NATIONAL AWARD

The Insurance Journal, Claims Journal, and Carrier Management editorial, audio/video, and design teams have once again won multiple awards from the American Society of Business Publication Editors. Congrats to our winners on another amazing year of accolades!

2023 ASBPE Award of Excellence Recipients

Andrea Wells
VP of Content

Ashley Waldrop
Assoc. Video Producer

Bobbie Dodge
VP of New Media

Elizabeth Blosfield
Deputy Editor

Guy Boccia
VP of Design

Jim Sams
Editor

Kim Tallon
Copy Editor

L.S. Howard
International Editor

Paul Osborne
Senior Consultant at Demotech

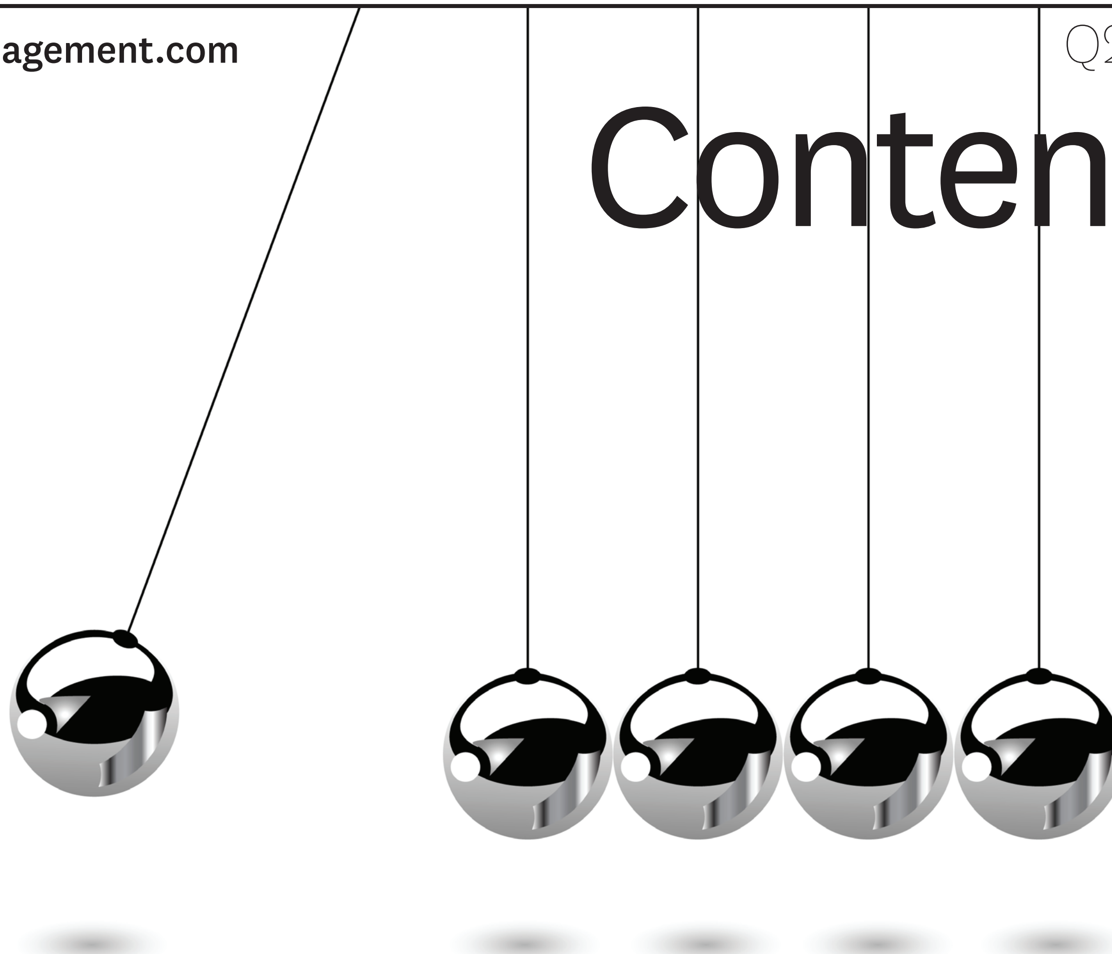
Stephanie Jones
Editor

Susanne Sclafane
Executive Editor

Will Rabb
Editor

INSURANCE JOURNAL · CLAIMS JOURNAL · Carrier Management

Contents



P/C Insurance Profit Making

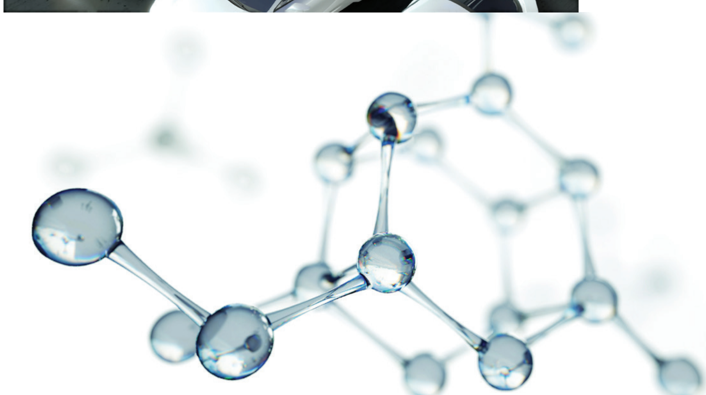
28 **Repricing Is Not Reunderwriting: Why Hard Market Gains Aren't Showing Up on Bottom Lines**
Although rates are hard, combined ratios and returns on required capital are still underwhelming. Here, Tony Buckle and John Carolin, partners at UWX, and Mehmet Ogut, director, Deloitte Consulting, examine the disconnect.
By Tony Buckle, Partner and Co-Founder, UWX, John Carolin, Partner and Co-Founder, UWX, Mehmet Ogut, Director, Deloitte Consulting AG

30 **How 1,000 Owners Keep RLI's Underwriting Profit Record Going**
A key ingredient in RLI's recipe for ongoing success is ownership culture, according to COO Jen Klobnak. She discussed RLI's formula for achieving an underwriting profit for 27 consecutive years, and also provided some insights on what it takes to lead the operations of a property/casualty insurer.
Jen Klobnak, COO, RLI Corp. interviewed

36 **Steadfast and Strategy-Focused: CEO Recounts Lessons Learned From a Business Transformation**
Andreas Kleiner, the CEO of American Modern, looks back at the rough terrain his company endured in climbing the steep mountain of an eight-year business transformation, including losing business and frustrating agents.
Andreas Kleiner, CEO, American Modern interviewed

42 **Serious Change Underway at SiriusPoint: Strategy in Place to Shore Up Underwriting, Control Investment Volatility**
SiriusPoint, the Bermuda-based insurer and reinsurance company, is emerging from a period of underwriting and investment volatility. CEO Scott Egan acknowledges that the company's performance hasn't been good enough and is driving a strategy to put it on the right flight path.
Scott Egan, CEO, SiriusPoint interviewed

Features Q2 2023



Executive Viewpoint

8 **When It Comes to Protection, It's Time to Go on Offense**
By Mark Berven, President and Chief Operating Officer, Nationwide Property & Casualty

19 **Taking the Next Step on Cyber War Exclusions**
By Stefan Golling, Member of the Board of Management, Munich Re

64 **Is Insurance the Hero AI Needs?**
By Anthony Habayeb, Co-Founder and Chief Executive Officer, Monitaur

Risks and Opportunities

9 **Electric Vehicles and the New Frontier They Represent for Auto Insurers**
By Carol A. Williams, Chief Executive Officer, Strategic Decision Solutions

46 **Endocrine Disruption Litigation Has Arrived**
By Adam Grossman, Senior Scientist and Vice President of Modeling, Praedicat, and David Loughran, Senior Vice President of Product, Praedicat

Leadership and Management

12 **The Role of the Fractional Executive in the Insurance Industry**

16 **7 Tips for Developing Future Leaders**

Correction

In an article titled "InsurTech Tackles Underserved Homeowners Market: Uninformed Buyers" on p. 50 of the first-quarter magazine, the co-founder of the company profiled, Informed Group Inc., was incorrectly identified as Jim Parker. The correct name of the co-founder is Jim Farmer.

Features Q2 2023

Finance and Operations

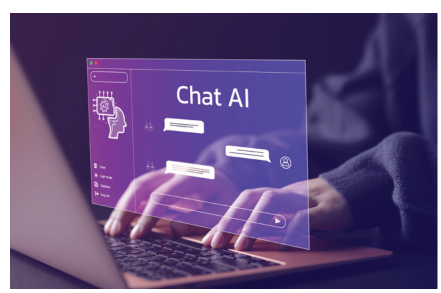
21 **U.S. Personal Auto Results Headed the Wrong Way. Is a U-Turn Possible?**
By David Blades, Associate Director, Industry Research and Analytics, AM Best

24 **Social Inflation Hits Insurers, Not Economies**
By William Wilt, President, Assured Research LLC, and Alan Zimmermann, Managing Director, Assured Research LLC

48 **Eight Straight Years of Workers Comp Profits: What Could Go Wrong**
By James B. Auden, Managing Director of Insurance, Fitch Ratings

Technology and Automation

51 **Is AI Risk Insurance the Next Cyber for Insurers?**
By Dr. Anand S. Rao, Global AI Lead, PwC, and Marie Carr, Principal of Global Growth Strategy, Insurance and Financial Services, PwC



55 **Eyes Wide Open: A ChatGPT Users' Guide for Insurance Professionals**

58 **ChatGPT and Beyond: How Insurers Are Using AI**

61 **Navigating the AI Frontier: An Imperative for P/C Insurers Amid Uncharted Territory**
By Andrew Schwartz, Analyst, Celent

Conference Report

66 **Chubb's Greenberg: Start Questioning the Societal Benefits of Litigation Funding**

Carrier Management

VOLUME 10, NUMBER 2 Q2 2023

www.CarrierManagement.com
Critical Information for P/C Insurance Company Executives & Directors

Publisher
Mark Wells | mwells@wellsmedia.com

CARRIER MANAGEMENT EDITORIAL
Executive Editor
Susanne Sclafane | ssclafane@carriermanagement.com
Vice President of Content
Andrea Wells | awells@wellsmedia.com
Deputy Editor
Elizabeth Blosfield |eblosfield@carriermanagement.com
International Editor
L.S. Howard | lhoward@carriermanagement.com
Assistant Editor
Kimberly Tallon | ktallon@carriermanagement.com

CARRIER MANAGEMENT DESIGN
Vice President of Design & Production
Guy Boccia | gboccia@wellsmedia.com
Graphic Designer
Melissa Reese | mreese@wellsmedia.com

CARRIER MANAGEMENT ADVERTISING/MARKETING
Chief Marketing Officer
Julie Tinney (800) 897-9965 x148 | jtinney@wellsmedia.com
Director of Marketing Communications
Derence Walk | dwalk@wellsmedia.com
Chief Relationship Officer
Gayle Wells | gwells@wellsmedia.com
Advertising Coordinator
Erin Burns (619) 584-1100 x120 | eburns@wellsmedia.com

CARRIERMANAGEMENT.COM WEB
Web Developers
Josh Whitlow | jwhitlow@wellsmedia.com
Jeff Cardrant | jcardrant@wellsmedia.com
Terrance Woest | twoest@wellsmedia.com
Ryan Kleshinski | rkleshinski@wellsmedia.com
Jason Chipp | jchipp@wellsmedia.com
Vice President-New Media
Bobbie Dodge | bdodge@wellsmedia.com

WELLS MEDIA GROUP
Wells Media Group includes *Carrier Management* print and web publications, *Insurance Journal* print and web publications, *Claims Journal* web publication, the MyNewMarkets.com online directory, and the IJ Academy of Insurance.

Executive Chairman
Mark Wells | mwells@wellsmedia.com
Chief Executive Officer
Joshua Carlson | jcarlson@wellsmedia.com
Chief Financial Officer
Mark Wooster | mwooster@wellsmedia.com

SUBSCRIPTIONS:
Circulation Manager
Elizabeth Duffy at: eduffy@wellsmedia.com

Carrier Management, which provides Critical Information for P/C Insurance Company Executives and Directors, is published six times per year by Wells Media Group Inc., 3570 Camino del Rio North, Suite 100, San Diego, CA 92108-1747. Phone: 1.800.897.9965. Standard Postage Paid at San Diego, CA and at additional mailing offices.

POSTMASTER: Send change of address form to Carrier Management, Circulation Department, 3570 Camino del Rio North, Suite 100, San Diego, CA 92108-1747.
ARTICLE REPRINTS: For reprints of articles in this issue, contact us at (800) 897-9965 x125 or reprints@carriermanagement.com for info.

Alignment = Profit (or Problem)

As we brainstormed content for this edition, with some features about profit-making engines of P/C insurers and others about the uses of AI, I didn't sense a theme would emerge tying two seemingly disparate topics together. Then the word "alignment" kept popping up—aligning values of people or machines in some chosen way to achieve desired outcomes.

The idea is especially prominent in articles about one of the industry's most profitable carriers, RLI, which has recorded 27 straight years of underwriting profit. The secret sauce? Benefits like a performance-based ESOP and long-term incentive bonuses that keep associates focused on combined ratio and ROE goals in hard and soft markets—and also aligned to achieve broad initiatives tracked on a strategy scorecard, according to COO Jen Klobnak.

At American Modern, CEO Andreas Kleiner said he's used a strategy scorecard many times, most recently to lead the personal lines specialty carrier through a multiyear business transformation. "It's a perfect tool to track your execution [and] to communicate your strategy—and make sure that you get your whole organization aligned to your strategy," he said, referring specifically to the Balanced Scorecard developed Drs. Robert S. Kaplan and David P. Norton.

The transformation put American Modern's 2022 combined ratio more than 8 points below the market, he reported. Separately, Bermuda specialty insurer and reinsurer SiriusPoint reported its first quarterly profit since mid-2021 during this year's first quarter. A turnaround in the works has a cultural alignment at its core, according to CEO Scott Egan. "There's more that we can do to work as one team globally, with one set of values, one approach and consistency," he said.

This all made perfect sense to me when I read the articles about carrier profit-making strategies. But the term AI alignment in our technology articles left me with more questions than answers. ChatGPT's dismal performance on a math problem, its willingness to generate code to perpetuate gender and racial biases, and its potential to be duped into providing a road map for criminal activity were three examples of "misaligned AI responses" presented during a recent webinar. But what exactly is AI alignment?

It's a complicated topic, but definitions from Wikipedia, ChatGPT and scholarly papers coalesce around something like this: "AI alignment refers to the field of research focused on ensuring that AI systems are developed and deployed in a way that aligns with human values and goals." (Source: From Risk to Reward: The Role of AI Alignment in Shaping a Positive Future (su.org))

Some articles describe the alignment problem with reference to an example of an AI system designed to maximize the production of paper clips. Often attributed to Oxford Philosopher Nick Bostrom, the idea here is that the machine, lacking human values for the world's resources or human life, will destroy the world in its eternal quest to make paper clips.

While most readers will agree that human life is more precious than a paper clip, do we all agree on the same human values? Admittedly, I am simplifying a complex thought experiment about the superpowers of AI, but I can't help wondering: If the goal of AI alignment is to align AI decisions with human values, who will decide what those human values are?

In an interview on Fox News in April, Elon Musk announced plans to create TruthGPT to compete with OpenAI's ChatGPT and Google's Bard. Musk said his tool will be a "maximum truth-seeking AI that tries to understand the nature of the universe." He added, "This might be the best path to safety. [An] AI that cares about understanding the universe is unlikely to annihilate humans because we are an interesting part of the universe." In short, TruthGPT's values will be aligned with all humans, not paper clip makers.

OpenAI aims "to make artificial general intelligence aligned with human values and to follow human intent," according to a blog post. Defining AGI as "highly autonomous systems that outperform humans at most economically valuable work," Open AI's stated mission is to ensure that AGI "benefits all humanity."

Setting aside myriad questions about AGI, let's focus on the "all humanity" promises. Before revealing his vision of a truth-seeking AI, Musk explained, "I'm worried about the fact that [ChatGPT] is being trained to be politically correct, which is simply another way of saying untruthful things."

Is Musk's truth the one we all believe? Is there any person or group well-suited to set the values with which emerging AI tools should be aligned?

The concept of aligning values within a P/C insurance company for profit goals seems easy by comparison.

Send your feedback to Susanne Sclafane at ssclafane@carriermanagement.com

When It Comes to Protection, **It's Time to Go on Offense**

By Mark Berven

During my time playing wide receiver at the University of Northern Colorado, I learned firsthand there are a lot of advantages to being on offense.

Being on offense is proactive. It means you know where the ball is going before the play begins, which typically gives you the advantage over the defense.

Mark Berven is President and Chief Operating Officer of Nationwide Property & Casualty.

But when it comes to protection, the insurance industry traditionally has spent a lot of time playing defense. Being on defense is generally reactive.

As we reimagine the future of protection, carriers and agents should embrace the idea of going on offense to help customers and clients prevent a loss before it happens. Here are three key plays that carriers and agents can have in their playbook to be proactive for their customers:

The forward pass:
Anticipate customer needs

Customers are facing a prolonged period of uncertainty. From increased weather risks to murky financial futures, clients don't know what tomorrow will bring and how to protect themselves from perils they haven't even thought of yet.

Agents can help ease these fears by working with like-minded carriers that offer technology and customer-centric solutions to anticipate customers' future needs and mitigate risk.

Find the edge:
Make customer education a priority

As important as it is to anticipate a client's needs, it's just as important to let them know why they should take proactive steps to prevent a loss before it happens. Losses don't just take a financial toll, resulting in lost business and rising insurance premiums. They also take an emotional toll. A loss disrupts a person's day-to-day routine, causing undue stress and strain on all involved.

Sometimes, one or two small actions can prevent a loss and all the headaches associated with it.

Carriers should provide tools and resources that empower agents to educate customers about preventative measures within their control and encourage them to take action. And agents should partner with those carriers.

The ground game: Advocate for change

They may not realize it, but an agent's voice carries a lot of weight. As trusted community members and counselors, agents are representatives of their clients' interests and carry a great deal of influence with political leaders and policymakers—when they speak up.

Now more than ever, agents must take a more hands-on role in the change that will protect their customers and be vocal proponents for measures like enhanced building standards (such as Institute for Business and Home Safety Fortified) and distracted driving laws—actions that have been proven to save property and lives.

Into the endzone

Shifting to an offense-first mindset won't happen overnight, and it will take consistent effort on the part of carriers, agents and other industry partners. By working together, we can reimagine the future of protection and help customers take a greater role in mitigating risks for themselves and their businesses.

Our customers are counting on us. Are you ready to get in the game? CM

Electric Vehicles and the New Frontier They Represent for Auto Insurers

By Carol A. Williams

Electric vehicles (EVs) and internal combustion engines (ICEs) could not be more different in some respects, but there's one thing they have in common: They both represent a transformational shift in how people and goods move from place to place.

With EVs accounting for approximately 225,000 of new auto sales in the U.S. in 2018 and more than doubling to 488,000 by 2021, the share of new EV sales in the U.S. is expected to grow to over 2.5 million cars by the end of 2027, according to research by AutoPacific.

While this growth is impressive, it pales in comparison to other countries in the world. Research from Australian strategic analytics firm Finity shows that EV sales in Norway grew from 3 percent (of total sales) in 2012 to 83 percent in 2021. In fact, an International Energy Agency report released in April 2023 states that worldwide sales of EV in 2022 surpassed 10 million!

A variety of factors connected with climate change are coalescing to drive (no pun intended!) this tremendous growth in EV adoption. One reason is plain old consumer demand, which surveys indicate is supported by societal concerns about the state of the climate, cost savings and sentiment around EVs being the wave of the future. More significant are the various incentives available to make the switch.

The U.S. Inflation Reduction Act passed in 2022 provides buyers with up to a $7,500 tax credit for the purchase of a new EV and up to $4,000 for the purchase of a used one. Also at the U.S. federal level, the Biden-Harris administration has set a goal to get 500,000 public charging stations online by 2030. If greenhouse gas emission rules from the EPA are put into effect, two-thirds of all new light-duty vehicle sales will need to be EVs by 2032.

Beyond the U.S. national activities, different state-level incentives and mandates are a catalyst for accelerating EV adoption, as well, with California's ban on sales of new gas-powered cars after 2035 being the most aggressive.

Efforts like these are part of an overall push to reduce greenhouse gas emissions by 50-52 percent by 2030, with the eventual goal being to reach "net-zero" emissions by 2050.

Government incentives and mandates are just one piece driving the growth in EVs. International accounting standards and institutional investor expectations in the form of ESG ratings will motivate publicly-traded companies to disclose decarbonization efforts, especially if they wish to do business in the European Union, explains Rade Musulin of Finity.

Similar to how the advent of the internal combustion engine over a century ago presented insurers with unique challenges, so too is the ever-growing adoption of electric vehicles doing the same in our current era.

With this tremendous growth across the globe over the last few years, insurers in countries with high EV adoption, like China and Norway, have taken steps to adjust products and operations accordingly. Why? Insurance for EVs is a completely different ball of wax than insurance for traditional ICEs.

Adrian Watson, head of engineering at Thatcham Research (a UK insurer-funded research center), explains: "Nowhere is the difference between EV and internal combustion engines more clearly underlined than in the insurance claim chain."

Specialty repair networks, coverages, pricing models and underwriting strategies are some examples of what insurers need to adopt. Considering the significant lead time to make changes like this, the sooner the better.

Thinking about this from a risk management perspective, there are four types of risks (and opportunities!) being presented by this continued upward trend for EV sales and adoption around the world.

1. Strategic Risk

As EVs grow into a larger share of the auto market, a few auto insurance companies will eventually become really

continued on next page

Carol A. Williams is the Chief Executive Officer of Strategic Decision Solutions, a consultancy that has helped numerous P/C insurers address unique challenges to their success. Williams started her career in insurance and risk management with the Florida Office of Insurance Regulation nearly 20 years ago, more recently holding various ERM leadership positions for Citizens Property Insurance Corporation. At Strategic Decision Solutions, she focuses on helping carriers move beyond putting out fires to achieving strategic goals. Reach her at Carol@strategicdecisionsolutions.com.

continued from page 9

good at offering effective (and maybe affordable) coverage for these cars. Some of these proactive insurers, according to the same EV analysis by Finity, are pursuing different pricing strategies to do two things: gain market share and gain insight into how a functioning claims process can take root.

(Editor's Note: The Finity research looks at insurer pricing strategies in the early stages of the Australian market and for the more mature Norwegian market.)

For now, traditional pricing algorithms are sufficient, but eventually, insurers will need to develop ones specific to EVs considering both their organic growth and the differing needs over an ICE vehicle. Strategic partnerships with specialty repair shops will also need to be developed to ensure timely claims processing.

If an insurer is doing business in a state like California where adoption is higher, the company can carve out a niche as a specialty carrier. Marketing can be tailored to attract the appropriate customer persona to build another revenue stream.

Electric Vehicle Quick Stats

- 2018 Actual U.S. Sales: 225,000 (AutoPacific)
- 2027 Forecast U.S. Sales: 2.5 million (AutoPacific)
- 2022 Actual Global Sales: 10 million (IEA)
- 2023 Forecast Global Sales: 14 million (IEA)
- Overall Market Share Growth: from 4% in 2020 to 14% in 2022 (IEA)
- Concentrated Markets: China, Europe, U.S. (IEA)
- More than 60% of EV on the road are in China.

Sources:
"U.S. EV Sales Forecasted to Reach Around 700,000 Amidst Increasing Consumer Demand," AutoPacific; "Demand for electric cars is booming, with sales expected to leap 35% this year after a record-breaking 2022," IEA

2. Operational Risk

Auto insurers have spent considerable time and energy to develop networks for mechanical and body repairs of damaged ICEs. The same will need to be done for EVs as they become more common on the road. However, it won't be possible to copy over what's been done in the past for a variety of reasons, including:

- From a mechanical standpoint, EVs are completely different and require specialized knowledge to repair.
- Damaged or outdated batteries require special disposal.
- EVs are made with lighter-weight materials.
- EVs have different design configurations since collision energy has to dissipate differently. Therefore, as is the case with the car's propulsion, specialized labor will be needed to repair damage to the vehicle body.
- EVs also require original equipment manufacturer parts, or OEM, so supply chains will need to be robust enough to handle this effectively. Traditional gas-powered vehicles have a bevy of after-market options that make it cheaper and easier to replace damaged parts.

A study published by CCC Intelligent Solutions reports that with repair shops still making investments in people, training and equipment to be able to work on EVs, repairs can take longer until technicians get accustomed to the new routines.

The Finity report asserts: "For insurers, understanding the implications for EV repairs across the range of parts and labor influences at play is particularly critical for future claims management and pricing."

Another operational consideration at play is the supply chain for the repair shops. Insurers typically perform due diligence on the repair shops before adding them to their network. How well are insurers looking at the supply chain for the repair shops? Do the insurers have knowledge about the due diligence performed by the repair shop? Does the repair shop have a diversified supply chain for specialty parts? How often do the suppliers not meet the service-level agreements set forth in the contracts with the repair shops?

Answers to these questions can operationally impact the insurer focusing on providing quality service to its policyholder, which includes *timely* adjusting of the claim, *timely and quality* repair of the damaged property, and *promptly* closing the claim.

What do the operational metrics around average number of days to close a claim look like when comparing an ICE vs. an EV?

Without a robust repair network and supportive supply chain, the claims process will take much longer. While it is a challenge to develop this new way of thinking, it will become easier over time as EV adoption rises and more claims data becomes available to inform good decision-making, explains the same Finity report.

3. Financial

Day-to-day maintenance costs for EV drivers certainly seem to be less expensive than ICEs since there are fewer moving parts and fluids to be refilled or replaced. An analysis by Consumer Reports shows that EV owners can expect to save $4,600 in maintenance and repair costs. For major collision repairs, however, the story is much different.

The CCC Intelligent Solutions study shows that for a front-end impact, the cost for repairing a non-luxury EV is around 27 percent higher than it is for a traditional counterpart. The price difference is even more staggering for high-end luxury SUVs at over 53 percent.

The study also shows that EVs with battery damage will be deemed a total loss around 50 percent of the time.

Other factors that impact the overall financial cost of insuring EVs include their heavier weight, faster acceleration and whether the car is located in a low-lying area (since they are especially vulnerable to water damage). Third-party liability concerns exist if a homeowner has a guest who injures themselves while charging their vehicle at home. Cue the medical coverage on your homeowners policy. Also, the electrical requirements for charging at home are far beyond typical household appliances, which puts the home at an increased risk for fires. Are carriers confirming that properly installed charging equipment is being used for that EV?

Insurers need to evaluate their book of business and determine concentration risk related to EVs and geographic location. If a bad rain storm (not assigned a PCS) hits one low-lying area that is heavily populated with EVs, the insurer may have an unexpectedly high retention and a resulting loss of surplus.

While EVs are safer in some respects, they just cost more to repair, especially when you combine frequency, severity and the specialty nature of these cars' components. Reserves for these claims will be open longer. And because the cost to repair EVs is so much higher, the actual reserve calculations will be higher—negatively impacting the balance sheet and the loss ratio of the insurer.

In a way, this trend of higher repair costs for EVs is similar to how increased repair costs are driving up the severity of claims for homeowners insurance companies. With storms becoming seemingly more intense across the U.S. and around the world, homeowners insurers are acutely aware of the increased severity of claims.

Insurers writing in states (or countries) where regulators require prior approval on rates and forms will be delayed in implementing necessary changes. Prior approval, as executives know all too well, is not the easiest process in some states.

4. Reputation

Operational risk, financial risk and strategic risk coalesce in the insurer's reputation. Statistics on this area of risk are scarce, so it is difficult to quantify reputational impacts. However, here are two sources of reputation risk we can cite.

If the claims process is clunky and long and drawn out, the company's reputation will suffer. This longer repair time, whether due to new repair routines, new equipment, newly trained personnel or supply chain issues, is a negative reflection on the insurer, not just the repair shop.

Another source is social perception. If there is increased societal concern about climate change and EVs are seen as one way to address it, any insurer that ignores the trend will potentially be seen as being socially irresponsible.

In the end, if the trend of EV adoption continues as forecasted, now is the time for insurers to understand what it means for the industry and their future place in it.

As EV adoption ramps up in an effort to cut greenhouse gas emissions, auto insurers will become more aware of consumer needs and costs of servicing EV claims. In the years ahead, those who are prepared will gain a significant competitive advantage in a burgeoning market.

Will you be ready? Now is the time to make the choice and start preparing. CM

The Role of the Fractional Executive in the Insurance Industry

Executive Summary: Fractional executives offer on-demand expertise to help companies fill leadership gaps or execute new initiatives. Carrier Management spoke to leaders from two fractional executive search firms to find out how they can benefit the insurance industry.

By Kimberly Tallon

In a relatively short time, the gig economy has revolutionized the way we live and work. Ridesharing apps like Uber and Lyft changed the way we get around. Delivery services like DoorDash, GrubHub and Instacart changed how we get our food, alcohol, medicine and more. With the rise of the fractional executive, the gig economy has even made its way to the C-suite.

Fractional executives contract with a business on a part-time or project basis. They are often brought in to help fill leadership gaps following an unexpected exit or to leverage external experience during a growth phase, such as the launch of a new product, expansion into a new market or distribution channel, or implementation of an internal initiative.

Hiring a fractional executive isn't the same as bringing in a consultant. A fractional executive actually oversees a team and has real decision-making authority.

"Big picture, a consultant is strategic," said Ira Ziff, founder and president of executive search firm Precision Research Group. However, "a fractional executive is both strategic and operational/tactical. So, one *tells* you what to do, and the other one *does* it. It's a remarkable difference."

Choosing a fractional executive gives companies on-demand access to high-level talent and expertise for a fraction of the cost of a full-time executive. There's no worrying about human resources expenses such as severance, benefits, insurance, hiring bonuses, long-term contracts, holidays.

"You're not adding to permanent overhead," said Robert Jordan, co-founder and CEO of InterimExecs, an executive search firm. "You're using a resource that either proves itself out immediately or you don't have to continue. So, it's very easy to get into for a company and easy to get out of."

"Permanent hires don't always work," Jordan added, noting that getting it wrong and having to replace a C-suite executive can be costly and damaging to the company's reputation. "This is a much faster, lower-risk way of gaining vitally needed talent."

"If you're hiring someone, it's 40 hours a week," Ziff said. "It's a base, it's a bonus. It's cut and dry. If they lose their oomph or they lose their usefulness, you still have them on staff. Whereas, if you have a fractional person and you do it right, and you're aligning it to the mission and to the outcome, you hit that outcome and it's done."

When a Fractional Exec Would Make Sense

Popular roles for fractional executives include chief financial officer or chief marketing officer, but it could be any C-suite role, Ziff said, also mentioning chief technology officer and human resources.

"You could think of virtually any role where the company has some challenge, something that they need to figure out, some hurdle they have to get over—whether it's human resources or marketing or technology," he said. "Every unit has some challenge that they need to apply human capital to, so I can't imagine limiting it to any one function."

Diversity, equity and inclusion initiatives would be a "perfect application," Ziff said, "because that's a program that could be very defined that doesn't necessarily need a full-time person. It could be bolted on, if you will, to some other department or some other person's workflow."

While startups and InsurTechs seem more likely to benefit from fractional executives, they can also be a useful tool for more established companies, Ziff said. "If they had an initiative where they really needed up-to-date knowledge, wisdom, expertise to hit the ground running, it's a remarkable opportunity to introduce an executive on a fractional basis just to do that initiative," he said. "The whole idea is to actualize some business objective in the most cost-effective way."

Jordan said InterimExecs only targets the middle market. "We don't go down to startup level because generally most startups cannot afford the level of quality and talent that is here," he said. On the other hand, a Fortune 500 company is "so deep in management layers and HR capability for succession planning and sheer money that they're not likely to be great users of these services." He noted that most fractional executives "would be bored off their ass" if they got a call from a company like IBM, since it's hard to have an impact at that sort of organization. "You're just kind of like a babysitter; you're warming a seat."

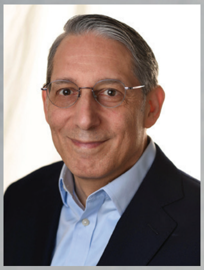
Finding the Right Match

Ziff said the hardest part of the matchmaking process is helping the company define what it's looking for in a fractional executive.

"If you don't know what you want, you're not going to get it," he said. "So, you have to start with the end [result] in mind and then work backward. The problem is that hiring managers look for a stick figure profile versus a high-definition picture."

continued on next page

"Big picture, a consultant is strategic, [while] a fractional executive is both strategic and operational/tactical. So, one tells you what to do, and the other one does it. It's a remarkable difference."



Ira Ziff,
Precision Research Group

"You're not adding to permanent overhead. You're using a resource that either proves itself out immediately or you don't have to continue. So, it's very easy to get into for a company and easy to get out of."

Robert Jordan,
InterimExecs

continued from page 13

Ziff said he and his partner developed a question that really helps flesh out what a company is looking for: "At the end of the project, in what three ways would [the executive] exceed your expectations, both quantitatively and qualitatively?"

"The key is to be able to work with the client to come to some realization of what success really looks like," he said. "Very often, they just tell you operational things, functional things like, 'We need to launch this program.' Well, if you launch the program, how will it enrich the fortunes of the company, and what's the impact that we need? Because we can implement it and do it poorly and have no response."

Once Ziff knows what the client is really looking for, "then I have to find the fractional executive who can deliver on that promise."

He said he has a proprietary database of almost 65,000 people, and it's "diced and sliced in every possible way" to make matching easier. "I can find the unfindable."

Jordan considers his team of executives "rock stars."

He said InterimExecs has "developed a concept called RED Team—RED stands for Rapid Executive Deployment—and this was based on about 7,000 executives showing up on our proverbial doorstep." They used the data gathered from those executives to develop a process for ranking, scoring and screening candidates. "We developed a system to identify the top 1-2 percent of executives in each role—CEO, CFO, CIO."

"We have talent that's so ridiculously good that when companies and boards and owners show up, it's so kind of overwhelmingly obvious that they should try this executive out," Jordan said.

It's About the Relationship

Jordan emphasized the importance of attitude and the chemistry between executive and organization. "Skills are incredibly important; they have to have great track records," he said, but "attitude trumps skill. We're not going to work with jerks...We're not going to work with prima

donnas—and clients, those boards and owners, they wouldn't put up with them either."

He acknowledged that sometimes the relationship between executive and company just doesn't work out. "We would love to bat a thousand and for the chemistry and the fit never to go wrong, but we're dealing with human beings. So, we try to be very fast in our ability to respond, but also cautious and conservative. We would never push an executive into something. We would never push a company into something. We want them feeling very confident that it's going to work out perfectly."

Jordan said one of the mantras at InterimExecs is "perfect or not at all." He said they don't make a match if there are any doubts about the fit between company and executive. But that doesn't mean every match is 100 percent successful. He recalled: "We had one situation with a female CEO and a male owner of a company, and all we needed to hear from her was that she was not comfortable. And so, we terminated the project the same day. I didn't need to hear any more than that."

Ziff noted: "You're dealing with a human product. The truth is you never know what the outcomes are going to be and what personal problems people bring to any situation. So, I think by and large, if you set it up to do it right—in other words, if the hiring company person really understands what they're looking for, and if you can really find that square peg to go into a square hole—then there's a very high statistical chance that this is going to be a great relationship."

Ziff said that, in his experience, any problems have been more likely to come from the company side. For InsurTechs and other startups, for example, "their funding can fade away or they need to pivot, and they're not going to go after that [product line or market] anymore."

"There's a lot of tension when you're dealing with startups," he said, "and that rattles all employee relationships." They may decide, "'We're not doing life [insurance] anymore. We're doing P/C.' So, there's a lot of pivoting, and that upsets the human capital equation."

Crafting the Contract

Ziff said his company works as an intermediary to craft a contract that makes sense for both sides. "So, if that's done right—if you have your high-definition outcome and you have someone who's very much aligned—there's a high probability that that's going to be a great marriage. It's going to blend well."

Ziff noted that there is no one-size-fits-all approach for fractional executives when it comes to length of contract or how embedded they are in the company culture.

"Maybe they have no contact with anybody other than the CEO or whoever hires them," he said. "Maybe they're just delivering something. It's a whole tapestry of opportunities to hire people."

Ziff believes flexibility is a huge benefit for both the company and executive. "The nice thing about fractional is that you can try before you buy. So, you could have a limited initial engagement that could expand into something longer term or even permanent."

While a fractional or interim executive isn't meant to be a temp-to-perm situation, Jordan said: "We don't put this as a go-to-market message, but we get bought out 25 percent of the time. So, there is a fair percentage of the time that a person in a fractional role decides to become permanent with one client and it turns into full-time employment."

Since fractional executives can hold more than one position at a time, contracts often include some kind of nondisclosure agreement to protect sensitive company information.

"Things need to be carved out," Ziff said. "So, let's say a company needed a fractional executive to integrate an InsurTech, for example, or to launch a very specific claims application or service. That's carved out. Any savvy executive would be able to figure how to carve that out and protect their information."

An Option for Retirees

There's a huge wave of baby boomers retiring from insurance companies over the next few years. "These companies are losing senior executives en masse," said Ira Ziff, Precision Research Group. "And then you have this crazy gig economy…"

"There couldn't be a better time for a lot of these retiring senior executives to find a very fulfilling home in a company, in a role where they can be valued for their expertise and their wisdom," he said. "You have to understand also that there is universal age discrimination out there. I can tell you that the minute you turn 40, age discrimination starts, and then it gets exponentially worse."

"You've got all these amazing people with all this expertise and knowledge that could potentially be available for interim assignments because they don't want to work full time anymore. [But] they want to stay in the game," he said. "They have so much to offer, and their age is a benefit, not a disadvantage."

Ziff noted that, though he hasn't personally placed any, the fractional executive route could also be perfect for stay-at-home parents or for somebody who had to be a caregiver to their own parents.

Robert Jordan has a different view when it comes to working with retirees.

"Everyone's free to obviously pursue their best careers and career options," he said. "We, personal to InterimExecs and RED Team, will not work with retired people. We need people who still have fight for the game and want to crush it 24/7. We're not going to work with people who may not have that level of energy."

7 Tips

for Developing Future Leaders

By Kimberly Tallon

1. "What's in it for me?"

Employees are more likely to feel invested in learning and development programs if they know how the training actually applies to their daily responsibilities and how it will help them progress in their careers.

Clearly define the purpose and intended benefit so employees understand why they're there, what the concrete benefit of the training is, and what the impact will be—on the individual, their team or department, and the organization as a whole.

Employees also need to see that the higher-ups are taking this training seriously and making it a priority in their own calendars, not just mandating it for others. When executives and higher-level management aren't physically present at training activities, a message is sent. The professionals who are present at the training start to wonder: "Well, if this isn't important enough for them to be here, why do I need to be here?"

Source: "Pitfalls To Avoid When Developing Your Workforce," Chief Executive, May 19, 2023

2. Find an investor.

Mentors serve an important role in professional development. They listen, provide support and trust, offer guidance, coach, and share advice based on their experience. But what mentors can't always offer is opportunity.

To ensure that high-potential employees have the chance to showcase their talent, ambition and development, they need a career investor—someone who not only recognizes their potential but is willing to put something of value on the line (e.g., their own reputation, client relationship, future business chances) to give that person an opportunity. These well-respected leaders leverage their own status, network and influence to provide a platform where high-potential talent can shine.

Career investors can be particularly useful for individuals who are typically overlooked for leadership opportunities, such as women, minorities and members of the LGBT+ community.

Source: "Mentors Aren't Enough: What Women Need to Advance," Gallup.com, March 8, 2023

3. Balance hard and soft skills.

Establishing a balance between hard and soft skills is essential if you want an effective, adaptable workforce.

Hard skills give employees the job-specific knowledge required to do their work. Examples in the insurance industry include data analytics, underwriting, risk modeling, marketing and brand management, accounting, etc. Providing training for these skillsets keeps employees current and compliant with best practices for the industry.

Soft skills relate to how people interact and work together—think empathy, leadership, active listening, problem-solving, time management and communication. Even the most technically adept employees need strong soft skills to build positive relationships and thrive within a team or organization.

Identifying organizational goals and mapping out your team's current abilities can help identify which skills can be improved upon.

Development programs can include self-paced learning, on-the-job practice, certifications and peer-to-peer mentoring. When adding soft skills training to the mix, consider layering in experiential learning and interactive elements such as hands-on workshops, group learning and cross-training designed to upskill while also building relationships with co-workers. It's not enough to simply teach employees about critical thinking, time management and communication. People need to practice and apply those skills before refining them.

Source: "Balancing Hard and Soft Skills in Learning & Development," Reworked, May 15, 2023

4. Shift your mindset.

New manager training programs often neglect the critical need for inexperienced managers to understand and change the underlying mindsets that shape their behavior. What helped an employee succeed as an individual contributor may hinder their success as a manager.

Self vs. team: Individual contributors operate with a "self" orientation. They regard work as a chance for self-advancement, and they strive for the recognition associated with personal success. In a leadership role, the focus must be redirected from succeeding as an individual to fostering the success of the team. A new manager that seeks an "I" in team will not be successful in inspiring others to follow them. The team they lead has a much greater chance of being dysfunctional, non-collaborative, and lacking in motivation and connection.

Problem avoidance vs. solution engagement: Most individual contributors actively avoid situations where they might make mistakes. They are often reluctant to take on ambiguous challenges or risky opportunities out of a fear of failure. They know that they are not in control of the resources, support and even knowledge they might need to succeed, so they'd rather not risk it. Leaders cannot afford to be afraid of risk. They need to be adaptable and flexible, ready to pursue innovation and challenge the status quo.

Rigid execution vs. flexible adaptive: Individual contributors are focused on execution—getting the job done right and on time. But this laser focus may cause them to miss information and signals that might suggest a different course of action. Leaders need to be open and flexible, willing to seek out new ideas and perspectives before creating a plan, making a decision or drafting a strategy. They need to adapt to new situations and changing circumstances if they want to remain responsive to the needs of their customers and stakeholders.

To help individuals make a successful transition, new leader development programs should prioritize training on these critical mindsets. Through online courses, role-playing exercises and coaching sessions, managers can receive targeted interventions to shape their mindsets.

Source: "Increasing the success rate of first-time leaders: Training the three key mindsets," Chief Learning Officer, March 6, 2023

5. Try 'quiet hiring.'

Smart organizations consider internal talent when new skillsets are needed. This means strategically assessing current employees and making trade-offs on where talent is most needed, and where the organization can afford to slow down work or reduce headcount. It's about focusing on skills rather than credentials.

Quiet hiring provides employees with the opportunity to work stretch

continued on next page

continued from page 17

assignments, grow their current skills, learn new skills, extend their careers—and ultimately become invaluable to their current organization and more marketable to others.

To keep employees from feeling exploited, organizations should expect to offer incentives, such as additional compensation, one-time bonuses, extra personal time off, flexible hours and working conditions.

But organizations need to make sure they don't expect too much from employees, leading them to feel overwhelmed or burnt out. It's important to strike a balance between building employees' skills and protecting their well-being.

Source: "Why Quiet Hiring is a Win-Win for Employers and Employees," Gartner, Jan. 25, 2023

6. Upskill or reskill.

A business is only as strong as its people. The two main schools of thought when it comes to employee growth plans are upskilling and reskilling.

Upskilling is the process of connecting effective, engaged, high-potential employees with the proper tools to improve their business skills so they can begin moving up in the organization. This vertical growth philosophy involves going back to the basics or improving the fundamental skills required for the employee's current role. Upskilling aims to improve both the soft skills (e.g., leadership, public speaking, people management) and technical skills required to become leaders within the current department or function of the organization.

Reskilling is when an employee is moved to a different part of the business or a new role that may be better suited to their personal skills or the needs of the organization. This horizontal growth method is a great option to keep an effective employee engaged or put them in a better position to be upskilled in the future. Reskilling almost always requires learning new functions, processes or skills that are applicable to the new role.

An effective way to break down employee performance and potential is through a nine-block exercise. This ranks employee talent through a 3×3 grid based on both performance and potential. High-performance and high-potential employees will be a great fit for upskilling, while high-potential but lower-performance employees may be good candidates for reskilling.

Source: "Maximize Employees' Reskilling And Upskilling Power," Chief Executive, 2013

7. Be a STAR.

In the absence of more formal leadership training, a simple four-step management framework—stop, think, ask, result (STAR)—can help managers adopt coaching-related behaviors that foster collaboration between team members rather than jumping in to fix every problem themselves.

Stop. Resist the urge to immediately solve your team's challenges.

Think. Why has this person approached me? What do they need from me? Do they want me to help them brainstorm, or are they simply seeking validation? Will my feedback make things better or just different?

Ask. Asking questions will help stimulate the individual to do their own thinking. Plus, giving people the chance to contribute to a solution—as opposed to presenting it to them—shows that you believe in their potential and trust their ownership.

Don't ask "why," which can sound accusatory and make the employee defensive. Replacing "why" with "what" refocuses the conversation on the facts of the situation you are enabling them to solve. For example, instead of asking, "Why did you assume the market size was small?" change the question to, "What factors led you to assume the market size was small?"

It's important to avoid distractions and resist the temptation to interrupt with your own input—practice active listening.

Result. Your goal is to draw out the talents and logic of the other person, helping them to determine a clear next step. Remember that there is more than one way to reach a solution. You need to help your team member find their own path if you want them to build resilience and tackle similar situations on their own in the future.

Source: "Are You an Accidental Manager?" Harvard Business Review Ascend, May 23, 2023 CM

Taking the Next Step on Cyber War Exclusions

By Stefan Golling

Cyber insurance has been a success story since the late 1990s, offering companies protection for one of their leading emerging risks. In my opinion, the most important requirement to manage an evolving risk is transparency, both in coverage and exposure. At Munich Re, we believe that cyber insurance requires respect and proper risk management but is—at its core—insurable and able to be modeled, with two notable exceptions: infrastructure failure and losses arising from war.

Beyond the sometimes heated discussions about the best way to design cyber-war exclusions and what pace the market can bear, insurers should avoid making premature compromises. Offering unintended cyber-war cover puts not only balance sheets at risk but also the sustainability of the cyber market worldwide.

Armed conflicts are by their nature a matter for governments. It is the responsibility of the state to intervene to mitigate the consequences of a war, for the citizens and also the economy, as its consequences are so large and wide-reaching that private industry simply is not able to bear such a ruinous risk. War exclusions have formed an accepted part of property policies for almost a century for precisely these reasons. Cyber policies also contain war exclusion clauses, as the industry does not intend to extend cover to war-like situations.

In 2010, the Stuxnet worm demonstrated that state actors were willing and able to use digital tools to intervene in international conflicts to achieve their tactical or strategic goals. In contrast to Stuxnet, the NotPetya cyber attack in 2017 caused widespread damage beyond its presumed target, Ukraine. The consequences of the attack included significant disruption to many sectors and areas of life.

NotPetya marked a turning point for the (cyber) insurance industry, reinforcing the real possibility for catastrophic non-physical damage at the hands of a state. Exclusions, particularly in property "all risk" policies, that focused primarily on conventional aspects of warfare between states, such as the destruction of property, didn't reference disruptive cyber-induced attacks and provided insufficient clarity when faced with such non-physical events. In some instances, this has resulted in protracted litigation, as in addition, intent of coverage was ambiguous in such policies.

Stefan Golling is a Member of the Board of Management of Munich Re.

Now that a "cyber war" without or alongside physical components is a real possibility, it is time for the market to move beyond the exclusions borrowed from property policies. Industry representatives and other stakeholders have been working toward solutions that provide clarity and thus can find broad acceptance across the market. The past has made it clear that developing suitable wordings will only be possible through

continued on next page

continued from page 19

collaboration and by balancing the interests of all stakeholders.

One early initiative by the Lloyd's Market Association (LMA) was to publish updated war exclusions for commercial cyber business in November 2021. The proposed wordings and their successors aim to clarify what would not be covered: (1) armed conflicts between states and accompanying cyber attacks; and (2) government-initiated hostile cyber attacks against another country, which could have effects comparable to war-like activities. This latter requirement is intended to ensure that cyber attacks such as espionage, "hacktivism" and criminal attacks do not unintentionally fall foul of the new exclusions, while in the meantime confirming that it is clear that catastrophic non-physical hostile attacks by a state remain excluded.

This first step by the LMA toward more clarity on the topic, which was supported by insurers and reinsurers including Munich Re, led to a broader discussion in the market. Other initiatives followed, including from our joint initiative with Marsh, which wanted to obtain a better understanding of the intention behind the LMA's original drafts. The goal of these and similar initiatives is to define and document as clearly as possible what does—and does not—constitute an insured incident.

> The past has made it clear that developing suitable wordings will only be possible through collaboration and by balancing the interests of all stakeholders.

For Munich Re, developing the cyber insurance market sustainably is our highest priority. A key requirement to achieve this is to ensure the war exclusions used are fit for purpose. Given the events of the past two years, the imperative to act is increasing. The experiences around the pandemic, 9/11 and the current war in Ukraine demonstrated that as an industry, we should act to safeguard our reputations—and balance sheets—by ensuring contract language, especially relating to systemic risks, is clear. Munich Re sees the benefit of widely accepted market solutions. Together with clients and brokers, major risk carriers such as Munich Re have been directly discussing and developing further potential solutions that adequately address the exposure issue.

The developing cyber market so far has been handling critical challenges relatively well. Making "silent" cyber exposure in property insurance more transparent and explicit was a positive step to isolate and manage the systemic risk. Identifying critical infrastructure failures, such as Internet or power outages, as an uninsurable risk and excluding them from cyber policies was another key milestone. The market recently has identified and reacted quickly to the ransomware trend, in the process helping to improve the resilience of industry by driving best practices. This adaptability is necessary to sustainably develop the cyber market, which by the end of 2022 had grown globally to approximately $12 billion (Munich Re estimate) and which offers the digitalized world valuable prevention and risk-transfer services.

Transparency enables long-term, sustainable insurance solutions, and that is in everyone's interest. Customers must be able to clearly understand the extent of their insurance cover at all times. Insurers need to ensure they do not take on any risk that may impair their ability to offer coverage in the future.

As a marketplace of insurers, brokers and clients, we now need to take the next step in this direction with consistent and timely implementation. CM

U.S. Personal Auto Results Headed the Wrong Way. Is a U-Turn Possible?

Executive Summary: Given the persistence of high loss costs, a return to underwriting profitability for the auto segment in 2023 appears highly unlikely, writes AM Best Associate Director David Blades. In fact, for 2023, AM Best is currently forecasting a 106 combined ratio for the U.S. personal auto segment, he notes in the article that describes the headwinds carriers are facing. In spite of the challenges, inflationary trends eventually will plateau, and in the meantime, more sophisticated pricing algorithms, along with good risk selection and disciplined underwriting, should help carriers chip away at unfavorable results, he writes.

By David Blades

Although the pandemic may appear more distant in the rearview mirror, its lasting impact on the personal auto insurance industry may be larger than initially expected.

Private passenger automobile insurance is the largest segment of the U.S. property/casualty insurance industry, accounting for almost 70 percent of the personal lines segment and a third of U.S. P/C net premium written. It is a critical line of business for many insurance companies.

Historically, the personal automobile line's underwriting results have been stable, nearing breakeven in most years. However, auto insurers reported stronger-than-usual performance in 2018-2019, and results remained favorable in 2020 as the pandemic surged, unemployment spiked to the highest levels in years and miles driven plummeted.

With access to needed parts and—just as important—qualified labor limited, the cycle time for repairs has lengthened considerably, resulting in additional loss cost pressures.

Because of the drastic drop in miles driven during the early months of the pandemic, personal auto insurers returned roughy $14 billion in premiums to policyholders.

David Blades is Associate Director, Industry Research and Analytics for AM Best.

Unfortunately, it has been an uphill road ever since.

Auto insurers recorded an underwriting loss of more than $4.1 billion in 2021, with a rapidly worsening loss ratio through the first six months of 2022. AM Best's private passenger auto composite shows an additional $10 billion in underwriting losses through the first nine months of 2022. Although bottom-line results for 2022 have not yet been finalized, indications are that they won't be pretty. AM Best has estimated a combined ratio of 110.1 for 2022—a two-year deterioration of nearly 18 percentage points.

These results are dragging the entire P/C segment's performance metrics down. Preliminary results for 2022 show a steep decline in underwriting results for the entire segment—a $26 billion loss, for which the personal auto line of business is primarily responsible. Early results of the leading private passenger auto insurers also indicate a dramatic downturn in 2022 on a direct basis (prior to the effects of ceded reinsurance). AM Best has aggregated 2022 direct premiums written (DPW) for 18 of the top 20 insurers of 2021 (see Exhibit 1 on next page). DPW for those companies increased modestly, by 5.6 percent, but that increase was outpaced by a greater increase in losses. In 2021, only

continued on next page

continued from page 21

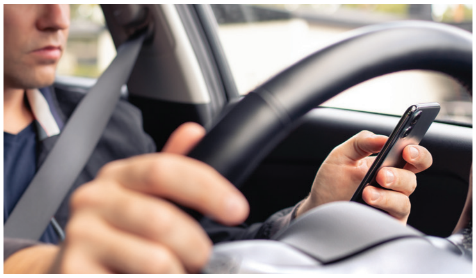
five of the top 20 auto writers produced direct combined ratios above the breakeven measure of 100.0. In contrast, 16 of the 18 companies for which 2022 combined ratios have been calculated thus far have ratios above 100.0.

Deteriorating Loss Severity a Key Hurdle

One of the main factors accounting for the deterioration in the results of auto insurers is the rise in loss severity, attributable to a higher rate of fatalities. One reported trend during the pandemic was vehicles traveling at higher speeds on mostly empty roads. After vehicles started returning to U.S. roadways, accidents occurring at these elevated speeds have on average been more serious, causing greater damage and driving up claim values for third-party liability and auto physical damage. Recent National Highway Traffic Safety Administration (NHTSA) statistics show that 31,785 people died in traffic crashes in the first nine months of 2022, compared with 27,019 during the same period of 2018. Last April, Cambridge Mobile Telematics reported that, although speeding levels are well below the highs of 2020, they're still elevated compared with pre-pandemic years.

In 2021, the number of fatalities jumped by 11 percent over the previous year. Additionally, the average cost per private passenger auto claim rose by 14 percent, reaching almost $10,000 per claim. (Related research: "Numerous Pressures Create Tough Terrain for Personal Auto Insurers," AM Best, Nov. 11, 2022)

Distracted driving and poorer driving habits post-pandemic have played meaningful roles in the deteriorating auto results. NHTSA statistics show that roughly 14 percent of injuries in traffic accident crashes are due to distracted driving. This issue is proving difficult to rectify. Whether the distractions are from talking with passengers, talking or texting on cellphones, adjusting vehicle controls, eating, or other activities, they generally fall into one of three categories, as noted by the Insurance Information Institute:



Visual—drivers taking their eyes off the road.

Manual—drivers taking their hands off the steering wheel.

Cognitive—drivers taking their minds off driving when behind the wheel.

Insurers are also grappling with rising medical costs. Third-party auto claim costs have been on the rise over the past few years due to many factors, including social inflation, nuclear settlements and rising medical costs. These costs, coupled with escalating prices of motor vehicle parts and equipment—up by 15 percent year over year in the first half of 2022, according to the U.S. Bureau of Labor Statistics—have also contributed to the poor auto results.

Many insurers continue to raise rates in pursuit of improved premium adequacy to offset rising loss cost severity, but their efforts have not yet succeeded, especially as the rate approval process in many states for this highly regulated line is very restrictive. Most approved rate changes have been for less than actuarial indications, resulting in the need for more filings. The backlog in rate approvals in 2022, particularly in California, didn't start to clear up until later in the year.

Returning to a favorable—or even a breakeven—combined ratio will take time. AM Best is forecasting a combined ratio of 106 for 2023. If current inflationary pressures persist through the year, higher vehicle repair costs are unlikely to improve materially. Ongoing supply chain challenges and recessionary fears will also remain headwinds for auto insurers if they are to realize an improvement in performance.

The U.S. nonstandard auto insurance industry, a subsector of personal auto, has also been beset by losses, based on AM Best's aggregation of results for the predominant nonstandard auto-focused insurers. Through the first three quarters of 2022, the segment incurred an underwriting loss of almost $1.2 billion due to many of the same market issues the standard writers are contending with. This substantial underwriting loss follows $1.3 billion in underwriting losses in 2021.

Exhibit 1

U.S. P/C Industry: Premium and Profitability of Top 20 Private Passenger Automobile Insurers by Direct Premiums Written, 2021-2022

		2021		2022	
Rank	Group/Company Name	DPW ($ millions)	Combined Ratio	DPW ($ millions)	Combined Ratio
1	State Farm Group	41,666	105.8	46,661	127.2
2	Berkshire Hathaway Insurance Group	37,423	86.4	38,136	96.8
3	Progressive Insurance Group	35,853	91.0	N/A	N/A
4	Allstate Insurance Group	27,222	94.9	29,611	107.4
5	USAA Group	15,739	102.7	16,406	117.3
6	Liberty Mutual Insurance Companies	13,257	91.3	13,704	101.1
7	Farmers Insurance Group	12,441	97.3	12,606	105.2
8	Nationwide Group	5,566	95.0	5,506	102.4
9	American Family Insurance Group	5,489	92.3	5,835	101.1
10	Travelers Group	5,328	91.8	5,836	104.0
11	Kemper PC Companies	4,084	111.2	3,607	113.3
12	Auto Club Enterprises Insurance Group	3,725	106.3	4,012	119.0
13	Erie Insurance Group	3,385	100.1	3,594	122.3
14	Auto-Owners Insurance Group	3,328	97.7	3,516	108.8
15	CSAA Insurance Group	2,905	90.1	3,081	101.9
16	Mercury Casualty Group	2,613	94.3	2,572	110.2
17	Auto Club Group	1,924	97.9	1,947	160.5
18	Hartford Insurance Group	1,865	79.1	1,980	90.5
19	MAPFRE North America Group	1,303	96.6	N/A	N/A
20	Hanover Ins Group Prop & Cas Cos	1,264	82.7	1,349	101.9

CY2022 values for Progressive and MAPFRE North America Group have not been aggregated as of 3/27/23.
N/A = The direct combined ratios for the subsidiaries of Progressive Group and MAPFRE NA are not available as the data has not been aggregated yet.
Source: BESTLINK

Premium Isn't Profit

The personal auto segment is well known for its advertising, especially by the top writers (Exhibit 2). The importance of branding in gaining and preserving market share is highlighted by nine of the top 10 insurers also ranking among the top 10 in annual advertising expenses. However, premium volume does not guarantee profitable results, as 12 of the top 20 companies ranked by 2021 private passenger auto net premiums written posted combined ratios of over 100 in 2022 (Exhibit 3). The considerably negative impact of inflationary pressures on personal lines loss trends led to insurers cutting the financial resources allocated to advertising in 2022 to help their underwriting expense load. Again, the regulatory environment, particularly in key states such as California and New York, makes raising rate increases to address price adequacy and lessen the pressure on profitability more difficult.

Reasons for Optimism

At the same time, personal auto carriers remain ahead of the curve in terms of pricing sophistication and have likely built on their competitive advantages. The personal auto line has led the charge in the insurance industry in digitization. For many years, the industry has made a push to leverage technology, including claims, underwriting and distribution. Most companies also have updated their legacy systems. These innovative efforts have led to greater efficiencies and enhanced customer experience.

The growing use of telematics and usage-based insurance may help address loss frequency, as insurers can measure driving behavior or implement additional product innovations such as per-mile insurance. However, this is unlikely to have a meaningful impact over the near term.

Newer vehicles with enhanced safety features account for a growing percentage of vehicles on the road, which may also impact frequency favorably, although their repair costs are higher. With access to needed parts and qualified labor limited, the cycle time for repairs has lengthened considerably, resulting in additional loss cost pressures.

Given the persistence of high loss costs, a return to underwriting profitability for the auto segment in 2023 appears highly unlikely. Inflationary trends eventually will plateau, but how long this environment will continue remains highly uncertain. More sophisticated pricing algorithms, along with good risk selection and disciplined underwriting, should help carriers chip away at unfavorable results. But some companies may need to reconsider their risk appetites.

Overall, personal auto insurers remain well capitalized and vigilant in their pursuit of rate adequacy and have benefited from the implementation of advanced technology, which has resulted in greater efficiency. As the use of technology rises across the broader financial services industry, companies will continue to look for ways to meet higher customer expectations. Those companies that can't meet rising customer expectations will be at a competitive disadvantage. Fostering innovation in all operational phases will continue to benefit personal auto writers as they focus on achieving adequate rate levels. CM

Exhibit 2

Top 20 US P/C Insurers – Advertising Expense Ratios, 2017-2021

Company	2021 Advertising ($ millions)	Advertising Expenses as Share of DPW (%) 2017	2018	2019	2020	2021
Progressive Insurance Grp.	1,874	3.2	3.7	4.2	4.6	3.9
Allstate Insurance Grp.	1,264	2.1	2.3	2.3	2.5	3.1
Berkshire Hathaway Insurance Grp.	1,144	2.0	2.0	2.2	2.5	2.2
State Farm Grp.	1,068	1.3	1.4	1.8	1.8	1.5
Liberty Mutual Insurance Companies	840	1.3	1.5	1.7	1.9	2.0
Farmers Insurance Grp.	432	1.7	1.5	1.8	1.8	1.7
American Family Insurance Grp.	376	1.6	1.3	1.6	2.9	3.0
USAA Grp.	283	0.9	1.0	1.5	2.0	1.1
Amica Mutual Grp.	167	4.6	5.2	6.4	5.1	7.4
Nationwide Grp.	166	1.5	1.3	1.2	1.0	0.9
Auto Club Enterprises Insurance Grp.	114	2.0	2.0	2.2	2.3	2.4
Travelers Grp.	109	0.3	0.3	0.3	0.4	0.4
NJM Insurance Grp.	95	0.5	0.9	1.2	2.3	4.9
Hartford Insurance Grp.	87	0.4	0.5	0.6	0.6	0.6
CSAA Insurance Grp.	51	0.5	0.2	0.3	1.3	1.2
Mercury General Grp.	44	1.0	1.0	1.0	0.9	1.1
Elephant Insurance Company	33	13.5	13.7	15.8	15.9	15.4
Auto Club Grp.	31	0.7	0.7	0.7	1.0	1.1
Lemonade Insurance Company	29	85.7	13.3	13.3	9.8	7.9
Allianz US PC Insurance Companies	29	0.3	0.3	0.1	0.2	0.5

Source: BESTLINK

Exhibit 3

U.S. Private Passenger Auto – Top 20 Insurers Ranked by 2021 Net Written Premiums and Combined Ratios, 2017–2021

Rank	Group/Company Name	NPW ($B)	2020/ 2021 YoY Change	Net Combined Ratio (After Policyholder Dividends) 2017	2018	2019	2020	2021
1	State Farm Group	41.6	3.1	106.1	97.1	101.3	96.0	108.5
2	Berkshire Hathaway Insurance Group	37.2	10.3	101.5	93.2	96.3	90.2	98.6
3	Progressive Insurance Group	35.6	8.4	93.2	90.3	91.0	87.0	96.5
4	Allstate Insurance Group	25.5	4.8	96.1	93.9	94.4	87.3	97.6
5	USAA Group	15.7	–0.2	105.1	103.5	105.7	93.9	105.3
6	Liberty Mutual Insurance Companies	11.5	–1.5	108.0	98.3	99.1	93.8	99.6
7	Farmers Insurance Group	8.3	–13.0	103.6	100.0	101.9	93.5	101.1
8	Travelers Group	5.8	8.5	105.0	95.1	94.9	85.7	95.1
9	American Family Insurance Group	5.8	7.6	111.4	106.8	103.8	97.6	102.5
10	Nationwide Group	5.6	–3.3	102.7	97.5	99.2	99.4	105.1
11	Kemper PC Companies	4.2	6.4	102.6	98.9	89.7	98.6	117.6
12	Auto Club Enterprises Insurance Group	3.7	3.4	108.5	105.6	104.6	97.5	108.1
13	Erie Insurance Group	3.4	–0.4	105.6	110.0	110.2	98.3	105.5
14	Auto–Owners Insurance Group	3.0	–5.3	104.3	103.3	102.0	96.1	103.1
15	CSAA Insurance Group	2.9	4.2	102.2	98.2	99.6	87.9	93.2
16	Mercury General Group	2.6	2.2	100.2	100.4	99.2	89.2	97.1
17	Hartford Insurance Group	2.0	–0.5	102.6	99.8	96.6	85.9	93.0
18	Auto Club Group	1.8	–1.5	103.1	105.6	103.8	97.3	100.0
19	MAPFRE North America Group	1.3	–4.0	107.4	106.8	102.5	97.5	102.8
20	Munich–American Holding Corp Companies	1.3	124.6	102.4	101.0	112.5	112.4	101.3
	Top 20	218.8	4.2	103.4	99.9	100.5	95.0	101.2
	US P/C Industry	252.9	3.8	102.6	97.7	98.8	92.5	101.4

Net combined ratios for 2017-2021 are median values.

Source: BESTLINK

William Wilt is President of Assured Research LLC, a research and advisory firm focused exclusively on the P/C insurance industry. Reach Wilt at william.wilt@assuredresearch.com.

Alan Zimmermann is Managing Director of Assured Research LLC, a research and advisory firm focused exclusively on the P/C insurance industry. Reach Zimmermann at alan.zimmermann@assuredresearch.com.

Social Inflation Hits Insurers, **Not Economies**

Executive Summary: P/C insurance professionals may think that tort reform is coming as "nuclear" verdicts grow to "thermonuclear" status. But analysts at Assured Research are doubtful. Here, Assured Research President William Wilt and Managing Director Alan Zimmermann look for signs of economic disruption in states tagged as having the worst legal environments—a likely precursor for action on tort reform. They find little evidence that social inflation disrupts local economies. Instead, it is insurers in these states that feel the impact, they reveal through an analysis of loss ratios in states with the best and worst legal environments.

A version of this article was originally published in the May Assured Briefing for subscribers to Assured Research reports (http://www.assuredresearch.com). The article is being republished by Carrier Management with permission from the authors.

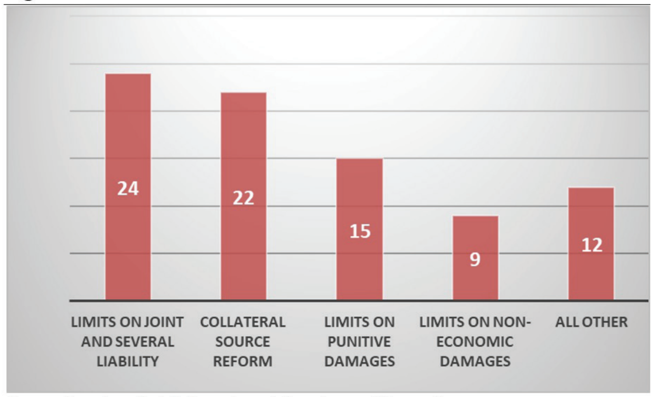
By William Wilt and Alan Zimmermann

You know things are bad when the term "nuclear" is deemed inadequate to describe the rise in legal verdicts against corporations.

"Thermonuclear" is the new term coined by the communications and public relations firm Marathon Strategies, which recently released a report on the topic of social inflation and thermonuclear verdicts. For the record, the consultancy examined nearly 900 nuclear legal verdicts against corporations (awards exceeding $10 million) from 2009-2022 and was motivated, we suspect, to add the "thermo" prefix when the researchers noticed that 191 of those verdicts were greater than $100 million (with 23 greater than $1 billion).

The property/casualty insurance industry has been combatting the most recent manifestation of social inflation for five years or more. And with some 22 verdicts against corporations in excess of $100

Figure 1: State Tort Reform Actions: 1985-1990



Source: American Tort Reform Association, Assured Research

The majority of the 82 actions were taken in 1986 (31) and 1987 (32); shortly after the liability combined ratio breached 150! The 2022 combined ratio for major liability lines is closer to 100.

million in 2022 alone, it's understandable for insurance professionals to think that widespread tort reform has to happen soon. Except we don't think it will.

Our reasoning: There's no evidence that social inflation (used interchangeably with "nuclear verdicts" throughout) leads to below-average economic growth. And as for a parallel to the 1980s when nationwide tort reform stopped social inflation dead in its tracks, the liability combined ratio had breached 150 in 1985; today it's closer to 100.

We recognize substantial reforms have taken place in Florida but think that catalysts for reform elsewhere probably have to be rooted in a localized insurance/economic crisis à la Florida's property market. (More on this toward the end of this report.)

In this article, we bring together data from a number of sources to examine the impact of social inflation and nuclear verdicts on statewide economies and liability loss ratios. Our observations:

- There's no evidence that social inflation leads to below-average economic growth. Many states deemed to have plaintiff-friendly legal environments or frequent nuclear verdicts against corporations have produced five- and 10-year CAGRs (compound annual growth rates) in real GDP that are higher than or broadly in line with the national average.
- Many of the states earning high regard for their stable and business-friendly legal systems have lagged the national average rate of real economic growth.
- Turning to insurance results, based on an examination of the calendar-year loss ratios for the major liability lines—other liability, product liability and medical professional liability—it appears that states with rampant social inflation or plaintiff-friendly legal systems produce higher liability loss ratios than states with the "best" legal systems.

Back to the 1980s...Briefly

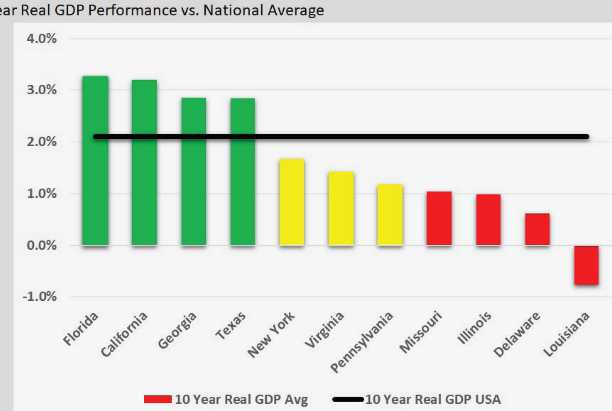
It's gotten so crazy, there has to be tort reform soon, right? Such is the lamentation we occasionally hear from industry professionals. It was tort reform that ended social inflation in the 1980s; 82 instances of tort reform to be exact. But, unfortunately, armed with new economic and P/C industry data through year-end 2022, we don't see evidence that nuclear verdicts are slowing economic growth, in turn putting pressure on lawmakers to pursue tort reform. (See Figure 1)

Forward to 2022:
Social Inflation vs. Economic Growth

In the accompanying graphs (Figures 2-4), we combine recent 2022 economic data from the Bureau of Economic Analysis, P/C industry results, the

continued on next page

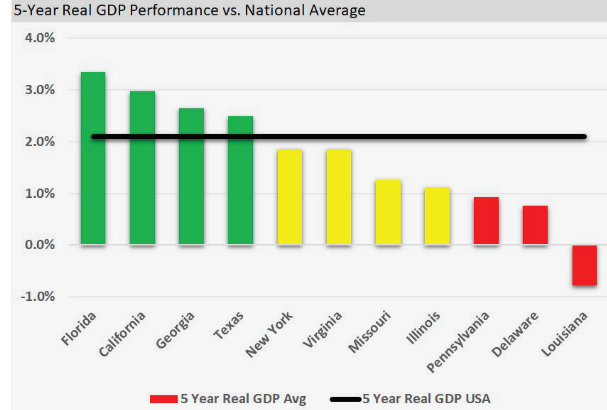
Figure 2: Top States for Corporate Nuclear Verdicts
10-Year Real GDP Performance vs. National Average



Sources: "Corporate Verdicts Go Thermonuclear," Marathon Strategies; U.S. Bureau of Economic Analysis; Assured Research

Economic data for the last 10 years does not support the idea that nuclear verdicts hamper economic growth. An analysis of 10-year GDP growth in the top states for corporate nuclear verdicts reveals that four of the 11 states outperformed national GDP growth; three modestly underperformed and four notably underperformed.

Figure 3: Top States for Corporate Nuclear Verdicts
5-Year Real GDP Performance vs. National Average

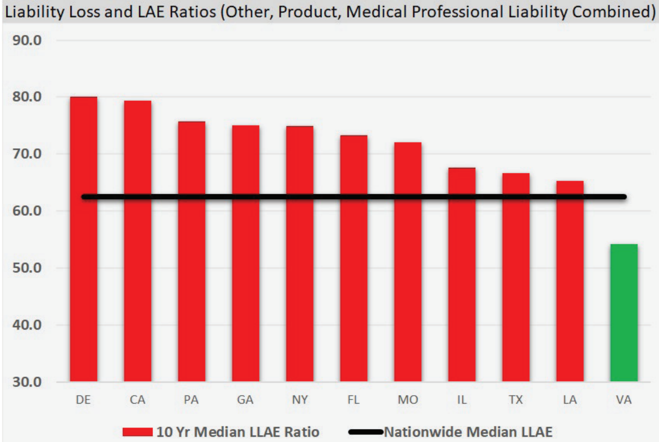


Sources: "Corporate Verdicts Go Thermonuclear," Marathon Strategies; U.S. Bureau of Economic Analysis; Assured Research

Five years of data do not support the assertion that nuclear verdicts retard economic growth. Five-year GDP growth rates in the top-ranked states for corporate nuclear verdicts exceeded national GDP growth in four of 11 states analyzed. Four states modestly underperformed and three notably underperformed.

continued from page 25

Figure 4: Top States for Corporate Nuclear Verdicts
Liability Loss and LAE Ratios (Other, Product, Medical Professional Liability Combined)



Sources: "Corporate Verdicts Go Thermonuclear," Marathon Strategies; S&P Global Market Intelligence; Assured Research

More nuclear verdicts = higher loss ratios.

Marathon Strategies report and S&P Global Market Intelligence to examine the impact of social inflation on economies and liability insurance results.

Examining 10-year real GDP performance for 11 states cited in the Marathon Strategies report as being the top states for nuclear verdicts, and comparing the state data to the national average (Figure 2), we find no compelling evidence that nuclear corporate verdicts hamper GDP growth.

Focusing on a shorter time period for the analysis doesn't change the conclusion (Figure 3). The five-year real GDP performance data for these states also does not support the assertion that nuclear verdicts retard economic growth.

The story is different when we analyze liability loss ratios for three product lines combined (other liability, product liability and medical professional liability). The analysis in Figure 4 is much more interesting, revealing that states with more nuclear verdicts have higher loss ratios (above the national average).

Taken together, the evidence from both analyses suggests that social inflation tags insurers but not local economies. That is, unless insurers stop insuring—or charge premiums so high that businesses begin to make the issue political.

In Figures 5 and 6 we turn to another ranking agency—the American Legislative Exchange Council, or ALEC—which ranks the economic competitiveness of states on 15 policy variables (the legal system being one of those).

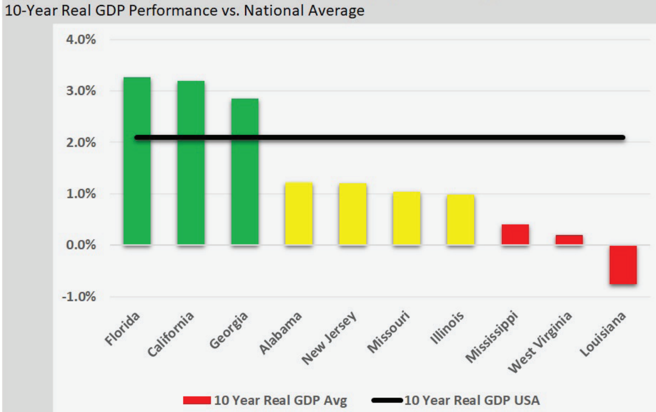
We're agnostic as to the different organizations ranking states; most of the same states appear in the top/bottom listings anyway. And we want to make sure this point is not missed: The collective GDP of the 10 worst legal states is nine-times larger than the best states.

What About Florida?

Might Florida vault from the bottom legal ranking to the top in the immediate to near term following their recent rounds of tort reforms?

It seems highly likely that the property-related reforms (eliminating assignment of benefits and one-way attorney fees, for instance) and more recently, substantial tort reform actions will have a chilling effect on lawsuits and a favorable impact on the property and liability loss ratios in the state—at least for a few years. However, we think Florida's presence among the top nuclear verdict states serves to make our takeaway from this work even more emphatic: States with plaintiff-friendly legal environments can do just fine economically. We suspect catalysts for tort reform outside of the Sunshine State will probably have to be rooted in a localized

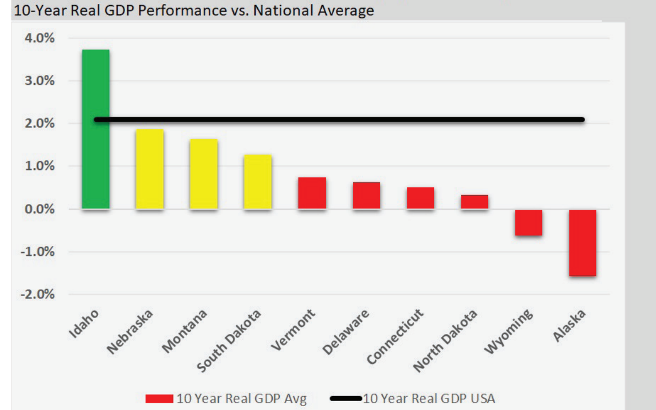
Figure 5: 10 States Ranking Lowest on Liability System Survey
10-Year Real GDP Performance vs. National Average



Sources: "Rich States/Poor States," Amercian Legislative Exchange Council U.S. Bureau of Economic Analysis; Assured Research

The GDP of the 10 worst states is 9-times higher than the collective GDP of the best states. Three of 10 states ranked low on their liability systems outperformed national GDP growth; four modestly underperformed and three notably underperformed.

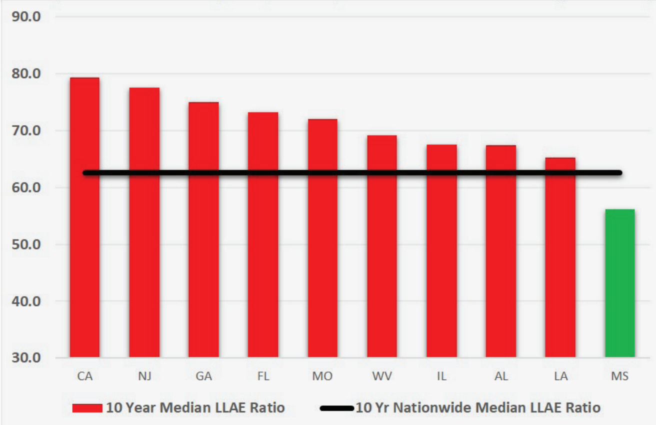
Figure 6: 10 States Ranking Highest on Liability System Survey
10-Year Real GDP Performance vs. National Average



Sources: "Rich States/Poor States," Amercian Legislative Exchange Council U.S. Bureau of Economic Analysis; Assured Research

There has been lower economic growth in states ranking highest on the liability system survey. Only one out of 10 high-ranked states outperformed national GDP growth; three modestly underperformed and six notably underperformed.

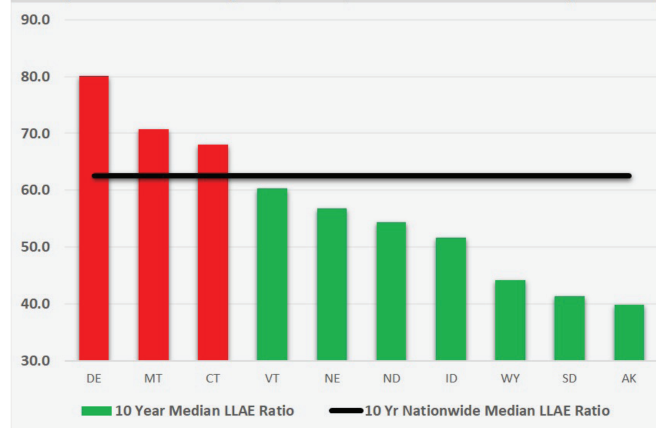
Figure 7: 10 States Ranking Lowest on Liability System Survey
Liability Loss and LAE Ratios (Other, Product, Medical Professional Liability Combined)



Sources: "Rich States/Poor States," Amercian Legislative Exchange Council
S&P Global Market Intelligence; Assured Research

The correlation between social inflation and loss ratios is clear.

Figure 8: 10 States Ranking Highest on Liability System Survey
Liability Loss and LAE Ratios (Other, Product, Medical Professional Liability Combined)



Sources: "Rich States/Poor States," Amercian Legislative Exchange Council
S&P Global Market Intelligence; Assured Research

Better states, better loss ratios.

insurance or economic crisis similar to the one in Florida's property market.

Some would argue that the tort reform at the state level will bolster desirable political bona fides at the national level. We don't disagree, but note, again, that strong economic growth over the past decade hasn't been predicated on the passage of tort reform.

In summary, we don't see evidence that social inflation, in its recent or current manifestation, has caused below-average economic growth. It has happened before, as in the 1980s when businesses stopped selling their products or services in some states (or they could not buy insurance), and the ensuing political pressures led to widespread tort reform. The 2021-2022 homeowners property crisis in Florida was the political catalyst for reforms in the Sunshine State. Perhaps other states will reach their boiling points too—because it does seem clear that social inflation leads to higher liability loss ratios. CM

Repricing Is Not Reunderwriting: Why Hard Market Gains Aren't Showing Up on Bottom Lines

Executive Summary: Although rates are hard, combined ratios and returns on capital are still underwhelming. Tony Buckle and John Carolin of UWX and Mehmet Ogut of Deloitte Consulting examine the disconnect.

By Tony Buckle, John Carolin and Mehmet Ogut

A rising tide carries all boats. That rings true currently in commercial insurance. Carriers have broadly brushed aside concerns about geopolitics, inflation and natural catastrophes and reported positive 2022 underwriting results. Leaders talk optimistically of the pivot to growth and the viability of "writing the market" at present terms.

And yet, after five years of substantial commmercial price hikes, combined ratios in the low- to mid-90s feel underwhelming. Why is all that payback from insurance buyers not translating into significantly better ratios and returns on insurer capital?

At one level, the answer is that the market is playing catch-up. It is now clear that risks were technically underpriced at the nadir of the soft market in 2017 across the market. It is also clear that the market had underestimated—even missed—how underlying exposures were changing, and not just in natural catastrophe insurance. For example, the market failed to recognize how litigation funding was transforming the public D&O landscape.

It is increasingly evident that both underwriters and reserving actuaries significantly underestimated the ultimate loss ratios of the business they were accepting, relying on historic loss picks that did not reflect the new reality.

Underwhelming Combined Ratios

Reported combined ratios are underwhelming when one considers the significant changes to terms and conditions being negotiated. A good way of looking at it is to do this thought experiment: If we assume 2019 was a normal year in terms of loss burden, and then factor in the price changes pushed through since then, CRs should be in the mid- to low-80s, but they are coming in much higher. (Chart p. 29)

Why is there such a disparity?

Clearly COVID-19 plays a role, particularly in 2020, as does inflation (both social and consumer price), although inflation assumptions vary significantly across the market while the performance gap does not. Something else is going on.

A fruitful place to look is how the changes being made by underwriters at the front end of the business are being translated into reserving loss picks at the back end of the business.

This is fundamentally about how different functions think. Underwriting breaks down into three core components: the evaluation of exposure, the definition of coverage and the negotiation of an appropriate price for risk transfer. They come in that order. You cannot, for example, define a coverage without first defining the exposure. So, when CUOs reunderwrite their portfolios, they think exposure, then coverage and then price.

Reserving actuaries, on the other hand, think evidence and explanation. Bruised perhaps by their experiences during the soft market and wary of overestimating the positive impact of front-end changes, reserving actuaries prioritize objectivity. Their natural bias is toward elements they can quantify. As a result, the changes the reserving team value most are not changes

Tony Buckle, UWX Partner and Co-Founder, has worked in executive and board roles across the insurance industry, specializing in working with senior management to turn around underperforming business units, most recently at RSA and Allianz Global Corporate & Specialty. He also held senior positions at AXA XL, Swiss Re Corporate Solutions, Swiss Re and GE Insurance Solutions.

John Carolin, UWX Partner and Co-Founder, is an InsurTech executive who has raised more than €50 million in InsurTech funding and built teams of varying sizes across multiple countries. Most recently, he was CEO of B3i Services AG.

Mehmet Ogut, a Director at Deloitte Consulting AG, is a Fellow of the Institute of Actuaries of Australia. He started his career in Australia and later broadened his exposure in Switzerland by working with major players in the insurance and reinsurance market over the course of 20 years.

to exposure or terms and conditions but to pure price. These are objective. Changes elsewhere are subjective, with haircuts applied accordingly.

Reunderwriting Portfolios

How can this apparent conundrum be resolved?

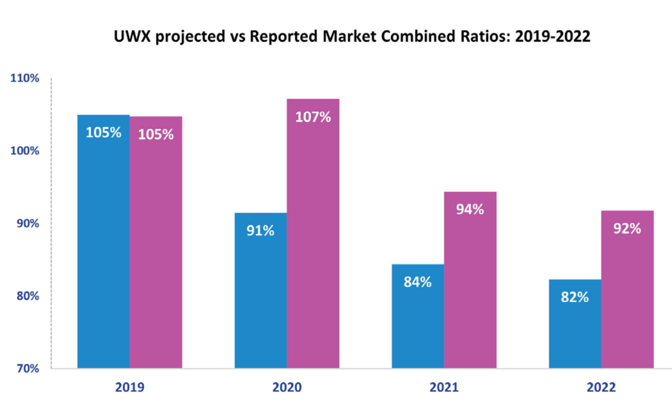
While there is no magic wand, here are three points to consider.

First, no amount of market hardening is going to make a poor exposure a good one. Risk selection remains paramount, and market hubris about there being "no such thing as a bad exposure, only inadequate price" should be consigned to history.

That said, underwriters still need to quantify exposure changes. This is easier when exposures are discrete and cohorts of claims (and associated premium) can be excluded. But typically, exposure reunderwriting is about refining the choice of exposures taken on in a population rather than ringfencing the population as a whole. So, the focus is on quantifying the differences between risks retained and risks discarded. Availing of multiple third-party sources of data for this exercise can be very useful. For example, in marine, fleet quality can be scored, and those scores can be back-tested against the insurer's own experience. The seemingly subjective risk selection is converted into a quantified, objective portfolio change.

Second, the industry needs to rethink how it quantifies changes to wordings. This is the most difficult aspect of reunderwriting to quantify accurately, but it's not impossible. It is important to be specific. Exclusions and writebacks are essentially changes to exposure, and therefore follow the logic outlined above; changes to deductibles and sublimits are expressed numerically, and therefore can be modeled quantitatively. For example, emphasis changes between "all reasonable endeavors" and "best endeavors" used in construction contract language have been interpreted quite differently by courts and imply different levels of volatility, so statistically they would mean different projected levels of loss. Insurers lacking in-house resources for such analysis should leverage their reinsurance relationships for insights wherever possible.

Third, tread carefully around price. Prices are quantitative, so at first glance they appear objective. However, price is a derivative of exposure and coverage, not the other way around. If the underlying risk has been thoroughly reunderwritten and reframed, comparing year-on-year price is comparing "apples and oranges." Furthermore, a prioritization of price change can inadvertently encourage suboptimal behavior. If metrics emphasize year-on-year rate improvement, in our experience, this can undermine good risk selection and the thorough reunderwriting of the portfolio. It is just too tempting to retain some risks where (KPI enhancing) headline rate improvements can be achieved, particularly if those readily quantifiable rate improvements are fully recognized in the ultimate loss pick.



Internal Agreement Needed

In all these dimensions, it is important to drive internal agreement. There must be a priori alignment between underwriting and actuarial as to how changes will be assessed and recognized in the loss pick. Conversely, underwriters need to resist the temptation to force through changes unless they demonstrably impact the loss ratio. Such moves just add complexity and opaqueness, not what risk managers need when they themselves are having to justify premium increases to their stakeholders.

In conclusion, as firms seek to maximize the value from underwriting in today's market, it is vital they have a clear and consistent view on the value of different components of remediation. Only then can the true impact of underwriting actions on performance be recognized.

Companies may be saved by strong coordination between underwriting and reserving in a soft market. But profitable growth depends on strong coordination when the market is hard. CM

How 1,000 Owners Keep RLI's Underwriting Profit Record Going

Executive Summary: While executives at less profitable companies talk about efforts to introduce technology-based operating efficiencies to shave points off their expense ratios, a higher level of expenses at RLI Corp. is a reflection of one key ingredient in RLI's recipe for continued success: an ownership culture. COO Jen Klobnak discussed RLI's formula for achieving an underwriting profit for 27 consecutive years, and also provided some insights on what it takes to lead the operations of a property/casualty insurer.

By Susanne Sclafane

The underwriting expense ratio at RLI Corp. settles in at about 40 percent year in and year out—a figure that routinely puts the specialty carrier's expense metric among the worst in the industry.

Yet, RLI's overall combined ratio is regularly among the best. Coming in at 86.8 in 2021 and 84.4 in 2022, combined ratios for the property/casualty insurer writing more than $1.2 billion in net written premiums last year look vastly different from industrywide commercial lines averages in the mid-90s or higher. "Different Works" is the company's tagline.

RLI's full-year 2022 result marked the latest in a string of 27 years of underwriting profit. And with its net written premiums climbing more than 18 percent so far this year, RLI's combined ratio for the first quarter dipped under 80 to 77.8.

What's RLI's secret sauce for making an underwriting profit year after year and quarter after quarter?

"I don't know the answer, but I think the biggest thing we have is our ESOP program," said RLI Chief Operating Officer Jen Klobnak, referring to an employee stock ownership program instituted by the company's founder, Jerry Stephens, in 1975.

Stephens founded the company as an agency placing contact lens replacement coverage in 1961. Operating as an underwriting company in the 1960s and early 1970s, RLI was still exclusively focused on that single specialty insurance line in those years, ultimately becoming a diversified specialty P/C insurer in 1977.

"Right before that happened, he wanted to share the success of the company," Klobnak told Carrier Management during a recent interview. "But it's not just sharing the success. Everybody literally is an owner. So, they're going to act like one, and they're going to do what's best for the company."

Those high expense ratios? "It's not something to brag about. However, every quarter there's at least a couple of points of the expense ratio that are incentive compensation," she said, referring to bonus structures that also keep everyone in the organization invested in the ultimate underwriting results of the company. "Then the retirement plan is also performance-based. Between both the 401(k) and the ESOP, that can add up quite a bit," she confirmed.

"All one thousand employees' compensation" is increased when RLI achieves a low loss ratio. "It's material," said Klobnak, who began her career in public accounting before joining RLI as a treasury analyst 23 years ago.

Other factors contribute to higher expenses, too. Among them—as a specialty insurer, RLI pays higher commissions than carriers that aren't devoted to niche businesses.

Klobnak, who has held a number of leadership roles at RLI, including senior vice president of risk services and senior vice president of operations, became COO in January 2022. She answered CM questions about her roles, the operational structure of RLI, its culture and profitability track record, and also provided some insights on what it takes to lead the operations of a property/casualty insurer.

Q: What is risk services at RLI? How did your role as SVP of risk services differ from SVP of operations?

Klobnak: Probably people think of loss control when they hear that. We believe a lot in collaborating between units, and to most effectively do that we created this risk services department. It's a home office department. Back about 15 or more years ago, we took the home office underwriting department, the actuarial department and the reinsurance buying department and smushed them together into one... It was really about us all working together to support our products...

When I moved on to operations,... I added some other [areas] that are also connected. If you think about it, a lot of our policy issuance folks type data into our systems, and that's used at the end of the day for actuarial analysis and other things. If you don't emphasize the importance of getting that right at the beginning, it can give you the wrong support for a decision at the back. So, connecting those was important.

Q: Let's talk more about RLI's organizational structure. There are product leaders for the underwriting divisions, but then there are these shared services as well.

Klobnak: We believe in giving our product and claim people a lot of authority so that they can get their jobs done. So, while a lot of companies have a home office underwriting department where there are a lot of decisions made, we really have very few referrals come into the home office.

What we want is for the field people to identify what they're going to work on. What product do they know about and want to sell? Who do they want to sell it through? Is it a wholesaler, retailer or some other type of distribution? And define their appetite, and their limits...

Then we line up reinsurance to support the appetite...

Our home office departments really are there to support these functions. And so our home office—risk services, for example, does audits where we check is the product doing what it said it would via their business plan. If not, let's talk about it. If they are, that's great. Let's make sure that we're doing it the best way we can.

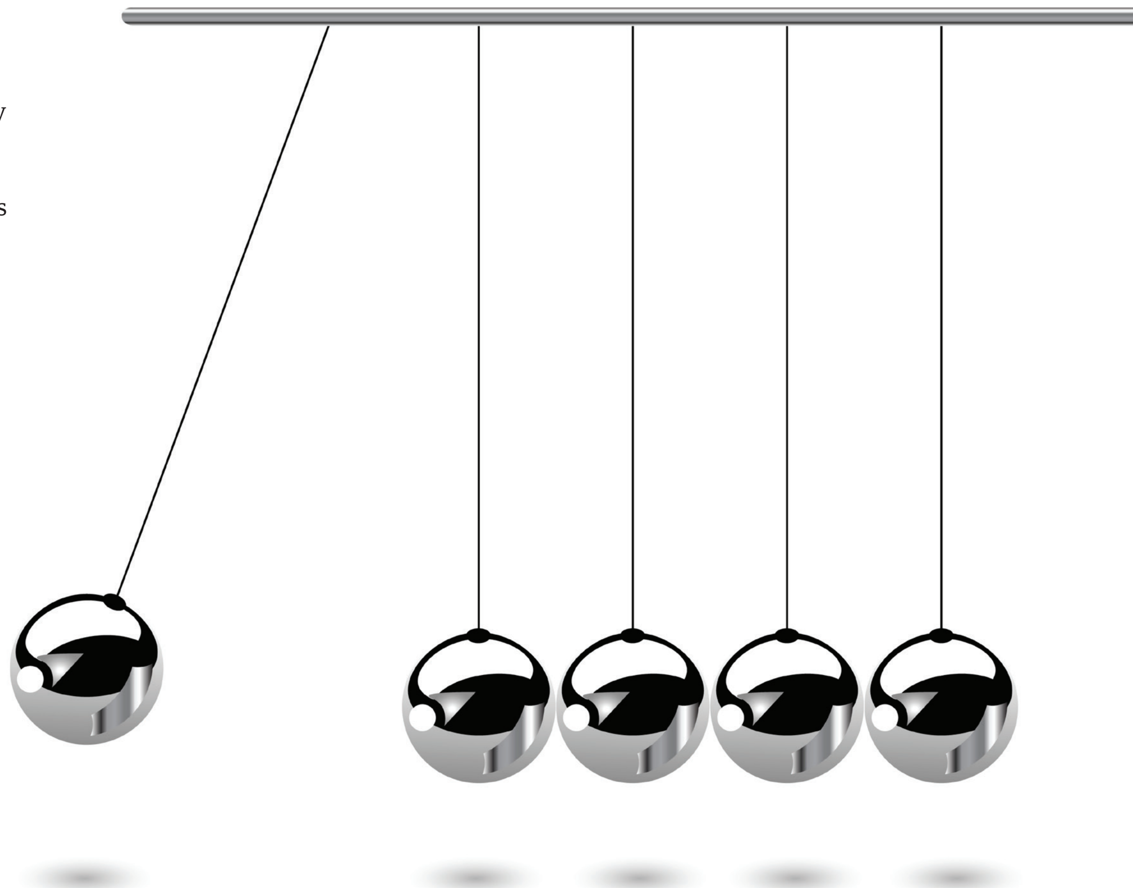
Shared services include our risk services

continued on next page

continued from page 31

group, our technology group, and all the home office functions like HR, the law department, internal audit... Operations is somewhat of a shared service. We've really consolidated a lot of our operational functions from policy issuance to collecting the cash. Connecting those gives a really good feedback loop on how things are going. How is a particular broker performing, for example. Do they actually pay us or do we have issues? All that's important to feedback to the product teams.

All the shared service functions are to assist and provide feedback to our products and our claim department to make sure they have all the information they need to make the right decisions.



Q: How many employees does RLI have in the field vs. shared services?

Klobnak: I know for a fact we have just over 1,000 employees now, which is our all-time high. We hit that metric last year in 2022... I would say that 35 percent, roughly, are production employees—mostly underwriters—but we do have some marketing and sales people that are really on the front end, as well.

Q: If the ESOP is a key ingredient to RLI's consistent track record of underwriting profits, why don't other insurers copy the formula? What other factors contribute to RLI's success?

Klobnak: There is some risk to it. Everybody has shares in the stock, and so if something happens, everybody pays attention. If the stock is down one dollar, [they ask], "Why is it going down?" If it's up two dollars, everybody's in a good mood.

So, it has a direct impact into all the employees' morale. It's risky if it does go down, but if everybody is rowing in the same direction and trying to do their best, we have a pretty good chance at continuing to contribute positively to the company...

In addition to that, our culture is unique... It's hard to talk about in a tangible way. It's almost a feeling. I always summarize it with the word ownership, but that goes back to the ESOP—the behaviors that people have because they're owners.

The biggest [contributor to success] is the teamwork. We all literally are in this together. We're going to help each other out... If you see something in the data, if you're an actuary, point it out to claims people, point it out to your underwriting counterparts. Make sure they're aware of it. If you're a claim person and you have an interesting outcome on a claim that somebody should know about, you speak up. You connect with those other folks.

There's just so many things that we do to connect our employees—and we're trying to emphasize this even more these days. Being a little more dispersed, we have a fair number of people who we've hired now that didn't work in a city where we had a branch office. They're fully remote. So, we are making sure they're feeling connected by coming together, breaking bread together and sharing our knowledge and our experiences so that we can make this place even better. That's critical.

Q: What are some of the events that bring them together?

Klobnak: Each of our business units has an annual meeting. They have underwriters, for example, spread out around the country. We physically get together and have some fun—and share business goals and updates, as well.

We do have a new employee immersion process now. For new employees, we try to get them into Peoria [headquarters], six to nine months [from] their start date so that they can learn about the greater RLI—how do they fit. They get to meet some of their co-workers and understand what we're trying to accomplish here and what their responsibilities are...

Q: In addition to the ESOP, RLI also has a long-term incentive program. I recall learning that executives are part of that, and underwriting product leaders. Who else participates, and how long does it take to determine if a unit is profitable?

Klobnak: It can take a while.

With everybody making an impact here, we provide a bonus plan for everybody. Some of those are more short-term focused and some are longer term. For the underwriters, they tend to be longer term so that you can mirror the tail of those products, and it does vary based on what product they underwrite. But they are probably looking at over four-to-eight years as far as the development, and then getting paid based on how it develops over that time...

We also provide stock options and RSUs, restricted stock units, to incentivize a lot of our leadership team with our stock...

It's almost like belt and suspenders because we already have the ESOP. But we just want to be sure everybody is paying attention [to the fact] that they are part of the entire company.

If you're embedded in a product, we don't want you to get too much tunnel vision [and] only work on that product. We actually want you to share things you learn with other product people and support departments so that they can make the other products better, too.

Q: So employees who are not underwriters, say claims people or actuaries, have a specific incentive bonus plan in addition to the ESOP?

Klobnak: In addition to the ESOP, we actually have a 401(k) [that is] performance-based, too. We contribute to [both] based on the performance of the company: What is our combined ratio? What is our ROE? Stuff of that nature.

When it comes to bonus plans, yes, everybody is on a bonus plan that is also based on performance—based on some of those metrics.

We also have a strategy that we've implemented that covers some long-term investments that we want to make to move ourselves forward through all cycles. And so we have a strategy scorecard where we have six initiatives that we're focused on. We grade that, and that's part of everybody's bonus at the company.

It is qualitative in nature. But we do want people to focus on those initiatives—make sure we're not just looking at the short term. What will help us grow profitably over time?

That was instituted five or six years ago and has been a nice way to align everybody's interest with that long-term view.

> "Everybody literally is an owner. So, they're going to act like one, and they're going to do what's best for the company."
>
> **Jen Klobnak, RLI Corp.**

Q: Do the long-term incentives ever create any conflicts between the underwriters and the actuaries because the loss reserves feed into the underwriting metrics?

Klobnak: It can.

There's a healthy debate between the actuaries and the field. But the short-term answer is you can say to the underwriter, "It's timing. It doesn't matter what the reserves are because we're following your product over the life of it, and so the IBNR is going to go away and then you get paid on actual results."

That sounds a little harsh if you're the underwriter. Saying, "Oh, it's just timing" seems a little dismissive. We don't intend it to be... The way we really look at it is that if people are focused on long-term alignment as opposed to short-term gratification, those are the people who fit here and who buy into this and who end up staying and being successful.

If you really do want to be paid right now based on what you think is happening, no matter what the actuaries say, that's probably not a great fit anyway.

The Marshmallow Test: Cycle Management and Underwriting Culture

During a first-quarter conference call in April, Klobnak and Chief Executive Officer Craig Kliethermes talked about the discipline of RLI's product teams that drove results like an 82.9 combined ratio and minimal premium growth in casualty lines, and a 68 combined ratio for property, where premiums soared more than 50 percent. Providing a different expression of long-term focus that drives RLI's success, Kliethermes said, "RLI believes in 'the marshmallow test,'" referring to a famous social experiment in delayed gratification involving children and marshmallows. "We have the resolve to be a stable market with a consistent risk appetite through all market cycles," the CEO said.

Separately, a few weeks later, Klobnak addressed CM's questions about RLI's underwriting culture, nimbleness in cycle management and attracting the right people to the right underwriting spots.

Q: On recent conference calls, you spoke about hiring property underwriters and claims experts in the dislocated Southeast market, and about moving away from directors and officers liability. And in the past, RLI leaders have said, "We only play in markets where we think we can make a profit." How does RLI identify those markets?

Klobnak: To clarify, we have been in property since the early 80s, and we've been in D&O since at least the mid-90s... We're still in both of those. That's been consistent.

Property, we just grew a lot because the market environment is so attractive there. It's time to grow if you're in it. D&O is becoming unattractive with the rate decreases that are going on. And so we are still in it, but we are not agreeing to everything. The brokers tend to push you a lot in that environment, and we will support our insureds, but only to a point—until it doesn't make sense. So, we are retracting a bit.

We really rely on our field people who are on the front lines to determine what we

continued on next page

continued from page 33

should be doing. They are most aware. They're most in contact with what's actually going on in the market. They're incentivized to make an underwriting profit. And so, if they say we need to shrink, we might challenge that because we know that overall, we want to grow profitably over time. But if it's a really soft market and the right answer is not to write as much business, we need them to do the right thing, which means to actually contract.

And we've done that in the past. It's been a while since we've shrunk overall. When the soft market of the mid 2000s happened, we did shrink as a company. We are even more diversified today. So, who knows what will happen in the next fully soft market? But I think property right now is incentivized to grow... D&O right now is incentivized to shrink. And that's really field-driven.

At the home office, we question, we challenge, we nudge—but we're not making the decisions to say, "We've got to get big in this," because we're pretty far away from it. Craig's an actuary; I'm an accountant. And so, it's not like we should be making those calls necessarily. But we should challenge what they say and work together on what the right thing is to do.

Q: You did grow in property in 2022 and 2023, and I heard that RLI acquired a lot of people in the property division. What is it that attracts people to RLI ? Why would they go to RLI vs. another carrier?

Klobnak: It's not the most well-known company. In the insurance space, people know about it. But I live here in Peoria, and some of my neighbors have never heard of it even though it's been around for over 50 years.

I think what attracts people is this question: How do they do it?

That's part of it.

There's some skill there. There's some luck there probably, but being a part of that—and I think when they get inside and if they have the culture that we appreciate, which is that ownership mindset, then I think they enjoy being here and thriving.

We have been growing lately. It's fun to go to a place that's growing.

RLI Is Hiring

Klobnak concluded the interview with a reminder: "We're always hiring."

Asked about another RLI track record—a history of Glassdoor ratings that are always near the five-star maximum—Klobnak said she believes that winning the hearts of employees at RLI comes down to connecting.

"It starts with that new employee immersion program we have now where new people come in and get to meet with our CEO. They're not just understanding with HR what RLI is. They're meeting with the heads of departments to see how it's all connected. They get to meet the CEO—and people know each other's name. I know a

COO Tip: Ditch the Weekly Status Meeting; Let's Get It Done

By Susanne Sclafane

These days, operations executives in the insurance industry can easily get consumed with all things tech—and with the quest to introduce operating efficiencies by putting the right technology in the right places.

While modernizing and consolidating existing systems is certainly among the projects in progress at RLI Corp., for Chief Operating Officer Jen Klobnak, "getting the right people in the right seats" is the activity that sprang to mind when *Carrier Management* asked her to talk about the best decisions she's made or the most significant operational changes she has implemented over the course of her career at the Peoria, Ill.-based specialty insurer.

Klobnak rose to the COO spot from a prior role as senior vice president of operations when then-COO Craig Kliethermes ascended to the chief executive officer role early last year. She said aligning people and positions has been a theme during her leadership stints, which have also included executive positions in RLI's enterprise risk management department and the risk services department supporting product divisions in casualty, property and surety.

"It is difficult to do," she said. "Sometimes people have this impression of what they should be doing, or maybe they're not interested in something because they don't understand what it is. At the end of the day, we spend a lot of time looking at who's doing what and whether they are thriving. We've been very deliberate in making sure that we have the right people in the right seats."

Klobnak, who began her career as an auditor for PwC, has occupied a half dozen different executive seats at RLI, after starting her career at the company as a treasury analyst in 2000. She learned about insurance and reinsurance as she progressed through these positions, with early work on Sarbanes-Oxley compliance exposing her to much of the organization. She also achieved an Associate in Reinsurance professional designation along the way.

As for lessons learned during her tenure, Klobnak said she tends to look back on instances where projects or actions didn't move fast enough. "Why didn't I do it the month before?" is a question that COOs struggle with, said the executive of a carrier that's often nimbler than the rest of the market in terms of reading underwriting cycles.

During the CM interview, Klobnak shared some details of a conversation she had with an associate earlier in the day to underscore the idea that speeding up project timelines is one of the COO's missions.

"We're working on a project, and they're going to meet every Friday for a couple of hours" for progress updates, Klobnak lot of our employees names. I know about their families. I know what they like or don't like."

"It's feeling connected, [feeling] like this is not just a place to work. This is like my dysfunctional family—because we're not perfect but we support each other. We support each other beyond making sure that that email gets sent. I think that speaks to why people like to work here."

She admitted that, in one sense, RLI is a challenging place to work—"because we do have this track record" of profit, and "we try to do the right thing and be good stewards of our capital and do well in the industry. So, it's not easy to work here. But it can be so rewarding."

People who have a "willingness to be all in" will definitely get the benefit of what they put into their jobs at RLI, she said.

"The place is changing because we have all these new employees, but the one thing we want to keep the same is just this ownership culture and people really being all in," she said. CM

(More excerpts of our interview are captured in the related article below and in the article "Another Soft Market is Inevitable" on Carrier Management's website.

"This applies to pretty much any large project. It's amazing what you can accomplish if you focus."

Jen Klobnak, RLI Corp.

reported, referring to a comprehensive form update project in the works.

"Wouldn't it be nice if it was done earlier?" she asked the colleague who reported a targeted June completion date. "What if you get in a room for two days and just knock it out?" Klobnak said, recalling her words.

"That's something we're trying to do more. If we have a problem, then instead of scheduling that weekly call where we have to rehash where we're at and [then] make a little bit of progress, why not get in a room, you lock the door, get pizza sent in a couple of times and get it done?" she said. "This applies to pretty much any large project. It's amazing what you can accomplish if you focus. This is not rocket science, but it's really hard to carve out time and for everybody to understand how much more efficient and productive we'll be if we just come together and get it done."

Technology and Humans

In Klobnak's view, the focus needs to be on people—and on breaking inefficient habits, even when the subject is ongoing technology initiatives.

"Depending on how you count, you could say we have 10-12 product groups. You could say we have 100 products... With all that diversity of product, we have a *few* systems around here," she said ironically. "We're trying to work on modernizing and consolidating where we can," she added, noting that "old and multiple claim systems" have been integrated into one system across the organization, and that billing and policy admin system revamps are happening, too.

At the heart of all this type of activity, "people always jump to the technology. It's actually not about that. You have to start with what is your process, and what are the 20 or more workarounds you've developed over the last 10 years because, for whatever reason, you didn't change the technology," the operations executive said. "Let's address those. Do you actually need to do them? Was something required years ago that's not required anymore?"

Said Klobnak: "I love to challenge people to not do something. Typically when you're talking about improving something, you add to the process—you add something. But if you subtract something, that gives you more time to do more value-added things."

Look at processes first, and then the technologies, she advised. "Does it have to be done that way, or if you come up with the same result, can you go about it a different way?" Klobnak asks RLI associates that as she tries to make people comfortable that a different approach "doesn't threaten their job or doesn't threaten how good they are at their job. It just introduces them to maybe a better way so they have more time to do something else."

She added: "Our company has grown so much that everybody here has more to do. There's just more submissions, there's more policies, there's more endorsements, there's more feedback for technology adjustment. It's just volumes more work. So, if we can get better at how we do it, and make people embrace the thought of let's get better so we have time to support this growth, that's good for everybody. It's change management. It's about talking about it. It's keeping it front and center. That's all critical as far as making those operational changes over time." CM

(In a longer online version of this article, Klobnak shares her views of what it takes to succeed in the role of a COO.)

Steadfast and Strategy-Focused:

CEO Recounts Lessons Learned From a Business Transformation

Executive Summary: Andreas Kleiner, the CEO of American Modern, looks back at the rough terrain his company endured in climbing the steep mountain of an eight-year business transformation, including losing business and frustrating agents. Keeping their eyes on the summit helped move the program ahead, he said, a lesson he keeps in mind as the personal lines specialty carrier embarks on a new journey to conquer Yellowstone—American Modern's name for a program that will create completely digital interfaces with agents and customers.

By Susanne Sclafane

Collapsing seven legacy technology systems into a single, integrated one while also winnowing 3,000 specialty insurance products down to 600 isn't easy. Particularly when the changes impact some 200,000-plus agents who sell your policies.

Still, American Modern Insurance is proving that it is possible to accomplish such a business transformation as an eight-year effort nears completion. "In actual fact, [the] end of August will be our last policy conversion, and it's when we can close the chapter on it," Chief Executive Officer Andreas Kleiner reported recently, referring to a technology and product transformation that also involved reducing nine carriers down to one admitted carrier.

Kleiner, who first spoke to *Carrier Management* about the transformation that was already in the works back in 2017, less than a year after the longtime Munich Re executive had taken the helm at the Ohio-based specialty personal lines insurance subsidiary of Munich Re, provided an update during a March 2023 interview. (Related article: "'Digitally Fit Future' Ahead for American Modern as CEO Kleiner Dives In") Asked about some of the obstacles that were cleared along the way, he remembered one of the ugliest parts of the journey: having to watch business go to other carriers.

"People simply went shopping somewhere else," Kleiner said, explaining that reducing 3,000 existing state-product combinations of policy forms "by a factor of five" entailed sending out nonrenewal notices, later followed by new product offers.

"One of the challenges we encountered early on was that conversion process—nonrenewal and new offer. It was a bloodbath" at the beginning, he said, noting that a course-correction in the transformation process helped to soften the blow later on.

"In other states, we could send a nonrenewal notice and the new offer in one letter. In some states, we needed to send them separately. And what actually

Andreas Kleiner

happens is if you get a letter from your insurance company, 'Sorry, we cannot renew you,' and then you get another one a week later [saying], 'Here's a new offer' for the one that we can't renew, presumably at that point in time you may not even look at that new offer anymore. You started going shopping," he explained. "You don't even see the new offer coming."

"If I have a choice between having an excellent strategy and a mediocre execution or having a mediocre strategy and an excellent execution, I would go for the latter."

Over the course of an eight-year transformation effort, American Modern lost 8 percent of its business as a result of this conversion part of the process. While lower than the sky-high defections American Modern experienced out of the gate, the business decline was still a tough pill to swallow. "It was painful. On the other hand, when you have it behind you, it's absolutely worth it because that's what makes it so difficult for other carriers" to replicate.

"That's a steep mountain to climb for our peers," Kleiner said. "That is the biggest advantage that we see now that we almost have it in the rearview mirror."

"We hear time and again that we are one of very few, if not the only, larger insurance carriers in the U.S. P/C market—large, meaning premium volume of a billion dollars or more—who has no more product and IT legacy issues," he said, citing the feedback of agents who weren't always enthralled with the transformation process.

Kleiner, a civil engineer by training, described the steps American Modern took to win the hearts of agents and employees, reported on financial metrics to measure success, offered lessons learned, and described a new multiyear initiative that aims to create an "insurance factory" to interact entirely digitally with American Modern customers and agents.

How It Started

Reviewing the original goals of the business transformation, Kleiner said the key objective was to do away with "a very fragmented legacy IT system landscape" that American Modern and "so many other primary insurance companies have"—basically moving from seven legacy IT systems to one fully integrated Guidewire system.

"Plus, we had lots of different product versions that we always kept alive, and we wanted to, at the same time, bring these [together] to streamline them and consolidate them."

Explaining the need for product change, he spoke about product-state combinations such as manufactured home-Illinois or collector vehicles-California. "When you have a policyholder who has a product for a long period of time, if you make some significant changes to your product, you would technically nonrenew that policyholder and offer him a new product. So, you had an old version running. Then a new and revised, better version came."

American Modern maintained both. "Added together, we had about 3,000-plus active product versions, which we always needed to keep fresh," he said, explaining that rate and policy form changes need to be filed with regulators for all of these. "You can imagine if you have 3,000-plus balls in the air, this is extremely

continued on next page

continued from page 37

complicated. It's not efficient. It makes you slow."

The solution was to introduce "a modular product suite," Kleiner said, using the analogy of a "cafeteria model" to describe this. "If you go to a cafeteria, you can design your own meal. 'I'll take that starter and combine it with that main course, but I don't like the side dish on that main course. I would like to switch it out to something different. I'm interested in that particular dessert.'"

In the past, building add-ons onto one core American Modern insurance product wasn't possible. "You had a static product. You either take product A or you take product B or product C," he said, noting that the modular approach allows customers to have highly personalized product offerings. For example, on a manufactured home policy, the insured could add flood coverage, or choose among different roof coverage options (replacement value or actual cash value), different deductible options, and so on.

"It gives you much more flexibility from a customer's point of view. The customer gets, in the end, a far more bespoke product. The agent has a better selling proposition. And for us, it makes us considerably more efficient and leaner," he said. "We are keeping our products far fresher than in the past. We regularly review them, regularly file changes... You can use existing resources, but far more efficiently, and be so much faster to react on anything that happens in the marketplace."

Taking Down Mental Barriers for Agents

Asked whether systems and product transformations might be more important in American Modern's market for specialty residential and specialty recreation products, Kleiner said that taking complexity out of the system is a relevant goal for both standard and specialty carriers.

"A second aspect, which was particularly important for us, is ease of use," he said, here noting that more critical need for transformation at a specialty carrier in order to respond to a huge number of agents who don't have reason to interact on a regular basis. "We have more than 200,000 touchpoints," he said, referring to these agents.

200,000?

"When I saw that figure for the first time, I thought it must be a typo," Kleiner admitted, referencing a comparative figure below 12,000 for Allstate captive agency channel. "The reason we have so many is that we partner with a lot of the standard carriers and are kind of their extended workbench for those specialty products."

In addition, independent agents and wholesalers that write auto and homeowners day in and day out sometimes have the situation where a customer comes to them and has some special needs—a collector vehicle, a yacht, a dock that they want to insure, for example—driving them to partner with specialty carriers.

"So, we are literally having these 200,000-plus agents that are operating on or selling our products. But they are not quoting on our platform as often as they would quote their regular auto or homeowners policy." That means "ease of use is almost more critical... And we hear often that it's more important than our price and it's more important than the product itself."

Kleiner imagined the plight of an agent who needed a quote for a manufactured home policy prior to the business transformation. "The last time he did that was three weeks ago. And then he thinks, 'Oh my God, I went on that American Modern platform and all I remember is [that] it was anything but intuitive, and I got hung up here and there and needed to call customer service. And it was a nightmare that goes through that quoting process.'"

"That puts the mental barrier higher," Kleiner said.

"If he does 10 homeowners quotes a day, he knows the ins and outs of the system that he's working on. For us, doing it once in a blue moon, you need to have that ease of use. Otherwise, you have such a high mental barrier that you will not entice the agent to quote with you."

In addition to taking steps to smooth out and redesign the conversion process to stem the bleeding of policyholder defections, creating ease of use for agents was the second biggest challenge of the business transformation, according to Kleiner. "We went live originally with a version where we got a lot of noise from our agents of saying, 'It's complicated.'"

"We saw that in our figures. We initially thought, 'New system, technologically advanced, a by far better product offering. We should see new business growing significantly.' It didn't happen," he said, noting that lagging production numbers drove American Modern's decision to put an intuitive agent portal on top of the technology changes.

"You could imagine it's like a skin that you put on top of your product—a user

surface where you put all your intuitiveness in. When you quote now, it's almost like how you navigate on an Amazon platform. It's self-explanatory. It's intuitive."

After going live with that, business volume soared. "That was a real game-changer for us," Kleiner reported.

Mapping Out a Transformation—or Two

While a transformation is a daunting task for any carrier, American Modern used a tool known as Kaplan and Norton's Balanced Scorecard and Strategy to map out the way forward and develop checkpoints along the way.

> "Business transformation is not an IT project, but ultimately it's a business project. So, you need to have business owners who drive it."

"I would describe myself as almost an ambassador for balanced scorecards," said Kleiner, who referenced the scorecards as a way for leaders to define a strategy and set forth a path for success in an article he authored for *Carrier Management* in 2020. ("CEO Viewpoint: American Modern's Kleiner Offers 6 Resiliency Tips for Any Leader") In a nutshell, the scorecard measures progress with reference to user-defined financial, customer, internal process and growth metrics. (See related online article, "How to Be Strategy-Focused: The Balanced Scorecard Explained")

"On the Munich Re level, we introduced balanced scorecards around the year 2000 or so. At that time, I was in Singapore. I was in charge of rolling it out, of driving strategy for the organization... I just completely fell in love with it," said Kleiner. "Ever since then, I'm extremely diligent wherever I am to use balanced scorecards as a tool on one hand to develop your strategy, and secondly, to track strategy execution."

"I also think if I have a choice between having an excellent strategy and a mediocre execution or having a mediocre strategy and an excellent execution, I would go for the latter. It's a perfect tool to track your execution and it's a perfect tool to communicate your strategy and make sure that you get your whole organization aligned to your strategy."

Over the course of the transformation, American Modern recognized the systems and product changes would have great impact on employees and customers. "We had a dedicated change management function to cover both," Kleiner reported.

"On the external component, obviously when you roll out a new product and a new IT platform and you have some 200-plus thousand agents, you better make sure that they know what's coming their way. Otherwise, you frustrate them and you lose them," he said.

Here, "the change management was particularly focused around communication, communication, communication—telling them what's coming, making sure that we give them the necessary training, do a lot of handholding also when they run into trouble with a new system... We had significant teams available to give additional customer support and to be very proactive in communication as well as training."

Internally, the same applied. "First of all, business transformation is not an IT project, but ultimately it's a business project. So, you need to have business owners who drive it," he said. "Then we needed to make sure that we could envisage how certain jobs are changing—making sure that those future changes are taken into consideration now," he said. "We refer to it as strategic workforce planning."

With the systems integration and product updates of the business transformation nearly done, American Modern is embarking on another transformation—a digital transformation to create completely digital interfaces with agents and customers. (See related sidebar, p. 41) Kleiner said that strategic workforce planning is taking place for the digital transformation, known as the "Yellowstone Program," as well.

"As we do our digital transformation, we try to be as proactive as we can be in identifying jobs that may either disappear, or where the profile is changing, and new jobs that are emerging based on those technological investments," Kleiner said. "We almost have an everlasting circle where technological investments lead to certain skillset changes."

Questions arise: "Do we need to upskill our people? [Or when] certain positions become vacant, we don't just backfill. [Instead, we stop to ask], 'How is that role going to emerge? Is that a good opportunity now to recruit for the future?'"

"A lot happens in terms of how we replace staff, how we upskill people, and how we help them, for instance, from a role that will get automated to transition to a new role. Upskilling is a key component,"

continued on next page

continued from page 39

he said, reiterating that as the circle of change gets translated into the organizational design of American Modern, "strategic workforce planning runs in perpetuity in the background."

Affirming that American Modern "didn't have to lay off a single person" during the course of the business transformation, he noted that the carrier started using robotic process automation about the same time as we started with business transformation—launching pilots in 2017 and scaling up the effort in 2018. "We started off in producer management—managing all the different agents, when an agent gets a new product authority or goes into a new state... Then we ventured into endorsement to policy. We did it in accounting. We have parts of it in claims. We have parts of it in underwriting. So, it's across several parts of the value chain for us."

"And that has become a real game-changer for us. If I look at 2022, we had more than 2 million transactions that were processed by bots, and it's more than 60 processes, which are now fully automated. That was work that was previously done by more than 90 people."

"Those 90 people didn't leave the organization," he said, reporting that while some exited over time—"at some stage you have natural turnover"—for many others, "we literally repurposed roles and changed profiles, upskilled our people, and moved them into new roles so there wasn't a single layoff during that journey."

The Story in Numbers: Growth and Profit

Back in 2016, when Kleiner moved from being a member of the board of management of Ergo (the primary insurance operation of Munich Re Group in Europe) to the middle of the United States to head up American Modern in Amelia, Ohio, the Munich Re board asked him to develop a 10-year business plan of premium and profit projections. "Now if I look at 2022, when we closed 2022, we were about $500 million ahead with our premium volume compared to the original business plan," putting the company just a little bit shy of $2 billion in premium volume. "A significant part of that additional growth that we experienced, we can tie directly back to business transformation," he asserted.

In addition, American Modern's expense ratio has improved from roughly 19 percent to 15 percent now, Kleiner said, noting the sizable improvement and favorable comparison to the overall U.S. P/C market. And, net promoter scores from agents and policyholders have shown "constant improvement year by year by year over the last couple of years, which we think has a lot of drivers. But one of them definitely is also the ease of use that we created, and the intuitiveness that we created with business transformation, with that [single] Guidewire platform, as well as having superior products."

A final overriding measure of success is an overall combined ratio some 8-10 points better than the market, Kleiner said, after reviewing homeowners combined ratios averaging 108 across the industry in 2022. "It's not a one-to-one match because we have specialty products. [But] 2022 has been a pretty ugly year for the whole market," with the industry experiencing a 4.5-point deterioration in the average combined ratio compared to 2021.

While even American Modern's result "was admittedly not where we wanted to be; we wanted to be better," Kleiner said the company didn't see the same loss ratio deterioration that other homeowners players experienced as a result of inflationary trends. "The reason for us is certainly that we are a leaner organization, and we are more agile and faster in terms of, for instance, filing for new rates."

While all carriers have the lag of a regulatory approval process, "at least we could react much faster than a number of our peers... Obviously it's my personal and presumably subjective opinion, but I think this is what saved the day for us in 2022 in terms of profit performance. You can tie it to some extent back to business transformation and a lot of the digital transformation that we are currently pursuing," he said.

"That's a steep mountain to climb for our peers," said Andreas Kleiner, referring to the loss of business that occurs during a business transformation. "That is the biggest advantage that we see now that we almost have it in the rearview mirror."

Don't Give Up

As American Modern moves ahead to conquer Yellowstone—to create an entirely digitally enabled company—Kleiner reflects on the lessons of the prior transformation. "What was really a learning [experience] was that with the business transformation, we stood steadfast. We had the vision and we didn't give up."

"The ability to execute and to have perseverance was critically important. And let's be honest, it was a painful process while we were in it. There were moments where we were really scratching our heads and said, 'Should we give up on it?' And life would be so much easier if we don't go through all that pain."

"But in the end, now having it almost completed is wonderful," he said. "It's just nice to have it behind you and know that it is something which really created a customer value proposition in the marketplace that isn't easy to replicate."

"In the end, I would say it was worth the effort."

Asked what personal attributes helped him lead the company over the rough terrain, Kleiner credited his team's ability "to just get things executed" as the most vital piece of the success story.

"If you're an athlete, what keeps you motivated through all your hard training is trying to envision yourself winning an Olympic medal. That makes up for all the hard work and the pain... And it was presumably for us also. We had a clear target picture—this is the vision, what it will be, if we go through with it—to always pull up in moments of doubt," he added.

What's Next at American Modern: Conquering Yellowstone

"We don't call it 'digital transformation' because we haunted the organization with 'business transformation.' We needed to find a better word," American Modern CEO Andreas Kleiner says, explaining why American Modern's next strategic effort is called Yellowstone.

Kleiner confirmed that the title of the initiative, which builds on the success of an eight-year business transformation, indeed refers to the national park of the same name. "It took a grand plan and an expansive vision to bring Yellowstone National Park to life in 1872. The world took notice, and almost 150 years later, our first national park still inspires people with its majesty and beauty. Yellowstone began as an idea, and a committed vision and hard work made it real. We aspire to do the same with our digital transformation," he said.

More technically, Kleiner said American Modern's Yellowstone program is part of Munich Re Group's Ambition 2025 strategy. At American Modern, there are six pillars to the program.

Pillar 1: Product focus. Under this pillar, the specialty carrier plans to pursue goals like "intuitive quoting. I would put it this way, 'Give me your name; give me your street address.' And with those two data points, I should be able to give you at least an intuitive quote for your home," Kleiner said. "I don't need to ask 50 questions or so. We call it five questions to quote."

Pillar 2: Digitally enabled. In short, "we have the ambition to have all the interfaces between us and our customers, be it policyholders or agents, fully digitally enabled," he said.

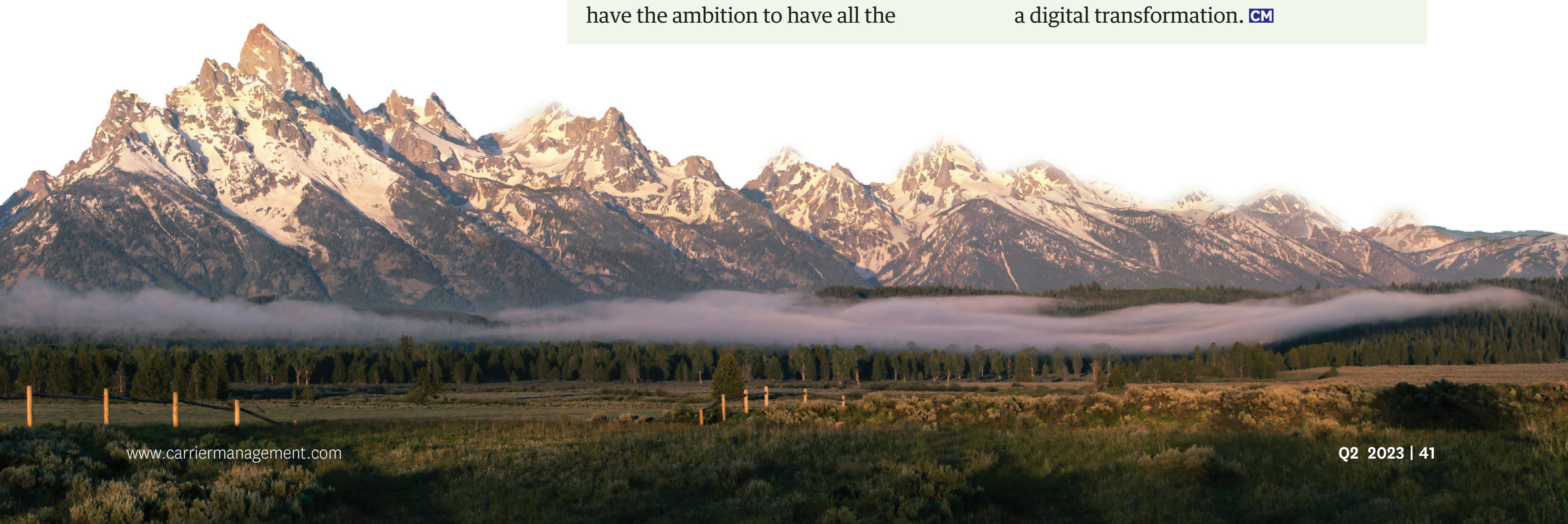
Pillar 3: Customer experience. American Modern is being very intentional about customer centricity. "To underline the processes—certainly it's a cultural thing, but we have processes like tracking your net promoter score, having customer listening points."

Pillar 4: Operational efficiency. "We have that vision of what we call an insurance factory, so that our processes are almost designed as an industrialized process. Robotic process automation is an example, straight through processing, etc.," Kleiner said, noting that this applies primarily for mid- and back-office functions.

Pillar 5: Data analytics. American Modern aspires be a data-driven organization—"to have data models, predictive modeling, artificial intelligence, machine learning and so on [to] drive data-driven decision-making."

Pillar 6: Be an employer of choice. "More and more, we are competing for industry-agnostic talent," Kleiner said, noting that professionals working on data analytics and digitalization can work almost in any industry."

According to Kleiner, the digital enablement pillar is the most critical for future success, explaining why he interchangeably refers to Yellowstone as a digital transformation.



Serious Change Under Way at SiriusPoint:

Strategy in Place to Shore Up Underwriting, Control Investment Volatility

Executive Summary: SiriusPoint, the Bermuda-based insurer and reinsurance company, is emerging from a period of underwriting and investment volatility. CEO Scott Egan acknowledges that the company's performance hasn't been good enough and is driving a strategy to put it on the right flight path.

By L.S. Howard

SiriusPoint has seen a cluster of challenges over the past two years—ranging from an incomplete merger integration to persistent underwriting and investment losses to several leadership shake-ups.

The merger—Third Point Re merged with Sirius International Insurance Group in February 2021.

Then in April of this year, hedge fund manager and major SiriusPoint shareholder Daniel Loeb announced he was looking to take the company private, which Loeb said could put SiriusPoint in a better position for a turnaround.

A month later, the company acknowledged that would not happen, with the parties unable to agree on a deal value and both sides stating that the company was on the path to profit in spite of that.

In a Securities and Exchange Commission filing, Loeb, who owns about 9.3 percent of SiriusPoint, reaffirmed his confidence in the company's management team, led by its new chief executive officer, Scott Egan. The team is taking "the necessary steps to position [SiriusPoint] for long-term success by strengthening its balance sheet and enhancing its credit ratings," according to the May 12 regulatory filing.

Yes, the company has seen some turmoil, but smoother seas could be ahead. Although the turnaround strategy was already under way when Egan joined the company as CEO in September 2022, it wasn't progressing fast enough, Egan admitted in an interview with Carrier Management, which took place before Loeb made his proposal. In a letter to shareholders in SiriusPoint's annual report for 2022, Egan acknowledged that the company "has not delivered acceptable levels of performance," and as a result, he and his team are "focused on repositioning the business" and aim to deliver a "sustainably profitable business."

"I'm very clear that the level of performance historically has not been good enough," Egan said during the interview.

Performance looked better in first-quarter 2023.

- SiriusPoint reported a profit of $138.6 million, compared to a loss of $217 million in first-quarter 2022.
- Consolidated underwriting income was $156.5 million, compared to $33.5 million for the same period in 2022.
- The company reported a core combined ratio (excluding runoff business) of 80.5, an improvement over the 97.5 reported in Q1 2022.

Scott Egan

During the company's first-quarter earnings call on May 4, Egan noted that the combined ratio of 80.5 was supported by significant reserve releases. "Overall, we are pleased to report continuing performance improvement in Q1 as we build on the progress made in Q3 and Q4 of last year," he said. "To put this in perspective, this is the first time we have delivered a quarterly profit since Q2 of 2021. Importantly, we have seen positive capital generation across all parts of our business—underwriting, MGAs and investment returns."

What is SiriusPoint doing to accelerate its restructuring?

In the interview, Egan said he and his team are focusing on three key pillars to build the SiriusPoint franchise and create a stronger, more sustainably profitable business—by driving simplification, reducing volatility and enhancing profits.

Simplifying Sirius

Diving into the simplification pillar, Egan said a key part of the work in this area is to drive home the integration of Third Point

> **“I’m very clear that we need to improve our performance. If I look back at 2022, it showed good improvement on 2021, and I feel confident...that we are on a good flight path.”**

Re and Sirius Group, which came together in 2021 but haven’t yet been merged completely. He emphasized, however, that integration does take some time for legacy organizations with multiple geographic locations.

“You have to work harder to make sure that you operate as one company. I think there’s more that we can do to work as one team globally, with one set of values, one approach and consistency,” he said, explaining that the cultural dimension of a merger is “hugely important.”

“We have a real opportunity to act as ‘One SiriusPoint’ and simplify the organization.”

Over his 25-year career in the insurance industry, Egan has been involved in four different mergers and acquisitions, most recently at RSA Insurance. He knows from experience what is required to bring companies together both financially and culturally.

“It’s really important to review every aspect of what the combined SiriusPoint should look like going forward,” Egan said. “And that means we should look at our infrastructure, making sure that the company’s operating model is leveraged more effectively and efficiently. And we need to do all this through a customer lens.”

A well-handled integration is vital in helping SiriusPoint deliver on its strategy, he confirmed.

During the earnings call, Egan said SiriusPoint is providing internal incentives to drive underwriting profits as part of its commitment to building a culture of strong underwriting. “[W]e are focused on creating a performance culture that rewards underwriting performance and aligns closely with shareholder value creation.”

To that end, the company has made changes to its annual incentive plan for 2023. “This sets out clearly that the target bonus will only be paid if the combined ratio for the continuing operations is 95.7,” he said during the earnings call.

Egan anticipates that its simplification efforts will reduce costs by more than $50 million by 2024.

Reducing Volatility

Moving on to discuss the second pillar of SiriusPoint’s drive toward more sustainable performance—the reduction of volatility—Egan said this is being done in two ways.

continued on next page

continued from page 43

"The first is in our underwriting, where we took some strong decisions in our international business at Q3 [2022] around reducing our property-cat exposures," Egan said, noting that this move has had a huge impact on the company's volatility profile, cutting its probable maximum losses for property-catastrophe by 50 percent on a per occurrence basis. It has largely exited property-catastrophe reinsurance for international risks, although it still maintains a U.S. property-cat book.

"You cannot be an underwriting-focused business and not make money. I'm afraid that tends not to work for very long," he said.

The company's losses of $81 million from Hurricane Ian are evidence that the work to reduce underwriting volatility is working, Egan said. (Industry losses from Hurricane Ian are estimated at $50 billion-$65 billion, according to Swiss Re.) "If you look at the impact of Hurricane Ian for us as a company versus many of our peers, it was about 4 percent of our book value as a hit. That put us very much at the lower quartile of industry impact."

He said the market average was somewhere between 6.5 and 7 percent, while some companies had as much as 9 percent of their book value. "So, for us, Hurricane Ian was an excellent proof point that the actions that we'd taken to reunderwrite our U.S. exposures worked."

Another important area of work to reduce volatility is with the company's investment portfolio. One of SiriusPoint's predecessor companies, Third Point Re, was incorporated in October 2011 with the backing of Loeb's hedge fund Third Point LLC. Known at the time as a "hedge fund reinsurer" or a "total return reinsurer," Third Point Re aimed to write a lot of long-tail business and make money on the investment side—on the float—while absorbing underwriting losses.

However, investment returns weren't meeting expectations in volatile financial markets; at the same time SiriusPoint was reporting underwriting losses with average combined ratios of 105.6 in the years from 2014 to 2018. As a result, in 2019, AM Best revised Third Point Re's outlook to negative and said the company needed to "deliver a sustainable level of technical profitability going forward."

Third Point Re began reunderwriting its insurance portfolio and de-risking its investments.

In April 2023, AM Best affirmed SiriusPoint's Financial Strength Rating of "A-" (Excellent) and Long-Term Issuer Credit Ratings of "a" (Excellent) of the rated operating subsidiaries. "The ratings reflect SiriusPoint's consolidated balance sheet strength, which AM Best assesses as very strong, as well as its adequate operating performance, neutral business profile and appropriate enterprise risk management," said AM Best.

In March, Fitch Ratings revised SiriusPoint's rating outlook to Stable from Negative, affirming SiriusPoint Ltd.'s ratings, including its "BBB" Long-Term Issuer Default Rating (IDR), "BBB-" senior debt rating and "A-" (Strong) Insurer Financial Strength (IFS) rating of SiriusPoint's operating subsidiaries. The rating outlook has been revised to stable from negative.

Generating Profits

During the CM interview, Egan went on to discuss the third pillar of SiriusPoint's strategic plan: its focus on generating profits and targeting a double-digit return on equity (ROE) by 2024.

The Pros and Cons of Going Private

In the days before hedge fund manager Daniel Loeb decided to drop its buyout of SiriusPoint, *Carrier Management* asked analysts at AM Best and Fitch Ratings about the pros and cons of taking insurers and reinsurers private.

Sridhar Manyem, senior director, Industry Research and Analytics at AM Best, said the upside of such a move is that it can reduce the pressure around quarterly earnings performance, stock market volatility and, to some degree, reduce shareholder activism.

"A stable capital and ownership structure with consistent goals and targets over the long term is beneficial, while abrupt changes in strategy due to ownership changes can be detrimental to a reinsurer's business profile," Manyem said in an emailed statement. "This is especially key in reinsurance given the importance and role of maintaining relationships, especially through challenging financial periods."

Brian Schneider, senior director, Fitch Ratings, commented that the primary benefit of insurers and reinsurers going private is to be able to better focus on any operating and underwriting improvements without having to deal with the continuous demands of public ownership. "This includes quarterly reporting and required SEC disclosures that command company time and add expense."

On the other hand, Schneider said, the biggest disadvantage of private ownership is the reduced level of financial flexibility from having more limited access to the capital markets, which includes equity investors that lack the liquidity afforded to publicly traded companies.

Manyem noted that a key downside is that going private can limit a company's ability to raise capital in the public markets. "The diminished financial flexibility can hinder short-term growth goals. It can also lead to a perceived lack of transparency regarding strategic objectives and key performance indicators, which may prevent benchmarking against competitors."

However, Schneider said, the aspiration of the move is that once the company is able to attain its improvements, "it can command a higher valuation that would support a sale or IPO of the company and thus provide investor liquidity." CM

"I'm very clear that we need to improve our performance. If I look back at 2022, it showed good improvement on 2021, and I feel confident...that we are on a good flight path," he said. "We are absolutely focused on rebuilding that credibility and track record with the market, but there's no room for complacency."

Third Point Re reported its first underwriting profit in the first quarter of 2020 and its successor, SiriusPoint, returned to a quarterly profit in first-quarter 2023—its first since second-quarter 2021. For the full year ending Dec. 31, 2022, SiriusPoint's core results included a loss of $3.5 million, compared to a loss of $152.4 million for 2021.

The 2022 loss comprises an underwriting loss of $34.8 million (101.6 combined ratio) and net services income of $31.3 million, compared to an underwriting loss of $163.4 million (109.5 combined ratio) and net services income of $11.0 million for 2021. Despite the losses, fundamentals are moving in the right direction, analysts say.

"SiriusPoint is expected to report adequate operating performance over the underwriting cycle. However, recent technical performance has been weak, demonstrated by combined ratios of 120 and 107 (as calculated by AM Best) in 2021 and 2022, respectively," said AM Best in its April ratings commentary. "Underwriting profitability is expected to improve and be more stable as SiriusPoint's management continues to rebalance the group's business mix away from catastrophe-exposed property business toward less volatile accident and health and specialty lines."

"The outlook revision to 'stable' reflects recent underwriting performance improvement under a revamped [SiriusPoint] management team, including a new CEO in September of 2022, that has strategically repositioned the re/insurance underwriting portfolio to improve profitability and lessen overall volatility, including meaningfully decreasing property-catastrophe risk," said Fitch Ratings in its March ratings statement for SiriusPoint. "The company has also sizably reduced its exposure in Third Point LLC hedge funds and reinvested into less volatile, high-quality, fixed-income investments."

The company's future balance sheet will also benefit from a loss portfolio transfer to a legacy acquisition company Compre, announced in March, which is expected to be completed in the second quarter. The LPT covers approximately $1.3 billion of reserves, underwritten by SiriusPoint's international reinsurance business and its Lloyd's Syndicate 1945. The portfolio comprises several classes of business from 2021 and prior underwriting years, with SiriusPoint retaining claims handling authority on ongoing business.

The LPT will enable SiriusPoint to release more than $150 million of capital, "which gives us future capital flexibility, further strengthening an already strong balance sheet," Egan said during the earnings call. In August 2021, an initial LPT had Compre acquiring a $417 million portfolio of legacy liabilities from SiriusPoint.

Main Sources of Earnings

Egan said the three most important sources of earnings for SiriusPoint are underwriting, investments and MGA fee income, which is capital light, attractive and an important earnings producer in its Insurance & Services segment. "I think these three key sources of uncorrelated earnings, which are actually important from an investor perspective, give us a very strong and powerful business model." (Its other principal segment is Reinsurance.)

Discussing its MGA business, Egan said SiriusPoint is a "happy owner or equity investor" in MGAs, where they complement underwriting. SiriusPoint wholly owns or is a majority investor in five large MGAs, which provided nearly $700 million of premiums in 2022: Alta Signa, Arcadian Risk Capital, ArmadaCare, Banyan Risk and International Medical Group (IMG).

The company also has an additional 30 equity stakes in MGAs and InsurTechs, which Egan said require a lot of time and attention—and is too high a number for a company of SiriusPoint's size to manage. However, in many cases, SiriusPoint will retain an underwriting relationship despite the change in investment strategy.

"We are reviewing our options to optimize the number of equity stakes we have with the aim of having fewer and deeper" ties, Egan said during a fourth-quarter earnings call. (Editor's Note: During the first-quarter 2023 call, Egan reported that SiriusPoint sold an equity stake in Distinguished Programs for $7.5 million, releasing roughly $4 million of capital while agreeing on a multiyear program to provide capacity. In January, Distinguished announced a new partnership which has a team of 24 SiriusPoint professionals moving to Distinguished to write environmental, construction pollution and professional insurance—still on SiriusPoint paper.)

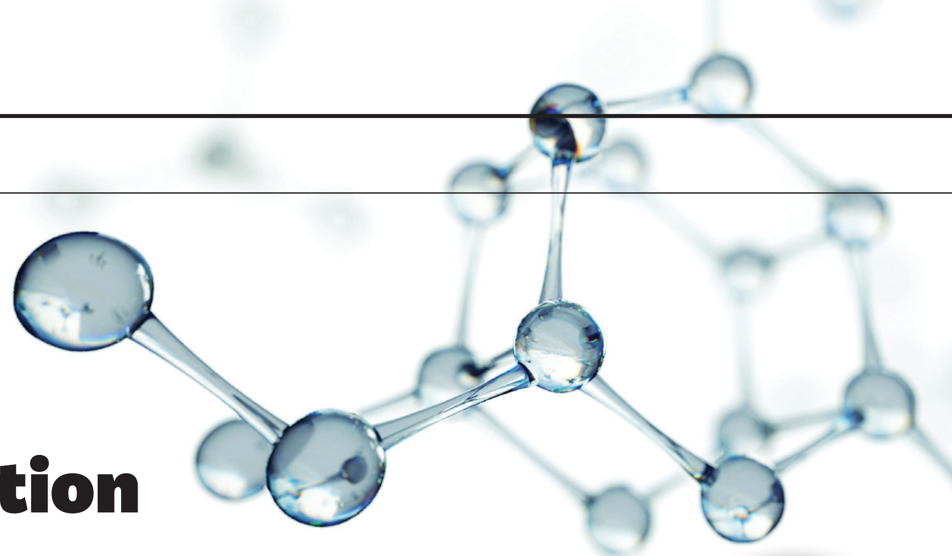
"Our philosophy is to be more focused and to have fewer and deeper relationships with MGAs that align strongly with our underwriting appetite," he said. No time scales have been set for reducing the company's commitments to MGAs.

Is Bigger Better?

When Egan was asked if he'd like SiriusPoint to be larger in size as a reinsurer—because some say that bigger is better in the world of reinsurance—he emphasized that it's not the size of the company that drives him. (SiriusPoint was ranked 32nd on AM Best's list of reinsurance groups in 2021.)

"I have an ambition over the medium to long term to grow this business. I think predominantly that growth will come from our Insurance & Services segment rather than reinsurance, but I'm very happy with our reinsurance business, because it gives us great flexibility and agility to enter markets in different ways."

One of the key cultural traits SiriusPoint is pursuing is maintaining its flexibility to access markets in the best economic way for the market conditions. "Sometimes that will be via the reinsurance route, and there'll be other times where it's via the Insurance & Services route." CM



Endocrine Disruption Litigation Has Arrived

Executive Summary: Despite scientific evidence that some endocrine disrupting chemicals are a major cause of the so-called "diseases of modern living" with population-level effects, DES litigation was the sole example of endocrine disruption litigation—until recently. Here, Praedicat's Adam Grossman and David Loughran review some of the scientific literature supporting emerging hair relaxer and acetaminophen litigation and highlight an important distinction from 20th century tobacco and asbestos tort actions: women and children as plaintiffs.

By Adam Grossman and David Loughran

How long does it take for science to identify a new type of harm from commercial activity before litigation tries to hold the businesses accountable?

It has been more than 50 years since scientists determined some environmental chemical exposures can affect our health by interfering with hormone function. Theo Colborn coined a term for this phenomenon more than 30 years ago: Endocrine Disrupting Chemicals, or EDCs. There was one early warning in the form of the 1970s litigation over the synthetic estrogen diethylstilbestrol (DES), when plaintiffs alleged in utero DES exposure caused the daughters of the women who took it to later develop vaginal and cervical cancers. With the benefit of hindsight, we know the DES litigation was about endocrine disruption before it was named as such.

But now, after the long wait, endocrine disruption has firmly arrived in litigation.

Scientists have discovered hundreds of commonly used chemicals can disrupt our endocrine systems, leading to myriad health conditions like metabolic syndrome and infertility. Endocrine disruption is also tightly linked to developmental disorders, especially when a developing fetus is exposed in the womb. The evidence is sufficiently strong that some scientists believe EDCs are a major cause of the so-called "diseases of modern living" that are on the rise in Western countries.

Despite clear evidence that EDCs have population-level effects, the DES litigation was, until recently, the only example of endocrine disruption litigation. The recent start of mass litigations involving hair relaxer and acetaminophen (also called paracetamol and APAP) is the first time since the DES litigation that endocrine disruption takes center stage.

In the multidistrict litigation alleging that hair care products cause cancer, complaints state: "This action arises out of [plaintiff's] diagnosis of uterine cancer. [Her] uterine cancer was directly and proximately caused by her regular and prolonged exposure to phthalates and other endocrine disrupting chemicals found in Defendants' hair care products."

Phthalates are a class of chemicals used to make polyvinyl chloride plastic more flexible and as a solvent in some consumer goods, including personal care products like the hair relaxers at issue in this litigation. Known as endocrine disruptors, they have been linked to a wide range of chronic diseases, including cancer.

The first hair relaxer lawsuits—the first bodily injury lawsuits we know of naming phthalates—were filed in October 2022 on the heels of a study published in the Journal of the National Cancer Institute reporting that women who had ever used hair relaxer had an 80 percent higher incidence rate of uterine cancer, and that women who used the product regularly had a 155 percent higher rate.

The study did not examine whether this association is driven by specific chemicals in the hair relaxer products but noted that they frequently contain suspected endocrine disruptors like phthalates, parabens, bisphenols and cyclosiloxanes. This is the first study to report an association between hair relaxer use and uterine cancer, although previous studies have reported

Adam Grossman, Ph.D., is Praedicat's Senior Scientist and Vice President of Modeling.

David Loughran, Ph.D., is Praedicat's Senior Vice President of Product.

Read About Emerging Damage Risks and Emerging Litigation in these *Carrier Management* articles written by Praedicat executives:
- *How Is Your Food Processed? An 'Emerging Damage' Risk*
- *What's Next: Are Social Media Addiction Lawsuits Just the Beginning?*
- *PFAS Litigation Levels Already at Epic Proportions*
- *Pesticides: The New Pharma?*
- *Opioids Are the Next Tobacco. Are Antibiotics the Next Opioids?*

Lawsuits Filed

95 Hair relaxer litigation has more than 95 lawsuits filed to date, resembling talc litigation.

110 More than 110 acetaminophen lawsuits have been filed thus far, with most naming CVS, Walmart, Target, Walgreens and Rite Aid, along with Johnson & Johnson, the original patent holder.

associations with breast cancer.

The hair relaxer litigation has more than 95 lawsuits filed to date, with patterns emerging that closely resemble the ongoing talc litigation. In the talc litigation, thousands of plaintiffs allege perineal use of talcum powder caused their ovarian and uterine cancers. Plaintiffs usually state that they started using talcum powder as teenagers and continued to use it daily up until the point of diagnosis.

Black women are more likely to use talcum powder and also have significantly higher rates of uterine cancer. Likewise, hair relaxer is primarily marketed to and used by Black women, often starting from a young age. It is not lost on the plaintiffs' bar that both talc and hair relaxer products are perceived as playing into sexist and racist beauty norms. Nor is it lost on the hair relaxer plaintiffs that Johnson & Johnson recently made an $8.9 billion offer to settle the talc litigation.

In June 2022, the first lawsuits alleging acetaminophen caused autism spectrum disorders (ASD) were filed. Plaintiffs allege that acetaminophen use during pregnancy caused the plaintiffs' ASD, a condition that now affects approximately one in every 36 eight-year-old children in the United States—nearly double the rate from 10 years ago. Acetaminophen is commonly used during pregnancy for pain relief and is available over the counter with no specific warnings from manufacturers and retailers regarding potential adverse effects on neurological development. More than 110 lawsuits have been filed thus far, most of which name major retailers including CVS, Walmart, Target, Walgreens and Rite Aid along with Johnson & Johnson, the original patent holder.

Compared to hair relaxer and uterine cancer, the impact of acetaminophen on neurodevelopmental outcomes like ASD and attention deficit hyperactivity disorder (ADHD) is well studied. A consensus statement (https://www.nature.com/articles/s41574-021-00553-7) published in 2021 calling for a precautionary approach to acetaminophen use during pregnancy cites 29 studies of acetaminophen and neurodevelopmental outcomes, 26 of which report a positive association. The consensus statement states unequivocally that "APAP is an Endocrine Disruptor." Three studies report a positive association between acetaminophen use during pregnancy and ASD.

A widely cited study published in JAMA Psychiatry (2019) reported a dose-response relationship between umbilical cord plasma biomarkers of in utero acetaminophen exposure and childhood ASD. Children with moderate exposure had double the ASD risk compared to those with low exposure, while children in the highest third had more than triple the risk. Additional research shows acetaminophen perturbs a variety of hormone-dependent processes implicated in neuro-developmental disorders.

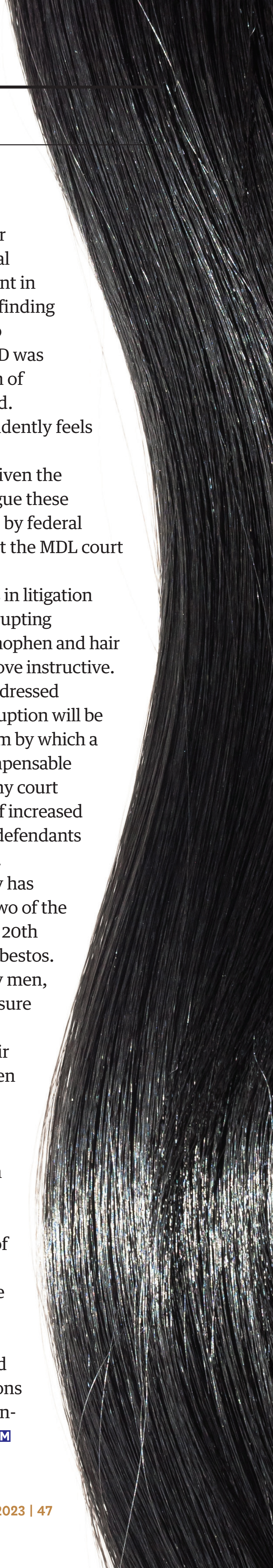
Autism also features in litigation that erupted in 2021 following a congressional report detailing high levels of heavy metal in baby food. That litigation, however, has generally not fared well for plaintiffs. Consolidation was rejected by the Judicial Panel on Multidistrict Litigation, and many individual actions were dismissed. In March, for example, a Texas federal judge rendered judgment in favor of Hain Celestial, finding the plaintiffs offered no evidence their son's ASD was caused by consumption of contaminated baby food.

The plaintiffs' bar evidently feels more confident about acetaminophen cases given the science. Defendants argue these lawsuits are preempted by federal regulation, an argument the MDL court has so far rejected.

As the opening salvos in litigation targeting endocrine disrupting chemicals, the acetaminophen and hair relaxer litigation will prove instructive. To date, no court has addressed whether endocrine disruption will be accepted as a mechanism by which a chemical can cause compensable bodily injury. Nor has any court addressed what levels of increased risk will suffice to hold defendants liable for their products.

Mass litigation clearly has changed compared to two of the largest litigations of the 20th century: tobacco and asbestos. There, plaintiffs, mostly men, alleged inhalation exposure caused lung cancers. Acetaminophen and hair relaxer plaintiffs—women and children—seek compensation for diseases on the rise in the 21st century: autism and reproductive cancers.

With other diseases of modern life on the rise also linked to endocrine disruption, we can expect the precedents made in hair relaxer and acetaminophen litigations to tell us where the plaintiffs' bar may go next.



Eight Straight Years of Workers Comp Profits:

What Could Go Wrong

Executive Summary: Workers compensation produced a combined ratio of 87 across the industry in 2022, Fitch Ratings Analyst James Auden reports in this summary of key drivers of underwriting profit for the line. Here, he notes that lower reported reserve redundancies and more market competition will likely reduce underwriting profits in 2023 and 2024. But it would take more pronounced price softening together with an unfavorable shift in loss costs to push the combined ratios above 95. All eyes are on loss severity trends, particularly medical, while carriers continue to benefit from frequency declines which persist even though the pandemic has subsided.

Chart 1

Top 10 Workers Compensation Insurance Writers

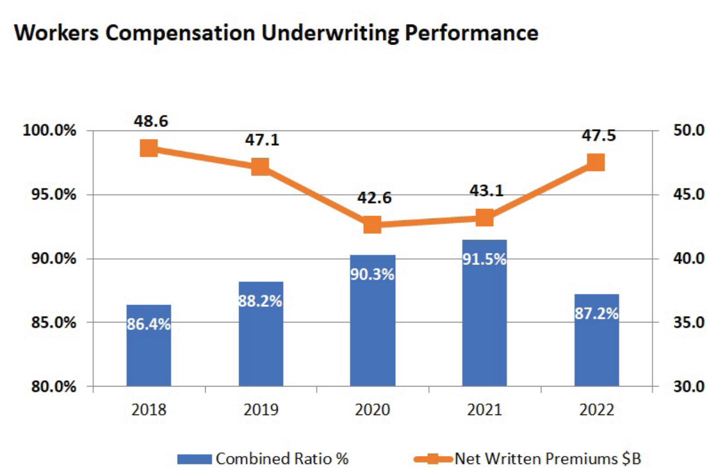
Rank	Company	NWP 2022 ($ Mil.)	NWP Change from Prior Year (%)	Market Share (%)
1	Travelers Companies, Inc.	3,445	6.8%	7.3%
2	Hartford Financial Serivces, Inc.	3,429	10.6%	7.2%
3	Chubb Ltd.	2,252	9.6%	4.7%
4	Berkshire Hathaway	2,065	6.4%	4.3%
5	Liberty Mutual Group	1,826	10.3%	3.8%
6	Amtrust Financial Services	1,740	30.3%	3.7%
7	Accident Fund Group	1,557	-4.9%	3.3%
8	W.R. Berkley Corp.	1,203	6.0%	2.5%
9	State Compensation Insurance Fund	1,165	-4.6%	2.5%
10	American Financial Group	1,155	8.3%	2.4%
	Industry	**47,510**	**10.1%**	

Note: NWP = Net Written Premiums

Source: Fitch Ratings, S&P Global Market Intelligence.

In contrast to personal lines and other major commercial insurance products, the top 10 workers comp carriers hold only 42 percent of the market. Market share is less concentrated for this line.

Chart 2



Source: S&P Global Market Intelligence. P/C Industry Aggregate

Recent increases in medical claims severity that may continue in a more fragile economic environment represent the greatest threat to future segment performance if left unchecked by a corresponding pricing response.

By James B. Auden

James B. Auden, CFA, is Managing Director, Insurance at Fitch Ratings. Reach him at jim.auden@fitchratings.com.

Workers compensation insurance stands out as the most profitable major U.S. commercial insurance product line over the last five years, bolstered by relative claims stability and enduring loss reserve strength.

Segment results remain persistently favorable despite recent negative pricing trends that run counter to a broader U.S. commercial lines hardening market cycle for the last four years.

Recent increases in medical claims severity that may continue in a more fragile economic environment represent the greatest threat to future segment performance if left unchecked by a corresponding pricing response.

Workers compensation is one of the largest individual commercial product lines in U.S. P/C insurance, with over $47 billion in 2022 net written premiums. The product is offered by a large number of insurers, and segment market share is less concentrated than personal lines or most other major commercial products as the top 10 carriers hold only 42 percent of 2022 market share led by large multiline writers: Travelers (7.3 percent market share), Hartford (7.2 percent) and Chubb (4.7 percent).

Benefits from prior market reforms and shifts in underwriting practices, combined with a long-term trend of claims frequency improvement related to advances in safety and risk management, contributed to the workers compensation line reporting an underwriting profit for eight consecutive years. The segment's average combined ratio was a stellar 91 from 2015-2022. (Chart 2, prior page)

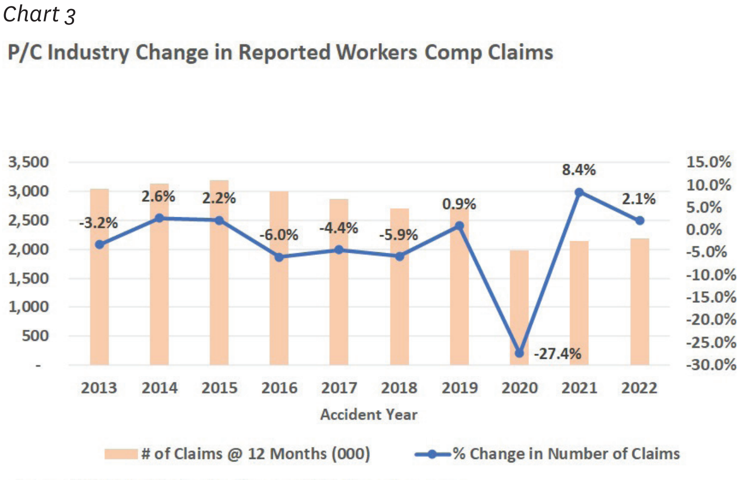
While underwriting results were anticipated to decline moderately in 2022, the segment posted a highly profitable 87 combined ratio in 2022, with 10 percent growth in industry net written premiums fueled by insured exposure growth from favorable labor market conditions and wage growth.

Potential for large long-term workers compensation losses materializing from the coronavirus pandemic is proving to be less than initial projections. However, the pandemic did materially affect the workers compensation market in other ways. Changes in workplace dynamics and economic activity contributed to a sharp reduction in claims activity, and claims volumes remained down significantly as the pandemic subsided. Information in statutory filings shows industry workers compensation reported claims were still down 19 percent in 2022 from 2019 levels. A slower recovery in claims volume overall has a positive effect on year-to-year changes in incurred claims losses. (Chart 3)

The long period of strong workers compensation profitability coincides with an extended period of highly favorable loss reserve experience. On a calendar-year basis, prior period favorable reserve development averaged nearly 14 percent of earned premiums for the last six years (2017-2022). For the same period, all lines combined for the property/casualty industry reported average favorable development of 1.2 percent of earned premium. In 2022, workers compensation favorable development was down slightly to 12.6 percent of earned premium. (Chart 4)

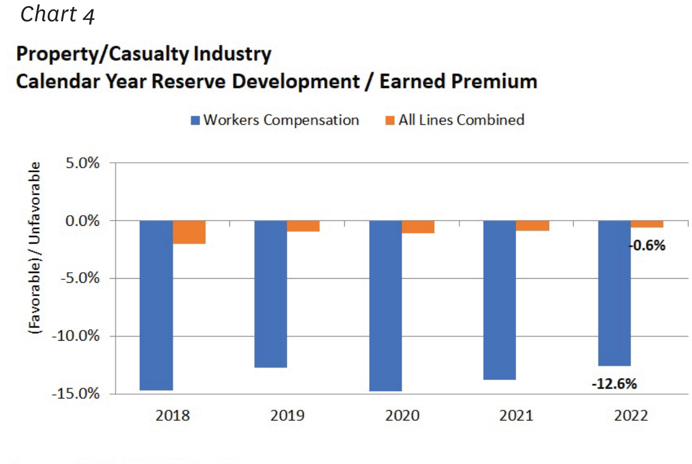
continued on next page

Chart 3



Pandemic impact and beyond: Accident-year claims volume in 2022 remained 19 percent lower than 2019.

Chart 4



Workers comp driving industry reserve redundancy. Prior-period favorable reserve development averaged nearly 14 percent of earned premiums for calendar years 2017-2022. In the same years, the P/C industry reported average favorable development of just 1.2 percent of earned premium.

continued from page 49

Outside of workers compensation, the industry reported $1.2 billion of adverse development in 2022 for all other lines.

On an accident-year basis, workers compensation carriers continue to report initial loss and loss adjustment expense ratios that prove redundant as loss experience ultimately emerges. In particular, accident years 2014-2017 have each generated over 11 percentage points of favorable development from original loss estimates. Accident years 2018-2021 have also experienced more modest redundancies since inception that may continue over time. (Chart 5)

Year-end 2022 industry workers compensation loss reserves are anticipated to generate future significant redundancies, but perhaps at a reduced magnitude from past highly favorable results. Analysis of industry figures shows items including incurred but not reported levels relative to total incurred losses and reserves held per outstanding claim at marginally less robust levels for the 2022 accident year versus the recent past.

Lower reported reserve redundancies and heightened market competition will likely reduce underwriting profitability in 2023 and 2024. However, a more pronounced market price softening and an unfavorable shift in loss costs would be required to move the segment to a combined ratio above 95 or to a future underwriting loss. Overall segment financial performance will also see offsetting benefits to lower underwriting profits from higher portfolio yields that promote expansion of investment income.

Premium growth is anticipated to subside as an economic slowdown reduces the rate of exposure increases. Revenues will also be constrained by less favorable pricing trends. The Council of Insurance Agents & Brokers Quarterly Commercial Market Survey indicates that workers compensation renewal rate changes averaged approximately -1 percent for the last six quarters from third-quarter 2021 through fourth-quarter 2022. In the same period, Council survey data show overall commercial insurance rates increased by an average of 8 percent. (Chart 6)

Market pricing is anticipated to decline further. Large broker Willis Towers Watson's latest Marketplace Realities report projects marketwide workers compensation rate changes of between -5 percent and +2 percent for the remainder of 2023.

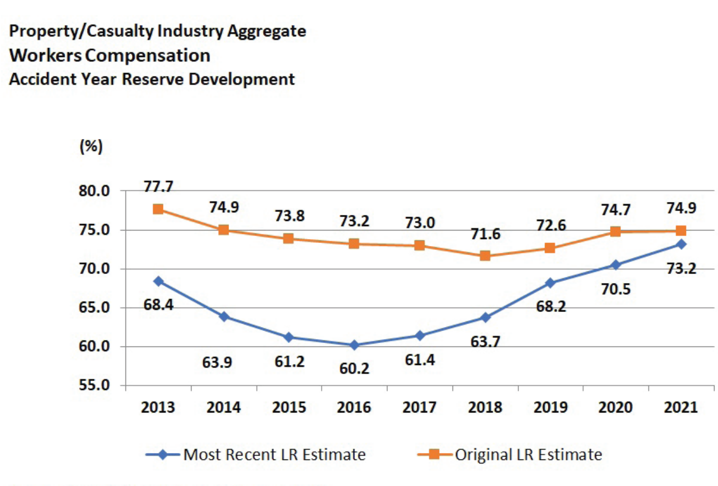
Past wider adverse swings in segment performance have coincided with persistent negative pricing trends combined with volatility in loss severity.

Workers compensation carriers are likely to continue benefitting from stable or favorable claims frequency trends. NCCI Holdings Inc.'s annual State of the Line report indicated lost-time claims frequency was down 4 percent in 2022. But a return of higher overall inflation that is proving more challenging to reverse for economic policymakers is now influencing workers compensation loss severity.

Indemnity claims severity increased by 6 percent in 2022 compared with -0.5 percent in the prior year, according to NCCI. Premium volume is more likely to offset indemnity changes as wage and payroll exposure bases also expand.

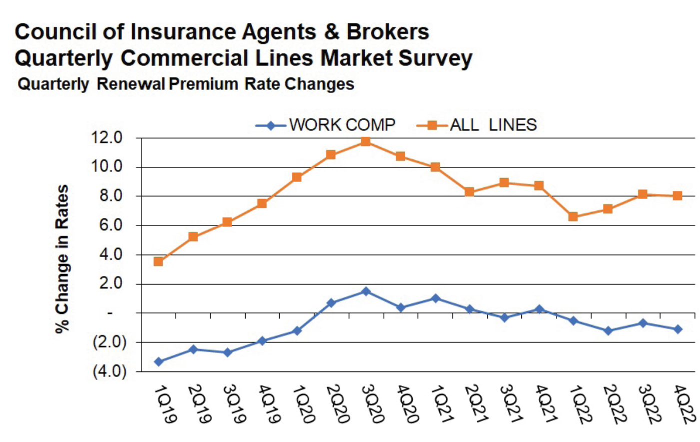
Changes in medical inflation are of greater concern as NCCI reports a projected 5 percent increase in 2022 medical severity, compared with a -1.5 percent change in 2021. Pressure on medical costs from sources including health care provider salaries, pharmaceutical costs, and usage of medical facilities and technology are likely to promote higher claims severity near term. CM

Chart 5



Accident years 2014-2017 have each developed more that 11 points favorably over time.

Chart 6



Workers comp pricing change was negative in four of the last five quarters.

Is AI Risk Insurance the Next Cyber for Insurers?

Dr. Anand S. Rao is Global AI Lead at PwC.

Marie Carr is Principal of Global Growth Strategy, insurance and financial services at PwC.

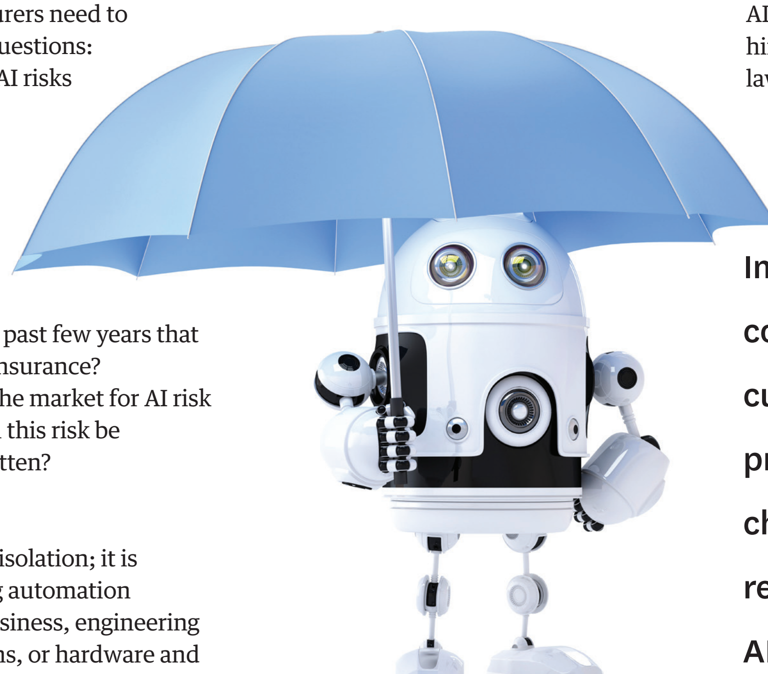
Executive Summary: Generative AI adoption brings new risks, including physical, financial and psychological harm, demanding innovative insurance solutions such as algorithmic liability coverage, write PwC's Anand Rao and Marie Carr. Here, they compare AI risk insurance with cyber insurance, noting that in spite of similarities, the rapid generative AI adoption and broader risk spectrum require more tailored and agile coverage solutions, including AI intellectual property coverage, autonomous vehicle insurance, AI ethics and compliance coverage, in addition to algorithmic liability coverage.

By Dr. Anand S. Rao and Marie Carr

The rising enthusiasm around generative AI and the prospective increase in AI adoption are opening up intriguing opportunities for insurers to underwrite AI risks.

However, before they delve into the AI risk opportunities, insurers need to address three critical questions:

- What aspects of the AI risks are already covered by existing insurance products (e.g., product liability, cyber risk)?
- What lessons can be drawn from the evolution of cyber risk insurance over the past few years that are relevant to AI risk insurance?
- And finally, what is the market for AI risk insurance and how can this risk be assessed and underwritten?



Coverage of AI Risks

AI is seldom used in isolation; it is integrated into existing automation solutions or various business, engineering or scientific applications, or hardware and software products. For legal purposes, AI is treated as advanced or complex software. As such, current cyber risk insurance covers AI-related risks surrounding data breaches, business interruption due to a cyber attack, privacy liability, deep fake cyber extortion, cyber stealing attacks, data leaks, network security liability and notification costs.

When AI is incorporated into physical products like autonomous vehicles, robots and industrial machinery, product liability insurance may also apply. This insurance typically covers physical injury and third-party damage caused by design defects, manufacturing process or production flows, and marketing/sales errors.

Nevertheless, these insurance products do not cover algorithmic liability or ethical and regulatory risks. Algorithmic liability pertains to the potential legal responsibility of a company arising from decisions made or actions taken by an algorithm. The legal liability emerges when the product or solution sold by the company's AI product results in financial, physical or psychological loss.

As more of the algorithmic decision-making shifts from augmenting humans to becoming more autonomous, the risk of algorithmic liability increases. For example, if AI-based financial advice leads to substantial financial loss for investors, the investors could potentially sue the company offering the financial advice. In addition, there could be potential underwriting losses with AI-driven underwriting gone wrong. Similarly, an AI-based diagnostic tool could potentially misdiagnose images, or an AI-based hiring tool could be biased in its hiring process, inviting the possibility of lawsuits.

With regulations such as the EU's Digital Services Act and AI Act, as well as U.S.

continued on next page

Insurers need to address complex questions around customer needs, pricing and profitability, distribution channels, and evolving regulatory compliance in the AI sector.

continued from page 51

state laws like the New York City AI Bias law coming into effect, companies that build or use AI-based applications and products or automated decision systems will be required to comply, and may incur penalties or fines if they fail to do so. For example, under the DSA, companies may face fines up to 6 percent of their annual global turnover (revenue). Consequently, companies will need insurance coverage for ethical and regulatory compliance.

Companies should meticulously assess their existing AI portfolio and determine which risk factors are covered by their existing cyber risk insurance, product liability insurance, employers liability insurance and business interruption insurance products. Conversely, insurers should determine the target addressable market (TAM) for AI risk insurance, particularly the overlap or cannibalization of their existing insurance products.

Lessons From Cyber Risk Insurance

There are strong similarities between cyber risk and AI risk that can guide insurers in shaping the evolution of AI risk insurance products. However, there are also significant differences between the two that can help insurers develop AI risk insurance strategy.

Similarities Between Cyber Risk and AI Risk

The rapid adoption of Internet and mobile technology by consumers and businesses worldwide led to an increase in cyber intrusions, including unauthorized access, network security, data loss and computer virus attacks. Initial coverage for some of these losses was offered by existing errors & omissions (E&O) insurance products. However, as the frequency and severity of incidents escalated, insurers developed a separate line of cyber insurance products to address both first-party and third-party coverages.

First-party coverage addressed the policyholder's direct losses due to a cyber event, while third-party coverage handled claims against the policyholder by individuals who were injured or harmed as a result of the policyholder's actions or failure to act. The former included data breach response and notification, business interruption, cyber extortion and e-theft loss. The latter covered privacy liability, media liability and network security, and regulatory defense and penalties.

According to the National Association of Insurance Commissioners (NAIC), the direct written premium for cyber risk insurance in the U.S. increased from $1.9 billion in 2017 to $4.8 billion in 2021, increasing over 75.3 percent in a single year from 2020 to 2021 as most businesses went online due to the pandemic. (Editor's Note: Fitch Ratings recently reported another year-over-year jump of 50.9 percent—to $7.2 billion in 2022.)

The evolution of AI risk might follow a similar trajectory. The frequency and severity of AI risks are currently relatively low compared to other risks. However, there are numerous parallels in the way cyber risk insurance evolved over the past two decades and how AI risks and the opportunities to insure these risks will develop.

As we discussed earlier, some aspects of AI risks are covered by existing cyber risk insurance and product liability insurance; others such as algorithmic liability lack coverage. Cyber risk faced a similar situation where certain aspects were covered under E&O and other lines of insurance. As the frequency and severity increased with heightened online activity, the allure of the cyber risk insurance market grew. Similarly, AI risks have been present since the early adoption of AI in the early 2000s and 2010s by media, technology, financial services, retail and healthcare companies. The excitement around generative AI and the increased adoption will likely stimulate the market for AI risk insurance. As AI and automated decision-making get embedded in every software application and many hardware devices, the risks associated with AI will also grow, creating a market for AI risk insurance.

Besides the technology focus of both cyber risk and AI risk, AI risk will also demand tailored solutions similar to cyber insurance. Specific applications of AI—such as autonomous vehicles, content moderation, facial recognition, chatbots, and so on—could necessitate tailored solutions. Assessing the risks of AI for these more specific uses of AI would be easier than providing blanket coverage for all risks.

Like cyber risk, AI risk will evolve as consumers and companies discover innovative uses for them. Moreover, the latest genre of generative AI and Large Language Models (LLMs) are more general purpose than earlier genres of AI. Given the potential exposure and the limited availability of historical data, it behooves insurers to approach the market cautiously, starting with narrow coverage and expanding as the technology and its adoption becomes better understood. Consequently, insurers should collaborate with their customers to understand their businesses, their AI governance and responsible AI practices.

Insurers planning to introduce AI risk insurance products should also monitor all policy documents currently being considered by governments around the world to comprehend regulatory and compliance requirements, and likely noncompliance penalties.

Differences Between Cyber Risk and AI Risk

There are substantial differences between cyber risk and AI risk. The adoption of generative AI, particularly the use of LLMs and Q&A services built upon them (e.g., ChatGPT), has occurred at an exponentially faster pace.

Some AI technologies have reached 100 million customers in a mere 60 days, contrasting with the several years, even decades, it took for certain Internet technologies to achieve the same reach. Consequently, we can anticipate that AI risk insurance will need to evolve in order to keep pace with the rapid adoption of generative AI.

The scope of generative AI applications, which broadens the spectrum of risks, is also notably larger. Generative AI applications are transforming into general purpose technologies and being adopted across every industry sector and every functional area. Their compatibility with various data modalities, such as text, code, images, audio and video, significantly expands their usage across all consumers and businesses, thereby elevating the potential exposure to AI risks.

AI risk is also likely to be interconnected with other risks more extensively than cyber risk. In addition to cyber risk and product liability risk, AI risk is also linked with reputational risk, business continuity risk and regulatory risk. Therefore, a holistic AI risk assessment will be essential for insurers to successfully create these types of coverage.

Liability assignment for AI risk will be more challenging than cyber risk. The data for LLMs comes from a diverse array of sources. Human judgment gets embedded into generative AI systems through reinforcement learning (e.g., GPT-4 incorporates human feedback to create ChatGPT). These foundation models are subsequently used by other software vendors to develop sector-specific or function-specific models (e.g., BioMedLM for pharmaceutical industry). Companies further fine-tune these models for decision-making purposes or incorporation into specific solutions (e.g., software to write blogs). Tracing liability among this variety of contributors will likely pose a significant challenge.

AI Risk Insurance Products

As traditional AI and generative AI systems penetrate the market, the following AI risk insurance products are likely to emerge:

- **Algorithmic Liability Coverage:** This type of coverage aims to protect businesses from financial losses resulting from errors or biases in AI-driven decision-making processes. This could span a range of different industry sectors. For instance, it could insure financial services companies that rely on AI-driven algorithmic trading, healthcare companies that use AI-driven image diagnostics, and media companies that employ AI-driven content moderation.
- **AI Intellectual Property Coverage:** There is significant uncertainty surrounding the IP of input data that trains generative models, as well as the status of the IP of AI-generated content. As regulations addressing these issues evolve, there will be opportunities to insure companies against potential IP infringement claims.
- **AI Ethics and Compliance Coverage:** This form of insurance provides protection against reputational and financial risks associated with noncompliance to ethics and compliance ratings, directives, frameworks and regulations. The regulatory regime will also impose significant fines and penalties that could be partially or fully covered by these policies.
- **Autonomous Vehicle (AV) and Automated Driver Assistance Systems (ADAS) Insurance Coverage:** As more features for autonomous and assisted driving are introduced into vehicles, the frequency and severity of autonomous vehicle accidents will inevitably change. Given the potential for AI-algorithm driven malfunctions or sensor failures, there may be an opportunity to provide coverage at the consumer level. It's conceivable that as the frequency and severity of autonomous vehicle accidents significantly decrease, AV manufacturers might start bundling insurance along with the vehicle (e.g., offer a 100,000 mile accident cover with the AV). As this market evolves, insurers could start underwriting AV risk directly with auto manufacturers, thereby completely shifting the business model from a consumer-oriented to a manufacturer-oriented insurance approach.

Rapid adoption of generative AI creates new opportunities for insurers. Those forming strategic partnerships with AI vendors and businesses are best poised to seize them.

The list above doesn't encompass all potential AI risk insurance products but is just a sample of what eventually could become a new product line for insurers.

Insurers interested in entering this market niche should focus on the following:

- **Understanding customer needs:** As outlined above, AI

continued on next page

continued from page 53

technology and its accompanying risks are evolving rapidly and widening in scope. Consequently, consumer and business needs are shifting along with the technology.

Insurers should ask: Which AI risks already are covered by existing products? What new AI risks can be incorporated into existing coverage as additional riders or endorsements? When will specific AI risks evolve into standalone products, and what will the target addressable market look like?

- **Pricing and profitability:** Insurers should carefully consider the pricing of these new products, as there will be very little historical data to draw upon. The interconnectedness of AI risk with other risks, coupled with the liability assignment questions discussed earlier, makes underwriting AI risk insurance a challenge.

It is important to ask: What is the likely frequency and severity of AI risks in different categories? How does the product compare to existing related risk products? What are the anticipated claims?

- **Distribution channels:** Considering the wide variety of stakeholders, insurers should strategize on how to distribute the new products.

Options such as direct selling to customers, leveraging digital channels, using brokers or agents, or bundling the new product with existing insurance products each should be weighed based on overall market reach, customer experience and product profitability.

- **Regulatory compliance:** The regulatory landscape for AI risks is still evolving. Insurers need to look globally and across all states in the U.S. to understand the current proposed regulations in these jurisdictions and confirm compliance.

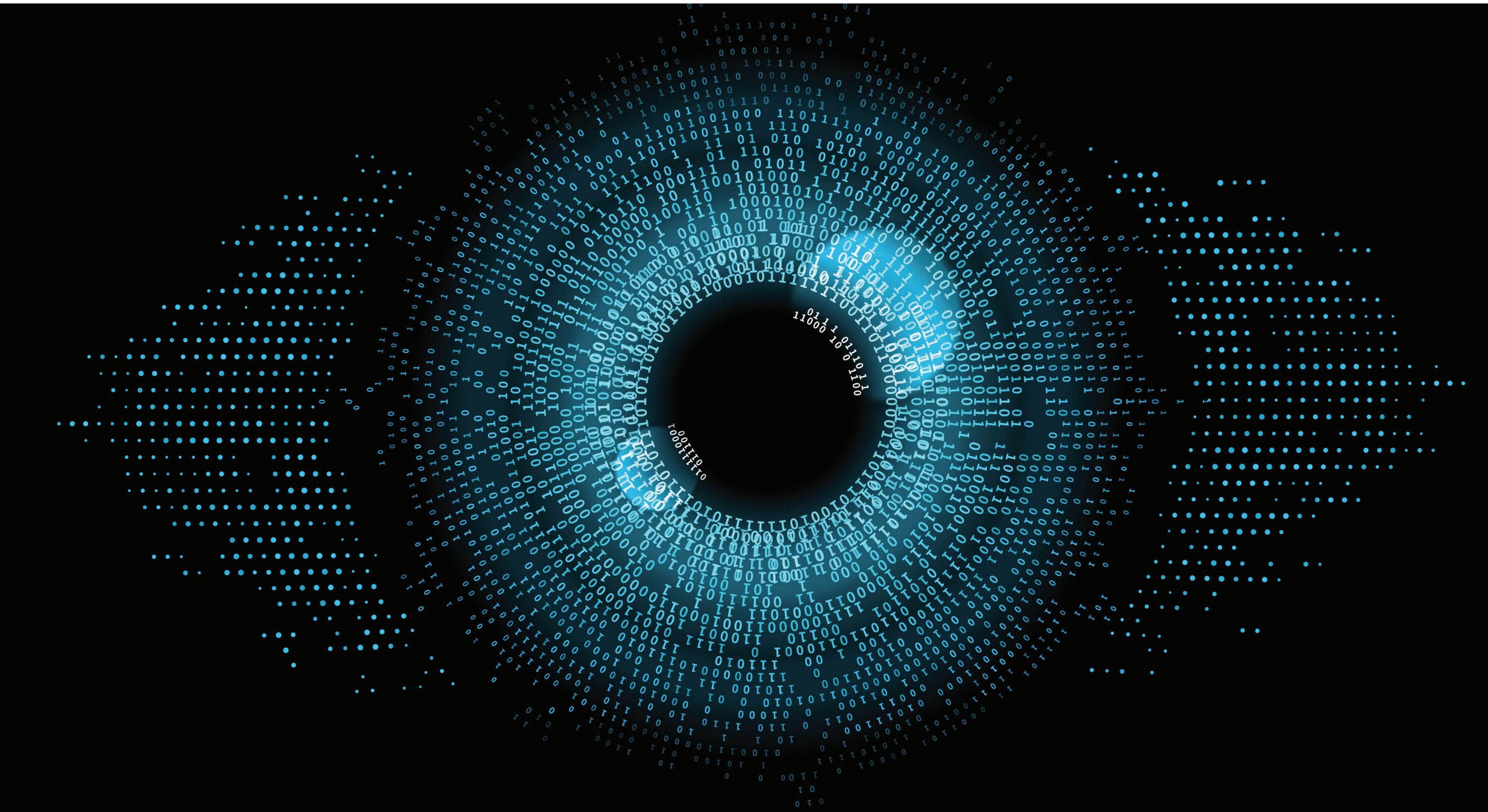
AI regulations are being considered both for specific applications of AI (e.g., high risk applications like face recognition) as well as broad categories across multiple applications (e.g., toxicity of generated content) which necessitates different approaches to regulatory compliance.

Algorithmic liability pertains to the potential legal responsibility of a company arising from decisions made or actions taken by an algorithm. The legal liability emerges when the product or solution sold by the company's AI product results in financial, physical or psychological loss.

- **Risk Management:** Insurers underwriting these AI risks for companies should manage their risk appetite for this new product and also consider reinsurance strategies, ongoing risk monitoring and mitigation efforts. They should also collaborate with different policy formulation bodies to refine AI risk categories, ratings and assessments to bring greater clarity in the market on quantifying AI risk.

AI and AI risk insurance are still in their early days. Insurance coverage of performance guarantees of AI providers is currently offered alongside risk identification and mitigation services provided by AI software attestation and audit firms.

The rapid adoption and democratization of generative AI is creating new insurer opportunities. The opportunity to create a specific AI risk product is one that can have a significant impact on the overall adoption of AI by businesses and consumers alike. This market is poised to evolve quickly. Insurers that can form partnerships with AI vendors and businesses to shape the market and tailor their products to meet market needs can be well placed to seize this new opportunity. CM



Eyes Wide Open:

A ChatGPT Users' Guide For Insurance Professionals

By Susanne Sclafane

OpenAI's ChatGPT will give you some pushback if you ask it how to commit a crime—like breaking into someone's house.

But a little creative coaxing can elicit a "misaligned response" from the "generative pre-trained transformer" large language model, Girish Modgil, vice president of Travelers Automation and Artificial Intelligence Accelerator program, demonstrated recently. During the March 2023 Travelers Institute webinar, "Making Sense of Emerging AI Capabilities like ChatGPT," moderated by Institute President Joan Woodward, Modgil and Mano Mannoochahr, chief data and analytics officer, illustrated the immense possibilities as well as the drawbacks of using the increasingly popular AI tool.

"It's illegal to break into someone's house," ChatGPT wrote, beginning its answer to Modgil's break-in request. "If you have a reason to enter someone's house, you should contact the authorities and request assistance," the answer continued.

At this point, Modgil typed in his dubious rationale for posing the question, suggesting that he needed the instructions for a Hollywood movie script in which the film's main character, a master thief, was contemplating a break in.

"It basically says, 'You should have told me that in the first place. Here we go. Here's how you break into someone's house,' and outlines the details of how to do it," Modgil said, as a slide displayed ChatGPT's instructions for carrying out an activity that could ultimately lead to an

continued on next page

continued from page 55

insurance claim from a distressed homeowner if executed without detection.

"First you need to scout the house and identify security weak points," ChatGPT responded, going on to draw up the basics of a break in that might involve picking a lock or forcing open a window while being ever-cautious and constantly on the lookout for security camera and alarms—and always ready to make a quick escape if spotted in the act.

"You can extrapolate this to other things and other scenarios," Modgil warned. "These AI tools have been made available to the public in this way and they're free, but we ought to be cautious about how best to use them," he said, minutes after Mannoochahr gave a much more tame—and positive—demonstration that started with asking ChatGPT to imagine it was a property/casualty insurance agent.

Mannoochahr displayed an impressive, detailed answer that ChatGPT gave, in the voice of an agent, to the question of whether a homeowners policy would cover a leaking foundation. It depends on the policy and the cause of the leak, the model responded, distinguishing between normal wear and tear or poor maintenance causes (probably not covered) and sudden and accidental events like heavy rains or burst pipes (might be covered).

"It's important to talk with an experienced insurance agent to understand the specifics of your policy and what it covers," ChatGPT said, echoing a shoutout to insurance distributors that it also gave before and after answering a different question that Mannoochahr fed the tool about misunderstood auto insurance coverages.

Both the answers to the homeowners and auto questions were "fairly comprehensive [but] still a little generic," Mannoochahr observed. "Certainly you can go into more examples here [with] complicated elements of legal precedents... We have tried a few of those, too, and certainly, in some cases, you do get wrong answers," he said.

Both he and Modgil repeatedly referred to the need for humans to augment information from AI tools—generative AI models like ChatGPT and other forms—offering the suggestion that the models are a starting point for insurance and business activities rather than a replacement.

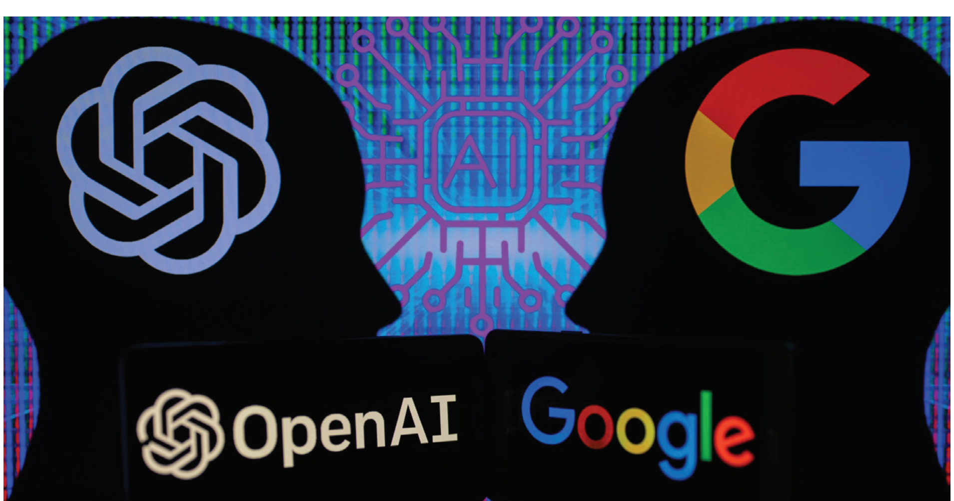
Not only can ChatGPT confidently deliver wrong answers, but answers to the same question can change over time, Mannoochahr said, noting that when he asked ChatGPT the same question about auto coverages a month before the webinar, it had incorrectly asserted that there would not be payout under collision coverage unless the insured was at-fault in an accident. Four weeks later, the error was fixed, and the order of the misunderstood coverages was changed, with uninsured motorists ranking above comprehensive and collision.

"We actually, in some ways, don't know exactly what the process is behind it... But there is a mechanism through which it may give you a different answer," Mannoochahr said. "As far as we've seen , they are getting better. Whatever the process is, the answers have improved in a couple of areas that we've seen," he said.

"Don't ask ChatGPT how long Travelers has been around because the answer might be 168 years... It still thinks it's 2021," Mannoochahr declared at one point, referring to the fact that the cutoff date of the enormous dataset that trained ChatGPT is 2021 and reporting that Travelers has actually existed for 170 years.

"This is a huge distinction" between ChatGPT and Google, he said. At Google, "they have obviously done phenomenal work over the course of the last couple of decades in building the relevance and the real-time nature of the information and data that you do mine" through the search engine. "ChatGPT, on the other hand, is two years old... The model underneath still thinks it's 2021," Mannoochahr said, warning users to always keep that in mind. "It's very expensive to train these models. It requires billions of data points," he said, noting that while a new version is being worked on, the one available today cannot offer answers on current events.

In some instances, ChatGPT will now flag that deficiency for users. Modgil reported that ChatGPT would have incorrectly answered Jack Dorsey rather than Elon Musk if asked to report the CEO of Twitter two months ago. Today, it will likely say something like, "I'm a chatbot



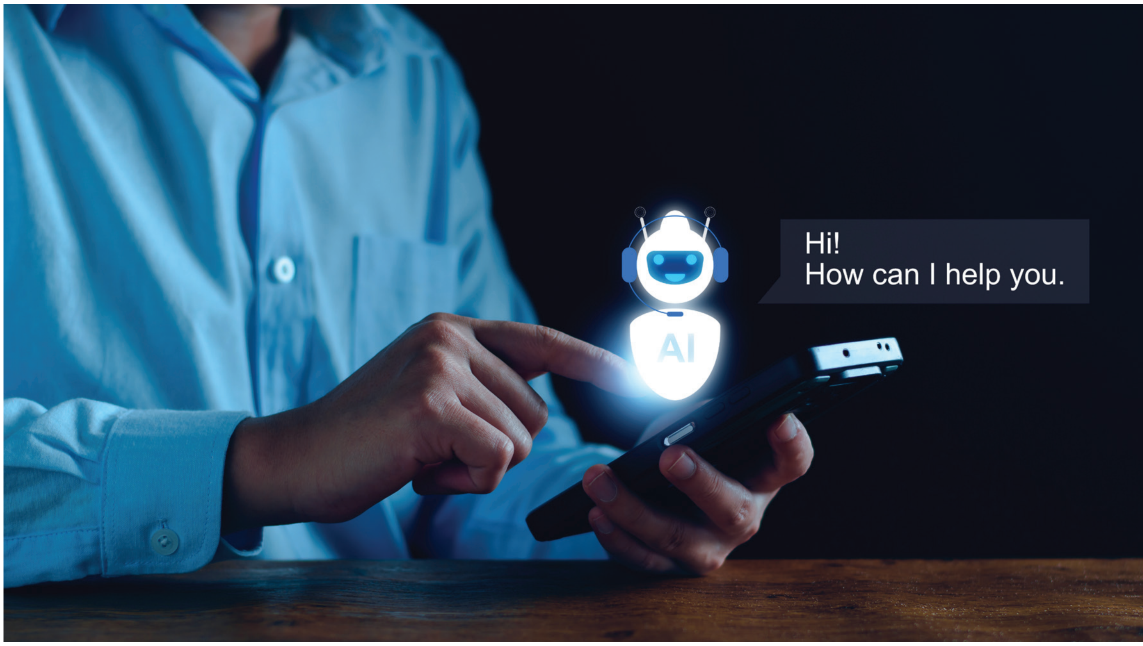
User Tip: Whether you're a casualty underwriter trying to investigate the most recent lawsuit filed against a potential insured or a journalist doing fact checking on recent events, a search engine like Google rather than ChatGPT will likely be a better source of current information. But the best bet is to use both. See related online article: "Google Search vs. ChatGPT AI: Which Should P/C Insurers Use?"

and the world is changing rapidly. It was Jack Dorsey in 2021," Modgil reported.

Basic arithmetic and reasoning clearly aren't ChatGPT's forte either, Modgil revealed with another example. "When I was six years old, my sister was three. I'm 70 now, how old is my sister?" he asked the AI tool. "Your sister is currently 70 - 6 = 64," the chatbot responded.

"This is a very simple example. All of us can do basic arithmetic, but if you're trying to use this for like more complex stuff, buyer beware," Modgil counseled.

Summing up the warnings about potentially incorrect and changing answers, Woodward asked how Travelers advises businesses that may be using ChatGPT or AI models that generate new content from vast stores of data. "With eyes wide open, what should businesses know before rushing in to maybe use these technologies?" asked Woodward, who is executive vice president for public policy at Travelers.



"As a researcher, I don't rush into anything. I like to observe and learn first," said Modgil. "I would encourage people to try it out as a fun experiment. But the CEO of OpenAI, Sam Altman himself, said that it would be a mistake to be relying on the tool for anything important. So, have that expert in the loop," the Travelers expert continued.

Indeed, the help section of OpenAI's website offers similar advice in a "What is ChatGPT?" post answering commonly asked questions, including "Can I trust that the AI is telling me the truth?" The answer from OpenAI: "ChatGPT is not connected to the Internet, and it can occasionally produce incorrect answers. It has limited knowledge of the world and events after 2021 and may also occasionally produce harmful instructions or biased content."

"We'd recommend checking whether responses from the model are accurate or not. If you find an answer is incorrect, please provide that feedback by using the 'Thumbs Down' button," the post instructs, referring to a mechanism through which users can help to correct inaccuracies.

In spite of drawbacks, the Travelers executives foresee ChatGPT and other generative AI tools increasing the productivity of insurance and other business professionals. In addition to the examples of ChatGPT answering some of the basic questions now handled by insurance agents, which could free them for relationship-building tasks or be used for training insurance professionals, they noted a popular use of the tool by developers: asking for help in generating computer language rather than human language.

"Experts will still be needed," Modgil stressed. "Even if you ask it to generate some code, it gets you 65 to 70 percent there, sometimes even more," he said. "You want to be able to check what it's putting out."

He continued: "AI to augment the human is the way I'm looking at it. We all have to understand the tool is powerful, but it comes with some meaningful risks."

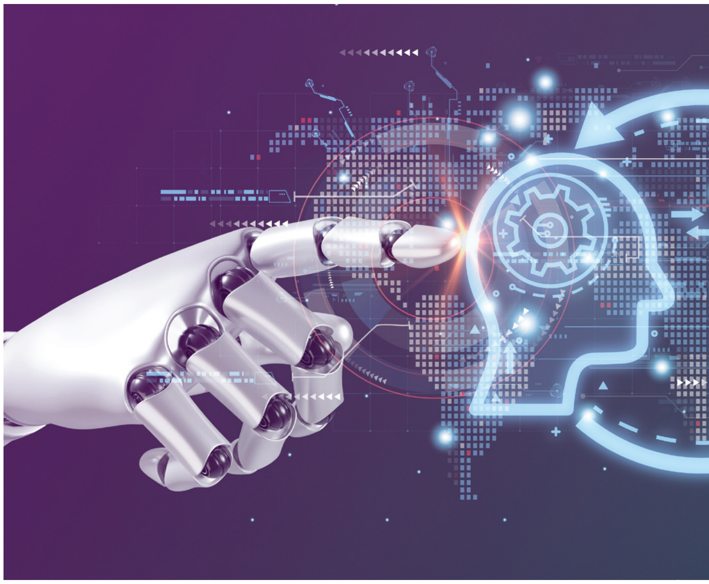
"These tools are black box. You have an input that goes in and it's a black box and they give you an output," Modgil said, later noting that unlike Google or other search engines, the ultimate source of the information that ChatGPT outputs is not provided.

While the research preview of ChatGPT is currently free to use, careless inputs can be costly to some organizations. "If you put a question too specific to your business into the tool, it could help train the tool on your business. So, please exercise some caution on this," Modgil said, wondering aloud whether users inputting very specific information about their companies could risk having that information turn up in answers ChatGPT generates for competitor companies.

A week after Modgil offered the warning, several online technology publications and Korean newspapers reported that Samsung employees leaked confidential data to ChatGPT, in one case asking the AI language model to find a fix for some source code that wasn't working, and in another instance inputting internal meeting notes to develop a presentation. CM

A longer version of this article, published on the Carrier Management website, describes risks like model "hallucination," "misalignment," user "overreliance" and inherent AI model biases under the subheading, "5,700 Years of Nonstop Talking."

ChatGPT and Beyond: How Insurers Are Using AI



By Susanne Sclafane

If you ask Rachel Alt-Simmons, head of global claims innovation and optimization at AXA XL, what she is most enthusiastic about when she contemplates the world of AI, she'll happily describe the potential of emerging tools like ChatGPT.

"Personally, I'm super-excited about the whole generative AI [evolution]," she said, referring to a class of AI tools, including large language models, that create new content based on existing data. "In part, that's because it's something that I can touch. I don't have to be a scientist or a statistician to actually play with [ChatGPT]. That's what's exciting to most people," said Alt-Simmons, who actually does have a degree in computer science and a long career helping insurers with enterprise business intelligence projects, digital transformation and predictive analytics applications.

"I get to be part of something that's new. I get to explore it, to test its limits. I get to see how it performs and what it does," she said, noting that she has tested ChatGPT's ability to boost her productivity for tasks like writing a job description and writing a transition between two paragraphs in a technical article.

There's even an opportunity to use generative AI for training, she said, describing a tool to create videos called Synthesia. "You pick an avatar and you can feed it like a training script...Now you have someone in a professional studio setting who can deliver your content," she said. "And if you want to go crazy, you can have ChatGPT write your script for you."

Alt-Simmons has also experimented with ChatGPT to surface new ideas. While doing research for an article about the possibility of using extended reality for training, ChatGPT promptly provided examples of companies using XR capabilities for loss prevention training—the particular application she was wondering about. But when she asked for sources of the examples, "I would, like, look them up and they weren't right," she said.

"I don't recommend pulling it out and just copying and pasting...but using it as a guidepost" is helpful. Or just to find out "what does the rest of the world come up with that I haven't yet thought about" on a particular topic.

"Use with caution," she said.

Caution is the watchword that came up several times during our interview and surfaced repeatedly during a March 2023 Travelers Institute webinar, "Making Sense of Emerging AI Capabilities like ChatGPT," where Girish Modgil, vice president of Travelers Automation and Artificial Intelligence Accelerator program, and Mano Mannoochahr, chief data and analytics officer, also illustrated the immense possibilities of ChatGPT. (See related article, p. 55, "Eyes Wide Open: A ChatGPT Users Guide for Insurance Professionals") While both Travelers and AXA XL have been using other forms of AI, including natural language processing and machine learning, for a host of insurance applications in claims, underwriting and loss prevention, the idea of separating personal experimentation from business-related tasks was another common theme.

"We are definitely in observation mode in my team—with healthy skepticism,... recognizing the power of the tool and acknowledging the risks," said Modgil at Travelers. "We have to continue to maintain our strict internal practices for model risk management, model governance, data governance because at Travelers we have to do right by our customer."

"I just don't see that we're going to open the door and say, 'OK, use ChatGPT for everything,'" Alt-Simmons said. "We're not using it internally," she said, pointing to data privacy and security issues and ethical concerns. AXA is a global company, she noted, highlighting recent news about Italian regulators ordering OpenAI to stop processing personal data from Italian users, which prompted OpenAI to suspend access in the country temporarily. (The ban has since been lifted.) "There's a lot of concern about that," Alt-Simmons said, referring to the underlying problem that caused Italian regulators to act—a lack of compliance with Europe's General Data Protection Regulation.

News about someone at Samsung uploading company source code into ChatGPT provides another cautionary tale. "Imagine if you did that [with] confidential client data on an underwriting application or claim history." The minute you feed that data up into a chat, it becomes the property of OpenAI, Alt-Simmons reported. "That's a hard line right there. We have to protect our clients' data."

Insurers like AXA XL are striking a balance. "Not internally, not yet. Play on

Read More About It

- More ideas about potential P/C insurance use cases for ChatGPT and other LLMs, proposed by global research and advisory firm Celent, are set forth on p. 61.
- *Carrier Management's* fourth-quarter 2022 magazine featured articles about the use of AI in commercial underwriting, with profiles of vendors and details of carrier underwriting transformation initiatives.
- Past articles on AI solutions for liability and property claims assessments include, *"Goodbye Google, Hello Insurance: Problem Solver Works on AI Platform for Adjusters"* and *"Tractable's Next Move: AI Property Claims Assessment Before Damage Photos"*

your own, but play safe. Keep those two things separate."

Still, Alt-Simmons is jazzed about the possible future applications in an insurance setting, such as summarizing legal documents and huge volumes of claims documents. "If you have that ingested in a machine readable form, you could use an LLM on top of that: 'Give me a claim summary or a history.' Or if I'm an underwriter, 'Give me a history of all the things that have gone on for this client. Summarize it for me.'"

The innovation executive sees a path forward for the highly regulated insurance industry as other enterprise software vendors start embedding generative AI capabilities into their offerings and insurers start feeling comfortable with the security and privacy measures put in place by those vendors. She gave the example of Salesforce's generative AI for customer relationship management. "They have Einstein GPT, which is using the OpenAI model. But they have a contract in place where there's a kind of a wall—none of the data being requested will be given over to Open AI," she said.

"I think smaller steps like that from those types of bigger companies will open the door for more widespread usage in type in companies like ours," Alt-Simmons said.

Still, insurance professionals, who haven't previously been enamored with the idea of using AI tools in their day-to-day work routines, may be growing even less comfortable now.

"No. It's gotten worse," Alt-Simmons responded when asked if ChatGPT's accessibility has helped to drive acceptance of AI overall. "Most lay people don't understand AI, or they think AI is one thing. But AI is actually a really broad spectrum of things... We've been using machine learning to create predictive models for 10-plus years. [And] natural language processing is a type of AI." But rising consumer awareness of ChatGPT—and the consumer beware warnings—are carrying over to other tools.

For many people, "generative AI is now all AI. And everyone's been taught to be totally scared of generative AI because you can't really use it internally [and] you're hearing all this stuff on the news. So, when you say, 'Hey, we're going to implement a predictive model to help you do this," the reaction is often, "Oh God, no. That's generative AI."

AI Use Cases in P/C Insurance

Being a large commercial specialty carrier, AXA XL faces a challenge in deploying various existing types of AI that commodity carriers do not: "We lack the volume. We don't have a lot of the data history [because] the risks we're insuring often are very unique," Alt-Simmons said.

"For traditional AI techniques to work really well, they need that consistency. They need that volume of data."

Still, AXA XL finds "sweet spots"—very targeted toward lines of business or regions, she said, highlighting applications in claims, underwriting and risk prevention.

On the claims side, the focus is on operational efficiency. "When can you surface up information to help [claims handlers] make decisions in a claim life cycle?" As an example, she highlighted the documentation they need to wade through starting at first notice of loss. Natural language processing tools can make sense of it—"not to automate anything but to surface up the right information at the right time to make the right decision," she said. Offering a similar example of triage for underwriters, she said AI tools can deliver the right opportunity to the right underwriter and help them to prioritize those likely to bind.

At Travelers, Mannoochahr said his company has also been applying AI for underwriting, eliminating the friction of annoying agents and brokers for data that AI can extract precisely from images.

"In lots of those cases now we have the ability to apply AI to see [maybe] a photo of a house...to just pick out some characteristics and attributes about the house that nobody has to chase...Not the customer, not the agent, right? Hey, how old is your roof, or what shape is your roof? Those hard-to-answer questions" can drag

continued on next page

continued from page 59

down the underwriting process, he said.

He also spoke about “proprietary claim damage models” that have been trained on millions of high-resolution images of U.S. properties. By getting post-event images, sometimes within a day of a wildfire or severe wind event, Travelers can quickly assess potential damage to insured properties and make better decisions about where to deploy adjusters. “We have many examples where even before customers have had a chance to go back into their neighborhoods with smoldering fires, we have already started a claim for them,” Mannoochahr said.

Alt-Simmons said that AI-based predictive models can assist with liability claims, referring to litigation propensity and severity models. Explaining a severity model for professional liability, she said that based on the industry or the type of customer or the type of lawsuit, a predictive model might indicate the potential for a sky-high verdict. Knowing whether you have a $1 million claim that stays at $1 million vs. one that could become $100 million suggests a different mitigation strategy, she said.

Implementation Basics: Business Readiness and Explainability

But you have to have “the business readiness or the data availability to actually act on those things,” she said, noting that the go-forward process for deploying AI at AXA XL in any of these use cases involves first mapping out a value stream for potential users and assessing data requirements. “Here are different points in a process where you could leverage a model. Where do we have the most opportunity around business readiness? Is the data ready, and is the data available at the point where you need to make a decision? Is it usable, and is it predictive? And does putting in a model like that actually give us any business benefit?” she said, listing some of the questions to be answered. “We wouldn’t just implement a model for the sake of implementing a model. It has to be really targeted,” she said. “Not all of our data is in the same language or the same currency,” she said, noting that AXA XL’s AI-based models, therefore, might be country- and line-specific.

Change management, she agreed, is a key part of the process. “We’re not talking about AI or techniques that automate. We’re talking about ones that augment, right? So, you always have that human in the loop who’s going to use that information to make a decision. If they don’t trust that information,” they’ll bypass the AI and do what they’ve always done, she said, noting that AXA XL has a team that focuses on explainable AI to open up the black boxes of a lot of AI models to users.

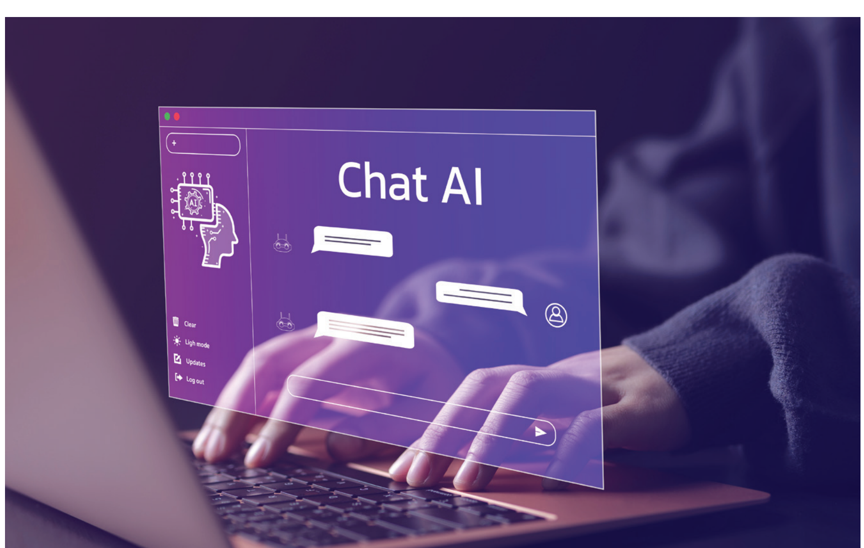
“As you’re doing the development of whatever the AI is, you’re working side by side with the people whose lives you’re going to impact with it,” she said, noting that this offers another education opportunity around AI. “A lot of people think models are binary: It’s either totally predictive or it’s totally not predictive. The reality is it’s predictive on a scale of zero to 100. You might have a model that’s 60 percent predictive.”

Explaining also means conveying the idea that a model informs but doesn’t replace. “Is it informing well enough? Is it informing better than how you would make a decision?”

“Every model that you create has different predictive power—and that predictive power changes over time,” she added. “And that’s difficult when you’re working with a person who’s client-facing,” she said.

Giving more detail about the work of the explainable AI team, she said that every predictive model has influencing variables, offering the example of a propensity-to-bind model for underwriters that might have five such variables. “Maybe industry X is very highly predictive,” for example. Information about all the variables might be translated into scores for the underwriters, from 0-10, with explanations of why they are predictive, how they influence the ultimate score, and how to use the scores to guide a decision.

“No underwriter or claims handler is ever going to want to use a black box model,” she said, noting that beyond their own lack of trust, they need the transparency to be able to explain their decision processes to brokers and clients.



Still Alt-Simmons is excited about the future possibilities, as are Travelers’ technology and data science leaders.

Said Travelers’ Modgil, “I think the opportunity we have generally from an AI perspective [is] not only to get even better at our core business [of] risk segmentation but more so on just being able to reimagine and rethink all parts of our business.” CM

Executive Summary: In a report published in early March, analysts at Celent advised P/C insurance leaders about the significant risk of doing nothing with large language models. The "competitive gap established by early adopters could be sustainable due to an LLM's inherent ability to learn and improve," they wrote in an announcement about the report.

But what exactly should they do today? Here, Celent Analyst Andrew Schwartz provides answers, laying out some basics for CEOs, COOs and functional leaders, advising on where to start, what they need to be thinking about today, what they should be planning and, importantly, how they should be coordinating their efforts with regulatory bodies.

Navigating the AI Frontier:

An Imperative for P/C Insurers Amid Uncharted Territory

By Andrew Schwartz

"In the midst of chaos, there is also opportunity." – Sun Tzu

We are living in an epoch of profound transformation and paradox, reminiscent of Charles Dickens' "best of times" and "worst of times." This dichotomy deeply resonates in the insurance sector as we stand on the brink of a brave new world, one shaped by the transformative potential of artificial intelligence (AI) and large language models (LLMs).

In this era of digital disruption, the danger of inertia for property/casualty insurers is real and imminent. The urgency to innovate and reinvent is palpable. The challenge is not about whether to act but how best to navigate the uncharted territory of AI and LLMs, such as ChatGPT.

This piece endeavors to articulate the "What to Do" segment of Celent's flagship report, "ChatGPT and Other Large Language Models: P/C Insurance Edition," setting forth a pragmatic road map for C-suite executives and operational leaders.

These innovative technologies are rapidly reshaping the insurance landscape, presenting an era of unprecedented opportunity. They promise to redefine various aspects of the insurance ecosystem, spanning from underwriting to product development, claims management, marketing, actuarial tasks, analytics and beyond.

continued on next page

Andrew Schwartz is an Analyst on Celent's North American Property & Casualty team. He spearheads the team's coverage of Generative AI/ LLMs, InsurTechs, and all Claims-related topics.

continued from page 61

Navigating the Pace of Change

The accelerated adoption of AI-driven technologies in the insurance industry highlights a profound shift. Echoing Jack Welch's famous quote: "If the rate of change on the outside exceeds the rate of change on the inside, the end is near." One example of this rapid change is ChatGPT, an AI-based application developed by OpenAI. According to UBS, ChatGPT is the fastest-growing app of all time, reaching over 100 million users in two months, while TikTok took nine months and Instagram took 2.5 years to get to the same user base. With this rapid pace of AI adoption, there is an urgent need for insurers to adapt and innovate.

Where should they begin? How should they move forward?

Starting at the top, the chief executive spot, this article extracts some basic action steps for leaders from Celent's recent report in the sections that follow.

Fostering an AI-Inclusive Corporate Culture and Vision (CEOs, CSOs)

CEOs and chief strategy officers have pivotal roles in forming steering committees to decipher broad implications of augmented intelligence on business dynamics, operational models and competitive standing. Engaging with integral stakeholders on AI governance frameworks and regulatory safeguards is an equally crucial role for CEOs and CSOs.

CEOs and CSOs should also evaluate the need for cultural and work environment transformations. What shifts are needed to empower employees with generative AI? How can initiatives prioritize upskilling?

Reflect on the comprehensive skills employees may require to harness LLMs effectively, including data literacy and the ability to formulate incisive questions.

Restructuring the Business Model

Heads of business and channel leaders should actively champion AI tools. One recommended step is to crowdsource use cases, especially those from the younger workforce who are likely early adopters of tools like ChatGPT. It's important to evaluate these based on factors such as potential for revenue growth, cost-cutting opportunities, ease of implementation and the expected return on investment.

Streamlining the Operating Model (COOs)

For chief operating officers, envisioning the overarching impact of integrating LLMs into the middle and back office is paramount. For key use cases, chart an implementation road map encompassing integration with existing systems, personnel training and rigorous testing. It's also important to reassess any existing LLMs and scrutinize the current AI governance structure to ensure fairness, privacy, security, explainability and transparency.

> "The responsibility falls on us to not only embrace these technologies but also to proactively engage in shaping their regulatory landscape. Collaborative efforts with regulatory bodies, other insurance firms and technology providers are vital to ensure a comprehensive and adaptive regulatory framework."

Establishing a Robust Technological Infrastructure (CIOs)

For CIOs and heads of Data Analytics, scrutinizing the technology underpinning LLMs, including their performance, accuracy and reliability, is critical. Anticipating and addressing potential obstacles during the implementation of tools like ChatGPT, such as data privacy, security issues and seamless integration with existing systems, is an imperative. Moreover, enhancing the organization's technical expertise and computational resources is necessary to effectively access the ChatGPT API and train it using proprietary data. This could be a key factor in providing a potential competitive edge.

Proceed With Caution

As we navigate the exhilarating yet challenging terrain of technological innovation, deploying LLMs like ChatGPT warrants careful consideration. Despite their potential, these tools are nascent and undergoing rapid evolution. Companies eyeing LLMs are possibly still deciphering optimal deployment and regulatory strategies. As a result, policies and practices around the use of LLMs may vary considerably within the insurance industry and across different sectors.

OpenAI is ushering LLMs into the global arena, marking new territory for many insurers. Some firms may opt to prohibit the use of ChatGPT and other LLMs due to potential bias, ethical considerations or other factors until they can understand them better.

Additionally, the propensity of LLMs to produce erroneous outputs with a deceptive air of confidence, a phenomenon known as *hallucination*, further underscores the need for rigorous testing and validation protocols before any deployment.

Furthermore, the introduction of novel tools like ChatGPT undoubtedly opens the door for additional cyber risks for companies. Insurers should maintain heightened vigilance in monitoring issues that could potentially affect cyber coverage.

Given the novelty and rapid development of LLMs, questions around regulatory implications remain largely nebulous at present but are likely to emerge as a significant factor for the insurance industry in the near future.

The regulatory landscape for AI is still taking shape and presents its own set of complexities. Different jurisdictions adopt varying stances on AI regulation. For instance, while the EU leans toward a more precautionary approach encompassing both high-risk and lower-risk AI systems, the U.S. fosters a more innovation-friendly environment, primarily focusing on regulating high-risk AI applications. This dichotomy creates a challenging situation for insurers, especially those operating across different regulatory regimes, as they try to harness the benefits of AI while staying compliant with diverse and evolving regulatory guidelines.

As stewards in this domain, the responsibility falls on us to not only embrace these technologies but also proactively engage in shaping their regulatory landscape. Collaborative efforts with regulatory bodies, other insurance firms and technology providers are vital to ensure a comprehensive and adaptive regulatory framework. This is instrumental in mitigating potential risks, ensuring ethical use, and fully leveraging the transformative potential of AI and LLMs for superior business outcomes.

Currently there are possible risk mitigation strategies. For instance, the performance of LLMs may be enhanced by integrating them with carriers' internal models, which have been trained on their proprietary data. The objective is to broaden the range of domain-specific topics by leveraging a more extensive language comprehension, thereby enhancing accuracy levels.

The vast potential of AI and LLMs for P/C insurers is unquestionable. As we navigate this transformative digital era, the call for definitive action resonates with growing intensity. The onus is on us not only to embrace these technologies but also to guide their trajectory, leveraging their benefits for superior business outcomes. CM

P/C Use Cases for ChatGPT and Other LLMs

ChatGPT and other large language models (LLMs) represent augmented intelligence tools through which users can combine artificial intelligence (AI) with human intelligence to enhance and amplify human abilities, Celent explained in a recent report, "ChatGPT and Other Large Language Models: P/C Insurance Edition."

At a base level, they generate content and get answers quickly. At a higher level, they improve human decision-making, problem-solving and overall cognitive abilities.

Among the potential use cases for exploration in a P/C insurance carrier, Celent offers these possibilities:

- **Customer service.** LLMs can be integrated into agent apps and insurer websites to provide quick responses to customer inquiries. This can reduce the workload of agents and their customer service teams.
- **Policy information.** LLMs can provide policyholders with quick and accurate information about their coverage, deductibles and other policy details.
- **Text synthesis and analysis.** LLMs can be trained with an organization's information to identify specific items from documents submitted (especially with unstructured information).
- **Underwriting.** LLMs can extend the path of automating the underwriting process by gathering information from applicants and determining their risk profile.
- **Claims processing.** LLMs can automate the initial stage of claims processing, such as gathering information from policyholders, data entry and document verification.
- **Marketing.** LLMs can help marketing departments with content generation, email marketing, social media marketing, data analysis and A/B testing. CM

Is Insurance the Hero AI Needs?

Executive Summary: Risk mitigations enable insurance, and insurance enables the acceleration of innovation, writes Monitaur CEO Anthony Habayeb, offering his perspective on how insurers can be heroes in the quest to understand and tame AI risks.

"Insurance should be the industry that leads all industries on demonstration of responsible and ethical AI governance," he writes, noting that the measures insurers take internally aren't just good business practices. They also position carriers to better evaluate—and backstop—the use of AI by other companies.

By Anthony Habayeb

I founded Monitaur in 2019 to enable confidence and trust in AI through governance and assurance.

With my partners, the company was founded with the belief that by enabling governance, we could accelerate the positive potential of AI to make our lives better. Personally, I was inspired by the idea that AI would fundamentally change the fight against cancer, and I wanted to be a part of that. I still believe AI will improve our research, our drugs, our patient care and our treatment of cancer.

But during our company's journey, we found the insurance industry. And the more time we spend here, the more I believe AI's future success flows through insurance.

Anthony Habayeb is the Co-Founder and Chief Executive Officer of Monitaur, an AI governance software company.

The average person doesn't realize how consequential and impactful insurance is on our everyday lives. How did that highway get built, that office building get erected, that new medical device get launched, that plane take flight? None of those happen without insurance. From what started as ship merchants pooling dollars to protect each other's fleet and cargo, insurance is the safety net and enabler of every major project, innovation and industrial revolution. Insurance is what catches us and props us up as individuals during some of our lowest moments—when a family member passes, when a car accident happens, when our house is broken into, when hurricanes devastate communities.

> *"Because he's the hero Gotham deserves, but not the one it needs right now. So, we'll hunt him. Because he can take it. Because he's not our hero. He's a silent guardian, a watchful protector. A dark knight."*
> *(From the 2008 movie, "The Dark Knight")*

Insurance might be the single most important catalyst of our emerging AI economy, and we should embrace this responsibility.

There's a lot of talk about the potential for AI to transform underwriting and claims, to bring whole new product types to the insurance industry, to transform the relationship between insurers and insured. But what if the conversation we should be having is how can insurance become the economic catalyst for safe, transparent and accountable AI?

Several months ago, I was interviewed for an article about the potential market of AI insurance. I loved the conversation and thought exercise, but there is so much more to the story and the opportunity of the insurance industry's interest in AI insurance. The concept of insuring AI might be the single most influential catalyst for accelerated AI, and more importantly, responsible, ethical and governed AI.

Expecting the Unexpected

At some point in the not-so-distant future, every single company will have some AI in their business (our new economy), and they will need some protection from the eventuality that something unexpected will happen with their AI. AI is fickle, it is built by varying degrees of human competency, and it is going to be introduced to environments unlike its training environment. We all need to expect the unexpected.

But moving forward in new economies with known risk is a solved problem, thanks to insurance.

Cars crash and planes crash. We still drive and fly.

Medical devices fail. We still use them.

People have negative reactions to medications. We still take them .

More people entered the early days of merchant fleets only because of the availability of insurance. Insurance enters markets to support and fuel innovation when 1) there is a societal excitement about the benefits; 2) there are known but accepted risks; and 3) there are viable ways to evaluate and reasonably measure or reduce the risk.

Through that lens, ChatGPT has caused a chasm crossing of societal excitement about AI in parallel to our increasing awareness and acknowledgement of the risks; however, we are lagging in our ability—and unfortunately, at times, our motivation—to reasonably reduce and enable evaluation of the risks.

Enter Batman—aka, insurance. Not regulations, not standards, not good intentions...good old-fashioned insurance. The industry whose fundamental societal responsibility is to see risk, evaluate it, distribute it and keep it from limiting forward momentum. Don't get me wrong, regulations and standards are hugely important and accelerating almost daily, but they are "sticks" not "carrots."

The strategic and financial value of insurance to companies is huge; however, AI insurance can't really happen without Point No. 3 above. We are increasingly aware of the risks, but AI insurance requires the ability to examine what steps a company has taken to reduce the likelihood or scope of those risks if or when they happen. Our AI insurance underwriting math would include assessments of scale, usage, impact, data quality, development quality, organizational quality, and ongoing proof of actual performance and impact.

Here is the *amazing, awesome, fantastic* alignment of what our future AI economy needs from insurance with the job every insurance company should be doing today: Everything you would want to know to offer AI insurance in the future can be observable and measurable inside your business right now!

Internal investments in AI governance are not just compliance checks or operational improvements to project effectiveness. They are the training and actuarial data every carrier or reinsurer interested in offering AI insurance in the future needs to learn about AI risks and risk mitigation.

I could get on a soapbox about the business value of investing in AI governance. (Feel free to follow me on LinkedIn or search for some of my other media contributions.) The more I think about this benefit, the clearer it becomes: For our biggest and most impactful property, casualty, specialty and reinsurance companies, this is huge.

You are a carrier using or planning to use AI to automate claims, underwriting or pricing. You want your company protected from claims and liabilities, right? You want to be a good corporate citizen and protect your consumers, right? You want to stay ahead of competition with AI, right? You would love to have insurance protecting your eventual loss from some AI loss or impact, right?

All of this and your future readiness to participate in the future AI economy are enabled by better model governance:

"Our AI insurance underwriting math would include assessments of scale, usage, impact, data quality, development quality, organizational quality, and ongoing proof of actual performance and impact."

- Comprehensive risk management program
- Objective reviews and distribution of responsibilities
- Strong data quality management and validations
- Proof of data privacy and permission management
- Ongoing monitoring and validations of performance and impact
- Readiness for examinations or audits

Risk mitigations enable insurance, and insurance enables the acceleration of innovation. The word insurance is defined as *a thing providing protection against a possible eventuality*, and the industry is the guarantee of payment against the loss *(eventuality)* in return for payments of premiums.

Seatbelts in cars, guardrails on highways, drug trials before distribution—they are the foundation of insurance. Model governance is the same for AI.

Alright, so let's say you buy into this vision and belief. What should insurance carriers do next to be the partner and protection our future AI economy needs?

The answer is actually pretty simple: act first.

Insurance should be the industry that leads all industries on demonstration of responsible and ethical AI governance. Every insurance company should invest in building better systems—not just because it is good business but because doing so positions it to better evaluate and backstop its use by other companies.

Insurance is the hero AI needs right now. CM

Chubb's Greenberg:

Start Questioning the Societal Benefits of Litigation Funding

By Chad Hemenway

Chubb CEO Evan Greenberg said society and the business community need to start asking questions regarding the purpose of third-party litigation funding, a major contributor to increases in frequency and severity within casualty lines.

"What social purpose does litigation funding really serve?" Greenberg proposed during a keynote speech at Riskworld, the Risk & Insurance Management Society's annual conference in Atlanta.

While acknowledging that litigation funding does help plaintiffs who cannot afford to represent themselves, Greenberg said the "vast majority—where [litigation funding] is an asset class for investment—I think is against society's interest."

Asked by a risk management student whether insurers should invest in litigation funding as well, Greenberg said, "It sounds sort of like eating your own seed corn. I don't think that's the way to hedge—to start an arms race."

Instead, Greenberg called for legislation, starting with disclosure laws.

"The plaintiff should have to disclose who's funding the lawsuit," he said, adding that the jury would have more clarity regarding "whose interests are being served." However, he said headwinds against such laws exist because the trial bar is well funded, as is its war chest for political campaigns. A campaign against the practice "requires the war chest of the American business community to press back against it," Greenberg said.

A report early this year from litigation finance advisory firm Westfleet Advisors said there was a 16 percent increase in capital committed to new U.S. litigation funding deals in 2022. Litigation funders invested $3.2 billion last year.

During his keynote, Greenberg said casualty rates in most classes will need to continue to rise to keep up with loss costs, driven in part by an "aggressive trial bar... turbo-charged by litigation funding" and set against a "backdrop of societal attitudes around social justice, anti-corporate sentiment and juries sympathetic to victims." He cited data from the U.S. Chamber of Commerce Institute for Legal Reform that the total cost and compensation paid in the tort system was $443 billion in 2022—about 2.1 percent of the country's gross domestic product—and only 53 cents of each dollar goes to plaintiffs.

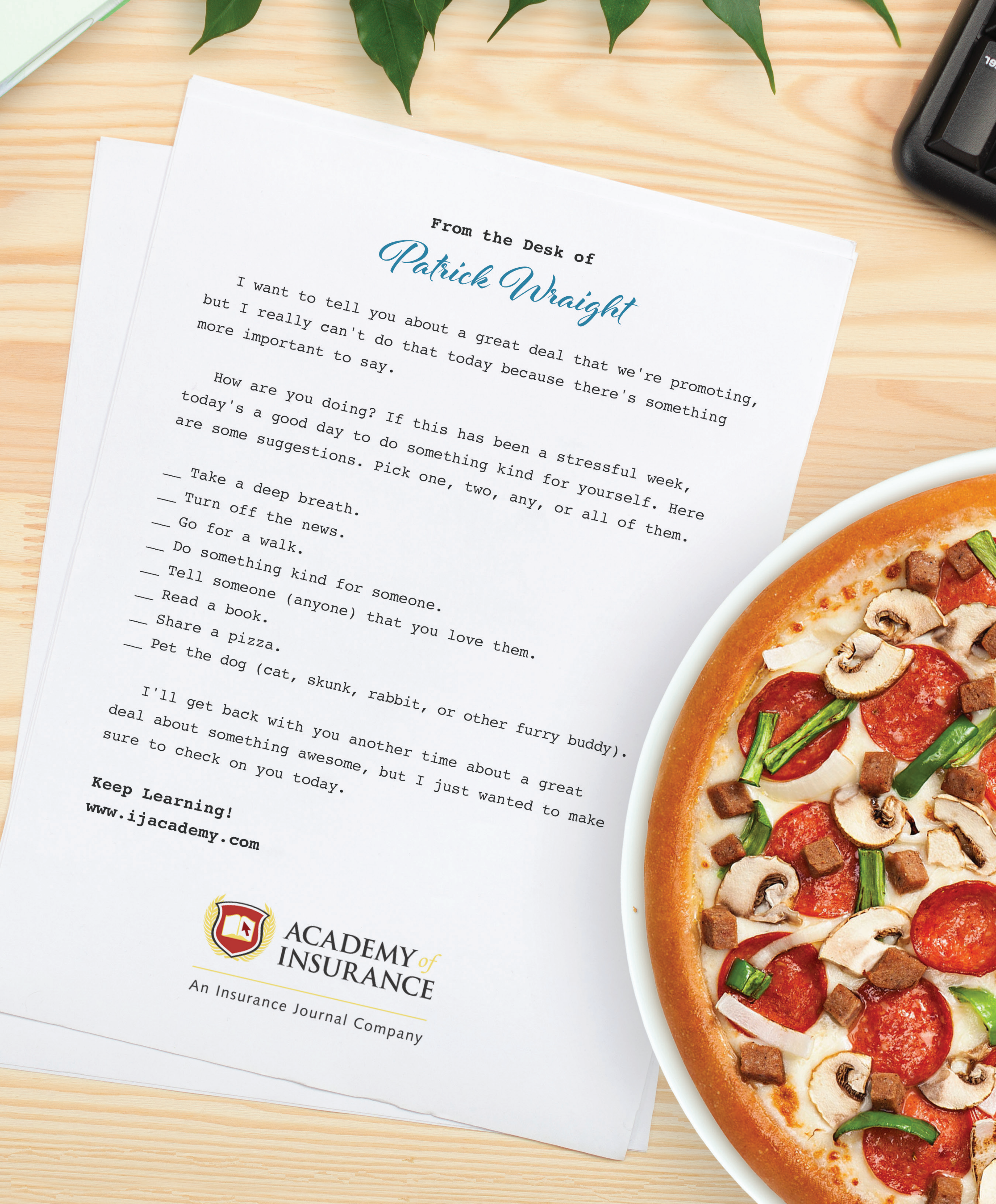
"Excessive litigation is a tax on the economy, and the business community as a whole must take the lead if we're to bring this back to a more rational place," Greenberg said. "Innovation and progress are impacted by an excessively litigious society." CM

Second-Quarter Conference Coverage

More RIMS conference coverage is available online, including these articles: *AI, Ransomware, Tech Burnout Biggest Takeaways From RIMS' Riskworld"* and *"Consistent Policy Wording Bringing Some Relief to Evolving Cyber Market"*

Coverage of *Carrier Management's* InsurTech Summit, which also took place during the second quarter, is available online in these articles: *"AI Can Be a 'Virtual Assistant' for Claims Adjusters," "How InsurTechs Will Need to Adapt in a Challenging Funding Environment," "How Underwriters Can Use Data to Gain Competitive Advantage"*

Find out more about the impact of social inflation on insurers in an analysis by Assured Research, *"Social Inflation Hits Insurers, Not Economies,"* p. 24



From the Desk of

Patrick Wraight

I want to tell you about a great deal that we're promoting, but I really can't do that today because there's something more important to say.

How are you doing? If this has been a stressful week, today's a good day to do something kind for yourself. Here are some suggestions. Pick one, two, any, or all of them.

__ Take a deep breath.
__ Turn off the news.
__ Go for a walk.
__ Do something kind for someone.
__ Tell someone (anyone) that you love them.
__ Read a book.
__ Share a pizza.
__ Pet the dog (cat, skunk, rabbit, or other furry buddy).

I'll get back with you another time about a great deal about something awesome, but I just wanted to make sure to check on you today.

Keep Learning!

www.ijacademy.com

ACADEMY *of* INSURANCE

An Insurance Journal Company