Insurance Buyers' News

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How AI is Changing the Paradigm of Insurance

An article in the May 2022 issue of National Underwriter by Daniel Turgel outlines "How artificial intelligence [AI] is moving the insurance industry in a bold, new direction."

In the past, the expectation of an accident occurring at some point was pretty much the main reason motivating a business owner to buy insurance. Until the advent of AI, the only exception to this rule has been Mechanical Breakdown insurance (see our article in this issue), where loss prevention is the principal commodity. Now AI is set to change all that for most other insurance lines as well. Though losses will still occur, they should occur far less frequently, and the main advantage of having insurance may well be the AI that comes with it.

Auto: Human error is responsible for about 1.3 million automobile deaths worldwide each year: 38,000 of them in the US with an annual cost of $55 billion in medical and related expenses. As self-driving technology improves, it's expected that nearly 90 percent of these deaths and costs can be eliminated. The other 10 percent? The Insurance Institute for Highway Safety says some remnants of human error will continue to operate and be responsible for over 90 percent of those fatalities, something it calls "final failure."

But there are AI applications for "final failure," too. For example, to reduce losses caused by truck drivers, commercial tech insurance companies collect data about the truck's operation and the driver's behavior that can reveal careless or even malignant

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This Just In…

In a letter dated March 29, 2022, the US Chamber of Commerce implored members of the US Congress to respond to the recent "significant increase in retail theft and organized retail crime."

The letter says 54 percent of small business owners experienced an increase in shoplifting in 2021. In addition, organized retail crime cost larger stores an average of over $700,000 per $1 billion in sales in 2020, up more than 50% in the last five years.

To address the problem, the Chamber:

- **Urges Congress to pass the bipartisan H.R. 5502, "Integrity, Notification, and Fairness in Online Retail Marketplaces for (INFORM) Consumers Act," which would increase**

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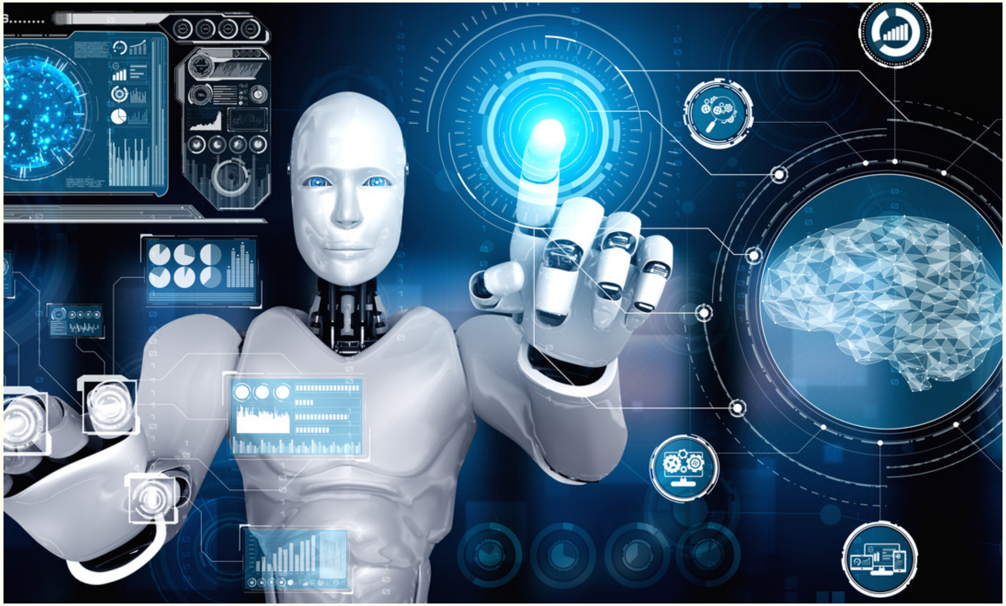

This Just In

transparency and identity verification of high-volume third-party sellers in online retail marketplaces. This legislation would deter retail crime by closing off a prominent avenue by which criminals seek to profit by selling stolen goods, often to unsuspecting customers.

- **Asks states to update the definition of organized retail crime and increase criminal penalties. They should act to define the crime of "organized retail theft" in criminal law to specify those thefts involving two or more participants and an intention of resale and include increased penalties for those specific violations.**
- **Asks all legislative bodies to hold accountable those who engage in organized and significant retail theft: Since 2000, at least 40 states have raised the thresholds for the value of stolen goods to trigger a felony charge, allowing criminals to take advantage of these increased higher thresholds to engage in repeated thefts and avoid prosecution. States should reconsider these thresholds and prosecutors should avoid adopting broad non-prosecution policies.**

behavior which deviates from the norm. In turn, drivers are coached into correct behavior that helps them avoid making careless mistakes such as "falling asleep at the wheel, backing up in a tight space with unseen obstructions, or spotting a car approaching at an unsafe speed and alerting truckers to the best way to avoid an accident."

Property: A water loss study by LexisNexis found that smart technology provided by the Internet of Things (IoT) can eliminate 90 percent of water damage losses by constantly monitoring facilities with water and fire prevention devices. What's more, it's expected that if there is a flare up somewhere, a robot will simply grab a fire extinguisher, walk up to any devices that are sparking and douse the flames.

Workers Compensation: The biggest problem with workers comp losses is not that safety measures and protocols have not been established. It's that these measures and protocols are sometimes breached. Now, though, companies like Safesite, Pillar Technologies and Guardhat, using sensors and protective equipment, can address these compliance issues in real time with immediate feedback that prevents these breaches. Foresight Group, an insurance company, reports that these devices can reduce workplace incidents an average of 31 percent.

Insurance Fraud: Probably the most sophisticated artificial intelligence application for reducing insurance costs is pattern and anomaly recognition software. For example, one workers compensation third party provider, CodeBlue, has replaced the conventional First Notice of Loss process with what is called a "First Notice and Response (FNAR)" service. In this approach the claims specialist and the policyholder "collaborate" to "eliminate unnecessary demolition and reconstruction, limit unnecessary travel time and create efficiency, allowing adjusters to settle claims more quickly." Most importantly, fraudulent behavior can be detected by capturing an image of the claims site before "unscrupulous contractors can get in and begin unnecessary repairs."

Eventually, AI's payoff should be far fewer accidents and much lower costs.

Equipment Breakdown Coverage Goes Beyond Insurance

Equipment Breakdown insurance — formerly called Boiler & Machinery insurance — covers much more than boilers and machinery.

Insurers introduced boiler and machinery coverage in the mid-1800s to cover valuable steam-powered machinery from explosion or breakdown, and to cover the equipment's owner from liability for resulting property damage or bodily injury. Today, few businesses use steam-powered machinery for business operations, but some still use steam-powered equipment for generating heat or power. Many states require these boilers to be inspected annually. If your boilers fall into this category, you may find equipment breakdown coverage a bargain, as coverage includes an inspection by the insurer along with protection from loss due to property damage or bodily injury. This is actually the component of your insurance premium because the mechanical breakdown inspections are quite thorough and will typically reveal any problems that exist, which once corrected, means that you are unlikely to experience a loss during the policy period.

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To prevent business shutdowns or slowdowns, an organization might want to cover other kinds of valuable equipment from mechanical breakdown, too. In addition to boilers, today's equipment breakdown insurance can cover these types of equipment:

1. Equipment designed to operate under internal pressure or vacuum
2. Equipment designed to generate, transmit or use energy
3. Communications equipment and computers
4. Equipment owned by a utility and used to provide service to an insured's location.

Don't think you need this coverage? Consider the following examples of claims from Hartford Steam Boiler, an insurer that specializes in boiler and machinery insurance and equipment breakdown insurance:

1. Owners of an office building had to spend nearly $1.6 million to restore power to tenants — including an accounting firm on tax-season deadlines—after electrical arcing destroyed three electrical panels, leaving the building without power.
2. A medical clinic had to discard more than $21,000 worth of drugs when they froze after a controller on its refrigerator malfunctioned.
3. A printer spent more than $136,000 to repair a high-speed press after a bolt came loose and jammed the cylinder and gears.

Insurers typically write equipment breakdown coverage under a stand-alone policy; however, some will include the coverage under highly protected risks (HPR) policies or in business package policies. Most policies provide seven typical coverages.

Equipment breakdown policies are designed to cover your equipment from mechanical failure only, so they typically exclude damage from earth movement, flood, nuclear hazard, windstorm or hail. They also exclude "causes of loss" typically covered by other property policies, such as aircraft, vehicles, freezing, lightning and vandalism. Many other exclusions apply; however, you can modify many of these by adding an endorsement to your policy.

Equipment breakdown coverage is highly specialized and should be handled by an experienced broker. For more information on equipment breakdown coverage, please contact us.

How Litigation Is Driving Up U.S. Commercial Auto Insurance Costs

Social inflation—the impact of rising litigation on insurers' costs—increased claim payouts for commercial auto insurance liability alone by over $20 billion between 2010 and 2019.

This is according to a new paper by Insurance Information Institute (Triple-I), in partnership with the Casualty Actuarial Society (CAS).

The Triple-I/CAS paper, Social Inflation and Loss Development confirms and quantifies one of the primary factors driving up the cost of commercial auto insurance. A separate Insurance Research Council (IRC) paper illustrated how losses across several insurance lines have accelerated in recent years much faster than economic inflation alone can explain.

In addition, while the Triple-I/CAS paper focused on commercial auto insurance, it also identified evidence of similar trends in other lines, such as "other liability occurrence" and claims-made medical malpractice. An occurrence policy pays claims arising during the policy term, even if they are filed many years later. Claims-made insurance can provide coverage when a claim is made, even if it arises from an incident that occurred years ago.

Drivers of Social Inflation

Considered to be a growing cost of doing business in the insurance industry, social inflation is influenced by negative public sentiment

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about larger corporations, litigation funding, and tort reform rollbacks at the state legislative level, all of which have increased liability costs. Shifting public perceptions and attitudes may lead jurors to sympathize with plaintiffs when awarding damages. Jurors may also believe the business, or the insurance company, has unlimited financial resources, leading to what's commonly known as "shock" verdicts. These monetary damage awards are much higher than expected based on the evidence presented at trial, often exceeding $10 million.

Emotional appeals to juries by plaintiff's attorneys are nothing new. Neither are class action lawsuits. But the plaintiff's bar has gone to a new level with tactics like third-party litigation funding and litigation lending, the report notes. Funding of lawsuits by international hedge funds and other financial third parties – with no stake in the outcome other than a share of the settlement – has become a $17 billion global industry, according to Swiss Re. Law firm Brown Rudnick sees the industry as even larger, estimating it as a $39 billion global industry in 2019, according to Bloomberg.

Some states have implemented rules requiring disclosure of third-party litigation funding in lawsuits, which would give defense attorneys and juries insight into the entities other than the plaintiff who are financing the legal fees of plaintiff's attorneys. Such efforts predictably meet resistance from third-party litigation funders. In 2020, the 13 largest commercial litigation funders in the world formed the International Legal Finance Association (ILFA) to advocate for litigation funding and oppose blanket disclosure requirements.

Commercial transportation is among the sectors most severely affected by more frequent lawsuits generating higher insurance claim payouts. A 2020 study by the American Transportation Research Institute found that, from 2010 to 2018, the size of jury verdict awards grew 33 percent annually, as overall inflation grew 1.7 percent and healthcare costs grew 2.9 percent.

More frequent lawsuits and costlier jury verdicts can lead to increased insurance costs as rates are adjusted to reflect the changing risk profile. It can even force insurers to stop writing certain forms of coverage. Higher claim costs tend to be passed along to policyholders in the form of higher premiums. In extreme cases, climbing claim costs can ripple through the entire economy, creating conditions analogous to the 1980s liability crisis, where liability claims were adversely impacting the U.S. insurance industry to the point where some insurers faced insolvency.

What Do Equipment Breakdown Policies Cover?

The typical equipment breakdown insurance policy includes the following coverages:

1 Damage to "covered property" at the location named in the policy.

2 Expediting expenses, to cover the costs needed to get insured equipment operational as fast as possible, such as expedited shipping and making temporary repairs.

3 Business income and extra expense. Similar to coverage you should have under your property or business owners policy, many equipment breakdown policies will cover income lost due to the slowdown or stoppage caused by breakdown of the insured equipment. Extra expense coverage reimburses the insured for extra charges you incur to keep your business running while the equipment is not functioning, such as outsourcing or renting equipment. If your policy only lists extra expense coverage, it does not cover lost business income.

4 Utility interruption, which extends the policy's business income coverage to losses or spoilage caused by interruption of any utility service to the insured's premises, rather than just losses or spoilage caused by a breakdown of equipment at the insured premises.

5 Newly acquired premises, or premises unnamed in the policy, for the number of days shown in the policy's declaration page. The coverage only applies if equipment at the new location is of the same type covered by the policy.

6 Errors and omissions, which covers the insured for unintentional errors or omissions in describing or naming the insured property or location, and errors that cause cancellation of a covered premises.

7 Contingent business income and extra expense, which apply business income and extra expense coverage to breakdowns of equipment at a named "contingent location" not owned or operated by the insured. It can also include coverages to meet special needs, such as spoilage coverage, "brand and label" coverage, hazardous substance cleanup, and more.