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**Insurtech in the M&A Landscape**

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April 19<sup>th</sup>, 2021

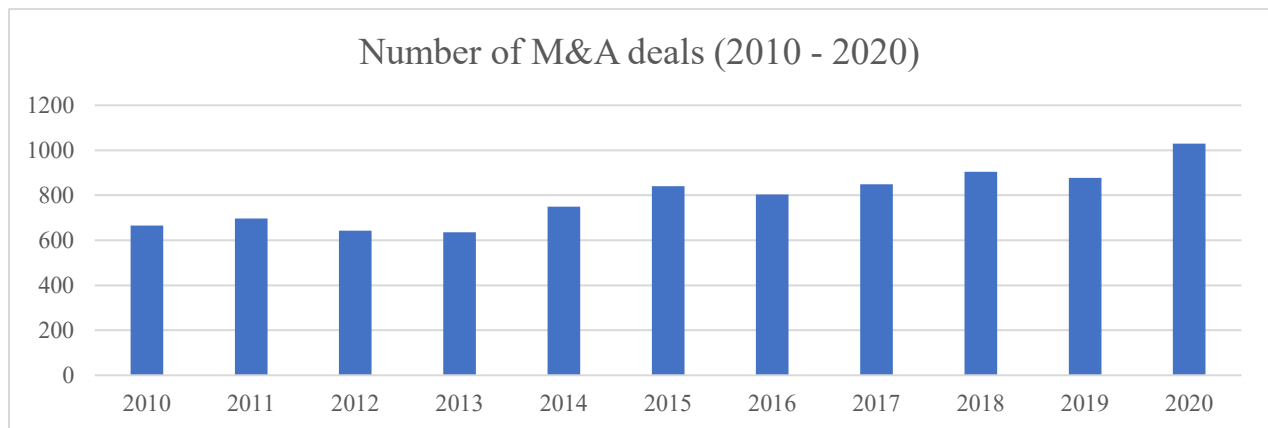
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## Introduction

With the advent of COVID-19, the insurance industry has seen unprecedented levels of Merger and Acquisition (M&A) activity. However, even before the pandemic, M&A within the insurance industry were on the rise, with 878 deals in 2019 (Statista, 2022). In fact, figure 1 illustrates how the number of M&A deals in the insurance industry has been on the rise for the last decade. This increased activity over the last number of years shows that insurance companies are understanding the need for change, innovation, and growth within the sector. With new demands from a younger customer base and clear benefits to firms and consumers, it's clear that Insurtech acquisitions are the key to succeeding in an ever-evolving field. It is incredibly important to not only recognize the value of these deals and what they can bring to the table, but also to be aware of common pitfalls that tend to occur in M&A and how to best handle the challenges they bring.

*Figure 1*



Source: Statista. (2022, January 11). *M&A: number of insurance deals worldwide 1985–2020*. Retrieved January 2, 2022, from <https://www.statista.com/statistics/1056851/number-of-merger-and-acquisitions-deals-in-the-insurance-sector-worldwide/>

## **COVID-19 and the increased Demand for Insurtech**

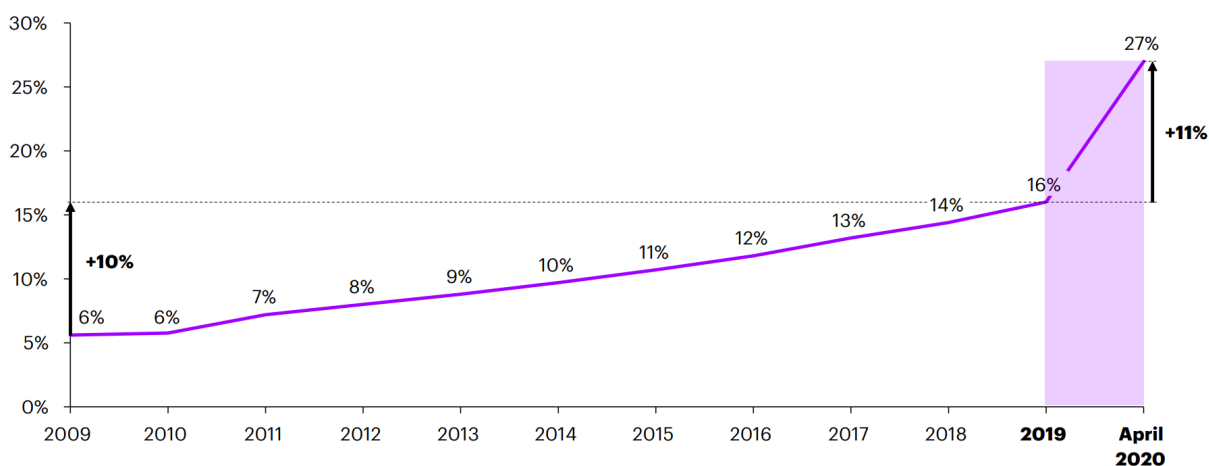
COVID-19 has caused massive changes in all industries. Like other sectors, the demand for virtual and remote options from insurance providers has been accelerated by the pandemic. However, the industry has been trending this way for a while, as innovations in technology in the last 20 years have slowly but surely raised the bar for virtual options for consumers. A product of this development is the expectations of a new customer base; Millennials and Gen-Z, who largely grew up with the innovations of the information age. These consumers have high expectations for mobile and web-based options, along with fast and speedy service, as this has become the new normal for most sectors. According to a study by PricewaterhouseCoopers (PWC), 41% of consumers surveyed said that they are “likely” or “more likely” to switch insurance providers because of a lack of digital capabilities, while 15% said that they found a lack of digital options to be the top challenge when interacting with their insurer (PricewaterhouseCoopers, 2020). Clearly, digital options like the ability to file online claims, purchase plans remotely, and premiums that make use of modern innovations are important to consumers.

The pandemic has only sped up these needs, as firms were forced to adapt to a remote customer base. Figure 2 illustrates the spike in eCommerce as a percentage of total retail sales in the first four months of the pandemic with a growth of 11%, which was more than the last 10 years of eCommerce growth combined (Accenture et al., 2020). This unprecedented spike in digital marketplace sales is indicative of a broader change that will need to be continually adapted to, as these numbers will only go up over the coming years. However, most insurance companies do not have the means to adapt to these changes. To do so, they must work with or acquire firms that specialize in Insurtech, or technology companies and startups that use AI,

blockchain, and other emerging technologies to overhaul and revolutionize various aspects of the insurance industry, like claim filing, underwriting efficiency, and premium pricing.

*Figure 2*

US eCommerce penetration as % of retail sales



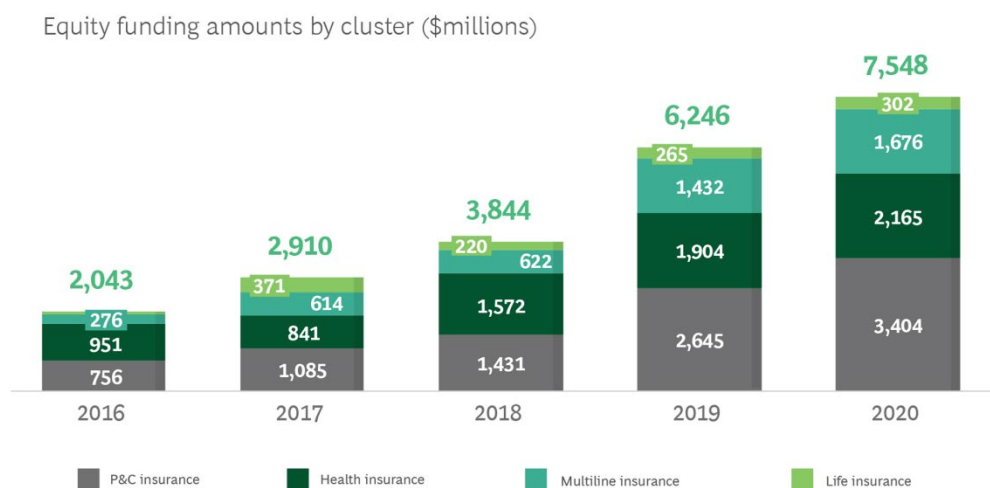
Source: Bank of America, US Department of Commerce, ShawSpring Research via L'Oreal presentation at Deutsche Bank Access Global Consumer Conference, June 9, 2020.

### **Insurtech: Perception in the Industry**

While the emergence of these Insurtech firms is relatively new, their perception from large industry players has shifted rapidly over the past decade. As recent as five years ago, Insurtech was perceived as a threat to the status quo rather than an opportunity for innovation. Incumbents saw insurtechs as technologically savvy startups that were attempting to cash in on a younger market that they themselves were unable to serve as easily. Caitlin et al. (2018) states “the Insurtech edge is in its early adoption (and adaptation) of new technology... and concepts that incumbents are only just beginning to experiment with,” remarking that “Insurtechs clearly represent a market risk for incumbents.” However, this attitude has begun to shift in recent years, as incumbents look to take advantage of the innovations available through insurtech. For instance, 2020 saw 81 insurtech acquisitions take place, which was the highest on record at the

time, despite the pandemic (Porch, 2021). Furthermore, figure 3 displays insurtech funding on the rise over the last five years, with a record \$7.5 billion in spending during 2020. Incumbent firms are recognizing the potential of these firms and should continue to acquire and take advantage of their innovations. Insurtech should not be viewed as competition to incumbents, but instead collaborators, as large, established firms have the capital to fund these companies and provide them with resources that will help them grow.

*Figure 3*



Source: BCG FinTech Control Tower.

## Benefits of Insurtech M&A

Now that the insurance industry has moved away from stigmatizing Insurtech and are beginning to embrace it, it is clear to see that everyone stands to benefit from the innovations of Insurtech— firms *and* consumers.

### *Firms and Employees*

The world's biggest players in insurance are already benefiting from the improvements in efficiency that Insurtech can allow, like in the way that insurers are moving away from the

days of pen and paper to a largely online model (Talage Team, 2021). For instance, filing and reviewing claims has become much more streamlined in the last five years. Claims can be filed online to be promptly analyzed with the latest software and Artificial Intelligence (AI) tools for the quickest and most accurate assessment (Hoffmann, 2021). This eliminates the need for an employee to spend time searching through every last detail of a claim to ensure accuracy. AI also can help improve premium and pricing structure by better analyzing clients and using predictive information to more accurately determine how much any given individual should be paying. For years, actuaries have used a number of underwriting factors to help determine an individual's premium, like age, gender, income and more. Now, AI can help get better detailed and more accurate information, like an individual's geographical location, marital status, and likelihood to file a claim (Rivelli, 2021). The introduction of new factors and more accurate information allows pricing structures to be more accurate, which benefits firms and consumers alike, as both parties will be more likely to be paying the best price for coverage.

Blockchain is another innovative technology that assists firms in record-keeping and security. Rather than needing to keep physical copies of records, blockchain can keep sensitive data safe by encrypting it and "marking" it to verify its accuracy and validity. The insurtech firm Ryskex, for example, does just this, using a blockchain technology to automate claims processes and allow for secure transactions. The significance of the improvements to efficiency cannot be understated; as few as ten years ago, claims filing and transactions done on pen and paper could take weeks, if not months to fully process. Different accounts of events, issues in communication, and human error meant that coming to a consensus could be incredibly difficult. AI and blockchain can ensure accuracy, efficiency, and security to streamline these processes greatly.

## *Consumers*

Consumers stand to see benefits from insurtech as well with technological innovations that increase convenience and improve the user experience. Insurance can be confusing and complex for consumers, especially for young people who are purchasing policies for the first time. There are a number of features that take advantage of mobile devices and the internet, like online policy comparisons, which allow consumers to gather information for themselves rather than through an agent, or mobile policy management, which allows consumers to file claims online and view their coverage from anywhere (Talage Team, 2021). Other innovations, like on demand insurance, which is a way for policyholders to buy short-term insurance for an event of specific time period, would likely not be possible without Insurtech (Insurtech- the threat that inspires). At the end of the day, these innovations can make the insurance experience much better and more streamlined for consumers. While these innovations may not appeal to everyone, they are still an option for those who want them, and they widen the potential customer base.

## **How firms can make the most of M&A**

While Insurtech acquisition and general industry consolidation does have clear benefits, it is important to recognize the impact it has on insurance professionals. All acquisitions inevitably bring change with them, and these changes must be handled professionally to help secure the long-term success of all parties involved, including its workers, as they are the lifeblood of any merger. Special care must be taken to make sure that employees have a sense of security and purpose through any acquisition to make sure efficiency and output stays consistent. A 2016 study from PWC found that only 19% of workers surveyed said that they had “very favorable results” regarding employee morale (PricewaterhouseCoopers, 2016). Poor employee disposition and morale in the face of a M&A deal makes sense—after all, these deals are typically filled with

uncertainties as workers wonder how their roles and positions will change. Schuyler Holder, a risk management specialist at Charles Schwab who came from the TD Ameritrade Acquisition, revealed her outlook in the face of her company's deal: "The biggest challenge being on the acquired side was not knowing if you would make it to the other side. I wasn't sure if my former role would align to an already existing group within Schwab, or if I would have to apply to an entirely different group. That state of uncertainty and overall 'in limbo' feeling definitely affected mine and my team's morale". Therefore, it is the job of management and firm executives to be as transparent and communicative as possible through any M&A to avoid causing these negative dispositions in their employees.

One of the most significant things that workers need to look out for in M&A is the possibility of large, systemic change within their firms, especially with Insurtech acquisitions. Like discussed in previous sections, Insurtech often allows for massive overhauls to decades-old systems. The status quo will be tampered with— and employees need to be ready to manage these changes with grace and humility. Even those who have been in the industry for years may struggle with these new systems. For example, pay-per-mile insurance is a drastic reimagining of traditional auto insurance. Instead of paying a flat premium rate, policyholders instead pay a certain amount per mile driven. These sorts of innovations are still new and require employees and veterans of the industry to be willing to adapt.

Finally, the most overlooked aspect of M&As would have to be what PWC calls "cultural fit". Essentially, when two firms merge, or a firm is acquired by another one, special care needs to be taken to make sure that the two parties are in an understanding about their mission, goals, and values (PricewaterhouseCoopers, 2016). Especially between companies who are very different, M&As can create tension for both parties who are not used to each other's practices.

To illustrate, think of a large, established firm who has been in the insurance sectors for decades. They likely have long standing company traditions and practices. Now, think of that same company acquiring a small, brand-new insurtech start-up that is full of young software engineers and entrepreneurs. Obviously, these two firms will have completely different cultures, and effort will need to be put forth by both parties to secure success. Employees at both types of firms, established and new, have distinct norms, and thus adjustments will need to be made on both sides. In speaking on this issue, PricewaterhouseCoopers (2016) argues: “The most effective combinations happen when management is clear on what key employees value, and then designs programs to reward behaviors it wants to encourage”. These sorts of considerations are not just key to worker wellbeing, but the firm as well. PWC found that organizations with a “distinct culture” were more likely to see and increase in customer satisfaction (89%), employee satisfaction (80%), and revenue (48%).

## **Conclusion**

The current insurance landscape is constantly changing. For companies to be able to successfully navigate these changes and the transition to more emerging technologies, they will need to keep in mind several things. Insurtech options are in high demand, and consumer trends do not show any sign of this slowing down. Established firms need to acquire and work with the firms that specialize in these technologies and learn how to best collaborate to deliver a cohesive product and goal to their consumer base. It is key in these deals to make sure that employers in both firms are comfortable and well communicated with, otherwise the firm itself will suffer. Continuing to innovate and be adaptable to industry changes will be what differentiates successful firms from the ones that fail.

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# Impact of the Talent Crisis on the Insurance Industry

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April 19, 2022

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## **Introduction**

A career in insurance is not often the first choice for many young professionals. This is even more apparent for the wholesale, specialty, and surplus lines market, mostly due to a lack of awareness and education for this sector of insurance. Retirement rates in the industry are also higher than ever, which means not enough new talent is coming in to replace the professionals that are leaving. Furthermore, the COVID-19 pandemic has posed a new challenge of adapting the insurance workplace to a newfound hybrid world where employees now expect a dynamic and flexible work environment. However, by learning how to appeal to new generations and create an innovative and diverse workplace, the current talent gap can be reduced, and future crises can even be prevented.

## **Reasons for the Talent Gap and its Impact**

According to the U.S. Bureau of Labor Statistics, almost 500,000 employees in insurance will retire soon. This along with the lack of knowledge of the insurance industry among many younger people is concerning. The Institutes conducted a survey that concluded eight out of ten millennials have limited knowledge of career opportunities in the industry (AmTrustFinancial). Many young people simply do not have the experience with insurance that older generations may have. In our inflationary economic state, we are seeing young people significantly delay buying houses and cars. They likely have no excess funds to spend on extra insurance products beyond basic policies required for renting. It is intuitive that in order to be drawn to a specific career, one usually has decent background knowledge or exposure to its subject matter. This predicament with insurance and Millennials/Generation Z causes less interest in the career and ultimately unfilled positions in a rapidly declining insurance workforce.

It is also possible that many insurance companies haven't focused on their strategies for obtaining talent like they do with other general business strategies (Catlin et al.). Businesses rarely hesitate to come up with new and exciting ways to market or expand their insurance product, often with much more focus and commitment than strategizing ways to find new and exciting talent. However, it is now imperative that the industry tackle this issue head on and with a higher priority lest they face great consequences that could disrupt the insurance market.

Although there was a 21.9% increase in premiums according to the WSIA 2021 Midyear Report of the U.S. Surplus Lines Service and Stamping Offices, this growth can be affected by the talent gap. The failure to attract new workers will directly affect the wholesale, specialty, and surplus lines sector of insurance. We also see an increasingly more competitive talent market, and with fewer people available to work, the expenses associated with hiring only continue to increase (Beckman). This is yet another reason to prioritize talent strategy more. Not just in the excess and surplus area, but the whole industry is competing over a dwindling pool of talent. These expenses can negatively impact other aspects of a company that otherwise wouldn't be affected in the absence of the talent gap.

## **Closing the Talent Gap**

### How to Appeal to Young Talent through Technology

First, adjusting exactly how the industry connects to young people is crucial in attracting talent. It is important to realize the differences that the new generation of employees has from the ones currently reaching retirement age. Above all else, technology is the key to this predicament. With the exponential growth of social media in recent years, putting efforts into new technology and innovative techniques can help attract a younger generation of new insurance professionals.

Some suggest an increase in using social media and apps for hiring, since this part of the Internet is so much a part of everyone's lives (AmTrustFinancial). New recruitment techniques and the use of new technology will positively impact the way insurance businesses approach hiring across the whole industry. In an increasingly digitalized world, being vigilant about taking advantage of new technologies to attract young people is one of the most effective ways to close the talent gap.

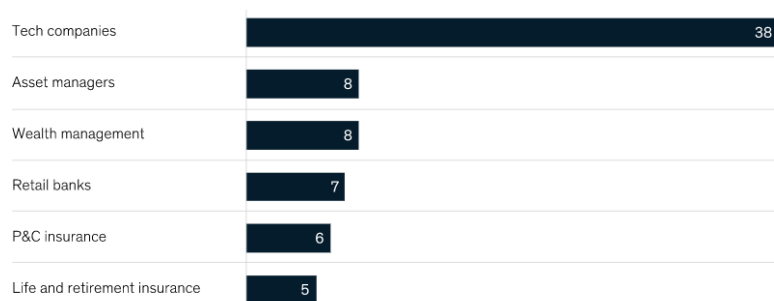
Another thing to consider is advertising insurance careers to students even younger than college. High schoolers generally would not even know what wholesale, specialty, and surplus lines insurance is. By broadening the audience, younger people could possibly become interested in a career in insurance. The industry is already pretty good about valuing its interns but ensuring that they are reaching a young audience and increasing overall awareness for a career in insurance is still important (Cassian). Dedicating more time for recruiters to present at local high schools or career fair events could go a long way in securing future employees.

### Reskilling Employees

Another way to decrease the talent gap could be to reskill existing employees to meet the needs of companies, rather than simply hiring new ones. For example, McKinsey and Company published the figure on the following page (Figure 1) depicting the lack of employees skilled in technology in the insurance industry. By reskilling current employees in technology, companies across the industry could fill some of their vacant positions without the need for outside hiring (Catlin et al.). Furthermore, it is up to each industry sector to make changes right now that anticipate future increases in the need for digital skills. This means it is necessary to help employees reinvent their roles according to the demand for skills (PwC).

**US insurers have less digital and technology talent than other financial-services companies.**

% of full-time equivalents (FTEs) in digital roles<sup>1</sup>



<sup>1</sup> Software engineering, design, product management, data and analytics. Nominator and denominator includes only FTEs based in the United States.  
Source: Outside-in analysis of LinkedIn and Glassdoor data

McKinsey  
& Company

(Figure 1) Source: *McKinsey and Company*

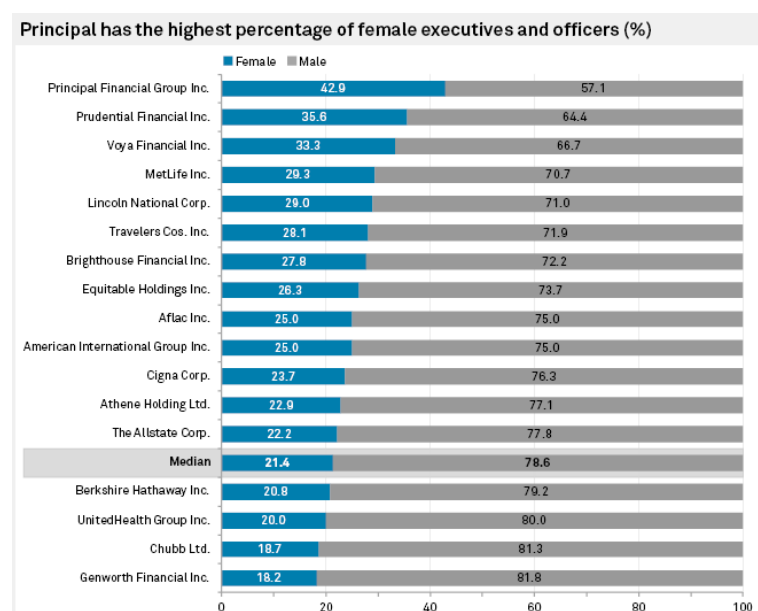
Oftentimes, some of the best candidates for a position may already be at the very company that is searching for new talent. They are just in need of some internal training. This strategy could potentially alleviate the significantly higher cost of hiring externally. Valuing each employee's unique skillset can prove to be a great asset. As the Insurance Information Institute put it, "We can teach you the skills you need to do the job," [...] "but we can't teach someone to be you."

Furthermore, to aid in training, it is crucial to create strong learning and development programs that cater to the flexibility needs of employees (Catlin et al.). In almost every industry, a continuing education is simply part of the job. If companies already have a program in place that is designed for current employees to learn new technical skills and trends within their position, these same programs can be used by employees switching positions as well. Solid learning programs should be accessible and convenient while still allowing for efficient intake of valuable information. Many companies have incorporated a hybrid learning model consisting of both independent, digital learning and immersive classroom experiences (Brassey et al.). This

works best for insurance workforces who are already stretched thin and don't have time to teach courses during the workday. By designing a strategy that values human capital and takes advantage of existing talent resources, insurers can possibly spend less on new talent and more on ensuring profitability of their sector of the insurance industry.

### Diversity and Inclusion

It is known that the more effort businesses put into diversity, the more successful they are. In Figure 2 below, it is shown that top surplus lines insurers such as Berkshire Hathaway and American International Group have relatively low numbers of women in higher positions (Ross). However, this doesn't necessarily mean that the E&S industry is not an accepting work environment towards women. Since insurance is a heavily aging workforce (based solely on the numbers of expected retirements), women in older age groups could have been discouraged by the cultural norms of their time to not take on higher-level roles, or they simply didn't desire the lifestyle that comes with corporate management.



(Figure 2) Source: *S&P Global Market Intelligence*

There are other reasons that could explain this, but old stereotypes that have a lasting influence on women today may be a key contributor (AAUW). Even though this sector of the industry has worked to implement diversity efforts, such as Lloyd's of London recently setting a target for 35% of leadership positions to be occupied by women, they still need to be persistent in implementing policies that will encourage diversity in the workplace (Sheehan).

Also, note that diversity should be less about percentage "targets" for a certain group to be represented and more about an idea cultivated in the workplace that encourages minorities to apply for a job or work their way up the ranks from a current position. When these employees feel they are in an accepting and inspiring environment, productivity for the business inevitably increases and minorities are more comfortable in their positions and therefore less likely to shy away from going after a senior position. Then, upper management no longer must purposely pick people to promote because of race, gender, et cetera just to be able to present statistics that depict they are a company with diverse leadership. That could be taken as not being inclusive because it is essentially forced hiring based on classification by employees' race and gender.

Ultimately, companies who strongly value their employees attract new ones at a similar strength. Young generations want more than ever to work for someone who supports them for who they are. Gender norms and systemic racism are pressing issues that this generation values immensely.

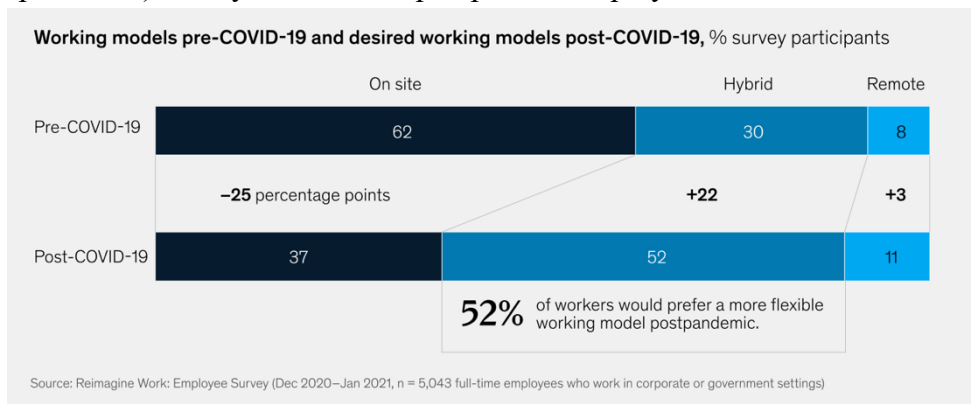
## **Looking Forward**

### Adapting to a Changing Workplace

With the recent pandemic, it is important to note that the typical office workplace has changed tremendously in the last two years. Most obviously, there has been an increase in remote

work, with many companies not even going fully back to a completely in-person office set up. This huge change comes with an opportunity to reinvent roles and attract talent by advertising the willingness to be adaptable for the sake of employee health and safety (PwC). Julie Lamm, Global Workforce Strategy Leader at PwC noted that, “Once you’re open to creating a hybrid or remote plan, you can compete for talent in any market in the country.” COVID-19 displayed the resiliency of industry employees, and insurance companies must respond by ensuring that they are flexible and willing to change with this new work environment. The future of excess and surplus insurance company operations is changing because of this.

In Figure 3, it can be shown that most workers would prefer a hybrid work style, even post-pandemic. If employers can work to make this a reality, they are more likely to attract and retain talent. Knowing that a potential workplace is willing to commit to the well-being of the people that make its success possible (especially during high-stress situations like a worldwide pandemic) is very attractive to prospective employees.



(Figure 3) Source: *McKinsey and Company, Reimagine Work*

### Additional Talent Pipelines

Expansion of existing internships is another talent pipeline to consider. We saw the flexibility of some employers in offering virtual options for internships promised for summer of 2020 when COVID-19 first broke out (Grzadkowska). Having virtual internship opportunities for students shows the dedication of the industry in attracting potential candidates. However, the

potential to capitalize off this pipeline is only growing. Prioritizing intern recruitment techniques as well as constantly improving internship experiences for young professionals can secure a consistent inflow of new employees to replace the ones retiring, as interns are prime candidates for open full-time positions. Another way to find more talent could be through consultancy positions, where a non-insurance professional can work as a consultant part-time in order to learn more about the insurance profession (Turner). This could alleviate the workload created by unfilled positions when the talent pool is competitive and filling positions is especially difficult.

## **Conclusion**

The talent crisis within the insurance industry is not to be taken lightly, especially by the wholesale and specialty sector. Regardless, it is possible to close the growing gap through strategic initiatives to advertise the career to younger audiences, as well as the reskilling of current employees, and creating a diverse, inclusive workplace. Attracting new talent is easily attainable when a company chooses to invest in the education and well-being of its employees. Moreover, the pandemic has facilitated a shift in this industry's work environment, maybe even for the better, that serves as an opportunity for employers to showcase their flexibility, which new talent is increasingly drawn towards. As an industry that's never going away, insurance can be a lucrative career prospect for young professionals, as long as they have the appropriate knowledge of the industry and its job opportunities. This is only ensured by prioritizing talent strategy now more than ever.

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# **The Effect of Rising Construction Costs on the Insurance Industry**

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# Introduction

Following the COVID-19 pandemic lockdowns, many suppliers were forced to shut down or operate in a limited capacity. Even when they were able to continue production, a labor shortage across the entire market made it difficult for suppliers to find workers. With reduced production due to shortages in labor and resources, suppliers increased the cost of any finished goods available for purchase. The finished goods also faced increased costs due to an insufficient pool of transportation drivers to distribute goods to warehouses and stores. Altogether, various factors of inflation led to an increase in construction costs for all construction projects, whether for home improvement or reconstruction.

For insurers, higher construction costs pose additional risks across the entire industry. In addition to higher claim payouts, insurers may face additional delays and losses in their operations. As a result, insurers should diligently assess their operations to ensure that they have enough money in their loss reserves to pay for anticipated claims.

## Actuarial Viewpoint

From an actuarial viewpoint, inflation has increased the cost of building materials and construction costs. Due to the higher construction costs, in the event of a loss, a homeowner would face higher reconstruction costs to restore their property to its previous condition using similar materials (Myers, 2021). Therefore, insurers should prepare for increased claims expenses and higher estimates for reconstruction projects.

Insurers tend to use a formulaic approach to make projections based on historical claims data (The Actuary, 2014). From a stable environment, it may suffice to use mathematical risk models based on previous statistics from past claims and policies. However, since the current external changes will impact insurers more than models may suggest, insurers must adopt an actuarial viewpoint to view the potential impact of risks more broadly. For example, some insurance companies have responded to current and projected inflation rates by reassessing property values and policy limits of their insureds to the appropriate evaluations (Lerner, 2021a). By updating their mathematical models with accurate property values and limits, insurers will be able to analyze the risk of higher claim payouts across their entire operations.

## Impact on Various Lines of Business

Rising costs and inflation have a large impact across all lines of business for insurers. Higher inflation will increase payouts and expenses across the entire industry if the changes continue (The Insurer, 2021). However, the exact change in costs will depend on the specific line of business. Although some lines of business such as property and auto will show changes quickly, other lines of business will adversely affect insurers later (Fitch Ratings, 2022).

### Property

Supply chain distributions, increases in demand for homes, and a strain on homebuilding construction and repair are all factors that have increased costs for policyholders looking to buy or repair homes (Lerner, 2021a). In fact, lumber costs

increased almost 40% from 2019 to the end of 2021 while other materials such as steel and concrete also had above-average price increases (Lerner, 2021a). Besides the increased repair times for property claims, policyholders can be underinsured in their policy due to elevated repair costs (Lerner, 2021b). A repair or construction project may be valued at a certain amount, but the increased construction costs for property may exceed the policy limit for the building, leaving a named insured to pay for costs out of their own pocket. Insurance companies may also find themselves exceeding their estimated reserves if they pay for subrogation claims. Consequently, risk professionals should frequently reassess the values of their inventory in a rapidly changing market (Lerner, 2021b). By having accurately priced values for insured properties, both policyholders and insurers will benefit by being prepared to pay for increased repair costs with an appropriate policy in place.

## Workers' Compensation

Current labor and skills shortages have led to a struggle for companies to hire workers (Wilkinson, 2022). The cost of labor has risen sharply with the shortage in workers. For instance, a survey found that 99 percent of rural hospitals had a staffing shortage for nurses, which led them to increase nurses' salaries or hire temporary nurses at a higher rate (Scott, 2021). In turn, healthcare providers increase payments from insurers to make up for their increased costs. Afterward, insurers raise premiums and deductibles for policyholders to offset their elevated payments.

Although the cost of labor has increased, employers have been forced to take on workers who lack the proper training and qualification (Insurance Journal, 2021). Accordingly, these underskilled workers are more likely to get injured, resulting in more

workers' compensation claims. Furthermore, the increased demand for construction and the resulting overtime work may also increase the number of injuries and workers' compensation claim payouts. Overall, workers' compensation claims have risen in severity with more than a 120% increase since 2018 in the average charge per claimant (Risk & Insurance, 2021).

## Liability

Due to the increased costs in property construction and repair as well as the increased costs of workers' compensation claims, insurers are at risk for higher payouts for liability claims. Longer-term casualty segments such as liability sometimes take longer to experience the effects of higher inflation on factors such as litigation costs (Fitch Ratings, 2022). While other lines of businesses such as property and auto will quickly see higher costs for parts and labor, the liability segment may face unanticipated impacts of inflation down the road when paying for defense and litigation to protect insureds' liability. Accordingly, liability professionals should anticipate increased costs in claim payouts and expenses due to a wide variety of factors.

## Challenges and Opportunities to Insurers

### Challenges

Due to shortages in construction materials and labor, insurers can face delays when attempting to resolve claims (Lehman, 2021). In the event of a loss, building materials may take longer to arrive and construction projects may be delayed by a

shortage of workers. In turn, these delays may cause insurers to exceed the statute of limitations or policy time element limitations.

In addition, the inflation of construction costs may lead to costs that exceed claims reserves and estimated expenses. Insurers typically hold liabilities in the form of loss reserves to cover future expenses (Burns, 2021). Normally, loss reserves hold enough money to pay for future claims and expenses. Similarly, insurers base their customer pricing based on the projected cost of future claims (Burns, 2021). However, if inflation is higher than the rates used to establish loss reserves and claims pricing, insurers risk running out of money to pay for claims, which can potentially lead to coinsurance penalties or underinsured policyholders.

## Opportunities

However, there are many opportunities for insurers to continue to grow amid the challenges. For example, Travelers has experienced growth in its business insurance profits by increasing both its rates and exposure growth (Demos, 2022). The company was able to raise profits by taking on more exposures in various policies and increasing rates paid by policyholders. The company has also cited wage inflation as an aid in boosting overall premiums collected for workers' compensation insurance (Demos, 2022).

Insurers can also rearrange contract designs and terms to reduce the length of liabilities. For example, a claims-made policy only covers incidents reported to insurers within the policy period (Karl, 2012). Insurers can also add a sunset clause to limit coverage to losses reported before a certain date (Karl, 2012). Such implementations to

the contract design will decrease the coverage period for policies and reduce the length of the liabilities that are assumed.

Additionally, insurers can purchase reinsurance to share the risk of additional claims exposure with a reinsurance company (Karl, 2012). Thus, any impacts of inflation felt by the insurer will be less severe because some of the exposure is transferred to the reinsurer.

## Perception of Risks for Underwriters

Rising costs create challenges for underwriters assessing the amount of premiums to charge for risks taken on. Over an extended period of time, inflation makes it harder to maintain the appropriate pricing with volatile increases in loss costs and higher incurred loss ratios (Fitch Ratings, 2022). Not all costs are immediately apparent to insurers and may arise unexpectedly, especially in insurance segments that are impacted indirectly by inflation. Insurers risk running out of reserves if underwriters do not charge prices that are high enough to cover future claims affected by inflation (Burns, 2021). Consequently, underwriters should set premiums that are consistent with losses and inflation rates that are accurate and up to date.

## Impacts on Brokers and Agents

To help policyholders anticipate potential risks, costs, and delays brought by recent changes, brokers and agents should review their insureds' policy terms and conditions and provide them with guidance to ensure that they have an appropriate policy in place (Lehman, 2021). For example, brokers and agents can review policy limits and reevaluate

asset values and replacement costs with their insureds to protect them against unexpected fluctuations in costs. They can also remind insureds to have a backup plan in place to procure materials and labor from alternative sources with the ongoing shortage in construction. Furthermore, brokers and agents can advise their clients to add an inflation guard endorsement, which is an option that increases an insurance policy's coverage by a certain percentage every quarter. By increasing coverage over time, the inflation guard endorsement protects policyholders from rising costs in inflation, replacement, and reconstruction (Dick, 2021). As a result, policyholders will have a lower risk of being underinsured by their policy.

## Effects on Claims

Shortages in construction materials due to the manufacturing, transportation, and supply chain process may increase the length of time needed to make repairs for claims (Lerner, 2021b). Therefore, insurers might not be able to resolve claims as quickly as anticipated. It is very important for insurers to ensure that they do not exceed the statute of limitations or policy terms or else they are at risk for fines and imposed penalties.

Since claims are measured based on historical data, new claims will potentially require changes in the measurement process (Lerner, 2021b). Companies should not always use the results of claims from previous years to determine how to plan for new claims. Instead, companies should add additional time and reserves to their estimates due to delays in obtaining relevant building materials and labor for construction projects. They should also use updated property evaluations and reconstruction costs when they

project future expenses. Overall, insurers should look at recent trends to measure and document claims.

## Best Practices for Insurers to Implement

To face added exposures, insurers should use updated technology in information systems and finance to get detailed information about losses at a quicker speed (Fitch Ratings, 2022). The data collected from these systems will help the companies predict and adapt to changing trends seen in the industry. For example, insurers can use data regarding wage rates, costs of living, and inflation for a certain geographical area to determine the appropriate premiums to charge for policyholders in the area.

Investment income is a major source of revenue for U.S. insurers, with an estimated surplus of \$990 billion for the end of 2021 (Insurance Information Institute, 2021). Companies must analyze the cash flow and interest rates of their investments to compare their investment income with current market conditions. Although different types of investment will vary in their levels of risk and return, insurers can reduce risk by obtaining stocks, real estate, and other assets (Burns, 2021).

## Conclusion

The effects of inflation and elevated construction costs are felt across the entire insurance industry. Property, workers' compensation, liability, and other lines of business all face higher costs to resolve claims because of increases in the costs of building materials, medical expenses, labor, and property values. With higher claim payouts, insurers must actively reassess their insureds' property values to charge the appropriate

pricing for premiums. Otherwise, if insurers do not use updated data to make projections for claim expenses, they will not have enough money in their loss reserves for claim payouts and expenses.

To reduce the amount of risk assumed by potential losses, insurers can change the contract design of its policies to reduce the length of liabilities. For example, they can add a claims-made policy and a sunset clause to their policies. Insurers can also reduce risk by purchasing reinsurance and maintaining investment income from stable assets. Although insurers may experience higher expenses and loss ratios, they can still grow their profits by increasing rates and exposure while decreasing the length of liabilities and potential claim payouts.

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