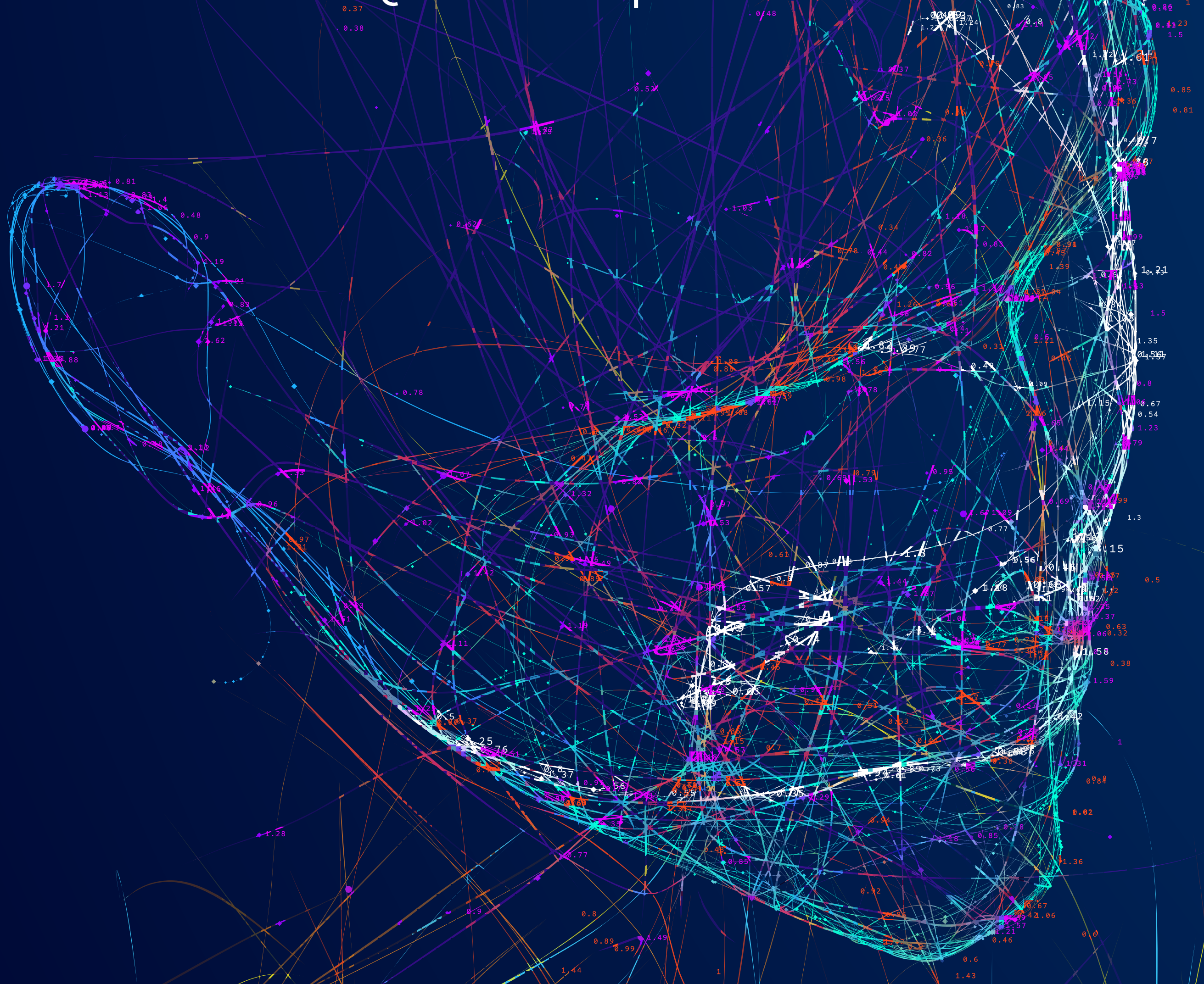
Global Insurance Services

Executive Brief
Q1 2023 Recap



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In This Issue

Ethical Use of AI in Insurance Modeling and Decision-Making

With increased availability of next-generation technology and data mining tools, insurance company use of external consumer data sets and artificial intelligence (AI) and machine learning (ML)-enabled analytical models is rapidly expanding and accelerating. At the same time, regulators worldwide are intensifying their focus on the governance and fairness challenges presented by these complex, highly innovative tools – *specifically, the potential for unintended bias against protected classes of people*.

Liability Insurance: Social Inflation Indicators Amidst Economic Data

Social inflation (i.e., rising costs to insurers due to outsize jury awards, tort reform or prolonged litigation) remains a top concern for insurance professionals. In this note authored by Bill Wilt, President of Assured Research, the author provides data that shows how real wages can be used as a leading indicator of social inflation, offering an easily observed, monthly data point that should not be ignored.

Special Insights and Guidance Advisory

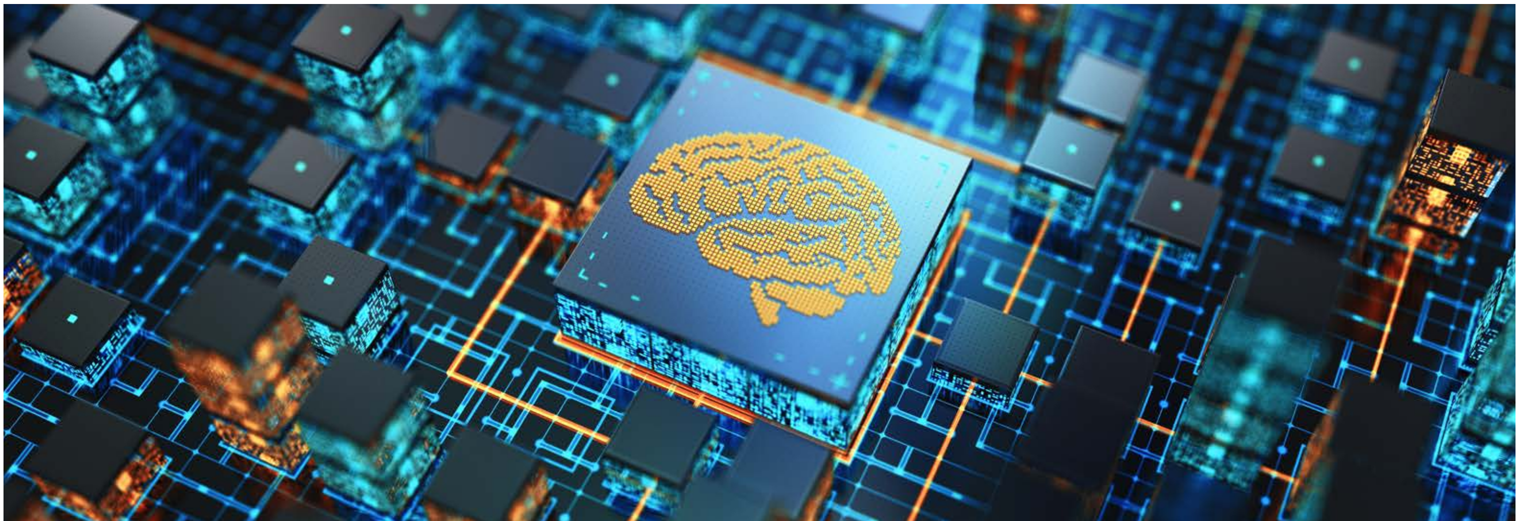
While conditions in the market have changed dramatically since half-year 2022, EU dealmaking pace set last year has largely continued, setting new record volumes. With rising interest rates starting to bite and debt financing costs rising amidst the recessionary threat, the opportunities for deals may start to narrow. Whether valuations reduce as a result remains to be seen.

In the News

Own Your Future, an initiative of Minnesota Department of Human Services' (DHS) Aging and Adult Services Division, announced a project with FTI Consulting to conduct an innovative study to help increase access to long-term services and supports (LTSS) for Minnesota's older adult population.

Spotlight on ESG

With proposed SEC regulations in the United States and Corporate Sustainability Reporting Directive (CSRD) regulations in the European Union (EU) on the horizon, public companies must prepare for potential requirements to include detailed sustainability data in financial and related reporting as soon as 2025. Beyond SEC regulations, some U.S. companies and financial institutions that meet certain size thresholds and do business in the EU may need to comply with the CSRD. With expanded reporting requirements and complexity, it is likely that scrutiny from regulatory agencies will increase in tandem. Consequences of noncompliance could include litigation, regulatory enforcement, and monetary fines.



Ethical Use of AI in Insurance Modeling and Decision-Making

Insurance companies are increasingly using external data sets and AI/ML-enabled analytical models for underwriting, pricing, fraud detection, marketing distribution, and claims management. However, regulators worldwide are focusing on the fairness challenges presented by these tools, particularly the potential for unintended bias against protected classes of people.

To ensure the ethical use of external data and AI-powered analytics, regulators are imposing new policies and legal frameworks that prohibit using external data resulting in unfair discrimination against consumers. Leading companies that want to get ahead of the curve may opt for partnership with external experts to meet expected reporting and model testing obligations enforced by these policies. This allows insurers to balance the need for proactive risk management, market penetration and profitability objectives with principles of consumer fairness. Compliance with these regulations can provide many benefits such as stable analytic insight models, improved new business profitability, and a better customer experience.

Read the full article.[1]

Liability Insurance: Social Inflation Indicators Amidst Economic Data

The topic of social inflation continues to be a top concern

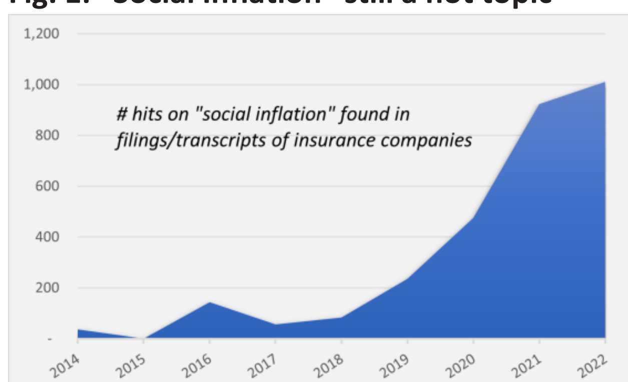
By Bill Wilt, President, Assured Research

We began to hear about ‘social inflation’ in early 2017 when insurers reported their full-year 2016 earnings. As seen in Figure 1, the topic shortly thereafter gained a substantial head of steam and it remains a top concern for insurance professionals.

And while the impact of social inflation (*e.g.*, a ‘frequency of severe losses’) is now manifesting in claims and actuarial data, it still makes sense to consider how bouts of social inflation can be anticipated using objective, real-time measures of the economy or social trends, for instance. Our objective in this note is to demonstrate that there are useful concurrent, and even leading indicators of bouts of social inflation to be found in real-time economic data.

Social inflation holds greater sway over the liability loss ratio than changes in economic inflation.

Fig. 1: “Social Inflation” still a hot topic



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Social inflation matters more. First, it bears repeating our view that social inflation holds greater sway over the liability loss ratio than do changes in economic inflation. For instance, with data back to 1973, there is an insignificant (6)% correlation between the CPI and the liability loss ratio. This and similar analyses/

findings are among the reasons we've been saying for some time that actuaries, over the decades, have proven adept at pricing for changes in economic inflation and neutralizing their impact on the loss ratio.

Changes in Real Wages Provide a Useful Indicator of Liability Loss Ratio Trends

The topic of real wages is frequently on the first page of the business section of newspapers across the country. Concerned that a wage/price spiral could frustrate efforts by the Federal Reserve to cool inflation by raising interest rates, Chairman Powell seeks to engineer annual wage growth, now around 4-5%, to something (lower) that is consistent with its longer-term inflation target of 2%.

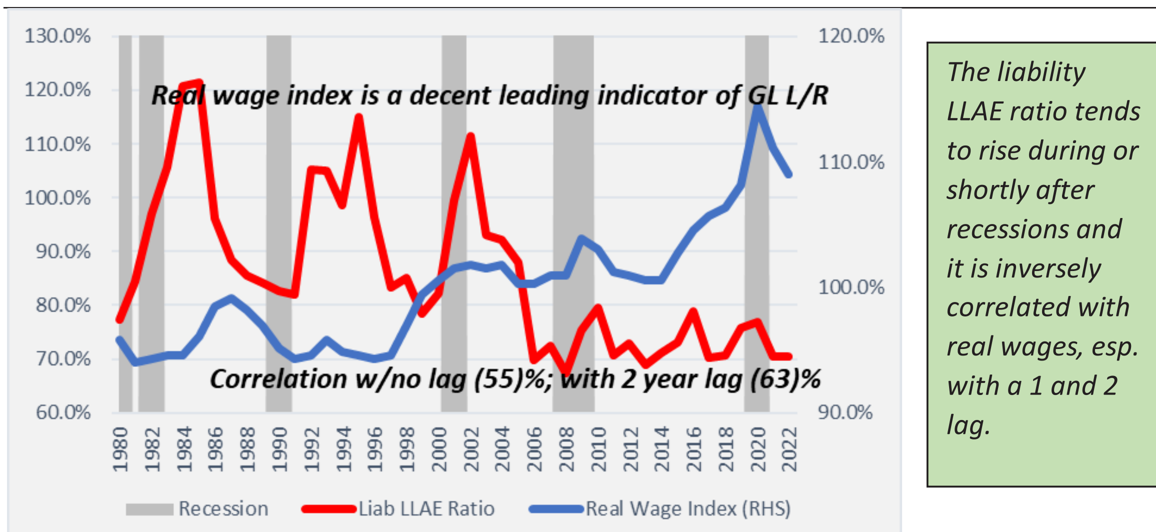
But when wage growth falls short of inflation, 'real' wages decline. Economic frustration rises. That dynamic, multiplied across millions of workers surely has an impact on peoples' receptiveness to legal advertisements, their propensity to file liability claims or to seek redistribution of wealth as either a claimant or juror. And it's well understood that rising jury awards beget rising legal case settlements; thus, the seeds of social inflation are sewn.

Our theory finds support in historical insurance industry and economic data back to 1980. When real wages rise, liability loss ratios tend to decline. Conversely, when real wages decline, as they did during 2022, the liability loss ratio tends to rise – particularly with a 1- and 2-year lag.

A practical application of this observation: If real wages fall during 2023, that's probably not helpful when considering the economic and social influences on the liability loss ratio in 2024 or 2025. If real wages rise, well, one might become more optimistic.

There are other tools one can use to monitor the likely resurgence or tempering of social inflationary forces; but trends in real wages offer an easily observed, monthly indicator of economic health that should not be ignored.

Figure 4: Changes in real wages are a decent (and inverse) leading indicator of the liability L/R



Source: ©2023 S&P Global Market Intelligence, Assured Research, Federal Reserve

Biography

Assured Research is a boutique research firm that has for more than a decade been dedicated to producing substantive and actionable research for property/casualty insurance and investment professionals. The firm currently reaches P/C (re)insurers, brokers, and consultants writing or controlling more than $400 bil. in premiums. The author, Bill Wilt, is the founder of Assured Research. Prior to forming the firm he worked in diverse roles as an industry actuary, credit and equity analyst, and business development professional. Bill can be reached at william.wilt@assuredresearch.com.

Special Insights & Guidance Advisory

European Insurance M&A Barometer Report 2022

Despite a confluence of headwinds from rising interest rates and debt financing costs amidst the threat of recession, 2022 saw a continued increase in European insurance M&A, up 15% when compared with 2021, fueled predominantly by broker consolidation. In FTI Consulting's 2022 European Insurance M&A Barometer, we shine a light on the key trends in the insurance M&A market, its most notable transactions in the quarter and the players to watch.

Key Highlights

— Private equity investors maintained their strong appetite and accounted for 60% of Europe's deal volume. Strategic buyers have also repositioned and pursued opportunities, and accounted for 40% of the deal activity, up 22% from 2021.

— The acquisition of insurance distribution and services businesses accounted for most of Europe's deal volume last year, up 24%.

— Speculation that valuations could hit a new peak in 2022 came to pass, with several transactions making it to the finish line at record-high multiples.

— Inflation is affecting non-life insurers' earnings, impacting volumes while life transaction volumes remained steady, driven by legacy transactions and bancassurance deals.

— Despite the UK and Ireland continuing to lead the European market for insurance industry M&A, activity may have peaked, with fewer deals completing in 2022 than 2021.

— Continental Europe is now the focus, with a new wave of established broker consolidation platforms. Almost all continental European markets saw an increase in deal activity, with the Central & Eastern Europe region being the notable exception, reflecting the impact of the current geopolitical crisis.

Access the full report.[2]

In the News

Minnesota – Own Your Future News & Information

FTI Consulting is working with Own Your Future, an initiative of Minnesota Department of Human Services' (DHS) Aging and Adult Services Division, to study how to help Minnesota's older adult population increase their access to long-term services and supports (LTSS). FTI Consulting will partner with two highly regarded organizations with significant expertise in LTSS: Altarum and Actuarial Research Corporation (ARC). The work will include a robust stakeholder engagement process, a thorough analysis of various LTSS funding options, a strong actuarial analysis to support pricing and sustainability recommendations, and a final report recommending a course of action for Minnesota.

Read the full press release.[3]

Spotlight on ESG

Addressing the Gap Between Looming ESG Reporting Requirements and Internal Audit Functions.

Companies must take action to ensure that their internal audit functions are equipped to handle ESG reporting requirements. To achieve this, FTI Consulting experts in the Forensic & Litigation Consulting and the Strategic Communications segments have developed a roadmap to help companies develop effective audit processes and internal controls. Their framework allows companies to comply with future regulations more quickly and provides additional benefits including:

— Proactive identification and mitigation of ESG risk

— Clear delineation of data governance and oversight responsibilities

— Informed decision-making and management of ESG issues

— Confident public disclosure of ESG data

Read the full article.[4]

As a leading independent advisor and consultancy to the insurance industry, Global Insurance Services helps clients identify opportunities and define strategies to manage risk, improve operational and financial performance, and drive growth.

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1 Peter Kelly and Marc Zimmerman, *"Ethical Use of AI in Insurance Modeling and Decision-Making,"* FTI Consulting, Inc. (March 23, 2023), https://www.fticonsulting.com/insights/articles/ethical-use-ai-insurance-modeling-decision-making.

2 AN FTI CONSULTING REPORT – PUBLISHED Q4 2022- *"European Insurance M&A Barometer: Q3 2022 Update,"* https://live.fticonsulting.com/European-Insurance-MnA-Barometer-Report-2022

3 Minnesota Own Your Future, "*Own Your Future News & Information*", https://images.now.fticonsulting.com/Web/FTIConsultingInc/%7B5c1a99ec-bb3a-477a-a171-4f7ea8f50587%7D_Own_Your_Future_News_and_Information.pdf

4 *"Addressing the Gap Between Looming ESG Reporting Requirements and Internal Audit Functions,"* FTI Consulting, Inc. (March 7, 2023) https://fticommunications.com/addressing-the-gap-between-looming-esg-reporting-requirements-and-internal-audit-functions/

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