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A scramble to insure against AI risks?

Are we fully comprehending the risks associated with the cultural zeitgeist of our generation, AI? This is a question insurers are asking, not only in relation to their own AI use cases, but also from a product development perspective.

Is it possible to accurately underwrite AI risks? Spare a thought for the product development actuaries who are tasked by their management teams to be the first to go to market with such an innovative product, and are expected by their Chief Risk Officers to provide convincing responses to this question. How do you price for the cost of capital on a risk you don't have experience for? By now the pressure to launch an AI insurance product is a weighty cloud. The pace of innovation in AI and the scramble for adoption by businesses is so frenetic that even traditional risk experts find it challenging to properly understand all of AI's (and the variety of models') characteristics.

Who is hallucinating?

As recently as 2023 (remember ChatGPT was only released on 30 November 2022), the Cambridge Dictionary selected "hallucinate" as its word of the year. In spite of the chaos around the world, this wasn't due to a sudden increase in the global population experiencing a compelling sense of a false reality. Instead, it reflected a new reality - the tendency of AI models to potentially generate inaccurate, nonsensical or fabricated information and present it as though it were factual.

Operational risks associated with AI can range from mildly embarrassing to potentially very costly, with recent examples including:

- In January 2025, Virgin Money issued an apology after a customer was reprimanded by an AI-powered chatbot for using the word "virgin."[1]
- Last year, a tribunal mandated that Air Canada honour a discount that its chatbot for customer support had invented.[2]
- A portion of the customer support bot used by courier organization DPD (a UK parcel delivery company) was disabled after it cursed at clients and referred to its owner as the "worst delivery service company in the world."[3]
- WestJet's chatbot mistakenly forwarded a customer a suicide prevention website link.[4]

Model hallucination therefore presents a material risk to companies deploying an AI chatbot solution, one for which a general disclaimer may not offer a sufficient legal shield against claims of financial loss resulting from inaccurate information or advice. The legal exposure is further compounded when businesses fail to verify AI-generated outputs or neglect to disclose the involvement of AI in customer interactions. In such cases, liability may arise, particularly if consumers suffer harm based on misleading product advice.

Given that the development of specific legislation tends to lag innovation, companies and individuals are left in the dark as to how to navigate potential grey areas during the establishment of best practice and legal precedent. This exacerbates the challenge when implementing AI use cases and increases the demand for indemnity insurance cover for AI.

[1] Harris, L., & Heikkilä, M. (2025, May 11). *Insurers launch cover for losses caused by AI chatbot errors*. Financial Times. https://www.ft.com/content/1d35759f-f2a9-46c4-904b-4a78ccc027df?utm_source=chatgpt.com

[2] Yagoda, M. (2024, February 23). *Airline held liable for its chatbot giving passenger bad advice – what this means for travellers*. BBC. https://www.bbc.com/travel/article/20240222-air-canada-chatbot-misinformation-what-travellers-should-know

[3] Gerken, T. (2024, 01 19). DPD (a UK parcel delivery company) error caused chatbot to swear at customer. Retrieved from BBC: https://www.bbc.com/news/technology-68025677

[4] Anderson, D. (2018, September 25). *WestJet's compassionate and confused chatbot sends happy customer to suicide prevention site*. CBC. https://www.cbc.ca/news/canada/calgary/westjet-ai-chatbot-confusion-suicide-hotline-1.4836389

So can you insure something you don't fully understand?

It seems at least some market players have taken a view on AI's inherent risk profile. A Lloyd's of London syndicate has recently introduced a novel insurance product designed to address liability arising from AI-generated errors. Developed by Armilla (a "Y Combinator" backed startup) the insurance policy provides coverage for legal costs and damages associated with defective AI performance, including model hallucinations and declining model accuracy. This progressive form of insurance represents a proactive measure for businesses seeking to mitigate the legal and reputational fallout associated with increased operational reliance on AI.[1]

Unless this is a hallucination of our own, we predict that it's only a matter of time before insurance products providing indemnity for AI associated risks will become mainstream in South Africa. In an environment where errors are an inherent aspect of AI systems, insurance may serve as a critical tool for managing-rather than evading-the associated risks of AI. Who will be courageous enough to launch such a product first in our context?

When it comes to the target market, the need for AI-related insurance is clear. There's a growing need for AI-related insurance in the context of the way operational risks manifests with such models. Legal and reputational risks abound. It is likely that many current disclaimers attached to AI use cases may prove unenforceable in court or fail to deter costly litigation if a claim is lodged against a company that has relied on an AI use case that's gone wrong.

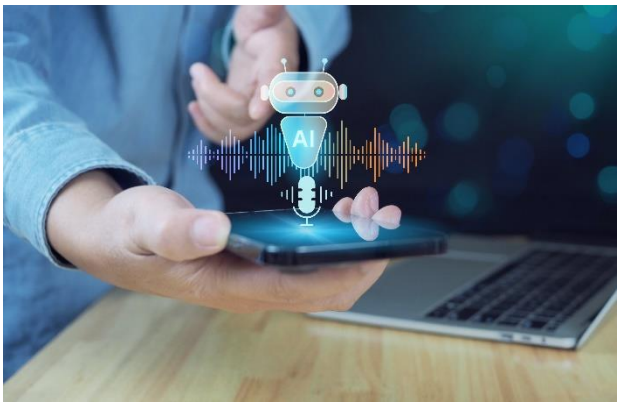
Insurance (in theory) presents a pragmatic mechanism for mitigating any form of model risk that results in loss of value. If adequately priced, it offers coverage for potential claims arising from AI deployment and consequential loss. One would of course expect typical terms and conditions in such policies, for example, a requirement for regular independent audits on AI models and other general responsible use criteria.

How would this differ from general indemnity insurance coverages?

AI language models, by their dynamic and often self-evolving nature, introduce new types of risks that may fall outside the scope of conventional technology Errors and Omissions (E&O) coverages or indemnity covers. This presents a current coverage gap that insurers are only now beginning to confront. As noted by Armilla CEO Karthik Ramakrishnan, the introduction of their tailored insurance solution could accelerate AI adoption by addressing the operational concerns that have thus far deterred many businesses.

Online transactions in South Africa are, for example, primarily governed by the Electronic Communications and Transactions Act (ECA), rather than the Consumer Protection Act (CPA). Under the ECA, online vendors are obligated to ensure that consumers have clear access to all relevant terms and conditions. These provisions often define the point at which a transaction becomes binding – typically only upon the supplier's acceptance of the order.[5]

Online vendors are not currently legally required to honour incorrect prices displayed on their websites, as such pricing is typically regarded as an invitation to transact rather than a binding offer. This implies that if an AI-powered chatbot communicates an incorrect price, clear disclaimers and transparency measures may serve to limit or exclude liability. However, it may also be contended that the chatbot functions as an extension of the company, thereby exposing the business to potential accountability - particularly in light of precedents such as the Air Canada case.



[5] Christophers, N. (2025). *Incorrect pricing by online suppliers – How important are those pesky T's & C's?* Tomlinson Mnguni James. https://tmj.co.za/News/Read/100159

While South Africa currently lacks comprehensive AI-specific regulation, factors such as the degree of control a company exercises over its AI systems, efforts to ensure accuracy, transparency, and data protection, as well as the extent of any harm suffered by the consumer, are likely to influence determinations of liability in a court of law.

Hypothetically, if a consumer relies on inaccurate product advice provided by an AI chatbot and incurs financial loss, the company may face liability for failing to verify the chatbot's response or disclose that the interaction involved AI. In addition, if any professional relies on AI to apply judgement which results in financial loss to their client, would their existing professional indemnity product provide sufficient cover?

To mitigate such risks, businesses should implement clear internal policies, maintain appropriate human oversight, ensure regulatory compliance, disclose the use of AI, and educate both employees and customers on the limitations of AI-generated outputs. It is worth noting that the legal status of AI language models in customer service remains unsettled, with considerable uncertainty as the regulatory landscape continues to evolve.[6]

Prompting all SA insurers

As AI tools progressively evolve from generative to agentic systems, the risks associated with autonomous decision-making will grow in both scale and complexity, especially when integrated into customer facing (commercial) service offerings.

A question remains to what extent existing policies or traditional disclaimers may offer protection against this risk –prompting a growing need for insurance frameworks tailored to AI-driven interactions.

Will South African insurers rush to capitalize on this opportunity?

[6] Dippenaar, S. (2024, February 1). *Understanding business liability when using AI-generated content*. DEREBUS. https://www.derebus.org.za/understanding-business-liability-when-using-ai-generated-content/

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