Facing AI Hallucinations: Insurance Prescribes a Remedy

Source: China Banking and Insurance News
Date: November 4, 2025
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Since the beginning of this year, as AI has been widely adopted across global industries, its efficiency gains and innovation opportunities have attracted much attention. However, the accompanying risk issues have also increasingly drawn the focus of the global insurance industry. The inherent risk of hallucinations in AI has been recognized as a new challenge that insurers must confront, and corresponding insurance remedies have emerged.

According to China Banking and Insurance News, both domestic and international insurers have started exploring ways to cover AI-related risks. For example, in May this year, PICC Property and Casualty launched China's first batch of generative AI (GenAI) content infringement liability insurance. On the academic-industry collaboration front, the University of Edinburgh in the UK partnered with AXA Group, Warwick Manufacturing Group (WMG), and Oxford University to initiate a £2 million research project aimed at laying the foundation for future AI risk insurance systems.

Beware of the Silent Risk of AI Hallucinations

"AI and generative AI bring many opportunities, but they also introduce new risks and amplify existing ones," said Michael von Gablenz, Head of Global AI Insurance Solutions at Munich Re, in an interview. AI risks are becoming increasingly diverse; for instance, MIT has built a database containing over 700 types of AI risks.

Not all risks are entirely new. AI's impact on existing risks may affect traditional insurance products such as professional liability and cyber insurance. Gablenz noted that the changing risk landscape driven by AI has prompted discussions about the silent AI issue: Are AI-related risks already implicitly covered under traditional policies? How should insurers manage these risks? Should coverage continue, or should underwriting strategies and pricing mechanisms be adjusted—or even exclude certain risks?

Meanwhile, AI and GenAI have indeed introduced entirely new risks. Even when AI systems operate normally, there remains a probability of errors or hallucinations.

"We believe that AI output errors and GenAI hallucinations are among the most fundamental risks for enterprises adopting AI," Gablenz said. All industries and companies using AI or GenAI should carefully assess these new risks, especially in processes where errors could lead to financial loss or legal liability. "Businesses rely on model outputs for automation, efficiency, or decision-making. However, since AI and GenAI models are inherently probabilistic, even the most advanced systems can produce errors or hallucinations. This risk cannot be fully eliminated—it is a new uncertainty introduced by AI."

To address this, Munich Re launched **aiSure™**, an AI insurance solution designed to cover losses caused by AI errors or GenAI hallucinations, including third-party liability and business interruption. Coverage details depend on the application scenario. Current insured AI use cases span multiple industries, including financial services, agriculture, manufacturing (quality control and predictive analytics), and document processing.

How to Price AI Risk

Pricing this new and rapidly evolving risk is a major challenge for insurers. How to quantify the economic loss from AI incidents and determine key factors for pricing are critical questions.

Gablenz explained that the biggest challenge lies in quantifying the frequency of model errors. Since AI and GenAI are trained and tested on data, this characteristic can help estimate the probability of errors or hallucinations. Achieving this requires new actuarial methods and statistically rigorous testing of AI models.

He also highlighted the issue of **data drift risk:** AI models operate by identifying patterns in data, making them vulnerable when application environments change. Such changes can significantly degrade model performance, increasing error and hallucination rates. Mitigation requires effective monitoring and retraining. As for the severity of losses, this is not unique to AI—whether caused by AI systems or humans, the consequences are often similar. Insurers can leverage historical experience to quantify such losses.

Gablenz advised enterprises to establish robust AI governance frameworks and use appropriate insurance solutions to cover identified AI risks. While Munich Re does not provide pre- or post-incident services, its AI risk-based pricing serves as a signal of the risk level associated with an AI application. Rates reflect the cost of risk, helping businesses assess whether expected benefits justify the risk cost and whether investing in more data or complex models to reduce error rates is worthwhile. Thus, AI insurance is not only a risk transfer tool but also a soft regulatory mechanism promoting trustworthy AI adoption.

Finally, Gablenz warned of **accumulation risk:** AI and GenAI models may create new systemic risks. For example, if multiple companies use AI systems built on the same foundational model in similar scenarios, errors or hallucinations could occur simultaneously, creating risk clusters. The insurance industry must remain vigilant and manage these new accumulation risks effectively. "I personally believe the future of AI insurance will resemble that of cyber insurance. AI and GenAI introduce novel risks that cannot be fully mitigated by technology, but their consequences can be addressed through suitable insurance solutions," Gablenz concluded.

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