

# SIX KEY TRENDS



Insurance | Risk Management | Consulting

## IMPACTING INSURANCE AND RISK MANAGEMENT IN THE RAIL INDUSTRY. A FORWARD VIEW INTO 2023.



### Headlines

- **Unprecedented investment:** \$1.2 trillion of public funding unlocked following enactment of the bipartisan Infrastructure Investment and Jobs Act (IIJA)<sup>1</sup> in late 2021. Focus on infrastructure improvements, rolling stock purchase and positioning rail transport as a viable (and greener) alternative to air and motor travel.
- **Nuclear verdicts and rising litigation:** 300% increase in claims lodged since 2016 with 2022 settlements in excess of US\$200 million. Deepening concern across the transportation sector and increased challenges for underwriters when assessing liability limits.
- **High-speed rail and infrastructure investment:** with the scope and scale of opportunities evolving year-on-year, connecting regional business hubs and unlocking cross-state growth opportunities. In 2022, 735 km of the high-speed rail network was fully operational (11th position globally<sup>2</sup>, with China, Spain and Japan ranking as the top three). Multi-billion dollar financial package to support and upgrades to track and rolling stock with US\$80 billion earmarked for rail.
- **Technology gap:** rapid digitalization is needed to bring the US railroad network up to speed with the broader transportation sector. Existing railroad technology infrastructure is outmoded and archaic, creating system risk exposures and multiple points of vulnerability.
- **Insurance underwriting challenges:** risk exposure, higher loss ratios and increased liability influenced by higher accident probability and incidents involving trains, rail workers and aging infrastructure. Challenges with assessing, and analysing risk adds further weight to the list of concerns within the industry. Carriers choosing to exit unprofitable markets and risks.

Following a growing demand for transportation options — freight and passenger — the US transportation sector is in a significant phase of investment and structural change. With 140,000 route miles connecting regional transport and commerce hubs the US railroad network is widely considered the largest, safest and most cost-efficient freight system in the world. As a transportation sector insurance and risk management specialist, Gallagher is a trusted partner to railroad operators and the supporting supply chain network, helping the industry move forward with increased confidence. In 2023, the scope of challenges, risk exposures and barriers to growth continue to evolve, with six key trends being of particular concern:

# 1

## UPGRADING AGING INFRASTRUCTURE — INVESTMENT AND STRUCTURAL CHANGE IS PIVOTAL TO POWERING ECONOMIC GROWTH

Contributing roughly US\$1.8 trillion (-8.4%) to US GDP<sup>3</sup> in 2021, transportation sector growth has been influenced by competitive pricing, infrastructure and technology investment and also by record fuel prices, a disrupted supply chain and upward inflationary pressures. While there is a mix of positives and negatives, structural investment remains a priority to deliver longer-term sustainability and meeting the expectations of both freight operators and passengers head-on.

The signing of the \$1.2 trillion bipartisan **Infrastructure Investment and Jobs Act (IIJA)** in late 2021 has presented the industry with unprecedented access to funding. Coupled with private-sector funding and direct investment by railroad operators, there is an opportunity for the industry to accelerate its growth plans and counter a period of stagnation and underinvestment.

Positioning railroad transportation — freight and passenger — as an attractive (and greener) proposition and viable competitor to air and motor travel will be a key area of focus in the foreseeable future. With air travel almost back to pre-pandemic levels, and increased motor and road transport volumes, competing for commercial and passenger dollars require targeted investment in rolling stock and infrastructure.

"Over the past decade US Class I railroads (>US\$250 million operating revenues) have spent more than \$250 billion on infrastructure and equipment, and have laid approximately six million tons of new rail."<sup>3</sup>

**Pushing through bureaucratic hurdles and regulatory red tape.** Despite significant injections of public and private funding, regulatory hurdles and process-related bottlenecks are hampering progress and may ultimately dampen appetite if access to capital cannot be realised within a reasonable timeframe.<sup>5</sup> Thankfully, there appears to be light at the end of the tunnel and railroad operatives are finding ways to navigate challenges.

**Aging infrastructure and rolling stock.** With railroad operators prioritizing track and asset upgrades, including rolling stock, addressing infrastructure shortfalls and vulnerabilities remain a medium to longer-term priority.



## 2

## RECLAIMING SUPPLY CHAIN SHARE

Intermodal connectivity and ease of transporting goods and people will be a critical driver of economic growth and re-engineering supply chains disrupted by geopolitical tensions and the after-effects of the global pandemic. Large railroads, being well-equipped to transport freight and consumer goods across a nationwide transport network, will help to open up new trading routes and commercial hubs. Working hand-in-hand with a sustained period of infrastructure improvement will help to boost the favorability. This will require tighter truck-rail integration operationally, technology upgrades to connect and the flexibility to adjust the supply chain links to accommodate rail transportation. Improvements to terminals, storage facilities, port access and loading ramps would offer additional benefits to support this move. This also needs to work hand-in-hand with marine and cargo operators, warehouse and storage providers.

**Onshoring:** reflecting a prolonged period of international trade and supply chain disruption, US manufacturers and distributors are restructuring their operations and bringing production hubs back within faster transportation distance to market. Steady economic growth in recent years has also fuelled increased utilization of transport and freight hubs, adding to the impetus to grow, invest and improve.

**Ongoing labor and material shortages:** continue to challenge freight operators and suppliers nationwide. By offering a cost-effective and profitable alternative to air- and truck-based transportation, railroads could be one of a mix of factors contributing to improved productivity across multiple sectors including construction, manufacturing, hospitality and retail.

**Green credentials:** with growing awareness and support of the ESG agenda and expectations of greener transport and supply chains, commercial buyers and household consumers challenging brands to deliver environmentally sustainable outcomes. There is more work to be done within the sector to deliver on this. From high-speed trains to switching to alternate power and renewable energy sources, to decarbonization and broader tech-based innovations efforts, there is both scope and commercial appetite to gradually evolve railroad infrastructure and operations to meet evolving expectations.

# 3

## NUCLEAR VERDICTS, RISE IN LITIGATION AND SPIRALLING SETTLEMENTS

**Nuclear verdicts** continue to plague the transportation sector marked by the exponential growth of settlement amounts (up ~300% since 2015, reaching \$200 million in 2020), upward trend in premiums, liability insurance is more difficult to underwrite and carriers choose to exit unprofitable markets.

The evolving **litigation landscape** has left both insurance underwriters and transport operators grappling with high loss ratios and reduced profitability. **Growing claims complexity** and the scale, scope and magnitude of critical incidents have delivered a series of jaw-dropping verdicts that are deepening structural challenges for insurance carriers and risk assessors making it difficult to underwrite potential legal risks, driving upward premium pressure and threatening to put effective levels of liability cover out of reach for many transportation businesses and their suppliers.

A rise in **unregulated third-party litigation funding**, enabling hedge funds to speculate on judgements and profit from settlement outcomes, has led to growing calls for federal intervention to address the situation. Lengthy litigation timescales also drive social inflation, lifting premiums and affecting the general affordability of insurance.

As public exposure to nuclear verdicts becomes more normalized, the risk of social inflation has emerged as people become desensitized to the broader issue and longer-term implications for railroad operators. With rising claim pay-outs and higher loss ratios the question is being asked of who is best placed to absorb risk. In contrast to economic inflation where insurers can use pricing models and loss ratios to offset market fluctuations, jury awards and non-economic damages are often unpredictable and difficult to assess. Along with unregulated funding, social inflation has the potential to become an ethical issue.

Another dimension to the challenge is **Hazmat cases and legal action undertaken by railroad and transportation workers** exposed to hazardous chemicals and substances (e.g., asbestos, welding fumes and diesel exhaust fumes). In some cases, the product of aging and under-maintained rolling stock, supports the agenda for structure change and deeper investment to address both aging infrastructure and outdated workplace practices.



# 4

## TECHNOLOGY ADVANCES, RAPID DIGITALIZATION AND LEVERAGING NEW INNOVATION

Technology is a pervasive force of change across the transportation industry and offers a range of benefits, longer term. From automation to diagnostic and analytical platforms through complex databases and fully leveraging IoT (Internet of Things) related innovation, investment and training is urgently required to re-tool the industry to embrace a rapid pace of change and shifting customer freight and passenger expectations.

**Regional Integrated Multi-Modal Information Sharing (RIMIS) systems** used by railroad operators are generally outdated and archaic, with sporadic access to databases, gaps in available data and maps, and conflicting systems amongst some of the prevailing issues. Given the purpose of these systems is to provide a live/real-time view for both maintenance and accident response, investment will improve access to critical incident data and assist first responders, transport planners and risk managers in the daily work.

**A new wave of technology-led innovation** is helping to transform the sector, with sonic listening<sup>4</sup> capability being an example of track safety improvement. The benefits are becoming steadily apparent. Between 2000 and 2021, reported railroad accidents have declined by 33%, between 2000 and 2020, the hazmat accident rate was down 60%. The rail employee injury rate in 2020 reached an all-time low. These safety achievements are a testament to the industry that they can achieve an accident-free future.





## 5

## CYBERSECURITY AND RISK CONCERNS

The US Transportation Security Administration (TSA) is working to create a more secure and risk-resilient transportation sector. In 2021, TSA announced cybersecurity directives that require critical rail and transit systems to identify a cybersecurity point person, report incidents to CISA, create an incident recovery plan and complete a vulnerability assessment to identify potential gaps in their operations.<sup>5</sup>

Targeting “higher risk” (passenger and freight), operators are now required to develop a vulnerability assessment, implement robust risk management measures and a process to report incidents. With coordinated attacks on transport operators on the rise, cyber risk defence initiatives to tackle the issue are underway to mitigate identified vulnerabilities across infrastructure, rolling stock and traffic control systems to generally counter a rapidly evolving cyber threat. Improved cyber awareness and incident response training, technology upgrades and data protection to support the above all points in the right direction.

Taking a joined-up approach to assessing and mitigating cyber risks could fast-track industry-wide improvement. This would involve collating insights from railway operatives to map hypothetical threat scenarios and develop a co-ordinated risk management approach with corresponding security measures to standardize the response.

### Key cyber risks include:

- Compromised signalling system and/or automatic train control system, leading to an accident or re-routing for crime purposes
- Traffic supervising systems sabotage, including impact to freight intermodal facilities
- Ransomware attacks, including the theft of client, passenger and operator data
- Sensitive data leaks caused by an unsecured, exposed database

That said, cyber activities are not always malware related. Crowdsourced data is used to provide traffic flow and infrastructure can be unreliable and a point of vulnerability for malicious intent involving the manipulation of the data to serve a criminal intent. Pilot testing exercises to test transportation ecosystems for points of vulnerability in a real-world setting is being more frequently used to better understand how and where a cyber event could impact transportation operators.

The promising news is that cyber risk management is becoming more connected, although dependent on advanced computing and communication systems, and software being implemented.<sup>6</sup>

# 6

## CATASTROPHIC EVENTS AND REMOTE RESPONSE CHALLENGES

Viewed as non-revenue generating, under-resourced claims, PSR (Policy Service Representative) and incident response teams are often crippled with case volume overload and having to adopt quick-fix solutions. This leaves operators exposed, and reliant on an inefficient response strategy when larger-scale incidents occur. A lengthy delay in resolving claims and critical skills gaps in assessing and understanding risk events have become more common in recent years. Addressing this situation remains a key priority.

**Industrial action, strikes and social activism** are further impacting progress to deliver urgent changes, as well as delivering decarbonization and greener transport initiatives. Organised strike action<sup>7</sup> and industrial disputes by railroad workers relating to contractual issues, overly demanding schedules and general workplace challenges have become more visible in recent years. Hopefully a combination of investment, structural change and co-creating the forward strategy with input from railroad workers and transport operatives will go some way towards alleviating the situation.

"While the industry continues to navigate market challenges and unlock emerging opportunities, partnering with a team of rail specialists can make all the difference. Having the expertise to help you create a risk management program that closes gaps and supports the continuous running of your business. Gallagher works closely with clients to help them enhance their growth and development, while protecting their assets and reputation. We conduct in-depth assessments to better understand their unique culture and the specific risks their business faces."



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