LloydSadd INSURANCE BROKERS

NAVACORD®

MARKETPLACE
INSIGHTS

The Gap Between **Hearing & Seeing**

NOVEMBER | 2021

Local Touch. National Strength.™

As we look forward to 2022 and think about how brokerages will change throughout the coming year, a phrase used previously continues to resonate, the flight to quality... The industry consolidation will continue but scale alone will not drive success.

Clients demand the highest level of technical expertise combined with efficient and smooth customer service, and this cannot be achieved without a significant investment in talent... If you're not ready to do that, you could very well be left behind—first by talent and then by clients.

Shawn DeSantis, President & CEO,
Navacord

Insurers reported strong results for the first half of 2021, but there's no letup in hard market conditions.

After more than two years into the hard market cycle there are finally some indicators that the end may be in sight. A majority of Canadian property and casualty (P&C) insurance companies posted excellent results for the first half of 2021 due to very strong growth in underwriting income combined with a reprieve in claims activity.

On the one hand, there is the good news customers and their brokers have been hearing from insurance companies in recent months about a return to profitability necessary for the market to soften. The overall combined ratio for Canada's predominantly commercial insurers was 79.3% for the first half of 2021, a stunning drop of more than 26 points from an unprofitable 106% for the same period one year prior. Direct written premium for these insurers rose to more than $7.5 billion, an increase of over 15% compared to the first half of 2020.

On the other hand, there is the reality of what customers and brokers are still seeing on the ground as they continue to work through challenging renewals and placements: very little letup in hard market conditions that have defined the last few years. This includes ongoing substantial rate increases, rising deductibles and continued restrictions of capacity.

Despite the overall improvement in industry profitability, certain lines of business remain deep in the red, troubled by persistent high frequency and growing severity of claims.

Information security and privacy (cyber) insurance continues to suffer alarmingly high losses, while claims resulting from a volatile business and investment climate impact professional lines, especially directors and officers (D&O) insurance.

Also unchanged despite insurers' improved financial performance is their workload. The volume of submissions remains extremely high as brokers work to overcome capacity restrictions by involving more insurers on placements and renewals. There is some debate among labour force observers about the extent of "The Great Resignation" in the financial services industry during the pandemic. However, many insurance executives continue to be challenged in addressing workload issues, reporting anecdotally that attrition due to retirement has increased in this period, resulting in a loss of institutional knowledge and expertise at the same time. Movement of staff between companies has also slowed, made worse by the difficulties of onboarding new staff in a remote work environment. For insurance customers, these factors underscore the ongoing need for increased planning time and preparation for renewals and the importance of managing expectations in challenging times.

COVERAGE TIP

Unlicensed Insurers

During times like the current hard market when many domestic insurers have withdrawn capacity in certain lines of business, brokers may look to complete insurance placements using unlicensed insurers. An unlicensed insurer is not necessarily insolvent. In these cases, an unlicensed insurer is one that is financially sound but does not have offices or a license to do business in Canada or pay corporate taxes here. Customers can access capacity from unlicensed insurers as long as they and their broker satisfy a number of regulatory requirements that demonstrate that the risk was uninsurable, or the capacity was unavailable, in the domestic market. Failure to satisfy these requirements can result in substantial tax penalties for insureds of up to 50% of the premium.

Another way unlicensed insurers can provide capacity is through a fronting arrangement with a licensed insurer in the target market. In this scenario, the domestic fronting company collects the premium and cedes most of it back to the unlicensed company in an arrangement that is very similar to a facultative reinsurance transaction. If a loss occurs, the fronting company pays it, relying on the reinsurance arrangement with the unlicensed insurer.

In the current environment where these arrangements are more common, customers obtaining capacity from unlicensed insurers, or that notice unfamiliar names of insurers on insurance slips, should ensure that any such capacity is properly vetted based on the underlying insurer, and not necessarily the fronting Canadian insurer. Failure to do so may leave an insured in a situation where a substantial loss cannot be paid.

Property

What To Expect

- **Rate increases from 5% to 15%***
- **Higher deductibles, especially for water damage**
- **Limited new capacity, but very expensive**

Insurance companies mostly returned to profitability this year by continuing to seek substantial rate increases upon renewal for property risks and maintaining restrictions on capacity, while also benefiting from a brief claims holiday. However, that holiday is now over.

Catastrophic Events

Insurers continue to worry about the threat of class action suits around COVID-related business interruption coverage, but it is an increase in catastrophic events that will likely impact bottom-line results for the year. The July tornadoes in the Barrie, Ontario, area caused over $100 million in insured damages (adjusted upwards from an initial estimate of $75 million); the September storms in Southern Ontario caused $105 million in damage; and of course, the most recent catastrophic floods in British Columbia have caused damages still yet to be calculated, but estimated to be as high as $1 billion. While all indications prior were that the property market was stabilizing, these incidents are the type that may cause a transitioning market to slow down—changing multiple underwriting companies' approaches to an entire region. We witnessed this happen before with the Fort McMurray wildfires and floods with many companies withdrawing completely from the region while those that remained restricted capacity and imposed higher rates and deductibles to offset potential exposure to the next event. With so much in flux, we are keeping a timely and watchful eye on the market as each area rebuilds and recovers.

High Hazard

Capacity for high-hazard property categories remains extremely limited and very expensive when it is available, as insurers mostly continue to limit exposure to risks where the losses can be severe. September explosions at a chemical plant in Toronto, which killed one worker, and at a lumber plant in Beauceville, Quebec, which killed three, are examples of how both property and liability claims for these risks can quickly climb into the millions of dollars.

*Expected renewal increase for clients who are not reporting new claims experience or undue risks.

Lloyd's Capacity

A notable development in the property market for this period is the turnaround of Lloyd's, which posted strong results while growing market share at the same time. A few Lloyd's syndicates that had previously withdrawn capacity are now redeploying some, but at rates that are 15-20% higher than what is available in the domestic market. This has made it a little easier for brokers to complete property placements compared to a year ago, but is still costing much more than we think it should. New capacity for residential and commercial real estate during this period has been highly opportunistic, with companies taking advantage of the current rate structure through elevated pricing, rather than entering the market at competitive price points to help drive rates back down.

Outlook

Navacord's current experience is indicating rate increases between 5% and 15% for most property clients depending on the class of risk—barring new claims or concerning risk profiles being reported—as well as increases in deductibles which can help mitigate some rate increases. Even as hard market conditions eventually subside, the current underwriting rigour around property risks is likely here to stay.

The new normal means customers will need to continue allocating the time and resources necessary to complete highly detailed property schedules, especially for older buildings and properties with any risk elements that lie outside of standard occupancies (e.g. strip malls that include restaurants or warehouses storing goods that may be flammable or hazardous). Underwriters facing unprecedented workloads are downloading some information gathering tasks back to customers and brokers. Incomplete submissions will receive less preferential treatment in the current environment.

> *Lloyd's maintained its position as the top commercial insurer and continues to hold its position as the largest direct writer of commercial risks in Canada with approx. 12% of the overall market (excluding personal lines).*

Marc Lipman, President,
Lloyd's Canada

Liability & Auto

What To Expect

- **Rate increases beginning to moderate**
- **Some capacity returning for primary layers, but expensive**
- **Umbrella and excess remains challenged, especially for U.S. exposures**

General liability lines are another area of the insurance market where customers may note a gap between what they're seeing and hearing. As with property, insurers mostly reported improved profitability in commercial general liability (CGL) and commercial auto, thanks to the combination of hard market rate increases and a drop off in claims activity. And yet customers will continue to see the same market conditions likely well into 2022. Fortunately, the rate increases insurers are seeking on liability lines should not be as severe as previous years. Liability rate increases ranged from 10% to 20% last year and we expect to see a slight drop to between 5% and 15% this year. The suppression of driving activity during the pandemic is also beginning to wane as the economy slowly recovers and more people begin commuting to work again, leading to a renewed uptick in claims that will keep pressure on auto rates.

In recent months some carriers have shown renewed interest in writing primary liability layers for businesses that they backed away from at the beginning of the hard market cycle. However, the market for umbrella and excess liability layers remains significantly challenged. Capacity remains accessible but exponential rate increases continue to be the norm; from three to five-fold upon expiring premium, last year and again this year. For some sectors, it remains extremely difficult to find any capacity at all for umbrella and excess. Insurers are particularly weary of passenger hazard and transportation because of large jury awards in the United States, such as a $1 billion "nuclear" verdict in Florida against a Quebec transportation company for a traffic fatality.

Directors & Officers (D&O)

What To Expect

- **Rate increases moderating but hard market conditions remain**
- **Taking your company public? Limits may be an issue**
- **Boardroom fights and oversights making governance a focus area**

Speculation at the end of 2020 that hard market conditions for D&O insurance would begin to subside by late 2021 has not been borne out. However, the news is not all bad. Price increases upon renewal have begun to moderate somewhat—from the 50% range last year down to 20% this year—and some capacity is beginning to return to the market, although it remains expensive and insurers will usually attach it at higher levels of liability in a program. Brokers are also not seeing widespread COVID-related exclusions in the D&O market.

An area of focus for D&O insurers that has come into sharp relief during the pandemic is around transactions for taking a private company public. These include initial public offerings (IPOs), reverse takeovers (RTOs) and, most notably, mergers with special purpose acquisition companies (SPACs). In the U.S., the use of SPACs to take a company public has risen steadily over the last 10 years and exploded since 2020 (from 59 IPOs in 2019 to 248 in 2020 and 521 in 2021, according to SPACInsider). The average size of SPAC deals has also grown. Concomitant with this trend is a rise in securities class action claims around SPAC deals. Consequently, D&O insurers weary of the risks are seeking elevated pricing and high retentions. The SPAC trend is relevant to the Canadian market because many SPACs are looking at Canadian companies as acquisition targets, and these companies may have difficulty obtaining the insurance limits they are seeking prior to going public.

D&O insurers are also putting renewed focus on strong corporate governance. Recent headlines involving some of the most recognizable names in the Canadian corporate landscape—CN Rail's abandoned takeover of Kansas City Southern due to regulatory issues and boardroom squabbles between members of the Rogers family in the midst of an attempted merger with Shaw—demonstrate that even the biggest companies are not immune to poor decision making due to lack of robust oversight mechanisms. In the current volatile investment climate, D&O insurers will look closely at these mechanisms to be satisfied that these risks are minimized.

COVERAGE TIP:

Employment Practice Liability
With vaccines for COVID-19 now widely available and case counts dropping throughout most of the country, many employers are now implementing vaccination mandates for their employees while winding down work-from-home arrangements. Consequences of this shift may include disciplinary action, forced layoffs and even termination of employees that refuse to comply with mandates. Enforcement of these policies is inevitably leading to actions against employers for discrimination or wrongful termination, embroiling employers in potentially costly litigation.

As part of a comprehensive risk management strategy, business owners may want to consider employment practices liability (EPL) coverage as part of their overall insurance program. Premium and retention will reflect the level of risk and uncertainty brought on by COVID in your workplace.

Contact your Lloyd Sadd representative to discuss your EPL risks and how this coverage can respond to them.

Cyber Liability

What To Expect

- **Ongoing hard market conditions driven by heavy losses**
- **Higher minimum standards of cyber "hygiene" to qualify for coverage**

The cyber insurance market continues to evolve, driven by ever expanding uptake of the coverage among Canadian businesses and a loss ratio that is matching the pace of that uptake. In the years since the coverage first came on the market, the business of hacking and cyber attacks has grown to become a deeply entrenched endemic business risk. Cyber losses have slowed somewhat from their alarming frequency in the first months of the pandemic, but loss ratios remain high at over 96% for the industry at the half year mark.

Cyber insurance remains widely available but the cost continues to rise sharply. This is partly in response to escalating losses and also because insurers have much more data available to them now than they did 10 years ago to price the risk appropriately. They are also increasingly aware of systemic risks that have the potential to impact thousands of customers at once, such as vulnerabilities in Microsoft Office 365 and the Kaseya ransomware event. Existing cyber customers may see increases of anywhere from 25% to doubling or tripling of expiring premium, as well as possible limit decreases and increases to deductibles (which can help mitigate exorbitant rate increases). Insurers are also adding more co-insurance penalties and restrictions to the amount of cover they will provide in ransomware attacks.

More importantly, cyber insurers are raising the minimum standards for what organizations are insurable based on the state of their information technology (IT) infrastructure and security.

Even companies that once qualified for coverage may no longer unless they have certain basic IT security protocols in place, such as:

- Multi-factor authentication (MFA) as part of VPN and remote desktop protocols
- Endpoint detection and response (EDR)
- Offline backups of data that are regularly tested
- Advanced email filtering
- Formal security and event management plans.

However, even being turned down for cyber insurance can be useful step in the process of improving IT security, in that many insurers will now provide a report on an organization's network vulnerabilities as part of the explanation for why coverage was denied. And while the cost of this insurance is currently rising, it is still fairly inexpensive relative to other forms of insurance.

Moreover, the cost of not having cyber coverage in place can be devastating. A single network intrusion can have severe consequences, such as permanent loss of market share and customer trust. For smaller businesses, this can pose an existential threat that may mean closing the business entirely. The accelerated pace of the "shift to digital" during the pandemic—and the rise in cyber attacks that came with it—has only underscored the need to continue making investments in IT security.

Here's What You Need To Succeed

Time And Resources

Workloads for underwriters remain heavy and recruiting more staff during the pandemic has been a challenge. Complete submissions with detailed information will naturally receive preferential treatment as a result. Work with your broker to plan your lead times and resource requirements accordingly.

Proactive Risk Management

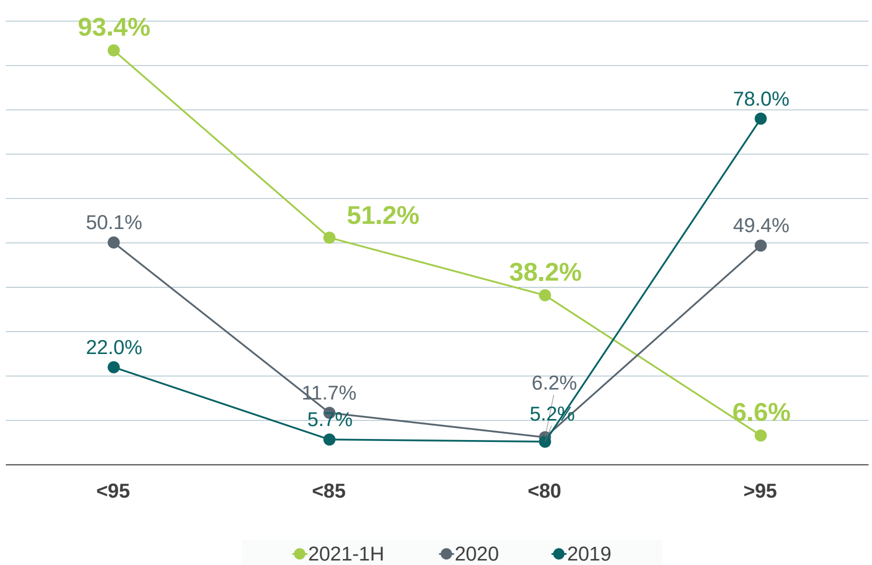
Elevated claims activity has been a major driver of the hard market. Despite market conditions, insurers remain eager to work with customers that demonstrate an ongoing commitment to managing sources of risk before they turn into claims. Talk to your Lloyd Sadd representative about how our risk control services can place your business in a favourable light with insurers.

IT Security Investment

Now is the time to take IT security seriously and ensure your organization meets basic minimum standards of good cyber "hygiene." Beyond the technical requirements, this includes training of staff and regular testing to ensure that training is effective, as well as a comprehensive incident management plan. Most cyber insurance policies come with pre-claims services to help you put these things in place.

Vital Signs

Hard market conditions have helped Canadian insurers to a remarkable turnaround in profitability over the last two years. For the first half of 2021, more than 93% of insurers (when measured on market share) achieved a combined operating ratio (COR) below 95, compared to just 22% of insurers in 2019. Over half of carriers had a COR below 85.



Source: MSA Research www.msaresearch.com

Company Results

Year-end 2020 Combined Operating Ratios (COR) for several key commercial insurers. A number greater than 100 indicates a loss.

AIG	**98.8**	*Arch*	**94.1**	*Chubb**	**85.5***	*CNA*	**100.0**
Allianz	**99.3**	*Berkley*	**94.4**	*FM*	**92.5**	*Northbridge~*	**89.6**
Liberty	**101.3**	*Intact/RSA***	**91.3**	*Travelers~*	**96.8**	*Zurich*	**93.9**
*Aviva***	**93.0**						

* These companies write substantial personal lines business as well

~ Includes results of personal lines portfolio

** Includes results of significant personal lines portfolio

If you have questions specific to your business, or would like additional information, please reach out to your Lloyd Sadd Advisor.

After several months of integration and transition planning, on June 1 we welcomed RSA's employees to Intact and increased our premium base by 70%. This added scale enhances our ability to invest in our core capabilities of data, risk selection and claims.

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