NAVACORD®

MARKETPLACE
INSIGHTS

Cautious **Optimism**

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Local Touch. National Strength.™

There's competition for the good clients, well-managed with good risk management practices and solid financials.

Patty McNeil, COO
Jones DesLauriers

Cautious Optimism

As the world appears more predictable in 2023, the P&C insurance industry looks to stabilize. Despite a convergence of economic factors indicating a hard market should persist, that is not what we are finding in practice, with some caveats.

Increased capacity and robust insurer appetite for risk have boosted competition in 2023, and that looks to continue into the second half of the year. Even as some insurers initially seek rate increases between 7-15%, they've been forced to settle on marginal increases of 5%, and often even flatten or discount rates to remain competitive in most categories. The insurance company's fear of losing clients to competitors is back.

Commercial clients, and specialty brokers on their behalf, are in position to consider shopping around.

That said, a myriad of factors still have potential to disrupt a softening market: economic and political instability, continued supply chain disruption that lengthens claim times, labour shortages across most sectors, inflation, and the threat of a recession later in the year all loom in the background. Regulatory changes and record global catastrophic losses also contributed to a record-high bump in reinsurance rates, which are likely to have a trickle-down effect.

But other factors are offering counterbalance.

For one, Lloyd's syndicates and other opportunistic international insurers have re-emerged to expand their offerings in Canada once again. This is contributing to innovation in the market and putting pressure on legacy insurers to up their game. Domestic underwriters are diversifying their offerings and demonstrating a willingness to take on risk in specialty areas where they may not have played before.

Furthermore, underwriters are coming off a year of healthy profits, even as interest rates dampen their investment returns. Despite a loss of 52% in investment income, in 2022, insurers saw top line growth of 12%, comparable to the previous year. Net claims, meanwhile, grew by a modest 2%, resulting in a nearly 25% increase in underwriting income across the industry, and a profitable COR of 84.3%, which is a vast improvement from the 100% COR posted a few years back.

Insurers are finding some success in the strategy of taking calculated risk in a volatile economy, and yet maintaining profitability.

Although some analysts suggest the hard market will continue, it's a far cry from 2020 when doors slammed shut and insurers turtled. Getting a single quote for a client in the early days of the pandemic was difficult. Today, with the right broker expertise, it's possible to put multiple options in front of clients once again.

Commercial clients can't rely on brokers casting the net wide looking for bottom-of-the-barrel pricing, as we may have done in soft markets before 2020. Rather, clients need to work with experienced brokers who understand how to target specialized insurers. A good broker will find their "insurer match," and target niche underwriters to find profitable risk that meet clients' specific needs. With that expertise, there are solutions to be found, with some category exceptions.

For the insured, elements of the hard market will persist, but not necessarily in the form of more rate hikes. Demand for due diligence is not going away and underwriters continue to seek detailed evidence of risk mitigation practices, and healthy financials. To take advantage of a competitive market, our clients need to keep their books up to date, and be able to demonstrate they have capacity to absorb the shock of external economic disruption. Working with your broker and risk manager as a partner will also strengthen negotiating power to obtain competitive rates and terms that meet your needs.

The opening of appetite by domestic insurers to sectors historically dominated by MGAs is significant. MGAs don't have the actuaries or deep pockets. They rely on their underwriting discipline. They have shown the industry how to segment the good from the bad and how to insure what are essentially low-risk businesses.

Jennifer Adams, Vice President, Commercial Insurance
Waypoint Insurance

Property Insurance Forecast

WHAT TO EXPECT

- **Stable rates due to increased capacity and risk appetite in most lines of insurance**
- **Increase of replacement values and repair costs may offset any value to customers**
- **Inflation and record-high reinsurance renewals may harden pricing or access to capacity in some classes**

Property insurers continue to seek rate increases into the low double digits, insisting the hard market is still with us. Generally, however, we're finding capacity is up and pricing is stable, except with hard-to-place lines. Higher levels of competition relative to 2022 is cooling ambitions on rate hikes. Lloyds' re-entry into the Canadian market, active MGAs, and the emergence of new domestic insurers has boosted capacity even in some highly specialized areas, forcing established insurers to hold the line on rates. This is good news for our clients.

Despite relatively stable rates, however, there are factors which could drive up premium for clients, such as:

INFLATION AND REPLACEMENT VALUES

Inflation of goods and services continues to elevate repair costs and replacement values (RVs), putting clients at risk of having undervalued property in their schedules. This is especially true for construction equipment but applies to buildings, inventory, and other tangible assets too. Although supply chains are starting to flow again, pent up demand, along with global political risks like the War in Ukraine, persistently contribute to inflated pricing on inputs. Moreover, labour and skill shortages in almost all industries continues to trigger costly claim delays in both personal and commercial lines.

INFLATION, RECORD CATASTROPHIC LOSS, AND REINSURANCE

Inflation is playing out in the reinsurance market as well, following a year of record catastrophic losses with Hurricane Ian and others. January's reinsurance renewals saw rates climb in some cases by a hefty 25% to 75% in Canada, an anticipated market correction, but one not seen for decades. Deductibles on reinsurance are higher than ever, while limits per client are less than what was previously available.

Property underwriters may respond in various ways. Most simply, hardening conditions among reinsurers may seep into the general market, as insurers pass rate hikes and restrictive terms onto their own clients. This could have an impact on access, with some property insurers shifting risk away from any exposure to catastrophic losses, limiting options for clients in certain geographic areas. We also expect to see more subscriptions, where risk is spread out amongst insurers. For example, a client that requires a $700-million policy on a condo construction project can't expect a single carrier, but may require up to ten insurers, each with a $70 million limit.

We're keeping an eye on the September reinsurance renewals for Canada's small mutuals as well. To increase profitability, insurers require a boost in investment profits, or they need to grow underwriting profits. The impact of high reinsurance rates may be difficult for smaller mutuals to absorb, causing them to get out of certain lines altogether, and limiting options for our clients.

Insurers want to see clients' due diligence in business planning, risk management and financial reporting, with proof you're positioned to withstand external disruptions. By working with your expert broker to give lead time on negotiations with the right specialized insurers, we can secure the best pricing and terms tailored to your business.

Risk Mitigation Tools

TAKE A SECOND LOOK AT REPLACEMENT VALUES

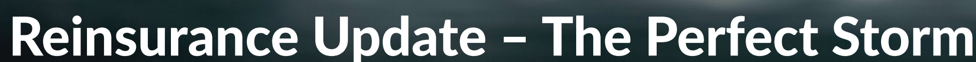
Examine the replacement cost (RC) and actual cash value (ACV) of all property and equipment relative to RC and ACV conditions on your schedules, to ensure they're not undervalued in your policy.

KNOW WHAT IS COVERED WHEN IT COMES TO CATASTROPHIC LOSS

Anticipate the need to self-insure to some level against natural disasters, such as flood, earthquake and wildfires, as property insurers figure out how to mitigate against reinsurance hikes and price the unknown.

TREAT YOUR BROKER AS A BUSINESS PARTNER

We've got specialists in house who know your industry, including engineers, analysts and risk managers. Engage, consult, and strategize.



Reinsurance Update – The Perfect Storm

THE REINSURANCE TRIFECTA: NATURAL DISASTERS, INFLATION AND NEW ACCOUNTING RULES FOR INSURERS COULD CONVERGE TO TIGHTEN THE MARKET.

Unless you're in a flood, fire or quake zone, it may be hard to see how natural catastrophes impact your property insurance pricing. Canadian insurers are part of a finite global reinsurance market. Insurers, in other words, underwrite their own risk. Although Canada represented only 2% of the US $123 billion in global catastrophic loss payouts in 2022, we all pay to insure the many.

NATURAL DISASTERS ARE BIGGER AND MORE FREQUENT

Inflation, combined with the frequency and size of catastrophic events, is triggering a shift in reinsurance capacity. Flooding, hurricanes, hail, wildfires and ice storms that used to happen once in every 100-to-500 years are now occurring habitually. Hurricane Ian, to name one example, was the third costliest natural catastrophe on record. Not only was it the deadliest storm to hit Florida since 1935, but the price to clean up and rebuild has been heavily affected by the recent spike in inflation.

INFLATION TRIGGERS COSTLY CLEAN-UP

Loss from natural disasters represented approximately US $275 billion in 2022, with insurers covering 45% of the loss. From 2018-2022, global wildfire losses alone, equalled US $69 billion, including $39 billion paid out by insurers. In the reinsurance world, deductibles are higher than ever, while limits may be less than what was previously available. Reinsurers are looking at how to limit their exposure as they figure out pricing.

THE IMPACT OF IFRS 17 ON INSURER CAPITAL

In January, just as insurers prepared for rate renewals with reinsurers (at a mind-boggling 25-75%, in some cases), the domestic inflation rate was around 7%. At the same time, new regulations from the Office of the Superintendent of Financial Institutions (OSFI) came into play in Canada, requiring underwriters to have actuaries review the money they have in reserves. This is part and parcel to new, more stringent accounting standards with actuaries reviewing all lines and forcing insurers to demonstrate they have the capital to cover even unprofitable lines of business.

As a result, insurers were forced to pull $7 billion out of reserves, declare it as income, and pay tax, accordingly. Although they've been preparing for the institution of IFRS 17 for years, this represents a huge hit to capital.

THE EFFECT ON INSUREDS

There are several ways this may affect insureds. For one, if your carrier is paying more to insure their own risk, you may find them risk averse, putting limits on large projects or withdrawing from certain geographic areas. At the same time, as insurers undergo more scrutiny with their own risk management and accounting, meeting new standards of cautious actuaries, they're sure to be more scrupulous about terms and the accounting integrity of their own business clients. Finally, as carriers try to absorb capital losses, there is the possibility of rate hikes for clients. Small mutual companies are especially vulnerable, due to their limited access to capital.

On the upside, we're keeping an eye on shifting capacity in the reinsurance market as well. In 2022, flooding and now wildfire events in the Atlantic may trigger reinsurers to move capacity west with a greater appetite for earthquake risk.

The frequency and size of catastrophic losses are not just a Canadian problem, but a global problem, and we all pay.

David Stearn, Director of Operations
Henderson Insurance

Liability Insurance Forecast

WHAT TO EXPECT

- **MGA competition pushes innovation among legacy insurers into previously untouched territory**
- **Competition also has larger carriers open to negotiation of terms**

MGAs are Managing General Agents, who pool capacity together to offer to retail brokerages. We cannot underestimate the role of MGAs in boosting capacity in previously hard-to-place industries. Traditionally, MGAs were the go-to markets for risks perceived as out of the box. They picked up a lot of otherwise uncoveted risks such as restaurants, hairdressers, nail salons, and cosmetics. MGAs have done a great job at showing the industry these are essentially low-risk business sectors and they've demonstrated how to insure these risks. As a result, we're seeing more options and competitive pricing across the board in these markets.

Likewise, renewed market competition is causing incumbent insurers to moderate their rating demands, fearful of losing long-standing business to a new insurer with a more aggressive approach, and perhaps without the burden of past losses. This is good news for clients with good loss ratios, who can therefore expect stable pricing into late 2023.

OPEN TO NEGOTIATION

For large-sized carriers in the construction sector, expect to see some loosening of terms on wrap-up liability. We don't anticipate rates will decrease much, but increases are expected to be marginal this year. Insurers are taking a more conservative approach, but they're still looking to generate some top line growth.

Larger carriers are open to negotiation on terms favourable to the insured. Working with your broker gives you options to navigate these negotiations. Keep in mind, it's a different story for small and medium carriers. The transactional nature of their relationship with clients leaves them less willing to compromise on terms.

Rates are somewhat elevated in builders' risk. Despite some new capacity, there are fewer options here compared with general property insurance. Residential capacity for all construction types is still more limited than before 2020, with focus on water damage mitigation plans and loss control by the contractor/developer. Wood frame capacity continues to be scarce, but there's ongoing work in the industry to reassess the risks involved.

"Hungry" For Business in British Columbia

Changes in B.C. auto liability legislation create new appetite in hospitality industry.

Recent legislative changes in British Columbia to no-fault auto has contributed to a reduction in litigation that habitually came with auto claims liability in the province. Liability is now several, rather than joint and several. We're finding insurers more open to underwriting certain classes of business they may not have touched previously.

Historically, claims against restaurants have been higher than other classes of business because of host liquor liability in B.C. For restaurateurs who'd been in business fewer than three years, the transient nature of staff and other factors meant traditional insurers would not touch them. If they did, many stayed away from clients with liquor exposures representing anything over 25% of revenue.

With the new legislation, more carriers are getting in the game, evaluating the risk as healthy, and willing to go up to 60% liquor exposure, which is unprecedented.

Auto Insurance Forecast

WHAT TO EXPECT

- **Claim frequency on personal auto to normalize to pre-pandemic levels**
- **Inflation and supply chain factors continue to extend repair times and claims' settlement**

Expect to see personal auto rates rise incrementally. Statistics Canada reported there were 2.8 million fewer daily commuters in May 2021 than there had been in 2016. By 2022, however, driving rates were on par with six years earlier, while use of public transit remained at record lows. As more people return to the office and hybrid work environments, it is anticipated there will be an increase of drivers on the road as well. With that, frequency of auto claims is expected to return to pre-pandemic levels in 2023.

On the commercial side, Individually Rated Commercial Auto (IRCA), which is closely related to personal lines rating systems, will also likely see marginal rate increases. Parts and other replacement prices have steadily increased, impacting repair and replacement costs of damaged or stolen vehicles. There are indicators that supply chains in production are improving, and used car prices are finally on a downward trend, which could see claim time and costs level off. But it is unlikely the customer will see any reduction in insurance pricing for the coming year, given the trend to more vehicle utilization and the inflationary considerations referenced above.

For larger fleet automobile policies, pricing remains relatively stable, despite unchanged capacity. That said, premiums are increasing as rateable exposure increases. As with contractor equipment and general property, verify RVs and ACVs on fleet are updated at renewal time to account for higher costs.

A Surety Thing

Despite turbulence in a construction sector marked by supply chain woes and rising input costs and labour shortages, Canadian surety underwriters posted direct written premiums of just over $900 million in 2022, with a respectable loss ratio of 26% (surety is a large severity class and prequalification service so its loss ratios are necessarily lower than insurance lines).

Bonding companies, however, are starting to see some erosion on the balance sheets of their clients who are being forced to manage these supply-chain issues, while also managing increased claims-related noise. There is anticipation in some circles that contractor defaults will tick upwards in the coming months, a trend many thought would occur at the height of the COVID pandemic, but has been deferred as a result of the federal stabilization and subsidy programs.

While some sureties are tightening their underwriting because of these signals, new players are keeping competition healthy in the surety market. This influx of capacity is ensuring that – despite warning signs on the horizon – terms remain competitive, especially for best-in-class contractors.

Navacord's surety advisors continue to advocate for their clients to mitigate default risks and ensure their clients receive highly supportive surety terms.

RISK MITIGATION TIPS:

Grow your balance sheet
Retain profits within your business so you can afford to absorb unforeseen shocks from across your projects.

Carefully vet your project partners, including owners, general contractors and subcontractors
Know who you're working with, and use available tools (proof of financing letters, bondability letters, etc.), to feel confident in your partners' abilities to finance or execute on projects.

Be disciplined in your project selection
It may not be a time to swing for the fences by focusing on one big job in an uncertain environment. Consider spreading risk around to various smaller projects, rather than one big one.

Work with a specialized surety broker
Navacord's surety experts can be differentiators for your firm. Work with one that understands your business plan and can bring an innovative approach to the fluctuations in the construction and surety marketplaces.

If you’re not already on board with environmental, social and governance sustainability, you’ve missed the boat.

Danielle Gorst, National Practice Leader, Financial Lines
Iridium Risk Services

Directors & Officers (D&O)

WHAT TO EXPECT

- **Better pricing, new competition**
- **Securities class action filings in Canada and the US remain stable, however macro-economic events may increase filings in the near future**
- **Increase in restricted risk class for clients unable to demonstrate environmental sustainability.**

After what may have been the hardest market in more than two decades for D&O, there are signs that the market is opening for business. Two years of profits for existing insurers has given them a renewed appetite for risk, while new entrants in the space are creating healthy competition to make pricing more attractive. Although not the profit peak of 2021, D&O premium growth remained steady in 2022. The top five D&O underwriters in Canada generated $1.3 billion in profit, a decrease of just 2% over the previous year.

Underwriters may be hungry, but they're not relaxing requirements established during the pandemic. Be prepared for insurers to be demanding when it comes to the state of your business. Unlike the softer market conditions pre-pandemic, it is not good enough to tick a box and expect insurers to respond. Clients must be on top of financial statements and be prepared to answer specific questions about the effects of inflation, recession and bankruptcy risk to their businesses.

Macro-economic events will continue to put pressure on D&O as well. Oil, commodity and input prices, labour inflation costs and talent shortages are all squeezing company margins. Insureds must clearly demonstrate that recession and inflation won't significantly impact their balance sheets or cash flow position to be in position to find deals. Not only will they benefit from reduced pricing, but they won't be subject to material exclusions.

Securities class action filings did not increase in 2022 over the previous year, but there has been a shift in the type of claims that will leave certain sectors open to uncertainty in the D&O space. Cannabis was the hot topic in 2021, with a shift to attention on the cryptocurrency sector more recently. In 2023, we're keeping an eye on the current banking crisis in the US – which has generated multiple filings already – and sectors like aviation that aren't recovering as quickly as others from the pandemic. It's possible 2023 will see an uptick in filings that put pressure on rates.

FOCUS ON ESG

The list of restricted risk classes by insurers is getting longer, as shareholders push underwriters to demand action on environmental, social and governance (ESG) standards from their clients, with a particular focus on the "E." For shareholders, greenwashing is no longer acceptable. It's not enough to put emissions targets in an annual report and expect it to be evidence of action against climate change. Insurers and their stakeholders are looking for public companies to demonstrate tangible achievements toward net zero targets. Certain sectors, such as the oil sands, are finding themselves left out in the cold, forced to find alternatives to traditional insurance such as captives.

RISK MITIGATION

FOR ESG, THE FOCUS IS ON "ENVIRONMENT"

Insureds are looking for large public clients to release climate and sustainability targets, but they also require evidence that clients are actively contributing to emissions reduction.

LOCK IN FOR THREE YEARS

Small private and non-profit, low-risk companies can lock in renewals for three years. These multi-year deals are something that haven't been seen since before the pandemic. The advantage for the client is if the market hardens suddenly, they're not subject to a rate change.

RECESSION-PROOF YOUR BUSINESS

Keep financials up to date and have room to absorb input increases, further inflationary pressure and maintain healthy cash flow.

Cyber insurance remains one of the best value-added insurance purchases.

Insurers are increasingly focused on threat detection and risk control to avoid paying losses in the first place.

Cyber Liability

WHAT TO EXPECT

- **Moving target with rates**
- **Multi-factor authentication (MFA) is a precondition for larger companies**
- **Encrypted policies**

Cyber is not expensive coverage, yet it is the one risk you're most likely to get hit with. When your doors get shut down because of a cyber attack, no other policy will cover you except a cyber policy. Nearly one-quarter of Canadian companies do not have cyber coverage in their policies.

Insurers in this space are increasingly sophisticated. Underwriters generally require that companies have risk mitigation in place as a precursor to coverage; in particular, multi-factor authentication (MFA) and may not offer much by way of 'social engineering' coverage (where a third party tricks the customer into wiring funds to an unintended recipient) except to those with the most sophisticated risk management protocols. But specialty cyber insurers are also your risk mitigation partner, some offering encrypted policies to avoid ransom claims, continuous monitoring of your data, and even "hacking the hackers" in real time, if someone finds a way into your system.

Cybercrime is not going away, and the nature of attacks is ever-changing. The first half of 2022 saw a decline in the frequency of attacks, but not the severity, and frequency picked up later in 2022 and is expected to be continuing on this trend in 2023. Proactive risk management on the client's part can help keep premiums stable, despite an ever-shifting cyber security landscape, but rates are a moving target.

TAKEAWAYS

- Think of cyber insurance as both liability coverage and a risk management service
- It can also provide coverage for social engineering and ransom attacks
- Cyber liability covers loss of income, reputational damage and data restoration
- Ensure MFA, or two-step authentication, is in your cyber risk mitigation toolbox

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