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INSURANCE

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MARKETPLACE INSIGHTS

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The Slow Grind To The “Next Normal”

Local Touch. National Strength.™



From the beginning of the crisis and over the course of the year, Intact provided \$530 million in relief that has helped more than 1.2 million customers across the country. This includes \$50 million of relief to more than 100,000 of our small business customers through the Intact Small Business Relief Program.

— Charles Brindamour, CEO
Intact Financial Corporation



Insurers are inching their way back to profitability. But the pandemic has prolonged the pain and created new problems.

We're now over a year into the COVID-19 pandemic and almost two years into the hard market cycle. While the quickening pace of vaccinations across the country brings hope of a widespread return to in-person socialization and business activities later this year, it's a different story for the insurance industry and the economy as a whole. The ongoing uncertainty and business volatility brought on by the pandemic has only increased the pressure

on insurers to restrict the capacity they deploy while also expanding the number of variables they factor in to underwriting decisions. To be sure, financial performance across predominantly commercial lines insurers is improving, with a number of insurers finally bringing their combined operating ratios (COR) back below 100% (see [Company Results](#) section below). However, many are still incurring underwriting losses and all indications are that hard market conditions will persist for the remainder of 2021 and likely well into 2022. Moreover, new challenges have arisen driven in part by the volatile business environment that the pandemic created. Loss activity for directors and officers (D&O) liability remains very high, maintaining the need for substantial rate increases for the insurers that have not exited this line. And the frequency and severity of cyber liability losses have ballooned to an alarming degree during the pandemic.



INSURANCE 101

Earned Premium:
The premium collected by an insurance company for the portion of the policy that has expired. That is, the amount the insured customer paid for the period of time the insurance policy was in effect, but has since expired. Because policyholders pay premiums in advance, insurance companies don't immediately consider those premiums as earnings. For example, the premiums you pay for your insurance policy beginning with your July renewals this year will not be considered earned premium by the insurance company until July of 2022.

Direct Premium Written:
Direct premiums written are the total premiums written by an insurance company before considering reinsurance ceded (i.e. net premiums written). Direct premiums written represent an insurance company's "topline" growth during a given period. When direct premiums written exceed direct premiums earned a company is said to be experiencing an increase in underwriting volume.

Reinsurance:
Insurance for insurers. Insurers use reinsurance to transfer portions of their risk portfolios to other parties by some form of agreement to reduce the likelihood of paying a large obligation resulting from an insurance claim or multiple claims, depending on the type of reinsurance used.



Over the last year insurers have refined their strategies, moving on from broad brush rate increases and capacity restrictions applied across entire portfolios toward narrower actions aimed at specific industries and individual risk categories.

In some cases, this has led to insurers deciding to exit certain lines of business, leaving even less capacity and increasing rate pressure for insurers that remain (liability coverage for public entities is the latest area of concern). In other cases, insurers are aggressively targeting new business that fits within well-defined risk parameters where they can see profitability. For example, in recent months a number of insurers have launched initiatives to attract new property and casualty customers in the small business sector and others are pursuing auto business for niche local fleets. These strategies require allocating dedicated underwriting resources to provide superior service

for these niches, segregating them from resources required for renewal business. That is important because underwriting resources within insurance companies continue to be extremely strained by the massive increase in submission marketing activity currently required for renewals. Virtually every insurance program now requires bringing in multiple insurers to achieve desired limits, all of whom are very strict with the limited capacity they can deploy and the terms and conditions under which they will do so.

For customers, this means planning much longer lead times and dedicating more resources for gathering a wider range of information requested by underwriters to ensure optimal renewal results. In the current environment, there are no "standard" renewals anymore. Even best-in-class accounts need to be prepared for rate increases and tighter conditions—and the time it will take to negotiate them.

Vital Signs

How did predominantly commercial lines insurers (excluding Lloyd's) in Canada finish 2020? Here are some key indicators and what they mean.

PROFITS

- Direct premium written (DPW) grew by 18% compared to Q4 2019, to \$14.2 billion. Insurers are mostly getting the topline growth they are looking for.
- Expense ratios declined by 1% driven by higher overall volumes against fixed expenses.

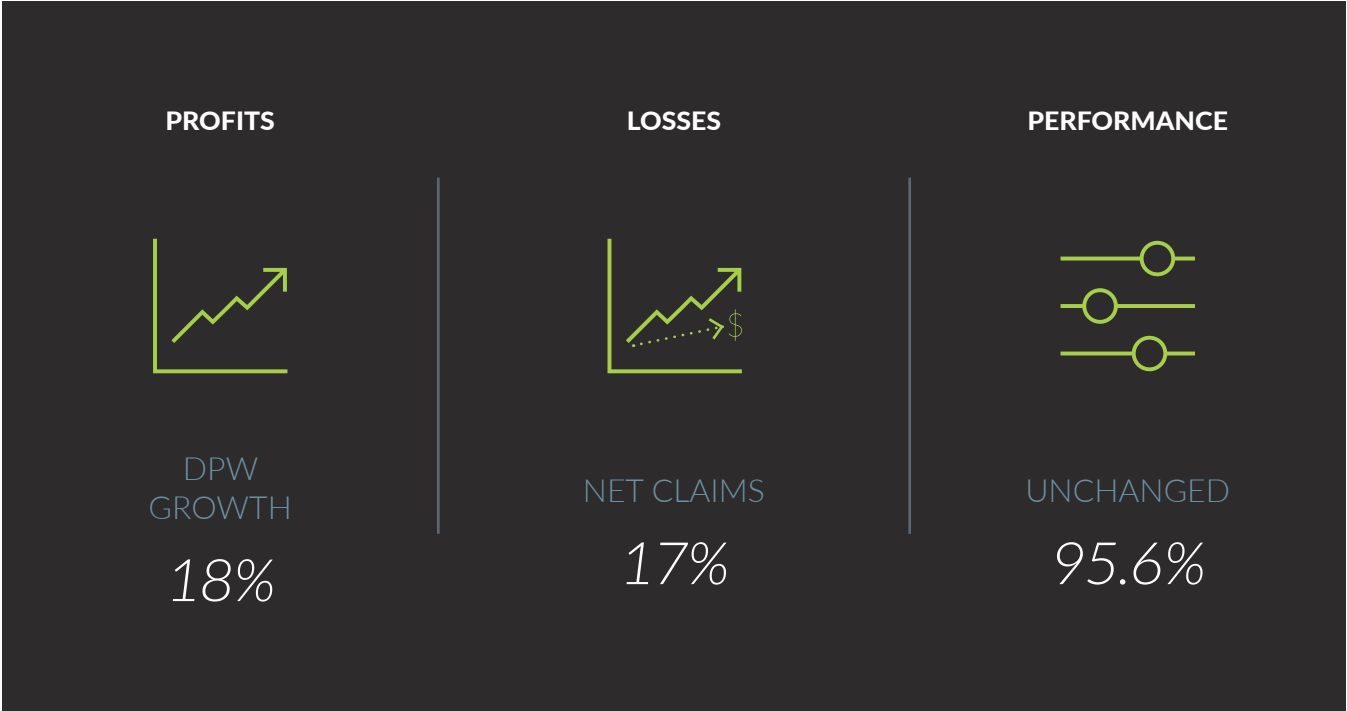
LOSSES

- Net claims were up 17%, outpacing the 16% growth in net earned premiums.
- Reinsurers had a terrible year. The overall COR for the sector shot up from a profitable 92.6% in 2019 to 103.7% with 11 of Canada's 21 reinsurers finishing the year with a COR over 100%. It remains to be seen what impact July 1 reinsurance renewals will have on the cost of insurer capacity.

PERFORMANCE

- Industry COR was virtually unchanged at 95.6% (96% in 2019).

Return on equity (ROE) was 6.24% due in part to historically low interest rates continuing to suppress investment income.



PIG IRON UNDER WATER

This is an old insurance industry expression that was originally used to describe fire risk. If a risk is described this way it means that it is very unlikely to ever burn down and so is a good risk to insure. The expression derives from the fact that iron is considered relatively inflammable. In the iron making process, ingots are broken off from the iron runner (the “sow”) and dropped in water to cool where they form into shapes that look like baby pigs.

Use it in a sentence? In the current hard market, an underwriter won't extend their full limits on a property risk unless it's pig iron under water.

Property

Rate actions by insurers on property insurance portfolios helped lower loss ratios in 2020, even in the face of significant catastrophic (“CAT”) losses such as the Calgary hailstorm in June that caused well over \$1 billion in insured losses. However, while dramatic rate increases are starting to level off for some categories, rate increases will continue and capacity is selectively deployed. Property program renewals have required brokers to exercise increasing amounts of creativity to achieve desired limits and coverage, especially on larger risks.

In addition to the ongoing impact of extreme weather events, another factor driving up property claims costs in recent months has been a spike in the price of building materials, especially wood and lumber, which have roughly tripled in cost. The price spikes reflect a combination of an increase in demand driven by an uptick in home improvement projects during the pandemic and a reduction in supply as sawmills throughout North America were forced to reduce or shutter operations at the same time.

Hard: Property accounts with favourable loss histories in classes—such as offices for professional services, wholesale/retail locations and low-hazard manufacturing—in regions with no significant CAT exposure or claims issues can expect rate increases of at least 5-10% this year. Rates may soften in 2022 as some new capacity enters the market.

Harder: Capacity remains very restricted, with no new entrants, and rate hardening continues for the following classes: residential real estate, including condominium

and strata; manufacturing such as chemicals, oil and gas, automotive, recycling; hospitality, such as hotels, bars, and restaurants; public entity and institutional property. Even on accounts with good risk management and excellent loss history, these classes may experience rate increases ranging from 15-50% as well as deductible increases and limitations on terms and conditions. Accounts with recent losses may be facing increases anywhere from 30-100%.

Other highlights from property and property-adjacent lines of business include the following:

- **Personal Property:** Rates rose steadily in 2020 and will continue to do so this year to offset elevated CAT risk. Loss ratios in 2020 remained lower as a result of insurers' use of reinsurance. However, reinsurers endured very poor results last year and it remains to be seen how primary insurers will adjust their reinsurance strategies following July 1 renewals.
- **Boiler and Machinery:** Rate hardening has helped steadily improve performance in this line of business since 2018, helped also by lower economic activity over the past year.
- **Marine:** Despite the strain on supply chains in 2020 this line has not yet seen elevated loss ratios. The first half of 2021 may reveal whether or not there has been any significant disruption.

Liability

Most businesses continue to see rate increases for general liability (GL) provided by domestic insurers ranging from 5-15%, with increases at the higher end driven by businesses with new operations, new risk exposures and poor claims experience. Businesses that are high hazard or impaired by previous losses can expect higher GL rate increases. Lloyd's capacity remains extremely restricted after exiting a number of lines due to high loss ratios (public entity insurance is the latest challenging area). However, most of what Lloyd's exited has been able to find a home in the domestic market without significant rate hardening.

Other notable liability line developments include the following:

AUTO

Not surprisingly, loss ratios for commercial auto and trucking were relatively flat in 2020 as insurers benefited from lower traffic volumes caused by pandemic-related restrictions. As the economy opens back up in the latter half of 2021, we expect these results to begin deteriorating again. Throughout the last year, rates remained firm, but rate increases this year will likely be under 10% for the vast majority of well-managed fleets.

Indeed, we have begun to observe some healthy competition between insurers this year for quality risk-managed “local” fleets that don't necessarily haul goods or cross borders. These include niches such as contractors, plumbers and cable installers. Some insurers are dedicating underwriting resources to new business in this area as a means of providing good service and quicker turnaround compared to the often lengthy back and forth currently required for renewal business.

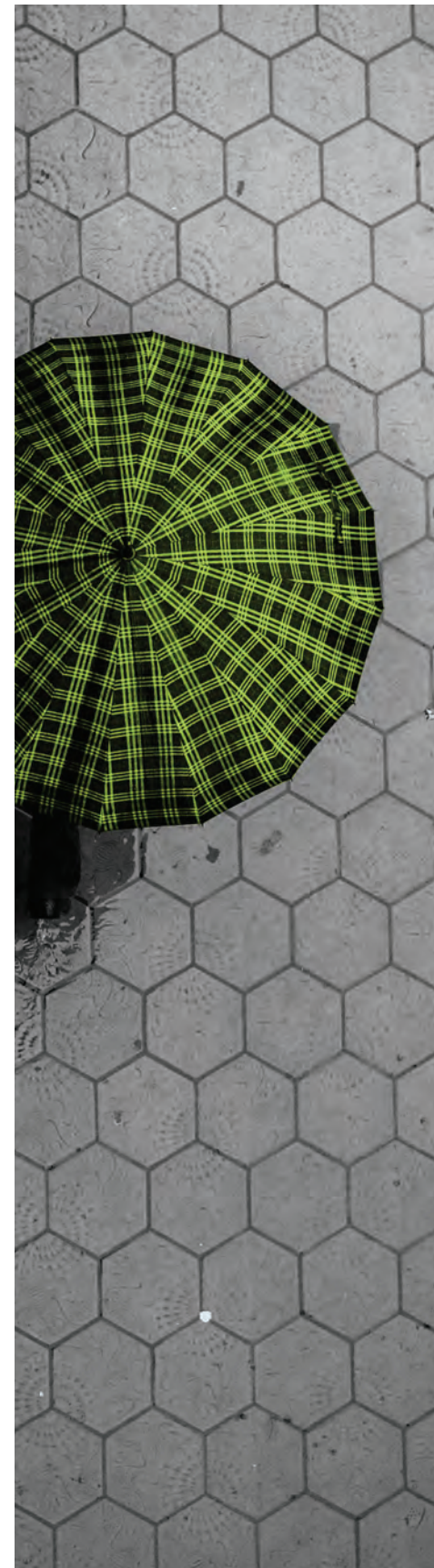
Long haul trucking, especially for fleets with exposure in the U.S., remains challenged due to large liability claims and the rising costs of repairing physical damage. Umbrella and excess liability lines for these customers have stabilized somewhat since the end of 2020 but remains difficult to place and very expensive with significantly higher rate increases compared to general liability.

CYBER

Uptake of cyber liability insurance continues to grow steadily, with the premium pool expanding by 60% in 2020 to over \$223 million. However, claims and losses are currently far outpacing premium growth as cyber attacks climb in both frequency and severity—including successful attacks on insurance companies. The loss ratio on this line for all insurers in Canada stands at over 160% with Lloyd's as the leading provider enduring an eye-watering 600% loss ratio. The number of ransom demands in excess of \$250,000 grew substantially in 2020 and demands of seven to eight figures against larger organizations have become common, as exemplified by the ransomware attack on the Colonial gasoline pipeline in the U.S.

Despite these setbacks, rate increases remain manageable as underwriting sophistication for this line of business continues to improve. Many insurers can determine some of an organization's vulnerabilities before providing a quote. Cyber insurance is also a unique product in the industry in that it provides customers with services and training for improving their security without having had a claim first.

Customers that make use of these services and demonstrate a firm commitment to robust cyber security tend to receive more favourable terms and conditions.





There are a number of trends driving these losses, and the last year has only amplified them.

Spotlight on D&O

While insurer actions have started to produce the desired results, one line of business that remains troubled by high loss ratios despite large increases in premium is directors and officers' liability. Indeed, some insurers that were long time suppliers of this coverage in the Canadian market have given up and exited the line entirely. Those that remain are continuing to quote steep increases upon renewal—approximately 25-30% in 2021—for accounts with no material change in risk profile or financial stability.

There are a number of trends driving these losses, and the last year has only amplified them. The volatile business environment created by the pandemic has tested the resiliency of many companies and exposed a number of

them that were not well managed, intensifying a trend in the US of Shareholder Derivative Actions. These are lawsuits advanced by shareholders on behalf of the corporation against the directors, officers or management of the corporation for a failure to perform their fiduciary duty. Lack of appropriate cyber security and privacy measures, or an inadequate response to cyber attacks, has been one of the main drivers of escalating D&O claims and losses in recent years, even before the explosion of cyber incidents in the last year. The number of shareholder lawsuits against listed companies in Canada is small compared to the US. However, the trend is not going away and the cost to defend and settle these claims is rising and can cripple a company's balance sheet if not appropriately covered under a D&O program.

Beyond cyber attacks, the pandemic has also given rise to a number of claims against D&O and related financial lines such as employment practice liability (EPL) for actions associated with:

- Claims for unpaid wages due to insolvency or bankruptcy
- Inadequate severance pay, particularly for high wage earners
- Wrongful dismissal and discrimination against employees that raise COVID-19 safety concerns
- Litigation around fees for service, i.e. providing credits instead of refunds.

In response, and especially in the current volatile business environment, D&O underwriters are:

- Continuing to limit the capacity they deploy on any single risk, reducing limits of \$10-\$15 million down to \$5 million, for example:
- Focusing heavily on risks they want to address and exclude such as insolvency, and how COVID-19 and a business's response to it affects its financial projections
- Considering a wider array of variables and information about a company than ever before when making underwriting decisions. One area of note that insurers are starting to pay much more attention to is a company's environmental and social governance (ESG) framework and reporting practices.

Customers preparing for their D&O renewal in 2021 need to be prepared to engage in the process earlier than usual and provide answers to more questions than in the past, particularly with regard to financial projections. They should also be ready to prepare their board for changes in their D&O program, including budgeting for premium increases.



This market will not tolerate preventable losses; as brokers, it's up to us to be the change we want to see. We need to educate clients and provide proactive risk mitigation strategies and solutions to truly add value.

— **Shawn DeSantis,**
President & CEO,
Navacord

(excerpt from Canadian Underwriter's 2021 Executive Outlook)

Here's What You Need To Succeed

To get through the hard market cycle and the current unstable economy, insurers are focusing on quality and selecting best-in-class risks. This year's insurance renewals will be some of the most challenging companies have ever faced. It will require budgeting more time and providing more information than you have ever done before, and the consequences of failing to do so could be serious.

Your broker can help make sure your submission gets to the top of the pile, but we can't do it without your help. Here's what you need to make sure your renewal stands above the crowd:



TIME

Underwriters, while working from home with limited social supports, continue to face unprecedented workloads managing a huge volume of submissions. The amount of lead time an underwriter has to assess a risk is now as critical as the underwriting information you provide to them. Incomplete submissions provided with little time to assess them are much less likely to obtain a favourable result. Be sure to give insurers ample time to engage with a risk and be prepared to provide them with more information than they request.



C-SUITE INVOLVEMENT

An old insurance industry truism is that "Insurance is a relationship business," and that's never been more true than right now. Meetings between your company's senior leadership and key insurer executives can help differentiate your business among an insurer's customers. Demonstrating a willingness to provide information and attend to risk management issues can help the placement and renewal process go smoothly, even where there are unexpected losses.



CLEAR GOALS

Talk to your broker so that they have a clear understanding of what your insurance priorities are, what are the essentials that you can't give up and where you can be more flexible. Be open to discussions about alternative program structures, reducing limits purchased, increased use of deductibles and improved risk management. Make sure you and your broker are on the same page about all of these. In the current business environment, your insurance program should be tailored to your organizational needs for the next 12-24 months.



A COMMITMENT TO GOOD RISK MANAGEMENT

All companies have losses. The important thing is being able to demonstrate to an insurer what you have learned from past claims, including what changes you have made to operations and processes to deal with issues and prevent reoccurrence. While pandemic restrictions remain in place, be prepared to engage in virtual risk inspections, using videos or interviews to provide information to insurers.



Company Results

Year-end 2020 Combined Operating Ratios (COR) for several key commercial insurers. A number greater than 100 indicates a loss (see *Insurance 101*).

AIG	102.3	Arch	123.5	Chubb*	74.8	CNA	95.4
Allianz	86.7	Berkley	88.9	FM	85.0	Northbridge~	97.4
Liberty	101.2	SGL	94.3	SovGen	97.3	Travelers~	96.8
Aviva**	94.7	RSA	88.3	Intact**	91.2	Zurich	100.1

* 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 Henderson Insurance Advisor.

Contact Us



LET US HELP YOU MANAGE YOUR RISK

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