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A Hard Market & Historic Downturn

Insurance companies are doing all they can to support customers through a historic business slowdown. But their need for ongoing rate increases persists.

Through the first quarter of 2020 Canadian insurance companies continued to follow through on rate increases and appetite restrictions—undertaken in 2019—which were aimed at returning the industry to profitability. Most are succeeding.

The aggregate combined operating ratio (COR) for predominantly commercial insurers in Canada (excluding Lloyd's) dropped to 97.7% in Q4 2019 from an unsustainable 103.3% the prior year. Underwriting income turned around from a $227 million loss in 2018 to a modest $176 million profit in 2019, driven partly by a 17% year-over-year increase in direct written premiums to $12.7 billion in Q4.

By mid-March the world's economic landscape was beginning to change—radically. The COVID-19 pandemic began sweeping the globe and governments began enacting emergency preventative measures to slow the spread of the virus. As a result of these measures in Canada, many businesses have now either drastically reduced or temporarily ceased operations. The insurance industry—an essential service—has adapted quickly, rapidly converting their entire workforce to work-from-home arrangements. Brokers and carriers alike are working together to support customers whose revenues have been impacted while reviewing and responding to a series of new risks that have emerged during the crisis.

The pandemic will have meaningful financial consequences for Insurers with claims exacerbating the industry's profitability issues and market downturn impacting investment portfolios. These consequences will further extend the aforementioned corrective actions taken by carriers to return to profitability. Lloyd's estimates that the 2020 underwriting losses covered by the industry will hit $107 billion and the industry will also experience falls in investment portfolios of an estimated $96b.

"If policymakers force insurers to pay for losses that are not covered under existing insurance policies, the stability of the sector could be impacted and that could affect the ability of consumers to address everyday risks that are covered by the property casualty industry."

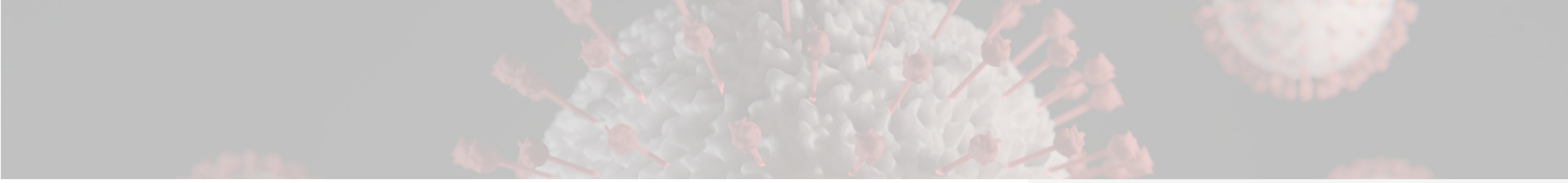
David Sampson - CEO

American Property Casualty Insurance Association (APCIA), March 26

INSURANCE 101

Combined Operating Ratio (COR):
A key performance indicator that compares losses paid and expenses against premiums earned.

If the COR is above 100, the insurer is unprofitable based solely on underwriting performance. Most companies target a COR of 95% or less.



CLAIMS ARISING FROM COVID-19

Business activity is down dramatically. At the same time, insurance companies are facing a number of challenges related to the pandemic across multiple lines of business.

- **Travel Insurance**

  This historically profitable line will suffer losses due to trip cancellation provisions and medical costs claims. A smaller number of travellers will also mean a sharp decline in policies sold to offset claims.

- **Event Cancellation**

  The cancellation of many high-profile events, including conferences, concerts and sporting events could result in historic losses.

- **Trade Credit**

  While use of this form of insurance has increased in recent years, insurance to recoup uncollectable accounts receivable is still relatively uncommon. Business that took advantage of the product offering may be able to offset losses due to their customers' financial duress.

- **Directors & Officers (D&O)**

  Business failures caused by the pandemic could trigger D&O claims to deal with outstanding liabilities such as unpaid taxes and wages. Canada's oil and gas sector, for example, will be hard hit by the double blow of the pandemic and oil trading at near zero value.

- **Employment Practice Liability**

  The recent spike in newly unemployed workers may lead to an increase in wrongful termination suits.

- **Cyber Risk**

  The sudden switch to work-from-home arrangements for thousands of workers has left many companies more exposed to ransomware and malware attacks through poorly secured networks.

In addition, insurers will face an increase in litigation in the coming months and years, even as the pandemic subsides. Class actions and other lawsuits will develop as clients and legal counsel challenge both corporate decision-making and insurer claim denials during the crisis *(see also Social Inflation and Liability Lines).*

"It's our view–and the view of the industry–that business interruption requires there to be physical damage to property in order to be triggered. It would therefore require an overturning of the contract in order to open that up to provide broad-based business interruption coverage for losses arising from COVID-19."

Andrew Barnard - President

Fairfax Insurance Group, April 16

SOCIAL INFLATION AND LIABILITY LINES

In addition to the increasing claims activity that will result from COVID-19, insurers were already responding to a troubling trend affecting liability lines: social inflation. Social inflation is an industry term that refers to increases in claims costs that are driven by societal trends, rather than economic trends.

Key trends driving social inflation include:

- Increasing attorney involvement in claims and a better funded plaintiff's bar.
- A rapidly expanding plaintiffs' pool, such as with opioid litigation and the #MeToo movement.
- Rising jury awards that favour the plaintiff, combined with negative public attitudes toward corporations.

While the majority of instances supporting these trends have been localized in the United States, there is increasing evidence that the same issues are spilling over into Canada and driving up costs faster than insurers can catch up through rate increases. The likely result will be a further tightening of capacity in liability lines.

Social inflation's impact on insurance in Canada has been most acutely felt in commercial auto, particularly for customers with exposure in the U.S., but it is also spreading to other related liability lines. Over the past year, we have observed significant increases in the cost of umbrella and excess lines—in some cases, as much as five times the expiring premium.

BUSINESS INTERRUPTION COVERAGE

Many business owners are currently experiencing decreases in sales or closures, which may lead to questions regarding business interruption coverage within property policies. Coverage for loss of income or extra expense following a property loss normally requires physical damage by an insured peril (such as fire or water damage) to trigger a claim. The industry position is that income losses that are solely due to a government mandated shutdown and barring actual physical damage—in this case those resulting from a global pandemic outbreak—are not insurable claims.

However, a recent Ontario court decision, and initiatives in some U.S. states suggesting insurers be legislatively compelled to pay pandemic-related business interruption claims regardless of the policy wording and intent, are keeping this discussion active. Insurance company leaders have stated they will strongly resist efforts to force them to pay losses that the product was not intended, or priced, to cover. They argue that pandemics are like war—something with global impact, unquantifiable financial consequences and of such massive scale as to be uninsurable.

There are, of course, exceptions, and certain policies contain provisions or extensions that may allow for small expense claims to be submitted. If you have experienced any COVID-19 related loss with respect to the mandatory shutdown directives and feel you may have a claim, please contact your insurance advisor to discuss.

HOW INSURERS AND IRIDIUM CAN HELP:

Canadian insurance companies have done a good job of rapidly shifting priorities—finding creative ways to offer assistance to customers during this moment of unprecedented financial and social upheaval. Our representatives are working closely with Insurers to help our customers adapt to these new circumstances in a number of ways. But we need you to be engaged, too.

1. **Talk to us.**

   We need to hear from you to understand how your business circumstances have changed and the impact that has on your risks and exposures.

   For example, many property policies contain a clause that excludes coverage when a property has been left unoccupied for more than 30 days. Your business may have now reached that limit due to social distancing requirements and mandatory shutdowns, so it is important that we address this with you.

2. **Premium relief may be available.**

   Many businesses are in cash preservation mode right now and looking for premium relief to reduce expenses. Most insurers are open to discussions about what critical coverages should remain in place and what can be suspended mid-term. Likewise, many group insurance carriers are offering substantial premium credits for employee health and dental benefits.

   On monthly direct-billed accounts, some insurers are open to payment deferrals, and will consider these on a case-by-case basis.

3. **A good time to review your coverages.**

   The pandemic has affected virtually every business in some way and made owners more aware of how their business can be impacted by events and circumstances they had not previously considered. At the same time, many businesses' operations have been impacted in ways that may have materially changed their risks and exposures. These changes may mean your business is eligible for premium credits or other savings. There has never been a better or more important time to review the entirety of your insurance program, like a number of our customers have done in the last few weeks. We're just a phone call away.

COMPANY RESULTS

2019 year-end Combined Operating Ratios (COR) for several key commercial insurers. A number greater than 100 indicates a loss. *(See Insurance 101)*	*AIG*	**96.1**	*Arch*	**129.1**	*Chubb*	**74.5**	*CNA*	**90.4**
	Allianz	**121.7**	*Berkley*	**92.5**	*FM*	**75.4**	*Northbridge*	**98.2**
	Liberty	**92.4**	*SGI*	**97.6**	*SovGen*	**102.1**	*Travelers*	**102.5**
	Aviva	**102.6**	*RSA*	**99.6**	*Intact*	**98.6**	*Zurich*	**99.3**

LET US HELP YOU MANAGE YOUR RISK

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