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Bucking the **Trend**

DECEMBER | 2023

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Commercial property, personal lines, and auto fleet have not been super money makers for insurance companies. Add supply chain difficulties, climate change and an increase in frequency and severity of catastrophic events with an impact we've never seen before in this country. It's the perfect storm for rates to get worse. But we're not predicting that.

Robert Beeston, Vice President, Construction Practice
Navacord

Bucking the Trend

There's an old saying that you don't know if there will be a recession until you're in one. For now, all the markers are there – inflation, interest rate hikes, record-high bankruptcies, labour tightening, class-action suits, hampered supply chains, and global conflict. Despite this, the insurance industry, with some exceptions, remains relatively stable across personal and commercial lines.

Underwriters are seeing strong results in the first six months of 2023. Mirroring the rest of the market, commercial writers benefited from a dramatic turnaround in investment results. The outcome is a 71% jump in net income over the previous year and top line growth of 9.3%.

It could be a lag effect, but even the near 20% year-over-year bankruptcies in Canada in June and a hike in SPAC filings in the US haven't dampened the appetite and aggressive competition for underwriters in the directors and officers (D&O) liability space. D&O is expected to see a continued softening for both primary and excess liability.

For commercial general liability, we're seeing ample room for brokers to put together policies that benefit both insurers and the insured. Contractors in the commercial construction industry are a preferred class, with abundant capacity, room to move and favourable terms as clients come up for renewal. Some of the savings may be hampered by a 100% increase in material, input and labour costs, and uncertainty about the inflationary environment, leading contractors to put the brakes on some projects.

Certain classes of business are still hard to place. High-risk subcontractors such as roofers, HVAC and plumbers, and wood frame project cover continue to be subject to scrutiny and not-as-favourable terms by insurers. In agriculture, underwriting requirements for fire protection haven't caught up to a new size of business in rural Canada. We're now dealing with increasingly sophisticated conglomerate food growing, processing, and manufacturing, and shipping operations replace the smaller operations of the past. Many of these companies are finding innovative ways to respond with more agility to manage ever-changing supply route options. But brokers need to do better to analyze and communicate the opportunity for insurers in the new risk environment.

Rampant auto theft, a return to pre-COVID driving patterns, and government action in the provincially mandated auto sector may hinder appetite in some parts of the country. At the same time, more stringent regulations regarding property in flood and wildfire zones may see two classes of home insurance in future.

For the moment, however, there is appetite among existing insurers, as well as continued new entrants in many markets, which is amping up competition and keeping prices relatively stable. At the same time, insurers continue to experience profitability. Whether this is a lag effect or optimism remains to be seen. What we are seeing is the expectation from insurers for due diligence, with ample opportunities for best-in-class clients to work with broker expertise and find the right mix of risk control and insurance.

There are classes of business that most insurance companies have considered to be favourable and profitable, and this includes most classes of construction.

Robert Beeston, Vice President, Construction Practice
Navacord

Commercial Property Insurance Forecast

WHAT TO EXPECT

- **Easing of pricing across many lines**
- **Rampant claims inflation challenging the industry**
- **Shifting and new competition may benefit clients in some regions**

Commercial property, including auto fleet have not been super money makers for insurance companies for several years. A hampered supply chain, increase in frequency and severity of catastrophic events due to climate change in Canada and globally, are all taking a bite out of topline growth. Add to that the spate of auto thefts, inflation, rising reinsurance rates and labour shortages, and it's easy to see why hard market conditions could persist into 2024.

That said, insurers have been making a bit more money over the past two years. Improved loss ratios and increased gross written premiums due to rating actions should contribute to an easing of prices across many lines. We anticipate property rate increases will moderate over the next several months.

Geographic location may dictate capacity, however. For one, it's challenging to predict how the record catastrophic events of 2023 will come into play. Extreme weather events in Nova Scotia throughout the summer may see an exodus of some capacity in Atlantic Canada. Wildfires in Northern Canada and in the West make it hard to predict how insurers will rate protected and unprotected clients in future.

Although most domestic companies are not taking risks in areas unfamiliar to them, we're seeing new entrants in every region trying to capture market share, which could translate into competition and new opportunities. Brokers should look to the fastest growing insurers in their regional markets to find deals for clients.

Construction Insurance Forecast

WHAT TO EXPECT

- **General softening of construction market, except for hazardous and hard-to-place classes**
- **Abundant capacity will see decrease in rates for most contractors**
- **Underwriters are demanding evidence that clients can execute on risk management and safety controls**

The past couple of years have seen syndicates re-enter Canada, offering abundant new capacity for contractor general liability, property and construction cover. This is good news for clients who will start to see an easing of pricing and increased liability limits as they come up for renewals. In fact, contractors of all sizes and parts of the industry – general construction, electrical, civil, road construction – will see substantial savings as they move into the next six months. Even contractors in excess of half a billion in revenues will find savings this year.

With the exception of CAT zones, like B.C., which is still quake shy, we're seeing the potential for rates to come down 20 to 30% for some clients following several years of hard market conditions. Large tower projects in Ontario and Eastern Canada are seeing terms they haven't experienced since 2008.

COMMERCIAL CONSTRUCTION PROPERTY TRENDS

While the overall market is still stable to hardening, construction product market cycle points to more widespread softening across all lines of renewable business. General liability will be flat to decreasing as much as 10% or more. Commercial excess will be flat to decreasing up to 5%. Auto fleet is flat to volatile, with thefts in Ontario and government action in Alberta seeing a trend upwards.

COMMERCIAL CONSTRUCTION LIABILITY TRENDS

Project covers for non-residential, including builders' risk, course of construction and wrap-up liability are trending similar to general property outside construction, with up to 5% decrease for course of construction. Wrap-up liability capacity continues to increase, and pricing will soften as much as 10-15%.

For residential segments – primarily multi-family condos and strata – rates are stable to decreasing, up to 10-15% and capacity is increasing to pre-pandemic levels in all segments except wood frame.

Overall premium spends on both renewable and project lines may end up looking relatively flat

(+5% to -5% vs prior year total spend). This is due to the interplay between inflationary inputs, with material and labour costs impacting property values, project values, and revenues, and offsetting any decreases in rates. Where rate decreases exceed 5-10%, however, opportunities for savings exist, and where clients demonstrate good loss history and meaningful risk management practices, larger reductions are available.

CERTAIN HIGH HAZARD CLASSES OF CONTRACTORS

For certain hazardous sub-trades, we're still seeing limited liability room. Roofers, HVAC and plumbers are not a preferred class among insurers, primarily because claims on big projects often come down to water damage or mechanical failures that trail back to these subs.

WOOD FRAME CONSTRUCTION – WILL INDUSTRY CATCH UP?

Another area that's historically been difficult to find deals with is wood frame, with rates five to ten times those of non-wood frame. Residential construction in Canada has been predominantly wood frame for residential and low-rise construction outside the main centres of Toronto and Vancouver, and there aren't many losses relative to the size of the industry. But when loss does happen, it's big, into the tens of millions of dollars. Rates in this space have been exceptionally stable for twenty years.

We're keeping our eye on industry innovation that is testing other combustible materials that could potentially replace wood frame, like mass timber, which takes longer to burn than its traditional counterpart, or traditional timber treated with fire retardant. It's hard to know if the industry is ready to adopt these methods, given the additional costs involved from an input perspective. If longevity and the environmental sustainability is preferred over non-combustibles like concrete and steel, we anticipate insurers will start to take a closer look at rating.

Trends towards improved terms in the wood frame with fewer restrictive conditions, such as warranties and exclusions, are evident in the current market.

Risk Management Tools

FOCUS ON TRANSFER RISK

Brokers have an essential role to play in helping clients understand contractual transfer risk. This comes down to how risk is appointed between owners, designers and trade contractors, and how everyone is protecting themselves. Brokers understand how to interpret these contracts. This is necessary expertise for clients. If a claim happens and one party hasn't met contractual requirements, they could be in some trouble.

USE YOUR BROKER AS A RISK MANAGEMENT PARTNER

The existence of a safety plan is no longer enough. For insurers, it's more important for clients to demonstrate they can execute on risk management strategies. Brokers can provide counselling and guidance on project risk. Companies that can showcase improvement of risk controls are going to have better results on the marketplace and will have fewer claims. Work with your broker to tell that story of risk reduction and execution to get traction and competitive terms.

SPOTLIGHT ON AGRI-BUSINESS

“Opportunities await in the Prairies. As brokers, we weave the essential story of risk assessment and properly convey these opportunities to insurers.”

David Stearn, Director of Commercial Operations
HK Henderson

Agricultural processing remains a challenging market segment. Consolidation and international investment in the industry have triggered significant upgrading to many facilities. The Prairies, once dotted with dusty wood crib elevators, now boast state-of-the-art food production plants. It has recently become evident the actuarial data and underwriting have yet to align with these advancements.

These facilities are made of steel, equipped with advanced ventilation systems, automated monitoring, and sprinkler systems. However, due to their location in rural areas without nearby hydrants and dependence on volunteer fire departments, they are classified as vulnerable to fire risks without protection.

And while higher commodity prices from regional wars, like Russia-Ukraine, have inflated stock limits and put increased pressure on Canadian producers, processors, and manufacturers to help feed the world, our clients are experiencing supply chain disruption that has triggered challenges and creative solutions for the storage and movement of goods.

As a result, we are now witnessing the use of short line rail for storage purposes. The rationale is these additional storage containers are ready for swift deployment when national rail companies have the capacity to transport them to a port. Underwriters, however, are currently facing a challenge in determining how to effectively assess the risk of these commodities in the space.

BROKERS PLAY AN ESSENTIAL ROLE

Adding value for our clients involves articulating opportunities for insurers to enter challenging markets. We advocate that Canadian agri-business is the global breadbasket, emphasizing these advanced facilities pose lower risks than they seemingly appear.

In this sector, there is immense potential for innovative solutions. For instance, with a major client, we assessed their risk threshold by looking at the highest probable loss at each facility instead of solely focusing on total insured values to determine capacity.

The complex nature of agri-business requires collaboration between brokers and clients with risk management partners. This entails conducting inspections, appraisals, and thorough risk reviews before approaching insurers. Armed with comprehensive information, we can provide a detailed risk assessment, allowing us to effectively communicate the opportunities available.

SPOTLIGHT ON BRITISH COLUMBIA PROPERTY

WHAT TO EXPECT

- **Stable pricing with up to 5% increase on rates**
- **Insurers looking for more and better details on building inspections**
- **Competitive rates coming forward for construction**

British Columbia has always been a unique market for property owners because of the consideration of catastrophic risk from earthquake, which remains a capacity challenge. There continues to be limited appetite from insurers for older buildings and high-rises, and extremely tight capacity for properties in high earthquake cresta zones.

Overall, rating for property in B.C. has stabilized, but we anticipate hefty inflationary increases of around 7%, over and above a 5% rate increase. On the positive side, the resurgence of Lloyd's into the B.C. property market has encouraged other large domestic players to follow suit. Insurers are competing especially for best-in-class buildings constructed after 1995.

For property owners, best-in-class is not only age-related, but also dictated by occupancy – residential versus mixed commercial, and strata, where units are owned, versus rentals. There's traditionally been more capacity for commercial occupancy, and less for residential, particularly rental units. But with the soaring housing prices in B.C., we're starting to see a shift in the marketplace, which includes a new class of professional renter that appeals to underwriters.

At the same time, builders are incentivized to build differently than they have in the past. We're seeing a lot more mixed use with retail in the bottom, and then a mix of strata and rental units. To address housing shortages, municipal laws have changed to allow for the construction of multiple residences on what was previously considered a single-family lot in cities such as Vancouver and Victoria.

Construction is ramping up in B.C., both in the form of renovations and new builds, and there seems to be interest from insurers in this market. We expect to see some fairly competitive rates coming for contractors in the province.

WILDFIRES

We anticipate more sophistication in how insurers rate and look at wildfire exposure going forward. Comparable to flood, protected versus unprotected areas may determine where insurers put capacity and favourable terms.

Unprotected areas will be rated differently than they have in the past. Maintenance may become a factor for those looking to insure buildings in wildfire-prone areas. Those in wildfire zones may start to see a limited appetite from insurers, driving rates up, especially in remote areas where they aren't near fire hydrants. These increases likely won't happen all at once, but we anticipate a slow and steady increase or a hike in deductibles for those in unprotected wildfire zones once the industry figures itself out.

TIPS FOR PROPERTY OWNERS

It's all about the details. As data becomes ever predominant in evaluating risk, insurers are looking for more detailed building inspections and data on secondary modifiers. Beyond the façade, insurers want to know the shape of the building, proximity to other structures, building envelope materials, and even the type of nails used. Drilling down and providing the nitty-gritty will drive rates.

Work with your broker to assess risk and put together a complex and detailed analysis of the opportunities for insurers in this space.

It’s a positive story in B.C. for property owners and construction firms, with insurers competing for best-in-class business.

Jennifer Adams, Senior Vice President, Commercial Division
Waypoint Insurance

Surety and Construction

WHAT TO EXPECT

- **Meaningful upticks in claims-related activity to surety bonds**
- **Labour shortages and inflation will continue to hamper project starts and completion**

Project costs are increasing across the board, with spikes in labour and material inputs, while access to capital for owners is proving more difficult. Firms who bid on projects a year ago are experiencing quantifiable increases to hard costs and material procurement costs. Labour challenges continue to create schedule delays, which can have a cascading effect across entire projects.

Evidence of claims activity seems to be increasing across the country, with all types of contractors affected. There is still abundant capacity in the surety market, but bonding companies are increasingly focused on balance sheets to have confidence that clients can execute on their backlog of work.

RISK MITIGATION TIPS

Document everything. If there's a dispute between a general contractor and a sub-contractor, you need to be positioned to defend that claim. If you haven't got the right documentation, you're not in a position to negotiate.

Build a team of experts around you. Especially for smaller companies, have a surety broker, a lawyer, and accounting expertise that you can turn to for advice. They don't have to be on the payroll, but they should be part of your team.

Aim for cautious growth. Under current conditions, it's not the time to take the big swing on high-risk, capital-intensive projects.

"Surety companies are looking at balance sheets, and everyone is fighting for the good, well-capitalized contractors."

Woody Brown, Vice President, Surety Practice Leader
Petrela, Winter & Associates

COMMERCIAL LIABILITY INSURANCE FORECAST

WHAT TO EXPECT

- **Overall market is stable from a rate perspective**
- **Insurers in this space continue to be profitable**
- **Casualty competition is heating up for desirable classes**

We continue to see healthy competition for primary, umbrella and excess liability. The pollution market is highly competitive as well. Insurers are making money, with significant profitability in the first six months of 2023 and improved loss ratios, following years of sluggish growth from 2019 and through the pandemic.

This is good news for many clients, who can expect stable rates.

Significantly, there is a lot of movement in the Commercial General Liability (CGL) space. The resurgence of Lloyd's in the Canadian market cannot be understated. As newcomers poach underwriting expertise from traditional insurers, we expect a continued boost in capacity.

The due diligence demanded by underwriters throughout the hard market isn't going away, however. Insureds still need to demonstrate that they have risk management practices in place, that they're using alternative risk mitigation like captives and reciprocals where it makes sense, and most importantly that they aren't overstretching on their balance sheets.

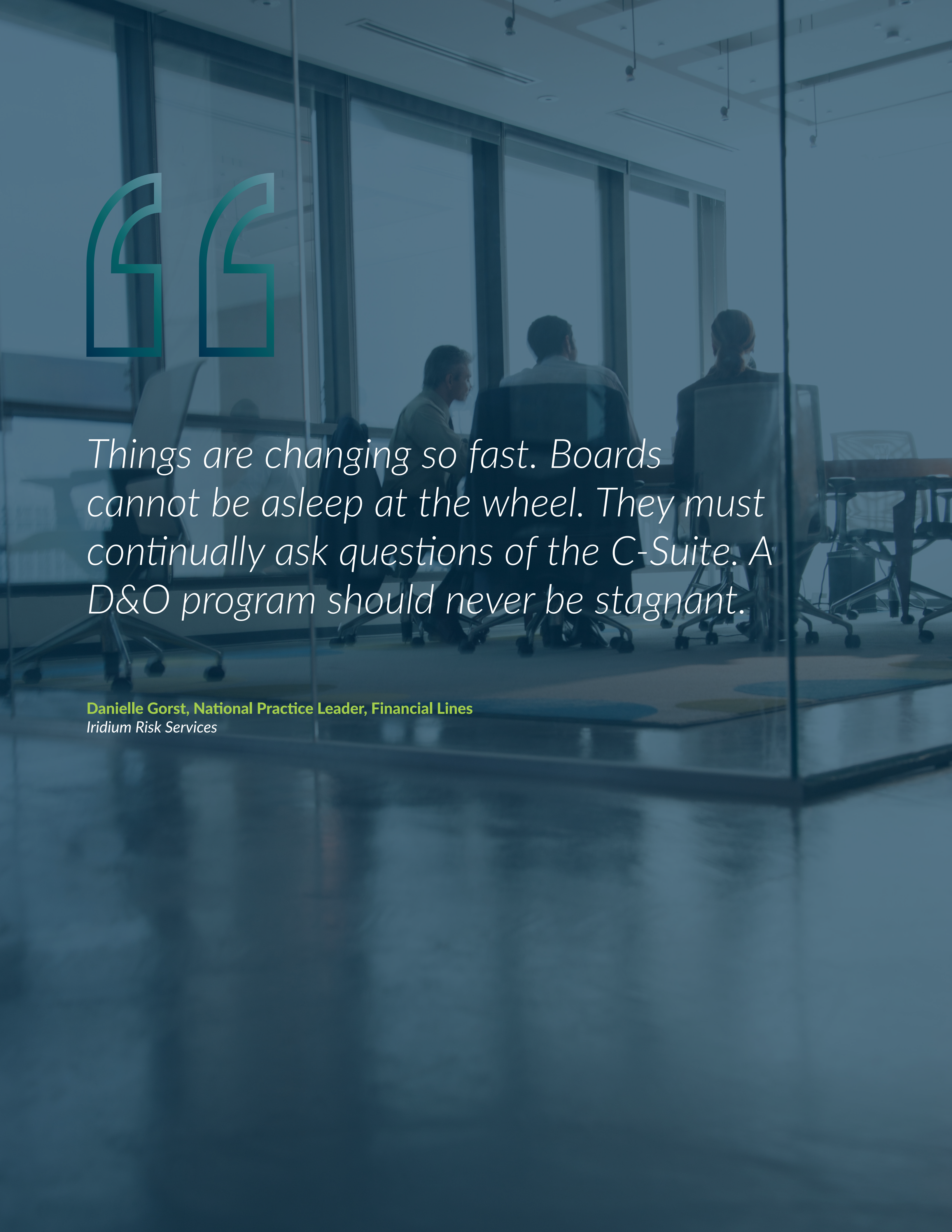
TIME TO MOVE?

Certainly, conditions look favourable for clients to shop around. After several 10-30% rate hikes from 2019 to now, it's possible under the right conditions to find that 20% rate reduction in 2024.

Buyer beware. There are some that think the best way for a broker to look after clients is to move them the minute they find broader terms and better rates. But switching underwriters is a decision that should never be taken lightly. There are savings to be had, but negotiations should start with the incumbent carrier. Long-term relationships matter when it comes time for claims settlements.

Rates aren't everything. Underwriter expertise and the relationship between the underwriter and the broker are arguably more important than the company providing capacity. Brokers have a responsibility to ensure clients understand the rates they're paying, whether or not those rates are market leading. Coverage must be sufficient with claims treated effectively and with the right expertise.

At the end of the day, brokers need to know more than just the rate story – they need the whole picture, in consultation with the client.



Things are changing so fast. Boards cannot be asleep at the wheel. They must continually ask questions of the C-Suite. A D&O program should never be stagnant.

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

Directors & Officers (D&O)

WHAT TO EXPECT

- **Ongoing softening of the D&O market into the final quarter of 2023 and early 2024**
- **Up to double-digit decreases for accounts affected by the hard market in 2022 – decreases in early 2024 may be single-digit or level off**
- **Continued diligence demand by underwriters for strong corporate governance and a clean balance sheet**

The D&O space is growth-challenged compared to other lines of coverage, but insurers have seen decent profits in the first half of the year, almost at pace with 2022. The first two quarters were mainly flat, but at least insurers aren't losing money.

Insureds may not feel the impact of these industry growth challenges, with capacity opening across the board. Following on the trend of a rapid softening in excess D&O liability, we're now seeing aggressive competition and quotes for primary business, as new and existing insurers look to build back market share in the primary space.

Don't expect underwriters to relax when it comes to due diligence, however. There's a continued focus on the balance sheet, with underwriters looking for evidence that clients can weather the storms of inflation, labour constraints and supply chain disruptions. Ramped up conflict in the Middle East and the war in Ukraine continue to destabilize predictability.

The backdrop to all of this is a spike in US bankruptcies, and US securities class action filings at their highest rate since 2020. D&O insurers are feeling the effects of the banking crisis south of the border, a continuation of COVID-19 filings, as well as Cryptocurrency and Special Purpose Acquisition Companies (SPAC) related filings. Canada isn't immune, with a notable 19.6% year-over-year increase in corporate bankruptcies between June 2022 and June 2023.

We're seeing, however, that bankruptcies are both detrimental and provide opportunity for our clients. Those on our book of business that have low debt loads are taking advantage of rock-bottom-priced acquisitions of competitors to boost revenues.

FOCUS ON ESG

Last year, the industry focus was on "greenwashing," the trend of companies boasting about commitments and impact on climate change, without supporting evidence to back it up. In 2023, companies are getting quieter about their environmental commitments, fearing backlash from shareholders and regulators. This new phenomenon is called "greenhushing," with many organizations not publicly reporting on (or downplaying) their climate action activities. Despite this, companies will continue to feel pressure on environmental issues, as we get closer to mandated climate change disclosure regulation in Canada and the US.

Risk Mitigation

STAY INFORMED

Boards need to pay attention to the fast-moving economic climate and its impact on planning and decision-making. This means continually monitoring external factors, asking questions of the C-suite, and early identification of potential issues that can arise.

REVIEW D&O INSURANCE FREQUENTLY

Regularly review insurance coverage within the context of the broader economic environment that's so unpredictable right now. Determine whether a limit change or structure change is required to respond to external events, or whether any exclusions have been added to preclude coverage.

Spotlight on Cyber

WHAT TO EXPECT

- **Steady rates due to ample capacity in the market, following tough market conditions in 2022**
- **An increase in both severity and frequency of Ransomware and Funds Transfer Fraud, especially for small-to-mid-sized businesses**
- **Continued underwriting focus on cybersecurity training for personnel, with human error the weakest link, especially as it pertains to email security**

Underwriters are seeing topline growth in Canada, with cyber general liability showing significant profitability in the first six months of 2023. Lloyd's continues to command a sizeable chunk of the Canadian market and captured the bulk of underwriting profit in the first half of the year. Cyber is the fastest growing market globally, anticipated to triple to more than $36 billion by 2028, from $12 billion in 2022.

Cyber coverage is becoming more standardized with similar agreements, endorsements and exclusions, regardless of the underwriter.

Even clients with past claims can be attractive to insurers, providing they can demonstrate they've mitigated losses and become more vigilant about cybersecurity awareness across the organization. Human error remains the weakest link, especially when it comes to email security. Clients that can demonstrate they have regular cybersecurity training and testing in place will appeal to insurers.

It's not always reflected in the news headlines, but small and medium-sized Canadian companies are being hit more frequently and with heightened severity. Unlike larger organizations, smaller firms may not have in-house expertise to mitigate risk and manage claims.

Brokers have a role to play as risk management partners for organizations of all sizes, but especially with smaller firms who may not have that expertise on their payroll.

Personal Lines

WHAT TO EXPECT

- **Inflation will continue to drive up replacement costs**
- **Increased severity and frequency of auto accidents with driving surpassing pre-pandemic levels**
- **Government action in response to catastrophic events and inflationary pressure may affect pricing**
- **Anticipate mid to high single-digit rate increases**

Personal lines make up 60% of the Canadian market, representing $55 billion. As with commercial lines, geo-political volatility and economic uncertainty are impacting this segment. But the outlook for personal lines is also impacted by unique trends.

Overall outlook is a mid to high single-digit rate environment due to normalizing of auto claims frequency, continued volatility in weather events, and increased costs related to inflation, labour, and materials.

Personal Auto

EVOLVING DRIVING PATTERNS

Accident frequency and severity are now surpassing pre-pandemic levels. Hybrid work means commuter patterns aren't the same as they were. In many cases, individuals aren't reporting their commute, which makes data difficult to analyse, challenging insurers to set rates appropriately.

RECORD AUTO THEFTS

Auto thefts have become increasingly sophisticated and have hit record rates, especially in Ontario, driving claims to $1.2 billion in 2022. The rise in organized crime driving auto theft is fuelled by a hampered supply chain, initially driven by a chip shortage, and now parts. Many stolen vehicles are never recovered and perpetrators aren't caught. At the same time, the cost of new automobiles is up 20 to 30% over pre-pandemic prices, driving up replacement and rental costs.

Although the supply chain is starting to open, it's not what it was. Labour shortages continue to contribute to longer claim delays with not as many mechanics available to do repair work. The result of these trending factors is increased cost per claim, which will affect rates going forward.

INCREASED GOVERNMENT ACTION

Auto is one area of insurance that's mandated at the provincial level. A recent government announcement in Alberta to put a rate pause on renewals to take the edge off inflation may have the opposite effect for insureds. For one, insurers may choose not to renew policies at flat rates, instead going after new business where the rate pause doesn't apply. It may also encourage some insurers to move out of the market altogether, lessening competition and increasing costs to the insured.

RISK OF SELF-INSURANCE

Inflation is driving up costs of everything. We're seeing an increasing number of clients looking at their monthly insurance premium as a place to trim the fat, with more people self-insuring by taking higher deductibles. In an accident situation, however, most Canadians couldn't find an extra $400 to pay a deductible, which is a huge risk, not only for individuals, but for the collective when it comes to home and auto rates.

WEATHER AND CATASTROPHIC EVENTS

With the record number of CATS in 2023, we could start to see two classes of home insurance going forward, or more exclusions to account for those in wildfire and flood zones. Weather will continue to be an issue with flood, fire and wind events as the new normal in weather patterns.

At the same time, as in the commercial space, more stringent industry regulations regarding property wildfire zones may see two classes of home insurance for protected and unprotected properties going forward.

Travel

With the pandemic mostly behind us, we're seeing people returning to travel in droves. The costs of travel – everything from flights to car rentals to accommodation – have gone up dramatically in the past few years. The aging population and a new class of wealthy immigrants, combined with a growing consciousness of the need for medical insurance suggests travel insurance is around to stay. It looks to represent a growing segment, especially with the pent-up demand of the past few years.

RISK MANAGEMENT

With all the trends in place and continued inflation, Canadians should be looking for broker advice when putting together their personal insurance packages. Brokers can help clients to see where they're most susceptible to risk and help with risk mitigation to compensate for rate increases – simple things such as installation of anti-theft devices and precisely identifying the level of coverage required in various geographic regions.

Rates are continuing to go up. Now more than ever Canadians should be turning to brokers for advice. As the world gets riskier, having an expert to talk to about risk is essential to finding the right coverage at the right price.

Melanie Muise, President, Personal Lines & Travel
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