Canada Midyear Market Report

2023

Gallagher

Insurance | Risk Management | Consulting

Foreword

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The big picture: A tale of two markets

Two distinct markets are emerging as we progress through 2023. On the property side, we are seeing some reductions, but there are still increases on most accounts. Within the casualty and liability classes, we are seeing less challenging conditions.

This market update includes a special spotlight on current trends within the property market and the various strategies being utilized by insurance buyers in partnership with their brokers.

The hard reinsurance market remains a key factor driving capacity constraints within property insurance. Those dislocations were even more pronounced at the market's April 1 renewals.

As anticipated, clients with earthquake and/or less desirable risk profiles (coastal, tougher occupancies, outstanding recommendations, etc.) have experienced more difficult renewals. The impact of inflation on valuations continues to compound many of these pressures, and severe weather events during the first half of the year—following record claims from Hurricane Ian and Fiona in 2022—are adding further operational friction and loss cost pressures.

Catastrophes are impacting the marketplace more than anticipated. In addition to traditional CAT perils, losses from severe convective storms, wildfires and flooding are impacting market conditions in 2023 so far.

At this stage, it seems likely the challenging headwinds within the property business will continue through the rest of the year and most likely into 2024.

Competition returns to the rest of the market

Within casualty, a steadier market trend is developing.

As our premium trend charts demonstrate, pricing increases are beginning to ease for many casualty lines of business, including those that experienced severe capacity constraints over the past three to four years, including cyber and D&O.

Many accounts are renewing at single-digit rate increases, with plenty of choice on the program. Bucking the trend in quite a spectacular way is public D&O, where rates have pulled back from the spikes we saw in 2020, as capacity and competition return to the market.

Market Dynamics at a Glance

Property

Buyers are experiencing challenging renewals, driven by the hard reinsurance market and elevated recent catastrophe claims

Casualty

A more rational market is emerging, but social inflation and nuclear verdicts will continue to challenge pricing trends

Reinsurance

An early indication, based on July 1 reinsurance renewals, would support somewhat of a firm market through the balance of the year

Cyber

Ransomware continues to be a great concern, with new and increased ransomware attacks emerging. Insurers seem to be responding well to these challenges

D&O

An influx of capacity over the past 12 months has brought relief to the space, with public companies enjoying premium discounts

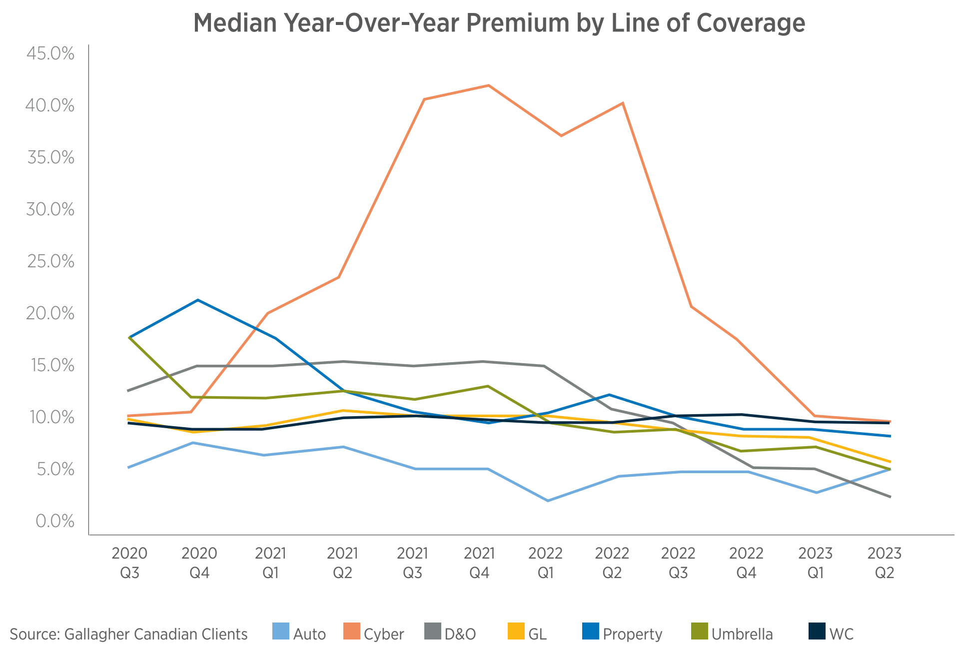
Nonetheless, it is clear that carriers are committed to maintaining underwriting profitability with no sign of the behaviors that characterized the prior soft market. All in all, we see a sensible and sustainable market emerging on the casualty side of the business.

Reasons to be hopeful

The economic conditions continue to leave some uncertainty with regard to inflation, higher interest rates and political interference within the industry. It is uncertain what the overall impact will be on pricing.

Meanwhile, the insurance industry has responded in a sensible way to a number of challenges, including increasing cyber risk and pandemic impacts, and we can expect this approach to continue.

We will continue to reach out early to our clients and present their risk profile transparently to our insurer partners to help navigate this ever-changing market. As ever, our role remains helping our clients manage their risk in all market conditions.



Spotlight on Property: Navigating a Perfect Storm

Key takeaways

- A significant dislocation in the (re)insurance sector is directly impacting pricing and capacity in the primary market, particularly for CAT-exposed business.
- The challenging property market will continue for some time, with inflation, valuation adjustments and rising loss costs as other key drivers, although some risks are seeing flat or minimal increases.
- Overall, rates increased by a median of 8% in the second quarter of 2023 and by 15.7% for the top quartile.
- Pricing and capacity are more challenging for CAT-exposed accounts. There are fewer markets available and, in some cases, cover is not available at any price. This is particularly evident in earthquake zones.

Reinsurance—the unseen influence

We remain in the midst of a challenging environment as far as property market dynamics are concerned, with the rising cost of reinsurance being the dominant trend.

Often described as a driving force, the reinsurance sector is experiencing its most dislocated market since 2005. This is having a direct impact on both how much protection carriers themselves can afford and, as a direct result, the limits they are able to offer.

The hard reinsurance market has been triggered by a series of major catastrophe losses—including losses in excess of $50 billion in relation to Hurricane Ian—and a lack of substantial new capital entering the market. Global reinsurance capital declined by 12% during 2022 to $638 billion, according to Gallagher Re. It comes at a time when reinsurers are reevaluating their exposure to natural catastrophe business, having failed to earn their cost of capital in the past five out of six years (2017–2022).

Unlike previous hard markets—including those post Hurricane Andrew, 9/11 and Hurricane Katrina—we are not yet seeing an influx of capital into the sector to take advantage of the more favorable pricing environment.

Treaty reinsurance renewal outcomes will continue to dominate the primary property market for the rest of the year and likely into 2024.

CAT capacity crunch

The challenging dynamics in the reinsurance market continue to directly impact available capacity within primary property. There are several larger commercial carriers seeking reinsurance renewal at midyear, and we know they are factoring in further price increases.

Insurers are taking on more net risk and increasing their retained volatility. This impacts their own CAT capacity deployment and aggregation management, pricing, and the overall limits carriers are able to deploy. It also influences attachment points and pricing.

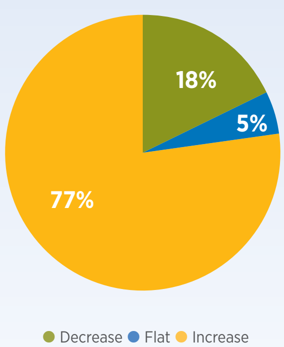
The most obvious impact at present can be seen in the outsize rate increases for CAT-exposed risks. We are seeing an increase in the number of insurers it takes to complete a program, with many incumbent markets cutting back on their expiring capacity.

Some carriers are holding back capacity for new business at opportunistic pricing, with rates for CAT-exposed portfolios seeing average increases of 30% during Q1 2023.

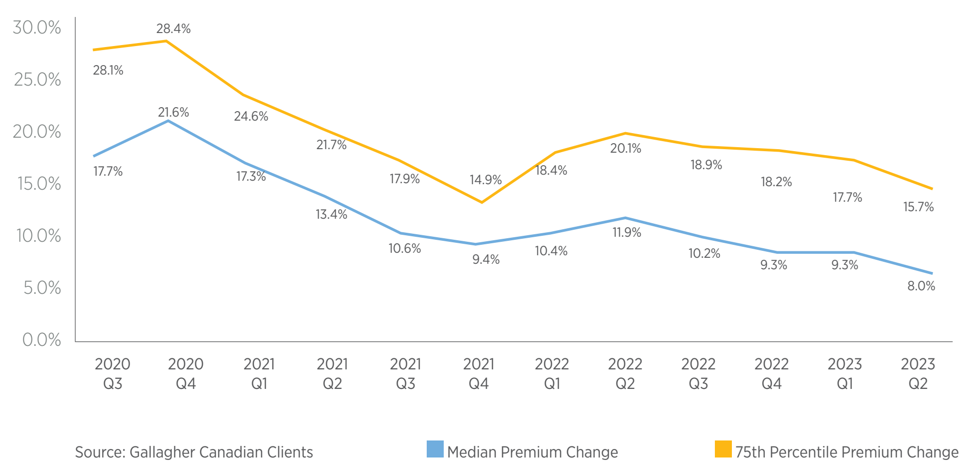
Overall, there is an absence of significant new capacity due, in part, to a lack of confidence in the market's ability to price extreme volatile risk. Property books with assets in British Columbia and/or significant earthquake exposure are experiencing rates in excess of these averages, often with lower CAT limits and higher deductibles/retentions.

Insurers continue to adjust their catastrophe exposures in an effort to manage their portfolio aggregates (and reinsurance spend). And for European insurers, the strengthening of the US dollar has eroded how much risk capital they have available for North American exposures. Capacity on offer via MGAs and other delegated authorities has also been significantly curtailed.

Q2 2023 Property Premium Changes
Gallagher — Canadian Clients



Property Premium Trends



Secondary perils reexamined

The attritional impact of secondary catastrophe perils (most recently detailed in Gallagher Re's Q1 Natural Catastrophe report) is further denting (re)insurer appetite for CAT-exposed risks. Atmospheric rivers and severe convective storms (SCSs) during the first three months of the year drove insured losses to nearly $10 billion, resulting in one of the most costly first quarters on record.

There is growing evidence that lightly modeled or non-modeled events, such as wildfires, derechos and atmospheric rivers, are increasing in frequency and magnitude.

As a result, insurers are charging more premium to these types of loss drivers.

We are seeing more scrutiny of accounts previously considered to be non-CAT exposed. Clients with exposure to wind, wildfire and/or severe weather events across the country may now be seen as riskier than in the past, with additional loadings and/or exclusions applied.

Deductible trends

- Increased deductibles, in particular for water damage, as the loss trend continues to rise
- Increased percentage deductibles for earthquake
- Increase in named windstorms deductibles, which we are seeing in the US and may start trending in Canada, from 2% to 5% (Florida is generally now 5% across the board, with some clients taking even higher)

NOAA continues to expect an above-normal season in the North Atlantic, although it is worth keeping in mind that an active season does not always result in a major landfall, just as it only takes one major loss in an otherwise benign year. Meanwhile it is always earthquake season, as we were reminded by the February 6 earthquake sequence in Turkey.

Inflationary impacts continue

Global inflation and economic uncertainty are causing an increase in the cost of capital, driving up loss costs and adding to rising property rates. Supply chain backlogs are easing in comparison to 2022 but remain a factor when considering potential rebuild and restoration costs.

Generally speaking, the increased cost and uncertain availability of construction materials and labor are resulting in more downtime and business income losses, which are becoming a larger percentage of the overall loss.

Carriers are demanding up-to-date valuations where inflation has caused insurable amounts to rise, especially in regions that are exposed to natural catastrophes. This is in part due to additional concerns regarding the impact of demand surge on loss costs following an event.

We are seeing an increased focus on inflation in all renewal discussions, with underwriters seeking to better understand how clients are determining the replacement value of their assets. Many of these are being updated for the first time in a while, and this is creating significant operational friction.

Clients who have seen values remain unchanged and/or unsupported are seeing their rates increase dramatically, a reduction in capacity offered and, in some cases, submissions falling to the bottom of the pile.

Increased values are, however, leading to more demand for all-risk covers and increased CAT limits, further exacerbating the ongoing supply-demand imbalances in the property market.

Buyers look for alternatives

Looking ahead, clients continue to anticipate challenging property renewal. Buyers may choose to retain more of the risk, opting for higher deductibles or self-insurance, or seeking coinsurance for certain layers.

An absence of peak zone catastrophes in 2023 could alleviate some of the market pressures in the near term, but other factors will continue to drive market conditions.

More favorable renewal pricing and terms exist for clients with secure incumbent capacity and attractive risk profiles, including those with up-to-date valuations. Buyers with single admitted carriers and a clean loss history are achieving a better result in the current market, with rates in the single digits to low teens.

A strong risk profile also helps prevent claims and losses, further reducing costs and optimizing your total cost of risk. You can improve your risk profile through risk exposure reduction, implementing loss prevention programs and selecting appropriate insurance coverage. Insureds are using all the tools at their disposal to minimize the impact of the hard market, buying what they can this year and demonstrating a willingness to consider

Terms and conditions continue to tighten

- Buyers unable to meet minimum valuation metrics receiving disproportional rate increases, decreases in capacity and more restrictive terms
- More restrictive language around valuation
- Carriers dissatisfied with the accuracy of the reported values may decline coverage
- Increasing values may impact the CAT coverage that carriers are willing to deploy
- Decrease in sublimited coverages
- Increasing rate pressure and deductible increases for property in earthquake zones, as well as reduced capacity

all the alternatives. This includes options that lie outside of traditional markets, including alternative risk transfer via captives and parametric structures.

They are retaining more risk with either percentage deductibles, self-insuring, purchasing less catastrophe coverage or—worryingly—in some cases, choosing to insure to a limit less than the replacement cost.

In the latter situations, underinsurance is a critical concern, leading to downstream issues with lenders over noncompliant loan covenants, and opening up the potential for claims disputes, lengthy periods of business interruption and significant uninsured cost burdens should a loss arise.

Captive owners are continuing to make more use of their vehicles, benefiting from broader, more affordable coverage that is tailored to their risk profile. They are also gaining more direct access to reinsurance markets at a time when these relationships really count. Buyers with captives are funding additional layers throughout their programs.

Meanwhile, the hard market is pushing non-captive owners to explore risk retention solutions for the first time, as they carry out due diligence on the various captive jurisdictions and structures, and assess the setup costs and time involved.

Clients are also exploring alternative risk transfer options such as ILS and parametric products to secure the CAT coverage they need.

As we have seen in previous hard markets, some of this business may not come back into the commercial markets, even after traditional capacity returns and rates begin to stabilize.

> “Property renewal premium increases across Canada appear to be stabilizing throughout the first half of 2023. We have observed average premium changes ranging from flat to increases of 10% on accounts with a good loss history. Most insureds will encounter renewals in the lower half of this range. The top end of this range is largely reserved for insureds with losses or significant exposure to British Columbia (BC) earthquake risk.
>
> While the magnitude of premium increases seems to be tapering off for some policyholders, we are cautious to say that this downward trend will continue throughout 2023. Insurers have taken note of record wildfires and remain vigilant toward BC quake risk.
>
> **Tyler Averill, President, National Sales, Gallagher**”

Casualty: Premium Increases Start to Stabilize

Key takeaways

- We continue to see moderate premium increases across casualty lines, particularly within auto, general liability (GL) and lead umbrella business.
- Social inflation continues to impact the casualty market, driving premium increases. We can expect this to continue for a number of years.
- There is more choice of markets at renewal, and capacity is even returning to mid-excess layers.
- The uncertain economic environment could start to impact claims trends.
- In emerging risk areas, such as PFAS chemicals and biometric privacy, breaches are being monitored closely, with carriers introducing exclusions (BIPA).

A steadier market is emerging within casualty classes of business, with competition and capacity coming back in. We are seeing steady premium increases ranging from 5%–7% in Q2 2023 primarily in GL, auto, umbrella and excess coverage.

Having seen substantial pricing corrections during 2019–2022 (stabilizing the effect of the soft market that preceded it), a certain level of pricing moderation was anticipated. The decision by many clients to take on substantial risk retentions is also subduing the rate of price increases, even where the exposure remains the same.

There is more competition in the low to mid layers of the excess liability placement, while the lead umbrella marketplace remains limited. More markets are willing to provide premium relief above certain attachment points in the excess liability tower.

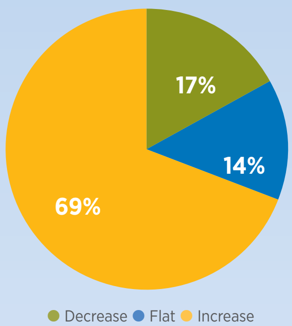
Auto liability premiums have yet to stabilize. General inflation and the activities of third-party litigation continue to drive pricing upward. Supply chain disruptions and labour shortages have eased, but the cost of repairs remains much higher than in the pre-pandemic era. The premiums increases of the past three years have gone a long way toward creating a market that is more stable and sustainable from a carrier perspective.

General inflation is driving up the overall level of exposure and cost of claims, ultimately resulting in higher premiums and creating additional pressure for insureds. We are working with clients to review their coverages and the feasibility of retaining more risk in order to reduce these costs.

In the US, social inflation continues to impact casualty classes, with an exponential growth in settlement amounts. The median verdict against corporate defendants increased 95% from 2020 to 2022, reaching $41.1 million. The total costs of these verdicts in 2022 amounted to $18.3 billion, with 20 verdicts surpassing $100 million and four exceeding $1 billion.

We could see the cost-of-living crisis impacting the size of settlements within GL, auto and umbrella business, as jurors become more likely to factor current financial challenges into their considerations.

Q2 2023 General Liability Premium Changes
Gallagher — Canadian Clients



This is against the backdrop of an ongoing trend toward more sympathetic juries and wider public sentiment against corporations. In New York, a law has been passed requiring defendants to disclose how much coverage they have in place within 90 days of answering the complaint. Together, these developments will continue to drive severity.

Carriers move to exclude emerging risks

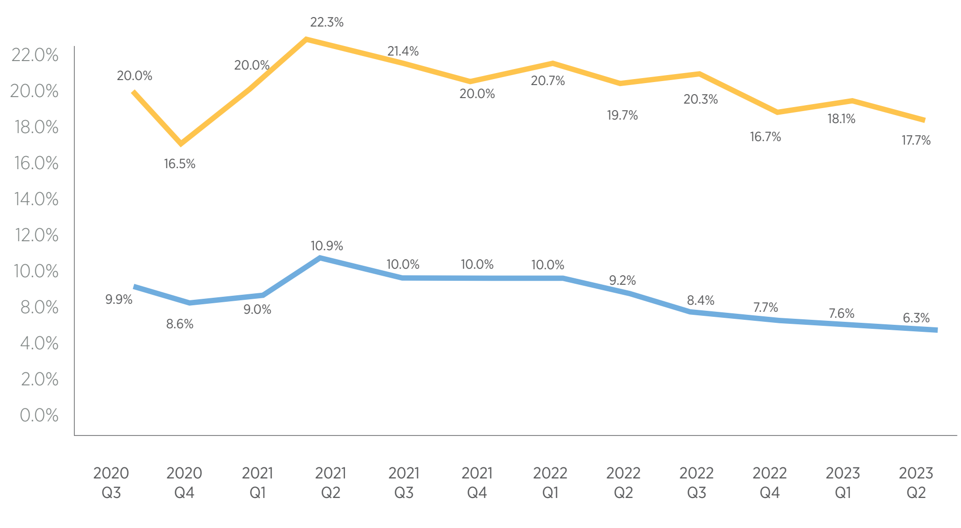
While it is impossible to predict if and where the "new asbestos" will arise, claims involving PFAS (a group of over 4,000 chemicals called per- and polyfluoroalkyl substances) are becoming more prevalent. By their nature, these pollution claims typically involve multiple carriers and policy periods, with settlements ranging from millions of dollars to $4 billion. It is likely we will see more exclusionary wording in GL policies going forward as a result.

As we approach renewals, clients need to be prepared to answer tough and new underwriting questions relating to emerging issues, and/or accept the introduction of mandatory exemptions.

Meanwhile, we are continuing to work with insureds to manage the impact of inflation on their programs, specifically by converting to noninflationary exposures and/or negotiating audit swings.

For those in tougher classes of business and distressed industry sectors, where harder market conditions continue to prevail with no end in sight, it pays to consider selective self-insurance strategies via captives or other risk retention structures.

General Liability Premium Trends Q3 2020–Q2 2023



Source: Gallagher Canadian Clients

Commercial auto premiums have been impacted by general inflation, increased litigation and rising costs of equipment and repairs, but we are seeing light at the end of the tunnel.

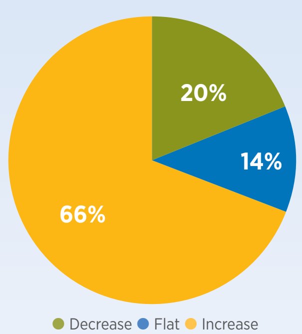
Profitability has returned to this line of business, easing premium increases and moving us toward a more stable marketplace. Carrier competition has increased and I expect to see the auto market continue to improve.

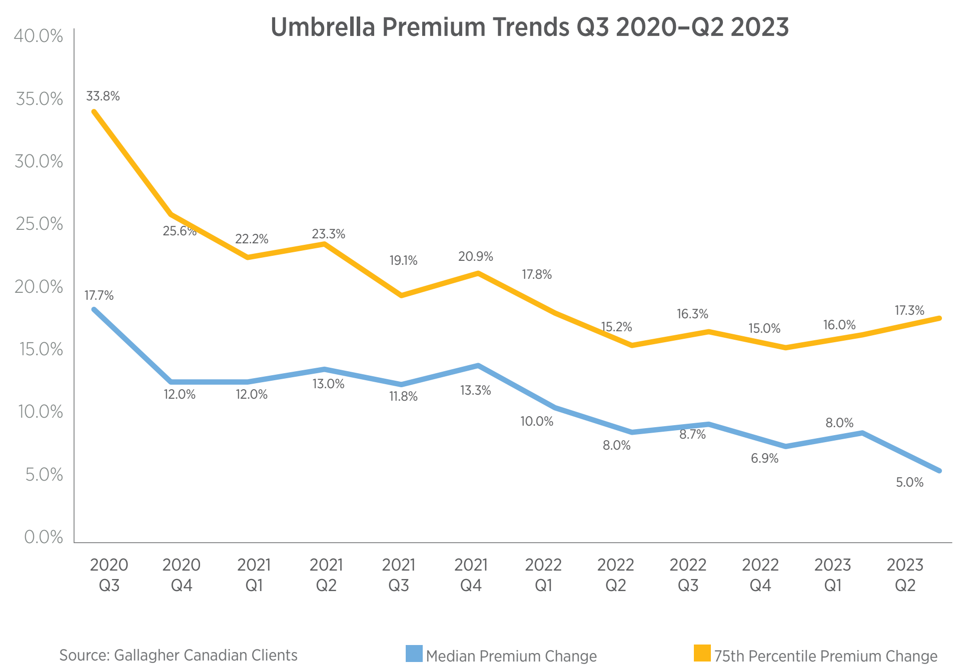
We are seeing low to mid single-digit increases on average, as an attempt to keep pace with inflation, with increased competition as carriers are now trying to grow the automobile portfolios. Equipment and repair costs, social inflation and inadequate loss control practices are certainly still areas of concern.

In the long-haul transportation market, excess auto liability remains a challenge, with limited capacity and rates that remain high, particularly with companies who have higher US exposure.

Joe Palmer, SVP and National Practice Leader, Transportation, Gallagher

Q2 2023 Umbrella Premium Changes
Gallagher — Canadian Clients





Cyber: Industry Responds to Ransomware Losses

Key takeaways

- Competition has returned to the market after a short, sharp correction, driven by improved loss ratios during 2022 and has resulted in more attractive levels of pricing.
- Carriers have introduced tighter policy language to limit their exposure to potential systemic risks, including cyberwarfare. Many of these exclusions have yet to be properly tested.
- Capacity is coming back in, either through incumbents, MGAs and/or start-ups, resulting in improved limits and a flattening of rate increases.
- In some cases, clients with superior security controls have been able to secure a discount on their premium and/or better terms and conditions.
- The threat landscape remains rich and evolving, with ransomware activity up during the first quarter of the year (after dipping in 2022).
- There is heightened attention on the potential for risks arising from AI.

The insurance industry's sensible response to the frequency and severity of cyber losses over the past several years has helped bring more stability back into the market.

From its peak in late 2021 and early 2022, rate increases have begun to flatten, particularly for accounts that can demonstrate a sophisticated approach to cyber risk management. For some, there is now an expectation of premium discounts.

A combination of new wordings to address accumulation risks, clearly communicated risk appetites and improved risk controls are giving underwriters much greater comfort levels than was the case three years ago when the market began its substantial correction.

Capacity has come back into the market, attracted by a more favourable pricing environment and improvement in loss ratios over the past year. Existing carriers are willing to deploy more limit, and we have seen the arrival of a number of start-up carriers and MGAs into the space.

While claims have not disappeared, we did not see as much ransomware activity over the course of 2022, in part due to an improvement in insureds' security controls. The decrease in claims activity resulted in improved loss ratios for insurers, reassuring underwriters that current pricing levels are more reflective of the underlying risk.

Cyber insurers continue to demand that clients demonstrate strong levels of cyber hygiene in order to qualify for cover.

Ransomware activity levels resume

The threat landscape continues to evolve, with cybercriminals continually seeking to exploit new vulnerabilities and circumvent existing security measures.

We have seen an uptick in ransomware activity during the first half of 2023 which will be a factor at upcoming renewals. Meanwhile, business email compromise and social engineering are becoming more sophisticated and costly, with AI tools offering cybercriminals the capability to develop more convincing scams.

From a severity perspective, the average cost of a data breach continues to rise year over year, with corporate risk and insurance managers frequently citing business interruption and reputational damage as among their primary concerns.

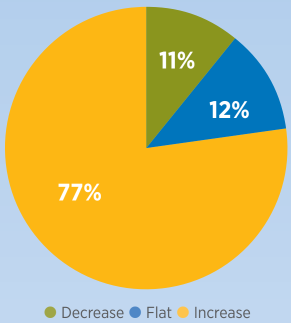
Systemic risk remains an ongoing concern for the reinsurance industry, with a strong appetite to limit exposure to scenarios such as prolonged cloud outages. Meanwhile, non-cyber markets continue to focus on potential silent cyber exposures to ensure their policies are clear on where cyber coverage begins and ends.

Wordings have tightened, with carriers moving to explicitly exclude cyberwarfare and/or state-sponsored attacks, although it has yet to be seen whether such exemptions will stand up to legal scrutiny.

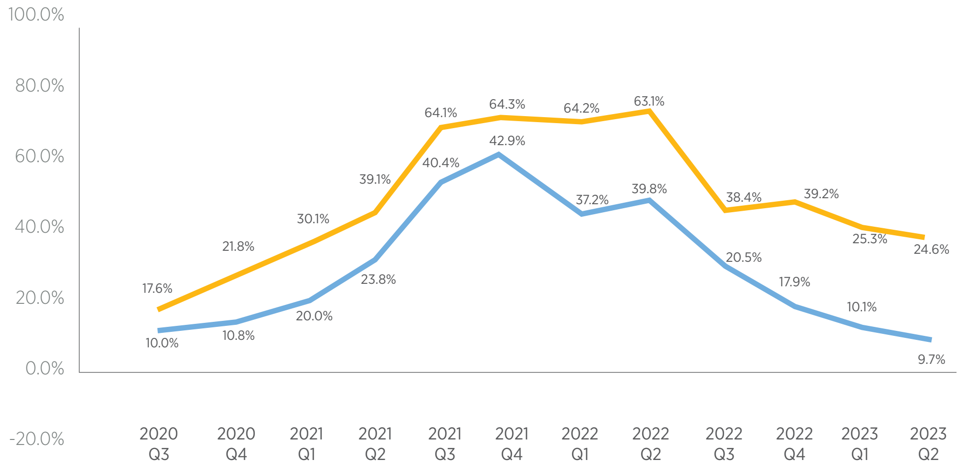
Loss modeling continues to be essential for quantifying the impact of a cyber attack on an entire book of business. The analytics available to cyber carriers and brokers continues to improve, facilitating the continued growth and innovation of the market.

> "The cyber insurance market has undergone a substantial change over the course of the last 24 months - from significant changes in rate and capacity, to changes in underwriting guidelines and scrutiny toward cybersecurity controls. With the premium stabilization being experienced and the welcoming of new capacity into the Canadian market, we are looking to the latter half of 2023 and 2024 with a refreshed sense of optimism. The changes levied from a controls stance by the insurance market have proven to provide favorable outcomes from a loss ratio standpoint, but with that come different tactics from threat actors in deploying and monetizing their attacks—so we continue to see the severity of claims increasing, and this continues to be front of mind for insurers, especially as it relates to systemic risk and aggregation concerns.
>
> While we have a refreshed outlook on market conditions, the threat landscape continues to evolve and the exposure remains very real and should continue to be a top-of-mind consideration for organizations of all sizes.
>
> **Brian Dagg, Assistant Vice President, Commercial Insurance & Cyber Liability, Gallagher**"

Q2 2023 Cyber Premium Changes
Gallagher —Canadian Clientss



Cyber Premium Trends Q3 2020–Q2 2023



Source: Gallagher Canadian Clients

D&O: Rate Relief as Capacity Floods In

Key takeaways

- Insurers' desire for growth supercede rate stability.
- For private companies, renewal rates are flat or have single-digit increases and, for public companies, there are some significant price reductions. Overall, there was a median premium increase of 3% during Q2 2023.
- Insurers are focused on retaining existing business, often at any price.
- D&O loss frequency continues to be low for public companies in Canada.
- Underwriters are paying more attention to environmental, social and governance (ESG) as a potential driver of greenwashing claims.

After a significant hard market correction, premium increases for private directors and officers (D&O) have eased and begun to decrease for public company insureds. Rates have come down most dramatically for public companies, with significant rate reduction during the first and second quarter of 2023. This follows steady reductions during 2022, which came as a pleasant surprise to clients, many of whom were anticipating further rate rises.

The current downward pressure on rates reflects an increase in competition resulting from an influx of new capacity into the market, attracted by the more favorable pricing environment and a low frequency of securities claims. Some markets that previously only wrote private D&O may now consider public, and vice versa.

New capacity has driven incumbent markets to decrease current rates, primarily due to a lack of growth and a decrease in new business opportunities given capital market conditions (i.e., fewer public offerings). They are willing to secure renewals, even at significant decreases. As a result, legacy and less risky public companies may even see pricing closer to 2019 levels at upcoming renewals.

Inflation continues to add to the financial strain many are currently under. Whether this translates into claims remains to be seen. The wave of insolvencies expected post-pandemic has not materialized, but turmoil in the banking sector continues to play out and should be watched. Defense cost inflation continues to be an issue, as hourly rates in the high single digits have perpetuated for several years, driving the total cost of D&O defense work ever higher.

ESG issues, such as board diversity and investment strategies, have grown in prominence, and claims could arise against growing scrutiny and the backdrop of a rising tide of greenwashing lawsuits and anti-ESG sentiment. Underwriters are requesting more information about clients' commitments on ESG issues and asking what concrete action they have taken to back these statements up.

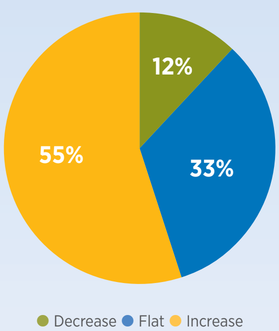
Clients should not forget about the "S" in ESG either, with the unsuccessful action brought against a large pharmaceutical company over its use of race and ethnicity in college admissions being just one example of where company D&Os could be more exposed moving forward.

Other claims drivers remain constant. Governments are setting out aggressive regulatory agendas, with increasingly vigorous stances on bribery and corruption, as well as anti-competitive behavior.

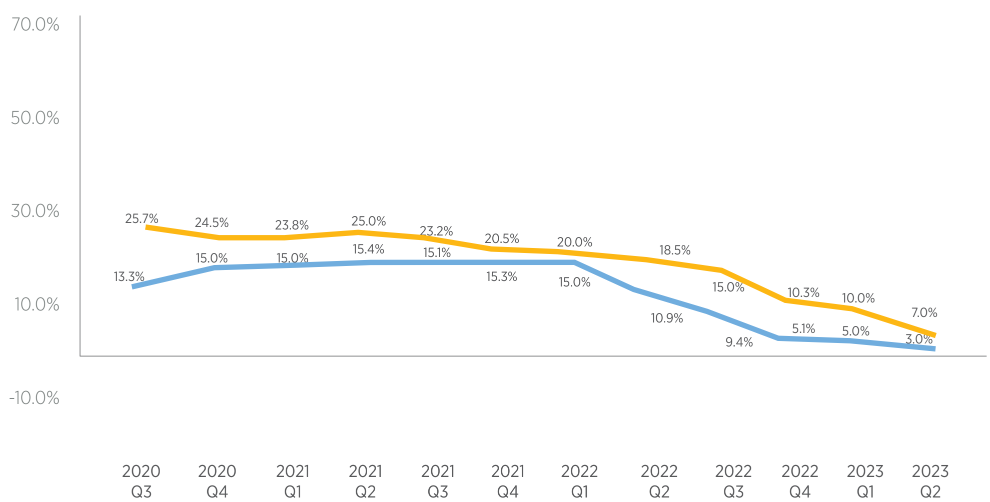
High standards of corporate governance will continue to be important, with underwriters actively seeking out clients that can demonstrate a proactive and transparent approach to governance, corporate culture and executive compensation.

> "In prior D&O market cycles, we have seen overcorrections; rates rise significantly and then steadily drop to unsustainable levels. It appears we are in the throes of the start of the downward trend again. I prefer to see a steady market, but time will tell. Insurers are focused on both growth and retention of existing business, and both tend to fuel market softening."
>
> **Dan Lewis, Senior Vice President, Management Liability Practice Leader, Gallagher**

Q2 2023 D&O Premium Changes
Gallagher—Canadian Clients



D&O Premium Trend



Source: Gallagher Canadian Clients

Median Premium Change

75th Percentile Premium Change

About Our Data

Gallagher Drive® is our premier data and analytics platform that combines market condition, claims history and industry benchmark information to give our clients and carriers the real-time data they need to optimize risk management programs. When used as part of **CORE**360®, our unique comprehensive approach to evaluating our clients' risk management program, Gallagher Drive creates meaningful insights to help them make more informed risk management decisions, find efficient use of capital and identify the top markets with the best solutions for their risks.

Rate changes in this report were calculated by using the changes in premium and exposure of Gallagher clients renewing in Q2 2023.

About the Contributors

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As chief marketing officer, Kevin fosters our many long-standing carrier partnerships to leverage and negotiate competitive, tailored insurance solutions for our clients. In addition to his chief marketing officer role, Kevin serves as president of Western Canada, supporting area presidents and business growth in the west.

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For more information, contact your local Gallagher representative.

*Source: Gallagher Drive Canada Client Data, January 2023–March 2023. The median is the value separating the upper half from the lower half data sample (or the middle value). Seventy-fifth percentile rate is the average of the top 25% of Gallagher client accounts that received the highest rate increases. Due to the variability that we're seeing in this market and specific account characteristics, individual rates may vary.

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