Spring/Summer Market Update

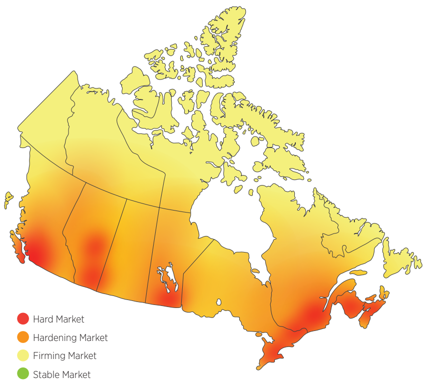
June 2020

Gallagher

Insurance | Risk Management | Consulting

The disruptions caused by COVID-19 have had a pronounced effect on businesses and everyday life. Across the insurance industry, communication channels have stayed open, submissions are being underwritten, and insurance renewals are being bound.

The table and heat map below show overall pricing and most lines of coverage are firming or hardening in the current marketplace.



LINE OF COVERAGE	CURRENT MARKET PLACE (Range of rate increases)
Property	15% to greater than 25%
Casualty	5% to 10%
Commercial Auto	Flat to 10%
Umbrella	Flat to greater than 10%
Management Liability (Public)	Greater than 20%
Management Liability (Private)	Flat to 10%

This is not the case for many of our clients who may have had to temporarily close their doors or scale back operations. Recognizing the difficult times these clients are facing, many of our carriers have offered relief through extended payment terms, and are allowing midterm exposure changes and premium reductions.

Legislation is very active as insurance regulators are issuing various orders to support policy holders nationally. These have ranged from requiring carriers to extend payment terms to issuing return premiums on certain lines of coverage. While we continue to monitor these updates on behalf of our clients, the position some of our carriers will take on these orders remains uncertain.

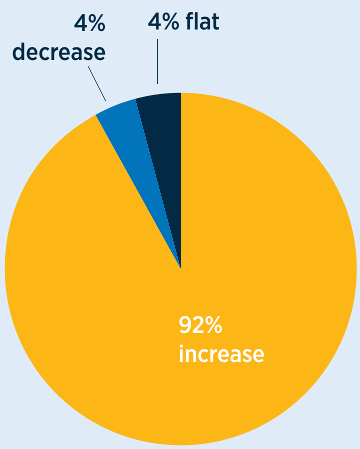
Leading up to Q2 2020, what had been driving the marketplace was fairly simple — for years, the industry's rates hadn't kept up with the loss cost trends. Put another way, rates stayed flat, but costs went up. In a normal environment (where interest rates are above 0%), insurance carriers can still make money on the investment income portion. When you combine interest rates holding at 0% for an extended period of time with severe weather trends and social inflation, you get the majority of clients experiencing sizable increases in 2019 for the first time in years.

While much of the recent focus has been on the industry's response to COVID-19, the challenging market conditions that were reported in our Winter Market Update haven't slowed down. Carriers remain intensely focused on underwriting discipline, ensuring they secure the right terms and pricing on certain lines of coverage that have historically not performed from an underwriting standpoint. As a result, we continue to see extreme differences in how the market is responding between classes and sizes of business.

Taking this into account, we will focus on these key general trends:

1. Overall property costs accelerated faster than anticipated in the first Q1 2020.
2. Casualty continues to be impacted by mega verdicts.
3. The hard market still exists in pockets.
4. Public company D&O is the most distressed line of coverage in the marketplace.
5. Cyber exposure has shifted with the changing nature of the remote workforce.

Q1 Property Rate Changes
Gallagher - Canada Clients



> “92% of clients saw a rate increase in Q1.”

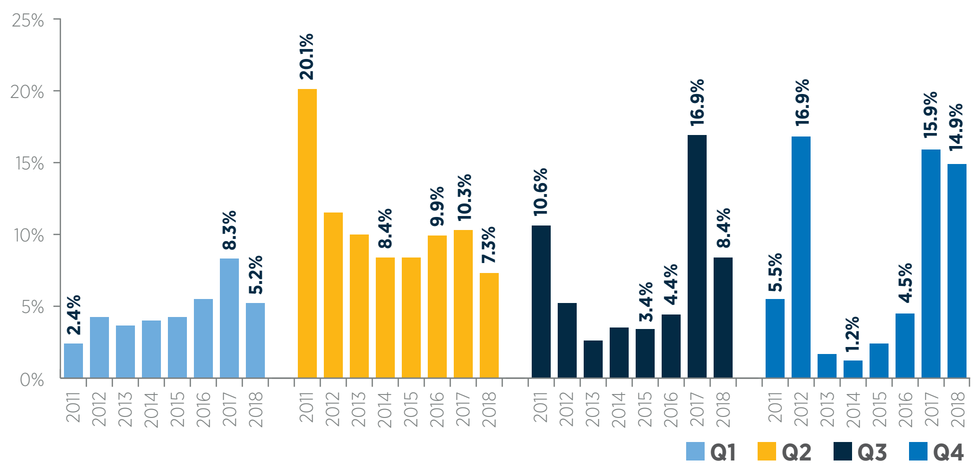
Property

Overall property costs accelerated faster than anticipated in the first quarter of 2020. Like many other lines of insurance, the property marketplace needed to increase rates to offset the increase in loss costs. In addition to rising rates, carriers have scaled back on discretionary limit deployment, and issued tougher terms and conditions.

- 92% of Gallagher clients saw a premium increase in Q1 2020, the highest number recorded since the early 2000s.
- 68% of Gallagher Canada clients saw >10% property rate increase in Q1. 36% of clients saw an increase excess of 20%.
- Clients with significant claims and risk exposures are seeing rate increases from 25% to 50%.
- Capacity remains a significant issue for large property programs. We are seeing a reduction in line size from carriers and an unwilligness to follow lead terms. Carriers that previously would offer 100% capacity are commonly reducing line size to 30% to 40%.
- Quota Share programs are increasingly difficult to fill, shifting focus on parallel programs to support partially filled Quota Share programs.
- Many carriers are requesting different conditions, in particular for Property Damage and Time Element coverages and are now trying to input margin clauses amongst others, including communicable disease endorsements.
- Increasing deductibles, shrinking sublimits (especially CAT), and carriers’ conservative limit deployment have led to less favorable terms and conditions for clients.
- Some industries — including habitational, public sector, healthcare, plastics, molten metals, and clients with CAT exposure (including hail) — are seeing above average-rate increases and a generally harder market than the rest of the marketplace.
- With the uncertainty regarding COVID-19 and carriers’ potential exposure to business income losses, all eyes will be on the upcoming CAT season.

CATASTROPHE CLAIMS BY SEASON

Catastrophe claims as % of total claims



Historically, the second and third quarters are the largest from a CAT storm perspective. Catastrophic storm actvitity for the remainder of this year is still an unknown.

Based on the above, as well as the uncertainty around the COVID-19 pandemic, we expect the current conditions in the property marketplace to continue, if not accelerate, through the end of 2020.

Losses are net of reinsurance but include loss adjustment expenses. Sources: ISO PCS; Insurance Information Institute calculations: https://www.iii.org/presentation/industry-update-yesterday-today-and-tomorrow-101519

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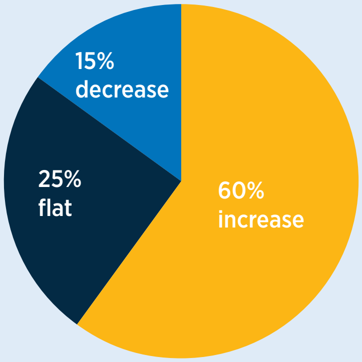
Q1 Primary General Liability Rate Changes
Gallagher - Canada Clients



"60% of clients saw a rate increase in Q1."

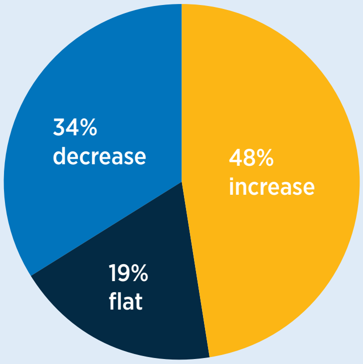
General Liability

General liability costs continued to rise in Q1, as the overall legal landscape shifts in North America.

- The frequency of large judgments, increases in litigation financing and an empowered plaintiff bar continue to challenge our industry.
- Clients with tougher product exposure, or those operating in healthcare or other sectors where they are susceptible to higher frequency of lawsuits, can expect larger rate increases.
- An item the industry will certainly watch is whether there is a liability exposure arising from failure to adequately follow and communicate public health guidelines such as their responsibility to provide personal protective equipment (PPE).
- Insurance carriers are beginning to introduce or enhance their communicable disease exclusions in response to COVID-19.

Even though loss costs have been rising, plenty of capacity remains. We expect a firming rate environment to continue, with rate increases in the mid to high single-digit range for desirable risks.

Q1 Commercial Auto Liability Rate Changes
Gallagher - Canada Clients



"48% of clients saw a rate increase in Q1."

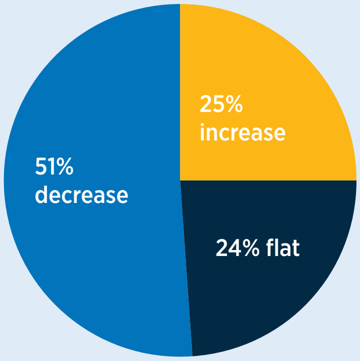
Commercial Auto

Despite recent year's price increases in auto liability, rates continued to increase in Q1 as the price increases are still not keeping pace with the increases in claim frequency and severity.

- Clients with high loss runs are seeing significant increases above 30% to 50%.
- Loss costs are rising as new technologies make vehicles more expensive to repair. We expect carriers to continue to push rate increases across the board in auto liability.
- Maybe more so than any other line of coverage, auto insurance has been directly impacted by COVID-19 with some estimates that vehicle usage is down 50% since mid-March.

Almost every major auto carrier for personal lines of insurance has outlined plans for premium rebates to customers, largely in the 15 to 20% range for two months. How will the commercial insurance sector respond to this change in exposure? We are expecting to see auto rates level off with the reduction in exposure (kilometres driven) related to COVID-19.

Q1 Umbrella/Excess Liability Rate Changes
Gallagher - Canada Clients



"49% of clients saw a rate increase or remained flat in Q1."

Umbrella/Excess Liability

Umbrella and excess liability placements have been affected by social inflation (generally defined as an increase in insurance costs due to rising litigation, larger jury verdicts and overarching anti-corporate sentiment in the economy). Q1 rates remain favourable however, early Q2 numbers suggest we should expect an increase in line with what we are seeing in the US and the rest of the Canadian market.

- Carriers are increasing their attachment points. Few will attach below $2 million, or $5 million for significant auto exposure, and they are looking to reduce line size.
- Social inflation goes to the sensibility of juries and how that translates into the expected value of claim outcomes.
- Carriers are pushing significant rate increases on clients with heavy auto fleet exposure or operating in higher hazard industries.
- Carriers are also restricting the amount of limit they are willing to put forth, or repositioning their capacity at a higher level. For example, carriers that have historically offered lead $25 million umbrella policies are now limiting their lead positions to $10 million or less in most cases. Many are reluctant to be the lead umbrella carrier.
- Capacity management has been a recurring message from the market. Carriers want to limit their exposure to these higher umbrella/excess layers. We have had multiple instances of clients not being able to buy the limit they purchased last year because of lack of availability.
- Umbrella and excess lines carriers are beginning to introduce or enhance their communicable disease exclusions in response to COVID-19.

Underwriters need to return to making money underwriting. Accordingly, we do not expect much change in the casualty environment for the rest of 2020. General liability and auto costs will continue to climb modestly; umbrella/excess pricing will rise, and higher umbrella/excess layers will be limited; and the industry will keep a careful watch over the impact of COVID-19 on the marketplace.

The Hard Market Still Exists

While the hard market is not as severe as compared with the market of the early 2000s, pockets of the marketplace certainly resemble that of a traditional hard market.

In particular, realty and manufacturing (especially if a hazardous class or if with high values) are increasingly challenging classes to place. Large construction projects are tough to place and capacity issues are straining excess liability placements on transportation accounts. Any account with high property values is facing capacity issues currently.

While the market has several difficult to place industries, there are still many favourable classes of business. As a broker, the challenge becomes balancing carrier negotiations to place both desirable and difficult risks.

PROPERTY

- Limits: $100 million + TIV
- Frame/hab/auto/dealer
- CAT exposure
- Molten metals
- Food/agribusiness
- Plastics/polycarbonate tech
- Any locations with large hail exposure
- Outstanding engineering recommendations

UMBRELLA EXCESS

- Large limits: $25 million + capacity has diminished, and pricing has dramatically increased (mega-verdicts)
- Any underlying exposure with a large fleet
- Any underlying exposure with a moderate hazard GL exposure (especially construction)

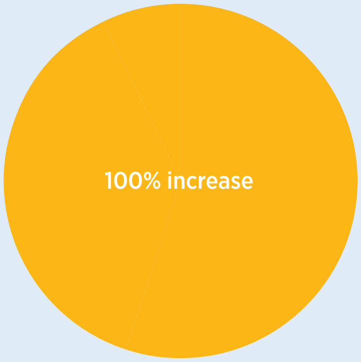
EXECUTIVE LINES

- Limits $15 million +
- Publicly traded D&O
- Sexual abuse and molestation

INDUSTRIES

- Senior living
- National accounts
- Transporation/logisitics
- Marine
- Habitational
- Nonprofit
- Public sector

Q1 Primary D&O Rate Changes - Public Companies
Gallagher - Canada Clients



"100% of clients saw a rate increase in Q1."

Directors and Officers

More so than any other line of coverage, D&O is more bifurcated between public and private companies. Privately held companies with favorable loss histories are seeing modest rate increases, whereas publicly held companies face an entirely differently marketplace, as listed below:

Capacity

- Carriers are often reducing capacity and reducing or eliminating sublimits on publicly traded accounts.
- Fewer carriers wish to write primary and first excess D&O layers for public companies.
- Capacity for private companies is still plentiful, but loss experience is deteriorating.

Terms and conditions

- Cyber exclusions are being added in some cases.
- Bankruptcy exclusions are possible when financial condition is weak.
- Automatic renewals and 3-year deals are not commonly seen.

Pricing

- Very dependent on market segment, financial condition, claims history and current pricing.
- Unfavorable industries have seen or may soon see 50 to 100% increases.
- Typical commercial D&O renewals with no claims or financial concerns can expect increases of 10-20%.
- The Q1 rate data above does not reflect the current market environment, as many privately held programs are coming off of 3-year deals in 2020 where the rate was locked in. Pricing could rise significantly once the deal expires.

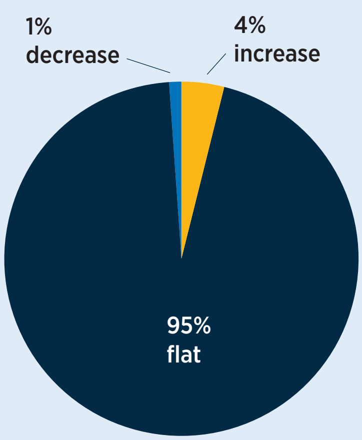
Market segments of most concern

- Oil and gas, mining, and related service sectors
- Financial services
- REITs
- Airlines
- Cannabis
- Life sciences
- Technology

Other tips (all companies — public and private)

- Start the renewal process early. Prepare a more detailed submission than in past years using the available templates.
- Be prepared to share detailed financial information with D&O underwriters including plans to raise capital.
- Information contained in a GL submission is useful to D&O underwriters.
- Plan an underwriting call between interested D&O insurers and the client.
- Reevaluate business continuity plans especially with respect to operations in light of COVID-19 (and in general) with outside counsel.
- Be prepared to proactively address COVID-19 impact with D&O underwriters.

Q1 Cyber Rate Changes
Gallagher - Canada Clients



> "95% of clients rate remained flat in Q1."

Cyber

A Stable Market – But Monitoring Longer Term Trends

Opposed to other lines of coverage, the Canadian cyber market is relatively stable. There are signs of market tightening among the more established players as loss activity grows and as more organizations purchase coverage. Increases on loss-free accounts could be between 5-10% across all sectors. Accounts with claims could see policies non-renewed, or premiums could triple in some cases, where the base premium was historically extremely low.

Competition continues to be robust, with new entrants and new policy forms released regularly. Coverage additions such as 'bricking', 'botnetting', 'contingent business interruption', and 'physical damage', are becoming more common.

The slight rate rise in the Canadian cyber market has been driven mostly by an increase in frequency and severity of ransomware claims that manifested in 2019 and continue into 2020. The 2020 Beazley Breach Briefing* reported a 131% increase in ransomware attacks compared to the previous year. Additionally, reports of seven and eight figure ransom demands are becoming more common.

Heightened Cyber Risk: COVID-19 and the Remote Workforce

With the sudden onset of COVID-19 in March, the majority of the global workforce was moved to remote locations in an effort to stop the spread of the Coronavirus. In doing so, it became apparent for many organizations that their staff may be operating in an environment that is inherently less secure that their normal office space. Questions were raised regarding insecure WiFi networks, the usage of personal devices, video conferencing platforms potentially being open to cyberattacks, and whether or not the increased strain on IT networks could lead to business interruption losses.

While we have not seen an abnormal rise in frequency in cyber claims directly attributed to the employees working outside their normal environments as of this writing, there is evidence of several COVID-19 themed criminal phishing campaigns are being aimed directly at the remote workforce.

Take steps to assess your cyber risk:

- Review cyber polices to evaluate the scope of coverage and how it may cover cyber losses related to the use of employee-owned devices and remote networks. Specific focus should be given on how a policy might define "computer networks", "computer systems" and other key terms.
- Be aware that cyber claims costs for business interruption losses are almost always impacted by waiting periods before coverage will apply and are limited to a specific period of restoration.
- Review policies carefully to see whether any portion of the loss may be covered. For example, if faced with a social engineering loss, it is possible that lost funds may not be covered under the cyber policy and that other policies, such as crime, may apply.

Conclusion

The duration of the pandemic, the magnitude of its economic impact and the subsequent impact on the insurance industry remain unknown. However, the underlying fundamentals we see within the environment today will likely continue for some time; it is rational. There are many reasons for it, and there's nothing to indicate that momentum will slow. If anything, it has picked up in recent months and is broader.

The biggest thing we can do is to be prepared, both from a client and broker perspective. This means being at least 90 to 120 days in front of renewals and having all required exposure information ready at this time. We need to get as complete information as possible in order to allow carriers adequate time to make decisions.

To combat capacity issues, many carriers need to conduct risk inspections (often virtually) in advance to put up higher line limits. The current environment requires more time be budgeted ahead of renewal to complete these on time. Carriers need time to underwrite, time to assess their capacity and, in some cases, time to secure reinsurance on accounts.

Due to the highly nuanced nature of the current market, it is imperative that you are dealing with an insurance broker who specializes in your particular industry and/or line of coverage.

Gallagher has a vast network of specialists that understand your industry and business, along with the best solutions in the marketplace for your unique challenges and exposures.

For more information please contact your local Gallagher representative.
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800.636.8143

For up-to-date information regarding COVID-19, please visit **ajgcanada.com/pandemic**

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