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State of the Canadian Commercial Property & Casualty Insurance Market

Pressures Facing the Canadian Commercial Insurance Market in 2020

November 2020



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Executive summary

The core objective of commercial insurance is to financially protect businesses and non-profit enterprises against the insurable risks that they face. Currently, the Canadian commercial insurance market is experiencing a period of significant change. Several sizable external pressures are negatively impacting insurers, intermediaries, and their clients and creating tension in the commercial insurance market.

The Canadian commercial insurance market became a "hard market" in 2019, which means the market entered a period of higher rates and reduced underwriting capacity for certain lines of business and/or geographies (e.g., commercial property). Years of subpar underwriting profitability, driven by rising claims costs, and low returns on investment led to an overall decline in net income between 2015 and 2019 for property and casualty (P&C) insurers. The environmental and macroeconomic events of 2020 have exacerbated these market dynamics, driven by three immediate pressures:

Immediate pressures

Rise in extreme weather events



Canada is experiencing an increase in the severity and frequency of extreme weather events, which have led to a significant rise in catastrophic losses. Over the last five years, the costs to cover losses from floods, wildfires, and storms have increased, with the highest natural catastrophe loss for a single year occurring in 2016, at the cost of \$5.1 billion.

Insurers, intermediaries, and clients are feeling the impact of these catastrophic events. Insurers face growing volatility in the risks they cover due to the unpredictability of extreme weather, alongside rising claims losses. Intermediaries struggle to place coverage for their clients. Businesses face growing costs associated with extreme weather damage, including property damage, liability costs, and potential incremental costs of doing business (e.g., investments into staff safety).

The frequency and severity of extreme weather events are projected to continue to rise, creating sizable pressure on the commercial insurance market.

COVID-19 pandemic



COVID-19 has created a global health crisis, with a broad range of impacts, including financial strain on the Canadian businesses and the global economy, and changing the risk exposures that insurers and businesses face.

The impact of COVID-19 will be disproportionately felt by certain industries (e.g., Arts and Entertainment, Accommodation and Food Services) and small businesses. Insurers will face greater financial challenges as their clients' risk profiles change, and premium volumes decline due to business closures.

COVID-19 has compounded pre-existing hardening market conditions, exacerbated the tensions between insurers, intermediaries, and clients.

Macroeconomic conditions



Insurers have faced multiple years of low investment returns, driven by declining bond yields. This pressure has been heightened in 2020, as COVID-19 led to unprecedented economic uncertainty and drove Canada into the deepest recession in post-war history.

Economists project that Canada will experience a 5.8% decline in GDP in 2020. Insurers will receive fewer premiums, as a growing number of clients cease operations during this economic decline. While growth is projected for 2021, it comes in a period of record low interest rates (e.g., 0.4% for a five-year government bond), placing further pressure on insurers to improve underwriting profitability to counter the declines in investment performance.

Global macroeconomic conditions remain uncertain and investors are therefore hesitant to provide capital. Insurers may accept less risk and reduce their underwriting capacity to ensure sufficient financial strength to service future claims.

Industry financial performance

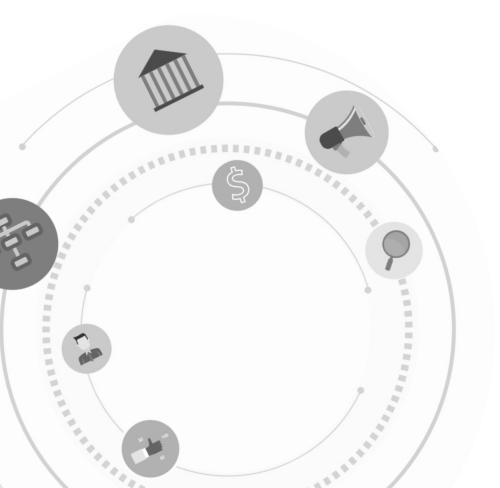
By the end of Q2 2020 (YTD), the P&C insurance industry's financial performance remained strained. The industry experienced a sizable underwriting loss (-\$564 million), alongside a 28.6% decline in investment income. While net income increased by \$138 million compared with 2019 YTD, this was driven by a sizable increase in "other revenue" of \$668 million, which rose largely as a result of accounting adjustments (e.g., reclassification of financial instruments, gains on fluctuations in foreign exchange rates). The increase in net income is not an improvement in the underlying drivers of insurers' performance, as evidenced by the underwriting loss and decline in investment income.

This financial pressure is felt even more by commercial insurers who experienced significant claims losses over this period. The commercial insurance net loss ratio (i.e., net claims incurred as a percentage of net premiums earned) grew by 11.5%, highlighting the financial challenges felt by commercial insurers and their clients.

Preparing for the future

Insurers, intermediaries, and clients must prepare themselves for a continuation of current hard market conditions. A full Canadian economic recovery is forecast for 2022 at the earliest. After this point, the economic impacts on the insurance market will be reduced, which is likely to result in a rise in underwriting capacity and lower annual increases in clients' insurance rates.

However, action is still required in the short-term. Canada's insurers and intermediaries need to find creative solutions to ensure that Canadian businesses can access the insurance they need.



State of the Canadian Commercial Property & Casualty Insurance Market

The Canadian commercial insurance market is in a challenging position.

Over the past decade and a half, commercial property and liability insurance loss ratios (i.e., net claims incurred as a percentage of net premiums earned) have steadily climbed, from a five-year industry average of 57.4% over 2006 to 2010, up to a high of 65.2% for 2015 to 2019¹. Meanwhile, the average premium rate increase has not risen proportionally.

The financial pressure experienced by the Canadian commercial property and casualty (P&C) insurance market is unsustainable. Many insurers have reduced the risk they take on and, in some cases, exited product lines entirely. The result has been a decline in commercial insurance availability and a corresponding rise in clients' rates, as the insurance market adjusts to the new conditions. The shift in market conditions has been exacerbated by the events of 2020. In particular, the impact of COVID-19 is affecting insurers, intermediaries (i.e., brokers and Managing General Agencies [MGAS]), and clients alike.

Historic market conditions

The insurance market is cyclical, with regular rises and falls in insurers' financial capacity to take on certain risks, and a corresponding impact on clients' premium rates. Most recently, the state of the Canadian commercial insurance market began to shift in early 2019. Canada entered a period of higher premium rates and reduced underwriting capacity (i.e., the total amount of insurance

Commercial Property & Liability Net Loss Ratio (5-Year Average)

written by insurers), also known as a "hard market." This occurred after more than a decade of advantageous conditions for businesses, which provided access to sufficient underwriting capacity and favourable rates for insurance coverage.

Loss ratios and combined ratios (i.e., net claims and operating expenses incurred as a percentage of net premiums earned) rose over the past decade, following the last P&C industry-wide hard market, which ended in the early 2000s. Between 2015 and 2019, the P&C five-year industry average combined ratio was 97.5%, up from a low of 92.3% between 2003 and 2007². A market adjustment was required by insurers to maintain their financial security.

Many factors caused the financial challenges that led to these hardening market conditions. Within the insurance industry, there has been an increase in competitive intensity over the past decade. Several global insurers entered the Canadian market, alongside an increase in many insurers' risk appetites as a means to maintain market share and/or achieve growth. These competitive dynamics impacted the ability to increase rates, putting initial pressure on insurers' underwriting profitability. Externally, several major shifts in environmental and macroeconomic conditions over the previous decade compounded these industry dynamics, including a significant decline in return on investment (ROI) from 6.2% in 2003 to 3.6% by 2019³. Ultimately, insurers were left with subpar underwriting profitability, and lower investment returns struggling to offset the worsening underwriting results.

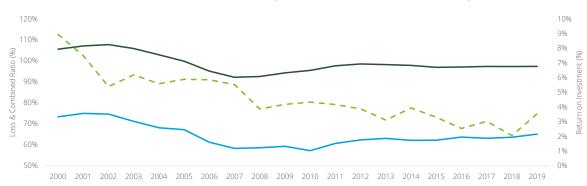


Exhibit 1: Canadian P&C ROI, Loss Ratio (5-Year Average), and Combined Ratio (5-Year Average); 2000-2019

Sources: IBC, MSA, SCOR, AMF*

P&C Combined Ratio (5-Year Average)

^{*}Insurance Bureau of Canada, "2020 Facts of the Property and Casualty Insurance Industry in Canada," 2020, http://assets.ibc.ca/Documents/Facts%20Book/Facts_Book/2020/IBC-2020-Facts.pdf

Immediate pressures

Canadians have a shared interest in making sure that as many businesses as possible can access the insurance coverage they need, particularly in a time of heightened uncertainty and risk. The first step to addressing the needs of Canadian businesses is to better understand the factors affecting the Canadian commercial insurance market today.



Rise in extreme weather events

The increase in frequency and severity of extreme weather events is one of the most complex factors affecting the commercial insurance market. While the rise in severe weather events may lead to increased demand in high-risk regions and for certain insurance products, the pricing of such policies is challenging. Competitive pressures and significant risk volatility, due to the wide fluctuations in weather patterns reduce the ability of insurers to raise premiums to address the growing risks of extreme weather events.

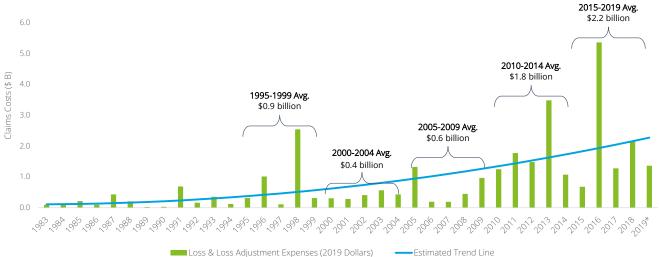
In the last five years, Canada has experienced its most costly wildfire, flood and hailstorm events. Canada's insurers now routinely pay out over \$1 billion a year in losses relating to extreme weather events, with the record high natural catastrophe* loss for a single year occurring in 2016, at the cost of \$5.1 billion. This has had a significant capital impact on the P&C insurance industry, accounting for up to 10% of Canadian P&C insurers' \$52 billion in equity. The rise in losses from extreme weather is a key contributor to insurers' underwriting profit pressures and the shift into a hard market in 2019. In the first six months of 2020, the P&C industry (including personal and commercial lines) experienced over \$2 billion in claims, compared

with \$726 million over the same period in 20194. The frequency and severity of extreme weather events is projected to continue to rise, further increasing the strain on the market.

Canadian commercial insurers increasingly need access to reinsurance to reduce the financial impact of catastrophic losses. Global reinsurance capital has increased from US \$470 billion to US \$610 billion (2.6% compound annual growth rate) between 2010 and 2020. However, catastrophic losses have risen at a faster rate in Canada and globally⁵. Furthermore, global reinsurers' willingness to deploy additional capital into the Canadian market remains uncertain, particularly as capital needs for other global catastrophes, such as COVID-19, have grown. Meanwhile, uncertainty related to upcoming changes to regulatory guidelines for capital requirements in Canada may increase constraints on insurers' risk tolerance, particularly for commercial insurers. The availability and rates for reinsurance in the Canadian commercial market will be a key question over the coming years and will impact insurers' risk tolerance in providing commercial insurance coverage.



Exhibit 2: Catastrophic Losses in Canada; 1983-2019 and Trend Line (in \$billions)



Sources: From 1983-2007: IBC, PCS Canada, Swiss Re, Deloitte; From 2008-2019: CatIQ**

^{*}According to Catastrophe Indices and Quantification Inc. (CatlQ), a catastrophic event is an event that affects multiple policies and causes more than \$25 million in insured damage

^{**}Insurance Bureau of Canada, "2020 Facts of the Property and Casualty Insurance Industry in Canada," 2020, http

Intermediaries Clients **Insurers** · Growing annual claims costs, with • Prioritization of claims support for clients • Increased understanding of the need for greater concerns of geographic risk experiencing high value loss events insurance following significant loss events concentration • Greater scrutiny on ensuring clients · Need for investment into prevention and · Need for enhanced pricing capabilities are sufficiently covered for catastrophic mitigation measures to reduce the cost of to address the uncertainty over extreme losses extreme weather events and limit weather events exposure Reduced focus on premium and market share growth in favour of improvements to underwriting profitability





COVID-19 pandemic

The onset of the COVID-19 pandemic in 2020 has compounded the hardening market conditions. The impact of COVID-19 is a public health crisis causing a systemic risk for the insurance industry, with severe negative consequences across the Canadian economy.

Canadian businesses are struggling and shuttering. This has been driven by government-mandated closures to businesses' physical premises, in addition to Canadian consumers curtailing their spending in certain industries (e.g., Arts and Entertainment, Accommodation and Food Services). The result is that the rate increases that began in 2019 are now occurring at a time when many Canadian businesses are particularly sensitive to fluctuations in their cost structure, including insurance, and are expected to curtail non-essential spending.

The financial strain of COVID-19 has led many businesses to reduce their investment in risk management and loss prevention, due to a lack of available capital. As a result, businesses' risk profiles may increase post-2020, as the accumulation of operational risks (e.g., building damage) may not have been sufficiently addressed. For insurers, this necessitates rate increases for many clients to address the greater risks in their portfolio.

The pandemic has had a disproportionate impact on certain industries and on small businesses*. The most affected industries and businesses are those that have a limited ability to generate revenue digitally and those that were already struggling entering 2020. Mid-2020 projections state that 158,000 Canadian small businesses will close due to the impact of COVID-19, accounting for 14% of small businesses. The Canadian market is disproportionately made up of small businesses, which, as of 2016, represented 75% of Canadian companies and an estimated \$8.8 billion commercial insurance opportunity. As a result, these closures will have a material impact on commercial insurers' revenue, as lost clients translate into declines in premiums.

The impact of the pandemic on insurers and their clients would be more significant without the government's financial support for Canadian businesses, such as the Canadian Emergency Business Account (CEBA) and the Canadian Emergency Wage Subsidy (CEWS). However, as government support programs end during the second half of 2020, the financial pressures businesses face will lead to a rise in business closures.

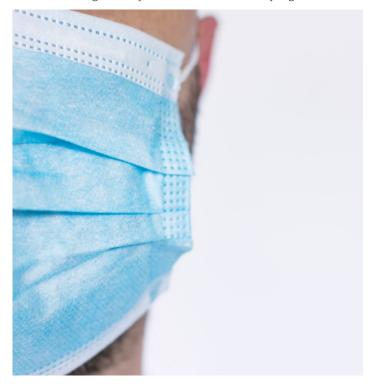
From an insurance standpoint, policy wordings, and particularly those for business interruption coverage, are critical to understanding insurers' exposure to the potential financial impact of COVID-19. Exposure is expected to be small on an industry-wide basis, due to the fact that the majority of business interruption policies have a requirement that the financial losses are caused by an insured peril which resulted in physical damage (e.g., fire). This was a key lesson learned during the 2003 SARS pandemic.

Recognizing that pandemic risk is not generally insurable, many reinsurers have started introducing specific pandemic exclusions in their reinsurance policies with commercial insurers. This was also the case with respect to the 2003 SARS pandemic, when shortly after the SARS pandemic began, most reinsurers introduced SARS-specific exclusions within their policies⁹.

There is still risk of judicial intervention that would result in insurers being forced to cover exposures that are not within their contractual agreements with policyholders. For many businesses required to close because of COVID-19, claims for business interruption losses alleged to have been caused by COVID 19 have been denied, and lawsuits are currently making their way through Canadian and global judicial systems.

A recent ruling by the UK High Court of Justice involving business interruption wordings that were issued by various insurers in the UK resulted in mixed findings on whether policyholders were covered 10. It should be noted that none of these wordings used physical damage as the trigger for the business interruption coverage. These findings were specific to the UK policy wordings and UK insurance law.

If courts were to determine that there is business interruption coverage within the pandemic context, despite the policy language indicating that such coverage was not intended to be provided by insurers, the commercial insurance market may experience significant losses. This would, in turn, disrupt the solvency of many insurers and impact their ability to service future claims. This is a risk that cannot be ignored by insurers or their solvency regulators.



^{*}Defined as companies with less than 10 employees and/or under \$5 million in revenue

Insurers

- Decline in premiums as many clients close their operations
- Focus on enabling self-service digital capabilities and supporting clients with more proactive understanding of their coverages
- Negative reputational impact associated with declined claims, resulting in the need to rebuild lost trust in the insurance industry

Intermediaries

- Greater expectation for brokers and MGAs to have a detailed understanding of policy wording and associated gaps (e.g., pandemic-specific business interruption)
- Need for greater sensitivity to clients' financial circumstances and industryspecific business challenges

Clients

- Reduction of businesses' ability to absorb rate increases due to loss of revenue
- Rising costs to maintain operations during COVID-19 (e.g., PPE, wage increases) may further increase financial pressures
- Launch of new business models (e.g., loss prevention partnerships with insurers, use of captive insurers) to manage costs



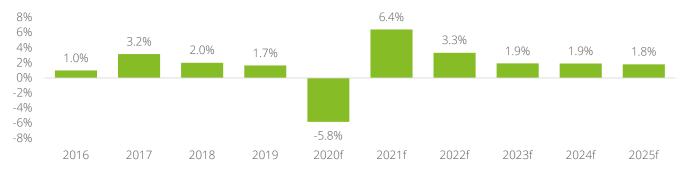
Macroeconomic conditions

The Canadian economy entered 2020 after more than a decade of sustained economic growth, with compound annual GDP growth of 2.1% from 2010 to 2019¹¹.

Throughout 2020, the state of the Canadian economy has been upended, as the COVID-19 pandemic created unprecedented economic uncertainty and the deepest recession in Canadian postwar history. In the short-term, Canada is facing a sizable negative economic impact. This includes a projected 2020 GDP decline of

5.8% for the full year, and an unemployment rate of 8.6% by the end of 2020¹². This projected unemployment rate is an improvement from Canada's 2020 peak of 13.7% in May, however, it is still well above Canada's 2020 Q1 rate of 6.3%. By 2021, economists project that Canadian GDP will grow by 6.4%, helping the economy move past the current recession^{13/14}. Looking forward, the Canadian economy is projected to fully recover by 2022 at the earliest.

Exhibit 3: Real GDP Growth; 2016-2025 Forecast



Sources: Statistics Canada; Deloitte Analysis*

^{*}Deloitte Canada, "Economic Outlook: Strong reopening leads to long recuperation", September 2020 https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/finance/ca-economic-outlook-report-sept-2020-aoda-en.pdf?icid=heroReportLink en.

While global stock markets have achieved record highs throughout 2020 and delivered YTD growth of 8.8% (as of Oct 26, 2020)¹⁵, despite the global recession, this is contrasted with a soft bond market. The 5-year Bank of Canada bond yield declined at a compound annual rate of 10.5% from 1990 to 2020, and remains at \sim 0.4%, as of 2020 Q3¹⁶. Insurers rely heavily on their investment returns—and yields

from government bonds in particular—to maintain healthy capital reserves, which enable them to pay out claims. In an environment of persistently declining bond yields, insurers' investment returns have fallen, placing further pressure on their capital structure.

1990-2000 10-Year Compound Annual Rate
-6.0%

2000-2010 10-Year Compound Annual Rate
-9.5%

2010-2020 10-Year Compound Annual Rate

Exhibit 4: Government of Canada Benchmark Bond Yields: 5-Year Bond (%); 1990-2020

Sources: IBC, Bank of Canada*

4%

2%

0%

The decline in investment returns and their impact on insurers began long before 2020. By 2019, multiple years of poor underwriting returns and a lack of strong investment returns caught up to the industry. At this time, many commercial insurers were already reducing capacity from or exiting select product lines. For example, in 2018, Lloyd's of London (Lloyd's) closed eight syndicates which globally wrote a combined £1.5 billion in gross written premiums. Lloyd's also announced more than 70 exits or significant reductions in capacity for various lines globally¹⁷. The exit of Lloyd's, and other insurers, has had a particularly sizable impact on Managing General Agencies (MGAs) in Canada. MGAs, which can underwrite on behalf of insurers, lost a key source of capital in Lloyd's. As a result, much of the business underwritten by MGAs was shifted to other insurers, increasing many insurers' risk in a time of economic uncertainty.

Insurers are preparing for the current economic environment's impact on their premiums, claims volumes, and losses. Insurance claim frequencies and severities tend to increase during times of economic hardship, and in many cases, this includes a rise in rates of insurance fraud. For example, during the 2008 recession, the Association of British Insurers reported a 17% increase in fraudulent insurance claims compared with the prior year¹⁸.

The uncertainty in global macroeconomic conditions reduces insurers' ability to rely on investment income to achieve profitability. Insurers tend to respond through greater hesitation to take on risks that might negatively impact their underwriting results, further reducing the market's capacity. Additionally, uncertain macroeconomic conditions reduce global investors' willingness to provide capital, creating further capacity constraints.

^{*}Insurance Bureau of Canada, "2020 Facts of the Property and Casualty Insurance Industry in Canada," 2020, http://assets.ibc.ca/Documents/Facts%20Book/Facts_Book/2020/IBC-2020-Facts.pdf

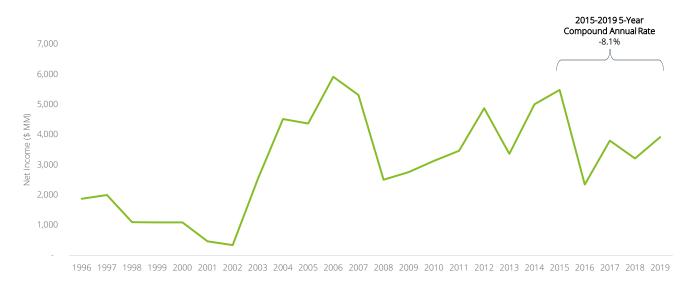
Insurers	Intermediaries	Clients
 Increase in required claims reserves to address potential claims increases Further focus on increasing underwriting 	evolaining lincoming rate increases to	 Rate increases at renewal and for new business projected to average ~10–15% in the short-term
income to balance declines in investment yields		Potential challenges in affording insurance coverage, and greater demand
		for financial support from insurers and governments

Industry financial performance

Industry financial summary

The Canadian P&C insurance industry's profitability has been on a steady decline for the past five years. Since 2015, net income has become more volatile and decreased at a compound annual rate of 8.1% to \$3.9 billion in 2019^{19/20}. While the industry does remain profitable, the underlying drivers of financial performance are all showing severe signs of pressure for insurers. This pressure includes significant declines in underwriting performance since 2015 (-15.6% CAGR) and persistently low investment yields.

Exhibit 5: Canadian P&C Insurance Industry Net Income; 1996-2019 (in \$millions)



Sources: IBC, MSA, SCOR, AMF*

^{*}Insurance Bureau of Canada, "2020 Facts of the Property and Casualty Insurance Industry in Canada," 2020, http://assets.ibc.ca/Documents/Facts%20Book/Facts_Book/2020/IBC-2020-Facts.pdf

During the first half of 2020, industry performance was under strain. Although insurers achieved small improvements in underwriting performance due to the rate increases that began in 2019 and exits of less profitable product lines, an underwriting loss of \$564 million still occurred. Investment income struggled to balance the underwriting losses, as increased volatility in 2020 led to a 28.6%

decline compared with 2019 YTD. While net income increased year over year, this was driven by a \$668 million increase in "other revenue" and would have declined if not for significant accounting adjustments (e.g., reclassification of financial instruments, gains from fluctuations in foreign exchange rates)

Exhibit 6: Canadian P&C Insurance Industry Net Income; 1996-2019 (in \$millions)

	2019 June YTD	2020 June YTD	Year over Year Change
Net Premiums Earned	24,886	28,229	+13.4%
Net Claims and Expenses	17,364	20,116	+15.8%
Operating Expenses	8,322	8,805	+5.8%
Underwriting Income	-668	- 564	+\$105
Net Investment Income	2,335	1,666	-28.6%
Other Revenue	-236	452	+\$668
Net Income	1,165	1303	+11.8%
Net Loss Ratio	69.8%	71.3%	+1.5%
Combined Ratio	103.2%	102.5%	-0.7%
ROI (Annualized)	4.3%	2.9%	-1.4%
ROE (Annualized)	4.6%	4.9%	+0.3%

Sources: IBC, MSA*

Within commercial lines, results have been particularly challenged by the pressures in the external and internal insurance environment. Commercial property and liability lines have not yet experienced declines in net earned premiums, in part due to government subsidies that helped many businesses remain solvent for the first half of 2020. However, claims losses have increased sharply in 2020. The net loss ratio for commercial property has risen from its 2015 to 2019 five-year average of 68.5% to a high of 77.9% for 2020 YTD.

Meanwhile, commercial liability experienced a greater increase, from a five-year average of 60.9% to 86.6%. Further contributing to this negative result was the sizable increase in losses related to natural catastrophes, up from \$726 million in 2019 YTD to over \$2 billion in 2020 (across personal and commercial lines).

Commercial insurance will likely continue to experience financial pressure as net earned premiums fall and claims losses build during this period of economic hardship.

Exhibit 7: Commercial Property & Liability Insurance Financial Performance (in \$millions, except where noted)

	2019	2020	Year over
	June YTD	June YTD	Year Change
Net Premiums Earned	5,996	6,993	+16.6%
Net Claims and Expenses	4,198	5,697	+35.7%
Net Loss Ratio	70.0%	81.5%	+11.5%

Sources: IBC, MSA*

^{*}MSA Research and IBC Analysis, Accessed October 2020, https://www.msaresearch.com/

Key line of business impacts

As insurers re-evaluate the extent of their risk exposure, several industries and commercial insurance product lines have experienced greater impacts than others related to insurance affordability and availability.

Within the Canadian commercial property insurance market, average rate increases upon renewal ranged from 7% to 9% from 2019 Q3 to 2020 Q1* across all industries. Within the casualty insurance market, rate increases were greater and rose from 5% in 2019 Q3 to 10% by 2020 Q1. Auto liability is expected to see one of the greatest rate increases within casualty lines, due to its high historic losses. Lastly, within the commercial auto market, capacity remains stable, but clients can expect double-digit rate increases going forward, with 2019 Q3 to 2020 Q1 increases ranging from 8% to 11%²¹. While industry-wide reporting for 2020 Q2 is limited at this point, it is likely that

the trend towards double-digit rate increases across industries and product lines has continued.

Commercial insurers should remain aware of the disproportionate effect of COVID-19 on some industries. Economists project that the Arts and Entertainment, Accommodation and Food Services, and Transportation and Warehousing industries will experience >15% declines in real GDP during 2020²². Within industries experiencing financial strain, there is greater tension between insurers, intermediaries, and clients, as all stakeholders experience financial challenges due to the compounding impacts of extreme weather, COVID-19, and global macroeconomic conditions.

Longer term considerations

In addition to the immediate pressures of 2020, several long-term trends are influencing the commercial insurance market. While not yet having a material financial impact on the market,—and the underwriting cycle, in particular— the influence of the following trends will continue to grow:



Changing client exposures

Beyond the impact on businesses' exposure caused by extreme weather events, dramatic changes in business and society are impacting the underlying exposure of commercial clients. To date, few clients have sufficiently protected against these exposures, creating a substantial need for new product development and innovation to address these emerging risks. Canada's commercial insurers and intermediaries have a large role in helping businesses better understand and protect against the changing risks that they face.

Growing technological complexity of operations

Canadian businesses are becoming ever more connected and enabled by technology, such as cloud computing, intelligent automation, and ecosystem partnerships. As operations become more technologically sophisticated and interconnected, the potential costs associated with loss events will rise. For example, a single web transaction now crosses an average of 35 different technology systems, with the potential inability to engage with customers if a single system fails. While clients' technology investments have many benefits for insurers, such as access to data for improved underwriting decisions and proactive claims mitigation, the cost of interruptions to operations due to technology challenges will also grow.

Increase in cyber risk

Cyber risks for Canadian businesses are rapidly rising. The Canadian economy faced the third most cyber breaches of any country in 2017, resulting in a loss of \sim \$3 billion in GDP²³. COVID-19 has accelerated digital transformations for many companies, which has exposed them to an even greater frequency of cyber attacks, with

an estimated 250% to 350% increase in ransomware attacks since 2020 Q1²⁴. However, few Canadian businesses are sufficiently aware of the growing risk of cyber attacks, with 33% of Canadian small and mid-sized enterprises (SMEs) spending nothing on cyber security annually and another 28% unaware of their cybersecurity budgets²⁵. Cyber risk is a significantly under-protected area of the market, with the need for coverage continuing to rise.

Rise of the sharing and gig economies

The growth of the Canadian sharing economy (i.e., sharing access to individuals' property, such as home-sharing) and gig economy (i.e., independent, part-time labour) have been sizable. In 2017, the sharing economy was estimated at \$1.3 billion, while more than 8.2% of the Canadian labour force completed some gig work in 2016, up from 5.5% in 2005²⁶. This trend has created a range of new risks driven by an increasingly temporary workforce and the use of assets for both personal and commercial applications. For example, the renting of one's residence to guests through home-sharing platforms creates new commercial property and liability exposures, in addition to the personal property risks still faced. While the COVID-19 pandemic has slowed the sharing economy's growth, many gig economy organizations have experienced an uptake in staff and usage since the start of the pandemic, with an estimated 1.8% growth in the number of temporary workers during 2020²⁷. Canadian individuals and businesses now increasingly require insurance products that cover both personal and commercial risks and are accessible as needed.

^{*}Based on Aon calculations

Insurers	Intermediaries	Clients
 Growing applicability and uptake of innovative new products and services 	 Need for better education of clients on the emerging risks they face 	Increased need for guidance from insurers and intermediaries to
that address the shifting exposures faced by Canadian businesses	 Greater opportunity to partner with insurers to identify gaps in clients' 	understand the risks faced by their business
 Increased emphasis on marketing "sensing" functions to identify future coverage gaps 	coverage and develop new products and services	Rise in loss events associated with emerging risks



Shifting client expectations

The commercial insurance market is focusing on improving its client experience, with a mentality of 'retention as the new growth.' This trend has been amplified during the COVID-19 pandemic, as clients increasingly expect support from their insurers and brokers. Recent media focus on the role of insurers and the importance of covering nuances of businesses' risks has driven uncertainty among business owners and a greater need for trusted advice. Clients are requiring guidance from experienced underwriters and brokers who are experts in their respective industries and truly understand their risks. Additionally, with a significantly slowed economy, clients will not only be seeking advice but also price concessions from their insurers—particularly for clients in industries that are experiencing the greatest economic impacts from the downturn, such as Arts and Entertainment.

Digital direct sales models have been a growing desire for many clients, especially in the micro and small commercial market, alongside growing interest in digital servicing across all client segments. Commercial clients are unlikely to fully revert to analogue methods post-pandemic as they build confidence in using digital tools. Insurance organizations will need to double down on efforts to create leading, digitally enabled customer experiences.

Key impacts on the Canadian commercial insurance market

Insurers	Intermediaries	Clients
Rise in investment into advice capabilities and digital client experiences	Greater need to provide trusted advice to clients during the current uncertain conditions	 Improved client experience and ability to engage with insurers and brokers digitally
Increased use of premium reductions, deferrals and flexible payment plans to support clients	Growing competition with insurers offering direct-to-client sales models	 Need and expectation of financial support throughout the COVID-19 pandemic



Increasing broker needs

Brokers' expectations of commercial insurers are rising. Ease of doing business in the digital age has become a right to play for many insurers, rather than a differentiator. A consistent theme across all brokers is a greater desire for efficiency in their interactions with insurers, across quoting through to servicing. Additionally, brokers are increasingly expecting underwriters to have specialized expertise in the industries they are serving. The hardening market conditions have put further strain on broker-insurer relationships, as brokers are directly feeling the lack of capacity and rate increases as they struggle to align insurers' risk tolerances with clients' rate expectations.

Throughout COVID-19, brokers have adapted to the 'new normal' of remote work differently. Brokers were previously modernizing at differing paces, with the current health crisis only widening the gap in

broker capabilities. Smaller, independent brokers will find it difficult to both invest in digital modernization and outlast the recession with limited capital. As a result, brokers' expectations have stratified, with a split between those who have enabled, and now prefer, digital first interaction with their insurers, and more traditional brokers preferring a rapid return to normal.

The stratification of brokers' needs will create new investment requirements for insurers. There will need to be a balance between investing to meet the growing digital and automation expectations of many brokers (e.g., automated SME quoting) while continuing to support a traditional, human-centred approach for many others. Insurers will need to invest in efforts to maintain and enhance their broker partnerships.

Key impacts on the Canadian commercial insurance market

Insurers	Intermediaries	Clients
 Increased need to invest in digital broker tools and support 	Consolidation of less financially secure brokers	 Greater choice in broker engagement model, based on digital or human
 Growing value in intermediary segmentation, with sizable variations in brokers' needs and preferences 	 Greater differentiation in broker value propositions, based on investment priorities 	 engagement preferences Improved customer experience, as brokers enable new digital capabilities to meet clients' needs



Industry talent gaps

The insurance industry has long experienced challenges in attracting sufficient talent with the right skillsets to meet the industry's needs. A brief 2019 Deloitte survey of commercial insurers and brokers identified the talent gap as one of the top pressures facing their businesses. The demographic shift in Canada is causing this gap, with the retirement of skilled members of the insurance workforce (e.g., experienced underwriters with client industry expertise) insufficiently balanced by younger Canadians interested in joining the industry. While there is a growing demand for advice and knowledge from both clients and brokers, the difficulty in acquiring experienced staff in key roles will negatively impact the experience of all insurance stakeholders.

A growing skills mismatch is also developing between the digital and technical skills that employers require and the skillsets of the existing insurance workforce. This mismatch will continue to widen as insurers further invest in digitization and enable advanced technological capabilities, such as the use of Al and automation, across product development, underwriting, servicing, and claims.

Leading insurers and intermediaries will be those that are most successful in attracting skilled new talent to their organizations.

Key impacts on the Canadian commercial insurance market

Insurers and Intermediaries

- Growing need for upskilling of internal talent to address gaps in staff skillsets
- Need for investment into enhanced talent value propositions (e.g., flexible work arrangements, leadership opportunities) to attract new employees
- Rising competition between organizations for access to skilled talent

Clients

 Decline in risk management support, as clients lose access to insurance professionals whose skillsets and expertise meet their risk management needs (e.g., brokers, claims adjudicators)

Preparing for the future

The challenges in Canada's commercial insurance market will not abate overnight. The market was already in a challenging position in 2019, with the additional environmental and macroeconomic pressures of 2020 furthering its financial difficulty. Costs are likely to continue to rise, putting even greater financial pressure on insurers, intermediaries, and their clients. Given the current state of the market, improvements to hard market conditions will take time.

The current market conditions are likely to present opportunities for insurers, intermediaries and clients. New product development will occur, while improvements in pricing will grow in importance. New business models may arise, such as loss prevention partnerships between insurers and clients, and an increased use of captive insurers and risk insourcing as solutions that businesses take to manage costs. Organizational agility and the ability to capitalize on new opportunities and quickly address risks will be essential to ensure the success of the commercial insurance industry.

The recovery of the Canadian economy will heavily influence when the hard market conditions will subside. This is driven by uncertainty over when the impacts of COVID-19 will end, with current economic forecasts projecting a full recovery by 2022 at the earliest²⁸. Subsequently, the economic influences on the commercial insurance market will be reduced. However, history has shown that no hard market is permanent. There is a light at the end of the tunnel for a return to more stable conditions.

In the meantime, action needs to be taken. Canada's insurers and intermediaries need to find creative solutions to ensure that Canadian businesses can access the insurance they need.



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Prepared in collaboration with Insurance Bureau of Canada.

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