

WHO'S WHO LEGAL

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The majority of Canadians, whether in their personal or business/employment capacities, are profoundly influenced by two industries: real estate and insurance. We are constantly advised that three factors govern the real estate industry: location, location, location. It might be said, in the middle of the second decade of the 21st century, that the three factors also profoundly influencing the insurance industry: change, change and change. Forty years ago, when the writer was still a law student, the Canadian insurance industry consisted of a significant number of corporate entities each

maintaining – typically, less than an 8 per cent market share. Insurance purchasers, whether business entities or individuals, were typically served by a proliferation of brokerages. The market focused on home or commercial property, commercial general liability and, to some extent, errors and omissions policies. Escalating damage awards along with newly emerging risks such as pollution liability were of concern.

Time has profoundly changed the Canadian insurance industry for all participants be they insurers, brokers, policyholders, risk managers or legal counsel. Monetary exposure has increased exponentially. The writer remembers the lively discussion in law school tort class when the first \$1 million judgment in a personal injury case was released. Such judgments are now “routine”. Also commonplace are seven, eight and nine-figure judgments impacting commercial policies whether property, commercial liability, Directors and Officers or other. Of perhaps more significance, the risks faced by policyholder and, in turn, insurers has and continues to evolve. Technological change has brought with it, drones, so called semi-autonomous vehicles, widespread theft of data and, indeed a new exposure “category”: cyber liability. In many respects focus is changing from loss involving tangible property to claims centered on intangible property (data) loss and rights (privacy) violations. In turn the new decade has brought and continues to see new insurance products. Are cyber products replacing commercial liability and property products as the insurance contracts most in demand?

Change impacting industry participants is also found elsewhere. Consolidation in the Canadian marketplace is pronounced. The number of insurers writing business in Canada has markedly diminished. The reduction in the number of insurance underwriters has been accompanied, in the personal lines sector, by the launching of “direct writing” subsidiaries. These developments in turn have impacted the brokerage community. Two further trends are now evident. In the first place certain carriers having significant market share have begun to purchase brokerages. Also, particularly within the past few years, there has been a marked trend to consolidations of brokerages. The era of the small town insurance broker may be passing.

A further change has been noted by both carrier executives and leaders in the brokerage community. Government scrutiny, whether at the Federal or Provincial level, continues to evolve and grow. A number of industry leaders have expressed caution and concern respecting expanded and changing

government scrutiny of the industry. Some of the “change trends” noted above are the subject of comment below.

The Canadian Marketplace

Globally, leading insurers challenged by sluggish growth and increased competition view consolidation as a means of remaining competitive and managing expense. In 2015 and the first half of 2016, consolidation of the industry continued. Canada has not been exempt from this trend. In 2015 there were two significant consolidations which impacted the Canadian marketplace. XL Group PLC completed its takeover of Lloyds of London Underwriter Catlin Group. Similarly, ACE completed its acquisition of Chubb, creating one of the largest commercial and personal property and casualty insurers in the world. Of interest, the putative takeover of British insurer RSA by Swiss insurer Zurich was not completed. However, within this country Aviva Insurance Company and Royal Bank of Canada announced the sale of the latter's non-life insurance book of business to the former. Further consolidation within the Canadian insurance industry can be anticipated.

Consolidation, as noted above, continued within the Canadian brokerage community. Recent months have witnessed a continuation of the trend evident in 2015 wherein small and medium-sized brokers combined or were “swallowed” by international or national brokers. By way of example, global broker Hub International Limited, within the space of one week, acquired two well-known Canadian brokerages. Barrie Ontario entity Sarjeant Insurance Brokers and Edmonton based New Dimension Underwriters Ltd were acquired. Similarly, a number of small to medium-sized Ontario brokers, including CCV Insurance of Brampton, Ontario, were acquired by larger Canadian brokers.

A Canadian insurance executive recently commented upon a further trend impacting Canadian insurance brokers. Specifically, the chief agent of Allianz Global Corporate and Specialty Americas noted the ongoing acquisition of brokers by some of Canada's larger carriers. The executive suggested that the ownership of brokers by insurers has not only impacted the brokerage community, but significantly impacted the personal and small commercial lines business in Canada. The article queried whether many insurers were being pushed to mid and large commercial business. The impact on corporate performance was not insignificant.

Another trend impacts Canadian insurance brokers and influences consolidation. In 2015, Intact, the largest Canadian P&C insurer announced the acquisition of Canadian Direct Insurance Inc. The acquisition extended Intact's direct to consumer operations nationally. In 2016, Economical Insurance Company, which is undergoing a demutualisation process, announced a new online direct channel, Sonnet Insurance Company. Sonnet has been expressly formed to offer personal home, tenants, condo and auto insurance directly to Canadians.

The Canadian marketplace also evolves at the cedant-reinsurer level. In September 2016, the Group CEO for Brit Insurance Ltd suggested that the higher frequency of natural catastrophes in Canada with insured losses of several billion dollars, combined with other events, would require the global reinsurance community to “view Canada differently”. Pricing would have to reflect recent Canadian events and trends. In the same month, an American observer noted that the impact upon the insurance industry of fires, floods and related natural disasters was resulting in, and would continue to lead to, an escalation of reinsurance disputes in North America. The Fort McMurray wildfire was cited by this American commentator as one example of losses which would escalate reinsurance disagreements.

Risks

The participants within the Canadian insurance marketplace including Canadian insurers, brokers and reinsurers, evolve. Similarly the risks that are assessed, underwritten and subject to dispute are rapidly evolving. Not just risk itself but also the source of exposure changes. In the second half of the twentieth century, the Canadian insurance industry and its products tended to focus on habitational risk and loss arising from commercial activity. Tangible property damage and bodily injury were the risks of concern. Further the focus typically centered on Canadian based property and activity. The challenges faced by carriers, brokers and insureds in the second decade of the 21st century have evolved.

Technology has profoundly modified the personal lives of Canadians as well as business activity within this country. Technology has impacted not simply the method by which business is undertaken, but the exposure which exists particularly in the commercial marketplace. Not just the nature of exposure but its source or genesis is evolving. In the last century Canadian insurers typically insured loss originating in and impacting Canadians. Loss occurring in the US might be covered. Clauses dealing with jurisdiction and law were at best afterthoughts given typical exposure. Emerging claims, whether liability or property sourced, now frequently begin "off-shore" or impact those outside of Canada. By way of one example, privacy loss can occur from activity centered outside of Canada or, if communication is initiated here, can impact those well outside our borders. On the property side, so called global supply chains can necessitate the Canadian carrier investigating offshore activity. In some respects it is not just the insurance industry which is consolidating and changing. It is the global marketplace which is shrinking. With it, the exposure which Canadians and their insurers face evolves beyond "a local concern". Airbnb, crowdfunding activity, data transfer/theft all serve as examples of evolving commercial risk which extends beyond the local community. Similarly "sharing" industries like Uber or Car A-Share serve as examples of risk which is emerging, and must be suitably managed by the industry.

Leaving aside these issues, clearly an entire new risk exposure has emerged and continues to evolve; namely so called "cyber liability". The industry was principally concerned in the 1970s and 1980s with environmental contamination, asbestos liability and sexual abuse along with the occasional large construction loss. In 2016 and beyond, insurers will focus on a response to cyber liability and related "intangible property" exposure. A recent American survey has suggested that one in three US consumers has experienced a computer virus, hacking incident, or other form of cyber-attack. US jurisprudence is replete with reference to class proceedings arising out of hacking and other so called cyber-related events. This trend is unlikely to dissipate in the near future. Kaspersky Lab, in September 2016, noted that vulnerabilities and security deficiencies exist in numerous consumer and business products, including digital kiosks, interactive terminals, speed cameras and related devices. The "internet of things" and other referenced activity/products will lead to new and significant risk for which coverage will be sought under traditional but also emerging products.

Other technological change is beginning to and patently will impact Canadian insurers. Growth in use of personal and commercial unmanned aircraft systems or drones have been noted. Most Canadians have now observed at least one of their acquaintances using a drone device. Claims said to involve invasion of privacy or other form of interference with lifestyle are beginning to emerge. Of greater importance, the public and insurance literature, within the past year, has considered, increasingly, the phenomena known as "the self-driving car" or "autonomous vehicle". It has been suggested that within ten years, self-driving cars will be common place. Indeed, John Zimmer, the President of Lyft Industries, has suggested that by 2021, the majority of rides will be in self-driving vehicles. Discussion is presently ongoing within the Canadian insurance and auto industries respecting responsibility for loss occasioned by self-driving vehicles. That assessment and debate will intensify.

The immediate preceding paragraphs discussed emerging risk. Insurers, however, also face “growing” exposure from “traditional sources”. Weather related loss has been the subject of underwriting, claim management and general concern on the part of insurers for decades if not centuries. That said, the impact of weather related loss upon the Canadian industry grows and evolves. Whether due to climate change or a combination of factors, weather related loss increasingly profoundly impacts the financial results of Canadian insurers. Examples are not limited to the Fort McMurray wildfire of 2016, which consumed 10 per cent of the homes or business structures in that community. Prior to the Fort McMurray loss which may result in excess of \$12 billion in covered claims, northeastern snowstorms resulted in \$1.8 billion in insured losses. Tornadoes, rain and hail wreaked-havoc across Alberta and Saskatchewan, resulting in \$230 million in insured damage. Southwestern Ontario floods resulted in a mere \$30 million in insured damage. Forest fires and flooding have damaged or destroyed in excess of 12,000 homes in Alberta, British Columbia and Saskatchewan in recent years.

Additional weather-related catastrophic loss can be anticipated. In that respect, a report prepared for the Property and Casualty Insurance Compensation Corporation of Canada warned of the “risk of a financial contagion” if earthquake losses exceed \$30 billion. The PACICC analysis followed other industry reports which have expressed concern regarding exposure arising from earthquake zones in lower British Columbia and Quebec. Put succinctly, Canadian insurers face evolving risk arising not just from technology, but by unsettled weather patterns and tectonic risk.

The Products

The Canadian industry, as noted, faces evolving and increasing risk. The industry has been proactive in addressing this risk. Specifically, industry associations and individual carriers study and respond to changing/emerging exposure. The Canada-based carriers, in particular, have worked to both amend existing products and underwrite new insurance contracts which address the emerging/evolving exposures. Policy amendment and creation of new policies has reached an unprecedented level in this country in 2015/16. As an aside, emerging technology not only creates new exposure but significantly assists the study, assessment, amendment creation process.

Policy assessment and change covers a range of risk and insurance contracts. Perhaps nowhere is industry effort more pronounced than the release of a range of policies responsive to cyber and data concerns. While contracts drafted in the United States and Europe are in use, there exist a significant range of “made in Canada” insurance contracts responsive to these emerging technological based exposures. Further products as well as amendment to recently release policies is anticipated. As David Mackenzie of Blaney McMurtry noted at a recent conference, cyber exposure is evolving. As such the products of necessity will evolve.

Policy change has not been restricted to the emerging cyber/data security area. Insurers react to change in exposure and the globalisation of personal and commercial activity. For example many Canadian insurers have modified habitational policies to better address loss arising from flood and other weather related events. Commercial property policies have been modified to address not simply evolving risk, but, particularly in the area of contingent business interruption, global exposure. The expanded use of choice of law as well as jurisdiction clauses is also evident given the globalisation of risk.

Coverage Litigation

Canadian courts continue to interpret insurance policies underwritten in Canadian provinces. A recent judgment of the Supreme Court of Canada will significantly impact the rights of policyholders and carriers. The Court’s judgment in *Ledcor Construction Ltd v Northbridge Indemnity Insurance Co*, 2016 SCC 37 (SCC) is significant not just in respect of determination of the scope of faulty workmanship

exclusion/exception clause in a Builder's Risk policy but in regard to policy interpretation generally. In the writer's view the Court's guidance respecting policy interpretation will have a significant impact upon the insurance industry and may not ultimately have introduced clarity or provided guidance that reduces coverage litigation expense.

The judgment of the Supreme Court arose out of the damage caused to property during the course of construction of a commercial building. The policy involved was a Canadian Builder's Risk insurance contract. The insured was contracted to clean windows. Its work was inadequate and damaged the windows. The Court narrowly interpreted the faulty workmanship exclusion. Indemnity was available for the cost of window replacement. That said it is the Court's guidance in respect of insurance contract interpretation that may be of particular significance for all industry participants.

In *Ledcor* the Supreme Court considered and in the writer's view modified the standard of contract review previously determined by the country's highest court. In *Sattva Capital Corp v Creston*, 2014 SCC 53 the Supreme Court held that contract review by an appellate court generally gave rise to a question of mixed law and fact. As such the *Sattva* court held the standard of appellate review was palpable and over-riding error. Query if such standard had been applied in *Ledcor*, whether the Alberta Court of Appeal judgment dismissing *Ledcor*'s claim for coverage would have been set aside. However in *Ledcor* the Supreme Court created an exception to its *Sattva* standard of review. The Court determined that standard contracts such as insurance policies will be reviewed as a question of law applying a standard of correctness. As such the findings of the trial judge are not entitled to deference. An appellate court may effectively substitute its' own view of proper policy interpretation.

The implications of the *Ledcor* judgment will extend well beyond interpretation of this Builder's Risk policy. The creation of an exception for appellate standard of review in respect of a standard form contract will at the very least increase appeals from the trial court's interpretation of policies. As well since the exception to the "Sattva principle" applies only to standard form contracts, one can anticipate in the context of commercial contracts, the necessity of evidence speaking to whether the contract was in fact standard or was the subject of negotiation.

Summarising, it has been a challenging year, and one marked by profound change for the Canadian marketplace. The upcoming year is likely to bring about further change.

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