



# DÉJÀ VU ALL OVER AGAIN

Like the movie *Groundhog Day*, Canada's p&c insurers tend to get stuck in a perennial vicious circle of inadequate pricing, big hits on the auto side, volatile investment returns, growing cat losses and overcompetition.

---

BY GLENN MCGILLIVRAY

MANAGING DIRECTOR, INSTITUTE FOR CATASTROPHIC LOSS REDUCTION

**Glenn McGillivray**

Managing Director, Institute for  
Catastrophic Loss Reduction

For most people in this part of the world, time is time. A day is a day, a week is a week, a month is a month and a year is a year. In Western society we tend to take these methods of temporal measure for granted. But we shouldn't because time means different things to different people, largely because it is conceptualized differently depending on where you are and to whom you speak.

Essentially, there are two main theoretical ways of viewing time: the Abrahamic (i.e. Christian/Jewish/Muslim)-based practice of time as a linear phenomenon, and the pantheistic (i.e. where the universe and God are viewed as one in the same) view of time as a cyclical phenomenon.

With the former, time constantly marches forward; it does not speed up at times or slow (though often it seems to), it does not go backward, and it does not repeat. Time is infinite, and we move forward with the sole intent of improving our collective lot in life as we go; as time advances, we work to advance society.

With the latter, time is a circle or a spiral. Here, time does not plod on, it is static, and we move through time like we may move through a valley. Further, the same events will repeat themselves in one form or another. Under this paradigm, because of the notion of cyclicity, there is no goal to progress or advance society; here, we are all just spectators, bystanders if you will.

Think the pantheistic view of time is ridiculous?

Soft markets, weak results, auto reform, catastrophe losses.

Heard it before?

### **Industry results**

PACICC – the Property and Casualty Insurance Compensation Corporation – notes in its 2009 annual report that results for the Canadian p&c industry continued to weaken in 2009 as insurers headed deeper into the challenging part of the insurance cycle: “Indeed, adjusted for the release of auto insurance reserves in Alberta, return on equity and the industry combined ratio were at their worst levels since 2002.”

It noted that accident year data will eventually confirm that claims costs grew faster than premiums. “Increases in claims costs were largely related to Ontario auto insurance and catastrophe losses in property. Further a series of decisions by the courts and government will have an uncertain impact on the industry’s operating environment during 2010.”

According to PACICC, while no Canadian carriers became financially distressed in 2009 as a result of either subprime-related investments or the

turmoil of the financial markets, going forward into 2010, interest rate risk is elevated: “The consensus forecast among bank economists foresees a

full percentage point increase in interest rates. The correlation (73 percent) between such interest rate volatility and insolvency is high. Since 1970, interest rates have moved a full percentage point 19 times and an insurer failed in a majority of those years.”

Overall, PACICC noted, industry underwriting profitability was down in 2009, driven by worsening loss ratios in many lines of business. Since 2007, the growth in claims costs has exceeded the growth in premiums. This has eroded the positive underwriting performance that occurred during the 2003 to 2007 period.

In the key auto insurance segment, which represents nearly half of the industry by premium volume, PACICC noted that premiums in 2009 increased on par with claims costs. “This insurance cycle differs from the previous one in that claims costs have been stable or declining modestly in the liability segment of the automobile insurance product,” it said.

## Summary Ratios

	2009	2008
Combined Ratio	100.9%	101.4%
Loss Ratio	71.0%	71.3%
Expense Ratio	29.9%	30.1%
ROI	4.3%	3.8%
ROE	7.1%	5.9%
Change in equity	10.8%	-3.5%
MCT	232.3%	220.9%

GAAP Reporting  
Source: IBC with data from MSA

## Auto reform

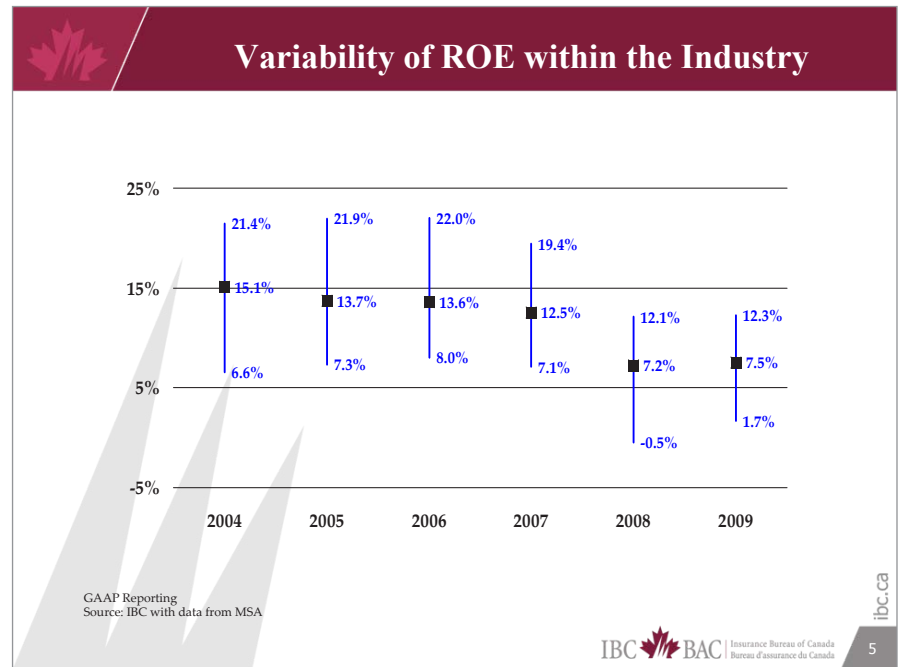
According to PACICC, the accident benefits (AB) component of the auto insurance product – specifically in Ontario – has been worse than that of the previous cycle with the industry average accident benefit loss ratio exceeding 130 percent: “After stable or declining rates in 2007 and 2008, insurers began increasing rates during 2009. Entering 2010, risk in this segment remains as claims growth continues to exceed that of premium growth.”

In 2009, there was significant movement in the two key auto markets in the country, Alberta and Ontario.

In December, the auto product situation in Alberta was clarified when the Supreme Court of Canada upheld Alberta’s \$4,000 cap on minor auto injuries when it dismissed the application for leave to appeal the Alberta Minor Injury Regulation (MIR). This follows a previous decision in February 2008 where the MIR cap on non-

pecuniary damages for minor injuries was struck down as unconstitutional. In June 2009 the Alberta Court of Appeal overturned the decision made by the

lower court and the decision was subsequently appealed to the Supreme Court of Canada. The decision effectively closed the final avenue for appeal



against an important component of the province's 2004 auto reforms.

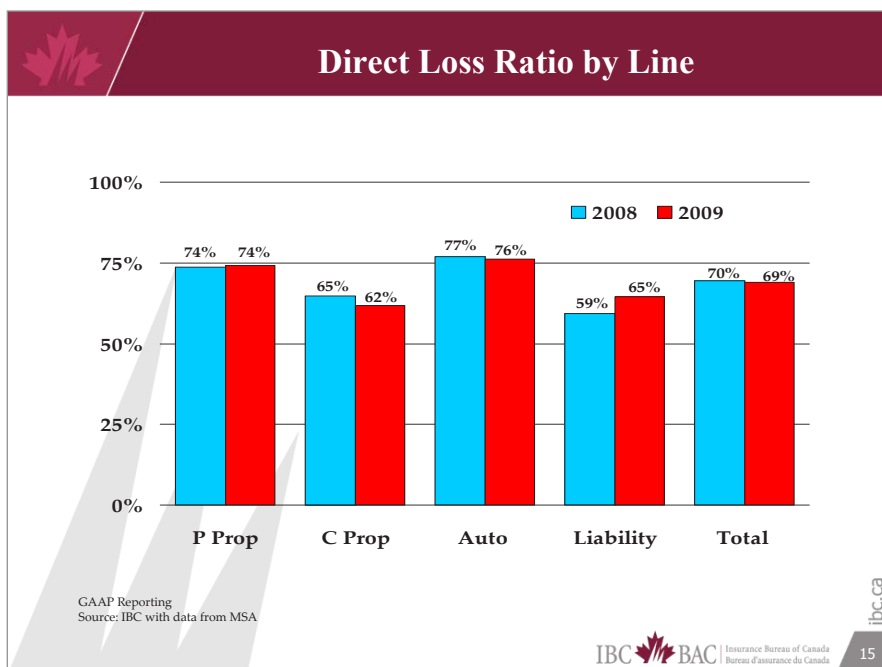
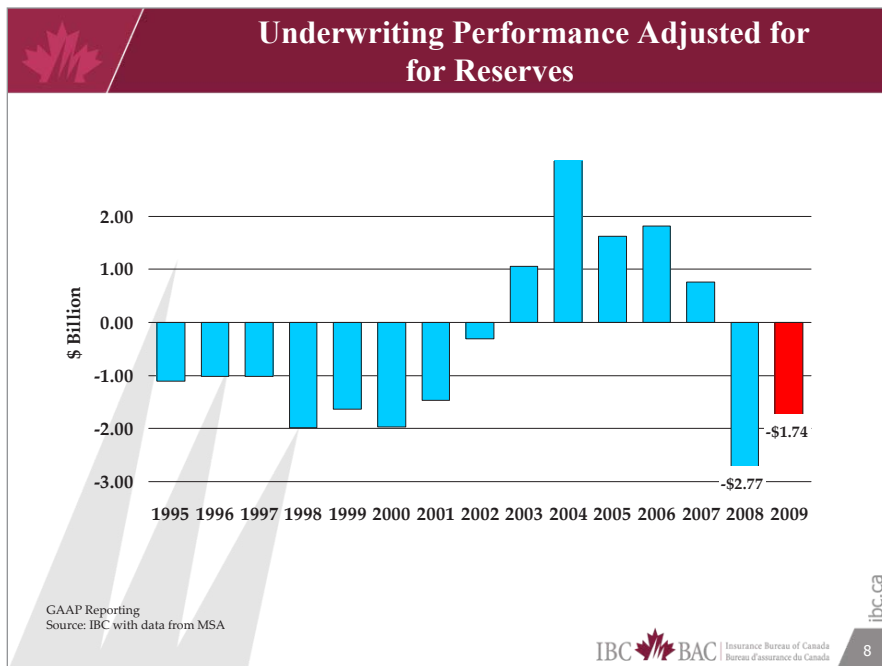
In Ontario late last year, the Ontario Ministry of Finance released a package of reforms to the Ontario auto product that observers hope will help limit potential future claims growth.

According to Barbara Sulzenko-Laurie, IBC's vice president of policy, at Swiss Re's 25th annual Statistical Breakfast in Toronto March 30, the reforms may have come too late. She

noted that Canadian p&c insurers writing Ontario auto lost \$907 million in 2009 and that the continued escalation of the "excesses and abuses" of Ontario's no-fault SABS system resulted in a 23.5 percent increase in the direct loss ratio in AB lines. From 2008 to 2009, she noted that the loss ratio increased from 124 per cent to 148 percent.

Ontario introduced the new regulations on March 2, 2010 and the

**"The notion that events repeat themselves and that we are all essentially innocent bystanders in the process implies that players in the p&c segment are at the mercy of some sort of mystical universal force that directs the fortunes of the industry. But things like bad underwriting and investment decisions, over-concentration of business, poor risk management, rapid growth, expansion into ill-understood lines of business and the like don't just happen. We make them happen."**



changes will become effective on September 1. According to a Financial Services Commission of Ontario bulletin released on March 3 of this year (No. A-01/10, Changes to Automobile Insurance Regulations), the new SABS will include the following changes:

- Capping medical/rehabilitation and assessment/examination expenses for minor injuries to \$3,500.
- Replacing the existing Pre-Approved Framework Guideline for Grade I and II Whiplash Associated Disorders with a new Minor Injury Guideline for accidents occurring on or after September 1, 2010.
- Providing standard medical and rehabilitation coverage for non-catastrophic claims of \$50,000, with optional coverage of \$100,000 or \$1,100,000.

- Offering standard attendant care coverage for non-catastrophic claims of \$36,000, with optional coverage of \$72,000 or \$1,072,000.
- Supplying optional caregiver, house-keeping and home maintenance benefits for non-catastrophic claimants.
- Capping each assessment to \$2,000 – this applies for all assessments, whether they are requested by the claimant or insurer.
- Providing payment for in-home

assessments only to claimants who have sustained more than a minor injury.

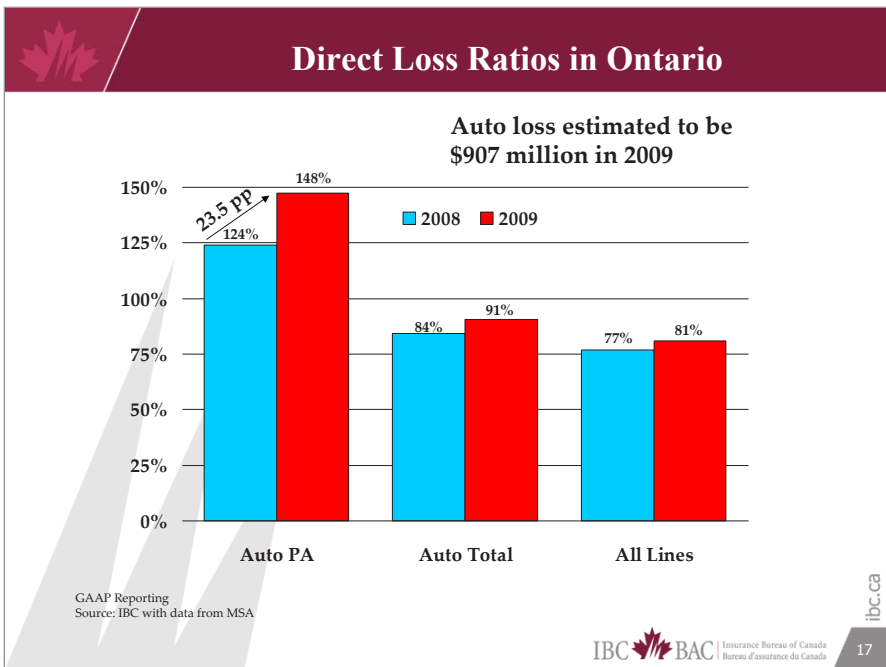
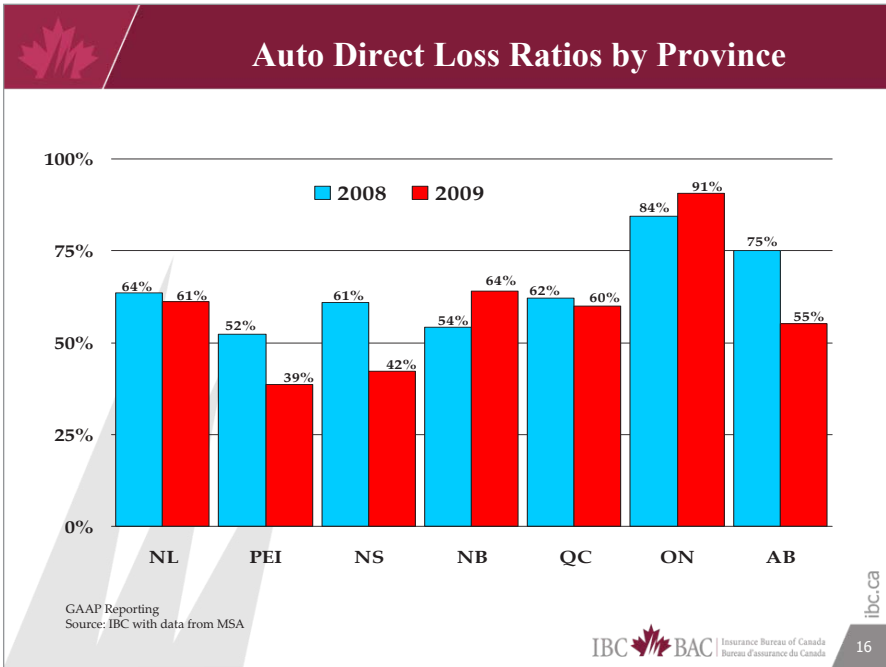
- Eliminating rebuttal examinations.
- Offering \$2,500 for accounting reports to support income replacement benefits claims.
- Merging treatment plans and applications for approval of assessments or examinations into one process.
- Providing adjusters with discretion in the use of insurer examinations.

- Creating a definition for “incurred expense”.
- Simplifying and consolidating the rules that govern claims processing.
- Eliminating a number of approved forms.

**Reinsurance**

According to MSA’s Joel Baker: “Reinsurer results stayed level despite increases in assumed business of 10.6 per cent. The 2009 combined ratio came in at 98.7 percent which is identical to the 2008 result...Reinsurers were hammered by property losses in 2009 primarily from a series of mid-sized catastrophes that hit Canada during the year. the growth in assumed business can be partially attributed to capital relief that primary insurers sought out during 2008 renewal season amid the financial upheaval that occurred then. Since that time, the financial markets have calmed down and primary insurer financials have stabilized, leading us to believe that the growth the reinsurers experienced was short lived.”

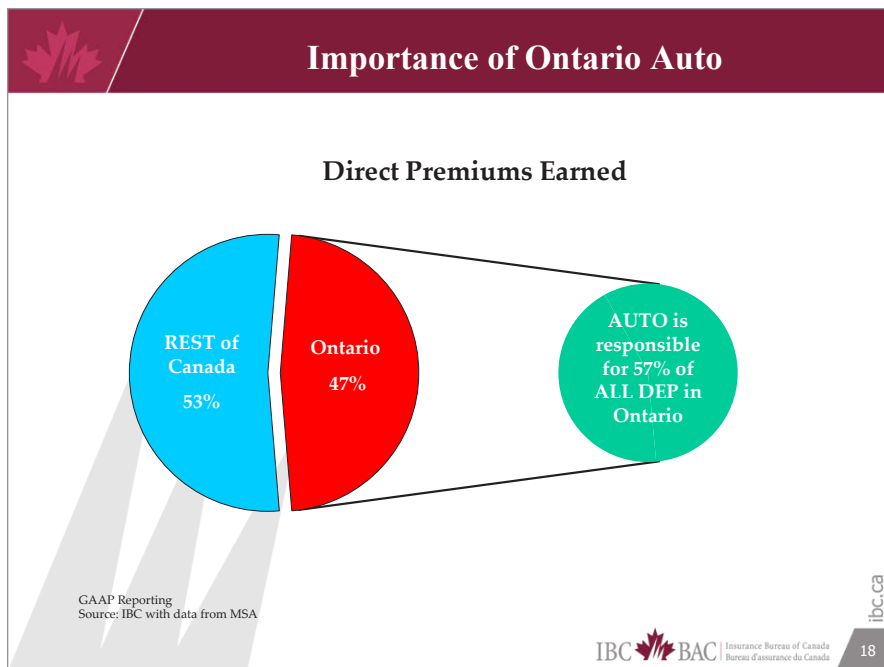
Aon-Benfield noted in its annual market survey that key issues in Canada at January 1 renewals were the release of Risk Management Solutions’ v9 seismic model which increased PMLs by 35 to 40 percent on average in Western Canada. According to the reinsurance intermediary, “Most companies increased their catastrophe limit and we estimate that the Canadian market purchased between \$2.5 and \$3 billion of additional catastrophe capacity for 2010. Pricing was generally stable to up slightly. Any increases were primarily based on loss activity and/or PMLs that grew over and above the impact of the RMS model change.” The broker noted that capacity was adequate but not abundant: “Property per risk treaties were impacted by a significant increase in both frequency and severity of losses in 2009. The results of many programs ended in a deficit position leading to a much harder market at renewal as reinsurers tried to recoup their losses. Casualty programs experienced a relatively



stable renewal with respect to both price and coverage.”

Competitor Guy Carpenter noted that in Canada at 01/01 renewals

showed a slight softening of rates. “For working layers, much depended on the reinsured’s loss activity. Property per risk covers with little or



**“Indeed, basement flooding is a major concern for many (if not most) urban municipalities – and, thus, insurers - in Canada. Increases in the frequency and intensity of heavy rainfall events exacerbated by rising urbanization, deteriorating infrastructure and climate change will increase basement flood risk in the future. Effective management of flood risks requires improving sewer infrastructure, and also the cooperation of more informed homeowners.”**

no loss activity averaged reductions of 3 percent to 6 percent. Greater loss activity pushed rates up on average 5 percent to 10 percent. Casualty programs’ working and clash layers were generally flat, again depending on loss activity. If there were significant losses, working layers increased 3 percent to 5 percent. Clash layers were flat to declining 3 percent.”

Regarding the new RMS release, Guy Carpenter estimated that an additional \$2 billion to \$3 billion of catastrophe capacity was purchased at renewal. The broker maintains that this occurred “because the changes to RMS’s earthquake model caused an increase in companies’ British Columbia probable maximum loss by 30 percent to 50 percent.”

Guy Carpenter reported that catastrophe rates increased from 5 percent to 10 percent for programs with losses and generally declined 3 percent to 6 percent without losses. “Generally, rates were pushed this year to confine the level of oversubscription that has been typical of the market (for property per risk and cat business) for the past few years. This continued to occur in part because of the continuing trend of foreign-controlled insurers to incorporate

some or all of their Canadian property and cat exposures within global reinsurance programs controlled by the parent. This practice left a preponderance of long tail exposure in the domestic reinsurance market without the potentially desirable and diversifying short tail exposures.”

Last year in this space, one facultative casualty underwriter was quoted as saying, “As far as the market overview is concerned, I think we are in transitional

casualty market, it has not hardened, but is expected to be on the verge of hardening, if not later this year then in 1st quarter 2010. So, at the current time most accounts are being renewed with ‘as-is’ terms and pricing, although there are still accounts seeing price and rate decreases typically in the 5 to 15 percent range. The market remains competitive, particularly AIG, who are protecting their business at all costs and Lloyds and the London market are very competitive.”

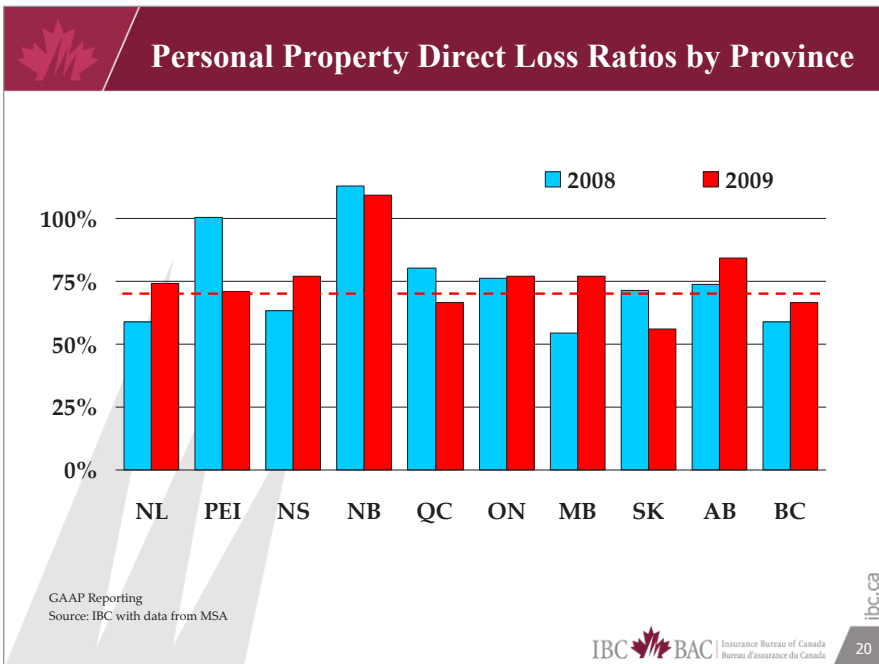
Musing that he thought, perhaps, that his timing was off, of 2009 he noted: “I still think we are in a transitional market and hope we will see things start to tighten later this year, if not very early in 2011 as the Canadian economy continues to improve and outperform the U.S. economy. Right now we are witnessing a very undisciplined casualty market, on the one hand, renewing ‘as-is’ is fairly typical, but on the other hand there are accounts being moved by primary brokers for as little as a 5 percent premium difference. So it is a very competitive environment right now. New players are pricing Canadian casualty business very aggressively, including many London market carriers. Average rate decreases remain in the 5 percent to 15 percent range.

My sense is that the tightening will start in the tougher liability lines, like long haul trucking and spread to other casualty classes. I think this will not be a strong market correction, rather a brief flurry where rates may go up by up to 25 percent and then competition will creep back in and the long soft cycle will be back all too soon.”

**Catastrophes**

The year in review proved to be a heavy one from a catastrophe loss standpoint. Internationally, even with the absence of any major north Atlantic hurricanes, catastrophe losses came in at USD22 billion, the 11th worst year on record according to Swiss Re.

Domestically, Canada got its share, with very close to a cool \$1 billion in losses, the second such time in four



	Personal Lines Insurers	Commercial Lines Insurers
Combined Ratio	105.3%	86.8%
Loss Ratio	75.5%	58.0%
ROI	3.8%	4.7%
ROE	3.5%	13.2%
Change in Equity	15.9%	4.4%

Companies with more than 50% DWP in each subgroup

Lloyd's Included  
Source: IBC with data from MSA

IBC BAC Insurance Bureau of Canada  
Bureau d'assurance du Canada



years, as 2005 came in with like-numbers. All-in-all, cat losses added 2.4 points to the industry's combined loss ratio for property last year, according to PACICC.

As is usually the case, the country was hit by several relatively small events last year. Among these was a February 2 snowstorm in Ontario, which caused an estimated \$25 million in insured damage, according to Aon Benfield.

The Insurance Bureau of Canada (IBC) reported that an F2 tornado in Mont Laurier, Quebec on August 4 caused an estimated \$6 million in damage. In the Atlantic provinces, Hurricane Bill caused an estimated \$10 million on August 23 and Tropical Storm Danny caused about \$25 million on August 29, according to Aon Benfield.

Hailstorms in southern Manitoba from August 13 to 15 caused an

estimated \$50-\$75 million in damage (mostly crop hail), Aon Benfield says. The Canadian Crop Hail Association commented on August 28 that storms produced hail around Niverville, Hamiota, Lasalle, Starbuck, Brandon, Miniota, Birtle, Somerset, Deloraine, Hartley, Melita, Boissevain, Oak River and Notre Dame De Lordes, and baseball-sized hail hit areas near Lasalle and Brandon, causing 100 percent crop loss in the heart of the storm.

Moving up in scale, eighteen confirmed tornadoes — a record for the most in one day in Canada — tore across Southern Ontario on August 20, resulting in the tragic death of a young boy in Durham and damage to some 600 homes in Vaughan, just north of Toronto. Damage, concentrated largely in Woodbridge and Maple, was widespread, including smashed cars, utility poles and buildings. IBC pegged the insured damage at more than \$76 million, a number that may appear low to many given the perceived size of the event.

Just as occurred in 2005 with the August 19 'Freaky Friday' event in the GTA and storms in Alberta, two events alone caused the lion's share of the insured damage in 2009.

On July 26 more than 100 millimetres of rain in under three hours inundated parts of Hamilton, Ontario, flooding thousands of basements -- particularly in the city's east end. Aon Benfield notes that providing accurate estimates of insured damage for this event is difficult, since many insurers suffered aggregate damage that fell within their retentions. The reinsurance intermediary estimated insured damage of \$100 to \$150 million. Other sources have put the range between \$200 million and \$300 million, and even as high as \$325 million. IBC, however, pegs the damage figure at \$196 million. The final numbers may not be known for some time.

Just a few days later, from August 1-3, major wind and hail in Alberta caused more than \$365 million in insured damage, according to IBC. Other sources place the insured



damages from this event in the neighbourhood of \$500 million, which would make it the second-most-costly natural catastrophe loss in Canadian history (pushing the August 19, 2005 GTA event to third place).

In Alberta, one person was killed and 15 were injured — four critically — when high winds knocked down a stage at the Big Valley Jamboree in Camrose on August 1, 2009. The winds were also blamed for the death of a three-year-old girl in downtown Calgary after corrugated sheet metal fell from a construction site onto a family walking on 9 Avenue SW. Her father and seven-year old brother were sent to hospital with serious injuries. The strongest reported winds were clocked at 141 km/h at Three Hills and 125 km/h at Red Deer. Subsequently, overnight Sunday and into the wee small hours Monday, vicious winds clocked at 107 km/h, lightning and hail wracked Calgary and area, leaving a swath of downed trees, shattered windows and hail damage. According to David Phillips of Environment Canada, hail inside the main zone reached baseball size. In some places, hail measured 10 centimetres deep.

### **Water losses**

According to PACICC, the disaster losses of 2009 highlight the impact of climate risks on the industry and a changing understanding of claims cost trends: “The very nature of claims costs in property coverages trends is changing. Historically, property insurance had been synonymous with fire insurance. However, since 2004, weather related (water and wind) claims costs have exceeded those of fire to become the largest source of property insurance claim costs.”

Indeed, basement flooding is a major concern for many (if not most) urban municipalities — and, thus, insurers — in Canada. Increases in the frequency and intensity of heavy rainfall events exacerbated by rising urbanization, deteriorating infrastructure and climate change will increase basement flood risk in the future.

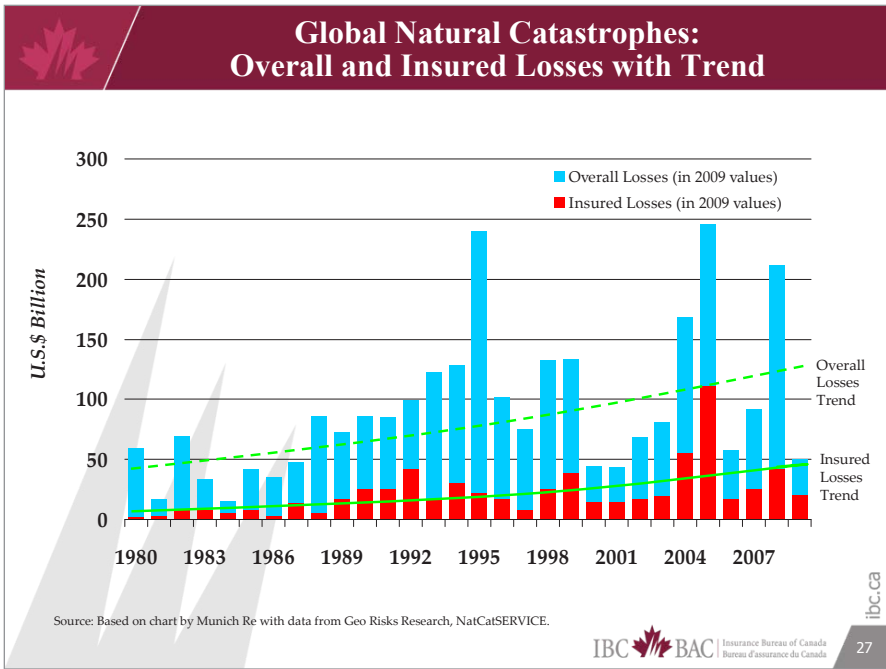
Effective management of flood risks requires improving sewer infrastructure, and also the cooperation of more informed homeowners.

Damages from sewer backup can be extensive. In August 2005, a severe rainfall event in the Greater Toronto Area (GTA) caused extensive overland flood and sewer backup damages, resulting in more than 13,000 sewer backup insurance claims at a value of \$247 million. Total damage from the event exceeded \$500 million. The City of Edmonton was hit with two severe rainfall events in 2004, resulting in 9,500 sewer backup insurance claims valued at \$143 million. Many other communities across Canada have experienced similar loss events, not the least of which was Hamilton this past summer (Ottawa was also hit with significant sewer backups last summer).

In this spirit, last June ICLR released its *Handbook for reducing basement flooding*, which is designed to address the concerns of homeowners, local governments and homeowner insurers of the increasing instances of basement flooding. The handbook provides comprehensive information on how to prevent such a loss from occurring or, at the very least, mitigating the impacts of such an event.

The handbook is meant to represent ICLR's advice on preventing basement flooding. It is a substantial 56 pages in length, although ICLR will in the near future produce a smaller guide that highlights some of the immediate steps homeowners can take to prevent basement flooding. Additionally, municipal governments and insurance companies can use the handbook to produce their own material for homeowners.

The threat of fire to property has fallen from top position due to the concerted efforts of the insurance industry, municipal and provincial governments and homeowners to reduce the risk and impact of fire. The hope is that by providing information on basement flooding, ICLR — in partnership with local governments and insurance company members — can make the same happen with water-related claims.



## 2010 and beyond

From a solvency perspective the outlook for the p&c insurance industry for 2010 and 2011 is much weaker, and subject to greater uncertainty than the healthy improvement in performance recorded between 2003 and 2009, says PACICC. “The industry is entering a point in the insurance cycle where history signals an increased risk of insolvency and financial distress. The number of PACICC member insurers reporting underwriting losses has increased significantly, which combined with volatility in financial markets, and the threat of severe weather events represent some of the immediate risks to insurer solvency.”

The good news, says PACICC, is that the industry has significantly built up its capital between 2003 and 2007, though there are important variations in capital strength between companies. Also there are important differences in degree of exposure to various risks. Nevertheless, industry-wide measures show that Canada’s p&c insurers are facing the current downturn in the cycle from a position of capital strength.

## Conclusion

The different ways in which time is viewed is fascinating, and may give one much fodder for thought.

However, as interesting and thought-provoking the pantheistic view of time is, the theory holds one great weakness, at least with regards to how we view time in the Canadian p&c industry.

The notion that events repeat themselves and that we are all essentially innocent bystanders in the process implies that players in the p&c segment are at the mercy of some sort of mystical universal force that directs the fortunes of the industry.

But things like bad underwriting and investment decisions, over-concentration of business, poor risk management, rapid growth, expansion into ill-understood lines of business and the like don’t just happen. We make them happen.

And without this fundamental understanding history will, as Santayana forewarned, indeed repeat. ☰

