AM BEST SINCE 1899 ®

BEST'S MARKET SEGMENT REPORT

Our Insight, Your Advantage®

October 23, 2024

Canadian Property/Casualty: Stable Despite Rising Cat Events and Persistent Market Challenges

Canada's P/C segment posted favorable results in 2023, supported by equity growth and increased net income

Principal Takeaways

- Property/casualty segment results in 2023 were again favorable despite persistent headwinds.
- Insurers' profitability was underpinned by solid equity growth and a substantial increase in net income.
- Personal property, auto liability, and commercial property were the three largest lines by insurance revenue in 2023—all three reported solid underwriting gains.

Outlook for Canada's Non-Life Insurance Segment Remains at Stable

Despite notable headwinds related to growing catastrophe events and challenges in the personal auto market, AM Best's outlook for Canada property/casualty insurers remains Stable, driven by the following factors:

- Solid risk-adjusted capitalization, supported by very strong operating results in 2023
- Favorable combined ratios and growth in insurance service revenue
- Improving investment returns, reflecting higher yields on new money over the last few years and recent portfolio gains due to moderating interest rates
- Stable regulatory environment and continued availability of reinsurance cover
- Effective risk management practices
- Moderating levels of inflation

Given the hard market of recent years, reinsurance costs are expected to normalize, although we have yet to see any indications of a soft market. Results remain favorable despite persistent headwinds, including the following:

- Growing frequency and severity of extreme catastrophe weather events
- Continued increases in the cost of reinsurance driving higher levels of balance sheet retention
- Continued pressure on personal auto

Losses due to catastrophe events in 2023 are estimated to have reached CAD 3.1 billion, making it one of the five worst cat years on record, trailing only inflation-adjusted cat losses in 2013 and 2016. In recent years, both the frequency and severity of weather-related losses have been increasing. Weather-related losses reached a high-water mark in 2023, with 24 storms, exceeding records set in 2017 and 2022. The industry endured 13 large events, defined as those equaling or exceeding CAD 100 million, resulting in estimated insured losses of CAD 2.7 billion (**Exhibit 1**).

When viewing cat events in five-year increments (except for the 2020 to 2023 period), the costs of cat events over numerous decades show worsening severity, adjusted for inflation and higher

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frequency (**Exhibit 2**). The cumulative costs for the period surpassed CAD 48.4 billion, adjusted for inflation, with 286 events recorded. The number of events grew to significant levels in the 2020 to 2023 period, occurring at twice the rate of prior periods (**Exhibit 3**).

Catastrophe activity during the first half of 2024 was manageable, although four major events occurred during the third quarter of 2024 that will make 2024 another record year. These include the Ontario flood event, with insured losses of CAD 940 million; the Jasper wildfire, with insured losses of CAD 880 million; recent flooding in Quebec, with CAD 2.5 billion in insured losses; and the Calgary Hail event in August. The Calgary Hail event is reportedly the second-costliest catastrophe event ever for Canadian insurers, with an initial estimate provided by Catastrophe Indices and Quantification Inc (CAT IQ) of CAD 2.8 billion in insured losses. This event resulted in sizeable damage to the city's international airport, as well as many homes, commercial businesses, personal, and commercial vehicles. Hurricane Debby is also a factor, as the remnants of the storm caused torrential rains in parts of Canada, although its scope was modest. Cat activity was lower in the first half of 2024, but third-quarter 2024 losses alone have more than doubled from full year 2023.

The State of Canada's Reinsurance Market

Earlier this year, AM Best upgraded its market segment outlook for the global non-life reinsurance industry from Stable to Positive. The upgrade reflected the industry's strong profit margins, higher attachment points, and tighter terms and conditions

Exhibit 1

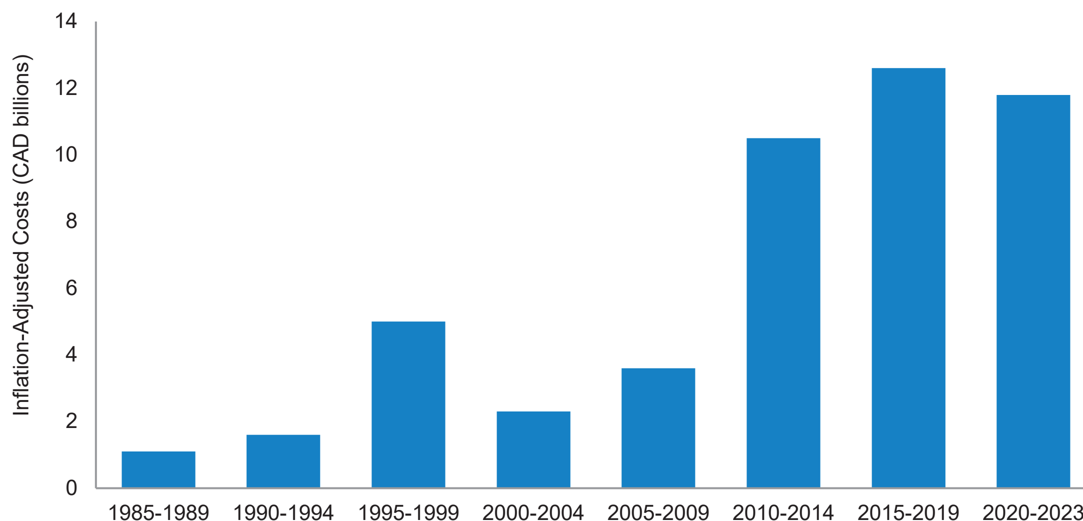
Canadian Property/Casualty – 2023 Cat Events Exceeding CAD 100 Million in Insured Losses

	Insured Losses (CAD millions)
Eastern Canada Cold Snap (Southern Ontario and Quebec)	150
Spring Ice Storm (Ontario and Quebec)	350
Tantallon Wildfire (Nova Scotia)	250
Severe Storms (Ontario and Quebec)	225
Hailstorm (Alberta)	150
Southwestern Ontario and Southern Quebec Storms	100
Flooding (Nova Scotia)	230
Early August Storms (Ontario and Quebec)	120
Kelowna Wildfires (British Columbia)	415
Bush Creek East Wildfire (British Columbia)	210
Southwestern Ontario Flooding and Storms	125
Winnipeg Hailstorm (Manitoba)	250
Eastern Canada Wind and Rain	125

Source: CatIQ

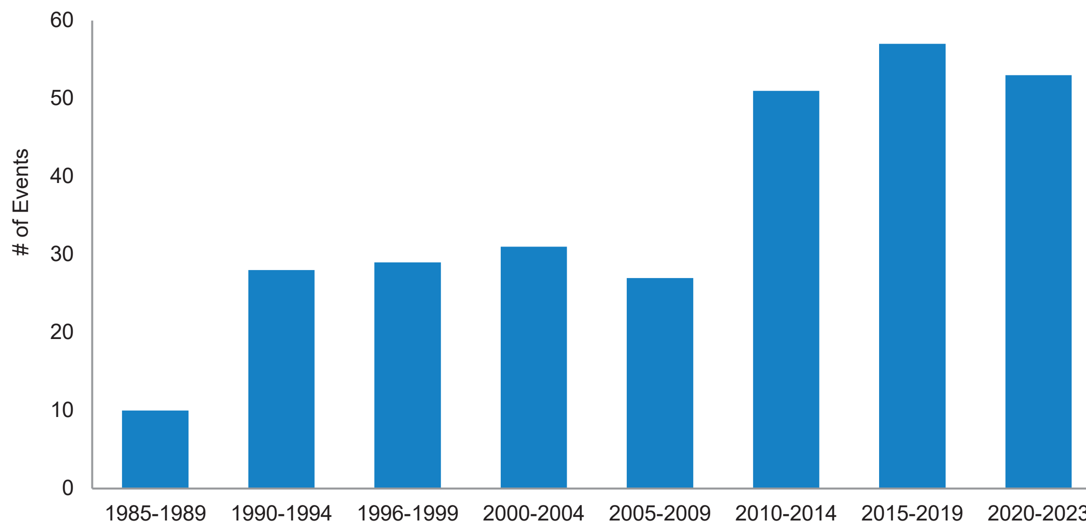
Exhibit 2

Canadian Property/Casualty – Catastrophe Losses



Source: IBC

Exhibit 3
Canadian Property/Casualty – Catastrophe Frequency



Source: IBC

following a period of significant repricing.

Canada's property/casualty reinsurance industry plays a pivotal role in providing financial stability to primary insurers given the increase in weather-related events affecting the country. The market is dominated by large international players, providing a broad range of reinsurance products. The increase in cat events has been a headwind for direct writers in recent years but has resulted in a hard market for reinsurers, and Canada remains an attractive market for participants.

Exhibit 4
Canadian Property/Casualty – Reinsurance Highlights*

	Loss & LAE Ratio (Net/Net)	Expense Ratio (Net/Net)	Combined Ratio (Net/Net)	Combined Ratio (Net/Gross)	Insurance Revenue (CAD billions)
2022	64.8	10.5	75.3	83.6	3.4
2023	53.9	11.7	65.6	77.8	4.2

* Figures reported in accordance with IFRS 17.
Source: BESTLINK

The Canadian P/C market made extensive changes in the terms, conditions, and structures of reinsurance programs during the 2023 reinsurance renewal season, leading to significant price increases for primary insurers. As a result, despite catastrophe losses in Canada reaching CAD 3.1 billion in 2023, the 2024 reinsurance renewal season was much more orderly, as the changes implemented the prior year proved effective. Nonetheless, with the unprecedented wildfire season throughout the year and the increase in flooding events, concentrated regional carriers have been disproportionately impacted by additional reinsurance rate increases.

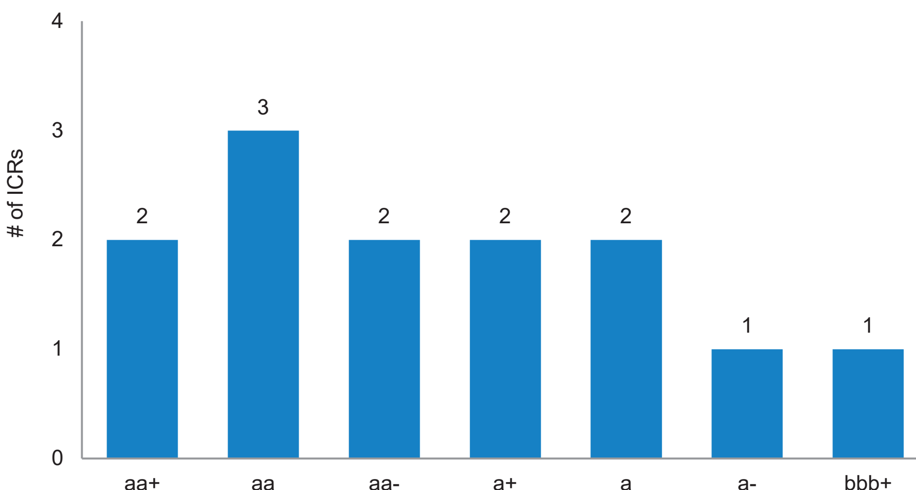
The results of the Canadian reinsurers rated by AM Best were positive (**Exhibit 4**), benefitting from a favorable underwriting environment and improved pricing conditions. In 2023 the industry reported combined ratios of 65.6% (net/net) and 77.8% (net/gross), versus 75.3% (net/net) and 83.6% (net/gross) in 2022. Additionally, market demand remains elevated, as insurance revenue rose to CAD 4.2 billion, highlighting the continued attractiveness of the segment.

Ratings Remain Consistent

The rated population of Canada's P/C reinsurance segment highlights the stability and strength of the industry. Approximately 92% of reinsurers have an AM Best ICR (Issuer Credit Ratings) rating of "a-"

or higher (**Exhibit 5**). Additionally, all ratings in the reinsurance industry composite currently have a Stable outlook. For 2025, AM Best expects reinsurance renewals to follow the orderly transition seen in 2024. However, rising catastrophe risks, as well as macroeconomic and geopolitical risks, remain a key consideration that may impact the segment. Additionally, the rise of secondary perils will also have an impact on pricing and terms/conditions.

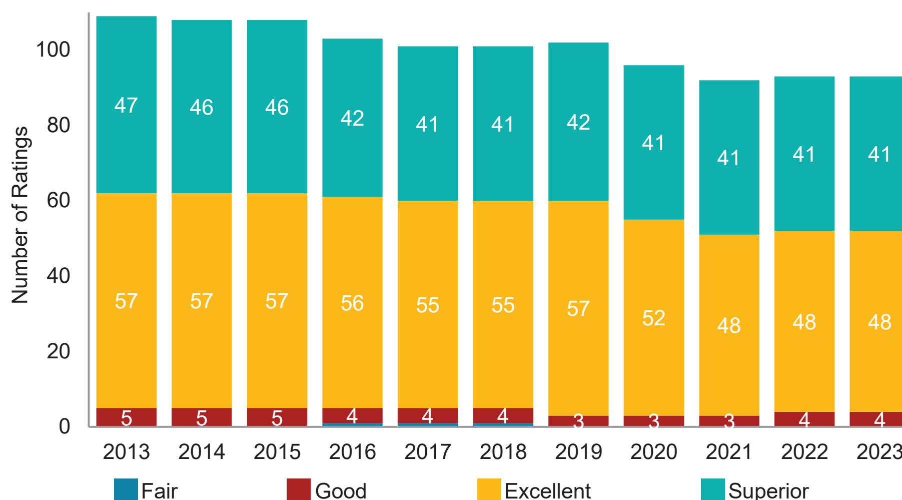
Exhibit 5
Canadian Property/Casualty – Reinsurance ICRs



Notes: ICR = Issuer Credit Rating. Ratings as of July 18, 2024.
Source: BESTLINK

In 2023, approximately 96% of AM Best Canadian P/C rated entities had financial strength ratings (FSR) of either Superior (A++ or A+) or Excellent (A or A-), consistent with results of the past ten years. The stability of the Canadian P/C industry is highlighted by the fact that all rated entities have maintained FSRs of B++ or higher in each of the past five years.

Exhibit 6
Canadian Property/Casualty – Ratings*

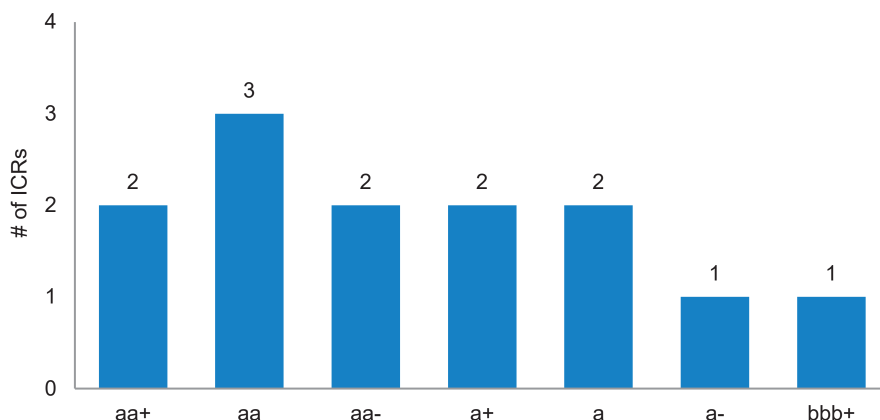


* As of July 18, 2024
Source: BESTLINK

Most ICRs were affirmed in 2023, but 11 ratings were changed, more than double from the prior year (**Exhibits 6 and 7**). Of the 11 rating changes, nine were upgrades and two were downgrades. Four of the nine upgrades are for companies in the same group and were due to increased levels of support from the parent company. Two upgrades were a result of reduced drag from the parent company. The remaining three upgrades benefited from higher assessments of balance sheet strength, an improvement in investment income owing to higher portfolio yields, which contributed to increased net income, and changes in parental support due to acquisitions.

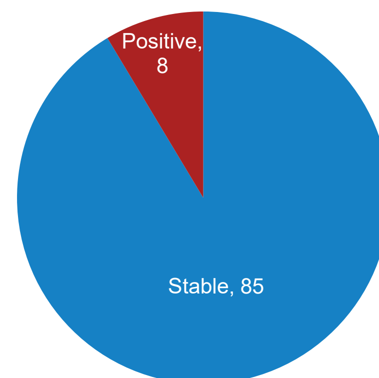
The two rating downgrades reflect declines in underwriting performance due to elevated natural catastrophe losses and reserve strengthening that highlighted weaknesses in enterprise risk management capabilities, and poor operating results leading to an exit from unprofitable product

Exhibit 7
Canadian Property/Casualty – 2023 Issuer Credit Ratings*



* As of July 18, 2024.
Source: BESTLINK

Exhibit 8
Canadian Property/Casualty – 2023 Outlooks*



* As of July 18, 2024.
Source: BESTLINK

Exhibit 9
Canadian Property/Casualty – Net Income*
(CAD billions)

	2019	2020	2021	2022	2023
Insurance Service Result/Net Underwriting Income	0.2	1.9	7.6	7.1	7.9
Investment Return/Net Investment Income	2.2	2.1	1.5	-1.2	5.1
All Other Income	1.0	1.8	1.5	-0.7	-4.0
Income Tax	0.7	1.2	2.3	1.2	1.9
Net Income	**2.7**	**4.6**	**8.3**	**4.0**	**7.1**

* Excludes Lloyd's, CAB, and ICBC. 2022 and 2023 figures are reported in accordance with IFRS 17

Source: BESTLINK

lines. These events led to changes in strategy that will diminish both the overall market footprint and business profile. Both entities whose ratings were downgraded are Canadian branches of much larger global corporations.

Of the 93 rated entities, 85 had a Stable outlook, and eight had a Positive one (**Exhibit 8**). None of the rated entities had a negative outlook. Just over 91% of the rating population has a Stable outlook, reflecting the market's stability owing to consistently robust risk-adjusted capitalization, strong operating earnings, and effective ERM frameworks. Of the ratings assigned a Positive outlook, six were driven by favorable operating performance compared with peers, while the remaining two reflected improved risk-adjusted capitalization and a more favorable overall balance sheet strength assessment.

Strong Financial Results Lead to Steady Growth in 2023

In 2023, Canada's P/C insurance industry proved resilient, with profitability underpinned by solid equity growth and a substantial increase in net income. The industry managed to achieve favorable financial results, with net income up an astounding 77.5%, from CAD 4.0 billion in 2022 to CAD 7.1 billion in 2023 (**Exhibit 9**). Profitability was driven by growth in underwriting income and a resurgence in investment income, partly counterbalanced by rising finance expenses from insurance contracts, as well as general and operating expenses.

Calculations Under IFRS 17

Note that segment results are not entirely comparable prior to 2023 due to the change in accounting standards to IFRS 17. Nonetheless, underlying trends and patterns remain discernible, allowing for meaningful analysis of performance over time.

Exhibit 10 shows the calculations for IFRS 17 reporters.

Exhibit 10
Claims and Expense Ratios Under IFRS 17

1. Net/Gross

Net Claims Ratio	Net Expense Ratio
Gross Claims + Reinsurance Held Loss (Profit) / *(Re)insurance Services Revenue*	*Expenses* / *(Re)insurance Services Revenue*

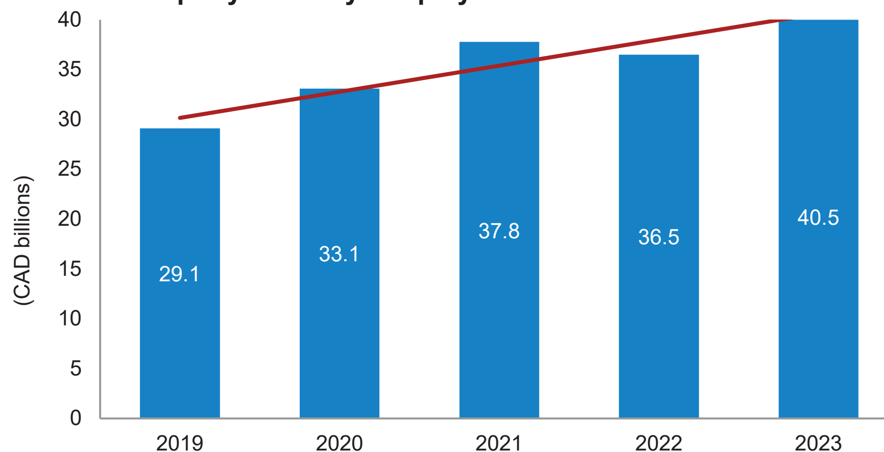
Note: The net expense ratio is the same as the gross expense ratio.

2. Net/Net

Net Claims Ratio	Net Expense Ratio
Gross Claims – Reinsurance Held Recoveries / *(Re)insurance Services Revenue – Reinsurance Held Expenses*	*Expenses* / *(Re)insurance Services Revenue – Reinsurance Held Expenses*

Source: AM Best data and research

Exhibit 11
Canadian Property/Casualty – Equity*



* Excludes Lloyd's, CAB, and ICBC. 2022 and 2023 figures are reported in accordance with IFRS 17.
Source: BESTLINK

Despite facing challenges such as increased claims from natural catastrophes and rising operational costs, most insurers managed to report profitability through strategic pricing and improved underwriting discipline. Insurance service results increased approximately 10.5%, as total insurance revenue growth outpaced insurance service expenses. Personal property, auto liability, and commercial property were the three largest lines by insurance revenue in 2023, and all three reported solid underwriting gains.

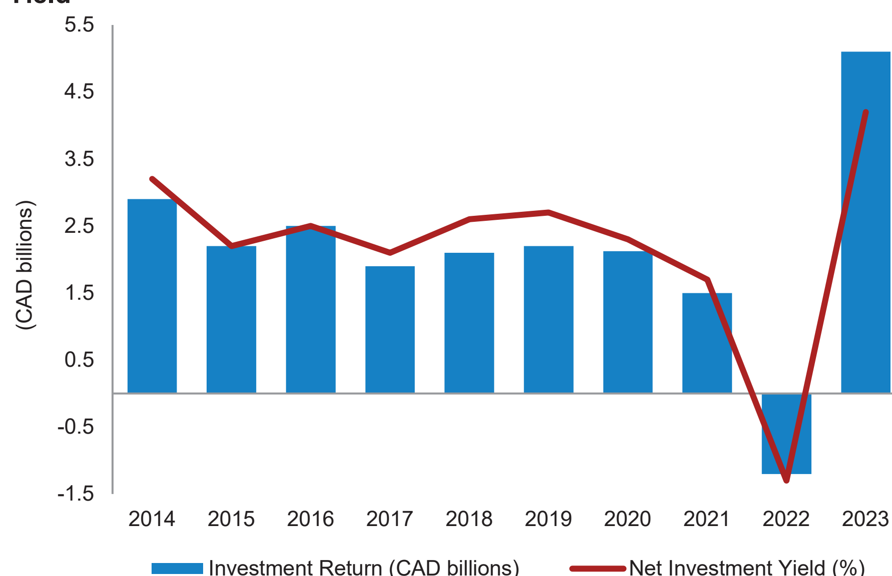
Over the past five years, Canada's P/C industry has seen a notable increase in equity, up by 39.2% from 2019 to 2023 (**Exhibit 11**). Despite the dip in 2022, when earnings were muted by the impact of rising interest rates on fixed income investments, equity rebounded in 2023, reaching CAD 40.5 billion. Double-digit equity growth of 11.1% was a highlight for the industry in 2023, driven by increased net income, substantial contributed capital, and modest AOCI (accumulated other comprehensive income) gains The rise in equity, despite the increase in dividends, reflects the industry' solid financial performance and is seen as credit-positive.

Investment Income Increases Substantially

Investment performance also played a key role in profitability, helping offset rising claims costs and augmenting overall profitability. This was achieved primarily by the favorable investment environment in 2023, in which many insurers saw significant returns on their investment portfolios due to a combination of higher interest rates and strong performance in financial markets. The P/C industry's investment return in 2023 came to CAD 5.1 billion compared with a loss of CAD (1.2) billion in 2022, an improvement of CAD 6.3 billion (**Exhibit 12**). Investment yields were also positive ; however, returns were tempered by ongoing market volatility and fluctuating equity returns.

There has been an ongoing, sizeable shift in insurers' investment portfolios towards bonds over the last three years. In 2023, bonds reached a ten-year high, accounting for 69.8% of invested assets, up significantly from 2021 when bonds amounted to less than half of invested assets (**Exhibit 13**). Given the higher interest rate environment, insurers have reallocated investments in affiliated invested assets and other loans and invested assets towards more attractive higher-yielding bonds. There has also been a more moderate increase in allocations of stocks, real estate and mortgage loans, and cash in 2023. The drop in other loans and invested assets in 2023 is related to reclassification of pooled funds, which are required to be reported in the category that reflects their underlying credit profile (such as bonds, stocks, mortgage loans), as opposed to being separately disclosed in prior years as part of other loans and invested assets on the balance sheet. The rise in other loans and invested assets in 2016 was related to pooling arrangements and partnerships, which were reclassified from bonds to other loans and invested assets.

Exhibit 12
Canada Property/Casualty – Investment Return and Net Investment Yield*



* Excludes Lloyd's, CAB, and ICBC. 2022 and 2023 figures are reported in accordance with IFRS 17.
Source: BESTLINK

Exhibit 13
Canadian Property/Casualty – Invested Assets*
(%)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Bonds & Debentures	67.6	68.0	57.2	54.5	53.4	52.4	52.2	48.0	56.7	69.8
Total Stocks	12.2	11.4	8.3	8.9	7.3	7.4	6.5	8.0	7.6	10.7
Real Estate & Mortgage Loans	1.0	1.0	0.7	0.7	0.8	0.8	0.8	0.7	0.5	1.9
Affiliated Invested Assets	3.6	3.5	3.7	4.5	5.4	5.7	5.5	5.8	5.5	2.6
Cash & Cash Equivalents	3.9	3.9	3.5	4.2	4.0	4.3	6.0	7.3	5.9	6.6
Other Loans & Invested Assets	11.7	12.1	26.5	27.2	29.2	29.3	29.1	30.3	23.8	8.4
Invested Assets	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

* Excludes Lloyd's, CAB, and ICBC. 2022 and 2023 figures are reported in accordance with IFRS 17.
Source: BESTLINK

Despite the BOC cutting rates by 75 basis points to 4.25% as of August 2024—and assuming stable economic conditions—insurers are likely to experience solid investment returns in 2024, albeit muted compared to 2023. Returns will be driven primarily by favorable bond yields and mortgage loan returns. However, the overall outcome will be influenced by equity market performance, further interest rate cuts, and any changes in economic conditions.

GPW/Insurance Revenue & Underwriting Results

Although the insurance industry has historically used gross premiums written (GPW) as a measure of growth, it is not a direct measure under IFRS 17. Many companies in the industry will continue using GPW as it remains relevant in assessing growth trends. Nonetheless, insurance revenue can be used, along with other metrics under IFRS 17, as a proxy for growth over time. In 2023, the industry reported insurance revenue of CAD 77.4 billion compared with CAD 67.7 billion in 2022, an increase of about 14.3% (**Exhibit 14**).

Similarly, underwriting ratios under IFRS 17 may differ from traditional methods under the previous accounting standard. However, the overall scope and meaning of key ratios remains the same. In 2023, the Canadian P/C loss and loss adjustment expense (LAE) ratio remained relatively stable, despite another year of extraordinary catastrophe activity. Additionally, the expense ratio increased modestly, resulting in a combined ratio of 92.3 for the industry, which compares with the combined ratio of 91.0 reported in 2022.

Exhibit 14

Canadian Property/Casualty – Combined Ratio Components*

	Net Premiums Written (CAD billions)	Net Insurance Revenue (CAD billions)	Loss & LAE Ratio	Underwriting Expense Ratio	Combined Ratio
2014	38.0	-	66.3	31.7	98.0
2015	39.3	-	63.2	32.2	95.4
2016	41.1	-	65.6	32.5	98.1
2017	40.7	-	63.9	33.2	97.1
2018	43.8	-	69.6	31.9	101.4
2019	44.9	-	67.3	33.1	100.3
2020	51.1	-	64.9	31.9	96.8
2021	55.5	-	53.7	32.4	86.3
2022	-	52.5	59.9	31.1	91.0
2023	-	60.6	60.4	31.9	92.3

* Excludes Lloyd's, CAB, and ICBC. 2022 and 2023 figures are reported in accordance with IFRS 17.

Source:

Exhibit 15

Canadian Property/Casualty – Reserve Development (Non-Discounted)*

(CAD billions)

	Accident Year Original Reserves	Accident Year Developed Reserves	Accident Year Development	Calendar Year Original Reserves	Calendar Year Developed Reserves	Calendar Year Development
2019	17.2	16.9	-0.3	51.4	49.5	-1.9
2020	17.6	15.6	-2.1	54.8	50.7	-4.2
2021	19.6	18.2	-1.4	59.3	55.4	-3.9
2022	21.7	21.4	-0.3	62.7	59.7	-3.0
2023	38.4	38.4	-	63.6	63.6	-

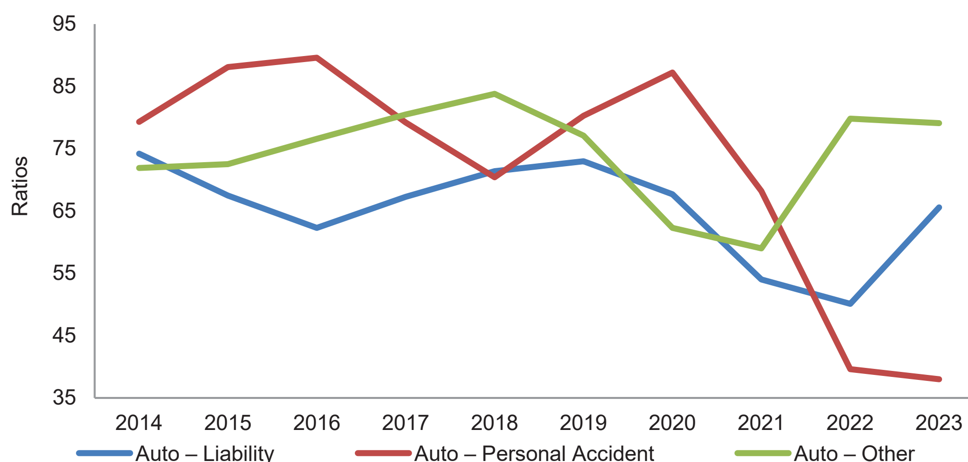
* Excludes Lloyd's, CAB, and ICBC. 2022 and 2023 figures are reported in accordance with IFRS 17.

Source:

Historically, Canadian P/C insurers have adopted conservative initial loss reserve estimates, leading to favorable long-term reserve development trends. Despite the inflationary pressures and elevated catastrophe activity in recent years, positive reserve development trends continued through 2023 (**Exhibit 15**).

Exhibit 16

Canada Property/Casualty – Private Auto Insurers' Loss & LAE Ratios (Net/Net)*



* Excludes Lloyd's, CAB, and ICBC. 2022 and 2023 figures are reported in accordance with IFRS 17.
Source: BESTLINK

Auto Liability Losses Up; Auto Personal Accident and Auto Other Results Stable

The auto liability line experienced the most significant change in 2023, as the loss ratio increased by 15.5 points from 2022. This resulted in a 65.6 auto liability loss ratio at year-end 2023, still slightly lower, but more consistent with results prior to the COVID-19 pandemic (**Exhibit 16**).

The auto personal accident ratio declined by 1.6 points, and the auto other lines loss ratio, by 0.7 points. However, auto personal accident remained at historically low levels, while auto other remained at all-time highs from 2014 to 2023. Another year removed from pandemic lockdowns is evident from the noticeable uptick in claims frequency and severity in 2023. This trend, along with elevated vehicle repair costs, medical treatments, and legal services, negatively impacted the auto liability segment.

Commercial Property Results Steady

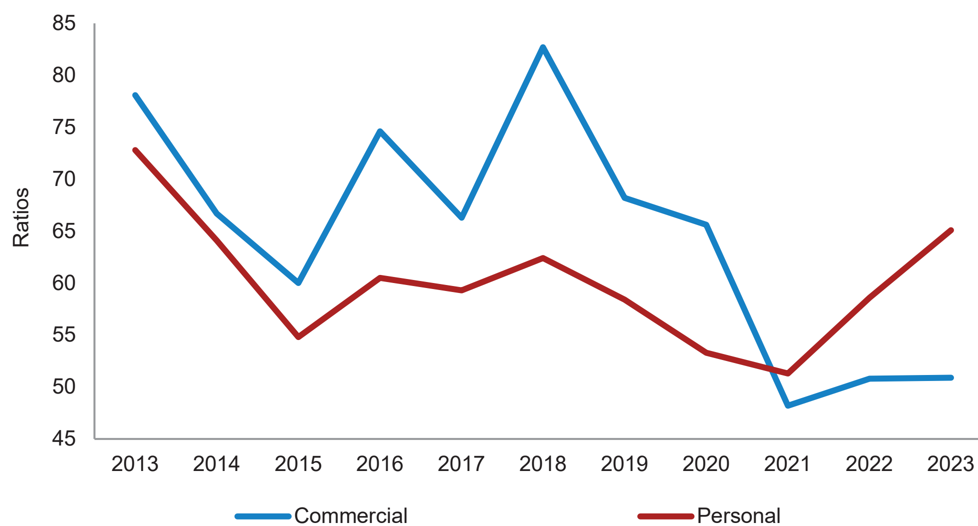
The results for the commercial property line of business remained relatively stable and continue to outperform historical trends. Prior to 2021, the commercial property line generated loss ratios above 60. However, the pandemic contributed significantly to the improvement in results in 2021, related primarily to commercial business closures throughout the country. In 2022, the line's net loss ratio was 50.8, and in 2023, 50.9. These results highlight the strong underwriting discipline of Canadian insurers, which continue to focus on risk selection and pricing. Additionally, insurers continue to refine their overall risk management and technological capabilities, further supporting price adequacy and enhanced risk selection. Nonetheless, the commercial property market remains sensitive to shifts in the economic environment and climate-related events. AM Best expects the hard market conditions will extend into 2025, although they may moderate as inflation and reinsurance market conditions continue to stabilize.

Personal Property Insurance Results Decline

The personal property loss ratio rose by approximately 6.5 points in 2023 to 65.1, reflecting elevated catastrophe activity and a rise in claims. The loss activity was the highest in a decade (**Exhibit 17**). Going into the 2023 renewal cycle, many personal property insurers were faced with increasing their retentions. Therefore, many insurers absorbed more losses owing to the

elevated catastrophe environment. Numerous severe weather events hit Canada in 2023, but personal property insurers were also impacted by inflation and the rise of raw material costs in re-building homes. However, insurers were able to raise rates accordingly, positioning them to achieve rate adequacy in a timely fashion.

Exhibit 17
Canada Property/Casualty – Personal & Commercial Property Loss & LAE Ratios (Net/Net)*



* Excludes Lloyd's, CAB, and ICBC. 2022 and 2023 figures are reported in accordance with IFRS 17.
Source:

Emerging Risks

Climate

Climate risk is a key risk for Canada as the country is experiencing higher catastrophe frequency and severity of climate-related events above global trends. Awareness of and concerns about climate risk are growing globally and in Canada. Flooding events have been heavily affected by intense rainfall events and increased urbanization, aging municipal infrastructure, and nascent efforts at the household level for flood mitigation.

Increasingly, climate risk is being seen as not only a physical risk but also a strategic risk, as the Canadian P/C industry navigates progressively challenging personal property and commercial markets. The impact of climate change is evident in many parts of Canada and is projected to intensify, which is contributing to AM Best's view that Canada, along with other developed countries, will face higher catastrophe events and economic costs in the future.

The impact of climate risk extends beyond the insurance industry, although risk to the segment is magnified, given its direct exposure. Climate risk also indirectly affects many other important sectors of the Canadian economy, including agriculture, forestry, fisheries, mining, and infrastructure. The frequency and intensity of extreme weather events such as heat waves, flooding, wildfires, and storms continues to increase.

Flooding and water-related risks are problematic for Canada—the Intact Centre for Climate Adaptation estimates that roughly 10% of residential properties in Canada (roughly 1.5 million homes) are not insurable for flood damage in basements. One of the issues is that many of Canada's flood maps are outdated by as much as 25 years, and some communities continue to build in flood plains. Canada's federal, provincial, and territorial governments have convened another task force on flood insurance, with the goal of developing a low-cost flood insurance program and furthering educational efforts to provide accessible flood risk coverage for Canada. Managing and mitigating climate risk requires partnerships between government regulators and insurance companies.

Cyber

AM Best expects that demand for cyber insurance will continue to grow. Demand has grown due to broader take-up rates, improving cyber security practices, improved underwriting practices and refined policy language, and market capacity through reinsurance support.

Since 2018, cyber insurance premiums have grown from CAD 87 million, to CAD 550 million insurance service revenues in 2023, per the Insurance Bureau of Canada (IBC). Claims costs, which peaked in 2020, have moderated in recent years and in 2022 the segment reported a very strong combined ratio on an IFRS 4 basis, reflecting significant reserve increases in 2020-2021. In 2023, carriers wrote CAD 550 million in cyber reported as insurance revenue under IFRS 17 and reported an insurance service ratio of 83.4, which is the new IFRS 17 profitability ratio. The impact of ongoing growth in exposures and flat pricing are effectively softening the market.

The Canadian Centre for Cyber Security (Cyber Centre) is Canada's technical authority on cyber security. The Cyber Centre operates as a single unified source of guidance, services, and support on cyber security for Canadians and Canadian organizations. In its National Cyber Threat Assessment 2023-2024, the Cyber Centre focused on five exposures as having the greatest potential to drive cyber threats in 2024:

- Ransomware, which remains a persistent threat to Canadian organizations
- Critical infrastructure, which is increasingly at risk from cyber threat activity
- State-sponsored cyber threat activity impacting Canadians
- Cyber threat actors attempting to influence Canadians
- Disruptive technologies bringing new threats—as well as new opportunities

These exposures dovetail with emerging issues previously identified by AM Best focused primarily on systemic risk and artificial intelligence. Cyber risk continues to evolve and, without a systemic event, cyber exposure modeling has not been fully tested. As a result, insurers avoid over-reliance on models while estimating aggregate risk exposures. The potential for a rise in the frequency of attacks remains a threat, as cyber criminals become increasingly sophisticated. Improvements in AI will benefit both cyber security and the insurance industry overall, although these advances will be challenged, as AI will provide cyber criminals with the opportunity to create new risk exposures.

PFAS

PFAS (per- and polyfluoroalkyl substances) refer to a family of human-made chemicals that are used in many consumer and industrial products and are seen increasingly as a growing environmental risk in both the US and Canada. PFAS are ubiquitous, as they are used in a variety of products such as textiles, solvents, refrigerants, fire fighting foams, and paints.

The actual PFAS exposure in Canada is not known, although its widely thought to be present throughout the country with designated hot spots, including over 100 government sites, that have been exposed to fire fighting foams. On July 27, Environment and Climate Change Canada enacted a new reporting requirement for PFAS, "Notice with respect to certain per- and polyfluoroalkyl substances," requires any person who manufactured or imported PFAS or PFAS-containing articles, or used PFAS in the manufacture of goods, in 2023 to electronically report on specific PFAS identities, uses, production volumes, and disposal.

For the insurance industry, PFAS exposure can cut across many product lines, potentially including general liability, product liability, environmental impairment liability (for example, the dispersal of

chemicals during a manufacturing process) and professional liability directors and officers (D&O) coverages. PFAS risk can be challenging from a claims and reserve perspective due to its long latency and limited quantifiable exposure risk, and could lead to adverse reserve development over time. For these reasons, PFAS are sometimes referred to as the new "asbestos" risk.

Social Inflation

Social inflation—in the form of rising "nuclear" jury awards that are pushing claims costs well beyond economic inflation—is increasing in the US market, driven by changes in societal beliefs and the expansion of third-party litigation financing. Changing societal norms often aimed at pitting the little guys against the big insurers are a key factor in rising nuclear jury awards; in the US in 2023, the 50 biggest awards amounted to $2.4 billion, with large claims more than tripling over the last 10 years. Social inflation typically impacts commercial lines such as commercial auto, D&O, product liability and medical malpractice insurance lines. Although rare in Canada, as personal injury cases rarely proceed to jury trials, there is some cross-border exposure when Canadian companies are included in US cross-border claims (e.g., the Canadian affiliate of a US company is named in a lawsuit), although to date the impact of this has been very modest. However, the risk remains and will continue to evolve due to changes in societal expectations, the ongoing proliferation of social media, and sophisticated litigation tactics, which increasingly use data analytics and AI as litigation tools.

Geopolitical

Geopolitical risks are broadly defined as the potential political, economic, military, and social risks that can emerge over time globally. They are not unique to Canada but do pose potential risks to insurance which are typically not controllable. For example, geopolitical risks in the last few years have caused supply chain imbalances and driven up claims costs as a result.

Geopolitical risk is especially pronounced in 2024, as 44% of the population in more than 70 countries and territories are holding national elections in 2024. Globally, this creates a sizeable amount of election risk and potential for political dislocation. In Canada, federal elections are scheduled for 2025 but polls have indicated that 44% of those surveyed would like to see it move up to 2024, due primarily to the challenges in Canada's economy, with inflation persistently high until recently and declining real GDP growth. Given the strong business relationships with the US, to which Canada exports 78%, the biggest direct political risk to Canada will be what happens in the US election.

M&A Trends

The M&A market for Canada's P/C insurers and brokers continues to grow, albeit at a more moderate pace in recent years, as companies seek to expand distribution in the brokerage market. By acquiring brokerages, insurers can enhance their market shares and customer relationships in niche segments. Additionally, brokers continue to consolidate in the market, making it more difficult for smaller brokers to compete due to rising operating costs and higher volume requirements in certain geographic areas, leading to the acquisition of smaller players. BrokerLink, one of Canada's largest insurance brokerages, completed 20 acquisitions alone in 2023. Westland Insurance was also again active, completing several strategic acquisitions. However, smaller brokerages tempered M&A due to the elevated interest rate environment and other economic factors. M&A deals have been primarily in the provinces of Ontario, Alberta, and British Columbia, as the demand for retail brokers in provinces with public auto insurance remains lower. The pace of acquisition was partly affected by the rising cost of capital, but transactions are directly impacted by the excess capital, leverage and financing available to fund a transaction, as needed. Through 2024 thus far, broker acquisitions have picked up steam again as interest rates started being cut and inflation slows down.

Regulation

Regulatory changes will always pose some emerging risk. Regulatory resistance to rate adjustments in certain markets, such as personal auto rates in Alberta, is a persistent risk in insurance regulation. The Alberta government implemented a rate freeze in 2023 and a rate cap for good drivers in 2024. Opposition to auto rate increases has created challenges for insurers, forcing them to decide whether to reduce their participation or completely withdraw from the province. Furthermore, insurers that remain in the market have significantly cut their marketing expenses and implemented other cost saving measures. Additional headwinds include rising claims costs (comprised of rising legal costs) and auto theft, which have further pressured insurers and provincial governments to implement reform legislation.

Unlike auto insurance, homeowners insurance in Canada is neither regulated nor mandatory, and consumers are not legally required to purchase any minimum level of coverage unless applying for a mortgage. Canadian insurers have therefore been able raise premiums accordingly, to maintain loss cost stability. The Office of the Superintendents of Financial Institutions (OSFI) has highlighted the growing need for resilience initiatives to counteract the impact of rising weather events on personal property. This could include a backstop fund similar to the Canada Deposit Insurance Corporation, which backs the banking industry. Given these circumstances, the personal property industry may experience future regulatory changes, although AM Best expects these to be gradual.

An additional issue of growing significance within the regulatory environment is the use of artificial intelligence. Currently, there is an evolving regulatory framework in Canada specific to AI. However, there is a code of conduct that provides Canadian companies common standards to follow voluntarily until formal regulation is in place.

In the insurance industry, AI is becoming more prominent, playing a role in multiple areas such as risk prevention, customer service, claims, and underwriting. Although AI provides substantial benefits to insurers, concerns for regulators remain. For instance, some insurers may use AI to find data that supports insuring against certain vulnerable classes. As a result, regulators want insurers to be able to validate data inputs and the parameters of how AI came to its conclusion. Additionally, the quality and depth of data is important, and insurers must take appropriate steps and precautions to ensure data variables are truly predictive of insurance risk.

As AI continues to shape the insurance landscape, regulators will look for ways for insurers to provide transparency and accountability in AI-driven processes.

On the climate front, OSFI introduced Guideline B-15: Climate Risk Management in March 2023, solidifying Canada's commitment to ESG (environmental, social, and governance) integration in the insurance industry. Guideline B-15 will take effect at fiscal year-end 2024 for domestic systemically important banks and internationally active insurance groups headquartered in Canada, and at fiscal year-end 2025 for all other in-scope federally regulated financial institutions (FRFIs). Although OSFI has federal oversight, Canada's regulatory regime includes provincial and territorial regulation, which makes regulation on climate change as well as other key industry issues difficult. The OSFI may issue additional guidelines to appropriately gauge an insurer's ability to manage evolving catastrophe events.

Artificial Intelligence

Insurance carriers have been using some form of AI for years, focusing primarily on improving workflow and the customer experience. However, with the recent boom in generative AI, companies have begun to use AI more extensively. The use of chatbots and virtual assistants has grown markedly

in recent years, improving customer service, and handling simple customer inquiries more efficiently. Chatbots and virtual assistants are also able to recommend product offerings and navigate with potential customers throughout the buying process. The uptake of GenAI is further evidenced by insurers leveraging it for code generation, content and image generation, and fraud detection.

An additional application of AI is seen in the underwriting process, whereby AI-driven tools can assess risks more accurately and quickly. Companies have placed an increased emphasis on predictive analytics tools and made significant investments to ensure they have the capabilities necessary to effectively use these tools. Predictive analytics allows insurers to price policies appropriately by using large data sets to analyze future trends, such as policyholder behavior and potential claims. Predictive analytics also help detect fraudulent claims by looking at unusual patterns, even being able to monitor a claimant's social media pages for any irregularities. As insurers continue to embrace AI applications, the key challenge will be ensuring that these technologies are integrated into business operations responsibly and finding the right balance to ensure robust risk management and compliance policies are upheld.

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