October 6, 2023

Canada Insurance: Positive Results Expected Despite a Slowing Economy

Canada's P/C and L/A industry outlooks remain at Stable, although the economic recovery is expected to slow down in 2023

Principal Takeaways

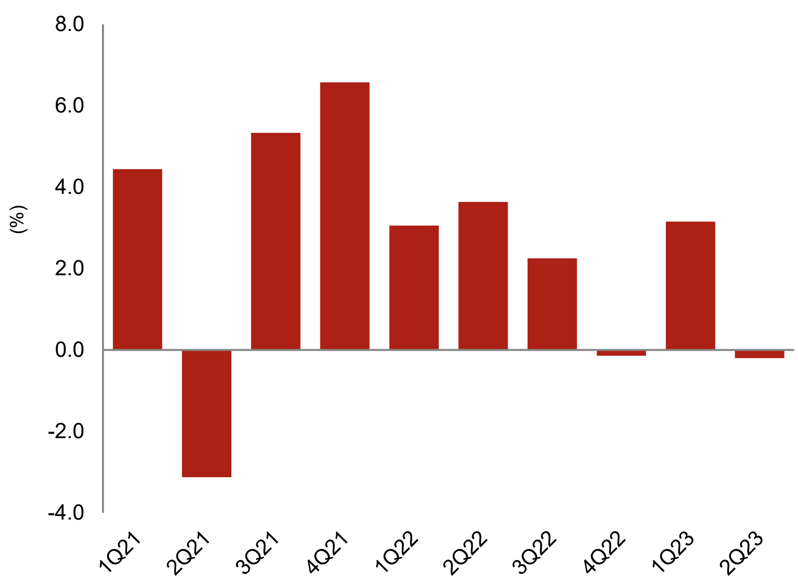
- Canada's economy remains resilient, although the recovery is expected to slow down in 2023.
- The country's P/C industry weathered a number of obstacles in 2022, for a fourth year of underwriting profitability and solid risk-adjusted capitalization.
- Canada's L/A insurers posted generally favorable operating results in their core lines of business and are well equipped to navigate uncertainty in the coming year.

Canada Economic Activity Set to Slow in 2023

Despite numerous headwinds, Canada's economy has been remarkably resilient. According to the IMF, real GDP grew by 3.4% in 2022, fueled by domestic demand, non-residential business investment, and higher commodity prices. Economic activity surprised on the upside in 2022, as Canada weathered the impacts of higher interest rates and persistently high inflation better than expected. Consumer demand remained strong, supported by a tight labor market, rising real wages, and accumulated savings. However, signs of weakness are starting to show, which will lead to slower growth.

The Canadian economy grew by 2.6% in the first quarter of 2022 and 3.6% in the second, driven mainly by household expenditures and business fixed investment/inventories. Drags on the economy included a drop in international export volume and housing investment. GDP fell in the third quarter to 2.2% and contracted by 0.1% in the fourth, as both household consumption and housing investment slowed.

Exhibit 1
Canada – Quarterly GDP, 1Q22-2Q23



Source: Statistics Canada

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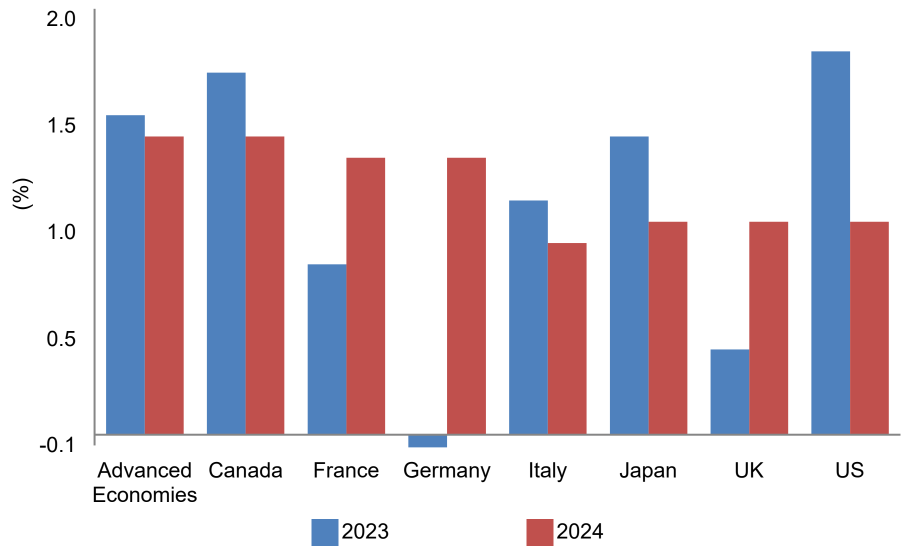
During the first quarter of 2023, economic activity returned to growth, driven mainly by strong household expenditures and exports, although a drawdown in inventories was a drag. The return to growth was short-lived as the Canadian economy contracted by 0.2% in the second quarter of 2023 due to declines in housing investment and smaller inventory accumulation (**Exhibit 1**).

Exhibit 2
IMF GDP Growth Projections

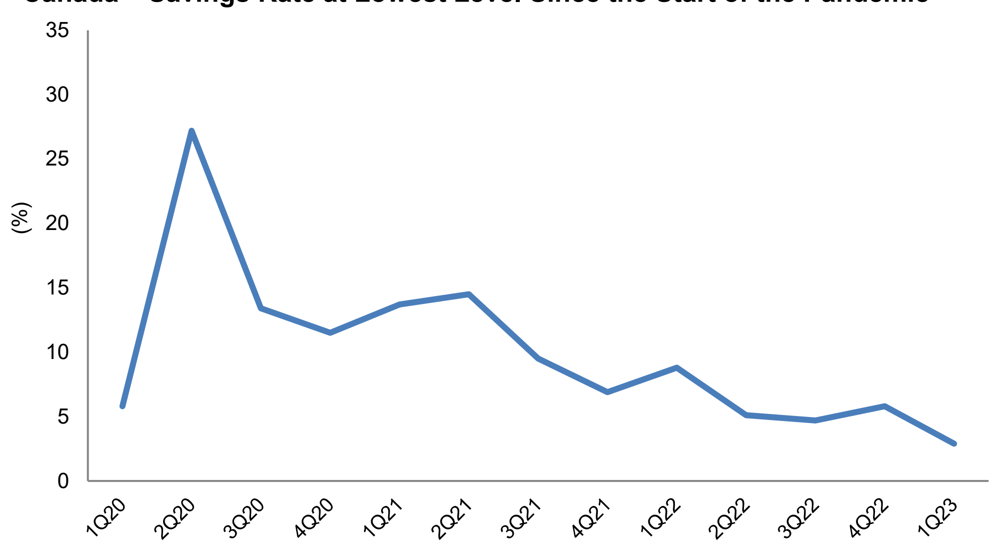


Source: IMF

Although the economy has been able to withstand the tighter credit conditions, we seem to be at an inflection point, and higher interest rates will slow growth. Historically, the impact of monetary policy tightening takes time to trickle down to the broader economy. From March 2022 to July 2023, the Bank of Canada (BOC) raised its policy rate from 0.25% to 5.0%, for one of the steepest monetary policy tightening cycles in decades.

The IMF is forecasting that GDP growth will slow to 1.7% in 2023 and 1.4% in 2024 due to the cumulative impact of higher borrowing costs and tighter credit conditions. Despite slowing economic growth, Canada still has one of the highest GDP growth projections for advanced economies in 2023 and 2024. However, risks are elevated, and the IMF believes the country could slip into a mild recession over the short term. Risks include a worse-than-expected slowdown in global economic activity (particularly in the US and China). Furthermore, inflation expectations remain elevated due to sticky inflation, and concerns about the housing sector and elevated household debt are growing (**Exhibit 2**).

Exhibit 3
Canada – Savings Rate at Lowest Level Since the Start of the Pandemic



Source: Statistics Canada

A Mixed Picture for the Consumer

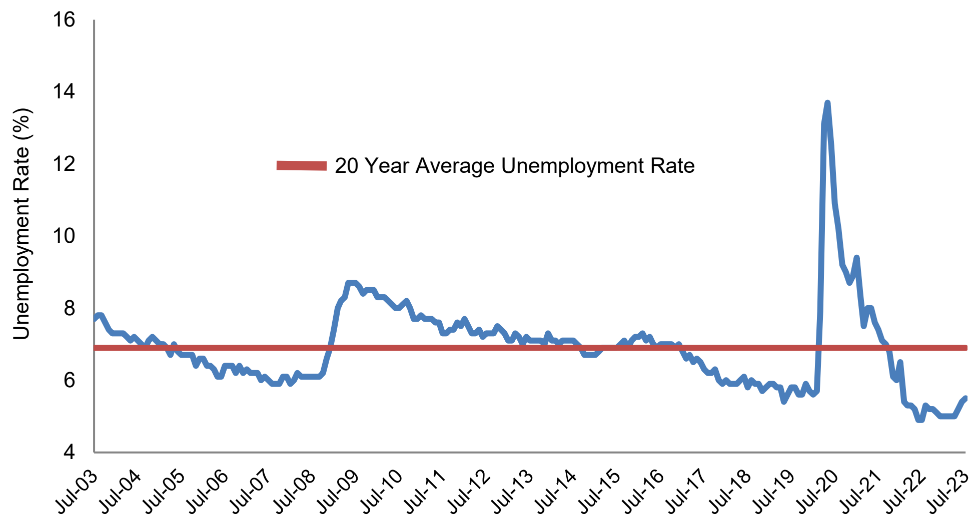
Personal consumption, which accounts for approximately 60% of Canada's GDP, will face rising pressure the longer high interest rates and inflation are part of the macroeconomic environment. On the surface, consumer spending continues to fuel economic growth, which increased almost 6% in the first quarter of 2023. However, household incomes fell by 6.5%, indicating that consumers are supporting their spending either by accumulating debt or drawing down on savings.

According to Equifax's Canada Market Pulse Quarterly Credit Trends report for first-quarter 2023, total consumer debt rose by almost 5% year over year, and credit card balances up 14.5% due to the higher cost of living. According to Equifax, the largest increase in credit card spending came from those who don't pay off their balances each month. In the first quarter of 2023, the personal savings rate fell to 2.9%, the lowest level since the start of the pandemic (**Exhibit 3**). Consumers are apparently drawing down on accumulated savings or taking on more debt rather than altering their spending behavior.

The strong labor market has been a tailwind to consumer spending. In July 2023, unemployment registered 5.5%, above the post-pandemic low of 4.9% in July 2022 but well below the 20-year historical average of approximately 7.0% (**Exhibit 4**). The labor market remains relatively tight but is showing signs of easing. Businesses have reported fewer issues attracting workers and job vacancy rates are falling. Canada's population has grown the fastest in decades, helping ease labor shortages but also fueling demand and the need for housing.

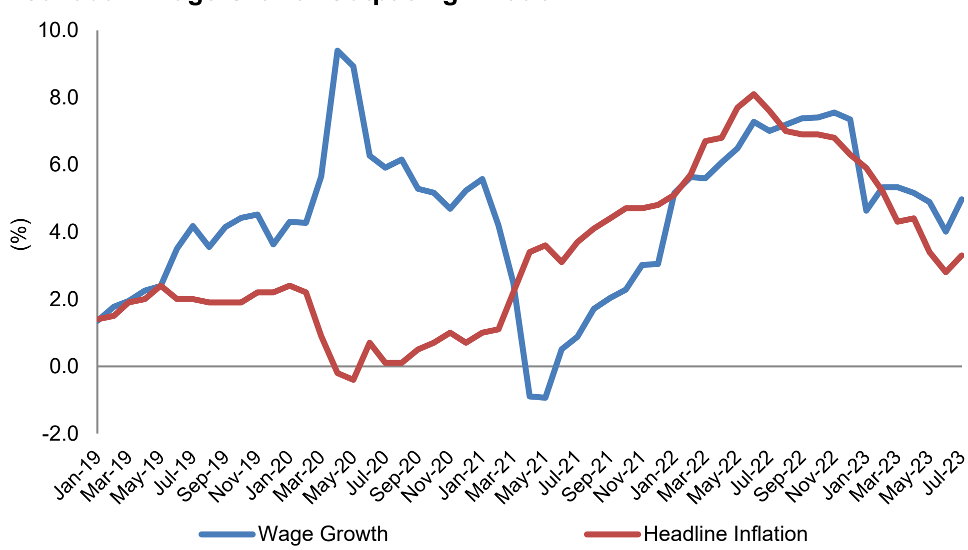
An additional factor supporting consumer spending is annual wage increases, which have outpaced inflation since August 2022 (other than in January 2023). However, wage growth

Exhibit 4
Canada – Unemployment Rate



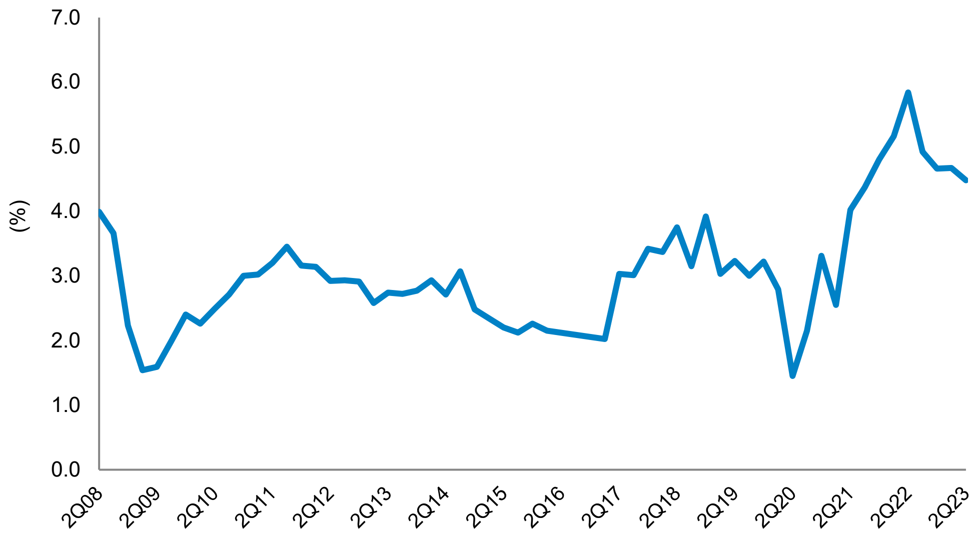
Source: Statistics Canada, AM Best calculations

Exhibit 5
Canada – Wage Growth Outpacing Inflation



Source: Bank of Canada

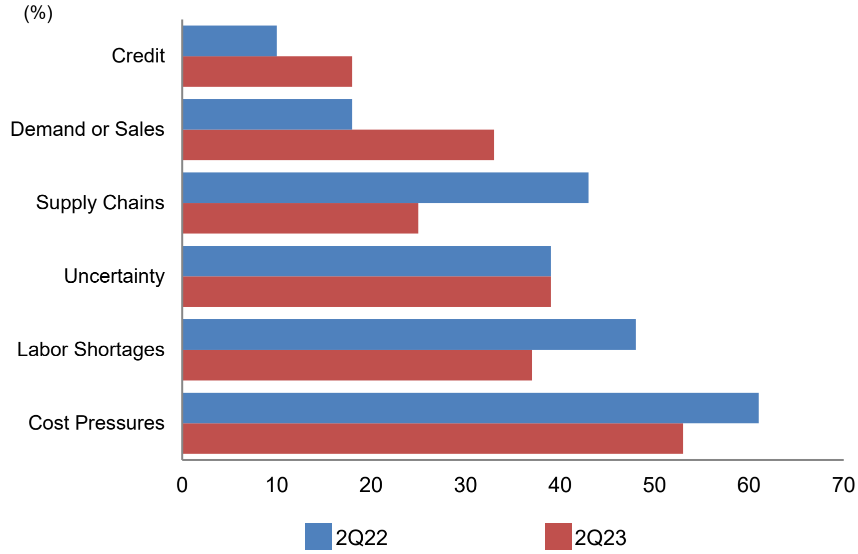
Exhibit 6
Canada – Expected Annual Wage Growth



Source: Bank of Canada, Business Outlook Survey

is a double-edged sword—it supports consumer spending but if wage growth is too elevated it could also fuel excess demand, which leads to higher inflation (**Exhibit 5**). Businesses have reported planned wage increases over the next 12 months of 4.5%, well below peak but above historical trends (**Exhibit 6**).

Exhibit 7
Canada – Shift in Business Concerns over the Last Year



Source: Bank of Canada, Business Outlook Survey

Business Concerns have Shifted

According to the BOC's most recent Business Outlook Survey (a survey of Canadian businesses), business sentiment has declined since the second quarter of 2022. Responses to the survey question, "In the current quarter, what items have been the most pressing concern for your company? Select up to three" show that, although businesses still see cost pressures and labor shortages as concerns, slowing demand over the next 12 months has become a more widespread concern (**Exhibit 7**).

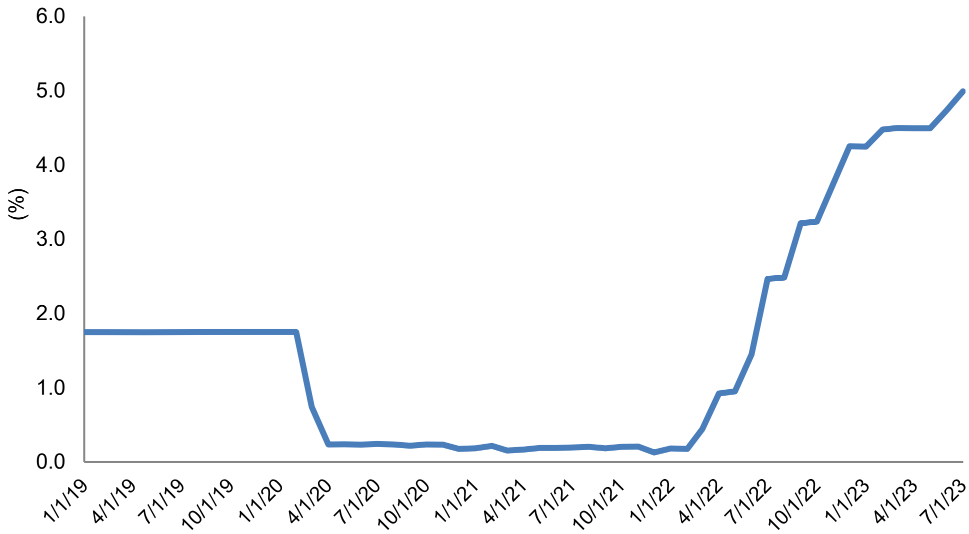
Some firms are more optimistic and point to fewer concerns about a recession and uncertainty about interest rates. Additionally, firms in the trade sector point to the improvement in supply chains and the ability to work through order backlogs.

Inflation Declines but Remains Above Central Bank Target

The BOC began tightening monetary policy in March 2022, raising its policy rate by 25 basis points to 0.5%, and continued to do so through July 2023. During this time the BOC has raised the policy rate a cumulative 475 basis points to a rate of 5.0% (**Exhibit 8**). There was a "conditional pause" from late January 2023 through June 2023 when the BOC did not raise rates. The BOC noted that, during the pause, it believed the interest rate increases were working but would continue to monitor data and how the economy was evolving. Since peaking at 8.1% in June 2022, headline inflation dropped to 3.3% in July 2023 (**Exhibit 9**).

Exhibit 8

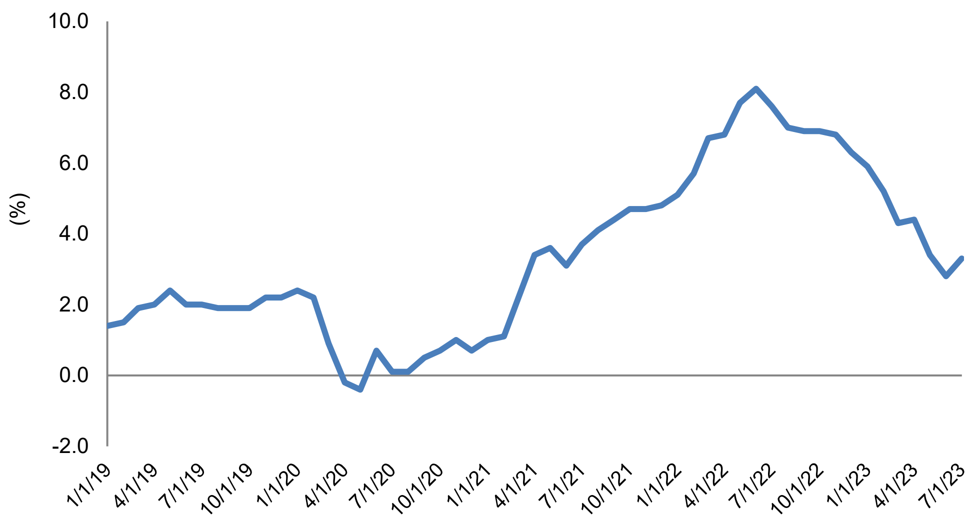
Canada – Bank of Canada Policy Interest Rate



Source: Bank of Canada

Exhibit 9

Canada – Headline Inflation



Source: Statistics Canada

However, the bank resumed raising the policy interest rate, increasing it by a cumulative 50 basis points in June and July 2023. The BOC noted that "while CPI inflation has come down largely as expected so far this year, the downward momentum has come more from lower energy prices, and less from easing underlying inflation. With the large price increases of last year out of the annual data, there will be less near-term downward momentum in CPI inflation." It added that concerns about higher inflation expectations were becoming anchored, and it will take longer to reach the central bank's inflation target of 2.0%.

To further tighten financial conditions, the bank began to reduce its balance sheet in October 2020 by discontinuing both mortgage bond and money market purchases. In April 2021, the BOC became the first major central bank to scale back purchases of government debt. In March 2020, at the start of the pandemic, total assets on the bank's balance sheet came to approximately CAD 119 billion, which rose to a peak of approximately CAD 575 billion in March 2021. Its balance sheet assets now stand at approximately CAD 349 billion as of August 2023 (**Exhibit 10**).

Exhibit 10
Canada – Bank of Canada, Balance Sheet Assets

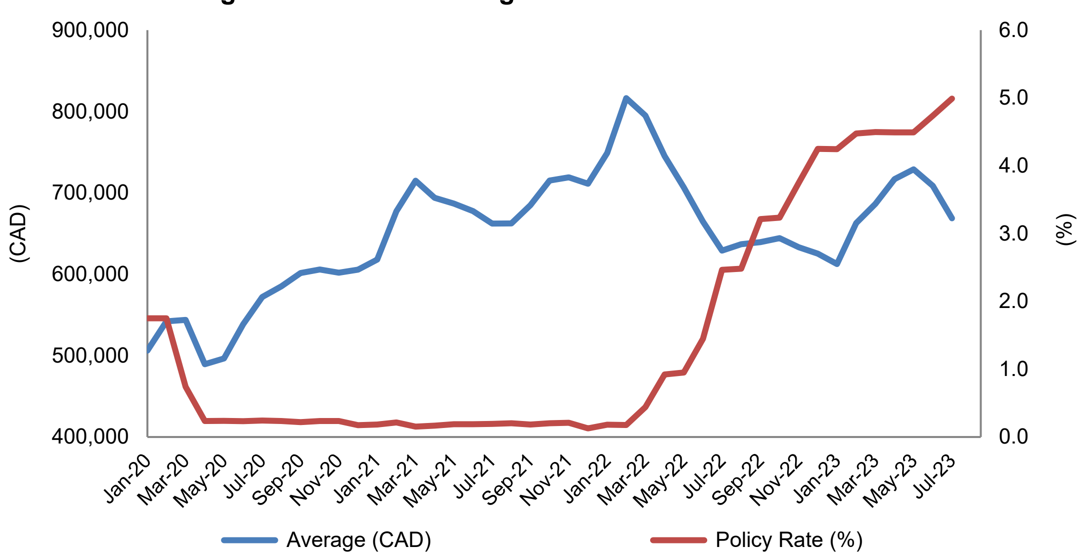
Source: AM Best data and research

Housing Supported by Limited Inventory

Housing prices corrected sharply in 2022. After peaking at approximately CAD 816,500 in February 2022, the average sales price declined to approximately CAD 612,500. During this period, the BOC commenced its monetary policy tightening cycle and raised policy rates from 0.25% to 4.5%. After the BOC's conditional pause, housing prices started to recover, reaching approximately CAD 729,000 in May 2023, but they took another hit, falling to approximately CAD 668,750 in July 2023, after the BOC reinstated rate hikes in June and July 2023 (**Exhibit 11**).

Prices have been volatile and are still well above what they were at the start of the pandemic. Demand still exceeds supply—the population has surged the last few years due to immigration, which has added to the need for additional housing. Moreover, the inventory of homes remains low, and builders

Exhibit 11
Canada – Average Residential Housing Prices



Sources: Canadian Real Estate Association, Bank of Canada are cautious about new construction due to zoning rules, high material costs, and the lack of skilled labor. As a result, a significant correction in the housing market is unlikely.

Canada Property/Casualty: Profitable 2022 Despite Elevated CAT and Market Volatility

Canada's property/casualty industry faced a considerable number of challenges in 2022, including elevated catastrophe activity, unprecedented inflation, capital markets volatility, and substantial reinsurance pressures on terms and conditions. Insurers also prepared for the adoption of the new IFRS 17 accounting standard.

However, the industry managed to navigate through these obstacles for a fourth year of underwriting profitability and solid risk-adjusted capitalization. As a result, AM Best's outlook on the segment remains at Stable, driven by the following factors:

- Solid risk-adjusted capitalization despite increased capital pressure
- Four years of underwriting profitability despite rising insured losses stemming from climate-related events
- Enhanced enterprise risk management capabilities with the continued integration of environmental, social, and governance (ESG) principles and underwriting guidelines
- Carriers ability to fully place reinsurance programs, despite increased retentions and higher costs given the hard reinsurance market
- A relatively stable regulatory environment

While results for the Canadian PC industry have been historically profitable, near-term challenges remain. Some challenges have emerged in recent years, while others remain persistent concerns for the industry. These include:

- Growing frequency and severity of extreme catastrophe weather events
- Market volatility driven mainly by rising interest rates resulting in some balance sheet volatility
- Increases in reinsurance pricing as well as changes in terms and conditions as a result of decreased reinsurance capacity with the net result of higher balance sheet retained risk exposure.
- Inflation remains a headwind, particularly wage inflation, although overall inflation is trending lower compared to 2022. Nonetheless, 2022 results were pressured due to inflationary headwinds.

Because of the increase in the severity and frequency of weather-related events in 2022, Canada's P/C insurers faced the third-worst year for insured losses in their history. Insurers have had to quickly adapt to find solutions and limit the impact of what are increasingly viewed as unsustainable losses. Underwriting guidelines have been tightened and exposure modeling has been enhanced. Additionally, the rapid rise in interest rates throughout 2022 to combat inflation led to substantial mark-to-market losses on insurers' fixed income bond portfolios. As a result, capital and liquidity were pressured for some carriers, although the overall industry was able to withstand these challenges through strong balance sheets and solid risk management.

The difficult environment in 2022 was followed by a problematic 2023 reinsurance renewal season, with many programs needing to be restructured due to a decline in reinsurance capacity. This led to price hikes on programs throughout the industry and resulted in many carriers having to expand retentions. Still, the industry was resilient, with a majority of programs being fully placed for 2023.

Catastrophe activity has continued to impact the industry through 2023 thus far, with an unprecedented number of wildfires occurring in the Atlantic and British Columbia regions. Insurers will need to remain aware and continue to enhance their underwriting, risk-appetite, and overall enterprise risk-management programs while remaining vigilant about price increases, to adapt to the growing impact of climate-related events.

Rating Levels Trending Stable

In 2022, 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 over the past ten years (**Exhibit 12**). All rated entities currently have FSRs of B++ or higher.

From an issuer credit rating perspective (ICR), the vast majority of rating actions in 2022 were affirmations, reflecting the continued stability of Canada's P/C industry, despite the headwinds in 2022. Additionally, two ratings were upgraded, one was downgraded, two were assigned, and one was withdrawn. The rating upgrades were driven by the ongoing improvement in risk-adjusted capitalization and operating performance; the downgrade reflected a deterioration in underwriting performance driven by elevated catastrophe activity. The two assigned ratings were for the addition of two Canadian branches into larger rating units. The rating withdrawal was for the Canadian branch of a larger rating group no longer transacting business in Canada.

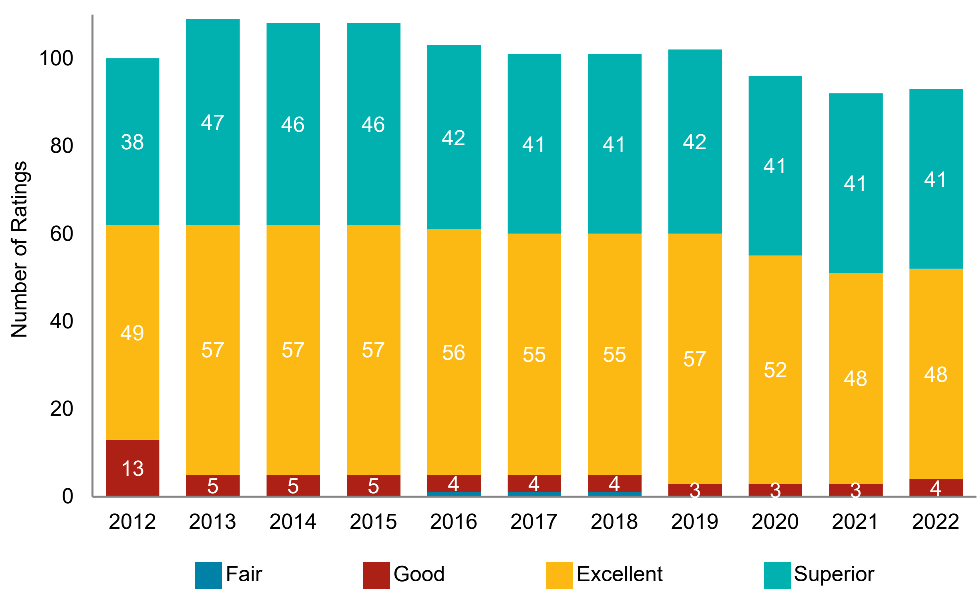
Two issuer credit rating (ICR) outlooks were revised to Positive from Stable, based on their association with larger groups and improved risk-adjusted capitalization and operating performance. No ICR outlooks were revised to Negative, but we did maintain a Negative outlook on two ratings.

AM Best expects segment ICRs to remain stable (**Exhibit 13**), although, over the near term, volatility and increased losses may pressure the ratings on carriers geographically concentrated in more catastrophe-prone areas.

Exhibit 12

Canada Property/Casualty – Interactive Ratings*

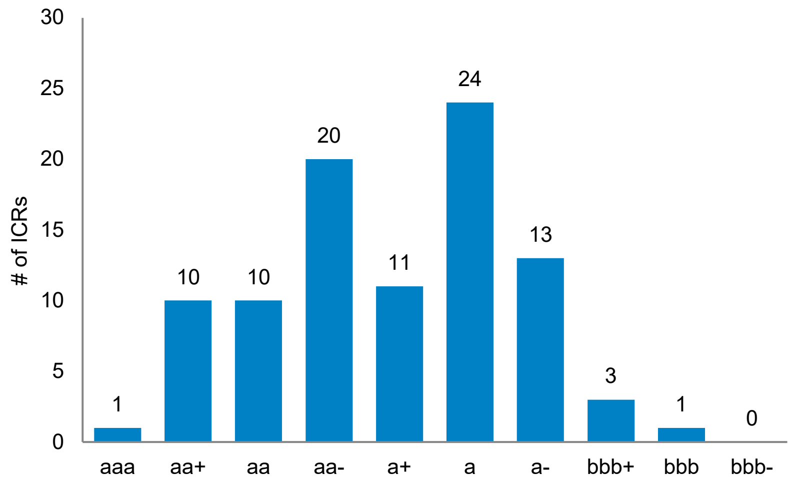
# of Ratings as of July 11, 2023



Source: AM Best data and research

Exhibit 13

Canada Property/Casualty – 2022 Issuer Credit Ratings



As of July 11, 2023

Source: AM Best data and research

2022 Results Within Expectations

Market conditions remain complex, but Canada's P/C industry was profitable and results were within our expectations for modest earnings growth in 2022, despite volatility and a moderate decline in net income, following a record year of outsized investment performance in 2021 and within our expectations that earnings growth would moderate in 2022. Net income was a healthy CAD 6.6 billion and well above the reported results of the last five years, other than in 2021.

Key industry headwinds persist, including supply chain imbalances, economic inflation, global political uncertainty, rising climate risk, rising reinsurance costs, and cyber risk, but the industry has adequately improved its underwriting performance through rate increases, risk mitigation, and improvements to underwriting processes and technology. As a result, the industry's 2022 results were generally favorable (**Exhibit 14**).

Despite positive net income, equity growth was muted and constrained by the impact of rising interest rates on fixed-income investment valuations, which also remain headwinds in 2023. The impact of declines in investment valuations was sizeable, with a drop in AOCI (accumulated other comprehensive income) of CAD 4.4 billion, significantly higher than the CAD 60.6 million in 2021, which was a significant counter to reported net income of CAD 6.6 billion. Net income was also impacted by realized investment losses of CAD 600 million, versus realized gains of CAD 535 million in 2021. In response, insurers moderated their dividend payouts and cut dividends by 25%, to CAD 2.4 billion, down from CAD 3.2 billion the prior year.

Underwriting leverage rose, with the ratio of net premiums written (NPW) to equity at 1.03, which reflected the lack of equity growth and higher though modest premium growth. Insurers' risk appetites for specialty lines such as cyber remain more limited, particularly in higher-risk sectors, despite an increase in global capacity. Rising ransomware costs continue to dampen profitability.

Exhibit 14

Canada Property/Casualty – Net Income*

(CAD billions)

	2017	2018	2019	2020	2021	2022
Net Underwriting Income	0.7	-0.4	0.2	1.9	7.6	7.4
Net Investment Income	1.9	2.1	2.2	2.1	1.5	2.0
All Other Income/Expense	0.7	-0.1	1.0	1.8	1.5	-0.9
Income Tax	0.6	0.3	0.7	1.2	2.3	1.9
Net Income/Loss	**2.7**	**1.4**	**2.6**	**4.7**	**8.3**	**6.6**

* Excludes Lloyd's, CAB and ICBC.

Source: BESTLINK

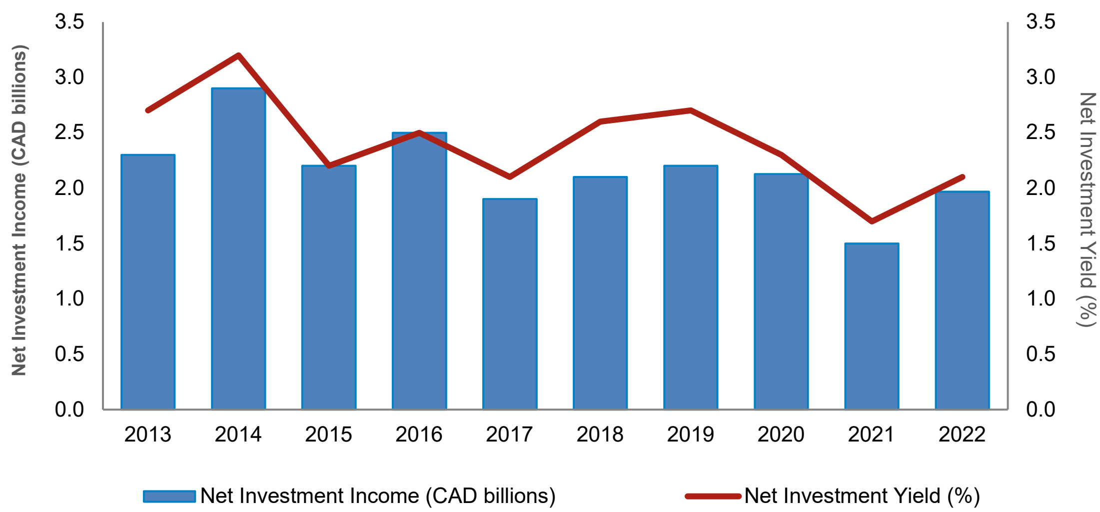
The pace of broker consolidations continue, with four Canadian brokers acquired in the second quarter of 2022. Two brokerages—Link and Westland—acquired four independent brokerages during the quarter (Booth Burnett, Savante, Tailormade, and Maple Insurance). We believe that insurer M&A and consolidations will continue at a fairly rapid pace; one large insurer has indicated the potential for 15% consolidation over the next five years.

Net Investment Income and Net Investment Yields Up

Net investment yields rose benefiting from interest rates rising to levels not seen in recent years, with an average return of 2.1% (**Exhibit 15**). The improvement contributed to a moderate increase in net investment income of CAD 2.0 billion, slightly below the ten-year average of CAD 2.2 billion, although this should improve in 2023 given the continued rise in interest rates. The allocation of bondholdings grew significantly (**Exhibit 16**), while allocations of stockholdings, mortgages, and other invested assets declined moderately, as companies took strategic advantage of rising rates to minimize risk, and overall returns improved owing to rising interest rates and stable credit spreads. The significant bump in other invested assets in 2016 was due to a reclassification related to pooling arrangements and partnerships. These investments were composed predominantly of government and corporate bonds at the time and were reclassified as "other loans and invested assets." Since then, other loans and invested assets had grown steadily, but declined modestly in 2022.

Exhibit 15

Canada Property/Casualty – Net Investment Income and Net Investment Yield*



* Excludes Lloyd's, CAB, and ICBC.

Source: BESTLINK

Exhibit 16

Canadian Property/Casualty – Invested Asset Categories as a Percentage of Total Invested Assets*

(%)

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

* Excludes Lloyd's, CAB, and ICBC.

Source: BESTLINK

Rising interest rates have supported economic returns but have had an unfavorable impact on balance sheets due to the declines in market values, which constrained capital growth. This trend may continue in 2023.

NPW Essentially Flat

NPW growth was close to flat, up just 0.8% to CAD 7.4 billion. The combined ratio rose slightly, to 87.2, from 86.3 in 2021 (**Exhibit 17**), owing to an uptick in expense ratios—despite modest premium growth, inflation, and rising catastrophe severity, the loss ratio was stable. The increase in expense ratios was modest overall and reflects inflation costs related to selling, general, and administrative (SGA) expenses, and expense spends for technology systems and innovation initiatives. Premium increases varied by province and were generally in the mid- to mid-upper single-digit range for personal lines.

Exhibit 17

Canada Property/Casualty – Combined Ratio Components, 2014-2022*

	NPW (CAD billions)	NPW Growth (%)	Loss & LAE Ratio	Underwriting Expense Ratio	Combined Ratio
2014	38.0	7.0	66.3	31.7	98.0
2015	39.3	3.5	63.2	32.2	95.4
2016	41.1	4.6	65.6	32.5	98.1
2017	40.7	-1.1	63.9	33.2	97.1
2018	43.8	12.8	69.6	31.9	101.4
2019	44.9	2.5	67.3	33.1	100.3
2020	51.1	13.0	64.9	31.9	96.8
2021	55.5	7.1	53.7	32.4	86.3
2022	56.2	0.8	53.7	33.5	87.2

* Excludes Lloyd's, CAB, and ICBC.

Source: BESTLINK

Canada's insurers have historically set conservative initial loss reserve estimates, which have resulted in favorable long-term reserve development for both accident and calendar years (**Exhibit 18**).

The personal auto, personal property, and commercial property loss & LAE ratios have all outperformed their US peers the past five years (**Exhibit 19**) and compared favorably to the US in 2022. The US personal property segment's loss ratio was impacted by continued high levels of catastrophic activity in 2022. Loss ratios in US are more elevated than in Canada, which we believe reflects the fact that the higher levels of frequency and severity in the US. Additionally, there is the problem of social inflation on jury awards, which is more elevated in the US as well as the fact that US drivers tend to drive larger automobiles and more trucks. Canada's personal auto segment performed

Exhibit 18

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

	Accident Year Original Reserves (CAD billions)	Accident Year Developed Reserves (CAD billions)	Accident Year Development (CAD billions)	Accident Year Combined Ratio (%)	Calendar Year Original Reserves (CAD billions)	Calendar Year Developed Reserves (CAD billions)	Calendar Year Development (CAD billions)
2018	16.2	15.4	-0.8	103.4	50.3	46.5	-3.8
2019	16.4	16.0	-0.4	103.6	50.0	48.5	-1.5
2020	16.7	14.9	-1.9	88.3	53.0	49.6	-3.4
2021	18.7	17.2	-1.5	87.6	57.5	53.9	-3.6
2022	20.3	20.3	-	98.4	59.9	59.9	-

* Excludes Lloyd's, CAB, and ICBC.

Source: BESTLINK

better in 2022, as driver activity normalized at a slower pace than in the US, but we expect those differences to become less impactful in 2023.

Additionally, US commercial property loss ratios are moderately higher than Canada's, although they are more similar than other segments. Both countries are dealing with climate change and inflationary pressures compounded by supply chain issues, and insurers have raised rates and reinsurance pricing.

Exhibit 19
Canada Property/Casualty* – Loss & LAE Ratio Compared to US P/C Industry

	2022 Loss & LAE Ratio	Five-Year Average Loss & LAE Ratio
US Private Pass Non-Stand. Auto	86.5	76.9
US Private Pass Stand. Auto	91.4	78.1
US Personal Property	79.1	74.6
US Commercial Property	57.6	62.1
Canadian Private Auto Liability	50.1	62.6
Canadian Private Auto Pers. Acc.	39.6	69.2
Canadian Private Auto Other	79.8	71.7
Canadian Personal Property	58.6	56.6
Canadian Commercial Property	50.8	61.0

* Excludes Lloyd's, CAB, and ICBC.
Source: BESTLINK

Muted Impact of IFRS 17 on Equity

The impact of IFRS 17 on equity overall (**Exhibit 20**) was very muted, at CAD 39.0 million per the OSFI (Office of the Superintendent of Financial Institutions), although shareholders' equity for the top 10 P/C companies rose moderately, CAD 1.6 billion, or 7.6%. Larger companies have the resources and ability to model underwriting costs related to (DAC) deferred acquisition costs; the positive impact on equity is largely related to DAC.

Exhibit 20
Canadian Property/Casualty – Impact of IFRS 17 on 2022 Equity

Company Name	2022 Equity	Impact on Equity	2022 Equity Restated for IFRS 17
Intact Insurance Co.	4,586,290	431,519	5,017,809
The Wawanesa Mutual Insurance Co.	3,781,294	129,078	3,910,372
Co-operators General Insurance Co.	2,355,909	249,537	2,605,446
Northbridge General Insurance Corp.	2,042,595	114,556	2,157,151
Certas Home and Auto Insurance Co.	1,719,342	143,912	1,863,254
Definity Insurance Co.	1,575,643	177,883	1,753,526
Aviva Insurance Co. of Canada	1,525,655	136,601	1,662,256
The Dominion of Canada General Insurance Co.	1,168,001	61,818	1,229,819
Allstate Insurance Co. of Canada	1,128,220	110,030	1,238,250
Chubb Insurance Co. of Canada	1,065,783	40,623	1,106,406
Top 10 P/C Insurance Cos.	**20,948,732**	**1,595,557**	**22,544,289**
Total Canadian P&C	**32,839,974**	**38,996**	**32,878,970**

Source: OSFI
Source: BESTLINK

2022 Segment Results

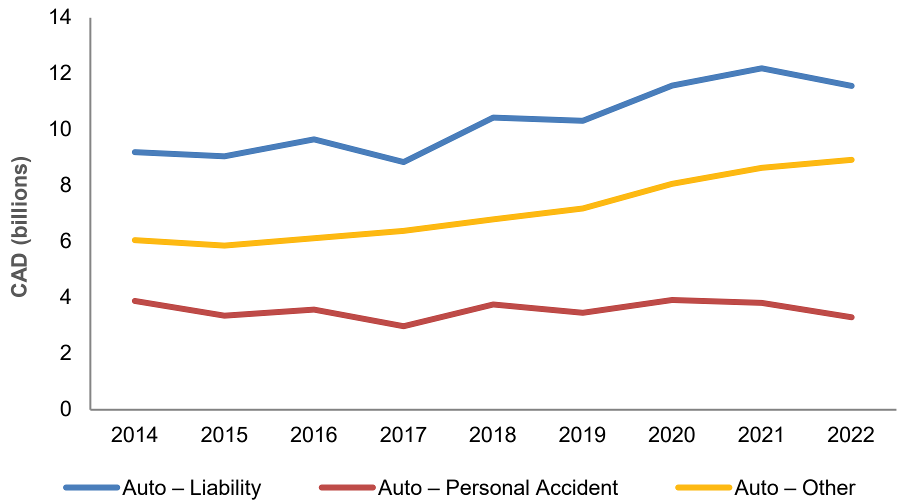
Private Auto NPW Down; Varied Results for Three Auto Lines

Consolidated private auto NPW declined by 3.5% in 2022 (**Exhibit 21**), driven by auto personal accident (down 13.5%) and auto liability (down 5.2%). The auto - other segment was the only auto line that improved, up 3.3%. Overall, the private auto market remains a major contributor to the country's P/C industry results. Auto liability accounted for 20.6%, auto - other for 15.9%, and auto personal accident for 5.9% of total NPW in 2022.

Many insurers have ended their pandemic relief measures and, in most cases, raised rates beyond pre-pandemic levels. Rate increases varied by province, with Quebec showing the largest year-over-year increase, 9.9%, through June 2023 for personal auto, according to Applied Systems. All other provinces that report auto rates showed moderate premium rate increases in the mid- to upper single-digit range.

Exhibit 21

Canadian Property/Casualty – Private Auto Insurers' NPW*



* Note: Excludes Lloyd's, CAB, ICBC.
Source: BESTLINK

Auto premium rates are frequently impacted by regulatory pressures, as highlighted by recent moves in Alberta. On January 1, 2022, the Alberta government implemented "Direct Compensation for Property Damage" (DCPD) regulation, whereby an insurance company will compensate a policyholder who is not at fault for damages and personal contents. DCPD is part of mandatory auto insurance, and policyholder insurance will cover 100% of the vehicle damage claim. This applies to basic auto insurance for accident benefits and third-party liability, given that collision and comprehensive are not mandatory. Despite the change (which applies to both personal and commercial), the impact on personal auto premium has been insignificant.

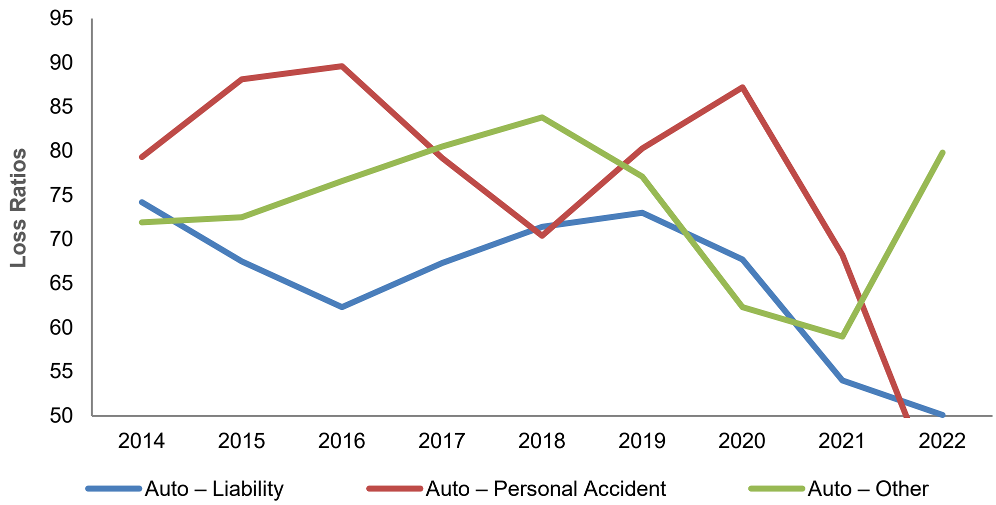
The Alberta government also implemented a rate pause on personal auto rate increase approvals until the end of 2023. Additionally, the government required that insurers provide most insureds with a premiums payment plan rather than taking the full amount of annual premiums up-front upon renewal. AM Best expects this to strain the profitability of carriers that are concentrated in the province, and insurers will need some time to adjust before returning to normal—even after the rate pause is discontinued at the end of 2023 and despite the Auto Insurance Rate Board's (AIRB) approving average rate increases for personal auto lines of 4.45% as of July 2023.

In Ontario, the Financial Services Regulatory Authority (FSRA) has already approved rate increases of up to 15% (as of May 2023) due to inflationary pressure, and increase in driving, and a surge in auto thefts. According to a report by the Canadian Finance and Leasing Association, vehicle theft incurred a cost of CAD 1 billion for the country in 2022—Toronto has experienced a staggering 300% increase in vehicle theft since 2015. The Ontario auto market also has seen moderate, but meaningful increases in speeding and other aggressive driving behaviors.

Underwriting results for the three auto lines varied in 2022 (**Exhibit 22**). The auto - other line's results declined significantly, but this was more than offset by significant improvement in the auto personal accident line and more modest improvement in the auto liability line. The private auto market was struggling prior to the pandemic but returned to profitability because of a decline in driving. Underwriting results were profitable in 2022, despite claims normalizing to pre-pandemic levels and inflationary impacts, particularly in the second half of the year.

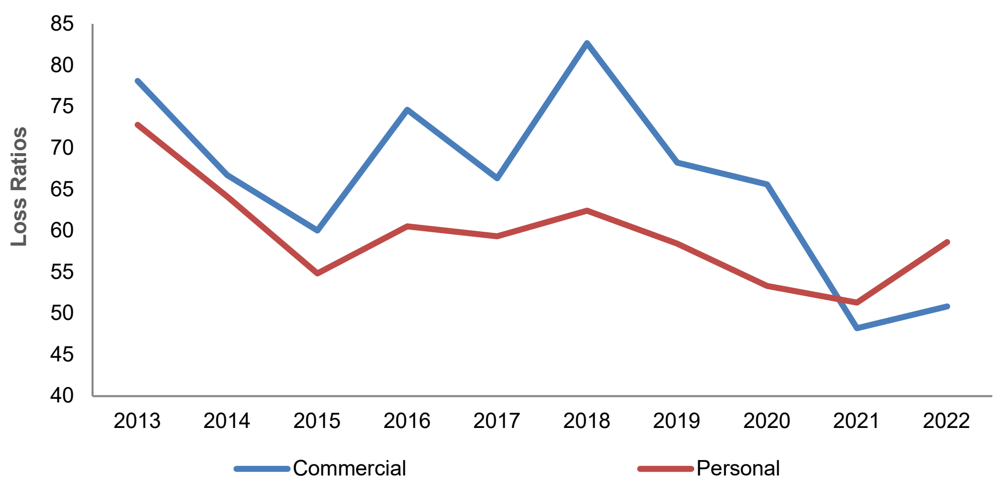
Claims frequency has increased as driving has almost returned to pre-pandemic levels, although it is slightly lower than pre-pandemic levels in larger densely populated areas due to the shift to hybrid working. Inflationary pressures remain elevated and continue to impact vehicle damage claims, but supply chain challenges improved in the latter half of 2022, and used car prices have declined slightly, suggesting that severity may stabilize or even drop slightly in upcoming quarters. These trends, along with the surge in auto theft, are expected to increase industry pricing, as insurers focus on underwriting discipline. Vehicle theft in Canada remains a headwind, as frequency remained elevated in first-quarter 2023, despite a modest decrease in severity from fourth-quarter 2022. AM Best expects a normalization of claims frequency close to pre-pandemic levels, as people gradually return to on-site work environments.

Exhibit 22
Canadian Property/Casualty – Private Auto Insurers' Loss & LAE Ratios*



* Note: Excludes Lloyd's, CAB, ICBC.
Source: BESTLINK

Exhibit 23
Canadian Property/Casualty – Personal and Commercial Property Net Loss & LAE Ratios*



* Note: Excludes Lloyd's, CAB, ICBC.
Source: BESTLINK

Substantial Improvement in Commercial Property Results

Commercial property line results have improved substantially over the last two years versus historical trends. The line's reported loss ratio had been above 60 since 2013 (**Exhibit 23**). Results for commercial property have been improving in recent years owing in part to the decline in losses driven by business closures because of the pandemic. Additionally, Canadian insurance carriers continued to enhance risk selection and pricing through 2022, supported by improvements in technological capabilities and overall risk management. As a result, the line's net loss ratio was 48.2 in 2021 and 50.8% in 2022, down substantially from 2020 and prior years. The improvement in the net loss ratio for commercial property comes at a time when personal property is suffering higher losses owing to elevated catastrophe activity. The contrast in performance may be partially related to the geographical areas in which the risks are insured.

In 2022, NPW grew 7.8% to CAD 9.4 billion, as direct writers continued to cede more premium to reinsurance partners. Further premium growth is likely to be pressured due to the headwinds the industry is facing, although AM Best expects this to be offset by carriers being able to implement rate actions, given the minimal push-back from regulatory authorities.

Overall, AM Best anticipates the hard market conditions for commercial property to continue, as carriers deal with economic and climate-related challenges. Additionally, insurers are likely to continue reducing their exposures in certain geographical areas as reinsurance capacity is pressured.

Personal Property Loss Ratios Up Markedly

Loss ratios for personal property rose by more than seven percentage points from 2021 (as **Exhibit 23** showed), reflecting higher CAT activity and the impact of Hurricane Fiona in September, a material event with loss costs greater than CAD 660 million. However, the loss ratios remain below the ten-year average despite the significant uptick. The line continues to benefit from rate increases despite the moderation in increases in 2022—most of the line's risk mitigation occurred a few years ago, although addressing flood risk through a national program similar to the US remains a key policy objective for Canada. Catastrophe activity has dampened some reinsurance shareholder returns, which is impacting the cost of coverage.

Year-over-year premium rate increases in British Columbia were the highest, up 9%. Other provinces also posted mid- to high single-digit rate increases for personal property, other than Quebec, which posted a slight decrease of -0.4%.

Consumers are increasingly aware of climate change and the potential impact of weather-related storms in residential housing, which means demand for property coverage is growing. Canadian companies are generally able to pass the costs associated with inflation, more frequent weather events, and higher storm-related severity on to policyholders, as there is generally no regulation on price increases for property coverage.

Hot Topics

Catastrophic Storms and Climate Regulation Remain Headwinds

Catastrophe events in 2022 followed similar trends as in the US, with rising costs and increasing storm frequencies. CAT losses totaled CAD 3.1 billion, making 2022 the third-worst year ever for insured losses in Canadian history, trailing only 2013, which saw the Alberta floods and the 2016 Fort McMurray wildfires. The number of major events rose slightly in 2022 from 2021. Notable large events included the Ontario and Quebec derecho storms in May 2022 (damages of CAD 1.0 billion), followed by Hurricane Fiona in September 2022 (CAD 800 million), and the Eastern Canada Bomb Cyclone in December 2022 (CAD 180 million); insured losses from these three storms came to roughly CAD 2.0 billion and roughly 64% of total losses.

Of the 21 events that occurred in 2022, the most prominent were severe convective storms, which accounted for roughly two thirds of the year's total economic losses, with the May 2022 derecho storms causing CAD 1.2 billion of the roughly CAD 2.0 billion in economic losses due to these storms. The second-largest event was Hurricane Fiona, which, between the Caribbean and Canada, caused CAD 4.1 billion in losses.

Thus far, 2023 has seen several catastrophe events: the April 2023 Canadian ice storm in Quebec and Ontario, followed by the Tantallon wildfires in Nova Scotia and Alberta in May 2023, which resulted in eight million hectares of land being burned as well as severe smoke across Canada and the US and contributed to many days of unhealthy air quality. In August, British Columbia experienced a record number of wildfires, although the sparse population makes the likelihood of large insured losses less probable. However, the number of hectares—14.1 million—destroyed is now almost double the record number reported several decades ago. Insured losses were moderate, as most of the wildfires occurred far away from population centers and needed only to be monitored, without significant suppression activity.

The Canadian Climate institute recently forecast that, by 2025, climate-related costs would amount to CAD 25 billion and cut economic growth in half. Insured losses in Canada now routinely exceed CAD 2 billion annually, and these trends will likely only accelerate. A significant amount of the impact of climate change can be attributed to Canada's oil and gas industry (which accounts for an estimated 22% of greenhouse gas emissions) and households (17.5% of greenhouse gas emissions). However, the level of investment in the development of renewable resources is relatively modest—although it is growing each year.

In late March, Canada introduced government funding for flood risk as part of a national flood insurance program, to be implemented over the next two years. Flood risk has been cited as one of Canada's largest climate-related risks, with over 1.5 million households considered highly exposed, according to a report from the Task Force on Flood Insurance and Relocation (August 2022).

Greater Focus on Cyber Risk

The environment for the Canadian cyber insurance market improved in 2022, generating a negative loss ratio, owing to reserve releases, as cyber insurers had reserved more funds than needed to pay for outstanding claims, in addition to tighter underwriting and insurers' focus on providing additional cyber support to the small to medium-sized businesses that are most vulnerable.

Despite improvement in recent periods, cyber risk grows in tandem with technology advances, posing a significant threat to Canada's insurance market. Cyber insurance will remain one of the country's most challenging sectors due to the growing number of cyber incidents, particularly those involving ransomware, accompanied by escalating financial and reputational repercussions. According to an IBM survey (published in July 2023) of 26 victimized organizations in Canada, the average cost to companies for a cyber security breach was CAD 6.94 million as of 2023, and the average amount of time companies took to identify and contain a data breach was 215 days.

M&A and Consolidation Expected To Continue

Acquisitions and consolidation in Canada's insurance industry will continue to grow over the near term, as companies focus on the need to achieve scale to compete with larger, more advanced companies and invest in emerging technologies to improve operating platforms, as they aim for operating efficiencies amid competitive market conditions. This trend is evident in the broker market, consolidation of which is expected to grow rapidly. We expect that consolidation will have an uneven impact on the industry, which could result in significant changes in market share over time.

Market share for the largest participants in Canada's P/C industry (by direct premiums written—DPW) has changed only modestly year over year, although there has been some slight shuffling among the ranks over the longer term. Ten carriers account for roughly 69% of the market's DPW, which is up only marginally over the last three years. We believe this reflects the impact of more competition from mid-market companies that have shown higher levels of premium growth and improved their market share as a result.

Following years of consolidations, the market has reached a point where the largest companies are expanding their market share through acquisitions of both carriers and distribution channels. At the same time, incremental organic growth is being achieved through rate actions and some growth in underlying exposures, investment in data warehouses, and a focus on reaching insureds through expanding distribution channels.

Owing to consolidation, the DPW of carriers outside the Top 10 has contracted in recent years. The industry's largest carriers continue to drive premium growth, while market participants outside the Top 10 must compete for the remaining premium volume in an increasingly disrupted and fragmented market.

Benefitting from Technology

Persistent competitive pressure will require carriers to embrace technological innovation to improve their operating performance, enhance the consumer experience, and improve their ability to retain customers. The ability to analyze data—and large amounts of it—creates a competitive advantage for carriers. Access to meaningful data provides carriers with the ability to improve decision-making on both pricing and reserving, allowing them to recognize emerging trends early and make decisions in real time. Companies that are early to recognize a change in market dynamics will be in a better position than those that don't.

Carriers with balance sheet depth are investing heavily in technology in an ongoing effort to transform both product development and distribution platforms, striving to meet consumers at their preferred points of contact through the insurance process, whether purchasing coverage, paying premiums, or filing claims.

Rather than compete on price, insurers have embraced technological advances by investing in or partnering with insurtech companies that can provide a competitive advantage. Carriers have increasingly demonstrated their willingness to develop relationships with insurtechs already operating in the insurance industry, rather than trying to innovate in-house, which can take years with no guarantee of success. Through outreach, carriers have benefitted from emerging technologies that they can embed in their product development or that help refine their underwriting and claims handling procedures for better outcomes.

Carriers that have developed data warehouses to support their decision-making will continue to differentiate themselves from other market participants. Some insurers have created science labs that allow for a more refined look at rate per risk on the underwriting side, so that they can provide a rate per risk that goes well beyond the multivariate pricing of prior years. To streamline and automate standard processes, companies are using Robotic Process Automation (RPA) for underwriting and claims, which can lead to faster and better decision-making. Carriers can use RPA to enhance operating efficiencies and eliminate manual work flow procedures, which can generate cost savings. Some are also revamping their business models and product distribution channels to be closer to consumers while lowering costs.

Canada Life/Annuity: Insurers Well Equipped To Navigate Uncertainty over the Coming Year

AM Best's outlook on Canada's life/annuity insurance industry is Stable, based on the following factors:

- Very strong regulatory capital levels in preparation for the transition to IFRS 17 as well as adequate liquidity and financial flexibility to navigate through uncertainties
- Favorable earnings and underwriting bolstered by rising interest rates and generally favorable mortality trends despite higher expenses associated with rising inflation and valuation markdowns

in L/A insurers' commercial real estate and alternative investment portfolios
- Favorable top-line growth in the fixed-rate annuity, participating whole life and accident, and sickness lines of business, bolstered by favorable economic conditions and ongoing improvements in customer experience through a heightened focus on innovation
- The capital and financial impacts of IFRS 17 (effective on January 1, 2023), which were largely as expected and as communicated by L/A insurers in the industry

L/A insurers have performed relatively well over the past year due to these factors, but they still face a number of strong headwinds, including the following:

- Rising costs due to continued inflationary pressures, including wage inflation, which along with a tight labor market, has exacerbated L/A insurers' ability to attract and retain talent
- Persistent uncertainty about domestic and global economy due to inflation and ongoing geopolitical tensions, which may result in a more challenging sales environment
- Concerns about L/A insurers' exposure to the commercial real estate market and the growing exposure to alternative investments in Canada and the US, which may result in greater earnings volatility.

Canada's L/A insurers have posted generally favorable operating results in their core lines of business the past year, as the impacts of the COVID-19 pandemic continue to recede and favorable macro-economic conditions, including higher interest rates, accelerate the demand for products such as participating whole life and fixed-rate annuities. Both of these product lines have experienced record sales in Canada and the US the past year. In addition, mortality results for the L/A insurers continue to decline from their pandemic highs, although there is some uncertainty about overall mortality due to potential longer-term impacts associated with the pandemic.

Credit impairments have been manageable the past year, but a rapid rise in interest rates and the implementation of work-from-home policies due to the pandemic have increasingly pressured L/A insurers' commercial real estate portfolios. Some have already made significant valuation markdowns, as these investments must be assessed by third-party appraisers and marked to market under IFRS 17 guidelines. In addition, the prolonged low interest rate environment resulted in the reallocation of investment portfolios to higher-risk holdings, including mortgage loans, equities, private bonds, below investment grade bonds, and securities categorized as other. The impact of these moves to enhance yield may begin to reverse somewhat due to the recent rise in interest rates, and the increased exposures may pose challenges in a recessionary environment. In addition, L/A insurers gravitated to fee-based business such as asset and wealth management during the low interest rate environment. As a result, earnings are more susceptible to equity market volatility.

Despite these concerns, L/A insurers remain in a position of strength, with strong balance sheets marked by high levels of regulatory capital, adequate liquidity, and good financial flexibility. In addition, L/A insurers continue to expand their enterprise risk management programs to ensure they are capturing current as well as new and emerging risks. As a result, Canada L/A insurers are well equipped to navigate any uncertainties over the near term.

Rating Actions: All Affirmations

As in prior years, rating actions consisted of affirmations driven by solid levels of risk-adjusted capitalization and persistently positive earnings. All of Canada's life insurance companies have financial strength ratings (FSRs) of A- (Excellent) or higher.

Furthermore, all but one of Canada's rated life insurance companies have Stable outlooks (**Exhibit 24**). In August 2022, the FSR of ivari was downgraded to A (Excellent) from A+ (Superior) and the ratings were placed under review with negative implications, following the announcement by ivari's parent company, Wilton Re Ltd., that it had entered into an agreement to sell ivari to Sagicor Financial Company Ltd. The relatively high ratings distribution for Canada L/A insurers is due primarily to Canada's comprehensive regulatory environment, which generally mandates conservative reserving practices and strong capital and liquidity.

Exhibit 24

Canada Life – AM Best Ratings

As of September 26, 2023

AMB #	Company Name	Long-Term ICR	FSR	ICR Rating Oulook	Rating Effective Date
08074	Assumption Mutual Life Insurance Co.	a-	A-	Stable	8/17/2023
66835	BMO Life Assurance Co.	a	A	Stable	12/8/2022
62246	Brookfield Annuity Co.	a-	A-	Stable	8/24/2022
06493	Canada Life Assurance Co.	aa	A+	Stable	12/7/2022
66801	Canadian Premier Life Insurance Co.	a	A	Stable	11/18/2022
06290	Co-operators Life Insurance Co.	a	A	Stable	2/1/2023
66893	First Canadian Insurance Corp.	a	A	Stable	11/2/2022
66847	Foresters Life Insurance Co.	a+	A	Stable	8/17/2023
60132	Independent Order of Foresters	a+	A	Stable	8/17/2023
06554	Industrial Alliance Ins & Financial Svcs.	aa-	A+	Stable	6/23/2023
66805	ivari*	a+ u	A	Negative	8/31/2023
94126	La Capitale Civil Service Insurer Inc.	a	A	Stable	9/23/2022
06688	Manufacturers Life Insurance Co.	aa-	A+	Stable	8/10/2023
66827	Optimum Reassurance Inc.	a	A	Stable	9/12/2023
66889	PartnerRe Life Reinsurance Co of Canada	aa-	A+	Stable	4/27/2023
60156	Primerica Life Insurance Co of Canada	aa-	A+	Stable	10/13/2022
66806	RBC Life Insurance Co.	a+	A	Stable	3/31/2023
66817	RGA Life Reinsurance Co. of Canada	aa-	A+	Stable	10/27/2022
66903	SSQ, Life Insurance Co. Inc.	a	A	Stable	9/23/2022
07101	Sun Life Assurance Co. of Canada	aa	A+	Stable	2/17/2023
66882	TruStage Life of Canada	a-	A-	Stable	12/9/2022
60079	Wawanesa Life Insurance Co.	a	A	Stable	12/16/2022

ICR = Issuer credit rating; FSR = Financial strength rating; u = under review.

* Rating on ivari under review with negative implications.

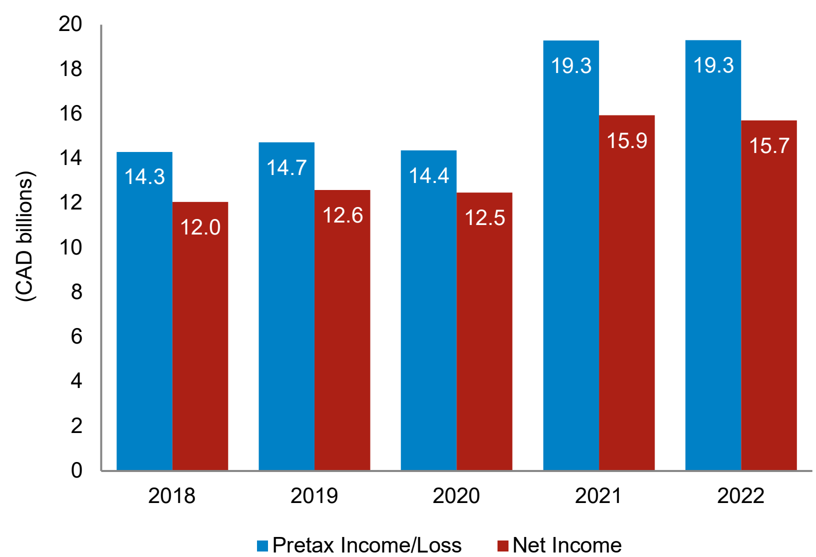
Source: BESTLINK

Operating Performance Steady in 2022, Following a Record Year

In 2021, pretax net income (based on International Financial Reporting Standards) for Canada's life insurance companies rose at its fastest pace in over five years, to CAD 19.3 billion from CAD 14.4 billion (**Exhibit 25**). Net income also rose, to CAD 15.9 billion from CAD 12.5 billion. Given such an outlier year of growth, a more tempered year was expected by many in the industry for 2022.

Exhibit 25

Canada Life – Pretax Operating Gains & Net Income



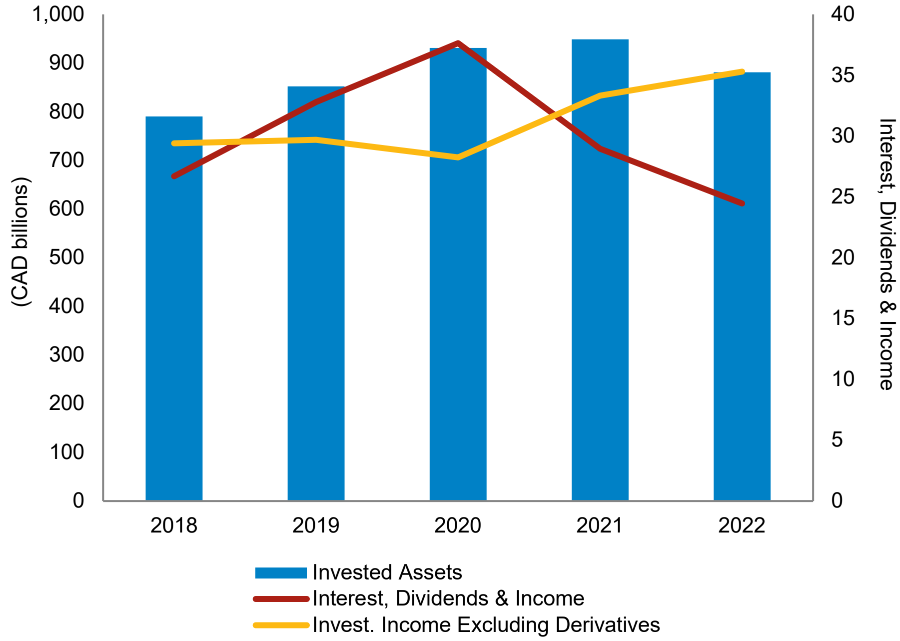
Source: BESTLINK

Results in 2022 largely matched the figures of 2021 indicating favorable earnings but a lack of growth. Pretax net income for 2022 of CAD 19.3 billion were the same as in 2021, with after-tax results coming in slightly less favorably, at CAD 15.7 billion, a decline of CAD 200 million.

Despite the decline, overall earnings remain bolstered by investment gains (**Exhibit 26**), which should continue to improve as carriers turn over their portfolios to take advantage of the rise in interest rates that began in late 2021. Further, despite some excess mortality at the height of the pandemic, COVID claims have declined substantially, although non-COVID claims remain somewhat elevated. Group life insurance mortality has been very favorable the past year, and margins continue to improve as insurers implement necessary rate increases. Earnings from the accident and sickness line of business also improved, after years of increasing claims due to rising mental health issues. Companies have taken pricing actions and expanded wellness offerings to partially mitigate the rise in mental health-related illness.

Exhibit 26

Canada Life – Investment Income

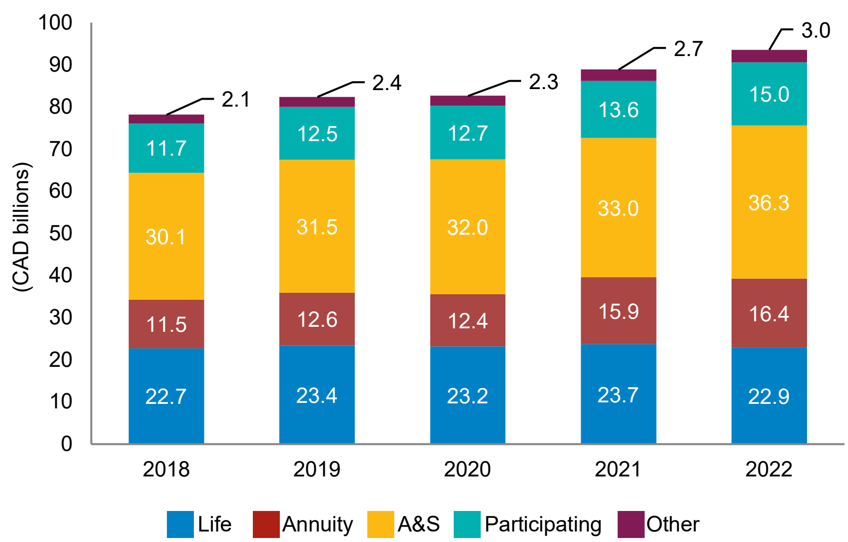


Source: BESTLINK

Exhibit 27

Canada Life – Direct Premiums Written by Line of Business

Canada and United States only



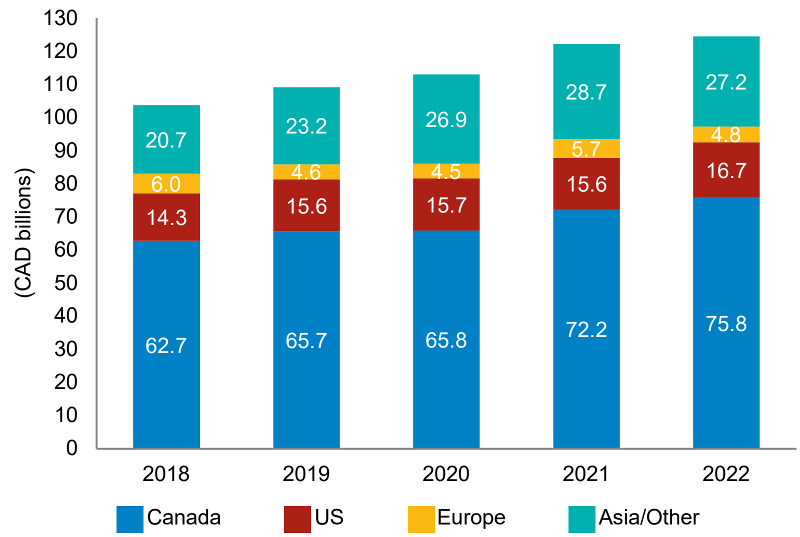
Source: BESTLINK

Operating and net earnings were flat with the prior year, but overall premiums written were not. New business growth continued throughout 2022, with direct premiums written rising to CAD 93.6 billion, from CAD 88.9 billion the year prior (**Exhibit 27**). Annuities, accident and sickness, participating, and products categorized as other all grew, with only life products declining slightly. Accident and sickness, participating, and other products grew by approximately 10% each, with annuities up a more modest 3%. Fixed-rate annuities grew substantially (benefiting from the rise in interest rates), but sales of segregated funds declined due to volatile equity markets, as well as a reduction in sales of segregated funds with higher guarantees. Annuity premiums in particular can fluctuate substantially year to year due to the amount and size of pension risk transfer deals.

The growth in 2022 came primarily from the US and Canadian markets, as growth in both Europe and Asia declined modestly (**Exhibit 28**). L/A insurers with exposures to Asian markets such as Hong Kong and mainland China experienced a significant disruption in sales due to the COVID-related lockdowns early in 2022. Sales in Asia began to rebound later in 2022 and into 2023. Asia has historically been a source of significant growth for the larger global L/A insures, as growth rates in these economies are typically much higher than in the more mature economies of Canada, US and Europe. This trend is expected to continue over the medium to longer term, albeit with expected disruptions such as general economic fluctuations, changing regulatory environments, and COVID lock downs.

Exhibit 28

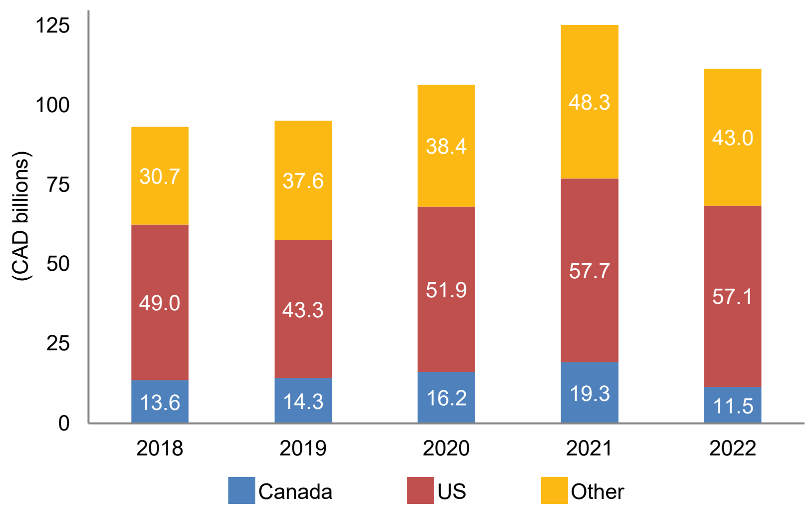
Canada Life – DPW by Geographic Distribution



Source: BESTLINK

Exhibit 29

Canada Life – Mutual Fund Deposits by Geographic Distribution



Source: BESTLINK

Mutual Fund Deposits Down

Mutual fund deposits declined noticeably in 2022, after increasing considerably the prior two years (**Exhibit 29**). Low interest rates and rising equity markets during the pandemic fueled a rise in flows into L/A insurers asset and wealth management segments from retail and institutional clients in both Canada and the US. The decrease over the past year reflects higher mutual fund redemptions and lower investor demand amid higher interest rates and equity market declines. Canada's L/A insurers have gravitated to these less capital intensive and more fee-driven retirement products in recent years partly because of the low interest rate environment. While this segment has been a growth driver for some L/A insurers, it does increase their exposure to equity market volatility, especially for those L/A insurers that have been more focused on adding alternative investments to their fund platforms.

Capitalization Strong Despite IFRS 17 Changes

Canada's L/A insurers maintained their strong capital positions, as evidenced by Life Insurance Capital Adequacy Test (LICAT) ratios well in excess of the OSFI Supervisory Target Total Ratio of 100% and the Supervisory Minimum Total Ratio of 90%. The capital of entities under Quebec's Capital Adequacy Requirements Guideline for Life and Health Insurance ratios (CARLI) also remains well in excess of the

AMF (Autorité des Marchés Financiers) Supervisory Target. The strong ratios are supported by capital growth, driven by strong core earnings and minimal investment impairments. In general, companies maintained higher-than-normal capital ratios in preparation for the transition to IFRS 17. Furthermore, L/A insurers have generally been reducing their financial leverage the past year from the higher levels during the pandemic. L/A insurers have also been more hesitant about issuing new debt due to the rising costs of doing so.

Exhibit 30
Canadian Life Insurance Companies - Impact on 2022 Equity from IFRS 17*

Company Name	2022 Equity	IFRS Impact on Equity	2022 Equity Restated for IFRS 17
Manufacturers Life Insurance Company	67,512,126	-8,154,700	59,357,426
Sun Life Assurance Company of Canada	25,671,436	-5,762,881	19,908,555
Canada Life Assurance Company	25,509,781	-2,721,381	22,788,400
ivari	1,610,314	-611,651	998,663
Co-operators Life Insurance Company	1,372,559	-95,382	1,277,177
RGA Life Reinsurance Company of Canada	1,271,435	429,227	1,700,662
Primerica Life Insurance Co of Canada	692,881	-149,130	543,751
Brookfield Annuity Company	407,967	-56,504	351,463
Foresters Life Insurance Company	312,178	-30,003	282,175
Wawanesa Life Insurance Company	251,562	37,215	288,777
Top 10 Canadian Life Insurance Companies	**124,612,239**	**-17,115,190**	**107,497,049**
Total Canadian Life Insurance Companies	**134,376,409**	**-22,846,686**	**111,529,723**

* Note: Excludes Lloyd's, CAB, ICBC
Source: OSFI

The transition to IFRS 17 has been a time consuming and expensive endeavor, but Canada's carriers were largely well prepared for the switch on January 1, 2023. Canadian L/A insurers began communications with investors and other stakeholders about the impact of IFRS 17 well in advance of implementation and, as largely expected, many of the country's L/A insurers saw a significant decline in shareholders' equity—of up to 20% for some companies (**Exhibit 30**)—because of the establishment of the contractual service margin (CSM), which defers the recognition of new business gains and certain investment-related activities under IFRS 17. Although shareholders' equity has declined, the OSFI will be treating CSM as available capital when calculating LICAT ratios. The OSFI has also applied a similar treatment to the IFRS 17 risk adjustment. Because of these factors, most of Canada's L/A insurers did not experience a material impact on their LICAT ratios at transition. In addition, the expectation is that LICAT ratios will become less sensitive to interest rate movements under IFRS 17.

Certain balance sheet metrics that AM Best uses in its analysis, such as Best's Capital Adequacy Ratio (BCAR) and financial leverage calculations, will be impacted by the IFRS 17 accounting change. However, AM Best maintains its economic view of insurers' balance sheets. The introduction of IFRS 17 has not had a direct impact on the ratings of Canada's L/A insurers.

Investment Allocation Trends Continue … for Now

Although the industry is now operating in a rising interest rate environment, the asset allocations of Canada's L/A insurers have not changed significantly the past several years, apart from a gradual move toward higher-yielding but lower-quality asset classes. Despite this move, investment allocations generally remain more conservative compared with their US counterparts. Bonds continued to make up the majority of the general account investment portfolio, at 62.5% (**Exhibit 31**), a slight decline from just under 65% in 2021. The proceeds from the sale of bondholdings were allocated to mortgage loans, which rose from around 10% in 2021 to 11.3% in 2022, and to securities categorized as "other invested assets," which rose from 6.4% in 2021 to 7.9% in 2022. The rise in other assets pushed equities down to the fourth-highest allocation from third in 2021. The remaining fifth of the portfolio consists of stocks, real estate, policy loans, cash and short-term investments, and derivatives.

Over the past five years, Canada L/A insurers' bondholdings have shifted from federal government assets, which now constitute just under 30% of fixed-income portfolios (**Exhibit 32**). Municipal bonds also declined during the period but at a much slower place and accounted for just under 6% of overall bondholdings in 2022, as in 2021. Public corporate bonds have been steady, at around 44%, but private corporate bonds have grown notably, jumping to 21% in 2022, from just under 18% in 2021. Given the pressure of the prolonged low interest rate environment on investment yields, insurers looked to private corporate bonds for additional yield. AM Best expects this trend to slow—or even reverse—given the recent rise in interest rates, which makes public corporate and governments more attractive again.

Corporate-sector allocations have changed only modestly (**Exhibit 33**), primarily because of a decline in energy and utilities due to the sector's volatility the past couple of years, as well as ESG guidelines on moving investments out of the oil and gas sector. Industrials continued to move up slightly on strong business sentiment in core sectors of the economy. Below-investment-grade bonds as a percentage of equity continued to grow (**Exhibit 34**), surpassing 10% for the first time in recent history, due primarily to fallen angels (credit downgrades). However, some insurers have expanded these exposures over time as a means to fight lower interest rates, as they see value in issues that offer a yield more attractive than the perceived risk. AM Best views allocations to below-investment-grade assets as appropriate for a well-diversified portfolio. Insurers are well positioned to manage any credit impairments, which thus far have been minimal.

Exhibit 31

Canada Life – Invested Assets

(CAD billions)

	2018	2019	2020	2021	2022
Bonds	65.1	64.7	64.9	64.6	62.5
Mortgage Loans	11.4	10.9	10.0	10.1	11.3
Stocks	5.8	6.1	6.0	7.1	6.6
Real Estate	3.2	3.2	3.0	3.3	3.8
Policy Loans	1.9	1.8	1.6	1.6	1.8
Cash & Short-term	4.3	4.6	5.2	4.6	4.6
Derivatives	1.9	2.6	3.5	2.2	1.5
Other Invested Assets	6.3	6.1	5.8	6.4	7.9

Source: BESTLINK

Exhibit 32

Canada Life – Bond Portfolio Distribution

(%)

Portfolio Components	2018	2019	2020	2021	2022
Government	34.3	34.0	33.5	32.4	29.6
Municipal, Public Authority, Schools	6.1	6.0	5.9	5.7	5.7
Corporate - Public	43.2	43.5	43.9	44.3	43.7
Corporate - Private	16.4	16.5	16.7	17.6	21.0
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: BESTLINK

Exhibit 33

Canada Life – Corporate Investments

(%)

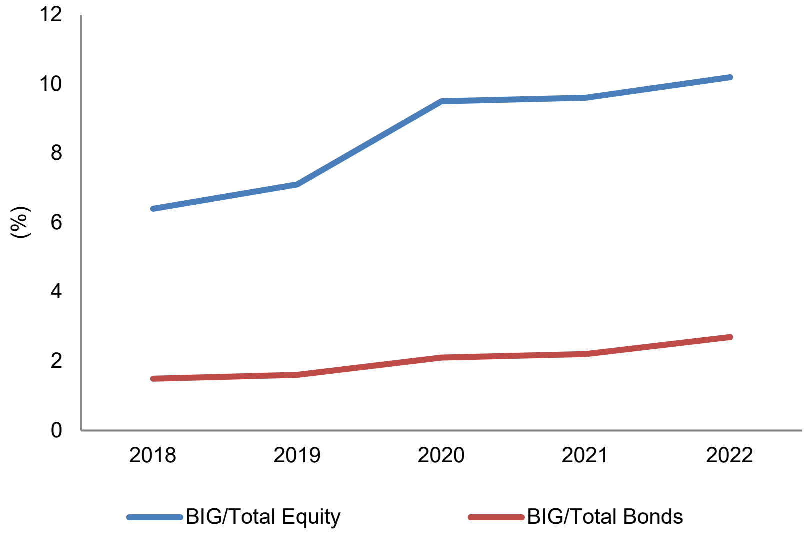
Sector/Country	2018	2019	2020	2021	2022
Energy	10.5	11.0	10.5	9.8	9.0
Basic Materials	2.1	2.2	2.3	2.2	2.3
Industrial	10.8	11.1	11.6	12.1	12.2
Consumer Cyclical	4.7	4.3	4.2	4.1	4.5
Consumer Non-Cyclical	8.4	8.5	8.9	9.3	9.1
Diversified/Healthcare	2.4	2.4	2.3	2.2	2.1
Financial	22.0	21.3	21.4	22.0	23.0
Technology	1.8	1.9	1.9	2.2	2.1
Communications	4.2	4.3	4.6	4.6	4.2
Utilities	24.4	24.2	24.0	23.5	23.2
Other	8.8	8.7	8.3	7.9	8.3
Total All Sectors	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Canada	34.5	34.5	33.6	32.7	30.6
United States	41.2	41.5	42.5	43.5	45.6
Other	24.3	24.0	23.9	23.8	23.9
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Note: Percentages may not add up to 100 due to rounding.

Source: BESTLINK

Concerns about insurers' commercial mortgage loan (CML) portfolios persist, due primarily to excess office space because of the pandemic and work-from-home policies, as well as the rapid rise in interest rates which has made refinancing property debt more challenging, Insurers have been marking down the value of these investments to fair value as required by IFRS guidelines and increasing their expected credit losses. However, the number of delinquencies to date remains modest, and most CMLs are current on loan payments. Canada's L/A insurers typically invest in high-quality CMLs that meet strict underwriting standards and diversification criteria.

Exhibit 34
Canada Life – Below Investment-Grade Bonds



Source: BESTLINK

Accelerating Innovation Initiatives

Due to necessity during the pandemic, Canadian L/A insurers are accelerating digitization to the next level in 2022 and beyond. Although the L/A segment remains a laggard compared with property/casualty carriers owing to the costs and time needed to replace legacy systems, they continue to make strides post-pandemic, particularly in digitization. Many L/A carriers are now striving to become digital leaders, with the lofty goal of becoming fully digitized over the next several years. L/A insurers are launching or acquiring digital platforms for both customers and agents in a number of markets, to substantially enhance efficiency with regard underwriting, administration, claims handling, and customer service. Furthermore, given more recent advancements in artificial intelligence, many carriers are looking to incorporate AI into their platforms for greater efficiency. Insurers that were early to embrace innovation generally outperformed their peers during and immediately following the height of the pandemic and are well positioned to take advantage of future growth opportunities. These realized efficiencies are of greater importance recently, to combat the inflationary environment, which can impact new sales and retentions.

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