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TRENDS

INSURANCE

As part of our series on current trends across different industries, we take a look at what's happening in the insurance industry.

1

Technology's Impact on the Industry

Until recently, most investments in insurance technology focused on distribution, policy administration, internal controls and security. Now, telematics, data analytics, wearables and social media are redefining virtually all aspects of the insurance industry. Emerging technologies are offering new opportunities and revenue. They may also substantially reduce losses, enabling insurers to offer lower premiums, while also creating risk through new sources of competition and the unprecedented pace of change.

The Internet of Things (IoT) — including telematics, body sensors and a variety of other monitoring technologies and smart devices — is challenging insurers to create new products, devise new pricing algorithms and underwriting methods, and revise how claims are processed.

As sensors enhance the ability to verify behaviours and predict, prevent and mitigate risk, insurers are beginning to shift focus from loss recovery to prevention/risk management and mitigation. Insurers are also offering usage-based insurance (UBI) policies to underwrite risk in a more granular way and technology is making it possible to offer a wider range of insurance choices based on risk allocation and risk reduction models — all at significant savings. Some auto insurers already provide policyholders with reduced premiums based on safe driving habits measured by in-car sensors. Telematics subscriptions are expected to increase dramatically, and drones and aerial imaging will speed up property damage assessments.

In the face of evolving consumer behaviours and expectations, growing competition, disruptive technologies and heightened regulatory oversight, P&C insurers need to rethink how they can remain competitive and ensure their long-term sustainability. Insurance companies need to invest heavily in self-directed services that use online/mobile channels and devices to meet consumer demands and lifestyle expectations. Service has the potential to become a key differentiator in terms of how insurers market their products, serve customers, structure prices and communicate.

Technology, big data and analytics offer great potential, enabling insurers to accumulate and understand the information needed to reach customers with the right product at the right time and price. Insurers will need to be strategic in assessing behaviours, risks, coverage options and standards and in structuring their businesses to leverage IoT data to improve operations, service and the overall customer experience. They will also want to consider strategic alliances, joint ventures, minority investments or mergers and acquisitions to acquire or develop certain technologies and expertise.

2 Insurance M&A

While many expected significant consolidation in the Canadian P&C insurance industry, instead we have seen a steady stream of more tactical, targeted deals. Among the key forces likely to continue driving M&A activity in the P&C and broker space are continued fragmentation, an aging population, low growth and low interest rates. The weak Canadian dollar and political uncertainty in the U.S. and the U.K. may also attract foreign market participants to Canada, including Asia.

In the last few years, Asian insurance companies have entered the U.S. insurance market through acquisitions, in part because their home regulators are directing them to diversify their markets. Domestic demutualization could also increase the pace of M&A activity in the P&C sector as some demutualized insurers gain access to capital markets to fund acquisitions and others are able to convert to a structure that allows them to be acquired.

InsurTech is a fast-growing sector worldwide and includes everything from companies focused on measurement devices (e.g., sensors, telematics) to those harnessing data to improve pricing, enhance the customer experience and improve back-office processes such as fraud prevention. Canadian insurance companies will continue to engage with domestic and foreign startups and early-stage companies in this space through control acquisitions, as well as through minority investments. In some cases, they will engage in collaborations or joint venture arrangements, where the insurance company uses or helps to develop the application or solution by providing access to the insurance company's customer base and IT infrastructure. As an "innovation strategy," participating in financing rounds of InsurTech startups has its limits, but it could assist incumbents in potentially identifying early winners and losers in the InsurTech space.

3 Niche or Product-Focused Insurance

Niche insurance product offerings have grown dramatically in recent years. With revenue nearly doubling from specialty programs in the last five years, these programs are among the fastest-growing types of P&C coverages.

For everything from RV and ATV/ROV to golf clubs to pets, niche market insurance can provide a lucrative revenue source for the insurance sector without the cost burden of marketing broad-spectrum products. Another example is ride-sharing insurance for services like Uber, which covers drivers' liability.

These coverages require deep industry, customer and product-specific knowledge and analytics based on demographic and financial trends. Underserved niche markets present significant growth opportunities for both independent niche-focused insurers and traditional insurers who possess the expertise or can acquire attractive niche insurers.

4 Policy Language, Claims and Coverage Challenges

The business of claims continues to become more complex. In a soft market, where premium is at a premium, insurers are taking on novel risks without issuing new wordings. This has resulted, and will continue to result, in more and larger-value legal challenges to coverage determinations.

Because of this trend, the Supreme Court of Canada (SCC) has also stepped in over the last two years in an attempt to clarify the principles of contract interpretation (although its success is debatable). In *Sattva Capital Corp. v. Creston Moly Corp.*, which dealt with contracts more generally, the SCC recently stated that the interpretation of any contract (including an insurance policy) necessarily involves consideration of the surrounding circumstances. This means that, in the insurance context, the courts will be interested in the underwriting process and industry understanding of the underwritten risk.

In September 2016, the SCC released its decision in *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.* in which it confirmed that surrounding circumstances are relevant to the interpretation of insurance contracts. The SCC also said that, as a matter of practice, if the insurance policy includes a standard form clause, the interpretation of that clause is a pure matter of law and therefore an appeal is easier.

The *Ledcor* case provided an interesting interpretation of the often-found faulty design or workmanship exclusions, and the exception to those exclusions. The SCC held that the boundary between what is excluded as faulty design or workmanship and what is covered as resulting damage is tied to who was contractually responsible for the work. A soft market, new types of insurance and the high value of insurance policies mean that the courts increasingly are likely to be called upon to address coverage questions.

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