

Escalating Cost of Municipal Claims

Index

Introduction 1

Overview 1

Drivers of Escalating Claims Costs..... 3

 Climate Change..... 3

 Joint & Several Liability (The 1% Rule)..... 3

 Class Actions..... 4

 Changing Legal Landscape..... 5

 Future Care Costs..... 5

Conclusion – What can we do? 7

Introduction

At Frank Cowan Company, we are concerned about recent and historical trends affecting the cost of municipal insurance. Municipal claims costs continue to escalate. At a time when municipalities are facing considerable pressure managing their budgets due to increasing economic challenges, increasing claims costs creates additional financial pressure since it affects all municipalities and their insurance providers. We believe it is important you understand why.

This report was created to help municipal clients understand the changing landscape. The information was compiled based on analysis conducted by Frank Cowan Company using industry data, as well as real claims from our own database that contains years of information collected over our long history in the municipal insurance business. This report provides an overview of the major trends influencing claims costs, and then looks closer at some of the primary drivers, including:

- Climate Change
- Joint and Several Liability (The 1% Rule)
- Class Actions
- Changing Legal Landscape
- Future Care Costs
- Cyber Liability

There is clearly a shift in a number of areas that impact the cost of municipal claims. All of the insurers of municipal governments are being impacted by this increasing cost of claims, and will need to respond in order to ensure that premiums are adequate to pay for these claims.

Overview - Claims are driving premiums

One of the most significant factors in the pricing of insurance is the “long tail” nature of municipal liability claims. An incident may occur in a given policy year, but the claim may not be presented until many years later. Then the claim may take several years to settle. Forecasting what the courts may award a plaintiff several years, if not decades, in the future is very challenging.

Over the past few years, there has been a shift in a number of factors impacting municipal claims – factors that are driving up claims, which, in turn, are driving up the cost of insurance. These trends will likely never reverse.

What has changed?

Property losses are more frequent and severe. Climate change has resulted in a substantial increase in property losses and catastrophic losses. Regardless of whether this has impacted a municipality directly, the substantial escalation in the cost of claims has increased both property insurance and reinsurance rates worldwide.

Joint and several liability (the 1% rule) is a significant concern for municipalities in Ontario. The Association of Municipalities of Ontario (AMO) has created a number of working groups over the years with the goal of reforming this law. As the severity of awards increases, so too does the exposure to those who have deep pockets. Although AMO initiatives have not generated change, they have increased awareness and Frank Cowan Company will continue to assist the municipal sector in lobbying for relief.

Class action lawsuits are increasing in frequency because the certification process is now much easier and there are more plaintiff lawyers who pursue this type of claim. Municipalities have a growing exposure here. Even though a municipality may be innocent of the allegations, class actions are much more difficult and costly to defend.

The changing legal landscape. There is a continuing trend that shows we, as a society, have become more litigious and demonstrate less personal accountability resulting in a higher frequency and severity of claims. In response, judges have awarded more contributory negligence to municipalities versus plaintiffs.

Damage awards are substantial. A number of years ago it was alarming to hear about a \$5M liability award. Today, larger awards are more frequent. Court awards for severe bodily injury claims have increased dramatically in the last ten years. Claims that may have settled for \$5M ten years ago are now settling for \$12M - \$18M. These awards are primarily driven by the costs of providing future care for catastrophically injured plaintiffs. Municipalities have a large exposure to this type and size of damage award and are currently feeling the impact through the cost of insurance.

The cost of defending a claim is going up. Individual claims are more complex to defend resulting in more time to manage the claim with more detailed investigation, more experts and more legal time involved in the process – at ever-increasing rates.

Cyber liability claims have risen dramatically in the last three years. More important, it is anticipated that these claims will continue to grow at an exponential rate. In 2017, alone, there were multiple billion-dollar cyber-attacks: the NotPetya ransomware attack in June, Wannacry in May and Equifax in July. More is expected with the growth of the internet of things and the increased sophistication of hackers.

The big picture

Over the course of our nine decades of successful and continuous business in Canada, Frank Cowan Company has watched as new insurers have entered and exited the municipal insurance sector. Many have underestimated the long tail nature of municipal liability claims. They thought they could deliver coverage to the marketplace at a discount, only to find out within a few years that they lacked sufficient premium to pay the cost of claims. The only solutions available at that point was to either raise their clients' premiums to the appropriate level or exit the business, sometimes leaving municipalities without insurance coverage.

In 2016, OMEX discontinued underwriting operations. As reported in Canadian Underwriter in 2016, OMEX “has struggled in recent years to grow in an extremely soft insurance market and a highly competitive business environment. This low pricing environment, combined with the impact of joint and several liability on municipal claim settlements has made it difficult to offer sustainable pricing while still addressing the municipalities' concern about retro assessments.” **Insurance providers that do not have a long term perspective will not survive.**

Frank Cowan Company's long term, sustainable model has stood the test of time. Some brokers in the municipal insurance space frequently change insurers so that they can continue to offer deeply discounted premiums at the expenses of other critical elements of a value proposition. When the insurance market hardens, some brokers may not be able to find a market that will offer insurance to municipalities.

Frank Cowan Company partners with insurance companies that understand the high risk and the long tail nature of municipal liability claims. Together, we recognize that as the cost of claims continues to rise, premiums must adjust accordingly. We validate pricing decisions with actuarial reviews that ensure the long term sustainability of our product and the continued ability to provide broad insurance coverage and our top quality, local risk management and claims services. Our actuarial studies are based on decades of data from the experience of hundreds of Canadian municipalities.

The rising cost of claims and the impact on insurance premiums is a critical issue to manage as part of an organization's overall risk management plan. We believe it is very important for all clients to understand the factors that are driving up the cost of claims and the long term dangers if municipalities and insurers are not managing this risk proactively. While there may be opportunities in the marketplace where some insurers are prepared to underprice

their product, it must be understood that this will invariably lead to a return to realistic premium levels as the impact of claims is realized.

Municipalities need to be certain they have the appropriate insurance protection for their assets and liabilities on an ongoing basis. The purchase of sustainable and appropriately priced insurance and a robust risk management program must remain at the core of their insurance program.

Drivers of Escalating Claims Costs

Climate change

Globally, the frequency and severity of catastrophic property losses is on the rise. No one can argue that our weather patterns have not changed. What was deemed to be a “100-year storm” years ago now occurs with increasing frequency.

The actuarial societies of US and Canada jointly publish a quarterly index, The Actuaries Climate Index (ACI) that measures the climate extremes across the two countries. The index is designed to provide actuaries, public policy makers and the general public with objective data about changes in the frequency of extreme weather events over recent decades. The ACI reveals that the five-year moving average of climate extremes remains at record levels for both the US and Canada.

According to Munich Re, overall losses from worldwide natural catastrophes (cat losses) in 2016 totaled \$175 billion dollars, up from \$103 billion in 2015. Insured losses from these events rose to \$50 billion in 2016, up from \$32 billion in 2015. Insured losses in 2016 were higher than the average of the past 10 years and the past 30 years.

There were 750 cat loss events worldwide in 2016, compared with 730 events in 2015. The ten-year average is 590 annually while the 30-year average equates to 470. Clearly, both severity and frequency are on the rise.

2017 has become the second worst year on record for cat losses. Some significant property catastrophic losses included: Hurricanes Harvey, Irma and Maria, Mexico earthquakes and California wildfires. Total losses for 2017 approximated \$330 billion, while insured losses amounted to an estimated \$135 billion which are well above the historic averages.

Canada is not immune to catastrophic property losses. The 2016 Fort McMurray wildfire event was the single largest cat loss in Canadian history. Prior to Fort McMurray, the largest single cat loss event was the Alberta floods of 2013. Severity is on the rise in Canada as well. In the first half of 2017, Canada experienced five cat loss events, which is what we would usually see in a full year. BC fires raged during the summer of 2017 causing even more damage. Canada is experiencing the same global trends – an increase in frequency and severity of property cat loss claims.

Worldwide events, Canadian events and insurance trends directly impact Canadian Insurance capacity. Simply put, property and reinsurance rates are on the rise. Often when rate targets cannot be solely achieved with increases on one line, rates increases will spill over to other lines as well (primarily auto and liability).

Joint & Several Liability (The 1% Rule)

Joint and several liability is legislated in many Canadian provinces. In Ontario, the governing statute is The Negligence Act. This legislation directs that a person injured by two or more wrongdoers may collect his/her full damages from one of the wrongdoers regardless of the proportion of their liability. In our opinion, the legislation has a very negative impact on municipalities.

Severe injuries are most common in road maintenance cases. People that become injured in road accidents, bring actions against the at fault driver of the vehicle as well as the municipality, alleging poor road maintenance or design.

Due to the high value of severe injuries, the limits of insurance on the vehicle are generally not enough to satisfy the judgment. Therefore, due to joint and several liability, the municipality's insurer must pay the balance, even if it is only 1% liable.

For over a decade Frank Cowan Company has participated in a number of initiatives with AMO and the Provincial government to solicit change to the 1% rule for municipalities and relieve them of this unfair burden. The latest initiative occurred in 2014 when the Ontario government (Attorney General's Office) was considering the Saskatchewan model of proportionate joint and several liability. Unfortunately, the Ontario Provincial election resulted in a newly appointed Attorney General and the proposal was abandoned.

Recent regulatory changes to the Statutory Accident Benefit Schedule could expose municipalities to a higher frequency of joint and several claims allegedly arising due to poor road conditions. For claims arising out of accidents that occurred on or after June 1, 2016, the maximum benefits available under the Statutory Accident Benefit Schedule to 'catastrophically impaired' persons have been reduced from \$2 million (\$1 million in medical and rehabilitation plus \$1 million in attendant care benefits) to a total of \$1 million (i.e. a 50% reduction). This benefit reduction only impacts new claims for accidents occurring on or after June 1, 2016. This represents a significant change and that shortfall in available coverage under the Statutory Accident Benefits Schedule for claimants, whom did not purchase optional benefits, must be addressed by the at-fault auto defendant thereby eroding the auto defendant's liability limits quicker. Given that the majority of auto liability policy limits are \$1 million; municipalities will likely see an increase in the frequency of joint and several claims from injured claimants.

Frank Cowan Company handles numerous joint and several exposure claims. Here are two examples:

A young recently-licensed driver lost control of a vehicle on a gravel road. A passenger sustained a severe brain injury. The liability limits on the vehicle were \$1,000,000. The allegation against the municipality is a failure to grade the road. The damages claimed for the passenger are \$15,000,000. If liability is found on the municipality, any damages awarded in excess of \$1,000,000 will be payable by the municipal insurer.

In another case the plaintiff and two minor grandchildren were passengers in a vehicle. The driver came to a stop at a stop sign. The driver proceeded to make a left hand turn into the path of an oncoming vehicle. The sightlines and signage at the stop sign were within standards. The plaintiff placed the municipality on notice because they claimed snow piles at the edge of the road were too high, therefore obstructing visibility. The claim for the plaintiff(s) will greatly exceed the limits of \$1,000,000 on the automobile. The claim has a total value of approximately \$6,000,000. The exposure to the municipality based upon an estimated 25% liability would be \$1,500,000. Because of the 1% rule, the exposure to the municipality will increase to \$5,000,000 if the plaintiff(s) are successful with their case.

Class Actions

The Class Proceedings Act of 1992 allows for class actions in Ontario. A class action may be commenced in any common law province (except for Prince Edward Island which does not have class proceedings legislation), as well as Quebec.

When a large group of people are collectively harmed they can collectively bring an action before the Court. Class actions are an economical way of bringing suit because the expenses are shared among many parties. In addition, where the group can't afford the expenses to bring a class action forward, a government fund has been created to assist them. It has become increasingly difficult to successfully oppose class certification in all jurisdictions. Our Courts are more readily willing than before to certify class actions. Recent examples of class actions include: 1) Claims against a Health Department for negligent inspection of a public swimming pool which lead to infectious disease of claimants. 2) Claims against a municipality by charitable organizations for the collection of fees (taxes) for which the municipality did not have the authority to impose. 3) Claims against municipalities related to property damage arising from flooding following a rain event and the legal risk associated with storm-water management.

At Frank Cowan Company, we have seen the increases in the number of class actions over the past few years. If liability is found against the municipality, the damage award can be significant depending upon the number of people in the group. However, more importantly, the cost of defending class actions is very high. For example, a recent class action claim commenced against a municipality for breach of privacy had a potential of 85,000 claimants as per the pleadings. Through the legal process it was finally determined that there were only 40 claimants. After careful review of all the submissions by claimants the claim was settled. All but one of the claims were rejected for a total damage payout of \$113.04. The big costs were in the form of third party legal costs, defence costs and expenses which totalled approximately \$1,335,000.

Changing Legal Landscape

Recent court decisions have shown a reluctance to assign contributory negligence to claimants whom have been catastrophically injured. For example, consider *Stephen Campbell et al. vs. the Municipal Corporation of the County of Bruce*.

This was an occupier's liability claim in which the claimant cyclist was advancing over a "Free Fall" apparatus at the municipality's adventure park, when he fell off the obstacle, rendering him a quadriplegic. "Free Fall" is a variant of a Teeter-Totter that was fixed to the ground with concrete and piping to swivel the teeter-totter up and down. It is marked as having a high difficulty rating.

The trial judge noted that the plaintiff, testified that he was a relatively active middle-aged man who had extensive experience with road and mountain biking. He further noted that when he attended at the bike park he knew that there were risks of injury associated with mountain bike riding, that he understood the rating system employed at the mountain bike park and that the mountain bike park was an unsupervised, non-fee-paying facility. The plaintiff further observed the signs requiring him to ride within his own abilities and his own risk and to wear a helmet, although he did not do so on the first day. With respect to the incident itself, the trial judge noted that the plaintiff "overestimated his abilities and underestimated his skill required to successfully ride this teeter-totter". The trial judge further noticed that Campbell "acknowledged that his exit strategy off of Free Fall was incorrect". Despite all this, the trial judge concluded that the plaintiff bore no contributory negligence in this case.

Recently, the Financial Services Commission of Ontario contracted an independent research company to collect statistics on motor vehicle accident claims. Here is a highlight of some of the findings and comparisons to their last study:

- 91% of the claimants had some type of legal representation (a 37% increase since last reported).
- 83% of claimants ultimately commenced legal action (an increase of 60% since the last report)

Future Care Costs

Future care costs address the medical and non-medical needs of a person who has suffered a catastrophic injury. Future care takes into account the person's future needs that will enhance the person's life. Consideration is given to medications, rehabilitative needs, nursing, home renovations, orthotics, assistive devices, transportation, social outings, educational or vocational needs, housekeeping and personal care services, recreational activities and future medical complications.

Future care costs are by far the largest component of a serious bodily injury claim. Providing future care is extremely expensive. People with severe brain injuries, spinal cord injuries and multiple orthopedic injuries are living longer. Coupled with rising healthcare costs, the cost of future care has ballooned over the past five years.

Brain injury cases are the types of cases where future care awards are the most significant. In the past 10 years, Frank Cowan Company has seen a dramatic increase in the number of brain injury cases reported.

Examples of Future Care Awards

Frank Cowan Company handled a claim in which a teenager was catastrophically injured when hit by a car in an intersection. The case was settled mid-way through trial for \$8,300,000. Future care accounted for \$5,000,000 of the settlement.

In *MacNeil vs. Bryant*, the Court awarded an \$18,427,207 judgement to a 15-year-old female who received a severe head injury as a result of a motor vehicle accident. Over \$15,000,000 of the award was for future care.

In *Sandhu vs. Wellington Place Apartments*, a severe head injury was sustained by a child who fell from an apartment window. The Court awarded a \$17,000,000 settlement which included \$11,000,000 for future care.

In *Marcoccia vs. Gill*, a 20-year-old male received catastrophic injuries as a result of an automobile accident. The Court award was in the range of \$15,500,000 as plaintiff counsel argued he would need 24/7 attendant care for the rest of his life.

In *Morrison and Gordon vs. Greig*, Gordon was rendered a paraplegic and Morrison sustained a catastrophic brain injury. Morrison was awarded \$11,500,000 and Gordon \$12,600,000.

As outlined in the cases above, future care costs ranged from \$5,000,000 to \$15,000,000 which had an immense impact on the total cost of these claims.

What Factors are Impacting Future Care Assessments?

Attendant Care

Attendant care, private duty nursing or a personal support worker is often required/demanded in the most serious cases. Depending upon the level of care provided, the hourly rates can be very costly. To help illustrate how these costs can escalate quickly; imagine a young person with a brain injury who has a 50-year life expectancy requiring 24/7 care. Attendant care for that person could easily cost in the millions. There are other providers of future care services including services such as: housekeeping, nanny services, lawn and home maintenance, speech therapists, psychological counseling, occupational therapy, personal support worker and employment counseling.

Inflation on Medical Expenses

Statistics have shown that the medical expenses inflate at a higher rate than average. Statistics Canada published inflation rates demonstrate that Health Care Services inflation exceeds CPI by 23.3% over the last 15 years. In the case of *MacNeil vs. Bryant*, the Court accepted the expert evidence that medical costs will inflate at a higher rate than average. Our medical system is currently strained and with no future relief in sight, medical services will increase in cost as demand exceeds supply. This alone can increase future care costs significantly.

Management Fees

Awards for future care must be managed to ensure the capital provided lasts a lifetime. In many cases neither the plaintiff nor the plaintiff's family is capable or experienced in managing a large sum of money. The Courts realize that a professional guardian needs to be hired to ensure the funds are properly invested and managed. Today, these management fees are approximately 5% (or more) of the futures award.

In *Sandhu vs. Wellington Place Apartments*, the future care cost awarded was \$11,000,000. In addition, management fees of \$1,795,000 were awarded. This fee is well above 15%.

Interest Rate and Discount Rate Impact

Current interest rates are low. When a claim for future care is settled an insurer is paying a large sum of money today for an expense into the future. A discount rate, which is tied to interest rates, is used by our Courts to assess the current value of this future expense. Until 2003, the rate was 2.5% on all damage awards for future losses. Since then, the rate was lowered to 0.1% for the first fifteen (15) years of the future award and 2.5% thereafter. This change has resulted in a minimum increase of 18% on these awards.

Additional Heads of Damage

A head (or type) of damage for loss of competitive advantage was the first “new head” argued in the early 1980’s. It was argued that a person, with even the most minor injury, was entitled to damages in the case of a job loss and/or the fact that a prospective employer may not hire a “damaged person”. In 1980, this head started at a \$5,000 award. Today, it is typically valued at \$100,000 or more.

Loss of Interdependent Relationship (LOIR) was first pleaded in the early 2000’s. The damages are based on the fact a severely injured person may never have a spousal relationship, and benefit from the ability of two people living cheaper than one. When first pleaded, this award was less than \$100,000 and has subsequently doubled.

Municipal Claims Inflation

Claims inflation should not be confused with the Consumer Price Index (CPI).

CPI is an indicator of the changes in consumer prices experienced by Canadians. These items include food, shelter, transportation and clothing. The CPI is frequently used to estimate the extent to which purchasing power of money changes, so it is widely used as a measure of inflation.

Inflation on municipal claims is a very different concept. Actuaries refer to this concept as trending. Actuaries will take a measurement of claims trending on a large book of business, such as Ontario municipal liability, and will use this information to determine appropriate rate adjustments. To determine the level of trending in the municipal portfolio the actuary considers trends related to both claims severity and claims frequency. This is a predictive measure used to estimate future expected values by analyzing historical data and other relevant information. They also take into consideration jury awards, court decisions, changes to legislation, emerging trends that may impact the claims as well as any professional fees for lawyers, adjusters, and experts.

Frank Cowan Company has a large statistically relevant municipal database established over 90 years of working with our clients. Taking all factors into account, our actuaries estimate that municipalities have a claims cost trend that is well above CPI.

Conclusion – What can we do?

Insurance is complicated and the landscape continues to become even more complex when considering other exposures such as terrorism, cyber and climate change. Municipalities must increasingly rely on an insurance provider that keeps abreast of emerging issues and provides best in class risk management and claims services.

What can we do? When selecting your insurance carrier through an RFP process, think of insurance as a product, not a commodity. Make sure your provider has superior tailored risk management and claims services. Municipalities can’t rely on the Province to provide relief - they must take matters into their own hands. A Total Cost of Risk (TCoR) approach must be deployed to ensure your insurance program is cost effective and efficient. A TCoR methodology is a tailored approach that mitigates local exposures (risk management) and implements best practices in claims management.

Each municipality must be informed of how their insurer provides risk management and claims services.

You need to ask questions about claims management:

- How does your insurer manage claims?
- Are all lines serviced by one Canadian provider under “one roof” or by multiple insurers in various countries?
- Does your insurance provider utilize best practices to manage their claims volume?
- What is the cycle time of claims?
- Are older claims increasing in proportion?
- Is the legal spend being managed appropriately?
- Some municipalities have large deductibles – can your insurance provider assist with implementing a best practices environment in your municipality?
- In some municipalities the cost of claims below the deductible is the largest expenditure of the insurance program. Is the cost of consulting services covered by the premium or does your insurance provider charge additional fees?

Municipalities have long tail claims; managing claims properly will reduce municipal expenses.

You need to ask questions about risk management:

- What risk management services does your insurer provide?
- Do they utilize a tailored approach or are the risk management services generic and not industry/geographically specific?
- Can their staff perform a road review, MMS review, inspect a toboggan hill or trail?
- Does your insurance company provide you with the tools to mitigate risks (GPS systems monitoring compliance with MMS)?
- Is the cost of the risk management services covered by the premium or does your insurance provider charge additional fees?

You need to ask how long your service provider has been part of their insurance program?

Municipal insurance operates in a long tail claims environment. Some programs compete on price and shed their municipal insurance providers regularly to ensure they can continue to offer low premiums. This approach is not sustainable. Constantly changing markets results in poor claims service with multiple insurers providing claims services from different countries and lines. Your partners need to be committed to the municipal insurance space. It is important to ask how long your service provider has had their markets, specifically liability?

With the described escalation in the cost of claims, it is necessary to ensure that premiums are adequate to recover the cost of claims. What is viewed as a problem today may become a full-blown crisis tomorrow, especially in a highly specialized area such as municipal liability.

Based upon the descriptions of what are driving claims costs, there is strong justification for an increase in the cost of insurance. It is recognized that this may cause increased pressure on the finances of the municipal client base in the short run. It is also recognized that some insurers may be prepared to ignore these trends, and offer lower premium levels. We believe, however, that the need to offset the ever-increasing cost of claims with premium adjustments cannot be ignored. We trust that our clients will continue to value our expertise based on our past experience and insight in order to be assured of long term sustainability in their insurance program.

In the interim, our municipal clients must continue their efforts to attack the root causes of this problem by working to reduce both the frequency and severity of claims.

Frank Cowan Company has been working with municipalities for over 90 years. We understand municipal liability and we are here to assist you in addressing your various risks. We believe the best way to keep your total insurance costs low is by preventing claims before they happen. As a Frank Cowan Company client, you have unrestricted access to our risk management services – at no extra charge. These include educational sessions, consultation services and on-site inspections. Our experts can analyze your operational policies and procedures, identify exposures and risks in your facilities, and consult with municipal workers on risk management topics.

Let us help you!