

MARKETS IN FOCUS

CANNABIS



Insurance Pricing &
Market Update
Q3 2022

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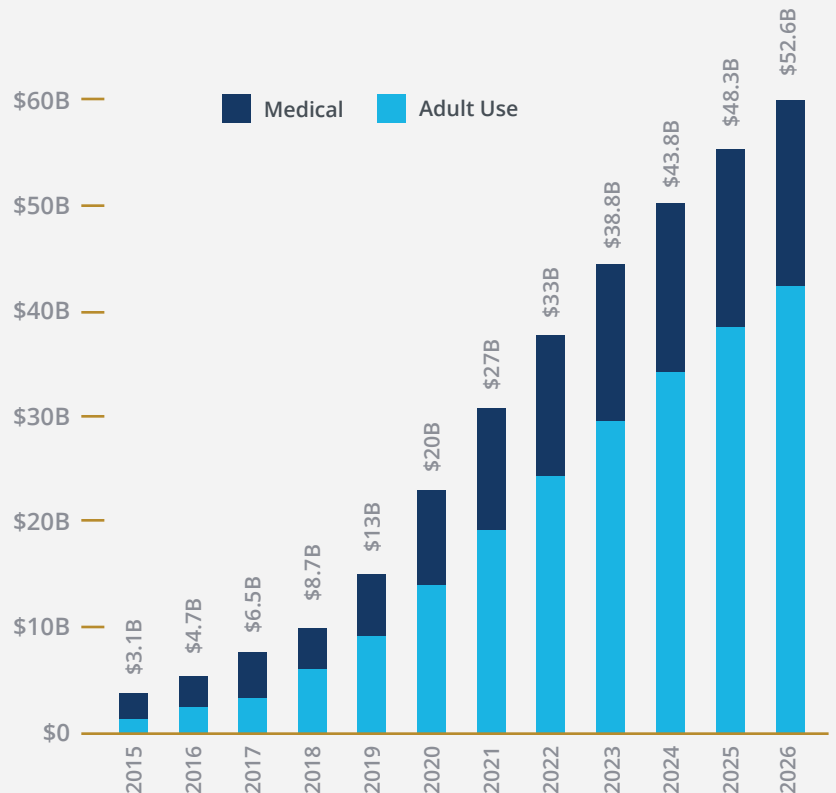
Introduction

As the push for legalization domestically and abroad grows, the cannabis industry continues to garner significant attention from investors, manufacturers and researchers.¹

- + Combined U.S. medical and recreational cannabis sales are expected to reach \$33B by the end of 2022, driven by the opening of new adult usage markets.²

Recently, flower market share has declined in both the U.S. and Canada.³ Beverages and pre-rolled joints saw the most robust YoY growth rates in the United States, while tincture and sublingual products in Canada, released in late 2020 with other “cannabis 2.0” products, saw an unprecedented 3000% growth YoY.⁴

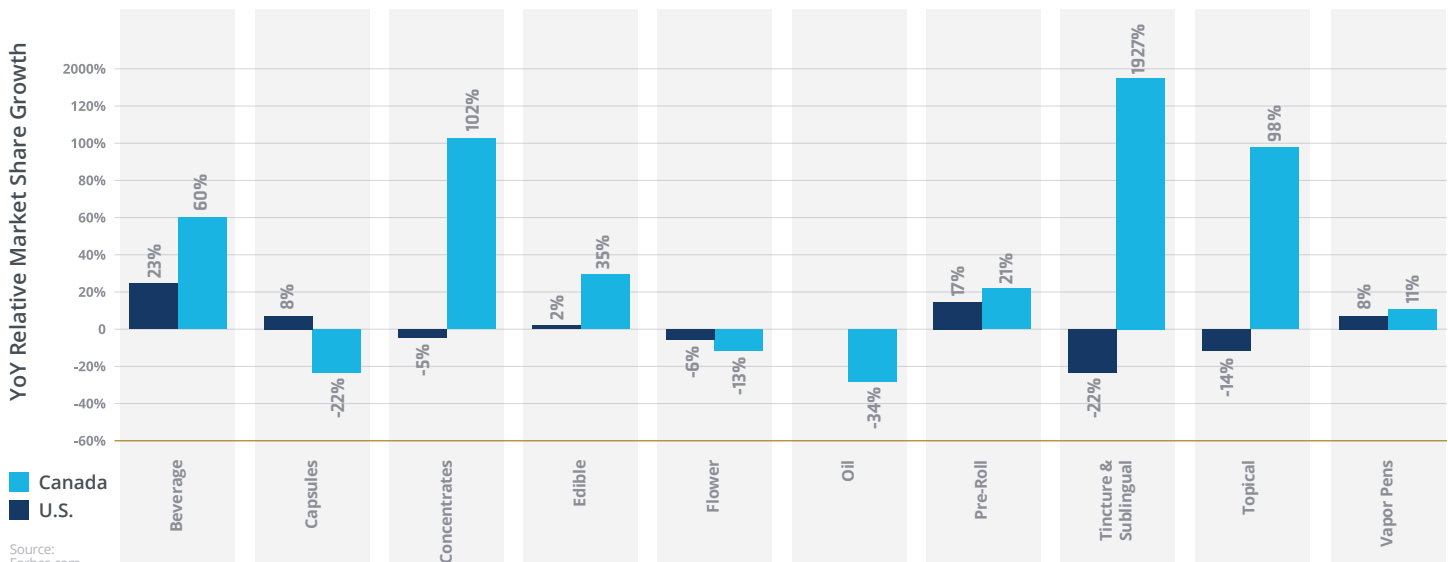
U.S. Cannabis Retail Sales Estimates: 2015 - 2026



Source: MjBiz Factbook

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2021 Year Over Year Category Market Share Growth

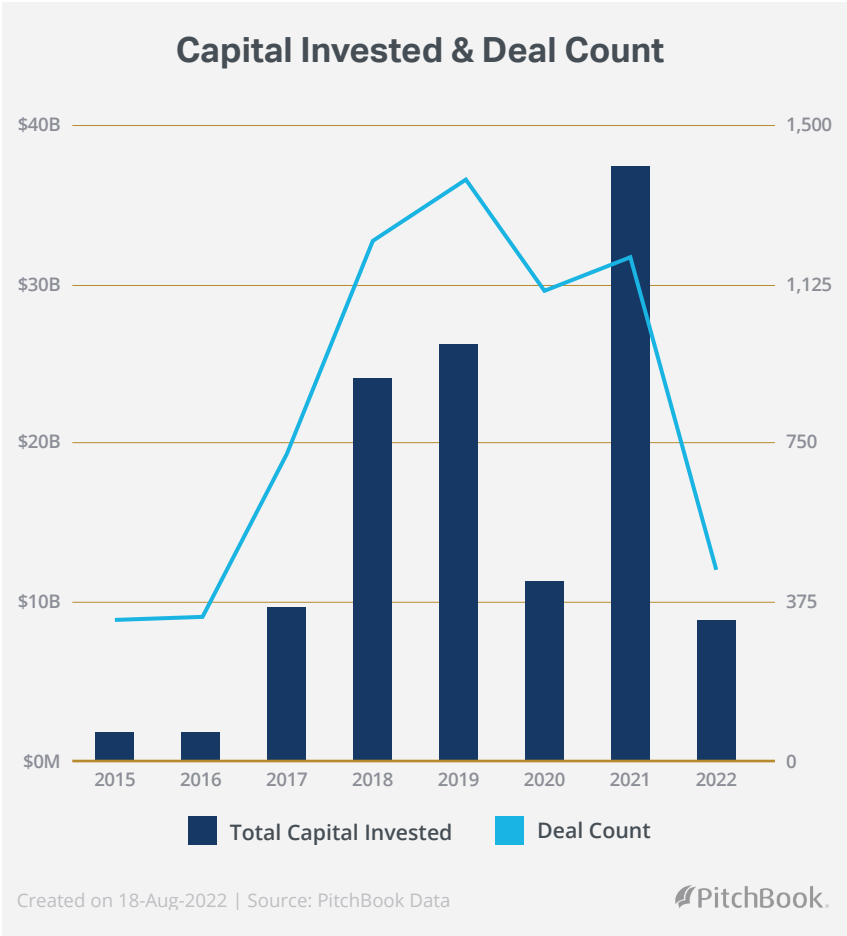


Source: Forbes.com

Since year end 2021, 16 additional states (bringing the grand total to 37), territories and the District of Columbia have legalized various aspects of the cannabis industry.⁵

M&A was a major factor in the cannabis space last year, but deal flow has slowed in 2022.

- + 2021 was a flagship year for U.S. cannabis M&A activity with 306 transactions reported through December verses 86 transactions reported in 2020. This represents a 306% increase in one year alone.⁶ However, rising interest rates and concerns about stability in the greater economy have impacted deal making in the cannabis space, as in other sectors of the global economy.



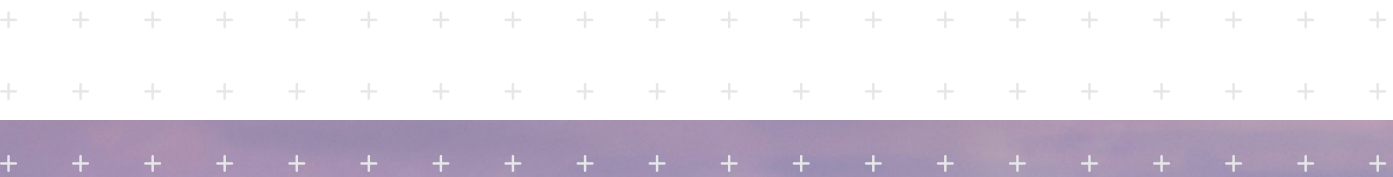


Legislation

Under the U.S. Federal Law in the Controlled Substance Act, cannabis is still considered a Schedule I substance.⁷ Nevertheless, as the number of states legalizing cannabis either recreationally, medically or both has increased, so too has the sentiment for legalization at the federal level.⁸

There are a handful of bills in the U.S. Congress that may positively impact the cannabis industry if passed, some of which could alleviate the litany of banking and insurance challenges operators in the space continue to face.⁹

- + With the Schedule I federal classification of cannabis, most banks will not work with cannabis companies out of fear of losing their FDIC protection, facing criminal charges or violation of the Commerce Clause, which has created a tedious banking hurdle which is exceedingly difficult to solve.¹⁰ Without traditional banking solutions, many in the space struggle with expansion, servicing customers and are forced to stockpile cash which, clearly, is a major safety concern.
- + **The SAFE Banking Act** would formally afford banks and equity investors in the space protections from federal penalties. If passed, it would be a major step towards ensuring cannabis operators have access to a broader array of financial services and capital solutions.¹¹



IRS Code Section 280E, stipulating that if a business is trafficking certain controlled substances, like cannabis, the business is then unable to deduct business expenses on their taxes, has also caused some consternation for cannabis operators.¹² Unfortunately for those in the cannabis industry, there are no current movements to make changes to this code.

The CLAIMS Act refers to “The Clarifying Law Around Insurance of Cannabis” (CLAIM) Act of 2021. This legislation is aimed to ban criminal prosecution of insurers who work with statute-legal cannabis businesses.¹³ The majority of the coverage for the industry is being found in the more expensive Surplus Lines and Managing General Underwriters/Agencies markets, but passage of the CLAIMS Act would allow for household-name carriers to provide much needed capacity and thus, theoretically, lower pricing. Many states still require cannabis companies to obtain General Liability, Property and Workers’ Compensation insurance to obtain state business licenses, and these costly insurance items pose a challenge to operators’ bottom lines given the current state of the market.

Unfortunately, the CLAIMS Act and SAFE Banking Act continue to be included in wider federal legalization regulation, resulting in roadblocks for their passage despite both having bipartisan support.

In this upcoming midterm election cycle, a handful of states have adult-use cannabis on their ballots, including Delaware, Maryland, Minnesota, Missouri, New Hampshire and Ohio.¹⁴

In our opinion, we do not think any sweeping federal legalization movements are likely in the near-term. Instead, we tend to believe the cannabis space will continue to grow through a series of state-by-state legalization wins and vocal support from large financial institutions such as Bank of America and US Bank.

We believe the cannabis space will **continue to grow** through legalization wins and vocal support.





2H Outlook

PROPERTY

Cannabis industry operators, regardless of sector, must establish the highest level of safety for your operations to achieve the best results in the current property insurance market as carriers are more stringent in underwriting cannabis risk than nearly all other industries.

- + When acquiring property insurance, it is important to disclose the exact operation type and the specific use of the building or facility. This is particularly true for operations including growing, processing and mixed-use facilities
- + Ample capacity remains for placing Property coverage, but it can be more difficult for those companies located in Gulf Coast states, given their Catastrophic (CAT) storm exposure.
- + When looking at Western States, placing coverage has not been an issue but insureds need to be cognizant of which sub-geography they are in, and there are some carriers who may exclude losses related to wildfires.
 - Although limited, coverage is available, with pricing heavily dependent on loss-history and current risk mitigation
- + Another concern for carriers in the property market continues to be the nationwide shortage of building materials and adequate labor having an inflationary impact on claims. Carriers continue to struggle with the gap between what is reported as replacement value when underwriting a policy verses the actual cost to repair when a claim occurs.
- + **Crop Insurance** – Capacity continues to be limited for this product and may come with sublimits. Since hemp was removed from the list of Scheduled I controlled substances with the passage of the 2018 Farm Bill, there has been more capacity and better terms for these operators compared to cannabis operators.
- + For both cannabis and hemp operators, damage to crops and finished product inventory is available via traditional property coverage. It is important to note it is expensive and is subject to more policy safeguard warranties.

GENERAL PRICING ESTIMATES

Non-CAT exposed property with favorable loss history	Flat to single digit increases
CAT exposed property with favorable loss history	Flat to 10% increases
Property with unfavorable loss history and/or a lack of demonstrated commitment to risk improvement (unresolved reccs, pattern of same issues, etc.)	10%+ increases for non-CAT 25%+ increases for CAT exposed accounts and higher, depending on frequency/severity of losses and when there are limited markets for a risk due to occupancy/class of business or concerns related to loss control



CASUALTY

Capacity in the casualty market remains sufficient for cannabis, with carriers capable of providing \$5-10M primary **General Liability** layers, typically including Products Liability.

- + Like Life Sciences and other hard Product Liability industries, sometimes the general liability policy is separate from the Products Liability policy.

Nuclear verdicts and inflation elevating the total cost of claims are two concerns impacting the casualty market, but cannabis has not been a leader in these two claims factors.

- + The Cannabis industry is not following this trend; there have been a handful of Product Liability claims which have made headlines but claims activity is not as prevalent as some predicted when cannabis products were first legalized

Many **General Liability** carriers are concerned with the **Product Liability** portion of coverage for the cannabis industry, especially for operations making or selling vaping products, edibles or beverages. A significant worry for carriers is how appealing these products are for children and the expensive judgments that could arise out of a lawsuit related to underage consumption.



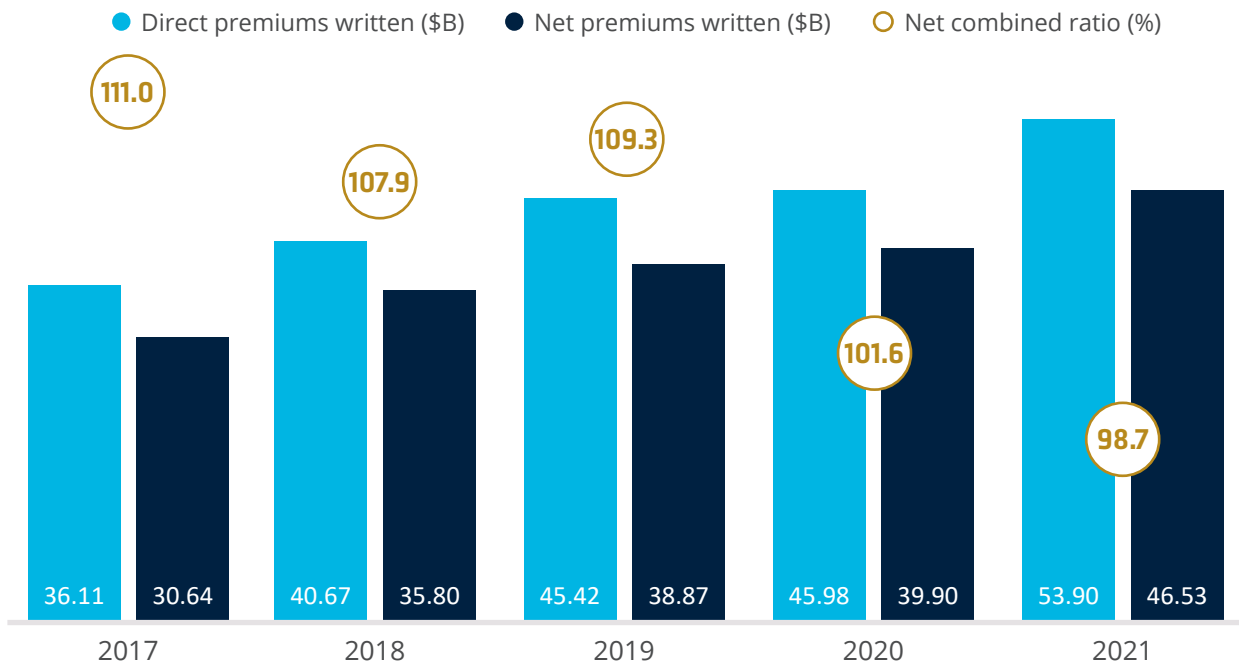
Product Recall – Traditionally, many **Product Liability** coverage forms only offer an “expense only” sublimit and limited coverage terms for product recalls. To address this costly coverage gap, many carriers are offering a standalone **Products Recall insurance solution**, which is designed to provide coverage limits for re-testing costs, loss of income, costs associated with notifying customers and other expenses connected with a product recall that would typically only be covered by the Products Liability sublimits or not at all.

- + One scenario where these limits might be of use is when state legislature mandates a product recall; for example, Michigan ordered a recall after identifying “inaccurate and/or unreliable results of products tested in laboratories.”¹⁵

Auto – The auto industry had loss ratios above 100.0 for the ten years prior to 2021, which now has resulted in challenges for those who have large fleets. Social inflation and nuclear verdicts have hit this sector hard, and carriers have taken note. The demand for fleet monitoring technology is on the rise, and many auto carriers are investing in telematics in hopes of improving loss ratios. New “insurtech” entrants are driving the trend toward telematics implementation and adoption in the auto industry, which will allow underwriters more rate flexibility on new business, but also help insure less favorable drivers.

Industry’s combined ratio under 100% for first time in at least 5 years

Industry’s commercial auto combined ratio dropped below 100% in 2021



Date compiled April 25, 2022.

Data reflects the aggregation of all individual property and casualty filers that submit regulatory statements to the NAIC. Based on the annual NAIC statutory property and casualty statements. U.S. filers only. May include business written outside of U.S., if reported in NAIC statement. Direct data is derived from exhibit of premiums and losses, prior to consideration of reinsurance for commercial auto physical damage, commercial auto liability, and commercial auto no fault reported lines of business. Net data is derived from insurance expense exhibit, after consideration of reinsurance for commercial auto physical damage in commercial auto liability reported lines of business. It was common practice to ensure premium credits during 2020 for auto insurers, but there was no standard practice for this among insurers. No effort was made in the exhibit to fully adjust the premiums for year over year premium growth beyond what was reported by each company. Combined ratios displayed hour before policyholder dividends. Source: S&P Global Market Intelligence.

- + **Auto physical damage (APD)** coverages are seeing scrutiny from underwriters due to the difficulty of assessing vehicle valuations. Recently, the value of in-use tractors and trailers have been on a steep incline as supply chain issues cause delays and an increased demand for equipment and critical components. Operators should carefully appraise their fleets, as the cash value of their units listed on the policy may not be sufficient to replace with a comparable unit if they were to experience a loss.

Workers’ Compensation – Pricing and capacity remain favorable with rates typically remaining flat for those with positive loss history and sufficient experience modification factors.

GENERAL PRICING ESTIMATES

General Liability	Generally Flat
Workers’ Compensation	Flat to Negative
Auto	Up 8% to 20%+ Up 30% if large fleet and/or poor loss history
Excess Liability – Middle Market	Up 10% to 50%+
Excess Liability – Risk Management and other Complex/ Hazardous Exposures	Up 25% to 75%+ Some have excess layers and have increased more than 150% on large accounts

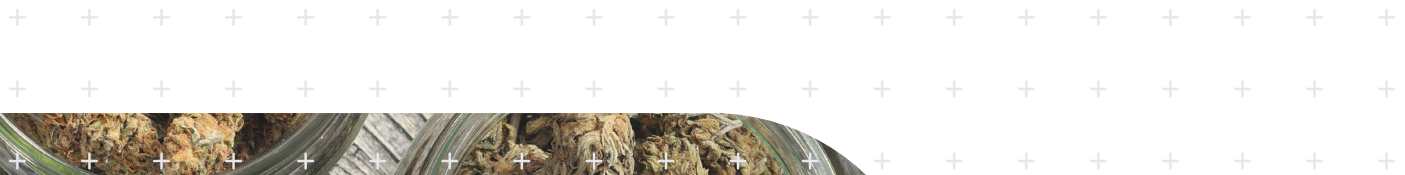


EXECUTIVE RISK

Directors & Officers (D&O) – After an extremely hard market in 2020 and much of 2021, rates stabilized in early 2022 and there now appears to be small downward pressure on rates for the second half of this year, in general, across most industries.

D&O & Cyber markets are seeing their own set of **unique challenges**.

- + However, despite positive pricing trends across other industries, the cannabis sector continues to be a challenge to place due to the lack of federal regulations surrounding bankruptcies in the industry.
- + As such and without many bankruptcies in the space to act as reference points, D&O pricing models continue to be challenged by this business.
- + Operators should continue to expect elevated pricing in this sector as neither of these two trends appear to be changing in the near term.



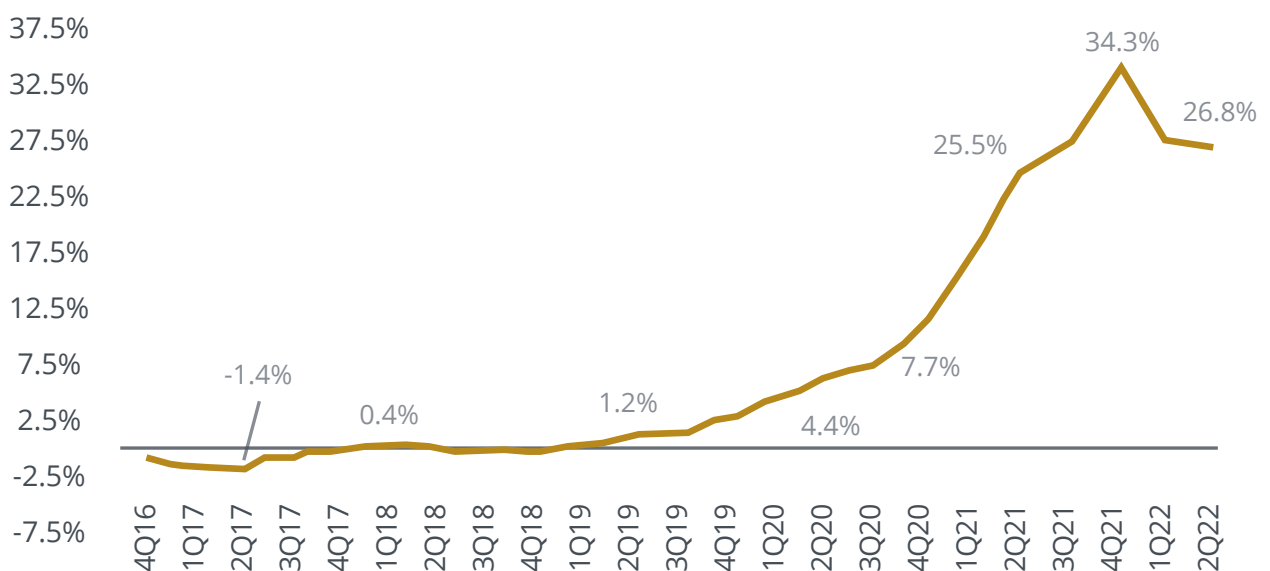
Cyber – The Cyber insurance market is best categorized as “transitioning out of a hard market.”

- + Loss activity has decreased in the aggregate
- + According to Moody's Investor Service, the sector's loss ratio improved to 62% in 2021 from 65% in 2020
- + Frequency has decreased but severity remains an issue

Average and Median Ransom Payments in Q1 2022:

- + Average Ransom Payment: \$211,529 (-34% from Q4 2021)¹⁶
- + Median Ransom Payment: \$73,906 (-37% from Q4 2021)¹⁷
- + We continue to see a change in tactics amongst attackers. Due to improvements in data backups, attackers are avoiding the encryption step altogether and instead are focusing exclusively on stealing data and demanding payment to prevent disclosure of data.
- + Carriers are still focused on “must have” controls and are increasingly reliant on external scanning technology in their risk assessments
- + Pricing increases are still the norm
- + According to the CIAB (Council of Insurance Agents & Brokers), the average premium increase in Q1 was 27%
 - We caveat this is an average and certain industry groups continue to see higher increases

Premium Change for Cyber, Q4 2016 - Q2 2022



Source: https://www.ciab.com/wp-content/uploads/dlm_uploads/2022/05/Q1-2022-PC_FINAL.pdf



Major Claims in the Sector

COMMERCIAL AUTO

On March 13, 2022, a commercial bus driver was charged with 38 counts of reckless endangerment after blacking out behind the steering wheel while snacking on gummies he did not know were infused with THC.¹⁸ Police found the driver parked on the side of the road, slumped unconscious in his seat, next to an open package of edible cannabis-infused fruit chews.¹⁹ The driver claims he had no idea he had been snacking on anything but regular candy.²⁰

CLASS ACTION LAWSUIT

A multi-state operator agreed to pay more than \$500,000 to settle a class action lawsuit over mislabeled vape cartridges.²¹ The company had mislabeled 186,000 vape cartridges under its Select Brand as 100% marijuana when the employees had cut the cannabis oil with additives and other ingredients.²² The business has already paid out \$110,000 to the state in penalties for the same incident.



Guidance



BEGIN THE RENEWAL PROCESS EARLY

Broadly speaking, the **General Liability, Umbrella/Excess, and Property** markets are constrained and more difficult to navigate in the disciplined market, especially for players in the cannabis industry. With an outcome of increasing prices across most lines of business and in every industry sector, brokers are being swamped with submissions from their insureds who want to minimize these additional costs.



PARTNER WITH INDUSTRY EXPERTS

The Cannabis industry presents a unique set of challenges and risks, and therefore it is important to work with your broker's team of professionals who understand the business and the market for placing risk. With the challenges and litigious nature of this industry, it is paramount to have a team on your side who can best represent your risks, offer **Risk Control** services to improve processes and have strong, reliable carrier relations. **Having operated in the Colorado, California and Oregon market for many years and working with many different clients in the cannabis space, we have gained significant level industry expertise.**



LOOK TO PARTNER WITH CARRIERS WHEN POSSIBLE

Fostering strong relationships with key trading partners is always important, but even more so during challenging times. This business philosophy also applies to the insured's relationships with carriers. Where possible, insureds should look to meet, virtually, if necessary, with their current and prospective carriers. **This interaction not only builds rapport and allows them to put a face (or voice) to a submission by telling their company's story, it also allows for insureds to control the narrative of their risk verses letting underwriters decide based off an inert loss run.** This is especially true if there have been losses and insureds are then able to explain what happened and use the opportunity to discuss lessons learned and what new practices have been implemented, as opposed to underwriters simply looking at loss histories.



PRODUCT RECALL LIABILITY

It is extremely important to understand what exactly is covered in the **Product Liability** product recall sublimit, or to consider purchasing a **Product Recall Liability** policy if the desired coverages are not met by the sublimits. Your service team can also assist in helping you make this decision.



HIGHLIGHT CYBERSECURITY

Since cyber policies are becoming more expensive and difficult to place for cannabis clients, it is key for insureds to highlight the specificity of their cybersecurity programs. **It is vital to start the process 120 days in advance of your renewal and to highlight any additions in cybersecurity staffing or upgrades to programs as well as lessons learned from any past attacks.**



HIGHLIGHT SAFETY

Carriers are always looking to assess EH&S practices, but underwriters will add more scrutiny to workplace safety in disciplined markets. If there have been claims in the past, it will be essential to explain to carriers what knowledge was gained through the claims process and how the company is working to avoid repeat incidents. **Additionally, our Client Advantage EH&S and Risk Control professionals can help strengthen policies, provide training based on the latest regulations or conduct on-site audits.**



CONTRACTS

Carriers are becoming increasingly interested in indemnity language in contracts. Many underwriters are even asking for samples of contracts to review as part of their renewal process to clarify what insureds are agreeing to indemnify. **Our Client Advantage attorneys can help strengthen indemnity language and give feedback on current contracts to help protect clients and make the risk more attractive to underwriters.**



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More Than Just Insurance

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