



Global Risk
Observatory

Marijuana in Canada: Legalization & the Insurance Industry

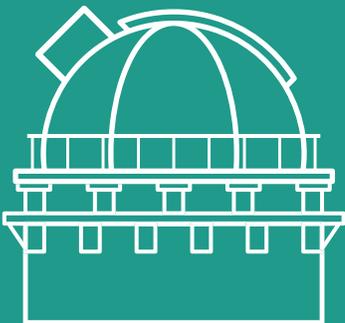
Risk Brief | Spring 2018

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Marijuana: Legalization &
the Insurance Industry
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Executive Summary

The following risk brief will elaborate and analyze the threats and opportunities to the insurance industry that arise from the legalization of cannabis in Canada once legalization is finalized. The risk brief is outlined as follows:

Environment

The legalization of cannabis possession and production creates a sudden change in the risk environment for insurance firms, one which is problematic for lack of reliable actuarial data.

Insurers will have to adapt their models in order to optimize their coverage of risks particular to cannabis and claims that might not have been paid out previously due to cannabis-related ineligibility.

Measurement

Popular opinions surrounding cannabis create risks for insurers who might face reputational problems in the eyes of some customers.

Legalization impacts a broad array of insurance products and insurers.

Key Stakeholders: licensed producers, dispensaries and cannabis clubs, auto insurance companies, home insurance companies, health/life insurance companies.

Evaluation

Based on the GRO intensity scale outlined in our methodology document, we describe and prioritize scenarios into first, second, and third order events.

Risk Management

Firms should be constantly working with their lawyers to ensure compliance with the new regime.

Firms should iterate coverage options as they work to comply with the law despite the lack of actuarial data.

Insurance companies should try to integrate cannabis coverage into their regular insurance products.

Conclusion

Marijuana production was a significant but previously uninsurable activity, and the ability of a market player to gain a first-mover advantage could enhance its position in the marketplace overall. Any strategy to capitalize on this opportunity, however, should be conservative and fully realize the risk and uncertainty that is inextricable from the issue.



Risk Environment

Key Takeaways:

The introduction of Bill C-45 and C-46 presents threats and opportunities to the insurance industry to integrate cannabis in areas such as commercial, automobile, and homeowner policies.

Actuarial models, premium pricing, and the willingness to extend coverage for cannabis-related claims will need to be reassessed by insurers.

Legal Marijuana sales were approximately \$9.7 billion in North America in 2017 according to a report from Arcview Market Research, which predicted the entire legal marijuana market will reach \$24.5 billion in sales — a 28% annualized growth rate — by 2021.¹ The Canadian federal government has introduced legislation to legalize cannabis (colloquially referred to as marijuana) beyond medicinal use, which will impact society across industries, including ones that have yet to emerge, and which will affect insurance providers. There will also be inter-provincial variation – for example, in those that choose to make insurance coverage mandatory for marijuana producers, distributors, and retailers.² With a market of this size, provincial governments could allocate additional tax revenues towards policies outlined in their campaigns (such as education, healthcare, and agriculture), pay down debt, or provide income tax relief.

Bill C-45 is the proposed legislation that will decriminalize the possession of fewer than 30 grams of marijuana by people over 18 years of age and allow adults to grow a maximum of 4 plants per household.³ Bill C-45 also addresses licensing for everything from the import and export of cannabis to its testing, packaging, labelling, transportation, sale, possession, and disposal. Additionally, Bill C-46 outlines three new drug-impaired driving offences.⁴ Both bills have passed the House of Commons and, as of

March 1, 2018, Bill C-45 is at second reading in the Senate.⁵ It is highly unlikely that all provinces and territories will be logistically prepared to implement legalization before the fall.⁶

The possession, production, and trafficking of marijuana is currently prohibited under the Controlled Drugs and Substances Act (CDSA), except for medical purposes as regulated by Health Canada.⁷ Initially, patients with a prescription could only acquire medical marijuana directly from Health Canada, but this was expanded to include licensed producers (or “LPs”) are certified by Health Canada.⁸ The Federal

Court also ruled that restricting medical marijuana users’ cannabis supply to LPs prevented them from having “reasonable access”, resulting in new Access to Cannabis for Medical Purposes Regulations (ACMPR) enforced in 2016.⁹ ACMPR is administered by Health Canada and encompasses the commercial industry as well as individuals who produce marijuana for their

own medical use or on behalf of someone else.¹⁰

The risk to the insurance industry is prescriptive in nature. Insurers are required by law to have sufficient funds to pay for insurance claims.¹¹ Insurance companies thus need to predict how much money that needs to be put aside to pay for the coming year’s claims. Calculating insurance premiums, the monthly or

annual rate individuals pay to an insurer for assuming a risk (i.e. car crash) on their behalf, are based on informed predictions and involves a process that requires risk assessment techniques based on actuarial science.¹² Insurers need to gather information based on experience to help

them set fair but accurate premium prices. The legalization of marijuana threatens to challenge existing actuarial models because of the lack of Canadian data (and reliable data more broadly) on cannabis and is expected to exert pressure on the insurance industry to extend marijuana-related coverage into many insurance fields.

Legalization creates opportunities for the insurance industry to offer new products

Risk Measurement

Key Takeaways:

While long term, the legalization of cannabis might prove beneficial, short-term, the legalization of cannabis will cause a substantial and urgent change to the Canadian insurance industry.

KEY STAKEHOLDERS

licensed producers, dispensaries and cannabis clubs, auto insurance companies, home insurance companies, health/life insurance companies.

The legalization of recreational cannabis in Canada will pose several impending challenges for both commercial and personal insurance professionals, including a necessary expansion of the industry that will account for:

- Insurance related to Licensed Producers (LPs),
- Insurance related to Dispensaries and Cannabis Clubs, and
- Insurance related to Personal Lines.¹³

From an insurance perspective, there are several implications of recreational cannabis legalization, including but not limited to: “impairment while operating a vehicle; insurance for companies that may be transporting marijuana products; water or fire losses; damages to buildings, equipment and the marijuana crop itself; employers’ liability and workers’ compensation; and product recalls and contamination.”¹⁴

There is an overall feeling of uncertainty among insurance professionals because of the lack of a proper framework to address the upcoming legalization of marijuana. Linda Papadopoulus, Vice President of Corporate Risk Management at Pearson Dunn Insurance, said at the ARC Group Canada’s 2017 annual seminar that:

We need to know what the laws are because we do not, and we cannot, operate outside the boundary of those laws...Who is actually overseeing the production? Who is going to be

Vulnerability of Various Stakeholders

Stakeholders	Vulnerability
LICENSED PRODUCERS	Commercial General Liability, Building and Equipment, Earthquake and Sewer Backup, Equipment Breakdown, Business Interruption and Extra Expense, Director's & Officer's Liability, Crime (employee theft), Crop (Stock), Product Liability and Product Recall, Cargo/Transit/Contingent Cargo
DISPENSARIES AND CANNABIS CLUBS	Premise liability, Stock Cover, Product Liability Policy, Sewer Backup, Business Interruption and Extra Expense, Crime & Accident Coverage,
AUTO-INSURANCE COMPANIES (Allstate Insurance, Desjardins, TD Insurance, Aviva Canada, State Farm Mutual, Wawanesa Mutual Insurance, Intact Financial Corporation)	Automobile Policies – Impairment, Liability Coverage, Accident Loss & Damage
HOME INSURANCE COMPANIES (Intact Financial Corporation, Aviva Canada, Desjardins General Insurance Group, RSA Canada Group, Wawanesa Mutual Insurance, Co-operators General Insurance Co, Lloyd's Underwriters, TD Insurance, Economical Insurance)	Claims related to Property Damage (Pollution, Mold, Fire, Water), Theft, Damage to Marijuana Plants, Electrical Safety Hazards
HEALTH/LIFE INSURANCE COMPANIES (UL Mutual Company, Equitable Life Insurance Company of Canada, Great-West Life Assurance Company, Industrial Alliance Life Insurance, Industrial Alliance Pacific Life, Manulife Financial, RBC Life Insurance)	Medical Marijuana Coverage, Treatment of Individuals as Non-Smokers, Employment Benefits

*ensuring that they follow the risk management rules and the loss control? It probably will be the insurance industry. Third parties – how are they controlled and regulated? Are we looking at a whole new opportunity for different suppliers to the legal marijuana industry? We as an insurance industry need to address all assets along this new legal supply chain. No one wants to take on a risk if there are no controls in place.*¹⁵

In Canada, an estimated five million adults use cannabis at least once a month, and this figure is expected to increase by 19% after legalization, putting a significant amount of new pressure on the insurance industry.¹⁶

From the public's perspective, 25.2 percent disagreed or strongly disagreed with the legalization of recreational marijuana, and 6.9 per cent had no stance on the subject. Overall, more than half of those surveyed – 58.5 percent – reported that their largest concerns revolved around the risk to children that may arise from legalizing recreational marijuana.¹⁷ Positive public perception around legalizing cannabis should force the

insurance industry to develop new frameworks to address risks associated with marijuana integration into existing policy options, specifically: appropriate standards for quality control, vendor liability, commercial host liability exposure, employers liability, transit and product recalls.¹⁸ While long term, the legalization of cannabis might prove beneficial, short-term, the legalization of cannabis will cause a substantial and urgent change to the Canadian insurance industry.

Legalization may be beneficial in the longer term, but short-term disruption will require urgent change in the industry

From an international perspective, European marijuana standards are important. For example, the EU has fundamentally exported its privacy standards worldwide and set somewhat of a gold standard where countries should inevitably adopt the European model. To date, there has not been an indication that Canada will follow the European approach regarding mari-

juana. In fact, Canada will become the second country (alongside Uruguay) to federally legalize marijuana. Subtle indicators have suggested that Canada would like to become a global leader for which other countries could adopt similar legalization legislation going forward.¹⁹

Risk Evaluation

Impact Assessment

Key Takeaways:

FIRST ORDER

Potential Lack of Provincial Harmonization; LPs; Dispensaries; Increased Auto Insurance Exposure.

SECOND ORDER

Breathalyzers and Auto Claim Uncertainty; Homeowner Insurance and Spillover Effects.

THIRD ORDER

Pursue Long Term Research Tailored at Uncovering Marijuana Health Effects; Be Aware of Potential Legal Consequences of the Canadian Government's Failure to Withdraw from International Agreements Prior to Legalization; Consequences for Firms Working in the USA or With American Firm.

First Order

POTENTIAL LACK OF PROVINCIAL HARMONIZATION

Under Bill C-45, Provinces and territories, acting on their own authority, would have the ability to increase but not lower the minimum age, lower the possession limit, and impose additional requirements on personal cultivation.²⁰ They can also extend authority to municipalities, if they have not already, to set additional restrictions and local requirements related to cannabis, such as zoning restrictions for cannabis-related businesses and restricting where cannabis can be consumed in public.²¹ Insurance companies operating in multiple Canadian jurisdictions need to be aware which premium adjustments can be adopted into pricing models based on customer location.

LICENSED PRODUCERS (LPs)

LPs, as with other commercial businesses, require different forms of insurance. There are currently only 71 LP producers²² requiring expensive and restricted coverage, but this could change with legalization.²³ If the LP market

expands, which seems likely, some insurance companies may refuse to issue commercial insurance because of reputational risks associated with marijuana in the short-term. This tactic used by insurance companies, over time, has been progressively applied to the tobacco industry.²⁴ Once legalization occurs, many LPs should consider broad coverage across commercial general liability; building and equipment; crime (such as employee theft); product liability and product recall (in case of claims such as unintended side effects); and cargo (when the product is shipped).

DISPENSARIES

Until the legislation is passed and dispensaries and cannabis clubs operate illegally, insuring them will be much more difficult. However, in Vancouver the city has chosen to regulate these businesses instead of shutting them down, allowing for limited insurance options.²⁵ As dispensaries are not licensed to grow cannabis, they are not able to get product liability insurance for products they make that contain cannabis, like baked goods.²⁶ Renting to dispensaries can also cause issues for landlords. A dispensary in a commercial building limits the landlord's options for insurance and results in high premiums but shifting the additional costs onto the dispensary tenant is one option many landlords have opted to do.²⁷

INCREASED AUTOMOBILE INSURANCE EXPOSURE

Currently, individuals who are authorized to use medical marijuana are not required to disclose this to their insurer, as it is treated as any other prescribed medication.²⁸ As such, driving

while intoxicated from marijuana will continue to be treated the same as alcohol intoxication.²⁹ The existing mandate creates problems for insurance companies as the Ontario Automobile Policy (OAP1) states that drivers who are broadly under the influence of "intoxicating substances" are denied coverage for accidental loss or damage.³⁰ A study by the Highway Loss Institute looked at states that legalized recreational use - Colorado, Oregon, and Washington - and compared their claim frequency for collisions to surrounding control states. They found that those states that legalized marijuana has "resulted in collision claim frequencies that are about 3 percent higher overall than would have been expected without legalization."³¹ In 2017, there was about 8670 claims issued, with just over 10,000 collisions in Colorado and uninsured rate of 13.3%. An average claim of \$3160 would mean that the total amount of claims paid out would be approximately \$27,397,200.³² An increase of 3% would total an extra \$821,916 that insurance companies would have to pay out in claims. This is one of a couple reasons for why Colorado has the third fastest rising premiums across the country.³³

Second Order

BREATHALYZERS AND AUTO CLAIM UNCERTAINTY

There is still no definitive roadside testing machine that can determine what constitutes a level of offence akin to the 0.08 blood alcohol level calculated with breathalyzers.³⁴ Currently, the breathalyzer can only detect if there has been tetrahydrocannabinol (THC) in the subject's

breath but cannot detect the amount. It is likely that multiple varying legal interpretations are on the horizon because of the lack of scientific consensus for what constitutes impairment under the influence of THC.³⁵

Determining the extension of coverage for automobile claims will come down to professional judgment, creating policies that would not be harmonized across the industry. As it stands, the police “drug recognition experts” make a judgment call as to whether a driver is impaired, and from there can demand a blood, urine, or oral fluid sample (the admissibility of this evidence is currently being challenged in court).³⁶ The Canadian government is currently drawing on scientific evidence to determine legal limits for marijuana and researching roadside screening devices that could be used.³⁷ This may prove to be more difficult than alcohol because THC, the high-inducing component of cannabis, dissolves in fat as opposed to alcohol, which dissolves in water.³⁸ The link of THC levels to behavior is further obscured because although THC clears quickly from blood, it remains in the brain and other fatty tissues for longer, prolonging the high while also potentially prolonging the window where it is detectable but does not influence behavior.³⁹

HOMEOWNER INSURANCE AND SPILLOVER EFFECTS

Individuals growing marijuana are currently excluded from property damage claims under standard homeowner insurance.⁴⁰ The parameters inside a homeowner’s insurance policy dictates whether homeowners must disclose whether they grow their own cannabis; if they





do, individuals in the past have had to acquire insurance through a specialty market.⁴¹ If the insurance industry decides to push back on the coverage options available for homeowners, it can find natural allies. The Canadian Federation of Apartment Associations is in favor of prohibiting marijuana growing in rented units, as there are concerns of electrical safety hazards and potential mold damage due to moisture.⁴² These dwellings would also use a greater proportion of utilities such as electricity and water, problematic in units without submeters; could constitute fire hazards if growers dry marijuana on stoves; and the odor could disturb other tenants.⁴³ Expect judicial interpretations of Bill C-45 to dictate the minimum requirements that must be offered to homeowners.

Third Order

PURSUE LONG TERM RESEARCH TAILORED AT UNCOVERING MARIJUANA HEALTH EFFECTS

There is a lack of longitudinal research done on the effects of recreational marijuana as it relates to North American behaviour and societal patterns because legalization is a relatively new phenomenon. There are only three years of data available for states like Washington and Colorado, and California only recently legalized recreational marijuana on January 1st, 2018.⁴⁴ To date, the most comprehensive review of marijuana health impacts was written by National Academies of Sciences, Engineering, and Medicine in 2017 (see footnote for key findings).⁴⁵ Although some of their conclusions lack consensus, it remains likely that recreational and medical marijuana us-

age produces enough positive externalities on employee health that could force companies to integrate coverage into their benefit packages. In the short term, the perception of the adverse effects of marijuana is likely to drive the price of premiums to deal with this “marijuana rush” that is expected to occur after legalization.⁴⁶ Going forward, more research will need to be conducted to ensure that insurance policies are accurately priced given the potential inclusion of marijuana into benefit packages.

BE AWARE OF POTENTIAL LEGAL CONSEQUENCES OF THE CANADIAN GOVERNMENT’S FAILURE TO WITHDRAW FROM INTERNATIONAL AGREEMENTS PRIOR TO LEGALIZATION

In the period leading to legalization, the Government of Canada failed to withdraw from the relevant treaties governing international narcotics law. Organizations such as the International Narcotics Control Board, which monitor compliance, have noted that as of July 1st, Canada will be in violation of its international

commitments.⁴⁷ This is unlikely to directly impact the Canadian insurance industry, but there may be consequences concerning Anti-Money Laundering and Terrorist Financing (AML-CFT) governance, which is tightly linked with anti-narcotics efforts at the international level.

CONSEQUENCES FOR FIRMS WORKING IN THE USA OR WITH AMERICAN FIRMS

While several of its constituent states have legalized the recreational use of cannabis, the USA remains firmly committed to prohibition. Under Attorney General Jeff Sessions, the executive branch recently tightened restrictions on financial institutions doing business with cannabis firms.⁴⁸ Previous federal policy was to only selectively enforce federal law in states where cannabis was legal. Going forward, financial institutions which operate across state lines risk heavy penalties and AML-CFT investigations. As the federal government regulates international commerce in a similar legal capacity, Canadian firms (insurers or the insured) that do business with cannabis companies operating legally could face American penalties.

Risk Governance

Key Takeaways:

Legalization of recreational marijuana threatens to change to traditional insurance standards and policies. The insurance industry should work constantly with legal advisors to stay abreast of legislation and court decisions governing marijuana use and the potential impact on such risk management areas as workers' compensation, workplace safety, and liability. As with all high-severity risks, risk management and risk control of commercial enterprises will be an important factor in distinguishing the best-in-class risks, as well as what should be the acceptable standard for risk management in a volatile industry.

Mitigation

CONDUCT INTERNAL REVIEWS/ AUDITS TO ADJUST PREMIUM LEVELS BASED ON NEW RISK FACTORS

The insurance industry should conduct periodic reviews of the growing body of clinical research supporting the use of medical cannabis for other conditions and update its criteria if necessary. In-home marijuana production, for example, comes with new inherent risk factors including increased water, mold, and fire damage claims. In the short-term, Canadian insurance companies should look to mimic standards in North American markets with legalization of recreational marijuana - particularly monitoring the situation in California, where legalization is still in an infancy stage.

RAISE PUBLIC AWARENESS

Insurance providers should proactively seek avenues that increase recognition of dangerous driving habits and encourage Canadians to drive responsibly on the road, especially for insurance companies that are considering offer auto insurance coverage with marijuana-specific provisions or exemptions.

Two examples that could promote public awareness of cannabis include: (1) developing partnerships with organizations that specialize in road safety research and promote safe driving habits and (2) launching campaigns that focus on the dangers of cannabis impaired driving with accompanying surveys highlighting the concerns and misconceptions of driving while under the influence of cannabis.

LOBBY THE ONTARIO GOVERNMENT

Under Bill C-45, Provinces and territories will be able to take responsibility for developing, implementing, maintaining, and enforcing systems to oversee the distribution and retail sale of cannabis and cannabis products.⁴⁹ It is likely that insurance companies will support the Ontario government putting in place more penalties (e.g. fines, demerit points) for drug-impaired driving. In addition, they would believe that the government should prioritize road safety funding on technology development for cannabis testing and public education targeting youth, as the 18-24 age group projected to be the most likely to use recreational marijuana when it becomes legal.⁵⁰

Opportunities

PROGRESSIVE INTERPRETATION OF CURRENT LEGISLATIVE FRAMEWORKS

Sun Life Assurance Co. will be the first major Canadian insurance company to add medical cannabis to its group benefits plan on March 1. Sun Life's coverage will categorize medical cannabis under "medical services and equipment" rather than under a drug benefit since it does

not have a drug identification number (DIN).⁵¹ A DIN is an eight-digit code that is assigned by Health Canada to a drug prior to marketing. This code is crucial for insurance companies because DIN searches identify the type of drug it is and whether it is qualified for coverage.⁵²

Underwriting for medical and recreational cannabis can be quite diverse because of the different rationales individuals inevitably give as to why they are ingesting the product. With medicinal users, underwriters have an additional layer of authority in the doctor or medical adviser.⁵³ For recreational users, insurers have to consider the problem of where people will safely consume the product. For example, people using cannabis in public might cause public safety issues or nuisance within a community. Becoming a first-mover in the industry by establishing policy guidelines for recreational marijuana underwriting could result in an influx in customers in the short-term.

INCLUDE CANNABIS OPERATIONS UNDER COMMERCIAL INSURANCE

With a new marijuana-based market opening, commercial insurance is expected to be required for the 190 stores planning to open.⁵⁴ These stores are strictly regulated by Health Canada, and in cases like Ontario, could be managed by a liquor control board (LCBO). Bill C-45, alongside oversight by the LCBO, reduces the risk property damage, theft, and loss, creating a safer market for insurance companies.⁵⁵ Supply to large retail chains, i.e. LCBO, will require products to be transferred in bulk, creating an increased potential risk of theft or damage to product while in transit. This model of retail

distribution could create an ancillary need for specialized cargo coverage.

Additionally, from an insurance perspective, LPs are not particularly different than commercial ventures, with processes strictly regulated by Health Canada, subject to regular inspection.⁵⁶ Again, a stringent regulatory framework has resulted in managed and significantly reduced associated risks. Areas of coverage that may be offered to LPs include product liability coverage, business interruption coverage, and Director and Officers' liability insurance.⁵⁷ Once marijuana is harvested, its transportation will create potential for loss exposure and provide another area for insurer business growth.

HIGH PREMIUM POTENTIAL

This opportunity relies on the assumption that the market capitalization of certain Cannabis companies is inaccurate and intertwines nicely with the two previous topics if insurance companies embark on a progressive incorporation of cannabis into their business. We predict that a cannabis company with an overtly high valuation would presuppose a higher quality of product provided by said company, a larger overall footprint, or some combination of both. These companies would have a greater capacity of revenues and therefore greater liabilities that would need to be insured (with high premium potential) to ensure that their product is protected.

OFFER CYBER INSURANCE

Bill C-45 permits provinces to run e-commerce websites relating to the sale recreational marijuana. This provides insurance companies an

opportunity to offer cyber-insurance in the case of data breaches by third-party vendors (i.e. Marijuana dispensary personal health files hacked).⁵⁸ Traditional insurance policies may have gaps where they may find themselves on the other end of statement of claim for breaches of the duty of care and fiduciary duties, so it is not surprising that there could be an increased interest in specialty products like cyber insurance. The insurance industry must exercise caution and due diligence when operating or offering cyber-related products as verification of theft, as well as payout structures for individual cyber fraud cases, will be uncharted territory for many insurance companies.

LOBBY GOVERNMENT FOR AUTONOMOUS VEHICLE REGULATIONS

Insurance companies price premiums based on driving history and how much of a risk an individual is on the road. If a human is removed from the driving equation, there could be debate over whether insurance would be necessary at all. To combat the potential loss of premium revenue, insurance companies should proactively lobby the provincial government to consider legislation (similar to the U.K.) that would make insurance for self-driving cars mandatory.⁵⁹ The idea is that if there is a car malfunction during an accident, then the manufacturer would have to pay for damages unless the car owner made unauthorized changes to the vehicle's software or failed to install an update.

Conclusion

The legalization of cannabis in Canada is a classic example of both risk and opportunity. The risks are potentially dramatic: without extant actuarial data, there will necessarily be a period of trial and error while firms both compete to offer better products and make sure those products are statistically sound. The opportunity, however, is equally significant. Marijuana production was a significant but previously uninsurable activity, and the ability of a market player to gain a first-mover advantage could enhance its position in the marketplace overall. Any strategy to capitalize on this opportunity, however, should be conservative and fully realize the risk and uncertainty that is inextricable from the issue.

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