SPECIALTY

Big Business, Scant Coverage

The booming cannabis industry still struggles to attract adequate coverage.

By Alex Wright

Despite the booming growth of cannabis sales in the U.S., the insurance market for the product remains tepid.

Cannabis has become a multi-billion-dollar business in the U.S. over the last decade.

The legal marijuana market alone has grown exponentially from almost nothing in 2011 to more than $10.4 billion in 2018, with the creation of 250,000 jobs, according to New Frontier Data.

Its phenomenal rate of expansion has only been accelerated by the legalization of recreational and medicinal cannabis across multiple States.

Despite many States imposing hefty revenue taxes on cannabis businesses, entrepreneurs have realized an opportunity to make money, with investors pumping $13.8 billion into the industry in 2018 to drive production, distribution and sales of the drug.

However, a major problem for companies in the sector has been finding affordable coverage and capacity across a spectrum of risks, with many now requiring $5 million or $10 million limits as a bare minimum. And while the Federal government continues to classify cannabis as a Schedule 1 narcotic, many mainstream insurers are unwilling to enter the market.

There have also been high-profile departures, the most notable being Lloyd's of London, which pulled out in 2015. Mounting class action lawsuits brought against officers and directors from some of the larger cannabis companies, as well as a lack of historical loss data, have only reduced appetites further.

Added to that, the COVID-19 pandemic has put increased pressure on bottom lines, prompting many insurers to scale back on unprofitable segments, tighten their terms and conditions and add exclusions.

The wildfires that continue to rage across California, which accounts for about 70% of the cannabis market, and the start of the hurricane season, have only exacerbated the problem, as has widespread civil unrest, resulting in vandalism and looting of property.

"This industry is not for the faint of heart," said TJ Frost, vice president and U.S. cannabis segment leader at HUB International.

"As a broker you must stay on top of every aspect of the industry – from carriers to state regulations."

Yet, despite all this, there are still a handful of specialist brokers and managing general underwriters (MGUs) keen to write the business and close the supply and demand gap.

"Carriers with an appetite for the cannabis industry remain overwhelmingly surplus lines companies, with a long history of underwriting acumen," said Robert Raber, associate director at A.M. Best.

"Their history of understanding unique risks provides a benefit in the underwriting process."

"A lack of capacity, limited reinsurance for the carriers in the market, and a general lack of carrier participation all complicate placements and operate to hinder meaningful market growth."

— David Kennedy, *founder and CEO of Purple Risk Insurance Services.*

D&O CHALLENGES

The biggest challenge for cannabis businesses is the high premiums and lack of capacity for directors' and officers' (D&O) liability coverage, primarily driven by a recent wave of lawsuits alleging mismanagement and unethical behavior. Where it is available as a coverage, rates are between two to 10 times higher than those in established industries.

"The majority of larger publicly-listed U.S. cannabis businesses have been sued by shareholders over

SUMMARY

- ***A lack of*** capacity and underwriting appetite continues to hinder the cannabis insurance market.
- ***Directors' and Officers'*** coverage, as in many other sectors, is a pain point in the cannabis industry.
- ***There are a*** handful of specialty underwriters and brokers operating in the space.

the last two or three years for a range of alleged misdemeanors and inappropriate practices," said Max Carter, CEO Of New Dawn Risk.

"That, coupled with concerns over the fact cannabis is illegal under Federal legislation, makes D&O coverage very unappealing for insurers."

Cyber security is another massive problem, given the multiple customer data access points for transactions and limited coverage availability. It is also prohibitively expensive.

Product liability is a tricky area too, with several lawsuits arising from misleading or inaccurate labeling and marketing being filed in recent months. To boot, up until only last year product liability for cannabis was typically excluded within general liability programs.

Crop insurance, particularly outdoor, is problematic as well, given its scarcity and traditionally low limits, and losses from all manner of disasters including wildfires, mudslides and earthquakes. Hail and early snow have also become more prevalent in recent months.

"General market conditions and numerous claims in prior years are making it difficult to get good coverage for perils as important as wind/hail, for example," said Brian Richardson, founder of Foundations Insurance & Financial Services.

"Wildfires raging all across many legal cannabis states isn't helping and neither is a very active hurricane/flooding season for the U.S."

Larger farms and distributors have also struggled to find fleet auto and cargo coverage, mainly because of their load's high value and the risk of hijacking or theft. Most policies that do exist omit hired and non-owned auto for retailers.

Additionally, changes in business models and delivery methods during the pandemic have introduced a host of new exposures that companies require coverage for. Another problem for large brokers and insurers is sustainability.

"The large brokers need to get a quicker return on investment," said Matthew Karlsruher, property and casualty broker at USI Southwest.

"But the problem is many cannabis companies are quite small, as are the numbers they can make on premiums."

John Deneen, vice president at AmWINS Insurance Brokerage of California, added:

"Success in the space requires education in both directions. Brokers must educate underwriters who may not be familiar with new or unique products and processes, and must also educate their clients about the risks they face and using insurance to mitigate those risks."

NEW AREAS OF OPPORTUNITY

But there is light at the end of the tunnel, with core commercial coverage including general and product liability, and property insurance now widely available. And with new lines of business emerging and changes to legislation, opportunities abound.

"A lack of capacity, limited reinsurance for the carriers in the market, and a general lack of carrier participation all complicate placements and operate to hinder meaningful market growth," said David Kennedy, founder and CEO of Purple Risk Insurance Services.

"However, we are witnessing new entrants exploring unique additional offerings for the industry."

A big area of opportunity for insurers is employment practices liability insurance, particularly as companies expand and take on more staff. As they continue to evolve, the chance of losses increases, as well as demand.

The hemp market has also opened up since the 2018 Farm Bill was passed, removing the crop from the Constituted Substances Act and making it legal provided it is harvested with less than 0.03% (THC) content. The hemp CBD industry as a whole is expected to top $22B by 2022, according to Brightfield Group.

Despite all this, there's still a reluctance by brokers and insurers to get involved in the more problematic risks.

"The problem is that the industry is very labor-intensive both in terms of insurance and application; we have seen more underwriters enter the market, but they tend to gravitate towards the easier to insure risks," said Jeff Kleid, founder of Elite Risk Insurance Services.

"You don't see so many companies coming into the D&O or product liability space."

The National Cannabis Risk Association is leading the way in trying to redress the balance, launching a member-owned insurance company at the end of last year to help it manage and transfer risks. Garnet Casualty Insurance Corporation uses an MGU and several managing general agents to provide coverage.

The U.S. House of Representatives has postponed a vote on the MORE Act, which would decriminalize marijuana, until the November election. Additionally, the SAFE Banking Act is at the Committee stage in Congress; if approved it would permit banks, insurers and credit unions to work with cannabis businesses.

"As the industry continues to push forward towards Federal legalization, it's an opportunity for brokers and underwriters to become part of an up and coming industry," said Charles Pyfrom, chief marketing officer at CannGen Insurance Services.

"By being able to provide comprehensive coverage and capacity that meets the needs of cannabis companies' ever-changing needs, they can help to shape the industry moving forward."

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Growing risk of vaporizers

Vaporizer products have become a major concern for insurers with many losses resulting from exploding batteries, as well as health effects that are poorly understood. The loss potential from vape product additives was highlighted by last year's EVALI (e-cigarette, or vaping, product use-associated lung injury) crisis.

"Underwriters now give additional scrutiny to vape products, but most will cover products sold in tightly regulated State marijuana markets," said John Deneen, vice president at AmWINS Insurance Brokerage of California. "On the other hand, insurance for CBD vapes is extremely limited since those products are not subject to similar regulations."

Edible products are another area of concern due to their popularity with first-time users, particularly older people and those with health issues. That's because their effects can be delayed by several hours and vary significantly between individuals, while overconsumption has been linked to alleged problems with anxiety, psychosis and heart conditions.

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