

Issues Review  
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**Few carriers currently offer coverage for this rapidly emerging industry—that's bound to change**

## Cannabis: New Opportunities for Insurers, But with Burgeoning Risks

Moves to legalize marijuana have been expanding rapidly at state and local levels every year since 2010. Currently, 33 states and the District of Columbia have laws allowing the use of medical marijuana. Of those, 10 states, as well as DC, have legalized recreational marijuana use as well. In October 2018, marijuana became legal in Canada also, under Bill C-45.

This expansion, coupled with projected future growth, would classify the industry as an emerging market for insurance carriers. Those directly and tangentially involved in the industry need insurance that addresses the specific needs of growers, retailers, distributors, property owners, and lab researchers. However, despite growing demand from both producers and retailers alike, many carriers are reluctant to embrace the industry owing to its classification as a Schedule I drug in the eyes of the US Federal Government, under the Controlled Substance Act of 1970. Since the drug is not legal federally, offering marijuana insurance is debatable for most carriers. Conflicting state and federal laws and rapidly evolving regulations have largely served as a deterrent for some insurers to participate in the emerging market and offer insurance for cannabis-related products, even where coverage is required by state law.

With such a controversial product, the potential for a broad array of liabilities for businesses operating in the field is high. What's more, the division between state and federal legality makes it difficult for businesses to find inclusive, affordable coverage, which, in turn, creates several concerns for the industry with regard to meeting its insurance needs. In this report, we outline some of the unique issues in marijuana insurance and how effectively participating insurance carriers are meeting the needs of this burgeoning market.

### Limited Number of Carriers Offering Coverage

Currently, around 25 carriers (mostly non-admitted) are providing coverage in the US and Canada. The Lloyds Market, consisting of close to 90 syndicates and the #1 Excess & Surplus market supplier in the US, does not provide coverage for businesses in this country, owing to the drug's federal status as an illegal substance. However, the company does offer insurance for the cannabis industry in Canada, where its use became legal in 2018.

Insurers that have thrown their hats in the ring for this line of business have partnered with agencies and producers that have a better understanding of the industry and the needs of cannabis businesses. One example is specialty insurer Topa Insurance Group, which represents and supports Cannasure, a Westlake, Ohio, managing general agency and wholesale brokerage that focuses solely on the cannabis industry. Cannasure provides coverage for companies (see Exhibit 1 for the various segments) that specialize in the cannabis industry and operate in states are heavily regulated.

### Marijuana Insurance Is a Fast-Growing and Evolving Market

As noted, marijuana coverage for the US and Canada comes from mostly non-admitted insurance companies. Admitted carrier coverage was almost non-existent until the efforts of California Insurance Commissioner David Jones to encourage commercial insurers to provide coverage options for cannabis businesses began to take shape. In November 2017,

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## Exhibit 1

### Marijuana-Related Market Segments in Need of Market Solutions

Segment	Description
<b>Cultivation</b>	Businesses that handle marijuana along the supply chain including indoor, outdoor, and mixed businesses that cultivate, process, harvest, test, package, and transport cannabis for sale and consumption.
<b>Dispensaries &amp; Retailers</b>	Retail outlets or stores where most consumers can purchase medical or recreational marijuana products. Like cultivation facilities, dispensaries go through an application process to obtain state licensure. Cash management is often vitally important to these businesses.
<b>Infused products</b>	An extremely lucrative segment of the industry that offers a wealth of growth opportunities through a wide variety of products, including cannabis beverages, beauty & skin care products that contain cannabidiol (CBD) oil, edibles such as chocolates or gummies, and cannabis capsules.
<b>Landlords</b>	A wide range of businesses offering business-to-business services to other companies in the industry, such as testing laboratories, packaging firms, marketing firms, and consumption device manufacturers, in addition to real estate owners of commercial properties leased to cannabis-related operations.

Source: AM Best data and research

Jones approved Golden Bear Insurance Company as the first admitted insurer in the state, as well as the first Cannabis Business Owners Policy (CannaBOP) through Golden Bear. The company offers both property liability and general liability coverage to companies such as cultivators, manufacturers, dispensaries, and retail stores operating in California that are in need of coverage.

In May 2018, Commissioner Jones approved California Mutual Insurance Company, another California-domiciled admitted insurer, as the first provider in the state to offer lessor's risk coverage, for property owners exposed to risks from tenants that rent spaces for commercial activities like cultivation and dispensary operations. The emergence of admitted carriers such as Golden Bear and California Mutual demonstrates that some insurers are indeed trying to identify new ways to collect data and provide coverage for the personal and commercial lines' cannabis-related exposures.

Another California-based company, Next-Wave, was one of the first companies to market marijuana insurance. Currently, marijuana policies account for roughly 50% of its revenue, with around \$50 million in premiums in 2016-2017. AAG (Associated Agency Group, a Washington-based company) provides insurance for many different industries, including cannabis, which accounts for 5% to 10% of its overall business. However, these two companies are intermediaries that connect the marijuana companies to actual insurance carriers. Nevertheless, they show that the agency market is also evolving, with more agencies wanting to jump in.

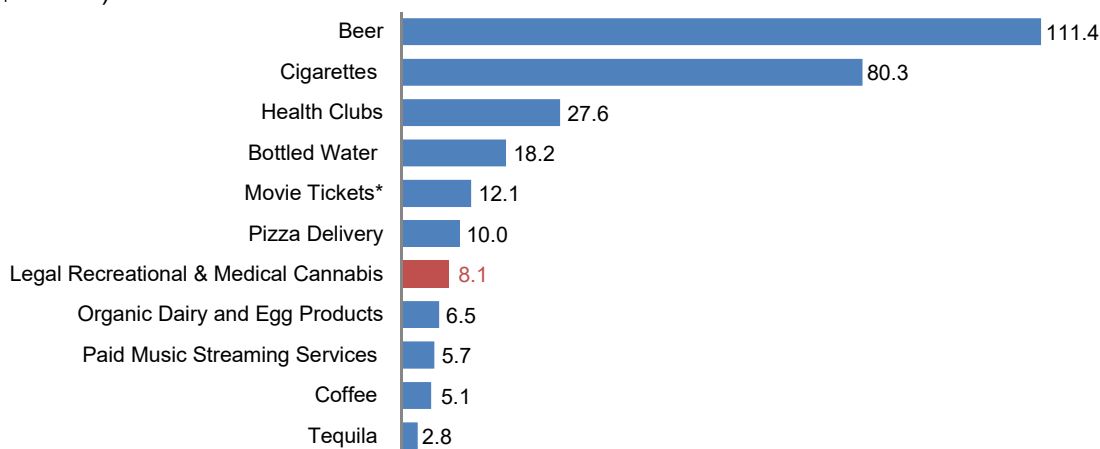
We are also seeing the emergence of pure play companies like Cannasure, whose only goal is helping legal marijuana businesses secure insurance coverage. Marijuana-related business owners may not know which insurance companies cover marijuana business ventures, so such organizations are very important, especially in a burgeoning industry. The singular focus of these carriers may make identifying and securing the needed coverage easier for marijuana business owners.

Marijuana (both medical and recreational) is a rapidly growing business, with revenue that rivals popular industries in the US such as coffee and movie tickets (Exhibit 2). According to industry sources, 2017 sales of legal marijuana reached \$8 billion (\$5 billion medical and \$3 billion recreational), while sales of illegal marijuana reached an estimated \$42 billion. With a growing number of states voting to legalize marijuana, the market for legal marijuana sales is

## Exhibit 2

### Annual US Marijuana Sales vs. Other Industries, 2017

(\$ billions)

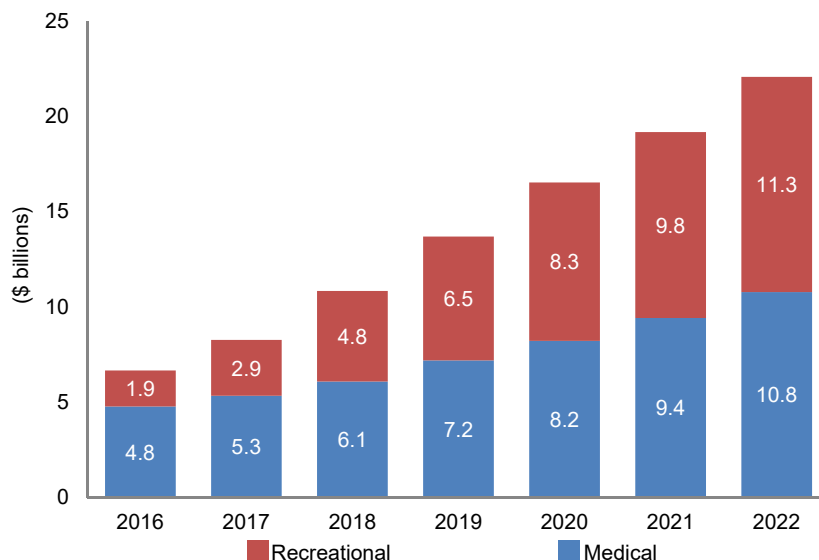


\* Includes US & Canada.

Source: Brewers Association, Alcohol & Tobacco Tax & Trade Bureau, Mordor Intelligence, Statista, Eli Lilly and Company, US Distilled Spirits Council

## Exhibit 3

### Projected Growth of Marijuana Revenue, 2016-2022



Source: Cannabis Business Plan

projected to increase to \$22 billion (Exhibit 3), and illegal marijuana sales, to decrease to less than \$5 million, by 2022. Despite the industry's rapid growth, the integration of marijuana coverage for carriers has been slow and steady. As the industry matures and insurers have greater access to quality statistics on actual loss history, insightful actuarial data, and more clarity on the effects of cannabis, more carriers are likely to enter the market.

### Insureds May Need More Coverage than What's Currently Available

One key challenge for businesses (and insurers) is deciding which coverage is needed—or not needed. Most marijuana businesses need general liability and product liability coverage,

### Canada Already Tackling Marijuana-Related Challenges

In Canada, medicinal use of cannabis was legalized nationwide in 2001 under specified regulations; in October 2018, Canada became the second country in the world (after Uruguay) to formally legalize the cultivation, acquisition, possession, and consumption of cannabis and its by-products. Customized general liability policies are available to dispensaries, marijuana manufacturers, and now retailers in the country. The general liability policies address coverage for on-premise exposures, products, and other related liabilities that business owners might face. Product recall insurance is also available and covers costs related to as business interruption and crisis communication. Such specialty policies can be hard to find in the US.

The Canadian federal government has left it to the country's 13 provinces and territories to carry out the new legislation and set their own rules. Given the difficulty of determining when an individual is under the influence of marijuana, a number of questions on legalized marijuana use remain, among them: How can police test drivers who may be under the influence? How can employers deal with employees who smoke before coming to work, given that a breathalyzer test can't be used, as is the case for alcohol? The level of intoxication associated with a given THC (tetrahydrocannabinol) blood concentration depends on many variables: how the cannabis is ingested, whether someone is a regular user, the level of THC in the dose, and whether the user has ingested other drugs or alcohol.

In June 2018, Canada reformed its Criminal Code to better reflect impaired driving protocols. The changes include new "legal limit" drug offenses as well as new tools to better detect drug-impaired driving. Officers have the right to request an oral fluid sample if they have a reasonable suspicion that the driver has ingested drugs, based on objectively visible facts like red eyes, muscle tremors, agitation, and speech patterns. Offenses are based on the specified levels of the drug in a person's blood within two hours of driving. However, THC can remain detectable in the bloodstream for as long as seven days, depending on how frequently one uses the drug. Someone who smokes cannabis daily will likely carry cannabis metabolites for longer than someone who doesn't. The intricacies related to these issues pose numerous challenges for auto insurers.

as well as property liability coverage, to protect against accidents and injuries that occur on a business's premises.

Most insurers who are just entering the marijuana market are offering a core set of policies that usually consist of the following:

- Commercial general liability, with limits of \$1 million per occurrence/\$2 million aggregate
- Property liability, with limits of \$1 million per occurrence/\$2 million aggregate
- Product liability, with limits of \$1 million per occurrence/\$2 million aggregate

However, these limits may be inadequate for marijuana businesses owners, who may need higher aggregate limits. Because this is an emerging market for insurance companies, insurers believe that their risk in these businesses is best managed with their current limits. Another reason for the low limits is the challenge of finding reinsurers to back marijuana-related books of businesses, as reinsurance is typically a separate book or tower to cover these risks. Other problems for business owners are the shared limits between general liability and product liability, as well as non-stacking endorsements, which limit the amount of coverage available to an insured. Many of these policies also lack a duty to defend—a significant issue for marijuana businesses.

Marijuana businesses also need supplemental policies, products, and endorsements to minimize their liabilities. Directors & Officers coverage for businesses like dispensaries, testing facilities, and manufacturers may further protect owners and officers from mismanagement of the product. Businesses might also need a commercial auto coverage for any vehicles used in the business, while dispensaries may need cyber and privacy liability coverage, as they may have patient information in their records. Currently, the cannabis industry in the US walks a fine line on whether dispensaries are governed by HIPAA (Health Insurance Portability and Accountability Act of 1996) laws. Some dispensaries don't need to be in compliance with HIPAA and thus aren't required to take the reasonable steps to properly protect customer information and medical records.

Cultivators are also concerned about finished products, inventory, and products in process, as well as living plant coverage. Infused product manufacturers and dispensaries (which are unlikely to be growing product at their facilities) may not be concerned about living-plant coverage but need policies that cover goods in process, stock, and inventory. Since marijuana dispensaries are prime targets for burglary, insurance companies are adding provisions to their contracts that eliminate coverage for a product if a business is not securely locked up during off hours. These provisions help carriers ensure that the businesses they are insuring are in compliance with the loss mitigation techniques required by the insured's state.

### Major Lines of Business Face a Number of Potential Concerns

The growth of the marijuana industry is also having an impact on other insurance segments—for example, homeowners, commercial property, automobile, and workers' compensation (Exhibit 4). Personal lines insurers may encounter heightened risk hazard levels for insureds with in-home growing facilities owing not just to theft or burglary peril, but also to complications in some cases concerning the classification of marijuana products as personal versus commercial property. Both personal and commercial lines insurers need to study early claims frequency and severity trends in states where marijuana has been legalized, to help determine their risk appetite in those states. Writers of workers' compensation insurance need to consider the legal complexities regarding testing for marijuana intoxication, their approach to dealing with situations in which marijuana has been prescribed for injured workers, and the potential impact on indemnity payments, among other issues.

Interest in whether marijuana can serve as a suitable substitute for prescription opioids remains unabated. Physicians first have to consider the legality of such options in the context of state laws, as well as the suitability and prudence of the pain-relieving qualities of marijuana, compared to the addictive risks associated with prescription drugs. The addiction potential of cannabis has been vigorously debated and remains open to question. However, deaths from overdoses of prescription opioids have increased substantially over the past couple of decades.

### Legislative Challenges Abound

The insurance industry, along with regulators, is increasingly recognizing that this is new territory, replete with unique challenges. Some of the challenges come with regulating policies when the drug is legal at a state, but not a federal, level. To help study and resolve issues, the National Association of Insurance Commissioners created the Cannabis Working Group in August 2018. This group will help state insurance regulators to better understand where insurance coverage gaps exist and provide insight on how to cover those gaps, from seed to sale.

The status of marijuana legality in the US is tricky, a thick tangle of conflicting rules with states, counties, cities, and federal government each creating and trying to carry out their own laws. Conceptually, for many, the governance of activities involving the drug is

## Exhibit 4

### Key Property/Casualty Insurance Concerns Regarding Legalized Use of Marijuana

By Line of Coverage

Coverage Line	Concerns
Homeowners	<ul style="list-style-type: none"> <li>• Increased risk profile for policyholders that grow marijuana</li> <li>• Uncertainty over how well equipped electrical systems in homes are to handle the power necessary to safely operate an in-home growing facility</li> <li>• Potential disputes for classifying marijuana-related property as personal property vs commercial property</li> </ul>
Commercial Property	<ul style="list-style-type: none"> <li>• Substantial fire risks associated with complex apparatus and electrical configurations for commercial-scale marijuana growing facilities</li> <li>• Significantly heightened risk profile due to burglary and theft</li> <li>• Higher fire and vandalism risk for landlords and insurers of landlords owing to the operations of tenants in marijuana business; higher exposure to burglary, theft, or vandalism loss to neighboring tenants who aren't involved in the business owing to their proximity to the business</li> </ul>
Automobile	<ul style="list-style-type: none"> <li>• Higher claims collision frequency in states where marijuana is legalized</li> <li>• Dramatic increases in claims adjustment and defense and cost containment expenses for auto claims due to the difficulty of definitively identifying impairment caused by marijuana use as the proximate cause</li> <li>• For personal injury protection (PIP) or "no fault" coverage that pays for incurred medical expenses regardless of cost, complications in claims settlement when reimbursement for injuries includes the obligation to reimburse for prescribed marijuana stemming from a motor vehicle accident</li> <li>• Exposures for commercial auto (and/or inland marine) insurers covering the transport of cannabis as motor/truck cargo</li> </ul>
Workers' Compensation	<ul style="list-style-type: none"> <li>• Question of whether workers' compensation will cover medical marijuana when prescribed by a physician, or whether marijuana treatment should be excluded from workers' compensation will be a key issue for workers' compensation insurers</li> <li>• The difficulty of settling claims to determine whether employees who sustained injuries on the job were under the influence of marijuana at the time, given the challenge of testing for accurate marijuana intoxication levels</li> <li>• Marijuana as a viable alternative for opioids for pain relief still undetermined and highly controversial</li> </ul>

Source: AM Best data and research

somewhat inconsistent. Vermont (which in 2018 became the first state to legalize marijuana for recreational use through the legislative process rather than via a ballot measure) has established laws allowing people 21 and over to grow and possess small amounts of marijuana—but state law does not permit the sale of nonmedical cannabis. California passed a law in November 2016 called Proposition 64 that allows individuals to grow marijuana at home and carry up to an ounce of it. Like Vermont, states that allow medical marijuana have also passed laws restricting the possession and sale of the drug; these laws are less restrictive in some states than in others.

Legislation in some states gives cities and counties a strong say in how to implement laws in their jurisdictions. This dichotomy has led to cities and counties differing on the treatment of marijuana. For example, some towns in California are marijuana-friendly, allowing a wide range of businesses related to the drug that residents are free to use at their own discretion. Other jurisdictions are less enthusiastic and have blocked the development of marijuana-related enterprises, as well as passing laws that significantly limit personal use. In New Jersey, nearly 40 municipalities have already banned marijuana-related businesses—before a recreational marijuana legalization bill even made it to the table.



### A Closer Look at Auto

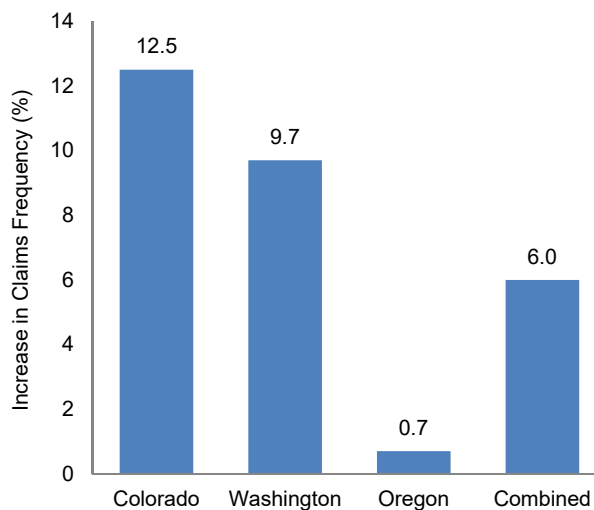
With more US states legalizing marijuana, debate about whether the availability of marijuana products is causing an increase in auto accidents continues to grow. However, with marijuana's relatively new legal drug in most states, the data available for any kind of meaningful analysis about consumption and its effect on collision claims is insufficient.

Since the wave of legalization began, health and safety experts have been trying to measure the potential influence on highway safety. The Insurance Institute for Highway Safety (IIHS) conducted a study in which it analyzed vehicle collision insurance claims

filed between January 2012 and October 2016. The IIHS compared claims in the three states where the drug has been legalized for five to seven years (Colorado, Washington and Oregon) with claims in neighboring states that had not legalized the drug (Idaho, Montana, Utah, and Wyoming), and found that over that period, collision claims frequencies in the states that had legalized marijuana were about 6% higher than those that had not (Exhibit 5). As noted, however, determining if an individual was under the influence of marijuana while driving prior to an accident is difficult. Some initial data does appear to support the notion that the legalization of marijuana has led to an increase in collision crashes, but it's still too soon to tell. As the market continues to evolve, whether marijuana legalization is affecting auto insurers lines will become clearer.

### Exhibit 5

#### Estimated Effect of Marijuana Sales on Collision Claims Frequency, 2012-2017



Source: Insurance Institute for Highway Safety

### Development of Loss Mitigation Techniques

Most states have mandated interior/exterior monitoring as well as on-site loss mitigation for marijuana facilities. Some states require surveillance systems that maintain 45 days of footage, as well as alarms and panic buttons to be used to prevent vandalism and theft. Companies must also provide vault storage for finished stock and goods in process, along with multiple layers of securities such as bulletproof extraction rooms and booths, fire suppression systems, cross capture ventilation, and supply fans. Given the significant vulnerability of these businesses to burglary, companies must maintain required loss mitigation techniques for both on- and off-premises. Some insurance companies or agencies offer on-site risk management inspections, on top of the government and agency inspections from the state in which these businesses are operating, to ensure they are adhering to state regulations.

In their underwriting, some non-admitted insurers incorporate a special application that takes into account all of the different loss mitigation techniques available and how well they are maintained, in addition to typical physical plant questions, labeling and packaging, extraction methods (CO<sub>2</sub> vs. hydrocarbon), experience, and geography.

Besides on-premises loss mitigation measures, loss mitigation statutes for product liability have also been enacted by some states. The American Society for Testing Material (ASTM) is beginning a standardization process that involves warnings about THC in products, packaging, and labels. According to the ASTM, a product warning is sufficient when it informs an ordinary user of (1) an specified risk or harm that may be expected in normal use of the product or (2) any danger or risk from failing to properly follow instructions.

### **Exposure Risks Will Continue to Grow Along with the Market**

The volume of insurance premiums collected related to marijuana coverage will increase as the industry continues to see growth in the sales recreational and medical marijuana and in the growing number of states allowing the legal use of medical or recreational marijuana. But, as the choice of products grows and the market expands, the exposure risks will also increase.

The market for insurance products for the cannabis industry will develop as both education about the potential risks and the regulatory environment evolve. More risks are likely to emerge as the long-term effects of proliferating drug usage emerge, particularly for workers compensation and auto coverage.

Data about written premium and the corresponding exposures of rated companies to cannabis-related businesses and products is limited. For this reason, AM Best does not expect company performance related solely to cannabis insurance coverage to have any rating impact. We will continue to monitor emerging developments in the market and in risk management related to insurer risk appetites and risk mitigation, given that the potential emergence of issues that could have a meaningful impact on rating considerations.



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