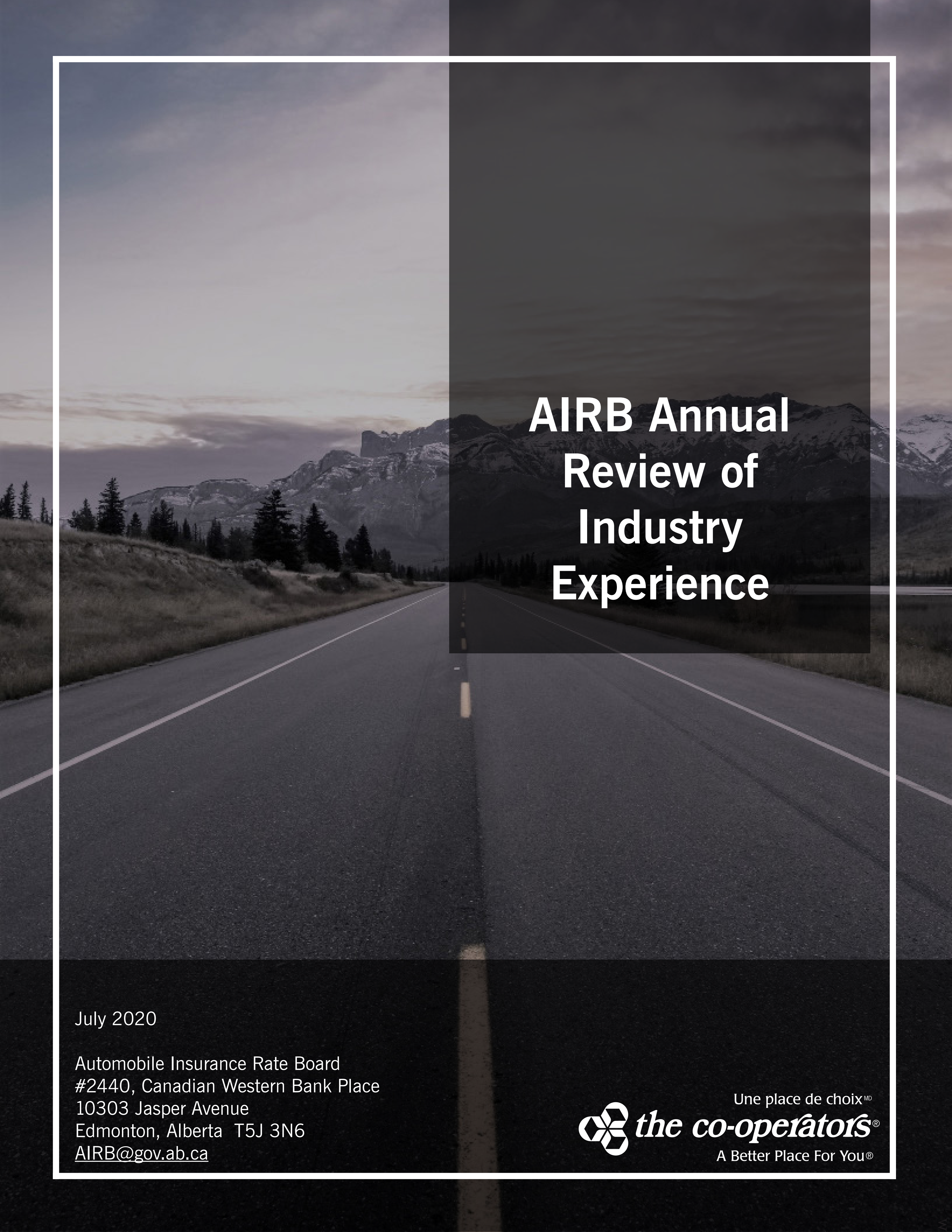

AIRB Annual Review of Industry Experience

July 2020

Automobile Insurance Rate Board
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Table of Contents

INTRODUCTION

The Co-operators Group Limited ("The Co-operators") is a leading Canadian, diversified, integrated, multi-line insurance and financial services organization. As a co-operative, our 46 members include co-operatives and credit union centrals representing a combined membership of millions of Canadians. In Alberta, we have nine member organizations, including the Alberta Federation of Agriculture, the Federation of Alberta Gas Co-ops Ltd., and UFA Co-operative Ltd.

We have a strong footprint in Alberta, insuring approximately 263,500 private passenger vehicles and 52,800 commercial vehicles across our group of companies, ranking fourth in market share by direct written premium. We employ over 680 staff in addition to having independent distribution contracts with 96 financial advisors who in turn operate their own agencies, employing over 535 staff across 124 offices. Guided by our co-operative principles, we are committed to the communities in which we work, and in the last year alone, we invested over $400,000 in various charities, non-profits and co-operatives throughout the province.

We are proud to provide insurance and financial services to more than two million Canadians. We are even prouder that we provide financial security to Canadians in their communities while staying true to our co-operative values.

The Co-operators is pleased to once again participate in the Automobile Insurance Rate Board's (AIRB) annual review of industry experience for private passenger vehicles (PPV) to establish industry benchmarks to be used in the review of insurers' PPV filings for basic and additional coverage. We appreciate the opportunity to provide our feedback on loss development and trends, and commend the action that has been undertaken over the last year by both the regulators and the government, including the expiration of the rate cap, the introduction of the new Simplified Filing guidelines, a commitment to road safety through Vision Zero initiatives, and our collaborative relationship with the AIRB during these unprecedented last few months.

FINANCIAL CONTEXT

2019 was a significantly challenging year in the Alberta market.

In order to deliver on our claims guarantee, adapt to changing circumstances and pursue evolving business opportunities, our reasonable target return on equity (ROE)[1] is set at 12% across all product lines, in all provinces. Due to the nature of the insurance market, we know that there will be individual years when we will not achieve our target return on equity. However, our target needs to be achieved over the long term.

In 2019, our ROE was -14.5%, driven by an underwriting loss of over $52 million.

Our target ROE is 12%

Our average ROE for the last five years is -2.6%

	2019	2018	2017	2016	2015
Underwriting loss	**($52,126,466)**	($16,533,384)	($16,714,202)	($12,939,022)	($23,903,346)
YTD ROE	**(14.5%)**	0.4%	1.6%	2.8%	(3.3%)

[1] Return on equity (ROE) is the ratio of new income to the average of opening and closing stakeholders' equity excluding accumulated other comprehensive income. The target ROE and the presented results are for the Co-operators General Insurance Company (CGIC), a member of The Co-operators group of companies.

We acknowledge the efforts of the AIRB to co-operatively and expeditiously approve rate increases following the expiry of the second rate cap in 2019. While this rate relief is a positive step in the short term, a sustainable and equitable product, in a competitive marketplace, can only be achieved through product and regulatory reform.

In the duration of our submission, we will outline our reform recommendations to improve the accessibility, equitability and sustainability of the auto product for Alberta consumers, and provide our commentary on the preliminary report issued by Oliver Wyman, with a focus on claim amount development and the recommended loss trend rates. We will also discuss the ongoing COVID-19 pandemic, our client-focused relief efforts, as well as pricing considerations for future rate level indications.

REFORM RECOMMENDATIONS

With claims costs and cumulative underwriting losses continuing to increase, the province's auto insurance market is in a vulnerable state. We are committed to doing business in Alberta, but action is required to protect the market's sustainability and the availability and choice of product for consumers. Product changes are required to ensure that consumers can afford the true costs of the mandatory auto product moving forward, a concern that has accelerated due to current economic conditions.

Addressing claims costs through product reform will have a favourable impact on rates in future years.

We strongly support a private no-fault, first-party payer system, which will provide comprehensive coverage and lower premiums, ensuring security and choice for Albertans.

We have also developed regulatory reform recommendations that will result in more equitable rates charged among our clients and a competitive marketplace that is enabled to respond quickly to changing consumer needs and preferences.

In pursuit of our common goal for automobile insurance to be accessible, equitable and sustainable for all Albertans, we urge the AIRB to implement change where possible and support reform efforts that will improve the system.

PRODUCT REFORM

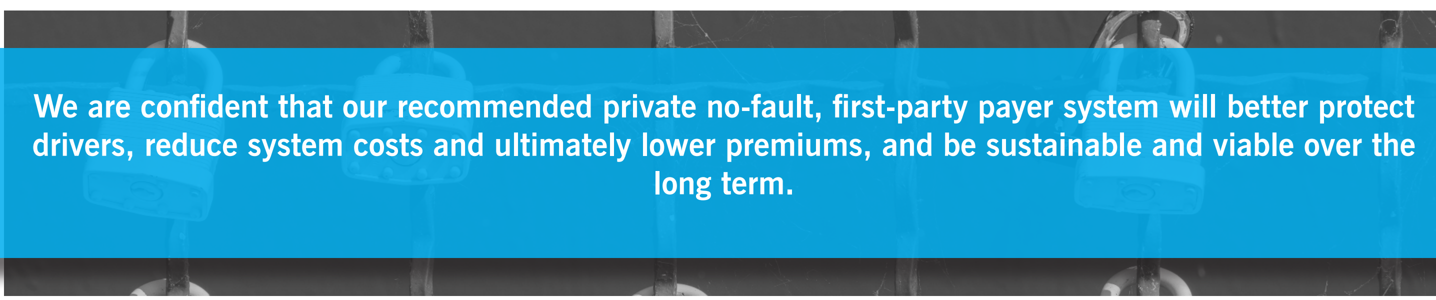
Private no-fault, first party payer system

At its core, our **private no-fault, first-party payer system** recommendation is focused on the consumer. We believe a transformational Alberta auto insurance system should provide all drivers with:

- Comprehensive coverage and the ability to tailor the product to their personal needs
- Early and pre-approved access to care
- The ability to work directly with the insurer of their choice
- Long-term premium sustainability and viability of the privately delivered auto insurance system

Our recommended private no-fault, first-party payer system will provide a comprehensive base coverage that protects all drivers, regardless of fault. This will provide added security and peace of mind, establishing increased fairness across the system. We will maintain consumer choice with options to enhance or reduce certain coverages and benefits, allowing the ability to tailor the auto insurance product to meet consumers' personal needs. This system will also allow clients to work directly with their own insurer, ensuring a more efficient and seamless consumer experience.

In developing our coverage model, we have focused on providing benefits for all drivers to ensure optimal treatment and claims outcomes and eliminate the need for litigation to cover care and other necessary expenses. Under our private no-fault, first party payer system, we are focused on ensuring that anyone injured in an automobile accident receives pre-approved, early intervention in accordance with a prescribed treatment protocol aligned with the injury. Our intent is to re-align the system to foster successful and early return to daily activities through reliable access to evidence- and outcomes-based treatment models.



We are confident that our recommended private no-fault, first-party payer system will better protect drivers, reduce system costs and ultimately lower premiums, and be sustainable and viable over the long term.

Introduce direct compensation property damage coverage

The current tort resolution for property damage claims is inefficient, time consuming and costly. For auto physical damage losses, subrogation is required between insurers when multi-vehicle collisions occur. A client who does not carry collision coverage has to approach the at-fault party for recovery of damages and may have to pursue legal action. **Direct compensation property damage** (DCPD) eliminates the need for subrogation between insurers and allows individual clients to deal directly with their own insurer rather than pursuing damages from the at-fault third party. Under a DCPD system, while cost savings are expected, efficiency and personal service from a client's own insurer are the most significant benefits. For example, a claim can be settled in under 30 days rather than having to wait over 180 days for a resolution under the tort system. This is a proven model that is used in most jurisdictions across Canada.

Amend the minor injury definition

Pending a holistic reform of the auto product, in order to contain costs, the minor injury definition must be amended to better reflect its true intent of capturing soft tissue injuries within its parameters.

We have traditionally referenced Alberta's minor injury definition and the tort scheme overall as being one to be modelled. However, over recent years, judicial interpretation has resulted in movement away from the minor injury definition's original intent.

We recommend minor psychological injuries, mild traumatic brain injuries and chronic pain—subject to the serious impairment definition—be specifically included in the minor injury definition. We also recommend that deference be given to the certified examiner process as was originally intended.

REGULATORY REFORM

Support emerging models

Consumer behaviour and expectations are changing. The need for new products and services was evident before 2020 and the ongoing global pandemic may now accelerate that need. The AIRB and the Office of the Superintendent are experts in terms of the regulation and policies that guide the insurance industry and serve to protect Alberta drivers. Similarly, the insurance industry and our partners have gained extensive knowledge on the changing needs of consumers and are eager to continue creating products to meet those needs. In anticipation of upcoming reform, we invite the AIRB to collaborate and innovate with us, bringing our areas of expertise together to design and implement new products and services for Albertans.

Modernize the rate filing process

We commend the work of the AIRB's staff in reviewing rate submissions as quickly as possible and for finding creative solutions within the regulations to remove red tape.

We recognize that the regulations you operate within are restrictive. This makes the entire rate filing process time-consuming and costly, and causes delays that prevent insurers from moving overall rate levels in the direction of rate adequacy and charging premiums that are commensurate with risk in a timely manner.

Insurers need the ability to adjust pricing quickly in response to competitive pressures and risk analysis. The new **Simplified Filing guidelines**, introduced in 2019, were a step in the right direction. We believe these guidelines could be further enhanced by removing the cumulative limit over three policy years and the tie to the residual indication from the latest Full filing, as well as a move to a use-and-file approach. A use-and-file approach, for both Simplified and Full filings, would allow insurers to immediately implement rate changes based on market changes and file within a defined time period, preventing delays in reactions to current circumstances. An even more impactful long-term solution would be a move towards an open and competitive environment, eliminating the red tape associated with the rate filing process, allowing insurers to differentiate themselves, driving innovation, efficiency and client service.

Reduce subsidization

To level the playing field and establish a more competitive market, we strongly recommend allowing insurers the flexibility to establish their own territory definitions for all coverages, including the number of territories. Over the years, varying territory segmentation allowances have been grandfathered in on an individual basis. These allowances, plus the limit of four basic coverage rating territories that The Co-operators and other insurers are held to, are not supported by regulation or the Act. Discrimination has been built into the regulatory design resulting in unfair competitive advantages for certain insurers and ultimately adverse selection against The Co-operators, which have accumulated for a decade. Although we have highlighted this discrimination at every opportunity, it has remained unchanged. In order to return to a level playing field for all insurers operating in Alberta, this situation must be addressed immediately. These challenges, aggravated by the "all comers rule," have directly contributed to our significant losses in Alberta. Given our year-over-year underwriting losses—which amounted to over $52 million in 2019 alone—it is clear this policy is not sustainable. Moreover, the current limitations on territory segmentation for basic coverages have resulted in premium subsidization across the province. Levelling the playing field and permitting complete flexibility for territory segmentation will allow us to allocate costs fairly, eliminating the current subsidization within the restricted territory system.

Within the current grid system, good drivers are now effectively subsidizing demonstrated high-risk drivers, and there is little incentive for drivers who have displayed poor behaviour to remove themselves from the program. The grid system is also a very difficult system to administer. It has significant operational and technological implications, adding unnecessary cost and cycle time to the process, which ultimately increases the cost that consumers pay for automobile insurance. While making changes to the grid steps or identifying high-risk driving attributes that would eliminate specific drivers from protection by the grid would be incremental steps forward, we recommend removal of the grid system altogether, noting it is the only system of its kind in Canada. Removal of the grid, which would allow insurers to charge premiums from their approved rating programs for all drivers, provides a way to more appropriately incentivize safe driving behaviour by distinguishing between the demonstrated poor behaviour of individual drivers and the experience of a group of drivers. In addition to removing the grid system, we also recommend opening up alternative and residual markets for those individuals who have demonstrated poor driving habits, as these markets provide a stronger motivation for drivers to return to the general market.

Publish list of prohibited rating variables

Under the current system, there is no single, published list of rating variables that are either prohibited or permitted. Decisions regarding rating variables approved for use have been inconsistently made and applied across insurers. Additionally, the uncertainty surrounding permitted rating variables has led to fruitless actuarial efforts and prevented the introduction of new variables. This restricts our ability to innovate and compete, which directly impacts the choices and costs available to consumers. Therefore, to create a level playing field, introduce clarity and foster innovation, we recommend the publication of a list of prohibited rating variables that are truly discriminatory. This will be more effective than a list of approved rating variables, which would require frequent updates.

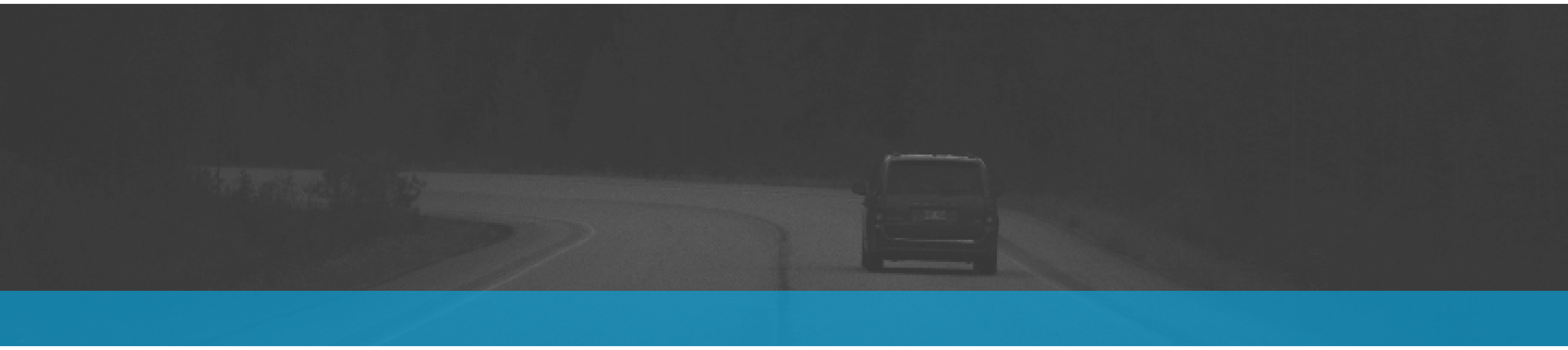
Reduce costs of physical damage claims

Physical damage claims are a growing cost driver within the auto insurance system. With the addition of **Advanced Driver Assistance Systems** (ADAS) to vehicles, the price of replacement parts is escalating and we are seeing new costs related to re-programing/re-calibrating these systems. In order to reduce these costs, we recommend working to limit the cost to re-program and re-calibrate as well as encouraging manufacturers to reduce all price parts. Similarly, a limit on towing and storage fees will protect consumers, limit abuse and help to reduce costs.

Enhance road safety

Improving the safety of our roads and working to reduce distracted driving will help to prevent accidents and claims, which in turn will help address rates. We commend the City of Edmonton for its **Vision Zero strategy**, which has resulted in serious injuries from motor vehicle collisions dropping 30% since 2015.[2] Implementing similar plans across the province could help to improve road safety for drivers, pedestrians and cyclists, reducing collision and claims rates.

Distracted driving is a growing trend impacting road safety and claims. In fact, distracted driving fatalities have surpassed impaired driving fatalities in a number of jurisdictions across Canada.[3] To address this trend, jurisdictions have begun implementing stronger penalties and fines for distracted driving convictions. As a founding member of the **Canadian Coalition on Distracted Driving**, we support strong distracted driving legislation to improve the safety of our roads, with a goal of reducing the frequency and severity of claims.



POTENTIAL IMPACT

We recently presented our reform recommendations to the government-appointed automobile insurance advisory committee, on which the AIRB's consumer representative serves as an expert.

As part of this exercise, we conducted modelling on our own claims from the past four years and are projecting a reduction in Section B and Bodily Injury loss costs under our proposed model. Were our reform recommendations to be implemented, the associated premium reduction potential would impact future benchmarks and filings and have lasting benefits for consumers.

[2] City of Edmonton. (2019). Vision Zero Edmonton: 2019 Annual Report. https://www.edmonton.ca/transportation/PDF/VisionZero_2019AnnualReport.pdf.

[3] Traffic Injury Research Foundation. Preventing Distracted Driving. http://diad.tirf.ca/wp-content/uploads/2019/06/Distracted-Driving-One-Stop-Resource-6.pdf.

LOSS TRENDS

Our selected loss trend rates are generally consistent with the recommended selections from Oliver Wyman's preliminary report, with one exception.

Using internal Bodily Injury loss cost data, we observe an upward trend beginning in 2010 without a noticeable change in pattern in recent years. This is in contrast to Oliver Wyman's note at the top of page 18 of their report, which says the Bodily Injury loss cost exhibits *"a steep upward trend beginning in 2010 that appears to be possibly becoming less steep over the past two years."* Evaluating our internal frequency and severity models separately, the observed 2019 frequency represents an increase from the prior year and a one-time change from an otherwise decreasing trend, while the observed 2019 severity represents a decrease from the prior year and a one-time change from an otherwise increasing trend. The 2019 loss cost however, forms part of the steep upward trend observed from prior years without a noticeable change in pattern. Additionally, we cannot conclude from a single data point, from the most recent year for a long-tailed coverage, that a long-term pattern has changed.

It is our understanding Oliver Wyman is relying on *"some evidence of moderation to the steep increases in the (Bodily Injury) loss costs"* as support for recommending past and future Bodily Injury loss cost trend rates that are 1.5% below their sections following the 2019 Annual Review, including a future trend rate that is 1.0% below the past trend rate. We submit that 8.4% is a more appropriate past and future Bodily Injury loss cost trend rate selection. As observed in Figure 4 of Oliver Wyman's report, 8.4% is the indicated trend rate using data from 2010.25 to 2019.75, thereby balancing stability and responsiveness, and it has one of the highest Adjusted R-squared values at 96.6%.

We have presented the reasons for ongoing increasing loss costs, driven by increasing severity, to the Board in past submissions. However, they are worth repeating. The **McLean v. Parmar** decision (February 2015) serves to push minor injuries outside of the cap. We have not seen evidence that the number of minor injuries pushed outside of the cap is stabilizing, which does not align with the view stated by Oliver Wyman at the bottom of page 21 of their report. Although the 2018 changes to the minor injury regulation wording were certainly an important step, given the long tail nature of Bodily Injury claims, it will take years before we can assess whether there has been a resulting reduction in BI loss costs.

Court cases impacting those injuries that were previously accepted as under the cap drive up settlement amounts and result in files remaining open for longer periods of time, which has a significant impact on severity.

We continue to believe that changes have not gone far enough to ensuring that true minor injuries remain within the cap. Only allowing a three- to six-month window for the resolution of soft tissue injuries can push many cases outside of the cap, which limits the impact of the minor injury regulation amendment. Further consideration of how the minor injury regulation can adequately address claims trends is warranted.

Increased legal representation on all files is another factor impacting severity as well as loss costs. It is routine for costly expert reports, commissioned by third party solicitors, to total 20% to 30% of the total settlement value. This is a trend we have noted over previous years and expect to continue over the long term.

THEFT CLAIMS

Auto theft continues to be a concern in Alberta. From 2017 to 2019, we observed a steady year-over-year increase in auto theft incurred losses. In the first quarter of 2020, we saw the largest number of first quarter auto theft claims in the last four years. During the heart of the pandemic and “stay-at-home” order however, we noticed a slight reduction in the second quarter of 2020. As the province reopens, we are concerned that auto theft will return to growth similar to the pre-pandemic demonstrated experience.

We know many auto thefts in the province are preventable. For example, many stolen vehicles have the keys in them at the time of the theft. We are supportive of the Auto Theft Resource Team’s work in Calgary and continue to contribute to the RCMP bait vehicle program, which combats vehicle theft. Together with public education efforts regarding preventative measures to avoid theft, we believe these programs are having an impact on the incidence of auto theft claims. We hope, based on these successes, that similar programs will be implemented province wide.

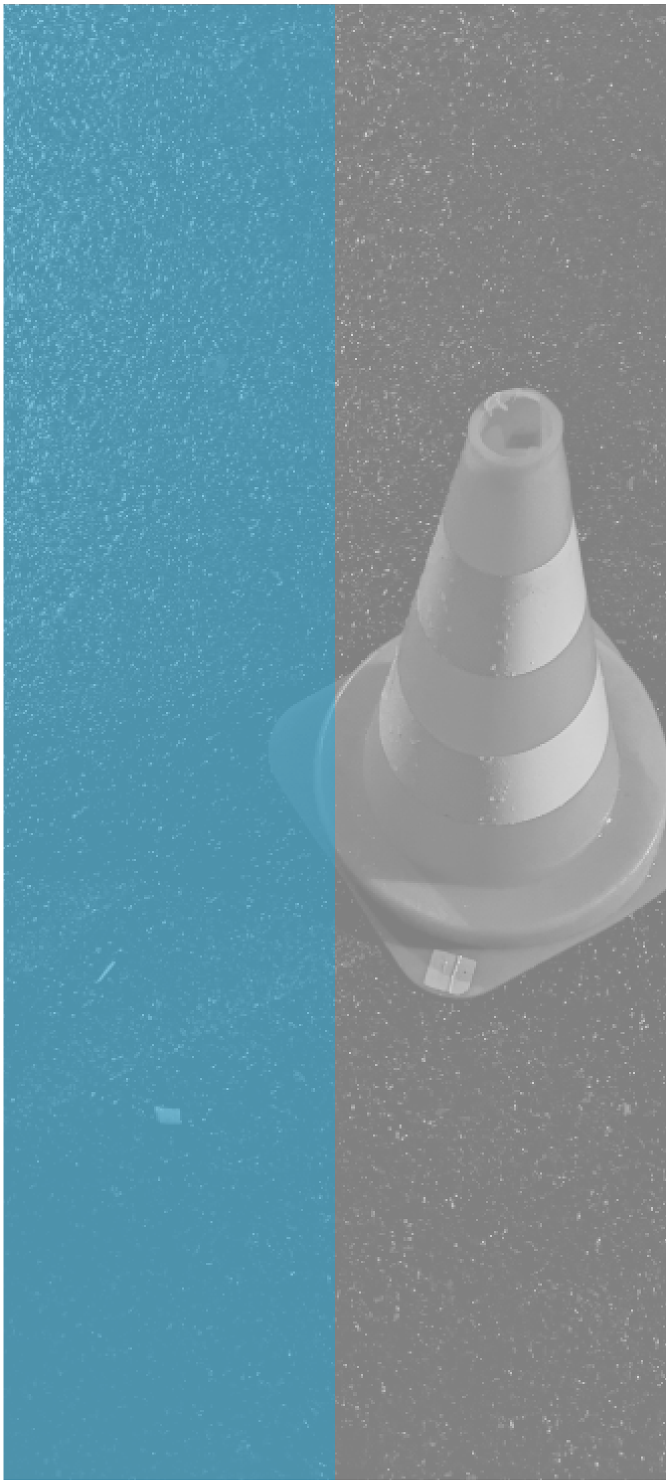
Presently, there is no deductible on auto theft claims for policyholders in Alberta.

We continue to recommend that the comprehensive deductible should apply to claims for theft of the entire vehicle to give policyholders more financial incentive to prevent the theft of their vehicles. We also support regulatory action to prevent fraudulent registration of stolen vehicles.

LOSS DEVELOPMENT

For Bodily Injury coverage, our internal experience demonstrates continued prior years' adverse loss development. This same observation was made a year ago and reported through our 2019 Annual Review written submission as well. Specifically, from our internal data as of December 31, 2019, loss development in the 12 months following the end of an accident year has increased at an average rate of 11% in each of the last three years. This has not been offset by reduced loss development in later periods. This means our selected age-to-ultimate development factors have increased at early maturities and remain relatively consistent otherwise. This is not what we observed from Oliver Wyman's preliminary report this year and final report last year, as many of the selected age-to-ultimate development factors from their most recent report are lower than those from the prior year's report.

On page 12 of Oliver Wyman's preliminary report this year, they state, *"Overall, for the four-year period 2015 to 2018, our estimates of ultimate loss costs have decreased by 0.6%."* On page 11, the report further states *"We find the emerged losses during the second half of 2019 to be generally consistent with our expectations based on our prior selected loss development factors."* These statements are inconsistent with our observations using internal data, as we continue to see an overall deterioration in our loss cost estimates. For every accident year from 2010 to 2018, our estimates of ultimate losses increased between the December 31, 2018 and December 31, 2019 valuations, as we observed a pattern of higher than expected development during 2019. In fact, the development we observed in 2019 exceeded anything observed in our historical data prior to 2019.



The cause of this deterioration, we submit, lies in the challenges associated with being a third-party insurer. When access to information is limited, particularly with respect to a claimant's diagnosis or prognosis, the task of accurately reserving losses is difficult, especially when a claimant is represented. It is not unusual for pleadings, issued at two years post-accident, to be the source of initial information outlining the plaintiff's loss for the third-party insurer. As a result, it is common for reserves to be impacted two to three years post-accident resulting from previously undisclosed information or negative contingencies.

The information presented in this subsection is not intended to challenge or object to Oliver Wyman's estimates of ultimate loss amounts. Instead, we are providing information and insights to illustrate that the experience and development patterns for the industry may not be representative of, or do not necessarily hold for, an individual insurer. This is because the mix of business, claims handling practices, reserving practices and the portfolio itself varies from one insurer to another.

IMPACT OF THE COVID-19 PANDEMIC

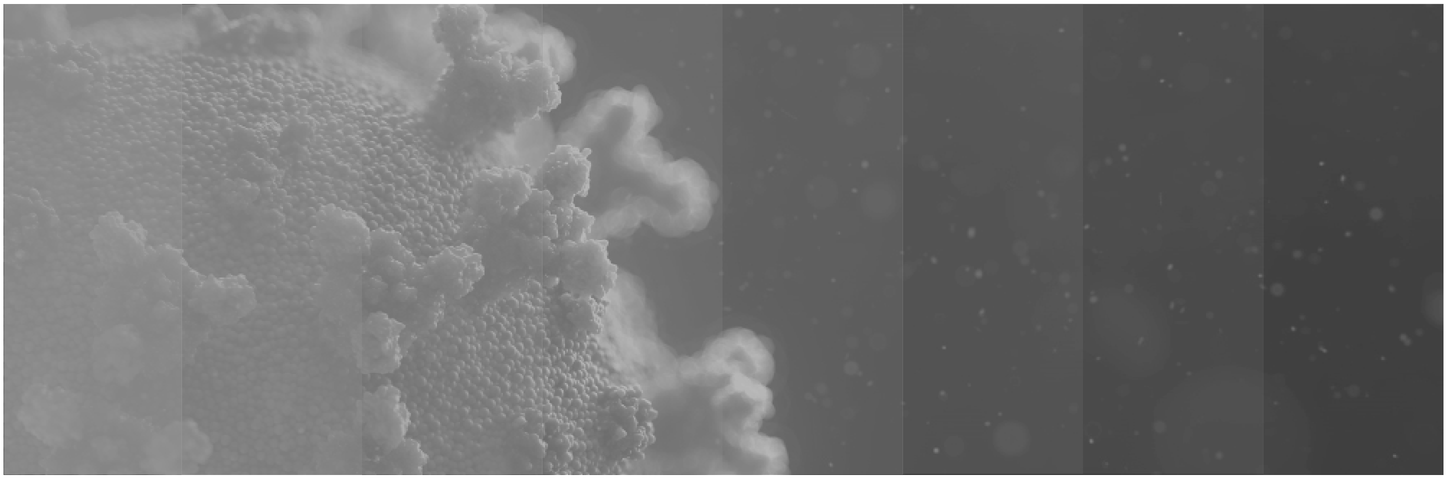
The COVID-19 pandemic has impacted all areas of our business, but it also brought us a unique opportunity to support our clients. We know our clients in Alberta have faced and continue to face financial challenges and are looking for assistance from their insurers to manage through these unprecedented times. In response, we implemented a comprehensive client relief plan with both a refund program and ongoing relief options.

Since the beginning of the pandemic, we worked diligently to develop and implement simplified, easy-to-access solutions, that were and continue to be transparent and equitable for all clients, and maximize the savings we can offer.

REDUCED DRIVING REFUND

The “stay at home” order and physical distancing practices have reduced overall auto risk in Alberta. We committed to share our savings from that reduced risk directly with our clients in an equitable manner. We believe our approach is unique and measured; we reviewed actual experience from April and May before determining the amount of our **Reduced Driving Refund**, allowing us to share the actual savings back with our clients, meeting their ongoing needs in a fair way while also preserving the health and sustainability of our organization.

As of mid-July, clients have started to receive our 15% Reduced Driving Refund, which is applied to two months’ premium.



ONGOING OPTIONS

We have and continue to offer cost savings and flexible payment options to help alleviate the ongoing financial challenges many Albertans are facing. These relief options include flexible payment options and extended payment grace periods as well as:

- Reducing or deferring a payment (up to two payments)
- NSF forgiveness
- Waiving of NSF fees

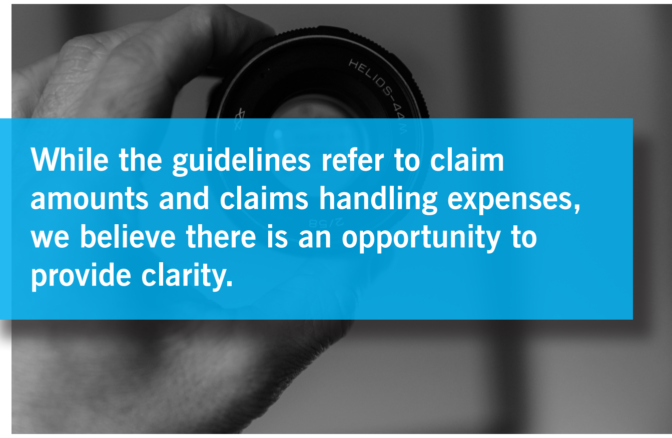
We are also providing clients options to individually change their risk profile (these changes are unique to them and reflect individual circumstances) such as:

- Changing vehicle use from “business” or “commute” to “pleasure” to reduce auto insurance premiums.
- Temporarily suspending coverage if the client’s situation warrants these changes (for example, if they want to park or store their vehicle and not use it for the duration of the pandemic).

As long as an individual client’s circumstances have changed, the changes to their risk profile will remain.

PRICING CONSIDERATIONS

Effective July 1, 2020, the AIRB released new **Full Filing guidelines**, providing pricing direction for the periods impacted by the COVID-19 pandemic and for the treatment of relief measures specifically. We agree with the AIRB that *"rate indication calculations should take steps to ensure these changes do not distort the rate indications for rating programs effective after the pandemic."* However, we are concerned about the prescriptive nature of the statement *"the on-level premiums and premium trends should be calculated in a manner which removes or unwinds the impact of any associated premium relief."* Premiums and claim amounts must be on a comparable basis within rate indication calculations, so an adjustment to earned premium to remove refunds and other premium relief must be combined with a similar adjustment to claim amounts to state them at a pre-pandemic level.

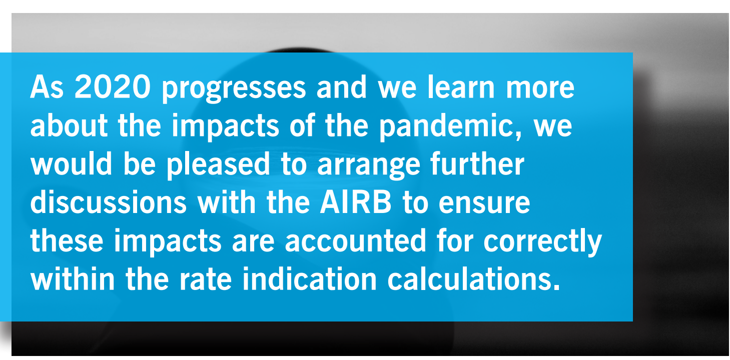


While the guidelines refer to claim amounts and claims handling expenses, we believe there is an opportunity to provide clarity.

From a loss trend perspective, we also recommend that any approach the AIRB considers with respect to approved future rate levels must be appropriately based on long-term cost trends as has always been the intention to date.

We acknowledge physical distancing measures will change the trend lines temporarily, but adjusting charged rates, which has a long-term impact, by adjusting for unexpected short-term changes to trends would be inconsistent with actuarial principles. We submit that approaches to rate regulation must continue to use actual experience to set future rate levels to prevent a potentially dangerous precedent in terms of how insurers should approach all unexpected changes in trends (e.g. natural catastrophes).

There is uncertainty regarding the length of the pandemic, and we are all questioning whether or not consumer and driving behaviour will return to pre-pandemic levels. In all likelihood, without significant adjustments to the inputs of the rate indication calculations that would rely heavily on assumptions, the forecasted 2020 loss ratio may provide little value when projecting the future rate level need.



As 2020 progresses and we learn more about the impacts of the pandemic, we would be pleased to arrange further discussions with the AIRB to ensure these impacts are accounted for correctly within the rate indication calculations.

CONCLUDING REMARKS

We appreciate the opportunity to participate in the AIRB's annual review process. We look forward to continuing to work collaboratively with the AIRB and the Government of Alberta towards solutions that ensure Alberta consumers have an automobile insurance product that provides security, is simple to understand, meets their needs and is affordable.

We are not members of the Insurance Bureau of Canada (IBC) and prefer to contribute to the policy development process directly. As a co-operative financial services organization, we believe we bring a unique perspective to public policy consultations.

If you have any questions or require clarification, please contact our **Associate Vice President of Government Relations**, **Maya Milardovic**, at **maya_milardovic@cooperators.ca**.

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