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Ms. Charlene Butler
Chair, Automobile Insurance Rate Board
#2440 Canadian Western Place
10303 Jasper Avenue
Edmonton, AB T5J 3N6

**RE: AIRB 2022 Annual Review**

Dear Ms. Butler,

Thank you for the opportunity to participate in the Automobile Insurance Rate Board's (AIRB) annual review of auto insurance trends and rates for basic and additional coverage. Consistent with our past approach to this annual review, Insurance Bureau of Canada (IBC) retained an outside actuary, Deloitte, to review Oliver Wyman's preliminary report, *Annual Review of Industry Experience as of December 31, 2021 Private Passenger Vehicles.* The commentary contained in this letter reflects data from Deloitte's review and the views of insurers operating in Alberta's private passenger vehicle (PPV) insurance market.

## State of the Industry

### Rate Adequacy and Inflation

According to monthly premiums data from the General Insurance Statistical Agency (GISA), over the past 12 months, premiums have stabilized as the average premium in Alberta remained largely unchanged, decreasing by just 0.1% from May 2021 to May 2022. While this premium stability was the intent of government's 2020 reforms, it would be inappropriate to ascribe this stability to those reforms alone. The COVID-19 pandemic, and its temporary — and now historical — impact on consumer driving habits, played a significant role in limiting premium pressure over the past two years. More recently, however, consumer driving habits are now exceeding pre-pandemic levels, according to the latest data from Environics Analytics, a data services provider. This increase, combined with actuarial projections of steep claims costs increases moving forward, are likely to place significant pressures on the rate adequacy of insurers moving forward.

Over the past 6 to 12 months, Canada's insurers have seen sizable increases in the cost of vehicle repairs and replacement, due to the supply chain and inflation challenges occurring throughout the economy. In the year to June 2022, Statistics Canada (StatCan) reported that the all-item Consumer Price Index (CPI) has increased by 8.1%. Recent increases in spending on auto-related parts and vehicle repairs suggest that vehicle-damage related costs are even higher than this 8.1% figure:

- According to Statistics Canada, in the 12 months to January, 2022[1], spending on vehicles and automotive parts increased by over 15%;

[1] CANSIM table 20-10-0008-03

- Global supply chain disruptions have contributed to steep increases in the price of used vehicles. According to an April 2022 article in the Globe and Mail, the average used vehicle list price in the Canadian Black Book increased by 47% over the last year. This increases the actual cash value of vehicles on the road as well as the roughly one-quarter of vehicles that are considered a total loss following a collision. It is also contributing to a significant increase in vehicle theft; and

- A shortage of parts is leading to longer cycle times to repair vehicles. This is leading to both higher vehicle repair costs as well as insurers paying more than anticipated due to consumers needing vehicle rentals longer while their vehicles are being repaired.

Oliver Wyman and Deloitte have put forward projected total coverage loss cost increases of 4.2% and 5.0%. While substantial, it is important to note that these projected loss cost increases do not account for the significant inflationary pressures that have arisen. With the above noted emerging cost pressures, it is likely that vehicle damage-related coverages will exhibit significant loss cost increases in the year ahead that are far greater than currently projected.

In June, IBC submitted an analysis to your office on the impact that inflation is likely to have on claims costs and insurer rate adequacy in the province. We noted that if DCPD and collision loss costs increase at a more realistic level of 10% (instead of Oliver Wyman or Deloitte's projections of less than 3%), while conservatively assuming that claim frequency remains 5% below pre-pandemic levels, insurers could face combined loss ratios of 102.5% in 2022. If claim frequency returns to pre-pandemic levels, this could increase to 106.5%. Should these scenarios come into fruition, current rates for many Alberta insurers will not be sufficient to cover claims costs.

In light of the above, it is critical that the AIRB give insurers the flexibility to change their rates as deemed appropriate, in order to foster a more competitive auto insurance market that will give consumers the ability to shop around for the best policy at the best possible price. The historical and continued rate inadequacy of Alberta's auto insurers, combined with both inflationary pressures and forthcoming claims costs challenges identified by Oliver Wyman and Deloitte, solidify the need for actuarial justified rate increases to proceed.

While the AIRB's Business Plan notes that insurer rate increases should not exceed 2% over the next year, it is clear that this threshold is not adequate. In light of the significant claims costs pressures facing Alberta insurers and their customers, permitting rates to reach their actuarially justified level will best ensure that Alberta's 3 million drivers are benefiting from true market competition that promotes innovation and consumer choice. We urge the AIRB to be prospective when considering rate changes to account for these pressures. Allowing for sustainable actuarially justified rates now will help mitigate the risk of rate shocks in the near-future for consumers.

**Regulatory Improvements**

IBC and its members applaud the AIRB for its recent efforts to improve the province's rate regulation framework. The recent adoption of a file-and-use rate filing system for both PPV and commercial vehicles is a positive step that will create a more dynamic and competitive insurance market that is more responsive to the needs and wants of Alberta's 3 million drivers. While this is a significant improvement that will foster a more efficient and effective regulatory framework, further improvement is necessary to ensure that Alberta develops a best-in-class insurance system that fully fosters choice and innovation for its drivers. To that end, we recommend the AIRB continue to move forward with regulatory enhancements and undertake the following:

- Review the province's rate filing guidelines to streamline the process and establish clear timelines for insurer information and approvals;
- Reform the province's Grid rating system to refocus the framework to better align with its original intent (see following section for further details); and
- Move towards a more principle-based regulatory model that better promotes healthy market competition and more choice for consumers.

In addition, IBC strongly recommends that the AIRB amend the recent changes to its filing guidelines to clarify that it will consider the approval of insurer rate filings based on the reasonableness of those filings, and not the alternate opinion of another consulting actuary. As noted by Oliver Wyman, not only did the COVID-19 pandemic result in "additional uncertainty associated with the estimates for the 2020 and 2021 accident years", but also that "the uncertainty surrounding inflation, adds uncertainty around selecting an appropriate future trend rate". In light of this, it is more important than ever that insurers are able to use their individual experience and projections, where reasonable, in their rate filings and that the AIRB not give deference to its own consulting actuary.

**Grid Framework**

Alberta's Grid framework was introduced as a mechanism to provide new drivers access to affordable auto insurance. However, over time, the Grid has shifted away from its original intent and now provides discounted premiums to drivers that are outside of its original purpose.

As noted in our letter to your office on July 4, IBC commissioned Deloitte to examine the Grid framework and to provide recommendations to realign it with its original intent. Deloitte found that while the Grid is providing subsidized premiums to new drivers, it is also subsidizing a significant number of experienced drivers, including those with a history of claims and infractions. As a result of the Grid's vastly expanded scope, safe and experienced drivers in Alberta are paying higher auto insurance premiums than is justified in order to subsidize the premiums of both high-risk and experienced drivers.

In the most detailed exploration of its kind, Deloitte analyzed the demographics of drivers on each Grid step and has found:

- In 2021, total Grid subsidies were estimated to be $180 million. This equates to an average cost of $65, or 4% of premiums, for every driver in Alberta;
- The number of drivers subject to the Grid's framework has grown 29.6% over the past five years—vastly outpacing the growth in overall numbers of new drivers;

- Over half of all Grid subsidies are distributed to drivers with more than seven years' experience — drivers who should not be receiving subsidized premiums as they fall outside the scope of the Grid's original purpose; and

- On average, high-risk drivers with a history of infractions and/or at-fault claims (i.e. drivers on Grid steps +7 and above) receive subsidies of $2,516 or greater. Again, these are drivers that should not be benefiting from subsidized Grid premiums.

In its current form, it is clear that the Grid framework is no longer aligned with its original intent and penalizes the province's safe drivers with higher premiums. As a result, the Grid does nothing to support – and actually works against – the very thing we should seek to encourage most: safe driving.

While IBC understands that the AIRB views the removal of the Grid as beyond the scope of its decision-making authority, we have provided your office with recommended improvements that can be made to the existing framework to help reduce the financial burden it has on the province's safe and experienced drivers. As recommended by Deloitte in its report, we urge the AIRB to introduce the following reforms to the existing Grid framework:

- Enable minor-conviction surcharges beginning at Grid step 1, as opposed to the current Grid step 2;

- Include at-fault claims, other than third-party liability claims, in moving drivers up or down Grid steps;

- Reduce the number of years that drivers are subject to Grid ratings by phasing out Grid steps –7 to –15. To limit the near-term impact this would have on consumers, Deloitte recommends that this subsidy be eliminated over the course of three years, reducing the subsidy by 33% per year; and

- Restrict Grid access to only those drivers who have been licensed for seven years or fewer. There is no public policy rationale or justification in providing subsidized premiums to high-risk drivers with histories of at-fault claims and/or infractions.

These efforts would help reduce the premium impact of the Grid on safe drivers, maintain subsidized premiums where government feels that is appropriate and help ensure that new drivers have access to an affordable entry-level premium. Moreover, with an average cost of approximately $65 for every driver in Alberta, reforming the Grid can help improve the affordability of auto insurance for the province's good drivers generally.

Of immediate concern, Deloitte's analysis outlines that the number of vehicles placed on the Grid is likely to double this year. Recent insurer data confirms this and, going further, suggests that this doubling has already happened. This growth in the Grid is vastly outpacing the growth in new drivers and serves only to further expand the Grid beyond its original intent, increasing its cost on drivers overall.

In our 2021 Annual Review submission, IBC warned that the changes being undertaken to Grid base premiums, as well as the relativity changes made to Grid steps, were likely to increase the number of drivers being placed on the Grid. At that time, the AIRB moved forward with a Grid level rate change of -31.9% and, in doing so, assumed savings from the governments reforms that have yet to be realized and may not fully come to fruition. With significant loss cost increases projected due to inflation and an increase in consumer driving habits, it is clear that these changes need to be reversed in order to limit the excessive growth in the Grid and its cost for good drivers overall.

While we have provided your office with concrete recommendations to reform the Grid framework, in the interim, it is critical that the AIRB work to immediately reduce the growing number of drivers subject to Grid premiums to reduce the impact on drivers overall. To do so, we recommend that the AIRB:

- Restore Grid premiums to their 2020 levels by adopting a +15% base premium change; and

- Undertake relativity changes to the Grid steps, with an aim to better align the framework with its original intent.

We focus our remaining commentary on future loss cost trend rates, the catastrophe provision, health cost recovery factor, operating expenses, investment income on cash flow, and the profit provision.

## Commentary on Loss Cost Analysis

For this year's Annual Review, Oliver Wyman and Deloitte projected that several coverages, particularly those related to injury claims, will increase considerably over the next year. The table below highlights projected future trend rates from both actuaries.

Future Loss Cost Trend Rates

| | Basic Coverage | | | Additional Coverage | |
|---|---|---|---|---|---|
| | **Bodily Injury** | **Property Damage** | **Accident Benefits** | **Collision** | **Comprehensive** |
| **Oliver Wyman** | **+5.0%** | +1.5% | **+12.0%** | +2.5% | +3.5% |
| **Deloitte** | **+6.2%** | +1.7% | **+10.0%** | +2.9% | +5.7% |

*IBC with data from Oliver Wyman and Deloitte.*

Oliver Wyman's projected bodily injury future loss trend rate is +5.0%, while Deloitte's is +6.2%. Both actuaries are once again projecting double digit accident benefits future trend rates, at +12.0% and +10.0%, respectively. These selections highlight that under the current product, injury claims costs will continue to rise at significant rates and signal the need for further improvement to the province's auto insurance system. In the near-term, IBC will be sharing its recommendations to the AIRB that will provide Albertan's with more choice, increase the care received after an accident, and importantly, reduce the price drivers pay for coverage These improvements build on previous advocacy under our *More Care, Less Court* proposal.

Similar to the semi-annual review, both Oliver Wyman and Deloitte project relatively modest vehicle damage future trend rates, with property damage and collision future trend rates of less than 3.0%. However, in stating that its physical damage trend factors "may not be an accurate indication of future trend rates," Oliver Wyman acknowledges that its trend rates do not adequately account for the rise in inflation associated with vehicle parts, maintenance, and repair costs.

To address this, Oliver Wyman suggests that insurers should consider the *vehicle maintenance and repair costs* CPI data in Alberta at the time of the rate application preparation. We support greater insurer ability to use real-time data in rate applications, but also strongly recommend that Oliver Wyman's recommendation here extend to other Statistics Canada data elements related to vehicle damage, including:

- The value of new and used vehicles, which are directly related to the actual cash value for the one-quarter of vehicles that are considered total loss after a collision;
- Vehicle parts, accessories and supply costs;
- Private passenger vehicle lease costs; and
- Rental of passenger vehicle costs.

In order to maintain rate stability and reduce the likelihood of future rate shocks for consumers, it is critical that the AIRB permit insurers to justify rate changes that incorporate the above metrics.

### Catastrophe Provision

Oliver Wyman notes they are no longer approving a benchmark for the catastrophe provision. IBC supports this decision, as it allows insurers to select their own catastrophe provision based on their individual loss experience caused by significant weather events in the province.

### Health Cost Recovery

Consistent with the 2022 Health Cost Recovery Assessment recommended benchmark from the Alberta Treasury Board and Finance, Oliver Wyman agrees that insurers should reflect the health levy of 3.55% in their 2022 filings. IBC and Deloitte believe that this is a reasonable provision.

### Operating Expenses

Oliver Wyman selected an operating expense ratio of 27.1% based on the GISA Industry Expense Report. IBC and Deloitte consider this to be reasonable.

### Investment Income on Cash Flow

In July 2019, the AIRB updated its Guidelines to allow insurers to use their individually-selected investment income rate in their rate applications. IBC continues to support this decision to let insurers select their expected investment income rate based on their own individual experiences.

### Profit Provision

Writing PPV insurance in Alberta has been extremely unprofitable for much of the last decade. According to GISA's *Industry Profit and Loss Report*, since 2013, Alberta PPV auto insurers have paid out considerably more in claims costs, operating expenses and premium taxes than they earned in premiums and investment income.

While the current profit provision benchmark is 7%, the Alberta PPV auto insurance industry rarely even approaches this level, let alone exceeds it. In fact, since 2013, the industry faced *negative* underwriting income for eight of the last nine years. The problem in Alberta's auto insurance market is that it has been broadly unprofitable, which makes changes to the province's profit provision both unnecessary and potentially harmful to the choice and competition that consumers enjoy in the marketplace today.

Limiting the ability of insurers to work towards long-term and sustainable profitability runs counter to Alberta's inherent free-market values and would have a chilling effect on insurers looking to expand in Alberta. Insurers decide where to deploy their limited capital and resources based on the ability to realize a return on equity. Changing the profit provision will impact insurer decisions to grow or continue to operate in Alberta, which would negatively impact on insurer capacity in the province at a time when Alberta needs to attract additional capital and increase competition.

Attracting new companies, particularly those in financial services, is a government priority as it works to re-build the economy after the devastating effects of COVID-19. Changes to the profit provision would only hinder these efforts and negatively impact the choice and options available to consumers in the province. This is particularly important in the commercial insurance space.

In light of the above, IBC agrees with the AIRB Board's position to maintain a 7% profit provision, as stated in the Annual Review document. Alberta's history of volatile and severe weather make it a high-risk province for insurers. The unpredictable nature of these weather events makes it near impossible to predict and adds to the insolvency risk of insurers in the province. This warrants a higher profit provision in the province as insurers rely on greater capital funds and profit margin to ensure their availability under such adverse scenarios.

### Conclusion

As stated throughout the submission, there are significant cost pressures facing Alberta's auto insurance system. While it may appear that premiums have stabilized, insurers' current rates will no longer be sufficient to cover increased claims costs insurers are incurring, even without factoring in the impact of rising inflation on vehicle damage rate rates in particular. Evidenced by both Oliver Wyman and Deloitte's projected trend factors, under the current product, injury claims are expected to increase significantly over the next year. As such, IBC recommends that the AIRB continue to work with industry to permit actuarially justified rate changes, improve the

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rate regulation environment in the province, and realign the current Grid vehicle framework with its original intent.

Again, thank you for the opportunity to provide input for this year's Annual Review. We look forward to virtually meeting with the AIRB on August 18.

Sincerely,

Aaron Sutherland, Vice-President
Western & Pacific, Insurance Bureau of Canada