

July 28, 2021

Ms. Laurie Balfour  
Executive Director, Automobile Insurance Rate Board  
#2440 Canadian Western Place  
10303 Jasper Avenue  
Edmonton, AB T5J 3N6

Dear Ms. Balfour,

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, 2020 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.

### **IBC Position on Annual Review and Recommended Path Forward**

In October 2020, the government of Alberta introduced a series of reforms to the province's auto insurance system designed to stabilize costs, enhance the care drivers receive after an accident, and improve the province's regulatory framework and cut red tape. While this Annual Review presents an opportunity to analyze the initial trends associated with that reform, too little time and experience has been included for any meaningful conclusions to be drawn with regard to their effectiveness. The COVID-19 pandemic, and its impact on driving habits and claims trends, are likely only to further delay the ability of industry and the government to fully assess the impact of reforms.

The uncertainty and challenges created by the limited claims experience associated with the reforms, as well as the impact of the COVID-19 pandemic, was highlighted in the analysis undertaken by both IBC's and the AIRB's actuaries. Specifically, Oliver Wyman noted that:

*The insurance industry data that this Annual Review report is based upon, as of December 31, 2020, does not include sufficient claims experience to update the expected cost impact of Bill 41. Due to the impact of COVID-19, we expect an additional time lag before the effect of the reforms can be accurately measured...*

A stable premium environment presents an important opportunity for the AIRB to focus on its rate regulation objectives. For this reason, IBC strongly encourages the AIRB to continue to move forward with improvements to the province's regulatory framework,

as envisioned by the 2020 reforms, as it awaits a more informed understanding of the cost impacts associated with the reforms. In that light, IBC recommends the AIRB focus its current efforts on:

- Improvements to the province's rate regulation framework, and a continued move towards a true file-and-use system, as referenced in the AIRB's 2021-2024 Business Plan;
- Streamlining the Alberta Grid framework to realign it with its original intent – namely, supporting new driver access to affordable premiums; and
- Moving towards a more principled-based regulatory model that better promotes competition in the market and greater choice for drivers.

The historical and continued rate inadequacy of Alberta's auto insurers, combined with the continued cost pressures indicated in both Oliver Wyman and Deloitte's analyses, suggests that where insurers have justified rate increases, these must be allowed to proceed to ensure Alberta's drivers have access to a healthy, competitive and dynamic auto insurance market.

At the time of last year's auto insurance reforms, analyses undertaken by both the insurance industry and the Alberta government projected that the reform package would stabilize – but not lower – driver premiums in the province, given the existing insurer rate inadequacy in the province. While the reform's increase in accident benefits (and their associated costs) were immediate, any cost savings associated with the reforms – particularly with regard to bodily injury awards – are long-term, and the impact of these will not be known for some time.

Once a better understanding of the impact of reforms is known, further improvements to the province's auto insurance system may be warranted and IBC would again recommend that its *More Care, Less Court* proposal be considered as a model that can help reduce the premiums drivers pay in the province. Additionally, this proposal would also aim to improve the affordability of auto insurance overall while also increasing benefits to better support the recovery of those injured in auto accidents.

### **Grid Vehicles**

IBC and its members greatly appreciate the AIRB's decision to accelerate its 2021 Grid vehicle guidance in order to facilitate a smooth transition to Direct Compensation for Property Damage (DCPD), and for its decision to launch a full review of the overall Grid framework.

The Grid leads to many negative outcomes for consumers because it forces safe drivers to pay more for auto insurance than they otherwise would, in order to subsidize those

at higher-risk. In doing so, it also removes a key incentive to practice safer driving habits on Alberta roadways – namely, the threat of increased premiums.

While IBC understands that the AIRB views the removal of the Grid as beyond the scope of its decision-making authority and mandate, we believe that improvements can be made to the existing framework to help mitigate the negative impact it has on drivers. IBC has submitted proposals to that the AIRB recommending that there be a reduction in the number of Grid steps so that lower risk Grid drivers can obtain insurance from the competitive market, in addition to a recommendation to reform Grid rules around infractions and territories.

The Grid population in Alberta has risen significantly in recent years, from 5.2% of the driving population (or roughly 150,000 drivers) in 2016 to 7.1% (or roughly 198,000 drivers) in 2020<sup>1</sup>. This increase is further evidence of the expansion of the Grid beyond its original scope and intent, and we look forward to reviewing the AIRB's feedback on IBC's proposals to address this.

Following Oliver Wyman's *Private Passenger Automobile: Grid Analysis*, the Board for the AIRB put forward an overall Grid rate level change of -31.9% this year, to account for the removal of DCPD from Grid premiums (-20.5%) as well as its projected impact of the 2020 reforms (-11.4%). In doing so, however, the Board has assumed savings from the reforms that have yet to be realized and may not ultimately come to fruition.

The AIRB Board has also directed that Grid Step Differentials decrease this year at both the lower and higher ends of the Grid steps. With no corresponding overall Grid increase to offset this, or consideration of the historical underpricing that has existed for Grid rated drivers (which Oliver Wyman's analysis indicates to be 13.9%), it is likely that the number of drivers being placed on the Grid will further increase in the coming year. A corresponding increase in the subsidisation of Grid drivers by other policyholders is also highly likely, placing additional pressure on the premiums of safe drivers to offset this further expansion of the Grid.

The unintended consequences described above lend more evidence and urgency to the need to reform (if not replace) the Grid entirely and, as such, IBC continues to recommend that the Grid be reformed to better focus on its original intent and design – namely, to ensure that new drivers have access to an affordable entry-level premium. Such an effort would also reduce the premium impact of the Grid on safe drivers in the province and allow insurance premiums to better incentivize safe driving behavior on Alberta roadways.

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<sup>1</sup> IBC analysis based on industry data

## Loss Trend Rates

In their analysis of industry's experience in 2020, both Oliver Wyman and Deloitte noted that cost pressures in several coverages, particularly those related to injury claims, had increased considerably, and the table below shows the projected future trend rates from both actuaries.

Future Loss Cost Trend Rates by Sub-Coverage

	Basic Coverage			Additional Coverage	
	Bodily Injury	Property Damage	Accident Benefits	Collision	Comprehensive
<b>Oliver Wyman</b>	<b>+5.0%</b>	+1.5%	<b>+11.5%</b>	+2.5%	+6.5%
<b>Deloitte</b>	<b>+6.0%</b>	+1.7%	<b>+10.0%</b>	+2.7%	+5.8%

*IBC with data from Oliver Wyman and Deloitte.*

To account for the impact of the Alberta government's 2020 reforms, both actuaries estimated a lower increase for bodily injury loss trends; the impact on accident benefits was higher given the immediate effect of reforms in that regard. While both of these considerations are prudent, significant uncertainty remains in these projections and are unlikely to be truly indicative of expected trend rates moving forward.

Oliver Wyman's projected bodily injury future loss trend rate is +5.0%, while Deloitte's is +6.0%. Projected accident benefits future trend rates are even larger, at +11.5% and +10.0%, respectively. Both of these selections highlight that under the current product, injury claims costs will continue to rise much faster than the rate of inflation in Alberta.

Both actuaries project relatively modest vehicle damage future trend rates, with property damage and collision future trend rates of less than 3.0%. However, Oliver Wyman conducted similar analyses in July 2021 for Ontario and projected considerably higher trend rates for these coverages, at +9.2% and +9.6%, respectively. The difference is likely due to economic-growth reasons, as Ontario consumers have purchased proportionally more new vehicles in recent years<sup>2</sup> compared to Albertans. However, as Alberta's economy rebounds and drivers here replace older vehicles with newer ones, we anticipate Alberta vehicle damage claims costs will inevitably exhibit a similar trend as that seen in Ontario.

<sup>2</sup> IBC with data from Statistics Canada

### Accident Benefits Loss Costs and Selected Trend Rates

Annual Accident Benefits Loss Cost Increase, 2015 - 2019	Oliver Wyman Future Accident Benefits Trend Rate	Deloitte Future Accident Benefits Trend Rate
9.6%	+11.5%	+10.0%

*IBC with data from Oliver Wyman and Deloitte.*

While the COVID-19 pandemic may have temporarily reduced claims costs due to its impact on consumer driving habits, prior to 2020, accident benefit claims had been increasing dramatically. Between 2015 and 2019, the last full year before the pandemic began, accident benefits loss costs increased by an average of 9.6% per year. More concerning, both Oliver Wyman and Deloitte project these claims will increase at an even faster pace in the year ahead, with future accident benefits trend rates of +11.5% and +10.0%, respectively.

Although these began from a relatively low base, the near-double-digit increases in recent years mean accident benefits loss costs increased from \$55 in 2015 to \$73 in 2019. Deloitte projects that by next year, this will increase to \$93 per vehicle. Accident benefits claims cost per vehicle in Alberta are rapidly approaching the highest levels in Canada, outside of Ontario.

As stated at the outset of this section, despite the significantly higher observed and projected trend rates by both actuaries, there continues to be significant uncertainty around how accident benefit and bodily injury loss costs will ultimately be impacted by the recent reforms. With only two months of post-reform experience, there is simply too little industry experience and data available to assess or project their impact, a matter made more complicated by the temporary impact of COVID-19.

### **Catastrophe Provision**

Oliver Wyman proposed a catastrophe provision of 51%. Deloitte selected a higher provision of 55% based on historical catastrophe claim data from 2002 to 2019. However, both selections were made based on the 2019 GISA Catastrophe Report. Given that the available data does not include the considerable impact of the significant severe weather events that occurred in Alberta in 2020, and which caused over \$357 million in auto insurance losses alone, we strongly recommend the AIRB consider a higher catastrophe provision moving forward.

Alberta's history of volatile and severe weather make it a high-risk province for insurers. Six of the top 10 most expensive natural disasters in Canada having occurred in the province, with all but one of these having occurred in the decade. These trends can

result in periods of significant underwriting losses, warranting larger catastrophe provisions and other buffers to ensure insurer solvency and prevent large swings in premiums for drivers.

Between 2015 and 2019, Alberta had the highest average comprehensive loss costs of any province, with comprehensive claims comprising a much larger share of total claims costs than any other province. The size and unpredictability of severe weather events in Alberta and their associated claims have the potential to cancel out most – if not all – underwriting profit in a given year.

As noted in IBC's 2021 Semi Annual Review submission, when selecting this benchmark, IBC recommends the AIRB consider substantial losses from catastrophic events that are not reflected in Oliver Wyman's catastrophe provision, such as the 2021 hail event in the Calgary area. With extreme weather events only expected to increase in Alberta moving forward, Alberta insurers are raising the province's risk profile. To allow insurers to better mitigate the premium impacts these events have on consumers, a higher catastrophe provision is necessary.

### **Health Cost Recovery**

Consistent with the 2021 Health Cost Recovery Assessment recommended benchmark from the Alberta Treasury Board and Finance, Oliver Wyman agrees that insurers should reflect the health levy of 2.94% in their 2021 filings. IBC and Deloitte believe this is a reasonable provision.

### **Investment Income on Cash Flow**

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

### **Operating Expenses**

Oliver Wyman selected an operating expense ratio of 26.0% based on the GISA Industry Expense Report and has partially made IBC's recommended adjustment to use earned premiums instead of written premiums in the calculation. However, Oliver Wyman only made this adjustment for the general expenses component of the operating expenses ratio and not for the other components.

Deloitte applied this adjustment consistently across all operating expenses components, resulting in a total operating expenses ratio of 26.8%, which is 0.8% higher than Oliver Wyman's estimate.

## Conclusion

As stated throughout this submission, and as referenced in both the Oliver Wyman and Deloitte analysis, there is significant uncertainty surrounding the impact of government's 2020 reforms and too little data exists for meaningful conclusions to be drawn. Alberta's reforms were intended to stabilize premiums for consumers and, if successful, this environment presents an important opportunity for the AIRB to focus on its rate regulation objectives. As such, IBC recommends that the AIRB work with the industry to improve the rate regulation environment in Alberta to improve the overall efficiency of the system, encourage more stable insurance premiums and improve the alignment of premiums to driver risk.

Again, thank you for the opportunity to provide input for the annual review. We look forward to virtually meeting with the AIRB on August 19.

Sincerely,

Aaron Sutherland



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