co-operators

The Co-operators Group Limited

August 19, 2022

Tim Bzowey
Executive Vice President, Auto/Insurance Products
Financial Services Regulatory Authority of Ontario (FSRA)
Auto Insurance Sector
25 Sheppard Avenue West, Suite 100
Toronto, ON M2N 6S6

Dear Mr. Bzowey,

Subject: Ontario PPA Annual Review based on Industry Data as of December 31, 2021

Introduction

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.

Our footprint in Ontario is strong: we insure approximately 704,000 private passenger vehicles, 363,200 homes, 10,200 farms and 45,000 businesses, and employ over 3,700 staff. The insurance and financial products and services provided by Co-operators are delivered primarily through our independently contracted but exclusive financial advisor channel. We have independent distribution contracts with 250 financial advisors in the province who operate offices in 310 locations. In turn, these independent financial advisors hire their own office staff and employ or independently contract with over 1,028 associate insurance and financial advisors.

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

Co-operators has reviewed the draft Ontario Private Passenger Vehicles (PPA) Annual Review report, based on industry data through December 31, 2021, prepared by Oliver Wyman and distributed by your office. We would like to thank FSRA for the collaborative approach taken with this annual review, which allows insurers to respond with written feedback prior to the selection of the final benchmarks. We would also like to thank Oliver Wyman for their efforts which produced a detailed, comprehensive report.

In the sections of this response that follow, we provide feedback on a few topics from Oliver Wyman's report that we have deemed important.

Inflation

Inflation at higher than historical levels and persistent supply chain issues are among the hot topics in the P&C insurance industry today and we are monitoring both from an automobile insurance physical damage perspective. With the production of new vehicles slowing for an extended period, and vehicle lots sitting with far less than capacity as a result, we've observed inflation on total losses. From our internal, countrywide data, we have seen significant growth on total loss amounts the last three quarters and can conclude confidently this growth applies to Ontario specifically as well. A trusted industry partner with additional access to industry data has confirmed for us the significant growth in total loss actual cash value payments over the last couple of years. We have also experienced an increase in cycle time on repairs due to delays with parts supplied. Consequently, our policyholders have required their rental vehicles for longer periods. Our preferred rental vehicle provider has shared related data with us confirming this impact for Co-operators as well as the industry overall. We expect these two phenomena, the inflation on total losses and the increased cycle time on repairs, to be temporary. As new car production continues to grow and inventory levels return to a normal level, we expect to see a reduction in rental vehicle costs and an associated reduction in actual cash value estimates on total losses.

In addition to the inflation on total losses, we are also experiencing inflation on vehicle replacement parts. We have not specifically quantified the amount of the inflationary increase but, relying on high-level comparisons, we know it is not as significant as the inflation experienced on some property lines of business. At some point in the future, without certainty as to the specific timing, we expect the observed parts inflation to level out but we do not believe the cost of vehicle parts will retreat to prior levels.

On page 38 of their report, Oliver Wyman acknowledges the recent rise in inflation associated with vehicle parts, maintenance and repair costs. They suggest that insurers "use the most recent CPI data for vehicle maintenance and repair costs in Ontario" to calculate an adjusted past severity trend that can be used to support a selected future trend rate. Further, the following formula is provided to estimate the future severity trend rate:

$$Future\ Severity\ Trend\ Rate = (1 + Annual\ Future\ Inflation\ Rate) \times \frac{(1 + Past\ Severity\ Trend\ Rate)}{(1 + Historical\ Inflation\ Rate)} - 1$$

$$Future\ Loss\ Cost\ Trend\ Rate \approx (Annual\ Future\ \ Inflation\ Rate) + (Past\ Loss\ Cost\ Trend\ Rate - Historical\ Inflation\ Rate)$$

We believe the methodology and adjustments proposed by Oliver Wyman are reasonable for physical damage coverages.

On page 36 of their report, Oliver Wyman states that health care costs "appear unaffected by the recent inflationary trends." We do not necessarily agree with this position. Similar to the physical damage coverages, where parts inflation is only one component of overall inflation, there is more than one component subject to inflation for the injury coverages as well. Wage indemnity is one such component.

Wage indemnity losses are an important component of loss settlements, particularly for Bodily Injury coverage. We have observed recent increases for this cost category. For example, year-over-year wage increases recently spiked in June 2022, as measured by the Health Care CPI. Average hourly wages rose 5.2% (+$1.54 to $31.24) on a year-over-year basis in June, up from 3.9% in May and 3.3% in April (not seasonally adjusted.)[1]

In addition to the Health Care CPI, FSRA releases their annual indexation percentage at year end for the following year. Policies and claims are affected differently depending on the coverages purchased. The indexation benefit for 2022 is 4.4%[2] compared to 0.5% the previous year.

In summary, there are early indicators that support the anticipation of severity increases for Bodily Injury and Accident Benefits coverages. They are long-tailed coverages, so we have not observed a notable severity increase on paid claims yet, but we believe this is a situation to monitor.

COVID-19 Loss Adjustment Factors

We have reviewed Oliver Wyman's proposed methodology to adjust for the pandemic period within the rate level indications and we are aligned with this methodology. To be more precise, the effects of the COVID-19 pandemic must be removed from 2020 and 2021 data and then all years in the experience period should be adjusted to reflect the expected "new normal." The timing of the shift to the "new normal" is an important input to this methodology and we continue to actively monitor our data to identify this timing, which will be gradual. Given rate level indications are sensitive to loss trend selections, we believe these selections must continue to balance stability and responsiveness as the shift towards the "new normal" occurs.

Oliver Wyman considers the use of the mobility composite metric published by the Institute of Health Metrics and Evaluation (IHME), which measures typical mobility levels. We agree there is an intuitive relationship with claims frequency, but note that this metric fails to account for factors that impact severity, including:

- Pandemic lockdowns orders which hinder the availability/convenience of injury treatments and health care
- Mental health and reduced resiliency of claimants

The inclusion of these factors will bring impacted losses to their assumed "new normal" state, for the purpose of projecting the cost level of the proposed rating period.

Oliver Wyman also acknowledges the rate at which mobility returns to normal is uncertain and difficult to predict. As a result, they do not quantify the pandemic's expected impact on claims costs for 2022-2 and beyond. When new rate level indication calculations are completed for upcoming rate filings, many insurers will need to project beyond this date. As a result, there is likely to be a wide range of COVID-19 pandemic cost and saving projections, depending on the assumptions and approach followed by each insurer.

[1] Source: https://www150.statcan.gc.ca/n1/daily-quotidien/220708/dq220708a-eng.htm

[2] https://www.fsrao.ca/industry/auto-insurance/regulatory-framework/guidance-auto-insurance/2022-automobile-insurance-indexation-amounts-guidance

Loss Trends

Comprehensive

For Comprehensive coverage, Oliver Wyman's loss cost model is fit to accident years 2011 to 2021, with a selected past loss cost trend of +7.1%. We believe this selection is too low for a few reasons.

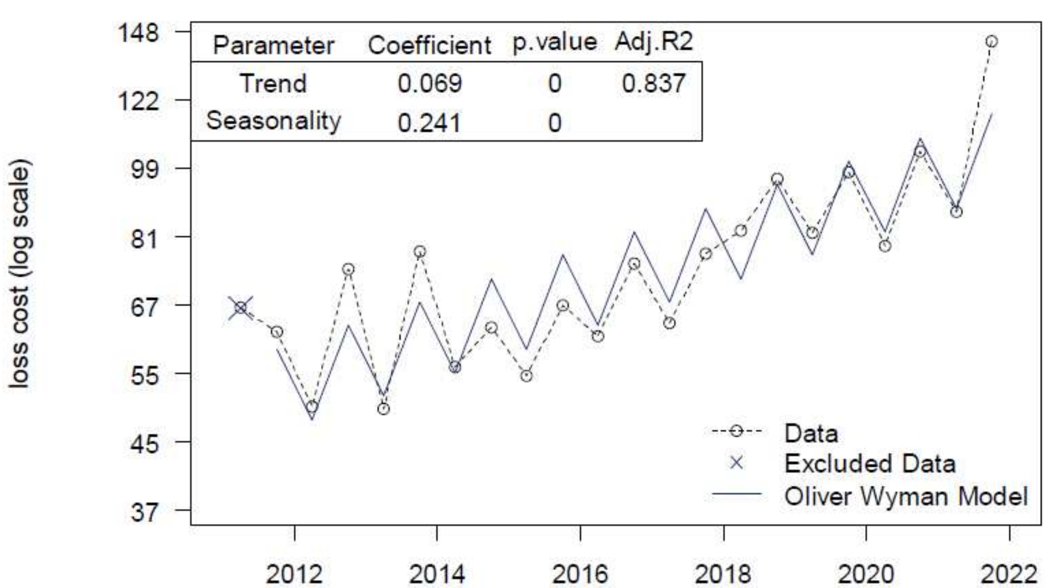
First, this loss cost trend selection represents a 2.8% decrease from the previous benchmarks (+9.9% to +7.1%.) The latest data point indicates an increasing trend, so we submit that a lower selection from the previous selection is not appropriate.

Second, separate Comprehensive trend selections are made by Oliver Wyman for Theft, All Other and Total. A reasonability check is to infer the Total trend from the Theft and All Other selections. As shown in the chart immediately below, by weighting the Theft and All Other selections we derive an impact (+12.4%) much higher than the selection.

	Loss Cost Trend	Weight[3]
Theft	+27.1%	34%
All Other	+5.0%	66%
Total (inferred)	+12.4%	100%
Total Selected	+7.1%	

Third, in Figure 29 from the report (shown below), we observe the model under-predicts the latest period and consistently over-predicts the data from 2015 to 2017. This result is an understated trend.

Figure 29: Comprehensive - Fitted Loss Cost



[3] Theft Weight estimated as (Column 7 total from Appendix B page 10) / (Column 7 total from Appendix B page 10)

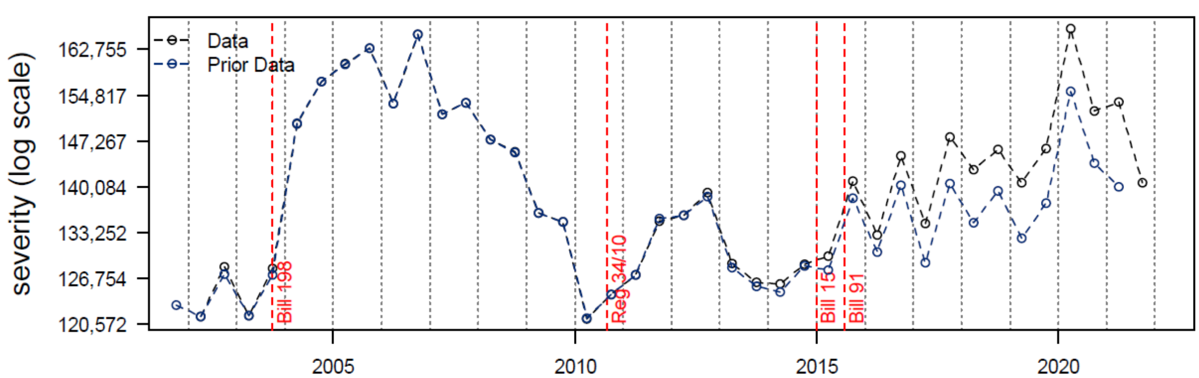
We believe a more appropriate approach is to rely on a start date later than 2011. For example, using the same model with the start date 2014-2, the R^2 is higher at 0.893. The resulting indicated trend from this model is +10.19%. Another reasonable option is a model with a mobility parameter (p = 5%) and the start date 2014-2. In this example, the R^2 value is 0.919 and the indicated trend is +12.44%. This aligns with the total inferred loss trend using the individual Theft and All Other selections.

Bodily Injury and Accident Benefits

Co-operators' pricing actuaries analyze frequency, severity, and loss cost trends separately, using Co-operators' internal data only, prior to making trend selections. We are not impacted by the claims amount and claims count challenges from the GISA data discussed by Oliver Wyman, which allows us to evaluate the individual components of the loss cost first. Additionally, when we modify our claims handling and/or reserving practices, the knowledge of our data combined with the available expertise from our Claims and Reserving teams, equips us to make appropriate adjustments.

Using chain ladder development directly without properly adjusting for historical claims triangles may distort the ultimate claim projection. We acknowledge this is challenging for Oliver Wyman to properly account for and, therefore, represents a limitation when using industry data. Given that Bodily Injury and Accident Benefits coverages are long-tailed, the less developed years (ie. more recent years) are sensitive to inaccuracies in the selected loss development factors. For example, in Table 8 on page 26 of Oliver Wyman's report, for Bodily Injury, the estimate of ultimate loss costs for the four-year period 2017 to 2020 increased by 6.3% due in part to higher emerged loss amounts than expected. This sensitivity should be considered in the trend selections.

For Bodily Injury severity specifically, referencing the chart immediately below, the starting period for Oliver Wyman's selected trend is 2011-1. However, we observe unusual data points in 2012 and have determined that including this data in the model leads to a poorer fit. We believe a more appropriate starting point is 2013-1. Based on this starting point, the adjusted R^2 is higher at 0.678 and the indicated trend is +2.07%.



Impacting both Bodily Injury and Accident Benefits coverages, we have observed a recent increase in legal involvement and disputes. Cycle times (ie. the time it takes to cycle through a claim, from the initial report until the claim is closed) began to increase in 2020 and 2021. Additionally, the COVID-19 pandemic has delayed treatments and return to work for injured claimants, along with many other well documented impacts. Loss costs for these coverages, as well as for the physical damage coverages, were notably lower during the pandemic period but this was a frequency story, not a severity story. As frequency returns to normal levels, and some insurers are reporting we're already at that point, we expect pre-pandemic trends to continue. For this reason, we believe Oliver Wyman's selected Accident Benefits trend of -0.8% in particular, for the period after June 1, 2016, is too low. Likewise, we believe Oliver Wyman's selected Bodily

Injury trend is also too low. We agree there is a tremendous amount of uncertainty at this time and will discuss the rationale for our trend selections for these coverages with our next rate filing submission, with the benefit of additional data and time.

Application of Industry Benchmarks

In the first iteration of FSRA's PPA Annual Review Guidance, FSRA clarified that "insurers will no longer be permitted to directly adopt the Benchmarks without justification" and that "FSRA requires that all actuarial assumptions be fully supported with an analysis of the insurers' own data, to the extent credible, regardless of whether FSRA Benchmarks are assumed." The industry benchmarks are an important tool for all insurers and their pricing actuaries. For larger insurers such as Co-operators, the Annual Review Report and the benchmarks offer another qualified point-of-view, that may challenge an actuary's thinking or confirm what the actuary is observing in their internal data and/or their selections.

We agree that insurers should be permitted to rely on their internal data and apply the selections or inputs derived from that data within their rate level indication calculation, provided full support is included. An actuary has intimate knowledge of its internal data, they have access to the insurer's internal experts to explain shifts or anomalies in the data and they partner with qualified internal personnel who make appropriate adjustments to the data or analysis as needed prior to the pricing actuary's selection. Additionally, internal data reflects the mix of business of the insurer which may be different or poorly represented by the industry data. It is our position that a qualified actuary should be given the flexibility to determine the appropriate dataset and to make selections for the rate level indication calculation. This represents the spirit of principles-based regulation.

Concluding Comments

We would like to thank FSRA for providing Co-operators, and our industry peers, with the opportunity to make written submissions in response to Oliver Wyman's draft report. We look forward to more opportunities to work collaboratively with FSRA along its transition to a principles-based regulatory approach.

As previously noted, 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 with respect to any of the topics discussed within this written submission, please do not hesitate to contact me at todd_saunders@cooperators.ca.

Todd Saunders
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Co-operators