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August 18, 2022

Financial Services Regulatory Authority of Ontario (FSRA)
25 Sheppard Avenue West, Suite 100
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Re: FSRA Annual Review

We welcome the opportunity to comment on Oliver Wyman's report on industry experience as part of FSRA's annual review for private passenger vehicles. This year's review is especially important given the unprecedented level of uncertainty in the market coming from inflation and changing driving patterns that makes it more challenging than usual to predict future auto insurance costs.

Inflation Challenges

Unlike historical trends where we see development over time, inflation emerged suddenly in the latter part of 2021, hitting the three main components of auto property damage costs:

1. Cost of replacing unrepairable vehicles
2. Repair costs
3. Vehicle rental costs.

Cost of Replacing Vehicles

The price of used vehicles is the main cost associated with replacing unrepairable vehicles. Because the pandemic allowed many Canadians to save more, the demand for vehicles increased. However, a combination of the pandemic, the global microchip shortage, and plant closures caused a shortage in new vehicles in the market. As Statistics Canada explains, used vehicles filled the gap and became more expensive.

> "Supply chain disruptions, notably for the semiconductor chips used in various components of newly manufactured vehicles, and pandemic-related plant closures continue to impact the manufacture of new vehicles, leading to reduced inventories. With fewer new cars and trucks available for purchase and lengthy delays for delivery of new vehicles purchased, consumers have sought out used cars, driving up demand. At the same time, fewer consumers are trading in their used models, creating a supply shortage in the used vehicle market. These shifting market dynamics have, consequently, resulted in steeper price increases for used vehicles than for new vehicles."

Autotrader reports that as of Q1 2022, the national average price of a used vehicle was $37,768, a 38% year-over-year increase, the highest on record. As for where used vehicle prices are headed, Canadian Black Book reports that they have started to decline but because they remain much higher than this time last year, it could take a while before they return to pre-pandemic levels.

Repair Costs

Because of supply chain challenges that caused a shortage of parts as well as inflationary pressures on the cost of labour, repairing a vehicle became more expensive. Fortunately, insurers with agreements with preferred repair shops have been able to absorb some of the underlying cost pressures. Nevertheless, although bound by current contractual agreements, these preferred shops are renegotiating their agreements with insurers to reflect the new economic realities.

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As an indication of what is coming, Boyd Group Services, one of North America's largest operators of non-franchised collision repair centres, reports that "the ability to service demand continues to be constrained by labor availability and parts supply chain issues" and that it has "successfully negotiated an unprecedented number of meaningful rate increases from clients, demonstrating that insurers understand the need for increasing pricing".

Vehicle Rentals

Vehicle rental costs are higher than usual for two reasons.
1. At the start of the pandemic, rental companies reduced their fleets to accommodate a sudden change in demand and cashflow. There are now fewer rental vehicles available to meet the increasing demand.
2. The difficulty in sourcing parts for repairs means that customers waiting for their repaired vehicle need to rent a vehicle for a longer period.

Statistics Canada reports that as of July 2022, the cost index for passenger vehicle rentals was 28.5% higher than the previous year. Although still high, rental costs have been declining since peaking in late 2021 as rental companies replenish their fleets.

Driving Patterns

Driving patterns are also changing quickly. Google mobility trends for Ontario show that retail mobility has reached pre-pandemic levels and workplace mobility, which remains below pre-pandemic levels, has been increasing. As people get more comfortable being out and more businesses implement their return-to-work models, people will likely drive even more. But where driving patterns and claims frequency settle is an unknown.

Recommendations

1. We agree with Oliver Wyman's approach of recognizing the current economic environment when calculating future loss cost trend rates. In addition to accounting for CPI data for vehicle maintenance and repair costs, as Oliver Wyman describes in its report, we recommend that insurers be allowed to account for the new CPI data on the price of used vehicles and the CPI data for rental of passenger vehicles. This way, insurers can account for the inflationary pressures facing the three main auto property damage cost components. We also advise FSRA to be open to other methods and data sources for recognizing inflation in future loss cost trend rates.

2. Given the level of uncertainty in the market from both inflation and changing driving patterns, FSRA will likely see a range of cost predictions from insurer to insurer, many of which might differ significantly from Oliver Wyman's trend rates. For this reason, we advise FSRA to approach each company's rate filing with a broader than usual interpretation of what meets the Insurance Act's just and reasonable criterion.

We hope FSRA finds these comments helpful as it finalizes its benchmarks for forthcoming rate approvals. We would be pleased to discuss our comments further.

Sincerely,

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