

Deloitte.



Alberta Grid rating

Demographic composition and subsidization

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Disclaimer

This report analyzes historical data, from years 2016 to 2021, in the Alberta personal auto-insurance market to assess the performance of the Grid rating system. The report was developed for the exclusive and confidential use of the Insurance Bureau of Canada (IBC). The report addresses many complex issues related to personal auto insurance and the Grid mechanism and therefore it should be read in its entirety before landing on any conclusions.

The scope of this report and the questions it attempts to answer are specific to IBC's mandate. We therefore caution the reader that Deloitte is not responsible for any consequences related to the usage of this report for any purposes other than reviewing the historical performance of the Grid rating system in Alberta.

Due to the evolving nature of the automobile insurance industry, the political environment, Grid ratings, and insurance operations, this report should be considered simply a representation of the current opinion of Deloitte specialists.

Executive summary

In October 2004, the Alberta government introduced the Grid rating program, or Grid, to the province's auto-insurance framework. Using a stepped point system ranging from -15 to +15 and above, Grid steps correspond to the highest premiums that insurance companies can charge for mandatory coverage (this includes third-party liability and accident benefits). Drivers pay the lowest premium of that determined by the Grid rate formula set by the Automobile Insurance Rate Board (AIRB) and by that of the relevant insurer's internal risk-classification framework.

The original purpose of the Grid was to provide new, inexperienced drivers access to affordable auto-insurance premiums. Over time, there's been a shift away from this intent; now the Grid provides subsidized premiums for high-risk drivers generally, including those with many years of driving experience and those with a history of claims and infractions. As a result, safe and experienced drivers in Alberta are paying significantly more in premiums than is actuarially justified to subsidize the premiums of high-risk drivers. This distorts the price signal that insurance companies can provide to incentivize safe-driving behaviour and works in direct opposition to other mechanisms—such as driving convictions and infraction penalties—intended to improve driving habits on provincial roadways.

In order to better understand the current function of the Grid, the Insurance Bureau of Canada (IBC) engaged Deloitte to work with the AIRB and others to assess the Grid's current framework and impacts, and to provide recommendations that can help better align the framework with its original intent and/or identify an alternative framework that better supports the affordability of new-driver premiums.

Reviewing Alberta's Grid structure

Working with industry data from seven medium- and large-sized insurers that make up approximately 80% of the private passenger vehicle auto-insurance market in Alberta, we investigated the demographic profiles of drivers capped by Grid premiums. We then analyzed the cost subsidy these drivers receive—the difference between an insurer's premium and the Grid premium when the latter is the lesser of the two.

Key findings

Given the parameters noted, we found that the current function of the Grid no longer aligns with its original intent. More than half of all drivers receiving a premium subsidy for auto-insurance premiums have more than seven years of clean driving and can no longer be considered new drivers. The level of subsidy provided to experienced drivers—as well as those with histories of claims and infractions—is also of concern. For example, those with 15 years of clean driving experience (Grid step -15) who are receiving a subsidy, receive an average subsidy of \$414 annually, while those with an extensive history of claims and infractions (Grid step +15) who are receiving a subsidy receive an average subsidy of \$9,859.

The following are some other of our findings:

- In 2021, total Grid subsidies were estimated to be \$180 million. This equates to an average 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;
- The average 15- to 18-year-old Grid driver, who receives a subsidy, is subsidized roughly \$1,709;
- Nearly 50% of the total subsidies are distributed to drivers aged 15 to 24;

- 33% of total subsidies are distributed to Grid drivers aged 36+. These drivers should not be receiving subsidized auto insurance premiums, as they fall outside the target demographic of the Grid’s original intent; and
- On average, high-risk drivers with histories of infractions and/or at-fault claims—i.e., those categorized in Grid steps +7 and above—receive subsidies of \$2,516 or greater. As per the previously noted group, these drivers aren’t among the Grid’s original target demographic and therefore should not be receiving these subsidies.

To realign the Grid with the program’s original purpose of providing new and inexperienced drivers with access to affordable auto-insurance premium Deloitte recommends the following reforms:

- Enabling minor-conviction surcharges beginning at Grid step 1, as opposed to the current Grid step 2
- Including at-fault claims, other than third-party liability claims, in moving drivers up or down Grid steps
- Reducing 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
- Restricting Grid access to drivers who’ve been licensed seven years or fewer; noting, that there is little public-policy rationale in providing subsidized premiums to high-risk drivers with histories of at-fault claims and/or infractions

In its current form, the Grid protects new, inexperienced drivers, as originally intended. However, significant subsidies are also being passed along to both experienced and high-risk drivers. With the number of drivers covered by the Grid increasing dramatically and vastly outpacing the growth in new drivers —indicating a continued expansion beyond the system’s original intent and current sustainability—it’s clear that significant reform is required. The recommendations outlined in this report are intended to help realign the current application of the Grid to its original intent, better support new drivers with affordable premiums, and reduce the overall financial cost of the Grid to Alberta’s drivers.

1. Introduction

1.1. Background on the Alberta Grid

Alberta's Grid rating program was introduced in October 2004 along with risk-sharing pools (RSPs). The purpose of the program was to cap basic-coverage premiums so that they would be affordable and sustainable for inexperienced drivers, while also penalizing those with poor driving behaviour. The Grid addresses these goals by:

- Setting a maximum premium that insurers can charge drivers for basic coverage
- Providing reasonable entry-level premiums
- Accounting for individual driving history
- Stabilizing premiums and preventing substantial annual increases
- Maintaining transparency in the rating process

The Grid consists of a stepped point system that ranges from -15 to +15 and higher, corresponding to the lowest and highest premium levels that can be charged. Where drivers are positioned on the Grid is determined by their years of experience and at-fault claim histories. As they gain experience, as well as years without claims and/or convictions, they move down the Grid and, as a result, the maximum premiums they can be charged are reduced.¹

For each driver, insurance providers must charge premiums at or below those set by the Grid. According to a 2021 report from the Automobile Insurance Rate Board (AIRB)—the most recent data available—7.1% of Alberta drivers are capped by the Grid.²

The Facility Association (FA) ensures that automobile insurance is available to high-risk drivers nationwide who otherwise might not be eligible under standard providers. In Alberta, FA operates the Facility Association Residual Market (FARM), a Grid RSP, and a non-Grid RSP. There is no limit to the number of risks allowed to transfer to the Grid RSP, whereas for the non-Grid RSP, risks are limited to 5% of an insurance company's non-Grid private passenger vehicle (PPV) risks. According to FA, the market share of Alberta PPV for 2020 across FA mechanisms was 0.1% for FARM, 2.3% for Grid RSP, and 2.4% for non-Grid RSP. Since the introduction of Grid and the two RSPs, the majority of FARM risks shifted to RSPs, which has resulted in a significant decrease in FARM risk. Meanwhile, the total number of risks in all FA mechanisms increased significantly after 2004 as a result of Grid and RSPs.

1.2. Purpose of this report

In order to better understand the current function of the Grid system, the Insurance Bureau of Canada (IBC) engaged Deloitte to work with the AIRB and others to assess the Grid's current framework and impacts, as well as to provide recommendations to help better align the framework with its original purpose.

Specifically, Deloitte analyzed industry data from seven medium- and large-sized insurers that constitute about 80% of the PPV auto-insurance market in Alberta in order to:

¹ Refer to Appendix C, Alberta auto insurance Grid rate calculator, for more details on Grid rate calculations.

² AIRB 2021 annual report, <https://airb.alberta.ca/about/annual-reports/2021/2021-airb-annual-report.pdf>

- Investigate the demographics and profiles of drivers whose premiums are more likely to be capped by the Grid; these factors include age, gender, years licensed, and number of driving-based convictions
- Calculate which driver demographic factors are subsidized according to the Grid, and to what degree
- Determine whether the demographics of Grid steps and subsidization levels align with the original purpose of the Grid
- Identify where the Grid system could be adjusted to better align the focus on new drivers—the group the system was originally intended to support
- Identify any other policy initiatives that could better match the original intent of the Grid

1.3. Past research into efficacy of the Grid

The AIRB updates the Grid yearly to reflect market rate-level trends, based on the annual Oliver Wyman trend-rate report. In each of the previous seven years, there have been annual rate increases to Grid premiums (see figure 1.3.1), reflecting an upward trend in overall claims costs; note, however, the rate decreased in 2022.

Figure 1.3.1: AIRB Grid rate-level changes, 2015–2022^{1,2}

| Year | Rate-level change |
|--------------------|--|
| (effective Jan. 1) | |
| 2015 | +7% (base rate change) |
| 2016 | +7% (base rate change) |
| 2017 | +8% (Base rate change) |
| 2018 | +10% (base rate change) |
| 2019 | +5% (base rate change) |
| 2020 | +15% (base rate change) |
| 2021 | +5% (base rate change) |
| 2022 | -31.9% (base rate and differential change) |

In a 2020 study commissioned by IBC, Dr. Ron Miller found that between 2012 and 2019, Grid-loss costs³ were significantly higher than non-Grid-loss costs, with losses overall showing an upward trend (see figure 1.3.2).

¹ AIRB orders archive, 2005–2018, <https://airb.alberta.ca/industry-information/communications/orders/archive/default-archive.aspx>

² AIRB orders, 2019–2021, <https://airb.alberta.ca/industry-information/communications/orders/>

³ Often referred as “claim cost per vehicle,” a grid-loss cost is the average amount insurers pay to cover the cost of all claims for all vehicles.

Figure 1.3.2: Compulsory-coverage loss costs and loss ratios (Grid and non-Grid), 2012–2019¹

| | Grid-loss cost | Grid-loss ratio | Non-Grid-loss cost | Non-Grid-loss ratio |
|------|----------------|-----------------|--------------------|---------------------|
| 2012 | \$1,280 | 99% | \$445 | 90% |
| 2013 | \$1,306 | 97% | \$477 | 93% |
| 2014 | \$1,409 | 101% | \$499 | 93% |
| 2015 | \$1,642 | 111% | \$546 | 96% |
| 2016 | \$1,614 | 101% | \$580 | 95% |
| 2017 | \$1,655 | 97% | \$643 | 99% |
| 2018 | \$1,762 | 97% | \$666 | 97% |
| 2019 | \$1,684 | 90% | \$693 | 94% |

While figure 1.3.2 shows that Grid-loss ratios have been improving overall, possibly due to past base-rate changes, IBC estimates that it will continue to experience high underwriting losses (see figure 1.3.3). Our analysis also shows that the proportion of drivers added to the Grid has been growing year over year—with a particular jump in Q1 2022, likely a result of relaxation of COVID-19 restrictions. Should this trend continue, it is therefore reasonable to expect Grid underwriting losses to trend upward, potentially affecting premiums charged to non-Grid drivers that are subsidizing the Grid’s capped drivers.

Figure 1.3.3: Estimated Grid vehicle underwriting losses (in millions), 2012–2019²

| 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Average |
|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| \$47.0 | \$43.1 | \$51.8 | \$78.1 | \$56.7 | \$48.9 | \$55.6 | \$41.8 | \$52.9 |

In 2020, FA revealed and analyzed Alberta RSPs’ market shares (see figure 1.3.4). The data shows that the number of drivers added to Grid and non-Grid RSPs in the recent past have been similar, even though the number of drivers capped by the Grid currently represents only around 7.1% of the market. Generally, insurers transfer cases they deem to be higher risk and inadequately priced. This discrepancy supports the view that insurers find a disproportionate number of their Grid risks to be inadequately rated, a condition that can be supported by the Grid’s historically poor underwriting performance.

¹ AIRB 2020 annual review report, <https://airb.alberta.ca/industry-information/annual-review/2020/>

² Ibid.

Figure 1.3.4: Alberta RSPs' market shares (written exposures/count basis), 2015–2019¹

| Year | Total W. count | Market share | Grid RSP | | Non-Grid RSP | |
|------|-------------------|--------------|----------|--------------|--------------|--------------|
| | | | W. count | Market share | W. count | Market share |
| 2015 | 119,658 | 4.3% | 61,813 | 2.2% | 57,845 | 2.1% |
| 2016 | 131,112 | 4.7% | 63,360 | 2.3% | 67,752 | 2.4% |
| 2017 | 132,941 | 4.8% | 66,524 | 2.4% | 66,417 | 2.4% |
| 2018 | 137,048 | 4.8% | 62,955 | 2.2% | 74,094 | 2.6% |
| 2019 | 153,870 | 5.4% | 80,752 | 2.8% | 73,119 | 2.6% |

In 2021, Oliver Wyman published its annual Grid indication study based on loss experience in accident years 2015–2019. Indications showed a 16.8% increase in raw base rates, which excludes the impact of direct compensation and property damage (DCPD) removal and reform savings that were effective as of January 1, 2022. This finding further implies that, historically, the Grid has been operating at a level that does not sufficiently cover claims costs.

Additionally, in 2021, there was residual rate indication of 13.9% from the previous year due, in part, to AIRB approving only a 5% rate increase (see figure 1.3.5). Continued rate increases that do not match the actuarial indication are expected to result in Grid premiums that are not sufficient to cover losses. The Grid's overall inadequate rate levels thus suggest that the number of drivers capped by Grid will continue to grow.

Figure 1.3.5: Oliver Wyman prior-rate indication, 2021²

| | |
|-----------------------------|--------|
| Prior rate-level indication | +18.9% |
| Approved rate indication | +5% |
| Residual rate indication | +13.9% |

In summary, past research on the Grid highlights a few key themes, including:

- The proportion of drivers ceded to the grid has been steadily increasing in recent years; barring any changes to methods and format, we expect this trend to continue.
- Insurers have seen high underwriting losses for risks submitted to the Grid, with losses possibly increasing.
- The Grid no longer serves its original intent, namely, to provide affordable auto insurance to inexperienced drivers. Instead, an overall rate deficiency has been forcing insurance companies to charge lower premiums to generally high-risk drivers, which in turn adds costs to Alberta drivers who are forced to subsidize the premiums of those on the Grid.

¹ AIRB 2020 annual review report, <https://airb.alberta.ca/industry-information/annual-review/2020/>.

² AIRB bulletin 07-2021, <https://airb.alberta.ca/industry-information/communications/bulletins/>.

1.4. Past consultations with insurers on the Grid

In the *AIRB 2020 annual review report*, the insurance industry voiced its concerns about the Grid's current framework and continued to advocate for its reform. Some of these concerns included:

- Grid-loss costs are significantly higher than non-Grid loss costs; these loss ratios from high-claims costs are financially unfavourable to insurers:
 - o Poor loss experience in the Grid system has resulted in significant rate subsidization by lower-risk drivers, which runs contrary to the original purpose of the Grid.
 - o Alberta's safe drivers are, as a result, forced to pay more than they normally would for their auto insurance in order to subsidize the province's less experienced and highest-risk drivers.
- Grid premiums have been inadequate and rate action has been insufficient:
 - o Grid rates should be increased beyond the 5% approved rate indication.
 - o Uniform rate changes have overlooked individual changes in Grid steps (while Grid-step differentials were adjusted in 2022, there was strong agreement that these may result in an increase in experienced drivers subject to the Grid).
 - o The Grid system is complex, inefficient, and costly, both from an insurer's perspective and for consumers overall.
 - o The determination of Grid step is limited by historical information available and, depending on the information an insurer can gather, could be inaccurate.
 - o The Grid system has significant operational and technological implications, adding unnecessary costs and cycle times to the overall insurance-assessment process.

1.5. Report exclusions

The following considerations are beyond the scope of this report and thus were excluded:

- A rate review to calculate Grid adequacy or actuarial indications
- An assessment of how individual insurers redistribute costs to drivers at specific Grid rated subsidy levels
- An assessment of the direct impact to policyholders of proposed changes to the Grid system
- A prediction of overall auto-insurance affordability in Alberta
- A commentary on emerging trends (e.g., the COVID-19 pandemic, artificial intelligence in actuarial pricing, electric vehicles) and how these might affect the Grid rating system

2. Procedures

2.1. GISA data request and analysis

Upon review of data exhibits from the General Insurance Statistical Agency (GISA), Deloitte requested customized AUTO1201 data for Alberta (data available up to December 2020).¹ The AUTO1201 grouping includes five years (2016–2020) of insurance information, broken down by Grid indicator and Grid step. To analyze Grid-step demographics, we requested inclusion of the following four tables so that several variables in addition to the usual factors could be assessed:

- Table 1: AUTO1201 data + driver’s age + driver’s gender + driver’s number of years licensed + statistical territories
- Table 2: AUTO1201 data + driver’s number of years licensed + number of years claims-free + driver training indicator + statistical territories
- Table 3: AUTO1201 data + driver’s number of type-A convictions + number of type-B convictions + number of type-C convictions + statistical territories
- Table 4: AUTO1201 data + driver’s number of at-fault claims + number of years licensed + number of years claims-free + statistical territories

All variables follow the standard definitions outlined in the *GISA Automobile Statistical Plan (ASP)* manual. Published AUTO1201 results include exclusions and/or adjustments that were not applied to the four previously noted customized tables. As a result, there are some minor inconsistencies in results between the standard AUTO1201 data and the numbers customized for our analysis; however, these discrepancies did not affect the overall results of our demographic analysis.

GISA data involves a larger population of written vehicles than does insurer data, so it proved a more robust source for our demographic analysis. More details on these analyses can be found in section 3.

2.2. Insurer data request and analysis

Deloitte, in collaboration with IBC, obtained the following data from seven mid- and large-sized insurers that together make up approximately 80% of the market in Alberta:

1. Historical or on-levelled premiums
 - a. Insurer premiums, not capped by the Grid
 - b. Grid premiums
2. Driver-level in-force data, with driver characteristics including:
 - a. Age
 - b. Gender
 - c. Number of years licensed
 - d. Number of driving-related minor, major, and criminal convictions
 - e. Grid step
 - f. Territory—either Calgary, Edmonton, Alberta’s northern district, or the rest of the province

¹ AUTO1201-AB—noted here as AUTO1201—offers an analysis of Alberta earned-loss ratios, claim frequencies, average costs per claim, and claim costs per earned vehicle, broken down by Grid step; <https://www.gisa.ca/Documents/View/2177>.

3. Identifiers for whether drivers were capped by the Grid

As noted, the initial data request was for five years of historical data. In some cases, insurers were not able to provide data that matched our request, either due to confidentiality restrictions or organizational limitations on the data-extraction process. For a full description of the resulting possible limitations on the research, please refer to section 2.4.

The purpose of requesting data directly from insurance companies was to calculate subsidization levels according to various driver characteristics. By comparing original insurer premiums (i.e., what an insurance company would have charged policyholders had the Grid not existed) with their Grid-calculated counterparts, we were able to calculate subsidies. For a full description of this calculation, please refer to section 4.

2.3. Stakeholder and industry consultations

As part of our research, we conducted several meetings with insurance companies and other key stakeholders (e.g., AIRB, FA). In addition, we considered written reports (both formal submissions and informal communications) from insurers. Different observations about the efficacy of the Grid arose during these consultations, which we found helpful in identifying data trends and producing what we feel is a more robust report.

Discussions that came up during these consultations included:

1. Whether the Grid is successful at achieving its objectives
2. Whether the Grid promotes or impedes innovation
3. How the Grid might be reformed, including alternatives to the system

For further details regarding findings and recommendations of these consultations, please refer to section 5.

2.4. Data restrictions and adjustments

Several restrictions and adjustments were identified during the data request and submission process, including:

1. Historical premiums versus on-levelled premiums

Our preferred data for the purposes of this report was historical premiums from each insurer. In some cases, an insurer could provide on-levelled premiums only as a substitute. We worked with the assumption that on-levelled rates were representative of the insurer's then-current standard premiums.

2. Limited years of historical data

Because some insurers could provide on-levelled premiums only, the number of years of data available from those insurers was limited. So, instead of the time-consuming exercise of running multiple extension-of-exposure analyses, we prioritized only the most recent year of on-levelled premiums for which data was available (2021). This resulted in smaller sample sizes for years prior to 2021 for the subsidy analysis. As a result, section 4 presents findings from 2021 alone.

3. Data granularity not at driver level

In some instances, insurers were able to provide data on vehicle-level premiums only, versus driver-level premiums. As we did not want to skew premium calculations in the subsidy analysis, vehicles with more than one driver were not considered in

our assessment. Fortunately, vehicle-only data with this issue accounted for less than 0.5% of our sample, so this adjustment did not have a material impact on our analysis.

3. Demographic analysis

3.1. Grid-capping proportions

Over the five-year horizon of 2016–2020, the proportion of drivers capped by the Grid increased. This trend is evident in figure 3.1.1, with an upward shift from 5.4% to 7.0% of drivers—a growth of 29.6%. During this period, an additional 107,000 drivers were added to the Grid, while those who saw their premiums capped increased by 50,000. This means that close to 50% of the growth in driving population met Grid-capping standards.



Key finding No. 1

The proportion of driver premiums capped by the Grid increased by 29.6% from 2016 to 2020.

Grid step -15 comprises the most drivers of any other Grid step; however, it also has a very low proportion of drivers capped by the Grid. This Grid step represents drivers with consistently clean driving records; insurers are generally more comfortable offering them lower premiums.

Figure 3.1.1: Drivers capped by Grid premiums, by accident year, 2016–2020

| Accident year | Percent of drivers capped by the Grid | Number of drivers capped by the Grid | Growth in number of drivers capped by the Grid (year over year) |
|---------------|---------------------------------------|--------------------------------------|---|
| 2016 | 5.4% | 145,510 | N/A |
| 2017 | 5.7% | 155,076 | 7% |
| 2018 | 5.7% | 157,545 | 2% |
| 2019 | 7.2% | 201,335 | 28% |
| 2020 | 7.0% | 195,821 | -3% |

Figure A.1.1 in Appendix A shows the number of written vehicles in each Grid step (except Grid step -15) and the proportion of those vehicles that are capped by the Grid. The largest number of written vehicles, outside of Grid step -15, can be found in Grid step -2 (this holds true for all accident years).



Key finding No. 2

Grid step -15 has the largest driver population of all Grid-capped drivers, followed by Grid step -2.

In 2020, step -15 accounted for 21% of all Grid-capped drivers and step -2 represented 14%.

The relationship identified in figure 3.1.1—a year-over-year increase in drivers being capped by the Grid—is consistent across all Grid steps. The largest overall increase across the Grid steps—Grid step 0, representing new drivers without driver training, with 28% capped in 2017 increasing to 44.7% capped in 2020—suggests that the Grid is acting as a safeguard against potential increases in premium rates for these Grid step 0 drivers. It is important to note, however, that the proportion of drivers aged 15–18 increased from 16% in 2017 to 20% in 2020, accounting for some, but not all, of the increase in numbers of capped drivers.

In Grid step –2, representing new drivers that have received driver training, there was also an increase in the proportion capped by the Grid; however, this increase is consistent with those seen in other Grid steps.

3.2. Grid-step demographics

Across each Grid step, proportion by age group is unique. This is shown in Appendix A, figure A.2.1.

Drivers by age

Young drivers have a substantial proportion of written vehicles at Grid steps higher than –8. As noted, inexperienced drivers with driver training start on the Grid at Grid step –2; here, there’s a higher proportion of drivers 15–18 years old. There are also substantial numbers of drivers in the 19–24, 25–35, and 36–55 age groups, followed by a smaller proportion of those aged 56 and older. A similar pattern is seen at Grid steps –1 and 0. Since we know that the percent of vehicles capped by the Grid is highest at steps 0, –1, and –2 (see Appendix A, figure A.1.1), this suggests that Grid capping is largely used for younger, new, inexperienced drivers.



Key finding No. 3

The Grid works to ensure premium affordability for young and inexperienced drivers, who are categorized in substantial proportions at Grid steps above –8.

Almost all drivers grouped below Grid step –10 are aged 25 or older, whereas almost all at Grid step –15 are 36 years old or more. These findings are not particularly surprising, as it takes several years of no at-fault claims to reach these Grid steps. However, these points may suggest a natural progression of age groups across Grid steps: –3 to –9, –10 to –14, and –15. This could be explored to set step-number starting points if the intention is to combine Grid steps.



Key finding No. 4

The data suggest that, at the lower end of steps, there has been a deviation from the original purpose of the Grid rating system: Grid steps below –10 include only older and experienced drivers. However, there was no original intention for experienced drivers to obtain lower Grid premiums.

Analyzing Grid step –10, we see that the demographics closely resemble those of Grid step –15. This can be attributed to drivers in the latter group who have one at-fault claim and

are thus automatically moved five steps up to Grid step -10. The result is an age-group demographic shift upward at step -10. This is validated in Appendix, figure A.2.5: there is a spike in Grid step -10 for drivers with 0 years of claims-free status.

Driver training

The proportion of drivers who have driver training is shown in Appendix A, figure A.2.2. This table shows the number of new drivers entering the Grid rating system. In Grid step -2, for example, we see that a large proportion (just above 50%) have completed driver training. Then, as those new drivers gain years of experience, we see them move either up or down Grid steps. There is a large proportion of drivers with driver training at Grid step +3, corresponding to new drivers with one at-fault claim in their first year.

Grid steps -1 and 0 have the largest proportions of drivers with no training. These steps indicate the Grid starting points of inexperienced drivers with no driver training, as reflected in the data.

Gender

There is a slightly higher number of written vehicles for males than for females, particularly at Grid steps below 0 (see Appendix A, figure A.2.3). Notably, for all Grid steps, the proportion of males with capped premiums is larger than the corresponding proportion of females. For example, in Grid step -2, 40% of males had their premiums capped, compared with only 16.4% of females. However, the Grid rating system does not differentiate risk based on gender. Other confounding factors (e.g., convictions) might contribute to this capping difference; however, males generally appear to be considered by insurers as higher-risk drivers than females in the same Grid step.

Driver location

From the proportion of vehicles by statistical territory (refer to Appendix A, figure A.2.4), we see that almost all Grid steps follow a similar pattern. The largest proportion of written vehicles are from territory 100 (the rest of Alberta), territory 101 (Calgary), and territory 102 (Edmonton), followed by a smaller proportion in territory 105 (the northern district).

The only exceptions appear to be in Grid steps 0 and -15, both of which have higher proportions of written vehicles in territory 100 (the rest of Alberta).

Claims history

The proportion of written vehicles by number of years claims-free is shown in Appendix A, figure A.2.5.

Here, we see that as a driver moves from Grid step +15 to -15, the number of claims-free years generally increases. However, there are two exceptions:

- i. At Grid steps +13, +14, and +15 and beyond, there is a larger-than-expected proportion of drivers that have been claims-free for 6 or more years. It might be counterintuitive, but this finding represents drivers that were grouped at very high Grid steps (likely above +15) who have slowly improved their driving records over the last number of years.
- ii. At Grid step -10, we find an unusually large spike of drivers at 0 years claims-free. This represents drivers who had previously been in Grid step -15 (possibly for many years) but who then have one at-fault claim that drops them to Grid step 10. This

sudden-shift concept was previously identified in discussions of figure A.2.1 in Appendix A.

Years licensed

In Appendix A, figure A.2.6, we see written vehicles by number of years licensed.

Drivers that are licensed for 0 years make up the largest number of written vehicles in Grid step 0. Those licensed for one year are the largest corresponding proportion in Grid step -1, and those licensed for two years make up the majority of written vehicles in Grid step -2. This pattern continues for Grid steps -3, -4, and beyond.

Convictions

For all Grid steps, most written vehicles are not associated with any minor convictions (see Appendix A, figure A.2.7). There are, however, substantial numbers of written vehicles across all Grid steps that have one minor conviction each. For the most part, the trend of minor convictions progresses in line with Grid steps: As drivers move up the Grid steps (i.e., from lower- to higher-risk drivers), they tend to have accumulated more and more minor convictions.

4. Subsidy analysis

Under the application of the Grid system, a policyholder's premium can be capped, meaning that an insurer can't charge the full amount they believe necessary to cover expected claims, expenses, and profit loading. A subsidy is the difference between the insurer premium and the Grid premium if the Grid premium is the lesser of the two.

An important consideration when discussing subsidies is redistribution of costs. The millions of dollars of subsidies that arise as a consequence of the Alberta Grid are not solely absorbed by insurance companies. These costs are shared by other policyholders, in essence penalizing drivers who are not capped by the Grid. Identifying where subsidies lie in the Grid system is vital to understanding who is benefiting/losing-out the most from the framework.

Total subsidies for the seven insurers who provided industry data for the purposes of this report were approximately \$143.8 million in 2021, representing 31.6% of full insurance rates for drivers capped by the Grid. As these seven insurers represent approximately 80% of the Alberta personal-auto market, total Grid-enabled subsidies across all insurers is estimated to be in the range of \$180 million.

4.1. Subsidy by Grid step in 2021

A summary of total, average, and range of subsidies can be seen in Appendix B, figure B.1.1. Totals were highest at Grid step -2, followed by 0 and -15. Subsidies between steps 0 and -15 constituted about 95.4% of the overall total (see figure 4.1.1). This imbalance may be attributed to the higher number of exposures in the 0 to -15 group. The total subsidy amounts in Grid steps 0, -1, and -2 align with the original objectives for the Grid: protecting new drivers with affordable insurance. Notably, Grid steps 0 and -2 comprised about 36.2% of total subsidies.

Total subsidies are substantial at Grid step -15; although the proportion of drivers capped by the Grid is small, this step has the largest number of written vehicles of any other in the Grid system, so it follows that total subsidies are large. However, to reach step -15 requires that drivers maintain clean records for many years; therefore, a large number of experienced drivers are receiving subsidies. Section 4.2 examines the relationship between age and subsidy, which further demonstrates that experienced drivers (i.e., those aged 35 and older) have been receiving subsidies.

With total subsidies normalized by exposures, average subsidies¹ at step -2 and above trended higher than those below. Step 15 or higher had the highest average subsidies, suggesting that drivers with the worst records were highly subsidized. Those at step -15 had the lowest average subsidies, implying that these very experienced drivers with good records do not need to be subsidized as much as those who were either inexperienced or had poor driving records.

Step 8 showed the widest range in subsidies, followed by steps 15 and above. Qualitatively, range sizes were more consistent from step 1 to -15 than from step 2 and above. Inconsistencies in range at higher Grid steps could be partly attributed to smaller sample sizes: the tendency for minimum subsidies to be higher at these Grid steps suggests that

¹ All references to average subsidies in this section are conditional, except for the \$65 per driver estimate on page 19. In other words, "average subsidy" refers to the average subsidy for those drivers that qualify for a subsidy. It does not represent the average subsidy for all drivers, regardless of whether they were capped by Grid rating.

drivers with poor driving records receive larger subsidies than do those with good driving records.

Figure 4.1.1: Summary of Grid subsidies

| Grid steps | Total exposures | Total subsidies | Percent of subsidies |
|--------------------|-----------------|-----------------|----------------------|
| 0 to -15 | 169,226 | \$137,189,556 | 95.4% |
| 1 to +15 or higher | 3,297 | \$6,594,312 | 4.6% |
| Total | 172,523 | \$143,783,868 | 100% |

As noted previously, total Grid subsidies in 2021 were nearly \$144 million, representing 80% of insurers. This implies that total subsidies across all insured drivers in the province is around \$180 million, or \$65 per driver¹.



Key finding No. 5

Total Grid subsidies in 2021, based on data provided by 80% of the market, were nearly \$144 million.

4.2. Subsidy by age in 2021

Figure 4.2.1 examines total subsidies by age group and shows the highest total subsidy was in the 19 - 24 age group, followed by the 15 to 18 age group (see also Appendix B, figure B.2.1). Together, these two age groups comprise 49.7% of the total subsidies in 2021. The age group 36 to 55 also had the highest total exposures, followed by the 19 to 24 age group and the 25 to 35 age group. Fifty percent of the total subsidies were applied to drivers aged 25 or higher, with 32.5% received by drivers aged 36+.

The age distribution of average subsidies in Appendix B, figure B.2.1, shows the highest average subsidies in the 15 to 18 age group, followed by the 19 to 24 age group. Altogether, the results support the Grid’s objective of assisting the young and inexperienced drivers who were deemed to be risky by the insurers. That said, there is still a large volume of subsidies being provided to drivers 25 and over.

It is possible that some of these older drivers have fewer years licensed and therefore receive subsidies that are aligned with the original intent of the Grid. For example, drivers who have recently immigrated to Canada and do not have any driving experience in Alberta. However, our analysis shows that drivers with at least seven years licensed still received a total subsidy of \$56 million in 2021. Clearly, a large volume of subsidies were allocated to both older drivers and drivers with many years of driving experience in Alberta.

¹ GISA data from 2020 shows approximately 2.8 million insured vehicles in Alberta

Figure 4.2.1: Summary of total subsidies by age, in 2021

| Age | Total exposures | Total subsidies | Percent of total subsidies |
|-------|-----------------|-----------------|----------------------------|
| 15-18 | 17,833 | \$30,481,333 | 21.2% |
| 19-24 | 38,825 | \$41,350,166 | 28.5% |
| 25-35 | 36,561 | \$25,232,376 | 17.5% |
| 36-55 | 47,992 | \$27,117,400 | 18.9% |
| 56+ | 31,311 | \$ 19,602,593 | 13.6% |



Key finding No. 6

The young and inexperienced drivers from age 15 to 24 received nearly 50% of the total subsidies.

The experienced drivers aged 25+ received the other half of the total subsidies with 32.5% received by drivers aged 36+. This age group represents drivers that fall outside of the target demographics under the Grid’s original intent.

4.3. Subsidy by minor convictions in 2021

In 2021, drivers with no minor convictions received the highest total subsidies (see Appendix B, figure B.3.1), although this was a result of the majority drivers also having no minor convictions that year. Additionally, as the number of minor convictions increased, total subsidies decreased. Thus, the Grid subsidized those with safe-driving records.

Considering average subsidies by minor convictions, we see an increase in this average with increases in minor convictions, except for those with nine convictions. However, the sample size for the nine-convictions group was extremely low, so this result may not reflect real-world data.

The large variation in high minor-conviction counts suggests that the rules and rates for calculating premiums are quite different among insurers, resulting in some drivers receiving small subsidies while others received substantial amounts.

5. Stakeholder and industry interviews

Insurance companies have expressed concerns with the current Grid system. In our interviews, these businesses agreed with the objective of ensuring inexperienced drivers have access to more affordable auto-insurance premiums; however, they questioned the Grid system's efficacy in addressing this issue.

Companies reiterated a need to balance pricing sophistication with IT complexity and cost of implementation/maintenance. If the Grid algorithm evolves to include more rating variables and refined segmentation, this would likely require insurance companies to undergo expensive systems work to upgrade their current rating infrastructure. However, these changes to rating frameworks may allow the Grid to offer improved risk segmentation, which could lead to a lower prevalence of adverse selection and, ultimately, more affordability for policyholders.

5.1. Outdated/inadequate Grid algorithm

One of the main concerns expressed by insurers concerns the Grid rating algorithm. According to them, insurance pricing and actuarial techniques have evolved since the inception of the Grid system. Meanwhile the Grid rating algorithm has not changed, with updates to base rates and rating differentials only.

The following are the most significant areas for improvement in the Grid rating system identified by insurers:

1. Minor-conviction surcharge

Currently, this additional fee comes into play at two convictions. However, any number of convictions is indicative of higher-risk driving behaviour. Starting this surcharge at two convictions could potentially result in insufficient segmentation; beginning with one conviction might better control for certain risks. One important consideration to keep in mind is the possibly high correlation between a young driver and having just one minor conviction.

2. At-fault claims for Grid-step location

Currently only third-party liability at-fault claims affect the Grid step and premium. This allows some drivers with poor driving behaviour (for example, those with at-fault collision claims) to unfairly benefit from the Grid's rating structure.

3. Lack of segmentation

Variables used in premium determination are limited and significantly less sophisticated than those commonly used in industry pricing. For example, considering existing variables, only three defined territory differentials affords very limited geographical segmentation. Other variables that could be considered for the rating algorithm include CLEAR rate groups, type/model of vehicle, and interaction terms between driver's age and years licensed.

5.2. Inefficiencies and hindrances to innovation

Insurance companies noted inefficiencies in the Alberta Grid system that potentially stifle innovation in the industry, potentially leading to higher-than-average premiums for policyholders. These organizations believe their approved rates are risk-based, and that they are fair and equitable based on analyses of loss experience. They feel that risks capped by the Grid, especially those at Grid step -10 or lower, create inefficiencies in the Alberta's personal-auto-insurance ecosystem.

The following are identified areas of concern about Grid-system efficiency:

1. Rate adequacy

Insurers determine rates that are adequate for their book of business, all subject to AIRB approval. However, there are concerns that approved rates are already below insurers' indicated rates. This is because Grid rates impose caps on the risk-based rates already approved by AIRB.

2. Grid duration/step

The Grid may have too many steps, with drivers subject to this rating system for too many years. Currently, Grid steps can be as low as -15, for drivers with at least 15 years of experience. However, the original intention of the Grid was to assist inexperienced drivers (usually defined as those licensed for less than six years). Thus, with these low steps, the Grid allows some experienced drivers to be charged unfair auto-insurance premiums.

3. Usage-based insurance

Usage-based insurance (UBI) is an innovative approach that can help low-exposure drivers (i.e., those that aren't driving a lot) find affordable policies. Under this system, the premiums that policyholders pay are directly related to driving frequency and, in some cases, can be tied to driving behaviour. But it is difficult for insurers to implement UBI while still being required to compare rates to the Grid. Further, the FA does not accept UBI policies in Grid RSPs, thus resulting in higher claims costs for insurers.

5.3. Trend of increasing proportion of drivers capped by the Grid

Figure 3.1.1 seems to confirm an idea that many insurers have shared over the last several years: that the number of drivers capped by the Grid is increasing. This is true across virtually all Grid steps and demographics. Insurers have expressed concern that there has not been enough action to curb this upward trend.

In addition to the prevailing trends of recent years, Grid rates effective as of January 1, 2022, have worsened the situation. This rate decrease—with the assumption of direct compensation and property damage (DCPD) removal and reform savings—has resulted in even more drivers being capped by the Grid. FA projects that the number of vehicles placed in the Grid RSP will nearly double to 133,000 (from 77,000 in 2021), based on observations made as of the end of Q1 2022.

6. Conclusion and recommendations

This report adds to previous research conducted on the Grid by using data from GISA and insurance companies to:

- Investigate the demographics and profiles of drivers whose premiums are more likely to be capped by the Grid; these factors include age, gender, years licensed, and number of driving-based convictions
- Calculate which driver factors are subsidized according to the Grid, and to what degree
- Determine whether the demographics of Grid steps and subsidization levels align with the original purpose of the Grid
- Identify where the Grid system could be adjusted to better align the focus on new drivers—the group the system was originally intended to support
- Identify any other policy initiatives that could better match the original intent of the Grid

Interviews with industry stakeholders discussed in section 5 provided several qualitative suggestions to help improve the Grid. One such proposal stood out as both logically sound and supported by the historical data analyses presented in section 3 (demographic assessments) and section 4 (subsidy assessments): placing limits on the number of years that drivers can be subjected to Grid ratings.

However, Deloitte has yet to quantify the potential impact to insurers, policyholders, and/or regulators as a result of implementing any of these suggested changes.

6.1. Helping young, inexperienced drivers receive affordable insurance

Section 3 (notably associated figures A.2.1 and A.2.7 from Appendix A) offers a discussion of the number of young drivers that are in Grid steps 0 and –2. Further, section 4 (notably the portion on figure B.1.1 from Appendix B) shows the large subsidies these Grid steps are receiving. The Grid assists young, inexperienced drivers by capping the amount of premiums they can be charged, an action that is in line with the original intent of the Grid.

6.2. Subsidies for good, experienced drivers

The data has shown that a significant number of drivers capped by the Grid are good and experienced drivers and categorized at steps –7 to –15; this group accounted for 52% of all capped drivers in 2020. However, this is inconsistent with the original intent of the Grid: to ensure affordable auto insurance for inexperienced drivers.

Focusing on Grid step –15, which is linked with the largest number of experienced drivers of all Grid steps, we see yet another deviation from the system’s original purpose. Drivers at this Grid step (categorized as good, experienced drivers) receive significant subsidies—an average of \$414 per driver. Not only is this relatively high, but, because of the multitude of drivers, step –15 results in a very large total subsidy (\$22.5 million).

In fact, this driver profile is not one that needs to be protected through a Grid rating system.

6.3. Subsidies for poor, experienced drivers

Toward the higher end of the Grid's steps (step 6 and above), there are examples of poor, experienced drivers. Their numbers are relatively few (less than 0.5% of all drivers capped by Grid), but their average subsidies can be quite high. At Grid step 15 or above, for example, the average subsidy is \$9,859. This is in opposition to the previously discussed original intention of the Grid. These hefty subsidies can also contribute to higher premiums for Alberta's good drivers.

6.4. Policy recommendations

As noted, section 5 offers several recommendations from insurers. We believe that the following two suggestions could lead to quick, positive improvements to the Grid by helping to isolate the impact to higher-risk drivers:

- 1) Implementing surcharges beginning with one (as opposed to two) minor convictions
- 2) Including at-fault claims, other than third-party liability claims, in movements across Grid steps

Additionally, in the short term, differentials for certain Grid steps could be changed (e.g., using a phase-out approach over three years, in which subsidies for Grid steps lower than -7 are reduced by 33% annually until they're eliminated). Admittedly this would deviate from selecting differentials based on what traditional actuarial indications support. However, actuarial support is not relevant in this situation; rather, it's important to recognize that premium subsidies are not in line with the original intent of the Grid. To avoid instances of significant dislocation to individual policyholders, many insurance companies already have implemented premium capping. This will assist with premium stability during the transitional period.

In the medium to longer term, additional structural policy changes can help promote more innovation, competition, and market-based pricing. This is especially true regarding improvements in automobile and driver technologies, UBI, and telematics, which is arguably leading to increased risk segmentation. While insurers are becoming more technologically capable and are ready for advancements to the Grid rating system, it is important that any structural changes strike a balance between pricing sophistication and ease of implementation.

Assuming advancements do lead to stronger risk segmentation, it is also important to balance increasing segmentation with protection of young, inexperienced drivers, all the while being careful not to unnecessarily subsidize poor, more experienced drivers.

Aside from the current Grid program, there are other mechanisms available to assist young and inexperienced drivers with premium affordability while promoting road safety. These mechanisms have been implemented in other provinces and serve the same purpose as the Grid's initial mandate – for example, discounts for driver training or discounts for safe driving behaviours through UBI and telematics. Whilst take-up of these options may be voluntary, it nevertheless encourages young or inexperienced drivers (in particular) to take some responsibility for their own driving habits and rewards them with more affordable premiums.

To realign the Grid's original intent with current practice, we recommend that AIRB:

- 1) Limits the number of years that drivers can be subjected to Grid ratings: It is evident that in its current form, the Grid can protect young, inexperienced drivers; in the meantime, significant premium subsidies are being passed along to experienced

drivers (those at steps -7 to -15), which is in opposition with the Grid's original purpose.

- 2) Assesses whether the Grid should apply to drivers for only a predetermined, specified number of years post-license.

If implemented, these revisions would require a fundamental change to Alberta's personal auto-insurance regulations. However, the result could be a more effective and efficient support structure, helping to ensure affordable premiums for new drivers while mitigating the significant costs the current Grid structure places on drivers overall.

Finally, if these recommendations are implemented, it will be important to monitor the level of subsidy in a similar study to the one conducted in this report. Monitoring will allow AIRB to assess whether the recommended changes are having the intended affect and they can address any concerns as they rise.

Appendix A: Demographic analysis

Figure A.1.1: Proportion of drivers capped by Grid premium, Grid step, and accident year (2017-2020)

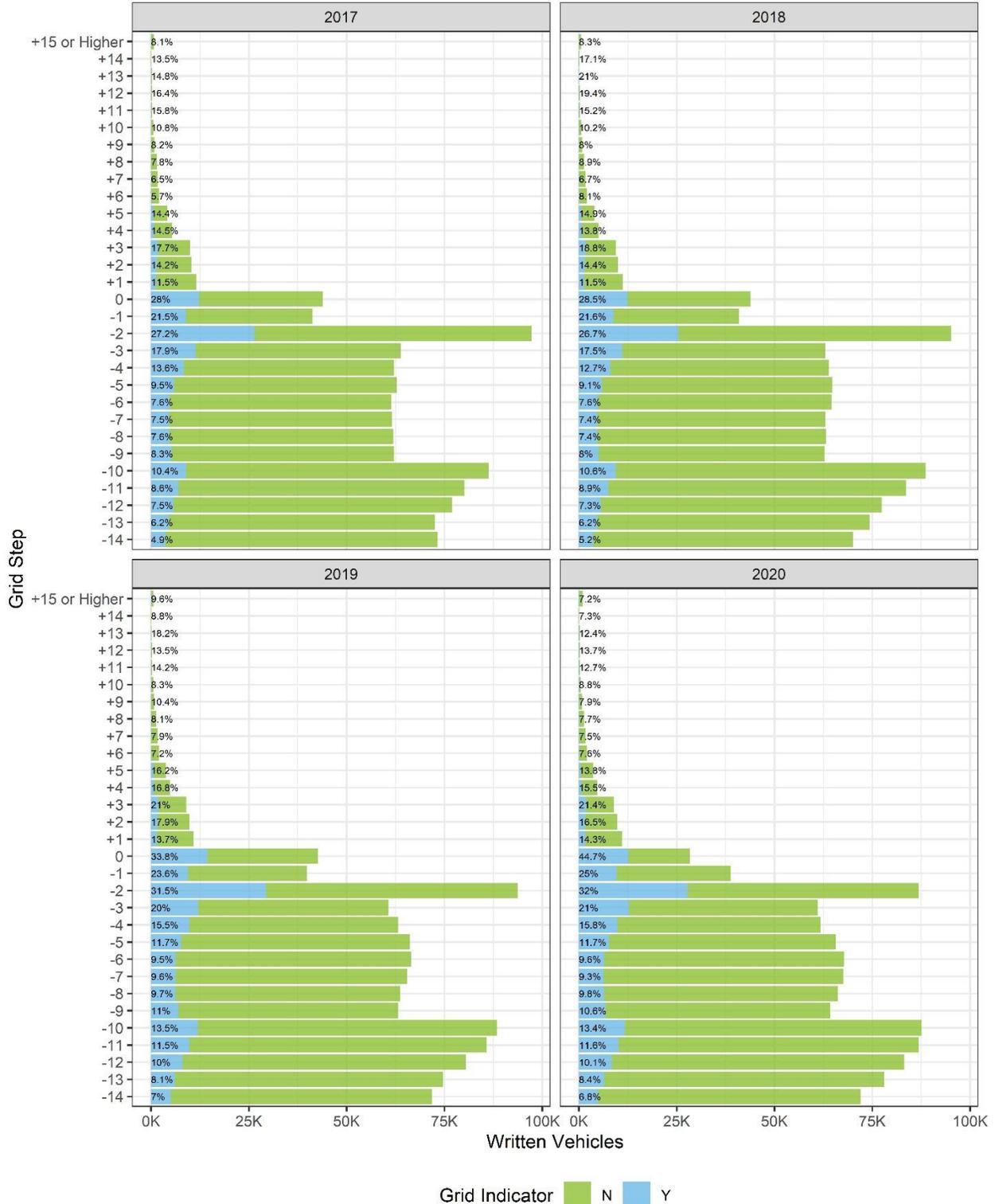


Figure A.2.1: Proportion of written vehicles by age group and Grid step

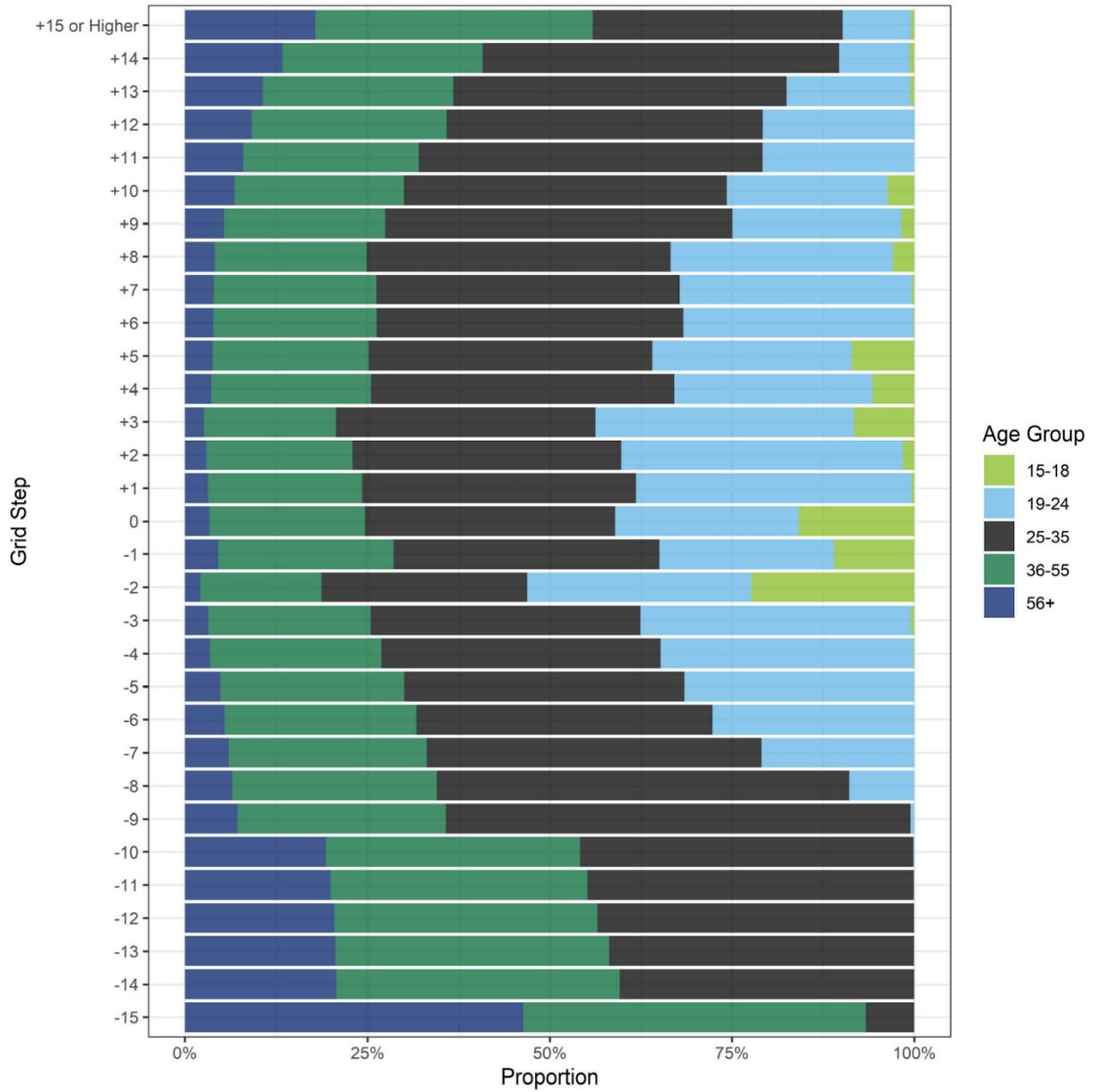


Figure A.2.2: Proportion of written vehicles by driver training and Grid step

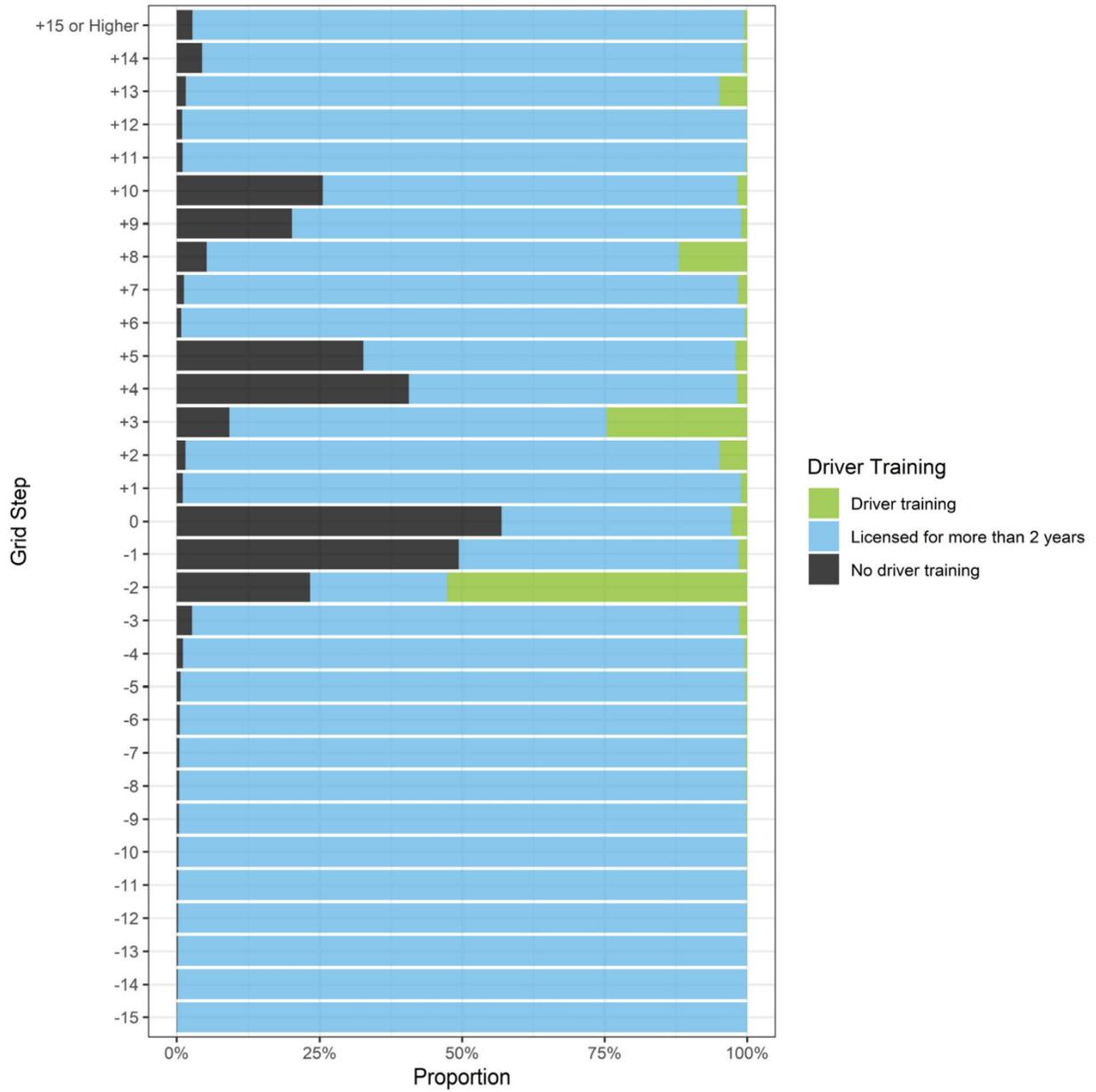


Figure A.2.3: Written vehicles by gender and Grid step

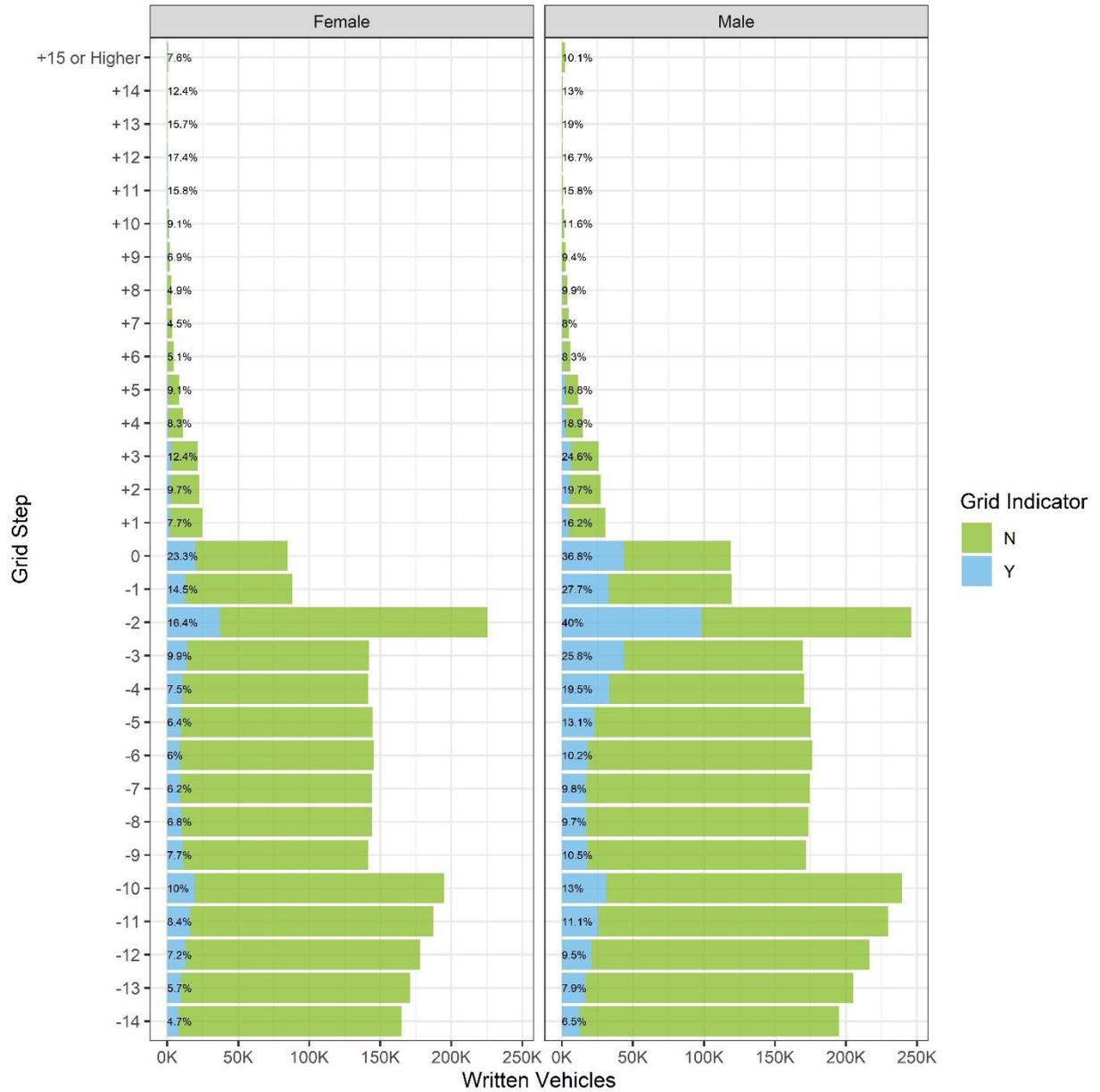


Figure A.2.4: Proportion of written vehicles by statistical territory and Grid step

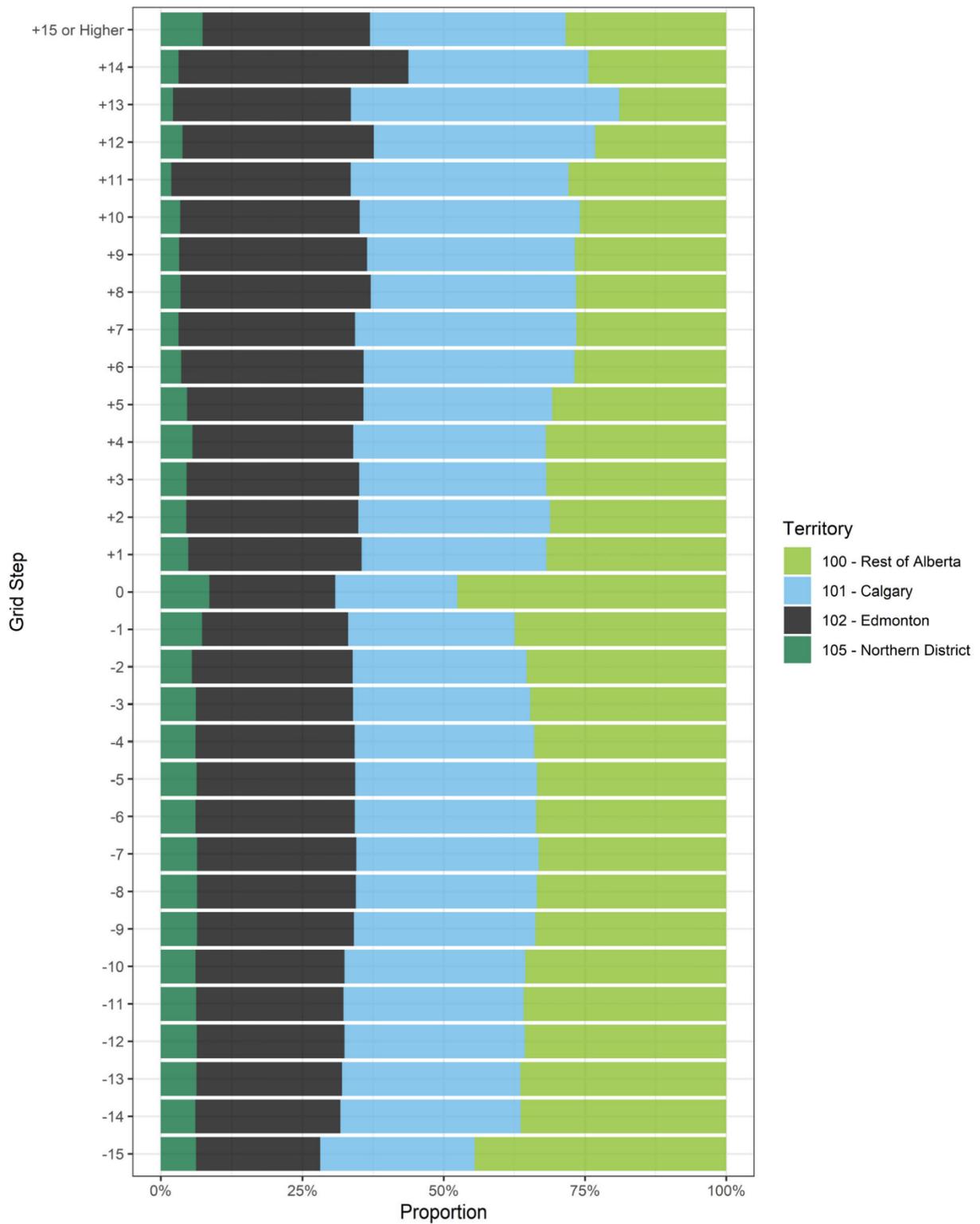


Figure A.2.5: Proportion of written vehicles by number of years claims-free and by Grid step

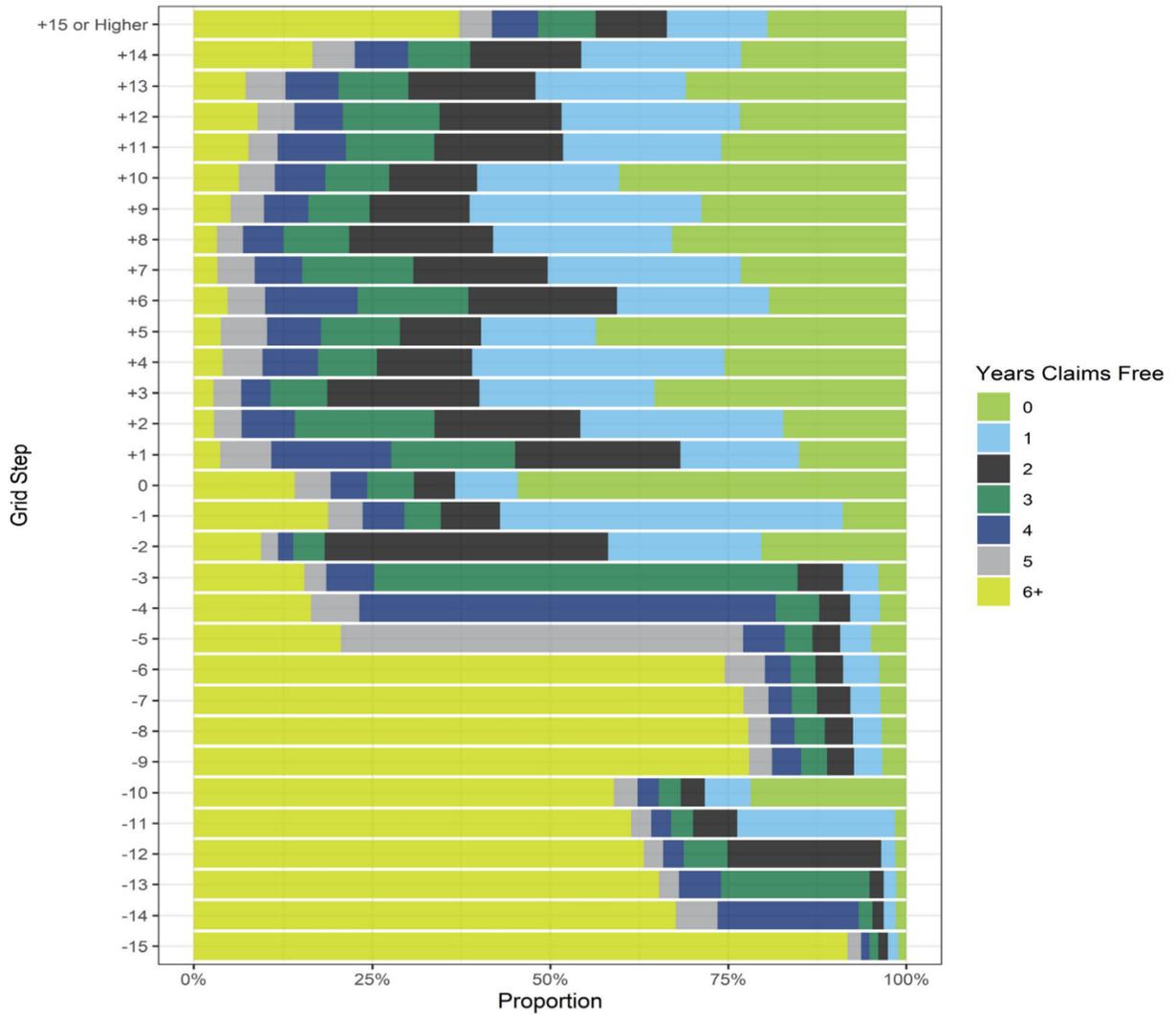


Figure A.2.6: Proportion of written vehicles by years licensed and Grid step

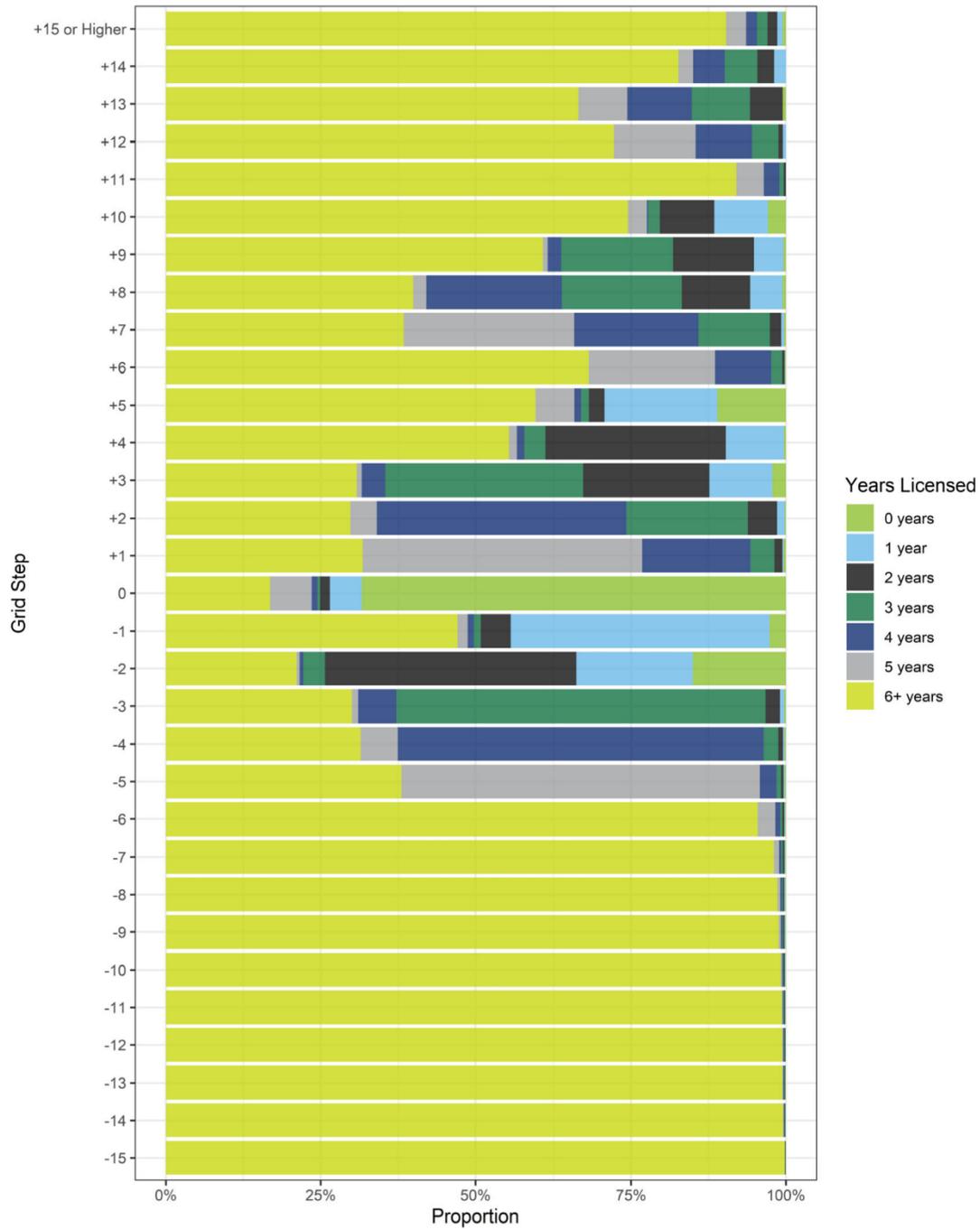


Figure A.2.7: Proportion of written vehicles by minor convictions and Grid step

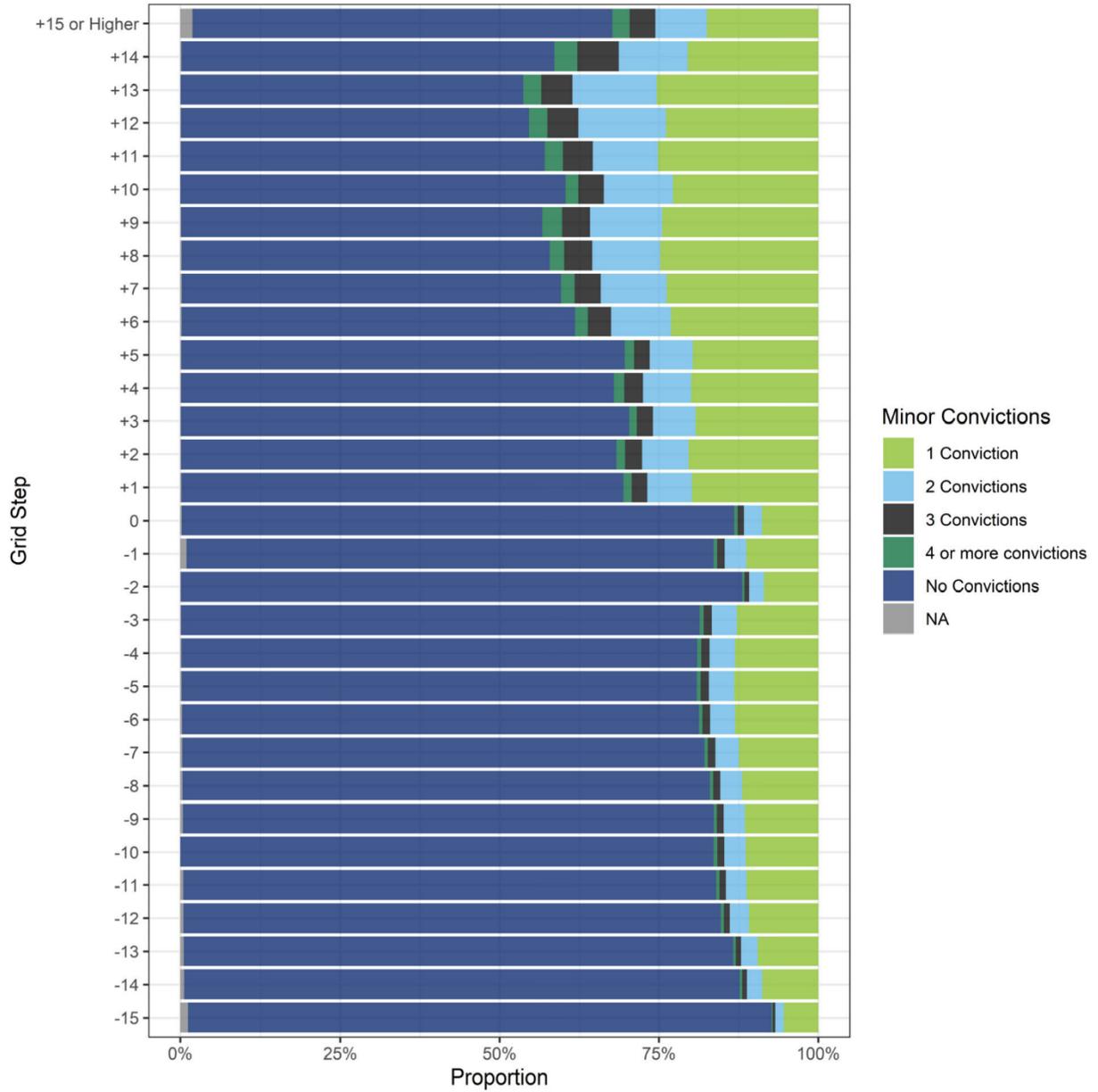


Figure A.3: Average age by Grid step

Average age was approximated using linear interpolation of the age group column from GISA data. For example, for age group 25–35, we assumed all drivers were aged 30.

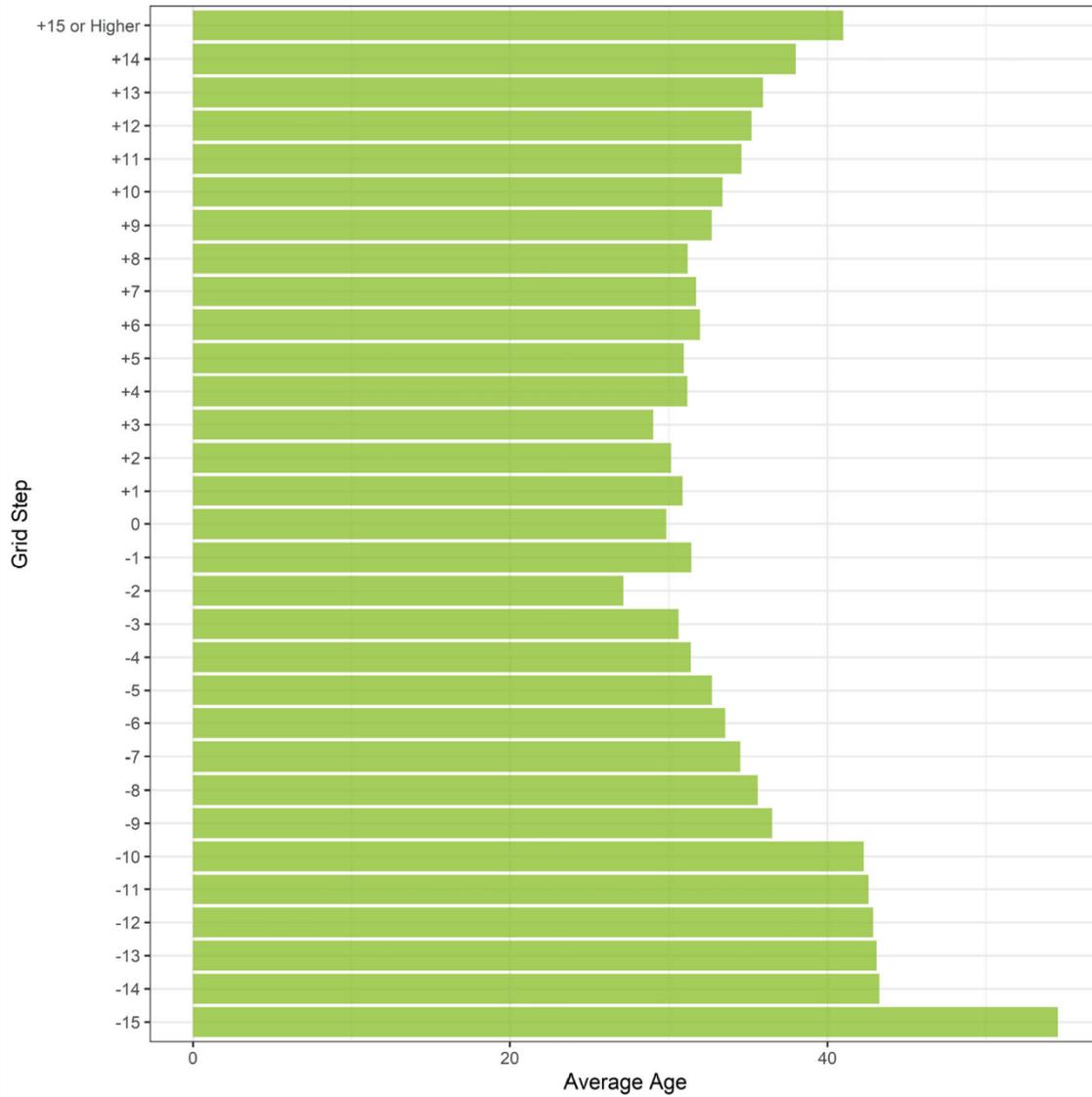


Figure A.4: Proportion of written vehicles by at-fault claims, by Grid step

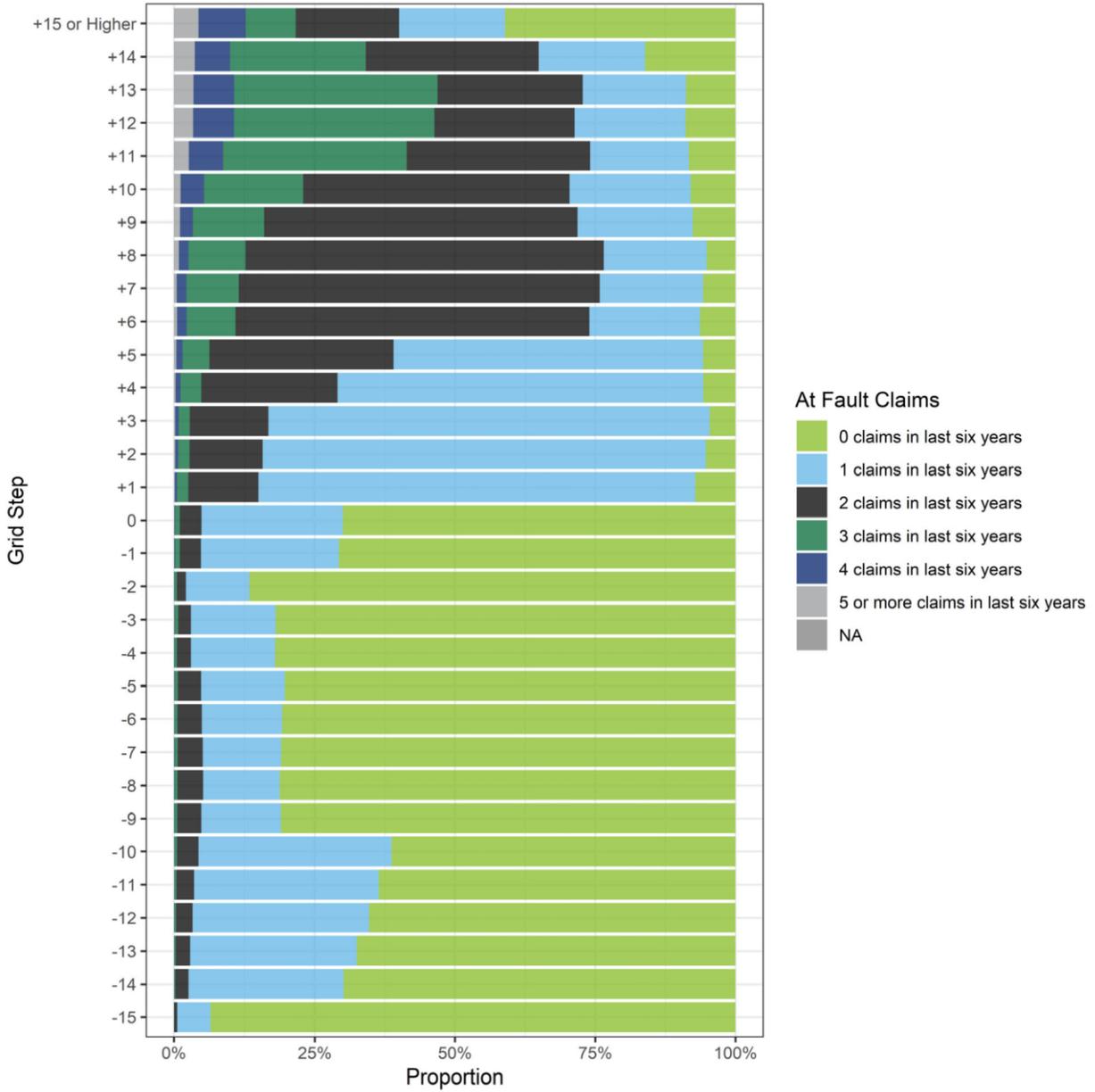


Figure A.5: Proportion of written vehicles by criminal convictions and Grid step

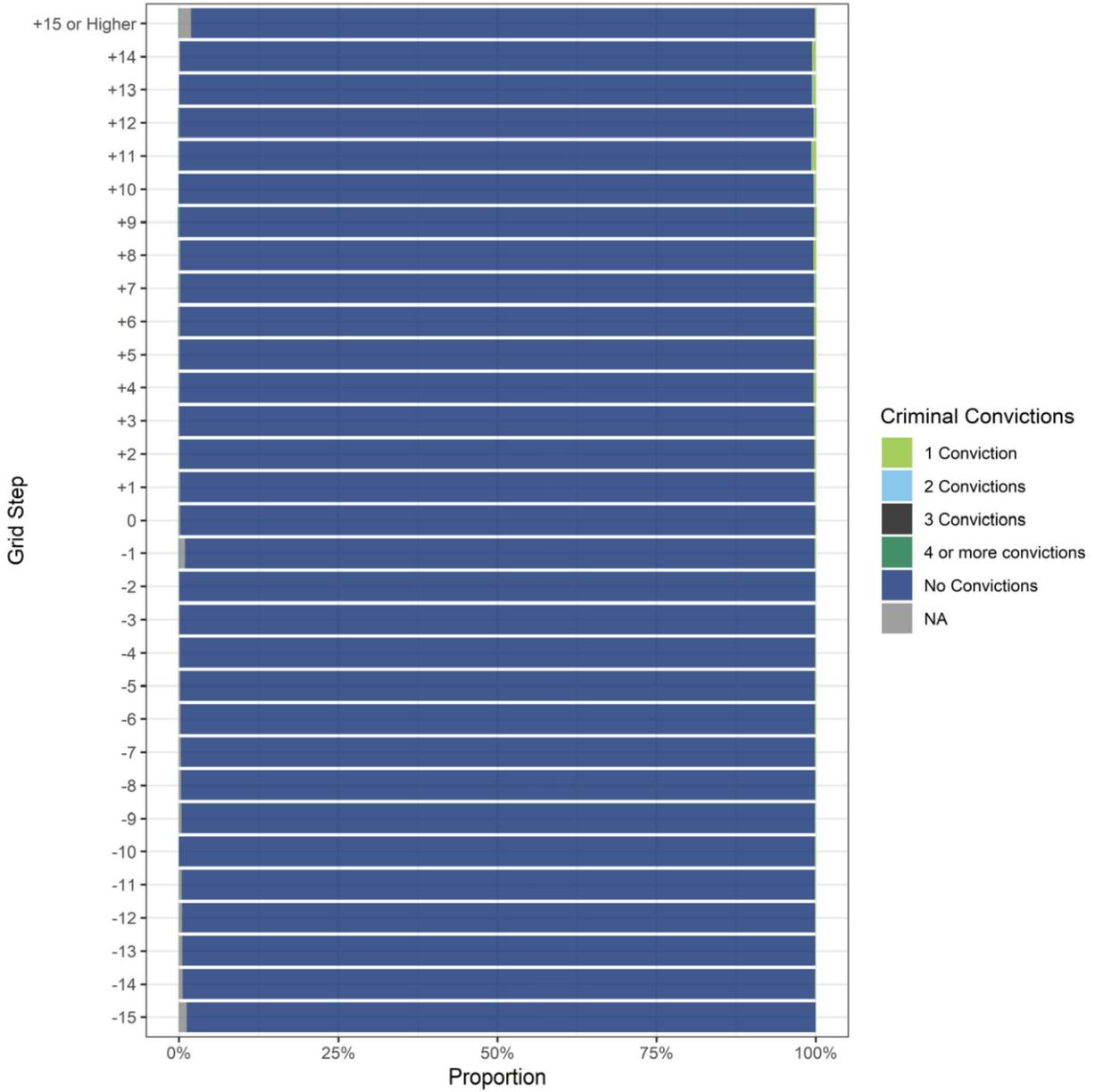
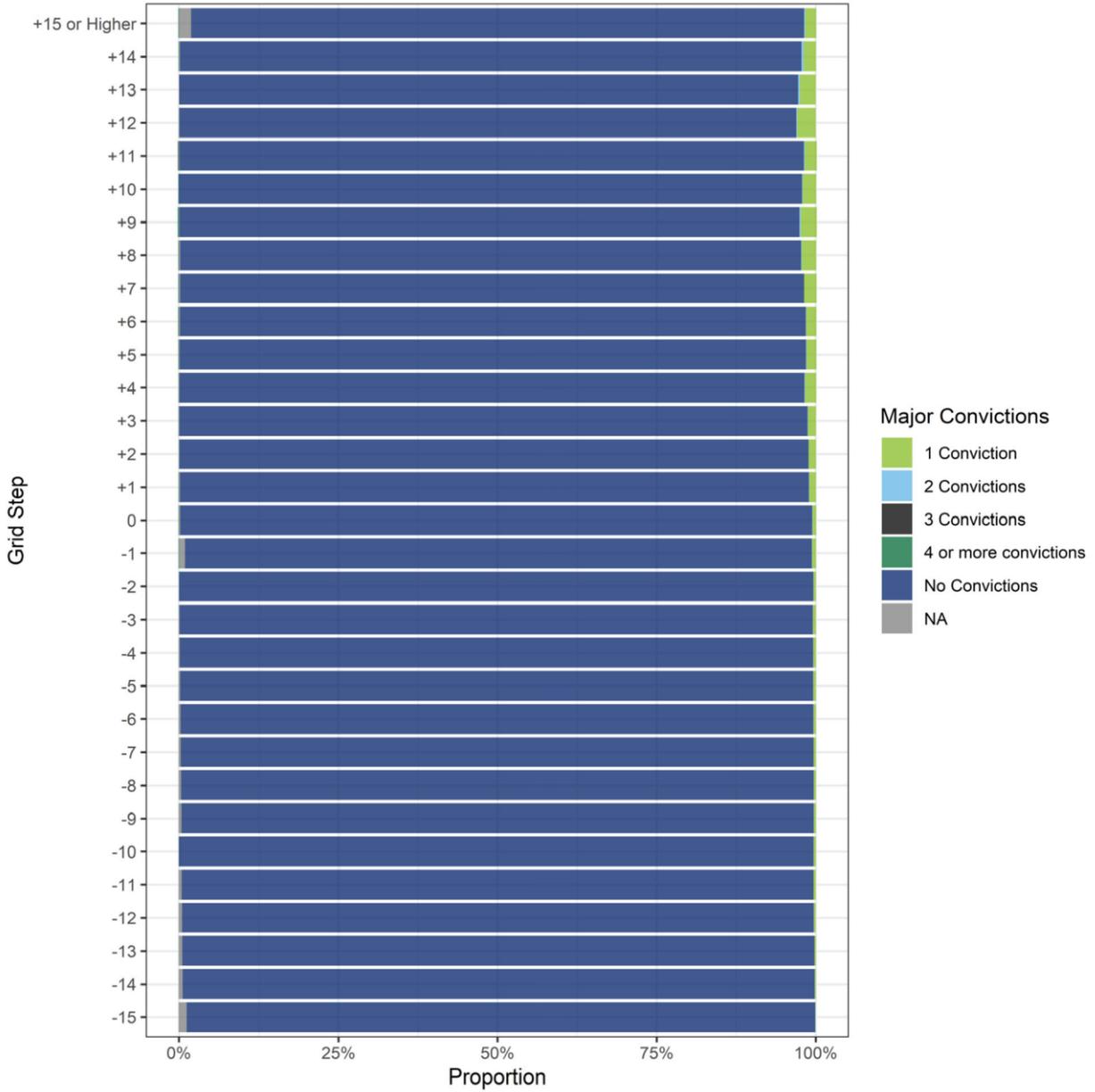
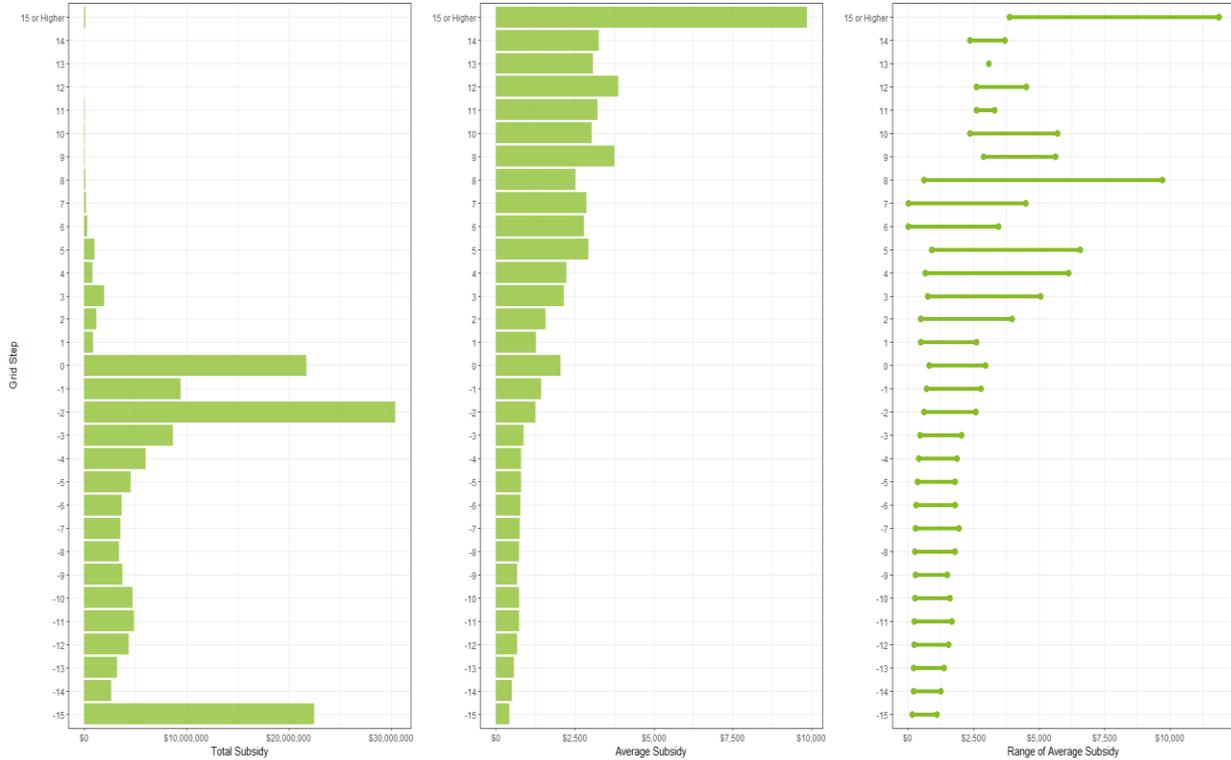


Figure A.6: Proportion of written vehicles by major convictions and by Grid step



Appendix B: Subsidy analysis

Figure B.1.1: Summary of total, average, and range of subsidies in 2021, by Grid



The third graph shows the distribution of individual insurers' average subsidies. The two end-points connecting each line represent, respectively, the minimum and maximum average subsidies obtained from insurers that provided this data.

Figure B.2.1: Summary of total, average, and range of subsidies, by age range, 2021

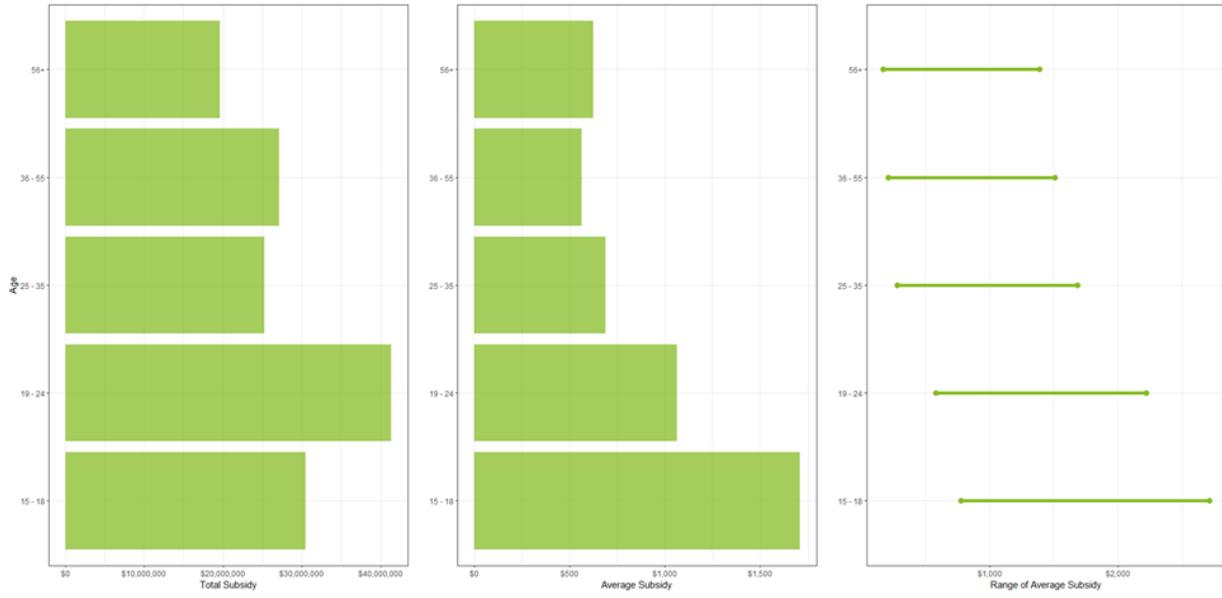
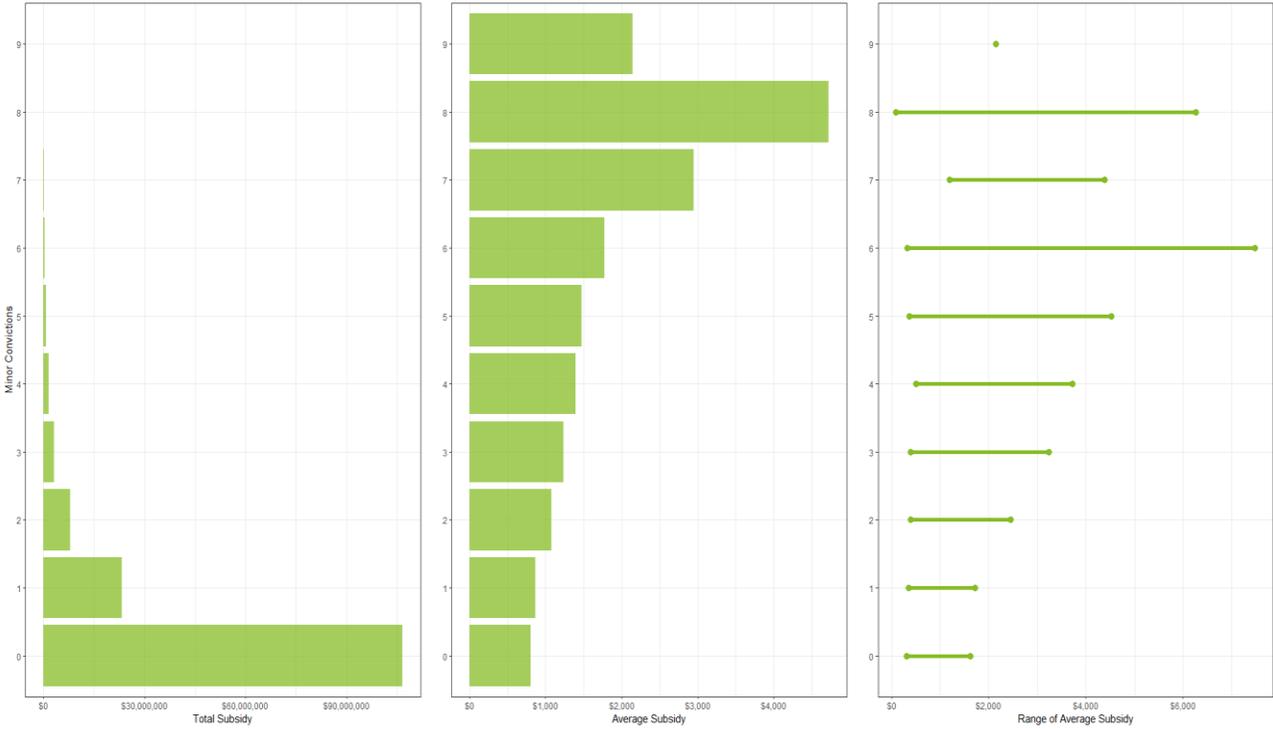
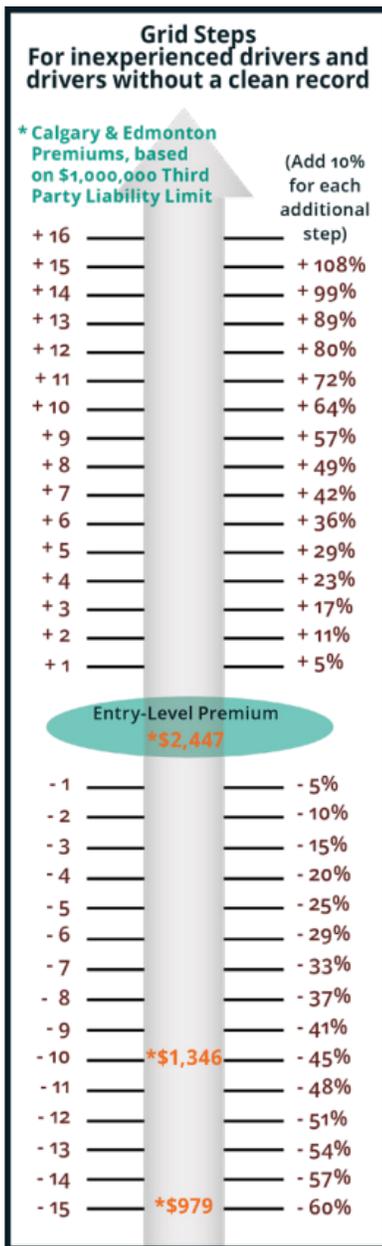


Figure B.3.1: Summary of total, average, and range of subsidies, by minor convictions, 2021



Appendix C: Alberta auto insurance Grid rate calculator

The Grid applies to basic-coverage premiums (third-party liability and accident benefits). Inexperienced drivers who have training start at Grid step -2 (without driver training, they start at step 0). Each year without an at-fault claim in third-party liability coverage, drivers move down by one Grid step, whereas each at-fault claim in the previous six years results in a five-step increase. Additionally, premiums are further adjusted based on geographic location, third-party liability-limit level, and number of convictions and at-fault claims during a given period. The graph displayed here shows the different premium levels by, Grid step, of a driver in Calgary or Edmonton who has a \$1 million third-party liability limit.





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