

2016 Annual Review

- Alberta Private Passenger Vehicles

ALBERTA AUTOMOBILE INSURANCE RATE BOARD

September 30, 2016

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AUTOMOBILE INSURANCE RATE BOARD

Mission:

As an independent body, the Automobile Insurance Rate Board (referred to herein as either the AIRB or the Board) regulates rating programs of Alberta automobile insurers to ensure premiums are fair and predictable. The Board also ensures consumers have access to information to facilitate informed choices.

Background:

Legislative and Regulatory Authority

The AIRB was established on October 1, 2004 under Section 599(1) of the *Insurance Act* (the Act). On November 27, 2013, the Enhancing Consumer Protection in Auto Insurance Act was passed. The Act and supporting Automobile Insurance Premiums Regulation came into force on July 1, 2014. The mandate of the AIRB is defined in the Act and the Premiums Regulation and includes the duty to:

- submit an annual report to the Minister on the operations of the Board;
- review and approve all rating programs for new insurers licensed to sell automobile insurance in Alberta;
- review and approve any changes to existing insurer rating programs for insurers licensed to sell automobile insurance in Alberta;
- conduct an Annual Review of automobile trends and premiums relating to basic and additional coverage for private passenger vehicles;
- conduct an annual open meeting to receive comments from the automobile insurance industry, the consumer representative and the public; and
- exercise and perform any other powers and duties assigned to it by the Minister or prescribed by regulations..

Legislative Reforms and Government Actions

In 2003, the Alberta Government enacted Bill 53, the Insurance Amendment Act, which provided for:

- a cap on pain and suffering for minor injuries at \$4,000;
- introduction of treatment protocols;
- elimination of the double-recovery of compensation from more than one source;
- determination of wage loss based on net, rather than gross, wages;
- an increase in the maximum medical/rehabilitation benefits under accident benefits to \$50,000; and
- introduction of the “take all comers” underwriting system.

The reforms set out in Bill 53 became effective October 1, 2004, with the exception of the consideration of collateral sources and the determination of wage loss based on a net, rather than gross, wages, which became effective January 26, 2004. Also on October 1, 2004, the Government introduced the Grid rating program, which set maximum premiums to be charged for basic coverage, and established two risk sharing pools¹.

¹ Coverage for insureds whose premium for basic coverage is limited by the Grid can be ceded to Grid risk sharing pool. Insurers may voluntarily cede up to 4% of their insured vehicles rated below the Grid through Non-Grid risk sharing pool.

The *Minor Injury Regulation* is amended annually to adjust the amount of the CAP on non-pecuniary damages recoverable for minor injuries by the Consumer Price Index for Alberta. The amount increased to \$4,956 as of January 1, 2016.

Private Passenger Rate Level History

The table below outlines the average written premiums for basic coverage, additional coverage, and combined coverage for the most recent 5 years.

The overall rate level has been quite stable since 2004 but an upward trend started in 2012. Basic coverage premiums dropped significantly from the 2004 level, until 2012; the year over year changes have since been increasing. These increases are a result of previously approved Industry-wide adjustments and recent insurer filings, caused by adverse development resulting from issues such as a higher proportion of claims exceeding the definition of minor injury with increasing incidence of chronic pain, TMJ/TMD (as a result of the Sparrowhawk decision), psychological injury, new heads of damage being claimed and a higher percentage of claims being litigated.

Additional coverage premiums increased significantly from 2004 but have been increasing at a lower rate in more recent years. The increases are mainly the result of recent severe weather events such as hail storms and flooding events most notably in southern Alberta along with upward pressure on repair costs due to more expensive materials and higher labor costs.

Calendar Year	Basic Coverage	Additional Coverage	Combined	Combined Coverage % Change
2011	551	519	1,070	-1.02%
2012	562	525	1,087	+1.59%
2013	579	534	1,113	+2.39%
2014	609	544	1,153	+3.59%
2015	644	535	1,179	+2.25%

Source: 2015 GISA Actual Loss Ratio Exhibit

Annual Review

Premiums Regulation

The Premiums Regulation requires the AIRB to conduct an Annual Review for private passenger vehicles and as part of that review to conduct an open meeting each year.

Automobile Insurance Premiums Regulation – Annual Review

9(1) The Board must, in accordance with its policies and procedures, conduct an annual review of automobile insurance trends and premiums relating to basic coverage and additional coverage for private passenger vehicles.

(2) The review must consider, on an industry-wide basis,

(a) loss costs, as that term is understood by the Board;

(b) administrative expenses, including commissions, taxes and general expenses;

(c) profitability;

(d) other matters recommended by the Superintendent and approved by the Board;

(e) any other matters that the Board considers appropriate.

(3) The Board must publish a preliminary report of its findings of the review.

(4) Following publication of its preliminary report, the Board must invite comment from insurers, the consumer representative and the public and must give at least 30 days for any comments to be provided.

(5) The Board must publish a final report of its findings by September 30 of each year.

6) The final report must include

(a) the Board's findings on the matters referred to in subsection (2),

(b) a report of the consumer representative,

(c) the Board's responses to comments received from the automobile insurance industry, the consumer representative and the public,

(d) the target for profitability for the following year, and

(e) the target for administrative expenses for the following year.

(7) In addition to, or as part of, an annual review referred to in subsection (1), the Board must also conduct an open meeting each year, in accordance with the Board's policies and procedures, to receive comments from the automobile insurance industry, the consumer representative and the public.

Notice of Open Meeting

On June 24, 2016, the AIRB notified stakeholders by letter that the Board would be holding a consultation meeting on August 16, 2016 to review Alberta Industry loss experience for private passenger vehicles to assist the Board in setting Industry Benchmarks for the review of insurer rate filings for basic and additional coverage. All interested parties were requested to submit a letter to the Board by July 22, 2016 of their intent to participate in the open meeting. The meeting would be part of the process to review automobile insurance trends and premiums relating to basic coverage and additional coverage for private passenger vehicles and to receive comments from the automobile insurance industry, the consumer representative and the public. The notice was also posted on the AIRB website in July.

On June 24, 2016, the Board placed notices in the Grande Prairie and Fort McMurray newspapers and on June 25, 2016 in the Edmonton, Calgary, Red Deer, Lethbridge and Medicine Hat newspapers

notifying stakeholders that the Board would be holding a consultation meeting on August 16, 2016 to review Alberta Industry loss experience for private passenger vehicles to assist the Board in setting Industry Benchmarks for the review of insurer rate filings for basic and additional coverage.

Presentations and Written Submissions

The Board received three letters of intent to participate in the open meeting and three written submissions. All parties that requested the opportunity to make a presentation were provided with a copy of the Rules of Procedure for the open meeting and asked to ensure that their comments were within the scope of the annual review.

Open Meeting

The open meeting was held on August 16, 2016 at the Canadian Western Bank Place in Edmonton, in the Western Room. The Board was assisted by Ted Zubulake, the Board's Consulting Actuary, and Board staff, Del Dyck, Executive Director, Vivian Cao, KimBerley Kern and Fei Mo.

The following parties made presentations at the public meeting:

- Oliver, Wyman Limited
- Insurance Bureau of Canada (IBC)
- Facility Association
- Consumer Representative (AIRB)
- TD Insurance

The following parties made written submissions to the Board, which were tabled publicly on August 16:

- The Co-operators Group Limited
- Intact Financial Corporation
- Desjardins General Insurance Group

All information submitted to the Board as part of the public meeting process including the audio file of the open meeting has been posted to http://airb.alberta.ca/public_meetings/2016.aspx.

The Oliver Wyman Review of Industry Experience Report (Appendix A)

On June 27, 2016, the Board released the preliminary report of its consulting actuary, Oliver Wyman, titled, "Review of Industry Experience as of December 31, 2015 Private Passenger Vehicles" (Oliver Wyman Report). The Oliver Wyman Report presented its analysis and findings regarding the private passenger insurance industry claims experience for basic and additional coverage. The Board requested the Oliver Wyman Report to provide information and professional advice with respect to automobile trends and premiums for private passenger vehicles. This report found that while premiums for additional coverage are adequate, the premiums for basic coverage are inadequate and therefore, it is expected that the upcoming year could see a continued increase in basic premiums. This preliminary report is posted on the AIRB website.

On September 16, 2016, Oliver Wyman presented its final report to the Board. This report addressed certain issues arising from the open meeting in August 2016 (appendix A).

Oliver Wyman based its analysis and findings on data that includes all insured vehicles in the province including those in the Facility Association and in the Risk Sharing Pools. The General Insurance Statistical Agency (GISA) provided claim data as reported up to December 31, 2015.

Industry Benchmarks (Appendix B)

The Board reviews individual insurer's filings based on their reasonableness relative to industry benchmarks selected by the Board.

The following Industry Benchmarks must be considered in all full filings.

1. Loss Development Factors
2. Loss Trends
3. Catastrophe Loading
4. Investment Income Rate
5. Administrative Expense & Unallocated Loss Adjustment Expense (ULAE)
6. Health Cost Recovery
7. Profit

The Oliver Wyman estimates as respects components 1, 2, 3, and 5 are Board approved "benchmarks". These components are to be based on each company's own experience – to the extent they are deemed credible. However, should a company find a need to calculate industry loss costs or loss ratios to serve as credibility complements, then it is expected that the board approved benchmarks for each of the ratemaking components be used. Component 4 sets the lowest discount rate that companies are allowed to use in calculating their rate indications. Components 6 and 7 are to be used by companies to calculate their rate indications.

Loss Development Factors

Historical numbers of claims and claim amounts must be projected to expected ultimate values by coverage and sub-coverage. Prior years' experience provides insight as to how the number and amount of claims tend to develop from initial reporting. Insurers are expected to select and support claim count and claim amount development factors based on their own experience in calculating their rate level indications.

The Board's consulting actuary, Oliver Wyman, conducted an analysis of Industry claim count and claim amount development patterns based on Alberta Industry data as of December 31, 2015. No industry comments were received with regard to the loss development selections.

The Board accepts Oliver Wyman's selected development factors as a benchmark for insurers to use to the extent Industry claim experience is a consideration in developing their rate level indications. Insurers that consider Industry claims experience must use the benchmark development factors without adjustment.

**Oliver Wyman Selected Age-to-Ultimate Development Factors
As of December 31, 2015
Alberta
Private Passenger Automobile (Excluding Farmers)**

**As of 2015-2
Age-to-Ultimate Factors
Incurred Claim Amount**

	Bodily Injury	Property Damage	AB - Disability Income	AB - Medical Rehab	AB - Funeral	AB - Death	AB - Uninsured
180-Ult	1.000	1.000	1.000	1.000	1.000	1.000	1.000
174-Ult	1.000	1.000	1.000	1.000	1.000	1.000	1.000
168-Ult	1.000	1.000	1.000	1.000	1.000	1.000	1.000
162-Ult	1.000	1.000	1.000	1.000	1.000	1.000	1.000
156-Ult	1.000	1.000	1.000	1.000	1.000	1.000	1.000
150-Ult	1.000	1.000	1.000	1.000	1.000	1.000	1.000
144-Ult	1.000	1.000	1.000	1.000	1.000	1.000	1.000
138-Ult	1.000	1.000	1.000	1.000	1.000	1.000	1.000
132-Ult	1.000	1.000	1.000	1.000	1.000	1.000	1.000
126-Ult	1.000	1.000	1.000	1.000	1.000	1.000	1.000
120-Ult	1.000	1.000	1.000	1.000	1.000	1.000	1.000
114-Ult	1.003	1.000	1.000	1.000	1.000	1.000	1.000
108-Ult	1.006	1.000	1.000	1.000	1.000	1.000	0.997
102-Ult	1.017	1.000	1.000	1.001	1.000	1.000	0.998
96-Ult	1.021	1.000	1.000	0.997	1.000	1.004	1.025
90-Ult	1.029	1.000	1.000	0.997	1.000	1.005	1.036
84-Ult	1.038	1.000	1.003	0.997	1.000	1.005	0.940
78-Ult	1.043	1.000	1.003	0.996	1.000	1.004	1.038
72-Ult	1.058	1.000	1.008	1.000	1.000	1.006	1.127
66-Ult	1.071	1.000	1.009	1.001	0.997	1.016	1.106
60-Ult	1.097	1.000	1.012	1.001	0.994	1.012	1.090
54-Ult	1.122	1.000	1.017	1.001	0.992	1.013	1.139
48-Ult	1.162	1.000	1.028	1.003	0.986	1.002	1.118
42-Ult	1.217	1.000	1.024	1.003	0.985	0.999	1.267
36-Ult	1.301	1.000	1.038	1.007	0.982	0.994	1.416
30-Ult	1.423	0.999	1.053	1.004	0.969	0.983	1.769
24-Ult	1.552	1.004	1.055	0.983	0.957	0.982	2.282
18-Ult	1.718	1.013	1.128	0.993	0.945	0.987	2.443
12-Ult	1.874	1.033	1.287	0.957	0.920	0.973	5.582
6-Ult	2.306	1.219	1.754	0.700	1.010	1.143	8.834

**Oliver Wyman Selected Age-to-Ultimate Development Factors
As of December 31, 2015
Alberta
Private Passenger Automobile (Excluding Farmers)**

**As of 2015-2
Age-to-Ultimate Factors
Incurred Claim Amount**

	Collision	Comprehensive	Specified Perils	All Perils	Underinsured
180-Ult	1.000	1.000	1.000	1.000	1.000
174-Ult	1.000	1.000	1.000	1.000	1.000
168-Ult	1.000	1.000	1.000	1.000	1.005
162-Ult	1.000	1.000	1.000	1.000	1.006
156-Ult	1.000	1.000	1.000	1.000	1.006
150-Ult	1.000	1.000	1.000	1.000	1.016
144-Ult	1.000	1.000	1.000	1.000	1.033
138-Ult	1.000	1.000	1.000	1.000	1.033
132-Ult	1.000	1.000	1.000	1.000	1.035
126-Ult	1.000	1.000	1.000	1.000	1.035
120-Ult	1.000	1.000	1.000	1.000	1.029
114-Ult	1.000	1.000	1.000	1.000	1.025
108-Ult	1.000	1.000	1.000	1.000	1.035
102-Ult	1.000	1.000	1.000	1.000	1.048
96-Ult	1.000	1.000	1.000	1.000	1.027
90-Ult	1.000	1.000	1.000	1.000	1.031
84-Ult	1.000	1.000	1.000	1.000	1.009
78-Ult	1.000	1.000	1.000	1.000	1.023
72-Ult	1.000	1.000	1.000	1.000	1.055
66-Ult	1.000	1.000	1.000	0.999	1.068
60-Ult	1.000	1.000	1.000	0.998	1.091
54-Ult	1.000	1.000	0.999	1.000	1.104
48-Ult	1.000	1.000	0.999	1.000	1.120
42-Ult	0.999	1.000	0.999	0.997	1.171
36-Ult	0.998	1.000	0.999	0.997	1.276
30-Ult	0.995	0.999	0.997	0.996	1.447
24-Ult	0.977	0.998	0.995	0.978	1.821
18-Ult	0.934	0.996	0.999	0.959	2.140
12-Ult	0.800	0.988	0.971	0.896	2.872
6-Ult	0.573	0.999	0.920	0.793	8.331

Loss Trends

Trending is a means of evaluating how changes over time affect claim costs in addition to the development on claims. Loss trend varies by coverage and sub-coverage.

Based on the industry analysis, Oliver Wyman selected the following trend rates for each coverage:

Coverage	Oliver Wyman Selected Past/Future Trend Rates
Bodily Injury	0.0%/+7.0%*
Property Damage	+3.0%
AB - Medical	+3.0%
AB - Disability	+0.0%
AB-Total	+2.0%
Collision	+4.0%
Comprehensive	+3.0%/+5.0%**

* Level change factor of 1.11 at 2011.2

** Level change factor of 1.10 at 2015.1

IBC and other insurers commented on the continuing increase in Bodily claim costs (which is reflected in the recommended trend). Reasons given for the increase include:

- erosion of the minor injury cap (Sparrowhawk v Zapoltinsky and McLean v Parmar rulings cited)
- increased legal representation and use of strategies to avoid cap limitations (psychological impairment, head injuries, chronic pain)
- inefficiency/uncertainty of current Certified Examiner process
- high pre-judgment interest awards (4% interest rate)

Oliver Wyman has taken into consideration the industry comments in their final recommendations.

The Board accepts Oliver Wyman's selected trend rates as a benchmark for insurers to consider in developing rate level indications. The industry trend rates developed by Oliver Wyman will serve as a point of reference in the review of filings received on or after October 1, 2016. The Board acknowledges that insurers may select different trend rates based on their own claim experience. Insurers have the option to (a) use their own experience where it is fully credible; (b) use their own experience to the extent that it is credible and apply the Board's accepted industry benchmark trend rates without adjustment as the complement of credibility; or (c) apply the Board's accepted industry benchmark trend rates without adjustment.

Catastrophe Loading

Comprehensive coverage (in particular) claims experience is affected by the occurrence or non-occurrence of “weather-related events” such as windstorms, hail, or flooding. Since catastrophes cannot be predicted, it is generally accepted actuarial practice to remove the actual claim costs arising from catastrophes and include a provision for the average level of catastrophic losses that could be expected to occur in a given year. In Oliver Wyman’s preliminary report a loading of 55% was recommended based on the 2014 GISA catastrophe exhibit.

IBC and other insurers (e.g. Desjardins, Intact) continue to find the current 1.45 Benchmark to be too low and recommend 1.65 as being more appropriate.

With the release of the 2015 GISA catastrophe exhibit as well as consideration of the points made by stakeholders, Oliver Wyman continues to recommend a loading of 55% to be reasonable. The loading reflects the adjustment made for the rising theft claims.

The Board accepts Oliver Wyman’s recommended loading of 55% as an industry benchmark based on the review of industry experience. Where the insurers’ own claim experience differs from industry and is credible, the Board acknowledges that insurers may select a different catastrophe loading based on their own claim experience.

Investment Income Rate

Insurers must discount claim costs for the investment income on policyholder funds until claims are paid. Based on the Government of Alberta’s forecasts of short and long term bond yields, Oliver Wyman recommended an investment rate of 0.65% for all coverage.

IBC finds an investment rate of 0.5% for all coverages and a rate of 0.60% for basic coverages to be appropriate. Desjardins stated that it finds the investment rate forecasts used by OW to be “unrealistically high.”

The Board accepts 0.65% for all coverage as the benchmark risk-free rate. Insurers must use a risk-free rate that is no lower than 0.65% when discounting claims in filings submitted to the Board. The investment rate will be updated semi-annually; the updated investment rate will be posted on the AIRB website.

Administrative Expense & Unallocated Loss Adjustment Expense (ULAE)

Administrative expenses are non-claims related expenses, which are usually composed of commission, taxes and other. ULAE is the claim and settlement related expense that cannot be associated directly with individual claims.

The General Insurance Statistical Agency (GISA) publishes the Automobile Insurance Financial Information exhibit which establishes industry averages for administrative expenses. GISA also publishes AIX exhibits where ULAE ratios are incorporated.

IBC has suggested that it would be more appropriate to calculate the weighted average based on direct earned premium, rather than direct written premium – as doing so would recognize premium dollars for those insurers that report expenses but do not have direct written premium. Under this approach, the average expense ratio increases from 25.4% to 26.6% (including increasing the average premium tax to 4.0%) according to IBC. Desjardins stated that it agrees with IBC.

Since the expense provision benchmark is only used as a reference when reviewing active insurers' rate filings, the Board does not believe that including expenses from companies that are running off (i.e. closing their book) is reasonable.

The Board accepts the industry average expense ratios and the ULAE ratio for Alberta presented in the GISA exhibit as the benchmarks. They are used in the Grid analysis and will be the points of reference when considering administrative expenses and ULAE in the review of individual insurer filings. The AIRB will recognize the individual insurer's own experience where it is credible.

Expense Category	Board Selections
Total Commission	11.9%
Premium & Fire Taxes	4.0%
All Other Expenses	9.5%
Total Expenses	25.4%
ULAE	10.3%

Health Cost Recovery

Under Provincial legislation, a levy is paid by each insurer to achieve a target amount set by Government. GISA calculates and provides the level as a percentage of earned third party liability premiums. The Government has no subrogation rights against the at-fault parties who have third party liability coverage. The Minister of Finance publishes the levy percentage applied to Third Party Liability written premiums every year.

IBC has suggested that given the Government's history of increasing the aggregate assessment every year, and since many of the policies that will be written under the rate filings submitted between October 1, 2016 and March 31, 2017 will be in effect in 2017 and 2018, that it would be more

appropriate for the Benchmark to reflect an increase in the assessment in 2017 and 2018. Desjardins commented that it agrees with IBC.

Since the Board is not responsible for calculating the Health Cost assessment, keeping the current practice is deemed fair to all policyholders.

The Board accepts the Health Cost Recovery as a component of claims costs reported by insurers. Insurers must use the most updated percentage published on the Minister of Finance's website at http://www.finance.alberta.ca/publications/tax_rebates/healthcostsrecovery/. The 2016 assessment factor is 5.90%.

Profit

The Board has established 7% of premium as a target pre-tax profit provision for all coverage. Also, No industry comments were received with regard to the provision. The Board will annually review and determine the percentage of premium that represents a reasonable level of profit for insurers for all coverage. Insurers must justify any target that is higher than the Board's selected percentage of premium for profit.

Grid Rating Program

The Grid rating program sets maximum premiums that insurance companies can charge for basic coverage for any driver profile. Many drivers with limited driving experience are capped by the Grid. Insurance companies must compare the premium for a vehicle under their current rating program to the Grid premium and charge the lesser of the two premiums with exceptions under Section 8(2) of the Premiums Regulation.

With the new Premiums Regulation, the Grid premium level will be adjusted based on the analysis of its own claims experience. Due to data credibility of the Grid-only risks, industry benchmarks accepted by the Board without adjustment will be used for the analysis.

At the open meeting, stakeholders expressed concerns regarding Grid rate level adequacy. The Board will take into consideration these concerns and adjust Grid premiums as necessary, after considering:

- loss experience specific to the Grid
- loss experience for all Alberta private passenger vehicles
- industry benchmarks as detailed above
- any other matters the Board considers appropriate

Other matters might include premium stability and how premium level is changing in the overall private passenger market.

Due to the nature of the Grid rating program, an increase in Grid premium will not likely bring the Grid rates to an adequate level. Some risks will leave the Grid program after the rate increase, and hence the selected rate increase will not be fully realized. Moreover, the risk make-up of the Grid will change significantly, which suggests that the setting of Grid premium level needs to be an on-going process.

In accordance with Schedule 3 Section 3(1) of the Premiums Regulation, the final decision for the Grid base premium adjustment is required to be made on or before October 1st, 2016. The Board has made its decision in regard to the Grid adjustment, and has published the decision on Board Order 01-2016. The Order can be viewed on our website at <http://www.airb.alberta.ca/orders>. The approved Grid adjustment takes effect on January 1, 2017.

Consumer Representative Report (Appendix C)

The Consumer Representative, Mr. Chris Daniel, contracted a consulting and research firm to conduct the annual telephone survey of consumers' perceptions of automobile insurance in Alberta. Mr. Daniel conducted focus groups in Edmonton and Calgary as well as follow up interviews with a number of participants located elsewhere in the province and surveyed insurance brokers to learn about their experience in the market. In addition, this year Mr. Daniel added a "Youth Group" dimension and conducted a special discussion with this group. As part of his process, he also reviewed data from other provinces, traffic safety trends and other indications. Consumers also contacted him by e-mail and letter with their specific concerns.

The results of his findings are presented in his report Appendix C.

Appendices

- A. Oliver Wyman Review of Industry Experience**
- B. Industry Benchmarks Schedule**
- C. Consumer Representative Report**