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August 5, 2014

Via email airb@gov.ab.ca
Original to follow by courier

Mr. Del Dyck
Executive Director
Alberta Automobile Insurance Rate Board
2440 Canadian Western Bank Place
10303 Jasper Avenue
Edmonton, Alberta T5J 3N6

Re: Annual Review of Automobile Insurance Premiums for Basic Coverage

Dear Mr. Dyck,

Please find enclosed the required signed original and twelve copies of the Facility Association submission to the Alberta Automobile Insurance Rate Board's Annual Review of Automobile Insurance Premiums for Basic Coverage.

Attending at our presentation on behalf of Facility Association will be:

David Simpson, President & CEO
Shawn Doherty, Senior Vice President, Actuarial & CFO

Please also find enclosed a signed disclosure form.

With respect to our presentation needs, we will be using a laptop-driven PowerPoint presentation to highlight facts and themes from our submission. A projector (with USB cable connectivity) and screen are all that we need. We will email the presentation to you in the next few days.

If you require anything further in the interim, please let me know directly.

Yours truly,

David J. Simpson, M.B.A., FCIP, C. Dir.
President & CEO

c.c.: J. Robert Tisdale, Facility Association Board Chair

Alberta Automobile Insurance Rate Board

Annual Review of Automobile Insurance Premiums for Basic Coverage

August 19, 2014

Submission

David J. Simpson, M.B.A., FCIP, C. Dir.
President & CEO

INTRODUCTION

This submission provides the Alberta Automobile Insurance Rate Board (AIRB) with an annual update on the size, volume trends and financial performance of the two Alberta Risk Sharing Pools for private passenger vehicles administered by Facility Association on behalf of automobile insurers in the province. It is patterned on previous annual updates for ease of comparison.

Appendix 1 provides a background to the history and operations of the Alberta Risk Sharing Pools, as well as a brief overview of Facility Association's other operations in the province.

RISK SHARING POOLS: SIZE

In August of 2013 Facility Association adopted the following Mission and Vision statements:

Mission

> Facility Association's mission is to administer automobile insurance residual market mechanisms, enhance market stability, and guarantee the availability of automobile insurance to those eligible to obtain it. We strive to keep the market share of the residual markets as small as possible, so consumers may benefit from the competitive marketplace to the greatest extent possible.

Vision

> Facility Association's vision is to be recognized and relied upon as a highly efficient and effective administrator of automobile insurance residual markets, whose objective opinion on residual markets and related issues is respected and sought by stakeholders.

It can be seen that our position continues to be that residual market volumes should be as small as possible. This stems from the belief that consumers are best served by companies competing directly for their business in an environment where these companies do not have to frame their decisions based on the potential impacts arising from compulsory participation in residual market mechanisms. That is, residual market mechanisms should be small enough that their presence in a compulsory auto insurance jurisdiction should be “incidental” to a company’s participation in that jurisdiction.

In 2013, we again saw an overall decrease in written premiums transferred to the Risk Sharing Pools (RSPs) on a combined basis as the premium volume transferred dropped $23 million, from $241 million to $218 million. Like 2012, the 2013 decline came only from the Grid RSP (down $24 million or 15.3%), as the non-Grid RSP increased by $1 million (1.4%). At $218 million, written premiums transferred to both RSPs are estimated to represent approximately 7.7% of all private passenger automobile insurance premiums written in Alberta in 2013, down from the 9.1% estimated for 2012.

Please see Table 1 for a summary of Risk Sharing Pools written premium and market share data for the last five years.

Table 1
Alberta Risk Sharing Pools – Market Share (Written Premium Basis)

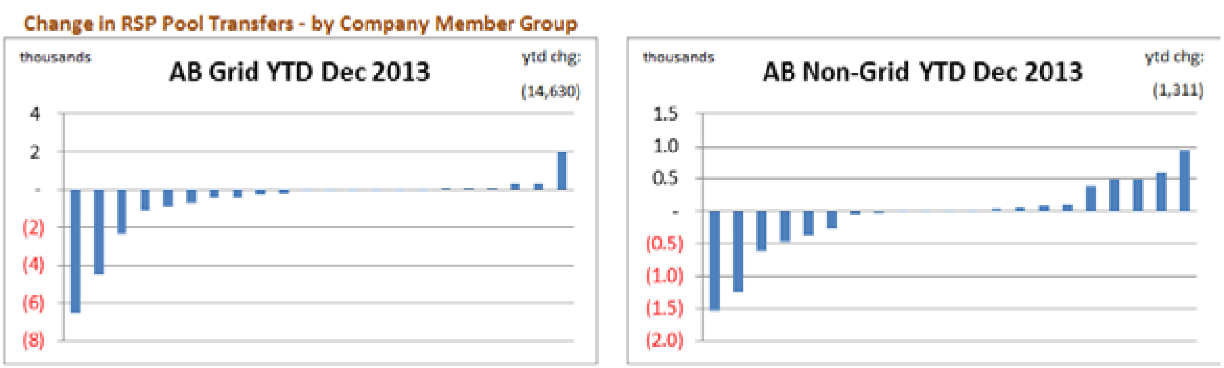
	Total		Grid RSP		Non-Grid RSP	
Year	**W. Prem**	**Mkt Share**	**W. Prem**	**Mkt Share**	**W. Prem**	**Mkt Share**
2009	$317,089,241	13.8%	$242,035,611	10.5%	$75,053,630	3.3%
2010	$278,161,214	11.2%	$203,185,486	8.2%	$74,975,728	3.0%
2011	$267,328,606	10.6%	$191,576,497	7.6%	$75,752,109	3.0%
2012	$241,099,956	9.1%	$160,342,475	6.0%	$80,757,481	3.0%
2013	$217,733,967	7.7%	$135,874,432	4.8%	$81,859,535	2.9%

On a written exposure count basis (exposure is defined as one car insured for one year) a total of approximately 124,000 exposures were transferred to both RSPs in 2013, down approximately 16,000 from 2012. Unlike premium, where the Grid RSP was down but the non-Grid RSP was up, the exposure count declined in both RSPs in 2013 (the Grid RSP down approximately 15,000 or 18.6%, and the Non-Grid RSP down approximately 1,300 or 2.2%).

Please see Table 2 for a summary of Risk Sharing Pool written exposure and market share data for the last five years.

Table 2 Alberta Risk Sharing Pools – Market Share (Written Exposure Basis)						
	Total		**Grid RSP**		**Non-Grid RSP**	
Year	**W. Exp**	**Mkt Share**	**W. Exp**	**Mkt Share**	**W. Exp**	**Mkt Share**
2009	165,579	7.6%	112,921	5.2%	52,658	2.4%
2010	153,661	6.6%	98,384	4.2%	55,277	2.4%
2011	152,402	6.5%	94,610	4.0%	57,792	2.5%
2012	139,502	5.7%	78,609	3.2%	60,893	2.5%
2013	123,561	4.9%	63,979	2.5%	59,582	2.3%

While there was an overall decline in transfers in both RSP, the changes in usage at the Member Company Group level is more nuanced, as indicated in the charts below. Specifically, while there was an overall decline for the Grid RSP, more than one-third (6 of 22) active Member Company Groups increased their transfers. Conversely, while there was an overall decline for the Non-Grid RSP, just under two-thirds (13 of 21) increased their transfers during 2013.



	# grps	chg
decliners:	16	(17,421)
no changers:	-	-
growers:	6	2,791

	# grps	chg
decliners:	8	(4,562)
no changers:	-	-
growers:	13	3,251

PRIVATE PASSENGER RESIDUAL MARKET SEGMENT – SIZE

Facility Association also administers the private passenger residual market segment, a small volume, tightly defined pooling mechanism for higher-risk cars and drivers. The annual premiums for approximately 80-90% of the exposures insured through the residual market segment are capped by the insurance premium regulation grid. The market share of the private passenger residual market segment has been very stable over the last five years as Table 3 shows.

Table 3 **Alberta Private Passenger Residual Market Segment** **Market Share (Written Exposure Basis)**				
Year	**W. Premium**	**Market Share**	**W. Exposure**	**Market Share**
2009	$16,752,374	0.7%	5,799	0.3%
2010	$17,352,000	0.7%	6,023	0.3%
2011	$16,752,673	0.7%	5,755	0.2%
2012	$16,053,755	0.6%	5,282	0.2%
2013	$15,176,036	0.5%	4,844	0.2%

The market share of the Alberta private passenger residual markets on a combined basis (i.e. FARM and RSPs), remain among the largest in North America, behind only Nunavut, North Carolina, and the Northwest Territories as shown in Table 4.

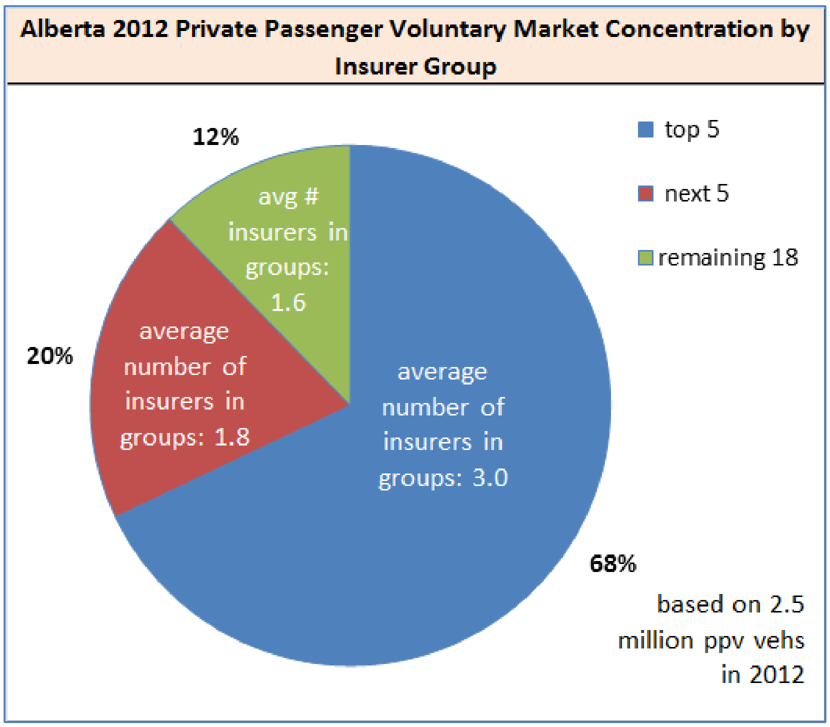
Table 4 **Top Ten Private Passenger Residual Market Jurisdictions in North America**	
Jurisdiction	**Market Share (vehicles)**[1]
Nunavut	30.1%
North Carolina	22.0%
Northwest Territories	15.9%
Alberta (RSP & FARM)	5.1%
Newfoundland & Labrador	3.9%
New Brunswick (RSP & FARM)	3.3%
Nova Scotia (RSP & FARM)	2.9%
Ontario (RSP & FARM)	2.3%
Massachusetts	2.4%
Yukon	2.0%

[1] Sources: Canadian data is for 2013; USA data is for 2012 as per Insurance Information Institute

The size of the Risk Sharing Pools can be influenced by a number of factors. Insurers tend to keep on their own books risks they believe to be adequately priced, and transfer to the Risk Sharing Pools (subject to eligibility rules) risks they believe to be inadequately priced. One could point to the loss ratios of the Grid RSP and ask why companies transferred many of those risks to the RSP when presumably it would have been worthwhile for them to keep those risks on their own books. While we do not have "hard evidence" as to why, anecdotally much of it comes down to uncertainty — uncertainty of the impacts of the 2004 product reforms themselves on claims costs, compounded by the additional uncertainty resulting from the subsequent court challenges to the Minor Injury Regulation.

It is worthwhile to note that when we talk about "insurers", "industry" and "member companies" in the context of private passenger vehicle insurance in Alberta, we are talking about a relatively few number of companies. The top five companies (at the group level) represent approximately 68% of the insured private passenger exposures in Alberta, while the top 10 represent 88%. Please see figure 1. The presence of several relatively large insurers in the province means that the decisions of one of them on what they will or will not transfer to an RSP can make a significant difference in the volumes on that RSP AND have a significant impact on the financial results of an RSP.

Figure 1:



In general, there is a correlation between residual market size and the degree of price competition permitted in a given jurisdiction. In the United States, rate regulation is under the authority of individual states similar to the provincial authority that exists in Canada. In the last decade or so there has been an increased trend in the U.S. to allow the competitive forces of the marketplace to regulate prices. Interestingly, for 2012 (the most recent year for which data is available) 38 states of the 49 states reporting data had less than 1,000 private passenger cars insured through residual market mechanisms, and 45 of 49 states reporting data had less than 1% of private passenger cars insured through residual market mechanisms (Texas does not report data).

Because we believe residual markets should be a small as possible, we are encouraged by the fact that Alberta has moved away from the previous “one size fits all” nature of the previous industry-wide rate adjustment process to a “File and Approve” system which reviews rates on a company-by-company basis. To the extent the new rate regulation system recognizes the unique pricing, underwriting and marketing approaches of each company, and to the extent it allows companies to have greater confidence in their pricing programs, we would expect to see an increase in competition in the marketplace. To the extent competition is increased, we would expect to see a decline in residual market volumes. We continue to believe that moving even further beyond a “File and Approve” system to one of open competition under the price ceiling provided by the premium grid regulation at some point in the future would provide an additional opportunity to reduce the number of cars insured through the residual market mechanisms.

Facility Association also believes competition could be increased to the benefit of consumers by making the transfer of Section C coverage premium to the Grid RSP optional for insurers. We have provided a briefing note to the Superintendent on this issue and look forward to further dialogue with his office on the matter.

FINANCIAL PERFORMANCE

Table 5 summarizes the financial performance of the Risk Sharing Pools since inception. The data in the table is taken directly from our audited financial statements.

Table 5

Alberta Risk Sharing Pools - Excess/(Deficiency) of Revenue over Expenses ($’000)

Fiscal Year	Grid RSP	Non-Grid RSP	Combined
2005 (13 months)	($93,902)	($28,038)	($121,940)
2006	$8,498	($30,562)	($22,064)
2007	$93,357	($9,422)	$83,935
2008	($73,490)	($29,955)	($103,445)
2009	$85,747	($9,184)	$76,563
2010	$83,893	($1,114)	$82,779
2011	$13,432	($17,668)	($4,236)
2012	($1,556)	($20,953)	($22,509)
2013	($14,452)	($37,883)	($52,335)
Total	**$101,527**	**($184,779)**	**($83,252)**

Automobile insurance is a business based on estimates − the true results of a given accident year cannot be known until many years in the future. Deriving estimates for the RSPs is especially challenging from an actuarial perspective as it involves taking into account the independent decision-making of member companies with respect to what types of risks they will transfer to a given pool. The estimated ultimate loss ratios for the RSPs by accident year and how those estimates have evolved since the inception of the RSPs are shown in Table 6. Please note these loss ratios include indemnity payments and only loss adjustment expenses specifically allowed (generally legal and professional expenses – all other loss adjustment expenses are reimbursed to members using the RSPs through an expense allowance). As such, care must be taken in comparing these results with loss ratio exhibits that DO include adjustment expenses.

The industry loss ratios shown are indemnity only and are Facility Association's internal estimates.

Table 6
Alberta Risk Sharing Pools – Undiscounted Estimated Ultimate Loss Ratio

Period	**--------------------------------- Accident Year ----------------------------------**					
Grid RSP	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
as at Oct 31, 2009*	70.7%	67.5%				
as at Oct 31, 2010	64.7%	61.1%	60.8%			
as at Oct 31, 2011	65.7%	59.4%	60.0%	64.1%		
as at Oct 31, 2012	66.4%	60.4%	59.7%	63.7%	67.8%	
as at Oct 31, 2013	66.8%	62.0%	61.3%	66.4%	69.4%	65.6%
Non-Grid RSP	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
as at Oct 31, 2009*	101.4%	101.6%				
as at Oct 31, 2010	100.9%	94.6%	92.6%			
as at Oct 31, 2011	101.0%	91.7%	85.9%	95.4%		
as at Oct 31, 2012	102.4%	94.2%	86.5%	85.8%	96.1%	
as at Oct 31, 2013	104.5%	97.6%	94.8%	83.8%	101.9%	96.0%
Industry**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
as at Dec. 31, 2012	61.3%	58.1%	60.8%	57.3%	63.7%	
as at Dec. 31, 2013	61.5%	58.7%	61.7%	58.7%	65.4%	64.6%

*Please note that in Table 6, the Undiscounted Estimated Ultimate Loss Ratios as at October 31, 2009 reflect both the exclusion of the provision for the MIR court challenge and revisions to the accident year estimates.

**Industry loss ratios:

Industry loss ratios in this table reflect indemnity only – while they do include IBNR (related to indemnity), they do NOT include any loss adjustment expenses nor loading for other expenses such as health care levies. This is to make industry results more akin to RSP results, being indemnity with some additional specifically allowed adjustment expenses.

Of course, the impact of the RSPs to any one company may differ from the impact of the RSPs to the industry in total, as the impact of any one individual company depends not only on their transfers to the RSPs, but also on their market share (which dictates their share of the result of the RSPs).

FINANCIAL IMPACT ON THE INDUSTRY

Because we must prepare our financial statements according to Generally Accepted Accounting Principles, our statements can only show the results of our own operations. As member companies incorporate their share of Risk Sharing Pool premiums and results into their own statements, they have to reflect items such as health levies, premium taxes, investment income, income tax effects and their cost of capital on those premiums and results. In past years, we have modelled the "overall industry impact" results. We are currently re-visiting the methodologies and assumptions for those illustrations, and will make them available once that work is complete.

One could look at the overall financial results of the Risk Sharing Pools and conclude that the presence of the Grid RSP has, and will continue to be, relatively benign. For those that do, we would again provide the following notes of caution:

- On an accident year loss ratio basis, the Grid RSP loss experience has been worse than that of the industry since inception. In the event of a deterioration in industry loss ratios, we would expect the Grid RSP loss experience to deteriorate as well.

- Competitive enterprises need to generate a competitive level of return. To the extent that companies may not be generating a competitive level of return on approximately 7.7% of revenue (the current market share of the Alberta RSPs), that return must be generated from those paying the remaining 92.3% of premium in the marketplace.

- Taken together, the Risk Sharing Pools represent a large volume of premium likely to behave in a more volatile way than of most individual companies. Although this volatility impacts all companies in a similar way, smaller companies with limited financial resources very probably find those impacts more difficult to absorb. As well, the presence of such large RSPs with their inherent volatility may act as a barrier to entry to insurers who would otherwise seek the opportunity to serve Alberta consumers.

CONCLUSION

We stated near the beginning of this submission our belief that consumers are best served by companies competing directly for their business in an environment where those companies do not have to frame their business decisions based on impacts from residual markets.

Simply stated, maximizing insurance availability for consumers can be achieved in an environment where both the costs associated with the insurance product are stable and where there is a significant degree of pricing flexibility. We therefore believe that the move away from a rigid industry-wide rate-setting process to a more flexible company-specific approach to reviewing rates will not only lead to greater competition for consumers but smaller residual market mechanisms as well. In a similar vein, we continue to encourage, as we have in previous years, that steps be taken to ensure the protection afforded by the premium grid remains as tightly focused as possible on the group of consumers it is intended to protect and that insurers be allowed to charge adequate rates for risks not targeted by the grid. As long as the premium grid remains in force, we believe allowing open price competition below the maximum premium set by the grid will pave the way for the smallest possible residual market volumes in the current regulatory framework.

APPENDIX I: RISK SHARING POOLS BACKGROUND, AUTHORIZATION & OPERATION

BACKGROUND

Facility Association is an administrative mechanism that administers involuntary residual market automobile insurance on behalf of the voluntary/private sector automobile insurance industry across Canada. Created by the industry and empowered by statute, Facility Association's mission and vision are:

> **Mission**
>
> Facility Association's mission is to administer automobile insurance residual market mechanisms, enhance market stability, and guarantee the availability of automobile insurance to those eligible to obtain it. We strive to keep the market share of the residual markets as small as possible, so consumers may benefit from the competitive marketplace to the greatest extent possible.
>
> **Vision**
>
> Facility Association's vision is to be recognized and relied upon as a highly efficient and effective administrator of automobile insurance residual markets, whose objective opinion on residual markets and related issues is respected and sought by stakeholders.

Facility Association has a full-time staff of thirty-seven people and fulfills its mandate via a network of outsourcing arrangements.

In Alberta, Facility Association administers the Alberta Risk Sharing Pool (RSP) (in reality, two Pools – one for Grid risks and the other for Non-Grid risks) for private passenger vehicles. It also administers the traditional Residual Market for non-private passenger vehicles and a very small "Residual Market Segment" (with very tightly defined risk criteria) for private passenger vehicles.

Because all licensed automobile insurers must participate in the residual markets administered by Facility Association according to specified sharing formulas, their individual financial results are subject to greater volatility and uncertainty than would otherwise be the case. Participation in the Residual Market also imposes additional costs on Facility Association member companies for such expenses as premium taxes and health levies on their respective shares of residual market premiums and the cost of the capital that members must maintain to support residual market premiums.

THE RESIDUAL MARKETS - AUTHORIZATION

In Alberta, Facility Association administers the RSPs and Residual Market Segment as authorized by its Plan of Operation (Plan), which is approved by member companies and the Superintendent of Insurance. (The Plan may be viewed and downloaded at www.facilityassociation.com.) All companies licensed to sell automobile insurance in Alberta are required to abide by the provisions of the Plan.

For risks ceded to the Alberta RSPs, the Plan requires Facility Association to maintain and report separate financial results for those risks that are subject to the premium grid and those that are not. This creates the need for two RSPs, commonly referred to as the Grid RSP and the Non-Grid RSP. Both are for private passenger automobiles only. All financial results of the Alberta RSPs and the traditional Residual Market are assigned to member companies based on their participation in the Alberta automobile insurance market. That is, they are not spread across the other jurisdictions Facility Association serves.

THE RISK SHARING POOLS - OPERATION

Essentially, a RSP is a residual market that acts as an industry-wide reinsurance mechanism that is largely invisible to consumers and intermediaries. A consumer buys insurance in the normal way, and the application is forwarded to a company underwriter. The underwriter assesses the risk and then decides whether to keep it on the company's own books or to transfer the risk to the RSP (subject to the operational rules and eligibility guidelines of the RSP).

Companies receive an expense allowance from the RSPs to cover costs such as those incurred for policy acquisition, policy issuance, policy administration and claims servicing. That expense allowance is set annually by the Facility Association Board of Directors in consultation with the Alberta Superintendent of Insurance. For both RSPs, companies are required to submit 100% of all premiums for all coverages on a policy and are eligible for 100% reimbursement of eligible claims and related expenses. Financial results (top **and** bottom lines) of the Pools are shared among companies based on the proportion of a company's private passenger automobile exposures not ceded to a RSP divided by the number of industry private passenger automobile exposures not ceded to a RSP. As Facility Association is simply an administrative mechanism, all companies receive a monthly report reflecting the operations of the Pool which provides them with the amounts they are then required to book into their own financial statements.

The two RSPs differ primarily in the number of risks companies can transfer to each. For the Grid RSP, companies can transfer eligible risks (i.e. risks whose premiums are capped by the premium regulation or "Grid") without limit. This lack of limit is based on the philosophy that companies are required to accept risks for which they have no control over price and, therefore, little or no control over the financial results of that business. In a general way, the size of the Grid RSP will be a function of how companies view the adequacy of the grid premium for a given risk. If the grid premium is above, or approximately the same as, the company's own risk-based premium the company might prefer to keep the risk on their own books. The upper limit to the size of the Grid RSP is, of course, a direct function of how many risks in the province are impacted by the grid.

For the Non-Grid RSP, companies can transfer up to 4% of written exposures not transferred to the Grid RSP. This Pool is designed to help companies cope with the "take-all-comers" environment in the province.

In a competitive market, most insurers tend not to target the entire universe of private passenger automobile risks. Insurers generally each have their areas of expertise and a healthy competitive marketplace tends to allow a proper mix of generalist and specialist/niche private passenger automobile writers. Moreover, because it is a practical impossibility to have a perfect price for every risk, most insurers choose to have risk eligibility rules to complement and protect their respective pricing structures. An underwriter faced with a requirement to accept a greater degree of risk than that contemplated by the company's classification system and rates can transfer that risk to the Non-Grid RSP. The Non-Grid RSP has a relatively low limit to ensure that it does not become used as a marketing tool. That is, without such a limit, companies could deliberately adopt a strategy of underpricing certain risks to attract new customers. Because these risks could then be transferred to the Non-Grid RSP, and because of the way all insurers share in the results of the Pool, this would amount to companies growing their businesses at the expense of their competitors.

The key point here is that RSPs are designed as mechanisms to promote stability in the marketplace by making it possible for companies to accept risks they believe are not adequately priced. Therefore, the general expectation is that RSPs by their very nature will operate at a financial loss. It is also important to note that because the RSPs also act as a cross-subsidization mechanism across the industry, at any given point in time, companies will have their own, unique, financial results vis-à-vis the Pools.

Information Disclosure Statement

The Automobile Insurance Rate Board (the Board) is mandated to conduct an annual review of automobile insurance trends and premiums relating to basic coverage and additional coverage for private passenger vehicles. To enable the Board to do this, it needs to collect or receive information under the authority of sections 9 and 11 of the *Automobile Insurance Premiums Regulation*. The Board is committed to making its rate setting process as open and transparent to the public as possible.

Therefore, this is to notify you that any information (including personal or business information) that is submitted to the Board for consideration in the annual review will be considered made in the context of a public hearing, whether made as a written submission or an oral presentation. This information, including the transcript of discussions held at public hearings will be published on the board's web site as authorized by the Minister of Finance under section 816(7)(c) of the Insurance Act.

I acknowledge that I am submitting the attached information to the Board in the context of an open public hearing in the rate setting process and that, subject to section 11 of the Automobile Insurance Premiums Regulation, A.R. 117/2014, I am not required by law or by the Board to provide this information, that I do so on my own account at my own instance. For these reasons, I understand that the attached information will be made public and I am submitting the information to the Board on that basis.

If you have any questions concerning the management or disclosure of Board information, you may contact the Executive Director of the Board at 780-415-1126.

Signature

August 5, 2014
Date

David J. Simpson
Print Name President + CEO

Facility Association
Organization