

Alberta Automobile Insurance Rate Board

Annual Review of Automobile Insurance Loss Experience

August 18, 2015



FACILITY
Association

Submission
July 23 2015

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 and the residual market segment 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

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.

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 those 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

36 compulsory auto insurance jurisdiction should be “incidental” to a company’s participation in that
37 jurisdiction.

38

39 In 2014, we saw an overall increase in written premiums transferred to the Risk Sharing Pools
40 (RSPs) on a combined basis as the total premium volume transferred rose \$20.6 million, from
41 \$217.7 million to \$238.3 million. Most of the increase, \$19.9M or 96%, occurred in the Grid RSP
42 as the non-Grid RSP increased by only \$.7 million. At \$238.3 million, written premiums
43 transferred to both RSPs are estimated to represent approximately 7.8% of all private passenger
44 automobile insurance premiums written in Alberta in 2014, up from the 7.7% estimated for 2013.

45

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

48

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
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%
2014	\$238,352,224	7.8%	\$155,765,149	5.1%	\$82,587,075	2.7%

49

50 On a written exposure count basis (exposure is defined as one car insured for one year) a total of
51 approximately 133,000 exposures were transferred to both RSPs in 2014, up approximately 9,600,
52 or 7.8%, from 2013. The exposure count increased in both RSPs in 2014 (the Grid RSP was up by
53 approximately 7,000 exposures or 10.9%, and the Non-Grid RSP was up approximately 4.4%).

54

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

57

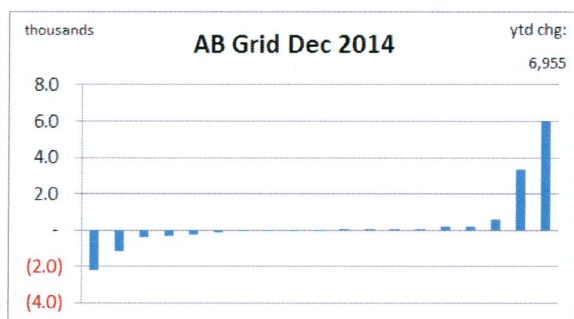
Table 2**Alberta Risk Sharing Pools – Market Share (Written Exposure Basis)**

	Total		Grid RSP		Non-Grid RSP	
Year	W. Exp.	Mkt Share	W. Exp.	Mkt Share	W. Exp	Mkt Share
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%
2014	133,164	5.1%	70,934	2.7%	62,230	2.4%

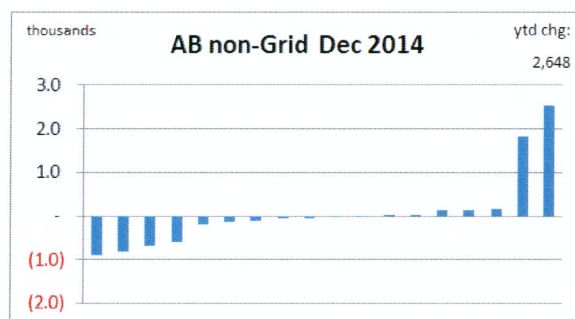
59

60 While there was an overall increase in transfers in both RSPs, the changes in usage at the Member
 61 Company Group level is more nuanced, as indicated in the charts below. Specifically, while there
 62 was an overall increase for the Grid RSP, almost half (10 of 21) active Member Company Groups
 63 decreased their transfers. Conversely, while there was also an overall increase for the Non-Grid
 64 RSP, just over one half (11 of 21) decreased their transfers during 2014.

65

FOR CURRENT CALENDAR YEAR-TO-DATE TO Dec 2014**Change in RSP Pool Transfers - by Company Member Group**

	# grps	chg
decliners:	10	(4,377)
no changers:	-	-
growers:	11	11,332



	# grps	chg
decliners:	11	(3,507)
no changers:	-	-
growers:	9	6,155

66

67

PRIVATE PASSENGER RESIDUAL MARKET SEGMENT – SIZE

69

70 Facility Association also administers the private passenger residual market segment, a small
 71 volume, tightly defined pooling mechanism for higher-risk cars and drivers. The annual premiums
 72 for approximately 80-90% of the exposures insured through the residual market segment are

73 capped by the insurance premium regulation grid. The market share of the private passenger
 74 residual market segment has been very stable over the last five years as Table 3 shows.
 75

Table 3				
Alberta Private Passenger Residual Market Segment				
Market Share (Written Exposure Basis)				
Year	W. Premium	Market Share	W. Exposure	Market Share
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%
2014	\$14,140,333	0.5%	4,250	0.2%

76
 77 The market share of the Alberta private passenger residual markets on a combined basis (i.e.
 78 FARM and RSPs), remain among the largest in North America, behind only Nunavut, North
 79 Carolina, and the Northwest Territories as shown in Table 4.
 80

Table 4	
Top Ten Private Passenger Residual Market Jurisdictions in North America	
Jurisdiction	Market Share (vehicles)¹
Nunavut	27.0%
North Carolina	22.0%
Northwest Territories	15.1%
Alberta (RSP & FARM)	5.3%
Newfoundland & Labrador	3.7%
New Brunswick (RSP & FARM)	3.3%
Nova Scotia (RSP & FARM)	2.9%
Massachusetts	2.4%
Ontario (RSP & FARM)	2.2%
Yukon	1.9%

¹ Sources: Canadian data is for 2014; USA data is for 2012 as per the Insurance Information Institute

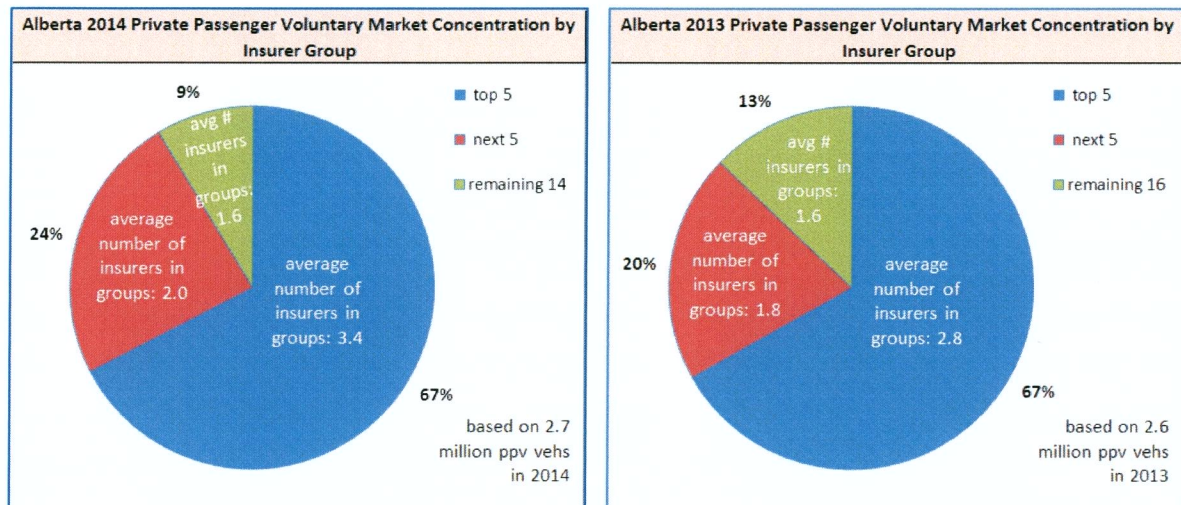
81
 82 The size of the Risk Sharing Pools can be influenced by a number of factors. Insurers tend to keep
 83 on their own books risks they believe to be adequately priced, and transfer to the Risk Sharing
 84 Pools (subject to eligibility rules) risks they believe to be inadequately priced.
 85

86 It is worthwhile to note that when we talk about “insurers”, “industry” and “member companies”
 87 in the context of private passenger vehicle insurance in Alberta, we are talking about a relatively
 88 small number of companies. For 2014, the top five companies (at the group level) represent

89 approximately 67% of the insured private passenger exposures in Alberta, while the top 10
 90 represent 91% (up from 87% a year ago). Please see Figure 1. The presence of several relatively
 91 large insurers in the province means that the decisions of one of them on what they will or will not
 92 transfer to an RSP can make a significant difference in the volumes on that RSP AND have a
 93 significant impact on the financial results of an RSP.

94

95 Figure 1: Market Concentration – 2014 vs 2013



96

97

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

106

107 Because we believe residual markets should be as small as possible, we are encouraged by the fact
 108 that Alberta has moved away from the previous “one size fits all” nature of the previous industry-
 109 wide rate adjustment process to a “File and Approve” system which reviews rates on a company-
 110 by-company basis. To the extent the new rate regulation system recognizes the unique pricing,
 111 underwriting and marketing approaches of each company, and to the extent it allows companies to
 112 have greater confidence in their pricing programs, we would expect to see an increase in
 113 competition in the marketplace. To the extent competition is increased, we would expect to see a
 114 decline in residual market volumes (all other things being equal), especially in the Non-Grid RSP.

It is still “early days” in the new rate regulation system though and we continue to monitor monthly volumes closely. 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)
2014	(\$39,190)	(\$40,653)	(\$79,843)
Total	\$62,337	(\$225,432)	(\$163,095)

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 (especially initial 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 over the last five years 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 and Industry Private Passenger– Undiscounted Estimated Ultimate Loss Ratio

Period	----- Accident Year -----					
Grid RSP	2009	2010	2011	2012	2013	2014
as at Oct 31, 2010	61.1%	60.8%				
as at Oct 31, 2011	59.4%	60.0%	64.1%			
as at Oct 31, 2012	60.4%	59.7%	63.7%	67.8%		
as at Oct 31, 2013	62.0%	61.3%	66.4%	69.4%	65.6%	
as at Oct 31, 2014	61.9%	62.6%	67.5%	74.7%	73.1%	70.3%
Non-Grid RSP	2009	2010	2011	2012	2013	2014
as at Oct 31, 2010	94.6%	92.6%				
as at Oct 31, 2011	91.7%	85.9%	95.4%			
as at Oct 31, 2012	94.2%	86.5%	85.8%	96.1%		
as at Oct 31, 2013	97.6%	94.8%	83.8%	101.9%	96.0%	
as at Oct 31, 2014	97.1%	91.1%	86.7%	103.7%	101.5%	102.2%
Industry*	2009	2010	2011	2012	2013	2014
as at Dec. 31, 2012	58.1%	60.8%	57.3%	63.7%		
as at Dec. 31, 2013	58.7%	61.7%	58.7%	65.4%	64.6%	
as at Dec. 31, 2014	61.2%	63.4%	60.9%	68.9%	68.4%	70.0%

*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 7.8% of revenue (the current market share of the Alberta RSPs), that return must be generated from those paying the remaining 92.2% 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.

194 Simply stated, maximizing insurance availability for consumers can be achieved in an
195 environment where both the costs associated with the insurance product are stable and where there
196 is a significant degree of pricing flexibility. We therefore believe that the relatively recent move
197 away from a rigid industry-wide rate-setting process to a more flexible company-specific approach
198 to reviewing rates will not only lead to greater competition for consumers but smaller residual
199 market mechanisms (especially the Non-Grid RSP) as well. In a similar vein, we continue to
200 encourage, as we have in previous years, that steps be taken to ensure the protection afforded by
201 the premium grid remains as tightly focused as possible on the group of consumers it is intended to
202 protect and that insurers be allowed to charge adequate rates for risks not targeted by the grid. As
203 long as the premium grid remains in force, we believe allowing open price competition below the
204 maximum premium set by the grid will pave the way for the smallest possible residual market
205 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

241 results are subject to greater volatility and uncertainty than would otherwise be the case.
242 Participation in the Residual Market also imposes additional costs on Facility Association
243 member companies for such expenses as premium taxes and health levies on their respective
244 shares of residual market premiums and the cost of the capital that members must maintain to
245 support residual market premiums.

246

247 **THE RESIDUAL MARKETS - AUTHORIZATION**

248

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

254

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

262

263 **THE RISK SHARING POOLS - OPERATION**

264

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

271

272 Companies receive an expense allowance from the RSPs to cover costs such as those incurred
273 for policy acquisition, policy issuance, policy administration and claims servicing. That
274 expense allowance is set annually by the Facility Association Board of Directors in
275 consultation with the Alberta Superintendent of Insurance. For both RSPs, companies are

276 required to submit 100% of all premiums for all coverages on a policy and are eligible for
277 100% reimbursement of eligible claims and related expenses. Financial results (top **and**
278 bottom lines) of the Pools are shared among companies based on the proportion of a
279 company's private passenger automobile exposures not ceded to a RSP divided by the number
280 of industry private passenger automobile exposures not ceded to a RSP. As Facility
281 Association is simply an administrative mechanism, all companies receive a monthly report
282 reflecting the operations of the Pool which provides them with the amounts they are then
283 required to book into their own financial statements.

284

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

295

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

299

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

311 the way all insurers share in the results of the Pool, this would amount to companies growing
312 their businesses at the expense of their competitors.

313

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