FACILITY Association

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July 29, 2020

Ms. Laurie Balfour
Executive Director
Alberta Automobile Insurance Rate Board
#2440 Canadian Western Bank Place
10303 Jasper Avenue
Edmonton, Alberta T5J 3N6

V*ia email* *airb@gov.ab.ca*

Re: Annual Review of Automobile Insurance Loss Experience

Dear Ms. Balfour:

Please find enclosed the required signed original of the Facility Association submission to the Alberta Automobile Insurance Rate Board's Annual Review of Automobile Insurance Loss Experience. Also enclosed is the Powerpoint file for our presentation at the Open meeting on August 20th.

Please note we have also submitted an additional submission which addresses the draft Oliver Wyman ("OW") reports entitled "Annual Review of Industry Experience – Preliminary Report as of December 31, 2019 Private Passenger Vehicles" dated June 26, 2020, and "Annual Review of Industry Experience – Preliminary Report as of December 31, 2019 Commercial Vehicles" dated June 15, 2020.

Delivering our presentation at the Open meeting of August 20th on behalf of Facility Association will be:

Saskia Matheson, President & CEO
Aidan Chen, AVP Data & Analytics
Derek Tupling, VP GR & Communications

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

Yours truly,

Saskia Matheson
President & CEO

Encl.

c.c.: Chris Cooney, Facility Association Board Chair

Alberta Automobile Insurance Rate Board

Annual Review of Automobile Insurance Loss Experience

August 20th, 2020

Submission

July 29th, 2020

Saskia Matheson
President & CEO

INTRODUCTION

We are pleased to make this submission to the Alberta Automobile Insurance Rate Board (AIRB), continuing in the tradition of the Facility Association to provide information and what insight we can on issues related to automobile insurance, market stability and availability. Our submission consists of 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 (FA) on behalf of automobile insurers in the province. It is patterned on previous annual updates for ease of comparison.

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.

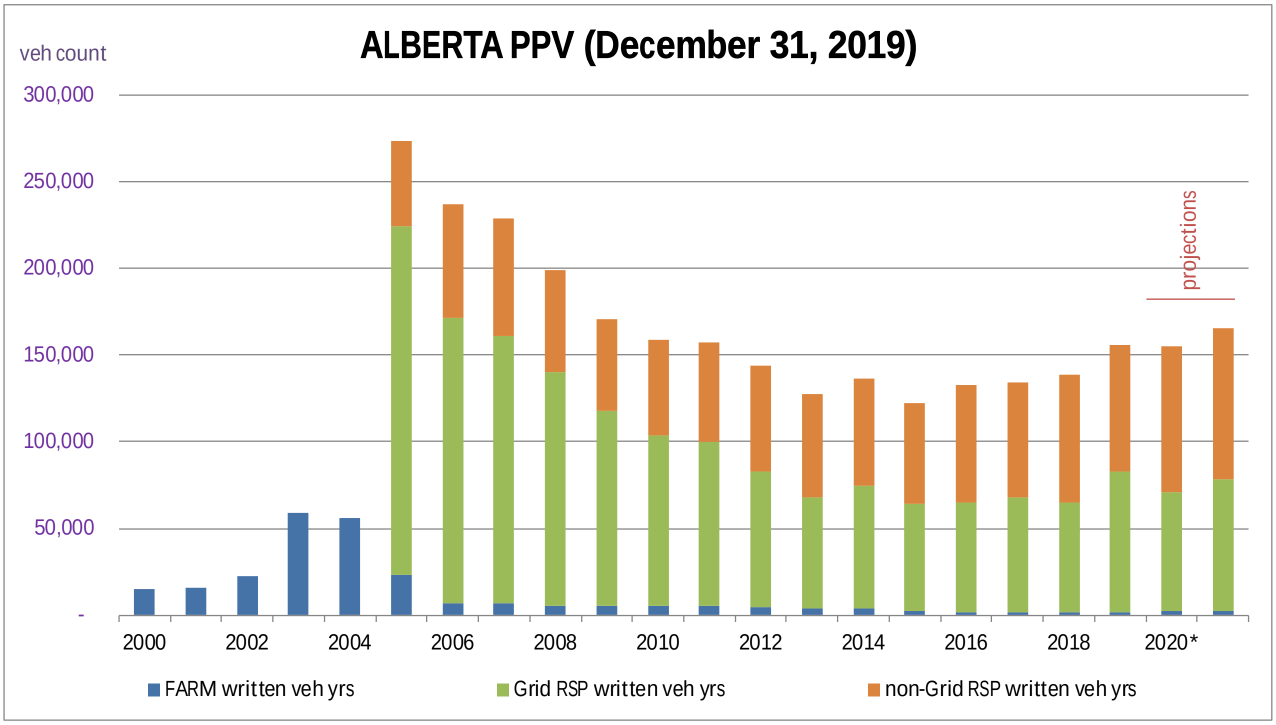
Vision

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.

Our position continues to be that residual market volumes (both in the Risk Sharing Pools and the residual market segment) should be as small as possible. There are two reasons for this: First, a small residual market is ongoing evidence that the market is competitive, and that consumers are successfully finding coverage in a market they choose. Second, we believe those consumers are best served by companies competing directly for their business without the need to calculate the impact arising from their 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 competitive participation in that jurisdiction.

The chart at the top of the next page provides historical and projected Alberta individually-rated private passenger vehicles counts for the FA residual market mechanisms collectively by year. We provide a 20 year perspective to show the variability over time. It is sometimes tempting to believe that current conditions are immutable, but as the past year has more than demonstrated, circumstances change, and the market reacts.

Alberta individually-rated vehicle counts through the FA residual market mechanisms



The residual market volumes have been described as the proverbial canary in the coal mine of the auto insurance industry, providing an early warning indicator for the general health of the industry. In Facility Association, the voluntary market risk appetite is one of the top ten risk items we watch, and regardless of the changes over time in our assessments of the top 20 risks, voluntary market appetite is always near the top of the list.

2019 to 2020 Risk Ranking Changes

2019*	RANK	2020**
GOVERNMENT & REGULATORY	1	GOVERNMENT & REGULATORY
LOW VOLUNTARY APPETITE	2	COVID-19 PANDEMIC (NEW)
DATA GOVERNANCE – SERVICING CARRIERS & MEMBER DATA	3	↑ PRICING
DATA GOVERNANCE – UNDERWRITING INFORMATION PLAN (UIP)	4	↓ LOW VOLUNTARY APPETITE
THIRD PARTY RISK – EXCLUDING SERVICING CARRIERS	5	↑ TECHNOLOGY
THIRD PARTY RISK – SERVICING CARRIERS	6	↑ PEOPLE
PEOPLE	7	↓ DATA GOVERNANCE - UNDERWRITING INFORMATION PLAN (UIP)
PRICING	8	↓ DATA GOVERNANCE - SERVICING CARRIERS & MEMBER DATA
STAKEHOLDER SATISFACTION	9	↓ THIRD PARTY RISK - SERVICING CARRIERS
MEMBER ASSET STEWARDSHIP	10	ONTARIO ACCIDENT BENEFITS STATUTORY INTEREST (NEW)

*Risk Ranking from Management in 2019 ** June 3, 2020 Risk Ranking from Board

Measuring market availability and voluntary market appetite directly is not possible; we assess it through a measure of its complement - the involuntary market. FARM volumes are of course restricted in Alberta for PPV's by the eligibility criteria, and so to provide a measure of the involuntary PPV market, the best proxy is the total PPV residual market mechanisms together. In total, both the absolute counts and market share bottomed-out in 2015 (market share of 4.4% of private passenger vehicles), moving back up to 5.6% in 2019. So far in 2020, FARM PPV counts are up 31.8% over last year, while Grid RSP counts are down 16.8%, and non-Grid counts are up 3.2%. In total, we are projecting a 0.4% decrease in 2020 counts, but an overall 6.2% increase in 2021 counts from 2019. Our projections are based on the projections of our major member companies, who provide their projections for the coming months. With the pandemic and the surrounding economic and market uncertainty, those estimates have become both divergent and uncertain.

The Facility Association Residual Market (FARM) is a small volume, tightly defined pooling mechanism for higher-risk cars and drivers. The volume of vehicles insured through this mechanism dropped as a result of the 2004 reforms and the accompanying restrictions on FARM PPV eligibility, with counts decreasing to approximately 1,532 in 2017 (market share 0.1%). Even when counts rebounded in 2019 to 1,730, it did not move the market share. To qualify for the FARM as a PPV, the risk must be eligible based on claims or conviction history, or payment history. As a result, the annual premiums for approximately 90% of individually-rated private passenger exposures insured through the FARM are capped by the insurance premium regulation grid. With these restrictions on eligibility for FARM PPV, the mechanism has a small and finite growth potential.

IMPACT OF THE PANDEMIC

Recognizing the unprecedented situation in the market and in the Canadian economy brought about by the pandemic, customers have taken measures such as, placing their vehicles in storage, or taking advantage of the “temporarily out of use and in storage” endorsements to remove road coverage for return premium. Customers are also amending classification to reflect reduced use or change in use. The industry response to the pandemic and consumers has been varied, with each company choosing the methodology and approach that reflects their position in the market, and their mix of customers.

FA’s position in the market is unique in that our mandate is to be the insurer of last resort, and an industry follower. While we are committed to supporting customers in this time of need, we are taking care not to move in a direction that would place us in the inappropriate and market damaging role of competitor. As an example, were FA to rebate while many companies serving the general population do not, we would not only be treating the highest risk drivers better than many of the best drivers, but also potentially impacting the ability of our members to take meaningful action for their customers.

With that said, Facility Association, working with our Servicing Carriers, have identified opportunities to extend relief to FA residual market (FARM) customers faced with financial hardships as a result economic fallout. A bulletin was issued to all brokers and agents to ensure that we are transparent regarding available relief, and to date, FA has provided over **$6.5 million** in premium relief to consumers in Alberta. The Facility Association Board of Directors, it’s Committees and FA Management will continue to take every action necessary to support customers, and work toward a positive and stable environment in the P&C industry in the months ahead.

It should be noted, that the lower claim counts we are experiencing may or may not translate to reduced loss ratios depending on how the industry accounts for the removal and of vehicles and coverages from the road. It will be critical to determine the best actuarial methods for separating observed claim count reductions already reflected in these use reductions from possible frequency change that may be part of a larger trend. Rate making is necessarily a prospective exercise, and there is a divergence of views in the industry regarding how trends will develop. This is, in our view, the strength of a competitive and diverse industry, offering alternative views and approaches for both customers and shareholders.

Permitting flexibility in response is also important as we consider other current and upcoming influences on claim activity. The hail storm of June 13th resulted in substantial losses for both FA and the industry generally. Recently, the Alberta government announced a $10 billion infrastructure investment into projects aimed at getting Albertans back to work. In all, the program is projected to create some 50,000 new jobs. As the program begins to roll-out, there will naturally be a corresponding increase in both PPV and commercial activity on Alberta roads. In the same way that the economic shut-down resulted in reductions in claims activity, we can expect that economic re-opening will have a corresponding upward influence on crash and claims frequency.

Since the declaration of the state of emergency, we have instituted regular emergency meetings of the Audit and Risk Committee of the FA Board, as we plan further action, and as we consider the potential and changing risks to our members. The duration of the physical distancing is an unknown variable, and FA lacks the responsiveness through our Servicing Carrier distribution to quickly adjust rules for what could be a short term impact. The reduction in claim counts in the immediate shadow of the state of emergency and distancing is only one of a several factors influencing a complex and unprecedented business environment:

Table 1
Alberta Private Passenger Residual Market Segment – Market Share

Year	Written Premium Basis		Exposure Basis	
	W. Prem ($000s)	Mkt Share	W. Count	Mkt Share
2015	11,410	0.4%	2,543	0.1%
2016	7,587	0.2%	1,644	0.1%
2017	7,179	0.2%	1,532	0.1%
2018	8,134	0.2%	1,697	0.1%
2019	8,673	0.2%	1,730	0.1%
2020	10,704		1,986	
2021	10,743		1,986	

2020 and 2021 projections based on FA Management projections used for May 2020 Operational reporting

Table 2 below provides written premium volumes for the two Alberta Risk Sharing Pools, the Grid Risk Sharing Pool (Grid RSP) and the Non-Grid Risk Sharing Pool (Non-Grid RSP).

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

Year	Total		Grid RSP		Non-Grid RSP	
	W. Prem ($000s)	Mkt Share	W. Prem ($000s)	Mkt Share	W. Prem ($000s)	Mkt Share
2015	224,297	7.0%	138,309	4.3%	85,988	2.7%
2016	248,140	7.5%	148,472	4.5%	99,668	3.0%
2017	258,972	7.5%	159,965	4.6%	99,007	2.9%
2018	272,525	7.4%	158,548	4.3%	113,977	3.1%
2019	329,583	8.3%	207,230	5.2%	122,353	3.1%
2020	336,269		188,586		147,683	
2021	370,564		213,998		156,566	

2020 and 2021 projections based on FA Management projections used for June 2020 Operational reporting

Counts are a better measure of market growth, and counts have continued to climb, reaching 5.4% in 2019, and the highest it has been since 2008.

Table 3
Alberta Risk Sharing Pools – Market Share (Written Exposures or "Count" Basis)

Year	Total		Grid RSP		Non-Grid RSP	
	W. Count	Mkt Share	W. Count	Mkt Share	W. Count	Mkt 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%
2020	152,936		68,556		84,379	
2021	163,245		76,515		86,730	

2020 and 2021 projections based on FA Management projections used for June 2020 Operational reporting

In our 2019 submission to the AIRB, we discussed the various drivers of industry transfer volumes to the Pools. While on a general level, 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, as we noted, the movement of business appears to be subject to a more complex relationship.

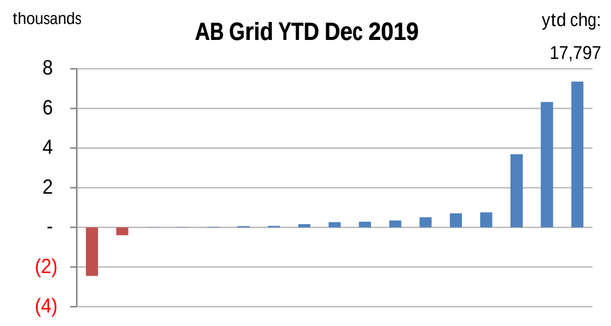
The Risk Share Pool mechanisms are designed to support insurance availability in a generally stable market, where temporary and limited disturbances in profitability create *subsets* of the market that are underpriced. In that circumstance, the Risk Share Pool offers an avenue for companies to insulate themselves from the full impact of writing too much of that subclass while the market adjusts and responds, and market availability is therefore protected.

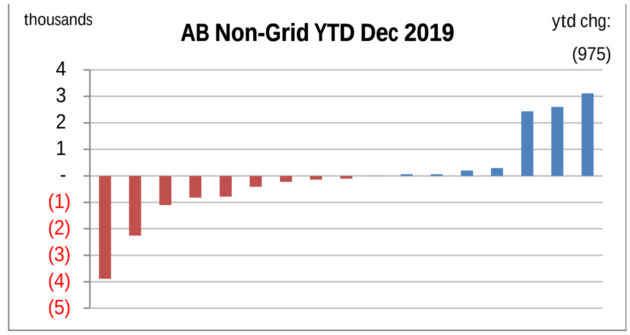
In such circumstances, we expect to see one of two patterns: If the underpricing is in a single industry-wide subclass of business, we will see most member companies increase their transfer activity as they insulate their results from the unknown. As pricing responds, the transfers will return to earlier levels. Alternatively, if there is a wide variety of pricing models and responses, we will see a spread of industry response, with some members increasing their use of the Pools, while others see this as an opportunity and take more business back onto their own books. This is generally the sign of a competitive and healthy market, where companies focus on different areas of opportunity, and pricing models offer consumers a variety of price points.

However, there is one other reason we can see such divergence in Pool transfers among companies. In a case of a system shock, where there is simply no reliable data upon which to make a solid estimate of future claims patterns, companies must make estimates on behalf of their shareholders in any case. The estimates vary significantly between companies, and even within the company, where the range of possible outcomes widens substantially. As a result, we are seeing some companies increase their pool use substantially, while others are decreasing their transfers or removing business previously transferred. In this case, the divergent pool use [see the chart '2020 Grid and non-Grid RSP Changes in Count by Member Group (as at June 2020) on next page], is evidence not of a wide variety of pricing models and risk appetites, but of a significant uncertainty over near and medium term frequency, severity and even premium activity.

To support our RSP count projections, significant users for the RSPs are requested, on a quarterly basis, to provide projected RSP usage by month to the end of the next calendar year – 9 of the 17 member groups provided projections, but these 9 account for almost 90% of the projected count for 2020. As indicated in the "growers vs. decliners" charts at the top of the next page (where each bar in the charts measures the projected change in count for member groups), the majority of members using the Grid RSP are transferring less in 2020 in contrast to 2019 where the majority of members transferred more, while it is more evenly split in relation to the projection for the non-Grid RSP.

2019 Grid and non-Grid RSP Changes in Count by Member Group

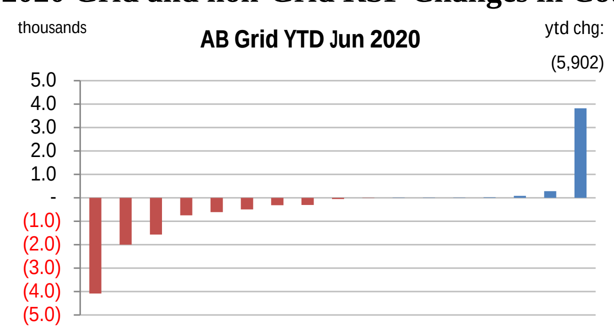


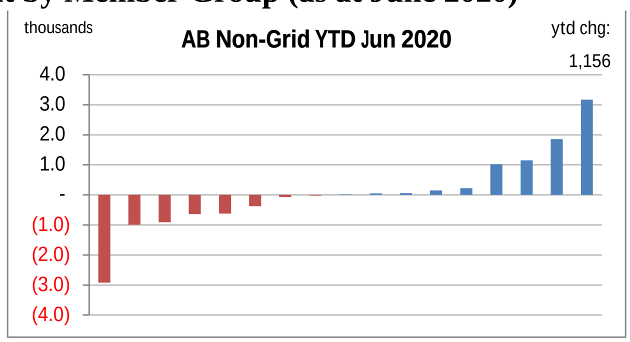


	# grps	chg
decliners:	2	(2,841)
no changers:	-	-
growers:	15	20,638

	# grps	chg
decliners:	9	(9,747)
no changers:	-	-
growers:	8	8,772

2020 Grid and non-Grid RSP Changes in Count by Member Group (as at June 2020)



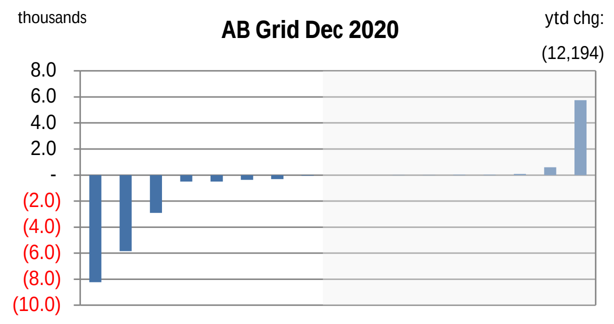


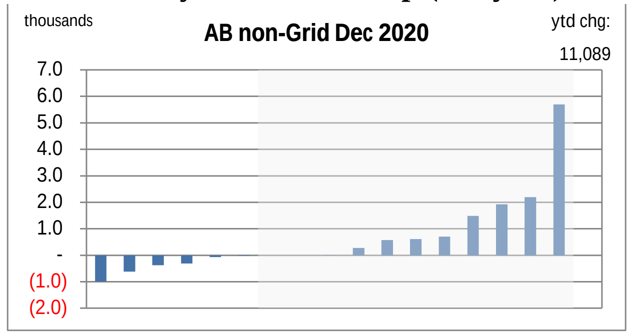
	# grps	chg
decliners:	10	(10,156)
no changers:	-	-
growers:	7	4,254

	# grps	chg
decliners:	8	(6,559)
no changers:	-	-
growers:	9	7,715

For the full year projections for 2020 and 2021 (top of the next page), we see the higher level of decliners in the Grid RSP continue through 2020, but shows a reversal in 2021, the high level of Members projecting no change highlights the uncertainty in the current market. The Non-Grid RSP continues to project growth through 2020 and 2021.

2020 Grid and non-Grid RSP Projected Changes in Count by Member Group (full year)





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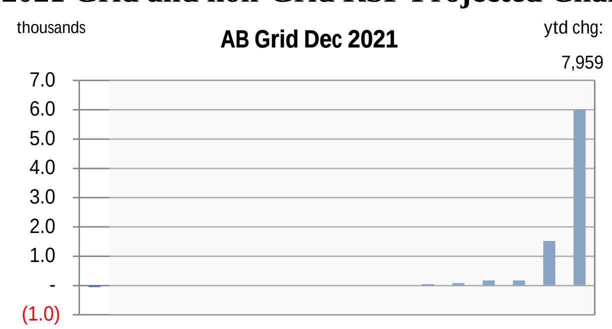
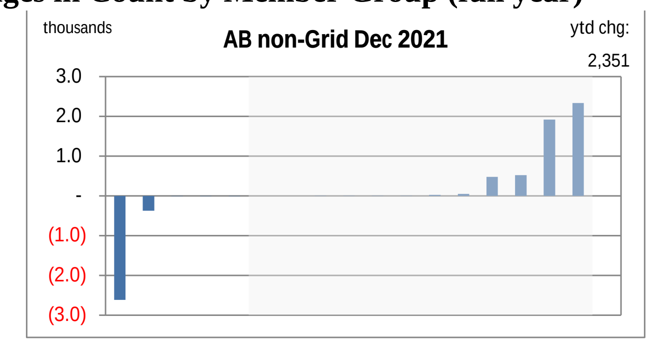
decliners:	8	(18,706)
no changers:	2	-
growers:	7	6,512

	# grps	chg
decliners:	6	(2,386)
no changers:	2	-
growers:	9	13,475

2021 Grid and non-Grid RSP Projected Changes in Count by Member Group (full year)





	# grps	chg
decliners:	1	(52)
no changers:	10	-
growers:	6	8,011

	# grps	chg
decliners:	5	(2,991)
no changers:	2	-
growers:	10	5,342

There is currently a 4% limit to the total number of risks that can be transferred to the Non-Grid RSP, as each member-group is limited to a 4% transfer amount relative to their previous non-Grid private passenger vehicles insured in the prior calendar year. – we estimate that the maximum that could be transferred in 2020 at approximately 113,000 vehicles, so the 84,379 projected transfers represents about 75% of the maximum. That said, 4 member groups are projected to be at over 95% of their limit for 2020, and another 2 between 80% and 95% of their 2020 limits.

Following a multi-year review, and as part of a series of reforms designed to harmonize the various Risk Sharing Pool mechanisms across the country, the FA Board of Directors has passed a resolution to increase the transfer limit in the Alberta Non-Grid Pool to 5%, effective January of 2022. This corresponds with the intended implementation date of the other reforms to other Pools. Facility Association management continues to monitor the situation for the total Pool, as well as for individual members. FA has worked with our member companies and the regulators to ensure that the RSP is able to support consumer relief measures. As an example, FA worked with the

Superintendent of Insurance as well as member companies to ensure that drivers using their personal lines vehicles temporarily for food or other delivery during the pandemic are able to retain PPV rating and can be placed in the Pool. Price reductions and rebates are also supported in the Pool as long as the company action is in line with provincial requirements. The Board of the FA is sensitive to the fact that this may result in pressures for some members around their transfer limit. Thus, the FA Board will continue to review requests for increased transfer limits from individual companies through the prescribed process.

As we have noted in previous years, there is a correlation between residual market size and the degree of price competition permitted in a given jurisdiction. In jurisdictions with a FARM type mechanism with no eligibility restrictions, general price inadequacy in the market will lead to direct growth in the residual market. In Alberta, where the FARM mechanism is restricted, the correlation will be less straightforward.

In the past, we have said that it is our view that the move away from the "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 would have a beneficial effect on residual market volumes due to the potential for increased price competition. That remains our view, and we continue to believe that pricing flexibility combined with product cost stability, premised both on product design as well as economic predictability generally, will be correlated with lower residual market volumes over time.

Insurers have the responsibility to manage their shareholders' and their customers' resources. In circumstances where predictability is limited, and where estimates of future frequency and severity are as widely divergent as they are today, it is more critical than ever that companies have the latitude to take action based on their best estimates from the data available. 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 either a redesigned premium grid regulation, or the dismantling of the grid system, at some point in the future would provide an additional opportunity to reduce the number of cars insured through the residual market mechanisms, and stabilize the market availability now and into the future for Albertan motorists.

FINANCIAL PERFORMANCE

Table 5 at the top of the next page summarizes the financial performance of the Risk Sharing Pools since inception. The data in Table 5 is taken directly from our audited financial statements, and we've included our current projections for fiscal years 2020 and 2021 (these projected results are NOT included in the total in the table).

Table 5
Alberta Risk Sharing Pools – Excess / (Deficiency) of Revenue over Expenses

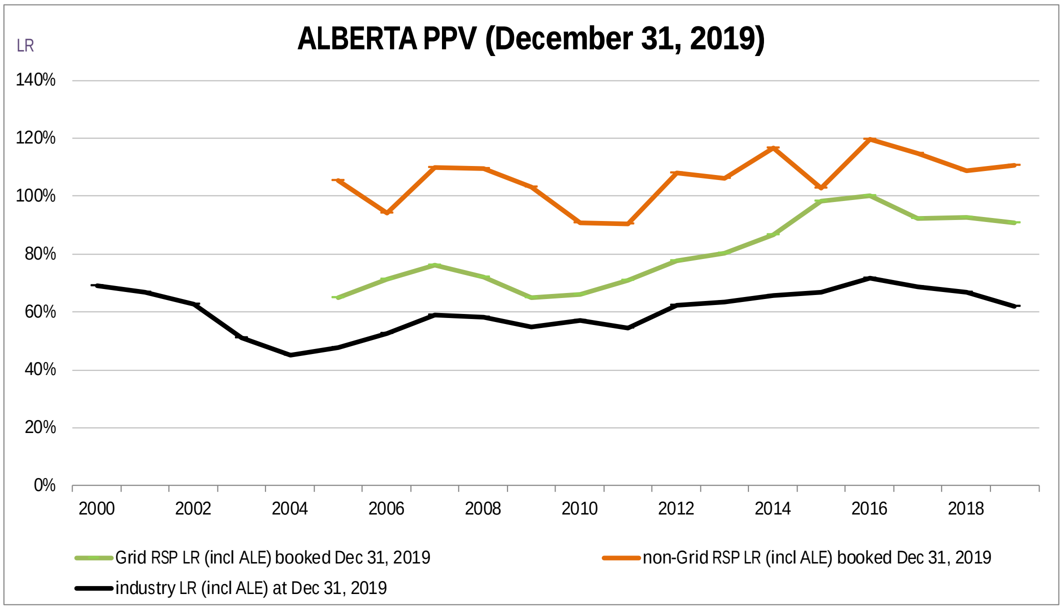
Fiscal Year ($000s)	Total	Grid RSP	Non-Grid RSP
2009 and prior	(86,951)	20,210	(107,161)
2010	82,779	83,893	(1,114)
2011	(4,236)	13,432	(17,668)
2012	(22,509)	(1,556)	(20,953)
2013	(52,335)	(14,452)	(37,883)
2014	(79,843)	(39,190)	(40,653)
2015	(19,760)	(591)	(19,169)
2016	(115,825)	(69,699)	(46,126)
2017	(110,439)	(62,015)	(48,424)
2018	(75,432)	(36,792)	(38,640)
2019	(28,373)	(9,010)	(19,363)
2020	(41,224)	(3,001)	(38,223)
2021	(89,345)	(31,259)	(58,086)
Total (excluding 2020, 2021)	(512,924)	(115,770)	(397,154)

Source: FA audited Financial Statements
projections based on Management projections used for June 2020 Operational reporting

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.

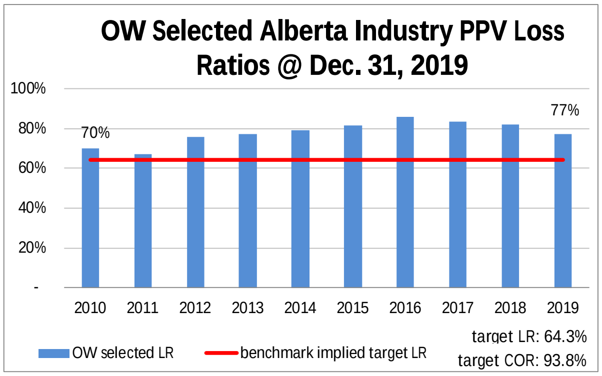
- On an accident year loss ratio basis, the Grid RSP loss experience has been worse than that of the industry since inception (see all-coverages loss ratio chart below, which includes loadings to include all claims expenses). The increasing gap between industry loss ratio and grid loss ratio is evidence of the industry's improving understanding of which grid business is unprofitable, and which is best kept for their own books.

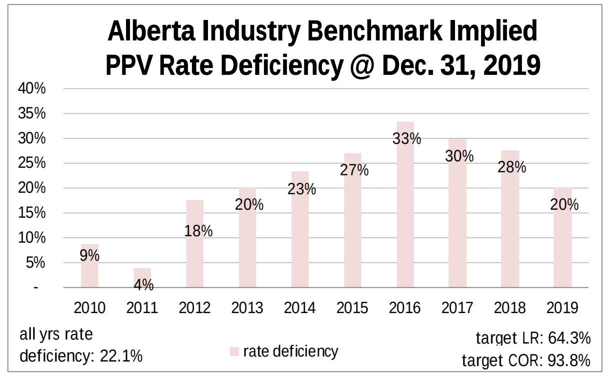


- Competitive enterprises need to generate a competitive level of return. To the extent that companies may not be generating a competitive level of return on approximately 8.3% of revenue (the 2019 premium market share of the Alberta RSPs), that return must be generated from those paying the remaining 91.7% of premium in the marketplace. If it cannot be, then as noted, companies may begin to take other actions.
- Taken together, the Risk Sharing Pools represent a large volume of premium likely to behave in a more volatile way than that of most individual companies. For example, per the loss ratio chart above, the Grid RSP loss ratio jumped from 87% to 98% from accident year 2014 to 2015, and the Non-Grid RSP loss ratio decreased from 117% to 103% in the same period. 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.

Using the (all coverages) estimates provided in the preliminary Oliver Wyman Private Passenger Report and the associated preliminary proposed benchmark assumptions, we have estimated the associated all coverages ultimate accident year loss ratios (indemnity plus claims expenses), and compared those ultimates against a target loss ratio level consistent with the expense and profit provision benchmark assumptions (and using discount rates based on FA pricing assumptions) as proposed in the OW PPV Report. Comparing the target to the historical loss ratios provides some context for the *historical* rate adequacy relative to the *current* proposed benchmark assumptions. These results are summarized below, indicating significant rate deficiency (again, against the *current* proposed benchmark assumptions).

OW PPV Preliminary Report – All Coverages Loss Ratios and implied rate deficiencies





The above would suggest that an industry-wide significant rate deficiency exists – a deficiency that may have existed over the course of at least a full underwriting cycle (typically 7-10 years). As anticipated the removal of the 5% rate cap in August of 2019 allowed companies to take needed larger increases as their individual results required.

While product reform is not part of the discussion topics for this review, it is important to note that any product that cannot be accurately costed, or whose future cost is unstable, will necessarily lead to restrictions in market appetite: contrary to popular mythology, insurers are not in the business of assuming all risk, but in spreading calculable risk. The one certainty about an inestimable cost product is that there won't be a market for it.

THE GRID

While we appreciate that the AIRB does not have jurisdiction over the design of the Grid system, it is an important component of the PPV system in Alberta, and its design problems have an impact on the market.

The grid system was designed for a single driver/vehicle combination, and has severely limited ability to cover complex risks. More importantly, the calculation of the grid "steps" presumes perfect historic information is available to insurers at every point. Establishing the grid step for a risk in 2020 and beyond requires insurers to use the limited history available based on an application, or the prior insurer's report. This results in different insurers validly calculating different grid steps for the same risk. In the years since the introduction of the grid, the regular and necessary rate increases have also been applied uniformly across the grid steps without recognition of the very real likelihood that the loss experience and risk differs significantly from one end of the spectrum to the other. FA has provided data and analysis on this matter to the AIRB in previous years, and would be prepared to undertake such a study again if this would be of use to the Board. Finally, it should be noted that the regulations contain self-contradictory sections the calculation of steps following a claim. As a result, and it is not surprising that 15 years following its introduction, the Grid system has become burdensome and complex for all.

COMMERCIAL

In 2019, we submitted information to the AIRB regarding the growth of commercial vehicles in the FARM. For commercial, there is no restriction on eligibility for these vehicles in the FARM and as a result, when the market is restricted, we see a direct and immediate impact on the size of the FARM.

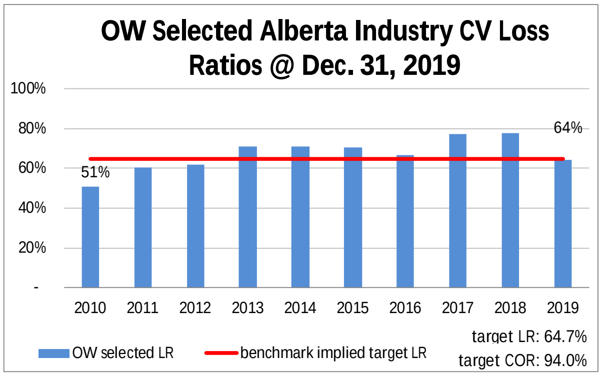
We are always concerned when there is growth in the residual market, but we are doubly concerned when that growth is accompanied by a deterioration in experience.

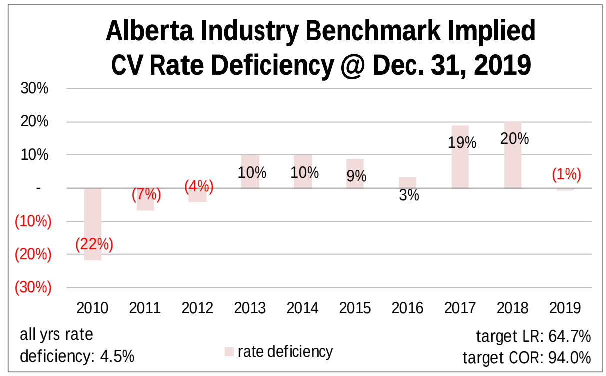
In the Fall of 2019, the volume of commercial business, and especially fleet business coming to FARM was so large our Servicing Carriers could not keep up, and we had significant service delays as a result. FA implemented special procedures, allowing risks to be issued as submitted, and the Carriers staffed up, and implemented overtime programs to clear the backlog. This was achieved, finally, in the early months of 2020.

With the pandemic, and the consequent shut-downs, the volume of commercial business has slowed significantly. One of the major areas of concern for FARM commercial was undisclosed US exposure. With border restrictions, this is currently less of an issue. It is unclear at this point if the slowing in Commercial business represents the end of the growth cycle, or merely a lull, which will pick up as the economy re-opens and strengthens.

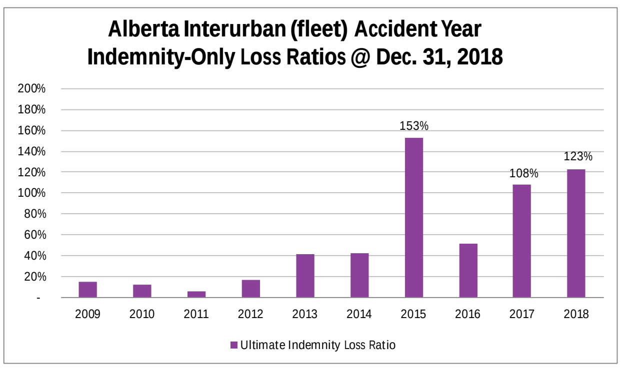
As we noted in our submission last year, In 2019 FA established a Commercial working group with representatives from commercial writers and large commercial brokerages as well as input from the Trucking Associations. The result was a series of rule changes to ensure that FA would have the information to charge the correct premium for commercial and fleet business. These rules go into effect in October. While current data shows FA's interurban class remains significantly underpriced, it is our view that the rule changes will equip our carriers to charge the risk the right price for its fact-based risk elements, and avoid the necessity to raise rates more generally.

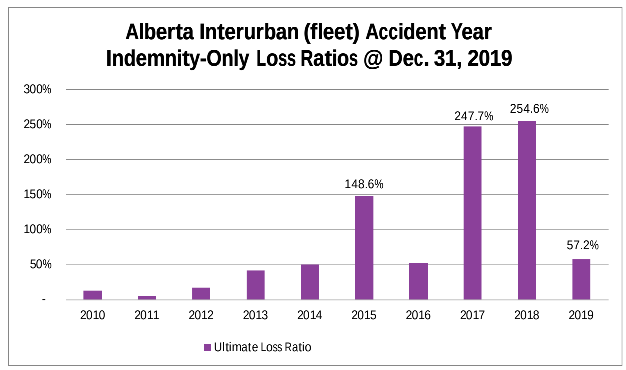
OW CV Preliminary Report – All Coverages Loss Ratios and implied rate deficiencies





The chart below shows the deterioration in the fleet loss ratio in 2019, as well as a similar figure for 2018.





CONCLUSION

The FA's purpose is to ensure availability of auto insurance for those who are required to obtain it. It is 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 potential financial impacts from residual market mechanisms such as the Risk Sharing Pools and the Residual Market Segment.

We further believe that maximizing voluntary market insurance availability for consumers is achieved in an environment where both the costs associated with the insurance product are stable and predictable, and where there is a significant degree of pricing flexibility. It is also the case that where circumstances reduce the stability of the costs, or their predictability, flexibility in pricing needs to increase in response. We further 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. While we believe the Grid may have now outlived whatever usefulness it has had, as long as it 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.

Facility Association's primary concern is always the protection of market availability, and the best guarantee of market availability is a heathy, competitive regular market.

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-nine people and fulfills its mandate via a network of outsourcing and professional services 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 in Alberta must be members of Facility Association, and because they must participate in the residual market mechanisms 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 balances (e.g. 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.