

August 5, 2014

Mr. Alfred Savage
Chair
Automobile Insurance Rate Board
#2440 Canadian Western Place
10303 Jasper Avenue
Edmonton, AB T5J 3N6

Dear Mr. Savage,

Thank you for the opportunity to participate in the AIRB's annual review of auto insurance trends and rates for basic and additional coverage. This review is the first under a rate regulation framework that we believe will promote a market more conducive to offering consumers innovative insurance products and prices that better reflect their unique driving characteristics.

IBC retained Baron Insurance Services to examine Oliver Wyman's report, *Review of Industry Experience as of December 31, 2013 Private Passenger Vehicles*, as well as the loss experience for the total market and the Grid population. Our objectives with this commentary and subsequent recommendations are to:

- Help identify the source of the cost pressures affecting claims;
- Maximize the benefits to consumers under the new rate regulation framework; and
- Support an adjustment to the Grid that reflects its significantly worse loss experience compared with the competitive market for basic coverage.

Grid Adjustment

The Grid level is vital to the performance of the new framework. Obviously, if the Grid base premium is higher than actuarial indications, the government will not achieve the public policy objective associated with having a price ceiling. But, if the base premium is lower than the indications, apart from lower-risk consumers having to pay a disproportionate amount of the cost of insuring higher-risk consumers, the overall consumer base will not experience the degree of choice in product offerings and price that the new framework has been designed to achieve.

Baron reviewed the differential loss experience between the Grid population and the total market. This comparison provides insight into the large – and, for the most part, growing – differences in driver performance between these two segments. Below are the loss costs and loss ratios for basic coverage for the Grid population and the total market from 2009 to 2013.

Loss Costs and Loss Ratios for Basic Coverage

	Grid LC	Total LC	Grid LR	Total LR
2009	\$1,103	\$462	79%	76%
2010	\$1,121	\$463	81%	79%
2011	\$1,276	\$494	97%	88%
2012	\$1,351	\$524	104%	94%
2013	\$1,305	\$508	97%	89%

IBC with data from Baron Insurance Services. Includes Health Levy.

Over this five-year period, the loss cost for basic coverage for the Grid population was not only consistently higher, but also increased substantially more (18%) compared to the total market (10%). The average loss ratio for the Grid population was more than 92% compared to 85% for the total market.

The underwriting results for the Grid population indicate that there is a significant difference between the average street premium for basic coverage and the average required premium. A combination of rising Bodily Injury (BI) claims costs and recent Grid adjustments that were below actuarial indications contributed to these results and, in turn, demonstrate the need for a sizable adjustment to the Grid base premium for policy year 2015.

Rate-Making Guidelines

The table below shows the 2013 loss development factors by sub-coverage from Oliver Wyman, Baron and GISA.

Loss Development Factors

	OW 2013/1	BIS 2013/1	GISA 2013/1	OW 2013/2	BIS 2013/2	GISA 2013/2
BI	1.731	1.874	1.895	2.106	2.211	2.305
PD	1.012	1.014	1.014	1.213	1.187	1.203
AB-MR	0.921	0.925	0.926	0.686	0.687	0.682
AB-DI	1.187	1.186	1.169	1.599	1.619	1.550
COLL	0.848	0.841	0.841	0.615	0.616	0.614
COMP	0.987	0.978	0.980	1.000	0.982	0.989

The factors derived from the three analyses are almost identical, except in the case of BI where Oliver Wyman's numbers are lower. The table below shows the same pattern of differential BI factors for previous accident-years.

BI Loss Development Factors

	OW	BIS	GISA
2012/2	1.694	1.810	1.811
2012/1	1.587	1.697	1.694
2011/2	1.477	1.570	1.565
2011/1	1.360	1.433	1.430

2010/2	1.263	1.324	1.320
2010/1	1.194	1.242	1.238

Baron selected higher factors for BI because it believes the adverse loss development identified last year (i.e. in 2013 for AY 2012) will continue. Baron's factors are similar to GISA's factors. On page 15 of its report, Oliver Wyman explains that because it believes reserve strengthening accounted, at least in part, for the adverse development experienced in 2012, it selected lower loss development factors for accident-year 2013 and for prior accident-years. In our view, this assumption is not supported by insurers' reports of continuing pressures on BI claims costs (see below, p. 5).

The table below shows the annual future loss cost trend rate by sub-coverage from Oliver Wyman and Baron. The estimated future loss cost trend rates are fairly close, except for Collision (COLL) and Comprehensive (COMP) (for the latter, OW has omitted losses from catastrophic events, which are treated elsewhere in their report).

Future Loss Cost Trend Rates

	OW	BIS	Difference
BI	+2.5%	+2.6%	0.1 p/p
PD	+2.0%	+1.6%	0.4 p/p
AB-MR	+3.0%	+3.2%	0.2 p/p
AB-DI	-1.5%	+0.3%	1.8 p/p
COLL	+2.5%	-0.02%	2.52 p/p
COMP	+1.0%	+5.5%	4.5 p/p

Catastrophe Provision

For the COMP catastrophe provision, Oliver Wyman selected 30%. This percentage, which is an average of the provisions calculated using the past 15 years and the past 20 years of loss data, is low relative to the 36% and 44% provisions for the past 10 years and 5 years, respectively. During these latter periods, Albertans experienced some of the most devastating weather events in Canadian history.

Using the figures in Oliver Wyman's report and the number of earned vehicles with COMP, we examined the frequency trend of catastrophe claims. We found that over a 20-year period, the frequency of catastrophe claims was rising. Between 2008 and 2012, the frequency was 0.92 claims per 100 vehicles, compared to 0.52 between 2003 and 2007, 0.32 between 1998 and 2002 and 0.57 between 1993 and 1997.

Also during this period, the number of catastrophe events recorded in GISA's Catastrophe Report for Alberta increased. Between 2008 and 2012, there were 31 catastrophe events, compared to 27 between 2003 and 2007, 18 between 1998 and 2002 and 14 between 1993 and 1997. According to Dr. Gordon McBean from the Institute for Catastrophic Loss Reduction (ICLR) and author of IBC's *Telling the Weather Story*, in the coming years, more hail and storm events will likely hit Alberta.¹

¹ McBean, Gordon. The Institute for Catastrophic Loss Reduction. *Telling the Weather Story*. June, 2012.

We also examined Alberta weather data from Public Safety Canada and PCS Canada and found that over the past 20 years, around 80% of the costliest hail, thunderstorm, wind and flood events occurred in Calgary and Southern Alberta.

Given the rising frequency of severe weather and of catastrophe claims in recent years and their concentration in certain parts of Alberta, we expect many insurers to use different catastrophe provisions for different regions and to set the percentages either higher or lower than Oliver Wyman depending on the distribution of their exposures throughout the province.

Cost Experience for Private Passenger Vehicles

We welcome the AIRB's interest in examining cost trends. The importance of the auto insurance product to millions of consumers underlines the need for ongoing monitoring and collaboration among insurers, the government and regulators.

The table below shows loss costs by sub-coverage from 2009 to 2013.

Loss Costs by Sub-Coverage

	BI	PD	AB	COLL	COMP
2009	\$249	\$149	\$39	\$236	\$123
2010	\$255	\$145	\$39	\$211	\$197
2011	\$271	\$153	\$38	\$227	\$110
2012	\$295	\$154	\$42	\$233	\$175
2013	\$280	\$160	\$40	\$263	\$165

IBC with data from Baron Insurance Services (BI/PD, excludes Health Levy) and GISA.

Based on these figures, only COMP experienced significant volatility and cost escalation over the period as a whole. The erratic weather affecting the province was responsible for these results. For BI claims, the overall increase in loss costs is noted, but the underlying development raises the most concern. The table below shows the loss costs for BI for different reporting periods.

BI Loss Costs for Different Reporting Periods

	AY 2009	AY 2010	AY 2011	AY 2012	AY 2013
2009	\$183				
2010	\$171	\$180			
2011	\$205	\$210	\$208		
2012	\$233	\$231	\$233	\$236	
2013	\$249	\$256	\$271	\$295	\$280

IBC with data from Baron Insurance Services.

As mentioned previously, we believe the adverse loss development continues. To assess the respective contribution of frequency and severity of BI claims to the overall cost increase, we compared each factor for different reporting periods.

BI Claims Frequency for Different Reporting Periods

	AY 2009	AY 2010	AY 2011	AY 2012	AY 2013
2009	0.60				
2010	0.62	0.66			
2011	0.60	0.62	0.65		
2012	0.60	0.61	0.61	0.59	
2013	0.60	0.60	0.60	0.59	0.58

IBC with data from Baron Insurance Services.

BI Claims Severity for Different Reporting Periods

	AY 2009	AY 2010	AY 2011	AY 2012	AY 2013
2009	\$30,538				
2010	\$27,700	\$27,350			
2011	\$33,847	\$33,738	\$32,106		
2012	\$38,716	\$38,098	\$38,184	\$39,894	
2013	\$41,663	\$42,635	\$45,647	\$50,487	\$48,650

IBC with data from Baron Insurance Services.

These comparisons show that an increase in the average cost of a claim was solely responsible for the adverse development of BI claims. After conducting a similar comparison for each sub-coverage, we did not find evidence of adverse development, except for Accident Benefits (AB) in accident-year 2012. As with BI claims, an increase in claims severity was responsible for the adverse development of AB claims.

AB Loss Costs for Different Reporting Periods

	AY 2009	AY 2010	AY 2011	AY 2012	AY 2013
2009	\$39				
2010	\$40	\$41			
2011	\$39	\$37	\$38		
2012	\$39	\$39	\$38	\$38	
2013	\$40	\$39	\$38	\$42	\$39

IBC with data from GISA.

Earlier this year, we met with claims managers from several large insurers operating in Alberta. They confirmed that BI claims frequency is stable while severity is continuing to rise. Specifically, insurers report seeing a greater proportion of people with minor sprains and strains who are:

- Securing legal counsel earlier in the claims process; and
- Claiming to have subjective and difficult-to-prove impairments such as temporomandibular joint disorder (TMD), a psychological condition, a concussion and/or chronic pain so as to pursue a pain and suffering award above the *Minor Injury Regulation* amount.

Added to this experience is the fear that some insurers have expressed to the effect that the government's recent decision to transfer jaw pain, as a treatable symptom of whiplash, from the *Diagnostic and Treatment Protocols Regulation* (DTPR) to an interpretive guideline may further aggravate this trend.

Health Levy

In seven of the past nine years, the government has raised the health levy by at least \$5 million. Overall, during this period, the health levy nearly doubled, from \$60 million in 2005 to \$105 million in 2014.

Last year, the average cost of the health levy for Alberta consumers as a whole was \$28 per vehicle. Because the health levy is applied as a percentage of premium, for the Grid population, the health levy represented about \$70 per vehicle.

It is to be noted that the changes to the health levy occurred while the number of BI claims has been stable from year to year and the number of people injured or killed in motor vehicle collisions has declined. According to Alberta Transportation, between 2005 and 2012, the number of people injured or killed in motor vehicle collisions declined by 25%. Moreover, while since 2005 the overall cost of public-system health care in Alberta has risen at an annual rate of 3.2%, the large majority of motor vehicle collision injuries are sprains, strains or simple fractures and thus do not generally require the type of specialized care that drives public system health costs.

IBC is aware that the amount of the health levy is established by Alberta's Ministry of Health and Wellness. However, we are using this occasion to alert the AIRB and the government to the substantial – and we believe unjustified – impact that the levy is now having on auto insurance premiums, and in particular Grid premiums.

Conclusions and Recommendations

In advance of the public hearing, we want to leave the AIRB with the following messages.

- Premium levels for Grid-rated policies have fallen well below indications. It will be important to the overall functioning of the auto insurance market to commence a program of adjusting Grid base premiums so that they are a better reflection of the actual loss experience of this population. Otherwise, significant cross-subsidization of the Grid population will continue as an unfair burden on all other consumers and, indeed, stands to grow to the extent that it begins to narrow the room for competitive pricing.
- While the similarities of the estimates from Oliver Wyman and Baron validate their findings, the differences show the importance from a rate regulation perspective of applying target **ranges** when adjudicating rating program changes. Throughout the course of a year, the 48 insurers operating in Alberta with different business models and strategies will produce actuarially-justified rates, either using their own claims data or industry-wide data subject to trend factors that may differ from Oliver Wyman and Baron's factors.

We understand the AIRB's desire to have access to industry-wide trend factors. But, because of the diversity of the Alberta auto insurance market and the sizable

uncertainties acknowledged in the Oliver Wyman analysis, we continue to advise the AIRB to use the factors only as "guidance" when adjudicating rating program changes.

- You will recall that last year, because of rising BI claims costs, we recommended that the government begin an in-depth examination of the claims environment. For our part in helping to identify the source of these cost trends and, in turn, develop legislative and/or regulatory solutions, we are undertaking a study of closed BI claims. We discussed the survey with the Superintendent of Insurance and will begin collecting data later this summer. We will share the results with the government.

Again, thank you for the opportunity to provide input for the annual review. We look forward to meeting with the AIRB on August 19th.

Sincerely,

A handwritten signature in black ink, appearing to read 'W. Adams', with a stylized, flowing script.

William A. Adams