

July 23, 2015

Mr. Allan Cleiren, CA, ICD.D
Chair
Automobile Insurance Rate Board
#2440 Canadian Western Place
10303 Jasper Avenue
Edmonton, AB T5J 3N6

Dear Mr. Cleiren,

Thank you for the opportunity to participate in the AIRB's annual review of auto insurance trends and rates for basic and additional coverage. IBC retained Dr. Ron Miller to review Oliver Wyman's report, *Preliminary Review of Industry Experience as of December 31, 2014 Private Passenger Vehicles*, and to undertake an analysis of the loss experience of the grid vehicle population and the total market. Our commentary reflects Dr. Miller's review as well as the views of insurers operating in Alberta's private passenger vehicle insurance market, 85% of which, on a market share basis, participated in a meeting where we examined Oliver Wyman's findings and the loss experience in the market.

We focus our commentary on:

- The loss experience of the grid population;
- Bodily injury (BI) claims trends, specifically those claims involving individuals with minor physical injuries; and
- The loss cost trend rates and other benchmarks that the AIRB will use for adjudicating rating programs.

Loss Experience of the Grid Vehicle Population

The table below shows the market share of the grid population for the past five accident years.

Market Share of Grid Vehicles based on Car-Years Earned Exposure

	2010	2011	2012	2013	2014
Vehicle Count	168,867	170,987	181,465	175,213	169,658
Market Share	7.5%	7.4%	7.6%	7.0%	6.7%

IBC with data from Dr. Ron Miller.

Because of the 5% adjustments that the AIRB set during the annual reviews in 2012 and 2013, the market share of the grid population declined by almost a full percentage point between 2012 and 2014, from 7.6% to 6.7%. The effect of the 7% adjustment that the AIRB set last year will be seen in the 2015 data.

The table below shows the loss cost and loss ratio for basic coverage for the grid population and the total market for the past five accident years.

Loss Costs and Loss Ratios for Basic Coverage

	Grid Loss Costs	Grid Loss Ratio	Total Loss Costs	Total Loss Ratio
2010	\$1,092	79%	\$445	76%
2011	\$1,198	91%	\$476	85%
2012	\$1,359	105%	\$514	93%
2013	\$1,375	102%	\$522	92%
2014	\$1,434	102%	\$537	90%

IBC with data from Dr. Ron Miller. Includes ULAE and the health levy.

Over this five-year period, the loss cost for basic coverage for the grid population increased more than 31%. For the total market, it increased 21%. The average loss ratio for the grid population during this period was 95%. For the total market, it was 87%.

The underwriting results for the grid population demonstrate that there is a significant difference between the average street premium for basic coverage and the required premium. Even though the market share of the grid population has declined in recent years, there are still more than 160,000 vehicles, comprising between 6% and 7% of the market, paying quite a bit less than indicated for auto insurance.

At a minimum, the adjustment to the grid base premiums will need to match the future loss cost trend rates for basic coverage for the total market. Otherwise, the gap between the competitively set risk-based premiums and the grid premiums will shrink and the market share of the grid population will likely increase. Last year, the future loss cost trend rates and the underwriting results of the grid population justified a 7% increase. This year, the trend rates are higher and the underwriting results are worse. For these reasons, for policy year 2016, we believe that a larger adjustment is necessary.

Bodily Injury Claims Trends

The table below shows the loss cost by sub-coverage for the past five accident years.

Loss Cost by Sub-Coverage by Accident Year

	BI	PD	AB	COLL	COMP
2010	\$237	\$145	\$39	\$210	\$197
2011	\$252	\$153	\$39	\$227	\$110
2012	\$285	\$155	\$42	\$228	\$175
2013	\$291	\$164	\$40	\$247	\$167
2014	\$307	\$164	\$41	\$253	\$183

Annual Change	6.7%	3.1%	1.3%	4.8%	(1.8%)
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IBC with data from GISA. Includes ULAE but excludes the health levy.

The sub-coverage that has sustained the largest year after year of rising costs is BI. Specifically, the loss cost for BI claims increased at a rate three times faster than inflation. The table below shows the frequency rate for BI claims, the average cost of a BI claim and the loss cost for BI claims for the past five accident years.

BI Claims Experience by Accident Year

	Frequency per 100 Vehicles	Average Claims Cost	Loss Cost
2010	0.60	\$39,540	\$237
2011	0.60	\$42,431	\$252
2012	0.58	\$48,745	\$285
2013	0.57	\$50,649	\$291
2014	0.57	\$53,660	\$307

IBC with data from GISA. Includes ULAE but excludes the health levy.

The rising average cost of a BI claim was almost exclusively responsible for the rising loss cost, with the majority of the increase happening between 2010 and 2012. During that time, the average cost of a BI claim increased 23%. By 2014, the average cost of a BI claim had increased by another 10%.

Insurers report that in the second half of 2011, a greater proportion of BI claims began presenting with ancillary conditions such as temporomandibular joint disorder (TMD), anxiety and/or pain symptoms. Typically, the individual claiming to have one of these conditions sought a significantly higher settlement than the traditional settlement for an individual with only a physical injury.

Shortly after the onset of this claiming trend, in January 2012, the decision in the Alberta Court of Queen's Bench case of *Sparrowhawk v. Zapoltinsky* solidified the approach of using TMD to seek higher settlements. It also put emphasis on the uncertainty as to whether the MIR would be determined by a court to apply in the case of an individual with a minor sprain or strain who also reports having any one of the ancillary conditions.

Last year, we conducted a study of closed claimant files to identify the sources of the rising cost of BI claims. The study involved the fourteen largest insurers in Alberta and the largest servicing carrier for Facility Association. Combined, these insurers represented 84.1% of the market.

The insurers provided data on 2,460 closed claimant files with collision dates between January 1, 2005 and December 31, 2012. We set these parameters to ensure the sample contained only files from post-reform collisions and had an adequate distribution of minor, moderate and severe injury files. In particular, we wanted enough moderate and severe injury files so that we could be confident of any trends we identify from the data. Overall, 54% of the claimant files were from accident year 2012, 14% were from 2011 and the rest were from the years 2005 to 2010. All the claimant files had closed in 2013 or 2014, after the sudden increase in the average cost of a BI claim.

Of the claimants in the study who settled under the MIR, 1,210 had a minor physical injury. Another 24 claimants had a minor physical injury and at least one ancillary condition, such as a non-fracture TMD, a psychological/emotional disorder, or chronic pain or fibromyalgia. There were also 186 claimants with a minor physical injury who did not settle under the MIR. All of these claimants had at least one ancillary condition. The table below shows the settlement data for all claimants in the study that had a minor physical injury.

Average Settlement for Claimants with a Minor Physical Injury

	Claimants	Special Damages	Non-Pecuniary	Other General	PJI	Party & Party	Total
MI Only	1,210	\$1,016	\$3,603	\$245	\$185	\$368	\$5,419
MI w/ AC (MIR)	24	\$1,690	\$4,678	\$1,489	\$153	\$429	\$8,439
MI w/ AC (Non-MIR)	186	\$5,833	\$23,658	\$4,634	\$3,959	\$4,378	\$42,432

Approximately 89% of claimants with a minor physical injury and an ancillary condition were not subjected to the MIR. The average payment for non-pecuniary damages to these claimants was considerably larger than the average payment to claimants with a similar physical injury who settled under the MIR. Overall, the value of settlements to those 186 claimants who were not subjected to the MIR totaled \$7.9 million. This amount was greater than the \$6.8 million in settlements for the 1,234 claimants with a minor physical injury who settled their claim under the MIR.

The table below shows the total loss cost by province for the past five accident years.

Total Loss Cost by Province

	AB	ON	NB	NS	PE	NL
2010	\$792	\$1,244	\$525	\$470	\$410	\$750
2011	\$754	\$980	\$514	\$522	\$451	\$748
2012	\$854	\$953	\$478	\$518	\$381	\$815
2013	\$863	\$1,035	\$505	\$543	\$416	\$870
2014	\$900	\$1,057	\$560	\$533	\$408	\$819
Annual Change	3.2%	(4.0%)	1.6%	3.2%	(0.1%)	2.2%

IBC with data from GISA. Includes ULAE and the health levy.

Since 2010, the total loss cost has increased proportionately more in Alberta than in the other jurisdictions where private companies sell auto insurance, except for Nova Scotia, where it increased by the same amount. With BI claims representing one-third of total claims costs in Alberta and having increased the most over this time period, fixing the MIR is critical. Otherwise, more stakeholders will take advantage of the loophole to receive compensation for non-pecuniary damages well above the prescribed limit. The table below shows the frequency rate for BI claims, the average cost of a BI claim, and the loss cost for accident year 2014 as well as Dr. Miller's projections for 2015, 2016 and 2017.

BI Claims Cost Projections

	Frequency per 100 Vehicles	Average Claims Cost	Loss Cost
2014	0.57	\$53,660	\$307
2015	0.58	\$54,848	\$320
2016	0.59	\$57,034	\$335
2017	0.59	\$59,298	\$351

IBC with data from GISA (2014) and Dr. Ron Miller (2015, 2016, 2017). Includes ULAE but excludes the health levy.

Without action to fix the MIR, Dr. Miller estimates that the loss cost for BI claims will continue to rise and, over time, could return to levels that have not been seen since the crisis years of the late 1990s and early 2000s.

Loss Cost Trend Rates and Other Benchmarks

Loss Development Factors and Loss Cost Trend Rates

The table below shows the loss cost by sub-coverage for accident year 2014 based on the loss development factors that Oliver Wyman and the actuaries at GISA, respectively, used for their analyses. It also shows the percentage changes over a five-year period.

Loss Cost by Sub-Coverage Comparison

	OW 2014	GISA 2014	OW 5-Year Change	GISA 5-Year Change
BI	\$309	\$307	31.0%	29.5%
PD	\$164	\$164	12.9%	13.2%
AB-MR	\$27	\$28	5.9%	6.5%
AB-DI	\$9	\$10	(5.9%)	(3.6%)
COLL	\$257	\$253	22.1%	20.3%
COMP	\$184	\$183	(6.6%)	(7.2%)

Includes ULAE but excludes the health levy.

Except for a few minor differences, the loss cost estimates by accident year from Oliver Wyman are similar to GISA's estimates. For estimating the future loss cost trend rates, Dr. Miller also used his own loss development factors. Dr. Miller's estimates were similar to Oliver Wyman's and GISA's estimates.

The table below shows the annual future loss cost trend rate by sub-coverage from Oliver Wyman.

Oliver Wyman's Future Loss Cost Trend Rate by Sub-Coverage

	BI	PD	AB-MR	AB-DI	COLL	COMP
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Trend Rate	+4.5%	+3.0%	+2.0%	-2.5%	+5.0%	+1.0%
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Dr. Miller's future loss cost trend rates were similar to Oliver Wyman's estimates. The insurers we met with to discuss Oliver Wyman's preliminary report noted that the future loss cost trend rates were reasonable for benchmarking purposes. The only trend rate that they did not have a great deal of confidence in was for accident benefits disability income (AB-DI). Because of the tendency for the frequency rate of injury claims to increase with downturns in the economy, they expect that the reduction in the loss cost for AB-DI may be less than Oliver Wyman estimates, if it declines at all.

For BI, while Dr. Miller and the insurers we met with agreed that Oliver Wyman's future loss cost trend rate was reasonable, they had different estimates for the one-time adjustment to BI claims costs in 2011-2. In its model, Oliver Wyman included a one-time change in severity of 10%. Because Oliver Wyman did not include a change for the frequency rate, the resulting change in the loss cost was 10%. Dr. Miller fitted a one-time change for severity with an increase of 16%, and a change for frequency with a reduction of 4%. The resulting change in the loss cost was 11.3%. Based on their own loss experience, some insurers believe a one-time adjustment of 20% for the BI loss cost is justified, which is similar to Oliver Wyman's estimate during the semi-annual review. We expect that when adjudicating rating programs, the AIRB will see applications with different yet reasonable adjustments for the BI loss cost to reflect a change in experience in 2011-2.

Catastrophe Provision

The 40% catastrophe provision that Oliver Wyman selected is an average of the provisions calculated using the past ten years of loss data. It is considerably lower than the 54% average provision calculated using the past five years of data.

During the five-year period between 2009 and 2013, there were more natural catastrophes that on a per claim basis caused more damage than the five-year period between 2004 and 2008. Prior to 2009, the most expensive year was 2007 with \$61 million in catastrophe losses. Since then, there were three years with more than \$100 million in catastrophe losses, including \$184 million in 2010, \$171 million in 2012 and \$131 million in 2013.

The table below shows the claims experience between the two five-year periods.

Comprehensive Catastrophe Experience

	2004 to 2008	2009 to 2013	Difference
Event Count	28	31	11%
Claim Count	44,701	110,816	148%
Average Cost	\$3,845	\$5,189	35%
Annual Cost	\$34,379,980	\$115,004,429	235%

IBC with data from GISA.

GISA may not release the updated *Catastrophe Report, Province of Alberta*, until the fall. Nonetheless, data from CAT-IQ and PCS, which is based on surveys of insurers that allow

CAT-IQ and PCS to estimate the amount of insured losses from natural catastrophes that cause at least \$25 million in total insured damages, shows that in 2014, a couple of events caused significant damages to insured vehicles. Specifically:

- The hail, wind and thunderstorm that struck southern Alberta, including Red Deer, High River and Airdrie, on July 17th caused more than \$28 million in insured vehicle damages; and
- The hail, wind and thunderstorm that struck Airdrie and the surrounding area on August 7th and 8th caused more than \$177 million in insured vehicle damages.

By the time the AIRB releases its decision on this matter, we expect that GISA's updated catastrophe report will be available.

Because of changing climate patterns, we believe that a catastrophe provision based on an average of the loss experience during the most recent five-year period is more appropriate for predicting future costs than the ten-year average.

Investment Income on Cash Flow

Oliver Wyman selected an investment rate of 1.5%. It selected this rate using forecasts from the Alberta government for the 3-month treasury bill yield of 0.95% in 2016 and 1.60% in 2017 and for the 10-year bond yields of 2.65% in 2016 and 3.40% in 2017. Given that the current yield on 3-month treasury bills is approximately 0.6% and that the yield on the long-term 10-year bonds are approximately 1.75%, Oliver Wyman's rate seems to be too high. Earlier this month, because of the performance of the global and Canadian economies, the Bank of Canada lowered its target for the overnight lending rate from 0.75% to 0.5%. This announcement was the second time this year the Bank of Canada lowered its target.

Given the need to maintain premium adequacy in a low interest rate environment and the uncertainty in the economy, we believe that a rate reflecting current returns and negative economic projections for the coming quarters is more appropriate than Oliver Wyman's selected rate.

Health Cost Recovery

In 7 of the past 10 years, the government increased the annual health levy by at least \$5 million. For 2015, the government increased the levy by \$15 million or 14%, from \$105 million to \$120 million.

Oliver Wyman implies that insurers should reflect the 2015 health levy of \$120 million in their filings for rating program changes up until the government announces the levy for 2016.

Many policies that will be subjected to the benchmarks from this annual review will be written in 2016 and effective into 2017. We expect that because of the Auditor General's comments last year on the health levy, adjustments of \$15 million or more will become normal. Given the financial implications, we continue to recommend that the AIRB allow insurers to account for a higher levy in 2016 and 2017 for policies written in 2016.

Operating Expenses

Oliver Wyman selected the *weighted-average* expense ratio from the industry expense report in GISA's *Automobile Insurance Financial Information Report*. The *weighted-average* expense ratio for 2013 was 24.2% of direct written premium. Included was a premium tax ratio of 2.8%, 0.2 percentage points less than the 3% prescribed rate.

According to the absolute amounts for the expenses in GISA's report, the expense ratio for 2013 was 24.7% or 0.5 percentage points higher than the *weighted-average*, with a premium tax ratio of 3%, in line with the prescribed rate. We believe that the expense ratio based on the absolute amounts is more appropriate.

In the 2015 Budget that the previous government introduced, the premium tax was going to increase from 3% to 4% effective April 1, 2016. The new government has not stated its intention with the premium tax. Depending on the government's decision, the AIRB may have to adjust its benchmark for the expense ratio.

Other Methodology Considerations

During the semi-annual review, an industry stakeholder suggested that Oliver Wyman analyze the claim indemnity amounts separate from allocated loss adjustment expenses (ALAE). Oliver Wyman noted that combining the two amounts was the general practice for adjudicating rating programs. We agree with proceeding with the traditional approach.

An industry stakeholder also suggested that Oliver Wyman not reflect a provision for unallocated loss adjustment expense (ULAE) in the trend analysis. Oliver Wyman noted that it includes a provision for ULAE to avoid any biases that may happen from insurers shifting claims costs from ALAE to ULAE or vice-versa. We agree with proceeding with the current approach.

Conclusion

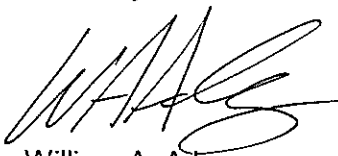
In advance of the public hearing, we want to leave the AIRB with the following comments:

- The grid base premiums require an increase that at least maintains the current gap between the competitively determined risk-based premiums and grid premiums, but should also reflect the higher cost trends and poorer underwriting results of the grid population;
- Without action from the government to fix the MIR, the cost of BI claims will continue to rise at a steady pace; and
- When adjudicating rating program changes,
 - Insurers may present with reasonable trend rates and assumptions that may differ from Oliver Wyman's selected rates and assumptions,
 - Changing climate patterns support using a COMP catastrophe provision based on five years of loss experience instead of Oliver Wyman's ten-year average,

- Current returns and projections for the economy justify using a lower investment return rate than Oliver Wyman's selected rate,
- The higher than usual increases expected to the health levy support allowing insurers to account for a higher levy in 2016 and 2017 for policies written in 2016, and
- An expense ratio based on the absolute amounts in GISA's industry expense report is more appropriate than using the *weighted-average*.

Again, thank you for the opportunity to provide input for the annual review. We look forward to meeting with the AIRB on August 18th.

Sincerely,

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

William A. Adams

cc: Del Dyck, Executive Director, AIRB