

July 22, 2016

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, 2015 Private Passenger Vehicles*, and to undertake an analysis of the loss experience of the grid vehicle population. Our commentary reflects Dr. Miller's review as well as the views of insurers operating in Alberta's private passenger vehicle insurance market, 84% 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; 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 for the grid population since accident year 2006.

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

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
10.9%	8.8%	9.1%	8.0%	7.5%	7.4%	7.6%	7.0%	6.6%	6.1%

IBC with data from Dr. Ron Miller.

Since the annual review in 2012, when the AIRB began adjusting the grid base premiums upwards by between 5% and 7% on an annual basis, the number of vehicles insured subjected to grid premiums has declined a percentage point and a half, from 181,473 or 7.6% of insured vehicles in 2012 to 161,029 or 6.1% of insured vehicles in 2015. The result of the 7% increase that the AIRB announced last year will not be known until the 2016 data is available.

The table below shows the loss costs and loss ratios for basic coverage for the grid population and the non-grid population for the past five accident years.

Loss Costs and Loss Ratios for Basic Coverage

	Grid Loss Costs	Grid Loss Ratio	Non-Grid Loss Costs	Non-Grid Loss Ratio
2011	\$1,180	90%	\$417	83%
2012	\$1,274	98%	\$441	89%
2013	\$1,282	95%	\$467	91%
2014	\$1,384	98%	\$488	91%
2015	\$1,557	104%	\$518	91%

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

Over the five-year period, the loss cost for basic coverage for the grid population increased at a higher rate than the loss cost for the non-grid population. Specifically, for the grid population, it increased by 32%. For the non-grid population, it increased by 24%.

Over the most recent three-year period, between 2013 and 2015, the loss cost for the grid population increased at a rate twice as fast as the non-grid population. For the grid population, it increased by 22%. For the non-grid population, it increased by 11%.

Because of the different cost trends, in recent years the gap between the loss ratio for the grid population and the loss ratio for the non-grid population widened. In 2011, the gap was 7 percentage points. In 2015, the gap was 13 percentage points.

The table below shows total claims costs and underwriting results, including operating expenses, for the grid population for basic coverage for the past five accident years.

Underwriting Results for Grid Vehicles for Basic Coverage by Accident Year

	2011	2012	2013	2014	2015
Total Claims Costs	\$201,803,855	\$231,150,315	\$224,595,123	\$235,979,395	\$250,772,852
Underwriting Results	(\$21,902,445)	(\$46,232,067)	(\$42,426,196)	(\$50,095,719)	(\$60,387,212)

IBC with data from Dr. Ron Miller. Includes ULAE and the health levy. Operating expenses based on data from GISA and Dr. Miller.

Although the size and market share of the grid population declined by a fair amount in recent years, the overall cost of claims that the grid population incurred and the overall underwriting losses increased. Specifically, between 2012 and 2015, the annual cost of claims increased by 8%, from \$231 million to \$250 million and the annual underwriting loss increased by 31%, from \$46 million to \$60 million. The reason for this development is that the annual adjustments to the grid base premiums were smaller than the annual increases in the cost of claims for the grid population.

Dr. Miller forecasts that for policy year beginning January 1, 2017, the average current street premium for the grid population for basic coverage will be 24% lower than the indicated required premium. Accordingly, this year's adjustment should account for the cost trend for the grid population and the gap that has developed between the average street premium and the indicated required premium. Otherwise, the difference between premiums set in the competitive

market and the premiums set according to the grid will decline and the market share of the grid population will increase again.

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
2011	\$251	\$154	\$39	\$227	\$110
2012	\$275	\$155	\$42	\$227	\$175
2013	\$291	\$165	\$41	\$245	\$167
2014	\$314	\$167	\$41	\$252	\$186
2015	\$342	\$162	\$45	\$246	\$186
Annual Change	8.0%	1.4%	3.6%	2.0%	14.0%

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

Besides comprehensive (COMP), the sub-coverage that sustained the largest year after year of rising costs is BI. Specifically, the loss cost for BI claims increased at a rate five 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
2011	0.60	\$41,907	\$251
2012	0.59	\$46,507	\$275
2013	0.59	\$49,766	\$291
2014	0.57	\$54,665	\$314
2015	0.55	\$62,318	\$342

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

The rising average cost of a BI claim was exclusively responsible for the rising loss cost. Each year between 2011 and 2015, the average cost increased by at least 7%. Between 2014 and 2015, it increased by 14%. Over the five-year period, the average cost increased by 49%.

IBC tried to identify the source of this cost trend by conducting a study of closed BI claims. The study shows unusual claiming patterns for some individuals with a minor physical injury. Specifically, the average payment for non-pecuniary damages to many individuals with a minor physical injury and an ancillary condition, such as temporomandibular joint disorder (TMD), anxiety and/or pain symptoms, was considerably larger than the average payment to individuals

with a similar physical injury who settled their claim pursuant to the prescribed limit in the *Minor Injury Regulation* (MIR).

Largely because of the cost trend for BI claims, total loss costs in Alberta increased at a faster rate than in other parts of the country.

- In 2011, the loss cost in Alberta was 34% higher than in Atlantic Canada. By 2015, the loss cost was 40% higher.
- In 2011, the loss cost in Alberta was 79% of the cost in Ontario. By 2015, the loss cost was 87% of the cost in Ontario.

The cost of BI claims in Alberta is expected to continue to increase at a much higher rate than in other provinces. The tables below show the most recent published future loss cost trend rates for BI claims for the provinces across Canada that publish trend factors as well as Dr. Miller's projected loss cost for BI claims for accident years 2015 to 2018.

Published Future Loss Cost Trend Rates for BI Claims

	Alberta	Ontario	Nova Scotia	Newfoundland & Labrador
Trend Factor	7.0% / 7.6%	2.2%	0.5%	4.5%

Alberta data is from Oliver Wyman and Dr. Ron Miller. Ontario data is from the Financial Services Commission of Ontario and is based on data up to the second half of 2014. Nova Scotia and Newfoundland and Labrador data is from Oliver Wyman and is based on data up to the first half of 2015.

Projected Loss Cost for BI Claims

	2015	2016	2017	2018
Loss Cost	\$342	\$365	\$393	\$422

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

Both the experience of the past five accident years and the projected future trend rates indicate that regulatory reform is needed to reduce and contain the cost of BI claims. Dr. Miller projects that without changes to the MIR so that the prescribed compensation limit for non-pecuniary damages applies to all types of minor injuries, the loss cost for BI claims will continue to increase, reaching \$422 in 2018, which is higher than the annual loss cost during the auto insurance crisis of the late 1990s and early 2000s.

Loss Development Factors and Loss Trend Rates

The table below shows the loss cost by sub-coverage for accident year 2015 based on the loss development factors that Oliver Wyman, Dr. Miller and the actuaries at GISA used for their individual analyses. It also shows the percentage changes over a five-year period.

Loss Cost by Sub-Coverage Comparison

	OW 2015	RM 2015	GISA 2015	OW 5-Year Change	RM 5-Year Change	GISA 5-Year Change
BI	\$341	\$342	\$342	35.8%	37.0%	36.3%
PD	\$161	\$162	\$162	4.9%	5.6%	5.8%
AB-MR	\$31	\$31	\$32	15.7%	16.0%	17.6%
AB-DI	\$11	\$11	\$11	8.2%	9.9%	12.2%
COLL	\$244	\$245	\$246	7.8%	7.8%	8.5%
COMP	\$186	\$186	\$186	68.8%	68.9%	68.6%

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 Dr. Miller's estimates and GISA's estimates.

Because, for a few recent accident half-years, Oliver Wyman removed the reported BI claim amounts and claim counts of a few insurers and based its estimates partially on confidential information from those insurers instead of only public data, Dr. Miller cannot assess Oliver Wyman's methodology. While Oliver Wyman's loss costs for BI claims are similar to Dr. Miller's estimates, if Oliver Wyman continues to rely on an analysis of confidential information in future reviews, the differences could become significant. These differences could be pertinent to future applications for changes to rating programs.

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

Future Loss Cost Trend Rate by Sub-Coverage

	OW	RM	Difference
BI	+7.0%	+7.6%	0.6 p/p
PD	+3.5%	+2.0%	(1.5 p/p)
AB-MR	+3.0%	+2.6%	(0.4 p/p)
AB-DI	0.0%	+2.9%	2.9 p/p
COLL	+4.0%	+3.5%	(0.5 p/p)
COMP	N/A	+1.7%	N/A

The future loss cost trend rates are similar except for property damage (PD) and accident benefits disability income (AB-DI). The difference in the trend rates for BI claims could be because of Oliver Wyman's use of confidential information from a few insurers.

For accident half-year 2011-2, Oliver Wyman included in its model a one-time change in severity for BI claims of 11%. Because Oliver Wyman did not include a change for frequency, the resulting change in the loss cost is 11%. Dr. Miller also included in his model a one-time

change, although he fitted it to frequency, with an increase of 3.3%, and to severity, with an increase of 4.0%. The resulting change in the loss cost is 7.4%.

Some actuaries may create models without a change in level for accident half-year 2011-2. In these instances, the resulting future loss cost trend rate could be higher than Oliver Wyman's and Dr. Miller's projections.

Catastrophe Provision

The 55% catastrophe provision that Oliver Wyman selected is an average of the weighted average factors for the past 5 and 10 accident years up to 2014. The table below shows the claims experience between the two most recent five-year periods in GISA's *Catastrophe Report, Province of Alberta*.

COMP Catastrophe Experience

	2005 to 2009	2010 to 2014	Difference
Number of Events	27	33	22%
Number of Claims	46,314	128,287	177%
Average Claims Cost	\$4,130	\$5,563	35%
Annual Cost of Claims	38,251,937	142,729,388	273%

IBC with data from GISA.

During the five-year period between 2010 and 2014, there were more natural catastrophes that on a per claim basis caused more damage than the five-year period between 2005 and 2009. Prior to 2009, the most expensive year is 2007 with \$61 million in catastrophe losses. Since then, there have been four years with more than \$100 million in catastrophe losses, including \$188 million in 2010, \$171 million in 2012, \$132 million in 2013 and \$178 million in 2014.

Data from PCS, which estimates the amount of insured losses from natural catastrophes that cause at least \$25 million in total insured damages, shows that in 2015, a few events caused significant damages to insured vehicles. Specifically:

- The hail, wind and thunderstorm that struck the Medicine Hat area on July 11th and 12th caused more than \$4.7 million in insured vehicle damages;
- The wind and thunderstorm that struck parts of central and southern Alberta on July 21st and 22nd, caused \$115 million in insured vehicle damages; and
- The wind and thunderstorm that struck the Calgary area and other parts of southern Alberta on August 4th and 5th caused nearly \$55 million in insured vehicle damages.

Mostly due to the wildfire in Fort McMurray, 2016 will probably have the highest insured vehicle damage losses from natural catastrophes in Canadian history.

Because of the increases in losses from natural catastrophes in recent years, Dr. Miller continues to advise using a provision based on the weighted average of the last five accident years. For the most recent five-year period, the weighted average is 65%.

Health Cost Recovery

For 2015 and 2016, the government increased the health levy by \$15 million, from \$105 million to \$120 million and from \$120 million to \$135 million, respectively. The typical increase in prior years was \$5 million.

Oliver Wyman implies that insurers should reflect the 2016 health levy of \$135 million in their filings for rating program changes up until the government announces the levy for 2017. Dr. Miller's position is that because of the size of the recent increases and because many policies written in 2017 will be in effect into 2018, insurers should be able to account for a higher levy in 2017 and in 2018 in their filings.

Investment Income on Cash Flow

Oliver Wyman selected an investment rate of 0.65% using forecasts from the Alberta government for the 3-month treasury bill yield of 0.53% in 2016 and 0.75% in 2017 and for the 3-year bond yields of 0.59% in 2016 and 0.85% in 2017. Current yields on both the 3-month treasury bill and 3-year bonds are approximately 0.50%. Dr. Miller noted that Oliver Wyman's rate is only slightly above his estimates of 0.50% for total coverage and 0.60% for basic coverage based on risk-free rates as of mid-June.

Operating Expenses

The expense ratio based on GISA's *Automobile Insurance Financial Information Industry Expense Report* for 2014 is unusual as the 2.8% calculated premium tax does not align with the 3.0% statutory tax from that year. The reason for this inconsistency is that GISA's calculation apportions earned (i.e. incurred) claims costs and expenses to direct written premium instead of direct earned premium. By using direct written premium, GISA also excludes insurers with non-positive written premium but with positive expenses, and presumably also positive earned premium.

Oliver Wyman addressed part of this problem by adding a 1.2% increase to the published premium tax so that it comes to the 4.0% that has been in effect since April 1, 2016. Accordingly, Oliver Wyman's selected expense ratio is 25.4%. Dr. Miller calculated the expense ratio using direct earned premium. The result is an expense ratio of 26.6%.

The table below shows the components of Oliver Wyman's expense ratio, which is based on direct written premium, and Dr. Miller's expense ratio, which is based on direct earned premium.

Expense Ratio Comparison

	OW (using written premium)	RM (using earned premium)
Direct Commissions	10.5%	10.9%
Contingent Commissions	1.4%	1.5%
Total Commissions	11.9%	12.5%
Premium & Fire Taxes	4.0%	4.0%
Other Acquisition Expenses	3.2%	3.4%
General Expenses	6.3%	6.7%
Total Expenses	25.4%	26.6%

Conclusion

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

- The grid base premiums warrant an increase that accounts for the loss cost trend for basic coverage for the grid population and the gap that has developed between the average street premium and the indicated required premium;
- Without action from the government to fix the MIR, the cost of BI claims will continue to rise at a rate much higher than inflation; 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,
 - The size of the increases expected to the health levy support allowing insurers to account for a higher levy in 2017 and in 2018, and
 - An expense ratio based on direct earned premium is more appropriate than an expense ratio based on direct written premium.

Again, thank you for the opportunity to provide input for the annual review. We look forward to meeting with the AIRB on August 16th.

Sincerely,



William A. Adams

cc: Del Dyck, Executive Director, AIRB