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Automobile Insurance Rate Board
2440 Canadian Western Bank Place
10303 Jasper Avenue
Edmonton, AB T5J 3N6

STATEMENT OF STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY

I appreciate the opportunity to provide comments to the Board regarding the annual review of auto insurance premiums for basic and optional coverages in Alberta.

The State Farm Mutual Automobile Insurance Company is the largest insurer of automobiles in North America. State Farm commenced writing auto insurance in Canada in June of 1938.

State Farm is a multiple line insurance organization insuring almost 1 million automobiles in Canada, of which almost 119,000 are in Alberta. In addition, we have about 900,000 Property and Casualty (P&C) policies other than automobile insurance and over 250,000 Life Insurance policies in Canada. State Farm's Canadian Headquarters is in Aurora, Ontario. There are 44 exclusive State Farm insurance agents in Alberta, in addition to a variety of different employees residing and working in Alberta to support their efforts.

It is worth noting that the automobile insurance marketplace in Alberta is very competitive. State Farm is one of a number of insurance companies writing automobile insurance in Alberta. However, since the introduction of the Risk Sharing Pool (RSP), the RSP has become one of the larger insurers in Alberta. This creates significant concerns for a properly functioning competitive marketplace and was not the intent of the RSP. The grid rate level needs to be established at a high enough ceiling that it performs its intended function and also allows the competitive marketplace to operate underneath it. The maximum premium grid should not restrict rates for the lowest cost customers. Increasing the maximum premium is consistent with recent loss costs and will promote competition and reduce the size of the RSP, thereby reducing the grid subsidy.

It is important that the Board not disrupt the competitive market by adopting a rigid and uniform method that might deny insurers a fair and reasonable profit. A competitive marketplace is the best regulator of rates. We are optimistic that the premium regulation will improve the responsiveness of rates in the market to the underlying costs.

The purpose of my written submission is to provide suggestions to the Alberta Insurance Rate Board regarding the automobile insurance issues set for hearing in August 2014.

Loss Trends

It is important to recognize that ratemaking is prospective. The auto insurance product is priced before the ultimate costs are known.

We caution the use of overly optimistic assumptions in the ratemaking process for the maximum premium. We suggest that the maximum premium be established toward the upper threshold of what is an actuarially justified rate. In addition, the grid places a ceiling on the premiums but no such limit exists on the losses. Last year, the grid premium was increased 5%, which was much less than indicated based on the claim costs.

Following decreases in bodily injury claim frequency in 2009, which may have resulted from injured drivers who refrained from making a claim during the MIR challenge process, bodily injury claim incurred frequency has increased considerably. Recent loss experience shows bodily injury frequency has started to flatten, however, it remains at an elevated level. The average paid claim for bodily injury increased sharply from fourth quarter of 2011 through second quarter 2013. Similar to frequency, severity for bodily injury coverage has started to flatten, however both severity and the average cost per policy, remain at an elevated level when compared to historical loss experience. For accident benefits coverage, the average cost per policy decreased during the end of 2011 and beginning of 2012. However, since that time we continue to see increases in the average cost per policy. These increases have been primarily driven by an increase in claim severity.

Costs for the mandatory coverages have risen. While insurers have the ability to adjust their rates, if the grid premiums are not adjusted to reflect the increasing costs, insurers will not realize all of the additional premium from rate increases, and the RSP will grow as more policies are capped.

Our physical damage coverages: Collision, Comprehensive and Property damage, have been impacted by the changing environment relative to increases in the price of parts and repair costs. All three coverages have seen increase in the average cost per policy mainly driven by the increase in paid severity.

Impact of Economic Climate on Claim Costs

Several influences affect claim costs. It is difficult to identify one source. The improving economy can have an impact. Claim severity often increases as the cost of goods and services rise. The kilometres driven usually increase during a favorable economic cycle as well, and we have already begun to see frequency levels increase in the last year. As the economy in Alberta continues to improve, we expect inflation and kilometres driven will increase, adding pressure to claim severity and frequency, respectively.

It is also worth noting that investment yields have decreased, and we expect them to remain at these lower levels, resulting in less investment income to support the insurance operation. Hence, everything else being equal, the insurers need more from underwriting income to achieve the same return on equity investment.

Another consideration is the impact on injury claims of the Sparrowhawk vs. Zapoltinsky decision made in January of 2012. We have seen an increase in claims involving temporomandibular joint disorder (TMD) injuries as a result of this decision and we expect that impact to continue. We believe this decision has impacted BI and Accident Benefits costs.

Summary

The annual rate review will establish guidelines for ratemaking factors to be used in the review of insurer's filings for basic and optional coverage. As discussed above we continue to see increases in the average cost per policy. If the maximum premium of the RSP is not adjusted to adequately reflect the rising costs we will continue to see a low ceiling which does not allow a competitive marketplace to operate beneath it.

We should allow the competitive marketplace to deal with these marketing strategies and not through a regulatory process that implies one size fits all. Consumers are best served by a competitive marketplace which is responsive to their specific and individual needs. The most successful companies will be those who can satisfy individual customer needs by offering the best combination of value – quality products, excellent service, and competitive prices.

In conclusion, we have significant concerns with the current maximum premium and the grid structure. State Farm is having a larger percentage of our new business capped by the grid compared to our renewal book. Over time, this would have a negative impact on the size of the Risk Sharing Pool. In addition, the percentage of new business capped by the grid is even larger for Edmonton. The subsidy for Edmonton is against cost-based pricing and disrupts the natural functioning of the marketplace.


Again, I appreciate the opportunity to provide comments to the Board regarding Auto Insurance in Alberta.

State Farm is committed to working with AIRB in providing a healthy auto insurance environment that is responsive, stable, affordable, and sustainable at meeting the needs of Albertans.

All questions concerning this written submission should be directed to:

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Sincerely,



Steve Harr
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