

**ANNUAL INDUSTRY-WIDE ADJUSTMENT OF RATES FOR
BASIC COVERAGE**

EFFECTIVE NOVEMBER 1, 2009

**SECTION 4 OF THE
AUTOMOBILE INSURANCE PREMIUMS REGULATION**

ALBERTA AUTOMOBILE INSURANCE RATE BOARD

BOARD DECISION REPORT

Order No: 01-09

July 29, 2009



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1.0 BACKGROUND

1.1. LEGISLATIVE AND REGULATORY AUTHORITY

The Automobile Insurance Rate Board (referred to herein as either the AIRB or the Board) was established on October 1, 2004 under Section 653(1) of the *Insurance Act* (the Act). The mandate of the AIRB is defined in the Act and the *Automobile Insurance Premiums Regulation* (the Regulation) and includes the duty to:

- annually determine if rates for basic coverage¹ should be changed through an industry-wide adjustment;
- monitor optional coverage;
- review and approve rating programs for new insurers granted a license to sell automobile insurance in Alberta by the Superintendent of Insurance; and
- fulfill the duties and responsibilities carried out by the previous Automobile Insurance Board regarding non-private passenger insurers.

Section 4 of the Regulation requires that the Board announce on or before August 1 of each year whether premiums for basic coverage for private passenger vehicles are to be adjusted effective November 1. The Board must consider, in respect of basic coverage for private passenger automobiles:

- a) Industry wide loss costs;
- b) Administrative expenses, which may include:
 - Commissions;
 - Federal, provincial, and municipal taxes; and
 - General expenses;
- c) Other industry wide costs or expenses that the AIRB considers appropriate; and
- d) Any other criteria recommended by the Superintendent and approved by the Board.

1.2. LEGISLATIVE REFORMS AND GOVERNMENT ACTIONS

In 2003 the Alberta Government enacted Bill 53, *the Insurance Amendment Act*, which provided for:

- a cap on pain and suffering for minor injuries at \$4,000;

¹ Basic coverage is the third-party liability and accident benefits portion of an automobile insurance policy.

- introduction of treatment protocols;
- elimination of the double-recovery of compensation from more than one source;
- determination of wage loss based on net, rather than gross, wages;
- an increase in the maximum medical/rehabilitation benefits under accident benefits to \$50,000; and
- the introduction of the “take all comers” underwriting system.

The reforms set out in Bill 53 became effective October 1, 2004, with the exception of the consideration of collateral sources and the determination of wage loss based on a net, rather than gross, wages, which became effective January 26, 2004. Also on October 1, 2004, the Government introduced the grid rate system, which set maximum premiums to be charged for basic coverage, and established two risk sharing pools².

The initial annual review process in 2005 resulted in a 4% reduction in premium level for basic coverage. The 2006 annual review process resulted in a further 3% reduction in premium level for basic coverage. The 2007 annual review decision was for 0%, or no adjustment. The 2008 decision was for +5% which broke down to -5% for experience and +10% as a partial response to the expected impact on claim costs of removal of the cap on non-economic damages under the *Minor Injury Regulation*, pending the outcome from the Alberta Court of Appeal.

On February 8, 2008, the Alberta Court of Queen’s Bench struck down the *Minor Injury Regulation* cap on non-pecuniary damages recoverable for minor injuries, ruling it unconstitutional. No stay was granted on the ruling. The Alberta Court of Appeal overturned the lower court decision on June 12, 2009 and the cap was restored. Section 5.5 provides further details on the impact of the court decisions.

The *Minor Injury Regulation* is amended annually to adjust the amount of non-pecuniary damages recoverable for minor injuries by the Consumer Price Index for Alberta. The amount increased to \$4,504 as of January 1, 2009.

² Coverage for insureds whose premium for basic coverage is limited by the grid can be ceded to one of the risk sharing pools. Insurers may voluntarily cede up to 4% of their insured vehicles rated below the grid through the second risk sharing pool.

1.3. THE OLIVER WYMAN REPORT

On June 1, 2009, the Board released the report of its consulting actuary, Oliver Wyman, titled, "Actuarial Analysis for Industry-wide Rate Adjustment Effective November 1, 2009" (Oliver Wyman Report). The Oliver Wyman Report presented its analysis and findings regarding the private passenger insurance rates being charged in Alberta for basic coverage. The Oliver Wyman Report was commissioned by the Board to provide information and professional advice to assist the Board to fulfill its mandate with respect to the annual uniform industry-wide rate level adjustment for private passenger vehicles.

Oliver Wyman prepared an Addendum to the Oliver Wyman Report which was presented to the Board at a duly constituted meeting held on July 20, 2009. The Addendum addressed certain issues arising from the public meetings in June 2009.

Based on the actuarial analysis, the Oliver Wyman Report, as modified by the Addendum, found that for private passenger automobile insurance policies to be written during the period November 1, 2009 through October 31, 2010 (hereafter referred to as policy year effective November 1, 2009), the industry average street premium for basic coverage is expected to be higher than the required average premium for basic coverage by 1.2%.

Indicated Industry-wide Rate Level Adjustment

Policy Year Effective November 1, 2009

Private Passenger Automobile

Table 1 – Experience Adjustment

Policy Year Nov 1-08 to Oct 31-09	TPL and Accident Benefits	Indicated Rate Level Adjustment
Required Avg. Premium	\$603	
Average Street Premium	\$610	-1.2%

2.0 PUBLIC MEETINGS

2.1. NOTICE

On April 8, 2009 the Board published notice of public meetings to be held in Edmonton on June 16 and 17, 2009 for the purposes of determining if rates for basic coverage should be adjusted on an industry-wide basis effective November 1, 2009. All interested parties were invited to submit a letter of intent to the Board by May 1, 2009. In addition to the notice, the Board placed newspaper ads in Edmonton, Calgary, Red Deer Medicine Hat and Lethbridge on May 2 and Grande Prairie and Fort McMurray on May 1.

2.2. PRESENTATIONS AND WRITTEN SUBMISSIONS

The Board received 15 letters of intent to participate in the public meetings. Eleven requested the opportunity to make a presentation during the public meetings while 4 asked to submit only a written submission. All parties that requested the opportunity to make a presentation were scheduled a time slot, provided with a copy of the Rules of Procedure for the public meeting and asked to ensure that their comments were relevant to the annual adjustment process.

2.3. PUBLIC MEETINGS

The public meetings were held over two days, June 16 and 17 at the Delta Centre Suite Hotel in Edmonton. The Board was assisted by Mr. Ted Zubulake, Managing Director of Oliver Wyman and Board Actuary, and Board staff Mr. Del Dyck, Executive Director, Ms Susan Steeves, and Ms KimBerley Kern.

The following parties made presentations at the public meetings:

1. Oliver, Wyman Limited
2. Intact Financial Corporation
3. Alberta Motor Association Insurance Company
4. Palliser Insurance Agency Ltd.
5. Dominion of Canada General Insurance Company
6. Alberta Civil Trial Lawyers Association
7. Merle Taylor, Consumer Representative on the AIRB
8. Insurance Bureau of Canada (IBC)

9. Facility Association
10. Allstate Canada Group
11. Peace Hills General Insurance Company
12. TD Meloche Monnex

The following parties made written submissions to the Board, which were tabled publicly on June 17th:

1. Co-operators General Insurance Company
2. McCourt Law Offices
3. State Farm Mutual Automobile Insurance Company
4. The Wawanesa Mutual Insurance Company

All information submitted to the Board as part of the public meeting process has been posted to its website: www.airb.alberta.ca. Transcripts of the proceedings are also posted on the website.

3.0 ACTUARIAL EVIDENCE AND ANALYSIS

3.1. OVERVIEW OF OLIVER WYMAN'S ANALYSIS AND FINDINGS AT PUBLIC MEETINGS

Mr. Zubulake, Managing Director of Oliver Wyman, provided the Board with Oliver Wyman's findings that were posted on the website on June 1, 2009. A July 20 Addendum relates Oliver Wyman's adjustments in response to the information disclosed through the public meetings and confirmation of information following those meetings.

The key issues contained in the Oliver Wyman Report were:

- The industry-wide adjustment applies to policies written in the policy year effective between November 1, 2009 and October 31, 2010. Oliver Wyman refers to this period as the policy year effective November 1, 2009. This is in contrast to insurance industry financial results, which are typically presented on a calendar year basis, which is the year when claim payments, claim reserves, or changes in reserves are recorded in a company's financial statements. Since claim payments and changes in claim reserve estimates occur over a period of time following the year in which the insurance policy was written, an insurer's reported financial results are affected by claim activity over a period spanning many policy years. A policy year will reflect the experience of policies with an effective date in the given year, regardless of when payments are made toward the policy. The difference between policy year and accounting year explains in part why findings presented by Oliver Wyman and other actuaries may appear to be inconsistent with recent financial results reported by the insurance industry.
- Virtually all of the numbers presented to the Board by Oliver Wyman or by other parties, whether on a policy year basis or on an accounting year basis, are either estimates or based on estimates. Insurers will not know for certain what their costs will be for the claims of drivers they insure in the policy year effective November 1, 2009 for some time as it takes several years for all claims that occur to be reported and settled.

- The data upon which Oliver Wyman based its analysis and findings includes all insured drivers in the province, including those in the Facility Association and those in the Risk Sharing Pools.
- The latest claim data that was provided to Oliver Wyman by the General Insurance Statistical Agency (GISA) through the Insurance Bureau of Canada (IBC) was as reported up to December 31, 2008.
- There are three components to the premium charged by insurance companies:
 1. a provision for claims and claims administration/adjudication expenses that must be paid, including a discount for the investment earnings expected to be earned on the premiums until the claims are fully paid. The claims provision represents about two-thirds of the premium dollar;
 2. a provision for insurance company operating expenses, which represents about one-fourth of the premium dollar; and
 3. a provision for cost of capital or profit.

Oliver Wyman projected the total of the three components, on average, for policies that will be written in the policy year effective November 1, 2009. This is referred to as the “required average premium.” This “required average premium” was compared to the average premium expected to be charged by insurers for the policy year effective November 1, 2009, which Oliver Wyman referred to as the “street premium.” The percentage difference between Oliver Wyman’s estimate of the required average premium and Oliver Wyman’s estimate of the street premium represents Oliver Wyman’s estimate of the adequacy of the industry-wide rates, on average.

The June 12 decision of the Alberta Court of Appeal restored the cap on non-economic damages under the *Minor Injury Regulation* and, therefore, the Oliver Wyman Addendum estimates only consider premium requirements in an environment with the cap in place.

3.2. OLIVER WYMAN INITIAL ESTIMATE OF THE REQUIRED AVERAGE PREMIUM

3.2.1. The Provision for Claims

The provision for the cost of claims and claims administration/adjustment expenses is the largest component of the premium dollar and the most difficult to estimate. The best indicator of what the provision for claim costs should be is claim costs in the recent past, adjusted for environmental changes or trends. Oliver Wyman's general approach was to consider recent past experience in a three-step process:

1. First, it estimated what the ultimate claim costs will be for claims incurred in the recent past, which Oliver Wyman has defined as the accident years 2004 through 2008. Oliver Wyman applied generally accepted actuarial techniques to develop the reported claims to their expected ultimate level.
2. Second, Oliver Wyman adjusted the estimated ultimate claim costs in each accident year to reflect environmental changes or trends that have occurred that would cause the claim costs for the policy year effective November 1, 2009 to be different than the estimated ultimate claim costs for the accident years 2004 through 2008. The two major environmental changes that Oliver Wyman reflected are: the expected impact of insurance reform (Bill 53) and trends in claims frequency and claim severity.
3. Finally, Oliver Wyman applied discount factors to the expected payout pattern of claims and claims administration/adjudication expenses to reflect the expected investment earnings on the premiums based on a selected "risk-free" rate of investment return.

Making these adjustments resulted in five separate estimates of what the average claim cost component will be for the policy year beginning November 1, 2009 - one estimate for each of the five years in the experience period considered by Oliver Wyman. Oliver Wyman selected a best estimate from among the five estimates, which was an average of the five estimates, with most of the weight given to the accident year 2007 and 2008 estimates.

As explained in its report, because of issues surrounding the bodily injury claim amount data for 2008 (and to a lesser extent to the updated data for prior accident years as well) in response to Associate Chief Justice Wittmann's decision to eliminate the minor injury cap and the resulting adjustments made by insurers to their claim reserving and claim settlement practices, Oliver Wyman departed from this general methodology in estimating the claim cost for the bodily injury coverage. Instead, Oliver Wyman relied on its estimate of the bodily injury claim severity that it derived for the 2008 industry-wide adjustment, trended forward by the same severity trend rate that it had selected for the 2008 IWA. Oliver Wyman estimated the bodily injury frequency following its general methodology, but with the trend rate selected in a manner similar to how it selected the frequency trend rate for the 2008 industry-wide adjustment which included a tempering of the selected past trend rate by half to arrive at the selected future frequency rate. Oliver Wyman derived its selected bodily injury claim cost by multiplying its selected severity and selected frequency.

3.2.2. The Provision for Expenses

Oliver Wyman selected an expense provision of 26.5% of premium based on the insurance industry's actual expenses for 2008 as reported through the Insurance Bureau of Canada (IBC). Oliver Wyman further assumed that "other operating expense costs" are split 50%/50% between fixed and variable with the premium level. This split is consistent with what the Board has accepted for prior year IWA's.

3.2.3. Health Recovery Cost

The Health Recovery Cost levy has increased in each of the prior four years that the industry-wide adjustment process has been in place. Oliver Wyman initially assumed an increase from \$90 million to \$92.5 million for 2010.

3.2.4. Profit

Oliver Wyman reflected the 7% of premium profit provision established by the Board.

3.2.5. Investment Rate

Investment income expected to be earned on premiums that are paid is recognized in determining the required average premium by reducing (“discounting”) the claim cost estimates based on the selected investment rate. Oliver Wyman initially selected a 2.0% investment rate based on the prevailing three-year Government of Canada Bond rates and the fact that rates were increasing.

3.2.6. Required Average Premium

Based on this general approach and the particular assumptions, selections, and calculations made by Oliver Wyman, Oliver Wyman derived its initial estimate of the required average premium, \$596, which it presented to the Board at the public meeting.

3.3. OLIVER WYMAN INITIAL ESTIMATE OF THE STREET PREMIUM

Oliver Wyman initially estimated the average street premium to be \$614.

3.4. OLIVER WYMAN INITIAL ESTIMATE OF THE INDUSTRY-WIDE ADJUSTMENT

Oliver Wyman’s initial estimates of the required average premium (\$596) and street premium (\$614) for the policy year effective November 1, 2009 led to its initial finding of a redundancy of 3.0%.

4.0 ISSUES FROM PUBLIC MEETINGS AND OLIVER WYMAN FINAL ESTIMATES

The technical discussion at the public meetings centered on the different bodily injury and property damage claim cost estimates between Oliver Wyman and IBC. While it was not a source of difference between Oliver Wyman and IBC, the increase in the expense provision was discussed at some length. The Health Levy was not an item of discussion as the Oliver Wyman and IBC estimates were identical. Ultimately, there was no difference in the selected investment rate, but there was discussion about its method of determination. The street premium received a fair amount of attention.

4.1. BODILY INJURY CLAIM COST

4.1.1. Discussion

Despite different approaches, the Oliver Wyman and IBC bodily injury claim cost estimates were relatively close (\$10 apart).

4.1.2. Oliver Wyman Final Estimate

Given the relative closeness of the Oliver Wyman and IBC bodily injury claim cost estimates, and the uncertainty surrounding the 2008 bodily injury claim amount data (as explained by Oliver Wyman in its report and at the public meetings), Oliver Wyman maintained its position with respect to frequency and severity of bodily injury trends, and, hence, maintained its initial estimate of the bodily injury claim cost.

4.2. PROPERTY DAMAGE CLAIM COST

4.2.1. Discussion

The estimated property damage claim cost represents the largest difference between the Oliver Wyman and IBC estimates. This difference, in turn, is primarily attributed to the consideration given to the effect of economic conditions on recent and future claim costs. Oliver Wyman implicitly considered the impact of the economy by selecting a future loss cost trend rate that is between the relatively high trend observed from 2004 through the first half of 2007 and the relatively flat trend observed through to the end of 2008. IBC explicitly reflected the impact of the economy by adding a parameter to its trend model and assuming that the Alberta economy will begin to recover in the second

half of 2009, fully recover by the first half of 2011, and that property damage loss trend would sharply rise as the economy recovers.

4.2.2. Oliver Wyman Final Estimate

Oliver Wyman has maintained its original position with respect to property damage loss cost trend for reasons presented in its Addendum.

4.3. THE PROVISION FOR EXPENSES

4.3.1. Discussion

Both Oliver Wyman and IBC selected an expense provision of 26.5% of premium based on the insurance industry's actual expenses for 2008 as reported through IBC. The issue of increased 2008 expenses - particularly for the commission category of expense - was raised in the public meetings. Following the public meetings, IBC investigated the increase in commission level, and the result confirmed the 26.5% overall expense provision.

4.3.2. Oliver Wyman Final Estimate

Oliver Wyman made no change to its selected expense provision.

4.4. HEALTH RECOVERY COST

4.4.1. Discussion

Oliver Wyman initially assumed an increase from \$90 million to \$92.5 million for 2010. However, a subsequent announcement by the Government left the 2010 Health Recovery Cost at \$90 million.

4.4.2. Oliver Wyman Final Estimate

Oliver Wyman reduced its original estimate of the Health Recovery Cost levy to \$90 million, which caused its estimate of the required average premium to decline by 0.1%.

4.5. INVESTMENT RATE

4.5.1. Discussion

Oliver Wyman originally selected a 2.0% investment rate based on the three-year Government of Canada Bond rates and the fact that rates were increasing.

At the public meetings Oliver Wyman endorsed the IBC 75/25 weighting of the two and three-year Government of Canada Bond rates as it better aligns with the 2.3 year average basic coverage claim duration. Oliver Wyman also suggested that the final investment rate be selected at a time closer to the decision. Since the public meetings, the bond rates have declined and the 75/25 weighted average as of the date of its Addendum was 1.34%, which Oliver Wyman applied in its revised indication.

4.5.2. Oliver Wyman Final Estimate

The lower 1.34% investment rate caused Oliver Wyman to increase its original estimate of the required average premium by 1.2%.

4.6. ACCIDENT BENEFITS – MEDICAL/REHABILITATION

4.6.1. Discussion

Since the public meetings, the Superintendent of Insurance announced an increase for fees for physiotherapy and chiropractic services that is effective August 1, 2009.

4.6.2. Oliver Wyman Final Estimate

As a result, Oliver Wyman increased its selected severity trend factor from 0% to 3%, which in turn caused Oliver Wyman to increase its original estimate of the required average premium by 0.3%.

4.7. STREET PREMIUM

4.7.1. Discussion

Concerns with the reliability of the data used for determining the street premium led to further discussions following the public meetings. The outcome was that the “fast-track” data used to estimate the street premium was determined to be reliable. Based on this information, and at the Board’s request, Oliver Wyman and IBC reconciled their respective estimates and agreed to an estimated street premium of \$610 for the policy year effective November 1, 2009.

4.7.2. Oliver Wyman Final Estimate

The \$610 street premium estimate is \$4 lower than Oliver Wyman’s initial estimate.

4.8. OLIVER WYMAN FINAL ESTIMATE OF THE INDUSTRY-WIDE ADJUSTMENT

Oliver Wyman's final estimates of the required average premium (\$603) and street premium (\$610) for the policy year effective November 1, 2009 leads to its finding of a redundancy of 1.2%.

5.0 BOARD DECISION

The results of Oliver Wyman's additional analysis as set forth in its July 20 Addendum is a finding of a redundancy of 1.2% in the average street premium for basic coverage.

The Board accepts Oliver Wyman's revised finding as respects the changes it made to the Health Recovery Cost, method for determining the investment rate (i.e., the 75/25 weighting), trend for accident benefits – medical/rehabilitation coverage, and the street premium.

5.1. BODILY INJURY CLAIM COST

5.1.1. Board Position

The Board accepts Oliver Wyman's view concerning the unreliability of the 2008 bodily injury claim amount data, and, therefore, accepts Oliver Wyman's estimate of bodily injury claim severity – which is consistent with the Board's 2008 IWA decision.

As respects bodily injury claim frequency, both Oliver Wyman and IBC showed bodily injury frequency to have continued to decline in 2008, and rather sharply. The Board accepts that the frequency of bodily injury claims will stabilize or even increase at some point in the future. However, the Board also notes that this expectation, which has led to a tempering of the selected frequency trend rate in past decisions, has not yet been realized. The Board also notes that the IBC estimated bodily injury frequency is lower than Oliver Wyman's estimate. The Board expects frequency of bodily injury claims to continue to decrease at the average rate of 6.7% (the "past trend rate" selected by Oliver Wyman) for the policy year commencing November 1, 2009, which in turn would reduce the Oliver Wyman final estimate of the required average premium by about 2.9%.

5.2. PROPERTY DAMAGE CLAIM COST

5.2.1. Board Position

The Board recognizes the high degree of uncertainty surrounding the estimate of the property damage claim cost (as evidenced by the difference between the Oliver Wyman

and IBC estimates), and that given the economic conditions and the prospects for recovery, the future trend could very well be greater than (as IBC estimates) or less than what Oliver Wyman has estimated. The Board accepts Oliver Wyman's final estimate as a reasonable estimate of the property damage claim cost that reflects the rate of increase over the past three years.

5.3. SELECTION OF INVESTMENT RATE

As respects the selection of the investment rate, Oliver Wyman originally selected a 2.0% investment rate based on the three-year Government of Canada Bond rates and the fact that rates were increasing. IBC increased its initial selected rate from 1.25% to 2.0% at the start of the public meetings, also in recognition that rates were increasing. Oliver Wyman subsequently reduced its selected investment rate to 1.34% to reflect the 75/25 weighting of the two and three-year bond rates and the fact that bond rates had declined since the public meetings.

However, the relevant rate is that for May 2010, the mid point for writing policies for the November 1, 2009 policy year and, therefore, the outlook for interest rates is relevant.

There are forecasts such as the Alberta Economic Outlook issued in April 2009 of some recovery in interest rates over the coming months and, therefore, it is plausible to expect the original and very modest 2.0% rate of return for the November 1, 2009 policy year. The Board accepts the revised method of arriving at the rate of return on investment, and the initial Oliver Wyman estimate of 2.0%, in the belief that interest rates will recover to that level in the coming months.

5.4. INDUSTRY-WIDE ADJUSTMENT

Adjusting Oliver Wyman's revised finding of a 1.2% redundancy in the average street premium for the Board's selected bodily injury frequency trend and investment rate results in an indicated adjustment of -5%.

5.5. MINOR INJURY CAP

The 2008 industry-wide adjustment followed a Queen's Bench decision in February of that year that removed the *Minor Injury Regulation* cap for non-economic damages. The decision was under appeal but with no stay granted, the legal environment was one with no cap. The Board accepted its consulting actuary's estimate that removal of the cap would result in a 45.5% increase in bodily injury claims costs which would translate to a 20% increase in required premium level for basic coverage.

The Board faced a dilemma. To grant the 20% increase would be unfair to consumers if the appeal was successful and the cap restored. On the other hand, potential liabilities accrued since the implementation of the cap would continue to mount until a final outcome and posed a threat to the viability of the Alberta automobile insurance market. An option to allow insurers to collect the additional premium "in trust" and to return it with interest if the cap were restored posed logistical problems. The Board decided that industry and consumers would share the risk and granted half of the indicated impact of removal of the cap or 10%. The +10% was moderated by an experience adjustment of -5% for a net adjustment of +5%.

The initial Oliver Wyman Report for this year's adjustment process that was posted on the AIRB website on June 1 considered both scenarios, an environment with and without the cap. The balance of the adjustment for removal of the cap was calculated at +7.3%. Oliver Wyman's Addendum following the Court of Appeal decision and the public meetings only examines premium requirements with the benefit of the *Minor Injury Regulation* cap in place.

The June 12 unanimous decision of the Court of Appeal that restored the cap preceded the public meetings by only a couple of days. The discussion during the public meetings focused on premium requirements with the benefit of the *Minor Injury Regulation* cap on non-economic damages. Some insurers voiced a note of caution that with the virtual certainty of a further appeal to the Supreme Court of Canada, that the final outcome

remained in question and some element of uncertainty would remain for the immediate future.

The Board's mandate is to determine a fair rate level; that is, fair to the consumer and fair to industry to ensure a viable and competitive market. While a level of uncertainty persists until the outcome of the appeal to the Supreme Court is known, the current environment is one where the *Minor Injury Regulation* applies. In view of the unanimous decision of the Alberta Court of Appeal, the Board based its decision on the current automobile product that is the basis of settlement for any open claim.

5.6. IMPACT ON INDUSTRY

Insurers that are not in a position to accommodate the average adjustment have the option to make individual application for an adjustment under Section 6 of the *Automobile Insurance Premiums Regulation*.

6.0 ORDER NO: 01-09

ANNUAL ADJUSTMENT OF RATES EFFECTIVE NOVEMBER 1, 2009

In accordance with Section 4 of the *Automobile Insurance Premiums Regulation*, the Board hereby orders that the rates under rating programs for basic coverage (third party liability and accident benefits) for private passenger vehicles be reduced uniformly on an Alberta industry-wide basis by 5.0% effective November 1, 2009.

The Board has considered all of the oral and written information presented through the public meeting process, including the analysis and findings presented by its actuary, Oliver Wyman, and has decided on an adjustment of a 5.0% reduction in premium level for basic coverage.

7.0 APPENDIX A - AUTOMOBILE INSURANCE PREMIUMS REGULATION

Part 1, Section 4

- 4(1)** On or before August 1 in each year, the Board may adjust uniformly on an Alberta automobile insurance industry-wide basis, in accordance with the criteria described in subsection (3), the rates under rating programs for basic coverage of private passenger vehicles.
- (2)** In accordance with the procedures of the Board, the Board may hear representations with respect to an adjustment under this section.
- (3)** The criteria for an adjustment are
- (a) the Alberta automobile insurance industry-wide loss costs, as that term is understood by the Board, for basic coverage for private passenger vehicles;
 - (b) the administrative expenses relating to basic coverage for private passenger vehicles, on an Alberta automobile insurance industry-wide basis, that the Board considers appropriate to consider, which may include commissions, federal, provincial and municipal taxes and general expenses, as reported in the annual returns submitted by insurers to the Superintendent or a similar regulatory authority in another jurisdiction;
 - (c) other Alberta automobile insurance industry-wide costs or expenses that the Board considers appropriate relating to basic coverage for private passenger vehicles;
 - (d) any other criteria recommended by the Superintendent and approved by the Board.
- (4)** An adjustment under this section is effective November 1 of the year in which the adjustment is made by the Board.
- (5)** Notwithstanding subsection (4), if the Board increases the rates under a rating program for basic coverage in respect of private passenger vehicles, the increases may be applied by an insurer over a period of not more than 3 years commencing November 1 of the year in which the adjustment is made by the Board.
- (6)** Information about adjustments under subsection (1) must be made publicly available in a manner satisfactory to the Superintendent.

8.0 APPENDIX B – PRESENTATION SCHEDULE FOR PUBLIC MEETINGS

Tuesday, June 16, 2009 – Edmonton

**MacKenzie/Champlain Room, Delta Edmonton Centre Suite Hotel,
10222 – 102 Street NW**

Oliver, Wyman Limited
Intact Financial Corporation
Alberta Motor Association Insurance Company
Palliser Insurance Agency Ltd.
Dominion of Canada General Insurance Company
Alberta Civil Trial Lawyers Association
Merle Taylor, Consumer Representative on the AIRB

Wednesday, June 17, 2009 – Edmonton

**MacKenzie/Champlain Room, Delta Edmonton Centre Suite Hotel,
10222 – 102 Street NW**

Insurance Bureau of Canada (IBC)
Facility Association
Allstate Canada Group
Peace Hills General Insurance Company
TD Meloche Monnex

9.0 APPENDIX C - DEFINITIONS OF KEY TERMS

To assist the reader in his or her understanding of the Decision, several insurance terms are defined and explained below.

9.1. AUTOMOBILE INSURANCE COVERAGE

We begin with a general description of the insurance coverage. We note that throughout this discussion of the insurance coverage, the term “insured” is generally used to mean the family of the owner of the policy, as well as any passengers or other drivers using the car with the owner’s permission.

Third Party Liability (TPL) There are two parts to this mandatory coverage:

Bodily Injury (BI) coverage protects the insured against liability arising from an accident that causes bodily injury to another person. Coverage amounts available in Alberta range from the legal minimum of \$200,000 per claim to well over \$2,000,000 per claim.

Property Damage (PD) coverage protects the insured against liability arising from an accident that causes damage to the property of another person.

Accident Benefits (AB)

This coverage provides for such items as reimbursement of lost income, medical care costs, and funeral costs; it also provides benefits to the dependants of a deceased insured.

Underinsured Motorist (UIM)

This optional coverage protects the insured if he or she is caused bodily injury by an at-fault driver who is insured, but who does not have sufficient insurance to cover the liability; in this case the insured collects, from his or her own insurer, the amount of the damage that is in excess of the at-fault driver’s liability coverage and up to the limit of UIM coverage purchased.

Collision

This optional coverage generally provides coverage (subject to a deductible) for damage to the insured’s vehicle arising out of a collision.

Comprehensive

This optional coverage generally provides coverage (subject to a deductible) for damage to the insured’s vehicle arising out of a peril other than collision (e.g., theft, vandalism, flood, hail, fire, etc.).

All Perils

This optional coverage combines the coverage for both collision and comprehensive into one coverage, subject to a common deductible level.

Specified Perils

This optional coverage, like collision and comprehensive, provides coverage (subject to a deductible) for specific perils to the insured's vehicle.

9.2. OTHER TERMS

Accident Year

The year in which an incident that gives rise to a claim occurred, regardless of when the claim is actually reported to an insurance company. For example, a claim reported on January 15, 2003 for injuries suffered in an automobile accident that occurred on December 15, 2002, is considered to be an accident year 2002 claim.

Allocated Loss Adjustment Expense (ALAE)

ALAE is the claim and settlement expense that can be associated directly with individual claims (e.g., legal expenses). (See ULAE)

Base Rate and Rate Differentials

Insurers generally determine the premium for a particular insured by multiplying a base rate by a series of rate differentials (or rate factors, or rate relativities) that reflect the particular characteristics of the insured. The terms rate differentials, rate factors and rate relativities are used interchangeably. Typically, there is one base rate for each combination of coverage and rating territory. For example, assume a base rate for the TPL coverage of \$200 in Territory #1 and a base rate for the TPL coverage of \$300 in Territory #2. Also assume the rate differential for a married male driver, age 40, is 1.25. The TPL premium for this driver would be \$250 in Territory #1 (\$200 times 1.25) and \$375 in Territory #2 (\$300 times 1.25).

Case Reserve

The Case Reserve is the provision established by insurance companies for the payment of future losses and claim related expenses associated with a particular claim.

Claim Frequency

Claim Frequency is the average number of claims that occur in a year, per insured vehicle. Claim frequency is a measure of the incidence of automobile claims. For example, if an insurance company provided insurance on 100 vehicles in year 2002 and 5 TPL claims occurred during 2002, the company's TPL claim frequency for 2002 would be 5 percent.

Claim Severity

Claim Severity is the average reported incurred loss and ALAE per claim. Claim severity is a measure of the average cost of automobile claims. For example, if the 5 claims in the previous example resulted in a total incurred loss and ALAE of \$100,000, the claim severity would be \$20,000.

Claim Count Development

Claim Count Development refers to the change in the number of reported claims for a particular accident year over time. (See Loss Development)

CLEAR

CLEAR refers to Canadian Loss Experience Automobile Rating, a system of categorizing Private Passenger vehicles, by make and model-year, for physical damage coverage rating purposes. CLEAR was developed by the Vehicle Information Centre of Canada (VICC), a part of the Insurance Bureau of Canada. CLEAR considers such elements as the repairability and damageability of the make and model-year. (See MSRP)

Combined Ratio

Combined Ratio is another common measure of premium adequacy. This is the sum of the loss ratio plus the expense ratio (operating expenses divided by written premium). A combined ratio in excess of 100 percent is an indication of premium inadequacy, before consideration of profit and investment income.

Earned Premium

Earned Premium is the amount of written premium that is associated with the portion of the policy term that has expired. For example, assume an automobile policy with a 12-month term is sold on January 1 for \$1,000. The amount of earned premium would be \$500 on June 30

Exposure Unit

A measure of loss potential. In Private Passenger automobile insurance, the exposure unit that is commonly used is the number of insured vehicles. For example, all else being equal, it would be expected that the cost to an insurance company to insure 50 cars would be twice the cost to insure 25 cars.

Health Services Levy

As per Provincial legislation, a levy is paid by each insurer to achieve a target amount set by Government. IBC calculates and provides the level as a percentage of earned third party liability premiums. Under the legislation, the Government has no subrogation rights against the at-fault parties who are insured by policies of TPL insurance; but instead, collects the levy.

Loss Cost

Loss Cost is the average incurred loss and ALAE in a year per insured vehicle. The loss cost is the product of claim frequency and claim severity. Using the above example, a claim frequency of 5 percent, multiplied by a claim severity of \$20,000, produces a TPL loss cost of \$1,000.

Loss Development

Loss Development is the amount by which reported incurred losses and ALAE for a particular accident year change over time. The two main reasons why reported incurred losses and ALAE amounts change (or develop) over time are:

- a) Reported incurred losses and ALAE only include case reserve estimates on claims for which the claim adjuster has knowledge, i.e., case reserves are only established

on the claims that have been reported to the insurance company. Since typically some period of time elapses between the time of the incident and when it is reported as a claim, the number of reported claims for an accident year would be expected to increase over time. Claims that are reported after the close of an accident year are referred to as “late-reported” claims; and

- b) Reported incurred losses and ALAE also develop because, for a number of reasons, the initial case reserves established by claims adjusters, can not fully and accurately reflect the amount the claim will ultimately settle at. This pattern of under-reserving and over-reserving is common within the insurance industry (although the degree to which reported incurred losses and ALAE are under-reserved or over-reserved varies by company, jurisdiction, line of business, etc.). We further note that, over time, the percentage by which reported incurred losses and ALAE develop for a given accident year should decline. This is because as accident years become more mature (i.e., become older), fewer and fewer reserve estimates are adjusted to reflect newly reported late claims, actual payments, and additional information that becomes available to the claims adjuster.

Loss Ratio

Loss Ratio is defined as reported incurred losses and ALAE divided by earned premium. This is the common measure of premium adequacy. A loss ratio that exceeds a company’s break-even loss ratio (100 percent less budgeted expenses) would suggest premium inadequacy.

Loss Reserving Methods: Incurred Loss Method and Paid Loss Method

Loss reserving methods are often based on historical data grouped into a triangle format. A common approach is to have the rows represent the accident years, and the columns representing the value of the loss at specific dates, such as 12 months, 24 months, 36 months etc., from the beginning of the accident year. The historical changes in the loss data from period to period is reviewed to estimate a pattern to predict how current accident years losses will change over time as claims are settled and closed. The Incurred Loss Method refers to the triangle method of analysis, based on reported incurred losses. The Paid Loss Method refers to the triangle method of analysis, based on paid losses.

MSRP

MSRP refers to the Manufacturer’s Suggested Retail Price, and is a system of categorizing Private Passenger vehicles, by make and model-year, for rating purposes for physical damage coverages, according to the original price of the vehicle. (See CLEAR)

Operating Expenses

Insurance company expenses, other than ALAE and ULAE, are typically categorized as Commissions, Other Acquisition, General, Taxes, Licenses, and Fees.

Paid Losses

The total aggregate dollar amount of losses paid on all reported claims as of a certain date.

Premium Drift

Premium Drift is a more general term, and refers to the changes in the amount of premium collected by insurance companies that is attributed to the purchase of newer and more expensive cars (i.e., rate group drift) as well as to changes in the amount of insurance coverage that is purchased (e.g., the purchase of higher limits of liability coverage would increase the amount of premium collected by insurance companies, while the purchase of higher physical damage deductibles would reduce the amount of premium collected by insurance companies). (See Rate Group Drift)

Rate Group Drift

Rate Group Drift refers to the amount of additional premium collected by insurance companies that is attributed to the purchase of newer and more expensive cars by insureds. The premiums charged by insurance companies are higher for newer and more expensive cars. Therefore, as insureds purchase newer and more expensive cars, the amount of premium collected by insurance companies increases. (See Premium Drift)

Ratemaking Methods: Pure Premium Method and Loss Ratio Method

The Pure Premium Method of ratemaking develops indicated rates that are expected to provide for the expected losses and expenses, and provide for the expected profit. The Loss Ratio Method of ratemaking develops indicated rate changes rather than indicated rates.

Rating Territory

Automobile premiums vary by the principal garaging location of the vehicle. Based on Insurance Bureau of Canada's automobile statistical plan, Alberta is currently divided into three areas, or rating territories, of principal garaging location; and, therefore, has three separate sets of rates depending upon which of the three territories the vehicle is principally garaged. (see Statistical Territory)

Reported Incurred Loss

The sum of:

- (a) the total aggregate dollar amount of losses paid on all reported claims as of a certain date (referred to as the valuation date), and
- (b) the total aggregate dollar amount of losses set in reserve by the claim adjusters on each open claim (referred to as "case reserves") as of a certain date (the same evaluation date as for the paid loss amounts).

For example, if two claims were filed against an insurance company, one that settled for \$50,000 and the other that was open with a paid amount of \$25,000 and a "case

reserve” (i.e., the claim adjuster’s estimate of the dollars still to be paid on the claim) of \$30,000, then the total reported incurred loss on the two claims would be \$105,000 (the sum of \$50,000, plus \$25,000, plus \$30,000).

Reserve

A Reserve is the aggregate provision identified by an insurance company for the payment of future losses and claim related expenses associated with claims that have been incurred.

Surplus

The excess of the assets of an insurance company over its liabilities.

Statistical Territory

Automobile premiums vary by the principal garaging location of the vehicle. Alberta is divided into four statistical territories, of principal garaging location. Specific statistical territories are grouped together to represent a specific rating territory. In some cases there is one statistical territory in a rating territory, in other cases the rating territory is comprised of two or more statistical territories. (see Rating Territory)

Total Return on Equity

Total Return on Equity (ROE) refers to an insurer’s profit as a percentage of its surplus, where profit is the sum of (a) underwriting profit, and (b) investment income earned on both the underwriting operations of the company and on the surplus carried by the company.

Underwriting Profit

Underwriting Profit is defined as earned premium, less reported incurred losses and ALAE, less ULAE, less operational expenses.

Underwriting Profit Margin

Underwriting Profit Margin is the provision that is included in the insurance premium for underwriting profit to be earned by the company.

Ultimate Incurred Loss

An estimate of the total amount of loss dollars that will ultimately be paid to settle all claims that occur during a particular accident year.

Written Premium

Written Premium represents the total amount of premium charged by an insurance company for the insurance policies it has sold. It is generally measured over a one-year period.

Unallocated Loss Adjustment Expense (ULAE)

ULAE is the claim and settlement related expense that cannot be associated directly with individual claims (e.g., claim adjuster salaries). (See ALAE)