ANNUAL INDUSTRY-WIDE ADJUSTMENT OF RATES FOR BASIC COVERAGE

EFFECTIVE NOVEMBER 1, 2010

SECTION 4 OF THE AUTOMOBILE INSURANCE PREMIUMS REGULATION

ALBERTA AUTOMOBILE INSURANCE RATE BOARD

BOARD DECISION REPORT

Order No: 01-10

July 29, 2010

Alberta airb Automobile Insurance Rate Board

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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 coverage[1] 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
- 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 pools[2].

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. The 2009 decision was for a -5% which broke down to +5% for experience and -10% to remove the provision for removal of the cap because of the Alberta Court of Appeal’s reversal of the lower court’s decision that restored the cap on non-economic damages under the *Minor Injury Regulation*. The Supreme Court of Canada’s December 2009 decision not to allow leave to further appeal the decision validated the Board’s earlier decision not to make an explicit provision for a possible adverse outcome.

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. On

[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.

December 17, 2009, the Supreme Court of Canada denied leave to appeal the decision, thereby confirming the *Minor Injury Regulation* cap.

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 $4,518 as of January 1, 2010.

1.3. THE OLIVER WYMAN REPORT

On June 1, 2010, the Board released the report of its consulting actuary, Oliver Wyman, titled, "Actuarial Analysis for Industry-wide Rate Adjustment Effective November 1, 2010" (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 19, 2010. The Addendum addressed certain issues arising from the public meeting in June 2010.

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, 2010 through October 31, 2011 (hereafter referred to as policy year effective November 1, 2010), the industry average street premium for basic coverage is expected to vary from the required average premium for basic coverage by between -2.1% and +3.0%.

Indicated Industry-wide Rate Level Adjustment

Policy Year Effective November 1, 2010

Private Passenger Automobile

Table 1 – Experience Adjustment

Policy Year Nov 1-10 to Oct 31-11	TPL and Accident Benefits	Indicated Rate Level Adjustment
Required Avg. Premium (BI frequency trend -6.4%)	$571	
Average Street Premium	$583	-2.1%
Required Avg. Premium (BI frequency trend -3.2%)	$586	
Average Street Premium	$583	+0.5%
Required Avg. Premium (BI frequency trend 0.0%)	$601	
Average Street Premium	$583	+3.0%

The required average premium varies depending on whether frequency of BI claims is expected to continue to decrease at the same rate as over the past five years, abate to half the rate of decrease of the past five years or flatten out. The issue is discussed under Section 4.

2.0 PUBLIC MEETING

2.1. NOTICE

On April 14, 2010 the Board published notice of a public meeting to be held in Calgary on June 15, 2010 for the purposes of determining if rates for basic coverage should be adjusted on an industry-wide basis effective November 1, 2010. All interested parties were invited to submit a letter of intent to the Board by May 3, 2010. In addition to the notice, the Board placed newspaper ads in Edmonton, Calgary, Red Deer, Medicine Hat and Lethbridge on April 17 and Grande Prairie and Fort McMurray on April 16.

2.2. PRESENTATIONS AND WRITTEN SUBMISSIONS

The Board received 13 letters of intent to participate in the public meeting. Six requested the opportunity to make a presentation during the public meeting while 7 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 MEETING

The public meeting was held over one day, June 15 at the Telus Convention Centre in Calgary. 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 meeting:

1. Oliver, Wyman Limited
2. Insurance Bureau of Canada (IBC)
3. Facility Association
4. Merle Taylor, Consumer Representative on the AIRB
5. Intact Financial Corporation
6. Allstate Canada Group
7. TD Insurance

The following parties made written submissions to the Board, which were tabled publicly on June 15th:

1. Alberta Motor Association Insurance Company
2. Aviva Canada Inc.
3. Co-operators General Insurance Company
4. Desjardins General Insurance Group
5. The Dominion of Canada General Insurance Company
6. McCourt Law Offices
7. State Farm Mutual Automobile 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 MEETING

Mr. Zubulake, Managing Director of Oliver Wyman, provided the Board with Oliver Wyman's findings that were posted on the website on June 1, 2010. A July 19 Addendum relates Oliver Wyman's adjustments in response to the information disclosed through the public meeting and confirmation of information following the meeting. 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, 2010 and October 31, 2011. Oliver Wyman refers to this period as the policy year effective November 1, 2010. 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, 2010 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, 2009.

- 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 polices that will be written in the policy year effective November 1, 2010. 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, 2010, 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.

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 2005 through 2009. 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, 2010 to be different than the estimated ultimate claim costs for the accident years 2005 through 2009. The major environmental change that Oliver Wyman reflected is 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, 2010 - 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 2008 and 2009 estimates.

As explained in its report, Oliver Wyman reverted back to its general methodology in estimating the claim cost for the bodily injury coverage.[3] But in doing so, Oliver Wyman advised the Board that because the changes in the status of the minor injury cap affected how insurers reported bodily injury coverage claims, its bodily injury coverage claim cost estimates continue to be subject to a higher than normal degree of uncertainty.

[3] As explained in the 2009 Oliver Wyman report, Oliver Wyman had departed from its general methodology for the 2009 IWA because of issues related to the minor injury cap.

Oliver Wyman addressed a second source of higher than normal uncertainty in the bodily injury coverage claim cost estimates: future changes in the bodily injury coverage claim frequency rate. It did so by presenting to the Board a range of claim cost estimates based on: (1) a continuation of the pattern of declining bodily injury coverage trend rates over the past five years; (2) a tempering of the observed past bodily injury coverage trend rate by half; and (3) a flattening of the bodily injury coverage frequency trend rate. Oliver Wyman referred to these alternatives as its “Low Range”, “Mid Range” and “High Range” bodily injury future claim frequency trend estimates.

3.2.2. The Provision for Expenses

Oliver Wyman selected an expense provision of 24.9% of premium based on the insurance industry’s actual expenses for 2009 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 did not increase for 2010. Oliver Wyman initially assumed no change to the $90 million levy for 2011.

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 and two-year Government of Canada Bond rates consistent with the manner in which it selected its recommended investment rate for the 2009 IWA.

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 range of initial estimates of the required average premium - $564 under its "Low Range" bodily injury coverage future claim frequency trend estimate; $578 under its "Mid Range" bodily injury coverage future claim frequency trend estimate; and $592 under its "High Range" bodily injury coverage future claim frequency trend estimate - 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 $583.

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

Oliver Wyman's initial estimates of the required average premium and street premium for the policy year effective November 1, 2010 led to its initial finding of an indicated IWA ranging from a reduction of 3.3% ("Low Range" estimate), to reduction of 0.9% ("Mid Range" estimate), to an increase of 1.6% ("High Range" estimate).

4.0 ISSUES FROM PUBLIC MEETING AND OLIVER WYMAN FINAL ESTIMATES

Unlike prior IWA public meetings, no party presented alternative IWA calculations to those presented by Oliver Wyman. However, IBC pointed out that Oliver Wyman's selected "development factors"[4] were generally lower than those presented in the "Green Book"[5] and that all else being equal, the selection of higher development factors would lead to a higher indicated IWA. TD Insurance also commented that it believed certain of Oliver Wyman's selected development factors to be low.

A second issue that was discussed in Oliver Wyman's report and during the public meeting is the effect of the economy on claim costs. For reasons expressed by Oliver Wyman in its Addendum to its 2009 IWA report, Oliver Wyman did not explicitly adjust its claim cost estimates to reflect future changes in Alberta's economic conditions. Although it did not provide specific estimates, IBC referred to the analysis it prepared for the 2009 IWA in which it had forecast that as the Alberta economy recovered, claim costs would increase by more than what Oliver Wyman had projected – and it noted, "To some degree, the data we have at hand, subject to all the uncertainty in it, supports that that's what's happening…"[6] Allstate expressed a similar position; however, Intact stated that it had conducted "an exhaustive study to determine the impact of economic conditions on the underwriting results of the industry"[7] and did not find any significant correlations, nor did it find any correlation between levels of employment and automobile claim costs.

A third issue that was discussed during the public meeting was the sharp rise in medical expense claim costs evident in the industry data that Oliver Wyman had noted in its report. Intact acknowledged that it had observed a "most significant and alarming"

[4] Development factors are factors applied to the reported claim amounts and claim counts to estimate what the claim amounts and claim counts that occurred in a particular year will be when all claims are reported and settled. Development factors are selected for each coverage. Development factors are selected for six-month time intervals that reflect the age of the years in which the claims occurred.
[5] The "Green Book" is the annual report issued by the General Insurance Statistical Agency that presents its estimates of Industry private passenger premiums, claim costs, loss ratios, and other statistical information, by province, accident year, and coverage.
[6] Ron Miller, Insurance Bureau of Canada, Public Meeting Transcript, page 71.
[7] Martin Beaulieu, Intact Financial Corporation, Public Meeting Transcript, page 142.

nearly 30% increase in accident benefits claim cost, which it attributed to a number of factors including “the increase in the cost of diagnostic treatment protocols introduced in 2009”[8]. TD Insurance also reported an increase in medical expense costs, but also noted a change it made to its claim reserving practices, which caused some distortion (higher than actual) in the numbers it reported to GISA.

Oliver Wyman reported that it was advised by IBC that the reduction in the expense percentage from 2009 (26.5% to 24.9%) was largely due to a reduction in commission expenses and essentially the same companies that reported higher commission costs in 2008 reported lower commission costs in 2009. Oliver Wyman also reported that following the release of its report, it was advised that the Government had made a decision not to change the $90 million Health Recovery Cost levy.

No other technical issues were raised during the public meeting.

4.1. CLAIM COST ESTIMATES

4.1.1. Discussion

Following the public meeting, Oliver Wyman reviewed all of the development factors it had selected for each of the basic coverages. Based on its review, and in consideration of the comments expressed by IBC, Intact, and TD Insurance, Oliver Wyman changed (increased) four of its selected development factors:

BI Claim Amount Factor for 6-12 months

BI Claim Amount Factor for 66-72 months

PD Claim Amount Factor for 6-12 months

Med Expense Claim Amount Factor for 6-ultimate

As respects the impact that changes in the economy might or might not have on claim costs, Oliver Wyman continues to hold the same position it expressed for the 2009 IWA and, therefore, made no further changes.

[8] Martin Beaulieu, Intact Financial Corporation, Public Meeting Transcript, page 141.

Oliver Wyman believes that the change it made (noted above) to the medical expense claim amount development factor appropriately responds to the issue raised concerning the increase in reported claim costs.

Oliver Wyman continues to find a range of indicated IWA adjustments is appropriate considering the uncertainty surrounding future bodily injury coverage claim frequency rate.

4.1.2. Oliver Wyman Final Estimate

Oliver Wyman revised its "Low Range," "Mid Range," and "High Range" claim cost estimates to reflect the above noted changes it made to its selected development factors.

4.2. The Provision for Expenses

4.2.1. Discussion

No discussion.

4.2.2. Oliver Wyman Final Estimate

Oliver Wyman made no change to its selected expense provision.

4.3. Health Recovery Cost

4.3.1. Discussion

Oliver Wyman initially assumed the Government's $90 million Healthy Recovery Cost levy in 2009 would not change in 2010. This was confirmed at the public meeting.

4.3.2. Oliver Wyman Final Estimate

Oliver Wyman made no change to its selected Health Recovery Cost provision.

4.4. Investment Rate

4.4.1. Discussion

Oliver Wyman originally selected a 2.0% investment rate based on an average of the prevailing (at the time it prepared its report) three-year and two-year Government of

Canada Bond rates. This is consistent with the approach it adopted in recommending an investment rate for the 2009 IWA.

However, since the time of its report, the three-year and two-year rates have declined. As of July 16 they were 1.80% and 1.59%, respectively.

4.4.2. Oliver Wyman Final Estimate

Based on the more current three-year and two-year Government of Canada Bond rates, Oliver Wyman reduced its selected investment rate from 2.0% to 1.75%.

4.5. Street Premium

4.5.1. Discussion

No discussion.

4.5.2. Oliver Wyman Final Estimate

Oliver Wyman made no change to its estimated street premium.

4.6. Oliver Wyman Final Estimate of the Industry-Wide Adjustment

Oliver Wyman’s final estimates of the required average premium ($571 under its “Low Range” bodily injury coverage future claim frequency trend estimate; $586 under its “Mid Range” bodily injury coverage future claim frequency trend estimate; and $601 under its “High Range” bodily injury coverage future claim frequency trend estimate) and street premium ($583) for the policy year effective November 1, 2010 lead to its finding of an indicated IWA ranging from a reduction of -2.1% (“Low Range” estimate), to an increase of 0.5% (“Mid Range” estimate), to an increase of 3.0%.(“High Range” estimate). Oliver Wyman’s recommendation to the Board is to make no adjustment for policy year 2010.

5.0 BOARD DECISION

The results of Oliver Wyman's additional analysis as set forth in its July 19 Addendum is a finding that ranges from -2.1% to +3.0% for policy year 2010.

The Board accepts Oliver Wyman's revised finding as respects the changes it made to its selected development factors.

5.1. BODILY INJURY CLAIM COST

5.1.1. Board Position

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 led to a tempering of the selected frequency trend rate in some prior decisions has not yet been realized. The Board expects frequency of bodily injury claims to continue to decrease at the average rate of 6.4% (the "past trend rate" selected by Oliver Wyman) for the policy year commencing November 1, 2010, consistent with the Oliver Wyman "Low Range" estimate.

5.2. SELECTION OF INVESTMENT RATE

As respects the selection of the investment rate, Oliver Wyman originally selected a 2.0% investment rate based on an average of the then prevailing two and three-year Government of Canada Bond rates. At the time of writing its addendum, the bond rates had decreased prompting Oliver Wyman to reduce its selection to 1.75%.

However, the relevant rate is that for May 2011, the midpoint for writing policies for the November 1, 2010 policy year and, therefore, the outlook for interest rates is relevant. There are forecasts such as the Alberta Economic Outlook released in February 2010 of some recovery in interest rates over the coming months. The outlook for 2011 suggests an improved rate of return for the November 1, 2010 policy year. The Board selects a 3.0% rate of return in the belief that interest rates will recover to that level by mid 2011.

The 3.0% rate of return on investment as opposed to the Oliver Wyman selection of 1.75% would reduce the estimate of the required average premium by about 2.5%.

5.3. Industry-Wide Adjustment

Adopting the Oliver Wyman bodily injury frequency trend of -6.4% based on the past five years and an expected investment rate of 3.0% suggests a 4.4% redundancy in the average street premium, which the Board rounded up for an adjustment of -5%.

5.4. 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: 01-10

ANNUAL ADJUSTMENT OF RATES EFFECTIVE NOVEMBER 1, 2010

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, 2010.

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 MEETING

Tuesday, June 15, 2010 – Calgary
Room 108/109, Telus Convention Centre,
120 – 9th Avenue SE

Oliver, Wyman Limited
Insurance Bureau of Canada (IBC)
Facility Association
Merle Taylor, Consumer Representative on the AIRB
Intact Financial Corporation
Allstate Canada Group
TD Insurance

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.

<u>Loss Ratio</u>
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.

<u>Loss Reserving Methods: Incurred Loss Method and Paid Loss Method</u>
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.

<u>MSRP</u>
MSRP refers to the Manufacture’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)

<u>Operating Expenses</u>
Insurance company expenses, other than ALAE and ULAE, are typically categorized as Commissions, Other Acquisition, General, Taxes, Licenses, and Fees.

<u>Paid Losses</u>

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

<u>Premium Drift</u>
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)

<u>Rate Group Drift</u>
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)

<u>Ratemaking Methods: Pure Premium Method and Loss Ratio Method</u>
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.

<u>Rating Territory</u>
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)

<u>Reported Incurred Loss</u>
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)