

# Annual Report

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For the Year Ending December 31, 2006



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## **Introduction**

The Alberta Automobile Insurance Rate Board, constituted under subsection 653(1) of the *Insurance Amendment Act, 2003 (No. 2)*, is empowered under section 654 to exercise the powers and carry out the duties conferred on the Board under the *Insurance Act*, the *Automobile Insurance Premiums Regulation* and any other powers and duties assigned by the Minister.

This annual report documents the activities of the Automobile Insurance Rate Board during the period of January 1, 2006 to December 31, 2006.

## **The Alberta Automobile Insurance Rate Board**

Board Members are drawn to represent various geographical regions of the province and for a range of expertise they bring to the organization.

### **Mr. Alfred H. Savage, Chair**

Mr. Savage possesses over 30 years of private and public sector experience as a senior executive within some of the most progressive organizations in Canada and the United States. He has held senior positions in various municipalities in Alberta and Ontario and U.S. cities such as New York and Chicago. Now retired, Mr. Savage devotes his time to board and community work. He was a Board Member and Chair of the Olds College from 1997-2003 and is currently an Officer for the Alberta Municipal Government Board. Additional community involvement has included volunteering for the 1987 Commonwealth Games and the 1998 World Student Games and serving as Director of the Calgary Downtown Rotary Club.

### **Mr. Harry Gough, Q.C., Vice Chair**

Mr. Harry Gough, QC is a partner with Schumacher, Gough & Pederson in Drumheller and has been practicing law since 1975. Mr. Gough was a member of the Alberta Auto Insurance Board from 1997-2004. His community involvement includes member of the Criminal Law Practice Advisory Committee and member of the Custody and Mediation Committee with the Alberta Law Society. Through his involvement with the former Alberta Auto Insurance Board, Mr. Gough has gained a strong knowledge of the various insurers across Alberta.

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**Mr. Dennis Gartner**

Mr. Gartner is the Assistant Deputy Minister of Alberta Finance and Superintendent of Pensions, Insurance and Financial Institutions and is an ex-officio member of the Board. Born and raised in Saskatchewan, Mr. Gartner started his public service career with the Government of Saskatchewan in 1972. In 1979 he entered Alberta Government Services as a program consultant in health and social services. Since that time he has worked in various government departments. In 2002, Mr. Gartner was appointed Assistant Deputy Minister of Finance and Superintendent of Pensions, Insurance and Financial Institutions.

**Ms Patti Grier**

Ms Grier is Vice President, Government Relations and Assistant Corporate Secretary for the Calgary Health Region. She was a Trustee and Vice Chair with the Calgary Board of Education from 1992-1995 and served as Alderman, Ward 13 in the City of Calgary from 1995-2000. Ms Grier has sat on a number of private, provincial and municipal boards and committees both through her professional work as well as through her personal commitment to the community.

**Mr. Lewis Klar, Q.C.**

Prof. Klar is currently a Professor within the University of Alberta's Faculty of Law. He served as Dean of the Faculty from 1997-2002. His major teaching and research interests are in Tort Law and Insurance Law. Prof. Klar is a non-practicing member of the Alberta Law Society and was appointed to Queens Counsel in 2002. He was recently elected to the American Law Institute, one of a very small number of Canadians who are members of this advisory body. He has also written advisory reports for the Alberta Law Reform Institute.

**Mr. David Marshall, CA, Hons B.A., PhD**

Mr. David Marshall is a Chartered Accountant currently residing in Calgary. He consults to public entities and corporations through David G. Marshall Professional Corporation. He has practiced as a Chartered Accountant for over 30 years in public practice, corporate and professional services including significant audit experience with insurance underwriters. He served the Alberta Institute of Chartered Accountants for several years as practice reviewer, advisor and education developer. He has lectured and published extensively on professional and accounting issues. Mr. Marshall is a member of the Calgary Sarcee Rotary Club, a past Chairman and President of the Calgary Fiddlers Association, and a member of the Saskatchewan Cultural Exchange Society.

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**Mr. William Moore**

Mr. Moore is a Fellow of both the Canadian Institute of Actuaries and the Society of Actuaries. He currently is the Staff Actuary at Alberta Finance and acted as Executive Director to the Board from February 2006. Prior to joining the government in 2006, he worked as a consulting actuary for most of 30 years providing pension consulting services to public and private sector pension plan sponsors in Western Canada. Prior to joining the consulting industry, he worked in the insurance industry in Canada and the United States.

**Ms Merle Taylor, CMA, Consumer Representative**

Ms Merle Taylor is a management consultant. She has expertise in policy, operational and organizational reviews in the public and non-profit sectors. In addition to her work as a management consultant, Ms Taylor has held several leadership positions within the community and not-for-profit volunteer organizations.

**Mr. David White**

Mr. White has diverse experience in the insurance brokerage industry and was co-owner of a full services life, disability and group insurance company for 10 years. He has served on various boards and planned and facilitated policy workshops. He has a good financial management background and a facilitative style of leadership. Board experience includes, Lethbridge Youth Foundation, Lethbridge Family YMCA and the City of Lethbridge Standing Committee on Transportation, Utilities and the Environment.

## **Statement of Purpose**

The purpose of the Automobile Insurance Rate Board (the Board) is to regulate premiums for basic automobile insurance in Alberta and to monitor the rates for optional coverage for private passenger vehicles. With respect to private passenger vehicles, the Board approves the rating programs of new insurers, reviews and approves changes to an existing insurer's rating plan at the request of the Superintendent of Insurance and accepts notices of revenue-neutral changes to rating variables within an insurers rating plan.

The Board is further mandated to fulfill the functions and responsibilities of the former Alberta Automobile Insurance Board for non-private passenger vehicles, which include reviewing, and approving rates and rating programs for basic coverage for all other classes of automobile insurance besides private passenger vehicles.

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# Year in Review

The year 2006 marked the Board's second full year of operation.

## **Annual Adjustment**

The Board is required under section 656 of the *Insurance Act* and Section 4 of the *Automobile Insurance Premiums Regulation* to complete the annual adjustment; a process that uses the industry-wide experience to determine whether premiums for basic coverage on private passenger vehicles should be adjusted. The Board requested its actuary, Mercer Oliver Wyman (MOW) to complete an analysis of the industry-wide experience for the past year, 2005. Stakeholders were given the opportunity to respond to the MOW analysis at the public meetings that were held over three days, June 14 and 15 in Edmonton and June 20 in Calgary. During the public hearings, sixteen stakeholders presented to the Board and three written submissions were given to the Board.

The Board considered the information received through submissions and the public meetings in conjunction with the MOW analysis and, on July 31, 2006, issued Order 1-06 for a 3% decrease to premiums for basic coverage on private passenger vehicles in Alberta. All insurance companies were to implement the adjustment by November 1, 2006. The previous adjustment ordered for November 1, 2005 was a 4% decrease.

## **Geographical Differential Adjustment**

On July 31, 2006, the Board issued Order 2-06 reducing the differential in the grid base premiums between Edmonton and Calgary by 50% as directed by Schedule 3, Section 2(2)(b) and adjusting premiums in compliance with Schedule 3, Sections 2(3) and 2(4) of the *Automobile Insurance Premiums Regulation*, effective November 1, 2006. The remaining difference between the Edmonton and Calgary area territorial differentials will be eliminated on November 1, 2007 as required by the Premiums Regulation.

## **Cost of Capital**

There are three components to the premium dollar, those being claims, expenses and profit. Though the smallest portion, the latter is the most controversial. The Board chose to sever discussion of cost of capital from the annual industry-wide adjustment process, holding consultation meetings in Calgary on November 8, 9 and 10, 2006. During 2007, the Board will deliberate on whether the current 5% of premium profit provision adequately covers insurers' cost of capital and, if not, what might be an appropriate provision.

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## Consumer Representative

The Consumer Representative, Ms Merle Taylor, conducted an independent and impartial study on consumer's thoughts and perspectives on automobile insurance in Alberta and presented her findings to the AIRB at the public meetings in June. Ms Taylor captured consumer response and feedback by conducting sessions in four centres around the province where insurance brokers and the public were invited to discuss their experience in the market. She also presented to the consultation meetings on cost of capital in November. Both reports can be viewed on the AIRB website.

## Board Applications

As required under the *Automobile Insurance Premiums Regulation*, the Board reviews applications under Sections 6, 10 and 19 of the Regulation. Under section 6, insurers may apply to the Superintendent of Insurance for a review of their private passenger rating program for basic coverage, which may be directed to the Board for review. Section 10 of the Regulation requires new insurers entering Alberta to submit and obtain the prior approval of the Board for their private passenger rating programs for basic coverage. Section 19 is a transitional provision from the former *Insurance Act* that requires insurers to obtain prior approval to establish new or revise existing rating programs as they relate to third party liability and accident benefits coverage for other than private passenger vehicles. There were a total of 15 applications to the Board under section 6 (19 in 2005), 1 application under section 10 (4 in 2005) and 21 applications under section 19 (2 in 2005), with the following results:

Premiums Regulation	Approved	Subject to Limitation/Partially Approved	Declined	Total Applications
Section 6	7	3	5	15
Section 10	0	1	0	1
Section 19	17	3	1	21
Total	24	7	6	37

Section 6 - Application for review of rating program for basic coverage on private passenger vehicles Section 10 - Application for new entrant for private passenger automobile insurance Section 19 – Revision to rating program or new entrant for third party liability and accident benefits on other than private passenger automobile
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Under Section 5 of the Regulation, insurance companies are required to send a written notice to the Board if the company adjusts rating variables for basic coverage on private passenger vehicles. The overall adjustment must be revenue neutral with the increase for

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any one policyholder not exceeding 10%. The Board received 6 Section 5 notices in 2006 (2 in 2005).

Under Section 9 of the Regulation, insurance companies must send written notice to the Board of changes to their rating programs for additional coverage. The Board received 42 Section 9 notices in 2006 (7 in 2005).

### **Rates**

Insurers conducting business in Alberta are required under the *Insurance Act* to report their experience to a Canadian statistical plan. The results are compiled annually in the Insurance Bureau of Canada published statistical exhibits that are then analyzed by the Board's actuarial consultant. The most recent available results are for 2005.

Claims experience was unfavourable for a number of years into the early 2000s, particularly for private passenger vehicles. The phenomenon was attributed to the growth in compensation for bodily injury claims under third party liability and, to some extent in later years, under accident benefits coverage. Premiums for third party liability and accident benefits rose in response to rising claim costs. Pricing for all categories of general insurance hardened in the latter part of 2001 and that course continued until October 30, 2003 when rates were frozen for automobile insurance. Though the freeze ended on November 1, 2005, the improved business results for the general insurance industry including automobile insurance forestalled any immediate pressure on premiums.

### **Market**

Until the Freeze Order, premiums for third party liability and accident benefits on Private Passenger vehicles continued to increase in response to claims experience. Collision and comprehensive coverage have generally yielded satisfactory results, which in part offset adverse results for third party liability and accident benefits.

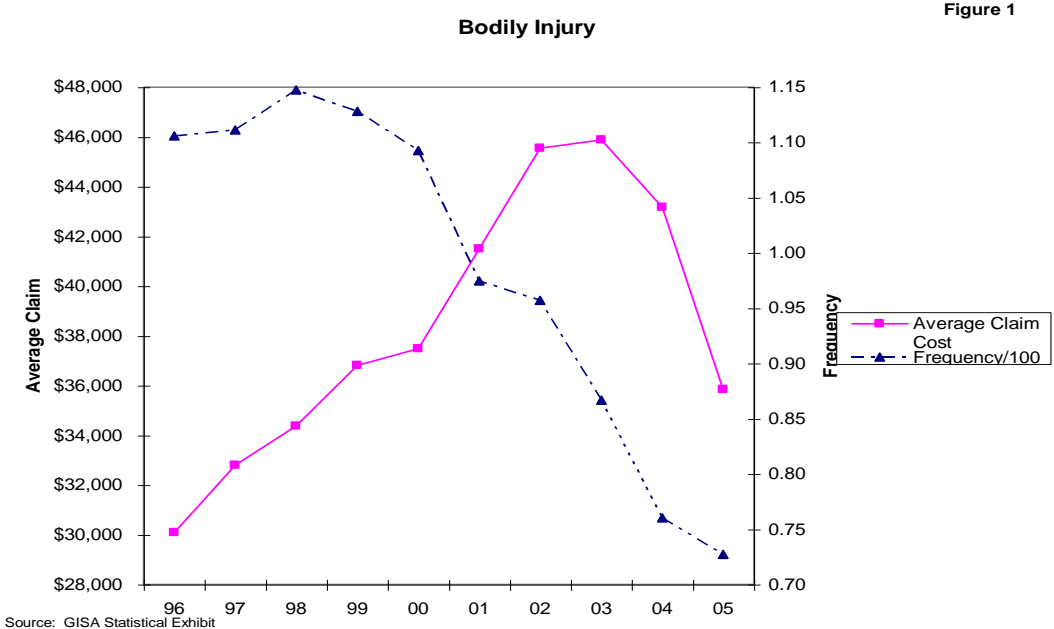
A modest improvement in results for third party liability on private passenger vehicles emerged in 2001 and 2002. A continued and more apparent improvement was evident with the results for 2003 with that trend continuing through 2005, the latest year being the first full year of experience under the reforms implemented in October 2004.

Third party liability encompasses bodily injury and property damage. The area of concern for many years was the escalation in both average cost and frequency of bodily injury claims. After a steady spiral that peaked in 1998, frequency finally showed some modest declines with the most significant changes in 2003 and 2004. The sustained decline in



frequency since 1998 lends credibility to a positive outlook in which frequency would continue to fall, albeit more slowly or at least stabilize well below the levels of the mid to late 1990s.

It takes a number of years for third party liability bodily injury claims incurred in a given year to mature. Therefore, results for recent years are projected to their expected ultimate values based on historical observations of the maturation of such claims. Expectations are that over the five years 2001 to 2005, the average claim cost for a bodily injury claim will have decreased 4% while frequency of this type of claim will have decreased by 33%. For bodily injury the decline in claims costs and frequency combines for a 36% decrease in the claim cost per vehicle insured. Figure 1 tracks changes in average claim costs and frequency of claims for bodily injury for a longer ten-year period ending in 2005. All costs are in nominal dollars (unadjusted for inflation).



In comparison, the average property damage claim cost will have increased by 31% while frequency of this type of claim will have actually fallen by 17%. For property damage the increase in claims costs and decrease in frequency combines for a 9% increase in the claim cost per vehicle insured. Figure 2 shows the change in average claim costs and frequency of claims over a longer ten-year period.

Property Damage

Figure 2

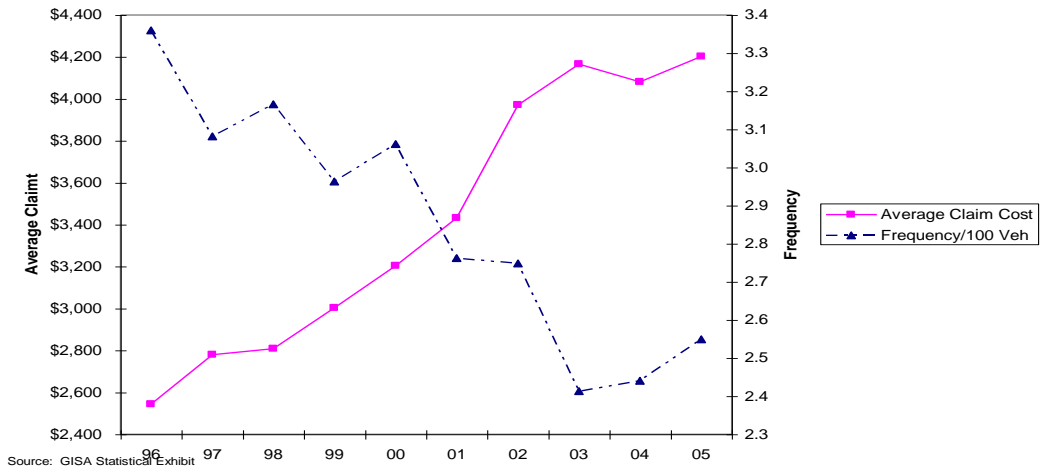


Figure 3 displays loss costs per vehicle insured, which are total losses divided by the number of vehicles insured. The figure relates the combined effect of average claim cost and frequency.

Bodily Injury & Property Damage

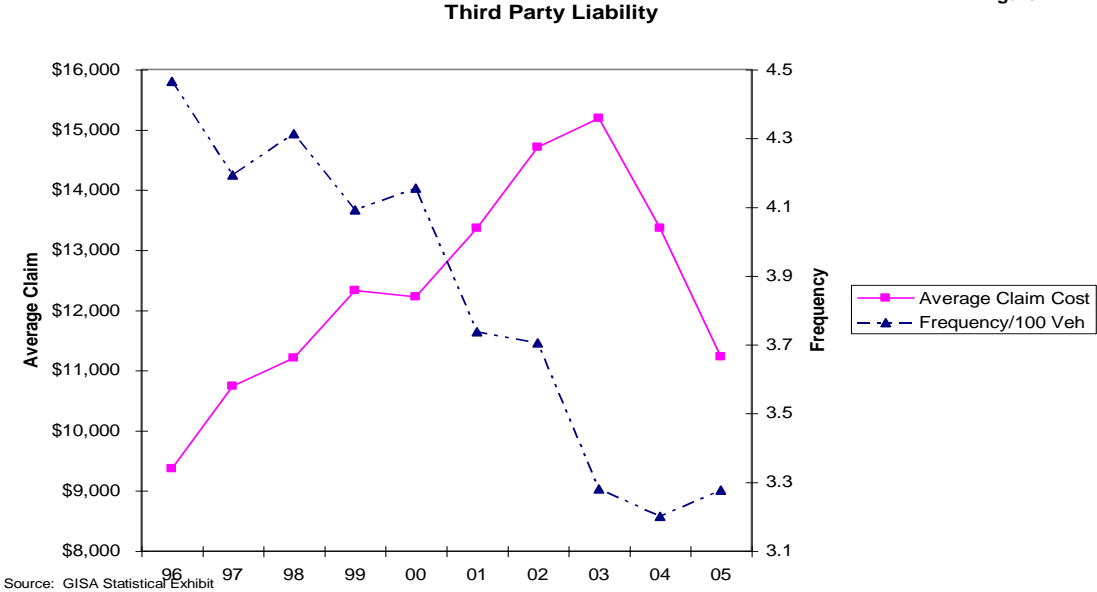
Figure 3



Over the past five years, the overall effect for third party liability coverage was an 8% decrease in the average claim cost while frequency will have decreased 21%. The decline in claims costs and frequency combines for a 28% decrease in the claim cost per vehicle insured.

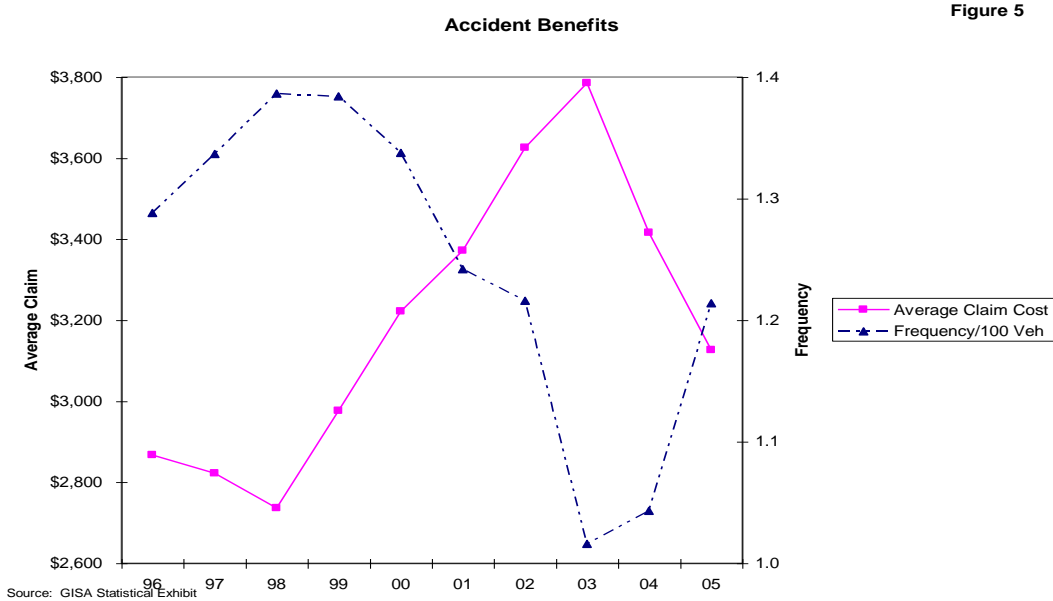
Bodily injury is expected to comprise 71% of total third party liability claim costs for 2005, down from a peak of over 82% for 1999. Figure 4 shows the change in average claim costs and frequency of third party liability claims over a longer ten-year period. Average claim cost increased steadily until 2003. There is a reversal of the trend in 2004 with a decrease in average claim cost. A further decrease is apparent for 2005, the first full year that the reforms were in operation.

Figure 4

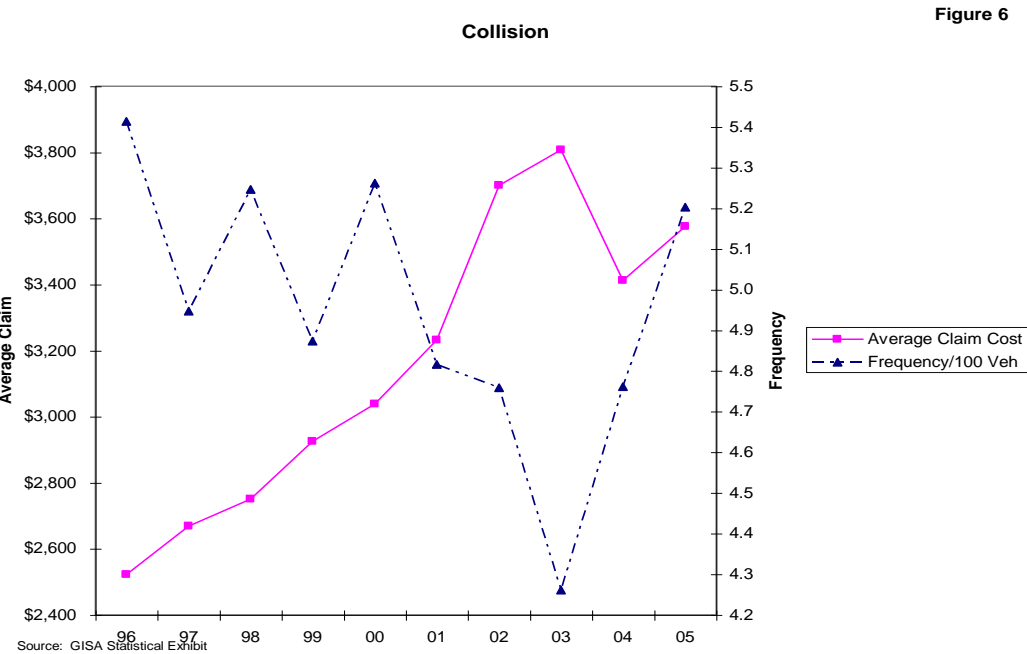


Rising average claim costs affected accident benefits for a number of years prior to 2004. In the five years ending in 2005, the average claim cost will have decreased by 3% while frequency of this type of claim decreased by 9%, having moderated since peaking in 1998. The decline in claims costs and frequency combines for a 12% decrease in the claim cost per vehicle insured.

Figure 5 shows the change in average claim costs and frequency of claims over a longer ten-year period. Compensation available under accident benefits coverage doubled for losses occurring as of October 1, 1995, contributing to increased average claim costs since 1996. Changes to accident benefits provisions effective October 1, 2004 were expected to increase average claim costs for future years, though the increase should be partially offset as the compensation is deducted from any third party liability claim. Average claim size increased steadily for the five years ending in 2003, though have unexpectedly decreased for 2004 and 2005. Frequency of claims increased in 2004 and 2005 after decreasing steadily since 1999.



Frequency for collision claims has fluctuated over the past five years. Frequency of comprehensive claims continued to diminish until 2003 but that trend reversed in 2004 and 2005. Over the same five-year period, the average claim cost for collision will have increased by 18% while frequency will have decreased 1%. The increase in claims costs and decrease in frequency combines for a 16% increase in the claim cost per vehicle insured.

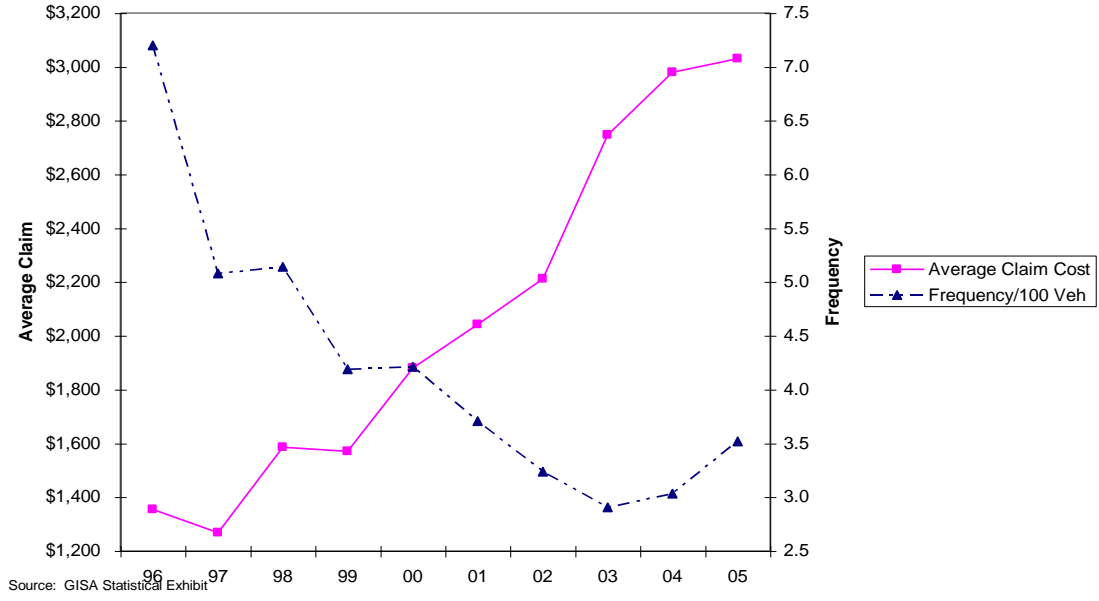


The average claim cost for comprehensive will have increased by 61% while frequency will have dropped 16%. The increase in claims costs and decrease in frequency combines for a 35% increase in the claim cost per vehicle insured.

There have not been any weather related catastrophes that significantly impacted results. Figures 6 and 7 show the change in average claim costs and frequencies of claims over a longer ten-year period. In summary, Figure 8 shows claims costs per vehicle insured for each coverage.

Comprehensive

Figure 7



Claim Cost Per Vehicle Insured

Figure 8

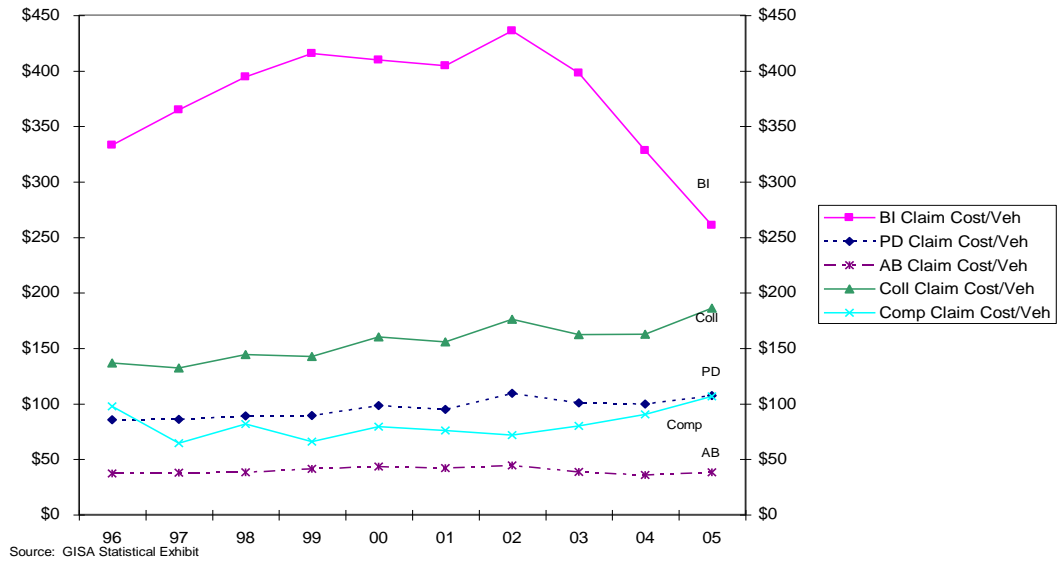
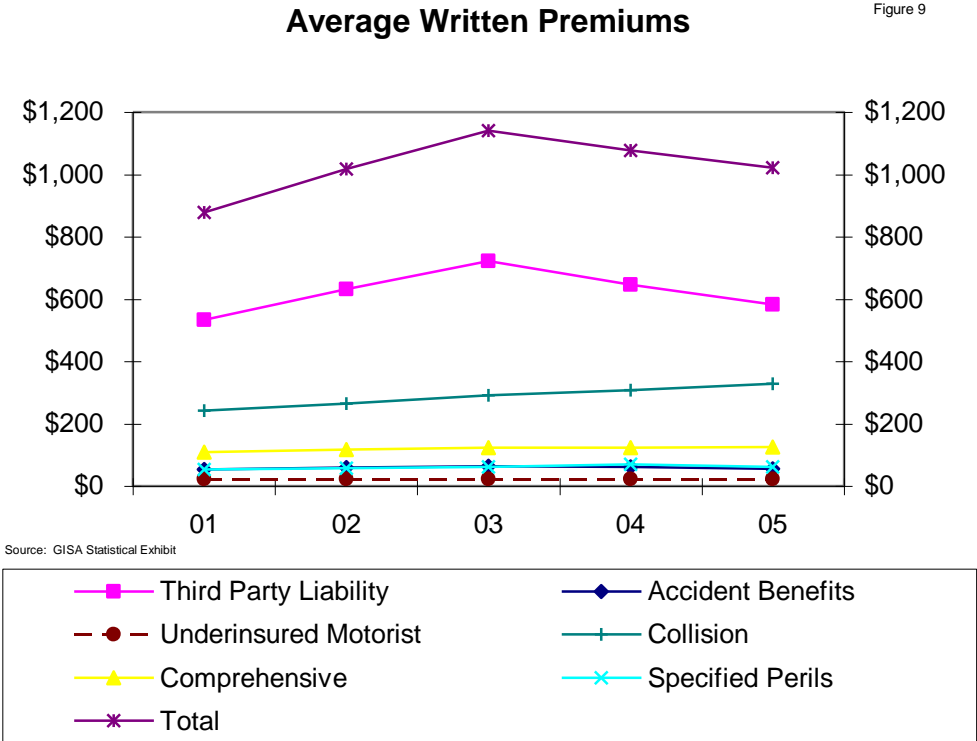


Figure 9 shows average written premiums over the past five years. Premiums for third party liability coverage peaked in 2003 and then declined in 2004 and 2005.



Traditionally, the standard market's criteria for acceptable risks responded to results. As loss experience improved, underwriting criteria relaxed and more drivers gained access to the standard market. Conversely, criteria became more stringent as results deteriorated. Drivers that were deemed undesirable by the standard market were directed to insurers that operated in the residual or non-standard markets at higher premiums. The Facility Association was the industry's mechanism for providing insurance to those consumers who were refused coverage elsewhere.

As of October 1, 2004, that model was replaced for private passenger vehicles by a take-all-comers rule and a Grid rating program that sets maximum premiums for basic coverage (third party liability and accident benefits) for any driver profile. The Facility Association continues to operate as the industry's mechanism for providing insurance to those consumers who are refused coverage elsewhere for other than private passenger vehicles.

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## Meetings

The Board held 5 meetings in 2006 to deal with administrative issues of the Board and otherwise exercise its mandate. In addition, there were three days of public meetings for the annual adjustment process and three days of consultation meetings on the issue of cost of capital.

## Pending Issues

A constitutional challenge to the limitation on compensation for non economic damages under the Minor Injuries Regulation will go to trial in April 2007. The provisions under the Minor Injury Regulation have served to reduce average bodily injury claim costs, thereby supporting the premium reductions for third party liability coverage and are a cornerstone for future premium stability.

The *Automobile Insurance Premiums Regulation* will be reviewed in 2007.

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For additional information

[www.airb.gov.ab.ca](http://www.airb.gov.ab.ca)

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