

2017 Annual Review

- Alberta Private Passenger Vehicles

ALBERTA AUTOMOBILE INSURANCE RATE BOARD

September 29, 2017

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AUTOMOBILE INSURANCE RATE BOARD

Mission:

As an independent body, the Automobile Insurance Rate Board (referred to herein as either the AIRB or the Board) regulates rating programs of Alberta automobile insurers to ensure premiums are fair and predictable. The Board also ensures consumers have access to information to facilitate informed choices.

Background:

Legislative and Regulatory Authority

The AIRB was established on October 1, 2004 under Section 599(1) of the *Insurance Act* (the Act). On November 27, 2013, the Enhancing Consumer Protection in Auto Insurance Act was passed. The Act and supporting Automobile Insurance Premiums Regulation came into force on July 1, 2014. The mandate of the AIRB is defined in the Act and the Premiums Regulation and includes the duty to:

- submit an annual report to the Minister on the operations of the Board;
- review and approve all rating programs for new insurers licensed to sell automobile insurance in Alberta;
- review and approve any changes to existing insurer rating programs for insurers licensed to sell automobile insurance in Alberta;
- conduct an Annual Review of automobile trends and premiums relating to basic and additional coverage for private passenger vehicles;
- conduct an annual open meeting to receive comments from the automobile insurance industry, the consumer representative and the public; and
- exercise and perform any other powers and duties assigned to it by the Minister or prescribed by regulations.

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;
- 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 rating program, which set maximum premiums to be charged for basic coverage, and established two risk sharing pools¹.

¹ Coverage for insureds whose premium for basic coverage is limited by the Grid can be ceded to Grid risk sharing pool. Insurers may voluntarily cede up to 4% of their insured vehicles rated below the Grid through Non-Grid risk sharing pool.

The *Minor Injury Regulation* is amended annually to adjust the amount of the CAP on non-pecuniary damages recoverable for minor injuries by the Consumer Price Index for Alberta. The amount increased to \$5,020 as of January 1, 2017.

Private Passenger Rate Level History

The table below outlines the average written premiums for basic coverage, additional coverage, and combined coverage for the most recent 5 years.

The overall rate level has been quite stable since 2004 but an upward trend started in 2012.

Basic coverage premiums dropped significantly from the 2004 level, until 2012; the year over year changes have since been increasing. The recent increases reflect the upward insurance cost pressure in both basic and additional coverages. The increases in basic coverage are caused by adverse development resulting from issues such as a higher proportion of claims exceeding the definition of minor injury with increasing incidence of chronic pain, TMJ/TMD (as a result of the Sparrowhawk decision), psychological injury, new heads of damage being claimed, a higher percentage of claims being litigated, low investment return, and a longer period of treatment which is believed to be related to the economic climate.

Additional coverage premiums increased significantly from 2004 but have been increasing at a lower rate in more recent years. The increases are mainly a result of recent severe weather events such as hail storms and flooding events most notably in southern Alberta, the Fort McMurray fire, along with upward pressure on repair costs due to more expensive materials and higher labor costs. The recent hike in vehicle theft also contributed to the increase.

Calendar Year	Basic Coverage	Additional Coverage	Combined	Combined Coverage % Change
2012	562	525	1,087	+1.59%
2013	579	534	1,113	+2.39%
2014	609	544	1,153	+3.59%
2015	644	535	1,179	+2.25%
2016	686	523	1,209	+2.54%

Source: 2016 GISA Actual Loss Ratio Exhibit

Annual Review

Premiums Regulation

The Premiums Regulation requires the AIRB to conduct an Annual Review for private passenger vehicles and as part of that review to conduct an open meeting each year.

Automobile Insurance Premiums Regulation – Annual Review

9(1) The Board must, in accordance with its policies and procedures, conduct an annual review of automobile insurance trends and premiums relating to basic coverage and additional coverage for private passenger vehicles.

(2) The review must consider, on an industry-wide basis,

(a) loss costs, as that term is understood by the Board;

(b) administrative expenses, including commissions, taxes and general expenses;

(c) profitability;

(d) other matters recommended by the Superintendent and approved by the Board;

(e) any other matters that the Board considers appropriate.

(3) The Board must publish a preliminary report of its findings of the review.

(4) Following publication of its preliminary report, the Board must invite comment from insurers, the consumer representative and the public and must give at least 30 days for any comments to be provided.

(5) The Board must publish a final report of its findings by September 30 of each year.

6) The final report must include

(a) the Board's findings on the matters referred to in subsection (2),

(b) a report of the consumer representative,

(c) the Board's responses to comments received from the automobile insurance industry, the consumer representative and the public,

(d) the target for profitability for the following year, and

(e) the target for administrative expenses for the following year.

(7) In addition to, or as part of, an annual review referred to in subsection (1), the Board must also conduct an open meeting each year, in accordance with the Board's policies and procedures, to receive comments from the automobile insurance industry, the consumer representative and the public.

Notice of Open Meeting

On June 26, 2017, the AIRB notified stakeholders by letter that the Board would be holding a consultation meeting on August 15, 2017 to review Alberta Industry loss experience for private passenger vehicles to assist the Board in setting Industry Benchmarks for the review of insurer rate filings for basic and additional coverage. All interested parties were requested to submit a letter to the Board by July 7, 2017 of their intent to participate in the open meeting. The meeting would be part of the process to review automobile insurance trends and premiums relating to basic coverage and additional coverage for private passenger vehicles and to receive comments from the automobile insurance industry, the consumer representative and the public.

The notice was also placed in the Grande Prairie and Fort McMurray newspapers on June 24, 2017 and in the Edmonton, Calgary, Red Deer, Lethbridge and Medicine Hat newspapers on June 25, 2017. The AIRB also posted the notice on our website.

Presentations and Written Submissions

The Board received four letters of intent to participate in the open meeting and five written submissions. All parties that requested the opportunity to make a presentation were provided with a copy of the Rules of Procedure for the open meeting and asked to ensure that their comments were within the scope of the annual review.

Open Meeting

The open meeting was held on August 15, 2017 at the Canadian Western Bank Place in Edmonton, in the Western Room. The Board was assisted by Ted Zubulake, the Board's Consulting Actuary, and Board staff, Del Dyck (Executive Director), Vivian Cao, KimBerley Kern and Fei Mo.

The following parties made presentations at the public meeting:

- Oliver Wyman Limited
- Insurance Bureau of Canada (IBC)
- Facility Association
- Consumer Representative (AIRB)
- Aviva Canada Inc.
- Peace Hills Insurance

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

- The Co-operators Group Limited
- Intact Financial Corporation
- Desjardins General Insurance Group
- Economical Insurance
- TD Insurance

All information submitted to the Board as part of the public meeting process including the audio files of the open meeting has been posted to www.airb.alberta.ca.

The Oliver Wyman Review of Industry Experience Report (Appendix A)

On June 26, 2017, the Board released the preliminary report of its consulting actuary, Oliver Wyman, titled, "Review of Industry Experience as of December 31, 2016 Private Passenger Vehicles" (Oliver Wyman Report). The Oliver Wyman Report presented its analysis and findings regarding the private passenger insurance industry claims experience for basic and additional coverage. The Board requested the Oliver Wyman Report to provide information and professional advice with respect to automobile trends and premiums for private passenger vehicles. Oliver Wyman based its analysis and findings on data that includes all insured vehicles in the province including those in the Facility Association and in the Risk Sharing Pools. The General Insurance Statistical Agency (GISA) provided claim data as reported as of December 31, 2016. This preliminary report is posted on the AIRB website.

On September 29, 2017, Oliver Wyman presented its final report to the Board. This report addressed certain issues arising from the open meeting in August 2017 (appendix A).

Industry Benchmarks (Appendix B)

The Board reviews individual insurer's filings based on their reasonableness relative to industry benchmarks selected by the Board.

The following Industry Benchmarks must be considered in all full filings.

1. Loss Development Factors
2. Loss Trends
3. Catastrophe Loading
4. Investment Income Rate
5. Administrative Expense & Unallocated Loss Adjustment Expense (ULAE)
6. Health Cost Recovery
7. Profit

The Oliver Wyman estimates as respects components 1, 2, 3, and 5 are Board approved "benchmarks". These components are to be based on each company's own experience – to the extent they are deemed credible. However, should a company find a need to calculate industry loss costs or loss ratios to serve as credibility complements, then it is expected that the board approved benchmarks for each of the ratemaking components be used. Component 4 sets the lowest discount rate that companies are allowed to use in calculating their rate indications. Components 6 and 7 are to be used by companies to calculate their rate indications.

Loss Development Factors

Historical numbers of claims and claim amounts must be projected to expected ultimate values by coverage and sub-coverage. Prior years' experience provides insight as to how the number and amount of claims tend to develop from initial reporting. Insurers are expected to select and support claim count and claim amount development factors based on their own experience in calculating their rate level indications.

The Board's consulting actuary, Oliver Wyman, conducted an analysis of Industry claim count and claim amount development patterns based on Alberta Industry data as of December 31, 2016. No industry comments were received with regard to the loss development selections.

The Board accepts Oliver Wyman's selected development factors as a benchmark for insurers to use to the extent Industry claim experience is a consideration in developing their rate level indications. Insurers that consider Industry claims experience must use the benchmark development factors without adjustment.

Details to be found in the Appendix B – Industry Benchmarks Schedule

Loss Trends

Trending is a means of evaluating how changes over time affect claim costs in addition to the development on claims. Loss trend varies by coverage and sub-coverage.

Based on the industry analysis, Oliver Wyman selected the following trend rates for each coverage:

Coverage	Past/Future Trend Rates
TPL - Bodily Injury	+7.5%
TPL - Property Damage	+1.5%
TPL – Subtotal	+5.6%
AB - Death	-3.0%
AB – Funeral	-5.0%
AB - Medical	+3.5%*
AB - Disability	+3.5%
AB – Uninsured Motorist	+0.0%
AB-Total	+3.5%
Collision	+3.0%
Comprehensive	+3.0%/+5.5%**
Specified Perils	+3.0%/+5.5%**
All Perils	+5.0%
Underinsured Motorist	+3.0%

* With a level change adjustment of +16% at 2015-1

** Level change adjustment of +7.5% at 2015-1

IBC and other insurers commented on the continuing increase in Bodily claim costs (which is reflected in the recommended trend). Reasons given for the increase include:

- erosion of the minor injury cap (Sparrowhawk v Zapoltinsky and McLean v Parmar rulings cited)
- increased legal representation and use of strategies to avoid cap limitations (psychological impairment, head injuries, chronic pain)
- inefficiency/uncertainty of current Certified Examiner process
- high pre-judgment interest awards (4% interest rate)

Oliver Wyman has taken into consideration the industry comments in their final recommendations.

The Board accepts Oliver Wyman’s selected trend rates as a benchmark for insurers to consider in developing rate level indications. The industry trend rates developed by Oliver Wyman will serve as a point of reference in the review of filings received on or after October 1, 2017. The Board acknowledges that insurers may select different trend rates based on their own claim experience. Insurers have the option to (a) use their own experience where it is fully credible; (b) use their own experience to the extent that it is credible and apply the Board’s accepted industry benchmark trend rates without adjustment as the complement of credibility; or (c) apply the Board’s accepted industry benchmark trend rates without adjustment.

Catastrophe Loading

Comprehensive coverage (in particular) claims experience is affected by the occurrence or non-occurrence of “weather-related events” such as windstorms, hail, or flooding. Since catastrophes cannot be predicted, it is generally accepted actuarial practice to remove the actual claim costs arising from catastrophes and include a provision for the average level of catastrophic losses that could be expected to occur in a given year.

IBC and other insurers (e.g. Intact) continue to find the current 1.55 Benchmark to be too low and recommend 1.70 as being more appropriate.

With the release of the 2016 GISA catastrophe exhibit as well as consideration of the points made by stakeholders, Oliver Wyman modified the weighting method and recommended a loading of 65% to be reasonable. The loading reflects the adjustment made for the rising theft claims.

The Board accepts Oliver Wyman’s recommended loading of 65% as an industry benchmark based on the review of industry experience. Where the insurers’ own claim experience differs from industry and is credible, the Board acknowledges that insurers may select a different catastrophe loading based on their own claim experience, providing their catastrophe definition has been consistent in the experience period.

Investment Income Rate

Insurers must discount claim costs for the investment income on policyholder funds until claims are paid. Based on the Government of Alberta’s forecasts of short and long term bond yields published, OW recommended a benchmark interest rate of 1.75% in the preliminary report. Stakeholders found the benchmark interest rate to be reasonable.

The government published updated forecasts of short and long term bond yields in July, after the preliminary report was published. OW revised their recommendation to 1.95%.

The Board accepts 1.95% for all coverage as the benchmark risk-free rate. Insurers must use a risk-free rate that is no lower than 1.95% when discounting claims in filings submitted to the Board. The investment rate will be updated semi-annually; the updated investment rate will be posted on the AIRB website.

Administrative Expense & Unallocated Loss Adjustment Expense (ULAE)

Administrative expenses are non-claims related expenses, which are usually composed of commission, taxes and other. ULAE is the claim and settlement related expense that cannot be associated directly with individual claims.

The General Insurance Statistical Agency (GISA) publishes the Automobile Insurance Financial Information exhibit which establishes industry averages for administrative expenses. GISA also publishes AIX exhibits where ULAE ratios are incorporated.

IBC has suggested that it would be more appropriate to calculate the weighted average based on direct earned premium, rather than direct written premium – as doing so would recognize premium dollars for those insurers that report expenses but do not have direct written premium. Under this approach, the average expense ratio increases from 26.7% to 27.6% according to IBC. Desjardins stated that it agrees with IBC.

Since the expense provision benchmark is only used as a reference when reviewing active insurers’ rate filings, the Board does not believe that including expenses from companies that are running off (i.e. closing their book) is reasonable. However, to be more in line with general ratemaking practices, the General Expense provision will be changed to be based on direct earned premium.

The Board accepts the industry average expense ratios and the ULAE ratio for Alberta presented in the GISA exhibit as the benchmarks. They are used in the Grid analysis and will be the points of reference when considering administrative expenses and ULAE in the review of individual insurer filings. The AIRB will recognize the individual insurer’s own experience where it is credible.

Expense Category	Board Selections
Total Commission	12.4%
Premium & Fire Taxes	4.0%
All Other Expenses	10.7%
Total Expenses	27.1%
ULAE	8.5%

Health Cost Recovery

Under Provincial legislation, a levy is paid by each insurer to achieve a target amount set by Government. GISA calculates and provides the level as a percentage of earned third party liability premiums. The Government has no subrogation rights against the at-fault parties who have third party liability coverage. The Minister of Finance publishes the levy percentage applied to Third Party Liability written premiums every year.

IBC has suggested that given the Government’s history of increasing the aggregate assessment every year, and since many of the policies that will be written under the rate filings submitted between October 1, 2017 and March 31, 2018 will be in effect in 2018 and 2019, that it would be more

appropriate for the Benchmark to reflect an increase in the assessment in 2018 and 2019. Desjardins commented that it agrees with IBC.

Since the Board is not responsible for calculating the Health Cost assessment, keeping the current practice is deemed fair to all policyholders.

The Board accepts the Health Cost Recovery as a component of claims costs reported by insurers. Insurers must use the most updated percentage published on the Minister of Finance’s website at http://www.finance.alberta.ca/publications/tax_rebates/healthcostsrecovery/. The 2017 assessment factor is 5.67%.

Profit

The Board has established 7% of premium as a target pre-tax profit provision for all coverage. Also, no industry comments were received with regard to the provision. The Board will annually review and determine the percentage of premium that represents a reasonable level of profit for insurers for all coverage. Insurers must justify any target that is higher than the Board’s selected percentage of premium for profit.

Grid Rating Program

The Grid rating program sets maximum premiums that insurance companies can charge for basic coverage for any driver profile. Many drivers with limited driving experience are capped by the Grid. Insurance companies must compare the premium for a vehicle under their current rating program to the Grid premium and charge the lesser of the two premiums with exceptions under Section 8(2) of the Premiums Regulation.

With the new Premiums Regulation, the Grid premium level will be adjusted based on the analysis of its own claims experience. Due to data credibility of the Grid-only risks, industry benchmarks accepted by the Board without adjustment will be used for the analysis.

At the open meeting, stakeholders expressed concerns regarding Grid rate level adequacy. The Board will take into consideration these concerns and adjust Grid premiums as necessary, after considering:

- loss experience specific to the Grid
- loss experience for all Alberta private passenger vehicles
- industry benchmarks as detailed above
- any other matters the Board considers appropriate

Other matters might include premium stability and how premium level is changing in the overall private passenger market.

Due to the nature of the Grid rating program, an increase in Grid premium will not likely bring the Grid rates to an adequate level. Some risks will leave the Grid program after the rate increase, and hence the selected rate increase will not be fully realized. Moreover, the risk make-up of the Grid will change significantly, which suggests that the setting of Grid premium level needs to be an on-going process.

In accordance with Schedule 3 Section 3(1) of the Premiums Regulation, the final decision for the Grid base premium adjustment is required to be made on or before October 1st, 2017. The Board has made its decision in regard to the Grid adjustment, and has published the decision on Board Order 01-2017. The Order can be viewed on our website at <http://www.airb.alberta.ca/industry-information/communications/orders>. The approved Grid adjustment takes effect on January 1, 2018.

Consumer Representative Report (Appendix C)

The Consumer Representative, Mr. Chris Daniel, contracted a consulting and research firm to conduct the annual telephone survey of consumers' perceptions of automobile insurance in Alberta. Mr. Daniel conducted focus groups in Edmonton and Calgary as well as follow up interviews with a number of participants located elsewhere in the province and surveyed board members of the Insurance Brokers Association of Alberta and the Canadian Association of Direct Relationship Insurers to learn about their experience in the market. "Youth Group" and "Senior Group" discussions were held specifically to gain insights from these two unique groups. As part of his process, he also reviewed data from other provinces, traffic safety trends and other indications. Consumers also contacted him by e-mail and letter with their specific concerns.

The results of his findings are presented in his report Appendix C.

Appendices

A. Oliver Wyman Review of Industry Experience

B. Industry Benchmarks Schedule

C. Consumer Representative Report