

# A Submission to the Alberta Automobile Insurance Rate Board 2010 Annual Rate Adjustment

May 28, 2010



On behalf of the Allstate Canada Group of Companies, which includes Allstate Insurance Company of Canada, Pembridge Insurance Company and Pafco Insurance Company, please accept the following submission for consideration and review for the 2010 Annual Rate Adjustment process.

ACG is a multi-channel producer and distributor of home and auto insurance products, which are accessible through our community-based agents, our broker representatives, directly on-line, and our Customer Contact Centre at 1-800-ALLSTATE.

Allstate Insurance Company of Canada has 80 agents across Alberta with \$76.7 million in Gross Written Premium in 2009. Pembridge Insurance has 27 broker partners with Gross Written Premium of \$9.6 million in 2009. Pafco Insurance Company is an alternative market for high-risk drivers which are operating in several other provinces, but not yet in the Alberta market.

ACG appreciates the opportunity to participate in the sixth review by the Alberta Automobile Insurance Rate Board (AIRB) of all-industry premiums for mandatory automobile insurance and to be able to share its perspective on this very important issue. ACG continues to be optimistic about the potential for growth in a stable and competitive Alberta market and looks forward to continuing to provide Albertans with high-quality products and exceptional customer service in the years ahead.

There has been tremendous change in the insurance marketplace in Alberta over the past ten years, and the reforms introduced in 2004 have succeeded in achieving a far more positive environment for both customers and insurers. The decade began with escalating costs, skyrocketing BI claims, and considerable uncertainty about the future. Product reform stabilized claims costs and prices dropped, but also raised considerable uncertainty around whether the cap could withstand an inevitable legal challenge. In addition, the Alberta economy went from a period of unprecedented growth to a severe downturn which added to the overall uncertainty and affected the nature of its influence on automobile claims and experience.

The field of pricing in the realm of property and casualty insurance is both the science and the art of predicting future events. We use a myriad of inputs to predict the number of crashes, and the consequent number of claims. We predict the increase and decrease in the average cost of those claims, both in terms of the amount to compensate the victim, and the cost of managing the transaction of that compensation. We put a great deal of higher order math to the task, but in the end, we must accept that we are predicting the future, which is an activity that by its very nature is uncertain.

In providing insurance to our customers, we are trading the uncertainty of future claims, for the certainty of a premium. We fund this uncertainty through the investment of our shareholders who are prepared to trade their own certainty for the possibility of a return. The competition for capital is global and it is fierce. As a result of the continuing financial crisis, investors are demanding more certainty in exchange for their investment. Determining the likelihood of potential outcomes and evaluating the mitigating factors and potential cost is at the heart of pricing and risk assessment. It is important to note that this exercise is entirely prospective.

Insurers often find themselves in the middle of these two groups, attempting in the best interest of both, to predict and as much as possible minimize the uncertainty they face. In this annual review of pricing in Alberta automobile insurance, we share that responsibility with the Board. As ACG has submitted in past years, we recommend that the government move away from this annual review of industry rates as if it were one simple question that could be decided with one number. We appreciate the Board shares our concern and we understand this is not within the scope of these hearings to discuss alternatives.

Our goal is to continue to keep auto insurance rates at an appropriate level in an open and competitive Alberta market, and to earn a fair and reasonable return for our shareholders. These goals are not mutually exclusive and ACG is committed to helping create and sustain the type of marketplace from which both consumers and insurers can benefit.

ACG appreciates that in the context of a single industry wide rate adjustment, it is difficult to recognize the diversity of company needs in maintaining and attracting capital, while at the same time solidifying the achievements of the past few years to build a stable industry and market. However, this is what the rate process needs to achieve. It is our hope that in the future, the regulatory structure will recognize and permit the use of various factors used by companies in their rate making practices. Imposing one methodology or one profit target on some 60 insurers operating in Alberta contradicts the spirit of capital enterprise that has become synonymous with the province.

**Therefore, respectfully, ACG supports the ongoing work to amend the premium regulations in order to limit the annual rate adjustment to grid rates.**

ACG believes that insurers have an obligation to provide submissions that include the best options available within the confines of the current regulatory environment. The Board is required to make a single industry wide adjustment to rates effective November 1<sup>st</sup>. That rate change will not only affect each company, but also will affect grid prices.

Nevertheless, the very fact that the Board is being asked once again to determine an industry wide adjustment to rates that are influenced company to company in so many diverse ways makes the task even more difficult.

Two of the areas the Board has requested input are critical components with respect to predicting the future and determining the probability of outcome: loss trends and the impact the economy has on claim costs. The third area the Board has asked for input concerns bodily injury claim costs for past years in light of the confirmation of the Minor Injury Regulation. This is complex because it involves both retrospective and prospective analysis.

It is ACG's hope that the following submission will provide the Board with some additional insight into the fundamental principles that ACG considers when we determine the appropriate price for automobile insurance in Alberta, and which we trust will be of value to the Board in its deliberations.

Claim costs represent the most significant factor that must be considered when determining appropriate auto insurance rates. When analyzing the trends there are two components to consider: frequency and severity. We would like to share our recent analysis of these trends and hope the Board finds the information useful in its deliberations.

Last year we indicated that we were observing what appeared to be a large increase in frequency, but needed to fully consider the impact of a new claims system before drawing any conclusions. As you will see from the updated chart, our frequency numbers have stabilized, and we have had the opportunity to control for those system changes. The frequency trends are reflective of two and half years under the new claims system, and we are confident in their direction.

**Allstate Insurance Company of Canada  
Average Frequency and Severity  
12 Month Rolling Accident Year**

	<b>Claim Frequency</b>	<b>Avg Claim Severity</b>
<b>Third Party Liability</b>		
2006-3	3.84	10,778
2007-3	4.23	10,632
2008-3	4.14	10,196
2009-3	4.21	9,058
2010-3	4.43	10,069
<b>Bodily Injury</b>		
2006-3	0.91	26,191
2007-3	0.86	29,446
2008-3	0.78	27,880
2009-3	0.74	26,598
2010-3	0.76	29,565
<b>Property Damage</b>		
2006-3	2.93	5,986
2007-3	3.37	5,823
2008-3	3.36	6,068
2009-3	3.47	5,302
2010-3	3.68	6,060
<b>Accident Benefits</b>		
2006-3	1.57	2,130
2007-3	1.49	2,144
2008-3	1.38	2,783
2009-3	1.29	2,746
2010-3	1.24	2,665

\* The above figures are as at Q1 (March) 12 month rolling average, including development.

For Third Party Liability (TPL), frequency increased in 2009, but not as much as it appeared to be from last years data as at March. In 2009 that frequency has increased again by a small amount. TPL frequency is comprised of Bodily Injury (BI) and Property Damage, and in 2009, BI frequency started to increase, albeit by a small amount. Property damage frequency is up as well. In both cases, severity continues to rise.

In the case of Accident Benefits (AB), our date shows a decrease in frequency, as well as a slight decrease in severity.

These trends are far more steady and stable than we have seen in the last two years, suggesting greater stability both in our own experience and in the industry in general. This is a comment we made last year, when we cautioned that our own data might be influenced by a newly introduced claims system.

In our submission last year we also reported that our data indicated a growing gap between the time a claim occurred and the time it was reported. We have provided for your interest, the updated figures for this year. The situation appears to be less extreme than it was last spring, although the gap has not returned to pre-cap challenge levels. This suggests that reporting patterns were affected by the cap challenge, but there may also be some other factors influencing claimants' timeliness in reporting TPL claims. In the past, close to 90% of BI claims reported in the first quarter were claims which occurred in that quarter. In 2008 that figure dropped substantially, and seemed to bottom out in 2009. Now we see, in a stable, post cap challenge and post claim system change environment, a pattern of more late reported BI claims.

We do not have access to industry figures regarding this issue, but it is unlikely that this situation is unique to ACG. If there is a trend toward delay in reporting of BI claims, regardless of the reason, it will have an impact on development patterns and calculations of IBNR that is worth considering.

### **Accident Year to Report Year BI Ratios As at March**

Report Year	Accident Year				
	AY	AY-1	AY-2	AY-3	All other
2006	83%				
2007	88%	11%			
2008	71%	27%	1%		
2009	63%	33%	2%	1%	0%
2010	78%	19%	1%	0%	0%

In February 2008, Alberta Court of Queen's Bench Justice Neill Wittmann struck down the province's \$4,000 cap on pain and suffering awards for minor injuries, declaring it unconstitutional. The Alberta government launched an appeal which meant this case would remain unresolved for the foreseeable future. In 2008 and 2009, ACG took the view that the final outcome of the constitutional challenge was far from certain which made a recommendation allowing for an optional increase representing the full amount of the associated costs of removing the cap inappropriate. This was a somewhat different position from others who participated at the industry wide adjustment, but we felt it was the right approach to take on behalf of our customers. It was our position that each company would need to make this prediction and prospective assessment of risk on behalf of its customers and shareholders. ACG recommended including between one quarter and one half of the estimated impact in consideration of a rate adjustment.

In 2009, ACG recommended a consistent approach, and we do so again this year. The outcome of the constitutional challenge to the minor injury cap is an important illustration of the very nature of prospective risk pricing. Its importance was magnified because a single decision made such a substantial impact, but more importantly, it illustrated that making a single price decision on behalf of an entire industry is virtually impossible.

In each of the last two years, a number of stakeholders made submissions to the Board indicating the impact of removing the cap could be anywhere from 10 to 30 points on mandatory coverages. These estimates came from extremely experienced and knowledgeable people who provided the best advice possible given the remarkably scarce data available. Since the cap was only introduced in 2004 there was little history available to form a “baseline” once it was struck down. As a result, insurers took different approaches to reserving based on their own assessment of potential exposure and prediction of potential outcomes, and actuaries had to perform costing analyses with the available data.

As in past years, ACG offers our best advice based on what we would do on behalf of our shareholders and customers. In situations where there are external factors with uncertain outcomes that could impact cost we use the information available to make the best estimate of both the possible range of severities and the likelihood of outcome. We then estimate what is required to cover that outcome. Our ability to accurately predict the final outcome is one of the most important measures of the success of an insurer, but it is in no way a certain exercise. ACG recommended an increase in rate that recognized part of the impact which was intended to reflect the potential for this cost, and the increased risk assumed by shareholders who pledged their capital to pay these potential awards, while balancing the needs of our customers and our view that rate increases should be balanced over time.

We have shared with the Superintendent’s office our approach to managing and reserving the claims that might have been subject to the cap. We have, during the entire period where the outcome was uncertain, managed these claims with a separate lump sum reserve, so as not to allow the possible outcomes to unwittingly be double counted. In our own pricing, we considered not only the possible cost of the cap being struck down, but the likelihood of the outcome of the appeal, and the increased risk to the results, and to our shareholders as a result of these considerations.

Each insurer was impacted differently as a result of the constitutional challenge surrounding the cap on pain and suffering awards for minor injuries and pricing decisions are based on individual claims handling practices, reserving philosophies, and ability to predict the final outcome.

As stated in previous submissions, the unique nature of the insurance product creates an inherent risk and volatility for insurers as the cost of any one policy will not be known for years. There may not be any losses incurred or there could be one claim worth millions of dollars. There are many techniques and methods for estimating the cost with accuracy. But even with sophisticated techniques, there is considerable volatility in the end result. While the decision by the Supreme Court of Canada not to hear an appeal of the minor injury cap has removed the most significant factor affecting market uncertainty, it has been replaced with other factors including economic conditions, premium regulation, and other court challenges and decisions that affect claim costs and processes.

Insurance provides consumers with peace of mind and the comfort that if they purchase a policy from Allstate or Pembrige we'll be there to provide the necessary treatment or re-build their home in the unfortunate event that tragedy occurs. This is business as usual for insurers who trade a stable today for an uncertain tomorrow. Constant reassessment and balancing of priorities is the nature of our business, and the value we offer to our customers. Nonetheless, rates going up and down by small amounts are the sign of a healthy, competitive market. Rates that swing up and then radically down is the sign of an unhealthy broken market.

Last year ACG recommended the work of Professor Marc Gaudry of the University of Montreal around the development of macroeconomic models to explain accident frequency. We were pleased to see that the Board's actuarial consultant referenced Dr. Gaudry's work in his report, although we were disappointed that it did not seem to offer the guidance the Board was looking for in this area. Our submission offered an extensive review of the available literature, and we would like re-iterate the general conclusions reached by the academics and scientists who have studied this matter:

The general wealth level of the economy appears to increase frequency, but decrease severity. An increasingly wealthy economy translates into more people driving more kilometers, especially those in higher risk groups: younger and inexperienced drivers in particular, who have greater access to vehicles and the desire to drive in higher risk times and environments—evenings, weekends, and vacation driving. At the same time, the general wealth of the economy seems to result in a lower severity of crashes, with increased wealth translating into a demand for newer vehicles with improved safety features. What is often counterintuitive is that lower severity crashes while preferable to those more severe, can often result in higher treatment costs.

In order to understand the impact of the economy on automobile crashes and costs, it is not merely the economic factors that are critical, but how they compare with the rest of the world. To illustrate, rising unemployment is generally accepted to contribute to a decrease in crash frequency. If the unemployment rate in Alberta is considerably higher than the rest of North America, the impact will be significantly different than if Alberta has a high unemployment rate yet a stronger job market than the surrounding regions. Even economic variables are not absolute. An area with 10% unemployment may be the market of choice if people are comparing it to 15%. The nature of the 2009 world economic roller coaster of recession and recovery makes understanding the impact on Alberta very difficult.

From our analysis of the various studies, it would appear that the economy has an impact, not so much because of the economic variables themselves, but through their influence on attitude and behaviour. This in turn is the result of the comparative economy.

We are left with some general truths: high employment leads to lower severity and higher frequency among the groups that are already driving. Comparative high employment leads to more marginally employed groups, such as young drivers, being added to the driving population, which will increase the frequency and severity. Long term underemployment, and consequent erosion of wealth, will lead to lower frequency, but higher severity. Short term higher fuel prices leads to lower frequency and severity. Long term higher fuel prices are subsumed into expectations and the impact disappears.

These general truths give us some insight, but as we have previously noted, this is a field we believe is deserving of more study both within the industry, and within the social policy arena.

ACG is proud of the progress that has been made to date on implementing the reforms and will continue to provide high-quality products and services at the most affordable and appropriate price for the consumer. In addition, ACG continues to look within the organization to see what more can be done for not just current customers but for any potential customer. We believe the collective goal should be to minimize or eliminate the wild roller coaster ride that has defined insurance cycles in order to provide a measure of stability for consumers.

Rates have remained low while new products and services are being introduced into the market, competition is strong and consumer complaints are down dramatically. Evidence strongly suggests that the competitive market can be allowed to operate to the advantage of consumers in Alberta. An open and competitive insurance market provides the consumer with the freedom and flexibility to find the coverage that is the most appropriate for them at the most appropriate price.

While the industry has regained a measure of profitability due in large part to the product reform of 2004, and the stability in pricing it allowed, we remain faced with an industry with much variation in price in mandatory coverages, where companies have traditionally turned to pricing of non-mandatory coverages to support underpriced TPL and AB. The extent of this cross subsidy varies across companies, but as the Board and the government completes its review of rate regulation, it is important to note that correcting an imbalance in the system always leads to some instability, and moving cautiously to avoid significant consumer dislocation is important.

**In conclusion, ACG would like to respectfully make two recommendations to the Board with respect to the 2010 Annual Rate Adjustment Process:**

- 1. ACG supports the ongoing work to amend the premium regulations in order to limit the annual rate adjustment to grid rates.**
- 2. In an effort to ensure the long-term stability of the marketplace, ACG recommends that the Auto Insurance Rate Board allow the industry within the confines of the current process, an optional rate increase of 5%. This would be achieved through an overall rate change of this amount that would apply to grid rates, and in compliance with the regulations, permit companies the latitude to make filings in accordance with their individual requirements.**

ACG appreciates the opportunity to present its experience in the Alberta market and make recommendations to the Alberta Automobile Insurance Rate Board. ACG would like to thank the Board for their measured consideration of all components that affect consumers and the companies that serve them.