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May 28, 2010

Mr. Del Dyck  
Executive Director  
Alberta Automobile Insurance Rate Board  
200 Terrace Building  
9515 – 107 Street  
Edmonton, Alberta T5K 2C3

*Delivered via email airb@gov.ab.ca  
Original to follow by courier*

**Re: Annual Review of Automobile Insurance Premiums for Basic Coverage**

Dear Mr. Dyck,

Please find enclosed the required signed original and twelve copies of the Facility Association submission to the Alberta Automobile Insurance Rate Board's Annual Review of Automobile Insurance Premiums for Basic Coverage.

Attending at our presentation on behalf of Facility Association will be:

David Simpson, President & CEO

Please also find enclosed a signed disclosure form.

With respect to our presentation needs, we will be using a laptop-driven PowerPoint presentation to highlight facts and themes from our submission. A projector (with USB cable connectivity) and screen are all that we need. We will email the presentation to you a week before the Hearing as requested in your letter to me of May 6<sup>th</sup>.

If you require anything further in the interim, please let me know directly.

Yours truly,

A handwritten signature in black ink, appearing to read 'David J. Simpson', written over a light blue horizontal line.

David J. Simpson, M.B.A., FCIP  
President & CEO

c.c.: Martin Beaulieu, FA Board Chair

# **Alberta Automobile Insurance Rate Board**

## **Annual Review of Automobile Insurance Premiums for Basic Coverage**

**June 15, 2010**



### **Submission**

A handwritten signature in black ink, appearing to read 'David J. Simpson', written over a horizontal line.

David J. Simpson, M.B.A., FCIP  
President & CEO

1 **INTRODUCTION**

2

3 This submission provides the Alberta Automobile Insurance Rate Board (AIRB) with an annual  
4 update on the size, volume trends and financial performance of the two Alberta Risk Sharing  
5 Pools administered by Facility Association on behalf of automobile insurers in the province.

6

7 It also provides the AIRB with an overview of the impact of the Supreme Court of Canada’s  
8 decision to not hear an appeal of “Morrow vs. Zhang”, effectively upholding the  
9 constitutionality of the Alberta Minor Injury Regulation. With that decision, we were able to  
10 release the provisions in our statements held in the event a different outcome was reached.

11

12 Appendix 1 provides a background to the history and operations of the Alberta Risk Sharing  
13 Pools.

14

15 **RISK SHARING POOLS SIZE**

16

17 As always, our view is that residual market volumes should be as small as possible. This stems  
18 from the belief that consumers are best served by companies competing directly for their  
19 business in an environment where these companies do not have to frame their decisions based  
20 on the potential impacts arising from compulsory participation in residual market mechanisms.

21

22 In 2009, we again saw an overall decrease in written premiums transferred to the Risk Sharing  
23 Pools (RSPs) on a combined basis as the premium volume transferred dropped from \$348.6M  
24 to \$317M. Within that overall decline however, we saw an increase in premiums transferred to  
25 the Non-Grid RSP of \$9.7M and a decrease in premiums transferred to the Grid RSP of \$41M.  
26 At \$317M, written premiums transferred to both RSPs represented approximately 13.8% of all  
27 private passenger automobile insurance premiums written in Alberta in 2009.

28

29 Please see Table 1 for a summary of Risk Sharing Pools written premium and market share  
30 data for the last four years.

Year	Total		Grid RSP		Non-Grid RSP	
	W. Prem	Mkt Share	W. Prem	Mkt Share	W. Prem	Mkt Share
2006	\$380,543,231	18.6%	\$309,538,332	15.1%	\$71,004,099	3.5%
2007	\$382,378,719	17.7%	\$302,904,752	14.0%	\$79,473,967	3.7%
2008	\$348,642,315	15.1%	\$283,278,774	12.3%	\$65,363,541	2.8%
2009	\$317,089,241	13.8%	\$242,035,611	10.5%	\$75,053,630	3.3%

32

33 On a written exposure count basis (exposure is defined as one car insured for one year) a total  
 34 of 165,579 exposures were transferred to both RSPs in 2009, down from 193,191 exposures in  
 35 2008. Despite the increase in written premium in the Non-Grid RSP in 2009, written exposures  
 36 declined in each RSP in 2009. Specifically, written exposures declined from 134,700 to  
 37 112,921 in the Grid RSP, and declined from 58,491 to 52,658 in the Non-Grid RSP.

38

39 Please see Table 2 for a summary of Risk Sharing Pool written exposure and market share data  
 40 for the last four years.

41

Year	Total		Grid RSP		Non-Grid RSP	
	W. Exp	Mkt Share	W. Exp	Mkt Share	W. Exp	Mkt Share
2006	230,568	12.0%	164,643	8.6%	65,925	3.4%
2007	221,445	10.3%	153,649	7.1%	67,796	3.2%
2008	193,191	8.8%	134,700	6.1%	58,491	2.7%
2009	165,579	7.6%	112,921	5.2%	52,658	2.4%

42

### 43 **PRIVATE PASSENGER RESIDUAL MARKET SEGMENT – SIZE**

44

45 Facility Association also administers the residual market segment, a small volume, tightly  
 46 defined pooling mechanism for higher-risk cars and drivers. The premiums for approximately  
 47 80-90% of the exposures insured through the residual market segment have their annual  
 48 premiums capped by the insurance premium regulation grid. The market share of the private

49 passenger residual market segment has been very stable over the last four years as Table 3  
 50 shows.  
 51

<b>Table 3</b>				
<b>Alberta Private Passenger Residual Market Segment - Market Share</b>				
<b>(Written Exposure Basis)</b>				
<b>Year</b>	<b>W. Premium</b>	<b>Market Share</b>	<b>W. Exposure</b>	<b>Market Share</b>
2006	13,467,167	1.2%	6,766	0.3%
2007	14,290,380	1.2%	6,831	0.3%
2008	13,384,324	1.1%	6,091	0.3%
2009	16,752,344	1.4%	5,799	0.3%

52  
 53 Although total residual market volumes have declined once again, the Alberta private passenger  
 54 residual markets on a combined basis, remain among the largest in North America, behind only  
 55 Nunavut, North West Territories and North Carolina.

56  
 57 Table 4 shows the top ten private passenger residual market jurisdictions in North America.  
 58

<b>Table 4</b>	
<b>Top Ten Private Passenger Residual Market Jurisdictions in North America</b>	
<b>Jurisdiction</b>	<b>Market Share</b>
Nunavut	48.4%
North West Territories	23.0%
North Carolina	21.6% <sup>1</sup>
Alberta (RSP & FARM)	7.9%
Nova Scotia	4.5%
New Brunswick	4.3%
Massachusetts	3.5% <sup>2</sup>
Newfoundland & Labrador	3.4%
Yukon	3.3%
Ontario	2.8%

59 <sup>1</sup> Source: Insurance Information Institute Data is for 2007

60 <sup>2</sup> Source: Massachusetts Division of Insurance Data is for 2008

61

62 The size of the Risk Sharing Pools can be influenced by a number of factors. Insurers tend to  
63 keep on their own books risks they consider to be adequately priced, and transfer to the Risk  
64 Sharing Pools (subject to eligibility rules) risks they consider to be inadequately priced. In the  
65 current context, there is a risk that a negative industry-wide rate adjustment would lead to an  
66 increase in the number of risks transferred to the Risk Sharing Pools.

67

68 In general, there is a correlation between residual market size and the degree of price  
69 competition permitted in a given jurisdiction. In the United States, rate regulation is under the  
70 authority of individual states similar to the provincial authority that exists in Canada. In the last  
71 decade or so there has been an increased trend to allow the competitive forces of the  
72 marketplace to regulate prices. Interestingly, for 2007 (the most recent year for which data is  
73 available) 35 states had less than 1,000 private passenger cars insured through residual market  
74 mechanisms, and 45 states had less than 1% of private passenger cars insured through residual  
75 market mechanisms.

76

77 Because we believe residual markets should be as small as possible, we are encouraged by the  
78 Chair's remarks in the 2008 and 2009 Annual Reports of the AIRB that the Board supports a  
79 change from the current industry-wide process to a "File and Approve" system to foster greater  
80 competition to the benefit of consumers. To the extent competition is increased, we would  
81 expect to see a decline in residual market volumes. We believe that, at some point, moving  
82 beyond a "File and Approve" system to open competition under the price ceiling provided by  
83 the premium grid regulation would provide an additional opportunity to reduce the number of  
84 cars insured through the residual market mechanisms.

85

## 86 **FINANCIAL PERFORMANCE**

87

88 Table 5 summarizes the financial performance of the Risk Sharing Pools since inception. The  
89 data in the table is taken directly from our audited financial statements.

90

<b>Fiscal Year</b>	<b>Grid RSP</b>	<b>Non-Grid RSP</b>	<b>Combined</b>
2005 (13 months)	\$(93,902)	\$(28,038)	\$(121,940)
2006	\$8,498	\$(30,562)	\$(22,064)
2007	\$93,357	\$(9,422)	\$83,935
2008	\$(73,490)	\$(29,955)	\$(103,445)
2009	\$85,747	\$(9,184)	\$76,563
Total	\$20,210	\$(107,161)	\$(86,951)

92

93 One of the key factors influencing our financial results this year was the decision by the  
 94 Supreme Court of Canada to not hear an appeal of “Morrow vs. Zhang”, effectively upholding  
 95 the constitutionality of the Minor Injury Regulation or MIR. Having reached “the end of the  
 96 legal road” we were then in a position to release the provision we had been holding in our  
 97 statements in the event the Minor Injury Regulation had been struck down by the courts. Before  
 98 we present the final impact of the release of that provision, the following offers a brief re-cap of  
 99 the derivation of the provision. More detail on this issue can be found in the bulleting sent to  
 100 member companies at [www.facilityassociation.com](http://www.facilityassociation.com).

101

102 Following the original MIR court decision (commonly referred to as the “Wittmann” decision)  
 103 and after consultation with our auditors, it became clear to us that to receive an unqualified  
 104 auditor opinion on our financial statements, we would need to include a provision for liabilities  
 105 that could arise if the Wittmann decision was ultimately upheld. The methodology for deriving  
 106 the provision was developed by our valuation actuary, Cynthia Potts of Eckler Ltd. after  
 107 extensive consultation with member companies. After arriving at an actuarial estimate of the  
 108 total liabilities expected to arise if the MIR was struck down, a factor of 0.5 was applied to  
 109 reflect the reality that the court decision could go one way or the other. As we said in our  
 110 submission last year:

111

112 “That assumption was not based on a legal evaluation of the case but simply reflects  
 113 that the decision of the Alberta Court of Appeal is unknowable in advance.  
 114 Therefore, the court’s decision will have a material impact on the financial results  
 115 of the RSPs one way or another, and that underscores the highly uncertain operating

116 environment Alberta’s automobile insurers are working within. If, as has been  
117 speculated, the decision of the Alberta Court of Appeal is appealed to the Supreme  
118 Court of Canada, the dollar amount reflecting that uncertainty will only continue to  
119 grow in magnitude until an ultimate legal decision is reached.”

120

121 By the time we released those provisions, on an undiscounted basis they had grown to \$65M  
122 for the Grid RSP and \$18M for the Non-Grid RSP, so releasing them had an obvious positive  
123 impact on our 2009 fiscal year results.

124

125 It needs to be made clear, however, that the MIR provision amounts shown in our statements  
126 will not necessarily match those in the financial statements of our member companies. Unlike  
127 written premiums, for example, which are a “hard” number and must be booked directly by the  
128 member companies, the MIR provision is an estimate based on several judgmental assumptions,  
129 which the members are able to modify and change, subject to acceptable standards of actuarial  
130 and accounting practice. As an example, as stated previously we used a factor of 0.5 to reflect  
131 the legal probability the MIR would be upheld. A member company could certainly have used a  
132 different factor, presumably supported by a qualified legal opinion. As well, those familiar with  
133 the nature of our operation will know that to try and gauge the financial impact of the MIR  
134 being held by the industry by adding our provision amounts to those of our members will be a  
135 form of double counting since members are required to book amounts for residual market  
136 liabilities in their own statements either as is or modified as just described.

137

138 The comments above also apply to the provision included in the residual market segment  
139 financial statements. The residual market segment provision released relative to private  
140 passenger vehicles was \$6M.

141

142 Details of the MIR provisions and their derivation are available in the Member Bulletin of our  
143 website, [www.facilityassociation.com](http://www.facilityassociation.com)

144

145 Automobile insurance is a business based on estimates – the true results of a given accident  
146 year cannot be known until many years in the future. Deriving estimates for the RSPs is  
147 especially challenging from an actuarial perspective as it involves taking into account the  
148 independent decision making of member companies with respect to what types of risks they  
149 will transfer to a given pool. The estimated ultimate loss ratios for the RSPs by accident year  
150 and how these estimates have evolved since the inception of the RSPs are shown in Table 6.

151

<b>Period</b>	<b>----- Accident Year -----</b>					
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
<b>Grid RSP</b>						
As at Oct 31 2005	82.3%	82.5%				
As at Oct 31, 2006	69.2%	73.7%	76.3%			
As at Oct 31, 2007	51.7%	57.3%	65.5%	69.1%		
As at Oct 31, 2008	54.7%	60.0%	69.0%	75.1%	75.6%	
As at Oct 31, 2009	50.9%	57.4%	64.9%	68.8%	70.7%	67.5%
<b>Non-Grid RSP</b>						
As at Oct 31 2005	173.7%	123.4%				
As at Oct 31, 2006	204.2%	107.8%	103.8%			
As at Oct 31, 2007	210.5%	94.0%	89.8%	100.0%		
As at Oct 31, 2008	242.4%	93.2%	88.8%	101.7%	107.2%	
As at Oct 31, 2009*	340.9%	88.5%	84.5%	96.5%	101.4%	101.6%
<b>Industry** as at June 30 2009</b>	Not comparable	50.0%	54.2%	59.2%	56.8%	56.7%

153 Please note that in Table 6, the Undiscounted Estimated Ultimate Loss Ratios as at October 31, 2009  
 154 reflect both the exclusion of the provision for the MIR court challenge and revisions to the accident  
 155 year estimates.  
 156

157 \*\*Industry loss ratios:

158 [1] All estimates exclude loss adjustment expenses in order to be comparable to the Risk Sharing  
 159 Pools.

160 [2] The loss ratio for AY 2004 has been omitted, because it includes experience prior to the product  
 161 reform, whereas the AY 2004 loss ratios for the Risk Sharing Pools pertain to losses incurred on  
 162 or after 1 October 2004.

163 [3] The loss ratio for AY 2009 was estimated based on the experience for the accident half year  
 164 2009-1, adjusted for seasonality. The seasonality adjustment was computed as a 5-year average  
 165 of the ratio of accident year loss ratios to loss ratios for the corresponding "-1" half year:

166  $56.7\% = 50.8\% \times 1.116$   
 167

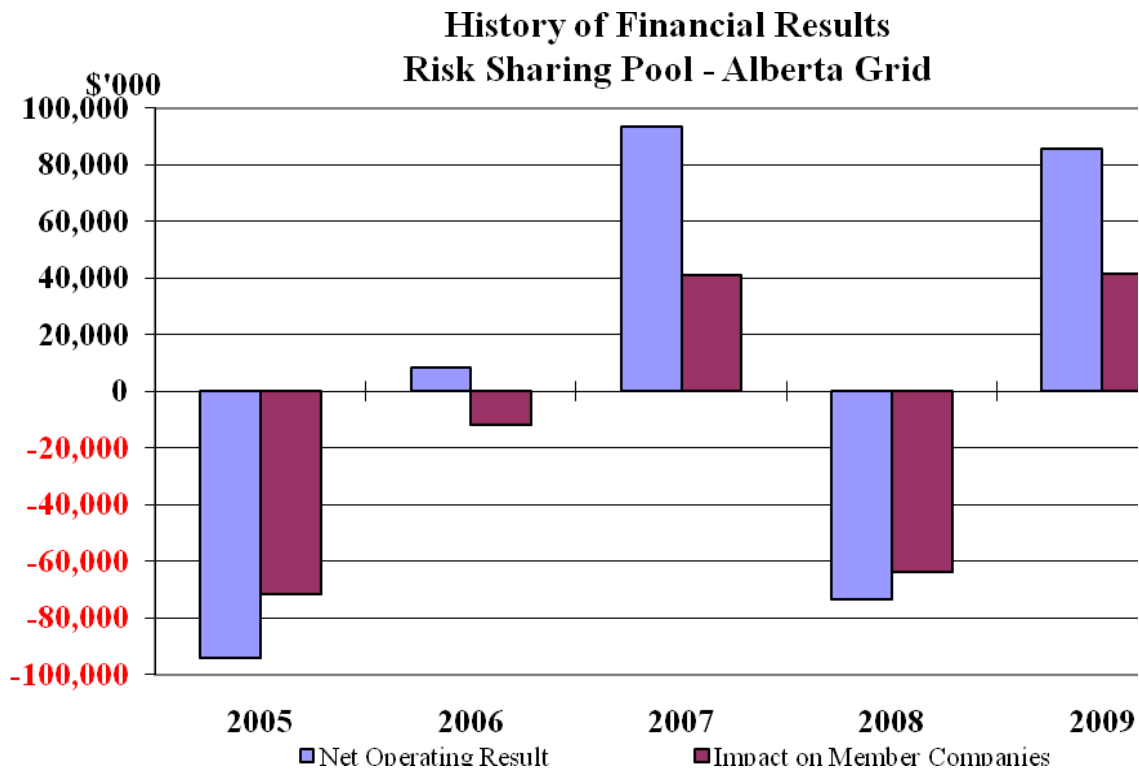
168 **FINANCIAL IMPACT ON THE INDUSTRY**

169

170 Because we must prepare our financial statements according to Generally Accepted Accounting  
171 Principles, our statements can only show the results of our own operations. As member  
172 companies incorporate their share of Risk Sharing Pool premiums and results into their own  
173 statements, they have to reflect items such as health levies, premium taxes, investment income,  
174 income tax effects and their cost of capital on those premiums and results. Table 7 illustrates  
175 what an adjusted operating result might look like from the industry's perspective.

176

177 **Table 7**



178

179

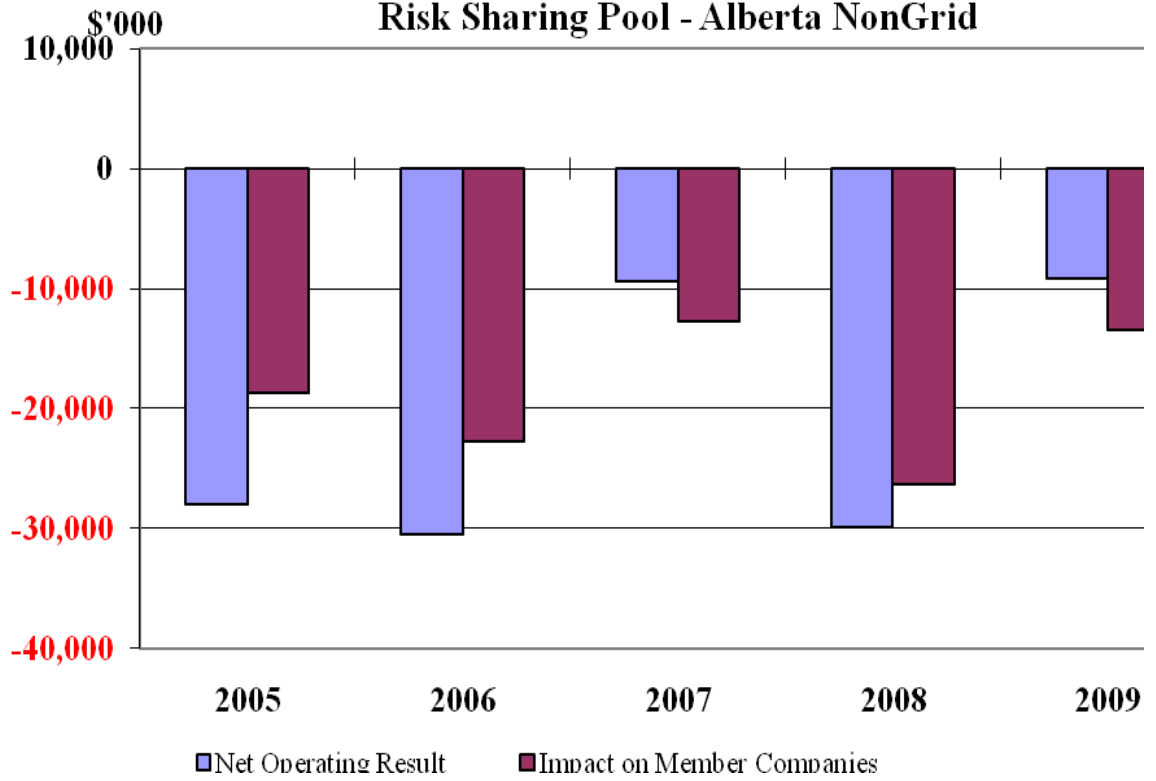
**ALBERTA RISK SHARING POOL**  
**SUMMARY OF OPERATIONS - INDUSTRY IMPACT FOR ILLUSTRATION PURPOSES**  
**ADJUSTED OPERATING RESULT**  
(Amounts in \$000's)

	GRID RSP					
	Total	Oct-09	Oct-08	Oct-07	Oct-06	Oct-05
<b>Net Operating Result</b> <i>(per Financial Statements)</i>	<b>\$20,210</b>	<b>\$85,747</b>	<b>(\$73,490)</b>	<b>\$93,357</b>	<b>\$8,498</b>	<b>(\$93,902)</b>
<b>Adjustments :</b>						
Premium Taxes Paid Directly by Members	-46,744	-7,491	-8,566	-9,291	-9,264	-12,132
Health Levies Paid Directly by Members	-45,371	-6,229	-9,172	-13,495	-10,291	-6,184
Discounting of policy liabilities	18,016	-13,793	-1,945	-1,533	15,117	20,170
Assocociation Dues paid directly by members	-6,233	-999	-1,142	-1,239	-1,235	-1,618
Investment Income	102,166	26,328	31,923	22,724	15,250	5,941
Net Adjustment	21,834	-2,184	11,098	-2,834	9,577	6,177
<b>Adjusted Net Operating Result</b>	42,044	83,563	-62,392	90,523	18,075	-87,725
Income Tax on net Operating result	11,469	24,233	-18,406	29,058	6,077	-29,493
<b>Operating Result Before Cost of Capital</b>	30,575	59,330	-43,986	61,465	11,998	-58,232
Deemed after tax Cost of Capital	95,554	17,841	19,841	20,617	23,774	13,481
<b>Combined Net Operating result</b>	<b>(\$64,979)</b>	<b>\$41,489</b>	<b>(\$63,827)</b>	<b>\$40,848</b>	<b>(\$11,776)</b>	<b>(\$71,713)</b>

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183 Please see Appendix II for the background assumptions to Table 7.

## History of Financial Results Risk Sharing Pool - Alberta NonGrid



184  
185

**ALBERTA RISK SHARING POOL**  
**SUMMARY OF OPERATIONS - INDUSTRY IMPACT FOR ILLUSTRATION PURPOSES**  
**ADJUSTED OPERATING RESULT**  
(Amounts in \$000's)

	NON-GRID RSP					
	Total	Oct-09	Oct-08	Oct-07	Oct-06	Oct-05
<b>Net Operating Result</b> <i>(per Financial Statements)</i>	(\$107,161)	(\$9,184)	(\$29,955)	(\$9,422)	(\$30,562)	(\$28,038)
<b>Adjustments :</b>						
Premium Taxes Paid Directly by Members	-10,320	-2,226	-2,094	-2,134	-2,674	-1,192
Health Levies Paid Directly by Members	-9,526	-1,552	-1,878	-2,789	-2,741	-566
Discounting of policy liabilities	5,586	-2,834	-1,282	169	6,379	3,154
Association Dues paid directly by members	-1,377	-297	-279	-285	-357	-159
Investment Income	15,000	3,861	4,821	3,657	2,095	566
Net Adjustment	-637	-3,048	-712	-1,382	2,702	1,803
<b>Adjusted Net Operating Result</b>	-107,798	-12,232	-30,667	-10,804	-27,860	-26,235
Income Tax on net Operating result	-34,249	-3,547	-9,047	-3,468	-9,367	-8,820
<b>Operating Result Before Cost of Capital</b>	-73,549	-8,685	-21,620	-7,336	-18,493	-17,415
Deemed after tax Cost of Capital	20,461	4,800	4,698	5,342	4,296	1,325
<b>Combined Net Operating result</b>	(\$94,010)	(\$13,485)	(\$26,318)	(\$12,678)	(\$22,789)	(\$18,740)

187  
188

189 As the AIRB has requested in the past, we have calculated “break even” loss ratios for both  
190 RSPs from the industry’s perspective. These loss ratios are shown in Table 8.

191

Fiscal Year	Grid RSP		Non-Grid RSP	
	Break-even Loss Ratio	Actual Loss Ratio	Break-even Loss Ratio	Actual Loss Ratio
2005	55.3%	92.3%	-17.0%	139.6%
2006	71.8%	69.9%	63.3%	109.2%
2007	76.1%	44.4%	68.1%	83.0%
2008	74.3%	93.4%	73.9%	109.7%
2009	83.4%	45.2%	75.3%	86.8%

192

193 Note: In preparing this year’s exhibit, we noticed an error in the information provided to the  
194 AIRB in last year’s submission to the annual review process. We apologize for the error. The  
195 current table contains the correct information.

196

197 Of course, it is unlikely that the loss experience of any one particular company will be identical  
198 to that of the industry as a whole, as each company's loss experience will depend on the loss  
199 experience of risks they have transferred to the RSPs, relative to the total loss experience of the  
200 RSPs.

201

202 One could look at the overall financial results of the Risk Sharing Pools (especially the Grid  
203 RSP) in the context of the Minor Injury Regulation ultimately being upheld and conclude that  
204 the presence of the Grid RSP has, and will continue to be, relatively benign. For those that do,  
205 we would provide the following notes of caution:

206

207 - The Grid RSP loss experience compares poorly to that of the overall market. To the  
208 extent that the overall market loss performance deteriorates, we would expect the Grid  
209 RSP loss experience to deteriorate as well.

210

211 - Competitive enterprises need to generate a competitive level of return. To the extent that  
212 companies are not generating a competitive level of return on approximately 14% of  
213 revenue, that return must be generated from those paying the remaining 86% of  
214 premium in the marketplace

215

216 - Taken together, the Risk Sharing Pools represent a large volume of premium likely to  
217 behave in a more volatile way than of most individual companies. Although this  
218 volatility impacts all companies in a similar way, smaller companies with limited  
219 financial resources very probably find those impacts more difficult to absorb. As well,  
220 the presence of such large RSPs with their inherent volatility may act as a barrier to  
221 entry to insurers who would otherwise seek the opportunity to serve Alberta consumers.

222

## 223 **CONCLUSION**

224

225 We stated near the beginning of this submission our belief that consumers are best served by  
226 companies competing directly for their business in an environment where those companies do  
227 not have to frame their business decisions based on impacts from residual markets. So we were  
228 heartened to again read in the Chair's remarks in the 2009 annual report of the AIRB the  
229 Board's support of increasing competition in Alberta automobile insurance:

230

231 “While this decision of the Supreme Court ends the uncertainty regarding  
232 payouts for minor injury claims, companies applied differing methods to reserve  
233 for these potential claims. These variations in reserving practices compromise the  
234 current industry-wide rate setting process, which adds support to the Board’s  
235 position to move away from an industry-wide process that treats all companies as  
236 operating under identical circumstances.

237

238 In 2009, the Board forwarded a recommendation to the Minister of Finance and  
239 Enterprise recommending that the regulation be changed from the current  
240 industry-wide process to a “File and Approve” system. The Board believes this  
241 system where each company is dealt with on its merits will provide for better  
242 regulation, thereby reducing uncertainty in the market which in turn fosters  
243 greater competition for consumers over the longer term.”

244

245 Simply stated, maximizing insurance availability for consumers can be achieved in an  
246 environment of product stability and pricing flexibility. We therefore believe that a move away  
247 from a rigid industry-wide process to a more flexible company-specific approach to rate review  
248 would not only lead to improved premiums but smaller residual market mechanisms as well. In  
249 a similar vein, we continue to encourage suggest, as we did last year, that steps be taken to  
250 ensure the protection afforded by the premium grid remains as tightly focused as possible on  
251 the group of consumers it is intended to protect and that insurers be allowed to charge adequate  
252 rates for risks not targeted by the grid. As long as the premium grid remains in force, we believe  
253 allowing open price competition below the maximum premium set by the grid will pave the  
254 way for the smallest possible residual market volumes in the current regulatory framework.

255

256 **APPENDIX I: RISK SHARING POOLS BACKGROUND, AUTHORIZATION &**  
257 **OPERATION**

258

259 **BACKGROUND**

260

261 Facility Association is an administrative mechanism that administers involuntary residual  
262 market automobile insurance on behalf of the voluntary/private sector automobile insurance  
263 industry across Canada. Created by the industry and empowered by statute, Facility  
264 Association’s mission is to guarantee the availability of automobile insurance coverage for  
265 consumers who require it to legally operate their vehicles. Facility Association has a full-  
266 time staff of twenty-seven people and fulfils its mandate via a network of outsourcing  
267 arrangements.

268

269 In Alberta, Facility Association administers the Alberta RSP (in reality, two Pools – one for  
270 Grid and the other for Non-Grid risks) for private passenger vehicles. It also administers the  
271 traditional Residual Market for non-private passenger vehicles and a very small “Residual  
272 Market Segment” (with very tightly defined risk criteria) for private passenger vehicles.

273

274 Because all licensed automobile insurers must participate in the residual markets  
275 administered by Facility Association according to specified sharing formulas, their financial  
276 results are subject to greater volatility and uncertainty than would otherwise be the case.  
277 Participation in the Residual Market also imposes additional costs on Facility Association  
278 member companies for such expenses as premiums taxes, health levies, and the cost of  
279 capital members must maintain to support residual market premiums.

280

281 **THE RESIDUAL MARKETS - AUTHORIZATION**

282

283 In Alberta, Facility Association administers the RSPs and Residual Market as authorized by  
284 its Plan of Operation, which is approved by the provincial Superintendent of Insurance. (The  
285 Plan may be viewed and downloaded at [www.facilityassociation.com](http://www.facilityassociation.com).) All companies  
286 licensed to sell automobile insurance in Alberta are required to abide by the provisions of  
287 the Plan.

288

289 For risks ceded to the Alberta RSPs, the Plan requires Facility Association to maintain and  
290 report separate financial results for those risks that are subject to the premium grid and those

291 that are not. This creates the need for two RSPs, commonly referred to as the Grid RSP and  
292 the Non-Grid RSP. Both are for private passenger automobiles only. All financial results of  
293 the Alberta RSPs and the traditional Residual Market are assigned to member companies  
294 based on their participation in the Alberta automobile insurance market. That is, they are not  
295 spread across the other jurisdictions Facility Association serves.

296

297 **THE RISK SHARING POOLS - OPERATION**

298

299 Essentially, a RSP is a residual market that acts as an industry-wide reinsurance mechanism  
300 that is largely invisible to consumers and intermediaries. A consumer buys insurance in the  
301 normal way, and the application is forwarded to a company underwriter. The underwriter  
302 assesses the risk, decides whether to keep it on the company's own books or to transfer the  
303 risk to the RSP, subject to the operational rules and eligibility guidelines of the Pool.

304

305 For both Alberta RSPs, companies receive an expense allowance to cover costs such as  
306 those incurred for acquisition, policy issuance, policy administration and claims servicing.  
307 That expense allowance is set annually by the Facility Association Board of Directors in  
308 consultation with the Superintendent. For both Pools, companies are required to submit  
309 100% of all premiums for all coverages on a policy and are eligible for 100%  
310 reimbursement of eligible claims and related expenses. Financial results (top **and** bottom  
311 lines) of the Pools are shared among companies based on the proportion of a company's  
312 private passenger automobile exposures not ceded to a RSP divided by the number of  
313 industry private passenger automobile exposures not ceded to a RSP. As Facility  
314 Association is simply an administrative mechanism, all companies receive a monthly report  
315 reflecting the operations of the Pool, providing them with the amounts they are then required  
316 to book into their own financial statements.

317

318 The two Pools differ primarily in the number of risks companies can transfer to each. For  
319 the Grid RSP, companies can transfer eligible risks without limit. This lack of limit is based  
320 on the philosophy that companies are required to accept risks for which they have no control  
321 over price and, therefore, little or no control over the financial results of that business. In a  
322 general way, the size of the Grid RSP will be a function of how companies view the  
323 adequacy of the grid premium for a given risk. If the grid premium is approximately the  
324 same as the company's own risk-based premium, the company might prefer to keep the risk

325 on their own books. The upper limit to the size of the Grid RSP is, of course, a direct  
326 function of how many risks in the province are impacted by the grid.

327

328 For the Non-Grid RSP, companies can transfer up to 4% of written exposures not transferred  
329 to the Grid RSP. This Pool is designed to help companies cope with the “take-all-comers”  
330 environment in the province.

331

332 In a competitive market, most insurers tend not to target the entire universe of private  
333 passenger automobile risks. Insurers generally each have their areas of expertise and a  
334 healthy competitive marketplace tends to allow a proper mix of generalist and  
335 specialist/niche private passenger automobile writers. Moreover, because it is a practical  
336 impossibility to have a perfect price for every risk, most insurers choose to have risk  
337 eligibility rules to complement and protect their respective pricing structures. An  
338 underwriter faced with a requirement to accept a greater degree of risk than that  
339 contemplated by the company’s classification system and rates can transfer that risk to the  
340 Non-Grid RSP. The Non-Grid RSP has a relatively low limit to ensure that it does not  
341 become used as a marketing tool. That is, without such a limit, companies could deliberately  
342 adopt a strategy of under-pricing certain risks to attract new customers. Because these risks  
343 could then be transferred to the Non-Grid RSP, and because of the way all insurers share in  
344 the results of the Pool, this would amount to companies growing their businesses at the  
345 expense of their competitors.

346

347 The key point here is that RSPs are designed as mechanisms to promote stability in the  
348 marketplace by making it possible for companies to accept risks they believe are not  
349 adequately priced. Therefore, the general expectation is that RSPs by their very nature will  
350 operate at a financial loss. It is also important to note that because the RSPs also act as a  
351 cross-subsidization mechanism across the industry, at any given point in time, companies  
352 will have their own, unique, financial results vis-à-vis the Pools.

353

354 **APPENDIX II: BACKGROUND ASSUMPTIONS TO TABLE 7**

355

356 The net operating result between 2005 and 2009 shown above is taken from Audited Alberta Grid and  
357 Non Grid Financial Statements.

358

359 The "impact on member companies" illustrates the effect on member companies of, in addition to  
360 sharing in Risk Sharing Pool's Net Operating Result, also having to pay income and premium taxes,  
361 health levies, association dues and incur a cost of capital due to their compulsory participation in Facility  
362 Association as described in Note 2 of the Audited Financial Statements. Member impact also includes  
363 investment income earned on funds held by members and the effect of discounting.

364

365 Minor Differences may Occur due to rounding.

366

**Assumptions:**

<b><u>Adjustments</u></b>	<b><u>Source</u></b>	<b><u>Assumption</u></b>
Premium Taxes Paid Directly by Members	Insurance Bureau of Canada	n/a
Health Levies Paid Directly by Members	Alberta Finance, Tax and Revenue Administration	n/a
Discounting of policy liabilities	Eckler Ltd.	Risk free rate of return used is based on a portfolio of Government of Canada bonds, for which the dates and amounts of maturities were matched to the expected payout of policy liabilities. 2009 discounted rate 2.00%.
Investment Income	Eckler Ltd.	Market yield rates attributable to a portfolio of Government of Canada bonds with durations consistent with the duration of Alberta RSP policy liabilities.
Income Tax on net Operating result	Facility Association	Published income tax rates.
Association Dues	Facility Association Accounting Committee	0.40005% of Written Premium
Deemed after tax Cost of Capital	Facility Association Accounting Committee	Deemed after tax Cost of Capital 10% . Surplus based on 1.5:1 ratio.

367

### Information Disclosure Statement

The Automobile Insurance Rate Board (the Board) is mandated to annually determine and set premiums for basic coverage. Basic coverage for private passenger vehicles means the insurance coverage statutorily mandated or provided for under sections 627 (third party liability coverage) and 629 (e.g. Section B benefits) of the *Insurance Act*. To enable the Board to do this, it needs to collect or receive information under the authority of section 656 of the *Insurance Act* and sections 4 and 11 of the *Automobile Insurance Premiums Regulation*. The Board is committed to making its rate setting process as open and transparent to the public as possible.

Therefore, this is to notify you that subject to section 816 of the *Insurance Act*, any information (including personal or business information) that is submitted to the Board for consideration in the rate setting process, will be considered made in the context of a public hearing, whether made as a written submission or an oral presentation will be made available to the public upon request to the Board.

I acknowledge that I am submitting the attached information to the Board in the context of an open public hearing in the rate setting process and that, subject to section 11 of the Automobile Insurance Premiums Regulation, A.R. 124/2004, I am not required by law or by the Board to provide this information, that I do so on my own account at my own instance. For these reasons, I understand that the attached information will be routinely made available to the public upon request and I am submitting the information to the Board on that basis.

If you have any questions concerning the management or disclosure of Board information, you may contact the Executive Director of the Board at (780)415-1126.



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Signature

May 28, 2010

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Date

David J. Simpson, M.B.A., FCIP  
President & CEO  
Facility Association

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Print Name