



ALBERTA INDUSTRY-WIDE
ADJUSTMENT
FOR THE YEAR 2010

A submission
to the
Automobile Insurance Rate Board
by
Intact Financial Corporation

May 2010

INTRODUCTION

Intact Financial Corporation is a 100% public Canadian company protecting the assets of millions of customers across the country. More Canadians rely on us for their peace of mind than any other company in the country.

We are also the largest provider of property and casualty insurance in the province of Alberta with over \$822 million in written premiums in 2009. We offer automobile, property and liability insurance to individuals and businesses through Intact Insurance, Novex Insurance and Grey Power, employing 1000 people who live and work in the province. We insure 475 000 individual drivers in Alberta through a vast network of 500 brokerages active in their respective communities across the province. Automobile insurance is an important segment in our business and currently accounts for nearly 67% of our sales in the province.

In our submission, we will address the three topics upon which the Board intends to focus their review this year, namely:

- the recent trends in the cost of claims;
- the costs of bodily injury claims in light of the confirmation of the Minor Injury Regulation on non-economic damages; and
- the impact of the current economic climate on claims costs

We will also take this opportunity to discuss the evolution of the Industry-Wide Adjustment process in the province.

Since our last submission in May of last year, Alberta drivers have continued to benefit from the reforms adopted by the government back in 2004. These reforms have contributed significantly to the increased stability of the market place over the last six years.

As you embark on your review process, we would respectfully submit that the Board:

- considers that the claims cost trends in the province are increasing, regardless of the confirmation of the minor injury cap;
- adopts a consistent, prospective and forward looking approach in determining the industry-wide adjustment; and
- continues to encourage greater competition in the marketplace by recommending to the Government to evolve the current process and to implement a file-and-use process while keeping the premium level protection provided by the GRID rating program.

I. LOSS TRENDS – MANDATORY COVERAGES CLAIMS COSTS ARE INCREASING

An in-depth analysis of the performance of our own portfolio in 2009 and in the first three months of this year as well as other recent data that we have compiled shows a definitive increase in claims costs in the province. This increase is driven both by a higher number of claims submitted and an increase in their average cost, notably for Accident Benefits.

The number of claims is increasing

Most specifically, we continued to experience in 2009 an increase in the number of property damage claims. Bodily injury claims, on the other hand, have flattened after two years of declining trends, contrary to what many expected a year ago. This recent development highlights the difficulties encountered in forecasting accurately the future evolution of claims.

In the first quarter of this year, we experienced a slightly different trend as a result of highly favourable weather patterns characterized by extremely low precipitations across the province. In the two main urban centres of the province, precipitation levels were down from the historical average by 50% and approximately 75% for Calgary and Edmonton, respectively. As a result, the number of claims for property damage declined by nearly 10%, a development that will be unsustainable in the months and years to come.

Despite the significant decrease in property damage resulting from the favourable weather conditions, it was unusual to see that the number of bodily injury claims remains more or less stable. This would indicate that the current stability in bodily injury claims frequencies is unlikely to be sustained in the future and could even increase within the next 12-24 months.

Overall, our analysis shows that the historical declining trend of bodily injury claims has been reversed and we expect that a higher number of claims in the upcoming accident year. In the case of Accident Benefits Medical Costs, we expect that the number of claims per car insured will either remain the same or increase, while the increasing historical trend for property damage claims will continue at similar levels to those experienced in the last few years.

The cost of claims is also increasing

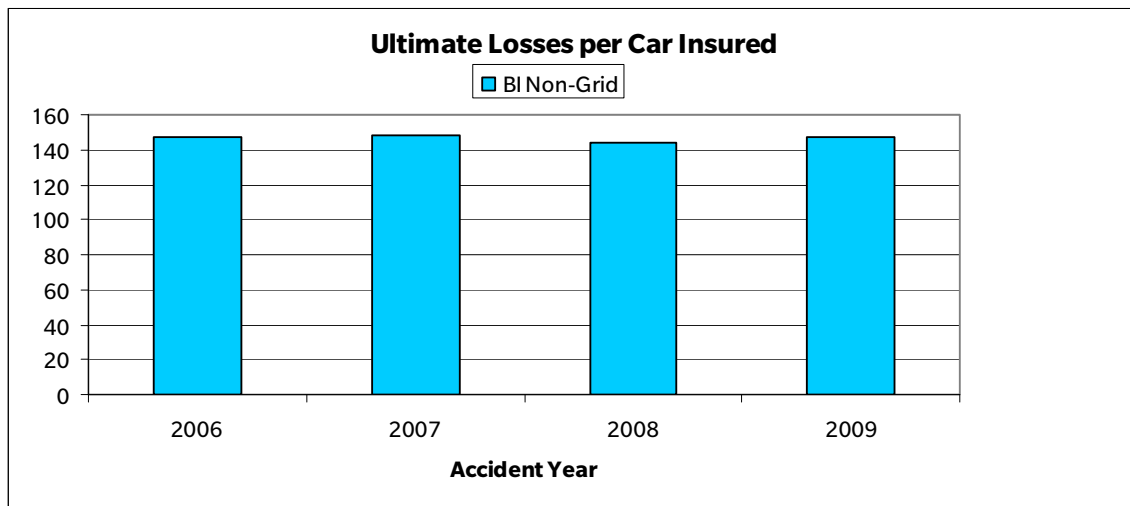
In 2009, the average amount paid both for bodily injury claims and Accident Benefit Medical Costs continued to increase, confirming the trends of past years. The increase was most significant and alarming in Accident Benefit with a nearly 30% jump. This increase stems from a number of factors including the increase in the costs of diagnosis and treatment protocols, which were introduced in 2009, and a greater use of this benefit as plaintiffs attempt to build a stronger BI claim.

Given the continuing prevalence of the inflationary pressures for both BI and AB, we expect the cost of claims will increase consistently in the coming years. The fact that the minor injury cap is indexed would also contribute to the claims inflation in the years to come.

Property damage remained more or less stable in 2009 and we expect the current stability will be maintained for the remainder of the year.

II. THE COSTS OF BODILY INJURY CLAIMS IN LIGHT OF THE CONFIRMATION OF MINOR INJURY REGULATION ON NON-ECONOMIC DAMAGES

The constitutional challenge of the Minor Injury Regulation establishing a cap on non-economic damages did not have an impact on our own bodily injury claims costs. These remained stable over the last few years due in part to offsetting changes in the number of claims and the cost of these claims. Since the uncertainty around the future of the regulation did not have an impact on claims costs in the past, the confirmation of the cap, likewise, should not have an impact moving forward, assuming no change in the behaviour of both third party claimants and the plaintiff bar.



Our experience in other jurisdictions has shown the resilience of claimants and the legal profession and their ability to adopt innovative approaches to counter the limitations built into the insurance regimes to better control the costs of claims. As the uncertainty of the minor injury cap has been removed only recently, we are unable to predict at this point the actions of those involved in the claims process and their potential impact on future costs. As a result, we would recommend that the Board adopts a prudent and cautious approach in the rate setting process.

III. ECONOMIC CLIMATE AND ITS IMPACT ON CLAIMS COSTS

We conducted two years ago an exhaustive study to determine the impact of economic conditions on the underwriting results of the industry over a period of twenty years. Overall, we did not find any significant correlations. We also did not find any correlation between the levels of employment and automobile claims costs and, over the last year, we have not observed any new trends that could correlate automobile claims costs with the economic conditions that were prevailing at the time.

However, unpredictable events in the global economy may lead to unexpected volatility in capital markets, as we have seen over the recent past months, which could impact the

industry's investment income. At this point, all indications point towards the fact that the current environment of historical low returns is here to stay.

We would recommend that the Board exercise caution in predicting how economic factors will impact claims costs and take into consideration the most authoritative views on the future of the Canadian economy and the inflation trends at work. The Bank of Canada indicated in its recent quarterly update that the CPI will most likely increase above its 2% target in the coming year. Such inflationary pressures would magnify the increasing claims cost trends we have already observed.

IV. THE FUTURE OF THE INDUSTRY-WIDE ADJUSTMENT PROCESS.

With annual premiums of more than \$3 billion, the Alberta auto insurance market is a significant one and approximately 70 insurers fiercely compete for a share of this market. Since automobile insurance is such an important part of the overall insurance market in the province, maintaining an environment that will foster competition and promote innovation is key. This will provide Alberta drivers with a dynamic market that will broaden the range of the offers they will receive both in terms of prices and of product and service features.

To foster such an environment, you recommended last year to the Government to evolve the Industry-Wide Adjustment process and we enthusiastically supported your position.

One of the unintended consequences of the current process is that it tends to reduce both the availability and the affordability of insurance in the province. This could lead eventually to reduced capacity and competition as a number of insurance companies may decide not to offer their products in the province. Our analysis of the industry results for the last five years shows that there is significant disparity in the performance of the insurance companies active in Alberta. In fact, the loss ratio gap between the top quartile of companies and the bottom quartile is no less than 17 percentage points.

As a result, a single premium adjustment that applies industry-wide does not reflect the experience of each individual company operating in the province and may create distortions in the competitive landscape favouring some insurers and disadvantaging others.

In addition to support the Board's view to evolve the Industry-Wide Adjustment process, we would also suggest that you recommend to the Government to maintain the GRID adjustment process but to adopt a simplified file-and-use system while keeping the premium level protection provided by the GRID rating program. Such a system would allow the industry to react rapidly to changing market conditions and to further innovate to gain market share by offering well-priced products. This would not be without attracting new entrants into Alberta.

Since the reforms adopted in 2004, the auto insurance marketplace in the province is one of the most stable in the country, as all stakeholders contributed to the success of these reforms either through their guidance, their oversight or their desire to ensure that the policy objectives pursued by the government would be reached. In addition, the adoption of the GRID also guaranteed the availability and affordability of auto insurance to all drivers in the province. As a result we have reached a point where letting insurers compete in terms of product design, underwriting and pricing has become the best guarantee of availability, affordability and stability of insurance for Alberta drivers.

CONCLUSIONS

As you embark on your review process, we would suggest you consider in your analysis that both the number of claims and their costs are increasing regardless of the confirmation of the minor injury cap. We would recommend you take into consideration the relative stability of property damage claim costs, the slight increase in the costs of Bodily Injury Benefits and the alarming trend that has developed over the last three years in Accident Benefits Medical Costs. We would also respectfully suggest that you adopt a consistent, prospective and forward looking approach in determining the Industry-Wide Adjustment by taking into consideration the projected loss costs for the coming year.

Fifteen months ago, we embarked on the most important transformation of our organization in its 200-year history in Canada. Not only did we become a 100% public Canadian company, we also reaffirmed our commitment to provide our customers an outstanding experience that goes beyond their expectations. Our new name says it all. It is not simply an affirmation of our new corporate identity; it is a reflection of our customer-driven strategy and our promise to our customers. It is also the representation of the company that our 7000 employees across the country - and all of them that live and work here in Alberta - are helping to build: a company recognized for putting our customers at the centre of everything we do.

Over these fifteen months, we launched numerous initiatives to protect more Canadians and more residents and drivers in the province. Now that we are offering one of the best customer experience in the industry, our 1000 employees in Alberta are more than eager to grow our market share in the province. That's the reason we are supporting their efforts by one of the most extensive advertising and branding campaigns ever launched in our industry. That's also the reason we have reduced our rates more than the mandated adjustment and introduced a discount for new customers. We could not have done this in an unstable market.

Today, we are looking forward to a more liberal regulatory environment that would allow all of us at Intact to further our efforts and expand upon our innovative offering.