

Submission to the Alberta Automobile Insurance Rate Board

2010 Annual Review of Automobile Insurance Premiums for Basic Coverage

May 28, 2010

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Introduction

This submission is made on behalf of The Dominion of Canada General Insurance Company (“The Dominion”) by Steve Whitelaw, Vice President – Underwriting and Claims - Head Office, and Erika Schurr, Assistant Vice President – Actuarial and Underwriting Projects, to the Alberta Automobile Insurance Rate Board (“The Board”).

Firstly, we would like to thank The Board for the opportunity to provide input into the 2010 Annual Review of Automobile Insurance Premiums for Basic Coverage. The Dominion remains committed to working with The Board to ensure the long term success of the automobile insurance system in Alberta.

Incorporated in 1887, The Dominion is a 100% Canadian-owned insurer operating only in Canada. The Dominion has extensive experience under changing environments over many years across various jurisdictions in Canada. We take pride in the service we have provided to Alberta residents over the many years and the resulting goodwill we enjoy in the province. As a significant writer in the province, we currently insure approximately 62,000 private passenger drivers in Alberta. As an insurer with all of our business solely within Canada, this represents a significant portion of our business. The decisions of The Board are of paramount importance to us, our shareholder and ultimately our policyholders.

Long Term Viability of the Annual Review Process

The automobile insurance reforms have successfully delivered a more affordable product for Alberta drivers. In our view, the government and the insurance industry have worked well together over the years to ensure the objectives of the reforms remain at the forefront of our discussions. The Dominion values this relationship, as we believe it necessary in order to foster a stable and viable automobile insurance system in the province of Alberta.

As we have noted in our previous presentations to The Board, The Dominion's policyholders have indicated that price stability is of utmost importance when judging their satisfaction with the product and service we provide as an insurance company. It is this important objective of "price stability" upon which The Dominion once again bases its analysis, both actuarial and operational, and recommendations. Price stability is becoming more relevant as increasing costs begin to place upward pressure on premiums in an environment of increasing uncertainty. There are opportunities to increase the level of competition in the Alberta marketplace.

Despite some positive collaborative work in the past, we recognize that the plan is to once again mandate an industry-wide adjustment. As you are aware, The Dominion strongly supports a system that allows individual companies to apply to The Board for rate changes that are justified by their unique results, trends and financial performance. We share the common view that such a system is undoubtedly in the best collective interest of policyholders, government and the industry.

We appreciate the opportunity for continued dialogue on the best system to price automobile insurance in Alberta, including specific feedback on this year's review of the premiums for basic coverage. As stated in our letter of intent to The Board, The Dominion's submission will focus on the following topics:

1. The Dominion's loss trends, in the context of industry-wide loss trends;
2. The Dominion's estimate of ultimate bodily injury claim costs in light of confirmation of Minor Injury Regulation cap on non-economic damages;
3. The impact of the economic climate on claim costs; and
4. The combined effect of 1, 2 and 3 (above) on the cost of basic automobile insurance for The Dominion's policyholders.

Due to timing, this submission does not consider any content of the 2010 report on industry wide experience being prepared by Oliver Wyman ("OW") for The Board.

1. Loss Trends

Actuarial analysis relies upon projecting historical experience into the future. Loss patterns can only be identified once they have occurred and have been established. This results in an inherent uncertainty in any estimate of future costs.

We would like to share The Dominion's experience on loss trends, specifically in recent times, all of which is actual experience since the major Reforms were implemented in late 2004. The experience reflects the actual effect of the minor injury regulation on incurred losses, as well as fluctuations in reserve levels due to past uncertainty relating to the minor injury regulation. We have made no adjustment for a change in level due to reforms.

The following table summarizes the change in The Dominion's loss cost, as at December 31, 2009, for private passenger automobile business in Alberta for compulsory coverages:

Loss Cost Year-to-Year Change			
Accident Year	Bodily Injury	Property Damage	Accident Benefits
2004 / 2003	-33.2%	-1.3%	-8.4%
2005 / 2004	-30.3%	13.6%	1.7%
2006 / 2005	13.4%	19.2%	10.4%
2007 / 2006	12.5%	14.8%	-12.7%
2008 / 2007	-5.1%	2.1%	-10.5%
2009 / 2008	43.0%	18.6%	29.9%
Total 2005 to 2009	73.1%	65.7%	12.0%

("Total 2005 to 2009" is the compound effect of the prior four rows, i.e., the total change between 2005, the first full accident year after the reform, and 2009)

From the above table it is apparent that The Dominion's Third Party Liability – Bodily Injury loss costs have begun to deteriorate in 2009 after a slight improvement in 2008. We suspect that the improvement in 2008 was due to uncertainty because of the minor injury regulation court challenge. The large decreases in 2004 and 2005 include the impact of the reforms.

For Property Damage, loss costs continue to increase, however, now at a much higher rate than most recent years. The Dominion's Accident Benefits loss costs had been improving for 2007 and 2008 but have now begun to deteriorate as well. Over the past 5 years, all loss costs trends have deteriorated significantly, with Third Party Liability – Bodily Injury having the worst increase at 73%. In contrast, the Board has ordered decreases to mandatory coverage for 3 of the last 5 years for a total premium reduction of -7%. This is especially concerning and clearly is evidence against an industry wide adjustment as individual company results vary and establish a position where a company may be forced to apply for severe rate correction.

The following table summarizes the change in The Dominion's loss frequency, as at December 31, 2009, for private passenger automobile business in Alberta for compulsory coverages:

Frequency Year-to-Year Change			
Accident Year	Bodily Injury	Property Damage	Accident Benefits
2004 / 2003	-6.6%	1.3%	-0.1%
2005 / 2004	-0.3%	17.5%	22.7%
2006 / 2005	-4.7%	7.3%	8.8%
2007 / 2006	-8.6%	-3.4%	-7.2%
2008 / 2007	-12.5%	3.1%	-12.8%
2009 / 2008	15.7%	15.6%	4.0%
Total 2005 to 2009	-11.8%	23.6%	-8.5%

As seen previously in other Canadian jurisdictions, we have observed that post reform trends tend to deteriorate after a period of initial improvements. From the above table it is apparent that the expected increase in claim counts that typically follows after reforms have been in place for a number of years has begun to show for all mandatory coverages.

The following table summarizes the change in The Dominion's loss severity, as at December 31, 2009, for private passenger automobile business in Alberta for compulsory coverages:

Severity Year-to-Year Change			
Accident Year	Bodily Injury	Property Damage	Accident Benefits
2004 / 2003	-28.5%	-2.6%	-8.3%
2005 / 2004	-30.1%	-3.4%	-17.1%
2006 / 2005	18.9%	11.1%	1.5%
2007 / 2006	23.0%	18.8%	-6.0%
2008 / 2007	8.5%	-1.0%	2.7%
2009 / 2008	23.7%	2.5%	24.8%
Total 2005 to 2009	96.2%	34.1%	22.3%

From the above table it is apparent that The Dominion's claim severity has started to deteriorate once again. This trend will be further compounded by the change in the economic environment in Alberta. Recent rapid growth has been followed by an economic slow down, demographic shifts and changes in the unemployment rate. This will be discussed in more detail in section 3. As a result of all of the above, the past trends must be reviewed in the broader context of all of the current factors.

2. Estimate of ultimate bodily injury claim costs in light of confirmation of Minor Injury Regulation cap on non-economic damages

While the December 2009 Supreme Court decision removed much of the uncertainty around the ultimate cost of minor injuries, this does not diminish the difficulty in estimating ultimate claims costs for long tail coverages such as Third Party Liability – Bodily Injury and Accident Benefits. This challenge is even greater when trying to assess ultimate claims costs on an industry wide basis. The Dominion did experience a reduction in ultimate claim costs due to the confirmation of the cap on non-economic damages and subsequently released reserves accordingly on capped claims. Unfortunately, this was offset by a deterioration of underlying severity trends affecting the non-minor injury claims, increasing the estimate of ultimate claim cost in total. These changes are fully reflected in the losses used to project future claim costs.

As the Alberta economy recovers, it will do so in the context of external factors associated with the worldwide and national economic recovery. It is almost certain that

we can expect more inflationary pressures to be put on the ultimate claim cost over and above the current loss trends.

There continues to be pressure from plaintiff counsel to look for areas that fall outside the cap. For now, the definition of minor injury seems to be quite sound. As we have seen from the start, for claims that have a component falling within the cap along with another component falling outside the cap, such as a broken bone, treatment occurs in tandem. There is a push currently by plaintiff counsel to have certain conditions considered outside of the cap. There is a risk that they may succeed and put more pressure on claim costs.

3. Impact of the economic climate on claim costs

The current economic climate in Alberta can only be described as challenging. There has been a tremendous swing in economic activity over the past few years. It is not unreasonable to attribute a portion of any reduction in claim levels over the last few years to the prosperous economic times experienced in Alberta. Coming off a very low unemployment rate and a higher pay scale in the province over the past couple of years, policyholders may have had less incentive to seek compensation through insurance claims. In particular, drivers may have elected not to put in a claim for a short time away from work, attempted to return to a high paying job sooner or decided to repair damage to their vehicle themselves.

The continued impact of the economic downturn will most certainly have the reverse effect. The continued increase in unemployment levels will have a direct impact on the cost of Bodily Injury and Accident Benefits coverage for loss of income and medical and rehabilitation expenses through increased frequency of claims. The effect is much greater than a change from a “boom period” to an average, more typical economy. When a robust economy experiences a significant downturn, the time away from work and the need for medical attention increases as the benefits are greater than the alternative of no work or a work environment with more frequent layoffs. Historically, there is also the

potential for an increase in fraud in any type of recession. The degree of the overall change in trends needs to be factored into any pricing model.

Adding to these concerns is the possibility of future inflationary pressures on costs. We have not seen the drop in wage levels typically associated with a recessionary environment. As the Alberta economy recovers, we will see additional pressure on the cost of coverage for loss of income, as well as inflation on other pecuniary damages. Pricing of insurance is a prospective exercise and the inflationary pressures make predictions difficult and uncertain.

Although not directly part of the pricing decision for basic coverage, we wanted to provide some comments on optional physical damage claims costs as they pertain to the impact of the economic climate. In last year's submission, it was anticipated that the improved availability of labour will be more immediate in the vehicle repair sector of the economy. We have seen a slight reduction in wait times and faster repairs which has reduced the payouts for rental of replacement vehicles. This has been offset with an increased frequency of these claims given shrinking disposable income levels within the province. Therefore, we have yet to experience the decrease in repair costs as expected. As the Alberta economy is now experiencing positive inflation again, we expect repair costs to only increase from this time forward. Further we note that these principles would also apply to the Property Damage coverage within compulsory coverages.

We also want to highlight a temporary drop in the frequency of claims in 2008 that may mask the longer term claims trends. In harder economic times, less people driving to work, more people unemployed and higher gas prices all contribute to fewer vehicles on the road. Just as it was during the boom period, any such impact is temporary and artificial and will need to be given the proper perspective in long term pricing considerations.

CONCLUSION

The ultimate effect of the uncertainties noted in sections 1, 2 and 3 on the cost of basic automobile insurance coverage is significant. It is in the best interest of all stakeholders to ensure we maintain a financially stable automobile insurance environment where companies can effectively determine the cost of the product and provide that product at a competitive, yet adequate price.

The combination of the reservations regarding current claims trends and the difficulty forecasting the economic recovery all make it extremely important that caution is applied when considering a mandated rate change for the coming year. As an industry committed to the objectives of the insurance reforms, we need to proactively manage our current and future claims costs to avoid the need for large premium increases for Alberta policyholders in the future. The key is ongoing maintenance of rate adequacy, even in times when the need for increased rate is less obvious due to uncertain trends.

The Dominion remains committed to long term price stability both as a core operating principle and because we believe it serves the best interests of Alberta drivers. As a result, we respectfully submit the following recommendations:

- High levels of uncertainty exist due to the large number of unknowns in the current trends, the potential for higher Bodily Injury costs and the difficulty forecasting the economic recovery. Following indications will mitigate the need for more extreme rate correction in the future. As outlined in the Loss Trends section of this report, our trends support the need for a rate increase on compulsory coverages.
- If an industry-wide adjustment occurs, allow companies the flexibility to distribute the “overall” rate adjustment based on their individual corporate results, reserving practices, economic forecast, competitive position and risk profile strategy.

While outside the scope of the current exercise with respect to the Industry Wide Adjustment, The Dominion also recommends:

- Building on the ongoing dialogue between the government and the insurance industry and in support of the consumer benefits of a competitive market system, quickly adopt a system of company-initiated rate filings based on individual loss results, reserving practices, economic forecasts and risk profiles rather than rely on the “one size fits all” approach of mandated rate changes. In addition to helping the industry, this approach will benefit Alberta consumers as it reduces the long term risk of potentially large rate fluctuations. This can be achieved by applying a separate grid level adjustment each year without the industry-wide mandated change.
- In response to the need for ongoing adequate pricing to maintain long term price stability, review the current rate filing process with the industry and work towards the simplest model possible that meets the needs of all stakeholders.
- Resume the positive work being done by the government and the industry to refine the existing automobile insurance system, including changes to the grid system and further reforms aimed at reducing the subsidization of poor drivers in the system.

We would like to thank The Board for their time and for the opportunity to share our comments. There are many elements within the current automobile system in Alberta that are working. The Dominion remains strongly committed to partnering with the government and The Board to ensure a successful, sustainable automobile insurance market place for all Alberta policyholders.