

# State Farm Mutual Automobile Insurance Company



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Automobile Insurance Rate Board  
200 Terrace Building  
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## **STATEMENT OF STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY**

I appreciate the opportunity to provide comments to the Board regarding the annual review of auto insurance premiums for basic coverage in Alberta.

The State Farm Mutual Automobile Insurance Company is the largest insurer of automobiles in North America. State Farm commenced writing auto insurance in Canada in June of 1938.

State Farm is a multiple line insurance organization insuring over 1 million automobiles in Canada, of which 105,000 are in Alberta. In addition, we have over 900,000 Property and Casualty (P&C) policies other than automobile insurance and over 250,000 Life Insurance policies in Canada. State Farm's Canadian Headquarters is in Aurora, Ontario. There are 45 exclusive State Farm insurance agents in Alberta, in addition to a variety of different employees residing and working in Alberta to support their efforts.

It is worth noting that the automobile insurance marketplace in Alberta is very competitive. State Farm is one of a number of insurance companies writing automobile insurance in Alberta. However, since the introduction of the Risk Sharing Pool (RSP), the RSP has become one of the larger insurers in Alberta. This creates significant concerns for a properly functioning competitive marketplace and was not the intent of the RSP. The grid rate level needs to be established at a high enough ceiling that it performs its intended function and also allows the competitive marketplace to operate underneath it. The maximum premium grid should not restrict rates for the lowest cost customers. Increasing the maximum premium will promote competition and reduce the size of the RSP, thereby reducing the grid subsidy.

It is important that the Board not disrupt the competitive market by adopting a rigid and uniform method that might deny insurers a fair and reasonable profit. A competitive marketplace is the best regulator of rates. A more open, competitive market will provide the insurance-buying public availability and reasonable stability of prices. The annual rate adjustment should only apply in establishing the maximum premium and not apply to the rates for individual insurers.

The purpose of my written submission is to provide comments to the Alberta Insurance Rate Board regarding the automobile insurance issues set for Hearing in June 2010.

### **Loss Trends**

It is important to recognize that ratemaking is prospective. The auto insurance product is priced before the ultimate costs are known. The rates for the 2010 annual adjustment will affect the premiums for policies effective November 1, 2010 through those policies beginning November 1, 2011; thus over 2 years from now.

We caution the use of overly optimistic assumptions in the ratemaking process for the maximum premium, especially in light of the uncertainty surrounding the marketplace. We suggest that the maximum premium be established toward the upper threshold of what is an actuarially justified rate. In addition, the premium grid places a ceiling on the premiums but no such limit exists on the losses. The uncertainty of the Minor Injury Regulation (MIR) cap over the last two years has had an impact on recent loss trends. Bodily Injury losses have been reduced as frequency continues to decline since the MIR was introduced. However, given the uncertainty of the MIR cap, some injured drivers may have refrained from making

Bodily Injury claims during the challenge process, which could result in an increased volume of claims following the Supreme Court decision in December 2009. The bodily injury claim frequency and pure premium seems to be flattening in 2010.

Losses for Property Damage coverage have increased significantly over the last four years, driven both by the frequency of claims and the average pay-out under the coverage. For Accident Benefits coverage, claim frequency has dropped following the reforms in 2004. However, the average paid claim for Accident Benefits coverage has increased dramatically following the increase in the limit to \$50,000 with the reforms in 2004.

In addition, the increase in the allowable billing costs for physiotherapy and chiropractic services in middle of 2008 resulted in increasing costs.

We believe that the very favourable winter weather experienced in Alberta this year has contributed to the favourable claim frequency trends.

### **Impact on BI claim costs due to MIR decision**

State Farm did not adjust our individual claim reserving practices for MIR claims during the constitutional challenge. There is some indication that overall Bodily Injury payments were affected by the uncertainty around the MIR during 2008, as BI paid claim counts were lower for that accident year. We anticipate that bodily injury claim frequencies may increase now that the constitutional challenge has been completed. The MIR has resulted in significant claim cost savings for Bodily Injury coverage; had the cap been eliminated, we would have expected a significant increase in losses to occur. In response to the lower claim costs resulting from the MIR, rates have also been reduced since 2004. It is important to note that while many insurers may have released loss reserves following the MIR decision, this distorts the calendar year underwriting results.

### **Impact of Economic Climate on Claim Costs**

Several influences affect claim costs. It is difficult to identify one source. However, the slowed economy appears to have impacted the claim costs to some degree. Prior to the economic downturn, claim severity was increasing significantly as the cost of goods and services rose. That pace has slowed some with the economy; however, claim severity continues to increase. In a down economy, claim costs are not subject to the same inflationary pressures as might be experienced during a more robust economy. The miles driven usually are reduced during an unfavourable economic cycle; thus less exposure is typically present affecting claim frequency. Increases in unemployment can generally lead to increases in losses for bodily injury and accident benefits coverages as claimants may seek additional means to be compensated for injuries or loss.

It is also worth noting that the slowdown in the economy has led to less investment income to support insurance operations. Hence, everything else being equal, insurers need more income from underwriting to achieve the same return on equity investment.

The main purpose of the annual rate review process is to establish the maximum premium. The fact that industry data, including data for those below the maximum premium, is used should be considered when reviewing the change to the maximum premium. One would expect the claim cost and claim frequency levels to be higher for those insureds capped by the grid rate level.

We should allow the competitive marketplace to deal with these marketing strategies and not through a regulatory process that implies one size fits all. Consumers are best served by a competitive marketplace which is responsive to their specific and individual needs. The most successful companies will be those who can satisfy individual customer needs by offering the best combination of value – quality products, excellent service, and competitive prices.

In conclusion, we have significant concerns with the current maximum premium and the grid structure. State Farm is having a larger percentage of our new business capped by the grid compared to our renewal book. Over time, this would have a negative impact on the size of the Risk Sharing Pool. In addition, the percentage of new business capped by the grid is even larger for Edmonton. The subsidy for Edmonton is against cost-based pricing and disrupts the natural functioning of the marketplace.

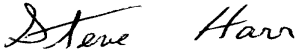
Again, I appreciate the opportunity to provide comments to the Board regarding Auto Insurance in Alberta. State Farm is committed to working with AIRB in providing a healthy auto insurance environment that is responsive, stable, affordable, and sustainable at meeting the needs of Albertans.

All questions concerning this written submission should be directed to:

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Sincerely,



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Cc: Barbara Bellissimo