

A Submission to the
Alberta Automobile Insurance Rate Board
2011 Annual Rate Adjustment

May 28, 2011



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 2011 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 79 agents across Alberta in 13 offices with \$76.5 million in Direct Written Premium in 2010. Pembridge Insurance has 30 broker partners in 60 locations with Direct Written Premium of \$11.2 million in 2010. Pafco Insurance Company is an alternative market for high-risk drivers, which is operating in several other provinces, but not yet in the Alberta market.

ACG appreciates the opportunity to participate in the seventh 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. Once again, we find ourselves in the position of presenting to the Board in an annual review and upcoming industry wide adjustment, and once again much of our submission centers on our advice that only by allowing the competitive market to work, are Albertans best served.

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 continues to be fierce. Investors are looking for the possibility of return 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 by design sit between these groups – customers and shareholders - attempting in the best interest of both, to predict costs and stabilize the uncertainty of prediction. 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. And yet, each year we return and all take part in the process of applying what should be an academic

exercise to a real world outcome. Each year the exercise of calculating the average industry adjustment based on average industry experience has brought the industry and the board's consulting actuary closer together in terms of factors, adjustments, and even predictions. None of that work, laudable as it is, addresses the core contradiction that an average change would only be applicable to an average company, and there are none.

We can calculate an average rate need for an average customer, but unless all differences between customers related to their driving habits, vehicle details and coverage choices are ignored, that average will never apply at an individual level. We would not consider a system that forced such a rate scheme to be fair and just in any way, and yet we continue to do so at the company level, assuming that average loss costs, average expenses, and average book distributions are somehow immaterial.

The legislation allows for the implementation of the industry wide adjustment in an individualized fashion through section 5 filings. However, since the adjustment is announced just before August 1st and applies to renewals effective November 1st, which are automatically issued by most company systems on or around September 1st, these filings, which must be submitted, approved, programmed and tested in a 30 day period are reserved for only the most extreme circumstances.

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 looks forward to continuing to provide Albertans with high-quality products and exceptional customer service in the years ahead.

ACG appreciates that in the continued context of a single industry wide rate adjustment, it is difficult to recognize the diversity of company needs in maintaining and attracting capital, and of meeting the needs of differing customer groups. At the same time the goal remains to solidify the achievements of the past few years to build a stable industry and market. Nevertheless, this is what a single rate adjustment for the entire industry must aspire to. It is our hope that in the future, the regulatory structure will recognize and even promote the development of new and innovative factors in rate making practices. Imposing one methodology or one profit target on some 60 insurers operating in Alberta contradicts the spirit of capital enterprise that creates competition and innovation, and therefore benefits Albertans.

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

Nevertheless, 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 1st. That rate change will not only affect each company, but also will affect grid prices.

The two 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.

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.

Loss Trends

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.

As shown in the data below, Bodily Injury frequency has been dropping, while severity continues to climb. This speaks to the removal from the mix of minor injury claims. In Accident Benefit Coverage, we see a drop in both frequency and severity. We have included, for its illustrative value, the Collision frequency and Severity, as it serves as a proxy for general crash data. The BI and AB numbers are a subset of overall crash likelihood, and from our own data, it would appear that frequency of crashes is on the increase, back to the level it was as at March of 2009.

Accident Year Incurred Frequency and Severity by Coverage

Rolling 12 month as at end of March (03),
Data is developed, using industry development factors.

	Claim Frequency	Avg Claim Severity
Bodily Injury - Tort		
2007-03	0.86%	28,079
2008-03	0.77%	27,357
2009-03	0.77%	26,483
2010-03	0.77%	28,639
2011-03	0.70%	36,082
Property Damage - Tort		
2007-03	3.37%	3,608
2008-03	3.37%	4,138
2009-03	3.45%	3,943
2010-03	3.45%	3,870
2011-03	3.50%	4,190
Third Party Liability		
2007-03	4.23%	8,574
2008-03	4.14%	8,452
2009-03	4.23%	8,073
2010-03	4.22%	8,399
2011-03	4.20%	9,516
Accident Benefits		
2007-03	1.61%	2,033
2008-03	1.52%	2,528
2009-03	1.39%	2,506
2010-03	1.28%	2,536
2011-03	1.21%	2,401
Collision		
2007-03	3.90%	4,519
2008-03	4.20%	4,934
2009-03	4.14%	4,690
2010-03	4.04%	4,351
2011-03	4.12%	3,968

Impact of the Economy on Claims Cost

The second area for which the Board has requested input is in the area of the impact of the economy on claims cost. In previous submissions, particularly in 2009, Allstate provided what we believe to be a fairly extensive review of the available academic literature and studies on this topic. While the world of

statistical and academic review undoubtedly continues, we do not feel that on the general topic of economic predictors of claims frequency there is anything substantive to add to our previous submission.

The work of Pr. Marc Gaudry and other traffic safety experts in the field remains important to the understanding of the subject of economic influences on claims costs. We reiterate from our previous submission that the various studies seem to concur that the economy has an impact, not so much because of the economic variables themselves, but through their influence on attitude and behavior.

In addition to the influence of the economy through wealth (choices to own and drive) gas prices, lost income as a cost of accidents, there is an additional area where economic conditions can influence claims costs, and that is in the area of fraud.

The complex joint influence of a number of variables leaves us with some general truths, but no absolute answer: 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.

Additions of these complex drivers to claims outcome models improve their accuracy. Nonetheless, the more complex the models become, the more obvious that they are in fact subject to a significant level of judgment. Their impact also varies depending on the customer group and the business approach in each insurer. We appreciate the outcomes are complex, as was reiterated in the addendum to the Board's consulting actuary's report in 2009.

We have, however, spent some time in reviewing ongoing work on one specific aspect of the issue of economic climate and claims cost which is a growing field of concern, and that is the impact of fraud on the overall claim cost level.

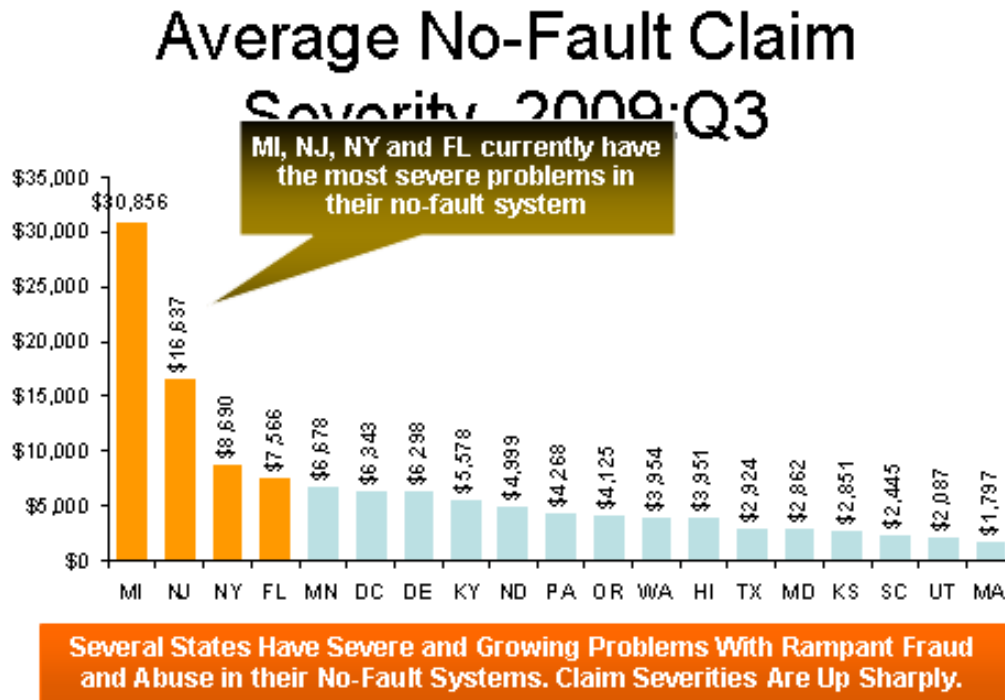
Fraudulent claims practices, whether the "hard" fraud of staged accidents or fake injuries, or the more insidious "soft" fraud of inflated losses or unnecessary medical treatments is estimated to be anywhere from 10%¹ to 40%²

There are few academic studies relating fraud specifically to the economy, and much that is mentioned in the press tends to be assertions rather than fact

¹ Caron and Dionnes' study " Insurance Fraud Estimation: More Evidence from the Quebec Automobile Insurance Industry" *Assurance* 64, 4, 567-578 1997

² Insurance Fraud, Insurance Information Institute, May 2011

based.³ However, studies are starting to appear on a regional level. Most of these are from the US, where the economic downturn has been much more dramatic. In 2009 The Florida Department of Financial Services, released a study on the correlation between the economic downturn and insurance fraud. One stunning finding was that in Florida, the personal injury protection (PIP - similar to our own AB coverage) fraud increased by 41% increase from the 1st quarter of FY 2008/2009 to the 4th quarter of FY 2008/2009.⁴



Source: EOI/PCI First Week data; Insurance Information Institute.

In addition to tracking statistics in Florida, they reviewed work undertaken in other states, and in England, South Korea and South Africa and concluded:

“Insurance fraud increased significantly over the past year, indisputably as an impact of the down-turned economy. While there are several products of which exposure has been noted, the greatest measured impacts are as a result of vehicle insurance fraud, mortgage fraud, and workers’ compensation premium fraud.”⁵

³ “We have said the economy may - and the operative word there is ‘may’ - be a factor. But there isn’t any empirical data or study that specifically addresses the economy and a higher incidence of fraud” Frank Scafaldi, Director of Public Affairs for the National Insurance Crime Bureau (USA) reported in Claims Advisor August 26, 2010

⁴ **IMPACTS of the ECONOMY and INSURANCE FRAUD** The Florida Department of Financial Services, Division of Insurance Fraud, Crime Intelligence Analyst Unit, August 7, 2009

⁵ *ibid*

When the economy is in downturn, it is fairly simple to follow the logic of how insurance fraud becomes more prevalent. The most direct is that there will be vehicles which have been purchased or leased where the owner can no longer afford the payments. The NICB has reported that “Owner give ups” (cars falsely reported as stolen) increased 24% in 2009, while suspicious vehicle arsons increased 27%.⁶

These impacts will not be as dramatic in any Canadian jurisdiction, for the simple fact that our economic downturn was not nearly as dramatic as that in other jurisdictions. However, there is a longer term impact of the economic rollercoaster which we believe has an important impact on claims costs.

In economic expansion, we see that there is both a frequency correlation, as noted in previous submissions, and of course an overall increase in claims as the economy and the number of motorists increases. In this environment, there will naturally be an expansion of the infrastructure to treat the victims of claims - clinics, paralegals, chiropractors, physiotherapists. When the economy contracts and the pure number of injuries reduces, what happens to that infrastructure?

The findings in Florida, California, New York, and other jurisdictions points to an increased pressure on what we would call “soft fraud”: pressure on the claimant to continue therapy because the infrastructure requires clients.

This finding leads to the conclusion that the increase in frequency in injury claims that occurs during an economic expansion acts to widen the claim “pipeline” which then itself has a vested interest in inflating claim severity particularly for soft tissue injuries.⁷

The unfortunate outcome is that the upward pressure on claims severity and frequency that come about as a product of economic change are “sticky” on the way down. Simply put, they unfortunately go up more easily than they come down, and much of that impact will depend on where companies write business, the market segments served, and the very specific nature of the economic change.

Conclusion

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 not just for current customers but for any potential customer. We believe the collective

⁶ *ibid*

⁷ Insurance Fraud, Insurance Information Institute, May 2011

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 and transparency for consumers.

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 the following recommendations to the Board with respect to the 2011 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. ACG recommends that the annual adjustment apply solely to grid rates, and that those rates be kept at current levels. ACG recommends that the Auto Insurance Rate Board maintain current rate levels in the market, and allow companies to file increases or decreases based on 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.