

Submission to the Alberta Automobile Insurance Rate Board

2011 Annual Review of Automobile Insurance Premiums for Basic Coverage

May 30, 2011

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INTRODUCTION

This submission is made on behalf of The Dominion of Canada General Insurance Company (“The Dominion”) by Steve Whitelaw, Senior Vice President – Personal Lines and Business Solutions – Head Office, and Erika Schurr, Assistant Vice President – Actuarial, 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 2011 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 60,000 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.

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.

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. The possibility of annual mandated rate decreases is an ongoing risk factor which inhibits competitive activity as companies assess the risk when considering targeted rate changes. Companies will compete and respond to market changes when and as appropriate. This is evident in the rate changes for Additional Coverages posted on The Board's website and in The Dominion's rate change history. Without mandated changes, changes have varied from negative to positive and back to negative as the economy and the market has adjusted over the past five years.

We appreciate the opportunity for continued dialogue on what constitutes the best system to price automobile insurance in Alberta. 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 impact of the economic climate on claim costs; and
3. The combined effect of 1 and 2 (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 2011 report on industry wide experience being prepared by Oliver Wyman ("OW") for The Board. As such, The Dominion may incorporate additional comments at the public presentations based on our review of this report.

ANALYSIS

Actuarial analysis relies upon projecting historical experience into the future. Loss patterns can only be confirmed once they have occurred and have been established. Underlying assumptions and parameters of the analysis may not be the same as what actually occurs resulting in an inherent uncertainty in any estimate of future costs.

The claims experience in Alberta stabilized as a result of the December 2009 Supreme Court decision to uphold the cap for minor injuries. We have seen the claim count for Third Party Liability - Bodily Injury and Accident Benefits decrease and then level off since the introduction of reforms in October of 2004. While much of the uncertainty around the ultimate cost of minor injuries has been removed, 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's ultimate claim costs fully reflect the post-reform impact of the cap.. Unfortunately, underlying severity trends continue to deteriorate, increasing the estimate of ultimate claim cost in total. These changes are fully reflected in the losses used to project future claim costs. However, The Dominion's mix of business is different from that of the Industry and as such, may not be reflective of other companies' experience.

Since 2008, we have seen an increased propensity for injured parties to retain legal representation, presumably because claimants are more financially vulnerable. There continues to be pressure from plaintiff counsel to look for areas that fall outside the cap, with a push currently by plaintiff counsel to have certain conditions considered outside of the cap. We are seeing more claims put forth by plaintiff counsel for things like post traumatic stress and chronic pain syndrome in an attempt to have the cap removed for soft tissue injuries. There is a risk that they may succeed and put more pressure on claim costs.

In our view, it is almost certain that inflationary pressures will continue to impact ultimate claim cost over and above the current loss trends. Inflation is evident even in the cap placed on General Damages which has increased from \$4,000, when originally put in place in October 2004, to \$4,559. Any future reform that increases amounts available for catastrophic claims will obviously add inflationary pressure to the Accident Benefits coverage which will have to be accounted for separately. We have also not seen the drop in wage levels typically associated with a recessionary environment. As the Alberta

economy recovers, and wage levels continue to grow, 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 must account for the inflationary pressures despite the inherent difficulty in forecasting.

Predicting the economic climate in Alberta, and its effects on auto insurance, 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 frequency levels from 2005 to 2008 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, but rather elected to return to a high paying job sooner or to repair damage to their vehicle themselves.

The continued impact of the economic downturn will most certainly have the reverse effect. The continued levels of high unemployment (5.6% as at December 2010 compared to 3.4% as at August 2008 before the market crash) 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. 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.

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. 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, presumably relating to shrinking disposable income levels within the province. Therefore, we have yet to experience the decrease in repair costs expected. As the Alberta economy is now experiencing positive inflation again, we expect repair costs to increase going forward. Further we note that these principles would also apply to the Property Damage coverage within compulsory coverages.

CONCLUSION

The ultimate effect of the uncertainties noted above on the cost of basic automobile insurance coverage is potentially 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. 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. As a result, we respectfully submit the following recommendations:

- Allow companies more flexibility in adjustment of rates based on their individual results, reserving practices, economic forecast, competitive position and risk profile strategy. Rate changes should be made in the direction of indications. This will mitigate the need for larger rate corrections in the future, especially as high levels of uncertainty exist due to the large number of unknowns in the current trends, and the difficulty forecasting economic conditions.

- Building on the ongoing dialogue between the government and the insurance industry and to maximise the opportunities for a competitive marketplace, quickly adopt a system of company-initiated rate filings based on individual loss results, reserving practices, economic forecasts and risk profiles rather than the “one size fits all” approach of mandated rate changes. In addition to maintaining stability for the industry, this approach will benefit Alberta consumers by reducing 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.