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May 30, 2011

Mr. Del Dyck
Executive Director
Alberta Automobile Insurance Rate Board
200 Terrace Building
9515 – 107 Street
Edmonton, Alberta T5K 2C3

*Via email airb@gov.ab.ca
Original to follow by courier*

Re: Annual Review of Automobile Insurance Premiums for Basic Coverage

Dear Mr. Dyck,

Please find enclosed the required signed original and twelve copies of the Facility Association submission to the Alberta Automobile Insurance Rate Board's Annual Review of Automobile Insurance Premiums for Basic Coverage.

Attending at our presentation on behalf of Facility Association will be:

David Simpson, President & CEO
Shawn Doherty, Senior Vice President, Actuarial & CFO

Please also find enclosed a signed disclosure form.

With respect to our presentation needs, we will be using a laptop-driven PowerPoint presentation to highlight facts and themes from our submission. A projector (with USB cable connectivity) and screen are all that we need. We will email the presentation to you a week before the Hearing as requested in your letter to me of May 5th.

If you require anything further in the interim, please let me know directly.

Yours truly,

A handwritten signature in blue ink, appearing to read 'David J. Simpson', written over a light blue horizontal line.

David J. Simpson, M.B.A., FCIP, C. Dir.
President & CEO

c.c.: Gary Quon, Facility Association Board Chair

Alberta Automobile Insurance Rate Board

Annual Review of Automobile Insurance Premiums for Basic Coverage

June 14, 2011



Submission

A handwritten signature in black ink, appearing to read 'David J. Simpson', written over a light blue horizontal line.

David J. Simpson, M.B.A., FCIP, C. Dir.
President & CEO

1 **INTRODUCTION**

2
3 This submission provides the Alberta Automobile Insurance Rate Board (AIRB) with an annual
4 update on the size, volume trends and financial performance of the two Alberta Risk Sharing
5 Pools administered by Facility Association on behalf of automobile insurers in the province.

6
7 [Appendix 1](#) provides a background to the history and operations of the Alberta Risk Sharing
8 Pools, as well as a brief overview of Facility Association's other operations in the province.

9
10 **RISK SHARING POOLS SIZE**

11
12 As always, our view is that residual market volumes should be as small as possible. This stems
13 from the belief that consumers are best served by companies competing directly for their
14 business in an environment where these companies do not have to frame their decisions based on
15 the potential impacts arising from compulsory participation in residual market mechanisms.

16
17 In 2010, we again saw an overall decrease in written premiums transferred to the Risk Sharing
18 Pools (RSPs) on a combined basis as the premium volume transferred dropped from \$317M to
19 \$278M with almost all of that decline coming from premiums transferred to the Grid RSP. At
20 \$278M, written premiums transferred to both RSPs represented approximately 11.5% of all
21 private passenger automobile insurance premiums written in Alberta in 2010.

22
23 Please see Table 1 for a summary of Risk Sharing Pools written premium and market share data
24 for the last five years.

Table 1						
Alberta Risk Sharing Pools – Market Share (Written Premium Basis)						
	Total		Grid RSP		Non-Grid RSP	
Year	W. Prem	Mkt Share	W. Prem	Mkt Share	W. Prem	Mkt Share
2006	\$380,543,231	18.6%	\$309,538,332	15.1%	\$71,004,099	3.5%
2007	\$382,378,719	17.7%	\$302,904,752	14.0%	\$79,473,967	3.7%
2008	\$348,642,315	15.1%	\$283,278,774	12.3%	\$65,363,541	2.8%
2009	\$317,089,241	13.8%	\$242,035,611	10.5%	\$75,053,630	3.3%
2010	\$278,161,214	11.5%	\$203,185,486	8.4%	\$74,975,728	3.1%

26

27 On a written exposure count basis (exposure is defined as one car insured for one year) a total of
 28 153,661 exposures were transferred to both RSPs in 2010, down from 165,579 exposures in
 29 2009. Written exposures declined from 112,921 to 98,384 in the Grid RSP, while they actually
 30 increased from 52,658 to 55,277 in the Non-Grid RSP.

31

32 Please see Table 2 for a summary of Risk Sharing Pool written exposure and market share data
 33 for the last five years.

34

Table 2						
Alberta Risk Sharing Pools – Market Share (Written Exposure Basis)						
	Total		Grid RSP		Non-Grid RSP	
Year	W. Exp	Mkt Share	W. Exp	Mkt Share	W. Exp	Mkt Share
2006	230,568	12.0%	164,643	8.6%	65,925	3.4%
2007	221,445	10.3%	153,649	7.1%	67,796	3.2%
2008	193,191	8.8%	134,700	6.1%	58,491	2.7%
2009	165,579	7.6%	112,921	5.2%	52,658	2.4%
2010	153,661	6.7%	98,384	4.4%	55,277	2.5%

35

36 **PRIVATE PASSENGER RESIDUAL MARKET SEGMENT – SIZE**

37
 38 Facility Association also administers the residual market segment, a small volume, tightly
 39 defined pooling mechanism for higher-risk cars and drivers. The premiums for approximately
 40 80-90% of the exposures insured through the residual market segment have their annual
 41 premiums capped by the insurance premium regulation grid. The market share of the private
 42 passenger residual market segment has been very stable over the last five years as Table 3 shows.
 43

Table 3
Alberta Private Passenger Residual Market Segment - Market Share
(Written Exposure Basis)

Year	W. Premium	Market Share	W. Exposure	Market Share
2006	\$13,467,167	0.7%	6,766	0.3%
2007	\$14,290,380	0.7%	6,831	0.3%
2008	\$13,384,324	0.6%	6,091	0.3%
2009	\$16,752,344	0.7%	5,799	0.3%
2010	\$17,352,000	0.7%	6,014	0.3%

44
 45 The market share of the Alberta private passenger residual markets on a combined basis (i.e.
 46 FARM and RSPs), remain among the largest in North America, behind only Nunavut, North
 47 West Territories and North Carolina.

48
 49 Table 4 shows the top ten private passenger residual market jurisdictions in North America.
 50

Table 4
Top Ten Private Passenger Residual Market Jurisdictions in North America

Jurisdiction	Market Share
Nunavut	47.1%
North West Territories	21.5%
North Carolina	20.5% ¹
Alberta (RSP & FARM)	7.2%
New Brunswick (RSP & FARM)	4.0%
Newfoundland & Labrador	3.5%
Nova Scotia (RSP & FARM)	3.1%
Ontario (RSP & FARM)	3.0%
Massachusetts	2.8% ¹
Yukon	2.5%

¹ Source: Insurance Information Institute (U.S.A.) data is for 2008

51

52 The size of the Risk Sharing Pools can be influenced by a number of factors. Insurers tend to
53 keep on their own books risks they believe to be adequately priced, and transfer to the Risk
54 Sharing Pools (subject to eligibility rules) risks they believe to be inadequately priced. One could
55 point to the loss ratios of the Grid RSP and ask why companies transferred many of those risks to
56 the RSP when presumably it would have been worthwhile for them to keep those risks on their
57 own books. While we do not have “hard evidence” as to why, anecdotally much of it comes
58 down to uncertainty—uncertainty of the impacts of the 2004 product reforms themselves on
59 claims costs, compounded by the additional uncertainty resulting from the court challenges to the
60 Minor Injury Regulation. To the extent that the environment has become more certain, and to the
61 extent companies have increased confidence in the stability of claims costs, there may be room
62 for optimism that the size of the RSPs will decline further still.

63

64 In general, there is a correlation between residual market size and the degree of price competition
65 permitted in a given jurisdiction. In the United States, rate regulation is under the authority of
66 individual states similar to the provincial authority that exists in Canada. In the last decade or so
67 there has been an increased trend in the U.S. to allow the competitive forces of the marketplace
68 to regulate prices. Interestingly, for 2008 (the most recent year for which data is available) 37
69 states of the 49 states for which data is available had less than 1,000 private passenger cars
70 insured through residual market mechanisms, and 46 of 49 states had less than 1% of private
71 passenger cars insured through residual market mechanisms.

72

73 Because we believe residual markets should be as small as possible, we are encouraged by the
74 Chair’s remarks in the Annual Reports of the AIRB that the Board supports a change from the
75 current industry-wide process to a “File and Approve” system to foster greater competition to the
76 benefit of consumers. To the extent competition is increased, we would expect to see a decline in
77 residual market volumes. We believe that, at some point, moving beyond a “File and Approve”
78 system to open competition under the price ceiling provided by the premium grid regulation
79 would provide an additional opportunity to reduce the number of cars insured through the
80 residual market mechanisms. In a similar vein, the Superintendent Bulletin of this past April with
81 respect to the use of unbundled or segmented auto insurance rating programs may foster
82 increased competition and therefore lead to less reliance by companies on the Risk Sharing
83 Pools.

84

85 **FINANCIAL PERFORMANCE**

86

87 Table 5 summarizes the financial performance of the Risk Sharing Pools since inception. The
 88 data in the table is taken directly from our audited financial statements.

89

Table 5			
Alberta Risk Sharing Pools - Excess/(Deficiency) of Revenue over Expenses (\$'000)			
Fiscal Year	Grid RSP	Non-Grid RSP	Combined
2005 (13 months)	(\$93,902)	(\$28,038)	(\$121,940)
2006	\$8,498	(\$30,562)	(\$22,064)
2007	\$93,357	(\$9,422)	\$83,935
2008	(\$73,490)	(\$29,955)	(\$103,445)
2009	\$85,747	(\$9,184)	\$76,563
2010	\$83,893	(\$1,114)	\$82,779
Total	\$104,103	(\$108,275)	(\$4,172)

90

91 Automobile insurance is a business based on estimates – the true results of a given accident year
 92 cannot be known until many years in the future. Deriving estimates for the RSPs is especially
 93 challenging from an actuarial perspective as it involves taking into account the independent
 94 decision making of member companies with respect to what types of risks they will transfer to a
 95 given pool. The estimated ultimate loss ratios for the RSPs by accident year and how these
 96 estimates have evolved since the inception of the RSPs are shown in Table 6. Please note these
 97 loss ratios include indemnity payments only and do not include any loss adjustment expenses and
 98 as such cannot be compared to loss ratio exhibits that include adjustment expenses. The full year
 99 industry year loss ratios are estimates based on loss experience as at the first half of 2010 and, as
 100 has become apparent with the GISA all-industry experience data for Accident Year 2010 (that
 101 has only recently been made available), the actual loss experience for the full year has emerged
 102 quite differently from the initial estimate provided here.

103

Table 6						
Alberta Risk Sharing Pools – Undiscounted Estimated Ultimate Loss Ratio (ELR)						
Period	----- Accident Year -----					
Grid RSP	2005	2006	2007	2008	2009	2010
as at Oct 31 2006	73.7%	76.3%				
as at Oct 31, 2007	57.3%	65.6%	69.1%			
as at Oct 31, 2008	60.0%	69.0%	75.1%	75.6%		
as at Oct 31, 2009*	57.4%	64.9%	68.8%	70.7%	67.5%	
as at Oct 31, 2010	57.2%	64.4%	67.9%	64.7%	61.1%	60.8%
Non-Grid RSP	2005	2006	2007	2008	2009	2010
as at Oct 31 2006	107.8%	103.8%				
as at Oct 31, 2007	94.0%	89.8%	100.0%			
as at Oct 31, 2008	93.2%	88.8%	101.7%	107.2%		
as at Oct 31, 2009*	88.5%	84.5%	96.5%	101.4%	101.6%	
as at Oct 31, 2010	90.2%	81.3%	94.8%	100.9%	94.6%	92.6%
Industry**	2005	2006	2007	2008	2009	2010
as at June 30 2009	50.0%	54.2%	59.2%	56.8%	56.7%	
as at June 30 2010	49.3%	53.5%	59.0%	56.6%	52.5%	49.3%

*Please note that in Table 6, the Undiscounted Estimated Ultimate Loss Ratios as at October 31, 2009 reflect both the exclusion of the provision for the MIR court challenge and revisions to the accident year estimates.

**Industry loss ratios:

- [1] All estimates exclude loss adjustment expenses in order to be comparable to the Risk Sharing Pools.
- [2] The loss ratio for AYs 2009 at June 30, 2009 and 2010 at June 30, 2010 were estimated based on the experience for the accident half year 2009-1 and 2010-1 respectively, adjusted for seasonality. The seasonality adjustment was computed as a 5-year average of the ratio of accident year loss ratios to loss ratios for the corresponding "-1" half year:

$$\text{AY 2009: } 56.7\% = 50.8\% \times 1.116$$

$$\text{AY 2010: } 49.3\% = 44.7\% \times 1.104$$

Of course, it is unlikely that the loss experience of any one particular company will be identical to that of the industry as a whole, as each company's loss experience will depend on the loss experience of risks they have transferred to the RSPs, relative to the total loss experience of the RSPs.

122 **FINANCIAL IMPACT ON THE INDUSTRY**

123

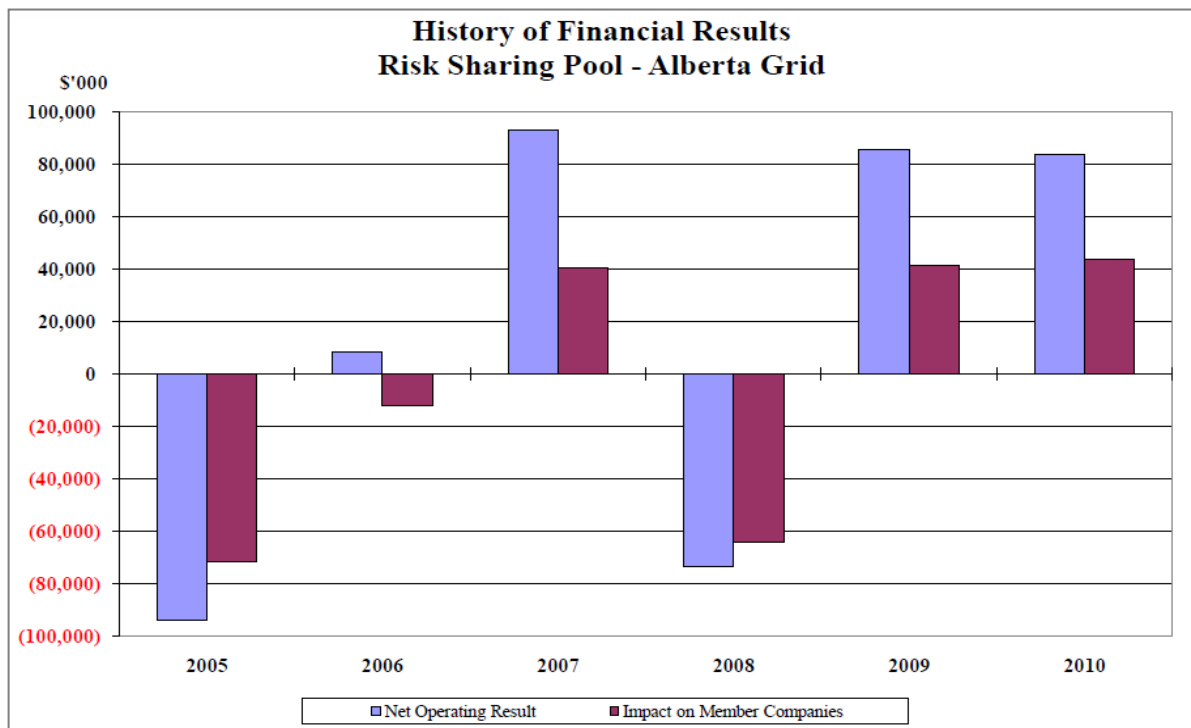
124 Because we must prepare our financial statements according to Generally Accepted Accounting
125 Principles, our statements can only show the results of our own operations. As member
126 companies incorporate their share of Risk Sharing Pool premiums and results into their own
127 statements, they have to reflect items such as health levies, premium taxes, investment income,
128 income tax effects and their cost of capital on those premiums and results. Table 7 illustrates
129 what an adjusted operating result might look like from the industry's perspective.

130

131 Of course, it is unlikely that the loss experience of any one particular company will be identical
132 to that of the industry as a whole, as each company's loss experience will depend on the loss
133 experience of risks they have transferred to the RSPs, relative to the total loss experience of the
134 RSPs.

135

136 **Table 7**



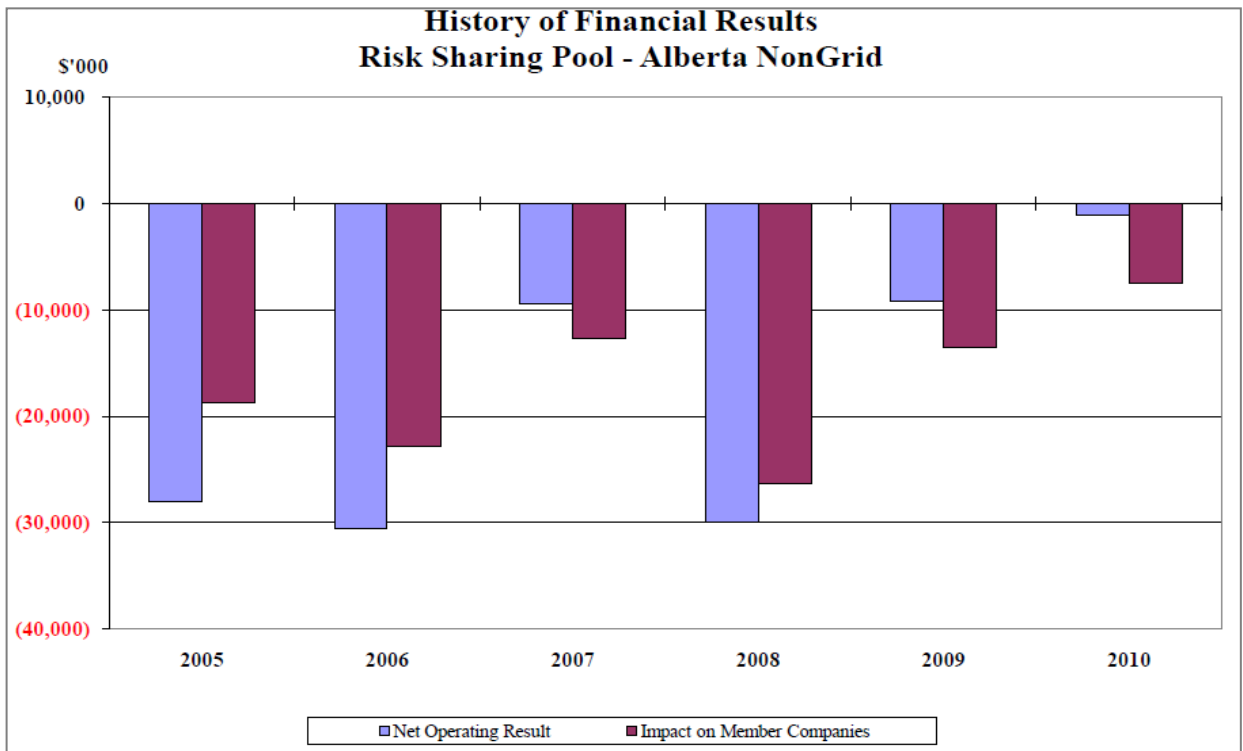
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ALBERTA RISK SHARING POOL
SUMMARY OF OPERATIONS - INDUSTRY IMPACT FOR ILLUSTRATION PURPOSES
ADJUSTED OPERATING RESULT
(Amounts in \$000's)

	GRID RSP						
	<u>Total</u>	<u>Oct-10</u>	<u>Oct-09</u>	<u>Oct-08</u>	<u>Oct-07</u>	<u>Oct-06</u>	<u>Oct-05</u>
Net Operating Result <i>(per Financial Statements)</i>	\$104,103	\$83,893	\$85,747	(\$73,490)	\$93,357	\$8,498	(\$93,902)
Adjustments :							
Premium Taxes Paid Directly by Members	(52,884)	(6,140)	(7,491)	(8,566)	(9,291)	(9,264)	(12,132)
Health Levies Paid Directly by Members	(51,851)	(6,480)	(6,229)	(9,172)	(13,495)	(10,291)	(6,184)
Discounting of policy liabilities	9,898	(8,118)	(13,793)	(1,945)	(1,533)	15,117	20,170
Association Dues paid directly by members	(7,052)	(819)	(999)	(1,142)	(1,239)	(1,235)	(1,618)
Investment Income	121,981	19,815	26,328	31,923	22,724	15,250	5,941
Net Adjustment	20,092	(1,742)	(2,184)	11,098	(2,834)	9,577	6,177
Adjusted Net Operating Result	124,195	82,151	83,563	(62,392)	90,523	18,075	(87,725)
Income Tax on net Operating result	34,471	23,002	24,233	(18,406)	29,058	6,077	(29,493)
Operating Result Before Cost of Capital	89,724	59,149	59,330	(43,986)	61,465	11,998	(58,232)
Deemed after tax Cost of Capital	110,699	15,145	17,841	19,841	20,617	23,774	13,481
Combined Net Operating result	(\$20,975)	\$44,004	\$41,489	(\$63,827)	\$40,848	(\$11,776)	(\$71,713)

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Please see [Appendix II](#) for the background assumptions to Table 7.



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ALBERTA RISK SHARING POOL
SUMMARY OF OPERATIONS - INDUSTRY IMPACT FOR ILLUSTRATION PURPOSES
ADJUSTED OPERATING RESULT
(Amounts in \$000's)

	NON-GRID RSP						
	<u>Total</u>	<u>Oct-10</u>	<u>Oct-09</u>	<u>Oct-08</u>	<u>Oct-07</u>	<u>Oct-06</u>	<u>Oct-05</u>
Net Operating Result <i>(per Financial Statements)</i>	(\$108,275)	(\$1,114)	(\$9,184)	(\$29,955)	(\$9,422)	(\$30,562)	(\$28,038)
Adjustments :							
Premium Taxes Paid Directly by Members	(12,484)	(2,164)	(2,226)	(2,094)	(2,134)	(2,674)	(1,192)
Health Levies Paid Directly by Members	(11,415)	(1,889)	(1,552)	(1,878)	(2,789)	(2,741)	(566)
Discounting of policy liabilities	4,493	(1,093)	(2,834)	(1,282)	169	6,379	3,154
Association Dues paid directly by members	(1,666)	(289)	(297)	(279)	(285)	(357)	(159)
Investment Income	17,966	2,966	3,861	4,821	3,657	2,095	566
Net Adjustment	(3,106)	(2,469)	(3,048)	(712)	(1,382)	2,702	1,803
Adjusted Net Operating Result	(111,381)	(3,583)	(12,232)	(30,667)	(10,804)	(27,860)	(26,235)
Income Tax on net Operating result	(35,252)	(1,003)	(3,547)	(9,047)	(3,468)	(9,367)	(8,820)
Operating Result Before Cost of Capital	(76,129)	(2,580)	(8,685)	(21,620)	(7,336)	(18,493)	(17,415)
Deemed after tax Cost of Capital	25,339	4,878	4,800	4,698	5,342	4,296	1,325
Combined Net Operating result	(\$101,468)	(\$7,458)	(\$13,485)	(\$26,318)	(\$12,678)	(\$22,789)	(\$18,740)

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As the AIRB has requested in the past, we have calculated “break even” loss ratios on a fiscal year basis for both RSPs from the industry’s perspective. These loss ratios are shown in Table 8. Because fiscal year results reflect the impact of changes to prior accident year loss ratio estimates, we would caution against the use of these ratios for comparison to the current accident year.

Fiscal Year	Grid RSP		Non-Grid RSP	
	Break-even Loss Ratio	Actual Loss Ratio	Break-even Loss Ratio	Actual Loss Ratio
2006	71.8%	69.9%	63.3%	109.2%
2007	76.1%	44.4%	68.1%	83.0%
2008	74.3%	93.4%	73.9%	109.7%
2009	83.4%	45.2%	75.3%	86.8%
2010	79.9%	36.6%	76.7%	77.2%

151

152 One could look at the overall financial results of the Risk Sharing Pools and conclude that the
153 presence of the Grid RSP has, and will continue to be, relatively benign. For those that do, we
154 would again provide the following notes of caution:

155

156 - On an accident year loss ratio basis, the Grid RSP loss experience has been worse than
157 that of the industry since inception. In the event of a deterioration in industry loss ratios,
158 we would expect the Grid RSP loss experience to deteriorate as well.

159

160 - Competitive enterprises need to generate a competitive level of return. To the extent that
161 companies may not be generating a competitive level of return on approximately 11.5%
162 of revenue, that return must be generated from those paying the remaining 88.5% of
163 premium in the marketplace

164

165 - Taken together, the Risk Sharing Pools represent a large volume of premium likely to
166 behave in a more volatile way than of most individual companies. Although this volatility
167 impacts all companies in a similar way, smaller companies with limited financial
168 resources very probably find those impacts more difficult to absorb. As well, the presence
169 of such large RSPs with their inherent volatility may act as a barrier to entry to insurers
170 who would otherwise seek the opportunity to serve Alberta consumers.

171

172 **CONCLUSION**

173

174 We stated near the beginning of this submission our belief that consumers are best served by
175 companies competing directly for their business in an environment where those companies do
176 not have to frame their business decisions based on impacts from residual markets. So we were
177 heartened to read in the Chair's remarks in the 2010 annual report of the AIRB the Board's
178 support of increasing competition in Alberta automobile insurance:

179

180 “With those obstacles behind us and what appears to be a stable market in Alberta,
181 the Board is now looking forward to working with Government and Industry to
182 review the Premiums Regulation with the view to moving away from the current
183 industry-wide adjustment process to a file-and-approve system. The Board believes
184 a model that deals with each company on its own merits will provide for more
185 efficient and effective regulation, which in turn should foster greater competition
186 for consumers over the longer term.”

187

188 Simply stated, maximizing insurance availability for consumers can be achieved in an
189 environment of product stability and pricing flexibility. We therefore believe that a move away
190 from a rigid industry-wide process to a more flexible company-specific approach to rate review
191 would not only lead to improved premiums but smaller residual market mechanisms as well. In a
192 similar vein, we continue to encourage, as we have in previous years, that steps be taken to
193 ensure the protection afforded by the premium grid remains as tightly focused as possible on the
194 group of consumers it is intended to protect and that insurers be allowed to charge adequate rates
195 for risks not targeted by the grid. As long as the premium grid remains in force, we believe
196 allowing open price competition below the maximum premium set by the grid will pave the way
197 for the smallest possible residual market volumes in the current regulatory framework.
198

199 **APPENDIX I: RISK SHARING POOLS BACKGROUND, AUTHORIZATION & OPERATION**

200

201 **BACKGROUND**

202

203 Facility Association is an administrative mechanism that administers involuntary residual
204 market automobile insurance on behalf of the voluntary/private sector automobile insurance
205 industry across Canada. Created by the industry and empowered by statute, Facility
206 Association’s mission is to guarantee the availability of automobile insurance coverage for
207 consumers who require it to legally operate their vehicles. Facility Association has a full-time
208 staff of thirty-one people and fulfils its mandate via a network of outsourcing arrangements.

209

210 In Alberta, Facility Association administers the Alberta RSP (in reality, two Pools – one for
211 Grid risks and the other for Non-Grid risks) for private passenger vehicles. It also administers
212 the traditional Residual Market for non-private passenger vehicles and a very small “Residual
213 Market Segment” (with very tightly defined risk criteria) for private passenger vehicles.

214

215 Because all licensed automobile insurers must participate in the residual markets administered
216 by Facility Association according to specified sharing formulas, their individual financial
217 results are subject to greater volatility and uncertainty than would otherwise be the case.
218 Participation in the Residual Market also imposes additional costs on Facility Association
219 member companies for such expenses as premium taxes, health levies, and the cost of capital
220 members must maintain to support residual market premiums.

221

222 **THE RESIDUAL MARKETS - AUTHORIZATION**

223

224 In Alberta, Facility Association administers the RSPs and Residual Market as authorized by
225 its Plan of Operation, which is approved by the provincial Superintendent of Insurance. (The
226 Plan may be viewed and downloaded at www.facilityassociation.com.) All companies
227 licensed to sell automobile insurance in Alberta are required to abide by the provisions of the
228 Plan.

229

230 For risks ceded to the Alberta RSPs, the Plan requires Facility Association to maintain and
231 report separate financial results for those risks that are subject to the premium grid and those
232 that are not. This creates the need for two RSPs, commonly referred to as the Grid RSP and
233 the Non-Grid RSP. Both are for private passenger automobiles only. All financial results of

234 the Alberta RSPs and the traditional Residual Market are assigned to member companies
235 based on their participation in the Alberta automobile insurance market. That is, they are not
236 spread across the other jurisdictions Facility Association serves.

237

238 THE RISK SHARING POOLS - OPERATION

239

240 Essentially, a RSP is a residual market that acts as an industry-wide reinsurance mechanism
241 that is largely invisible to consumers and intermediaries. A consumer buys insurance in the
242 normal way, and the application is forwarded to a company underwriter. The underwriter
243 assesses the risk, decides whether to keep it on the company's own books or to transfer the
244 risk to the RSP (subject to the operational rules and eligibility guidelines of the Pool).

245

246 For both Alberta RSPs, companies receive an expense allowance to cover costs such as those
247 incurred for acquisition, policy issuance, policy administration and claims servicing. That
248 expense allowance is set annually by the Facility Association Board of Directors in
249 consultation with the Alberta Superintendent of Insurance. For both Pools, companies are
250 required to submit 100% of all premiums for all coverages on a policy and are eligible for
251 100% reimbursement of eligible claims and related expenses. Financial results (top **and**
252 bottom lines) of the Pools are shared among companies based on the proportion of a
253 company's private passenger automobile exposures not ceded to a RSP divided by the number
254 of industry private passenger automobile exposures not ceded to a RSP. As Facility
255 Association is simply an administrative mechanism, all companies receive a monthly report
256 reflecting the operations of the Pool, providing them with the amounts they are then required
257 to book into their own financial statements.

258

259 The two Pools differ primarily in the number of risks companies can transfer to each. For the
260 Grid RSP, companies can transfer eligible risks (i.e. risks whose premiums are capped by the
261 premium regulation or "Grid") without limit. This lack of limit is based on the philosophy that
262 companies are required to accept risks for which they have no control over price and,
263 therefore, little or no control over the financial results of that business. In a general way, the
264 size of the Grid RSP will be a function of how companies view the adequacy of the grid
265 premium for a given risk. If the grid premium is above, or approximately the same as, the
266 company's own risk-based premium the company might prefer to keep the risk on their own
267 books. The upper limit to the size of the Grid RSP is, of course, a direct function of how many
268 risks in the province are impacted by the grid.

269

270 For the Non-Grid RSP, companies can transfer up to 4% of written exposures not transferred
271 to the Grid RSP. This Pool is designed to help companies cope with the “take-all-comers”
272 environment in the province.

273

274 In a competitive market, most insurers tend not to target the entire universe of private
275 passenger automobile risks. Insurers generally each have their areas of expertise and a healthy
276 competitive marketplace tends to allow a proper mix of generalist and specialist/niche private
277 passenger automobile writers. Moreover, because it is a practical impossibility to have a
278 perfect price for every risk, most insurers choose to have risk eligibility rules to complement
279 and protect their respective pricing structures. An underwriter faced with a requirement to
280 accept a greater degree of risk than that contemplated by the company’s classification system
281 and rates can transfer that risk to the Non-Grid RSP. The Non-Grid RSP has a relatively low
282 limit to ensure that it does not become used as a marketing tool. That is, without such a limit,
283 companies could deliberately adopt a strategy of under-pricing certain risks to attract new
284 customers. Because these risks could then be transferred to the Non-Grid RSP, and because of
285 the way all insurers share in the results of the Pool, this would amount to companies growing
286 their businesses at the expense of their competitors.

287

288 The key point here is that RSPs are designed as mechanisms to promote stability in the
289 marketplace by making it possible for companies to accept risks they believe are not
290 adequately priced. Therefore, the general expectation is that RSPs by their very nature will
291 operate at a financial loss. It is also important to note that because the RSPs also act as a
292 cross-subsidization mechanism across the industry, at any given point in time, companies will
293 have their own, unique, financial results vis-à-vis the Pools.

294

APPENDIX II: BACKGROUND ASSUMPTIONS TO TABLE

The net operating result between 2005 and 2010 shown above is taken from Audited Alberta Grid Financial Statements.

The "impact on member companies" illustrates the effect on member companies of, in addition to sharing in Risk Sharing Pool's Net Operating Result, also having to pay income and premium taxes, health levies, association dues and incur a cost of capital due to their compulsory participation in Facility Association as described in Note 2 of the Audited Financial Statements. Member impact also includes investment income earned on funds held by members and the effect of discounting.

Minor Differences may Occur due to rounding

Assumptions:

<u>Adjustments</u>	<u>Source</u>	<u>Assumption</u>
Premium Taxes Paid Directly by Members	Insurance Bureau of Canada	n/a
Health Levies Paid Directly by Members	Alberta Finance, Tax and Revenue Administration	n/a
Discounting of policy liabilities	Eckler Ltd.	Risk free rate of return used is based on a portfolio of Government of Canada bonds, for which the dates and amounts of maturities were matched to the expected payout of policy liabilities. 2010 discounted rate 1.70%
Investment Income	Eckler Ltd.	Market yield rates attributable to a portfolio of Government of Canada bonds with durations consistent with the duration of Alberta RSP policy liabilities.
Income Tax on net Operating result	Facility Association	Published income tax rates.
Association Dues	Facility Association Accounting Committee	0.40005% of Wirthen Premium
Deemed after tax Cost of Capital	Facility Association Accounting Committee	Deemed after tax Cost of Capital 10% Surplus based on 1.5:1 ratio