

May 31, 2013

Mr. Alfred Savage
Chair
Automobile Insurance Rate Board
2440 Canadian Western Bank Place
10303 Jasper Avenue
Edmonton, AB T5J 3N6

Dear Mr. Savage,

Insurance Bureau of Canada (IBC) is pleased to respond to the Alberta Automobile Insurance Rate Board's (AIRB) request for input regarding the 2013 review of the required premium for basic coverage beginning November 1, 2013. Attached is the actuarial analysis prepared by IBC's consulting actuary, Dr. Ron Miller of Exactor Insurance Services.

IBC has and continues to express the view to governments and regulators throughout the country that, while the regulation of rates provides a degree of comfort to some stakeholders, in a competitive market the cost of auto insurance claims is the major factor in determining the price of the product. For example, premiums in Ontario are the highest in Canada, despite the province employing one of the most strict rate regulation regimes. The reason for Ontario's high premiums is high claims costs, which are the result of many years of excessive utilization of an overly rich no-fault benefit package that is susceptible to abuse and outright fraud.

Since 2004, the price of auto insurance in Alberta has fluctuated only modestly from year-to-year because of the relative stability of the product's cost structure. On many occasions, the government and the industry have collaborated to help maintain this cost stability and overcome threats to it, such as the constitutional challenge to the *Minor Injury Regulation* (MIR). The result is one of the most affordable auto insurance products in the country. In 2011, Albertans, on average, spent 2.8% of their disposable income on auto insurance, compared to 3.2% in Atlantic Canada and 5.3% in Ontario.¹ While the Facility Association's market in Alberta remains the largest among the provinces it serves, it has been declining steadily and now stands at 6.1%.²

Cost Environment

There are three related factors we want to highlight for their potential to have an impact on the cost of delivering automobile insurance in Alberta. They are:

- Changes in injury claims patterns;
- Changes in property damage claims patterns; and
- Potential product reforms, such as raising the limit in the MIR on compensation for general damages.

¹ IBC with data from GISA and Statistics Canada.

² Facility Association (FARM and RSP).

Changes in Injury Claims Patterns

In preparation for last year's IWA, IBC carried out a survey of fifteen insurance companies operating in Alberta in an effort to determine whether any impact on claiming behaviour has been seen following the January 2012 court decision in *Sparrowhawk v. Zapoltinsky*. As you know, the Alberta Court of Queen's Bench ruled that the temporomandibular joint disorder (TMD) suffered by the claimant in this case was not appropriate for treatment under the *Diagnostic and Treatment Protocols Regulation* (DTPR) and was not a minor injury. Most of the companies surveyed by IBC reported that the number of TMD claims was increasing. This development concerned us because TMD is associated with relatively high settlement costs. Indeed, a closed claims study that IBC sponsored for the Alberta constitutional challenge found that, as far back as 2004, claims with TMD diagnoses were responsible for 18.4% of bodily injury settlement dollars paid by insurance companies, while representing only 7.7% of these claims.³

We repeated our survey this year and were informed that this pattern is continuing. We also found that, along with TMD, companies are experiencing more Section B claims for psychological impairment and chronic pain, both of which some stakeholders consider to be outside the MIR's application. These claims, which typically take longer to close, are beginning to appear earlier in the claims management process. Insurers also reported that there appears to be a positive correlation between an injured person having legal representation and that person pursuing a claim for TMD, psychological impairment and/or chronic pain.

In our view, these developments suggest that more stakeholders may be beginning to use the Section B process to assert those types of injuries (TMD, chronic pain, depression) that can take their claim out of the minor injury class in order to build the case for more lucrative bodily injury general damages awards. According to some of the companies we surveyed, there is already beginning to be evidence that more people are pursuing claims for general damages, outside the MIR, based on TMD, psychological impairment and/or chronic pain. This was reflected in a statement that appeared in the 2012 annual report of one large carrier in describing recent Alberta injury claims developments: "*Due to the age of older minor injury claims and the changing environment, plaintiff lawyers are aggressively working files in order to build the case for their clients*".⁴

Changes in Property Damage Claims Patterns

A legal decision from December 2012 threatens to have negative effects for property damage liability costs. In *Taylor v. Hrytsak*, the judge at the Provincial Court of Alberta awarded the plaintiff \$17,000 after finding that a vehicle involved in a collision had experienced "diminished value". Already, companies report receiving more claims for compensation for the perceived diminished value of a vehicle after it has been repaired following a collision. This development is not surprising because the size of the award in the case cited established an attractive windfall target even for individuals with no plans to sell their repaired vehicles. Thus, this court decision has created an opportunity for claimants that, coupled with the developments since the decision in *Sparrowhawk v. Zapoltinsky*, leaves the auto insurance product vulnerable to a rising number of more expensive liability claims.

Changes to the *Minor Injury Regulation* (MIR)

IBC understands that, at the urging of certain stakeholders, one of the changes the government is considering, in its review of the regulations related to the auto insurance product, is a one-time

³ Alberta Closed Claims Study, May 2006, prepared by Barb Addie, F.C.I.A., Exactor Insurance Services.

⁴ Intact Financial Corporation. Annual Report 2012.

increase in the award limit for general damages in the MIR. The current limit has been subject to annual inflation indexation since 2007.

Governments in Atlantic Canada recently reviewed their limits on general damages that may be awarded for minor injuries. In 2010, the Nova Scotia government raised the limit from \$2,500 to \$7,500, and indexed it to changes in the Consumer Price Index (CPI). The New Brunswick government has just reformed its regulation, raising the limit to \$7,500 effective July 1, 2013. While industry data is not mature enough to show the full impact of raising the limit in Nova Scotia, preliminary data indicates that, as between collisions that occurred in 2009 and those happening in 2011, the cost per car for bodily injury claims rose 9%, from \$131.33 to \$143.41.⁵ We believe that this increase is, in part, simply the result of the higher non-pecuniary awards now available to those incurring minor injuries, but also that, to some extent, it may reflect an incentive effect that these higher awards have created.

As we see in the actuarial analysis submitted with this letter, it appears that the statistical plan may already be reflecting cost pressures arising from the *Sparrowhawk v. Zapoltinsky* decision, as well as perhaps some measure of the typical erosion of the effectiveness of savings measures over time after a reform. In the case of the more recent *Taylor v. Hrytsak* decision, there is only anecdotal evidence to date from insurers that it may be changing the dynamics of property damage claims. Nonetheless, the fact that these new sources of cost pressure are clearly present suggests to us that, during this period in which the auto insurance market remains fairly stable, it would be highly prudent for the government to initiate an in-depth review of the claims cost environment in Alberta, and to work with stakeholders to develop solutions to the problems identified and ensure that the cost stability Albertans have come to expect continues into the future. IBC would welcome the opportunity to participate in these discussions.

Commentary on the Industry-Wide Adjustment (IWA)

On many occasions, we have expressed the view that a process reliant on competition is more appropriate than uniform adjustments for regulating the price of auto insurance. This view is based on several reasons:

- Uniform adjustments are more likely to disrupt the stability of the market. If a single company sets its premiums incorrectly in a competitive market, only that company feels the repercussions. But if an industry-wide indication is wrong, all companies and their consumers feel the effects.
- Experience in jurisdictions with rate regulation processes reliant on competition shows that premiums follow market conditions, and that competition tends to smooth out the impact that sudden changes in costs may have on prices.
- Strict regulation is costly. Last year, IBC conducted a Canada-wide study on the costs to the industry and its consumers that arise from funding the operations of the nearly 30 federal and provincial bodies having responsibilities for regulating insurance carriers and intermediaries. The results of the study showed that, in 2010, the direct cost that regulators charged to the industry was \$80 million. It should be noted that this figure is, by no means, exclusive to auto insurance rate regulation, but rather covers the many governing bodies and types of regulation that the industry is subject to. Further, this estimate does not include the very substantial costs incurred by companies which need to use numerous expert personnel to carry out the activities required by regulators. In the case of auto insurance rate regulation, for example, depending upon the jurisdiction,

⁵ IBC with data from GISA.

companies can incur application fees, additional actuarial costs, and extensive staff time to comply with the different rate filing instructions used by different rate boards. As well, they incur the systems and human resources costs of reporting the additional data that rate regulators request, and the cost associated with the delay in getting indicated rates through the approval process and to the market.

- A more competitive rate-making environment encourages companies to differentiate themselves. This provides consumers with more choice through innovative product offerings and service models as companies compete more aggressively for the business of consumers.

Last fall, IBC welcomed the opportunity to engage with the government and the AIRB in discussions on the *Premiums Regulation*. During that review, the industry proposed transitioning from an IWA process for basic coverage and a file-and-use process for optional coverage to a file-and-approve process for the entire product. The industry believes this model is more appropriate for a competitive market and will continue to provide a level of regulatory oversight that benefits consumers.

Indication

IBC does not endorse the assignment of a single rate adjustment indication for the entire industry. But because the IWA process calls for the provision of an indication, we retained Dr. Ron Miller of Exactor Insurance Services to conduct an actuarial analysis for this submission.

On page 22 of Dr. Miller's enclosed report, the estimate given for the all-industry average of indicated required premium for basic coverage for November 1, 2013 is \$670.82, while the projection of average street premium per car year, before annual adjustment, is stated as \$591.00. These numbers imply that the indicated all-industry rate change is 13.5%.

This indicated rate increase results largely from the confluence of two factors: the first factor is the influence of rising costs for bodily injury claims. Dr. Miller found that bodily injury claims from previous years are closing at a higher cost than was initially predicted. In reviewing past exhibits from GISA, we have found, that because of this development, the ultimate cost per car for Third-Party Liability (TPL) claims for accident-years 2008 to 2011 has been adjusted upwards. The annual adjustments are set out in the table below.

Changes to Ultimate Cost per Car for TPL Claims for Accident-Years (AY) 2008 to 2012⁶

Exhibit Year	AY 2008	AY 2009	AY 2010	AY 2011	AY 2012
2008	363.86				
2009	378.55	370.76			
2010	386.39	366.27	381.62		
2011	406.04	379.79	379.86	399.71	
2012	434.02	416.92	411.54	429.44	442.51

The table also shows that the largest increases happened between the 2011 and 2012 GISA publications. In fact, between the publication of the 2011 and 2012 exhibits, the estimated ultimate cost per car for TPL claims for accident-years 2008, 2009, 2010 and 2011 increased by

⁶ IBC with data from GISA.

an average of 8.1%. By comparison, the increase between the 2010 and 2011 exhibits for accident-years 2008, 2009 and 2010 was an average of 2.8% and the change between the 2009 and 2010 exhibits for accident-years 2008 and 2009 was an average of 0.4%. The substantial adjustments between the 2011 and 2012 publications coincide with the court decision in *Sparrowhawk v. Zapoltinsky*.

A second factor contributing to the magnitude of the indicated rate increase for 2013 is related to previous decisions of the AIRB regarding price adjustments. As noted above, Dr. Miller estimates that the average street premium for the basic auto insurance product as of November 1, 2013, prior to implementation of the IWA adjustment, will be \$591.00. That the average street premium will be this low and the corresponding difference between street and indicated premium so wide, is in part a reflection of the Board's decision at last year's IWA. Thus, a year ago, the kinds of bodily injury cost pressures that are described in this letter and documented in the accompanying actuarial analysis were already very much in evidence. It was for this reason we understand that the Board's actuary, Oliver Wyman, identified an indicated adjustment for 2012 of +11.5%. However, the AIRB decided to permit an IWA of only +5% last year, leaving a sizable gap between the cost escalation trend, which was well under way, and the premium adjustment. Unfortunately, on an all-industry basis, the gap between average premium and costs has continued to grow over the past year.

IBC is, of course, quite aware that not all companies have applied the +5% permitted adjustment. While companies have up to three years to apply the adjustment, we see the fact that some companies have not taken it as providing strong and positive evidence to support the industry's long-held position that a single, one-size-fits-all adjustment factor is not at all appropriate in a competitive market. It also shows that, even in a restrictive rate regulation context, companies' pricing decisions are based as much as they can be on each company's own book of business and market strategy. At the same time, however, we want to caution that individual company responses to past IWA directives should not take away from the requirements in the *Premiums Regulation* to decide on an all-industry adjustment that is reflective of industry-wide experience.

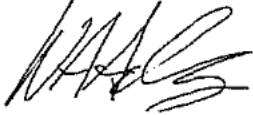
Conclusion

The principal messages we want to convey to the AIRB are summarized as follows:

- According to IBC's consulting actuary, the indicated rate adjustment for basic coverage, effective November 1, 2013 is 13.5%. We believe that the evidence, including Oliver Wyman's analysis and information from individual companies, will be sufficient to allow the AIRB to arrive at an adjustment decision that truly reflects the cost trends and projections that are put before it. In this regard, we believe that it will be particularly important that, on an all-industry basis, basic product rates are at or close to actuarial adequacy when the rate regulation system transitions to a more competitive process.
- There is little doubt that the pressures on bodily injury claims costs, as well as – albeit more recently – property damage tort claims, have become more pronounced. Consequently, we are urging the government to undertake an in-depth review of the factors affecting claims costs with a view to developing solutions that can protect the future stability of Alberta's automobile insurance market.
- Finally, we want to reiterate our support of the government moving forward with changes to the *Premiums Regulation* that permit competition to play a greater role in determining auto insurance premium levels. In our view, this will bring benefits to Alberta's driving public through lower premiums for good drivers, stronger incentives for safe driving, increasing product innovation, and more consumer choice.

We look forward to reviewing Oliver Wyman's analysis when it becomes available, and subsequently meeting with the AIRB on June 11, 2013.

Sincerely,

A handwritten signature in black ink, appearing to read 'W.A. Adams', written in a cursive style.

William A. Adams
Vice-President, Western & Pacific

Enclosure (1)