ANNUAL INDUSTRY-WIDE ADJUSTMENT OF RATES FOR BASIC COVERAGE

EFFECTIVE NOVEMBER 1, 2008

SECTION 4 OF THE AUTOMOBILE INSURANCE PREMIUMS REGULATION

ALBERTA AUTOMOBILE INSURANCE RATE BOARD

BOARD DECISION REPORT

Order No: 01-08

July 31, 2008

Alberta Automobile Insurance Rate Board

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1.0 BACKGROUND

1.1. LEGISLATIVE AND REGULATORY AUTHORITY

The Automobile Insurance Rate Board (referred to herein as either the AIRB or the Board) was established on October 1, 2004 under Section 653(1) of the *Insurance Act* (the Act). The mandate of the AIRB is defined in the Act and the *Automobile Insurance Premiums Regulation* (the Regulation) and includes the duty to:

- annually determine if rates for basic coverage[1] should be changed through an industry-wide adjustment;
- monitor optional coverage;
- review and approve rating programs for new insurers granted a license to sell automobile insurance in Alberta by the Superintendent of Insurance; and
- fulfill the duties and responsibilities carried out by the previous Automobile Insurance Board regarding non-private passenger insurers.

Section 4 of the Regulation requires that the Board announce on or before August 1 of each year whether premiums for basic coverage for private passenger vehicles are to be adjusted effective November 1. The Board must consider, in respect of basic coverage for private passenger automobiles:

a) Industry wide loss costs;
b) Administrative expenses, which may include:
    - Commissions;
    - Federal, provincial, and municipal taxes; and
    - General expenses;
c) Other industry wide costs or expenses that the AIRB considers appropriate; and
d) Any other criteria recommended by the Superintendent and approved by the Board.

1.2. RECENT LEGISLATIVE REFORMS AND GOVERNMENT ACTIONS

In 2003 the Alberta Government enacted Bill 53, *the Insurance Amendment Act*, which provided for:

- a cap on pain and suffering for minor injuries at $4,000;

[1] Basic coverage is the third-party liability and accident benefits portion of an automobile insurance policy.

- introduction of treatment protocols;
- elimination of the double-recovery of compensation from more than one source;
- determination of wage loss based on net, rather than gross, wages;
- an increase in the maximum medical/rehabilitation benefits under accident benefits to $50,000; and
- the introduction of the “take all comers” underwriting system.

As part of the reforms, the Government also ordered premiums to be frozen from October 30, 2003 until November 1, 2005.

The reforms set out in Bill 53 became effective October 1, 2004, with the exception of the consideration of collateral sources and the determination of wage loss based on a net, rather than gross, wages, which became effective January 26, 2004. Also on October 1, 2004, the Government introduced the grid rate system, which set maximum premiums to be charged for basic coverage, and established two risk sharing pools[2]. Effective October 1, 2004, the Government also mandated a 5% rate reduction for premiums for basic coverage that were not limited by the grid.

In April 2005, the Government mandated a rate reduction for basic coverage of at least 6% by July 1, 2005. This reduction did not apply to the grid rates.

The initial annual review process in 2005 resulted in a 4% reduction in premium level for basic coverage. The 2006 annual review process resulted in a further 3% reduction in premium level for basic coverage. The 2007 annual review decision was for 0% or no adjustment.

As of March 1, 2007, the provisions under accident benefits coverage were amended to increase funeral benefits from $2,000 to $5,000 and increase weekly indemnity for total disability from $300 to $400 and from $100 to $135 for persons age 18 and over and not engaged in an occupation or employment for profit or wages.

[2] Coverage for insureds whose premium for basic coverage is limited by the grid can be ceded to one of the risk sharing pools. Insurers may voluntarily cede up to 4% of their insured vehicles rated below the grid through the second risk sharing pool.

The *Minor Injury Regulation* was amended to adjust the amount of non-pecuniary damages recoverable for minor injuries by the Consumer Price Index for Alberta. The amount increased to $4,339 as of January 1, 2008.

On February 8, 2008, the Alberta Court of Queen Bench struck down the *Minor Injury Regulation* cap on non-pecuniary damages recoverable for minor injuries, ruling it unconstitutional. No stay was granted on the ruling. The decision is under appeal to the Alberta Court of Appeal.

1.3. THE OLIVER WYMAN REPORT

On May 30, 2008, Oliver Wyman, the Board's actuary, released a report titled, "Actuarial Analysis for Industry-wide Rate Level Adjustment Effective November 1, 2008" (Oliver Wyman Report). The Oliver Wyman Report presented their analysis and findings regarding the private passenger insurance rates being charged in Alberta for basic coverage. The Oliver Wyman Report was commissioned by the Board to provide information and professional advice to assist the Board to fulfill its mandate with respect to the annual uniform industry-wide rate level adjustment for private passenger vehicles.

Oliver Wyman prepared an Addendum to the Oliver Wyman Report which was presented to the Board at a duly constituted meeting held on July 25, 2008. The Addendum addressed certain issues arising from the public meetings in June 2008.

Based on the actuarial analysis, the Oliver Wyman Report, as modified by the Addendum, found that for private passenger automobile insurance policies to be written during the period November 1, 2008 through October 31, 2009 (hereafter referred to as policy year effective November 1, 2008), the industry average street premium for basic coverage is expected to be higher than the required average premium for basic coverage by 5.0% had the cap on non-pecuniary damages been maintained. The repeal of the *Minor Injury Regulation* cap on non-pecuniary damages recoverable for minor injuries will increase the premium required to settle claims for basic coverage by 20%. Therefore, the net change required to average premium level is +14%.

Indicated Industry-wide Rate Level Adjustment

Policy Year Effective November 1, 2008

Private Passenger Automobile

Table 1 – Experience Adjustment

Policy Year Nov 1-08 to Oct 31-09	TPL and Accident Benefits	Indicated Rate Level Adjustment
Required Avg. Premium	$575	
Average Street Premium	$605	-5.0%

Table 2 – Adjustment for Repeal of the Cap

Policy Year Nov 1-08 to Oct 31-09	TPL and Accident Benefits	Indicated Rate Level Adjustment
Required Avg. Premium	$690	
Average Street Premium	$605	+14.0%

2.0 PUBLIC MEETINGS

2.1. NOTICE

On April 23, 2008 the Board published notice of public meetings to be held in Calgary on June 17 and 18, 2008 for the purposes of determining if rates for basic coverage should be adjusted on an industry-wide basis effective November 1, 2008. All interested parties were invited to submit a letter of intent to the Board by May 5, 2008. In addition to the notice, the Board placed newspaper ads in Edmonton, Calgary, Red Deer Medicine Hat and Lethbridge on May 3 and Grande Prairie and Fort McMurray on May 2.

2.2. PRESENTATIONS AND WRITTEN SUBMISSIONS

The Board received 15 letters of intent to participate in the public meetings. Twelve requested the opportunity to make a presentation during the public meetings while three asked to submit only a written submission. All parties that requested the opportunity to make a presentation were scheduled a time slot, provided with a copy of the Rules of Procedure for the public meeting and asked to ensure that their comments were relevant to the annual adjustment process.

2.3. PUBLIC MEETINGS

The public meetings were held over two days, June 17 and 18 at the Telus Convention Centre in Calgary. The Board was assisted by Mr. Ted Zubulake, Managing Director of Oliver Wyman and Board Actuary and Board staff Mr. Del Dyck, Executive Director, Ms Susan Steeves and Ms KimBerley Kern.

The following parties made presentations at the public meetings:

1. Oliver, Wyman Limited
2. Insurance Bureau of Canada (IBC)
3. Facility Association
4. Alberta Civil Trial Lawyers Association
5. Allstate Canada Group
6. Peace Hills General Insurance Company
7. Canadian Direct Insurance Inc.
8. Merle Taylor, Consumer Representative on the AIRB

9. ING Canada
10. TD Meloche Monnex
11. Dominion of Canada General Insurance Company
12. Tawkin Law Offices
13. Canadian Direct Insurance Incorporated
14. Alberta Motor Association Insurance Company

The following parties made written submissions to the Board, which were tabled publicly on June 17th:

1. Co-operators General Insurance Company
2. McCourt Law Offices
3. State Farm Mutual Automobile Insurance Company

All information submitted to the Board as part of the public meeting process has been posted to its website: www.airb.gov.ab.ca. Transcripts of the proceedings are also posted on the website.

3.0 ACTUARIAL EVIDENCE AND ANALYSIS

3.1. OVERVIEW OF OLIVER WYMAN'S ANALYSIS AND FINDINGS AT PUBLIC MEETINGS

Mr. Zubulake, Managing Director of Oliver Wyman, provided the Board with Oliver Wyman's findings that were posted on the website on May 30, 2008. A July 25 addendum relates Oliver Wyman's adjustments in response to the information disclosed through the public meetings. The key issues contained in the Oliver Wyman Report were:

- The industry-wide adjustment applies to policies written in the policy year effective between November 1, 2008 and October 31, 2009. Oliver Wyman refers to this period as the policy year effective November 1, 2008. This is in contrast to insurance industry financial results, which are typically presented on a calendar year basis, which is the year when claim payments, claim reserves, or changes in reserves are recorded in a company's financial statements. Since claim payments and changes in claim reserve estimates occur over a period of time following the year in which the insurance policy was written, an insurer's reported financial results are affected by claim activity over a period spanning many policy years. A policy year will reflect the experience of policies with an effective date in the given year, regardless of when payments are made toward the policy. The difference between policy year and accounting year explains in part why findings presented by Oliver Wyman and other actuaries may appear to be inconsistent with recent financial results reported by the insurance industry.

- Virtually all of the numbers presented to the Board by Oliver Wyman or by other parties, whether on a policy year basis or on an accounting year basis, are either estimates or based on estimates. Insurers will not know for certain what their costs will be for the claims of drivers they insure in the policy year effective November 1, 2008 for some time as it takes several years for all claims that occur to be reported and settled.

- The data upon which Oliver Wyman based its analysis and findings includes all insured drivers in the province, including those in the Facility Association and those in the Risk Sharing Pools.
- The latest claim data that was provided to Oliver Wyman by the General Insurance Statistical Agency (GISA) through the Insurance Bureau of Canada (IBC) was as reported up to December 31, 2007.
- There are three components to the premium charged by insurance companies:
  1. a provision for claims and claims administration/adjudication expenses that must be paid, including a discount for the investment earnings expected to be earned on the premiums until the claims are fully paid. The claims provision represents about two-thirds of the premium dollar;
  2. a provision for insurance company operating expenses, which represents about one-fourth of the premium dollar; and
  3. a provision for cost of capital or profit.

Oliver Wyman projected the total of the three components, on average, for polices that will be written in the policy year effective November 1, 2008. This is referred to as the “required average premium.” This “required average premium” was compared to the average premium expected to be charged by insurers for the policy year effective November 1, 2008, which Oliver Wyman referred to as the “street premium.” The percentage difference between Oliver Wyman’s estimate of the required average premium and Oliver Wyman’s estimate of the street premium represents Oliver Wyman’s estimate of the adequacy of the industry-wide rates, on average.

This year, there are two estimates of “required average premium”; one assuming the *Minor Injury Regulation* cap on non-pecuniary damages recoverable for minor injuries continued to operate and another estimating the impact of the February 8, 2008 court decision that struck down the cap.

3.2. Estimate of the Required Average Premium

3.2.1. The Provision for Claims

The provision for the cost of claims and the claims administration/adjustment expenses is the largest component of the premium dollar and the most difficult to estimate. The best indicator of what the provision for claim costs should be is claim costs in the recent past, adjusted for environmental changes or trends. Oliver Wyman considered recent past experience in a three-step process:

1. First, it estimated what the ultimate claim costs will be for claims incurred in the recent past, which Oliver Wyman has defined as the policy years (accident years) 2003 through 2007. Oliver Wyman applied generally accepted actuarial techniques to develop the reported claims to its expected ultimate level.

2. Second, Oliver Wyman adjusted the estimated ultimate claim costs in each year to reflect environmental changes or trends that have occurred that would cause the claim costs for the policy year effective November 1, 2008 to be different than the estimated ultimate claim costs for the policy years 2003 through 2007. The two major environmental changes that Oliver Wyman reflected are: the expected impact of insurance reform (Bill 53) and trends in claims frequency and claim severity.

3. Finally, Oliver Wyman applied discount factors to the expected payout pattern of claims and claims administration/adjudication expenses to reflect the expected investment earnings on the premiums based on an expectation of a 3.0% rate of investment return.

Making these adjustments resulted in five separate estimates of what the average claim cost component will be for the policy year beginning November 1, 2008 - one estimate for each of the five years in the experience period considered by Oliver Wyman. Oliver Wyman selected a best estimate from among the five estimates, which was an average of the five estimates, with most of the weight given to the policy year 2006 and 2007 estimates. An additional aspect to this year's adjustment was estimating the impact of the repeal of the *Minor Injury Regulation* cap on non-pecuniary damages recoverable for minor injuries.

3.2.2. The Provision for Expenses

Oliver Wyman selected an expense provision of 25.3% of premium based on the insurance industry's actual expenses for 2007 as reported through the Insurance Bureau of Canada (IBC).

3.2.3. Profit

Oliver Wyman used the 7% of premium profit provision established by the Board.

3.2.4. Oliver Wyman Finding – Required Average Premium

Oliver Wyman found that the required average premium for basic coverage (which is the total of its selected claim cost, expense, and profit provisions) is 4.3% to 9.3% less than the street premium.

3.2.5. Oliver Wyman Finding – Adjustment for Removal of the Cap

The February 8, 2008 decision of the Court of Queen's Bench that the *Minor Injury Regulation* cap on non-pecuniary damages for minor injuries will cause bodily injury claims to increase by 44%. The impact on required premium level for basic coverage as estimated by Oliver Wyman is an increase of 20.0%.

3.3. Estimate of the Street Premium

Oliver Wyman estimated the average street premium for the policy year effective November 1, 2008 at $605 based on "fast-track" written premium information reported by insurers to IBC for the months of March and April 2008.

3.3.1. Estimate of the Industry-Wide Adjustment

Oliver Wyman's estimates of the required average premium ($549 to $579) and street premium ($605) for the policy year effective November 1, 2008 leads to its finding in the range of a redundancy of 4.3% to 9.3%. Oliver Wyman finds -5.0% to be an actuarially sound selection for $575 before consideration of the repeal of the cap on non-pecuniary damages for minor injuries.

Oliver Wyman's estimate of the impact on required premium level for basic coverage of the repeal of the *Minor Injury Regulation* cap on non-pecuniary damages for minor injuries is an increase of 18.0% to 19.1% that should be rounded to +20.0%. The resulting required premium would be $690.

4.0 ISSUES FROM PUBLIC MEETINGS

The technical discussion centered around three components that enter into determination of the required average premium, the bodily injury trend rates, the property damage trend rates, and the impact of the repeal of the *Minor Injury Regulation* cap on non-pecuniary damages recoverable for minor injuries. Other differences between the Oliver Wyman analysis and the IBC analysis, as performed and presented by Dr. Ron Miller of Exactor Insurance Services, Inc., included:

- accident benefits claim cost estimates
- expense provisions,
- health services levy, and
- projected street premium.

However, the differences in these components were relatively small, and so received little discussion at the Public Meetings.

4.1. BODILY INJURY LOSS TREND

4.1.1. Discussion

There are two components to loss trend: 1) severity trend, which reflects change in average cost per claim over time, and 2) frequency trend, which reflects change in the claim incidence rate over time. Oliver Wyman selected a past trend rate and a future trend rate for each coverage.

The selection of loss trend rates entails a considerable degree of judgment, and the indication for a required change in average premium level is very sensitive to the selections that are made.

Three major issues concerning the bodily injury trend rates were discussed at the Public Meetings: the length of the period of time considered in identifying the past trend rate, degree to which reported claim experience for the 2007 year should be considered in identifying the past trend rate, and whether the identified past trend rate will continue beyond 2007 (that is, whether the past and future trend rates should be the same).

Trend Consideration Period

In their initial analysis, Oliver Wyman considered the period 2003-2007 in determining the Alberta past bodily injury claim cost trend pattern. IBC considered the period 1996-2007. IBC's consideration of a longer trend period results in a higher severity trend pattern and a higher (less negative) frequency trend pattern than the severity and frequency trend patterns resulting from Oliver Wyman's consideration of a shorter trend period.

Both Oliver Wyman and IBC presented their reasons for the particular trend periods that they considered, and other presenters offered comments on the issue.

Oliver Wyman presented an alternative approach in their June 25 Addendum that considers points made by IBC and other parties. In their alternate approach, Oliver Wyman separately calculates indicated severity and frequency past trend rates based on multiple time periods and averages the results.

Consideration of the 2007 Claim Experience

Both Oliver Wyman and IBC observed a sharp decline in the bodily injury claim costs for the 2007 year as reported as of December 31, 2007. IBC and other presenters suggested that the observed decline could, in part, be the result of injured persons waiting for the announcement of the court decision on the Minor Injury Challenge before filing/reporting their claims to their insurance companies. Some thought the decline could be attributed to injured persons turning to their enhanced Schedule B benefits for recovery rather than attempting to recover through the tort system.

We agree that it is plausible, but not definite, that at that time, injured persons were, to some extent, holding back reporting "minor" personal injuries caused by others.

Oliver Wyman presented an alternative approach to deal with this issue in their Addendum. In their alternative approach, Oliver Wyman tempers the consideration given to 2007 results in projecting future claim costs.

Continuation of Past Trends

Although Oliver Wyman and IBC selected different trend patterns, each assumed that their selected past trend will continue beyond 2007. This assumption was challenged by several presenters at the Public Meetings in the context of the Oliver Wyman Report. The principal point made was that it is not reasonable to assume that Bodily Injury claim costs would continue to decline at a rate of 8.8% per year as Oliver Wyman had projected.

Oliver Wyman addressed this issue in its Addendum by presenting two scenarios.

> **Scenario A** - assumes a continuation of the new past trend pattern that Oliver Wyman identified;
>
> **Scenario B** - assumes a tempering of the past trend that Oliver Wyman identified.

4.1.2. Board Position

The Board recognized that the rate indications developed by Oliver Wyman are very sensitive to the trend rates. As a result of the information submitted to the Board, Oliver Wyman revised their selected loss trend factors for bodily injury. The Board accepts Oliver Wyman's revised estimates of the claim cost provision.

4.2. PROPERTY DAMAGE FUTURE TREND

4.2.1. Discussion

The Property Damage past and future trend rates selected by Oliver Wyman and IBC were 8.7% and 9.7%, respectively. IBC and other presenters suggested that Oliver Wyman's selected future trend rate may be low in light of the significant cost increases that have been occurring in labour rates and parts.

Oliver Wyman addressed this issue by incorporating a 10% future trend rate into Scenario B.

4.2.2. Board Position

The Board recognized the pressures on severity of property damage claims from increasing repair shop rates and increasing cost of replacement vehicles due to delays for repairs. As a result of the information submitted to the Board, Oliver Wyman revised their selected loss trend factors for property damage. The Board accepts Oliver Wyman's revised estimates of the claim cost provision.

4.3. IMPACT OF REPEAL OF MINOR INJURY REGULATION

4.3.1. Discussion

Oliver Wyman and IBC explained that their respective estimates of the impact of the repeal of the *Minor Injury Regulation* were based on the analysis of the trend patterns that they each performed; and that the relatively large difference between their respective estimates was due to the length of the trend period that they each considered.

In their Addendum Oliver Wyman presented the cost impact estimate resulting from the alternative trend periods that they considered.

4.3.2. Board Position

The Board accepts the Oliver Wyman best estimate of the impact of the repeal of the *Minor Injury Regulation* on bodily injury claim costs.

4.4. OLIVER WYMAN FINDING

4.4.1. Discussion

The results of Oliver Wyman's additional analysis as set forth in its July 25 Addendum is a finding of a range of a redundancy of 4.3% (Scenario B) to 9.3% (Scenario A) before consideration of the repeal of the cap on non-pecuniary damages for minor injuries; and a finding of the impact on required premium level for basic coverage of the repeal of the *Minor Injury Regulation* cap on non-pecuniary damages for minor injuries to of an increase of 18.0% (Scenario A) to 19.1% (Scenario B).

Oliver Wyman's finding was a redundancy of 5.0% before consideration of the repeal of the cap on non-pecuniary damages for minor injuries and a finding of a 20% increase as the impact for basic coverage of the repeal of the *Minor Injury Regulation* cap on non-pecuniary damages for minor injuries.

4.4.2. Board Position

The Board accepts Oliver Wyman's revised findings that incorporate the findings from the information submitted to the Board through the public meetings. That is, they agree that experience supports that the required average premium could decrease by 5.0% had the product remained unchanged. The Board agrees removal of the *Minor Injury Regulation* cap on non pecuniary damages recoverable for minor injuries would increase the average premium required by about 20.0 percent. However, the appeal of the court decision means there is uncertainty around the question of future bodily injury claim costs.

4.5. THE GRID

Insurers urged de-linking the annual industry-wide adjustment process and the adjustment to the Grid. The Board notes that the Premiums Regulation explicitly links the application of the annual adjustment to premiums on the grid.

5.0 ORDER NO: 01-08

ANNUAL ADJUSTMENT OF RATES EFFECTIVE NOVEMBER 1, 2008

In accordance with Section 4 of the *Automobile Insurance Premiums Regulation,* the Board hereby orders that the rates under rating programs for basic coverage (third party liability and accident benefits) for private passenger vehicles can be increased uniformly on an Alberta industry-wide basis by up to 5.0% effective November 1, 2008.

The Board has considered all of the oral and written information presented through the public meeting process, including the analysis and findings presented by its actuary, Oliver Wyman, in coming to its decision.

The Board agrees the indication based on experience is a redundancy in the range of -4.3% to -9.3%. Therefore, the Board has decided on an adjustment of a 5.0% reduction in premium level for basic coverage.

The Board further finds that the additional premium for basic coverage required as a result of the repeal of the cap under the *Minor Injury Regulation* on non-pecuniary damages for minor injuries is about 20.0%. The court decision is under appeal, placing the eventual outcome and long-term impact on bodily injury claim costs in question. The Board concluded that they could not ignore the impact on bodily injury claim costs pending the outcome of the appeal process. Neither did the Board consider fair the alternative of placing the entire burden for the potential of increased claims costs on policyholders. The Board has decided to grant half of that indication, that is, an increase of 10.0% for the repeal of the *Minor Injury Regulation* cap on the 2008 adjustment.

The available net adjustment effective November 1, 2008 is an increase of 5.0%. Insurers have up to three years from the effective date of the adjustment to implement any part or all of the increase.

6.0 APPENDIX A - AUTOMOBILE INSURANCE PREMIUMS REGULATION

Part 1, Section 4

4(1) On or before August 1 in each year, the Board may adjust uniformly on an Alberta automobile insurance industry-wide basis, in accordance with the criteria described in subsection (3), the rates under rating programs for basic coverage of private passenger vehicles.

(2) In accordance with the procedures of the Board, the Board may hear representations with respect to an adjustment under this section.

(3) The criteria for an adjustment are

(a) the Alberta automobile insurance industry-wide loss costs, as that term is understood by the Board, for basic coverage for private passenger vehicles;

(b) the administrative expenses relating to basic coverage for private passenger vehicles, on an Alberta automobile insurance industry-wide basis, that the Board considers appropriate to consider, which may include commissions, federal, provincial and municipal taxes and general expenses, as reported in the annual returns submitted by insurers to the Superintendent or a similar regulatory authority in another jurisdiction;

(c) other Alberta automobile insurance industry-wide costs or expenses that the Board considers appropriate relating to basic coverage for private passenger vehicles;

(d) any other criteria recommended by the Superintendent and approved by the Board.

(4) An adjustment under this section is effective November 1 of the year in which the adjustment is made by the Board.

(5) Notwithstanding subsection (4), if the Board increases the rates under a rating program for basic coverage in respect of private passenger vehicles, the increases may be applied by an insurer over a period of not more than 3 years commencing November 1 of the year in which the adjustment is made by the Board.

(6) Information about adjustments under subsection (1) must be made publicly available in a manner satisfactory to the Superintendent.

7.0 APPENDIX B – PRESENTATION SCHEDULE FOR PUBLIC MEETINGS

Tuesday, June 17, 2008 – Calgary
Room 106, Telus Convention Centre, 120 – 9th Avenue SE
Oliver, Wyman Limited
Insurance Bureau of Canada
Facility Association
Alberta Civil Trial Lawyers Association
Allstate Canada Group
Peace Hills General Insurance Company
Canadian Direct Insurance Inc.
Merle Taylor, Consumer Representative on the AIRB

Wednesday, June 28, 2008 – Calgary
Room 106, Telus Convention Centre, 120 – 9th Avenue SE
ING Canada
TD Meloche Monnex
Dominion of Canada General Insurance Company
Tawkin Law Offices
Canadian Direct Insurance Incorporated
Alberta Motor Association Insurance Company

8.0 APPENDIX C - DEFINITIONS OF KEY TERMS

To assist the reader in his or her understanding of the Decision, several insurance terms are defined and explained below.

8.1. AUTOMOBILE INSURANCE COVERAGE

We begin with a general description of the insurance coverage. We note that throughout this discussion of the insurance coverage, the term “insured” is generally used to mean the family of the owner of the policy, as well as any passengers or other drivers using the car with the owner’s permission.

Third Party Liability (TPL) There are two parts to this mandatory coverage:

Bodily Injury (BI) coverage protects the insured against liability arising from an accident that causes bodily injury to another person. Coverage amounts available in Alberta range from the legal minimum of $200,000 per claim to well over $2,000,000 per claim.

Property Damage (PD) coverage protects the insured against liability arising from an accident that causes damage to the property of another person.

Accident Benefits (AB)
This coverage provides for such items as reimbursement of lost income, medical care costs, and funeral costs; it also provides benefits to the dependants of a deceased insured.

Underinsured Motorist (UIM)
This optional coverage protects the insured if he or she is caused bodily injury by an at-fault driver who is insured, but who does not have sufficient insurance to cover the liability; in this case the insured collects, from his or her own insurer, the amount of the damage that is in excess of the at-fault driver’s liability coverage and up to the limit of UIM coverage purchased.

Collision
This optional coverage generally provides coverage (subject to a deductible) for damage to the insured’s vehicle arising out of a collision.

Comprehensive
This optional coverage generally provides coverage (subject to a deductible) for damage to the insured’s vehicle arising out of a peril other than collision (e.g., theft, vandalism, flood, hail, fire, etc.).

All Perils
This optional coverage combines the coverage for both collision and comprehensive into one coverage, subject to a common deductible level.

Specified Perils

This optional coverage, like collision and comprehensive, provides coverage (subject to a deductible) for specific perils to the insured's vehicle.

8.2. OTHER TERMS

Accident Year

The year in which an incident that gives rise to a claim occurred, regardless of when the claim is actually reported to an insurance company. For example, a claim reported on January 15, 2003 for injuries suffered in an automobile accident that occurred on December 15, 2002, is considered to be an accident year 2002 claim.

Allocated Loss Adjustment Expense (ALAE)

ALAE is the claim and settlement expense that can be associated directly with individual claims (e.g., legal expenses). (See ULAE)

Base Rate and Rate Differentials

Insurers generally determine the premium for a particular insured by multiplying a base rate by a series of rate differentials (or rate factors, or rate relativities) that reflect the particular characteristics of the insured. The terms rate differentials, rate factors and rate relativities are used interchangeably. Typically, there is one base rate for each combination of coverage and rating territory. For example, assume a base rate for the TPL coverage of $200 in Territory #1 and a base rate for the TPL coverage of $300 in Territory #2. Also assume the rate differential for a married male driver, age 40, is 1.25. The TPL premium for this driver would be $250 in Territory #1 ($200 times 1.25) and $375 in Territory #2 ($300 times 1.25).

Case Reserve

The Case Reserve is the provision established by insurance companies for the payment of future losses and claim related expenses associated with a particular claim.

Claim Frequency

Claim Frequency is the average number of claims that occur in a year, per insured vehicle. Claim frequency is a measure of the incidence of automobile claims. For example, if an insurance company provided insurance on 100 vehicles in year 2002 and 5 TPL claims occurred during 2002, the company's TPL claim frequency for 2002 would be 5 percent.

Claim Severity

Claim Severity is the average reported incurred loss and ALAE per claim. Claim severity is a measure of the average cost of automobile claims. For example, if the 5 claims in the previous example resulted in a total incurred loss and ALAE of $100,000, the claim severity would be $20,000.

Claim Count Development

Claim Count Development refers to the change in the number of reported claims for a particular accident year over time. (See Loss Development)

CLEAR

CLEAR refers to Canadian Loss Experience Automobile Rating, a system of categorizing Private Passenger vehicles, by make and model-year, for physical damage coverage rating purposes. CLEAR was developed by the Vehicle Information Centre of Canada (VICC), a part of the Insurance Bureau of Canada. CLEAR considers such elements as the repairability and damageability of the make and model-year. (See MSRP)

Combined Ratio

Combined Ratio is another common measure of premium adequacy. This is the sum of the loss ratio plus the expense ratio (operating expenses divided by written premium). A combined ratio in excess of 100 percent is an indication of premium inadequacy, before consideration of profit and investment income.

Earned Premium

Earned Premium is the amount of written premium that is associated with the portion of the policy term that has expired. For example, assume an automobile policy with a 12-month term is sold on January 1 for $1,000. The amount of earned premium would be $500 on June 30

Exposure Unit

A measure of loss potential. In Private Passenger automobile insurance, the exposure unit that is commonly used is the number of insured vehicles. For example, all else being equal, it would be expected that the cost to an insurance company to insure 50 cars would be twice the cost to insure 25 cars.

Health Services Levy

As per Provincial legislation, a levy is paid by each insurer to achieve a target amount set by Government. IBC calculates and provides the level as a percentage of earned third party liability premiums. Under the legislation, the Government has no subrogation rights against the at-fault parties who are insured by policies of TPL insurance; but instead, collects the levy.

Loss Cost

Loss Cost is the average incurred loss and ALAE in a year per insured vehicle. The loss cost is the product of claim frequency and claim severity. Using the above example, a claim frequency of 5 percent, multiplied by a claim severity of $20,000, produces a TPL loss cost of $1,000.

Loss Development

Loss Development is the amount by which reported incurred losses and ALAE for a particular accident year change over time. The two main reasons why reported incurred losses and ALAE amounts change (or develop) over time are:

a) Reported incurred losses and ALAE only include case reserve estimates on claims for which the claim adjuster has knowledge, i.e., case reserves are only established on the claims that have been reported to the insurance company. Since typically some period of time elapses between the time of the incident and when it is reported as a claim, the number of reported claims for an accident year would be expected to increase over time. Claims that are reported after the close of an accident year are referred to as “late-reported” claims; and

b) Reported incurred losses and ALAE also develop because, for a number of reasons, the initial case reserves established by claims adjusters, can not fully and accurately reflect the amount the claim will ultimately settle at. This pattern of under-reserving and over-reserving is common within the insurance industry (although the degree to which reported incurred losses and ALAE are under-reserved or over-reserved varies by company, jurisdiction, line of business, etc.). We further note that, over time, the percentage by which reported incurred losses and ALAE develop for a given accident year should decline. This is because as accident years become more mature (i.e., become older), fewer and fewer reserve estimates are adjusted to reflect newly reported late claims, actual payments, and additional information that becomes available to the claims adjuster.

Loss Ratio
Loss Ratio is defined as reported incurred losses and ALAE divided by earned premium. This is the common measure of premium adequacy. A loss ratio that exceeds a company’s break-even loss ratio (100 percent less budgeted expenses) would suggest premium inadequacy.

Loss Reserving Methods: Incurred Loss Method and Paid Loss Method
Loss reserving methods are often based on historical data grouped into a triangle format. A common approach is to have the rows represent the accident years, and the columns representing the value of the loss at specific dates, such as 12 months, 24 months, 36 months etc., from the beginning of the accident year. The historical changes in the loss data from period to period is reviewed to estimate a pattern to predict how current accident years losses will change over time as claims are settled and closed. The Incurred Loss Method refers to the triangle method of analysis, based on reported incurred losses. The Paid Loss Method refers to the triangle method of analysis, based on paid losses.

MSRP
MSRP refers to the Manufacture’s Suggested Retail Price, and is a system of categorizing Private Passenger vehicles, by make and model-year, for rating purposes for physical damage coverages, according to the original price of the vehicle. (See CLEAR)

Operating Expenses
Insurance company expenses, other than ALAE and ULAE, are typically categorized as Commissions, Other Acquisition, General, Taxes, Licenses, and Fees.

Paid Losses

The total aggregate dollar amount of losses paid on all reported claims as of a certain date.

<u>Premium Drift</u>
Premium Drift is a more general term, and refers to the changes in the amount of premium collected by insurance companies that is attributed to the purchase of newer and more expensive cars (i.e., rate group drift) as well as to changes in the amount of insurance coverage that is purchased (e.g., the purchase of higher limits of liability coverage would increase the amount of premium collected by insurance companies, while the purchase of higher physical damage deductibles would reduce the amount of premium collected by insurance companies). (See Rate Group Drift)

<u>Rate Group Drift</u>
Rate Group Drift refers to the amount of additional premium collected by insurance companies that is attributed to the purchase of newer and more expensive cars by insureds. The premiums charged by insurance companies are higher for newer and more expensive cars. Therefore, as insureds purchase newer and more expensive cars, the amount of premium collected by insurance companies increases. (See Premium Drift)

<u>Ratemaking Methods: Pure Premium Method and Loss Ratio Method</u>
The Pure Premium Method of ratemaking develops indicated rates that are expected to provide for the expected losses and expenses, and provide for the expected profit.
The Loss Ratio Method of ratemaking develops indicated rate changes rather than indicated rates.

<u>Rating Territory</u>
Automobile premiums vary by the principal garaging location of the vehicle. Based on Insurance Bureau of Canada's automobile statistical plan, Alberta is currently divided into three areas, or rating territories, of principal garaging location; and, therefore, has three separate sets of rates depending upon which of the three territories the vehicle is principally garaged. (see Statistical Territory)

<u>Reported Incurred Loss</u>
The sum of:

(a) the total aggregate dollar amount of losses paid on all reported claims as of a certain date (referred to as the valuation date), and

(b) the total aggregate dollar amount of losses set in reserve by the claim adjusters on each open claim (referred to as "case reserves") as of a certain date (the same evaluation date as for the paid loss amounts).

For example, if two claims were filed against an insurance company, one that settled for $50,000 and the other that was open with a paid amount of $25,000 and a "case reserve" (i.e., the claim adjuster's estimate of the dollars still to be paid on the claim) of $30,000, then the total reported incurred loss on the two claims would be $105,000 (the sum of $50,000, plus $25,000, plus $30,000).

Reserve
A Reserve is the aggregate provision identified by an insurance company for the payment of future losses and claim related expenses associated with claims that have been incurred.

Surplus
The excess of the assets of an insurance company over its liabilities.

Statistical Territory
Automobile premiums vary by the principal garaging location of the vehicle. Alberta is divided into four statistical territories, of principal garaging location. Specific statistical territories are grouped together to represent a specific rating territory. In some cases there is one statistical territory in a rating territory, in other cases the rating territory is comprised of two or more statistical territories. (see Rating Territory)

Total Return on Equity
Total Return on Equity (ROE) refers to an insurer's profit as a percentage of its surplus, where profit is the sum of (a) underwriting profit, and (b) investment income earned on both the underwriting operations of the company and on the surplus carried by the company.

Underwriting Profit
Underwriting Profit is defined as earned premium, less reported incurred losses and ALAE, less ULAE, less operational expenses.

Underwriting Profit Margin
Underwriting Profit Margin is the provision that is included in the insurance premium for underwriting profit to be earned by the company.

Ultimate Incurred Loss
An estimate of the total amount of loss dollars that will ultimately be paid to settle all claims that occur during a particular accident year.

Written Premium
Written Premium represents the total amount of premium charged by an insurance company for the insurance policies it has sold. It is generally measured over a one-year period.

Unallocated Loss Adjustment Expense (ULAE)
ULAE is the claim and settlement related expense that cannot be associated directly with individual claims (e.g., claim adjuster salaries). (See ALAE)