



133 Richmond St. W., Suite 401, Toronto, ON, Canada, M5H 2L3  
Tel: 416 368-0777, Fax: 416 363-7454  
msaresearch.com

October 31, 2006

William T. Moore  
Acting Executive Director  
Alberta Insurance Rate Board  
200 Terrace Building 9515 – 107 Street  
Edmonton, Alberta T5K 2C3  
Canada

Dear Mr. Moore:

I'm pleased to enclose a pdf of the powerpoint slides I intend to use during my presentation to the AIRB on November 10<sup>th</sup>, 2006. I will be the only presenter from MSA.

As discussed, my presentation will focus on external analytical views of the Alberta private passenger auto environment. The presentation addresses rating agency views and our own perspectives.

I will be using PowerPoint and will require a projector.

Sincerely,

Joel Baker  
President & CEO

# An External Analytical View

*Presentation to the  
Alberta Insurance Rate Board  
Calgary, November 10<sup>th</sup>, 2006*



*Joel Baker – President and CEO, MSA Research Inc.*

# Background

- MSA Research Inc. is a Canadian, independent analytical research firm that is focused on the Canadian insurance industry.
- Founded by Joel Baker in 2004.
- Prior to MSA, Joel was General Manager of A.M. Best Canada Ltd.
- Prior to that, Joel was G.M. of the Canadian rating agency, TRAC Insurance Services Ltd.

# Sources & Conventions

- Unless otherwise specified...
  - The financial data contained in this presentation originated from MSA's analytical databases.
  - Auto results include both commercial and private passenger (Lloyd's data was excluded).
  - Results are presented on a calendar-year (accounting) basis. Thus losses for any given period include development on prior-year claims.

# Outline of Presentation

- Rating Agency Perspectives
- View from MSA
- Historical and Recent Results
- Alberta Auto Contributions as a % of Non-Government Auto in Canada
- Big Groups Gaining Share
- Potential Areas of Concern for AIRB, Alberta Finance and Driving Public.

# Rating Agency Perspectives

- For most insurers, Alberta Auto (AA) represents a small part of their overall portfolio.
  - While performance of this book is important in the rating review, in most cases deterioration in AA will not, on its own, trigger a rating downgrade on large national players.
  - Agencies attempt to rate ‘Through the Cycle’.
  - However...

# Rating Agency Perspectives

- ...However
  - Exposure to the uncertainties emanating from Alberta's auto regime are certainly a concern for agencies, particularly for companies that are heavily exposed to that market.
  - Only one Alberta-based insurer is currently rated. Rating reflects its overweight exposure to AA.

# Rating Agency Perspectives

- Quotes from the two main agencies:

- Standard & Poor's: *“The Alberta government's premium grid, which was designed to bring about more affordable and available auto insurance for young and inexperienced drivers, does not reflect the economic reality for this driver class.”*
- A.M. Best remains concerned about the effects that recent regulatory changes to the Alberta automobile insurance product will have upon long-term profitability.”

Excerpt from an A.M. Best press release from December 8, 2005

- *“These strengths are partially offset by... rate restrictions imposed by regulators on the automobile insurance product in most provinces in Canada...”*

Excerpt from an A.M. Best press release from June 13, 2006.



# View from MSA

- Concerns:

- Current regime appears uncertain and unstable:

- Declining cap on revenue, while claim costs are less contained.
- Non grid risks are penalized while riskier drivers benefit from grid caps.
- Un-paralleled size of risk sharing pools (particularly in the grid). Both RSP's currently account for about 22% of premiums (or 13.9% of private passenger vehicles – this is expected to decline slightly in the mid-term).

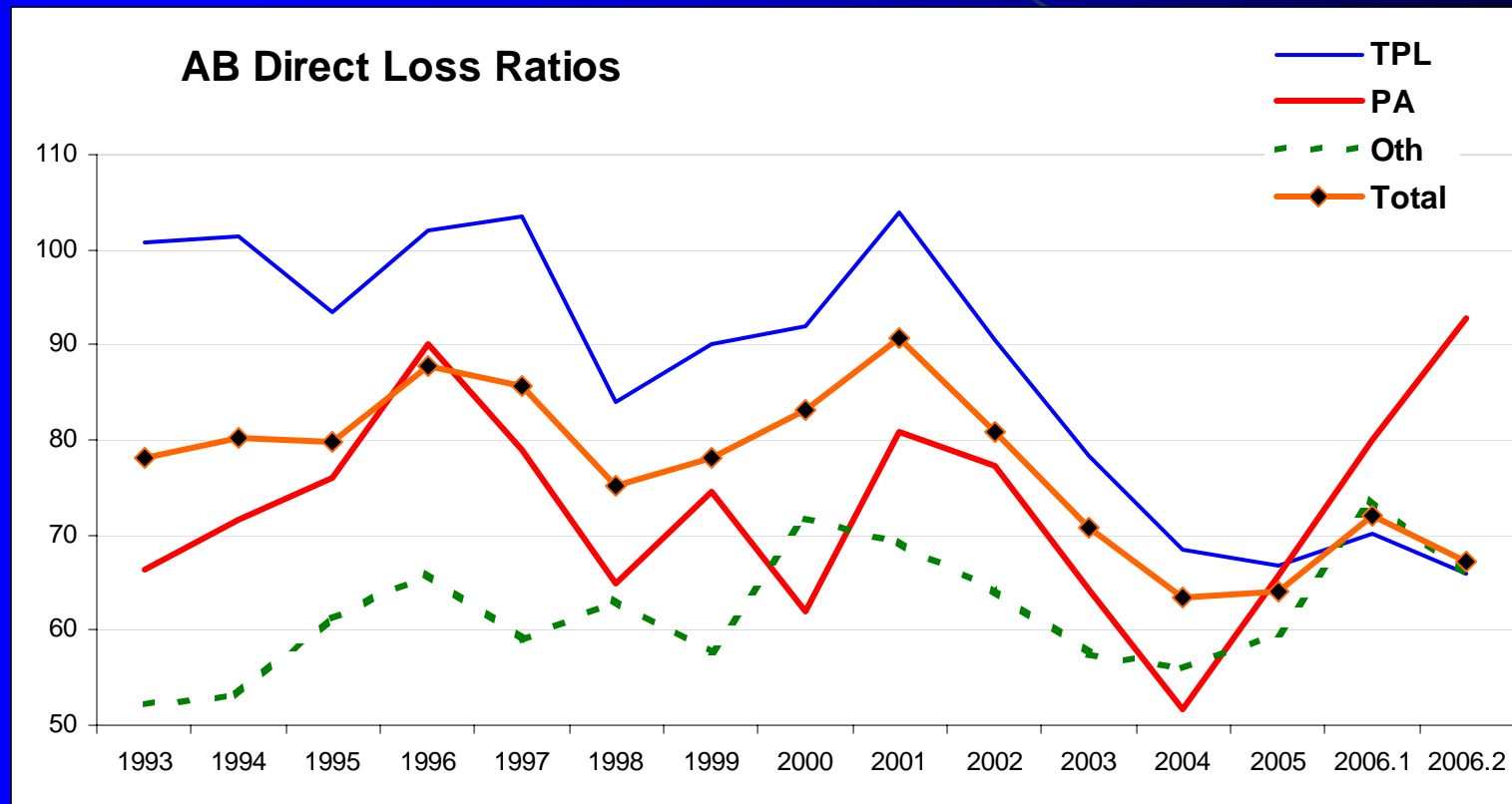
Implications:

- RSP's will grow further if results deteriorate.
- Overpopulation of RSP's typically indicate unhealthy market conditions.
- Carriers lose control of their 'pen' under take-all-comers.
- Economic distortions are introduced.

# View from MSA

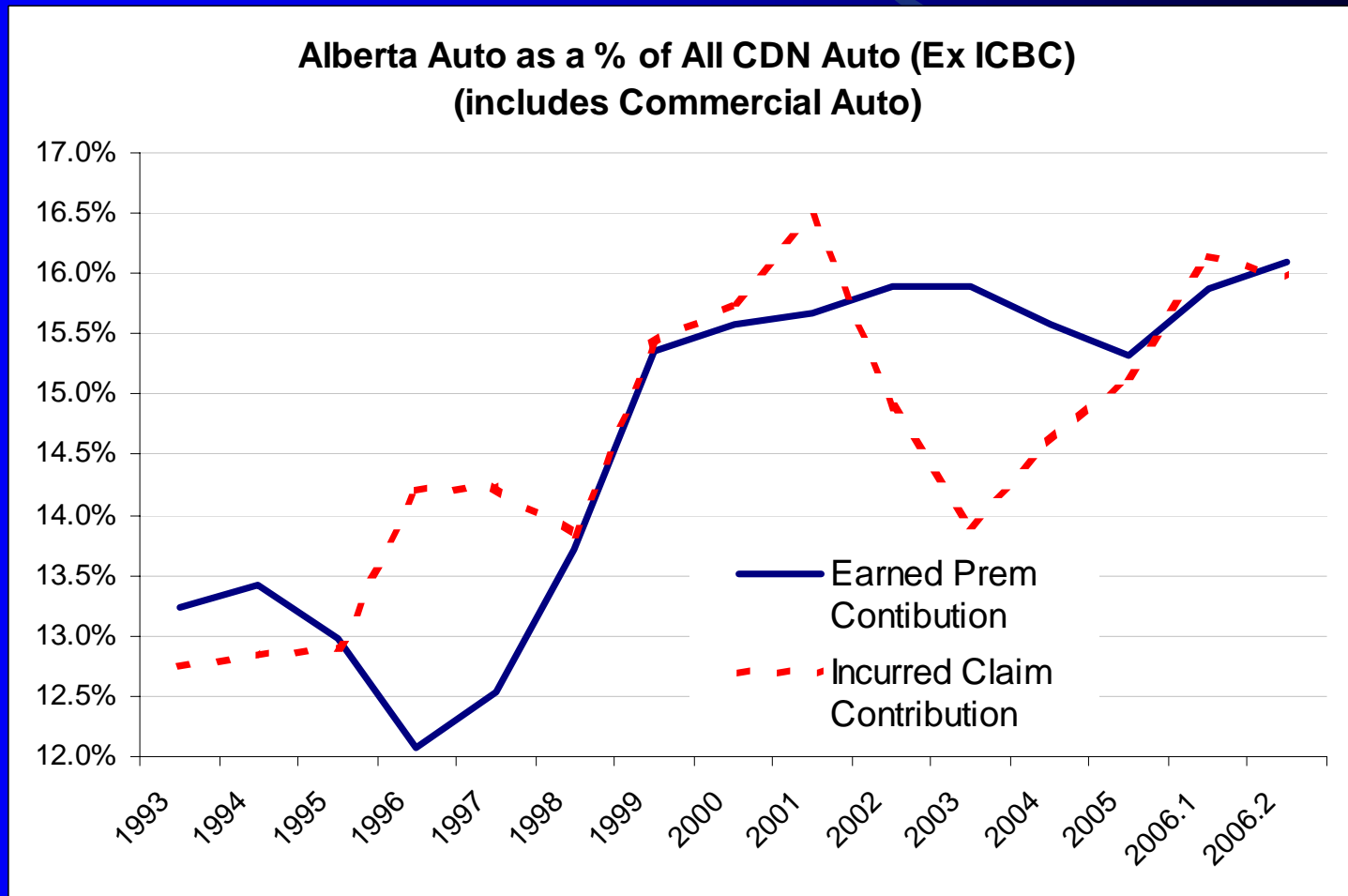
- Concerns (continued):
  - ROE targets - Cost of capital very difficult to determine
    - Product immature and experience evolving.
    - Conflict with prudential capital requirements (MCT/BAAT).
    - If set, should be viewed over a cycle and not annually.
    - Investment yields must be taken into account.
    - Capitalization levels and capital provider requirements vary widely by company types (mutuals vs. stock)
    - Difficult to translate ROE target to loss ratio/combined ratio target.
  - Charter Challenges – Financial Impact, Rating Impact.
  - Philosophy of model.
  - Sustainability of model.

# All Quiet For Now (Almost)

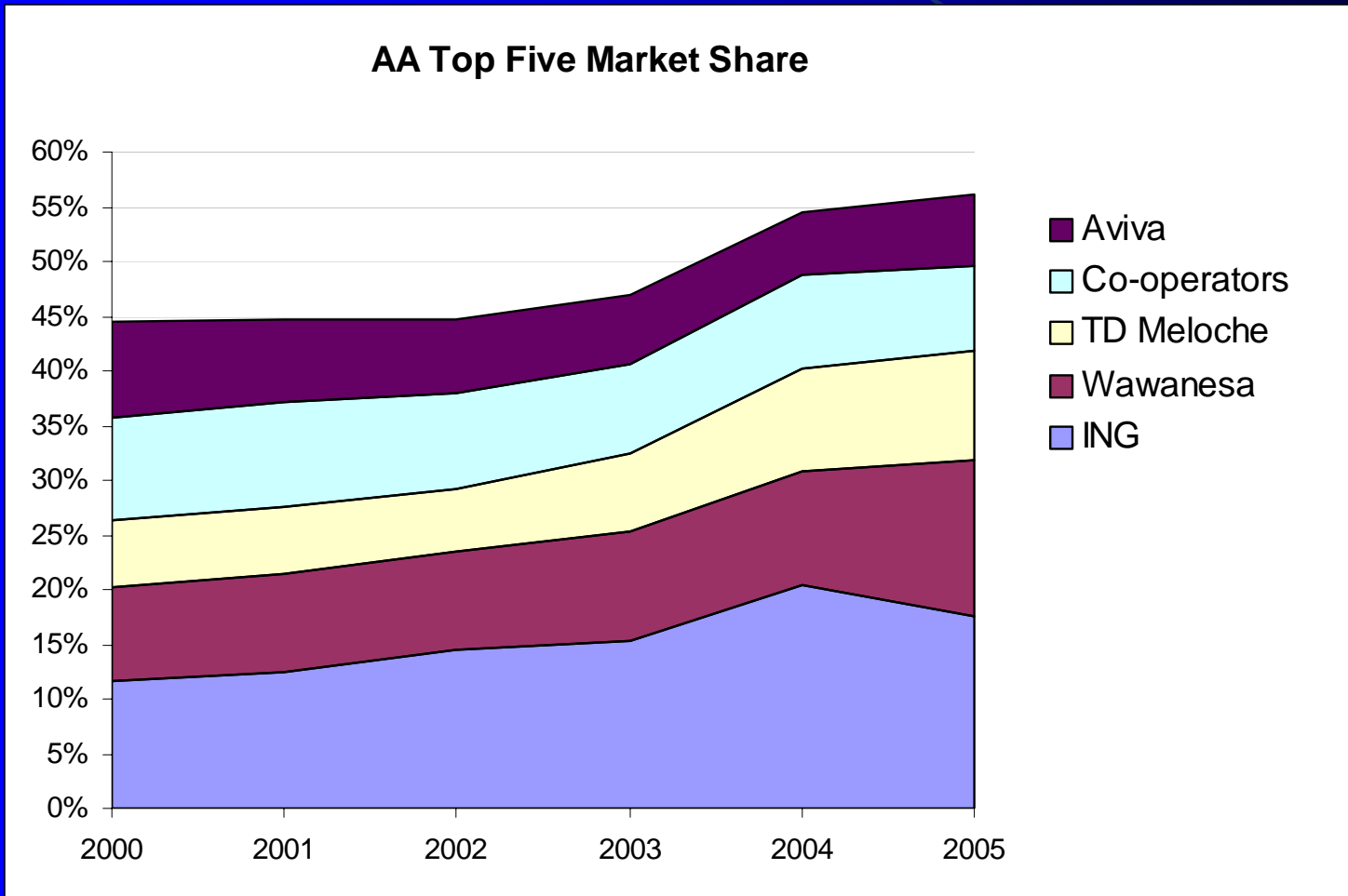


# Give and Take - Alberta Auto Premium and Claim Contributions to Total Canadian Auto.

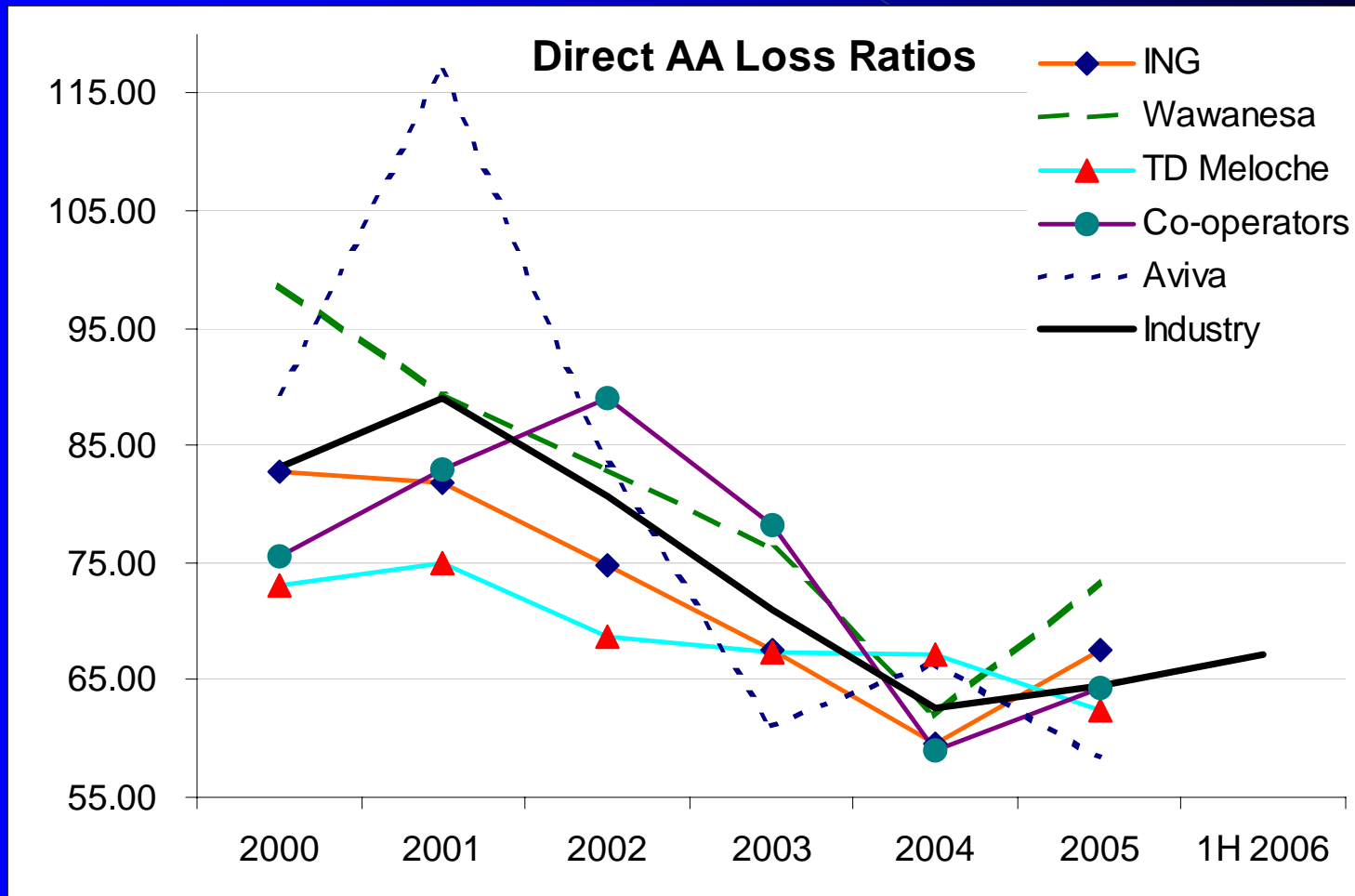
Over the period 1993 - 1H 2006 it is a wash.



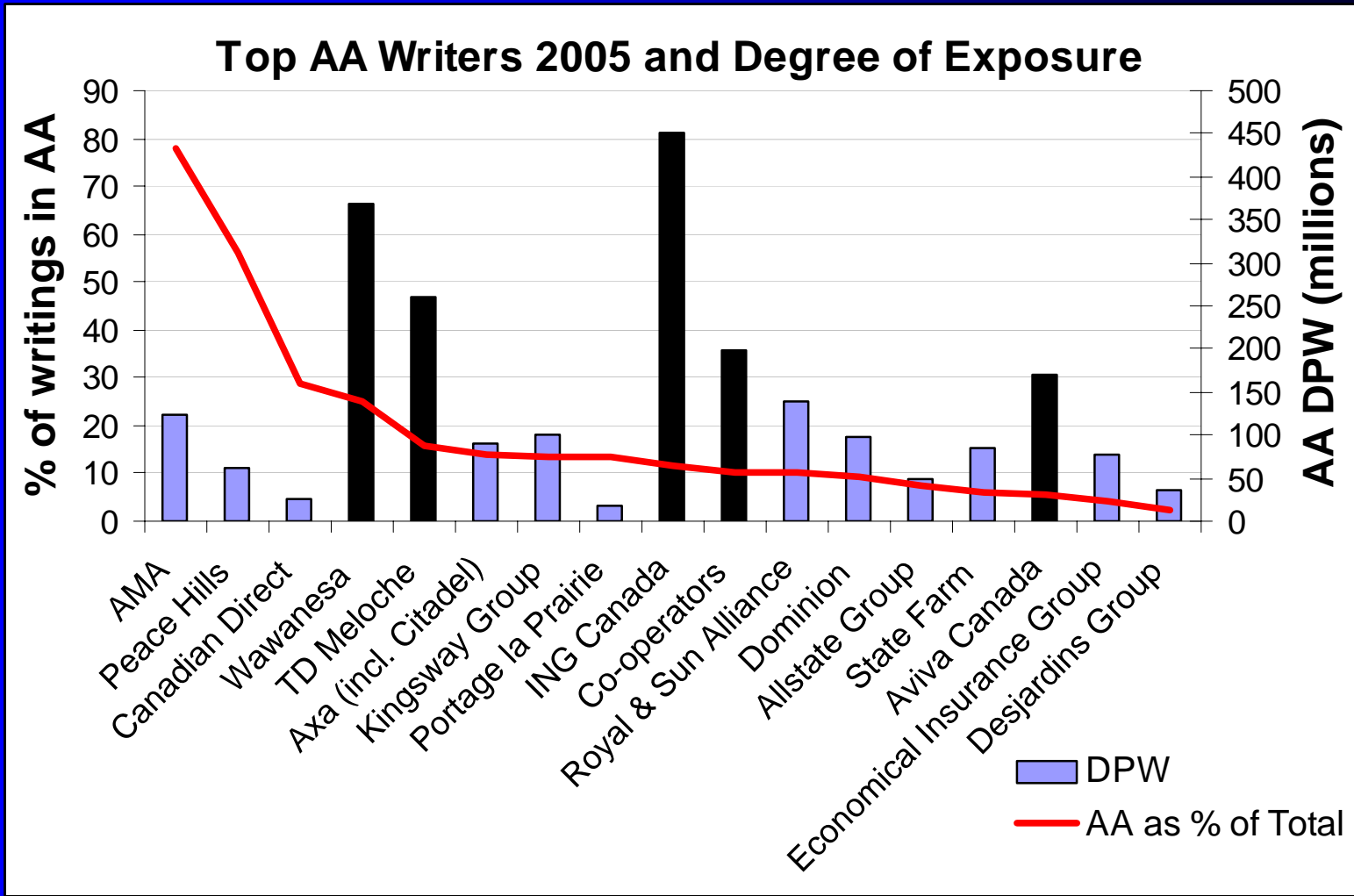
# Big groups on the march.



# Performance of Top Five Groups



# Skin in the game



# Potential Areas of Concern for AIRB, Alberta Finance and Driving Public.

- Regime currently is in what is known as “honeymoon stage”.
  - Profitability in the period following radical reform typically over-states long-term profitability as market forces adjust to new reality.
  - Early data is “too green” for effective or accurate actuarial forecasting.



# Potential Areas of Concern for AIRB, Alberta Finance and Driving Public.

- Reduction in competition/participation:
  - If prospective risk-weighted returns are unattractive and the perceived, or real, regulatory risks and risks of participating in the RSP's are too high, insurers will hesitate to come into the market or work to reduce their exposure there. 55% of the market is already controlled by the large five. Several insurers have reduced their participation or have effectively withdrawn.

# Potential Areas of Concern for AIRB, Alberta Finance and Driving Public.

- Claims inflation:

- Claims inflation can arise from various sources:

- Increased frequency.
- Higher-end vehicles 'fueled' by oil boom.
- Increased cost of repairs due to labour shortages.
- Potential, albeit unproven, for less stringent claim handling for Grid/RSP business.
- Fraud.

# Potential Areas of Concern for AIRB, Alberta Finance and Driving Public.

- Downturn will adversely affect local carriers:
  - If overall results, grid results, or FA results deteriorate, locally based insurers will feel the pain disproportionately.
  - In extreme, but not far-fetched, scenarios, their solvency or independence could be put at risk.



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