

CANADIAN BAR ASSOCIATION

Economica Ltd. Report June 16, 2008

Background

In 2003 - 2004, insurance companies dramatically increased car insurance premiums charged to Albertans. Insurers blamed rising injury claims. They lobbied the Alberta government to pass a law limiting injury claims.

In October 2004, the Alberta government introduced the *Minor Injury Regulation* limiting Albertans' access to justice by placing a \$4,000 cap on damages for pain and suffering for some injuries.

On February 8, 2008, Associate Chief Justice Wittmann struck down the cap, finding that it violated equality rights under the Canadian Charter of Rights and Freedoms. The Alberta government has appealed that ruling.

A report by the independent research organization Economica Ltd., a respected Alberta economics firm, analyzes and presents findings in four areas: profitability of the insurance industry; trends in injury claims costs; the reason for the dramatic increase in insurance premiums; and the effect on premiums with the removal of the cap.

Economica Ltd. was retained by the Canadian Bar Association.

Summary

1. The insurance industry is profitable

- Before the Cap, between 1996 and 2004, insurers made a profit from auto insurance in Alberta in every year (p5).
- Before premiums increased in 2003, the average yearly profit was about \$90 million, or a 7.4% return after tax (p5).
- In the first year premiums went up in 2003, profits were almost \$300 million, or a 23.4% return after tax (p5).
- From 2003 to 2006, average yearly profits have been \$368 million, or a 25% return after tax (p5). That is an extra \$278 million per year in profit compared to the 7 years before premiums increased.

2. Claims were not out of control

- Between 1996 and 2002, before premiums went up, injury claims costs did not vary significantly as a percentage of total expenses or total premiums (p11).
- Before premiums went up in 2003, premiums were keeping pace with claims costs (p12).
- Claims costs per vehicle and injury claims in particular, adjusted for inflation, have been declining since 2000, starting before the premium increase (p16).

3. Insurers increased premiums to increase their profits

- Premium increases starting in 2003 cannot be explained by changes in administrative costs or rates of return on insurer investments (p19-20).
- The only explanation for the dramatic increases in premiums starting in 2003 was that insurers wanted to make more than the \$90 million per year (7.4% return after tax) profit that they had been making (p23).
- The government's Alberta Insurance Rate Board considers a 9.5% return after tax on mandatory coverage to be reasonable (p22).
- A number of different sources suggest a 12.75% return after tax to be a reasonable profit for auto insurers (p22).
- Since premiums started going up in 2003, Alberta insurers have reported the following profits: 23.4% (2003), 27.1% (2004), 27.8% (2005), and 21.9% (2006) (p5).

4. Premiums need not increase without a cap

- Without the cap, if premiums do not change insurer profits will be about a 16% return after tax (12.2% on basic coverage) using 2006 data and assumptions (p26).
- Without the cap, the average premium would have to increase by \$112 per year on all coverages, if insurers are to keep making profits of more than a 20% return after tax (p25).

5. Notes

The Economica Ltd. report uses the same method of analysis used by an industry expert retained by the insurance industry to give expert evidence at the Charter trial. Economica Ltd. used only published insurance industry information.