Alberta's Vehicle Insurance Options

By

Jack M. Mintz
School of Public Policy
University of Calgary

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Executive Summary

1. Alberta has grappled with auto insurance premiums for over two decades. To curb increases, it has undertaken many reforms such as introducing the command-and-control Grid rating system, caps on premium increases, no-fault insurance for compensation for property damage and a limit on insurance premium increases for good drivers. Price caps fail in curtailing increases over time. Limits such as no-fault insurance come at the expense of reducing compensation that would otherwise be paid under a tort system.

2. Since automobile insurance is mandatory, it is perhaps not surprising that the Alberta government has become so involved with premium regulation. Insurance is a relatively minor expenditure for households (about 2 percent of average consumer expenditure) compared to food, shelter, non-insurance transportation and taxes. Still, it can be a significant burden for low-income households who must buy insurance (that issue could be dealt with by other policies such as low-income tax credits rather than complex price regulations).

3. Regardless, rising auto insurance costs due to inflationary pressures including litigation costs, bodily injury costs, income replacement costs, car repair costs, and auto thefts have put pressure on the Alberta government to respond given its rate setting role.

4. Reform options should be carefully evaluated in terms of economic efficiency, fairness and financial stability of the industry. Economic efficiency would require insurance policies to minimize moral hazard and adverse selection costs. The use of deductibles, co-payments and experience-rating are policies that help minimize costs. So does the right for non-fault drivers to sue for compensation.

5. Several options for reform are considered in this paper.

    a. A shift to a monopolistic non-profit government-operated insurance system looks tantalizing in reducing costs. However, as BC has shown, premiums can be higher as than private insurance markets and the lack of competition can impact service delivery over time. Generally, public provision of auto insurance is less efficient than private provision in many industries as studies have concluded over the years.

    b. Price caps distort pricing and leads to financial instability when insurance companies cannot earn sufficient profits to maintain capital investment. Freezing insurance premiums, even temporarily, is ill-advised since it will lead to higher premium hikes in the future. Their negative impact on the availability of coverage – due to either insurer withdrawal or sales restrictions – forces many drivers to find new, often more expensive coverage, elsewhere in the market.

This situation makes the policy intent of price caps ultimately self-defeating. The Grid used by Alberta includes various price caps to protect certain drivers from higher insurance premiums, but this comes at the expense of other drivers who have to bear higher premiums such as good drivers. It is complex to administer and distorts prices. Both the rate cap and Grid should be abolished immediately.

c. No-fault insurance can reduce costs by reducing litigation and ease the compliance associated with determining fault. However, as the comprehensive 2011 Rand study has shown for U.S. states, costs need not stay low in the longer run as no-fault insurance can lead to fraudulent behaviour to push up claims and increase medical costs as well reduce the incentive for safe driving. No-fault insurance is also unfair if the insurance benefits are established that only provide partial compensation to persons and property injured in an accident.

d. A hybrid system of no-fault insurance and tort insurance is best option that would maintain fairness as well as improve efficiency without compromising financial instability. In particular, no-fault insurance makes sense for minor claims for compensation when litigation, administrative and compliance costs are more than or a large portion of the value of compensation benefits. The right-to-sue should be available for more significant claims involving death, impairment and lost income particularly.

6. Rather than the Alberta government controlling auto insurance pricing or adopting no-fault insurance for most claims, it should let the competitive insurance markets set competitively determined contracts with drivers. Instead, the Alberta government could require some minimum conditions such as experience-rating, basic insurance benefits and the use of deductibles and co-payments in an effort to better influence premium levels for drivers. It could also limit tort insurance when the costs are in excess of the compensation benefits. Otherwise, it should let insurance companies compete for customers with contracts that offer consumer choice that vary by price and benefits.

7. If Alberta wants to take leadership in reducing auto premiums, it should consider reducing the insurance premium tax of 4 percent to at least 3 percent or abolish it altogether.

In recent years, Alberta has reviewed and amended its automobile insurance regulations with the aim of lowering costs. The typical approach is to limit tort claims as a means of reducing litigation costs although the province has at times resorted to rate freezes or other reforms that limit insurance premiums for certain categories of drivers. Other options have been suggested such as no-fault insurance for care, benefits and compensation following bodily injuries. Even moving towards a monopolistic public-operated insurance plan has been suggested following the approach used other three Western provinces.

Putting premium cost in perspective, it is somewhat surprising that automobile insurance is a hot political issue for a government compared to other affordability issues. The average written auto premium for 2021, for example was $1578[1], which is only 2.1 percent of average household consumption expenditure in Alberta. Compared to income taxes, housing, food, and even non-insurance transportation expenses, auto insurance payments pale by comparison.[2]

Nonetheless, affordability issues have put pressure on governments to reduce auto insurance premiums. Passenger vehicle insurance premiums in Alberta have risen 5.8 percent this past year (as of August 2024 year over year) and 21.3 percent since August 2020.[3] Low-income drivers have difficulty paying for insurance that is mandatory. Since governments are highly involved with auto insurance regulation, voters assume that governments are responsible for the operation of the market and insurance pricing.

In this paper, I will discuss the policy issues related to insurance provision. I will first provide an analysis of inflationary trends in the Alberta auto insurance market impacting on premiums, the number of companies competing in the market and some comparisons with other provinces and recent experiences in Alberta's regulatory system. I will then turn to potential reforms including public provision of automobile insurance, no-fault insurance, tort reforms and other options to reduce costs and ensure a competitive insurance industry. I will suggest that tort reforms are minimally disruptive and the best approach to improve efficiency, fairness and financial stability in regulatory reform.

Alberta's Auto Insurance System

The auto insurance industry in Alberta is competitive with 37 companies offering their product to drivers. Basic Insurance is required for direct compensation for property (collision damage to the vehicle and personal property at the fault of another), third party liability (injuries and death) and accident benefits (loss of income, medical treatment, funeral costs and death benefit). The province regulates the maximum insurance rate to be charged for basic insurance with the aim of providing a sufficient return to the insurance company.

Consumers may elect to have additional insurance benefits. These include collision costs for the driver at fault, comprehensive insurance (damage due to fire, theft, vandalism etc.) and glass.

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[1] Based on industry data from GISA Exhibits AUTO1005-AB and AUTO0003-AB.

[2] In 2021, the average Albertan spent $75,028 on goods and services of which shelter was $24,609, food was $11,929 and transportation $10,879. Income taxes were $20,300. See Statistics Canada, https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1110022201.

[3] See consumer price index for private insurance for transportation in Alberta, Statistics Canada, https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810000407&pickMembers%5B0%5D=1.23&cubeTimeFrame.startMonth=08&cubeTimeFrame.startYear=2024&referencePeriods=20240801%2C20240801.

For over two decades, the Alberta government has undertaken policy reforms to curtail rising insurance premium costs faced by drivers over the years. As illustrated in Table 1, the average written premium has cumulatively risen 50 percent from $1143 in 2013 to $1670 in 2023. As this is faster than the Alberta consumer price index (32 percent), real insurance premium costs have risen by 18 percent. The average increase in insurance premiums has been 4.1 percent and the inflation-adjusted increase in prices (1.1 per cent).

While insurance premium costs have risen faster than general inflation, they have not risen as fast as claim costs (84 percent over 11 years for an average increase of 6.3 percent), and bodily injury claim costs (116% over the period and 8 percent on average). These costs obviously put pressure onto the premium costs. However, there has been a reduction in the frequency of claims that have offset some of the inflationary impact of claim costs on insurance profitability. Frequency of claims have diminished during the period 2013-2023 (an annual average of -3.3 percent for bodily injuries, -1.2 percent for accident benefits, -2.6 percent for property damage, -6.8 percent for collision and -1.3 percent for comprehensive claims). However, as shown in Table 2, loss costs (frequency times the average claim size) have risen especially for bodily injury and accident benefits (only collision loss cost has fallen in the same period). Overall, rising loss costs has been a significant factor influencing insurance premiums.

Table 1: Alberta Average Premiums, average clam size and bodily injury claim size

Year	Avg. Written Premium	Avg. Claim Size	Avg. Bodily Injury Claim Size
2013	$1,113	$7,785	$46,358
2014	$1,153	$8,246	$49,319
2015	$1,179	$9,001	$55,957
2016	$1,206	$9,218	$61,064
2017	$1,252	$9,976	$63,084
2018	$1,316	$10,504	$70,403
2019	$1,407	$11,260	$76,647
2020	$1,523	$11,961	$85,719
2021	$1,578	$12,421	$87,868
2022	$1,586	$13,404	$96,892
2023	$1,669	$14,287	$100,027
Annual Change	**4.1%**	**6.3%**	**8.0%**
10-Year Change	**50%**	**84%**	**116%**

Source: IBC analysis based on industry data from GISA Exhibits AUTO1005-AB and AUTO0002-AB.

Table 2 Loss Cost by Category for the years 2013 to 2023

Year	Bodily Injury	Accident Benefits	Property Damage	Collision	Comprehensive	Total
2013	$295	$42	$166	$245	$168	$916
2014	$314	$41	$168	$252	$187	$966
2015	$357	$51	$170	$252	$191	$1021
2016	$383	$52	$158	$248	$255	$1096
2017	$414	$62	$173	$275	$174	$1098
2018	$448	$66	$176	$283	$175	$1148
2019	$493	$73	$170	$273	$170	$1179
2020	$368	$60	$116	$187	$265	$996
2021	$397	$74	$135	$196	$191	$993
2022	$438	$91	$186	$255	$207	$1177
2023	$453	$91	$223	$215	$234	$1216
10-year change	**54%**	**117%**	**34%**	**12%**	**39%**	**33%**
Annual change	**4.4%**	**8.0%**	**1.2%**	**-1.3%**	**3.4%**	**2.9%**

Source: IBC analysis based on industry data from GISA Exhibits AUTO1005-AB and AUTO0002-AB.

The profitability of auto insurance companies reflects not only premium revenues and loss costs but also expenditures related to administration (salaries, office expenditures, training and regulatory costs), information technology, marketing and renewal costs and the insurance premium tax of 4 percent. The Wyman report estimates these taxes add up to 25.6 percent of direct premium costs.[4] These expenses would imply an additional cost of providing insurance roughly equal to $450 in 2023, for example.

In Table 3, the return to equity is reported for Alberta insurance and compared to the average return to equity for the six provinces with a privatized insurance industry. While the return to equity has changed little for the industry in the six provinces, the return to equity in Alberta has been abysmal. The average rate of return on equity has been *negative* 1.2 percent over years 2012-2022 and 0.5 percent for the past six years (the only two years with reasonable returns were in 2021 and 2022). It is therefore not surprising that auto insurance companies are exiting the Alberta market with 10 leaving since 2013 by 2022. In 2024, three have announced that they are leaving the market due to rate caps and poor profitability (as discussed further below).

[4] Averaged 2018 to 2022. See O. Wyman, Feasibility Study of Long-term Auto Insurance Reforms", https://open.alberta.ca/dataset/6a9575f8-eed8-4773-8f2e-93325ba68a04/resource/f75ae36c-1721-4b64-af69-b882750b73d6/download/tbf-auto-insurance-changes-in-alberta-2024.pdf.

Table 3: Number of Companies and Rate of Return to Equity for Alberta Auto Insurance Companies 2013-2022. 2023 not yet available.

Year	Rate of Return to Equity: Alberta	Rate of Return to Equity: GISA Jurisdictions*	Number of Companies
2013	-2.9%	6.0%	48
2014	0.0%	7.8%	46
2015	-0.8%	5.5%	47
2016	-12.7%	2.7%	45
2017	-5.20%	2.8%	43
2018	-6.4%	0.6%	45
2019	-4.0%	1.3%	47
2020	1.1%	8.5%	45
2021	12.3%	13.0%	40
2022	6.8%	8.1%	38
Average 2013-2022	**-1.2%**	**5.7%**	
Average 2017-2022	**0.5%**	**5.6%**	

*Average rate of return on equity for Alberta, Ontario, Nova Scotia, New Brunswick, Prince Edward Island and Newfoundland and Labrador.
Source: IBC analysis based on industry data from GISA Exhibit AUTO9501-AB, ON, NS, NB, PE, NL, CW.

Past Reform Measures

As a result of voter concerns over rising premiums, the Alberta government has undertaken a series of reforms to reduce the cost of auto insurance. In 2003 and 2004, a cap of $4000 (indexed for inflation thereafter) was imposed on minor injuries for non-pecuniary damages. Coverage for medical and rehabilitation treatment was increased from $10,000 to $50,000 for victims, regardless of fault. A Grid system was established to set a maximum price that consumers are charged for auto insurance.

Although the average premium rose by only $100 from 2014 to 2017 (Table 1), the NDP government decided to introduce a 5 percent cap on company-wide auto insurance premiums in November 2017 that remained in place until September 2019. Obviously, the cap would not impact the rising costs which increased on average by $81 from 2017 to 2019. With the cap, the Alberta insurance industry lost money from 2017 to 2019.

After the May, 2019 election, the Kenney government introduced several reforms to reduce insurance premiums (Bill 41), including cutting red tape for insurers pursuing claims from third parties, limiting the number of experts in traffic injury lawsuits, applying a floating interest rate on pain and suffering damages when a claim is served and allowing not-at-fault drivers to have their own insurer cover car repairs. The industry's profitability improved (in part due to a lower frequency of claims as lockdowns led to less driving in 2020).

As consumer price inflation surged after the pandemic, the Alberta government became once again became concerned about rising auto insurance rates. It applied a one-year pause on auto insurance rate increases as of January 26th, 2023. In November 2023, the government introduced a "good driver" cap of 3.7 percent for "good" drivers with no at-fault accidents in the last six years, no criminal code traffic convictions in the last four years, no major traffic convictions in the last three years and no more than one minor traffic conviction in the last three years.

The problem with the good driver cap is that past claim history is not a forecast of future claims since even good drivers might have an at-fault experience. Thus, the cap for good drivers would require insurance companies to charge higher premiums for bad drivers to make up for any profit reduction on good driver plans. With the average premium equal to $1669 (Table 1) in 2023, the loss costs (Table 2) of $1216 and estimated costs of $450, the net profit in 2023 would be a paltry $4 for each policy. This would undoubtedly result in another poor year of profitability for the industry. It is thus not surprising that some companies have announced that they are leaving the Alberta market in 2024 (Zenith Insurance, Aviva's subsidiary S&Y and Sonnet Insurance).[5]

As these companies depart Alberta, and with others signaling their intent to follow, impacted drivers will be forced to find new coverages from other carriers.[6] New policies for those impacted are likely to come at a higher price, driving up overall premium levels in the province, counter to the intent of the rate cap. A similar situation is occurring as other carriers restrict the sale of coverages, finding it unviable financially to continue delivering insurance under the rate cap. Some of the largest insurers in the province are no longer able to offer their customers physical damage (collision and comprehensive coverages) under the rate cap, greatly impacting the availability of these product in the market. Similar to company withdrawals, the loss of these coverages will force impacted Alberta's to search for new, often more expensive coverage from other carriers. These factors are one reason why, despite having capped rates this year, and having frozen rates last year, premiums for drivers have continued to rise 12% over the same time period.

Overall, insurance premiums have been pressured by several factors. General inflationary costs have risen since 2021. Car repair, bodily injury and property costs have also risen along with higher theft rates that have increased by 39 percent in the 2023[7]. Insurance freezes itself supports more driving in the economy as it reduces the expected cost of accidents. The one factor that has reduced insurance premium costs has been lower frequency of reported claims in the past ten years which in part may be due to better driving or owners simply avoiding reporting claims to avoid paying higher premiums under experience-rating.

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[5] See https://www.cbc.ca/news/canada/edmonton/auto-insurance-companies-keep-leaving-alberta-here-s-why-1.7261145.

[6] See https://dbrs.morningstar.com/research/435905/alberta-rejects-public-auto-insurance-examining-viable-solutions-and-ways-to-stop-the-exit-of-private-insurers.

[7] Data from Insurance Bureau of Canada.

Continual intervention in the auto insurance market to reduce premiums has led to increased regulation and price controls in the past decade. In some cases, such as price caps, the regulations may have temporarily kept premiums from rising. However, price caps do not freeze costs, so premiums roar back later to make up for lost profitability. If companies earn insufficient profits that are below the minimum return that investors can earn elsewhere, companies leave the market, which has happened in the past decade.

Interprovincial Comparisons

Considerable variation exists among provinces in regulations with respect to auto-insurance (Table 4 for the years 2012 and 2022). Provincial average premiums will vary according to the benefits, operational costs and frequency of accidents, which makes comparisons more difficult to assess.

Several provinces restrict competition by creating a monopolistic state-owned company to provide automobile insurance: British Columbia, Manitoba, Saskatchewan and Quebec (the latter respect to certain insurance liabilities as explained below). Even with nationalization of auto insurance, average premiums differ considerably ranging from Quebec ($939) to British Columbia ($1411). Indeed, drivers in the Atlantic provinces experience quite low auto insurance premiums even though the provinces have privatized systems. Alberta, which has a competitive private system, has the second highest average premium in 2022 (Ontario highest at $1683). These differences, however, can be explained by different regulated benefits, costs and frequency of accidents.

Table 4: Average Written Premiums by Province

	2012	2022	10-year Cumulative Change	Annual Increase
British Columbia	$1267	$1411	11%	1.1%
Alberta	$1087	$1587	46%	3.9%
Saskatchewan	$1055	$1347	28%	2.5%
Manitoba	$905	$1193	32%	2.8%
Ontario	$1549	$1683	9%	0.8%
Quebec	$712	$939	32%	2.8%
New Brunswick	$795	$1132	42%	3.6%
Nova Scotia	$775	$1181	52%	4.3%
Prince Edward Island	$740	$948	28%	2.5%
Newfoundland & Labrador	$1018	$1303	28%	2.5%

Source: IBC analysis with data from ICBC Annual Service Plan Report, 2022 and Revenue Requirement Application, 2022; IBC analysis with data from MPI Rate Applications, 2023; Société de l'assurance automobile du Québec, Groupement des assureurs automobiles.

One of the differences among provinces is the application of no-fault insurance. Most provinces, have a hybrid system in which some claims are based on no-fault insurance while the right-to-sue is enabled for other claims such as bodily injury or lost income. Alberta, as well as Ontario and the Atlantic Provinces, have no-fault insurance for direct compensation for property damage.

No-fault insurance does not imply that drivers in a collision are at no-fault. Instead, no-fault insurance enables the insurance companies to sort out claims and determine the fault according to "Fault Determination Rules" that could impact premiums if the driver is partially or wholly at fault with experience-rating.

Table 5: No-Fault Insurance for Direct Compensation Property Damage

	Driver at fault	Driver not at fault
No-fault system (AB, NB, NFLD, NS, ON, PEI)	Insurance covers car repairs with collision coverage or all-perils coverage.	Insurance provider pays for car repair under DCPD coverage.
Standard coverage (BC, MB, SK, NWT, NU, YT)	Insurance covers car repairs with collision coverage or all-perils coverage.	The other driver's insurance company will pay for car repairs.

Source: TDInsurance. See https://www.tdinsurance.com/products-services/auto-car-insurance/tips-advice/no-fault-insurance.

It is quite striking how different regulatory environments apply to auto insurance in each of the provinces in Canada. Even among the provinces with public monopolistic provision of auto insurance, the no-fault benefits vary widely (see Table 6 for basic insurance benefits). Saskatchewan enables drivers to choose between a tort and no-fault option. Quebec restrictions, including no-fault insurance, enable drivers to benefit from low-cost insurance.

While no-fault insurance saves litigation costs, compensation provided as a benefit is not fair. For example, income replacement benefits are restricted to 90% of net wages up to a maximum of $93,500 per year in Quebec. For many individuals who earn higher employment income before an accident, the compensation is clearly inadequate.

Table 6: Selected Benefits with No-Fault Insurance Provinces

	British Columbia (no-fault)	Saskatchewan (no-fault)	Manitoba (no-fault)	Quebec (no-fault)
Death Benefit	Based on age and income. Minimum $68,863 to spouse.	50% of annual employment income of deceased to survivor	Up to $575,000 for spouse.	Up to $467,500 (five times victim's income)
Permanent Impairment	N/A	Up to $235,186xP (P is a percentage allowed).	Lump sum up to $295,272 (catastrophically insured)	Up to $295,687
Income Replacement	Up to 90% of net income (basic $113,000 with top up).	Maximum insurable earnings $110,914. Benefit up to $1000 per week.	90% of net income up to $115,000	90% of net income up to $93,500
Medical Expenses	Extended provided by ICBC and private insurers	Up to $8,225,824	$500,000	Reimbursement of medical expenses
Third-party liability	Up to $200,000	Up to $200,000	$200,000 (basic)	Up to $50,000 (not covered in Quebec)
All Perils (collision and comprehensive)	Up to $200,000	$700 deductible	$750 deductible up to $50,000.	Private insurance

Source: Saskatchewan Government Insurance, Insurance Corporation of British Columbia, Manitoba Public Insurance and Société de l'assurance automobile du Québec.

Optimal Regulation of Auto Insurance

An important advantage of the Alberta market is that it is competitive with many companies operating in the auto insurance industry. This enables consumers to have choice in insurance products. Competition also puts pressure on companies to improve benefits, keep insurance rates as low as possible and provide good service to their clients. Insurance that reduces the risks associated with driving also supports demand for automobiles and increased driving in the economy.

Competitive markets also enable innovative ideas to be adopted. A good example is the recent adoption by some insurance companies of pay-as-you-go pricing. Consumers pay a fixed price and variable price related to the number of kilometers that are driven (a maximum price could also be set when kilometers reach a certain limit). The insurance company has a meter installed in the car and uses the signal to track kilometers. Two-part pricing of this type can reduce insurance costs especially for those who drive less. It can also encourage consumers to drive less. It is undoubtedly fair in that those who drive less, pay less insurance.

While competitive markets operate well in providing insurance, there are three *economic efficiency* issues that impact the performance of the industry.

- The first is *adverse selection* whereby companies do not have information to judge the quality of each drivers. Companies might use signals to indicate quality (such as years of driving experience, age, urban vs rural living, etc.) but these signals may correlate with good driving but are not perfect. Companies also use deductibles and co-payments that separate high from low-risk drivers (low risk drivers would choose higher deductibles while high-risk drivers choose smaller deductibles, for example). There is still an element of an inefficiency in markets even with signalling since insurance costs more for good drivers to separate themselves from bad drivers buying insurance.[8] The worst situation is a breakdown in the market whereby insurance companies cannot earn profits at all since bad drivers drive out good drivers from buying insurance. The market fails altogether when this happens.

- The second is *moral hazard* whereby insurance encourages drivers to take more risks (e.g. drive faster) that increases the probability of an accident or the size of the loss. To reduce moral hazard costs, insurance companies will often insure risks up to a maximum and limit compensation net of a deductible amount.[9] Companies will also use experience-rating whereby those drivers with more frequent at-fault claims pay higher insurance premiums.

- The third is related to spillovers arising from actions taken by the drivers that cause income, property, bodily harm and pain and suffering losses to others. As a driver causes harm to others, policies should encourage drivers to reduce the incidence of accidents as much as possible. Lower accident rates reduce economic costs and save lives.

In addition to efficiency, other public policy objectives play a role in the design of insurance regulation. The most important is fairness. The cost of insurance should be similar for those in similar circumstances (horizontal equity). Thus, drivers with similar driving records should bear similar costs. Those who are safer drivers should be rewarded accordingly. If insurance is mandatory, governments may provide relief for those unable to afford insurance through a grant or tax credit program (vertical equity).

Regulation in auto insurance focuses on three primary instruments: mandatory insurance, the role of liability in determining compensation and the pricing mechanism.

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[8] Jean-Jacques Laffont and David Martimort, *The Theory of Incentives: The Principal-Agent Model*, Princeton University Press, Princeton, New Jersey 2002.
[9] Ibid.

Mandatory Insurance

Mandatory insurance covers third-party liability, personal injury protection or first-party accident benefits and uninsured motorist coverage. Regulations stipulate the amount of insurance to be purchased at the minimum. In Alberta, a motorist must purchase mandatory basic insurance that covers property damage, third party liability, and certain accident benefits.

Mandatory insurance is typically required by governments to mitigate spillover costs whereby those who negligently cause an accident will bear the costs imposed by other drivers. While commonly found in many jurisdictions today, it should be acknowledged that mandatory insurance costs bear most heavily on low-income families. Further, mandatory insurance does not cover medical costs associated with accidents that are shifted onto taxpayers (e.g., public-provided Medicare), and therefore not borne by negligent party.

Mandatory insurance is not a significant regulatory issue if premium costs are reasonable for most drivers. It is the high premium costs that make mandatory insurance more difficult for low-income residents to handle as part of their household budgets.

Liability for Compensation Costs

Compensation for accident claims is provided by affected parties suing negligent drivers for the vehicle costs, bodily injury, lost working days, and pain and suffering. In a tort-based system, the injured driver has the right to sue for damages that would be covered by an insurance company and the at-fault driver. Knowing that a person might be liable for significant costs associated with accidents, more care will be taken to avoid an accident.

As litigation costs and time taken to settle claims can be expensive, most provinces, even those with tort insurance for other claims, have implemented some form of no-fault insurance to reduce procedural costs (see Table 5 for direct compensation property damage insurance by province). Pure no-fault systems with no right to sue applies in Manitoba and in Quebec for bodily injury and death. Other provinces have a mix of no-fault and tort-based systems limiting accident benefits and right to sue for compensation under certain conditions (such as size of the claim or type of injury).

No-fault insurance does not imply that drivers in a collision are at no-fault. Instead, no-fault insurance enables the insurance companies to sort out claims and determine the fault according to “Fault Determination Rules” that could impact premiums if the driver is partially or wholly at fault.

Pricing Mechanism

Insurance pricing is an important and somewhat controversial issue. Two approaches include “risk-based insurance pricing” based on driver expected claim costs, and “social pricing” that reflects average claim costs and does not vary by type of driver. Instead, price is established according to the risk profile of the community, typically a territorial rating.

Under a risk-based pricing, consumers are charged higher insurance premiums reflecting the greater risk they impose on the insurance system. If correlated with true costs (expected claim costs), it provides incentives for policyholders to be more careful. As discussed above, the *efficiency* principle for pricing is that the premiums charged should reflect the expected value of a driver's insured losses. If insurance premiums cannot fully adjust to a driver's choices regarding safe driving, because these are not perfectly observed or they vary over time, insurance is mispriced in the sense that the expected benefits from insurance may differ from expected costs.

In practice, most automobile insurance systems use a hybrid approach incorporating both risk-based and social pricing. For example, the public insurance provinces use characteristics such as vehicle type, usage and the insured's driving record and exclude characteristics that cannot be controlled by the insured such as age and gender (the latter are based on expected, not actual, outcomes). Social pricing schemes, however, tend to lead to higher accident rates and claims and thus higher average insurance costs.[10] To reduce moral hazard costs, some sort of risk-based pricing, such as based on driving records and metering, would be useful for efficient pricing. Saskatchewan's insurance provider uses the driving record but not a driver's age, gender, or place of residence. Manitoba prices insurance based on insured lives, vehicle use, vehicle type, and driving record. In British Columbia premiums vary with location, rate class, and claims history.

Options for Reform

While the politics are important, governments should be concerned about policy objectives. The object of regulation is threefold.

- Regulations should be *efficient* by not unduly distorting the insurance markets. Since a poorly structured insurance package can result in more accidents as drivers take less care to avoid accidents, it is important to maintain policy variables like deductibles, and experience rating to minimize moral hazard. Efficiency is also achieved by competitive markets whereby companies provide consumer benefits at the lowest cost possible to earn sufficient profits to attract funding from investors.

- Regulations should promote *fairness* whereby good drivers are rewarded for their behaviour and bad drivers pay more into the insurance system. Those who have incurred an accident due to another's negligence should be appropriately compensated.

[10] Quebec, for example, introduced in 1978 no-fault insurance pricing based on vehicle type confirms that accident and claims rates were higher than otherwise predicted. See S. Tennyson, M. Kelly, and A. Kleffer, "The Design of Auto Insurance Systems: Research and Implications for Ontario", Insurance Bureau of Canada, Toronto, 2012 for a review of other studies including the United States.

- Insurance regulation should ensure *financial stability* whereby insurance companies – whether private and public s – earn sufficient profit to cover losses arising from accident claims and provide a sufficient return on capital for their investors to cover the cost of capital financing.

If governments are concerned about some parts of the population are unable to cover the cost of insurance (as other necessities like food and shelter), then a grant should be provided rather than using polices such as price controls that distort the market.

In this section, I shall compare and contrast five policy reforms with respect to efficiency, fairness and financial stability: (i) public monopolistic insurance provision, (ii) price controls or caps, (iii) no-fault insurance, (iv) tort reforms and (v) insurance premium tax.

1. State-owned Monopolistic Insurance Provider vs Competitive Private Insurance

As mentioned above, several provinces – British Columbia, Saskatchewan, Manitoba and Quebec – have not only introduced no-fault insurance for many accident claims but have also adopted a monopolistic public model for automobile insurance (in Quebec, collision and comprehensive insurance is provided by private insurance companies). Historically, public insurance was adopted by CCF or NDP parties in the western provinces based on an ideology that profit-seeking companies charge higher prices. Of course, even a public insurance company would need to earn profit to invest in capital expenditures (e.g., information technology, structures, land and machinery) simply to operate. Otherwise, a state-owned company must fund its investment with debt or budgetary transfers. And those transfers come with an economic cost due to taxation. Dahlby estimates the 2024 marginal cost of taxation for Quebec corporate, personal and sales taxes to be $3.32 and $3.06 and $1.92 respectively for each dollar of revenue collected.[11]

The question is whether state-owned companies operate more efficiently than competitive companies (especially since the automobile insurance market has many competing firms, as mentioned above). With competitive auto insurance markets, several advantages are in favour of privatization[12].

1. *Efficiency*: Private businesses are expected to have stronger incentives to improve efficiencies since poor profitability and losses will result in shareholders losing money and the company facing potential bankruptcy. State-owned enterprises do not have the

[11] B. Dahlby, "The High Cost of Raising Provincial Taxes has Gotten Even Higher" Briefing Paper, 17(13), School of Public Policy, University of Calgary, 2024. At https://www.semanticscholar.org/reader/234b7c77c5f0bb31275aad19e0a8c1f2d93f9074.

[12] See A.E. Boardman, C. Laurin, and A.R. Vining, 2003, "Privatization in North America," in David Parker and David Saal (eds.), *International Handbook on Privatization*, Chapter 7, Cheltenham, UK: Edward Elgar, 2003, 129-160 and J. Nellis, "The International Experience with Privatization", *SPP Research Papers*, 5(3), School of Public Policy, University of Calgary, 2012.

same pressures to reduce costs since the government provides funding as a last resort, leaving managers off the hook.

2. *Labour Productivity*: Without incentives to control costs, government organizations tend to employ excess workers (feather bedding). Nellis notes that layoffs of 25 percent are not uncommon after privatization in many countries[13].

3. *Capital Investment*: Private businesses have incentives to maintain their facilities in good repair and to invest to meet rising demands. They have greater ability to fund expansions, by using retained earnings and financing from debt and equity markets. State-owned enterprises also raise capital, but their decision-making is affected by political considerations that may limit funding provided by governments.

4. *Transparency*: Auditors, shareholders, and creditors monitor a private company's performance. And consumers monitor companies in the marketplace, giving feedback with their purchasing behaviour. In contrast, citizens have little incentive to monitor government agencies. The goals of agencies are often vague, and their finances may not be transparent for scrutiny by opposition members and third-party advocates.

5. *Foreign Investment*: Privatization enables a jurisdiction to attract new capital, especially from foreign sources. Along with capital comes access to global technologies and foreign managerial skills. On the other hand, government companies tend to have less access to new industrial innovations and better managerial practices.

Yet, privatization has its limitations. If government subsidy policies are still required to support an industry, private entrepreneurs have less incentive to control costs. This inefficiency could be even worse than having a state-owned enterprise operate instead. Governments also give up any corporate profits, if earned, in favour of corporate taxation that only takes a portion of the profits (on the other hand, the government incurs losses if the state-owned company is unprofitable, which was the experience in British Columbia until recently). Further, a state-owned enterprise using the government's credit rating might afford a lower cost of capital, although this financing must ultimately be covered by taxes which can be expensive to raise due to economic, administrative and compliance costs. Privatization may also result in higher consumer prices since firms must earn sufficient profits to cover the opportunity cost of capital.

A variant is a monopolistic state-owned insurance company is providing only basic insurance for bodily harm and death on a no-fault basis, which, as seen in Table 2 above, are quite expensive claims with the largest loss cost taking into account frequency of claims. Some claims such as collision and comprehensive insurance could be provided by private companies, which is the current approach used in Quebec. The benefits are restricted under no-fault insurance enabling lower costs. Further, there is no right to sue for economic losses in excess of no-fault benefits. With deductibles, many drivers do not make minor claims for injury.

[13] Nellis, note 20, p. 16.

Contrary to the Wyman report that argued that monopolistic state-owned insurance companies save costs for consumers[14], studies around the world though have generally found that privatization provides a net economic gain through better firm performance to the economy.[15] It is not just a matter of reducing prices but also the availability and quality of service provided to consumers of a product.

Most important, it is market competition that underlies better industrial performance. Privatization of a monopoly often fails to provide conditions needed for a more dynamic and better performing industry since the private monopoly managers face little pressure to increase efficiency especially if the government continues to act as a last resort for capital. Without the pressure of competition, a privatized monopoly will restrict production to earn excess profits and likely fail to keep costs at a minimum or innovate. Overall, there is not a strong case for Alberta to adopt the public monopolistic insurance model given it already has a competitive market in the automobile insurance industry. Thus, the public option is an inferior choice for reform.

The Wyman Report on Alberta Auto-insurance

The Wyman report is a case in point, suggesting that insurance premiums would be lower in Alberta if it adopted state-owned monopolistic insurance provision as in British Columbia, Manitoba, Saskatchewan and Quebec. While considering differences in benefits across the provinces, the report does not take into account behavioural responses of either consumers or the management of the state-owned enterprise. For example, the report assumes that Alberta drivers take the maximum benefits. However, this is contrary to a market behaviour in which deductibles or benefit limits separate high from low-risk drivers (low-risk drivers will tend to purchase policies with higher deductibles and lower benefits rather than purchase the most expensive policies).

Further, as discussed above, without competitive pressures, monopolistic public insurance companies can operate less efficiently as discussed above. In British Columbia, the state-owned ICBC ran significant losses prior to 2021 that led to BC adopting no-fault insurance limiting the ability of no-fault drivers to sue for compensation for accident benefits especially bodily injury. Changing benefits is not an improvement in efficiency but a way of reducing costs by limiting the rights of victims to sue for compensation. Similarly, the Manitoba Public Insurance has had to introduce major upgrades to its information technology that was not accounted for in the Wyman report since it was out of scope.

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[14] O. Wyman, "Feasiblity Study of Long-Term Auto Insurance Reform". https://www.alberta.ca/automobile-insurance-reform.

[15] Op. cit supra note 14, See Nellis for an international assessment. Boardman and Vining provide an analysis suggesting that privatization has worked well for many Canadian industries.

2. Price Controls or Caps

Price controls and caps have been used in the past for two reasons: relief for consumers and eliminating differential prices.

The first motivation is simply to avoid further increases in insurance premiums during inflationary periods for consumers. Yet, temporary price caps exacerbate pricing for years to come. The initial cap keeps prices from rising to clear markets. However, as time goes by, the supply of insurance shrinks and consumers have greater demand to buy more insurance at lower prices. With poor profitability, insurance companies cut back benefits or leave the market altogether. California, for example, has had this experience since the pandemic year 2020. With less driving, Californian insurance companies were asked by the regulator to refund premiums ($2.4 billion was returned to policy holders) as well as freezing further rate increases. The rate cap, however, remained 2023 when two large insurers, Allstate and Geico, were approved a 6.3 percent increase in order to offset losses and limit further cutbacks in new policies. [16] Temporary freezes might keep prices from rising in the short run, but companies must raise prices even further in later periods to make up for financial losses.

The second is an outcome of premium setting when adverse selection or moral hazard is involved, as discussed above. Insurance companies are unable to observe the driving practices of insured drivers and their willingness to avoid risks. Some drivers are more prone to accident than others or, with insurance, willing to drive less carefully. To reduce risks, auto insurance companies use a wide variety of mechanisms including deductibles, limits on benefits, experience-rating in premium setting and price variation according to characteristics of drivers (years of driving experience, age, gender, vehicle type, and location). For example, if male, young and urban drivers are expected to have a greater propensity to have accidents, they will be subject to higher insurance premium rates compared to older women in rural areas. It is the latter price mechanism that often leads to regulatory price caps since insurance companies will be accused of discriminatory practices against certain types of drivers.

Regulators will apply price controls that limit differential risk pricing among categories of drivers. Females might have to be priced similarly to males. Young or inexperienced drivers would be assessed no differently than experienced drivers. However, the price caps reduce profitability on certain contracts that must be made up with higher premiums set for other contracts (since insurance companies earn competitive rates of return on equity). It also distorts behaviour if some drivers, not subject to higher premium rates, take less care to drive safely.

Alberta uses a grid for premium since 2004 that effectively imposes price caps on certain drivers. Premiums cannot differentiate between age, gender or vehicle. Since 2022, direct compensation for property damage was removed from the Grid (with no-fault insurance being introduced). Currently, the Grid sets a premium based on third party bodily injury and property

[16] https://www.cbsnews.com/losangeles/news/auto-insurance-companies-pull-out-of-california/.

liability and accident benefits. A driver is initially set at zero and moves down the grid each year without an accident to -15, the lowest premium level (two-fifths of drivers are at this level). If a driver has an at-fault accident, the premium level is raised five steps as a surcharging mechanism.

However, as the Automobile Insurance Rate Board reports[17], the Grid is complex since it satisfies three criteria: (i) insurance companies must have reasonable entry level premium, (ii) the system should be stable and transparent, and (iii) insurance should be tied to personal driving responsibility. Safer drivers are rewarded, and caps are levied on basic mandatory insurance (third-party liability for bodily injury and property damage tort and accident benefit coverages).

As the AIRB admits, the Grid is "complicated to administer and limits the flexibility of insurers to distribute their premiums, resulting in unnecessary protection for more experienced drivers, which could be redistributed to good, safe drivers to ensure the Grid continues to protect new drivers and offer them protection as they develop their driving history." Other issues include: the lack of information when a person first received a driver's license; applying 2004 date for drivers who have moved to Alberta in later years; no annual adjustment downwards for drivers who had one accident but a good record in a following year; no adjustment for seniors for have had experience but prone to have an accident; and the lack of defining Edmonton as a territory for rate-setting.

Some of these above issues with Grid pricing can be corrected easily (such as better information data bases). The AIRB suggests moving away from Grid movement for at-fault accidents by assessing a flat-surcharge of 25 percent for the first six years of the first at-fault claim (higher surcharges if more at-fault accidents are incurred). While this seems reasonable, the flat charge is not related to the actual size of the damage (there will be an adjustment made between minor and major offences). Experience-rating is important, but it should match as close as possible the damage incurred. It is further suggested to realign premiums so that new drivers would be protected for ten years but this could impose costs on good, experienced drivers.

It is hard to see the Grid system working well unless regulators relax some of the constraints that treat many things alike. Like any command-and-control system that tries to set prices, anomalies are bound to develop. For that reason, it sometimes best for competitive insurance companies to set their own grids and surcharges for at-fault accidents rather than Alberta setting a one-size-fit-all grid system. If regulators set the parameters rather than require certain principles to be followed, the regulations undermine the role of competition to reduce prices and implement innovative policies.

As shown in Table 3, Alberta insurance companies have not been highly profitable from 2013-2022 under the Grid system. So, it is no surprise that the Grid, even if well meaning, distorts

[17] Automobile Insurance Rate Board, 2024 Grid Rating System Reform", Government of Alberta, 2024.

insurance premiums for other drivers who happen to have a good driving record. The current system with experience rating is important to preserve.

3. No Fault-Insurance

No-fault insurance systems have become common in Canada and many parts of the United States. Unlike tort systems, no-fault includes restrictions on the right to sue other drivers for accident costs, compensation for pain and suffering and non-economic costs, and a mandate for costs to be recovered from the driver's own insurance company.

Studies regarding the impact of no-fault insurance are at best mixed. Given that no-fault insurance reduces the costs incurred by poor driving, it would be expected that there would be a higher accident rate as drivers take less care.[18] However, accidents impose costs on drivers including harm to themselves and family, loss of income or property, and higher premium costs when insurance companies use experience-rating. Even with no-fault insurance, drivers may have other incentives – experience-rated premiums, fines and point-record licenses[19] – that encourage them to drive carefully. With other implemented incentive schemes, no-fault insurance will have a smaller, if negligible, impact on fatalities and accidents.[20]

While no-fault insurance is expected to reduce investigation and litigation costs, it can lead to higher claim costs over time. The comprehensive RAND study[21] on automobile insurance provides several reasons why both U.S. consumer and insurance companies have become resistant to no-fault systems as a replacement for tort-based systems in recent years. Between 1971 and 1976, 16 states adopted no-fault insurance resulting, initially, in lower premium costs. However, over time, these savings were no longer being realized resulting in four states dropping no-fault insurance altogether.

The RAND study states that recent studies using improved empirical techniques have found mixed results as to whether no-fault contributed to a higher incidence of accidents. There is evidence that the repeal of no-fault insurance reduces insurance costs as accidents drop.[22] However, it did find:

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[18] See, for example, J. D. Cummins, M. A. Weiss and R. D. Phillip, "The Incentive Effects of No-Fault Insurance", Journal of Law and Economics, 44(2), 2001. The authors find that no-fault insurance leads to higher fatality rates in U.S. states during the 1968-94 period.

[19] Quebec introduced these policies in 1992 and it is estimated that they reduced the frequency of traffic violations by 15 percent. See G. Dionne, J. Pinquet, M. Maurice and C. Vanasse, "Incentive Mechanisms for Safe Driving: A Comparative Analysis with Dynamic Data" The *Review of Economics and Statistics*, Vol. 93, No. 1 (February 2011), 218-227.

[20] Comparing fatality data for 29 countries for the period 2005-10, experience-rating reduced fatalities while no-fault insurance primarily impact pedestrian fatalities. See K. Winkler, "Effects of No-Fault Insurance on Safety Incentives", Victoria University of Wellington, New Zealand, 2015.

[21] J. M. Anderson, P. Heaton and S. J. Caroll, *The U.S. Experience with No Fault Insurance: A Retrospective*, RAND Institute for Civil Justice, Santa Monica, California, 2010.

[22] See P. Heaton, "How Does Tort Law Affect Insurance Costs", *The Journal of Risk and Insurance*. Vol. 84, No. 2, 691–715. (2017). Heaton concludes "Of the five modifications to tort law examined in the article —introduction of

(i) Litigation costs under partial no-fault insurance systems rose above tort system costs in the 1990s, due to more cases breaching thresholds.
(ii) Fraudulent over-claiming of injuries (such as hard-to-assess soft tissue claims) and,
(iii) Higher medical costs in no-fault states leading to excess costs rising from 4.7% to 40% in no-fault compared to tort-based states.

The RAND study authors conjecture that some of the automobile accident costs would be reduced if United States had a similar universal health care system as New Zealand and Canada that would lower no-fault insurance costs. Given that Canada has a single-payer universal medical system (Medicare), medical costs would be a smaller factor in determining insurance premiums compared to the United States. However, taxpayers must still cover any health, disability and other costs associated with accident claims that are borne by Medicare. If Alberta, for example, adopts no-fault insurance, it could result in higher health care costs covered by the government.

Thus, no-fault insurance is contrary to reforms based on efficiency, fairness and financial stability. No-fault insurance could reduce litigation costs but lead to higher claim costs due to over-claimed expenses and other non-insured costs. No-fault insurance also can be unfair as no-fault insured drivers are unable to fully recover their costs such as lost income that are limited under no-fault schemes. If governments control both rates and benefits, there is that no-fault insurance providers will not have sufficient profits to cover their risks.

4. Tort Reforms

With a focus in reducing premiums, various tort reforms have been proposed besides no-fault insurance. Here, I will discuss two reforms. The first is the adoption of consumer choice between a no-fault and right-to-sue insurance. The second are options for tort reforms that would reduce costs including taxation.

Optional No-Fault and Tort Insurance

As referenced above, Saskatchewan provides an option to drivers to elect no-fault insurance or tort-based insurance with the right to sue (under no-fault insurance, drivers can elect for higher Autopak benefits for third-party, family insurance, lower deductible and loss of vehicle). Tort coverage provides lower basic benefits compared to no-fault insurance while a driver can sue for greater amounts (with risk of being found at fault). Autopak benefits are also provided for tort coverage for income replacement (and additional 25 percent of basic income replacement and 50 percent of a deceased' net income for death benefit of deceased instead of 45 percent

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caps on noneconomic damages, no-fault repeal, reform of joint and several liability, limitation of the collateral source rule, and introduction of a tort for surer bad faith—only no-fault repeal and collateral source limitations are robustly associated with reductions in consumer insurance costs. No-fault repeal reduces consumer costs in subsequent years by 12 percent, while collateral source limits reduce costs by 6 percent."

of basic insurance). For example, in 2023, basic annual income loss benefits are restricted to $29,201 under tort insurance compared to a limit of $108,253 under no-fault insurance.[23] Under the tort option, basic funeral expenses under can be covered up to $7651 compared to $11,726 under basic no-fault insurance (under tort insurance an additional 50 percent of funeral expenses can be covered).

Premiums charged are the same between no-fault and tort insurance. Given the reduction in income replacement benefits and risk of being sued under the tort option, it is not surprising that only one percent of drivers elect tort insurance.[24] It is not a truly optional approach.

A different approach has been in used in New Jersey since 1998 with options to sue under a no-fault insurance for lost income, death benefit, medical expense, and replacement services[25]. Drivers have a limited right to sue an at-fault driver for pain and suffering for a loss in body part, significant disfigurement, displaced fracture, loss of fetus, permanent injury and death.

Drivers have an unlimited right to sue for non-pecuniary damages regardless of severity unlike limited right-to-sue insurance that restricts non-pecuniary damages to the "most seriously" insured damages.

If the driver purchases insurance with unlimited right to sue, a higher premium is charged, unlike Saskatchewan. Only 3.6 percent of drivers elect the unlimited right to sue. After its initial implementation insurance rates dropped 10 percent before rising in later years. From 1998 to 2020, New Jersey premiums have only increased 10 percent compared to 43 percent for the United States as a whole.[26] By comparison, the consumer price index for urban centres rose 57 percent in the same period.

Compared to pure no-fault insurance, New Jersey at least enables drivers to have a limited right to sue even under basic insurance. If consumers willing to pay for an unlimited right to sue, they will have fewer severe injuries to be covered. It is a hybrid no-fault insurance system that at least provides some fairness to drivers who wish to recover higher benefits. However, it still imposes some limits to sue for pecuniary damages.

Other tort reforms

It might be useful to remember the regulatory goals: efficiency, fairness and financial stability. Price caps, no-fault insurance and even optional systems do not achieve more efficiency,

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[23] See Mello Insurance, https://melloinsurance.ca/what-automobile-injury-coverage-should-i-have-if-i-want-to-sue-someone-for-injuries/.
[24] See https://www.cbc.ca/news/canada/saskatchewan/sgi-no-fault-tort-insurance-difference-saskatchewan-1.4623986#:~:text=More%20than%2099%20per%20cent%20of%20Saskatchewan%20residents,suffering%20damages%20if%20they%20were%20in%20an%20accident.
[25] See https://www.nolo.com/legal-encyclopedia/new-jersey-no-fault-car-insurance.html.
[26] Insurance Bureau of Canada, "New Jesiey Option Tort and Alberta Auto Insurance Reform Proposal", August 21, 2023.

fairness or, in the case of price caps particularly, financial stability if companies leave the market due to a lack of profitability. So, are there other potential reforms that one could consider?

Grid Reform: As discussed above, it has been argued that the current grid could be improved to make it efficient and fair. The Automobile Insurance Rate Board recommends several Grid reforms including a flat surcharge for experience-rating in setting auto premiums, a flat discount for driver training rather than grid movements and simplifying territorial definitions. Other proposals include limiting number of years of Grid protection (10 years for new drivers) and reclassifying infractions such that those with fewer than 4 demerit points would be minor infractions (and except with respect to stunting (e.g. race driving). If these changes improve efficiency and fairness in pricing, they would be consistent with reform principles.

A more general question is whether the Grid is necessary at all. If its aim is to cap premiums for some drivers, efficient pricing can be violated since premiums will be raised on good drivers. Insurance companies could compete instead in setting premiums to attract drivers within a regulatory framework without setting prices through the Grid.

If the government is concerned about high insurance costs for lower-income drivers, a better approach would be to provide a refundable low-income tax credit that does not interfere with pricing.

Tort Reforms: The ability to sue for compensation has been a key element of tort law in history. Tort has been used for punishment, deterrence, compensation, and efficient sharing of losses from the cost of accidents. However, there is administrative and compliance cost to operating a tort system that reduces, in some cases severely, the value of compensation paid. So, over the years countries have adopted procedures or optional approaches to tort to reduce administrative and compliance costs. Even the development of a social safety net is an alternative form of compensation paid to victims. Thus, from an efficiency perspective, one should consider the net benefits of achieving compensation through tort versus other approaches.

No-fault is one perhaps extreme form of tort reform by abolishing the right to sue for compensation. However, it goes too far if the compensation paid is unfair compared the costs borne by those who are harmed. The New Jersey approach is an example of trying to balance the benefit of right to sue with costs involved. However, it is only one approach.

The Alberta government brought in no-fault insurance for compensation for property damage. One could extend no-fault to other claims. Nonetheless, the issue is when would it be appropriate to do so. An obvious case is when net benefits of claims are negative or close to zero. For example, using no-fault for minor injuries would be appropriate if the litigation and other costs are in excess of compensation. This can include sprains, abrasions, concussions etc. that would be subject to a limit in terms of medical and rehabilitation care.

Another approach is to limit the right to sue for non-pecuniary damages such as pain and suffering, emotional stress, permanent impairment and reduced quality of life. It is not clear non-pecuniary damages should be viewed as less harmful than pecuniary ones – it would be a judgement call. Certainly, minor non-pecuniary damages such as a temporary emotional stress etc. could be subject to a no-fault approach for compensation. A person could elect for the right to sue for major non-pecuniary damages by paying a higher premium, which might be a more reasonable alternative. The Insurance Bureau of Canada[27] estimates that the average auto premium could be reduced to $1500 by making treatment, care and income replacement benefits available regardless of fault; tort access for pecuniary damages and limited tort access for others incurring non-pecuniary damages. Rather than applying regulations that requires the same conditions for all drivers (one-size-fit-all approach), Alberta could provide opportunities for insurance companies to offer different contracts to drivers depending on benefits, prices and the right to sue.

Whatever approach is considered, tort reform should focus on costly litigation in pursuit of relatively small claims. This might imply reducing costly processes or limiting the right to sue when net benefits from tort actions are small or negative. While it imposes some limitations, much of the fairness and efficiency objectives of regulatory policies are achieved without undue limits imposed by governments on tort actions.

Insurance Premium Tax: Albertans pay a 4 percent tax on insurance premiums except for life, sickness and accident insurance that subject to a rate of 3 percent. Besides being a revenue-raiser, it is unclear why insurance is subject to a special tax compared to other products. Nor is it clear as to why life, sickness and accident insurance is taxed less.

The insurance premium tax was initially imposed in Canada over a century ago as a surrogate for the corporate income tax that was complicated to levy on insurance profits. However, its incidence is to raise insurance premium rates rather than being shifted back as lower profits to investors who can invest in other markets instead. With the adoption of Goods and Services Tax in 1991, insurance premiums have been exempted, implying that insurance companies do not collect the GST on premiums nor able to claim credits for the tax on their input costs (e.g., car repair services). The insurance premium tax can therefore be a surrogate for the provincial value-added tax like the GST, although Alberta has no sales tax. However, given the GST applies to product prices inclusive of excise taxes, the insurance premium tax results in higher GST revenues for the federal government.

The effect of insurance premium tax is not only to make automobile insurance more expensive for consumers but also businesses. While a business might shift forward the tax through higher consumer prices, it has less ability to do so when competing in export markets or facing competition from imports. When business absorb the tax, they must cut their expenses such reducing wages or employment.

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[27] Insurance Bureau of Canada, "Enhancing Care and Expanding Choice", Spring 2024.

Thus, there is no redeeming economic argument for the general insurance premium tax outside of its role to fund Alberta's budget to the tune of $906 million in the fiscal year 2024/25.[28] Auto premium revenues are estimated at $185 million.[29] The full elimination of the auto insurance premium tax would save drivers almost $68 per policy. Even a partial reduction in the premium tax would signal that the Alberta government will share some of the burden to reduce insurance rates. From the perspective of neutrality that all insurance premium taxes should be at taxed at the same rate such as 3 percent. If only applied to auto insurance, a 3 percent rate would provide a $17 average reduction in auto insurance premiums for 2023 (and a loss in Alberta revenues of about $45 million).

Conclusions

Auto insurance premiums have been a contentious issue perhaps due to it being a mandatory expenditure regulated by governments rather than being a significant expenditure for consumers (roughly 2 percent of average consumer expenditure). Rising auto insurance costs due to inflationary pressures including litigation costs, bodily injury costs, income replacement costs, car repair costs, and auto thefts have put pressure on the Alberta government to respond to affordability pressures.

Reform options should be carefully evaluated in terms of economic efficiency, fairness and financial stability. Economic efficiency would require insurance policies to minimize moral hazard and adverse selection costs. The use of deductibles, co-payments and experience-rating are policies that help minimize costs. So does the right for non-fault drivers to sue for compensation.

Price caps distort pricing and leads to financial instability when insurance companies cannot earn sufficient profits to maintain capital investment. Freezing insurance premiums, even temporarily, is ill-advised since it will lead to higher premium hikes in the future. The Grid used by Alberta includes various price caps to protect certain drivers from higher insurance premiums, but this comes at the expense of other drivers who have to bear higher premiums such as good drivers. The Grid is complex to manage and should be abolished.

No-fault insurance can reduce costs by reducing litigation and ease the compliance associated with determining fault. As the 2010 Rand study has shown for U.S. states, however, costs need not stay low in the longer run as no-fault insurance can lead to fraudulent behaviour to push up claims as well potentially reducing the incentive for safe driving.

No-fault insurance can be especially unfair if the insurance benefits are established that only provide partial compensation to persons and property injured in an accident.

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[28] The amount raised from taxing only automobile insurance is obviously much smaller. Alberta Budget, https://open.alberta.ca/dataset/9c81a5a7-cdf1-49ad-a923-d1ecb42944e4/resource/9c5a6bc4-0e12-4913-abfb-a0ab133d2565/download/tbf-2024-25-first-quarter-fiscal-update-and-economic-statement.pdf.

[29] Based on $4.6 billion in written auto premiums from data provided by IBC.

Probably, the best approach is to consider some hybrid system of no-fault insurance and tort insurance. No-fault insurance makes sense for minor claims for compensation when litigation, administrative and compliance costs are more or a large portion of the value of compensation benefits. The right-to-sue should be available at least as an option for more significant claims involving death, impairment and lost income.

If Alberta wants to take leadership in reducing auto premiums, it could consider reducing the insurance premium tax of 4 percent to be the same as 3 percent applied to life, sickness and accident insurance or abolish it altogether.