

2005

SH No. 236705

IN THE SUPREME COURT OF NOVA SCOTIA

BETWEEN:

**HELEN HARTLING, MELISSA GIONET, ANNA MARIE MACDONALD and
THE NOVA SCOTIA COALITION AGAINST NO-FAULT INSURANCE
SOCIETY, an incorporated association**

APPLICANTS

- and -

**THE ATTORNEY GENERAL OF NOVA SCOTIA, representing HER
MAJESTY THE QUEEN IN RIGHT OF THE PROVINCE OF NOVA SCOTIA**

RESPONDENT

- and -

INSURANCE BUREAU OF CANADA, an incorporated association

INTERVENOR

2004

S.P. No. 217706

IN THE SUPREME COURT OF NOVA SCOTIA

**SAQUOIA MCKINNON, an infant by her Litigation Guardian,
KATHRYN JEAN MCKINNON and JOHN MACKINNON**

APPLICANTS

- and -

ADAM THOMAS ROY

RESPONDENT

**THE ATTORNEY GENERAL OF NOVA SCOTIA, representing HER
MAJESTY THE QUEEN IN RIGHT OF THE PROVINCE OF NOVA SCOTIA**

STATUTORY RESPONDENT

HEARD BEFORE: The Honourable Justice Walter Goodfellow

PLACE HEARD: Halifax, Nova Scotia

DATE HEARD: Wednesday, October 15th, 2008

COUNSEL: Mr. Barry J. Mason
Mr. Glenn E. Jones
Solicitors for the Applicants,
Gionet and MacDonald

Mr. Janus Siebrits
Solicitor for the Applicants, McKinnon

Mr. D. Geoffrey Machum, QC
Ms. Christa M. Hellstrom
Solicitors for the Respondent, Adam Roy

Mr. Alexander M. Cameron
Solicitor for the Attorney General of NS

Mr. Jeffrey W. Galway
Solicitor for the IBC

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Per: Mark L. Aurini, Commissioner of Oaths

1002 MR. ZUBULAKE, DIRECT EXAMINATION BY MR. CAMERON

--- Upon resuming at 11:22 a.m.

THE CLERK: Court is now resumed.

THE COURT: Thank you. You're still under oath,
sir. Mr. Mason?

MR. MASON: Thank you, My Lord.

--- CROSS-EXAMINATION BY MR. MASON:

Q. Mr. Zubulake, good to see you again.

A. Yes.

Q. I have a few questions for you. I just want
to make sure I understood your evidence in direct. In terms of
private passenger automobile insurance in Nova Scotia and the

data that you rely on, that comes from GISA. Is that correct?

A. Again, as I said, there were three sources of information. Are you referring to the claim cost information?

Q. Claims cost, yeah.

A. Generally, yes, GISA. I mean -- yes, the private passenger, yes, GISA, yes.

Q. And as I understand it, the GISA data comes from the Insurance Bureau of Canada. Is that correct?

A. Well, the Insurance Bureau of Canada is a -- I guess, a -- works for GISA or GISA subcontracts that compilation of data to the Insurance Bureau of Canada, so in that extent, they help GISA compile that data, yes.

Q. But they get the data from the Insurance Bureau of Canada. They may statistically -- IBC may work on and do statistical analysis, but it goes to -- they get it from GISA.

A. Yes. As I understand it -- and I'm not really familiar with the process -- the companies report their information to GISA and IBC collects that information on behalf of GISA. IBC is the one that edits that information and compiles it all on behalf of working for GISA. That's my

understanding.

Q. Okay. I just want to make sure I've got it right.

A. Yes.

Q. The insurance companies would report it to IBC, IBC would do some things to it, and then would send it to GISA? Is that your understanding essentially? I just want to make sure I've got the chain right here.

A. I think you have me stumped. I don't know the actual chain or how the information is passed along, other than that -- by the way, GISA was formed in 2005, and prior to the formation of GISA, IBC handled everything.

Q. Yes.

A. For whatever reason -- I wasn't involved in this -- but GISA was created to create, I guess, a separation between the IBC and the data, and so GISA is responsible for the data, but IBC is the organization that does the compilation, it's my understanding, and edits and checks and publishes the reports, all for GISA.

Q. So the statistical information comes from the IBC, in other words. Is that correct?

A. Well, it comes from the -- the companies go to GISA, who hands it -- I guess that hands it off to IBC. IBC puts together the -- does the -- again I'm repeating myself -- the checking and the editing and produces the reports.

Q. And for private passenger automobile, if we're looking at claims costs, for example, you would look to the data that's compiled by the IBC and GISA.

A. Yes.

Q. You would have no ability to independently audit that documentation or the information that's provided. Correct?

A. No, sir.

Q. Okay. Thank you. And as I understand it, the -- I understood your evidence earlier that the data for a particular year is -- and figures are released by GISA or IBC roughly in May or June of the following year. Is that right?

A. I don't think there's a set time schedule, but generally it comes out in May or June of the following year. That's my understanding.

Q. So you would be able to get the claims loss data, loss ratios, return on equity for insurance companies, or

November of 2003.

Q. Sure.

A. And I happen to know that because my colleague, Paula Elliott's report comments on that -- a report that she issued in November of 2003.

Q. That's when they normally publish the data would be November for the half year.

A. I think it varies by year, but that's kind of the typical timeframe, yes.

Q. Yeah. And you may not be familiar with this, so if you don't know the answer, that's fine. But if government said, in June of 2003, "Look, we want the data for your six-month period," is that something that the IBC could have expedited and provided to government?

A. I don't know that, but I would -- my guess is, possibly, yes.

Q. Okay. And that data would have included or would include claims costs. Correct?

A. Yes.

Q. Okay. Thank you. And the Insurance Bureau of Canada, as you understand it, is -- it's the lobbyist for the

insurance industry in Canada. Correct?

A. That's part of their charge, yes.

Q. Yeah. They're paid by the insurance industry, right?

A. Again, I -- yes.

Q. Okay. And as I understood your evidence, when this information is provided by insurance companies to IBC, the claims cost data that is, the IBC's actuary actually reviews the claims cost data?

A. That's correct.

Q. Yeah, reviews, I call them reserves but ---

A. Yes. I didn't want to use that term.

Q. Reserves.

A. Okay, yes.

Q. Okay. And as I understand it from your evidence, the IBC's actuary can increase or reduce those reserves, correct?

A. Well, to answer that question let me just take a step back.

Q. All right.

A. The companies report to -- there are two types of reserves, as you put it. When a claim is reported to a company it's assigned to a claim adjuster and that claim adjuster estimates what he thinks the company -- he or she thinks the company is going to pay out on that claim, and that's done for each and every claim that's reported to an insurance company by the policyholders.

That reserve -- it's referred to as a reserve, it's referred to as the case reserve or the claim reserve.

Q. Yes.

A. We know -- actuaries know from the work that we do that in aggregate the claim reserves set up by individual claim adjusters tends to be too low, inadequate, it doesn't fully provide for the claim costs that the companies are going to actually have to pay out on those claims. And so what actuaries do is they calculate what we -- what I'll call an actuarial reserve, a supplemental reserve, that is in addition to the sum of all the claim reserves.

And now to get to your question, what the companies report to IBC is their claim reserve, the case reserve estimates, they do not report to IBC their supplemental

actuarial reserve estimates. It's the actuarial reserve estimate -- that supplemental reserve with IBC is what IBC's actuary estimates.

Q. I've got you. I think I've got it.

A. Okay.

Q. So, we've got the claim reserve that's set by an adjuster that historically is too low.

A. Yeah.

Q. Okay. And then you've got the -- is it the IBC's actuary that puts in the supplemental reserve?

A. Only for purposes of the reporting -- the numbers that are reported to GISA.

Q. Yes.

A. Each company, as I said, has their own actuary. For their own financial statements these companies' own actuary does that analysis.

Q. Okay.

A. But for purposes of the GISA reports, the IBC actuary performs that analysis.

Q. Okay. And, again, I just want to make sure I'm clear on this, that when the data goes to the IBC actuary it has the reserve from the file done by the claims adjuster?

A. Yes.

Q. And the company's actuary, have they had a hand in bumping that reserve as well?

A. No. No. No.

Q. Okay. And then it would go to the IBC's actuary who has rein to increase or in theory decrease the reserves, right?

A. In theory, but again as I said, typically the reserves in aggregate are too low, so what is usually the case is the reserve that's put up the by IBC actuary in this case tends to increase the numbers that are coming into GISA.

Q. Do you know -- this is the way it was done back in 2000, 2001, 2002 except we didn't have GISA.

A. Right.

Q. But IBC was doing it.

A. Yes.

Q. That's correct?

A. Yes.

Q. And do you know, Mr. Zubulake, if the IBC's actuary was increasing the reserve in 2001, 2002, 2003, the supplemental reserve?

A. Well, again, the supplemental reserve is a positive number so it represents an increase over the reserves, the claim reserves that were being reported, so it's a number.

Q. Yeah.

A. So, what I said was that -- I'm just making up numbers -- if the IBC actuary thought that the supplemental reserve should be a hundred dollars (\$100) for the 2001 year, when he looked at it in 2001 he would have put up that number.

When he looked at it again in 2002 -- I'm really simplifying things here a lot -- he would have determined, you know, that the hundred dollars (\$100) that he added in 2001 in retrospect was too high, it should have been eighty dollars (\$80) ---

Q. Yes.

A. --- and when he looked at it again 2003 it should have been only seventy-five dollars (\$75).

It's just the way things worked out that in hindsight it looks like that supplemental reserve that was added was too high, was too much.

Q. Yeah. But did you actually see -- have you been able to view in any way what the supplemental reserve was in 2001, 2002, 2003?

A. Well, I would have been able to see it. I mean, it's available.

Q. Okay.

A. The reports produced by the IBC include the analysis performed by the IBC actuary.

Q. Do you recall, Mr. Zubulake, how much the supplemental reserve was increasing -- or was increased in 2001, 2002, 2003? If you don't, that's fine.

A. I don't.

Q. Okay.

A. And, again, it wasn't increasing over time, it was actually decreasing. So, an amount was put up in 2001 that turned out to be too high but it was still a positive number.

Q. Got you, okay. So, in terms of the IBC's actuary to set those reserves, that supplemental reserve, that's something within the IBC actuary's sole discretion, I take it?

A. The IBC actuary performs a typical actuarial analysis to arrive at his estimates but it's his judgments that govern here, yes.

Q. It's his neck on the line at the end of the day, so he's got to make sure it's appropriate?

A. Yes. And, of course, what he calculates is shared with the industry, and, you know, I've seen his work and it's generally reasonable. We don't agree all the time but his analysis is published and it's available for all to see and comment on.

Q. All right. I want to ask you a few questions just to -- there are a number of factors that impact on the premium that's charged by an insurance company.

A. Yeah.

Q. As I understand it, we've got the claims costs, that's one. We've got administrative expenses, profit or, you know, return on equity, ROE, interest on premiums, and

you talked about both the interest on the equity and interest on the actual reserve that's held.

A. Yes.

Q. Am I missing anything other than that?

A. No. Again, you've -- the three major components really are claim costs, expenses and profit. You had separately broken out interest but that's really part of -- a component of the profit.

Q. All right. And as I understood your evidence -- and you spoke quickly so I just want to make sure that I have that right -- the government relies -- when it's looking at data in terms of administrative expenses, it relies on the IBC for administrative expenses, is that right?

A. Yes. The only -- to my knowledge, the only source of administrative expenses by province for private passenger automobile insurance is this survey that is conducted by IBC. It's conducted on an annual basis and it's, as I said, a voluntary survey.

Q. What I didn't hear from you in your direct -- and you did say it but I just missed it -- was the percentage of companies that actually participate in this voluntary survey.

A. Things began to change and both our firm or the KPMG firm that did the analysis at the time did not think that those changes that we're seeing were evidence of a true change in the pattern.

Q. Yeah.

A. And that's -- that was a reality.

Q. It's fair to say that KPMG and your firm got it wrong because they didn't ---

A. In hindsight there was a change in the pattern, yes.

Q. All right. And in terms of the returns on equity that were projected back in 2001 and 2002 at the time they were wrong as well?

A. Oh, yes, that's what I've said. Yes, they were too high.

Q. Yeah. And in fact in 2002 you'd agree with me that the loss ratio for private passenger auto in Nova Scotia was 10.8 percent.

A. No, no, that's the return on equity.

Q. Sorry, return on equity.

A. Again ---

Q. Sorry ---

A. --- that is my firm's estimate based on all of the assumptions we have made. I think you will hear evidence that other actuaries have come with slight difficulty.

Q. I'm interested in hearing this.

A. Yeah that was ours, 10.8 percent, yes.

Q. And if we use the 22.9 percent administrative expense figure that would actually jump that?

A. I'll tell you we're at about 12 percent then, yes.

Q. Okay, very good. And that was more than what the insurance industry was looking for in terms of profitability back in 2002 isn't it?

A. I will say it's more than the benchmark we've established. I think the insurance ---

Q. Fair enough.

A. --- was looking for more than a ten, 12 percent return on equity.

Q. In fact they were looking for whatever they could get, weren't they?

A. I've attended hearings where the industry

has sought anywhere from 15 to 18 percent return on equity as a reasonable target.

Q. So we know that we have a return on equity in 2002 of roughly 10.8 to 12 percent, somewhere in that range?

A. Now we know that, yes.

Q. Now we know that. But you state in your reports, Mr. Zubulake that premium increases were still required. Why were they still required? We have claims costs going down. We've got more than a healthy return on equity, 10.8, 12 percent.

Why would there be a need in 2003 for premium increases?

A. Okay, we just -- that's -- we're confusing time periods here. If I were looking -- doing a study of the industry's rate level needs today back in -- for the year 2002/2003 I don't think we would have concluded that the rates were inadequate by 10 to 20 percent.

But at the time based on the information, the best information available at the time, it was our position that the rates were inadequate by ten to 20 percent. As you said in hindsight we were wrong.

But at the time KPMG included the same thing a year later. The rates were -- seemed to be inadequate.

Q. All right. So you would agree with me that in hindsight looking back that there was no need for an increase in premiums in 2003 in order for insurers to achieve their ten percent return on equity?

A. I will just say this, you know, I don't have the exact numbers here but I would say that the ten percent to 20 percent estimate that we provided turned out to be too high.

I don't know if it would bring it all the way down to zero and the other point is we're talking about averages here. Individual companies -- you know some companies are higher than average, lower than average.

So even if you know overall average the industry didn't to increase certainly some companies probably would have needed increases and some would have rates that were too high.

Q. And I get it, you mean you were on the outside looking in. You don't know what's going on ---

A. Right.

Q. --- in these different companies and so on.

A. Right.

CERTIFICATE OF COURT TRANSCRIBERS

We, Lorrie Boylen, Janine Seymour, Sandy Adam and Gwen Smith-Dockrill, Court Transcribers, hereby certify that we have transcribed the foregoing and it is a true and accurate transcript of the evidence given in this matter, **HELEN HARTLING et al** (Applicants) and **AGNS et al** (Respondents) and **THE INSURANCE BUREAU OF CANADA** (Intervenor), taken by way of electronic recording.

Lorrie Boylen,
Janine Seymour,
Sandy Adam and
Gwen Smith-Dockrill
Court Transcribers

Halifax, Nova Scotia
Wednesday, October 15, 2008