IN THE MATTER OF the *Insurance Companies Act,* R.S.N. 1990, Chapter I-10, and the *Automobile Insurance Act*, R.S.N. 1990, c. A-22 as amended

and

IN THE MATTER OF an application by Facility Association for an Order of the Board approving an increase in rates charged for private passenger and commercial automobile insurance policies issued through the Facility Association mechanism, pursuant to Section 102 of the *Insurance Companies Act*

FINAL SUBMISSION OF CONSUMER ADVOCATE

February 6, 2003

CONSUMER ADVOCATE
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PART 1:

(A) INTRODUCTION

This is an Application by the Facility Association ("the Applicant") for approval of a rate filing that proposes very significant increases in the rates to be charged for the private passenger and commercial vehicle insurance policies sold in this province through the Facility Association mechanism. The purpose of the public hearing is to determine the appropriate pricing for this insurance product during a policy period that will commence on an effective date approximately three months after the decision of the Board is received.

The rate filing presented to the Board consists of separate private passenger vehicle and commercial vehicle rate programmes. Each of the proposed rate programmes contains actuarial components and non-actuarial components. The rate filing is nominally prepared by Eckler Partners Ltd. ("Eckler"), a firm of consultants and actuaries retained by the Applicant. The evidence demonstrated that the actuarial components of the rate filing originated with Eckler while the remaining components originated with the Applicant[1].

The public hearing process has consisted of twelve hearing days, during which eleven witnesses testified and three public presentations were made. In addition to the rate filing and pre-filed evidence, the Board has received in excess of forty documents in evidence.

The Consumer Advocate has reviewed the oral and documentary evidence presented to the Board and will submit that based on the evidence presented to the Board:

a) rate increases of the magnitude requested by the Applicant are not justified;

b) moderated rate increases are justified in the rates for both private passenger vehicles and for commercial vehicles;

c) the proposed adoption of the VICC Advisory CLEAR differentials and rate group table for private passenger vehicles should be deferred by the Board pending the preparation and review of an updated dislocation study by the Applicant;

d) the proposed changes to the accident and conviction surcharge schedules for private passenger and commercial vehicles should not be approved by the Board;

e) the proposed change to the uninsured automobile premium for commercial vehicles should not be approved;

f) the Board should approve the implementation of a 5% clean driver discount;

g) the Board should approve the Applicant's proposals in the private passenger rate program relating to:

  (i) specified perils coverage;

  (ii) all perils coverage;

h) the Board should approve the Applicant's proposals in the commercial vehicle rate programme relating to:

  (i) specified perils coverage;

  (ii) comprehensive rate group differentials; and,

  (iii) deductible changes.

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[1] Transcript, December 12, 2002, page 33, lines 6-25.

(B) THE ROLE OF THE CONSUMER ADVOCATE

The Consumer Advocate represents the interests of those consumers within the province who presently utilize or who will be required to utilize the Facility Association mechanism to obtain automobile insurance during the policy period that will begin on the effective date ordered by the Board. The role of the Consumer Advocate is to ensure that any rate increases ordered by the Board are fully justified on the evidence and are made in accordance with the relevant legislative scheme and appropriate ratesetting principles and goals.

(C) THE LEGISLATIVE FRAMEWORK OF THE APPLICATION

Prior to addressing the evidence presented at this public hearing, the Consumer Advocate submits that a review of the relevant legislative provisions is necessary in order to make submissions as to the nature and extent of the Board's authority and the appropriate exercise of its jurisdictional powers in this Application.

Facility Association

Section 97 of the *Insurance Companies Act* creates the facility association and ss. 98 (1) and (2) of that *Act*[2] sets out the policy of the Province in so creating it:

> **Facility Association continued**
>
> **97.** The unincorporated non-profit association of insurers known as the Facility Association is continued under the name Facility Association.
>
> 1994 c4 s4

[2] *Insurance Companies Act* RSNL, c. I-10, s. 97, s. 98.

Facility Association

98. (1) An insurer licensed to transact automobile insurance in the province is a member of the association and shall be bound by the articles and by-laws of the association.

(2) The association shall, in its articles of association or by-laws and in terms not inconsistent with this Act, establish a plan to be known as the Plan of Operation

> (a) to provide automobile insurance to owners and licensed operators of automobiles who would be unable to obtain that insurance without the Plan of Operation; and
>
> (b) to provide, in accordance with sections 45.1 to 45.21 of the *Automobile Insurance Act*, payment with respect to claims for damages made by persons who are not insured under a contract within the meaning of section 33 of the *Automobile Insurance Act* and who have no other insurance or who have other insurance that is inadequate with respect to the damages claimed,

and shall, in accordance with those articles of association or by-laws and this Act, establish and implement the Plan of Operation and carry out its obligations in the province with respect to that plan.

The Public Utilities Board

By virtue of the provisions of Section 102 of the *Insurance Companies Act*[3] the legislature has delegated jurisdiction to supervise the rates charged for insurance coverage through the Facility Association to the Board of Commissioners of Public Utilities (the "Board"). Section 102 of the *Insurance Companies Act* reads as follows:

Rates

102. (1) The association shall file with the Public Utilities Board the rates that it proposes to charge for automobile insurance placed through the association.

(2) The Public Utilities Board shall deal with a filing under subsection (1) as if it were a filing made under subsection 49(1) of the *Automobile Insurance Act*.

[3] *ibid,* s. 102(1)(2)(3)(4) and (5)

> (3) Subsection 49(2) and sections 51, 52, 54, 55, 56, 57 and 58 of the *Automobile Insurance Act* shall apply in connection with a filing under subsection (1).
>
> (4) Where the rates filed in accordance with subsection (1) or the application for a change in rates under section 51 of the *Automobile Insurance Act* have been approved, the Public Utilities Board may investigate the rates charged for automobile insurance placed through the association, and notwithstanding approval of those rates, may order the association to make a change the Public Utilities Board considers appropriate.
>
> (5) A member of the association shall not, after February 1, 1986, charge rates for automobile insurance placed through the association that have not been approved by the Public Utilities Board in accordance with this section.
>
> 1985 c21 s12

Under s. 102(3) of the *Insurance Companies Act* the provisions of subsection 49(2) and sections 51, 52, 54, 55, 56, 57 and 58 of the *Automobile Insurance Act*[4] are made specifically relevant to the Board's consideration of rate filings presented by the Applicant.

The exclusion of s. 53 of the *Automobile Insurance Act* from this provision highlights the fact that there can be no deemed approval of a filing or a change of rate application by the Applicant under the legislation, unlike filings and change of rate applications by insurers generally which will be considered to be approved after 60 days if not otherwise approved, prohibited or varied by the Board. This provision suggests that the Board will apply an increased level of scrutiny to the Applicant's filings.

This heightened emphasis in respect of the Applicant's filings and change of rate applications is also confirmed by virtue of the Board's jurisdiction to investigate rates

[4] *Automobile Insurance Act* RSNL 1990,. c.A-22, s. 49(2), ss. 51-8.

and order the Applicant to change rates where they have already been approved under s. 51 of the *Automobile Insurance Act*. The power to order the Applicant to make the changes that the Board considers appropriate in already approved rates is similar to that of the Board respecting automobile insurers generally under the Act, except that for automobile insurers generally, filings and change applications are considered approved after 60 days from said filing or application.

It is also notable that the legislation does not limit the circumstances under which the Board may investigate an already approved or considered approved filing or rate change application. For example, under s. 82 of the *Public Utilities Act*[5], the Board must believe that a utilities' approved rates are "unreasonable or unjustly discriminatory, or that a reasonable service is not provided" in order to investigate the rates or services, on its own motion, with or without notice. Under the *Insurance Companies Act* and *Automobile Insurance Act*, there are no such limiting pre-conditions to an investigation and change of rate on the Board's own motion.

The Consumer Advocate submits that the legislature has not sought to limit the discretion and jurisdiction of the Public Utilities Board in matters of rate filings or applications for changes of rates. The Board's jurisdiction on an application for approval of changes in rates extends to examining, approving, varying or prohibiting the proposed change in rates. Where rates have been approved under s. 51 of the *Automobile Insurance Act*, the Board may nevertheless, upon investigation, order the Applicant to make the changes in those approved rates that the Board considers appropriate. The legislation does not specify that the Board may only do this, for example, where it believes that the approved rates are "unreasonable or unjustly discriminatory" as is the case with utility rates. The Board's jurisdiction is to make the changes it considers appropriate in the context of the purpose of the legislation governing insurance ratesetting in the province.

By virtue of s. 57 of the *Automobile Insurance Act* the provisions of the *Public Utilities Act* relating to the constitution, powers, procedures and practices of the Board apply to it when hearing a change of rates application under s. 102(4) of the *Insurance Companies Act*. Thus, the provisions of s. 118 of the *Public Utilities Act*[6], set out below, would apply to the Board in a hearing under s. 102 of the *Insurance Companies Act*:

> **Act to be liberally construed**
>
> **118.** (1) This Act shall be interpreted and construed liberally in order to accomplish its purposes, and where a specific power or authority is given the board by this Act, the enumeration of it shall not be held to exclude or impair a power or authority otherwise in this Act conferred on the board.
>
> (2) The board created has, in addition to the powers specified in this Act, all additional, implied and incidental powers which may be appropriate or necessary to carry out all the powers specified in this Act.
>
> (3) A substantial compliance with the requirements of this Act is sufficient to give effect to all the rules, orders, acts and regulations of the board, and they shall not be declared inoperative, illegal or void for an omission of a technical nature.

The provisions of the *Public Utilities Act* relating to the constitution, powers and practices of the Board were recently reviewed by the Supreme Court of Newfoundland and Labrador, Court of Appeal in *Ref. Re Public Utilities* (1998), 164 Nfld. & P.E.I.R.,

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[5] *Public Utilities Act* RSNL 1990, c. P-47, s. 82.
[6] *Ibid*, s. 118(1)(2) and (3)

60 (NFCA)[7]. While the case dealt specifically with the appropriate approach to the determination by the Board of a "just and reasonable return" on the rate base of an electrical utility, and various related questions, in the course of determining the issues the Court of Appeal reviewed the correct interpretation of s. 118. The Court stated that "It follows from these provisions that a literal and technocratic interpretation and application of the provisions of the Act is to be avoided, in favor of an interpretation which will advance the underlying purpose of the legislation …".[8] The Consumer Advocate commends this general approach to the Board in determining this Application.

The Consumer Advocate submits that the purpose and role of the Board pursuant to s. 102 of the *Insurance Companies Act* is therefore to act as the general supervisor of the setting of insurance rates in the province, independent of the executive branch of government, the ministers of the Crown, and the industry. The Board should determine appropriate rates of automobile insurance placed through the Facility Association mechanism in accordance with the general legislature concerning automobile insurance ratesetting. The Board should conduct public hearings in the manner of a court proceeding in a process open to public participation and scrutiny. The Board should consider all relevant matters, bearing in mind that the economic, accounting and actuarial complexity of insurance ratesetting requires that the Board will need to rely to a large degree on objective expert evidence to allow it to critically examine applications placed before it.

[7] *Ref. Re Public Utilities* (1998) 164 Nfld. & P.E.I.R., 60 (NFCA).
[8] *Ibid*, para. 18.

The Board previously reviewed certain jurisdictional issues arising under s.102 of the *Insurance Companies Act* in the Board Order arising from Hearing AI 36 2000/2001[9], a public hearing in which the Board of its own motion investigated the rates charged by the Facility Association. The Board determined a number of jurisdictional questions in the course of making that Order.

The first question was whether or not the Board possessed the jurisdiction to conduct a hearing to investigate the Applicant's rates in the absence of previously approved rates. The Board found that it did have a jurisdiction to investigate Facility rates in the circumstances. The second question concerned the Board's jurisdiction to deal with the issue of the payment of commission rates to brokers and agents who were placing insureds with Facility Association. The Board decided it had no jurisdiction over this issue. Thirdly the Board found it had no jurisdiction over the membership of the Facility Association Board of Directors and declined to order consumer representation to be appointed to the Board. Finally, the Board implicitly accepted that it had jurisdiction to consider the issue of the financial results of the Applicant, but accepted the evidence of two actuaries that the issue was irrelevant for ratesetting purposes.

The Consumer Advocate submits that the Board therefore has full authority with respect to investigating, varying, approving or refusing to approve rates proposed to be charged by the Applicant. The Board has broad jurisdictional powers permitting it to inquire into the operational aspects of the Applicant in order to determine the appropriate rate level need. The Consumer Advocate submits that the appropriate approach to ratesetting for this Application is to set the rates in a manner that does not contravene the specific legislative scheme established under the general law of the province for automobile insurance, and is in accordance with the established principles and goals of ratesetting as generally applied by this Board.

[9] Public Utilities Board Insurance Order A.I. 36 (2000-2001).

PART 2: THE HEARING PROCESS

(A) WITNESSES FOR THE FACILITY ASSOCIATION

The Applicant called two witnesses who testified at the hearing, Mr. Brian Pelly, an actuary and consultant to Facility Association employed with Eckler ("Pelly") and Mr. David Simpson, the President and CEO of the Applicant ("Simpson"). By way of a brief summary, Pelly appeared to present and defend the rate filing on behalf of the Applicant. Pelly was qualified by the Board as an actuarial expert with special expertise in automobile insurance rate making work, but he also claimed responsibility for and defended every aspect of the rate filing, including the non-actuarial aspects originating with the Applicant. The Consumer Advocate submits that while Pelly was clearly a qualified actuary, his role as a proponent and advocate for his client's rate filing calls into question his objectivity, as an expert, and his evidence must be approached accordingly.

Simpson was not listed on the Applicant's Proposed Witless List and the Applicant notified the Board of its intention to call him on the morning of the third day of the hearing. The Consumer Advocate submits that his evidence, while of assistance regarding the internal workings and administration of the Applicant, was often vague and general with respect to the particulars of the rate filing. For example, Simpson had no knowledge of the proposal to peg the uninsured automobile premium at $19 and only general information on the proposal to implement CLEAR, two proposals of relevance to consumers affected by the rate filing.

(B) WITNESSES FOR THE BOARD

The Board called three witnesses, Ms. Paula Elliott ("Elliott"), an actuary with Mercer Risk, Finance and Insurance Consulting ("Mercer Risk") Mr. Thomas Hickey, an insurance broker representative and vice-president withT.P. Hickey ("Hickey"), and Mr. David Anthony, a servicing carrier representative and president of a brokerage and member company of the Applicant ("Anthony"). These witnesses provided important evidence that will be reviewed during oral argument.

(C) WITNESSES FOR THE CONSUMER ADVOCATE

The Consumer Advocate called six witnesses, Mr. Winston Morris, the Superintendent of Insurance ("Morris"), Mr. Bruce Whiffen, a meteorologist ("Whiffen"), Sergeant John Hill, a Royal Newfoundland Constabulary Accident Investigator ("Hill"), Mr. Cluney Mercer, an employee of the Department of Works, Services & Transportation ("Mercer"), Mr. Thomas Beckett, the Deputy Registrar of Motor Vehicles ("Beckett"), and Ms. Joan Marshall, the Chairperson of the Seniors Resource Centre ("Marshall"). The evidence of these witnesses will be reviewed during oral argument.

(D) PUBLIC PRESENTERS

Three public presenters appeared and gave evidence at the Facility Association hearing, Ms. Jennifer Power (“Power”), on behalf of CGU, Mr. Michael Keough (“Keough”), on behalf of the Independent Taxi Owners Association, and Ms. Victoria Harnum (“Harnum”), on behalf of the Citizens for Fair Insurance Rates. Each of the public presenters consented to give sworn evidence, and each provided valuable information concerning the perspectives of the insurance industry and consumers respectively.

PART 3: THE CONTEXT OF THE RATE APPLICATION

This section reviews the contextual background to the Application developed through the evidence.

On the first day of the hearing the Board made a decision to broaden the scope of the nature of the evidence to be presented to the Board in order to enable it to come to a proper decision on this Application. The Consumer Advocate submits that, as a result of the Board's decision, there was considerable additional evidence led at the public hearing, evidence that served to provide the Board with a complete evidentiary background on the context of the rate filing and assisted consumers affected by the Application in gaining a clearer understanding of the operations of the Applicant. The Consumer Advocate submits that this decision was a necessary and advisable exercise of the Board's jurisdiction.

(A) THE LEGISLATIVE CONTEXT

The Board is involved in setting rates for the Facility Association, a legislative mechanism set up to provide auto insurance to owners and drivers who cannot obtain insurance through the regular market.[10] The rate filing establishes that the rate programmes for private passenger and commercial vehicle are calculated in the rate filing on the basis of a zero profit provision. Simply put, it is the submission of the

Consumer Advocate that a zero profit provision is a requirement of the existing legislative scheme for automobile insurance in the province and in setting rates the legislation must be applied by the Board.

Under the existing automobile insurance scheme established under provincial law, all automobiles operated on public highways must carry liability insurance. Because licensed auto insurers authorized to transact that business in the province are entitled to decline any risks that do not meet their specific underwriting requirements, the Facility Association legislative mechanism exists to make automobile insurance product available to every owner and qualified driver who wishes to obtain the product, regardless of risk profile. Risks that are not voluntarily accepted by any of the licensed auto insurers participating in the "voluntary" market place are, by law, required to be insured collectively by all auto insurers in the province, through the unincorporated non-profit profit association of insurers known at the Facility Association. This requirement balances the creation of a compulsory market for auto insurance with a legislative mechanism designed to guarantee a fair and affordable supply of the product.

The submission of the Consumer Advocate is that, under provincial law, consumers who are required to obtain auto insurance through the Facility Association mechanism are entitled to purchase that product at a price established by calculating the level of rates required to cover only the claims and expenses that will be incurred by Facility Association, with no profit provision. During the hearing submissions have been made by and on behalf of the Applicant in respect of the difficulties and potential inequities

[10] *Insurance Companies Act*, s. 97-102.

that can arise as a result of preparing rates without a provision for the "cost of capital" or the "value of money". The Consumer Advocate submits that this is a legally irrelevant consideration for the Board. It is the duty of the Board, in setting any rates, to set the rates in accordance with the scheme of regulation of established by the legislature. Where the scheme of regulation, as here, does not provide for a return on investment, or "return on capital", the Board has no jurisdiction to investigate or determine the investment or capital upon which an applicant may be seeking a return, and has no authority to order any margin of return. The Consumer Advocate notes that where legislative schemes do establish a "return on capital" the legislation specifically sets out the parameters of the return as a rate-making tool, ie. a 'fair return", a market rate of return or a rate of return sufficient to maintaining a sound financial position. Simply put, the scheme of regulation established through the *Insurance Companies Act*, the *Automobile Insurance Act* and the *Public Utilities Act* does not provide for any return an investment or "return on capital" for the Applicant, and so no rates can be properly recovered from consumers on that basis.

The Consumer Advocate submits that seen in the broader context of the automobile insurance market, this makes sense. Mandatory insurance provides a minimum level of protection to all consumers using the public highways and it is in the general interests of all citizens that every vehicle is insured. The regular market for automobile insurance is now essentially a mandatory marketplace, one in which prices for consumers are set through a benchmark system that do include a built-in profit provision. In order to participate in that mandatory marketplace, and compete for profitable business, auto insurance companies are obliged to make the same product available to the small percentage of persons not insured through the regular market on a zero profit basis, and must share in the results of the Applicant's operations. These companies understand this to be the case when they enter the market, have voluntarily accepted that obligation, and are prepared to accept the benefits that have arisen in the past.

While the system may be imperfect, and while the Consumer Advocate accepts that the evidence clearly demonstrates that neither the members of Facility Association nor those insured through the mechanism are willing participants, that is the present legislative scheme and it must, as a matter of jurisdiction, be applied by this Board.

(B) THE DEMOGRAPHIC AND GEOGRAPHIC CONTEXT

The Province of Newfoundland and Labrador has an aging population. The evidence demonstrates that a significant portion of that population is living on a fixed income[11]. While the evidence does not establish the existence of specific underwriting criteria which mandate that senior citizens have their insurance placed through Facility Association, it is clear that the older a person gets the more likely they are to be placed in Facility Association[12].

There were 8372 private passenger vehicles insured through the Facility Association mechanism in the province in 2001 out of a total of 218,192 vehicles insured in total.

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[11] Pre-filed evidence of Joan Marshall, December 3, 2002.
[12] Exhibit Information 4, December 16, 2002.

The figures are not yet available for 2002 however it appears clear from the evidence that a significant increase in the vehicle count must have occurred during 2002 as the written premium for the Applicant in 2002 was about $20,000,000, which was significantly higher than the written premium in 2001[13]. The Consumer Advocate submits that on the preponderance of the evidence the number of private passenger vehicles insured through the Facility Association in the province is likely to continue to increase rather than to decrease in 2003[14].

Furthermore, the Consumer Advocate submits that the geographic realities of the Province of Newfoundland and Labrador are such that, in the absence of a substantial public transportation infrastructure[15], most people must depend on private passenger vehicles as their primary means of transportation. In this geographic and demographic context, the issue of availability of a fair and affordable supply of insurance products becomes more crucial to consumers and supports a close scrutiny of any rates increases sought by the Applicant, particularly increases of the magnitude requested in this Application.

(C) THE HISTORICAL CONTEXT

The evidence placed before the Board indicates that, based on the annual audited statements of the Applicant, over the 17 year period in which the Applicant has operated in the Province of Newfoundland and Labrador its operations have generated a significant

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[13] Transcript, January 8, 2003, page 34, lines 3-5
[14] Transcript, January 13, 2003, page 37, lines 52-66; Transcript, January 13, 2003, page 38, lines 68-88

excess of revenues over expenses[16]. Pelly and Simpson accepted that an excess existed even after considering the $5,000,000.00 unaudited figure produced in response to the Morris evidence.[17] This is important for two reasons, firstly because it clearly demonstrates that whatever "cross-subsidization" may be occurring at a given moment in time as a result of the operations of the Applicant in this province, in historical terms the residual market has returned the excess of revenue over expenses to the member auto insurance companies, and therefore if cross-subsidization is occurring the consumers of the voluntary market have been "cross-subsidized" historically rather than the other way around[18].

Secondly, and more significantly from the perspective of the Consumer Advocate, it supports the submission that the forecasts provided over the years by Eckler on behalf of the Applicant have been consistently, significantly and demonstrably inaccurate. In fact, the evidence shows that in the Applicant's filings for accident years 1993 through 1996, the actual loss costs were consistently and significantly lower than the projected values[19] and that, but for the Board's refusal to approve further increases in 1997, the significant surplus situation that resulted in 1998 and the years following would have been even more favourable to the members of the Applicant[20]. Finally the rates filed by Eckler in 2001 were considered seriously inadequate by May or June of 2002.

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[15] Transcript, January 10, 2003, page 8, lines 37-43; Transcript, January 10, 2003, page 10, lines 10-43.
[16] Transcript, January 13, 2003, page 3, lines 33-45; Transcript, January 13, 2003, page 4, lines 16-48; Schedule "A" to Pre-Filed Evidence of Winston Morris, December December 3, 2002.
[17] Transcript, January 8, 2003, page 44, lines 22-47.
[18] Transcript, January 13, 2003, page 3, lines 33-45; Transcript, January 13, 2003, page 4, lines 16-48; Transcript, January 13, 2003, page 10, lines 60-82.
[19] Exhibits, Information 6, page 15

The Consumer Advocate submits that the Board should consider the historical reliability of the Eckler forecasts in approaching the issue of which actuary's recommendations ought to be followed in setting the rates. The Consumer Advocate also submits that the issue of "cross-subsidization", if it were considered relevant by the Board on this hearing, would not support the Applicant's increase for rate request.

(D) THE MARKET CONTEXT

The relationship of the residual market to the voluntary market has in the past not been clearly understood by members of the general public. As the broader contextual evidence demonstrates, there is a direct relationship between the size of the voluntary market and the size of the residual market. The evidence shows that the membership of the Facility Association and the membership of the voluntary market are one and the same[21], and that it is the underwriting rules and practices of the voluntary market that determine, to a large extent, the population of the Facility Association[22]. Because private licensed auto insurers in the province are not required to accept any individual risk, it is their underwriting guidelines and actions which, broadly speaking, determine the population of the residual market[23].

[21] Transcript, January 8, 2003, page 25, lines 45-62.
[22] Transcript, January 13, 2003, page 29, lines 49-57; Transcript, January 13, 2003, page 34, lines 72-85; Transcript, January 13, 2003, page 35, lines 21-67.
[23] Transcript, January 13, 2003, page 29, lines 49-57; Transcript, January 13, 2003, page 34, lines 72-85; Transcript, January 13, 2003, page 35, lines 21-67.

Therefore, while the Applicant may claim to have as its stated goals non-competition with the voluntary market and ultimately a zero population, according to Hickey in practical terms it is the underwriting and rating rules and guidelines of its members within this jurisdiction that largely determine the competitiveness of its rates with the Applicant's rates[24], as well as the size and make-up of the residual market. The suggestion that the population in Facility Association will be automatically decreased through increased pricing as allegedly demonstrated by the scatter graph in Exhibit BGP #4 (and leaving aside other relevant evidentiary considerations raised by the Exhibit) is therefore inaccurate at best.

The other evidence provided by the Applicant at the rate hearing with respect to the market context is the suggestion that one of the other positive effects of increasing rates for the residual market will be to create an opportunity for grey market insurers to serve "the best of the worst" from the Applicant's book of business, thereby decreasing the Applicant's market share. In the first instance, while there was evidence from Hickey that one "grey market" insurer had suspended writing and was considering not writing further business in the province, there was other evidence from Power that the CGU grey market insurer wrote over $5,000,000.00 in business in 2001[25]. The evidence also established that the relative population of the residual and voluntary markets, and therefore the opportunities for "grey market" insurers, is subject to many systemic issues[26]. Therefore, even if it were within the jurisdiction of the Board to undergo what is essentially a marketing role rather than a pricing role, to attempt to do so would be an

[24] Transcript, January 13, 2003, page 39, lines 43-85.
[25] Transcript, January 14, 2003, page 12, lines 33-37.

exercise in futility. Neither the Board nor the Applicant can directly influence the actions of grey market insurers and the existence or non-existence of the "middle market" is simply a matter of market dynamics.

(E) THE WIDER INDUSTRY CONTEXT

The evidence demonstrates that 2001 was the worst year on record for the property and casualty insurance industry in Canada[27]. Furthermore, because the insurance market is cyclical and inherently competitive, as private insurers react to conditions in the wider market place by tightening or loosening underwriting requirements the actions of the voluntary market directly determine the relative size of the residual market, and the characteristics of the population therein[28]. The evidence demonstrates that we are now entering a period of a tightening market where restrictive underwriting rules will lead to increased rates across the industry and likely force more and more persons to seek automobile insurance through the residual market[29]. From the mid 1990s to 2001, the overall strategy employed by the property and casualty industry was to focus on the capture of market share in order to generate revenue from investing the premium volume in the markets. As investment returns have plummeted since 2001 the industry has been forced to return to more disciplined underwriting criteria[30]. These industry realities are beyond the control of the Applicant or the Board. What they do mean is that, in the upcoming rate period, it is logical to assume that the population of persons insured

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[26] Transcript, January 14, 2003, page 12, lines 1-22.
[27] Exhibit J.P. #1.
[28] Transcript, January 13, 2003, page 37, lines 49-66.
[29] Transcript, January 14, 2003, page 38, lines 66-88; Transcript, January 14, 2003, page 39, lines 3-31.

through the Applicant will continue to increase, and that the percentage of that population with clean driving records will likely increase rather than decrease.

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PART 4: PRIVATE PASSENGER VEHICLE RATE PROGRAM

(A) PROPOSED AVERAGE RATE LEVEL CHANGES

The proposed average rate level changes set out in the filing are 51.7% for third party liability, including 60.5% in the largest territory by population, Territory 1. While the average rate level changes for all coverages combined are 41.3%, the Consumer Advocate submits that the evidence demonstrates that the premium generated by compulsory liability coverage comprises 70%-80%[31] of the net written premium for private passenger business, because it is the most expensive coverage, it is mandatory, and because a lower percentage of persons insured through the Applicant avail of optional coverages. As the increases in liability are the highest proposed increases in the private passenger rate program, and form 70%-80% of the premium dollars, the Consumer Advocate submits that the impact of these proposed increases on the driving public will be very dramatic. The Consumer Advocate also submits that because these are average rate level changes, the effect on the individual rate levels will be both higher and lower than the proposed changes, so it is not difficult to see how Hickey and Simpson could respectively describe these as "devastatingly large rate increases"[32] and "very significant increases". [33]

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[31] Transcript, January 8, 2003, page 33, lines 65-71.
[32] Transcript, January 13, 2003, page 43, lines 4-7.

(B) SUMMARY OF ISSUES

The private passenger rate programme contains both actuarial and non-actuarial components. The primary actuarial issues are grouped under the headings loss development, loss trend, ULAE, and the credibility standard. The non-actuarial issues are the proposed introduction of CLEAR, the changes proposed to the Accident and Conviction Surcharge Schedule, the change to the Specified Perils coverage, and the proposed change to the All Perils calculation.

There are three loss development factor issues to be considered, namely the selection of the last five year period as the primary data source, the use of a straight average as opposed to a weighted average, and the basis upon which the selection and exclusion decisions were made by the actuary.

The primary role of the actuary is to determine the indicated rate level changes, that is the percentage by which the existing rate levels will need to change in order to meet the expected cost levels over a policy period commencing on a future effective date. The most contentious actuarial issue in the private passenger vehicle rate programme relates to the approach adopted by Eckler to loss development. The process used by Eckler to select the multiplicative factors (the "loss development factors") that are applied to the past reported incurred losses to forecast what the incurred losses will ultimately be

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[33] Transcript, January 8, 2003, page 34, lines 65-68.

accounts for 12 of the 17 percentage point difference between the indicated rates in the Eckler and Mercer Risk reports.[34]

Other actuarial evidence to be addressed in respect of the private passenger vehicle rate programme includes issues relating to the loss trend rates, the factors that are applied to adjust for the expected cost levels during the future policy period. These issues include the number of years used in the determination of trend, the use of yearly as opposed to half-yearly data, the use of an unemployment variable in determining trend and the selection by Eckler of a flat frequency trend for a coverage where the regression model indicated that a declining frequency rate was demonstrated. In all, these loss trend issues account for 3 of the 17 percentage point difference between the actuarial analyses.

Two other issues arise in the context of actuarial issues for the private passenger vehicle rate program, each accounting for about a 1 percentage point difference, namely the provision for expenses be loaded in the accident year data (the ULAE factor) and the means by which the credibility loss experience was weighted by Eckler.

The actuarial issues as referred to in this part of the Final Submission are equally relevant to the commercial vehicle rate programme and the submissions made therein are relied upon, mutatis mutandi, in this section. Where there is any distinction or different emphasis placed on a particular aspect of the actuarial analysis each section will develop those issues separately.

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[34] Mercer Risk Report, page 12.

(C) ACTUARIAL ISSUES

(i) LOSS DEVELOPMENT FACTOR ISSUES

(a) Number of Years Used

In forecasting the losses expected to be incurred by the Applicant during the future policy period, Eckler has looked at the reported incurred losses of the Applicant over the last five years, 1997-2001, as the primary data source upon which to base its projected future losses. Mercer has accepted that the use of this data for the last five years is a reasonable approach in the circumstances and strikes an appropriate balance between responsiveness and stability. The Consumer Advocate submits that this evidence should be accepted by the Board.

(b) Straight Average vs. Weighted Average

As a default approach, Eckler has used the straight or arithmetic average of the factors experienced over the previous five years of data. Mercer on the other hand recommended the use of a weighted average which would give greater emphasis to the most recent loss experience and proportionally lesser weight to the older experience. While both actuaries appear to agree that responsiveness to the latest loss experience is the main goal in the selection of an appropriate approach to averaging, and both claim that their approach achieves responsiveness, the question for the Board is which approach best achieves that result?

The Consumer Advocate submits that on the preponderance of the evidence, the position adopted by Mercer Risk should be accepted over the Eckler approach and applied in setting the rates. While not claiming to have adopted this approach as a result of the declining vehicle volumes in the Applicant's private passenger vehicle rate programme, Pelly observed in evidence that the effect of using the weighted average in a period of declining volume would be to make the analysis less responsive to the most recent development[35]. The Consumer Advocate submits that this was not a valid criticism of the weighted average approach because Pelly's comments were related to vehicle counts declining, rather than loss costs. In any event, the evidence demonstrates however that, for the private passenger coverage at least, the use of a weighted average was more responsive than a straight average in 14 of the 15 periods projected by the loss development factors[36]. The Consumer Advocate therefore submits that the use of the five year weighted average is the approach which should be adopted by the Board in pricing the product for consumers in the province in this Application.

(c) Selection/Exclusion Issues

The most contentious area of dispute with respect to loss development factors in the private passenger vehicle rate programme is the reasonableness of the method, (or indeed the lack of method), used by Eckler in the selection/exclusion of the loss development factors. Eckler's approach was to judgmentally exclude data points that Pelly considered were not representative of what one would expect to see in the future, and to then apply a

[35] Transcript, December 12, 2002, page 7, lines 39-61.
[36] Transcript, December 18, 2002, page 20, lines 75-87; Transcript, December 18, 2002, page 21, lines 1-5.

straight or arithmetic average of the remaining four or sometimes three data points. Mercer Risk's approach, on the other hand, was to make no exclusions from the actual data points that had occurred during the five year period and to apply a weighted average to the data, giving greatest precedence to the most recent years in order to increase responsiveness to the most recent data. The basic approaches adopted by Eckler and Mercer are both, according to the evidence, probably acceptable under actuarial practice, but the Eckler approach results in significantly higher indicated rate levels for consumers. Should the Board approve the Eckler approach?

The evidence clearly demonstrates that each of the data points excluded by Pelly was an actual data point that had occurred within the five year period chosen by Eckler to measure the loss development. The evidence also demonstrated that on each occasion that a data point(s) was excluded from the five year period the excluded point was the lowest data point or points in the five year period[37], and its exclusion therefore resulted in higher indicated rates for consumers. No rationale was provided by Eckler in the rate filing for the exclusions. Furthermore, Pelly did not exclude any high data points that were arguably outliers, which the Applicant had done in the previous 2001 application before the Board[38], and no objective test was outlined to determine the existence of an outlier. The selections were made purely on the basis of the judgment of Pelly.

The evidence presented by Pelly regarding his exercise of judgment in specific circumstances was contradictory. Sometimes an exclusion was justified by Pelly on the

[37] Transcript, December 17, 2002, page 14, lines 31-43; Transcript, December 18, 2002, page 18, lines 62-65.

basis that it was not consistent with the most recent years[39]. On another occasion the exclusion was the most recent data point[40] and there were seven other low points. On another occasion an exclusion was justified on the basis there was no other point in the older history that compared to the excluded point[41], and on yet other occasions the exclusion was simply justified on the basis that the data point did not, in Pelly's view, represent "a reasonable expectation for going forward".[42]. Finally, no exclusions were made of high data points even where those high data points had neither clear support within the five year period nor in the older history[43].

The Consumer Advocate submits that the approach utilized by Eckler offends a basic goal of ratemaking because it does not promote simple and understandable rates, and it is characterized by factors that can change at every interval. The Consumer Advocate submits that the approach used by Eckler in selecting and excluding only the lowest data points should be rejected by the Board as biased high and not representative of reasonable actuarial practice. Elliott testified that this approach was biased[44], and the Consumer Advocate submits that the Board should reject the Eckler approach and unreservedly adopt the consistent, unbiased approach recommended by Mercer Risk.

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[38] Transcript, December 19, 2002, page 30, lines 62-73.
[39] Transcript, December 17, 2002, page 20, lines 1-4.
[40] Transcript, December 17, 2002, page 17, lines 6-14.
[41] Transcript, December 17, 2002, page 15, lines 45-49.
[42] Transcript, December 17, 2002, page 16, lines 69-73.
[43] Transcript, December 17, 2002, page 17, lines 57-71.
[44] Transcript, December 19, 2002, page 22, lines 1-10.

(ii) LOSS TREND ISSUES

Once historical loss costs by accident year have been developed to their expected ultimate value, it becomes necessary to apply a factor to the ultimate loss costs to take into account how costs are likely to change during the future policy period.

In making this forecast, the actuary applies another multiplicative factor representing the percentage change in costs expected over the future period by looking at the pattern of change in the past. This is known as the development of a loss trend factor. The loss trend issues raised by the evidence concerning the private passenger rate programme result in a 3% difference in the rate level indications.

(a) Number of Years Used

The first question to be determined by the Board in the calculation of a loss trend is the number of years that should be looked at to determine the pattern of change over time, a pattern of change that is being applied in this case to the expected ultimate values of the most recent five years of data, 1997-2001. Mercer has recommended the use of a ten year period for the analysis of bodily injury trend, a ten year period for the analysis of property damage coverages severity trend and a five year period for the analysis of property damage coverages frequency trend. The periods of time adopted by Eckler in developing loss trend vary from coverage to coverage and extend back in the case of severity as far as 1984 for certain property coverages. There is no suggestion that either approach is unacceptable under actuarial practice.

The Consumer Advocate submits that the approach recommended by the Board's actuary is a straightforward, consistent approach, one that is more responsive to the recent data, and is in accordance with accepted actuarial practice and the goal of simple, understandable rate making. The selection of significantly longer past periods to analyze trend, up to 18 years, makes less intuitive sense when the object of the exercise is to project loss costs from a recent period over the ensuing 2½ years and leads to an a more complex analysis. On balance, the Consumer Advocate submits that the preponderance of the evidence supports the approach recommended by the Board and recommends its use in this Application.

(b) Yearly vs. Half-Yearly Data

In analyzing the data for the purpose of determining trends, the Applicant has used the IBC industry loss experience data, a larger body of data than the Applicant's loss experience data which is used in the analysis of loss development. This use of a broader database is accepted in actuarial practice, because the purpose of analyzing a loss trend is to capture how overall conditions in the claims environment are likely to be reflected in the change in cost levels in the upcoming period.

The IBC data used by the Applicant is originally provided by IBC in half-yearly segments, and was compiled into annual industry data by Eckler. Mercer Risk has used the same IBC industry loss experience, but has analyzed it in the original half-yearly segments, which Mercer Risk states will permit the data to be scrutinized with greater precision to determine if aberrations have occurred that should not be considered for the purpose of projecting trends for the future. The evidence established that both approaches are considered acceptable under current actuarial practice[45].

The Applicant attempted to show that the use of half-yearly data led to increased "noise" in the regression analysis and was therefore less reliable than the use of annual data. The Consumer Advocate submits that the evidence shows that the approach followed by Mercer is the approach used by the actuary for the IBC, the approach used in Ontario, and was used by the Applicant in the 2001 rate filing for the purpose of updating its trend projection.

Furthermore, Elliott testified that the use of the half-yearly data does not in and of itself have an effect on the actual findings for the annual trend rates. If no exclusions are made from the data, the same or a very similar trend will result from the use of half-yearly data as results from the use of yearly data[46]. This evidence was repeated on a number of occasions and was not contested by either viva voce or exhibit evidence.

[45] Transcript, December 20, 2002, page 21, lines 9-11; Transcript, December 20, 2002, page 21, lines 13-17.
[46] Transcript, December 18, 2002, page 26, lines 50-61; Transcript, December 20, 2002, page 10, lines 58-64.

The Applicant also suggested that the seasonality identified in the data was not statistically significant or was in some manner unexpected in this province. By its own evidence the Applicant acknowledged that seasonality is not something that cannot be readily addressed in a regression analysis. In fact the evidence showed it was statistically significant in the regression analysis used by Mercer Risk to analyze private passenger bodily injury trend if two more years of trend were simply included.[47]

The Consumer Advocate submits that these issues as raised by the Applicant really amount to a smokescreen. The real issue before the Board is whether or not analyzing the data half-yearly permits a more in-depth and precise analysis of the data as claimed by Mercer Risk and therefore produces a more responsive and accurate projection of the trend. This is crucial for the analysis of the trend for the commercial vehicle bodily injury trend for 2000-2001, and the Consumer Advocates refers to the analysis of the 2000-2001 winter loss experience set out herein. The Consumer Advocate submits that on the preponderance of the evidence the recommendation of Mercer Risk should be accepted on this point.

(c) Unemployment Variable

One of the variables that can be considered in developing a trend projection for the future is the influence of the overall economic performance within the jurisdiction. In this regard, the unemployment rate is treated as being representative of economic performance and the rate is used as a surrogate for the economic cycle to determine the

[47] Transcript, December 18,2002, page 24, lines 1-10.

influence of the economic cycle on claims experience. By analyzing both past unemployment rates and unemployment rates projected into the future policy period, this variable is then applied to influence the trend pattern expected in the future. The rate filing stated that unemployment was a statistically significant variable for property damage tort frequencies and collision frequencies.

Elliott testified that the use of the unemployment variable in developing a trend for this jurisdiction is not recommended by Mercer Risk for a number of reasons. Elliott pointed out that it involves the prediction of future unemployment rates, which is in itself inherently imprecise and volatile, and that the application of an unemployment variable in this province can have quite a dramatic effect on the loss trend (1% drop in unemployment equals 7% change in frequency)[48]. In this filing, the effect of using the unemployment rate variable was to offset the declining frequency trend observed in each coverage and therefore increase the indicated rates for the future policy period[49].

Elliott has also given uncontested testimony that the unemployment variable was not relied upon by Eckler in determining loss trend for these coverages in 2001, it was not statistically significant in 2002 if the ten year period recommended by Mercer Risk is adopted, and it was not statutorily significant if the years judgmentally excluded by Pelly are included. The Applicant did not dispute these conclusions on cross-examination and Pelly acknowledged that projecting the unemployment rate into the future is a very difficult proposition.

[48] Transcript, December 19, 2002, page 3, lines 37-42.
[49] Mercer Risk Report, page 16.

Finally, the Consumer Advocate submits that further uncertainty as to the reliability of this variable is raised by the fact that the projected unemployment rates are provincial rates, and not territorial. Unemployment rates are at historically low levels in the St. John's area while the other territories covered by the application continue to experience chronic high levels of unemployment. Without an analysis that takes this factor into account, the use of this variable raises further uncertainty.

The Consumer Advocate submits that based on the preponderance of the evidence the unemployment variable should not be considered by the Board in the calculation of loss trends for the future policy period covered by this application.

(d) Selection of Flat Frequency Trend

In the rate filing before the Board, Eckler's trend analysis projected a negative 6.8% annual frequency trend for the comprehensive coverage and, despite a strong performing regression, Pelly judgmentally rejected this trend and simply selected a zero flat frequency. There is no evidence to support this selection nor does it make sense intuitively. While it may be normally expected that as one plots the change over time in claims severity the trend will demonstrate an inflationary effect, no such expectation applies to plotting the changes over time in loss frequency.

The Consumer Advocate submits that on the evidence the Board should not endorse this selection decision as it completely ignores the data demonstrated by Eckler's analysis and results in an increase in indicated rate levels based on a purely judgmental selection. It is not in accordance with the goal of setting rates on a consistent and understandable basis to ensure transparency. There is no evidence that the frequency trend will not continue to decline and the selection of a flat frequency trend has a relatively dramatic effect on the rate level indication for the coverage affected.

(iii) ULAE

The expense loading factor for ULAE utilized by Eckler in the rate filing was based on the IBC generated expense factor for accident year 2000 (1.093). After the application had been substantially prepared, a more updated expense factor was released by IBC for accident year 2001 (1.082). Mercer Risk has recommended that the more updated figure be used and Pelly did not dispute the logic of using a more updated figure. The Consumer Advocate submits that the updated expense factor relates to the data used by the Applicant and the evidence fully supports the adoption of this recommendation.

(iv) The Credibility Standard

The rate filing employs a credibility standard to compare the loss experience in the industry data to that in the Facility Association data. The approach used by the Applicant for determining the credibility standard is to combine the experience for bodily injury and property damage into a single third party liability coverage rather than analyze the losses separately as bodily injury tort and property damage tort.

Mercer Risk has submitted that the approach used by Eckler weakens the credibility analysis and that a bifurcated approach should be used for the purpose of calculating the credibility standard in order to make the analysis more accurate. Pelly does not dispute that this approach has merit, and has suggested that it will be studied. The Consumer Advocate points out that this same recommendation was apparently made in 2001 and was not acted upon. The Consumer Advocate submits that the preponderance of the evidence supports the rejection of the Eckler approach and the use of the approach recommended by Mercer Risk.

(D) RATING ISSUES

(i) CLEAR

The private passenger vehicle rate programme proposes the implementation of CLEAR. CLEAR is a new vehicle rating system for property damage coverages which is in the process of implementation across Canada. The evidence indicates that this new rating system will replace the existing system of rating vehicles for property damage coverages based on the manufacturers suggested retail price (MSRP). The new system involves an analysis of the individual characteristics of vehicles such as which are more likely to be stolen or more difficult to repair. Higher premiums will therefore be charged to insure vehicles that exhibit these characteristics rather than the premium being tied to MSRP.

The primary difficulty with the implementation of CLEAR in Newfoundland and Labrador at the present time is that the proposed implementation is based on a policy-in-force file that is now more than two years old. This may result in significant dislocation to the Applicant's policyholders. Furthermore, there is no satisfactory evidence that CLEAR is presently widely implemented in this province, as it may be elsewhere, and in fact Anthony indicated that it is being implemented by a "fair" number of national insurers and is "slowly getting adopted". The Insurance Corporation of Newfoundland does not presently use the CLEAR rating system in the voluntary market[50].

The Applicant has placed considerable reliance upon a dislocation study based on the data and partial information provided relating to Facility Association's vehicle count more than two years ago. It is pointed out however that in Ontario, the implementation was conducted much closer to the date of preparation of the relevant policy-in-force file, and no rate level changes were being implemented in conjunction with the implementation of CLEAR. It was also suggested by the Applicant that due to the lower level of retention in the Applicant's book of business dislocation was not as great a concern. With respect to that point, the Consumer Advocate submits that both the general market conditions and the direct evidence in Exhibit DJS #2 and in Exhibit DJS #3, Illustration 5 suggest that the Applicant's market share will likely continue to increase and that retention is occurring and will continue to occur.

[50] Transcript, January 15, 2003, page 14, lines 45-49.

Both Pelly and Simpson testified that if the Board was not prepared to order implementation it react with an order of deferral rather than with caps or phase-ins. The Consumer Advocate recommends that the preponderance of the evidence supports the position that CLEAR should not be implemented until a more recent policy-in-force file is completed.

(ii) ACCIDENT AND CONVICTION SURCHARGE

At present, there are already very significant surcharges applied to policies issued through the Facility Association mechanism relating to convictions and surcharges incurred by policyholders. The Consumer Advocate submits that as the surcharge schedule applies retrospectively it will have the effect of even greater individual rate increases to any new entrant to the Facility Association. So, for example, a policyholder entering Facility Association with relevant accidents or convictions can expect to see a premium surcharge, presumably as a reflection of the increased risk relating to that policyholder.

The present proposal is to increase those accident and conviction surcharges fairly dramatically however it is conceded by the Applicant that there is no actuarial evidence in support of this proposal. The accident and conviction surcharge changes are instead being proposed as an integrated “carrot and stick” package by the Applicant in conjunction with the more salutary “clean driver discount”, but on a stand alone basis it is clearly an arbitrary tool that will result in higher individual rates for consumers. The

Consumer Advocate submits that in fact there is no evidence of any kind which supports the imposition of the increased surcharges. This is a proposal motivated by administrative convenience rather than rate level need and the Board should not approve the increase. The Applicant suggested that such a system acts as "behaviour modification" but based on the evidence that most of the consumers insured through Facility Association have clean driving records, this seems a largely irrelevant consideration.

The real issue is whether or not there should be a clear driver discount. As stated, the present changes to the rating program are presented as an "integrated package", meaning that the Applicant does not want one to be implemented without the other. The Applicant has, however, a greater than 50% ratio of persons insured with clean driving records[51]. The evidence as to the wider context of the Application supports the logical conclusion that this situation will if anything increase over the short term. This issue needs to be addressed by the Board and is an issue of great significance to consumers. It appears that the Facility Association mechanism in 2003 will not be primarily made up of high-risk drivers at all, it will now be a residual market made up of the least desirable risks. In such an atmosphere there is an independent need for a clean driver discount, one that is not funded by imposing a corresponding levy on "bad" drivers when there is no evidence that they are not being adequately surcharged already.

The Consumer Advocate recommends that the Board impose a clean driver discount of 5% for all persons who have a clean driving record who are insured through Facility

Association. In terms of the argument that this is an "all or nothing" proposal, the Consumer Advocate points to the decision of the New Brunswick Board that directed an extra 5% clean driver discount without recalculating the off-balance factor.[52] The Consumer Advocate recommends that the Board reject the proposal for further increases to the surcharges presently applied against consumers through the Facility Association mechanism.

(iii) Specified Perils

The proposal to revise the Specified Perils premium calculation should be approved.

(iv) All Perils Premium

The proposal to revise the All Perils premium calculation should be approved.

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[51] Exhibit DJS #3, Illustration 5.
[52] Decision of N.B. Board, November 15, 2002, page 4.

PART 5: COMMERCIAL VEHICLE RATE PROGRAM (PROPOSED)

(A) PROPOSED AVERAGE RATE LEVEL CHANGES

The proposed overall average rate level change for commercial vehicles insured through Facility Association in the Province of Newfoundland and Labrador is 47.7% for all coverages combined. The most significant coverage in terms of percentage of premium volume, at 85%[53], is mandatory third party liability coverage for which a 59.2% increase is requested. The effect of these increases on consumers purchasing commercial vehicle coverage will obviously be very dramatic.

(B) SUMMARY OF ISSUES

The commercial vehicle rate programme raised both actuarial and non-actuarial issues. The primary actuarial issue is the recommendation by Mercer Risk to exclude the loss experience from 2000-2001 relating to the extraordinary winter conditions experienced over the period. Non-actuarial issues include rating changes to the comprehensive rate group differentials, deductible changes and changes to the specified perils coverage. Finally, it is proposed to peg the uninsured motorist premium at $19.

The actuarial issues as referred to in Part 4 are equally relevant to the commercial vehicle rate programme as well and the submissions made therein are relied upon, mutatis mutandi, in this section. Where there is any distinction or different emphasis placed on a particular aspect of the actuarial analysis this section will develop those issues.

(C) ACTUARIAL ISSUES

(i) LOSS DEVELOPMENT FACTOR

(a) Number of Years Used

See Part 4, (c),(i)(a)

(b) Straight Average vs. Weighted Average

See Part 4, (c),(i)(b)

(c) Selection/Exclusion Issues

The Consumer Advocate submits that the Applicant's rate filing contains no rationale for the particular exclusions that were selected in terms of loss development factors for the commercial vehicle rate programme. There was no objective measurement provided to define a data point as an outlier, for example by determining whether a data point is unusually high or low by reference to its difference from the standard deviation of all the items in the average. In the relevant appendix to the commercial vehicle rate programme Pelly again made selections for exclusion that were the lowest data point or points found within the five year period considered under the rate application and did not exclude the high points.[54]. In each case, there is no consistent basis for the selection/exclusion decision and

[53] Transcript, December 19, 2002, page 36, lines 10-14.
[54] Transcript, December 17, 2002, page 19, lines 1-23.

the explanations offered by Pelly in evidence are contradictory. The Consumer Advocate relies on the submissions made in Part 4 (c)(i)(c) and submits that the preponderance of evidence supports the recommendation of the Board's actuary that a consistent, unbiased approach be adopted and maintained, consistent with the goal of simple and understandable rate making. The Consumer Advocate submits the selections and/or exclusions made by Facility Association should be rejected for the reasons set out herein.

(ii) LOSS TREND ISSUES

(a) Number of Years Used

See Part 4(c)(ii)(a)

(b) Yearly vs. Half-Yearly Data

See Part 4(c)(ii)(b)

(c) Unemployment Variable

See Part 4(c)(ii)(c)

(d) Winter of 2000-2001.

In the development of loss trend for the commercial vehicle coverage both actuarial approaches have excluded certain data as representing outliers. A major difference between the two approaches arises with respect to the decision by Eckler to include the entire 2000-2001 loss experience in its trend projection, and the decision by Mercer Risk to exclude two half-yearly data points, 2000-02 and 2001-01, the data points which most closely correspond to the winter of 2000-2001.

The exclusion of outliers for the purpose of developing loss trends is an accepted approach in actuarial practice and is based on the premise that data which is clearly unrepresentative of the other past experience should not be relied upon to project that data. The position of the Consumer Advocate from the outset of the hearing has been that the data from the worst winter in recorded history in this jurisdiction, because of its inherent unreliability as a predictor of future events, should be excluded from the actuarial analysis of loss trends.

The evidence clearly and convincingly demonstrates that the winter of 2000-2001 in Newfoundland was extremely unusual from a climatological perspective[55]. There was an extremely high level of snowfall (648.4 cm) lower than average temperatures throughout the winter season, lower than average rainfall, record snow depth, and a high frequency of moderate snowfall events rather than a series of heavy snowfall events[56]. The evidence also demonstrates that both the frequency of accidents and the volume of incurred losses increased by very significant portions over previous comparable periods. In terms of the number of accidents, the Royal Newfoundland Constabulary, Accident Investigation Division confirmed that there was a very significant increase in accidents during this particular winter in the area of the province containing roughly half the

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[55] Pre-filed Evidence of Bruce Whiffen, December 3, 2002.
[56] *Ibid*, Schedule "A".

province[57]. The industry evidence of frequency of accidents in the 2003 benchmark analysis confirms this phenomenon on a provincial basis. The evidence also demonstrates that in the opinion of Hill the combination of unusual climatic conditions contributed to the higher accident volume, and the unusual climatic conditions were the "major reason" reported to him by accident investigators for the increased accidents over that period.[58] Finally, Hill testified that in adverse conditions private passenger vehicles are taken off the road before commercial vehicles.[59]

A breakdown of accident statistics from exhibit JH #1, as compared with snowfall records, shows a remarkably consistent relationship between the number of accidents and the snowfall.

Month/Year	**Actual Monthly Snowfall**	**Average Monthly Snowfall**
December 2000	173.4 cm	54.7 cm
January 2001	151.4 cm	83 cm
February 2001	122.6 cm	68.8 cm
March 2001	45.8 cm	54 cm
April 2001	104.0 cm	26.8 cm

Month/Year	**Actual No. of Monthly Reported MVA'S**	**Average No. of Reported MVA'S For 1996, 1997, 1998, 1999, 2001, 2002**
December 2000	433	336
January 2001	477	306
February 2001	484	288
March 2001	333	271
April 2001	346	238

[57] Transcript, January 10, 2003, page 56, lines 29-35.
[58] Transcript, January 10, 2003, page 47, lines 42-63.
[59] Transcript, January 10, 2003, page 47, lines 64-88.

In terms of the analysis of IBC loss experience Elliott testified, in evidence uncontested by the Facility Association, that the half-yearly data showed that incurred losses were close to 70% higher in 2000.2 than a comparable period in 1999.2 and around 40% higher in 2001.1 than a comparable period in 2000[60]. Analyzed on an annual basis the 2000 and 2001 losses were the highest values shown in the rate filing exhibit 5.2 and the 2000 losses were 50% higher than in 1999[61]. Finally, the commercial bodily injury trend proposed by Eckler is 11.4% (a trend which if accepted would mean that for losses incurred during the period contemplated by the Board order a 31% trend factor would result while the private passenger vehicle bodily injury trend for the same period was 7.5%. Elliott testified that an accurate picture of the trend should not normally demonstrate a 4% difference in trend between the same coverages.

The Consumer Advocate notes that in direct evidence Pelly testified and presented exhibits to demonstrate the failure of certain of the regression models adopted by the Board's actuary to pass statistical tests, tests that Pelly testified were used on a regular basis in actuarial analysis. In fact, the evidence of Elliott, uncontested by the Applicant, was that the regression models employed by the Board's actuary were statistically justified at the levels suggested by Eckler (95% or greater) by simply using the same period of time in the trend analysis as used by the Facility Association analysis. In other words, the selection of a ten year past period for analyzing trends caused the regression model adopted by Mercer Risk to fail the statistical test, but when the same extra two

[60] Transcript, December 17, 2002, page 22, lines 44=69.
[61] Transcript, Decembe3r 17, 2002, page 23, lines 16-36.

years of data analyzed by the Eckler regression model was included, the regression model utilized by Mercer Risk was fully justified statistically. Furthermore, Mercer Risk employed a balanced approach that excluded both high and low data points in its consideration of loss trend.

Based on the foregoing, the Consumer Advocate submits that on the preponderance of evidence, the Board should decide to accept the approach recommended by Mercer Risk and exclude the two data points in question from the trend in losses and to accept the commercial vehicle bodily injury trend of 8.4% proposed by the Board's actuary rather than the 11.4% annual trend proposed by Eckler. The evidence supports the conclusion that the worst winter in this jurisdiction's history inflated the loss experience for those two half-yearly periods. The evidenced linked the climatic conditions to the increased accidents and supported the common sense explanation offered for the difference in loss experience between commercial vehicle and private passenger coverages.

(iii) ULAE

See Part 4(c) (iii)

(D) RATING ISSUES

(i) ACCIDENT AND CONVICTION SURCHARGE

The clean driver discount will not apply to commercial vehicles. See Part 4(D)(ii) for the submission of the Consumer Advocate regarding proposed changes to the accident and conviction surcharge schedule.

(ii) UNINSURED AUTOMOBILE

The proposal to peg the uninsured automobile premium at $19 should be rejected by the Board. The indicated increase 90.2% and the proposed increase is 216.7%. The Board should not set the rates in excess of rate level needs.

(iii) SPECIFIED PERILS

The proposal to revise the Specified Perils premium calculation should be approved.

(iv) ALL PERILS

The proposal to revise the All Perils premium calculation should be approved.

(v) COMPREHENSIVE RATE GROUP DIFFERENTIALS

The proposal to revise the Comprehensive Rate Group Differentials should be approved.

(vi) DEDUCTIBLE CHANGES

The proposal to revise the commercial vehicle deductibles should be approved.

PART 6: RECOMMENDATIONS/SUBMISSIONS

(A) RECOMMENDATIONS

The Consumer Advocate recommends that the accident benefits coverage be rated on a territorial rather than a provincial basis.

The Consumer Advocate will make certain procedural recommendations in the course of oral argument.

(B) COSTS OF THE HEARING

The Consumer Advocate requests its costs of the hearing pursuant to the relevant statutory provisions.

(C) CONCLUSION

The Consumer Advocate submits that the evidence in this hearing demonstrates clearly that the Applicant does not require the rate increases proposed under the private passenger vehicle and commercial vehicle rate programmes. The Consumer Advocate submits that the evidence supports much lower overall rate level indications in each programme and submits that the Board should order the rates to be varied in accordance with the evidence presented.

The Consumer Advocate submits that the proposed introduction of CLEAR automobile rating system should be deferred.

The Consumer Advocate submits that the proposals to revise the Specified Perils and All Perils premium calculations, the proposal to revise the Comprehensive Rate Group Differentials, and the proposal to revise the commercial vehicle deductibles should be approved.

The Consumer Advocate submits that the proposal for increases to accident and conviction surcharge schedule should be refused.

The Consumer Advocate submits that a 5% clean driver discount should be introduced on the new effective date.

The Consumer Advocate submits that the Applicant's indications should be recast in accordance with the accepted evidence and revised to reflect the new effective date.

The Consumer Advocate requests his costs.

DATED at St. John's, this 6th day of February, 2003.

Peter O'Flaherty
Consumer Advocate

David Goodland
Goodland O'Flaherty